TAXATION OF NON-RESIDENTS AND FOREIGN DOMICILIARIES 2024-25

by

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VOLUME ONE

Chapters A1, 1-3: Non-dom policy & avoidance
Chapters 4-7: Domicile & residence

TWENTY THREE EDITION

Key Haven Publications Ltd
P. O. Box 669, Oxford, OX3 3AU
Tel: 01865 352121
http://www.khpplc.co.uk

To my Jane

Vejo melhor os rios
quando vou contigo
Pelos campos até à beira
dos rios;
Sentado a teu lado
reparando nas nuvens
Reparo nelas melhor ...

I see the river more
clearly when I go with you
Through the fields to the
riverside
Sitting by your side
watching clouds
I see them better ...

INTRODUCTION AND WHAT'S NEW

1.1 Scope of this book
1.2 A statute-focussed approach
1.3 The year 2023/24 in review, and the future
1.3.1 Simplification/complification
1.4 The future
1.5 Thanks ...and request for help

1.1 *Scope of this book*

There are three original themes to this book:

(1) Taxation of foreign domiciliaries
(2) Taxation of non-residents on UK assets
(3) Taxation of UK residents on foreign assets

To attempt to cover these topics comprehensively is ambitious, perhaps quixotic, and if books could burst, this one might. But these territorial issues must be understood in a wider context: in taxation, as in life, everything is connected. So I discuss private client topics which go beyond the original themes of this book:

- substantial: fundamental terms and concepts, and tax avoidance codes
- procedural: disclosure/compliance, tax return filing positions, CDD, TRS

1.2 *A statute-focussed approach*

I set out statutory and other material verbatim:

> ... in the end we must always return to the words of the statute[1]

Returning to the verbatim text, it is surprising how often one finds that the words do not say what one expects.

This is not just a common law approach. Richard Hyland tells this story of his class at Université Paris II Panthéon-Assas:[2]

[1] *RFC 2012 Plc v AG* [2017] UKSC 4 (the *Rangers* case) at [11]; see 87.5.2 (A judicial gloss).

[2] Hyland. *Gifts: A study in comparative law*, 1st ed (1989) p.xvi.

> Mme Gobert asked simply: *L'article 2 du Code civil, qu'est-ce qu'il dit?* Article 2 of the Civil Code, what does it say?
> My classmates were some of the best private law students in France. This was a question to which they knew the answer. One of them explained that article 2 provides for the nonretroactivity of the law. Mme Gobert looked at the student without smiling. Then she repeated the question. *L'article 2 du Code civil, qu'est-ce qu'il dit?* A different student mentioned Paul Roubier's suggestion that a new law may be applied to *les situations juridique en cours.* Again she repeated the question. *L'article 2 du Code civil, qu'est-ce qu'il dit?* Another student tried, and then another, each new voice attempting yet a more refined statement of the concepts involved. After each comment she responded in the same way. It was my first French law class, so I did not know what to think. It seemed like a Zen-like version of the Socratic method. The French students were terrified. This was material they thought they knew, and yet they could not guess what was on her mind. Finally, one of the students had the presence of mind simply to read the code provision aloud. Mme Gobert's eyes lit up. *Mais bien sûr!* she responded *C'est ça qu'il dit!*

1.3 *The year 2023/24 in review, and the future*

HMRC have had an unbroken run of successes establishing a UK domicile. *Fisher* finally reached Supreme Court, only to be promptly reversed by the F(no.2)A 2024. We have the first case on the statutory residence test, introduced in 2013 (*A Taxpayer v HMRC*), now on the way to the Court of Appeal, and the first on the remittance basis, introduced in 2008 (*Seghal v HMRC).* Scotland continues its fiscal drift from the UK, with Northern Ireland and Wales following.

But the changes of 2023/24 are overtaken by the surprise announcement in the Spring Budget 2024 of the abolition of domicile as a connecting factor for UK tax, from 2025/26, and the replacement of the remittance basis with a short term relief for foreign income/gains. The next edition of this book will be different from the present, and will have a new title.

1.3.1 *Simplification/complification*

OTS stated in 2017:

> The UK tax code is widely cited as being the longest in the world".[3]

[3] It is hard to empirically assess the claim that the UK has the longest tax code in the world, and OTS made no attempt to do so. But if any readers are aware of other

This claim had been made at least since 2010.[4] In recent years Parliament added:[5]

Finance Act(s)	**Pages**		
2012	703 (a record)	2018	196
2013	648	2019	337
2014	668	2020	217[6]
2015	597 (2 Finance Acts)	2021	428
2016	662	2022	225
2017	829 (2 Finance Acts)	2023	416 (2 Finance Acts)

The Office of Tax Simplification estimated HMRC guidance at 90,000 pages in 2018;[7] whatever the true figure, it will have grown considerably since then. This guidance was "not comprehensive" - something of an

serious contenders for that title, I would be interested to hear.

[4] For older references see the Introduction to the 2016/17 edition of this work.

[5] Finance Act page counts are a rough proxy for the ever growing complexity of the UK tax system, but not an altogether bad one. A (slightly) better proxy would also consider secondary legislation and HMRC guidance; and, perhaps, case law; then the page counts would multiply the Finance Act numbers set out here tenfold.
For a discussion of the multidimensional concept of tax complexity, see Tran-Nam and Evans, "Towards the Development of a Tax System Complexity Index" (2014) Fiscal Studies Vol 35 p.341.
OTS have published two (somewhat simplistic) discussions of tax complexity:
Length of Tax Legislation as a Measure of Complexity (Apr 2012)
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193496/ots_length_legislation_paper.pdf
OTS Complexity Index (2012)
http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193493/ots_complexity_index_methodology_paper.pdf

[6] The unusually short length of the FA 2020 is due to the December 2019 election.

[7] OTS, "Guidance for taxpayers: a vision for the future" (2018) para 1.21. These pages have assuredly not been printed or counted. Quantification raises methodological issues which deserve a short essay to itself. We have reached the stage where the amount of HMRC guidance is impossible to quantify: the words are uncountable. Within the limits of guesswork, and assuming 500 words per page (single spacing), the figure of 90,000 pages seems to me to be on the low side. There are 150 HMRC Manuals, just for a start.
Perhaps the focus of enquiry should be whether HMRC guidance is too short, because 90,000 pages would not be sufficient to do justice to the topic. The legislation, measured by pages of the Orange & Yellow tax handbooks, can be counted and amounts to 20,836 pages in 2020/21 (that does not include DTAs, which would be another 3,000 pages). The Tax Cases reports, which began in 1875, and ceased publishing in 2014, reached 82 volumes and did not cover VAT.

understatement; but according to the OTS "real life cannot be reduced to a neat description in a few (!) pages of writing".[8]

F(no.2)A 2023 abolished the OTS. In its 12 years of existence, the OTS did not achieve much simplification, at least in relation to topics covered in this book, and I do not think it will be missed.[9]

It is easier to *talk* of simplification. In the ill-fated "mini" budget of October 2022:

> the government will embed tax simplification into the institutions of government ... and set a mandate to HM Treasury and HMRC to focus on simplifying the tax code.[10]

The reader may think that satirists better identify the reality:

> We will further complicate the UK tax system so that large companies can no longer find loopholes.[11]

This year, the abolition of furnished holiday letting relief is a simplification; though that is not much to set against the size of this year's Finance Acts.

1.4 *The future*

We face an extended period of change and uncertainty, in politics, economics, law and taxation, and will continue to live in fiscally exciting times.

1.5 *Thanks ...and request for help*

I am very grateful to my colleagues in chambers, especially Robert

[8] Para 1.24.

[9] This view is not unanimous; according to CIOT,"OTS has achieved a great deal".; Letter to Chancellor of the Exchequer (24 October 2022).

[10] HM Treasury, "The Growth Plan 2022".
https://www.gov.uk/government/publications/the-growth-plan-2022-documents
The emphasis, or one might say, rhetoric, of simplification has fluctuated. OOTLAR 2008 had 45 references to simplification. OOTLAR 2021 had none. The "Growth Plan 2022" had 15.
In (I think) 2013 the government came up with the slogan "Creating a simpler, fairer tax system", which OTS adopted; it imagines away a troubling reality in which simplicity and fairness are competing values which require hard choices.
https://www.gov.uk/government/policies/creating-a-simpler-fairer-tax-system

[11] Official Monster Raving Loony Party Manifesto 2017
https://www.loonyparty.com/2017-general-election-manicfesto

Venables KC, Philip Simpson KC and Rory Mullen KC, for discussions on many aspects of tax. Yijia Liu as research assistant resolved many puzzles. I owe a great debt to Jane Hunt and Ruth Shaw who work committedly on this text throughout the year.

Comments from my readers and clients continue to be of the greatest value and interest. I am very grateful to all who commented, and in particular to John Barnett and Sam Dewes (who commented on a variety of topics), and Mark Pearce (cryptoassets). In order not to be defeated by the size of this work, readers' help is needed more than ever. If anyone would like to offer to write or revise a section - or chapter - of this book please get in touch.

The pleasure in writing this book consists in the interest of the questions which it raises, and the success which it may have achieved in answering them. On the basis of what is known at 1 April 2024, and assuming the F(no.2) Bill 2024 is enacted in its present form, it seeks to state the law for 2024/25.

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OBTAINING FURTHER ADVICE - AND DISCLAIMER

Further advice

If you want advice on which you are legally entitled to rely you can obtain it - but not from this work.

In particular, you may instruct the author to advise. I enjoy writing, but spend most of my time giving independent specialist professional advice in private client matters, especially areas covered in this work. For further details see *https://www.kessler.co.uk*

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The professional bodies issue the *Professional Conduct in Relation to Taxation* with a disclaimer:

> While every care has been taken in the preparation of this guidance[1] the PCRT Bodies do not undertake a duty of care or otherwise (?) for any loss or damage occasioned by reliance on this guidance. Practical guidance cannot and should not be taken to substitute appropriate legal advice.[2]

[1] PCRT is not in fact guidance: it is mandatory.

[2] *Professional Conduct in Relation to Taxation* (2019), Forward. *https://www.tax.org.uk/professional-standards/professional-rules/professional-conduct-relation-taxation*
The second sentence is an improvement on the common form that guidance on legal

When that appeared in 2011 it seemed extraordinary. But nowadays no professional body issues guidance without a disclaimer.[3] Similarly, and *a fortiori*, the views expressed in this book are put forward for consideration only and are not to be relied upon. Neither the author nor the publisher accept responsibility for any loss to any person arising as a result of any action or omission in reliance on this work. But could anyone have thought that a claim might arise in absence of this disclaimer?

A note to the lay reader

This book is not intended as a self-help guide, and is addressed to tax practitioners. In earlier editions I said: "... but it is readable for a lay person." I think that is still true, though the text is more daunting than when I first wrote those words, because the law has become much more complicated. However, initiation in these matters must often be by the taxpayer. If you wish to research this subject in depth, and so take more control of your own tax affairs, read on. But for implementation you will need to find professionals to advise you. Self-help guides extol "the benefit of bypassing expensive lawyers"; but the bypass may prove the more expensive route in the long run.

Edition history

1st 2001/2
2nd 2003/4
3rd 2004/5
4th 2005/6
5th 2006/7
6th 2007/8
7th 2008/9
8th 2009/10
9th 2010-11
10th 2011/12
11th 2012/13
12th 2013/14
13th 2014 /15
14th 2015/16
15th 2016/17
16th 2017/18
17th 2018/19
18th 2019/20
19th 2020/21
20th 2021/22
21st 2022/23
22nd 2023/24

This book was called *Taxation of Foreign Domiciliaries* for 9 editions; it

issues "does not constitute legal advice". That seems an idiosyncratic use of the word "advice"; but for the meaning of "advice" see 132.6 (Tax adviser).

[3] For instance, the Law Society likewise issue a disclaimer for their Practice Notes: The standard form is: "While care has been taken to ensure that they are accurate, up to date and useful, the Law Society will not accept any legal liability in relation to them."

changed to *Taxation of Non-Residents and Foreign Domiciliaries* in the 10th edition.[4]

[4] The text of earlier editions is available on *https://www.foreigndomiciliaries.co.uk*

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TABLE OF ABBREVIATIONS

Statutes, Statutory Instruments, EU Directives, Treaties

ACA 2002	:	Adoption and Children Act 2002
AMLD	:	Anti-Money Laundering Directive (also called Money Laundering Directive)
CA	:	Companies Act
CFA	:	Criminal Finances Act 2017
CJJA 1982	:	Civil Jurisdiction and Judgments Act 1982
CRCA 2005	:	Commissioners for Revenue and Customs Act 2005
CTA	:	Corporation Tax Act
DMPA	:	Domicile and Matrimonial Proceedings Act 1973
DTRR	:	Double Taxation Relief (Taxes on Income) (General) Regulations 1970
ECHR	:	European Convention on Human Rights
EUSD	:	European Savings Directive 2003/48/EC
FA	:	Finance Act
F2A	:	Finance (no. 2) Act
FB	:	Finance Bill
FLRA 1987	:	Family Law Reform Act
FSMA[1]	:	Financial Services & Markets Act 2000
GOWA	:	Government of Wales Act 2006
HFEA 2008	:	Human Fertilisation and Embryology Act 2008
HGB	:	Handelsgesetzbuch
ICTA	:	Income and Corporation Taxes Act 1988
IHTA	:	Inheritance Tax Act 1984
IRD	:	Interest and Royalties Directive
ITA	:	Income Tax Act 2007
ITEPA	:	Income Tax (Earnings and Pensions) Act 2003
ITTOIA	:	Income Tax (Trading and Other Income) Act 2005
IMOCR	:	International Movement of Capital (Required Information) Regulations 2009
LLCA	:	Limited Liability Company Act

[1] Statute sometimes uses the abbreviation FISMA.

LP(MP)A	:	Law of Property (Miscellaneous Provisions) Act 1989
MLR 2017	:	Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017
MSSCA	:	Marriage (Same Sex Couples) Act 2013
OFTR	:	The Offshore Funds (Tax) Regulations 2009
PA 1890	:	Partnership Act 1890
POA Regs	:	Charge to Income Tax by Reference to Enjoyment of Property Previously Owned Regulations 2005
SLA	:	Settled Land Act
SLR 2017	:	Scottish Partnerships (Register of People with Significant Control) Regulations 2017
SSC	:	Protocol on Social Security Coordination
SSCBA	:	Social Security Contributions and Benefits Act 1992
SSCER	:	Social Security (Categorisation of Earners) Regs 1978
SSCnR	:	Social Security (Contributions) Regs 2001
TCGA	:	Taxation of Chargeable Gains Act 1992
TFEU	:	Treaty on the Functioning of the European Union
NRLR	:	Taxation of Income from Land (Non-residents) Regs 1995
TIOPA	:	Taxation (International and Other Provisions) Act 2010
TOLATA	:	Trusts of Land and Appointment of Trustees Act 1996[2]
TMA	:	Taxes Management Act 1970
VTA	:	Variation of Trusts Act 1958

Periodicals

BTR	:	British Tax Review
OITR	:	Offshore & International Taxation Review
OTPR	:	Offshore Tax Planning Review[3]
PCB	:	Private Client Business
PTPR	:	Personal Tax Planning Review
STI	:	Simon's Tax Intelligence

HMRC Manuals and Publications

References to HMRC Manuals are accompanied by their dates of entry according to information provided at *http://www.taxhub.co.uk*.

BI Manual	:	Business Income Manual
CF Manual	:	Corporate Finance Manual

[2] I would prefer TLATA, but TOLATA has become the standard form.

[3] OTPR (1992-1996) was renamed "Offshore Taxation Review" (1997-1998) and renamed OITR from 1999.

CG Manual	:	Capital Gains Manual
CT Manual	:	Company Taxation Manual
EI Manual	:	Employment Income Manual
IFM	:	Investment Funds Manual
INT Manual	:	International Manual
IPT Manual	:	Insurance Policyholder Taxation Manual
NI Manual	:	National Insurance Manual
NRLS	:	Non-resident Landlord Scheme
PI Manual	:	Property Income Manual
RDR Manual	:	Residence Domicile and Remittances Manual[4]
SAI Manual	:	Savings & Investment Manual (*HMRC sometimes call this the Savings & Investment Income Manual*)
SALF	:	Self Assessment: The Legal Framework
TAH	:	Transfer of Assets Handbook
TSE Manual	:	Trusts Settlements and Estates Manual

Courts

FTT	:	First-tier tribunal
UT	:	Upper Tribunal
CoA	:	Court of Appeal
HL	:	House of Lords
SC	:	Supreme Court

Other

AIP	:	Accrued income profits
ATED:	:	Annual tax on enveloped dwellings
AUT	:	Authorised unit trust
BAD relief	:	Business Asset Disposal relief (formerly called entrepreneurs' relief)
BEPS	:	Base erosion and profit shifting
BiK	:	Benefits in kind
BPR	:	Business property relief (for IHT)
BSB	:	Bar Standards Board
CCF	:	Common Contractual Fund
CDD	:	Customer Due Diligence

[4] The RDR Manual must not be confused with HMRC Guidance Notes known as RDR1 (a general guide to residence issues), RDR3 (the Statutory Residence Test) and RDR4 (Overseas Workday Relief).

CG	:	Capital gains
CFC	:	Controlled foreign company
CFP	:	Fonds commun de placement
CGT	:	Capital Gains Tax
CIOT	:	Chartered Institute of Taxation
CMC	:	Central management and control[5]
COE	:	Chargeable overseas earnings
CRP	:	Corporate Residential Property
CRS	:	Common Reporting Standards
CT	:	(1) Corporation Tax
		(2) *in case names:* Commissioner of Taxation
CVI	:	Centre of vital interests
DDS	:	Deeply discounted security
DIMF	:	Disguised investment management fees[6]
DOTAS	:	Disclosure of tax avoidance schemes
DRs	:	Depository receipts
DT	:	Discretionary trust
DTA	:	Double taxation arrangement
EC	:	Commission of the European Communities
EEA	:	European Economic Area
EEIG	:	European Economic Interest Grouping
EN	:	Explanatory notes
ESC	:	Extra-statutory concession
FATF	:	Financial Action Task Force
FATCA	:	Foreign Account Tax Compliance Act (US)
FCT	:	Federal Commissioner of Taxation
FI	:	Financial Institution
FIFO	:	First in first out
FIG	:	Foreign income & gains
FTC	:	Failure to correct
GAAR	:	General anti-abuse rule[7]
GB	:	Great Britain

[5] The abbreviation CM&C is also found.

[6] HMRC use the abbreviation DMF.

[7] In this book references to "the GAAR" are to the general anti-abuse rule in FA 2013. For completeness, there are (at least) two other (rather specialist) GAARs (where the abbreviation stands for general anti-*avoidance* rule): Part 5 Revenue Scotland and Tax Powers Act 2014; Part 3A Tax Collection and Management (Wales) Act 2016.

GWR	:	Gift with reservation of benefit
HMRC	:	Her Majesty's Revenue and Customs
ICAEW	:	Institute of Chartered Accountants in England & Wales
IFS	:	Institute of Fiscal Studies
IGA	:	Intergovernmental Agreement
IHT	:	Inheritance tax
IME	:	Investment manager exemptions
IoM	:	Isle of Man
IOV	:	Instrument of variation
IIP	:	Interest in possession[8]
IP	:	Intellectual property
IPDI	:	Immediate post-death interest
IT	:	Income tax
LIFO	:	Last in first out
LLC	:	Limited liability company
LLP	:	Limited liability partnership
LTT	:	Land Transaction Tax
MLI	:	Multilateral instrument
MS	:	Member state
NAV	:	Net asset value
NFE	:	Non-financial entity
NINO	:	National insurance number
NICs:	:	National insurance contributions
NOR	:	Not ordinarily resident
NPO	:	Non-profit organisation
NRCGT	:	Non-residents CGT (CGT on UK dwelling-house held by non-resident)
NRLS	:	Non-resident landlord scheme
oao	:	on the application of
OECD	:	Organisation for Economic Cooperation and Development
OEIC	:	Open-ended investment company
OIG	:	Offshore income gain
OPC	:	Office of Parliamentary Counsel
ORIP	:	Offshore receipt from intangible property
OTS	:	Office of Tax Simplification
OWR:	:	Overseas workday relief
PCRT	:	Professional Conduct in Relation to Taxation

[8] I prefer IP, but adopt IIP to be consistent with HMRC practice.

PE	:	Permanent establishment
PET	:	Potentially exempt transfer
PFA	:	Profit Fragmentation Arrangements
POEM	:	Place of effective management
POA	:	Pre-owned assets
PRs	:	Personal representatives
PRR:	:	Private residence relief
PPT	:	Principal purpose test
RFI	:	Relevant foreign income
RFI	:	Reporting Foreign Institution (in context of CRS)
RI	:	Revenue Interpretation
RTC	:	Requirement to correct
SA	:	Self-assessment
SDLT	:	Stamp Duty Land Tax
SDRT	:	Stamp Duty Reserve Tax
SP	:	Statement of practice
SPTS	:	Standards for the Provision of Taxation Services
SRA	:	Solicitors Regulation Authority
SRT	:	Statutory residence test
SSE	:	Substantial Shareholding Exemption
STEP	:	Society of Trust & Estate Practitioners
TAAR	:	Targeted anti-avoidance rule
ToA	:	Transfer of assets abroad[9]
TG	:	Technical Guidance
TIIN	:	Tax Information and Impact Notes
TIN	:	Taxpayer Identification Number
TNR	:	Temporary non-residence
TRS	:	Trust Registration Service
TSI	:	Transitional serial interest
UN	:	United Nations
WHT	:	Withholding Tax

[9] Some use the abbreviation TOAA.

CHAPTER A1

FIG RELIEF/ABOLITION OF DOMICILE

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A1.1 The 2025 revolution: Introduction

This chapter discusses the domicile tax reforms announced in Spring Budget 2024.

At the time of writing, a few days after the Budget, the information available is:

Spring Budget 2024 and Spring Budget 2024: Policy Costings[1]
HMRC: Spring Budget 2024: Overview of tax legislation and rates (OOTLAR)[2]
HMRC Technical note: Changes to the taxation of non-UK domiciled

[1] *https://www.gov.uk/government/publications/spring-budget-2024*

[2] *https://www.gov.uk/government/collections/spring-budget-2024-tax-related-documents*

individuals Updated 7 March 2024[3]
The Technical Note covers everything in the other two papers, except for estimates of yield, so that is all that one needs to study.

This chapter will be updated online during the year as further details emerge.

A1.2 FIG relief for new residents

A1.2.1 *FIG relief*

The Technical note provides:

> **3.1 4-year FIG regime overview**
> From 6 April 2025, a new regime for personal FIG [foreign income & gains] will be available to individuals for the first 4 tax years once becoming UK tax resident after a period of 10 years non-UK tax residence. Eligible individuals will not pay tax on FIG arising in the first 4 years, where a claim is made, and will be able to remit these funds to the UK free from any additional charges....

I coin the following terminology (with initial capitals to reflect the technical meaning of my terms):

Term	Meaning
New Resident	Individual who comes to UK after 10 years non-residence
Exempt Period	First four years of tax residence
FIG relief	Relief for first 4 years of tax residence

It appears that the New Resident will need to dispose of foreign assets during the Exempt Period, to obtain the relief, there is no rebasing at the end of it.

Life insurance might be an attractive investment vehicle for those staying in the UK for more than 4 years, but not permanently.

Will the foreign income/gains qualify for DT relief? Article 4(1) OECD Model second sentence provides:

> This term ["resident of a Contracting State"], however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.[4]

[3] *https://www.gov.uk/government/publications/changes-to-the-taxation-of-non-uk-domiciled-individuals/technical-note-changes-to-the-taxation-of-non-uk-domiciled-individuals*

[4] See 9.8 (Liable to source tax only). But this will be a question for the foreign State to answer, it will not arise in the UK.

What about capital losses? Losses on disposals of foreign assets during the 4 year period will not be allowable, will losses on disposals after that be allowable? What will be the effect of existing capital-loss elections?

It may be useful to set out an aide memoire of when a full four year's FIG relief can apply:

Last UK resident year	**First possible year of return for 4 years FIG relief**
2014/15	2025/26
2015/16	2026/27
2016/17	2027/28
2017/18	2028/29
2018/19	2029/30
2019/20	2030/31
2020/21	2031/32
2021/22	2032/33
2022/23	2033/34
2023/24	2034/35

It seems optimistic to assume that the FIG regime will remain in its current form for a whole decade. But clearly there is an incentive for those who are nearly there to remain non-resident a little longer.

A1.2.2 *Claim for relief*

The Technical note provides:

> Claims to use the new 4-year FIG regime are to be made for each year to which it is to apply. Individuals need not make a claim for every year of the 4-year period. For example, an individual who makes a claim for the new 4-year FIG regime in year 1 but chooses not to make a claim for year 2 will still be able to claim for years 3 and 4.

Will the claim have to specify the amount of the foreign income and gains? If so the taxpayer will have additional work to complete their tax return; if not, the true cost of the relief will not be known.

The Technical note provides:

> If an individual chooses to be taxed under the new 4-year FIG regime, they will lose entitlement to personal allowances and the CGT annual exempt amount.

If one ignores the CGT annual exemption, now trivial, a claim is worthwhile if the individual has foreign income above the personal allowance, but that now a modest £12,570 (and frozen to 2028). The income would have to be larger if a foreign tax credit was available.

Taxpayers with small amounts of foreign income will need to do the computation to check the benefit matches the cost.

A1.2.3 *The test of residence*

The Technical note provides:

> The Statutory Residence Test will be used to determine tax residence for any one tax year. Treaty residence or non-residence and split years will be ignored.

That is, a UK resident year is counted as one of the years of the exempt period, even though it is a year during which the person is treaty non-resident or a split year, so FIG relief may not be needed. That is not surprising, as these are the usual rules:

Rule	**See**
Treaty non-residence ignored	9.2
Split year treated as a resident year	10.2

A1.2.4 *Non-residence in Exempt Period*

The Technical note provides:

> If an individual leaves the UK temporarily during the 4-year period they will be able to make a claim under the 4-year FIG regime for any of the qualifying tax years remaining on their return to the UK. For example, if someone becomes non-UK resident in year 2 and 3 but is UK resident again for year 4, they will be able to use the new 4-year FIG regime for year 4.

A1.2.5 *Transitional rules for UK residents*

The Technical note provides:

> Individuals who on 6 April 2025 have been tax resident in the UK for less than 4 years (after a period of 10 years non-UK tax residence) will be able to use this new regime for any tax year of UK residence in the remainder of those 4 years. For example, an individual who became resident in the UK in 2022-23, after a 10-year period of non-residence, will have been resident in the UK for up to three tax years on 6 April 2025. They will be able to claim under the new 4-year FIG regime for 2025-26 because this is their fourth year following a period of 10 years non-UK tax residence.

The transitional rules for return to the UK before FIG relief starts (but were away for 10 years before they returned) will be:

Last UK resident year	**First possible year of return for FIG relief from 25/26**	**FIG relief for**	**Years of relief**
2011/12	2022/23	2025/26 only	1
2012/13	2023/24	2025/26 + 2026/27	2
2013/14	2024/25	2025/26 to 2027/28	3

A1.2.6 *FIG relief/rem. basis compared*

The main differences between the new FIG relief and the old remittance basis are as follows:

Topic	**Remittance basis**	**FIG relief**
Relief	Remittance basis (on FIG)	Exemption (on FIG)
Who qualifies	Non-doms	New Residents
Cost of claim	Rem.basis charge + allowances lost	Allowances lost (only)

FIG relief is for a shorter period than the remittance basis, but:

(1) it is much more generous (exemption for foreign income/gains, rather than remittance basis); no flat charges

(2) it is much more widely targeted (applying to all New Residents, including UK domiciled individuals)[5]

Those thinking of returning to the UK in the course of a year would do well to defer their return until the following year (avoiding a split year), if that is possible.

A1.3 Offshore trusts

A1.3.1 *Post-2025 income/gains*

The Technical Note provides:

> **3.3 Trust Protections**
> From 6 April 2025, the protection from tax on income and gains arising within settlor-interested trust structures will no longer be available for non-domiciled and deemed domiciled individuals who do not qualify for the new 4-year FIG regime. FIG arising in the trust (whenever established) from 6 April 2025 will be taxed on the settlor on the same basis as UK domiciled settlors at present, unless the settlor is eligible for

[5] The pre-2025 regime, particularly once the remittance basis charges applied, was restricted to very top of the income distribution. According to Advani, Burgherr & Summers, "Taxation and Migration by the Super-rich", IZA DP No. 16432, 29% of those claiming the remittance basis were in the top 0.1% income range. See *https://docs.iza.org/dp16432.pdf*

the new 4-year FIG regime.

A1.3.2 *Pre-2025 income/gains*

The Technical Note provides:

> From 6 April 2025 the matching of pre-6 April 2025 FIG to trust distributions will continue, but UK resident non-domiciled individuals will no longer be entitled to the remittance basis in respect of worldwide trust distributions. Beneficiaries and settlors who are within the 4-year FIG regime will also be able to receive benefits from 6 April 2025 free from any UK tax charges whether or not the benefits are received in the UK. However, such benefits are not matched to trust income and gains and will be subject to a modified onwards gift rule.

The best course will sometimes be to wind up the trust, but there will be IHT and many other matters to consider.

A1.4 Non-dom transitional reliefs

Spring Budget 2024 provides three transitional reliefs for "existing non-doms claiming the remittance basis". Presumably a claim for 2024/25 will suffice. It may be beneficial to make a remittance basis claim to take advantage of the transitional reliefs (rather than to qualify for the remittance basis).

A1.4.1 *2019 CGT Rebasing*

The Technical Note provides:

> **3.5 Capital Gains Tax rebasing**
> From 6 April 2025, an individual who is not, or who later ceases to be, eligible for the new 4-year FIG regime will be taxed on foreign gains in the normal way.
> Transitional rules will apply for individuals who
> [1] have claimed the remittance basis and
> [2] are neither UK domiciled nor UK deemed domiciled by 5 April 2025.
> If, on or after 6 April 2025, they dispose of a personally held foreign asset that they held at 5 April 2019, they will be able to elect to rebase that asset to its value as at 5 April 2019. This rebasing will be subject to conditions that will be set out later.

Rebasing reliefs can been done in many different ways. Details remain to follow.

There is no relief proposed for assets held in trusts or companies.

A1.4.2 *2025/26 50% IT relief*

The Technical Note provides:

> **3.4 Reduced amount of foreign income subject to tax**
> There will be a one-year reduction in the amount of foreign income that will be subject to tax for individuals who
> [1] move from the remittance basis to the arising basis from 6 April 2025 and
> [2] who are not eligible for the new 4-year FIG regime.
> For these individuals only 50% of the foreign income arising in 2025-26 will be subject to tax. The reduction in the amount of foreign income subject to tax will apply for one tax year only and the reduction will not apply to foreign chargeable gains.

Charles Russell Speechley comment:[6]

> It is not entirely clear from this whether only individuals who would have been eligible for the remittance basis in 2025/26, had the regime continued, will be eligible for the reduced rate, or whether individuals becoming deemed domiciled on 6 April 2025 will also qualify.
> A further question is whether the relief will apply to offshore income gains and other deemed income. The Parliamentary drafting team have form for forgetting about OIGs and producing tax legislation that does not address them, resulting in anomalies and controversy.

A1.4.3 *Temporary Repatriation Facility*

The Technical Note provides:

> **3.6 Temporary Repatriation Facility (TRF)**
> A new 12% rate of tax will be introduced for remittances of FIG made in tax years 2025-26 and 2026-27 where the FIG arose to the individual personally in a year when the individual was taxed on the remittance basis and the individual is UK resident in the relevant tax year.
> There will be some relaxation of the mixed fund ordering rules to make it easier for individuals to take advantage of the TRF if, for example, they have FIG in a mixed fund or they are unable to precisely identify the quantum of their FIG.

[6] *https://www.charlesrussellspeechlys.com/en/insights/expert-insights/private-wealth/2024/regime-change-the-beginning-of-the-end-of-the-remittance-basis/* (March 2024)

> From 2027-28 remittances of pre-6 April 2025 FIG will be taxed at normal tax rates.

Where DT relief is available, this will generally be an effective 0% rate. Taxpayers will plan to remit, and, where appropriate to trigger clawback of remittance investment relief.

A1.5 Overseas Workday relief

A1.5.1 *Who qualifies for OWR*

The Technical Note provides:

> **3.2 Overseas Workday Relief**[7]
> Relief will continue to be available for employees who opt to use the new 4-year FIG regime. The new Overseas Workday Relief (OWR) will be like that currently available, providing relief on earnings for employment duties performed outside the UK.
> The new OWR will be available for the first 3 tax years of UK residence.
> The new OWR will provide relief from income tax whether or not these earnings are brought to the UK. As under the current rules, the new OWR will not provide relief from National Insurance contributions (NICs), so any NICs liabilities on these earnings will be determined as usual.

Thus differences between OWR and FIG relief include:

Topic	**FIG relief**	**OWR**
Relief for	FIG (not OWR income)	employment income for duties abroad
Duration of relief	4 years	3 years
Applies to	All New Residents	OWR Employees
Transitional rules	2023/4 & 2024/5 OWR users	New Residents only

A1.5.2 *23/4 & 24/5 residents: Transitional rule*

The Technical Note provides:

> Employees who are eligible for OWR in 2023-24 or 2024-25 for their first year since returning to the UK should still be able to claim OWR for the full three years. However, those re-entering from 2025-26 will not be able to claim OWR, if they are not eligible for the FIG regime.

[7] See 34.22 (Overseas workday relief).

A1.6 Remittance basis for pre-2025 FIG

The Technical Note provides:

> **4. Ending the existing income tax and capital tax regime**
> The remittance basis of taxation will be abolished for UK resident non-domiciled individuals from 6 April 2025. The last year for which a remittance basis claim can be made will be the 2024-25 tax year.
> FIG that has arisen to a remittance basis user prior to 6 April 2025 will continue to be taxed if they are remitted on or after 6 April 2025, subject to the TRF set out above.
> Business Investment Relief will be available for qualifying investments of pre 6 April 2025 FIG made on or after 6 April 2025 and will continue to be available for qualifying investments made prior to 6 April 2025.

The remittance basis is not abolished: it is *prospectively* abolished.

A1.7 IHT domicile reform

The Technical Note provides:

> **5. Inheritance tax**
> Inheritance tax (IHT) is currently a domicile-based system. The government intends to move IHT to a residence-based system, subject to consultation and applying this only from 6 April 2025.

A1.7.1 *Non-settled property post-2025*

The Technical Note provides:

> **5.3 The position from 6 April 2025 – Property owned outright**
> It is envisaged that the new rules will involve charging IHT on worldwide assets owned outright when a person has been resident in the UK for 10 years (the "residence criteria"), with a provision to keep a person in scope for 10 years after leaving the UK (the "tail" provision). The design of the system (including consideration of further criteria such as other connecting factors) will be subject to consultation. UK situs assets will remain in charge on the same basis as at present, regardless of residence.

In the following discussion, a **"IHT-chargeable person"** is an individual who

(1) been resident in the UK for 10 years, and
(2) if they have left the UK, have not achieved 10 year's non-residence

There will be winners and losers. The winners may include UK

domiciliaries who are not IHT-chargeable persons.[8] They will fall outside the scope of personal IHT under the new regime. The losers are individuals who are:
(1) non-domiciled and non deemed domiciled; and
(2) become IHT-chargeable persons (10-year residents).

Losers will outnumber winners. For some there will be a strong incentive not to become an IHT-chargeable person, or to cease to be one, ie to leave the UK (or not to come).

Important commencement issues are currently unanswered. If a long term resident leaves in 2024/25, they should avoid the 10 year tail, but that remains to be seen. HMRC's intention might be that there should be no transitional rules and that potentially those who left as long ago as 2016/17 (and have been non-resident since) could be brought back into the 10 year tail in 2025/26. But this would seem particularly retroactive and would give rise to significant lobbying against

The restriction on the IHT spouse exemption will operate differently. Expect gifts from H to W to be PETs, not exempt, (and within GWR) if H is an IHT-chargeable person and W is not; subject to a domicile election.

A1.7.2 *Post-2025 settlements*

The Technical Note provides:

> **5.4 The position from 6 April 2025 – Property held in trust**
> It is envisaged that the new rules for chargeability of assets comprised in a settlement will depend upon whether a settlor meets the residence criteria or is within the tail provision at the time the assets are settled and/or when charges such as 10-year anniversary charges or exit charge arises.
> The design of the system (including consideration of further criteria such as other connecting factors) will be subject to consultation. UK situs assets will remain in charge on the same basis as at present, regardless of residence.

It appears that if the settlor becomes an IHT-chargeable person, a post-2025 settlement will fall within the scope of IHT, and (unless the settlor is excluded) GWR. What will happen after the death of the settlor? The current intention seems to be that the settlor's status at the date of death

[8] Depending on the (unidentified) "other connecting factors".

fixes the IHT status of the trust permanently thereafter.

The reference to "other connecting factors" is intriguing, but it is impossible to say what it might mean.

Settlement will move in and out of the IHT net from time to time. The 10 year tail means that trusts which fall within the IHT net will generally suffer at least one 10-year charge.

A1.7.3 *Pre-2025 settlements*

The Technical Note provides:

> The treatment of non-UK assets that are settled by a non-UK domiciled settlor and become comprised in a settlement prior to 6 April 2025 will not change. For these settled assets:
>
> - provided the assets in the settlement continue to meet the legislative requirements to be excluded property under current legislation, and subject to any future anti-avoidance provisions, there will be no IHT charges; and
> - the interaction between the gift with reservation provisions and excluded property trust rules will also remain, meaning excluded property will not be brought into charge on the settlor's death even if the settlor retains a benefit in the trust assets.

This seems a generous transitional rule, but it would have been difficult or impossible, in some cases, to backdate a 10-year residence rule, as residence records may not be available. So domicile is not abolished for IHT purposes. It is *prospectively* abolished. Domicile will remain important for the duration of pre-2025 settlements, ie for about a century.

> The exception to this is that the treatment of non-UK property comprised in a settlement that currently comes back into scope where the settlor is a formerly domiciled resident (see above) will be subject to consultation.

It is impossible at present to say what will be the position of a settlement made by a formerly domiciled resident, but perhaps it will remain as at present.

A1.7.4 *IHT consultation questions*

The Technical Note provides:

> **5.5 The IHT consultation**
>
> The IHT consultation will deal with the design of a new residence based system to apply from 6 April 2025. There are a number of detailed

> issues and interactions that will be consulted on such as ...

The Technical Note identifies the following:

Issue	**JK Comment**
Transitional provisions	
Length of the residence criteria	
Length of the tail provision	
Connecting factors other than residence	
Gifts with reservation	
Domicile elections	See 5.14 (Election-domicile)
Formerly domiciled residents	
Calculation of trust charges	

One can add to this list. What about existing IHT DTAs?

A1.7.5 *Comments on IHT reforms*

The IHT proposals are at an early stage, and the final rules may be significantly different from the sketch in the Technical Note.

If a 10-year tail applies to those who are UK resident for 10 years, there would in some cases be a significant incentive to leave within 10 years (in other cases an IHT DT relief may apply; in other cases (younger individuals, especially if married) the effective IHT exposure could inexpensively be covered by insurance or ignored (self-insured). The individual would still need advice in connection with lifetime giving for 10 years (essentially the need to avoid chargeable transfers, and the risks of PETs and, perhaps, GWR).

A1.7.6 *International comparisons*

Short summary descriptions of foreign tax laws are bound to mislead. Nevertheless the following quote is of interest as it illustrates how foreign jurisdictions have, unsurprisingly, struggled with the policy issues of using residence as a connecting factor for IHT:[9]

> Last year, [2017] Japanese inheritance tax rules were amended such that, where a foreign national had lived in Japan for 10 years (in the aggregate) out of the last 15, died outside of Japan, the foreigner national's heirs would be subject to Japanese inheritance tax on such foreign national's assets located both in Japan and elsewhere (a similar

[9] *https://www.notaio-busani.it/it-IT/INTERNATIONAL---JAPAN--Disastrous-Japanese-inheritance-tax-IHT-amendment-to-be-repealed.aspx*

> rule also applies for gift tax purposes).
>
> The above rule resulted in a situation where the heirs of a foreign national who had left Japan would potentially be subject to Japanese inheritance tax on the foreign national's worldwide assets for up to five years after such foreign national had left Japan. The fact that Japanese inheritance tax could "follow" a foreign national for up to five years after such person had left Japan caused great concern among Japan's expatriate community, and threatened to derail the Japanese government's efforts at attracting successful foreign talent to live and work in Japan.
>
> In this year's tax reform, [2018] the Japanese government indicates that it will abolish the above rule applying to foreign nationals, subject to a certain anti-avoidance countermeasures in the context of gift tax... This change to the inheritance tax provisions should aid Japan in its efforts to show Japan to be an attractive location for successful foreign executives to reside long term.

I would be interested if readers with knowledge of Japanese IHT have further comments on this episode.

A1.8 Other domicile reforms?

There are other topics where domicile matters for tax purposes, for instance, trustee residence.[10] It would be logical to rewrite all these rules to avoid reference to domicile, but the work involved would be considerable.

The Technical Note does not consider these aspects, and what will happen remains to be seen.

A1.9 Amounts raised and policy issues

A1.9.1 *Amounts raised*

Spring Budget 2024 provides estimates, combining into one figure 3 distinct matters: the abolition of the nondom regime, the FIT regime which replaces it, and transitional reliefs.

Sensibly, the estimates ignore the IHT reforms, though these may well increase Revenue receipts.

2024-25	**2025-26**	**2026-27**	**2027-28**	**2028-29**
+0m	+185m	+2,805m	+3,675m	+2,715m

[10] See 7.6 (Mixed-resident trustees).

These figures should not be given any credence, because:

(1) There is no indication of the working behind the figures[11] (the reader may think this suggests that the authors would prefer no serious investigation into the figures).
(2) We do not have full details as to what the rules will be, on which large sums will depend.
(3) The Warwick/LSE paper estimated the saving from abolishing the remittance basis as £3.2 billion *without any short term residence relief.*[12] The cost of FIG relief can hardly be less than that.

The apparent precision (to within 5m) is obviously spurious. It would be more reasonable to estimate figures to the nearest £500m.

Spring Budget 2024 states that the Temporary Repatriation Facility "is expected to bring in an additional £15 billion of foreign income and gains onshore to the UK and raise over £1 billion in additional tax receipts." [13] Assuming the £1billion is spread equally between 2025/26 and 2026/27, that equates to £500m receipts in each of the two years. It is not clear if those sums are included in the figures above. But while the TRF will affect the timing of receipts, it is not obvious why someone should chose to remit and pay the tax if there is a viable alternative of not remitting.[14] The TRF will not raise significant *additional* tax receipts.

My own guess would be no net gains to the Revenue at all, and more likely than not a net loss, except for additional receipts:

(1) For 2025/26, because of additional income timed to take advantage of 2025/26 50% IT relief
(2) for 2025/26 and 2026/27, because of remittances to take advantage of the Temporary Repatriation Facility

Those receipts will be outweighed by lower receipts in other years.

A1.10 Policy issues

Spring Budget 2024 states that the reforms create "a modernised[15] regime

[11] For what it is worth, HM Treasury, "Spring Budget 2024 Policy Costings" states:

> "The costing accounts for behavioural responses including migration and tax planning."

But what allowance is made for these matters is not identified.

[12] See 1.6 (Warwick/LSE paper). This is likely to be an overestimate.

[13] Para 2.36.

[14] Unless the UK tax charge is covered by DTA relief.

[15] Para 2.35; see App 1.2 (Clarify/modernise/reform).

that is simpler, fairer and more competitive". But I doubt if anyone is expected to take that seriously.

A1.10.1 *Tax competitive*

Spring Budget 2024 claims the new system will remove a rule "that incentivises individuals to keep income and gains offshore in the current system".[16] That is very broadly correct, though it does not mention that the new relief will continue to incentivise individuals to realise income and gains offshore in the four year Exempt Period, that IHT may also continue to provide a similar incentive, and that the incentive will continue to apply to pre-2025 FIG (mitigated to some extent by the Transitional Relief Facility).

A1.10.2 *Simplicity*

The sketch in the Technical Note is simple. The final law will not be simple; FIG relief and transitional provisions will need 3 schedules and I guess about 100 pages of legislation.

The Technical Note says:

> Under the new regime individuals will not be required to track the movement of their FIG through investments in the way they are required to do now under the current regime. This will make the new 4- year FIG regime much simpler than the remittance basis regime.

The law for post 2025 FIG will be simpler than the present law, because the remittance basis has become so very complicated (mainly a result of the 2008 and 2017 reforms). But the remittance basis, with all its complications, will remain for a generation, as it will continue to apply to unremitted income/gains before 2025/26, though mitigated by the TRF, and after a couple of decades will gradually fade into insignificance.

Simplicity is multi-faceted. The abolition of protected trusts (certainly a simplification) means that attention will need to be given to the ToA and CGT s.3 motive defences, and reliefs such as SSE, which did not have to be considered for protected trusts.

A1.11 Some certainties and uncertainties

A1.11.1 *Certainties*

Countless client briefing emails will be sent, and conferences arranged.

[16] Box 2C, p.40.

Tax practitioners will be busy advising on the implications of the new regime (coming up to 5 April this year, and next year, frantically so).

There will be much scope for tax planning.

Parts of this book will need to be rewritten - but large parts will remain substantially the same. The title of the book will change; I have wanted to change it for a while but have been unable to think of the right title. Suggestions from readers would be welcome.

A1.11.2 *Uncertainties*

Some non-doms will leave the UK as a result of the reforms, (and some will chose not to come). But how many?

Others will be attracted to the UK, but how many and will they stay?

We will know a little more in a decade, when figures for the early years of the FIG regime are available and academics have studied them.

Macfarlanes say:[17]

> we would anticipate that individuals who are planning a major exit from a business within that four-year period will be attracted to the UK. In this sense, the regime is better than Italy, because in Italy there can be significant problems with disposals of major private company shareholdings in the first five years of residence.

It remains to be seen what view the next government take. It was Labour policy to abolish the remittance basis and replace it with a new residents relief.[18] On that basis one can expect the FIG regime to survive for now. The transitional reliefs might be restricted or abolished even before they take effect.

The Technical Note does not mention forestalling rules, but such rules may emerge (under the current government or the next) and it may be desirable for taxpayers to act sooner rather than later. We will only know with the benefit of hindsight.

The new law will not be enacted in the Bill which will become the F(no2)A 2024. It is a matter of politics whether it will be in FA 2025, or

[17] *https://www.macfarlanes.com/what-we-think/in-depth/2024/non-uk-domiciliary-regime-an-analysis* (March 2024)

[18] The nature of Labour's new relief were unspecified, presumably undecided, and most likely, unconsidered.
There is of course a history of Conservative governments adopting popular Labour policies; see 1.10.1 (Political background). There is nothing necessarily wrong with that: indeed, one might applaud it.

in a F(no.3)A 2024, though there is not enough time to do a good job in 2024 and anything enacted in 2024 will be reviewed in 2025. One hopes that the debacle of the 2008 reforms will not be repeated.[19]

The IHT reforms can only go in the FA 2025. The timetable might slip to 2026 but I would not plan on that.

A1.11.3 *Will IT/CGT regime be stable*

The law will no doubt be amended a few times in the next few years, as issues emerge. After that, will the new law be stable? It seems unlikely. A government in need of funds might:

(1) Cut the Exempt Period to 2 or 3 years, or

(2) Impose a FIG relief claim charge comparable to the remittance basis claim charge.

That is especially likely if, as I would guess, the published figures underestimate the cost of FIG relief.

On the other hand, there will be pressure to increase the Exempt Period. Macfarlanes say:[20]

> ... the four-year period is really very short, especially when looked at in the international context. The Irish remittance regime does not have a time limit, the Italian and Greek regimes are each available for 15 years, a French inbound regime lasts for eight years and the Spanish "Beckham" law lasts five years.
>
> A four year period is significantly less attractive. Such a short period could also be said to encourage what might be termed "fiscal nomadism". Individuals who choose to benefit from the regime are likely to leave a limited footprint in the UK. After all, why would they purchase a property, or invest in the UK, if they only choose to be in the UK for four years?

That is not comparing like with like. FIG exemption while it lasts is more generous than a remittance basis, is uncapped, and does not incur a significant flat tax payment. The length of the Exempt Period is only part of the picture.

As to whether the new IHT law will be stable, discussion should wait until we know what the law will be.

[19] See 1.9.4 (FA 2008 enactment process).

[20] *https://www.macfarlanes.com/what-we-think/in-depth/2024/non-uk-domiciliary-regime-an-analysis* (March 2024)

CHAPTER ONE

MOBILE INDIVIDUALS: TAX POLICY

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1.1 Introduction

In this chapter I coin the following terms:

“Mobile Individuals” means some class of individuals who are less connected with, or settled in, the UK than Established Residents.

“Established Residents” are UK residents with sufficient UK links that they do not qualify as Mobile Individuals.

“Mobile Individual relief” is some relief for UK resident Mobile Individuals (which is not available to Established Residents)

Until 2025 the distinction between Mobile Individuals and Established Residents was determined by reference to domicile (supplemented by 7-year, 12-year and 15-year residence tests). After 2025, as all readers will know, the distinction will principally be determined by 10-year absence followed by no more than four year's residence.[1]

The topics of this chapter are:

(1) Policy arguments for a lighter tax regime for a class of Mobile Individuals
(2) How that class may be determined (which is to change in 2015)
(3) A brief history of domicile tax reform, with comments on the reforms of:
    (a) 2008
    (b) 2017
(4) The state of UK tax reform, and prospects for the future

1.2 Tax competition

All UK residents may choose where to reside, but some are less securely attached to the UK than others. Tax competition arguments claim that if their tax burden was as great as established residents, fewer would choose to live in the UK, and overall the UK economy would lose:

(1) directly, from tax paid by them (including VAT and SDLT); and
(2) indirectly, from UK investment and expenditure which is more likely to be made by UK residents.[2]

Similarly, UK firms competing in the global market for talent and expertise will find recruitment easier if the tax regime for foreign employees is lighter. Some potential employees would not choose, or could not afford, to come if the UK tried to tax them on worldwide income.

In a nutshell: the argument is that the UK economy benefits from mobile individual reliefs.

1.2.1 *Tax competition: Analysis*

Tax competition raises a number of sub-issues:

(1) To assess the existence and amount of tax competition
(2) What the UK should do in the light of that tax competition
(3) What international agreements might do to regulate tax competition

The first question is essentially one of fact; the second is a question of domestic politics. The third is a matter of foreign politics.

[1] See Chapter A1 (FIG Relief - Abolition of Domicile).

[2] Except to the extent that tax makes UK investment unattractive, as to which, see 19.23 (Investment relief: Critique).

The debate about international tax competition is long standing.[3] All countries, of course, grapple with the same issues.[4]

1.2.2 *Extent of tax competition*

It seems clear that there is plenty of tax competition for wealthy mobile individuals: there are many low-tax or preferential tax regimes in Europe where they may choose to reside,[5] even without looking any further.

In assessing the existence and amount of international tax competition several points must be borne in mind.

Effective low tax may be achieved in other countries by relaxing legal provisions at administrative level, in a non-transparent way.

One-paragraph summaries of a country's tax system are bound to be

[3] See the evidence of Lord Vestey to the 1920 Royal Commission, *https://www.kessler.co.uk/wp-content/uploads/2013/07/Vestey_Royal_Commission_evidence_and_ensuing_debate.pdf*

[4] See eg New Zealand Inland Revenue "Tax, foreign investment and productivity" *https://taxpolicy.ird.govt.nz/publications/2022/2022-other-draft-ltib* (2022)

[5] Switzerland, for instance, has a lump sum taxation regime for non-Swiss citizens, specifically targeted for this purpose and more favourable than the UK remittance basis; see 9.5.4 (Swiss forfait taxpayer). This was at one time politically controversial; it was abolished in Zurich in 2009 and 5 other cantons followed suit. But in a referendum in 2014, the regime was supported by 59% of voters, on a 49% turnout; see Sigg and Luongo, "The Swiss lump-sum taxation regime: after the storm comes the calm?" [2015] JITTCP 169
http://www.swissinfo.ch/eng/bloomberg/swiss-say-foreign-millionaires-are-still-welcome-after-tax-vote/41144174
So I expect that Swiss tax law is now stable. In the 2014/15 edition of this work I added "and probably more stable than the UK" and that proved to be correct!
In 2017, Italy introduced a *forfait* regime for new residents: art.24-bis [Italy] *Testo unico delle imposte sui redditi*; as there is no further tax on remittance, this is more favourable than the UK remittance basis.
In 2024, Macfarlanes comment:

> ... other regimes have been created (most notably by Italy and Greece) which are based on the UK rules but are significantly more generous. As a result, wealthy individuals probably now have greater choice than they have ever had if they want to take advantage of a time limited but tax advantaged status. Some attractive inpatriate regimes (such as the Portuguese regime) have come and gone but overall, the number of international competitors to the UK has grown.

https://www.macfarlanes.com/what-we-think/in-depth/2024/non-uk-domiciliary-regime-an-analysis/?utm_source=vuture&utm_medium=email&utm_campaign=11%20march%202024-passle%20emails%20(ongoing)
Ireland retains the pre-2008 remittance basis.

misleading.

The terms of statutory tax law are only one aspect of tax competition. Compliance costs are important. The quality of tax administration is important. An OECD study identifies six desiderata: a developed legal system, confidentiality, impartiality, proportionality, responsiveness (meaning a CRM for large companies, and at least answering correspondence from lesser taxpayers) and competence. They add:

> Frequent changes in legislation, particularly where there has been an absence of consultation, can have an adverse impact on the taxpayers and their advisers trust in the tax system.[6]

But there are others: can a tax authority subject an individual to an expensive and intrusive tax investigation without evidence that tax returns were wrong? Certainty is very important.[7] When individuals make decisions of where to live, perception matters as much as reality. Rates of tax on UK source income may matter more than non-dom reliefs. By some of these measures, the UK competes poorly.

1.3 Other tax competition

Tax competition arises in many areas of taxation, and affects different types of income in different ways.

In areas where investment by non-residents is (more or less) completely mobile, tax competition has driven UK tax rates down to zero. Examples include:

Topic: Relief	**See para**
Interest: Reliefs for non–residents	26.23; 45.1
IME: Trading income of non-residents from dealing in investments	72.1
UK funds: IHT relief for foreign domiciliaries[8]	75.3

[6] "Engaging with High Net Worth Individuals on Tax Compliance" (2009) para 208 and 243; see *http://www.oecd.org/ctp/aggressive/engagingwithhighnetworthindividualsontaxcompliance.htm*

[7] See 2.8 (The Rule of Law).

[8] Another example from the field of shipping:

> "The location of ownership, flagging (registration) and management activities is very 'footloose', since it can easily be transferred from one country to another. This makes it vital to have regard to the fiscal regimes in other countries if we want to maintain a successful shipping industry in the UK. The modern armoury in the battle for success invariably includes a virtually tax-exempt fiscal regime."

In the case of very mobile sources of income, such as interest on bank deposits and trading income from asset management, any UK tax charge would only cause non-resident investors to move the investments to a different jurisdiction with a resultant loss in economic activity and profits in the UK.

In the corporate field, tax competition reduced the rate of CT, before 2023, though not of course to zero or near it. Tax competition may not have been the only factor which contributed to the historic reduction in CT rates, but if HM Treasury is to be believed, it was an important factor. In the 2017 spring budget:

> 3.11 The UK is one of the most open economies in the world, and a highly competitive business tax regime remains a key factor in retaining that position. The UK's corporate tax rate is the lowest in the G20.[9]

But headline rates are only part of the story.[10]

The increase in CT rates announced in the 2021 budget with effect from 2023 is a reversal of this trend, which surprised everyone who expected consistency in tax policy. The explanation may be that the government were constrained by promises not to raise the rates of IT or VAT. And as Paul Johnson has pointed out, a rise in corporation tax is politically attractive because it is not obvious who bears the burden of the tax. What the vagaries of the CT rates do illustrate is that tax competition is only one factor in determining tax policy.

(Independent Enquiry into a Tonnage Tax, Lord Alexander, HM Treasury 1999.) Another example is the exemptions for major sports events; see s.48 FA 2014. These events would not be held in the UK in the absence of tax exemption.

[9] *https://www.gov.uk/government/publications/spring-budget-2017-documents*
This was the latest in a line of similar statements, traced in the 2016/17 edition of this work para 1.2.2, but I omit that here as it has little contemporary significance.
Reductions in UK corporation tax rates from 2012 may have been partly motivated by anticipation of Scottish tax competition; but if so, this was tactfully not mentioned.

[10] If one looks deeper, a different (and more complex) picture emerges, having regard to other major changes to corporate taxation:

(1) Reduced capital allowances (subsequently increased); see Pomerleau, "What We Can Learn from the UK's Corporate Tax Cuts" (2017) *https://taxfoundation.org/can-learn-uks-corporate-tax-cuts/*

(2) Increases in taxation of dividends in 2016, and again in 2023 (though dividend tax is less relevant to tax competition, as it does not apply to non-residents).

1.3.1 *Tax competition within UK*

Devolution raises the issue of tax competition within the UK.

The possibility was once mooted that Scotland may compete in the corporate field, by a lower corporation tax rate than England:

> a lower headline rate of corporation tax could encourage greater investment by Scottish and UK firms in both physical and human capital and in research and development within Scotland.
>
> At the same time, it could make the country more attractive as a location for multi-national investment. It could also act as an important signal to global companies and investors as to Scotland's ambition to be a location for competitive business.[11]

Similar issues apply to taxation of individuals.[12] Competition in the foreign domicile field is therefore only one aspect of a wider topic.

1.3.2 *Attitudes to tax competition*

Most sober commentators accept that tax competition is an important consideration in framing UK taxation. The UK could not act alone, as if

[11] "Devolution of tax powers to the Scottish Parliament - Commons Library Standard Note" (2012, 2013)
The consultation paper does not consider the possibility that England might match the Scottish lower rate and does not address the question of what constitutes a Scottish company for the purpose of the lower rate. The most recent version of this paper is "Devolution of tax powers to the Scottish Parliament - recent developments" (2016)
https://commonslibrary.parliament.uk/research-briefings/sn07077/
Likewise in Northern Ireland: The Corporation Tax (Northern Ireland) Act 2015; House of Commons Briefing paper No 7078, "Corporation tax in Northern Ireland" (2017)
http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN07078#fullreport
HMRC, "Draft guidance on the NI CT regime"
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/677832/NI_CTregime-draft_guidance.pdf
Wales would also like to join in:

> "If Northern Ireland is allowed to cut corporation tax, it would be outrageous if Welsh politicians did not have the option of doing the same."

Gerald Holtham, chair of the Holtham Commission for Wales (Cited in the Scottish consultation paper).
So in the future there might be no shortage of corporation tax competition within the UK.

[12] See 43.3.4 (IT competition within UK).

there were no such thing as international tax competition.[13]

Tax competition offers advantages to countries which compete successfully and disadvantages to those who do not. In some areas government have accepted the challenge of competition, and sometimes with enthusiasm:

> The [investment manager] exemption enables non-residents to appoint UK-based investment managers without the risk of UK taxation and is one of the key components of the UK's continuing attraction for investment managers.[14]

Those opposed to the consequences of this line of argument deride it as:
(1) a "race to the bottom"[15]; and
(2) "harmful" tax competition

It is correct that if tax competition were the only policy consideration, it should logically drive tax rates on the mobile sources of income of non-residents down to zero; and in some cases that has been the result. Of course tax competition is not the only consideration in forming tax policy.

The expression "harmful tax competition" conceals awkward questions about harmful to whom? "Harm" is not an obvious or self-defining concept. The focus is often on harm to the G7 countries.[16]

[13] However at the extreme even this is denied; eg "Tackle Tax Avoidance" a campaign of Progress (which describes itself as a New Labour pressure group):

> "There is real fear at the heart of government that if it gets tough on business, businesses will flee the UK. But as the chief executive of Google, Eric Schmidt, himself admitted in an interview: 'Google will continue to invest in the UK no matter what you guys do because the UK is just too important for us.'

[14] SP 1/01; see 72.1 (Investment manager exemptions). The point is restated in HMRC "Expanding the Investment Transactions List for the Investment Management Exemption and other fund tax regimes" section 1 (2022) *https://www.gov.uk/government/consultations/expanding-the-investment-transactions-list-for-the-investment-management-exemption-and-other-fund-tax-regimes*

[15] This metaphor goes back at least to OECD *Harmful Competition* (1998) *https://www.oecd.org/ctp/harmful/1904176.pdf*
The problem is not unique to tax: international regulatory competition may also lead to a "race to the bottom"; but perhaps in areas outside tax it is easier to reach international agreements imposing minimum standards.

[16] See Littlewood, "Tax Competition: Harmful to Whom?" in Asif Qureshi and Xuan Gao, eds, Critical Concepts in Law: International Economic Law, Routledge, London (2010) volume VI, 162-234; reprinted from (2004) 26 Michigan Journal of International Law 411-487
https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1227&context=mjil

Unfortunately, it is usually hard and sometimes impossible to predict the economic effects of any reform, even approximately; and predictions reflect the views and hopes of the partial pundits who make them.[17] Ascertaining the effect of reforms after they are made is scarcely less difficult. As a significant number of non-doms[18] work in senior roles in banking or finance,[19] one might infer that non-dom reliefs have until now contributed to the UK's success in these industries, but it is difficult to prove or disprove.

1.3.3 *Tax competition: International law*

International tax competition against other countries is subject to certain constraints of international law and politics. International fiscal co-operation in this area at present operates only to a limited extent. It made some progress in a (non-binding) EU code of conduct on business taxation,[20] but that is now defunct as far as the UK is concerned.

State Aid rules also impose restrictions on UK's freedom to tax and untax.

Tax competition extends beyond the EU, and those hoping for a body to curb international tax competition tend to look to OECD.[21] At present this is focussed on corporate rather than personal taxation. There seems little prospect of that changing.

Avi-Yonah "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State" [2000] Harvard Law Review p.1573.

[17] For instance, HMRC estimate that a reduction in the rate of Corporation Tax in Scotland to 12.5% would cost £2.6bn, but the Scottish Parliament say the impact would be positive: "Corporation Tax: Discussion Paper Options for Reform" (2011) p.43, *https://webarchive.nrscotland.gov.uk/3000/https://www.gov.scot/Resource/Doc/919/0120786.pdf*

[18] I use the term "non-dom" here to mean those who benefit from non-dom reliefs; see 4.2.1 ("Non-doms").

[19] A CAGE Warwick Policy Briefing, "The UK's 'non-doms': Who are they, what do they do, and where do they live?" (2022) records that around 22% of bankers in the top 1% (income above £125,000) are non-doms. *https://warwick.ac.uk/fac/soc/economics/research/centres/cage/manage/publications/bn36.2022.pdf*

[20] *https://taxation-customs.ec.europa.eu/harmful-tax-competition_en*

[21] Eg Jeffrey Sachs "Stop this race to the bottom on corporate tax" Financial Times, March 28 2011.

1.4 Mobility tests

1.4.1 *Domicile test*

The domicile concept is not ideally framed to identify the mobile (or "footloose") individuals, whose UK links are sufficiently less that a lighter IT/CGT regime is appropriate on fairness or tax competition arguments.

(1) The adhesive quality of a domicile of origin, and the restrictive rules for the acquisition of a domicile of choice, sometimes allow fortunate individuals to enjoy foreign domicile tax treatment, despite close UK links and only tenuous, historical and fortuitous links to their domicile of origin.

(2) The test depends on intention, which is expensive to prove and allows the possibility of mistaken or false claims.[22]

To the extent that those points apply, non-dom reliefs fail on both economic and fairness criteria.

In considering these objections to domicile, however, one should bear in mind that there are no perfect criteria of what we are seeking to ascertain, which is "footlooseness", or "UK links". The question is not whether domicile always produces the right answer, but whether one can do significantly better with other concepts or refinements.

1.4.2 *Residence tests*

Various long term residence concepts are sometimes used:

(1) Deemed domicile: 15 years residence
(2) Remittance basis claim charge: 7 and 12 years residence
(3) Temporary non-residence: 4 years residence and 5 years absence
(4) Arriver/leaver rules for residence: 3 years non-residence
(5) New residence rules: 10 years non-residence and up to:
  (i) 4 years residence (FIG, proposed)
  (ii) 3 years residence (OWR, proposed)
  (iii) 10 years residence (IHT, proposed)

These are ways to distinguish between UK residents with stronger or weaker UK links.

Citizenship/nationality is not much used in tax, and is unsuitable as a sole test of taxability,[23] though it might be used to supplement other tests.

[22] See 4.24.1 (Change of HMRC practice).

[23] See App 15.5 (When citizenship matters for UK tax).

Until 2025, these residence-based concepts were used to modify or supplement a domicile test rather than to wholly replace it.

Budget 2024 proposes to abandon domicile as a test and replace it with a new residence-based test. To those who have lobbied against domicile, one might say: be careful what to wish for! To the extent that UK domiciled individuals who have worked abroad would return to their home in any event, the mobile residents relief fails at least on economic criteria. Just as there are non-doms, or alleged non-doms, who did not "deserve" the relief, there will be "undeserving"new residents who do not "deserve" FIG relief.

But again, the question is not whether this always produces the right answer, but whether one can do significantly better with other concepts or refinements.

1.5 Fairness and mobile-individual reliefs

The other consideration in the assessment of mobile individual taxation is fairness.

The starting point for any serious discussion of fairness in tax is terminology from economics:

Term	**Meaning**
Horizontal equity	Those relevantly equal should pay the same amount of tax
Vertical equity	Those relevantly different should pay different amounts of tax

It is considerations of vertical equity which have lead to the (more or less) accepted view that fair taxation should be progressive rather than regressive.

Economists have developed the concepts of horizontal/vertical equity with considerable sophistication[24] but their limitations are exposed when one tries to apply them in a real life context, such as an assessment of the fairness of a non-dom remittance basis or of the proposed new residence relief. The concepts are not so much a definition of fairness as an approach to identifying the issues. In deciding whether non-dom reliefs are fair, one needs to ask if UK domiciliaries are relevantly equal; in deciding whether

[24] For a starting point, see Kaplow, "Horizontal Equity: Measures in Search of a Principle" National Tax Journal 42, no. 2 (1989) p.139-55
https://www.nber.org/system/files/working_papers/w1679/w1679.pdf
Musgrave "Horizontal Equity Once More" National Tax Journal 43, no. 2 (1990) p.113-23
https://www.journals.uchicago.edu/doi/abs/10.1086/NTJ41788830?journalCode=ntj

new residents FIG relief is fair, one needs to ask if new residents are relevantly equal. In neither case is the answer self-evident.

1.6 Warwick/LSE paper

This section discusses two papers (together, "the Warwick Paper")

- Reforming the non-dom regime: revenue estimates
- Taxation and Migration by the Super-Rich[25]

As far as I know, this is the first attempt to assess the financial implications of abolishing UK non-dom reliefs[26] on anything other than an impressionistic or anecdotal basis.[27]

Key questions here are:

(1) The **"emigration response"**: how many would leave if non-dom reliefs were abolished
(2) The **"immigration response"**: how many would chose not to come

The Warwick Paper concluded, contrary to the generally- and long-accepted view, that the emigration and immigration responses would be small. If that were right, the tax competition argument for non-dom reliefs[28] is invalid. The Paper gives figures for the tax yield which would *increase* if the reliefs were abolished:

> After accounting for this limited migration response, including the loss of existing tax paid by non-doms who leave, the additional tax that would be received is £3.23 billion. The net additional revenue to government, after also accounting for the loss of the remittance basis

[25] *https://warwick.ac.uk/fac/soc/economics/research/centres/cage/manage/publications/bn38.2022.pdf*
https://warwick.ac.uk/fac/soc/economics/research/workingpapers/2022/twerp_1427_-_advani.pdf
Both by Arun Advani, David Burgherr and Andy Summers, two economists and a lawyer, and published Sep 2022. The two papers need to be read together.

[26] I use the expression "non-dom reliefs" to mean the remittance basis for IT/CGT and protected-trust reliefs. The Warwick Paper does not consider IHT.

[27] For international studies in this area, see: Kleven et al., "Taxation and Migration: Evidence and Policy Implications" NBER Working Paper No. 25740 (April 2019); Young et al., "Millionaire Migration and Taxation of the Elite: Evidence from Administrative Data" American Sociological Review Vol 81, Issue 3, (2016); Kleven et al., "Migration and Wage Effects of Taxing Top Earners: Evidence from the Foreigners' Tax Scheme in Denmark" The Quarterly Journal of Economics (2014) p.333.

[28] 1.2 (Tax competition).

> charge receipts, is £3.16 billion. Based on the upper bound for the expected migration effects, we can rule out increases in receipts of below £2.4 billion.
>
> These findings allow us to rule out the concern – previously raised by Labour and Conservative politicians alike – that abolishing the non-dom regime would 'cost Britain money'. For the reform not to raise any revenue, the migration response would have to be more than 15 times larger than the emigration response that we observe following the 2017 reforms. There remains uncertainty over the precise extent of any immigration response and the wider economic impacts associated with abolishing or restricting the non-dom regime, but these would need to be very large to outweigh the revenue gains under even our upper bound (for migration) estimate. Objections to restriction or removal of the remittance basis cannot therefore be based on their fiscal effects.

The methodology of the Warwick Paper is as follows:

(1) It estimates the foreign income/gains of non-doms by reference to comparable UK domiciled taxpayers. The economic analysis here is as sophisticated as one would expect, and the author (not being an economist) could not critique it, except to say that the precision of the headline figures of £3.23/£2.4 billion (suggesting tax yields could be reliably measured to within £10m/£100m) seems unjustified.

(2) The paper estimates the emigration response to the abolition of all non-dom reliefs by assuming it would be the same as the emigration response as two groups:
   (a) those who became deemed UK domiciled (for IT/CGT) under the 15 year rule
   (b) formerly domiciled residents

   It finds those response rates in 2018 to have been small.[29]

(3) The paper assumes that:
   (a) The immigration response would be small (based on its conclusion that the emigration response would be small)[30]

[29] Data from subsequent years was not available though the authors propose to consider subsequent years in due course.

[30] The Paper says: "Looking at the (small) variation in responsiveness by length of time in the UK is suggestive that any immigration response is also likely to be small, given the limited size of the emigration response even for very recent arrivals."

Clearly, if the Paper's comments on the emigration response are wrong, its assumption that there would be no immigration response is also wrong. But even if the emigration response was small, or tiny, it is a leap to say that the immigration

(b) Once deemed domiciled, non-doms in the UK would pay the same amount of tax as their UK domiciled comparables.[31]

(c) The headline figure of £3.2 billion is computed on the assumption that:

  (i) there would be no transitional reliefs[32]

  (ii) there would be no relief for short-term residents to replace the current remittance basis[33]

There are reasons to doubt the points at (3).[34] But the biggest weakness in the analysis, which seems to me to render its conclusions unreliable, is at point (2). The Paper cites and takes at face value the Chancellor's statement that the 2017 changes "abolished permanent non-dom status".[35] But that was (at best) a half truth.[36]

(1) For those who became deemed domiciled under the 15-year rule, the 2017 reforms did not involve the abolition of non-dom reliefs. In assessing the emigration response of this class of non-doms one must take into account:

response would be the same. In the absence of data, we are in the field of intuition, or guesswork, but a decision to come is not the same as a decision to remain.

[31] Those coming to the UK, and those planning to leave, have tax planning opportunities which are not available to those here long term See 13.1 (UK arrival or departure: Tax Checklist). The most obvious include realising income/gains before arriving, or deferring until departure; and rebasing gains before arriving; see 13.2 (Individual coming to UK; not TNR). If non-dom reliefs were abolished, this would become more important than it is now, because non-doms currently expect to qualify for the remittance basis, and so (generally) do not need to take any further tax planning steps.

[32] The Paper does not note that extensions to the territorial scope of UK tax have normally had transitional relief; see 56.16.1 (Rebasing reliefs).

[33] In fact current Labour policy is that:

> "We will ... introduce a modern scheme for people who are genuinely living in the UK for short periods."

James Murray MP, Shadow Financial Secretary to the Treasury
https://hansard.parliament.uk/Commons/2023-01-31/debates/7A361B65-9960-49F1-BE34-EA2A0B5FDD4F/Non-DomicileTaxStatus

The authors estimate that if a remittance basis was allowed for up to four years of UK residence, the tax saving is cut by half, because many non-doms who claim the remittance basis do not stay in the UK for more extended periods.

[34] See above footnotes.

[35] Warwick Paper p.12. It is at one point acknowledged that non-dom reliefs were not "entirely abolished".

[36] See 90.2 (Protected trusts: Policy).

(a) protected-trust relief[37]
(b) cleansing relief which (if it had any purpose) was specifically designed to mitigate the cost of the changes for this class of taxpayer

(2) For those who became deemed domiciled as formerly domiciled residents, the emigration response is more relevant, as this class of non-doms did not qualify for those reliefs. However this class of individuals:
(a) is small, and
(b) by definition, has UK connections that other non-doms lack[38]

In short, the Warwick Paper does not assess the emigration response to a future reform by reference to the actual response to the actual 2017 reform, but by reference to the actual response to an imaginary reform which did not happen. Had the 2017 changes actually "abolished permanent non-dom status" (more analytically, abolished non-dom reliefs for deemed domiciliaries under the 15-year rule), the emigration response may have been different.

1.6.1 *Are mobile reliefs fair*

Even if it is accepted that it is fair to tax foreign domiciliaries less than UK domiciliaries, the question of what constitutes a fair reduction is a distinct and more difficult issue.

The 2008/2017 reforms accepted the principle of a distinction (which is why they did not go far enough for some commentators) but reduced the extent of the tax reduction by making the remittance basis less attractive. The effective rate of tax under the remittance basis (broadly) declines with income and it can be described as regressive taxation. If one accepts that taxation ought in principle to be progressive, which has long been a broad feature of UK taxation, then there is a sound argument that the remittance basis is unfair.

What effect did the 2008/2017 reforms have in this area? So far as they

[37] The Warwick Paper paid little attention to protected-trust relief other than to disparage it as a "major loophole"; this tabloid expression is to be deprecated in serious policy discussion; see App. 1.9 (Loophole/tax break).

[38] Just how significant those UK connections are will vary from case to case, and anyone in this class must also have substantial foreign connections in order to justify the claim to have acquired a foreign domicile of choice, but on average they will be more UK linked than other non-doms.

decreased the attractiveness of the remittance basis they have decreased the unfairness.

So far as they have introduced the remittance basis claim charge, the reforms have targeted the benefit of the remittance basis at a small number of ultra-wealthy individuals. That may make sense under the tax competition argument, but from a fairness point of view it is difficult to justify.

FIG is a much more generous relief, though for a relatively short term. Is it fair? Discuss.

1.7 Non-dom tax reform history

The chequered history reflects the difficulty, or impossibility, of reconciling incompatible policy considerations.[39]

1.7.1 *1974-2002*

The 1974 Finance Bill included a provision (clause 18) that an individual ordinarily resident in the UK for 5 out of 6 years should be deemed UK domiciled for IT and CGT purposes. By the time the clause came to be debated, the Labour (Wilson) administration proposed to amend it so that individuals resident for 9 years out of 10 years were deemed UK domiciled.[40] That would have been similar to the 2017 reforms, but without protected-trust relief. But even after this concession, the clause did not survive to the Finance Act.[41]

The 1988 Consultative Document (Residence in the UK) made radical proposals. The remittance basis would be abolished. Those resident here for less than seven out of 14 years (and, perhaps, also not UK domiciled) would qualify for a new "intermediate basis" of taxation. This would require disclosure of worldwide income in order to tax it at an effective rate of 2% or less. This proposal was abandoned.

[39] See too 17.2 (History of remittance basis).

[40] Hansard, Finance Bill debate 9 May 1974.

[41] For an account of the lobbying behind this, see Barnett, *Inside The Treasury* (1982) p.28–9. For the Parliamentary debate, see HC Deb 13 June 1974 vol 874 cc1842-948 *https://api.parliament.uk/historic-hansard/commons/1974/jun/13/cases-i-and-ii-of-schedule-e*
It is perhaps relevant to the outcome that the Labour administration was a minority government from 4 March 1974 until the election on 10 October 1974, after which it had a majority of 3 seats.

1.7.2 *2003 - 2008*

In 2002 a newspaper campaign pressed the Blair administration into action, or at least into the appearance of action. The Budget of April 2003 delivered a "Background Paper".[42] This was a facile document[43] but it may be unfair to criticise its (unnamed) authors. Their instructions may have been to be uncontroversial; by saying nothing, there was nothing in the document to which anyone could object.

Nothing then happened from 2003 to 2008. It is clear that the 2003 review of foreign domicile tax did not follow the normal course of consultation, decision and implementation. In the absence of a frank explanation of what went on, it is tempting to speculate. The likely explanation is that the Blair administration wanted to do nothing, but prevaricated to avoid an announcement which would have lead to a furore from those in favour of reform. Blair resigned in 2007. A change of power led to an unannounced U-turn from that unannounced policy.[44]

1.8 Assessment of reform: Metrics

It is a common feature of HMRC papers to ignore point [2], and to claim the mantles of fairness and competitiveness without acknowledging a conflict between them. Thus the HMRC policy paper "Domicile: Income Tax and CGT":

> The government wants to reform the tax treatment of non-doms so that the UK can continue to benefit from the presence of talented foreigners

[42] "Reviewing the residence and domicile rules as they affect the taxation of individuals" *http://webarchive.nationalarchives.gov.uk/20091222074811/http://www.hmrc.gov.uk/budget2003/residence_domicile.pdf*

[43] It contained an outline of the law and one paragraph summaries of the law of 29 other countries (of insufficient detail to be of any use and generally said to be misleading). The paper did not consider any proposals or their possible impact. It (consciously?) ignored every earlier discussion of reform: the Royal Commissions of 1920 and 1955, the 1936 Codification Committee, the 1974 Finance Bill, the 1987 Law Commission Report and the 1988 Consultation Paper.
For an account of the decline in quality of government white and green papers, see Forster, *British Government in Crisis* (2005), p.134.

[44] Earlier editions of this work contain a more detailed history of the period 2003-2007, see the 9th edition of this work para 1.3.2, but details seem less important with the passage of time.

> while also addressing unfair tax outcomes.[45]

One might describe this as the Janet and John approach to tax reform, but the phenomenon is currently known as "cakeism" referencing Boris Johnson's witticism on cake: "pro having it and pro eating it".

The House of Commons Treasury Committee provide an intelligent approach to assessment of tax reform, identifying 8 criteria:

> The Committee recommends that tax policy should be measured by reference to the following principles. Tax policy should:
> 1. **be fair**. We accept that not all commentators will agree on the detail of what constitutes a fair tax, but a tax system which is considered to be fundamentally unfair will ultimately fail to command consent.
> 2. **support growth and encourage competition**.
> 3. **provide certainty**. In virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs. **Certainty about tax requires**
> i. **legal clarity**: Tax legislation should be based on statute and subject to proper democratic scrutiny by parliament.
> ii. **Simplicity**: The tax rules should aim to be simple, understandable and clear in their objectives.
> iii. **Targeting**: It should be clear to taxpayers whether or not they are liable for particular types of charges to tax. When anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system.
> 4. **provide stability**. Changes to the underlying rules should be kept to a minimum and policy shocks should both be avoided. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
> 5. The Committee also considers that it is important that a person's tax liability should be easy to calculate and straightforward and cheap to collect. To this end, tax policy should be **practicable**.
> 6. The tax system as a whole must be **coherent**. New provisions should complement the existing tax system, not conflict with it.

The Committee acknowledge that these objects are incompatible:

> 85. No tax system is, or can be, static. There will always be trade-offs

[45] *https://www.gov.uk/government/publications/domicile-income-tax-and-capital-gains-tax/domicile-income-tax-and-capital-gains-tax* (2016)

> and difficult decisions; a desire for fairness may increase complexity; a desire for certainty may increase administrative complexity. Nonetheless, the principles we set out, which reflect a surprising degree of convergence within our evidence, give a direction of travel which, in the long run, can both secure consent and improve the performance of the economy.[46]

1.9 2008 reform: Assessment

The 2008 reforms increased the tax burden on foreign domiciliaries in four main ways:

(1) Remittance basis claim charge for long-term residents
(2) Withdrawal of personal allowances for remittance basis claimants
(3) ITA remittance basis, stricter than the pre-2008 remittance basis
(4) Extension of anti-avoidance provisions to remittance basis taxpayers (in particular, the s.720, s.3 and s.87 remittance bases)

1.9.1 *Clear and easy to operate*

It will be evident to anyone who skims this work that the 2008 rules were a failure by this criteria. The rules are unclear, often difficult and sometimes impossible to operate. In these respects they are unquestionably worse than the pre-2008 rules.

1.9.2 *Benefit to UK economy*

On one side of the account is the gain of more tax paid by foreign domiciliaries. On the other is:

(1) Tax and investment lost from individuals who leave the UK, and those who (because of the reforms) decide not to come.
(2) The loss to the economy that the 2008 rules generally discourage or prevent investment in the UK and use of UK service providers.

The 2008 reforms did not in the event greatly reduce the non-dom population, though they may have reduced it slightly.

1.9.3 *Fairness of 2008 reforms*

The FA 2008 contained a package of reforms and any short assessment of its merits must be limited to its main features.

[46] Treasury "Principles of tax policy" (2011) *http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/753/753.pdf*

The remittance basis claim charge distinguishes between short term and long-term residents, and taxes the latter more heavily, the connecting factor here being the long term residence tests. One cannot categorise those distinctions as unfair.

On the other hand, among long-term foreign domiciliaries, the charge distinguishes between the extremely wealthy (to whom the remittance basis is still attractive) and others (to whom it is not). This offends against the principle of vertical equity, that people with higher incomes should pay more tax. That is not fair, it represents a decision to prioritise the economic advantage of tax competition by targeting the remittance basis to the wealthiest. The tax competition consideration conflicts with fairness.

The withdrawal of personal allowances as a quid pro quo of a remittance basis is not unfair (though it comes at a cost in terms of complexity).

Of perhaps greater importance is the other aspects of a package of reforms which affect all foreign domiciliaries, not just long-term residents.

The stricter ITA remittance basis is not unfair, except for the wilder reaches of the relevant person definition[47] and the supposed rule (probably ignored in practice) that the taxable amount remitted may exceed the value of the asset remitted.[48]

The extended 2008 anti-avoidance rules can work unfairly but complete fairness is impossible to achieve in this area.

All in all, the 2008 reform may be given some limited marks for fairness. This is not to say that the pre-2008 rules should be regarded as unfair: the concept of fairness (especially if viewed with some attention to practicality) is so vague that a very wide range of tax policies may all be categorised as "fair".

1.9.4 *FA 2008 enactment process*

The manner in which the FA 2008 was introduced deserves to be recorded.

In January 2008, 26 pages of draft clauses were published whose unwritten message to wealthy non-residents was broadly: *do not come to the UK if possible; if you must, do not invest any money here.* The clauses were officially described as work in progress, but this was unfit for publication.

[47] See 18.8.1 (Company person: Critique); 18.12 (Relevant person rules: Critique).

[48] See 18.35.2 (Remittance of derived property).

HMRC[49] presumably agreed. On 27 March the Finance Bill was published, containing 54 pages of legislation. The FB clauses bore almost no resemblance to the January draft. One consequence is that the professional time and clients' money spent considering the old clauses was almost entirely wasted. That certainly cost many £millions. Another consequence was that the profession had nine frantic days to scramble around before the end of the tax year. Because of the absence of sensible transitional reliefs, large amounts of tax depended on decisions and actions taken in those days. Sensible consideration of difficult and important matters was rendered impossible.

On the date of publication the Treasury announced that the Finance Bill was incomplete and amendments covering almost every aspect of the rules[50] were made in the course of progress of the Finance Bill.[51] Thirty pages of amendments duly emerged in mid June – far too late in the Finance Bill timetable to give them any serious consideration. Forty eight more Report Stage amendments were published on 26 June. The report stage and third reading (after which no further amendments could be made) were held on 1 and 2 July 2008. Avery Jones notes that "Report Stage amendments are usually a disaster."[52]

The former editor of *Taxation* is blunt:

> The standard of strategic policy making at the Treasury has been unacceptably poor in recent years, but this must surely have been one of its lowest ebbs ever.[53]

[49] In this work I use the expression HMRC loosely, to include those in HM Treasury and in Government who share the responsibility for tax reform; it is not easy, or necessary, to identify where tax reform decisions are actually made.

[50] Explanatory notes to sch7, para 36 (mixed funds); para 47 (s.87 charge); para 52 (non-resident trusts); para 74 (sch 4C); para 91 (ToA provisions; para 106 (works of art); para 107 (employment related securities).

[51] In the 2008/09 edition I said:
"This is a new development in tax legislation. While from time to time inadequately drafted clauses have always been found in Finance Bills, this is as far as I am aware the first time that the Government has had to announce that fact at the time of publication of the Finance Bill."
There are similar examples in the FA 2009 but it has not become a trend.

[52] See "Taxing Foreign Income from Pitt to the Tax Law Rewrite—The Decline of the Remittance Basis", Avery Jones in *Studies in the History of Tax Law* (Vol 1 2004) *https://www.kessler.co.uk/wp-content/uploads/2013/12/Remittance-basis.pdf*

[53] *Taxation* 12 June 2008 Vol 161 No. 4160 p.627 (Malcolm Gunn).

CIOT say:

> when corners are cut, especially under time pressures, there can be serious deficiencies.

and their example to prove the point is the 2008 non-dom reforms.[54]

The House of Lords Economic Affairs Committee comment in measured language:

> Our private sector witnesses would not have used words like "a real shambles" if they did not feel strongly about this. ...
> 176. We recommend that, if they have not already done so, HMT and HMRC should carry out a full review of the reasons why there were so many difficulties in the development of this policy initiative. They should ensure that the lessons are learned so that these problems do not emerge in other initiatives.

No review was carried out.

> 177. We also recommend that if another policy initiative gets to the point where the legislation cannot be finalised for inclusion in the Finance Bill, that initiative should not be included in the Bill, or, if feasible, the part which is not finalised should not be included. We cannot support the approach of the Finance Bill's still being subject to much amendment at the time it is published, particularly when the proposals come into effect from the beginning of the tax year, as in this case. [55]

Does it now matter? Readers may think it pointless to cry "foul" in a game which had no referee, whose result was long ago declared, and which (from 2025) is no longer played. But I think the story deserves to be recorded as what Lord Howe described as "an object lesson in how not to legislate."[56]

1.10 2017 domicile reform: Assessment

The 2017 reforms[57] contained another package of reforms and any short assessment of its merits must be limited to its main features. These are:

[54] The Making of Tax Law, para 3.2, CIOT, June 2010.

[55] Select Committee on Economic Affairs, 2nd Report of Session 2007–08, The Finance Bill 2008
http://www.publications.parliament.uk/pa/ld200708/ldselect/ldeconaf/117/117i.pdf

[56] Making Taxes Simpler - The final report of a Working Party chaired by Lord Howe (2008) *https://conservativehome.blogs.com/torydiary/files/making_taxes_simpler.pdf*

[57] I use the term "2017 reforms" to refer to the reforms which took effect in 2017 and the supplemental offshore trust reforms which were announced in 2017 and implemented in 2018.

(1) 15-year deemed domicile rule for IT/CGT
(2) Formerly-domiciled resident rules
(3) Protected-trust regime
(4) IHT residential-property regime
(5) Non-resident disregard for s.87 gains

1.10.1 *Political background*

The inspiration for the changes was political. The decision did not much depend on an assessment of the policy arguments analysed in this chapter. The decision should be seen in the context of the 2015 summer budget's adoption of a number of Labour policies: the increased national living wage[58] and the apprenticeship levy.[59] The Cameron administration sought to occupy ground left vacant, or perceived vacant, by the Corbyn opposition.

The Government showed no interest in debate on the policy issues. Since the policy was taken from the Labour manifesto,[60] and continued to be supported by Labour, there was no opposition to it.

This is not to say that the 2017 reforms are not defensible, on the basis of fairness or otherwise, just that little reasoned debate took place in public, and probably little debate took place in private. The IFS, as usual, shone an intelligent beam into the fog, but I am not sure that anyone took any notice.[61]

Contrast the 2008 reforms where there was at least the appearance of consultation and debate (though not on the legislation itself).

Perhaps it would be naive to expect otherwise.

1.10.2 *Clear and easy to operate*

By this criterion the 2017 reforms failed hopelessly.

[58] Labour Manifesto 2015 provided: "We will [raise] the National Minimum Wage to more than £8 an hour by October 2019". *https://manifesto.deryn.co.uk/wp-content/uploads/2021/04/BritainCanBeBetter-TheLabourPartyManifesto2015.pdf*

[59] Labour Manifesto 2015 provided: "[Apprenticeships] will be co-funded ... by employers..." *https://www.slideshare.net/miquimel/2015-04-labourgeneralelectionmanifesto2015britaincanbebetterlabour*

[60] See 1.5.2 (Are non-dom reliefs fair).

[61] IFS, "Unknown quantities: Labour's 'non-dom' proposal" (2015) *http://www.ifs.org.uk/publications/7703*

1.10.3 *Fairness*

A 15-year deemed domicile rule for IT/CGT seems fair. The protected-trust regime leaves us short of equality between long term foreign domiciled individuals and UK domiciliaries, but that can itself be defended as fair.

Formerly-domiciled resident rules can work harshly, but all workable rules must have hard cases at the borders and the number of truly unfair cases will be very small.

The difficulty in assessing the fairness of the IHT residential-property regime is that IHT (unlike its predecessor, CTT) is a fundamentally unfair and illogical tax. I would have thought it reasonably clear that any advantage does not justify the complexity and oddity of the results from the territorial limits of the tax which now apply.

The non-resident disregard operates unfairly, and significantly extends the unfairness of a code which was already unfair.

1.10.4 *Benefit to UK economy*

Perhaps more importantly: Did the 2017 reforms benefit the UK economy? The consultation was prefaced with the statement that:

> The government wants to attract talented individuals to live in the UK who will help to contribute to the success of this country by investing here and creating jobs. The long-standing tax rules for individuals who are not domiciled in the UK are an important feature of our internationally competitive tax system, and the government remains committed to that aim.[62]

I wonder how far that was meant to be taken seriously.

Perhaps economic benefit was not a major consideration, or not a consideration at all, in the 2008 or the 2017 reforms. Does that now even matter? Discuss.

1.10.5 *2017 enactment process*

The 2017 revolution on the reform of offshore trust taxation - the term is not too strong - was introduced in breach of the Tax Consultation Framework, as the proposals first emerged in the HMRC summary of

[62] Consultation paper "Reforms to the taxation of non-domiciles" (2015) *https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles/reforms-to-the-taxation-of-non-domiciles*

responses to the original consultation paper. In fact there was little consultation on the principles at all, and only limited opportunity to consult on the drafting, since the draft published September 2017 differed substantially from the Finance Bill, which in turn received 32 amendments at committee stage. Parliamentary discussion in the Public Bill committee was perfunctory. In this respect the pattern of the 2008 reform was repeated. Perhaps one should not be surprised.

1.11 The promise of stability

There is a long tradition of instability in the UK tax system. In 1981:

> One of the most noticeable characteristics of the British tax system is that it is under continual change.[63]

In 1993:

> The major distinguishing characteristic of the British tax system is its instability. The British tax system changes faster, more frequently, and more radically than any other tax system I have observed.[64]

In 1999:

> The UK tax system is caught in a culture of never-ending change.[65]

The years 2008 - 2013 saw a series of broken promises of stability without any perceptible change of practice.[66] The promises of stability should be regarded as lip-service to the desideratum of stability. The practice, which lies deep in the culture of government, proved immune to such announcements. A true commitment to stability requires HMRC to refrain from making reforms which they would like to make, and when actual proposals come to the table, the interest of reform overcomes the interest of stability. It is easier for politicians to talk about stability than to achieve it. Perhaps HMRC recognised this, as the 2014, 2015 budgets contained no further promises of stability. The 2017 budget had a vague reference to "a more stable and certain tax environment", but I doubt if anyone was

[63] James & Nobes, *Economics of Taxation* (1st ed., 1981), p.135.

[64] Steinmo, *Taxation and Democracy* (1993), p.44.

[65] ICAEW TAXGUIDE 4/99 (Towards A Better Tax System) *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/pre-2017/taxguide-0499.ashx*

[66] I set them out the 2016/17 edition of this work para 1.10 (The promise of stability) but omit that here as it has diminishing contemporary significance.

expected to take that seriously. Subsequent budgets have made no reference to stability in taxation; and everything changes again in 2025.

1.12 State of UK tax reform

In 2010 CIOT expressed itself strongly:

> The way tax law is developed and effected in the UK is deeply flawed.[67]

Two publications shed light on what went wrong with tax legislation in recent years. Demos say:

> The centralisation of [tax policy-making power] is a particular problem because of the lack of institutional accountability of the Treasury on taxation policy and the lack of accountability of chancellors themselves in matters of taxation. ... The concept of checks and balances in tax policy is nonexistent.
>
> ... the current relationship between the Treasury and HMRC was 'very dysfunctional', had 'almost gone as wrong as it could have gone'...
>
> At the moment, pursuing a career only in tax policy is not valued within the Treasury hierarchy. Officials pass through the tax teams rather than making tax policy a career choice. ... High turnover results in a lack of experience in the tax section and little institutional memory...
>
> ... There are traditional areas that are ring-fenced as not for consultation, including tax rates and anti-avoidance measures. ...
>
> ... 'at the moment [anti-avoidance] works like a drive-by shooting. You might hit your objective but you also hit a lot of other people.'
>
> At present, policies are frequently changed without understanding the impact the policy has initially had in practice.[68]

Re-inforcing the tendency not to consult is an HMRC culture which is hostile to the tax profession . The Director of the HMRC Tax Avoidance Group 2004-2009 records:

> ... I was never happier than when a new tax avoidance initiative was greeted with howls of protest from the tax avoidance quarter.[69]

In short, preventing avoidance has been a priority that outweighs other considerations, such as certainty, workability and the Rule of Law; or

[67] Letter from CIOT to George Osborne, 19 May 2010

[68] Ussher and Walford, *National Treasure* (Demos, 2011) *https://demos.co.uk/wp-content/uploads/2011/03/National_treasure_-_web.pdf* Demos claims to be Britain's leading cross-party think-tank.

[69] Tailby, "Some Reflections on Tax Avoidance" [2011] PCB 41.

rather obliterates all consideration; and listening to the tax avoidance quarter – which includes the professional bodies and almost any practitioner who said what HMRC did not want to hear – has been ruled out. The professional bodies are regarded by HMRC as a pressure group whose vaunted commitment to fairness, practicality and the Rule of Law is merely a cloak for self-interested whingeing of a featherbedded elite.[70]

That policy has ruled since the 1997 Blair administration, and its consequences can be seen in seeking to state the law, as this book seeks to do, or in seeking to understand the law, as you the reader will do now.

1.12.1 *Tax Consultation Framework*

In 2011 the coalition administration promised a fresh start with the Tax Consultation Framework. The 2015 Cameron administration also committed to this.[71] I am not aware that any subsequent administration has formally committed to it, though it has not been repudiated either.

The Tax Consultation Framework provides:

> 2. There are five stages to the development and implementation of tax policy:
> Stage 1 Setting out objectives and identifying options.
> Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.
> Stage 3 Drafting legislation to effect the proposed change.
> Stage 4 Implementing and monitoring the change.
> Stage 5 Reviewing and evaluating the change.
> 3. Where possible, the Government will:
> - engage interested parties on changes to tax policy and legislation at each key stage of developing and implementing the policy;
> - make clear at what stage (or stages) the engagement is taking place so that its scope is clear;
> - carry out at least one formal, written, public consultation in areas of

[70] This may be seen in the context of a more general antagonism to the legal (and other) professions, and dismissal of their ethical pretensions. That is an ancient trope, but took renewed vigour under the Thatcher administration, and has lead to a transfer of regulatory power from the Bar and Law Society to regulation by non-lawyers.

[71] HM Treasury: "Tax policy consultation will continue and be strengthened. The government remains committed to consulting on policy as set out in 'The new approach to tax policy making' in 2010." (2016). *https://www.gov.uk/government/news/7-things-you-need-to-know-about-the-new-budget-timetable*

significant reform;

- set out, as the policy develops, its strategy for stakeholder engagement including planned formal consultation periods, informal discussions, working groups and workshops;
- consult, where it can, on the policy design, draft legislation and implementation of anti-avoidance and other revenue protection measures, provided this does not present additional risk to the Exchequer;
- minimise the occasions on which it consults only on a confidential basis. Where confidential consultation has been necessary the Government will be as transparent as possible about its outcome and consult openly if pursuing the policy change further; and
- provide feedback which sets out the Government's response to the views received and makes clear what changes, if any, have been made to the planned approach as a result of those views.

4. At each stage of consultation, the Government will set out clearly:

- the policy objectives and any relevant broader policy context;
- the scope of the consultation, in particular what is already decided and where there is still scope to influence the outcome;
- its current assessment of the impacts of the proposed change and seek to engage with interested parties on this analysis. A final assessment of impacts will be published once the final policy design has been confirmed...

5. Informal consultation will be as transparent as possible, consistent with the need to protect revenue. The best principles of formal consultation will be applied to informal consultation to ensure clarity of scope, impact, accessibility, and meaningful feedback. ... Informal consultation can run alongside formal consultation but will often be most appropriate at the earliest and latest stages of tax policy development to identify options and then to fine-tune the detailed legislation and implementation of change.

Exceptions

8. The Government will generally not consult on straightforward rates, allowances and threshold changes, or other minor measures; recognising, however, that even in these cases some level of consultation can often be informative. It may also adopt a different approach for revenue protection or anti-avoidance measures where following this Framework could present a risk to the Exchequer. In other circumstances where the Government decides not to consult during tax policy development it will explain the reasons for that decision.

9. There will be times when it will be necessary to deviate from this Framework. In these circumstances the Government will be as open as

> possible about the reasons for such deviations.[72]

Of course tax is not unique in this respect: similar considerations apply to all areas of law reform. The Data Retention and Investigatory Powers Act 2014 was enacted in two working days; and in holding it to be unlawful, the Divisional Court noted in moderate terms:

> legislation enacted in haste is more prone to error.[73]

And again:

> it is widely acknowledged that the [Immigration] Rules have become overly complex and unworkable. They have quadrupled in length in the last ten years. They have been comprehensively criticised for being poorly drafted, including by senior judges. Their structure is confusing and numbering inconsistent. Provisions overlap with identical or near identical wording. The drafting style, often including multiple cross-references, can be impenetrable. The frequency of change fuels complexity.[74]

1.12.2 *Compliance with Framework*

How far has tax reform since 2011 complied with the Framework? That is a broad question; it would need a series of volumes, there has been so much.

In brief, compliance with the Framework's tax reform timetable has been patchy. It is easier to announce good intentions than to abide by them. The culture of "ready, fire, aim" still prevails.

A few examples will illustrate the point.

The ATED regime was introduced in breach of the Framework. The House of Lords Economic Affairs Committee commented:

> ... the Government's response to SDLT avoidance might have been more appropriately designed had it consulted interested parties at the outset as its 'new approach to tax policy making' stipulates. We recommend that the Government adhere to that approach in designing future tax changes.[75]

[72] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/89261/tax-consultation-framework.pdf*

[73] *Davis (R, oao) v Secretary of State* [2015] EWHC 2092 (Admin) at [121].

[74] Law Com No 388, "Simplification of the Immigration Rules: Report" (2020) para 1.1.

[75] House of Lords Select Committee on Economic Affairs *The Draft Finance Bill 2013* (March 2013) para 210

The 2016 dividend income reforms, a major change (also misdescribed as simplification[76]), were introduced in breach of the Framework. The House of Lords Economic Affairs Committee comment:

> We deeply regret the lack of consultation on the savings [Personal Savings Allowance] and dividend income proposals and repeat the recommendation in our Report on the draft Finance Bill 2014 that the Government should reassert its commitment to the 'new approach' to tax policy making and make sure that, in future, it adheres to it in full except in the most exceptional circumstances.[77]

The Law Society say:

> ... the new approach is (i) not always followed, and (ii) side-stepped by labelling new tax law as anti-avoidance when it is no such thing.
> A case in point is the FA 2014, which introduced changes to the way in which certain members of limited liability partnerships were taxed. When this proposal was first published, it was an anti-avoidance measure. Following initial consultation, the nature of the proposal changed markedly and became more widely applicable to professional partnerships. This was not anti-avoidance legislation but, nevertheless, there was no formal consultation of the kind envisaged by Tax Consultation Framework.[78]

The Tax Professionals Forum note some cases where the framework was followed, and then say:

> In contrast, however, in other cases, consultations have started:
> - part way through the process (such as that on the provisions relating to the transfer of assets abroad and gains made by offshore close companies),
> - without a clear articulation of the policy involved (for example, on IR35 and Controlling Persons), or
> - without any discussion of the policy (for example, the changes to SDLT on properties owned by non-residents through companies,

http://www.publications.parliament.uk/pa/ld201213/ldselect/ldeconaf/139/139.pdf

[76] Summer Budget 2015, para 1.186: "the government will reform and simplify the system of dividend taxation...".

[77] "The Draft Finance Bill 2016" (2016), para 250.
http://www.publications.parliament.uk/pa/ld201516/ldselect/ldeconaf/108/108.pdf

[78] The House of Lords Economic Affairs Committee was also critical: see the Committee report "The Draft Finance Bill 2014" (2014).

investment funds and others and the cap on income tax reliefs).[79]

The 2017 domicile reforms were announced in 2015, which should have allowed time for thinking and consultation. Two years is an appropriate time scale to introduce major reforms, and at the time it seemed a refreshing break from the pattern of 2008 to see reform enacted on that basis. But two caveats to this welcome development:

(1) A distant deadline allowed the more difficult and serious work to be put off, the matter was concluded in the usual frantic rush, and the end result is disappointing. Still, deferring some aspects of the offshore tax reforms to 2018, to allow consideration, is encouraging.

(2) The need for time was not accepted by Labour:

> ... why else would the Government have given a grace period for those non-doms affected to get an offshore trust if they do not have one already? ... why else would the Government have actively signposted the changes for non-doms, which has set hares running? It seems to me that those are things that the architect of the measures would do if they were of a mind to completely undermine the measures' effectiveness.[80]

On the other hand, the IHT residence nil-rate band, 10 pages of dense, foolish legislation, was slotted into F(no.2)A 2015, precluding debate and consideration, even though the rules only took effect from 2017/18! and even though there had to be a second installment of the legislation in FA 2016.

The last part of the Tax Consultation Framework requires post-implementation monitoring and evaluation. This is almost never done.[81] It is interesting to speculate what would happen if it were. Much would depend on the identity of those carrying out the review and, in controversial areas, on their instructions and on their politics.[82]

Does anyone think that the 2025 reforms will be stable?

[79] Tax Professionals Forum Second Independent Annual Report (2013).

[80] Peter Dowd (Labour Shadow Chief Secretary to the Treasury) Hansard, 19 Oct 2017 *https://hansard.parliament.uk/Commons/2017-10-19/debates/aea0b4b1-dc6c-4153-a24f-09fb6be7d155/FinanceBill(FourthSitting)*

[81] Even in the cases where the FA 2018 required post-implementation reviews, the results were "singularly unilluminating. Most of them merely contains words to the effect of 'this legislation is new and we haven't yet seen how it will work in practice'." See Hubbard, Taxation Magazine, 4 April 2019.

[82] See 121.16.5 (12 year limit: Critique).

1.12.3 *Alternatives to Framework*

There is one route and one route only to a good tax system: sound tax policy, devised by those with a sound understanding of the current tax system, carried out by those who have reflected seriously on the issues in the context of the tax system as a whole; a leisurely timetable of consultation and legislative drafting as envisaged in the Tax Consultation Framework and the 10 tax tenets of ICAEW.[83] That is a hard prescription, though CIOT and others continue to bang the drum, and IFS do useful work.[84]

It is tempting to look for easier solutions. Past attempts include the Tax Law Rewrite, which achieved little; and, perhaps, the GAAR.[85] Advocates of the GAAR claimed:

> Enacting an anti-abuse rule should make it possible, by eliminating the need for a battery of specific anti-avoidance sub-rules, to draft future tax rules more simply and clearly. Also, fewer schemes would be enacted and so there will be less call for specific remedial legislation...In time, once confidence is established in the effectiveness of the anti-abuse rule, it should be possible to initiate a programme to reduce and simplify the existing body of detailed anti-avoidance rules.[86]

I am not sure if anyone seriously believed that, but it has not happened, and it seems unlikely that it will. But it will take several decades to assess

[83] *https://www.icaew.com/en/technical/tax/towards-a-better-tax-system/ten-tenets-of-tax*

[84] See Institute for Government, “Overcoming the barriers to tax reform” (2020). *https://www.instituteforgovernment.org.uk/publications/overcoming-barriers-tax-reform*
See too House of Lords Select Committee on the Constitution, “The Legislative Process: Preparing Legislation for Parliament”
https://publications.parliament.uk/pa/ld201719/ldselect/ldconst/27/27.pdf (2017)
For Finance Bill procedures, see House of Commons Briefing Paper 813, “The Budget and the annual Finance Bill”
https://commonslibrary.parliament.uk/research-briefings/sn04680

[85] I have wondered whether the HMRC Charter might be added to this list, but its object lies in administration rather than substantive tax law. Its subject is “standards of behaviour and values to which HMRC will aspire when dealing with people in the exercise of their functions”; s.16A CRCA 2005.

[86] Aaronson, *GAAR Study* (2011) para 1.7
http://webarchive.nationalarchives.gov.uk/20130321041222/http:/www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf

whether the GAAR will yield a consistent case law and reasonable predictability of outcome.

CHAPTER TWO

TAX AVOIDANCE

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2.1 Tax avoidance: Introduction

Tax avoidance is as old as taxation itself;[1] but the topic has taken prominence in recent decades, with extensive attention from parliament and the media.[2]

[1] For examples from 1798 and 1920, see "Tax Avoidance in 1798" *https://www.kessler.co.uk/wp-content/uploads/2013/06/Tax-avoidance-criticism-in-1798.pdf* and "Vestey: Royal Commission debate" *https://www.kessler.co.uk/wp-content/uploads/2017/11/Vestey_Royal_Commission_debate.pdf*

[2] It is interesting to speculate why that has been the case. I think the reasons lie in politics and sociology rather than tax law or practice. The Public Accounts

The subject impinges on many aspects of this book, but it is best to consider it as a topic of its own. This chapter considers general aspects, and the following considers targeted anti-avoidance rules (TAARs).

2.2 Avoidance/mitigation, evasion

I first discuss the complicated, emotionally charged, and in practice constantly abused term "tax avoidance".

2.2.1 *Terminology*

It is helpful to begin with a fourfold categorisation:

(1) *Tax evasion*: Conduct which constitutes a criminal offence (fraud on HMRC or similar offences). This typically involves dishonest submission of an incorrect tax return. Dishonesty is essential to these offences.[3]

(2) *Honest misdeclaration*: The submission of an incorrect tax return without dishonesty. Those involved may be culpable (eg careless) but not dishonest.

(3) *Tax avoidance*: Arrangements that reduce tax liability in a manner contrary to the intention of parliament (I come later to consider this concept in more detail).

(4) *Tax mitigation*: Conduct which reduces tax liabilities without "tax avoidance" (not contrary to the intention of parliament).

The distinctions between these concepts (especially avoidance/evasion and avoidance/mitigation distinctions) are now commonplace. They may appear obvious. They are taught to every student. No sensible debate is possible without them. However, the concepts and their terminology have only emerged after a gradual process of development and even now the terminology is not always adopted. It is essential to bear this in mind on reading sources on this subject.[4]

Committee, and some effective pressure groups, have clearly contributed but given the pressure on the front page, why has their work received so enthusiastic a reception? The 2008 financial crisis and climate of austerity may be a factor.

[3] See 127.8 (Fraudulent tax offences). Although there are now offences which do not require dishonesty, see 123.10 (Offshore tax offences), I would not characterise these offences as evasion

[4] eg the 1920 Royal Commission on the Income Tax Cmd. 615 discussed evasion, honest misdeclaration and avoidance in a chapter headed "The Prevention of Evasion", in which the words "avoidance" and "evasion" were used quite indiscriminately, see para 625. It is an interesting question whether the absence of

2.2.2 *Avoidance/evasion distinction*

An avoidance/evasion distinction very similar to the present was recognised very early (and was surely self-evident at any time) but at first there was no terminology, or at least no commonly agreed terminology, to express it. In 1860 Turner LJ suggested evasion/contravention (where evasion stood for the *lawful* side of the divide).[5] In 1900 the distinction was noted as two meanings of the word "evade".[6] It is possible that the current use of the words avoidance/evasion in the modern sense originated in the USA where it was established by the 1920s.[7] But by 1936, at least, knowledgeable writers in the UK adopted the same terminology, and castigated those who did not:

> In referring to these devices, those who took part in the debates on the new [ToA] provisions in the House of Commons repeatedly used the word "evasion." Even the spokesmen of the Government at times allowed themselves this indulgence. The Financial Secretary to the Treasury (for example) described [s.18 FA 1936, transfer of assets] as a "Clause for the prevention of tax evasion", while the Attorney-

terminology hampered discussion of the issues or whether the lack of discussion or interest led to the absence of suitable terminology. I suggest the latter: in the 1920s, criminal prosecution for tax evasion was rare, and only in blatant cases. Thus the avoidance/evasion distinction was not relevant. Likewise, tax avoidance (in the modern sense) was still in its infancy, so the avoidance/mitigation distinction also had little relevance.

[5] *Fisher v Brierly* (1860) 1 de G F&J 643 at p.663. It is a pity that this use of *contravention* did not catch on because it is more transparent than *evasion*.

[6] *Bullivant v AG* [1901] AC 196 at p.207:
"The word 'evade' is ambiguous. ... there are two ways of construing the word 'evade': one is, that a person may go to a solicitor and ask him how to keep out of an Act of Parliament – how to do something which does not bring him within the scope of it. That is evading in one sense, but there is nothing illegal in it. The other is, when he goes to his solicitor and says, 'Tell me how to escape from the consequences of the Act of Parliament, although I am brought within it'. That is an act of quite a different character."

[7] It is found in the scholarly Sears, *Minimising Taxes* (1922), and can be traced to Oliver Wendell Holmes in *Bullen v Wisconsin* (1916) 240 US 625 at p.630. It is regarded as basic in Hartman, *Tax Avoidance* (1930) which cites two textbook definitions in similar terms. Perhaps the practice of tax avoidance began earlier in the USA; the first published work on the subject in England was Moore, *The Saving of Income Tax Surtax and Death Duties* (1935), the publication of which lead to the enactment of the ToA provisions.

> General, dealing with the same clause, spoke of "marginal cases in which there may be some element other than tax evasion". Private members, and on at least one occasion the Financial Secretary, spoke of "guilt" and "innocence" as though the House were discussing the suppression of crime.[8]
>
> There can be no question of any real confusion of thought, but the confusion of language is none the less to be deprecated. The new provisions have nothing to do with "evasion"; they are concerned solely with legal avoidance.[9]

The distinction is accepted internationally:

> 72. The terms "tax evasion" and "tax avoidance" have not always been used precisely or with a uniform meaning. Strictly speaking, tax evasion is considered to consist of wilful and conscious non-compliance with the laws of a taxing jurisdiction. Tax evasion is an action by which a taxpayer tries to escape legal obligations by fraudulent or other illegal means. The illegal conduct might involve simply failing to report income or fabricating deductions, or it may involve highly sophisticated tax planning that is premised on false or intentionally deceptive

[8] Official Reports, 15th June 1936, col. 676, 704, 692.

[9] Stein & Marks, *Tax avoidance: An interpretation of the provisions of the Finance Act, 1936, relating to transfers of assets, companies' sur-tax, children's settlements* (1936) p.1. Jacques Stein (1887–1973) was a significant figure in his day, see *http://www.encyclopedia.com/religion/encyclopedias-almanacs-transcripts-and-maps/stein-leonard*.

Similarly, the 1955 Royal Commission Cmd. 9474 para 1016:

> "It is usual to draw a distinction between tax avoidance and tax evasion. The latter denotes all those activities which are responsible for a person not paying the tax that the existing law charges upon his income. *Ex hypothesi* he is in the wrong, though his wrongdoing may range from the making of a deliberately fraudulent return to a mere failure to make his return or to pay his tax at the proper time. By tax avoidance, on the other hand, is understood some act by which a person so arranges his affairs that he is liable to pay less tax than he would have paid but for the arrangement. Thus the situation which he brings about is one in which he is legally in the right, except so far as some special rule may be introduced that puts him in the wrong."

Note that "evasion" is used here (unlike present usage) to describe dishonest criminal evasion and honest mis-declaration. Lord Templeman used this (by then old-fashioned) terminology in *IRC v Challenge Corporation* [1986] STC 548: "Tax evasion occurs when the commissioner is not informed of all the facts relevant to an assessment of tax. Innocent evasion may lead to a re-assessment. Fraudulent evasion may lead to a criminal prosecution as well as re-assessment." It does aid clarity if the term "evasion" is restricted to what Lord Templeman termed "fraudulent evasion".

> representations to the tax authorities. ...[10]
> 73. Tax avoidance, in contrast, involves the attempt to reduce the amount of taxes otherwise owed by employing legal means. However, the borderline between evasion and avoidance in specific cases may be difficult to define. For one thing, the criminal laws of countries differ, so that behaviour that is criminal under the laws of one country may not be criminal under the laws of another. In addition, the definitions of civil and criminal tax fraud may overlap, so that it is within administrative discretion whether or not to pursue a criminal fraud case in a specific instance. In reality, there is a continuum of behaviour, ranging from criminal fraud on one extreme, to civil fraud, to tax avoidance that is not fraudulent but which runs afoul of judicial or statutory anti-avoidance rules and therefore does not succeed in minimizing tax according to law, and finally to tax-planning behaviour which is successful in legal tax reduction. ...[11]

Avoidance/evasion distinctions are found outside tax, though the terminology may differ. Accountants for instance distinguish "creative accounting" (also known as aggressive accounting), which is legal; and accounting fraud, which is criminal.[12]

2.2.3 *Avoidance/evasion terms misused*

There are contexts where the reader will see evasion/avoidance terminology misused (evasion being used for avoidance or vice versa).

The first is historical: in law reports and elsewhere, at least up to the 1970s. In *Hawker v Compton* (1922):[13]

> ... it is perfectly open for persons to evade this particular tax if they can do so legally. I again say I do not use the word "evade" with any dishonourable suggestion about it. If certain documents are drawn up,

[10] The text muddies the waters here by adding: "In a broader sense, tax evasion may encompass a reckless or negligent failure to pay taxes legally due, even if there is no deliberate concealment of income or relevant information." But this is not common usage, and is better regarded as incorrect usage.

[11] United Nations, Note on the Revision of the Manual for Negotiation of Bilateral Tax Treaties 2011 (footnotes omitted).

[12] See Jones (ed) *Creative Accounting, Fraud and International Accounting Scandals* (2011).

[13] 8 TC 306 at p.314.; the tax involved was income tax of occupiers of farmland; the tax would be reduced if the land was farmed in partnership, and the issue was whether a partnership existed. So this was not what one would call a case of avoidance in modern terminology.

> and the result of those documents is that persons are not liable to a particular duty, so much the better for them.

The word "evade" continued to be used to refer to lawful tax planning (not necessarily avoidance in the modern sense)[14] until the 1970's.[15] At that time UK economists were giving increasing attention to the subject of tax avoidance and evasion[16] and perhaps their work had an effect on legal usage.

The second context is in post-1970 writing of those not knowledgeable about tax, including lawyers[17] (non-tax lawyers) and politicians.[18] When writing for non-tax lawyers, it may be helpful to use the expressions "legal avoidance"[19] and "illegal evasion", or better, "fraudulent evasion" to make the meaning clearer.

Outside the UK, the older terminology may still be found.[20]

Lastly, the distinction may be deliberately muddled for polemical effect:

> in practice tax evasion and avoidance are too often conflated ... For

[14] Examples include: *Coutts v IRC* [1964] 1 AC 1393 at p.1420; *Jamieson v IRC* (1963) 41 TC 43 at p.70; *Cory v IRC* [1965] AC 1088 at p.1107; *Greenberg v IRC* (1971) 47 TC 240 at p.271: "Parliament attempted to prevent this and other methods of tax evasion by provisions in the FA 1960".

[15] Note that this is purely a semantic and not a substantive point that is being made here. The old usage does not reflect the view that the evasion/avoidance distinction is unreal or unclear or that one can shade into the other. The legal distinction between the two is tolerably clear since evasion involves dishonesty, a tolerably well defined and understood concept. The IEA *Tax Avoision* (1979) coined the term "avoision" to mean avoidance/evasion. The book noted the lack of *economic* distinction between the two concepts; the economic similarity was the justification for the new coinage. The book also noted the blurring of a moral distinction between the two concepts either because avoidance was seen by some as immoral or because evasion was seen by some as not immoral; the book did not suggest a lack of a legal distinction which was unquestioned then and still should be now.)

[16] IEA, *Tax Avoision* (1979) p.1,

[17] For example, see *R v Charlton* [1996] STC 1418 at p.1421.

[18] Eg The Progress Tackle Tax Avoidance Charter: "HMRC HAS GOT TO GET A GRIP … 4. Get tough on tax avoiders by mounting more prosecutions." See *http://www.progressonline.org.uk/campaigns/tackle-tax-avoidance*

[19] "Legal avoidance" is a standard term in recent double tax conventions.

[20] The avoidance/evasion distinction in UK terminology is not adopted in EU law, which has a distinct technical terminology.
Similarly, s.482 United States Internal Revenue Code refers to allocation of income that "is necessary to prevent evasion of taxes" but the intended concept is one of avoidance.

> example, users of disguised remuneration schemes were troubled when the schemes were called "illegal" by the Chancellor of the Exchequer and the Financial Secretary to the Treasury. HMRC has not claimed that these schemes are illegal; rather that they are not effective, ... in reducing an individual's tax liabilities.[21]

It is sometimes hard to tell whether the misuse is deliberate or accidental. But as Alldridge observes, those who wish to equate avoidance and evasion should pay attention to where this may lead.[22]

See too 127.10 (Offshore tax offences),

2.2.4 Validity of tax avoidance

There is no *universal* rule that tax avoidance is ineffective. In *Hurstwood Properties v Rossendale BC*:[23]

> We emphasise that this conclusion is not founded on the fact that the defendant's only motive in granting the lease was to avoid paying business rates, although that was undoubtedly so. If the leases entered into by the defendants had the effect that they were not liable for business rates, their motive for granting the leases is irrelevant.

Similarly,the *Ramsay* doctrine (whatever it is) is not a "broad spectrum antibiotic which killed off all tax avoidance schemes".[24]

But the rules which do exist are numerous and sufficient to ensure that successful avoidance is rare. Have there been any recent cases where a tax avoidance scheme has been upheld, and if so, how many? An answer to this must depend on what one means by avoidance. Examples at or near the abusive end of the spectrum are not recent cases:

[21] House of Lords Economic Affairs Committee "HMRC: Treating Taxpayers Fairly" (2018) para 23, 24.
https://publications.parliament.uk/pa/ld201719/ldselect/ldeconaf/242/242.pdf
The report recommended "Clearer distinctions are needed in the Government's approach and rhetoric towards tax avoidance." But the Government rejected the recommendation, so this debate will continue: HMRC, "The Powers of HMRC: Treating Taxpayers Fairly (House of Lords Paper 242) Government Response" p.2
https://www.parliament.uk/documents/lords-committees/economic-affairs/Govt%20HMRC%20Powers%20report%2022%20Jan%202019%20.pdf

[22] Alldridge, *Criminal Justice and Taxation* (1st ed, 2017) p.34 (Blurring the line between avoidance and evasion).

[23] [2021] UKSC 16 at [51].

[24] *MacNiven v Westmoreland Investments* [2001] UKHL 6 at [49], often cited.

Case	**Topic**	**See para**
HMRC v Mayes [2011] EWCA CIV 407	Secondhand insurance policies	-
HMRC v D'arcy [2007] EWHC 163 (Ch)	Manufactured dividends	-
Davies v Hicks [2005] EWHC 847 (Ch)	Share pooling/matching	56.11.4

Few would expect the same outcome if these schemes were re-litigated now (though the question is moot, as that will never happen).

Non-abuse examples of where avoidance is still possible, if they constitute avoidance, are:

Example	**See para**
Going non-resident	6.42
Use of protected trusts	91.1

2.3 Politics of tax avoidance

The topic is political, so I begin with a politician (David Cameron):

> Of course there is a difference between tax evasion and tax avoidance. Evasion is illegal. It can and should be subject to the full force of the criminal law.
>
> But what about tax avoidance? Now of course there's nothing wrong with sensible tax planning and there are some things that governments want people to do that reduce tax bills, such as investing in a pension, a start up business or giving money to a charity. But there are some forms of avoidance that have become so aggressive that I think it is right to say these raise ethical issues, and it is time to call for more responsibility and for governments to act accordingly.
>
> In the UK we've already committed hundreds of millions (?) into this effort, but acting alone has its limits. Clamp down in one country and the travelling caravan of lawyers, accountants and financial gurus will just move on elsewhere. ...
>
> I believe in low taxes, that is why my government is cutting the top rate of income tax, we've cut corporation tax. [*Delete - political*].[25]
>
> Individuals and businesses must pay their fair share. And businesses who think they can carry on dodging that fair share, or that they can keep on selling to the UK and setting up ever more complex tax arrangements abroad to squeeze their tax bills right down, well they need to wake up and smell the coffee, because the public who buy from

[25] This side note is included in the version of the speech published online; one wonders what happened when the speech was delivered.

> them have had enough.[26]

All the main tropes of the political debate are in this passage:
(1) Everyone should pay a "fair share" of tax.
(2) Some taxpayers fail to do so due to tax avoidance.
(3) Tax avoidance is unethical, immoral or anti-social.
(4) Acknowledgement of the avoidance/evasion distinction;[27] but it does not contradict point (3). In the words of Margaret Hodge: "We're not accusing you of being illegal, we're accusing you of being immoral."
(5) Disparaging references to tax advisers.[28]

On the political left, the same points are made, but more stridently, and, of course, without Cameron's approval of low taxes.

2.4 Need for analysis

This chapter draws on a paper published by the Oxford University Centre for Business Taxation, (the **"OUCBT paper"**).[29] The OUCBT paper says:

> The question is how to tackle the problems. This requires a clear analysis of their cause and differentiation between different causes. Labelling a whole range of quite different behaviours as "avoidance" without further differentiation is unhelpful. ...

Differentiation requires terminology. As there is no agreed terminology, it is best not to use any terms at all without some explanation of what is meant.

2.4.1 *Categorisation of avoidance*

If one is to identify the correct response to the problems of avoidance, one must distinguish:
(1) **Ineffective avoidance** (no tax saving if the law is correctly applied)

[26] David Cameron speech to World Economic Forum in Davos, 2013 *https://www.gov.uk/government/speeches/prime-minister-david-camerons-speech-to-the-world-economic-forum-in-davos*

[27] I suspect newspaper libel readers (rightly) insert this if a journalist overlooks it.

[28] This feeds on a very ancient trope concerning lawyers. Of course this is not limited to tax. Contemporary attacks on lawyers have focussed on those working in immigration law ("lefty lawyers")

[29] "Tax avoidance" (2012) *https://wayback.archive-it.org/org-467/20200808011125/http://eureka.sbs.ox.ac.uk/4428/2/TA_3_12_12.pdf* (I omit some footnotes here).

(2) **Effective avoidance** (tax saved by avoidance)
(3) **Non-avoidance** (little tax paid but not due to avoidance)[30]

These distinctions matter because:
(1) Ineffective avoidance may be countered by enforcement of the law.
(2) Effective avoidance can only be countered by changes in tax law.
(3) In cases of non-avoidance:
  (a) It may be no change in tax law is appropriate.[31]
  (b) If change is needed, the change is one of policy as well as of tax law; and the matter should be considered without the haste and moral outrage associated with avoidance.

If one wishes to assess emotional and moral responses to avoidance, and actual or theoretical anti-avoidance rules, we need further vocabulary to discuss the range of tax-motivated behaviour.

We might cover the terrain in four categories:[32]

Uncontroversial tax planning Taking advantage of a tax relief in a manner *everyone* would accept as reasonable and indeed desirable. As this is at the bottom of the spectrum, it is easy to find clear examples: for instance, pension contributions, and moderate[33] charity giving.[34] This is so even if, as is usually the case, care is needed in order to use or to maximise the relief, for instance, limiting contributions each year to below the cap for the relief, or limiting benefits within the permitted limits for gift aid.

"Ordinary" tax planning Using tax legislation in a way which *some* politicians and commentators do not like, but where the planning is

[30] The OUCBT paper adopts the somewhat unhelpful labels "categories A, B, and C". It is difficult to find short labels which neatly sum up the concepts: "Ineffective avoidance" is not ideal as this is not really "avoidance" at all.

[31] It may be that a change in public expectation or knowledge is desirable.

[32] There are many ways to slice this cake. Lord Walker proposed seven types of tax avoidance (a riff on Empson's *Seven Types of Ambiguity*): "Ramsay 25 years on" [2004] LQR 120. Contrast Barnett, "A baker's dozen" Taxation Magazine, 2 August 2012. But one must resist the temptation to taxonomy for its own sake. Classification is (or should be) purposive: a useful taxonomy must draw *useful* distinctions: it should identify categories which call for different responses, and only those.

[33] In the debate on the Budget 2012, some said that giving more than £50k or 25% of income was excessive.

[34] These are the examples which Cameron called "sensible tax planning" in the quote at the start of this chapter.

ordinary in the sense that many people have done and continue to do it; it is obvious and foreseeable; the point probably came to the mind of those responsible for the legislation, or should have done, or there is no reason to think that parliament would have done anything different if it had considered the point. "Ordinary" tax planning is not contrary to the "intention of parliament" as that construct is normally understood.

I write the word "ordinary" with scare quotation marks, to indicate the vague, evaluative and disputable nature of the expression.

I regard the following as examples of "ordinary" tax planning (but other views have been expressed):

"Ordinary" planning	**But for other views see**
Advancing/delaying:	
(a) disposals for CGT purposes	56.9.7
(b) payment of income (eg dividends or bonus)	2.5.9
(c) pension contributions for IT purposes	
in anticipation of tax rate changes/becoming resident/non-resident	
Inter-spouse transfer to equalise income	2.5.9
Transfer to a company to reduce tax rates	
Lifetime giving to avoid IHT	
Going non-resident (unless the planning involves further steps)	

The term "tax mitigation" could be used as a synonym of "ordinary" tax planning, but it covers uncontroversial tax planning and "ordinary" tax planning: anything short of avoidance.

Occasionally one sees the epithet "vanilla" tax planning, paraphrased as "such as any High Street Solicitor would recommend to any client."[35] The cases have concerned applications to set aside transactions for mistake. In *Hartogs v Sequent (Schweiz) AG*[36] the planning involved a (supposedly) non UK domiciled settlor transferring funds to a trust, which acquired a company, which acquired a UK residence and classic cars. The settlor described this as a "normal and standard approach to estate-planning for someone in his position" and the judge agreed: "this was not a controversial tax planning scheme".

[35] *PBC v JMA* [2018] EWCOP 19 at [54]. The planning in this case was a lifetime gift (to a trust) which was intended to be a PET (!).

[36] [2019] EWHC 1915 at [25]. The facts were (more or less) the same in *Abadir v Credit Suisse Trust* [2021] EWHC 2573 (Ch), where the planning was "not an artificial form of avoidance against which public policy would militate against setting aside the transfer".

Tax avoidance Something legal but contrary to the intention of parliament in the sense that had parliament thought about it, it would probably prevent the tax advantage. Examples are likely to have been counteracted by subsequent legislation; though it may be a matter of judgement whether:

(1) The planning was avoidance, stopped by legislation.

(2) The planning was "ordinary" and the legislation reflected a change in policy.

Some examples (beginning with clear avoidance, concluding with what might be regarded as the top end of the "ordinary" planning spectrum):

Avoidance	**Counteracted by**	**See**
Transfer of assets abroad	ToA code	48.1
Share-for-share relief	CGT reorganisation TAAR	58.3; 58.6
Temporary non-residence	TNR rules	11.2

Tax abuse Tax avoidance with aggravating features (typically, self-cancelling steps) that make it (more) unreasonable.[37] As this is at the top of the spectrum, it is easy to find clear examples, eg:

Ramsay
Fitzwilliam v IRC[38]
Astall
Mayes
UBS
The Rangers case[39]

This terminology raises three distinctions:

(1) Uncontroversial/"ordinary" tax planning

(2) Tax planning/avoidance

(3) Tax avoidance/abuse

Before considering whether these distinctions have, or should have,

[37] The epithet commonly used is "egregious" or "aggressive". That does not clarify anything but it neatly expresses the point.
For completeness: In technical EU-law terminology the term "abuse" is used in a different sense; similarly in OECD discussion; see 108.7 (OECD-concept abuse). However we are not concerned with that usage here.

[38] For this case, see 99.9 (Trust appoints to B, B gives to new trust).

[39] *RFC 2012 Plc (formerly Rangers Football Club) v AG* [2017] UKSC 45 at [2]: "an aggressive tax avoidance scheme".

different consequences, it is important to note three difficulties which they entail:

(1) *Demarcation problems* Except at the extreme ends of the spectrum, the demarcation problem is intractable: the classification of specific examples (if it actually had to be decided) would give rise to endless disagreement (and has done so in the context of tax motive defences). There are two reasons for this:
    (a) The distinctions rely on:
        (i) imponderable hypothetical questions (what would parliament have done if it had noticed the issue?)
        (ii) vague constructs ("intention of parliament" and "spirit of the legislation")
        (iii) identifying tax policy (there may be no clear policy, or it may fluctuate)
    (b) The four distinct categories attempt to impose an order on tax motivated behaviour which exhibits a scale of unreasonableness, without distinct divisions. It might be better to mark out a sliding scale from 1 to 10, recognising finer distinctions, but that would not help for practical purposes. It is often the case that experience is a continuum on which the law seeks to impose bipolar categories, but the difficulty in doing so here is greater than usual because the distinction is more imponderable.

(2) *Tax-law knowledge problems* Except for the extreme ends of the spectrum, (a small part of the field) a serious discussion of where any particular arrangement should be classified, or graded, can only be carried out by someone who understands the tax background. Few non-practitioners have much understanding. Journalists in the UK do not allow their work to be reviewed by someone who understands tax. Politicians are characterised by grandstanding and soundbites. Pressure groups grind their axes. The details, important to those within the profession, tend to bore or bewilder people outside it.

(3) *Factual knowledge problems* If discussing particular instancies, one needs to know the facts, which are not usually in the public domain.

2.4.2 *Why distinctions matter*

The distinctions I have drawn are not entirely satisfactory, but it is hard to think of better.

The "ordinary" tax planning/tax avoidance dividing line is established in tax law at least since *Willoughby* (1997). It marks the point where:

(1) Tax motive provisions begin to bite
(2) Extra-statutory concessions cease to apply
(3) HMRC Manuals cease to bind HMRC[40]

For this distinction, see 3.20 (Avoidance/mitigation distinction) to 3.27 (Tax avoidance: Critique).

The tax avoidance/tax abuse distinction was established in 2013: it marks the point at which the GAAR is intended to bite.[41] It may also mark the point where a Court might refuse discretionary remedies such as setting aside for mistake.

There has not been much judicial discussion but a passage in *Furniss v Dawson* anticipated something like a tax avoidance/abuse distinction:

> The scheme [in *Furniss*] has none of the extravagances of certain tax avoidance schemes which have recently engaged the attention of the courts, where the taxpayer who has been fortunate enough to realise a capital profit has gone out into the street and, with the aid of astute advisers, manufactured out of a string of artificial transactions a supposed loss in order to counteract the profit which he has already made.[42] The scheme before your Lordships is a simple and honest scheme which merely seeks to defer payment of tax until the taxpayer has received into his hands the gain which he has made.[43]

The arrangement in *Furniss* was, in modern terms, avoidance but not abuse.

[40] HMRC Guidance Manuals introduction: "Subject to [limited specified] qualifications readers may assume the [HMRC Manual] guidance applies in the normal case; but where HMRC considers that there is, or may have been, avoidance of tax the guidance will not necessarily apply."
http://www.hmrc.gov.uk/manuals/advisory.htm

[41] It is significant that the GAAR is called a general anti-*abuse* rule, not a general anti-*avoidance* rule, in contrast to the two devolved GAARs. See 3.26 (The GAAR).

[42] [Author's footnote] At least two of these schemes were litigated, so preserving in the law reports examples of "extravagent" schemes with "a string of artificial transactions":
Ramsay v HMRC 54 TC 101; see App. 2.14 (s.132 TCGA definition)
Eilbeck v Rawling 54 TC 101; see 99.12.1 (Transfer: A's trust to B's trust)
Needless to say, the schemes failed to generate an allowable loss even without recourse to the *Ramsay* principle.

[43] [1984] AC 474 at p.518.

2.5 Attitudes to tax avoidance

2.5.1 *Morality and taxation*

This is intended to be a practical work. But attitudes to tax avoidance do of course have practical consequences for tax: it affects judicial attitudes and decisions; it was a driver for the enactment of the GAAR and other legislation.

The topic of the relationship between morality and taxation should be seen as part of a wider discussion of the relationship between morality and law. Without entering into these deep waters, it should generally be accepted that not everything which is disapproved of should be proscribed by law.

2.5.2 *Judicial view in the past*

Older cases uniformly took a neutral attitude to tax avoidance. In 1900:

> Bundey J. recognises to the full both the legal *and the moral* right of every man to dispose of his property if he can in a way which does not expose it to be taxed under the existing system of taxation.[44]

In 1922:

> it is perfectly open for persons to evade[45] this particular tax if they can do so legally. I again say I do not use the word "evade" with any dishonourable suggestion about it. If certain documents are drawn up, and the result of those documents is that persons are not liable to a particular duty, so much the better for them.[46]

In 1926:

> the highest authorities have always recognised that the subject is entitled so to arrange his affairs as not to attract taxes imposed by the Crown, so far as he can do so within the law, and that he may legitimately claim the advantage of any express terms or of any omissions that he can find in his favour in taxing Acts. In so doing, he neither comes under liability *nor incurs blame*.[47]

[44] *Simms v Registrar of Probates* [1900] AC 323 at p.333.

[45] Nowadays one would use the word "avoid" here; but the modern terminology had not developed at this point; see 2.2.2 (Avoidance/evasion distinction).

[46] *Hawker v Compton* 8 TC 306 at p.30.

[47] *IRC v Fisher's Executors* 10 TC 302 at p.340. If more examples are needed, which I doubt, see *Levene v IRC* 13 TC 486 at p.501-502; and the well known passage from

During the second world war, judicial opinion changed. The most familiar passage to that effect comes in 1941:

> It scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers.[48]

This expresses an ethos appropriate to the wartime background; "as we are at war, the ordinary mode of construing legislation has been suspended".[49] In 1943:

> of recent years much ingenuity has been expended in certain quarters in attempting to devise methods of disposition of income by which those who were prepared to adopt them might enjoy the benefits of residence in this country while receiving the equivalent of such income, without sharing in the appropriate burden of British taxation. Judicial dicta may be cited which point out that, however elaborate and artificial such methods may be, those who adopt them are "entitled" to do so. There is, of course, no doubt that they are within their legal rights, but that is no reason why their efforts, or those of the professional gentlemen who assist them in the matter, should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of good citizenship. On the contrary, one result of such methods, if they succeed, is, of course, to increase pro tanto the load of tax on the shoulders of the great body of good citizens who do not desire, or do not know how, to adopt these manoeuvres.[50]

After the war, the old orthodoxy returned. In 1965:

> The fact that a settlement is drawn with a view to avoiding particular charging provisions is *neither reprehensible, nor* a proper ground for inclination to a conclusion that it ought to come within those or some other charging provisions. ... If any moral criticism could be levelled at them, then the consciences of the judges of the Chancery Division, in the exercise of their discretionary jurisdiction under the Variation of Trusts Act 1958, would be in a sorry state.[51]

Ayrshire Pullman Motor Services v IRC (1929) set out at 2.5.7 (Impact of the GAAR).

[48] *Howard de Walden v IRC* 25 TC 121at p.124. For the full passage, see 48.2.2 (ToA provisions: Penal).

[49] Darling J, cited in Foxton, "*R v Halliday* in Retrospect" [2003] LQR 455.

[50] *Latilla v IRC* 25 TC 107 at p. 117.

[51] *Re Kirkwood* [1965] Ch 286 at p.327.

Lord Diplock expressed the traditional view in 1964:

> Tax law no more lies within the field of morals than does a crossword puzzle.[52]

Likewise in 1982:

> the fact that the purpose of the scheme was tax avoidance does not carry any implication that it was in any way reprehensible or other than perfectly honest *and respectable*.[53]

2.5.3 *Attitudes outside UK*

Without attempting a full survey, which would require a team of experts, it appears that the same view was held throughout the common law world. In America in 1947:

> Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.[54]

Oliver Wendell Holmes is often quoted for his extra-judicial comment "I like to pay taxes. With them I buy civilization."[55] But those who quote that tend to quote selectively. The same judge said:

> The only purpose of the vendor here was to escape taxation... The fact that it is desired to evade the law, as it is called, is immaterial, because the very meaning of a line in the law is that you may intentionally go as close to it as you can if you do not pass it.[56]

In Australia in 1995:

[52] Diplock, "The Courts as Legislators" Address to The Holdsworth Club (1965) *https://www.kessler.co.uk/wp-content/uploads/2012/05/CourtsAsLegistlators.pdf*

[53] *IRC v Burmah Oil* 54 TC 200 at p.220; followed in 1988 in *Craven v White* 62 TC 1 at p.196.

[54] *Commissioner v Newman*, 159 F2d 848 (1947). The case concerned the taxation of settlor-interested trusts.

[55] In *Ensign Tankers v Stokes* [1992] STC 226 at p.235 the apophthegm is paraphrased, with, perhaps, a change of nuance: "taxation is the price which we pay for civilisation."

[56] *Superior Oil Co v Mississippi* 280 US 390.

> The obligation to pay [income tax] is a legal one. Some politicians try to treat it as a moral obligation. But it is not. The citizen is bound to pay no more tax than the statute requires him to pay according to the relevant state of his affairs.
> Consistently with this view, it has long been a principle of the law of income taxation that the citizen may so arrange his affairs as to render him less liable to pay tax than would be the case if his affairs were cast in some different form. .. This is sometimes expressed as a right to avoid tax.[57]

2.5.4 *Pro-avoidance rationale*

The following points can be made in favour of the traditional view, that tax avoidance is morally neutral:

(1) *Difficulties of "right" amount of tax*
The tax system is full of anomalies, artificial, arbitrary, and not based on any consistent principles. One might say there is generally no "right" amount of tax except in the sense of what is due by statute.

(2) *Difficulty of applying moral principles*
This is perhaps another way of putting point (1): The view that taxation is governed by moral principles distinct from the rules of black letter tax law either:

(a) requires one to enter into the intractable distinction of tax avoidance/abuse; or
(b) spreads the net very wide, far wider than any practitioner is likely to accept (and still requires one to enter into the intractable distinction of uncontroversial/"ordinary" tax planning).

In practice, public debate does not engage with black letter tax law and it is difficult to envisage that it ever could. Ethics is a practical subject. It only works if the entities called "right" and "wrong" are reasonably distinguishable and of a more or less permanent nature. If standards are so vague, or so difficult to apply in actual cases, that we cannot see how we could act on them, we become sceptical. That suggests that morality has little if any role to play.

(3) *Egregious over-taxation*
I coin the expression **"egregious over-taxation"** to refer to situations

[57] Sir Garfield Barwick (Chief Justice of Australia 1964–81), *A Radical Tory* (1995) at p.229.

where HMRC take advantage of anomalies in their favour in a manner which is unfair and contrary to the intention of Parliament (as that expression is understood in a tax avoidance context). It is the opposite of tax avoidance. Three distinct sub-issues arise here:

(a) Does egregious over-taxation arise in practice
(b) Is it proper for HMRC to seek egregious over-taxation
(c) What light does that shed on the issue of tax avoidance morality

Issue (a) is a question of fact, to which the short answer is, yes. Of course the Courts generally try to construe statutes to prevent egregious over-taxation, just as they try to prevent avoidance; but sometimes they do not achieve this. For instance, the unfortunate Mr Lobler fell into the trap of a partial surrender of life policies:

> He made no profit or gain as that term is commonly or commercially understood and yet he becomes liable to pay tax which exhausts his life savings and may bankrupt him. That is an outrageously unfair result....
> This is legislation which does not seek to tax real or commercial gains. Thus it makes no sense to say that the legislation must be construed to apply to transactions by reference to their commercial substance….No overriding principle can be extracted from the legislation....
> Thus with heavy hearts we dismiss the appeal.[58]

There are then four possible moral approaches:

View	**Tax avoidance**	**Egregious over-taxation**
1	Wrong	Right
2	Right	Wrong
3	Wrong	Wrong
4	Right	Right

One might perhaps adopt view 1, that tax avoidance is wrong but egregious over-taxation is right, in other words, fairness should apply in favour of HMRC but not the taxpayer; but no-one has had the temerity to advocate that.

[58] *Lobler v HMRC* [2013] UKFTT 141 (TC). In order to avoid the unfairness the Upper Tribunal allowed the appeal, though it had to rewrite the law of rectification in order to do so; see [2015] UKUT 152 (TCC). The law was later amended; see 70.3.5 (Partial surrender trap). But that does not affect the point being made here.
For another example, see *Hunters Property v HMRC* [2018] UKFTT 96 (TC), where EIS relief was unfairly lost, because a group company was member of a guarantee company which was "merely a vehicle for holding client funds and had no intrinsic value of its own". For another example, see 90.56 (Capital contribution).

One might perhaps adopt view 2, that tax avoidance is right, but HMRC should be bound by a further requirement of fairness; but few if any advocate that either.

So if sauce for the goose is sauce for the gander, we are limited to views 3 or 4.

View 3 is possible, but it is not supported by HMRC. Those who support the view that tax should be governed by rules rather than discretion cannot logically criticise HMRC for seeking egregious over-taxation, where the law requires, though one could criticise HMRC for not seeking to change the law promptly after unfairness has been identified (and, if appropriate, publish an ESC to operate in the meantime).

So we fall back on view 4, thus this consideration supports the view that there is nothing wrong in avoidance.[59]

One might wish that HMRC were as concerned about egregious over-taxation as they are about its flipside, avoidance (egregious or otherwise). Of course, egregious over-taxation is different in that it brings in revenue rather than losing it. However, it imposes the cost of professional fees for better advised taxpayers who avoid it, and an intangible cost in that it brings the UK tax system into disrepute, even if one is indifferent to the unfairness for its victims. But there it is.

(4) *Tax avoidance sometimes leads to fair result*

This relates to point (3): There are cases where tax avoidance avoids egregious over-taxation. An example is the use of multiple policies to avoid the tax trap of partial surrender.[60]

Parliament sometimes admits this, by enacting a new relief to allow directly what had previously been achieved by avoidance. Examples are:

(a) Nil rate band discretionary trusts, which allowed transferable nil rate bands before the IHT relief was enacted in 2007.

(b) CGT group relief to obtain loss relief. A company about to realise a gain on an asset would formerly transfer it to a group company that had realised an allowable loss. Alternatively, a company which had realised a gain might acquire from a group company an asset which was to be sold at a loss. That would allow the loss to be set against the gain before the introduction of group loss elections, in 2009.[61]

[59] For an example of this line of reasoning in use, the well known passage from *Ayrshire Pullman Motor Services v IRC* (1929) set out at 2.5.7 (Impact of the GAAR).

[60] See 70.3.5 (Partial surrender trap).

[61] Section 171A TCGA.

Offshore trusts mitigate the economically deleterious lock-in effect of CGT by deferring tax until gains are received.

Tax avoidance (if it be such) sometimes permits a business to continue which would otherwise be destroyed by taxation.[62]

Related to this is the use of tax avoidance for political/economic ends. High tax rates may be mitigated by avoidance, achieving a pragmatic compromise between incompatible political viewpoints, or allowing a public perception which is different from the reality. IFS say:[63]

> ... there may even be benefits to the UK from avoidance opportunities if the lower tax rates achieved on mobile activities – for example, through profit shifting – mean that more real activity is in the UK than would otherwise be the case.[64]

This fudge has its costs, including the inefficiencies that arise from tax planning, fiscal instability and public cynicism; but it happens.

2.5.5 *Practitioner/judicial views today*

The above sets out the intellectual case in favour of the view that avoidance, like Lord Diplock's crossword, is morally neutral. It was formerly generally accepted, and has never been refuted. But the argument has been found less convincing, or unconvincing, I think for two reasons:

(1) The traditional view was formed in earlier times when there was tax avoidance but little (if any) activity in the category of tax abuse. After that began to change, I think in the 1970's, the view became far reaching, and so might be regarded more skeptically.

(2) The argument requires an understanding of the tax system as it actually is. Politicians and other non-tax practitioners entered into the debate without that knowledge.

Whatever the reason, the argument has become perceived as less cogent. By 2007:

> For many directors, the objection to arrangements that are in their view

[62] For an example, see *Fisher v HMRC* [2021] EWCA Civ 1438.

[63] IFS, *Green Budget 2013* p.290 *https://ifs.org.uk/sites/default/files/output_url_files/gb2013.pdf*

[64] Footnote original: There is an academic literature on the costs and possible benefits of tax planning. See for example, D. Dharmapala, "What problems and opportunities are created by tax havens?", Oxford Review of Economic Policy, 2008, 24, 661–79.

> ‘too’ artificial may be framed largely in terms of business ethics. Other directors, equally determined to behave in an ethical way, may consider that the degree of artificiality is not an ethical issue provided no attempt is made to misrepresent the facts or to hide them from the tax authorities....
>
> At one time such a view would perhaps have been more widely held than now. At the present time it represents one end of a range of views in a debate where probably most commentators would hold that within the compass of what is legal there is some behaviour that is acceptable and some that is not...[65]

In 2011, Aaronson’s GAAR study reported the views of taxpayer representative bodies:

> There was unanimous disapproval, indeed distaste, for egregious tax avoidance schemes.[66]

Of course tax practitioners do not all share the same view. But I think it is the case that they are mostly drawn to the view that opprobrium should only attach at the top end of the scale, in cases of tax abuse, in which case the GAAR has more or less rendered the issue academic; or if any opprobrium attaches to tax motivated behaviours lower down the scale, the amount of opprobrium should vary according to the scale.

This might be consistent with Lord Templeman’s views in tax abuse cases, which were expressed trenchantly (some would say, stridently[67]):

> In common with my predecessors I regard tax-avoidance schemes *of the kind invented and implemented in the present case* as no better than attempts to cheat the Revenue.[68]

In the Supreme Court in 2014:

> Since the seminal decision of the House of Lords in *Ramsay v IRC*[69]

[65] David Williams “Developing the Concept of Tax Governance” (2007)

[66] Aaronson, *GAAR Study* (2011) *http://webarchive.nationalarchives.gov.uk/20130321041222/http:/www.hm-treasury.gov.uk/d/gaar_final_report_111111.pdf*

[67] Lord Neuberger referred tactfully to Lord Templeman’s “characteristically colourful language”; *Evans (R, oao) v Attorney General* [2015] UKSC 21 at [53].

[68] *IRC v Fitzwilliam* (1993) 67 TC 614 at p.756. Lord Templeman’s claim that his attitude was held in common with his predecessors is untenable. It was not even held in common with his contemporaries. But it is held in common with his successors. In this respect, Lord Templeman was ahead of his time.

[69] (1982) 54 TC 101.

> there has been an increasingly strong and general recognition that artificial tax avoidance is a social evil which puts an unfair burden on the shoulders of those who do not adopt such measures.[70]

"Social evil" represents the top end of judicial rhetoric in recent times;[71] though the scope of the critique depends on the word "artificial", which may mean little or much.

And again in 2015, but more moderately expressed:

> [Tax avoidance] gives rise to social costs which are significant and increasingly controversial.[72]

Since the 1970's there has been no judicial unanimity, and that is still the case today. So the pendulum seems to swing erratically. In a rating avoidance case in 2019:

> Views may differ as to whether the purpose for which the SPVs were used was socially reprehensible.[73]

2.5.6 *Avoidance: Discretionary remedies*

In *Altus Group v Baker Tilly* negligent accountants argued it was contrary to public policy to award damages for their failure to advise or implement an avoidance scheme. The argument was summarily rejected.[74]

Where courts grant discretionary remedies, the question arises whether tax avoidance is a reason to refuse the remedy ("avoidance-based reasoning"). This issue may arise in discretionary remedies such as: setting aside a gift for mistake, rectification, variation of trusts, and remedies for unfair prejudice to minority shareholders.

The idea was first tentatively raised in *Futter v HMRC*:[75]

> In some cases of artificial tax avoidance the court might think it right to refuse relief, either on the ground that such claimants, acting on supposedly expert advice, must be taken to have accepted the risk that the scheme would prove ineffective, or on the ground that discretionary

[70] *Futter v HMRC* [2013] UKSC 26 at [135].

[71] But perhaps "social evil" differs from evil as "social justice" differs from justice.

[72] *Pendragon v HMRC* [2015] UKSC 37 at [5].

[73] *Hurstwood Properties v Rossendale BC* [2019] EWCA Civ 364. The decision was reversed on appeal but without comment on this point. For other aspects of this case see 76.17.5 (Companies: Situs planning).

[74] [2015] EWHC 12 (Ch) at [59](3) and [65].

[75] [2013] UKSC 26 at [135].

> relief should be refused on grounds of public policy. ... But it is unnecessary to consider that further on these appeals.

In Guernsey, the Courts have rejected the idea. Thus when an ill-advised gift to an EBT was set aside for mistake, the fact that the individual was seeking to avoid UK tax was not a reason for the Guernsey Court to refuse relief.[76] It may be that UK tax avoidance is regarded with less hostility in foreign jurisdictions, and especially tax haven jurisdictions. Foreign courts may also be more sympathetic than UK courts to taxpayers facing unfair or penal anti-avoidance rules.[77]

In practice, there has not yet been a case in the UK where a discretionary relief was actually refused on the grounds of avoidance, though have been some where this has been mooted.[78] I do not attempt to discuss all the cases where this point has been discussed, but only to assess (if one can) which way the wind is blowing.

Estera Trust (Jersey) v Singh[79] was an unfair prejudice case. The unfairly prejudiced shareholder was a non-resident trust. The Court ordered the company ("the defendant co") to purchase the trust's shares. Unfortunately that would be a distribution for tax purposes, and subject to IT at the dividend trust rate. The trust proposed a different arrangement:

(1) The trust transferred the shares to a newly created company wholly owned by the trust ("Newco")
(2) The defendant co purchased its shares from Newco

This would avoid the IT charge.[80] The Court refused to order this arrangement for a variety of reasons, but one of them was that:

> the scheme ... could be regarded as aggressive tax avoidance, even though relatively unsophisticated in comparison with other notified avoidance schemes. The Court should not without very good reason order reluctant parties to enter into a scheme that could be held to be

[76] *Whittaker v Concept Fiduciaries* (Guernsey 15/2017).
See too *Nourse v Heritage Trustees* (Guernsey) 15 Jan 2015) at [15] and [71] accessible *https://www.kessler.co.uk/tfd-archive*

[77] See App 14.5.1 (Critique of s.87 regime).

[78] See *Bhaur v Equity First Trustees* [2021] EWHC 2581 (Ch) at [118] - [119]; Herbert, "Equitable mistake and artificial tax avoidance" [2022] PCB 59.

[79] [2019] EWHC 2039 (Ch).

[80] The case was not a tax case, and does not give much tax analysis. For completeness: the transfer at step (1) would in principle give rise to a trust gain but presumably that did not matter on the facts of the case.

> improper (in the sense that I have identified).[81]

A tax practitioner may be surprised that this simple arrangement could be regarded as "aggressive"; for as the Court acknowledged, it is "perfectly common" for Jersey trusts to own companies that hold trust assets. But practitioners should remember that these issues are not decided by tax practitioners. Perhaps mere use of non-resident trusts for UK resident beneficiaries is sufficient?

The problem with avoidance-based refusals of discretionary remedies is of course how uncertain and subjective the concept of avoidance actually is.[82] For that reason, avoidance-based reasoning, if it applies at all, ought to be limited to clear and egregious cases and in practice it has not been applied to "vanilla tax planning" involving offshore trusts and companies.[83] In the light of the GAAR, such cases are not likely to happen after 2013, though pre-2013 avoidance cases will continue to occupy the Courts for a little longer.

2.5.7 *Impact of the GAAR*

Has the GAAR altered the position? GAAR guidance provides:

> B2.1 The GAAR ... rejects the approach taken by the Courts in a number of old cases[84] to the effect that taxpayers are free to use their ingenuity to reduce their tax bills by any lawful means, however contrived those means might be and however far the tax consequences might differ from the real economic position.

HMRC cite one of the best known dicta in taxation. In *Ayrshire Pullman Motor Services v IRC*:[85]

> [1] No man in this country is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Inland Revenue to put the largest possible shovel into his stores.
>
> [2] The Inland Revenue is not slow - and quite rightly - to take every

[81] [2019] EWHC 2039 (Ch) at [26].

[82] See 3.27.1 (Avoidance: coherent concept?).

[83] See 2.4.1 (Categorisation of avoidance).

[84] The phrase "a number of old cases" is a tendentious way to refer to judicial unanimity from the earliest times until the 1980s; see 2.5.2 (Judicial view in the past). But GAAR guidance is not a neutral document: it is written by HMRC and adopts an HMRC perspective.

[85] (1929) 14 TC 754 at p.763.

> advantage which is open to it under the taxing Statutes for the purpose of depleting the taxpayer's pocket.
>
> [3] And the taxpayer is in like manner entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue.

HMRC say that the GAAR has changed this:

> [The above quote] epitomises the approach which Parliament has rejected in enacting the GAAR legislation.[86]

At the abuse end of the spectrum, the GAAR now applies, so the rules have indeed changed. This impinges on the avoidance-morality debate insofar as the debate only concerns successful avoidance, ie avoidance not caught by the GAAR. But nothing else has changed. *Ayshire* itself was *not* an abuse case (the issue was whether the taxpayer's children had entered into a valid partnership) and the decision would not have been affected by the GAAR.

Proposition [1] of the quote is still correct. It also continues to be the case that HMRC enforce egregious over-taxation when the rules work in their favour,[87] and it is unlikely that they intended to cast doubt on proposition [2]. And proposition [3] is still broadly correct, though now qualified in cases which pass the high threshold of abuse.

The above paragraph is reading the text closely and in the manner of a lawyer. It is it is a matter of speculation as to what thoughts were actually in the mind of the author of the GAAR guidance. I think we are in the territory of mood music here.

The rhetoric continues:

> Taxation is not to be treated as a game where taxpayers can indulge in any ingenious scheme in order to eliminate or reduce their tax liability.

The game metaphor begs an essay to itself.[88]

[86] HMRC, "GAAR Guidance" (2017) *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

[87] See 2.5.4 (Pro-avoidance rationale) under the heading: Egregious over-taxation.

[88] What, in fact, is a game? It is an elastic concept which can be analogised in different ways. What is it in the notion of game which HMRC would characterise as significantly different from tax? Is it a notion of non-seriousness? Or an adversarial approach? Or a notion of a rule-based activity? Or arbitrary rules? In the latter three respects, tax law and non-tax law very much resemble games.
Perhaps the thinking is that games are morally neutral, whereas tax avoidance is held to be morally obnoxious. If this is the point, it is significant that a moral based argument needs to present itself in non-moral terminology. But elsewhere, "fair play"

2.5.8 *Codes of practice/regulators*

PCRT provides:

> Members must not create, encourage or promote tax planning arrangements or structures that
> i) set out to achieve results that are contrary to the clear intention of Parliament in enacting relevant legislation and/or
> ii) are highly artificial or highly contrived and seek to exploit shortcomings within the relevant legislation.[89]

I take this as a rough paraphrase of the GAAR. In earlier editions of this work I criticised this, saying:

> But as no-one would *sensibly* advise clients to enter into avoidance schemes which do not work, because of the GAAR or otherwise, it is (more or less) meaningless exhortation.

But this overlooks that the code does serve a purpose in providing a sanction for members of professional organisations who foolishly or cynically advise clients to enter into avoidance schemes which are hopeless or worse than hopeless.

and "playing by the rules" are understood positively, and even claimed as defining features of the English national character.

These problems suggest that it would help clarity of thinking not to use the word "game": a stale and failed metaphor. See Midgley, *Heart and Mind* (1981) chapter 8 (The game game).

However the game metaphor seems to be irresistible, in rhetoric if not in sober thought. For a recent example, see *Clark v HMRC* [2020] EWCA Civ 204 at [114]: "Both grounds seem to me to be examples of tax litigation as a board game, with large prizes for the winners. People who pay tax in the usual way are entitled to feel aggrieved when elaborate avoidance schemes ... succeed."

[89] PCRT, Helpsheet B: Tax Advice. Para (ii) is otiose, but it does not matter.
In 2015 HMRC called on the professional bodies

> "to take on a greater lead and responsibility in setting and enforcing clear professional standards around the facilitation and promotion of avoidance to protect the reputation of the tax and accountancy profession and to act for the greater public good."

See "Tackling tax evasion and avoidance" (the juxtaposition is significant) (2015) para 3.19.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413931/Tax_evasion_FINAL__with_covers_and_right_sig_.pdf
This was the spur for PCRT Helpsheet B.
The same wording is found in HMRC Standard for Agents para 3.3; see 122.1.2 (HMRC standard for agents).

A more literal reading might take this as prohibiting advice on avoidance arrangements which *do* work. There are conflicting normative visions of the lawyer's role, raising the basic question: can a good lawyer be a good person? For legal practitioners, client autonomy is a fundamental value, and the client is in all cases entitled to be told what the law is. That is an aspect of the Rule of Law.[90] So far as that may be what it means, the PCRT does not apply to lawyers, because SRA/Bar codes of conduct have priority.[91] SRA say:[92]

> When advising a client on avoidance of tax schemes you should make clear that any avoidance arrangements the client enters into might deliver tax outcomes that were never envisaged or intended by Parliament and may be challenged. You should be clear as to the legal implications, the costs and penalties of non-compliance should the arrangement fail.
>
> You should also consider your own position in facilitating such an arrangement. Should the arrangement be found to be abusive, your conduct may be called into question. To be involved in such arrangements is likely to reflect badly on you and to damage public confidence in those delivering legal services. You will leave yourself open to the risk of disciplinary proceedings as well as committing a criminal offence. Where you believe, as a consequence of your client's instructions, you are at risk then you should advise your client you cannot comply with their instructions and unless they change instructions you should terminate your retainer.

SRA refer to PCRT and say:

> Where you consider that a scheme is likely to be found to be abusive, you can advise a client to this effect. Where a scheme can reasonably be argued not to be abusive, you can advise a client to this effect, facilitate the scheme where so instructed by a client properly advised as to the

[90] That view is not wholeheartedly accepted, or understood, by the general public or by HMRC, and a whole chapter would be needed to discuss this topic. For an introduction, see Windsor, "The Ethics of Government Legal Advisers" in Feldman (ed) *Law in Politics, Politics in Law* (2015).

[91] See 122.1.1 (Status of PCRT).

[92] SRA, "Tax avoidance your duties" (2019)
https://www.sra.org.uk/solicitors/guidance/tax-avoidance-duties/
The original version (2017) was criticised in earlier editions of this work, see the 2023/24 ed, para 2.5.8 (Codes of practice/regulators). But the guidance was substantially rewritten in 2019, and the earlier version is now of historic interest only.

> risks, and litigate on behalf of a client as to the legality of the scheme where you can do so in a manner consistent with your duty to the Court. It is for the relevant courts and tribunals to adjudicate on the legality of tax avoidance schemes. However, where schemes are found to be abusive, or where there is no finding but schemes contain indicators of abuse (such as, but not limited to, misleading conduct or the indicators set out in the GAAR or PCRT), and solicitors have facilitated such schemes, whether by providing supportive advice which advocates the use of such schemes, or does not sufficiently highlight the associated risks or otherwise, we will see this, on the face of things, as evidence of breach of the SRA Principles and are likely to investigate. If a solicitor gives advice to the effect that a scheme is likely to be found to be abusive and takes no steps to give effect to such a scheme, it is unlikely that enforcement action would be taken.

In practice there have been disciplinary proceedings[93] and further cases are pending. They tend for obvious reasons to be extreme cases where the question of what is abusive does not arise.

2.5.9 *Views of non-tax practitioners*

Outside the tax profession, the concept of what is unacceptable/immoral is not restricted to tax abuse, but extends to the "ordinary" tax planning level. Indeed, some very "ordinary" tax planning has come under fire. Practitioners might dismiss the views of those who know nothing about tax as unworthy of consideration. I give four examples from those whose views carry some weight.

Deferring bonus in order to take advantage of announced reduction in tax rates: This arose in 2013/14 when top rates fell from 50% to 45%. Practitioner-readers are likely to agree that this is "ordinary" tax planning near the bottom end of the spectrum. But Mervyn King, then Governor of the Bank of England, is reported to have criticised Goldman Sachs for it.[94] The House of Lords select committee noted that the GAAR will not apply to the deferral of bonuses from one tax year to another,[95] but one might

[93] See *Solicitors Regulation Authority v Chan* [2015] EWHC 2659 (Admin).

[94] Financial Times, 15 Jan 2013. King is co-author of the excellent (now out of date) *British Tax System* (5th ed, 1990).

[95] Select Committee on Economic Affairs Report on The Draft Finance Bill 2013 *http://www.publications.parliament.uk/pa/ld201213/ldselect/ldeconaf/139/139.pdf* The Select Committee said this was because that "the issue is one concerning the structure of the tax system rather than avoidance involving manipulation of loopholes

infer that they disapproved none the less for that.

The Bump Plan In 2013 a now-forgotten political furore arose after a tax practitioner was secretly filmed, suggesting bonus payments to pregnant employees; if made during the relevant period this would increase the amount of statutory maternity pay. I do not think practitioners would regard that as on the abusive side of the line (though there are many points which need to be made to properly understand the legal and moral analysis, none of which were heard in the public debate).[96] Perhaps the point was just political hot air but the practitioner involved had to leave the GAAR panel.

Income transfer between spouses I think practitioners were surprised that HMRC found this unacceptable in their (ultimately unsuccessful) attack in *Jones v Garnett*.

To digress: It is interesting to note that the same planning has been criticised in India:

> While tax evasion is universally condemned, there is a disposition in certain quarters to regard tax avoidance as a permissible course of action. We are unable to endorse this view. The mere fact that the income-tax law is not violated does not mean that the procedure which results in tax avoidance is justified. We might take as an illustration the act of introducing, without adequate consideration, one's wife ... as partner in a business of which the assessee himself is a partner. It is an attempt to fraction income and reduce tax liability under a provision of law meant to apply to genuine partnerships. Conduct of this nature, though legal, cannot but be regarded as anti-social.[97]

Different jurisdictions will approach the intractable issues of taxation of

in the legislation." More analytically, the reason is that these are not examples of tax abuse (in my sense, which I take to be the same as the definition of "abusive" in the GAAR).

The GAAR guidance makes this point; see 56.10.8 (Postpone disposal: GAAR).

[96] In particular: (1) This planning does not give rise to a tax advantage, but to a benefit advantage for the employer; it could not be counteracted by the GAAR. (2) Not every payment to an employee is earnings so it is possible for planning of this kind to fail on the facts. (3) The privacy aspects of secret filming, and the ease with which short clips may misrepresent nuanced positions, seem particularly worrying.

For the background, see Johnson, "Tax, Lies and Hypocrisy" (CCH Tax News , Issue 133 25 September 2013); for the law, see the Statutory Maternity Pay (General) Regulations 1986.

[97] Government of India, *Report of the Taxation Enquiry Commission* (1953-54), Vol II para 5.

families in different ways. I would not go so far as to say that international comparisons are never helpful, but valid comparisons would require a good understanding of both tax systems, which would generally need a team rather than a single author. Isolated quotes are likely to mislead. In the UK, at least, Parliament has decided that income sharing and other inter-spouse transfers are acceptable tax planning, subject to quite limited exceptions.[98]

Gift of company to political party A donor who owns a suitable company might arrange that:
(1) The donor gives the company to the political party.
(2) The political party extracts the funds by way of dividend.

The gift at stage (1) qualifies for CGT hold-over relief; and the distribution at stage (2) would not be taxable, assuming the party is a company for tax purposes.

It seems that Labour arranged this in 2013, giving rise to a fit of indignation, or purported indignation, from the Tories. An open letter from George Osborne to Ed Milliband provided:

> ... the Labour Party has gone to great lengths to help your biggest donor, ... avoid paying tax on a political donation. ...
> The Labour Party registered a donation of shares in JML worth £1.65 million in January 2013, from Mr John Mills. By making a donation in shares rather than as a single cash dividend, it has been reported that Mr Mills managed to avoid a potential tax charge of £724,710.[99] ...
> As leader of the Labour Party, and given your previous statements on tax avoidance, such actions by your party appear to be directly at odds with your public statements.
> Most importantly, will you now pass the amount of tax that has been avoided to the Exchequer? As you say, this is money that is needed to fund vital public services such as the health service and our schools.[100]

What is one to make of this? I think any practitioner, or anyone who understood the tax background, would regard this as in the category of

[98] See 93.1 (Non-dom/non-resident spouse).

[99] This figure is wrong: it represents a tax rate of 44%. The effective rate of tax should have been 36.11% = £600k tax. Perhaps it is a typo. Perhaps it is irony. Perhaps no-one is intended to take the letter so seriously as to check the figures. If this is an indication of the tax advice given to Mr Osborne, it is rather worrying.

[100] 6 June 2013

"sensible tax planning" or, perhaps, "ordinary" tax planning; in either case, well short of avoidance and opprobrium. The letter could be seen as just an example of debased political debate, meaningless playground insults whose object is just to knock the opposition. It could be taken as a case where "ordinary" tax planning is regarded as immoral. However, it may be regarded as an illustration of the difficulties which arise if one regards taxation as governed by moral principles distinct from black letter tax law. The letter might then be regarded as a rather subtle contribution to the political/moral debate. Perhaps there are elements of each of these.

2.5.10 *Context of discussion*

It is possible to discuss tax-morality in a lofty, disinterested and high-minded way. What is the good life? What would Aristotle say?

But in practice discussion is invested with flaming indignation, hatred for those who benefit from or support perceived injustices. This is fed by a sense of superiority that we are not like these instruments and accomplices of evil. The result is moral panic, contempt and aggression.[101] There is a great and easily mobilised hostility to anything that can be represented as avoidance. The remedies proposed become ever more penal and more discretionary.

The debate sometimes suffers from profound bad faith or hypocrisy. Politicians accuse others of tax-immorality in order to attack their opponents. Or journalists do so to sell papers. A example is when the archive of Tony Benn was transferred to the British Library, under the acceptance in lieu scheme, which one might have thought as innocuous as any transaction could possibly be.[102]

In 2021, it emerged that:

(1) Tony & Cheri Blair had (in 2017) incorporated a company (the purchaser).
(2) The purchaser acquired a BVI property company (holding office accommodation) from an unconnected non-resident company.
(3) The purchaser liquidated the BVI company and so acquired the land, which was subsequently used for a trading business of Cheri Blair.

[101] This is a danger to which any discussion of morality is subject: see Taylor, *A Secular Age* (2007) chapter 18.

[102] Reported by the Telegraph (4 Mar 2019) under the snide headline "Tories praise Tony Benn's financial planning as donation of his archive knocks £210,000 off family's tax bill". The article shows some signs of a libel readers scrutiny, as it falls just short of an allegation of hypocrisy.

The (suggested) avoidance here was that SDLT was not payable, which it could have been if the purchaser had acquired the land directly rather than the BVI company![103] Of course any practitioner would understand that:

- The choice between a company purchase and an asset purchase is one which Parliament has allowed, is not avoidance, and is so commonplace that no-one would have expected the matter to be dealt by a company purchase.
- The fact that this was a *BVI* company was irrelevant to the SDLT saving, as (more or less) the same saving would have applied to a purchase of a UK property company.[104]

"Move along, nothing to see here" - but that does not sell news or promote party politics.

2.5.11 *Conclusion*

In short, there is widespread disagreement about the starting point, not to mention finish line, when it comes to the concept of avoidance or on issues of morality in connection with tax avoidance. This should not be a surprise, since the same applies to many contemporary moral issues, for instance, assisted suicide. There is no tribunal to adjudicate arguments on morality, except the court of public opinion, which, as Ibsen observed, is an extremely mutable thing. But disapproval of avoidance, however understood, is now the norm. That that represents a major change of attitude is now forgotten. Changes in morality are accompanied by amnesia.

2.6 Tax Gap

Another thread in public debate is a vast estimate of the amounts involved.

[103] The Guardian, 5 Oct 2021 "Tony and Cherie Blair bought property via offshore firm and saved £300,000 in tax".

[104] In the case of a UK company the SDLT saving would have been slightly reduced by SDRT at the rate of 0.5%.
For a complete tax analysis further points need to be made.
There was also a tax downside to the arrangement as the purchaser acquired the historic acquisition cost of the BVI company; though that too could be avoided by an onward sale of the UK company rather than its asset.
Even the acquisition of the property by the BVI company should not be regarded as avoidance: Non-residents will (almost) always acquire non-residential investment property through a company - again from a UK tax viewpoint it makes no difference whether it is a BVI company or established elsewhere.

HMRC publish annual figures, with a catchy title, the "tax gap".[105] This is said to be £35 billion, or 5% of tax liabilities, in 2021/22.[106]

Broken down, the HMRC figures are:

Amount £bn	**Behaviour**	**Explanation**
10.7	Failure to take reasonable care	
4.1	Criminal attacks	
4.7	Evasion	Excluding hidden economy
4.1	Legal interpretation	Taxpayer/tribunal disagree with HMRC on tax law (excluding avoidance)[107]
3.3	Non-payment	Tax written off as uncollectible
2.1	Hidden economy	Income undeclared/understated
5.4	[Non-careless] error	
1.4	Avoidance	
35.8	Total	

Statistics are only as useful and reliable as the definitions on which they are based. Most of these categories are vague, and assessment of the figures is, to say the least, challenging. I think a certain amount of scepticism is in order. There is a danger that spurious statistics may gain currency and influence policy.[108]

The combination of disparate categories makes the total "tax gap" figure meaningless, but perhaps it is intended only for headline purposes. I write

[105] I think this tabloid term originated in the US, where IRS have been measuring the Federal Tax Gap since at least 1993: *https://www.irs.gov/statistics/irs-the-tax-gap*

[106] HMRC, "Measuring tax gaps 2023 edition, table 7.1 *https://www.gov.uk/government/statistics/measuring-tax-gaps*

[107] The concept is so arbitrary and subjective that it can fairly be described as ludicrous. CIOT rightly ask why it should be part of the tax gap at all.

[108] For a critique of the methodology, see Oxford University Centre for Business Taxation "The Tax Gap for Corporation Tax", (2012) *https://wayback.archive-it.org/org-467/20200808011019/http://eureka.sbs.ox.ac.uk/4428/4/TaxGap_3_12_12.pdf*

The HMRC paper itself acknowledges at B3 that "there are sources of uncertainty and potential error". (Formerly this read "*many* sources" but the *many* has been deleted.) The caveat is forgotten in the figures provided, which present a spurious precision, and in public discussion.

For the practical relevance of the data, see Mirrlees Review, *Dimensions in Tax Design* (2010), p.1132.

it with scare quotation marks.

IFS say:

> we don't know how much corporate tax is lost to the UK as a result of tax avoidance. This is partly because there is no accepted definition of exactly what constitutes 'avoidance' and partly because we lack full information about the activities of firms.[109]

Of course, the fact that an amount is unknown and unknowable does not mean that it is small or unimportant. I wonder if time spent guessing at figures is productive. It is however striking how tiny a part tax avoidance plays in the "tax gap" figures, 0.2% in percentage terms, compared to the attention it receives.

The IFS report continues:

> Importantly, even if we knew that information and could calculate the tax lost to avoidance, it would not be right to assume that, were all avoidance opportunities to be completely removed, the UK would be able to collect that full amount. We would expect higher taxes to feed through, at least to some degree, to lower investment and changes in prices such that genuine UK profits may be lower. To the extent that the corporate tax affects prices or wages, or the location of firms' activities (and therefore jobs), there may also be lower receipts from income taxes or VAT.

This is true for all taxes, but particularly for corporation tax:

> First, corporation tax is a particularly distortionary form of taxation that can work to reduce investment. This is especially the case for internationally mobile investments because firms will consider tax when choosing where to locate real activities...
>
> Second, the ultimate incidence of corporate tax always lies with households and is borne either by the owners of capital (in the form of lower dividends), by workers (in the form of lower wages) or by consumers (in the form of higher prices). We do not know with any precision who is made worse off as the result of the corporation tax. However, estimates suggest that, because capital tends to be much more mobile than workers or consumers, a significant share of the burden of corporate tax tends to be shifted to domestic factors – and specifically labour. In other words, there is reason to believe that at least a part, and

[109] IFS, *Green Budget 2013* p.297 *https://ifs.org.uk/sites/default/files/output_url_files/gb2013.pdf*

> in some cases a large part, of the corporation tax that companies are subject to is ultimately passed on to workers in the form of lower wages.[110]

There is a certain irony in the second point, given the left's enthusiasm for corporation tax; I think most economists agree that the burden of corporation tax is generally borne by employees,[111] though not all. But all that matters in politics is that no-one *realises* who pays it.

2.7 Avoidance legislation 1955 critique

In 1955 the Royal Commission said:[112]

> We are disturbed by the criticism that much of the anti-avoidance legislation is obscurely worded and drawn more widely than its purpose requires. ... We doubt if many lawyers could expound with confidence the effect of the 26 sections that make up Part XVIII of the [ITA 1952]. [The Royal Commission quoted the ToA definition of "power to enjoy" to illustrate the point, and continued:] It appears to us that, if the legislation in this field has to be expressed in this way, there is a danger that our system is becoming delusive. For, while it presents the form of statutory control of the subject by Parliament, it means that in substance the assessment of the individual affected and the charge of tax upon him is not determined by law but by the decision of the [Revenue] ... we think that, now that the main lines of this legislation are to be regarded as fully developed[113] and the administration of them has had time to settle down, the opportunity should be taken in the course of the next few years to conduct an expert review of the enactments as a whole... The purpose of the review would be (a) to enquire to what extent, if any, the relevant legislation may have been shown, in the light of experience, to have been drawn too widely for its purpose,[114] (b) to recommend any

[110] IFS, *Green Budget 2013* p.290 *https://ifs.org.uk/sites/default/files/output_url_files/gb2013.pdf* (footnotes omitted).

[111] ETPF Policy Paper 1 "Who bears the burden of corporate income taxation?" (2015) European Economic and Social Committee, "The Role of Taxes on Investment to Increase Jobs in the EU – An Assessment of Recent Policy Developments in the Field of Corporate Taxes" (2019) *https://www.eesc.europa.eu/sites/default/files/files/qe-03-19-343-en-n.pdf*

[112] Cmd. 9474 para 1029

[113] With hindsight, we see that anti-avoidance legislation was then in its infancy. The 26 sections complained of covered the settlor-interested trust code, ToA and transfer of income streams, with a concision which today one could not dream of.

[114] The decision in *Vestey* subsequently addressed one of the concerns at (a).

modifications of the legislation that will make it shorter, briefer, and more precise.

Here are 4 critiques which have become familiar: obscurity, imprecision, provisions drawn too widely ("overkill"), and discretionary application. Nowadays these critiques may be framed in terms of the Rule of Law.

2.8 The Rule of Law

2.8.1 *What is "the Rule of Law"*

There is a consensus on the Rule of Law. It is a constitutional principle.[115] It is one of four fundamental British values.[116]

There is no consensus on the meaning of the expression. It is an emotionally charged label for a set of principles, or sub-principles, the content of which is contested. This may not be a bad thing: consensus on the importance of the Rule of Law is only possible because of dissensus as to its meaning. There is a certain irony in that the principle which forbids vague legislation is itself difficult to pin down. But the same is true of other cherished political virtues, such as democracy. A discussion needs a book to itself;[117] but as the term is used in different ways, it is best

[115] Section 1 Constitutional Reform Act 2005.

[116] The other three are democracy, liberty and tolerance, according to the Government "*Prevent* Strategy", Cm 8092 (2011), para 6.58 where opposition to these values is the definition of "extremism". The point is repeated in the Government "Counter-Extremism Strategy" Cm 9148 (2015): "Extremism is the vocal or active opposition to our fundamental values, including democracy, the rule of law, individual liberty and the mutual respect and tolerance of different faiths and beliefs."
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/97976/prevent-strategy-review.pdf
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/470088/51859_Cm9148_Accessible.pdf
The new 2024 definition of extremism does not refer expressly to the Rule of Law, though it does refer to "fundamental rights and freedoms" ("in particular those rights and freedoms listed in Schedule 1 to the Human Rights Act 1998") which perhaps covers similar territory.
https://www.gov.uk/government/publications/new-definition-of-extremism-2024/new-definition-of-extremism-2024?utm_source=substack&utm_medium=email#fn:5
The Rule of Law is also one of the six values on which the EU is founded (the others are respect for human dignity, freedom, democracy, equality, and respect for human rights); see Article 2 TEU. But that matters less in the UK after Brexit.

[117] Raz, *The Authority of Law* (2nd ed., 2009), ch. 11 ("The Rule of Law and its Virtue"); Tamanaha, *On the Rule of Law* (1st ed, 2004); Pech, "The Rule of Law as

not to use it without some explanation of how it should be, or may be, understood. This section draws on a paper by Craig, "The Rule of Law" prepared for the House of Lords Constitution Committee.[118]

There is a consensus that the Rule of Law includes at least the following minimum requirements.[119]

Craig says:

> *The Rule of Law and Lawful Authority*
> A core idea of the rule of law to which all would subscribe is that the government must be able to point to some basis for its action that is regarded as valid by the relevant legal system. Thus in the UK such action would commonly have its foundation in statute, the prerogative or in common law power.

It follows that tax should be imposed by parliament through legislation.

Craig continues:

> *The Rule of Law and Guiding Conduct*
> A further important aspect of the rule of law is that the laws thus promulgated should be capable of guiding ones conduct in order that one can plan ones life.
>
> It is from this general precept that Raz deduced a number of more specific attributes that laws should have in order that they could be said to comply with the rule of law. All are related to the idea of enabling individuals to be able to plan their lives. The 'list' includes the following
>
> (1) laws should be prospective, not retrospective;
> (2) they should be relatively stable;
> (3) particular laws should be guided by open, general and clear rules;[120]
> (4) there should be an independent judiciary;

a Constitutional Principle of the EU" (2009)
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1463242
For the Rule of Law in a tax context, see Freedman & Vella,"HMRC's Management of the UK Tax System: The Boundaries of Legitimate Discretion" Legal Research paper No 73/2012 (2012)
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2174946##

[118] *http://www.publications.parliament.uk/pa/ld200607/ldselect/ldconst/151/15115.htm*

[119] This may be referred to as a thin, formal, procedural or narrow understanding of the Rule of Law. Some add Human Rights to the list. I would have thought Human Rights is conceptually at least best regarded as a separate matter from Rule of Law; though ultimately Rule of Law is a term which one might define as one wishes.

[120] The OUCBT paper spells out an implication of this: "The rule of law requires that taxpayers are able to determine the tax consequences of their actions in advance."

(5) there should be access to the courts;
(6) the discretion which law enforcement agencies possess should not be allowed to undermine the purposes of the relevant legal rules.

I think these are best regarded as distinct principles, albeit with one underlying rationale.

Although not standard usage, in this work I write *Rule of Law* with initial capitals. It is not exactly a technical expression, that suggests a precision of meaning; but the capitals do indicate that it carries considerable intellectual baggage. It may also be helpful sometimes to specify which aspect (or sub-rule) of the Rule of Law is in point; eg one might refer to Rule of Law/certainty.

2.8.2 *Rule of Law v. other values*

The Rule of Law is something to boast of,[121] and a feature which makes the UK an attractive place to reside, invest or litigate. The Judicial Office boast:

> The Rule of Law represents the cornerstone of liberty and democracy, and is one of the main reasons that the UK attracts global businesses and investors.
> Laws in the UK are:
> - public (so that everyone knows what they say)
> - certain (so that everyone knows where they stand)
> - prospective rather than retrospective (so that they cannot be broken before they exist)[122]

The reality may not match the rhetoric. There is nothing in the idea of government by majority to show that the majority will respect the Rule of Law. Rule of Law principles are challenged, or breached, in various aspects of taxation,[123] but the conflict in the context of tax avoidance is particularly deep. Anti-avoidance is facilitated and indeed characterised by features which breach the Rule of Law:

(1) Legislation which is:

[121] The boast is an old one. See Blackstone's *Commentaries on the Laws of England* (1765) vol 2 chap 37: "a country like this, which boasts of being governed in all respects by law and not by will"; and contrast John Adams "A government of laws, and not of men" (1780).

[122] "English Law, UK Courts and UK Legal Services after Brexit The View beyond 2019".

[123] See for instance the problems raised by *Lobler* at 2.5.2 (Judicial views).

    (a) obscure
    (b) vague
    (c) retrospective

(2) Administrative discretion, which falls into two types:
    (a) expressly conferred
    (b) a consequence, unavoidable but no doubt sometimes intended and welcomed, of obscure or vague legislation

(3) Soft tax law, ie rules (which may be described or misdescribed as guidance or statements of practice) laid down by HMRC without authority of Parliament. This is typically combined with administrative discretion, both because the terms of guidance in practice are generally vague, but more fundamentally, because HMRC are not usually bound by their guidance and may withdraw retrospectively.

(4) Overkill is not (or at least, not necessarily) a breach of the Rule of Law. However in practice it is generally accompanied by administrative relaxation, which breaches Rule of Law principles because it is not laid down by Parliament, and because it confers HMRC discretion.

It is desirable to recognise that there is a *trade-off* between conflicting policy aims, the Rule of Law and the combat of avoidance, rather than to fudge the matter by saying, or pretending, that these matters are consistent with the Rule of Law. Indeed there is a set of trade-offs, because the Rule of Law is a set of rules. For instance, if a TAAR has a clearance procedure, then the ability of taxpayers to plan with confidence is increased, which supports one aspect of the Rule of Law; but HMRC discretion is also increased, which breaches another aspect.

Then one can face the choices aware of the consequences of one choice or another. Craig says:

> ... the rule of law in the above sense is only one virtue of a legal system, and may have to be sacrificed to attain other desired ends. We may feel that the rule of law virtues of having clear, general laws should be sacrificed if the best or only way to achieve a desired goal is to have more discretionary, open-textured legal provisions. This may be so where it is not possible to lay down in advance in the enabling legislation clear rules in sufficient detail to cover all eventualities. Modifications to the rule of law in this manner are not somehow forbidden or proscribed. Given that it is only one virtue of a legal system it should not prevent the attainment of other virtues valued by that

> system.

In 1974, Lord Simon put the Rule of Law above the need to combat tax avoidance:

> Disagreeable as it may seem that some taxpayers should escape what might appear to be their fair share of the general burden of national expenditure, it would be far more disagreeable to substitute the rule of caprice for that of law.[124]

The cure could be worse than the disease.[125] In contemporary debate it is rare to find a statement in such strong terms. An exception comes from the Joint Committee on Statutory Instruments, discussing an arrangement-disregard TAAR in the following form:

> If—
> (a) a person enters into any arrangements; and
> (b) the main purpose, or one of the main purposes, of the person in entering into the arrangements is to avoid any obligation under these Regulations,
>
> these Regulations are to have effect as if the arrangements had not been entered into.[126]

The Committee said:

> ... people who are satisfied that the terms of the regulations do not apply to them will be at constant risk of HMRC initially concluding that they have attempted to avoid the regulations and that the regulations therefore apply anyway – that being the default position in the absence of an appeal. It is unclear that such a result, which breaches the principle of certainty, would be within the contemplation of enabling powers that do not contain express provision for the type of anti-avoidance provision used.
>
> The fact that Parliament has, notably in Part 5 of the Finance Act 2013, [the GAAR] enacted anti-avoidance provisions which are similarly

[124] *Ransom v Higgs* 50 TC 1 at p.94. A similar spirit informed the decision in *Vestey v HMRC* in 1979; see 49.3 (Charge on transferor).

[125] Nietsche puts the point poetically: “Wer mit Ungeheuern kämpft, mag zusehn, dass er nicht dabei zum Ungeheuer wird. Und wenn du lange in einen Abgrund blickst, blickt der Abgrund auch in dich hinein.” (He who fights monsters should be careful lest he become a monster. And if you gaze into an abyss, the abyss will also gaze into you).

[126] Reg 21 The Taxes (Base Erosion and Profit Shifting) (Country-by-Country Reporting) Regulations 2016.

> imprecise or discretionary is irrelevant to the security of such provisions in subordinate legislation, in the absence of express enabling powers. The Committee accordingly reports regulation 21 for a doubt as to whether it is *intra vires*.[127]

But this view did not commend itself to legislators. The regulation which they criticised as possibly *ultra vires* remains in the legislation. Identical wording (where the same criticisms might be made) is found in other regulations.[128] The wording is now common in primary legislation (where the ultra vires objection does not arise, but the Rule of Law/certainty objection is the same).

Tax avoidance is an issue of international tax as well as domestic tax, and in the US, the Rule of Law is, perhaps, more highly valued.[129] Bob Stack (US Treasury Deputy Assistant Secretary for International Tax Affairs) criticised OECD BEPS reforms, and UK diverted profits tax, for breaching Rule of Law/international tax law principles:

> Rather than producing administrable rules, the BEPS negotiators seemed to be opting instead for giving wide discretion to tax officials.[130] This brought into question the whole international tax system. Do the international tax rules even matter anymore?" Do we really need a standard setter to say, 'Tax administrators can use the pornography test to catch tax avoidance. We know it when we see it. And we will get you if we want to'?...
>
> [Diverted Profits Tax] ... took us further down the road in which a taxpayer is at the mercy of whatever a tax auditor decides is the right amount to pay. What made this particularly perturbing was that these measures emanated not from the usual suspects such as India, China, Brazil and South Africa, but from strong traditional residence countries

[127] *http://www.publications.parliament.uk/pa/cm201516/cmselect/cmstatin/461-ix/46103.htm#inst01*
The Committee report was published after the provision came into force.

[128] Reg 23 International Tax Compliance Regulations 2015. The argument that reg. 23 is ultra vires is weaker than in the case of the regulation considered by the Joint Committee, because unlike the position for the 2016 regulations, CRS authorises and requires "rules to prevent ... practices intended to circumvent the reporting and due diligence procedures". See 130.35 (CRS TAAR). Perhaps the argument is still tenable. Perhaps reg 23 will be read purposefully and somewhat restrictively.

[129] Though it is difficult to assess the validity of such a broad generalisation and the statement became more doubtful under the former Trump administration.

[130] Stack probably had in mind the PPT; see 108.8 (Principal purpose test). For another example, see 9.18 (Tie-breaker: mutual agreement).

> [UK and Australia] that happened to be two of our closest friends.[131]

2.8.3 *Breach of Rule of Law*

Craig says:

> The fact that a law is vague or unclear, and that it therefore provides little by way of real guidance for those affected by it, will not lead to a statute being invalidated in the UK.

In relation to secondary legislation (statutory instruments) a court could strike down provisions on the grounds of breach of the Rule of Law (which might be said to be ultra vires, in the absence of clear authority in the authorising act of parliament). In relation to primary legislation, a court could issue a statement of incompatibility. But in a tax context this has not happened.

In other words, the Rule of Law lacks full justiciability. Perhaps ironically, the Rule of Law is not in the strict sense a rule of law. To adopt Dworkin's distinction, it is a principle and not a rule. As such it may encourage a court to interpret a statute more narrowly, in favour of the individual. In this way, however deeply, inchoately, and inconsistently, Rule of Law considerations do to some extent affect case law outcomes[132] and perhaps, tax policy (though I am less sure about that.)

2.8.4 *Is tax Rule of Law compliant*

In earlier editions of this work, I said:

> The UK tax system is largely based on the rule of law rather than informal practice and discretion.

By 2014, as TAARs and other anti-avoidance were multiplying, I qualified the boast, saying: "that is less the case than formerly".[133]

In 2014 the City of London Law Society said:

> 2.4 ... tax policymakers are insufficiently conscious of the importance of the rule of law – that is, the constitutional right of a citizen to determine the law applicable to him at any given date. Related to this is

[131] Speech to OECD International Tax Conference, 2015.

[132] In the context of rules which would prevent access to a Court, the Rule of Law affects outcomes more directly; see for example *Haworth v HMRC* [2019] EWCA Civ 747 at [66].

[133] Kessler, *Taxation of Non-Residents and Foreign Domiciliaries* (13th ed., 2014) para 2.4 (The Rule of Law).

> a similar problem of lack of respect for legislation as the only proper source of law, and over-reliance on guidance.[134]

In 2015 the Law Society made the same point:

> ... in recent years, there has been a tendency on the part of government to allow the rule of law in taxation to risk being eroded in the interests of making the executive more effective, in particular in seeking to combat avoidance...

The question "is tax Rule of Law compliant" seems meaningful but as the Rule of Law is a set of rules, it is not one question but a set of questions. In relation to each of the rules, the question is not *whether* tax is Rule of Law compliant but *to what extent*. To answer that question fully, one would test every rule of tax law against each of the principles of the Rule of Law set out above. As tax is vast, discussion must be selective and impressionistic.[135]

In the broadest outline, then, to what extent is it the case that:

Taxpayers are able to determine the tax consequences of their actions in advance? Increasingly not, obscurity, vagueness and overkill are rife, mitigated by HMRC guidance or concession mislabeled as guidance.[136] Most supporters of the GAAR deny or downplay its uncertainty, but, significantly, Jim Harra, Director General, Business Tax at HMRC applauded it:

> It will also create an additional level of uncertainty for the promoters and users of schemes. I believe that that will be a deterrent.[137]

Even the Supreme Court have said something similar. In *Hurstwood*

[134] Response to OTS competitiveness review (2014)
No-one appears to have taken any notice of the Law Society's lobbying.

[135] For the question of Rule of Law compliance in a general (non-tax) context, see the Justice report, "The State We're in: Addressing Threats & Challenges to the Rule of Law" (2023)
https://justice.org.uk/the-uks-longstanding-commitment-to-the-rule-of-law-is-under-grave-threat-according-to-landmark-report-from-justice/

[136] Examples include: (1) s.30 FA 2014 (avoidance by transfer of corporate profits); (2) TAARs, which have become standard in new legislation, especially those of the tax-advantage type. See for instance, 65.21 (Capital-loss TAAR).

[137] Hansard, Public Accounts - Minutes of Evidence (6 December 2012)
http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/788/121206.htm

Properties v Rossendale BC:[138]

> The value of legal certainty does not extend to construing legislation in a way which will guarantee the effectiveness of transactions undertaken solely to avoid the liability which the legislation seeks to impose.

But we return to a conventional view in *HMRC v Fisher*:[139]

> At some points [HMRC] seemed to be suggesting that this degree of uncertainty about when and to whom the charge applied was a positive virtue of the drafting. The provision was, he said, designed to discourage people from moving assets abroad with a tax avoidance purpose. The problem with having a bright line is that people devise a way round it. The penal provision works better to achieve its aim if taxpayers are unable to know whether they would be caught or not. HMRC could then assess them to tax on the income of the overseas person, leaving the taxpayer to try to convince HMRC or the tribunal on appeal that they were not transferors. That is, in my judgment, an improper argument for HMRC to run. It has a flavour of the same unconstitutional approach to the enforcement of these provisions that was so strongly deprecated in *Vestey*. I agree with [the taxpayer's] submission in response when he said that the law cannot be left in some unclear state "just to scare people".

Is tax imposed by Parliament or HMRC? Increasingly the latter.
Is there a right of appeal to a Court? Not quite always.[140]
Is tax law retrospective? Sometimes, though I do not detect a trend towards increasing retrospectivity.
Is tax law stable? No, though it never has been.

Breaking down the issues under these separate heads illustrates what a disparate group of principles fall within the concept of the Rule of Law. I doubt whether "the Rule of Law" is a helpful label in the context of tax law. It conflates disparate issues and so confuses discussion.[141] While it

[138] [2021] UKSC 16 at [61].

[139] [2023] UKSC 44 at [76].

[140] For instance: (1) The Code of Practice on Taxation for Banks; there is no right of appeal against HMRC determination of a breach of the code. (2) Follower notices: there is no right of appeal against the issue of such a notice on a number of important grounds.

[141] The point is not limited the context of tax. For instance, a summary of the Justice report "The State We're In: Addressing Threats & Challenges to the Rule of Law" (2023) provides:

gives a critique gravitas - the Rule of Law is a powerful slogan - it lies at a level well above the pragmatism that is said to characterise an Anglo-Saxon approach to large philosophical, political and economic issues.

However that may be, we are not, for the most part, as disturbed about these problems as was the Royal Commission in 1955. Should we be? Discuss.

2.9 Retrospective tax legislation

There is general agreement that the Rule of Law includes a prohibition of retrospective legislation.

Although a sub-topic of the Rule of Law, the topic deserves a separate discussion. A full discussion requires a book to itself.[142]

2.9.1 *Meaning of retrospective*

It seems to me that retrospectivity is best considered as a matter of degree, not a matter of yes/no, either/or. Legislation not retrospective in form may be retrospective in effect, if it operates by reference to arrangements carried out in the past, and/or lacks fair and appropriate transitional provisions. In assessing whether (or, better, the extent to which) a provision is retrospective, one should have regard to the object of the prohibition on retrospective legislation, which is that a person should be reasonably able to plan their affairs on the basis of what the law says. In this sense, legislation backdated to the date of an announcement of a proposed change in the law is not retrospective, or at least not objectionably so.

On this analysis, to determine whether a provision is retrospective is an evaluative exercise. So those defending legislation can and generally do

> "... the UK's reputation for upholding the rule of law is under grave threat. In practice we see a palpable reduction in access to justice; inadequate progress in tackling inequalities; a disregard for judicial oversight and independence, including verbal attacks on the profession; and an overall deterioration of the quality of our law-making."

Five distinct matters are mentioned here, and the reader may agree that each is a cause of concern. But does it help to consider them as one item under the rubric of the Rule of Law? They have nothing much in common.

[142] For an illuminating discussion of the policy issues in a US context, see Shaviro, *When Rules Change* (1st ed, 2000). UK taxpayers may on this point look with envy to the USA, where a norm opposing retrospective legislation is "strongly rooted in popular sentiment, legislative practice, and perhaps even the Constitution as the courts are likely to interpret it" (p.104).

contend, with varying degrees of plausibility, that the relevant provision is not retrospective.[143]

The issue does not usually arise in a justiciable context. We are in the realm of politics, not law.

2.9.2 *Retrospective legislation: Extent*

It is perhaps only a slight exaggeration to say that retrospective tax legislation has become a matter of routine, having been applied in particular to a somewhat arbitrary selection of tax avoidance schemes. Examples include:

Topic	**Date**	**See para**
Retrospective reversal of avoidance schemes:		
DT relief for partnership	1987	85.25
s.23 FA 2012 (loan relationships)	2012	*Not discussed*
Provisions retrospective in effect:		
Pre-owned assets	2004	83.39.2
IHT: former Accumulation & Maintenance trusts	2006	*Not discussed*
Aspects of the ITA remittance rules	2008	1.9.3
Disallowance of debts for IHT	2013	80.36.2

Generally, I think the norm requiring commencement rules to avoid retrospective effect has weakened since about 2000, perhaps in line with changed attitudes to tax avoidance.

2.9.3 *Retrospective legislation: Protocol*

In Budget 2011, the coalition Government published a statement on retrospective legislation, grandly entitled a "Protocol" with a capital P. The most important part provides:

> The Government has made clear its aim to strike the right balance between
> [1] restoring the UK tax system's reputation for predictability, stability and simplicity (!) and
> [2] preserving its ability to protect the Exchequer by making changes where necessary.
> In particular, changes to tax legislation where the change takes effect

[143] See for instance HM Treasury, "Section 95 of the Finance Act 2019: report on time limits and the charge on disguised remuneration loans" (March 2019) *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/789160/DR_loan_charge_review_web.pdf*

> from a date earlier than the date of announcement will be wholly exceptional.[144]

The attempt to formulate the principles behind a decision to enact retrospective legislation is to be applauded. But the sanction (if any) for ignoring the protocol is political only.

The 2011 statement does not purport to bind future governments. The Cameron administration (2015 - 2016) did not resile from it, but the extent to which the current or subsequent administrations will follow it remains to be seen. The protocol has perhaps shifted political debate from whether or not legislation is justified to debate on whether or not legislation is retrospective, but it is doubtful whether it has had much if any effect on the outcome.

2.9.4 *Retrospective legislation*: *Validity*

The Rule of Law is not justiciable as such and so neither is the restriction on retrospective legislation. Human Rights challenges have not been successful.[145] The protocol has not changed this. That is self-evident, but if authority is needed:

> The Protocol was an extra-statutory announcement or promise made by the government. As such, it operated: in the realm of politics, not of the courts, and the question whether the government should be held to such a promise is a political rather than a legal matter... The sovereignty of Parliament cannot be confined by extra-statutory promises like the Protocol.[146]

I think this is as it should be: the content of legislation is in principle a matter for parliament and not for the courts.

2.9.5 *Retrospective legislation*: *Politics*

Various reasons have been given to justify retrospective legislation.

One is that it concerns an avoidance scheme which will fail (or so the Government believe). If that is true, the legislation is unnecessary; if not (and it is generally debatable) it is not a good reason.

[144] *http://webarchive.nationalarchives.gov.uk/20130129110402/http://cdn.hm-treasury.gov.uk/2011budget_taxavoidance.pdf*

[145] See *Huitson (R, oao) v HMRC* [2011] STC 1860; *APVCO 19 Ltd (R, oao) v HM Treasury* [2015] EWCA Civ 648; *Zeeman v HMRC* [2020] EWHC 794 (Admin).

[146] *APVCO 19 Ltd (R, oao) v HM Treasury* [2015] EWCA Civ 648 at [58].

Another is that it concerns an abusive avoidance scheme (however that flexible term may be understood). Whether that justifies retrospective legislation is ultimately a political question on which views differ depending on how much one values the Rule of Law. It is arbitrary and unfair in that a few particular schemes are retrospectively stopped and others – no less elaborate, artificial and abusive – are not. Pragmatists (to whom the Rule of Law is of little interest) should bear in mind that retrospective legislation increases the "legal risk", a measure under which the UK falls low on international surveys, and the lowering of the UK's reputation in that regard has a significant albeit intangible cost. I suspect major factors in picking on some arrangements may include salience, politics, and the amount of money involved.

2.9.6 *Retrospective relieving legislation*

Retrospective legislation has also become common to provide relief for unintended charges under(what the need for retrospective legislation shows to be) ill thought out legislation. The policy issues are different here. So far as retrospective legislation favours the taxpayer, most would regard it as unobjectionable on Rule of Law grounds; even to the Rule of Law purist, it is less objectionable than the alternative of extra-statutory concession. But the need for it on a regular basis should cause concern about the quality of the tax legislation process.

2.9.7 *Retrospective legislation*: *Future*

How often will retrospective legislation be used in the future? What advice can anyone give to taxpayers seeking to know their position? Prior to the enactment of the GAAR, I said:

> Much depends on the politics of the day, but I guess that retrospective legislation will continue to be a rare response; a popular scheme carried out by many taxpayers and involving larger sums is certainly more at risk than others.[147]

The compatibility of the GAAR with the Rule of Law is open to debate, on the grounds of vagueness in particular. But one positive consequence may be (and should be) at least to restrict the practice of retrospective anti-avoidance legislation; wholly retrospective legislation should less often be necessary. But effectively retrospective legislation, in the form of unfair

[147] Kessler, *Taxation of Non-Residents and Foreign Domiciliaries* (7th ed., 2008), Vol.1

commencement rules, will no doubt continue.

2.10 Naming and shaming

"Naming and shaming": The alliteration is irresistible, and for some reason sounds more reputable than just "shaming", which is what this topic is about.

The expression covers a variety of arrangements. I distinguish between statutory shaming, discussed elsewhere,[148] and media shaming, discussed here.

The OUCBT paper provides:

> ... searching for individual or corporate villains will not assist in remedying the underlying problems...
> Even if public naming and shaming influences a few taxpayers in the public eye to impose their own voluntary constraints, it will not necessarily affect the worst avoiders, and may even encourage some non-compliance from those who feel that "everyone is at it". Only understanding the flaws in the tax system and working on serious changes can give long-term results....
> Even if that were to have an effect on one taxpayer it would not tackle the underlying issues.

No-one has taken any notice of that!

Media shaming is at present common for various purposes (more than one may be present at the same time):

(1) In marketing: To sell newspapers with exposures of celebrities who have been involved in tax avoidance schemes.[149]

(2) In politics: To knock the opposition by alleging that politicians, or other party supporters, are guilty of tax avoidance. In this respect, anything goes and some stories have been farcical. For instance, Peter Mandelson was berated for taking a loan from a UK company[150] and Ed Miliband was accused of avoiding tax by means of a deed of variation.[151] The allegations are so off-target as to cast doubt the good

[148] See 126.53 (Public list of defaulters).

[149] Typically film schemes, as the names of members of the LLPs concerned are in the public domain.

[150] *http://www.theguardian.com/politics/2015/jan/27/peter-mandelson-400000-pound-tax-free-loan* The Guardian later amended its website to concede that the loan had been wrongly described as tax-free.

[151] Leading to a gibe in the Spring 2015 budget announcing a policy review of deeds of variation. The Guardian rightly asked: what came first – the policy or the joke?

faith of those who make them and newspapers which uncritically promote them.

(3) As a scandalisation technique, to promote the view that avoidance is immoral; often combined with juxtaposition of avoidance and evasion and the suggestion that there is little or no difference.

When these allegations are made it is impossible to defend oneself.

So public debate is not uninformed but misinformed. It is a yeasty mingling of dimly understood facts with vague but deep impressions, and images, half real, half fantastic. It has more than its fair share of misunderstanding and jejune polemics.

In these circumstances, media shaming may easily lead away from the Rule of Law. In 2012, Starbucks paid £20m to HMRC following a threat to occupy its cafes.[152] If one calls that payment "taxation" at all, it was certainly not taxation imposed by law. A hostile commentator would call this taxation by mob rule. Google and Amazon, who do not have public premises vulnerable to the same threat, have not had to pay similar sums. Perhaps the point was understood, as the campaign was not repeated.

The reader may agree with the journalist Rachel Cooke:

> I'm not saying that shame doesn't have its place ... We should want others to think well of us. But ... it can be a terrifyingly blunt instrument, a cudgel not a scalpel. Wield it too enthusiastically, and the collateral damage is likely to be both grave and enduring.

2.11 EU tax haven blacklist

2.11.1 *"Non-cooperative jurisdictions"*

EU publish a list of "non-cooperative jurisdictions for tax purposes". The current list is set out in Annex 1 of 2020/C 64/03. This provides a list of 12 tax havens, and the reasons they are on the list:

1. American Samoa
American Samoa does not apply any automatic exchange of financial information, has not signed and ratified, including through the jurisdiction they are dependent on, the OECD Multilateral Convention on Mutual Administrative Assistance as amended, did not commit to apply the BEPS minimum standards and did not commit to addressing these issues.

2. Cayman Islands
Cayman Islands does not have appropriate measures in place relating to economic

[152] Ironically, the post-tax cost of the payment would have been diminished as it should in principle be deductible in computing taxable profits.

substance in the area of collective investment vehicles.

3. Fiji

Fiji is not a member of the Global Forum on transparency and exchange of information for tax purposes (‘Global Forum’), has not signed and ratified the OECD Multilateral Convention on Mutual Administrative Assistance as amended, has harmful preferential tax regimes, has not become a member of the Inclusive Framework on BEPS or implemented OECD anti-BEPS minimum standard, and has not resolved these issues yet.

4. Guam

Guam does not apply any automatic exchange of financial information, has not signed and ratified, including through the jurisdiction they are dependent on, the OECD Multilateral Convention on Mutual Administrative Assistance as amended, did not commit to apply the BEPS minimum standards and did not commit to addressing these issues.

5. Oman

Oman does not apply any automatic exchange of financial information, has not signed and ratified the OECD Multilateral Convention on Mutual Administrative Assistance as amended, and has not resolved these issues yet.

6. Palau

Palau does not apply any automatic exchange of financial information, has not signed and ratified the OECD Multilateral Convention on Mutual Administrative Assistance as amended, and has not resolved these issues yet.

7. Panama

Panama does not have a rating of at least ‘Largely Compliant’ by the Global Forum on Transparency and Exchange of Information for Tax Purposes for Exchange of Information on Request and has not resolved this issue yet.

8. Samoa

Samoa has a harmful preferential tax regime and has not committed to addressing this issue.

Furthermore, Samoa committed to comply with criterion 3.1 by the end of 2018 but has not resolved this issue yet.

9. Seychelles

Seychelles has harmful preferential tax regimes and has not resolved these issues yet.

10. Trinidad and Tobago

Trinidad and Tobago does not apply any automatic exchange of financial information, has a ‘Non-Compliant’ rating by the Global Forum on Transparency and Exchange of Information for Tax Purposes for Exchange of Information on Request, has not signed and ratified the OECD Multilateral Convention on Mutual Administrative Assistance as amended, has harmful preferential tax regimes, and has not resolved these issues yet.

11. US Virgin Islands

US Virgin Islands does not apply any automatic exchange of financial information, has not signed and ratified, including through the jurisdiction they are dependent on, the OECD Multilateral Convention on Mutual Administrative Assistance as amended, has harmful preferential tax regimes, did not commit to apply the BEPS minimum standards and did not commit to addressing these issues.

12. Vanuatu

Vanuatu does not have a rating of at least ‘Largely Compliant’ by the Global Forum on Transparency and Exchange of Information for Tax Purposes for Exchange of

> Information on Request, facilitates offshore structures and arrangements aimed at attracting profits without real economic substance and has not resolved these issues yet.

The 2020 list is limited in number; from a UK perspective the only significant entry is Cayman, and I doubt if it will stay there very long. The immediate significance of being on this list is relatively small,[153] but it seems to have had some success in encouraging change.

Scotland will not make a coronavirus-related grant to a company with a parent/subsidiary in these jurisdictions.[154] Clearly, there will not be many, if any, grants refused as a result of that particular provision, though it may form part of a more general trend.

How will this approach of ostracism/penalisation of tax havens develop in the future? This is a question of international politics, not law.

2.12 Avoidance: Multinationals

Much attention has been given to multinational companies. The Public Accounts Committee looked at Starbucks, Amazon and Google. The verdict was guilty.[155]

It is not possible to comment sensibly on the taxation of a multi-national group without knowing the relevant facts, which are not usually in the public domain. The claim that these companies have avoided UK corporation tax is often based on the size of their UK sales or UK staff, set against the corporation tax actually paid. But all well-informed commentators know that corporation tax is not a tax on sales, or the size of an establishment, and large sales/staff does not mean large profits. The OUCBT paper provides:

> Starbucks and Facebook ... have been criticized for not paying tax where they are making sales, but sales are not the basis for the corporation tax,

[153] See Thornton, "The Cayman Islands and the EU 'blacklist' Tax Journal, 6 Mar 2020.

[154] Para 16 sch 4 Coronavirus (Scotland) (No.2) Act 2020.

[155] Or was it? "We were not convinced that their actions, in using the letter of tax laws both nationally and internationally to immorally minimise their tax obligations, are defensible." Public Accounts Committee 19th report 2012, para 12. If the convoluted wording was intended to reflect a note of caution, it was lost in the public debate. But perhaps the obfuscation is just the dialect of politics.
The PAC returned to this theme in Ninth Report of Session 2013–14 "Tax Avoidance–Google". A PAC hearing is not, perhaps, well suited to ascertaining the facts; it is not possible to ascertain from this whether the complaint of the PAC is that Google have been conducting successful or unsuccessful tax avoidance.

> so this alone is no cause for criticism of the companies concerned. We could argue that the tax base should change, but unless and until that occurs, the fact that there is a high turnover but no taxable profit is not in itself an indicator that the taxpayer is behaving in an unreasonable way.

Likewise the fact that relatively little CT is paid proves nothing. The OUCBT paper provides:

> The fact that there is little or no tax payable is not, however, conclusive evidence that there is effective or ineffective avoidance. In some of these cases, these companies are simply operating in accordance with incentives created by the international tax system and by domestic governments trying to attract economic activity into their jurisdictions. This the governments may do for non-tax reasons, or because this activity gives rise to forms of taxes other than those which are not being collected. ...

The IFS say:

> A low corporate tax bill is not in itself therefore evidence of tax avoidance. Even if income appears high, there may be genuinely low UK taxable profits if a firm has relatively high current expenditures or can offset the effects of large investment expenditures or losses. The UK tax bill can also be appropriately relatively low compared with declared income if that income is the result of genuinely non-UK activities.

HMRC make the same point:

> Globalisation means that multinationals have the opportunity to structure their business to take advantage of beneficial tax rules in different countries. Provided that this results in profits being taxed in line with where genuine economic activity is carried on, this does not amount to tax avoidance. ... In broad terms, companies are required to pay corporation tax in the country where they carry on the economic activity that generates their profits, not where their customers are located.[156]

Unusually, the facts are known in relation to Apple as a result of US congressional hearings (I suspect, better conducted than the UK equivalent). These have been well analysed by Antony Ting.[157] In short,

[156] HMRC, "Taxing the profits of multinational businesses" Issue Briefing (2012) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/89030/profits-multinationals.pdf*

[157] Ting, "iTax—Apple's International Tax Structure and the Double Non-Taxation Issue" [2014] BTR 40. See 91.1 (Hybrid entities).

there is no reason to think that Apple have avoided *UK* tax. The group has avoided Irish/US tax by Irish/US hybrid entities; and, perhaps, it has reduced Irish tax by informal transfer pricing agreements with the Irish Revenue.

2.12.1 *Transfer pricing*

It is often said that multinationals engage in avoidance through transfer pricing. For instance, Christian Aid say:

> There is debate about the extent to which companies engage in trade mispricing (artificially suppressing the income they earn from activities such as resource extraction, to reduce payments to government), but few would doubt that it has a significant impact on the incomes of governments in the global South.[158]

Transfer pricing is not strictly avoidance. It is in principle in the category of ineffective avoidance:

> We may well question whether the transfer pricing rules are adequate, ... but these are considerations relating to tax policy reform and not to tax avoidance.

The fundamental problem is not terminology, but that the facts needed to assess these claims are not in the public domain. Robert Maas says:

> The Public Accounts Committee believes that Starbucks overpays for its coffee. I am not an expert on the economics of coffee, but I am a bit puzzled that the PAC members consider themselves sufficiently knowledgeable in this area to be able to pass judgment (sorry, to express scepticism).
>
> The committee thinks that a 16.67% margin to a company that sources and buys coffee throughout the world, exercises quality control and works with local farmers, is excessive. Personally, I do not but then I don't have any expertise in coffee.
>
> The PAC also believes that the rate of interest on the inter-company loan from the US company (4.9%) is excessive, "at a higher rate than any similar loan we have seen". I do not know what similar loans the committee has seen, ie a loan to a loss-making business with little asset backing. I must say it looks modest to me...[159]

[158] Christian Aid, "Tax for the common good (2014)

[159] Maas, Taxation Magazine, 27 February 2013.

If transfer pricing is conducted with the consent of the tax authority concerned, it is not avoidance, though it may be unfair tax competition. The EC are currently pursuing state aid rules; it will be interesting to see what results.

2.12.2 *GAAR*

The GAAR guidance provides:

> Many of the established rules of international taxation are set out in double taxation treaties. These cover, for example,
> [1] the attribution of profits to branches or between group companies of multi-national enterprises, and
> [2] the allocation of taxing rights to the different states where such enterprises operate.
> The fact that arrangements benefit from these rules does not mean that the arrangements amount to abuse, and so the GAAR cannot be applied to them. Accordingly, many cases of the sort which generated a great deal of media and parliamentary debate in the months leading up to the enactment of the GAAR cannot be dealt with by the GAAR.[160]

In my terminology, these issues are non-avoidance, and in some cases, tax avoidance, but not tax abuse.

But where there is abuse, one country's domestic GAAR cannot resolve the issue. Apple's planning, for instance, turned on a hybrid entity:

(1) transparent under Irish tax law, and so not paying tax on its profits in Ireland;
(2) opaque in US tax law, and so not paying tax on its profits in the US.

CIOT say:

> As in much of the BEPS project, this is not a case of tax avoidance as previously understood; there can be no avoidance where there is no intent to tax in the first place.[161]

[160] HMRC, "GAAR Guidance" (2017) para B5.2
https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules
The House of Lords Select Committee made the same point

[161] CIOT, "BEPS Action 2: Neutralise the effects of hybrid mismatch arrangements (Recommendations for domestic laws) Response by CIOT (May 2014)
https://www.oecd.org/ctp/aggressive/comments-action-2-hybrid-mismatch-arrangements.pdf

If avoidance is action contrary to the intention of a Parliament, then this kind of planning may properly be described as tax avoidance if it is the case that:

(1) The intention of Oireachtas is that the entity's income should be taxed in the US, and
(2) The intention of US Congress is that the entity's income should be taxed in Ireland.

One might refer to it as international tax avoidance (though there is of course no such tax as "international tax"). The tax advantage is not contrary to the tax policy of either country in isolation; it is the result of a gap between the two.[162] In this case, the gap may in fact be intentional, in that both Ireland and the US deliberately chose to facilitate the planning;[163] in which case the planning should not be called avoidance at all.

Whatever the terminology, CIOT are right to say that the tools to deal with multinational planning/avoidance will not be the same as those used for domestic tax avoidance. It is an international problem which only international consensus can resolve. Hence the OECD BEPS project and Pillar 1 & 2.

We should never lose sight of the fact that public debates about tax avoidance are simultaneously fiscal, moral and political debates, raising issues of equality, redistribution, class, and tax competition; and sensitive ears may also detect elements of xenophobia.

[162] See de Boer & Nouwen (eds) *The EU's struggle with Mismatches and Aggressive Tax Planning* (2013), para 3.5.2 (General anti-abuse rule).

[163] Ting, "Old wine in a new bottle: Ireland's revised definition of corporate residence and the war on BEPS" [2014] BTR 237.

CHAPTER THREE

TARGETED ANTI-AVOIDANCE RULES (TAARs)

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3.1 TAAR/unallowable purpose test

This chapter discusses TAARs and the GAAR:

Abbreviation	Meaning	See
TAAR	**T**argeted **A**nti-**A**voidance **R**ule	*Discussed here*
GAAR	**G**eneral **A**nti-**A**buse **R**ule	3.26

I discuss TAARs in detail, but the GAAR only in outline.

3.1.1 *TAAR terminology*

I use the word "TAAR" to describe unallowable purpose tests in specific tax codes (as opposed to the GAAR, which is an unallowable purpose test which applies throughout taxation).

As far as I know, the term "TAAR" was first used in an HMRC press release of 5 December 2005, and the term "unallowable purpose" was first used in 1996, in the context of loan relationships.[1]

Before then the term used was motive (or purpose) test.[2] That label remains in use for the ToA motive defence, which is, I think, the oldest TAAR in current legislation.

"TAAR" has become a technical term, detached from its literal meaning. So IFS can say without obvious irony that:

> TAARs need to be well targeted ... costs can outweigh... lost revenues when a poorly targeted TAAR is compared with a well-targeted

[1] See 3.19.6 (Loan relationship TAAR guidance).

[2] A note on terminology. The word "motive" is not used in tax legislation, and is perhaps not ideal because a distinction is sometimes drawn between purpose and motive. However the label is convenient, reasonably accurate, and is standard in modern case law, at least in relation to ToA; see eg *HMRC v Fisher* [2021] EWCA Civ 1438. It originates from the Inland Revenue's Notes on clause 18 Finance Bill 1936 *https://www.kessler.co.uk/wp-content/uploads/2014/07/1365_001.pdf*

TAAR.[3]

"TAAR" is a tendentious, approbative term; who could object to *targeted* anti-avoidance? Parliamentary Counsel do not use it in statutory drafting. "Unallowable purpose test" is transparent but clumsy. I have very occasionally seen "specific anti-avoidance rule" (SAAR) but that does not seem better and has not caught on. Principal Purpose Test (PPT) would be an accurate label, but that term is used specifically in relation to DTAs. So *faute de mieux,* I use "TAAR" in its technical sense in this work.

3.2 Types of TAAR

3.2.1 *Types of unallowable purpose*

One can distinguish types of TAAR, depending on the nature of the unallowable purpose, and I coin the following terminology:

Unallowable purpose	**Type of TAAR**	**Example**
Tax avoidance (in strict sense)	Avoidance-purpose TAAR	ToA
Obtaining a tax advantage	Tax-advantage TAAR	TiS
Avoiding application/effect of rule	Arrangement-disregard TAAR	IHT resid prop

A tax-advantage TAAR is wider than an avoidance-purpose TAAR, as "tax advantage" includes cases where there is no element of tax avoidance. An arrangement-disregard TAAR may be wider still. The Joint Committee on Statutory Instruments said this wording is too wide and vague.[4] But no-one took any notice of that. It continues to be a common form for new TAARs.

3.2.2 *Matters tested*

One can distinguish types of TAAR, depending on what it is whose purpose is tested:

Matter tested	**Example**
Arrangement	*Most common form*
Transaction	TiS TAAR
Transfer/associated operation	ToA Motive Defence

[3] The same report refers later to a "wide-ranging TAAR". IFS, "Countering Tax Avoidance in the UK" TLRC discussion paper 7 (2009), para 8.18 *https://ifs.org.uk/sites/default/files/output_url_files/dp7.pdf*

[4] See 2.8.2 (Rule of Law v. other values).

3.2.3 *Consequences of TAAR*

One can distinguish types of TAAR, depending on the nature of the unallowable purpose:

(1) Restricting anti-avoidance rules (a defence, or "escape clause")
(2) Restricting a tax relief
(3) Protecting (or one might say, extending) a code of rules by providing that arrangements intended to avoid the code are disregarded

So a TAAR may be a shield or a sword. I coin the following terminology:

Consequence of TAAR	**My term**	**Example**
Defence/escape clause	TAAR defence	TIS;ToA motive defence
Disapply specific relief	Relief-restriction TAAR	CGT reorganisations
Disregard arrangements	Arrangement-disregard TAAR	Sch A1 IHTA

Some anti-avoidance rules confer a discretion on HMRC to counteract the avoidance; I call that a **"counteraction discretion"**. TiS is an example.

The same code may include more than one TAAR.

3.2.4 *List of TAARs*

The number of TAARs is very large.[5]

Here is a table of TAARs discussed in this book identifying:

(1) Type of unallowable purpose
(2) The arrangement or transaction whose purpose is tested
(3) The consequences of the TAAR

Topic	**Purpose**	**Test**	**Consequence**	**Para**	**Date**
ToA					
Motive defence	Tax avoidance	Transfer/assoc ops	Defence to ToA	52.1	1936
Company transferor	Tax avoidance	Arrangements	Defence to ToA	49.6	2024
Company transferor	Application	Arrangements	Disregard arrangement	49.6	2024
TiS (CT)	Tax advantage	Transactions	Counteraction	55.11	1960
CGT reorganisation	Tax avoidance	Arrangements	Disapply relief	58.6	1977
Loan relationships	Tax advantage	Transaction	Counteraction	3.19.8	1996
SDLT group relief	Tax avoidance	Transaction	Disapply relief	52.29.3	2005
Capital loss	Tax advantage	Arrangements	Disapply relief	65.21	2007
Mixed funds	Tax advantage	Arrangements	Just & reasonable	20.11	2008
TiS (IT)	Tax advantage	Transactions	Counteraction	55.11	2010

[5] Unallowable Purpose Draft Guidance p.7 gave the number as "over 200" in 2009. The number increases with every Finance Act.

s.3 TCGA	Tax avoidance	Arrangements	Defence to charge	64.16	2012
Remittance investment relief	Avoidance	Arrangements	Disapply relief	19.7	2012
Sales relief	Tax avoidance	Arrangement	Disapply relief	19.37.6	2012
GAAR	Tax advantage	Arrangements	Counteraction	3.26	2013
IHTdebt deduction	Tax advantage	Discharge of debt	Disallow debt	80.38	2013
Salaried LLP member	Application	Arrangements	Disregard arrangement	-	2014
Disguised trading	Application	Arrangements	Disregard arrangement	-	2014
DIMF/carried interest	Application	Arrangements	Disregard arrangement	73.26	2015
CRS	Application	Arrangements	Disregard arrangement	130.35	2015
Country reporting	Application	Arrangements	Disregard arrangement	2.8.2	2016
Land-dealing	Tax advantage	Arrangement	Counteraction	22.4	2016
Transactions in land	Tax advantage	Arrangement	Counteraction	22.16	2016
Royalty deemed source	Effect	Arrangements	Disregard arrangement	32.8.6	2016
Royalty withholding tax	Effect	Arrangements	Disregard arrangement	32.11.2	2016
Winding up	Tax advantage	Winding-up	Defence to charge	30.14.4	2016
Hybrids	Tax avoidance	Arrangements	Counteraction	91.23	2016
Residence-property	Effect	Arrangements	Disregard arrangement	82.17	2017
Profit fragmentation	Tax advantage	Arrangements	Defence to charge	53.16	2019
Land-rich company	Tax advantage	Arrangements	Counteraction	57.13.1	2019
Offshore IP receipts	Tax advantage	Arrangements	Counteraction	32.35	2020

TAARs occasionally include:

Topic	**See para**
Commerciality test	App. 5.2
“Reasonable to assume/ conclude” wording	App. 2.24
Clearance procedure	

Here is a list of such TAARs discussed in this work:

Topic	**Commercial**	**Reasonable to assume**	**Clearance procedure**	**Para**	**Date**
ToA	Y	Y		52.1	1936/2005
TiS (IT)			Y	55.11	1960
TiS (CT)	Y		Y	55.11	1960
CGT reorganisations	Y		Y	58.6	1977
Loan relationships		Y		3.19.8	1996
SDLT group relief	Y			52.29.3	2005
GAAR		Y		3.26	2013
IHT deduction of debt	Y			80.38	2013
Winding up		Y		30.14.4	2016
Profit fragmentation		Y		53.16	2019

3.3 Disentangling issues

Discussion of a TAAR should logically be split into a number of distinct issues:

(1) Identify the arrangements/transactions whose purpose is to be found
(2) In the case of a tax advantage/avoidance TAAR:
   (a) Is there a tax advantage/avoidance (with a sub-issue, the meaning of tax advantage/avoidance)
   (b) Is there a purpose to obtain that tax advantage/avoidance (with sub-issues, the meaning of purpose and how to ascertain purpose)
   (c) Is that a "main" purpose (with a sub-issue, the meaning of "main")

If the conditions of an arrangement-disregard TAAR are met, its application raises a further issue: what does one regard and what does one disregard? There is no case law on this yet.[6]

A counteraction discretion raises the question of what should be the counteraction.

The topics of this chapter are therefore:

- The meanings or concepts of purpose/main purpose
- The meanings or concepts of tax advantage and tax avoidance

But in practice discussion easily segues from one to the other.

3.3.1 *Guidance and case law*

In 2009 HMRC issued a discussion document, "Simplifying Unallowable Purpose Tests"[7] which included 60 pages of guidance (**"Unallowable Purpose Draft Guidance"**). Nothing further came of the proposal, but the guidance is discussed here where relevant.

Cases (and guidance) on one TAAR can shed light on others, though of course one must allow for differences of context and wording. It is impossible to discuss (say) the ToA motive defence without regard to non-ToA cases, and wrong to try:

(1) So far as the issue is "purpose", cases on any TAAR may be helpful.
(2) So far as the issue is "tax avoidance", cases on avoidance-purpose TAARs may be helpful.

As TAARs range across the whole of taxation there is a vast amount of material potentially in point. As in any large body of case law, it is

[6] For one set of examples, see 82.17 (Sch A1 TAAR).

[7] *http://webarchive.nationalarchives.gov.uk/20091102172916/http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_029748*

possible to find cases or dicta supporting inconsistent views or approaches. It may be possible to reconcile some inconsistent cases by saying that it is only a question of fact, or that different TAARs have different principles, even if similarly worded. But where inconsistency exists it would be better to grasp the nettle and prefer one line of authority to the other.

3.4 View arrangement as a whole

3.4.1 *Test whole arrangement*

Most TAARs depend on the purpose of an arrangement. In ascertaining the purpose of an arrangement one looks at the whole arrangement. I would have thought that was self-evident, but the point is now confirmed in *Delinian v HMRC*:[8]

> it is necessary to consider whether the entire exchange of shares in question ... forms part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax or corporation tax. In making that ... inquiry, the scheme or arrangements that must be considered are **the whole** of the scheme or arrangements undertaken by the taxpayer in question, not a selected part or selected parts of them.

Delinian was a case on the CGT reorganisation TAAR.[9] The arrangement was as simple as can be: the shareholders exchanged their shares for:
(1) shares worth $85m, and
(2) Redeemable shares worth $21m

Redeemable shares were used (rather than $21m cash, as originally proposed) and with the intention of qualifying for SSE, and this was held to be a tax avoidance purpose.[10] But the redeemable shares were a small part (20%) of the total consideration. Looking at the matter as a whole, avoidance was a minor purpose, not a main purpose, of the arrangement; even though it was a main purpose (or perhaps the only purpose) of one element of the arrangement.

[8] [2023] EWCA Civ 1281 at [8] (emphasis original). This case was reported under the name *Euromoney* in the FTT and UT, because Euromoney changed its name to Delinian in 2023, following a takeover.

[9] See 58.6 (CGT reorganisation TAAR).

[10] See 3.20.3 (How evident is “evident”).

3.4.2 *Test transaction in wider context*

The TiS TAAR depends on the purpose of "the transaction in securities, or any of the transactions in securities".[11] This is different from standard TAAR wording which depends on the purpose of the "arrangement". Here the wording might seem to suggest that one looks for the purpose of the transaction(s) individually and in isolation; but *IRC v Brebner*[12] stated that one tests the purpose of those transaction(s) in the context of the whole arrangement:

> Admittedly, an object of the carrying out of the broad scheme by way of the resolutions was a tax advantage. But that which had to be ascertained was the object (not the effect) of each interrelated transaction in its actual context, and not the isolated object of each part regardless of the others.

3.4.3 *Identifying the arrangement*

This raises the question of identifying:
- the whole arrangement (where an arrangement is to be tested); or
- the wider context (where a transaction in securities is to be tested)

Identifying the arrangement is a question of fact for the FTT.[13] Identifying the wider context (for TiS) is similarly a question of fact.

In *Brebner,* the transactions consisted of two steps:

Step 1: A group of shareholders purchased (nearly) all the shares of a company, and borrowed on a short term loan in order to pay.

Step 2: In order to provide tax free funds for the shareholders to repay the loan:

(a) The company issued shares to its shareholders.

(b) The company immediately reduced its share capital (ie cancelled the shares which had just been issued) and made a payment to shareholders. This payment was at that time not subject to IT as a distribution.[14]

[11] See 55.11 (TiS TAARs).

[12] 43 TC 705 at p.715.

[13] *HMRC v Euromoney* [2022] UKUT 205 (TCC) at [49] and [54].

[14] See 30.9.10 (Issue of debenture/loan stock). But today the payment would constitute a distribution subject to IT, so HMRC would not need to rely on TiS; see 30.6.4 (Para C/D: Issue of securities). (Also the issue and immediate cancellation of shares would fall within the *Ramsay* principle).

There was at the time no CGT but disposal of the shares just purchased would not

HMRC argued that the focus should be on Step 2 alone; Step 1 was "purely introductory". The Special Commissioners regarded the two Steps together as the arrangement, despite the 2 year gap. That is not surprising: indeed it now seems almost self-evident.[15]

So although the transactions in securities which gave the tax advantage were at Step 2, the purpose was decided by looking at the whole arrangement, which included both Steps:

> The first chapter [Step 1] dealt with the transaction down to the acceptance of the group's offer [to purchase shares] ... when it was recognised, though no plans were made, that to implement that offer the group must rely upon, and extract, the cash lying in the company's coffers. ...
>
> It was then said that a second chapter opened and that the group then arranged that the available money for the payment of this project should be obtained from the coffers of the company as capital. Thus ... nearly two years later, the main object of the operation in this chapter was to enable a tax advantage to be obtained because, although it would have been possible to extract the cash from the company by a dividend ... the whole object of the reduction of capital was to extract the cash without paying tax; that, it was strongly urged, showed it to be a main object.
>
> So, the argument proceeds, while the first chapter was carried out for purely bona fide commercial reasons without having as a main object the gain of a tax advantage, it must be regarded as purely introductory to the all important second chapter two years later, when the scheme was devised to extract the cash by a reduction rather than the declaration of a dividend, so that it became plain that one of the main objects of the

have realised a substantial gain. This consideration may have been part of the unarticulated background to the decision.

[15] See App 2.2.5 (Sufficient unity test). Though HL thought the point might have gone the other way:

> [The taxpayer] has, in my view, wisely conceded that the Special Commissioners could have found that there were two separate chapters, one of which [Step 1] was purely commercial, the other of which [Step 2] had as its main object the obtaining of a tax advantage.

Had the Special Commissioners looked at matters that way, the consequence would have been to focus on the purpose of the transactions in securities in the context of Step 2, without regard to the context of Step 1. HL said a main object of Step 2 was to obtain a tax advantage. It might have been argued that the main object of Step 2, even viewed in isolation, was to repay a debt, not to avoid IT; but clearly HL would not have agreed with that.

> transaction was to enable a tax advantage to be obtained...
> I agree the question whether one of the main objects is to obtain a tax advantage is ... essentially a task for the Special Commissioners.[16]

It is considered that the same approach is applied:
(1) in TiS cases, where the question is the purpose of the transaction; and
(2) in cases on standard TAAR wording, where the question is the purpose of the arrangement

3.5 Purpose words: Terminology

TAARs generally use the word "purpose".

"Purpose" is one of a cluster of words describing volition:

Term	**Examples where used**	**See para**
Purpose	TAARs	*Discussed here*
	Definition of settlor: provide property for purpose of settlement	
	Deductible expenses: wholly/exclusively for purpose of trade	
Object	CT TiS TAAR	55.11
	Sale of occupation income	s.773 ITA
Intention	Domicile: Intend to reside permanently	4.7; 4.12; 4.24.8
	Residence: Intend to leave when possible	6.17.5
	IHT: Intention to confer gratuitous benefit	74.13
With a view to		
	Carry on business with a view to profit	App 5.3
	With a view to enabling/facilitating:	
	- a disposition	74.11
	- an arrangement	26.26.1
Deliberate	Penalties	126.9.3
Designed to	ToA motive defence condition B	52.6.2
Words common in general use but not much used in tax:		
	Seek to	
	Motive	

In ordinary English, and in general legal usage, these words are often (I would say, generally) used synonymously and interchangeably.

HMRC agree. Unallowable Purpose Draft Guidance provides:

> Romer LJ in the *Bentleys Stokes* case[17] uses the words 'object', 'motive' and 'purpose' quite indiscriminately... there is no difference between

[16] 43 TC 705 at p.718.

[17] *Bentleys, Stokes and Lowless v Beeson* 33 TC 491, a wholly/exclusively case.

> purpose and object.[18]

Cases on any statutory provisions using the word “purpose” may elucidate the meaning of “purpose” in a TAAR. For example, regard may be had to cases on the meaning of wholly and exclusively “for the purposes of a trade”[19] (“wholly/exclusively cases”) even though the context might seem rather different. Cases on (what is now) the (CT) TiS TAAR are relevant, though the word used there is “object” not “purpose”,[20] because object/purpose here have the same meaning.[21]

Lord Simon deplored what he called “chaotic terminology”:

> Will, volition, motive, purpose, object, view, intention, intent, specific intent or intention, wish, desire; ... such terms, which do indeed overlap in certain contexts, seem frequently to be used interchangeably, without definition ...[22]

It seems to me that this terminological richness should not cause much difficulty - indeed in practice we have no choice but to cope with it - provided one remembers that:

(1) Purpose/intention/object are generally used with the same meaning.

(2) They are occasionally used with specific and distinct meanings[23] but those senses should not be regarded as generally applicable.

In discussing any particular provision, it is best to follow the terminology

[18] Para 10040. In DTAs and other treaties, the doublet “object and purpose” is so standard that one rarely sees one word without the other. This reflects the wording of the Vienna Convention and the OECD Model; see 107.10 (DTA interpretation principles); 108.8.1 (OECD Model/BEPS PPT).

[19] This is the test of deductible expenses: s.34 ITTOIA.

[20] See 55.11 (TiS TAARs). “Object” is unusual, and it survives for historical reasons: had the provision been drafted today the word used would have been purpose. When the IT TiS code was rewritten, the word “purpose” replaced “object”.

[21] See *Wroe v HMRC* [2022] UKFTT 143 (TC) footnote at [112]:

> “The statutory wording under consideration in *Brebner* involved an earlier version of the TiS legislation which used the words "main object" rather than "main purpose". Neither party in this appeal, correctly in my view, sought to draw any distinction between the slightly different wording.”

And note how the Unallowable Purpose Draft Guidance set out below cites cases where the statutory word is “object” and cases where the statutory word is “purpose”.

[22] *DPP v Lynch* [1975] AC 653 at p.688.

[23] See 3.11.2 (Terminology of distinction).

used in the statute; though if that is not done, it is not likely to matter.[24]

The word "motive" may be used with the same meaning as purpose, as it is in the label "motive test". It may alternatively have a different nuance, but there is no need to pursue that here because "motive" is not used in statutory drafting.

3.6 Whose purpose?

3.6.1 *Purpose of arrangement*

Standard TAAR wording refers to arrangements "of which the main purpose" is tax avoidance/obtaining a tax advantage.

"Purpose", if it means anything, is an attribute of a mind.[25] When one says that an inanimate but man-made object such as a tool has a purpose, one is *attributing* to the tool the purpose in the mind(s) of the maker or user of the tool. When one says that an arrangement has a purpose, one is attributing to the arrangement the purpose(s) of purpose(s) the person(s) who make, or enter into the arrangement, ie, the parties to the arrangement. In short, the purpose of the arrangement is the purpose of those who make it.

HMRC agree. Unallowable Purpose Draft Guidance provides:

> **10200 Whose purpose?**
> A purpose test will define the person whose purpose is being considered. Some purpose tests refer to the purpose of a scheme or transaction: in this case, the purpose of the parties to the transaction needs to be considered.[26]

Where only one person enters into an arrangement, the purpose of the

[24] In *HFFX v HMRC* [2023] UKUK 73 (TCC) the FTT had used the word "intention" when the statutory provision used the word "object". The UT said at [128]:

> As regards the FTT's reference to "intention", while on the face of it that displays an error, when the paragraph is read ... with the surrounding context ... it is plain the FTT considered that tax reduction was not simply an intention but an object.

It would have been better to say that there was no error here: "intention" and "object" were used synonymously; but the end result is the same.

[25] This is self-evident, but if authority is needed, see *Chandler v DPP* [1964] AC 763 at p.804: "A purpose must exist in the mind. It cannot exist anywhere else."

[26] Similarly at p.14: "One particular difficulty with testing the purpose of arrangements rather than the purpose of a person is that arrangements are self-evidently inanimate. Any purpose inherent in such arrangements must usually be derived from the purposes of a person or persons who are party to the arrangements." Similarly at para 10110.

arrangement is that person's purpose in making the arrangement. Further consideration is needed where several persons enter into one arrangement with different purposes; see below.[27]

3.6.2 *ToA/Tis: purpose of transactions*

The ToA motive defence depends on "the purpose for which the *relevant transactions were effected*". Similar points apply. The purpose(s) of a transactions (transfer of assets and associated operations) is the purpose(s) of the person(s) who make or enter into the transaction, ie the parties to the transaction. Where only one person enters into an transaction, the purpose of the transaction is that person's purpose in making the transaction. Further consideration is needed where several persons enter into one transaction with different purposes; see below.[28]

Similarly, the IT TiS TAAR depends on the purpose of the transaction(s) in securities, which depends on the purposes of all the persons party to the transactions.

3.6.3 *Purpose of company*

In *Brebner v HMRC*:[29]

> The "object" which has to be considered ... cannot be narrowed down to a mere object of a company, divorced from the directors who govern its policy or the shareholders who are concerned in and vote in favour of the resolutions for the increase and reduction of capital. For the company, as such, and apart from these, cannot form an intention.[30] Thus the object is a subjective matter to be derived in this case from the intentions and acts of the various members of the group.

Company law/agency principles[31] should be applied to attribute to the company (and so to the arrangement/transfer/transaction to which the company is party) the purpose of the individual(s) who manage and control the relevant actions of the company; in other words, the company's

[27] See 3.7 (Multiple minds).

[28] See 3.7 (Multiple minds).

[29] 43 TC 705 at p.715. For the facts see 3.4 (View arrangement as a whole).

[30] Note how "intention" is used here as a synonym of the statutory word "object".

[31] See *El Ajou v Dollar Land Holdings* [1994] BCC 143 at p.150-151. The principles are not entirely clear, and different attribution principles may apply in different circumstances; see Watts, "Attribution and limitation" [2018] LQR 350.

directing mind(s) in respect of the relevant actions.[32]

3.7 Multiple minds

3.7.1 *Multiple minds: Arrangement*

What is the purpose of an arrangement if different parties to an arrangement have different purposes? One identifies the purpose of the arrangement by looking at the matter in the round, considering the purposes of all the parties to the arrangement.

Coll v HMRC, a case on the CGT reorganisation TAAR,[33] concerned a share-for-debenture exchange where:

(1) one shareholder intends to leave the UK and dispose of the debenture free of CGT, which is a tax avoidance purpose; but
(2) another shareholder intends to stay and does not have that purpose

The UT said:[34]

> s 137 is an all-or-nothing provision applying to all the shareholders ... if there is such a scheme or arrangement as is mentioned in s 137 then none of the shareholders qualify for [reorganisation relief] under s 135, other than unconnected shareholders holding 5% or less.

At first sight that seems rather surprising. It could operate unfairly. But it is difficult to see how any other conclusion could be reached from the statutory words. In practice the problem may not often arise.

3.7.2 *Multiple minds: ToA transfer*

A transfer will typically have only one transferor. But there might be more than one transferor in relation to the same transfer. How does one ascertain the purpose of the transfer if the transferors have different purposes? The same approach applies. One identifies the purposes of the transfer by looking at the matter in the round, considering the purposes of all the transferors, both direct and quasi-transferors.

In *IRC v Pratt*[35]

> There is a single transfer. That transfer was either made with the purpose

[32] This is not quite how the FTT put the point in *Fisher* at [290] - [297] but it comes close.

[33] See 58.6 (CGT reorganisation TAAR).

[34] [2010] UKUT 114 (TCC) at [10].

[35] 57 TC 1 at 53.

> or not with the purpose of avoiding liability to taxation. How could one apply that to, say, a two-transferor situation where A had the purpose of avoiding tax and B had only a simple commercial purpose?

The Revenue's solution was to look at each co-transferor separately:

> [The Revenue's] answer was to say that, in such a case, B could show that so far as he was concerned the purpose was a simple commercial purpose, and that will enable him to claim the benefit of [the Motive defence].

That would be the sensible outcome, but the judge rejected it:

> But this is not what the subsection says. It is not the transferor's purpose in effecting the transfer" but "the purpose for which the transfer was effected".[36]

At the CoA stage in *Fisher v HMRC*:[37]

> it is by no means uncommon for tax legislation to require a single purpose or object to be identified in circumstances where individuals with different motivations may have been involved... It is true that, if a transfer is considered to have had more than one transferor, a particular transferor might find himself unable to rely on [the ToA motive defence] because the overall purpose of the transfer was tax avoidance despite having no such purpose himself. In practice, however, cases of that kind can be expected to be rare: those promoting a transfer are likely to have had a common purpose.

This was common ground in the Supreme Court:

> the [ToA motive defence] focuses on the purpose for which the *transfer* was effected not the purpose of each individual whom HMRC seek to charge to tax.

But since the SC held that shareholders are not transferors in relation to a transfer made by a company, the problem of multiple minds will not often arise in a ToA context.

[36] 57 TC 1 at p.53. the judge added: "Of course, if, as is in my judgment the case, there can only be a single transferor to consider at a time, this subsection presents no problems whatsoever." But the judge did contemplate the possibility of multiple transferors, in cases of companies with two or three shareholders, even though that situation did not arise on the facts of *Pratt.*

[37] [2021] EWCA Civ 1438 at [70].

3.8 Effect/purpose distinction: Subjective test

It is (almost) self-evident that there is a distinction between:

(1) The effect of a transaction/arrangement
(2) The purpose of the transaction/arrangement

Purpose is subjective in the sense that it depends (at least usually) on what is in the mind of the individual. Effect is objective in that it does not (at least usually) depend on what is in the mind of the individual. Two transferors may carry out identical transactions, with the same effect, but with different purposes.

A transaction which has the effect of avoiding tax may not have that purpose. A transaction which does not have the effect of avoiding tax might nevertheless have had that purpose.[38]

In the context of TiS TAAR, I do not think this view has ever been disputed. In *IRC v Brebner*:[39]

> the question whether one of the main objects is to obtain a tax advantage is subjective

In the context of the ToA motive defence, HMRC once argued for an "objective purpose" test. But that view is no longer tenable and HMRC have abandoned it.[40]

[38] That was the case in *McGuckian* 69 TC 1, where transaction had the purpose of avoiding income tax, but did not have the effect of avoiding tax, because an anti-avoidance provision had been overlooked. If further authority is needed, which I doubt, see *Tower One St George Wharf Ltd v HMRC* [2022] UKFTT 154 (TC) at [63]:

> "Arrangements may be intended to achieve a purpose, even if they ultimately fail to achieve it due to an inherent flaw in the design of the arrangements themselves. Thus, arrangements can have the purpose of avoidance of liability to tax, even if ultimately no liability to tax is avoided."

In this case transactions had the purpose of avoiding CT, but did not do so because the scheme failed for reasons not made clear.

[39] 43 TC 705 at p.718. Similarly Lord Clyde in the Court of Session:

> "There is no doubt that this transaction did result in a tax advantage to the shareholders, ... but that is not the issue in this case. The material question is not what was the effect of each or all of the interrelated transactions; the question is what was the main object or objects for which any of them was adopted. [The TiS TAAR] draws a clear distinction between effect and object."

See too *Addy v IRC* 51 TC 71 at p.81E.

[40] I considered the argument in detail in the 2020/21 edition of this work para 49.9.4 (Objective purpose?) and 49.9.5 (Objective test abandoned), but omit that now as it

Draft ToA guidance provided:

> **10050 What is purpose?: effects do not determine purpose**
> There is a clear difference between the purpose of a transaction and its effects. The effects are the advantages or benefits actually obtained (whether intended or not); these benefits can often be computed mathematically and can usually be measured objectively...
> In the Special Commissioners' decision of *Snell v HMRC*,[41] it was observed that the implications of [the *Brebner* case] were that:
>
> > "That case is also authority for the proposition that there is a clear distinction between the effect and the object of a transaction. I take that to mean that however directly a transaction leads to a tax advantage the question whether that was one of its objects is not answered by that clarity of effect"
>
> In *Mallalieu v Drummond* [42] Lord Brightman said:
>
> > "The object of the taxpayer in making the expenditure must be distinguished from the effect of the expenditure."
>
> Thus, merely reviewing the effects of a transaction will not usually enable a conclusion to be drawn as to the taxpayer's purpose.

When the draft guidance moved the INT Manual, this passage was not included, but there is no reason to think that HMRC's view has changed.

3.8.1 *The limit of subjectivity*

Unallowable Purpose Draft Guidance para 10030 provides:

> Thus, where there is a purpose test, the consequences of a transaction will be dependent on the subjective purpose of the taxpayer. It is entirely

is of historical interest only. In brief, an objective test was put forward in RI 201 and said to be supported by a sentence in *IRC v Willoughby* [1997] STC 995 at p.1003:

> "Where the taxpayer's chosen course is seen upon examination to involve tax avoidance (as opposed to tax mitigation), it follows that tax avoidance must be at least one of the taxpayer's purposes in adopting that course, whether or not the taxpayer has formed the subjective motive of avoiding tax."

But the subjective test was affirmed in *Beneficiary v IRC* [1999] STC (SCD) 134 at p.143; *Carvill v IRC* [2000] STC (SCD) 143 at [9]–[13]; and *Burns v HMRC* [2009] UKSPC SPC00728 at [36]. In *Fisher v HMRC* [2021] EWCA Civ 1438 at [82] it was common ground that the test was subjective. The sentence set out above was set out uncritically in *Tower One St George Wharf Ltd v HMRC* [2022] UKFTT 154 (TC) but hopefully that will turn out to be a blip.

See too App. 5.4.1 (Does objective/subjective matter).

[41] [2008] UKSPC SPC00699 at [23].

[42] 57 TC 330 at p.365; this was a wholly/exclusively case.

> possible that two taxpayers entering into similar transactions, but with different purposes, will be taxed differently....

This can lead to uncomfortable consequences. In *Mallalieu v Drummond*[43] a wholly/exclusively case, it lead to the position that the cost of a barrister's suit to wear in court would be deductible if and only if the barrister preferred coloured clothes to black. The majority thought that was ridiculous, and one can understand why. They decided that purpose turned on the barrister's subconscious purpose, and what was her subconscious purpose was decided by the Court, not by the barrister. So (at a cost of logical rigour[44]) they fell back on what one might describe as an objective test of purpose (if that is not a contradiction in terms):

> As the taxpayer's "object" in making the expenditure has to be found, it inevitably follows that (save in obvious cases which speak for themselves) the Commissioners need to look into the taxpayer's mind...[45]

Mallilieu v Drummond was, it seems, an obvious case which spoke for itself.

I cannot see how a case of this type could arise in the context of a TAAR. But HMRC will not rule it out:

> However, in the *Vodafone* case Millett LJ said that:
>
> > "Some consequences are so inevitably and inextricably involved in the payment that unless merely incidental they must be taken to be a purpose for which the payment was made."[46]
>
> So, in some circumstances, the "inevitable consequences" of a payment do allow the inference to be drawn that a particular purpose existed, even if that was only an unconscious motive of the taxpayer.

The CT Manual makes similar comments on comparable wording in the winding-up TAAR.[47]

3.9 How to identify purpose

How does one ascertain an individual's (subjective) purpose? All facts

[43] 57 TC 330.

[44] Cf the Oliver Wendel Holmes' apothegem: "The life of the law has not been logic: it has been experience." These are deep waters.

[45] *Mallalieu v Drummond* 57 TC 330 at p.365. Note that "object" is here used as a synonym of "purpose".

[46] *Vodafone Cellular v Shaw* 69 TC 376.

[47] See 30.14 (Winding-up TAAR).

which may shed light on purpose must be taken into account. This is self-evident, but if authority is needed, see *IRC v Brebner:*

> The question whether in fact one of the main objects was to avoid tax[48] is one for the Special Commissioners [now the first-tier tribunal] to decide upon a consideration of all the relevant evidence before them and the proper inferences to be drawn from that evidence.[49]

An assertion by an individual of their intention is not definitive, because that assertion may be self-serving, and not credible in the light of other facts.[50]

It is relevant to consider two objective questions:

(1) did the transfer significantly reduce tax? ie was that the effect
(2) was a tax reduction reasonably foreseeable at the time?

These are objective indicators of subjective intention. If the tax reduction was not reasonably foreseeable, it is not likely to have been the purpose to achieve it.

Conversely the fact that a tax advantage is reasonably foreseeable as a consequence of the transfer may be cogent evidence of subjective purpose. We normally have the purpose of achieving the foreseeable consequences of our acts. However, this is not necessarily so. First the transferor may not have foreseen the advantage even though a reasonably well-informed person might have done so: no-one at all times acts with the foresight of the reasonably well-informed.[51]

In *Brebner* there were two issues, identifying the arrangement, and whether a main purpose of the arrangement once identified was to obtain

[48] This is a slightly loose paraphrase of the statutory question, which is whether the transactions "had as their main object, or one of their main objects, to enable tax advantages to be obtained"; but nothing turns on that.

[49] 43 TC 705 at p.718.

[50] See too 4.12 (Statements of domicile).

[51] Contrast s.8 Criminal Justice Act 1967:

"A court or jury, in determining whether a person has committed an offence,—

(a) shall not be bound in law to infer that he intended or foresaw a result of his actions by reason only of its being a natural and probable consequence of those actions; but

(b) shall decide whether he did intend or foresee that result by reference to all the evidence, drawing such inferences from the evidence as appear proper in the circumstances."

This is also a common law approach: *Frankland v The Queen* [1987] AC 576.

a tax advantage.[52] These are both questions of fact not law.

3.10 Purpose: Party's adviser/agent

In ascertaining purpose, one should have regard not only to the mind of the relevant individuals, but also the mind of those acting for or advising them.[53]

Where a person is acting by an agent or attorney, the purpose of the agent/attorney should, on normal agency principles, be attributed to them.

If a person relies on advisers (typically professionals but also others, such as parents) and executes documents with no more than a vague idea of approving proposals put to them, they have adopted the purpose of their advisers or (which comes to the same thing) the purpose of their advisers should be attributed to them. This is so even if they have not read, or not understood, the advice. This is (almost) self-evident, but authority can be cited if needed. In *IRC v Pratt*, a ToA case, an individual (who transferred £80k to an offshore company) "did not understand the scheme: it was masterminded by his own professional advisers". Nevertheless, "he, *through his advisers*, was fully acquainted with the fact that what was to follow was a tax avoidance scheme, he must fall fairly within the section".[54]

[52] See 3.4 (View arrangement as a whole).

[53] See too 99.33 (Purpose: Settlor's adviser/agent).

[54] 57 TC 1 at pp.47, 49. The same point is made in *Burns v HMRC* [2009] UKSPC SPC00728 at [20] and [39]: "The purpose for which the two girls effected the transactions was simply to do what their parents suggested, and it seems appropriate to me to proceed on the basis that the two girls effectively sought to achieve those purposes that influenced their parents."

Hoey v HMRC [2019] UKFTT 489 (TC) at [145] - [161] offers another example, if needed. This concerned an offshore EBT: see 52.25 (Employee benefit trusts). The naive Mr Hoey "had no idea that the arrangements involved tax avoidance". But the ToA motive defence did not apply. The point was upheld on appeal; [2021] UKUT 82 (TCC) at [241] - [242].

I stress this because the opposite view was taken in *Philippi v IRC* 47 TC 75 at p.114:

> "Young Mr. Philippi ... said that he never had any idea of tax in his mind when he made that transfer. It was true that it was saving him a great deal in UK tax ... but that had not occurred to him; the only reason why he had made the transfer was because his father and other members of the family had told him that he ought to do so. He appears to have had no idea why they gave him that advice."

"Young Mr Philippi" was aged 23; that did not seem young when I wrote the 1st edition of this work, though it does now. But however that may be, a court would nowadays hold that he had adopted the (tax avoidance) purpose of his father.

Likewise in *Addy v IRC,* a TiS case:[55]

> [The taxpayer] says one has to look simply to the minds of the [directors], but I would think also that of their professional adviser"

The INT Manual provides:

> **INTM602960 Avoidance purpose exemption: Purposes** [Jul 2023]
> ... If any professional advice obtained in a particular case is treated as a relevant factor and the individual states that they had no intention to avoid tax, it is reasonable to see whether the advice they acted on is consistent with that contention.
>
> If the individual proceeds in accordance with advice obtained (or simply instructs the agent to proceed), the purpose of the adviser would on normal principles be attributed to the individual, whether they understood the implications of the advice or not. For example, if evidence emerged that an individual's adviser or agent had
>
> - devised a particular structure, or
> - recommended or arranged the creation (or use) of a particular non-resident entity
>
> for the purpose of saving UK tax, that purpose should be taken into account in determining, from all the circumstances of the case, the purposes for which the transactions were effected. That is the case whether or not the adviser had expressly informed the client of the purposes behind the transactions. For example, it would be sufficient if evidence emerged from third parties or from the agent's working papers.

For the purposes of ToA New Conditions A and B, s.737 ITA provides an express rule to this effect:

> (5) In determining the purposes for which the relevant transactions or any of them were effected, the intentions and purposes of any person within subsection (6) are to be taken into account.
>
> (6) A person is within this subsection if, whether or not for consideration, the person—
>
> (a) designs or effects, or
>
> (b) provides advice in relation to,
>
> the relevant transactions or any of them.

This (more or less) restates the general law and so makes no difference to the position. So it does not matter that this provision is not applicable to other TAARs, or other provisions referring to purpose.

[55] 51 TC 71 at p.81g.

Of course the adviser's purpose is only attributable to the individual if or so far as the individual adopts or accepts the advice, and the advice may be privileged.[56]

3.10.1 *Significance of tax advice*

If a person enters into a transaction without any tax advice, or without tax planning advice, that may suggest that tax saving was not a purpose of the transaction. But of course it does not prove it: possibly the person understood the tax position without needing advice (or thought they did).

If a person does take tax advice before entering into a transaction, that does not suggest that tax saving was a purpose of a transaction, because it is sensible to consider the tax position before doing anything:

> Apparently this part of the country[57] is inhabited by persons so unsophisticated that they enter into transactions without thinking of the Income Tax Acts, whereas everybody who does anything ought to think, how are the Income Tax Acts going to affect, or will they affect at all, this transaction which I am entering into?[58]

The significance of tax advice is discussed in *Ebsworth v HMRC*:[59]

> Much was made ... of certain of the notes made by Mr. Ebsworth's tax advisers. ... I did not find them particularly illuminating in reaching my decision as they were what one would expect from a tax adviser engaged to advise on tax rather than as a commercial or other adviser. Taking tax advice does not of itself make tax avoidance one of the main objects of the transactions concerned....
>
> 62. The fact that Mr. Ebsworth sought tax advice ... does not of itself mean that tax avoidance was a main object of the transactions.

GAAR guidance makes the same point:

[56] See 52.34.3 (Professional privilege).

[57] The reference is to Seaham, a small town in County Durham.

[58] *Seaham Harbour Dock Co v Crook* 16 TC 333 at p.340. Likewise *Khan v HMRC* [2021] EWCA Civ 624 at [1]: "a cautionary tale, which illustrates all too graphically the importance of seeking specialist tax advice before entering into commercial arrangements that might have adverse tax consequences, however remote that risk might appear."

[59] [2009] UKFTT 199 (TC) at [13]. In *Fisher v HMRC* [2020] UKUT 62 (TCC) at [107] it was common ground that "The mere fact of taking tax advice does not mean there is a tax avoidance motive".

> It is important to note that the fact that tax advice has been obtained is not, on its own, an indication that the obtaining of a tax advantage is a main purpose of the arrangement. Where large sums are involved many taxpayers will routinely seek professional advice, including tax advice.[60]

In *Fisher* in the Upper Tribunal it was common ground that:[61]

> Awareness of tax aspects does not equate to having a tax avoidance motive.

On the other hand, much depends on what the advice says. In *BCM*, the accountants had said that their proposed scheme was "a bespoke piece of tax planning developed by Ernst & Young". That was taken to support the Tribunal's finding a main object to obtain a tax advantage.[62] One should bear in mind how notes of advice may be scrutinised unsympathetically a decade later, in determining the purpose of a transaction. Though that is easier said than done.

3.11 Foresight/purpose distinction

3.11.1 *Making the distinction*

It is (almost) self-evident that there is a distinction between:

(1) Foresight - anticipating that a result will follow from an act

(2) Purpose - having the purpose of achieving that result (ie wanting it)

Foresight is a necessary but not sufficient condition of purpose. Purpose requires foresight, but foresight does not entail purpose.[63]

This is easiest to see where a result is foreseen but not desirable. A purchaser of shares can foresee that the purchase incurs stamp duty, but will not enter into the transaction with the purpose of paying stamp duty.

The same applies where the foreseen result is a matter of indifference.

The same may apply where the foreseen result is desired, but it is not in

[60] HMRC, "GAAR Guidance" (2017) para C3.7. *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

[61] [2020] UKUT 62 (TCC) at [107].

[62] *HMRC v BlueCrest Capital Management* [2022] UKUT 00200 (TCC) at [141].

[63] See too Kaveny, "Inferring Intention from Foresight" 120 LQR 81; Avery Jones "The mental element in anti-avoidance legislation" [1983] BTR 22
Bratman, "Intention, Plans & Practical Reason" (1987), chapter 10 (Intention and expected side effects)
https://www.foreigndomiciliaries.co.uk/index.php/Documents_archive

fact the purpose. It may just be "the icing on the cake", or a mere "by-product".

Mallalieu v Drummond (a wholly/exclusively case) offers this example:[64]

> An expenditure may be made exclusively to serve the purposes of the business, but it may have a private advantage. The existence of that private advantage does not necessarily preclude the exclusivity of the business purposes. For example a medical consultant has a friend in the South of France who is also his patient. He flies to the South of France for a week, staying in the home of his friend and attending professionally upon him. He seeks to recover the cost of his air fare. The question of fact will be whether the journey was undertaken solely to serve the purposes of the medical practice. This will be judged in the light of the taxpayer's object in making the journey. The question will be answered by considering whether the stay in the South of France was a reason, however subordinate, for undertaking the journey, or was not a reason but only the effect. If a week's stay on the Riviera was not an object of the consultant, if the consultant's only object was to attend upon his patient, his stay on the Riviera was an unavoidable effect of the expenditure on the journey and the expenditure lies outside the prohibition in [what is now s.34 ITTOIA].

For example, suppose a purchaser wants asset A, but in order to acquire it has to buy a company which holds two assets, A and B.

(1) It may be that his purpose is to acquire asset A but not to acquire B, because:
    (a) he would rather not acquire B, but has to do so to get A
    (b) it is a matter of indifference whether he acquires B or not (eg suppose asset B is cash which the company needs)
    (c) he is pleased to acquire B as well as A, but it is not sufficiently important
(2) It may be that the purpose is to acquire both assets.

RI 201 makes the point this way:

> "Purpose" is taken to be the end it is sought to achieve by the transaction.[65]

[64] 57 TC 330 at p.365.

[65] This is based on *Newton v CT* [1958] AC 450 at p.465. Note by the way how use of the passive voice ("it is sought to achieve") ducks the issue of whose purpose one is looking for. Contrast 6.22.3 (Para 26(2) employment-income test) where a similar

Purpose in a TAAR is what an individual actually wants, or hopes, to achieve (not merely foresight).

3.11.2 *Terminology of distinction*

Sometimes an attempt is made to desynonymise the words intention/ purpose/object, in order to provide labels for a purpose/foresight distinction. But none of these have found general acceptance.[66]

For instance, clause 14(1) of the draft Offences Against the Person Bill[67] defines intention in this way:

> A person acts *intentionally* with respect to a result if—
> (a) it is his *purpose* to cause it, or
> (b) although it is not his purpose to cause it, he knows that it would occur in the ordinary course of events if he were to succeed in his purpose of causing some other result.

Paras (a)/(b) express the purpose/foresight distinction. Applying this terminology to a purchaser of shares, the purchaser would have the *intention* to incur stamp duty but not the *purpose* of incurring it.

However the words "purpose" and "intention" are not always understood that way:

> The word [purpose] can be used to designate either
> [1] the main object which a man wants or hopes to achieve by the contemplated act, or ...
> [2] those objects which he knows will probably be achieved by the act, whether he wants them or not.
> I am satisfied that in the criminal law ... its ordinary sense is the *latter* one.[68]

Applying this terminology to the purchaser of shares, one would say that the purchaser did not have the *object* of incurring stamp duty, but did have the *purpose* of doing so.

It is unfortunate that there are no standard words to express a foresight/ purpose distinction. Butit does not matter much, as long as one bears the distinction in mind, and, where appropriate, defines or explains the terms

point arises in connection with the phrase "if value were received".

[66] Bentham's terminology was direct and oblique intention: *The Principles of Morals & Legislation*, Chapter VIII (Of Intentionality).

[67] A Home Office consultation paper, 1998, never implemented.

[68] *Chandler v DPP* [1964] AC 763 at p.804, emphasis added.

being used.

3.12 Choices and purpose

We must begin with a "celebrated"[69] passage in *IRC v Brebner*:[70]

> [1] ... when the question of carrying out a genuine commercial transaction ... is reviewed, the fact that there are two ways of carrying it out - one by paying the maximum amount of tax, the other by paying no, or much less, tax - it would be quite wrong, as a *necessary* consequence, to draw the inference that, in adopting the latter course, one of the main objects is, for the purposes of the section, avoidance[71] of tax.
>
> [2] No commercial man in his senses is going to carry out a commercial transaction except upon the footing of paying the smallest amount of tax that he can.
>
> [3] The question whether in fact one of the main objects was to avoid tax is one for the Special Commissioners...

3.12.1 *A close reading*

This passage is cited so often that it seems canonical. It is in general a mistake to construe a passage from a judgment as if it was a statute, but let us examine it closely.

The third sentence is not contentious.

The second sentence is not a proposition of law: it is a statement of fact. It is self-evident: of course a commercial person carrying out a commercial transaction would seek to pay as little tax as possible.

So it is the first sentence which matters, or seems to. It is a proposition of law. But it is (almost) self-evident. No-one would seriously contend that where there are two ways of carrying out a commercial transaction,

[69] *IRC v Willoughby* [1995] STC 143 at p.167.

[70] For the facts of *Brebner* see 3.4 (View arrangement as a whole).
There are minor stylistic differences between the law reports [1967] 2 AC 18 at p.30, and 43 TC 705 at p.718. I here set out the AC version which is more authoritative and more correct (in particular, using the word *speech* rather than *judgment* in the first line). The italic emphasis is in the original printed report, though it is missing in the LexisNexis database.

[71] This is a loose paraphrase of the statutory provision, which asks whether main object, or one of their main objects, is to enable "tax advantages" to be obtained. Lord Upjohn is here considering purpose, not the tax avoidance/mitigation distinction; though that distinction might perhaps be thought to lie behind the dictum, or to be embryonically present.

there is a *necessary* inference that, in adopting the latter course, a main purpose *must* be the avoidance of tax or (to use the correct statutory words) to obtain a tax advantage.

But this does not take us far, because there is still a *possible* inference that the main purpose *may* be a tax advantage. The proposition at [3] is statement of the trivial. It addresses a "straw man" argument that a choice of the lower tax route necessarily means a tax advantage purpose.

3.12.2 *Non-commercial transactions*

What *Brebner* says about commercial transactions is equally true of a non-commercial transaction. It is obvious that:

> [1] ... when the question of carrying out a genuine transaction, *commercial or not* ... is reviewed, the fact that there are two ways of carrying it out - one by paying the maximum amount of tax, the other by paying no, or much less, tax - it would be quite wrong, as a *necessary* consequence, to draw the inference that, in adopting the latter course, one of the main objects is, obtaining a tax advantage.
>
> [2] No person in his senses is going to carry out a transaction *commercial or not,* except upon the footing of paying the smallest amount of tax that he can.
>
> [3] The question whether in fact one of the main objects was to avoid tax is one for the Special Commissioners...

For instance, a person making a gift to charity, a non-commercial transaction, would seek to pay as little tax as possible, and there are often two or more ways of carrying that out, paying more or less tax. But even understood or extended in this way, it remains the case that the statement does not take us very far.

In *Allam v HMRC* the FTT said:

> We accept that, in a particular case, the fact that an alternative transaction existed and was perhaps considered but rejected, may be a factor in deciding whether or not an inference can be drawn that the obtaining of an income tax advantage was a main purpose of a transaction.

In *Fisher v HMRC* the FTT said:[72]

> the *Brebner* dicta does not go as far as suggesting that if you take the lower tax route this cannot mean you have a tax avoidance purpose.

[72] [2014] UKFTT 804 (TC) at [283] citing 70 TC 57 at p.108.

> While taking a lower tax route does not mean that by that fact alone it must be inferred that one of the main objects is tax avoidance, tax avoidance is not precluded.

Quite so.

The question then is *when* does a conscious choice of a tax advantageous course evidence a tax avoidance purpose in its own right in addition to any other (commercial) purpose? Lord Upjohn does not give an answer to this: to say at [3] that it is a question of fact for the Commissioners, if true, is not exactly helpful.

A useful approach may be to ask: does the tax advantage form an incidental or subsidiary consequence of achieving the commercial transaction (as opposed to being an end in its own right)? If so, there is no tax avoidance purpose and *a fortiori* not a main purpose. This is an evaluative test which is perhaps easier to state than to apply, but it may sometimes be helpful.

3.13 Commercial needs and purpose

I suggest the spirit of *Brebner* lies here: where one purpose (or the principal purpose) for a transaction is a commercial (non-tax) purpose, one should be *a bit slower* to conclude that another purpose is tax avoidance than in the case of a purely tax motivated transaction.

Another way to put it may be to ask: does some overwhelming commercial objective frank or override any tax advantage purpose? That might explain *Brebner*. The shareholders held their eye only on the commercial necessity to acquire the shares. Tax fell outside their range of vision. Or even if that seems implausible, the Special Commissioners were entitled so to decide. That line of thinking might be said to represent the spirit of the decision.

If that is the law, it is unfortunate. It does not really make sense to provide a different approach to purpose when considering commercial transactions. The same principles should apply to any transaction carried out for primarily non-tax reasons including "ordinary family dealing".[73] Still, right or wrong, *Brebner* seems to suggest that the Courts should take a generous and sympathetic approach in relation to commercial dealings.

However the cases are not consistent.

[73] *Mangin v IRC* [1971] AC 739 at p.751 and p.756, restating the *Brebner* principle in the context of an extremely free reading of a New Zealand statute.

HMRC v Fisher neatly raised this issue. It was not a choice case, as the taxpayer had no real choice to make; but it was a commercial case because the transfer to a foreign company, which avoided Betting Duty, was essential in order to achieve the business purpose, which was to save the business. The business could not run at all if it had to pay Betting Duty (which its foreign competitors did not). The "choice" was to make the transfer or close down the business.

CA rejected an argument that the purpose was saving the business and betting duty avoidance was "simply the means of achieving" that purpose:[74]

> The avoidance of betting duty and saving of the business were inseparable. The main purpose of the transfer of the business was to avoid betting duty and thereby to save the business: the two were perceived as going together. Put slightly differently, there can be no question of [the ToA motive defence] applying because a transferor hopes that an intended avoidance of liability to taxation will achieve some further end. It will rarely, if ever, be the case that a transferor wishes to avoid liability to tax for the sake of it; in normal circumstances, a transferor will be intending to use the avoidance of tax to attain another object. That being so, were someone able to escape [ToA] by looking beyond the tax avoidance to its consequences, the motive defence would, as the FTT pointed out, be generally available. That will not have been Parliament's intention.

The situation in *Fisher* was that the tax charge would destroy the business: no business was possible unless the tax could be avoided/mitigated. But that is not in the least unusual. Everyone knows, or should know, that investors are interested in *post-tax* returns; and much business activity which would be profitable pre-tax is not profitable post-tax, and does not take place, as a result of taxation. That is unavoidably the case.

On this basis the decision in *Fisher* on this point ought to be upheld on appeal. But the cases are not consistent.

Allam v HMRC[75] was a TiS case on simple facts: The taxpayer sold one company to another company. The vendor received a capital sum from the company which was an Income Tax Advantage.[76] The question was whether one of the main purposes was to obtain the IT Advantage.

The taxpayer's purposes were (1) to facilitate borrowing by the group (a commercial purpose) and (2) to obtain funds for retirement (described as

[74] [2021] EWCA Civ 1438 at [91].

[75] [2020] UKFTT 216 (TC) at [210].

[76] See 55.14.4 (Sale to close co for cash).

a personal purpose). The TiS motive-defence TAAR applied:

> (1) [the taxpayer gave clear reasons for the transfer: the need to unite ADL and AML under common corporate ownership to support the bank financing ... and the desire to create a cash fund for his retirement. ... Those reasons are either "commercial" or "personal" reasons, to adopt the terminology used by HMRC, but the crucial point is that they are not the purpose of obtaining an income tax advantage.
> (2) ... The second reason[77] that HMRC gave was that the transaction could have been undertaken in an alternative manner which would have incurred an income tax cost....
> As regards the second argument, ... the mere fact that there exists an alternative means of undertaking a transaction which has a different tax result is not conclusive of the question as to whether an inference can be drawn that the obtaining of an income tax advantage was a main purpose of the transaction.
> We accept that, in a particular case, the fact that an alternative transaction existed and was perhaps considered but rejected, may be a factor in deciding whether or not an inference can be drawn that the obtaining of an income tax advantage was a main purpose of a transaction. However, we do not draw that inference on the facts of the present case. Dr Allam did not consider an alternative transaction. Dr Allam had a clear purpose for the transfer (to unite the companies under common ownership) and a clear purpose for his desire to receive the proceeds in cash (to fund his retirement). The latter was not a commercial reason. It was a personal reason, but it was not a tax reason.
> (3) The effect of the transaction was to realize the value of ADL and to use that value to support Dr Allam's desire for a fund for his retirement. The sale of the shares to AML was the simplest transaction to undertake to achieve that purpose and the purpose of uniting the companies under common ownership.
> (4) The other surrounding circumstances do not support the inference that Dr Allam was seeking to obtain an income tax advantage: he received significant dividends from the companies in the tax year in question including the dividend of £550,000 from ADL representing almost 50% of the retained profits in that company.
> 211. For these reasons, in our view, ... the obtaining of an income tax advantage was not a main purpose of Dr Allam in being party to the transaction. The income tax advantage was merely an incidental benefit that was obtained as a result of the transaction.

[77] The first reason turned on unusual facts and is not of general interest.

The reader may think that HMRC had the better of the argument. If the taxpayers argument is right, it could apply generally. The purpose of a transaction extracting value from a company is never to obtain a tax advantage for its own sake: a tax advantage is always a means to an end, not an end in itself. Money is obtained in order to be spent in some particular way. In *Allam* the purpose was to obtain a pension; would it be any different if the purpose was to pay for a house? or a chattel? or to gamble? The law would be more consistent if the decision had been reversed on appeal. But on the basis that the question was one of fact, the UT did not reverse it.

3.14 "Main" purpose

3.14.1 *Main purpose: Requirement*

TAARs generally refer to main purpose.

It is helpful to have a term for a purpose which is not a main purpose. I refer to that as a **"minor purpose"**.

Standard TAAR wording refers to a main purpose, and a minor purpose does not pass the test. The ToA motive defence is different and, I think, unique: it refers to "the purpose or one of the purposes" of transfers or associated operations: it does not say "main" purpose.[78] It would seem sensible to bring the wording of the ToA motive defence ("the purpose or one of the purposes") into line with standard TAAR wording, ("main purpose or one of the main purposes"). But the change would be more trouble than it is worth, unless made as part of a wider ToA reform. In practice it does not make much difference.

3.14.2 *Main purpose: Meaning*

In *Travel Document Service v HMRC*:[79]

[78] For the reason for the omission of the word *main*, see 52.5 (Enactment history). Outside TAARs, an example is the test of deductible expenditure where the expenditure must be incurred wholly and exclusively for the purpose of the trade. This is self evident but if authority is needed, see *Mallalieu v Drummond* 57 TC 330 at p.365: "If it appears that the object of the taxpayer at the time of the expenditure was to serve two purposes, the purposes of his business and other purposes, it is immaterial ... that the business purposes are the predominant purposes intended to be served."

[79] [2018] EWCA Civ 549 at [48]. This was said in relation to the main purpose test in the loan relationship TAAR, but the comment applies generally in TAARs.

> I do not accept that, as was submitted by [HMRC], "main", as used in [the loan relationships TAAR], means "more than trivial". A "main" purpose will always be a "more than trivial" one, but the converse is not the case. A purpose can be "more than trivial" without being a "main" purpose. "Main" has a connotation of importance.

HMRC formerly argued that:

> any purpose which is more than incidental is prima facie a main purpose.[80]

That is no longer tenable. Still, if a purpose is just incidental, then it is clearly not a main purpose. That does not take us very far, as "incidental" is itself vague and evaluative. In *Allam*, cited above, "The income tax advantage was merely an incidental benefit that was obtained as a result of the transaction."

The temptation to explain a vague and evaluative expression (such as main purpose) with a paraphrase is irresistible. One sometimes sees "more than mere icing on the cake"[81] but that metaphor (I am tempted to say, stale metaphor) does not help at all. One also sees "just a bonus", which is not much better, and "one of the primary aims" but "primary" is just a synonym of "main"; and by-product.

In *Tower One St George Wharf Ltd v HMRC:*[82]

> A purpose can be a "main" purpose, even if it is not as significant a consideration as another main purpose. Thus, if arrangements are driven by two particularly significant aims, A and B, as well as other subsidiary aims, both A and B may both be "main" purposes even if the taxpayer considers A to be more important than B.
>
> Indeed, purpose B could be a main purpose of the arrangements, even if the arrangements would not have been entered into at all but for the need to achieve purpose A. Even if purpose A is the sole reason for entering into arrangements in the first place, once the decision to enter into the arrangements has been taken, an additional purpose can become an additional main purpose of the arrangements. Whether this is the case will be a question of fact, depending on the individual case. The question is whether a purpose is one of the main purposes, not whether it is the

[80] HMRC Discussion Document "Simplifying Unallowable Purpose Tests" (2009) para 10140.

[81] *Sema Group Pension Scheme v IRC* 74 TC 593, in the High Court judgment at [53].

[82] [2022] UKFTT 154 (TC) at [69]-[70].

> most important purpose, and not whether the arrangements would be proceeded with in the absence of any of the other purposes.

That is self-evident.

3.15 Burden of proof

3.15.1 *Identifying scheme*

In *Coll v HMRC*[83]

> We agree with [HMRC] that there is no obligation on HMRC to identify the scheme or arrangements [whose purpose is tax avoidance] and it is for the appellants to prove that there is no scheme or arrangements [whose purpose is tax avoidance].

But while that reflects the general rule that the onus is on the taxpayer, it does not matter because the tribunal will have normally plenty of evidence to identify the what the scheme or arrangement is, and what its purpose is. The point was made in *Wilkinson v HMRC*:[84]

> Nor am I persuaded that HMRC's submission that *Coll* [citing the passage set out above] has any particular significance this case: there is sufficient evidence before the tribunal for me to find, in this case, that there *was* a scheme or arrangements of which the exchange formed part; the nature and extent of that scheme are, as the Upper Tribunal said in Euromoney, matters on which this tribunal is called upon to make findings of fact.

3.15.2 *Burden in TiS TAAR*

For completeness: In *Wroe v HMRC,* a TiS case:[85]

> Previous iterations of the Transactions in Securities legislation made it clear that the burden of proof lay upon the taxpayer to demonstrate that its purpose was not to obtain an income tax advantage.[86]

[83] [2010] UKUT 114 (TCC) at [8].

[84] [2023] UKFTT 695 (TC) at [81].

[85] [2022] UKFTT 143 (TC) at [104] - [105].

[86] Section 685 ITA 2007 provided prior to 2010:

Section 684 does not apply to a person in respect of a transaction in securities or two or more such transactions if the person shows that the transaction or transactions meet conditions A and B.

The underlined words should be regarded otiose; see App 2.24.5 ("It is shown that"). But see *IRC v Garvin* 55 TC 24 at p.52 and p.79

> However, the current wording of section 684(1) [ITA] is silent as to who must demonstrate the requisite purpose of being a party to the transactions in securities. A number of commentators[87] consider that the burden of proof now lies upon HMRC. This is a curious result, because the main purpose of the person who is a party to a transaction in securities, the test being a subjective one, will be a matter which is primarily within the knowledge of the taxpayer rather than HMRC.

The general rule is that the burden of proof rests on the taxpayer.[88] The change from the wording of previous legislation is not an indication to the contrary. The former wording was just otiose and the argument is an argument from redundancy.[89] In *Wroe v HMRC*, HMRC accepted that the burden of proof lay on them to show that one of the main purposes of the transaction was to obtain an IT advantage, and the judge proceeded on that basis. If that is right, it is an exception which applies to TiS cases only.

In *Wroe,* it made no difference to the outcome. Burden of proof rarely does. The person on whom the burden of proof lies speaks first at the hearing, and has the right of reply, and some advocates consider that to be an advantage; but I don't think there is much in it, and it would be a sad reflection on our jurisprudence if there was.

3.16 Time to ascertain purpose

What matters is the purpose at the time of the arrangement or transaction whose purpose is being tested.[90]

3.17 Meaning of "avoidance"

3.17.1 *History of avoidance concept*

The clear[91] articulation of the *concept* of an avoidance/mitigation

[87] The text does not identify who these commentators are, presumably because the point was not in issue.

[88] See 6.36 (Residence: Burden of proof).

[89] See App 2.1.2 (Argument from redundancy);

[90] This is self-evident, but if authority is needed, see *Herdman v IRC* 45 TC 394. Similarly *Mallalieu v Drummond* 57 TC 330 at p.365: "the Commissioners need to look into the taxpayer's mind at the moment when the expenditure is made. After events are irrelevant to the application of [the wholly & exclusively test] except as a reflection of the taxpayer's state of mind at the time of the expenditure."
ToA has rules to address this; see para 52.26 (Associated operations: Introduction).

[91] One can find some earlier examples: *Mangin v IRC* [1971] AC 739 is a moderately clear example; the concept is embryonically present in *Newton v CT* [1958] AC 450.

distinction goes back only to the 1970s[92] and the concept originated from economists, not lawyers. In 1973 Sandford wrote:

> A government may have one of three attitudes to a particular 'avoidance' measure – using the wide definition of avoidance.
>
> It may welcome it; the government may have deliberately offered a tax concession to promote some objective, e.g. tax concessions on mortgage interest ... in order to encourage owner-occupation; or investment and initial allowances to stimulate new investment in development areas.
>
> Second, without having sought positively to encourage a particular 'avoiding' action the government may find it entirely acceptable as when an income tax payer reduces his tax liability by taking a wife or having children; or when a person on retirement transfers savings from a building society to some other form of investment in order to reclaim income tax.[93]
>
> Third, the government may deplore certain actions as contrary to its intentions; the action is in accord with the letter of the law but not its spirit. *Only actions in this third category should rank as 'avoidance'.*[94]

But these cases do not draw the line as clearly or quite on the same basis as Sandford and modern cases following him.

[92] In 1946, Wrottesley J was unaware of it. Discussing the motive defence, he said: "There cannot, I think, be two opinions as to what 'avoiding' means. Where what is to be avoided is a liability, it must mean to evade, or to keep out of the way of, whether it be as in Richard III, 'The censures of the carping world', or anything else unpleasant that might befall a man, such as a tax": *Congreve v IRC* 30 TC 163. This is describing avoidance in the loose or etymological sense (including mitigation).

[93] Child allowance was abolished in 1979, and one can now reclaim tax deducted from building society interest; but that does not spoil the validity of the examples.

[94] *Hidden Costs of Taxation*, IFS, 1973, p.113 (emphasis added). Sandford proposed a second requirement of "avoidance" which he related to the taxpayer rather than to the legislature:

> "It is reasonable to confine 'avoidance' to action which results in the would-be avoiders substantially achieving the objective to which the tax had become an obstacle. Let us give some examples. If a man ceases to buy cigarettes because of tobacco tax he has not achieved his pre-tax objective, i.e. to smoke. Buying sweets instead of cigarettes therefore, is not avoidance. Again, if a taxpayer decides to use most of his wealth for a consumption spree because estate duty makes it not worth while saving for heirs, he is not 'avoiding' for he has abandoned his objective of passing property to heirs. On the other hand, if he reacts to estate duty by making *inter vivos* gifts (assuming he survives for seven years), this is avoidance; it has achieved, though by a more circuitous route, the objective of passing to heirs an intact property."

This is problematic, because there is no obvious way to identify the "objective to

3.17.2 *Terminology of concept*

The use of the terminology avoidance/mitigation to express this distinction is an innovation of Lord Templeman in 1986.[95] The expression "tax avoidance" has very often been used in the loose sense, meaning or including mitigation.[96] The reason may be either that the author does not have any avoidance/mitigation distinction in their mind or (if they do) that they are not using the modern terminology to express it. Even now, the term "tax avoidance" is sometimes still used in a loose or etymological sense to include mitigation but nowadays this usage is sometimes jocular, which suggests that the technical meaning has seeped into public consciousness.[97]

Likewise "mitigation" was and sometimes still is used in the sense of "avoidance".[98]

Other vocabulary has been used or suggested. In *Newton v Taxation Comr*, Lord Denning said that "ordinary" transactions do not count as avoidance.[99] In *Peterson v IRC*, Lord Millett said that "acceptable" tax advantages do not count as avoidance.[100] I do not think these words imply

which the tax has become an obstacle", and it has not been adopted into the law.

[95] *IRC v Challenge* [1986] STC 548. Lord Templeman was describing a concept relatively new to tax jurisprudence and framing terminology altogether new to describe it. But in accordance with the (according to Austin, "childish") declaratory theory of law, he did not say so.

[96] C.T. Sandford:

> "Amongst tax practitioners the generally accepted definition of avoidance ... is any legal method by which a person can reduce his tax bill... this definition can cover almost anything... I can legally reduce my income tax bill by buying a more expensive house (on which I get additional mortgage interest relief), getting married, having more children, taking out more insurance or simply stopping work."

(*Hidden Costs of Taxation*, IFS, 1973).

[97] The author once saw an advertisement for PEPs: "Be a tax avoider!" (PEPs were a tax free investment now replaced by ISAs.) For another example, see *Board of Inland Revenue v Hoe*, A.P. Herbert's *More Uncommon Law*: "Evidently those who do not smoke or drink are ... avoiding taxation."

[98] eg C.T. Sandford wrote in 1973 that tax avoidance (in the strict sense) "is often referred to by expressions such as tax planning or tax mitigation": *Hidden Costs of Taxation*, IFS, 1973, p.104. *Craven v White* 62 TC 1 at p.203 (a requirement of *Furniss v Dawson* is that a transaction "had no other purpose than tax mitigation").

[99] [1958] AC 450 at p.466.

[100] [2005] UKPC 5 at [35]–[37].

different tests, but only different terminology.

In this book I use the words "avoidance" and "mitigation" in the strict (or correct) sense and I use "ordinary" tax planning as a synonym of mitigation.

It would be convenient to have a neutral term to describe both avoidance and mitigation (described above as the loose etymological sense of "tax avoidance"). There is no agreed term, but "tax reduction",[101] "tax saving", "tax planning" and "tax advantage" might all be used in this sense. It may be less confusing if less elegant to refer to "avoidance/ mitigation" where one wishes to refer to the two.

3.17.3 *"Avoidance" in motive defence*

The House of Lords decided in *IRC v Willoughby* that "avoidance" in the ToA motive defence means tax avoidance in the strict sense and not mitigation:

> ... it was essential to understand what was meant by "tax avoidance" for the purposes of [the ToA motive defence]. Tax avoidance was to be distinguished from tax mitigation.[102]

This would have surprised those who framed the legislation in 1936/8; they were unaware of any avoidance/mitigation distinction. But the enormously increased complexity of the tax system since 1936 makes the distinction sensible, perhaps necessary:

> One of the traditional functions of the tax system is to promote socially desirable objectives by providing a favourable tax regime for those who pursue them. Individuals who make provision for their retirement or for greater financial security are a familiar example of those who have received such fiscal encouragement in various forms over the years. This, no doubt, is why the holders of qualifying policies, even those issued by non-resident companies, were granted exemption from tax on the benefits received. In a broad colloquial sense tax avoidance might be said

[101] INT Manual provides:
INTM208010 Introduction to the motive test [May 2012]
... Despite numerous valiant attempts there has never been a consensus about what is meant by 'tax avoidance' ...
The [CFC] motive test attempts to solve the first problem by avoiding any mention of the term 'tax avoidance', settling instead for the rather more neutral concept of a 'reduction in tax' ...

[102] [1997] STC 995 at p.1003.

> to have been one of the main purposes of those who took out such policies, because plainly freedom from tax was one of the main attractions. But it would be absurd in the context of [the motive defence] to describe as tax avoidance the acceptance of an offer of freedom from tax which Parliament has deliberately made.[103]

HMRC accepted that the purchase of an "ordinary" offshore bond should be taxed under the chargeable event provisions and not under the ToA provisions. The most obvious way[104] to reach that result is to give a narrow meaning to tax avoidance and so to widen the motive defence

3.17.4 *Purpose of tax evasion*

Suppose an individual transfers assets abroad with the dishonest purpose of *evading* UK taxation. Can one apply the avoidance/evasion distinction and say that the individual did not intend to *avoid* taxation, so that – while they may be liable to criminal sanctions – the motive defence applies and excludes the transfer of assets rules? The answer is plainly no. The argument is anachronistic, since in 1936 and for 40 years afterwards, the word "evasion" was used in English jurisprudence to describe avoidance. More fundamentally, the context shows that the expression "tax avoidance" includes (criminal) tax evasion. This was assumed without argument in *R v Dimsey*.[105]

3.18 Purpose of tax avoidance

The first task is to look into the mind of the transferor to ascertain whether their purpose was (to use the neutral term) to reduce tax. If they had no purpose to reduce tax then that is the end of the matter.

Before *Willoughby,* identifying a purpose of reducing tax was the also the end of the matter because an avoidance/mitigation distinction had not been recognised. Any tax reduction purpose would fail the ToA motive defence.

Now there is a second stage. If the individual did have the purpose of reducing tax, one must move on, applying *Willoughby*, to categorise that purpose as "avoidance" or "mitigation".

[103] 70 TC 57 at p.116.

[104] An alternative, less satisfactory, would be to refuse to recognise the tax purpose of the acquisition, by saying that it is merely incidental, or by applying a *Brebner* or choice principle: see 3.20.6 (A choice principle?).
Another solution is to say there is no relevant transfer.

[105] [2001] UKHL 46.

This is a question of law. It is determined objectively (in the sense that the issue is independent of the mind of the individual). It would be wrong at stage (2) to ask whether the individual subjectively thought their purpose was "tax avoidance" (as opposed to mitigation) because

(1) Avoidance/ mitigation is a question of law, a matter for the court.
(2) It would generally be pointless to ask the individual, since (unless the individual is a tax lawyer) they will not know the correct meaning of the terms.[106]

Whether or not the transferor knew that their purpose was tax avoidance is as irrelevant as whether M. Jourdain knew that he was speaking prose.

The motive defence therefore involves a mixture of objective and subjective elements, as often happens.

Anything said on the meaning of tax avoidance in cases before *Willoughby* needs to be reviewed because it will not have considered an avoidance/mitigation distinction.

3.19 "Tax advantage"

3.19.1 *Tax advantage: Definitions*

The expression "tax advantage" is always defined. There is no single standard definition, but the definitions are based on a common template, so it is helpful to consider the as a separate topic, rather than in any particular context in which it may arise.

The expression was first used in the TiS TAAR in 1960.[107] That

[106] This is self-evident but if authority is needed, see *Beneficiary v IRC* [1999] STC (SCD) 134 at p.143: "The question of whether there was tax avoidance must be looked at objectively".
For completeness: In *Davies v HMRC* [2020] UKUT 67 (TCC) at [29], one ground of appeal was that the witnesses said that their motive was tax mitigation, and it should have been put to the witnesses that the motive was tax avoidance. The point was dismissed on the broad ground that the witnesses had fair notice of the issue and an opportunity to respond to it. But more narrowly and analytically, it should also have been said that the avoidance/mitigation issue was a point of law, not evidence, on which evidence not needed or admissible. (There is a suggestion to this effect at [33]).
The point was overlooked in *Fisher v HMRC* [2014] UKFTT 804 (TC) where the FTT asked, I think wrongly, whether the transferor appreciated that the transfer was avoidance rather than mitigation: see paras [422] - [430]. The point was not considered in the later appeals.

[107] Section 43(4)(g) FA 1960.

definition survives in the current CT version of TiS, and elsewhere. I discuss here the following definitions:[108]

Definition (my terminology)	**Reference**
Standard definition	Many; for example, s.16A TCGA
GAAR definition	s.208 FA 2013
IHT definition	s.162A(8) IHTA

Standard definition	**GAAR definition**	**IHT definition**
"Tax advantage" means—	A "tax advantage" includes—	"tax advantage" means—
(a) relief or increased relief from tax,	(a) relief or increased relief from tax,	
(b) repayment or increased repayment of tax,	(b) repayment or increased repayment of tax,	
(c) the avoidance or reduction of a charge to tax or an assessment to tax,	(c) avoidance or reduction of a charge to tax or an assessment to tax,	(a) the avoidance or reduction of a charge to tax, or
(d) the avoidance of a possible assessment to tax,	(d) avoidance of a possible assessment to tax,	(b) the avoidance of a possible determination in respect of tax.
	(e) deferral of a payment of tax or advancement of a repayment of tax, and	
	(f) avoidance of an obligation to deduct or account for tax.[109]	

The drafter sometimes adds a provision that:

> it does not matter whether the avoidance or reduction is effected—
> (a) by receipts accruing in such a way that the recipient does not pay or bear income tax[110] on them, or
> (b) by a deduction in calculating profits or gains.

[108] TiS has a non-standard definition: see 55.11.1 ("Income tax advantage").

[109] I think para (f) is referring to withholding tax.

[110] See App.2.3.2 (Bear tax by deduction or otherwise).

This also derives from the original 1960 provision. It is hard to see what it adds, and it probably adds nothing.[111] But as the precedent is there it has often been followed.

3.19.2 *The definitions compared*

The GAAR definition is slightly wider than the standard definition:

(1) It has become an inclusive definition. But this probably makes no difference. It is not easy to think of anything which is a tax advantage (in the general sense) which does not fall within paras (a) to (f).

(2) Paras (e) and (f) are added.

Post-2013 TAARs often adopt the GAAR definition, either by reference or repeating it verbatim,.

The IHT definition is based on the standard definition with minor variations appropriate for IHT.

3.19.3 *"Tax"*

The definitions set out above refer to "tax"; the actual tax or taxes referred to varies from one TAAR to another. The word is either defined expressly for the purposes of the definition of tax advantage; or else a default definition applies (in the IHTA, tax means IHT; in the IT Acts, tax means IT or CT).

In the GAAR definition, the word "tax" is of course widely defined. Section 206(3) FA 2013 provides:

> The general anti-abuse rule applies to the following taxes—
> (a) income tax,
> (b) corporation tax, including any amount chargeable as if it were corporation tax or treated as if it were corporation tax,
> (c) capital gains tax,
> (d) petroleum revenue tax,
> (da) diverted profits tax,
> (e) inheritance tax,
> (f) stamp duty land tax, and
> (g) annual tax on enveloped dwellings.

[111] This is (almost) self-evident, but if authority is needed, see *HMRC v Hyrax Resourcing Ltd* [2019] UKFTT 175 (TC) at [185]: "I would say that those additional words are unnecessary as that meaning is implicit in the first part of the definition ...".

TAARs refer only to UK taxes. A foreign tax advantage, or avoidance of foreign taxation, does not count.[112]

3.19.4 *Relief/repayment*

After some vacillation, the courts decided that "relief" in limb (a) of the definition is a word of wide import. It includes the exemptions for charities and pension schemes. In *Sema Group Pension Scheme v IRC*:[113]

> 63. [The taxpayer] submits that the relevant advantage obtained by the trustees in consequence of the buybacks was the tax credit to which the trustees were entitled ... and that the entitlement to a tax credit is not a "tax advantage" ... since it is neither a "relief" from tax nor a "repayment" of tax.
>
> 64. As to "relief", he submits that exemption from tax is a different concept from relief from tax, in that whereas relief from tax predicates a liability to tax which would have existed but for the relief, exemption from tax by definition precludes the existence of any such liability.
>
> [65] He further submits that there is nothing in the authorities to indicate that "relief" ... is to be given anything other than its normal and natural meaning, and that to construe it as including an entitlement to a tax credit would be to distort that meaning.
>
> [108] ... I reject [the taxpayer's] submissions based on the conceptual difference between exemption and relief. Such submissions seem to me to involve a degree of sophistication which runs entirely counter to the general approach to be adopted to the construction of the [TiS Code]...
>
> [109] In my judgment, what the draftsman was manifestly trying to do when defining "tax advantage" ... was to cover every situation in which the position of the taxpayer vis a vis the Revenue is improved in consequence of the particular transaction or transactions. ... the distinction between "relief" and "repayment" is not based on any conceptual difference between the two; the true interpretation of [the TiS TAAR] is in my judgment much simpler than that. In my judgment, "relief" ... is intended to cover situations where the taxpayer's liability is reduced, leaving a smaller sum to be paid, and "repayment" is intended to cover situations in which a payment is due from the Revenue. In the same way, the references to "increased relief" and "increased repayment" are directed at situations in which the taxpayer is otherwise entitled to a relief or repayment, with which the "relief" or "repayment" ... must be

[112] See 52.10 (Meaning of "taxation").

[113] 74 TC 593 confirming *IRC v Universities Superannuation Scheme* 70 TC 193.

> aggregated.
> [110] It follows that I respectfully agree with the observation of Aldous J in *Sheppard* (at p.253e) that the words "tax advantage" in the relevant statutory provision ... presuppose that a better position has been achieved. However, I respectfully differ from him when he goes on to answer the question "An advantage over whom or what?" by saying: "An advantage over persons of a similar class". In my judgment, the simple answer to that question is that a better position has been achieved vis a vis the Revenue.

3.19.5 *Tax advantage: Comparators*

The GAAR guidance provides:

> The concept of a "tax advantage" is common in UK tax legislation. The language suggests that in deciding whether an advantage arises the actual tax position should be compared with another tax position.
> The appropriate comparison or alternative tax position will depend on the facts, but will usually derive from the arrangements that would have occurred without the abusive tax purpose (which may include no arrangement at all).
> In situations where there is more than one alternative arrangement that might have been adopted if the taxpayer had not adopted an abusive arrangement, then the appropriate comparison would be the transaction that the taxpayer would most likely have carried out.[114] This might not be the arrangement that would give rise to the greatest tax liability.[115]

The loss-TAAR guidance[116] proposes a test to help identify the main purpose:

> ... it will be relevant to draw a comparison in order to consider whether,

[114] Footnote original: This follows the approach adopted by Lord Hoffmann in the Hong Kong case *IRC v Tai Hing Cotton Mill* (CACV 343/2005): "[The Commissioner] would not be entitled, as the more alarmist submissions of counsel for the taxpayer suggested, to make an assessment on the hypothesis that the taxpayer had entered into an alternative transaction which attracted the highest rate of tax. That would not be a reasonable exercise of power. But she may adopt the hypothesis which the evidence suggests was most likely to have been the transaction if the taxpayer had not been able to secure the tax benefit."

[115] HMRC "GAAR Guidance" (2015) para C2.5 *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

[116] See 65.21 (Capital-loss TAAR).

> in the absence of the tax considerations:
> [1] the transaction giving rise to the advantage would have taken place at all;
> [2] if so,
> [a] whether the tax advantage would have been of the same amount;[117] and
> [b] whether the transaction would have been made under the same terms and conditions.

I refer to this as a "**but-for**" test. It is not a decisive test.

Where the taxpayer passes the but-for test, ie the same arrangements would be made even without the tax advantage, it is likely that tax is not a main purpose. But tax *might* still be a main purpose. A person may have two main purposes, P1 (non-tax) and P2 (tax) either of which may be sufficient to cause the arrangements.

Where the taxpayer fails the but-for test, ie the same arrangements would *not* have been made but-for the tax advantage, it is likely that tax is a main purpose. A person may have two purposes, P1 (non-tax) and P2 (tax), where P1 is the main purpose (but not sufficient to trigger the arrangements). P2 is just enough, the straw that breaks the camel's back, but not a main purpose in itself. But that scenario seems somewhat implausible.

Elsewhere in the loss-TAAR guidance, HMRC say:

> So to determine whether or not the TAAR applies all the circumstances surrounding the arrangements have to be taken into account, considering:
> - the overall economic objective of the arrangements,
> - whether that objective is one that the participants might be expected to have, and which is genuinely being sought, and
> - whether that objective is being fulfilled in a straightforward way, or additional, complex or costly steps have been inserted.

3.19.6 *Loan relationship TAAR guidance*

The guidance on the loan relationship unallowable purpose test is lengthy, and it is not necessary to set it out in full. Cutting to the chase, s.442(4) CTA 2009 requires a "business or other commercial purpose" and that excludes a tax avoidance purpose if it is:

[117] Para [a] is not well expressed. It seems to ask whether in the absence of the tax considerations the tax advantage would have been of the same amount. It is not clear what point is being made here. But the rest of the paragraph makes sense.

> (a) the main purpose for which the company is a party to the loan relationship or, as the case may be, enters into the related transaction, or
> (b) one of the main purposes for which it is or does so.

Section 442(5) CTA 2009 provides:

> The references in subsections (3) and (4) to a tax avoidance purpose are references to any purpose which consists of securing a tax advantage[118] for the company or any other person.

This differs in part from standard TAAR wording. But the guidance is still relevant for other TAARs. The CF Manual provides:

> **CFM38150 Example** [Nov 2019]
> **Example of unallowable purpose**
> A company borrows £50 million from a finance company at arm's length. The company becomes insolvent and disposes of all its assets. This leaves it with an outstanding debt of £40 million. The company is not liquidated and interest continues to accrue on the debt.
> The finance company either does not accrue the interest receivable or it accrues the interest and then writes it off as a bad debt. The company accrues the interest and makes a deficit on which group relief claims are made.

The company continues to exist and the interest accrues, but is it correct to say that the company "accrues the interest"? The company does not do anything. Still, interest does accrue. HMRC give two reasons why the debit is disallowed. The first is based on s.444(2) which has no equivalent in other TAARs.

> The company has no activity which is within the charge to corporation tax (CTA09/S442(2)). The purpose of the loan relationship is therefore specifically excluded from being a business or commercial purpose and it is an unallowable purpose.

The second reason is of wider interest:

> In addition, although the loan relationship was originally bona fide, its continued existence is not commercial. The test of unallowable purpose

[118] "Tax advantage" has the CT definition: see s.476(1) CTA 2009. It is confusing to use the term "tax avoidance" and define it to mean tax advantage, as the two concepts are usually used with quite distinct meanings. But there it is.

> given by CTA09/S442(1) & (2) is the purpose of the loan relationship in the accounting period. The only purpose of the loan relationship in the current accounting period is to generate group relief, securing a tax advantage for another group company (CTA09/S442(5)).
> The debits relating to the loan relationship should be disallowed.

The omission to liquidate the company, or write off the debt, is itself an unallowable purpose. Is that going too far? Since HMRC's first reason is sufficient, the question does not arise here but it might elsewhere.

CFM38160 Application [Nov 2019]
Applying the unallowable purposes rule
... You will note from the Economic Secretary's comments that SS441-442

- will normally apply where UK branches of overseas companies borrow for overseas activities outside the UK tax net,
- will not normally apply where a company borrows to acquire shares in companies, whether in the UK or overseas, or to pay dividends, provided that the borrowings are not structured in an artificial way. And a similar view is taken as regards borrowings, whether from a third party or intra group, to acquire other business assets whether located in the UK or overseas. This approach is not affected by the substantial shareholdings rules, and
- will not normally apply where a company is choosing between different ways of arranging its commercial affairs, if it chooses the course that gives a favourable tax outcome, provided that tax avoidance is not the object, or one of the main objects, of the arrangements.

CFM38170 Application: Hansard Report [Nov 2019]
Applying the unallowable purposes rule: Economic Secretary's comments
'The Government are aware of concerns that have been raised by my hon. Friends and by others regarding the particular anti-avoidance provisions in paragraph 13 [now s.441/442]. This paragraph was amended significantly in Standing Committee but, because of the concerns that my hon. Friends and others have raised, I take the opportunity to allay some of the fears that have been expressed about the anti-avoidance rules.

Paragraph 13 of the schedule disallows tax deductions to the extent that tax avoidance is the main motive behind a loan relationship. We have been told of concerns that this could be interpreted as preventing companies from getting tax relief for legitimate financing arrangements. I am happy to offer a reassurance that this is not the intention of the legislation. The paragraph denies tax deductions on loans that are for the purpose of activities outside the charge to corporation tax. Among other things, this will ensure that UK branches of overseas companies do not get tax relief for borrowings that are for overseas activities outside the UK tax net.

We have been asked whether financing - which, for example, is to acquire shares in companies, whether in the UK or overseas, or is to pay dividends - would be affected by the paragraph. In general terms, the answer is no, but the paragraph might bite if the financing were structured in an artificial way.

It has been suggested that structuring a company's legitimate activities to attract a tax relief could bring financing within this paragraph - some have gone so far as to suggest that the paragraph might deny any tax deduction for borrowing costs. These suggestions are clearly a nonsense.[119] A large part of what the new rules are about is ensuring that companies get tax relief for the cost of their borrowing.

One specific point has been put to me by my hon. Friend the Member for Gloucester - that is, borrowing by a finance leasing company to acquire assets where this is more tax efficient than the lessee investing in the asset direct. Again, I am happy to offer a reassurance. Where a company is choosing between different ways of arranging its commercial affairs, it is acceptable for it to choose the course that gives a favourable tax outcome. Where paragraph 13 will come into play is where tax avoidance is the object, or one of the main objects, of the exercise.

Companies that enter into schemes with the primary aim of avoiding tax will inevitably be aware of that. The transactions we are aiming at are not ones which companies stumble into inadvertently. As one top tax adviser said recently, companies will know when they are into serious tax avoidance; apart from anything else, they are likely to be paying fat fees for clever tax advice and there will commonly be wads of documentation.

The last thing I want to do, however, is set out a list of so-called acceptable or unacceptable activities. Borrowing for commercial purposes can be structured in a highly artificial way in order to avoid tax. If we said that borrowing for certain types of activity would always be okay, tax advisers would quickly take advantage and devise artificial financial arrangements simply to avoid tax. Provided that companies are funding commercial activities or investments in a commercial way, they should have nothing to fear. If they opt for artificial, tax-driven arrangements, they may find themselves caught.

It is clear that a balance must be struck between meeting the concerns that have been raised and weakening the provision in those instances where it needs to apply, but I can assure my hon. Friends that we shall keep the matter under review.' (Hansard 28 March 1996 Finance Bill Report Stage, Columns 1192-1193.)

The reader may think that is rather shallow.

CFM38180 Transactions Not Normally Within 'Unallowable Purposes' [Nov 2019]
When CTA09/SS441-442 will not normally apply

S441-442 will not normally apply to loan relationship debits:

- simply because a company is able to obtain relief for the same expenditure or loss on the borrowing to which the debits relate in more than one jurisdiction. However, S441-442 would apply where the structure that has been adopted has one or more non-commercial features (so that the loan relationship can be said to have an unallowable purpose) and/or where, taking account of the overall position of the company or group, relief for interest and other finance costs might otherwise be available more than once in the UK in respect of the true economic costs of the borrowing;
- that relate to a borrowing from an exempt body (such as a pension fund), even if that exempt body is connected with the borrower, provided the arrangements are commercial;
- that relate to a straightforward borrowing by a UK plc in order to fund a repurchase of its shares provided that there are no attempts to structure the arrangement in such a way as to provide a tax advantage for any other person and/or the amount borrowed (the level

[119] Author's footnote: The reader may not agree.

of gearing up) is dictated by market forces and hence is at arm's length;

- that relate to a third party borrowing undertaken by one group member, that fulfils the commercial borrowing requirements of the group, which it on-lends interest-free (or at a rate not exceeding the costs of the third party borrowing) to other UK-resident group members. In such circumstances, S441-442 would not apply, provided that the group gets one and only one deduction in the UK for the costs associated with the true economic cost of the borrowing. For example, S441-442 will not normally apply where intra-group interest-free loans are made primarily to enable borrowings to be matched with assets within the meaning of CTA09/S317; or
- where a loan relationship debit in one group company is matched by an equal and opposite loan relationship credit, which is fully taxed, in another group company for the same loan relationship and the funding is not then utilised to secure a tax advantage. On the other hand, S441-442 are potentially in point if the main or one of the main purposes of the intra-group funding is to achieve a tax advantage for the group as a whole, in that the loan relationship credit on the intra- group funding is in some way shielded from tax. An example of the loan relationship credit being shielded would be the soaking up of otherwise stranded surplus expenses of management etc. Where the loan relationships involve cross-border transactions, thin capitalisation and transfer pricing legislation as well as the provisions of the Double Taxation Treaties may be applicable.

CFM38190 Transactions Normally Within 'Unallowable Purposes' [Nov 2019]

When CTA09/SS441-442 will normally apply

SS441-442 would normally apply to loan relationship debits:

- which, subject to the comments at CFM38180 (fourth and fifth bullets), relate to the write-off of loans where the purpose of the loans was not amongst the business or other commercial purposes of a company. An example of a loan of this nature would be an interest-free loan made by a company, whose business consists in operating a widgets retail outlet, which had lent the money to a football club supported by one of the directors of the company for the purpose of providing financial support to the football club. Furthermore, if the company borrowed to make the loan to the football club, then SS441-442 would normally also apply to disallow the loan relationship debits relating to the interest or other finance costs on that borrowing. If, however, the purpose of the loan included a commercial or other business purpose such as advertising, then this would be taken into account in arriving at the amount attributable to the unallowable purpose on a just and reasonable basis (S441(1)-(3));
- which, subject to the comments at CFM38180 (fourth and fifth bullets), relate to a borrowing the proceeds of which are used in such a way that the company cannot or does not expect to make an overall pre-tax profit. An example would be where a company borrows at interest and on- lends at a rate of interest that is less than the rate of interest on the borrowings; or
- where a company or a group of companies enters into one or more transactions or arrangements which have the main purpose or one of the main purposes of securing loan relationship debits for repayments of loan principal, in addition to payments of interest, on the true economic commercial borrowing to the company or group. An example of this would be where one group company undertakes a borrowing of £20 million at 8.4% for 5 years from a third party and at the same time a second group company pays that third party £13 million for preference shares of £20 million in the first group company to be delivered 5 years later. The effect of this is that, economically, the group borrows

£7 million on an amortising basis at 8.4% but for tax purposes the group claims relief as loan relationship debits for both the interest of £1.4 million on the group amortised borrowing of £7 million and the repayment of the £7 million loan principal. In such circumstances SS429-430 are likely to apply to disallow the amounts equivalent to repayments of principal.

3.19.7 *Tax advantage: Case law*

The TAAR guidance above is soundly based on TiS case law. The leading case is *IRC v Parker*:

> The paragraph, as I understand it, presupposes a situation in which
> [1] an assessment to tax, or increased tax, either is made or may possibly be made,
> [2] that the taxpayer is in a position to resist the assessment by saying that *the way in which he received what it is sought to tax* prevents him from being taxed on it;
> [3] and that the Crown is in a position to reply that if he had received what it is sought to tax *in another way* he would have had to bear tax.
> In other words, there must be a contrast as regards the "receipts" between
> [a] the actual case where these accrue in a non-taxable way with
> [b] a possible accruer in a taxable way,
> and unless this contrast exists, the existence of the advantage is not established.[120]

In the following discussion:

(a) The actual case, where the receipt accrues in a non-taxable way, is the **"actual receipt"**

(b) The "possible accruer in a taxable way" is the **"comparator"**, (sometimes called the "hypothetical receipt")

The comparator need not be received as a result of the same kind of transaction as was the actual receipt. *IRC v Cleary*[121] concerned a share sale: the shareholder sold shares to a company for cash. The actual receipt of the proceeds of sale was not income-taxable. The comparator was a possible dividend from the company (which would have been income-taxable). So there was a "tax advantage".[122] A dividend and a sale are different types of transaction. The dividend would reduce the company's

[120] 43 TC 396 at 441 (emphasis added).

[121] 44 TC 399 at p.423. For TiS aspects of this case, see 55.14.4 (Sale to close co for cash).

[122] At that time the standard definition applied to both IT and CT TiS codes.

assets available for distribution (unlike the actual sale). That did not matter. So in short, the question was whether the company can pay a dividend to the shareholder equal to the amount which the shareholder received tax-free.

The comparator must involve receipt of the same asset as the actual receipt. *Anysz v IRC*[123] concerned a share for share exchange: the shareholder transferred shares in A Ltd to another company (B Ltd) in exchange for an issue of shares in B Ltd. B Ltd could have declared a cash dividend, but cash was not a valid comparator to the actual receipt of B Ltd shares. However A Ltd could have:

(1) bought B Ltd shares, and
(2) distributed them to the shareholder by dividend in specie.

That was a valid comparator. Hence the shareholder obtained a "tax advantage".

3.19.8 *Tax advantage/avoidance compared*

On a natural reading,"tax advantage" in the standard sense is wider than tax avoidance. Tax advantage includes a relief from or repayment of tax, as well as the avoidance or reduction of a charge to tax. The concept thus includes both tax avoidance and mitigation.

In *Marwood Homes v IRC*:

> Taking steps to obtain relief under s 242 [ICTA 1988] following payment of a dividend outside a group election is clearly within the spirit of the ACT code in the tax legislation. But the fact that a transaction has been carried out to achieve a benefit conferred by a statutory provision will not of itself exclude the application of [the TiS rules]. This follows from the definition of tax advantage in [what is now s.732 CTA 2010] which covers both everyday tax planning and transactions, such as traditional dividend stripping, which fall more obviously within the mischief that [the TiS code] was introduced to counteract. The only safeguards available to the taxpayer are the clearance procedures and the escape clause [motive defence]. It cannot therefore avail Marwood to rest its case on the simple proposition that the dividends ... were directly within the spirit of s 242.[124]

That concerns the meaning of "tax advantage" in the TiS code, where

[123] 53 TC 601.

[124] [1999] STC (SCD) 44 at [20].

special principles of construction apply, but it should apply to TAARs generally.[125]

The same approach was taken in the context of DOTAS.[126]

Nevertheless, the context of some TAARs may show otherwise. HMRC guidance on TAARs often adopts an avoidance test.[127]

3.20 Avoidance/mitigation distinction

This section sets out the most important judicial and other statements on the avoidance/mitigation distinction, which is at the core of the concept of "tax avoidance".

I would first of all note a widespread misconception. It is the misconception that the term "tax avoidance" has a single, relatively clear-cut referent; that subject perhaps to some borderline cases, to classify a transaction as tax avoidance is as straightforward and unproblematic as to identify the colour of a dye. This may relate to a wider misconception about the nature of language, namely the mistake that the meaning of words is given by the existence of things in the world to which they correspond, so that, with any contested term, one can find a core referent and establish what the word really means.

3.20.1 *Avoidance: Willoughby definition*

IRC v Willoughby is the leading case:[128]

> Tax avoidance within the meaning of [the ToA motive defence] is a course of action designed to conflict with or defeat the evident intention of Parliament.[129]

I refer to this as the **"Willoughby definition"** of tax avoidance.

[125] See 55.1.2 (Construction of TiS code).

[126] *HMRC v Hyrax Resourcing Ltd* [2019] UKFTT 175 (TC) at [151] - [161]. But the arrangement in that case did constitute tax avoidance in the strict sense, so the issue did not need to be decided.

[127] See 65.21.5 ("Genuine" loss and the TAAR).

[128] [1997] UKHL 29.

[129] The Tax Law Review Committee used a similar definition of "avoidance" but referring also to the possibility of Parliamentary oversight:

> We have regarded tax avoidance as action taken to reduce or defer tax liabilities in ways that Parliament plainly did not intend or could not possibly have intended had the matter been put to it.

Tax avoidance: A Report by the Tax Law Review Committee (1997) para 1.13, citing *Willoughby*.

3.20.2 *Avoidance/mitigation distinction rejected*

Two cases on the CGT reorganisation TAAR have rejected the avoidance/mitigation distinction. In *Snell v HMRC*:[130]

> 35. Counsel for the Revenue did not dispute the relevance of the dictum of Lord Nolan in *IRC v Willoughby*. He was content to submit that the relevant parliamentary intention is that to be found in s.135, namely that acceptance of loan notes is legitimate to defer liability to capital gains tax but not as part of a scheme to avoid it altogether. Such a scheme, he submitted, comes within the express words of s.137. Accordingly that section applies so as to withhold the right to deferral of liability which would otherwise be conferred by s.135.

But the Judge took a different view:

> 36. I have difficulty in understanding why the dictum of Lord Nolan in *IRC v Willoughby* is relevant to the construction of that part of s.137(1) as requires one of the main purposes of the scheme or arrangements to have been the avoidance of liability to capital gains tax. The passage on which counsel for Mr Snell relies deals with the difference between tax mitigation and tax avoidance. No such distinction is drawn in s.137.... it matters not whether the scheme etc. was formed for purposes of tax mitigation, avoidance or indeed evasion.[131]

It is true that the avoidance/mitigation distinction is not "drawn", in the sense that it is not expressly mentioned, in s.137 TCGA. But it is also not expressed in the ToA motive defence, or anywhere else. It is inherent in the word "avoidance", as understood by tax lawyers and well informed commentators, since *Willoughby*.

The comment in *Snell* was not a necessary part of the decision, and so non-binding.[132] In *Wilkinson v HMRC*[133] it was simply ignored (pre-

[130] [2006] EWHC 3350 (Ch). For completeness, the same issue arose in *Coll v HMRC* [2010] UKUT 114 (TCC) but this case primarily concerns the factual issue of what whether the taxpayer actually intended to leave the UK at the time of the exchange in question.

[131] [2006] EWHC 3350 (Ch) at [36].

[132] The textbook *Taxation of Companies & Company Reconstructions* (looseleaf) agrees: para W1.4.1.

[133] [2023] UKFTT 695 (TC) at [87]; though the FTT held that the transaction was avoidance, not mitigation, so the issue did not in fact arise; see 3.20.3 (How evident is "evident").

sumably HMRC did not raise it in argument). I thought it was just an aberration. However the same conclusion was reached in a lightly reasoned passage in *Delinian v HMRC*:[134]

> 52. We can deal briefly with Euromoney's argument that the FTT ought to have held that the word "avoidance" in section 137(1) was to be construed objectively as a course of conduct designed to defeat the evident intention of Parliament, as distinct from the acceptance of an offer of freedom from tax which Parliament has deliberately made (the *Willoughby* point). Euromoney submitted that taking advantage of the substantial shareholdings exemption was not tax avoidance, and that section 137 was not engaged because the second limb, with its reference to tax avoidance, never arose.
> 53. In our judgment, the Chancellor was right in *Snell* to place emphasis on the fact that the regime in sections 135-137 provides for the right to defer tax to be lost if it is used to avoid tax altogether. Parliament has said that, if the exchange of shares forms part of a scheme or arrangements of which even a main purpose is tax avoidance, the taxpayer loses the ability to rely on the deferral mechanism at all, and must pay all the tax at that stage. That is an entirely intelligible Parliamentary intention.
> 54. Lord Nolan in *Willoughby* was contrasting tax avoidance with the acceptance of a deliberate offer made by Parliament of freedom from tax. That was not the situation in this case. Euromoney's scheme or arrangements involved deferring tax in order later to take advantage of the substantial shareholdings exemption. That was to rely on a provision intended to defer tax to secure an outcome where no tax was paid. The meaning of tax avoidance in section 137(1) is clear without the need to refer to Willoughby. If the scheme or arrangements lead to the non-payment of tax that would otherwise have had to be paid, even if deferred, then that is tax avoidance for these purposes.

There is no material distinction between the ToA motive defence and the CGT reorganisation TAAR. The distinction should apply to the CGT reorganisation TAAR as it applies to other TAARs which use the word "avoidance". TAARs carefully distinguish between tax avoidance and tax advantage. It remains to be seen if the Supreme Court will have an opportunity to put the matter right.

[134] [2023] EWCA Civ 1281 at [8] (emphasis original). This case was reported under the name *Euromoney* in the FTT and UT, because Euromoney changed its name to Delian in 2023, following a takeover. For the facts of this case, see 3.4.1 (Test whole arrangement).

Assuming no appeal, the passage in *Delinian* is not binding because the case was decided on another point. If it comes up again it deserves to be dealt with at length, not "briefly". It is suggested that a tribunal below the level of CoA should refuse to follow it, even in the context of the CGT reorganisation TAAR. If that does not happen, the point may become settled in Courts below the level of CoA. Even then, it is considered that the comment ought to be restricted to the CGT reorganisation TAAR and not to apply to other TAARs.

In practice the issue will rarely arise, as nowadays the Courts are quick to find that there is avoidance in the *Willoughby* sense, as they did on the facts of *Snell* and *Delinian*.

What if, say, there was a share for share exchange with the expectation that the individual would make a (CGT free) gift to charity in the following year? Or die and receive the CGT uplift on death? One would expect that that reorganisation relief would apply. Prior to *Delinian* I would have said this was because there was mitigation not avoidance. Now one would have to say that the purpose was not avoidance or mitigation.

Lying unexpressed behind *Snell*, and, perhaps, *Delinian,* was scepticism about the use and coherence of an avoidance/mitigation distinction. There is a debate to be had on those topics,[135] but the ship has sailed.

3.20.3 *How evident is "evident"*

Looking back on the *Willoughby* definition of avoidance, after a generation has passed: it still represents the law on the meaning of avoidance, but the Courts have applied the test of what is avoidance with less stringency than "evident" intention might suggest. The boot is on the other foot: there is mitigation if the tax planning is consistent with the evident intention of parliament, and less clear cases are avoidance. On this reading, even *Willoughby* would be a borderline case.[136] For example, avoidance includes:

(1) A Jersey resident non-domiciled individual transferring UK farmland to a Jersey company, to avoid IHT[137]

(2) An exchange of shares for securities, in circumstances where:

  (a) An immediate sale of the shares would be subject to CCT; but

[135] See 3.27 (Tax avoidance: Critique).

[136] The result would have been different if it was planned from the start that the taxpayer would be non-resident when disposing of the offshore policy.

[137] See 52.21.2 (Transfer for avoidance).

(b) A disposal of the securities a year or so after the exchange would not be subject to CGT, because:
 [i] The individual would then be non-resident[138]
 [ii] shares were given to the shareholder's children who would then qualify for entrepreneur's relief[139]
 [iii] the individual would then qualify for the substantial shareholder exemption[140]

In this list:

(1) Item [i] is not surprising. Going non-resident has at least an element of avoidance.[141]

(2) Item [ii] is not surprising in the context of the decision, because artificial steps were required to qualify for the relief:

> I do not ... accept the appellants' argument that the Wilkinsons' CGT planning was ... merely "the acceptance of an offer of freedom of tax which Parliament had deliberately made" – as
> (1) securing the CGT planning affected the deal in material ways ...
> (2) one of those ways – satisfying the condition [that the daughters held shares after the share-for-share exchange, and were directors] – went against the commercial grain of the deal – being, to have BCA take over P Ltd from its former shareholders; that element therefore
> (a) required significant negotiation (and ... caused there to be some risk of the deal failing) and
> (b) led to the insertion into the deal of significant features that otherwise would not have been present (the daughters' post completion holding of B ordinary shares and directorships).[142]

(3) Item [iii] seems somewhat surprising. But there it is. The point will not often arise, as SSE will usually be available on a reorganisation as on a sale of shares.[143]

[138] See 58.6.2 (CGT avoidance by non-residence).

[139] *Wilkinson v HMRC* [2023] UKFTT 695 (TC) at [87].

[140] *Euromoney v HMRC* [2021] UKFTT 61 (TC); the point was not discussed on the appeals to the UT or to the CoA (where the case was reported under the name *Delinian*).

[141] See 108.7.2 (Emigration to treaty-state).

[142] [2023] UKFTT 695 (TC) at [87].

[143] SSE did not apply in *Euromoney* because at the time of the share-for-share exchange, the shares carried no dividend rights: see [2021] UKFTT 61 (TC) at [5].

3.20.4 *Watered down definitions*

HMRC adopt this watered-down approach:

> Tax avoidance is any action taken to obtain a tax advantage in a way that Parliament did not intend or would not have intended had the matter been put before it. This definition is based upon the report on tax avoidance produced by the Tax Law Review Committee in 1997.[144]

Note that HMRC had already altered the nuance by deleting the words "plainly" and "possibly" from the TLRC formulation set out above: Lord Nolan's emphasis (expressed by use of the word *evident)* is absent in HMRC's definition.

House of Commons Briefing Paper "Tax avoidance and tax evasion" has offers more examples of watering down the definition:[145]

In the House of Lords:

> Lord McKenzie: The term "tax avoidance" is usually used to refer to an inappropriate reduction in tax liability.

In the Commons:

> Mr Gauke: avoidance ... is widely understood to entail taking a view of the tax treatment of a transaction that is tenable but has tax consequences that were not intended by the legislature.

And HMRC:

> Judith Knott (then HMRC Director, Corporation Tax International Anti-Avoidance): What we mean by legitimate tax planning is tax planning that is very much in line with Parliament's intentions when it passed the rules. A good example would be putting cash into an ISA account. That is legitimate and what Parliament intended to happen. Avoidance, on the other hand, is behaviour that seeks to bend the tax rules in a way that Parliament did not intend.

With hindsight, one can see that HMRC have been successful in promoting these looser readings of the definition in the Courts. This reflects changes

[144] IR152 Trusts: An Introduction (withdrawn on 30/09/04) *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

[145] Briefing paper no 7948, 13 April 2021 *http://researchbriefings.files.parliament.uk/documents/CBP-7948/CBP-7948.pdf*

in public and judicial opinion since *Willoughby* was decided in 1997.[146]

There have been some attempts to be more specific.

3.20.5 *Special tax regime*

In *IRC v Willoughby*:

> The genuine application of the taxpayer's money in the acquisition of a species of property for which Parliament has *determined a special tax regime* does not amount to tax avoidance merely on the ground that the taxpayer might have chosen a different application which would have subjected him to less favourable tax treatment.[147]

This repeats the test of the intention of parliament (what parliament has "determined" is, I think, the same as what parliament has intended). It brings the added refinement of identifying "special tax regimes" which parliament intended to apply. Professor Willoughby's offshore bonds seem a reasonably clear[148] example of a "species of property for which parliament had determined a special tax regime".

This approach can be generalised into all occasions where parliament has determined a "special tax regime" (regardless of whether there is any particular "species of property" involved):

> The adoption of a course of action which avoids[149] tax should not fall within section 99 if the legislation, upon its true construction, was intended to give the taxpayer the choice of avoiding it in that way.[150]

The existence of a special tax regime is neither a necessary nor a sufficient condition of tax mitigation. It is only a factor to consider. There is no relieving provision for bed-and-breakfast transactions, which are accepted as mitigation.[151] Conversely, as the Special Commissioner rightly said in *Carvill v IRC*:

[146] See 2.5 (Attitudes to tax avoidance).

[147] [1995] STC 143 at p.183, emphasis added. This is from the CoA judgment, but HL did not disagree.

[148] It might be argued that parliament had intended the chargeable events regime for normal bonds but not for personal portfolio bonds.

[149] Lord Hoffmann has here used "avoid" in the loose etymological sense (to include mitigation). Section 99 provided that an arrangement was void as against the Commissioner for Income Tax if its purpose or effect was "tax avoidance".

[150] *O'Neil v IRC* [2001] STC 742.

[151] See 3.20.8 (Other indicia of avoidance).

> It is not enough to say that if you find a relieving provision then it is the evident intention of Parliament that the taxpayer should be entitled to use it whatever the circumstances. As *Furniss v Dawson* shows it is quite possible to mis-use a relieving provision. To give an example in the same area as this case, suppose the Appellant had formed [the non-resident company] solely to give him a non-resident employer in order to obtain the foreign emoluments deduction. If that company had been funded entirely by the UK companies and had done nothing other than employ the Appellant, it might be the case that the Appellant would have been avoiding tax because he was misusing a relieving provision. ... the taxpayer must do more than point to the existence of a relieving provision; he must be using, rather than misusing, the relieving provision in a way consistent with Parliament's evident intention.[152]

Willoughby was perhaps close to the line. In *Davies v HMRC* the taxpayer owned a non-resident property development company through an offshore life insurance wrapper. This was (unsurprisingly) held to be avoidance:

> The taking out of life policies per se does not constitute tax avoidance. However, unlike in *Willoughby*, that is not the only transaction in this case. The creation of a special purpose vehicle was primarily for the purpose of creating an entity to complete the purchase in SAP's place. The selection of Mauritius as the jurisdiction for this vehicle, however, was specifically for tax reasons: to avoid paying tax in the UK under the terms of the Treaty. In addition, the purpose of creating a vehicle to replace SAP was to avoid SAP becoming liable to UK tax on income from the property development ...[153]

3.20.6 *Choices and avoidance*

There is sometimes said to be a "choice principle", which is:

> Choosing between two alternatives – if one is carrying out a commercial or a family or an investment transaction, choosing the most tax-efficient – is not avoidance.[154]

[152] [2000] STC (SCD) 1543 at [91].

[153] [2018] UKFTT 559 (TC) at [88]. The UT agreed: [2020] UKUT 67 (TCC) at [43]. HMRC conceded that the company did not have a UK PE, but nowadays the company would be subject to CT on its profits, PE or no PE: see 22.3 (Dealing/developing UK land).

[154] Baker "Tax avoidance, tax mitigation and tax evasion" *https://vdocuments.mx/tax-avoidance-tax-mitigationphilip-baker.html*

It is self-evident that no such principle exists; or at least, expressed in this form, it goes too far. If a UK settlor creates a trust for their family they have to choose between UK and foreign trustees; but the choice of foreign trustees by a UK settlor is avoidance.[155]

One can accept a choice principle if it is combined with the concept of the intention of parliament, ie if the settlor makes choices *within the intention of parliament*, there is no tax avoidance; this is equivalent to the concept of "special tax regime".[156]

The choice principle is said to be based on the well-known passage from *Brebner*.[157] But it is essential to distinguish two issues:

(1) Identifying the purpose
(2) Classifying the purpose as avoidance/mitigation

Brebner, if one reads it carefully, only concerns point (1). It is not an early recognition of an avoidance/mitigation distinction: that would be anachronistic because the distinction was not then made.[158] It would also be wrong because that distinction is irrelevant in the transactions in securities motive defence.

In *Fisher* in the Upper Tribunal it was common ground that:[159]

> Picking a lower tax route over a higher tax route does not equate to tax avoidance (but equally does not preclude tax avoidance)

3.20.7 *Economic consequences*

In *Willoughby*:[160]

> The hallmark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the *economic consequences* that Parliament *intended* to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hallmark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to

[155] The choice principle has been criticised in Australia, as a "false dichotomy": see Myers "Tax avoidance and the High Court since Sir Garfield Barwick" *http://law.unimelb.edu.au/__data/assets/pdf_file/0005/1585994/2005-Myers1.pdf*

[156] See 3.20.5 (Special tax regime).

[157] See 3.11 (Choices and purpose).

[158] It is possible that an unarticulated avoidance/mitigation distinction was embryonically present in *Brebner*.

[159] [2020] UKUT 62 (TCC) at [107] where this proposition was common ground.

[160] See App.7.7.2 (Economic reality/consequences).

> him by the tax legislation, and genuinely suffers the *economic consequences* that Parliament *intended* to be suffered by those taking advantage of the option.[161]

This repeats the test of the intention of parliament with the added refinement of identifying "economic consequences". This is based on two Templeman judgments:

> The material distinction in the present case is between tax mitigation and tax avoidance ... Income tax is mitigated by a taxpayer who reduces his income or incurs expenditure in circumstances which reduce his assessable income ...Income tax is avoided ... when the taxpayer reduces his liability to tax without involving him in the loss or expenditure which entitles him to that reduction. The taxpayer engaged in tax avoidance does not reduce his income or suffer a loss or incur expenditure but nevertheless obtains a reduction in his liability to tax as if he had.[162]

The non-recourse loan in *Ensign Tankers* is an example of a transaction without economic consequences and in *Challenge* Lord Templeman gave another example which is particularly relevant to trusts:

> When a taxpayer makes a settlement, he deprives himself of the capital which is a source of income and thereby reduces his income. If the settlement is irrevocable and satisfies certain other conditions the reduction in income reduces the assessable income of the taxpayer. The tax advantage results from the reduction of income.[163]

These are transactions with obvious economic consequences.

Professor Willoughby's investment in his bond had some "economic consequences" as compared to a direct investment in the underlying assets though one might have thought they were not very substantial.[164]

[161] [1997] UKHL 29 (emphasis added).

[162] *IRC v Challenge* [1986] STC 548 cited in *Ensign Tankers v Stokes* [1992] STC at p.240. Lord Millett (whose decision in the High Court was reversed in *Ensign Tankers*) took the opportunity in *Collector of Stamp Revenue v Arrowtown Assets* [2003] HKCFA 46 *http://www.ird.gov.hk/eng/pdf/facv4_2003.pdf* to cast doubt on the correctness of *Ensign Tankers*, but that does not affect the point here.

[163] *IRC v Challenge* [1986] STC at p.554–555.

[164] Lord Nolan identified the following economic consequence [1997] UKHL 29:

> "The reality in truth is that the bond holder has a contractual right to the benefits promised by the policy, no more and no less. It is therefore quite wrong to describe the bond holder as having, in the words of the Appellants' printed case 'in substance all the advantages of direct personal ownership without the tax

The GAAR also uses an "economic" criteria. Section 207(4) FA 2013 provides:

> Each of the following is an example of something which might indicate that tax arrangements are abusive—
>
> (a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,
>
> (b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes...

3.20.8 *Other indicia of avoidance*

It is suggested that "economic consequences" and "special tax regime" are categories of tax saving steps which do accord with the intention of parliament but are not an exhaustive categorisation of mitigation. They should be regarded as indicia or "badges" of mitigation (like the badges of trade). One can think of others. The Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations are interesting series of attempts to identify indicia of tax avoidance for the purposes of disclosure obligations. The fact that the regulations (originally made 2004) were amended in 2006, 2009, 2010, 2013 and 2016 shows that the exercise was not a straightforward one. The indicia in the Regulations include:
(1) confidentiality from other promoters; and
(2) premium fees (typically linked to tax savings).

OECD also identified secrecy[165] as a common characteristic of avoidance:

> disadvantages'. The significance of this misdescription would become all too apparent if—perish the thought—Royal Life were to become insolvent and unable to meet its obligations to the bond holders."

Before 2008 I described this as unconvincing, as the insolvency of Royal Life seemed so remote a possibility as to be discounted. The 2008 recession proved the risk was not quite as low as one might have thought.

See App 7.7 (Economic reality etc).

[165] There are different types of secrecy:
(1) Secrecy (better described as confidentiality) against other tax advisers (the scheme vendor wishing to keep the profits of a scheme to themselves).
(2) Secrecy against HMRC (as OECD envisage) in order to postpone the time when HMRC are informed for as long as lawfully possible.
(3) Secrecy against HMRC in order to avoid or frustrate any investigation. Of course dishonest breach of a duty of disclosure marks a point where avoidance

> Secrecy may also be a feature of modern avoidance. In some cases tax advisers sell ready-made avoidance devices, one term of the contract of sale being that the taxpayer keeps the facts secret for as long as possible. It is in the interest of the avoiders to keep the administration from learning about new schemes because official and public knowledge may be followed by legislation to counter that kind of avoidance.[166]

Neither secrecy nor premium fees are normally associated with commonplace offshore trust transactions. But if, exceptionally, that was the case then it would be a factor suggesting that the transaction should be characterised as tax avoidance.

3.20.9 *Established practice*

An important indicia is familiarity and use. Once a tax avoidance arrangement becomes common, it is almost always stopped by new legislation within a few years. If something commonly done is contrary to the intention of parliament, it is only to be expected that parliament will stop it. So that which is commonly done and not stopped is not likely to be contrary to the intention of parliament. It follows that tax reduction arrangements which have been carried on for a long time are unlikely to constitute tax avoidance.

There are arguments against this view.

(1) It may seem strange that an act might be stigmatised as tax avoidance if challenged by HMRC or parliament promptly after it is first done; but if such acts become the general practice over a period of time then the intention of parliament is decided differently.

(2) Common practice may not be easily identified, It may be quickly forgotten (especially given a swift turnaround of HMRC staff and lack of institutional memory).[167] Whether it is recorded may be a matter of chance.

becomes evasion.

Concealment in category (3) is not primarily characteristic of tax avoidance schemes. It is a problem which may affect all aspects of tax collection (whether or not involving avoidance). The Keith Committee recognised this: Enforcement Powers of Revenue Departments (1983) Cmnd 8822 para 7.3.5. By contrast, lawful concealment in category (1) and (especially) category (2) is an indicia of tax avoidance.

[166] OECD Report by Committee of Fiscal Affairs (1980) cited in OECD International Tax Avoidance and Evasion (1987), p.17.

[167] For an example, see 34.18.8 (Dual-contract rule: Critique).

Nevertheless, the better view is to have close regard to this factor. Judges have a strong intuitive sense that that which everyone does, and has long done, should not be stigmatised with the pejorative term of "avoidance". This, I suggest, is the true reason why the courts classify bed-and-breakfast transactions and back-to-back loans as mitigation and not tax avoidance.[168]

This is consistent with the approach of the GAAR. Section 207(5) FA 2013 provides:

> The fact that tax arrangements accord with established practice, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice, is an example of something which might indicate that the arrangements are not abusive.

Professor Sandford drew another categorisation of tax savings which offers a related indicia of avoidance. He refers to:

(1) Tax savings offered by government to induce a certain kind of behaviour or to fulfill what it feels to be an obligation.
(2) Methods of saving that a government dislikes, but allows to remain for administrative reasons.
(3) Tax savings deriving from technical loopholes unforeseen at the time of drafting.[169]

Category (1) is obviously mitigation and category (3) is obviously avoidance. It is suggested that category (2) should be classified as mitigation rather than avoidance. An example is a transfer of a land-owning company (instead of its land) to reduce the rate of stamp duty from SDLT rates on land to SD rates (if any) on shares. The Government considered imposing stamp duty at land rates on shares in land-owning companies to prevent this, but decided not to proceed with the idea.[170]

[168] *Ensign Tankers (Leasing) v Stokes* 64 TC 617 at p.741: "A taxpayer who carries out a "bed and breakfast" transaction by selling and repurchasing shares establishes a loss for capital gains tax because he has actually suffered that loss at the date of the transaction. In "back to back" transactions the taxpayer is entitled to any reduction in tax which Parliament has attached to each transaction."
Back-to-back loans have been accepted by HMRC for decades: International Tax Handbook, para 1201.

[169] *Tax Avoision* (1979, IEA) p.81.

[170] Modernising Stamp Duty (HMRC, Consultative Document 2002) para 2.34. Contrast Australia where the transfer of shares in "land-rich" companies is subject to stamp duty at the rates applicable to land.

ATED is said to be aimed at these transactions, but is restricted to residential property. Transfers involving other property should be considered mitigation rather than avoidance. An example is the use of offshore companies to hold UK assets (other than UK residential property) to save IHT.

3.21 Failed indicia of avoidance

3.21.1 *Spirit of statute*

Other approaches in distinguishing tax avoidance and tax mitigation are to seek to identify "the spirit of the statute" or "misusing" a provision. I take this to mean exactly the same as the "evident intention of parliament" properly understood. If that is right, the expression adds nothing but rhetoric and confusion. If it means anything vaguer or more intuitive than that, then the concept deserves the ridicule expressed in *Norglen v Reeds Rains Prudential*.[171] Either way, the expression is best avoided in this context (and indeed in any context, other than the theological[172] from which it draws its rhetorical power.)

3.21.2 *"Artificial/devices"*

Another approach is to seek to identify "artificial" transactions. This raises a number of difficulties.

First, while tax avoidance frequently involves transactions that can be described as "artificial", this is not always the case. You can have tax avoidance without much (if any) artificiality[173] and, of course, artificiality without tax avoidance. That in itself would not be a fatal objection if we are merely seeking badges of avoidance and not a test which will work every time.

However, the unlawyerlike term "artificial" is too vague to be useful even as a badge of tax avoidance. The 1955 Royal Commission commented on s.44 F(No. 2)A 1915 ("A person shall not, for the purpose of avoiding

[171] "It is not that the statute has a penumbral spirit which strikes down devices or strategies designed to avoid its terms or exploit its loopholes. There is no need for such spooky jurisprudence." [1999] 2 AC 1 at p.14.

[172] 2 Corinthians 3:6-8: "... a new covenant, not of the letter but of the Spirit. For the letter kills, but the Spirit gives life".

[173] For instance: (1) appointment of a non-resident trustee; (2) transfer to a non-resident company; (3) sale of an income stream for a capital sum (now caught by Income Stream code).

payment of excess profits duty, enter into any fictitious or artificial transaction ..."):[174]

> A transaction is not well described as "artificial" if it has valid legal consequences, unless some standard can be set up to establish what is "natural" for the same purpose. Such standards are not readily discernible.

The Supreme Court makes the same point:

> Artificiality, if it is to be deployed as a workable legal concept, has to be tested against some standard of transactional normality, and the search for such a standard is far from straightforward.[175]

The problem is not that the word "artificial" is meaningless. But it only has a meaning to the extent that there are standards of what is non-artificial (or "natural" or "normal").[176]

For a striking illustration, see the comment of a MP opposing the proposal in the Married Women's Property Bill 1868, that a married woman should own property, as creating:

> an *artificial* and an unnatural equality between men and women.[177]

The 1915 Act was used as a model for anti-avoidance provisions, thus forcing the courts to decide what is artificial as best they can:

> 'Artificial' is an adjective which is in general use in the English language. It is not a term of legal art; it is capable of bearing a variety of meanings according to the context in which it is used. ... their Lordships

[174] Royal Commission on the Taxation of Profits and Income Cmd. 9474 para 1024.

[175] *Pendragon v HMRC* [2015] UKSC 37 at [5]. Similarly, *Hurstwood Properties v Rossendale BC* [2021] UKSC 16 at [51]: "Nor does it illuminate the legal issues to use words such as "artificial" or "contrived" ..."

[176] In this respect "artificial" is like "real"; see App 7.7.1 (Economic terms with antonym).
A further problem is that if standards of artificiality can be identified, a transaction is may be regarded as more or less artificial, that is, artificiality is a matter of degree which does not easily lend itself to resolution into the stark dichotomy of artificial/non-artificial. But resolving shades of gray into black or white is a problem which frequently arises in law.

[177] Married Women's Property Bill Deb 18 May 1870, vol 201 cc878-92 *https://api.parliament.uk/historic-hansard/commons/1870/may/18/bill-16-second-reading* see Holford, "Victorian Wives and Property" in Vicinus, *A Widening Sphere* (1980).

> reject the trustees' first contention that its use by the draftsmen of the subsection is pleonastic, that is, a mere synonym for 'fictitious'. A fictitious transaction is one which those who are ostensibly the parties to it never intended should be carried out. 'Artificial' as descriptive of a transaction is, in their Lordships' view a word of wider import.

No further definition was attempted:

> Where in a provision of a statute an ordinary English word is used, it is neither necessary nor wise for a court of construction to attempt to lay down in substitution for it, some paraphrase which would be of general application to all cases arising under the provision to be construed. Judicial exegesis should be confined to what is necessary for the decision of the particular case. Their Lordships will accordingly limit themselves to an examination of the shares agreement and the circumstances in which it was made and carried out, in order to see whether that particular transaction is properly described as 'artificial' within the ordinary meaning of that word.[178]

In *CT Audit v Cigarette Company of Jamaica* the Privy Council cite this and continue:

> 22. ... a transaction is an abstract construct. Every transaction is in a sense artificial in that it is put together by two or more parties in order to create or alter legal rights and obligations as between them. While mindful of Lord Diplock's warning against too much judicial exegesis the Board consider that in this context a transaction is "artificial" if it has, as compared with normal transactions of an ostensibly similar type, features that are abnormal and appear to be part of a plan. They are the sort of features of which a well-informed bystander might say, "This simply would not happen in the real world." Recognising a transaction as artificial in this sense is an evaluative exercise calling for legal experience and judgment. It is certainly not an ordinary question of primary fact....
> 23. A transaction is not artificial merely because it is not commercial, or not fully commercial. Income tax affects transactions by way of bounty as well as commercial transactions. But if a transaction effected in a commercial context is attacked as uncommercial that may be a reason for looking at it closely... it is necessary to examine the particular transaction and the circumstances in which it was made and carried out.[179]

[178] *Seramco Superannuation Fund Trustees v IT Commissioner* [1977] AC 287.
[179] [2012] UKPC 9 at [22] - [23].

A long term interest-free company loan to a shareholder (rather than dividend) was held not to be artificial. It was relevant that the borrower was able to repay.

It would be easy to compose a judgment in favour of the opposite view (as did the court at first instance.) The word "artificial" is unclear because there are rarely clear standards. It is of little if any use in determining whether examples which arise in practice are tax avoidance.

In practice the word "artificial" is often used to describe a transaction carried out for tax avoidance purposes. A transaction is not categorised as tax avoidance because it is artificial: it is described as artificial because it is tax avoidance. For instance:

> such elaborate arrangements would not have been entered into other than for the purpose of tax avoidance. The arrangements had no genuine commercial purpose. ... The arrangements can, *therefore*, correctly be described as artificial.[180]

Similar points apply to that particular obstacle to clear thinking, the pejorative term "device".[181] The term "contrived" is just a synonym of "artificial".

In UK statutory drafting the word or concept "artificial" is not used. The word abnormal is occasionally used, and whatever its problems, it is at least clearer than artificial, as it raises the fundamental issue directly and not indirectly: what is normal and what is not?

3.21.3 *"Genuine"*

The word "genuine" is used in three distinct senses:

(1) It is used as the antithesis of sham (in the legal sense of the term, aka fictitious). In *Ramsay v IRC*:[182]

> to say that a document or transaction is a "sham" means that while professing to be one thing, it is in fact something different. To say that a document or transaction is genuine, means that, in law, it is what it

[180] *Huitson (R, oao) v HMRC* [2010] EWHC 97 at [11] (emphasis added).

[181] *Norglen v Reeds Rains Prudential* [1999] 2 AC 1 at p.13: "I do not think that it promotes clarity of thought to use terms like stratagem or device."

[182] 54 TC 101 at p.18. Likewise *McGuckian v IRC* 69 TC 1 at p.78: "It was thought that if the steps were genuine, ie. not sham or simulated documents or arrangements, the court was not entitled to go behind the form of the individual transactions."

professes to be, and it does not mean anything more than that.

(2) It is used as the antithesis of tax avoidance. For instance:

> Genuine commercial transactions (i.e. those where gaining or obtaining a tax advantage was not a main purpose, or one of the main purposes) ...[183]

A transaction is not tax avoidance because it is non-genuine: it is non-genuine because it is tax avoidance.

(3) "Genuine" in expressions such as "genuine commercial transaction". The word here reflects the drafter's sense of a risk that (because of the vagueness of the word *commercial*) a transaction which is not actually commercial may wrongly be presented as if it was. The word might be regarded an intensifier[184] but it seems to me that is no difference between "commercial transaction" and "genuine commercial transaction" even as a matter of nuance. The word is (more or less) otiose. In this context the older expression *"bona fide* commercial", and the plain English paraphrase "*real* commercial (reason)" have the same connotation.

In none of these senses is the word or concept "genuine" of any assistance in drawing the line between what is and is not tax avoidance. In this respect it is like the word "real" which requires serious unpacking: see App.7.1 (What do we mean by "real"?).

3.22 Intention: parliament\government

I suggest two broad approaches to "tax avoidance" can usefully be distinguished:

(1) "Tax avoidance" as politicians, civil servants (and perhaps most non-tax lawyers) use the term. This means a tax reduction arrangement which is contrary to the intention or wish of the *Government of the day* (ministers or civil servants, primarily HMRC). A National Audit Office Report offers an example of this usage:[185]

[183] HMRC Consultation Document, *Simplifying Transactions in Securities Legislation* (July 2009) para 3.3. For another example see 52.14 (UK settlor and UK beneficiaries).

[184] See App 7.4 (Real used as intensifier).

[185] Countering VAT Avoidance, (1992).

> Avoidance involves complex issues and the position is constantly changing. A policy change in the UK, or a ruling from the European Commission or European Court of Justice, can easily result in today's unacceptable avoidance becoming tomorrow's acceptable tax mitigation, and vice versa.

This is "tax avoidance" for the purposes of politics and administration.[186] For example, accumulation & maintenance trusts[187] which between 1974 and 2006 were a paradigm example of mitigation, suddenly became tax avoidance in the political vocabulary of the Blair administration when it imposed IHT charges on such trusts in 2006.

Similarly when lobbyists (particularly those in favour of higher taxation) use the term tax avoidance to mean any tax behaviour of which they disapprove, often including behaviour which neither government nor HMRC regard as objectionable.[188]

(2) "Tax avoidance" in the sense used by tax lawyers. This means a tax reduction arrangement which is contrary to the intention of*parliament*. The view of the Government or HMRC should not come into it.

This lawyer's concept of "tax avoidance" is better in law because it is consistent with the Rule of Law: the rule of law requires that tax liabilities are to be determined by settled rules derived from statute and other sources of law, and not by the opinion or decision of a civil servant or politician.[189] This concept is also less volatile. It is right, indeed necessary, for it to be so. If the meaning of "tax avoidance" were "constantly changing" as a result of a mere "policy change in the UK" then the concept is unworkable for tax.

My distinction was accepted in the former ITH:

[186] A purist may say this usage is incorrect or debased; that takes us to the debate as to whether or not there is such a thing as "correct" English usage (where different groups use English differently) and how one determines it if there is. But the purist cannot stop the word being used in this political sense.

[187] These trusts qualified for IHT relief under s.71 IHTA 1984.

[188] The 2016 version of Professional Conduct in Relation to Taxation used a similar concept: "The definition of 'avoidance' is an evolving area that can depend on the tax legislation, the intention of Parliament, interpretations in case law, the view of HMRC and the varying perceptions of different stakeholders...". But this is not in the current version; see 122.1 (Codes of conduct).

[189] See 2.8 (The Rule of Law).

> **103. Avoidance in international context**
> *Within the Revenue we do not categorise avoidance in quite the narrow way that the Courts have done.* Of course we make a distinction between mitigation and avoidance. However, if a taxpayer takes advantage of the law to get a tax advantage which is not, *in our understanding*, within the spirit of the legislation, we tend to look on that as avoidance.[190]

The avoidance/mitigation distinction is not self-explanatory, it is not a given. It is a construct defined and determined by reference to values and attitudes of the tax culture in which we live. The difference between the approaches (1) and (2) is partly: *whose* values and tax culture does one apply, and: *to what materials* does one refer to ascertain these values?

The taxation of PETs offers an example. In 1973, CT Sandford wrote:

> At present gifts made more than seven years prior to death pay no tax (with the possible exception of capital gains tax). ... Is there evidence that such gifts are contrary to the intention of Parliament? Both circumstantial evidence and logic point to this conclusion. Thus if Parliament were indifferent to the making of gifts prior to death, would there have been successive increases in the gifts *inter vivos* period, which, since 1894, has risen in four successive stages from one to the present seven years?

Sandford considered and dismissed some policy arguments in favour of an estate duty and concluded:

> A reasonable interpretation would be that the gifts *inter vivos* provision was intended to prevent as many gifts as possible from circumventing estate duty.[191]

The repeal of CTT and return to an estate duty under the name of Inheritance Tax shows that lifetime giving since 1986 cannot now be regarded as "tax avoidance".[192] I suggest that even in 1973 lifetime giving was not "avoidance" of estate duty (in the strict sense). If parliament intended to tax all lifetime gifts it would *not* have increased the lifetime

[190] Emphasis added.

[191] *Hidden Costs of Taxation*, 1973, p.113.

[192] This is self-evident, but if authority is needed, HMRC's GAAR guidance para 2.2.1 provides at D2.2.1 that "giving assets to children to reduce future IHT liabilities" is not abusive.

gift period to seven years. It is obvious that such an increase would not stop tax-free lifetime giving. parliament would certainly not have enacted IHT taper relief under which gifts made more than four years before death pay a reduced rate! How then did Professor Sandford reach the opposite conclusion? Perhaps because he wished to advocate the imposition of a capital transfer tax. When one wishes to support a tax reform, the temptation to describe the old law as permitting "avoidance" is irresistible (as a tool of advocacy) and also has a certain underlying logic. There is tax avoidance in a political if not a lawyer's sense. If a future Government abolishes PETs, and returns to some form of CTT, it seems safe to predict that those supporting the reform will castigate lifetime giving as tax avoidance.

One point to note is that a comment from the Government (or any proponent of a tax reform) that existing law permits "avoidance" needs special scrutiny because it is easy to conflate the intention of parliament (tax avoidance in the strict sense) with the intention of Government (or of the proponent), which I would call tax avoidance in a political sense.

Understood in this sense, the term "tax avoidance" is still vague but not, I think, hopelessly so, as, for instance, the phrase "the right amount of tax".

3.23 Finding intention of parliament

This is the problem at the heart of the *Willoughby* definition of "tax avoidance". If this term means an action contrary to the intention of parliament, one must identify that intention. C.T. Sandford addressed the problem:

> But here we meet the major difficulty. ... As individuals we may feel certain that a particular action is contrary to the intention of the law; but the *objective* interpretation of that intention can only be found in the words the law uses.[193]

Sandford was right. The issue is statutory interpretation and the principles of statutory interpretation should be applied. The intention of parliament should be decided primarily from the words of the statutes. Other material may be relevant on the usual principles of statutory interpretation: White and Green Papers, Royal Commission Reports, Hansard on *Pepper v Hart* principles, textbooks and learned articles.

The City of London Law Society comment:

[193] IFS, *Hidden Costs of Taxation*, 1973, p.114 (emphasis in original).

> Government and HMRC must also improve their institutional memory in relation to policy decisions. Members of our Committee have had experiences of talking to HMRC officials who have no idea why particular provisions are included within given legislation, even where that legislation was introduced relatively recently. In the world of the GAAR, where it is necessary to identify the consistency or otherwise of a transaction with policy, it will in turn be necessary for that policy to be identifiable if excessive uncertainty is not to result.[194]

This is true not just for the GAAR, but whenever policy is an explicit or implicit factor in tax law.

Textbooks can help support fading institutional memories with fuller discussion of policy issues.

3.23.1 *Levels of intention*

It has been said that a concept of "tax avoidance" based on what is contrary to "the intention of parliament" is not coherent. The object of statutory construction is always said to be to find "the intention of parliament".[195] A successful tax avoidance scheme is a scheme where a court has concluded that the intention of parliament was not to impose a tax charge in the circumstances which the tax avoiders had placed themselves. This applies whether the scheme constitutes mere avoidance or tax abuse (though abusive schemes are not likely to succeed after the GAAR).

Shenfield made this point:

> What is meant by the intentions of the law and in what sense does avoidance circumvent them? Courts of law in our system seek to find the intention of a law in the words it uses. In this sense the avoider does not circumvent its intentions but abides by them.[196]

The answer is that the expression "intention of parliament" is being used

[194] Response to Office of Tax Simplification competitiveness review (2014) para 2.6.

[195] See *Cross on Statutory Interpretation*, Oxford University Press (3rd ed., 1995), Chapter 2.

[196] A.A. Shenfield, *The Political Economy of Tax Avoidance*, Institute of Economic Affairs, Occasional Paper 24, 1968, pp.20–21. Lord Hoffmann made the same point in "Tax Avoidance" [2005] BTR 197 at p.206: "tax avoidance in the sense of transactions successfully structured to avoid a tax which Parliament intended to impose should be a contradiction in terms. The only way in which Parliament can express an intention to impose a tax is by a statute which means that such a tax is to be imposed."

in two senses. It is consistent to say that (say) the *Fitzwilliam* scheme:

(1) escapes IHT (there being no provision to impose an IHT charge); and yet

(2) constitutes the avoidance of IHT.

One is seeking the intention of parliament at a higher, more generalised level. A statute may fail to impose a tax charge, leaving a gap that even a court cannot fill even by purposive construction, but nevertheless one can conclude that there would have been a tax charge had the point been considered. An example is the notorious case of *Ayrshire Employers Mutual Insurance Association v IRC* where the House of Lords held that parliament had "missed fire".[197] A.A. Shenfield recognised this (perhaps grudgingly):

> What the complainant against avoidance means by the intentions of a law is not what may be deduced from what it says, but what parliament intended it to say, or what parliament ought in the complainant's opinion to have intended it to say, or what in his opinion it would have been equitable for it to say. Now I do not say that this can never have substance. We all know that, quite apart from outright errors of draftsmanship, there is a distinction between the letter and the spirit of a law. But the spirit of a law is elusive. It is tempting to believe that one has grasped the spirit of a law when in truth one is moved by prejudice or preconception. We ought to be extremely careful ...[198]

3.24 Time to ascertain intention of parliament: Change in law

The concept of tax avoidance as an act contrary to the intention of parliament raises the question of *at what time* parliament's intention is to be ascertained. The intention of parliament may change and the same act could be tax avoidance at one time but not at another. Of course, it needs an Act of Parliament to make this change.

[197] 27 TC 331. It might be objected that this case is wrongly decided, by modern standards of statutory interpretation: "I venture respectfully to suggest that if, as in this case, the courts can identify the target of Parliamentary legislation their proper function is to see that it is hit: not merely to record that it has been missed"; Diplock, "The Courts as Legislators", Address to the Holdsworth Club (1965). *https://www.kessler.co.uk/wp-content/uploads/2012/05/CourtsAsLegistlators.pdf* In *Cooper v Billingham* 74 TC 139 para 35 the CoA thought that the same result could happen (albeit rarely); but that was in 2001, and I doubt if one could find that view stated more recently.

[198] *Ibid*, note 94.

For the purpose of TAARs, tax avoidance must mean an act contrary to the intention of parliament at the time of the arrangement or transfer which is tested. This is consistent with the rule that one examines the purpose of the transferor at the time of the transfer.[199] Otherwise changes in the intention of parliament would often have considerable retrospective effect: a transfer which was not tax avoidance when it was made would retrospectively be treated as made for a tax avoidance motive (or vice versa). This view was adopted in *Rialas v HMRC.*[200]

This rule may of course favour HMRC. A transfer to avoid (say) Selective Employment Tax would fail the motive defence and that would continue to be the case even after the abolition of that tax.

3.24.1 *Transfer in anticipation of reform*

An arrangement or transfer made in 2007/08 to avoid the rules in the FA 2008 from 2008/09 is not tax avoidance for two reasons:

(1) It is not contrary to the intention of parliament to avoid *future* tax laws: the intention of parliament is to be determined at the date of the transfer.[201]

(2) Parliament clearly anticipated and accepted that such disposals and appointments would be made and took no steps to counteract them.

3.24.2 *Transfer by non-resident pre-1996*

Parliament decided in 1936 not to apply (what is now) s.720 ITA to transfers made by non-resident transferors, and that was (after some vacillation) held to be the law.[202] It might be argued that a transfer of assets by a non-resident between 1936 and 1996 could not be said to be contrary to the intention of parliament, and so it could not constitute income tax avoidance.[203] However the legislation which reversed *Willoughby* and brought transfers by non-residents into the scope of the transfer of asset provisions applies to pre-1996 transfers, so it is clearly

[199] See 3.16 (Time to ascertain purpose).

[200] See 52.21.2 (Transfer for avoidance).

[201] See 3.24 (Time to ascertain intention of parliament: change in law).

[202] See 49.21.3 (Transferor non-resident when transfer made).

[203] Contrast pre-1936 transfers by UK resident individuals; these were caught by the new 1936 legislation, but parliament had never made a decision that such transfers should not be taxed so it would be possible to regard such transfers as made for tax avoidance purposes.

assumed that such transfers could have been for avoidance purposes.[204] The explanation is that:

(1) A transfer by a non-resident before 1996 does not normally involve income tax avoidance.

(2) However, there are special circumstances where a transfer by a non-resident may be for income tax avoidance[205] and, of course, a pre-1996 transfer made for CGT or IHT avoidance would also be caught.

3.24.3 *Transfer pre-1981; no power to enjoy*

Similar considerations apply to a transfer before 1981 to which s.720 ITA did not apply (because the transferor had no power to enjoy the income of the asset transferred). Parliament decided in 1936 not to apply the transfer of asset provisions to transfers where the transferor had no power to enjoy, and that was (again after some vacillation) held to be the law.[206] So it might be argued that a transfer where the transferor had no power to enjoy could not be said to be contrary to the intention of parliament, so it could not constitute income tax avoidance. However in 1981 parliament brought in s.731 ITA which applied to pre-1981 transfers,[207] so it is clearly assumed that such transfers could have been for avoidance purposes. The explanation is that:

(1) A transfer made before the 1981 reforms where the transferor had no power to enjoy does not normally involve income tax avoidance.

(2) However there are special circumstances where a transfer where the transferor had no power to enjoy may be IT avoidance (one example would be where the settlor did have power to enjoy but later died or was excluded) and, of course, a pre-1981 transfer made for CGT or IHT avoidance would also be caught.

[204] s.81 FA 1997. There is an exemption only for income arising before 1996.

[205] Examples of special cases are:

(1) a transfer in anticipation of becoming UK resident or

(2) a transfer made just before the enactment of the new legislation (when the change of the law was predictable).

Another view could be that such transfers constitute tax avoidance from after the 1952 and 1970 consolidations, which parliament enacted on the basis of the *Congreve* and *Herdman* decisions (later reversed) that transfers by non-residents were caught. But that offends common sense and the principle that a consolidation does not alter the law.

[206] See 47.6 (Meanings of “settlor-interested”).

[207] s.45 FA 1981; there is an exception for income arising before 1981.

3.25 Reduction/deferral/failed avoidance

3.25.1 *Reduction*

The motive defence refers to "avoidance" alone but standard definitions of "tax advantage" refer to "avoidance *or reduction*" of tax.[208] In this expression it could be that avoidance is used in the strict sense and reduction is referring to mitigation, but that is anachronistic (since the distinction was not known at the time). The word "reduction" was probably added to forestall an argument that the mere reduction of tax was not avoidance as long as some tax remained payable.[209] But nowadays a court would not be so literal and there is no doubt that (for the purposes of the motive defence) a reduction of tax from £10 to £6 amounts to the avoidance of £4.

3.25.2 *Deferral*

Arrangements to defer tax may constitute "avoidance".[210] Indeed the classic avoidance case *Furniss v Dawson* might be characterised as involving mere "deferral" of tax. However, the fact that tax is merely deferred, and will or may later be paid, is a factor which may support the conclusion that the arrangement is to be characterised as mitigation and not avoidance.[211]

3.25.3 *Unsuccessful avoidance*

A purpose may exist independently of its success. HMRC correctly say:

[208] See 3.19 ("Tax advantage"). The earliest use of this formula was s.35 FA 1941 (Excess Profits Tax), 3 years after the ToA motive defence was recast; but I do not think anything turns on that chronology.

[209] Contrast the statutory expression "mitigate or remit" a penalty.

[210] This is self-evident, but if authority is needed, see *Davies v HMRC* [2020] UKUT 67 (TCC) [at 44]: "there could be tax "avoidance" where tax was deferred or reduced; it was not necessary for the arrangements to produce the result that no tax was payable in any circumstance."

[211] This is also self-evident, but for an example, see *IRC v Willoughby* in the Court of Appeal [1995] STC at p.183: "I do not see why the choice of an offshore bond or policy, for the taxation of which Parliament has made express and recent provision, should be regarded as tax avoidance at all. The tax is not avoided it is deferred. Moreover it is deferred to an event which Parliament has prescribed not to a time of the taxpayer's choice." This aspect was not considered on appeal.

> ... even if the transaction does not achieve its expected result, there may still be a tax avoidance purpose.[212]

OECD agree:

> Successful tax reduction is neither a sufficient nor a necessary test of tax avoidance. It is not sufficient because this would cover acceptable tax planning [ie mitigation] and it is not necessary because an avoidance scheme designed to reduce tax may not succeed.[213]

3.26 The GAAR

3.26.1 *GAAR terminology*

"GAAR" is the acronym for the **g**eneral **a**nti-**a**buse **r**ule introduced in the FA 2013. This has inspired similar rules in devolved taxes:

Rule	**See**
General anti-avoidance rule	s.81A Tax Collection and Management (Wales) Act 2016
General anti-avoidance rule	s.62 Revenue Scotland and Tax Powers Act 2014

The original *anti-abuse* rule has been extended (or watered down, depending on one's outlook) into wider *anti-avoidance* rules. These, confusingly, also abbreviate to GAAR, but some other term is required to avoid confusion, perhaps, "devolved GAARs". I do not discuss the two devolved GAARs in this work.

3.26.2 *Tax arrangements*

Section 207(1) FA 2013 defines "tax arrangements" using standard TAAR wording:

> Arrangements are "tax arrangements" if, having regard to all the circumstances, it would be reasonable to conclude[214] that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements.

3.26.3 *Anti-abuse rule*

Section 206 FA 2013 provides:

[212] Unallowable Purpose Draft Guidance para 10050.

[213] OECD Report by Committee of Fiscal Affairs (1980) cited in OECD's International Tax Avoidance and Evasion (1987), p.17.

[214] See App 2.24 (Reasonable-to-assume).

> (1) This Part [Part 5 FA 20130 has effect for the purpose of counteracting tax advantages arising from tax arrangements that are abusive.
> (2) The rules of this Part are collectively to be known as "the general anti-abuse rule".

Thus the GAAR is not an anti-*avoidance* rule; it is an anti-*abuse* rule. The key term is "abusive". Section 207(2) FA 2013 provides:

> Tax arrangements are "abusive" if they are arrangements the entering into or carrying out of which cannot reasonably be regarded as a reasonable course of action in relation to the relevant tax provisions...

This is the so called "double-reasonableness test". In practice no-one has been able to provide an example of arrangements which fail a single reasonableness test, but are saved by the double reasonableness test. The difference is not so much a test as an attitude of mind:

> The Government agrees with the Report's recommendation to introduce a rule which is targeted at artificial and abusive arrangements (those that the Report refers to as "egregious", "very aggressive" or "highly abusive contrived and artificial"). It accepts the Report's conclusion that introducing a "broad spectrum" general anti-avoidance rule would not be beneficial for the UK tax system. ... the GAAR should not affect what the Report describes as "the centre ground of tax planning".[215]

The extent to which HMRC or the Courts will focus the GAAR on this target remains to be seen. The GAAR's definition (perhaps unavoidably) allows some scope for mission creep.[216]

3.26.4 *GAAR factors*

Section 207(2) FA 2013 continues:

> ... having regard to all the circumstances including—
> (a) whether the substantive results of the arrangements are consistent

[215] HMRC consultation document "A General Anti-Abuse Rule" (2012) para 2.1. Similarly, HMRC consultation document "Modernising the taxation of corporate debt and derivative contracts" (2013) para 14.3:

> "The test of "abuse", for the purposes of the GAAR, is a high threshold, and ...[the GAAR] does not seek to encompass the full range of tax avoidance activity."

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/205432/2013_06_05_Condoc_FINAL_FOR_PUBLICATION.pdf

[216] See 30.14.7 (Sale of company: GAARable?).

> with
> [i] any principles on which those provisions are based (whether express or implied) and
> [ii] the policy objectives of those provisions,
>
> (b) whether the means of achieving those results involves one or more contrived or abnormal steps, and
>
> (c) whether the arrangements are intended to exploit any shortcomings in those provisions.

Section 207 FA 2013 continues:

> (3) Where the tax arrangements form part of any other arrangements regard must also be had to those other arrangements.
>
> (4) Each of the following is an example of something which might indicate that tax arrangements are abusive—
>
> (a) the arrangements result in an amount of income, profits or gains for tax purposes that is significantly less than the amount for economic purposes,
>
> (b) the arrangements result in deductions or losses of an amount for tax purposes that is significantly greater than the amount for economic purposes, and
>
> (c) the arrangements result in a claim for the repayment or crediting of tax (including foreign tax) that has not been, and is unlikely to be, paid,
>
> but in each case only if it is reasonable to assume that such a result was not the anticipated result when the relevant tax provisions were enacted.
>
> (5) The fact that tax arrangements accord with established practice, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice, is an example of something which might indicate that the arrangements are not abusive.
>
> (6) The examples given in subsections (4) and (5) are not exhaustive.

Of course the Courts would have worked that out for themselves, so all this might be regarded as unnecessary; but perhaps it is helpful.

3.26.5 *Avoidance/abuse compared*

The GAAR provides a different test from "avoidance". What is abusive will be avoidance, but the contrary does not hold: what is avoidance need not be abusive. But the GAAR factors are all also applicable to determine what is avoidance.

It follows that guidance on what is abusive for the GAAR may not necessarily be applicable to the question of what is avoidance for an avoidance-purpose TAAR. But it should be helpful - so far as guidance ever is or can be helpful. In many cases the GAAR guidance is all there is.

At present the concepts seem quite close. It might happen in the future the Courts (further) water down the concept of avoidance, but uphold the (intended) high threshold for abuse. Then the gap between the concepts would increase.

In the first decade of the GAAR we have not had any GAAR case law.[217] Perhaps in 10 or 20 years time we will know more. Or perhaps not. Discuss.

3.27 Tax avoidance: Critique

3.27.1 *Avoidance: coherent concept?*

Littlewood surveyed the Privy Council case law and reached a gloomy conclusion:[218]

> ... on the basic issue—what is tax avoidance?—very little progress has been made. In particular, no one (neither the Privy Council, nor the courts of Australia or New Zealand, nor anyone else) has yet devised a satisfactory definition of tax avoidance. Worse, the Privy Council (like the Australian and New Zealand courts and the various commentators who have addressed the problem) has not only failed to *define* tax avoidance; it has failed even to produce a coherent set of guidelines as to how it might be recognised... Of the 13 cases, some were found by the Privy Council to fall on one side of the line, and some on the other. Surely, then, it might be said, these cases must provide *some* guidance as to where the line is to be drawn? Even this, however, seems unduly optimistic. In other areas of the law, judges (and commentators) might disagree as to how particular cases should be resolved, but at least they generally agree as to what constitutes a marginal case (as with, for example, the distinction between capital and revenue). This is not so,

[217] The absence of case law may be partly due to the deterrent penalty cost of taking and losing a GAAR appeal; see 126.52 (GAAR penalties).
There have been many decisions of the GAAR Panel. It is debatable how much attention should be given to these, but almost of them concern schemes that seem clearly abusive. The only decision so far in favour of the taxpayer is the Opinion Notice issued on 26 April 2022, for which see 40.10 (Company loans: GAAR).

[218] Littlewood "The Privy Council and the Australasian Anti-Avoidance Rules" [2007] BTR 175.
https://www.yumpu.com/en/document/read/28456681/the-privy-council-and-the-australasian-anti-avoidance-rules

> however, of the distinction between tax avoidance and tax mitigation. Rather, the judges tend to present whichever outcome they prefer not only as correct, but as clearly so—even when they fail to agree. This is perhaps the strangest feature of these cases. For example, in *Challenge* Lord Templeman (for the majority) said "a clearer case ... cannot be imagined",[219] though this was evidently less clear to Lord Oliver who dissented. Similarly in *Peterson* the majority regarded it as clear that the anti-avoidance rule did not apply; and the minority as equally clear that it did: "a clearer case", said Lord Bingham and Lord Scott in their joint *dissenting* judgment, "can hardly be imagined".[220]

But to describe an uncertain point as "clear" is common in judicial rhetoric, even outside the field of avoidance.[221]

> The cases thus confirm what is notorious: that the idea of tax avoidance is one of the most difficult in the whole of the law. To describe the distinction between avoidance and mitigation as "vague" is to understate the problem, for it suggests that there is general agreement as to roughly where the line lies and that the disagreement is only as to marginal cases. But none of their Lordships appear to have regarded any of the cases as marginal. It is difficult, therefore, to extract from them any guidance as to where the line lies. Notable, too, is the frequency of disagreement: of the eight cases decided after the Privy Council started permitting dissents in 1966, only two were decided unanimously.[222] Dissents tended, moreover, to be colourful. Lord Wilberforce, dissenting in *Mangin v IRC*, accused the majority of "interpretative astigmatism".[223] Lord Oliver, in *Challenge*, described the majority view as "eccentric".[224] And, in *Peterson*, Lord Bingham and Lord Scott said the majority view was "extraordinary"[225] and required "shutting one's eyes to the obvious."[226] It would seem reasonable to conclude that the idea of tax avoidance is simply not susceptible to coherent explication.

[219] [1987] 1 AC 155 at p.164.

[220] [2005] UKPC 5 at [96]. See also *Peate v CT* [1967] 1 A.C. 308*, O'Neil v IRC* [2001] STC 742, *Mobil Oil v CT* [1966] AC 275, and the judgment of Lord Donovan and Viscount Dilhorne in the first *IRC v Europa Oil* [1971] AC 760.

[221] See App 1.3 ("Clear").

[222] *Ashton v IRC* [1975] STC 471; *O'Neil v IRC* [2001] UKPC 17

[223] [1971] AC 739 at p.755.

[224] [1987] 1 AC 155 at p.173.

[225] [2005] UKPC 5 at [101].

[226] [2005] UKPC 5 at [78] and [101].

Technical Teams Operational Guidance Manual reaches the same conclusion:

> **TTOG3435 Identification of Code 8 cases: Tax avoidance** [Jun 2016]
> ‘Avoidance’ is not defined in the Taxation Acts and attempts to define it have not in the past been successful.

There has been some judicial recognition of this point, though not as strongly expressed:

> While ‘tax avoidance’ is a phrase that most people think they understand, tax avoidance is a difficult concept to define and means different things to different people.[227]

3.27.2 *Avoidance concept defended*

Recognising the shortcomings of the attempts to define tax avoidance often triggers scepticism. According to such views, the concept is illusory and the search for a definition is a wild goose chase. Rules against tax avoidance amount to taxation by discretion; and existing anti avoidance rules, or at least, the GAAR, should be repealed. Littlewood comments:

> Arguments along these lines are indeed common. Perhaps they are sound. But there are nonetheless grounds upon which anti-avoidance rules might be defended.
> The first of these is expediency: the rules might be radically indeterminate, but they work.
> Secondly, the complaint is based on a fallacy. The scope of anti-avoidance rules is obviously uncertain, but it does not follow that *not* having such a rule results in any less uncertainty: even in the absence of a rule against avoidance, the courts seem inevitably (as in the UK) to be called upon to determine whether taxing statutes should be interpreted in such a way as to give efficacy to, or to negate, taxpayers’ attempts to avoid tax. The UK’s experience, in particular the *Ramsay* line of cases, suggests that the degree of uncertainty might be much the same, or worse. For, although the scope of the *Ramsay* principle remains uncertain, it seems that the idea of avoidance (and presumably also,

[227] *HMRC v Hyrax Resourcing* [2019] UKFTT 175 (TC) at [153]. Likewise *Carlton (R, oao) v HMRC* [2018] EWHC 130 (Admin) at [69]:
“There is, of course, a good reason why the statute makes no reference to tax avoidance: that concept is difficult to define ...”.
Likewise *Fisher v HMRC* [2020] UKUT 62 (TCC) at [130]:
“The concept of avoidance is a slippery one.”

> therefore, the distinction between avoidance and mitigation) is embedded in it ... Consequently there seems to be little reason to suppose that anti-avoidance rules *add to* the level of uncertainty from which taxing statutes suffer. In other words, the uncertainty may be a feature not of the anti-avoidance rule, but of the rules defining the scope of the tax. The effect of the anti-avoidance rule, therefore, is perhaps to tilt the field in favour of the Revenue, whilst leaving the degree of uncertainty more or less unchanged (or perhaps ameliorating it a little).
>
> Thirdly, the unpredictable scope of general anti-avoidance rules seems appropriately selective in whom it inconveniences. Taxpayers and their representatives in Australia and New Zealand routinely complain that this unpredictability deters taxpayers from undertaking economic activity which is not tax-driven and which would be beneficial to society.[228] The 13 Privy Council cases, however, suggest that this is not so, since in every one of them (including those in which the rule was held not to apply) the taxpayer plainly went out of his way to structure his affairs in a manner calculated to reduce his liability to tax. The cases thus suggest that it is only those who sail close to the wind who get wet. On this last point, however, it is necessary to acknowledge that the taxpayers who have ended up in the law reports may not be typical of all those against whom the Australian and New Zealand Revenues have invoked their general anti-avoidance rules. In particular, it is possible that the rules have been invoked in cases in which the amount of tax in dispute was too small to be worth litigating, or in which the taxpayer could not afford to litigate.
>
> In other words, it is possible that the general anti-avoidance rules *have* served as a basis for arbitrary taxation even though the law reports contain no evidence of it. It is possible that in the UK the *Ramsay* principle has functioned in this way also.[229]

In the current climate of hostility to avoidance, the point is perhaps academic.

[228] Footnote original: see, e.g. *CIR v Challenge Corp Ltd* [1987] 1 AC 155 at 167.

[229] Littlewood "The Privy Council and the Australasian Anti-Avoidance Rules" [2007] BTR 175.

CHAPTER FOUR

DOMICILE

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The following topics are discussed elsewhere

Topic	**See para**
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4.1 Domicile: Introduction

Domicile is important for many tax purposes, in particular:

(1) IT/CGT remittance basis
(2) IHT on foreign situate assets

Domicile is also important for non-tax purposes, including aspects of family law, civil jurisdiction and succession.

4.2 Concepts of domicile

Domicile is a concept of private international law.

In English law, the rules are laid down by common law, but modified by statute. *Coller v HMRC* contains a convenient 7 page summary of the law of domicile.[1]

Scots domicile law is the same as English law (except where statutory provisions have diverged, which they have only on minor points[2]). Indeed the leading case of *Udny v Udny* is a Scottish case. Northern Ireland domicile law is the same as English law.

These rules apply for tax purposes except so far as modified by tax law.

"Domicile" has a technical meaning in UK law which is distinct from the meaning of "domicile" in ordinary English (it is not used much in

[1] [2023] UKFTT 212 (TC) at [11] ff.

[2] *Arnott v Groom* (1846) 9 Court of Sess Cas (2nd Series) 142 accessible *https://www.kessler.co.uk/wp-content/uploads/2015/06/Arnott-v-Groom.pdf* "in a matter like the present, involving a question of international law, the judgments of the English courts are of equal authority with our own."

ordinary English, but if used it simply means, home).[3]

This chapter considers the UK law sense of domicile, which one may call the general law sense; and references to domicile below are to that sense of the word. Note however that there are a number of other (more or less) distinct concepts of domicile.

An individual may be deemed to be UK domiciled for tax purposes ("deemed domicile").[4] I discuss deemed domicile in the next chapter.

For DTA purposes it is sometimes necessary to look at foreign law concepts of domicile. As a general rule:

(1) Foreign common law jurisdictions have a concept of domicile which derives from English law, and is very similar. Statutory provisions have diverged, but only affect minor points; the apples have not fallen far from the tree.

(2) Civil law jurisdictions also use the word "domicile" but it has a different meaning there (which is, perhaps ironically, close to ordinary English usage).[5]

The term "domicile" is used in a defined sense in IHT DTAs. I refer to that as **"treaty-domicile"**; the definition varies from one treaty to another.[6]

Article 4 of the OECD Model contains the definition of (what I call) "treaty-residence". The heading to that article in the 1963 version of the Model was "fiscal domicile". The 1977 version changed the heading to "Resident", which is more apt; but some existing DTAs still use the old heading "fiscal domicile". Here the drafter used the word domicile as a synonym of residence, and it may be that civil lawyers generally regard the two terms as (broadly) the same. But in UK law, the terms residence and domicile have distinct meanings. The term "fiscal domicile" is not apt to describe residence, or treaty-residence, and I think it is best avoided altogether.

The term "domicile" is also used in a defined sense in international treaties and elsewhere,[7] but that is not usually relevant for UK tax

[3] e.g. in Walt Disney's *Lady and the Tramp*:
"Now we lookin' over our new domicile
If we like we stay for maybe quite a while" (!)

[4] See 5.1 (Deemed domicile: Introduction); App 10.1 (Parliamentarians).

[5] See 115.9.3 ("Domicile" in France/Italy).

[6] See 114.5 (Treaty-domicile).

[7] Eg Part 5 CJJA 1982.

purposes.

The spelling *domicil* (without the final -e) is archaic.[8]

A person whose domicile is under consideration was traditionally called the propositus, but the Latin word is unnecessary and best avoided.

4.2.1 *"Non-doms"*

"Non-dom" started as slang, but language evolves, and in keeping with the Zeitgeist, the irresistible monosyllables entered the statute book in 2013.[9] "Non-dom" should now be regarded as acceptable standard usage. For the time being, at least, I prefer not to use it in more formal writing; though it is useful in headings, where space is limited, and eventually the title of this book might be shortened to *Taxation of Nonresidents and Non-doms*.

"Non-dom reliefs" may be used to refer to IT/CGT remittance basis, or more widely, extend other IT/CGT reliefs such as protected-trust relief and rebasing.

In current usage, the expression "non-dom" is used not to refer all those who are not UK domiciled (which is of course almost all the world's population) but to a smaller group, namely UK resident non-domiciled individuals who claim the remittance basis, or otherwise enjoy non-dom reliefs. It is sometimes useful to have a label to describe this group, and "non-dom" has come to serve it. I think it is now pedantic to object that this is not correct legal usage. But the expression does contain some ambiguity unless one specifies exactly what "non-dom reliefs" are included. Is a person a "non-dom" in this sense if they have claimed the remittance basis in the past, or if they may do so in the future? or if they do not claim the remittance basis but qualify for protected-trust reliefs? Does the term extend to UK resident foreign domiciliaries who benefit from IHT reliefs? Or UK domiciliaries (or deemed domiciliaries) who have created a settlement when non-UK domiciled when the trust qualifies as excluded property? Careful writers should consider and explain the intended meaning of the expression before using it, or these ambiguities may lead to error.

[8] A Google search records an overwhelming preference for spelling with a final -e.

[9] The FA 2013 uses the heading *Remittance basis restricted to non-doms*. A *Bailii* search shows the expression gradually finding its way into the law reports. At present the law reports often use quotation marks, implying a certain unease; but it seems safe to predict those will disappear in the course of time.

4.3 Only one domicile

Everyone has one and only one domicile. The expression "**non-domiciled**" is in a literal sense inapt, because everyone is domiciled somewhere. It is, however, an acceptable and convenient abbreviation (in context) for non-UK domiciled (just as "non-resident", in context, means non-UK resident).

A person must be domiciled in a single legal jurisdiction.[10] The expression "**UK domiciled**" is in a literal sense inapt because a person must be domiciled in England, Scotland or Northern Ireland. It is, however, universally and aptly used to describe someone who is domiciled in England, Scotland or Northern Ireland.[11] (Similarly the expression "UK law" may aptly be used to refer to the law applicable in any part of the UK, ie English/Scots or Northern Ireland law, as appropriate.)

For tax purposes it makes no difference where in the UK a person is domiciled, though for non-tax purposes that may be important.

4.4 Domicile of origin

Dicey states:[12]

> Every person receives at birth a domicile of origin:
> (a) A legitimate child born during the lifetime of his father has his domicile of origin in the country in which his father was domiciled at the time of his birth;
> (b) A legitimate child not born during the lifetime of his father, or an

[10] See 4.22 (Domicile territory/country).

[11] For completeness: legislation does very occasionally refer to a person domiciled
- "in any part of the UK"
- "in a part of the UK" or
- "anywhere within the UK"

Eg, s.721(3) ITEPA (somewhat pedantically) provides:

> "Any reference in this Act to being domiciled in the UK is to be read as a reference to being domiciled in any part of the UK."

The Tax Law Rewrite later decided this was unnecessary, and (quite correctly) did not put an equivalent clause in subsequent rewrite legislation. It would be tidier to repeal s.721(3) as it is unnecessary, but that is probably more trouble than it is worth, until such time as ITEPA itself comes to be rewritten or replaced. Complete consistency in legislation is not to be expected.

[12] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 6R-025 ("*Dicey*"). "Mr Dicey's celebrated work" (*IRC v Cohen* 21 TC 301 at p.309) is the one that the Courts cite.

> illegitimate child, has his domicile of origin in the country in which his mother was domiciled at the time of his birth; ...

This rule embodies gender assumptions which reflect its date of origin. Domicile is now one of the few areas of English law where legitimacy still matters.

Where the parents of an illegitimate child marry, the child becomes legitimate from the date of the marriage, so that does not affect the domicile of origin.[13] The legal definition of legitimacy is a large topic, but not sufficiently important to discuss here.

At present illegitimacy issues rarely arise, because domicile most commonly concerns older individuals who were born at a time when illegitimacy rates were low. Approximately 50% of children in the UK are now born to unmarried parents, so in a generation's time, the issues will arise much more often.

The position in Scotland has been revised and avoids sex/marital status discrimination.[14] English law should follow Scotland, and, the reader may think, the sooner the better.

See too 4.19 (Adoption and parental orders); App. 3.7 (Illegitimacy).

4.5 Domicile of choice

The test of acquiring a domicile of choice has been expressed in a variety of ways. In *IRC v Bullock*:

> ... the true test is whether he intends to *make his home* in the new country....[15]

In *Whicker v Hume*:[16]

> By domicile we mean home, the permanent home;[17]

[13] Section 2 Legitimacy Act 1976. The marriage may affect a domicile of dependency; see 4.17 (Child's domicile: England).

[14] See 4.18 (Child's domicile: Scotland). It is doubtful whether the English law rule is human-rights compliant.

[15] 51 TC 522 at p.540.

[16] (1858) 7 H.Cas. 124, 160.

[17] The passage continues:

> "and if you do not understand your permanent home, I am afraid that no illustration drawn from foreign writers or foreign languages will very much help you to it."

This witticism has often been cited. But it is not true: "permanent home" is a vague expression which benefits from further elucidation and examples.

In *Udny v Udny*,[18] the test is "the country in which he has chosen to settle himself". A person who acquires a domicile of choice:

> does an act which is more nearly designated by the word 'settling' than by any one word in our language. Thus we speak of a colonist settling in Canada or Australia, or of a Scotsman settling in England.

Here the word "settling" is another way of expressing the test that a person must live in a place as his sole or chief residence.

In *Bell v Kennedy*[19] the test is whether the person:

> had determined to make, and had made, Scotland his home, with the intention of establishing himself and his family there, and ending his days in that country.[20]

The above cases refer to "home" but others use the term "residence". In *Udny v Udny* the test is that:[21]

> a man fixes voluntarily his sole or chief residence in a particular place with an intention of continuing to reside there for an unlimited time.

Dicey states:[22]

> Every independent person can acquire a domicile of choice by the combination of residence and intention of permanent or indefinite residence, but not otherwise.

All the above come to the same thing. In domicile cases, the expressions home and residence are used interchangeably.[23]

Adopting Dicey's formulation, there are two requirements: residence and intention. I consider them separately.

Case law expressions should not be construed like statutory expressions, and that applies even if the expression is codified in a textbook rule in the style of Dicey.

[18] LR 1 Sc & Div 441 at p.452.

[19] (1868) LR 1 Sc and Div 307 .

[20] This is often cited, eg *SA v FA* [2022] EWFC 115 at [15]: "this test by its reference to ending one's days usefully emphasises the need for the subject to have a fixed purpose that he will live in the country of his domicile of choice".

[21] (1869) LR 1 Sc & Div App 441 at p.458.

[22] Dicey, Morris & Collins, Conflict of Laws (16th ed., 2022), para 6R-037 (Rule 12)

[23] The conflation of *home* and *residence* is found elsewhere; see 6.21.3 (Home/residence compared).

4.6 "Domicile-residence"

Residence matters for:

(1) Acquisition of domicile of choice: in order to acquire a domicile of choice, the individual must be resident in the country concerned.

(2) Abandonment of domicile of choice: in order to lose a domicile of choice, the individual must cease to be resident in the country concerned.

"Residence" in this context is not quite the same as residence for tax purposes (the SRT). It is necessary to have different terms: I use "**tax-residence**" and "**domicile-residence**".

Domicile cases do not provide much discussion of domicile-residence. It has been said to mean "a bona fide resident here, not casually, or as a traveller";[24] not, as one would say today, a tourist or short-term business visitor. The word sometimes used is an "inhabitant"; as in *Plummer v IRC*:[25]

> I find the contrast between an inhabitant and a person casually present useful to describe the minimum quality of residence which must be taken up in a new country before a domicile there can be acquired...

But inhabitant is just another word for resident, so this does not take us very far.

It is considered that residence, in the context of domicile-residence, has its ordinary meaning (sometimes called the common law meaning). This is the same as jurisdiction-residence,[26] and (more or less) the same as the concept of residence applied for tax purposes before the SRT.[27]

In practice the SRT and domicile-residence will usually come to the same thing, since the SRT is intended to encapsulate the ordinary meaning of the word residence.[28] So far as possible it would be best to avoid having two concepts of residence, one for tax and one for domicile. But there are some differences:

(1) For domicile-residence an individual is resident (or not) on a

[24] *Manning v Manning* (1871) LR 2 P & D 223.

[25] 60 TC 452 at p.463.

[26] See 102.14.2 ("Jurisdiction-residence").

[27] For the common law (pre-2013) test, see the 2012/13 edition of this work chapter 3 (Residence of individuals).

[28] See 6.38.1 (SRT/pre-2013 law compared).

particular date, whereas for tax-residence an individual is UK resident (or not) for a tax year.

(2) Assuming an individual resides as an inhabitant, there is no minimum period of presence required for domicile-residence: domicile-residence commences immediately on arrival if the intention is to stay.[29]

(3) Domicile-residence must be in one of England, Scotland or Northern Ireland; tax-residence is in the UK. But this will rarely if ever matter in practice.

(4) Is it possible to have domicile-residence (or in the case of dual residence, a chief residence) in the UK without being tax-resident under the SRT? It should not be common because the object of the SRT is to clarify the ordinary meaning of residence, not to set a residence test significantly different from the ordinary meaning of "residence".[30]

(5) The SRT only applies for determining whether individuals are resident in the UK. But for domicile-residence the issue may be whether individuals are resident in some other jurisdiction.

4.7 Permanent/indefinite residence

Intention to reside permanently/indefinitely matters for:

(1) Acquisition of domicile of choice: in order to acquire a domicile of choice, the individual must intend to reside permanently/ indefinitely in the country concerned.

[29] *Fasbender v AG* [1922] 2 Ch 850 at p.857-8: "I have great doubts whether her domicile at the time of the marriage was English. She had left England, and become resident in Germany at the time, though she had only been there a few days. She had done so with the intention of being married to a German resident in Germany, and of continuing to reside there with him after marriage, and I think this is, at any rate, evidence that she had adopted a German domicile." Likewise *Bell v Kennedy* (1868) LR 1 Sc & Div 307 at p.320: "Now this case was argued at the Bar on the footing, that as soon as Mr. Bell left Jamaica he had a settled and fixed intention of taking up his residence in Scotland. And if, indeed, that had been ascertained as a fact, then you would have had the *animus* of the party clearly demonstrated, and the *factum,* which alone would remain to be proved, would in fact be proved, or, at least, would result immediately upon his arrival in Scotland."
If further authority is needed, which I doubt, see *Re Plummer* 60 TC 452: "When there is no competing place of continuing residence, settlement may be established by presence for a very short time; even for a single day."

[30] See 6.38.1 (SRT/pre-2013 law compared).

(2) Abandonment of domicile of choice: in order to lose a domicile of choice, the individual must cease to intend to reside permanently/indefinitely in the country concerned.

"Permanent" residence seems straightforward, but despite the apparent rigidity of the word, what constitutes "permanence" in human affairs is to some extent a matter of degree and dependant on context.[31]

The meaning of "indefinite" is similarly, and more obviously, a matter of degree and context-dependent.

The phrase "permanent or indefinite" should be regarded as a composite expression, with a nuance slightly different from the sum of its parts, but given the context-dependant nature of the parts, it does not much matter. It is not a statutory expression, and should not be construed in the manner of a statute.

"Indefinite" (in its context) requires that the individual intends to reside in a country "until the end of their days". It seems to me that "indefinite" is an inapt word to use, because in its standard sense it is used to describe any period whose duration is not known exactly, even a relatively short period. For instance the duration of a strike may be indefinite;[32] so is the duration of a contract of employment. That is not the meaning here. However there is no single English word which neatly encapsulates the intended meaning. "Unlimited" is sometimes used and seems to me to be more apt, but this too needs clarification. *IRC v Bullock* 51 TC 522 cited the "classic statement" that a domicile of choice is acquired when:

> a man fixes voluntarily his sole or chief residence in a particular place with an intention of continuing to reside there for an *unlimited* time... it must be residence fixed not for a limited period or particular purpose, but general and indefinite in its future contemplation.[33]

[31] For a context where relatively short periods count as "permanent" see 9.12.2 ("Permanent").

[32] This is self-evident, but if authority is needed, see *Howard E. Perry v British Railways Board* [1980] 1 WLR 1375 at p.1380 which described the period of a strike as "clearly ... indefinite. It may be short, or it may be long; but it is plainly uncertain." The Law Commission made the same point in *The Law of Domicile* (1987) Law Com 186 *http://www.scotlawcom.gov.uk/download_file/view/228/* para 5.12: "'Indefinitely' by itself is insufficient: it could, on one view, cover an intention to live in a country for a short time for some temporary purpose, for example a short holiday of indefinite duration."

[33] *Udny v Udny* (1869) LR 1 Sc & Div App 441 at p.458 (emphasis added).

IRC v Bullock continues:

> I accept that statement ... with this qualification only that the expression "unlimited time" requires some further definition. A man might remove to another country because he had obtained employment there without knowing how long that employment would continue but without intending to reside there after he ceased to be employed. His prospective residence in a foreign country would be indefinite but would not be unlimited in the relevant sense. On the other hand, ... I do not think that it is necessary to show that the intention to make a home in the new country is irrevocable or that the person whose intention is under consideration believes that for reasons of health or otherwise he will have no opportunity to change his mind.[34]

And crucially:

> ... the true test is whether he intends to make his home in the new country until the end of his days unless and until something happens to make him change his mind.[35]

It is helpful to have a label to describe this, and I use the expression **"intention to reside permanently (in the domicile sense)"**. Earlier generations used the expression *animus manendi* (intention to remain). Legal Latin provided convenient shorthand labels for complex legal concepts. In the absence of a knowledge of Roman law, which contemporary lawyers do not possess, the use of Latin expressions offers little more than that, it seems to me; but also no less. But the current generation does not know even the rudiments of the classical languages, and Latin expressions should not now be used.[36]

The intention to reside permanently (in the domicile sense) is therefore very strict. In *IRC v Bullock*[37] the taxpayer resided in England for over 40 years but intended to return home to Nova Scotia (to which his wife objected) should he survive her or persuade her to change her mind. This possibility had sufficient substance to represent a real determination to return home rather than a vague hope or aspiration.[38] Group Captain

[34] 51 TC 522 at p.540.

[35] *IRC v Bullock* 51 TC 522 at p.540. This test was reaffirmed in *Barlow Clowes International v Henwood* [2008] EWCA Civ 577 at [5] to [7].

[36] See 34.5.1 (Latin causation test rejected).

[37] 51 TC 522 at p.541.

[38] It is significant that at the time of this case Bullock was in his early 60's. Had he been a decade or more older, and still in the UK, a tribunal might perhaps have found an

Bullock did not acquire a UK domicile of choice but retained his domicile of origin.[39]

4.7.1 *Insufficient intention*

In *IRC v Bullock*:

> ... if a man who has made his home in a country other than his domicile of origin has expressed an intention to return to his domicile of origin or to remove to some third country upon an event or condition of an indefinite kind; for example. "if I make a fortune" or "when I've had enough of it." it might be hard, if not impossible, to conclude that he retained any real intention of so returning or removing. Such a man ... is like a man who expects to reach the horizon; he finds it at last no nearer than it was at the beginning of his journey. In *Aikman v Aikman*[40] Lord Campbell LC said that a mere intention to return to a man's native country on a doubtful contingency would not prevent residence in a foreign country putting an end to his domicile of origin.[41]

An example is *Re Furse* where the individual intended to live in England for the rest of his life except that he would return to America if he became physically incapable of taking an active interest in his farm. This was too indefinite:

> That contingency is altogether indefinite. It has no precision at all. A man's idea of an active physical life is likely to contract with the years. At the age of 80, after 40 years in England, the testator was still living at West Hoathly and, although he had been ill, he had no firm plans at all for leaving England.
>
> The testator's expressed intention, it seems to me, depended entirely on his

intention to return home to Nova Scotia was less likely. See *Ray v Sekhri* [2014] EWCA Civ 119 at [40]: "the potential death of a spouse is no more than a matter which may, or may not, prevent the acquisition of a domicile of choice. All will turn upon the facts in any individual case."

[39] For examples of long UK residence without acquiring a UK domicile of choice see:

Case	**Period in UK**
Ramsay v Liverpool Royal Infirmary [1930] AC 588	36 years
Winans v AG [1904] AC 287	37 years
IRC v Bullock 51 TC 522	44 years
Buswell v IRC [1974] 1 WLR. 1631	34 years
Cyganik v Agulian [2006] EWCA Civ 129	43 years

[40] (1861) 4 LT 374.

[41] 51 TC 522 at p.541.

> own assessment of whether an ill-defined event had occurred.[42]

Accordingly Mr Furse acquired a domicile of choice in England. Again:

> If a man intends to return to the land of his birth upon a clearly foreseen and reasonably anticipated contingency, e.g., the end of his job, the intention required by law [to acquire a domicile of choice] is lacking; but, if he has in mind only a vague possibility, such as making a fortune (a modern example might be winning a football pool), or some sentiment about dying in the land of his fathers, such a state of mind is consistent with the intention required by law.[43]

In another case, the intention to return was "no more than a pipe dream" and the individual acquired a domicile of choice in the UK.[44] In plain English: "wishful thinking".

In *Henkes v HMRC*[45] the taxpayer claimed to intend to leave the UK on retirement. That would normally prevent acquisition of a domicile of choice in the UK. However the facts cast doubt on his claim:

(1) He was age 76 and had no current plans to retire. The intention to retire was "no more than a vague aspiration."

(2) He had no significant links to his domicile of origin, or elsewhere. (A holiday home in Spain, and a Dutch passport, did not count for much).

(3) His links to the UK were profound: more than 50 years residence; his children and grandchildren were settled here; his wife was settled here and even after retirement he might stay in the UK during the rest of her lifetime.

In these circumstances he was held to have acquired a domicile of choice here. Other cases where a claim to intend to leave was similarly unimpressive are *Coller* and *Strachan*.

4.7.2 *Tax and intention*

Tax may be relevant to intention. For instance if a tax exile remains in the UK, intending to return home if and when their home tax regime is

[42] [1980] STC 596 at p.604.

[43] [1980] STC 596 at p.604.

[44] *Ray v Sekhri* [2014] EWCA Civ 119.

[45] [2020] UKFTT 159 (TC). If further factual examples are needed, which I doubt, implausible claims of an intention to leave the UK (which never happened) were rejected in *Coller v HMRC* [2023] UKFTT 00212 (TC); *Shah v HMRC* [2023] UKFTT 539 (TC).

relaxed, they would not acquire a domicile of choice here.

Likewise if an individual intended to remain in the UK only so long as UK tax law continues to allow a remittance basis and protected-trust reliefs, they would not acquire a domicile of choice here.

In *Spence v Spence* an individual moved to Spain to avoid CGT. The CGT avoidance motive showed an intention to remain in Spain long enough to cease to be resident and ordinarily resident in the UK (the then requirement) but as far as intention to reside permanently was concerned, it was a neutral factor. It shed no light either way. It was argued that if the avoidance of tax was a dominant factor in the move to Spain, this undermined the argument that the individual had from the start the intention of residing there permanently. That was a non-sequitur:

> ... the mere fact that a person moves to another country in order to avoid liability to tax in the country of origin does not necessarily mean that he cannot or is unlikely to acquire thereby a domicile of choice in that other country. It is plainly a matter which depends upon the facts and circumstances of the particular case.[46]

The acquisition of a foreign domicile which is primarily motivated by a desire to avoid UK tax is possible in theory, but may be difficult in practice, as if the only driver is to avoid tax, the intention to live in the territory may prove to be insufficiently firm. Sir Charles Clore is an example. In *Re Clore (No. 2)*:[47]

> ... Sir Charles was ... unhappy in Monaco and often said that he would really like to return to England permanently and accept the tax consequences. [A witness] asked him why he had decided to go there when all his interests were elsewhere. Sir Charles said that he did not know and that he was thinking of changing his mind and returning to live in England... he did not feel at home in Monaco.

On those facts the court found that Clore had not acquired a domicile of choice in Monaco. But it is a question of fact.

4.7.3 *Standard of proof*

In *Ramsay v Liverpool*:[48]

[46] [1995] SLT 335 at p.339.

[47] [1984] STC 609 at p.615.

[48] [1930] AC 588, at p.590. Again, in *Winans v Attorney-General* [1904] AC 287 at p.291:

> A domicile of origin can be changed and in its place a domicile of choice acquired, but the alteration is a serious matter not to be lightly assumed, for it results in a complete change of law in relation to two of the most important facts of life, marriage and devolution of property.

It is considered that the same applies to the abandonment of a domicile of choice:

> That leaves the question whether there is any difference in
> [1] the strength of the case which Mr Henwood must show if he acquired a domicile of choice in Mauritius without his domicile of origin reviving and
> [2] the strength of the case which he must show if his domicile of origin revived [on abandonment of a domicile of choice].
> It would be odd to have two different approaches within the same case... It seems to me that as a general proposition the acquisition of any new domicile should in general always be treated as a serious allegation because of its serious consequences. ... such an approach ensures logical consistency between two situations where the policy interest to be protected is ... the same.[49]

But just how "clear and compelling" the evidence needs to be depends on the facts of the case in point.[50]

4.7.4 *Who has burden of proof*

In *The Lauderdale Peerage*:[51]

> The onus of proving a change of domicile... lies upon those who assert it.

> "'unless you are able to shew that with perfect clearness and satisfaction to yourselves, it follows that a domicil of origin continues.' So heavy is the burden cast upon those who seek to shew that the domicil of origin has been superseded by a domicil of choice! And rightly, I think. A change of domicil is a serious matter -- serious enough when the competition is between two domicils both within the ambit of one and the same kingdom or country -- more serious still when one of the two is altogether foreign. The change may involve far-reaching consequences in regard to succession and distribution and other things which depend on domicil."

If further authority is needed, which I doubt, see *Re Fuld* [1968] P 675 at p.686.

[49] *Barlow Clowes International v Henwood* [2008] EWCA Civ 577 at [89] -[94]. The contrary view has been suggested; see *Strachan v HMRC* [2023] UKFTT 617 (TC) at [157]. The view expressed in *Barlow Clowes* is to be preferred, but it is difficult to imagine a case which turns on this point.

[50] *Barlow Clowes International v Henwood* [2008] EWCA Civ 577 at [84] to [96].

[51] (1885) 10 App Cas 692, at p.739.

So the burden of proof lies on HMRC to show that an individual has acquired a UK domicile of choice.[52]

But the significance of this is limited:

> the importance of onus of proof is easily exaggerated. While the burden of proof always exists, few substantial cases turn upon it and in making their factual findings the judge is usually expressing their considered judgment as to what in truth occurred.[53]

The onus of proof may be significant in ascertaining the domicile of a person who died long ago, as the evidence available is likely to be limited.

4.7.5 *Domicile of choice: Critique*

It is difficult to acquire a domicile of choice for two reasons:

(1) The requirement of intention to reside permanently (in the domicile sense) is a strong one.
(2) The onus of proof is a heavy one.

The reason is in part historical:

> For centuries, people have gone into the world from this country intending ultimately to return and without any intention of severing their connection with the British legal system and the ideas underlying it. It would not be in harmony with the temper of the British people if those who happen to be living abroad had to be told that there was no method whereby they could continue to regulate their lives according to the familiar British conceptions. It should also be remembered that a country which does not apply nationality as a yardstick in matters of private international law is bound to substitute for it a strict test involving a measure of permanence.[54]

The rules were designed to accommodate the empire builders of the 19th century. It is pleasant and profitable to trace the origin of legal rules in the social and economic conditions of a bygone age. But the question arises whether the rules are appropriate at the current time. The purpose here is of course private international law, not (or not primarily) tax law.

[52] See too 6.36 (Residence: Burden of proof).

[53] Bingham, "The Judge as Juror", *Current Legal Problems* (1985) p.2; reprinted in *The Business of Judging* (2000) p.2 (good holiday reading).

[54] First Report of the Private International Law Committee (1954) Cmd 9068, para 7 *https://www.kessler.co.uk/wp-content/uploads/2014/07/1261_001.pdf*

It has often been said that the rules are too strict. In 1954 the Private International Law Committee proposed that if an individual had his home in a country, they should be presumed to intend to reside there permanently (in the domicile sense).[55] A bill to that effect was introduced in 1958 but failed as a result of lobbying by UK resident foreign domiciliaries. The government argued that the fears of foreign businessmen were groundless, as the reform would not affect them; but that was a damaging defence, as if the reform did not have much effect, why was it worth making?[56]

A similar reform was proposed by the Law Commission in 1987.[57] The Government initially accepted the proposals but there was no change in the law. In 1996 the proposals were formally abandoned, probably for the same reason.[58]

Neither of these proposals were tax motivated. If they had any effect, it should have been broadly revenue-neutral, as to the extent that they may have made it easier to acquire a UK domicile of choice, they also made it easier to acquire a foreign domicile of choice. But they suffered from the problem of many tax reforms, that losers (UK resident foreign domiciliaries) complain more than winners.

In considering reform of the onus of proof, one should bear in mind that it may have limited significance in the way that cases are actually decided. If that is right, the reform of amending the burden of proof in domicile cases would have little if any practical effect.

In an interesting article in 1991, Professor Fentiman argued that "substantial connection" is a better test than intention, for acquisition of a domicile of choice.[59] That would have given a more sensible outcome,

[55] First Report of the Private International Law Committee (1954) Cmd 9068, para 7; *https://www.kessler.co.uk/wp-content/uploads/2014/07/1261_001.pdf*

[56] The controversy is recorded in Mann "The Domicile Bills"(1959) 8 ICLQ 457.

[57] Law Com. No. 168 *The Law of Domicile* *http://www.scotlawcom.gov.uk/download_file/view/228/*

[58] According to Hansard HC, 16 Jan 1996 Col 487:

> "The Government have decided not to take forward these reforms on the basis that, although they are desirable in themselves, they do not contain sufficient practical benefit to outweigh the risks of proceeding with them and to justify disturbing the present long established body of case law on this subject."

This was the right reason for the right decision. However, behind this decision was pressure of the foreign domicile lobby: see "Rules for Determining Domicile", Law Reform Commission of Hong Kong (2005) para 4.28 *http://www.hkreform.gov.hk*

[59] Fentiman, "Domicile Revisited" [1991] CLJ p.445.

in cases such as *Bullock, Ramsay,* and *Winans,* (where the individuals' connections with England were very substantial indeed). It seems to me that if we actually had a substantial connection test, the question of what amounts to a substantial connection would generate even more difficulty than an intention-based test; and in any case, it would not be desirable for the Courts to upset well-established rules of private international law. In practice the Courts have not developed the law in that direction and the intention test rules the day. However as intention is determined by examination of connections, substantial connection may determine findings of intention; and it is possible that a tribunal may pay lip service to intention but decide a case on the basis of substantial connection, holding that the individual's stated intention, however genuine, is insufficiently firm.[60]

4.8 Remaining non-dom: UK resident

Suppose an individual with a foreign domicile of origin (and not born in the UK) comes to the UK and wishes to retain their foreign domicile. The concern is not to acquire a UK domicile of choice.

The primary advice to be given is that the individual may live in the UK as long as they wish from year to year, but should not form the intention to reside here permanently. Unless they do so, the essential condition for the acquisition of a new domicile is not satisfied.

However, the individual should not be content with this mental step unless their stay here is short or fixed term. They should also take appropriate steps to broadcast the absence of any intention of residing here permanently and to manifest an intention to return elsewhere in due course. This is important because the court will decide for itself what is the true intention of the individual, and will have regard to the way that the individual conducts their affairs while in the UK.

The individual should if possible retain ties with their country of origin or the country where they intend in the future to settle. There are many ways to do so and what they do must be tailored to their circumstances. Possibilities for consideration include regular and extended visits home; local business interests, bank accounts and investments; membership of local social, political and religious organisations.

Conversely, the individual's social and business commitments in the UK

[60] See 4.12.2 (Evidence of living person).

should be minimised. But the significance of such commitments depends on the facts. The purchase of a home in this country (directly or through a trust structure) may indicate a greater degree of permanence than rented accommodation, but purchasing a property may imply nothing more than an intention of medium-term residence. Changing one's name (or its spelling) to accord with UK usage, may suggest a long term intention to remain in the UK; but it was common before and during the 2nd world war for refugees to change their name for the protection of themselves and relatives exposed to enemy control;[61] and not much of an inference as to long term intention could be drawn from that.

The individual should make a will taking effect under the law of their domicile.[62] The will should include a declaration that the individual intends to return home in due course or the circumstances in which that is to occur. The will might if appropriate express a desire to be buried in that country.

The purchase of a burial plot suggests an expectation to be buried in that country. If that is in the UK, it suggests an intention to remain there for the rest of the individual's life. If the burial plot is elsewhere, it may suggest an intention to leave the UK. However, this is not necessarily a matter which carries much weight and if done at the suggestion of a tax adviser, it carries no weight at all.

The retention of a foreign domicile of origin is not dependent on establishing a positive intention to return home: it is determined negatively by the absence of an intention to stay in the UK. An intention to move from the UK, whether to the country of origin or somewhere else, is enough to enable the domicile of origin to be retained:

> though a man has left the territory of his domicile of origin with the intention of never returning, though he be resident in a new territory, yet if his mind be not made up or evidence be lacking or unsatisfactory as to what is his state of mind, his domicile of origin adheres.[63]

The assembling of evidence of an intention to return to the country of origin, while potentially helpful, is in some cases unnecessary or inappropriate.

[61] This was so common that there was a standing order to facilitate the procedure: Army Council Instruction no 475 of 1943.

[62] A separate UK will may also be appropriate to deal with UK property.

[63] *Re Fuld* [1968] P 675 at p.685.

4.8.1 *Involvement in politics*

The general rule is that involvement in UK politics is compatible with a non-UK domicile though it is a factor to be taken into account in ascertaining intention to reside permanently. However, MPs and other parliamentarians are deemed UK resident and domiciled,[64] and the position of politicians is fraught if they or even their spouses are foreign domiciled, at least if they claim the remittance basis.[65]

There is a proposed rule that (in short) non-resident and foreign domiciled individuals may not make gifts (above a small amount) to a political party.[66] But although the law was enacted in 2009,[67] it is not in force: the necessary commencement order has not been made. Presumably the Brown administration fell before it could be done, and subsequent coalition/Conservative administrations did not favour the change. So gifts to political parties by foreign domiciliaries are currently lawful. It may be safer for foreign domiciliaries whose domicile might be challenged not to make major donations; but it depends on the facts.

The UK franchise may include commonwealth and Irish citizens, so while voting in the UK is not irrelevant to intention and domicile, it should not count for much.

[64] See App 4.1 (Parliamentarians).

[65] In April 2022 it was leaked (how?) that the wife of the Chancellor claimed the remittance basis; she was (or was said to be) domiciled in India. This was thought by some to be scandalous. It is difficult to see how anyone who had any understanding of UK tax could think that, but there it is. The story died down after she said that she would not claim the remittance basis.
This has been the state of politics at least since the 1920's when a peerage was given to Lord Vestey who had been a tax exile: see *"Vestey: Royal Commission evidence and debate*"
https://www.kessler.co.uk/wp-content/uploads/2013/07/Vestey_Royal_Commission_evidence_and_ensuing_debate.pdf

[66] The requirement is that "the individual's liability to income tax for the current tax year (including eligibility to make any claim) falls to be determined (or would fall to be determined) on the basis that the individual is resident, ordinarily resident and domiciled in the UK in that year."
Would that condition be met if the individual was deemed domiciled, or did not claim the remittance basis in the year, at least if the individual was not the settlor of a protected trust? At present the point does not arise.

[67] Section 10 Political Parties and Elections Act 2009 amending s.54 Political Parties, Elections and Referendums Act 2000.

Registration and voting as an overseas elector[68] is (in short) ignored in a domicile tax appeal, unless the taxpayer wishes otherwise.[69] This rule was intended to encourage UK expatriates to vote without imperiling their claim to be non-UK domiciled. There is considerable force in the objection made by Labour MP Mike O'Brien:

> Whereas the American colonies in 1774 cried, "No taxation without representation," it seems that ... overseas voters are now demanding representation without taxation... [Section 200] has all the hallmarks of a cynical amendment motivated by the self-interest of the Tory party. ... registration to vote shows a commitment to one's country. It can be evidence of domicile. In each case, that evidence will have a different weight, depending on the other circumstances of the individual, but it is right that registration should have some weight and show some degree of commitment to one's country.[70]

The rule ought to be repealed, but in the scrabble for political advantage it would be unrealistic to expect cool and impartial reflection, and it does not much matter.[71] Those who are concerned about possible UK domicile would still be best advised not to register or vote in the UK (and to vote in their country of domicile, if possible).

[68] This is an interesting corner of election law. Before 1985 non-residents could not vote in Parliamentary elections. The Representation of the People Act 1985 extended the franchise to "Overseas electors" who are (in short) non-resident British citizens who had registered as voters when UK resident; they may continue to vote until they have been non-resident for 15 years.
See House of Commons Library "BRIEFING PAPER 5923", 28 April 2022
http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN05923

[69] See s.200 FA 1996; the section was (unhelpfully) rewritten for IT purposes in s.835B ITA.

[70] Hansard, HC Deb 27 March 1996 vol 274 cc1106-10.
http://www.publications.parliament.uk/pa/cm199596/cmhansrd/vo960327/debtext/60327-41.htm The subsequent election (1997) was the Blair landslide, and O'Brien was no doubt also right to question whether this provision helped the Tories.

[71] There are over 5m overseas British citizens, and as of December 2021, there were almost 100,000 overseas electors: see
https://www.ons.gov.uk/peoplepopulationandcommunity/elections/electoralregistration/bulletins/electoralstatisticsforuk/december2021#overseas-electors
The US has a similar rule in s.106 [US] Uniformed and Overseas Citizens Absentee Voting Act 1986, but since the US taxes its non-resident citizens, the objection of "representation without taxation" does not arise.

4.9 Abandoning domicile of choice

Dicey states:[72]

> A person abandons a domicile of choice in a country by ceasing to reside there and by ceasing to intend to reside there permanently or indefinitely, and not otherwise.

Thus there are two requirements: cessation of residence[73] and cessation of intention[74]. Dicey continues:

> When a domicile of choice is abandoned, either
> (i) a new domicile of choice is acquired; or
> (ii) the domicile of origin revives.[75]

A note on terminology. A person may be said to "abandon" a domicile in in three circumstances.

(1) A person may abandon a domicile of choice without acquiring a new domicile of choice, so their domicile of origin revives.

(2) Acquisition of new domicile of choice:
   (a) A person with a domicile of choice in country A, who acquires a new domicile of choice in country B, may be said to "abandon" their old domicile of choice.
   (b) A person with a domicile of origin in country A, who acquires a domicile of choice in country B, may be said to "abandon" their domicile of origin (though the domicile of origin continues in a spectral sense, as if they later abandon their domicile of choice, without acquiring a new domicile of choice, the domicile of origin revives).

IRC v Bullock illustrates all 3 senses:[76]

> since no man can have more than one domicile at one time, the act of acquiring a new domicile must necessarily involve the abandonment of the previous domicile.... *Lord v Colvin*[77]... refers to a man intending to abandon an acquired domicile and to resume his domicile of origin or to

[72] Dicey, Morris & Collins, Conflict of Laws (16th ed., 2022), para 6R-077 (Rule 15).
[73] See 4.6 ("Domicile-residence").
[74] See 4.7 (Permanent/indefinite residence).
[75] Dicey, Morris & Collins, Conflict of Laws (16th ed., 2022), para 6R-077 (Rule 15).
[76] 51 TC 522 at p.539.
[77] 4 Dr. 366 at p.422.

> his abandoning his domicile of origin to acquire a domicile of choice. In truth the insistence of Lord Chelmsford upon the importance of finding a fixed intention of abandoning one domicile and permanently adopting another is but a method of emphasising the importance of finding that the person in question intends to make his new country his permanent home. The abandonment of the previous home is implicit in the adoption of the new home if the latter is intended to be exclusive and permanent.[78]

It seems to me that the word "abandon" is most apt to describe case (1), ie where a person abandons a domicile of choice without acquiring a new one. In cases (2)(a)(b) it would be more apt to say that the former domicile is "lost", rather than "abandoned". As *Bullock* observes, the focus of enquiry in these cases is not on abandonment but on acquisition of the new domicile of choice (though the latter implies the former). But the terminology is too well established to change; and no difficulty arises as long as one bears in mind the differences between the three types of abandonment.

4.9.1 *Abandoning domicile of dependency*

A domicile of dependency ceases:
(1) for a child, on attaining the age of independence
(2) for a woman who was married on 1 January 1974, on that date or when the marriage ended, if earlier

Once the dependency has ceased, the domicile of dependency continues but it may be lost or abandoned in the same way as a domicile of choice.[79] In this respect a domicile of dependency is treated like a domicile of choice.[80]

[78] Likewise *Steiner v IRC* 49 TC 13 at p.35: "A criticism was made of the decision of the Special Commissioners that there was no finding in terms of abandonment of the German domicile of choice. This is, strictly speaking, correct; but I do not take it to be a valid criticism, because, if a tribunal comes to the conclusion that a sufficient intention has been established to justify a conclusion of a different domicile of choice, then it necessarily involves a finding of abandonment of the other. They are inseparable opposite sides of the same coin."

[79] See 4.16.2 (Marriage existing in 1974); 4.16.1 (Marriage ended pre-1974); 4.17 (Child's domicile: England).

[80] Indeed, a domicile of dependency has been described as a type of domicile of choice, see 4.16.3 (Marriage ended pre-1974). The reader may think that is stretching the concept of "choice", and some writers have suggested the term "quasi-choice". But it does not matter whether or not one calls a domicile of dependency a type of

It has been suggested that the test for abandonment of a domicile of dependency is more lenient than the test for abandonment of a domicile of choice. However, it is considered that the *test* is the same: the individual must (1) cease to reside in the place of domicile of dependency and (2) cease to intend to reside there permanently. In the case of a domicile of dependency it is possible that the individual may never have intended to reside there permanently, in which case requirement (2) may in practice be easier to satisfy. The test is more lenient in that the onus of proof may be easier to satisfy.[81]

4.10 Losing UK domicile of origin

The domicile rules are favourable to individuals with a foreign domicile of origin. They may stay many years in this country without acquiring a UK domicile of choice and becoming exposed to the concomitant tax burden (though this is subject to the 15-year deemed domicile rule). But the rules are correspondingly unfavourable to an individual who wishes to replace their UK domicile of origin by a foreign domicile of choice. Such a person must not only reside in that other country; they must hold and manifest their intention to remain resident there permanently. Having done so, they must:

(1) maintain their residence in the country of domicile of choice; or
(2) maintain the intention to reside there permanently; or
(3) acquire a new foreign domicile of choice.

An individual cannot shed their UK domicile of origin without acquiring

domicile of choice, or quasi-choice. We simply need some rule for abandoning a domicile of dependency, after the dependency has ceased, and it is sensible to apply the same rule as that which applies for abandoning a domicile of choice.

[81] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022) para 6-018 states:
There is a presumption that a person continues to be domiciled in the country in which he is domiciled; or, to put it differently, the burden of proving a change of domicile lies on those who assert it. This presumption varies in strength according to the kind of domicile which is alleged to continue. It is weakest when that domicile is one of dependency and strongest when the domicile is one of origin.
Henderson v Henderson [1967] P. 77 at p.82 cites this and comments:

> There are dicta in some Scottish and Irish cases to support this statement; though I think that it is really more a matter of common sense and experience than a rule of law. The abandonment of a domicil of choice acquired dependently in favour of a domicil of origin re-acquired by personal volition must, in the nature of things, generally be of all changes of domicil the one the least onerous of proof.

a domicile of choice in another country; it is not enough to intend to leave the UK permanently, never to return. Departure from the UK must therefore be accompanied by permanent residence in the chosen country. If any time is spent in the UK, the UK must not be the chief residence

In order to acquire a domicile of choice in a country, one must *want* to live there. If a UK domiciliary has plans of a business or personal nature which lead them to want to settle abroad, then acquiring a foreign domicile may be feasible. Links with the UK must be kept to a minimum, particularly at first: there must be a break with the UK.

Fawcett concluded in 1985 that an unspoken policy of not allowing individuals with a UK domicile of origin to escape UK tax was influential in determining the result in domicile tax cases.[82] Subsequent cases suggest this is still true.[83]

4.11 Dual residence and domicile

The tests of residence and intention to reside are (relatively) straightforward if a person resides (and intends to reside) in only one country. What if the person resides (or intends to reside) in more than one country? Increased mobility makes this a common problem.

4.11.1 *Acquiring domicile of choice: Dual resident*

In *Udny v Udny* Lord Westbury said that a domicile of choice is acquired when:

> a man fixes voluntarily his sole *or chief* residence in a particular place, with an intention of continuing to reside there for an unlimited time.[84]

If a person resides in more than one country, they acquire a domicile of choice in country A if and only if:

(1) country A is their chief residence; and

(2) their intention is permanently to reside in country A as their chief

[82] "Result Selection in Domicile Cases" (1985) OJLS vol 5 p.378. *https://academic.oup.com/ojls/article-abstract/5/3/378/1599609?redirectedFrom=fulltext* The formerly-domiciled resident rule reflects a similar intuition: see 4.7.1 (Former-dom resident: Critique).

[83] Cases in which apparently strong claims of a UK domiciliary to a foreign domicile of choice failed include: *Portland; Plummer; Gaines-Cooper*.
Fawcett also found that a policy of upholding wills is influential in probate cases.

[84] (1869) LR 1 Sc & Div App 441 at p.458 (Emphasis added).

> residence.[85]

If a person has a secondary residence in a country (for example a holiday home used every summer or winter), they do not acquire a domicile in that country even if:
(1) they intend to retain that secondary residence permanently, or
(2) they intend to make it their primary residence at some future time.[86]

But if a person acquires (and intends to permanently retain) a chief residence in a country, they become domiciled there even if they retain a secondary residence elsewhere.

In *Plummer v IRC*:[87]

> ... a person who retains a residence in his domicile of origin can acquire a domicile of choice in a new country only if the residence established in that country is his chief residence...
> [Counsel] submitted that a person whose presence in a new country is sufficient to amount to residence may, notwithstanding that his chief residence remains in his domicile of origin, acquire a domicile of choice by evincing an intention to continue to reside permanently in the new country. I think that this submission is inconsistent with the passage which I have quoted[88] ... which has always been treated as an authoritative statement of the circumstances in which a domicile of choice may be acquired.

This should not be controversial.[89]

[85] This passage was approved in *Strachan v HMRC* [2023] UKFTT 617 (TC) at [360].

[86] These were the facts of *Strachan* (see above FN).

[87] 60 TC 452 at p.463.

[88] See 4.7 (Permanent/indefinite residence).

[89] "It is possible for a person to have two homes, each in a different territory. In that event, the relevant enquiry is which of the two homes is the chief residence": *Re Shaffer* [2004] WTLR 457 at [11]. The same point is made in *IRC v Bullock* 51 TC 522 at p.539F where the expression used is "principal home": " A man may have homes in more than one country at one time. In such a case, for the purpose of determining his domicile, a further inquiry may have to be made to decide which, if any, should be regarded as his principal home."
In *IRC v Duchess of Portland* 54 TC 648 at p.656, Nourse J said that the test was, in which of the two countries did the individual reside "as an inhabitant". That comes to the same thing, but to ask which of the two countries is the chief or principal residence is a clearer way to approach the question. This point was made in *Plummer v IRC* 60 TC 452 at p.463 ("the concept of being an inhabitant seems to me less illuminating in cases of dual or multiple residence").

4.11.2 *Losing domicile of choice: Dual resident*

The judge continued:

> Rule 13(1) of Dicey and Morris, if read literally, appears to go too far. This says that:
>
> > "A person abandons a domicile of choice in a country by ceasing to reside there and by ceasing to intend to reside there permanently or indefinitely, and not otherwise."
>
> These words might suggest that a domicile of choice (and presumably a fortiori a domicile of origin) cannot be lost unless the person in question has ceased altogether to reside there. I do not think that the rule was framed with dual residence in mind. At any rate, it seems to me that *Udny v Udny* shows that loss of a domicile of *origin or choice* is not inconsistent with retention of a place of residence in that country if the chief residence has been established elsewhere.
>
> (Emphasis added)

This passage has caused confusion. One needs to consider domicile of origin and domicile of choice separately:

(1) *Loss of domicile of origin* The only way to lose a domicile of origin is to acquire a domicile of choice. This passage (so far as it concerns a domicile of origin) is correctly stating the point made at 4.11.1 (Acquiring domicile of choice: dual resident).

(2) *Loss of domicile of choice* There are two ways to lose a domicile of choice:
   (a) by acquiring a new domicile of choice
   (b) by abandonment without acquiring a new domicile of choice

The judge here is considering acquisition of a new domicile of choice.[90] The passage (so far as it relates to a domicile of choice replaced by a new domicile of choice) correctly states the point made at 4.11.1 (Acquiring domicile of choice: dual resident) above.

What is the test for abandonment of a domicile of choice (without acquiring a new domicile), in a dual residence context? It is considered that Hoffmann is correct to say that T abandons his domicile of choice where:

(1) T acquires a domicile of choice in country A.

[90] Hence the words at the end of the passage ("if the chief residence has been established elsewhere").

(2) T continues to reside in country A but
  (a) they cease to reside there as their chief residence; and
  (b) they cease to intend to reside there as their chief residence.
(3) T does not acquire a domicile of choice elsewhere.

This is consistent with the test of acquisition of domicile of choice.[91]

4.11.3 *Which is chief residence*

How does one ascertain which of two competing residence countries is the chief residence? The term sometimes used is principal home, but it comes to the same thing.[92]

The test is multifactorial: no single factor is decisive. In *Barlow Clowes International v Henwood*:

> [The] test of chief residence ... cannot simply be a reference to the main home in terms of size or amenities. Nor can it be a reference to the home in which the subject spends the most time. The court has to look at the quality of the residence in order to decide in which country the subject has an intention to reside permanently.[93]

The cases offer examples and a little guidance, but the question is essentially one of fact and degree.

In *Plummer v IRC* the taxpayer had a domicile of origin in England. She intended to live in Guernsey, but was studying at university in London. In all, she spent two-thirds of her time in England and one-third in Guernsey (some weekends and holidays). It was held that England remained her chief residence so she did not acquire a domicile of choice in Guernsey. However the test was not just a matter of counting days:

> [Counsel for the taxpayer] submitted that the Commissioners paid no regard to anything except the relative amounts of time which the taxpayer spent in England and Guernsey during the years in question. They ignored the quality of her presence in each country; the fact that she was in England solely for the purpose of education and in Guernsey because it was her family home. I do not think that this is a fair reading of the Commissioners' decision. They set out at length the taxpayer's ties

[91] See 4.11.1 (Acquiring domicile of choice: Dual resident).

[92] Perhaps inevitably, we also have references to the "real" home: *Barlow Clowes* at [141]. But references to reality do not help much, if at all; see App.7.1 (What do we mean by real).

[93] [2008] EWCA Civ 577 at [104].

> with Guernsey and her reasons for remaining in England. In deciding whether the house in St. Peter Port had become her chief residence, they said:
>
> > "We accept the [taxpayer's] evidence that she likes Guernsey and enjoys the amenities of the island when she is there, quite apart from enjoying the company of her family ... We do not underestimate the part which Guernsey plays in her thinking.."
>
> Nevertheless they said that these considerations did not outweigh the fact that the taxpayer had resided for the greater part of the year in England and that there had been no "break in the pattern" which would justify a finding that she had ceased to have her chief residence in England. She had not, to use the language of Lord Hatherley in *Udny v Udny*,[94] settled in Guernsey.
>
> ... in my judgment it was the right conclusion. If the taxpayer had ... broken altogether with England and settled in Guernsey like her mother and sister and then, even after a relatively short interval, returned to England for study, the quality of her presence here might have been such as to prevent a revival of her domicile of origin. But the fact is that she has not yet settled in Guernsey, and the reasons why she has been unable to do so are in my view irrelevant. ... To treat the house in Guernsey as her chief residence simply because it is the sole residence of her mother and sister would in my view be attributing to her a kind of quasi-dependent domicile for which there is no legal justification. And the fact that the taxpayer may intend to settle in Guernsey after her education and training are completed and then to remain permanently is not sufficient to give her a proleptic domicile of choice.[95]

The concept of "chief residence" is one of a cluster of similar concepts:

Concept	**Relevant for**	**See para**
Centre of vital interests	Treaty-residence	9.13
Main private residence	MPR relief	59.7

Some guidance may be had from discussion of those concepts, though the period of enquiry may perhaps be different.

4.12 Statements of domicile

4.12.1 *Written statements*

Where domicile may be unclear, a will should contain at least a brief

[94] See 4.5 (Domicile of choice).

[95] 60 TC 452 at p.464.

statement of domicile, or a statement should be prepared to accompany the will. An individual making a lifetime gift may also wish to prepare a domicile statement.[96]

According to *Proles v Kohli*:[97]

> the courts are reluctant to give effect to declarations which refer in terms to "domicile" since the declarant is unlikely to have understood the meaning of the word.

Whether the individual has understood the meaning of "domicile" depends of course on the facts. An uninstructed lay person is unlikely to fully understand the legal meaning of the word, but if competent advisors are acting, the matter will be explained.

A short template declaration that "I am domiciled in xxx" is sufficient if it is just desired to record the fact of, or claim to, foreign domicile; but if it is desired to serve as evidence to support the claim then more details are needed. The statement should not be regarded as a formality. Even a brief statement in a will should be drafted in accordance with the individual's specific circumstances and the domicile issue should be properly considered.[98]

The declaration may be self-serving and often is. The statement is most needed when the individual has a tax motive for claiming a particular domicile. It is then of limited value. *Agulian v Cyganik* made the point:

> in a case of proof of the subjective intentions of a person who has died, little weight is attached to direct or indirect evidence of statements or declarations of intention by the person concerned. Subjective intentions have to be ascertained by the court as a fact by a process of inference from all the available evidence about the life of the person, whose domicile is disputed.[99]

Of course, declarations of intention are not conclusive. They

> must be examined by considering the persons to whom, the purposes for which, and the circumstances in which they are made, and they must be further be fortified and carried into effect by conduct and action

[96] For added gravitas, that might take the form of a statutory declaration under the Statutory Declarations Act 1835. But I doubt if that would make a difference.

[97] [2018] EWHC 767 (Ch) at [13].

[98] For precedents, see Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 18.36 (Testator domiciled outside UK).

[99] [2006] EWCA Civ 129 at [13].

> consistent with the declared expressions.[100]

One should bear in mind that a domicile statement will be considered in the light of records (including contemporary email and text messages) which are likely to be available. Expect the correspondence to be reviewed in the event of a challenge. There is a temptation to 'overegg the pudding' when drafting domicile statements, which needs to be avoided. One cannot draft one's way to a foreign domicile. The value of the statement is that it is a record of the relevant facts for the benefit of all concerned, available to supply to HMRC or other interested parties. It may become particularly important for the future when the facts may be more difficult to obtain or when the individual may not be able or available to give evidence.

It may be helpful to keep a domicile statement up to date by reviewing every few years and amending as appropriate. The statement might usefully be supplemented by statements from other connected or unconnected persons who are familiar with the facts.

In *Morgan v Cilento*, the evidence included the memoir of the playwright Anthony Shaffer:[101]

> The book opens with a quotation from Gore Vidal:
>
> > "A memoir is how one remembers one's own life, while an autobiography is history, requiring research, dates, facts double-checked."
>
> The parties invited me to read it, which I did. I have not taken it as evidence of historical facts, but it has helped me in forming a view about Mr Shaffer's state of mind during its composition.

4.12.2 *Evidence of living person*

In the event of a dispute, an individual who is alive and well will give oral evidence subject to cross examination. So their domicile statement is of value as a first draft of a witness statement, and as a record of evidence which may be needed if the issue comes to be reviewed some time later, especially after the individual has died.

[100] *Ross v Ross* [1930] AC 1 cited in *Proles v Kohli* [2018] EWHC 767 (Ch) at [12]. For an example of a simple declaration rightly disregarded, see *Reddington v MacInnes* [2002] ScotCS 46 at [28]. (If those drafting the will had considered domicile more carefully, the litigation might have been avoided.)

[101] [2004] EWHC 188 (Ch) at [5]-[6].

In *Wilson v Wilson*:[102]

> when we have the man here, and when he swears that that was his intention, why should not the Court believe him?

The answer is that the court may accept the individual's oral evidence (though of course it assesses that evidence in the light of any other evidence). This is self-evident, but *Wilson v Wilson* makes the point, if authority is needed:

> The Court must not take his word as conclusive proof of the fact, and if there are circumstances in the case which tend to shew that what he says is not true or likely to be true, they may influence the conclusion at which the Court would arrive. Therefore the question is here not so much whether the circumstances of his English residence tend to prove English domicile as whether, the man swearing to his intention to create an English domicile, there are such circumstances on the other side as warrant the Court in throwing over his oath and disbelieving him.

Rejecting an individual's oral evidence as to intention does not require a finding that the individual is dishonest. In *Macey v Pizza Express* the question was whether the landlord intended to occupy for business purposes. Rejecting the landlord's evidence did not involve impeaching his honesty:[103]

> It was not open to the Judge to find that Mr Macey was lying about his intentions, and the Judge did not do so. Rather the Judge concluded that, although Mr Macey was asserting that he had a "firm and settled" intention, considering the totality of the evidence, Mr Macey had (perfectly understandably and innocently) mischaracterised his state of mind. His "intention" was insufficiently firm and settled to constitute "subjective" intention for the purposes of section 30(1)(g).

Or it may be that the individual is unconsciously biased in favour of the desired outcome.

4.13 Domicile of choice: Illness

In *Moorhouse v Lord*:

[102] (1872) LR 2 P & D 435 at p.444.

[103] [2021] EWHC 2847 (Ch) at [33]. Likewise *Gaines-Cooper v HMRC* [2007] EWHC 2617 (Ch) at [22]-[24].

> Take the case of a man labouring under a mortal disease. He is informed by his physicians that his life may be prolonged for a few months by a change to a warmer climate and that at all events his sufferings may be mitigated by such a change. Is it to be said that if he goes out to Madeira he cannot do that without losing his character as an English subject, without losing his right to the intervention of the English laws as to the transmission of property after his death, and the construction of his testamentary instruments. My lords, I apprehend that such a proposition is revolting to common sense, and the common feelings of humanity.[104]

Thus a person does not *acquire* a domicile of choice in a place to which they move for short term medical reasons. This is so even if they go for end-of-life care and know that they will not recover to return home.

For the same reason, a person will not *lose* a domicile of choice in a country, if they leave that country for end-of-life medical care, even if they go to the country of their domicile of origin for treatment.[105] In *Proles v Kohli* an individual had a domicile of origin in India, acquired a domicile of choice in England, but fell ill and died in India:

> It may be that as his illness progressed, it became clear that he would be unable to [return to England]. It may be that at some stage it became clear to the deceased that he would die within a short period; and that at that stage he decided to remain in India. In my judgment, such decisions would not be an abandonment of his English domicile of choice, for two reasons. The first is that such a decision would be one forced upon him by his illness and impending death: .... The second is that it would not be a decision as to where he was to live indefinitely, because, for all practical purposes, there was, sadly, no life remaining to be lived by him. Indeed, even if the deceased had travelled to India intending to die there,

[104] (1863) 10 HLC 272 at p.292. Similarly *Udny v Udny* (1869) 1 LR Sc & Div 441 at p.458: "There must be a residence freely chosen, and not prescribed or dictated by any external necessity, such as ... the relief from illness ...". And more recently, *Foote v. Foote Estate* [2011] ABCA 1 at [21]: "Some authorities speak of one's domicile of choice as a place where one intends to "end one's days". That language is unhelpful where, as here, a person with a fatal and fast-moving illness makes a trip shortly before his death for treatment. Determining an intention to change domiciles in such a situation is not a simple matter of saying the deceased intended to "live out his days" in the new location. It could not, in most cases, be described as a voluntary move."

[105] But the individual could become deemed UK domiciled, as a formerly-domiciled resident.

> this would not, in my judgment, be an abandonment of his domicile of choice, for similar reasons. Where, for practical purposes, a person has no life left to live, then a decision to go to his/her country of origin to die, is not a decision to spend any significant part of one's life ("the end of one's days") in that country - it is a decision that the specific event of his/her death should be in that country.[106]

However, that applies only to a person who goes purely for short term medical treatment or palliative care. If, say, a person comes to England who is housebound and needs long-term care, or because the weather in Bournemouth is better for their health than Falkirk,[107] they may acquire an English domicile. In *Hoskins v Matthews*:

> it was contended ... that Mr Matthew's residence out of England was a matter of necessity and not of choice. That his health compelled him to reside abroad, and that domicile cannot be founded on such a compulsory residence. That there may be cases in which even a permanent residence in a foreign country, occasioned by the state of the health, may not operate a change of domicile may well be admitted. ... But such cases must not be confounded with others in which the foreign residence may be determined by the preference of climate or the hope or the opinion that the air or the habits of another country may be better suited to the health or the constitution. In the one case, the foreign abode is determined by necessity; in the other it is decided by choice.[108]

It seems to me that to ask whether a person has acted by necessity or by choice is not the best way to put the question: where a person goes to a country for medical reasons, there is (almost) always *some* element of volition. The better way to put the question is whether the individual has "settled" in the country to which they have gone; whether they are there "as an inhabitant". But it comes to the same thing, as if an individual goes to a country for medical reasons as a matter of necessity, they will not have settled there.

4.14 Citizenship and domicile

This section draws on:
Shachar (ed), *Oxford Handbook of Citizenship* (**"Oxford Handbook"**)[109]

[106] [2018] EWHC 767 (Ch) at [144], [145].

[107] As in *Reddington v MacInnes* [2002] ScotCS 46.

[108] (1856) 8 De GM & G 13 at p.28.

[109] 1st ed, 2017

Citizenship: Our Common Bond (**"Goldsmith report"**)[110]

Citizenship[111] has generated a lively scholarship, which ranges across law, politics, sociology and ethics.

4.14.1 *Citizenship/domicile compared*

The starting point is to note that citizenship is distinct from domicile.[112] Important differences include the following:

(1) The rules for acquiring/changing domicile are distinct from the rules for acquiring/changing/losing citizenship.

(2) Every person has one and only one domicile, but a person may have two or more nationalities (dual nationals) or no nationality (stateless persons).

(3) A citizen of a federal or multi-jurisdiction state can only be domiciled in one of its constituent legal jurisdictions, not the state itself. Eg, a UK citizen may be domiciled in England, Scotland or Northern Ireland, but not (strictly speaking) in the UK.

Although citizenship and domicile are distinct, decisions to acquire, retain or renounce citizenship of a state may shed light on intention to reside in that state, which is central to domicile.

Note that while a citizen will usually have a substantial connection with their country, that is not necessarily the case. A person may be unaware that they are a citizen of a country, which they may never have visited, and to which they have only a tenuous connection. The Australian dual citizenship crisis of 2017-18 illustrates the point. Australia bans dual citizens from sitting in parliament. *Fifteen* MPs discovered that their election was void because unbeknown to them they were also nationals of another state. In one case, for instance, an MP's mother had taken Italian

[110] *https://www.kessler.co.uk/wp-content/uploads/2012/10/Citizenship-Report-Goldsmith.pdf*

[111] A note on terminology: In UK law the words citizenship and nationality are (more or less) interchangeable; though attempts are made to desynonymise them, and when dealing with statutory provisions it is best to adopt the statutory term.
The position might be different elsewhere, which may explain why the Government Service article of some DTAs, such as the Taiwan/UK DTA, refer to a "citizen or national" of a territory; but it is not necessary to pursue that here.

[112] This is self-evident, but if authority is needed, see *IRC v Bullock* 51 TC 522 at p.540; *Udny v Udny* 1 Sc & Div 441 at p.452: "The question of naturalization and of allegiance is distinct from that of domicile;" likewise at p.457.

citizenship, not realising that this arguably made her son an Italian citizen, disqualifying him from sitting as an Australian MP.[113]

4.14.2 *Retention of citizenship*

In *IRC v Bullock*:

> The fact that the taxpayer chose to retain his Canadian citizenship and not to acquire UK citizenship would not be inconsistent with his having acquired a domicile in the UK, but his adherence to his Canadian citizenship is, in my opinion, one of the circumstances properly to be taken into consideration in deciding whether he acquired a UK domicile.[114]

That is not controversial.

4.14.3 *Change of citizenship*

Acquiring citizenship is known as naturalisation. In *Wahl v AG*:[115]

> [1] Naturalisation is one thing; change of domicile is another:
> [2] it is not the law either
> [a] that a change of domicile is a condition of naturalisation, or
> [b] that naturalisation involves necessarily a change of domicile.

Point [1] is correct. The two points at [2] are distinct:
(a) Whether acquisition of UK domicile is a condition of naturalisation is a question of nationality law and practice.
(b) Whether UK naturalisation involves acquisition of UK domicile is a question of domicile law.

These points require further consideration in the light of changes in law and practice since *Wahl*. I only discuss acquisition of British citizenship.

[113] *https://en.wikipedia.org/wiki/2017%E2%80%9318_Australian_parliamentary_eligibility_crisis*

[114] 51 TC 522 at p.540. Similarly, in *Gaines-Cooper v HMRC* the Special Commissioners noted that the taxpayer retained British citizenship, and did not apply for citizenship in the Seychelles. Perhaps more significantly, his wife applied for British citizenship: [2007] EWHC 2617 (Ch) at [12] (quoting the Special Commissioners comments at [141]).

[115] (1932) 147 LT 382; [1938] All ER 922 at p.926.
https://www.kessler.co.uk/wp-content/uploads/2012/04/Wahl-v-Attorney-General.pdf
The case concerned naturalisation under the 1870 Act.

4.14.4 *Nationality law background*

The law of naturalisation has changed over the years:

Act	**Intention required for naturalisation**
1870 Act	To reside [permanently][116] in the UK[117]
1914 Act	To reside [permanently] in His Majesty's dominions[118]
1948 Act	To reside [permanently] in the UK or in any colony, protectorate or UK trust territory, or Anglo-Egyptian Sudan[119]
1981 Act	Home (or principal home) in the UK

The current legislation is the British Nationality Act 1981. In order for a person to become a British citizen under this Act, it is usually a requirement that:

> his intentions are such that, in the event of a certificate of naturalisation as a British citizen being granted to him, his home or (if he has more than one) his principal home will be in the UK.[120]

I refer to this as the **"UK-home naturalisation requirement"**. The applicant must certify that that is their intention; I refer to that as the **"UK-home statement"**.

The 1981 Act was preceded by a White Paper, *British Nationality Law* ("the 1980 white paper").[121] This sheds some light on the present wording, and why it differs from the pre-1981 law, which referred to *residence* as opposed to *home/principal home*:

> 60. In the Government's view the residential qualification should be such as to demonstrate very clearly that an applicant has thrown in his lot with the UK, and that he intends to regard the UK as his home. There have been signs that under the present [pre-1981] law citizenship has sometimes been sought merely for the convenience of having a UK passport, and that having obtained one, the person has later gone elsewhere to live. The Government do not take the view that citizenship should be available solely for convenience of travel.

[116] The word "permanently" was not in the Acts of 1870, 1914 or 1948, but it appears to have been required by Home Office practice.

[117] Section 7 Naturalization Act 1870 (this is the spelling of the 1870 Act).

[118] Section 2 British Nationality and Status of Aliens Act 1914.

[119] Sch 2 para 1(e) British Nationality Act 1948.

[120] Para 1(d) sch 1 British Nationality Act 1981.

[121] Cmnd 7987 (1980) *http://www.uniset.ca/naty/maternity/wpaper.pdf*

This may explain why the practice before 1981 was to require a declaration of intention to reside *permanently*.[122]

> 61. Neither of the terms "residence" and "ordinary residence" has been the subject of interpretation by the Courts for purely nationality purposes. Neither has been found entirely satisfactory in all circumstances.[123]

This may explain why the wording of the naturalisation UK-home requirement changed from "residence" to "home/principal home". The change was not intended to relax the naturalisation requirement and maybe tends to strengthen it.[124]

Home Office practice is set out in the document "Nationality policy: Naturalisation as a British citizen by discretion".[125] This contains the guidance used by the Home Office when deciding applications for citizenship.

> **Principal home in the UK**
> ...Information may also come to our attention that HMRC regard an applicant as domiciled abroad for tax purposes. In such cases, you must request the applicant's permission to contact the HMRC. You should then ask the HMRC to provide us with a copy of the applicant's completed 'Domicile Enquiry' questionnaire,[126] which may throw some light on future intentions. If the applicant refuses permission, you must refuse the application. ...
> **Applicant intends to live outside the UK**
> If applicants make it clear that, while they intend to live in the UK for a period, they have made firm plans to establish their principal home abroad at some future date the application must be refused. You must not refuse an application solely on the suspicion that the applicant will reside outside of the UK.

[122] The word "permanently" was not in the statute, but as the grant of nationality was discretionary, the Home Office presumably considered it had power to add this requirement.

[123] This is something of an understatement: see the 2012/13 edition of this work para 3.12 (Commentary: Assessment of case law tests).

[124] But although residence/home may have a slightly different nuance, the words are often used interchangeably; see 4.6 ("Residence").

[125] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032568/Naturalisation_as_British_citizen_by_discretion.pdf* (November 2021)

[126] Author's footnote: The reference is to form Dom 1, which has not been used since 2009! But any tax return will disclose if a claim is made for foreign domicile.

> ... Where an applicant has more than one home and their principal home is outside of the UK at the time of application you must refuse the application.

Home Office guidance formerly stated expressly that the UK-home naturalisation requirement (that the individual's "home is in the UK") was distinct from, and fell short of, the requirement for acquisition of a domicile of choice (an intention to reside in the UK permanently, in the domicile sense).[127] The current guidance suggests that, at least from Sep 2019, the Home Office will not accept an application for naturalisation by a person who openly maintains that they will not be domiciled in the UK after naturalisation. It is not clear whether the Home Office regard this is a requirement of nationality law, or as a matter of Home Office practice in exercising their discretion. The Home Office have probably not addressed the question; it does not much matter.

There is no case discussing the meaning of home/principal home in the British Nationality Act 1981, but the concept is (more or less) the same as "chief residence" for domicile (where the expression "principal home" is also used).[128]

4.14.5 *Naturalisation: Domicile cases*

The case law in this area needs some care as a cursory reading will mislead.

Wahl v Attorney-General concerned an individual naturalised under the 1870 Act. He declared that he intended to reside *permanently* in the UK and had no intention of permanently leaving the UK. The House of Lords found nevertheless that he did not intend to make his home in the UK and did not acquire a UK domicile of choice.[129] But that was a finding of fact

[127] The Home Office Nationality Instructions 2013, discussed in the 2018/19 edition of this work para 3.11.4, stated:

> "The replies to the [HMRC] domicile questionnaire [form Dom 1] should not be given undue weight, and they should not form grounds for refusal if they merely indicate that applicants see their ultimate home as a country other than the UK. (It is not a requirement for naturalisation that applicants intend to make their home permanently in the UK.)"

The change was made in Sep 2019.

[128] See 4.11 (Dual residence and domicile).

[129] (1932) 147 LT 382; [1938] All ER 922
https://www.kessler.co.uk/wp-content/uploads/2012/04/Wahl-v-Attorney-General.pdf
The reader may find the decision less than convincing. Lord Macmillan dissented

(not law) which depended on all the facts of the case and was not binding on other cases.[130]

The point was reargued in *Steiner v IRC*, which also concerned naturalisation under the 1870 Act. So once again the taxpayer had declared that he intended "to reside *permanently* in His Majesty's dominions" (which, in the context, meant England). The court, I think rightly,[131] brushed *Wahl* aside:

> The Special Commissioners attached some importance to the declaration associated with the naturalisation application, and so do I ... I bear in mind, of course, the views expressed in the House of Lords in *Wahl v Attorney-General*. But the significance of such matters must be judged in the context of any particular case and the background against which the application for naturalisation and the statements therewith is to be viewed. ... I think it would be quite wrong for this Court to dismiss the view of the Special Commissioners ...

And again:

> Now, it is true that in *Wahl v Attorney-General* a similar application and a statement in somewhat similar terms were regarded by the majority of the House of Lords as not affording any strong evidence of intention to reside permanently in England; but Lord Macmillan, in a dissenting speech, was of opinion that considerable weight should be attached to these matters, and Lord Atkin, who was one of the majority, said, at page 385: "I am far from saying that an application for naturalisation is not a matter to be carefully considered as part of the evidence in a case of domicile"; and the opinion of Lord Atkin was entirely concurred in by Lord Dunedin. In those circumstances, it appears to me that the Special Commissioners acted entirely properly in taking into account
> [1] the fact of the application for naturalisation, to which they indicated that they did not attach great weight, and
> [2] further in taking into account the statement made as to the applicant's intentions as to residence.[132]

and the failure of the mainstream law reports to report the case might be taken as tacit disapproval.

[130] Nowadays the Supreme Court would not concern itself with issues of fact. The reader may think this finding of fact somewhat implausible, but insofar as the point is one of fact and not law, it does not now matter.

[131] But for a defence of *Wahl*, see 4.14.8 (Citizenship: Critique).

[132] 49 TC 13. Likewise *Gulbenkian v Gulbenkian* [1937] 4 All ER 618 at p.627: "When ... Gulbenkian expressed upon oath that he intended to reside permanently

It would be relevant to consider whether after naturalisation the individual has dual citizenship. There are three possibilities:

(1) After naturalisation the individual may be a British citizen only, because:
   (a) The individual was formerly stateless, or
   (b) Foreign citizenship lapsed on becoming a British citizen[133]
(2) After naturalisation the individual may have dual citizenship

Naturalised citizens may and often do identify with their original homeland as well as with their new state of residence: both form part of their identity. But of course "identity" is not the test of domicile.

4.14.6 *Naturalisation: Conclusions*

In summary:

(1) British naturalisation, and the declaration of intention which that requires, are relevant in determining intention for domicile purposes, and always have been.
(2) Nevertheless, it was accepted practice before 2019[134] that:
   (a) A change of domicile was not a condition of naturalisation, and
   (b) Naturalisation did not *necessarily* involve acquiring a UK domicile.

   In particular, it was considered that the UK-home statement in the naturalisation application did not entail the high degree of permanency in residence which a domicile of choice requires (the intention to reside permanently in the domicile sense).

in Great Britain, I can see no reason why that declaration should not be taken at its full value as a desire to acquire a domicile of choice in this country."
Likewise *Bheekhun v Williams* 1 ITELR 491: on the independence of Mauritius in 1968, the individual had to choose British or Mauritian nationality; the choice of British nationality was a "clear pointer" towards acquisition of a domicile of choice in England.
For completeness, *Wahl* was cited in *F v IRC* [2000] STC (SCD) 1 but *Steiner* was not cited and *F* has nothing to add.

[133] Dual citizenship is increasingly common. In the UK, the rule was formerly that British citizenship lapsed on becoming a citizen elsewhere, s.13 British Nationality Act 1914, but that ceased to be the case after the 1948 Act. In some countries, eg China, citizenship is lost on naturalisation elsewhere. India prohibits dual citizenship but there is an intermediate category,"Overseas Citizen of India", which confers some citizenship rights (to reside and to work) but not political rights.

[134] This applied to naturalisation under 1981 Act and under its predecessors.

(3) From 2019 it seems that:
   (a) A change of domicile is or is intended to be a condition of naturalisation: Home Office practice is to refuse a naturalisation application made by a person who openly maintains that they will continue to be domiciled outside the UK if granted citizenship.
   (b) While Home Office practice does not determine the facts or the law, the inference that a person acquiring a British citizenship post 2019 has the intention to reside permanently in the domicile sense, (and so acquires a domicile of choice) is somewhat stronger than before.
   (c) An applicant for naturalisation whose priority is not to become UK domiciled should make their position clear in the application; but that carries a risk that the naturalisation application may fail. Better not to apply at all, if circumstances permit.

There are circumstances where naturalisation falls short of demonstrating an intention to reside permanently (in the domicile sense):

(1) If an application was primarily for the convenience of a UK passport, (or if for any other reason the application was not accompanied by a genuine intention to reside in the UK permanently).
   (a) The 1980 White Paper records this happened in practice under the 1948 Act.
   (b) *F v IRC*[135] concerned an application under the 1981 Act. The individual wanted citizenship in order to obtain a British passport; he lied in his naturalisation application. In the circumstances his application did not show an intention to reside in the UK.
   (c) The same may apply after the 2019 Home Office change of practice. A taxpayer is not bound by the terms of their UK-home statement, or any other statement which accompanies the application for naturalisation.[136] Mistakes are always possible, and indeed lies. But the Tribunal may not view with favour a taxpayer who argues that statements made in their application for naturalisation were incorrect or were intended to be understood narrowly.[137] In short, the Tribunal may adopt an unspoken policy

[135] [2000] STC (SCD) 1.

[136] See 4.12.2 (Evidence of living person).

[137] The argument might also risk revocation of naturalisation on the grounds of false representation; see s.40 British Nationality Act 1981.

of not allowing individuals naturalised after 2019 to escape UK tax.

(2) There are two further exceptions of somewhat narrow interest:

(a) A person who intends their home to be in the UK might not have decided whether to reside in England, Scotland or Northern Ireland: one cannot acquire a UK domicile of choice unless and until one intends to reside in one specific jurisdiction.[138] However, in practice this will rarely if ever matter, since a person who makes an application for naturalisation will normally have decided where in the UK their home is to be.

(b) In some exceptional cases an applicant for naturalisation does not need to intend that their home will be in the UK.[139] In these cases it is still consistent for an the individual who becomes a naturalised British citizen to maintain that they have not acquired a UK domicile of choice. However even without the UK-home naturalisation requirement, the decision to apply for naturalisation still tends to suggest that the individual has formed the intention to live in the UK permanently: the issue is to be decided in the light of all the facts.

An individual who does acquire a UK domicile of choice on naturalisation may of course lose it later, by abandonment.[140]

An individual who is naturalised, or who acquires a UK domicile of choice, may still be treaty-resident outside the UK, if (in short) the facts show the centre of vital interests (personal and economic relations) are abroad.

It is possible to renounce citizenship and renunciation is likely to be

[138] This is self-evident, but if authority is needed, the point was made in *Wahl*.

[139] A full discussion of naturalisation law is not possible here, but one alternative requirement is that the person intends, in the event of naturalisation,

> "to enter into, or continue in,
>
> [a] Crown service under the government of the UK, or
>
> [b] service under an international organisation of which the UK or Her Majesty's government therein is a member, or
>
> [c] service in the employment of a company or association established in the UK."

See sch 1 British Nationality Act 1981.

In these cases a person may become a British citizen by registration without expressing any intention to make their home in the UK.

[140] See 4.9 (Abandoning domicile of choice).

persuasive evidence of an intention not to return. Though again, it depends on the facts.

4.14.7 *Holding a UK passport*

A British passport is evidence that the holder is a British citizen, and something to which every British citizen is in principle entitled.[141] Holding British citizenship and holding a British passport are (more or less) synonymous: they are two sides of the same coin. So holding a passport is not a separate or further indication of intention, for the purposes of the law of domicile.

4.14.8 *Citizenship: Critique*

Citizenship is a status. It confers a bundle of rights and responsibilities, but not just that. It also has social, psychological, cultural, political and emotional aspects, which link to deep questions of nationhood and identity. As a matter of political theory, naturalisation involves a reciprocal relationship in which an individual offers loyalty to a state in exchange for protection.[142] It is a form of membership of a community.

Many will accept this theory,[143] and may even think it self-evident. But attitudes vary. Naturalised individuals will feel or understand the implications of their nationalisation in a variety of ways.[144] The incentives to naturalise may be instrumental or affective. Likewise, some native born citizens may not lightly accept naturalised individuals as full members of

[141] See the Goldsmith report para 3.34.

[142] See the Goldsmith report para 1.1.

[143] For instance, in *SA v FA* [2022] EWFC 115 at [13] the individual "was proud and pleased to accept and achieve British citizenship by naturalisation in 2005 and ... had a sense of pride and belonging when she publicly swore her allegiance to HM The Queen". That was a factor in concluding the individual had acquired a domicile of choice in the UK

[144] That is, the immigrants may not have studied or accepted the political theory. The 1980 White Paper reported that "citizenship has sometimes been sought merely for the convenience of having a UK passport, and that having obtained one, the person has later gone elsewhere to live." And notwithstanding Government disapproval, that may sometimes continue to be the case.

The literature shows different behaviour for immigrants from different origin countries and human capital endowments. For example, while naturalised non-Turkish immigrants were found to less likely to leave Germany, citizenship is not significantly correlated with the return migration of Turkish immigrants living in Germany; Oxford Handbook, p.214.

the community, no doubt more in the past than now.[145]

If one does accept the political theory, what impact does it have on domicile, or on domicile taxation? Can we descend from the general to the particular? In earlier editions of this work I suggested that there should be a rule that naturalised citizens should be deemed UK domiciled for UK tax purposes.[146] On this point the lighter fiscal regime for foreign domiciliaries could be better targeted.

Subsequently, I rejected the suggestion, on the pragmatic grounds that the need for this change was reduced by the introduction of the 15-year deemed domicile rule, and the benefit did not seem to be worth the trouble involved in a statutory change.[147]

But the 2019 change in Home Office practice is a step towards just that reform. The reader may speculate whether the change was connected with the change in HMRC practice on domicile.[148] It is perhaps unlikely to be entirely co-incidental. Needless to say, there was no public consultation.

4.15 Refugee/illegal immigrant/temporary visa

Refugees may be forced to sever their links with their country of origin. But while that may show they have no intention to return to their country of origin, it would not, by itself, show that they have acquired an intention to reside in the UK permanently.

A person in a country illegally may become domiciled there, though the illegality is a factor in deciding whether they have a genuine intention of remaining there.[149]

In *Barlow Clowes International v Henwood*:

> He was not able to live there on a permanent basis without the permission of the Mauritian government. His residence was ... in that

[145] Eg *Loudon v Ryder (no.2)* [1953] Ch 423 at p.424:

> "The defendant Ryder is a Polish Jew, born in Galicia, and educated in Vienna. He lived until 1938 on the Continent ... and though he has been in this country since shortly before the war and was naturalized in 1947, he remains very much a foreigner."

This sceptical, perhaps hostile, attitude to naturalisation and naturalised citizens may explain the thinking behind the decision in *Wahl*. Naturalisation has in the past been, and perhaps sometimes still is, a contested concept.

[146] See the 2015/16 edition of this work para 3.11.6 for a fuller discussion of the issues.

[147] See the 2017/18 edition of this work, para 3.11.6.

[148] See 4.24.1 (Change of HMRC practice).

[149] *Mark v Mark* [2005] UKHL 42.

> sense precarious. This does not make it impossible for him to acquire a domicile of choice in Mauritius but makes it less likely that he did so.[150]

In *Puttick v Attorney-General* an individual came to England to escape arrest and trial in Germany:[151]

> The mere fact that a person is liable to be deported, for example, an alien subject who was subject to the Aliens Order 1920 (see *Boldrini v. Boldrini and Martini* [1932] P. 9), does not of itself prevent acquisition of a domicile of choice: but see *Briggs v. Briggs* (1880) 5 P.D. 163, where the respondent left the country through fear of his creditors but did not acquire a domicile of choice in the United States of America. The question is whether the person is in England primarily to avoid detection, or is it primarily to set up home? She never set up home here, although she resided and obtained work qualifications; but she did not want to go back to Germany, her domicile of origin, because she did not want to surrender to her bail, to be tried. Her primary purpose in living here was to avoid detection, and no abandonment of domicile of origin has been proved. She agreed also in her evidence that she might have returned to Germany if the charges against her were ever dropped. In my opinion she did not acquire a domicile of choice in this country.

4.16 Married women

4.16.1 *Marriage post-1974*

Until 1 January 1974, a married woman had the domicile of her husband (a "domicile of dependency"). This no doubt represented a patriarchal view of the family, though giving husband and wife the same domicile also simplified family law jurisdiction issues, and prevented dual nationality for the offspring, which was once more frowned upon than it is today.

Section 1 Domicile and Matrimonial Proceedings Act 1973 ("DMPA") now provides:

> (1) Subject to subsection (2) below, the domicile of a married woman as at any time after the coming into force of this section [1 Jan 2014] shall, instead of being the same as her husband's by virtue only of marriage, be ascertained by reference to the same factors as in the case

[150] [2008] EWCA Civ 577 at [119].

[151] [1980] Fam. 1

> of any other individual capable of having an independent domicile. ...
> (3) This section extends to England and Wales, Scotland and Northern Ireland.[152]

Although a wife does not automatically acquire the domicile of her husband, the decision to marry and set up home in the UK tends to suggest an intention to reside in the UK permanently; but of course that depends on all the facts.[153]

4.16.2 *Marriage existing in 1974*

There is a transitional rule for women who were married on 1 January 1974. Section 1(2) DMPA provides:

> Where immediately before this section came into force [1 January 1974] a woman was married and then had her husband's domicile by dependence, she is to be treated as retaining that domicile (as a domicile of choice, if it is not also her domicile of origin) unless and until it is changed by acquisition or revival of another domicile either on or after the coming into force of this section.

A domicile of choice under s.1(2) continues unless and until it is lost by abandonment.[154]

The issue arose in *IRC v Duchess of Portland* 54 TC 648, where a foreign domiciled wife married a UK domiciled husband before 1974, so she acquired a UK domicile of dependency. After 1974 she continued to reside in the UK. However at no time did she intend to reside there permanently. She therefore retained her former domicile of dependency ("as a domicile of choice"). That domicile could only be abandoned by ceasing to intend to reside in the UK permanently (which she did) *and* ceasing to reside in the UK (which she did not).

In Ireland the wife's domicile of dependency was held unconstitutional[155]

[152] For the background to this provision, see Law Commission report no. 48, *Family Law Report on Jurisdiction in Matrimonial Causes* (1972) *http://www.bailii.org/ew/other/EWLC/1972/48.pdf*

[153] This is obvious but if authority is needed, see *Cyganik v Agulian* [2006] EWCA Civ 129 at [46]. Likewise the fact that T's spouse is resident in the UK (and not resident elsewhere) may tend to suggest that T has not acquired a foreign domicile of choice; see (if authority is needed) *Gaines-Cooper v HMRC* [2007] EWHC 2617 (Ch) at [46] [47].

[154] See 4.9.1 (Abandoning domicile of dependency).

[155] *JW v JW* (1992) 4 Irish Tax Reports p.437.

and it is an interesting question whether the UK transitional provision is human-rights compliant. In practice the issue may never arise.

4.16.3 *Marriage ended pre-1974*

Under the pre-1974 law, a domicile of dependency also continued after the marriage ended, unless and until it was lost by abandonment.[156] The issue arose in *Re Wallach*[157] where a widow died in 1943, five days after the death of her husband. The Judge cited *Udny* ("Other domicils, including domicil by operation of law, as on marriage, are domicils of choice") and continued:[158]

> He, therefore, included the domicil which counsel for the plaintiff prefers to call a dependent domicil under the heading of domicil of choice and that seems to me to be the appropriate heading under which to put it because when a woman marries a man she exercises a choice in the marriage and takes the consequence of that choice which in law involves the acquisition of his domicil. There is no reason why, if it is a domicil of choice, it should be lost in a way different from that in which any other domicil of choice can be lost, namely, by abandonment.

This is the same test which applies to a woman who was married on 1 January 1974.

The marriage in *Wallach* ceased on death of the husband, but the position is the same in the case of a pre-1974 divorce: the ex-wife's domicile of dependency continues as a domicile of choice, unless and until it is abandoned.

4.16.4 *Woman a US national*

The USA/UK DTA[159] undoes the effect of a UK domicile of dependency for a woman who is a US national who married before 1974. Article 4(6) of the treaty provides:

> A marriage before January 1st, 1974 between a woman who is a United States national and a man domiciled within the UK shall be deemed to

[156] See 4.9.1 (Abandoning domicile of dependency).

[157] [1950] 1 All ER 199, followed in *Re Scullard* [1957] Ch 107 where, on the facts, the domicile of choice was found to have been abandoned immediately following the death of the husband.

[158] [1950] 1 All ER 199 at p.200.

[159] That is, the IT/CGT treaty (2001). The USA IHT DTA (1978) does not contain the same rule. Gender issues presumably had greater importance by 2001.

> have taken place on January 1st, 1974 for the purpose of determining her domicile for UK tax[160] purposes, on or after the date on which this Convention first has effect in relation to her.

The USA/UK DTA Technical Explanation provides:[161]

> under UK law, a female US citizen who married a UK domiciliary male before January 1, 1974, does not have the same opportunity to prove a domicile outside the UK as does a male US citizen who married a UK domiciliary female before January 1, 1974. Paragraph 6 of the Convention equalizes the treatment of male and female US citizens in this situation.

As far as I am aware, the US Treaty is the only one which does this. Perhaps this reflects a cultural difference, a greater sensitivity to gender equality issues in the US.[162] This rule does not however apply where a *UK* woman married an *American* man before 1 January 1974. In that case the 1974 transitional rule continues to apply, and the woman keeps her domicile of dependency as a domicile of choice. In this situation a woman is in a better position than a man.

4.17 Child's domicile: England

The domicile of a child is not usually important during its minority. However if the child acquires a domicile of dependency during their minority, that domicile will continue until lost by abandonment, so the issue may arise long after the child has become adult.

This section deals with the position in England and Northern Ireland. Scotland is considered in the next section.

4.17.1 *Domicile independence age*

Section 3 DMPA provides:

> (1) [a] The time at which a person first becomes capable of having an independent domicile shall be when he attains the age of sixteen or marries under that age;
>
> [b] and in the case of a person who immediately before 1st January 1974 was incapable of having an independent domicile, but had

[160] ie, Income tax and CGT; see art 2(1) USA/UK DTA.

[161] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[162] The English common law rule that a married woman had the domicile of her husband was rejected by US case law.

> then attained the age of sixteen or been married, it shall be that date.
>
> (2) This section extends to England and Wales and Northern Ireland (but not to Scotland).

The age at which a person becomes capable of having an independent domicile has been reduced gradually:

Age of independence	**In force from**	**May apply to those born from**	**Reference**
21	-	-	Common law rule
18	1 Jan 1970	1 Jan 1949[163]	s.1 Family Law Reform Act 1969[164]
16	1 Jan1974	1 Jan 1958[165]	s.3 DMPA

The age of 16 was set as the age at which a person may marry; it was thought a person old enough to marry should be regarded as old enough to acquire a domicile of choice.[166]

4.17.2 *Domicile of dependency*

Dicey states:[167]

> Subject to [s.4 DMPA discussed below] the domicile of an unmarried child under 16 is determined as follows:
> (1) the domicile of a legitimate child is, during the lifetime of his father, the same as, and changes with, the domicile of his father;
> (2) the domicile of a legitimated child is, from the time at which the legitimation takes effect, during the lifetime of his father, the same as, and changes with, the domicile of his father;

[163] Those born 1949-1951 reached the age of independence on 1 January 1970, which would have been after their 18th Birthday.

[164] The 1969 Act adopted the recommendations of the Report of the Committee on the Age of Majority (the Latey Report), 1967 Cmnd 3342. Northern Ireland had separate legislation: s.1 Age of Majority Act (Northern Ireland) 1969.

[165] Those born 1956-1957 reached the age of independence on 1 January 1974, which would have been after their 16th Birthday.

[166] See Law Commission report no. 48, *Family Law Report on Jurisdiction in Matrimonial Causes* (1972) *http://www.bailii.org/ew/other/EWLC/1972/48.pdf* In 2023 the minimum age for marriage in England was raised to 18, and if this rule was extended to Scotland and Northern Ireland, there would be a case for raising the domicile age to 18; but it does not seem important.

[167] *Conflict of Laws* (16th ed., 2022), para 6R-092. Some tie-breaker rule will be needed in case of a child adopted by same-sex civil partners/spouses, if the couple have different domiciles.

> (3) the domicile of an illegitimate child and of a child whose father is dead is, in general,[168] the same as, and changes with, the domicile of his mother;
> (4) the domicile of a legitimate or legitimated child without living parents, or of an illegitimate child without a living mother, probably cannot be changed;
> (5) the domicile of an adopted child is determined as if he were the legitimate child of the adoptive parent or parents.

A child's domicile of dependency can be abandoned after the age of independence.[169]

4.17.3 *Parents living apart*

Section 4 DMPA provides:

> (1) Subsection (2) of this section shall have effect with respect to the dependent domicile of a child as at any time after the coming into force of this section when his father and mother are alive but living apart.
> (2) The child's domicile as at that time shall be that of his mother if—
> (a) he then has his home[170] with her and has no home with his father; or
> (b) he has at any time had her domicile by virtue of paragraph (a) above and has not since had a home with his father.
> (3) As at any time after the coming into force of this section, the domicile of a child whose mother is dead shall be that which she last had before she died if at her death he had her domicile by virtue of subsection (2) above and he has not since had a home with his father.
> (4) Nothing in this section prejudices any existing rule of law as to the cases in which a child's domicile is regarded as being, by dependence, that of his mother.
> (5) In this section, "child" means a person incapable of having an independent domicile.[171]
> (6) This section extends to England and Wales, Scotland[172] and Northern Ireland.

Prior to 1/1/1974, what was the test of domicile of a child whose parents

[168] See *Conflict of Laws* (16th ed., 2022), 6R-092 (Rule 17)

[169] See 4.9.1 (Abandoning domicile of dependency).

[170] See 9.12.1 ("Home").

[171] See 4.17.1 (Domicile independence age).

[172] Schedule 3 Family Law (Scotland) Act 2006 repeals this section in relation to Scotland. However see below on whether this has effect for tax purposes.

were divorced, and who was living with the mother? Dicey recorded that the position in Scotland was that domicile followed the father; in Northern Ireland, it followed the mother; Dicey suggested English law should follow the Northern Ireland decision.[173]

4.18 Child's domicile: Scotland

The position is different in Scotland.

4.18.1 *Age of independence: Scotland*

In the law of Scotland the age at which a child could acquire an independent domicile was originally 12 for girls and 14 for boys.[174] These ages derived from Roman law, reflecting an understanding that girls mature faster than boys.

The provisions of the FLRA 1969 and the DPMA 1973 which set the age of independence for domicile in England did not apply in Scotland. The rule was instead altered by s.7 Age of Legal Capacity (Scotland) Act 1991 which provided:

> The time at which a person first becomes capable of having an independent domicile shall be the date at which he attains the age of 16 years.

This provision was repealed by the Family Law (Scotland) Act 2006 (which provided new rules for children under 16, see below). Presumably it was considered unnecessary because by implication, it continued to be the case that children over the age of 16 may acquire a domicile of choice. So the age at which a person becomes capable of having an independent domicile under Scots law is as follows:

Age of	**In force**	**Applies to**	**Reference**
independence	**from**	**those born from**	
12 (girls)	-	-	Scots common law rule
14 (boys)	-	-	Scots common law rule
16 (girls)	25 July 1991	25 July 1979	s.7 ALC (Scotland) Act 1991/s.22
16 (boys)	25 July 1991	25 July 1977	Family Law (Scotland) Act 2006

[173] Dicey & Morris, *Conflict of Laws* (9th ed., 1973) p.119. This passage is not in later editions.

[174] Scottish Law Commission Report No 110, "Legal Capacity and Responsibility of Minors and Pupils" (1987), recommending the changes which took effect in 1991.

4.18.2 *Domicile of child under 16*

Section 22 Family Law (Scotland) Act 2006 provides:

> **Domicile of persons under 16**
> (1) Subsection (2) applies where—
> (a) the parents of a child are domiciled in the same country as each other; and
> (b) the child has a home with a parent or a home (or homes) with both of them.
> (2) The child shall be domiciled in the same country as the child's parents.
> (3) Where subsection (2) does not apply, the child shall be domiciled in the country with which the child has for the time being the closest connection.
> (4) In this section, "child" means a person under 16 years of age.

I refer to domicile under the rules of s.22(2)/(3) as **"s.22(2)/(3) domicile"**.

4.18.3 *Scots domicile post- age 16*

The relevant commencement order provides:

> 2 ... the provisions of the Act shall come into force on 4th May 2006....
> 4 The provisions of sections ... 21, 22 ... shall not apply in relation to any proceedings which commenced before 4th May 2006.[175]

This does not consider domicile after the individual has reached the age of 16. Clearly, an individual after 16 can acquire a new domicile of choice. But can an individual abandon their s.22(3) domicile, without acquiring a domicile of choice? There are various permutations. Suppose, for instance:

Case 1	**Case 2**
At birth, an individual ("P") has a s.22(2) domicile in country X (both parents domiciled in X, and P has a home with them).	At birth, an individual ("P") has a s.22(3) domicile in country X (eg parents differently domiciled, and P's closest connection is in X.
P then acquires a s.22(3) domicile in country Y (eg parents separate, and P's closest connection is in Y.	P then acquires a s.22(3) domicile in country Y (eg P's closest connection becomes country Y.

[175] Reg 2 Family Law (Scotland) Act 2006 (Commencement, Transitional Provisions and Savings) Order 2006.

P then attains 16	P then attains 16

Can P abandon their s.22(3) domicile by ceasing to reside in country Y, and ceasing to intend to reside there? and if so, is country X regarded as a domicile of origin, which revives? It is considered that domicile of origin is abolished, in Scotland, and s.22 domicile cannot be abandoned, it continues unless replaced by a new domicile of choice.[176]

4.18.4 *Commencement*

The 2006 Act does not make plain the time at which the section 22 rule takes effect. Does it govern the domicile only of those who, at the date of coming into force of the Act, were under 16, and those born subsequently? Or does it also govern the domicile of someone who attains 16 before commencement, but dies after commencement? One would expect not.

4.18.5 *Abolition of illegitimacy*

Section 22 domicile does not depend on legitimacy/illegitimacy: that is irrelevant for s.22 domicile. Scots law (like most countries but not, yet, England) has abolished the status of illegitimacy:

> No person whose status[177] is governed by Scots law shall be illegitimate; and accordingly the fact that a person's parents are not or have not been married to each other shall be left out of account in—
> (a) determining the person's legal status; or
> (b) establishing the legal relationship between the person and any other person.[178]

This raises the question of when a person's status is governed by Scots law.

If (applying s.22 if relevant) a person has Scottish domicile, their status cannot be one of illegitimacy.

If (applying s.22 if relevant) a person does not have a Scottish domicile, their status must be determined by foreign law, which may apply a

[176] This accords with the recommendation of the Law Commission in *The Law of Domicile* (1987) Law Com 186 *http://www.scotlawcom.gov.uk/download_file/view/228/* para 4.21 etc. Though the Law Commission draft Bill, sensibly, made this point expressly.

[177] "Status" means the status of being legitimate/illegitimate.

[178] s.1(1) Law Reform (Parent and Child) (Scotland) Act 1986 as amended s.21 Family Law (Scotland) Act 2006.

legitimate/ illegitimate distinction.[179]

4.18.6 *Does Scots domicile law apply for tax*

The Family Law (Scotland) Act 2006 is an Act of the *Scottish* Parliament. It is an interesting question whether its reform of Scots domicile law applies for tax purposes. Taxation is (in general) a reserved matter over which the Scottish Parliament has no competence.

A full discussion of Scottish Parliament competence would need a long chapter, which the importance of the issue here does not justify; it is however suggested that a reform of domicile law, which has a merely incidental consequential effect on taxation, should be within the power of the Scottish Parliament.[180]

HMRC agree: the RDR Manual provides:

> **RDRM22120 The Family Law (Scotland) Act 2006** [Mar 2019]
> The Family Law (Scotland) Act 2006 [FL(S)A 2006] came into effect on 4 May 2006. Section 22 of the Act creates a new form of domicile in Scotland for individuals under the age of sixteen. Legitimacy has ceased to be a factor in determining domicile in Scots law under the FL(S)A 2006, section 21 of the Act having abolished the status of illegitimacy.
> In Scotland only, since 4 May 2006, where a child's parents share a domicile and the child has a home with either or both of them, the child is domiciled in the same country as its parents.
> Where a child's parents are domiciled in different countries, or the child has a home with neither parent, the child is domiciled in the country with which he or she has 'for the time being the closest connection'.
> The wording of FL(S)A 2006 indicates that in any proceedings commenced on or after 4 May 2006 the legislation should be applied retrospectively in order to determine the domicile of an individual under the age of sixteen.

But then what is the position of a person where English and Scots law produce a different answer as to domicile? The solution to the conundrum is to remember that when statute refers to domicile in the UK, that is shorthand for domiciled in England, Scotland or Northern Ireland. A person should be regarded as domiciled in the UK if they are:

(1) domiciled in England according to English law, or
(2) domiciled in Scotland according to Scots law, or

[179] See s.41 Family Law (Scotland) Act 2006.

[180] See *Martin v HM Advocate* [2010] UKSC 10.

(3) domiciled in Northern Ireland according to NI law.[181]

It could then happen that (say) an English tribunal has to apply Scots law principles in order to consider whether a taxpayer is domiciled in Scotland, and so domiciled in the UK. But that is inevitable; one should avoid so far as possible a situation under which the selection of a tribunal (which may turn on matters such as the residence of a witness) leads to a difference as to applicable law and so to a different outcome.

It is suggested that the law of domicile ought to be as similar as possible in each jurisdiction, and in this case, the law of England and Northern Ireland ought to be amended to adopt the Scots law approach.

4.19 Adoption and parental orders

A parental order transfers parenthood status to the intended parents in a surrogacy arrangement. I refer to them as "the new parents".

There are about 3,000 adoptions and 400 parental orders p/a in England.[182]

For a full discussion of parenthood and its impact on domicile, see Dewes, "Is this My Child? Who is My Parent? Legal Parent-child Relationships in UK Tax Law in An Era of Complex Family Networks" (2018).[183]

4.19.1 *Family law background*

The relevant legislation is:

- the Adoption and Children Act 2002 (ACA 2002)
- Human Fertilisation and Embryology Act 2008 (HFEA 2008)
- Human Fertilisation and Embryology (Parental Orders) Regs (HFEA regs 2018)

The same principles apply to adoption under Scots and Northern Ireland law.[184]

[181] See too 102.18.2 (Situs in Scots law).

[182] *https://www.gov.uk/government/statistics/family-court-statistics-quarterly-april-to-june-2021/family-court-statistics-quarterly-april-to-june-2021*

[183] Accessible *https://www.foreigndomiciliaries.co.uk/index.php/Documents_archive* I am grateful to Sam Dewes of HW Fisher for his comments on this topic.

[184] Section 40 Adoption and Children (Scotland) Act 2007; s.40 Adoption (Northern Ireland) Order 1987. HFEA 2008 applies throughout the UK. Further consideration would be needed in the case of foreign law adoption/parental orders.

It is not possible to discuss the law fully here, but in outline:

Adoption: s.67 ACA 2002	**Parental order: s.67 amended by HFE regs**
(1) An adopted person is to be treated in law as if born as the child of the adopters or adopter.	(1) A person to whom a parental order applies is to be treated in law as the child of the person or persons (as the case may be) who obtained that order, and, if more than one person, is to be treated as the child of the relationship of those persons.
(2) An adopted person is the legitimate child of the adopters or adopter and, if adopted by— (a) a couple, or (b) one of a couple under section 51(2), is to be treated as the child of the relationship of the couple in question.	(2) A person to whom a parental order applies is to be treated in law as not being the child of any person other than the person or persons (as the case may be) who obtained that order, but this subsection does not affect any reference in this Act to a person's natural parent or to any other natural relationship.
(3) An adopted person— (a) if adopted by one of a couple under section 51(2) [one adoptive parent], is to be treated in law as not being the child of any person other than the adopter and the other one of the couple, and (b) in any other case [two adoptive parents or one adopter under s.50 ACA 2002], is to be treated in law, subject to subsection (4), as not being the child of any person other than the adopters or adopter; but this subsection does not affect any reference in this Act to a person's natural parent or to any other natural relationship. (4) In the case of a person adopted by one of the person's natural parents as sole adoptive parent, subsection (3)(b) has no effect as respects entitlement to property depending on relationship to that parent, or as respects anything else depending on that relationship.	(3) Where a parental order is granted under section 54A [one new parent] of the 2008 Act to a person who is a natural parent of the person to whom the order applies, subsection (2) has no effect as respects entitlement to property depending on relationship to that parent, or as respects anything else depending on that relationship.

4.19.2 *Domicile consequences*

Dicey states:[185]

> A domicile of origin may be changed
> [1] as a result of adoption or
> [2] by issue of a parental order under the HFEA 2008,
> but not otherwise.

A child adopted by opposite-sex parents is treated as the legitimate child of their adoptive parents and so their domicile of origin is that of their adoptive father.

What matters is the domicile of the adoptive father at the child's birth, rather than at the date of the adoption order. For example, if the adoptive father was domiciled in England when the child was born, but domiciled in France when the adoption order was granted, the child would (as from the date of the adoption) have a domicile of origin in England and a domicile of dependency in France.

Under the previous HFEA Regs (from 2010), a parental order had the same impact as an adoption order as regards the status of the child; i.e. the child is treated as being the legitimate child of the new parents. The purpose of the subsequent HFEA Regs 2018 was to allow parental orders to be granted to a single person. However, they also removed any reference to the child's legitimacy status (perhaps accidentally). The Government's consultation document on the draft HFEA Regs 2018[186] suggests that the intention was to provide for the child to be legitimate and, in this case, it may be reasonable to treat the child as such, albeit the law is now unfortunately unclear.

An adoption/parental order can be made in favour of a sole parent.[187] In this case the domicile of origin must follow the domicile of the sole parent (whether adoptive mother or father), except in the case of a person adopted by the natural mother as sole adoptive parent.

4.20 Same-sex parents

There are around 40,000 same-sex families with dependent children in the

[185] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 6R-025.

[186] *https://assets.publishing.service.gov.uk/media/5a9fd645ed915d07a00fd8a8/consultation-document-human-fertilisation-and-embryology-parental-order-regulations-2018.pdf*

[187] Section 51(2) ACA 2002; s.54A HFEA 2008.

UK.[188] It will be not be long before these children are old enough that their domicile becomes important for tax and general law purposes.

The domicile rules discussed thus far assume that an individual is a child of opposite-sex parents. An individual with same-sex parents with different domiciles faces the difficulty of applying rules of domicile of origin/dependency which depend on the domicile of their father.

Sam Dewes[189] proposes some solutions to these problems. One must first distinguish three categories:
(1) Individuals with two female parents from birth
(2) Individuals with same-sex parents by virtue of a parental order
(3) Individuals with same-sex parents by virtue of an adoption order

4.20.1 *Two female parents from birth*

For individuals in category 1, their female parents are:
(1) their birth mother, and
(2) another woman who has met the conditions in either s.42 or s.43 of the HFEA 2008 (referred to in the Act as the "other parent").

This is the only scenario in which an individual can have same-sex parents from birth.

In this case it is possible to distinguish between the two parents, either on account of who provided the egg to create the embryo (which could be either parent) or on account of the fact that only one of them carried the child. On the basis that the common law identifies a mother through childbirth, and that the HFEA 2008 does not call the other female parent a "mother", it is suggested that the child's domicile should follow that of the birth mother, rather than the other female parent.

4.20.2 *Same-sex parents: Parental order*

Section 54 HFEA 2008 requires that one of the applicants to the parental order has provided one half of the gametes needed to create the embryo. It is suggested that the child's domicile should follow that of the parent who provided the gametes. Although in some cases the applicants do not know whose gametes have been used, it should be relatively easy to ascertain. Dicey supports this view:[190]

[188] *https://www.gov.uk/government/statistics/families-and-households-in-the-uk-2021* These figures are unreliable but more definitive figures are not available.

[189] "Uncharted Waters" STEP Journal, Issue 2, 2020.

[190] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 6-036.

> In the case of a child the subject of a parental order, an objective method of choosing between the two parents would be for the child to take the domicile of the parent whose gametes were used to bring about the creation of the embryo.

4.20.3 *Same-sex parents: Adoption*

Unless one of the applicants to the adoption order was previously a parent of the child prior to the adoption order being granted, it is difficult to distinguish between two adoptive parents.

If the adoptive parents do not share a common domicile, one could determine the adopted child's domicile based on the closest connection test used in Scots Law. This is not an ideal test: it was designed to determine an individual's domicile at a moment in time and is less appropriate for determining an individual's domicile of origin which is capable of reviving later in life. But it is difficult to think of a better test.

4.21 No mental capacity

Dicey states:[191]

> A person lacking mental capacity to make decisions as to his future permanent residence cannot acquire a domicile of choice and, subject to the Exception hereinafter mentioned, retains, while lacking that capacity, the domicile he had when last having that capacity...
> *Exception:* The domicile of a person who never acquires, or who loses as a dependent child, the mental capacity to make decisions as to his future permanent residence is determined, so long as he lacks that capacity, as if he continued to be a dependent child.

The exception does not apply in Scotland. The Law Commission say:[192]

> The effect of the current rules governing the domicile of adults who lack the mental capacity to acquire a domicile of choice' appears to be that:
>
> (a) a mentally incapable person cannot acquire a domicile of choice and, subject to (b) below, retains while his incapacity lasts the domicile he had at the onset of his incapacity or (in Scotland) on the attainment of the age when his domicile of dependency

[191] Dicey, Morris & Colins, *Conflict of Laws* (16th ed., 2022), para 6R-110, 6E-117.

[192] "The Law of Domicile" (Law Com no. 168) para 6.1. *https://www.lawcom.gov.uk/project/private-international-law-law-of-domicile/*

ceases, whichever is the later; but

(b) in England and Wales and Northern Ireland, where the onset of the incapacity predates the person's sixteenth birthday, his domicile of dependency continues thereafter unless and until he recovers his capacity.

Thus it is possible to envisage circumstances where Scotland/England reach different outcomes, for a person who never had capacity, or who loses capacity while under 16. But that will rarely matter for tax. An individual who loses capacity while under 16 is not likely to have substantial taxable assets.

4.22 Domicile territory/country

Dicey states that a person has a domicile in a "country", and comments on the terminology:[193]

> This word [Country] has from long usage become almost a term of art among English-speaking writers on the conflict of laws... It was defined by [Albert Venn] Dicey as 'the whole of a territory subject under one sovereign to one body of law.'

In *Adams v Cape Industries*:[194]

> ... for conflict of law purposes, each state within the United States is a "country" and ... for many conflicts of law purposes the United States is not a "country". Each state, for example, has its own common law. The United States has no common law... Domicile in the United States as a whole is a meaningless concept.

This rule is obviously necessary because one of the main purposes of domicile is to link a person to a jurisdiction for the purposes of family and succession law. If one needs to know which law to apply, one must make the link to a single jurisdiction, applying a specific law; and in the USA, each state has its distinct family and succession law.

The question, then, for federal states is to determine whether

(1) the federation has "one body of law", in which case one is domiciled in the federation; or

(2) the individual states have distinct bodies of law, or as it is sometimes

[193] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 1-020 (Meaning of "Country").

[194] [1990] Ch. 433 at p.488.

put, distinct legal systems,[195] in which case one is domiciled in an individual state within the federation.

Dicey states:[196]

> England, Scotland, Northern Ireland, the Isle of Man, Jersey, Guernsey, Alderney, Sark, each British colony, each of the American and the Australian states and each of the Canadian provinces is a separate country in the sense of the conflict of laws, though not one of them is a state known to public international law.
> ... On the other hand, Wales is not a country, because its system of law is the same as that of England.

There may be borderline cases, and the position may change from time to time as a result of devolution or other major constitutional changes.

4.22.1 *Terminology*

When the word "Country" is used in this technical sense, one should perhaps use an initial capital, or scare quotation marks. I think "legal jurisdiction" is a better expression, because, say, California is not in the normal sense a country, but it is a legal jurisdiction.

There have been other suggestions:[197]

> [Albert Venn Dicey] suggested that a better expression might be 'law district': but this phrase has never found much favour with English-speaking writers, who prefer the more familiar word 'country'.

The use of the word "Country" seems too well established to change.

4.22.2 *Bailiwick of Guernsey*

The Royal Commission on the Constitution states:[198]

> The Channel islands consist of two separate Bailiwicks, the Bailiwick of Jersey... and the Bailiwick of Guernsey, which comprises the Islands of Guernsey (with Herm and Jethou), Alderney and Sark... There are no formal links between the two Bailiwicks. ... Alderney and Sark both have a large measure of independence within the Bailiwick of

[195] *Re Fuld* [1968] P 675 at p.684.

[196] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 1-020 - 1-022.

[197] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 1-020 (Meaning of "Country").

[198] Cmnd. 5460 (1973) para 1349 etc.

> Guernsey ... and legislative assemblies of their own.

The RDR Manual provides:

> **RDRM20060 Domicile and Law Territories** [Mar 2019]
> ... the Bailiwick of Guernsey includes Guernsey, Alderney and Sark, which are all separate law territories.

That is, a person is domiciled in one of these three jurisdictions, not in "the Bailiwick of Guernsey".[199]

4.22.3 *Ireland*

Para 8 Government of Ireland (Adoption of Enactments) (No. 1) Order 1922 provides:

> For the purpose of determining the domicile of any person, Northern Ireland shall be deemed always to have been a separate part of the UK.

In *Re M*[200] the question arose concerning a person's domicile prior to the partition of Ireland in 1922. A person who lived all their life in what is now Northern Ireland was held to be domiciled in the part of the divided territory in which they had resided.

The RDR Manual provides:

> **RDRM20060 Domicile and Law Territories** [Mar 2019]
> The last two centuries have seen many changes in national and political boundaries. Any new territories should be regarded as having existed for the purposes of ascertaining domicile **prior** to their creation. Authority for this approach is provided by cases in which the 1921 division of Ireland into its present parts was considered.

4.22.4 *Switzerland*

Switzerland is a federation of 26 cantons. But I understand that Swiss family and succession law are set at federal level, and not at canton level.[201] So it is considered that a person is domiciled in Switzerland, not in one of its cantons.

[199] See too App 2.19.2 (British Isles).

[200] [1937] NI 159 followed in *Re P* [1945] Ir Jur Rep 17. Both cases accessible *https://www.kessler.co.uk/tfd-archive*

[201] See Thommen, *Introduction to Swiss Law* *https://www.open-ius.ch/literatur/thommen_introduction-to-swiss-law.pdf*

4.23 HMRC domicile ruling

HMRC formerly provided rulings on domicile, but that stopped in 2010.[202] Perhaps rulings were judged not to be efficient use of HMRC resources.

Domicile rulings are obtainable on death. PRs complete form IHT401 (Domicile outside the UK). The IHT Manual explains HMRC practice on receipt of this form:

> **IHTM13011 Investigation of form IHT401** [Jan 2020]
> When a taxpayer or agent considers that a deceased person was domiciled outside the UK they must submit a form IHT400 together with a form IHT401. We will consider the question of domicile after the grant has been issued..
> Pre-Grant will flag up the fact that a foreign domicile has been claimed before they issue form IHT421 [Probate summary]. The file will then be passed to Risk who will decide whether a domicile outside the UK can be accepted or should be referred to Compliance to take the matter up with the taxpayer or agent.
> If a Double Taxation Convention (IHTM27161) applies and foreign tax has not been paid the initial calculation should be made without taking the convention into account. The caseworker should investigate the tax implications of the convention further at a later stage.
> **IHTM13012 Risk decisions** [Jan 2020]
> Where an IHT401 is submitted with a foreign domicile claimed, it is referred to Risk. They will make a risk assessment decision to:
>
> - accept the domicile, or
> - investigate the domicile.
>
> This decision is based on a number of factors. These can include whether the deceased was born, lived and died abroad, or whether they were born abroad and resided in the UK for a fixed period (which ended before the death and lasted no more than 10 years).
> If the domicile can be accepted, that will be the end of the domicile question, unless other information subsequently arises which will lead HMRC to challenge it.
> In cases where Risk cannot agree the domicile, the file will be referred to Compliance to challenge the domicile claim.
> If Risk need any further information to make a decision at this stage they will refer the file to Technical.

[202] HMRC Brief 34/10.

4.23.1 *Effect of old ruling*

A ruling that a UK resident individual is not UK domiciled will generally entail two findings of fact:

(1) The individual did not have a UK domicile of origin (or a UK domicile of dependency).

(2) The individual had not acquired a UK domicile of choice at or before the time of the ruling.

It is self-evident that a ruling does not entail any statement that the individual will not acquire a UK domicile of choice *after* the date of the ruling. HMRC Brief 17/09 makes this point:

> Where an individual has already submitted a form DOM 1 or P86 and obtained an initial view from HMRC about their domicile status it will be unusual for us to open an enquiry into domicile status in the few years after that, unless new information becomes available that indicates our initial view was incorrect or there has been a change in circumstances. However with the passage of time, circumstances and intentions change and so that initial view from HMRC can become less and less useful as an indicator of domicile status. For example if an individual had advised HMRC on their arrival in England a decade or so ago that they planned to leave the UK after five years but had since married, had a family and decided to make England their permanent home then they will have adopted a domicile of choice within the UK.
>
> **Domicile and Inheritance Tax**
>
> ... As is currently the case, where HMRC has expressed an opinion on the domicile status of a settlor for Inheritance Tax purposes we will not normally seek to reconsider that opinion unless new information becomes available that indicates our initial opinion was incorrect or there has been a material change in the circumstances of the settlor. However, when we make a decision it applies only to the date of the transaction concerned. So if circumstances change, the individual returns to the UK for example, that individual's domicile may need to be considered again at another point in time. Domicile is not a static thing, it can change as people's circumstances and intentions change.
>
> ... Where HMRC has expressed a view on an individual's domicile status for income tax or capital gains tax purposes, as a result of an enquiry, then that view will also apply for Inheritance Tax purposes at that time. Likewise a HMRC view expressed for Inheritance Tax purposes, following a Part VIII IHTA enquiry, will also apply for income tax and capital gains purposes at that time. However, it is important to remember that each decision on domicile will be made at

> a certain point in time, if circumstances have changed since the time of the relevant decision, the domicile of the taxpayer may also have changed.

In *Gulliver v HMRC*[203] the taxpayer (chief executive of HSBC) had a UK domicile of origin. He obtained a (somewhat cursory[204]) ruling for 2002 that he had acquired a domicile of choice in Hong Kong in about 1999.[205] HMRC opened a domicile enquiry for 2013/14, a decade or so later. The taxpayer argued that HMRC were bound (presumably, for ever) by the ruling: they could not question the acquisition of a domicile of choice, though they were entitled to contend that the taxpayer had abandoned his domicile of choice after the date of the ruling. This was an argument that HMRC were bound not to collect tax which may actually have been due. It is well established that such an argument requires judicial review, and cannot be taken before the tribunal in a tax appeal, or in proceedings preliminary to a tax appeal (in this case, an appeal against a sch 36 notice requiring information going back to 1981.) The taxpayer's appeal failed for that procedural reason.

Could the taxpayer have succeeded in judicial review? That was (rightly) not investigated, but the facts reported in the judgment fall far short of the required degree of unfairness. This does not mean that all ruling are unenforceable, but enforceability depends on the facts, it requires something more than just an HMRC view or representation, and even if enforceable for earlier periods, the unfairness of reopening the

[203] [2017] UKFTT 222 (TC).

[204] The decision at [10] provided:

> At the time, HMRC took a "risk based approach" to requests for confirmation of the IHT treatment of lifetime transfers that took into account the amount of the tax potentially in issue, and the chance of the taxpayer concerned being UK domiciled on the basis of the information provided. Applying that approach, Mr Murray did not consider it an appropriate use of resources to engage in a full enquiry into all aspects of Mr Gulliver's domicile given that the amount of tax in issue was only £4,735. He also concluded that there was not a high risk, based on the information provided, of Mr Gulliver having a UK domicile. Mr Murray did not, therefore, conduct a detailed investigation as to Mr Gulliver's circumstances before writing the Letter.

With hindsight, there was perhaps a false economy on the part of the taxpayer. But that is not relevant to the decision.

[205] That seems surprising, bearing in mind that Hong Kong sovereignty was only transferred to China in 1997.

issue diminishes over time.[206]

The particular issue in *Gulliver* was whether HMRC were bound by a ruling that an individual with a UK domicile of origin had acquired a foreign domicile of choice. More commonly the question will be whether HMRC are bound by a ruling that an individual has a foreign domicile of origin (and at the date of the ruling, had not acquired a UK domicile of choice). But the principles of enforceability are the same.

The issue will arise less often after the introduction of the 2017 deemed domicile rules, but actual domicile still matters for protected trusts and for years before 2017/18.

With hindsight, HMRC domicile rulings should have included clear indication of when they can be relied on. Some did, but we generally had the usual muddle and fudge.

4.24 HMRC investigations

4.24.1 *Change of HMRC practice*

In 2013, HMRC practice on domicile was described as follows:

> with the exception of the one case of *Steiner v IRC*[207] and perhaps another one, HMRC had never won a case on domicile against a living taxpayer [with a foreign domicile of origin] and ... they rarely take on such cases.[208]

In the past, HMRC's domicile cases normally concerned those with a UK domicile of origin who claimed to have acquired a foreign domicile of choice.

HMRC policy changed in about 2016 (there was no announcement). HMRC have set up a unit which pursues investigations into individuals with a foreign domicile of origin, who have been UK resident for substantial periods. The change is illustrated by the fact that HMRC have often decided that HMRC's earlier domicile rulings were wrong.[209]

This is so even though from 2017, under the current deemed domicile

[206] It is also relevant to note that post-ruling facts are relevant to the issue of acquisition of domicile of choice in a pre-ruling year; see 4.24.7 (Period for domicile enquiry).

[207] For *Steiner* see 4.14.4 (Citizenship if UK home required).

[208] *Mehjoo v Harben Barker* [2013] EWHC 1500 (QB) at [258]. The point was not considered on appeal.

[209] See 4.23.1 (Effect of old ruling).

rules, the amount at stake will be less than before.[210]

This unit is acting zealously, and in some cases, in a manner which amounts to bullying and harassment. This includes HMRC sending letters in 2018 to their customers directly, even though the taxpayer is professionally represented.[211] These letters threatened penalties under the Requirement to Correct legislation. ICAEW comment:

> We understand that HMRC's Wealthy Units are writing to all taxpayers within their units with respect to the RTC. From what we have seen there appear to be two different categories of letters going out:
>
> 1. Specific detailed letters where there is an ongoing enquiry.
> 2. A basic one-page bulk mailing to other individuals within the Wealthy Units.
>
> There is a sub-category of letters within category 1 letters that deals with enquiries into individuals claiming foreign domiciled status. The letters sent out are detailed (a four-page letter and a three-page schedule) and are mostly the same for each taxpayer, with some occasional minimal tailoring of the schedule to add requests for a few additional pieces of information HMRC considers relevant.
>
> **Our concerns**
>
> We have a number of issues with these letters and have communicated our concerns to HMRC.
>
> We think that where there is an ongoing enquiry, the letters are too aggressive in tone (particularly the domicile letters). We are particularly concerned that none of the letters mention reasonable excuse where appropriate advice has been taken from a disinterested adviser. This is a material omission and gives advisers and individuals the wrong impression.
>
> We also think that the information HMRC is requesting from taxpayers goes beyond what the legislation defines as "relevant information" and does not follow HMRC's own guidance on domicile enquiries.

HMRC have so far been successful in establishing a UK domicile, in all of the domicile appeals which have followed this change of practice:

[210] In the absence of neglect, the years in issue will be 2013/4 to 2016/17. Of course even in those four years the tax at stake, with interest, may be substantial.

[211] The professional bodies criticised HMRC for similar action in 2013, see 17.26 (Remittance compliance/enquiry).

Case	**Ref**	**See**
Henkes v HMRC	[2020] UKFTT 159 (TC)	4.7.1
Perlman v HMRC	[2021] UKFTT 219 (TC)	4.24.5
Shah v HMRC	[2023] UKFTT 539 (TC)	4.7.1
Coller v HMRC	[2023] UKFTT 212 (TC)	4.7.1
Strachan v HMRC	[2023] UKFTT 617 (TC)	4.11.1, 4.24.9

These all seem clear cases, at least on the basis of the facts found by the Tribunal. More cases are bound to follow.

4.24.2 *Enquiry procedure*

The usual enquiry rules apply. HMRC Brief 17/09 provides:

> **Enquiries into domicile status**
> ... if HMRC decides to enquire into an individual's domicile status this will be by way of a section 9A TMA enquiry into their Self Assessment tax return. (Alternatively in appropriate cases HMRC may enquire into an individual's domicile status by way of a Part VIII IHTA enquiry into an Inheritance Tax return.)
> Where a claim to the remittance basis is not challenged for that year it does not mean HMRC necessarily accepts the individual's domicile is outside the UK and does not prevent HMRC from later opening an enquiry to consider the domicile status of the individual in relation to that, or any earlier year.

HMRC Brief 34/10 provides:

> HMRC will consider opening an enquiry where domicile could be an issue, or making a determination of Inheritance Tax in such cases, only where there is a significant risk of loss of UK tax.
> The significance of the risk will be assessed by HMRC using a wide range of factors. The factors will depend very much on the individual case but will include, for example:
>
> - a review of the information available to HMRC about the individual on HMRC databases
> - whether there is a significant amount of tax (all taxes and duties not just Inheritance Tax) at risk
>
> HMRC does not consider it appropriate to state an amount of tax that would be considered significant, as the amount of tax at stake is only one factor.[212] It should be borne in mind that HMRC will take into

[212] Author's footnote: I would have thought the main (and proper) reason to withhold this information is to prevent fraud; but it does not matter.

> account the potential costs involved in pursuing an enquiry, and also those of potential litigation should the enquiry not result in agreement between HMRC and the individual; clearly such costs can be substantial.
>
> Where HMRC does open an Inheritance Tax enquiry in any of these cases, it will keep the factors in view and may stop the enquiry at any stage if it considers the continuation of the enquiry is not cost effective. The outcome of such an enquiry may be that HMRC does not consider it appropriate to make a determination of the Inheritance Tax.

4.24.3 *Domicile appeal procedure*

HMRC should be supplied with the information they reasonably require; and once HMRC have sufficient information to make a decision on domicile, the taxpayer should generally apply for a closure notice. In the absence of such pressure, HMRC domicile enquiries may drag on for years, and sometimes decades.

4.24.4 *Domicile as preliminary issue*

Domicile appeals typically raise two distinct sets of issues:

(1) Domicile
(2) The amount of tax at stake, if the taxpayer loses on domicile

Point (2) will sometimes raise lengthy and complex issues. Then the sensible procedure would be to resolve the issue of domicile first, leaving other issues to be considered later if it turns out to be necessary to do so. That seems self-evident, but the Courts have been reluctant to allow it to happen.

In order to follow discussion on *Embiricos*, the reader must bear in mind that there are for present purposes two types of tax appeals. In short:

(1) An enquiry procedure, where the steps are:
 (a) an enquiry
 (b) a closure notice
 (c) an appeal against the closure notice
(2) A discovery procedure. where the steps are:
 (a) a discovery assessment
 (b) an appeal against the assessment

The first *Embiricos* case concerned an enquiry. The CoA decided that under the enquiry procedure, statute requires HMRC to issue a closure notice in relation to domicile and related tax issues.[213] The Tribunal had no case-management power to hear the domicile point first, as a preliminary issue, even if it was sensible to do so (as the FTT found it was).

The taxpayer tried again in the second *Embiricos* case, which was a discovery appeal. As this concerned an appeal which had been made to the Tribunal, the Tribunal did have a case-management power, if it thought fit, to hear the domicile point as a preliminary issue. But a differently constituted FTT did not think fit; it was better for all the issues to be heard at one single hearing.[214]

A sub-issue in such cases is how long a preliminary domicile hearing ought to take. HMRC estimate more than the taxpayer:

Case	**Domicile issue time estimate (days)**			**Other issues**	**See at**
	HMRC	*Taxpayer*	*Court*		
Wrottesley	4-5	2-3	3-4	10-15 days	[50]-[51]
Embiricos	7	2-3	7 !	6+	[29]

The time estimate of 7 days in *Embiricos* is in the author's view excessive.[215] Better case management is needed to prevent cases running so long. In *U v J* the Court had to determine the domicile of both parties, and an issue of *forum non conveniens,* in a case involving "particularly unusual and complex facts," and "about as difficult a forensic exercise as one might encounter in a case of this kind".[216] The hearing lasted 3 days.

[213] *Embiricos v HMRC* [2022] EWCA Civ 3. The reader may think that FTT's decision to the contrary was to be preferred; but there it is.
For completeness: It would be possible to hear domicile as a preliminary issue in an enquiry if both parties agree; s.28ZA TMA. However in *Embiricos* HMRC did not agree, and it appears that it is HMRC's policy not to do so.

[214] *Embiricos v HMRC* [2022] UKFTT 464 (TC).
In *Wrottesley v HMRC* [2015] UKUT 637 (TCC) the issues were (1) domicile of origin and (2) domicile of choice/dependency. The Tribunal refused to hear issue (1) as a preliminary issue.
Wrottesley also considered the position where the issues were (1) domicile and residence. These are separate issues but given the inevitable factual overlap it would not usually be sensible to consider one of them as a preliminary issue; see at [26]. I don't think either of those conclusions are surprising.

[215] Nine days is far longer than the courts have generally taken to decide domicile: see *https://www.kessler.co.uk/wp-content/uploads/2017/06/Domicile-cases-length-of-hearing.pdf* Whether for this or some other reason, the substantive hearing in *Wrottesley* never took place.

[216] [2017] EWHC 449 (Fam) at [6].

The FTT allowed the recent *Coller*[217] domicile appeal, a straightforward domicile case, to last a leisurely 9 days, including 3 days to cross - examine the taxpayer! That would not have happened in the High Court.

4.24.5 *Domicile in information notice appeal*

In *Perlman v HMRC*[218] the FTT held:

(1) It could not determine a disputed domicile in an appeal against an information notice.
(2) Even if it could, it would chose not to do so.

Even if the FTT did have power to determine domicile on an appeal against an information notice, cases where it would be appropriate to do so would be very rare.

4.24.6 *Further appeals*

It is well established that a trial judge who has heard the witnesses is to be afforded considerable respect by an appellate court which has not. The principle has been applied in a domicile context. *Agulian v Cyganik* considered the role of an appellate court in a domicile appeal considering inferences drawn by the trial judge, rather than findings of primary fact:[219]

> …this was not an appeal against the exercise of a discretion by the lower court nor was it a case in which the lower court was applying a fairly flexible and imprecise standard involving an evaluation of all the facts. In those cases the appellate court is more reluctant to interfere with the trial judge's decision than in the case of a finding of primary fact or an inference from primary facts. This is an appeal contesting the correctness of an inference as to Andreas's relevant intentions between 1995 and 1999. The function of the appellate court is to decide whether the inference is wrong, making proper allowances for any advantages that the trial judge would have had and an appellate court would not have and not interfering with inferences which the judge could reasonably have made.

Similarly *Barlow Clowes*:[220]

> ... the approach of the appellate tribunal to findings of fact would

[217] *Coller v HMRC* [2023] UKFTT 212 (TC); see at [161].

[218] [2021] UKFTT 219 (TC), not following *Henkes v HMRC* [2020] UKFTT 159 (TC).

[219] [2006] EWCA Civ 129 at [12].

[220] *Barlow Clowes International v Henwood* [2008] EWCA Civ 577 at [6].

> depend on the extent to which the judge had had an advantage over the appellate court. So, where findings turn wholly or substantially on oral evidence given by witnesses at trial, an appellate court will be slow to interfere. Thus there is in general a greater latitude where the findings in issue on an appeal are not primary facts but inferences from the proved facts… If an appellate court considers that the judge has come to a conclusion that is plainly wrong and outside the ambit within which reasonable disagreement is possible, it is bound to intervene, even though the question is one of fact.

4.24.7 *Period for domicile enquiry*

What is the period for an enquiry into domicile?[221] The issue is normally domicile as at some particular date, but conduct long before that date may be relevant. In *Cyganik v Agulian* :

> ... whether Andreas was domiciled in England and Wales at the date of his death. Although it is helpful to trace Andreas' life events chronologically and to halt on the journey from time to time to take stock, this question cannot be decided in stages. Positioned at the date of death in February 2003 the court must look back at the whole of the deceased's life, at what he had done with his life, at what life had done to him and at what were his inferred intentions in order to decide whether he had acquired a domicile of choice in England by the date of his death. Søren Kierkegaard's aphorism that 'Life must be lived forwards, but can only be understood backwards'[222] resonates in the biographical data of domicile disputes.[223]

Likewise, although the question is domicile on some particular date, conduct after that date may be relevant. That is self-evident, but if authority is needed, see *Perdoni v Curati*:[224]

> In making an assessment of the intention as to domicile of a person at a particular date, the evidence of things said and done by him up to that date will obviously be important. In my view, evidence of things said and done by him after that date may also be relevant, but only in so far as an inference can properly be drawn from them as to what his

[221] See 9.16 (Period of enquiry: Tie-breaker).

[222] Kierkegaard,(1843) Journals IV.A.164 in Papers and Journals: A Selection (1996) (A. Hannay, trans.) pp 63, 161.

[223] [2006] EWCA Civ 129 at [46].

[224] [2011] EWHC 3442 (Ch) at [26]; this point was not discussed on the appeal.

> intention in fact was at the date in question.[225]

Likewise *Gaines Cooper v HMRC*:[226]

> if the fact-finder is required to determine which of two residences is a person's chief residence, then the tribunal must look at the evidence over a more prolonged period ...
> It seems probable, as a matter of common sense, that the further one gets from the point at which a domicile of choice is alleged to have been acquired, the less cogent will be any inference that one can draw from conduct. But that is a question of evaluating the evidence, rather than saying that it is irrelevant.

4.24.8 *Facts relevant to domicile*

Domicile disputes generally turn on the individual's intention. So the court must determine what is or was the individual's intention. In order to do so the court will have regard to all facts which might shed light on intention.[227]

HMRC Brief 17/09 provides:

> Enquiries aimed at establishing an individual's domicile are, by their very nature, examinations of an individual's background, lifestyle, habits and intentions, possibly over the course of a lifetime. Consequently, any such enquiries conducted by HMRC will, where necessary, extend to areas of individuals' and their families' affairs that may not normally be regarded as relevant to their UK tax position. ...

The RDR Manual provides:

> **RDRM23080 Domicile: Enquiries into domicile status: Schedule of useful information and documents** [Mar 2019]
> The list below shows the types of information that might be requested during an enquiry. It should not be regarded as either prescriptive or comprehensive, and the individual may offer other relevant information or evidence for consideration too.
> Any information request should be tailored to the particulars of the

[225] Likewise *Re Grove* (1888) 40 Ch D 216; "in order to determine a person's intention at a given time, you may regard not only conduct and acts before and at the time, but also conduct and acts after the time, assigning to such conduct and acts their relative and proper weight and cogency."

[226] [2007] EWHC 2617 (Ch) at [39], [43].

[227] Except voting as an overseas elector: see 4.8.1 (Involvement in politics).

> individual's claim, and their present circumstances. It is always important to think about the relevance of particular items of information to the detailed subject matter of each enquiry.

This is sound advice, but not always well observed in practice.

> An information request need not be limited only to the items listed here, nor will all items listed necessarily be appropriate in all cases. It may not be possible for some individuals to provide some of the items on the list, even if they would be useful to an understanding of their domicile status. Given the inevitable passage of time in many cases, HMRC and the individual may need to consider how best the facts can be checked and tested.

HMRC lists the following:

Information
Date of birth.
Full name at birth.
Parents' full names, including mother's maiden name, and places of birth.
Place of birth, identifying the relevant law territory.
Background to the place of birth, if this was not in the same territory as the parental home at the time.
Details of any name changes, and where, if at all, such changes were registered.
Nationality (citizenship) at birth, including an explanation of its basis where this is not obvious from the context.
Details of any changes in or additions to the nationality (citizenship) at birth, with explanations of the relevant background.
Family background, including marital status of parents during the period of derived domicile[228].
Information about any adoption proceedings.
If parents were not living together at any time during the period of derived domicile, an explanation of the background to this matter and how parental responsibilities were exercised.
Information about relationships entered into by parents following their separation during the period of derived domicile.
Details of siblings
List of places of residence from birth to the time of the enquiry, including home addresses.

[228] A note on terminology. In the RDR Manual:

> "derived domicile" refers to what is usually called "domicile of dependency"
> "The period of derived domicile" is the period during which an individual is incapable of acquiring a domicile of choice, ie from birth to (now) age 16.

The terminology is not helpful, and as far as I know, it has not been adopted outside the RDR Manual; but it does not matter.

An explanation of the reason for residence at each place on the list.

Details of legal rights of residence in respect of each place and a summary of any visas, permits or other official documents required.

Summary of educational background, including places of education, periods of attendance and qualifications obtained.

Details of military service.

Details of governmental or diplomatic service.

Summary of employment and/or business history.

Explanation of employment and/or business plans, including anticipated retirement, and any arrangements that are in place in respect of these matters.

A detailed summary of properties that have been available for use other than as short-term holiday lettings. This should include the addresses of all the properties, a description of them, details of their ownership, the periods during which the properties have been available, and an explanation of how they have been used when not occupied by the individual.

Details of all marriages, civil partnerships, separations and divorces, including information relating to other relationships involving long-term cohabitation. These should cover the full names of any relevant parties, their dates, places of birth and nationalities, the periods during which the relationships existed, the dates of any formal acts or ceremonies, information relating to the domicile of the other parties, and explanations of any periods during which the parties to the relationship did not live together.

Information about transfers of property, including those between spouses or civil partners.

A summary of the names, dates of birth and nationalities of the children of the individual.

Details of where any children were or are being educated.

The current locations of any children and the relevant background.

Information relating to the exercise of political rights in any territory, as either a voter or a representative.

Membership of any political parties, or participation in campaigns or lobbying groups, and the extent of any activities.

Details of professional qualifications, membership of professional bodies and active participation in these, including offices held.

Summary of membership of clubs, societies, associations, organisations and other bodies, and details of the level of participation in these.

Information about any representative activities undertaken on behalf of a country, territory, or any political, territorial or other sub-division thereof.

The location of personal papers and any items of financial, sentimental or other value. If such items are moveable, the place where they are usually kept and details of any insurance policies in respect of them.

Details of any wills, including an explanation of the law by which the will is intended to be construed and upon which it relies for its formal validity.

Summary of any deeds, declarations, covenants and similar documents created, including those relating to dependants.

Information relating to any legal proceedings or other matters in which domicile was relevant, either as a basis for any action or as an evidential point.

Locations of members of the extended family, including a description of the relationship between the individuals.

Details of religious, cultural and social connections, including the degree of religious observation, the level of participation in social and cultural life, and ability to speak, read and write relevant languages.

Information about charitable and voluntary activities, including the foundation of charitable trusts, donations to charities and good causes, and active participation in the administration or fund-raising activities of third-sector organisations.

Summary of professional and personal advisers, including their locations and details of the nature and extent of the services that they provide.

An explanation of the individual's intentions for the future. What plans have been made? What contingencies have been taken into account? What would cause a change of residence? What provision has been made for the future? What has the individual actually done that provides evidence for the answers to these questions?

A summary of any connections not specifically mentioned above that the individual has with various territories. When did these begin and precisely what form have they taken over the years? How much time has the individual spent in each territory during the relevant period? What was the reason for such presence?

Documents

The list below deals with the types of documentary evidence that might be requested during an enquiry. Again, it is important to think about the relevance of particular documents to the detailed subject matter of each enquiry. Also, consider the extent to which corroborative documentary evidence of particular aspects of an individual's lifestyle or background is needed.

In some cases it might be necessary to request applications and other documents relating to the acquisition, loss or withdrawal of the items listed below:

Birth certificates
Adoption papers
Registrations of name changes
Marriage certificates
Civil Partnership certificates
Passports and identification documents
Social security documents
Applications for nationality (citizenship)
Documents renouncing nationality (citizenship)
Visas, residence permits, work permits and similar documents
Driving, firearms and other licences
Practising certificates and authorisations from professional or regulatory bodies
School records and reports
Examination certificates
Military service records
Employment contracts
Business accounts, reports and planning documents
Conveyances, leases, tenancy agreements and other documents relevant to the ownership, occupation or use of property
Mortgage and loan agreements
Health insurance policies
Property, motor and other insurance policies
Life assurance policies
Documents relating to savings, retirement and pension plans
Wills, expressions of wishes, deeds of covenant and other legal documents
Personal financial records, including bank account and credit card statements and documents relating to investments
Documents confirming membership of or participation in organisations and activities
Personal correspondence, photographs or electronic records relating to an individual's background, lifestyle and intentions

This is a daunting list, but forewarned is forearmed.

There are nevertheless limits to what information HMRC can require, based on relevance, proportionality and article 8 ECHR (respect for private life and correspondence). In *Re Flynn*:[229]

> In one sense there is no end to the evidence that may be adduced; for the whole of a man's life and all that he has said and done, however trivial, may be prayed in aid in determining what his intention was at any given moment of time.

If one takes that approach to its logical conclusion, then no enquiry will ever be completed. But the judge continued:

> ... All that the court can do is to draw inferences from what has been said and done; *and in doing this, too much detail may stultify.*

There are 3 objections to providing more information than reasonably required. The first is a principle of privacy.[230] The second is cost. The third is the risk that what starts out as a domicile enquiry may segue into other issues.

4.24.9 *Allegation of carelessness*

It appears that HMRC may routinely allege carelessness in domicile cases. Whether or not a taxpayer, or their agents, are guilty of carelessness is a matter of fact, but some general points can be made.

A taxpayer may be careless if:

(1) They have never considered the issue of domicile.
(2) They have relied on an old domicile ruling without considering whether the facts have changed.[231]

However ascertaining domicile may not be a straightforward question. The difficulties have often been recognised. The Hong Kong Law Reform Commission say:

> 2.10 The principal criticisms of the rules for acquiring a domicile of choice are … they also lead to uncertainty: it is hard to decide a person's domicile because of the inherent difficulty of ascertaining his

[229] [1968] 1 All ER 49 at p.51. This comment is cited with approval in a number of subsequent domicile cases.

[230] In particular, article 8 ECHR (respect for private and family life).

[231] *Strachan v HMRC* [2023] UKFTT 617 (TC) at [337] ff. All domicile rulings are now very old.

> intention.
>
> 2.12 The problems stemming from the difficulties and uncertainties of determining a person's domicile were well summarised as follows:
>
> > Trials are apt to be long and expensive; for since a man's state of mind must be investigated, evidence even of the smallest matter is relevant. Besides, the difficulty of reaching certainty in matters of domicile in the absence of any decision by a competent court is a serious inconvenience to numerous people when they come to make a will or in the many other circumstances in which it is necessary to know which legal system is applicable. The practitioner may find it impossible to advise his client with confidence, since he cannot prophesy what impact the facts will have upon the judge's mind.[232]

The English Domicile Report mentioned went on to note:

> Mr Winans' optimistic hopes of being able at some time to return to the United States impressed Lord Macnaghten, but were dismissed by Lord Lindley as of no significance.

It would be easy to assemble further observations of this kind.

There has been a significant change in HMRC practice.[233] What steps should be taken by a reasonably careful taxpayer, and their reasonably careful advisors, should be assessed in the light of HMRC's practice at the time the issue arises. In case where the issue was carelessness HMRC's change of practice, the circumstances behind setting up the current HMRC unit, and what proportion of cases where the domicile question is conceded immediately lead to an allegation of carelessness by HMRC, against the taxpayer or their advisors, are matters which would merit a full examination. But in practice that has not happened. I think today reasonably careful advisers should take more care than was previously the case, and generally they do.

Although the issue is, often, domicile in the years to 2016/17, conduct after that date is relevant insofar as it may shed light on intention at an earlier time.[234] But facts not available at the time the relevant tax returns were submitted should not be relevant to the issue of carelessness, which

[232] Law Reform Commission of Hong Kong, *Rules For Determining Domicile* (2015) *https://www.legco.gov.hk/yr06-07/english/bc/bc54/papers/bc540713-rpt0504-e.pdf* citing the First Report of the Private International Law Committee (1954) Cmd 9068 para 9 *https://www.kessler.co.uk/wp-content/uploads/2014/07/1261_001.pdf*

[233] See 4.24.1 (Change of HMRC practice).

[234] See 4.24.7 (Period for domicile enquiry).

should not be decided with the benefit of hindsight.

In a case where a taxpayer's advisors were careless, but the taxpayer was not, the question would arise as to whether the advisors were acting on behalf of the taxpayer, in the relevant sense.[235]

In *Strachan v HMRC*[236] the taxpayer was found to be careless, having failed to seek advice. However if he had taken advice, it was not clear whether that would have made any difference, because:

(1) Some advisers would have advised correctly that he was UK domiciled but
(2) At least one adviser would have advised incorrectly that he was not (and later did so).[237]

It was held that HMRC had failed to meet the burden of proving that the carelessness caused a loss of tax. But the point was not thought through. The FTT should have asked *why* a tax adviser gave, or might have given, the wrong advice. Was it because the tax adviser took the wrong view of the law? One would think at least on the balance of probabilities that competent advisers would advise correctly on the law.[238] Or was it because the tax adviser took the wrong view of the facts? In that case the question should have been whether the facts were properly put to the adviser. One cannot evaluate advice of Counsel (or any adviser) without considering their instructions. Further discussion will have to wait until the case is final.

4.24.10 *Disclosure to curtail enquiry*

The advantage of full disclosure is that, for any tax year, HMRC can only open the domicile issue, after the end of the enquiry period for that year (one year from submission of the tax return), if (in short) the inspector "could not have been reasonably expected to be aware" that the taxpayer is UK domiciled.[239]

It is impossible to disclose *all* the information which could be relevant

[235] See 121.15.6 (Carelessness of agent).

[236] [2023] UKFTT 617 (TC) at [364] ff.

[237] The basis on which that incorrect advice was given was not examined, and it was not clear whether the Tribunal was supplied with instructions and a copy of the advice. But one should never assess or rely on Counsel's advice without reviewing their instructions.

[238] Not least because the relevant law was clearly set out in this work.

[239] See 121.10 (Full-disclosure defence).

to domicile, but if the taxpayer discloses the principal information relevant to the case *against* foreign domicile, it should be difficult for HMRC to raise an assessment, after the one-year enquiry period, unless they can show that some of the statements given are false.

In practice the taxpayer might supply:

(1) The answers to the questions in the former form Dom 1 (which asks mostly routine questions)[240]

(2) A statement setting out the relevant background information.

This would be attached to the self-assessment tax return.

4.25 Domicile of company

A company is domiciled where it is registered, which is the place of incorporation.[241]

Company domicile as such[242] does not usually matter for tax purposes. But the issue of company domicile can arise; for instance, Inheritance Taxation of trusts depends on the domicile of the settlor, and this rule applies to a corporate settlor.

A UK resident foreign incorporated company could be deemed domiciled in the UK for IHT purposes, as the relevant provision refers to a "person", which includes a company. In practice this point will rarely (if ever) arise.

A company could not be deemed domiciled for IT/CGT purposes as the relevant provision refers to an individual. But this point will not arise because a UK resident company is subject to CT, not IT/CGT.

It is better where possible to avoid using the word domicile, in relation to a company, and to refer to place of incorporation/registration, as that term is more basic and transparent; but it comes to (more or less) the same thing.

In general speech, the word domicile is often used in connection with companies without any very precise meaning.[243] But the same is true of

[240] *http://webarchive.nationalarchives.gov.uk/20090211190203/http://www.hmrc.gov.uk/cnr/dom1.pdf*

[241] *Gasque v IRC* 23 TC 209; Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 30-002.

[242] Tax rules generally refer to place of registration or incorporation, rather than domicile, though of course it comes to the same thing.

[243] For instance, Budget 2016 provides: "The measure forms part of wider work to establish the UK as an attractive domicile for vehicles issuing insurance linked

domicile in connection with individuals.

See too 90.59 (Redomiciliation).

4.26 Domicile: Adviser's duty of care

An adviser's duty depends on the terms of their retainer:

> There is no such thing as a general retainer ... The expression "my solicitor" is as meaningless as the expression "my tailor" or "my bookmaker" in establishing any general duty apart from that arising out of a particular matter in which his services are retained. The extent of his duties depends upon the terms and limits of that retainer and any duty of care to be implied must be related to what he is instructed to do.[244]

In *Mehjoo v Harben Barker* the judge held that a generalist accountant should:

(1) Raise the topic of domicile, if aware that the client was originally from outside the UK.

(2) Be aware that "non-dom was a favoured status ... which brought with it tax advantages... there was some sort of opportunity there."[245]

(3) Advise the client to take further advice from a non-dom expert.[246]

But the CoA took a more limited view of the accountant's retainer, or more accurately speaking, of this accountant's retainer:

> 56. The reasonably competent accountant setting out to advise Mr Mehjoo of the tax consequences of the sale would not, in my view,

securities..,. the government has been working with the insurance industry to develop a new corporate and tax structure for allowing vehicles issuing Insurance Linked Securities to be domiciled in the UK."

HMRC, "Overview of legislation and rates" (2016) para 1.43

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508859/OOTLAR_complete_for_publication.pdf

[244] *Midland Bank Trust Co v Hett Stubbs & Kent* [1979] Ch 384 at p.402.

[245] The opportunity was a bearer share scheme. There is still scope for planning, and for CGT planning if action is taken at the time the company is set up (rather than at the time of disposal): see 103.24.4 (UK resident non-UK incorporated co).

[246] [2013] EWHC 1669 (QB) at [183] - [189]. The judge said, correctly, that it is not time-consuming or difficult for a generalist to recommend taking specialist advice. In that case, £800k CGT was at stake; the damages came to £1.2m and the claimant's costs were over £5m. The cost of consulting a specialist (in 2004) was said to be £500 (presumably the cost of an initial enquiry rather than detailed advice).

> have been under any obligation to raise for discussion the claimant's domicile unless it was relevant to the CGT liability on the disposal. The accountant would have known that [domicile] gave Mr Mehjoo no tax advantages in relation to the sale of [UK registered] shares unless the situs of the shares could be changed. As this was something which [the accountants] neither knew or could have been expected to know was achievable, there was no reason to mention the matter still less a liability in negligence for not having done so...
> 59. I take the same view in respect of the claim that [the accountant] should have told Mr Mehjoo that his probable non-dom status carried with it significant tax advantages. Again, these were not advantages which were available to the claimant on the sale of UK registered shares and, in the absence of any claim that [the accountants] should have known and advised Mr Mehjoo that it would or might be possible to change the situs of the shares without triggering a charge to CGT in the process, it is difficult to understand why they were under any legal duty to bring the existence of "very significant tax advantages" to the claimant's attention. The competent accountant would not have believed that they existed.[247]

4.27 Domicile mistakes

In (at least) two cases the Courts have set aside a gift to a trust made under a mistaken view of the settlor's domicile (and so a mistaken view of the IHT consequences).[248] In the second case the mistake was not as to domicile (which was never determined) but just as the risk that HMRC would investigate domicile. That may be help to close down an HMRC investigation.

[247] *Hartogs v Sequent (Schweiz) AG* [2014] EWCA Civ 358; *The Representation of Q re The R, S, T and U Trusts* [2021] JRC 166

[248] *In the Matter of the E Settlement* [2022] JRC 052. See too 5.17 (Deemed domicile mistakes).

CHAPTER FIVE

DEEMED DOMICILE

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Cross references

The following topics are considered elsewhere:
1.10 (2017 Domicile reform: Assessment)
4.25 (Deemed domicile of company)
App 10.1 (Parliamentarians)

5.1 Deemed domicile: Introduction

This chapter discusses the deemed domicile rules which apply for IHT and IT/CGT.

The development of the 2017 rules can be traced in a series of papers which are now of historical interest only:

- "Technical Briefing on Non-Dom changes" (**"the July 2015 Non-Dom paper")**[1]
- Consultation paper "Reforms to the taxation of non-domiciles" **("the September 2015 condoc")**[2]
- Policy paper "IHT: reforms to the taxation of non-domiciles" & draft IHT clauses (December 2015)[3]
- Policy paper "Domicile: Income Tax and CGT" & draft IT/CGT clauses ("**the 2016 policy paper**")[4]
- Budget 2016
- "Reforms to the taxation of non-domiciles: further consultation" (August 2016) ("**the 2016 consultation paper**")[5]
- Finance Bill (March 2017)
- Revised draft clauses + EN (13 July 2017)

5.2 Deemed domicile: Outline

IT/CGT have 2 categories of deemed-domicile; IHT has those and 2 more, making four in all:

Deemed-domicile category	**ITA**	**IHTA**
Formerly-domiciled resident	s.835BA Condition A	s.267(1)(aa)
15-year rule	s.835BA Condition B	s.267(1)(b)
3-year rule	*not applicable*	s.267(1)(a)
Election-domicile	*not applicable*	s.267ZA

A person who is domiciled under these rules is **"deemed domiciled"**.[6]

A person who is UK domiciled under the general law, discussed in the last chapter, may be described as **"actually domiciled"**.

[1] *https://www.gov.uk/government/publications/technical-briefing-on-foreign-domiciled-persons-changes-announced-at-summer-budget-2015* (July 2015)

[2] *https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles/reforms-to-the-taxation-of-non-domiciles* (September 2015)

[3] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/484090/151209_publication_v1_4.pdf*

[4] *https://www.gov.uk/government/publications/domicile-income-tax-and-capital-gains-tax* (2 Feb, updated 5 Feb 2016)

[5] *https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles-further-consultation*

[6] Thus the meaning of "deemed domiciled" depends on whether the context is IT/CGT or IHT. Where statute uses this term, it is defined: for instance, para 5A sch 5 TCGA, see 92.4 (Condition D: Tainting).

If an individual is deemed UK domiciled, their actual domicile may not matter; but it may still be important, eg for:

- protected-trust relief
- 2017 rebasing[7]
- non-tax purposes

5.3 Scope of deemed-domicile

5.3.1 *Scope of IT/CGT deemed-dom*

Section 835BA(1) ITA provides:

> This section has effect for the purposes of the provisions of the Income Tax Acts or TCGA 1992 which apply this section.

So IT/CGT deemed-domicile only applies when s.835BA is expressly applied. This is done by a standard form clause:

> Section 835BA of ITA 2007 (deemed domicile) applies for the purposes of [the specified provision].

I refer to that as a **"standard-form deemed-domicile application clause"**. That clause appears dozens of times, and the total list covers (just about) everything which is important:

Income tax
ICTA: s.266A
ITEPA: s.355, s.373, s.374, s.376
ITA: s.476, s.718, s.809B, s.809E, s.834
CGT
TCGA: s.69, s.86, s.275, Sch 5A para 3
Sch 7 FA 2008 transitional reliefs (formerly-domiciled residents only):
paras 100(1)(b), 101(1)(c) and 102(1)(e)
para 118(3)(b) so far as having effect for the purposes of para 118(1)(d)
paras 124(1)(b), 126(7)(b), 127(1)(e) and 151(1)(b)

Where IT/CGT legislation refers to domicile but does not expressly apply s.835BA, the IT/CGT deemed-domicile rules do not apply and the reference is to actual domicile. This is rare, but there are examples:

Section	**Topic**	**See para**
s.809D ITA	Remittance basis for sub-£2k taxpayer	17.9
sch 5A TCGA	Disclosure of non-resident trusts	128.4.1

[7] See 56.16 (2017 rebasing).

Tax often distinguishes formerly-domiciled residents (more harshly treated) from other deemed domiciliaries. So a common formula is to refer to an individual who-

> (a) is domiciled in the UK, or
> (b) is regarded for the purposes of [a specified provision] as domiciled in the UK as a result of section 835BA having effect because of Condition A in that section being met [formerly-domiciled resident].

In para (a), the context, and the absence of a standard-form deemed-domicile application clause, show that the reference to domicile is a reference to actual domicile; for clarity, I gloss the provision to add the word [actual] in square brackets.

The drafter of the s.643A close-family income rule, and the s.731 equivalent, coined the term "relevantly domiciled" to describe this case (ie where someone is actually domiciled or a formerly domiciled resident).[8] The reader may think that the legislation is easier to follow without this opaque term; and, perhaps for the best, it is not used elsewhere.

5.3.2 *Scope of IHT deemed-dom*

IHT deemed-domicile applies "for the purposes of the IHTA"[9] ie for all IHT purposes, unless expressly disapplied.

There are 3 (somewhat specialist) occasions where deemed-domicile is disapplied for IHT:

Topic: cross reference
FOTRA securities: see 75.5.1; and for FOTRA reliefs, see 75.4; 75.11
Qualifying certificates of IoM/Channel Island doms: see 75.7
Double tax treaties: see 115.8.1 (Deemed domicile); 115.8.2 (Election-domicile)

The IT/CGT and IHT 15-year rules do not apply to visiting forces.[10]

5.4 IT/CGT deemed-domicile

5.4.1 *IT/CGT deemed-domicile rules*

Section 835BA(2) ITA provides:

> An individual not domiciled in the UK at a time in a tax year ("the

[8] See 50.15.1 ("Relevantly domiciled").
[9] See s.267(1) IHTA.
[10] See App 11.2.3 (Residence/domicile relief); App 11.4.2 (IHT deemed-domicile).

> relevant tax year") is to be regarded as domiciled in the UK at that time if—
>
> (a) condition A is met, or
> (b) condition B is met.

I use the following terminology:

Condition	**Term**
A	IT/CGT formerly-domiciled resident rule
B	IT/CGT 15-year rule

5.4.2 *IT/CGT formerly-dom resident rule*

Section 835BA(3) ITA provides:

> Condition A is that—
>
> (a) the individual was born in the UK,
> (b) the individual's domicile of origin was in the UK, and
> (c) the individual is resident in the UK for the relevant tax year.[11]

Statute does not coin a term for an individual who is domiciled under IT/CGT dom condition A. Instead, it uses the clumsy formula:

> regarded for the purposes of [a specified section] as domiciled in the UK as a result of section 835BA having effect because of Condition A in that section being met

I use the term **"formerly-domiciled resident"**[12] for IT/CGT as well as for IHT. This might be regarded as slightly loose language, because:

(1) Statute uses the term "formerly domiciled resident" only in its IHT sense.[13]

(2) The two definitions (IHT and IT/CGT) are not quite identical, as IT/CGT has no equivalent to para (d) of the IHT definition (one-year grace period).

(3) The expression "formerly-domiciled resident" is in any case a rough shorthand, because it ignores the requirement to be born in the UK. ("Born-domiciled" would be more accurate; but it is best to adopt the statutory terminology, because anything else is even more confusing).

[11] The "relevant tax year" is the tax year in which deemed domicile may apply; see 5.4.1 (IT/CGT deemed-domicile rules).

[12] For clarity I add the hyphen which is not in the statutory term.

[13] See 5.5 (IHT Formerly-domiciled resident rule).

I do not think my terminology is likely to cause confusion in practice.

So for IT/CGT, the domicile start date for a formerly-domiciled resident is 6 April in the 1st year of residence. In that year, an individual may be a formerly-domiciled resident for IT/CGT but not for IHT.

The domicile end date is 6 April in a year of non-residence, which is the same as the IHT rule.

5.4.3 *IT/CGT 15-year rule*

Section 835BA(4) ITA provides:

> Condition B is that the individual has been UK resident for at least 15 of the 20 tax years immediately preceding the relevant tax year.[14]

Section 835BA(5) ITA provides:

> But Condition B is not met if—
> (a) the individual is not UK resident for the relevant tax year, and
> (b) there is no tax year beginning after 5 April 2017 and preceding the relevant tax year in which the individual was UK resident.

At first this seems slightly different from the IHT rule, because s.835BA(5) is not an exact equivalent of s.267(1)(b)(ii). But after the wording is compared, it is clear the end result is the same, and the IHT and IT/CGT 15-year rules are equivalent.[15]

5.5 IHT formerly-domiciled resident rule

Section 267(1) IHTA provides:

> A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if ...
> (aa) he is a formerly domiciled resident for the tax year in which the relevant time falls ("the relevant tax year")

I refer to this as the **"IHT formerly-domiciled resident rule"**.

"Formerly-domiciled resident" is a label for a set of four rules. Section 272 IHTA provides:

[14] The "relevant tax year" is the tax year in which deemed domicile may apply; see 5.4.1 (IT/CGT deemed-domicile rules).

[15] See 5.13 (Deemed dom wording compared). See too 5.6.1 (15-year rule start date: Figures).

> In this Act, except where the context otherwise requires ...
> "formerly domiciled resident", in relation to a tax year, means a person—
> (a) who was born in the UK,
> (b) whose domicile of origin was in the UK,
> (c) who was resident in the UK for that tax year, and
> (d) who was resident in the UK for at least one of the two tax years immediately preceding that tax year.

I call the condition in para (d) the **"one-year grace period"**. IT/CGT does not have this requirement.[16]

The place of birth can be ascertained if necessary from the birth certificate.

The domicile start date for formerly-domiciled residents under the IHT deemed dom rule is 6 April in the 2nd year of residence.

The domicile end date for formerly-domiciled residents is 6 April in the first year of non-residence.

The rules can catch in particular:

(1) Those who (would like to) return to the UK for medical treatment of a terminal illness
(2) Short term secondees from abroad
(3) Those who make settlements when non-domiciled and subsequently return to the UK

5.5.1 *Former-dom resident: Critique*

The rule reflects an intuition that a formerly-domiciled resident is likely to have a closer connection to the UK than other UK resident non-doms. Perhaps there is also a disapproval of those losing UK domicile and subsequently becoming UK resident again, or some administrative convenience in not having to argue domicile issues in these circumstances.

However the rule can affect those whose UK connections seem quite tenuous, because:

(1) The rules which determine domicile of origin can be capricious
(2) The place of birth is to some extent a matter of chance

CIOT give this example:

> an individual:
> - born in the UK of UK domiciled but non-resident father who is in the UK for some temporary purpose

[16] See 5.4.2 (IT/CGT formerly-dom resident rule).

- taken out of the UK in infancy, grows up, lives and works abroad for the next, say, 30-40 years during which time he acquires a foreign domicile of choice;
- seconded by his employer to the UK on a short term basis

CIOT say:

> The individual will ... be treated for income tax and capital gains tax purposes in the same way as a UK domiciliary.
> This is arguably inequitable given that it is pure happenstance that the individual was born in the UK.
> The harshness of the rule is highlighted further if one compares the position with the individual's sibling who was born outside the UK and who is, therefore, not affected by the returning UK domiciliary proposal. The sibling may therefore take up temporary secondment in the UK or come to the UK to look after his/her parents without incurring the same adverse consequences as the individual.[17]

This applies for IHT and IT/CGT, though in the case of IHT the unfairness is mitigated slightly by the one-year grace period.

It seems to me that the answer to this objection is that all connecting factors used to define territorial limits to tax must be somewhat arbitrary.[18] There is no perfect solution, and to ask for one is to cry for the moon.[19]

Others may question whether the place of birth should be regarded as "pure happenstance". Compare the rule (known as birthright citizenship) that a person becomes a citizen of the place where they happen to be born. This applies even to children of short term visitors and illegal immigrants. That was formerly UK law[20] and continues to be the law in the USA[21] and some other countries.

But views may differ.

5.6 IHT 15-year rule

Section 267(1) IHTA provides:

[17] CIOT, "Response to Consultation on draft clause 43 Finance Bill 2016" (Feb 2016).

[18] See App 1.10 (Arbitrary).

[19] See 1.4.1 (Domicile as fiscal test: Critique).

[20] Until the British Nationality Act 1981.

[21] The 14th Amendment to the United States Constitution, ratified in 1868, provides: "All persons born ... in the United States, and subject to the jurisdiction thereof, are citizens of the United States ...".
Hence the phenomenon of "accidental Americans", a category which included Boris Johnson.

> A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if ...
>
> (b) he was resident in the UK—
>
> (i) for at least fifteen of the twenty tax years immediately preceding the relevant tax year,[22] and
>
> (ii) for at least one of the four tax years ending with the relevant tax year.

I refer to this as the "**IHT 15-year rule**".

The start date for acquisition of 15-year deemed domicile is 6 April in the tax year *after* the 15/20 year test is satisfied. It does not matter whether or not a person is resident in that tax year. But if the person remains non-resident, the only impact of IHT deemed-domicile is a 3 year "tail" of IHT exposure, which may not be a serious matter.

5.6.1 *15-year rule start date: Figures*

It may be useful to set out an aide memoire of when the 15-year rule begins to apply. The position is the same for IHT and IT/CGT. Assuming a continuous period of UK residence:

UK residence	**Deemed-domicile**	**UK residence**	**Deemed-domicile**
from	**start date**	**from**	**start date**
2005/06	6 April 2020	2006/07	6 April 2021
2007/08	6 April 2022	2016/17	6 April 2031
2008/09	6 April 2023	2017/18	6 April 2032
2009/10	6 April 2024	2018/19	6 April 2033
2010/11	6 April 2025	2019/20	6 April 2034
2011/12	6 April 2026	2020/21	6 April 2035
2012/13	6 April 2027	2021/22	6 April 2036
2013/14	6 April 2028	2022/23	6 April 2037
2014/15	6 April 2029	2023/24	6 April 2038
2015/16	6 April 2030	2024/25	6 April 2039
		2025/26	6 April 2040

5.6.2 *Domicile end date*

Deemed domicile under the 15-year rule ends when an individual ceases to meet *either* of the two conditions in s.267(1)(b). The conditions are:

> (b) he was resident in the UK—

[22] The "relevant tax year" is the tax year in which deemed domicile may apply; see 5.5 (IHT formerly-domiciled resident rule).

(i) for at least fifteen of the twenty tax years immediately preceding the relevant tax year, *and*

(ii) for at least one of the four tax years ending with the relevant tax year.

The condition in (b)(ii) is not met from the beginning of the individual's fourth consecutive year of non-residence (including the relevant tax year). But if the individual has not been UK resident for 15 consecutive years, then the condition in s.267(1)(b)(i) will not be satisfied. So the condition in (ii) only matters at the margin.

Take the case of an individual continually UK resident since 2004/05 who ceases to be UK resident in 2019/20:

Relevant Tax Year			**deemed dom**	**Res^{t} years / 20** ***exclude* rel year**[23]	**non-res^{t} years** ***include* rel year**[24]
1	2004/05	resident	no	0	-
2	2005/06	resident	no	1	-
3	2006/07	resident	no	2	-
4	2007/08	resident	no	3	-
5	2008/09	resident	no	4	-
6	2009/10	resident	no	5	-
7	2010/11	resident	no	6	-
8	2011/12	resident	no	7	-
9	2012/13	resident	no	8	-
10	2013/14	resident	no	9	-
11	2014/15	resident	no	10	-
12	2015/16	resident	no	11	-
13	2016/17	resident	no	12	-
14	2017/18	resident	no	13	-
15	2018/19	resident	no	14	-
16	2019/20	non-resident	yes	15	1
17	2020/21	non-resident	yes	15	2
18	2021/22	non-resident	yes	15	3
19	2022/23	non-resident	no *	15	4
20	2023/24	non-resident	no *	15	5
21	2024/25	non-resident	no *	15	6
22	2025/26	non-resident	no	14	7

[23] That is, the number of years in the last 20, not including the relevant tax year, in which the individual was UK resident.

[24] That is, the number of years, including the relevant tax year, in which the individual was continually not UK resident.

In the years marked *, ie 2022/23 to 2024/25, the fourth to sixth years of continuous non-residence, the individual escapes deemed domicile because of s.267(1)(b)(ii) (four continuous years of non-residence). If they resume UK residence, they become deemed domiciled. But in the following year, the seventh year, the individual escapes deemed domicile because of s.267(1)(b)(i) (less than 15 years UK residence over the last 20) and if they subsequently become UK resident, the 15 year period starts again from zero.

5.6.3 *"Residence" for 15-year rule*

Section 267(4) IHTA provides:

> For the purposes of this section the question whether a person was resident in the UK for any tax year shall be determined as for the purposes of income tax.

This is not needed from 2013/14, as the statutory residence test applies for IHT generally.[25]

It is, perhaps, relevant for the years from 1993 to 2013 (when the SRT took effect), but the wording was there for historical reasons only.

Prior to 1993/94, the provision concluded: "but without regard to any dwelling-house available in the UK for his use".[26] That phrase was deleted in 1993 "where the year of assessment concerned is 1993-94 or a subsequent year of assessment."[27] The pre-1993 wording would still be relevant in ascertaining the domicile of the settlor for IHT purposes, and so for excluded property status, if a settlement was made between 1975 and 2013, and residence in the period 1973-1993 is in issue.

5.7 Counting split years

A tax year for which the individual is UK resident will count in full for deemed domicile purposes, even if the year is a split year.[28]

It follows that there is a mismatch in the overseas part of a split year:

(1) For IT/CGT: Foreign income/gains arising to the individual in the

[25] See 6.3 (Scope of SRT).

[26] For a more detailed analysis, see Kessler, *Taxation of Non-Residents and Foreign Domiciliaries* (15th ed., 2016-2017) para 4.2.5 (Meaning of "residence" for 17-year rule).

[27] Section 208 FA 1993.

[28] See 10.1 (Residence throughout tax year).

overseas part of a split year are not usually taxed; deemed domicile does not prevent split-year relief applying.

(2) For IHT: Foreign situate property is chargeable (non-excluded) property even in the overseas part of the year.

But this is not the only mismatch between IHT and IT/CGT deemed-domicile rules; so perhaps it does not matter.

5.8 IHT 3-year rule

Section 267(1) IHTA provides:

> A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if—
>
> (a) he was domiciled in the UK within the three years immediately preceding the relevant time...

The 3-year rule concerns the person who is actually UK domiciled and who loses their UK domicile. The domicile start date for this rule is the date of change of domicile, and the domicile end date is 3 years after that date.

The IHT Manual gives a straightforward example:

> **IHTM13024 Change of Domicile: Deemed Domicile** [Jan 2020]
> ... **Example 1** (Paula)
> P has an English domicile and lives in England. She retires from work and decides that she wants to live for the rest of her life in Spain. She goes to Spain and takes a Spanish domicile of choice on 31 January 2007.
> She dies on 1 January 2010 still in Spain.
> Because of the deemed domicile 'three year rule' she is deemed domiciled in the UK at her death and her world wide estate is chargeable to IHT. Her estate can, of course, claim tax relief for any Inheritance Tax paid in another country.

Unlike the 15-year rule, the domicile start and end dates do not relate to tax years.

Section 267(5) IHTA provides:

> In determining for the purposes of this section whether a person is, or at any time was, domiciled in the UK, sections 267ZA and 267ZB are to be ignored.

Thus election-domicile and the 3-year rule operate independently: the loss of election-domicile does not give rise to deemed domicile under the 3-year rule.

5.9 Start/end date uncertainty

Under the 15-year rule, deemed domicile in a year (year X) can depend on:

(1) UK residence for the previous year, under s.267(1)(b)(i), which depends on facts during the previous year, and also in some cases, on facts after that year; and

(2) UK residence for the actual year (relevant tax year) under s.267(1)(b)(ii)

So on 6 April, and for some time after, an individual may not know whether they are resident, and so they will not know whether they are deemed domiciled for IHT or not. On the facts of the example set out above, the individual ceases to be UK domiciled on 6 April 2022 and may in principle safely make a gift of excluded property to a trust. But if they unexpectedly become UK resident in the year 2022/23, that turns into a chargeable transfer. So the tax cost of a return to the UK may be high.

Similar problems arise for formerly-domiciled residents, whose domicile in a year depends on UK residence for that year.

As at a domicile start or end date of 6 April, in any year, the individual will often not know whether they will be resident for the year or not, because facts which emerge during the year (or even after the year) are relevant to determine residence. So they will not know whether they are deemed domiciled or not. For IT/CGT this matters less, as tax returns are due long after the year end, by which time the position should be known. For IHT, on the other hand, the returns may be due before the relevant facts are known. Taxpayers will have to judge as best they can.

5.10 Children

5.10.1 *Child of deemed domiciliary*

The July 2015 Non-Dom paper provides:

> 20. The deemed domicile of the long term resident non-dom has no effect on the domicile status of the children, whose actual and deemed domicile position is looked at independently. Thus they will take their father's domicile under general law at the date of their birth and if they are long term residents within the new rules will become deemed domiciled here. But they do not become deemed domiciled here simply because either parent is deemed domiciled here nor do they lose deemed

> domicile just because a parent does.

Similarly, the RDRM provides:

> **RDRM25080: Deemed domicile: Other issues** [May 2020]
> Unlike domicile under common law, deemed domicile status is not passed from parent to child.

5.10.2 *Child under 18*

UK resident years count towards the 15 year total even if the individual is under the age of 18. So a child who is born in the UK and who does not have a UK domicile of origin could become deemed-domiciled before reaching adulthood. However, the child could still lose deemed-UK domiciled status if they leave the UK and spend sufficient years non-resident.

5.11 Transitional rules

Section 30(9) F(no.2)A 2017 provides:

> The amendments made by this section have effect in relation to times after 5 April 2017, subject to subsections (10) to (12).

5.11.1 *15-year rule: 2017 transition*

The July 2015 Non-Dom paper provides:

> 16.... For those who leave the UK before 6 April 2017 but would nevertheless be deemed domiciled under the 15 year rule on 6 April 2017 the present [pre-2017] rules will apply.

Accordingly, s.30(10) F(no.2)A 2017 provides:

> The amendment to section 267(1) of IHTA 1984 made by subsection (1)(c) does not have effect in relation to a person if—
> (a) the person is not resident in the UK for the relevant tax year, and
> (b) there is no tax year beginning after 5 April 2017 and preceding the relevant tax year in which the person was resident in the UK.
>
> In this subsection "relevant tax year" is to be construed in accordance with section 267(1) of IHTA 1984 as amended by subsection (1).[29]

Undoing the 2017 amendments, s.267(1)(b) IHTA reverts to its pre-2017

[29] The "relevant tax year" is the tax year in which deemed domicile may apply; see 5.5 (IHT formerly-domiciled resident rule).

form (a 17-year rule):

> A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if ...
>
> (b) he was resident in the UK in not less than seventeen of the twenty years of assessment ending with the year of assessment in which the relevant time falls.

Section 30(11) F(no.2)A 2017 provides:

> The amendment to section 267(1) of IHTA 1984 made by subsection (1)(c) also does not have effect in determining—
>
> (a) whether settled property which became comprised in the settlement on or before that date is excluded property for the purposes of IHTA 1984;
>
> (b) the settlor's domicile for the purposes of section 65(8) of that Act in relation to settled property which became comprised in the settlement on or before that date;
>
> (c) whether, for the purpose of section 65(8) of that Act, the condition in section 82(3) of that Act is satisfied in relation to such settled property.

Although there is no grandfathering, the 15-year rule is not retrospective in that it does not impact on past actions taken. For example, suppose a trust was made in January 2017, by a settlor who

(1) was not deemed domiciled under either the then 17-year rule or the 3-year rule, but

(2) would be deemed domiciled under the current 15-year rule.

The trust continues to have excluded property status after 5 April 2017.

CIOT lobbied for transitional relief for individuals who:

(1) left the UK before they became deemed-domiciled for IHT under the former 17-year rule and

(2) subsequently returned to the UK:

> a non-UK domiciliary who had been in the UK for many years, then left prior to 2011/12 and returned just after 2014/15 would have stayed for four complete tax years out of the UK. On their return he/she would have reasonably expected to be able to complete another 17 years in the UK before the current IHT deemed domicile 17/20 year test would have caught them again. It is not unreasonable for 17 years to be shortened to 15 years for such a case. However, it is unreasonable for the period to be shortened to zero years, because they will be become immediately

> deemed domicile again on 6 April 2017.[30]

However no relief is given for this case, so on these facts the individual would become deemed domiciled on 6 April 2017.

5.11.2 *Former-dom: 2017 transition*

There is no transitional relief for formerly-domiciled residents. The July 2015 Non-Dom paper provides:

> 29. This measure will affect all returning UK doms from 6 April 2017, including those who returned prior to April 2017. The five year rule will affect UK doms leaving after 5 April 2017. It will also affect trusts set up while such individuals were not UK domiciled if they are UK resident on or after 6 April 2017. In these circumstances, an individual will be taxed on all income and gains arising in such trusts under the same rules as any other UK domiciliary. The IHT treatment of such trusts will also be the same as for UK taxpayers who have never lost a UK domicile.

5.11.3 *Pre-2015 temporary non resident: CGT*

ICAEW raised a problematic interaction with the temporary non-UK residence rules:

> On 2 January 2015, prior to the announcement, an individual, who would have met the “15 out of 20” rule if it had been in force, left the UK on a three year secondment.
>
> Between January and June 2015 she made various disposals of foreign assets at very significant gains with the expectation that when she returned she would pay the £90,000 Remittance Basis Charge and not have to pay tax on the gains (as there would not be any remittances).
>
> Without a transitional provision the changes mean that she will not be able to access the remittance basis when she returns to the UK, so she will have a very significant CGT liability.[31]

The 2016 policy paper accepted the point:

> The part of the measure affecting capital gains tax in respect of foreign chargeable gains accruing to temporary non-residents will not affect accruals arising in respect of periods of temporary non-residence beginning on or before 7 July.

[30] CIOT, “Response to Consultation on draft clause 43 Finance Bill 2016” (Feb 2016).

[31] Taxguide 04/15.

Accordingly, para 16 sch 8 F(no.2)A 2017 provides:

> (1) This paragraph applies in a case where section 10A of TCGA 1992 as substituted by paragraph 119 of Schedule 45 to FA 2013 applies in relation to an individual.
> (2) For the purposes of capital gains tax in respect of foreign chargeable gains accruing to the individual during a temporary period of non-residence beginning before 8 July 2015, the amendment made by paragraph 14(2) does not have effect in relation to the tax year which consists of or includes the period of return.
> (3) Where by virtue of sub-paragraph (2) an individual makes a claim under section 809B of ITA 2007 for any of the tax years 2017–18 to 2020–21 inclusive, sections 809C, 809G and 809H of ITA 2007 do not apply to the individual for that tax year.
> (4) In this paragraph, "foreign chargeable gain" has the meaning given by section 12(4) of TCGA 1992.
> (5) Part 4 of Schedule 45 to FA 2013 explains what "temporary period of non-residence" and "period of return" mean.

Para 15 contains the same rule for pre-2013 departures; that is needed as they have a separate code.

This only refers to gains. It does not apply to *income* accruing in the period of temporary non-residence. For employment income, the 2016 consultation paper provides:

> Some stakeholders sought clarification of the tax treatment which would apply where an individual who is subject to the remittance basis receives employment income relating to a period when they were not deemed-domiciled under the 15 out of 20 rule but is paid after they become deemed-domiciled... the government can confirm that such income will be taxable only to the extent that it is remitted to the UK. This is in line with the current treatment, which currently applies to deferred payments made after an individual ceases to be taxed on the remittance basis.

5.11.4 *1974 transitional rules*

Section 267(3) IHTA contains five transitional rules:

> Para (a) of subsection (1) above shall not apply in relation to a person who (apart from this section) has not been domiciled in the UK at any time since 9th December 1974 ...

This disapplies the 3-year rule only. It would only apply in a relatively rare case of someone who was actually UK domiciled and ceased to be so before 9 December 1974.

> and para (b) of that subsection shall not apply in relation to a person who has not been resident there at any time since that date ...

This only disapplies the former 17-year rule. It would apply to someone who had been UK resident for 17-years and ceased to be so before 9 December 1974.

> and that subsection shall be disregarded—
> (a) in determining whether settled property which became comprised in the settlement on or before that date is excluded property,

This applies to pre-9 December 1974 settlements.

> that subsection shall be disregarded— ...
> (b) in determining the settlor's domicile for the purposes of section 65(8) above in relation to settled property which became comprised in the settlement on or before that date, and
> (c) in determining for the purpose of section 65(8) above whether the condition in section 82(3) above is satisfied in relation to such settled property.

This applies to the exemption for FOTRA securities.

These transitional reliefs are preserved by the 2017 reforms. Section 30(12) F(no.2)A 2017 provides:

> Despite subsection (2), section 267(1) of IHTA 1984, as originally enacted, shall continue to be disregarded in determining—
> (a) whether settled property which became comprised in the settlement on or before 9 December 1974 is excluded property for the purposes of IHTA 1984;
> (b) the settlor's domicile for the purposes of section 65(8) of that Act in relation to settled property which became comprised in the settlement on or before that date;
> (c) whether, for the purpose of section 65(8) of that Act, the condition in section 82(3) of that Act is satisfied in relation to such settled property.

5.12 Deemed domicile: Planning

5.12.1 *Anticipating deemed domicile*

There is scope for planning in anticipation of acquisition of deemed domicile. For a summary see 13.10 (Pre-deemed-domicile planning)..

A person ("H") with a UK place of birth and domicile of origin may be married to a person ("W") who was not born in the UK, or who did not have a UK domicile of origin. If H and W become UK resident, then H will be deemed domiciled as a formerly-domiciled resident; and W will not. In that case the tax issues can be resolved by a transfer from H to W (and a transfer from a settlement made by H to W). This should be considered before H and W become UK resident.

5.12.2 *Losing deemed domicile*

An individual who is deemed domiciled because of:

(1) a domicile election; or

(2) 15 years UK residence

will lose deemed domicile status for IHT after 3 or 4 non-resident years. A formerly-domiciled resident ceases to be UK domiciled on non-residence.

For such individuals, a simple form of IHT planning is to refrain from making any gifts until they have ceased to be deemed domiciled.

5.13 Deemed dom wording compared

The text of IT/CGT and IHT deemed domicile rules does not sit side by side altogether neatly, because the wording is not always closely aligned. But it may be helpful to try:

s.835BA ITA	**s.267 & 272 IHTA**
(1) This section has effect for the purposes of the provisions of the Income Tax Acts or TCGA 1992 which apply this section.	**s.267(1)** A person not domiciled in the UK at any time (in this section referred to as "the relevant time") shall be treated for the purposes of this Act as domiciled in the UK (and not elsewhere) at the relevant time if—
[No equivalent]	(a) he was domiciled in the UK within the three years immediately preceding the relevant time,
(2) An individual not domiciled in the UK at a time in a tax year ("the relevant tax year") is to be regarded as domiciled in the UK at that time if— (a) condition A is met, or (b) condition B is met.	

(3) Condition A is that—	(aa) he is a formerly domiciled resident for the tax year in which the relevant time falls ("the relevant tax year"), or
	s.272 "formerly domiciled resident", in relation to a tax year, means a person—
(a) the individual was born in the UK,	(a) who was born in the UK,
(b) the individual's domicile of origin was in the UK, and	(b) whose domicile of origin was in the UK,
(c) the individual is UK resident for the relevant tax year.	(c) who was resident in the UK for that tax year, and
[No equivalent to para (d)]	(d) who was resident in the UK for at least one of the two tax years immediately preceding that tax year;
(4) Condition B is that the individual has been UK resident for at least 15 of the 20 tax years immediately preceding the relevant tax year.	**s.267(1)** (b) he was resident in the UK— (i) for at least fifteen of the twenty tax years immediately preceding the relevant tax year, and
(5) But Condition B is not met if— (a) the individual is not UK resident for the relevant tax year, and (b) there is no tax year beginning after 5 April 2017 and preceding the relevant tax year in which the individual was UK resident.	(b) he was resident in the UK ... (ii) for at least one of the four tax years ending with the relevant tax year.

Lastly, for completeness, s.267 has four further subsections which have no IT/CGCT equivalent because that is not needed:

> (2) Subsection (1) above shall not apply for the purposes of section 6(2) or (3) or 48(4) above and shall not affect the interpretation of any such provision as is mentioned in section 158(6) above.
> (3) Paragraph (a) of subsection (1) above shall not apply in relation to a person who (apart from this section) has not been domiciled in the UK at any time since 9th December 1974, and paragraph (b) of that subsection shall not apply in relation to a person who has not been resident there at any time since that date; and that subsection shall be disregarded—
> (a) in determining whether settled property which became comprised in the settlement on or before that date is excluded property,
> (b) in determining the settlor's domicile for the purposes of section

65(8) above in relation to settled property which became comprised in the settlement on or before that date, and

(c) in determining for the purpose of section 65(8) above whether the condition in section 82(3) above is satisfied in relation to such settled property.

(4) For the purposes of this section the question whether a person was resident in the UK for any tax year shall be determined as for the purposes of income tax

(5) In determining for the purposes of this section whether a person is, or at any time was, domiciled in the UK, sections 267ZA and 267ZB are to be ignored.

5.14 Election-domicile

5.14.1 *Navigation*

The legislation is slotted in after s.267 and before s.267A, so the two sections are numbered s.267ZA and s.267ZB.[32] The drafting is as abstruse as the numbering.

There are essentially two parties involved here, and I call them H (the donor) and W (the non-dom donee). My terminology embodies a gender assumption, which the drafter of the statute rightly avoids, namely that *H* (the donor) makes a gift to *W* (the donee). But in the statutory provision "person" sometimes refers to one spouse[33] and sometimes the other, and discussion is easier to follow if this is glossed with H or W, as the case may be. The reader may grasp at any aid to navigation.

The spur to the provisions was EC infringement proceedings, and their development can be traced through an HMRC Technical Note[34] but that is now of historical interest only.

5.14.2 *Right to elect UK domicile*

Lifetime election s.267ZA(1) IHTA	**Death election s.267ZA(2) IHTA**
A person [W, the non-dom donee] may, if condition A or B is met, elect	A person's personal representatives [W's PRs] may, if condition B is met, elect for the person [W]

[32] See App.13.3 (Section numbering system).

[33] I use the word "spouse" to include a civil partner.

[34] HMRC, "IHT: spouses and civil partners domiciled outside the UK" (2012) *http://webarchive.nationalarchives.gov.uk/20130102183002/http://www.hmrc.gov.uk/budget-updates/11dec12/784.pdf*

to be treated for the purposes of this Act as domiciled in the UK (and not elsewhere).	to be treated for the purposes of this Act as domiciled in the UK (and not elsewhere).

I coin the following terminology:

Term	**Meaning**
Election-domicile	IHT deemed-domicile under s.267ZA
Domicile election	Election under s.267ZA
Election conditions A & B	The conditions in s.267ZA

The point of making a domicile election is to qualify for the unrestricted IHT spouse exemption[35] and the GWR spouse exemption.[36] Election-domicile only applies for IHT, not for IT/CGT.

5.14.3 *Election conditions A & B*

Lifetime of W : Condition A **s.267ZA(3) IHTA**	***Death of W: Condition B*** **s.267ZA(4) IHTA**
Condition A is that,	Condition B is that
	[A] a person ("the deceased") [H, the donor] dies and,
at any time [a] on or after 6 April 2013 and [b] during the period of 7 years ending with the date on which the election is made,	[B] at any time [i] on or after 6 April 2013 and [ii] within the period of 7 years ending with the date of death,
the person [W, the non-dom donee] had a spouse or civil partner [H, the donor] who was	the deceased [H, the donor] was—
domiciled in the UK.	(a) domiciled in the UK, and
	(b) the spouse or civil partner of the person [W, the non-dom donee] who would, by virtue of the election, be treated as domiciled in the UK.

[35] See 93.2 (Restricted IHT spouse exemption for non-dom spouse).
[36] See 78.10 (GWR spouse exemption).

The election conditions are in short that H (the donor) is or was UK domiciled or deemed domiciled. But in practice W (the non-dom donee) or her PRs will only consider a domicile election if:

(1) H has made (or intends to make) a gift to W.
(2) The IHT spouse/GWR exemptions are not available because at the date of the gift:
    (a) H is UK domiciled or deemed-domiciled.
    (b) W is not UK domiciled or deemed-domiciled.
(3) The gift would or might otherwise give rise to IHT because:
    (a) It was chargeable gift, ie it was:
        (i) made on the death of H (the donor) or
        (ii) a failed PET (H has died within 7 years of the gift) or
        (iii) a failed PET is anticipated (H still living but may not survive 7 years) or
    (b) H would be chargeable on his death under the GWR rules.

In the following discussion, it is assumed that this is the case. These are the scenarios where the domicile election is important.[37]

5.14.4 *Lifetime/death election*

Section 267ZB(1) IHTA defines these terms:

> For the purposes of this section–
> (a) references to a lifetime election are to an election made by virtue of section 267ZA(3) [Condition A, election by W, the non-dom donee], and
> (b) references to a death election are to an election made by virtue of section 267ZA(4) [Condition B, election by W's PRs].

A *lifetime* election (s.267ZA(3)) is made by W so W must be alive at the time of the election. H (the donor) may be alive or dead at the time of a lifetime election.

A *death* election (s.267ZA(4)) is made by W's PRs, so W must have died at the time of a death election. H must also have died in order to make a death election. The term "PR's election" would have been better than "death election", but it is easier to stick to the statutory term as anything else is even more confusing.

Summarising in a table:

[37] See 93.2 (Restricted IHT spouse exemption).

W(non-dom donee)	H (donor)	Election	Which condition met
Alive	Alive	Lifetime election	A
Alive	Dead	Lifetime election	A
Dead	Alive	No election possible until H dies[38]	
Dead	Dead	Death election	B

5.14.5 *Conditions A/B: 7 year periods*

Election conditions A and B refer to distinct periods, thus:

Condition	Period
Condition A	7 years ending with date on which the election is made
Condition B	7 years ending with date of death of H (the donor)

I refer to these as the "**7-year periods**".

5.14.6 *Election-domicile start date*

It is necessary to distinguish:
(1) The date that the domicile election is *made*
(2) The date that the domicile election *takes effect*; this is earlier, and will be election-domicile start date.

The starting point is that W (the non-dom donee), or her PRs, can choose the date from which the domicile election takes effect. Section 267ZB(3) IHTA provides:

> A lifetime or death election is treated as having taken effect on a date specified, in accordance with subsection (4), in the notice.

Then s.267ZB(4) IHTA goes on to impose a number of restrictions on that freedom of choice. Firstly:

> (4) The date specified in a notice under subsection (3) must—
> (a) be 6 April 2013 or a later date

The earliest date that a domicile election can take effect is 6 April 2013. That is the effective commencement date of the election-domicile regime. That will not normally matter now, as pre-2013 PETs must have become exempt.[39]

[38] It does not seem logical that if W dies survived by H, no election can be made until H dies. Could it be that an election could be made under s.267ZA(3) by W's PRs?

[39] The issue could still arise where:
(1) H made a gift to W before 2013.

Section 267ZB IHTA continues:

> (4) The date specified in a notice under subsection (3) must ...
> (b) be within the period of 7 years ending with—
> (i) in the case of a lifetime election [condition A], the date on which the election is made, or
> (ii) in the case of a death election [condition B], the date of the deceased's death ...

In the case of a lifetime election the election must take effect (and election-domicile begins) within 7 years of the election.

If H (the donor) makes a gift to W (the non-dom donee), and the gift is a PET, there is a choice:

(1) W could elect immediately.
(2) W could wait and see. If H died (or was expected to die) then an election could be made later:
  (a) If H survived 7 years then an election would not be needed.[40]
  (b) If H died within the 7-year period, W could make an election after the death of H.

This allows W to consider the advantages and disadvantages of the election in the light of the circumstances at the time. For instance, if H survived more than 3 years from H's gift, then W's election decision could take into account IHT taper relief.

Section 267ZB IHTA provides:

> (4) The date specified in a notice under subsection (3) must—
> (c) meet the condition in subsection (5).

So we turn to s.267ZB(5) IHTA:

> The condition in this subsection is met by a date if, on the date—
> (a) in the case of a lifetime election—
> (i) the person making the election [W, the non-dom donee] was married to, or in a civil partnership with, the spouse or civil partner, and
> (ii) the spouse or civil partner was domiciled in the UK, or

(2) The gift was a gift with reservation of benefit.
(3) H dies and there is a charge under the GWR rules.

In practice that will not often happen (and if it does, the GWR may often be overlooked).

[40] Unless there is a GWR.

> (b) in the case of a death election—
> (i) the person who is, by virtue of the election, to be treated as domiciled in the UK [W, the non-dom donee) was married to, or in a civil partnership with, the deceased, and
> (ii) the deceased was domiciled in the UK.

In short, H (the donor) must be UK domiciled when the domicile election takes effect, but that does not matter as in practice the election is only wanted in those circumstances.

If H (the donor) has become UK domiciled, W may still make an election to cover an earlier period when H was non-UK domiciled.

The IHT Manual correctly provides:

> **IHTM13046: election by non-UK domiciled spouse or civil partner: the date the election takes effect** [Jan 2020]
> The person making the election does not need to be married or in a civil partnership when the election is made

Individuals who divorce may make an election to cover the period they were married.

5.14.7 *Election-domicile end date*

IHT deemed-domicile is advantageous from the point of view of allowing the unrestricted IHT spouse exemption; but of course it has the drawback that IHT may become due on the death of W (the non-dom donee) and on gifts and trusts made by her. How much that matters depends of course on the facts of the case. It may be a serious drawback; it may not. The point of the election is to allow W (the non-dom donee) to weigh the advantages and disadvantages.

Section 267ZB(9) IHTA provides:

> A lifetime or death election cannot be revoked.

There is one escape from election-domicile once an election is made: non-residence. Section 267ZB(10) IHTA provides:

> If a person who made an election under section 267ZA(1) [W, the non-dom donee] is not resident in the UK for the purposes of income tax for a period of four successive tax years beginning at any time after the election is made, the election ceases to have effect at the end of that period.

So the election-domicile end date is 5th April in the 4th non-resident year; four years non-residence effectively breaks the connection with the UK, and IHT liability then ceases for foreign situate assets.[41]

The IHT Manual provides:

> **IHTM13049: election by non-UK domiciled spouse or civil partner: election ceasing to have effect** [Jan 2020]
> ...This approach is in line with the position where a taxpayer is deemed domiciled in the UK under IHTA84/S267(1)(b). To shake off that deemed domicile, they need to be resident outside the UK for four years.

In fact the rules are not aligned. The election-domicile end date is 5th April in the 4th *successive* tax year of non-residence; under the 3 year rule, the deemed-domicile end date is at the end of the 4th year of non-residence. The requirement to lose s.267 deemed IHT domicile under the 15-year rule is to be non-resident for 4 tax years, but the non-resident years need not be successive and the deemed domicile end date is the start of the fourth year of non-residence.[42]

5.14.8 *Time limit for election*

There is no express time limit for a lifetime election. However since the election can only take effect within the 7-year period up to the election, there is an effective time limit of 7 years:

(1) from the date of the gift, in the case of a lifetime election
(2) from the date of the death of H (the donor) in the case of a death election.[43]

Section 267ZB(6) IHTA provides:

> A death election [by W's PRs] may only be made within 2 years of the death of the deceased [W][44] or such longer period as an officer of Revenue and Customs may in the particular case allow.

CIOT complained that the rule was not EU-law compliant, but the EC did not pursue the matter, and post-Brexit the point is not likely to arise.

[41] Assuming W (the non-dom donee) is not then deemed IHT domiciled under s.267 IHTA, or actually UK domiciled.

[42] See 5.6.2 (Domicile end date).

[43] See 5.14.3 (Spouse-election condition B).

[44] I think "the deceased" refers to W (the non-dom donee) and not to H (the donor) (though in the case of a death election, H has also died).

5.14.9 *Planning*

The IHT Manual provides some IHT planning advice:

> **IHTM13047 election by non-UK domiciled spouse or civil partner: consequences of making an election** [Jan 2020]
> When an election is made, the person making the election will be treated as domiciled in the UK for all IHT purposes from the date stated in the election. Consequently, any transfers between spouses or civil partners made after that date qualify for full spouse or civil partner exemption. Whether to make an election and the date it is take effect from will require careful consideration as it could mean that a transfer that did not give rise to a charge at the time is was made, proves to be chargeable.
> **Example** (David and Birgit) ("H" and "W")
> H, who is domiciled in the UK transfers property worth £1m in 2014 to his spouse, W who is not domiciled in the UK.
> Subsequently, in 2016, W transfers some German shares to the trustees of an offshore[45] trust.
> H dies in 2019.

The HMRC analysis is as follows:

> At the time of H's transfer, the value transferred is exempt to the extent of £325,000 and a PET to the extent of £675,000. Following his death, the failed PET is chargeable and after deducting the nil-rate band, £350,000 is subject to tax.[46]
> W's transfer was a transfer of excluded property, IHTA84/S6(1). Following H's death, W has the choice of electing to be treated as domiciled in the UK. If she does so, the gift from H in 2014 will become fully exempt as a transfer where both spouses are domiciled in the UK. However, W will then be treated as domiciled in the UK from 2014 for all IHT purposes. This means that her transfer to the trustees is no longer one of excluded property and will be subject to IHT. As a transfer to a trust, it will be immediately chargeable to tax.
> W will need to consider all the consequences of making an election...

W (or her advisers) will indeed have much to consider. Firstly, if she elects and falls within the scope of IHT, what will be the IHT on her

[45] Author's footnote: The residence of the trust is not relevant to the example.

[46] Author's footnote: It is assumed that H has not made earlier gifts which would reduce the IHT spouse exemption. Some taper relief is available as H survived 5 years from the date of the gift.

death? Will she be non-resident for 4 years, so as to lose election-domicile status?

The example assumes that W did not have to consider the position until the death of H in 2019. But if she is non-resident, she should consider the issue in 2014 when the gift was made. If she had made an election then, and was non-resident, her election-domicile would expire in 2018; by waiting until 2019, she extends the period during which she is at risk of IHT on her death.

In fact, if W is non-resident, she should consider the position before H makes the gift. If W had made the domicile election in 2013, then the gift made in 2016 would be exempt, and election-domicile would expire in 2017. Even if W is in good health, insurance against the risk of death would be cheaper if the election is made sooner rather than later.

5.14.10 *Procedure for making election*

Section 267ZB(2) IHTA provides:

> A lifetime or death election is to be made by notice in writing to HMRC.

There is no prescribed form. The IHT Manual provides:

> **IHTM13043: election by non-UK domiciled spouse or civil partner: how to make an election** [Jan 2020]
> An election must be made by notice in writing and sent to HMRC. It must be made by the person who is not domiciled in the UK. There is no prescribed form of election, but for HMRC to keep meaningful records it must contain:
> - the full name and address of the person making the election, or for whom the personal representatives are making an election,
> - their date of birth and, if appropriate, their date of death,
> - the full name of their spouse or civil partner who is domiciled in the UK, and
> - the date the election is to take effect from.
>
> If you receive an election that does not contain all of the information we need you should write to the sender, using standard letter SL16, to ask for the missing information. The election should be sent to:
> WMBC Assets Risk Team (Elections), Inheritance Tax, HM Revenue and Customs, BX9 1HT.

5.14.11 *IHT payment/return dates*

A retrospective election could mean that gifts and trusts made by W (the non-dom donee) become retrospectively chargeable. This requires some tinkering with the rules relating to time limits and interest. Section 267ZB IHTA provides:

> (7) Subsection (8) applies if—
> (a) a lifetime or death election is made,
> (b) a disposition is made, or another event occurs, during the period beginning with the time when the election is treated by virtue of subsection (3) as having taken effect and ending at the time when the election is made, and
> (c) the effect of the election being treated as having taken effect at that time is that the disposition or event gives rise to a transfer of value.
>
> (8) This Act applies with the following modifications in relation to the transfer of value—
> (a) subsections (1) and (6)(c) of section 216 [date for payment of IHT][47] have effect as if the period specified in subsection (6)(c) of that section were the period of 12 months from the end of the month in which the election is made, and
> (b) sections 226 and 233 [interest on unpaid tax] have effect as if the transfer were made at the time when the election is made.

5.14.12 *Informing PRs of election*

The IHT Manual provides:

> **IHTM13045: election by non-UK domiciled spouse or civil partner: disclosure about elections** [Jan 2020]
> If a person who has made an election has died, it is possible that their personal representatives may want to know whether or not a lifetime election had been made. This is because it could have a significant impact on the tax liability that arises following their death. If they cannot trace any information amongst the deceased's papers, they may phone the Helpline to find out if we have any record of an election.
> You may not disclose any information about the existence of an election over the phone. Instead, you should ask the executors to make their request in writing and provide evidence that they are the people entitled to apply for a grant of representation.
> If the executors can demonstrate that they are appointed by sending us a copy of the Will, you can disclose whether or not the person has made an election and the date that the election took effect. You can also disclose this information to administrators, provided they can

[47] See 125.5 (Reporting: Standard estate).

> demonstrate that they are applying for letters of administration, or that they are entitled to apply. You should refer any case of doubt to Technical.

5.14.13 *Election domicile: Critique*

I wonder if this was fully worked out at the time when the legislation was enacted. Probably not.[48]

Election-domicile was introduced in order to comply with EU law, and post-Brexit, there is much to be said for abolishing it: that would be a simplification.

5.15 Channel Islands/IoM Domicile

The law discussed in this section is of historical interest only, but there are territorial policy issues here which continue to resound.

Section 45(1)(c) FA 1975 formerly provided a person was deemed domiciled for IHT purposes if:

> *[i] he has, since 10th December 1974, become and has remained domiciled in the Islands*[49] *and,*
> *[ii] immediately before becoming domiciled there, he was domiciled in the UK.*

This was unlike other types of deemed domicile in that it would continue without limit of time.

The rule was repealed by s.12 F(no.2)A 1983:

> (1) Section 45(1)(c) of the FA 1975 (which treats certain persons who have become domiciled in the Channel Islands or in the Isle of Man as domiciled in the UK) shall cease to have effect.
> (2) This section has effect in relation to transfers of value made, and other events occurring, on or after 15th March 1983.

The repeal extends to the taxation (from 1983) of a settlement made by an

[48] One's confidence is slightly dented by s.267ZA(8) IHTA which provides:

> In determining for the purposes of this section whether a person making an election under this section is or was domiciled in the UK, section 267 is to be ignored.

This is otiose as the domicile of the person making the election (in my terminology, W, the non-dom donee) is not relevant. The provision made sense under the original Finance Bill clauses, but lost its purpose when the provisions were amended at committee stage.

[49] Section 45(3) FA 1975 provided: "In this section "the Islands" means the Channel Islands and the Isle of Man."

Islander who was deemed domiciled under the former s.45(1)(c): the former deemed domicile of the settlor is now disregarded so the trust property may now be excluded property.

John Moore (then Economic Secretary to the Treasury) explained the reason for the repeal:

> The original justification for the [deemed domicile] rule applying to emigrants to the offshore islands was that they were thought to provide particularly convenient bases for those who wished to maintain some contact with the mainland. Morever, at the time when the rule was introduced the islands were within the exchange control area. It was thus easier to shift property there than elsewhere abroad. The rule has been strongly resented in the islands as being discriminatory. The removal of exchange control restrictions has deprived one of the main arguments in support of the special rule of its force.[50]

Although not mentioned, I wonder if enforceability issues also affected the decision. EU-law compliance was probably not given consideration in 1983 as the issues only emerged subsequently.

5.16 International comparisons

Short summary descriptions of foreign tax laws are bound to mislead. Nevertheless the following quote is of interest as it illustrates how foreign jurisdictions have, unsurprisingly, also struggled with the policy issues underlying deemed domicile rules:

> Last year, Japanese inheritance tax rules were amended such that, where a foreign national had lived in Japan for 10 years (in the aggregate) out of the last 15, died outside of Japan, the foreigner national's heirs would be subject to Japanese inheritance tax on such foreign national's assets located both in Japan and elsewhere (a similar rule also applies for gift tax purposes).
>
> The above rule resulted in a situation where the heirs of a foreign national who had left Japan would potentially be subject to Japanese inheritance tax on the foreign national's worldwide assets for up to five years after such foreign national had left Japan. The fact that Japanese inheritance tax could "follow" a foreign national for up to five years after such person had left Japan caused great concern among Japan's

[50] Hansard HC Deb 14 July 1983 vol 45 cc1055-9, *https://hansard.parliament.uk/Commons/1983-07-14/debates/429c3b2a-86ac-44e2-9410-bcf3b71b3d7a/Domicile*

> expatriate community, and threatened to derail the Japanese government's efforts at attracting successful foreign talent to live and work in Japan.
> In this year's tax reform, the Japanese government indicates that it will abolish the above rule applying to foreign nationals, subject to a certain anti-avoidance countermeasures in the context of gift tax... This change to the inheritance tax provisions should aid Japan in its efforts to show Japan to be an attractive location for successful foreign executives to reside long term.

5.17 Deemed domicile mistakes

In (at least) two cases the Courts have set aside a gift to a trust overlooking the settlor's deemed domicile (and so based on a mistaken view of the IHT consequences).[51] Given the right facts, the case for setting aside the gift seems clear.

[51] *Hartogs v Sequent (Schweiz) AG* [2019] EWHC 1915 (Ch); *Abadir v Credit Suisse Trust* [2021] EWHC 2573 (Ch). See too 4.27 (Domicile mistakes).

CHAPTER SIX

RESIDENCE OF INDIVIDUALS

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Cross references

The following topics are considered elsewhere:
App 10.1 (Parliamentarians)

6.1 Concepts of residence

This main topic of this chapter is the definition of residence of individuals for UK tax. This is known as the statutory residence test (**"SRT"**).[1]

I also discuss the definition of Scottish/Welsh taxpayers.

It aids clarity of thought to distinguish between:

(1) A person's *residence for tax purposes*, which is a status, and requires a nexus between a person and a territory; and

(2) A person's residence in the sense of *home* or *dwelling*, which is an item of property, and requires a nexus between a person and that property[2]

I use the terms *tax-residence* (or territory-residence) and *private residence* (or dwelling/residential property). Both terms should be seen in the context of a cluster of synonyms and related concepts:

Concepts of territory-residence:

Concept	***Relevant for***	***See para***
Tax-residence:	Most taxes	
for individuals (SRT)		*See this chapter*
for trusts		7.1
for companies		8.1
Treaty-residence	DTAs	9.1
Jurisdiction-residence[3]	Situs/private international law	102.14.2
Domicile-residence	Domicile	4.6
Ordinary residence	NICs and others	6.38.3
Habitual residence	International law	46.12.6
Habitual abode in state	Treaty-residence	9.14
Usual place of abode outside UK	Withholding tax	26.11

[1] This is the statutory term. Para 1(2) sch 45 FA 2013 provides: The rules are referred to collectively as "the statutory residence test".

[2] Though of course there is some overlap, as the location of a private residence is relevant to territory-residence.

[3] One might perhaps use the term "common-law residence" to describe what I refer to as jurisdiction-residence and domicile-residence.

Usual place of residence in country	VAT	26.22.5
Normally lives/lived in country	Employment-related loan	40.5.1
Permanent home in state	Double Tax Treaties	9.12
Place to live in UK	Accommodation tie	6.29.1
Place of residence in UK	Scottish/Welsh taxpayer	6.43.5
SDLT residence test	SDLT non-resident surcharge	98.43
CRS-residence	CRS	130.31
MLR-residence	Trust registration (TRS)	131.4.2

Concepts similar to private residence:

Concept	***Relevant for***	***See para***
[Private] residence	CGT private residence relief	59.2
Dwelling/Residential property	CGT/SDLT/ATED/IHT	App 2.22
Living accommodation	Accommodation tie/benefits in kind	6.29.1; 39.8
Home	Many purposes	6.20
Usual residential address	TRS	131.23.2

Tax law is not economical with its concepts; or at least, with its terminology, because different words do not necessarily entail different concepts. Such is the patchwork nature of taxation.

Generally a person is tax-resident (or not) for all tax purposes, but occasionally a person may be tax-resident for some purpose but not for others.[4]

The question may also arise which of two competing territories is the chief territory-residence; and which of two competing private residences is the main private residence.[5]

6.2 History and guidance

HMRC guidance is in the RDRM.[6]

For completeness there are also:

(1) RDR3[7] (post-2019 version): this is now short, entry-level guidance.

[4] See 56.6.4 (CGT/CT charge: UK residents).

[5] See 4.11.3 (Which is chief residence); 59.7 (Which is main residence).

[6] Historical note: From 2013-2019, HMRC guidance was in RDR3. The text moved to the RDRM in 2019. I discussed this change in earlier editions, but omit that now as it is of historical interest only.

[7] HMRC, "RDR3: Statutory Residence Test (SRT) notes" *https://www.gov.uk/government/publications/rdr3-statutory-residence-test-srt/guidance-note-for-statutory-residence-test-srt-rdr3*

(2) A general guide (RDR1)[8] covering residence and domicile and their tax implications. In any attempt to address these vast topics in 88 pages, oversimplification and omission is inevitable. RDR1 is entry-level guidance, aimed at the non-professional reader.[9]
(2) An online Tax Residence Indicator.[10] I suspect that this is also aimed at the non-professional user and practitioners will not usually find it useful.

The development of the SRT can be traced through 3 HMRC papers:
(1) Consultation paper[11]
(2) Response to consultation[12]
(3) A further response paper[13]

These are now of historical interest only.

6.3 Scope of SRT

Para 1 sch 45 FA 2013 provides:

> (1) This Part of this Schedule sets out the rules for determining for the purposes of relevant tax whether individuals are resident or not resident in the UK....
> (4) "Relevant tax" means-

[8] HMRC "Guidance Note: Residence, Domicile and the Remittance Basis" *https://www.gov.uk/government/publications/residence-domicile-and-remittance-basis-rules-uk-tax-liability*

[9] Gordon gave this a poor review in *Taxation Magazine*, 24 October 2013, p.5: "The new RDR1 goes so far out of its way to avoid making any promises that a taxpayer could rely on, that it puts caveats on propositions that are actually provided for by the statute. ... RDR1 will be an inadequate guide for anyone wishing to determine their residence status, whereas anyone who does rely on it will risk being misled."

[10] *https://www.gov.uk/government/collections/hmrc-calculators-and-tools*

[11] HM Treasury/HMRC, "Statutory Definition of Tax Residence" (2011) *http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81588/consult_condoc_statutory_residence.pdf*

[12] HM Treasury/HMRC, "Statutory definition of tax residence and reform of ordinary residence: a summary of responses" (2012) *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_srt_or_summary.pdf*

[13] HM Treasury, "Statutory definition of tax residence and reform of ordinary residence: summary of responses to the June 2012 consultation" (2012) *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/consult_responses_statutory_definitions_of_tax_residence_reform_of_ordinary_residence_responses.pdf*

(a) income tax,
(b) capital gains tax, and
(c) (so far as the residence status of individuals is relevant to them) inheritance tax and corporation tax.

In para (c), the words in brackets are not strictly needed, but they recognise the fact that (unlike IT/CGT) the residence of individuals is less important to IHT/CT. However, there are circumstances where the residence status of an individual is relevant to IHT; the most important is deemed domicile. But are there any circumstances where the residence status of an individual is relevant to CT? I cannot think of any.

The SRT does not apply for VAT[14] or NIC[15].

Para 1(3) sch 45 FA 2013 provides:

> The rules do not apply in determining for the purposes of relevant tax whether individuals are resident or not resident in England, Wales, Scotland or Northern Ireland specifically (rather than in the UK as a whole).

But it is a very rare case where that matters.

The SRT does not apply in determining whether an individual is resident in a foreign state, but that does not often matter for UK tax.[16]

In cases where the SRT does not apply, the common law residence test still applies,[17] but I expect that the SRT will be influential. That would be

[14] See 26.22.5 (Usual place of residence).

[15] See 46.12 (Residence and ordinary residence).

[16] Cases where residence in a foreign state is relevant for UK tax include:

Topic	**Definition of residence**	**See para**
DTA	Treaty-residence	9.3
Private residence relief	Mix of OECD Model/SRT	59.4
CI/IoM resident personal allowance	No definition	44.7.3
Offshore Receipts for IP	Based on OECD Model	32.8.1
Hybrid entities	Foreign tax/general sense	91.24.2

[17] See chapter 3 of the 2012/13 edition of this work. The pre-2013 law was hopelessly uncertain, and following changes of HMRC practice leading up to *Gaines Cooper*, it generated more litigation than any other topic. So cases on pre-2013 residence continue to roll in.

Residence needs to be reviewed in the light of: *Yates v HMRC* [2012] UKFTT 568 (TC); *Rumbelow v HMRC* [2013] UKFTT 637; *Daniel v HMRC* [2014] UKFTT 173; *Healey v HMRC* [2014] UKFTT 889 (TC); *Glyn v HMRC* [2015] UKUT 551 (TCC) and [2018] TC 06452; *Peck v HMRC* [2017] UKFTT 770 (TC); *Charman v HMRC* [2018] UKFTT 765; *McCabe v HMRC* [2022] UKFTT 356 (TC) *Hargreaves v* sensible since the SRT "broadly recreates the outcome" of the pre-2013 residence rules".[18] The fewer residence tests we have the better.

Para 2(1) sch 45 FA 2013 dots *I'*s and crosses *T'*s:

> In enactments relating to relevant tax, a reference to being resident (or not resident) in the UK is, in the case of individuals, a reference to being resident (or not resident) in the UK in accordance with the statutory residence test.

6.3.1 *SRT: Application to trustees/PRs*

The SRT only applies to individuals: there are distinct definitions of residence for trustees, PRs, and companies.

Para 145 sch 45 FA 2013 provides an non-standard definition of individual:

> In this Schedule ... "individual" means an individual acting in any capacity (including as trustee or personal representative)

Para 2(2) sch 45 FA 2013 makes a similar point; it needs to be read with para 2(1) to follow the sense:

> (1) In enactments relating to relevant tax, a reference to being resident (or not resident) in the UK is, in the case of individuals, a reference to being resident (or not resident) in the UK in accordance with the statutory residence test.
> (2) Sub-paragraph (1) applies even if the reference relates to the tax liability of an actual or deemed person who is not an individual (for example, where the liability of another person depends on the residence status of an individual).

I think the point is that where an individual is trustee or PR, the residence of the PRs or trustees depends (at least in part) on the residence of the individual in their private capacity; and for that purpose the SRT applies.

HMRC [2019] UKFTT 244 (TC) considers carelessness, established practice, and assessment time limits in the context of residence.

Australia follows pre-2013 UK tax-residence case law, and also generates much litigation: *Dempsey v CT* [2014] AATA 335; *Shord v CT* [2015] AATA 355; Board of Taxation, *Review of the IT Residency Rules for Individuals* (2017) para 1.48 *https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2018/07/T307956-income-tax-res-rules.pdf*

[18] See 6.38.1 (SRT/pre-2013 law compared).

6.4 Outline of SRT

Sch 45 FA 2013 provides:

> 3 An individual ("P")[19] is resident in the UK for a tax year ("year X") if–
> (a) the automatic residence test is met for that year, or
> (b) the sufficient ties test is met for that year.
> 4 If neither of those tests is met for that year, P is not resident in the UK for that year.

This suggests a two-stage test, but it is better to regard the SRT as having three stages:

1. Automatic overseas tests: First are 5 overseas tests; if one of these tests are met the individual is not UK resident:

No.	Requirement in outline	See para
1	Less than 16 UK days	6.6
2	3 years non-residence and less than 46 UK days	6.7
3	Overseas work	6.8
4	Death in year; 2 years non-residence & less than 46 UK days	6.33.2
5	Death in year; overseas work	6.33.3

2. "Automatic" UK tests: Subject to that, there are four UK tests, if one these tests are met the individual is UK resident:

No.	Requirement in outline	See para
1	183 UK days	6.10
2	UK home	6.11
3	UK work	6.13
4	Death in year; UK home	6.33.4

3. Sufficient ties test: Then comes the sufficient ties test, with 4 or 5 connecting ties. If the individual has sufficient UK ties (the number depending on the number of UK days) the individual is UK resident, and otherwise, not UK resident. The possible ties are:

Tie	See para
Family tie	6.28
Accommodation tie	6.29
Work tie	6.30
90-day tie	6.31
Country tie	6.32

[19] "P" stands for "person".

6.5 Automatic overseas tests

Sch 45 FA 2013 first sets out the "automatic" UK tests in paras 6-10, and then the automatic overseas tests in paras 12-16. I consider the overseas tests first as if they apply, they have priority over the UK test. An overseas test trumps an "automatic" UK test and leads to a conclusion of non-residence.

Para 11 sch 45 FA 2013 provides:

> There are 5 automatic overseas tests.

I refer to these as **"overseas tests 1-5"**.

6.6 Overseas test 1: < 16 UK days

Para 12 sch 45 FA 2013 provides:

> The first automatic overseas test is that–
> (a) P was resident in the UK for one or more of the 3 tax years preceding year X,
> (b) the number of days in year X that P spends in the UK is less than 16, and
> (c) P does not die in year X.

If condition (a) is not met (ie P was non resident for the 3 preceding years) then one moves on to the (more generous) overseas test 2.

If condition (c) is not met (ie P dies in year X) then one moves on to overseas tests 4 and 5.

6.7 Overseas test 2: 3 years non-resident

Para 13 sch 45 FA 2013 provides:

> The second automatic overseas test is that–
> (a) P was resident in the UK for none of the 3 tax years preceding year X, and
> (b) the number of days that P spends in the UK in year X is less than 46.

This applies even if P dies in the year.

6.7.1 *Newborn child*

A child born on or after 20 February (21 February in a leap year) is non-UK resident for that year! They will not have been resident in any previous year and will not spend 46 days or more in the UK in that year.

The same can apply to a child born before that date, if they spend some days out of the UK.

Or does one count days spent *in utero*?

6.8 Overseas test 3: Overseas work

6.8.1 *Introduction & terminology*

This test is complicated. Para 14(1) sch 45 FA 2013 provides:

> The third automatic overseas test is that—

A set of 4 conditions then follow: I refer to **"overseas work conditions (a) to (d)"**.

> (a) P works sufficient hours overseas, as assessed over year X,
> (b) during year X, there are no significant breaks from overseas work,
> (c) the number of days in year X on which P does more than 3 hours' work in the UK is less than 31, and
> (d) the number of days in year X falling within sub-paragraph (2) is less than 91.

I refer to days within (c) as **"UK workdays"** and days within (d) as **"UK days".**

For a comparison with UK test 3 (UK work) see 6.13.8 (UK/foreign work tests compared).

6.8.2 *(a): Sufficient hours overseas*

Para 14(1) sch 45 FA 2013 requires:

> (a) P works sufficient hours overseas, as assessed over year X.

This takes us to para 14(3) sch 45 FA 2013, which provides:

> Take the following steps to work out whether P works "sufficient hours overseas" as assessed over year X—
> *Step 1 [disregard UK workdays]*
> Identify any days in year X on which P does more than 3 hours' work in the UK, including ones on which P also does work overseas on the same day.
> The days so identified are referred to as "disregarded days".

It may be more helpful to use the term **"disregarded UK workdays"**.

> *Step 2 [net overseas hours]*
> Add up (for all employments held and trades carried on by P)

> [a] the total number of hours that P works overseas in year X, but
> [b] ignoring any hours that P works overseas on disregarded days [UK workdays].
>
> The result is referred to as P's "net overseas hours".
>
> *Step 3 [reference-period days]*
> Subtract from 365 (or 366 if year X includes 29 February)—
> (a) the total number of disregarded days [UK workdays], and
> (b) any days that are allowed to be subtracted, in accordance with the rules in paragraph 28 of this Schedule, to take account of periods of leave and gaps between employments.[20]
>
> The result is referred to as the "reference period".

Armed with the figures from steps 2 and 3, we proceed to the computation. This is set out in the remaining two steps:

> *Step 4 [reference-period weeks]*
> Divide the reference period by 7. If the answer is more than 1 and is not a whole number, round down to the nearest whole number. If the answer is less than 1, round up to 1.

Division by 7 (rounded down) yields the number of full weeks in the reference period. If there are no disregarded days or other deductions, then the computation is 365 (or 366) ÷ 7 = 52 (rounded down).

One might question whether rounding is appropriate at this preliminary stage; though in this case rounding down slightly helps the taxpayer. It does not matter much.

> *Step 5 [compute net overseas hours ÷ no. of reference-period weeks]*
> Divide P's net overseas hours by the number resulting from step 4.
> If the answer is 35 or more, P is considered to work "sufficient hours overseas" as assessed over year X.

The computation set out in steps 4 and 5 might have been more clearly expressed algebraically; but the drafter of the SRT was somewhat algebraphobic.

The RDRM provides two examples:

> **RDRM11180: Annual and parenting leave** [Aug 2019]
> Example (Anne)
> A is working overseas, and has had a period of maternity leave, she is considering her UK residence status. She finds she needs to consider

[20] See 6.24 (Reference period: non-work days).

whether she has worked sufficient hours overseas in the tax year, to be treated as working full-time overseas for the purposes of the third automatic overseas test.

Step 1: A has no disregarded days [UK workdays]

Step 2: A has no sickness absences or gaps between employments. Her normal pattern of employment is for 7 hours 40 minutes, Monday to Friday. During the year she:

- worked as normal between 6 April and 2 June
- started her maternity leave on 3 June, returning to work after 26 weeks, on 2 December
- worked from 2 December to 20 December
- took annual leave across the Christmas period from Monday, 23 December through to Wednesday 1 January, returning to work on 2 January
- worked as usual through from 2 January to 5 April; taking 5 days leave from Monday 3 February to Friday 7 February, and another 3 days leave from Thursday 13 March to Monday 17 March (dates are inclusive).

A calculates her net overseas hours (Step 2)

between 6 April and 2 June, she worked on 38 days, (there were 2 bank holidays in this period)

- between 2 December and 20 December she worked on 15 days
- between 2 January and 5 April she worked on 59 days
- total days worked = 38 + 15 + 59 = 112
- on each day she worked for 7 hours 40 minutes, therefore her total net overseas hours = 112 × 7 hours 40 minutes = 858 hours and 40 minutes

Step 3: To calculate her reference period A starts with 365 days and subtracts:

- maternity leave, including embedded weekends from Monday 3 June, to Friday 29 November = 180 days, (30 November and 1 December do not meet the rules about embedded non-working days)
- annual leave on 23, 24, 27, 30 and 31 January, 3-7 February and 13, 14 and 17 March = 13 days

As 25 and 26 December and 1 January and all the weekend dates are non-working days that do not meet the rules about embedded non-working days, A makes no adjustment for them.

A calculates her reference period:

= 365-180-13 = 172 days

Step 4: Divide number from Step 3 by 7 = 172/7 = 25.47 (rounded down to 25)

Step 5: Divide net overseas hours by result from Step 4 = 858 hours and

40 minutes/24 = 35.78
A meets the sufficient hours test. She will need to consider whether she meets all other parts of the third automatic overseas test, in particular that the number of days spent in the UK was less than 91.

RDRM11160: Gaps between employments [Aug 2019]
Example 2 (MayLing)
ML is considering whether she meets the third automatic overseas test in respect of her work in Italy in the previous tax year. She worked for her first employer there for an average of 8 hours a day, 5 days per week, between 6 April and 23 August (20 weeks). During that period she took 9 days annual leave, (there were no embedded non-working days); consequently ML had worked for 18 full weeks and only 1 day in another week. She ceased that employment and took a break of 30 days to tour round Italy.
She then took up a new employment, again in Italy, between 23 September and 5 April (27 weeks and 6 days - amounting to 28 working weeks). During that period she worked for 9 hours and 30 minutes from Monday to Thursday, and for 4 hours on a Friday. She took:

- 5 days of annual leave; for 3 weeks she only worked 3 long days and a short day, and for 1 week she worked 2 long days and a short day, thereby reducing her number of full working weeks by 5 weeks
- 10 days of annual leave, with 2 embedded non-working days, (the Saturday and Sunday in the middle of this 2 week period), reducing her number of full working days by 2
- 5 days continuous sick leave, (with no embedded non-working days), reducing her number of full working weeks by 1

She therefore worked for only 20 full working weeks in this part of the year. ML spends no time in the UK in the tax year.
Step 1
ML has no disregarded days
Step 2 Net overseas hours
Employer 1: 18 weeks and 1 day at (5 days × 8 hours) = 728 hours
Employer 2: 20 weeks at (4 days × 9.5 hours) + 4 hours) = 840 hours
3 weeks at (3 days × 9.5 hours) + 4 hours) = 97.5 hours
1 week at (2 days × 9.5 hours) + 4 hours) = 23 hours
Total net overseas hours: = 728 + 840 + 867.5 + 23 = 1688.5 hours
Step 3 Reference period:

subtract from	365 days
disregarded days	0 days

Other days that can be deducted:
9 days leave Employer 1
15 days leave Employer 2

2 embedded days
5 days sick = 9 + 15 + 2 + 5 = 31 days
Gaps between employments 15 days (total gap 30 days but the amount deducted is limited to 15 days)
Reference period is: 365-31-15 = 319 days
Step 4
Divide reference period by 7: = 319/7 = 45.57 (rounded down to 45)
Step 5
Divide net overseas hours by figure at Step 4
= 1688.5/45 = 37.52
ML meets the sufficient hours test. She will need to consider whether she meets all other parts of the third automatic test.

6.8.3 *Sufficient hours: Planning*

Peter Ashby has done the maths:

> The good news here is that you exclude from the days that qualify sick days and paternity or maternity leave. You also exclude holidays – which is fair enough as you don't work any hours then. But you do not exclude weekends (or more correctly non-working days because these include public holidays – and for shift workers it may not be the weekend that is a non-working day) unless they are 'embedded' in a holiday. So one week of holiday excludes five days and a two-week holiday means 12 days are excluded – unless you start your holiday midweek because you need at least three days before and after the weekend to qualify that weekend. As you divide the denominator by seven to calculate a weekly amount, you do lose out by including these 'non-qualifying embedded days'. The answer of course is to work longer hours. If you can!
> Say I usually work 37 hours per week and take three two-week holidays, the average hours would be:
>
> $$\frac{37 \times (52-6)}{(365 - (3\times12))/7} = 36.2 \text{ hours}$$
>
> If you work 40 hours a week it will probably make no difference. If you work 36 hours a week you may be borderline and fail. If you work 35 hours a week you will almost certainly not get [sufficient hours overseas] without doing some overtime.
> I suppose it does at least encourage a work mentality so [foreign] employers may be happy with this![21]

[21] Ashby, "Employees working abroad" [2013] Tax Adviser 38.

The minutes of the Joint Forum on Expatriate Tax and NICs provide:

> **Sufficient hours – interaction with significant breaks**
> **Question:** Can a non-working period of up to 31 days (i.e. a lesser period than a significant break) preceding or following a period of full-time work can be included as part of that period (assuming that the 35 hours test is met)?
> **HMRC Answer:** Provided the FTW test is met over the period by the calculations that are set out, it does not matter if there is a non-working period of up to 31 days at the start or end of the period. An individual would need to work significantly more than 35hrs a week in order to do enjoy periods off from work (which were not annual, sick or parenting leave) and still meet the FTW tests.[22]

6.8.4 *(b): No significant break*

Para 14(1) sch 45 FA 2013 requires:

> (b) during year X, there are no significant breaks from overseas work

See 6.25 ("Significant break from work").

6.8.5 *(c): Less than 31 UK workdays*

Para 14(1) sch 45 FA 2013 requires:

> (c) the number of days in year X on which P does more than 3 hours' work in the UK is less than 31

I refer to these days as UK workdays.

6.8.6 *(d): Less than 91 UK days*

Para 14(1) sch 45 FA 2013 requires:

> (d) the number of days in year X falling within sub-paragraph (2) is less than 91.
> (2) A day falls within this sub-paragraph if—
> (a) it is a day spent by P in the UK, but
> (b) it is not a day that is treated under paragraph 23(4) as a day spent by P in the UK.

Para 2(b) excludes the deeming rule (frequent visits) in computing days

[22] 29 January 2014 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/302475/140326_Expats_Forum_Jan_14_Minutes_FINAL.pdf*

spent in the UK.[23] Why?

6.9 "Automatic" UK tests

Sch 45 FA 2013 provides:

> 5 The automatic residence test is met for year X if P meets–
> (a) at least one of the automatic UK tests, and
> (b) none of the automatic overseas tests.
> 6 There are 4 automatic UK tests.

I refer to these as **"UK tests 1-4"**. "Automatic" residence tests is not a particularly apt label for this set of tests; I add scare quotation marks.

6.10 UK test 1: 183 UK days

Para 7 sch 45 FA 2013 provides:

> The first automatic UK test is that P spends at least 183 days in the UK in year X.

The figure 183 is one day more than half a year.

6.11 UK test 2: UK home

6.11.1 *Introduction*

This test is complicated. Para 8(1) sch 45 FA 2013 provides:

> The second automatic UK test is that–
> (a) P has a home in the UK during all or part of year X,
> (b) that home is one where P spends a sufficient amount of time in year X, and
> (c) there is at least one period of 91 (consecutive) days in respect of which the following conditions are met—
> (i) the 91-day period in question occurs while P has that home [the UK home],
> (ii) at least 30 days of that 91-day period fall within year X, and
> (iii) throughout that 91-day period, condition A or condition B is met or a combination of those conditions is met.

I refer to these 3 paragraphs as **"UK-home limbs (a) to (c)"**.

6.11.2 *UK home: Limb (a)*

Para 8(1) sch 45 FA 2013 requires:

[23] See 6.19 (Deeming rule (frequent visits)).

> (a) P has a home in the UK during all or part of year X

See 6.20 ("Home").

6.11.3 *30 days in UK home: Limb (b)*

Para 8(1) sch 45 FA 2013 requires:

> (b) that home [the UK home] is one where P spends a sufficient amount of time in year X

Para 8(4) sch 45 FA 2013 provides:

> In relation to a home of P's in the UK, P "spends a sufficient amount of time" there in year X if there are at least 30[24] days in year X when P is present there on that day for at least some of the time (no matter how short a time).

The test for limb (b) is the number of days spent in the home *in year X*, not in the Test Window (which is different).

6.11.4 *"Present at the home"*

Para 8(6)(b) sch 45 FA 2013 provides:

> In sub-paragraphs (4) and (5)...
>
> (b) a reference to P being present at the home is to P being present there at a time when it is a home of P's (so presence there on any other occasion, for example to look round the property with a view to buying it, is to be disregarded).

Thus "present at the home" means present at a time when the property is a home. It is not necessary to be present at midnight (unlike the days spent test).

6.11.5 *More than one UK home*

Para 8(8) sch 45 FA 2013 provides:

> If P has more than one home in the UK—
>
> (a) each of those homes must be looked at separately to see if the second automatic UK test is met, and

[24] Para 8(6)(a) sch 45 FA 2013 explains how to count to 30: "In sub-paragraphs (4) and (5)—
(a) a reference to 30 days is to 30 days in aggregate, whether the days are consecutive or intermittent".

> (b) the second automatic UK test is then met so long as it is met in relation to at least one of those homes.

Time spent at one home is not aggregated with time spent at another home, in assessing limb (b).

The RDRM provides a straightforward example:

> **RDRM11360: 30 day presence rule** [Aug 2019]
> Example (Fatima)
> F has had 4 UK homes for several years, in the tax year under consideration, F is present in her home in Swansea on 15 days, 20 days in her home in Callander, 29 in her London apartment and 29 in her Newcastle apartment.
> F has been present on 92 days in total in those UK homes. However, as she was not present in any individual home on at least 30 days, she will not have spent a sufficient amount of time in any single UK home. She will not meet the second automatic UK test for the tax year under consideration.

This example is straightforward: UK-home limb (b) is not met.

At first sight F's peripatetic lifestyle seems somewhat implausible; but perhaps F acted on tax advice on how to avoid the UK home test.

6.11.6 *91 day Test Window: Limb (c)*

Para 8(1) sch 45 FA 2013 requires:

> (c) there is at least one period of 91[25] (consecutive) days in respect of which the following conditions are met—
> (i) the 91-day period in question occurs while P has that home,
> (ii) at least 30 days of that 91-day period fall within year X, and
> (iii) throughout that 91-day period, condition A or condition B is met or a combination of those conditions is met.

It is limb (c) which makes the UK home test complicated.

Limb (c) is in fact a set of requirements, which I call **"conditions (c)(i)**, **(c)(ii)**, and **(c)(iii)A** and **C(iii)B"**.

I refer to the 91-day (= 13 weeks) period in limb (c) as the **"Test Window"**. As 30 days of the Test Window must fall within a tax year:

[25] Para 8(7) sch 45 FA 2013 explains that numbers do not stop at 91: " Sub-paragraph (1)(c) is satisfied so long as there is a period of 91 days in respect of which the conditions described there are met, even if those conditions are in fact met for longer than that."

- the Test Window must begin no earlier than 61 days before the tax year starts (ie 4 February[26])
- the Test Window must end no later than 61 days after the tax year ends (ie 5 June)

For any tax year, there are altogether 426 possible Test Windows:

- The first is 4 Feb[27] - 5 May (inclusive) starting in the previous tax year
- The next is 5 Feb[28] - 6 May (inclusive)
- The list of Test Windows continues from day to day until:
- The last Test Window is 4 Mar-2 June (inclusive) ending in the next tax year

6.11.7 *Overseas home conditions A & B*

Para 8(2) sch 45 FA 2013 provides:

> Condition A is that P has no home overseas.

Condition B is that P has a home but does not use it enough. Para 8(3) sch 45 FA 2013 provides:

> Condition B is that—
> (a) P has one or more homes overseas, but
> (b) each of those homes is a home where P spends no more than a permitted amount of time in year X.

Para 8(5) sch 45 FA 2013 provides:

> In relation to a home of P's overseas, P "spends no more than a permitted amount of time" there in year X if there are fewer than 30 days in year X when P is present there on that day for at least some of the time (no matter how short a time).

The test for Overseas Home Condition B is the number of days spent in the home *in year X*, not in the Test Window (which is different).

The requirement is that throughout the 91-day Test Window, condition A or condition B is met or a combination of those conditions is met. Conditions A and B cannot be met at the same time, but it is possible that first one condition is met, and then the other.

If P has a UK home, P must spend at least 30 days in year X in P's

[26] 5 February if the February is in a leap year.
[27] 5 February if the February is in a leap year.
[28] 6 February if the February is in a leap year.

overseas home. However, there is no requirement for P to have the overseas home during the whole of the 91-day Test Window, provided there is at least 1 day in the Test Window when P does have an overseas home.

If P's overseas home ceases to be P's home (eg it is sold) the requirements of UK test 2 will still not be met provided P acquires another overseas home within 90 days of the disposal of the previous home, and P is present in either the old overseas home or the new one for 30 days in year X.

6.12 UK test 2: Examples

The RDRM provides some examples of UK test 2 (UK home).

6.12.1 *Acquiring UK home*

The first example is straightforward: an individual ceases to have an overseas home and acquires a UK home. The facts (stripping out irrelevancies) are as follows:[29]

> **Example 1**
> S ceases to have an overseas home on 10 January 2014.
> S acquires a UK home on 1 February 2014 and remains there for a year.

The HMRC analysis is as follows:

> In 2013-14 S has a home in the UK ... and is present in it on at least 30 days.

Thus UK-home limbs (a) and (b) are met.

> Also from 1 February 2014 there is a period of 91 consecutive days at least 30 of which fell in 2013-14 (the tax year under consideration)

[29] The example in full (including its irrelevant detail) is as follows:
RDRM11340: Time spent in the UK home [Nov 2019]
Example 1 (Stan)
S has lived in Australia all his life. In June 2012 he takes a holiday in London and likes it so much he decides to immigrate to the UK. He spends the next few months preparing for the move. He sells his Australian house (his only home), on 10 January 2014, and arrives in the UK on 25 January 2014. He finds a flat in London and moves in on 1 February 2014. The London flat is now his only home and he lives there for a year.
During the 2013-2014 tax year S is present in his Australian home on 250 days, and he is present in his London flat on 55 days.

> when S has a UK home and no overseas home.

Thus UK-home limb (c) is met. The Test Window is 1 February - 3 May 2014. UK-home limb (c)(iii)A is met.

> As S does not meet any of the automatic overseas tests, he is resident under the second automatic UK test for tax year 2013-14.

There are several points to note from this example:

(1) The Test Window extends well into 2014/15, so S does not know on 6 April 2014 whether he was resident in 2013/14. If he had left, or died, before 3 May 2014, he would not have been UK resident.

(2) S is UK resident in 2013-14 even though he is present in his overseas home on 250 days, and present in his UK home on only 55 days. But split year relief (Case 8) may apply and DT relief should be available for the period when S was treaty-resident overseas.

(3) A little planning would avoid UK residence. For instance, if S kept his overseas home until 7 March, rather than selling or letting it on 10 January, he would not be UK resident.

6.12.2 *Acquiring overseas home*

The next example is an individual who acquires an overseas home and retains a UK home:

> **RDRM11340: Time spent in the UK home** [Nov 2019]
> Example 2 (Jane)
> J has a home in the UK throughout the tax years 2013-2014 and 2014-2015. She is present in that home on more than 30 days during the 2013-2014 tax year.

Thus UK-home limbs (a) and (b) are met.

> J acquires a home overseas on 1 March 2019 and is present there on 30 days in the 2013-2014 tax year.

The HMRC analysis is as follows:

> Although there is a period of 91 consecutive days, 30 of which fall in 2013-2014, (the tax year under consideration), when J had both a UK home and an overseas home; there is also a period of at least 91 consecutive days, (6 April 2013 to 28 February 2014), when she had a UK home, (in which she spent sufficient time in 2013-2014), but no overseas home.

The Test Window is 6 April - 28 February 2014. UK-home limb (c)(iii)A is met.

> J is therefore resident in the UK for 2013-2014 under the second automatic UK test.

6.12.3 *No overseas home*

The next example is an individual who retains a UK home and does not acquire an overseas home:

> Example 3 (Edith)
> E has had a home in Cheshire for many years. It is her only home. E retires towards the end of 2014-2015 tax year, and decides to use her retirement lump sum to see the world.
> During the 2015-2016 tax year she takes 3 long holidays, visiting 22 different countries. She moves around and does not establish a home overseas. She keeps her Cheshire home throughout, returning briefly between trips, and is present there on 41 days in the 2015-2016 tax year.

The HMRC analysis is as follows:

> In 2015-2016 E has a home in the UK in which she is present on at least 30 days in the tax year.

Thus UK-home limbs (a) and (b) are met.

> During the year E has no overseas home.

Thus UK-home limb (c) is met. The Test Window is the whole of 2015/16. UK-home limb (c)(iii)A is met.

> E does not meet any of the automatic overseas tests, and therefore she is resident under the second automatic UK test for the 2015-2016 tax year.

This is straightforward.

6.12.4 *Losing overseas home*

Next, an example of passing the UK home test by renting out an overseas home.

> Example 4 (Berni)
> At 6 April 2014 B considers whether she meets the second automatic UK test for 2013-2014:
>
> - she bought a home in the UK on 1 January 2013 - it was her only home throughout 2013-2014
> - she was present in that home on at least 30 days in the tax year 2013-2014

> - she came to the UK on 10 April 2013 and rented out her overseas home, (which she had owned for many years), from 11 April 2014 to 10 March 2014
>
> Therefore, during 2013-2014 there was a period of 91 days, 30 of which fell in the tax year during which B had a home in the UK in which she was present for a sufficient amount of time, and had no overseas home. As B did not meet any of the automatic overseas tests she is resident under the second automatic UK test.
>
> If there is any uncertainty over whether a property constitutes a home RDRM13020 gives further details.
>
> In certain circumstances a home can cease to be a home temporarily, which may have a bearing on whether an individual meets the second automatic UK test.

Thus UK-home limbs (a) and (b) and (c)(iii)A are met.

If B had not let out the overseas home, and had been present there sufficient days, she would not have been resident under the UK home test.

6.12.5 *Acquiring UK home*

The last example might be designed to illustrate the importance of tax planning. The facts (stripping out irrelevancies) are as follows:[30]

> Example 5 (Rosa)
>
> R is a professional cricketer who lives in New Zealand. She comes to the UK for the summer of 2015 to play for Trinity Bridge Ladies. She rents a house in Dorking for 4 months, commencing on 1 May 2015. She is present in her Dorking home on 100 days in 2015-2016. After the English cricket season ends she returns to New Zealand.
>
> Throughout 2015-2016 R owns a house in New Zealand. She is present in that house on 200 days in 2015-2016.
>
> While she is in the UK, R lets out her New Zealand home on a commercial basis to a third party, from 1 June to 31 August 2015, (92

[30] The example including its irrelevant detail in full is as follows:
"R is a professional cricketer who lives in New Zealand. She comes to the UK for the summer of 2015 to play for Trinity Bridge Ladies. She rents a house in Dorking for four months commencing 1 May 2015. She is present in her Dorking home on 100 days in 2015-16. After the English cricket season ends she returns to New Zealand.
Throughout 2015-16 R owns a house in New Zealand. She is present in that house on 200 days in 2015-16.
While she is in the UK, R lets out her New Zealand home on a commercial basis to a third party, from 1 June to 31 August 2015 (92 days). For that period the New Zealand house is not R's home."

> days). For that period the New Zealand house is not R's home.

The HMRC analysis is as follows:

> There is a period of 91 consecutive days, at least 30 of which fall in 2015-2016, when R had a UK home where she spends a sufficient amount of time, and when she does not have an overseas home. R meets the second automatic UK test for 2015-2016.

HMRC draw the moral:

> If R had not let out her New Zealand house, and it had remained available for R to use throughout the summer; it would have remained her home and R would not have met the second automatic UK test.

It may make no difference whether R is resident or not, once one has allowed for DT relief and that UK source income earned as a sportswoman while in the UK would be subject to UK tax anyway. But the cost of dealing with UK tax affairs may well exceed the rent from the short let of the overseas home.

6.13 UK test 3: UK work

6.13.1 *Introduction and terminology*

This test is complicated. Para 9(1) sch 45 FA 2013 provides:

> The third automatic UK test is that–
> (a) P works sufficient hours in the UK, as assessed over a period of 365 days,
> (b) during that period, there are no significant breaks from UK work,
> (c) all or part of that period falls within year X,
> (d) more than 75% of the total number of days in the 365-day period on which P does more than 3 hours' work are days on which P does more than 3 hours' work in the UK, and
> (e) at least one day which falls in both that period and year X is a day on which P does more than 3 hours' work in the UK.

I follow the terminology of RDRM and refer to the **"365-day reference period"**. This period must satisfy the five conditions, which I refer to as **"UK-work conditions (a) to (e)"**.

6.13.2 *(a): Sufficient UK hours*

Para 9(1) sch 45 FA 2013 requires:

> (a) P works sufficient hours in the UK, as assessed over a period of 365 days...

This takes us to para 9(2) sch 45 FA 2013 which provides:

> Take the following steps to work out, for any given period of 365 days, whether P works "sufficient hours in the UK" as assessed over that period—
> *Step 1 [disregarded overseas days]*
> Identify any days in the period on which P does more than 3 hours' work overseas, including ones on which P also does work in the UK on the same day.
> The days so identified are referred to as "disregarded days".

It may be more helpful to use the term "disregarded overseas days".

> *Step 2 [net UK hours]*
> Add up (for all employments held and trades carried on by P) the total number of hours that P works in the UK during the period, but ignoring any hours that P works in the UK on disregarded days.
> The result is referred to as P's "net UK hours".
> *Step 3 [reference-period days]*
> Subtract from 365—
> (a) the total number of disregarded days, and
> (b) any days that are allowed to be subtracted, in accordance with the rules in paragraph 28 of this Schedule, to take account of periods of leave and gaps between employments.[31]
> The result is referred to as the "reference period".
> *Step 4 [reference-period weeks]*
> Divide the reference period by 7.
> If the answer is more than 1 and is not a whole number, round down to the nearest whole number.
> If the answer is less than 1, round up to 1.

Division by 7 reflects the number of weeks in the reference period.

If there are no disregarded days or other deductions, then the computation is 365 ÷ 7 = 52 (rounded down).

One might question whether rounding is appropriate at this preliminary stage; it does not matter much.

> *Step 5 [compute net UK hours ÷ no. of reference-period weeks]*

[31] See 6.24 (Reference period: non-work days).

> Divide P's net UK hours by the number resulting from step 4.
>
> If the answer is 35 or more, P is considered to work "sufficient hours in the UK" as assessed over the 365-day period in question.

This mirrors the approach of overseas test 3 (overseas work).[32]

The RDRM provides an example:

> **RDRM11380: Is the work full-time in the UK** [Aug 2019]
>
> Example (Sam)
>
> S has never been resident in the UK. On 3 March 2014, he starts a 2 year contract to work on a North Sea oil platform in UK waters. S is contracted to work 2 weeks off-shore, working 12 hours a day over 14 days, followed by 2 weeks onshore field break.
>
> Unfortunately, half-way through his shift on 9 April 2014, S has an accident at work and is medically unfit to work up to 30 April 2014. The doctor certifies that he is fit enough to return to work from 1 May 2014.
>
> From 10 April to 30 April 2014 (21 days), when S is unfit to work, there is a period of 14 days (14-27 April), which were non-working days, when S was scheduled for his onshore field break.
>
> For the purpose of calculating whether he meets the third automatic UK test, S considers whether he worked sufficient hours in the UK. Usually, his non-working days cannot be deducted from the 365 day period over which his average weekly hours are calculated; as they do not meet the rules about embedded non-working days (see RDRM11190).
>
> However, when calculating whether S works sufficient hours in the UK over a 365 day period, the 14 non-working days between 14 and 27 April 2014 can be subtracted from the 365 day period when calculating the 'reference period' at Step 3 of the calculation.
>
> This is because the 14 non-working days are embedded within a period
>
> - where S was unfit to work, from 10-30 April 2014, and
> - there were at least 3 consecutive days of sick leave before the non-working period, and
> - there were at least 3 consecutive days of sick leave after the non-working period
>
> For the purpose of this example we look at the 365 day period starting on 3 March 2014, the date S started work in the UK.
>
> *Step 1:* there are no disregarded days on which S worked for more than 3 hours overseas
>
> *Step 2:* net UK hours - S worked for 23.5 days (between 3 March and midway through 9 April), then a total of 22 weeks and 5 days between

[32] See 6.8.2 ((a): Sufficient hours overseas).

5 May and 2 March 2015.
Hours worked = ((22 × 7) + 23.5) × 12 = 2190 hours
Step 3: calculate the reference period - subtract from 365 the disregarded days and other days that can be subtracted = 365 - 21 =344
Step 4: divide reference period by 7 = 344/7 - 49.19, rounded down to 49
Step 5: divide net UK hours by result of Step 4 = 2190/49 = 44.69
S works sufficient hours in the UK because he works an average of more than 35 hours per week, calculated over the 365 day period. He would have to consider other aspects of the third automatic UK test to determine his residence status.

6.13.3 *Significant break from work*

Para 9(1) sch 45 FA 2013 requires:

> (b) during that period, there are no significant breaks from UK work

See 6.25 ("Significant break from work").

6.13.4 *365-day period across tax year*

Para 9(1) sch 45 FA 2013 requires:

> (c) all or part of that period falls within year X

6.13.5 *75% UK workdays*

Para 9(1) sch 45 FA 2013 requires:

> (d) more than 75% of the total number of days in the 365-day period on which P does more than 3 hours' work are days on which P does more than 3 hours' work in the UK

I refer to days on which P does more than 3 hours' work in the UK as **"UK workdays"**.

6.13.6 *UK workday in year/365-day period*

Para 9(1) sch 45 FA 2013 requires:

> (e) at least one day which falls in both that period and year X is a day on which P does more than 3 hours' work in the UK.

Para (e) ensures that at least one day of more than 3 hours' work must fall within both year X and the 365-day period. Without it, the test could be satisfied if the 365-day period ended in, for example, May (with no days of working more than 3 hours in the UK in that tax year), but there was a solitary 7 hour UK workday in the following March.

6.13.7 *HMRC examples*

The RDRM provides some examples. The first is straightforward:

> **RDRM11370: Third automatic UK test** [Aug 2019]
> Example 1 (Henri)
> H travels to the UK on 1 July 2013 to start a new job the following day. His posting finished on 1 July 2014, and he leaves the UK on 6 August 2014, 400 days after he arrived.

The reference period is 1 July 2013 - 30 June 2014. UK-work conditions (a) and (b) are satisfied for that period. The period falls within 2012/13 and 2013/14 so condition (c) is satisfied for those years.

> Over the 365 day period to 30 June 2014, H calculates that he worked full-time in the UK and has not taken a significant break from his UK work during this period. Part of the period of 365 days fall in the tax year 2013-2014 and part within the tax year 2014-2015.

So UK-work condition (e) is satisfied for 2013/14.

> Over the period of 365 days ending 30 June 2014, H works for over 3 hours on 240 days, 196 (80%) of which are days when H worked for more than 3 hours in the UK. At least 1 day when H does more than 3 hours work in the UK falls within tax year 2013-2014; therefore H is resident in the UK under the third automatic UK test for 2013-2014 tax year.

So UK-work condition (e) is satisfied for 2014/15.

The next example is a case where one 365-day reference period does not satisfy the conditions, but another does (resulting in UK residence):

> Example 2 (Frank)
> F works full-time in Paris for a branch of a multi-national export company. He comes to work in the UK every month for 2 days; on both days he works for more than 3 hours in the UK. On 1 September 2013 F is seconded to work in the UK for a period of 2 years. F returns to the Paris office and works there for more than 3 hours on 2 days each month. In the period of 365 days ending 5 April 2014 F calculates he worked full-time in the UK, (the days worked overseas are identified and disregarded at Step 1 of the calculation of full-time work overseas). As F worked for more than 3 hours on 2 days each month in the UK prior to September 2013, F did not have a significant break from UK work. In the 365 day period ending 5 April 2014, F worked for more than 3

hours on 240 days. However, only 150 days (62%) were days when F worked for more than 3 hours in the UK. Using that 365 day reference period F would not be resident in the UK under the third automatic UK test for the 2013-2014 tax year.

So it seems that the UK work test is not satisfied. But no:

F needs to check the 75% test against another 365 day period.
In the 365 day period ending 31 August 2014, F calculates he worked full-time in the UK. Again days worked overseas are identified and disregarded at Step 1 of the calculation of full-time work overseas. In the 365 day reference period ending 31 August 2014, F worked for more than 3 hours on 230 days; 210 days (91%) were days when F worked for more than 3 hours in the UK. Part of this 365 day period falls within the 2013-2014 tax year and at least 1 day in 2013-2014 is a day on which F worked for more than 3 hours in the UK. Therefore, using the 365 day reference period ending 31 August 2014, F is resident in the UK under the third automatic UK test for 2013-2014.

6.13.8 *UK/foreign work tests compared*

To keep in mind the differences between the UK and the overseas full-time work tests, it may be helpful to set them side by side:

Sch 45 para 9: UK work test	**Para 14: Overseas work test**
(1) The third automatic UK test is that—	(1) The third automatic overseas test is that—
(a) P works sufficient hours in the UK, as assessed over a period of 365 days,	(a) P works sufficient hours overseas, as assessed over year X,
(b) during that period, there are no significant breaks from UK work,	(b) during year X, there are no significant breaks from overseas work,
(c) all or part of that period falls within year X,	
(d) more than 75% of the total number of days in the 365-day period on which P does more than 3 hours' work are days on which P does more than 3 hours' work in the UK, and	(c) the number of days in year X on which P does more than 3 hours' work in the UK is less than 31, and
(e) at least one day which falls in both that period and year X is a day on which P does more than 3 hours' work in the UK.	

(d) the number of days in year X falling within sub-paragraph (2) [UK days] is less than 91.

(2) A day falls within this sub-paragraph if—
(a) it is a day spent by P in the UK, but
(b) it is not a day that is treated under paragraph 23(4) as a day spent by P in the UK.

The definitions of sufficient hours are sufficiently close that they can more conveniently be set out in track change format. Para 9(2)/14(3) provide:

> ~~(3)~~(2) Take the following steps to work out, for any given period of 365 days, whether P works "sufficient hours ~~overseas~~ in the UK" as assessed over ~~year X~~ that period—
>
> *Step 1*
>
> Identify any days in ~~year X~~ the period on which P does more than 3 hours' work ~~in the UK~~ overseas, including ones on which P also does work ~~overseas~~ in the UK on the same day.
>
> The days so identified are referred to as "disregarded days".
>
> *Step 2*
>
> Add up (for all employments held and trades carried on by P) the total number of hours that P works ~~overseas in year X~~ in the UK during the period, but ignoring any hours that P works ~~overseas~~ in the UK on disregarded days.
>
> The result is referred to as P's "net ~~overseas~~ UK hours".
>
> *Step 3*
>
> Subtract from 365 ~~(or 366 if year X includes 29 February)~~ —
>
> (a) the total number of disregarded days, and
>
> (b) any days that are allowed to be subtracted, in accordance with the rules in paragraph 28 of this Schedule, to take account of periods of leave and gaps between employments.
>
> The result is referred to as the "reference period".
>
> *Step 4*
>
> Divide the reference period by 7. If the answer is more than 1 and is not a whole number, round down to the nearest whole number. If the answer is less than 1, round up to 1.
>
> *Step 5*
>
> Divide P's net ~~overseas~~ UK hours by the number resulting from step 4. If the answer is 35 or more, P is considered to work "sufficient hours ~~overseas~~ in the UK" as assessed over ~~year X~~ the 365-day period in

question.

The minutes of the Joint Forum on Expatriate Tax and NICs provide:

> **Sufficient hours - simultaneous FTWUK and FTWO**
> *Question:* Because of the way in which working days are disregarded for both the numerator and denominator of the sufficient hours test where the employee has worked for more than three hours in the "wrong" country (e.g. worked for more than three hours in the UK on some days when working all day abroad on most other days) it is possible to be employed full-time simultaneously in both the UK and an overseas work country for a period. This might happen where an individual transitions into a new cross-border role over a short period. This is not an intuitive outcome and will confuse taxpayers. Could there be a rule to prevent it?
> *HMRC answer:* Because the FTW tests are mechanical, HMRC agrees it is possible to be simultaneously FTWUK and FTWO. In reality this is likely to happen in a small number of cases and for a very short period of time. The SRT provides a tie-breaker in this scenario, with those meeting automatic overseas tests becoming definitively non resident. The split year cases have also been drafted so there is a priority rule between Case 5 (starting FTWUK) and Case 6 (ceasing FTWO).[33]

6.14 Sufficient ties test

Para 17(1) sch 45 FA 2013 provides:

> The sufficient ties test is met for year X if–
> (a) P meets none of the automatic UK tests and none of the automatic overseas tests, but
> (b) P has sufficient UK ties for that year.

6.14.1 *"Sufficient" ties*

Para 17(3) sch 45 FA 2013 defines "sufficient":

> Whether P has "sufficient" UK ties for year X will depend on–
> (a) whether P was resident in the UK for any of the previous 3 tax years, and
> (b) the number of days that P spends in the UK in year X.

The sufficient ties test distinguishes between "leavers" and "arrivers":

[33] 29 January 2014 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/302475/140326_Expats_Forum_Jan_14_Minutes_FINAL.pdf*

Category	**Para**	**Test**
Leavers	18	UK resident for 1 or more of the 3 tax years preceding year X
Arrivers	19	UK resident for none of the 3 tax years preceding year X

Para 18/19 sch 45 FA 2013 define "sufficient ties" for leavers/arrivers. It is convenient to combine the two into a single table:

Days spent by P in the UK in year X	**sufficient ties**	**sufficient ties**
	leavers	***arrivers***
More than 15[34] but not more than 45	At least 4	[non-resident]
More than 45 but not more than 90	At least 3	All 4
More than 90 but not more than 120	At least 2	At least 3
More than 120	At least 1	At least 2

See too 6.35.4 (Recordkeeping: UK ties).

The same result might have been achieved more neatly by counting residence in any of the 3 preceding years as another UK tie. But it comes to the same thing.

The rules reflect a policy principle that residence should be adhesive; that is, it should be harder to lose residency than to acquire it.

6.15 Days spent in UK

"Days spent" matters for many SRT purposes, in particular:

(1) Overseas test 1: Less than 16 UK days
(2) Overseas test 2: 3 years non-residence, less than 46 UK days
(3) UK test 1: 183 UK days
(4) The sufficient ties test:
    (a) The number of "sufficient" UK ties depends on the number of UK days spent
    (b) The 90 day tie
    (c) The country tie

Para 24 sch 45 FA 2013 tries to explain the word "in":

> Any reference to a number of days spent in the UK "in" a given period is a reference to the total number of days spent there (in aggregate) in that period, whether continuously or intermittently.

6.15.1 *Ascertaining "days spent" in UK*

Sch 45 FA 2013 provides the general rule:

[34] The words "More than 15" are otiose since if P spends less than 16 days in the UK automatic overseas test 1 will be satisfied and P will not be UK resident.

> 22(1) If P is present in the UK at the end of a day, that day counts as a day spent by P in the UK...
> 23(1) If P is not present in the UK at the end of a day, that day does not count as a day spent by P in the UK.

There are three exceptions to this general rule:

Exception	**Outline**	**See para**
Transit passengers	Transit days not counted as days in UK	6.16
Exceptional circumstances	Up to 60 UK days not counted	6.17
Deeming rule	Frequent visits count as UK days even though *not* present at midnight	6.19

So "days spent" are ascertained by a qualified midnight test, not a simple midnight test.

6.16 Transit days

The rule is in para 22(3) sch 45 FA 2013 but that needs to be read with para 22(1)(2):

> (1) If P is present in the UK at the end of a day, that day counts as a day spent by P in the UK.
> (2) But it does not do so in the following two cases.
> (3) The first case is where–
> (a) P only arrives in the UK as a passenger on that day,
> (b) P leaves the UK the next day, and
> (c) between arrival and departure, P does not engage in activities that are to a substantial extent unrelated to P's passage through the UK.[35]

This is vague, but the RDRM provides a gloss:

> **RDRM11730: Days spent in the UK: Transit days** [Dec 2019]
> Merely taking dinner or breakfast at their hotel, in the normal course of events, would be related to their passage.
> In contrast, enjoying a film at a local cinema, spending any time in your home in the UK or catching up with friends or relations would be considered substantially unrelated to their passage through the UK. ...
> Example 1 (Holly and Lawrence)
> H regularly visits the UK for work and social engagements. She also travels widely. She is planning to visit her aunt in Philadelphia, and will

[35] The drafting is, exceptionally for the SRT, from the pre-2013 legislation: s.831(1B)(b) ITA.

be flying in from Rome to connect with her flight at Heathrow.

H's flight lands at 23.05 on Monday evening. Her flight to Philadelphia does not depart from Heathrow until 11.05 on Tuesday morning. H decides to stay at an airport hotel to catch some sleep, before returning to board the plane for her onward journey. She merely leaves the airport terminal, catches a taxi to the hotel, sleeps, and snatches a quick breakfast before returning to the airport.

The transit arrival day (Monday) spent in the UK would not count as a day for H when she considers how many days she spent in the UK at the end of the tax year. The departure day (Tuesday), may count as a qualifying day under the deeming rule.

Example 2(a)

H's brother, L, has a similarly itinerant lifestyle. He too is visiting their aunt in Philadelphia, and will be flying in from Toulouse to connect with their continental flight at Heathrow.

L's flight lands at 17.20 on Monday evening. The flight to Philadelphia does not depart Heathrow until 11.05 on Tuesday morning. L decides to stay at an airport hotel, before returning to board the plane on Tuesday.

In this scenario the midnight spent in the UK will not count as a day spent in the UK for SRT purposes. The departure day (Tuesday), may count as a qualifying day under the deeming rules.

Example 2(b)

The circumstances are for 2(a), but L decides that as he has a long transit period in the UK he will meet up with some friends and go to the theatre.

In this scenario L's meeting friends and visiting the theatre is regarded as being to a substantial extent unrelated to his passage through the UK. The midnight spent in the UK will count as a day spent in the UK for SRT purposes. The following day (Tuesday), may also count as a qualifying day under the deeming rule.

Example 2(c)

The circumstances are as for 2(a), but L meets his team leader for dinner to discuss work related issues. Their meeting lasts for an hour and a half.

In this scenario the meeting with his team leader is regarded as being to a substantial extent unrelated to his passage through the UK, and the midnight spent in the UK will count as a day spent in the UK for SRT purposes. The following day (Tuesday), may also count as a qualifying day under the deeming rule.

Example 3(a) (Simon)

S is a lawyer who lives in France but works internationally. A business trip to Canada requires him to transit through the UK. He lands at Gatwick at 18.30 on Tuesday and his onward flight to Canada departs Heathrow at 14.00 on Wednesday.

While S is waiting for the shuttle bus to his Heathrow hotel he spots a work colleague from the London office who he has not seen for some time. They go for a coffee and talk about their families and recent holidays. That evening after dinner in his hotel, S uses social media to look at his colleague's holiday photographs and then exchanges a few emails with him about them. Before going to bed S watches a film on an internet website.

S's chance meeting with his colleague and his use of social media and internet websites are regarded as being related to his transit through the UK. This is because the meeting was entirely by chance, not planned, and he and his colleague did not talk about work issues. His use of social media at the hotel is acceptable, as it was not used in any way whatsoever for business or work purposes.

S's day of arrival in the UK may be treated as a transit day and will not count as a day of presence in the UK for SRT purposes. S's departure day (Wednesday) may also count as a qualifying day under the SRT deeming rule.

Example 3(b)

The situation is the same as for example 3(a), however S and his colleague discuss a litigation case they are both involved in. That evening S contacts his boss on his social media site to make him aware of the earlier discussion with his colleague, and they exchange some emails on the case.

Although S met his colleague by chance they discussed both private and work related issues. He also used social media for work purposes. These activities are regarded as being to a substantial extent unrelated to his transit through the UK.

S's day of arrival in the UK may not be regarded as a transit day and will be treated as a day spent in the UK for SRT purposes. If S works in the UK for more than 3 hours, the day will also count as a UK work day. S's departure day (Wednesday), may also count as a qualifying day under the SRT deeming rule.

EN FB 2008 provides some unexceptionable examples:

Example 1 – Peter works for the Jersey arm of HSBC and is travelling from Jersey to Frankfurt. He flies from Jersey to Gatwick and will catch his onward flight the next day to Frankfurt from London City airport. He travels from Gatwick to Canary Wharf for a meeting with several other HSBC colleagues before staying overnight in a nearby hotel.

The meeting with colleagues is not an activity substantially related to completing travel to a foreign destination. The transit passenger provisions will not apply.

Example 2 – John works for the Jersey arm of HSBC and is travelling from Jersey to Frankfurt via Gatwick and London City airport. In lobby of his hotel near London City Airport, he unexpectedly spots another colleague who has just arrived from Paris. They have a couple of pints together and their conversation covers a number of business-related issues. [John][36] then travels to London City airport to catch his onward connection.

This meeting was not planned and therefore it can be considered that John's activities in the UK substantially related to completing travel to a foreign destination. The transit passenger provisions will apply.

Example 3 – Shirley lives in Guernsey and is travelling to New Zealand by way of Gatwick and Heathrow. She has planned to spend most of the day with her daughter and grandchildren, who live in Crawley and will also spend the night there before travelling to Heathrow for her onward flight.

Her visit is not an activity substantially related to completing travel to a foreign destination. The transit passenger provisions will not apply.

Example 4 – Phil lives in Guernsey and is travelling to New Zealand by way of Gatwick and Heathrow. His flight from Guernsey is delayed by fog and he arrives too late to make his onward connection to New Zealand that day. His son had already arranged to meet him at Gatwick and drive him to Heathrow, now he drives him to a hotel near Heathrow instead where Phil will stay overnight before catching his rearranged flight. At the hotel they have a snack together.

These activities are substantially related to completing travel to a foreign destination – Phil would have eaten in the hotel even if he had been unaccompanied. The transit passenger provisions will apply.

Example 5 – George lives in the Isle of Man and is flying to New York on business via Manchester. He has made an appointment with a consultant orthopaedic surgeon based in Manchester to carry out a number of tests. He will stay in the clinic overnight before travelling on to New York the following afternoon.

The appointment is not an activity substantially related to completing travel to a foreign destination. The transit passenger provisions will not apply.

Example 6 – George lives in Jersey and is travelling to Stavanger. He does not fly and travels to the UK by ferry before continuing to London by train. He stays overnight at a West End hotel, having prearranged dinner and a trip to the theatre with friends. The next day he travels to Newcastle by train, where he boards a ferry to Stavanger. His activities in the UK are not substantially related to completing travel to a foreign destination. The transit passenger provisions will not apply.

The minutes of the Joint Forum on Expatriate Tax and NICs provides:

> **Transit days and "substantially related" – general clarification**
>
> *Question:* If the statutory phrasing is viewed narrowly, whatever [an individual] is likely to do, whether watching a film in his hotel room, telephoning family, reviewing work e-mails, catching up with friends on Facebook or going to the hotel gym or pool could be viewed as "substantially unrelated" to passage through the UK because it is not an intrinsic part of the journey.

[36] The original erroneously reads: Peter.

> *HMRC answer:* HMRC confirms that it will not interpret "substantially related" narrowly. It is reasonable to expect that, for example, anyone who chose to stay in a hotel to avail themselves of the facilities, to check Facebook and so on. The facts in each case will be important. In the final analysis we would consider whether a person was in fact enjoying the benefit of being in the UK – for example by going to the theatre – which is out with the spirit of a transit day. However it is true that doing any work, including reviewing emails, is unrelated to P's passage through the UK and the day would result in a day spent in the UK.
>
> **Transit days and "substantially related" – work of any sort and alternative approaches**
>
> *Question:* A restriction on doing work of any sort means individuals cannot check work emails (e.g. on smartphones and tablets) which is unreasonable. Can a more pragmatic interpretation be struck? e.g. US Treasury Regulations 301.7701(b)-3(d) covering Days in Transit, which hinges on whether or not there has been a business meeting.
>
> *HMRC answer:* HMRC interprets the term "substantially unrelated" with reference to what the transit day provisions are there to achieve – to allow leeway for day counting purposes for those passing through the UK who carry out no work. A simple reading means there is can be no debate around the degree and nature of work done.
>
> **Departure days and deemed days**
>
> *Question:* Are departure days that are disregarded under the transit rule counted for the deeming rule? In other words, do transit departure days count towards an excess over 30 days, as per in para 23(3)?
>
> *HMRC answer:* Departure days, following a day in transit, are not disregarded under the transit rules and may count towards the deemed days rule. A day of departure may be a "qualifying day" under the terms of para 23(3)(b). The intention is to minimises the scope for the deemed days rule to be circumvented.[37]

If the individual arrives in the UK and leaves on the *same* day, that day will not count even though work or other matters are done in between.[38] The individual does not need to rely on the transit passenger exemption.

The transit passenger rule is essential to the role of Heathrow airport as an international hub. Heathrow relies on transit passengers for the viability of its hub status. Transit passengers facilitate network diversity and

[37] 29 January 2014 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/302475/140326_Expats_Forum_Jan_14_Minutes_FINAL.pdf*

[38] Unless the deeming rule (frequent visits) applies.

frequency. Passengers would not change planes in the UK if that might make them UK resident.

6.17 Exceptional circumstances

6.17.1 *Exceptional circ. disregard*

The rule is in para 22(4) sch 45 FA 2013 but that needs to be read with para 22(1)(2):

> (1) If P is present in the UK at the end of a day, that day counts as a day spent by P in the UK.
> (2) But it does not do so in the following two cases....
> (4) The second case is where–
> (a) P would not be present in the UK at the end of that day but for exceptional circumstances beyond P's control that prevent P from leaving the UK, and
> (b) P intends to leave the UK as soon as those circumstances permit.

I refer to this as the **"exceptional circumstances disregard"**.

Para (4) can be unpacked into 5 separate requirements:[39]

Ref	**Requirement**
Para (a)[i]	The circumstances are exceptional
Para (a)[ii]	The circumstances are beyond P's control
Para (a)[iii]	The circumstances prevent P from leaving the UK
Para (a)[iv]	P would not be present in the UK at the end of the day but for those circumstances
Para (b)	P intends to leave the UK as soon as those circumstances permit

These are the five requirements which must be satisfied, and it is best to address them separately, though there is an element of overlap, and discussion easily segues from one element to another.

"The circumstances" here means the matters which cause P to be present in the UK at any particular time.

The exceptional circumstances disregard does not require a formal claim or election, but where the individual submits a tax return,[40] it is necessary to complete box 11 in SA109 (Residence, remittance basis etc) (2022/23). The rubric to this box provides: "Number of days in box 10 [days spent in the UK] attributed to exceptional circumstances".

[39] This is self-evident, but if authority is needed, see *A Taxpayer v HMRC* [2022] UKFTT 00133 (TC) at [134].

[40] See 121.4 (Duty to make SA return).

6.17.2 *Exceptional*

"Exceptional" is contextual, evaluative, and a matter of degree.

Para 22(5) sch 45 FA 2013 elucidates the word here:

> Examples of circumstances that may be "exceptional" are–
> (a) national or local emergencies such as war, civil unrest or natural disasters, and
> (b) a sudden or life-threatening illness or injury.

The point of saying that civil unrest, sudden illness etc, may be exceptional is it might have been argued that such matters are in fact not exceptional, or insufficiently exceptional: in practice, sadly, disasters of these kinds are all too common.

In *R v Kelly*:[41]

> We must construe 'exceptional' as an ordinary, familiar English adjective, and not as a term of art. It describes a circumstance which is such as to form an exception, which is out of the ordinary course, or unusual, or special, or uncommon. To be exceptional, a circumstance need not be unique, or unprecedented, or very rare; but it cannot be one that is regularly, or routinely, or normally encountered.

That seems self-evident.

The RDRM provides a self-evident example:

> **RDRM13240: What are exceptional circumstances** [Dec 2021]
> For example, if an individual is a passenger on a commercial aircraft that is forced to make an emergency landing in the UK, and there is no available onward flight to their original destination for 2 days afterwards. The 2 days that would otherwise count as time spent in the UK would be ignored due to exceptional circumstances...

Outside the movies, emergency landings are, happily, exceptional (and more often due to medical emergencies than other reasons).

6.17.3 *Foreseeability*

In *A Taxpayer v HMRC*:[42]

> 147... There is no requirement in the statutory language for foreseeability

[41] [2000] QB 198 at p.208, cited in *A Taxpayer v HMRC* [2022] UKFTT 00133 (TC) at [143].

[42] [2022] UKFTT 00133 (TC). This will need to be reviewed when the case is final.

> or non-foreseeability to determine whether circumstances are "exceptional". Foreseeability is not the statutory test. It is true that foreseeability may be an element of exceptionality, but it is not a determining factor which, of itself, excludes the application of the exemption. For example, it may be ... that a non-resident has a UK-located family member who has a long-term degenerative disease. It may be foreseeable that that condition may worsen and become life-threatening. That does not, however, lead to the conclusion that when the condition worsens and becomes life-threatening the circumstances become non-exceptional simply because they were foreseeable...
>
> 148. Furthermore, the fact that some or all of the circumstances claimed to be exceptional may be foreseeable does not necessarily mean that those circumstances are within the control of the taxpayer. Whether those circumstances are beyond the taxpayer's control is a matter to be determined in the light of all the relevant facts. Certainly, foreseeability may be a relevant factor in this context but it is not a determining factor.[43]

6.17.4 *Para (a)[iii] & [iv]*

Para (a)[iii] The circumstances prevent P from leaving the UK
Para (a)[iv] P would not be present in the UK but those circumstances

These are distinct conditions, but are conveniently considered together.

In assessing whether circumstances "prevent" P from leaving the UK, it is appropriate to adopt the approach in the test of duress in criminal law, which is "whether a person of reasonable firmness, sharing the characteristics of P, would have responded to the situation by acting as P did."[44] It is helpful to have a short label for the situation where the

[43] The RDRM provides:

> **RDRM13240: What are exceptional circumstances** [Dec 2021]
>
> ... the event or situation in question must be one over ... which cannot reasonably have been foreseen.
>
> **RDRM13260: Examples of circumstances not normally considered to be exceptional circumstances** [Dec 2021]
>
> Days spent in the UK will not be considered exceptional where the circumstances are not beyond the individual's control, or where they could have reasonably have been foreseen or predicted.

This needs to be rewritten, or, better, deleted, in the light of *A Taxpayer v HMRC*. The case is not yet final but HMRC do not appeal on this point.

[44] Halsbury's Laws of England , Volume 25 (Criminal law), para 27 (Duress by threats).

circumstances prevent P from leaving the UK, and I describe that as P's presence being **"forced"**.

> **RDRM13240: What are exceptional circumstances** [Dec 2021]
> **Example 3** (Claude's car crash)

The facts (stripping out irrelevancies) are as follows:[45]

> C came to the UK 1 June intending to leave on 31 October.
> On 29 September C has an accident and is in hospital for 14 weeks.
> He leaves the UK on the day he is discharged.

The HMRC analysis is as follows:

> C has been in the UK for 220 days.
> C spent 14 weeks in hospital, but because his original intention was to stay in the UK until 31 October, only the days from 1 November up to the date of discharge can be ignored due to exceptional circumstances.

More analytically, until 31 October, C fails the condition in para (a)[iv], that "P would not be present in the UK but those circumstances".

> The maximum number of days in the tax year that can be ignored is 60.
> In this scenario C has 160 days counted as a day of presence in the UK.

HMRC accept that (subject to the 60-day cap)[46] the hospital days fall within the exceptional circumstances disregard.

The RDRM provides:

> **RDRM13250: Foreign and Commonwealth Office advice** [Dec 2021]
> Exceptional circumstances will generally not apply in respect of events that bring an individual back to the UK. However, there may be circumstances such as civil unrest or natural disaster where associated FCO advice is to avoid all travel to the region.
> Individuals who return to and stay in the UK while FCO advice remains at this warning level would normally have days spent in the UK ignored under the SRT, subject to the 60 day limit.

[45] The example in full (including its irrelevant detail) is as follows:
"C is retired and came to the UK for the first time on 1 June for a 5 month extended travelling holiday, intending to leave on 31 October.
On 29 September while travelling to Scotland C is involved in a car crash, suffering multiple injuries. He is in hospital for a total of 14 weeks and arranges to travel back to his home in France on the day he is discharged."

[46] See 6.17.7 (60-day cap).

The Manual provides a straightforward example of this factual scenario:

> **RDRM13250: FCO advice** [Dec 2021]
> **Example** (Philip - military coup)

The facts (stripping out irrelevancies) are as follows:[47]

> P works outside the UK. His wife and children live in the UK.
> In early July the FCO issued advice against all but essential travel to the country. P continued to work there.
> In mid-October the FCO upgraded their advice, warning against all travel to the country. P returned to the UK on 21 October.
> On 29 January the FCO downgraded their advice to avoid all travel to the country. P took the first available flight back.

The HMRC analysis is as follows:

> The days P spent in the UK were due to an exceptional circumstance beyond his control, and can be ignored for the purpose of the day counting tests of the SRT. However, the maximum period that can be ignored due to exceptional circumstances is 60 days. P was in the UK for 103[48] days during this period, which means P must count 43 days as days spent in the UK for the purposes of the SRT day counting tests.

It is clear that Para (a)[iv] is met: P would not be present in the UK but those circumstances. Here, HMRC also accept Para (a)[iii] is met: the

[47] The example in full (including its irrelevant detail) is as follows:
"P is a structural engineer, and has worked full-time abroad for many years. He is currently working on a project in Africa. His wife and children live in the UK.
In May the government of the country in which he is working is overthrown in a military coup. This initially gave rise to peaceful protests, but soon developed into increasing levels of civil unrest. In early July the FCO issued advice against all but essential travel to the country. P continued to work there.
By mid-October the country was on the verge of civil war, and the FCO upgraded their advice, warning against all travel to the country. P returned to the UK on 21 October.
Due to international intervention, by the end of January the following year, political stability had returned to the country. On 29 January the FCO downgraded their advice to avoid all travel to the country. P took the first available flight back and resumed work on 31 January."

[48] For completeness: It does not affect the point of the example, but the figure of 103 days is wrong. P arrived in the UK on 21 October. The example does not precisely identify the date he left the UK, but it was between 29 January (when FCO downgraded their advice) and 31 January (when P resumed work). Days spent in the UK were therefore between 100 and 102 days.

circumstances prevent P from leaving the UK. HMRC do not object on the basis that P could have arranged to live almost anywhere else in the world, though no doubt he could. That must be right, assuming that P's home is in the UK, which is suggested by saying that "His wife and children live in the UK." This illustrates that whether P is forced to be in the UK is assessed by reference to what a reasonable person would do.

In *A Taxpayer v HMRC*:[49]

> ... HMRC argued that the "exceptional circumstances" exemption applied only to persons who were already in the UK and, while they were in the UK, were overtaken by "exceptional circumstances" which prevented them from leaving. The exemption did not, according to HMRC, apply to a taxpayer who came to the UK because of the "exceptional circumstances" and who was then prevented from leaving by those same circumstances. ... we consider that there is no statutory justification for such a limitation of the test. ... paragraph 22(4) looks at why a taxpayer is in the UK at the end of a particular day and whether a taxpayer is prevented from leaving the UK at that time in order to determine the number of days spent in the UK. It does not look at why the taxpayer came to the UK in the first place or whether the taxpayer was already in the UK.

Similarly, the exemption could apply to someone whose home was in the UK, and who had been planning to leave, but was prevented due to civil unrest\natural disaster in the intended destination. There would be nothing to stop them going to a third country. But that still counts as exceptional circumstances which prevent P leaving the UK if P is *reasonably* prevented from leaving the UK.

A similar point arises in relation to illness/injury of a person's family members. The RDRM provides:

> **RDRM13240: What are exceptional circumstances** [Dec 2021]
> There may also be limited situations where an individual who needs to stay in the UK to deal with a sudden or life threatening illness or injury to a spouse, person who they are living with as husband and wife, civil partner or dependent child; can have those days spent in the UK ignored under the SRT, subject to the 60 day limit.
>
> There may also be limited situations where an individual who comes back to the UK to deal with a sudden or life threatening illness or injury

[49] [2022] UKFTT 00133 (TC) at [151]. Note that this argument was contrary to the HMRC Manual example of Philip.

> to a partner or dependent child, can have those days spent in the UK ignored under the SRT subject to the 60 day limit.
> **Example 2(a)** (Henrik and Victoria - injury to minor daughter)

The facts (stripping out irrelevancies) are as follows:[50]

> H is a lone parent. V, his 13 year-old daughter, usually lives with him. V comes to the UK for a holiday. She has an accident and is taken to hospital with a suspected major injury.
> H travels to the UK, to be with V.
> H arranges for V to be moved back to Germany as soon as possible. This happens 3 days after the accident.

The HMRC analysis is as follows:

> The 3 days H spends in the UK with his daughter arranging her transfer, after this potentially life threatening[51] accident, would count as exceptional circumstances.

It is clear that Para (a)[iv] is met: H would not be present in the UK but the circumstances. Again, HMRC also accept Para (a)[iii] is met: the circumstances prevent H from leaving the UK. HMRC do not object on the basis that it would have been possible for the father not to visit his daughter. The requirements are not construed so strictly.

Why does the example specify that V is a lone parent? Suppose V lived with both parents, and H still came to the UK. I think H's visit is still forced, even if W could have come instead. But this illustrates how HMRC examples tend to posit strong facts, so as not to give any hostage to fortune.

> **Example 2(b)**
> A similar judgement would be applied had H and his daughter been in the

[50] The example in full (including its irrelevant detail) is as follows:
"H is working in the construction industry and lives in Germany. He has business interests in the UK and has spent 68 days working here in the current tax year. He is a lone parent and his children usually live in the family home in Germany with him. H sends V, his 13 year-old daughter, for a 2 week holiday at a UK summer holiday camp. Whilst undertaking one of the activities she has an accident and is taken to hospital with a suspected major neck injury. H immediately travels to the UK, to be with his daughter and arranges for her to be moved back to Germany as soon as possible. This happens 3 days after the incident. V remains in hospital in Germany for a further 4 weeks."

[51] This originally read "life changing": HMRC have strengthened the facts to avoid giving a hostage to fortune.

> UK when the accident had occurred. If H stays with his daughter beyond their planned return date,[52] until she can be transferred back to Germany, the additional days where he is present at midnight would count as exceptional circumstances.
>
> Had H chosen not to arrange for his daughter to be transferred to a German hospital, and had elected to stay in the UK until she was released from hospital here, the additional time spent in the UK would not be considered as exceptional circumstances.

It would be a matter of medical evidence at what point it becomes *reasonably* possible for H to return home, but that point should not be before the discharge from hospital.

In *A Taxpayer v HMRC*:[53]

> 149... HMRC submitted that the "exceptional circumstances" test did not encompass a person who came to the UK under a moral obligation or an obligation of conscience to care for a family member or other person. Instead, HMRC argued that the "exceptional circumstances" test only applied where a person came to and remained in the UK either under a legal obligation (e.g. to care for their minor child) or was physically prevented from leaving the UK (e.g. by a volcanic eruption which made flights impossible). HMRC based their submission on the word "prevent" which, so the argument ran, should be construed so as to preclude a moral obligation or an obligation of conscience...
>
> 150. ... It could hardly have been Parliament's intention to have required the "exceptional circumstances" test to be failed if, for example, a taxpayer thought it necessary to be present because of serious illness or at the death bed of a close relative. The word "prevent" can encompass all manner of inhibitions – physical, moral, conscientious or legal – which cause a taxpayer to remain in the UK.

On the facts of the case, the need to care for the taxpayer's twin, who needed help which no-one else could provide, and her minor children, constituted exceptional circumstances which qualified for relief. The FTT said that "it would be hard to imagine a more unjust conclusion than that advocated by HMRC".[54] The reader may agree with that sentiment. But HMRC may not, as they have appealed on this point, and the case is not yet final.

[52] The period before the planned return date does not meet the condition in para (a)[iv]; see the example of Claude's car crash, above.

[53] [2022] UKFTT 00133 (TC).

[54] *A Taxpayer v HMRC* [2022] UKFTT 00133 (TC) at [150].

6.17.5 *Para (b): Intention to leave*

The requirement in para 22(4)(b) is:

> P intends to leave the UK as soon as those circumstances permit.

The RDRM provides:

> **RDRM13240: What are exceptional circumstances** [Dec 2021]
> For days spent in the UK due to exceptional circumstances to be ignored, an individual must intend to leave the UK as soon as those circumstances permit. If an individual does leave the UK once the exceptional circumstances have ended, HMRC will usually accept this as evidence of such an intention.

Conversely if the individual does not leave as soon as the circumstances permit, it may be inferred that they never did intend to leave, in which case none of the days qualify for exemption.

The RDRM provides an example where the individual originally intended to leave as soon as possible, but changed his mind:

> **RDRM13240: What are exceptional circumstances** [Dec 2021]
> **Example 4**
> The circumstances are the same as example 3 [Claude's car crash[55]]. However, C's nephew, who lives in Wales, writes to him in hospital and suggests C should stay with him when C leaves hospital. C writes back on 1 December agreeing.
> From 1 December it is no longer C's intention to leave the UK as soon as the exceptional circumstances have come to an end; and so only the period 1 November to 30 November can be discounted as exceptional circumstances for SRT day counting purposes.

C would do better to leave the UK as soon as he recovers, and then visit the Welsh nephew on a subsequent occasion. How long a gap should there be? Strictly, one day away would suffice (or maybe even less?). But the reader may think that a little longer may be wise. Fortunately the problem will not often arise.

6.17.6 *Non-exceptional: examples*

The RDRM provides:

[55] See 6.17.4 (Para (a)[iii] & [iv]).

> **RDRM13260: Examples of circumstances not normally considered to be exceptional circumstances** [Dec 2021]
> Life events such as birth, marriage, divorce and death, are not routinely regarded as exceptional circumstances.

A visit to the UK on the occasion of the birth of a grandchild may not be exceptional enough, in the absence of special circumstances. But if a visit for the illness or accident of close family is sufficient (see above) why not the same for a visit to attend the funeral? One may be getting close to the border, here, and the issue is fact sensitive. "Not routinely" is not much guidance, but it may be the most that can be said.

> Choosing to come to the UK for medical treatment, or to receive elective medical services such as dentistry, cosmetic surgery or therapies will not be regarded as exceptional circumstances.

There are two possible reasons why the relief may not apply for less serious medical conditions such as routine dentistry:
(1 The condition may not be exceptional.[56]
(2) The condition may not prevent P from leaving the UK.

Suppose however:
(1) a person is suffering from a serious, life-threatening condition, which qualifies as exceptional circumstances, but
(2) they chose to come to the UK for treatment (to ensure continuity of treatment with their own doctor) when they might have sought treatment elsewhere.

The treatment, at least once it starts, does prevent P from leaving the UK. It might be said that the effective reason that the person is in the UK is not the treatment, but that they chose to come here for the treatment. But that does not matter. The requirement of para (a)[iv] is still met that "P would not be present in the UK but for the exceptional circumstances". That is a looser test of causation, which is met.

> Travel problems, for example a delayed or missed flight due to traffic disruption, train delays or cancellations, or a car breakdown, will not be considered as exceptional circumstances, nor will delays in obtaining visas.

Ordinary travel problems are (by definition) not exceptional, but it is a

[56] But it is a question of fact, and it is possible that a dental emergency may be exceptional circumstances.

question of fact and degree. HMRC (rightly) accepted that individuals prevented from leaving the UK because of travel disruption caused by the Eyjafjallajökull volcanic eruption qualified for the exceptional circumstances disregard.[57]

6.17.7 *60-day cap*

Para 22(6) sch 45 FA 2013 caps the number of exceptional days allowed:

> For a tax year–
>
> (a) the maximum number of days to which sub-paragraph (2) may apply in reliance on sub-paragraph (4) is limited to 60, and
>
> (b) accordingly, once the number of days within sub-paragraph (4) reaches 60 (counting forward from the start of the tax year), any subsequent days within that sub-paragraph, whether involving the same or different exceptional circumstances, will count as days spent by P in the UK.

The RDRM provides a simple example. The facts are the same as for Claude's car crash:

> **RDRM13240: What are exceptional circumstances** [Dec 2021]
> **Example 1 (Anna - explosion)**

The facts (stripping out irrelevancies) are as follows:[58]

> A suffers an accident on a boat. She is found unconscious. The emergency services airlift A to the UK, where she remains for 5 months.
> A leaves the UK as soon as she is discharged from hospital.
> A has been in the UK for 202 days.

The HMRC analysis is as follows:

> The disaster would be considered to be an exceptional circumstance

[57] See the 2012/13 edition of this work para 3.26.1 (Volcanic Ash: disruption to air travel 2010/11).

[58] The example in full (including its irrelevant detail) is as follows:
"A is returning to her home in Denmark having spent her 7 week summer holiday working in the UK. This was her first visit to the UK.
On her boat journey home there is an explosion in the engine room. Emergency rescue services attend the vessel, and A is found unconscious and badly burned. The emergency services make the decision to airlift A to a specialist burns unit in the UK, where she remains for 5 months. A returns to Denmark as soon as she is discharged from hospital.
A has been in the UK for 202 days."

> beyond A’s control. However, the maximum number of days that can be ignored towards days spent in the UK is 60. So A has 142 days which count as days spent in the UK.

What if A had remained conscious? Once again, the example posits easy facts and avoids harder problems.

6.17.8 *Exceptional: Record keeping*

RDRM12930 comments on record keeping. If appropriate, the individual should keep information and records relating to:

- what their circumstances were
- what did they do to mitigate them where that was possible, for example making alternative travel arrangements

6.17.9 *Exceptional circumstances ignored*

The RDRM provides:

> **RDRM13220: where exceptional circumstances can be taken into account when determining the number of days spent in the UK** [Dec 2021]
> The following parts of the SRT allow for days attributable to exceptional circumstances to be discounted:
> - First automatic UK test (RDRM11320) – an individual spends 183 days or more in the UK
> - First automatic overseas test (RDRM11120) – an individual spends fewer than 16 days in the UK
> - Second automatic overseas test (RDRM11130) – an individual spends fewer than 46 days in the UK
> - Third automatic overseas test (RDRM11140) – number of days an individual spends in the UK is fewer than 91, excluding qualifying days under the deeming rule
> - Fourth automatic overseas test for deceased individuals (RDRM11920) – an individual spent less than 46 days in the UK
> - Sufficient ties tables (RDRM11520) – number of days an individual spends in the UK compared against the number of ties they have
> - 90 day tie (RDRM11570) – an individual spends more than 90 days in the UK in the previous tax year, or the one before that
> - Split year cases 1 and 2 (RDRM12050 and RDRM12110) – permitted limit of number of days an individual spends in the UK, excluding qualifying days under the deeming rule
> - Split year case 3 (RDRM12130) - an individual spends fewer than 16 days in the UK
> - Split year cases 4, 5 and 8 (RDRM12150 , RDRM12170 and RDRM12270) –

proportionately reduced number of days an individual spends in the UK for sufficient ties

- Split year cases 6 and 7 (RDRM12190 and RDRM12240) – permitted limit of number of days an individual spends in the UK, excluding qualifying days under the deeming rule

6.17.10 *Exceptional circumstances not ignored*

However there are many SRT rules for which exceptional circumstances do not provide a defence:

RDRM13230: where exceptional circumstances cannot be taken into account when determining number of days spent in the UK [Dec 2021][59]
The following SRT tests do not allow for the deduction of days attributable to exceptional circumstances to be discounted:

[1] Second automatic UK test (see RDRM11330)

- An individual is present in their home on at least (for UK homes), or fewer than (for overseas homes) 30 separate days
- Period of 91 consecutive days, at least 30 of which fall within the tax year

[2] Third automatic UK test (see RDRM11370)

- An individual works sufficient hours in the UK, as assessed over a period of 365 days
- 75% of the total number of days
- At least 1 day in the tax year is a day on which an individual does more than 3 hours of work in the UK
- Significant break – 31 days go by

[3] Third automatic overseas test (see RDRM11140)

- Significant break – 31 days go by
- Number of days on which an individual does more than 3 hours work in the UK is fewer than 31

[4] Full-time work – 15 day gap between employments, and 30 day maximum number of days that may be subtracted for gaps between employments (see RDRM11150 or RDRM11380)

[5] Family tie (see RDRM11530)

- An individual spends time with their child in person on 60 days or fewer, for all or part of a day
- An individual's child spends fewer than 21 days in the UK outside term-time

[6] Accommodation tie (see RDRM11550)

- Continuous period of 91 days

[59] I have amended the layout for the sake of clarity.

- Gap of 15 days or fewer

[7] Work tie – an individual works in the UK for at least 40 days (see RDRM11560)

[8] Country tie – midnight test – greatest number of midnights (see RDRM11580)

[9] Deeming rule – if an individual has more than 30 qualifying days, the excess are treated as if the individual were in the UK at the end of the day, subject to the conditions set out in RDRM11720.

That rather reduces the value of the exceptional circumstances disregard.

6.18 Covid

6.18.1 *Covid: Exceptional circumstances*

RDRM specifies five straightforward cases where Covid-related circumstances meet the statutory requirements. I set these out here. But these cases are not a comprehensive list of when Covid constitutes exceptional circumstances, and do not claim to be:

> **RDRM11005 Coronavirus (COVID-19)** [Dec 2021]
> Whether days spent in the UK can be disregarded due to exceptional circumstances will always depend on the facts and circumstances of each individual case.

I set out the guidance below, but ultimately the question to consider is not whether P's circumstances fall within one of the HMRC specified cases, but whether they meet the statutory requirements set out above.

In considering whether a person is forced to be in the UK due to Covid, it should be assumed that the person will comply with the law and follow government guidance. It does not matter that a person might theoretically be able to leave the UK in breach of the law, or in breach of government guidance.

6.18.2 *Quarantine/self-isolation*

> **RDRM11005 Coronavirus (COVID-19)** [Dec 2021]
> ... if you:
> [1] are quarantined or advised by a health professional or public health guidance to self-isolate in the UK as a result of the virus...
> the circumstances are considered as exceptional.

> **RDRM13410 International tax clarifications due to coronavirus (COVID 19) - Q&A** [Dec 2021]
> **4. Does UK wide Government advice on self-isolation mean that**

> **exceptional circumstances apply?**
> If your stay in the UK has been extended because you are self-isolating in line with government advice, the period of self-isolation after your original planned departure date will be covered by exceptional circumstances.

6.18.3 *Advice not to travel*

> **RDRM11005 Coronavirus (COVID-19)** [Dec 2021]
> ... if you ...
> [2] find yourself advised by official Government advice not to travel from the UK as a result of the virus...
> the circumstances are considered as exceptional.

The RDR Manual provides:

> **RDRM13410 International tax clarifications due to coronavirus (COVID 19) - Q&A** [Dec 2021]
> ... **1. Are travel restrictions due to the COVID-19 pandemic counted as exceptional circumstances for the statutory residence test?**
> ... Circumstances are considered exceptional where you find yourself advised by official government advice not to travel from the UK as a result of the virus. For example, on the 17 March 2020 the Foreign and Commonwealth Office (FCO) advised British nationals against all but essential international travel during the pandemic.

Para [3] could apply to anyone in the UK, for the period that:

(a) The Government advised against all but essential travel, or
(b) Travel was prohibited in the absence of a reasonable excuse. What constitutes a reasonable excuse will partly depend on government guidance, which has varied over time. From 26 March to 1 June 2020, travel was permitted only for limited reasons, eg for work which could not be done from home.[60] Leaving one's home in the UK was in principle unlawful.

6.18.4 *Closure of borders*

> **RDRM11005 Coronavirus (COVID-19)** [Dec 2021]
> ... if you ...
> [3] are unable to leave the UK as a result of the closure of international

[60] Reg 6 Health Protection (Coronavirus, Restrictions) (England) Regulations 2020 (26 March 2020). Lockdown in the UK started 23 March 2020, with some restrictions in effect earlier.

> borders...
> the circumstances are considered as exceptional.

The RDR Manual provides:

> **RDRM13410 International tax clarifications due to coronavirus (COVID 19) - Q&A** [Dec 2021]
> **2. What does HMRC mean by closure of international borders?**
> Circumstances are considered exceptional where you are unable to leave the UK as a result of the closure of international borders.
> Many territories will continue to allow citizens, permanent residents or nationals to return to those territories even with wider border restrictions in place. However, if you are unable to leave the UK as a result of the closure of international borders, for exceptional circumstances to apply, you must be able to demonstrate that you have made every effort to leave once those restrictions have been lifted.

6.18.5 *Return at request of employer*

> **RDRM11005 Coronavirus (COVID-19)** [Dec 2021]
> ... if you ...
> [4] are asked by your employer to return to the UK temporarily as a result of the virus
> the circumstances are considered as exceptional.

6.18.6 *Return to support family*

> **RDRM13410 International tax clarifications due to coronavirus (COVID 19) - Q&A** [Dec 2021]
> **7. I came to the UK to support my vulnerable family members who needed assistance during the COVID-19 pandemic. Would this be considered an exceptional circumstance?**
> Certain vulnerable people have been asked to 'shield' or 'self-isolate' due to the COVID-19 pandemic. Whether or not the impact of those circumstances is exceptional to you, will depend on the facts and circumstances of your case. You will need to be able to demonstrate why it was necessary for you to come and remain in the UK to provide support for a vulnerable member of your family.
> Documentation to support your case may include, but is not limited to, a letter, email or text message from a medical professional telling the family member to shield or self-isolate, and evidence from the local authority that help or support was not available to them, or confirmation that they were relying on you to provide the support.

See the HMRC example of Henrik at 6.17.4 (Para (a)[iii] & [iv]).

6.18.7 *Covid: other residence rules*

Covid provides no relaxation or relief for tax rules beyond the exceptional circumstances rule. For instance, there are no extensions to the 60-day cap for exceptional circumstances,[61] or the 30 day UK workday limit[62]. The minutes of the Joint Expatriate Forum on Tax & NICs provide:

> **Question**: Is there going to be any movement from HMRC on the 60 days for exceptional circumstances, particularly given we are in June now? For people this year, still stranded in the UK, that is a key question. Also, regarding full-time work abroad, are HMRC are reviewing any concessions where an individual is remote working in the UK and has gone over the 30 workdays?
> **HMRC Answer**: The 60 days is a statutory rule. We have no latitude to impact that, and there is nothing in line to amend the legislation in respect to that at the moment. The same applies to working in the UK for 31 or more days. Discretion can be exercised with exceptional circumstances, however as statutory issues are not within our gift, it would be a ministerial consideration. There are also no plans to change the legislation in respect of a 'significant break'...
> There are no plans to change the legislation in respect of the 60 days and UK workdays, and we think the SRT is written broadly enough to accommodate people having to stay in the UK a little bit longer. We are only at the start of the tax year, and so people have the rest of the year to plan their presence here.[63]

Lobbying on that issue was not successful. The Manual now restates HMRC's approach:

> **RDRM13410 International tax clarifications due to coronavirus (COVID 19) - Q&A** [Dec 2021]
> ... The maximum of 60 days in a tax year that can be disregarded due to exceptional circumstances will continue to apply...
> Any day on which you work in the UK for more than 3 hours will count as a UK workday, even if they are days which have been disregarded for other tests due to exceptional circumstances...
> **9. I am normally non-resident for UK tax purposes. My company**

[61] See 6.17.7 (60-day cap).

[62] See 6.8.5 ((c): Less than 31 UK workdays).

[63] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/897729/HMRC_Joint_Expat-Forum-Tax_NICs_minutes-11-June-2020.pdf*

> **have asked me to come to the UK to work because of COVID-19. How will this impact my residence status?**
> Returning to the UK may result in a significant break in your overseas work (see RDRM11760) and you may no longer meet the 3rd automatic overseas test (working full-time abroad). Any day on which you work in the UK for more than 3 hours will count as a UK workday, even if they are days which have been disregarded for other tests due to exceptional circumstances.
> ... A change in anticipated residence in 2020-2021 may affect the prior year if it was a split year, see RDRM13230.
> **11. As a trustee of a non-UK resident trust, if I am unable to leave the UK due to COVID-19 travel restrictions, how will my presence in the UK affect the trust?**
> There are no special rules for determining the residence status of a trustee, the SRT rules apply. Days spent in the UK as a result of exceptional circumstances will be considered in determining whether you have become UK resident. If you become UK resident, this could affect the residence of the trustees as a body.
> **13. If I was planning to leave the UK during 2020-2021 so that I do not become deemed domiciled in 2021-2022, but I am unable to do so because of the restrictions currently in place, how am I affected?**
> There have been no changes to the deemed domiciled rules...
> **15. I usually carry out the duties of my employment both in the UK and abroad. I am non-UK domiciled and the duties I carry out abroad are taxed on the remittance basis. If I am unable to travel due to travel restrictions, how will I be taxed if I carry out my overseas duties in the UK?**
> There have been no changes to the current legislation. The earnings for the duties you perform in the UK will be treated as earnings in respect of UK duties. These earnings will not be eligible for the remittance basis and they will be taxed on the arising basis.
> **17. How will the employment article within a treaty be applied while I am working in the UK but for an overseas employer?**
> There is no change to the employment article and how it applies will depend on your circumstances.

In short: it is largely a matter of business as usual.

See too 9.31 (Covid and treaty-residence).

6.19 Deeming rule (frequent visits)

Para 23 sch 45 FA 2013 provides:

> (1) If P is not present in the UK at the end of a day, that day does not

> count as a day spent by P in the UK.
> (2) This is subject to the deeming rule.

Para 23 sch 45 FA 2013 provides:

> (3) The deeming rule applies if—
> (a) P has at least 3 UK ties for a tax year,
> (b) the number of days in that tax year when P is present in the UK at some point in the day but not at the end of the day ("qualifying days") is more than 30, and
> (c) P was resident in the UK for at least one of the 3 tax years preceding that tax year.
>
> (4) The deeming rule is that, once the number of qualifying days in the tax year reaches 30 (counting forward from the start of the tax year), each subsequent qualifying day in the tax year is to be treated as a day spent by P in the UK.
>
> (5) The deeming rule does not apply for the purposes of sub-paragraph (3)(a) (so, in deciding for those purposes whether P has a 90-day tie, qualifying days in excess of 30 are not to be treated as days spent by P in the UK).

The label "deeming rule" is opaque; I adopt the statutory term but add in brackets: "frequent visits".

6.20 "Home"

6.20.1 *Why "home" matters*

"Home" matters for many tax purposes, in particular:

Purpose	**Wording (in short)**	**See para**
The SRT:		
UK test 2	P has a UK home	6.11
UK test 4	P's home was in the UK in year of death	6.33.4
Accommodation tie	P's home is in the UK	6.29
Split-year rules:		
Case 2	No home in UK	10.7.4
Case 3	T ceases to have home in UK	10.8.2
Case 4	T has a home in UK	10.9.2
Case 7	T has no home in UK	10.12.3
Case 8	T has a home in UK	10.13.2
Treaty-residence	Permanent home available to T	9.12
Child's domicile, if parents living apart		4.17.3
Deductibility of travel expenses for employment income		35.9; 35.10

The word *home* is also used:

(1) as a synonym for private-residence (ie having a home is the same as having a private-residence);[64] and
(2) as a synonym for territory-residence (ie having a home in a territory is synonymous with residing in the territory)[65]

Para 25 sch 45 FA 2013 elucidates the meaning of "home". This provision only applies for the purposes of sch 45 (SRT, split year rules) but (with the exception of the rule relating to holiday homes) it sets out the normal meaning of the word "home", and so there is not much difference between the meaning of home in sch 45 and the meaning elsewhere.

Also see 6.35.2 (Record keeping: Home).

6.20.2 *Home: nutshell definitions*

In *Re Y*:

> 'Home' is defined thus in the Shorter Oxford English Dictionary:
>
> > "A dwelling-place, house, abode: the fixed residence of a family or household; one's own house; the dwelling in which one habitually lives, or which one regards as one's proper abode."
>
> It is a definition which, in my judgment, contains the essential elements of a "home" as it is to be understood for present purposes.[66]

The Law Commission observes:

> "Home" conveys ... the combined ideas of physical presence and emotional link.[67]

The point is encapsulated in the folk saying that "home is where the heart is". In the dictionary definition set out above, home is a place which one *regards* as one's proper abode. The views of the individual are therefore important. It would be surprising if a place which an individual regards as home is not in fact their home. The views of the parties as to which property was the main residence were held to be relevant in *Frost v Feltham*; see 55 TC at p.16; the same applies *a fortiori* in determining whether a property is a "home".

A New Zealand case offers a metaphor:

[64] See 6.21.3 (Home/residence compared).

[65] See 4.6 (Domicile-residence).

[66] [1985] Fam 136 at p.140.

[67] *The Law of Domicile* (1987) Law Com 186 at para 4.20 *http://www.scotlawcom.gov.uk/download_file/view/228/*

> the location of what for the present constitutes the centre of gravity of the domestic life of the taxpayer—the axis around which his domestic life revolves.[68]

I am not sure how helpful that would be in a borderline case.

Fox discusses "home" from an interdisciplinary viewpoint, and concludes that the concept "represents a complex amalgam of financial, practical, social, psychological, cultural, politico-economic, and emotional interests to its occupiers".[69]

The fact that one does not have a room set aside for oneself in a "home" does not shed much light on whether it is a "home". The more important question is whether space is available when one wishes to use it. In Robert Frost's lines:

> Home is the place where, when you have to go there,
> They have to take you in.

6.20.3 *HMRC examples: Disclaimer*

The RDRM provides the usual disclaimer:

> **RDRM13030 The second automatic UK test and the context of a 'home'** [Dec 2021]
> As the meaning of 'home' can vary according to its context, it is not possible for this guidance to provide an absolute definition of the term. What this guidance does is to give indicators outlining the characteristics that a home will generally have.
> There are some general examples of what a home may or may not be. Whether a place is or is not a home will always be dependent on the facts and circumstances of its use by the individual. HMRC may choose to enquire into those facts and circumstances.

6.20.4 *Any form of home*

Para 25(1) sch 45 FA 2013 provides:

> A person's home could be
> [1] a building or
> [2] part of a building or, for example,

[68] *Geothermal Energy New Zealand Ltd v CIR* [1979] 2 NZLR 324 approved *O'Brien v Quigley* [2013] IEHC 398 at [31] - [33].

[69] Fox, "The meaning of home: a chimerical concept or a legal challenge?" [2002] JLS 580.

> [3] a vehicle,
> [4] vessel or
> [5] structure of any kind.

OECD Model Commentary provides:

> 13 As regards the concept of home, it should be observed that any form of home may be taken into account (house or apartment belonging to or rented by the individual, rented furnished room).

This is making a similar point in the context of treaty-residence. The rule in para 25(1) reflects the general meaning of the word.

The RDRM gives a straightforward example of a caravan:

> **RDRM13050 The principles and characteristics of a home for the purposes of the SRT** [Dec 2020]
> Example 1 (Jim)
> J lives in a mobile home with his wife. They travel extensively throughout the UK to wherever J can find work. They keep their personal belongings in the mobile home, take most of their meals there, and with the exception of their annual holiday abroad, sleep in it every night. It is where J and his wife spend most of their time when J is not working. It is their home.

6.20.5 *Period of occupation*

One characteristic of a "home" is that one lives there, with some degree of permanency. In *Re Y*:[70]

> ... any individual may have two homes; but each, in my judgment, to be properly so called, must comprise some element of regular occupation (whether past, present, or intended for the future, even if intermittent), with some degree of permanency, based upon some right of occupation whenever it is required, where ... "You find the comforts of what is known as home"; the fixed residence of a family or household.

How long is needed? A few days or weeks is insufficient, but 6 months is clearly enough. In *Nemcova v Fairfield Rents Ltd*: [71]

> Occupation as a home requires a degree of permanence. This is likely to be met if [the appellant] were to sublet the Flat on an assured shorthold tenancy for a term of, say, six months. It is not, in our view, met in the

[70] [1985] Fam 136 at p.140.
[71] [2016] UKUT 303 (LC) at [15].

> type of short term letting entered into by the respondent where the occupants only stay for a few days or possibly weeks. We do not think it conceivable that such an occupant would think of themselves as using the Flat as a home.

However, the *amount* of time that one spends in a place may not shed much light on whether that place is a "home". One can spend relatively little time in a place which is still a home, or even a main or principal residence.[72] Para 25(2) sch 45 FA 2013 acknowledges the point without providing any further guidance:

> Whether, for a given building, vehicle, vessel, structure or the like, there is a sufficient degree of permanence or stability about P's arrangements there for the place to count as P's home (or one of P's homes) will depend on all the circumstances of the case.

The RDRM gives an example of an international commuter spending roughly equal time in two homes:

> **RDRM13050 The principles and characteristics of a home for the purposes of the SRT** [Dec 2020]
> Example 3 (William)
> W has business interest in both Switzerland and the UK. He flies to Switzerland each Monday returning to the UK every Thursday. In Switzerland he lives in a rented flat. When in the UK he lives with his family at the family home, which he has owned for many years.
> In this situation both properties are his homes.

That is an easy case.

A home ceases to be a home if it is let to a third party:

> W subsequently decides he does not need to spend so much time in Switzerland, and starts to travel there less frequently. He sub-lets his flat in Switzerland retaining no rights to use it, choosing instead to stay in whatever hotel can accommodate him.
> He now only has 1 home, which is in the UK.

The next example concerns a relatively short absence (2 months):

> **RDRM13050 The principles and characteristics of a home for the purposes of the SRT** [Dec 2020]
> Example 4 (Elizabeth)
> E is seconded to New York for 2 months by her UK employer. She stays

[72] *Frost v Feltham* 55 TC 10, see 4.11.3 ("Chief" residence).

> at a hotel when she is there. Prior to her secondment she lived with her husband in their home in London. Her husband continues to live and work in the UK. When E returns to the UK after her secondment she returns to live with her husband in their London home.
>
> The London house was E's home throughout the period of her secondment.

The next example concerns a longer and more indefinite absence:

> **RDRM13050 The principles and characteristics of a home for the purposes of the SRT** [Dec 2020]
>
> Example 5 (Asif)
>
> A has lived and worked in the UK for many years, occupying the same apartment in Liverpool since the day he arrived here. A's father lives in Sweden and is seriously ill. Ten months ago A decided to take a career break to care for his father and moved to Sweden. He does not know how long he will be out of the UK.
>
> Since moving to Sweden A has not returned to Liverpool, but his apartment remains empty and available for him to return to whenever he wants.
>
> In this situation A will have a home both in Liverpool and Sweden, even though he is spending all of his time in Sweden.

The next example concerns absence during temporary building work:

> **RDRM13050 The principles and characteristics of a home for the purposes of the SRT** [Dec 2020]
>
> A place that is used as a home will remain a home even if it is temporarily unavailable, for example, because of damage or renovation work.
>
> Example 6 (Rachel and Tom)
>
> R and T's kitchen and dining room have suffered flood damage. The estimated clean-up and repair operation will take 6 weeks, so they stay with R's parents while the work is being done.
>
> The property will remain their home even though R and T are unable to stay there for the time being.

That seems an easy case.

Building work *before* moving into a home is different:

> An individual's home starts to be their home as soon as:
>
> - it is capable of being used as their home, for example, individual has taken ownership of it, even if it is temporarily unavailable because of renovation
> - they actually use it as their home

> If the first point above is satisfied, but in fact the individual never actually uses it as their home, then it will not be the individual's home.
>
> **RDRM13050 The principles and characteristics of a home for the purposes of the SRT** [Dec 2020]
>
> Example 7 (Aneta)
>
> A moved from Poland to the UK and she completed the purchase of her new house on 1 June. Whilst it was empty she stayed with friends, until her belongings arrived. These were moved in by the removal firm on 15 June.
>
> A stayed in her new home overnight that night. However, as she had arranged to have some extensive refurbishment done to her bathrooms and kitchen, she stayed in a local hotel and with friends while the main works were carried out. She moved into her home on a permanent basis on 15 July.
>
> For SRT purposes HMRC would consider that the house became A's home from 15 July.
>
> The key points are that:
>
> - a place must be capable of being used as a home, even if it is temporarily unavailable
> - an individual must actually use it as a home.

The rule in para 25(2) represents the general meaning of the word "home".

Two DTA cases are consistent with this guidance, and illustrate how the issue is multi-factorial and fact sensitive.

In *FFF v IRC*[73] the taxpayer took a 3 year post in Fiji (later extended). He retained the property in New Zealand which had been the family home. He conducted building works at the property, expected to be a six-month project, but matters dragged on, as commonly happens. The building work was to enhance the property as his family home, and on return to New Zealand he returned to the property. In the meantime he lived in accommodation provided by his employer in Fiji, which did not constitute a home. In these circumstances the taxpayer continued to have a home in New Zealand throughout the rebuilding works.

Contrast *O'Brien v Quigley*.[74] Here the taxpayer, who did have a home in Portugal, purchased a property in Ireland in May 2000, commenced major work in June 2000, and moved into the property in 2002. The property was not his home prior to moving in, in 2002.

[73] [2011] NZTRA 8. The reader may think this a borderline case.

[74] [2013] IEHC 398; and see Avery Jones case note in 19 ITLR 605.

6.20.6 *Holiday home*

Para 25(3) sch 45 FA 2013 provides:

> But somewhere that P uses periodically as nothing more than a holiday home or temporary retreat (or something similar) does not count as a home of P's.

The RDRM provides:

> **RDRM13060 What is not considered a home for the purposes of the SRT** [Dec 2021]
> [The Manual sets out para 25(3) and continues:] So a holiday home where an individual spends time for occasional short breaks, and which clearly provides a distinct respite from their ordinary day to day life, will not be a home.
> However, if there comes a time when an individual's use of a holiday home or temporary retreat changes, so that it is used as a home, it will become a home from the time of the change. It will then continue to be a home until such time as circumstances change again, and it ceases to be used as a home.
> Example 3 (Jenny)
> J lives in Birmingham and works from home. She also owns an apartment in Spain, which she rents out apart from 2 to 3 weeks a year when she takes her holiday there. The Spanish property is not her home.

That is an easy case as the property is let out except for the 3 weeks it was occupied by J. But under para 25(3) the Spanish property would not be J's home if J occupied it for her 3 week holiday, and it was either empty or used by other members of J's family or friends for the rest of the year. In this respect it might be that the rule in para 25(3) might not represent the natural meaning of "home". That is, the property on those facts might be a home available to J for DTA purposes even though it was not a home for SRT purposes.

The HMRC example continues:

> However, J then decides to live in the Spanish apartment throughout the British winter time, from October to March. Her use of the property has changed from being somewhere she used as an occasional short break, to somewhere she uses as a home for part of the year. The property is her home from the point she commences using the property as her home.

6.20.7 *No ownership requirement*

Para 25 sch 45 FA 2013 provides:

> (4) A place may count as a home of P's whether or not P holds any estate or interest in it (and references to "having" a home are to be read accordingly).
> (5) Somewhere that was P's home does not continue to count as such merely because P continues to hold an estate or interest in it after P has moved out (for example, if P is in the process of selling it or has let or sub-let it, having set up home elsewhere).

The rules in para 25(4)(5) represent the general meaning of the word "home".

A house belonging to parents will be the home of children who live there:

> **RDRM13050 The principles and characteristics of a home for the purposes of the SRT** [Dec 2020]
> Example 2 (Mary)
> M comes back to the UK to take up employment after spending 3 years studying abroad. She has given up the tenancy on the flat she occupied abroad and moves into her parent's house. Her parent's house is her home.

The RDRM provides:

> **RDRM13060 What is not considered a home for the purposes of the SRT** [Dec 2021]
> If an individual moves out of their home completely, and makes it available to let commercially on a permanent basis; it will not be their home during the period it is let unless, they or their family retain a right to live there.
> This can happen, for example, where the rental agreement permits the individual to use the property or part of the property as living accommodation.
> Example 1 (Ivan)
> I left the UK to work in Germany. He lets the flat he previously lived in to a tenant on a 2 year lease. After 18 months I is made redundant and returns to the UK. The rental agreement on his flat gave exclusive use of the property to the tenant, so I arranged to stay with relatives and friend until the lease expires. For the period his property was let, it is not his home.
> However, if the rental agreement had allowed I to use the flat and he had stayed there when he visited the UK, it would have remained his home throughout.
> A place that has never been capable of functioning as a home cannot be a home. For example, a property purchased in such a state of disrepair that it is not capable of being lived in as a home, is not a home, until such time as it becomes habitable.

> If an individual completely moves out of a property and make no further use if it whatsoever, it will no longer be their home.
> **RDRM13060 What is not considered a home for the purposes of the SRT** [Aug 2019]
> Example 2 (Harry)
> H's new job requires him to travel extensively around Europe. He spends some time working in the UK, but most of his work is carried out in other countries. He decides to sell his UK property. On 3 June he puts his furniture and other belonging in storage, and 2 weeks later he hands the keys to his estate agent.
> He did not return to his UK property after 3 June, and stayed in hotels or with friends, on the occasions he came back to the UK. The property is not his home from 3 June, the date H put his furniture and belongings into storage.

It makes no difference whether a property is owned by an individual or by a company of which the individual is the ultimate beneficial owner.[75]

6.20.8 *No kitchen*

Uratemp Ventures v Collins[76] decided that a dwelling (ie a home) does not require a kitchen. The rhetoric to fine to omit, though the point will not often arise in a tax context:

> According to the Book of Common Prayer, "the fir trees are a dwelling for the storks" (Psalm 104); while W. S. Gilbert condemned the billiard sharp "to dwell in a dungeon cell" (The Mikado). It is hardly necessary to observe that Victorian prison cells did not possess cooking facilities... An earlier and greater poet wrote of Lucifer being hurled "to bottomless perdition, there to dwell in adamantine chaos and penal fire": (Paradise Lost).
> ... his home is not the less his home because he does not cook there but prefers to eat out or bring in ready-cooked meals.

6.21 "Home" vocabulary compared

I noted at the start of this chapter that "home" is one of cluster of synonyms or near synonyms, such as residence and dwelling. This section considers what differences there may be between these terms. This question matters, as so far as the words are the same, cases and guidance

[75] This is self-evident, but if authority is needed, see *O'Brien v Quigley* [2013] IEHC 398 at [49].

[76] [2001] UKHL 43 at [30].

on, say, what constitutes a residence for CGT private residence relief,[77] would be relevant in determining what is a home; and vice versa. And more generally, it is good to know what we are talking about.

I am here considering the general sense of these terms. Of course, the context, or a statutory definition may alter the general sense. In particular, para 25 sch 45 FA 2013 elucidates the meaning of home for the SRT and has no equivalent elsewhere. But most of para 25 represents the usual meaning of home, except for the exclusion of holiday homes: a holiday home is not a home for the SRT, but may be a home in the general sense.

There may be reasons for selecting any particular term. In the SRT and the OECD Model the word "home" is better than "private residence", because the legislation uses the word "residence" in the sense of tax residence. The drafter of the SRT may have had precedent of the OECD Model in mind when selecting the term "home".

When discussing a statute, it is better to use the statutory term, whichever it may be.

6.21.1 *Home: SRT/DTA compared*

According to the RDRM, "home" in DTAs has a different meaning from "home" in the SRT:

> **RDRM13030: the context of a 'home'** [Dec 2021]
> The concept of home as described in this guidance relates only to the SRT. The guidance does not apply for the purpose of applying the Residence Article under a double taxation agreement. Double taxation agreements have additional qualifiers that are not included as part of the SRT and so the 2 terms do not have the same meaning.

The differences are minor ones:

(1) The question for the OECD Model is whether a person has a permanent home *available*. A dwelling which has never been occupied, but which is ready for occupation, would be a home for the OECD Model but for the SRT.

(2) As noted, para 25 sch 45 FA 2013 applies for sch 45 but not for DTAs. Most of para 25 represents the usual meaning of home, but a holiday home (excluded for the SRT) may be a home for the DTA.[78]

[77] See 59.2 ("Residence").

[78] A further apparent difference is that the expression in the OECD Model is "*permanent* home"; but "permanent" does not add anything. Temporary accommodation does not constitute a "home" at all. See 6.20.5 (Period of

Subject to those points, it is suggested that the meaning of home is the same in both contexts.

6.21.2 *Home/dwelling compared*

"Dwelling" is the same as home. In *Uratemp Ventures v Collins:*[79]

> The words "dwell" and "dwelling" are not terms of art with a specialised legal meaning. They are ordinary English words, even if they are perhaps no longer in common use. They mean the same as "inhabit" and "habitation" or more precisely "abide" and "abode", and refer to the place where one lives and makes one's home....
> ... residential accommodation is "a dwelling" if it is the occupier's home (or one of his homes). It is the place where he lives and to which he returns and which forms the centre of his existence.

6.21.3 *Home/residence compared*

Is there a difference between:
(1) "home" (in the SRT or elsewhere) and
(2) "residence" (in the sense of private residence[80]) or dwelling-house?

There could be a difference of nuance, for while a home must be a residence, the word home is more emotive and perhaps a residence need not be a home. This view is supported by *Uratemp Ventures v Collins:*[81]

> The words "dwell" and "dwelling" ... mean the same as "inhabit" and "habitation" or more precisely "abide" and "abode", and refer to the place where one lives and makes one's home. They suggest a greater degree of settled occupation than "reside" and "residence" ...

And again, in *Nemcova v Fairfield Rents Ltd*[82]

> The covenant refers explicitly to use 'as a private residence'. It does not refer to the word 'home', nor does it require the occupier, in terms, to use the premises as his or her home. It is important to be extremely careful not to gloss the terms of the clause so as to impose a requirement that was not intended. It is necessary to take care in importing the concept of "home"... That concept may carry with it imputations of

occupation).

[79] [2001] UKHL 43 at [30].

[80] See 6.1 (Concepts of residence).

[81] [2001] UKHL 43 at [30] - [31].

[82] [2016] UKUT 303 (LC) at [47].

> permanence, personal attachment, emotional ties or exclusivity. None of those are necessarily inferred by the words actually employed. The question to be asked is not whether the premises are being used as the occupier's home but whether they are being used as a private residence.

But it is considered that the difference is too slight to bear any weight, given the general vagueness of both words. The words have essentially the same meaning: they as close as makes no difference. (Are there *any* two English words which are *completely* synonymous? Discuss).

The CG Manual takes this view:

> **CG64435 Meaning of residence: judicial interpretation** [Jul 2019]
> The scheme of private residence relief was summarised by Brightman J in *Sansom v Peay* (52 TC 1) as,
>
> > "To exempt from liability to Capital Gains Tax the proceeds of sale of a person's home."
>
> Here Brightman J uses the word 'home' in substitution for the word 'residence'.
> And in *Frost v Feltham* (55 TC 10), where the Court was asked to decide which of an individual's residences was his main residence, Nourse J stated,
>
> > "A residence is a place where somebody lives."
>
> These quotations clearly emphasise the point that the test of residence is one of quality rather then quantity: the dwelling house must have become the owner's home.

In the quote from *Sansom,* home is used as a *synomym* of residence. In the last sentence of the passage, home is used as an *explanation* of residence. But it comes to the same thing.

This view leaves the law in a more rational state, as a distinction between a home and a residence is a fine one, if it is comprehensible at all, and best avoided if possible.

6.21.4 *Home/living accommodation compared*

It is suggested that "living accommodation" does not require the degree of permanence of a home. A place one lives in for a few days may be living accommodation, though not a home.

6.22 "Work"

6.22.1 *Work: Introduction*

"Work" matters for:

(1) Overseas test 3: Overseas work

(2) UK test 3: UK work
(3) The work tie

See too 6.35.3 (Record keeping: Work).

The starting point is para 26(1) sch 45 FA 2013 which provides:

> P is considered to be "working" (or doing "work") at any time when P is doing something–
> (a) in the performance of duties of an employment held by P, or
> (b) in the course of a trade carried on by P (alone or in partnership).

In the following discussion:
Work within para (a) is **"employment-work"**.
Work within para (b) is **"trading-work"**.

The residence consultation response paper explains:

> 3.53 A variety of respondents asked for clarification about the definition of work as applied throughout the residence test. There were concerns that the definition would be too broad and could include activities that were related to work but which did not amount to undertaking work. ...
> 3.54 The Government proposes that, for the purposes of the residence test, an individual will be working if they are performing the duties of their office or employment or, in the case of the self-employed, doing something in the course of their trade. The Government believes this will ensure that the definition is not too broad.[83]

For instance, gardening in one's own garden, or completing one's own tax return, does involve work, often hard work, in the general sense; but it is not employment-work or trading-work, which is narrower.

6.22.2 *Employment-work*

Para 26(1) sch 45 FA 2013 provides:

> P is considered to be "working" (or doing "work") at any time when P is doing something–
> (a) in the performance of duties of an employment held by P...

There is a similar definition in s.689(6) ITEPA.[84]

[83] HM Treasury/HMRC, "Statutory definition of tax residence and reform of ordinary residence: a summary of responses" (June 2012) *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_srt_or_summary.pdf*

[84] See 36.5.3 ("Work").

In order to apply this, it is necessary to ask:

(1) whether P holds an employment; and
(2) what are the duties of the employment.

The question of what are the duties of an employment comes up in various contexts, but most importantly in s.336 ITEPA which provides:

> ... a deduction from earnings is allowed for an amount if... the amount is incurred wholly, exclusively and necessarily in the performance of the duties of the employment.

"Duties of the employment" has always been narrowly understood. *Snowdon v Charnock* summarised:[85]

> All the authorities distinguish between
> [1] expenditure incurred in the performance of duties (which is deductible) from
> [2] expenditure incurred to put the taxpayer in a position to perform the duties (which is not).

In *Consultant Psychiatrist v HMRC*:[86]

> The principle to be derived from the authorities is that there is a distinction between
> [1] the nature of the job requiring the incurring of the expenditure, and
> [2] the expenditure enabling the person to do the job better …

So in *Simpson v Tate*[87] the expenses of a medical officer keeping up-to-date were not deductible: this was not

> moneys expended in the performance of his official duties. He does not incur these expenses in conducting professional inquiries or get the journals in order to read them to the patients … He incurs these expenses in qualifying himself for continuing to hold his office.

Similarly, in *Humbles v Brooks*[88] the expenses of a headmaster attending history lectures were not deductible:

> "In the performance of the said duties" means in the course of their

[85] [2001] STC (SCD) 152 at [15]; and see Morse, "A confusion of facts, opinion and law? Employment income expenses and questions of fact and law: HMRC v Banerjee in the Court of Appeal" [2010] BTR 485.

[86] [2006] STC (SCD) 653.

[87] 9 TC 314 at 318.

[88] 40 TC 500 at 502.

> performance … "in doing the work of the office …". It does not include qualifying initially to perform the duties of the office, or even keeping qualified to perform them … it does not mean adding to [his] usefulness in performing his duties.

In *Perrin v HMRC*[89] the judge summarised these cases and continued:

> 25. These cases to my mind expose a prior question: you have to decide what is the nature of the job before you can decide whether what is done is in the course of the job, or is merely enabling or improving. A surgeon reads the latest research in his lunch break, looks at the scans and x-rays, consults his notes, washes his hands, puts on his gloves and picks up his knife. Which of those acts are part of the nature of his job and which enable him to do it better or puts him in a position to perform the duties of his job? It depends on how, semantically, you describe the nature of his job.
>
> In *Fitzpatrick v IRC* Lord Templeman said:
>
> > The journalists in the present case chose to spend several hours everyday reading a formidable mass of repetitive newsprint dealing with the events of yesterday. In my opinion, they were not, in the course of that reading, engaged in the performance of the duties for which they were paid.[90]
>
> I note the last few words 'for which they were paid'. Lord Templeman then also notes that a fact common to all the journalists was that 'the journalist was not remunerated for the time he spent in reading newspapers at home.' It seems to me therefore that a valuable insight into the nature of the job may be obtained by asking: what activities are paid for? And there may be a difference between the activities which are paid for, and those which are required as a condition of the employment (the student assistant in the laboratories in *Blackwell v Mills*, the bank manager in *Brown v Bullock* were all required to do something, but in each case that was not something 'paid for' or in the course of his duties)...
>
> 30. In *Snowdon v Charnock* Dr Brice found the following factors as being particularly relevant to the decision that the attendance at the psychotherapy sessions was not in the duties of the training post job: that the cost was not normally met by the employer; that the timing was not dictated by the employer but a matter between the individual and the analyst; and that the timing of the sessions was not acceptable as a reason for being unable to fulfil course requirements. It seems to me that the last

[89] [2008] STC (SCD) 672.

[90] 66 TC 407.

two of these factors are valuable indicators of what the psychiatrist was 'paid for'.

31. If an employer recruits a number of new employees and says to them 'You will start work in the summer, but on the following 1 October and 1 February you must all attend a week's course at our training centre', then it seems to me that this attendance is part of the nature of the job and in the performance of their duties: they are paid to attend, they attend at a place and at times specified by the employer, and do what their employer wants them to do there. The same would be true in my view if the course were run by a third party. And, in such a case, if the employee were obliged to pay for the course, then it could be said that the nature of the duties included attendance at the course, and that the obligation to pay was incurred in the performance of those duties.

32. But where the employer does not dictate the times of attendance, where the attendance is generally required but is outside normal working hours, where attendance must not conflict with other duties, in those situations one hesitates to say that the employee is 'paid for' attendance, and it can be said that the nature of the job does not encompass attendance even though it may be required by the employer.

33. In Mr Perrin's case I find that the following factors point away from the attendance at the courses being one of the duties for which he was paid (or something required by the nature of his job):

(i) some of the courses took place partly on Saturdays and he was not paid for attendance on Saturdays,

(ii) the staff handbook indicated that study leave could be granted in the discretion of the firm: it is described as 'leave' ie in the nature of time away from his duties; and there was no prescription as to what training should be done when. The requirement to attend training in the letter of 6 April 2004 did not alter the fact that paid leave to attend the courses was discretionary.

34. I do not find that [the employer's] view that the attendance at the courses was in the performance of Mr Perrin's duties, nor the fact that Mr Perrin was obliged to attend them by his contract nor even that he could be dismissed if he did not, sufficient to cause me to think that the attendance was part of the nature of his job. Mr Perrin was a trainee accountant and it seems to me that he was not paid for attending the courses, but for his work in the firm's business.

35, I conclude that the nature of Mr Perrin's job did not require the expenditure on the courses even though it enabled him to do the job better (with consequent benefit for himself and the firm), and even though attendance was required by his contract; and therefore that the cost of attendance was not incurred in the performance of the duties of his employment.

The EIM discusses this issue:

> **EIM31650 in the performance of the duties** [May 2020]
>
> An expense cannot be deducted under the general rule for employees' expenses in Section 336 ITEPA 2003 unless it is incurred "in the performance of the duties of the office or employment". The Courts have emphasised the importance of finding out exactly what the duties entail, see EIM31635, and have traditionally taken a very restrictive approach. In *Nolder v Walters* (15 TC 380) Rowlatt J commented at page 387 that the phrase means:
>
> > "in doing the work of the office, in doing the things which it is his duty to do while doing the work of the office."
>
> Therefore, to satisfy this test, the expense must be incurred in actually carrying out the duties of the job. It is not enough for the expense to be relevant to the job, or to be incurred in connection with the duties of the job. Nor is it enough if the expense only puts the employee in a position to start work or keeps the employee qualified to do the work. Expenses that are incurred in preparation to carry out the duties of the employment or as training to carry out the duties of the employment are not deductible...
>
> **EIM31651 decided cases** [May 2020]
>
> There are a number of cases in which the Courts have held that expenditure incurred in connection with an employment was not deductible because it was not incurred in the performance of the duties of the employment. Examples include
>
> *Shortt v McIlgorm* (26 TC 262) Fees paid to an employment agency to get a job, see EIM32560.
>
> *Blackwell v Mills* (26 TC 468) Cost of attending evening classes to become better qualified, see EIM32525.
>
> *Eagles v Levy* (19 TC 23) Legal costs to recover wages, see EIM32865.
>
> *Ansell v Brown* (73 TC 338) Cost of dietary supplements for professional sports player, see EIM32507.
>
> **EIM31652 Fitzpatrick v IRC** [May 2020]
>
> The case of *Fitzpatrick v IRC* (66 TC 407) contains a recent restatement by the House of Lords of the traditionally stringent and restrictive approach of the Courts to defining the duties of the employment.
>
> The case concerned journalists and other employees in the newspaper industry who received an allowance from their employer to pay for the purchase of other newspapers that they mostly read at home. It was not disputed that the allowance was a taxable emolument but they argued for a deduction for the amount spent because reading other newspapers was part of the duties of their employment.

> It was accepted by the Courts that the purpose of the journalists in reading other newspapers was to perform their duties more efficiently. It was also accepted that the reading of other newspapers was encouraged or even required by their employers. Nevertheless, no deduction was allowed.
>
> Lord Templeman commented on page 521 that:
>
>> "a journalist does not purchase and read newspapers in the performance of his duties but for the purpose of ensuring that he will carry out his duties efficiently... A sports reporter is employed to report sport, not to read newspapers, a photographer is employed to produce pictures for his newspaper not to study the pictures of others. An editor is employed to select, draft and arrange items in his newspaper, not to read other newspapers. A journalist who reads newspapers does so in order to be able to perform his duties to the highest possible standard but he does not read "in the performance of his duties".
>
> **EIM31653 in the performance of the duties: example** [May 2020]
>
> An employee is a salesman for a company with a major export trade to France. He knows that he will not be able to perform his duties properly unless he improves his command of the French language. He enrols in a night school course for one evening each week. He asks for a deduction for the cost of the course.
>
> No deduction is due. The employee's duties as a salesman do not extend to learning French at night school, see EIM31650.

Underlying all these decisions was a policy decision not to allow employees to deduct expenses. In *Simpson v Tate*:[91]

> I think that all subscriptions to professional societies and all taking in of professional literature and all that sort of expense, which enables a man to keep himself fit for what he is doing, are things which can none of them he allowed. If they were allowed every professional man would say "I have to belong to this society and I have to belong to that society; I have to take in this publication and I have to take in that publication, and to do all sorts of things," and there would be no end to it.

Lord Templeman picked up the point in *Fitzpatrick*:[92]

> If deductions of this kind were allowed in one case every journalist or other similar employee would claim to be entitled to deduct the payment made by him for every newspaper and periodical which he chose to

[91] 9 TC 314 at p.318.

[92] 66 TC 407 at p.521H.

> purchase "...and there would be no end to it".

But the phrase "in the performance of duties of an employment" should have the same meaning throughout, so the same approach applies in deciding what counts as working for the SRT; even though in residence cases it will sometimes be in the interest of HMRC to argue that actions *are* in the performance of the duties of employment, and in the interest of taxpayer to argue that they are not.

6.22.3 *Para 26(2) employment-income test*

Para 26(2) sch 45 FA 2013 provides:

> In deciding whether something is being done in the performance of duties of an employment, regard must be had to whether, if value were received by P for doing the thing, it [the receipt] would fall within the definition of employment income in section 7 of ITEPA 2003[93].

I refer to this provision as the **"para 26(2) employment-income test"**. There are two aspects to this provision:

(1) A hypothetical question: if value were received by P for doing something, would the receipt be employment income?

(2) If the answer to that question is yes, then it does not necessarily follow that the thing done is employment-work. One must "have regard" to that fact. It is suggested that this means that the thing done should be regarded as work if appropriate in the context of the SRT. That must be decided on the facts of the case.

The hypothetical question is not as straightforward as the authors of the SRT may have thought.

(1) It does not specify who provides the value received by P. The passive voice ("if value were received") conceals the identity of the actor, in this case the person who provides the value.[94] If value (a benefit) is provided by the employer, it would be deemed to be by reason of the employment and so necessarily employment income![95] But clearly that is to be ignored for the purposes of the hypothetical question. The question is whether the value would be ordinary earnings[96] (in pre-

[93] See 34.4.4 ("Employment income").

[94] See Fowler's *Dictionary of Modern English Usage* (4th ed, 2015) entry under *Passive Voice* 5: Criticised Uses).

[95] See 39.10 ("By reason of the employment").

[96] See 34.4.1 ("Ordinary" earnings).

rewrite terminology, emoluments).

(2) If someone else pays, the question is, why did they pay? Was it a reward for services?

For instance, an employee may choose to have a health check. If an employer paid the employee to do that, the receipt would be employment income.[97] But if anyone else paid then presumably, not. The health check is not employment-work. However, one hardly needs the help of para 26(2) to reach that conclusion.

Given the difficulties of the hypothetical question, and the intangible nature of the consequences of the answer to it if an answer can be found, it is doubtful whether the para 26(2) employment-income test is ever going to be helpful. It may be significant in relation to the topics of gardening leave and shadow directors; see below.

6.22.4 *Trading-work*

Para 26(1) sch 45 FA 2013 provides:

> P is considered to be "working" (or doing "work") at any time when P is doing something ...
>
> (b) in the course of a trade carried on by P (alone or in partnership).

In order to apply this, it is necessary to ask:

(1) whether P carries on a trade; and

(2) whether P is doing something in the course of that trade.

Para 145 sch 45 FA 2013 provides an inclusive definition of trade:

> "trade" also includes–
>
> (a) a profession or vocation,
>
> (b) anything that is treated as a trade for income tax purposes, and
>
> (c) the commercial occupation of woodlands (within the meaning of section 11(2) of ITTOIA 2005).

Para 26(3) sch 45 FA 2013 provides guidance towards the issue of whether something is done in the course of a trade:

> In deciding whether something is being done in the course of a trade, regard must be had to whether, if expenses were incurred by P in doing the thing, the expenses could be deducted in calculating the profits of the

[97] Perhaps under the benefits code, which falls within the definition of employment income, see 34.4 (Employment income/earnings).

> trade for income tax purposes.

Para 26(3) seems self-evident, since deductible trading expenses are incurred wholly for trading purposes. Perhaps the point is that if expenses could not be deducted (because they were incurred partly for non-trading purposes) then that suggests the activity is not done in the course of a trade. But since para 26(3) does not supply a determinative factor (it only says "regard must be had...") this really does not take us much further; though it does no harm.

6.22.5 *Training*

Para 26 sch 45 FA 2013 provides:

> (5) Time spent undertaking training counts as time spent working if–
> (a) in the case of an employment held by P, the training is provided or paid for by the employer and is undertaken to help P in performing duties of the employment, and
> (b) in the case of a trade[98] carried on by P, the cost of the training could be deducted in calculating the profits of the trade for income tax purposes.
>
> (6) Sub-paragraphs (4) and (5) have effect without prejudice to the generality of sub-paragraphs (2) and (3).

Para (a) does not add much, as the gist of the cases above is that training is paid for by the employer is likely to be one of the duties of the employment, in the general sense, and so working within the general definition.

Para (b) seems self-evident, since deductible trading expenses are incurred wholly for trading purposes. Perhaps the point is that if cost could not be deducted (because it was incurred partly for non-trading purposes) then that suggests the training is not done in the course of a trade.

6.22.6 *Time on call*

The RDRM provides:

> **RDRM11750: Days spent in the UK: Travel either to or from a temporary workplace** [May 2020]
> ... Being on- call or stand-by may count as time spent working depending on the conditions of an individual's employment and the nature of their duties.

[98] Para 145 sch 45 FA 2013 provides a wide definition set out in a footnote above.

The RDRM provides 2 examples:

> Example 3 (Paula)
> P works as an engineer and is contractually required to be on-call for 4 night a month, in addition to her normal full-time attendance. She is paid a retainer for those 4 nights, in addition to being paid for any work if she is called out. The 4 nights are counted as working time.
> Example 4 (Franek)
> F is a self-employed locksmith, who keeps his mobile phone switched on 24 hours a day to receive customer calls. For the purposes of calculating work time, F should only include the time spent carrying out his jobs and the related travelling time.

While care needs to be taken in referring to cases on different provisions, this is consistent with case law on the working time regulations.[99]

6.22.7 *Gardening leave*

The expression "gardening leave" is used when an employee is instructed not to work, during a notice period. P is not working in the general sense and not within para 26(1) as P is not "doing something". P is doing nothing. If that is working, how many hours a day is P working? and where is the work done?

But the para 26(2) employment-income test[100] does support the view that gardening leave counts as employment-work, as P is being paid for doing nothing, and what he is paid is employment income. The answer to the hypothetical question in para 26(2) is, yes.

The HMRC view is that gardening leave counts as working. The RDRM provides:

> **RDRM11740: Days spent in the UK: Work for the purpose of the SRT** [May 2020]
> ...An individual's time spent working includes:
>
> - instances where their employer instructs an individual to stay away from work, for example while serving a period of notice while they remain on the payroll.

HMRC say:

> *Question:* If an expat is on gardening leave abroad for say 90 days (in between 2 overseas employments), would this be considered a significant

[99] *MacCartney v Oversley House Management* [2006] UKEAT 0500_05_3101.
[100] See 6.22.3 (Para 26(2) employment-income test).

> break[101] when looking at residence status for FTWA. They would not be able to go to work for the odd day but are they really on call (so working) so not on a break ?
> *HMRC answer:* HMRC can confirm that for the purpose of the SRT gardening leave is regarded as work and satisfies the test at para 26(2) Sch 45 FA 2013. In the scenario outlined there is no significant break from work.[102]

6.22.8 *Travel*

Para 26 sch 45 FA 2013 provides:

> (4) Time spent travelling counts as time spent working–
> (a) if the cost of the journey could, if it were incurred by P, be deducted
> [i] in calculating P's earnings from that employment under section 337, 338, 340 or 342 of ITEPA 2003,
> [ii] or, as the case may be, in calculating the profits of the trade[103] under ITTOIA 2005, or
> (b) to the extent that P does something else during the journey that would itself count as work in accordance with this paragraph...
> (6) Sub-paragraphs (4) and (5) have effect without prejudice to the generality of sub-paragraphs (2) and (3).

The rules for the deductibility of travel costs are complex. For employments see 35.1 (Travel expenses: Introduction). For trades there are no express statutory rules but there is extensive case law, discussed in BIM37605 onwards. I hope to cover that topic in a future edition.

Para (a) raises the pleasing possibility of situations where HMRC argue *for* deductibility of the expenses, and the taxpayer argues against.

Para (b) applies "to the extent" that the individual works; eg if the individual spends 5 minutes working during a six hour journey only the 5 minutes will be classified as work. Reading emails will count as work, so in practice travel will generally involve some work, unless the employee deliberately chooses not to work.

What is "travelling" is not always clear. A person who stops at a traffic

[101] See 6.25 "Significant break from work".

[102] Joint Expatriate Forum on Tax and NICs (July 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/347913/140731_Expat_Forum_Minutes.pdf*

[103] Para 145 sch 45 FA 2013 provides a wide definition of trade, set out in a footnote above.

light is still travelling. A person who stops for lunch has stopped travelling. What about queuing at immigration or for luggage? Perhaps it depends on whether the queue is an ordinary one or unusually long.

See too 6.23 (Where is work done).

6.22.9 *Assumption of chargeability*

Para 26(7) sch 45 FA 2013 provides:

> Assume for the purposes of sub-paragraphs (2) to (5) that P is someone who is chargeable to income tax under ITEPA 2003 or ITTOIA 2005.

This prevents an argument that the rules in para 26(2)-(5) are not applicable where DT relief overrides the usual charge on employment income.

6.22.10 *Shareholder tasks*

Suppose a person is both shareholder and director. One must distinguish:

(1) Actions carrying out duties of the directorship
(2) Actions carrying out powers (or duties, if any) of shareholders which are not duties of the directorship ("shareholder tasks").

Shareholder tasks are not employment-work. Under standard company articles, that includes decisions such as appointing directors, issuing shares, and putting a company into liquidation.

It is considered that the para 26(2) employment-income test[104] does not alter that conclusion. But in practice, little time will be spent on shareholder tasks, and it is likely that the large majority of the time spent will count as employment-work.

6.22.11 *Work by shadow director*

Para 26(1) sch 45 FA 2013 provides:

> P is considered to be "working" (or doing "work") at any time when P is doing something–
>
> (a) in the performance of duties of an *employment* held by P...

A shadow director does not hold an "employment" within the applicable definition.[105] So at first sight it seems that a shadow director cannot do

[104] See 6.22.3 (Para 26(2) employment-income test).

[105] See 6.26.1 ("Employment"). It is assumed that the shadow director does not have an actual contract of employment.

employment-work.

It would however be surprising if one could avoid the work tie (and UK test 3, UK work) by:

(1) arranging not to be a director or employee, while
(2) continuing to work for the company, and act as shadow director, for no express remuneration (but able to take effective remuneration by way of dividend).

HMRC may well argue that the answer is found in the para 26(2) employment-income test:[106]

(1) If value were received by the shadow director for doing what he does, the receipt would fall within the definition of employment income in s.7 ITEPA.[107]
(2) One must "have regard" to that fact. In the context of the SRT, it is suggested that the implication is:
    (a) a shadow directorship is to be regarded as an employment
    (b) the things done by the shadow director are to be regarded as duties.

6.22.12 *Work by actual director*

Suppose an individual is not a shadow director, but nevertheless does work for a company (of which they may be the owner or indirect owner) for no express remuneration (but able to take effective remuneration by way of dividend). Assume that the individual does not have an actual contract of employment or office.

In this scenario, the individual again does not have an "employment" within the applicable definition.[108] So at first sight it seems that the individual cannot do employment-work.

HMRC may argue that the para 26(1) definition of work is inclusive, not exclusive. Thus a person who does not have an employment (or trade) may be "working", if their activities are otherwise exactly what one would expect to fall within the scope of para 26(1). But if one treats para 26(1) as an inclusive definition, it is difficult to see where to draw the line between work which counts for the SRT and work which does not.

HMRC may argue that the answer is found in the para 26(2) employment-income test:[109]

[106] See 6.22.3 (Para 26(2) employment-income test).
[107] See 39.6.4 (Charge on shadow director).
[108] See 6.26.1 ("Employment").
[109] See 6.22.3 (Para 26(2) employment-income test).

(1) If value were received by the individual for doing what he does, would the receipt would constitute employment income? In the absence of an employment, it would not. But if value were received, there is likely to be an employment. In other words, para 26(2) imposes a deemed employment.

(2) If the answer to the hypothetical question is yes, and one has regard for it, the provision may be taken to allow the non-employees employment-like activities to count as employment-work.

It is suggested that the court should draw the line at shadow directors, so those who are not employees or shadow directors cannot do employment-work. But taxpayers concerned about the work tie should err on the side of caution; and in cases where a taxpayer terminated a contract of employment specifically to take advantage of this rule, the courts may not be sympathetic.

6.23 Where is work done

The location of work matters as work must be done overseas to qualify for overseas test 3 (overseas work), and in the UK to qualify for UK test 3 (UK work) or for the work tie. See 34.30 (Where are duties performed). Para 27(1) sch 45 FA 2013 provides a commonsense rule:

> Work is done where it is actually done, regardless of where the employment is held or the trade is carried on by P.

There is special rule for the location of travelling work. Para 27 sch 45 FA 2013 provides:

> (2) But work done by way of or in the course of travelling to or from the UK by air or sea or via a tunnel under the sea is assumed to be done overseas even during the part of the journey in or over the UK.
> (3) For these purposes, travelling to or from the UK is taken to–
>> (a) begin when P boards the aircraft, ship or train that is bound for a destination in the UK or (as the case may be) overseas, and
>> (b) end when P disembarks from the aircraft, ship or train.

This applies:

(1) Where travel itself counts as work[110] ("work by way of travelling); and

(2) Where the travel is not work, but other work is done while travelling ("work in the course of travelling").

[110] See 6.22.8 (Travel).

This rule may make flying directly to or from a regional airport more attractive as UK work would not start until the individual disembarks at the regional airport rather than at (say) Heathrow/Gatwick before taking a connecting flight or other transport to the destination. The use of cross channel ferries may be disadvantageous when compared with travel by Eurostar given the point at which UK work is deemed to begin and end. But I suspect that however the journey is arranged, it will be rare for a business trip to the UK not to constitute a 3-hour UK workday.

6.24 Reference period: Non-work days

The reference period matters for computing the sufficient hours tests for
(1) Automatic overseas test 3 (Overseas work) and
(2) "Automatic" UK test 3 (UK work).

Para 28(1) sch 45 FA 2013 provides:

> This paragraph applies in calculating the "reference period" (which is a step taken in determining whether P works "sufficient hours in the UK" or "sufficient hours overseas" as assessed over a given period of days).

6.24.1 *Reduction for non-work days*

There are three reductions. Para 28(2) sch 45 FA 2013 provides:

> The number of days in the given period may be reduced to take account of—
> (a) reasonable amounts of annual leave or parenting leave taken by P during the period (for all employments held and trades carried on by P during the period, whether in the UK or overseas),
> (b) absences from work at times during the period when P is on sick leave and cannot reasonably be expected to work as a result of the illness or injury in question, and
> (c) non-working days embedded within a block of leave for which a reduction is made under paragraph (a) or (b).

6.24.2 *Annual/parenting leave*

These terms matter for the concepts of reference period and significant breaks from work, which are relevant for overseas test 3 (overseas work) and UK test 3 (UK work).

Para 145 sch 45 FA 2013 provides:

> "parenting leave" means maternity leave, paternity leave, adoption leave or parental leave (whether statutory or otherwise);

Para 146 sch 45 FA 2013 provides:

> In relation to an individual who carries on a trade—
> (a) a reference in this Schedule to annual leave or parenting leave is to reasonable amounts of time off from work for the same purposes as the purposes for which annual leave or parenting leave is taken, and
> (b) what are "reasonable amounts" is to be assessed having regard to the annual leave or parenting leave to which an employee might reasonably expect to be entitled if doing similar work.

HMRC say, correctly, that regular (rotational) leave is not "annual leave":

> *Question:* Client works a 48 hour week (Mon to Sat) in Saudi and he works the 48 hour weeks in blocks of 10. He then gets 2 weeks off and this is called rotational leave, he does not get any other annual leave.
> Are the 2 weeks off after every 10 weeks of work considered annual leave for the 'sufficient hours worked overseas' test, or would it fall within the non-working day embedded within a block of leave rules.
> *HMRC answer*: The SRT does not define annual leave. Any entitlement to annual leave will usually be set out in the clauses of an employment contract or contract for services.
> [HMRC refer to the statutory provisions and continue]
> In the example you have used the 2 week periods of rotational leave taken after every 10 weeks of working 48 hours per weeks do not appear to be annual leave and therefore no deduction in the reference period calculation will be due. The days do however appear to be non-working days. However no deduction can be made in the reference period calculation for them unless they are 'embedded within a block of leave'. This will of course be a question of fact.
> For example, if a period of sick leave includes days when the individual would not normally work (and does not work) no deduction can be made for those non work days in the reference period calculation. However, if the period of sick leave begins at least 3 days before the non work day(s) and ends at least 3 days after the non work days the non work days are regarded as 'embedded within' a block of leave and can be deduced in the reference period calculation.[111]

Para 28(4) sch 45 FA 2013 attempts to elucidate "reasonable amounts":

[111] Joint Expatriate Forum on Tax and NICs (July 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/347913/140731_Expat_Forum_Minutes.pdf*

> For any particular employment or trade, "reasonable" amounts of annual leave or parenting leave are to be assessed having regard to (among other things)—
> (a) the nature of the work, and
> (b) the country or countries where P is working.

6.24.3 *Disregarded days*

Para 28(3) sch 45 FA 2013 provides:

> But no reduction may be made in respect of any day that is a "disregarded day" (see paragraphs 9(2) and 14(3) in Part 1 of this Schedule).

For overseas test 3 (overseas work), "disregarded days" are UK workdays.[112]

For UK test 3 (UK work), "disregarded days" are overseas workdays.[113]

6.24.4 *"Embedded in block of leave"*

Para 28(5) sch 45 FA 2013 provides:

> Non-working days are "embedded within" a block of leave only if there are, as part of that block of leave—
> (a) at least 3 consecutive days of leave taken before the non-working day or series of non-working days in question, and
> (b) at least 3 consecutive days of leave taken after the non-working day or series of non-working days in question.

6.24.5 *"Non-working day"*

Para 28(6) sch 45 FA 2013 provides:

> A "non-working day" is any day of the week, month or year on which P—
> (a) is not normally expected to work (according to P's contract of employment or usual pattern of work), and
> (b) does not in fact work.

6.24.6 *Rounding*

Para 28(7) sch 45 FA 2013 deals with rounding:

> In calculating the reductions to be made under sub-paragraph (2)—

[112] See 6.8.2 ((a): Sufficient hours overseas).

[113] See 6.13.2 (Sufficient hours in UK)..

> (a) if it turns out, after applying sub-paragraph (3), that the reasonable amounts of annual leave or parenting leave or, as the case may be, the absences from work on sick leave do not add up (across the period) to a whole number of days, the number in that case is to be rounded down to the nearest whole number, but
> (b) any such rounding is to be ignored for the purposes of subparagraph (2)(c).

6.24.7 *Change of employment*

Para 28 sch 45 FA 2013 provides:

> (8) If—
> (a) P changes employment during the given period,
> (b) there is a gap between the two employments, and
> (c) P does not work at all at any time between the two employments,
>
> the number of days in the given period may be reduced by the number of days in that gap.
>
> (9) But—
> (a) if the gap lasts for more than 15 days, only 15 days may be subtracted, and
> (b) if there is more than one change of employment during the period, the maximum number of days that may be subtracted under subparagraph (8) for all the gaps in total is 30.

The RDRM gives a straightforward example:

> **RDRM11160: Gaps between employments** [May 2020]
> Example 1 (Jack)
> J is calculating his reference period and has 2 gaps between employments within the 365 day period he is considering.
> The first gap was of 21 days and the second 5 days. J does not work at all in either gap. As the first gap exceeded the maximum number of days allowed for a single gap, J can only subtract 15 days from his reference period in relation to this gap between employments. He can subtract the full 5 days of the second gap.
> J therefore subtracts a total of 20 days for gaps between employments from his 365 days period under Step 3 of the sufficient hours calculation.

The provision for gaps between employments does not apply for the self-employed; there is no deduction for gaps between self-employed work periods.

6.25 "Significant break from work"

"Significant break from work" matters for:
(1) Overseas test 3 (Overseas work)
(2) UK test 3 (UK work)

Para 29 sch 45 FA 2013 provides the definitions, which are conveniently read side by side:

Para 29(1): Break from UK work	**29(2) Break from overseas work**
There is a "significant break from UK work" if at least 31 days go by and not one of those days is—	There is a "significant break from overseas work" if at least 31 days go by and not one of those days is—
(a) a day on which P does more than 3 hours' work in the UK, or	(a) a day on which P does more than 3 hours' work overseas, or
(b) a day on which P would have done more than 3 hours' work in the UK but for being on annual leave, sick leave or parenting leave.[114]	(b) a day on which P would have done more than 3 hours' work overseas but for being on annual leave, sick leave or parenting leave.

6.26 Minor definitions

6.26.1 *"Employment"*

"Employment" matters for:
(1) Overseas test 3: Overseas work
(2) UK test 3: UK work
(3) The work tie

Para 145 sch 45 FA 2013 incorporates the standard ITEPA definition.[115] In short, the term includes:
(1) Employment in the strict employment law sense
(2) An office (the most common example is company director)

Para 26(8) sch 45 FA 2013 provides:

[114] See 6.24.2 (Annual/parenting leave).

[115] "employment"—
(a) has the meaning given in section 4 of ITEPA 2003, and
(b) includes an office within the meaning of section 5(3) of that Act.
For this definition see 34.3 ("Employer", "employee" "employment").

> A voluntary post for which P has no contract of service does not count as an employment for the purposes of this Schedule.

At first sight, this is otiose. A contract of service is simply another expression for an employment contract. It would however be relevant in the case of a director of a charitable company (or other nonprofit company). That director would typically not be paid and not have a contract of service. Such a person would not hold an employment for the purposes of the SRT. That may in principle be advantageous (if the director works in the UK) or disadvantageous (if the director works outside the UK); but in the latter case it may be possible to give the director a contract of service, so that time spent working for the charity does count for the sufficient hours test.

Similarly, a trusteeship is an office but an unremunerated trusteeship is a voluntary post. That is so even if trustees could be remunerated, under a trustee charging clause in the trust deed or by statute, so long as the power to remunerate is not used. So acting as unpaid trustee does not count as work. That is the case for private trusts and for charitable trusts.

Well organised nonprofit organisations will have contracts with regular volunteers, but the contract is not likely to be a contract of service (an employment contract) so volunteers are not likely to have an employment.

"Voluntary post" is not defined. A voluntary post must be unpaid, but not all unpaid posts are voluntary. The word suggests an element of altruism. A director/shareholder of a commercial (for-profit) company may choose to work for no remuneration, taking profits by way of dividend; but a directorship of that kind is not a voluntary post.

6.26.2 *"Overseas"*

Para 145 sch 45 FA 2013 provides a definition:

> "overseas" means anywhere outside the UK;

One might have thought "abroad" was more apt. Northern Ireland is not "overseas" but if one crosses the land border to the Republic of Ireland, one finds oneself "overseas"! But it does not matter.

6.26.3 *Zero is a number (!)*

Para 147 sch 45 FA 2013 provides:

> A reference in this Schedule to a number of days being less than a specified number includes a case where the number of days is zero.

The drafter's concern that zero may not be considered a number seems somewhat misconceived.

6.27 UK ties

This section considers the definition of "UK tie". This matters for the application of the sufficient ties test, see 6.14 (Sufficient ties test).

Para 31(1) sch 45 FA 2013 provides:

> What counts as a "UK tie" depends on whether P was resident in the UK for one or more of the 3 tax years preceding year X.

Thus there are different rules for leavers and for arrivers. Para 31(2) sets out the ties for leavers:

> If P was resident in the UK for one or more of those 3 tax years, each of the following ties counts as a UK tie.
> (a) a family tie,
> (b) an accommodation tie,
> (c) a work tie,
> (d) a 90-day tie, and
> (e) a country tie.

Para 31(3) sets out the ties for arrivers:

> Otherwise, each of the following ties counts as a UK tie.
> (a) a family tie,
> (b) an accommodation tie,
> (c) a work tie, and
> (d) a 90-day tie.

These are the same, but without the country tie.

6.28 Family tie

Para 32(1) sch 45 FA 2013 provides:

> P has a family tie for year X if–
> (a) in year X, a relevant relationship exists at any time between P and another person, and
> (b) that other person is someone who is resident in the UK for year X.

If a couple split up during the year, or a child attains 18 during the year, the family tie can still be met until the next tax year.

6.28.1 *Relevant relationship*

Para 32(2) sch 45 FA 2013 provides:

> A relevant relationship exists at any time between P and another person if at the time–
> (a) P and the other person are husband and wife or civil partners and, in either case, are not separated,[116]
> (b) P and the other person are living together as husband and wife or, if they are of the same sex, as if they were civil partners,[117] or
> (c) the other person is a child of P's and is under the age of 18.

6.28.2 *Limited child contact in UK*

Para 32(3) sch 45 FA 2013 provides:

> P does not have a family tie for year X by virtue of sub-paragraph (2)(c) if P sees the child in the UK on fewer than 61 days (in total) in–
> (a) year X, or
> (b) if the child turns 18 during year X, the part of year X before the day on which the child turns 18.

The RDRM provides examples:

> **RDRM13330: Annex C: Relevant relationships** [May 2020]
> Example 1 (Jurgen)
> Between May and November J visited the UK for 125 days, 104 of which were days on which he worked for more than 3 hours in the UK. When in the UK he stayed in a number of different hotels, so has no accommodation tie. He was not resident in the UK for any of the last 3 years. J's 17 year-old son lives and works full-time in the UK and is UK resident.
> Under the sufficient ties test, J will be resident if he has 2 or more UK ties. He has a work tie. However, the only tie J and his son spent together in the UK during his visit was 3 weeks in the summer. Therefore J has no family tie and, having only 1 tie is not resident in the UK for that tax year. ...
> Example 2 (Pierre)
> P has a company flat in the UK which is permanently available to him and which he always uses when he comes here. This year P has been in

[116] Para 32(5) sch 45 FA 2013 provides the standard definition of "separated": see App 3.4.3 (Living together: married couple). The definition is repeated here because the standard definition applies for IT/CGT but not for IHT or (generally) for CT.

[117] See App 3.4.3 (Meaning of "living together").

> the UK for 75 days, 41 of which were days on which he worked for more than 3 hours in the UK. He was resident in the UK the year before last. P's ex-wife lives in the UK with their 15 year old daughter. P has spent 70 days with his daughter this year.
> Under the sufficient ties test (see RDRM11500 onwards), P will be UK resident if he has 3 or more UK ties. He has an accommodation tie and a work tie.
> However, although P has spent 70 days with his daughter in the tax year, 21 of these days were spent at P's home in Paris, and 14 were spent in Spain. Only 35 of the days P has spent with his daughter were spent in the UK. So, P does not have a family tie, and because he only has 2 ties he will not be UK resident for this tax year. ...

It is a sign of the times that the drafter clarifies the word "see". Para 32(4) sch 45 FA 2013 provides:

> A day counts as a day on which P sees the child if P sees the child in person for all or part of the day.

Seeing one's child on Skype does not count.

A blind person cannot satisfy the family tie.

In some circumstances, a parent may need to instruct a child to stay in bed and not get up until they leave the house!

If relevant, the individual should keep records of time spent visiting children in the UK.

6.28.3 *Ascertaining spouse's residence*

In order for an individual to apply the family tie test, it is necessary to decide whether the spouse/child is resident in the UK. But in order to decide whether an individual's spouse is resident under the SRT, it may be necessary to decide whether the individual is resident in the UK.

Para 33 sch 45 FA 2013 solves that problem by amending the residence test:

> (1) This paragraph applies in deciding for the purposes (only) of paragraph 32(1)(b) whether a person with whom P has a relevant relationship (a "family member") is someone who is resident in the UK for year X.
> (2) A family tie based on the fact that a family member has, by the same token, a relevant relationship with P is to be disregarded in deciding whether that family member is someone who is resident in the UK for year X.

The RDRM provides:

> **RDRM13320: Annex C: The importance of a family tie** [May 2020]
> Example (George and Mary)
> G and his wife M both spend 140 days in the UK, (a fewer number of days than the 183 day threshold in the automatic UK test). Neither of them was resident in any of the 3 previous tax years. Under the sufficient ties test they will each be resident if they have 2 or more ties.
> Both G and M have an accommodation tie. They also have a relevant relationship to each other, because they are man and wife. Therefore, if they had a family tie they would both be regarded as resident in the UK. However, because the family tie only exists because of their relevant relationship, the tie can be ignored.
> As each of them only has 1 UK tie, neither of them is UK resident in that tax year.

6.28.4 *Child in full-time education*

Children at school in the UK are likely to be UK resident under one or more of:

(1) UK test 1: 183 UK days
(2) UK test 2: UK home
(3) The sufficient ties test

Para 33(3) sch 45 FA 2013 provides a special rule for residence of children for the purposes of the family tie:

> A family member falling within sub-paragraph (4) is to be treated as being not resident in the UK for year X if the number of days that he or she spends in the UK in the part of year X outside term-time is less than 21.

The RDRM provides:

> **RDRM13330: Annex C: Relevant relationships** [May 2020]
> For the purpose of the SRT half-term breaks are regarded as term-time.

Para 33(4) sch 45 FA 2013 provides:

> A family member falls within this sub-paragraph if he or she–
> (a) is a child of P's who is under the age of 18,
> (b) is in full-time education in the UK at any time in year X,[118] and

[118] Para 33(5) sch 45 FA 2013 provides:
In sub-paragraph (4)–

(c) is resident in the UK for year X but would not be so resident if the time spent in full-time education in the UK[119] in that year were disregarded.

The disregard means that the child will not be regarded as resident under 183 day test or the sufficient ties test. It is still possible that the child could be UK resident under the UK home test.

Note that in the year in which the child attains 18, the disregard (time spent in full-time education in the UK) may be reduced.

The RDRM provides 2 straightforward examples:

> **RDRM11540: Full-time education of children and the family tie** [May 2020]
> Example (Yok Lin)
> YL attends boarding school in the UK.[120]
> She remains in the UK for the half-terms, staying with various friends and relatives, returning to the family home in Thailand during Christmas and Easter holidays.
> She spends 2 weeks of the summer break with her friends, travelling home to Thailand on 21 July.

The HMRC analysis is as follows:

> As YL is only in the UK for 14 days outside term-time, her parents will not have a family tie with YL for the purposes of the SRT.

> **RDRM13330: Annex C: Relevant relationships** [May 2020]
> Example 3 (Clara)
> C is 14 years-old and her parents, who reside in Dubai, because of her father's work, send her to boarding school in the UK. She spends 10 days of her summer break on a school trip to Scotland, and 1 week (7 days), of her Christmas break staying with friends in London. C has therefore spent 17 days in the UK outside term-time, but will not be regarded as resident in the UK for the purposes of the family tie, even though C herself is resident for tax purposes in the UK. ...

(a) references to full-time education in the UK are to full-time education at a university, college, school or other educational establishment in the UK

[119] Para 33(5) sch 45 FA 2013 provides:
In sub-paragraph (4) ...
(b) the reference to the time spent in full-time education in the UK is to the time spent there during term-time.

[120] The example specifies the exact term dates, but I omit that as it is not relevant, except, perhaps, to confirm that YL is in full time education.

The 2022/23 edition of this work para 6.28 considered RDRM guidance on school closure due to Covid, which affected 2020/21 and 2021/22, but I omit that here as it is now of historical interest only.

6.29 Accommodation tie

Para 34(1) sch 45 FA 2013 provides:

> P has an accommodation tie for year X if–
> (a) P has a place to live in the UK,
> (b) that place is available to P during year X for a continuous period of at least 91 days, and
> (c) P spends at least one night at that place in that year.

6.29.1 *Place to live*

Para 34(3) sch 45 FA 2013 provides a commonsense definition:

> P is considered to have a "place to live" in the UK if–
> (a) P's home or at least one of P's homes (if P has more than one) is in the UK, or
> (b) P has a holiday home or temporary retreat (or something similar) in the UK, or
> (c) accommodation is otherwise available to P where P can live when P is in the UK.

Para (a) is unnecessary, as a home is by definition a place to live, but perhaps it is intended to set the context for para (b) and (c).

A hospital bed is not a place to live, as it is not a home or accommodation, but is also perhaps unlikely to be available for 91 days.

A hospice could be a place to live, at least if available for 91 days.

6.29.2 *Accommodation "available"*

Para 34(4) sch 45 FA 2013 provides:

> Accommodation may be "available" to P even if P holds no estate or interest in it and even if P has no legal right to occupy it.

The RDRM provides:

> **RDRM13070 accommodation tie** [May 2020]
> Example (Peter)
> P left the UK last year to travel the world. He let his UK property on a 2 year lease, and has no rights to use the property. P has no home in the UK.
> Before leaving the UK P agreed with his cousin that he could stay with her on any occasion he was in the UK. This is more than a casual offer;

P's cousin is fully prepared to put P up for several months at a time should he need it. He made 2 visits to the UK this year, each for 10 days, and stayed with her. P has an accommodation tie.

The main difference between the term 'home' for SRT purposes and available accommodation, is that accommodation can be transient and does not require the degree of stability or permanence that a home does. If an individual does not have a home in the UK they may still have an accommodation tie if they have a place to live in the UK.

RDRM13080 The principle and characteristics of accommodation as a UK tie [May 2020]

This guidance aims to give examples of what an accommodation tie may or may not be; whether somewhere is or is not an accommodation tie will always be dependent on the facts and circumstances of its use by the individual. HMRC may choose to enquire into those facts and circumstances.

Example 1 (Mary)

M has lived and worked in the USA for many years. Her uncle has a holiday houseboat in the UK where he has agree M can stay any time she wishes, for as long as she wishes, when she comes to the UK. M's uncle does not allow other people to stay in the houseboat.

Last year M came to the UK twice. She made arrangements to stay for 3 weeks with a friend and for 4 weeks with her brother. Although the houseboat was available for a continuous period of at least 91 days, M did not use it at all. Therefore, she had no accommodation tie in respect of the houseboat last year.

This year M again visited the UK twice, spending her 5 week summer holiday on her uncle's houseboat. This year M has an accommodation tie as the houseboat is available for a continuous period of at least 91 days and she has stayed on t for at least 1 night.

Example 2 (Simone)

S has lived and worked in France all her life. She and her brother purchased a cottage in the UK several years ago as a holiday home. The cottage is let for most of the year but June, July and August are always kept free so S or her brother can stay there. There are sufficient rooms in the cottage to ensure that S is able to stay there even when her brother and his family are there also.

S spent 2 weeks in the cottage last year and 3 weeks this year. S has an accommodation tie both last year and this year.

Accommodation is regarded as available to an individual for a continuous period of 91 days if they are able to use it, or it is at their disposal, at all times throughout that period, (subject to the 16 day gap rule, see below). If a relative were to make their home available to an individual casually, for a social visit, say, it will not mean that the accommodation would be

> regarded as being available to them. However, if it is available to an individual for a continuous period of 91 days and they use it casually, it will be a tie.
>
> Similarly, a casual offer from a friend to 'stay in my spare room any time', will not constitute an accommodation tie, unless the friend really is prepared to put the individual up for 91 days at a time, (whether they actually do so or not).
>
> Example 3 (Sacha)
>
> S visits the UK on business and usually stays in different hotels. On one of these visits he takes an opportunity to attend Wimbledon Tennis Championships. A business associate who lives in Wimbledon invites S to stay at his flat for 3 nights rather than use a hotel. The arrangement is a one-off invitation, and the accommodation is not available to S for 91 days. It is not an accommodation tie. ...
>
> **RDRM13090 When accommodation is not considered to be an accommodation tie** [May 2020]
>
> Accommodation owned by an individual but which they have wholly let out commercially would not be considered as available to live in unless they retained the right to use the property or part of the property...

The minutes of the Joint Forum on Expatriate Tax and NICs provide:

> *Question:* It would be useful to have some guidance as to what arrangements HMRC perceive to be continuously available for a consecutive period of 91 days – e.g. a situation where "your room" in your parents' home is always potentially available but is not maintained for your exclusive use. If the parent has other visitors, they may also be put in that room. Consequently, it will always necessary to check in advance of each visit whether it will be possible to stay on specific dates. Can HMRC confirm this type of arrangement would not constitute continuously available accommodation for purposes of the SRT?
>
> *HMRC answer:* HMRC can confirm that accommodation availability has to be more than ad hoc or casual. Arrangement can be tacit, verbal or written but the availability itself will be a question of fact and every case will be determined by reference to the available facts and circumstances of each case. Situations where availability is agreed but on a particular occasion it cannot be used - perhaps because some else is using it – will often be rendered irrelevant by the 'gaps of fewer than 16 days are ignored' rule at 34(2).[121]

[121] 29 January 2014 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/302475/140326_Expats_Forum_Jan_14_Minutes_FINAL.pdf*

6.29.3 *Continuous period of 91 days*

Para 34(2) sch 45 FA 2013 provides:

> If there is a gap of fewer than 16 days between periods in year X when a particular place is available to P, that place is to be treated as continuing to be available to P during the gap.

This would be a problem for those who visit and stay in hotels every fortnight, because one ignores the gap of 15 days. The RDRM provides:

> **RDRM13080 The principle and characteristics of accommodation as a UK tie** [May 2020]
> Example 4 (Hyo)
> H lives and works in Poland, he is his company's European sales manager. This year he will be responsible for launching a new product in the UK and will need to spend time here. His sales force are on the road in the last week of every month, so he books a room in the same hotel for the first 3 weeks of June, July, August and September.
> H has an accommodation tie.
> **RDRM13090 When accommodation is not considered to be an accommodation tie** [May 2020]
> Short stays at hotels and guesthouses will not usually be considered to be an accommodation tie. However, if an individual books a room in the same hotel or guesthouse, (and does not cancel those bookings), for at least 91 days continuously in a tax year, bearing in mind that short gaps may be discounted, they will have an accommodation tie. (See example 4 in RDRM13080).

6.29.4 *Home of close relative*

Para 34(5) sch 45 FA 2013 provides:

> If the accommodation is the home of a close relative of P's, sub-paragraph (1)(c) has effect as if for "at least one night" there were substituted "a total of at least 16 nights".

Amended as para 34(5) directs, para 34(1) provides:

> P has an accommodation tie for year X if–
> (a) P has a place to live in the UK [in the form of accommodation which is the home of a close relative of P],
> (b) that place is available to P during year X for a continuous period of at least 91 days, and
> (c) P spends ~~at least one night~~ a total of at least 16 nights at that place in that year.

The relief is that one can stay up to 15 nights at a close relative without satisfying the accommodation tie. If someone is in a position where night 16 could trigger an accommodation tie, they may have to move to a hotel.

Para 34(6) sch 45 FA 2013 provides:

> A "close relative" is–
> (a) a parent or grandparent,
> (b) a brother or sister,
> (c) a child aged 18 or over, or
> (d) a grandchild aged 18 or over,
> in each case, including by half-blood or by marriage or civil partnership.

The words "by marriage or civil partnership" do not make sense; maybe they come from an earlier draft; maybe the intention is to include close relatives of a spouse/civil partner or the spouse/civil partner of a close relative?

The RDRM gives a straightforward example:

> **RDRM13080 The principle and characteristics of accommodation as a UK tie** [May 2020]
>
> Example 5 (Ravi)
>
> R can stay with his grandparents whenever he is in the UK. They will put him up for more than 91 days if he wishes. He usually comes from India every year to visit them, and stays with them for the whole summer.
>
> Last year R spent only the first 2 weeks with his grandparents, then went on a one-off visit to his uncle, (who would not be regarded as a close relative for the purposes of the SRT), for 2 months before returning home. So, although accommodation at his grandparents, who are regarded as close relatives, was available for more than 91 days, R stayed with his grandparents for only 14 days, and therefore had no accommodation tie.
>
> This year R spent the whole of the summer with his grandparents.
>
> This year R has an accommodation tie.
>
> If an individual stays in UK accommodation held by a spouse, partner or minor children, then they will be considered to have an accommodation tie if they spend at least 1 night there.
>
> **RDRM13080 The principle and characteristics of accommodation as a UK tie** [May 2020]
>
> Example 6 (Peter and Andrew)
>
> P and his civil partner A share an apartment in London. Last year A moved to the USA to take up a university post to study marine biology. This year A came back to the UK for a 3 week holiday which he and P spent in Scotland. A spent the first and last nights of his holiday in their

> London apartment.
> This year A has an accommodation tie.
> It is possible to have more than 1 place in the UK that counts as available accommodation. However, this would still represent only 1 accommodation tie, no matter how many different places of accommodation are available.
> **RDRM13080 The principle and characteristics of accommodation as a UK tie** [May 2020]
> Example 7 (Julie)
> J has lived in Canada with her husband for many years.
> J and her husband own a holiday home in the UK which they do not let out, and in addition J can stay with her parents whenever she is in the UK, for as long as she wishes.
> This year J visits the UK and stays with her parent for 4 weeks, and then spends a further 3 weeks in her holiday home before returning to Canada.
> This year although J has 2 places that count as available accommodation, she only has 1 accommodation tie.

6.30 Work tie

Para 35(1) sch 45 FA 2013 provides:

> P has a work tie for year X if P works in the UK for at least 40 days (whether continuously or intermittently) in year X.

Para 35(2) sch 45 FA 2013 defines "works in the UK for a day":

> For these purposes, P works in the UK for a day if P does more than 3 hours' work in the UK on that day.

Thus the requirement is forty 3-hour UK workdays. An individual may work any number of days in the UK if they work less than 3 hours in that day. On a workday they may work up to 24 hours and the day would only count as one UK workday for the work tie.

A day may count as a UK workday which does not count as a "day spent" in the UK (because P is not in the UK at midnight or because of exceptional circumstances).[122]

6.31 90-day tie

Para 37 sch 45 FA 2013 provides:

> P has a 90-day tie for year X if P has spent more than 90 days in the UK

[122] See 6.15.1 (Ascertaining days spent in UK).

> in–
> (a) the tax year preceding year X,
> (b) the tax year preceding that tax year, or
> (c) each of those tax years separately.

It does not matter whether P is UK resident for the year in which P spends 90 days in the UK.

6.32 Country tie

Para 38(1) sch 45 FA 2013 provides:

> P has a country tie for year X if the country in which P meets the midnight test for the greatest number of days in year X is the UK.

Para 38(2) sch 45 FA 2013 provides a tie-breaker rule in the unusual case where P spends an equal number of midnights in two countries:

> If–
> (a) P meets the midnight test for the same number of days in two or more countries, and
> (b) that number is the greatest number of days for which P meets the midnight test in any country in year X,
> P has a country tie for year X if one of those countries is the UK.

The country tie applies to leavers but not to arrivers. That seems anomalous, but it does slightly simplify the administrative burden on those who are not leavers.

Perhaps one object is that HMRC can notify tax authorities of the country where the individual spends most time, to see if tax should be paid there.[123]

6.32.1 *The midnight test*

Para 38(3) sch 45 FA 2013 provides:

> P meets the "midnight test" in a country for a day if P is present in that country at the end of that day.

The 3 exceptions which qualify the midnight test for "days spent" (transit passengers /exceptional circumstances/frequent visitors deeming rule)[124] do not apply here.

Para 145 sch 45 FA 2013 provides:

[123] See too 6.40 (Resident of nowhere).

[124] See 6.15.1 (Ascertaining days spent in UK).

> "country" includes a state or territory

Thus if an individual spends time in different states of a federal state, such as the USA, then the time counts as spent in one country. Eg if P spends 100 days in Florida, 100 days in New York, and 165 days in the UK, that counts as 200 days in the USA and P will not satisfy the country tie. That might not have been clear without the definition.[125]

Some constitutional research will occasionally be necessary. Are Spain and Majorca one country? Or Guernsey, Alderney and Sark? Or are they separate countries?

6.33 Year of death

6.33.1 *Death and the SRT*

Many of the residence tests depend on the number of days that some condition is satisfied during the year. The outcome could be affected if the individual dies during the year. For instance, overseas test 1 requires less than 16 UK days. There needs to be some provision for death during the year, or someone who died between 6 and 20 April would be non-resident.

Death alters the SRT in the following ways:

(1) Overseas test 1 does not apply in the year of death
(2) Additional residence tests apply in the year of death: overseas tests 4 and 5 and UK test 4
(3) The day count requirement in the sufficient ties test is reduced in the year of death

6.33.2 *3 years non-resident: Overseas test 4*

Para 15 sch 45 FA 2013 provides:

> (1) The fourth automatic overseas test is that—
> (a) P dies in year X,
> (b) [i] P was resident in the UK for neither of the 2 tax years preceding year X or, alternatively,
> [ii] P's case falls within sub-paragraph (2), and
> (c) the number of days that P spends in the UK in year X is less than 46.
> (2) P's case falls within this sub-paragraph if—
> (a) P was not resident in the UK for the tax year preceding year X, and

[125] See 4.22 (Domicile territory/country).

> (b) the tax year before that was a split year as respects P because the circumstances of the case fell within Case 1, Case 2 or Case 3 (see Part 3 of this Schedule) [that is, a leaver's split year].

6.33.3 *Working overseas: test 5*

Para 16 sch 45 FA 2013 provides:

> (1) The fifth automatic overseas test is that—
>
> (a) P dies in year X,
>
> (b) P was resident in the UK for neither of the 2 tax years preceding year X because
>
> [i] P met the third automatic overseas test [Overseas work] for each of those years or, alternatively,
>
> [ii] P's case falls within sub-paragraph (2), and
>
> (c) P would meet the third automatic overseas test for year X if paragraph 14 were read with the relevant modifications.
>
> (2) P's case falls within this sub-paragraph if—
>
> (a) P was not resident in the UK for the tax year preceding year X because P met the third automatic overseas test for that year, and
>
> (b) the tax year before that was a split year as respects P because the circumstances of the case fell within Case 1 (see Part 3 of this Schedule) [leaving for overseas work].[126]
>
> (3) The relevant modifications of paragraph 14 are—
>
> (a) in sub-paragraph (1)(a) and (b) and sub-paragraph (3), for "year X" read "the period from the start of year X up to and including the day before the day of P's death", and
>
> (b) in step 3 of sub-paragraph (3), for "365 (or 366 if year X includes 29 February)" read "the number of days in the period from the start of year X up to and including the day before the day of P's death".

Amended as para 16(3) directs, para 14 reads:

> (1) The third automatic overseas test is that—
>
> (a) P works sufficient hours overseas, as assessed over ~~year X~~ the period from the start of year X up to and including the day before the day of P's death,
>
> (b) during ~~year X~~ the period from the start of year X up to and including the day before the day of P's death, there are no significant breaks from overseas work,
>
> (c) the number of days in year X on which P does more than 3 hours' work

[126] See 10.6 (Case 1: Start work overseas).

> in the UK is less than 31, and
>
> (d) the number of days in year X falling within sub-paragraph (2) is less than 91.
>
> (2) A day falls within this sub-paragraph if—
>
> (a) it is a day spent by P in the UK, but
>
> (b) it is not a day that is treated under paragraph 23(4) as a day spent by P in the UK.
>
> (3) Take the following steps to work out whether P works "sufficient hours overseas" as assessed over ~~year X~~ the period from the start of year X up to and including the day before the day of P's death—
>
> *Step 1 [disregarded days]*
>
> Identify any days in ~~year X~~ the period from the start of year X up to and including the day before the day of P's death on which P does more than 3 hours' work in the UK, including ones on which P also does work overseas on the same day.
>
> The days so identified are referred to as "disregarded days".
>
> *Step 2 [net overseas hours]*
>
> Add up (for all employments held and trades carried on by P) the total number of hours that P works overseas in ~~year X~~ the period from the start of year X up to and including the day before the day of P's death, but ignoring any hours that P works overseas on disregarded days.
>
> The result is referred to as P's "net overseas hours".
>
> *Step 3 [reference-period days]*
>
> Subtract from ~~365 (or 366 if year X includes 29 February)~~the number of days in the period from the start of year X up to and including the day before the day of P's death
>
> (a) the total number of disregarded days, and
>
> (b) any days that are allowed to be subtracted, in accordance with the rules in paragraph 28 of this Schedule, to take account of periods of leave and gaps between employments.
>
> The result is referred to as the "reference period".
>
> *Step 4 [reference-period weeks]*
>
> Divide the reference period by 7. If the answer is more than 1 and is not a whole number, round down to the nearest whole number. If the answer is less than 1, round up to 1.
>
> *Step 5 [compute net overseas hours ÷ no. of reference-period weeks]*
>
> Divide P's net overseas hours by the number resulting from step 4.
>
> If the answer is 35 or more, P is considered to work "sufficient hours overseas" as assessed over ~~year X~~ the period from the start of year X up to and including the day before the day of P's death.

6.33.4 *UK test 4: UK home*

Death in a year may prevent any of the UK tests from being met. For instance, UK test 2 (UK home) will not be met if P dies within the 91-day Test Window.

Para 10(1) sch 45 FA 2013 provides an additional UK test for the year of death:

> The fourth automatic UK test is that–
> (a) P dies in year X,
> (b) for each of the previous 3 tax years, P was resident in the UK by virtue of meeting the automatic residence test,

UK residence by virtue of meeting the sufficient ties test does not count.

> (c) even assuming P were not resident in the UK for year X, the tax year preceding year X would not be a split year as respects P (see Part 3 of this Schedule),

So if the preceding year (year X - 1) is a split year, UK test 4 is not met. The words "even assuming P were not resident in the UK for year X" are needed for split year Cases 2 and 3, under which a requirement for split year treatment in one year is that P is non-resident in the following year.[127]

> (d) when P died, either–
> (i) P's home was in the UK, or
> (ii) P had more than one home and at least one of them was in the UK

Unlike UK test 2, there is no requirement to have a home for a specified time, or to spend any time in the home. But there must be a home at the time of death (not earlier). There might be some scope for deathbed planning there: granting lease to a third party just before death would prevent this condition being met.

> (e) if P had a home overseas during all or part of year X, P did not spend a sufficient amount of time there in year X.

The point of para (e) is that the test is not intended to catch, for example, someone who is living back in their overseas home following a secondment to the UK but retains a UK home. Provided the 'spending sufficient time' requirement is met, in respect of an overseas home, the rule ensures that the individual does not automatically become UK resident as a result of their death.

Para 10 sch 45 FA 2013 provides:

> (2) In relation to a home of P's overseas, P "spent a sufficient amount of time" there in year X if—

[127] See 10.7.5 (Non-resident in next year: Case 2); 10.8.4 (Non-resident in next year: Case 3).

> (a) there were at least 30 days in year X when P was present there on that day for at least some of the time (no matter how short a time), or
> (b) P was present there for at least some of the time (no matter how short a time) on each day of year X up to and including the day on which P died.

Para (b) must be hard to meet. If P becomes ill, and is taken to hospital, then condition (b) is met if P dies on the same day but not if P dies on the next day. If P has two foreign homes, and is sometimes present in one and sometimes present in the other, condition (b) will not be met.

> (3) In sub-paragraph (2)—
> (a) the reference to 30 days is to 30 days in aggregate, whether the days were consecutive or intermittent, and
> (b) the reference to P being present at the home is to P being present there at a time when it was a home of P's.
> (4) If P had more than one home overseas—
> (a) each of those homes must be looked at separately to see if the requirement of sub-paragraph (1)(e) is met, and
> (b) that requirement is then met so long as it is met in relation to each of them.

This repeats the rules which apply to UK test 2.

6.33.5 *Death: Sufficient ties*

The sufficient ties test is amended if the individual dies during the year. Para 20(1) sch 45 FA 2013 provides:

> If P dies in year X, paragraph 18 has effect as if the words "More than 15 but" were omitted from the first column of the Table.

The first column of the table therefore reads:

Days spent by P in the UK in year X	**Number of ties that are sufficient**
~~More than 15 but~~ not more than 45	At least 4

Para 20 sch 45 FA 2013 provides:

> (2) In addition to that modification, if the death occurs before 1 March in year X, paragraphs 18 and 19 have effect as if each number of days mentioned in the first column of the Table were reduced by the appropriate number.
> (3) The appropriate number is found by multiplying the number of days, in each case, by A ÷ 12

where “A” is the number of whole months[128] in year X after the month in which P dies.

(4) If, for any number of days, the appropriate number is not a whole number, the appropriate number is to be rounded up or down as follows–

(a) if the first figure after the decimal point is 5 or more, round the appropriate number up to the nearest whole number,

(b) otherwise, round it down to the nearest whole number.

Amended as para 20 requires, the sufficient ties test for a death before 1 March becomes:

Leavers

Days spent by P in UK in year X	**Number of ties that are sufficient**
~~More than 15 but~~ not more than 46×A÷12	At least 4
More than 45×A÷12 but not more than 91×A÷12	At least 3
More than 90×A÷12 but not more than 121×A÷12	At least 2
More than 120×A÷12	At least 1

Arrivers

Days spent by P in UK in year X	**Number of ties that are sufficient**
More than 45×A÷12 but not more than 91×A÷12	All 4
More than 90×A÷12 but not more than 121×A÷12	At least 3
More than 120×A÷12	At least 2

The RDRM offers the following tables:

RDRM11970: Deceased individuals: Table C [May 2020]

Ties needed by a deceased person who was UK resident in one or more of the 3 tax years before the tax year under consideration.

The figures shown in the table below represent the days spent in the UK in the year of death.

Date of death	At least 4 ties	At least 3 ties	At least 2 ties	At least 1 tie
6 - 30 April	not more than 4	5 - 7	8 - 10	over 10
1 -31 May	not more than 7	8 - 15	16 - 20	over 20
1 - 30 June	not more than 11	12 - 22	23 - 30	over 30
1 -31 July	not more than 15	16 - 30	31 - 40	over 40
1 - 31 Aug	not more than 19	20 - 37	38 - 50	over 50
1 - 30 Sep	not more than 22	23 - 45	46 - 60	over 60
1 - 31 Oct	not more than 26	27 - 52	53 - 70	over 70
1 - 30 Nov	not more than 30	31 - 60	61 - 80	over 80
1 - 31 Dec	not more than 34	35 - 67	68 - 90	over 90

[128] Para 145 sch 45 FA 2013 provides: “whole month” means the whole of January, the whole of February and so on, except that the period from the start of a tax year to the end of April is to count as a whole month.

1 - 31 Jan	not more than 37	38 - 75	76 - 100	over 100
1 - 29 Feb	not more than 41	42 - 82	83 - 110	over 110
1 Mar - 5 Apr	not more than 45	46 - 90	91 - 120	over 120

RDRM11980: Deceased individuals: Table D [May 2020]

Ties needed by a deceased person who was UK resident for none of the 3 tax years before the tax year under consideration.

The figures shown in the table below represent the days spent in the UK in the year of death.

Date of death	All 4 ties	At least 3 ties	At least 2 ties
6 - 30 April	4 - 7	8 - 10	over 10
1 - 31 May	8 - 15	16 - 20	over 20
1 - 30 June	11 - 22	23 - 30	over 30
1 - 31 July	15 - 30	31 - 40	over 40
1 - 31 Aug	19 - 37	38 - 50	over 50
1 - 30 Sep	23 - 45	46 - 60	over 60
1 - 31 Oct	27 - 52	53 - 70	over 70
1 - 30 Nov	31 - 60	61 - 80	over 80
1 - 31 Dec	34 - 67	68 - 90	over 90
1 - 31 Jan	38 - 75	76 - 100	over 100
1 - 29 Feb	42 - 82	83 - 110	over 110
1 Mar - 5 April	46 - 90	91 - 120	over 120

6.33.6 *UK residence risk on death*

A person with a UK home faces some risk of being unexpectedly UK resident in the event of death. This can happen in two ways:

(1) An individual may expect not to meet UK test 2, on the basis that they will spend sufficient time 30 days in the overseas home later in the year. If they die unexpectedly, the person may be resident under UK test 2 because they may not have had the opportunity to clock up the 30 days.

(2) The person may be UK resident under UK test 4, particularly if they die early in the year and have not clocked up 30 days residence in the home.

The only way to avoid this risk is to ensure that the person spends some time in the overseas home in each of the first 30 days of the tax year; though there is no guarantee that will be possible.

A person with four UK ties also faces a risk of being unexpectedly UK resident in the event of death. The individual may expect not to spend 16 days in the UK, so as not to meet the usual sufficient ties test. But in the year of death they will be UK resident even if they spend *no* days in the UK.

6.33.7 *Transitional: Years to 2015/16*

Para 154(5) sch 45 FA 2013 deals with the transitional problem where the 3 previous tax years include pre-2013 periods, where the SRT (and in particular the automatic residence tests) did not apply:

> Unless, in relation to a pre-commencement tax year, an election is made under sub-paragraph (3) as respects that year[129]—
>
> (a) paragraph 10(b) of this Schedule has effect in relation to that year as if the words "by virtue of meeting the automatic residence test" were omitted

6.34 International transport workers

6.34.1 *"Relevant job"*

Para 30(1) sch 45 FA 2013 provides:

> P has a "relevant" job on board a vehicle, aircraft or ship if condition A and condition B are met.

"Relevant job" is not a helpful label: I refer to a person with a relevant job as an **"international transport worker"**.

I refer to **"international transport conditions A and B."**

6.34.2 *Transport condition A*

Para 30(2) sch 45 FA 2013 provides:

> Condition A is that P either—
>
> (a) holds an employment, the duties of which consist of duties to be performed on board a vehicle, aircraft or ship while it is travelling, or
>
> (b) carries on a trade, the activities of which consist of work to be done or services to be provided on board a vehicle, aircraft or ship while it is travelling.

Para 30(4) sch 45 FA 2013 provides:

> Sub-paragraph (2)(b) is not satisfied unless, in order to do the work or provide the services, P has to be present (in person) on board the vehicle, aircraft or ship while it is travelling.

6.34.3 *Transport condition B*

Para 30(3) sch 45 FA 2013 provides:

[129] See 6.38.2 (Ascertaining pre-2013 residence).

> Condition B is that substantially all of the trips made in performing those duties or carrying on those activities are ones that involve crossing an international boundary at sea, in the air or on land (referred to as "cross-border trips").

6.34.4 *Incidental duties*

The RDRM provides:

> **RDRM11750: Days spent in the UK: Travel either to or from a temporary workplace** [May 2020]
> ... Being on- call or stand-by may count as time spent working depending on the conditions of an individual's employment and the nature of their duties.
> Example 3 (Paula)
> P works as an engineer and is contractually required to be on-call for 4 night a month, in addition to her normal full-time attendance. She is paid a retainer for those 4 nights, in addition to being paid for any work if she is called out. The 4 nights are counted as working time.
> Example 4 (Franek)
> F is a self-employed locksmith, who keeps his mobile phone switched on 24 hours a day to receive customer calls. For the purposes of calculating work time, F should only include the time spent carrying out his jobs and the related travelling time.

Para 30(5) sch 45 FA 2013 provides:

> Duties or activities of a purely incidental nature are to be ignored in deciding whether the duties of an employment or the activities of a trade consist of duties or activities of a kind described in sub-paragraph (2)(a) or (b).

The RDRM provides:

> **RDRM11780: Days spent in the UK: Workers with relevant jobs** [May 2020]
> ... In deciding whether or not an individual falls within one of the categories of relevant job, duties or activities of a purely incidental nature can be ignored. For instance, where a pilot whose job consists of making long haul international flights; attends a meeting in the UK to hear an announcement about the airline's restructuring, the duties spent at the meeting are incidental to the duties of flying the plane, and so can be ignored.
> Example 2 (Preeya)
> P is a member of a cabin crew on board flights between London and

> Geneva for a short-haul airline. For 1 month during the year she changes her shifts and works on UK domestic flights. However, substantially all of the trips she makes in the performance of her duties are cross-border ones, P does have a relevant job.
>
> An individual will not have a relevant job simply because they occasionally work during a journey from 1 country to another; for example, if they catch up on business emails during a flight from their base in 1 country to visit a client in another country.

See 34.16 (Incidental duties in UK).

6.34.5 *Significance of relevant job*

Para 9(3) sch 45 FA 2013 disapplies UK test 3 (UK work):

> This paragraph does not apply to P if—
>
> (a) P has a relevant job on board a vehicle, aircraft or ship[130] at any time in year X, and
>
> (b) at least 6 of the trips that P makes in year X as part of that job are cross-border trips that either begin in the UK, end in the UK or begin and end in the UK.

Para 14(4) sch 45 FA 2013 disapplies overseas test 3 (Overseas work). The wording is identical.

The work tie is different for international transport workers. The rules in para 35, 36 sch 45 FA 2013 need to be read together:

> 35 (1) P has a work tie for year X if P works in the UK for at least 40 days (whether continuously or intermittently) in year X.
>
> (2) For these purposes, P works in the UK for a day if P does more than 3 hours' work in the UK on that day.
>
> 36 (1) This paragraph applies for the purposes of paragraph 35.
>
> (2) It applies in cases where P has a relevant job on board a vehicle, aircraft or ship.
>
> (3) When making a cross-border trip as part of that job—
>
> (a) if the trip begins in the UK, P is assumed to do more than 3 hours' work in the UK on the day on which it begins,
>
> (b) if the trip ends in the UK, P is assumed to do fewer than 3 hours' work in the UK on the day on which it ends.
>
> (4) Those assumptions apply regardless of how late in the day the trip begins or ends (even if it begins or ends just before midnight).

[130] Defined para 145 sch 45 FA 2013: "'ship' includes any kind of vessel (including a hovercraft)".

> (5) For the purposes of sub-paragraph (3)(a), it does not matter whether the trip ends on that same day.
> (6) A day that falls within both paragraph (a) and paragraph (b) of sub-paragraph (3) is to be treated as if it fell only within paragraph (a).
> (7) In the case of a cross-border trip to or from the UK that is undertaken in stages—
> (a) the day on which the trip begins or, as the case may be, ends is the day on which the stage of the trip that involves crossing the UK border begins or ends, and
> (b) accordingly, any day on which a stage is undertaken by P solely within the UK must (if it lasts for more than 3 hours) be counted separately as a day on which P does more than 3 hours' work in the UK.

6.35 Record keeping

Careful record keeping will often be necessary, especially for individuals whose residence is governed by the sufficient ties test.

6.35.1 *Record of UK days*

Note that it is not possible in practice to be present in the UK without leaving an electronic trail. In *Morris v HMRC*:

> the Revenue used their powers ... to obtain copies of the taxpayers' credit card and mobile phone records. These indicated that their credit cards and phones had been used in the UK on many more days than the taxpayers claimed they had been in the country. In subsequent correspondence, the solicitors said that this was because they had been used by other family members...[131]

Perhaps it would be wise for non-UK residents not to share their phones and credit cards with UK residents.

6.35.2 *Record keeping: Home*

Two issues may arise: whether a residence is a home; and when is the individual present in the home. The RDRM provides:

> **RDRM12920: Record keeping: Home** [May 2020]
> When considering whether the individual had a home in the UK or abroad, HMRC would look for evidence that establishes the individual's presence at a particular home, and whether or not a home existed, the

[131] 79 TC 184 at [6].

following information would help establish the facts:

- general overheads – utility bills which may demonstrate that the individual has been present in that home, for example, telephone bills or energy bills, which show usage commensurate with living in the property
- TV/satellite/cable subscriptions
- local parking permits
- membership of clubs, for example, sports, health or social clubs
- mobile phone usage and bills pointing to the individual's presence in a country
- lifestyle purchases pointing to the individual spending time in their home, for example, purchases of food, flowers and meals out
- presence of your spouse, partner or children
- engagement of domestic staff or an increase their hours
- home security arrangements
- increases in maintenance costs or the frequency of maintenance, for example, having their house cleaned more often
- insurance documents relating to that home
- SORN notification that a vehicle in the UK is 'off road'
- re-directed mail requests
- the address to which the individual's personal post is sent
- the address to which the individual's driving license is registered
- bank accounts and credit cards linked to the individual's address, and statements which show payment made – for example to utility companies
- evidence of local municipal taxed being paid
- registration at that address with local medical practitioners
- what private medical insurance cover the individual has, is it an international policy?
- credit card and bank statements which indicate the pattern and place of the individual's day by day expenditure

The list above is not definitive, no one piece of evidence will demonstrate the existence of the individual's UK or overseas home, with the requisite time spent there. HMRC will consider the weight and quality of all the evidence as, taken together, a number of pieces of evidence may be sufficiently strong enough to demonstrate their presence in a particular home.

Where the individual's home has changed from a holiday home to their home for the purposes of the SRT. The change in occupation could be evidence by amongst other things:

- utility bills which may show an increase in usage
- changes they have notified to:
- local municipal authorities

- the company providing their buildings and contents insurance

The same record keeping may be required to determine whether an individual is a Scottish/Welsh taxpayer.

6.35.3 *Record keeping: Work*

The RDRM provides:

> **RDRM12930: Record keeping: Working hours and location of work done - records** [May 2020]
> Where the individual's residence status is determined by the automatic tests relating to working full-time in the UK or overseas, they should keep information and records relating to:
>
> - the split in their working life between the UK and overseas, particularly noting days where they worked (including training, being on stand-by and travelling), for more than 3 hours
> - the nature and duration of their work activities – a work diary/calendar or timesheet is likely to indicate this. It might be found to be beneficial to ensure the diary is sufficiently detailed, maybe reflecting hours worked, and the nature of the work. For example, reviewing and responding to emails, meetings or completing travel claims
> - breaks the individual had from working, for example between jobs, and why
> - any periods of annual, sick or parenting leave
> - time spent visiting dependent children (those under the age of 18), when they are in the UK
> - their contracts of employment, and documentation/communications which relate to these, particularly to curtailment or extension of these or other changes to them
> - time the individual has had to spend in the UK owing to exceptional circumstances:

6.35.4 *Record keeping: UK ties*

The RDRM provides:

> **RDRM12940: Record keeping: The sufficient ties test** [May 2020]
> ...
>
> - In which countries they have spent their days and midnights, for example:
> - Their travel schedule/details
> - Booking information
> - Tickets and boarding cards (including etickets)

- If they left the UK to live or work abroad:
  - the date they left the UK
  - visa or work permit applications
  - contracts of employment
- If they come to the UK to live or work
  - the date they arrived here
  - Visa or work permit applications
  - documentation relating to when they take up employment, or ceasing their previous employment
- When the individual was present at their home or homes, or other available accommodation
- How long the individual owned or rented those homes, for example when they purchased, sold or leased those homes
- The time their home was unavailable for their use, for example because it was rented out

6.36 Residence: Burden of proof

The burden of proof generally lies on the taxpayer. This follows from s.50(6) TMA:

> If, on an appeal notified to the tribunal, the tribunal decides—
> (a) that the appellant is overcharged by a self-assessment;
> (b) that any amounts contained in a partnership statement are excessive; or
> (c) that the appellant is overcharged by an assessment other than a self-assessment,
>
> the assessment or amounts shall be reduced accordingly, but otherwise the assessment or statement shall stand good.

In *Norman v Golder*:[132]

> ... the language of [what is now s.50(6) TMA] makes it clear, beyond possibility of doubt, that the assessment stands, unless and until the taxpayer satisfies the Commissioners that it is wrong... The point really is not arguable.

In *Brady v Group Lotus Car Companies*:[133]

> The starting point is an ordinary appeal before the commissioners. Here, however unacceptable the idea may be to the ordinary member of the public, it has been clear law binding on this court for sixty years that an

[132] 26 TC 293 at p.297.

[133] [1987] STC 635, at p.642.

> inspector of taxes has only to raise an assessment to impose on the taxpayer the burden of proving that it is wrong.

Unfortunately the point which the Court of Appeal said was not arguable was argued successfully in a company residence case, where residence was wrongly said to be a matter of jurisdiction. It is no more a matter of jurisdiction than any other fact relevant to an appeal. In practice no-one has taken much notice and the burden of proof, in issues of individual and corporate residence, has generally been held to rest on the taxpayer.[134]

For completeness: a case to the contrary is *Marsh v HMRC* which concerned residence of an individual:[135]

> That the burden of proof [on residence] is on HMRC can be seen from *Cesena Sulphur Co Ltd v Nicholson* 1 TC 88 cited and approved in *Untelrab Ltd v McGregor* [1996] STC (SCD) 1).

But the parties were not represented by Counsel, and the point had not been argued.

The rule that the onus of proof is on the taxpayer is inconsistent with the HMRC Charter ("We'll assume you're telling the truth, unless we've good reason to think you're not."). But no-one takes any notice of that.

6.37 Non-resident's tax return: SA109

Non-residents who complete a tax return will include SA109 (Residence, remittance basis etc), which contains HMRC's standard questions on residence.

The Joint Expatriate Forum on Tax and NICs discussed this form in 2014:[136]

> 3.3 HMRC was aware that some agents and taxpayers felt that the SA109 asked for unnecessary or duplicate information. HMRC explained that this additional information was useful because it would allow HMRC to consider whether the claimed residence status was

[134] See *Wood v Holden* 78 TC 1 (Special Commissioners) at [120]. Brandon considers the point in more detail, and reaches the same conclusion, in *Taxation of Non-UK Resident Companies and their Shareholders* (1st ed, 2002) para 2.1.2 (Burden of Proving Residence Status). In any event, disputes are rarely decided by the burden of proof: see 4.7.4 (Who has burden of proof).

[135] [2017] UKFTT 320 (TC) at [58]. The burden of proof on ordinary residence was also held to be on HMRC, at [59]; but ordinary residence does not now matter.

[136] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/327284/140704_Expat_Forum_Minutes_FINAL.pdf* (April 2014)

> correct even though the basis of the claim was incorrect, e.g. an individual who failed to be automatically non-resident might not have sufficient UK ties or days of presence to be resident, and vice versa. HMRC made clear that an individual had no obligation to answer question other than those they believed to be appropriate to their circumstances.... HMRC said that it is up to the individual to decide which of the boxes are appropriate to complete and use a white space note to qualify the information provided.

6.38 Residence rules now abolished

6.38.1 *SRT/pre-2013 law compared*

The Residence Consultation Paper provides:

> 3.55 The SRT ... will broadly recreate the outcome of the current residence rules...[137]

In short, the SRT was not generally intended to change the old law, only to clarify its vagueness.

It is possible to identify some cases which would be decided differently under the SRT. I discussed these in earlier editions[138] and concluded that they were outliers: the SRT has provided a test of residence which is true to the principles of the pre-2013 (common law) rules as well as being more clear and certain.

Batten v HMRC[139] suggests the gap between the SRT and pre-2013 residence may be greater than that, perhaps because the more recent cases on residence had become increasingly stringent. There is no recent case where a taxpayer was held to be non-resident. In *Batten*, the the taxpayer was found to be UK resident under the pre-2013 rules, though he would have been non-resident under the SRT; and the FTT were not concerned by any inconsistency:

> We also recognise that the application of the SRT to the tax year 2012-2013 would have produced a different result. However, those rules are not applicable to that year. While we recognise that the SRT was designed to incorporate sufficient elements that it would generally produce the same result as the preceding common-law, codification of

[137] HM Treasury/HMRC, "Statutory Definition of Tax Residence" (2011) *http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81588/consult_condoc_statutory_residence.pdf*

[138] 2021/22 ed, para 5.39 (SRT/pre-2013 law compared).

[139] [2022] UKFTT 199 (TC) at [207].

> common law principles will, by nature, produce some differing results. ... More importantly, there is no basis on which we can apply the SRT retrospectively.

Fortunately the pre-2013 test is now (more or less) of historical interest only.[140]

6.38.2 *Ascertaining pre-2013 residence*

The distinction between leavers and arrivers depends on whether a person is UK resident in the previous 3 years, so pre-2013 residence will be relevant to determine whether a person is a leaver or an arriver, and so may be relevant to post-2013 residence:

2013/14: position depended on residence in 2010/11, 2011/12, 2012/13
2014/15: position depended on residence in 2011/12, 2012/13
2015/16: position depended on residence in 2012/13

From **2016/17** the position depends on residence in 2013/14 onwards, but the residence position may in part depend on the old law. Thus it will take decades before pre-2013 residence is completely irrelevant to post 2013 residence, but the number of cases in which it matters is now small and will continue to diminish.

Para 154 sch 45 FA 2013 explains how one determines pre-2013 residence. In short, one applies the pre-2013 residence law but with an election to apply the SRT. But it is not necessary to discuss this here.[141]

6.38.3 *Ordinary residence*

FA 2013 (more or less) removed the concept of ordinary residence from tax law. The concept survives in the context of NICs,[142] in non-tax law, and in obscure corners of tax where it could not conveniently be abolished.[143]

6.38.4 *Coronavirus worker relief*

This relief applied to determine residence of coronavirus workers for 2019/20 and 2020/21. Accordingly it is now of (more or less) historical interest only. I do not discuss it here, though the topic might conceivably

[140] But see 99.13.1 (Jurisdiction-residence).

[141] See the 2018/19 edition of this work para 5.28, 5.29.

[142] See 46.12 (Residence and ordinary residence).

[143] Eg, taxation of diplomats; see s.841 ITA. The concept of habitual residence, which covers similar ground, remains in the context of DTAs.

arise if UK residence in those years was relevant for deemed domicile or temporary non-residence. See s.109 FA 2020 and the 2023/24 edition of this work para 6.35 (Coronavirus worker relief).

6.39 Non-residence & tax avoidance

6.39.1 *Avoidance irrelevant to residence*

In *Reed v Clark* the taxpayer carefully organised his year abroad to reduce his tax liability but that did not matter:

> Residence abroad for a carefully chosen limited period ... is no less residence abroad for that period because the major reason for it was the avoidance of tax.[144]

Again, in *McCabe v HMRC*, a pre-SRT case on residence and treaty-residence:[145]

> The authorities set out what it means to be UK or non-UK resident for the purposes of UK law, and where a person actually arranges their life in the knowledge of those rules and in accordance with those rules, I would not consider that of itself to be an abuse of either UK law or the provisions of the DTC.

This principle continues to apply under the SRT.

6.39.2 *Is it tax avoidance?*

In the absence of a TAAR, it rarely matters whether planning is called avoidance or mitigation. But it is good to know what one is talking about. I prefer the view that the simple act of becoming non-resident for tax reasons ("a tax exile") is mitigation rather than avoidance in the strict sense. It is difficult to say that this is contrary to the intention of Parliament. Popular opinion would probably disagree; that reflects different approaches to the concept or definition of tax avoidance.[146]

[144] 58 TC 528 at p.556. Likewise the Special Commissioner in *Shepherd v HMRC* [2005] UKSPC SPC484 at [62]: "although the Appellant's intention in going to Cyprus was to mitigate tax, I do not regard that as a relevant factor in deciding whether he was resident in the UK."

[145] [2022] UKFTT 356 (TC) at [216]. For the treaty-residence point, see 108.7.2 (Emigration to treaty-state).

[146] See 2.5.9 (Views of non-tax practitioners); "Vestey: Royal Commission debate" *https://www.kessler.co.uk/wp-content/uploads/2017/11/Vestey_Royal_Commission_debate.pdf*

Further steps to take advantage of non-resident status may cross the avoidance line. Possible examples are:

Example: comment	**See**
Share for loan note exchange in advance of non-residence: avoidance	58.6.2
Becoming treaty non-resident: contentious, has been called treaty abuse	108.7
Timing of disposals: mitigation but Manuals do not like it	56.10.6 ff
Inter-spouse disposals: mitigation	93.13

What is tax avoidance is very fact-sensitive.

6.40 Resident of nowhere

"Resident of nowhere" is a convenient term to describe a person who is not tax-resident under the domestic law of any jurisdiction.

It is possible for a peripatetic individual to be a resident of nowhere, since most jurisdictions require a person to be present for a period of time before they become tax-resident.

In practice it would be unusual for an individual to be a resident of nowhere for an extended period. But it can happen that an individual was a resident of nowhere for a short time, eg if:

(1) someone ceases to be UK resident on 5 April,
(2) has a two week holiday in a third country, and
(3) then moves to a new country of residence.

They may (depending on the rules of the new country of residence) be a resident of nowhere for those two weeks.

In Australia:

> 1.231 ... Where an individual becomes a non-resident ... but has not established tax residency in another jurisdiction, the individual can become a 'resident of nowhere'. ..
> 1.232 When adopting the new outbound individual resident rules, the Board considers that, where an individual that has been an Australian resident might otherwise determine their status as a non-resident, the change in status should only be effective where the individual can demonstrate that they have established residency in another country...
> 1.233 The new test should reflect that such individuals remain Australian residents unless and until tax residency is established in another jurisdiction.[147]

[147] Board of Taxation recently a review of Australia's individual income tax residency rules (2018).

This is not part of UK law, under the SRT, though some of its rules may reflect a similar policy intuition.[148] There is a case for applying a similar rule in the UK. But like most "good ideas" relating to tax reform, it gets harder as one thinks more about it. Just for a start:

(1) It is a complication, as HMRC and taxpayers would need to consider whether individuals were tax resident elsewhere in the world under foreign tax laws.[149] Residence is not a simple concept, as anyone who studies this chapter will know.

(2) A person may be tax-resident for some purposes but not for others. Under the proposed Australian rule, would a person be regarded as resident in the UK during the offshore part of a split year?

(3) Rules would needed for countries that did not have a concept of tax-residence.

(4) It would be anomalous if the reform drew a distinction between:
  (a) resident of nowhere, who would be subject to UK IT/CGT and
  (b) a resident of a low-tax state, who would not be a resident of nowhere, and would not be subject to UK taxes, but may not pay much if any tax.

  There is little practical difference for tax between (1) being a resident of nowhere and (2) being a resident in a jurisdiction which does not impose tax on worldwide income/gains (which for non-doms could include the UK). The latter does not involve being a resident of nowhere, though it might be relevant for other regulatory purposes, such as CRS.

(5) Would tax raised by this reform justify these complications? It may be that residents of nowhere are not such a challenge to international taxation as the eye-catching label might suggest to a non-tax practitioner.

Trusts and companies may also be residents of nowhere. Indeed this is more easily the case, as criteria of trust residence differs more than for individuals.[150]

[148] See 6.32 (Country tie); 10.8.5 (Sufficient overseas link: Split Year Case 3). The former coronavirus workers relief (a relief of very narrow interest) was designed to exclude a resident of nowhere; see 6.38.4 (Coronavirus worker relief).

[149] FATCA/CRS require a person to know where they are resident, but they matter less: they only concern disclosure, not liability to tax.

[150] See 8.25 (Company resident nowhere).

6.41 SRT: Critique

The consultation response paper provided:

> 3.5 [1] The Government does not believe the test is complicated (!) and [2] taxpayers will be able to determine their residence status with clarity if they know how many days they have spent in the UK and which of the relevant connection factors they have.[151]

Tax complexity is a complex topic;[152] but no practitioner will take point [1] seriously, and nor do HMRC:

> HMRC noted that while the statutory test provides certainty, the legislation is quite lengthy and can be resource intensive to learn and apply.[153]

Australia will not follow the UK example:

> On balance, the Board considers that codification akin to the UK approach would not align with the Government's simplification agenda and the Board's preferred principles based drafting approach. The overly complex drafting of the law and increased length of legislation is in direct conflict with simplification.[154]

It is however true that taxpayers will be able to determine their residence status (in the large majority of cases) with reasonable certainty. That is a change for the better. The SRT is complex, voluble and repetitious, onerous in record keeping, and on some points uncertain; but no-one would swap the complexities of the SRT for the uncertainties of the previous law. Almost all the problems raised by the pre-2013 (non)definition of residence have been swept away. This carries out the

[151] HM Treasury/HMRC, "Statutory definition of tax residence and reform of ordinary residence: a summary of responses" (June 2012) *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_srt_or_summary.pdf*

[152] See the Introduction to this work.

[153] Board of Taxation, *Review of the IT Residency Rules for Individuals* (2017) para 1.171 *https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2018/07/T307956-income-tax-res-rules.pdf*

[154] Board of Taxation, *Review of the IT Residency Rules for Individuals* (2017) para 1.172 *https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2018/07/T307956-income-tax-res-rules.pdf*

reform recommended by the Consolidation Committee in 1936,[155] though the committee would have been astonished that the definition of residence required more than 50 pages of legislation and over 100 pages of guidance.

The reform benefited from the input of the professional bodies from an early stage of policy development, rather than being produced by HM Treasury/HMRC and then presented in a complete form, at a consultation stage.

6.42 Future of SRT

Section 218(2) FA 2013 provides:

> The Treasury may by order make any incidental, supplemental, consequential, transitional or saving provision in consequence of Schedule 45.

It appears that parliament anticipated that changes might be needed as the effect of the rules began to be understood. But in practice none have been made.

CIOT once lobbied for a review:

> CIOT notes that the TIIN for the SRT, published on 11 December 2012, included a commitment that 'This measure will be kept under review through communication with affected taxpayer groups.'...[156]
> Accordingly, after a suitable interval, CIOT recommends that the new SRT be formally evaluated, by an independent review, against its declared objectives in order to assess whether it is achieving those objectives.[157]

But HMRC did not carry out a significant review and it now seems unlikely.

One hopes that a review (if it did happen) would give weight to the desiderata of stability. Residence status in earlier years (sometimes very distant years) is often relevant to tax issues in the current year (the arrivers/leavers distinction for the SRT; temporary non-residence; deemed domicile; etc). So where there is a change in the definition of residence,

[155] See the 2012/13 edition of this work, para 3.15.1 (Practice prior to 1936).

[156] Author's footnote: An internet search shows this is a standard form sentence, frequently cut and pasted into TIINs. But perhaps it is not intended to be taken seriously: few if any substantial reviews seem to result in practice.

[157] CIOT, letter to HMRC (2013)
CIOT tried again two years later: letter to HMRC (21 July 2015).

advisers must keep in mind the old law as well as the present law, for two decades and sometimes more.

6.43 Scottish/Welsh taxpayers

6.43.1 *Scots/Welsh taxpayer: Concept*

The concepts of Scottish/Welsh taxpayer are distinct from the concept of residence as defined in the statutory residence test. They are relevant for the Scots/Welsh rates of income tax.[158] Even where the rates are the same, Scottish/Welsh taxpayer status is important for the government(s), as it affects the allocation of tax receipts.

The statutory provisions are in the Scotland Act (SA 1998) and Government of Wales Act 2006 (GOWA). The provisions are (more or less) the same so I set them out side by side.

HMRC have published Manuals (in very similar terms):

(1) Scottish Taxpayer Technical Guidance[159]
(2) Welsh Taxpayer Technical Guidance

6.43.2 *The basic rule*

s.80D(1) SA 1998	**s.116E(1) GOWA**
For any tax year, a Scottish taxpayer is an individual (T)—	For any tax year, a Welsh taxpayer is an individual (T)—
(a) who is resident in the UK for income tax purposes for that year (see sch 45 to the Finance Act 2013), and (b) who, for that year, meets condition A, B or C.	[identical]

For condition C, see App 10.3 (Scottish/Welsh parliamentarian).

In order to be a Scottish/Welsh taxpayer, the individual must be UK resident under the SRT. The following cannot be a Scottish/Welsh taxpayer:

(1) A non-individuals (trust or company)
(2) A non-resident individual

[158] See 43.5 (IT rates: the numbers); 43.6 (IT rates: Application).

[159] This is based on HMRC, "Scottish Rate of Income Tax – Technical Guidance on Scottish Taxpayer Status" (2015) (now withdrawn) ("Scottish Taxpayer Guidance").

6.43.3 *Condition A (close connection)*

s.80D(2) SA 1998	**s.116E(2) GOWA**
T meets condition A if T has a close connection with Scotland (see section 80E).	T meets condition A if T has a close connection with Wales (see section 116G).

Section 80E(1) SA 1998/s.116G(1) GOWA define close connection:

> To find whether, for any year, T has a close connection with any part of the UK see—
> (a) subsection (2) (where T has only one place of residence in the UK), or
> (b) subsection (3) (where T has 2 or more places of residence in the UK).

6.43.4 *One UK residence*

Section 80E(2) SA 1998/s.116G(2) GOWA provide:

> T has a close connection with a part of the UK if in that year—
> (a) T has only one place of residence in the UK,
> (b) that place of residence is in that part of the UK, and
> (c) for at least part of the year, T lives at that place.

6.43.5 *"Place of residence*"

Section 80E(4) SA 1998/s.116G(4) GOWA provide:

> In this section "place" includes a place on board a vessel or other means of transport.

Thus a caravan or houseboat may be a place of residence.[160]

Residence is not otherwise defined, but it should carry (more or less) the same meaning as "residence" for CGT private residence relief,[161] which is in turn (more or less) the same as "home" in the SRT.[162]

HMRC agree. Scottish Taxpayer guidance provides:

> 10. ["Place of residence"] is not defined by the legislation so must be given its ordinary meaning.
> For an individual its ordinary meaning is the dwelling in which that

[160] A similar rule applies for the SRT: see 6.20.4 (Any form of home).

[161] See 59.2 ("Residence").

[162] See 6.21.3 (Home/residence compared).

> person habitually lives: in other words his or her home. As such, it should be regarded as having similarities to the concept of "home" within the Statutory Residence Test.
> 11. This interpretation is supported by considerable case law, albeit relating to similar but not identical concepts elsewhere in law.
> N.B. An individual's election of 'main residence' for CGT purposes will not determine 'main place of residence for Scottish taxpayer status purposes.

The guidance then copies the text of the CG Manual on what is a residence for PRR.[163]

Scottish taxpayer guidance provides:

> **A property which is used as nothing more than a holiday home, temporary retreat or something similar** is not a place of residence. So a holiday home where an individual spends time for only occasional short breaks, and which clearly provides a distinct respite from their ordinary day to day life will not be a place of residence. However if there comes a time when an individual's use of a holiday home or temporary retreat changes so that it is used more frequently and for longer periods of time it will become a place of residence from the time of the change.
> *Example*
> 40. Jenny lives in Birmingham and works from home. She also owns a small house on Skye which she rents out apart from 2 to 3 weeks a year when she takes her holiday there. The Skye property is not a place of residence.

The SRT has an express provision to cover the point.[164]

> A property, vehicle or other 'home' that an individual never stays in will not be a place of residence for them. For example a property purchased solely as an investment or a property bequeathed to an individual and which they never stay in will not be a place of residence. This point is further reinforced by "close connection" test set out in s.80E Scotland Act 1998[165] making clear that "living" at a place is necessary to establish a "close connection".

Likewise for "residence" for PRR: see 59.2.4 (Physical occupation).

[163] For the CG Manual text, see 59.2 ("Residence").
[164] See 6.20.6 (Holiday home).
[165] The original erroneously reads: 2012.

6.43.6 *Two UK residences*

Section 80E(3) SA 1998/s.116G(3) GOWA provide:

> T has a close connection with a part of the UK if in that year—
> (a) T has 2 or more places of residence in the UK,
> (b) for at least part of the year, T's main place of residence in the UK is in that part of the UK,
> (c) the times in the year when T's main place of residence is in that part of the UK comprise (in aggregate) at least as much of the year as the times when T's main place of residence is in each other part of the UK (considered separately), and
> (d) for at least part of the year, T lives at a place of residence in that part of the UK.

If T has 2 or more places of residence in the UK at the same time, it is necessary to decide which is the main place of residence. For this question, Scottish taxpayer guidance repeats the CG Manual guidance on "main residence".[166]

Scottish taxpayer guidance provides:

> 68. Where, in the course of a tax year, an individual has more than one "main place of residence" but all in the same part of the UK, they will have a "close connection", to that part of the UK. If that part of the UK is Scotland they will be a Scottish taxpayer
> 69. Where in the course of a tax year, an individual has a "main place of residence" both in Scotland and elsewhere in the UK, (this may occur through a move from a single place of residence to another; or where there is more than one place of residence throughout the tax year) - whether a "close connection" with Scotland exists will be determined by whether his or her main place of residence was in Scotland for at least as much of the year as it was in any one other part of the UK
> 70. It is important to note that, for the purposes of this test, the time for which a main place of residence was in Scotland during a particular tax year is compared to the time for which it was in England, Northern Ireland or Wales individually during the course of that year not in aggregate.

The guidance gives an example of a move from one place of residence to another:

[166] See 59.7 (Which is main residence).

> Example (Donovan)
> 73. D has rented and lived at a house in Birmingham for a number of years – this is his sole place of residence.
> On June 30th he stops renting the Birmingham property and purchases a flat in Aberdeen, moving in immediately and living there for the rest of the tax year.

The HMRC analysis is as follows:

> In the course of the tax year D has two places of residence – one in Birmingham and one in Aberdeen. On the basis that D's place of residence was in Scotland (Aberdeen) for a greater period of time (July-April 5th) than it was in any other part of the UK (England – Birmingham from 6th April to June 30th), D has a close connection to Scotland and is a Scottish taxpayer for the whole of the tax year.
> Were the order of the moves to be reversed (i.e. Aberdeen to Birmingham) but the dates stay the same then D would not be a Scottish taxpayer as, on the basis the length of time at each place of residence, a close connection to England would exist.

In the next example the individual moves twice:

> Example (Emily)
> 74. E has owned and lived at a house in Fort William for a number of years – this is her sole place of residence.
> In the course of the year she sells her house in Fort William and moves into rented accommodation in Swansea where she stays until moving into a new house she has purchased in London.
> The period of time each location constituted her place of residence in the course of the tax year was as follows:

Fort William	125 days
Swansea	115 days
London	115 days

The HMRC analysis is as follows:

> E is a Scottish taxpayer, for the whole of the tax year, on the basis that the period of time for which her place of residence was in Scotland was a least as great (and in this case greater) than the periods of time her place of residence was in any one of the other parts of the UK.

6.43.7 *"Living at" place of residence*

"Living at" a place is not defined but I do not think it is obscure. If a person is physically present in a place of residence, for more than a minimal transitory period (such as dropping in to collect post) they are "living at" the place.

6.43.8 *Cond. B: Scots/Welsh days*

It will be a rare case where condition A does not apply. That would only arise if:

(1) T has no place of residence in the UK
(2) T has a place of residence in the UK but does not live at that place during the year
(3) T has 2 or more places of residence in the UK but none of them is T's main place of residence in the UK
(4) T has a main place of residence in a part of the UK but does not live there (or in another place of residence in that part) during the year.

In these circumstances one turns to condition B.

s.80D(3) SA 1998	**s.116E(3) GOWA**
T meets condition B if— (a) T does not have a close connection with England, Wales or Northern Ireland (see section 80E), and (b) T spends more days of that year in Scotland than in any other part of the UK (see section 80F).	T meets condition B if— (a) T does not have a close connection with England, Scotland or Northern Ireland (see section 116G), and (b) T spends more days of that year in Wales than in any other part of the UK (see section 116H).

There a slightly artificial definition of the phrase "spends more days of that year in Scotland/Wales":

s. 80F(1) SA 1998	**s.116H(1) GOWA**
T spends more days of a year in Scotland than in any other part of the UK if (and only if)-	T spends more days of a year in Wales than in any other part of the UK if (and only if)
(a) the number of days in the year on which T is in Scotland at the end of the day equals or exceeds	the number of days in the year on which T is in Wales at the end of the day exceeds each of the following—
(b) the number of days in the year on which T is in any other part of the UK at the end of the day.	(a) the number of days in the year on which T is in England at the end of the day;

> (b) the number of days in the year on which T is in Scotland at the end of the day;
> (c) the number of days in the year on which T is in Northern Ireland at the end of the day.

Scottish taxpayer guidance provides:

> **83. Where an individual spends at least as many days in Scotland as elsewhere in the UK they are a Scottish taxpayer.**
> 84. In other words - days spent in Scotland compared to days spent in England, Northern Ireland, and Wales in aggregate rather than to days spent in each of those parts of the UK individually.
> 85. For these purposes Scotland includes the adjacent UK territorial waters (i.e. up to 12 nautical miles from the shore), but does **not** include the adjacent UK continental shelf. Days spent in the UK continental shelf (for example on an oil rig or similar installation) are **not** days spent in any part of the UK for these purposes.
> **Note** - this is a different test to that used to establish "close connection" where an individual has had, in any given tax year, "places of residence" or a "main place of residence" in more than one of the constituent regions of the UK (England, Wales, Scotland & Northern Ireland). In such cases days where the residence is in Scotland are considered separately against days where the residence is in each region individually.

Section 80F(2) SA 1998/s.116H(2) GOWA provide a rule for transit days:

> T is treated as not being in the UK at the end of a day if-
> (a) on that day T arrives in the UK as a passenger,
> (b) T departs from the UK on the next day, and
> (c) during the time between arrival and departure T does not engage in activities which are to a substantial extent unrelated to T's passage through the UK.

This is based on the SRT rule; see 6.16 (Transit days).

Scottish taxpayer guidance provides an example where an individual has places of residence but no main place of residence:

> Example (Meera)
> 89. M and her husband own and run a successful multi-national business. They have no children or close family. Both travel extensively on business, occasionally staying in hotels but usually basing themselves

at houses they own in a variety of UK and overseas locations. Despite this travel both are resident in the UK for tax purposes. They are registered to vote at their London residence but seldom stay long at any of their residences and have numerous bank accounts and cars registered at different addresses.
M and her husband have numerous "places of residence" but it is not possible to identify one of these as their "main place of residence" – Scottish taxpayer status should be decided for each by a day count for days spent in Scotland and elsewhere in the UK.

Similarly an example where an individual has no place of residence:

Example (Ruth)
90. R is employed by an oil company working four weeks on/four weeks off, on a rig in the North Sea. R is single and has no children. When not on the rig she stays in work-related accommodation near Aberdeen but spend most of her nonworking time visiting friends or on holiday. She keeps some of her possessions in storage near Aberdeen but the majority are at her mother's home in Belfast which she also uses as her address for bank and other correspondence, although she seldom visits.
R has no place of residence. Her mother's house is not a "place of residence" as R does not reside there. Neither the rig (even if it is in UK territorial waters) nor the on-shore work accommodation are places of residence as there is little permanence or continuity in their occupation – none of her possessions are kept in them – there is no close connection. R's Scottish taxpayer status will be decided by day counting.

Example (Stuart)
91. S is a UK citizen but has no fixed place of residence during the course of a tax year – neither owning nor renting property. He works for consultancy firm advising on IT implementation projects and as such travels round the UK on short term assignments, staying in hotels. In the course of the tax year he spends 120 days in Scotland, 100 days in England, 50 days in Wales and 10 days in Northern Ireland.
Since S has no place of residence during the course of the tax year so the "days" he spends in Scotland are compared against the days he spends in aggregate in other parts of the UK. Since the 120 "days" S spent in Scotland is less than the 160 "days" he spent in another part of the UK he is not a Scottish taxpayer.
Had the number of days S spent in another part of the UK stayed the same but the number of days he spent in Scotland increased to 160 days or more – S would have been a Scottish taxpayer.

6.43.9 *Irrelevant factors*

HMRC Scottish Taxpayer guidance correctly states:

> None of the following factors will cause an individual to be a Scottish taxpayer if their place of residence is outside of Scotland.
>
> - National identity – regarding oneself to be Scottish
> - Location of work – working in Scotland
> - Location of income source – receiving a pension or salary from a Scottish entity
> - Travelling in Scotland – driving a lorry in or frequent work visits to Scotland

6.43.10 *Split year*

Scottish taxpayer guidance provides:

> 50. If an individual is identified as being a Scottish taxpayer that status applies for a whole tax year - it is not possible to be a Scottish taxpayer for part of a tax year.
>
> 51. However, it should be noted that, in a year that the individual becomes or ceases to be UK tax resident the extent to which income in that tax year is subject to income tax at the Scottish rates remains subject to 'split year' treatment under the statutory residence test.

6.43.11 *Administration*

An individual may not know until the end of the year whether or not they are a Scottish/Welsh taxpayer.

CIOT comment:

> 3.2 We understand that it is the responsibility of HMRC to identify Scottish taxpayers and notify them. In addition, for PAYE taxpayers, they will issue specific 'S' PAYE codes to employers and pension providers. We have a concern, however, that for some taxpayers, whose residence status changes during a tax year, the only way of resolving their tax position will be via self assessment – since it will only be possible to determine their final residence status in retrospect. It is likely therefore that many more individuals will be forced into self assessment as a result of the changes to income tax under the Scotland Act ...

See too 6.35 (Record keeping).

CHAPTER SEVEN

RESIDENCE OF TRUSTEES

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Cross references

The following topics are considered elsewhere:
10.17 (Split year of trustees and PRs)
87.8.2 (Non-classic trust: Trustee)

7.1 Trustees and residence: Introduction

The topics of this chapter are:

(1) Who are the trustees
(2) Residence of trustees

The identity of trustees matters in particular:
(1) to ascertain trust residence
(2) for liability to tax: the trustees are the persons liable to IT/CGT/IHT on trust income/gains/property.

Residence of trustees matters in particular for:
(1) Territorial limitations for IT/ CGT. Trust residence plays a role similar to individual residence:
    (a) UK resident trustees are taxable on worldwide income/ gains
    (b) Non-resident trustees are taxable only on UK source income and certain UK-linked gains.
(2) Anti-avoidance rules such as s.87 and ToA rules: these rules (in general) only apply to trusts which are non-resident.

The focus of this chapter is the residence of trustees of substantive trusts. Different rules apply to residence of:

Topic	**See para**
Bare trustees	7.21
Unit trusts	69.7.3
PRs	88.4 (PRs residence for CGT); 89.3 (PRs residence for IT)

7.2 Who are the trustees

"Trustee" is not usually defined in tax legislation, and the identity of trustees of a classic trust is a matter of trust law.

For the question whether a protector may be a trustee, see 7.18 (Protectors and trust residence).

For trustees of settlement-arrangements and IHT settlements, which may not be trusts in the trust-law sense, see 61.3 (Non-classic trusts).

7.2.1 *Nominees/bare trustees*

Trust property may be, and often is, held by nominees for trustees. Nominees are trustees in the sense that they hold property on trust. Nominee/bare trustee are synonymous terms, and a bare trustee must by definition be a type of "trustee". But nominees are not the "trustees of a settlement" for the purposes of s.474 ITA/s.69 TCGA:[1] they are trustees of

[1] In addition, for CGT, a nominee would be within s.60 TCGA which provides that "this Act shall apply as if the property were vested in, and the acts of the nominee or

a bare trust which is not a settlement. No-one would doubt that, but it is helpful to keep this in mind in considering the position of de facto trustees.

In ordinary legal usage, the term "trustee" (without further elaboration) is normally reserved for trustees of a settlement.

7.2.2 *De facto trustees*

What if there has been an invalid appointment of new trustees, and (perhaps) the trust property has been transferred to the invalidly-appointed trustees? Trust law distinguishes between:

(1) A validly appointed trustee

(2) A person purportedly but invalidly appointed trustee; such a person is not the proper owner and administrator of the trust assets, but:
   (a) If trust assets are held by them, of course they have a duty to transfer the assets to the correct trustees, like any bare trustee; and
   (b) if they act as trustee, they become a de facto trustee (also called a trustee *de son tort*, but it is not necessary, or desirable, to use antique Law French).[2]

A de facto trustee is not a "trustee" in the normal trust-law sense, for instance:

(1) A de facto trustee cannot exercise trustee powers, such as a power of appointment.

(2) It does not need a deed of retirement for a de facto trustee to cease to act.

A de facto trustee may be described as a constructive trustee, and so in one sense, perhaps a loose sense, may be described as a type of trustee.[3] But even if that usage is correct, de facto trustees are not "trustees of a settlement", for the purposes of s.474 ITA/s.69 TCGA,[4] and in ordinary

[bare] trustee in relation to the property were the acts of, the person or persons for whom he is the nominee or [bare] trustee"; see 87.7 (Bare trust/nomineeship). IT does not have an express equivalent of s.60, but if necessary the same rule could be implied.

[2] The term "de facto trustee" is defined and used in this sense in the Charities SORP. One might alternatively use the term "ostensible trustee".

[3] See R.C. Nolan's learned article "Equitable Property" [2006] LQR 232.

[4] See *Jasmine Trustees v Wells & Hind* [2007] EWHC 38 (Ch) at [33] - [50]; this describes the point as "obvious" - at [39] - but then goes on to examine the scheme of the TCGA in detail before concluding that the obvious answer is correct.
Express provision is therefore needed to say that a de facto executor is a personal

legal usage, the term "trustee" (without further elaboration) is normally reserved for the latter. In that respect the position is analogous to that of bare trustees or nominees.

7.3 Trustees a distinct person

The IT/CGT provisions are effectively identical; it may be helpful to read them side by side:

s.474(1) ITA	**s.69(1) TCGA**
For the purposes of the Income Tax Acts (except where the context otherwise requires), the trustees of a settlement are together treated as if they were a single person (distinct from the persons who are the trustees of the settlement from time to time).	For the purposes of this Act the trustees of a settlement shall, unless the context otherwise requires, together be treated as if they were a single person (distinct from the persons who are trustees of the settlement from time to time).

I call this the **"distinct-person rule"**.[5] Following the EN, I refer to the single person (distinct from the actual trustees) as the **"notional person"**.[6]

For corporation tax, s.1169 CTA 2010 incorporates the IT rule by reference.[7]

EN CTA 2010 Annex 1 change 3 discusses this provision:

> Section 474(1) of ITA ... substitutes a notional person for the trustees. That notional person is not a company and so cannot be an associated company [for the purposes of the small profits rate[8]]. It follows that [the former] ESC C9[9] is not needed to prevent a trustee company and a

representative for IHT purposes; see 125.2 (Meaning of "PRs" for IHT).

[5] I formerly used the term "distinct-person fiction"; but, in some ways at least, the rule reflects the substantive reality, so the word "fiction" is does not seem wholly apt.

[6] ITA uses the expression "the single person mentioned in s.474(1)"; TCGA uses the expression "the deemed person referred to in s.69(1)".

[7] The IHT position is more complicated. Sections 178(4)/191(3) IHTA apply a distinct-person rule for the purposes of Chapters 3/4 Part 6 IHTA (Sale of land/shares from deceased's estate). Apart from that there is no express distinct-person rule; but it may be implied, see 104.23.8 (PRs and beneficiaries of estate), and it will not often matter.

[8] See 43.20.1 (Small profits rate).

[9] ESC C9 provided (so far as relevant): "The Revenue will not, by concession, treat one company as being associated with a trustee company where the company is only

> company which it controls from being treated as associated.[10]
> Similarly, if section 474(1) of ITA treats the trustees of two settlements as separate notional persons, the concession is not needed to prevent two companies controlled by different settlements from being treated as associated [even if the trustees are actually the same person].[11]

It also matters in some other contexts that a trustee, even a corporate trustee, is a notional person, and not a company for IT/CGT/CT purposes.

The distinct-person rule applies for the taxation of the trust but not for the taxation of the trustee in their private capacity: trustee remuneration is income of the person who is actually the trustee, not the notional person. That is a case where context "otherwise requires".

Just as the notional person is not a company, it is also not an "individual". For completeness: s.65(2) TCGA provides:

> ... nor shall any trustee or personal representative be regarded for the purposes of this Act as an individual.

This is otiose, as the word individual is not normally understood to refer to trustees or personal representatives. So it does not matter that there is no equivalent for IT.

The distinct-person rule is only expressed to apply for IT/CGT/CT. But in other cases, a distinct-person rule, or something similar, is easily implied by context. Thus the SDLT Manual provides:

> **SDLTM31745: Changes in the composition of trustees of a continuing settlement** [Nov 2019]
> For Stamp Duty Land Tax (SDLT) purposes we treat trustees of a settlement as a single and continuing body of persons, as we do for capital gains tax.
> It follows that for a continuing settlement a change in the composition of trustees is not a land transaction.
> This means in particular that there is no charge on such an occasion where trust property is secured by a mortgage or other borrowing.

associated with that trustee company because it is under its control by taking into account rights and/or powers the trustee company holds in trust."

[10] Section 18E(4)(a) CTA 2010 provides that a company is an associated company of another if "one of the two has control of the other"; see 104.17.1 (Associated company).

[11] Section 18E(4)(b) CTA 2010 provides that a company is an associated company of another if "both are under the control of the same person or persons".

> Since there is no land transaction for SDLT purposes on a change in the composition of trustees of a continuing trust, a land transaction return should not be completed...

7.3.1 *Terminology: Trustees or trust*

As a matter of trust law, and tax law, trustees are persons, but a trust is not a person. So it is more accurate to refer to trustee residence, not trust residence; and to say *the trustees hold,* or *lend,* not *the trust holds,* or *lends*; etc. However the expressions may be used synonymously, without causing confusion; and they often are.[12]

Moreover, in the present context, it is essential to distinguish between:

(1) Residence of the trustees (in their capacity as trustees); or, more accurately, the residence of the notional person referred to in s.474/s.69

(2) Residence of trustees (in their private capacity)

For simplicity, I refer to:

(1) **"Residence of the trust"**

(2) **"Residence of trustees (in their private capacity)"**

7.4 Trust residence for IT/CGT

There is one main definition of trust residence, which is the same for IT and CGT.[13] The IT and CGT provisions are differently worded, but the effect of the rules is the same.[14] In this chapter I set out both sets of provisions.

The current rules adopt proposals originally made in the Trusts Consultative Document (1991).[15] This is of more than historical interest, as it explains the background to the current rules.

[12] See 9.21.1 (Trust law background).

[13] For IHT see 7.19 (IHT trust residence for IHT).

[14] When introduced in 2006, the wording was exactly the same (though the provisions were set out twice, in ICTA and in TCGA). But ITA repealed the ICTA provisions and recast them in its own plain English style. If (as the professional bodies asked at the time) the 2006 reform had been put back to 2007, this complication would have been avoided. This history is now unimportant, but it illustrates how transient microeconomic considerations (convenience of civil service administration) may lead to a permanent sub-optimal outcome.

[15] Chapter 10 *https://www.kessler.co.uk/wp-content/uploads/2014/02/1108_001.pdf*

s.475 ITA	**s.69 TCGA**
(1) This section applies for income tax purposes and explains how to work out, in relation to the trustees of a settlement, whether or not the single person mentioned in section 474(1) [the notional person] is UK resident.	
(2) If at a time either condition A or condition B is met, then at that time the single person is UK resident.	(2) The deemed person referred to in subsection (1) [the notional person] shall be treated for the purposes of this Act as resident in the UK at any time when a condition in subsection (2A) or (2B) is satisfied.
(3) If at a time neither condition A nor condition B is met, then at that time the single person is non-UK resident.	(2E) If the deemed person referred to in subsection (1) [the notional person] is not treated for the purposes of this Act as resident in the UK, then for the purposes of this Act it is treated as being not resident in the UK.

There are therefore two circumstances in which a trust is UK resident. In the ITA they are called Conditions A/B. In the TCGA they are called Conditions 1/2. I refer to them as "**trust-residence conditions**".

7.5 Trustees all UK resident

s.475(4) ITA	**s.69(2A) TCGA**
Condition A is met at a time if, at that time, all the persons who are trustees of the settlement are UK resident.	Condition 1 is that all the trustees are resident in the UK.

If all the trustees are UK resident, the trust is UK resident. If all the trustees are not resident in the UK, then (subject to the PE-residence rule) the trust is non-resident.

7.5.1 *Ascertaining trustee residence*

One must identify whether the trustees are UK tax-resident in their private capacities, applying:
(1) the statutory residence test, if the trustee is an individual[16]
(2) the company residence rules, if the trustee is a company

In the case of a company not incorporated in the UK, residence is decided by central management and control, which is where the top-level decisions are made. A company which is a trustee will make two classes of top-level decisions:
(1) Trustee decisions, made in its capacity as trustee (eg major decisions relating to management and distribution of trust assets)
(2) Corporate decisions, made in its private capacity (eg decisions as to whether to act as trustee, what it charges, how to distribute its profits)

Strictly speaking, only the corporate decisions are relevant to ascertain the trust company's tax-residence. Trustee decisions are treated as made by a separate, notional, person. The place where those decisions are made does not matter, for corporate residence, regardless of how important the decisions may be. But trustee decisions can matter for the PE-residence rule.

What if the trustee is a company incorporated *in* the UK? The company is UK resident for CT purposes under the incorporation rule.[17] But this rule is expressed to apply only for the purposes of Corporation Tax. Perhaps the company might regarded as non-resident, if central management and control was not in the UK. Perhaps a purposive (non-literal) construction is appropriate here. Fortunately this question is not likely to arise in practice.

7.6 Mixed-resident trustees

Condition B deals with the position of trustees of mixed residence.[18]

s.475(5), 476 ITA	**s.69 TCGA**
s.475(5) Condition B is met at a time if at that time—	(2B) Condition 2 is that:

[16] See 6.3.1 (SRT: Application to trustees/PRs).

[17] See 8.3 (The incorporation rule). The same would apply to other statutory company residence rules, but it is difficult to see that the point could ever arise in practice.

[18] For TRS, see 131.9.2 (Non-UK trust with UK trustee).

(a) at least one person who is a trustee of the settlement is UK resident and at least one such person is non-UK resident, and	(a) at least one trustee is resident in the UK, (b) at least one is not resident in the UK, and
(b) a settlor in relation to the settlement meets condition C (see section 476).	(c) a settlor in relation to the settlement was resident or domiciled[19] in the UK at a time which is a relevant time in relation to him
s.476(1) This section applies for the purpose of working out whether a settlor (“S”) in relation to a settlement meets condition C at a time.	(2C) In subsection (2B)(c) ‘relevant time’ in relation to a settlor—
s.476(2) If— (a) the settlement arose on S’s death (whether by S’s will, on S’s intestacy or in any other way), and (b) immediately before S’s death, S was UK resident or domiciled[20] in the UK, then S meets condition C from the time of S’s death until S ceases to be a settlor in relation to the settlement.	(a) means where the settlement arose on the settlor’s death (whether by will, intestacy or otherwise), the time immediately before his death, and
s.476(3) If— (a) the settlement is not within subsection (2)(a), and (b) at a time when S made the settlement (or is treated for the purposes of the Income Tax Acts as	(b) in any other case, a time when the settlor made the settlement (or was treated for the purposes of this Act as making the settlement).

[19] Section 476(3A) ITA/s.69(2F) TCGA provide:

Section 835BA (deemed domicile) applies for the purposes of subsections (2)(b) and (3)(b).	Section 835BA (deemed domicile) applies for the purposes of subsection (2B)(c).

This is the standard wording to apply the deemed domicile rules.

[20] See above footnote.

making the settlement), S was UK resident or domiciled[21] in the UK, then S meets condition C from that time until S ceases to be a settlor in relation to the settlement.

7.7 Residence condition C

Trust-residence condition C corresponds to the CGT relevant time requirement in s.69(2B)(c) and (2C) TCGA.

There is no express split-year rule, so the default rule applies: condition C is met even if a trust is made during the overseas part of a split year.[22]

For the purposes of discussion it is convenient to have some terminology and I coin the following terms:

(1) A "**UK-linked settlor**" is one within Condition C, i.e. (in short) who is resident or domiciled in the UK when they made the settlement.

(2) A "**UK-linked trust**" is one where the settlor (or a settlor) was UK-linked when they made the settlement.

(3) A trust has "**mixed-resident trustees**" if some trustees are UK resident and some are not.

Thus (in my terminology) a trust with mixed-resident trustees is UK resident if it is a UK-linked trust; conversely it is non-resident if it is not a UK-linked trust.

7.7.1 *Adding property: Tainting*

In trusts with mixed-resident trustees, it is necessary to identify the settlor(s)[23] and to ascertain when the settlor(s) provide trust property.

A trust whose settlor is not UK-linked may have some UK trustees (as long as they are not the sole trustees). In that case, however, one must take care that no other UK-linked person provides even a nominal amount of funds because that will make them co-settlors and the trust UK resident. This is known as "tainting" the trust.[24]

Suppose:

(1) Year 1: the settlor makes a trust when not UK resident;

[21] See above footnote.

[22] See 10.1 (Residence throughout tax year).

[23] See 99.1 (Why settlors matter).

[24] See 99.6 (Tainting).

(2) Year 2: the *same* settlor becomes UK resident and then adds property to the settlement.

The time that S made the settlement was year 1; S does not make a separate settlement in year 2; so at first sight it seems that the settlement is not UK-linked. But S is treated as making a settlement in year 2,[25] so it is considered that the settlement does become UK-linked.

7.7.2 *Ordinary residence: 2013 transitional rules*

Prior to the abolition of ordinary residence in 2013, s.476 ITA provided:

> (2) If—
> (a) the settlement arose on S's death (whether by S's will, on S's intestacy or in any other way), and
> (b) immediately before S's death, S was UK resident, ordinarily UK resident or domiciled in the UK,
> then S meets condition C from the time of S's death until S ceases to be a settlor in relation to the settlement.
> (3) If—
> (a) the settlement is not within subsection (2)(a), and
> (b) at a time when S made the settlement (or is treated for the purposes of the Income Tax Acts as making the settlement), S was UK resident, ordinarily UK resident or domiciled in the UK,
> then S meets condition C from that time until S ceases to be a settlor in relation to the settlement.

Para 57(2)(3) sch 46 FA 2013 deleted the underlined words. But para 57 provides:

> (4) The amendment made by sub-paragraph (2) does not apply if the person died before 6 April 2013.
> (5) The amendment made by sub-paragraph (3) does not apply if the settlement was made before 6 April 2013.

Thus the pre-2013 rules continue to apply to govern the income taxation of pre-2013 settlements. But it only makes a difference if a settlor is

[25] The pre-rewrite wording was clearer. Section 110 FA 1989 referred to "the time *or, where there is more than one, each of the times* when he has provided funds ... for the purposes of the settlement." It is an interesting question to what extent the courts will refer to pre-rewrite legislation to construe post-rewrite legislation. But that will not arise here, as the current legislation seems clear enough.

ordinarily resident but not UK resident, which rarely if ever happens.[26]

Prior to the abolition of ordinary residence in 2013, s.69 TCGA provided:

> (2) The [trustees] shall be treated for the purposes of this Act as resident and ordinarily resident in the UK at any time when a condition in subsection (2A) or (2B) is satisfied...
> (2B) Condition 2 is that—
> (a) at least one trustee is resident in the UK,
> (b) at least one is not resident in the UK, and
> (c) a settlor in relation to the settlement was resident, ordinarily resident or domiciled in the UK at a time which is a relevant time in relation to him.

Para 82 sch 46 FA 2013 deleted the underlined words. In this case there are no transitional provisions. There is a small difference between the IT and the CGT rules, though in practice it will rarely if ever matter.

7.8 Individual trustee/split year

The HM Treasury residence response paper provides:

> 3.122 Under the SRT an individual is resident for the whole of a tax year or not at all. It follows that provisions that look at residence status at a particular time may not work in the same way as previously. It is recognised that this may have an unintended impact on the position of a trust in the year in which an individual trustee comes to or leaves the UK and is resident for that year.
> 3.123 Accordingly the draft legislation contains a new rule that provides that an individual trustee is not regarded as resident for the purposes of determining the residence status of the trust if the only period in the year when the individual is a trustee falls within the overseas part of a split year for that individual.[27]

s.475(7)(8) ITA	**s.69(2DA) TCGA**
(7) Subsection (8) applies if—	A trustee who is resident in the UK for a tax year is to be treated for the

[26] See the 2012/13 edition of this work para 3.14 (Ordinarily resident but not resident).

[27] HM Treasury, "Statutory definition of tax residence and reform of ordinary residence: summary of responses to the June 2012 consultation" (2012) *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/consult_responses_statutory_definitions_of_tax_residence_reform_of_ordinary_residence_responses.pdf*

	purposes of subsections (2A) and (2B) as if he or she were not resident in the UK for that year if—
(a) an individual becomes or ceases to be a trustee of the settlement during a tax year,	(a) the trustee is an individual, (b) the individual becomes or ceases to be a trustee of the settlement during the tax year,
(b) that year is a split year as respects the individual, and	(c) that year is a split year as respects the individual, and
(c) the only period in that year when the individual is a trustee of the settlement falls wholly within the overseas part of the year.	(d) in that year, the only period when the individual is a trustee of the settlement falls wholly within the overseas part of the year.
(8) The individual is to be treated for the purposes of subsections (4) and (5) as if he or she had been non-UK resident for the year (and hence for the period in that year when he or she was a trustee of the settlement).	

This applies if an individual becomes trustee during the overseas part of a split year. It does not apply if the individual is trustee throughout the year. In such a case the trust may be resident in part of the year, and so subject to CGT for the whole year.

There is an exception relating to the PE residence rule:[28]

s.475(9) ITA	**s.69(2DB) TCGA**
But subsection (8) is subject to subsection (6) and, accordingly, an individual who is treated under subsection (8) as having been non-UK resident is, in spite of that, to be treated as UK resident whenever the individual acts as mentioned in subsection (6)	Subsection (2DA) is subject to subsection (2D) and, accordingly, an individual who is treated under subsection (2DA) as not resident is, in spite of that, to be regarded as resident whenever the individual acts as mentioned in subsection (2D).

[28] See 7.12 (PE residence rule).

7.9 Accidental residence: A trap

A trust may become UK resident if:
(1) its sole trustee becomes UK resident; or
(2) any trustee becomes UK resident and it is a UK-linked trust.

The consequences of a trust becoming UK resident may be disastrous for CGT and (except for IIP trusts) for IT. So it is essential for an individual to resign all trusteeships before becoming UK resident if:
(1) trustee of a UK-linked trust; or
(2) a sole trustee.[29]

This includes trusteeships of foreign law charitable trusts.

This state of affairs is deliberate, for the 1991 consultative document discussed a relief for temporary resident trustees, but suggested, the reader may think, implausibly, that the problem was not significant. In practice, in cases of unfairness, I expect the problem will be overlooked or ignored by non-compliant taxpayers, and HMRC may not spot it or turn a blind eye.

7.10 Separate sub-fund trustees

It is common for one trust to hold separate funds ("sub-funds") on separate terms, and it is possible (though not common) for the sub-funds to have separate trustees. The position here is governed by s.474(2)(3) ITA and s.69(3) TCGA. I do not set these out here because I do so elsewhere.[30]

The trust is UK resident unless the trustees of the sub-funds jointly meet the trust-residence conditions.

7.10.1 *Settled land act settlement*

The same provisions also deal with Settled Land Act settlements. These are (almost) obsolete in England, but the rules may shed light on the position of foreign trust-like entities by analogy. The trustees for tax purposes are the settled land act trustees *and* the tenant for life.

What is the position where the settled land is vested in the tenant for life, and there are no other investments, so nothing is vested in the trustees of the settlement? It is suggested that the trustees (for tax purposes) are still

[29] In the case of a non-UK linked trust, an appointment of a second non-resident trustee would be an alternative to resignation. See too 12.4.9 (Immigration on death of trustee).

[30] See 63.1.1 (Separate sub-fund trustees). For the (somewhat theoretical) case where a sub-fund election is made, see 63.9 (Effect of sub-fund election).

the tenant for life and the trustees of the settlement for SLA purposes. Whether the settlement includes investments representing capital money should not affect the question of who are the trustees.

7.11 Transfer between settlements

Section 476 ITA deals with transfers between settlements:

> (4) Further, if—
> (a) there is a transfer of property in relation to which section 471 applies,
> (b) S is a settlor in relation to settlement 2 as a result of that section, and
> (c) immediately before the disposal by the trustees of settlement 1, S meets condition C as a settlor in relation to settlement 1 as a result of subsection (2) or (3) or this subsection,
> then S meets condition C as a settlor in relation to settlement 2 from the time S becomes such a settlor until S ceases to be such a settlor.
> (5) "Settlement 1" and "settlement 2" are to be read in accordance with section 470(1).

For CGT, the equivalent is the last paragraph of s.69(2C) TCGA:

> and, in the case of a transfer of property from Settlement 1 to Settlement 2 in relation to which s.68B applies, "relevant time" in relation to a settlor of the transferred property in respect of Settlement 2 includes any time which, immediately before the time of the disposal by the trustees of Settlement 1, was a relevant time in relation to that settlor in respect of Settlement 1.

7.12 PE-residence rule

s.475(6) ITA	**s.69(2D) TCGA**
If at a time a person ("T") who is a trustee of the settlement acts as trustee in the course of a business which T carries on in the UK through a branch, agency or permanent establishment there, then for the purposes of subsections (4) and (5) assume that T is UK resident at that time.	A trustee who is not resident in the UK shall be treated for the purposes of subsections (2A) and (2B) as if he were resident in the UK at any time when he acts as trustee in the course of a business which he carries on in the UK through a branch, agency or permanent establishment there.

I refer to this as the "**PE-residence rule**".

The PE-residence rule has four requirements:

(1) A trustee carries on a business.
(2) It carries on business in the UK.
(3) It carries on business through a branch/agency or PE in the UK.
(4) It acts as trustee in the course of that business.

HMRC has published guidance on the PE-residence rule (**"HMRC PE-residence rule guidance"**).[31]

The professional bodies have issued a 31-page guidance note "Taxguide 06/15".[32] This consists of (I think, excessively) detailed examples put to HMRC, followed by brief generalities from HMRC. That format makes it difficult to identify relevant principles, though one or two significant points can be found.

See too 7.20.1 (Reason for PE-residence rule).

7.12.1 *"Business"*

The PE-residence rule only applies if the trustee carries on a business. A trustee which does not charge, or only charges to recoup expenses (such as a family/SPV trustee company) does not carry on business. This may offer a solution to the problem of the PE-residence rule.

HMRC agree. HMRC PE-residence rule guidance provides:

> By business we mean the business of providing professional trustee services for a fee.

7.12.2 *Acting in course of business*

The business must be (or include) the business of acting as trustee. For instance, if the trust holds UK investment properties, the trustee will carry on a property business in the UK, but is not acting as trustee in the course

[31] *http://www.hmrc.gov.uk/manuals/tsemmanual/attachments/tsem1461_appendix1.doc* The guidance was published in 2009 and lightly revised in 2011 (though the website version is still dated 1 July 2009). The guidance is in appendix 1 of the TSE Manual but in the form of a downloadable word file, not online text; as a result it is missing in commercial tax databases.

[32] *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/pre-2017/taxguide-0615.ashx*
This provides: "This Taxguide was originally published as Taxguide 3/10 which is now withdrawn. It has been reissued following a change to example 19 and the removal of example 28 which is now covered in the extended example 19. The revised example 19 was agreed by HMRC in 2015."

of running that business: it is running the business in the course of acting as trustee. In other words, the test is looking at the business that the trustee is carrying on in its private capacity, not in its capacity as trustee.

The CGT exit charge rules confirm that a trustee who (in the capacity as trustee) carries on a trade in the UK through a branch/agency or PE may be non-resident.[33]

HMRC agree. HMRC PE-residence rule guidance provides:

> 8. When considering the applicability of the [PE-residence rule] the following three questions are relevant:
>
> **A. Is the trustee carrying on a business in the UK?**
>
> ... This question does not relate to the business of a particular trust that might be conducted by the trustee. It enquires whether the person who is a trustee carries out business activities (as a professional or businessman, not as trustee of a particular trust) in the UK.
>
> **B. If the trustee is carrying on a business in the UK is it carrying on that business through a branch, agent, or permanent establishment in the UK?**
>
> Again this means that the trustee is carrying on through the branch, agency or permanent establishment the sort of activities from which it substantially derives its worldwide profits - providing professional services for a fee - and not what it is doing in relation to an individual trust.

7.12.3 *Business "carried on in UK"*

What if T carries on business partly in the UK and partly elsewhere? It is suggested that T carries on business in the UK, so if the UK part is carried on through a PE, T is deemed UK resident. If this is right, the rule lacks all proportionality. There is no *de minimis* rule. If a small part of T's trust business is carried on through a UK PE, the entire trust may become UK resident. As to whether a business is partly carried on in the UK, see 21.4.4 (Trading income of a non-resident), but if the business is carried on through a PE in the UK, there must be a business carried on (at least party) in the UK.

7.12.4 *One trustee of several trusts*

What is the position if a person is trustee of several trusts and acts as trustee through a UK PE for one trust, but not the others? It is considered that only

[33] See 12.4.2 (Assets of UK trade).

that one trust is UK resident. This follows from the rule that trustees are a notional person distinct from the person who is actually trustee.[34] This view also makes better sense in the context.

HMRC agree. HMRC PE-residence rule guidance provides:

> 8. When considering the applicability of the [PE-residence rule] the following three questions are relevant ...
> **C. If so is the trustee carrying on the activity of being a trustee of that particular trust in the course of its business through the branch, agent or permanent establishment?**
> For example, a corporate trustee could have a permanent establishment in the UK but it is only when it is acting as a trustee through that place that the deemed residence rules apply in relation to the particular trust for which the company acts as trustee. The test is on a trust by trust basis. So while a corporate trustee might be acting as a trustee in relation to one trust through a fixed place of business in the UK, other trusts must be considered separately according to their facts and circumstances.
> The same principle applies in the case of a non-corporate trustee: the test is on a trust by trust basis.

7.12.5 *Several trustees of one trust*

Suppose:

(1) A trust has two trustees, T1 and T2
(2) (a) T1 is deemed UK resident (because it has a UK PE)
    (b) T2 is not (e.g. T2 is an individual who does not carry on business)

This is treated as a trust with mixed-resident trustees So where a trust does not have a UK-linked settlor, the appointment of a co-trustee who does not carry on trustee business would solve the difficulty posed by the PE-residence rule.[35] HMRC agree. Trust residence guidance example 4b provides:

> **Example 4b** (December Ltd & Mr Wednesday joint trustees of Tuesday Trust)
> As in example 4a[36] but the significance of the meetings M has in the UK with the beneficiaries of the Tuesday Trust is sufficient for D Ltd to have a permanent establishment in the UK in respect of that trust. However D Ltd has a co-trustee Mr. W who is a non-UK resident trustee.

[34] See 7.3 (Trustees a distinct person).
[35] See 7.6 (Mixed-resident trustees).
[36] See 7.15.4 (Director/employee of trustee).

> **HMRC view**: As there is a co-trustee who is non-UK resident and as the settlor of the T Trust was not resident or domiciled in the UK when he introduced property into the trust that means that the trustees of the T Trust as a body will not be UK resident.

7.12.6 *"Through branch/agency/PE"*

In UK domestic tax law, the concept PE is used for companies[37] and "branch or agency" is used for individuals.[38]

HMRC PE-residence rule guidance provides:

> 5. HMRC accept that for trustees the '*branch*' and '*agency*' tests apply to non-corporate trustees and the '*permanent establishment*' test to corporate trustees. Non-UK resident companies that are trustees therefore need only be concerned about being treated as UK resident if they carry on a business through a permanent establishment in the UK. This is in line with section 10B TCGA 1992 which has the effect that an overseas company is not taxed on the gains made by a UK branch or agency, but only on those made by a permanent establishment here. ...

Thus in the HMRC view, the PE-residence rule applies:

(1) If a corporate trustee is carrying on a trustee business through a PE.
(2) If an individual trustee is carrying on a trustee business through a branch/agency.

One does not ask if an individual has a PE, or if a company has a branch or agency.

In practice offshore trusts do not often have individuals as trustees, and where individuals do act, they do not usually do so in the course of business. Accordingly, the question will normally be whether a corporate trustee has a PE: branch/agency will not normally arise. Since branch/agency is a somewhat undeveloped concept that is just as well. If, exceptionally, the issue did arise, the concept of branch/agency is more or less the same as PE and for most practical purposes is identical.[39]

If, as advocated in this book, the concept of branch/agency was replaced altogether by PE, this complication would cease.[40]

[37] The statutory definition of PE applies only to companies: see 106.2.2 (Scope of UK law definition).

[38] See 106.2 (PE: UK-law/OECD Model meanings); 106.27 (Meaning of "branch or agency").

[39] See 106.27 (Meaning of "branch or agency") .

[40] See 106.28 (Branch/agency: Critique).

7.12.7 *Which definition of PE*

The term "permanent establishment" has several distinct definitions.[41] I use the following terminology:

(1) "**UK-law PE**" defined in s.1141 CTA 2010
(2) "**OECD-Model PE**" defined in OECD Model
(3) PE as defined in any particular DTA

The term "PE" is not defined for the purposes of trust residence. Which definition applies? It is suggested that the UK-law PE should be the relevant definition. That is a statutory, taxes-act-wide definition.

The UK-law definition of PE only applies "in relation to a company"[42] so it does not apply to a non-corporate trustee, which is consistent with the view that for non-corporates, one applies the branch/agency rule and PE is not relevant.

A corporate trustee is treated as not being a company for IT/CGT purposes[43] unless the context otherwise requires. But we are here concerned with the business which the trustee carries on in its private capacity, so it is suggested that the context does otherwise require.

HMRC PE-residence rule guidance in its original form (2009) assumed that the applicable definition was OECD-Model PE. That is *an* ordinary sense, but in the light of the statutory definition, it cannot be said to be *the* ordinary sense. Another difficulty is that this definition changed in 2017.[44] Which definition applies, the pre-2017 definition one or the current one? While UK tax legislation occasionally delegates, or outsources, to OECD, one would expect the legislation to say so.

In 2011, the following passage was added to the guidance:

> **Treaty Issues**
> 13. Most UK treaties contain a permanent establishment threshold (Article 5 in OECD Model) for taxing business profits of a non-resident. This applies to both corporate and non-corporate trustees. Although permanent establishment is generally relevant to corporate trustees, and branch and agency to non-corporates, where trustees are residents of a treaty country (and the treaty contains a permanent establishment threshold) then effectively that is the standard that needs to be met in the

[41] See 106.2 (PE: UK-law/OECD Model meanings).
[42] See 106.2.2 (Scope of UK-law definition).
[43] See 7.3 (Trustees a distinct person).
[44] See 106.2.1 (Pre/post-2017 OECD Model).

> case of all trustees, non-corporate as well as corporate. This means that for treaty countries broadly the same considerations for permanent establishment as set out in the guidance will apply in the case of non-corporates. This includes the independent agent exemption outlined below.
> 14. Thus, where a treaty exists between the UK and the country in which the trustee is resident the permanent establishment article needs to be satisfied for the trustee to be treated as UK resident for the purposes of the trustee residence rules.
> 15. Annex A outlines in more detail how OECD Commentary interprets Article 5...

Thus the HMRC view is as follows:

(1) Where a corporate trustee is treaty-resident in a foreign state under a DTA with a definition of PE, the expression PE in the PE-residence rule is understood to refer to PE as defined in the treaty. Branch/agency does not apply.

(2) Where an individual trustee is treaty-resident in a foreign state under a DTA with a definition of PE, the expression PE in the PE-residence rule is understood to refer to PE as defined in the treaty. Branch/agency does not apply.

(3) Where a trustee is not treaty-resident in a foreign state under a DTA with a definition of PE:
    (a) In the case of a corporate trustee, one applies OECD-Model PE (I think); and branch/agency does not apply.
    (b) In the case of a non-corporate trustee, one asks whether the trustee has a UK branch/agency; and PE does not apply.

I suspect that the authors of the guidance (both the original and the 2011 revision) overlooked the UK-law definition of PE.

This is all a terrible muddle, though it could easily be resolved by straightforward tax simplification.[45] Fortunately (in the context of a trustee business in particular) there is probably little difference between:

(1) UK-law PE
(2) OECD-Model PE
(3) PE as defined in any particular treaty
(4) Branch/agency

So it will rarely if ever matter which definition or concept applies. Still, it

[45] See 106.25 (Definitions of PE: Critique).

would be good to know precisely what we are talking about.

7.13 When is there a UK PE

The more important question is what amounts to a PE, whichever definition applies. The difficulty is that the concept of PE, which was designed for international tax/DTA purposes, is not well suited as a test of trustee residence. Moreover I suspect that the part of HMRC which deals with trusts does not speak much to the part which deals with PE, and has little understanding of the difficult definition of PE. So on this point HMRC PE-residence rule guidance offers only vague and heavily qualified generalities.

There are two types of PE which I call:

(1) **"Fixed place of business PE"** and
(2) **"Agency PE"**

7.13.1 *Auxiliary v core activities*

HMRC PE-residence rule guidance provides:

> **Core activities**
> 9. In connection with Question C and in line with the Commentary to the OECD Tax Model Convention, "carrying on the function of being a trustee" means in this context activities which are the core activities of a trustee and not those activities which are auxiliary or preparatory.[46] This applies equally to non-corporate trustees.

It is correct that activities of a preparatory or auxiliary character do not constitute a PE.[47] The use of the label "*core* activities" to describe those which are not merely preparatory/auxiliary is not entirely apt. In another context, the expression is criticised by Lord Templeman, referring to the "incomprehensible test" of core duties.[48]

HMRC PE-residence rule guidance explains what it regards as "core activities":

> 10. A trustee is the person who has a legal duty to manage the assets of that trust in the best interests of the beneficiary or beneficiaries. The trustee manages, employs and disposes of the trust assets in accordance with both the terms of the trust and the duties and responsibilities which the law places upon trustees. The core activities of a trustee would

[46] See 7.12.4 (One trustee of several trusts).
[47] See 106.19 (Preparatory and auxiliary activities).
[48] *Fitzpatrick v IRC* 66 TC 407 at p.527.

> therefore be regarded as including:
> 10.1 the general administration of the trusts
> 10.2 the over-arching investment strategy
> 10.3 monitoring the performance of those investments
> 10.4 decisions on how trust income will be dealt with and whether distributions should be made.[49]

HMRC PE-residence rule guidance then explains "auxiliary activities":

> 11. There are other activities which trustees carry out which are not core activities central to their conduct and management of the trust, but are instead preparatory or auxiliary activities. These *generally* can include information gathering meetings, including meetings with independent agents or with beneficiaries but, as mentioned below, each case will have to be considered individually.

The rule that information gathering is auxiliary is in fact a statutory rule.[50] But in practice meetings tend to move seamlessly from information gathering to decision making.

> 12. In deciding whether the conduct and management of a particular trust is being carried on in the course of the corporate trustee's business through a permanent establishment, HMRC's approach will be to look at where the core activities are physically being carried out. If these core activities are being carried on in the UK through the corporate trustee's permanent establishment, the trustee would be treated as UK resident for the purposes of the particular trust. However as well as the nature or significance of the individual activities and meetings and whether they are core activities, we would also consider the issue of frequency. So where there is, in relation to a particular trust, evidence of considerable administrative work – such as meetings with investment managers or beneficiaries – being carried on in the UK through a permanent establishment, so that such meetings have become a major element of the trustee's activities in relation to that trust, and no longer preparatory or auxiliary, we would need to consider carefully whether as a matter of fact the non-UK resident corporate trustee was acting as a trustee through that permanent establishment.

Before turning to examples, the Guidance sets out the usual disclaimers:

[49] The draft guidance included a further paragraph 10.5: "accounting, making tax returns and record keeping." Significantly, the final guidance deleted this.

[50] See 106.19 (Preparatory and auxiliary activities).

> 16. The guidance that follows sets out examples of when a corporate trustee may or may not be regarded as UK resident. This guidance is based on the law as it stood on the day of publication. HMRC will publish amended or supplementary guidance if there is a change in the law or in the Department's interpretation of it. Whilst the guidance is intended to be as extensive and helpful as possible, it should not be assumed that it will provide a definitive answer in every case. That will depend upon the facts of each individual case. You can of course take your own advice on this issue...

7.13.2 *Marketing*

Marketing to prospective settlors is not carrying on trust business in the UK, because no trust at that time exists. HMRC agree:

> **1. Preparatory work prior to the creation of any trust**
> 1.1 A non-UK resident trust company that is to be a trustee of a settlement may carry out a number of activities in the UK before the trust is created. This might, for example, include discussions with clients such as potential settlors or beneficiaries over the appropriate terms of any trust. It could also include research with specialist professionals about possible trust investments and assets. These discussions may take place even before the beneficiaries are chosen.
> **Example 1** (February Ltd trustee of January trust)
> Before the J Trust is established, F Ltd, a non-UK resident trust company holds several meetings in the UK at its Manchester office with the potential settlor Mr J. The meetings are to discuss the possible terms of the trust and suitable investments.
> **HMRC view** The J trust does not yet exist, so there is no need to consider the tests in section 69(2D) TCGA 1992 and section 475(6) ITA. In any case, introductory meetings and discussions of this type would generally be regarded as preparatory or auxiliary activities and not core activities.

7.14 Fixed place of business PE

7.14.1 *Occasional visits*

A place which the trustees use occasionally to meet the settlor, beneficiaries or others cannot constitute a fixed place of business PE, which requires a degree of permanency.[51] HMRC PE-residence rule guidance provides:

[51] See 106.8.2 (Degree of permanency).

> **2. Trustee carrying out duties for the administration of any trust**
> As mentioned in paragraphs 9 to 11 of the Background section of this guidance,[52] a range of activities may be carried out by a trustee once a trust has been set up including meetings. When considering whether the corporate trustee is carrying on the administration of a particular trust in the course of their business through the permanent establishment, the frequency of the meetings will be looked at as well as their significance and quality.
>
> **Example 2** (March Ltd, trustee of April trust)
> M Ltd, a non-UK resident trust company that is trustee of the A Trust, holds quarterly meetings in the UK at its London offices with investment advisers. The purpose of these meetings is for M Ltd to collect purely factual information about potential assets to inform future investment strategy for the A trust. The actual decisions about the investment strategy are taken by M Ltd at their home office outside the UK. No other activities or meetings relating to the A Trust are carried on in the UK.
>
> **HMRC view:** M Ltd has a permanent establishment in the UK. However, the significance of the meetings with the investment advisers is not sufficient for March Ltd to be regarded as acting as a trustee in respect of April Trust through that permanent establishment. They will not, therefore, be regarded as UK resident for the purposes of the April Trust.

The correct analysis is that the trustee does not have a PE in the UK, for two independent reasons: information collecting is an auxiliary matter, and the office is not used with sufficient regularity to constitute a PE. (One is of course looking on the matter on a trust by trust basis).

The author assumes that the trustee does have a fixed place of business PE but does not carry on business through it. Strictly a PE means a place of business through which a business is carried on, so there is no PE. However the end result is the same.

By contrast:

> **Example 2a** (May Ltd, trustee of June Trust)
> M Ltd, a non-UK resident trust company, is sole trustee of the J Trust. M Ltd carries out all the work for the trust through its UK offices, including preparatory work, general administration, meetings with investment managers, accountants, beneficiaries etc.. The investment and distribution policies are also all determined in the UK office. Formal ratification of those strategies, including signature of documents, is made by M Ltd at very brief meetings outside the UK, with little or no further discussion of

[52] See 7.13.1 (Auxiliary v core activities).

> the proposals before approval is given.
> **HMRC view:** Although the strategic decisions are core activities, all the administration of the J Trust has been carried out in M Ltd's UK office. The formal meetings outside the UK although prima facie core activities are in reality merely "rubber stamping" all the UK work. M Ltd has acted as a trustee in respect of the J Trust through its UK permanent establishment and so will be treated as UK resident for the purposes of the J Trust.

That seems correct. M Ltd has a fixed place of business PE.

> **Example 2b** (July Ltd, trustee of August trust)
> J Ltd, a non-UK resident trust company is trustee of the A Trust. It always carries out the core activities of the A Trust at its office overseas. The beneficiary of the trust has a single one-off meeting with J Ltd at J's Manchester office to discuss the potential release[53] of capital from the A trust. The discussion involves the imposition of certain conditions on the beneficiary before such a release.
> **HMRC view:** On the face of it J Ltd by discussing the release of capital and the imposition of conditions with the beneficiary has engaged in a core activity and this has taken place at what is J's permanent establishment in the UK. So prima facie J Ltd is acting as trustee of the A Trust through a permanent establishment. However the whole context has to be looked at - i.e. where the decision making on the trust is being carried on and if the meeting in the UK was a one-off. If the trustee took the information from the meetings out of the UK with them and then discussed and made the decisions outside the UK, they would not be UK resident. If there was any doubt as to where the decision making is taking place we would as part of our considerations consider the frequency of any meetings both within and outside the UK.

More analytically, the issues (which are not clearly identified or addressed) are:

(1) Are the acts of the trustee in the UK merely preparatory (such as information gathering)? If so, there is no PE.

(2) Is the office used with sufficient regularity to constitute a fixed place of business PE? On the given facts, a one-off meeting is clearly not sufficient and the UK office is not a PE, so (although the HMRC example does not reach any conclusion) the answer is that the trustee

[53] The Guidance seems unfamiliar with trust terminology and practice, though nothing turns on that.

is not UK resident.

7.15 Agency PE

An agency PE arises if (in short):

(1) An agent has and habitually exercises authority to do business on behalf of the trustee; and

(2) it is not an agent of independent status acting in the ordinary course of their business.[54]

7.15.1 *Accountancy/law/tax advice*

A person who provides accountancy services, or legal or tax advice, cannot be an agency PE as providing services of that kind does not constitute doing business on behalf of the trustee: an accountant or tax adviser has no authority to do any business at all on behalf of the trustee.

If necessary, I would also say that these activities were auxiliary, not core; but it is not necessary to rely on that.

The accountant or adviser is likely to be an agent of independent status, and so not a PE for that reason too.

7.15.2 *Investment managers/brokers*

If IME PE relief applies, it is not necessary to consider further whether or not the broker/IM would otherwise be an agency PE.[55] In this section I concentrate on investment managers; the position of brokers is the same.

The relief is in s.1146(1) CTA 2010 which provides:

> This section applies if an investment transaction is carried out on behalf of a non-UK resident company in the course of the company's trade by a person in the UK acting as an investment manager.

This relief can apply. The non-UK resident company (the trustee) is not carrying on the trade of dealing in securities. However the trustee is carrying on the trade of acting as trustee in the UK. The contrary view has been suggested, but this seems reasonably clear.

The question then is whether investment manager conditions A to E are met. I deal with these briefly here as they are discussed in detail elsewhere.[56] Conditions A and B are straightforward. Conditions C and

[54] See 106.12 (Agency PE) and 106.16 (Independent agent exemption).

[55] See 72.2 (IME PE relief).

[56] See 72.7 (Investment manager conditions).

E require an arm's length relationship and full remuneration (which overlap: can one envisage an arm's length relationship without remuneration?). Condition D is the 20% rule. This was not written with trustees in mind, but construed in the context (perhaps a purposive construction) it should be regarded as satisfied provided that the investment manager (and connected persons) do not have an interest in more than 20% of the trust income. That will usually be the case.

It follows that investment managers/brokers on arm's length terms will not constitute a PE. Taxguide 06/15 confirms this:

> It doesn't matter that there is a corporate relationship between the investment manager and the trustee (such as the two entities being in the same corporate group) and this will not prevent the independent agent status applying. This follows the principle in OECD Commentary on Article 5 that a subsidiary is not automatically assumed to be a dependent agent of its parent.

7.15.3 *HMRC guidance*

The HMRC guidance in this area bears only a tenuous connection to the law. The original HMRC guidance did have the merit of clarity:

> I can confirm that our interpretation of the rules is that the provision of services on an arms length basis would not cause non-UK trustees to have a permanent establishment and therefore would not make the non-resident trustee UK resident.
>
> More specifically, this would include where services are carried out by a subsidiary on a fully arms length basis, such as:
>
> - maintaining the financial or accounting records
> - preparation of accounts
> - preparation and submission of tax returns for any settlement by a separate entity within the organisation contracting at arms length terms.
>
> Provided the services are contracted (at arms length terms) HMRC would not consider this constitutes a permanent establishment as the UK company will be rendering a service to the trust. Therefore, these activities would not cause the non-UK trustees to have a permanent establishment in the UK and the non-UK trustee is not made resident by [the PE-residence rule].[57]

The correct questions are whether the agent has and habitually exercises

[57] Extract from letter dated 18 July 2007.

authority to do business on behalf of the trustee, and if so whether the IM exemption applies, and whether the agent is of independent status and acting in the ordinary course of their business. The question is not whether the agent is receiving an arm's length fee. However the HMRC arm's length fee test reflects the policy aims of the provision, would be a simpler and workable rule, and would not normally give a different result from the correct approach.

In HMRC PE-residence rule guidance, this approach is maintained but is watered down with qualifications such as "likely" or "ordinarily":

> **3. Activities carried on for the trust other than by the non-UK resident trust company**
> 3.1 Whilst a non-UK resident trust company acting as a trustee may not carry out trust business at a fixed place of business permanent establishment in the UK, it is also necessary to consider whether activities are carried out in the UK on that non-UK resident trust company's behalf by a dependent agent. If this is the case the trustee may be treated as having a permanent establishment in the UK. ...
> 3.2 The activity of providing services to a non-UK resident trustee, whether by a connected person or not, does not of itself create a dependent agency permanent establishment ... It is necessary to consider the capacity in which the person provides the services to the trust on behalf of the non-UK resident trustee. Where
> [1] the services that are provided to the trust are only those that the person is contractually obliged to provide under their agreement with the non-UK resident trustee and
> [2] are remunerated at arm's length,
> then this is *unlikely* to create a dependent agency permanent establishment.

Point [1] is hard to understand. Who would provide services without a contract? Perhaps the author has in mind a beneficiary providing services to the trust informally, but it is difficult to see how remuneration could be paid in the absence of a contract, express or implied.

> 3.3 Whether there is a dependent agency permanent establishment will depend on the facts of the case; the position is the same whether it is an unconnected third party or a UK subsidiary or other connected person that carries out the work for the trust. Where, say, a UK subsidiary of a non-UK resident trust company is providing services to a trust, then unless the powers granted to it by the non-UK resident trust company are such that it becomes a '*dependent agent with authority to do business on behalf of the non-resident trustee*' ... we will not contend that the UK subsidiary's

> actions cause the non-UK resident trustee company to have a permanent establishment.

This is correct.

> **Example 3** (September Ltd trustee, October Ltd investment advisers, November trust)
> S Ltd, a non-UK resident trust company contracts with O Ltd which is a UK company within the same group. The services to be provided by O Ltd are for investment advice for the N Trust. The contract between S Ltd and O Ltd is on an arm's length basis and O Ltd has no powers granted to it by September Ltd.
> **HMRC view:** O Ltd is providing a service for S Ltd and has contracted to do so on arm's length terms. They have no authority to do business on behalf of S Ltd so are not their dependent agent. Therefore, S Ltd will not be treated as having a permanent establishment through the work carried out by O Ltd in the UK. So S Ltd will not be treated as UK resident for the purposes of the N Trust.

This is straightforward. If the investment adviser had no authority to do business on behalf of its principal, then it is not an agent at all. It cannot be an agency PE.

If the investment adviser did have power to do business on behalf of the trust, it is still not PE as long as it qualified for the IM exemption (which in practice should usually be the case).

> Other examples which would be treated in the same way where there was an arm's length relationship are:
> •. Preparing trust accounts for the trustees' review and approval
> - Preparing trust tax returns for the trustees' review and approval and filing the return on their behalf with HMRC
> - Obtaining quotes for necessary repair work on trust property
> - Having contact with workmen to ensure that those repairs are carried out
> - Day to day management of let property (such as dealing with tenants etc)
> - Signing small cheques such as paying for minor repairs
>
> **Example 3a** (September Ltd trustee, October Ltd investment advisers)
> As above but O Ltd also has authority to buy and sell commodities with a view to realising profits for the trust subject to trading limits set by S Ltd. It receives an arm's length fee for this activity.
> **HMRC view:** The investment manager is appointed by the trustee, and so is its agent. If it receives an arm's length fee for the investment management services, it will not *ordinarily* constitute a dependent agent

of the non-UK resident trustee.

If, however O Ltd was providing investment management services to the trustees other than on arm's length terms i.e. was acting as their dependent agent, rather than simply providing a service to them, in that case the trustees would be *likely* to have a dependent agent permanent establishment.

(This is in line with the Investment Manager Exemption provisions – in particular that the provision of services at less than a customary rate can indicate that the investment manager is not an independent agent of the non-UK resident trustee.)

7.15.4 *Director/employee of trustee*

The question may arise whether a UK resident director/employee of a corporate trustee can constitute an agency PE; though I wonder how often a non-resident trustee company has a UK resident director/employee.

HMRC PE-residence rule guidance provides:

> **4. UK resident directors or other employees of a non-UK resident trust company.**
>
> 4.1 First, it is necessary to consider the role of the UK resident director or employee of the non-UK resident trustee.
>
> 4.2 If the UK resident employee is not carrying out activities that would be regarded as core trustee activities in relation to a particular trust then the presence in the UK of an employee of a non-UK resident trust company could not by itself cause a non-UK resident trustee to have a permanent establishment in the UK.

This is consistent with the point made at 7.13.1 (Auxiliary v core activities).

> 4.3 Where in relation to a particular trust the UK resident employee does carry out [core] trustee activities in the UK then it is likely that the non-UK resident trustee will have a permanent establishment in the UK. This will be the case if
>
> [1] the employee operates from a fixed base, or
>
> [2] does not have a fixed base but habitually acts on behalf of the non-UK resident trustee for the particular trust, i.e. is a dependent agent permanent establishment of the non-UK resident trustee.
>
> The crucial point in relation to a dependent agent permanent establishment is whether the non-UK resident trustee company has in the UK-resident employee a dependent agent with authority to conduct business on behalf of the non-UK resident trustee. If this UK resident employee of a non-UK resident trustee does have the authority to make

> decisions then s/he is likely to constitute a dependent agent permanent establishment of the non-UK resident trust company.

The first example is a simple variant of example 1:[58]

> **Example 4 (December Ltd trustee; Mr Monday employee)**
> D Ltd, a non-UK resident trustee has a director or other employee M who is resident in the UK. (This individual may also be an employee or director of UK resident group members.)
> The group provides office accommodation in the UK to M. His role is to market the business of the non-UK resident trust company in the UK which includes meeting with prospective settlors and other business contacts for this purpose.
> **HMRC view:** In this case, M's role is only meeting with prospective settlors and other business contacts for the purpose of marketing the business of D Ltd. Although these activities are carried out at the same place, they are not activities as a trustee that are carried out at a fixed place of business. They would generally be preparatory or auxiliary activities. This would not cause D Ltd to be treated as carrying on trustee business through a permanent establishment in the UK.

In the next example, the director/employee does more than marketing:

> **Example 4a**
> As in example 4, but M's role also extends to meeting beneficiaries of existing trusts.
> **HMRC view**: In this case, the importance of the subject matters discussed and the decisions taken at those meetings, and the frequency of the meetings held, will need to be analysed in relation to each trust in order to reach a conclusion as to whether D Ltd is carrying on a business through a permanent establishment in the UK for that trust through M.
> If no office accommodation is at his disposal M could still constitute a dependent agent permanent establishment of the non-UK resident trustee if he has authority to enter into contracts or otherwise do business on behalf of the trustee of the trusts i.e. more than simply meeting the beneficiaries and he habitually exercises that authority on behalf of his employer for the trust.

HMRC do not answer the question in the example, but the general approach to the answer is correct. Of course the example only applies if the trustee acts as trustee in the course of a business.

[58] See 7.13.2 (Marketing).

7.16 Individual trustee: Branch/agency

7.16.1 *General approach*

Taxguide 06/15 provides:

> **Example 19** (Mr S trustee of Rho Trust; Sigma Ltd fund manager)
> Mr S, a resident of the Cayman Islands, carries on a business of providing trustee services in the Cayman Islands. Mr S is the sole trustee of the R Trust. Mr S is not UK resident.
> Because its sole trustee is non-UK resident, the R Trust is non-resident for income tax and CGT purposes, unless Mr S acts as trustee for the R Trust in the course of business which Mr S carries on in the UK through a branch or agency.
> HMRC accepts that the "permanent establishment" test normally applies only to corporate trustees. In this case there is no Article 5 in the UK: Cayman Double Taxation Agreement and the PE threshold do not need to be considered, only branch or agency.
> **Question**
> When might ITA 2007, s 475(6)/TCGA 1992, s 69(2D) apply such that the non-resident R Trust is UK resident for income tax and CGT purposes?
> **Analysis**
> As set down in the HMRC Trustee residence guidance (Trusts and Estates Manual, Appendix 1) when considering the applicability of the tests in ITA 2007, s 475(6) and TCGA 1992, s 69(2D) the following three questions are relevant:
> a) Is the trustee carrying on a business in the UK?
> b) If the trustee is carrying on a business in the UK is it carrying on that business through a branch, agent, or permanent establishment in the UK?
> c) If so is the trustee carrying on the activity of being a trustee of that particular trust in the course of its business through the branch, agent or permanent establishment?
>
> If the answer to all three questions is "yes" then Mr S will be acting as trustee for the R Trust in the course of business which he carries on in the UK through a branch or agency and, since he is the sole trustee, this will mean that the trust is UK resident.
> The answers to the three questions will depend on the specific facts. The facts set out above are insufficient to enable any of the questions to be answered. As such, supplementary facts are provided in each of scenarios 19.1 to 19.4 below...

7.16.2 *UK office*

Taxguide 06/15 provides:

> **19.1 Mr S has an office in the UK and activities with respect to his trustee business are carried out through that office.**
> Mr S's London office is a branch of his Cayman trustee business. As such:
> a) Mr S is carrying on a business in the UK.
> b) Since there is a London office Mr S is carrying on that business through a branch in the UK.
> If activities with respect to the R Trust are carried out through the London office, then the R Trust is UK resident. But the R Trust would not be UK resident if the affairs of the R Trust are not handled through the London office.
> Note that if Mr S has employees who work through the London office he would also have agents in the UK. However, since the London office is a branch and so within the ITA s 475(6) requirement by virtue of that fact alone, this does not need to be considered further.

7.16.3 *Fund manager*

Taxguide 06/15 provides:

> **19.2 Mr S does not have an office in the UK. Mr S appoints S Ltd. a London fund manager, to manage the R Trust's portfolio. Neither Mr S nor his employees visit the UK.**
> S Ltd is not connected to Mr S and so is not a branch of his business of providing trustee services. S Ltd is not acting as agent of the trustee, but providing a service to the trust, for which it is paid. S Ltd is not an agent of Mr S in his personal capacity of administering trusts. There is no branch or agency so the R trust is non-UK resident.

7.16.4 *Employee of trustee*

Taxguide 06/15 provides:

> **19.3 Mr S does not have an office in the UK. Mr S appoints S Ltd. a London fund manager, to manage the R Trust's portfolio. Mr S's employees visit the UK to discuss the affairs of the R Trust with S Ltd at S's London office.**
> As discussed above (19.2), S Ltd cannot be said to be either a UK branch or a UK agent through which Mr S carries out trustee activities with respect to the R Trust. Even though Mr S's Cayman trustee business does not have a UK office, the R Trust could be UK resident if employees of

Mr S visited the UK, and discussed the affairs of the R Trust with S Limited at its office. In this event Mr S would be carrying on part of his trustee business of providing trustee services in the UK through the employees acting as Mr S's agents in the UK.

Whether the trust was UK resident or not would depend on the nature and extent of the employees visits to the UK offices of S Limited:

- If the activities carried out are core activities then the trust will be UK resident.
- If the activities are merely auxiliary or preparatory (such as delivering instructions from Mr S or picking up reports) then the trust will not be UK resident.

7.16.5 *Trustee not own agent*

Taxguide 06/15 provides:

> **19.4 Mr S does not have an office in the UK. Mr S appoints S Ltd. a London fund manager, to manage the R Trust's portfolio. Mr S himself visits the UK to discuss the affairs of the R Trust with S Ltd at S's London office.**
>
> As discussed above (19.2), S Ltd cannot be said to be either a UK branch or a UK agent through which Mr S carries out trustee activities with respect to the R Trust.
>
> A person cannot be an agent of himself. As such, the R Trust would not be UK resident if Mr S made the visits to S Limited himself.
>
> As explained in above (19.3) the position would be different if Mr S's employees made the UK visits to S Limited as the employees would be acting as Mr S's agents in the UK.

7.17 PE-residence rule guidelines

It is considered that the following guidelines will avoid difficulties under the PE-residence rule. It is assumed that the trust has only a corporate trustee, or if it has individual trustees, they are not carrying on a business (so it is necessary to consider PE issues but not branch/agency issues).

Use of professional UK investment managers and brokers on arm's length terms is safe.

Use of professional UK advisers to prepare tax returns or give tax advice is safe.

Use of UK agents to manage UK property investments is safe, providing they are acting in the ordinary course of their business, which in practice they should be.

The trustees may meet beneficiaries (or others) in the UK in any of the following circumstances:

(1) If the meeting is at the offices of the beneficiaries (or others) or hotels; not in the trustees own offices, or in offices provided by a company in the same group as the trustees.
(2) If the meeting is occasional. Once a year or less would safely be "occasional" for this purpose.
(3) If the meeting is purely for information gathering purposes. (The minutes of the meeting should make that clear.) However it may be difficult to restrict meetings to information gathering topics.

The trustees should not appoint a beneficiary to act for the trustee (unless, exceptionally, the beneficiary is carrying on a business and acting in the course of that business).

Where the trustees own a house which is occupied by the beneficiary, I see no difficulty in the trustees authorising the beneficiary to maintain the house, as that does not constitute carrying on business in the UK.

Marketing and meetings with prospective settlors are safe.

In cases where the settlor was not UK resident or domiciled when the settlement was made, all difficulty under the PE-residence rule can be avoided by the appointment of an individual co-trustee who is not UK resident and not carrying on a business.

7.18 Protectors and trust residence

7.18.1 *Protectors*

The concept of "protector" is not a technical term: trust deeds provide different rights and obligations on a protector. Trusts typically confer on the protector:

(1) power to remove and appoint trustees and
(2) powers of consent, as key powers of the trustees are only exercisable with the protector's consent[59]

A protector could not be regarded as a trustee[60] and so their actual

[59] This is self-evident, but if authority is needed, see *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) at[180].

[60] In *Bridge Trustees v Noel Penny (Turbines)* [2008] EWHC 2054 (Ch) an employer had power to distribute the surplus assets of a pension scheme. The employer was not "a trustee properly so called, that is to say, a person in whom property is vested as trustee"; see at [23].
All the textbooks agree: Hubbard *Protectors of Trusts* (1st ed, 2013) paras 2.24 (Distinction between a Protector and a Trustee) and 8.70 ('Not a trustee' provision);

Underhill and Hayton, *Law of Trusts and Trustees* (20th ed, 2022), para 1.83: "A power-holder other than a trustee may be described in a trust deed as a 'protector' but this is not a legal term of art and some other expression may be used, such as 'advisor' or 'committee' or 'investment advisor', depending on the settlor's design."; Hayton (ed.,) *International Trusts* (3rd ed, 2011) at para 4.11; *Thomas on Powers* (2nd ed 2012), para 7.109 fn 458.

If further authority is needed, which I doubt, see *Manoogian v Sonsino* [2002] EWHC 1304 (Ch). In this case a trust provided (in short):

> “the Bank [which was the trustee] shall make such investments as may be directed to be made by the Armenian Patriarchate of Jerusalem.”

The Patriarch was not a trustee for the purposes of the Charities Act:

> “His position is analogous to powers of a life tenant under a conventional strict settlement. The life tenant is often given powers to possess land, direct investments and so on, but none of those things make him a trustee of the settlement.” See at [41].

To the same effect, see *Gomez v Gomez* [2008] EWCA Civ 1065. One of the questions in this case was whether the defendant was sued “as trustee of a trust” within the meaning art article 5(6) Council Regulation (EC) No 44/2001 (now repealed). Article 5(6) was to be interpreted narrowly, or restrictively. The Court of Appeal said at [99]:

> “... I can see no basis for extending Article 5(6) to such persons as appointors, or protectors, or to any other person with fiduciary powers who does not come within the normal meaning of the expression “trustee.”

Gomez is a decision on a provision where the word “trustee” had to be understood restrictively, but it confirms, if confirmation is needed, that protectors, and any other person with fiduciary powers, do not come within the *normal* meaning of the word “trustee.”

For completeness: It might be different if the protector’s role extends beyond that normally given to a protector. One could imagine a trust deed under which:

(1) persons named “trustees” held legal title to property; and

(2) a person (mis)named “protector” held the administrative and dispositive powers normally given to trustees.

This case (depending on the drafting) might be equivalent to the common situation where trust property is vested in nominees. In such a case no one suggests that the nominees are “trustees” for the purposes of the trust residence rule. Although the legal title may not be vested in the trustees, the trustees have the right to call for it.

Alternatively (depending on the drafting) the case may be equivalent to the situation where custodian trustees hold the trust fund on behalf of managing trustees under s.4 Public Trustee Act 1906. In such a situation, the (so-called) protector would be a trustee. This is hypothetical – I have never seen it in practice – but worth mentioning as warning of problems which might arise if the powers of a UK resident protector were extremely extended.

Many offshore Trust Laws state expressly that a protector is not a trustee; but (i) that only states what would in principle be the position, and (ii) that could not be residence is irrelevant in ascertaining the actual residence of the trustees in their private capacities.

A protector has functions conferred by the trust deed, and is not an agent of the trustees. So a protector does not constitute an agency PE, and does not affect trust residence under the PE-residence rule.

It follows that a protector may be UK resident without affecting the residence of the trust.

If trust assets are held through an underlying company, the acts of a protector in the UK could be relevant to the company's tax residence, if they impinge on its central management & control. But that seems unlikely.

7.18.2 *Reserved powers*

The same points arise for reserved power trusts. Taxguide 06/15 provides:

> If the settlor has reserved the investment function to himself do HMRC consider the settlor to be an agency PE of the trustees if he habitually exercises the investment function while present in the UK?
> Our view is that this is NOT the case. The settlor cannot be a PE of the trustees' business because the investment function is not part of the trustees' business. The trustees' primary and overriding responsibility is to comply with the terms of the trust deed and the trust deed does not give the trustees the investment function in the first place.
> **HMRC answer**
> If settlor has investment function under trust deed then it cannot be acting as agent of trustee.

7.19 Trust residence for IHT

Trust residence is not very important for IHT but the concept is used on a few occasions. IHT definitions of trust residence are different from the IT/CGT definition.

For the (somewhat academic) relief for foreign currency bank accounts,[61] s.157(4) IHTA provides:

> For the purposes of this section—
> (a) the question whether a person is resident in the UK shall, subject to paragraph (b) below, be determined as for the purposes of income tax; but

determinative of the meaning of "trustee" in a UK statute.

[61] See 76.13 (Foreign currency account).

> (b) the trustees of a settlement shall be regarded as not resident in the UK unless the general administration of the settlement is ordinarily carried on in the UK and the trustees or a majority of them (and, where there is more than one class of trustees, a majority of each class) are resident there.

For the duty to disclose the creation of non-resident trusts,[62] s.218(3) IHTA provides:

> For the purposes of this section trustees of a settlement shall be regarded as not resident in the UK unless the general administration of the settlement is ordinarily carried on in the UK and the trustees or a majority of them (and, where there is more than one class of trustees, a majority of each class) are for the time being resident in the UK.

For the purposes of s.201(1)(d) IHTA (collection of non-resident trust tax from settlor), s.201(5) IHTA makes an identical provision.[63]

For the question of where the administration of a settlement is carried on, see the 5th edition of this work, para 5.6. There are various interesting points that could in theory arise under these definitions, but I doubt if they will arise in practice.

7.19.1 *IHT trust residence: Critique*

IHT trust residence is a mess: essentially the same definition is repeated four times.

There is no need to have a separate definition of trust residence for IHT at all, and if we need to keep the concept of trust residence, it would be best to switch to the IT/CGT definition. Failing that, a single standard definition applying for all IHT purposes would be a small improvement.

7.20 Trust residence: Critique

Various policy considerations simmer below the surface of this topic.

One factor is tax competition: the desirability of attracting trust administration business to the UK (or not driving it away). The work will not be done in the UK if that is going to incur additional tax liabilities.

Another factor is to avoid a loss of tax, measured from the benchmark of the present system.

More fundamentally, trust residence needs to be discussed in the context

[62] See 128.2 (Reporting creation of settlement).

[63] For completeness, the same definition is set out yet again in the IHT (Delivery of Accounts) (Excepted Settlements) Regulations 2008.

of the very broad set of questions of how to tax trusts generally on (1) trust gains, and (2) trust income.[64]

Residence of *individuals* is a sensible connecting factor for UK taxation: everyone accepts that an individual who is UK resident should to some extent at least be subject to UK tax. It is not self-evident that residence should be the main connecting factor, or a connecting factor at all, for the taxation of *trusts*. The move from individual residence to trust residence is problematic in two respects:

(1) Residence of trusts is a matter which is chosen by the appointment of trustees.
(2) Trustees are taxed as representing the beneficiaries, who may or may not be UK resident. Unfortunately the solution of taxing beneficiaries on trust income or gains on an arising basis is not available.

There are three broad categories of solution. None are wholly satisfactory. The first solution is the present system with or without minor variants.

The second solution is a system of residence by election:

> Why not let all trustees elect that they and their beneficiaries and settlors should be taxed as if they were non-UK resident. All the trust business which now goes offshore could come back to the UK. The economy, and therefore the Revenue, would benefit, while beneficiaries would be less exposed to some of the practical problems to which offshore trusts are prone. Drug enforcement officers would then know that the reason that Mr X had set up a trust in some Caribbean jurisdiction would have nothing to do with UK taxation.[65]

Venables concludes: “No doubt the suggestion will be dismissed out of hand. Yet is it so absurd?” Discuss.

A third and more radical solution abandons the concept of trust residence. Trusts pay tax on trust income and gains regardless of the residence of the trustees: the connecting factor should be that property is provided by a UK domiciled or resident settlor. Conversely, trusts should be exempt from CGT and IT (like non-residents) in relation to property provided (or wholly provided) by foreign domiciled non-resident settlors. This is (I think) the

[64] In this paragraph I use the term “trust income” to mean income of trustees other than a life tenant’s income. The taxation of life tenant’s income is easy: one should tax the life tenant. I assume that settlor-interested trust rules are not in point.

[65] Venables, *Comments on the Inland Revenue Consultative Document on Trusts* (1991) p.60.

basis of taxation of trust income and gains in Canada, New Zealand and, I suspect, most other common law jurisdictions. It is also the basis of IHT trust tax. Of course, domicile and residence of the settlor are not perfect connecting factors. Such a thing does not exist. International families can sometimes break the link by tax planning. But the rickety anti-avoidance structure of ss.86 to 98 TCGA, bolstered (supposedly) by Schs 4A to 5A, can be replaced with one based on the TAA rules. The reform, like any, would bring winners and losers but the overall result could - if properly drafted - be a system which was fairer, simpler and more effective. New Zealand takes this view of the policy issue:

What is a foreign trust?
4.7 The term foreign trust is used to describe a trust that is established in New Zealand but where no settlor is resident in New Zealand at any time. The term was developed specifically for New Zealand tax purposes (see section HC 11 of the Income Tax Act 2007 (ITA)). This sometimes creates confusion, as a trust in Australia, for example, may be viewed from New Zealand as a foreign trust, but it would not be a foreign trust for New Zealand tax purposes.
4.8 A foreign trust may have one or more trustees resident in New Zealand. Most New Zealand foreign trusts have one resident trustee, often a limited liability company that provides professional trustee services. Some also have one or more trustees who are resident offshore.
4.9 It is normal for all of the beneficiaries of a foreign trust to be resident offshore, but there is no prohibition against having New Zealand beneficiaries.
Tax treatment and underlying tax policy
4.10 Foreign trusts which do not derive New Zealand source income or distribute income to New Zealand resident beneficiaries are exempt from New Zealand tax.[66] The tax exemption is one of the key features of New Zealand law that is attractive to offshore investors looking to establish foreign trusts in this country. The tax status of such trusts features prominently on the websites of firms providing services to foreign investors.
4.11 Commentary in the media around the Panama Papers has caused some observers to describe the exempt tax status foreign trusts enjoy in New Zealand as a loophole, and it has been suggested that this should be closed by imposing tax ...
4.12 Before 1988, New Zealand's rules for taxing trusts followed the residence of the trustees. This led to concerns in relation to the taxation of income derived by New Zealand residents from offshore. A trust established overseas with non-resident trustees was not liable to New Zealand tax on its foreign sourced income, even where the settlor and the beneficiaries were New Zealand residents.
4.13 As a result, the old trust tax rules made it relatively easy for New Zealand residents to escape tax on their offshore income. This could be achieved by establishing a trust offshore and settling investment assets on it. The trustee, who would be a non-resident of New Zealand, would invest the funds and accumulate income. No New Zealand tax would

[66] Footnote original: The exemption is in ss. CW 54 and HC 26(1) ITA.

be payable on the income except where it was distributed within six months of the trust's tax year end to beneficiaries resident in New Zealand. Distributions after that time were capital, and not taxable. Unsurprisingly, distributions of income were rare.

4.14 Like many aspects of the New Zealand tax system at that time, the trust tax rules were wholly deficient. They were overhauled in 1988 as part of a comprehensive overhaul of New Zealand's international tax rules. As was the case with the other international tax reforms, the changes were designed to protect the domestic tax base.

4.15 The reforms were based on the core principle of taxing New Zealand residents on their worldwide income and non-residents on income sourced from New Zealand. It follows from this principle that non-residents should not be taxed on non-New Zealand sourced income. This was, and remains, orthodox international tax policy.

4.16 For trusts, the residence of the settlor was chosen as the basis for determining the liability (through the trustee[67]) for New Zealand tax. This was because, although the settlor has no right to receive income from the trust, in reality he/she typically has substantial influence over the trustees, either through specific provisions in the trust deed or on an informal basis. The economic substance of a trust may differ from its legal form.

4.17 The Consultative Committee[68] that recommended the settlor regime in 1988 specifically recognised that one consequence of this approach would be that New Zealand would not tax the foreign source income of a resident who was the trustee of a trust with a non-resident settlor. The Committee noted[69]-

> *In our view, this is the appropriate treatment since such income has no definite connection with New Zealand apart from the existence here of the trust administrator ... who will ... have no beneficial interest in the income.*

4.18 The Inquiry considers that the current tax treatment of foreign trusts is based on design considerations that are entirely consistent with the coherent set of core principles that underpin New Zealand tax policy. It is clear from the history that the primary driver of the international tax reforms, of which the trust regime is an important subset, was to protect the New Zealand tax base.

The reforms appear to have been very effective in achieving that goal.[70] New Zealand's attractiveness as a place to invest from offshore was a by-product of the reforms and the primary reason for this (the foreign trust tax exemption) was identified at the time. While it seems unlikely that policy makers predicted the size of the New Zealand foreign trust industry that would emerge, the Inquiry doubts that it would have created any concerns had they done so.[71]

[67] Footnote original: If the trustee does not pay the tax (because it is not resident in New Zealand) the tax liability for trustee income falls to the New Zealand settlor as agent.

[68] Footnote original: Prebble, (1988) International Tax Reform Part 1. Report of the Consultative Committee.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1580354

[69] Footnote original: Ibid, para 5.25.

[70] Footnote original: The fact that very few New Zealanders have been named as investors in the entities in the Panama Papers is probably attributable to the scope and effectiveness of the international tax rules.

[71] Government Inquiry into Foreign Trust Disclosure Rules (2016)
https://treasury.govt.nz/sites/default/files/2016-06/report-giftdr-27jun2016.pdf

7.20.1 *Reason for PE-residence rule*

It appears that the PE-residence rule is based in part on loss of tax considerations and in part (somewhat implausibly) on a desire to support UK professional trustees.

The Trusts Consultative Document (1991) explains:

> 10.21 The income tax test might need to be modified for certain foreign corporate trustees. A trust company, resident outside the UK, could be the sole trustee of a trust which was dealt with in this country by the company's UK branch. It would not be appropriate if such a trust were treated as non-resident, because it would then be taxed more favourably than a similar trust dealt with by a branch of a UK corporate trustee, or by some other UK professional. That could both lead to a loss of tax and put UK professionals at a competitive disadvantage. It is therefore suggested that the UK branch of a foreign trustee should be treated as a trustee resident in the UK for the purpose of the common residence test.[72]

7.20.2 *Relief for professional trustee*

The law before 2007/08 provided that a UK professional trustee of a trust with a non-resident, non-domiciled settlor was regarded as non-resident. This sensible provision allowed UK professional trustees to act without attempting to tax them. The object was to allow the UK to compete on equal tax terms with foreign trustees. The reason given for its abolition was that the Department of Trade and Industry had advised the rule breached EU State Aid rules.[73]

[72] *https://www.kessler.co.uk/wp-content/uploads/2014/02/1108_001.pdf*

[73] The view that the former law was not State Aid compliant was debatable, and indeed the former UK rule still applies in Ireland: s.574(b) [Ireland] Taxes Consolidation Act 1997. HMRC refused to disclose the DTI advice which makes it impossible to assess the advice which HMRC said they received. One might speculate as to whether State Aid was the true reason or a pretext. Following an application under the Freedom of Information Act, the Information Tribunal urged HMRC to disclose their reasons (which were "bald and substantially unexplained.") Unfortunately the Tribunal did not order HMRC to do so and HMRC disregarded the urging of the Information Tribunal as non-binding. This hindered public debate, which the reader may think unfortunate. This non-disclosure may be viewed in the context of a more general culture of secrecy.
For the freedom of information aspect, see *https://www.kessler.co.uk/FoI* For the State Aid aspect.

7.21 Residence of bare trustees

The residence of bare trustees for tax purposes rarely matters. If it does arise, however, the position will not be governed by the statutory provisions which apply to substantive trusts.[74] The pre-1989 rules will apply. A sole bare trustee will be resident where they are resident in their private capacity. If there are joint bare trustees, they will not be UK resident unless they are all UK resident.[75]

The distinct-person rule does not apply to bare trustees, but that also rarely matters.

[74] See 7.2.1 (Nominees/bare trustees).

[75] *Dawson v IRC* 62 TC 301.

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TAXATION OF NON-RESIDENTS AND FOREIGN DOMICILIARIES 2024-25

by

JAMES KESSLER KC

VOLUME TWO

Chapters 8-13 Domicile & residence
Chapters 14 - 20 Income Tax: Principles & Remittance Basis
Chapter 21 Income by Category

TWENTY FOURTH EDITION

Key Haven Publications Ltd
P. O. Box 669, Oxford, OX3 3AU
Tel: 01865 352121
http://www.khpplc.co.uk

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6.36 Residence: Burden of proof

8.1 Company residence: Introduction

Residence of companies matters in particular for:

(1) Territorial limitations. Company residence plays a role similar to individual residence:
    (a) UK resident companies are taxable on worldwide income/gains.
    (b) Non-resident companies are taxable only on UK source income and certain UK-linked gains.
(2) Anti-avoidance rules such as s.3 TCGA and ToA only apply to companies which are non-resident.

Normally HMRC will want to argue that a company is UK resident, and the company will want to argue that it is not. But there are circumstances where the boot may be on the other foot.

The law is to be found in case law (the CMC test) which applies except so far as varied by statutory rules. The statutory rules are in Chapter 3 Part 2 CTA 2009, and are in short, the incorporation and DTA residence rules

Chapter 3 is expressed to apply for the purposes of Corporation Tax. However these rules also apply for IT and CGT:

s.835A ITA	**s.286A TCGA**	**s.109A TMA**
Chapter 3 of Part 2 of CTA 2009 (rules for determining residence of companies) applies for the purposes of the Income Tax Acts as it applies for the purposes of the Corporation Tax Acts.	Chapter 3 of Part 2 of CTA 2009 (rules for determining residence of companies) applies for the purposes of— (a) this Act (so far as relating to capital gains tax), and (b) any other enactment relating to capital gains tax, as it applies for the purposes of the Corporation Tax Acts.	Chapter 3 of Part 2 of CTA 2009 (rules for determining residence of companies) applies for the purposes of this Act as it applies for the purposes of the Corporation Tax Acts.

It could have been more economically expressed; but it works.

8.2 History of corporate residence

8.2.1 *Early history*

The INTM sets out the old ITH, parts of which are cited here. It is melancholic to compare the quality of the ITH with today's Manuals. But I expect it also outshone its contemporary Manuals.

ITH309 incorporation and residence: early days

In the early days we regarded a company as resident in this country if it was incorporated here. Viscount Sumner refers to the matter in the *Egyptian Delta Land* case (ITH311). He mentions Dowell who was the Board's Solicitor and whose 'Income Tax' was a standard work. The 1874 edition of Dowell, the first edition, said nothing at all on the subject of company residence. The second edition in 1885[1] merely said that a company incorporated here was resident here. We clearly started with the idea that residence was determined by incorporation and in the middle of the nineteenth century there was no problem. But as foreign trading became more complex this simple view was questioned.

ITH310 incorporation/residence: early days: Calcutta Jute Mills

One of the first cases was *Calcutta Jute Mills* [*Calcutta Jute Mills Company v Nicholson* 1 TC 83] a company which did what its name implies. It held board meetings and annual general meetings in London in an office lent by a director but everything of a practical nature was in India. It claimed that it was not resident here and that its trade was not carried on here. The judgements in *Calcutta Jute Mills* are the basis on which our later residence ideas rest and on which the case which became the authority on residence - *De Beers* - drew heavily (ITH314). The company was an English incorporated company at a time when it would have been exceptional for an English company to have directors and shareholders meetings anywhere but in England. The Judges, while looking at the board of directors and giving much weight to its constitutional role of management in this country, also took into account the fact that annual general meetings were here and incorporation was here. The people in India were mere agents acting solely on behalf of the company to be instructed by the company here; their acts were the company's acts. The case was decided before the Court of Appeal decision in the *Automatic Self-Cleansing Filter Syndicate Company*[2].

ITH311 incorporation/residence: early days: Egyptian Delta Land

After the *Calcutta Jute Mills* case in 1876 it was many years before another company residence case came before the Courts and it seems to have been generally accepted that a UK incorporated company was resident here. There was no further litigation until the *De Beers* case in 1905 and it is important to remember that De Beers was not a UK incorporated company. The significance or otherwise of incorporation was, rather surprisingly perhaps, not settled until the *Egyptian Delta*

[1] Author's footnote: The pace of change in the mid-19th century was such that 11 years passed between the first and the second edition.

[2] See 8.7.1 (Board /shareholder roles).

> *Land* [*Todd v The Egyptian Delta Land and Investment Company Ltd* 14 TC 119] case in 1928. Then the Lords reversing the lower Courts held that the bare fact of incorporation here did not constitute residence. Both Rowlatt J in the High Court and the Court of Appeal came down quite clearly for the Revenue. The Lords were equally clearly against us.

This is now of historical interest only but it explains the background to the older cases.

8.2.2 *Treasury consent to migration*

> **ITH401 Treasury consent: migrations/transfers of business**
> Subsection 1(a) and (b) of ICTA88/S765 and its predecessors required companies to have Treasury consent to a migration or to a transfer of business to a non-resident. Provisions (a) and (b) of subsection 1 were repealed by FA 1988 with effect from 15 March 1988. However, for nearly forty years (a) was the major obstacle in the Taxes Acts to companies moving their residence out of the UK without regard for loss of tax to the Exchequer. Consent for transfer of business was a necessary corollary to prevent the transfer of the whole of the business to a newly formed non-resident company thus defeating the purpose of the Section. But since 1965 the charge on capital gains has provided some compensation to the Revenue for transfers of business.
> **ITH402 Treasury consent: why needed**
> The reasons for the introduction of the Treasury consent requirement in 1951 were mentioned in chapter 1 (ITH127). The post war improvement in communication had led to greater mobility and some important companies transferred their management and control abroad. The Revenue regarded such action as tax avoidance. The Royal Commission of 1953 disagreed but the decision to enact what became Section 765 was pragmatically based. The country simply could not afford the loss of tax which wholesale migration would have led to and decided to hold on to what it held.
> **402-403 Company residence. Some consequences of the law**
> The difficulty our predecessors had in framing this provision was discussed in Chapter 1. In the climate of emergency at that time no alternative was seen to what has come to be known as the 'turnstile' - the requirement that Treasury consent be sought. The Treasury would rely on the Revenue for advice. The 1951 provision for Treasury consent extended to the issues and transfers of shares and debentures in non-resident subsidiaries of UK resident companies. This requirement survives in subsection 1(c) and (d) of Section 765 [ICTA, now repealed] ...

ITH403 migrations/business transfers: Treasury consent: later need

It became clear some years after the Treasury consent provisions were enacted that it would no longer be possible or necessary to resist the migration of the type of company at which the section had originally been aimed. The intention had been to keep resident in the UK companies whose main trading activities were overseas where tax rates were low so that substantial UK tax would continue to be paid. But as former colonies became independent, political pressure grew for these companies to be wholly established locally. At the same time overseas tax rates increased with a consequent increase of credit against UK tax. The terms of reference of the Advisory Panel, which was set up to advise the Chancellor on cases where refusal was contemplated, no longer justified refusal of consent for these companies to cease to be resident.

However, we continued to need subsections(l)(a) and (b) to prevent loss of tax from migrations in rather different circumstances. Absolute freedom in the residence field might have had some very undesirable consequences.

1 Take the case of the UK company whose business was here in every way. Without (1)(a) such a company could have run its operation here as a branch of a tax haven resident company. If it did, it would have had all sorts of problems, but it might not have been beyond the wit of the tax planners to surmount them.

2 After the tax haven legislation was enacted a UK company whose interests were mainly overseas could simply have moved offshore to avoid the legislation.

3 There would have been companies who would migrate just before realising substantial capital gains - possibly becoming resident again later.

ITH404 Companies: Treasury consent: migrations: Daily Mail Trust

One company which nearly succeeded in migrating to avoid a charge on capital gains was the Daily Mail and General Trust plc. This was an investment holding company whose main interests were in the UK. The company wanted to transfer its central management and control to the Netherlands before a reorganisation in the course of which it intended to sell part of its assets which would yield substantial capital gains. It applied for Treasury consent. When the Revenue and Treasury raised objections the company claimed, on judicial review [*Regina v HM Treasury ex p. Daily Mail and General Trust plc* (1987) STC 157 (1988) STC 787] that the requirement for Treasury consent was contrary to Article 52 of the Treaty of Rome. This Article prohibits restrictions on the freedom of establishment of nationals, including companies, of a Member State in the territory of another Member State. The English court referred the matter to the European Court of Justice. The European Court was clear that the Article applied to restrictions on nationals leaving to go to another Member State as well as restrictions on those coming in but, somewhat to the surprise of experts in European law, the Court decided that Article 52 did not confer a right on a company incorporated in one Member State to transfer its central management and control to another Member State.

The Daily Mail decision was something of an anti-climax. While the case was going through the European Court procedures, fundamental changes in UK law on company residence and migrations took place and the requirement for Treasury consent to migrations and transfers of business was abolished.

We have seen in the preceding chapter that it was in 1988 that the incorporation rule of residence was enacted and that the possible threat from the Treaty of Rome was a contributory factor. One obvious result of the rule was that, broadly speaking, it stopped UK incorporated companies from migrating, although FA94/S249 [now s.18 CTA 2009] has changed the position again.

8.3 The incorporation rule

Section 14(1) CTA 2009 provides:

> A company which is incorporated in the UK is UK resident for the purposes of the Corporation Tax Acts.

This is called the **"incorporation rule"**. This rule also applies for income tax and CGT.[3]

The INTM has an extract from the ITH:

> **ITH357 incorporation rule: reasons for the rule**
> Three factors contributed to the coming of the incorporation rule. One was the possible threat posed by the Treaty of Rome to the provision in what became ICTA88/S765 that UK resident companies could not lawfully cease to be resident without Treasury consent. This provision was repealed when the incorporation rule became law. ...
> The second factor was the growing use by non-residents of UK incorporated but non-resident companies in order to avoid other countries' tax or for even more nefarious purposes...

[3] See 8.1 (Company residence: Introduction).

> The third factor, not unconnected with the second, was that in not having an incorporation rule of residence the UK was out of line with most other countries in Europe and indeed in the developed world. Most of the countries have a residence type rule equivalent to our incorporation rule though in some civil law countries it takes the form of the 'seat' test which comes to much the same thing. Very broadly speaking, a company formed under the laws of a country which has a 'seat' test must designate its seat of central management and administration in its registered 'Articles' and it is generally difficult for such a company to have its designated seat outside the country in which it was formed.

8.3.1 *Relationship of incorporation rule/other rules*

Section 14(2) CTA 2009 provides:

> Accordingly, even if a different place of residence is given by a rule of law, the company is not resident in that place for the purposes of the Corporation Tax Acts.[4]

SP 1/90 refers to this and provides:

> 23 ... This incorporation rule determines residence under UK domestic law and is subject to the provisions of any applicable double taxation agreement. It does not override the provisions of a double taxation agreement which may make a UK incorporated company a resident of an overseas territory for the purposes of the agreement (see paras 20 and 21 above).

8.4 Business cessation/winding up

Section 15(1) CTA 2009 provides:

> This section applies to a company which is neither–
> (a) incorporated in the UK, nor
> (b) resident in the UK by virtue of section 16 or 17.[5]

There are two rules which may conveniently be read side by side:

s.15(2) CTA 2009	**s.15(3) CTA 2009**
If the company– (a) is no longer carrying on a	If the company– (a) is being wound up outside the

[4] This rule also applies for income tax and CGT; see 8.1 (Company residence: Introduction).

[5] See 8.23 (Societas Europea/SCE).

business, and (b) was UK resident for the purposes of the Corporation Tax Acts immediately before it ceased to carry on business,	UK, and (b) was UK resident for the purposes of the Corporation Tax Acts immediately before any of its activities came under the control of a foreign liquidator,[6]
the company continues to be UK resident for the purposes of the Corporation Tax Acts.	the company continues to be UK resident for the purposes of the Corporation Tax Acts.

In short, if a foreign company is UK resident under the CMC rule, UK residence continues during a period during which the company is dormant or being liquidated, even if it ceases to have its CMC in the UK.

These rules apply for income tax and CGT.[7]

8.5 Pre-1988 companies

The INTM has an extract from the ITH:

> **ITH359 Company residence: incorporation rule: exceptions**
> During the course of the Finance Bill representations were made on behalf of companies which had been resident but had migrated, or were about to migrate, with Treasury consent. In response to these representations, a category of indefinite exceptions to the incorporation rule was created for companies which migrated with Treasury consent, so long as they continued to carry on business and their central management and control remained outside the UK. Most of these companies would have had specifically to apply to the Treasury for consent and their reasons for migration would have been scrutinised. But some companies controlled by non-residents were entitled to migrate under the benefit of a general consent which did not require them to make a specific application. These companies only qualify for indefinite exception if they are also liable to tax in another country on a basis intended to be the equivalent of taxation on worldwide income. The aim of this latter provision was to cut down as far as possible the number of companies with operations based in tax havens which would be entitled to indefinite exception.

[6] Defined in ss(4): "In subsection (3) "foreign liquidator" means a person exercising functions which, in the UK, would be exercisable by a liquidator."

[7] See 8.1 (Company residence: Introduction).

SP 1/90 provides:

> 2 The incorporation rule applies to companies incorporated in the UK subject to the exceptions in FA 1988 Sch 7 for some companies incorporated before 15 March 1988.

8.5.1 *Carrying on business*

SP 1/90 provides:

> 3 The exceptions from the incorporation test in FA 1988 Sch 7 depend in part on the company carrying on business at a specified time or during a relevant period. The question whether a company carries on business is one of fact to be decided according to the particular circumstances of the company. Detailed guidance is not practicable but the Revenue take the view that "business" has a wider meaning than "trade"; it can include transactions, such as the purchase of stock, carried out for the purposes of a trade about to be commenced and the holding of investments including shares in a subsidiary company. Such a holding could consist of a single investment from which no income was derived.
>
> 4 A company such as a shelf company whose transactions have been limited to those formalities necessary to keep the company on the register of companies will not be regarded as carrying on business.
>
> 5 For the purposes of the case law test (see B below) the residence of a company is determined by the place where its real business is carried on. A company which can demonstrate that in these terms it is or was resident outside the UK will have carried on business for the purposes of FA 1988 Sch 7.

8.5.2 *Taxable in territory outside UK*

SP 1/90 provides:

> 6 A further condition for some companies for exception from the incorporation test is provided by FA 1988 Sch 7 paras 1(1)(c), 5(1). The company has to be taxable in a territory outside the UK. "Taxable" means that the company is liable to tax on income by reason of domicile, residence or place of management. This is similar to the approach adopted in the residence provisions of many double taxation agreements....[8]

[8] See 9.6.1 (By reason of residence).

8.5.3 *"Treasury consent"*

SP 1/90 provides:

> 8 Before 15 March 1988 it was unlawful for a company to cease to be resident in the UK without the consent of the Treasury. Companies which have ceased to be resident in pursuance of a Treasury consent, as defined in FA 1988 Sch 7 para 5(1), are excepted from the incorporation rule subject to certain conditions. A few companies ceased to be resident without Treasury consent but were informed subsequently by letter that the Treasury would take no action against them under the relevant legislation. Such letter is not a retrospective grant of consent and the companies concerned cannot benefit from the exceptions which depend on Treasury consent.

8.6 Central management/control test

So far as no statutory rule applies, case law fills the gap. In *De Beers Consolidated Mines v Howe*:[9]

> In applying the concept of residence to a company, we ought, I think, to proceed as nearly as we can upon an analogy of an individual. A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business...a company resides for purposes of income tax where its real business is carried on. I regard that as the true rule, and the real business is carried on where the central management and control actually abides.

This definition of residence applies not just for tax law, but also for non-tax law, generally[10], in the absence of other statutory provisions.

SP 1/90 provides:

> 10 The "central management and control" test, as set out in *De Beers*, has been endorsed by a series of subsequent decisions. In particular, it was described by Lord Radcliffe in the 1959 case of *Bullock v Unit Construction Company* [(1959) 38 TC 712 at 738] as being-
>
> > 'as precise and unequivocal as a positive statutory injunction … I do not know of any other test which has either been substituted for that of central management and control, or has been defined with

[9] 5 TC 198 at p.212. This view comes from the *Calcutta Jute Mills* case as far back as 1 TC. *De Beers* was the company founded by Cecil Rhodes, who has taken an unexpected prominence in contemporary political life.

[10] For an exception see 102.14.2 ("Jurisdiction-residence").

> > sufficient precision to be regarded as an acceptable alternative to it. To me … it seems impossible to read Lord Loreburn's words without seeing that he regarded the formula he was propounding as constituting the test of residence.'
>
> Nothing which has happened since has in any way altered this basic principle for a company the residence of which is not governed by the incorporation rule; under current UK case law such a company is regarded as resident for tax purposes where central management and control is to be found.

It is rare to elevate a case law phrase to the status of statute law, but that is what has happened here.[11] But the meaning of the phrase still depends on the case law.[12]

"Management and control" is a composite phrase, where the two words are used more or less synonymously. There are not two distinct tests, one of management and one of control.

Central management and control may be abbreviated to CMC.

8.6.1 *Guidance on CMC*

In addition to the usual UK sources, foreign revenue guidance may be helpful, as the CMC test applies in many common law jurisdictions. For instance, *Unit Construction v Bullock* cites the Australian case of *Koitaki Para Rubber Estates v FCT*.[13]

Material on place of effective management may be helpful as the test is (more or less) the same.[14] This chapter draws on:

"Australia CMC guidance" [15]

"SA POEM guidance" [16]

See too: 9.19.9 (Trust Fund CMC in Australia).

[11] It was relevant that this phrase had received statutory recognition: see *Bullock v Unit Construction* 38 TC 712 at p.735.

[12] This is self-evident, but if authority is needed, see *Swedish Central Railway v Thompson* 9 TC 342: "That test must be applied as interpreted in the decided cases."

[13] 64 CLR 15 and 241.

[14] See 9.19.4 (POEM/CMC compared).

[15] TR 2018/5 Income tax: central management and control test of residency

[16] Interpretation Note: No. 6 (Issue 2) (2015) *https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2012-06-IN-6-Resident-Place-of-effective-management-companies.pdf*
This strictly concerns place of effective management, not CMC, but the difference is not significant here.

8.7 Control: company law background

8.7.1 *Board /shareholder roles*

Gower explains:[17]

> Until the end of the 19th century, it was generally assumed that ... the board of directors was ... subject to the control of the company in general meeting. It followed that the shareholders could at any time by ordinary resolution give the directors binding instructions as to how they were to exercise their management powers...
> In 1906, however, the Court of Appeal in *Automatic Self-Cleansing Filter Syndicate Co v Cuninghame*,[18] made it clear that ... the division of powers between the board and the company in general meeting depended entirely on the construction of the article of association, and that, where powers had been vested in the board, the general meeting could not interfere with their exercise. ... since *Quin & Axtens v Salmon*[19] it has been generally accepted that where the relevant articles are in the normal form... the general meeting cannot interfere with a decision of the directors ...

The pre-1906 law may still be relevant to understanding the oldest company residence cases. Gower continues:

> In *Shaw & Sons (Salford) Ltd v Shaw*,[20] in which a resolution of the general meeting disapproving the commencement of an action by the directors was held to be a nullity, the modern doctrine was expressed ...as follows:
>
> > "A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its Articles be exercised by directors; certain other powers may be reserved for the shareholders in General Meeting. If powers of management are vested in the directors, they and they alone can exercise those powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the Articles in the directors is by altering the Articles or, if opportunity arises under the Articles, by refusing to re-elect the directors of whose actions they disapprove.[21] They cannot themselves usurp the powers which by the

[17] Gower, *Principles of Modern Company Law* (11th ed, 2021), para 9-003.

[18] [1906] 2 Ch 34.

[19] [1909] 1 Ch 311.

[20] [1935] 2 KB 113 at p.134,

[21] They can now remove the directors by ordinary resolution.

> Articles are vested in the directors any more than the directors can usurp the powers vested by the Articles in the general body of shareholders."

Standard articles now provide:[22]

> **3. Directors' general authority**
> 3.Subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company.
> **4. Shareholders' reserve power**
> 4.(1) The shareholders may, by special resolution, direct the directors to take, or refrain from taking, specified action.
> (2) No such special resolution invalidates anything which the directors have done before the passing of the resolution.

The board is therefore the normal source of management and control.

> **ITH317 Company residence: legal power to manage/control: with directors**
> ... Of course the shareholders in General Meeting have rights and duties apart from those of appointing and dismissing the directors. They approve the accounts and pass the dividend and have a voice in such matters as issuing new capital, in the reduction of capital and in changes of the objects clause of the Memorandum or changes in the Articles. These things do not constitute the management and control of the business. They are rather keeping a critical eye on the interests of the shareholders...

8.7.2 *Foreign law*

In the case of a foreign company, it will be a matter of considering the foreign company law, which may of course be quite different.

In Germany, a two-tier board is mandatory for an Atkiengesellschaft (public company). The managing board runs the business and the supervisory board monitors the managing board. The INT Manual provides:

> **INTM120180 How To Review Residence** [May 2020]
> ... We would usually take the view that central management and control of the business is to be found at Managing Board level. But the exact set-up differs from country to country and between different types of

[22] Sch 1 Companies (Model Articles) Regulations 2008.

> company in each country and may depend on the instrument governing the management of the company. In some companies the shareholders themselves may have management functions.

The supervisory/managing board split would only affect company residence if the two boards operate in different countries, which would be unusual.

8.8 CMC: Top level control

SP 1/90 provides:

> 11 In determining whether or not an individual company outside the scope of the incorporation test is resident in the UK, it thus becomes necessary to locate its place of "central management and control". The case law concept of central management and control is, in broad terms, directed at the highest level of control of the business of a company. It is to be distinguished from the place where the main operations of a business are to be found, though those two places may often coincide.

CMC means control at board level.

A decision of a director to resign does not count for the purposes of CMC, because it is not a board decision. Likewise shareholder decision in general meeting to appoint or dismiss directors.[23]

Decisions of a corporate trustee in its capacity as trustee also do not count for the purposes of CMC of the company.[24]

Australian CMC guidance comments further on what constitutes CMC:

> 16. Exercising central management and control of a company can involve:
> [1] setting investment and operational policy including:
> [a] setting the policy on disposal of trading stock, and/or the use and development of capital assets
> [b] deciding to buy and sell significant assets of the company
> [2] appointing company officers and agents and granting them power to carry on the company's business (and the revocation of such appointments and powers)
> [3] overseeing and controlling those appointed to carry out the day-to-day business of the company, and
> [4] matters of finance, including determining how profits are used and

[23] See 8.12 (Parent/subsidiary relationship).
[24] See 7.5.1 (Ascertaining trustee residence).

> the declaration of dividends.
>
> *Matters of company administration*
>
> 17. Matters of company administration are not acts of central management and control. These include:
>
> [1] keeping a company's share register, including registering transfers of shares
>
> [2] keeping and adopting a company's accounts
>
> [3] where a company pays dividends, and
>
> [4] the minimum acts necessary to maintain a company's registration.

8.8.1 *Day-to-day/operational level*

There are many ways to slice the management cake. One should distinguish top level and day-to-day control. The Australian CMC guidance provides:

> 12. The control and direction of a company is different from the day-to-day conduct and management of its activities and operations. The day-to-day conduct and management of a company's activities and operations is not ordinarily an act of central management and control. Nor is the management of day-to-day activities under the authority and supervision of higher-level managers or controllers.
>
> 13. The day-to-day conduct and management of a company's operations might be an exercise of central management and control in circumstances where they are effectively the same. For example, for a small passive investment company with a very small number of investments, the decisions to make, hold and dispose of those investments, would be both the day-to-day management and the central management and control of the company.

The term sometimes used is operational management: that is the same as day-to-day control. SA POEM guidance discusses the same issue:

> **4.2.6 Operational management versus broader top level management**
>
> Operational management decisions are generally of limited relevance in determining a company's place of effective management and must be distinguished from the key management and commercial decisions.
>
> Operational management generally concerns the oversight of the day-to-day business operations and activities of a company. Key management and commercial decisions are concerned with broader strategic and policy decisions and tend to be made by members of the senior management team. For example, a decision to open a major new manufacturing facility or to discontinue a major product line would be

> examples of key commercial decisions affecting the company's business as a whole. By contrast, decisions by the plant manager appointed by senior management to run that facility, concerning repairs and maintenance, the implementation of companywide quality controls and human resources policies, would be examples of operational management.
>
> What constitutes a key management or commercial decision as opposed to an operational management decision is critical since it is the former that is relevant in the context of establishing the place of effective management. Again, determining what constitutes a key management or commercial decision is an aspect that can be determined only on a case-by-case basis. For example, in some businesses the conclusion of each and every contract will be a key commercial decision while in other businesses the setting of standardised pricing will be a key commercial decision but the conclusion of individual contracts will not be.
>
> Depending on the particular case, the person responsible for operational decisions may be the same as the person responsible for the key management and commercial decisions. In this situation it is still necessary to distinguish between the two types of decisions and to assess where the key management and commercial decisions are made. The location of this decision-making is critical.

Kotakai[25] is a case of rubber but not rubber-stamping:

> 130. ... The company in *Koitaki*, which was incorporated in Sydney, owned rubber plantations in Papua. The plantations were managed by an officer of the company who acted under a power of attorney by which the company authorised him to manage, carry on and conduct the company's property, affairs and business. The officer sent weekly reports of the working of the plantations to the chairman of directors in Sydney which is where the directors of the company resided and met. He also periodically sent to the manager of the company in Sydney for presentation to the directors, reports concerning the running of the plantations and the yield of rubber.
>
> 131. ... the company was not a resident of Papua as the company's central management and control was not there exercised, despite the responsibilities of the attorney. His Honour stated that the responsibility of the attorney was confined to the production and shipment of rubber and did not extend to the control of the general or corporate affairs of

[25] *Koitaki Parra Rubber Estates v FCT* (1941) 64 CLR 241.

the company or to matters of policy and finance.[26] The matters of policy and finance were matters which in fact formed part of the CM&C of the company as distinct from the day to day management of the production and shipment of rubber. The fact that the performance of the attorney was being monitored from Sydney was also an important consideration in the decision of Dixon J.

8.8.2 *Head office v top level control*

The ITH provides:

> **ITH328 Company residence: looking at the command structure**
> ... the problems start to emerge when different levels of management can be seen in different countries.
> **ITH329 command structure: three levels of management**
> There might, for example, be a company engaged in some real activity in which it would be possible to detect at least three levels of management. Starting at the bottom there might be
> 1 shop floor or on the spot management;
> 2 what might, in every day language, be called the Head Office; the place where one would expect to find the executives and senior staff who actually make the business tick, the people directly giving the orders that govern the company's operations;
> 3 the central policy core of the whole enterprise - and this is the difficulty. It may be indistinguishable from (ii) above or it may not. It may be a passive sort of body merely keeping its eye on things or it may be a very active body.
> **ITH330 Company residence: executive/non-executive directors**
> The way in which UK public companies actually go about organising themselves has changed over the years. At the time of some of the older tax cases our whole social pattern was very different from today's. Then, the men at level two - the action men - would probably have been people like the chief general manager and his immediate management colleagues who would not have been members of the board at all. The board would have consisted wholly of non-executive directors. Later, senior managers became board members and indeed the managing director or chief executive may have near absolute power.
> That is a great change; such people are seen, and see themselves, as rare and valuable and will not be given orders by a non-executive board. But the practice of appointing non-executive directors did not disappear and indeed became more customary in the later years of the twentieth

[26] (1940) CLR 15 at 18; (1940) 6 ATD 42 at 45.

> century. These directors are not necessarily mere ciphers, and a board which includes both executives and non- executives may well exercise central management and control. Some so-called non-executives may in fact act more like executives. In this respect titles can be misleading and should not be regarded as conclusive of the true role taken by an individual.
>
> **ITH331 Company residence: command structure: The pinnacle doctrine**
>
> It is quite apt to think of the central management and control doctrine as the pinnacle doctrine - one looks at the very top of the pyramid of control. There is nothing conceptually wrong with that, indeed it is an idea which, in theory, is reasonably easy to apply. Putting aside the exceptional cases of dual residence in the special sense described in ITH338, a pyramid has only one top. There is no doubt whatever that in the past the non-executive directors who sat on the board did hold the reins though active intervention by them in the working of the company may have been a rare thing. Theirs was the power and everybody knew it. Even with the increasing power of executive directors it is difficult to find the pinnacle of control anywhere other than with the board combining executive and non-executive directors. That is level three management. With modern means of communication it is easy to move that sort of pinnacle about. The board does not have to be tied to the operational base. It is less easy, though not impossible, to move level two around.

8.8.3 *Economic nexus*

SA POEM guidance provides:

> **4.2.8 Economic nexus**
>
> The extent of a company's economic nexus with a country is generally irrelevant in the determination of its place of effective management. However, this factor may be considered circumstantial and given some weight in cases where other factors are inconclusive.

The term "economic nexus", undefined, is too vague to be a satisfactory test, or even a factor, for determining CMC.

8.8.4 *Legal nexus*

SA POEM guidance provides:

> **4.2.7 Legal factors**
>
> Legal factors such as a company's place of incorporation, formation or establishment, the location of its registered office and the location of its

public officer are generally not relevant in the determination of a company's place of effective management.

8.9 CMC a question of fact

In *De Beers* [*De Beers Consolidated Mines Ltd v Howe* 5 TC 198:

> ... where the central management and control actually abides... is a pure question of fact, to be determined, not according to the construction of this or that regulation or by-law, but upon a scrutiny of the course of business and trading.

SP 1/90 provides:

> 12 Successive decided cases have emphasised that the place of central management and control is wholly a question of fact. For example, Lord Radcliffe in *Unit Construction* said that "the question where control and management abide must be treated as one of fact or 'actuality'".[27] It follows that factors which together are decisive in one instance may individually carry little weight in another.

Why does the heart sink when one reads that something is a pure question of fact?

8.10 Directors meetings

8.10.1 *Board meeting significance*

SP 1/90 provides:

> 12... a series of decisions has attached importance to the place where the company's board of directors meet. There are very many cases in which the board meets in the same country as that in which the business operations take place, and central management and control is clearly located in that one place. In other cases central management and control may be exercised by directors in one country though the actual business operations may, perhaps under the immediate management of local directors, take place elsewhere.
> 13 But the location of board meetings, although important in the normal case, is not necessarily conclusive. Lord Radcliffe in *Unit Construction* pointed out[28] that the site of the meetings of the directors' board had not been chosen as "the test" of company residence. In some cases, for example, central management and control is exercised by a single

[27] 38 TC 712 at p.741.
[28] 38 TC 712 at p.738.

individual. This may happen when a chairman or managing director exercises powers formally conferred by the company's Articles and the other board members are little more than cyphers, or by reason of a dominant shareholding or for some other reason. In those cases the residence of the company is where the controlling individual exercises his powers.

14 In general the place of directors' meetings is significant only insofar as those meetings constitute the medium through which central management and control is exercised. If, for example, the directors of a company were engaged together actively in the UK in the complete running of a business which was wholly in the UK, the company would not be regarded as resident outside the UK merely because the directors held formal meetings outside the UK. While it is possible to identify extreme situations in which central management and control plainly is, or is not, exercised by directors in formal meetings, the conclusion in any case is wholly one of fact depending on the relative weight to be given to various factors. Any attempt to lay down rigid guidelines would only be misleading.

15 Generally, however, where doubts arise about a particular company's residence status, the Revenue adopt the following approach-

(i) they first try to ascertain whether the directors of the company in fact exercise central management and control;

(ii) if so, they seek to determine where the directors exercise this central management and control (which is not necessarily where they meet);

(iii) in cases where the directors apparently do not exercise central management and control of the company, the Revenue then look to establish where and by whom it is exercised.

8.10.2 *Where meeting takes place*

If or so far as the location of a meeting is important, the question arises where a meeting does takes place. Developments in communication and business practice have made this problematic.

If the directors meet in person, no problem arises. In other cases, assuming a fully functioning board, it is suggested that the position is in principle as follows:

(1) If one director attends electronically (by phone or computer link such as Zoom) and the rest meet physically in one place, the place of meeting is where the majority meet.

(2) Where all directors attend by electronic means:

(a) If all are in the same territory, the meeting takes place in that territory.

(b) If they are all in different territories, it is impossible to identify anywhere where the meeting "takes place". For corporate residence purposes the concept is then useless and inappropriate, and I would say it is meaningless. If all meetings take place in this way, one must either look for some other links to determine residence, such as the location of the head office; or else the company may have to be regarded as dual resident.[29]

(c) If they are all in the same territory but one, the meeting takes place in that territory.

Standard company articles provide:[30]

> If all the directors participating in a meeting are not in the same place, they may decide that the meeting is to be treated as taking place wherever any of them is.

But the place (if any) where a meeting actually takes place is a question of fact which is not determined or even affected by a deeming provision of that kind. Or more analytically, an article of that kind has effect only for the purposes of the articles,[31] and not for the purpose of ascertaining company tax-residence.

8.10.3 *Delegation of board powers*

The ITH provides:

[29] See 8.16 (Dual residence/no CMC). The issue is not an entirely new one. SP 1/90 also comments on developments in communications:

> 19 The case law test examined in this statement is not always easy to apply. The courts have recognised that there may be difficulties where it is not possible to identify any one country as the seat of central management and control. The principles to apply in those circumstances have not been fully developed in case law. In addition, the last relevant case was decided almost 30 years ago, and there have been many developments in communications since then, which in particular may enable a company to be controlled from a place far distant from where the day-to-day management is carried on. As the Statement makes clear, while the general principle has been laid down by the courts, its application must depend on the precise facts.

But that does not take us very far.

[30] Art 10(3) Model articles for private companies limited by shares, *https://www.gov.uk/guidance/model-articles-of-association-for-limited-companies*

[31] It would have effect for the purposes of an article (if there is one) referring to the place where a board meeting is held.

> **ITH318 Company residence: power to manage/control: managing director**
> ... Of course the board of directors can still appoint agents and as long as they are mere agents they do not, by the bare fact of being there and fulfilling their agencies, detract from the management and control of the board. There is, however, one special case and that is where the board under the authority of the Articles appoint a managing director. In such cases one has to look very carefully at what the powers of the managing director are. One distinguished writer [Gower, *The Principles of Modern Company Law*] on the subject has said that if the service agreement with a managing director purports to confer exclusive powers on him without expressly reserving a right of supervision, he thinks that the board could not interfere with a managing director's exercise of his powers during the subsistence of the service agreement. The writer concludes that in that situation the directors are in effect substituting a managing director for themselves as one of the primary organs of the company. Certainly there is all the difference in the world between a managing director in that sense and a manager who happens also to be a director.

Delegation by the board may be wider or narrower, but I expect it is usually narrower. In *BW Noble v Mitchell*[32] the directors exercised their power of delegation, granting a power of attorney which gave one of the directors power to carry on the company's business in France. The French attorney sent some reports on the progress of the business to the directors in London, and on one or two occasions received the agreement of the board to his proposals. It was held that CMC of the company remained with the board of directors in London, and had not shifted to France under the delegation:

> ...that power of attorney did not and could not, consistently with the Articles, and did not by its tenor, divest the Board in London of their authority; it did not make an independent plenipotentiary who could do what he liked until the power of attorney was determined. It seems to me that although he held the power of attorney, the Directors at any moment could have said to him: 'Well, we do not think under your power you ought to do this; we decide that it shall not be done, although you might have done it under your power of attorney if we had not told you to the contrary'.[33]

[32] 11 TC 372.
[33] 11 TC 372 at p.410.

8.10.4 *Passive oversight/tacit control*

SP 1/90 provides:

> 11 Moreover, the exercise of control does not necessarily demand any minimum standard of active involvement: it may, in appropriate circumstances, be exercised tacitly through passive oversight.

The ITH provides:

> **ITH327 difficulties: central management/ control test**
> It is now possible to look at the heart of our difficulties over the central management and control test. If, as is usual in this country and in many others, the directors of a company have the constitutional power to manage and control, they can exercise that power in truth and fact by doing very little indeed. They can appoint agents and servants to attend to the day-to-day running of affairs on the spot and they can exercise their management and control perhaps from far away. Nothing in the *Unit Construction* case changes that: what *Unit Construction* says is that if the directors stand aside and allow others to manage and control, it is those people to whom one must look in reaching a conclusion. The clearest example in Case Law of the minimal activity required to establish management and control is *Ogilvie v Kitton* [5 TC 338] the case of the gentleman in Aberdeen with a shop in Canada...[34] It is not indeed a residence case but concerned with the Case I/Case V [UK/foreign source] argument. It is nevertheless wholly relevant to the point.
> The difficulty can be put in this way - just as *Calcutta Jute Mills* can be managed and controlled in the UK so can an English trading company be managed and controlled in a tax haven. The law sets no minimum standard of participation in the affairs of the business to establish management and control. Lord Sumner said in the *Egyptian Hotels* Case (again on the Case I/Case V point - see ITH343) that it was not enough that the proprietors had the legal right to intervene. There must be actual participation and then come the very important qualifying words ‘though it may not go beyond passive oversight and tacit control’ [6 TC 542 at p.551].

In *Tulip Trading Ltd v Bitcoin Association For BSV*:[35]

[34] See 21.4 (IT territorial limit: Trading).

[35] [2022] EWHC 667 (Ch) at [149] ff. The case is not yet final, but is not likely to be reversed on this point.

> ... where its central management and control is located... is not a straightforward test to apply in this case. TTL has no active business. Its sole function appears to be to act as a vehicle to hold digital assets. I saw no evidence that it holds any digital assets apart from those the subject of the dispute. On TTL's case those assets were acquired before Dr Wright based himself in this jurisdiction. From that point on there is no indication that TTL took any material action until it decided to bring this claim.
>
> TTL's case relies on the fact that Dr Wright had power to access and control its assets from his home office in Surrey, and that he or his wife were TTL's CEO and controlled TTL ...
>
> More significantly, however, Dr Wright's own evidence is that he had not accessed the bitcoin for many years before the hack. Leaving to one side any administrative steps (which have not included filing any accounts or tax returns), TTL's only real "action" was therefore the inaction of not choosing to deal in the assets. It is not clear to what extent, if at all, there was any conscious decision-making to that effect. The claim to be resident here therefore appears largely to depend on management and control having been manifested by the fact that Dr Wright and/or his wife did not deal with the assets, but had the ability to do so.
>
> TTL also relies on the lack of any activity in the Seychelles (which neither Dr Wright nor his wife have ever visited) and its registration under the International Business Companies Act 2016, which TTL maintains is intended for companies not carrying on business there. Although there is a registered agent in the Seychelles which maintains the register of members, other books and records are said to be kept at Dr Wright's home office, where day to day management and administration is conducted. However, there is no indication that TTL has filed any tax returns or has registered a place of business[36] here...
>
> I would be prepared to conclude that TTL has the better of the arguments on residence. ... Dr Wright did in fact have the ability to deal in the assets from this jurisdiction, and determining not to do so (whatever level of activity that involved) can be described as an exercise of control. The only alternative to England that has been put forward appears to be the Seychelles, and it is hard to see that TTL is resident in a place where its directing minds have never visited, it keeps no books and records, and where it appears not even to have filed accounts.

[36] Footnote original: Strictly, a UK establishment: Overseas Companies Regulations, 2009.

8.10.5 *Usurping board powers*

In *Unit Construction v Bullock*, a UK parent company had three subsidiary companies incorporated in Kenya, with boards of directors consisting of local people, and carrying on trading activities in Africa - merchanting, mining, etc. The subsidiaries' articles of association provided that management was vested in the directors and their boards could meet anywhere other than in the UK. Presumably the drafter was trying to avoid UK residence.[37] But in practice, every decision of any importance was taken by the directors of the parent company in London. That was because the subsidiaries had been operating so unsuccessfully that the parent company had decided that "it was unwise to allow them to be managed in Africa any longer, and their management must be taken over by the directors of [the parent company] in London".[38]

On these facts the Kenyan subsidiaries were UK resident:[39]

> Nothing can be more factual and concrete than the acts of management which enable a Court to find as a fact that central management and control is exercised in one country or another. It does not in any way alter their character that in greater or less degree they are irregular or unauthorised or unlawful. The business is not the less managed in London because it ought to be managed in Kenya. Its residence is determined by the solid facts, not by the terms of its constitution, however imperative. ... it is the actual place of management, not that place in which it ought to be managed, which fixes the residence of a company.

De facto control was exercised in the UK and the local directors "stood aside" from their duties and did not even purport to function as a board of management. That was said to be unusual:

> It is surely exceptional for a parent company to usurp the control; it usually operates through the boards of the subsidiary companies.[40]

That is no doubt true, both when written and now, in cases of large and

[37] Ironically, it was the company which was arguing for UK residence, for reasons relating to loss relief.

[38] at p.737.

[39] 38 TC 712 at p.736.

[40] 38 TC 712 at p.744. The point was repeated in *Wood v Holden* [2005] EWHC 547 (Ch) at 23 describing *Unit Construction* as "a very important case, but ... a highly exceptional case in terms of the result".

well run company groups, with access to good legal advice. Beyond that, readers will have to judge for themselves. The answer is not self-evident.

The INTM has an extract from the ITH:

> **ITH323 legal control overridden: Unit Construction**
> ... the Revenue view had been that in looking at the acts which constitute management and control one should look only at those acts which are intra vires the Articles - at those acts which are constitutional. This view was held to be wrong in the *Unit Construction* .. case .... Here, the Lords, overruling both lower Courts, dismissed the argument that 'only constitutional, and therefore authorised, management and control are relevant to an enquiry as to the residence of a company'...

It seems strange that the Revenue chose to argue the point, for it was surely against their own interest.[41] But there it is.

The ITH continues:

> So there are two questions.
> 1 Where and by whom according to the constitution of the company and the law of the land ought this company to be managed and controlled.
> 2 Exceptionally, if the people lawfully charged with management and control did not exercise it, who did? ...

The distinction between passive oversight and no oversight can be a fine one. A case on the other side of the line is *Esquire Nominees v CT*.[42] The question was whether Esquire Nominees was resident in Norfolk Island, an Australian offshore territory. The company was incorporated in Norfolk Island, its office was there, the directors and shareholders were there, and meetings of the company and of the directors were held there. The business of the company was to act as trustee of trusts set up on the advice of accountants in Melbourne for its clients. The Australian Revenue contended that the directors of the trustee company merely carried out directions given to them by the accountants, so management and control of the company was in Australia. It was said that the activities of the company were confined to acting as trustee of trusts set up on the advice

[41] At p.736, as Counsel for the taxpayer must have pointed out:
"In how many cases would a limited company register in a foreign country, prescribe by its articles that its business should be carried on by its directors meeting in that country, and then claim that its residence was in that country though every act of importance was directed from the United Kingdom?."

[42] 129 CLR 177.

of the accountants; that the administration of the various trusts followed a pattern which had been laid down by that firm in advance; and that detailed agenda for meetings of the directors of the company, and of the company itself, were prepared by the accountants in advance. But the company was not controlled in Australia:

> ... what the appellant did ... was done in the course of carrying out a scheme formulated in Australia and that [the accountants] not only communicated to the appellant particulars of the scheme but advised the appellant in detail of the manner in which it should be carried out.
>
> But if it be accepted that the appellant did what [the accountants] told it to do in the administration of the various trusts, it does not follow that the control and management of the appellant lay with [the accountants]. That firm had no power to control the directors of the appellant in the exercise of their power or the 'A' shareholders in the exercise of their voting rights. Although it is doubtless true that steps could have been taken to remove the appellant from its position as trustee of one or more of the trust estates, [the accountants] could not control the appellant in the conduct of its business of a trustee company. The firm had power to exert influence, and perhaps strong influence, on the appellant, but that is all. The directors in fact complied with the wishes of [the accountants] because they accepted that it was in the interests of the beneficiaries, having regard to the tax position, that they should give effect to the scheme.
>
> If, on the other hand, [the accountants] had instructed the directors to do something which they considered improper or inadvisable, I do not believe that they would have acted on the instruction. It was apparent that it was intended that the appellant should carry on its business of trustee company on Norfolk Island. It was in my opinion managed and controlled there, none the less because control was exercised in a manner which accorded with the wishes of the interests in Australia.[43]

In short, the fact that directors of an SPV were accustomed to act in accordance with the wishes of the sponsor – in that case, the accountants as adviser to their client – did not lead to the conclusion that the CMC of company was where the sponsor was.

Another example is *Untelrab v McGregor*.[44] The directors of the company were in Bermuda and Jersey. Board meetings were held in

[43] at 190-1 (emphasis added). There was no appeal on this point, and on the appeal, 2 of the 4 members of the full Court expressly agreed with it.

[44] [1996] STC (SCD) 1.

Bermuda, two or three times a year. The meetings were not attended by the Jersey based director; but he was sent copies of the minutes. The company had been set up for the specific purpose of receiving a payment due to its parent, Unigate plc, The business of Untelrab was the receipt of the money, investment, and making loans to other companies in the Unigate group. Requests for such loans usually originated from Unigate. The Special Commissioners said:

> although a board might do what it is told to do it did not follow that the control and management of the company lay with another, so long as the board exercised their discretion when coming to their decisions and would have refused to carry out an improper or unwise transaction

The manner in which the board of Untelrab carried out its role was close to being controlled by the parent, Unigate, but did not cross the line. The board met in Bermuda and transacted the company's business there; at board meetings, proposals were discussed and decisions made by the two directors present "in the best interests of the company"; and the directors would have refused to carry out any proposal which was improper or unreasonable. Unigate could have removed the directors; but could not control them in the exercise of their powers. The special commissioners found that, although Untelrab was compliant to do the wishes of Unigate, "it did actually function in giving effect to its parent's wishes." That is, the directors did actually address their minds to the question whether, in relation to each request for a loan, it was in the interests of Untelrab to comply with the request.

The crucial question in cases of this type is whether the directors of the company are able to say "No" to a proposed transaction; and can be expected to do so if their duty to the company so requires.

Another example is *Wood v Holden* which concerned the residence of a company, Eulalia, incorporated in the Netherlands. Eulalia had been acquired, on the advice of Price Waterhouse, for a CGT avoidance scheme. The sole director was the trust company of a Dutch bank. Eulalia was used for a single transaction: the acquisition and disposal of shares. The director of Eulalia caused it to participate in the transaction in accordance with the scheme devised by Price Waterhouse and on the basis of documents which Price Waterhouse had prepared. Although Price Waterhouse intended and expected that Eulalia would make the decisions which it did make, Price Waterhouse did not dictate what decision it should take. In particular:

> it is inherently improbable that a major bank (or its trust company) would allow its actions to be dictated by a client's professional advisers (however eminent).[45]

Or so the CoA thought. There was no reason why Eulalia should not decide to do as it was requested; and ample reason why it should enter into the transaction, as it was expected that it would.

The INTM provides:

> **INTM120180 How To Review Residence** [May 2020]
> ...When determining whether the directors do have control, the first step may be to consider whether any person is, in fact, likely to be able to instruct the directors, irrespective of the legal position. If so, are the directors of sufficient standing and likely to have the requisite expertise to be able to act on their own authority and do they, in fact, do so?
> ... The place of directors' meetings is significant as an indication of the place of central management and control if, but only if, the board of directors does have the controlling power and exercises that power wholly or mainly at board meetings. The place of meetings will not be decisive if the directors are acting on the instructions of some other person or if they artificially divorce the place of their meetings from the place where they together manage and control the business outside the meetings - see paragraph 14 of SP1/90 at INTM120200.[46]
> It is necessary to look at what happens between meetings. But if, for example, a main board made up of executive and non-executive directors meets regularly overseas and the directors in the UK are only executive directors, subject to the control of the board, it is unlikely that the company is resident in the UK even though the role of the main board may be relatively passive. The board must, however, have real control. This is unlikely if it is made up partly of 'stooge' directors recruited simply to give the appearance of control.
> In a detailed examination of residence, try to build up a complete picture of just how the business is run, over a period of time. Meetings with those involved in the management, and examination of records and correspondence are essential to a thorough examination.

8.10.6 *Sleeping directors*

The Australian CMC guidance provides:

[45] [2006] EWCA Civ 26 at 41.

[46] See 8.10.1 (Board meeting significance).

> 23. A person who has legal power or authority to control and direct a company, but does not use it, does not exercise central management and control.[47] For example, in *Bywater*,[48] the court disregarded the role of those directors who were formally appointed but did not play any real role in the affairs of the company.

I refer to a board which is not "rubber stamping" the decisions of others as a **"functioning board"** and one all of whose directors participate (no sleeping directors) is a **"fully functioning board".**

8.10.7 *Influence v control*

Australian CMC guidance provides:

> 26. An outsider who merely influences those with legal power to control and direct a company, even if they can and do exert strong influence, is not the relevant decision maker and does not exercise central management and control of the company. However, if an outsider is more than merely influential, and actually dictates or controls the decisions made by the directors, the outsider will exercise central management and control of the company.
> 27. The distinction turns on what amounts to decision making for the central management and control test of residency. In *Bywater*,[49] the High Court observed that this turns on whether the people said to make the decisions of the company, actually consider whether to do what they are told, or are advised to do, and make a decision to do it because it is in the best interests of the company. If they do, they are the relevant decision maker and exercise central management and control of the company. If they do not, and merely mechanically implement or rubberstamp company decisions already made by others based on what they are told or advised to do, the person who gave the instruction is the real decision-maker and exercises central management and control of the company.
> 28. It is relevant to consider whether the directors would refuse to follow advice or directions of outsiders that are improper or inadvisable. If they would, it is more likely the directors are the real decision makers. If not, it is more likely the outsider who exercises central management and control.

[47] *BW Noble* at p.412.

[48] *Bywater Investments v CT* [2016] HCA 45.

[49] *Bywater Investments v CT* [2016] HCA 45.

> 29. The directors' knowledge of the business is also relevant. A lack of knowledge of the business sufficient to enable them to determine if following advice or instructions would be improper or inadvisable, suggests they are not the real decision makers and are more likely rubberstamping or implementing decisions already made by others.

SA POEM guidance provides:

> In considering whether a board is making the decisions or, alternatively, is limited to formally approving or rubber-stamping the decisions made by someone else, a variety of factors must be taken into consideration. These factors include, for example,
> [1] whether the directors have sufficient knowledge and information at hand,
> [2] whether the directors are suitably qualified and experienced generally and in relation to the particular company, and
> [3] whether the directors had reasonable time to assess the information and make the decision.
>
> The details regarding quorums and casting votes and the circumstances in which those aspects are applied may be relevant. Again, it is necessary to look at all the relevant facts and circumstances of a particular case.
>
> Similarly, when considering the role of different directors, it must be established whether the particular director is involved in the decision-making or is perhaps merely ratifying a decision made by other directors or people. For example, it is possible for a director to be appointed with a governance-focussed role or as a shareholder representative and custodian as opposed to being actively involved in making decisions on behalf of the company. In some companies executive directors have traditionally been involved in decision-making while non-executive directors have not had a decision-making role.

8.10.8 *Service of inevitability*

This section draws on an article by Chadwick LJ writing extra-judicially.[50] This considers the position of an "orphan SPV". That is an entity where:

(1) the entity is established for a person ("the sponsor") who does not control the entity (in the strict sense of control); but

(2) the sponsor intends and expects that the SPV will in practice conduct

[50] Chadwick, "Control of Special Purpose Vehicles" Jersey & Guernsey Law Review 2007 *https://www.jerseylaw.je/publications/jglr/Pages/JLR0706_Chadwick.aspx* This was written a year after Chadwick gave his judgment in *Wood v Holden*.

> its affairs in a way which fulfils the sponsor's purpose, which is usually determined in advance.

Directors or trustees of such entities may be said to provide a "commercial service of inevitability".[51]

In *Wood v Holden*:[52]

> 'Vehicle' has a belittling sound to it, but such companies ... can and do fulfil important functions within international groups, and they are principals, not mere nominees or agents, in whatever roles they are established to undertake. They usually have board meetings in the jurisdictions in which they are believed to be resident, but the meetings may not be frequent or lengthy. The reason why not is that in many cases the things which such companies do, though important, tend not to involve much positive outward activity. So the companies do not need frequent and lengthy board meetings

Chadwick gives the following advice:

> What guidance can be given in relation to practical problems which may arise in the course of administering an orphan SPV. The problems can, I think, be addressed under two main heads. The first may be described as constitutional: the second as comprehensional.

On the constitutional aspect:

> The constitution of the SPV company must ensure that the sponsor does not have legal control. That precludes the sponsor from having a legal or beneficial interest in a controlling shareholding. It is probably safer that the sponsor has no interest as shareholder. The structure in *Mahonia*[53] – where the shares in the SPV company were owned by a charitable trust[54] – provides an obvious way in which this requirement can be met. The structure in *Esquire Nominees*, or in *Regent*, will suffice: provided it can be demonstrated that the shareholders are wholly independent of the sponsor.
>
> The constitution of the SPV company should vest management control in the board of directors. It should provide for the appointment of

[51] This felicitous phrase is from *Macdonald v Dextra Accessories* 77 TC 134 at p.157.

[52] [2005] EWHC 547 (Ch) at [25] approved on appeal by Chadwick LJ at [2006] EWCA Civ 26 at [27].

[53] *Mahonia v West* [2004] EWHC 1938 (Comm).

[54] Author's footnote: A charity must take care to fulfill its charitable objects, which might be problematic. But Chadwick does not seem to share these concerns.

> directors by the shareholders. There are obvious dangers in giving the sponsor power to nominate directors; and dangers in giving the sponsor power to remove directors. Those dangers are better avoided. The constitution should specify the minimum number of directors. It should contain provisions as to the notice to be given in relation to board meetings; and should specify the quorum for a valid board meeting. A quorum of at least two directors is desirable: there are dangers in having a sole director, or in providing for a quorum of one.
>
> In cases where the residence of the SPV is of importance – as it usually will be if the SPV is to be used for a fiscal purpose – it will be sensible to provide for the territory in which the board is to meet. That will not, of course, be determinative of residence if the board does, in fact, choose to meet elsewhere: as the *Unit Construction* case demonstrates. But it may have the advantage of focussing attention on the need to exercise central management and control in the specified territory...[55]

The comprehensional aspect is what actually matters, because constitutional issues do not determine residence.[56]

> I have described the second of the problems as comprehensional. By that I mean that the directors of the SPV must have a proper understanding of their role; and that that understanding must be shared by the sponsor and its advisers.
>
> The directors must understand that their first and overriding duty is to have regard to the interests of the SPV company; the desire to give effect to the wishes of the sponsor must be subordinate to that duty. In that context it is, I think, no coincidence that, in [*Esquire Nominees*], one of the two directors was a solicitor; that a solicitor was the Jersey based director of Untelrab Ltd; and that both Regent and Mahonia were owned and directed by Jersey law firms. The advantages of having an independent lawyer or other professional in the role of director of the SPV are twofold. Not only can he be expected to appreciate the scope of the fiduciary duties imposed on directors: his own professional standing is likely to provide a powerful incentive to observe those duties. Taking those factors together, the assertion by a professional that he would not accede to a request which he thought contrary to the company's interests is likely to carry weight: as it did in the cases that I have mentioned.
>
> That is not, of course, to suggest that directors from other disciplines or

[55] The omitted passage deals with electronic meetings.

[56] See 8.12 (Parent/subsidiary relationship).

> with other experience or expertise will not inspire equal confidence; as in the case of the bank trustee company in the *Eulalia* case. But it is to suggest that the directors of an orphan SPV should be chosen with care; and with the requirement that they may need to demonstrate a proper understanding of their role in mind...
>
> Finally, I should emphasise that it is necessary that the sponsor and its advisers should have a proper understanding of the function of the SPV directors. The sponsor's wishes should not be couched in terms of instructions or demands; but in terms of proposals and requests. Its advisers should not lose sight of the fact that the SPV directors are not the sponsor's agents or employees: to do as they are told without question. If the course proposed is a sensible course and in the interests of the SPV company, the directors are no less likely to follow it if they are merely requested to do so than they would be if they were instructed to do so: or if they are, then they are the wrong choice for the role. And, if the transaction comes under scrutiny, it will be easier to satisfy the regulator, the revenue or the court that both sponsor and orphan understood the nature of the relationship if the communications between them reflect that understanding. The key to a successful relationship, of course, lies in the need for the sponsor and its advisers to be attuned to what the directors of the orphan SPV can, and cannot, properly be asked to do.

The issue may be compared to the philosophical problem of reconciling free will with determinism/divine foreknowledge. If it is (more or less) certain what the outcome will be, can directors (or anyone else) actually be making decisions? But maybe that is over-conceptualising.

8.10.9 *Residence in avoidance cases*

Underlying Chadwick's advice is an attitude of neutrality to tax avoidance which was changing at the time it was written and now seems dated.[57] Courts unsympathetic to avoidance could either step back from the law as set out above, or decide that appeals fail on the facts; and subsequent to the date of Chadwick's article (2007), this has been happening.[58]

[57] See 2.5.5 (Practitioner/judicial views today).

[58] Examples are:

(1) *Smallwood*. a POEM case, but (more or less) the same principles apply; see 9.19.7 (POEM: Round the World scheme).

(2) *HMRC v Development Securities* [2020] EWCA Civ 1705; see [2021] BTR 51 but this case is not yet final.

SP 1/90 comments on avoidance cases:

> 18 In outlining factors relevant to the application of the case law test, this statement assumes that they exist for genuine commercial reasons. Where, however, as may happen, it appears that a major objective underlying the existence of certain factors is the obtaining of tax benefits from residence or non-residence, the Revenue examine the facts particularly closely in order to see whether there has been an attempt to create the appearance of central management and control in a particular place without the reality.

8.11 Some UK directors

This section considers how the CMC test works where:

(1) The directors manage the company, ie we are not concerned with usurpation/rubber stamping.

(2) Some of the directors work is done in the UK.

De Beers offers an illustration. On one side:[59]

> The head office is formally at Kimberley, and the general meetings have always been held there.
> Also, the profits have been made out of diamonds raised in South Africa, and sold under annual contracts to a Syndicate for delivery in South Africa ...
> Further, some of the Directors and Life Governors live in South Africa, and there are Directors Meetings at Kimberley as well as in London.

On the other side:

> ... the majority of Directors and Life Governors live in England, ...
> the Directors' Meetings in London are the meetings where the real control is always exercised in practically all the important business of the Company, except the mining operations.
> London has always controlled the negotiation of the contracts with the Diamond Syndicates, has determined policy in the disposal of diamonds and other assets, the working and development of mines, the application of profits, and the appointment of directors.
> London has, also, always controlled matters that require to be determined by the majority of all the Directors, which include all questions of expenditure except wages, materials, and such like at the mines...

[59] 5 TC 198 at p.213.

On these facts, CMC was in the UK. I would not say that was obvious. A minority of directors, and governance of the mining (which one might think was important, for a mining company) were in South Africa.

8.11.1 *HMRC examples*

The INTM provides:

> **INTM120150 When HMRC Will Not Usually Review Residence: Examples** [May 2020]
> Examples 1 to 8 illustrate circumstances in which HMRC would not usually seek to establish that a company is UK resident for the purposes of S5/CTA09 (see INTM120010).

The examples are subject to 8 qualifications, which I set out first. These qualifications are wide as to would allow HMRC to refuse to follow the examples on any occasion, but of course the guidance is not binding on HMRC even if, as could happen, the facts were that all that the HMRC qualifications require them to be.

> [1] Enquiries will still be undertaken if they are necessary in order to fulfil the UK's obligations under a double taxation agreement.

It is difficult to see how this could arise in practice, or at least, it will be rare.

> [2] HMRC also reserves the right to enquire into any case in which arrangements appear to have been made to exploit these examples by, for example, creating the form of compliance without the substance.

This overlaps with point [6] below. In practice it could mean little or much. Maybe contemporary tax haven substance requirements likely to meet this requirement.

> [3] The following circumstances are assumed to be present in all the examples below;
> [a] the company is wholly owned by a UK headed group or a UK headed sub-group with a non-UK resident ultimate parent;

INTM120160 [May 2020] returns to this point:

> a company may fall outside one of the examples because it is not wholly owned by a UK headed group or sub-group. Where this is due to the presence of small minority shareholdings wholly unconnected with the wider group arising from, say, local legal requirements regarding

> employee share ownership, it is unlikely to have an impact on the corporate residence issue.

But why are the examples meant to be limited to cases of UK groups or subgroups? Would not a 100% UK parent only make a subsidiary more likely UK resident, not less?

> [b] the company is incorporated outside the UK in a territory where it is considered to be resident for tax purposes by virtue of its incorporation there;
> [c] the country of incorporation and residence has a double taxation agreement with the UK which contains a residence tie-breaker (INTM120070);

What has any of this to do with UK corporate residence is obscure.

> [d] the company is genuinely established in its territory of residence;

Whatever that means, it overlaps with point [1] above.

> [e] the company does not (except in the particular circumstances of examples 6 to 8 [holding co of trading group]) have investment business as its main business, and;
> [f] the central management and control of the business of the company is at least in part exercised at meetings of its board of directors.

The explanation of requirements [3](a) and (e) may perhaps be that the examples were composed to respond to questions from specific multinational trading groups, and the fact that the similar problems arise for corporate residence more generally has been ignored.

Subject to those (considerable) qualifications, the examples where HMRC will in principle accept non-residence then follow. In summary:

Example	**Directors**	**UK board meetings**
1	single UK director, not sole director	none
2,6	minority of UK directors	none
3	exceptionally, majority UK directors	none
4,7	minority UK directors	meet electronically, from UK
5,8	minority UK directors	1 or 2 UK board meetings

In all these cases, HMRC accept the company as non-resident:

> **Example 1** [single UK director, not sole director]
> A company includes as a member of its board of directors a UK resident, all other members being resident in its territory of residence and elsewhere outside the UK. The company's board of directors meets

only outside the UK.

Example 2 [minority of UK directors]

A company has more than one UK based director on its board, but the majority of board members are based outside the UK in its territory of residence or elsewhere. The board meets only outside the UK.

Example 3 [exceptionally, majority of UK directors]

The minority UK based attendance in example 2 becomes a majority on an isolated occasion due to the unforeseen unavailability of one or more of the overseas based directors.

Example 4 [minority UK directors meet by electronic link]

The UK based directors in examples 1 and 2 do not travel to attend board meetings in person but habitually participate by electronic link from the UK.

Example 5 [minority UK directors, small minority UK board meetings]

The board of directors in examples 1 and 2 hold the majority of its meetings in any one accounting period outside the UK but a small minority - no more than one or two - of the meetings are habitually held in the UK.

Similar rules apply to a holding company of a non-resident group, where examples 6-8 mirror examples 2, 4, 5

Example 6 [minority of UK directors]

A company has as its main business the holding of majority shareholdings in operating companies resident in its own territory of residence or region (which does not include the UK). Its board of directors meets both in its territory of incorporation and in the territories of incorporation of its subsidiaries. It includes on its board a minority of one or more UK based directors.

Example 7 [minority UK directors meet by electronic link]

The UK based directors in example 6 habitually participate in meetings by way of electronic link from the UK.

Example 8 [minority UK directors, small minority UK board meetings]

The situation is the same as in examples 6 or 7 except that while the board holds the majority of its meetings in any one accounting period outside the UK, a small minority of the meetings (no more than one or two) are habitually held in the UK.

INTM120160 When HMRC Will Not Usually Review Residence: Other Cases [May 2020]

Cases falling outside the examples

Inevitably very many cases will fall outside the scope of the examples set out at INTM120150. Whilst this means that they will not strictly be covered by this guidance it is crucial to remember that the application

> of the case law test depends on the facts in particular situations. Therefore a consideration of the reasons why a particular company falls outside the examples may assist in assessing the likelihood of HMRC raising enquiries. The examples therefore have a wider role in the risk assessment of company residence issues...

The passage ends remarkably:

> The examples should not be interpreted to suggest that the correct test for residence involves comparing the number of board meetings held in the UK against those held elsewhere. The application of the test in *De Beers Consolidated Mines Ltd v Howe*, 5 TC 213 involves scrutinising the company's course of business and trading. Relevant factors would therefore be what happened at particular board meetings and what happened between them...

That is of course exactly what all the examples (5 & 8 in particular) do suggest.

In summary, the author of INTM120150 wished to give the appearance of guidance without the slightest hostage to fortune, and succeeded in doing so. But I think the examples are worth studying, not so much because it is HMRC who published them, but because they are, subject to the usual caveats, a correct interpretation of the CMC test - as illustrated by the facts of *De Beers* itself.

8.11.2 *Director tax residence n/r*

Of course if director(s) spend more time in the UK, or if there is a larger number or proportion of directors living here, there is correspondingly more opportunity for management and control of the company to take place in the UK. But a director's tax-residence as such does not matter, in the sense that the SRT has no role to play here. HMRC agree:

> **INTM120170 When HMRC Will Not Usually Review Residence: Individual Directors** [May 2020]
> *Location of individual directors*
> The relevance of individual directors' tax residence to the place of central management and control of the companies that they serve is sometimes raised as an issue. In principle it is the place from which an individual exercises central management and control that is the relevant factor for locating the residence of a company rather than the territory in which their personal tax liabilities arise.

That is self-evident, though there is authority if needed.[60]

8.11.3 *UK directors meeting abroad*

The ITH provides:

> **ITH334 Company residence: the reality**
> It has been said that the management and control test is bad because it leads to the nonsense of directors flying to Jersey for board meetings. That device is no longer of use to a UK incorporated company which is resident here anyway. But it is quite easy for a company operating here to incorporate in Jersey and claim to be managed and controlled there with only a minimal tax cost in Jersey provided the shareholders are not resident there. So the criticism is still relevant.
> On the face of it the point is a valid one. But criticism of that kind is concerned as much with questions of fact as of concept and the two things must be kept separate in our minds. There is, in principle at any rate, no reason why a business which is visibly in this country should not be managed and controlled from, let us say, Jersey. But if the directors of that company are working in this country on a regular basis and probably living here as well, it may be highly unlikely that they will be doing anything more in Jersey than reaffirming decisions already taken here. If that is so the mere fact of having board meetings in the Channel Islands is irrelevant. The question is, where do the people concerned exercise management and control. If they really do it in this country and go through a meaningless form of words in Jersey, that will achieve nothing for them but, of course, it leaves the Revenue with the difficult burden of proof.
> It may help to put the problem into a context which is very familiar. A small grocery store is run by a man A and his son A junior. There is a grandfather, once sole proprietor, who no longer takes an active part in the business but owns the property and makes his views known on important matters. A company is formed with A as chairman and managing director, the son as sales director and grandfather as a mere shareholder. Every year A and his son spend holidays in Jersey. It is very unlikely that any body of Commissioners would accept that by holding their only board meetings when they are in Jersey they had made the company resident outside the UK. Both level two and level three management are exercised by A and his son and they are clearly based in the UK.

[60] *John Hood v Magee* 7 TC 327; *North Australian Pastoral Co v FCT* (1946) 71 CLR 623 at p.628.

> But an alternative scenario has grandfather as both major shareholder and chairman with A and his son as full-time working directors. Grandfather takes no part in the day-to-day running of the business but takes a keen interest in its success and his word on important matters carries great weight. Here level three management emerges as something quite distinct from level two which remains with A and his son. Level three may be found either with grandfather alone or with grandfather and his sons acting as a board depending on the extent of grandfather's real power. If grandfather moves to Jersey, level three management may genuinely move with him, either because he alone exercises central management and control from Jersey or because the board meetings, at which he plays an important part, are held there...

The INTM discusses the same question, but does not give any hostage to fortune:

> **INTM120150 When HMRC will not usually review residence** [May 2020]
> **Example 9**
> The majority of directors habitually perform a significant part of their duties in the UK, merely leaving the UK to attend board meetings. HMRC may wish to examine all relevant factors in such a case to determine whether or not the company should be regarded as resident in the UK.

It is instructive to contrast the two passages. The author(s) of the ITH would not have written anything deliberately vague and unhelpful. But the ITH was written before the Manuals were published.

8.12 Parent/subsidiary relationship

This section discusses subsidiary companies, but there should be little difference in principle between a group (parent/subsidiary) relationship and any other shareholder/company relationship, eg if the shareholder is a trust or an individual.

In *Wood v Holden*:

> in any consideration of the principles governing the common law of corporate residence the normal realities of the parent and subsidiary relationship have to be taken into account... In the context of a group of companies where matters proceed in a normal way and not in an exceptional way it is to be expected that the parent company will have plans for what it wants its subsidiaries to do, and that the directors of the subsidiaries will ordinarily be willing to go along with the parent

> company's wishes. If in those circumstances the subsidiaries were resident for tax purposes wherever the parent company is resident the consequences would, in my view, be unsatisfactory, productive of double taxation clashes between different jurisdictions, and disruptive of national tax systems.
>
> There is a difference between, on the one hand, exercising management and control and, on the other hand, being able to influence those who exercise management and control. There is another difference, highlighted by *Unit Construction v Bullock*, between, on the one hand, usurping the power of a local board to take decisions concerning the company and, on the other hand, ensuring that the local board knows what the parent company desires the decisions to be. It is also necessary to keep in mind that, while the cases which I have referred to so far all involved the residence of companies with active continuing businesses, it is possible (and is common in modern international finance and commerce) for a company to be established which may have limited functions to perform, sometimes being functions which do not require the company to remain in existence for long.[61]

SP 1/90 provides:

> 16 It is particularly difficult to apply the "central management and control" test in the situation where a subsidiary company and its parent operate in different territories. In this situation, the parent will normally influence, to a greater or lesser extent, the actions of the subsidiary. Where that influence is exerted by the parent exercising the powers which a sole or majority shareholder has in general meetings of the subsidiary, for example to appoint and dismiss members of the board of the subsidiary and to initiate or approve alterations to its financial structure, the Revenue would not seek to argue that central management and control of the subsidiary is located where the parent company is resident.

That is right, because CMC means control at board level, not at general meeting level.

> However, in cases where the parent usurps the functions of the board of the subsidiary (such as *Unit Construction* itself) or where that board merely rubber stamps the parent company's decisions without giving them any independent consideration of its own, the Revenue draw the conclusion that the subsidiary has the same residence for tax purposes

[61] From the decision at the HC stage: [2005] EWHC 547 (Ch) at [24].

> as its parent.
> 17 The Revenue recognise that there may be many cases where a company is a member of a group having its ultimate holding company in another country which will not fall readily into either of the categories referred to above. In considering whether the board of such a subsidiary company exercises central management and control of the subsidiary's business, they have regard to the degree of autonomy which those directors have in conducting the company's business. Matters (among others) that may be taken into account are the extent to which the directors of the subsidiary take decisions on their own authority as to investment, production, marketing and procurement without reference to the parent.

The INT Manual provides:

> **INTM120180 How To Review Residence** [May 2020]
> ... Some element of supervision by the parent will be expected. For example, there is often a system of regular reporting from subsidiaries to parents. Reporting by itself, or the issue of general group directives on such matters as finance control, do not necessarily indicate that the residence of the subsidiary lies with the parent. Intervention beyond this may lead to that result.
> ... It remains possible for central management and control to lie with a subsidiary's directors even where it seems improbable that they would act other than in accordance with the directors of the parent.

The INTM has an extract from the ITH:

> **ITH335 Company residence: parent subsidiary relationship**
> The next difficulty in identifying real management and control is concerned essentially with the parent subsidiary relationship. A parent company is merely a shareholder and may have no constitutional right to run the business of the subsidiary; but such parent companies do increasingly exercise influence in the management of their subsidiary companies. The Royal Commission of 1920 observed this and the problem has got a great deal worse since then. The question always is whether the influence exercised by the parent amounts to the management and control of the business of the subsidiary. Unit Construction wanted its African subsidiaries to be resident here - there were losses that could be relieved. For many years the Revenue had taken the view that that was an exceptional case, and it relied on some words of Lord Cohen in his judgment where he said

> ‘the facts of the case before your Lordships are most unusual. It is surely exceptional for a parent company to usurp the control; it usually operates through the boards of the subsidiary companies, and had the Commissioners found in the present case that that was what had in substance happened, it may well be that your Lordships could not have disturbed that finding’. [38 TC 744]

The Department adopted its line for good reason. First, there was some support for it in Lord Cohen’s words. We did not want to argue that large numbers of overseas subsidiaries of UK parent companies were resident here. When such subsidiary companies make profits one often finds that after Double Taxation Relief there is very little UK tax left. Further, we did not want to argue that large numbers of UK incorporated companies, being the subsidiaries of foreign parents, were not resident here: they were quite prepared to be treated as resident and their tax planning was on that basis.

But it became clear that *Unit Construction* was not so exceptional after all. It may be exceptional for the directors of a company to stand aside completely. It is, however, not unusual for directors to act in accordance with the wishes of the parent. We took advice about the matter and the advice was that the test should properly be whether the local directors apply their minds to ‘suggestions’ from the parent and form an independent judgment before implementing their parent’s wishes or whether, on the other hand, they merely ‘rubber stamp’ and carry out without serious question the higher policy wishes of the parent company.

8.12.1 *Parent co guidelines*

SA POEM guidance provides:

> Shareholders sometimes limit the authority of, or provide guidelines for, the board and senior managers of a company. For example, a parent company may set limitations of authority or guidelines for a subsidiary company. These limitations of authority or guidelines must, in conjunction with all the other facts and circumstances, be reviewed in detail to determine whether the effect is that the shareholder is actually making the key decisions or whether the company, although receiving guidance or some input, is still making them. It is quite common for a parent entity of a multinational group to set guidelines and policies for the group as a whole in order to direct, coordinate and monitor activities of the group as a whole. This does not necessarily mean, and often does not mean, that the subsidiary company is not making its own decisions, but all the facts must be considered when making this assessment.

> **Example 2 – Limitation of authority**
>
> *Facts:*
>
> Company A concludes long-term contracts with clients which extend over a number of years. A single contract can have a significant effect on the financial viability of Company A and as a result Company A's senior management team sign off on all contracts. The conclusion of sales contracts represents a predominant key commercial decision for Company A.
>
> Under a limitation of authority, the company's senior management team is restricted to concluding contracts not exceeding a contract value of R10 million. For contracts exceeding this value, the company must submit its recommendation to the parent company and the parent company makes the decision whether or not the contract may be accepted. The company must implement the parent company's decision. 90% of contracts have a value that exceeds R10 million.
>
> *Result:*
>
> Although more detail would be required and all the facts affecting all the key management and commercial decisions of the company as a whole would have to be taken into account, the facts suggest that the effective management of the company may have been usurped by the parent company. The limitation of authority in this case has effectively removed the company's real authority to make decisions and has gone beyond a mere monitoring mechanism or information-reporting requirement.

Limitations of authority and guidelines are common in multi-national groups of companies. The details are critical in assessing who is, in substance, making the company's key management and commercial decisions.

8.12.2 *Support functions*

SA POEM guidance provides:

> **4.2.9 Support functions**
>
> It is not uncommon for a multinational company to centralise certain support functions such as data management, human resources, customer support or accounting, and to locate those services in countries that offer advantages such as superior infrastructure, lower costs or a highly skilled workforce. A group of companies may house these services in the group's ultimate holding company or in a separate subsidiary which provides the services to all the members of the group.
>
> In these situations, the locations where those services are primarily

> performed and where the senior managers responsible for them are based may be different to the location of the company's head office where the top senior management and the senior management's direct support staff are located. Although such support services may be essential to a company with support service related policies and procedures having a company-wide effect, the managers in charge of those services are often not involved, or only secondarily involved, in making key management and commercial decisions that affect the conduct of the company's business as a whole (outside of the area of the specific support functions that they are responsible for). Consequently, the location where such support services may be located is generally of limited relevance to the determination of a company's place of effective management.
>
> The location where a company's accounting records are retained will generally not be indicative of the place where the key management and commercial decisions are made and in these circumstances would therefore be irrelevant in determining a company's place of effective management.

8.13 Period of enquiry

The position must be considered for each tax year under appeal.

In *HMRC v Development Securities*:[62]

> Events before or after the particular date in question may be relevant as casting light on the position on that date

In *Laerstate BV v HMRC*:[63]

> the residence of a company will not fluctuate merely by reason of individual acts of management and control taking place in different territories. The whole picture must be considered in each case.

Similarly *Untelrab v McGregor*:[64]

> when deciding the issue of residence one should stand back from the detail and make up one's mind from the picture which the whole of the evidence presents.

See too 9.16 (Period of enquiry: tie breaker).

[62] [2020] EWCA Civ 1705 at [14].

[63] [2009] UKFTT 209 (TC) at [29] followed in *Mark Higgins Rallying v HMRC* [2011] UKFTT 340 (TC) at [55].

[64] [1996] STC (SCD) 1 at 22-23.

8.14 Covid & company residence

INTM120185 HMRC Approach to Company Residence in response to COVID-19 Pandemic [May 2020]

Background

The COVID-19 pandemic has resulted in significant disruption to international travel and business operations, including the locations of directors, employees and other individuals.

HMRC is very sympathetic to the disruption that is being endured.

We have been asked about HMRC's response to the corporate residence challenges posed by COVID-19. The presence of individuals in the UK as a consequence of COVID-19 raises questions about whether the foreign companies, of which those individuals may be directors or employees, could become UK tax resident.

Overview

HMRC considers that the existing legislation and guidance in relation to company residence already provides flexibility to deal with changes in business activities necessitated by the response to the COVID-19 pandemic.

We do not consider that a company will necessarily become resident in the UK because a few board meetings are held here, or because some decisions are taken in the UK over a short period of time. HMRC guidance makes it clear that we will take a holistic view of the facts and circumstances of each case...

Company Residence.

Where the central management and control of a company actually abides is a question of fact. HMRC take the view that whilst the site of board meetings may be important in determining where CMC abides, it is not determinative (see INTM120130 and INTM120180). Each case turns on its own facts and circumstances which makes it difficult for HMRC to provide definitive guidance as to where CMC may abide in cases where businesses are forced to make changes in response to the COVID-19 pandemic.

However, our published guidance as to when we would not usually challenge a company's view on its residence will be relevant in the current circumstances. See in particular INTM120140 and INTM120150.[65] Whilst the examples given in the latter are based on a number of assumptions being made, this guidance sets out HMRC's view that occasional UK board meetings, or participation in such

[65] See 8.11 (Some UK directors).

> meetings from the UK, does not necessarily result in CMC abiding in the UK.
> Similarly, INTM120160 provides guidance in respect of cases which fall outside the examples in INTM120150. This guidance makes it clear that HMRC's view will depend on the facts in particular situations...

See too 9.31 (Covid and treaty-residence).

8.15 CMC: Summary

After a lengthy discussion, a summary may be helpful. In *Mark Higgins Rallying v HMRC*:[66]

> 52. We have found helpful the summary put forward by the Special Commissioners in *Untelrab*[67] (at [74]):
>
> > "From these authorities we have identified the following principles: that the residence of a company is where the directors meet and transact their business and exercise the powers conferred upon them; that if the directors meet in two places then the company's residence is where its real business is carried on and the real business is carried on where the central management and control actually abides; that a determination as to whether a case falls within that rule is a pure question of fact to be determined by a scrutiny of the course of business and trading; that the actual place of management, and not the place where a company ought to be managed, fixes the place of residence of a company; … and that when deciding the issue of residence one should stand back from the detail and make up one's mind from the picture which the whole of the evidence presents."
>
> 53. Also, the views of the Tribunal in *Laerstate*[68]:
>
> > "There is no assumption that [central management and control] must be found where the directors meet. It is entirely a question of fact where it is found. Where a company is managed by its directors in board meetings it will normally be where the board meetings are held. But if the management is carried out outside board meetings one needs to ask who was managing the company by making high level decisions and where, even where this is contrary to the company's constitution.
> >
> > It is significant, we think, that Lord Loreburn (in *De Beers*) referred

[66] [2011] UKFTT 340 (TC).

[67] *Untelrab v McGregor* [1996] STC (SCD) 1.

[68] *Laerstate BV v HMRC* [2009] UKFTT 209 (TC) at [27]-[29].

> > to the test as being where central management and control 'abides'.[69] This is a test that does not confine itself to a consideration of particular actions of the company, such as the signing of documents or the making of certain board resolutions outside the UK if, in a given case, a more general overview of the course of business and trading demonstrates that as a matter of fact central management and control abides in the UK. As Lord Loreburn said (at 212-213), the factual question must be considered 'upon a scrutiny of the course of business and trading'.
> >
> > This is consistent with the analogy with individual residence which was the basis on which Lord Loreburn propounded the central management and control test. Just as for an individual, for example, where a temporary departure from the UK would not of itself give rise to a change of residence, the residence of a company will not fluctuate merely by reason of individual acts of management and control taking place in different territories. The whole picture must be considered in each case."...
>
> 62. We find that the place where certain contracts – even important ones such as the manufacturers' works team agreements – were signed is not in itself a determining factor. It is evidence towards where decisions were being made but it is the location of the decision-making, rather than where the contracts were signed, which is important.

8.16 Dual residence/no CMC

In *Swedish Central Railway v Thompson* at first instance:[70]

> just as an individual can have two residences, so can a corporation. ... it is easier for a corporation to have two residences than for a natural person because, after all, a natural person, existing as he does in space, as a physical body, can only be in one place at once, and if he has got a residence where he is not in fact, it is because it is all ready for him and he is prepared to go there and intends to go there, and merely is away temporarily, but he is away. It seems to me that as regards a company, which only exists in law and in the mind and does not occupy space at all, the residence which can be imputed to it can co-exist, the presence which can be imputed to a company can be in more places than one at the same time. Therefore I do not think there is any difficulty in the fact that it may be necessary to impute two residences to a company; ... a company residence depends only on the fact of control. It may have two

[69] See 8.6 (Central management/control test).

[70] 9 TC 342 at p.352.

> residences if its control shifts every alternate six months or something of that sort from one capital to another. It may have both those residences, just as a natural person who lives a part of the year in one place and part of the year in another has both as his residences; but... the only test of residence, one or more, is direction and control of the business.[71]

This was for a time controversial, but it was confirmed in *Unit Construction v Bullock*:[72]

> it must now be regarded as clear law that an artificial person may, like a natural person, have more than one residence...
> [In the *Union Corporation* case 34 TC 207] The facts were not such as to allow of Lord Loreburn's test being applied, and therefore some other basis of decision had to be selected. The solution chosen by the Court of Appeal appears to have been that residence arose in any country in which "to a substantial degree" acts of controlling power and authority were exercised; ... It may perhaps still be open to question whether, where the facts are such that Lord Loreburn's test cannot be applied as a whole, the correct way of determining residence is, so to speak, to fragmentate his principle and establish a residence for tax purposes wherever the exercise of some portion of controlling power and authority can be identified. The point does not arise for our decision in this case and I express no view at all upon it. I only note the decision in the *Union Corporation* case as an instance of dual or multiple residence for tax purposes which has its origin in the fact that circumstances do not always make it feasible to apply the Loreburn [CMC] formula.

The International Manual provides:

> **INTM120060: central management and control** [Jun 2016]
> **... Divided or multiple residence**
> The *De Beers* test points to a single country of residence. But the courts have recognised that, exceptionally, a company may have a dual or multiple residence. ... There are some companies for which it is not possible to identify any one country as the seat of central management and control. Management and control may be divided or may change from place to place even. The *De Beers* test as such cannot be applied. No general rule for establishing the residence of these companies has

[71] Part of this is quoting the submissions of HMRC; but the judge is clearly approving them. Dual residence was upheld in the subsequent appeal.

[72] 38 TC 712 at p.735.

> been established. But if, in the context of the company's business, what is done in the UK amounts to part of the management and control, the company is arguably resident here. The decision in the *Swedish Railway Company v Thompson*, 9 TC 342, should be interpreted in this way. The company was not engaged in active trading and its administrative control was divided between this country and Sweden. The Courts decided that the company, while it might be resident abroad, was nevertheless also resident here for tax purposes...

The INTM has an extract from the ITH:

> **ITH338 Companies: dual residence: domestic law**
> Divided central management and control was considered by the Court of Appeal in the *Union Corporation* [34 TC 207] group of cases, although the House of Lords decided the cases on another issue and did not consider the question. Drawing on the judgment in an Australian case, Sir Raymond Evershed's view was that the final and supreme authority cannot be divided between two places. But that is not required for dual residence. The situation can arise where some part of the superior or directing authority may be found in two countries at the same time. The company is resident wherever 'to some substantial degree' acts of controlling power and authority are exercised.
> That conclusion is not entirely easy to reconcile with the idea that central management and control is to be found at the pinnacle. It is easier to understand that the pinnacle may move from place to place, for example where there are ambulatory board meetings. But if one thinks of the pinnacle as the top cone rather than the very top point then that cone can be divided even if one part carries with it the top point.
> Lord Radcliffe in *Unit Construction* makes a valuable contribution towards reconciling the cases on dual residence although dual residence was not an issue in the case. From him we learn that there is one class of case where the *De Beers* test cannot be applied - that is where it is not possible to find central management and control in one country alone. What test is then applicable remains, to some extent, an open question. Where there is a genuine division of the top-most layer of central management and control between identifiable places, we can follow the criteria adopted by the Court of Appeal in *Union Corporation* and cited by Lord Radcliffe - establishing in which of those places acts of controlling power and authority are exercised to some substantial degree. However, where there is not that kind of division but rather the company is peripatetic in the sense that relevant acts of control and management are exercised at different times at perhaps a variety of different locations, it is considered that the Courts have not yet fully

addressed the question.

Examples are (assume the company's directors between them exercise top-level control):

(1) Directors meet only by electronic means, and one cannot identify a territory where board meetings take place.
(2) Directors meetings are in a series of different countries each year.

In these cases one must look for other factors than directors meetings, or else fall back on dual residence. This may not arise much in practice, as a company conscious of residence issues will not do this.

SA POEM guidance provides an example of case (2):

> **Example 3 – Place of effective management** (Bigco)
> *Facts:*
> B is a multinational company, incorporated under the laws of the UK, with substantial operations in South Africa, the UK and the United States. Its shares have a primary listing on the JSE, a secondary listing on the London Stock Exchange and are also traded on the New York Stock Exchange through American Depository Receipts.
> The company's head office is located in South Africa and its Managing Director, Financial Director and Chief Operating Officer are based in South Africa. The divisional managers who are responsible for the company's operations in the UK and the United States are based in those countries, as are several non-executive directors.
> B's board makes the key management and commercial decisions for the conduct of the company's business as a whole. It generally holds three meetings each year, one in each of the countries where B operates. B's Managing Director, Financial Director and Chief Operating Officer typically attend all of the company's board meetings and use the trips to meet with the company's operational managers in the UK and the United States as well as to meet with investors or investment analysts in those countries.
> All of the 'board packs' are prepared by personnel at B's head office, which may include information sent to the head office by the divisional managers. Head office personnel, including the Managing Director, Financial Director and Chief Operating Officer, and their direct staff, are also responsible for developing and formulating proposed strategic plans for consideration and action by the board. The board actively reviews these plans before taking a decision and, from time to time, either rejects or requires modifications to those proposals.
> *Result:*
> Under the circumstances, B's place of effective management is South

> Africa. Amongst other things, one of the three board meetings where decisions are made is held in South Africa with a majority of board meetings not being held at the other locations. In addition, its head office and highest level of senior management are both located in South Africa.
> The fact that B is incorporated in the UK is irrelevant. Any circumstantial evidence related to the company's economic nexus with any of the countries in question would also be of limited or no probative value in this instance.

8.17 HMRC practice/clearance

> **INTM120160 When HMRC Will Not Usually Review Residence: Other Cases** [May 2020]
> ... HMRC is willing to discuss residence issues with businesses. Given the factual basis of the case law test such discussions are generally likely to be more profitable the more information there is available about a particular situation. However in some cases, such as those involving dual resident companies or non-standard tie-breakers (see INTM120070), operational certainty may not be achievable without a joint approach by the company to both tax authorities under the relevant double taxation agreement.

8.18 CMC/trade income source compared

Company residence depends on CMC. Source of trading income depends on whether the trade is carried on wholly abroad.[73] Since 1965 the question whether a UK resident company has foreign source trading income has been significant mainly for loss relief (corporate loss relief is not discussed here). The INTM has an extract from the ITH which discusses the issue:

> **ITH343 Company residence: Case V trade: UK central management control**
> ... If a company is resident in the UK because the central management and control of its business is here, can it have a Case V trade? Usually the answer will be 'no'. But there is one case which suggests that it can. It is the *Egyptian Hotels* [*Egyptian Hotels Ltd v Mitchell* 6 TC 152 and 542] case. That company succeeded as narrowly as possible in establishing a Case V trading source while at the same time remaining resident in the UK (The House of Lords being evenly divided, victory

[73] See 21.4 (IT territorial limit: Trading).

> went to the company). It is important to remember that residence was not an issue in the case and that Egyptian Hotels Ltd was incorporated in the UK. Although *Egyptian Hotels* was heard some six years after *De Beers* which is the great authority for the management and control test, there was ... still some idea that if a company was incorporated here it was resident here. There is no reason why a company which is resident by reason only of incorporation here should not have a Case V trade. The short answer to the apparent contradiction in the *Egyptian Hotels* case is that under the central management and control test (and ignoring the 1988 incorporation rule) we would probably today regard the company as non-resident.
>
> **ITH344 Company/foreign partnership: Case V: UK central management control**
>
> However, business has a wider meaning than trade. There is one situation where a company managed and controlled in the UK may reasonably have a Case V trade. That is where the company is a partner in a partnership but the business of the partnership is managed and controlled abroad.

8.19 DTA residence rule

Section 18 CTA 2009 provides:

> (1) This section applies to a company which is treated as–
> (a) resident in a territory outside the UK, and
> (b) non-UK resident,
> for the purposes of any double taxation arrangements.
> (2) For the purposes of the Corporation Tax Acts the company is–
> (a) resident outside the UK, and
> (b) non-UK resident.
> (3) Subsection (2) applies even if the company would otherwise be UK resident for the purposes of the Corporation Tax Acts by virtue of section 14, 15, 16 or 17 or another rule of law.

I refer to this as the **"DTA residence rule"**. This rule also applies for income tax and CGT.[74]

The usual case will be a company which is incorporated in the UK but treaty-resident in a foreign state under the tie-breaker: the treaty overrides the incorporation rule.

The INTM has an extract from the ITH:

[74] See 8.1 (Company residence: Introduction).

> **ITH365 incorporation rule/treaty non-residents**
> The incorporation rule was introduced primarily as a protection against exploitation of the case law rule and the misuse of UK incorporation. But it is hardly surprising that such a major change in the law had some less desirable repercussions. These appear in what we call Treaty Non-Resident companies - TNRs. These are companies which
> [1] are resident both in the UK under its domestic law and in another country under that country's law and
> [2] the tie-breaker in the Double Taxation Agreement between the two countries awards residence for Agreement purposes to the other country... The most common tie- breaker awards residence to the country in which the company's place of effective management is to be found. Even when the case law rule was the only residence rule of the UK it was possible for a company to be a TNR. It could be centrally managed and controlled here and effectively managed elsewhere.[75] But the incorporation rule increased the scope for TNRs because a company can be incorporated in the UK and yet conduct its business wholly overseas.
>
> **ITH366 Company residence: the problem**
> The problem of the TNR is that for treaty purposes it is non-resident and we cannot tax its income or gains unless the treaty allows us to. If a company incorporated here has all its management and operations abroad there will be little, if anything, that the UK can tax under the treaty. But before 1988 UK domestic law assumed that if a company was resident here it was liable to tax on its world-wide income and gains. So some provisions will not work as intended if the company is resident but not liable.

The Manual gives examples relating to group relief, CFCs and ToA:

> [1] For example, the capital gains provisions allow transfers of assets between resident members of a group on a no gain no loss basis on the assumption that the gain will be taxed when the asset is sold outside the group. But without specific provision to the contrary, an asset could be transferred to a TNR on that basis but the treaty could prevent our taxing the gain when the TNR sells the asset. Examples of other anomalies requiring special treatment for TNRs are to be found in other group situations where a TNR can be treated as a group member for the purpose of intra-group payments of dividends and interest.

[75] Author's footnote: This will be rare in practice; see 9.19.4 (POEM/CMC compared).

> [2] And, without specific provision to the contrary, a TNR could not be a controlled foreign company
> [3] nor count as a non-resident in the income tax anti-avoidance provisions against transfers of assets [abroad].
>
> **ITH367 Company residence: legislation against treaty**
> Starting with 1988 there had been legislation which was either aimed specifically at preventing possible avoidance through TNRs or which, in introducing new provisions for companies in general, took account of TNRs. These provisions are briefly considered in Chapter 4. But by 1993 it was realised that there were many other opportunities for tax planners to exploit the mismatches attributable to a company being resident under domestic law while not resident for treaty purposes. So rather than continue to tackle the problem piecemeal it was decided to go for a general solution and deem such a company to be not resident in the UK for all purposes...

8.19.1 *Claims*

Section 18 CTA 2009 provides:

> (4) To decide whether a company is treated as mentioned in subsection (1)(a) and (b) for the purposes of any double taxation arrangements, assume that–
> (a) the company has made a claim for relief under the arrangements, and
> (b) in consequence of the claim it falls to be decided whether the company is to be treated as mentioned in subsection (1)(a) and (b) for the purposes of the arrangements.
>
> **ITH368 Company residence: general solution**
> ... A company does not have to make a claim under a treaty before the new rule applies. This is to stop companies moving in and out of UK residence depending on whether a claim is made for a particular year.

8.19.2 *Treaties*

The position depends on the treaty, which may take various forms.

> **ITH368 Company residence: general solution**
> ... [1] The residence tie-breaker in most treaties applies an objective test - often the location of 'effective management' (ITH348). If under that objective test, residence has been or would be awarded to our treaty partner then Section [18] applies.
> [2] In a few treaties - for example, in the agreement with Canada, where the tie-breaker can only operate upon agreement between the two

> authorities, the new rule cannot run until that agreement has been reached. The new rule has no application where treaty residence would be awarded to the UK (because then there is no mismatch between the treatment under domestic law and under the treaty) or where the treaty does not contain a tie-breaker ...

The position is now reversed, in that mutual agreement, type [2] above, is now the usual form.[76]

> **ITH453 Company residence: other consequences of [s.18]**
> Although in cases where [s.18] applies it should be easier to challenge the more blatant cases involving manipulation of our residence rules, the main purpose of [s.18] is to align a company's treatment under domestic law with its treatment under a Double Taxation Agreement...
> **ITH453 Company residence: other consequences of [s.18]**
> Where a treaty does not contain a tie-breaker, the company remains UK resident under the treaty and it is logical that its UK residence under domestic law is also unaffected.
> Furthermore, it is not intended that the new rule should be applied in marginal cases where there is no mischief unless the company itself invokes the Double Taxation Agreement. For instance, the location of effective management of the holding company for the UK subgroup of an overseas group may be unclear in a case where a company is mainly managed here but some management decisions are taken abroad. We would not regard as objectionable the fact that the company exists to allow losses to flow as group relief between members of the UK subgroup and the benefit of any doubt on the location of effective management may be given to the company.

8.20 Residence outside UK

Tax legislation usually refers to a company as being "resident in the UK" or "not resident in the UK" and those are well understood expressions.

"Resident outside the UK" is unusual, but not unknown. Examples are:

Term: Definition (in short)	**See**
Person abroad: a person who is resident outside the UK	48.5
Foreign employer: body of persons resident outside UK & not resident in UK	34.15
Offshore fund: mutual fund constituted by body corporate resident out of UK	App. 66.15
IHT deduction for liability to person resident outside the UK	80.5.3

"Resident outside the UK" is not the same as "not resident in the UK" because a person may be dual resident (resident in and out of the UK).

[76] See 9.18 (Tie-breaker: Mutual agreement).

> **ITH358 Company residence: incorporation rule: effect of the rule**
> The incorporation rule takes precedence over the case law rule for UK incorporated companies. But it does not displace the case law rule which remains the rule of residence. Nor was there any attempt to enshrine the case law rule in statute so there is still no comprehensive statutory definition of residence. The case law rule is the only rule for companies incorporated outside the UK. If residence outside the UK is mentioned without any qualification, for example in ICTA88/S293 (2) 'resident in the UK and not resident elsewhere',[77] then, even for a UK incorporated company, 'resident elsewhere' means centrally managed and controlled elsewhere. Nor does the incorporation rule displace the tie-breaker in a double taxation agreement which may award residence to the other country for the purpose of the agreement.

8.21 Change of company residence

Under the SRT, an individual is resident (or not) for a tax year and not during part of a year.[78] This rule does not apply to a company, which may change residence at any time. But an accounting period ends (and a new one starts) when a company becomes, or ceases to be, UK resident.[79]

I do not discuss the CT exit charge in this work.

8.22 OEIC residence

ITTOIA EN Vol II discusses OEIC residence:

> 50. The definition of an open-ended investment company ... carries a limitation that the company should be incorporated in the UK[80] ... All open-ended investment companies within the definition ... are therefore subject to the company residence rule [the incorporation rule]... The company DTA residence rule] could in theory also apply to make such companies non-resident (as explained in connection with industrial and provident societies).[81]

8.23 Societas Europea/SCE

Post-Brexit, this ceases to be an issue but I deal with it for completeness.

[77] Author's footnote: This provision relates to the business expansion scheme, long repealed.

[78] See 10.1 (Residence throughout tax year).

[79] Section 10 CTA 2009.

[80] See App.66.1.2 (Open-ended investment co).

[81] See 26.17 (Co-operative & community benefit society income).

Prior to 31/12/2020 a SE and a SCE were able to transfer their registered office to and from the UK.

Section 16/17 CTA 2009 are conveniently read side by side:

s.16 CTA 09 Societas Europaea	**s.17 CTA Societas cooperativa Europaea**
(1) This section applies to an SE which transfers its registered office to the UK in accordance with Article 8 of Council Regulation (EC) No 2157/ 2001 on the Statute for a European company (Societas Europaea).	(1) This section applies to an SCE which transfers its registered office to the UK in accordance with Article 7 of Council Regulation (EC) No 1435/ 2003 on the Statute for a European Cooperative Society (SCE).
(2) The SE is UK resident for the purposes of the Corporation Tax Acts from the time of its registration in the UK.	(2) The SCE is UK resident for the purposes of the Corporation Tax Acts from the time of its registration in the UK.
(3) Accordingly, even if a different place of residence is given by a rule of law, the SE is not resident in that place for the purposes of the Corporation Tax Acts.	(3) Accordingly, even if a different place of residence is given by a rule of law, the SCE is not resident in that place for the purposes of the Corporation Tax Acts.
(4) The SE does not cease to be UK resident merely because it later transfers its registered office from the UK.	(4) The SCE does not cease to be UK resident merely because it later transfers its registered office from the UK.

In short: SEs/SCEs are treated as UK resident if they are:

(1) incorporated in the UK or

(2) incorporated in another Member State, and transfer their registered office to the UK.

In both cases, the SE/SCE could not cease to be UK resident merely by transferring its registered office out of the UK. But they could cease to be UK resident under the DTA residence rule.

8.24 Company residence: Critique

The INTM has an extract from the ITH:

> **ITH347 Company residence: proposed new management test**
> The central management and control test can be of advantage to the Revenue in the battle against tax haven subsidiaries. We look at this in the next chapter. But in the climate following the abolition of exchange control in 1979 the disadvantages of the case law test were considered

to outweigh any advantages. Wholesale migration of UK resident companies was not a danger whilst the requirement for Treasury consent was still in place.[82] But there were other possibilities of exploitation and no guarantee that the requirement for Treasury consent would continue forever.

So in 1981 proposals were made for a statutory definition of company residence which were designed to solve the problems inherent in the test of central management and control. The aim was for a definition which would have allowed us to look at the place where, in every day language, the Head Office was to be found rather than a remote place where ultimate policy decisions might be taken. The very pinnacle of control would have been ignored. In the case of the UK subsidiary of a United States parent company, for example, the purpose was to look at the activity of the UK board even though it might act under the de facto control of the United States parent. What was really being attempted was to cut level three - where it was distinguishable - out of the reckoning.

ITH349 Company residence: proposed new management test: abandoned

That kind of approach to a new test would have linked residence to a less mobile level though it was never supposed that it would have solved all the problems. It may have solved some of the loss-making problems like *Unit Construction* itself, but it certainly would not have solved all of them. The essential object of the proposed statutory definition was to make the law consistent with what in fact we had been doing for a long time. In the event it proved peculiarly difficult to devise a test which would cut out top level management - level three - but not end up at too low a level. In draft legislation it was suggested that 'immediate day-to-day management of the business as a whole' might identify the level of management to which residence should be attached. What was intended was the type of day-to-day management exercised by a managing director but the expression 'day-to-day' was criticised as possibly implying too low a level of management. The difficulty of providing a sufficiently precise definition, which would not require a long period of litigation before the Courts could determine its meaning, was one of the reasons which caused the attempt at a statutory definition to be abandoned - at least for the time being. However, in 1985 an echo of the draft legislation found its way into what became ICTA88/S812(7) - part of the suspended anti-unitary tax legislation held as a sword of

[82] See 8.2.2 (Treasury consent to migration).

> Damocles over companies connected with the unitary states in the United States (see chapter 5 ITH539).

Arnold discusses similar proposals:[83]

> Couzin finds both the place-of-incorporation and the central management and control tests vulnerable to manipulation by taxpayers. He suggests that consideration should be given to tests based on the location of executive (day-to-day) management of the corporation or the main business operations of the corporation. My initial reaction is to wonder why, even if these tests are better than the existing tests,[84] it is necessary to have a single test. Our current test is a combination of central management and control and place of incorporation. In principle, I have no difficulty adding other tests so that a corporation might be taxable on its worldwide income if
>
> - it is incorporated in Canada,
> - its central management and control are in Canada,
> - the executive (day-to-day) control is exercised in Canada,
> - the majority of the corporation's shareholders are resident in Canada,
> - a substantial or controlling shareholder is resident in Canada, or
> - the corporation has substantial business operations in Canada.
>
> In practice, however, I suspect that such supplementary tests would have little positive impact on the Canadian tax net... in most of these situations, the corporation will also be resident in another country, and the tiebreaker rule in the treaty will often work in favour of the other country. In many cases, therefore, the treaty... will effectively negate the addition of supplemental residence rules. If the tie-breaker rules do not resolve the dual-residence conflicts, unrelieved double taxation becomes a serious concern.

[83] Arnold, "A Tax Policy Perspective on Corporate Residence" [2003] Canadian Tax Journal 1559 at p.1562. *https://www.fcf-ctf.ca/ctfweb/Documents/PDF/2003ctj/2003ctj4_arnold.pdf*

[84] Footnote original: Superficially, it is not readily apparent why these tests are preferable to the existing tests. Executive management is probably as susceptible to manipulation as is central management and control. The executive management test provides less certainty than the place-of-incorporation test. The principal-place-of-business test is not susceptible to manipulation, and it has the virtue of establishing the residence of a corporation exclusively in one country. However, a principal-place-of-business test relies heavily on the facts in a particular case and is therefore uncertain in application. In my view, the type of test of corporate residence adopted by Canada is not as important as international consensus on a particular test.

8.25 Company resident nowhere

The INTM has an extract from the ITH:

> **ITH445 Company residence: nowhere companies before incorporation rule**
> Before looking at the consequences of the incorporation rule of residence, it is convenient to consider briefly the phenomenon of the UK registered non-resident 'nowhere' company before 1988. It was a product not so much of the central management and control test as of the absence of an incorporation rule.
> A 'nowhere' company is not subject to tax on worldwide income anywhere and is unlikely to suffer tax at all. In the 1970s, foreign operators began to realise that the UK provided an ideal opportunity for such companies. Traditional tax-haven countries such as the Channel Islands and Isle of Man have provided tax shelters for companies incorporated but not having real activity there on payment of a fee. In the UK there was no fee - only the cost of setting up and keeping the company on the register. All the operators had to do was to make sure that there was nothing like management and control or trading activity or income here. There was the added advantage of the respectability of UK incorporation. Before other countries got wise to the ploy they might even have assumed the company to be taxable here. Until 1979, exchange control was something of a hindrance ...
> Our own attempts at getting information met with little success. Not only would this information identify the exceptional case of UK resident ownership, it could be passed on to the countries of the beneficial owners where this exchange of information is authorised by a Double Taxation Agreement. But some companies operating in low tax areas such as the Middle East used the UK for the benefit of recourse to its law and had no reason to hide anything. Representations on behalf of these companies were partly responsible for stifling the proposal for an incorporation rule in 1981. By 1988 the number of dubious companies had increased enormously, the Revenue authorities of some countries were complaining at our acquiescence and it was suspected that a number of companies were being used for criminal activities.
> **ITH446 Company residence: successors to the nowhere company**
> ... 'Son of nowhere' companies have appeared in two main guises. In one there is a UK incorporated and, therefore, resident company. But the company is alleged to carry on all its activities as trustee or nominee and only the trustee's remuneration appears in the accounts. As with the original nowhere company, our difficulty is getting at the structure behind the company. The fact that the company is resident and,

therefore, within our taxing charge gives us a stronger lead. International Division is interested to see any such cases.

The other ploy to replace the nowhere company is the 'nowhere' limited partnership. There is more about this in chapter 16 on Foreign Partnerships (ITH1639).

Even after 1993 it is not quite impossible to come across a UK incorporated nowhere company although it will not be one of the type so far considered. A UK incorporated company which migrated with special Treasury consent and continues to be outside the incorporation rule may have become a nowhere company. It does not have to be managed and controlled in the same country or carry on the same business as when it migrated although it does of course have to comply with all the conditions for indefinite exception from the incorporation rule.[85]

8.26 Loss importation

The INTM has an extract from the ITH:

ITH419 Company residence: loss importation

We now come to two problems associated with the central management and control test which we have with companies which become or remain resident here. The first problem is referred to as loss importation. When an overseas subsidiary of a UK parent is making losses it is relatively easy for the parent to ensure that the central management and control of the subsidiary is in the UK even if the whole of its operations are overseas. The losses become available for group relief. The *Unit Construction* case gives an early example of this (chapter 3 ITH323). In those days relief was obtained by way of a deduction for subvention payments. Although the mischief is more obvious if the subsidiary only becomes resident when it starts to make losses, it can also be seen when the subsidiary is resident from the beginning. And there are also possible problems when losses are incurred not by a subsidiary but by an overseas branch of a UK resident company.

ITH420 Company residence: loss importation: the branch

The root of the problem is this. When two countries tax the same source of trading income the treaties, or unilateral relief, soften the impact of double taxation. But where there is a loss both countries may give relief for the loss. The simplest example is that of the genuine branch. In the following illustrations the company is resident in the UK and has a trading branch in country X. There is a standard Double Taxation

[85] See 8.5 (Pre-1988 companies).

Agreement with country X so both countries tax the profits and the UK gives credit. The tax rates are illustrative only.

ITH421 Company residence: loss importation: the branch: example

EXAMPLE 1

THE BRANCH	THE BRANCH	THE BRANCH
Branch result	Branch result	Branch result
Year 1	Profit	£1,000
Year 2	Loss	£(1,000)
Year 3	Profit	£1,000

	UK	Country X
Year 1	£	£
Profit	1,000	1,000
Tax @ 33%	330	330
Credit	-330	
Net Tax	NIL	330
Year 2		
Loss relief @ 33%	-330	
(reduces Case 1)		
Year 3		
Profit	1,000	1,000
Loss relief		-1,000
Tax	330	
Net Tax	330	NIL

Both countries give loss relief and the result is fair. The relief that the UK gives in year 2 is recouped in year 3, so there is nothing essentially offensive in the idea that we give relief for losses which have also been relieved abroad. The next example is of the same situation except that the losses in country X are so large that the operation there is closed down.

ITH422 Company residence: loss importation: branch closes down: example

EXAMPLE 2

THE BRANCH	THE BRANCH	THE BRANCH
CLOSE DOWN -	CLOSE DOWN -	CLOSE DOWN -
Branch result	Branch result	Branch result
Year 1	Profit	£1,000
Year 2	Loss	£1,000
Year 3	Profit	(£10,000)

	UK	Country X
Year 1	£	£
Profit	1,000	1,000
Tax @ 33%	330	330
Credit	-330	
Net Tax	NIL	330
Year 2 as Year 1		
Net Tax	NIL	330
(reduces Case 1)		
Year 3		
Loss relief @ 33%	-3,330	NIL

Country X may have some provision for allowing the loss in part by carry- backwards, but such a large loss is probably in the nature of things not totally relievable in country X which is taxing only the branch profit. The UK, on the other hand, will give relief either by setting against other Case I profit or by group relief. Thus we will have given relief which will never be recouped but that is arguably a consequence of asserting taxing rights on the basis of residence. The company might argue that overall the result is fair. Overall there is a loss of £8,000 (£10,000-£2,000), tax has been paid on £2,000 in country X and the UK has given relief on £10,000 so that in total only £8,000 has been relieved.

ITH423 Company residence: loss importation: the subsidiary

Next we have a similar situation but the trading operations are carried on wholly in country X by a subsidiary which is incorporated there and taxed as a resident there. If the subsidiary is managed and controlled in the UK it will also be taxed as resident here unless in a treaty case FA94/S249 applies to deem the company to be not resident in the UK. If country X allows relief for losses only by way of carry forward, then on the same results, the tax position of the subsidiary in the UK will be the same as that of the branch in examples 1 and 2, except that relief for losses will be by way of group relief.

But for a subsidiary company there are other possibilities. The subsidiary may be part of a sub-group in country X and that country may also give loss relief against group profits. It may be possible for the subsidiary to move its residence in and out of the UK so as to get the best advantage from the provisions for tax credit and loss relief. The following examples illustrate these possibilities.

ITH424 Company residence: loss importation: the subsidiary: example 3A

SUBSIDIARY RESIDENT IN COUNTRY X: Subsidiary results	SUBSIDIARY RESIDENT IN COUNTRY X : Subsidiary results	SUBSIDIARY RESIDENT IN COUNTRY X : Subsidiary results
Year 1	Profit	£1,000
Year 2	Loss	£(1,000)
Year 3	Profit	£1,200

The subsidiary is also resident in the UK all years. Country X gives group relief for year 2.

	UK	Country X
Year 1	£	£
Profit	1,000	1,000
Tax @ 33%	330	330
Credit	-330	
Net Tax	NIL	330
Year 2		
Group relief @ 33%	-330	-330
Year 3		
Profit	1,200	1,200
Tax	396	396
Credit	-396	
Net Tax	NIL	396
Overall Tax	-330	+396

ITH425 Company residence: loss importation: the subsidiary: example 3B

The subsidiary is not UK resident in Year 1; it is UK resident Years 2 and 3. It carries back losses in country X.

	UK	Country X
Year 1	£	£
Profit		1,000
Less Loss		Carried back 1,000
Net Tax	NIL	NIL
Year 2		
Group relief @ 33%	-330	NIL
Year 3		
Profit	1,200	1,200

Tax	396	396
Credit	-396	
Net Tax	NIL	396
Overall Tax	-330	+396

ITH426 Company residence: loss importation: the subsidiary: example 3C

The subsidiary is not UK resident Year 1; is resident Year 2; is not resident Year 3. It carries forward losses in country X.

	UK	Country X
Year 1	£	£
Profit		1,000
Tax @ 33%		330
Year 2		
Group relief @ 33%	-330	NIL
Year 3		
Profit		1,200
Less Loss		- 1,000
		200
Net Tax	NIL	66
Overall Tax	-330	+396

In all three examples A, B and C the UK gets no tax but gives relief on £1000 & 33%. The company makes net overall profits of £1200 but pays tax on only £200 if group relief is taken into account.

ITH427 Company residence: loss importation: the subsidiary: example 3D

If, in example 3C, the company remained resident in Year 3, we would expect the tax to be

	UK	Country X
Year 1	£	£
Profit		1,000
Tax @ 33%		330
Year 2		
Group relief @ 33%	-330	NIL
Year 3		
Profit		1,200
Less Loss		- 1,000
		200

Net Tax	NIL	66
Overall Tax	-330	+396

But prior to FA94/S249 the company may have turned to the treaty between the UK and country X. It would have argued that its place of effective management is in country X and that that is the country, and the only country, of which it is a resident for the purposes of the treaty (see chapter 5 ITH515). It may have a permanent establishment in the UK (the offices where the directors meet) but there is hardly any profit attributable to that. In such circumstances it is unlikely that we would be able to persuade country X that the place of effective management is in the UK or that we could tax any profit. So the result would be

	UK	Country X
Year 3	£	£
Tax	NIL	66

just as in example 3C.

ITH 427 Company residence: loss importation: the subsidiary: example 3D

In all the variations of example 3 the key factor is that the company is resident in the UK in the year of loss. Under the central management and control test that is reasonably straightforward to achieve. But following FA94/S249 if there is a treaty between the UK and country X containing a company residence tie-breaker, we will be able to look to the test in the tie- breaker in determining residence for UK tax purposes. If the tie-breaker is based on the location of effective management which is shown to be in country X in year 3, then it is likely that effective management in year 2 is also in country X.

ITH429 Company residence: loss importation: branch and subsidiary

One final comment on example 3: looking back to the branch position referred to in example 2, that obviously cost the Revenue money and it was suggested that it was, arguably, not offensive. It is the inevitable consequence of asserting taxing rights over income when the primary taxing rights lie with another country. The same sort of thing can occur in the context of an overseas subsidiary becoming resident in the UK during the period of large losses leading to the closure of its business. However, that is different from the branch situation. The benefits of loss relief in the UK do not then arise as an inevitable consequence of the UK's more general assertion of taxing rights over the entity but rather because the company, having chosen to put its profits out of range of UK tax, later endeavours to reverse the consequences of its own action.

Such claims merit critical examination.

ITH430 Company residence: loss importation: effect of Section 249

As we have seen, where a company is resident in the UK under the case law test and also resident in another country with whom we do not have a treaty, or where the treaty lacks a company residence tie-breaker, the company may be able to manipulate its residence status to its advantage. Where, however, it is also resident in another country with whom we have a treaty containing a tie- breaker the effect of Section 249 is to make manipulation more difficult. It will generally be less feasible to move the location of effective management.

It might be asked why we did not legislate for all dual resident companies. But this would have come close to introducing a new statutory company residence rule. The 1994 legislation was not directed specifically at loss importation but instead at removing the anomalies attributable to the mismatch between residence under domestic law and residence under a treaty.

ITH437 Company residence: getting profits back tax free

The second problem for specific mention is loosely referred to as profit importation. It is a fundamental of our tax system that we tax a UK company under Case V if and when it receives a dividend from an overseas subsidiary. There are other tax systems where this is not so - the exemption method countries. But as a matter of policy we do not have such an approach, although, where the subsidiary is a genuine trader, we accept its right to decide whether to retain its profits or to send home dividends. It follows that we must be concerned if companies devise ways of getting profit back to this country tax free. Subsection (1)(c) and (d) of Section 765 which is considered in chapter 13, is concerned with devices of that sort and chapter 13 also looks at the problem of ‘upstream loans’ - from overseas subsidiaries to UK parents. Our concept of residence too may be manipulated in a way which has the effect of bringing home profit tax free.

ITH438 Companies: getting profits back tax free: inward migration

All that happens is that a non-resident subsidiary company - full of lowly taxed profit - becomes resident in the UK. The fact of becoming resident here does not involve that company or its parent in any liability to UK tax in respect of the profit, and once the subsidiary is here it is quite a simple matter to make that profit available to the parent. There are two common ways of achieving this.

1 The subsidiary company declares a dividend which, since it is now resident, is intra-group.

The subsidiary makes a loan to its parent.

The parent company thus has the money in its hands and, tax apart, is in the same position as it would have been in, had the subsidiary company declared a dividend while it was non-resident. Some very large examples of this device have been seen. The tax-haven legislation may have reduced the amounts of lowly taxed profits available for importation and thus the need for legislative action. But capital gains and other profits which escape the CFC provisions may still be worth bringing in this way. International Division would like to be kept informed of cases detected in Districts. It is sometimes possible to make a challenge either by showing that the company was resident when the gains or other profits arose, or by showing that the company has not become resident in the UK. In a treaty case, following FA94/S249 it will normally be necessary for the company to show that effective management is now exercised in the UK.

ITH442 Company residence: advantage of central management/ control test

The consequences of the central management and control test are not all negative for the Revenue. Once we had recognised the significance of the Unit Construction case and had set out our views in the 1983 Statement of Practice, it was possible to take a firmer line on tax-haven subsidiaries. We could argue that central management and control lay in the UK either with the parent or with any UK resident directors of the subsidiary. We have had some success in bringing into the UK tax net tax-haven profits in this way.

Since 1984 the profits of some companies can be taxed under the tax-haven (controlled foreign companies) provisions, but these provisions do not afford complete coverage. The assiduous use of a mixer company to pass dividends to the UK (see chapter 7 ITH728) can further reduce the effectiveness of the provisions. So in CFC cases, as in others, residence will remain an important issue. The residence position should always be borne in mind when an overseas subsidiary is reviewed under the CFC provisions. If arguments on residence are likely to get to Commissioners the case requires an exhaustive review of the facts. Even so, much may depend on oral evidence before Commissioners. It is, therefore, not surprising that cases tend to be settled by some compromise agreement. Nevertheless some settlements have been very substantial indeed. Important cases are usually worked by or under the supervision of International Division who like to hear of potential cases at an early stage.

CHAPTER NINE

TREATY-RESIDENCE

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Cross references

The following topics are considered elsewhere:

Topic	**See para**
Introduction to DT reliefs	107.1

9.1 Treaty-residence: Introduction

The starting point is to note that there are (at least) three distinct concepts of residence.[1] We need terms to describe them, and I coin the following terminology.

Term	**Meaning**
UK tax residence/non-residence:	Residence as defined in UK tax law
UK tax-resident[2]	UK resident under UK tax law definition(s)
UK tax non-resident	Not UK resident under UK tax law definition(s)

[1] See 6.1 (Concepts of residence).

[2] If the context is clear (because other forms of residence are not being considered) one can abbreviate these terms to tax-resident or non-resident.
If looking at the position of an individual, one might use the terms SRT-resident and SRT non-resident; but that is only apt for individuals, as the SRT only applies to individuals.
In earlier editions I used the term "UK-law UK resident" or "UK law non-resident".

Treaty-residence:	Residence as defined in a DTA
Treaty-resident in the UK	Resident of UK within DTA definition
Treaty-resident in foreign State	Resident of foreign State within DTA definition[3]
Treaty-resident under art 4(1)	Resident under DTA art 4(1) (before tie-breaker)
Foreign-tax residence	Residence as defined in some foreign tax law
Domestic law	UK law, or a foreign State law (as opposed to treaty or international law)

This chapter discusses treaty-residence as defined in:

- The OECD Model
- The USA/UK DTA (which is similar but not identical)

I also consider some other treaties. In any particular case it will be necessary to review the terms of the relevant treaty.[4]

DTAs refer to a resident *of* a treaty State and UK tax law refers to a person resident *in* the UK; but nothing turns on the choice of preposition. I guess that OECD Model wording was influenced by the French version *résident d'un État contractant.*

9.2 Treaty/UK-tax residence compared

In general, a person cannot be treaty-resident in two treaty states: treaty tie-breaker tests usually require treaty-residence to be in one State alone.

However a person who is UK tax-resident may be resident in another State under the UK law, foreign law, or DTA definitions of residence. That is, UK tax-residence does not preclude residence elsewhere.

In particular, a person may be UK tax-resident while treaty-resident in a foreign State. Treaty-residence in a foreign State does not preclude UK tax-residence (except for companies[5]).

The INT Manual provides:

> **INTM154020. Dual residents** [Sep 2021]
> ... Although the agreement overrides some of the normal consequences of being a UK resident, it does not, in the case of an individual, override the fact of UK residence itself for purely domestic law purposes. Even though an individual may be resident for agreement purposes elsewhere,

[3] One could use the term "treaty-resident outside the UK". Statute sometimes calls this "treaty non-resident" but I think my term is clearer.

[4] See 9.18.6 (A cautionary tale).

[5] See 8.19 (DTA residence rule).

they (as a resident of the UK for UK tax purposes) still have to complete returns and fulfil any similar obligations imposed by the Taxes Management Act.

Sometimes this rule works in favour of the taxpayer; for instance, it may preserve the right to IT personal allowances (which are conferred on UK tax-residents but not always available to non-residents).[6] Mostly however the rule works in favour of HMRC. For instance, a year in which an individual is UK tax-resident counts for the purposes of:
(1) the long-term residence test for the remittance basis claim charge;[7]
(2) deemed domicile (the 15-year residence rule);
even though the individual is treaty-resident in a foreign State throughout the year.

The same rule is proposed for FIG relief from 2025.[8]

In the Canadian case *Black v The Queen*[9] the taxpayer was Canadian tax-resident but treaty-resident in the UK under the tie-breaker. He argued that (contrary to the view taken here) treaty-residence outside Canada precluded his being Canadian tax-resident. I do not see how this was properly arguable: under the treaty, treaty-residence was defined only *for the purposes of this Convention.* The court agreed, though it took 20 pages to set out the arguments behind that conclusion.

9.3 Residence under art 4(1)

Art 4(1) OECD Model	**Art 4(1) USA/UK DTA**
	Except as provided in paragraphs 2 and 3 of this Article,
For the purposes of this Convention, the term “resident of a Contracting State” means	the term “resident of a Contracting State” means, for the purposes of this Convention,
any person who, under the laws of that State, is liable to tax[10] therein	any person who, under the laws of that State, is liable to tax therein by

[6] See 44.8 (Personal allowances under DTAs).

[7] See 17.12.12 (Individual treaty non-resident).

[8] See A1.2.3 (The test of residence).

[9] 2014 TCC 12 *https://www.canlii.org*

[10] The 1963 draft Model referred to “taxation”; the 1977 Model changed the word to “tax”. But there is no difference.

by reason of his domicile,[11] residence,[12] place of management or any other criterion of a similar nature...[13]	reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature...

I describe a person who is within this paragraph as **"resident of a State under art 4(1)"**.

The USA/UK DTA is similar to OECD Model but:

(1) Citizenship is added. This reflects the US rule that US citizens are liable to US tax regardless of residence.

(2) Place of incorporation is added. This reflects the US rule that US incorporated companies are liable to US tax regardless of residence.[14]

(3) "Person" in the USA/UK DTA has a non-OECD Model definition.

(4) The USA DTA has further rules:

Art	**Topic**	**See**
4(2)	Green card holder	9.26.1
4(3)	Tax exempt organisations	9.27

For the purposes of discussion it is convenient to abbreviate the phrase "domicile, residence, place of management or any other criterion of a similar nature" to "UK-law residence"; in a UK context this is a permissible shorthand since in general it is UK-law residence (not the other criteria mentioned) which determines whether a person is liable to UK tax.

There are then four requirements to be a resident of a State under art 4(1):

[11] The word "domicile" here may be understood to have a meaning along the lines of the English common law concept, or the civil law concept; but it does not matter since both meanings are included, one way or another, in the expression "domicile, residence, place of management or any other criterion of a similar nature".

[12] "Residence" here has its domestic law meaning (in my terminology, tax-residence).

[13] The words which follow deal with States and pension schemes, discussed separately below.

[14] The reference to place of incorporation is strictly otiose, on the basis that place of incorporation is equivalent to domicile, or is a criterion of a similar nature; though it may be relevant in a treaty with a country with a different concept of domicile, and it is sensible to use a single form which works in all jurisdictions.

Rule	**See**
There must be a "person"	9.4
The person must be liable to tax in the State	9.5
The person must be domestic-law tax resident in that State	
Domestic-law residence must be the reason for liability to tax	9.6

These are conceptually distinct issues, but they may overlap in practice.

Under art 4(1):

(1) A person may be a resident of one treaty State alone, in which case they are treaty-resident in that State.

(2) A person may be a resident of both treaty states, in which case tie-breaker tests discussed below are applied to identify the State of treaty-residence.

So far as the UK is concerned, a person who is UK tax-resident is in principle a resident of the UK under art 4(1).

9.4 Treaty-person

The first requirement of treaty-residence is that there must be a "person" and one must identify:

(1) Who that person is

(2) Whether that person is an individual or not (because different tie-breaker tests apply)

(3) Whether that person is liable to tax

9.4.1 *Person: Treaty definition*

The use of the word "person" always requires some care.[15]

The term is defined (after a fashion).

Art 3(1) OECD Model	**Art 3(1) USA/UK DTA**
For the purposes of this Convention, unless the context otherwise requires:	[Identical]
a) the term "person" includes an individual,	[identical]
[*no equivalent*]	an estate, a trust, a partnership,

[15] See App.2.6 (Person).

a company[16] and any other body of persons; [17]	a company, and any other body of persons;

I refer to a person within this definition as a **"treaty-person"**. But the definition does not take us very far.

Individuals (who are "natural persons") are straightforward; but trusts, partnerships and some other entities are not mentioned in the OECD model and are more problematic. They are better considered individually, rather than as a single topic:

Entity	**See para**
Trust	9.21
Partnership	9.22
Pension scheme	9.24
Stichting	90.40.4
Cell co	90.50.2

The USA/UK DTA is different from the OECD Model form in that estates, trusts and partnerships are included. in the definition of person.

9.5 "Liable to tax"

Assuming we have identified a person, we move on to consider whether that person is "liable to tax". This should be regarded as a technical term in the OECD Model, and it is sometimes appropriate to write it in scare quotation marks.

9.5.1 *Liable to which tax?*

"Tax" is not defined as such, but the definition follows from art 2 of the DTA (Taxes Covered).[18] Article 2 France/UK DTA is typical:

> (1) The taxes which are the subject of this Convention are:
> (a) in the case of the United Kingdom:
> (i) the income tax;
> (ii) the corporation tax;
> (iii) the capital gains tax.

In order to be a resident of the UK, the person is must be liable to IT, CT

[16] See 30.15.4 (Company: DTA definition). But even if an entity is not a company, as defined, it is still a treaty-person if it is a "body of persons".

[17] See 9.22.1 (Partnership a treaty-person).

[18] See 107.13 (Taxes Covered).

or CGT. Liability to other UK taxes does not count. In this chapter references to tax are to those taxes.

"Liable to tax" means liable to any of the taxes covered by the DTA. This is illustrated by a case concerning the Mauritius/UK DTA. Art 3(1) of this DTA provides:

> (1) The existing taxes to which this Convention shall apply are...
> (b) in Mauritius:
> (i) the income tax;
> (ii) the capital gains tax (*morcellement*);

The trustee was liable to income tax in Mauritius by reason of its residence. That was sufficient to make them a resident of Mauritius under art 4(1); even though:

(1) the trustee was not liable to CGT in Mauritius; and
(2) the taxpayer in the UK claimed relief for CGT, under the capital gains article of the DTA, not IT relief[19]

9.5.2 *Narrow exemption*

It is useful for discussion to distinguish:

(1) **Narrow exemption**: exemption[20] from tax, as a result of which a person does not pay tax in some circumstances, even quite wide circumstances, but there are at least some circumstances where the person may pay tax.
(2) **General exemption**: there are no circumstances (other than a change of law) in which the person may pay tax.

A person may be "liable" to tax in a State (and so qualify as treaty-resident in the State) even if they enjoy narrow exemptions, and do not in fact actually pay any tax. Provided the taxpayer is "liable to tax", DT relief is in principle available even in respect of income/gains on which the person is not liable to tax.

Loss reliefs and DT reliefs are obvious examples of narrow exemptions. SP 1/90 provides:

> 7 ... a company is regarded as liable to tax in a particular territory if it is within the charge there even though it may pay no tax because, for example, it makes losses or claims double taxation relief.

[19] *HMRC v Smallwood* [2010] EWCA Civ 778 at [13]. The taxpayer lost for other reasons.

[20] or relief: the two words are synonymous.

Charity and pension fund reliefs are examples of narrow exemptions. The International Manual provides:

> **INTM162040 whether the customer is a resident of the UK** [Sep 2021]
> The phrase 'liable to tax' means that they only have to be within the general scope to tax. Charities and pension funds can therefore be regarded as resident even if their income is exempt from tax.

Similarly, HMRC, "Double Taxation Pension Scheme Consultation Document" provides:[21]

> The generally held view is that pension funds are tax resident in a jurisdiction for tax treaty purposes, even if they do not pay tax.[22] The UK agrees with this and therefore regards pension funds as resident for the purposes of tax treaties where they are located and able to access treaty benefits.

OECD Commentary leaves this point slightly open. It provides:

> 8.11 Paragraph 1 refers to persons who are "liable to tax" in a Contracting State under its laws by reason of various criteria. In many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax. For example, charities and other organisations may be exempted from tax, but they are exempt only if they meet all of the requirements for exemption specified in the tax laws. They are, thus, subject to the tax laws of a Contracting State. Furthermore, if they do not meet the standards specified, they are also required to pay tax. Most States would view such entities as residents for purposes of the Convention ...
> 8.12 In some States, however, these entities are not considered liable to tax if they are exempt from tax under domestic tax laws. These States may not regard such entities as residents for purposes of a convention unless these entities are expressly covered by the convention...

It seems reasonably clear that a UK charity is "liable" to UK tax since charity exemptions do not apply to all types of income, and are restricted

[21] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525399/Double_Taxation_Treaty_Passport_scheme_review.pdf* (2016) para 2.18.

[22] The document refers to para 8.6 OECD commentary on art 4, for which, see 9.5.5 (Liable at 0%: Jersey co).

by numerous anti-avoidance rules. The same applies to UK pension funds (though these are now dealt with expressly.)[23]

Perhaps the reservation expressed in para 8.12 concerns foreign entities which qualify for a general exemption under the foreign state tax law; see below.

The remittance basis is another example. A remittance basis taxpayer is "liable to tax" (and so a resident of the UK under art 4(1)).[24] Where a State operates a remittance basis, treaty relief is generally restricted to remitted (taxable) income.[25] So the fact that a remittance basis taxpayer is "liable to tax" does not much matter in practice, except so far as it affects the drafting of treaties. But it illustrates my point that a person may be "liable to tax" without actually paying any tax, because of (what I call) narrow exemptions.

9.5.3 *General exemption*

Different considerations apply where:

(1) An entity (unlike a UK charity/pension fund) has an general, unqualified exemption so it does not pay any tax under any circumstances. An example is a UK Local Authority, which is entirely exempt from UK tax.[26]

[23] See 9.24 (Treaty-residence: Pension fund).

[24] This is, I think, self-evident; but if authority is needed:
(1) The Canada Revenue Authority take this view: "The Department takes the view that individuals who are subject to tax on a remittance basis are liable to tax on a world income basis. Accordingly, persons who are liable to tax in a contracting state on a remittance basis, would not in our view, be precluded from being resident there for the purposes of paragraph 1 of the residence article of a convention." See Canada Revenue Authority, "Income Tax – Technical News No. 16" (March 1999).
(2) OECD Commentary also assumes that is right; see 107.21 (Remittance basis income).
See Sykes [2021] GITC Review p.54 criticising an Italian case which held that a UK remittance basis taxpayer was not treaty-resident in the UK.

[25] See 107.21 (Remittance basis income). For completeness: The issue is one for foreign tax authorities rather than HMRC. It would matter for UK tax only if the foreign State operated a remittance basis; the only examples of which I am aware are Ireland and Japan (in respect of remittances from a branch to head office in Japan). But the DTAs with those states contain the standard form restriction so that unremitted (untaxed) income does not qualify for DTA relief.

[26] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), chap 45 (Local Authorities).

(2) A person is resident in a jurisdiction which does not impose any tax.[27]

I refer to that as a **"wholly exempt person"**.

Is a wholly exempt person "liable to tax"?

Of course a wholly exempt person *could* be taxed, if the State decided to change its law, and that would be in accordance with the international law principle that a State may tax its residents. One could construe "liable to tax" so widely as to include such a case. On this view, "liable to tax" merely means within the scope of a taxing jurisdiction, within the scope of a state's right to tax. I refer to that as the **"wide view"**.

The wide view might be regarded as an application, or small extension, of the principle that a person who qualifies for narrow reliefs is still "liable to tax". However:

(1) It does not seem to fit the natural meaning of the words.
(2) It does not fit with the object of a DTA, to avoid double taxation.
(3) The well-established principle that narrow tax exemptions do not matter does not entail accepting the wide view. There is a difference between narrow and general exemptions, which is generally a significant difference, even if in some cases the difference may only be small (see the discussion on Jersey companies below).
(4) The well-established principle that transparent bodies are not "liable to tax" is not logically consistent with the wide view.

Crown Forest Industries v Canada, discussed below, is not consistent with the wide view. But international case law is inconsistent. (Perhaps that is not unusual, in relation to DTAs). On the other side is *Assistant Director of Income Tax v Green Emirate Shipping & Travels*.[28] The question was whether a shipping company was treaty-resident of UAE under the then India/UAE DTA:

> ... being 'liable to tax' in the contracting state does not necessarily imply that the person should actually be liable to tax in that contracting state by virtue of an existing legal provision but would also cover the cases where that other contracting state has the right to tax such persons irrespective of whether or not such a right is exercised by the contracting state.[29]

[27] It is difficult to see why a DTA should be made with a State which does not impose tax, but a State with a DTA might perhaps repeal the tax leaving the DTA in force.

[28] 9 ITLR 1.

[29] 9 ITLR 1 at p.10.

HMRC have argued in favour of the wide view. In *Weiser v HMRC*[30]:

> 22. ... There is, [HMRC] submitted, an internationally recognised distinction ... which gives the expression "liable to tax" a broader meaning that the expression "subject to tax". She argued that "liable to tax" is understood to require only an abstract liability to taxation on income in the sense that a contracting state may exercise its right to tax the income in question (whether or not the exercise of that right actually results in an amount of tax becoming payable).

But this was not a case where the issue actually arose, and I wonder if HMRC realised the full implications of their position.

The current OECD Model states expressly that the State and its subdivisions and local authorities are residents of the State.[31] Before then, they were generally regarded as treaty-resident, which implies they were "liable to tax" and so perhaps supports the wide view. But that is a very special case.

In conclusion: It is considered that the wide view is not one that the UK courts would find attractive.

9.5.4 *Swiss forfait taxpayer*

SP 1/90 provides:

> 7. A company has to be liable to tax on income so that a company which is, for example, liable only to a flat rate fee or lump sum duty does not fulfil the test.

The Swiss forfait regime (sometimes translated as "lump-sum taxation") is a tax that is usually calculated at five times the annual rental value of the individual's home in Switzerland (subject to a certain minimum amount). Forfait taxpayers do not pay tax on their worldwide income or on income from securities.[32]

Some Swiss DTAs deal expressly with the treaty-residence status of forfait taxpayers. For instance, art 4 Switzerland/Canada DTA follows OECD Model form for individuals, but art 4(5) provides:

[30] [2012] UKFTT 501 (TC). For other aspects of this case, see 108.13 ("Subject to tax").

[31] See 9.7 (State/subdivision/local authority).

[32] See Sigg and Luongo, "The Swiss lump-sum taxation regime: after the storm comes the calm?" [2015] JITTCP 169.

> 5. Where by reason of the provisions of paragraphs 1 and 2 an individual would be a resident of a Contracting State but is not subject in that State, with respect to all income generally taxable from sources from the other Contracting State, to the generally imposed income taxes, then such individual is not a resident of the first-mentioned State for the purposes of this Convention.[33]

USA/Switzerland DTA Technical Explanation provides:

> Paragraph 5 provides that certain individuals are not treated as Swiss residents because they are not liable for tax on the same basis as other Swiss residents. This rule is necessary because Switzerland permits certain alien residents to elect not to be subject to the regularly applicable income tax on residents and instead to pay the "forfait tax." The base for the forfait tax is a multiple of rental value, deemed rental expenses or living expenses of the electing resident. It also includes all income that benefits from a reduction of tax under Swiss income tax conventions. A person who would otherwise be treated as a resident of Switzerland will not be considered a resident of Switzerland for purposes of the Convention if the person makes an election under Swiss law not to be subject to the income tax on residents.[34]

A forfait taxpayer is liable to tax of some kind, and, it appears, they pay it by reason of their residence. The question is whether the forfait tax is a "tax" as defined in the Switzerland/UK DTA.[35] If not, the taxpayer is not treaty-resident in Switzerland.

However it would follow that all these express provisions are unnecessary;[36] and Obrist & Pfister record the opposite view as generally held:

[33] *https://laws-lois.justice.gc.ca/eng/regulations/SI-98-94/page-2.html*

[34] Department of the Treasury Technical Explanation of the USA/Switzerland DTA *http://www.irs.gov/pub/irs-trty/swistech.pdf*

[35] Article 2(1) Switzerland/UK DTA provides:

The taxes which are the subject of this Convention are ... (b) in Switzerland: the federal, cantonal and communal taxes on income (total income, earned income, income from capital, industrial and commercial profits, capital gains and other items of income)	Les impôts auxquels s'applique la présente Convention sont ... (b) en Suisse: les impôts fédéraux, cantonaux et communaux sur le revenu (revenu total, produit du travail, rendement de la fortune, bénéfices industriels et commerciaux, gains en capital et autres revenus)

[36] But this is not a powerful argument; see 107.10.6 (Variations between DTAs).

> Through [forfait] tax status, only a portion of the individual's worldwide income and wealth is ordinarily taxed. According to most Swiss DTCs, a lump sum taxpayer is generally considered as a resident under the DTCs and can therefore claim relief on his foreign source income.[37]

9.5.5 *Liable at 0%: Jersey co*

Section 123C [Jersey] Income Tax Act 1961 provides:

> (1) This Article applies to a company –
> (a) which is regarded as resident in Jersey, or which has a permanent establishment in Jersey; and
> (b) which is not any of the following –
> (i) a company to which Article 123D applies,
> (ii) a utility company, or
> (iii) a registered person within the meaning of Article 118C, such person being exempt from income tax under Article 118C(9).
>
> (2) Notwithstanding the rate of tax required by Article 1 to be charged for a year of assessment, a company to which this Article applies shall be charged to tax under Schedule D at the rate of 0%.

In short, Jersey companies pay income tax at the rate of 0%. Exceptions are:

- The trade of importing or supplying hydrocarbon oil
- Financial services companies with a PE in Jersey[38]

Is the company "liable to tax" and so treaty-resident in Jersey?

One might say liability at 0% is a liability of some kind, but I see no difference between tax at the rate of 0% and no tax liability. Even if there were thought to be a technical difference, a DTA is not to be technically construed.

One might say that a Jersey company qualifies for a narrow exemption and not a general one. It would be taxable if it was a financial services company. Exemption under the Jersey treaty rests on this somewhat

[37] Maisto (ed) *Residence of Individuals Under Tax Treaties and EC Law* (2010) p.565 (footnotes omitted). A full understanding of the relevant Swiss law would be needed to get to the bottom of this issue.
Sykes [2021] GITC Review p.54 reports that "the Italian authorities believe that an Italian resident paying the Italian flat tax for non-Italian income would be a resident of Italy for treaty purposes."

[38] Section 123CA and 123D [Jersey] Income Tax Act 1961.

slender possibility.

The protocol to the Jersey/UK DTA provides:

> It is understood that the term “liable to tax” in paragraph 1 will be interpreted by the Territories in accordance with the principles set out in paragraph 8.6 of the Commentary on Article 4 of the OECD Model Tax Convention as it read on 15 July 2014.

As at 15 July 2014 the Commentary provided:

> 8.6 Paragraph 1 refers to persons who are “liable to tax” in a Contracting State under its laws by reason of various criteria. In many States, a person is considered liable to comprehensive taxation even if the Contracting State does not in fact impose tax. For example, pension funds, charities and other organisations may be exempted from tax, but they are exempt only if they meet all of the requirements for exemption specified in the tax laws. They are, thus, subject to the tax laws of a Contracting State. Furthermore, if they do not meet the standards specified, they are also required to pay tax. Most States would view such entities as residents for purposes of the Convention (see, for example, paragraph 1 of Article 10 and paragraph 5 of Article 11).[39]

In the view of Revenue Jersey, this ensures that 0% tax paying companies are “liable to tax”.[40]

9.6 Liable: Causation requirement

It is not enough to be liable to tax: the person must be liable *by reason of* one of the specified criteria.

OECD Commentary on art 4(1) provides:

> 8. ... As far as individuals are concerned, the definition aims at covering the various forms of personal attachment to a State which, in the domestic taxation laws, form the basis of a comprehensive taxation (full liability to tax).

9.6.1 *Deemed residence*

OECD Commentary on art 4(1) provides:

> 8. [The definition of treaty-residence in art 4(1)] also covers cases

[39] The text, with insignificant amendments, is now in para 8.11 of the OECD Commentary.

[40] Private correspondence.

> where a person is deemed, according to the taxation laws of a State, to be a resident of that State and on account thereof is fully liable to tax therein (e.g. diplomats or other persons in government service).

An example in the UK would be parliamentarians, who are deemed UK resident.

Domestic law deeming raises interesting questions for DTAs; see too 107.22.1 (Deemed classification).

9.6.2 *By reason of domicile/place of management*

In relation to companies, SP 1/90 provides:

> 6. Territories which impose tax on companies by reference to incorporation or registration or similar criteria are covered by the term "domicile".[41] Territories which impose tax by reference to criteria such as "effective management", "central administration", "head office" or "principal place of business" are covered by the term "place of management".

In *Crown Forest Industries v Canada*[42] the question was whether a company was a resident of the USA for the purposes of the US/Canada treaty. The definition was not materially different from the OECD Model.

The company was incorporated in the Bahamas. Its office and place of business was in the US. Under the UK central management and control test, the company would no doubt be US resident. But the US marches to a different drum. It does not tax foreign incorporated companies on worldwide income even if management/control is in the US. Instead the US statute provided:

> A foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable ... on its taxable income which is effectively connected with the conduct of a trade or business within the United States.

The company was engaged in a trade in the US, and so would have paid US tax on its income; but it qualified for a narrow exemption as an international shipping company.

The Canadian Supreme Court accepted that the company was "liable to tax" (despite the shipping exemption, which was, in my terminology, a

[41] See 4.25 (Domicile of company).

[42] [1995] 2 SCR 802.

narrow exemption). However the company not liable to US tax *by reason of* its place of management. The test was "engaged in business in the US" which is different.

9.6.3 *Criterion of similar nature*

In *Crown Forest Industries v Canada*[43] the company was liable to tax by reason of its being engaged in a trade in the US; but that was not "a criterion of a similar nature" to place of management:

> the most similar element among the enumerated criteria is that, standing alone, they would each constitute a basis on which states generally impose full tax liability on world-wide income... In this respect, the criteria for determining residence in Article IV, paragraph 1 involve more than simply being liable to taxation on some portion of income (source liability); they entail being subject to as comprehensive a tax liability as is imposed by a state. In the United States and Canada, such comprehensive taxation is taxation on world-wide income. However, tax liability for the income effectively connected to a business engaged in the U.S. ... amounts simply to source liability. Consequently, the "engaged in a business in the U.S." criterion is not of a similar nature to the enumerated grounds since it is but a basis for source taxation.[44]

The taxpayer did not argue the wide view, ie that it was "liable to tax" on the basis that the US could have imposed a worldwide tax on the company. The result of the *Crown Forest* case is not consistent with the wide view.

GE Financial Investments v HMRC[45] concerned a company was liable to US tax under rules relating to stapled stock. This was held to be a resident of the US, and doubt was cast on the causation condition. Further discussion must be deferred until the case is final.

9.7 State/subdivision/local authority

Article 4(1) OECD Model continues:

> For the purposes of this Convention, the term "resident of a Contracting State" ... also includes
> [a] that State and

[43] [1995] 2 SCR 802

[44] at [40].

[45] [2023] UKUT 146 (TCC); and see Avery Jones, "GE Financial Investments v HMRC: a novel point of treaty interpretation" [2023] BTR 574.

> [b] any political subdivision or local authority thereof...

This is not found in the USA/UK DTA.[46]

9.7.1 *Pre-1995 Model form*

The OECD commentary provides:

> 8.4 It has been the general understanding of most member countries that the government of each State, as well as any political subdivision or local authority thereof, is a resident of that State for purposes of the Convention. Before 1995, the Model did not explicitly state this; in 1995, Article 4 was amended to conform the text of the Model to this understanding

If one thinks about it, the proposition that (say) the UK is liable to tax in the UK (not to mention, liable by reason of its residence, etc) is surprising. Some readers may use a stronger word. So it is not surprising that the OECD Model was amended. But the question is not likely to arise.

9.7.2 *Sovereign wealth funds*

The OECD Commentary provides:

> 8.5 This raises the issue of the application of paragraph 1 to sovereign wealth funds, which are special purpose investment funds or arrangements created by a State or a political subdivision for macroeconomic purposes. These funds hold, manage or administer assets to achieve financial objectives, and employ a set of investment strategies which include investing in foreign financial assets. They are commonly established out of balance of payments surpluses, official foreign currency operations, the proceeds of privatisations, fiscal surpluses or receipts resulting from commodity exports. Whether a sovereign wealth fund qualifies as a "resident of a Contracting State" depends on the facts and circumstances of each case. For example, when a sovereign wealth fund is an integral part of the State, it will likely fall within the scope of the expression "[the] State and any political subdivision or local authority thereof" in Article 4. In other cases, paragraphs 8.11 and 8.12 below will be relevant. States may want to address the issue in the course of bilateral negotiations, particularly in relation to whether a sovereign wealth fund qualifies as a "person" and is "liable to tax" for purposes of the relevant tax treaty (see also paragraphs 50 to 53 of the Commentary on Article 1)

[46] See 107.13.3 (Subdivisions/local authorities).

9.8 Liable to source tax only

Article 4(1) OECD Model/USA DTA continue with a second sentence:

> This term ["resident of a Contracting State"], however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

The OECD Commentary refers to liability to tax on worldwide income (or at least, not just on income with a source in the state) as "comprehensive liability to taxation" or just "comprehensive taxation".

This provision only applies in the unusual case where:

(1) A person is liable to tax in a State by reason of their domicile, residence, place of management or similar criterion; but
(2) the person is only liable on income/gains from a source in that State.

In most cases, a person is liable to tax on income from a source in a State but is not so liable by reason of their residence: non-residents are also liable. So the person would not be a resident of the State under the first sentence of the definition, and the second sentence is not applicable.

One example where the second sentence is needed is the case of a UK resident nominee or trustee for a non-resident beneficiary. Such a person is within the first sentence of art 4(1) but taken out by the second sentence.[47]

OECD Commentary refers to this sentence and provides four examples where it applies. Firstly:

> 8.1 ... That situation exists in some States in relation to individuals, e.g. in the case of foreign diplomatic and consular staff serving in their territory.

UK resident diplomats and consular officials are exempt from tax on foreign source income and gains and so not treaty-resident in the UK.

OECD Commentary provides:

> 8.2 [a] According to its wording and spirit the second sentence also excludes from the definition of a resident of a Contracting State foreign held companies exempted from tax on their foreign income by privileges tailored to attract conduit companies.
> [b] It also excludes companies and other persons who are not subject to comprehensive liability to tax in a Contracting State because these

[47] See 108.13.1 (Subject to tax: History).

> persons, whilst being residents of that State under that State's tax law, are considered to be residents of another State pursuant to a treaty between these two States. ...

I find para [b] difficult to understand.

> 8.3 [a] The application of the second sentence, however, has inherent difficulties and limitations. It has to be interpreted in the light of its object and purpose, which is to exclude persons who are not subjected to comprehensive taxation (full liability to tax) in a State,
> [b] because it might otherwise exclude from the scope of the Convention all residents of countries adopting a territorial principle in their taxation, a result which is clearly not intended.

I find part [b] of this sentence difficult to understand.

9.9 Residence change during year

9.9.1 *Split year of individual*

For individuals, UK tax-residence lasts an entire tax year: an individual cannot cease to be UK tax-resident during a tax year.[48]

Even if a tax year is a "split year" for an individual, the individual is still tax-resident in the UK throughout the tax year, including the overseas part of the split year. During that part the individual is still "liable to tax", since the reliefs for the overseas part of a split year cover most types of income but not all; so the individual is a resident of the UK under art 4(1) during the overseas part of a split year.[49]

For the avoidance of doubt, para 42 sch 45 FA 2013 confirms the point:

> The existence of special charging rules for cases involving split years is not intended to affect any question as to whether an individual would fall to be regarded under double taxation arrangements as a resident of the UK.

Some DTAs expressly address the question of migration during the year. For instance, art 14(6) France/UK DTA qualifies OECD Model CG article:

> The provisions of [art 14(5), CGT relief] shall not affect the right of a Contracting State to levy according to its law a tax chargeable in respect

[48] See 10.1 (Residence throughout tax year).
[49] See 10.2 (Split year rules).

> of gains from the alienation of any property ... on a person who is a resident of that Contracting State at any time during the fiscal year in which the property is alienated.

9.9.2 *UK/foreign tax years mismatch*

The INT Manual provides:

> **INTM154040 Individuals** [Sep 2021]
> ...Different countries have different fiscal years, for example, the United States tax year ends on 31 December. An individual who wishes to make a treaty claim as a resident of the United States in respect of the UK tax year 2010/11 will need to demonstrate that he is a resident of the United States during both of the United States tax years 2010 and 2011.
> If an individual was resident in the United States during the tax year 2010 but ceased to be so resident after 31 December 2010, then he may make a claim as a United States resident for any 2010/11 income which arose during 2010 but no claim is possible in respect of income arising in 2011.
> If income arises partly during a period of residence in the other country and partly during a period of residence in the UK, the income may be apportioned between the periods on a time basis, unless it is clear that the income arose unevenly over the two periods, for example a bonus payable for duties performed in one of the periods.

9.9.3 *Trust residence moves in tax year*

For the various ways that a trustee may change residence, and the time the change takes effect, see 10.17 (Split year of trustees and PRs).

The issue arose in *HMRC v Smallwood,* a case on the Round the World scheme.[50] A trust had three different trustees, resident in different states, in the course of the tax year 2000/01:

Apr - Dec: a Jersey resident trustee ("the Jersey period")
Dec - March: a Mauritius resident trustee ("the Mauritian period")
March onwards: UK resident trustees ("the UK period")

A gain accrued during the Mauritian period. During this period the trustee was a resident of Mauritius under art 4(1), as

(1) It was resident in Mauritius; and
(2) It was liable to Mauritian tax[51] by reason of its residence in Mauritius.

[50] [2010] EWCA Civ 778; see 9.19.6 (Round the World schemes).

[51] In fact the trustees were not liable to CGT in Mauritius, but only to income tax; but

One question was whether, during the Mauritian period, the trustee was also a resident of the UK under art 4(1).[52]

One might have thought that it was not, on the basis that it was not in fact tax-resident in the UK during that period. The Mauritian trustee was liable to CGT in the UK during the Mauritian period, but not by reason of *their* residence during the Mauritian period: it was liable by reason of *someone else's* residence (namely, the residence of their successor trustees) during the UK period.[53] However the CoA held that the trustee-body was a resident of the UK under art 4(1) during the Mauritian period.[54] The CoA reasoning is not easy to follow. Does the reasoning actually matter, when the answer to the question is clear? Discuss. However that may be, I think the best way to justify the outcome (if not quite how CoA put it) is as follows:

(1) the trustee was clearly liable to UK tax[55] during the Mauritian period; and

(2) it was so liable by reason of "its" UK residence, albeit in the subsequent UK period:

that made no difference; see 9.5.1 (Liable to which tax?).

[52] A further question arose concerning POEM; see 9.19.7 (POEM: Round the World scheme).

[53] At the time, s.2(1) TCGA provided (so far as relevant):

"*a person shall be chargeable to capital gains tax in respect of chargeable gains accruing to him in a year of assessment during any part of which he is resident in the UK*".

As the judge pointed out [2009] EWHC 777 (Ch) at [31:

"residence in part of the year gives rise to a charge to tax on gains made in another part of the year, but [the provisions] do not do so by deeming the residence to be for any period longer than the actual period of residence. They do so simply by defining the gains by reference to the period in which they arise. There is a difference between those approaches, and I do not consider this distinction to be too subtle for the purposes of the Treaty".

Note that the current law is different: see 56.6.3 (Territorial scope: Summary).

[54] and indeed during the Jersey period, but that is not relevant so I refer only to the Mauritian period here.

[55] In fact the trustees were *not* liable to CGT in the UK, because of s.77 TCGA. CGT was paid by the settlor, not by the trustees. But the trustees were still "liable to tax", and so resident of the UK under art 4(1). This is for two reasons (either would suffice):

(1) Section 77 TCGA was (in my terminology) a narrow exemption and not a complete exemption.

(2) The trustees were in any case liable to IT, even if s.624 ITTOIA applied,

(a) Because there is no rule that the trustee has to be resident at the moment the gain arises; or

(b) Because of the rule that trustees should be regarded as a continuing body, distinct from the actual trustees.[56]

During Mauritian period the trustee could not know that it was a resident of the UK under art 4(1), as the facts which made it a resident of the UK occurred later. That did not matter: "The issue of liability has to be looked at retrospectively".[57] Of course, it can happen that individuals do not know in real time whether they are UK resident, since that can depend on what happens later in the same tax year; or indeed, under the SRT, it may depend on events in the subsequent tax year. So the position is similar for trust residence.

Thus the trustee in *Smallwood* was both a resident of the UK under art 4(1), and a resident of Mauritius under art 4(1); so treaty-residence was decided under the tie-breaker test.[58]

The reader might think that the reasoning in the High Court was more convincing, but the point is moot because:

(1) The pre-2019 law is settled at all levels below the Supreme Court; and

(2) The law changed in 2019. In short, a trustee is now deemed to be UK resident for the whole year, if resident in any part of it.[59] That might be taken to decide residence for the purpose of the DTA. While not decisive, this does add a further argument in favour of the outcome of *Smallwood*

In *Smallwood* the outcome favoured HMRC. However the rule will sometimes favour the taxpayer, if

(1) Gains accure at a time when a person does not meet the requirements to be a resident of a treaty State under art 4(1)

[56] The court relied on s.69 TCGA. The wording of the section has changed, but the changes are not significant. The current wording reads:

> "*For the purposes of this Act* the trustees of a settlement shall, unless the context otherwise requires, together be treated as if they were a single person (distinct from the persons who are trustees of the settlement from time to time)."

It might have been argued that s.69 does not apply for treaty purposes. However art.3(2) (undefined terms have domestic law meanings) would justify treating trustees as a continuing body of persons, so the decision on this point seems right.

[57] *HMRC v Smallwood* [2010] EWCA Civ 778 at [42].

[58] See 9.19.7 (POEM: Round the World scheme).

[59] See 56.6.4 (CGT/CT charge: UK residents).

(2) the person later meets those requirements, and retrospectively qualifies for relief.

Suppose:

(1) A company within s.3 TCGA is resident in Jersey during part of a tax year ("the Jersey resident period").
(2) The company becomes resident in State A under the law of State A during part of the tax year ("the State A resident period").
(3) Under the tax law of State A the company is liable to tax throughout both periods. That is, State A has a rule similar to that which applies to individuals and trusts in the UK.
(4) The company is at no time UK tax-resident.

A gain accruing in the Jersey resident period will retrospectively qualify for relief under a treaty between the UK and State A, which could benefit a UK participator within the scope of s.3. (Before the CoA's decision in *Smallwood*, an adviser might have thought that the company had to be able to say at the time the gain accrued. that it was resident under art 4(1) at that time, in order for treaty relief to apply. But now we know the position is looked at retrospectively.)

9.10 Tie-breaker tests

It is possible for a person to be:
(1) a resident of State A under art 4(1) during the whole of a tax year and
(2) a resident of State B under art 4(1) during the whole of the same period.

This may arise for various reasons:
(1) Two states may have different domestic-law definitions of residence.
(2) Residence (however defined) is distinct from presence: a person may be UK tax-resident throughout a year while only present in the UK during part of the year; such a person may be regarded by the foreign State as a resident of the foreign State.

In such cases tie-breaker tests are needed. There are two tests, or sets of tests. Article 4(2) deals with individuals. Article 4(3) deals with other persons, which I call **"entities"**; that includes companies, trustees and PRs.

9.11 Tie-breaker tests: Individuals

On this topic, see Avery Jones et al, “Dual Residence of Individuals: The Meaning of the Expressions in OECD Model Convention”, [1981] BTR 15 & 104
Maisto (ed.) *Residence of Individuals under Tax Treaties and EC Law* (2010)

For individuals, there are a series of tie-breaker tests, in order of priority:
(1) permanent home
(2) centre of vital interests
(3) habitual abode
(4) nationality
(5) mutual agreement

OECD Commentary provides:

> 10. To solve this conflict special rules must be established which give the attachment to one State a preference over the attachment to the other State. As far as possible, the preference criterion must be of such a nature that
> [1] there can be no question but that the person concerned will satisfy it in one State only,
> [2] and at the same time it must reflect such an attachment that it is felt to be natural that the right to tax devolves upon that particular State.

The last sentence reflects the conflict, endemic throughout taxation, between formal rules which offer more certainty, and rules which seek to track the economic reality, if there is such a thing.

The OECD Model and the USA/UK DTA use the same wording

9.12 Permanent home

Article 4 OECD Model/USA DTA provide:

> 2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:
>
> a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him;

For clarity of exposition it is helpful to consider separately the concepts of:
(1) “home”
(2) “permanent”
(3) “available”

But this neat analysis is not wholly practical: the three terms interact, for a property which is not "available" or "permanent" is less likely to be a "home".

9.12.1 *"Home"*

"Home" matters for many tax purposes; for a discussion, see 6.20 ("Home").

9.12.2 *"Permanent"*

The concept of "permanent" is as vague as the concept of "home". OECD Commentary on para 4(2) is untrammelled by the restraint of precision:

> 11 The Article gives preference to the Contracting State in which the individual has a permanent home available to him. This criterion will frequently be sufficient to solve the conflict, eg where the individual has a permanent home in one Contracting State and has only made a stay of some length in the other Contracting State.
> 12 Subparagraph (a) means, therefore, that in the application of the Convention (that is, where there is a conflict between the laws of the two States) it is considered that the residence is that place where the individual owns or possesses a home; this home must be permanent, that is to say, the individual must have arranged and retained it for his permanent use as opposed to staying at a particular place under such conditions that it is evident that the stay is intended to be of short duration.
> 13. ... But the permanence of the home is essential; this means that the individual has arranged to have the dwelling available to him at all times continuously, and not occasionally for the purpose of a stay which, owing to the reasons for it, is necessarily of short duration (travel for pleasure, business travel, educational travel, attending a course at a school, etc).

Para 11 of the Commentary looks at the situation where "the individual has a permanent home in one Contracting State and has only made a stay of some length in the other Contracting State". The Commentary is not making a contrast between:
(1) permanent, and
(2) a stay of some length.

The point correctly being made is that the existence of one (undoubtedly) permanent home impacts on whether one regards *another* place as a permanent home.

Paras 12 and 13 contrast:

(1) permanent use, and
(2) a stay of short duration; exemplified as "travel for pleasure, business travel, educational travel, attending a course at a school, etc".

This suggests that a stay of more than short duration qualifies as permanent. Thus in *Hankinson v HMRC* an apartment was held under an 18 month lease. The taxpayer spent some 130 nights there in a period of 271 days (6 Apr 1998 - 2 Jan 1999). This was held to be a permanent home.[60]

A similar view is taken in Australia on the phrase "permanent place of abode":[61]

> "permanent" is used in the sense of something which is to be contrasted with that which is temporary or transitory. It does not mean everlasting. The question is thus one of fact and degree.[62]

9.12.3 *"Available"*

OECD Commentary provides:[63]

> For instance, a house owned by an individual cannot be considered to be available to that individual during a period when the house has been rented out and effectively handed over to an unrelated party so that the individual no longer has the possession of the house and the possibility to stay there.

In *McCabe v HMRC*,[64] the property was owned by the wife ("W") of the taxpayer ("H"). The circumstances were:

> (1) H was a welcome visitor to the property whenever he was in

[60] [2009] UKFTT 384 (TC) at [67]. The point was not discussed in the appeal. Likewise *Oppenheimer v HMRC* [2022] UKFTT 112 (TC) at [281]:

> "permanent" in that context is used objectively in contrast to "temporary". It is not subjectively in the sense of a place where the taxpayer intends to spend the rest of his life. That is not a high threshold...

[61] Section 6(1) [Australian] Income Tax Assessment 1936 provides: "resident or resident of Australia ... includes a person ... whose domicile is in Australia, unless ... his permanent place of abode is outside Australia".

[62] *Applegate v FCT* [1978] 1 NSWLR 126 at p.134, affirmed on appeal [1979] FCA 37; (1979) 38 FLR 1.

[63] Commentary on art 4 para 13.

[64] [2022] UKFTT 356 (TC) at [229].

> Scarborough. H did use it throughout the Relevant Period.
> (2) W would have given H permission to stay overnight whenever he wanted, and for as long as he wanted. The only reason he did not do so was that he had been advised not to for tax purposes.

In these circumstances it seems obvious that the property was "available" and the FTT so found. It added:

> Given the purposes of the DTC, I do not consider that I should place any weight on the artificial step of handing over his set of keys to Mrs McCabe when considering whether the house was available to Mr McCabe.

But it does not need a purposive construction to reach that conclusion.

9.13 Centre of vital interests

Article 4(2)(a) OECD Model/USA DTA provides (I include the French version as reference is made to this below):

if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);	si elle dispose d'un foyer d'habitation permanent dans les deux États, elle est considérée comme un résident seulement de l'État avec lequel ses liens personnels et économiques sont les plus étroits (centre des intérêts vitaux);

This test is only applied where the individual has a permanent home available to him in both States. If there is a permanent home in one State only, that is the State of residence. If there is no permanent home in either State, then one moves on to the habitual abode test.

9.13.1 *What is the CVI test?*

"Centre of vital interests" (CVI) is a convenient label for this test. But the actual test, in full, is where:

> his personal and economic relations are closer (centre of vital interests)

The brackets show that the words "centre of vital interests" are intended as an explanation, or paraphrase, and, perhaps a label, for the concept of where "personal and economic relations are closer".

There is some debate as to the meaning of "vital" interests. Hattingh and Avery Jones say that the English word is a mistranslation of a French original, and should read: "the centre of interests of his life"; the adjective *vitaux* derives from *vie*.[65] That makes perfect sense because then the phrase is an accurate and helpful explanation, or paraphrase, or label, of where "personal and economic relations are closer".

Oppenheimer v HMRC understood the word "vital" in its normal English sense:[66]

> "vital" meant "necessary or essential"... "…the things, in other words, that are of greatest importance…" to [the individual].

That somewhat overstates the point, because it does not give any weight to the words "[where] personal and economic relations are closer"; but it does not matter as long as the words are not understood too strictly.

Oppenheimer also cites the UN commentary to the United Nations Model:[67]

> Concepts such as 'centre of vital interest' and 'place of effective management' ... require a strong relationship between a taxpayer and a country.[68]

But even if it is right to cite the UN commentary[69] this does not take us very far, as

(1) "Strong relationship" is vague and evaluative; and

(2) However the CVI test is understood, there will always be a "strong relationship" in the circumstances envisaged here, which are that:
   (a) the individual is a resident of a State, and
   (b) the individual has a permanent home available in the State, and
   (c) their personal and economic relations are closer than elsewhere

One should not approach the CVI test by asking if the relationship is

[65] *Hattingh and Avery Jones* [2022] BTR 245. For use of French as an aid, see 107.10.5 (Treaty in two languages).

[66] [2022] UKFTT 112 (TC).

[67] Para 62.

[68] The UN Commentary continues:
"The fact that a taxpayer has a home available to him in a country where he sojourns frequently, is not enough to claim that that country is his centre of vital interests; likewise the mere fact that meetings of a board of directors of a company take place in a country is not sufficient to conclude that this is where the company is effectively managed."
But that is self-evident.

[69] See 107.11.7 (United Nations Commentary).

strong or sufficiently strong.

Oppenheimer records the taxpayer's submissions[70] that:

- The centre of vital interests is not easily moved.
- A move of State for a limited purpose is unlikely to shift the centre of vital interests.

These are two ways of making the same point. The Tribunal does not say expressly whether it accepted this view, though perhaps one might infer that it did. But this is considered to be the wrong approach. The mistake is to focus on the expression "centre of vital interests" and not the phrase which CVI is intended to explain, which is where "personal and economic relations are closer". But it depends on what nuance one gives to the evaluative expressions "not easily moved" and "for a limited purpose". If an individual goes to work in another country for 18 months, the Australian example discussed below, is that "for a limited period"? As the decision in *Oppenheimer* is final, these questions must be left for future litigation to resolve.

A similar expression, "centre of a debtor's main interests" is used in the EU Regulation on insolvency proceedings;[71] case law on that may be helpful in relation to the expression "centre of vital interests" but the wording and contexts are not the same, and we have more than enough cases specifically on treaty-tiebreaker, so there is no need to look further afield.

9.13.2 *Multfactorial test*

The test is multifactorial: no single factor is decisive. OECD Commentary provides:

> 15 If the individual has a permanent home in both Contracting States, it is necessary to look at the facts in order to ascertain with which of the two States his personal and economic relations are closer. Thus, regard will be had to
> [1] his family and social relations,
> [2] his occupations,
> [3] his political, cultural or other activities,
> [4] his place of business,
> [5] the place from which he administers his property, etc.

[70] at [30].

[71] (EC) No 1346/2000 (29 May 2000).

OECD Commentary gives some inkling of priority between the different factors:

> The circumstances must be examined as a whole, but it is nevertheless obvious that considerations based on the personal acts of the individual must receive special attention.

That does not take us very far, as most of the considerations will relate to "personal acts" and it is difficult to think of relevant considerations not based on personal acts of the individual.

Oppenheimer v HMRC[72] rejected the view that personal relationships trump economic relations, if they point in different ways:

> the correct approach is to consider both ties together and then determine with which State both economic and personal ties are closer.

Economic relations may be traced through trust and company structures.[73]

Oppenheimer v HMRC comments on the subjective aspects of the test:[74]

> we need to find facts about Mr Oppenheimer's thinking and, of course, that introduces a subjective element...
> intention alone is not sufficient to establish a movement in the centre of vital interests but it is relevant in assessing the level of attachment to a State, and indeed ... it could tip the balance.

9.13.3 *CVI examples*

Each case will turn on its own facts. They offer illustrations but are otherwise of little importance. In *Yates v HMRC*[75] the decisive point was that the taxpayer's partner (and financial support) was in the UK. The partner was the centre of the taxpayer's vital interests.

Similarly, in *Hankinson v HMRC*[76] the decisive points were the individual's wife and at least one of his sons were in the UK, and he had a house and investments here, as against a short term lease in the Netherlands. It seems a fairly plain case.

[72] [2022] UKFTT 112 (TC).

[73] That seems self-evident, but if authority is needed, see *Oppenheimer v HMRC* [2022] UKFTT 112 (TC) at [319]. Similarly, in *McCabe v HMRC*, the taxpayer's income was from a Belgian company, but what mattered was that all the Belgian company's income was from UK companies; see [2022] UKFTT 356 (TC) at [238]-[239].

[74] [2022] UKFTT 112 (TC) at [226], [230].

[75] [2012] UKFTT 568 (TC) at [126].

[76] [2009] UKFTT 384 (TC); the treaty-residence issue was not discussed in the appeal.

In *Oppenheimer* the facts fill more than 20 pages and it is not possible to see what facts were decisive.[77]

The Australian Revenue offer a helpful illustration:

> **Facts**
>
> The taxpayer and his spouse and children initially lived in the UK.
>
> The taxpayer accepted employment in Australia for a period of 18 months, which is the period in question.
>
> The taxpayer and his spouse and children moved to Australia for that period.
>
> The taxpayer and his spouse own family homes both in Australia and in the UK, and each home is maintained so that it can be used by the taxpayer or his family at any time.

Thus we apply the centre of vital interests test.

> Prior to, and during, the period in question, the taxpayer had business interests in both the UK and Australia.
>
> While the taxpayer lived in Australia, he managed both his Australian and UK business interests from Australia, but he made occasional short trips to the UK when it was necessary.
>
> The taxpayer is a member of several clubs in the UK. When he was living in the UK or visiting the UK he would regularly socialise with friends and with members of his extended family.
>
> While he was living in Australia the taxpayer did not join any clubs, and he did not socialise as regularly, as he did not have many friends or any extended family members in Australia.
>
> The taxpayer's hobby is attending cooking classes, and he attended cooking classes as often as he could, both in Australia and in the UK.
>
> During the 18 months that the taxpayer lived in Australia, he remained on the electoral roll in the UK but he was not on the Australian electoral roll.
>
> The taxpayer's children have a cat, which remained in the UK with friends while the taxpayer was living in Australia.
>
> At the end of the 18 months, the taxpayer and his spouse and children returned to the UK to live.
>
> **Reasons for Decision**
>
> [The decision refers to para 10 of OECD Commentary on art 4[78] and concludes:] In this case the relevant period is the 18 months that the

[77] For criticism of this decision, see *Hattingh and Avery Jones* [2022] BTR 245.

[78] See 9.16 (Period of enquiry: Tie-breaker).

taxpayer lived in Australia.

...

Klaus Vogel on Double Taxation Conventions[79] is consistent with paragraph 15 of the OECD Commentary on Article 4(2)(a) and states that 'personal relations encompass a taxpayer's entire way of life' .... This includes family and social, political and cultural relations. At paras 74 and 74a of p.249, Vogel suggests that factors that are part of a person's personal relations include intention to spend their old age at a certain place; possession of an identity card; enlistment on the electoral roll; and relations to a thing or to an impersonal entity such as a private collection or membership in a club or the exercise of a hobby.

[*Neutral pointers*] As the taxpayer pursued his hobby in both Australia and the UK, the hobby is not significant in deciding the centre of vital interests.

[*UK pointers*] The registration on the electoral roll; the club memberships; the presence of friends and extended family members and the family's cat; and the active social life when he visits the UK, are factors which point to the UK as the taxpayer's centre of vital interests during the 18 months that he is living in Australia.

[*Australian pointers*] However, at p.249, para 74a, Vogel states that the most significant factor in establishing to which state a taxpayer's personal relations are closer is where the taxpayer regularly lives with his family. Where a taxpayer lives alone, the location of any family members will be relevant if the taxpayer maintains relations with them. The taxpayer lived with his family in Australia during the 18 months in question. Even though he had strong ties with the UK during that time, the presence of his spouse and children in Australia carries greater weight.

Regarding economic relations, the OECD Commentary on Article 4 at paragraph 15 refers to 'the place from which he administers his property, etc'.

Consistent with this, Vogel at p.249, para 74b, states:

> **Economic relations will primarily exist with activities** linked with a locality or with sources of income. ... A permanent home mainly serving the realization or maintenance of economic relations, would be a manifestation of special ties with a place to live. This, will as a rule, be **that home from where the individual proceeds to perform his everyday work and from where he manages and**

[79] See *Klaus Vogel on Double Taxation Conventions* (4th ed., 2015), paras 92-101. The text of the current edition, which has changed somewhat from the 3rd edition referred to by the ATO, contains a helpful discussion.

> **controls his capital or income** (emphasis added).
>
> In this case, during the 18 months in question the taxpayer was employed in Australia so the home from where he proceeded to perform his everyday work was in Australia. In addition, although he made some trips to the UK when his business interests made it necessary, he generally managed his business interests from Australia during the time he lived in Australia.
>
> For the 18 months in question the taxpayer lived with his spouse and children in Australia, and generally managed his business interests from Australia. Consequently, even though he also had ties with the UK, the taxpayer's personal and economic relations, during the 18 months in question, were closer with Australia than with the UK.[80]

In short, an 18 month placement in Australia (with family) outweighed all the UK links, even the cat.

9.13.4 *Planning when CVI unclear*

CVI may often be unclear. It is possible to avoid the issue arising by arranging that the individual has a permanent home in one State and not in the other. If the individual has a permanent home in both states, and does not wish to sell one of them, the solution may be to grant a lease of one of them to an unconnected third party. Then the individual will be treaty-resident in the other State.

9.14 Habitual abode

Article 4(2)(b) OECD Model/USA DTA provides (I include the French version as reference is made to this below):

[i] if the State in which he has his centre of vital interests cannot be determined, or	si l'État où cette personne a le centre de ses intérêts vitaux ne peut pas être déterminé, ou
[ii] if he has not a permanent home available to him in either State,	si elle ne dispose d'un foyer d'habitation permanent dans aucun des États,
he shall be deemed to be a resident only of the State in which he has an habitual abode;	elle est considérée comme un résident seulement de l'État où elle séjourne de façon habituelle

[80] ATO ID 2011/53.

The habitual abode test applies in two cases:

(1) Where the individual has a permanent home available in both Contracting States and it is not possible to determine where is the centre of vital interests: the CVI test is too close to call

(2) Where the individual has no permanent home available in either Contracting State

I would have thought case (1) would rarely arise. A tribunal should normally be able to decide CVI one way or another. But it might happen if, say, an individual was resident in three or more countries.

OECD Commentary discusses this with a comment on habitual abode:

> 17 In the first situation, the case where the individual has a permanent home available to him in both States, the fact of having an habitual abode in one State but not in the other appears therefore as the circumstance which, in case of doubt as to where the individual has his centre of vital interests, tips the balance towards the State where he stays more frequently.

9.14.1 *Ascertaining habitual abode*

OECD Commentary continues:

> For this purpose regard must be had to stays made by the individual not only at the permanent home in the State in question but also at any other place in the same State.

OECD Commentary continues:

> 18 The second situation is the case of an individual who has a permanent home available to him in neither Contracting State, as for example, a person going from one hotel to another. In this case also all stays made in a State must be considered without it being necessary to ascertain the reasons for them.

OECD Commentary continues:

> 19. The application of the criterion provided for in [art 4(2)(b]) requires a determination of whether the individual lived habitually, in the sense of being customarily or usually present, in one of the two States but not in the other during a given period; the test will not be satisfied by simply determining in which of the two Contracting States the individual has spent more days during that period...
> As recognised in [art 4(2)(c)], it is possible for an individual to have an habitual abode in the two States, which would be the case if the

> individual was customarily or usually present in each State during the relevant period, regardless of the fact that he spent more days in one State than in the other. Assume, for instance, that over a period of five years,
> [1] an individual owns a house in both States A and B but
> [2] the facts do not allow the determination of the State in which the individual's centre of vital interests is situated.
> [3] The individual works in State A where he habitually lives but returns to State B two days a month and once a year for a three-week holiday.
> In that case, the individual will have an habitual abode in State A but not in State B.
> Assume, however, that over the same period of five years,
> [1] the individual works short periods of time in State A, where he returns 15 times a year for stays of two weeks each time, but
> [2] is present in State B the rest of the time
> [3] (assume also that the facts of the case do not allow the determination of the State in which the individual's centre of vital interests is situated).
> In that case, the individual will have an habitual abode in both State A and State B.

HMRC Self Assessment helpsheet HS302 (Dual Residents 2021) provides:

> **Habitual abode**
> This shows which of the 2 countries you live in regularly, normally or customarily. The test considers the frequency, duration and regularity of stays that are part of your settled routine for each country.

The OECD Commentary para 19 seeks aid from the French:

> The phrase *"séjourne de façon habituelle"*, which is used in the French version of subparagraph b), provides a useful insight as to the meaning of "habitual abode", a notion that refers to the frequency, duration and regularity of stays that are part of the settled routine of an individual's life and are therefore more than transient.

Similarly, *Hankinson v HMRC*:[81]

> In a case in the Tax Court of Canada ... *Lingle v R* 12 ILTR 55, Campbell J makes the point that the French equivalent to an habitual

[81] [2009] UKFTT 384 (TC); the issue was not discussed in the appeal. For use of French as an aid, see 107.10.5 (Treaty in two languages).

> abode is *où elle séjourne d'une façon habituelle* which means "where one stays[82] in an habitual way."

That does not take us much further. More usefully:

> In the overlap period [the appellant] did not stay in either state because he was in Barbados. We find that he did not have an habitual abode in either state during the overlap period. If it is possible to look at a longer period as required by paragraph 19 of the Commentary,[83] such as the UK tax year 1998-99, he stayed in an habitual way in both countries (some 130 nights in the Netherlands and 82 nights in the UK, including non-working days) and the intervals were fairly evenly spaced. We regard both of these as habitual.
>
> We do not read this test as purely a matter of counting days in spite of the Commentary's reference to "tips the balance towards the State where he stays more frequently" unless one is far larger than the other because the Treaty deals with the possibility of habitual abode being in both or neither state, which would virtually never arise with counting days. We would therefore decide if it were relevant that the Appellant had an habitual abode in neither state if only the overlap period were taken or that he had an habitual abode in both states if the tax year 1998-99 were taken.[84]

In *McCabe v HMRC*:[85]

> I do not accept [HMRC's] submission that the test is not comparative; it is plainly comparative, albeit that it is clear from the final limb of the tie-breaker and the 2017 Commentary, and illustrated by the decision in *Hankinson v HMRC* [2009] UKFTT 384 (TC), that an individual can have a habitual abode in both states.

And turning to the facts:[86]

> I have no hesitation in concluding that he had a habitual abode in Belgium. Mr McCabe spent 129 nights in Brussels in 2006-07 and 98

[82] Footnote original: We also point out that *séjourne* is also translated as "is present" in art 15(2)(c) of the Model: *le bénéficiaire séjourne dans l'autre État pendant une période ou des périodes n'excédant pas au total 183 jours durant toute période de douze mois*….("the recipient is present in the other state for a period or periods not exceeding in aggregate 183 days in any twelve month period…").

[83] See 9.16.2 (Enquiry period: Habitual abode).

[84] [2009] UKFTT 384 (TC) at [69].

[85] [2022] UKFTT 356 (TC) at [246].

[86] [2022] UKFTT 356 (TC) at [246].

> the following year; of the 85 occasions he was in Brussels, only two did not involve an overnight stay; the pattern of his travel is such that it was Brussels to where he was returning after his many overseas visits. His presence there was more than transient; he was customarily or usually present there.
> This is not the case for the UK. When reaching this conclusion, I take account of all of the facts in relation to Mr McCabe's physical presence in the UK (including the number of visits to the UK and days or part days in the UK) but pay particular regard to the limited number of nights spent in the UK (33 in 2006-07 and 43 the following year), and that the visits to the UK were generally for just one or two nights. The visits were frequent, but short and irregular. On balance, I conclude that he was not customarily present in the UK and did not have a habitual abode in the UK.

Oppenheimer v HMRC[87] offers another illustration; but each case will depend on its facts.

A person who is not tax-resident in a country may still have a habitual abode in that country. This may be why the word "abode" is used rather than residence.

9.15 Nationality/mutual agreement

Article 4(2)(c)(d) OECD Model/USA DTA provide:

> c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
> d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

This will rarely arise in practice.

9.16 Period of enquiry: Tie-breaker

OECD Commentary discusses this:

> 10. The facts to which the special [tie-breaker] rules will apply are those existing during the period when the residence of the taxpayer affects tax liability, which may be less than an entire taxable period. For example, in one calendar year

[87] [2022] UKFTT 112 (TC).

> [1] an individual is a resident of State A under that State's tax laws from 1 January to 31 March,
>
> [2] then moves to State B. Because the individual resides in State B for more than 183 days, the individual is treated by the tax laws of State B as a State B resident for the entire year.
>
> Applying the special [tie-breaker] rules to the period 1 January to 31 March, the individual was a resident of State A. Therefore, both State A and State B should treat the individual as a State A [treaty-]resident for that period, and as a State B [treaty-]resident from 1 April to 31 December.

9.16.1 *Enquiry period: CVI*

In *Oppenheimer v HMRC*:[88]

> we must look at each tax year in the Relevant Period, nevertheless, because of the possibly unique factual matrix ... we must also look at a broader perspective.

It is considered that one should look at the wider picture even in cases which do not have a "unique factual matrix".

History may be an important factor. The OECD Commentary provides:

> If a person who has a home in one State sets up a second in the other State while retaining the first, the fact that he retains the first in the environment where he has always lived, where he has worked, and where he has his family and possessions, can, together with other elements, go to demonstrate that he has retained his centre of vital interests in the first State.

9.16.2 *Enquiry period: Habitual abode*

OECD Commentary provides:

> 19.1 [Art 4(2)(b), habitual abode] does not specify over what length of time the determination of whether an individual has an habitual abode in one or both States must be made. The determination must cover a sufficient length of time for it to be possible to ascertain the frequency, duration and regularity of stays that are part of the settled routine of the individual's life. Care should be taken, however, to consider a period of time during which there were no major changes of personal circumstances that would clearly affect the determination (such as a separation or divorce). The relevant period for purposes of the

[88] [2022] UKFTT 112 (TC) at [229].

> determination of whether an individual has an habitual abode in one or both States will not always correspond to the period of dual-residence, especially where the period of dual-residence is very short.
> This is illustrated by the following example. Assume that
> [1] an individual resident of State C moves to State D to work at different locations for a period of 190 days.
> [2] During that 190-day period, he is considered a resident of both States C and D under their respective domestic tax laws.
> [3] The individual lived in State C for many years before moving to State D, remains in State D for the entire period of his employment there and returns to State C to live there permanently at the end of the 190-day period.
> [4] During the period of his employment in State D, the individual does not have a permanent home available to him in either State C or State D.

The OECD analysis is as follows:

> In this example, the determination of whether the individual has an habitual abode in one or both States would appropriately consider a period of time longer than the 190-day period of dual-residence in order to ascertain the frequency, duration and regularity of stays that were part of the settled routine of the individual's life.

In *Hankinson v HMRC*:[89]

> It seems therefore that while one applies the tie-breaker at the time of alienation in a case concerning capital gains, this does not mean that one cannot look at a longer period in applying the elements of the tie-breaker when appropriate, which it may not be for permanent home, but it is necessarily for habitual abode.

While one needs to determine whether a person is treaty-resident at a particular moment, or period, one looks over an appropriate period of time to determine whether they are treaty-resident at that moment.[90]

9.17 Tie-breaker: Entities

There are two main tie-breaker tests for entities (ie non-individuals). I refer to them as follows:

[89] [2009] UKFTT 384 (TC) at [60]. The issue was not discussed in the appeal.

[90] See 9.19.5 (Period for enquiry into POEM)). See too 4.24.7 (Period for domicile enquiry).

Tie-breaker	**OECD Model**	**See para**
Mutual agreement tie-breaker	Post-2017	9.18
POEM tie-breaker	Pre-2017	9.19

As early as 1978 some UK DTAs contained a mutual agreement tie-breaker.[91] The 2008 Update to the OECD Model Tax Convention offered the mutual agreement tie-breaker as an alternative to POEM. However a POEM tie-breaker remained the norm until 2017.[92]

There are different tests in some non-OECD Model treaties.[93]

The tie-breaker is only needed for a person who is a resident of both States under art 4(1). OECD Commentary provides:

> 21... It may be rare in practice for a company, etc. to be subject to tax[94] as a resident in more than one State, but it is, of course, possible if, for instance, one State attaches importance to the registration and the other State to the place of effective management. So, in the case of companies, etc., also, special rules as to the preference must be established.

9.17.1 *Person other than individual*

Art 4(3) OECD Model (both pre- and post-2017 forms) refers to "a person other than an individual".

That includes trustees. This may be said to follow from the distinct-person fiction[95] but I think it would be clear on first principles.[96]

OECD Commentary provides:

> 21. This paragraph [art 4(3)] concerns companies and other bodies of

[91] Eg the Canada/UK DTA (1978). Art 4(4) Netherlands/UK DTA (2008) roughly follows the OECD wording but has an exception, not considered here, for listed companies.

[92] See 9.19 (POEM tie-breaker).

[93] The report refers to art 4 commentary, para 24, 24.1; see 9.18 (Tie-breaker: Mutual agreement).

[94] This should read, "liable to tax" but it does not matter.

[95] See 7.3 (Trustees a distinct person).

[96] If authority is needed, which I doubt, see the IHT Manual:

> **IHTM353600 Claims by trustees in Ireland** [Mar 2016]
> Article 4(3) (Fiscal Residence) of the convention makes reference to 'a person other than an individual'. Trustees act as a body of persons and so are persons other than an individual for the purposes of the article, and we therefore refer to the criteria in Article 4(3) to determine whether trustees of an Irish trust are resident in the Ireland for the purposes of the convention...

persons, irrespective of whether they are or not legal persons.

9.18 Tie-breaker: Mutual agreement

From 2017, art 4(3) OECD Model and BEPS MLI[97] are effectively identical, with changes only to conform to MLI's terminology. The USA/UK DTA is broadly similar:

art 4(3) OECD Model	art 4(1) BEPS MLI	art 4(5) USA/UK DTA
[1] Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States,	[A] Where by reason of the provisions of a Covered Tax Agreement[98] a person other than an individual is a resident of more than one Contracting Jurisdiction,[99]	Where by reason of the provisions of paragraph 1 of this Article a person other than an individual is a resident of both Contracting States,
the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention,	the competent authorities of the Contracting Jurisdictions shall endeavour to determine by mutual agreement the Contracting Jurisdiction of which such person shall be deemed to be a resident for the purposes of the Covered Tax Agreement,	the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the mode of application of this Convention to that person.
having regard to [a] its place of effective management, [b] the place where it is incorporated or otherwise constituted and [c] any other relevant factors.	[identical to art 4(3) OECD Model].	[No equivalent]

Under the OECD Model, the States seek to agree which is the state of residence. Under the USA/UK DTA, the States seek to agree "the mode of application" of the DTA. But that seems to mean the same thing. The

[97] See 107.15 (BEPS MLI).

[98] See 107.16.3 (Covered Tax Agreement).

[99] See 107.16.2 (Contracting Jurisdiction/Signatory).

USA/UK DTA Technical Explanation[100] provides:

> Dual residents other than individuals (e.g., companies, trusts, and estates) are addressed by paragraph 5. If such a person is, under the rules of paragraph 1, resident in both Contracting States, the competent authorities shall seek to determine a single State of residence for that person for purposes of the Convention.

The Technical Explanation gives a straightforward example:

> For example, a company is treated as resident in the United States if it is created or organized under the laws of the United States or a political subdivision. Under U.K. law, a company is treated as a resident of the UK if it is either established there or managed and controlled there. Dual residence, therefore, can arise if a U.S. company is managed and controlled in the UK. Paragraph 5 provides that the competent authorities will try to determine a single State of residence for such a company.

The mutual agreement tie-breaker confers a wide Revenue discretion, but governments do not seem to regard that as objectionable.[101]

9.18.1 *Relevant factors*

The OECD Model refers to POEM[102] and place of incorporation and "any other relevant factors." OECD Commentary provides:

> 24.1 Competent authorities having to apply [art 4(3)] would be expected to take account of various factors, such as
> [a] where the meetings of the person's board of directors or equivalent body are usually held,
> [b] where the chief executive officer and other senior executives usually carry on their activities,
> [c] where the senior day-to-day management of the person is carried on, where the person's headquarters are located,
> [d] which country's laws govern the legal status of the person,
> [e] where its accounting records are kept,
> [f] whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the

[100] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[101] See 2.8 (The Rule of Law).

[102] See 9.19 (POEM tie-breaker).

> provisions of the Convention etc...

There is no express equivalent in the UK/US DTA, but one would expect the same approach to apply.

9.18.2 *Mutual agreement procedure*

OECD Commentary provides:

> 24.2 A determination under [art 4(3)] will normally be requested by the person concerned through the mechanism provided for under paragraph 1 of Article 25 [Mutual agreement procedure].[103] Such a request may be made as soon as it is probable that the person will be considered a resident of each Contracting State under paragraph 1. Due to the notification requirement in paragraph 1 of Article 25, it should in any event be made within three years from the first notification to that person of taxation measures taken by one or both States that indicate that reliefs or exemptions have been denied to that person because of its dual-residence status without the competent authorities having previously endeavoured to determine a single State of residence under [art 4(3)]. The competent authorities to which a request for determination of residence is made under [art 4(3)] should deal with it expeditiously and should communicate their response to the taxpayer as soon as possible.
>
> 24.3 Since the facts on which a decision will be based may change over time, the competent authorities that reach a decision under that provision should clarify which period of time is covered by that decision.

Even in the case of a POEM tie-breaker, the two States may of course seek to resolve residence (and other) issues under the mutual agreement procedure.

9.18.3 *Position if no agreement*

art 4(3) OECD Model	**art 4(1) BEPS MLI**	**art 4(5) USA/UK DTA**
[2] In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention	[B] In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by the Covered Tax Agreement	If the competent authorities do not reach such an agreement, that person shall not be entitled to claim any benefit provided by this Convention,

[103] See 113.1(Mutual agreement procedure).

except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.	except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting Jurisdictions.	except those provided by **Article: Topic**[104] Art 24(4): Foreign tax credit Art 25: Non-discrimination Art 26 Mutual agreement (MAP)

OECD Commentary provides:

> 24.4 The last sentence of [art 4(3)] provides that in the absence of a determination by the competent authorities, the dual-resident person shall not be entitled to any relief or exemption under the Convention except to the extent and in such manner as may be agreed upon by the competent authorities. This will not, however, prevent the taxpayer from being considered a resident of each Contracting State for purposes other than granting treaty reliefs or exemptions to that person. This will mean, for example, that the condition in subparagraph b) of paragraph 2 of Article 15 will not be met with respect to an employee of that person who is a resident of either Contracting State exercising employment activities in the other State. Similarly, if the person is a company, it will be considered to be a resident of each State for the purposes of the application of Article 10 to dividends that it will pay.

The USA/UK DTA Technical Explanation[105] provides:

> If the competent authorities do not reach an agreement on the single State of residence, that person may not claim any benefit provided by the Convention, except those provided by paragraph 4 of Article 24 (Relief from Double Taxation), Article 25 (Non-Discrimination), and Article 26 (Mutual Agreement Procedure). Thus, for example, a State cannot discriminate against a dual resident company, and such a company can bring issues to the competent authorities.
>
> Dual resident companies also may be treated as resident for purposes other than that of obtaining benefits under the Convention. For example, if a dual resident company pays a dividend to a resident of the UK, the U.S. paying agent would withhold on that dividend at the appropriate treaty rate because reduced withholding is a benefit enjoyed by the resident of the UK, not by the dual resident. The dual resident company that paid the dividend would, for this purpose, be treated as a resident

[104] For clarity, I set this out in a table format, and abbreviate the section descriptions. For the provisions referred to, see 111.2 (DTA/Unilateral Credit compared); 112.1 (Non-discrimination).

[105] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> of the United States under the Convention. In addition, information relating to dual resident companies can be exchanged under the Convention because, by its terms, Article 27 (Exchange of Information and Administrative Assistance) is not limited to residents of the Contracting States.

9.18.4 *The MLI change*

Article 4 BEPS MLI[106] provides:

> 2. Paragraph 1 shall apply in place of or in the absence of provisions of a Covered Tax Agreement that provide rules for determining whether a person other than an individual shall be treated as a resident of one of the Contracting Jurisdictions in cases in which that person would otherwise be treated as a resident of more than one Contracting Jurisdiction. Paragraph 1 shall not apply, however, to provisions of a Covered Tax Agreement specifically addressing the residence of companies participating in dual-listed company arrangements.

Art 4(3) BEPS MLI provides a variety of opt-outs but the UK has not opted out of this provision.

As required by art 4(4) BEPS MLI, HMRC have published a list of DTAs with tie-breaker provisions, which will be replaced by the mutual agreement tie-breaker under the MLI.[107]

9.18.5 *MLI transitional rules*

It is possible that as a result of the MLI change, a person who was formerly treaty-resident in one treaty-state under the POEM test, becomes treaty-resident in the other treaty-state, at the time the MLI takes effect. It is also possible that a person may change treaty-residence at any time as a result of changed view of the Revenue authorities, or as a result of some change in circumstances, which need not include a change in POEM. But in practice I expect that this will be exceptional.

The INTM provides:

> **INTM120070: 'Treaty non-resident' companies** [Sep 2021]
> **... DTAs with standard tie-breakers**
> ... Following Action Point 6 of the Base Erosion and Profit Shifting

[106] See 107.15 (BEPS MLI).

[107] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725261/Final_list_of_UK_reservations_and_notifications_made_on_deposit_of_the_instrument_of_ratification.pdf*

(BEPS) project, the tie-breaker provision of Article 4(3) of the OECD Model Tax Convention was amended from one based on the entity's 'place of effective management' to one based on a determination by the Competent Authorities. A number of the UK's existing DTAs, including those with Canada and the Netherlands, already include this type of tie-breaker. However, many others will be modified to give effect to this recommendation through the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI). As such, the Competent Authority based tie-breaker can now be referred to as the 'standard tie-breaker'.

Where an existing DTA is modified by the MLI and a company was subject to the tie-breaker of Article 4 and determined to be resident in only one of the countries before the modification came into effect, HMRC will generally not seek to revisit any previous determination of the treaty residence position so long as all the material facts remain the same. However, if the arrangements in relation to which the determination has been made are such that any treaty benefits under them would be denied under the conditions of the Principal Purpose Test (PPT) in paragraph 9 of Article 29 of the 2017 OECD Model Tax Convention then HMRC would review the prior determination. Where HMRC believes arrangements in relation to which the determination has been made are such that any treaty benefits under them would be denied under the conditions of the PPT, HMRC may seek a new determination from the date on which the modification came into effect.

In other cases, where the material facts change after the modification came into effect, HMRC would generally seek for any new determination (or the loss of treaty benefits pursuant to the absence of a mutual agreement) to apply only to income or gains arising after the new determination (or notice to the taxpayer of the absence of an agreement) but this will depend on the facts and circumstances.

HMRC cannot however apply the above approach unilaterally and will be subject to agreement between the Competent Authorities.

Such agreement has been reached with the New Zealand Competent Authority and so any previous determination would be 'grandfathered' as set out above. HMRC has also agreed with the Netherlands Competent Authority that in cases where the residence position has previously been determined under either the 1980 or 2008 UK/Netherlands DTC (before the latter was modified by the MLI), that determination will be 'grandfathered' as set out above.

In 2018, HMRC entered into new DTAs with Jersey, Guernsey and Isle of Man. These DTAs include standard tie-breakers. HMRC has agreed

> with the Competent Authorities of those territories that where a company was determined to be resident in either territory under the previous Arrangement that determination will be 'grandfathered' as set out above.
>
> As the standard tie-breaker depends on the agreement of the Competent Authorities, the CTA09/S18 rule cannot be applied unilaterally by HMRC. It can only apply where the respective Competent Authorities have made a determination of residence and residence has been formally awarded to the other country. As is clear from the wording of the legislation, the absence of a claim by a company will not prevent S18 from being applied following a determination by the Competent Authorities. However, it is likely that bilateral negotiations will generally be initiated following discussions between the company and at least one of the tax authorities concerned

9.18.6 *A cautionary tale*

The issue of residence under a mutual agreement tie-breaker arose in the context of a Round the World scheme, under which:

(1) Trustees resident in Canada were appointed for a short period, April - December 2001 ("the Canadian period").
(2) UK trustees were appointed in December 2001.

The Round the World scheme worked on the basis that the trustees were residents of Canada, during the Canadian period, under the treaty tie-breaker.

The advisers overlooked that the Canada/UK DTA applied a *mutual agreement* tie-breaker rule, not the (former) OECD Model POEM tie-breaker. CRA and HMRC agreed that the trust should be treaty-resident in the UK during the Canadian period, so DT relief did not apply.

The only surprise is that:

(1) it took until 2013 for the two authorities to reach that decision (the reason for the decade delay is not given); and
(2) (for limitation purposes) the Court considered that the loss from the adviser's negligence only arose in 2013, so the negligence claim was not out of time.

I would have thought that the authorities' decision on treaty-residence was inevitable from the outset, and so the loss arose in 2001.[108] However that

[108] *Evans v PricewaterhouseCoopers* [2019] EWCH 1505 (Ch). I mention this case only for illustration: The actual decision concerned limitation issues which are

may be, the moral of the story for tax advisers is to read the treaty, and not assume it follows OECD Model form.

9.19 POEM tie-breaker

Until 2017, art 4(3) OECD Model provided (I include the French version as reference is made to this below):

> *Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only*[109] *of the State in which its place of effective management is situated.*

> *Lorsque, selon les dispositions du paragraphe 1, une personne autre qu'une personne physique est un résident des deux États contractants, elle est considérée comme un résident seulement de l'État où son siège de direction effective est situé*

I refer to this as the POEM tie-breaker.[110]

The majority of UK DTAs originally had this form. Now, the mutual agreement tie-breaker is the standard form, but POEM still matters because:

(1) A number of treaties still have the POEM tie-breaker.

(2) The OECD mutual agreement tie-breaker refers to POEM as a relevant consideration. Where POEM is clear it should be an important consideration;[111] but where POEM is unclear, or marginal, it will not.

9.19.1 *One place of effective management*

Pre-2017 the OECD Commentary provided:

> 24. ... *An entity may have more than one place of management, but it can have only one place of effective management at any one time.*[112]

outside the scope of this work, and the facts are not likely to recur.

[109] The word "only" was not originally in the 1992 Model, and was added, but presumably only for the avoidance of doubt.

[110] See Avery Jones, "Place of Effective Management as Residence Tie-Breaker" (2005) 59 Bulletin for International Fiscal Documentation 1, 20; Avery Jones, "2008 OECD Model: Place of Effective Management- What can we learn from the History?" (2009) 63 Bulletin for International Taxation 183.

[111] See 9.18 (Tie breaker: Mutual agreement).

[112] The point is made in *Oceanic Trust Co Ltd v Commissioner for South African*

It makes sense in the context of a POEM tie-breaker clause, that there can only be one POEM, for if there were two, the tie breaker would not work.

In practice it would be unusual that the management would be so decentralised that a court is unable to identify one place as that of effective management, so the issue of whether there could be two POEMs is not likely to arise.[113]

9.19.2 *POEM: Top level management*

Pre-2017 OECD Commentary provided:

> 24. ... *The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made.*[114]

This has often been cited and adopted in UK cases, as one would expect.[115]

In *Wensleydale's Settlement Trustees v IRC*:

> The place of effective management is where the shots are called, to adopt a vivid transatlantic colloquialism.[116]

This slang may be a vivid metaphor, but it hinders clarity of thought:

> [Counsel for the taxpayer] warned about adopting alternative paraphrases such as "calling the shots" because in a way shareholders called the shots but this was not a relevant type of control.[117]

It is better to refer to the place where the most important decisions are made, which allows focus on the issue of what constitute the most important questions. Thus in *Lee v HMRC*:

> the essential question is, where were the most important decisions relating to the governance, or management, of the Settlements taken?

Revenue Service (2011) 15 ITLR 172 at [54] cited in *Lee v HMRC* [2017] UKFTT 279 (TC) at [61].

[113] Contrast 8.16 (Dual residence/no CMC).

[114] The passage continues: "All relevant facts and circumstances must be examined to determine the place of effective management." But that is self-evident.

[115] Eg *HMRC v Smallwood* [2008] UKSPC SPC00669 at [124], even though this comment originated in an amendment to the OECD Commentary made after the date of the relevant treaty

[116] [1996] STC (SCD) 241 at p 250j.

[117] *HMRC v Smallwood* [2008] UKSPC SPC00669 at [114].

> The first step in the enquiry, as it seems to me, is to identify what were the most important decisions.[118]

The UN Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries 2019 provides:[119]

> 215. There was uncertainty, however, concerning the meaning of "place of effective management".
> [1] Some countries considered that this referred to a place, such as the headquarters of a company, where an entity was managed on a day-to-day basis
> [2] while other countries considered that this referred to the place where the most senior person or groups of persons (such as the board of directors of a company) reached their decisions.

The UK is clearly in group [2], and I find it hard to see how the approach of group [1] ("day-to-day management") could be reconciled with the OECD Commentary ("key decisions").

9.19.3 *POEM: Real management*

There are, inevitably, references to "real" effective management. In *HMRC v Smallwood*:[120]

> We believe 'effective' should be understood in the sense of the French *'effective'* (*siège de direction effective*) which connotes real, French being the other official version of the [OECD] model, though not of the [Mauritius/UK] treaty.

And similarly:

> we adopt [counsel's] reference to "realistic, positive management".[121]

This does not take matters much further. The word "real" never does and "realistic" is even worse.[122]

[118] [2017] UKFTT 279 (TC) at [74].

[119] *https://financing.desa.un.org/sites/default/files/2023-03/manual-bilateral-tax-treaties-update-2019.pdf*

[120] [2008] UKSPC SPC00669 at [102] approved [2010] EWCA Civ 778 at [60]. For use of French as an aid, see 107.10.5 (Treaty in two languages).

[121] *HMRC v Smallwood* [2010] EWCA Civ 778 at [114] referring to *Wood v Holden* [2006] EWCA Civ 26 at [6].

[122] See App.7.1 (What do we mean by "Real"?); App.7.8 (Realistic view of facts).

9.19.4 *POEM/CMC compared*

The former ITH provided:

> **ITH348 Company residence: proposed new test: place/effective management**
> ... At one time the view of the UK was that our domestic concept of central management and control meant the same thing as place of effective management and there was a note to this effect in the Commentary on the 1977 OECD Model Double Taxation Convention.

This note, which lasted from 1977 to 1992, provided:[123]

> Concerning conventions concluded by the United Kingdom which provide that a company shall be regarded as resident in the State in which "its business is managed and controlled", it has been made clear, on the United Kingdom side, that this expression means the "effective management" of the enterprise.

The ITH continues:

> We no longer believe that necessarily to be so and the note does not appear in the 1992 edition of the OECD Model.
> The place of effective management is generally understood to be the place where the Head Office is: the Head Office in the sense of - not the registered office - but the central directing source. The place where one would expect to find the finance director, for example, the sales director and, if there is one, the managing director. The company records would normally be found there together with the senior administrative staff.
> If that Head Office were to be, let us say, in the Netherlands the place of effective management would not be altered if the directors chose to hold their occasional formal meetings in Belgium. ... We think our revised idea of effective management and the attempted 1981 definition[124] are nearer at least to our European Community partners' management tests than is central management and control. Nevertheless it is not that easy to divorce effective management from central management and control and in the vast majority of cases they will be located in the same place.

[123] This is set out in OECD, *Model Tax Convention on Income and on Capital 2017 (Full Version);* the OECD's "Condensed Version" does not include historical notes. *https://read.oecd-ilibrary.org/taxation/model-double-taxation-convention-on-income-and-capital_9789264055919-en#*

[124] See 8.24 (Company residence: Critique).

SP 1/90 also refers to the pre-1992 OECD Commentary and continues:

> 22... It is now considered that effective management may, in some cases, be found at a place different from the place of central management and control. This could happen, for example, where a company is
> [1] run by executives based abroad, but
> [2] the final directing power rests with non-executive directors who meet in the UK.
> In such circumstances the company's place of effective management might well be abroad but, depending on the precise powers of the non-executive directors, it might be centrally managed and controlled (and therefore resident) in the UK.

In *HMRC v Smallwood*:

> [In] *Wood v Holden* ... Chadwick LJ expressed the view that it was difficult to draw any meaningful distinction between the two tests [POEM, and CMC] but that even if they did in fact differ in substance, they were unlikely to lead to different results.[125]

The difference (if any) between top level control (CMC), and key management decisions (POEM) is one of almost imperceptible nuance; what matters is that both stress "top level" or "key supervision" and neither are concerned with day-to-day management. So there never has been a case where an entity had CMC in one place and POEM in another; and it seems safe to say that there never will be.

There is a difference that there can only be one POEM, but there could (at least theoretically) be two or more places of CMC, or perhaps no CMC.

In *HMRC v Smallwood* the Special Commissioners say:

> There was thus some debate about whether, or to what extent, POEM differed from CMC [central management and control]. We consider that this misses the point; the two concepts serve entirely different purposes.

[125] [2010] EWCA Civ 778 at [58]. This is right, though, for completeness, Chadwick LJ actually made the point more circumspectly, [2006] EWCA Civ 26 at [6]:

> "It is not clear—at least, not clear to me—whether the art 4(3) test [POEM] differs in substance from the *De Beers* test [CMC]; and, if the two tests are not, in substance, the same, I find it very difficult to see how, in the circumstances which the Special Commissioners had to consider, they could lead to different answers."

> [1] CMC determines whether a company is resident in the UK or not;
> [2] POEM is a tie-breaker the purpose of which is to resolve cases of dual residence by determining in which of two states it is to be found.
>
> CMC is essentially a one-country test; the purpose is not to decide where residence is situated, but whether or not it is situated in the UK…
>
> POEM, on the other hand, must be concerned with what happens in both states since its purpose is to resolve residence under domestic law in both states, caused for whatever reason, which could include incorporation in one state and management in the other, or different meanings of management applied in each state, or different interpretations of the same meaning of management applied in each state, or divided management. One must necessarily weigh up what happens in both states and ... decide in which state the place of effective management is found.[126]

But this is only theoretical, because in practice dual residence (CMC in two places or in none) does not arise.[127]

In practice, POEM cases and guidance refer extensively to CMC case law, which makes sense if they are (more or less) the same.

A different analysis was adopted by the UT in the second *Haworth* case.[128] I find this difficult to follow; but discussion should wait until the decision is final.

9.19.5 *Period for enquiry into POEM*

While one needs to determine whether a person is treaty-resident at a particular moment, one looks over an appropriate period of time to determine POEM.[129] The issue is where key management and commercial

[126] [2008] UKSPC SPC00669 at [111]-[112]. This case concerned a trust, but the same applies to a company: *Laerstate BV v HMRC* [2009] UKFTT 209 at [48]. See Avery Jones, "The Definition of Company Residence in Early UK Tax Treaties" [2008] BTR 556.

[127] See 8.16 (Dual residence/no CMC).

[128] *Haworth v HMRC* [2024] UKUT 58 (TCC)

[129] This is self-evident, but if authority is needed, see *HMRC v Smallwood* [2010] EWCA Civ 778 at [47]:

> "Both sides approached [the POEM] issue by reference to what the Special Commissioners described as the Mauritius period: i.e. the period up to and including the sale of the shares during which [the Mauritian trustee] remained the trustee. This was on the basis that it is in respect of the Mauritius period that the

decisions are regularly and predominately made.

9.19.6 *Round the World schemes*

As many POEM cases involved a (so called) Round the World scheme, it may be helpful at this point to explain this scheme.

The scheme was designed for a settlor-interested trust where:

(1) The trust was not UK resident.
(2) The trust was within s.86 (ie the settlor was UK resident & domiciled).
(3) The trust was (originally) resident in a tax haven which had no DTA with the UK (or if there was a DTA, it did not cover chargeable gains); for the purpose of discussion, say, Jersey.

If the trust realised a gain, the settlor would therefore be chargeable.

The scheme involved two simple steps and a commercial sale:

(1) The original (say, Jersey) trustees retired in favour of trustees who were residents of a State which had a DTA conferring CGT relief in OECD Model form (commonly, Mauritius).[130]
(2) The Mauritius trustees sold the trust asset and realised a gain.
(3) The Mauritius trustees retired in favour of UK resident trustees.[131]

The tax analysis was:

(1) The settlor was not taxed under s.86 because the trust was UK resident in part of the tax year.[132]
(2) The settlor was in principle within s.77 TCGA (long repealed) but claimed 3rd party treaty relief.[133]
(3) If the UK trustee were subject to CGT, they too claimed treaty relief

trustees are chargeable to tax in both Contracting States."

Contrast 9.16 (Period of enquiry: Tie-breaker).

[130] If the facts were that the trust was already in a state with a DTA, say, Mauritius, then step 1 would not be needed. None of the reported cases were of that kind, so they all began with the move to Mauritius.

[131] The reader may have considered a similar arrangement where the non-resident trust was not within s.86 but is within s.87. In the absence of an anti-avoidance provision, the same steps could be taken in order to avoid a s.1(3) amount (trust gain). But this is caught by s.88 TCGA; see 61.38 (Dual resident trust: s.88 TCGA).

[132] See 60.9 (Trust residence condition)..

[133] Section 77 TCGA formerly charged the settlor on gains of a settlor-interested trust which was resident in the UK in any part of the year. The settlor claimed third-party DT relief, which HMRC accepted could apply; see 109.1 (Third-party DT relief).

I wonder who came up with the catchy title "Round the World". It is not entirely inapt.

The scheme was stopped by statute in 2005.[134]

This scheme was widely used, and in due course, widely litigated. The key to the scheme was the availability of DTA relief at step (2). This required a POEM in Mauritius during the Mauritian period. The cases raise several interesting issues, but first and foremost, POEM.

The schemes had the following important features:

(1) The scheme was devised by tax advisers in the UK.
(2) Under the scheme:
    (a) Trustees in the foreign treaty state acted only for a few months.
    (b) Those trustees disposed of a significant trust asset.
    (c) UK trustees were appointed in the tax year of disposal.

The trustees argued that POEM was in the foreign State as the foreign trustees were managing the trust there during their period of office HMRC argued that POEM was in the UK as the settlor and/or professional advisers in the UK were the true managers.

One might regard this as a usurpation/rubber stamping issue.

Cases on Round the World schemes include:

Case: Level	**Topic**	**See**
Tax cases:		
Smallwood: CoA	POEM	
Lee: FTT	POEM	
1st Haworth case: SC	Follower notices/POEM	
2nd Haworth case: UT	POEM	
Wesley: FTT	POEM	[2023] UKFTT 1041 (TC)
Non-tax cases		
Evans v PWC: HC	Negligence; Limitation; Need to read DTA (!)	9.18.6
MacKay v Wesley: HC	Validity of appointment of UK trustee	*Not discussed*

Round the World schemes (in short) succeeded on all points other than the factual issue of POEM. But to lose on that was to lose on everything.

"Flip-flop" schemes were common at about the same time. After some vacillation, the s.87 version of these schemes succeeded, or at least those of them which held out to the end of the battle.[135] But the successful "flip-

[134] See 56.26 (Immigrant trust: DTR override).

[135] See 62.2 (Flip-flop schemes).

flop" schemes won on issues of law, and the unsuccessful Round the World schemes lost on issues of fact.

What lessons should be learned from this? I leave readers to ponder over that. Perhaps the most important point is that the tax world today is very different from what it was in the year 2000. Though we should hardly need to be told that.[136]

9.19.7 *POEM: Round the World scheme*

HMRC v Smallwood[137] was the first case on the Round the World scheme. In *Smallwood* a trust had three different trustees, resident in different states, in the course of the tax year 2000/01:

Apr - Dec: a Jersey resident trustee
Dec - March: a Mauritius resident trustee ("the Mauritian period")
March onwards: UK resident trustees

The trustees sold an asset, realising a gain, during the Mauritian period. It was necessary to find the POEM during the Mauritian period.[138]

As there is (more or less) no difference between CMC/POEM, the same distinction should drawn between influence and usurpation/rubber stamping, which is discussed in CMC cases.[139]

Patten LJ (dissenting) adopted the traditional usurpation test:[140]

> the question [is]
> [1] whether the effective decision by [the Mauritian trustee] to implement the tax scheme and to sell the shares was taken by the board of directors of that company, albeit on the advice and at the request of KPMG Bristol, or
> [2] whether the [trustees] effectively ceded any discretion in the matter to KPMG by agreeing to act in accordance with their instructions.
> Given that the directors of [the trustee] remained in place and exercised their powers as directors to effect the sale, the approach to this issue

[136] See 2.5 (Attitudes to tax avoidance).

[137] [2010] EWCA Civ 778.

[138] See 9.9.3 (Trust residence moves in tax year).

[139] Eg, South African Interpretation Note: No. 6 (Issue 2) (2015) *https://www.sars.gov.za/wp-content/uploads/Legal/Notes/LAPD-IntR-IN-2012-06-IN-6-Resident-Place-of-effective-management-companies.pdf*
For the "usurpation/rubber stamping" case law, see 8.6 (Central management/control test) ff.

[140] at [61].

> suggested by Chadwick LJ in *Wood v Holden* must be the right test.

Applying this test[141]

> ... the Special Commissioners ... accepted ... that there was no agreement that [the Mauritian trustees] would behave in a certain way or make certain decisions as a quid pro quo for the introduction of the trust and that had the sale of the shares not been in the interests of the beneficiaries as at the date of the sale then [the trustee] would not have agreed to sell.
> ... [the trustees] accepted the advice of KPMG to proceed with and implement the scheme in the interests of the beneficiaries. But they retained their right and duties as trustees to consider the matter at the time of alienation and did not ... agree merely to act on the instructions which they received from KPMG.
> The function of the directors was not therefore usurped in the sense described in *Wood v Holden*. It seems to me to follow that the Special Commissioners' conclusions are not ones which were therefore open to them on the evidence or on the findings of fact which they made.

But the majority reached the opposite conclusion:

> [68] If the question were the POEM of the particular trust company trustee for the time being at the moment of disposal, namely [the Mauritian trustee], then it may (?) be that the reasoning in *Wood v Holden* would justify the conclusion that the Commissioners fell into this kind of error. ... their findings do not go so far as findings that the functions of [the Mauritian trustee] were wholly usurped, and I agree that *Wood v Holden* reminds us that special vehicle companies (or, no doubt, special vehicle boards of trustees) which undertake very limited activities are not necessarily shorn of independent existence; indeed they would be ineffective for the purpose devised if they were.

So far, so conventional.

> [69] But it seems to me that to apply this reasoning to the present case is to ask the wrong question, and indeed to return to the rejected snapshot approach. The taxpayers with whom we are concerned ... are the trustees. Trustees are ... treated as a continuing body...
> On the primary facts which the Special Commissioners found ... I do not think that it is possible to say that they were not entitled to find that the POEM of the trust was in the UK in the fiscal year in question.

[141] at [62] - [63].

The Court then explains why:

> The scheme was devised in the UK by Mr Smallwood on the advice of KPMG Bristol. The steps taken in the scheme were carefully orchestrated throughout from the UK, both by KPMG and by Quilter. And it was integral to the scheme that the trust should be exported to Mauritius for a brief temporary period only and then be returned, within the fiscal year, to the UK, which occurred. Mr Smallwood remained throughout in the UK. There was a scheme of management of this trust which went above and beyond the day to day management exercised by the trustees for the time being, and the control of it was located in the UK.[142]

It seems to me that various arguments are suggested here.

The first is that one determines POEM on the basis of a whole year and not on the basis of the "brief temporary" Mauritian period (in fact, 2½ months). But that cannot be right.[143]

The second rejects the usurpation test. But the majority actually said that they were not doing this.

The third argument is that the Special Commissioners were entitled to find as a fact that discretion of the Mauritian trustee was usurped. On that basis *Smallwood* depends on its facts; and that is the analysis adopted in *Haworth, (R oao) v HMRC* ("the first *Haworth* case"):[144]

> Hughes LJ did not decide that it was an inevitable consequence of a scheme which shared the *Smallwood* pointers[145] that its POEM would be the UK and not Mauritius. All the members of the Court of Appeal accepted that the test was that set out in the Commentary ... that "no

[142] *HMRC v Smallwood* [2010] EWCA Civ 778 at [70].

[143] See 9.19.5 (Period for enquiry into POEM).

[144] [2021] UKSC 25 at [75].

[145] Seven "*Smallwood* pointers" were identified at [31]:
1 The applicable DTA had POEM tie-breaker (as was then standard form)
2 The taxpayer was UK resident.
3 The scheme or arrangements had been devised in the UK.
4 The steps taken in the scheme were carefully orchestrated throughout from the UK.
5 The trust was exported to the overseas territory for a brief period only.
6 The trust returned to the UK in the tax year.
7 The arrangements were implemented in a way which integrated these features. (Point 7 does not seem to add much to points 1-6, but it does not matter).
In practice Round the World schemes (almost) always met these "pointers".

> definitive rule can be given and all relevant facts and circumstances must be examined to determine the place of effective management". Although Hughes LJ summarised the findings of the Special Commissioners in para 70 of his judgment, he was not, in my view, listing those pointers as being necessary and sufficient to establish in any other case that the POEM of the trust is the UK. On the contrary, he referred to the full description of the primary facts found by the Special Commissioners as set out in the judgement of Patten LJ as supporting their finding that in Mr Smallwood's case, the POEM of their trust had been the UK.

The reader may think the dissenting judgment of Patten LJ is more convincing, but so far as the outcome depended on its facts, rather than a point of law, it does not matter - at least, as a matter of strict law. A legal realist may think that *Smallwood* is one of those cases where decision came first and grounds later.

A different, analysis was adopted by the UT in the second *Haworth* case.[146] I find this difficult to follow; but discussion should wait until the decision is final.

The reader can draw the conclusion that a Round the World scheme, and any avoidance scheme involving short term residence in a treaty State, needed meticulous care in execution if it is not to fail on factual POEM grounds.

9.19.8 *POEM of trust*

POEM is the tie-breaker for trusts (and estates), as well as for companies, even if the trustees (or PRs) are individuals.[147]

The test of POEM of a trust is the same as for a company, though the approach and terminology used requires adaptation to reflect trust structures.

The International Manual provides:

> **INTM353600. Claims by trustees in Ireland** [Mar 2016]
>
> ...
>
> ***Criteria for determining the place of effective management of an Irish trust***
>
> You need to find out who generally controls and supervises the work of administering the trust. By administering the trust we mean: keeping

[146] *Haworth v HMRC* [2024] UKUT 58 (TCC).

[147] See 9.21 (Treaty-residence: Trusts).

> accounts, conducting correspondence, arranging the trustees' meetings and putting the trustees' decisions into effect.
>
> ***If the trustees are all individuals***
>
> You will need to find out which of the trustees is responsible for the tasks outlined above, and the dates and locations of all trustees' meetings held during the period of the claim.
>
> ***If a professional body acts as a trustee***
>
> You can accept that the place of business of the professional body is the place of effective management of the trust.
>
> For this purpose the professional body is appointed by the testator or settlor of the trust, and does not include:
>
> - An individual who is a solicitor or an accountant
> - An agent or an attorney administrator appointed by the trustees
>
> ***Residence of a professional body***
>
> If a professional body acting as a trustee is a branch in Ireland of a UK bank or similar institution, it is considered to be in Ireland for the purposes of Article 4(3). A UK branch of an Irish bank would however not be considered to be in Ireland.

This is commenting on the Ireland/UK DTA which at the time adopted a POEM tie-breaker. But these are broad generalities which may give way to the facts of the particular situation.

9.19.9 *Trust Fund CMC in Australia*

The Australian Revenue have given guidance on "central management and control"of a superannuation fund (which is a trust) and it is considered this is also helpful to the concept of POEM of a trust. I only set out selections here:[148]

> ***Meaning of 'central management and control' in the context of a superannuation fund***
>
> 111. ... the question arises as to whether the CM&C test that is applied to companies can also be applied to determine the meaning of CM&C as it relates to superannuation funds.[149]
>
> ... despite differences between the kinds of activities a company may undertake and those

[148] Taxation Ruling TR 2008/9, "Income tax: meaning of 'Australian superannuation fund' in subsection 295-95(2) of the Income Tax Assessment Act 1997" *https://www.ato.gov.au/law/view/document?DocID=TXR/TR20089/NAT/ATO/00001*
Some footnotes are omitted.

[149] For the CM&C test for companies see TR 2018/5 discussed at 8.1 (Company residence: Introduction).

of a superannuation fund, we consider that an analogy can be drawn between the business activities of a company and the activities of a superannuation fund in that the activities of a superannuation fund, like the business activities of a company, require personal control and direction. Accordingly, we consider that the principles established in cases dealing with the operation of the CM&C test in relation to companies are capable of application to determine the meaning of CM&C as it relates to superannuation funds....

115. Like companies, determining the CM&C of a superannuation fund involves a focus on the who, when and where of the strategic and high level decision making of the fund.

116. In the context of the operations of a superannuation fund, the strategic and high level decision making of the fund includes the performance of the following duties and activities:

- formulating the investment strategy for the fund;
- reviewing and updating or altering the investment strategy of the fund as well as monitoring and reviewing the performance of the fund's investments;
- if the fund has reserves - the formulation of a strategy for their prudential management; and
- determining how the assets of the fund are used to fund member benefits, for example the decision to segregate certain fund assets to support superannuation income stream benefits.

117. The other principal areas of operation of a superannuation fund that form part of the day-to-day or operational side of the fund's activities will not constitute CM&C. These activities do not form part of the CM&C of the fund because they are not of a strategic or high level nature. Rather, these activities are of a more formalistic or administrative nature. Examples of such activities include the acceptance of contributions that are made on a regular basis, the actual investment of the fund's assets, the fulfilment of administrative duties[150] and the preservation, payment and portability of benefits.

118. Furthermore, in accepting such contributions, paying benefits and in the fulfilment of administrative obligations, the prudential requirements in SISA, the governing rules of the fund and other legislative requirements are merely being complied with. As emphasised by the courts in the context of companies, compliance with statutory requirements is not, of itself, sufficient to constitute CM&C but rather is a matter to be taken into account in determining where the CM&C is located...

Who exercises the CM&C of the fund?

119. As mentioned above, the majority of superannuation funds operate under a trust structure. According to the general law of trusts, a trust is not a legal person but rather is a collection of rights, duties and powers arising from the relationship to property held by the trustee for the benefit of beneficiaries. Therefore, the trustee is the legal person to that relationship. Since the legal responsibility for operating and managing the fund, including the responsibility for performing the high level duties and actions mentioned in paragraph 116 of this Ruling rests solely with the trustee, it is the trustee of the fund who has the legal obligation for exercising the CM&C of a fund.

122. ... the trustee's duty or responsibility to carry out or perform those activities that constitute CM&C does not, of itself, amount to CM&C. It is only by performing those

[150] Footnote original: Such as lodging the regulatory and income tax return for the fund, the preparation of financial statements, the audit of the fund and record-keeping.

> high level duties and activities that the trustee will be exercising the CM&C in practice. There also may be situations where a person other than the trustee is exercising the CM&C of the fund...
>
> ***Delegation of the investment management function***
>
> 128. The trustee of a superannuation fund will often appoint an investment manager to invest the assets of the fund, consistent with the investment strategy of the fund, on behalf of the trustee. Importantly, the investment manager is subject to a prudential requirement under SISA to periodically provide information to the trustee of the fund regarding the making of, and return on those investments and to provide such information as is necessary to enable the trustee to assess the capability of the investment manager to manage the investments of the fund.
>
> 129. The delegation of the investment management function to an investment manager does not mean however that the investment manager is exercising the CM&C of the fund in any sense. This is because the trustee is still controlling the operations of the fund by ensuring that the investments of the fund are consistent with the investment strategy of the fund and by monitoring and evaluating the performance of the investment manager. Further, the actions of the investment manager in investing the assets of the fund in accordance with the fund's investment strategy comprise part of the day-to-day or 'operational' side of the operations of the fund rather than the strategic or high level decision making activities of the fund...

9.20 POEM: Critique

The POEM tie-breaker test has arisen in tax avoidance cases. I refer to these as "POEM avoidance cases". Examples are the Round the World cases, and *Wensleydale*.

9.20.1 *POEM in avoidance cases*

Strictly, an avoidance context is irrelevant to POEM.[151] But the reader may think that an unspoken policy of defeating tax avoidance has in practice been a factor in determining the result in POEM avoidance cases. The policy is not wholly "unspoken". OECD Commentary provides:

> 24.5 Some States, however, consider that it is preferable to deal with cases of dual residence of entities through the rule based on the "place of effective management" that was included in the Convention before 2017. These States also consider that this rule can be interpreted in a way that prevents it from being abused.

I do not think that the UK was formerly one of the States that considered that the POEM rule could be interpreted in a way that prevented abuse. However the Principal Purpose Test (inserted into treaties by the BEPS

[151] See 6.39.1 (Avoidance irrelevant to residence tests).

MLI) will now achieve this.[152]

9.20.2 *Change from POEM*

OECD report BEPS Action 6 explains the background to the change from POEM to mutual agreement tie-breaker:[153]

> ... a company is a dual-resident often involve tax avoidance arrangements. For that reason, the current rule found in Article 4(3) should be replaced by the [Mutual agreement tie-breaker], which allows a case-by-case solution of these cases.

OECD Commentary provides:

> 22. When [art 4(3)] was first drafted, it was considered that it would not be an adequate solution to attach importance to a purely formal criterion like registration and preference was given to a rule based on the place of effective management, which was intended to be based on the place where the company, etc. was actually managed.
> 23. In 2017, however, the Committee on Fiscal Affairs recognised that although situations of double residence of entities other than individuals were relatively rare, there had been a number of tax-avoidance cases involving dual resident companies. It therefore concluded that a better solution to the issue of dual residence of entities other than individuals was to deal with such situations on a case-by-case basis.

Was this a good reason? Certainly, Round the World schemes were common, but that could have been (and indeed was) dealt with by more targeted legislation (as was the scheme in *Wensleydale*). How often did this problem arise elsewhere? OECD Commentary refers to “a number of tax-avoidance cases”. OECD report BEPS Action 6 went further and said that dual-resident companies *often* involve tax avoidance arrangements. Perhaps that “often” was an exaggeration, but it is hard to say. Did the problem of avoidance justify the substantial increase in Revenue power conferred by a mutual agreement tie-breaker? Or could it be justified by the advantage that we will no longer have unsatisfactory POEM case law? Perhaps there is now less uncertainty than before?[154] Discuss.

[152] See 108.8 (Principal purpose test).

[153] OECD/G20 “Preventing the Granting of Treaty Benefits in Appropriate Circumstances” (BEPS Action 6); (2015), p.72.

[154] See 3.27.2 (Avoidance concept defended).

9.20.3 *Modern business practice*

Van der Merwe identifies difficulties with CMC, which apply equally to POEM:

> ... the phrase was coined when companies were generally organised in a hierarchical structure and management could be located at a specific point within a certain period of time. However, modern companies are increasingly run and managed divisionally rather than through the legal entities in which the divisions are formed. This has resulted in an organisational network spread across different countries.

The second point is perhaps more serious:

> Also, due to modern technology, management has become much more mobile and traditional places of effective management may rotate. Technology has furthermore made it possible to manage without the need for a group of persons to be physically located or to meet in one place, for instance at the company's headquarters. Because of these changed management structures and technology, effective management based on where the directors meet becomes a matter of choice and manipulation. Even when based on a wider interpretation of key management and decision making, it is evident that technology makes it difficult to pin effective management down to one constant location...[155]

These difficulties were not cited as the driver for the change from POEM to mutual agreement tie-breaker, but perhaps they might have been.

The reader may think that this discussion of the merits of the change from POEM to mutual agreement is of academic interest only. The mutual agreement tie-breaker is now established. But exactly the same considerations arise in relation to the central management and control test of company residence. Here, however, it has not (yet?) been suggested that CMC should be replaced by a HMRC discretion to determine corporate residence.

9.21 Treaty-residence: Trusts

The first step is to identify who is the "person" for treaty purposes.[156]

[155] Van der Merwe, "The Phrase 'place of effective management': Effectively Explained?" 18 SA Merc LJ 121 at p.124-125.

[156] See 9.4 (Treaty-person).

9.21.1 *Trust law background*

The use of the word "person" always requires some care.[157]

Three propositions are well established:

(1) A trust is not a person (ie does not have legal personality). This is the case in the trust law of England, Scotland,[158] and, as far as I know, all common law jurisdictions.[159] (In other jurisdictions, trusts or trust-like entities generally do have legal personality.)

(2) A trustee is a person.

(3) It is often convenient to distinguish:
(a) a person acting in their capacity as trustee and
(b) that person acting in their private capacity.
However trust law does not usually recognise the concept of separate personality: as there is only one person, the person acting in one capacity is not a different person from the person acting in another capacity. For instance, a person (as trustee) cannot enter into a contract with himself or herself (in a private capacity, ie as an individual) because of the rule in English law[160] that a contract must be made between distinct persons.[161]

[157] See App.2.6 (Person).

[158] The Scottish Law Commission discussed but rejected a proposal to give trusts legal personality: *Discussion Paper on the Nature and the Constitution of Trusts* (2006) para 2.29-2.45 *https://www.scotlawcom.gov.uk/download_file/view/128*

[159] Though a trust is close to being a person. Gretton, "Trusts Without Equity" (2000) 49 ICLQ 599 reprinted in Valsan (ed), *Trusts and Patrimonies* (2015) chap 5:

> "In ordinary language the noun 'trust' is a person word. Idiom treats it like 'company'. 'This land is owned by a trust.' 'These shares are held by a trust'. ... 'The trust is liable for this debt.' Ordinary language is right."

So one should not rule out the possibility that context may show that the word "person" is used (loosely rather than strictly) to mean or include a trust.

[160] The contract law position may be different in Scotland: McBryde, *The Law of Contract in Scotland*, (3rd ed, 2007) para. 3-05 n.11: "A [person] might contract with himself under a different title, e.g. as an individual and as an executor". But the trust law rule is the same; see *Shenken v Phoenix Life* [2015] CSOH 96 at [24]:

> "From the perspective of [Phoenix Life] as debtor under the policy, Mr Schwartz was a single, indivisible, legal person. Either he had title, as a matter of law, to receive the policy proceeds or he did not. If he had had title ... then it would not have mattered, in my view, if he had purported to claim payment in the wrong capacity; the defenders would still have paid the correct person and their liability would have been extinguished."

[161] Discussion of the topic demands reference to *The Mikado:*

Ko-Ko. Pooh-Bah, it seems that the festivities in connection with my approaching

One might say that the source of difficulty is not the rule that a trust is not a person: it is the rule that a trustee does not have a separate personality. But perhaps that comes to the same thing. However that may be, this rule (or its consequences) can be overridden by context. Despite that rule, references in legislation to "individuals" have always been understood to exclude trustees even if the trustees are individuals in their private capacity. Likewise, references to "trustees" exclude individuals. That usage takes us towards some concept of separate personality. Further, for IT/CGT purposes, a trustee is deemed to be a distinct, notional person.[162] So in an IT/CGT context, at least, rule (3) does not apply: the person acting as trustee *is* in principle regarded as a separate person from the

marriage must last a week. I should like to do it handsomely, and I want to consult you as to the amount I ought to spend upon them.

Pooh-Bah. Certainly. In which of my capacities? As First Lord of the Treasury, Lord Chamberlain, Attorney General, Chancellor of the Exchequer, Privy Purse, or Private Secretary?

Ko-Ko. Suppose we say as Private Secretary.

Pooh-Bah. Speaking as your Private Secretary, I should say that, as the city will have to pay for it, don't stint yourself, do it well.

Ko-Ko. Exactly – as the city will have to pay for it. That is your advice.

Pooh-Bah. As Private Secretary. Of course you will understand that, as Chancellor of the Exchequer, I am bound to see that due economy is observed.

Ko-Ko. Oh! But you said just now "Don't stint yourself, do it well".

Pooh-Bah. As Private Secretary.

Ko-Ko. And now you say that due economy must be observed.

Pooh-Bah. As Chancellor of the Exchequer.

Ko-Ko. I see. Come over here, where the Chancellor can't hear us. Now, as my Solicitor, how do you advise me to deal with this difficulty?

Pooh-Bah. Oh, as your Solicitor, I should have no hesitation in saying "Chance it"

Ko-Ko. Thank you. I will.

Pooh-Bah. If it were not that, as Lord Chief Justice, I am bound to see that the law isn't violated.

Ko-Ko. I see. Come over here where the Chief Justice can't hear us. Now, then, as First Lord of the Treasury?

Pooh-Bah. Of course, as First Lord of the Treasury, I could propose a special vote that would cover all expenses, if it were not that, as Leader of the Opposition, it would be my duty to resist it, tooth and nail. Or, as Paymaster General, I could so cook the accounts that, as Lord High Auditor, I should never discover the fraud. But then, as Archbishop of Titipu, it would be my duty to denounce my dishonesty and give myself into my own custody as first Commissioner of Police.

Ko-Ko. That's extremely awkward.

[162] See 7.3 (Trustees a distinct person).

same person acting in their private capacity.

9.21.2 *Trustees under OECD Model*

One would expect:

(1) Trustees (if more than one) to be treated as one person ("a trustee-person"). That avoids the difficulty which may arise if a trust has trustees resident in different places in their private capacities.

(2) Where there is a single trustee, that person is to be treated as a person (again, I use the expression "trustee-person") who is distinct from the individual or company who is the trustee, acting in their private capacity. That allows for the possibility that the person may be treaty-resident in one State in their private capacity and treaty-resident in another State in their trustee capacity.

Is there any difficulty in reading the model treaty to reach this result? Where there is more than one trustee, there is no difficulty at all: the trustees should be regarded as a body of persons (and so constitute one person) for treaty purposes. That trustee-person is necessarily distinct from the persons who act as trustees.

Where there is a sole trustee, it should still be regarded as a person distinct from the person who is actually the trustee in their private capacity. It would be odd to have one rule for a sole trustee and another where there is more than one trustee. One way to reach this result is to say that even a sole trustee is a "body of persons". A single person constitutes a body of persons, because the current trustee together with successors and predecessors constitute the "body". A corporation sole may be an example.

Another way to reach this result is to say that "person" is to be understood by reference to domestic tax law, domestic IT/CGT law treats the trustee as a separate person, despite the trust law rule to the contrary; and so the same rule applies for treaty purposes.

The trustee-person is not an individual, so in a tie-breaker case, its treaty-residence is decided by the POEM rule, not the rule for individuals (which would obviously not be appropriate).

Another possible analysis would be that the *trust* is a person for OECD Model purposes (a treaty-person). There are two difficulties with that:

(1) A trust is not a "person" in English law.

(2) Even if the trust were a treaty-person, it is only a resident of a State under art 4(1) if it is a person "liable to tax". Whether a person is liable to tax is a matter of domestic law. In UK law, it is the trustees

rather than trust which is liable to tax.

These arguments are not insuperable: since treaties can be purpively construed, there are no words from which there is no escape. One could say that a trust is a treaty-person even though not a person in English law; and that the trust is "liable to tax" (in the treaty sense) since the trust fund will bear the tax. But there is no need to take this high-handed course, as to regard the trustee or trustees as a distinct trustee-person is the simpler and more satisfactory solution.[163]

INT Manual provides:

> **INTM162120. Certificates of Residence: for trusts** [Sep 2021]
> Trusts are not themselves liable to tax in the UK, but the trustees may be liable to tax in the UK. A trust therefore cannot be a resident of the UK for the purposes of most UK DTAs. Accordingly a Certificate of Residence (CoR) cannot normally be issued in respect of a trust...
> Trustees as a body (rather than the trust) are regarded as a single person. Where the trustees as a body are regarded as resident in the UK they will be entitled to the benefits of a DTA as they are liable to tax in the UK in respect of the income of the trust. Subject to the comments in the next paragraph a CoR can be issued in respect of a UK resident body of trustees.

9.21.3 *Trust a person in foreign trust law*

As noted above, a trust is not a person in English law or in trust law jurisdictions which follow English law. It is of course possible that a foreign law might classify a trust as a person. Thus a trust in Mauritius was found to be a person. But it made no difference to the applicability of treaty relief.[164]

The same would apply to the estate of a deceased person.

9.21.4 *Trusts: Non OECD Model DTAs*

INT Manual provides:

[163] It has been suggested that the question whether the person for the purposes of OECD Model is the trustees (as a body) or the trust is purely theoretical; it makes no difference in practice. I have some sympathy with that view. But (1) it is always good to know what one is talking about; (2) HMRC need to know what name(s) to put on a residence certificate: the trust or the trustee(s).

[164] *Lee v HMRC* [2017] UKFTT 279 (TC) at [87]. For the consequences, see 109.2 (Third-party DT relief).

> **INTM162120. Certificates of Residence: for trusts** [Sep 2021]
> ... However, some trusts are included within the definition of 'resident of a Contracting State' in specific DTAs. In those limited circumstances a certificate of residence can be issued in respect of a trust. It is therefore essential that the relevant DTA is checked on receipt of all applications.

An example is art 3(1) USA/UK DTA: a trust included in the definition of person in this DTA.[165]

9.22 Treaty-residence: Partnerships

This section considers whether a partnership is a treaty-resident of a State. For other DT issues see 85.25 (DT relief for partnership).

9.22.1 *Partnership a treaty-person*

The first question is whether a partnership is a treaty-person, ie a person for treaty purposes.[166] Before turning to the OECD Model definition, one might expect a partnership to be a treaty-person, since:

(1) It avoids difficulty which would arise if a partnership had partners who were resident in different places in their private capacity.
(2) It avoids an undesirable distinction between English partnerships (which are not legal persons in the English law sense) and Scottish partnerships (which are).
(3) "It is highly improbable that so common a vehicle for commercial activity as a partnership should have been intended to be excluded" from a DTA.[167]

Article 3(1)(a) OECD Model provides that the term "person" includes an individual, a company and any other body of persons.[168] There are three bases for arguing that a partnership is a treaty-person ie within this definition:

(1) A partnership is a body of persons, and so within the definition (the "body of persons" argument).
(2) A partnership is a person in the ordinary sense of the expression (the "ordinary person" argument.)

[165] See 9.4.1 (Person: Treaty definition).
[166] See 9.4 (Treaty-person).
[167] *Padmore v IRC* 62 TC 352 at p.377.
[168] See 9.4.1 (Person: Treaty definition)..

(3) Partners (being individuals or companies) are persons (in their private capacities) and a partnership is a person because the singular includes the plural (the singular/plural argument).

Discussion is made more difficult because of the variety of wording in different treaties.

The body of persons argument succeeded in *Padmore v IRC*, where a partnership was held to be a person for the purposes of the former Jersey/UK DTA. This was a pre-1963 DTA,[169] and the definition of "person" was not quite OECD Model form:

> The term "person" includes any body of persons, *corporate or not corporate*

The court held that a partnership is a body of persons in the ordinary sense of that term. Accordingly it constituted a treaty-person within that definition.

The Revenue referred to the statutory definition. What is now s.898 ITA/1119 CTA 2010 provides:

> 'Body of persons' means any body politic, corporate or collegiate, and any company, fraternity, fellowship and society of persons whether corporate or not corporate".[170]

That is, the Revenue argued:

(1) a partnership (although a body of persons in the general sense) was not a body of persons in this UK tax law sense and
(2) the UK tax law sense applied in the treaty because of the general rule that undefined treaty terms have domestic tax law meanings.[171]

The court's reason for rejecting the argument at point (2) was equally subtle:

> If that [UK tax law] definition [of body of persons] is applicable, a partnership is (I will assume) not within it; because a partnership cannot be brought within any of the groups specified in the definition.[172] ...

[169] See 107.24 (Pre-1963 DTAs).

[170] Jersey Law has a provision in the same terms; see *Padmore v IRC* 62 TC 352 at p.377. The terms used in the definition are of historical significance only, and it is a pity that the tax law rewrite failed to modernise and simplify this, but there it is.

[171] The relevant provision of the former Jersey/UK DTA was similar to OECD Model form; see 107.12 (Undefined treaty terms).

[172] This is supported by s.681DL(7) ITA, which expressly provides that a body of

> however ... the [UK tax law] definition is not applicable. The draftsman of the Arrangement in para 2(1)(d) was giving a comprehensive definition of the word "person". If he was assuming that the statutory definition of "body of persons" would apply, I see no reason why he should have added the words "corporate or not corporate". They form part of the Article 2(1)(d) definition itself, and their inclusion had no purpose if the statutory definition applied. I do not think that they can be dismissed as mere tautology. On the face of the Arrangement they are a specific part of what is intended to be a self-contained definition for the purposes of the Arrangement. They are not, it seems to me, consistent with an intention on the part of the draftsman to utilise the statutory definition. They indicate a contrary intention. A partnership is, as a matter of the ordinary use of English, plainly a body of persons, and the language used by the draftsman does not, in my opinion, indicate that he was intending any different meaning.

Unfortunately that reasoning does not apply to OECD Model definition, since that lacks the words "corporate or not corporate."[173] It is however considered that "body of persons" in OECD Model should still be given its ordinary meaning rather than its UK tax meaning. It is relevant to note that the term does not have a UK tax meaning, only an income tax meaning. There is no definition for CGT. Thus a partnership is a body of persons (within the meaning of the OECD Model) and so a treaty-person within the OECD definition.

Avery Jones agrees:[174]

> ...it is hardly likely that the other State, if it had troubled to ask in the course of negotiations what body of persons meant in UK tax law, would wish to have an 18th century list of bodies govern the interpretation of the treaty. It is therefore not difficult to say that the context otherwise requires, and one should include partnerships either within the ordinary meaning of body of persons, or merely by reading the singular as the plural.[175] On the basis a partnership may be included

persons includes a partnership.

[173] See 9.4.1 (Person: Treaty definition).

[174] Avery Jones, "Bodies of Persons" [1991] BTR 453 at p.464.

[175] Footnote original: This was mentioned as a possibility in *Padmore* [1989] STC 493, 498G but Fox L.J. stated that this was not sufficient for the taxpayer to succeed, as those persons were not all resident in Jersey. It is not clear why persons in partnerships should not be given a single residence under TA 1988, s.112, which the court held to be applicable for the purpose of interpreting the treaty...

> in those cases where wording similar to the 1977 Model is used.[176]

Alternatively one could fall back on the ordinary person or the singular/plural arguments. One difficulty with that is that the OECD model wording has varied over time:

1977 Model & subsequent Models	**1963 draft Model**
the term "person" *comprises* an individual, a company and any other body of persons;	the term "person" *means* an individual, a company and any other body of persons;

Both forms of wording are found in actual treaties. Avery Jones comments:

> Normally in modern UK treaties the definition of person is that it *comprises* an individual, a company and any other body of persons, which was the wording of the 1963 model; at first sight this might prevent the ordinary meaning of*person* from being used.[177] The official French version of the Model, however, uses the same word *comprend* in both the 1963 and the 1977 versions. There may therefore be no difference between it and the 1977 Model, which makes it difficult to see why the UK persists in using the 1963 wording. In eight treaties the word *means* is used instead of the Model's *includes*, in which case the ordinary meaning, in addition to the defined meaning, of person cannot be used. But certainly where *includes* and probably in the light of the French version where *comprises*, is used, the argument that the context includes partnerships under the ordinary meaning of body of persons is still available, as these words are not intended to be comprehensive. It is considered that partnerships are so included under that wording, on the basis that they cannot have been intended to be excluded.[178]

It is considered that any of these arguments will suffice, so a partnership is a treaty-person in all treaties, though the precise arguments must vary from one wording to another. OECD Commentary to art 3 supports this view:

> Partnerships will also be considered to be "persons"

[176] Footnote original: See art 1 Comm. Paras. 2-6 of the application of OECD Model to partnerships. The UK gives a residence to a partnership: TA 1988, s.112(1).

[177] Footnote original: OECD Commentary (art 3 Comm. Para.2), however, stated that the provision was not worded as an exhaustive definition and should be read as indicating that the term person is used in a very wide sense.

[178] Avery Jones, "Bodies of Persons" [1991] BTR 453 at p.464.

[1] either because they fall within the definition of "company"[179]
[2] or, where this is not the case, because they constitute other bodies of persons.

9.22.2 *Partnership "liable to tax"*

Even though a partnership is a person, it only qualifies as a resident of a treaty State within OECD definition if it is a person liable to tax. Whether a person is liable to tax is a matter of domestic law.

In UK law, it is the partners rather than the partnership which is liable to tax. Partners are of course "persons" in their private capacity. They can be treaty-resident in the UK. It seems that a partnership (though a "person") cannot be treaty-resident in the UK. A partnership could (depending on the foreign domestic law) be treaty-resident in a foreign State.

INT Manual provides:

> **INTM162110 certificates of residence: for partnerships** [Sep 2021]
> UK partnerships (including English and Scottish LPs and UK LLPs) cannot be resident in the UK for the purpose of most of the UK's DTAs, because they are not themselves liable to tax in the UK. Only in a few limited circumstances, when the DTA specifically states that a partnership can be regarded as resident, such as in the UK/Argentina DTA, will HMRC be able to issue a Certificate of Residence (CoR) in the name of the partnership.

This is correct.

Similarly the OECD Commentary on art 4:

> 8.13 Where a State disregards a partnership for tax purposes and treats it as fiscally transparent, taxing the partners on their share of the partnership income, the partnership itself is not liable to tax and may not, therefore, be considered to be a resident of that State In that case, however, paragraph 2 of Article 1 clarifies that the Convention will apply to the partnership's income to the extent that the income is treated, or purposes of taxation by that State, as the income of a partner who is a resident of the State. The same treatment will apply to income of other entities or arrangements that are treated as fiscally transparent under the tax law of a Contracting State (see paragraphs 2 to 16 of the Commentary on Article 1).

[179] This is not the case for UK partnerships, though it may be for foreign partnerships; see 30.15.4 ("Company" in OECD Model).

OECD, “The Application of the OECD Model Tax Convention to Partnerships” (1999) expands on this:

> 38. ... In many countries, the tax laws provide that income derived by a partnership from a particular source must be computed at the partnership level as if the partnership were a distinct taxpayer. Each partner is then allocated his share of that income which retains its character and is added to his income for purposes of determining his taxable income. His taxable income, including his share of the partnership’s income is then reduced by the personal allowances and deductions to which he is entitled and tax is then determined, assessed and paid at the partner’s level. In such cases, it is clear that the partnership is not itself liable to tax.

That is the UK tax system.

> 39. In other countries, the income and the tax payable is computed in a similar way, but the tax payable by the partners is then aggregated at the level of the partnership which is then assessed for the total amount of the tax. In these cases, the assessment of the tax in the hands of the partnership is a collection technique that does not change the fact that the tax payable on the income of the partnership is determined at each partner’s level taking into account the other income of that partner, the personal allowances to which he is entitled and the tax rate applicable to him (which may vary depending on his total income or his nature). In such cases, the partnership is also not liable to tax.

This was the pre-1995 UK tax system.

> 40. The Committee agreed that for purposes of determining whether a partnership is liable to tax, the real question is whether the amount of tax payable on the partnership income is determined in relation to the personal characteristics of the partners (whether the partners are taxable or not, what other income they have, what are the personal allowances to which they are entitled and what is the tax rate applicable to them). If the answer to that question is yes, then the partnership should not itself be considered to be liable to tax. The fact that the income is computed at the level of the partnership before being allocated to the partners, that the tax is technically paid by the partnership or that it is assessed on the partnership as described in the preceding paragraph will not change that result.
>
> 41. The fact that a partnership may be said to be liable to tax in a State will not, however, be sufficient for it to be considered a resident of that State for purposes of tax conventions. Paragraph 1 of Article 4 also

> requires that the liability to tax in that State be caused by one of the criteria listed therein (e.g. residence, domicile etc.). Thus, for a partnership to be a resident of a Contracting State, it has to be liable to tax in that State by reason of one of these criteria.[180]

However HMRC do not always apply this view in practice.

9.22.3 *Partnership claim on behalf of partners*

INT Manual provides:

> **INTM162110 certificates of residence: for partnerships** [Sep 2021]
> ... As a result [of fiscal transparency], partnerships are not themselves entitled to claim benefits under most of the UK's DTAs. However, partnerships will usually be able to claim benefits on behalf of those of its partners who are residents of the UK.[181]

HMRC allow claims from US partnerships. There is no reason why American partnerships should be treated better than other partnerships, and other partnerships could therefore seek to obtain similar treatment, even though there would be no legal remedy if HMRC insist on applying the strict law. In practice HMRC practice has been inconsistent: they have sometimes certified that a partnership is treaty-resident and sometimes

[180] This view was rejected in India: *Linklaters LLP v Income Tax Officer* [2010] ITELR 245. However in India (unlike the UK) a partnership is treated as a person for income tax purposes: s.2 [India] Income Tax Act 1961.

[181] The BI Manual repeats the point in relation to LLPs:
"**BIM82145 Limited Liability Partnership: international aspects** [Jun 2016]
...A UK LLP is not itself liable to tax in the UK as the LLP tax provisions identify other persons (i.e. the members) as the persons who are to be taxed. Accordingly for the purposes of the DTAs the LLP is not regarded as being resident in the UK and cannot itself therefore claim relief from foreign taxes under such agreements. As is the case with ordinary and limited partnerships the members must make the claim. Assuming they are UK residents in accordance with the provisions of the relevant DTA the members of a LLP are entitled to relief for any withholding tax on overseas dividends. Normally a DTA provides for withholding tax of a maximum of 15% to be deducted and relief for that tax given. Where a partner is an individual then no relief is due in respect of the taxes paid (the underlying taxes) on the profits out of which the dividend is paid.
In the very narrow circumstances where the LLP is not treated as transparent, but instead as a body corporate for tax purposes (such as when the LLP is in liquidation or being wound up in circumstances where transparency cannot be retained), we take the view that the LLP can itself claim relief for foreign taxes, including if appropriate underlying tax."

refused to do so. Comment on this point by OTS[182] may lead to greater consistency.

INT Manual provides:

> **INTM335510. Background** [Sep 2021]
>
> ***How Double Taxation Agreements treat partnerships***
>
> DTAs do not normally give a tax-transparent concern such as a partnership the right to claim treaty relief. Instead, in those cases where the income of the partnership is taxable in the hands of the partners (rather than at the level of the partnership) each partner should in strictness make a separate claim to treaty relief...
>
> ***HMRC's approach to Partnerships***
>
> We recognise that applying the provisions of the DTA in such a literal way would be unwelcome and could possibly hamper the business interests of both countries.
>
> Accordingly, HMRC may accept a single claim from a partnership on behalf of its partners. Where a partnership wishes to take advantage of this departure from the strict position and to claim treaty benefits on behalf of its partners, the general or managing partner should sign the declaration on the claim form. In addition to the normal information that is required by the claim form, a list of the names and addresses (residential addresses for individuals and registered addresses where the partners are companies) of the partners should be supplied. These lists should also normally show for each partner their respective percentage shares of the income that is the subject of the claim. In those cases where all of the partners are resident for tax purposes in the same country as the one in which the partnership is established (the country with which the DTA applies) it is not necessary to insist upon this information being provided.
>
> Where any of the partners are resident for tax purposes in a country other than that in which the partnership is established, they should make separate claims to relief from UK tax under the terms of any relevant DTA...
>
> **INTM335520. Examination of claims** [Sep 2021]
>
> ***What Personal Tax International will do***
>
> Where you are able to conclude that all of the beneficial owners of the income for which relief is being claimed are "qualifying persons" within the meaning of a DTA, then you should process the claim in the normal

[182] OTS, "Review of partnerships: final report" (2015) para 4.18 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/396668/ots_partnerships_report_final.pdf*

> way without further enquiry. This includes asking the tax office for the UK payer of the income to complete a report on forms in the 4450 series as appropriate.
>
> If the supplementary information that is supplied with the claim form does not allow you to conclude that each of the partners is resident for tax purposes in the same country as that in which the partnership is established, you will have to ask for further information to be supplied.
>
> If any of the partners that are identified are themselves (at face value) transparent for tax purposes (for instance Limited Partnerships and Limited Liability Companies, as well as Trusts and some types of investment funds) you should ask for similar information to be supplied about these 2nd and 3rd level partners. Your aim should be to reach a reasonable level of assurance that all of the underlying participators in these concerns are themselves "persons" who would be able to claim double taxation relief if they were receiving the money directly rather than through the partnership.
>
> *(This content has been withheld because of exemptions in the Freedom of Information Act 2000)*
>
> Where the partnership is unable to provide sufficient information about the identity of its partners to allow you to be satisfied that each person is entitled to relief from UK tax, the amount of relief to be allowed must be restricted to the percentage share of the income that is attributable to the partners who you accept as being entitled to treaty benefits in their own right.

INT Manual provides:

> **INTM162110 certificates of residence: for partnerships** [Sep 2021]
>
> UK partnerships (including English and Scottish LPs and UK LLPs) cannot be resident in the UK for the purpose of most of the UK's DTAs, because they are not themselves liable to tax in the UK. Only in a few limited circumstances, when the DTA specifically states that a partnership can be regarded as resident, such as in the UK/Argentina DTA, will HMRC be able to issue a Certificate of Residence (CoR) in the name of the partnership.
>
> As a result, partnerships are not themselves entitled to claim benefits under most of the UK's DTAs. However, partnerships will usually be able to claim benefits on behalf of those of its partners who are residents of the UK.
>
> To assist with such claims, HMRC therefore provides a CoR which confirms that whilst the partnership itself is not UK resident, some or all of its partners are.
>
> It should be noted that, with regards to LLPs, references to 'partners'

> below is interchangeable with 'members'. If requested by the customer, it will therefore be acceptable to replace the references to 'partners' in the CoR with 'members'.
>
> **Partnerships with only UK Resident Partners**
>
> For partnerships where all partners are UK resident there should not be a problem as we will, if requested, confirm that although the partnership itself cannot be UK resident the individual partners are, and are therefore entitled to the relevant DTA benefits.
>
> **Partnerships with Non-Resident Partners**
>
> Non-resident partners are not entitled to the benefits arising from DTAs between the UK and its treaty partners because they are not persons resident in the UK as set out in the residence Article of a UK DTA. But HMRC will, if requested, confirm that although the partnership itself cannot be UK resident, the UK resident partners are entitled to the relevant treaty benefits.
>
> **Information required**
>
> As with any request for a certificate of residence, any partnership requiring a CoR should provide the information listed at INTM162020 as well as:
>
> For partnerships with UK partners only: A list detailing the partners' names with confirmation that each and every partner is UK resident at the date of the request for the CoR.
>
> For partnerships with UK and non-resident partners:
>
> 1. A contact name and address for the partnership; and
> 2. A list detailing the partners' names, separately identifying those that are UK resident and those that are not and confirming that each of the UK partners is UK resident at the date of the request for the CoR.
>
> Once the Officer is satisfied that they can issue a CoR (after making the checks at INTM162030-50), they may issue one using the following form of words...
>
> As stated at INTM162030, HMRC can also certify residence for a particular period (for the purpose of claiming relief in all countries), so long as that period does not end any later than the date of issue. The wording in each case as above can therefore be amended to refer to the period for which certification is required if necessary (although the partnership would need to confirm the periods for which each partner was UK resident)...

9.23 Partnership: Non-OECD Model DTAs

Where specific difficulties are apparent, HMRC seek to make express provision in the treaty. Examples include the treaties with France and Japan, and protocols with Canada and India.

The INTM provides:

> **INTM335510. Background** [Sep 2021]
>
> ***How Double Taxation Agreements treat partnerships***
>
> ... In cases where such a partner is resident in a country which (unusually) does not regard the partnership as fiscally transparent - which would mean that it regards the partnership rather than the UK payer as the source of the payments its resident receives - then that partner may have difficulty in getting a claim form certified as relevant to a DT treaty with the UK. In such rare cases, you should consider accepting an uncertified claim form. If you decide to invite a claim in these circumstances you should ask for the claim form to be supported by additional evidence (for example copies of recent tax returns) to show that the partner is resident for tax purposes in the country concerned. Any such case should be referred to Specialist Personal Tax, PT International Advisory at an early stage.
>
> **INTM153340 Partnerships** [Sep 2021]
>
> UK policy, following *Padmore v IRC*, is to negotiate a provision in agreements confirming UK taxing rights over a UK resident partner's share of partnership profits where the partnership as an entity is resident in the other country for tax purposes under its domestic law. (See INTM163130 for more background).
>
> However, a special article is required in treaties where partnerships established in the other state count as 'persons' qualifying for benefits. It ensures that individual members of such a partnership who are themselves UK resident remain taxable in the UK on their share of the profits of the partnership.
>
> UK domestic law treats partnerships as transparent and taxes individual members on their share of the partnership's profits.
>
> What we now seek to do is either:
>
> - exclude all partnerships from a treaty, by removing them from the definition of 'person' in, typically Article 3, of our treaties; or
> - if the other state treats partnerships as taxable entities and wishes them to be covered by the treaty, another article, typically at Article 23A of our treaties, must be included. This ensures that the UK's right to tax UK resident members of partnerships set up under the laws of the other state is maintained.

9.23.1 *Switzerland & USA DTAs*

Article 4(1) UK/Switzerland DTA provides an example of the policy:

> In the case of Switzerland, the term [resident of a Contracting State] includes a partnership created or organised under Swiss law.

The DTR Manual provides:

> **DT18105: Switzerland: Notes** [Dec 2021]
> *Partnerships (Article 4)*
> This provision [Art 4(1)] should not be understood to override the general requirement that a resident must be liable to taxation in the relevant Contracting State. Where a claim is received in respect of the income of a Swiss partnership it should be ascertained that the income is actually taxed in Switzerland. Any claim that income of a Swiss partnership which has not been taxed in Switzerland should be relieved from taxation in the UK should be referred to Business Profits, International.

Article 27(2) UK/Switzerland DTA provides:

> Where under any provision of the Convention a partnership is entitled, as a resident of Switzerland, to exemption from the UK tax on any income, such provision shall not be construed as restricting the right of the UK to charge any member of the partnership which is a resident of the UK to tax on its share of the income of the partnership; but any such income shall be deemed for the purposes of Article 22 to be income from sources within Switzerland.

Article 3 USA/UK DTA provides that a partnership is a person under the DTA.

9.24 Treaty-residence: Pension fund

9.24.1 *Treaty-residence of pension fund*

Article 4(1) OECD Model provides:

> For the purposes of this Convention, the term "resident of a Contracting State" ... also includes ... a recognised pension fund of that State...

OECD Commentary provides:

> 8.6 Paragraph 1 also refers expressly to a "recognised pension fund". Most member countries have long considered that a pension fund established in a Contracting State is a resident of that State regardless of the fact that it may benefit from a limited or complete exemption from taxation in that State. Until 2017, that view was reflected in the previous version of paragraph 8.6, which referred to "pension funds, charities and other organisations" as entities that most States viewed as residents. Paragraph 1 of the Article was modified in 2017 to remove any doubt about the fact that a pension fund that meets the definition of "recognised pension fund" in paragraph 1 of Article 3 constitutes a resident of the

Contracting State in which it is established.

8.7 As indicated in paragraph 10.4 of the Commentary on Article 3, the effect of the definition of "recognised pension fund" and of the reference to that term in paragraph 1 of the Article will depend to a large extent on the domestic law and on the legal characteristics of the pension funds established in each Contracting State. The type of fund established within a legal entity that is described in paragraph 10.5 of the Commentary on Article 3 would not be covered by the definition of "recognised pension fund", which applies to an entity or arrangement that constitutes a separate person, but since the income of these funds is attributed to the legal entity of which it is part, the provisions of the Convention will apply to that income to the extent that the legal entity itself qualifies as a resident of a Contracting State under paragraph 1 of the Article.

8.8 Where, however, a fund constitutes a "person" which is distinct from any other person by whom, or for the benefit of whom, it has been established and is operated, the definition of "recognised pension fund" will be relevant and, to the extent that the conditions of that definition are met, the fund will itself constitute a "resident of a Contracting State". This will be the case in many countries because it is "liable to tax therein" by reason of the criteria mentioned in the first sentence of paragraph 1, as this sentence is interpreted by the Contracting States or, if that is not the case, because of the specific inclusion of the term "recognised pension fund" in paragraph 1.

9.24.2 *"Pension fund"*

Art 3(1) OECD Model provides:

i) the term "recognised pension fund" of a State means

[1] an entity or arrangement

[2] established in that State

[3] that is treated as a separate person under the taxation laws of that State and:

[4] (i) [ia] that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and

[ib] that is regulated as such by that State or one of its political subdivisions or local authorities; or

(ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in subdivision (i).

See too 38.10.1 ("Pension scheme").

9.24.3 *"Entity or arrangement"*

OECD Commentary provides:

> 10.9 The first part of the definition of "recognised pension fund" refers to "an entity or arrangement established in that State". There is considerable diversity in the legal and organisational characteristics of pension funds around the world and it is therefore necessary to adopt a broad formulation. The reference to an "arrangement" is intended to cover, among other things, cases where pension benefits are provided through vehicles such as a trust which, under the relevant trust law, would not constitute an entity: the definition will apply as long as the trust or the body of trustees is treated, for tax purposes, as a separate entity recognised as a separate person. It is required, however, that the entity or arrangement be treated as a separate person under the taxation laws of the State in which it is established: if that is not the case, it is not necessary to deal with the issue of the residence of the pension fund itself as the income of that fund is treated as the income of another person for tax purposes (see paragraph 10.5 above).

9.24.4 *Purpose to provide benefits*

OECD Commentary provides:

> 10.10 ... It does not matter how many individuals are entitled to such retirement benefits: a recognised pension fund may be set up, for instance, for a large group of employees or for a single self-employed individual. States are free to replace the phrase "retirement and ancillary or incidental benefits" by a different formulation, such as "retirement and similar benefits", as long as this formulation is interpreted broadly to include benefits such as death benefits.
>
> 10.11 The phrase "exclusively or almost exclusively" makes it clear that all or almost all the activities of a recognised pension fund must be related to the administration or the provision of retirement benefits and ancillary or incidental benefits to individuals. The words "almost exclusively" recognise that a very small part of the activities of a pension fund might involve activities that are not strictly related to administration or provision of such benefits (e.g. such as marketing the services of the pension fund).

9.24.5 *"Retirement benefit"*

OECD Commentary provides:

> 10.12 The entity or arrangement must be established and operated exclusively or almost exclusively for the purpose of administering or

> providing retirement benefits and ancillary or incidental benefits to individuals. A pension paid upon retirement from active employment or when an employee reaches retirement age would be the typical example of a "retirement benefit" but this term is broad enough to cover one or more payments made at or after retirement, or upon reaching retirement age, to an employee, a self-employed person or a director or officer of a company, even if these payments are not made in the form of regular pension payments.
>
> 10.13 In many States, pension funds provide a number of benefits that are not strictly linked to retirement and the phrase "ancillary or incidental benefits" is intended to cover such benefits. The words "ancillary or incidental" make it clear that such benefits are provided in addition to retirement benefits: a fund that would be set up primarily in order to provide benefits that are not retirement benefits would therefore not meet the definition. Whilst it would be impossible to provide an exhaustive list of all benefits that would qualify as "ancillary or incidental benefits", the following are typical examples of such benefits:
>
> - payments made as a result of the death or disability of an individual;
> - pension or other types of payments made to surviving members of the family of a deceased individual who was entitled to retirement benefits;
> - payments made to an individual suffering from a terminal illness;
> - income substitution payments made in the case of long-term sickness or unemployment;
> - housing benefits, such as a loan at a preferential rate granted from accumulated pension contributions to a pension contributor for the acquisition of a principal residence;
> - education benefits, such as the withdrawal of accumulated pension contributions that a pension contributor would be allowed to make for the purpose of financing her education or that of her children;
> - the provision of financial advice to pension contributors.

9.24.6 *Regulated*

OECD Commentary provides:

> 10.14 ... The requirement is intended to restrict the definition to entities or arrangements that are subject to some conditions imposed by the State where it is established (or one of its political subdivisions or local authorities) in order to ensure that the entity or arrangement is used as a vehicle for investment in order to provide retirement and ancillary or incidental benefits to individuals. That part of the definition would therefore exclude an entity, such as a private company, that might be set

> up and used by a person to invest funds in order to provide retirement benefits to persons related to, or employed by, that person but that would not be subject to any special treatment or to rules imposed by the State, political subdivision or local authority concerning the use of that entity as a vehicle to provide retirement benefits. It does not matter whether the regulatory framework to which the entity or arrangement is subjected is provided in tax laws or in other legal instruments (e.g. the legislation that establishes a State-owned entity that will operate a public pension fund); what matters is that the entity or arrangement be recognised by law as a vehicle established to finance retirement benefits for individuals and be subject to conditions intended to ensure that it is used for that purpose.
>
> 10.15 An example of an entity or arrangement that would satisfy the requirements of the definition of "recognised pension fund" is an agency or instrumentality of a State set up exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits under the social security legislation of that State. Another example would be a company or other entity that is established in a State for the purpose of administering or providing retirement benefits and ancillary or incidental benefits to individuals and whose only assets include funds that are covered by a retirement scheme regulated by the tax laws of that State which provide that the income from that scheme is exempt from tax. The definition of recognised pension fund would apply to that company or entity regardless of whether that company or entity otherwise qualifies as a resident of a Contracting State because it is "liable to tax therein" by reason of the criteria mentioned in the first sentence of paragraph 1 of Article 4, e.g. because it must pay tax on any income not derived from the scheme (see paragraphs 8.8 to 8.10 of the Commentary on Article 4).
>
> 10.16 Subdivision (i) of the definition applies regardless of whether the benefits to which it refers are provided to individuals who are residents of the State in which the entity or arrangement is established or are residents of other States....

9.24.7 *Pooled pension funds*

OECD Commentary provides:

> 10.17 Subdivision (ii) of the definition covers entities or arrangements that pension funds covered by subdivision (i) use to invest indirectly. Pension funds often invest together with other pension funds pooling their assets in certain entities or arrangements and may, for various commercial, legal or regulatory reasons, invest via wholly owned

> entities or arrangements that are residents of the same State. Since such arrangements and entities act only as intermediaries for the investment of funds used to provide retirement benefits to individuals, it is appropriate to treat them like the pension funds that invest through them.

9.24.8 *Administration*

OECD Commentary provides:

> 10.18 The phrase “exclusively or almost exclusively” found in subdivision (ii) makes it clear that all or almost all of the activities of such an intermediary entity or arrangement must be related to the investment of funds for the benefit of entities or arrangements that qualify as recognised pension funds under subdivision (i).

9.25 RIC/REIT/REMIC

The USA/Switzerland DTA Technical Explanation[183] provides:

> Certain entities that are nominally subject to tax but that in practice are rarely required to pay tax also would generally be treated as residents and therefore accorded treaty benefits. For example, RICs, REITs and REMICs are all residents of the United States for purposes of the treaty. Although the income earned by these entities normally is not subject to U.S. tax in the hands of the entity, they are taxable to the extent that they do not currently distribute their profits, and therefore may be regarded as “liable to tax.” They also must satisfy a number of requirements under the Code in order to be entitled to special tax treatment.

While this is directed at the US DTA, the wording in point (“liable to tax”) is the same and the same argument should apply to REITs in other states.

9.26 USA/UK DTA

9.26.1 *US citizen/green card holder*

Article 4(2) USA/UK DTA provides:

> An individual who is a United States citizen or an alien admitted to the United States for permanent residence (a “green card” holder) is a resident of the United States only

[183] *https://www.irs.gov/pub/irs-trty/swistech.pdf*

> [a] if the individual has a substantial presence, permanent home or habitual abode in the United States and
>
> [b] if that individual is not a resident of a State other than the UK for the purposes of a double taxation convention between that State and the UK.

The USA/UK DTA Technical Explanation[184] provides:

> Paragraph 2 contains an exception to the general rule of paragraph 1 that residence under internal law also determines residence under the Convention. The exception applies with respect to a U.S. citizen or alien lawfully admitted for permanent residence (i.e., a "green card" holder). Under paragraph 1, a person is considered a resident of a Contracting State for purposes of the Convention if he is liable to tax in that Contracting State by reason of citizenship. Although this rule applies to both Contracting States, only the United States taxes its non-resident citizens in the same manner as its residents. In addition, aliens admitted to the United States for permanent residence ("green card" holders) qualify as U.S. residents under the first sentence of paragraph 1 because they are taxed by the United States as residents, regardless of where they physically reside.
>
> Under the exception of paragraph 2, a U.S. citizen or green card holder will be treated as a resident of the United States for purposes of the Convention, and, thereby entitled to treaty benefits, only if he meets two conditions.
>
> [1] First, he must have a substantial presence (see section 7701(b)(3)), permanent home or habitual abode in the United States. This rule requires that the U.S. citizen or green card holder have a reasonably strong economic nexus with the United States.
>
> [2] Second, he must not be treated as a resident of a state other than the UK under any treaty between the UK and a third state. This rule prevents a U.S. citizen or green card holder who is a resident of a country other than the United States or the UK from choosing the benefits of the Convention over those provided by the treaty between the UK and his country of residence. If the U.S. citizen or green card holder's country of residence does not have a treaty with the UK, however, then he will be treated as a resident of the United States as long as he meets the first requirement of an economic nexus...

The text goes on to give some examples:

[184] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> Thus, for example, an individual resident of Mexico who is a U.S. citizen by birth, or who is a Mexican citizen and holds a U.S. green card, but who, in either case, has never lived in the United States, would not be entitled to benefits under the Convention. However, a U.S. citizen who is transferred to Mexico for two years would be entitled to benefits under the Convention if he maintains a permanent home or habitual abode in the United States and is not a resident of Mexico for purposes of the U.K.-Mexico tax treaty. If he were treated as a resident of Mexico under the U.K.-Mexico tax treaty, he could claim only the benefits of that treaty, even if the Convention would provide greater benefits.
>
> The fact that a U.S. citizen who does not have close ties to the United States may not be treated as a U.S. resident under the Convention does not alter the application of the saving clause of paragraph 4 of Article 1 (General Scope) to that citizen. For example, a U.S. citizen who pursuant to the "citizen/green card holder" rule is not considered to be a resident of the United States still is taxable on his worldwide income under the generally applicable rules of the Code.

9.26.2 *Substantial presence*

"Substantial presence" is a technical term in US tax law. 26 CFR 301.7701(b)-1 provides:

> (c) **Substantial presence test -**
>
> (1) **In general.** An alien individual is a resident alien if the individual meets the substantial presence test. An individual satisfies this test if he or she has been present in the United States on at least 183 days during a three year period that includes the current year. For purposes of this test, each day of presence in the current year is counted as a full day. Each day of presence in the first preceding year is counted as one-third of a day and each day of presence in the second preceding year is counted as one-sixth of a day. For purposes of this paragraph, any fractional days resulting from the above calculations will not be rounded to the nearest whole number. (See § 301.7701(b)-9(b)(2) for transitional rules for calendar years 1985 and 1986.)
>
> (2) **Determination of presence -**
>
> (i) **Physical presence.** For purposes of the substantial presence test, an individual shall be treated as present in the United States on any day that he or she is physically present in the United States at any time during the day. (But see § 301.7701(b)-3 relating to days of presence that may be excluded.)
>
> (ii) **United States.** For purposes of section 7701(b) and the

> regulations thereunder, the term United States when used in a geographical sense includes the states and the District of Columbia. It also includes the territorial waters of the United States and the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources. It does not include the possessions and territories of the United States or the air space over the United States.

(3) **Current year.** The term current year means any calendar year for which an alien individual is determining his or her resident status.

(4) **Thirty-one day minimum.** If an individual is not physically present for more than 30 days during the current year, the substantial presence test will not be applied for that year even if the three-year total is 183 or more days. For purposes of the substantial presence test, it is irrelevant that an individual was not present for more than 30 days in the first or second year preceding the current year...

(e) **Examples.** This section may be illustrated by the following examples:

Example 1.

B, an alien individual, is present in the United States for 122 days in the current year. He was present in the United States for 122 days in the first preceding calendar year and for 122 days in the second preceding calendar year. In determining his status for the current year, B counts all 122 days in the United States in the current year plus 1/3 of the 122 days in the United States in the first preceding calendar year (40 2/3 days) and 1/6 of the 122 days in the United States during the second preceding calendar year (20 1/3 days). The total of 122 40 2/3 20 1/3 equals 183 days. B meets the substantial presence test and is a resident alien for the current year.

Example 2.

C, an alien individual, is present in the United States for 25 days during the current year. She was present in the United States for 365 days during the first preceding year and 365 days during the second preceding year. The substantial presence test does not apply because C is present in the United States for fewer than 31 days during the current year.

Example 3.

D, an alien individual, is present in the United States for 170 days during the current year. He was present in the United States for 30 days during the first preceding year and 30 days during the second preceding

> year. In determining his status for the current year, D counts all 170 days in the United States in the current year plus 1/3 of the 30 days in the United States in the first preceding calendar year (10 days) and 1/6 of the 30 days in the United States during the second preceding calendar year (5 days). The total of 170 10 5 equals 185 days. D meets the substantial presence test and is a resident alien for the current year notwithstanding the fact that he was present in the United States for fewer than 31 days in each of the two preceding years.

HMRC accept this meaning applies in the treaty, and that seems right.[185] HMRC Self Assessment helpsheet HS302 (Dual Residents 2021) provides:

> **Substantial presence test**
> This shows how often you're in the US over a certain period. You'll have a substantial presence if you're in the US:
>
> - for at least 31 days of the calendar year in question
> - for the year in question and the 2 years before that and all 3 years add up to at least 183 days
>
> If you spend part of a day in the US, count it as a whole day.
> For the purpose of the example, a day spent in the US, in the following year under test, counts as a third, and a day in the year before that counts as a sixth.
>
> **Example**
> G spends 48 days in the US in 2018, 250 days in 2017 and 365 days in 2016. A day spent in the US in 2017 and 2016, counts as a third and sixth respectively. In 2018, the calculation is as follows:
>
> | | | |
> |---|---|---|
> | 2018 | 48 days × 1/1 | 48 |
> | 2017 | 250 days × 1/3 | 84 |
> | 2016 | 365 days × 1/6 | 61 |
> | Total | | 193 |
>
> G passes both parts of the substantial presence test. She's a resident in the US, under the country's domestic law.

9.27 Tax exempt organisations

The USA/UK DTA Technical Explanation[186] provides:

> [Article 4(3)] provides that certain tax-exempt entities such as pension funds and charitable organizations will be regarded as residents of a

[185] Notwithstanding the rule in art 3(2) USA/UK DTA that undefined terms have domestic law meanings; see 107.12 (Undefined treaty terms).

[186] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> Contracting State regardless of whether they are generally liable for income tax in the State where they are established. The inclusion of this provision is intended to clarify the generally accepted practice of treating an entity that would be liable for tax as a resident under the internal law of a State but for a specific exemption from tax (either complete or partial) as a resident of that state for purposes of paragraph 1.

9.27.1 *Pension scheme*

Art 4(3) USA/UK DTA provides:

> The term "resident of a Contracting State" includes—
> (a) a pension scheme;

For the definition, see 38.10.1 ("Pension scheme").

9.27.2 *Employee benefit trust*

Art 4(3) USA/UK DTA provides:

> The term "resident of a Contracting State" includes...
> (b) a plan, scheme, fund, trust, company or other arrangement established in a Contracting State that is operated exclusively to administer or provide employee benefits and that, by reason of its nature as such, is generally exempt from income taxation in that State;

The USA/UK DTA Technical Explanation provides:[187]

> Subparagraph (b) applies to any plan, scheme, fund, trust, company or other arrangement established in a Contracting State that is generally exempt from taxation in that State because it is operated exclusively to administer or provide employee benefits. The reference to a general exemption is intended to reflect the fact that under U.S. law, certain organizations that generally are considered to be tax-exempt entities may be subject to certain excise taxes or to income tax on their unrelated business income.

9.27.3 *Charity/NPO*

Art 4(3) USA/UK DTA provides:

> The term "resident of a Contracting State" includes ...

[187] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> (c) an organisation that is established exclusively for religious, charitable, scientific, artistic, cultural, or educational purposes and that is a resident of a Contracting State according to its laws, notwithstanding that all or part of its income or gains may be exempt from tax under the domestic law of that State;

The USA/UK DTA Technical Explanation provides:[188]

> ... an exempt section 501(c) organization (such as a U.S. charity) that is generally exempt from tax under U.S. law is a resident of the United States for all purposes of the Convention.

9.27.4 *Governmental entity*

Art 4(3) USA/UK DTA provides:

> The term "resident of a Contracting State" includes ...
> (d) a qualified governmental entity that is, is a part of, or is established in, that State.

Article 3(1)(k) USA/UK DTA provides the definition:

> the term "qualified governmental entity" means—
> (i) a Contracting State, or a political subdivision or local authority of a Contracting State;
> (ii)a person that is wholly owned, directly or indirectly, by a Contracting State or a political subdivision or local authority of a Contracting State, provided—
> (a) it is organised under the laws of the Contracting State;
> (b) its earnings are credited to its own account with no portion of its income inuring to the benefit of any private person;
> (c) its assets vest in the Contracting State, political subdivision or local authority upon dissolution; and
> (d) it does not carry on a business;

9.28 S Corporation

9.28.1 *US law background*

The Mirrlees Review summarises the nature of a US S corporation:[189]

[188] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[189] Dimensions of Tax Design ((2010) p.1047.
See too, Staff of the Joint Committee on Taxation, "Choice of Business Entity" (2015) *https://www.jct.gov/publications.html?func=startdown&id=4765*
See 90.57 (UK check-the-box rules?)

> ... in the USA, there has been a tax penalty on incorporation for those intending to distribute profits as a result of the classical system of dividend taxation which taxes dividends both at the corporate level (via corporation tax) and at the personal level (via income tax). This was tackled in 1958 by way of Subchapter S to the Internal Revenue Code which permits partnership or pass-through treatment for US corporations satisfying certain conditions ('S' Corps).

S corporation status is open to a US corporation, requires an affirmative election, and is subject to specific requirements as to the number and nature of shareholders, class of stock, etc. Thus an S corporation is not a specific type of entity: it is a company which has elected for a specific tax treatment, to be treated as transparent for US tax purposes.

9.28.2 *S corp: Treaty-residence*

HMRC classify an S corporation as opaque in the transparent/opaque list[190] so there is no doubt it is a treaty-person.

The Canadian Revenue Agency say:[191]

> **US S-Corps and LLCs**
> The Department views U.S. S-Corps to be resident in the United States for the purposes of the [US/Canada] Convention. This view is based on the fact that they are "liable to tax" under the Internal Revenue Code unless they make an election to be treated as a partnership. Furthermore, notwithstanding the election, an S-Corp. would be taxed in the United States on its world-wide income if certain conditions are not met.

The CRA express reservations about their own view:

> The Department recognizes that the above position is arguably inconsistent with its view that U.S. LLCs are not resident in the U.S. for the purposes of the Convention. [The Department continues to be of the view that a U.S. LLC that is treated under U.S. tax law as a partnership and which is therefore not liable to tax in the United States, is not a resident of the United States for the purposes of Article IV of the Convention.] Possibly if the Department had had the knowledge

[190] See 90.54 (HMRC transparent/opaque list).

[191] The text goes on to comment on Canadian foreign affiliate legislation, which is not relevant here; and Barbados exempt insurance companies, which is too specialist to be considered here.

> and experience it now has in the area of residency determination when it formed its opinion regarding the residence of U.S. S-Corps, it may have reached a different conclusion regarding the residence of U.S. S-Corps.

But the CRA practice (that an S Corp is "liable to tax") seems the better view, on the analysis of "liable to tax" set out above.

One might perhaps distinguish the case of LLCs, as a LLC is not subject to US tax unless it elects to be non-transparent; but a S Corporation is subject to tax unless it elects for transparency. Or one might say that LLC's too are, in fact, resident in the USA.

See too 26.31.3 (S corp/LLC lender).

9.29 Treaty-residence: Non-OECD DTA

9.29.1 *Resident for purposes of UK tax*

Article 4 UK/New Zealand DTA provides:

> (1) For the purposes of this Convention, the term "resident of a Contracting State" means, as the context requires:
> (a) any person who is resident in the UK for the purposes of UK tax; or
> (b) any person who is resident in New Zealand for the purposes of New Zealand tax...[192]

The INT Manual considers that this is the same as article 4(1) OECD Model ("liable to tax by reason of his residence"):

> **INTM162040 certificates of residence...** [Sep 2021]
> ... Some DTAs do not specifically use the phrase 'liable to tax' (for example the UK/New Zealand Double Taxation Convention). Instead, these DTAs state that a UK resident means any person who is a resident of the UK for the purposes of UK tax. HMRC interprets this also to mean that the person is liable to tax by virtue of their domicile, residence, place of management or any other criterion of a similar nature.

9.29.2 *Residence: Pre-1963 DTAs*

Pre-1963 DTAs[193] provide a different definition of treaty-residence.[194] I

[192] A tie-breaker follows in OECD Model form.

[193] See 107.24 (Pre-1963 DTAs).

[194] But the BEPS MLI may change this.

take art 2(1)(g) Belize/UK DTA as an example:

> (g)[i] The terms "resident of the United Kingdom" and "resident of Belize" mean respectively
>
> [A] any person who is resident in the UK for the purposes of UK tax and not resident in Belize for the purposes of Belize tax and
>
> [B] any person who is resident in Belize for the purposes of Belize tax and not resident in the UK for the purposes of UK tax;
>
> [ii] and a company shall be regarded as resident in the UK if its business is managed and controlled in the UK and as resident in Belize if its business is managed and controlled in Belize.

The INTM provides:

> **INTM154030 Resident of both countries** [Sep 2021]
> Some early agreements, mainly with former colonies in the Caribbean ... define a resident of one country as a person who is a resident there for the purposes of that country's tax and not resident for tax purposes in the other country. A person who, under those agreements, is a resident of both countries will only be able to get relief by way of credit for one country's tax against the others.

This comment clearly relates to provisions in the form of art 2(1)(g)[i] which govern treaty-residence of non-companies (individuals or trusts).

Treaty-residence of companies is governed by art 2(1)(g)[ii] on which HMRC say:

> HMRC now takes the view that the better interpretation of the [company residence tie-breaker] in these DTAs is that they include a tie-breaker clause to decide where a company is to be treated as resident for the purposes of the affected DTAs. This represents a change of view. HMRC's previous view was that a dual-resident company – for example, a company resident in the UK by virtue of incorporation and resident in the other jurisdiction by virtue of management and control – was not a resident of either jurisdiction under the terms of the provisions and so was outside the scope of the DTA. HMRC now takes the view that these provisions should be read as treating such a dual-resident company as a resident of the jurisdiction in which it is managed and controlled, for the purposes of applying the affected DTAs.
>
> In cases where the company is managed and controlled in both the UK

> and the other jurisdiction, it will remain outside the scope of the DTA.[195]

HMRC's revised view is correct; it is difficult to see the basis of the former HMRC view.

9.30 Proof of treaty-resident status

9.30.1 *Certificate of residence*

A person who is treaty-resident in the UK may need evidence of that status in order to obtain foreign DT relief. HMRC will help by issuing a certificate of UK DTA-residence (CoR).

Conversely a person who is treaty-resident in a foreign state generally needs a certificate of overseas residence in order to prove entitlement to UK DT relief.

9.30.2 *Certificate of DTA-residence*

The INT Manual provides:

> **INTM162010 certificates of residence: introduction and scope of guidance** [Sep 2021]
> Where the UK has a DTA with a foreign territory, a person who is a resident of the UK (within the meaning of the DTA) may be entitled to claim relief from certain taxes of that foreign territory (either by way of relief at source or refunds of tax already paid) if certain criteria are met.
> In order to assess whether a person is entitled to such relief, the overseas fiscal authority receiving the claim will usually require HMRC to certify that the person is a resident of the UK within the meaning of the DTA. Some fiscal authorities may also require HMRC to confirm that the person fulfils other conditions.
> The certification of residence may need to be made on a specific form produced by the overseas fiscal authority or in a general letter produced by HMRC. For the purpose of this guidance, a Certificate of Residence (CoR) refers to certification on a specific form or in a general letter.
> HMRC is committed to providing UK residents with assistance in claiming all the benefits they are entitled to under a DTA. These DTAs have been carefully negotiated with other states and HMRC will therefore help UK residents claim the benefits they are entitled to. On request, HMRC will therefore provide customers with a CoR where, to the best of our knowledge, that customer is a

[195] *https://www.gov.uk/government/publications/double-taxation-agreements-developments-and-planned-negotiations/change-of-view-on-the-interpretation-of-the-residence-articles-in-sixteen-double-taxation-agreements*
I have deleted Jersey/Guernsey/IoM from the list; these now have DTAs in OECD model form.

resident of the UK.

However, as the purpose of a CoR is to support claims for benefits under a particular Article of a DTA (being the Article applicable to the relevant income source), HMRC may refuse to issue a CoR where it is clear that the customer would not be entitled to those benefits. As such, there may be cases where a resident of the UK will not be able to obtain a CoR because they do not fulfil the criteria of the particular Article under which they intend to claim benefits. It is vitally important that HMRC upholds the terms and purpose of our DTAs by not issuing CoRs to those who are clearly not entitled to relief from foreign taxes.

The decision as to whether relief from foreign taxes can be granted is, ultimately, one to be made by the overseas fiscal authority. It is therefore anticipated that HMRC will issue a CoR in the majority of cases and that a request will only be refused if there is no doubt that customer would not be entitled to benefits.

If HMRC has reason to believe that a customer will not be entitled to benefits, we may request further information from the customer before deciding whether a CoR can be issued. In cases where it is not clear whether a customer would be entitled to benefits, HMRC may decide to make a spontaneous exchange of information with the other state to help them come to an informed decision as to whether benefits can be granted.

Customers should also be aware that the provision of a CoR will not guarantee that they will be successful in their claim to benefits under the relevant DTA. As stated above, it will be up to the overseas fiscal authority to determine whether the customer fulfils all the relevant conditions and whether benefits can be granted. However, in any case where a customer believes an overseas fiscal authority has denied them benefits which they should be entitled to, HMRC will consider engaging with those authorities on the customers behalf under the Mutual Agreement Procedure for the relevant DTA.

To help HMRC decide whether a CoR can be issued, we will require any customer who would like a CoR to provide a certain amount of information when making their request.

The following guidance sets out the information HMRC will require, the checks we will make and the circumstances in which a request may be refused. It also sets out the processes for making and handling such requests. This guidance replaces the guidance issued on 4 January 2013 and which was previously located at INTM162010 to INTM162040.

(This content has been withheld because of exemptions in the Freedom of Information Act 2000)

INTM162020 certificates of residence: information to be supplied with a request [Sep 2021]

As stated at INTM162010, before HMRC can certify residence for the purpose of claiming benefits under a DTA a customer will need to provide the information listed below. This applies to customers of all types and sizes and is also in addition to the information required in order to identify the customer when they make a request in accordance with INTM162160.

In certain limited circumstances, a customer may be able to agree with their Local Office, Customer Co-ordinator or Customer Compliance Manager that they may not need to provide all of the information listed below with every request.

However, individual customers will always have to provide the information referred to below as they should make a request via the on-line tool referred to at INTM162160. All other customers should also continue to provide the information referred to below unless agreement has been reached with their Local Office, Customer Co-ordinator or Customer Compliance Manager.

Where the other state produces a specific form on which a claim should be made, the customer should also provide a copy of that form (after completing the parts applicable to them) with their request. Details of those states which require claims to be made on specific forms can be found on the country specific pages of the Double Taxation Relief manual (DT2140) ... usually under the ‘relief from [name of territory] tax’ or ‘claims procedure’ section of those pages.

It should be noted that whilst HMRC tries to keep the DTR manual updated there will be occasions where it contains references to forms which are no longer used by the other state or where it does not mention forms which have been recently introduced. Customers should therefore check whether a claim has to be made on a specific form with the relevant overseas tax authorities before requesting a Certificate of Residence (CoR). Claim forms which appear over two pages should be printed on both sides of each piece of paper.

Note that HMRC will only be able to issue a CoR to a third party (such as an agent or other representative) if the principal customer has provided their consent for HMRC to do so. Such consent may be provided in the form of a 64-8[196] or in any other format. If the customer would like the CoR to be issued to a third party, a copy of the consent should therefore be sent with the request unless already provided.

The information HMRC will require with a request is as follows:

1. An explanation as to why the person requires a CoR, including confirmation of which DTA they wish to make a claim under.

2. Confirmation of the type of income in respect of which they wish to make a claim and the particular income article under which they wish to make a claim.

3. Confirmation of the period for which the customer requires a CoR if not for the date on which the certificate is to be issued.

4. If required by the specific DTA, confirmation as to whether the customer (for the whole of the period for which they require a CoR):

(a) is the beneficial owner of the income in respect of which they wish to make a claim,

(b) is subject to UK tax on all of the income in respect of which they wish to make a claim.

5. For newly incorporated companies, who have yet to file a Corporation Tax self-assessment return, the name and residence of each director and shareholder and the reason for which the company believes it is a resident of the UK (bearing in mind the guidance at INTM120030).

6. For individuals who require a CoR for periods on or after 6 April 2013 and

[196] *https://www.gov.uk/government/publications/tax-agents-and-advisers-authorising-your-agent-64-8*

who have yet to file a self-assessment tax return for the period required:

(a) the number of days spent in the UK during the tax year in which they require a certificate,

(b) if the individual has spent less than 183 days in the UK during the tax year in which they require a certificate, the basis on which they are believed to be resident under the Statutory Residence Test (SRT),

(c) the date on which the individual arrived in or departed the UK,

(d) if the individual arrived in or departed the UK during the tax year in which they require a CoR, confirmation of the date on which they began or ceased to be resident according to the SRT split-year rules.

Further information in respect of each of these questions can be found below:

1. If a customer requires HMRC to certify that they are a resident of the UK for any purpose other than claiming relief from foreign taxes under a DTA, they should ask for a 'letter of confirmation' in accordance with the guidance at INTM162140.

2. Customers most commonly require a CoR in order to make claims for relief from tax on business profits, dividends, interest and royalties. The income articles applicable to these sources are usually Articles 7, 10, 11 and 12 respectively (where the DTA follows the OECD Model Convention), although the numbering may be different in some DTAs.

General descriptions of the Articles normally present in a DTA can be found at INTM153000, although customers should always check the particular DTA under which they intend to make a claim as the contents may vary from one to another.

If a customer has more than one source of income (falling under the same or different articles) they should consider the questions at 3 and 4 as above in respect of each source.

3. Please note that a CoR cannot be issued for any future period as HMRC cannot certify that a customer will continue to be UK resident.

4(a). Most DTAs state that if a person wishes to claim relief from tax in the source state in respect of income such as dividends, interest and royalties (but not business profits), that person has to be the beneficial owner of that income. Customers should consider the guidance at INTM162080 before making a request for a CoR where this condition applies. If the customer is not the beneficial owner of the income, the other state may deny relief. In such cases, the customer should request or arrange for each of the actual beneficial owners to request a CoR in their own name (provided they are residents of the UK as well) so that relief can be granted.

4(b). Some DTAs provide that a person must be subject to tax on income such as dividends, interest and royalties as well as or instead of being the beneficial owner. The meaning of subject to tax, and its distinction from liable to tax, can be found at INTM162090 ...

5. Where a company has yet to file a self-assessment tax return, it may not be possible to issue a CoR. This will be particularly so where the company is registered overseas and claims to be UK resident by virtue of being centrally managed and controlled in the UK (INTM120060). If a newly incorporated company does require HMRC to provide a CoR, it should provide as much

information as possible to satisfy HMRC that it is UK resident. If HMRC is not satisfied that a company is UK resident, we may ask for further information and if still not satisfied, we may refuse to issue the CoR.

6. For periods on or after 6 April 2013, an individual's residence status for UK tax purposes will be determined by the SRT. In cases where an individual has yet to file a self-assessment tax return for the period in which the CoR is required, HMRC will require further information in order to satisfy us that they are resident for the period in question. In cases where the individual has just arrived in the UK, it may not be possible to issue a CoR until the individual has stayed in the UK for sufficient time to be able to demonstrate that they are indeed resident... It will only be not appropriate to answer the questions at 4(a) and 4(b) if the income article under which the customer wishes to make a claim does not include such a qualifying condition.

It should also be noted that the conditions referred to in 4(a) and 4(b) as above may not be the only conditions which have to be met for the claim to be accepted by the other state. All customers should therefore check the conditions of the particular income article under which they intend to make a claim before requesting a CoR...

INTM162030 certificates of residence: What HMRC will check - reason and date for which certification is required [Sep 2021]

When an Officer receives a request for a Certificate of Residence (CoR), including a request to certify residence on a specific form, they should initially check:

1. Why the customer wants HMRC to certify that they are a resident of the UK, including which DTA and income article the customer intends to claim relief under.

If the customer requires a CoR for any purpose other than claiming relief from, or refunds of, foreign taxes under a DTA, the instructions at INTM162140 should be followed instead.

2. Whether the other state provides a specific form, or use of words, which should be used to claim the relief in question.

The country specific pages of the Double Taxation Relief manual (DT2140) ... provides details of the forms and words known to be used by other fiscal authorities (usually under the 'relief from [name of territory] tax' or 'claims procedure' section of the country specific guidance).

Whilst HMRC tries to keep the DTR manual updated there will be occasions where it contains references to forms which are no longer used by the other state or where it does not mention forms which have been recently introduced.

If a customer does not believe it would be appropriate to complete a specific form which is mentioned in the DTR manual, the Officer can issue a general CoR instead but they should advise the customer that it may cause delay in their claim being processed if the other state insists on the specific form being completed.

3. The date as at, or period for which, the customer requires a CoR.

HMRC will normally certify that a person is a resident of the UK as at the date of issue. However, HMRC can also certify that a person was resident for a certain period, so long as the period does not end later than the date of issue

(HMRC cannot certify that a person will be a resident of the UK for any future period because we cannot verify whether that will be the case).

If a customer requires a CoR for a particular period, the Officer will need to consider the points at INTM162040 and INTM162070 for the whole of that period.

An Officer should also remember that a CoR can only be issued to a third party (such as an agent or other person acting on behalf of the customer) if the customer has provided consent for them to do so. Consent may be provided in the form of a 64-8 ... or in any other format. Once consent has been obtained, the Officer should note the extent of the consent on the taxpayers' record (on SA or COTAX) for possible future use.

INTM162040 certificates of residence: What HMRC will check - whether the customer is a resident of the UK [Sep 2021]

Once an Officer has completed the initial checks at INTM162030, the Officer should consider whether the customer is, to the best of their knowledge, a person who is a resident of the UK within the meaning of the Double Taxation Agreement (DTA).

[The Manual summarises the OECD Model definition of residence and continues]

The issue of whether a person is a resident of the UK is a matter of self-assessment which HMRC would only normally challenge through an enquiry into a person's self-assessment tax return. ... An Officer will not be expected to carry out a detailed review of residence when they receive a request for a Certificate of Residence (CoR). The Officer will usually be able to certify residence so long as they can see that the customer is (or was for the period requested) liable to UK tax by virtue of their residence (for example, by checking the customer's tax returns or, if no such returns have been submitted yet, the information provided with the request).

However, if HMRC do not have enough information to determine whether a customer is liable to UK tax by virtue of their residence or, despite the self-assessments made by the customer, there are reasonable grounds for believing that the customer may not in fact be a resident of the UK, the request may be refused if sufficient doubt remains following additional correspondence on the issue.

It should be noted that the provision of a CoR (to a customer of any type) will not amount to a formal determination that the customer is a resident of the UK. It will simply be confirmation that, to the best of HMRC's knowledge, the customer is, or was for the period in question, liable to tax by virtue of their residence. HMRC will still have the right to enquire into a customer's self-assessment tax return when it is received.

In cases where a company is suspected of being dual resident or where a customer requests a certificate of residence in respect of a branch or permanent establishment, please refer to the guidance at INTM162050 and INTM162060 respectively.

(This content has been withheld because of exemptions in the Freedom of Information Act 2000)

INTM162050 certificates of residence: Dual resident companies [Sep 2021]

[This is not set out here as it is too far from the themes of this book]

INTM162070 certificates of residence: what HMRC will check - whether there are any obvious reasons why the customer might not be entitled to treaty benefits [Sep 2021]

Once the Officer has completed their initial checks at INTM162030 and is satisfied that the customer is a resident of the UK for the purpose of the DTA in question (see INTM162040), they should then consider whether, to the best of their knowledge, the customer fulfils the criteria of the particular article under which they wish to make a claim.

Whilst HMRC will not certify that a person fulfils the criteria of a particular income article, the Officer will still be expected to consider whether there are any obvious reasons for believing that the customer might not be entitled to benefits under the DTA.

As such, the Officer will need to check the criteria of the particular income article under which the customer intends to claim relief.

In relation to claims to relief from foreign tax on dividends, interest and royalties, the main criteria which an Officer will need to consider are whether the customer is the beneficial owner of (see INTM162080) and/or is subject to tax (see INTM162090) on the income in question.

The Officer will need to check the particular income article of the DTA to see what conditions need to be fulfilled. Copies or descriptions of each DTA can be found on the GOV.UK site or in the country specific pages at DT2140 ...

The Officer should use the information provided with the initial request (see INTM162020 and, in particular, the answers in response to questions 4(a) and (b), and any other information available to them (for example, the accounts, tax return and electronic records) to decide whether there are any obvious reasons for believing that the customer may not be entitled to benefits.

Officers will need to take a risk assessment approach when dealing with a request for a Certificate of Residence ('CoR'). For example, where a Customer Compliance Manager has discussed the question of CoRs with the customer and is satisfied that they have sufficient internal governance and controls to ensure requests for CoRs are only made when they fulfil all the criteria for relief, the Officer may be able to provide the CoR without a detailed review.

(This content has been withheld because of exemptions in the Freedom of Information Act 2000)

As stated at INTM162010, customers should note that if HMRC does provide them with a CoR, the CoR will not guarantee that they will be able to claim benefits under the relevant DTA. The CoR will not confirm whether HMRC believe all of the relevant conditions have been fulfilled as that will be a matter for the other state to determine.

(This content has been withheld because of exemptions in the Freedom of Information Act 2000)

INTM162100 certificates of residence: for individuals and companies [Sep 2021]

[This discusses the wording of a certificate of residence and need not be set out here]

9.30.3 *Certificate: Partnership*

The INT Manual provides:

> **INTM162110 certificates of residence: for partnerships** [Sep 2021]
> ... partnerships will usually be able to claim benefits on behalf of those of its partners who are residents of the UK.
> To assist with such claims, HMRC therefore provides a CoR which confirms that whilst the partnership itself is not UK resident, some or all of its partners are.
> It should be noted that, with regards to LLPs, references to 'partners' below is interchangeable with 'members'. If requested by the customer, it will therefore be acceptable to replace the references to 'partners' in the CoR with 'members'.
> **Partnerships with only UK Resident Partners**
> For partnerships where all partners are UK resident there should not be a problem as we will, if requested, confirm that although the partnership itself cannot be UK resident the individual partners are, and are therefore entitled to the relevant DTA benefits.
> **Partnerships with Non-Resident Partners**
> Non-resident partners are not entitled to the benefits arising from DTAs between the UK and its treaty partners because they are not persons resident in the UK as set out in the residence Article of a UK DTA. But HMRC will, if requested, confirm that although the partnership itself cannot be UK resident, the UK resident partners are entitled to the relevant treaty benefits.
> **Information required**
> As with any request for a certificate of residence, any partnership requiring a CoR should provide the information listed at INTM162020 as well as:
> For partnerships with UK partners only:
> 1. A list detailing the partners' names with confirmation that each and every partner is UK resident at the date of the request for the CoR.
> For partnerships with UK and non-resident partners:
> 1. A contact name and address for the partnership; and
> 2. A list detailing the partners' names, separately identifying those that are UK resident and those that are not and confirming that each of the UK partners is UK resident at the date of the request for the CoR.
> Once the Officer is satisfied that they can issue a CoR (after making the checks at INTM162030-50), they may issue one using the following form of words:
> [The wording is not set out here]

9.30.4 *Certificate of residence: Trust*

The INT Manual provides:

> **INTM162120 certificates of residence: for trusts** [Sep 2021]
> **Information required and checks to be made**
> As with any request for a CoR, the information listed at INTM162020 should be provided and guidance at INTM162030-90 followed before issuing a CoR in respect of a trust. The trust should also however provide a list detailing all the trustees names with confirmation or otherwise of UK residence.

Confirm which CoR to issue

It is important that you check the definition of 'resident of a Contracting State' contained in the residence article (usually Article 4) of the specific DTA relevant to the income concerned to ensure that the correct wording of the CoR is used.

(This content has been withheld because of exemptions in the Freedom of Information Act 2000)

Wording for CoR to trust with resident body of trustees

[The wording is not set out here]

INTM162130 certification required to be supported by an apostille [Sep 2021]

... some countries (for example, Kazakhstan) require a Certificate of Residence provided under a Double Taxation Agreement to be supported by an "apostille". An apostille is a document prepared by the Legalisation Office of the Foreign and Commonwealth Office (FCO) that confirms that a UK public official who has signed a document is who they claim to be. The signature must be an original. The Legalisation Office have quite a few HMRC officers on their database, but it may save time for an Officer who is dealing with such a claim for the first time to send a specimen signature to the Legalisation Office in advance, otherwise they will need to verify it for first use. Once a name is on the database there is no need for subsequent verification. Details of the Legalisation Office can be found on the FCO website.

Responsibility for obtaining the apostille rests with the customer making the claim. A small fee is payable to the FCO. The customer should be referred to the current instructions on applying for an apostille that appear on the FCO website.

9.30.5 *Letter of confirmation*

The INT Manual provides:

INTM162140 certificates of residence: letter of confirmation [Sep 2021]

As stated at INTM162020-30, customers will occasionally ask HMRC for confirmation that we regard them as a resident of the UK for purposes other than claiming relief from foreign taxes under the terms of a Double Taxation Agreement (DTA). For example, some countries require confirmation that that person is regarded by HMRC as a resident of the UK before they can start trading in that country. Customers may also want HMRC to confirm that we regard them as UK resident so that they can claim relief from foreign taxes which they might be entitled to under the domestic law of the foreign state or EU law (such as under the EU Interest & Royalties Directive) rather than under the terms of the UK's DTA with that other state.

If a customer requests confirmation that HMRC regards them as being a resident of the UK for any purpose other than claiming benefits under a DTA, a 'letter of confirmation' should be issued instead of a Certificate of Residence (CoR).

The difference between a CoR and a 'letter of confirmation' is that a CoR is issued solely for the purpose of claiming benefits under a particular DTA. If a customer requires a CoR, they will be asked to provide the information listed at INTM162020 and HMRC will consider whether the customer is entitled to treaty benefits in accordance with the guidance at INTM162030-90 before issuing the

> CoR.
> If a customer requires a letter of confirmation, the Officer will not need to check whether the customer fulfils the conditions of any DTA. They will only need to check that they can verify the statements which they are being asked to make.
> The standard form of words to use with a letter of confirmation should be as follows: [The wording is not set out here]

9.30.6 *Customised wording*

The INT Manual provides:

> **INTM162150 customised certificates of residence and side letters** [Sep 2021]
> Customers occasionally ask HMRC to provide a customised Certificate of Residence (CoR) for the purpose of claiming relief under a Double Taxation Agreement. For example, a customer may ask HMRC to confirm that they fulfil particular conditions of the DTA in question.
> In such cases, providing the Officer can verify the additional statements they are being asked to make, it would be acceptable to issue a side letter to accompany the CoR. HMRC would, however, prefer not to make any deviations from the standard form of words it uses in certificates as set out in INTM162100 to INTM162129. If such deviations were allowed for some customers, it may result in other customers facing delays in having their claims to relief accepted.
> Any such side letter should be headed "THIS IS NOT A CERTIFICATE OF RESIDENCE FOR THE PURPOSES OF ANY DOUBLE TAXATION AGREEMENT WITH THE UNITED KINGDOM" and, for the sake of consistency, should be referred to CSTD Business, Assets & International, Base Protection Policy Team.

9.30.7 *Application for certificate*

HMRC say:

> **How to apply**
> There are different ways to apply depending on the type of organisation, or if you're an individual.
> **Individuals**
> You should apply online for a certificate if your foreign income hasn't been taxed yet.[197] This includes self-employed sole traders.
> **Partnerships - including Lloyd's syndicates**
> Partnerships with a Customer Relationship Manager (CRM) or Customer Coordinator within the Large Business Service (LBS) or Large Partnership Unit should send all requests to them.
> All other partnerships should send their requests to:
> HMRC, Self Assessment, PO Box 4000, Cardiff CF14 8HR

[197] *https://online.hmrc.gov.uk/shortforms/form/PT_CertOfRes*

> **Companies**
> Companies, usually limited companies, whose tax affairs are dealt with by HMRC's LBS should send requests to their CRM or any person nominated by the CRM to handle these requests.
> All other companies, whose tax affairs are dealt with by HMRC's Local Compliance office should send requests to the Corporation Tax Services office responsible for handling the company's tax affairs.
> **Registered pension schemes**
> Fill in form APSS 146E and send it back to HMRC. Use the address on the form.
> You'll also need to fill in forms APSS 146C and APSS 146D if someone's applying on your behalf.
> **Collective investment schemes**
> Fill in form CISC9 and send it back to HMRC. Use the address on the form.
> **Trusts or non-registered pension schemes**
> Write to HMRC Trust and Estates, First Floor, Ferrer's House, Castle Meadow Road, Nottingham NG2 1BB
> **Charities**
> Write to HMRC, Charities Correspondence SO708, PO Box 205, Bootle L69 9AZ
> **Public bodies**
> Write to HMRC Public Bodies Group, Customer Coordinator Team, Custom House, The Dockland, Pembroke Dock SA72 6TW[198]

9.30.8 *Claimant USA treaty-resident*

HMRC Self Assessment helpsheet HS302 (Dual Residents 2021) provides:

> **United States of America**
> The US taxes its citizens on their worldwide income, wherever they live, so if you live in the US, you do not need a certificate of overseas residence.
> You're a US resident if:
>
> - you've a substantial presence, permanent home or habitual abode in the US
> - no country other than the UK treats you as a resident

9.31 Covid and treaty-residence

OECD have produced guidance (**"OECD Covid guidance"**).[199]

[198] *https://www.gov.uk/guidance/get-a-certificate-of-residence*

[199] *https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Upd*

9.31.1 *Individual stranded abroad*

OECD Covid guidance provides:

> Two main situations could be imagined:
>
> - A person is temporarily away from their home (perhaps on holiday, perhaps to work for a few weeks) and gets stranded in the host jurisdiction by reason of the COVID-19 pandemic and attains domestic law residence there...
>
> 40.In the first scenario, it is unlikely that the person would acquire residence status in the jurisdiction where the person is temporarily because of extraordinary circumstances. There are, however, rules in domestic legislation causing a person to become a resident if they are present in the jurisdiction for a certain number of days. But even if the person becomes a resident under such rules, if a tax treaty is applicable, the person is unlikely to be a resident of that jurisdiction under the treaty's tiebreaker rule. Such a temporary dislocation should therefore have no tax implications in the vast majority of cases.

The earlier version of the guidance provided:

> ... it is probably unlikely that the person would have a "permanent home" available to them in the host country. But if they did (and an apartment rented for a sufficiently long period would count), and they had rented out their dwelling in their home country, they would be treated as treaty resident of the host state. Where the person had a permanent home in both states, it seems likely that the other tie-breaker tests (centre of vital interests, place of habitual abode, and nationality) would award residence to the home state. No remedial measure is suggested.

The answer is that the individual should not let out their dwelling in the home country; which in any event seems unlikely to happen in the short term.

9.31.2 *Individual returns home*

OECD Covid guidance provides:

> Two main situations could be imagined ...
>
> A person is working in a jurisdiction (the "current home jurisdiction") and has acquired residence status there, but they temporarily return to

ated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic
See 106.14.1 (OECD Covid guidance).

their "previous home jurisdiction" because of the COVID-19 situation. They may either never have lost their status as resident of their previous home jurisdiction under its domestic legislation, or they may regain residence status on their return...

44.In the second case, the same treaty rules apply, but their application produces a more uncertain result because the person's attachment to the previous home jurisdiction is stronger. In cases where the personal and economic relations in the two jurisdictions are close but the tie-breaker rule was in favour of the current home jurisdiction, the fact that the person moved to the previous home jurisdiction during the COVID-19 pandemic may tip the balance towards the previous home jurisdiction. This would usually be decided using the test of "habitual abode". According to paragraph 19[200] of the Commentary on Article 4 of the OECD Model, however, the habitual abode of a person is where the individual lived habitually, in the sense of being customarily or usually present; the test will not be satisfied by simply determining in which of the two contracting jurisdictions the individual has spent more days during that period. "Habitual abode" refers to the frequency, duration and regularity of stays that are part of the settled routine of an individual's life and are therefore more than transient. Days spent in a person's previous home jurisdiction because of travel restrictions imposed as a public health measure by one of the governments of the countries involved should not result in a change to the person's habitual abode. The determination of habitual abode must cover a sufficient length of time for it to be possible to ascertain the frequency, duration and regularity of stays that are part of the settled routine of the individual's life.

45.In conclusion, because the COVID-19 pandemic is a period of major changes and an exceptional circumstance, tax administrations and competent authorities will have to consider a period where public health measures imposed or recommended by the government do not apply when assessing a person's residence status. If in the context of and as a result of the COVID-19 pandemic, an individual's temporary presence in a jurisdiction results in them becoming dual-resident, that person's place of residence for the purposes of the tie-breaker included in the applicable treaty is unlikely to change, given that the tie-breaker provision requires consideration of factors that shall also be assessed in a more normal period. A dislocation because a person cannot travel back to their home jurisdiction due to a public health measure of one of the

[200] See 9.14 (Habitual abode).

> governments of the jurisdictions involved should not by itself impact the person's residence status for purposes of the tax treaty. A different approach may be appropriate however, if the change in circumstances continues when the COVID-19 restrictions are lifted.

9.31.3 *Entity residence*

OECD Covid guidance provides:

> 29.It is unlikely that the COVID-19 situation will create any changes to an entity's residence status under a tax treaty. A temporary change in location of board members or other senior executives is an extraordinary and temporary situation due to the COVID-19 pandemic and such change of location should not trigger a change in treaty residence...
> 31.This potential change of circumstances may trigger an issue of dual residence (in cases where the change in the place of effective management results in a company being considered a resident of two jurisdictions simultaneously under their domestic laws). However, as recognised by the Commentary on the OECD Model, situations of dual residence of companies are relatively rare.
> 32.But even in situations where there would be dual residence of an entity, tax treaties provide tie-breaker rules ensuring that the entity is resident in only one of the jurisdictions. If the treaty contains a provision like the 2017 OECD Model tie-breaker rule, competent authorities deal with the dual residence issue on a case-by-case basis by mutual agreement. This determination will take into consideration all of the facts and circumstances over the determination period. No single factor is determinative, rather a range of factors are taken into consideration.
> 33.In particular, paragraph 24.1[201] of the OECD Commentary on Article 4 illustrates the range of factors that the competent authorities are expected to take into consideration to make their determination, which includes: where the meetings of the company's board of directors or equivalent body are usually held; where the chief executive officer and other senior executives usually carry on their activities; where the senior day-to-day management of the company is carried on; where the person's headquarters are located; etc. It is also possible for competent authorities to agree to more general frameworks for such determinations, for example where particular fact patterns are present, under the authority of Article 25(3).
> 34.In situations where the treaty contains the pre-2017 OECD Model tie-breaker rule, the place of effective management will be the only

[201] See 9.18.1 (Relevant factors).

> criterion used to determine the residence of a dual-resident entity for tax treaty purposes. According to paragraph 24[202] of the Commentary on Article 4 of the 2014 OECD Model, the place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management. Paragraph 149 of the Commentary on Article 29 of the 2017 OECD Model explains that the concept of "place of effective management" was interpreted by some jurisdictions as being ordinarily the place where the most senior person or group of persons (for example a board of directors) made the key management and commercial decisions necessary for the conduct of the company's business.
>
> 35.Therefore, all relevant facts and circumstances should be examined to determine the "usual" and "ordinary" place of effective management, and not only those that pertain to an exceptional period such as the COVID-19 pandemic.
>
> 36.In conclusion, an entity's place of residence under the tie-breaker provision included in a tax treaty is unlikely to be impacted by the fact that the individuals participating in the management and decision-making of an entity cannot travel as a public health measure imposed or recommended by at least one of the governments of the jurisdictions involved.

HMRC sing from the same songsheet:

> **INTM120185 HMRC Approach to Company Residence in response to COVID-19 Pandemic** [Sep 2021]
>
> ... HMRC is very sympathetic to the disruption that is being endured.... POEM, like CMC, requires consideration of all the facts and circumstances. Unlike CMC however, the POEM can only be in one place at any one time. As such, even if CMC started to abide in the UK to a sufficient enough degree to result in UK residence under UK domestic law, it may be that after consideration of the activity in both territories, the POEM may be found to be in the other territory, and the company will therefore be treated as non-UK resident.
>
> In cases where the DTA includes a competent authority based tie-breaker, the UK competent authority usually takes into account the factors as set out at INTM120085. Whilst it is not possible to predict the outcome of any discussions between the two competent authorities, the

[202] See 9.19.2 (POEM: Top level management).

> UK competent authority would take into account a wider range of factors than just CMC and POEM, and these will all be viewed in the round.

See too 8.14 (Covid & company residence).

CHAPTER TEN

SPLIT YEARS

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The following topics are considered elsewhere:
10.16 (Arrival/departure: Disclosure)
6.43.10 (Split year): Scots/Welsh taxpayer
7.8 (Individual trustee: Split year)
12.1 (Exit taxes)
13.1 (Pre-arrival planning

The topic of companies becoming or ceasing to be UK resident is not discussed, though I hope to cover it in a future edition.

10.1 Residence throughout tax year

The starting point, under the SRT, is that an individual is resident (or not) in the UK during the whole of a tax year. Sch 45 FA 2013 provides:

> 3 An individual ("P") is resident in the UK for a tax year ("year X") if—
> (a) the automatic residence test is met for that year, or
> (b) the sufficient ties test is met for that year.
> 4 If neither of those tests is met for that year, P is not resident in the UK for that year.

Para 2(3) sch 45 FA 2013 explains the significance of being resident "for" a year:

> An individual who, in accordance with the statutory residence test, is resident (or not resident) in the UK "for" a tax year is taken for the purposes of any enactment relating to relevant tax[1] to be resident (or not resident) there at all times in that tax year.

This general rule is subject to two exceptions of such breadth that the principle only rarely applies:
(1) Statutory split-year reliefs
(2) DTA relief

10.2 Split year rules

Para 40 sch 45 FA 2013 provides:

[1] "Relevant tax" means IT, CGT, IHT and CT; see para 1(4) sch 45 FA 2013, discussed 6.3 (Scope of SRT).

> (1) The effect of a tax year being a split year is to relax the effect of paragraph 2(3) (which treats individuals who are UK resident "for" a tax year as being UK resident at all times in that year).
> (2) When and how the effect of paragraph 2(3) is relaxed is defined in the special charging rules introduced by the amendments made by this Part.

I refer to these special charging rules as "split-year reliefs".

> (3) Subject to those special charging rules (and any other special charging rules for split years that may be introduced in the future)[2], nothing in this Part
> [a] alters an individual's residence status for a tax year or
> [b] affects his or her liability to tax.

A split year matters for two purposes:
(1) It is the gateway to split-year reliefs
(2) It is relevant for temporary non-residence rules (see the next chapter)

However the individual is UK resident throughout the split year for (almost) all UK tax purposes. In a (so-called) split year, it is not the case that the individual is UK resident in part of the year and not UK resident in the offshore part. So far as it may suggest otherwise, the term "split year" is misleading. But it is difficult to think of a better term, and no harm arises as long as that is kept in mind.

10.3 Split-year reliefs

10.3.1 *Split year: Pt 4/5 ITTOIA Income*

For Part 4 ITTOIA (Savings & Investment Income), s.368(2A) ITTOIA provides the split-year relief. To follow the sense, it needs to be read together with its preceding subsection:

> (2) Income arising to a non-UK resident is chargeable to tax under this Part only if it is from a source in the UK.
> (2A) If income arising to an individual who is UK resident arises in the overseas part of a split year, it is to be treated for the purposes of this section as arising to a non-UK resident.

For Part 5 ITTOIA Miscellaneous Income, s.577(2A) repeats the same point verbatim.

[2] The words in brackets are otiose.

10.3.2 *Other split-year reliefs*

These two provisions are quite general: they apply to all categories of income within Parts 4/5 ITTOIA (S&I Income/Part 5 ITTOIA Miscellaneous Income). Elsewhere split-year relief is set out separately for each category of income/gains. I discuss them in the chapters considering that type of income/gains:

Type of income/gain	**See para**	s.720 income	49.21.2; 49.26.3
Trading income	21.4.5; 21.22.4	s.731 income	50.47; 50.39.3
Property income	24.3.2	Chargeable-event gains	70.4.5
Employment income	34.12.1	Chargeable gains	56.9
Pension income	38.2	s.3 gains	64.12

Most of the split-year reliefs adopt the same wording as the Parts 4/5 ITTOIA split-year reliefs: they provide that income/gains in the overseas part of the split year are not charged. The individual still retains the status of resident throughout the year, but that does not matter so far as split-year relief applies. I refer to that as **"standard form split-year relief"**.

Occasionally the split-year relief provides that the individual is treated for some limited purpose as non-UK resident in the overseas part of the split year.[3]

10.3.3 *When no split-year relief*

In the absence of an applicable split-year relief, the default rule remains that income/gains of a year are fully chargeable, even if the year is a split year. It is not possible to give a full list of the cases where the default rule applies, but they include:

Type of income/gain	**See para**
ToA income	
s.720 income	49.21.2; 49.26.3
s.731 income	50.39.3; 50.47
s.643A income	47.24
s.86 gains	60.14
s.87 gains	61.18
Non-resident IT relief	45.9

Where these rules are in point, tax needs to be considered before the start

[3] For instance, the trading income split-year reliefs.

of the tax year of arrival.

In addition, there is no split-year relief for the following:

Topic	**See para**
Rules for qualifying for the remittance basis	
Sub-£2k remittance basis taxpayers	17.9.1
Non-taxpayers remittance basis	17.10
Year counting for	
Deemed domicile	5.7
Remittance basis claim charge	17.12.13
OWR (recent arrivals) remittance basis	34.22
FIG relief for New Residents	A1.2.1

10.4 Definition of "split year"

"Split year" is elaborately defined. Para 43(1) sch 45 FA 2013 provides:

> As respects an individual, a tax year is a "split year" if–
> (a) the individual is resident in the UK for that year, and
> (b) the circumstances of the case fall within–
> (i) Case 1, Case 2 or Case 3 (cases involving actual or deemed departure from the UK), or
> (ii) Case 4, Case 5, Case 6, Case 7 or Case 8 (cases involving actual or deemed arrival in the UK).

I refer to **"split-year Cases 1-8"**. The Cases[4] can be summarised as follows:

Case	*sch 45 para/Outline*		*Year before*	*Year after*	*See para*
Leaving UK					
1	44	Start full-time work overseas	Resident	Non-resident[5]	10.6
2	45	Partner starts work overseas	Resident	Non-resident	10.7
3	46	Cease to have UK home	Resident	Non-resident	10.8
Coming to UK					
4	47	Start to have only home in UK	Non-resident	Does not matter	10.9
5	48	Start full-time UK work	Non-resident	Does not matter	10.10
6	49	Cease full-time work overseas	Non-resident[6]	Resident	10.11
7	50	Partner ceases work overseas	Non-resident	Resident	10.12
8	51	Start to have UK home	Non-resident	Resident	10.13

[4] Statute uses an initial capital, to reflect the technical terminology.

[5] The requirement for Cases 1 & 6 (only) is to be non-resident under overseas test 3 (full-time overseas work).

[6] See above footnote.

10.5 Definitions for split-year rules

It is helpful first to deal with some definitions.

10.5.1 *"Relevant year"*

Para 43 sch 45 FA 2013 provides:

> (2) The 8 Cases are described in paragraphs 44 to 51.
> (3) In those paragraphs, the individual is referred to as "the taxpayer" and the tax year as "the relevant year".
> (4) In applying Part 2 of this Schedule to those paragraphs, for "P" read "the taxpayer".

The "relevant year" will be a split year if the conditions of one of the Cases is met.

10.5.2 *"Previous/next tax year"*

Para 52 sch 45 FA 2013 provides commonsense definitions:

> (1) This paragraph applies for the purposes of paragraphs 44 to 51.
> (2) A reference to "the previous tax year" is to the tax year preceding the relevant year.
> (3) A reference to "the next tax year" is to the tax year following the relevant year.

10.5.3 *"Partner"*

Para 52(4) sch 45 FA 2013 provides:

> "Partner", in relation to the taxpayer, means—
> (a) a husband or wife or civil partner,
> (b) if the taxpayer and another person are living together[7] as husband and wife, that other person, or
> (c) if the taxpayer and another person of the same sex are living together as if they were civil partners, that other person.

In non-legal English the word "partner" has long had this sense. In legal English (or at least, in tax legislation) the word has only been used to describe a partner within the meaning of the Partnership Acts; so this is something of a Plain English innovation. But no confusion is likely to arise.

[7] See App 3.4.3 (Living together: married couple).

10.5.4 *Rounding*

Para 52(5) sch 45 FA 2013 provides:

> If calculation of the appropriate number results in a number of days that is not a whole number, the appropriate number is to be rounded up or down as follows—
>
> (a) if the first figure after the decimal point is 5 or more, round the appropriate number up to the nearest whole number,
>
> (b) otherwise, round it down to the nearest whole number.

10.5.5 *"The overseas part"*

Para 53 sch 45 FA 2013 provides:

> (1) "The overseas part" of a split year is the part of that year defined below—
>
> (a) for the Case in question, or
>
> (b) if the taxpayer's circumstances fall within more than one Case, for the Case which has priority (see paragraphs 54 and 55).[8]
>
> (2) For Case 1, the overseas part is—
>
> (a) if there is only one period falling within paragraph 44(3) [overseas work period], the part beginning with the first day of that period, and
>
> (b) if there is more than one such period, the part beginning with the first day of the longest of those periods.
>
> (3) For Case 2, the overseas part is the part beginning with the deemed departure day as defined in paragraph 45(7) and (8).
>
> (4) For Case 3, the overseas part is the part beginning with the day mentioned in paragraph 46(3)(a) [day ceasing to have UK home].
>
> (5) For Case 4, the overseas part is the part before the day mentioned in paragraph 47(3) [day UK Home Test is met].
>
> (6) For Case 5, the overseas part is—
>
> (a) if there is only one period falling within paragraph 48(3) [roughly, day starting UK work], the part before that period begins, and
>
> (b) if there is more than one such period, the part before the first of those periods begins.
>
> (7) For Case 6, the overseas part is—
>
> (a) if there is only one period falling within paragraph 49(3), the part ending with the last day of that period, and

[8] See 10.14 (Priority between Cases).

> (b) if there is more than one such period, the part ending with the last day of the longest of those periods.
>
> (8) For Case 7, the overseas part is the part before the deemed arrival day as defined in paragraph 50(7) and (8).
>
> (9) For Case 8, the overseas part is the part before the day mentioned in paragraph 51(3)(a) [day UK home is acquired].

10.5.6 *"The UK part"*

Para 56 sch 45 FA 2013 provides:

> "The UK part" of a split year is the part of that year that is not the overseas part.

10.6 Case 1: Start work overseas

Para 44(1) sch 45 FA 2013 provides:

> The circumstances of a case fall within Case 1 if they are as described in sub-paragraphs (2) to (4).

10.6.1 *UK resident in previous year*

Para 44(2) sch 45 FA 2013 provides:

> The taxpayer was resident in the UK for the previous tax year (whether or not it was a split year).

This is a requirement in each of split year Cases 1-3, which apply to leavers.

10.6.2 *Overseas work*

Para 44(3) sch 45 FA 2013 provides:

> There is at least one period (consisting of one or more days) that—
>
> (a) begins with a day that—
>
> (i) falls within the relevant year, and
>
> (ii) is a day on which the taxpayer does more than 3 hours' work overseas,
>
> (b) ends with the last day of the relevant year, and
>
> (c) satisfies the overseas work criteria.

10.6.3 *"Overseas work criteria"*

"Overseas work criteria" is a label for 4 sets of conditions. Para 44(5) sch 45 FA 2013 provides:

> A period "satisfies the overseas work criteria" if—
> (a) the taxpayer works sufficient hours overseas, as assessed over that period,

See 10.6.4 ("Sufficient hours overseas").

> (b) during that period, there are no significant breaks from overseas work,
> (c) the number of days in that period on which the taxpayer does more than 3 hours' work in the UK does not exceed the permitted limit, and

I refer to days within (c) as **"UK workdays"**.

> (d) the number of days in that period falling within sub-paragraph (6) does not exceed the permitted limit.

I refer to days within (d) as **"UK days"**; see 10.6.6 ("The permitted limit").

10.6.4 *"Sufficient hours overseas"*

Para 44(5) sch 45 FA 2013 provides:

> A period "satisfies the overseas work criteria" if—
> (a) the taxpayer works sufficient hours overseas, as assessed over that period...

Para 44(7) sch 45 FA 2013 provides:

> To work out whether the taxpayer works "sufficient hours overseas" as assessed over a given period, apply paragraph 14(3) but with the following modifications—
> (a) for "P" read "the taxpayer",
> (b) for "year X" read "the period under consideration",
> (c) for "365 (or 366 if year X includes 29 February)" read "the number of days in the period under consideration", and
> (d) in paragraph 28(9)(b), as it applies for the purposes of step 3, for "30" read "the permitted limit".

Amended as para 44(7) requires, para 14(3) provides:

> Take the following steps to work out whether [the taxpayer] works "sufficient hours overseas" as assessed over [the period under consideration]—
> *Step 1 [disregarded days]*
> Identify any days in [the period under consideration] on which [the

> taxpayer] does more than 3 hours' work in the UK, including ones on which [the taxpayer] also does work overseas on the same day.
>
> The days so identified are referred to as "disregarded days".
>
> *Step 2 [net overseas hours]*
>
> Add up (for all employments held and trades carried on by [the taxpayer]) the total number of hours that [the taxpayer] works overseas in [the period under consideration], but ignoring any hours that [the taxpayer] works overseas on disregarded days.
>
> The result is referred to as [the taxpayer]'s "net overseas hours".
>
> *Step 3 [reference-period days]*
>
> Subtract from the number of days in [the period under consideration]—
>
> (a) the total number of disregarded days, and
>
> (b) any days that are allowed to be subtracted, in accordance with the rules in paragraph 28 of this Schedule, to take account of periods of leave and gaps between employments.[9]
>
> The result is referred to as the "reference period".

Armed with the figures from steps 2 and 3, we proceed to the computation. This is set out in the remaining two steps:

> *Step 4*: *[compute reference period ÷ 7]*
>
> Divide the reference period by 7. If the answer is more than 1 and is not a whole number, round down to the nearest whole number. If the answer is less than 1, round up to 1.
>
> *Step 5 [compute net overseas hours ÷ reference-period weeks]*
>
> Divide [the taxpayer]'s net overseas hours by the number resulting from step 4.
>
> If the answer is 35 or more, [the taxpayer] is considered to work "sufficient hours overseas" as assessed over [the period under consideration].

See 6.8.2 ((a): Sufficient hours overseas).

RDRM provides:

> **RDRM12070: Residence: The SRT: Split year treatment: Case1: Calculating whether individual works full-time overseas in the relevant period** [Sep 2019]
>
> The table below, sets out the permitted limits for Case 1 – the appropriate portions of the full-year permitted limits.
>
> | Date | X - see note | Y - see note |
> |---|---|---|
> | 6 - 30 Apr | 30 | 90 |

[9] See 6.24 (Reference period: non-work days).

1 - 31 May	27	82
1 - 30 Jun	25	75
1 - 31 Jul	22	67
1 - 31 Aug	20	60
1 - 30 Sep	17	52
1 - 31 Oct	15	45
1 - 30 Nov	12	37
1 - 31 Dec	10	30
1 - 31 Jan	7	22
1 - 29 Feb	5	15
1 - 31 Mar	2	7
1 - 5 Apr		

Note

X = permitted limit on days where you can work more than 3 hours and maximum number of days that can be subtracted for gaps between employments

Y = permitted limit on days spent in the UK

RDRM provides some examples:

> **RDRM12080: Residence: The SRT: Split year treatment: Case1: The UK and overseas parts of the tax year** [Aug 2019]
>
> Example 1 (Richard)
>
> R has lived and worked in London for the last 10 years and is UK resident for tax purposes. He is seconded abroad by his employer for a 3 year period. His overseas contract starts on 3 November 2014, when he takes up duty at his new office in Madrid. For the purposes of this example R fails the third automatic overseas test for 2014-2015 but meets it for 2015-2016.
>
> On 2 December 2014 R returns to the UK office to finish off a project he was involved in before his secondment. His work in the UK is completed on 16 December 2014, (11 UK workdays and 4 non-working days). He then takes leave until 28 December (12 days), flying back to Madrid and resuming work on 29 December. On his return to Madrid he works only at the Madrid office until 5 April 2015.
>
> R calculates that he meets the criteria for Case 1 split year treatment from 3 November, this being the first date on which he works for more than 3 hours overseas. Using the table at RDRM12070 he calculates that between 3 November 2014 and 5 April 2015 he can spend 37 days in the UK and work for more than 3 hours in the UK for up to 12 days.
>
> R determines that:
>
> - he was UK resident for the previous tax year (2013-2014)
> - he is resident in the UK for the current year (2014-2015) and that he

does not meet the third automatic overseas test

- he was non-UK resident for 2015-2016
- he calculates he meets the sufficient hours overseas test for the period 3 November 2014 to 5 April 2015
- he did not exceed the limits of 12 UK work days and 37 days spent in the UK between 3 November 2014 and 5 April 2015, and
- he had no significant break from overseas work during the period.

To determine that he worked full-time overseas during the relevant period, R undertook the following calculation.

His reference period:

Days in period 3/11/14 to 5/4/15 =	154
Less:	
• Disregarded days	11
(days spent working in the UK for more than 3 hours)	
• Annual, sick and parental leave	6 (Leave on 17, 18, 19, 22, 23 and 24 December)
• embedded non-working days	2 (20 and 21 December)
Total	19
Reference period =	135 days

Sufficient hours test

All hours worked overseas from 3 November	670
Less	
Hours worked on disregarded days	Nil
Net overseas hours	670

Divide reference period by 7 (135/7) = 19.28 round down to 19

Divide net overseas hours by 19 (670/19) = 35.26

R meets the sufficient hours overseas test because his average over the reference period, (3 November 2014 to 5 April 2015) is more than 35.

For R the UK part of the tax year ends on 2 November 2014, and the overseas part starts on 3 November 2014 – the earliest date from which he meets all the conditions of the sufficient hours overseas test.

Example 2 (Amanda)

A has been living in the UK since she was born and is UK resident for tax purposes. She has worked in the media industry for 5 years and gets a job as a reporter on a 3 year contract based in India. She moves there on 10 November 2013, and lives in an apartment provided by her new employer. She meets the overseas work criteria from 10 November 2013. She returns to the UK to visit her family over the Christmas period for 2 weeks, and does not work while she is there.

A remains working in India throughout the tax year 2014-2015, again only returning to the UK for a 2 week period over Christmas.

A will receive split year treatment for 2013-2014 tax year because:

- she was UK resident for 2012-2013 and 2013-2104
- she is non-UK resident for 2014-2015 and meets the third automatic overseas test for that year

From 10 November 2013 until 5 April 2014 she:

- does not work at all in the UK
- spends 14 days in the UK, which is less, by reference to the table at RDRM12070, than the permitted limit of 37 days.

For A, the UK part of the tax year will end on 9 November 2013, and the overseas part of the tax year will start on 10 November 2013.

The overseas part of the tax year starts on the first day of the relevant period, as long as the individual meets the overseas work criteria for that period. (Refer to RDRM12060).

10.6.5 *UK days within permitted limit*

Para 44 sch 45 FA 2013 provides:

> (5) A period "satisfies the overseas work criteria" if ...
> (d) the number of days in that period falling within sub-paragraph (6) does not exceed the permitted limit.
> (6) A day falls within this sub-paragraph if—
> (a) it is a day spent by the taxpayer in the UK, but
> (b) it is not a day that is treated under paragraph 23(4)[10] as a day spent by the taxpayer in the UK.

I refer to days within (6) as **"UK days"**.

10.6.6 *"The permitted limit"*

The expression "permitted limit" is used in split-year Cases 1, 2 and 6. It is defined each time, but the Cases 1 and 6 definitions are identical.

For Case 1, the "permitted limit" matters for three purposes:

(1) UK workdays must not exceed the permitted limit: para 44(5))(c).
(2) UK days must not exceed the permitted limit: para 44(5)(d).
(3) For the purposes of ascertaining the reference period: para 44(7)(d).

Case 1 has two definitions of "permitted limit". It would have been simpler to have two terms, but there it is.

Para 44(8) sch 45 FA 2013 provides:

> The permitted limit is—
> (a) for sub-paragraphs (5)(c) [UK workdays] and (7)(d), the

[10] See 6.19 (Deeming rule (frequent visits)).

> number found by reducing 30 by the appropriate number, and
> (b) for sub-paragraph (5)(d) [days spent in UK] , the number found by reducing 90 by the appropriate number.

10.6.7 *"The appropriate number"*

The drafter of the SRT was fond of the expression "appropriate number" which is used in almost all the split year Cases, with a different definition every time, or sometimes (as in split-year Case 1) with two definitions. Para 44(9) sch 45 FA 2013 provides:

> The appropriate number is the result of—
> A × (B÷12)
> where—
> "A" is—
> (a) 30, for sub-paragraphs (5)(c) and (7)(d), or
> (b) 90, for sub-paragraph (5)(d), and
> "B" is the number of whole months in the part of the relevant year before the day mentioned in sub-paragraph (3)(a).

One rounds down or up to the nearest whole number (rounding half up to the next number).[11]

10.6.8 *Overseas work in following year*

Para 44(4) sch 45 FA 2013 provides:

> The taxpayer is not resident in the UK for the next tax year because the taxpayer meets the third automatic overseas test for that year (see paragraph 14).

In short, the individual must continue working overseas in the following year. See 6.8 (Automatic overseas test 3: Overseas work).
Minutes of the Capital Taxes Liaison Group provide:[12]

> The issue being raised was whether a split year residence applies, for case 1 split year treatment, if in the following year a person works full time abroad (and so is non-resident under the third automatic overseas test) and is also non-UK tax resident under other tests, given the wording in para 44 FA2013 Sch45 and para 44(4). It was suggested that this legislation could be interpreted to suggest that case 1 split year

[11] See 10.5.4 (Rounding).

[12] Minutes of meeting March 2023; *https://www.gov.uk/government/groups/capital-taxes-liaison-group*

treatment may apply only when the reason for non-residence was exclusively the third automatic overseas test and that other, for example the first automatic overseas test, cannot also apply where case 1 split year treatment is being claimed.
It was confirmed that as long as the third overseas test is met, case 1 split year treatment can apply regardless of other overseas tests also being met.

10.7 Case 2: Partner starts work overseas

Para 45(1) sch 45 FA 2013 provides:

> The circumstances of a case fall within Case 2 if they are as described in subparagraphs (2) to (6).

10.7.1 *UK resident in previous year*

Para 45(2) sch 45 FA 2013 provides:

> The taxpayer was resident in the UK for the previous tax year (whether or not it was a split year).

This is a requirement in each of split year Cases 1-3, which apply to leavers.

10.7.2 *Partner working overseas*

Para 45(3) sch 45 FA 2013 provides:

> The taxpayer has a partner[13] whose circumstances fall within Case 1 for–
> (a) the relevant year, or
> (b) the previous tax year.

10.7.3 *Living with partner*

Para 45(4) sch 45 FA 2013 provides:

> On a day in the relevant year, the taxpayer moves overseas so the taxpayer and the partner can continue to live together while the partner is working overseas.

10.7.4 *No (principal) UK home*

Para 45(5) sch 45 FA 2013 provides:

> In the part of the relevant year beginning with the deemed departure

[13] See 10.5.3 (“Partner”).

> day-
> (a) the taxpayer
> [i] has no home in the UK at any time, or
> [ii] has homes in both the UK and overseas but spends the greater part of the time living in the overseas home, and
> (b) the number of days that the taxpayer spends in the UK does not exceed the permitted limit.

There are two possible deemed departure days. Para 45 sch 45 FA 2013 provides:

> (7) If sub-paragraph (3)(a) applies, [partner's split year is the same year] the "deemed departure day" is the later of—
> (a) the day mentioned in sub-paragraph (4), and
> (b) the first day of what is, for the partner, the overseas part of the relevant year as defined for Case 1 (see paragraph 53).
> (8) If sub-paragraph (3)(b) applies, [partner's split year is the previous year] the "deemed departure day" is the day mentioned in sub-paragraph (4).

Para 45 sch 45 FA 2013 defines the permitted limit in two stages:

> (9) The permitted limit is the number found by reducing 90 by the appropriate number.
> (10) The appropriate number is the result of—
> A × (B÷12)
> where—
> "A" is 90, and
> "B" is the number of whole months in the part of the relevant year before the deemed departure day.

One rounds down or up to the nearest whole number (rounding half up to the next number).[14]

It would have been easier to say that the permitted limit is 90 – (A×B÷12) but the drafter of the SRT is somewhat algebra-phobic (or else thought that the reader would be).

10.7.5 *Non-resident in next year: Case 2*

Para 45(6) sch 45 FA 2013 provides:

> The taxpayer is not resident in the UK for the next tax year.

[14] See 10.5.4 (Rounding).

10.7.6 *HMRC examples*

RDRM provides:

> **RDRM12120: Residence : The SRT: Split year treatment: Case 2: The UK and overseas parts of the tax year** [Aug 2019
> Example (Peter and Amanda)
> P is A's husband (see example 2 at RDRM12080). He too lived in the UK for all his life and was resident in the UK for tax purposes. He travels with A on 8 January 2014 to live with her in India, having given up his job. A and P have let their flat in the UK for a 3 year period, commencing on 9 January 2014.
> Once in India P spends his time following his lifelong hobby as a lepidopterist, and catalogues Indian butterflies. He spend all his time there, except for the Christmas trips to the UK with A.
> P will receive split year treatment for the tax year 2013-2014, as he meets the Case 2 conditions:
>
> - he has no home in the UK after 8January 2014
> - he was resident for 2012-2013
> - he is non-UK resident for 2014-2015
>
> From 8 January 2014 until 5 April 2014 P spends less than the permitted limit of 22 days in the UK, (table at RDRM12070).
> For P the UK part of the tax year will end on 7 January 2014, and the overseas part of the tax year will start on 8 January 2014, the day he joined A to live together in India.

10.8 Case 3: Cease to have UK home

Para 46(1) sch 45 FA 2013 provides:

> The circumstances of a case fall within Case 3 if they are as described in subparagraphs (2) to (6).

10.8.1 *UK resident in previous year*

Para 46(2) sch 45 FA 2013 provides:

> The taxpayer was resident in the UK for the previous tax year (whether or not it was a split year).

This is a requirement in each of split year Cases 1-3, which apply to leavers.

10.8.2 *No UK home*

Para 46(3) sch 45 FA 2013 provides:

> At the start of the relevant year the taxpayer had one or more homes in the UK but-
>
> (a) there comes a day in the relevant year when P ceases to have any home in the UK, and
>
> (b) from then on, P has no home in the UK for the rest of that year.

10.8.3 *Less than 16 UK days*

Para 46(4) sch 45 FA 2013 provides:

> In the part of the relevant year beginning with the day mentioned in subparagraph (3)(a) [day when ceasing to have UK home], the taxpayer spends fewer than 16 days in the UK.

10.8.4 *Non-resident in next year: Case 3*

Para 46(5) sch 45 FA 2013 provides:

> The taxpayer is not resident in the UK for the next tax year.

10.8.5 *Sufficient overseas link*

Para 46 sch 45 FA 2013 provides:

> (6) At the end of the period of 6 months beginning with the day mentioned in sub-paragraph (3)(a), the taxpayer has a sufficient link with a country overseas.
>
> (7) The taxpayer has a "sufficient link" with a country overseas if and only if-
>
> (a) the taxpayer is considered for tax purposes to be a resident of that country[15] in accordance with its domestic laws, or
>
> (b) the taxpayer has been present in that country (in person) at the end of each day of the 6-month period mentioned in sub-paragraph (6), or
>
> (c) the taxpayer's only home is in that country or, if the taxpayer has more than one home, they are all in that country.

10.8.6 *HMRC example*

RDRM provides:

> **RDRM12140: Residence: The SRT: Split year treatment: Case 3: The UK and overseas parts of the tax year** [Aug 2019]
>
> Example (M)
>
> M has been based in the UK for most of her working life, and has been

[15] Para 145 sch 45 FA 2013 provides: "country" includes a state or territory.

resident here for tax purposes. On holiday in Bali in the summer of 2013 she meets Maurice, who lives and works in the United Arab Emirates. Some 12 months later, they marry. M resigns from her job and moves out of her home on 24 September 2014. She spends the nights of 24 and 25 September in a hotel and flies out to the UAE to live with Maurice on 26 September 2014. She has no close family in the UK and does not return to the UK in the remainder of the tax year. She does not take up any employment in the UAE. Maurice and M plan to live in the UAE for at least another 5 years.

M will receive split year treatment for 2014-2015 as she meets the Case 3 conditions:

- she was UK resident for 2013-2014
- she is non-UK resident for 2015-2016
- from 24 September 2014 until 5 April 2015 she has no home in the UK and spends fewer than 16 days in the UK
- she had established her only home is in the UAE within 6 months

For M, the overseas part of the tax year will start on 24 September 2014, the day she no longer had a home in the UK.

The overseas part of the tax year is the period which starts on the date in the tax year when the individual ceases to have a home in the UK until the end of the tax year.

10.9 Case 4: Start to have UK home only

Para 47(1) sch 45 FA 2013 provides:

> The circumstances of a case fall within Case 4 if they are as described in subparagraphs (2) to (4).

See too 10.13.5 (Cases 4/8 compared).

10.9.1 *Non-resident in previous year*

Para 47(2) sch 45 FA 2013 provides:

> The taxpayer was not resident in the UK for the previous tax year.

This is a requirement in each of split year Cases 4 - 8, which apply to arrivers.

10.9.2 *Acquiring UK home*

Para 47(3) sch 45 FA 2013 provides:

> [a] At the start of the relevant year, the taxpayer did not meet the only home test, but
> [b] there comes a day in the relevant year when that ceases to be the case

> and
> [c] the taxpayer then continues to meet the only home test for the rest of that year.

Para 47(5) sch 45 FA 2013 defines the Only Home Test:

> The "only home test" is met if-
> (a) the taxpayer has only one home and that home is in the UK, or
> (b) the taxpayer has more than one home and all of them are in the UK.

10.9.3 *UK-ties tests*

Para 47(4) sch 45 FA 2013 provides:

> For the part of the relevant year before that day [when Only Home Test is met], the taxpayer does not have sufficient UK ties.

UK-ties tests occur in split-year Cases 4, 5 and 8. The expression "sufficient UK ties" is defined separately, three times in all, but the definitions follow the same template. It has the usual SRT meaning[16] except for two adjustments:

(1) The test is applied over the "overseas part" of the split year (if it is a split year); UK days and UK ties in the UK part of the split year do not count.
(2) There is an reduction in the day count limit, reducing the days allowed in line with the length of the "overseas part" of the split year.

Para 47(6)(a) sch 45 FA 2013 deals with the first adjustment:

> (6) Paragraphs 17 to 20 (and Part 2 of this Schedule so far as it relates to those paragraphs) apply for the purposes of sub-paragraph (4) with the following adjustments-
> (a) references in those paragraphs and that Part to year X are to be read as references to the part of the relevant year mentioned in subparagraph (4) [time until Only Home Test is met] ...
> (8) Sub-paragraph (6)(a) does not apply to the references to year X in paragraphs 32(1)(b) and 33 of this Schedule (which relate to the residence status of family members)[17] so those references must continue to be read as references to year X.

It may be helpful to set out para 17 sch 45 FA 2013 as amended:

[16] See 6.14 (Sufficient ties test).
[17] See 6.28.3 (Ascertaining family residence).

> (1) The sufficient ties test is met for ~~year X~~ the part of the relevant year mentioned in subparagraph (4) [time until Only Home Test is met] if-
>
> (a) P meets none of the automatic UK tests and none of the automatic overseas tests, but
>
> (b) P has sufficient UK ties for that year.
>
> (2) "UK ties" is defined in Part 2 of this Schedule.
>
> (3) Whether P has "sufficient" UK ties for ~~year X~~ the part of the relevant year mentioned in subparagraph (4) [time until Only Home Test is met] will depend on-
>
> (a) whether P was resident in the UK for any of the previous 3 tax years, and
>
> (b) the number of days that P spends in the UK in ~~year X~~ the part of the relevant year mentioned in subparagraph (4) [time until Only Home Test is met].
>
> (4) The Tables in paragraphs 18 and 19 show how many ties are sufficient in each case.

10.9.4 *Computing number of days*

Para 18/19 sch 45 FA 2013 define "sufficient ties" for leavers /arrivers. It is convenient to combine the two into a single table. As amended by para 47(6)(a), para 18/19 provide:

Days spent by P in the UK in ~~year x~~	**sufficient ties**	**sufficient ties**
[the time until Only Home Test is met]	***leavers***	***arrivers***
More than [15] but not more than [45]	At least 4	[non-resident]
More than [45] but not more than [90]	At least 3	All 4
More than [90] but not more than [120]	At least 2	At least 3
More than [120]	At least 1	At least 2

Para 47 sch 45 FA 2013 adjusts the figures in square brackets:

> (6) Paragraphs 17 to 20 (and Part 2 of this Schedule so far as it relates to those paragraphs) apply for the purposes of sub-paragraph (4) with the following adjustments ...
>
> (b) each number of days mentioned in the first column of the Table in paragraphs 18 and 19 is to be reduced by the appropriate number.
>
> (7) The appropriate number is found by multiplying the number of days, in each case, by A ÷ 12
>
> where "A" is the number of whole months in the relevant year beginning with the day mentioned in sub-paragraph (3) [day Only Home Test is met].

RDRM provides:

> **RDRM12270: Residence: The SRT: Split year treatment: Case 8: Starting to have a home in the UK** [Oct 2019]
> ... not have sufficient UK ties to make them UK resident in the period from the 6 April to the point they start to have a UK home – when they are considering whether they have sufficient UK ties in this part of the year, they should reduce the day count limits in the sufficient ties tables (refer to RDRM11520) by substituting the values from the table below.

Day before satisfying only home or having a UK home tests is[18]

	6 to 30 Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	1 Mar to 5 Apr
"A"	1	2	3	4	5	6	7	8	9	10	11	12
A÷12	0.08	0.16	0.25	0.33	0.42	0.5	0.58	0.67	0.75	0.83	0.92	12
For 15 substitute	1	2*	4	5	6	7*	9	10	11	12*	14	15
For 45 substitute	4	7*	11	15	19	22	26	30	34	37*	41	45
For 90 substitute	7*	15	22*	30	37*	45	52*	60	67*	75	82*	90
For 120 substitute	10	20	30	40	50	60	70	80	90	100	110	120

There are two points to note about this table. Firstly, the author has taken the view that where the Only Home Test is met in the period 6-30 April, the number A is 1. Suppose the Only Home Test is met on 10 April. One might have thought that the number of whole months in the tax year beginning with 10 April is 11.

Secondly, the author has forgotten the rule that a fraction of exactly one half is to be rounded up.[19] The figures marked * should all be increased by one. Perhaps fortunately, that will not often make any difference.

10.9.5 *HMRC example*

RDRM provides:

> **RDRM12160: Residence: The SRT: Split year treatment: Case 4: The overseas and UK parts of the tax year** [Aug 2019]
> Example (Olan)
> O has been working for his employer in Germany for the last 5 years. He

[18] I have added the first two rows to explain the computation which follows, rounded to two decimal places in the second row, and added the asterix.

[19] See 10.5.4 (Rounding).

has no UK ties and was not resident in the UK. On 1 June 2013 O moves to the UK to look for work here. He rents out his apartment in Germany on a 2 year lease, from 27 May 2013.

O arrives in the UK and stays in temporary accommodation while he finds an apartment to rent. He signs a 12 month lease on an apartment in London on 1 July 2013.

He starts UK employment on 22 July 2013 and remains in the UK for a further 2 years.

O receives split year treatment for 2013-2014 as he meets the Case 4 conditions:

- he is non-UK resident for 2012-2013
- he started to have his only home in the UK during the tax year and that continued until at least the end of the tax year
- he had no UK ties from 6 April 2013 to 1 July 2013

For O the overseas part of the tax year will end on 30 June 2013, and the UK part of the tax year will start on 1 July 2013, the day he started to have his only home in the UK.

Note: O might also meet the criteria for Case 5 or Case 8 split years, but priority is given to that case where the overseas part of the tax year is the shortest.

10.10 Case 5: Start work in UK

Para 48(1) sch 45 FA 2013 provides:

> The circumstances of a case fall within Case 5 if they are as described in subparagraphs (2) and (3).

10.10.1 *Non-resident in previous year*

Para 48(2) sch 45 FA 2013 provides:

> The taxpayer was not resident in the UK for the previous tax year.

This is a requirement in each of split year Cases 4 - 8, which apply to arrivers.

10.10.2 *UK work*

Para 48(3) sch 45 FA 2013 provides a set of 5 conditions:

> There is at least one period of 365 days in respect of which the following conditions are met—
> (a) the period begins with a day that—
> (i) falls within the relevant year, and
> (ii) is a day on which the taxpayer does more than 3 hours'

> work in the UK,
> (b) in the part of the relevant year before the period begins, the taxpayer does not have sufficient UK ties,
> (c) the taxpayer works sufficient hours in the UK, as assessed over the period,
> (d) during the period, there are no significant breaks from UK work, and
> (e) at least 75% of the total number of days in the period on which the taxpayer does more than 3 hours' work are days on which the taxpayer does more than 3 hours' work in the UK.

10.10.3 *"Sufficient hours in the UK"*

Para 48(4) sch 45 FA 2013 provides:

> To work out whether the taxpayer works "sufficient hours in the UK" as assessed over a given period, apply paragraph 9(2) but for "P" read "the taxpayer".

10.10.4 *UK-ties test: Case 5*

Para 48(3) sch 45 FA 2013 provides:

> There is at least one period of 365 days in respect of which the following conditions are met ...
> (b) in the part of the relevant year before the period begins, the taxpayer does not have sufficient UK ties ...
>
> (5) Paragraphs 17 to 20 (and Part 2 of this Schedule so far as it relates to those paragraphs) apply for the purposes of sub-paragraph (3)(b) with the following adjustments—
> (a) references in those paragraphs and that Part to year X are to be read as references to the part of the relevant year mentioned in subparagraph (3)(b), and
> (b) each number of days mentioned in the first column of the Table in paragraphs 18 and 19 is to be reduced by the appropriate number.
> (6) The appropriate number is found by multiplying the number of days, in each case, by A ÷ 12
> where "A" is the number of whole months in the part of the relevant year beginning with the day on which the 365-day period in question begins.
> (7) Sub-paragraph (5)(a) does not apply to the references to year X in paragraphs 32(1)(b) and 33 of this Schedule (which relate to the residence status of family members) so those references must continue

to be read as references to year X.

This is (more or less) the standard form for split-year UK-ties tests, and I discuss it elsewhere.[20]

10.10.5 *HMRC example*

The RDRM provides:

> **RDRM12180: Residence: The SRT: Split year treatment: Case 5: The overseas and UK parts of the tax year** [Aug 2019]
> Example
> Andrea arrived in the UK on 20 May 2013 from Poland for a 2 week visit. She stays with her sister who is working in the UK. This is Andrea's first trip to the UK, and she has never previously been UK resident for tax purposes.
> Just before Andrea is about to return to Poland, she is offered a part-time job at a hotel. This will be her first ever job. She starts work on 10 June 2013. For the first 8 weeks of her employment she works 20 hours per week (5 hours per day), but from 5 August 2013 she is offered full-time work of 40 hours per week. Andrea takes 20 days leave during the tax year; there are no non-working days embedded within any of her periods of leave.
> Although for the first 8 weeks of her employment Andrea only works 20 hours per week, she works out that she meets the third automatic UK test from 10 June 2013, her computations are:
> Step 1: In a 365 days period that are no disregarded days when Andrea did more than 3 hours work overseas
> Step 2: Total number of UK hours worked during 365 day period (8 weeks x 20 hours & 40 weeks x 40 hours) = 1760 hours
> Step 3: Subtract disregarded days = 0, and 20 days annual leave, that can be deducted from 365 = 345 days reference period.
> Step 4: Divide reference period by 7 (345/7) = 49.29, rounded down to 49
> Step 5: Divide Andrea's net UK hours by 49 (the result of step 4) 1760/49 = 35.91 hours
> Andrea's hours average out at over 35 over the 365 day period from 10 June 2013 (which is a day on which she worked for more than 3 hours in the UK). She meets the third automatic UK test from that date.
> Andrea meets the criteria for Case 5 split year on the basis that:
>
> - she was non-UK resident in the previous tax year

[20] See 10.9.3 (UK-ties tests).

- she meets the third automatic UK test for the 365 day period commencing on 10 June 2013, (which is a day on which she worked for more than 3 hours in the UK)
- in the part of the year from 6 April 2013 until 10 June 2013 she did not have sufficient UK ties. (Refer to table in RDRM12220)

The minutes of the Joint Forum on Expatriate Tax and NICs provide:

> **Sufficient hours – non alignment of Case 5 and FTWUK**
> These tests diverge insofar as, for Case 5, the period starts with a day on which the individual works for three or more hours in the UK, but this is not a requirement for the third automatic UK test. You could therefore find that an individual is resident under the third automatic UK test in the tax year following return to the UK, but does not meet the Case 5 condition to split the arrival year, which would be seen as odd. Could this be addressed?
> HMRC reply: HMRC agrees these dates can differ and this is because the two tests are testing different things. If an individual meets the FTWUK test for a year they will be resident here. Case 5 then determines if they are entitled to split year tax treatment in that tax year. The Case 5 3hr requirement is there to ensure that the UK part of a split year does not start before the individual has done any UK work – which would otherwise be possible under the 35hr averaging requirement. Not setting it as a requirement does not seem to make sense for a split on the basis of FTWUK. The Government believes that for the majority of people the 365 day period they identify for FTWUK is likely to start with a day on which they worked more than 3 hours in the UK even though it is not a requirement for the 3rd automatic UK test.[21]

10.11 Case 6: Stop work overseas

Split-year Case 1 is for individuals who start work overseas. Case 6 is for individuals who have been working abroad and stop. Accordingly there are concepts and definitions in common, though the legislation repeats them in each place.

Para 49(1) sch 45 FA 2013 provides:

> The circumstances of a case fall within Case 6 if they are as described in subparagraphs (2) to (4).

[21] 29 January 2014 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/302475/140326_Expats_Forum_Jan_14_Minutes_FINAL.pdf*

10.11.1 *Non-resident in previous year*

Para 49(2) sch 45 FA 2013 provides:

> The taxpayer—
> (a) was not resident in the UK for the previous tax year because the taxpayer met the third automatic overseas test for that year (see paragraph 14), but
> (b) was resident in the UK for one or more of the 4 tax years immediately preceding that year.

Para (a) is a requirement in each of split year Cases 4 - 8, which apply to arrivers, but in this Case non-residence must be specifically due to meeting the 3rd overseas test. See 6.8 (Overseas test 3: Overseas work).

10.11.2 *Full-time overseas work*

Para 49(3) sch 45 FA 2013 provides:

> There is at least one period (consisting of one or more days) that—
> (a) begins with the first day of the relevant year,
> (b) ends with a day that—
> (i) falls within the relevant year, and
> (ii) is a day on which the taxpayer does more than 3 hours' work overseas, and
> (c) satisfies the overseas work criteria.

10.11.3 *"Overseas work criteria"*

Para 49 sch 45 FA 2013 provides:

> (5) A period "satisfies the overseas work criteria" if—
> (a) the taxpayer works sufficient hours overseas, as assessed over that period,
> (b) during that period, there are no significant breaks from overseas work,
> (c) the number of days in that period on which the taxpayer does more than 3 hours' work in the UK does not exceed the permitted limit, and
> (d) the number of days in that period falling within sub-paragraph (6) does not exceed the permitted limit.
> (6) A day falls within this sub-paragraph if—
> (a) it is a day spent by the taxpayer in the UK, but
> (b) it is not a day that is treated under paragraph 23(4)[22] as a day

[22] See 7.8 (The deeming rule).

spent by the taxpayer in the UK.

This is identical to the "overseas work criteria" in split-year Case 1: see 10.6.3 ("Overseas work criteria").

10.11.4 *"Sufficient hours overseas"*

Para 49(7) sch 45 FA 2013 provides:

> To work out whether the taxpayer works "sufficient hours overseas" as assessed over a given period, apply paragraph 14(3) but with the following modifications—
> (a) for "P" read "the taxpayer",
> (b) for "year X" read "the period under consideration",
> (c) for "365 (or 366 if year X includes 29 February)" read "the number of days in the period under consideration", and
> (d) in paragraph 28(9)(b), as it applies for the purposes of step 3, for "30" read "the permitted limit".

This is identical to "sufficient hours overseas" in split-year Case 1: see 10.6.4 ("Sufficient hours overseas").
Para 49 sch 45 FA 2013 provides:

> (8) The permitted limit is—
> (a) for sub-paragraphs (5)(c) and (7)(d), the number found by reducing 30 by the appropriate number, and
> (b) for sub-paragraph (5)(d), the number found by reducing 90 by the appropriate number.
> (9) The appropriate number is the result of A × (B÷12) where—
> "A" is—
> (a) 30, for sub-paragraphs (5)(c) and (7)(d), or
> (b) 90, for sub-paragraph (5)(d), and
> "B" is the number of whole months in the part of the relevant year after the 365-day period in question ends.

RDRM provides:

> **RDRM12220: Residence: The SRT: Split year treatment: Case 6: Calculating whether individual has worked full-time overseas in the relevant period** [Oct 2019]
> The table below sets out the permitted limits for Case 6 – the appropriate portions of the full year permitted limits.

Date	X - see note	Y - see note
6 - 30 Apr	2	7
1 - 31 May	5	15

1 - 30 Jun	7	22
1 - 31 Jul	10	30
1 - 31 Aug	12	37
1 - 30 Sep	15	45
1 - 31 Oct	17	52
1 - 30 Nov	20	60
1 - 31 Dec	22	67
1 - 31 Jan	25	75
1 - 29 Feb	27	82
1 Mar - 6 Apr	30	90

> Note
> X = permitted limit on days where you can work more than 3 hours in overseas part of the year or maximum number of days which may be subtracted from the reference period on account of gaps between employments
> Y = permitted limit on days spent in the UK in overseas part of year

10.11.5 *Resident in next year: Case 6*

Para 49(4) sch 45 FA 2013 provides:

> The taxpayer is resident in the UK for the next tax year (whether or not it is a split year).

10.11.6 *HMRC example*

RDRM provides:

> **RDRM12230: Residence: The SRT: Split year treatment: Case 6: The overseas and UK parts of the tax year** [Sep 2019]
> Example (Edward)
> E left the UK on 1 November 2010 to work full-time for a company based in Switzerland. Prior to this date he had always lived, worked and been resident in the UK. He has kept an apartment in the UK throughout his time in Switzerland; so he had a place to stay whenever visiting family in the UK.
> E retires from his employment, his last overseas workday being 31 October 2014. He returns permanently to the UK on 3 November 2014, and takes up residence in his apartment. E also has an apartment in Switzerland which is up for sale, but until a buyer is found he continues to use it when he visits Switzerland.
> Provided E did not exceed the limits for days spent working more than 3 hours in the UK, or days spent in the UK before the UK part of the tax year commenced (see table at RDRM12280), he will receive split year treatment under Case 6 for 2014-2015 as follows:

- he is not resident in the UK for 2013-2014 tax year because he met the test for full-time work overseas for that year
- From 6 April 2014 until 31 October 2014 he worked full-time overseas
- he was UK resident for one or more of the 4 tax years (2009-2010, 2010-2011, 2011-2012, 2012-2013), before the year in which he was not UK resident (2013-2014)
- he is resident for the tax year following his return to the UK, 2015-2016 tax year (he has retired permanently to the UK).

The overseas part of the tax year ends on 31 October 2014. This is the day that E finished his spell of working full-time overseas and the UK part of the tax year starts on 1 November 2014.

10.12 Case 7: Partner stops work overseas

Case 2 applies if an individual accompanies their partner who works overseas. Case 7 applies if the individual accompanies their partner who works in the UK. The two Cases share some common drafting.

Para 50(1) sch 45 FA 2013 provides:

> The circumstances of a case fall within Case 7 if they are as described in subparagraphs (2) to (6).

10.12.1 *Non-resident in previous year*

Para 50(2) sch 45 FA 2013 provides:

> The taxpayer was not resident in the UK for the previous tax year.

This is a requirement in each of split year Cases 4 - 8, which apply to arrivers.

10.12.2 *Living with partner*

Para 50 sch 45 FA 2013 provides:

> (3) The taxpayer has a partner[23] whose circumstances fall within Case 6 for—
>
> (a) the relevant year, or
>
> (b) the previous tax year.
>
> (4) On a day in the relevant year, the taxpayer moves to the UK so the taxpayer and the partner can continue to live together on the partner's return or relocation to the UK.

[23] See 10.5.3 ("Partner").

The wording is the same as Case 2: see 10.7.3 (Living with partner).

10.12.3 *No previous UK home*

Para 50 sch 45 FA 2013 provides:

> (5) In the part of the relevant year before the deemed arrival day—
> (a) the taxpayer
> [i] has no home in the UK at any time, or
> [ii] has homes in both the UK and overseas but spends the greater part of the time living in the overseas home, and
> (b) the number of days that the taxpayer spends in the UK does not exceed the permitted limit.
> (7) If sub-paragraph (3)(a) applies, the "deemed arrival day" is the later of—
> (a) the day mentioned in sub-paragraph (4), and
> (b) the first day of what is, for the partner, the UK part of the relevant year as defined for Case 6 (see paragraph 54).
> (8) If sub-paragraph (3)(b) applies, the "deemed arrival day" is the day mentioned in sub-paragraph (4).
> (9) The permitted limit is the number found by reducing 90 by the appropriate number.
> (10) The appropriate number is the result of—
> $A \times (B \div 12)$
> where—
> "A" is 90, and
> "B" is the number of whole months in the part of the relevant year beginning with the deemed arrival day.

10.12.4 *Resident in next year: Case 7*

Para 50(6) sch 45 FA 2013 provides:

> The taxpayer is resident in the UK for the next tax year (whether or not it is a split year).

10.12.5 *HMRC example*

RDRM provides:

> **RDRM12260: Residence: The SRT: Split year treatment: Case 7: The overseas and UK parts of the tax year** [Aug 2019]
> Example (Joan and Edward)
> J is E's wife (see RDRM12230). J lived with E in Switzerland for the duration of his employment. She also retires from work and returns to

live in the UK with E. However, she does not return on 3 November 2014 with her husband; she arrives in the UK on 8 November 2014, having worked her notice at her part-time job (20 hours per week) in Switzerland.

Provided J did not exceed the limits for days spent in the UK before the UK part of the tax year commenced, she meets the criteria for case 7 for 2014-2015 as follows:

- she was not UK resident for the 2013-2014 tax year
- she does not qualify for Case 6 as she does not meet the criteria for the third automatic overseas test – nor does she qualify for Case 4, 5 or 8
- her husband will receive Case 6 split year treatment
- she is resident in the UK for the tax year following her return to the UK, 2015-2016
- she has come to the UK to continue to live with her husband

The UK part of the tax year 2014-2015 starts on 8 November 2014 when J moves to the UK.

10.12.6 *Transitional rule for 2013/14*

Para 156 sch 45 FA 2013 provides:

> (1) Sub-paragraph (2) applies in determining whether the test in paragraph 50(3) is met where the relevant year is the tax year 2013-14.
> (2) The circumstances of a partner of the taxpayer are to be treated as falling within Case 6 for the previous tax year if the partner was eligible for split year treatment in relation to that tax year under the relevant ESC on the grounds that he or she returned to the United Kingdom after a period working overseas full-time.
> (3) Where the circumstances of a partner are treated as falling within Case 6 under sub-paragraph (2), the reference in paragraph 50(7)(b) to the UK part of the relevant year as defined for Case 6 is a reference to the part corresponding, so far as possible, in accordance with the terms of the relevant ESC, to the UK part of that year.
> (4) "The relevant ESC" means whichever of the extra-statutory concessions to which effect is given by Part 3 of this Schedule is relevant in the partner's case.

10.13 Case 8: Start to have UK home

Para 51(1) sch 45 FA 2013 provides:

> The circumstances of a case fall within Case 8 if they are as described in subparagraphs (2) to (5).

10.13.1 *Non-resident in previous year*

Para 51(2) sch 45 FA 2013 provides:

> The taxpayer was not resident in the UK for the previous tax year.

This is a requirement in each of split year Cases 4 - 8, which apply to arrivers.

10.13.2 *Acquiring UK home*

Para 51(3) sch 45 FA 2013 provides:

> At the start of the relevant year, the taxpayer had no home in the UK but—
> (a) there comes a day when, for the first time in that year, the taxpayer does have a home in the UK, and
> (b) from then on, the taxpayer continues to have a home in the UK for the rest of that year and for the whole of the next tax year.

10.13.3 *UK-ties test: Case 8*

Para 51(4) sch 45 FA 2013 provides:

> For the part of the relevant year before the day mentioned in sub-paragraph (3)(a) [date of acquiring UK home], the taxpayer does not have sufficient UK ties.

Para 51 sch 45 FA 2013 provides:

> (6) Paragraphs 17 to 20 (and Part 2 of this Schedule so far as it relates to those paragraphs) apply for the purposes of sub-paragraph (4) with the following adjustments-
> (a) references in those paragraphs and that Part to year X are to be read as references to the part of the relevant year mentioned in subparagraph (4) [year until acquiring UK home], and
> (b) each number of days mentioned in the first column of the Table in paragraphs 18 and 19 is to be reduced by the appropriate number.
> (7) The appropriate number is found by multiplying the number of days, in each case, by A ÷ 12
> where "A" is the number of whole months in the part of the relevant year beginning with the day mentioned in sub-paragraph (3)(a) [day of acquiring UK home].
> (8) Sub-paragraph (6)(a) does not apply to the references to year X in paragraphs 32(1)(b) and 33 of this Schedule (which relate to the

> residence status of family members) so those references must continue to be read as references to year X.

This is (more or less) the standard form for split-year UK-ties tests and I discuss it elsewhere.[24]

10.13.4 *Resident in next year: Case 8*

Para 51(5) sch 45 FA 2013 provides:

> The taxpayer is resident in the UK for the next tax year and that tax year is not a split year as respects the taxpayer.

10.13.5 *Cases 4/8 compared*

In outline:

Case 4: start to have *only* UK home	**Case 8: start to have *a* UK home**
Start of year: no UK home	Start of year: no UK home [same]
For rest of the year: (1) UK home and (2) no home elsewhere	For rest of year: UK home (may have home elsewhere)
Next year: need not have UK home	Next year: must have UK home
Next year: need not be UK resident	Next year: must be UK resident
UK-ties test period: from 6 April until later of (1) UK home acquired and (2) no home elsewhere	UK-ties test period: from 6 April until UK home acquired

10.13.6 *HMRC example*

RDRM provides:

> **RDRM12280: Residence: The SRT: Split year treatment: Case 8: The UK and overseas parts of the tax year** [Aug 2019]
> Example (Nicola)
> N is retired, she is non-resident in the UK for tax purposes having lived in Cyprus for a number of years. She has a home in Cyprus and she also has a property in the UK which has been let out on a commercial basis for the last few years.
> She recently became a grandmother, and decides she will split her time between Cyprus and the UK so that she can see more of her grandson, who lives in the UK.

[24] See 10.9.3 (UK-ties tests).

She comes back to the UK and moves into the UK property when the rental agreement with her tenant expires on 4 August 2014. She now has 2 homes, 1 in each country.

Between 6 April 2014 and 4 August 2014 when she started to have a UK home, N only spent 4 days in the UK, visiting her daughter; and therefore did not exceed the limit for days spent in the UK in the overseas period before she started to have a UK home.

N meets the criteria for Case 8 for 2014-2015 on the basis that:

- she was not UK resident for 2013-2014
- she is UK resident for 2015-2016 (N is possibly dual resident in UK and Cyprus)
- she continues to have a home in the UK for the rest of 2014-2015 and the following year
- she did not have sufficient UK ties to make her resident from 6 April 2014 until 4 August 2014

N does not meet the criteria for Cases 4, 5, 6 or 7 split year treatment.

The UK part of the split year starts on 4 August 2014, which is when N starts to have a home in the UK.

10.14 Priority between Cases

If more than one Case applies, priority between them matters because they may specify different periods as the Overseas/UK part of the year.

Para 54 sch 45 FA 2013 deals with priority between split-year Cases 1 to 3 (leavers):

> (1) This paragraph applies to determine which Case has priority where the taxpayer's circumstances for the relevant year fall within two or all of the following—
> Case 1 (starting full-time work overseas);
> Case 2 (the partner of someone starting full-time work overseas);
> Case 3 (ceasing to have a home in the UK).
> (2) Case 1 has priority over Case 2 and Case 3.
> (3) Case 2 has priority over Case 3.

Para 55 deals with priority between split-year Cases 4-8 (arrivers):

> (1) This paragraph applies to determine which Case has priority where the taxpayer's circumstances for the relevant year fall within two or more of the following—
> Case 4 (starting to have a home in the UK only);
> Case 5 (starting full-time work in the UK);
> Case 6 (ceasing full-time work overseas);
> Case 7 (the partner of someone ceasing full-time work overseas);

Case 8 (starting to have a home in the UK).
(2) In this paragraph "the split year date" in relation to a Case means the final day of the part of the relevant year defined in paragraph 53(5) to (9)[25] for that Case.
(3) If Case 6 applies—
   (a) if Case 5 also applies and the split year date in relation to Case 5 is earlier than the split year date in relation to Case 6, Case 5 has priority;
   (b) otherwise, Case 6 has priority.
(4) If Case 7 (but not Case 6) applies—
   (a) if Case 5 also applies and the split year date in relation to Case 5 is earlier than the split year date in relation to Case 7, Case 5 has priority;
   (b) otherwise, Case 7 has priority
(5) If two or all of Cases 4, 5 and 8 apply (but neither Case 6 nor Case 7), the Case which has priority is the one with the earliest split year date.
(6) But if, in a case to which sub-paragraph (5) applies, two or all of the Cases which apply share the same split year date and that date is the only, or earlier, split year date of the Cases which apply, the Cases with that split year date are to be treated as having priority.

10.15 Split year: Tax return

Split year reliefs do not require a formal claim or election, but the individual must tick box 3 in SA109 (Residence, remittance basis etc) (2022/23). The rubric to this box provides: "If your circumstances meet the criteria for split year treatment,... put 'X' in the box." The accompanying SA109 notes (2022/23) provide:

> **Box 3**
> ...If you put 'X' in box 3:
> - you must include details of which split year case applies to you in the 'Any other information' box, box 40
> - do not put 'X' in box 1, but fill in box 6
> - put the number of days spent in the UK for the overseas part of the tax year in box 10
>
> **Box 3.1 If more than 1 case of split year treatment applies**
> Put 'X' in box 3.1 if you think that more than one case of split year treatment applies for the 2022 to 2023 tax year. Give details of which cases apply to you in the 'Any other information' box, box 40, starting on page RR 3.

[25] See 10.5.5 ("The overseas part").

The Joint Expatriate Forum on Tax and NICs discussed this form in 2014:[26]

> When a taxpayer is completing Box 12[27] for split years and there are different ties for the UK/overseas parts, the taxpayer should explain in Box 40 [white space] which tie is relevant to which part. For split years and boxes 10[28] and 12, HMRC is only looking for information in relation to the overseas part of the year...
> When recording split year information, all relevant cases should be disclosed in Box 40 [white space] but there is no need to identify all relevant dates where multiple cases potentially apply (subject to the statutory order of priority) – only the date the individual considers applies need be recorded.

10.16 Arrival/departure: Disclosure

10.16.1 *Arrival*

The RDRM provides:

> **RDRM10215 Residence: Coming to the UK: Form P86** [May 2020]
> Since 1 June 2010 the form P86 has been withdrawn and new arrivals to the UK will be integrated into HMRC processes by existing means
> - The RTI process for new employees
> - CWF1 for newly self employed, or
> - SA1 registration process for customers who are not self-employed but who need to complete a tax return
>
> Please refer to EIM42890 and PAYE81750.

RDR1 provides:

> 1.17 You should tell HMRC immediately if you come to the UK to live or work or leave the UK to live or work overseas. You should also tell HMRC if those circumstances change while you're in the UK.

There is no legal obligation for an arriver to do this "immediately". But at some point arrivers will have to submit a tax return, make a remittance basis claim, or give HMRC notice of liability to tax;[29] it makes sense to

[26] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/327284/140704_Expat_Forum_Minutes_FINAL.pdf* (April 2014)

[27] This box asks: How many ties to the UK did you have in [the relevant tax year]

[28] This box asks: Number of days spent in the UK during [the relevant tax year]

[29] See 121.2 (Duty to notify liability).

complete the relevant form (form SA1 for those not employed or self-employed) well in advance of the formal deadlines for those steps.

10.16.2 *Departure: Form P85*

Form P85 (Leaving the UK – getting your tax right) is used to claim tax relief or a repayment of tax on becoming non-UK resident.[30]

10.17 Split year of trustees and PRs

Para 2 sch 45 FA 2013 provides that *individuals* are resident during whole tax years.[31] There is no equivalent statutory rule for trustees or PRs.

The split-year rules which exempt income/gains of the offshore part of a split year also apply only to individuals*,* and so do not apply to income/gains of trustees or PRs.

Para 41 sch 45 FA 2013 provides:

> This Part [Part 3: Split Year Treatment]—
> (a) does not apply in determining the residence status of personal representatives, and
> (b) applies to only a limited extent in determining the residence status of the trustees of a settlement (see section 475 of ITA 2007 and section 69 of TCGA 1992, as amended by this Part).[32]

10.17.1 *How can trust residence change*

There are various ways that a trust may change residence:

(1) Change of trustee's personal residence status:
    (a) An individual trustee may change residence in their private capacity. The change happens at the end of a tax year as an individual cannot change residence during a tax year.[33]
    (b) An corporate trustee may change residence in its private capacity. The change could happen during a tax year.
(2) Change in trustees: A trustee resident in one state may be appointed in place of a trustee resident in another state. This could happen during a tax year. In practice this is more common than a change of trustee's personal residence status.

[30] See 36.7 (Leaving UK: PAYE). For a discussion of form P86, see Finney, "A new form of test", Taxation Magazine (24 October 2013).

[31] See 10.1 (Residence throughout tax year).

[32] For para (b) see 7.8 (Individual trustee: split year).

[33] See 10.1 (Residence throughout tax year).

10.17.2 *Trust split year: IT rules*

The TSE Manual provides:

> **TSEM10025 trust residence for Income Tax and CGT purposes - changes during the tax year** [Aug 2019]
> **Changes in residence status - Income Tax**
> [1] For Income Tax purposes, for the period from 6 April 2007 to 5 April 2013, where the residence status of the trust changes during a tax year, the year is split, so that a trust could be resident for part of the year and non-resident for the other part.

But that is now of historic interest only.

> [2] With the introduction of the Statutory Residence Test from 6 April 2013 there is no longer a 'split year' treatment where the trustees are individuals and the residence status of the trust changes. In such circumstances, if a trust is resident for part of the tax year, it is treated as resident for all of the tax year.

That is correct.

> [3] However if an individual becomes or ceases to be a trustee of a settlement during a tax year, that tax year is a split year in respect of the individual. If the individual was acting as a trustee only in the period when they were not resident in the UK, for the purposes of determining the trust residence they will be treated as if they were non-resident for the year. This exception is overridden if the trustee is acting as such in the course of a UK business (see TSEM10020 final paragraph).

In the absence of an express relief, this is, I think, an informal concession.

> [4] The residence position of a corporate trustee follows the general rules for company residence when determining their residence for the purpose of the residence of the trust.

Similarly, form SA906 notes (2022-23) provides:

> If, for part of the year to 5 April 2023, all the trustees were corporate trustees and not resident in the UK, then the trustees as a whole will not be resident in the UK for that period for Income Tax purposes.

The position here is affected by the rule that trustees are a single and distinct person for IT[34] because this notional person is not an individual,

[34] See 7.3 (Trustees a distinct person).

and so not affected by the rule that an individual cannot change residence during a tax year.

10.17.3 *Trust split year: CGT*

The TSE Manual provides:

> **TSEM10025 trust residence for Income Tax and CGT purposes - changes during the tax year** [Aug 2019]
> **Changes in residence status - Capital Gains Tax**
> [1] For Capital Gains Tax purposes, if the trustees are resident for any part of a tax year, gains arising at any time in the tax year are chargeable to Capital Gains Tax.

This is correct. See 56.6 (Territorial scope of CGT).

> [2] However, under the Statutory Residence Test introduced with effect from 6 April 2013 an individual trustee who is resident in the UK for a tax year is resident for every day in that tax year, including those days that fall within the overseas part of a split year for that individual.

This is also correct, but it does not matter, having regard to point [1].

> [The next 2 paragraphs repeat points [3] and [4] above]...

10.17.4 *HMRC examples*

The Manual gives four examples:

Example	**Trustee**	**Facts**	**Result**
1: Alpha trust	Individual	Becomes UK resident during year	Taxable
2: Beta trust	Individual	Resigns in offshore part of year	Not taxable
3: Gamma trust	Individual	Resigns in UK part of year	Taxable
4: Delta trust	Company	Replaced by UK trustee	Split year

In examples 1-3 an individual is sole trustee. This simplifies the example, as it is not necessary to consider the rules for mixed residence trustees. But in practice a sole individual trustee would be unusual.

The first example considers an individual trustee acting throughout a split year:

> **TSEM10030 trust residence for Income Tax and CGT purposes - changes during the tax year - examples** [Aug 2019]
> **Example 1 individual acting as trustee changes residence** (Alpha trust)
> The A Trust was established many years ago and A an individual has been acting as sole trustee. A has been resident overseas.

> However, on 1 October 2013 he comes to live in the UK and is considered to be UK resident from that date.
>
> As A has become resident in the UK during 2013-14 the A Trust is considered UK resident for both Income Tax and Capital Gains Tax for the whole of 2013-14.

The moral is that A should have retired as trustee before coming to the UK.[35]

The next example considers an individual trustee acting as trustee only during the non-resident part of a split year:

> **Example 2 - individual ceases to act as trustee** (Beta trust)
>
> The B Trust was established many years ago and A an individual has been acting as sole trustee. A has been resident overseas.
>
> However, on 1 October 2013, A comes to live in the UK, after resigning as a trustee on 25 September 2013 and is replaced as trustee by B who is not resident in the UK.
>
> As A only acted as a trustee of the Beta Trust during the part of the year 2013-14 when he was not resident in the UK he is regarded as being not resident in the UK when determining the Trust's residence for the year.
>
> As B is not resident in the UK for any part of 2013-14 the B Trust is considered non-resident for both Income Tax and Capital Gains Tax for the year.

This is, I think, concessionary.

The next example concerns an individual trustee acting during both non-resident and resident parts of a split year.

> **Example 3 - individual ceases to act as trustee** (Gamma trust)
>
> The G Trust was established many years ago, and A an individual has been acting as sole trustee. A has been resident overseas.
>
> However, on 1 October 2013, A comes to live in the UK and resigns as trustee on 1 December 2013. B, who is not resident in the UK, replaced A as trustee on 1 December 2013.
>
> As A acted as a trustee of the Trust during the part of the year in which he was resident in the UK, he is regarded as resident in the UK when determining the Trust's residence for the year. In the circumstances, the G Trust is considered to be UK resident for both Income Tax and Capital Gains Tax for the whole of the year 2013-14.
>
> For the year 2014-15 assuming that B remains trustee and continues to

[35] If the trust is not UK-linked, the appointment of a second (non-resident) trustee would suffice.

be non-resident the Trust will be non-resident.

The moral is that A should have retired before the beginning of the UK part of the split year.[36]

The last example concerns a corporate trustee.

> **Example 4 - change in corporate trustees** (Delta trust)
> A Ltd, a trust company resident overseas, has always acted as sole trustee of the D Trust.
> On 1 October 2013, A Ltd resigns as trustee and is replaced by B Ltd, a company which is resident in the UK.
> In the circumstances, the year 2013-14 can be split with the result that, for Income Tax purposes, the Trust is not resident in the UK up to 1 October 2013, and resident in the UK from that date.

For CGT purposes the position is different, see above.

10.18 Split-year rules: Critique

CIOT say:

> The split-year rules... seek to replicate the previous concessions, but do not ask the question what a sensible split-year rule might look like.[37]

The reader who has studied this chapter may agree. Though CIOT do not address the harder question of what sensible split-year rules should look like. However that may be, HMRC do not seem to have an appetite for reform.[38]

[36] Again, if the trust is not UK-linked, the appointment of a second (non-resident) trustee would suffice.

[37] CIOT letter to HMRC (21 July 2015)

[38] See 6.42 (Future of SRT).

CHAPTER ELEVEN

TEMPORARY NON-RESIDENCE

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11.20.1 Pre-departure RFI
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11.20.3 DTA override: RFI
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11.21 Pre-departure gains remitted
11.21.1 Position pre-2019 CGT rewrite
11.21.2 Position from 2019/20
11.22 Planning
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Cross references

The following topics are considered elsewhere:

Topic	**See**
Transitional rule for pre-2015 temporary non residents	5.11.3
DIMF: Temporary non-resident	73.32
Interaction with sch 4C TCGA	62.28.2

11.1 Temporary non-residence: Introduction

This chapter discusses the IT/CGT temporary non-residence rules (**"TNR rules"**). The rules are in Part 4 sch 45 FA 2013.

Deemed-domicile rules also include a short term non-residence rule: a person who ceases to be UK resident (or domiciled) may (in short) continue for a 3 or 4 year period to be regarded as UK domiciled for tax purposes, and so within the scope of IHT.[1] But that is not a *temporary* non-residence rule as it applies to those who never return to the UK.

11.2 Purpose of TNR rules

It is helpful to outline the three sets of problems which the TNR rules are intended to address.

In the following discussion I use the terminology discussed in para 9.1 (Treaty-residence: Introduction):

Term	**Meaning**
UK tax residence/non-residence:	Residence as defined in UK tax law (the SRT)
UK tax-resident[2]	UK resident under UK tax law definition
UK tax non-resident	Not UK resident under UK tax law definition

[1] See 5.6.2 (Domicile end date).

[2] If the context is clear one can abbreviate these terms to tax-resident or non-resident. For individuals, one might use the terms SRT-resident and SRT non-resident.

Treaty-residence:	Residence as defined in a DTA
Treaty-resident in foreign State	Resident of foreign State within DTA definition[3]

11.2.1 *TNR gains*

In the absence of the TNR rules, gains accruing to temporary non-residents are not (in general)[4] subject to CGT.

So a possible method of CGT planning for a UK resident would be as follows. An individual could become UK tax non-resident and realise gains (typically by disposing of assets) during a year of non-residence; in the following tax year they could become tax-resident again. Thus relatively brief periods of tax non-residence offered the opportunity of CGT-free disposals.

A variant of this planning is: an individual could remain UK tax-resident but become treaty non-resident (ie treaty-resident in a state with a DTA conferring CGT relief under the tie-breaker); the individual realises gains while treaty non-resident; following the disposal the individual could cease to be treaty non-resident. Thus relatively brief periods of treaty non-UK residence offered some opportunity of CGT-free disposals (so far as CGT treaty relief could be available).[5]

The TNR rules bring gains ("TNR gains") into charge on the return of the temporary non-resident to the UK. The technique used is to deem the gains to accrue in the year of return, and to override DT relief (if otherwise applicable).

11.2.2 *TNR income*

In the absence of the TNR rules:

(1) foreign income of temporary non-residents is not subject to UK tax
(2) Some UK source income qualifies for non-resident IT relief.

So a similar method of IT planning for a UK resident would be to arrange for income to arise to an individual when UK tax non-resident, or when treaty non-resident. Relatively brief periods of tax non-residence or treaty non-residence offered the opportunity of receiving income free of IT.

The TNR rules bring some of this income ("TNR income") into charge on the return of the temporary non-resident to the UK. But whereas the TNR rules apply

[3] One could use the term "treaty-resident outside the UK". Statute sometimes calls this "treaty non-resident" but I think my term is clearer.

[4] See 56.6.3 (Territorial scope: Summary).

[5] For completeness: it has been suggested that planning involving short periods of treaty non-residence may constitute treaty abuse, and so not qualify for treaty relief: see 108.7 (OECD-concept abuse). But in practice, I think rightly, HMRC did not take that point.

to (almost) all chargeable gains, they only apply to limited categories of income. Presumably the rules are aimed at types of income which it was thought could most easily be arranged to arise during the non-resident period. The categories of income caught by the TNR rules are (in short) as follows:

Type of income: Section no	**See para**
Dividends from material interest in close company	11.11 ff
Chargeable-event gains (life policies)	11.18
Offshore income gains	11.19
Pension schemes charges: s.572A, 576A, 579CA ITEPA	*Not discussed*
Specific employment income:	*Not discussed*
(a) Disguised remuneration: s.554Z4A, 554Z11A ITEPA	
(b) Employer-financed retirement benefits: s.394A ITEPA	

The technique used is to deem TNR income to arise in the year of return, and to override DT relief (if otherwise applicable).

HMRC summarise the position as follows:

> 3.47 Ceasing to be UK resident means that an individual is no longer liable to UK tax on income from non-UK sources. In many instances there can also be a reduced tax liability on income from UK sources. This can result in people finding it advantageous to become not resident for a short period of time if they expect substantial amounts of income to arise which otherwise would be liable to tax in the UK. This leads to a cost to the Exchequer.
>
> 3.48 A similar position used to arise for CGT. It was possible for individuals to leave the UK temporarily and realise capital gains in the period of non-residence and therefore be exempt from liability to UK tax on those gains. Legislation was enacted in FA 1998 to counter such avoidance of CGT.
>
> 3.49 Introducing a statutory definition [the SRT] will make it clearer when a person is tax resident or not resident in the UK. This could enable those who want to avoid liability on substantial amounts of income to plan short periods of temporary non-residence with more certainty.
>
> 3.50 The SRT rules will therefore need to counteract the risk of individuals creating artificial[6] short periods of non-residence, during which they receive a large amount of income (which accrued during periods of UK residence) free of UK tax and then bring the income back into the UK tax-free. This activity would undermine the effectiveness of

[6] This is a tendentious use of the word “artificial”, see 3.21.2 (“Artificial/devices”).

an SRT (?) and present an unacceptable risk to the Exchequer.[7]

11.2.3 *TNR remittances*

In the absence of the TNR rules, a possible method of remitting RFI tax free would be as follows. Suppose an individual had RFI taxable on remittance (in this chapter called "**pre-departure income**").

The individual could become UK tax non-resident, and remit the pre-departure income during a year of non-residence; in the following tax year they could become UK resident again. Thus relatively brief periods of tax non-residence offered the opportunity of tax-free remittances of pre-departure income.[8] The same applies for pre-departure foreign gains, though not for foreign earnings.[9]

The technique used is to deem the income/gains to be remitted in the year of return.[10]

11.2.4 *TNR planning*

All the planning discussed above is still possible for recent UK residents, ie those who have become UK resident but not for long enough to pass the 4/7 UK-years test. This is deliberate. It slightly mitigates the unfairness of the rule that historic gains come into charge to UK tax on a disposal when UK resident, even though the gain accrued during a non-resident period. That is, there is no CGT rebasing on becoming UK resident.

Certain types of income are not within the TNR code, and are not taxed on return to the UK. That includes:

(1) Income arising to non-residents:
(a) Discretionary trust income (Annual Payments)
(b) Royalty income

(2) Income under anti-avoidance rules which do not apply to non-residents:

Topic	**See**
s.624 income (settlor-interested trusts)	47.9
ToA income:	
s.720 income (charge on transferors)	49.21
s.731 income (charge on benefits)	50.45

[7] HM Treasury/HMRC, "Statutory Definition of Tax Residence" (June 2011) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81588/consult_condoc_statutory_residence.pdf*

[8] See 17.18 (Remittance when non-resident).

[9] See 34.35 (Remittance when non-resident).

[10] See 11.20 (Pre-departure income remitted).

It would be rather bold to plan on this continuing to be the position in the future.

11.3 Terminology

11.3.1 *TNR terminology: Navigation*

The TNR provisions use a set of defined terms. There are no taxes-act-wide definitions, so they are either repeated verbatim or incorporated by reference, where used in other statutes in a TNR context. These terms are:

Term	**See para**	**My term (if different)**
Residence period	11.3.3	
Treaty non-resident	11.3.2	Treaty-resident in foreign state
Sole UK residence	11.3.4	
Period A	11.3.5	
Temporary period of non-residence	11.3.6	
Year of departure	11.3.7	
Period of return	11.3.8	
Temporarily non-resident	11.4	
I also coin the following terms:		
SRT-resident	11.3.2	
Treaty-resident	11.3.2	
Sole UK/non-sole UK periods	11.3.5	

11.3.2 *SRT/treaty residence*

In this book I use the following terminology:

(1) **"Tax-residence"** means residence as defined in UK tax law, the statutory residence test. An individual:
   (a) resident in the UK under the SRT is **"tax-resident"**
   (b) not resident in the UK under SRT is **"tax non-resident"**

(2) **"Treaty-residence"** means residence as defined in a DTA. A person who is:
   (a) a resident of the UK under a DTA is **"treaty-resident in the UK"**
   (b) a resident of a foreign state under a DTA is **"treaty-resident in the foreign state"**. Statute calls this *"treaty non-resident"*. Para 112(3) sch 45 FA 2013 provides:

> An individual is "Treaty[11] non-resident" at any time if at the time the individual falls to be regarded as resident in a country[12] outside the

[11] The legislation, I think rather oddly, uses a capital *T* in this expression.

[12] Para 145 sch 45 FA 2013 provides: "country" includes a state or territory.

> UK for the purposes of double taxation arrangements[13] having effect at the time.
>
> But I think my term is clearer.

Since tax-residence and treaty-residence are distinct concepts,[14] a person who is tax-resident may be:

(1) treaty-resident in a foreign state (treaty non-resident) under the tie-breaker test;[15] or
(2) not treaty-resident in a foreign state (ie, not treaty non-resident): statute calls this **"sole UK residence"**.

These are clumsy terms but it is difficult to think of better.

11.3.3 *"Residence period"*

This term is devised to deal with split years and tax years which are not split (**"non-split years"**).

Para 109 sch 45 FA 2013 provides:

> In relation to an individual, a "residence period" is—
> (a) a tax year that, as respects the individual, is not a split year, or
> (b) the overseas part or the UK part of a tax year that, as respects the individual, is a split year.

11.3.4 *"Sole UK residence"*

"Sole UK residence" is a technical term. It is a status, which lasts for a residence period.[16]

Para 112 sch 45 FA 2013 provides two definitions: one for non-split years and one for split years:

Para 112(1): non-split years	**Para 112(2): split years**
An individual has "sole UK	An individual has "sole UK

[13] Para 145 sch 45 FA 2013 provides the standard commonsense definition:
"In this Schedule ... "double taxation arrangements" means arrangements that have effect under section 2(1) of TIOPA 2010".

[14] See 9.2 (Treaty/UK-law residence).

[15] It is assumed that the treaty has a Model form tie-breaker clause.
It would be useful to have a short term to describe someone who is UK tax-resident but treaty-resident in a foreign state (treaty non-resident). But I cannot think of a good term, and prefer to use the full expression when it is needed.

[16] Contrast residence, also a status, which lasts for an entire tax year.

residence" for a residence period consisting of an entire tax year if— (a) the individual is resident in the UK for that year, and (b) there is no time in that year when the individual is Treaty non-resident.	residence" for a residence period consisting of part of a split year if— (a) the residence period is the UK part of that year, and (b) there is no time in that part of the year when the individual is Treaty non-resident.

I abbreviate the statutory language as follows:

Statutory term	**My term**
Residence period for which an individual has sole UK residence	Sole UK period
Residence period for which an individual does not have sole UK residence.	Non-sole UK period

A short period of treaty-residence in a foreign state (treaty non-residence) means that the entire residence period is a non-sole UK period, even if the individual is present in the UK for most of the period. See, for instance, the RDRM example of Max[17] who was treaty-resident in a foreign state for 6 weeks, but the entire tax year (a non-split year) was a non-sole UK period.

The UK part of a split year is a sole UK period unless the individual is treaty-resident in a foreign state. The overseas part of a split year is a non-sole UK period.

11.3.5 *"Period A"*

Para 110(1) sch 45 FA 2013 provides:

> An individual is to be regarded as "temporarily non-resident" if—
> (a) the individual has sole UK residence for a residence period,
> (b) immediately following that period (referred to as "period A"), one or more residence periods occur for which the individual does not have sole UK residence

"Period A" is the pre-departure sole UK period.

11.3.6 *"Temporary period of non-residence"*

Para 113 sch 45 FA 2013 provides:

[17] See 11.5.1 (Departure in non-split year, return in split year).

> In relation to an individual, "the temporary period of non-residence" is the period between—
> (a) the end of period A [the pre-departure sole UK period], and
> (b) the start of the next residence period after period A for which the individual has sole UK residence [the period of return].[18]

11.3.7 *"Year of departure"*

Para 114 sch 45 FA 2013 provides:

> "The year of departure" is the tax year consisting of or including period A [the pre-departure sole UK period].

This is an artificial definition, as it may not be the year in which the individual actually departs. See, for instance, the RDR example of Max[19] who ceased to be UK resident in the UK during 2014/15 (a non-split year) but his "year of departure" was 2013/14. In these cases it is helpful to write the expression with scare quotation marks.

11.3.8 *"Period of return"*

Para 115 sch 45 FA 2013 provides:

> "The period of return" is the first residence period after period A [the pre-departure sole UK period] for which the individual has sole UK residence.

11.3.9 *Multiple non-resident periods*

There may be more than one non-resident period. Suppose:

Period	**Status**	**Period A**
1	Sole UK period	No
2	Sole UK period	Yes ("period A1")
3	Non-sole UK period	No
4	Non-sole UK period	No
5	Sole UK period	No
6	Sole UK period	Yes ("period A2")
7	Non-sole UK period	No
8	Non-sole UK period	No
9	Sole UK period	No
10	Sole UK period	No

[18] Confusingly, the drafter here does not actually use the expression "period of return" which is defined in this sense.

[19] See 11.5.1 (Departure in non-split year, return in split year)

Periods 2 and 6 both meet the definition of period A, as they are followed by non-sole UK periods. I call them period A1 and period A2.

So there are two temporary periods of non-residence:

Period A	**Temporary period of non-residence**
Period A1	End of period A1 to end of period 5
Period A2	End of period A2 to start of period 9

HMRC may rely on either of these in order to apply a TNR charge, and each need to be tested under the 7-year test and 5-year absence test.

11.4 "Temporarily non-resident"

Armed with these definitions, we can turn to the key term "temporarily non-resident".

11.4.1 *Residence then non-residence*

Para 110 sch 45 FA 2013 provides:

> (1) An individual is to be regarded as "temporarily non-resident" if—

A set of four conditions then follow. The first two are:

> (a) the individual has sole UK residence for a residence period,
> (b) immediately following that period (referred to as "period A"), one or more residence periods occur for which the individual does not have sole UK residence ...

This sets the scene for the two key conditions: the 4/7 UK-years test and the 5-year absence test.

11.4.2 *4/7 UK-years test*

Para 110 sch 45 FA 2013 provides:

> (1) An individual is to be regarded as "temporarily non-resident" if...
> (c) at least 4 out of the 7 tax years immediately preceding the year of departure were either—
> (i) a tax year for which the individual had sole UK residence, or
> (ii) a split year that included a residence period for which the individual had sole UK residence

I refer to this as the **"4/7 UK-years test"** and the 7 years preceding the year of departure are the **"7 tested years"**. Years within (i) or (ii) are **"UK years"** and years outside (i) and (ii) are **"non-UK years"**. It may be useful to set out an aide memoire identifying the 7 tested years:

Year of Departure	**7 tested years (inclusive)**
2016/17	2009/10 - 2015/16
2017/18	2010/11 - 2016/17
2018/19	2011/12 - 2017/18
2019/20	2012/13 - 2018/19
2020/21	2013/14 - 2019/20
2021/22	2014/15 - 2020/21
2022/23	2015/16 - 2021/22
2023/24	2016/17 - 2022/23

11.4.3 *5-year absence test*

Para 110 sch 45 FA 2013 provides:

> (1) An individual is to be regarded as "temporarily non-resident" if...
>   (d) the temporary period of non-residence is 5 years or less.

I refer to this as the **"5-year absence test"** but the label is not completely apt because the period must be more than 5 years.

RDRM provides:

> **RDRM12610 Temporary non-residence: An introduction** [Dec 2021]
> For these special [TNR] rules not to apply, the individual's period of non-residence must exceed 5 years, that is, a minimum period of five years plus 1 day. For example, 4 May 2015 to 4 May 2020.

In the absence of split years, 5 complete non-resident tax years is not sufficient.[20] But if there are split years, the 5 years do not have to be 5 complete tax years.

11.4.4 *TNR issue list*

The steps to ascertain temporary non-residence are as follows:

(1) *Preparatory:*
    (a) Identify the residence periods (split/non-split years)
    (b) Classify each residence period as:
        (i) a sole UK period or
        (ii) a non-sole UK period
(2) *The 4/7 UK-years test:*
    (a) Identify period A (the pre-departure sole UK period)[21]

[20] See 11.5.3 (5 years non-residence, no split years).

[21] There may be more than one period A, in which case steps (2) and (3) need to be done for each period A.

(b) Identify the year of departure (tax year consisting of or including period A)
(c) Identify the 7 tested years
(d) Are (at least) 4/7 of the tested years UK years?

(3) *The 5-year absence test:*
(a) Identify end date of period A
(b) Identify start date of next sole UK period after period A
(c) Identify temporary period of non-residence (period between (a) and (b): is it 5 years or less?

I refer to this as the **"TNR issue list"**. It will be apparent that a rigorous application of the issue list may be a laborious exercise, particularly as the identification of split years can also be a complex matter.

11.5 Examples

RDRM provides 2 examples.

11.5.1 *Departure in non-split year, return in split-year*

The first example (Max) concerns the 5-year absence test. RDRM provides:[22]

> **RDRM12650: Meaning of year of departure and period of return** [Dec 2021]
> M has had sole residence in the UK for the previous 10 years.
> On 22 February 2015 M moves to Poland. From 22 February to 5 April 2015 he is Treaty non-resident.
> M does not satisfy the conditions for split year treatment in tax year 2014-2015.
> M returns to the UK on 26 May 2018, and split year treatment applies.

JK analysis
Working through the TNR issue list, I would analyse the matter as follows:

(1) Preparatory:
(a) Identify the residence periods (split/non-split years)
(b) Classify each residence period as:
(i) a sole UK period or
(ii) a non-sole UK period

Residence period	**Classify**	**Notes**
2013/14 Not split year	Sole UK period	Period A

[22] I have slightly changed the wording of the example for added clarity.

2014/15 Not split year	Non-sole UK period	Left UK 22 Feb
2015/16 Not split year	Non-sole UK period	
2016/17 Not split year	Non-sole UK period	
2017/18 Not split year	Non-sole UK period	
2018/19 Split year		Return UK 26 May
Offshore part (to 25 May 2018)	Non-sole UK period	
UK part (from 26 May 2018)	Sole UK period	

(2) ***The 4/7 UK-years test:***
(a) Identify period A (pre-departure sole UK period): 2013/14
(b) Identify "year of departure" (tax year consisting of period A): 2013/14 (Note that is not the year in which M actually departed!*)*
(c) Identify the 7 tested years: 2006/07 - 2012/13
(d) Are (at least) 4/7 of the tested years UK years? Yes (7 out of 7)

(3) The 5-year absence test:
(a) Identify end date of period A: 5 April 2014
(b) Start date of next sole UK period after period A: 26 May 2018
(c) Identify temporary period of non-residence (period between (a) and (b): is it 5 years or less? Yes

Conclusion: Max is temporarily non-resident.

The Manual analysis is as follows. First it identifies period A and the "year of departure":

> M is not solely UK resident from 22 February 2015, but he will remain UK resident for the tax year.
> As this is not a split year, Period A will end at the end of the tax year 2013-2014. This is because that is the end of the last tax year in which M was solely UK resident.
> His year of departure for the purpose of applying the temporary non-resident provisions is therefore 2013-2014; even though he physically left the UK on 22 February 2015.
> The next residence period begins on 6 April 2014, and M will begin to be regarded as temporary non-resident from this point.

The example next considers the position on return:

> M has sole UK residence from 26 May 2018. He is Treaty resident [in the UK] for the UK part of the year.
> His temporary non-residence ends on 25 May 2018. The period of temporary non-residence is 6 April 2014 to 25 May 2018 inclusive;

> which is less than 5 years, and so M is within the scope of the temporary non-residence provisions.
> 2014/15 is a non-split year and so one residence period.
> M does not have sole UK residence for that period (it is not a UK year) as:
> (a) He is UK law UK resident for the year; but
> (b) He is treaty-resident in a foreign state (treaty non-resident) for part of the year (22 February 2015 - 5 April 2015).
> So period A [the pre-departure sole UK period] is the previous residence period, which is the year 2013/14. The end of period A is 5 April 2014.
> The "year of departure" is 2013/14.
> 2018/19 is a split year.
> For the overseas part of the split year (6 April - 25 May) M does not have sole UK residence as:
> (a) He is UK law UK resident for the year; but
> (b) He is treaty-resident in a foreign state (treaty non-resident).
> For the UK part of the split year (16 May - 5 April) M does have sole UK residence. That is the period of return.
> The temporary period of non-residence runs from 6 April 2014 (end of period A) to 26[23] May 2018 (start of period of return). That is less than five years so M is temporarily non-resident

The conclusion is not surprising, since M's actual absence in fact was only just over 3 years.

11.5.2 *Split-year of arrival/departure*

The RDRM has one more example (Louis):

> L moves to the UK on 9 January 2014, becoming resident here for 2013-2014. He satisfies the conditions for split year treatment for 2013-2014, and is Treaty resident in the UK from arrival.
> On 4 January 2018, L moves to the USA. He becomes a US tax resident and is not treaty resident in the UK from that point onwards. He satisfies the conditions for split year treatment and his overseas part of the split year starts on 4 January 2018.
> L returns to the UK on 9 March 2023, and split year treatment applies. He is treaty resident in the UK from the date of his return.

[23] HMRC take the date to 25th, but it makes no difference: one is looking at midnight 25/26 May.

JK analysis

Working through the TNR issue list, I would analyse the matter as follows:

(1) Preparatory:

(a) Identify the residence periods (split/non-split years)

(b) Classify each residence period as:

(i) a sole UK period or

(ii) a non-sole UK period

Residence period	**Classify**	**Notes**
2013/14 Split year		
Offshore part (to 8 Jan 2014)	Non-sole UK period	
UK part (from 9 Jan 2014)	Sole UK period	
2014/15 Not split year	Sole UK period	
2015/16 Not split year	Sole UK period	
2017/18 Split year		
UK part (to 3 Jan 2018)	Sole UK period	Period A
Offshore part (from 4 Jan 2018)	Non-sole UK period	
2018/19 Not split year	Non-sole UK period	
2019/20 Not split year	Non-sole UK period	
2020/21 Not split year	Non-sole UK period	
2021/22 Not split year	Non-sole UK period	
2022/23 Split year		
Offshore part (to 8 Mar 2023)	Non-sole UK period	
UK part (from 9Mar 2023)	Sole UK period	

(2) The 4/7 UK-years test:

(a) Identify period A (pre-departure sole UK period): 6 Apr 17-3 Jan 18

(b) Identify year of departure (tax year including period A): 2017/18

(c) Identify the 7 tested years 2010/11 - 2016/17

(d) Are (at least) 4/7 of the tested years UK years? Yes (4 out of 7)

(3) The 5-year absence test:

(a) Identify end date of period A: 3 Jan 2018

(b) Identify start date of next sole UK period after period A: 9 Mar 2023

(c) Identify temporary period of non-residence (period between (a) and (b): is it 5 years or less? No.

Conclusion: The TNR rules do not apply.

The HMRC analysis is as follows:

> L meets the '4 out of 7' test for tax years immediately preceding the year of his departure.

- 2013-2014 was a split year which included a residence period for which L had sole UK residence
- 2014-2015, 2015-2016 and 2016-2017 were full tax years for which he had sole UK residence
- 2017-2018 was the year of departure. It was a tax year that included a residence period for which he had sole UK residence (6 April 2017 to 3 January 2018). This last period is period A.

5-year absence test

The HMRC analysis is as follows:

> L has more than 1 residence period immediately following period A in which he does not have sole UK residence. The first such period is 4 January 2018 to 5 April 2018, (the overseas part of the split year in the year of his departure).
> By the time L returns he has been non-resident for more than 5 years, (4 January 2018 to 8 March 2023), therefore he is not temporary non-resident for the purposes of the statutory residence test. He does not need to be non-resident for 5 complete tax years in order to be outside the scope of the temporary non-residence provisions.

The example illustrates that L does not need to be non-resident for 5 complete tax years in order to fall outside the scope of the TNR provisions.

11.5.3 *5 years non-residence, no split years*

STEP guidance provides:

> In certain circumstances, an individual will need to remain outside of the UK for six tax years in order not to be regarded as 'temporarily non-resident'.
> *Example*
> An individual:
> - leaves the UK on or before 5 April in one year (e.g. 4 April 2015);
> - stays outside the UK for five complete tax years (being both tax years and calendar years);
> - returns to the UK on 6 April or later during the following tax year (6 April 2020).
>
> The individual is not, at any point, treaty resident in another country and is not eligible for split-year treatment in the year of arrival or departure.

JK analysis
Working through the TNR issue list, I would analyse the matter as follows:

(1) Preparatory:

(a) Identify the residence periods (split/non-split years)

(b) Classify each residence period as:

(i) a sole UK period or

(ii) a non-sole UK period

Residence period	**Classify**	**Notes**
2014/15 Not split year	Sole UK period	Period A
2015/16 Not split year	Non-sole UK period	
2016/17 Not split year	Non-sole UK period	
2017/18 Not split year	Non-sole UK period	
2018/19 Not split year	Non-sole UK period	
2019/20 Not split year	Non-sole UK period	
2020/21 Not split year	Sole UK period	

(2) The 4/7 UK-years test:

(a) Identify period A (the pre-departure sole UK period): 2014/15

(b) Identify year of departure (tax year consisting of period A): 2014/15

(c) Identify the 7 tested years: 2007/8 - 2013/14

(d) Are (at least) 4/7 of the tested years UK years? Yes (7 out of 7)

(3) The 5-year absence test:

(a) Identify end date of period A: 5 Apr 2015

(b) Identify start date of next sole UK period after period A: 6 Apr 2020

(c) Identify temporary period of non-residence (period between (a) and (b): is it 5 years or less? No

Conclusion: The individual is outside the TNR rules. But STEP say:

> Under the new rules, the individual will be temporarily non-resident as the period of non-residence will be precisely five years and not more. Therefore, they would have to remain outside the UK until 6 April 2021 in order not to be regarded as temporarily non-resident.

But is that right?

11.6 TNR gain/loss

11.6.1 *Gain/loss accrues in year of return*

Section 1M(1) TCGA provides:

> If, in the case of the disposal of an asset by an individual who is temporarily non-resident—
>
> (a) a gain or loss accrues to the individual in the temporary period

> of non-residence, and
> (b) the asset is not excluded from this subsection by section 1N (certain assets acquired in that period),[24]
>
> the gain or loss is treated instead as accruing to the individual in the period of return.

I refer to gains/losses within s.1M(1) as **"TNR gains/losses"**.

Section 87 gains accruing to a non-resident beneficiary before 2008/09 were TNR gains, within (what is now) s.1M(1) TCGA, as they were chargeable gains, treated as accruing to the beneficiary under s.87, even if the beneficiary was non-resident. This point will cease to matter from 6 April 2024 when a 2017/18 s.87 gain will fall out of the scope of TNR. For capital payments to non-residents from 2018, see 61.22 (Payment to temporary non-resident).

Section 1M(1) does not catch s.86 or s.3 gains, as gains under these sections do not accrue to a non-resident. These sections only apply to a settlor or participator who is UK resident. Hence the drafter includes express provisions to catch these gains. It was not necessary to do this for s.87, prior to 2018.

For the interaction with sch 4C TCGA, see 62.28.2 (Trust within s.87).

11.6.2 *TNR s.3 gain*

In the absence of express provision, s.3 gains of a temporarily non-resident participator in a non-resident company would not be TNR gains.

Section 3E TCGA provides:

> (1) This section applies if-
> (a) an individual is temporarily non-resident, and
> (b) a gain or loss accrues to a company in a tax year falling wholly or partly in the temporary period of non-residence.
>
> (2) So much of the gain as would, as a result of section 3, have been treated as accruing to the individual in the tax year if the residence assumption were made is to be treated as accruing to the individual in the period of return.

Section 3E(6) TCGA defines the residence assumption:

> For the purposes of this section the "residence assumption" is-
> (a) that the individual was resident in the UK for the tax year in which the gain or loss accrued to the company, and

[24] See 11.7 (Post-departure acquisitions).

> (b) that the tax year was not a split year as respects the individual.

Section 3E TCGA then deals with the remittance basis:

> (3) But if-
>
> (a) the remittance basis applies to the individual for the tax year that comprises or includes the period of return, and
>
> (b) any part of the gain has not been remitted to the UK before the period of the return,
>
> subsection (2) has effect subject to the further application of Schedule 1 (as read with section 3D) in relation to that part of the gain.
>
> (4) Paragraph 5 of Schedule 1 applies for the purposes of subsection (3) as it applies for the purposes of that Schedule.

Section 3E(7) TCGA provides a treaty override:

> Nothing in any double taxation arrangements prevents a charge to capital gains tax arising as a result of this section.

11.6.3 *TNR s.3 loss*

In the absence of express provision, s.3 losses of a temporary non-resident would not be within the TNR rules, and would not be allowable. Section 3E(5) TCGA provides:

> So much of the loss accruing in the tax year as would, in accordance with section 3(9), have reduced or extinguished a gain treated as accruing to the individual in that year as a result of section 3 if the residence assumption were made is to be treated as accruing to the individual in the period of return.

Section 3 TNR losses are only set against s.3 TNR gains. This is consistent with the usual rule for s.3 losses: see 64.14 (Loss accruing to non-resident company).

Careful timing of disposals is necessary to ensure that s.3 losses are not wasted.

11.6.4 *TNR s.86 gain*

In the absence of express provision, s.86 gains would not be TNR gains. Section 1M(3) TCGA provides:

> If—
>
> (a) an individual is temporarily non-resident, and
>
> (b) a gain would, as a result of section 86, have accrued to the individual in a tax year falling wholly or partly in the temporary

> period of non-residence if the individual had been resident in the UK for that year,
>
> the gain is treated instead as accruing to the individual in the period of return (but see also section 86A[25]).

11.6.5 *Gain taxed on non-resident*

Section 1M(5) TCGA provides:

> Nothing in this section is to affect a gain or loss which, apart from this section, would be chargeable to capital gains tax or would be an allowable loss.

This sensibly disapplies the TNR rules where the temporarily non-resident individual is already subject to CGT. That may be:

(1) The situations where a non-resident is subject to CGT:[26]
    (a) Gain on a disposal of UK land or a land-rich asset
    (b) Individual carries on trade in the UK through a branch/ agency
(2) If the individual is tax-resident and treaty non-resident but:
    (a) the treaty does not have a CG article; or
    (b) the treaty CG article does not apply to the gain (eg UK land)

11.6.6 *TNR gain remitted*

Section 1M(2) TCGA provides:

> If—
>
> (a) a gain is, as a result of subsection (1), treated as accruing to an individual in a tax year for which the remittance basis applies to the individual,[27]
> (b) the tax year consists of or includes the period of return, and
> (c) the gain was remitted to the UK in the temporary period of non-residence,
>
> the gain is treated instead as remitted to the UK in the period of return.

See 11.2.3 (TNR remittances).

What about s.3 gains of a temporary non-resident?

A foreign domiciled settlor is not within s.86, so this provision does not

[25] See 11.10 (TNR s.86/s.87 interaction)

[26] See 56.6.5 (CGT/CT charge: non-residents).

[27] Defined in s.1M(7): "In this section the reference to "the remittance basis" applying to an individual for a tax year is to section 809B, 809D or 809E of ITA 2007 applying to the individual for the year."

refer to s.86 TNR gains.

11.7 Post-departure acquisition

Section 1N(1) TCGA provides:

> An asset is excluded from section 1M(1) if—

I refer to this as **"post-departure acquisition relief"**. Four conditions (or sets of conditions) then follow.

11.7.1 *Acquisition post-departure*

Section 1N TCGA provides:

> (1) An asset is excluded from section 1M(1) if—
> (a) it was acquired by the individual in the temporary period of non-residence,

The asset must be acquired in the temporary period of non-residence. The relief does not apply where:

(1) T acquires an asset when non-resident.
(2) T returns to the UK.
(3) T becomes temporarily non-resident.

The relief does not apply to a s.3 gain accruing to a temporary non-resident who is a participator in a non-resident company, on the disposal of an asset by the company, because the acquisition is not by the individual.

11.7.2 *No gain/loss acquisition*

Section 1N TCGA provides:

> (1) An asset is excluded from section 1M(1) if ...
> (b) the acquisition was otherwise than by means of a disqualifying no gain/no loss disposal,

Section 1N TCGA defines"UK resident disposal" and then "disqualifying no gain/no loss disposal":

> (3) For the purposes of this section "a UK resident disposal" means a disposal by a person ("P") of an asset which was acquired by P at a time when—
> (a) P was resident in the UK, and
> (b) P was not Treaty non-resident.
>
> (4) For the purposes of this section "a disqualifying no gain/no loss disposal" means a UK resident disposal to which section 58, 73 or

> 258(4) applies.

The sections referred to are:

TCGA	**Topic**
s.58	Transfers between spouses
s.73	Death of life tenant
s.258(4)	Works of art

The drafter has not used the term "Sole non-residence"; perhaps because the term is defined in sch 45 FA 2013 and incorporating a definition by reference was more trouble than it was worth.

11.7.3 *Exclusion for settled property*

Section 1N TCGA provides:

> (1) An asset is excluded from section 1M(1) if ...
> (b) the acquisition was otherwise than by means of a disqualifying no gain/no loss disposal.

This prevents an avoidance scheme under which T might acquire an interest under a settlement with relevant income or trust gains, and then sell the interest tax free.

11.7.4 *Exclusion after roll-over*

Section 1N TCGA provides:

> (1) An asset is excluded from section 1M(1) if ...
> (c) there is no reduction in the consideration for the acquisition under section 23(4)(b) or (5)(b), 152(1)(b), 153(1)(b), 162(3)(b) or 247(2)(b) or (3)(b) by reference to a UK resident disposal, and

The sections referred to are:

TCGA	**Topic**
s.23	Compensation and insurance
s.152/153	Business assets roll-over relief
s.162	Transfer of business to a company
s.247	Compulsory acquisition

11.7.5 *Exclusion after reorganisation*

Section 1N(2) TCGA provides:

> This exclusion does not apply in the case of an asset ("the new asset")

if—

(a) on a disposal of the new asset a gain or loss is treated as a result of 116(10) or (11), 134 or 154(2) or (4) as accruing (ignoring section 1M),

(b) the gain or loss is calculated by reference to another asset ("the old asset"), and

(c) the new asset is one that meets the conditions for exclusion but the old asset does not.

The sections referred to are:

TCGA	**Topic**
s.116	New asset is qualifying corporate bond
s.134	Compensation stock
s.154	Depreciating asset

11.7.6 *Interaction with share pooling*

CIOT raise an interesting question:

> Suppose an individual were to own 100 shares in a limited company.
> The individual becomes non-resident and, whilst non-resident, purchases in the market a further 200 shares (of the same class) in the same company.
> Whilst non-resident, the individual then disposes of the entire shareholding at a gain.
> Under [s.1M TCGA] assets owned at the date of departure which are then disposed of whilst non-resident are treated as disposed of in the year of return if the individual is away for fewer than five tax years. Section [1M] therefore catches the disposal of the 100 shares. The policy behind section [1M] would not therefore seek to charge tax on any gain arising in respect of the 200 shares acquired, held and disposed of whilst the individual was non-resident. This would ordinarily be provided for by section [1N TCGA]. However, section 104 provides that shares (and other fungible assets) are treated as a single asset 'growing or diminishing' as the case may be. Therefore, it would appear that section 104 TCGA treats the 200 shares as if they were part of the same asset which previously consisted of only 100 shares. That asset is one that was held prior to the individual's departure (and therefore falls outside the exception for post-departure acquisitions).[28]

[28] *https://www.kessler.co.uk/wp-content/uploads/2018/12/121011-CGTsection-10A-shares-and-nonresidents-CIOT-comments.pdf*

11.8 DTA override: Gains

Most DTAs with a capital gains article broadly adopt OECD Model form:

> Gains from the alienation of any property, other than [specified exceptions] shall be taxable only in the Contracting State of which the alienator is a resident.[29]

Gains accruing to an individual when treaty-resident in a foreign state (in the statutory terminology, treaty non-resident) would in principle qualify for this relief even if within the scope of s.1M. Section 1M(4) TCGA provides a treaty override:

> Nothing in any double taxation arrangements prevents a charge to capital gains tax arising as a result of this section.

This constitutes a breach of treaties in OECD Model form.[30] However the intention of parliament is clear and prevails over the treaty.[31]

11.8.1 *Foreign tax credit relief*

EN FB 2005 provides:

> The application of section 10A [now s.1M] in relation to an individual does not prevent the individual obtaining relief for foreign tax paid in respect of chargeable gains which are treated as arising to him or her in the year of return.

The same would apply to the current rules. For an example in the context of the USA/UK DTA, see 111.24 (Credit for TNR CGT charge),

11.9 TNR: BAD relief claim

Taxguide 1/12 (Entrepreneurs' relief - practical points) provides:[32]

> **Technical tax analysis put forward for HMRC comment**
> 88 Under [s.1M TCGA] the gain will be treated as accruing to a taxpayer in the year of return. The view taken is that the original disposal date applies for ER [now business asset disposal relief] purposes. As s.169M

[29] See 17.18 (DT relief for taxable gains).

[30] This is recognised in some treaties, where a specific provision authorises a TNR charge (and any foreign state equivalent). See 56.24.5 (DTA recent departure rules).

[31] See 107.19.8 (Conflict between DTA/UK law).

[32] *https://www.icaew.com/-/media/corporate/archive/files/technical/tax/taxguides/taxguide-1-12-er-final-at-25-jan-12.ashx*

> TCGA requires an election for ER to be made before the first anniversary of 31 January following the tax year in which the disposal takes place, it is likely that the individual will be out of time in making an ER claim if he waits until he has resumed UK residence. The advice is therefore to make a protective claim...
>
> **HMRC response** ...
>
> 89 ER is only available on the making of a claim and such claim must be made within the statutory time limit which is set by reference to the date of the qualifying disposal (see s.169M(3) TCGA 1992). It is for the taxpayer to consider whether to submit a protective claim for ER within this time period.

11.10 TNR s.86/s.87 interaction

In the absence of relief, gains accruing to the trustees during the settlor's period of temporary non-residence may be:

(1) s.86 gains of the settlor in the year of return, and

(2) s.1(3) amounts (trust gains) which may effectively be charged on beneficiaries of the settlement who receive capital payments.

Section 86A TCGA provides relief against double taxation

Section 86A TCGA provides:

> (1) Subsection (3) applies if—
>
> (a) chargeable gains of an amount equal to the amount referred to in section 86(1)(e) for a tax year ("year A") are treated under section 1M(3)[33] as accruing to a settlor under section 86 in the period of return

"Year A" is one of the temporary non-resident years. The label is not ideal, but I adopt it as it is easiest to follow the statutory terminology.

> (b) there are amounts on which beneficiaries of the settlement are charged to tax under section 87 or 89(2) for one or more tax years, each of which is earlier than the year of return, and
>
> (c) those amounts are in respect of matched capital payments[34] received by the beneficiaries.

It is considered that non-resident beneficiaries are not "charged to tax" unless they are temporary non-resident beneficiaries who have returned to

[33] See 11.6.4 (TNR s.86 gain).

[34] Defined s.86A(2): "A "matched" capital payment is a capital payment, all or part of which is matched under section 87A with the section 1(3) amount for year A."

the UK before the settlor’s year of return. Remittance basis beneficiaries are “charged to tax” even if nothing is remitted.

11.10.1 *The reliefs*

There are three reliefs. Firstly, s.86A(3)(4) TCGA provides s.87 gains charged to tax are deducted from the settlor’s s.86 gains:

> (3) The amount of the chargeable gains mentioned in subsection (1)(a) for year A that are treated under section 1M(3) as accruing to the settlor under section 86 in the period of return is to be reduced by the appropriate amount.
> (4) The appropriate amount is—
> (a) the sum of the amounts mentioned in subsection (1)(c) to the extent that the matched capital payments are matched under section 87A with the section 1(3) amount for year A, or
> (b) if the property comprised in the settlement has at any time included property not originating from the settlor, so much (if any) of that sum as, on a just and reasonable apportionment, is properly referable to the settlor.

Section 86 gains which are brought into charge are deducted from s.1(3) amounts. That follows the usual rule in s.87(4)(b) TCGA.[35] The legislation has separate rules for the year of return and for earlier years (why?). Section 86A(5) TCGA deals with the year of return:

> (5) If a reduction falls to be made under subsection (3) for the year of return, the deduction to be made in accordance with section 87(4)(b) for the settlement for that year must not be made until—
> (a) all the reductions to be made under subsection (3) for that year for each settlor have been made, and
> (b) those reductions are to be made starting with the year immediately preceding the year of return and working backwards.

Lastly, s.86A(6)(7) TCGA deals with the earlier years:

> (6) Subsection (7) applies if, with respect to year A, an amount remains to be treated under section 1M(3) as accruing to any of the settlors in the period of return after having made the reductions under subsection (3) with respect to year A.
> (7) The aggregate of the amounts remaining to be so treated (for all of

[35] See 61.6.7 (s.86 gain deducted from s.1(3) amount).

> the settlors) is to be applied in reducing so much of the section 1(3) amount for year A as has not already been matched with a capital payment under section 87A for any year prior to the year of return (but not so as to reduce the section 1(3) amount below zero).

Section 86A(8) TCGA provides definitions needed for a trust with multiple settlors:

> In this section—
> (a) "the settlement" means the settlement in relation to which the settlor mentioned in subsection (1)(a) is a settlor,
> (b) a reference to "the settlors" or "each settlor" is to the settlors or each settlor in relation to the settlement,
> (c) "period of return" and "year of return" have the same meanings as in section 1M(3), and
> (d) paragraph 8 of Schedule 5 applies in construing the reference to property originating from the settlor.

11.11 TNR dividend code

A table may assist navigation. In order of importance, the provisions are:

Section	**Topic**	**See para**
Foreign dividends		
408A ITTOIA	Foreign dividend	11.13
689A ITTOIA	Foreign distribution	11.13
UK dividends		
812A ITA	Non-resident IT relief	11.15
401C ITTOIA	DT relief	11.16
413A ITTOIA	Stock dividend	*not discussed*
420A ITTOIA	Release of loan to participator	*not discussed; see 40.8*

I refer to the provisions together as the **"TNR dividend[36] code**".

11.12 TNR dividends: Definitions

Some common terminology is used throughout the TNR dividend code.

11.12.1 *"Participator"/"associate"*

These terms have their standard meanings. Section 408A(4) ITTOIA provides:

> For the purposes of subsection (3)—

[36] Where context permits, I use the word "dividends" loosely to include distributions.

> "associate" and "participator" have the same meanings as in Part 10 of CTA 2010 (see sections 448 and 454)

This only applies for s.408A, but the same definition is repeated throughout the TNR dividend code.[37]

See 104.6 (Associates); 104.22 (Definition of "Participator").

11.12.2 *"Material participator"*

Section 408A(4) ITTOIA adopts the definition in the close company participator loan rules:

> a "material participator" is a participator who has a material interest in the company, as defined in section 457 of that Act

This only applies for s.408A, but the same definition is repeated throughout the TNR dividend code.[38] So there are two conditions:

(1) a participator
(2) a material interest

11.12.3 *Material interest*

Our journey takes us to s.457(1) CTA 2010, for the definition of material interest:

> A person has a material interest in a company for the purposes of section 456 if condition A or B is met.

It is helpful to see these side by side:

s.457(2) CTA 2010: condition A	**s.457(3) CTA 2010: condition B**
Condition A is that	Condition B is that, in the case of a close company,
[i] the person (with or without one or more associates) or [ii] any associate of that person (with or without one or more other such associates)	[i] the person (with or without one or more associates) or [ii] any associate of that person (with or without one or more other such associates)
is— (a) the beneficial owner of, or	possesses or is entitled to acquire such rights as would—

[37] See s.401C(12), 689A(4)(a) ITTOIA.
[38] See s.401C(12) (with immaterial differences); 689A(4)(b) ITTOIA.

(b) directly or indirectly able to control,	(a) in the event of the winding up of the company, or (b) in any other circumstances, give an entitlement to receive
more than 5% of the ordinary share capital of the company.	more than 5% of the assets which would then be available for distribution among the participators.

The wording derives from the close company code:

Condition	**Derived from**	**See**
Condition A	s.452(1)(c) CTA 2010	104.27.2
Condition B	s.439(3) & s.450(3) CTA 2010	104.28; 104.3.10

Condition B does not apply to non-resident companies, as it only applies to a close (ie UK resident) company. Nevertheless, condition A is wide, so the net is cast widely, and perhaps wider than necessary to deal with tax avoidance by temporary non-residents;[39] but that often happens in avoidance provisions.

11.12.4 *"Relevant time"*

"Relevant time" matters for the participator-causation condition.[40] Section 408A(4) ITTOIA provides:

> In this section ...
> "relevant time" means—
> (i) any time in the year of departure or, if the year of departure is a split year as respects the individual, the UK part of that year, or
> (ii) any time in one or more of the 3 tax years preceding that year;

This only applies for s.408A, but the same definition is repeated throughout the TNR dividend code.[41]

11.13 Taxation of TNR dividends

For historical reasons there are separate provisions for foreign dividends/ distributions[42] but the rules are (more or less) identical.

[39] Contrast s.3 TCGA, which also started with a 5% de minimis limit, later increased to 10% and (following EU pressure) is now set at an appropriate 25%.

[40] See 11.14.3 (Participator-causation condition).

[41] See 401C(12), 689A(4)(c) ITTOIA.

[42] See 30.8.4 (Income-distribution: IT charge).

11.13.1 *TNR dividends taxed on return*

The rules are in s.408A/689A ITTOIA:

Foreign dividends: s.408A	**Foreign distributions: s.689A**
(1) This section applies if an individual is temporarily non-resident.	(1) [Identical]
(2) Dividends within subsection (3) [TNR dividends] are to be treated for the purposes of this Chapter [Chapter 4 Part 4] as if they were received by the individual, or as if the individual became entitled to them, in the period of return.	(2) Distributions within subsection (3) [TNR dividends] are to be treated for the purposes of this Chapter [Chapter 8 Part 5] as if they had been received by the individual, or as if the individual had become entitled to them, in the period of return.

11.13.2 *TNR dividends remitted*

Foreign dividends: s.408A(5)	**Foreign distributions: s.689A(5)**
If section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for the year of return, any dividend within subsection (3) [TNR dividends] that was	If section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for the year of return, any distribution within subsection (3) [TNR dividends] that is
	[i] relevant foreign income and
remitted to the UK in the temporary period of non-residence is to be treated as remitted to the UK in the period of return	[ii] is remitted to the UK in the temporary period of non-residence is to be treated as remitted to the UK in the period of return.

See 11.2.3 (TNR remittances).

The requirement in s.689A(5)[i] that the distribution must be RFI is otiose, as the distribution will always be RFI. Perhaps it is a mistake which was noticed and corrected in s.408A, but remained uncorrected in s.689A.

Section 408A(9) ITTOIA deals with interaction with the SIP regime; not discussed here.

11.14 "TNR dividends"

TNR dividend: s.408A(3)	**TNR distribution: s.689A(3)**
A dividend is within this subsection if—	A distribution is within this subsection if—

A set of four conditions then follow. I refer to these as **"TNR conditions (a)-(d)"**. A dividend which meets these conditions is a **"TNR dividend"**.

11.14.1 *TNR condition (a): Receipt*

TNR dividend: s.408A(3)(a)	**TNR distribution: s.689A(3)(a)**
A dividend is within this subsection if— (a) the individual receives or becomes entitled to it in the temporary period of non-residence	A distribution is within this subsection if— (a) [identical]

This is straightforward.

11.14.2 *TNR condition (b): Close co*

TNR dividend: s.408A(3)(b)	**TNR distribution: s.689A(3)(b)**
A dividend is within this subsection if ... (b) it is a dividend of a company that would be a close company if the company were UK resident	A distribution is within this subsection if ... (b) it is a distribution of a company [i] that is a close company or [ii] that would be a close company if the company were UK resident

The reference in s.689A(b)[i] to a distribution of a *close* company is odd. A distribution from a close company will never be a TNR dividend (within s.689A(3)) because the shareholder will be liable to tax in respect of the distribution[43] so the condition in (d)(i) will never be satisfied.[44] Perhaps it is a mistake which was noticed and corrected in s.408A, but remained uncorrected in s.689A.

[43] See 30.3 (UK dividend regime).

[44] See 11.14.4 (Condition (d): Liability).

11.14.3 *Participator-causation condition*

TNR dividend: s.408A(3)(c)	**TNR distribution: s.689A(3)(c)**
A dividend is within this subsection if ... (c) the individual receives or becomes entitled to it by virtue of being at a relevant time— (i) a material participator in the company, or (ii) an associate of a material participator in the company	A distribution is within this subsection if .. (c) the individual receives or becomes entitled to the distribution by virtue of being at a relevant time— (i) a material participator in the company, or (ii) an associate of a material participator in the company

I refer to this requirement (which comes in many places in the TNR dividend code) as the **"participator-causation condition"**.

There are two requirements to satisfy this condition:

(1) The individual is a material participator/associate in the company at a relevant time.[45] That is relatively straightforward. If an individual purchases shares after departure, TNR condition (c) is not satisfied.

(2) The dividend is made to the individual *by virtue of* being a material participator/associate at the relevant time.

Requirement (2) is a causation test, and causation is not straightforward. The textbook TCCR says:[46]

> Take the most obvious case: a shareholder in a close company departs from the UK in Year 1 ("the year of departure") for a period of temporary non-residence.
> In Year 2 (a year of non-residence) a dividend is declared and paid on the shares he owned in the year of departure and which he continues to own.
> The issue is whether the income arises to him because he was a material participator in the company at "a relevant time" namely, at a time in the year of departure. In fact the income arises to him because he owns the shares when the dividend is declared in Year 2.

It is correct that the dividend arises to the shareholder because they own

[45] See 11.12.4 (Relevant time).

[46] *Taxation of Companies and Company Reconstructions* (looseleaf) para E2.3.8 (Temporary non-residents: distributions from close companies).

shares in year 2 when the dividend is declared. But the reason they own shares in that year is that they held the shares in year 1 (the year of departure) and have retained them. The causation test must be applied in the context of the purpose of the provisions. So in the context it is suggested that the causation part of TNR condition (c) is satisfied. (If that were wrong, would the provisions ever apply?)

Similarly, if T holds shares before departure, and by a reorganisation becomes entitled to new shares, then a distribution on the new shares in principle meets TNR condition (c).

What if T holds shares before departure and T sells those shares when non-resident and T repurchases shares in the same company? It is suggested that the causation condition is met if there is an arrangement designed to avoid the rules.

At first sight, one might have expected TNR condition (c) to provide:

> *The dividend/distribution arises in respect of shares held by the individual/associate at any time in the relevant period.*

But that would be too wide: it would catch cases where the individual had bought and sold and later bought the same shares in the period of temporary non-residence. The work involved in keeping track could be considerable. At the cost of some uncertainty, the causation wording allows some innocent arrangements to escape, and catches some arrangements designed to avoid the rules.

What if T holds shares before departure and T transfers the shares to his spouse?

11.14.4 *Condition (d): Liability*

TNR dividend: s.408A(3)(d)	**TNR distribution: s.689A(3)(d)**
A dividend is within this subsection if ...	A distribution is within this subsection if ...
(d) ignoring this section, the individual—	(d) ignoring this section the individual—
(i) is not liable for tax under this Chapter [Chapter 4 Part 4] in respect of the dividend, but	(i) is not liable for tax under this Chapter [Chapter 8 Part 5] in respect of the distribution, but
(ii) would have been so liable if the individual had received the dividend, or become entitled to it, in the period of return.	(ii) would have been so liable if the individual had received the distribution, or become entitled to it, in the period of return.

Is it ever the case that the condition in s.408A(3) is not met? While it is possible that the condition in s.698A(3)(d)(i) may not be met,[47] it is difficult to think of a case where the condition in s.698A(3)(d)(ii) is also not met.[48]

For dividends, s.408A(4)(d) ITTOIA provides:

> For the purposes of subsection (3) ...
>
> (d) paragraph (d)(i) includes a case where the individual could be relieved of liability on the making of a claim under section 6 of TIOPA 2010 (double taxation relief), even if no claim is in fact made.[49]

Why is this needed?

11.14.5 *Dividend to settlor-interested trust*

Suppose:

(1) Dividends ("trust dividends") arise to a non-resident settlor-interested discretionary trust.

(2) The settlor ("S") is temporarily non-resident.

(3) The dividend is from a non-resident close company, and the trustees hold more than 5% of the company and so have a material interest.

The trust dividends are not TNR dividends and so do not form part of the income of S in the year of return. TNR condition (a) is not met: S does not receive the income.[50]

If the income is distributed to S, it is still not taxed in the year of return as the income of S consists of Annual Payments, not within the TNR dividend regime.

[47] See 11.14.2 (TNR condition (b): Close co).

[48] ToA raises a similar puzzle; see 49.20 (s.721 income chargeable to IT),

[49] For distributions, s.689A(4) ITTOIA is identical.

[50] For completeness: TNR condition (c) may not be met because:

(1) S may not be a participator in the company.

(2) If S was a participator (because S held some interest in the company directly), S is likely to be material participator but this is not necessarily so.

(3) Even if S was a material participator a distribution to the trustees is not treated as made to S because S was a material participator.

But it is not necessary to rely on that.

11.15 Non-resident IT relief

11.15.1 *Relief clawback on return*

Section 812A(1) ITA provides:

> This section applies if—
> (a) an individual is temporarily non-resident,
> (b) the individual's liability to income tax for a tax year is limited under section 811 [Non-resident IT relief],[51]
> (c) that tax year ("the non-resident year") falls within the temporary period of non-residence, and
> (d) the individual's income for that tax year includes relevant investment income.

Assuming these conditions are met, we move on to the rule in s.812A(2):

> The total income (see Step 1 of the calculation in section 23) on which the individual is charged to income tax for the year of return is to be increased by an amount equal to the amount of that relevant investment income.

11.15.2 *Relevant investment income*

Section 812A(4) ITA provides the definition:

> Income is "relevant investment income" if—
> (a) it is chargeable under Chapter 3 or 5 of Part 4 of ITTOIA 2005 (dividends etc from UK resident companies and stock dividends from UK resident companies),
> (b) the distributing company is a close company, and
> (c) the income arises or is treated as arising to the individual because the individual was at a relevant time—
> (i) a material participator in that company, or
> (ii) an associate of a material participator in the company.

Para (c) is the participator-causation condition.[52]

11.15.3 *Credit for tax*

Section 812A(3) ITA provides:

> But the notional UK tax on that relevant investment income is to be

[51] See 45.1 (Non-residents IT relief: Introduction).

[52] See 11.14.3 (Participator-causation condition).

> allowed as a credit against the individual's liability to income tax for the year of return under Step 6 of the calculation in section 23.

Section 812A(7) ITA provides:

> The "notional UK tax" on relevant investment income is—
> (a) the total of any sums in respect of that income that were included within amount A in determining the limit under section 811, less
> (b) any credit for foreign tax paid in respect of that income that was allowed under Chapter 2 of Part 2 of TIOPA 2010 against the individual's liability to income tax for the non-resident year.

11.15.4 *DTA override: relief clawback*

Section 812A(9) ITA provides:

> Nothing in any double taxation arrangements is to be read as preventing the individual from being chargeable to income tax by virtue of this section (or as preventing a charge to that tax from arising as a result).

11.16 DTA override: UK dividend

11.16.1 *"Relevant distribution"*

Section 401C(6) ITTOIA provides:

> For the purposes of this section, a dividend or other distribution is a "relevant distribution" if—
> (a) it is a dividend or other distribution of a close company, and
> (b) it is made or treated as made to the individual because[53] the individual was at a relevant time—
> (i) a material participator in the company, or
> (ii) an associate of a material participator in the company.

Para (b) is the participator-causation condition.[54]

11.16.2 *UK dividends taxed on return*

In the absence of a specific rule, a relevant distribution may qualify for DT

[53] The drafter has used "because" where the s.408A/689A rules used "by virtue of ". I guess that the drafter started with more traditional legal language, and someone later remembered the plain legal English aspect, but did not reword the provisions consistently.

[54] See 11.14.3 (Participator-causation condition).

relief in the hands of a treaty user. Treaty relief is in art.10 OECD Model.[55] It is easier to follow if rewritten to specify which Contracting State is which. In outline, in the present context:

> 1. Dividends paid by a company which is a resident of a Contracting State [the UK] to a resident of the other [foreign] Contracting State may be taxed in that other [foreign] State.
> 2. However, dividends paid by a company which is a resident of a Contracting State [the UK] may also be taxed in that State [the UK] according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other [foreign] Contracting State, the tax so charged shall not exceed:
> a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company ... which holds directly at least 25 per cent of the capital of the company paying the dividends ...;
> b) 15 per cent of the gross amount of the dividends in all other cases.

Equipped with the definition of relevant distribution, and with this DT relief in mind, we can at last turn to the TNR rule itself. Section 401C(1) ITTOIA provides:

> This section applies if—
> (a) an individual is temporarily non-resident,
> (b) a relevant distribution is made or treated as made to the individual in the temporary period of non-residence,
> (c) the tax year in which it is made or treated as made ("the distribution year") is a tax year for which the individual is UK resident, and
> (d) the amount of income tax charged on the distribution under this Chapter [Chapter 4 Part 4] is less than it would have been if the existence of double taxation relief arrangements were disregarded.

If these conditions are satisfied, one moves on to the rules.

The rules distinguish between the year of return and earlier temporary non-resident years. For the earlier non-resident years, s.401C ITTOIA provides:

> (2) Subsections (3) and (4) have effect in cases where the distribution year is not the year of return.

[55] See 30.15 (DT relief: dividend income).

> (3) The total income (see Step 1 of the calculation in section 23 of ITA 2007) on which the individual is charged to income tax for the year of return is to be increased by an amount equal to the amount on which tax would be charged under this Chapter [Chapter 4 Part 4] in respect of the distribution disregarding any double taxation relief arrangements.
> (4) But the notional UK tax[56] on that distribution is to be allowed as a credit against the individual's liability to income tax for the year of return under Step 6 of the calculation in section 23.

For the year of return, s.401C(5) ITTOIA provides:

> If the distribution year is the year of return, the tax charged under this Chapter [Chapter 4 Part 4] in respect of the relevant distribution is to be charged and assessed without regard to the existence of double taxation relief arrangements.

11.17 Post-departure trade profits

The relief for post-departure trade profits is repeated four times, as follows:

Section	**Topic**	**Post-departure trade profit relief**
Foreign dividends		
408A ITTOIA	Foreign dividend	s.408A(6)
689A ITTOIA	Foreign distribution	*None*
UK dividends		
812A ITA	Non-resident IT relief	s.812A(5)
401C ITTOIA	DT relief	s.401C(7)
413A ITTOIA	Stock dividend	s.413A(7) *not discussed here*

There is no relief for a foreign distribution, under s.689A; I wonder if that is an oversight. The point will not often arise.

It is helpful to consider the statutory wording side by side:

s.408A(6) ITTOIA	**812A(5) ITA**	**s.401C(7) ITTOIA**
Foreign dividend	*Non-resident IT relief*	*DT relief*
This section does not apply to a dividend within subsection (3) to	But income within subsection (4) in the form of a cash or stock	But a dividend or other distribution within subsection (6) in the form

[56] Section 401C(10) ITTOIA provides: "The "notional UK tax" on the relevant distribution is so much of the income tax paid by the individual for the distribution year as is attributable on a just and reasonable basis to the relevant distribution." The tax is not "notional", it is payable.

the extent that it is paid in respect of post-departure trade profits.	dividend is not "relevant investment income" to the extent that the dividend is paid, or the share capital is issued, in respect of post-departure trade profits	of a cash dividend is not a "relevant distribution" to the extent that the dividend is paid in respect of post-departure trade profits.

The s.812A/401C reliefs apply only to a cash dividend. It is difficult to see why a dividend in specie should not qualify, but perhaps it will not often matter.

Suppose:

(1) A trading company is held by a holding company
(2) The trading company makes a distribution out of its Post-departure trade profits to the holding company; and
(3) The holding company makes a distribution of that sum to its shareholders.

It is considered that the distribution by the holding company is "in respect of" post-departure trade profits.[57]

The definitions of "post-departure trade profits" are slightly differently worded, but come to the same thing:

s.408A(7) ITTOIA *Foreign dividend*	**812A(6) ITA** *Non-resident IT relief*	**s.401C(8) ITTOIA** *DT relief*
"Post-departure trade profits" are—	"Post-departure trade profits" are—	"Post-departure trade profits" are—
(a) trade profits of the company arising in an accounting period that begins after the start of the temporary period of non-residence, and	(a) trade profits of the distributing company arising in an accounting period that begins after the start of the temporary period of non-residence, and	(a) trade profits of the close company arising in an accounting period that begins after the start of the temporary period of non-residence, and
(b) so much of any trade profits of the company arising in an accounting period that straddles the start of that temporary	(b) so much of any trade profits of the distributing company arising in an accounting period that straddles the start of that	(b) so much of any trade profits of the close company arising in an accounting period that straddles the start of that

[57] See App 2.4.1 (In respect of).

period as is attributable (on a just and reasonable basis) to a time after the start of that temporary period.	temporary period as is attributable (on a just and reasonable basis) to a time after the start of that temporary period.	temporary period as is attributable (on a just and reasonable basis) to a time after the start of that temporary period.

The definitions of "trade profits" are slightly differently worded, but the differences do not seem material:

s.408A ITTOIA	**812A ITA**	**s.401C ITTOIA**
Foreign dividend	*Non-resident IT relief*	*DT relief*
"trade profits of the company" means the profits of any trade carried on by the company, as they would be calculated in accordance with Part 3 of CTA 2009 (trading income) if the company were UK resident.	"trade profits of the distributing company" means the profits of any trade carried on by the distributing company, as calculated in accordance with Part 3 of CTA 2009 (trading income);	In this section... "trade profits of the close company" means the profits of any trade carried on by the close company, as calculated in accordance with Part 3 of CTA 2009 (trading income).

11.17.1 *Apportionment*

Section 408A(8) ITTOIA provides:

> The extent to which a dividend is paid in respect of post-departure trade profits is to be determined on a just and reasonable basis.

The same provision is found in s.401C(9) ITTOIA.

11.18 TNR: Life policies

11.18.1 *TNR chargeable-event gains*

Section 465B ITTOIA provides:

> (1) This section applies if an individual is temporarily non-resident.
> (2) The individual is liable for tax under this Chapter [Chapter 9 Part 4] for the year of return in respect of any gain that meets the conditions in subsection (3).
> (3) The conditions are—
> (a) the gain arose in the temporary period of non-residence,
> (b) it arose from a policy issued in respect of an insurance made, or

from a contract made, before the start of that period,[58]

(c) the chargeable event giving rise to it was neither
  [i] a death nor
  [ii] a chargeable event treated as occurring under section 525(2) [personal portfolio bond annual charge],

(d) no-one is liable under section 466 or 467 in respect of the gain, [personal representatives; UK trustees]

(e) no-one is liable by virtue of section 468 for either the year of return or an earlier tax year as a result of the gain, [transfer of asset rules] and

(f) the individual would have been liable under section 465 in respect of the gain, applying the assumptions in subsection (4).

(4) The assumptions are—

(a) the individual was UK resident for the tax year in which the gain arose, and

(b) that tax year was not a split year as respects the individual.

11.18.2 *CE gains taxed on return*

Section 465B ITTOIA provides:

(5) If the individual is liable by virtue of subsection (2) in respect of a gain—

(a) the amount of the gain in respect of which he or she is liable is the amount on which tax would have been charged under this Chapter [Chapter 9 Part 4] applying the assumptions in subsection (4), but

(b) in determining that amount, section 528 [non-resident period relief] must be applied ignoring those assumptions.

(6) That amount is treated as income of the individual for the year of return.

11.18.3 *Exception*

Section 465B(8) ITTOIA provides:

This section does not apply to a gain if—

(a) in relation to the policy or contract from which the gain arises,

[58] Section 465B(7) provides: "If the gain arises from a policy or contract treated under section 473A as a single policy or contract, the date, for the purposes of subsection (3)(b), on which the insurance or contract is made is the date on which the first insurance is made in respect of which the connected policies were issued or, as the case may be, the date on which the first of the connected contracts is made."

> a terminal event[59] occurs in the temporary period of non-residence or in the period of return,
> (b) the chargeable event giving rise to the gain occurred before that terminal event,
> (c) the chargeable event giving rise to the gain is one that is treated as occurring under section 509(1) as a result of the application of section 498(1)(a),
> (d) section 498(1)(a) applies other than by virtue of section 500, and
> (e) a person (whether or not the individual) is liable for tax under this Chapter [Chapter 9 Part 4] (including by virtue of this section) in respect of any gain resulting from the terminal event.

11.18.4 *DTA override: CE gains*

Section 465B(9) ITTOIA provides:

> Nothing in any double taxation relief arrangements is to be read as preventing the individual from being liable for tax under this Chapter [Chapter 9 Part 4] in respect of any gain in respect of which the individual is liable for tax by virtue of subsection (2) (or as preventing a charge to tax on that gain from arising under this Chapter).

11.19 TNR: Offshore funds

Regulation 23 OFTR provides:

> (1) This regulation applies where an individual (“the taxpayer”) is temporarily non-resident.
> (2) The taxpayer is chargeable to income tax as if offshore income gains within paragraph (3) were offshore income gains arising to the taxpayer in the period of return.

I refer to OIGs within (3) as **“TNR OIGs”**.

11.19.1 *TNR OIG*

Regulation 23 OFTR provides:

> (3) The offshore income gains within this paragraph are those that—
> (a) arise to the taxpayer in the temporary period of non-residence, and
> (b) would be treated under section 13 of TCGA 1992 (attribution of gains to members of non-resident companies) as it applies to

[59] Section 465B(11) ITTOIA provides a referential definition: In this section— “terminal event” means an event mentioned in section 499(3);...

> offshore income gains by virtue of regulation 24 as having arisen to the taxpayer in that period if the residence assumption were made.
>
> (4) The residence assumption is—
>
> (a) that the taxpayer had been resident in the UK for the tax year in which the offshore income gain arose to the company, or
>
> (b) if that tax year was a split year as respects the taxpayer, that offshore income gain had arisen to the company in the UK part of it.

This is the same as s.1M TCGA, except (consistently with the OIG regime) there is no relief for losses and no provision dealing with s.86.

11.19.2 *OIG taxed on arising basis*

Regulation 23(5) OFTR provides:

> But a gain is not within paragraph (3) if, ignoring this regulation, the taxpayer is chargeable to income tax in respect of it (and could not cease to be so chargeable by making a claim under section 6 of the Taxation (International and Other Provisions) Act 2010).

This sensibly disapplies the TNR rules where the temporarily non-resident individual is already subject to IT on the OIG. That may be:

(1) If the individual is tax-resident and treaty-resident in a state whose treaty does not have an article giving relief from OIGs.

(2) If the individual is tax non-resident but carrying on a trade in the UK through a branch or agency.[60]

11.19.3 *TNR OIG remitted*

Regulation 23(7) OFTR provides:

> If section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the taxpayer for the year of return, any offshore income gains to which regulation 19(2) applies falling within paragraph (3) of this regulation by virtue of sub-paragraph (a) of that paragraph that were remitted to the UK at any time in the temporary period of non-residence are to be treated as remitted to the UK in the period of return.

See 11.2.3 (TNR remittances).
What about gains within reg 23(3)(b)?

[60] This is only theoretical: see 67.9 (OIG non-residence defence).

11.19.4 *Post-departure acquisitions*

Regulation 23A(1) OFTR deals with post-departure acquisitions:

> (1) Regulation 23(2) does not apply to an offshore income gain accruing on the disposal by the taxpayer of an asset if –
>
> (a) the asset was acquired by the taxpayer in the temporary period of non-residence,
>
> (b) it was so acquired otherwise than by means of a relevant disposal[61] that by virtue of section 58, 73 or 258(4) TCGA 1992 is treated as having been a disposal on which neither a gain nor a loss accrued, and
>
> (c) the asset is not an interest created by or arising under a settlement.

See 11.7 (Post-departure acquisitions).

11.19.5 *DTA override: OIG*

Regulation 23A(2) OFTR provides the DTA override:

> Nothing in any double taxation relief arrangements is to be read as preventing the taxpayer from being chargeable to income tax in respect of any offshore income gains treated under regulation 23 as accruing to the taxpayer in the period of return (or as preventing a charge to that tax from arising as a result).

See 11.8 (DTA override: Gains).

11.19.6 *Time limit for assessment*

Regulation 23A(3) OFTR provides the (unnecessary) time extension for assessment:

> Nothing in any enactment imposing any limit on the time within which an assessment to income tax may be made prevents any assessment for the year of departure from being made in the taxpayer's case at any time before the end of the second anniversary of the 31 January next following the year of return.

See 11.19.6 (Time limit for assessment).

[61] Defined by reference in reg 23A(4) "In this regulation (a) "relevant disposal" has the meaning given in section 10AA(2) of TCGA 1992".

11.20 Pre-departure income remitted

Section 832A ITTOIA provides:

> (1) This section applies if an individual is temporarily non-resident.
> (2) Treat any of the individual's relevant foreign income within subsection (3) that is remitted to the UK in the temporary period of non-residence as remitted to the UK in the period of return.

See 11.2.3 (TNR remittances).

I refer to income within (3) as **"pre-departure RFI"**.

11.20.1 *Pre-departure RFI*

Section 832A(3) ITTOIA provides:

> Relevant foreign income is within this subsection if—
> (a) it is relevant foreign income for the UK part of the year of departure or an earlier tax year, and
> (b) section 832 applies to it.

So we need to refer back to s.832(1) ITTOIA:

> This section applies to an individual's relevant foreign income for a tax year ("the relevant foreign income") if section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for that year.

This is intended to apply to a temporary non-resident who is tax non-resident and remits pre-departure RFI[62] during the temporary period of non-residence.

It is not needed where a temporary non-resident is UK law UK resident treaty non-resident and remits pre-departure RFI during the temporary period of non-residence. Treaties do not provide relief in this situation, so tax planning of this kind was not possible. Nevertheless s.832A does apply in this case.

The drafter may perhaps have thought that this planning was possible, or may have introduced the rule unintentionally by copying across in s.832A the s.1M TCGA rules which were designed for a different situation.

[62] That is, RFI which:
(1) is taxed on a remittance basis, ie accruing to a remittance basis taxpayer while the individual was UK resident; and
(2) which was not remitted prior to departure (so was not subject to tax before departure).

Income arising after the year of departure is not caught by this section. What about pre-2005 income to which s.832 ITTOIA does not apply?

11.20.2 *Apportionment*

Section 832A(4) ITTOIA provides:

> Any apportionment required for the purposes of subsection (3)(a) is to be done on a just and reasonable basis.

11.20.3 *DTA override: RFI*

Section 832A(5) ITTOIA provides:

> Nothing in any double taxation relief arrangements is to be read as preventing the individual from being chargeable to income tax in respect of any relevant foreign income treated by virtue of this section as remitted to the UK in the period of return (or as preventing a charge to that tax from arising as a result).

This is based on a misconception that DT relief may apply in this case.

11.20.4 *HMRC examples*

RDRM gives a straightforward example:

> **RDRM12690: Residence: The SRT: Temporary non-residence: Remitted foreign income** [Mar 2020]
> **Example 46 (Marie)**
> M returned to the UK during the tax year 2018–19 after a period of residence abroad.
> She originally left the UK to become resident abroad on 2 September 2013 (end of period A) and so her year of departure was 2013–14. She had been resident in the UK for the seven years before her departure and claimed the remittance basis in those years.
> While M was resident abroad she remitted to the UK the following relevant foreign income (RFI):

RFI	**From**	**Remitted**
£15,000	2009–10	2014–15
£18,000	2010–11	2014–15
£18,000	2011–12	2015–16
£20,000	2012–13	2016–17
£71,000		

> As she was not resident in the UK, this income was not taxed when remitted here.

> On her return to the UK on 1 June 2018 (the beginning of the UK part of split year 2018-19), M is within the special [TNR] rules because her period of temporary non-residence was less than five years. She will be liable to UK tax on these earlier remittances which took place when she was temporarily non-resident. They will be chargeable to UK tax in 2018-19, the tax year of her return.

M should have been advised to remain outside the UK a little longer, so as to fall outside the TNR rules.

11.21 Pre-departure gains remitted

What is the position if a temporary non-resident remits pre-departure gains to the UK (ie gains which accrued when solely UK resident but which were (un)taxed on the remittance basis)?

11.21.1 *Position pre-2019 CGT rewrite*

Before 2019/20, s.12 TCGA provided:

> *(1) This section applies to foreign chargeable gains accruing to an individual in a tax year ("the foreign chargeable gains") if—*
> - *(a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for that year, and*
> - *(b) the individual is not domiciled in the UK in that year.*
>
> *(2) Chargeable gains are treated as accruing to the individual in any tax year in which any of the foreign chargeable gains are remitted to the UK.*

The gains are deemed to accrue when remitted. This deeming then brought into effect the former s.10A TCGA:

> *(1) This section applies if an individual ("the taxpayer") is temporarily non-resident.*
>
> *(2) The taxpayer is chargeable to capital gains tax as if gains and losses within subsection (3) were chargeable gains ... accruing to the taxpayer in the period of return.*
>
> *(3) The gains and losses within this subsection are—*
> - *(a) chargeable gains ... that accrued to the taxpayer in the temporary period of non-residence,*

Pre-departure gains remitted when non-resident did not accrue to the taxpayer in the temporary period of non-residence, but they were deemed to have done so, so they were further deemed to accrue in the year of return.

11.21.2 *Position from 2019/20*

Sch 1 TCGA has replaced the former s.12. Para 1 sch 1 TCGA provides:

> (1) This paragraph applies in the case of an individual to whom the remittance basis[63] applies for a tax year if—
> (a) in that year the individual disposes of foreign assets,[64]
> (b) chargeable gains accrue to the individual on the disposal of those assets, and
> (c) the gains are not taken outside the charge to capital gains tax as a result of section 1G (cases where tax year is a split year).
> (2) The gains are treated as accruing to the individual only so far as, and at the time when, they are remitted to the UK.

Section 1M(1) TCGA provides:

> If, in the case of the disposal of an asset by an individual who is temporarily non-resident—
> (a) a gain or loss accrues to the individual in the temporary period of non-residence, and
> (b) the asset is not excluded from this subsection by section 1N (certain assets acquired in that period),
> the gain or loss is treated instead as accruing to the individual in the period of return.

The deeming in sch 1 does not bring into effect s.1M(1) TCGA, as there is no disposal of an asset by an individual who is temporarily non-resident. So strictly there is no charge on remittance by a temporarily non-resident of pre-departure gains. But a purposive construction might possibly impose the charge. See 11.2.3 (TNR remittances).

11.22 Planning

It may be advantageous to arrange that temporary non-residents receive types of income not caught by the TNR rules while abroad. For instance:
(1) income payments from discretionary trusts
(2) payments of up front interest

[63] Para 5(2) sch 1 TCGA provides: “For the purposes of this Schedule any reference to "the remittance basis" applying to an individual for a tax year is to section 809B, 809D or 809E of ITA 2007 applying to the individual for the year.”

[64] Para 5(1) sch 1 TCGA provides: “For the purposes of this Schedule "foreign asset" means an asset situated outside the UK.”

Remittance basis taxpayers must take care not to mix foreign income/gains of the non-resident period with other sums which can be remitted tax free.

Careful timing is needed for gifts to charity: normally avoid gifts during the period of temporary non-residence, and defer them to the year of return. Likewise for other IT reliefs.

The conditions allow (indeed invite) tax planning by arranging that the period of non-residence is more than 5 years.

11.23 TNR rules: Critique

The TNR rules are aimed at taxpayers who deliberately accrue or remit income or gains in years of temporary non-residence.[65] But the rules apply regardless of whether the individual intended to reduce UK tax.

The TNR rules work unfairly in that they assign income and gains of up to *five* tax years into the year of return, so:

(1) Lower rate taxpayers may fall into the higher or additional rates of tax
(2) IT personal allowances of non-resident years are lost
(3) CGT annual exemptions of non-resident years are lost

Before 2013, this was unfair but perhaps not grievously so, as the amounts involved were not so significant, and bunching is always a possible downside of the remittance basis. Following the extension of the TNR rules in 2013, the unfairness has increased. A motive test would be difficult to operate and an averaging rule would be complicated. However the unfairness is not difficult to mitigate. The TNR rules should not apply to TNR income/gains if the rate of foreign tax is, say, at least 50% of the UK rate. If that exclusion does not apply, there should be a *de minimis* exclusion, say, twice the IT personal allowance/ CGT annual exemption for each year of non-residence. That would target the rules at those at whom they are aimed.

[65] See 11.2 (Purpose of the temporary non-residence rules).

CHAPTER TWELVE

EXIT TAXES

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Cross references

The following topics are considered elsewhere:
10.1 (Residence throughout tax year)
128.6 (Disclosure on trust emigration)
13.12 (Departure planning)

12.1 Exit taxes: Introduction

This chapter considers exit taxes, that is, taxes imposed on emigration from the UK. They are as follows:

(1) Emigration of individual:
(a) Clawback of hold-over relief

(b) Clawback of EIS relief

(2) Emigration of trust: deemed disposal charge[1]

(3) Emigration of persons carrying on a trade

Restrictions on CGT reorganisation relief are similar to an exit charge and need consideration if an individual who carries out a reorganisation is planning to leave the UK.[2]

I do not consider:

- Exit taxes on companies
- The anti tax avoidance directive (EU) 2016/1164 (which applies to taxpayers subject to corporate tax)[3]

In this chapter:

"Emigration" refers to a person becoming non UK tax-resident (eg an individual ceasing to be resident as defined in the SRT)

"Treaty-emigration" refers to a person becoming treaty-resident in a foreign state (ie a resident of a foreign State, as defined in a DTA)

12.2 Hold-over clawback: Emigration of individual

Section 168(1) TCGA provides a clawback of hold-over relief[4] where:

(1) A gift (or disposal) has been made to an individual ("the transferee").

(2) Hold-over relief is claimed.

(3) The transferee ceases to be UK resident.

Section 168(1) TCGA provides:

> If—
> (a) relief is given
> [i] under section 165 in respect of a disposal to an individual or
> [ii] under section 260 in respect of a disposal to an individual
> ("the relevant disposal"); and
> (aa) the transferee is resident in the UK at the time of that disposal; and
> (b) at a time when he has not disposed of the asset in question, the transferee ceases to be resident in the UK,
> then, subject to the following provisions of this section,

[1] Trust migration may also lose the benefit of transitional reliefs for s.86 TCGA; see 60.6 (Pre-1998 protected trusts); 60.8 (Pre-1991 protected trusts). But that is not an exit tax.

[2] See 58.6 (CGT reorganisation TAAR*)*.

[3] See 91.8.1 (Anti-tax avoidance directive).

[4] See 57.31 (Hold-over relief).

> [A] a chargeable gain shall be deemed to have accrued to the transferee immediately before that time, and
>
> [B] its amount shall be equal to the held-over gain (within the meaning of section 165 or 260) on the relevant disposal.

There is no charge if the individual becomes treaty non-resident but remains UK-law UK resident.

The gain accruing to the individual may qualify for DT relief.

An individual ceases to be resident in the UK at the end of a tax year, even if the year is a split year.[5]

12.2.1 *Pre-emigration disposal*

The clawback charge does not apply if the individual disposes of the asset before emigration. Section 168(2) TCGA provides an artificial definition of "disposal":

> For the purposes of subsection (1) above
>
> [a] the transferee shall be taken to have disposed of an asset before the time there referred to only if he has made a disposal or disposals in connection with which the whole of the held-over gain on the relevant disposal was represented by reductions made in accordance with section 165(4)(b) or 260(3)(b)
>
> [b] and where he has made a disposal in connection with which part of that gain was so represented, the amount of the chargeable gain deemed by virtue of this section to accrue to him shall be correspondingly reduced.

Where a transfer is made to a transferee who qualifies for 2017 CGT rebasing, and hold-over relief is claimed, the transferee could not make a disposal, under this definition, so remains exposed to a clawback for the full 6 years.

Section 168(3) TCGA provides that inter-spouse disposals are disregarded:

> [1] The disposals by the transferee that are to be taken into account under subsection (2) above shall not include any disposal to which section 58 applies[6];
>
> [2] but where any such disposal is made by the transferee, disposals by his spouse or civil partner shall be taken into account under

[5] See 10.1 (Residence throughout tax year).

[6] See 93.11 (CGT spouse exemption).

> subsection (2) above as if they had been made by him.

This is obviously right.

12.2.2 *Time limit*

Section 168(4) TCGA contains a time limit:

> Subsection (1) above shall not apply by reason of a person ceasing to be resident more than 6 years after the end of the year of assessment in which the relevant disposal was made.

12.2.3 *Short term posting abroad*

Section 168(5) TCGA contains a relief for short term postings abroad:

> Subsection (1) above shall not apply in relation to a disposal made to an individual if—
> (a) the reason for his ceasing to be resident in the UK is that he works in an employment or office all the duties of which are performed outside the UK, and
> (b) he again becomes resident in the UK within the period of 3 years from the time when he ceases to be so, without having meanwhile disposed of the asset in question;
> and accordingly no assessment shall be made by virtue of subsection (1) above before the end of that period in any case where the condition in para (a) above is, and the condition in para (b) above may be, satisfied.

Section 168(6) TCGA deals with part-disposals and inter-spouse disposals by the short term non-resident. The wording is based on s.168(2)(3) but its effect is different:

> For the purposes of subsection (5) above a person shall be taken to have disposed of an asset if he has made a disposal in connection with which the whole or part of the held-over gain on the relevant disposal would, had he been resident in the UK, have been represented by a reduction made in accordance with section 165(4)(b) or 260(3)(b) ...

This is a strict rule, since even a part-disposal loses the benefit of the relief for the entire asset. The subsection continues:

> and subsection (3) above shall have effect for the purposes of this subsection as it has effect for the purposes of subsection (2) above.

Thus there is no clawback charge on an asset if T goes non-resident, and gives the asset to the spouse, provided that T becomes UK resident again within 3 years and the spouse does not dispose of the asset during that period. It is irrelevant whether the spouse becomes UK resident.

12.2.4 *Liability of donor/trustee*

The exit charge tax may be collected from:
(1) the donor who gave the asset to the individual; or
(2) the trustee who transferred the asset to the individual.

This may not be important for an individual donor because they may be prepared to take a view about the future actions of their donee. It is important for trustees who transfer assets to beneficiaries and claim hold-over relief to avoid a charge under s.71 TCGA, or to avoid s.1(3) amounts (trust gains).

Section 168(7) TCGA provides:

> Where an amount of tax assessed on a transferee by virtue of subsection (1) above is not paid within the period of 12 months beginning with the date when the tax becomes payable then, subject to subsection (8) below, the transferor may be assessed and charged (in the name of the transferee) to all or any part of that tax.

Section 168(8) TCGA sets out a time limit:

> No assessment shall be made under subsection (7) above more than 6 years after the end of the year of assessment in which the relevant disposal was made.

Thus a transferor who makes a claim for hold-over relief is at risk of a clawback if the donee emigrates within (approximately) 4 years of the transfer. Suppose:
(1) In 2011/12 D makes a gift to E.
(2) E emigrates in 2015/16.

The exit charge is payable on 31 January 2017.
E cannot be assessed until 12 months later, 31 January 2018. That is just within "6 years after the end of the year of assessment in which the relevant disposal was made". But if E had made the gift in 2010/11 it would have been too late for HMRC to collect the tax from E.
Thus:

Disposal	**No charge on migration from**	**Transferor not liable from**
2016/17	6 April 2023	6 April 2021
2017/18	6 April 2024	6 April 2022

2018/19	6 April 2025	6 April 2023
2019/20	6 April 2026	6 April 2024
2020/21	6 April 2027	6 April 2025
2021/22	6 April 2028	6 April 2026

Section 168(9) TCGA provides an indemnity (for what it may be worth):

> Where the transferor pays an amount of tax in pursuance of subsection (7) above, he shall be entitled to recover a corresponding sum from the transferee.

Trustees may protect themselves against the risk of liability in the following ways:

(1) Express indemnity. This would be easier to enforce in a foreign jurisdiction than the statutory indemnity but there is still a risk that the covenentor may be unable to pay. If more than one person can be found so as to give the trustees a joint indemnity, the risk is reduced.
(2) Retain trust assets as security for the four year period.
(3) Hold-over relief liability insurance.

12.2.5 *Prevention of double charge*

Section 168(10) TCGA provides:

> Gains on disposals made after a chargeable gain has under this section been deemed to accrue by reference to a held-over gain shall be computed without any reduction under section 165(4)(b) or 260(3)(b) in respect of that held-over gain.

This prevents double UK taxation (if the individual later makes a disposal within the charge to CGT, eg if they return to the UK). It does not prevent double taxation if the individual pays foreign tax on the same gain.

12.3 Clawback of EIS relief

There is a similar clawback of EIS relief if (in short) an individual becomes non-resident within three years of acquiring EIS shares: para 3 sch 5B TCGA.

12.4 Charge on emigration of trust

12.4.1 *Trust emigration: Navigation*

This section discusses the exit charge on appointment of non-resident trustees. For other issues see:

Topic	See para
Reporting trust emigration	128.6
Share matching/identification rules	56.12.4
Emigration/trust transfer compared	56.9.2

12.4.2 *The exit charge*

Section 80 TCGA provides an exit charge for trusts:

> (1) This section applies if the trustees of a settlement become at any time ("the relevant time") not resident in the UK.
> (2) The trustees shall be deemed for all purposes of this Act—
> (a) to have disposed of the defined assets immediately before the relevant time, and
> (b) immediately to have reacquired them,
> at their market value at that time.

Unlike the clawback of hold-over relief discussed above, this applies to all gains on the deemed disposal, not just held-over gains.

The deemed disposal takes place at the time that the trustees become non-resident, even though they continue to be chargeable on gains accruing after becoming non resident until the end of the tax year.[7]

12.4.3 *Defined assets*

"Defined assets" is a label which brings in two rules which limit the scope of the charge. Section 80(3) TCGA provides:

> Subject to subsections (4) and (5) below, the defined assets are all assets constituting settled property of the settlement immediately before the relevant time.

The exceptions are:

TCGA	Topic
s.80(4)	Trading assets
s.80(5)	Assets protected by DTA

12.4.4 *Assets of UK trade*

Section 80(4) TCGA brings in an exception for UK trading assets:

> If immediately after the relevant time—

[7] See 10.17 (Split year of trustees and PRs): 56.6 (CGT/CT: Territorial scope).

> (a) the trustees carry on a trade in the UK through a branch or agency, and
> (b) any assets are situated in the UK and either used in or for the purposes of the trade[8] or used or held for the purposes of the branch or agency,
>
> the assets falling within para (b) above shall not be defined assets.

An exit charge not appropriate as UK trading assets remain within the charge to CGT even after the emigration.

12.4.5 *DTA-exempt assets*

Section 80(5) TCGA brings in an exception for assets protected by DTAs:

> Assets shall not be defined assets if—
> (a) they are of a description specified in any double taxation relief arrangements, and
> (b) were the trustees to dispose of them immediately before the relevant time, the trustees would fall to be regarded for the purposes of the arrangements as not liable in the UK to tax on gains accruing to them on the disposal.

An exit charge not appropriate as DTA-exempt assets were not within the charge to CGT even before the emigration.

12.4.6 *Restriction of roll-over relief*

Section 80 TCGA provides:

> (6) Section 152 shall not apply where the trustees—
> (a) have disposed of the old assets, or their interest in them, before the relevant time, and
> (b) acquire the new assets, or their interest in them, after that time,
>
> unless the new assets are excepted from this subsection by subsection (7) below.
>
> (7) If at the time when the new assets are acquired—
> (a) the trustees carry on a trade in the UK through a branch or agency, and
> (b) any new assets are situated in the UK and either used in or for the purposes of the trade[9] or used or held for the purposes of the branch or agency,

[8] See 56.7.3 (Used in/for purposes of trade).

[9] See 56.7.3 (Used in/for purposes of trade).

> the assets falling within para (b) above shall be excepted from subsection (6) above.
>
> (8) In this section "the old assets" and "the new assets" have the same meanings as in section 152.

Section 80(6) prevents roll-over relief under s.152 TCGA, from applying, so as to avoid the exit charge, where trustees:

(1) dispose of assets before becoming non-resident, and

(2) acquire new assets, outside the CGT charge, after becoming non-resident.

12.4.7 *Exit charge: UK land*

Section 80A TCGA provides:

> (1) This section applies if—
>
> (a) an interest in UK land[10] is deemed to have been disposed of under section 80(2) by trustees of a settlement at any time, and
>
> (b) the trustees make an election under this subsection.
>
> (2) The gain or loss that, but for this subsection, would have accrued to the trustees at that time is not to accrue at that time.
>
> (3) But, on a subsequent disposal by the trustees of the whole or part of the interest in UK land, the whole or a corresponding part of the gain or loss is treated as accruing on the subsequent disposal.
>
> (4) This gain or loss is in addition to any gain or loss that actually accrues on the subsequent disposal.

There is no exemption for land-rich assets, within the indirect disposal charge.

12.4.8 *Emigration on death of trustee*

Section 81(1) TCGA provides:

> Subsection (2) below applies where—
>
> (a) section 80 applies as a result of the death of a trustee of the settlement, and
>
> (b) within the period of 6 months beginning with the death, the trustees of the settlement become resident in the UK.

I refer to the period between the trustee death and the re-appointment of

[10] Section 80A(5) TCGA incorporates the s.1C TCGA definition: see App 2.21 (Interest in land/chargeable interest).

a UK resident trustee as the **"non-resident period"**.

The typical case is where a trust has a UK trustee and a foreign trustee, and the UK trustee dies, leaving it with a sole foreign trustee. There could be other cases.

Assuming this condition is met, we move on to the relief in s.81(2) TCGA:

> That section [s.80 trust emigration charge] shall apply as if the defined assets were restricted to such assets (if any) as—
> (a) would be defined assets apart from this section, and
> (b) fall within subsection (3) or (4) below.

In short, there is no exit charge apart from the exceptional cases of (3) and (4).

Section 81(3) TCGA provides:

> Assets fall within this subsection if they were disposed of by the trustees in the period which—
> (a) begins with the death, and
> (b) ends when the trustees become resident in the UK.

The trustees will be UK resident for the year of the death of the trustee[11] and in principle subject to CGT on the trust gains of the year.[12] If so s.81(3) will not usually make a great deal of difference, though it might alter the year in which the gain arises. But it is possible that during the non-resident period, the trustees dispose of assets and qualify for CGT DT relief. In that case s.81(3) effectively brings the gain (as at the time of migration) back into charge to CGT.

Section 81(4) TCGA provides:

> Assets fall within this subsection if—
> (a) they are of a description specified in any double taxation relief arrangements,
> (b) they constitute settled property of the settlement at the time immediately after the trustees become resident in the UK, and
> (c) were the trustees to dispose of them at that time, the trustees would fall to be regarded for the purposes of the arrangements as not liable in the UK to tax on gains accruing to them on the

[11] If the non-resident period straddles two tax years, the trustees will be UK resident for both tax years.

[12] See 56.6 (CGT/CT: Territorial scope).

disposal.

Trustees will need to consider the relevant treaty and the facts of the case; but assuming the trust was treaty-resident in the UK before the death, it is likely to be treaty-resident in the UK at the end of the non-resident period.

12.4.9 *Immigration on death of trustee*

Section 81(5) TCGA provides relief where there has been an accidental immigration to the UK followed by prompt emigration:

> Subsection (6) below applies where—
> (a) at any time the trustees of a settlement become resident in the UK as a result of the death of a trustee of the settlement, and
> (b) section 80 applies as regards the trustees of the settlement in circumstances where the relevant time (within the meaning of that section) falls within the period of 6 months beginning with the death.

Assuming this condition is met, we read on to the relief in s.81(6) TCGA:

> That section [s.80 trust emigration charge] shall apply as if the defined assets were restricted to such assets (if any) as—
> (a) would be defined assets apart from this section, and
> (b) fall within subsection (7) below.

In short, there is no charge apart from the exceptional case of s.81(7) TCGA:

> Assets fall within this subsection if—
> (a) the trustees acquired them in the period beginning with the death and ending with the relevant time, and
> (b) they acquired them as a result of a disposal in respect of which relief is given under section 165 or in relation to which section 260(3) applies [hold-over relief[13]].

This is only a limited relief: it avoids the exit charge, but it does not avoid the CGT charge on actual disposals of assets by the trustees in the year during which they accidentally UK resident. In some cases CGT treaty relief might be available, even during the period that the trust has UK resident trustees, on the basis that the trust continued to be treaty resident in the treaty State.

[13] See 57.31 (Hold-over relief).

12.5 Liability for trust exit charge

The usual rule for CGT liability of trustees is in s.65(1) TCGA:

> Subject to subsection (3) below, capital gains tax chargeable in respect of chargeable gains accruing to the trustees of a settlement or capital gains tax due from the personal representatives of a deceased person may be assessed and charged on and in the name of any one or more of the relevant trustees ....[14]

Section 65(3) has an exemption for trustees who retired before an emigration before a proposal to emigrate first emerged:

> Where section 80 applies as regards the trustees of a settlement ("the migrating trustees"), nothing in subsection (1) above shall enable any person—
> (a) who ceased to be a trustee of the settlement before the end of the relevant period,[15] and
> (b) who shows that, when he ceased to be a trustee of the settlement, there was no proposal that the trustees might cease to be resident in the UK,
>
> to be assessed and charged to any capital gains tax which is payable by the migrating trustees by virtue of section 80(2).

It is not, strictly, necessary for the retiring trustee to know of the proposal. It is sufficient that a proposal exists. But in practice that is not likely to arise.

Section 82 TCGA provides:

> (1) This section applies where—
> (a) section 80 applies as regards the trustees of a settlement ("the migrating trustees"), and
> (b) any capital gains tax which is payable by the migrating trustees by virtue of section 80(2) is not paid within 6 months from the time when it became payable.
>
> (2) The Board may, at any time before the end of the period of 3 years

[14] Defined in s.65(4): "In this section ...
"the relevant trustees", in relation to any chargeable gains, means the trustees in the year of assessment in which the chargeable gains accrue and any subsequent trustees of the settlement..."

[15] Defined by reference in s.65(4): "In this section "the relevant period" has the same meaning as in section 82".

> beginning with the time when the amount of the tax is finally determined, serve on any person to whom subsection (3) below applies a notice—
>
> (a) stating particulars of the tax payable, the amount remaining unpaid and the date when it became payable;
>
> (b) stating particulars of any interest payable on the tax, any amount remaining unpaid and the date when it became payable;
>
> (c) requiring that person to pay the amount of the unpaid tax, or the aggregate amount of the unpaid tax and the unpaid interest, within 30 days of the service of the notice.
>
> (3) This subsection applies to any person who, at any time within the relevant period,[16] was a trustee of the settlement, except that it does not apply to any such person if—
>
> (a) he ceased to be a trustee of the settlement before the end of the relevant period, and
>
> (b) he shows that, when he ceased to be a trustee of the settlement, there was no proposal that the trustees might cease to be resident in the UK.
>
> (4) Any amount which a person is required to pay by a notice under this section may be recovered from him as if it were tax due and duly demanded of him; and he may recover any such amount paid by him from the migrating trustees.
>
> (5) A payment in pursuance of a notice under this section shall not be allowed as a deduction in computing any income, profits or losses for any tax purposes.

SP 5/82 sets out HMRC practice:

> 5 Payment can only be sought from former trustees where the Revenue is unable to obtain payment from current trustees. In the first instance, payment will generally be sought from those persons who resigned as trustees immediately before the trust migrated and then from earlier trustees. Each case will, however, need to be considered in the light of the relevant facts.

12.5.1 *The relevant period*

This term is defined in s.82(6) TCGA:

> For the purposes of this section—
>
> (a) [this is a spent transitional rule for 1991/92];

[16] See 12.5.1 (The relevant period).

> (b) in any other case, the relevant period is the period of 12 months ending with the relevant time.

Thus the relevant period is in effect one year.

12.5.2 *Critique*

In short, a trustee at the time of the emigration is liable, and a trustee who retired up to a year before is liable if aware of the proposal to migrate the trust. This may help HMRC (because they can go back to trustees in an earlier year) and it may help the trustees (if they can say that they were not aware of a migration). But it is not likely to make any difference either way. There is no good reason for special rules and s.82 and s.65(3) TCGA should be repealed, resulting in a small tax simplification. But it does not really matter.

12.6 Treaty-emigration of trust

Section 83(1) TCGA provides:

> This section applies if the trustees of a settlement, while continuing to be resident in the UK, become at any time ("the time concerned") trustees who fall to be regarded for the purposes of any double taxation relief arrangements —
> (a) as resident in a territory outside the UK, and
> (b) as not liable in the UK to tax on gains accruing on disposals of assets ("relevant assets") which
> [i] constitute settled property of the settlement and
> [ii] fall within descriptions specified in the arrangements.

This is looking at the situation where trustees become treaty-non resident under a DTA tiebreaker test. Strictly, trustees who are treaty-resident of a foreign State are still liable for UK tax unless they make a claim, but that is just administrative and for the purpose of the charge, it is assumed that a claim will be made if it can.

If a treaty has a mutual agreement tie-breaker (rather than place of effective management) the trustees will not know until agreement is reached where they are treaty-resident, but they must manage as best as they can.

It is possible that agreement of a new DTA with a new CG article might bring about a treaty-emigration.

Assuming the conditions of s.83(1) are met, one moves on to s.83(2) TCGA which imposes the charge:

> The trustees shall be deemed for all purposes of this Act—
> (a) to have disposed of their relevant assets immediately before the time concerned, and
> (b) immediately to have reacquired them,
> at their market value at that time.

The treaty-emigration charge does not contain the two exceptions applicable to the s.80 exit charge but they are not needed:

(1) There is no need for an exemption for UK trading assets, as these will not qualify for DTA relief and so will not be relevant assets.
(2) There is no need for the exemption for DTA-exempt assets, as if the assets are DTA exempt, the trust cannot normally "become" DTA exempt.

The treaty-emigration charge has no special rules for trustee liability, but none are needed.

The definition of "relevant assets" is the same as the definition of "protected assets" in the s.87 code which applies (in a slightly amended form) to dual-resident trusts; see 61.38 (Dual-Resident trust: s.88 TCGA)

12.6.1 *"DTR arrangements" for CGT*

Section 288(1) TCGA defines DTR arrangements for CGT purposes:

> "double taxation relief arrangements"—
> (a) in relation to a company[17] means arrangements that have effect under section 2(1) of TIOPA 2010 except so far as they have effect in relation to petroleum revenue tax, and
> (b) in relation to any other person means arrangements that have effect under section 2(1) of TIOPA 2010 but only so far as they have effect in relation to capital gains tax;

The treaty needs to have effect in relation to CGT, in short, to contain a capital gains article. Most treaties do have a CG article, following the OECD Model, but some do not. For instance, the Belize DTA does not count as "DTR arrangements" within this definition, because it applies for IT but not for CGT. Note that the same expression is often used with a wider definition.[18]

[17] Companies are not relevant to this chapter, but one needs to read para (a) in order to follow para (b).

[18] For an example, see the definition of "Treaty non-resident" set out in 11.3.2 (SRT/treaty residence).

12.6.2 *Restriction of roll-over relief*

Section 84 TCGA provides:

> (1) Section 152 shall not apply where—
> (a) the new assets[19] are, or the interest in them is, acquired by the trustees of a settlement,
> (b) at the time of the acquisition the trustees are resident in the UK and fall to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the UK,
> (c) the assets are of a description specified in the arrangements, and
> (d) were the trustees to dispose of the assets immediately after the acquisition, the trustees would fall to be regarded for the purposes of the arrangements as not liable in the UK to tax on gains accruing to them on the disposal.

This is the equivalent of s.80(6) TCGA: see 12.4.6 (Restriction of roll-over relief).

12.7 Payment by instalments

Sch 3ZAA TMA (introduced 2019) allows payment of the CGT to be made by 6 annual instalments. Interest is payable. This is not a particularly generous relief.

It was introduced in order to satisfy EU law.[20] Some take the view that the 2019 reform is insufficient to make the UK legislation EU-law compliant. The relief only allows installments, with interest: there is still a dry tax charge.[21] But it seems unlikely that the point will ever be tested.

Paragraph 1 sch 3ZAA TMA provides:

> (1) This Schedule makes provision for certain persons who are liable to pay an exit charge under section 25 or 80 of the 1992 Act to agree with HMRC to pay the charge in instalments.
> (2) An agreement under this Schedule is called a "CGT exit charge payment plan".

12.7.1 *Eligibility*

The relief applies to charges under s.80 TCGA (trust emigration) and s.25

[19] Defined by reference in s.84(2): "In this section "the new assets" has the same meaning as in section 152."

[20] *Trustees of the P Panayi Accumulation & Maintenance Settlements v HMRC* C-646/15.

[21] See Bober, *CGT Exit Charges*, Tax Journal, 12 April 2019.

TCGA.[22] It is helpful to read para 2/3 sch 3ZAA TMA side by side:

Para 2 (s.25 charge)	**Para 3 (s.80 charge)**
(1) This paragraph applies where a person resident in an EEA state outside the UK is liable to pay an exit charge for a tax year by virtue of section 25(1) or (3) of the 1992 Act (deemed disposals by non-residents).	(1) This paragraph applies where the relevant trustees of a settlement are liable to pay an exit charge for a tax year by virtue of section 80 of the 1992 Act (charge on ceasing to be resident in the UK).
(2) The person is eligible to enter into a CGT exit charge payment plan in relation to any one or more of the assets to which the exit charge relates if—	(2) The relevant trustees are eligible to enter into a CGT exit charge payment plan in relation to any one or more of the assets to which the exit charge relates if—
(a) at the time of the event giving rise to the exit charge, the person had a right to freedom of establishment, or	(a) at the time the trustees of the settlement ceased to be resident in the UK for the purposes of that section, they had a right to freedom of establishment,[23]
	(b) immediately before that time, the trustees of the settlement used the asset or assets for an economically significant activity carried on in the UK,[24] and
(b) at any time after that event, the person carries on a trade in an EEA state other than the UK through a branch or agency and the asset or	(c) immediately after that time, those trustees— (i) become resident in another EEA state for the purposes of the 1992

[22] See 56.8 (Asset ceases to be chargeable). In practice s.25 rarely applies.

[23] Defined in para 10 sch 3ZAA TMA: "“right to freedom of establishment” means a right protected by—
(a) Article 49 of the Treaty on the Functioning of the European Union, or
(b) Article 31 of the EEA agreement”.

[24] Defined by reference in para 10 sch 3ZAA TMA: “economically significant activity” has the meaning given by section 13A(4) of the 1992 Act (reading references to a company as references to trustees)”. The drafter has overlooked the 2019 CGT rewrite; see 64.18 (Economically significant activity).

assets is or are—	Act, and
(i) used in or for the purposes of that trade,[25] or (ii) used or held for the purposes of the branch or agency.	(ii) use the asset or assets for an economically significant activity carried on there.

12.7.2 *Tax to which plan relates*

Paragraph 4 sch 3ZAA TMA provides:

> (1) A CGT exit charge payment plan may relate to—
>
> (a) the whole of the exit charge attributable to the asset or assets to which the plan relates (the "deferrable exit charge"), or
>
> (b) only part of the deferrable exit charge.
>
> (2) In this Schedule—
>
> "deferred exit charge" means the amount of the exit charge to which a plan relates;
>
> "taxpayer", in relation to a plan, means the person eligible under paragraph 2 or 3 to enter into the plan.
>
> (3) For the purposes of this Schedule the exit charge attributable to an asset is such proportion of the exit charge as any gain accruing to the taxpayer in respect of the asset by virtue of section 25(1) or (3) or 80 of the 1992 Act in the tax year bears to the total gains to which the exit charge relates.

12.7.3 *Payment by instalments*

Paragraph 5 sch 3ZAA TMA provides:

> A CGT exit charge payment plan must provide for the deferred exit charge to be payable in 6 equal instalments where—
>
> (a) the 1st instalment is due on the day on which payment of the exit charge is (apart from the plan) due and payable under section 59B, and
>
> (b) the other 5 instalments are due one on each of the first 5 anniversaries of that day.

12.7.4 *Application for plan*

Paragraph 6 sch 3ZAA TMA provides:

> (1) To enter into a CGT exit charge payment plan, the taxpayer must

[25] See 56.7.3 (Used in/for purposes of trade).

> apply to HMRC.
> (2) An application for a CGT exit charge payment plan must—
> (a) be made on or before the date specified in section 59B as the date by which the exit charge is payable, and
> (b) contain details of all the matters which are required by this Schedule to be specified in the plan.
> (3) A CGT exit charge payment plan is entered into when—
> (a) the taxpayer agrees to pay the deferred exit charge, and any interest on it, in accordance with the plan, and
> (b) an officer of Revenue and Customs agrees to accept payment of the deferred exit charge in accordance with the plan.
> (4) A CGT exit charge payment plan is void if—
> (a) an event giving rise to the exit charge is part of arrangements the main purpose of which, or one of the main purposes of which, is to defer the payment by the taxpayer of the exit charge, or
> (b) any information furnished by the taxpayer in connection with the plan does not fully and accurately disclose all facts and considerations material to the decision of the officer of Revenue and Customs to accept payment in accordance with the plan.

12.7.5 *Contents of plan*

Paragraph 7 sch 3ZAA TMA provides:

> (1) If the taxpayer is eligible under paragraph 2, a CGT exit charge payment plan must specify—
> (a) the EEA state in which the person entering into the plan is resident, and
> (b) if the person has ceased to carry on a trade in the UK through a branch or agency there, the date on which the person ceased to do so.
> (2) If the taxpayer is eligible under paragraph 3, a CGT exit charge payment plan must specify—
> (a) the date on which the trustees of the settlement became not resident in the UK for the purposes of section 80 of the 1992 Act, and
> (b) the EEA state in which those trustees became resident.
> (3) A CGT exit charge payment plan must specify—
> (a) the amount of the exit charge which, in the taxpayer's opinion, the taxpayer is liable to pay under section 25 or (as the case may be) section 80 of the 1992 Act in respect of the tax year, and
> (b) the amount of the deferred exit charge.

> (4) A CGT exit charge payment plan may contain appropriate provision regarding security for HMRC if an officer of Revenue and Customs considers that there would be a serious risk to collection of any amount of deferred exit charge without it.

12.7.6 *Effect of plan*

Paragraph 8 sch 3ZAA TMA provides:

> (1) This paragraph applies where a CGT exit charge payment plan is entered into by the taxpayer.
> (2) The deferred exit charge remains due and payable under section 59B (payment of income tax and capital gains tax: assessments other than simple assessments).
> (3) However, the Commissioners for Her Majesty's Revenue and Customs—
> (a) may not seek payment of any of the deferred exit charge otherwise than in accordance with the plan, and
> (b) may make repayments in respect of any of the deferred exit charge paid, or any amount paid on account of the deferred exit charge, before the plan is entered into.
> (4) The deferred exit charge carries interest in accordance with Part 9 as if the plan had not been entered into; and each time a payment is made under the plan, it is to be paid together with any interest payable on it.
> (5) The taxpayer is liable to penalties for late payment of the deferred exit charge only if the taxpayer fails to make payments in accordance with the plan (see item 3C of the Table at the end of paragraph 1 of Schedule 56 to the Finance Act 2009).
> (6) Any of the deferred exit charge which is for the time being unpaid may be paid at any time before it becomes payable under the plan together with interest payable on it to the date of payment.
> (7) If—
> (a) the taxpayer becomes bankrupt under the law of England and Wales or Northern Ireland or the taxpayer's estate is sequestrated under the law of Scotland,
> (b) an event corresponding to an event in paragraph (a) occurs under the law of an EEA state outside the UK, or
> (c) the taxpayer becomes resident in a country or territory that is not an EEA state,
>
> the outstanding balance of the deferred exit charge is payable on the date on which the next instalment would otherwise have been due under the plan.

12.7.7 *Definitions*

Sch 3ZAA TMA provides:

> 9 If, for the purposes of any double taxation arrangements, a person is treated at any time as resident in a territory other than an EEA state, the person is also to be treated as resident there at that time for the purposes of this Schedule.
>
> 10 In this Schedule—
>
> "double taxation arrangements" means arrangements made by two or more territories with a view to affording relief from double taxation;
>
> "exit charge" means—
>
> (a) for the purposes of paragraph 2, any amount of capital gains tax which a person is liable to pay for a tax year which the person would not be liable to pay if gains arising by virtue of section 25 of the 1992 Act in the tax year were ignored;
>
> (b) for the purposes of paragraph 3, any amount of capital gains tax which the relevant trustees are liable to pay for a tax year which they would not be liable to pay if gains arising by virtue of section 80 of the 1992 Act in the tax year were ignored;
>
> "trade" includes a profession or vocation.

12.7.8 *Pre-2019 emigration*

Para 7 sch 7 FA 2019 provides:

> The amendments made by paragraphs 1 and 2 [inserting sch 3ZAA TMA] have effect in relation to amounts of capital gains tax which a person is liable to pay by virtue of section 25(1) or (3) or 80 of TCGA 1992 in relation to events occurring on or after 6 April 2019.

What about an emigration before 6 April 2019? It was argued in the *Panayi* case that the exit charge was void! The FTT has rejected this somewhat claim, which would give a windfall benefit to pre-2019 migrations.[26]

12.8 Trader: Emigration/immigration

Section 17(1) ITTOIA provides:

[26] For some reason this is reported under the name *Trustees of the P Panayi Accummulation And Maintenance Trusts v HMRC* [2019] UKFTT 622. Normal practice (which is to be preferred) is to use the actual names of the trustees in the case title.

> (1) This section applies if—
> (a) an individual carries on a trade[27] otherwise than in partnership, and
> (b) there is a change of residence.

12.8.1 *"Change of residence"*

Section 17 ITTOIA provides:

> (1A) For the purposes of this section there is a "change of residence" if—
> (a) the individual becomes or ceases to be UK resident, or
> (b) a tax year is, as respects the individual, a split year.
> (1B) The change of residence occurs—
> (a) in a case falling within subsection (1A)(a), at the start of the tax year for which the individual becomes or ceases to be UK resident, and
> (b) in a case falling within subsection (1A)(b), at the start of whichever of the UK part or the overseas part of the tax year is the later part.

12.8.2 *Deemed cessation*

Section 17(2) ITTOIA provides:

> If this section applies and the individual does not actually cease permanently to carry on the trade immediately before the change of residence occurs, the individual is treated for income tax purposes—
> (a) as permanently ceasing to carry on the trade at the time of the change of residence, and
> (b) so far as the individual continues to carry on the trade, as starting to carry on a new trade immediately afterwards.

12.8.3 *Trading losses*

Section 17(3) ITTOIA provides:

> But subsection (2) does not prevent a loss made before the change of residence from being deducted under section 83 of ITA 2007 from profits arising after the change.

12.8.4 *Emigration of partner*

For the equivalent rules for partnerships, see s.852 ITTOIA:

[27] Section 17(4) ITTOIA provides:"This section applies to professions and vocations as it applies to trades."

> (6) If there is a change of residence, the partner is treated as permanently ceasing to carry on one notional trade when that change of residence occurs and starting to carry on another immediately afterwards...
> (8) Subsections (1A) and (1B) of section 17 apply for the purposes of subsection (6).

12.9 Exit taxes: DTAs

12.9.1 *Exit taxes/DTAs: Consistency*

OECD say that exit taxes are not prohibited by a DTA in OECD Model form:

> *Departure or exit taxes*
> 65. In a number of States, liability to tax on some types of income that have accrued for the benefit of a resident (whether an individual or a legal person) is triggered in the event that the resident ceases to be a resident of that State. Taxes levied in these circumstances are generally referred to as "departure taxes" or "exit taxes" and may apply, for example, to accrued pension rights and accrued capital gains.
> 66. To the extent that
> [a] the liability to such a tax arises when a person is still a resident of the State that applies the tax and
> [b] does not extend to income accruing after the cessation of residence,
> nothing in the [OECD Model] Convention, and in particular in Articles 13 [capital gains] and 18 [pensions], prevents the application of that form of taxation.
> Thus, tax treaties do not prevent the application of domestic tax rules according to which a person is considered to have realised pension income, or to have alienated property for capital gain tax purposes, immediately before ceasing to be a resident.
> The provisions of tax treaties do not govern when income is realised for domestic tax purposes (see, for example, paragraphs 3 and 7 to 9 of the Commentary on Article 13)[28]; also, since the provisions of tax treaties apply regardless of when tax is actually paid (see, for example, paragraph 12.1 of the Commentary on Article 15), it does not matter when such taxes become payable.[29]

[28] See 56.23.8 ("Alienation").

[29] OECD, BEPS Action 6: Final Report "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances" (2015).

12.9.2 *Exit taxes: Double taxation*

The double taxation problem arises where:

(1) An individual pays an exit tax on income/gain on migration to a new state; and

(2) The new state later charges tax on the same income/gain.

OECD discuss the double taxation problem:

> 66 ... The application of [exit] taxes, however, creates risks of double taxation where the relevant person becomes a resident of another State which seeks to tax the same income at a different time, e.g. when pension income is actually received or when assets are sold to third parties. This problem, which is the result of that person being a resident of two States at different times and of these States levying tax upon the realisation of different events, is discussed in paragraphs 4.1 to 4.3 of the Commentary on Article 23 A and 23 B.[30]

To follow the commentary at para 4, it is necessary to begin at para 3:

> 3. International juridical double taxation may arise in three cases:
>
> a) where each Contracting State subjects the same person to tax on his worldwide income or capital (**concurrent full liability to tax**, see paragraph 4 below);
>
> b) where a person is a resident of a Contracting State (R)[31] and derives income from, or owns capital in, the other Contracting State (S or E) and both States impose tax on that income or capital (see paragraph 5 below);
>
> c) where each Contracting State subjects the same person, not being a resident of either Contracting State to tax on income derived from, or capital owned in, a Contracting State; this may result, for instance, in the case where a non-resident person has a permanent establishment in one Contracting State (E) through which he derives income from, or owns capital in, the other Contracting State (S) (**concurrent limited tax liability**, see paragraph 11 below).
>
> 4. The conflict in case a) is reduced to that of case b) by virtue of Article

[30] OECD, BEPS Action 6: Final Report "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances" (2015).

[31] Footnote original: Throughout the Commentary on Articles 23 A and 23 B, the letter "R" stands for the State of residence within the meaning of the Convention, "S" for the State of source or situs, and "E" for the State where a permanent establishment is situated.

> 4 [treaty-residence]. This is because that Article defines the term "resident of a Contracting State" by reference to the liability to tax of a person under domestic law by reason of his domicile, residence, place of management or any other criterion of a similar nature (paragraph 1 of Article 4) and by providing special rules for the case of double residence to determine which of the two States is the State of residence (R) within the meaning of the Convention (paragraphs 2 and 3 of Article 4).
>
> 4.1 Article 4, however, only deals with cases of concurrent full liability to tax. The conflict in case a) may therefore not be solved if the same item of income is subject to the full liability to tax of two countries but at different times.
>
> The following example illustrates that problem.
>
> [a] Assume that a resident of State R1 derives a taxable benefit from an employee stock-option that is granted to that person. State R1 taxes that benefit when the option is granted.
>
> [b] The person subsequently becomes a resident of State R2, which taxes the benefit at the time of its subsequent exercise.
>
> In that case, the person is taxed by each State at a time when he is a resident of that State and Article 4 does not deal with the issue as there is no concurrent residence in the two States.

Where the source of the income is in the departure state, the source/residence conflict rules solve the problem.

> 4.2 The conflict in that situation will be reduced to that of case b) and solved accordingly to the extent that the employment services to which the option relates have been rendered in one of the Contracting States so as to be taxable by that State under Article 15 [Employment income] because it is the State where the relevant employment is exercised. Indeed, in such a case, the State in which the services have been rendered will be the State of source for purposes of elimination of double taxation by the other State. It does not matter that the first State does not levy tax at the same time (see paragraph 32.8). It also does not matter that that State considers that it levies tax as a State of residence as opposed to a State of source (see the last sentence of paragraph 8).

Although this is considering employment income, the same reasoning can apply to an exit charge on chargeable gains.

In other cases the only solution is by inter-state mutual agreement:

> 4.3 Where, however, the relevant employment services have not been rendered in either State, the conflict will not be one of source-residence double taxation and, as confirmed by the phrase "except to the extent

> that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State" found in paragraph 1 of Articles 23 A and 23 B, any resulting double taxation will be outside the scope of these Articles.
>
> The mutual agreement procedure provided for in paragraph 3 of Article 25 could be used to deal with such a case. One possible basis to solve the case would be for the competent authorities of the two States to agree that each State should provide relief as regards the residence-based tax that was levied by the other State on the part of the benefit that relates to services rendered during the period while the employee was a resident of that other State. Thus, in the above example, if the relevant services were rendered in a third State before the person became a resident of State R2, it would be logical for the competent authority of State R2 to agree to provide relief (either through the credit or exemption method) for the State R1 tax that has been levied on the part of the employment benefit that relates to services rendered in the third State since, at the time when these services were rendered, the taxpayer was a resident of State R1 and not of State R2 for purposes of the convention between these two States.

OECD BEPS action 6 (final report) cites the last paragraph, and continues:

> 67. Based on that approach, a possible basis for solving double taxation situations arising from the application of departure taxes would be for the competent authorities of the two States involved to agree, through the mutual agreement procedure, that each State should provide relief as regards the residence-based tax that was levied by the other State on the part of the income that accrued while the person was a resident of that other State. This would mean that the new State of residence would provide relief for the departure tax levied by the previous State of residence on income that accrued whilst the person was a resident of that other State, except to the extent that the new State of residence would have had source taxation rights at the time that income was taxed (i.e. as a result of paragraphs 2 or 4 of Article 13[32]). States wishing to provide expressly for that result in their tax treaties are free to include provisions to that effect.[33]

Some DTAs deal with this. For instance, art 13(10) Canada/UK DTA

[32] See 56.24 (DT CGT relief: Exceptions).

[33] OECD, BEPS Action 6: Final Report "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances" (2015).

provides:

> 10 Where an individual ceases to be a resident of a Contracting State and by reason thereof is treated under the laws of that State as having alienated property before ceasing to be a resident of that State and is taxed in that State accordingly and at any time thereafter becomes a resident of the other Contracting State, the other Contracting State may tax gains in respect of the property only to the extent that such gains had not accrued while the individual was a resident of the first-mentioned State. However, this provision shall not apply to property, any gain from which that other State could have taxed in accordance with the provisions of this Article, other than this paragraph, if the individual had realized the gain before becoming a resident of that other State. The competent authorities of the Contracting States may consult to determine the application of this paragraph.

12.10 Exit charge on individuals?

Apart from the above, there is no general charge on the emigration of an individual. It is sometimes suggested that there should be.

There are issues if the asset is illiquid, though those can be addressed by allowing deferral until the asset is disposed of. There are issues of double taxation discussed above.

The consequence of an exit charge should logically be rebasing on arrival, though that would substantially reduce the tax yield of the reform.

An exit tax on individuals would be a (major) restriction on free movement of persons, and an assessment of the merits of an exit charge depends on the extent to which that freedom is regarded as an important human right. The 2022/23 edition of this work para 12.9 and 12.10 discussed EU restrictions on exit taxes, based on freedom of establishment; this is no longer directly relevant after Brexit, but the policy issues are related.

CHAPTER THIRTEEN

UK ARRIVAL OR DEPARTURE: TAX CHECKLIST

13.1 Review of residence status
13.2 Individual coming to UK; not TNR
13.2.1 Before start of split year
13.2.2 Before UK part of split year
13.3 Key dates to diarise
13.4 Temporary non-resident
13.5 Individual an employee
13.6 Trustee
13.7 Director/partner
13.8 Trusts
13.8.1 Protected/settlor-excluded trust
13.8.2 Settlor-interested non-protected trust
13.9 Company not held in trust
13.10 Pre-deemed-domicile planning
13.11 Pre-actual domicile planning
13.12 Departure planning

The position will have to be reviewed in the light of the proposed FIG/domicile reforms discussed in chap A1; this is not considered here.

13.1 Review of residence status

An individual needs residence status advice *before* the start of the tax year of arrival:

Issue	**Comment/See para**
Consider whether the individual is treaty-resident in a foreign state for part of the year of arrival, or generally; and whether anything can be done to improve the position	9.2 (Treaty/UK-law residence)
Consider whether the year of arrival is a split year; if so identify the dates of the UK/overseas parts of the split year and whether anything can be done to improve the position	10.4 (Definition of "split year")
What record keeping is needed	6.35 (Record keeping)
If not first time of UK residence:	If individual was formerly UK resident

Consider whether temporary non-resident; and whether anything can be done to improve the position	but TNR rules do not apply, consider remitting income and gains from earlier residence period to UK; see 34.35 (Remittance when non-resident)
Review domicile; consider whether steps are appropriate to manifest domicile intention	4.8 (Remaining non-dom)

Note that small and easy changes may make the difference between:
(1) Split year/non-split year
(2) Residence/ non-residence.

Residence/non-residence is important even if the year of arrival would otherwise be a split year, for instance, for another year of overseas workday relief (arrivers earnings relief).

13.2 Individual coming to UK; not TNR

13.2.1 *Before start of split year*

Even if the year is a split year, some steps still need to be taken before the start of the *tax year* ie before 6 April; (not before the start of the UK part of the year):

Issue	**Comment/See para**
Realise dividends when non-resident to qualify for tax credit	30.7 (Non-resident recipient)
Realise UK "disregarded income" when non-resident if non-resident's IT relief applies	45.1 (Non-residents IT relief: Introduction)
Take benefit from trust within s.731/643A	50.47 (s.731 income in split year)
Take capital payment before start of year of residence	61.18 (s.87 gains of split year)

Advisors may also need to consider the foreign tax implications of moving to the UK.

13.2.2 *Before UK part of split year*

If the tax year is a split year, the following may be done before the UK part of the year; but if the year is not a split year, it needs to be done before the start of the year.

Issue	**Comment/See para**
Realise foreign income when non-resident	
Realise gains when non-resident (pre-arrival rebasing) if assets may be disposed of when UK resident	56.10 (Date of disposal/ acquisition)
Postpone realising losses until resident	
Review securities portfolio: avoid UK securities to avoid IT/CGT on arising basis	
Cryptoassets: consider transfer to non-resident trust or company to make non-UK situate.	96.6.6 (Cryptoasset: Planning)
If individual is a sole trader: consider arrangements to ensure foreign part of trade qualifies for remittance basis	21.4.3 (UK resident trader: Planning)
Transfer UK situate property (other than UK land/land-rich assets) to a trust/company held by a trust, if gain may otherwise arise on a disposal when UK resident	Move from arising basis to s.87 basis
Arrangements to separate taxable income/gains from (clean) capital Remit capital for property purchase and anticipated expenses at outset	18.55 (Remittance basis planning)
Consider if existing debts are relevant debts; if so review banking arrangements	18.21 (Relevant debt); 18.24.6 (Income/gains from collateral)
Review life policies if a chargeable event gain may arise when UK resident; review personal portfolio bonds This applies to policies held personally or in a trust created by individual	70.5 (No remittance basis)
Home or chattels held in a company: consider steps to avoid this	39.1 (Home/chattels owned by company)
If individual within POA rules once resident, consider POA election (in practice this would be rare)	83.33 (POA election)
Review Will, particularly: if UK situate property is acquired if individual may acquire UK domicile of choice, or	

UK habitual residence, if domicile/habitual residence may be uncertain[1]	
Spouses holding income-producing property in unequal shares	Consider unequal ownership declaration; see 94.7.4

13.3 Key dates to diarise

Deemed domicile	Diarise date deemed domicile begins
Temporary non residence	Diarise date that individual falls within temporary non-residence rules under 4/7 years residence test; see 11.2.1 (TNR gains)

13.4 Temporary non-resident

Some of the above points will apply to temporary non-resident individuals. TNR gains and TNR income will come into charge on return to the UK. But there may be scope for realising income when non-resident which is not TNR income. See 10.2.2 (TNR income).

13.5 Individual an employee

Employee within overseas workday relief: Nominate qualifying account for OWR mixed fund rule Deadline: 31 January after year of nomination	34.24 (OWR: Qualifying account)
Employee within overseas workday relief or split year: Apply for s.690 direction	36.6 (PAYE clearance: s.690 direction)

PAYE81950 and PAYE manual appendices 4, 5, 6, 7A and 7B set out special PAYE and NIC arrangements for internationally mobile employees/short term business visitors:

PAYE81950 Short Term Business Visitors	UK Employers in countries not covered by a DTA or who have branches overseas. These employers would be obliged to operate PAYE on non-resident employees who come to the UK to work for them from overseas group companies or branches, but only for a short period of time. If the employees are eligible for personal allowances there may ultimately be no UK liability. See 36.12 (Short Term Business Visitor: < 30 days).

[1] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 18.31 (EU Succession Regulation).

EP Appendix 4

For individuals who are:

- Resident in a country with a DTA with an employment income article
- Coming to work in the UK for a UK company or the UK branch of an overseas company, or are
- Legally employed by a UK resident employer, but economically employed by a separate non-resident entity
- Expected to stay in the UK for 183 days or less in any twelve month period. See 36.13 (Short-term visitors: EP app 4).

EP Appendix 5

For employers required to deduct foreign tax in addition to UK PAYE from payments being made to employees sent to work abroad: provisional relief for double taxation to employees who must pay both UK tax and foreign tax from the same payments of earnings. See 36.14 (Foreign tax credit: EP app 5).

EP Appendix 6

For employees assigned to work in the UK from abroad who are tax equalised. Tax equalisation is an arrangement between an employer and a foreign national employee who comes to the UK to work. The employee will be entitled to a specified amount of net earnings and benefits and the employer meets their UK Tax liability. See 36.15 (Tax equalisation: EP app 6).

Two further arrangements deal with NIC:

EP Appendix 7A

For employees subject to an EP Appendix 6 agreement, who are assigned to work in the UK from abroad and have an employer or host employer in the UK liable for secondary UK NICs. The employee pays NICs on earnings in this employment above the annual upper earnings limit (UEL) for the year or on earnings at or above the UEL in each earnings period throughout the year

EP Appendix 7B

For employees employed by a UK employer who are assigned to work abroad for a period of limited duration, but for more than a complete tax year, who have an ongoing liability to UK NICs whilst abroad.
The employee will be paid above the upper earnings limit (UEL) in every earnings period throughout the tax year and will receive some earnings and benefits derived from the employment from sources other than the UK employer.
The employee will not be liable to UK tax on the earnings from employment

13.6 Trustee

If individual is a trustee, including trustee of a charitable trust and a bare trust (or US Grantor trust):

Review impact of change of individual residence on residence status of trust. May need to retire before tax year of residence (or by concession, during offshore part of a split year).	7.4 (Trust residence for IT/CGT) 10.17 (Split year of trustees and PRs)
Consider whether having a UK resident trustee requires the trust to register under TRS (even if the trust is not UK resident)	131.9.2 (Non-UK trust with UK trustee)

13.7 Director/partner

If individual a director/shadow director: review impact of individual's residence on company residence.	
If individual a partner, consider place of partnership control/management.	85.19.2 (Control and management)

13.8 Trusts

13.8.1 *Protected/settlor-excluded trust*

Distribution from trust within s.731 to remove relevant income?
Review securities portfolio: avoid UK securities to avoid IT on an arising basis (non-protected income)

13.8.2 *Settlor-interested non-protected trust*

Distribute trust income when settlor non-resident
Realise gains when settlor non-resident (not in overseas part of split year)

13.9 Company not held in trust

Company within s.3 TCGA: Realise company gains when individual non-resident; postpone realising losses until resident	
Company within s.720: realise income when non-resident	
Consider transferring to trust to avoid non-protected income/tax on UK gains on arising basis	92.14 (Protected s.720 company income)

13.10 Anticipating deemed domicile

Diarise possible date of acquiring deemed IHT domicile
In anticipation of becoming deemed domiciled:

Formerly domiciled resident: review trusts made by individual (including charitable trusts)	
Deemed domicile under 15-year rule: consider creating protected trust	
Review loans to/from trusts to preserve protected trust status	92.7 (Payments under loans)
Arrange foreign income/gains while remittance basis still applicable (similar issues to pre-residence planning)	

See too 5.12 (Deemed domicile: Planning).

13.11 Anticipating actual domicile

Consider above steps and further planning in view of fact that:

Protected trusts lose protected status	
2008 CGT transitional reliefs lost	61.53

13.12 Departure planning

Many of the above points apply in reverse.
For instance, realise losses before departure and postpone realising gains or income; review impact of departure on trust or corporate residence.
In addition consider:

Form P85 (Leaving the UK - getting your tax right)
Form NRL1 (Non resident landlord scheme: Application to receive UK rental income without deduction of UK tax)
Form R43 (Claim to personal allowances and tax repayment by an individual not resident in the UK)
Revoke gift aid declarations for charities which the individual may wish to continue to support.[2] Otherwise there could be a Gift Aid clawback charge if the

[2] This would only be necessary for ongoing gift aid declarations, ie those which cover present and future gifts, but that is the standard form.

individual makes a gift to the charity (even a non-UK charity) and does not pay sufficient UK tax to frank the gift.[3]

Tax position in country of arrival

[3] Section 424 ITA; see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 15.44.4 (Gift Aid clawback charge). Online version *https://www.taxationofcharities.co.uk*

CHAPTER FOURTEEN

INCOME AND ITS CATEGORISATION

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14.1 Income: Introduction

I deal with the topic of income as follows.

This chapter deals with:

- The charge on income
- The concept of income
- Whether IT is a tax on income/an annual tax
- The categorisation of income for UK tax[1], and overlap rules for income falling into two categories

The next two chapters deal with:

- Territorial principles: location of income sources/the concept of RFI
- Income-recognition vocabulary

[1] DTAs operate a different scheme: see 107.9 (DTA income categorisation).

14.2 Terminology: Income/gains/profit

In modern terminology:

- "gains" is understood to mean capital gains
- "profits" (used for CT) means income and chargeable gains[2]

So in modern terminology we refer to:

Term	**Subject to**
Income	Income Tax/CT charge on income
Gains	CGT/CT charge on gains; sometimes IT (eg, offshore income gains)
Profits	Corporation Tax

"Profits or gains" is an archaic phrase formerly used to mean "income".[3] The Tax Law Rewrite took it out of the rewrite legislation, and it now survives only in dusty corners which the Tax Law Rewrite did not reach; and of course the old expression is preserved in the aspic of pre-rewrite case law.

14.3 Charges to IT/CGT

We begin with the charges to IT and CT. (For the charge to CGT, see 56.2).

14.3.1 *Charge to IT/CT*

s.4(1) ITA	**s.2(1) CTA 2009**
Income tax is charged for a year only if an Act so provides.	Corporation tax is charged on profits of companies for any financial year for which an Act so provides.
[No equivalent]	(2) In this Part [Part 2 CTA 2009] "profits" means income and chargeable gains, except in so far as the context otherwise requires.

That takes us to the F(no.2)A 2023:

[2] See 14.3.1 (Charge to IT/CT).

[3] See eg s.1 ICTA 1970 (derived from s.2 ITA 1853): Income tax "shall be charged ... in respect of all property, profits or gains respectively described or comprised in the Schedules ..."

s.1 F(no.2)A 2023

Income tax is charged for the tax year 2023-34.

s.5(1) F(no.2)A 2023

Corporation tax is charged for the financial year 2024.

14.3.2 *Tax year/financial year*

Section 4 ITA defines “tax year”:

> (2) A year for which income tax is charged is called a “tax year”.
> (3) A tax year begins on 6 April and ends on the following 5 April.
> (4) “The tax year 2007-08” means the tax year beginning on 6 April 2007 (and any corresponding expression in which two years are similarly mentioned is to be read in the same way).

Sch 1 Interpretation Act 1978 defines “financial year”:

> “Financial year” means, in relation to matters relating to the Consolidated Fund, the National Loans Fund, or moneys provided by Parliament, or to the Exchequer or to central taxes[4] or finance, the twelve months ending with 31st March.

14.3.3 *Assessment periods*

IT/CT differ on this point.
Section 4(5) ITA provides:

> Every assessment to income tax must be made for a tax year.[5]

Section 8 CTA 2009 provides:

> (1) Corporation tax for a financial year is charged on profits arising in the year.
> (2) Corporation tax is calculated and chargeable, and assessments to corporation tax are made, by reference to accounting periods.
> [I discuss ss(3)(4) at 15.2.2 (Arising: Quantum of charge)]
> (5) If a company's accounting period falls within more than one financial year, the amount of the profits arising in the accounting period that is chargeable to corporation tax must be apportioned between the financial years in which the accounting period falls.

[4] “Central taxes” is not defined but must include Corporation Tax.

[5] Section 4(6) ITA flags an exception to this rule:
“Subsection (5) is subject to Chapter 15 of Part 15 (by virtue of which an assessment may relate to a return period).”

14.3.4 *IT is an annual tax*

IT is often described as an annual tax. That label may describe two distinct (albeit related) rules:

(1) By longstanding tradition, each year's Finance Act imposes the tax for one tax year only, the tax being re-applied in each year.

(2) IT is usually computed, and assessments are usually made, by reference to a tax year.

Nothing turns on the first point. It would be possible for a Finance Act to impose IT for more than one year (as happens for CGT, and, occasionally, for CT). Nothing would change. Income tax does not lapse at the end of the year, and no-one expects it to.

The second point aptly describes a feature of income tax. It is also the case for CGT and CT.

But the saying that "income tax is an annual tax" is not a principle to be rigorously applied.[6]

CT, like IT, may be described as an annual tax, in the sense that:

(1) It is charged by reference to financial years.

(2) It is generally[7] imposed for a financial year only, the tax being re-applied in each year.

But nothing turns on that.

14.4 Need for a source?

In Walker *v Centaur Clothes Group*:[8]

> Income tax is traditionally a source-based annual tax, liability depending upon the existence of a source of income falling under one of the Schedules during the year of assessment...

There are two distinct rules here:

(1) Income tax was "traditionally" a source-based tax: it only applied to income from a source specified in one of the Schedules. So in the absence of a source there could be no income; or if it was said to be income, there would be no income tax on it

[6] See 16.6 (Need for a source?).

[7] That is not always the case, eg s.6(1) FA 2021 imposed CT for two successive years; it provided: "Corporation tax is charged for the financial years 2022 and 2023."

[8] *Walker v Centaur Clothes Group* [2000] UKHL 23 citing *Brown v National Provident Institution* 8 TC 57.

(2) Income tax was "traditionally" an "annual tax": it only applied if that source exists in the year of assessment.

The first rule was self-evident.[9] The second rule was decided in *Brown v National Provident Institution*.[10] But these rules have long ceased to apply:

> If the income tax had retained that ancient simplicity, it would be true to say that income could not be within the charge to tax unless there was a source within the charge ...
> It is, however, no longer true to say that liability to income tax depends upon the existence during the year of assessment of a source within the charge.
> [1] There are cases (such as post-cessation receipts) when liability depends upon the existence of income defined by reference to a source which does not exist within the year of assessment.[11]
> [2] Or liability may depend upon an event, such as a balancing charge on the sale of an asset which has attracted a capital allowance, or the receipt of a capital sum from a particular kind of transaction, which is deemed to be taxable income received in that year of assessment or sometimes spread over several years of assessment.[12]

[9] See s.1 ICTA 1970 (derived from s.2 ITA 1853): Income tax "shall be charged ... in respect of all property, profits or gains respectively described or comprised in the Schedules ..."

[10] 8 TC 57. The reader may think that the opposite view was better: ie, although there had to be a source within the schedules, there was no requirement that the source had to exist in the year of assessment. If so, the reader is in good company: that was the view of Rowlatt J and Lord Cave. One might therefore debate whether *Brown v NPI* was correctly decided, or whether it would be decided in the same way today. But it does not matter.

[11] [Author's footnote] For instance, under the ITA remittance basis, which applies from 2008, there is a tax charge on the remittance of income even though the source of income does not exist in the year of remittance.

[12] [2000] UKHL 23. The changes referred to can be seen by contrasting s.1 ICTA 1970 (derived from s.2 ITA 1853) and s.1 ICTA 1988:

s.1 ICTA 1970
Where any Act enacts that income tax shall be charged for any year at any rates, then, subject to the provisions of the Income Tax Acts, the tax at those rates shall be charged for that year in respect of all property, profits or gains respectively described or

s.1(1) ICTA 1988
Income tax shall be charged in accordance with the provisions of the Income Tax Acts in respect of all property, profits or gains respectively described or comprised in the Schedules, A, B, C, D, E and F, set out in sections 15 to 20 or which in accordance with the Income Tax Acts are

It continues to be the case that income is not taxed if it does not fall within one of the taxable categories (which have replaced the schedules). Most obviously, foreign source income of a non-resident is not taxable, not because of an exemption as such, but for lack of a charging provision.

For UK residents, the taxable categories are wide, as one would expect. Income falling outside them (other than under a specific exemption) is difficult to imagine, particularly as the category of Misc Sweep-up Income covers (more or less) all income not otherwise chargeable.

14.5 Income Tax: a tax on income?

"Income tax is a tax on income."[13] This witticism is less true now than when it was formulated in 1900, because (as noted just above) various receipts of a capital nature are now subject to income tax.[14] However there are contexts where this principle still applies, ie where an IT charge applies to receipts of an income nature, not to receipts of a capital nature, and the traditional income/capital distinction must be applied. Most notably, capital receipts are not trading receipts, capital expenditure is not deductible in computing trading income, and the distinction is related to the vexed question of the meaning of "trade".[15]

Examples relevant to this book are:

Topic	**See para**
Dividends from non-resident companies	30.9
Annual Payments	31.3
Misc Sweep up Income	33.2.1
Distributions from trusts	41.8

14.5.1 *What is income?*

To the extent that IT is a tax on income, we need to know what is income, or to put it another way, how to distinguish income/capital. The courts have found the capital/income border difficult to define and the reader may think the analysis is sometimes insufficiently rigorous.

The general trend in tax reform has been to abolish the distinction when

comprised in the Schedules contained in the following sections of this Act	to be brought into charge to tax under any of those Schedules or otherwise.

[13] *London County Council v Attorney General* 4 TC 265.

[14] There are too many to list, but examples (if needed) include offshore income gains, DDS gains, chargeable-event gains, and pre-owned assets.

[15] See App 2.23 (Trade).

possible (eg, the taxation of dividends from UK companies[16] and the trend has gone further for CT, eg loan relationships, intellectual property).

I think it is best to address the income/capital distinction in the context of the charging provision where it arises; but here make some general points which are more widely applicable.

14.5.2 *Tree and fruit*

In *Ryall v Hoare*:[17]

> "Profits or gains" [in modern terms, "income"[18]] mean something which is in the nature of interest or fruit, as opposed to principal or tree.

IRC v John Lewis Properties refers to the "hackneyed simile" and continues:[19]

> it may be more elucidatory in some contexts than in others. Sometimes, it merely begs the question: what is tree and what is fruit? I doubt whether the analogy is helpful in the present case. There is no doubt that if JLP had granted the bank, say, a 15 year lease of the properties for a premium, the premium would have been a capital payment.... But in what sense would that have been a disposal of the tree? And why would it be any more of a disposal of the tree than the mere assignment of the right to receive rents for 15 years? In both cases, JLP would retain its freehold interest intact, and in both cases the value of its reversion would be (temporarily) reduced by reason of the transaction.

In *Beard v HMRC*:[20]

> Many of the authorities referred to the well-worn analogy of the tree (for capital payments) and the fruit (for income payments). [HMRC] made the point that this analogy can only be taken so far. I agree.

The application of the analogy is sometimes risible. For instance, in *Courtaulds Investments v Fleming*:[21]

> the effect of building up a reserve of this character is to engraft on the tree of the shareholder's original investment in the form of paid-up share capital an additional member, not of the same provenance or of the same

[16] See 30.3.2 (Dividend of capital nature).

[17] 8 TC 521 at p.525.

[18] See 14.2 (Terminology: Income/gains/profit).

[19] [2002] EWCA Civ 1869 at [89].

[20] [2022] UKFTT 129 (TC) at [173].

[21] 46 TC 111 at p.125.

> original character as the tree itself, which must nevertheless be accepted as becoming part of the tree to the exclusion of any character it may previously have had as a fruit of the tree....The effect of the distribution ... was to lop from the tree part of the engrafted member consisting of a proportionate part of the share premium reserve. So the distribution did not, in my judgment, leave the foreign possession intact.

The metaphor works in easy cases when help is not needed. In difficult cases, anything can be called fruit or tree. What is needed is legal analysis. One might put it this way: if the analysis is not the fruit of the metaphor, the metaphor should not be grafted onto the analysis.

14.5.3 *Fact or law?*

In *Bluecrest v HMRC*:[22]

> Before us, neither side displayed any enthusiasm for investigating the further question whether the issue of the proper characterisation of the final PIP awards as being of a capital or an income nature was one of law or of fact, or a mixture of the two. Counsel said that an anthology of citations supporting almost any view on the topic could probably be found, and it would not be fruitful to spend time on it. Nevertheless, it seems to me that the question cannot be ignored, however difficult it may be to answer. My own view, which has not been tested in argument and which I therefore state with some diffidence, is that the question is in principle one of law, to which there can be only one correct answer in any given factual situation. It is not a question of evaluation, or of mixed fact and law, for the tribunal of fact...

BlueCrest cited *Beauchamp v F W Woolworth Plc* where the issue was whether a currency exchange loss was of an income or capital nature, and thus whether it was deductible in computing trading profits:[23]

> On principle, and in the light of the judicial pronouncements which I have cited, the question involved in the present case is one of law....

On the other hand, *BlueCrest* also said:[24]

[22] [2022] UKUT 200 (TCC). *Bluecrest* is one of a trio of what should turn out to be leading cases; the other two are *Odey Asset Management v HMRC* [2021] UKFTT 31 (TC); *HFFX v HMRC* [2021] UKFTT 36 (TC). But further discussion should wait until these decisions are final.

[23] [1990] 1 AC 478 at p.492G.

[24] at [114].

> Although the question is in my view ultimately one of law, I do attach some significance to the fact that in the present case both the expert tribunals have had little difficulty in concluding that the awards were of an income nature...

14.6 Income categories

Income must be categorised, (or classified) into categories, (or classes). Categorisation is necessary whenever different rules apply to different types of income, which often happens.

One might use the word "source" to describe what I here call categories, but the word "source" may be used in a more precise way. A bank account, (or a shareholding in a company), may be called a source of income, but the category of income is interest (or dividends). Source is where the income comes from; categorisation is the type of income. So in the present context, I prefer the word "category" to "source".

14.6.1 *Pre-rewrite categorisation: Schedules/Cases*

The pre-rewrite system categorised income into
(1) Schedules (broad categories or sets of categories)
(2) Schedules were divided into Cases (sub-categories).

In 1936 the IT Codification Committee reviewed the system and were not complimentary:[25]

> The existing classification of income cannot be defended on any logical ground, and was, no doubt, largely based on administrative convenience. On the one hand, it involves the distribution of income of the same nature among different Schedules and Cases ... On the other hand the existing classification brings together matters having no intelligible connection. ... In [Schedule D Case III] is there is grouped with interest ... income so dissimilar from it as the profits of dealers in cattle and sellers of milk.

For all these faults, this system survived another 80 years, until the tax law rewrite. Perhaps it shows that coherence is not an essential feature of a tax system; or a characteristically British pragmatism; or the weight of history and the difficulty of reform; or perhaps the criticism was exaggerated and minor reforms sufficed to improve matters; or perhaps all of the above. However that may be, the reader will acquire some familiarity with the

[25] (1936) Cmd 5131 at [43].

schedular system from pre-2005 case law, and of course it has influenced the post-rewrite system.

Abolition of the Schedules has not in fact made much difference.

In *Anson v HMRC*, CoA approved a comment from the HC in *Memec*:[26]

> The schedular character of income tax ... means that the court has always placed great importance on the concept of the source of taxable income ... The concept of source is a more or less coded subtext to income tax and corporation tax statutes.

CoA continued:

> The schedular character of income tax derives from the fact that historically the legislative approach was not to define income but to provide that income from sources specified in a number of schedules (Schedules A to F) to the legislation should be subject to income tax. If income could not be brought within the schedules, it was not taxable. Income tax is still imposed by reference to categories of income even though schedules are not generally used, and so the point made by Robert Walker J remains good.

But one does not need to look at the old law to see that sources of income (which I prefer to call characterisation of income) is fundamental to IT. While it is true that if income is not within the schedules, of their post-rewrite equivalents, it is not taxable, the rule has little if any application because income can (more or less) always within them.

14.6.2 *ITTOIA/CTA income categories*

ITTOIA/CTA 2009 classify income into:

(1) Categories (covered by a Part[27] of ITTOIA/CTA 2009)
(2) Sub-categories (covered by a Chapter of ITTOIA/CTA2009)

I refer to these as **"income categories"**. The main income categories are the following:

CATEGORY	**ITTOIA**	**CTA 2009**
	Part: *Chapter*	***Part:*** *Chapter*
Trading income	**2**	**3**
Trade profits	2: 2	3:2
Post-cessation receipts	2: 18	3:15

[26] *Anson v HMRC* [2013] EWCA Civ 63 at [33]; the point was not discussed on appeal.

[27] I adopt the style of the Taxes Acts, which write Part and Chapter with initial capitals, to reflect the technical nature of the words.

Property income	**3**	**4**
Property income	3: 3	4: 3
Mines, etc	3: 8	4: 7
Wayleaves	3: 9	4:8
Post-cessation receipts	3: 10	4:9
"Savings & Investment Income"	**4**	-
Interest	4:2	
Disguised interest	4: 2A	-
UK dividends	4: 3	-
Non-UK dividends	4: 4	-
Purchased life annuities	4:7	-
Deeply discounted securities	4: 8	-
Life policies: chargeable-event gains	4: 9	6:11[28]
"Part 5 ITTOIA Miscellaneous Income"	**5**	**10**
Royalties/intellectual property income	5: 2	-
Offshore receipts from intangible property	5: 2A	-
Settlor-interested trusts	5: 5	-
Estate in course of administration	5: 6	10:3
Annual-Payment income	5: 7	10: 7
Misc Sweep-up Income	5: 8	10: 8

CT has diverged from IT, in the following cases in particular:

Loan relationships/Deemed loan relationships	**5/6**
Derivatives	**7**
Intangible fixed assets/Intellectual property	**8/9**

A note on the naming of Parts of ITTOIA:
Parts 2/3: The names here (trading/property income) are straightforward.
Part 4: I describe this as **"Savings & Investment Income"** with initial capitals, to indicate that it is a technical term, meaning specifically income identified in the Chapters of Part 4 ITTOIA.
Part 5: "Miscellaneous income" as a label scarcely does justice to this set of income types, which have nothing in common except that they have been placed in Part 5, for lack of anywhere better. I refer to it as **"Part 5 ITTOIA Miscellaneous Income"** with initial capitals to reflect the technical meaning of my term.

14.6.3 *ITA income categories*

ITA 2007 deals with reliefs and rates, but it also creates income categories relating to avoidance, including:

[28] The correspondence between ITA and CTA is inexact.

CATEGORY	**ITA** ***Part:*** *Chapter*	**CTA 2010** ***Part:*** *Chapter*
Transactions in land	**9A**	**8ZB**
Accrued income profits	**12**	-
Tax Avoidance	**13**	
Transactions in securities	13: 1	**15**[29]
Transfer of assets abroad	13: 2	-
Transfer of income streams	13: 5A	16:1/1A/4
- ditto - through partnerships	13: 5AA/5D	
Loan or credit transactions	13: 5C	16: 3
Disguised investment management fees	13: 5E	
Income-based carried interest	13: 5F	

Most of these items have their own chapter in this work, except for ToA, which has five chapters.

The ITTOIA categorisation scheme is not exactly simple. It is influenced by the pre-rewrite system. The decision to rewrite CTAs 2009/2010 separately from ITTOIA/ITA doubled the number of provisions, and the reader may doubt whether that was worthwhile. But there it is.

The ITTOIA/CTA 2019 categorisations seem to make sense, just about; – at least, once the reader is familiar with them. The ITA/CTA 2010 categories of tax avoidance type income are entirely *ad hoc* and have no underlying general principles.

Could anything better be devised? Discuss.

14.7 Categorisation tie-breakers

There are statutory priority rules for income which fall into two categories.

These alter the pre-rewrite position under which HMRC had some choice how to assess income which fell within more than one Case of Schedule D.[30] Pre-2005 case law needs review in the light of the post-rewrite provisions, but the old cases are still important on some aspects.

14.7.1 *No double taxation*

It continues to be the case that:

(1) Income tax is regarded as one tax, not a set of taxes, notwithstanding that the different categories have different rules and methods of

[29] The correspondence between ITA and CTA is inexact.

[30] See *Liverpool and London and Globe Insurance v Bennett* 6 TC 327; ITTOIA EN Change 66.

computation and

(2) the same source of income cannot be taxed twice.[31]

14.7.2 *Priority in charging provision*

Sometimes priority is addressed in the charging provision. This is done in the charging provisions for Annual Payments/disguised interest/misc sweep-up income:

s.683 ITTOIA **Annual Payment**	**s.381A ITTOIA** **Disguised interest**	**s.687 ITTOIA** **Misc Sweep-up Income**
(1) Income tax is charged under this Chapter [Chapter 7 Part 5 ITTOIA] on annual payments that are not charged to income tax under or as a result of any other provision of this Act or any other Act.	(2) Income tax is charged on [a return which is economically equivalent to interest] return if the return is not charged to income tax under or as a result of any other provision of this Act or any other Act.	(1) Income tax is charged under this Chapter [Chapter 8 Part 5 ITTOIA] on income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act.
		(2) Subsection (1) does not apply to annual payments or to income falling within Chapter 2A of Part 4 [Disguised interest].
(2) Subsection (1) does not apply to annual payments that would be charged to income tax under or as a result of another provision but for an exemption.	(3) Subsection (2) does not apply to a return that would be charged to income tax under or as a result of another provision but for an exemption.	(3) Subsection (1) does not apply to income that would be charged to income tax under or as a result of another provision but for an exemption.

More often, there is a separate provision which addresses the issues of priority.

14.7.3 *Property/trade income overlap*

An activity may constitute both trading and a property business; and a receipt can be both a trading receipt and a receipt of a property business. The paradigm case is rent received by a property developer from

[31] *HMRC v PA Holdings* [2011] EWCA Civ 1414 at [28] - [30].

temporary letting of land awaiting development.

s.4(1) ITTOIA	**s.201(1) CTA 2009**
Any receipt or other credit item, so far as it falls within— (a) Chapter 2 of this Part (receipts of trade, profession or vocation), and (b) Chapter 3 of Part 3 so far as it relates to a UK property business, is dealt with under Part 3	Any receipt or other credit item, so far as it falls within— (a) Chapter 2 of this Part (receipts of trade), and (b) Chapter 3 of Part 4 so far as it relates to a UK property business, is dealt with under Chapter 3 of Part 4.
s.261 ITTOIA	**s.287 CTA 2009**
Any receipt or other credit item, so far as it falls within— (a) Chapter 3 of this Part so far as it relates to an overseas property business or Chapter 8 or 9 of this Part (rent receivable in connection with a UK section 12(4) concern or for UK electric-line wayleaves), and (b) Chapter 2 of Part 2 (receipts of a trade, profession or vocation), is dealt with under Part 2.	Any receipt or other credit item, so far as it falls within— (a) Chapter 3 of this Part so far as it relates to an overseas property business or Chapter 7 or 8 of this Part (rent receivable in connection with a UK section 39(4) concern or for UK electric-line wayleaves), and (b) Chapter 2 of Part 3 (receipts of a trade), is dealt with under Part 3.

EN ITTOIA explains:

> 1058. The priority rules ... make it clear that a charge under Part 3 of this Act as UK property income has priority over a charge under Part 2 as trading income. This reflects the rule in Schedule D Case I (section 18(3) of ICTA)...The rent is taxed as property income, even if it could properly be regarded as a trade receipt.
> 1059. In the case of a foreign trade and foreign property, the rule in section 65A(1)(b) of ICTA is the reverse of that in section 18(3) of ICTA. An overseas property business does not include "income to which section 65(3) of ICTA applies (income immediately derived from carrying on a trade)". So the priority rule in section 261 preserves this position.

Perhaps the reason for the anomaly is to maximise income classified as UK source. Under these rules, if UK property income is a receipt of a foreign trade, it is classified as UK property income (and so taxable even in circumstances where foreign trading income may not be); whereas if foreign property income is part of a UK trade it is treated as UK trading income (and similarly taxable).

14.7.4 *S&I/trade income*

A receipt can be both a trading receipt and Savings & Investment Income. The paradigm case is interest/dividends received by a bank/financial trader.

Section 366(1) ITTOIA provides:

> Any income, so far as it falls within–
> (a) any Chapter of this Part [Part 4, Savings & Investment Income], and
> (b) Chapter 2 of Part 2 (receipts of a trade, profession or vocation),
> is dealt with under Part 2.

14.7.5 *S&I/property income*

A receipt can be both a receipt of a property business and Savings & Investment Income. Section 366(2) ITTOIA provides:

> Any income, so far as it falls within–
> (a) any Chapter of this Part [Part 4, Savings & Investment Income], and
> (b) Chapter 3 of Part 3 so far as the Chapter relates to a UK property business,
> is dealt with under Part 3.

14.7.6 *Dividend /trade/property income*

Section 931W CTA2009 makes similar provision for CT:

> (1) Any income so far as it falls within—
> (a) this Part [Part 9A, company distributions], and
> (b) Chapter 2 of Part 3 (income taxed as trade profits),
> is dealt with under Part 3.
> (2) Any income so far as it falls within—
> (a) this Part, and
> (b) Chapter 3 of Part 4 (profits of property businesses) so far as the Chapter relates to a UK property business,
> is dealt with under Part 4.

14.7.7 *S & I Income/ITEPA income*

Section 366(3) ITTOIA provides:

> Any income, so far as it falls within–
> (a) any Chapter of this Part [Part 4, Savings & Investment Income] other than
> [ii] Chapter 3 [UK dividends] or
> [iii] [Chapter] 6 [release of close company loans], and
> (b) Part 2, 9 or 10 of ITEPA 2003 (employment income, pension income or social security income),
> is dealt with under the relevant Part of ITEPA 2003.

For instance, an annuity could be pension income in which case the ITEPA charge has priority over the annual payment charge in Part 4 ITTOIA. Conversely, the charge on dividends/release on close company loans appears to have priority over ITEPA.[32]

14.7.8 *S & I /chargeable event income*

Section 366(4) ITTOIA provides:

> Nothing in this section prevents amounts both–
> (a) being counted as income for the purposes of Chapter 9 of this Part (gains from contracts for life insurance etc.), and
> (b) being taken into account in calculating income, or counting as income, for the purposes of other Parts of this Act,
> but see section 527 (reduction for sums taken into account otherwise than under Chapter 9).

14.7.9 *Part 5 ITTOIA/trade income*

A receipt can be both a trading receipt and Part 5 ITTOIA Miscellaneous Income. The paradigm case is royalties received by an author.
Section 575(1) ITTOIA provides:

> Any income, so far as it falls within—
> (a) any Chapter of this Part [Part 5, Miscellaneous Income], and
> (b) Chapter 2 of Part 2 (receipts of a trade, profession or vocation),
> is dealt with under Part 2.

The charge on trading profits under Part 2 ITTOIA has priority over the charge on royalty income in Part 5 ITTOIA.

14.7.10 *Other Part 5 overlaps*

Section 575 ITTOIA provides:

[32] See *Esprit Logistics Management v HMRC* [2018] UKFTT 287 (TC) at [121] - [124].

> (2) Any income, so far as it falls within—
> (a) any Chapter of this Part [Part 5, Miscellaneous Income], and
> (b) Chapter 3 of Part 3 so far as the Chapter relates to a UK property business,
> is dealt with under Part 3.
> (3) Any income, so far as it falls within—
> (a) any Chapter of this Part [Part 5, Miscellaneous Income], and
> (b) Chapter 2 or 3 of Part 4 (interest and dividends etc. from UK resident companies etc.),
> is dealt with under the relevant Chapter of Part 4.
> (4) Any income, so far as it falls within—
> (a) any Chapter of this Part [Part 5, Miscellaneous Income], and
> (b) Part 2, 9 or 10 of ITEPA 2003 (employment income, pension income or social security income),
> is dealt with under the relevant Part of ITEPA 2003.

This does not oust the settlor-interested trust code in Chapter 5 of Part 5.[33]

14.7.11 *Trade /employment/ITEPA income*

IT/CT have different rules:

s.4(2) ITTIOA	**s.201(2) CTA 2009**
Any receipt or other credit item, so far as it falls within—	Any receipt or other credit item, so far as it falls within—
(a) this Part [Part 2, trading income], and	(a) this Part, and
(b) Part 2, 9 or 10 of ITEPA 2003 (employment income, pension income or social security income),	(b) Chapter 4 of Part 10 (income from holding an office),
is dealt with under the relevant Part of ITEPA 2003.	is dealt with under Chapter 4 of Part 10.

See 37.16.1 (Deemed non-employment) for some exceptions.

14.7.12 *Dividend/employment income*

I mention *PA Holdings v HMRC*[34] for completeness. This was an

[33] *Clipperton v HMRC* [2022] UKUT 351 (TCC) at [91]-[92]; the context shows that must be correct, as exclusion of Part 5 would have absurd consequences.

[34] [2011] EWCA Civ 1414.

avoidance scheme under which employees received remuneration in the form of dividends on alphabet shares. Section 20(2) ICTA stated, or seemed to, that the charge on dividends had priority. So the income had to be taxed as dividends (and at lower rates). The argument was baldly, if unconvincingly, rejected by the Court of Appeal.[35] The facts will not recur, as s.20(2) ICTA has no precise equivalent, not to mention disguised remuneration and the GAAR, so the case has limited contemporary relevance. But it is a striking illustration of the approach of the Courts, or at least, of some Courts, that avoidance of this nature will not be permitted to succeed.

[35] at [62] - [65].

CHAPTER FIFTEEN

INCOME RECOGNITION: RECEIVE/ENTITLED/ARISE/PAID

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15.1 Income-recognition vocabulary

This chapter considers a cluster of related expressions or concepts:

- a person *receiving or entitled to* income[1]
- income *arising* to a person
- income *of* a person

[1] In this chapter, where the context permits, I abbreviate income/gains to income and leave gains to be understood.

- *payment/paid* to a person
- income *payable* or *due and payable* to a person
- a person *deriving* income
- gains *accruing* to a person

These are some of the most common words in tax legislation. I refer to this as **"income-recognition"** vocabulary.

Meaning depends of course on context. Payment has been described as: "an ordinary English word, ... not a term of art", with "a flexible meaning depending on the context in which it is used".[2] That is true of all income-recognition vocabulary. But there is a core meaning worth investigation.

"Payment" is often defined, and occasionally an attempt is made to define "receipt":

Expression	**Context**	**See para**
Earnings *received* in a tax year	Employment income	34.12
Benefit *received* by a beneficiary	s.731; s.87	50.5; 61.8

I do not discuss any definitions here: this chapter considers the general meaning of these terms when there is no (or no meaningful) definition.

The following topics are also related, but I consider them elsewhere:

Topic	**See para**
Transfer of income stream	54.2
Beneficial ownership/entitlement	App 6.2
Transparent/opaque	90.6

15.2 Paradigm contexts

The following are not the only the contexts in which income-recognition vocabulary is used, but they are paradigm cases, in which their meaning is most commonly discussed.

15.2.1 *Receipt/entitlement basis of liability*

ITTOIA generally imposes liability to income tax on the person "receiving or entitled" to the income. For instance, s.371 ITTOIA provides:

> The person liable for any tax charged under this Chapter is the person *receiving or entitled to* the interest.

It would be convenient to coin a short name for this rule but I cannot think

[2] *Clark v HMRC* [2020] EWCA Civ 204 at [50]. Also see Proctor, *Mann and Proctor on the Law of Money* (8th ed, 2022) chap 7.

of one. In earlier editions I tried "standard person-liable rule" but that is opaque. I now refer to this rule as the **"receipt/entitlement basis of liability"**. A clumsy label but I cannot think of better.

Under this rule there are two bases of liability, which I call **"the receipts basis of liability"** and **"the entitlement basis of liability"**.

The rule is set out each time there is a charge on a category of income, about 20 times in all. It may be useful to set these out in a table:

ITTOIA	**TOPIC**		**ITTOIA**	**TOPIC**	
Section	*Part:Chapter*		*Section*	*Part:Chapter*	
8	**2:**2	Trading income	385[3]	**4:**3	UK dividends
230	**2:**17	Adjustment income	404	**4:**4	Non-UK dividends
245	**2:**18	Post-cessation receipts	425	**4:**7	Purchased life annuities
271	**3:**3	Property income	554	**4:**11	Transactions in deposits
332	**3:**7	Adjustment income	581	**5**:2	Intellectual property
352	**3:**10	Post-cessation receipts	611	**5**:3	Film & sound recording
371	**4:**2	Interest	685	**5**:7	Annual Payments
381C	**4:**2A	Disguised interest	689	**5**:8	Misc Sweep-up Income

Whether such repetition actually benefits the reader might be debated. Perhaps it depends on who is the reader. But that ship has sailed.

In *Anson v HMRC*:[4]

> ... taxpayers can be liable to tax in respect of income to which they are entitled without receiving payment of that income. Examples include the income of an interest-in-possession trust[5] or of a partnership[6].

Similarly, *HMRC v BlueCrest Capital Management*:[7]

> ... there is no requirement that the partners should have actually received their allocated shares. What matters is the partner's entitlement to it, even if (for example) the partner is contractually obliged to plough it back into the business.

The INTM provides:

> **INTM180040 How HMRC arrives at a definitive view of specific foreign entities** [Dec 2023]
> Whether a member will be treated as a person "receiving or entitled to"

[3] This is in a non-standard form; see 15.6 (When are dividends recognised).

[4] [2015] UKSC 44 at [116].

[5] Citing *Baker v Archer-Shee*.

[6] Citing *Reed v Young* [1986] STC 285 at p.289; *Padmore v IRC* [1987] STC 36 at p.51.

[7] [2023] EWCA Civ 1481 at [72].

> the profits or other income in question will depend on the respective rights of the entity and its members in relation to such profits or income, and therefore on the legal regime governing those rights (see *Anson v HMRC* [2015] UKSC 44 and *Khan v HMRC* [2021] EWCA Civ 624).
> In *Khan* and in *Good v HMRC* [2023] EWCA Civ 114, the Court of Appeal (CoA) examined the meaning of "receiving or entitled to" for the purpose of ITTOIA05/S385(1)(b) and ITTOIA05/S611 respectively.
> In *Khan*, the CoA said the phrase "the person receiving or entitled to" is used in many other provisions of ITTOIA and it must be given a consistent meaning when denoting the persons chargeable to Income Tax. In both cases, the CoA held that the focus of the respective statutory provisions must be on the transaction giving rise to the income in question, that either receipt or entitlement will be sufficient to come within the scope of those provisions and that to satisfy the "entitled to" leg, it is not a requirement for a person to be "beneficially entitled" to the income in the sense used in other statutory provisions.
> In *Good*, the CoA confirmed that the words "entitled to" should be given their ordinary meaning. Whilst Andrews LJ, in *Khan*, considered it appropriate to use the term "belong(s) to" in that case, Whipple LJ considered that the point at issue in *Good* was different and it was better to stick to the words of the statute in determining the issue in that case.
> HMRC has further guidance on what this phrase means in the context of trade profits, interest and distributions at BIM15015, SAIM2400-10 and SAIM5020.

It can happen that one person receives income and another is entitled to it; then both are liable, but the person entitled has credit for tax paid by the person receiving. The TSEM provides:

> **TSEM9310: receiving or entitled to** [Sep 2021]
> The 'receiving' basis enables you to tax the person in receipt of the income, even if you cannot trace the person entitled to it. But ultimately you want to tax the person who is entitled. For example, in an interest in possession trust (TSEM1105), the trustees are initially taxable on the trust income because they receive it. But the IIP beneficiary is ultimately taxable on the trust income because he or she is entitled to it. So you tax the beneficiary on the income on the 'entitled' basis, and give credit for any tax paid by the trustees who received it.
> In sum, for the purpose of taxation of income, you want to establish who is 'entitled to' the income.

15.2.2 *Arising: Quantum of charge*

ITTOIA generally provides that the charge is on the amount, or full amount, of income arising in the tax year. For instance, s.370 ITTOIA provides:

> Tax is charged under this Chapter on the full amount of the interest *arising* in the tax year.

This rule is also set out each time there is a charge on a category of income, in a section placed just before the person-liable rule.

Corporation tax is the same. Section 8 CTA 2009 provides:

> (1) Corporation tax for a financial year is charged on profits *arising* in the year...
> (3) Corporation tax which is assessed and charged for an accounting period of a company is assessed and charged on the full amount of profits arising in the accounting period.[8]

There are two distinct points here.
(1) The tax charge is on (or limited to) the income which "arises".
(2) The tax charge is on the "full amount" of the income.

I discuss the meaning of "arising" here. The question of what constitutes the amount/full amount, ie whether expenditure is deductible, is discussed in the chapters on the type of income concerned.[9]

Under this provision income must "arise" but it does specify to whom the income arises. But sometimes it is necessary to identify the person to whom income arises, or to whom income is paid.[10]

15.2.3 *Payment: WHT*, *PAYE*

Interest withholding tax applies:

> if a *payment* of yearly interest arising in the UK is made...

by or to certain persons.[11] PAYE and other withholding taxes also apply on making a "payment".[12]

A complication of the word "payment" is that it is used in two senses:
(1) A narrow sense, meaning payment of money only
(2) A wider sense, including transfer of assets (non-money payments)

[8] Section 8(4) CTA 2009 flags exceptions:
"Subsection (3) is subject to any contrary provision in the Corporation Tax Acts."

[9] See 26.8 (Interest: Charge to tax); 33.17 (Sweep-up income: Computation).

[10] See 21.5 (To whom trading income arises); 26.21 (To whom is interest paid).

[11] See 26.20 (Interest withholding tax).

[12] See 32.10 (IIP WHT conditions A&B); 36.2 (Relevant payment): PAYE.

The narrow sense (payment of money only) is the more natural, or strict, or default meaning; but if there is an inference to that effect it is a very weak one, and context may easily show that the wider meaning is applicable.[13]

15.2.4 *Accruing: Gains*

Section 1 TCGA provides:

> Capital gains tax is charged for a tax year on chargeable gains *accruing* in the year to a person on the disposal of assets.

The terminology of the Taxes Acts is that gains are said to *accrue*; but income is said to *arise*.

15.2.5 *Profits of companies*

Section 2(1) CTA 2009 provides:

> Corporation tax is charged on profits *of* companies...

Here the (deceptively) simple preposition *"of"* takes the place of arising/accruing. But s.8 CTA 2009 refers to "profits arising" (to a company)[14] and the meaning is clearly the same.

15.3 Recognition/attribution: Analysis

At first sight the different items of (what I call) income-recognition vocabulary seem to raise distinct questions:

- does income arise, and if so to whom
- is there a receipt/entitlement, if so by whom
- is income paid, and if so to whom? *etc*

The significance of these questions is that they decide **"recognition"** and **"attribution"** issues:

- In what circumstances/at what point is income *recognised* as existing
- Once recognised, to which person is the income (in principle[15])

[13] *Irving v HMRC* [2008] EWCA Civ 6 held that the natural meaning of "pays a sum" is payment of money; but context showed the phrase included transfer of an asset; see at [38]. By contrast, in *HMRC v Sippchoice* [2020] UKUT 149 (TCC) context showed that "contributions paid" meant paid in money.

[14] See 14.3.3 (Assessment periods).

[15] The common law (should one say, common sense?) attribution rules discussed in this chapter are of course subject to other rules, typically anti-avoidance rules, under

attributed[16]

Where the word "arising"or "payment" is used in isolation, it indicates a minimum level below which some item is not (or not yet) considered to constitute income at all. The issue is income recognition. That is, unless and until income "arises" there is no recognition of income.

Where the reference is to income arising (etc) *to a person*, it requires some connection between the income and the person to whom, in some sense, the income belongs. The issue is income attribution.

Wheeler proposes that varied expressions of income recognition should be seen as raising the same issues, or essentially the same issues, namely income recognition and attribution.[17] The varied terminology conceals the fact that the issues are essentially the same. There may be differences of context, and one should adopt the appropriate statutory terminology, but in practice these expressions cover (more or less) the same ground. So it is helpful and indeed necessary to consider them together.[18] It is also helpful to use one word to refer to income which is arising/received/entitled to/paid, and I call this **"recognising"** income, though one might use the term "taxable".

This approach goes against the lawyer's instinct that different words should have distinct meanings. But that is not a rule to apply strictly in tax legislation.

Tax legislation generally gives only a brief, seemingly commonsense, statement of recognition/attribution rules. In simple cases the position is clear. In other cases it has been left to the Courts to sort out. The borders of income recognition have proved difficult to identify, and much can depend on the drafting.

which what constitutes income/gains of one person for non-tax purposes is treated as income/gains of another person for tax purposes: eg s.624 ITTOIA, mixed partnership code, s.3 TCGA; and (putting aside the issue of whether what is allocated is technically the same income) s.720 ITA, and CFC rules.

[16] A note on terminology: in this context "attribution" and "allocation" are synonymous; I prefer "attribution".

[17] *The Missing Keystone of Income Tax Treaties* (2012) para 2.4 (Attribution of income) and Appendix 2.

[18] This was acknowledged in *Girvan v Orange Personal Communications* 70 TC 602 at p.621 where a case on whether interest was *paid* was relied on when the issue was receipt/entitlement (for the receipt/entitlement basis of liability).

15.4 Glosses and paraphrases

Although the statutory vocabulary seems more than rich enough, the temptation to explain it with a gloss or paraphrase is irresistible, and the cases disclose a large number:

Get the money: In *IRC v Whitworth Park*:[19]

> Traders pay tax on the balance of profits or gains and bring money owed to them into account in striking that balance, but ordinary individuals are not assessable and do not pay tax until they get the money because until then it is not part of their income.

That does not help much. In *Dunmore v McGowan*:[20]

> Of course, ... that remark, "individuals don't pay tax until they get the money" begs the question: for what is meant by the word "get"? Read in isolation it does not take one very much further because one doesn't know without reading the whole of the *Whitworth* case what precisely is meant by "get".

Exactly the same applies to other short paraphrases or slogans, such as:

- receivability without receipt is nothing: *Leigh*
- *actual* receipt and not *notional* receipt: *Parkside Leasing*
- the *swelling of a person's assets: Dunmore*
- in the *enjoyment* of a person: *Dewar*
- could a person *make use* of the money: *Dewar*
- placed *at the disposal* of a person: *Parkside Leasing*
- *practical control* over the disposal of the funds: *Aberdeen*
- money has *"come in"*, a test said to derive from the word *income*

Perhaps inevitably, we also have references to a "real" payment;[21] but references to reality do not help much, if at all.[22]

15.5 When is interest recognised

The area which has given rise to most discussion is the taxation of interest, but similar points arise in other areas. In this section I also discuss investment management fees, and in the next section, dividends.

[19] 38 TC 531 at p.573.

[20] 52 TC 307 at p.316.

[21] See 15.5.3 (Credit to non-bank account).

[22] See App.7.1 (What do we mean by "Real"?); App 7.9.2 (Cardinal principle reaffirmed).

15.5.1 *Pre-ITTOIA case law*

Pre-rewrite case law will continue to apply:

> 1512. As the phrase ["receiving or entitled to"] is well established in case law, it is retained in the rewritten legislation. It is not, however, considered appropriate to include any further explanation of the phrase because of its wide interpretation by the courts.[23]

15.5.2 *Interest due, not paid*

In *Dewar v IRC* the taxpayer was executor of an estate under which he was entitled to a pecuniary legacy and interest. He paid himself the legacy but not the interest. The interest was not recognised as received:[24]

> ... you must find something which is in the enjoyment of the subject. He could make use of the money which lies abroad to his use. It is in that sense in his enjoyment. At the present time, upon the present facts, there is no enjoyment by Mr. Dewar, there is no gain by him, he has derived no profit and there is nothing in his hands which will answer the test of what you mean by 'income'.
> … *Leigh v CIR* ... says this:[25]
>
> > 'It is to be remembered that for Income Tax purposes "receivability" without receipt is nothing. Before a good debt is paid there is no such thing as Income Tax upon it'...
>
> Now it is said, and said truly, that it has not been received by Mr. Dewar or placed at his disposal owing to his voluntary act or omission; that is to say the interest has not been paid, not because the debtor cannot pay it, but because Mr. Dewar has not thought fit to ask for payment, and further has intimated the possibility of his releasing the debtor altogether

[23] For completeness, the Tax Law Rewrite make this comment on receiving/entitled to, in the context of interest:

> "1511 The phrase "receiving or entitled to" has been considered at length by the courts, although no clear definition of it has emerged. In early cases the courts placed greater emphasis on the concept of receipt than on entitlement - see, for example, *Dewar v IRC* 19 TC 561. Later, equal importance was attached to each part of the phrase - see, for example, *Aplin v White* 49 TC 93. The most recent cases, such as *Macpherson v Bond* 58 TC 579, and *Peracha v Miley* 63 TC 444, have hinged on whether or not any benefit has accrued to the taxpayer."

Much of this is debatable; but it is not necessary to pursue that here.

[24] 19 TC 561.

[25] 11 TC 590 at p.77.

> from payment of that interest. But ... the question is what income the man has received, and not what income he has received or but for his wilful default might have received.

15.5.3 *Credit to non-bank account*

Everyone agrees that a credit to a bank account constitutes payment/ receipt. The question concerns non-bank accounts.

In *Girvan v Orange Personal Communications*:

> I consider that it would require very unusual circumstances indeed before the internal arrangements of the debtor, unknown to the creditor and not, at least on the face of it, giving any new rights to the creditor, could alter the liability of the creditor to tax. It is true that the sums paid quarterly into the suspense accounts by the bank could be said to be no more and no less "the property" of Orange than any payments of interest would have been if credited to the [bank] deposit accounts in the name of Orange. However, that appears to me to ignore commercial common sense and practice. In my judgment, payment of money into a person's bank account (although it may be said to involve nothing more than an entry into the bank's computer records) would be regarded in the commercial world as payment, in a way that payment into an account set up by the bank in its own name for internal accounting purposes would not.

In two cases a credit entry in a non-bank account was recognised as a payment:

In *IRC v Doncaster* the credit was to a directors loan account used for crediting directors fees, dividends and interest:[26]

> … it simply went into that loan account. I can conceive nothing more complete in the way of payment. It was simply putting it to the credit of what is equivalent to a banking account.

In *Garforth v Newsmith*,[27] a bonus credited to a director's loan account was similarly held to have been paid. Likewise in *Aberdeen Asset Management v HMRC*:[28]

> In considering what amounts to payment for the purposes of the PAYE

[26] 8 TC 623 at p. 631.

[27] 52 TC 522, approved *RFC 2012 Plc v AG* [2017] UKSC 4 (the *Rangers* case) at [52].

[28] [2014] SC 271 at [34] approved *RFC 2012 Plc v AG* [2017] UKSC 4 (the *Rangers* case) at [53].

> legislation, it is important in my opinion to bear in mind that money is a medium of exchange. In practical terms, therefore, the crucial question is whether funds have been placed in a position where as a practical matter they may be spent by the employee as he wishes; it is at that point that the employee can be said to obtain the benefit of those funds. If the PAYE legislation is construed purposively it is in my view obvious that it is such a benefit that is to be taxed. For this purpose it is not appropriate to deconstruct the precise legal nature of the employee's rights, drawing fine distinctions according to the methods that he must adopt in order to use the funds for his benefit. The fact that the employee has practical control over the disposal of the funds is sufficient to constitute a payment for the purposes of the legislation.

But it is not always the case that an entry in books of account crediting an amount as due to a payee will constitute payment. If, for instance, under the terms of a loan the creditor has the right to add arrears of interest to principal, an entry in the creditor's books showing that the interest has been added to the principal will not amount to payment of the interest. See *Paton (as Fenton's Trustee) v IRC* 21 TC 626. The taxpayer had loan accounts with two banks. Interest was debited and added to principal. The question was whether the interest had been paid:

> it may well be that in a question between a bank and its customer … the interest accruing annually may by the sanctioned method of accounting cease to be interest when it is accumulated with the principal, so that the bank can thereafter no longer sue for the interest as interest. ... But it is manifest that it is only by a legal fiction that the interest in such cases as the present can be said to have been paid. After, as before, the striking of the balance the same sum remains due, no longer, it may be, as interest,[29] but still due as part of the principal debt.
> … what the Income Tax Act requires as the condition of repayment of tax on interest is that the sum due as interest shall have been actually discharged, not merely constructively paid. To warrant repayment of tax there must have been a real payment of tax and a real payment of interest without deduction of tax.

In *Paton,* the entry adding the accrued interest to principal was an entry in

[29] The question whether interest accumulated in this way lost its character as interest was answered in *IRC v Oswald* 26 TC 435, which held that when the debtor paid the interest which had been added to capital, the payment was interest (and so subject to withholding tax).

the books of the lender. In *Minsham,* interest was credited to the loan account in the books of the borrower and in the books of the lender. It was suggested that there might at least be a payment if a lender agreed to increase his loan by an amount equal to the accrued interest: the increase in the amount of the loan would constitute payment of the accrued interest. But the judge disagreed even with that:

> I find it difficult to imagine circumstances in which a transaction would fall to be analysed in this way even if cheques for the loan and the accrued interest were circulated. The practical effect would be the same as if the accrued interest were added to the principal (as in Paton's case) save only that if the interest were yearly interest the borrower would be bound or entitled to deduct tax from the interest, a result which the taxpayer at least would be unlikely to contend for...
> I do not, however, find it necessary to consider whether this is a possible state of affairs. In my judgment it is quite plain on the facts of this case that all that happened was that accrued interest was added to principal with the result that it was compounded and thereafter bore interest.[30]

What is the difference between *Doncaster/Garforth*, where the entries in the account did constitute payment, and *Minsham/Fenton*, where the entries did not? The director became entitled to the money when the entry was made in the sense that the director had the right (without consent of the company) to draw on the loan account.[31] This is why the directors loan account was "the equivalent of a bank account".

Because of the difficulty, or impracticability, of opening bank accounts, the issue of whether inter-company or other book entries are recognised as payment has become more important than before.

15.5.4 *Interest capitalised*

In *Paton (as Fenton's Trustee) v IRC* 21 TC 626

> in the case of such a provision as is contained in the present deed, which enables the interest to be capitalized, the interest is not capitalized because it is in fact paid, but because it has in fact not been paid.

SAIM provides:

[30] 63 TC 570 at p.587.

[31] It might be that a different rule applies to directors loan accounts. Another difference is that the credit there made a difference. A debt came into existence. The credit of interest to a non-bank account of the debtor/creditor generally makes no difference, for the interest is due before and after the credit. But these are not the key points.

SAIM9100: Deduction of tax: yearly interest: capitalised interest [Jun 2020]

In cases of capitalised or compound interest, the amount to be added to the principal sum at any periodic rest should be the gross amount of the unpaid interest. The right and duty to deduct income tax arises only when the interest is paid, and capitalisation does not constitute payment (see *CIR v Oswald (Trustee of the Cosier Settlement)* 26 TC 435 and *Minsham Properties v Price* 63 TC 570).

Tax in respect of interest has to be accounted for only when payment of the interest is actually made, that is, at the final settlement and not at the periodic rests. Where the interest is added to the principal without deduction of tax, the tax to be accounted for is the tax at the savings rate in force at the time of the final payment on the amount of interest so calculated.

Example (Kirsty)

K is a director of, and owns 90% of the shares in, K Ltd. She makes a loan to the company of £10,000. The loan carries interest of 10% per annum, payable annually on 31 December, but under the terms of the loan, interest may be rolled up and added to the principal, whereupon it will itself bear interest. In years 1 - 3, the company's funds are fully committed in paying trade and bank creditors, and K is unable to draw on her loan account. The situation is therefore:

	Interest credited	**Loan principal**
31 December Year 1	£1,000	£11,000
31 December Year 2	£1,100	£12,100
31 December Year 3	£1,210	£13,310

On 1 January Year 4, the company makes a repayment of £5,000 to K. It is agreed between the parties that this should be allocated first of all to interest, with the remaining balance treated as repayment of the £10,000 capital.

The company therefore makes an interest payment of £3,310 on 1 January Year 4. It must deduct tax at the basic rate from this payment, and account for the tax to HMRC.

'Payment' of the interest also occurs on this date for other statutory purposes. K will only be taxable on the interest in the tax year in which she receives it (SAIM2440). And for the company, interest debits that have not been allowed on an accruals basis because of CTA09 S373 (CFM35810) will become deductible.

15.5.5 *Credit to charged account*

In *Dunmore v McGowan,* the taxpayer charged a bank account as security for a guarantee. Thus he could not withdraw interest credited to the account. The interest was nevertheless "received" and so taxable:[32]

> every penny of that interest inured to the Appellant's benefit in any event; it swelled the assets of the Appellant on that day. The reasoning is this. If the guarantee ended without the interest being resorted to under the terms of the [charge], then the £347 would be withdrawable by the Appellant from the account in due course. If the £347 was resorted to under the terms of the [charge], then it would pro tanto reduce the personal liability of the Appellant under the guarantee. In either event every penny of the interest inured immediately to the benefit of the Appellant and to the full extent of the £347. Admittedly the money was locked up in the deposit account while the guarantee subsisted, but it was locked up in such a way that it inured to the Appellant's benefit at once, either as money coming to his hands or reducing his liabilities. Whatever might be the ultimate destination of the £347, it was in my judgment received by the Appellant on the day when it was credited to the second deposit account.

Coxon v HMRC[33] is another example of a case where interest subject to a charge was taxable.

15.5.6 *Uncashed interest cheque*

In *Parkside Leasing v Smith*:[34]

> To regard the payment of money into the payee's bank account as equivalent to the payment of the money to the payee is one thing. It reflects the part that banking arrangements play in the manner in which people arrange their financial affairs. Money credited to a person's bank account in accordance with his instructions must, in common sense and in law, be regarded as money thereby received by that person. The money is thereby placed at the disposal of that person.
> But the receipt of a cheque seems to me to stand on a rather different footing. The receipt of a cheque does not of itself place the sum for which the cheque is made out or the proceeds of the cheque at the payee's disposal. It is not certain that the cheque will be honoured. It may be cancelled by the drawer before it is presented. It may be dishonoured by the bank on which it is drawn. The drawer may die before the cheque can be presented.[35] The bank may fail before the

[32] 52 TC 307 at p.315.

[33] For another aspect of this case see 97.3 ("Unremittable" income).

[34] 58 TC 282.

[35] Section 75 Bills of Exchange Act 1882 provides:
"The duty and authority of a banker to pay a cheque drawn on him by his customer

> cheque can be presented. All these contingencies, and there may be others, may intervene between the receipt by the payee of the cheque and the receipt by the payee of the proceeds of the cheque. If the proceeds of the cheque are not received by the payee I do not see how it can be said that the sum therein comprised was at the payee's disposal. And if the proceeds are received by the payee I do not see how it can be said that they were received at an earlier date than they were in fact received.

While it is not certain that a cheque will be honoured, these contingencies might have been dismissed as too unlikely to matter. On the other hand, the rule may be said to be attractive as the date of payment of a cheque will be known, and the date of receipt of a cheque may be less clear. However that may be, the point is decided, at High Court level, and as cheques are rarely used now, the point is not likely to arise. On the basis that a cheque would normally be cashed promptly, it does not make a great deal of difference.

15.5.7 *Offset interest*

If two pre-existing cross-demands for money immediately payable are set off against each other by agreement[36] without the formality of handing the money over and handing it back again, the set-off constitutes "payment".[37]

Coxon discusses offset mortgages (back-to-back loans):

> For an offset arrangement to have the desired tax effect requires that debit and credit balances owed to and from the bank are offset, with interest being charged or paid by reference to the net balance. It is not sufficient that interest is calculated separately on the debit and credit balances and then the two interest amounts are offset. In the former case the contract between customer and bank determines that only one amount of interest is due (usually from customer to bank). In the latter, there is both interest income and interest expense for the customer, albeit the amounts may be directly or indirectly netted against each other

are determined by—
(1) Countermand of payment:
(2) Notice of the customer's death."

[36] It is different if there is no agreement: *Mellham v Burton* [2003] STC 441.

[37] See *Coren v Keighley* 48 TC 370 at p.375. The same point is made in *Lowry v Consolidated African Selection Trust* 23 TC at p.288: "You need not pass cheques backwards and forwards across a table".

in the books of the bank.[38]

15.5.8 *HMRC examples*

The SAI Manual provides:

> **SAIM2440: when interest arises** [Feb 2020]
> Interest 'arises' when it is received or made available to the recipient. Interest has been made available if it is credited to an account on which the account holder is free to draw.

That is correct where the account is a bank account.

The SAI Manual gives 4 examples:

Example	Facts	Received
1	Credit to bank account; withdrawal requires 30 day notice	Yes
2a	Credit to bond account; penalty for early withdrawal	Yes
2b	No credit until bond matures	Not until maturity
3	Interest paid late	Not until paid

> **Example 1 (Jonathan)**
> J has a building society account, on which interest is credited every 31 December. He is free to make withdrawals from the account, at 30 days' notice, but has not withdrawn money for many years. On 31 December 2017 he receives interest of £524, he should return the interest as income of year ended 5 April 2018, even though he has not withdrawn it.
> Interest can in practice often be treated as arising when it becomes due and payable. However, if a taxpayer does not actually receive interest (or have it credited to an account) until a later date, it does not normally form part of his or her taxable income until it is received.
>
> **Example 2[a] (Sam)**
> S entered into a five year fixed-term bond on 6 April 2017. The bond credits interest to S's account annually on the 31 December. S can only gain access to both the annual interest and the principal in advance of 5 April 2022 if a penalty is paid for early access.
> Since the terms and conditions of the bond allow S to draw on the funds, although with a penalty, the interest arises and is taxable each year as it is credited.

I wonder if bonds of that kind exist. They are not likely to be popular with investors within IT. Perhaps the example is intended as tax planning

[38] On the documents of the case *Coxon* was on the wrong side of this line.

advice to bond issuers.

With whom does S have the account? A bank account credit would be taxable. A credit to an internal account of the bondholder should not be taxable.

> **[Example 2b (Sam)]**
> If the terms and conditions of the bond did not allow access until maturity, the interest would arise and be taxed at that point.
> **Example 3 (Jennifer)**
> In January 2017, J makes a loan of £5,000 to her cousin to help him set up a business. They agree that interest will be payable quarterly in arrears at a rate of 5% per annum. But the business initially struggles, and J does not receive any interest until June 2018 when, after she threatens legal action, her cousin repays the debt along with interest arrears of £875.[39]
> J is not required to pay any tax on the interest until 2018/19 when it arises. However, the whole £875 is taxable when she receives it. She cannot spread the arrears of interest over the years in which it accrued.
>
> Interest on a judicial award should normally be regarded as arising on the date on which it is paid...
> **Ponzi Schemes**
> Cases where there is the potential for a Ponzi (and Ponzi-type) schemes to be involved in the return of interest contact Financial Products team at BAI for advice.

15.5.9 *Investment management fees*

The IFM discusses when disguised investment management fees arise.[40] The rules changed in 2015, but the discussion of the pre-2015 rules is relevant to the meaning of the word "arise" when undefined. The IFM adopts the approach of the interest cases. There is nothing surprising to be found here, but I set out the passage for completeness:

> **IFM36351 sums arising on or after 6 April 2015 and before 22 Oct 2015 A management fee arising to the individual** [Oct 2020]
> ... Prior to 22 October 2015 a management fee had to arise directly or indirectly to an individual...
> **Has the management fee arisen to the individual?**
> ... Generally sums arise to an individual when they are allocated to that

[39] Author's footnote: The correct amount of interest is £375, but nothing turns on that.
[40] See 73.5 ("Disguised-fee condition (c): from investment scheme").

> individual and that individual actually has access to the sum allocated.
>
> *Example - allocation and access to management fees [Michelle]*
>
> M is a fund manager. She has two sums allocated to her as a reward for management services provided to an investment scheme. She has immediate access to the first sum and on receipt she chooses to reinvest the fee into the fund. The second sum is allocated to her but, at this stage, payment is to be deferred for a period of time, after which it will then become accessible.
>
> The first sum that M receives has been allocated to her and made accessible. The evidence therefore indicates that the sum has arisen to M. In considering if the sum has arisen to the individual it is irrelevant how the individual has chosen to apply the sum after it is made available (i.e. here it has been reinvested).
>
> The second sum that has been allocated to M has been deferred; the evidence therefore indicates that this sum has not yet arisen to her. It will arise to her at the point it is not only allocated, but also made available to her.
>
> The above example also applies where reinvestment of sums arising is mandatory or is otherwise automatically achieved by the agreements which govern the fund arrangements. The fee is being used to meet an obligation of the individual so sums applied in this way will be treated as arising to the individual at the point they are reinvested...
>
> Any application of sums that would otherwise be paid to the investment manager does not stop them having arisen to that individual. The DIMF rules cannot be circumvented in this way.
>
> **IFM36356 Fact dependent circumstances (sums arising on or after 6 April 2015 and before 22 October 2015)** [Oct 2020]
>
> ... *Transparent structures*
>
> Where an intermediate structure is transparent for tax purposes, such as a partnership, this will not be effective in taking sums arising to the manager out of the DIMF rules.

Similarly, trading income of a partnership has been held to be "payable" to the partners.[41]

15.5.10 *Escrow arrangements*

> **IFM36351 sums arising on or after 6 April 2015 and before 22 Oct 2015 A management fee arising to the individual** [Oct 2020]
>
> *Escrow arrangements*
>
> The exact analysis will depend on the terms of the arrangement.

[41] See 48.7.1 (Trading/partnership income).

> Generally, where an amount is placed into escrow and the fund manager cannot access the funds (or property representing the funds) that sum will not arise to the manager. Instead the fee will arise when the sum is released from escrow and the fund manager gains access to it. For this treatment to apply the arrangement must be a genuine escrow or deferral arrangement implemented for commercial reasons in agreement with the external investors to the fund.

If an example is needed, see *Hannah v HMRC*[42] where consideration held on trust for the buyer pending completion of a sale contract was not "paid or provided" to the seller.

15.5.11 *Payment in specie*

In *Cross v London & Provincial Trust Ltd*:[43]

> ... income can be in the form of money's worth.
> ... if the holder of a security, the contractual income from which is money, receives from the person liable to pay that money something of money's worth, namely goods, instead of the money, such goods are income arising from the security.[44]

15.5.12 *Payment by issue of note*

In *Cross v London & Provincial Trust Ltd*:[45]

> [1] ... where there is a mere substitution of a promise to pay at a later date for the obligation to make an interest payment presently due, the owner of the security cannot be said to have received income from it. In such a case in truth that is exactly what has not happened, since the payment has been postponed instead of being made on its due date.
> [2] Nor do I see how it can make any difference if upon the true reading of the transaction the original obligation is extinguished and the promise to pay at a later date is accepted in its place.

Point [2] is an example of substance over form.

This rule was reversed for Funding Bonds[46] but when the Funding Bond

[42] [2021] UKUT 22 (TCC) at [33]-[43].

[43] 21 TC 705 at p.716.

[44] *Cross* refers to *Scottish and Canadian General Investment Co v Easson* 8 TC 265 where interest due on bonds issued by an old company was satisfied by debentures of a new company

[45] 21 TC 705 at p.716.

[46] See 26.6 (Funding bonds).

rules do not apply, the old rule continues, for instance, on the issue of a funding bond to pay interest on a debt incurred by an individual or trust.

In *Associated Insulation Products v Golder*[47] a company resolution:

(1) declared a distribution "payable on 15 December 1936"
(2) resolved that the distribution should be "payable in scrip in the form of a certificate of indebtedness." The certificate recorded that it was "issued in payment of a distribution". It took the form of a promissory note, and could be described as a funding bond.

It was held that income did not arise on the issue of the note, but on payment under the note; in terms of the current provisions, the issue of the note was not a payment of a dividend. The reality or substance of the transaction was a declaration of a dividend payable at a future date. The reader may find that surprising, but there it is.

This rule may be reversed for UK companies by the extended definition of distribution, but it continues to apply non-resident companies.

15.6 When are dividends recognised

15.6.1 *The statutory provisions*

I here set out the provisions relating to UK resident companies (the UK dividend regime). I consider the position of non-resident companies (the offshore dividend regime) separately, below.[48]

Section 384 ITTOIA provides:

> Tax is charged under this Chapter on the amount or value of the dividends paid and other distributions made in the tax year.

So dividends are recognised if they are *paid*[49] and other distributions if they are *made*.

Section 1168(1) CTA 2010 provides an artificial payment date:

> For the purposes of the Corporation Tax Acts dividends are to be treated as paid on the date when they become due and payable.

[47] 26 TC 231.

[48] See 15.6.7 (Offshore dividend regime). For these two regimes, see 30.1 (Dividends and distributions).

[49] Similarly, s.1000(1) CTA 2010 provides:
"In the Corporation Tax Acts "distribution", in relation to any company, means anything falling within any of the following paragraphs.
Any dividend *paid* by the company, including a capital dividend..."

In the following discussion:
The **"due date"** is the date that dividends are due and payable.
The **"actual payment date"** is the date that dividends are actually paid
The **"relating-back rule"** is the rule in s.1168(1): dividends may be said to relate back to the due date, on which they are deemed to be paid.

The relating-back rule applies to UK dividends but not to interest: interest is not treated as arising when due and payable, the tax charge on interest arises at the time that it is paid.

The relating-back rule is expressed to apply for the purposes of the Corporation Tax Acts.[50] But sch 1 Interpretation Act 1978 provides an artificially wide definition of this expression:

> "The Corporation Tax Acts" means the enactments relating to the taxation of the income and chargeable gains of companies and of company distributions (including provisions relating to income tax)

So the rule applies for income taxation of UK dividends as well as CT.[51]

The CT Manual discusses the relating-back rule:

> **CTM15205: dividends, distributions and company law** [Jun 2023]
> [The Manual refers to s.1000 and s.1168 CTA 2010 and continues:]
> What is meant by due and payable is discussed below but for present purposes it is sufficient to know that a dividend may become due and payable on an earlier date than the one on which it is actually paid.
> CTA10/S1000 (1) A and CTA10/S1168 (1) are interpreted as working together to deem a dividend as paid on the date it becomes due and payable. On this view the object of the predecessor of CTA10/S1168 (1) was to ensure that Advance Corporation Tax under the system abolished from 1999 was linked with the due and payable date even if actual payment of the dividend was not made until later. It is not interpreted as deeming as paid dividends that would not otherwise be paid but rather as fixing the date of payment by reference to the due and payable date once it is paid. It follows that a waived dividend is not regarded as paid.

If that is right, the questions are:
(1) When is a dividend due and payable

[50] If further authority is needed, see *Gould v HMRC* at [47].
A historical note: A similar rule applies to annual payments; see s.4, s.835 ICTA 1988; *IRC v Crawley* [1987] STC 147. However dividends ceased to classified as annual payments on the introduction of schedule F in 1965.

[51] See 30.4 ("Distribution").

(2) Has the dividend been paid:
   (a) If so, tax arises on the due date, if earlier,[52] (not the payment date)
   (b) If not there is no tax charge

Section 385(1) ITTOIA provides:

> The person liable for any tax charged under this Chapter [Chapter 3 Part 4, UK dividends] is—
> (a) the person to whom the distribution
> [i] is made or
> [ii] is treated as made (see Part 6 of ICTA and sections 386(3), 389(3) and 396A),[53] or
> (b) the person receiving or entitled to the distribution.

15.6.2 *When dividend due & payable*

"Due" and "payable" are synonyms; the expression is doublet which can be abbreviated to "due".[54]

When a dividend is due is a matter of company law, summarised in *Potel v CIR*:[55]

> *(1) Final dividend*
> (a) [under standard form articles] directors who recommend a final dividend have power at the same time to stipulate the date on which such dividend shall be paid.
> (b) If a final dividend is declared by a company without any stipulation as to the date for payment, the declaration of the dividend creates an immediate debt.

[52] It could theoretically happen that a dividend is paid before its due date, in which case it would also be treated as paid on the due date, not the payment date; but in practice that would only happen by accident.

[53] The reference to Part 6 ICTA is out of date; the other references concern specialist topics not discussed in this work:

s.386(3)	OEICs
s.389(3)	Authorised unit trusts
s.396A	Arrangements offering choice of capital or income return

The standard rule is extended in the case of deemed income, because no-one actually receives/is entitled to it. This is only for the avoidance of doubt: if a distribution is deemed to be made, it is not difficult to conclude that there is a deemed receipt/entitlement. But it does not matter.

[54] This is self-evident, but if authority is needed, see Garner, *Dictionary of Legal Usage* (3rd ed., 2011), entry under *Due.*

[55] 46 TC 658 at p.667.

> (c) If a final dividend is declared and is expressed as payable at a future date a shareholder has no right to enforce payment until the due date for payment arrives.

Thus:

> there is a difference between declaring a dividend and paying a dividend. The declaration of a dividend by a company in general meeting creates a debt enforceable immediately or in the future, according to whether the dividend is or is not expressed to be payable at a future date. The payment of the dividend is a different operation. It is an actual distribution of part of the assets of the company. The two processes, declaration and payment, are quite separate.

Different rules apply to an interim dividend:

> In the case of an interim dividend which a board has resolved to pay, it is open to the board at any time before payment to review its decision and resolve not to pay the dividend

In *Gould v HMRC*[56] a company declared an interim dividend, on terms that payments to the shareholders should be made on different dates.[57] As a matter of company law, the dividend became due on the specified dates (and the tax consequences followed accordingly).

Further consideration is needed if a company has non-standard form articles, or if it is governed by non-UK law.

The CT Manual provides:

> **CTM15205: dividends, distributions and company law** [Sep 2020]
> **When is a dividend due and payable?**
> ... a final dividend which has been properly declared and which does not specify a date for payment creates an immediately enforceable debt. If a final dividend is declared under the terms of a resolution that states that it is payable on a future date (a fairly common occurrence for quoted companies) then the debt is enforceable, and the dividend is due and payable, only on that later date. An interim dividend, on the other hand, may be varied or rescinded at any time before payment and may

[56] [2022] UKFTT 431 (TC).

[57] By way of background: One shareholder wanted his dividend paid in 2015/16, before the rates of tax on dividends increased; the other shareholder wanted his dividend paid in 2016/17 as he was then non-resident (and, no doubt, not temporarily non-resident). But the tax planning background was not relevant to the company law/tax law analysis.

> therefore only be regarded as due and payable when it is actually paid...[58]
>
> Where a final dividend is declared and the resolution fixes a later date for payment then the declaration creates a debt owing to the shareholder but the shareholder may take no steps to enforce payment until the due date of payment (or payments if by fixed instalments, see *Potel*). The due and payable date in such circumstances is the date fixed for payment and not the date of declaration.
>
> In many small private companies the directors and shareholders are identical and dividends are often credited to the directors' or shareholders' account with the company. In the case of a final dividend the dividend is due and payable on the date of the resolution unless some future date for payment is specified.

15.6.3 *When is dividend actually paid*

The CT Manual provides:

> **CTM15205: dividends, distributions and company law** [Sep 2020]
>
> **When is a dividend paid?**
>
> A dividend is not paid, and there is no distribution, unless and until
>
> [1] the shareholder receives money or
>
> [2] the distribution is otherwise unreservedly placed at the shareholder's disposal, for instance by being credited to a loan account on which the shareholder has power to draw. ...

This adopts the approach of the interest cases.[59]

> In the case of an interim dividend (which, see above, does not create an enforceable debt and which can be varied or rescinded prior to payment), payment is only made when the money is placed unreservedly at the disposal of the directors and shareholders as part of their current accounts with the company. Payment is not made until such a right to draw on the dividend exists, expected to be when the appropriate entries are made in the company's books.
>
> If such entries are not made until the annual audit, not uncommon in a small company, and this takes place after the end of the accounting period in which the directors resolved that an interim dividend be paid, then the due and payable date is in the later rather than the earlier accounting period.

[58] The paragraph omitted here concerns cheques, considered below.

[59] *Parkside Leasing* does not use the word "unreservedly", but that does not add anything except emphasis.

15.6.4 *Payment to blocked account*

In *Jays v HMRC*[60] dividends were credited to a blocked account, in wording which varied slightly from one dividend to another. The key terms were:[61]

> (1) KJ's 2014 dividend was "credited to a blocked account and held in abeyance so that [she] would not be free to draw upon it or have it credited to her loan account until further notice."
> (2) MJ's 2015 dividend was "credited to a blocked directors' account and not paid to or available to the director until it is mutually agreed that it in in the interest of both parties that it should be."
> (3) Of KJ's 2015 dividend, part was paid, and the balance of £73k was "held in a blocked directors' account so that Mrs Jays would not be free to draw upon it until further notice."
> (4) Of KJ's 2016 dividend "in view of the illiquidity of the company" part was paid and the balance of £16k was "credited to a blocked account and held in abeyance so that Mrs Jays would not be free to draw upon it or have it credited to her loan account until further notice."

These were final dividends, not interim dividends. The result was the same in all cases: the dividends were not "paid":

> 34. ... in each case it is clear that the shareholder in question has no immediate right to enforce the identified part of the dividend at the point at which it is declared, and that payment was deferred "until further notice" in the case of all KJ's dividends and "until mutually agreed" in the case of MJ's dividend. ... the declaration of dividends [was] subject to stringent stipulations which, in the view of the Tribunal, had the legal effect of deferring the date on which the stated proportion of the dividends was payable. This conclusion is not, in the Tribunal's view, precluded because of the absence of a date to which payment is deferred, in each case there was a mechanism by reference to which the date was to be determined (on further notice or as mutually agreed).

The position of a charged account was different.

15.6.5 *Uncashed dividend cheque*

For some reason a cheque to pay a dividend is traditionally called a

[60] [2022] UKFTT 420 (TC).
[61] at [33]; emphasis added in the original judgment.

"dividend warrant", but nothing turns on the terminology.

> **CTM15205: dividends, distributions and company law** [Sep 2020]
> **... What is meant by payment of a dividend?**
> A cheque is a written order addressed by a person (the drawer) to a banker to pay money, generally to some third party (the payee) and constitutes a promise to pay on common law principles (*Marreco v Richardson* [1908] 2 KB 584). The issuing of a cheque or dividend warrant (in effect a cheque drawn by the company on its bank in favour of the shareholder concerned) renders a dividend paid at that time. If the company's Articles so authorise, the sending of a dividend warrant by post will constitute payment and the company's liability will be discharged (see *Thairwall v Great Western Railway* [1910] 2 KB 509).

The CT Manual provides:

> **CTM15205: dividends, distributions and company law** [Sep 2020]
> **Uncashed dividends**
> Prior to 6 April 1999, under the ACT system on declaring a final dividend the company assumed two liabilities; a liability to the shareholder for the dividend and a liability to the Revenue for the ACT. There was nothing in the legislation which absolved the company from meeting its liability simply because the shareholder had received the dividend warrant [ie cheque] but had decided for some reason not to pay it into their own bank account, or to endorse it to another. The shareholder had effectively assigned and not waived income...[62]
>
> Companies [after the relevant time limit] might write back uncashed dividends in their books. This does not mean that any ACT accounted for at the time of payment could be repaid.[63]

Parkside Leasing held that receipt of a cheque for interest is not receipt of the interest. HMRC say that receipt of a cheque for a dividend is payment of a dividend. They could both be right, but it would be surprising.[64] As cheques are not now used, I expect that the point will never be decided.

[62] The omitted passage briefly discusses time limits to recover dividends, but a reader researching that point should turn to company law textbooks.

[63] Author's footnote: A claim for repayment of ACT would normally be out of time, by the time that the limitation period had passed; but the point is now academic.

[64] In the days of ACT it would have been inconvenient if receipt of a cheque for a dividend was not payment of the dividend, because a company needed to know whether to pay the ACT; but a company does not now care whether or when its dividend is regarded as paid for tax purposes.

15.6.6 *When is a distribution made?*

> **CTM15205: dividends, distributions and company law** [Sep 2020]
> Other distributions, such as premiums on redemption of redeemable shares, are 'made' rather than 'paid' and the date of making the distribution needs to be determined on the facts.

"Needs to be determined on the facts" is not exactly guidance. It is considered that the principles which govern when a money dividend is actually paid ought in principle to govern when a distribution is made. In *Jays v HMRC*:[65]

> the making of a distribution [like payment of a dividend] also requires that the recipient has an enforceable right to the assets of the company.

15.6.7 *Offshore dividend regime*

A different set of provisions applies to non-resident companies ("the offshore dividend regime"). These take the standard form: IT is charged on dividends or distributions *arising*[66] and the person liable is the person *receiving or entitled* to the dividends. The relating-back rule does not apply. But apart from that, the same rules apply. As is generally the case, nothing much turns on the choice of income-recognition vocabulary.

15.6.8 *Planning: Early dividends*

It is sometimes advantageous to pay dividends sooner rather than later. Examples are:

(1) An individual is non-resident (and not temporarily non-resident) in year 1 but UK resident in year 2. UK or foreign source dividends in year 1 are free of income tax.
(2) An individual is a remittance basis taxpayer in year 1 but deemed domiciled in year 2. Foreign dividends of year 1 qualify for the remittance basis.
(3) Tax rates in year 2 are higher than in year 1.

If the company has available funds to make the distribution that is straightforward. A problem arise if the company does not have the cash or assets in specie to fund a distribution. If the individual is a director, a dividend credited to a director's loan account should suffice.[67] In *IRC v*

[65] [2022] UKFTT 420 (TC) at [37].
[66] See 30.8.1 (Dividend: IT charge); 30.8.4 (Income-distribution: IT charge).
[67] See 15.5.3 (Credit to non-bank account).

Doncaster:[68]

> [the Directors] would probably leave this sum in that loan account where it was bearing very good interest and was very well secured ... for a long time. Well, they may do or they may not. They were not under any obligation to do so. If it was the intention that they should do so, it was only an intention in the form of a probably very well grounded hope, and a situation of that kind does not seem to me to bear any affinity at all to the sort of situation which Lord Finlay ... meant when he spoke of the money not being received, because he was speaking of a case where the shareholder had not any right to receive it at all.

If the individual is not a director, it is considered that the sum could still count as paid (or received) but left outstanding as a loan, if properly documented.

15.7 Waiver of interest/dividends

15.7.1 *Waiver: Navigation*

Waiver of interest/dividends may raise many tax issues in addition to recognition of income:

Topic	**Concerns**	**See**
Validity of waiver	All waivers	99.18.1
Recognition of income	Interest & dividends	*Discussed here*
Loan or credit transaction	Interest	26.26
Settlement-arrangement/settlor	Usually, dividends	99.18 - 99.19
Benefit from trust	Interest	50.4.2
Transfer of value for IHT	Interest & dividends	99.18.2

15.7.2 *Waiver: Income recognition*

Interest is not recognised as paid/received if waived before payment, even if waiver is after the interest is due.[69]

The same applies to dividends. The CT Manual provides:

> **CTM15205: dividends, distributions and company law** [Sep 2020]
> **Dividend waivers**
> The waiver of a dividend is only possible before payment. An act that purports to be a waiver after payment is no more than an assignment or

[68] 8 TC 623 at p.631.

[69] *Dewar v IRC* 19 TC 561; *Girvan v Orange Personal Communications Services* 70 TC 602.

> transfer of income...
> As discussed above[70] ... Income Tax liability depends on whether a dividend is, or is not, actually paid.
> A waiver can be effective for all future dividends, or for any future period of time, or for specific dividends.

15.8 Receipt by nominee/trustee

Nominees/trustees raise two sets of questions: the position of the nominee/trustee, and the position of the beneficial owner.

15.8.1 *IIP/settlor-interested trust*

Trustees (generally) receive trust income (eg if it is paid to their bank account). This amounts to receipt, for the purposes of the person-liable rule, even if another person (the life tenant or settlor) is entitled to the income. Trustees of IIP trusts, and of settlor-interested trusts, are therefore (generally) liable under the receipts basis of liability.

15.8.2 *Trustee of discretionary trust*

Trustees of a discretionary trust are "entitled" to trust income[71], and so are liable under the entitlement basis of liability; (though this would only matter if they mandate the income to another person, and so are not liable under the receipts basis of liability).

15.8.3 *Nominee/agent*

SAIM provides:

> **SAIM2400 Taxation Of Interest: The Tax Charge** [Dec 2019]
> ... *A person 'receiving' interest*
> The 'receiving' leg of ITTOIA/S371 comes into play only where someone receives the interest as an agent or bare trustee for another person...

In *Aplin v White* an estate agent paid clients' money into a deposit account and received interest. The interest belonged beneficially to the clients.[72]

[70] See 15.6 (When are dividends recognised).

[71] They are not beneficially entitled, but they are entitled in the sense that they, and no-one else, has the right to call for the income. Though one should hesitate to draw support from the different concept of DTA beneficial ownership, it ay be relevant to note that the same rule applies there; see 108.10.4 (DTA meaning: General).

[72] Although the interest belonged to the clients, the estate agent kept it for himself and did not pay it to his clients! In the circumstances the estate agent's argument that he

The agent was taxable as the person receiving the interest:[73]

> ... the expression of "receiving or entitled to" in the alternative, enabled an assessment under Schedule D to be made upon a person who either received the income or was entitled to it. If he received some income to which be was entitled and also some income to which he was not entitled, in the sense that he was a trustee or other person who received it in a fiduciary capacity for others, it mattered not: he could be assessed under Schedule D on it all.

SAIM provides:

> **SAIM2400 Taxation Of Interest: The Tax Charge** [Dec 2019]
> ... In practice, it is only in exceptional circumstances that HMRC would argue that an agent or nominee is chargeable to tax on interest - see examples 1 and 3 at SAIM2410. In such a case, the person receives the income in a representative capacity and not because they are beneficially entitled to it. It is not their income as an individual and under ITA07/S11 tax is charged only at the basic (and not the higher) rate, and because the income is interest, the savings rate applies by virtue of ITA07/S12.

SAIM2410 formerly included this example, deleted 2019, concerning income from stolen/misappropriated property:

> *Example 3 (Keith)*
> K holds a power of attorney enabling him to manage the financial affairs of his elderly mother. He opens an offshore amount in her name, in which he invests part of her capital. Interest is paid gross on this account, but is not shown either on K's tax return or his mother's.
> HMRC open an enquiry into K's business, and the HMRC officer discovers that money introduced into the business comes from his mother's account. K admits that the money was not a loan, and he did not have his mother's consent to use her funds in this way.
> K is liable to tax on the interest earned on the account at the savings rate, but not at the higher rate. He is the person receiving the interest,

had not received the interest was more than slightly unmeritorious. If the estate agent had paid the interest on to its beneficial owner, HMRC would pursue the beneficial owner and not the agents for the tax; see 121.5 (Reporting bare trusts). The question whether HMRC could still claim the tax from the agent should not arise, but if it did, *Asplin v White* might, perhaps, be distinguished for pragmatic reasons.
(One hopes that estate agents nowadays are more closely regulated).

[73] 49 TC 93. The quoted words are from Counsel's submission, set out at p.97, which the judge accepted at p.98.

> even if he is not entitled to it. However, it is not part of K's income and higher rate tax only applies to K's income.

Perhaps HMRC have doubts about that analysis, but what else could it be? This is almost self-evident, and if there could be doubt, the correctness of the example is confirmed by *Asplin v White*.

15.8.4 *Position of beneficial owner*

The Manual gives this straightforward example of nominees:

> **SAIM2410 Interest: Taxation Of Interest: Person Chargeable: Examples** [Feb 2020]
> *Example 1 (Harriet: Nominee investment account)*
> H holds a portfolio of quoted company bonds through a nominee. Although the nominee's name appears on the companies' registers of bond-holders, H is the beneficial owner of the bonds and the person entitled to the interest arising from them. H is therefore chargeable to tax on the interest.

The question may arise as to who is the beneficial owner, or when they become beneficial owner:

> **SAIM2410 Interest: Taxation Of Interest: Person Chargeable: Examples** [Feb 2020]
> *Example 2 (Mehta and Ian: Court Order)*
> M and her former husband I, receive the decree absolute being granted on 29 December 2016. On 5 December 2016, a Court Order is made ordering M to transfer certain assets to I. These include a building society account in I's sole name. On 31 December, interest of £2,400 is credited to the building society account. On 2 January 2017, M writes to the building society asking them to change the account from her name to I's, and the building society acts on the request a week later.

The HMRC analysis is as follows:

> Beneficial ownership of the account is transferred when the Court Order is made on 5 December 2016, even though the name on the account is not changed until later. (See the guidance at CG22423 on when assets are transferred on divorce or dissolution of a civil partnership - although this applies for capital gains tax purposes, HMRC would take a similar view where entitlement to interest is concerned.)
> I is therefore the person who is entitled to, and taxable on, the interest that is paid on 31 December 2016. There is no question of apportioning the interest for her period of ownership of the account - see SAIM2420.

Transparent entities raise income attribution issues; see 90.6 (Transparency issues).

15.9 Income recognition: Breach of trust

If a trust/company distributes[74] an asset in breach of trust law/company law, it acquires in principle[75] two rights against the recipient:

(1) A claim *in personam* for an amount equal to the sum distributed; and
(2) A claim *in rem* for the asset transferred, which the recipient holds on constructive trust for trust/company (transferor).

In *Ridge Securities v IRC*,[76] a company made an unlawful distribution. The unlawful distribution was not a "payment" (or at least not a payment within the meaning of the provision in point[77]). The purported payment was "a nullity" which had "no legal operation".[78] In short, a distribution in breach of trust is not recognised as income.

CT Manual provides:

> **CTM15205: dividends, distributions and company law** [Sep 2020]
> **Ultra vires and illegal dividends**
> The question whether a dividend is unlawful or not is not a tax issue. It is rather the application of company law to the particular facts, and the tax consequences flow from those facts. This is a matter in the first case to be determined by the company ... so it will normally be the company or its advisers who first raise the point. Officers should not in general seek out cases in which it might be argued that dividends that have been paid are unlawful. An exception to this will be where the dividend is

[74] I use the word "distribute" loosely. Although there may be a transfer of the bare legal title, it would be more accurate to refer to a purported distribution, or to use scare quotation marks.

[75] Further thought may be needed if a foreign law applies.

[76] 44 TC 373.

[77] Section 169 ITA 1952 (not found in the current law).

[78] 44 TC 373 at p.395-396. HMRC apply this analysis in the context of Gift Aid; see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 9.7.5 (Unlawful distribution: Tax).
Likewise in *Russell Baker v HMRC* [2013] UKFTT 394 (TC) a company's purchase of its own shares in breach of company law was void, and the purported payment of the purchase price (held on constructive trust for the company) was not a distribution under the standard tax definition. Similarly, no chargeable gain would arise on a disposal (or purported disposal) in breach of trust because the transferee would hold the property on constructive trust for the transferor.
See too 50.4.11 ("Benefit" in breach of trust).

> paid as part of some avoidance scheme.
> There is a significant difference in the treatment of improperly paid dividends dependent upon the position of the recipient.

The Manual refers to s.847 Companies Act 2006:

> (1) This section applies where a distribution, or part of one, made by a company to one of its members is made in contravention of this Part.
> (2) If at the time of the distribution the member knows or has reasonable grounds for believing that it is so made, he is liable—
> (a) to repay it (or that part of it, as the case may be) to the company, or
> (b) in the case of a distribution made otherwise than in cash, to pay the company a sum equal to the value of the distribution (or part) at that time.

The Manual continues:

> No such liability exists in respect of a member who is an innocent recipient. The immunity of an innocent recipient shareholder is illustrated in *Re Denham & Co* [1883] 25 Ch D 752 and *Moxham v Grant* [1990] 1 QB 88. This principle relates mainly to the liability of a shareholder in a quoted company, who cannot be expected to have detailed knowledge of the day to day running of the company, but simply receives a reward for holding shares by way of dividend. When dealing with private companies controlled by directors who are shareholders, such a member ought to know the status of the dividend and it is expected that section 847 will apply in the majority of such cases.
> Where a dividend is paid and it is unlawful in whole or in part and the recipient knew or had reasonable grounds to believe that it was unlawful then that shareholder holds the dividend (or part) as constructive trustee in accordance with the principles stated by Dillon L J in *Precision Dippings Ltd v Precision Dippings Marketing Ltd* [1986] 1 Ch at page 457. Such a dividend (or part) is void for the purposes of both
> [1] the Income Tax charge on distributions under ITTOIA05/S383 and
> [2] the long abolished ACT charge under ICTA88/S14.
> The company has not made a distribution as a matter of company law, and so the dividend does not form part of the recipient's income for tax purposes. The company has not parted with title to the sum that it purported to distribute, which as a consequence remains part of its assets under a constructive trust (see also *Ridge Securities Ltd v CIR* (1964) 44 TC 373).
> Where the company concerned is a close company, it is regarded as

having made a loan to the shareholder by virtue of CTA10/S455(1), thereby triggering a charge under CTA10/S455(2).[79] Relief would however be available under CTA10/S458 where the dividend is repaid to the company. That repayment might be by cash or cheque, or by a suitable entry in the loan account.

A shareholder who had no knowledge of the illegality of the dividend and no reasonable grounds on which so to believe is not a constructive trustee and does not have to repay the sum, which will constitute a distribution under CTA10/S1000 (1) B.[80] If such a shareholder then repaid the company (although not liable to do so) this is simply a voluntary assignment or transfer of the shareholder's own income so that it does not affect the tax position. However, in practice it is desirable to consider all such cases on their particular facts and merits.

15.10 Retrospective acts/backdating

A related question is, could a receipt/entitlement/payment be nullified (or the other way round, could a non-receipt retrospectively become a receipt) as a result of:

(1) A court order, under a jurisdiction based on mistake, rectification, statutory divorce/insolvency powers etc

(2) Private powers:

Power	**See para**
Disclaimer/waiver	15.7
Assent	89.5
Set aside voidable transaction	*Not discussed*

I do not consider this in detail here, as I have considered it elsewhere.[81] In short, the issue is decided on an ad hoc basis; there is no general rule.

15.11 Income recognition in DTAs

Similar issues arise under the OECD Model, but the vocabulary is different.

15.11.1 *"Deriving" income*

OECD Model commonly refers to income "**derived by**" a person:[82]

[79] See 40.8 (Loan to participators).

[80] See 30.6.2 (Para B: Other distributions).

[81] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 10.6 (Backdating). The issue can arise in any area of tax, not just income recognition; eg see 62.11 (Loan to/from underlying co).

[82] This list is not comprehensive but includes the most common examples.

Art	**Outline of wording**
1	Income derived by or through a transparent entity
6	Income derived by a resident of a State from immovable property
10	A company derives profits or income from the other Contracting State
13	Gains derived by a resident from the alienation of immovable property
15	Remuneration derived by a resident in respect of an employment
16	Directors' fees derived by a resident in his capacity as a member of the board of directors

The usual UK tax terminology would be that the income (or gains) arise (or accrue) to the person from the property, or from a source in the other state, or the person receives/is entitled to it; but the meaning is the same.

The verb can be used transitively, as in "*a company derives profits or income*"[83], or *"persons deriving pensions"*[84]; where British English would say "receives/receiving".

This is not a neologism, nor is it restricted to OECD English. For instance, s. 6(1) [Australia] Income Tax Assessment Act 1936 provides:

> taxpayer means a person deriving income or deriving profits or gains of a capital nature.[85]

In British legal English, "derive" is commonly used in the context of property deriving from other property, ie property representing property.[86] It is not used as a synonym of income arising from property. The transitive usage seems particularly unidiomatic. But no practical difficulty should arise.

15.11.2 *"Paid" and "payment"*

In other places, the OECD Model uses other vocabulary, such as income of/arising to/paid:

Art	**Wording (in outline)**
	Income of
1	Income of a resident of a State
7	Profits of an enterprise of a State
21	Items of income of a resident of a State

[83] Article 10 OECD.

[84] From OECD Model Commentary on art 15.

[85] Likewise s.38(2) [New Zealand] Income Tax Act 1976, which provides for the payment of income tax "by every person on all income derived by him during the year".

[86] See App.2.9.3 (Derive from/represent compared).

Paid

10 Dividends paid by a company to a resident of the other Contracting State
15 Remuneration paid by an employer
18 Pensions paid to a resident of a State
19 Remuneration paid by a State

Arising

11 Interest arising in one State and paid to a resident of the other State
12 Royalties arising in one State, beneficially owned by a resident of the other State

Beneficial owner/owned

10,11,12 Beneficial owner[87]
–[88] Profits, income and gains owned by a resident of a State

The OECD Commentary provides:

> The term "paid" has a very wide meaning, since the concept of payment means the fulfilment of the obligation to put funds at the disposal of the creditor in the manner required by contract or by custom.[89]

This is the same as the English law approach to the word.[90]

15.11.3 *DTA recognition vocab compared*

The OECD Model expressions "derived" or "paid to" do not bring with them any specific requirement, or technical meaning. They are just more items in the vocabulary cluster used to describe the recognition and attribution of income, equivalent to UK domestic law received/ entitled to/arising, etc.

For instance, art 11(1) has *Gains derived from* and art 11(2) has *Gains from ...* Clearly the concept is the same. Thus the OECD Model makes no attempt to be consistent in its income-recognition vocabulary, and it does not use the words in any technical sense.

[87] See 108.10 (DTA beneficial owner rule).

[88] This form is not in the OECD Model but it is standard in UK Foreign Tax Credit articles; see 111.8.1 (Treaty-source rules). In this context "owned" is just another word in the income-recognition vocabulary cluster.
In the OECD Model, "owned" is used for capital but not for income, eg ("income derived or capital owned by a resident of a State"); except in the expression "beneficial owner", which has acquired a technical meaning of its own.

[89] Commentary on art 10 (dividends) para 7; on art 11 (interest) para 5; on art 12 (royalties) para 8.3.

[90] See 15.2.3 (Payment: WHT, PAYE).

CHAPTER SIXTEEN

SOURCE/RFI/TERRITORIAL PRINCIPLES

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16.1 Source/RFI: Introduction

The topics of this chapter are:

(1) Two concepts central to the territorial limit of IT:
   (a) Source of income
   (b) Relevant foreign income

(2) General territorial principles of UK taxation

16.2 Source: IT territorial limit

All UK taxes, and indeed all foreign taxes, have some territorial limits ("territoriality").

16.2.1 *UK IT territorial limit*

There is no single section which sets out a territorial limit for IT (or indeed for any other tax). Indeed, there is no single rule for territorial limits, though the rules share some common themes.

Section 368/577 ITTOIA provide:

> (1) Income arising to a UK resident is chargeable to tax under this Part [Part 4, Savings & Investment Income/Part 5, Miscellaneous Income] whether or not it is from a source in the UK.

> (2) Income arising to a non-UK resident is chargeable to tax under this Part only if it is from a source in the UK.

For categories of income within Parts 4 and 5, the test is one of source. IT is not charged on foreign source income of a non-resident. One might abbreviate "foreign source income" to "foreign income".

There are similar rules, though not in quite the same terms, for Part 2 ITTOIA (trading income), Part 3 ITTOIA (property income), and their CT equivalents.[1]

In *Colquhoun v Brooks*:

> The Income Tax Acts ... themselves impose a territorial limit,
> [1] either that from which the taxable income is derived must be situate in the UK
> [2] or the person whose income is to be taxed must be resident there.[2]

This is a statement of the territorial limits of IT in 1889.[3] It was reaffirmed in 1936 when the IT Codification Committee said:[4]

> ... a broad distinction between
> [1] UK income (which, generally speaking, renders the owner, whoever he may be, chargeable with tax) and
> [2] foreign income (which renders the owners chargeable only if he is a person residing in the UK).
> Although in the existing [Income Tax] Acts this is expressly stated only in relation to Schedule D, the universality of the principle has been recognised by the Courts.[5] It seems to us to be a fundamental principle of the [Income] tax...

In 1982 it was still "broadly correct".[6]

[1] See 21.4 (IT territorial limit: Trading); 21.6 (CT territorial limit: Trading); 24.3 (Territorial limits: Property income).

[2] 2 TC 490 at p.498.

[3] The passage can also been seen as stating, or at least illustrating, a more general principle of territoriality in taxation, see 16.11 (General territorial principle).

[4] (1936) Cmd 5131 para [44].

[5] The Committee refer to: *Whitney v IRC* 10 TC at p.112; *Marchioness of Ormonde v Brown* 17 TC 333 at p.344. Similarly, see *Perry v Aston* 19 TC 255 at p.280: "... the necessary limitation which is inherent in all our Income Tax legislation, namely, that what is taxed under or by virtue of this provision can only be either (1) income which is here, or (2) income of a person resident here." (This passage is in a dissenting judgment, but the majority did not disagree on this point).

[6] *Clark v Oceanic Contractors* 56 TC 183 at p.227.

One can say the same today; but with more emphasis on the qualification "broadly"; or a wider reading of the imprecise words at [1] (that there must be some kind of source in the UK).[7] For the general trend of recent years has been a gradual extension of the territorial scope of UK taxation.[8]

16.2.2 *Foreign IT territorial limits*

Most other countries adopt a similar approach, and it might be regarded as a general principle of international income tax law (if such a thing exists) that a state will not tax non-residents on foreign income.[9]

The UN says:

> International income taxation revolves around two main concepts—the concept of source and the concept of residence. Under their domestic tax law, countries will assert the right to tax income arising (or sourced) in their jurisdiction, and most countries will seek to tax residents on their income wherever arising.[10]

A tax on income from sources in and outside a country is best described as tax on **"worldwide income"**. In EU terminology the term used is limited/unlimited tax liability.

Originally, many, perhaps most, states taxed their residents only on income from sources within that state. The UK was not far from that position until 1914, when all foreign income was taxed on the remittance basis.[11] The general trend has been to extend income tax on residents from income from sources within the residence state to include worldwide income. Even now, some states continue to tax their residents on income only from sources within the state. The UK does not tax non-residents on gains from UK situate property, other than land or land-rich assets, and it

[7] See for instance 16.6 (No source/deemed source). *Colquhoun* is also authority for a general principle of construction relating to territorial limits in tax statutes: See App. 16.11 (Territorial principle).

[8] Examples are (1) Diverted Profits Tax; (2) Offshore Receipts in respect of Intangible Property; see 32.17 (Offshore receipts from IP); (3) Nonresidents holding UK land/land-rich assets.

[9] America is an exception, imposing worldwide taxation on its citizens even if non-resident.

[10] Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (2019) para 15 *https://financing.desa.un.org/sites/default/files/2023-03/manual-bilateral-tax-treaties-update-2019.pdf*

[11] See 17.2 (History of remittance basis).

does not always tax non-residents on UK source income.

16.2.3 *Source in UK tax law*

So, for Parts 4 and 5 ITTOIA, and for some other UK tax purposes:
(1) Income has a source.
(2) Every source has a geographical location.

There is no statutory definition of "source". The word has been paraphrased as "origin"[12] and "chief" or "originating" cause;[13] but these paraphrases are of no practical assistance. It has also been explained as either property or an activity (such as a trade, or services falling short of a trade but within the scope of misc sweep-up income); and it is certainly difficult to imagine a source which was not property or an activity.[14] I am not sure that that takes us much further.

The location of a source matters for various purposes, in particular:

Topic	**See para**
Taxation of non-residents	16.2.1
Definition of RFI	16.9.2
Withholding tax	26.22

16.2.4 *Source in DTAs*

The location of a source is also important for double tax treaties. DTAs sometimes lay down their own rules for locating a source (for treaty purposes) so it may be necessary to distinguish between UK domestic law source location and treaty-source location.[15]

16.2.5 *Source: terminology*

A note on terminology: UK tax statutes formerly used a variety of expressions[16] but now the standard phrases are:

[12] *Hart v Sangster* 37 TC 231 at p.235.

[13] *IRC v Philips' Gloeilampenfabrieken* [1955] NZLR 868. *https://www.kessler.co.uk/wp-content/uploads/2012/04/CIRvPhilips.pdf*
I discuss *Philips* in detail in the 14th edition of this work para 18.9.1 (IRC v Philips).

[14] *Spritebeam v HMRC* [2015] UKUT 75 (TCC) at [72]: "we cannot think of a source that could not be categorised as either property or activity.

[15] See 111.8.1 (Treaty-source rules).

[16] e.g. in section 65 ICTA 1988 (repealed) the test was whether a possession or security was "out of the UK", but that came to be understood to mean "having a source out of the UK"; see 26.11 (Rejection of situs approach).

(1) "income arising from a source in/outside the UK"; and
(2) "income arising in/outside the UK"

These expressions are synonymous.[17]

Similarly in the OECD Model, the phrases used are:

Expression	Article	Topic
Income from sources in a state	4	Residence
Payment arising from sources outside a State	20	Students
Income arising in a State	10/11/12	Dividends/interest/royalties

Again, the expressions *income arising from sources in/income arising in* are synonymous.

16.3 Approach to locating source

Different considerations naturally apply to different categories of income. This is discussed in the chapter on the specific income category concerned:

Type of income	See para
Trading	21.4.4
Interest	26.8
Royalties/intellectual property	32.4
Misc sweep-up income	33.19
Income from discretionary trust	41.3.1

This chapter makes general points about source which apply to more than one category of income.

Location is generally governed by case law, though occasionally statute chips in.

The IT rules for the location of an income source are different from the situs of asset rules for IHT/private international law.[18] It would aid clarity of thinking not to use the same word in both contexts, so in this book:

[17] An argument that there was a distinction between the source of income and the place where the income arose was rejected in *Bayfine v HMRC* [2011] STC 717 at [63]. This is also the view in Hong Kong: see 16.8 (Non-UK cases on source). The suggestion to the contrary in *Perrin v IRC* [2014] UKFTT 223 (TC) at [24] is *per incuriam.*

I have wondered if there might be a difference in that "income arising in a state" is more apt when referring to income which does not have a source; but I doubt if there is such a thing as income without a source: See 11.6 (No source/deemed source).

[18] See 102.1 (Concepts of situs).

(1) I use the term "**location**" of a source of income (abbreviated to location of income)
(2) I keep *situs* for IHT/international law concepts and CGT.

But the usage of "situs" in an income tax context is too well established to alter easily, and no difficulty ought to arise as long as one bears in mind that IHT/international law situs of assets, and IT location of source of income, may be different (though the rules often overlap).

It is considered that a source of income should be regarded as located in only one jurisdiction. This rule is necessary if source rules in tax law are to achieve the object of avoiding double taxation.

16.4 Do sources have a location?

The concept of the location of a source of income is sometimes said to be misconceived:

> Income itself does not have a geographical location.[19]

This is not an accurate statement of tax law. Every source of income has a location. In most cases it is easy to identify the location, as the same passage goes on to state:

> By long standing convention,[20] however, income is assigned a geographical location by reference to the location of the assets and activities that are used to generate the income. When all of those assets and activities are located in one State, that State may be considered to be the unambiguous source of the income.

The problem is how to identify the location in harder cases. The passage gives the example of trading income, the hardest case to locate a source:

> ... When some of the assets or activities generating income are located in more than one State, the source of the income is less clear. For example, business profits derived from the manufacture of goods in State A and their sale in State B have a significant relationship to State A and to State B. In these circumstances, some rules for determining source are needed.

[19] United Nations, Note on the Revision of the Manual for Negotiation of Bilateral Tax Treaties (2011) Para 2.

[20] Contrast the (misconceived) view that situs of intangible property is fictional: see 102.1 (Concepts of situs).

An American scholar makes the same point:

> ... the source of income is difficult to define. In fact, many public finance economists would claim that the concept lacks meaning in the majority of cases... the problem has been partially solved by arbitrary rules. ... Economists argue that defining the true economic source is almost impossible, because income has contributions from many countries.[21]

In cases where 2 or more states are involved, it is correct that there may be no "true" location of source of income in *economic* terms. However this is simply one of many cases where economists and tax lawyers reach different conclusions for the purposes of their different disciplines. Tax law must somehow choose connecting factor(s) to link a source to a state. There are many possible connecting factors, and the selection of the determining factor(s) must to some extent be arbitrary. It may matter so much what the rule is, as long as there is some rule and its application is clear.

16.5 Formal/substantive source rules

An American scholar draws an interesting distinction for rules which determine the location of a source of income: formal and substantive. This is helpful in identifying the policy issues which lie behind location of source rules:

> Source rules fall into two basic categories. The first category comprises formal rules. These rules do not attempt to trace the economic source of the income, but rather seek to achieve administrative ease and certainty. ... Consider the following example demonstrating the formal rule: Suppose a foreign corporation exists and all of its income is earned in the United States - it has no other business activity.[22] From an economic perspective, it is clear that a dividend paid by this foreign corporation to its shareholders is US-source. But it is foreign-source under the dividend rule, because the payor is a foreign corporation. Notice also that this means that the source of dividend income is under the control of the taxpayer ... The main reason behind this rule is that it is administratively hard to tax a dividend from a foreign corporation to foreign shareholders, but easy to tax a dividend from a US corporation.

[21] Avi-Yonah, *International Tax as International Law* (2007), p.27, 38.

[22] Author's footnote: A foreign corporation is non-resident for US tax purposes: there is no central management and control test for corporate residence.

> The rule for interest is also a formal rule, and it is the same as the rule for dividends ... This is fortunate because of the difficulty of distinguishing debt from equity in many cases; at least the source rule is the same. ...
>
> The other kind of source rule is the substantive rule, which attempts to trace the economic source of the income. The first one of these is the rule for royalties ... No universal consensus exists about what the source rule for royalties should be. Many countries have a source rule for royalties that focuses on the residence country; the place of ownership of the underlying copyright or the place of production (research and development). The American rule is a place of use rule, meaning that it focuses on where the copyright or patent is utilised. ...
>
> There are other categories in which a substantive rule applies. In services, for example, the place of delivery of service controls. ...
>
> The basic difference between formal rules and substantive rules is that the formal rules require one single determination (residence of the payor, residence of the seller, or passage of title), whereas substantive rules attempt to trace the economics of the transaction. Formal rules are generally relatively easy to administer, from both the IRS perspective and the taxpayer's perspective, whereas substantive rules may involve much more difficult determinations. For example, in the case of patents and copyrights, the rule requires determination of the location of use, which may be difficult to determine if it is used in many countries: it may be difficult to break up the income into where the service was actually delivered. Not all substantive rules are difficult to administer: real estate is relatively easy because the location of real estate governs residency, and location is simply to determine in real estate. Most of the important applications of substantive rules, however, are difficult to administer and are more difficult for the taxpayer to avoid because the formal rules are much more under the taxpayer's control.[23]

16.6 No source/deemed source

EN ITTOIA Vol II para 1639 notes that:

> Such chargeable amounts [capital receipts subject to income tax] could not therefore be said to derive from a "source" in the traditional sense.

Some provisions (such as s.830 ITTOIA, the definition of RFI) refer to income which arises from a source outside the UK. Other provisions (such as s.368/577, territorial limitation for Parts 4/5 ITTOIA) refer to

[23] Avi-Yonah, *International Tax as International Law* (2007), p.42.

income from a source in the UK. Income with no source raises an obvious difficulty here.

If no source exists, a source can be invested. One solution to this issue is to deem a source to exist, and to deem that source to be a UK or a foreign source. There are (at least) 2 provisions which adopt this technique, for the purposes of s.830 ITTOIA (definition of RFI). EN ITTOIA explains:

> 1640. Although the definition [of RFI] uses "income which arises from a source" in respect of all income within the definition, specific rules have been added, in view of [the comment in *Centaur Clothes Group s*et out above], in
> [a] sections 428(3) ITTOIA (deeply discounted securities)[24] and
> [b] 658(2) ITTOIA (... income from estates in administration),[25]
> to attribute a foreign source to the income in question to ensure that there is no doubt that the definition [of RFI] applies to these provisions.

These rules deem the income concerned to have a source out of the UK, so this part of the definition of RFT is met. An alternative solution would simply be to deem the income to be RFI, ie to bypass the definition. There are many routes to the same destination.

Two deemed source rules apply for s.368/577 (territorial limitation for Parts 4/5 ITTOIA). Section 368(3)/s.577(3) ITTOIA provide:

> References in this section to income which is from a source in the UK include, in the case of any income which does not have a source, references to income which has a comparable connection to the UK.

EN ITTOIA Vol II explains:

> 34. However, while the term "source" may apply to the majority of receipts chargeable to income tax it does not apply to all such receipts. "Source" is something from which income arises and not all sums charged to income tax are by nature income. "Source" may not be the appropriate term where the amount charged to tax represents a profit on a transaction which is not by nature income and would not be charged to income tax without a specific charge. Indeed, the chargeable profit may arise on the disposal of an income source.....
> 35. It has therefore been necessary to consider how to express the territorial scope in cases where there is no natural source of income.

[24] See 29.11 (DDS remittance basis).
[25] See 89.16 (Estate income remittance basis).

> 36. [Section 368(3) ITTOIA] is broadly worded to catch such income. Where the connection such income has to the UK is comparable to the connection that income with a source in the UK has to the UK, then it is treated for the purposes of this section as income from a source in the UK.

It may be that this concern was unjustified, but these statutory provision do no harm. They only apply for s.368/577 (and so for Parts 4/5 ITTOIA); they do not apply elsewhere, eg they do not apply for the definition of RFI.

16.7 Source of gains

UK domestic tax legislation does not use the word source in connection with gains of a capital nature, whether chargeable to CGT or IT. For instance:

- Foreign tax credit relief refers to gains *accruing in* a territory[26]
- CGT remittance basis applies to gains on a disposal of assets *situated outside* the UK

Although the word "source" is not used, it would not be an inappropriate term if it were used. The terminology itself does not matter.

In international tax law, capital gains are often said to have a source, which is taken to be the state where the asset is situate.

16.8 Non-UK cases on source

There are many Commonwealth cases, which ought to be helpful. It is of course necessary to consider whether the relevant Commonwealth legislation is differently worded from the relevant UK provision. This arises particularly for cases on the source of trading income.

A Southern Rhodesia statute imposed a charge on the amount:

> received by ... any person ... *from any source within the Territory* ...

In *Rhodesia Metals v CT*, the Privy Council said of this provision:

> ... numerous cases founded on the various Income Tax Acts, English, Australian, New Zealand and South African, were cited ...
> Their Lordships have no criticisms to make of any of those decisions, but they desire to point out that
> [1] decisions on the words of one statute are seldom of value in deciding on different words in another statute, and that

[26] See 111.8 (Foreign source rule).

> [2] different business operations may give rise to different taxing results.

Point [2] is obviously correct but we are here concerned with point [1]. The Privy Council continue:

> [3] If the charging words of the English statute are looked at,
>
> > "annual profits or gains arising to any person ... (ii.) residing in the UK from any trade wherever carried on, and (iii.) whether resident in the UK from any trade exercised within the UK";[27]
>
> they are obviously different from the Southern Rhodesian charging words,
>
> > total amount [other than capital] received by ... any person ... from any source within the Territory.
>
> [4] It is desirable, also, to point out that, at any rate for different taxing systems, income can quite plainly be derived from more than one source even where the source is business. For instance, in the case of the business of a railway company whose railway is situate abroad, as in *San Paulo (Brazilian) Railway v Carter*,[28] while the English company may be assessed in England on the whole of its profits because it carries on part of its business there, yet it could not be doubted that so much of the profits of the business as were in fact earned from running the railway in Brazil were derived from exercising a business in Brazil; and still less could it be doubted that the sums received by the company in Brazil were received from a source in Brazil.[29]

Lord Atkin correctly states at [4] that the Commonwealth legalisation and case law has no relevance to the (artificially wide) test of location of source of trading income for UK residents.[30] It is considered that the Commonwealth legislation does apply the same test as s.6(2) ITTOIA (trading income of non-resident). For this purpose the Commonwealth cases *are* persuasive authorities in the UK. For the object of the rules for non-residents is to avoid double taxation and ensure that income is taxed in one and only one jurisdiction. That object can only be achieved if there is an international "common law" on the subject. In practice this is the

[27] I have corrected a minor misprint in the law report. This is only a rough summary of the statutory wording, later s.18 ICTA, now rewritten in ITTOIA.

[28] 3 TC 407.

[29] [1940] AC 774 at p.788–9.

[30] See 21.4 (UK resident trader: IT).

view taken. For instance, the former International Tax Handbook referred to *Kirk*.[31]

The same applies to Hong Kong, where the charge is on profits "arising in or derived from Hong Kong".[32] *Smidth* is the basis of the Hong Kong case law.[33] The Hong Kong Revenue have issued useful guidance the **"Hong Kong guidance note"**. It is suggested that its status in an English court should be the same as that of a textbook. The Hong Kong guidance note provides:

> 4. Though the word "source" is not used in section 14, it has always been accepted by the courts that the words "arising in or derived from" raised the concept of source. Cases from other common law jurisdictions with legislation using the specific word "source" are therefore relevant and have been used in assisting the interpretation of the words used in section 14. In *IRC v Philips Gloeilampenfabrieken* [1955] NZLR 868, Barrowclough CJ at 874 said that the concept of derivation seems necessarily to imply the concept of a source.[34]

In an Indian statute, the charge was on profits "accruing or arising in British India". This was held to be substantially the same as in Hong Kong.

> This authority can only be distinguished from the instant case if the words in s 14 'derived from' are given a much wider meaning that the words 'arising in'. Whilst it may be that there is some marginal difference in the shades of meaning conveyed by the two phrases, their Lordships do not accept that it can possibly be sufficient to bear the weight sought to be put on it in distinguishing *Mehta's* case.[35]

16.9 Relevant foreign income

16.9.1 *Why RFI matters*

The expression RFI is used so often in tax that it is not possible to provide a complete list. In particular:

[31] See ITH826.

[32] Section 14 Hong Kong Inland Revenue Ordinance.

[33] *IRC v HK-TVB* [1992] STC 723 at p.728.

[34] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No. 21 (Revised) Locality of Profits December 2012, *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

[35] *IRC v Hang Seng Bank* [1990] STC 733 at p.739.

(1) RFI is a requirement for:
  (a) the remittance basis
  (b) protected-trust reliefs
(2) There are special deductions for RFI collection costs[36]
(3) There is a relief for RFI of consular officials[37]

16.9.2 *"Relevant foreign income"*

Section 830(1) ITTOIA provides the definition of "RFI":

> In this Act[38] "relevant foreign income" means income which
> (a) arises from a source outside the UK, and
> (b) is chargeable under any of the provisions specified in subs.(2) (or would be so chargeable if s.832 [remittance basis] did not apply to it).

Section 830(2) ITTOIA sets out 15 categories of RFI:[39]

Chapter/s.	**Part**	**Topic**
Chap 2, 17	2	Trading income, Trading adjustment income
Chap 3	3	Property income
Chap 2	4	Interest
Chap 4	4	Dividend from non-UK resident company
Chap 7	4	Purchased life annuity
Chap 8	4	Deeply discounted securities
Chap 13	4	Sale of foreign dividend coupon
s.579		Royalties
Chap 3	5	Film/sound recording
Chap 4	5	Telecommunication rights
s.649		Estate income
Chap 7	5	Annual Payments not otherwise charged

[36] See 16.10 (RFI collection costs).

[37] Section 771 ITTOIA.

[38] The s.830 ITTOIA definition of RFI only applies for ITTOIA, but s.989 ITA extends it to the Income Tax Acts:

> "The following definitions apply for the purposes of the Income Tax Acts ... "relevant foreign income"
> [a] has the meaning given by section 830(1) to (3) of ITTOIA 2005
> [b] but also includes, for any purpose mentioned in any provision listed in section 830(4) of that Act, income treated as relevant foreign income for that purpose by that provision".

[39] For the sake of clarity, I set this out in table format, and substitute my terminology for the statutory section headings.

Chap 8	5	Misc sweep-up income

Section 830(3) ITTOIA makes two rather specialist exceptions:

> But "relevant foreign income" does not include income chargeable as a result of—
>
> (a) section 844 (unremittable income: income charged on withdrawal of relief after source ceases),[40] or
>
> (b) section 517C or 517E of ITA 2007 (profits on certain disposals concerned with land in the UK treated as trading profits).[41]

Section 830(4) ITTOIA signposts 10 provisions which direct that income is treated as RFI:[42]
For a further exception, see 58.7 (Redomiciled (ex-UK) securities).

For the treatment of other income as relevant foreign income, see—

Section	**Topic**	**See para**
s.857(3) ITTOIA	Partnership income	85.19
reg 19 OFTR	Offshore income gains	67.7
para 6(3) sch 3	Commonwealth Development Corporation Act 1999[43]	
s.575(3) ITEPA	Foreign pension	38.5.2
s.613(4) ITEPA	Foreign annuity	
s.631(3) ITEPA	Pre-1973 pension under Overseas Pensions Act 1973	
s.635(4) ITEPA	Foreign voluntary annual payment	
s.679(2) ITEPA	Taxable social security income: foreign benefit	
s.670A ITA	Accrued income profit	28.9
ss.726/730/735 ITA	Transfer of assets abroad: s.720/s.731 income	50.39

I coin the following terminology:
Actual RFI: RFI within the definition in s.830(1)(2)
Deemed RFI: income treated as RFI under another statutory provision

Section 830(4) ITTOIA is just an index of deemed RFI, intended to help the reader to navigate the legislation, in accordance with the principles of plain English drafting. In fact it is not quite a comprehensive index, as there are further provisions which deem income to be RFI and which are

[40] See 97.8 (Clawback of unremittable assets relief).

[41] See 22.5 (Transactions in land: Introduction).

[42] For clarity, I again set this out in table format, and substitute my terminology for the statutory section headings.

[43] The Commonwealth Development Corporation, now called CDC Group Plc, is deemed non-resident and its distributions are treated as RFI.

omitted from the s.830(4) list,[44] but it does not matter.

As far as I can see, it makes no practical difference whether income is actual RFI or deemed RFI. But there is a theoretical difference that:

(1) For actual RFI, it is a requirement under s.830(1)(2) that the income arises from a source outside the UK (and so that the income has a source).

(2) Deemed RFI includes categories of income which have no source. (This may be because the income is deemed income which does not exist and has no source; or because the income is a capital gain, treated as income, which is not regarded as having a source).

There are about 25 categories of RFI altogether. The categories includes almost all foreign income (other than employment income); in particular, they include trading income, property income, interest and dividends.

"Relevant foreign income" is a slightly narrower concept than "foreign income" because some types of foreign income are not "relevant foreign income." The most important category is chargeable-event gains.[45]

16.9.3 *RFI of non-resident*

Foreign income arising to a non-resident is not "chargeable"; so it is not actual RFI, because it does not meet the condition in s.830(1)(b).[46]

The rule that foreign income of a non-resident is not RFI is not wanted when applying RFI-type exemptions to provisions which may tax a UK resident on income of a non-resident (such as s.720/731, and s.624). In these cases, statute reverses the rule by a clumsy (but effective) formula, referring to:[47]

Settlor-interested trust: s.628A(3) ITTOIA	**ToA: s.726/721A(3)/735(2)/735A(4) ITA**
income which would be relevant foreign income if it were income of a UK	[income which] would be relevant foreign income if it were the

[44] Reg 16 and 97 OFTR; see 68.4 (Taxation of reporting-fund income); 68.7 (Non-reporting fund holds reporting fund)..

[45] See 70.5 (No remittance basis). That may be the only example of foreign income which is not RFI. I would be interested if readers can identify other examples of foreign income that is not RFI.

[46] Unless the temporary non-residence rules apply. It could be that some types of deemed RFI count as RFI even if payable to a non-resident.

[47] See 49.26 (s.720 remittance basis); 50.39 (s.731 remittance basis); 50.42.4 (Place relevant income in order); 92.9.1 (Condition A: RFI); 92.13.1 (Condition (a): RFI).

resident individual	individual's

The reason for the slightly divergent wording is that:

(1) In the case of settlor-interested trusts, the settlor may be resident or non-resident, because s.624 can apply to both.

(2) in the ToA cases, the transferor must be UK resident because s.720 only applies to UK residents.

The drafter sometimes uses the term "foreign income" to describe such income; in that case "foreign income" is used in a somewhat technical sense, which is not quite the natural sense. It should perhaps be written with initial capitals or scare quotation marks.

16.9.4 *Definition of RFI: Critique*

"Relevant foreign income" is not a helpful label, but no short label could do justice to the complexities.

It is suggested that "RFI" should be extended to include all income arising outside the UK.[48] All foreign income should qualify for the treatment currently given to RFI.

This is a simplification. The amount of tax involved is small because properly advised remittance basis taxpayers will not invest in foreign income which is taxed on an arising basis. The law is simply laying traps.

If, contrary to that view, there must continue to be special cases of foreign income which does not qualify for the remittance basis, they should be specified as express exemptions from the definition of RFI. We should not specify the categories of RFI: RFI should be all foreign income with specified exceptions.

The term RFI could then be replaced by the more transparent label, "foreign investment income" or "foreign income"; but terminology is perhaps a secondary issue.

16.10 RFI collection costs

Section 838(1) ITTOIA provides:

> In calculating the amount of relevant foreign income to be charged to income tax for a tax year, a deduction is allowed for expenses incurred outside the UK that are attributable to the collection or payment of the income.

[48] Except employment income, which has a separate code.

EN ITTOIA provides:

> This includes, for example, banking costs involved in the collection and forwarding of dividends...
> The deductions that are allowed are those solely concerned with the costs of handling the income. There is nothing in the legislation that confines those costs to costs involved in sending the money to the UK, so no such restriction has been imposed....
> ... the costs attributable to the collection or payment of income from a foreign trade are deductible.

Section 838(2) ITTOIA provides:

> Subsection (1) does not apply to income charged for the tax year in accordance with section 832 (relevant foreign income charged on the remittance basis).

No deduction is needed when the remittance basis applies, as income used in payment of the expenses will not be remitted.

It is suggested that s.838 should be repealed. This would be a simplification. The relief made some sense when introduced in 1914, as a sop to the newly imposed restriction on the remittance basis for foreign income,[49] and because the collection costs then may have been more substantial. But the amount of allowable costs now will not usually be significant.

16.11 General territorial principle

In *Colquhoun v Brooks*:

> ... Schedule D.... impose[s] the tax upon the annual profits or gains arising or accruing to any person residing in the UK from any trade, whether carried on in the UK or elsewhere. The Respondent does reside in the UK, profits did arise or accrue to him from a business carried on elsewhere than in the UK; therefore, say the learned counsel for the Crown, the case is within the very terms of the Act, and he must be held liable to assessment. ...
> It is urged, however, on behalf of the Respondent, that if this construction be adopted a foreigner residing for a short time only in this country would be subjected to taxation here in respect of the whole of

[49] See 17.2 (History of remittance basis).

> his business earnings in his own country or elsewhere,[50] that so to tax him would be opposed to international comity, and that a construction which would involve such a consequence cannot be correct.
>
> I think the learned counsel for the Respondent are right in saying that the result which they point out would follow in the case of a foreigner, but I do not feel satisfied that it would involve a violation of international law, and that the construction contended for by the Crown ought on that ground to be summarily rejected.
>
> Reliance was placed upon the decisions under the Legacy and Succession Duty Acts, which have imposed a limit upon the broad language of the enactments, subjecting legacies and successions to taxation. But it must be remembered that it was necessary to put some limit upon these general terms in order to bring the matters dealt with within our territorial jurisdiction. Without such a limitation the Legacy Duty Act, for example, would have been applicable although neither the testator nor the legatee, nor the property devised or bequeathed, was within or had any relation to the British dominions. A construction leading to this result was obviously inadmissible.
>
> The Income Tax Acts, however, themselves impose a territorial limit,
>
> [1] either that from which the taxable income is derived must be situate in the UK
>
> [2] or the person whose income is to be taxed must be resident there.
>
> If the latter condition be fulfilled, I think it is competent for the Legislature to determine the measure of taxation to be applied in the case of a person so resident.[51]

There are 2 distinct points here.

Firstly, *Colquhoun* is a *description of the territorial limits of IT* in 1889.[52] Secondly, *Colquhoun* is authority for *a general principle of territoriality,* or *a rule or principle of construction for tax statutes* (not just IT, as the reference to succession and legacy duty shows).[53] I here discuss the second aspect.

In *Clark v Oceanic* the general territorial principle was summarised thus:

[50] Author's footnote: It appears to have been accepted that the income (from a trade carried on abroad by a partnership of which the taxpayer was a partner) did not qualify for the remittance basis.

[51] 2 TC 490 at p.498.

[52] For the current rules, see 16.2 (Source: IT territorial limit).

[53] This principle of construction of tax statutes is in turn part of a broader principle of construction applicable to all statutes: subject to context, an enactment is taken as not applying outside the UK.

> ... the general principle ... is simply that, unless the contrary is expressly enacted or so plainly implied that the Courts must give effect to it, UK legislation is applicable only to British subjects or to foreigners who by coming to the UK, whether for a short or a long time, have made themselves subject to British jurisdiction. Two points would seem to be clear: first, that the principle is a rule of construction only, and secondly, that it contemplates mere presence within the jurisdiction as sufficient to attract the application of British legislation. Certainly there is no general principle that the legislation of the UK is applicable only to British subjects or persons resident here. Merely to state such a proposition is to manifest its absurdity. Presence, not residence, is the test.[54]

If territorial requirements are totally absent in a statute, some requirements will be implied. If territorial requirements in the statute are insufficient, some further requirements will be implied. However, as befits a principle of construction, the question of what requirement or further requirement may be implied is context-sensitive: there is no fixed, absolute, universal or prescriptive rule.

It is easy to say that UK tax must have territorial limits, and hard to say what those limits must be in any particular case. International comity is a high level principle which does not help much in practice, and context only takes one so far. But illustrations from case law offer the guidance as to the Court's approach in applying a general territorial principle.

16.12 Territorial principle: Application

16.12.1 *Application in tax cases*

The outcome in *Colquhoun* now seems self-evident.[55] The Income Tax Act set out what are now seen as internationally accepted territorial limitations of IT, and nothing further needed to be implied by applying the general principle of territoriality.

Clark v Oceanic concerned the territorial limit of PAYE: was a non-resident employer required to deduct tax under PAYE?[56] PAYE already had the territorial requirement of the ITEPA charge on earnings. Two of

[54] 56 TC 183 at p.221; the passage was approved in *Jimenez (R, oao) v FTT* [2019] EWCA Civ 51 at [14].

[55] Presumably the position seemed less clear in 1889.

[56] See 36.4 (Duty to deduct PAYE).

the five judges were "attracted" to the view that no more need be implied by the general territorial principle. But in order to reach a 3:2 decision, and leave the law in a reasonably workable state, they adopted the compromise view that a little more was needed: the employer had to have what was called "tax presence". That (novel) requirement was satisfied by the fact that the employer had a place of business and address for service in the UK. (The minority adopted the view that the territorial principle restricted PAYE to employers who were UK resident; but that is not the law).

Agassi v Robinson concerned the territorial limit of the entertainers/ sportspeople code: on payment of a sponsorship fee from one non-resident (Nike) to another non-resident (Agassi Inc), was the payor subject to UK withholding tax?[57] The code already had a tenuous territorial requirement,[58] but that fell far short of the "tax presence" requirement judged the minimum sufficient for PAYE. However it was held (this time by 4:1, but reversing the CA) that the territorial requirement of the Entertainers/Sportspeople code was sufficient. Nothing further was to be implied:

> (1) I am impressed by the Revenue's point that, if Mr Agassi is right, the ease with which the tax liability imposed by [the entertainers/ sportspeople code] could be avoided simply by ensuring that the potentially taxable payments were made by foreign entities with no residence or trading presence in this country would render payment of the tax to all intents voluntary. That cannot, in my opinion, have been Parliament's intention...
>
> (3) ... The whole point of [the code] is to subject foreign entertainers or

[57] For completeness: The appellant was Mr Agassi, not Nike, and the issue was whether Mr Agassi was subject to income tax, not whether Nike was subject to withholding tax. But the two questions were the same question, because the then legislation only imposed a tax charge on the individual if the withholding tax applied. So the individual taxpayer (Mr Agassi) could succeed in the argument that the implied territorial limit exonerated the payor (Nike) from withholding tax, he would win because that in turn exonerated him from the personal tax charge.

The legislation was subsequently amended on this point; see 23.3 (Charge independent of withholding tax). Had that been done sooner, then Mr Agassi could not have appealed the tax liability, and Nike might have had a stronger case on withholding tax. But that change does not alter the rule that the withholding tax under the entertainers/sportspeople code does not require a "tax presence".

[58] See 23.2.2 (Relevant (taxable) activity); 23.5 (Connected payment/transfer).

> sportsmen to a charge to tax on profits on gains obtained in connection with their commercial activities in the UK. Payments to foreign companies controlled by them are to be treated as payments to them. The infrequent or sporadic nature of their commercial activities and presence in the UK and the difficulty of collecting from them the section 556 tax on their profits and gains from those activities was one of the reasons why the new collection regime was introduced .... To read into the statutory provisions a limitation preventing the collection regime from applying where the payer is a foreign entity with no UK presence and thereby relieving the foreign entertainer/sportsman from the charge to tax cannot, in my opinion, possibly be justified on the basis of a presumed legislative intention. I would hold that on the true construction of these sections the territorial limitation cannot be implied and that the statutory language should be given its natural meaning.[59]

It seems to me that *Agassi* constitutes a change in approach from *Clark v Oceanic* (as reflected in one dissenting judgment).

Jimenez (R, oao) v FTT[60] concerned the territorial limit of an information notice under sch 36 FA 2008. According to CA, the power to issue a notice already had one territorial requirement: the power is only exercisable on someone who is or may be liable for tax in the UK and so has at least that identifiable relationship with the UK.[61] The notice was served on a non-resident. CoA held (unanimously, but reversing the Court below) that no further territorial requirement should be implied: the power to issue an information notice is (more or less) a worldwide power:

> ... there are a number of factors which point towards HMRC being authorised by paragraph 1 to give a taxpayer's notice to someone outside the UK. The first is the subject-matter and purpose of the legislation. ... The prevention of tax evasion which will often have a cross-border aspect to it serves an important public purpose in maintaining public revenue. ... A paragraph 1 notice can only be given to someone who is or may be a UK taxpayer and it is this status rather than his place of residence which is key to availability and operation of the power.[62]

[59] 77 TC 686 at [17].

[60] [2019] STC 746.

[61] Different considerations might apply if the information notice was issued by HMRC at the request of a foreign revenue authority, as there would be no UK link.

[62] At [39]. The second reason which follows (based on the terms of sch36) does not seem persuasive, to say the least; but I omit discussion of that because it has limited relevance in other cases.

Other powers in sch 36 are more territorially constrained. For instance, it was implied that the power in para 10 sch 36 for an officer to enter business premises did not apply to premises abroad.[63]

These 3 cases concern withholding tax and information powers, the administrative side of tax. There are no modern cases on implied territorial requirements which focus on substantive charges to tax.

Of course each decision was rooted in detailed statutory provisions, which makes it hard to see the wood for the trees.[64] However in the light of *Agassi* and *Jimenez,* it is considered that *Clark v Oceanic* would not be decided the same way today. Under the doctrine of precedent the territorial requirements of PAYE are fixed at all levels below the supreme court, but the modern cases show that the *Clark v Oceanic* concept of "tax presence" (whatever that means) is not a principle of wide application. In the language of the doctrine of precedent: *Clark* is not (yet) overruled, but it may be "restricted to its facts"; which comes to more or less the same thing. We will not hear much more of "tax presence"; instead there is a firm reluctance to imply additional territorial requirements to a statutory provision unless that seems essential.

The reason for the change of approach may be that globalisation makes a stricter territorial principle of construction inappropriate; or that judges are more sympathetic than before to the needs of HMRC to collect tax, and to prevent avoidance or evasion. In the 2020/21 edition of this work I said:

> If that is right, the change of approach is permanent and the pendulum will not swing again. It will need a very strong case for the Courts to imply a territorial limitation beyond that (if any) set out in a tax statute.

This was now confirmed when SC approved the *Jimenez* decision in *KBR (R, oao) v Director of the Serious Fraud Office:*[65]

> In *R (Jimenez) v FTT* the Court of Appeal held that para 1 sch 36 FA

[63] at [33].

[64] This is self-evident, but if authority is needed see *KBR (R, oao) v Director of the Serious Fraud Office* [2021] UKSC 2 at [46]: "Judicial decisions concerning the effect of different statutory provisions may be instructive by way of analogy but they need to be approached with some caution because they are concerned with entirely different statutory schemes, often enacted for different purposes and operating in different contexts."

[65] [2021] UKSC 2 at [48/]

> 2008 empowered HMRC to issue a notice requiring a UK taxpayer resident outside the UK to provide information for the purpose of checking his tax position. Patten LJ identified two factors in particular which led him to that conclusion. The first ... was the subject matter and purpose of the legislation. The court was not concerned with the facilitation of private litigation but with the prevention of tax evasion which often has a cross-border aspect to it and which serves an important public purpose in maintaining public revenue. The second (at para 40) was that the strong policy objectives of conferring effective investigatory powers on HMRC were bolstered by the language of Schedule 36 itself. However, it is clear that in coming to his conclusion he was strongly influenced by two further factors... The first of these is that the powers conferred were expressly limited for the purpose of checking the taxpayer's tax position and this therefore meant that the powers were necessarily and only exercisable in relation to someone who is or may be liable for tax in the UK and who, to that extent, had an identifiable relationship with the UK. Accordingly, a notice under paragraph 1 could only be given to someone who was or might be a UK taxpayer and it was that status rather than his place of residence which was the key to the availability and operation of the power. ... Secondly, in Jimenez non-compliance with a notice was not made a criminal offence and so the presumption that a statute should not be construed as making conduct abroad a criminal offence had no application. ... Both Patten LJ and Leggatt LJ considered that the sending of an information notice to a UK taxpayer in a foreign State requiring him to produce information that was reasonably required for the purpose of checking his tax position in the UK did not violate the principle of State sovereignty or contravene any international obligation of the UK.

16.12.2 *Application in non-tax cases*

The general principle of territoriality in tax is part of a wider general principle of territoriality:

> In resisting the interpretation ... that the Human Rights Act has extra-territorial application, the Secretary of State places heavy reliance on what he describes as 'a general and well established principle of statutory construction'. This is ... that Unless the contrary intention appears, Parliament is taken to intend an Act to extend to each territory of the UK but not to any territory outside the UK... Unless the contrary intention appears … an enactment applies to all persons and matters within the territory to which it extends, but not to any other persons and matters. ...

> In the absence of an intention clearly expressed or to be inferred either from its language, or from the object or subject matter or history of the enactment, the presumption is that Parliament does not design its statutes to operate on its subjects beyond the territorial limits of the UK. ... That there is such a presumption is not, I think, in doubt. It appears ... to have become stronger over the years.[66]

[66] *Al-Skeini) (R, oao) v Secretary of State for Defence* [2007] UKHL 26 followed in *KBR (R, oao) v Director of the Serious Fraud Office* [2021] UKSC 2 at [21]. Note that all the recent tax cases were cited in this non-tax case.

CHAPTER SEVENTEEN

THE REMITTANCE BASIS

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17.23 Remittance basis for trustees: Pre-2007 transitional rules

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17.25 Divorce: Remittance liabilities
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17.27 Tax return: Unremitted RFI/gains

Cross references

I deal with this subject in four chapters:
(1) This chapter considers:
    (a) who qualifies for the remittance basis
    (b) the remittance basis claim charge
(2) Chapter 18.1: what counts as a remittance
(3) Chapter 19.1: remittance reliefs
(4) Chapter 20.1: mixed funds

The remittance basis as it applies to particular anti-avoidance rules is discussed in the chapter on those rules; see

Topic	See para
s.624 remittance basis	47.8
s.720 remittance basis	49.26
s.731 remittance basis	50.39
s.87 remittance basis	61.19

The following topics are considered elsewhere:

Topic	See para
Life tenant remittance basis user	42.5
Dividends: Remittance basis	43.10.3
Interest under remittance basis	43.9.4

17.1 Remittance basis: Introduction

Income tax and CGT employ two types or bases of assessment:

Basis	Rule
Arising basis	Tax charged all income/gains
Remittance basis	Tax charged income/gains received in the UK

The remittance basis applies (in short) when a foreign domiciliary receives:
(1) Foreign income/gains
(2) Deemed income/gains under the settlor-interested trust code, the ToA provisions and s.87 TCGA.

I use the following self-explanatory terminology:
"ITA remittance basis": applicable from 2008/09 for all tax purposes
"Pre-2008 remittance basis": applicable until 2008/2009; there were different rules for different types of income/gain, so one might specifically refer to **"pre-2008 RFI/CGT remittance bases"**.

17.2 History of remittance basis

It is not necessary for a practitioner to know the history of the remittance basis, but it makes an interesting story.[1]

Until 1914 all foreign income was taxed on a remittance basis.[2] Since then the remittance basis has been withdrawn, in stages, except for foreign domiciliaries.

In 1914 income from "securities, stocks, shares, or rents in any place out of the UK" was brought onto an arising basis.[3] This did not apply to foreign domiciliaries and non-ordinarily residents. Even those who were domiciled and ordinarily resident in the UK retained the remittance basis for foreign source income other than income from securities and rents. Hence the litigation to decide whether trust income was to be regarded as income arising from securities or from the trust.[4]

In 1940 the general remittance basis was further restricted, to (a) income from offshore trades, professions or vocations, and (b) income from offshore offices, employments or pensions.[5]

The same rules applied to companies as to individuals, until the introduction of corporation tax in 1965, which put UK resident companies onto an arising basis.

In 1974 the general remittance basis was finally abolished.[6] One driver[7] of the reform was an aspect of the Lonrho scandal, in which Duncan Sandys (a cabinet minister) was found to have received director's remuneration amounting to £130k. The amount itself was thought to be outrageous, but for good measure the sum was received in the Cayman Islands, and (presumably) claimed to be (un)taxed on the remittance

[1] See Avery Jones, "Taxing Foreign Income from Pitt to the Tax Law Rewrite—The Decline of the Remittance Basis", *Studies in the History of Tax Law* (Vol 1 2004) *https://www.kessler.co.uk/wp-content/uploads/2013/12/Remittance-basis.pdf*

[2] Section 100 Income Tax Act 1842.

[3] Section 5 FA 1914.

[4] See 42.9 (Life tenant: Source of Income).

[5] Section 19 FA 1940.

[6] Sections 22, 23 FA 1974.

[7] There may have been others. The exception was intended, perhaps, to encourage foreign trade. The pre-1974 law also allowed tax planning by splitting a single mixed UK and foreign based trade into separate UK and foreign source trades, the latter qualifying for the remittance basis. An arrangement of this kind was held to be successful in *Newstead v Frost* 53 TC 525.

basis.[8]

FA 2008 introduced the ITA remittance basis (new rules of what constituted a remittance) and the remittance basis claim charge.[9]

17.3 HMRC guidance

Most of the HMRC guidance is to be found in the vast RDR Manual.

The RDR Manual frequently makes its point by examples. In some cases the examples are straightforward and might have been better omitted in the interest of brevity.[10] In almost all cases the examples are padded out with irrelevant facts. I formerly thought that was intended, in the spirit of *Pooh-Bah*, "to give artistic verisimilitude to an otherwise bald narrative". But in fact the aim seems to be that the Manual should have a reading age of 11.[11] However that may be, this is an unhelpful method of explaining statutory provisions to grown-ups. The consequence is to make it quite unnecessarily difficult to identify the important points from the examples. I try to deal with this by editing or rewriting the example to identify the relevant point; I set the original text of the Manual in a footnote, so that the reader can see the source of what I have done.

The RDR Manual is updated from time to time, but no guidance can ever be up to date as long as tax reform continues at its present frenetic pace.

Earlier guidance was in the form of Q&As.[12] Most of the Q&As are superseded by the RDR Manual (published 2010) but some are still relevant.

17.4 "Foreign income and gains"

Section 809Z7(1) ITA provides:

> This section applies for the purposes of this Chapter [Chapter A1 Part 14, remittance basis].

[8] Whether the Inland Revenue accepted that claim is not in the public domain.

[9] See 1.9 (2008 reform: Assessment).

[10] But for the sake of completeness, and just in case some readers should find them helpful, I sometimes set them out.

[11] See App 1.9 ("Technical note").

[12] I refer to these as "**December 2008 Q&As**"; "**January 2009 Q&As**"; and "**March 2009 Q&As**". HMRC have removed the Q&As from their website but they are on
https://www.kessler.co.uk/wp-content/uploads/2012/07/December-2008-QandAs.pdf
https://www.kessler.co.uk/wp-content/uploads/2012/05/Jan2009QsAndAs.pdf
https://www.kessler.co.uk/wp-content/uploads/2012/07/March-2009-QandAs.pdf

So s.809Z7 gives chapter-wide definitions. In accordance with the principles of Plain English drafting, the Chapter contains occasional (strictly unnecessary) pointers to the definitions.[13]

Section 809Z7(2) ITA provides:

> An individual's "foreign income and gains" for a tax year are—
> (a) the individual's relevant foreign earnings for that year,
> (b) the individual's foreign specific employment income for that year,
> (c) the individual's relevant foreign income for that year, and
> (d) the individual's foreign chargeable gains for that year.

For the definition of RFI, see 16.9.2 ("Relevant foreign income").

17.4.1 *Relevant foreign earnings*

Section 809Z7(3) ITA provides the definition of RFE:

> An individual's "relevant foreign earnings" for a tax year are—
> (a) if the individual does not meet the requirement of section 26A of ITEPA 2003 [Overseas Workday Relief] for that year, the individual's chargeable overseas earnings[14] for that year, and
> (b) otherwise, the individual's general earnings within s.26(1) of ITEPA 2003 for that year (non-UK earnings).

17.4.2 *Foreign specific employment income*

Section 809Z7(4) ITA provides:

> An individual's "foreign specific employment income" for a tax year ("the relevant tax year") consists of the income (if any) within subsections (4A) and (4B).

These subsections concern (1) employment-related securities and (2) disguised remuneration:

> (4A) The income within this subsection is the individual's specific employment income for the relevant tax year so far as it consists of foreign securities income for the purposes of section 41F of ITEPA

[13] Eg s.809C(6) ITA: "See s.809Z7 for the meaning of an individual's foreign income and gains for a tax year".

[14] Section 809Z7(6) provides: "In subs.(3)(a) 'chargeable overseas earnings' has the same meaning as in s.22 of ITEPA 2003 (see s.23 of that Act)." See 34.14 (Chargeable overseas earnings).

> 2003.
> (4B) The income within this subsection is any income, or any part of any income, of the individual—
> (a) to which section 554Z9(2) or 554Z10(2) of ITEPA 2003 applies, and
> (b) which consists of the value of a relevant step, or a part of the value of a relevant step, which is "for" the relevant tax year as determined under section 554Z4 of ITEPA 2003.

These are specialist topics, not discussed in this book, though I hope to cover them in a future edition.

17.4.3 *Foreign chargeable gains*

Section 809Z7(5) ITA provides:

> An individual's "foreign chargeable gains" for a tax year are the chargeable gains accruing to the individual in that year on the disposal of foreign assets (within the meaning of Schedule 1 to TCGA 1992).[15]

TCGA formerly used the defined term "foreign chargeable gains" but this is not used after the 2019 CGT re-write, which now refers to gains on the disposal of foreign assets (defined as assets situated outside the UK). The reader may think the previous terminology was satisfactory; but there it is.

17.5 "Clean capital" and income/capital

A sum which can be received in the UK without a taxable remittance is referred to as **"clean capital"**; (the expression might be misunderstood, but I adopt this terminology as it is used in the RDR Manual[16] and FA 2017 refers to "cleansing").

The most common examples of clean capital are:

(1) Funds which are not income/gains: inheritance, borrowed money
(2) Income/gains not taxable in the UK: income/gains of an individual who is non-resident at the time that the income/gains arise
(3) UK source income/UK gains: the remittance basis only applies to foreign income/gains
(4) Foreign income/gains which have been remitted to the UK

A sum which is taxable if remitted may be described as foreign income/gains (sometimes abbreviated to FIG).

[15] See 56.17 (CGT remittance basis).
[16] See 20.2.3 (When are funds mixed); 20.6.8 (Example 2).

The conventional capital/income distinction is not applicable in the context of the remittance basis. One might describe items (2)-(4) in this list as income, but they are "clean capital". Conversely, suppose a remittance basis taxpayer accumulates income offshore for many years; the accumulated fund might be said to be their "capital" in the normal sense of the word.[17] Yet for the purposes of the remittance basis, it is taxable if remitted.

17.6 Remittance basis: Who qualifies

After the traditional overview, in accordance with the principles of plain English drafting,[18] s.809B, 809D and 809E ITA set out three categories of individuals to whom the remittance basis applies:

ITA	My term	Requirement (in outline)
s.809B	Remittance basis claimant	Remittance basis claim
s.809D	Sub-£2k taxpayer	Unremitted foreign income/gains under £2k
s.809E	Non-taxpayer	No UK income/gains & do not remit foreign income/gains

The advantages of being in one of the two de minimis categories are:

(1) No claim is needed, so the taxpayer may not need to submit a tax return.

(2) The remittance basis claim charge does not apply, personal allowances remain available,[19] and the individual is not forced to make a CGT loss election.[20]

I refer to the three groups together as "**remittance basis taxpayers**".

HMRC prefer the term "remittance basis user" (HMRC do not like to use the word "taxpayer"[21]). I did not originally favour this neologism: we

[17] This is self-evident, but if authority is needed, see *Walsh v Randall* 23 TC 55:

> "... the accumulated income which he had derived from the drawings of the firm of which he was a sleeping partner. I have no doubt that he had come to regard this sum of money as capital. It was invested savings and it was in that sense capital ... That, however, is not, for Income Tax purposes, the test. To the Crown the [unremitted] income of a person residing in the UK is, as I gather, always income until it is taxed."

[18] Section 809A ITA provides: "This Chapter provides for an alternative basis for charge in the case of individuals who are not domiciled in the UK".

[19] See 44.6 (Allowances: remittance basis user).

[20] See 65.16 (Loss of remittance basis taxpayer).

[21] See App.1.5 ("Customers" of HMRC). HMRC do occasionally lapse and use the expression "remittance basis taxpayer".

do not (or at least, formerly, did not) refer to an "arising basis user" or a "herd basis user". But language evolves, parliament used the term in 2012 (see table below), and it has now become familiar and no longer seems strange. I still prefer to refer to "remittance basis taxpayers"; except in headings, where space considerations override, but either term must be regarded as acceptable.[22]

Statute generally uses a clumsy formula. For a remittance basis taxpayer:

> If the individual is UK resident and one of sections 809B, 809D and 809E of ITA 2007 applies to the individual ...

For an arising basis taxpayer:

> If the individual is UK resident and none of sections 809B, 809D and 809E apply to the individual ...

Just occasionally one sees more transparent terminology:

Term	**Used in**	**Introduced**
Remittance basis user	s.809Y - 809Z10 ITA	2012
Individual to whom the remittance basis applies	Sch 1 TCGA	2019
Remittance-basis individual	s.8C TCGA	2019

All these expressions are defined.

17.7 Remittance-basis claim: s.809B

17.7.1 *Entitlement to claim*

Section 809B ITA provides:

> (1) This section applies to an individual for a tax year if the individual-
> (a) is UK resident in that year,
> (b) is not domiciled[23] in the UK for that year, and
> (c) makes a claim under this section for that year.

I refer to the claim as a **"remittance-basis claim"**.

17.7.2 *Is a claim worthwhile?*

A claim gives the advantages of the remittance basis but has the following

[22] See *https://en.wikipedia.org/wiki/Headlinese*

[23] Section 809B(1A) ITA provides: "Section 835BA (deemed domicile) applies for the purposes of subsection (1)(b)." This is the standard wording to apply the deemed domicile rules.

drawbacks:

(1) Loss of personal allowances:[24]
   - (a) CGT annual exemption
   - (b) IT personal allowance (only a concern for those with taxable income up to about £100k as otherwise there is no personal allowance to lose[25])

(2) The need to make a CGT loss election

(3) Remitted dividends taxed at a higher rate than dividends taxed on an arising basis

(4) For long-term residents: the remittance basis claim charge

The effect of the remittance basis claim charge is to withdraw the remittance basis from long-term residents except the most wealthy, since a claim is not likely to be worthwhile for individuals whose income is much less than £150,000 in the year in question, though the position varies a great deal from one case to another.

For short-term residents, ie those not subject to the remittance basis claim charge, a claim is likely to be worthwhile as long as they expect to have foreign income in excess of the IT personal allowance (if available).

17.7.3 *Minimising cost of claim*

Basic tax planning for spouses will be to arrange that foreign income/gains accrue only to one of them, so only one spouse has to pay the remittance basis claim charge.

Basic planning for individuals who do not wish to pay the remittance basis claim charge every year is to time disposals and accruals so far as possible that foreign income/gains accrue:

(1) before the 8th year of residence, and

(2) only once every few years subsequently (so a claim is only needed once every few years).

Indeed this may be worthwhile even in the first 8 years, in order to mitigate the other drawbacks of a remittance-basis claim.

This is possible as a claim can be made in one year but not in another year. In 2015 HMRC proposed that an election for the remittance basis should last for a minimum of 3 years. But the idea was dropped, sensibly,

[24] See 17.7.2 (Is a claim worthwhile?).

[25] See 44.5 (IT allowances: high earners). For completeness: in rare cases the allowance may be saved by a DTA: see 44.8.2 (Remittance basis claimants).

in the light of the 15-year deemed domicile rule.[26]

17.7.4 *Remit. basis claim: US taxpayer*

Bober states:

> Generally, the ability to claim double tax relief will mean that an adult US citizen (or green- card holder) who is a long-term UK resident will achieve a better overall tax result (meaning that less tax will be payable overall) by being subject to UK tax on the arising basis. This is because the individual will generally be subject to US tax on a worldwide basis anyway. For many, while UK tax rates are in excess of US tax rates, the additional UK tax that will be payable on the arising basis will not be in excess of the £30,000 RBC payable if the remittance basis claim is made. This will not always be the case, though, as:
>
> - the individual may have specific issues meaning that some of their foreign income or gains are sheltered from the US tax net, and/or
> - the individual might be sufficiently wealthy that the difference between the higher UK tax rates and the US tax rate will mean that paying the £30,000 is worthwhile.
>
> In addition, some US citizens (or green-card holders) may prefer to pay tax on the remittance basis in the UK rather than try to determine the UK tax treatment with respect to some of the offshore investments they have, and make the necessary disclosure. Since the US and the UK tax systems are different the fact that an individual has to submit a US tax return showing worldwide income and gains will not necessarily mean he or she is in a position to complete a UK return without incurring significant additional compliance costs. Paying the RBC will avoid the need for this work and may result in privacy gains.[27]

17.8 Remittance basis claim: Procedure

The standard claim procedure rules apply, except that is not necessary for a remittance-basis claim to be quantified (ie to specify the amount of

[26] HM Treasury, "Summary of responses on minimum claim period consultation" (July 2015) *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/446552/Summary_of_responses_to_minimum_claim_period_consultation__July_2015_.pdf*

[27] Bober "The remittance basis charge – US issues" (2011) 9 TQR p.8 *https://www.step.org/step-journal/step-journal-january-2011/remittance-basis-charge-us-issues#:~:text=RBC%20is%20the%20name%20given,basis%20for%20the%20tax%20year*

unremitted foreign income/gains).[28]

A claim is made by ticking the relevant boxes in a tax return:

- Box 28 in form SA109 (Residence, remittance basis etc) 2022/23. The caption by this box reads: *If you are making a claim for the remittance basis for 2022–23, put 'X' in the box*
- Box 23 in form SA109 (2022/2023). The caption by this box states: *If you are domiciled outside the UK and it is relevant to your Income Tax or Capital Gains Tax liability for 2022–23, put 'X' in the box. Please explain in box 40 [Any other information] how your domicile is relevant to your Income Tax or Capital Gains Tax liability*

Further information relating to domicile is then required in boxes 24-27.

- Box 8 in form SA100 (2022/23). The caption by this box states: *Were you, for all or part of the year to 5 April 2023, one or more of the following: not resident / not domiciled in the UK and claiming the remittance basis / dual resident in the UK and another country?*

17.9 Sub-£2k taxpayer: s.809D

Section 809D ITA provides:

> (1) This section applies to an individual for a tax year if-
> (a) the individual is UK resident for that year,
> (b) the individual is not [actually] domiciled[29] in the UK in that year, and
> (c) the individual's unremitted[30] foreign income and gains for that year are less than £2,000.
>
> unless condition A or condition B is met.
>
> (1A) Condition A is that conditions A to F in section 828B are met.[31]
>
> (1B) Condition B is that the individual gives notice in a return under section 8 of TMA 1970 that this section is not to apply in relation to the

[28] See 123.2.4 (Remittance-basis claims).

[29] The deemed domicile rules do not apply: see 5.3.1 (Scope of IT/CGT deemed-dom).

[30] Section 809D(2) provides a commonsense definition of "unremitted":

> "The amount of an individual's "unremitted" foreign income and gains for a tax year is—
> (a) the total amount of what would (if this section applied) be the individual's foreign income and gains for that year, minus
> (b) the total amount of those income and gains that are remitted to the UK in that year."

[31] This relates to lower-paid employees see 34.42 (Lower-paid employee exemption). I do not understand the reason for condition A.

individual for that year.

Why should anyone wish to give a notice under s.809D(1B) ITA, and move from the remittance basis to the arising basis? The reason may be that the remittance basis (for modest incomes) involves too much trouble and expense: it may be more cost effective to pay tax on an arising basis. Another reason might be to facilitate double taxation relief.

17.9.1 *£2k limit in split year*

Foreign income arising in the overseas part of a split year is not subject to UK tax. However in considering whether the £2,000 threshold limit applies, the foreign income/gains for the entire tax year must be taken into account.

This is straightforward, but the RDR Manual gives an example to drive the point home:[32]

> **RDRM32120 Below £2,000 threshold users: Years of arrival and departure - interaction with ESC A11** [Jan 2019]
>
> ...
>
> *Example (Ferdinand)*
>
> F enters the UK on 20 October 2010, and is resident for the tax year 2010-11. He claims[33] split-year treatment under ESC A11.
>
> F's RFI is as follows:
>
> | | |
> |---|---|
> | 6 April to 19 October 2010 | £2,200 |
> | 20 October 2010 to 5 April 2011 | £1,300 |
> | Total | £3,500 |
>
> F remits £1,000 to the UK in that year.
>
> At the end of the year his total unremitted foreign income is £2,500.

The HMRC analysis is as follows:

> Even though F has claimed split-year treatment for 2010-11, he still has to include any foreign income that arose before he entered the UK.
>
> As F's unremitted foreign income is above the £2k threshold he cannot use the remittance basis under s809D. If he wishes to use the remittance basis he will need to claim under ITA07/s809B, and will lose his personal allowances and the annual exempt amount.

[32] I have slightly altered the wording of the example for enhanced clarity.

[33] It would be more accurate to say F "qualifies" for split-year treatment since the former concession A11 did not need a claim, and neither do the current split-year rules. But nothing turns on that.

The example needs to be updated, as the former ESC A11 was replaced by the statutory split year rules in 2013; but as far as the s.809D £2k threshold is concerned, the position remains the same.

In practice, F (if well advised) would not make a claim for the remittance basis but could save a few pounds of tax by remitting £1,500.01 to the UK instead of £1,000.

The same applies for chargeable gains and RDRM32130 sets out an example. But in practice it hardly matters.

17.9.2 *How to claim: s.809D*

There is no formal claim or election for s.809D to apply. However it is necessary to tick the relevant boxes in the tax return:

- Box 29 in the SA109 form (2022/23). The caption by the box reads: *If your unremitted income and capital gains for 2022–23 is less than £2,000, put 'X' in the box*
- Box 23 in the SA109 form (2022/23). The caption by this box reads: *If you are domiciled outside the UK and it is relevant to your Income Tax or Capital Gains Tax liability for* 2022-23*, put 'X' in the box. Please explain in box 40 how your domicile is relevant to your Income Tax or Capital Gains Tax liability* (There are further relevant boxes if this is the first domicile claim.)
- Box 8 in the SA100 form (2022/23). The caption by this box reads: ***Residence, remittance basis etc.*** *Were you, for all or part of the year to 5 April 2023, one or more of the following – not resident, not domiciled in the UK and claiming the remittance basis, or dual resident in the UK and another country?*

17.9.3 *Concession: Sub-£2k taxpayer*

HMRC Brief 17/09 provides:

> **Remittance basis users whose foreign income and gains is less than £2,000**
> Individuals making use of section 809D are still taxable on any foreign income or gains remitted to the UK. ...
> It is recognised that some individuals, in particular those on low income, may make small cash remittances to the UK, out of foreign income or gains, and as a result have to complete a Self Assessment tax return possibly to pay only a small amount of tax. This is particularly the case where foreign tax has already been paid on the income or gains. Where an individual who is making use of section 809D remits less than a total of £500 in cash, which arises from foreign income or gains, into the UK

> during the tax year, then HMRC will accept that such an individual does not need to make a Self Assessment Tax return simply to pay the tax on those cash remittances. However where such an individual is required to complete a Self Assessment tax return for any other reason, or HMRC serves them with a notice to make a return, then they will need to include those remittances on the return and pay the tax due. This practice will apply for 2008-09 and subsequent years.

This is a concession (the word concession is not used, perhaps because HMRC are not now supposed to issue concessions). A concession which only applies if HMRC choose not to require an SA return is a new development in tax, and setting the limit at £500 is difficult to defend, but the manner of introduction of the concession precluded any possibility of debate on it.

17.9.4 *£2k limit: indexation*

The £2k limit has not changed since 2008.[34]

In 2011 HMRC rejected lobbying to increase the £2k limit:

> ... the Government will not look further at the following:
> *Simplification* Increasing the £2,000 de minimis limit to align with the income tax personal allowance
> *Government response* The Government considers that this would be likely to have a material Exchequer cost. It would also restore the income tax personal allowance and CGT Annual Exempt Amount to some individuals with a significant level of income or capital gains and the Government does not think that this can be justified.[35]

The paper does not mention that the decision not to increase the limit since 2008 amounts to a reduction in real terms. Lobbying continues.[36]

17.10 Non-taxpayer: s.809E

Section 809E(1) ITA provides:

[34] See 43.19 (Inflation/fiscal drag).

[35] HMRC & HMT, "Reform of the taxation of non-domiciled individuals: summary of responses to consultation" (2011) para 2.127 *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf*

[36] Low Incomes Tax Reform Group, Response to (HMT) consultation document "Reforms to the taxation of non-domiciles" (2015) *http://www.litrg.org.uk/sites/default/files/files/151109-LITRG-response-non-dom-FINAL.pdf*

> This section applies to an individual for a tax year if—
> (a) the individual is UK resident for that year,
> (b) the individual is not domiciled[37] in the UK in that year,
> (c) for that year the individual either has no UK income or gains or has no UK income and gains other than taxed investment income not exceeding £100.
> (d) no relevant income or gains are remitted to the UK in that year, and
> (e) either—
> (i) the individual has been UK resident in not more than 6 of the 9 tax years immediately preceding that year, or
> (ii) the individual is under 18 throughout that year.
> unless the individual gives notice in a return under s.8 of TMA 1970 that this section is not to apply in relation to the individual for that year.

I refer to a person within s.809E as **"a non-taxpayer"**. Thus there are five requirements which must all be met. Requirements (a), (b) and (e) do not need comment.

17.10.1 *(Almost) no UK income/gains*

The requirement in s.809E(1)(c) ITA is:

> for that year the individual either has no UK income or gains or has no UK income and gains other than taxed investment income not exceeding £100.

Section 809E(2) ITA provides a commonsense definition:

> For the purposes of subs.(1)(c) the individual's "UK income and gains" for the tax year are the individual's income and chargeable gains for that year other than what would (if this section applied) be the individual's foreign income and gains for that year.

HMRC say:

> (25.2) If a non-UK domiciled, UK resident individual has
> [1] total UK source savings income for the tax year of less than £1,000,[38] and/or
> [2] total UK source dividend income for the tax year of less than

[37] Section 809E(1A) ITA provides: "Section 835BA (deemed domicile) applies for the purposes of subsection (1)(b)." This is the standard wording to apply the deemed domicile rules.

[38] ie, the income qualifies for the savings nil rate; see 43.9 (Savings nil rate).

> £5,000,[39]
>
> can HMRC confirm that income be ignored for the purpose of the test at ss809E(1)(c) ITA?
>
> **Answer**
>
> (25.2) We can confirm that this income can be ignored for the purposes of S809E(1)(c) ITA.[40]

This is concessionary but sensible.

Section 809E(1)(c) ITA allows a paltry£100 "taxed investment income". This term is defined in s.809E(2A) ITA:

> For the purposes of subsection (1)(c) "taxed investment income" means UK income or gains consisting of payments within s.946 from which a sum representing income tax has been deducted.

Now that UK bank interest is generally paid gross, it no longer counts as taxed investment income, so a trivial amount of bank interest would, strictly, forfeit the statutory exemption. But in view of the HMRC practice above, this does not matter.

17.10.2 *No income/gains remitted*

The requirement in s.809E(1)(d) is:

> (d) no relevant income or gains are remitted to the UK in that year

Section 809E(3) ITA provides the definition:

> For the purposes of subs.(1)(d) "relevant" income and gains are—
>
> (a) what would (if this section applied) be the individual's foreign income and gains for the tax year mentioned in subs.(1), and
>
> (b) the individual's foreign income and gains for every other tax year for which s.809B or 809D or this section applies to the individual.

Para 85 sch 7 FA 2008 contains transitional provisions for pre-2008 income/gains:

> (1) In s.809E(3)(b) of ITA 2007, the reference to a tax year for which

[39] ie the income qualifies for the dividend nil rate. From 2018/19 the figure of £2,000 replaces the figure of £5,000. See 43.10.2 (Dividend nil rate).

[40] Expatriate Forum Minutes Oct 2019 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/855596/Expat_Forum_minutes_10_October_2019.pdf*

> s.809B, 809D or 809E of that Act applies to an individual includes a tax year (not later than the tax year 2007-08) in which the individual—
>
> (a) was UK resident, but
>
> (b) was not domiciled in the UK or was not ordinarily UK resident.
>
> (2) In relation to such a tax year, the reference there to the individual's foreign income and gains includes the individual's relevant foreign income if (and only if)—
>
> (a) the individual made a claim under s.831 of ITTOIA 2005 for the year, or
>
> (b) s.65(5) of ICTA (or any earlier superseded enactment corresponding to that provision) applied in relation to the individual for the year.

Foreign income arising in the overseas part of a split year is not subject to UK tax. However in considering whether the s.809E exemption applies, the foreign income/gains for the entire tax year must be taken into account.

17.10.3 *Purpose of s.809E*

EN FB 2008 provides:

> Individuals entitled to claim the remittance basis who have no UK income or gains, and who don't remit any foreign income or gains, won't have to claim the remittance basis in years they are not liable to the RBC. This avoids them having to complete a self assessment return only so they can claim the remittance basis and then have no tax to pay.

There will not be many non-taxpayers within s.809E – mainly spouses accompanying their partners, children and some students, perhaps.

17.11 Time of foreign domicile

Section 809B(1) ITA requires (in short) that the foreign domiciliary is not domiciled in the UK in the year that the income arises.

It is an interesting question what is the position if a person changes domicile during a year.

17.12 Remittance basis claim charge

17.12.1 *7 & 12-year residence tests*

Section 809H(1) ITA provides:

> This section applies if—
>
> (a) s.809B (claim for remittance basis to apply) applies to an

individual for a tax year ("the relevant tax year"),

(b) the individual is aged 18 or over in the relevant tax year, and

(c) the individual meets the 12-year residence test or the 7-year residence test for the relevant tax year.

That takes us to s.809C ITA which provides:

> (1A) An individual meets the 12-year residence test for a tax year if the individual–
>
> (b)[41] has been UK resident in at least 12 of the 14 tax years immediately preceding that year.
>
> (1B) An individual meets the 7-year residence test for a tax year if the individual–
>
> (a) does not meet the 12-year residence test for that year, but
>
> (b) has been UK resident in at least 7 of the 9 tax years immediately preceding that year.

In the following discussion:

(1) The tests are the **"7/12 year residence tests"**

(2) Adopting the statutory terminology, individuals who meet the 7/12 year residence tests are "**long-term residents**".

The period of residence might be continuous or broken.

While an individual is under 18:

(1) they are not subject to the remittance basis charge; but

(2) any UK resident years do count for the 7/12 year residence tests.

In the year a long-term resident attains 18, the charge is payable in full. The RDR Manual provides a straightforward example of a case involving a minor.[42]

[41] Para (a) has been deleted.

[42] **RDRM32230 Counting years of UK residence - Minors** [Mar 2022]

> ...
>
> *Example (Pranav)*
>
> "P was born on 23 October 1991. He came to the UK as a school boarder in August 2001 (tax year 01-02). He is domiciled outside the UK. He has stayed in education in the UK for every tax year since.
>
> 99-00 Not Resident
> 00-01 Not Resident
> 01-02 Resident
> 02-03 Resident
> 03-04 Resident
> 04-05 Resident
> 05-06 Resident
> 06-07 Resident
> 07-08 Resident
> 08-09 Resident
> 09-10 Resident

A split year counts as a full year of residence in determining whether an individual meets the 7/12 year residence tests.[43] The RDR Manual offers a straightforward example of a case involving a split year.[44]

> In 08-09 P has foreign income of £300,000 and he claims to use the remittance basis in that year. He is a long-term resident in the UK as he has been UK resident for eight years, but as he is under 18 he may use the remittance basis in 08-09 without paying the remittance basis charge.
>
> In October 2009 (tax year 2009-10) P turns 18. He has foreign income of £400,000. If he wishes to claim the remittance basis for that tax year he will be liable to the remittance basis charge."

The (implausibly large) income specified is of course strictly irrelevant to the application of the remittance basis charge: the position is the same whatever is P's income.

[43] See 10.1 (Residence throughout tax year).

[44] **RDRM32220 Counting years of UK residence (seven out of nine)** [May 2022]

> ... *Example (Ralph)*
>
> R, a non-dom, is resident in the UK for the tax year 2019-2020.
>
> R came to the UK on 10 May 2006 (2006-2007 tax year)
>
> He left to live in Spain on 2 January 2008 (2007-2008 tax year)
>
> He returned to the UK on 12 October 2010 (2010-2011 tax year)
>
> He left to work in the Republic of Ireland on 29 April 2012 (2012-2013 tax year)
>
> He then returned to the UK on 16 May 2014 (2014-2015 tax year) and has been resident here since
>
> R is tax resident in the UK for the current tax year (2019-2020). He has chargeable overseas earnings of £150,000 in that year, paid into his Spanish bank account and he does not remit anything. For the last 14 tax years he has been resident/not resident as follows:

Count	Year	Residence status
1	2005-2006	Non-resident as did not come to the UK until 10 May 2006
2	2006-2007	Resident
3	2007-2008	Resident (the year he went to Spain)
4	2008-2009	Non-resident
5	2009-2010	Non-resident
6	2010-2011	Resident
7	2011-2012	Resident
8	2012-2013	Resident (the year he went to Ireland)
9	2013-2014	Non-resident
10	2014-2015	Resident
11	2015-2016	Resident
12	2016-2017	Resident
13	2017-2018	Resident
14	2018-2019	Resident

> Having calculated the number of years he has been resident in the UK R determines that in 2019-2020 he has not been resident in 12 out of the previous 14 tax years; so,

It may be useful to set out an aide memoire for when the 7/12 year tests begin to apply. Assuming a continuous period of UK residence:

UK residence from	**7-year test met**	**12-year test met**
2008/09	2015/16	2020/21
2009/10	2016/17	2021/22
2010/11	2017/18	2022/23
2011/12	2018/19	2023/24
2012/13	2019/20	2024/25
2013/14	2020/21	2025/26
2014/15	2021/22	2026/27
2015/16	2022/23	2027/28
2016/17	2023/24	2028/29
2017/18	2024/25	2029/30
2018/19	2025/26	2030/31
2019/20	2026/27	2031/32
2020/21	2027/28	2032/33
2021/22	2028/29	2033/34
2022/23	2029/30	2034/35

A 17-year residence test (and £90k remittance basis charge) was introduced in 2015, but lasted only 2 years as it was made redundant by the introduction of the 15-year deemed domicile rule in 2017. I previously discussed some policy considerations here,[45] but omit that now as the point is of historical interest only.

In *Radice v HMRC*[46] the taxpayer's advisers ticked the box in the 2015/16 tax return stating that he had been UK resident for 12 or more of the preceding 14 tax years. However, they should have ticked the box indicating that he was resident in the UK for 17 out of 20 tax years. Also, the date of entry to the UK in box 27 of the return was not completed. Accordingly, Mr Radice paid a remittance basis charge of £60k instead of £90k. But he had not been careless (and so was not subject to a penalty):

> In a situation such as this, it is the action of a reasonable and prudent taxpayer to obtain advice on the basis for and computation of charges to

if he claims the remittance basis in 2019-2020, he will not be liable to the higher remittance basis charge of £60,000. He has however been resident in 7 of the previous 9 tax years, so would have to pay the lower remittance basis charge of £30,000.

[45] See the 2018/19 edition of this work, para 11.12 (Remittance Basis Charge).

[46] [2021] UKFTT 227 (TC) at [18].

> tax under the complex "remittance" rules applicable to non-UK domiciled person and, accordingly, it is reasonable for the taxpayer to rely on that advice. In the context of this understandable and good sense reliance and the difficulties for taxpayers in understanding and keeping up to date with such rules, we do not consider that Mr Radice was careless in failing to spot that an error had been made in his return which lead to an underpayment of tax. ... Mr Radice reviewed the return. He would have seen the statement in box 31 that he had been resident for 12 out of the last 14 tax years which, on its own terms, was correct. We do not consider that he could reasonably have been expected to realise that other boxes in that section of his return needed to be filled in (or what the significance of the information required in the other boxes is) when his advisers, on whom he reasonably relied, had selected box 31 and he knew that the information in it was correct.

But SA109 box 23.3 (2022/23) now requires the taxpayer to enter "the number of years you've been resident in the UK in the previous 20 years", so this particular mistake is not likely to recur.

17.12.2 *Duty to nominate income/gains*

Section 809C(1) ITA provides:

> This section applies to an individual for a tax year if the individual-
> (a) is aged 18 or over in that year, and
> (b) meets the 12-year residence test or the 7-year residence test for that year.

Assuming this condition is met, we move on. Section 809C(1) ITA provides:

> A claim under s.809B by the individual for that year must contain a nomination of the income or chargeable gains of the individual for that year to which s.809H(2) is to apply.

Following the statutory terminology,[47] I refer to the income/gains so nominated as "**nominated income/gains**".

Section 809C(3) ITA provides:

[47] Section 809H(3) ITA provides: "'Nominated' income or chargeable gains means income or chargeable gains nominated under s.809C in the individual's claim under s.809C for the relevant tax year." The definition is repeated in s.809I(3) and s.809J(3) ITA. (If a chapter-wide definition had been used the repetition would have been unnecessary.)

> The income or chargeable gains nominated must be part (or all) of the individual's foreign income and gains for that year.

The legislation does not say what happens if an individual fails to nominate any income/gains but one can infer that the remittance basis claim is invalid. HMRC agree. The RDR Manual provides:

> **RDRM32310 Nomination of foreign income and gains - overview** [Jan 2019]
> The individual may nominate either foreign income or foreign chargeable gains or a combination of the two. Both the claim and the nomination should be viewed as component parts of the same claims process and should not be separated. Any claim that does not include a nomination is not valid.

17.12.3 *How to nominate*

The RDR Manual provides:

> **RDRM32380 Completing the SA Return - How is this done in practice?** [Jan 2019]
> SA109 'Residence, remittance basis etc' is the supplementary page to the SA100 main tax return for remittance basis users to complete under Self Assessment.
> There is a box to claim the remittance basis on the SA109 and two boxes where the 'amount of nominated income' and the 'amount of nominated capital gains' must be entered. The amount nominated can be either income or gains or a combination of the two. The source(s) of the amount nominated is the individual's personal choice.
> When either or both of these boxes are completed the SA109 notes say that details of the nominations are to be shown in the "Any other information" box.
> The required information is:
>
> - the precise amounts of income and gains that have been nominated, (this should include the country of origin and the type and source of the income)
> - the computation of the gain (if applicable)
> - the exchange rates used[48]

[48] See 95.8 (Nominated income/gains: Currency conversion date).

- the calculation of the tax due in relation to the nominated income and gains.

Also if there have been deductions for expenses or losses from either foreign income or foreign gains in arriving at the final taxable amount, full details of the amounts and nature of those expenses or losses must also be provided.

All of this information is required to validate the nomination or nominations that have been made.

March 2009 Q&As provides:

> **Q3:** HMRC have indicated that individuals do not have to specify which account the nominated income comes from, and from this it could be inferred that without further disclosure of the particulars of the account the taxpayer may be at risk of "tainting" every other source of income of that type. For example if an individual has an account with one bank in Jersey and another bank in a different jurisdiction, he could nominate bank interest on his Jersey account, so that it would be obvious that if he remitted income from his other account, he might not fall foul of re-characterisation provisions. However, this may not be the case if he had three different accounts with the same bank in Jersey and he wishes to nominate income from one of those accounts without disclosing the account number of that account. Can HMRC clarify what their approach to this will be?
>
> **A:** It is up to the individual to decide how much information to give HMRC on their Self Assessment returns in order to identify the source of the nominated income or gains; if, as in this example, there is more than one account the individual should provide sufficient detail to distinguish between them and identify the "nominated" account. That might be the entire account number, or the account "name", or some other unique identifying feature of the account.

17.12.4 *Cap on nominated income/gains*

Section 809C(4) ITA provides:

> The income and chargeable gains nominated must be such that the relevant tax increase does not exceed
>
> (a) for an individual who meets the 12-year residence test for that year, £60,000;
>
> (b) for an individual who meets the 7-year residence test for that year, £30,000.

Section 809C(5) ITA provides a commonsense definition of "the relevant tax increase":

> "The relevant tax increase" is-
> (a) the total amount of income tax and capital gains tax payable by the individual for that year, minus
> (b) the total amount of income tax and capital gains tax that would be payable by the individual for that year apart from s.809H(2).

EN Amendments to the Remittance Basis Charge explains the reason for the cap in s.809C(4):

> This stops an individual from nominating too much income and gains and as a result paying a remittance basis charge of more than £30,000 [now the applicable amount].

The legislation does not say what happens if an individual nominates too much income/gains so the relevant tax increase exceeds the applicable amount. Perhaps the nomination is scaled back proportionately.

17.12.5 *HMRC example*

The following example from the RDR Manual shows how complicated this can be:

> **RDRM32350 Relevant tax increase - Example 2** [Apr 2019]
> Relevant tax increase: Example 2 (Lorna)
> L, a non domiciled long-term UK resident makes a claim to use the remittance basis in 2011 and must pay the £30,000 remittance basis charge (RBC). She is a higher rate taxpayer paying tax at 40%, with UK source employment income of £80,000.
> She also has £150,000 of interest (relevant foreign income) from an overseas investment in Country X paid to her.
> Because nominated income is taxed on the "arising basis", a remittance basis user is in the same position as any other UK resident person and is, subject to the ordinary rules that apply in such cases (s.18 TIOPA 2010), entitled to credit against UK tax for certain amounts of overseas tax that is payable on that same income.
> Under the domestic law of Country X in which the investment was made, the interest was paid after deduction of 15% withholding tax. The Double Taxation Agreement between the UK and Country X provides that tax on this interest may be retained in the "source" country at the rate of 15%.
> L is therefore entitled to a credit, which she takes in the form of foreign tax credit relief (FTCR), against UK tax for the tax withheld in the other country. ...
>
> *Foreign tax credit relief calculation – general principles*
> Ignoring the remittance basis issue for the moment:
> L has received foreign interest of £150,000, on which Country X's tax of

£22,500 (15% as provided for in the DT treaty) has been deducted.
L's income is chargeable to tax at 40%. The UK tax charge is respect of this £150,000 would be £60,000 (40%×£150,000).
If she claims foreign tax credit relief her net liability to UK tax after the foreign tax credit relief will be:
£60,000 minus £22,500 = £37,500

Relevant tax increase including FTCR
Foreign tax credit relief is only due to the extent that the foreign income on which it is given is brought into the UK tax charge. So for remittance basis users, relief for foreign tax paid on foreign income chargeable on the remittance basis is given when that income is remitted.
However for remittance basis charge payers like L, any foreign income which she nominates is chargeable on the arising basis so foreign tax credit relief can be given in relation to that nominated income.
Because the "relevant tax increase" must be £30,000, L will need to nominate £120,000 of her foreign interest if she wishes to create an overall remittance basis charge of £30,000.

FTCR calculation

Foreign tax that relates to the £120,000 nominated (at 15%)	−£18,000
UK tax on £120,000 (at 40%)	£48,000
Net liability to UK tax after the FTCR (£48,000 minus £18,000)	£30,000
	(refer to note 2 below)

Relevant tax increase calculation
To determine the relevant tax increase we must complete two calculations.
The first calculation (a) is of the total amount of L's income tax and capital gains tax actually payable in the year, as a remittance basis user and RBC payer.
The second calculation (b) is the total amount of L's income tax and capital gains tax that would be payable by L in the year as a remittance basis user less the tax charged on the nominated foreign income or foreign gains.
The relevant tax increase is the total of calculation (a) minus calculation (b)

			Calculation (a)			Calculation (b)
Non-savings income						
20%[1] on	£34,800	=	£6,960	£34,800	=	£6,960
40% on	£45,200	=	£18,080	£458,135	=	£18,080
	£80,000		£25,040	£40,000		£25,040
Savings						
40% on	£120,000[2]	=	£30,000	Note 4		
Total Income Tax Due			£55,040[3]			£25,040[4]

Notes

[1] Rates and thresholds used here for the purposes of this example only; use the rates applying in the relevant tax year.

[2] This is the foreign income that is nominated, and charged to tax on the arising basis in the year. FTCR is given, which has reduced the tax to £30,000.

[3] As a remittance basis user, L has no personal allowances due.

[4] L is a remittance basis user so would not be subject to tax on her unremitted foreign income, nor would any FTCR be due.

Relevant Tax Increase is	Total (a)		£55,040
less	Total (b)		£25,040
		Total	£30,000

17.12.6 *Charge on nominated income*

Section 809H(2) ITA provides:

> Income tax is charged on nominated income, and capital gains tax is charged on nominated chargeable gains, as if s.809B did not apply to the individual for the relevant tax year (and neither did s.809D).

This disapplies the remittance basis, so nominated income/gains are taxed on the arising basis. I refer to this as the "**nominated income charge**". (The label is not wholly apt, as the charge may be on nominated gains, but "nominated income/gains charge" is a clumsy expression.)

EN FB 2008 provides:

> 14. This charge is in addition to the tax liability for the year in question on any income and gains remitted to the UK, and any UK income or gains taxed on the arising basis. The £30,000 [now the applicable amount] will be paid on nominated income and gains not remitted to the UK in the year. (These income and gains are called "nominated" income and gains because the taxpayer is free to nominate the income and gains not remitted to the UK in the year on which tax of £30,000 is payable. For example, this could be £75,000 of unremitted foreign deposit interest on which UK tax was due at 40 per cent, so leading to an income tax charge of £30,000.)

17.12.7 *Deficit charge*

The removal of the remittance basis for nominated income/gains might not yield the desired additional tax for various reasons. The individual might under-nominate, ie, they might not nominate enough income/gains. There is no requirement to nominate enough to give rise to a IT or CGT charge of the applicable amount. Indeed, it is not always possible to know how much that would be. One could nominate just £1, as long as what is nominated is foreign income/gains. HMRC agree. The RDR Manual provides:

> **RDRM32320 Making a Nomination** [Jan 2019]
> *Insufficient nomination*
> Although an individual may choose to make an insufficient nomination RDRM32360 they must have foreign income and/or foreign chargeable gains from the tax year such that they can nominate something, even if only £1. This fulfils the mandatory requirement that a nomination **must** be made when making the claim.
> *Completing the self-assessment return*
> All claims and nominations are made on the individual's self assessment tax return. The minimum amount that can be nominated **is** £1 of foreign income or gains for the claim to be valid. Where a claim to the remittance basis is made under s809B but no nomination of either foreign income or capital gains is made the claim is invalid. ...[49]

According to EN Amendments to the Remittance Basis Charge, this was done to enhance confidentiality:

> 7. The legislation provides the option for those who can claim the remittance basis not to disclose anything about their unremitted income or gains as they can make a claim with a nominal £1 amount and do not have to specify what further foreign income or gains remain unremitted.

But it may not be in the interest of the taxpayer to under-nominate, and the confidentiality is limited because HMRC are entitled to make further enquiries to check a taxpayer's tax position.

The removal of the remittance basis for nominated income/gains might not yield the desired additional tax where the individual has some tax reliefs (eg loss relief, interest relief, DTRs, etc).

Section 809H(4) ITA goes on to ensure that HMRC will receive their desired amount of tax:

> If the relevant tax increase would otherwise be less than the applicable

[49] Similarly March 2009 Q&As provides:

> "**Q7:** The question has arisen whether less than £1 (ie pence) can be nominated income. Given current interest rates there is concern that accounts specifically set up to generate nominated income may not generate £1 before 6 April 2009. The concern expressed is that because pence are rounded down on tax returns, it might be your view that there is no nominated income?
> **A:** The minimum nomination of income or gains required to calculate the relevant tax increase is £1. This is the minimum figure to be declared on the relevant supplementary page of the Tax Return."

But where is the statutory authority for HMRC to disregard figures under £1?

> amount,[50] subsection (2) has effect as if—
>
> (a) in addition to the income and gains actually nominated under s.809C in the individual's claim under s.809B for the relevant tax year, an amount of income had been nominated so as to make the relevant tax increase[51] equal to the applicable amount, and
>
> (b) the individual's income for that year were such that such a nomination could have been made (if that is not the case).

I refer to s.809H(4) as the "**deficit charge**". The deficit charge is a tax on deemed income (deemed nominated income) and not on any actual income of the taxpayer (if indeed the taxpayer has other income). Section 809H(6) ITA makes this clear (if necessary):

> Nothing in subs.(4) affects what is regarded, for the purposes of s.809I or 809J, as nominated under s.809C.

I use the term "**remittance basis claim charge**" to mean the two distinct (albeit related) charges:

Charge	**Section**	**See para**
Nominated income charge	s.809H(2)	17.12.6
Deficit charge	s.809H(4)	*Discussed here*

It might be more accurate to refer to remittance basis claim *charges* (in the plural). However for many purposes it does not matter that there may be two charges rather than one, (especially since in practice the second

[50] Section 809H(5B) ITA provides: "The applicable amount" is–
(a) if the individual meets the 12-year residence test for the relevant tax year, £60,000;
(b) if the individual meets the 7-year residence test for the relevant tax year, £30,000.

[51] Section 809H(5)(5B) ITA repeats the definition of "the relevant tax increase" from s.809C(5) (5A):
"'The relevant tax increase' is—
(a) the total amount of income tax and capital gains tax payable by the individual for the relevant tax year, minus
(b) the total amount of income tax and capital gains tax that would be payable by the individual for the relevant tax year apart from subsection (2).
(5A) The references to income tax in subsection (5) do not include income tax under s.424 (gift aid)."
If there had been a chapter-wide definition the repetition would have been unnecessary.

may not often arise) and it is convenient to use the singular label for them both.

17.12.8 *Interaction with Gift Aid*

Tax paid under the remittance basis deficit charge may be used to frank a gift aid payment. The RDR Manual provides:

> **RDRM32450. Charitable Donations and Gift Aid** [Nov 2015]
> Chapter 2 of Part 8 ITA 2007 provides relief from tax for some gifts of money to charities that are made by individuals. This is known as 'Gift Aid'. One part of the Gift Aid rules is that the donor must pay at least as much UK income tax and/or capital gains tax in the tax year as the amount that is repayable to the charity...
> **The Remittance Basis Charge**
> In exactly the same way as any other amount of income tax or capital gains tax, amounts of tax that are paid to satisfy the Remittance Basis Charge can be used to frank Gift Aid donations. That is because the remittance basis charge is 'income tax charged' or 'capital gains tax charged' on nominated income and/or gains [for the purposes of s.424(2) ITA]. ...

Tax paid under s.424 ITA does not count towards the remittance basis claim charge. Section 809H(5A) ITA provides:

> The references to income tax in subsection (5) do not include income tax under s.424 (gift aid).

The RDR Manual provides:

> **RDRM32450. Charitable Donations and Gift Aid** [Jan 2019]
> ...
> - Section 414(2)(a) ITA 2007 treats a qualifying donation as if it had been made after deduction of basic rate income tax.
> - If the donor has not paid enough UK income tax and capital gains tax to 'frank' the gift aid donations in a tax year, a further amount of income tax is charged to make up the shortfall (s.424 ITA 2007).
>
> ... However, where the individual has:
> - chosen to use the remittance basis, and
> - claimed Gift Aid tax relief
>
> any income tax that is charged under s. 424 ITA 2007 is not taken into account when calculating the 'relevant tax increase' (see RDRM32330) that is required to produce the remittance basis charge (s.809C(5A) ITA 2007 and s.809H(5A)).

> **Effect**
> No matter how it is calculated, the Remittance Basis Charge is always £30,000 [or, in certain circumstances, from 6 April 2012, £50,000] – see RDRM32300.

For s.424 ITA, see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 15.44 (Tax to cover Gift Aid).[52]

17.12.9 *How much to nominate?*

It is important not to remit nominated funds to the UK. From that point of view it is convenient to under-nominate, ie nominate a nominal £1 only.

On the other hand, taxpayers who want to offset the remittance basis charge against foreign tax will want to nominate income/gains on which the foreign tax is at least equal to the applicable amount, or as close to the figure as possible; that requires a full nomination and some care in the choice of income/gains which are nominated.

17.12.10 *Claim if residence in doubt*

A person may be unsure whether or not they are UK resident in a year but know that they would be a long-term resident if they are UK resident in that year. That person may if appropriate make a remittance-basis claim in that year, for the avoidance of doubt, and argue the residence position at leisure; if they are eventually held to be UK resident the remittance basis claim charge is due, but if non-resident the sum is not due. Nothing is lost by making the claim.[53] Section 809B does not apply unless the individual meets the conditions of s.809B(1)(a) and (b) in the year.

Alternatively a person may know that they are UK resident in a year but not know if they are a long-term UK resident in that year (because they are unsure whether they were resident in earlier years). That person should make a remittance-basis claim but not nominate any income/gains. The claim is valid if they are not long-term UK resident. The claim is invalid if they are long-term UK resident, so the remittance basis claim charge is not due (unless they proceed to make a new election and

[52] Online version *https://www.taxationofcharities.co.uk*

[53] Similar points arise if a person is unsure about their domicile in a year, but in practice that would be less common because domicile is generally ascertainable.

nomination).

On the other hand a remittance-basis claim is effective (and the remittance basis charge payable) even if the individual has less than £2k unremitted income/gains, and so would qualify as a sub-£2k taxpayer. That may be an expensive box to tick in error!

17.12.11 *Claim charge: Foreign tax credit*

EN FB 2008 provides:

> 17. As the RBC consists of income tax or CGT paid on the arising basis ... the tax should be recognised as tax (on income or capital gains, as the case may be) for the purposes of our double taxation agreements.

The proposal in the Draft Clauses published January 2008 was for a simple charge of a fixed amount. This would not have qualified as a credit against foreign tax because it was not a tax on income or gains. HMRC presumably agreed, as the provisions were then recast in order that:

(1) The provisions took the form (so far as possible) of a charge on income or gains but
(2) the provisions had the effect (so far as possible) of a fixed charge.[54]

Article 24(1) UK/USA DTA provides:

> In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income
>
> (a) the income tax paid or accrued to the UK by or on behalf of such citizen or resident ...

It is suggested that the *nominated income/gains charge* can in principle be set against foreign tax since it is an income tax or CGT. However the remittance basis *deficit* charge is not a charge on actual income, and cannot be set against foreign tax. HMRC agree. EN Amendments to the Remittance Basis Charge provides:

> 16. The individual claiming the remittance basis might decide to nominate only £50,000 of bank interest under s.[809C(2)] and pay

[54] See too 17.12.13 (Claim charge: Split year).

> £20,000 of the £30,000 under s.[809H(2)] (assuming higher rate tax is due on all the £50,000). Section [809H(4)] would then apply with the effect that further income of £25,000 is treated as nominated to bring a further £10,000 of income tax into charge. However if the individual intended claiming credit for all or part of the £30,000 under a DTA then DTA relief will only be due on the income or gains actually nominated under s.[809C(2)] – £50,000 of income and £20,000 of income tax in this example. The income tax paid on income treated as nominated under s.[809H(4)] = £25,000 of income and £10,000 of income tax in this example, will not qualify for relief under DTAs as it is not tax on specific nominated income.

It follows that a careful choice of what income/gains to nominate is important, because (if foreign tax allows credit for the UK tax) that can make up to £90k difference to the foreign tax liability.

The RBC might have been regarded as a fixed levy, merely disguised as an income tax by sleight of hand, but in America, the IRS have after some delay[55] accepted the HMRC view. The question is of course one for foreign law, not UK law. The US ruling made August 2011 provides:

Rev. Rul. 2011-19
ISSUE
Whether a credit is allowable under section 901 of the Internal Revenue Code for the Remittance Basis Charge (RBC) of £30,000.[56]
[The ruling outlined the UK tax rules and continues]
LAW AND ANALYSIS
Section 901 generally allows a credit for the amount of any income, war profits and excess profits tax (collectively, an income tax) paid or accrued during the taxable year to any foreign country or to any possession of the United States. A foreign levy is an income tax if and only if (i) it is a tax and (ii) the predominant character of that tax is that of an income tax in the US sense. §1.901-2(a)(1).
A. Single Levy or Separate Levies
Each levy must be analysed separately to determine if it is an income tax under section 901. §1.901-2(d)(1). For purposes of section 901, whether a single levy or separate levies are imposed by a foreign country depends on US principles and not on whether foreign law imposes the levy or levies in a single or separate statutes. Where the base of a levy is different in kind, and not merely in degree, for different classes of persons subject to

[55] One would like to know what discussions took place behind the publication of this statement. Perhaps in 2041 the relevant files will be made public.
For HMRC's opening shot in this debate see BN 107 [2008] STI (20 March 2008) annex

[56] Author's footnote: The increase in the remittance basis charge in 2012 will not affect the reasoning.

the levy, the levy is considered for purposes of section 901 to impose separate levies for such classes of persons. For example, regardless of whether they are contained in a single or separate foreign statutes, a foreign levy identical to the tax imposed under section 871(b) on a US nonresident alien individual's income that is effectively connected with the conduct of a US trade or business is a separate levy from a foreign levy identical to the tax imposed by section 1 on the income of a US citizen or resident, as the tax on nonresidents has a more limited scope and therefore is different in kind from the tax on the worldwide income of US citizens and residents.

Where foreign law imposes a levy that is the sum of two or more separately computed amounts, and each such amount is computed by reference to a separate base, separate levies are considered, for purposes of section 901, to be imposed. Amounts are not separately computed if they are computed separately merely for purposes of a preliminary computation and are then combined as a single base. §1.901-2(d)(1). For example, where excess deductible expenses allocated to one type of income are applied to reduce other types of income, a single levy exists, since despite a separate preliminary computation the bases are combined before computing the tax due. See §1.901-2(d)(3), Examples (3), (4), and (5).

1. The Remittance Basis and the Arising Basis of Taxation Are Separate Levies

Under both the arising basis and the remittance basis of taxation, a non-domiciliary is subject to tax on UK-source and non-UK-source income and gains. However, under the arising basis, a non-domiciliary is subject to tax on worldwide income and gains that arise or accrue in a particular taxable year; while under the remittance basis, a non-domiciliary is subject to tax only on UK-source income and gains and on non-UK-source income or gains that are remitted in a particular taxable year, whether the non-UK-source income or gains arise or accrue in the year remitted or in an earlier year. Thus, the bases of these levies are different in kind, and not merely in degree; therefore, the arising basis and remittance basis of taxation are considered for purposes of section 901 to impose separate levies.

2. The RBC, in Combination with the Remittance Basis of Taxation, is a Single Levy that is a Separate Levy

All non-domiciliaries who elect the remittance basis of taxation are subject to tax on their UK-source and remitted non-UK-source income and gains. In addition, long-term non-domiciliaries must pay the RBC on nominated but unremitted non-UK-source income and gains (and, if the amount nominated generates a tax charge of less than £30,000, on income or gains realized but not nominated and on imputed income such that the tax charge equals £30,000). Losses and deductions allocated to UK-source income or gains, remitted non-UK-source income or gains, or nominated but unremitted non-UK-source income or gains may offset income or gains in another category in determining the amount of the long-term non-domiciliary's taxable income. Therefore, under §1.901-2(d)(1), despite a separate preliminary computation, the long-term non-domiciliary's UK-source income or gains, remitted non-UK-source income or gains, and unremitted non-UK-source income or gains giving rise to the RBC are combined in determining the long-term non-domiciliary's taxable income; therefore, the tax imposed on the sum of the long-term non-domiciliary's three separately computed amounts of income constitute a single levy (the Long-Term Non-Domiciliary (LTND) Levy).

A. The LTND Levy Is a Tax in the US Sense

A foreign levy is an income tax if and only if it is a tax and the predominant character of that tax is that of an income tax in the US sense. §1.901-2(a)(1). A foreign levy is a tax if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes. §1.901-2(a)(2)(i). The LTND Levy is a tax because it is required to be paid pursuant to the authority of the government of the UK to levy taxes.

A. The Predominant Character of the LTND Levy Is that of an Income Tax in the US Sense

The predominant character of a foreign tax is that of an income tax in the US sense if the tax is likely to reach net gain in the normal circumstances in which it applies, and liability for the tax is not dependent, by its terms or otherwise, on the availability of a credit for the tax against income tax liability to another country. §1.9012(a)(3). Liability for the LTND Levy is not dependent on the availability of a credit for the LTND Levy against income tax liability to another country.

Thus, whether the LTND Levy has the predominant character of an income tax depends on whether it is likely to reach net gain in the normal circumstances in which it applies. A foreign tax is likely to reach net gain in the normal circumstances in which it applies if and only if the tax, judged on the basis of its predominant character, satisfies each of the realization, gross receipts, and net income requirements set forth in §1.9012(b)(2), (b)(3), and (b)(4), respectively.

1. Realization

A foreign tax satisfies the realization requirement if, judged on the basis of its predominant character, it is imposed upon or subsequent to the occurrence of events that would result in the realization of income under the income tax provisions of the Code. §1.901-2(b)(2)(i)(A). A foreign tax that, judged on the basis of its predominant character, is imposed upon the occurrence of realization or pre-realization events described in §1.901-2(b)(2)(i) satisfies the realization requirement even if it is also imposed in some situations upon the occurrence of events not described in that paragraph. For example, a foreign tax that, judged on the basis of its predominant character, is imposed upon the occurrence of realization events satisfies the realization requirement even though the base of that tax also includes imputed rental income from a personal residence used by the owner. §1.901-2(b)(2)(i).

The UK-source and remitted non-UK-source income and gains of a long-term non-domiciliary electing the remittance basis of taxation generally are computed on the basis of amounts that satisfy the realization requirement. In addition, the income or gains nominated for purposes of the RBC must be part (or all) of the non-UK-source income and gains arising or accruing in that taxable year. Income tax is charged on nominated income, and capital gains tax is charged on nominated gains, as if the arising basis applied for the relevant taxable year. In other words, the nominated income and gains are subject to tax, even though they have not been remitted in the taxable year. Thus, the RBC is imposed on nominated income or nominated gains that have been realized or accrued in the taxable year.

If the long-term non-domiciliary realizes or accrues, but fails to nominate, sufficient income or gains, with the result that the tax charge on nominated income would be less than £30,000, an amount of income or gains is deemed to be nominated so as to make the tax charge equal £30,000. Thus, income or gains that have been realized or accrued but not nominated will be subject to the RBC. If a long-term non-domiciliary elects the remittance basis but does not have sufficient realized or accrued income or gains to make the tax charge equal £30,000, the long-term non-domiciliary is deemed to have sufficient realized or accrued income or gains and to have nominated such imputed income or gains to make the tax charge equal £30,000.

Section 1.901-2(b)(2)(i) states that, as provided in §1.901-2(a)(1), a tax either is or is not an income tax, in its entirety, for all persons subject to the tax; therefore, a foreign tax on a base that includes imputed rental income will satisfy the realization requirement even though some persons subject to the tax will on some occasions not be subject to the tax except with respect to such imputed income. However, a foreign tax based only or predominantly on such imputed income would not satisfy the realization requirement. Although it is possible for a long-term non-domiciliary to elect the remittance basis without having sufficient non-UK-source income or gains to support a £30,000 tax charge, in which case the base of the tax would include imputed income or gains, it is highly unlikely that substantial numbers of long-term non-domiciliaries in this situation would elect to be taxed on the remittance basis. Accordingly, it is reasonable to conclude that the RBC is not based only or predominantly on such imputed income or gains. The RBC in general is imposed on realized income or gains, whether nominated by the long-term non-domiciliary or considered by the UK statute to have been nominated. Thus, judged on its predominant character, the LTND Levy meets the realization test.

1. Gross Receipts

A foreign tax satisfies the gross receipts requirement if, judged on the basis of its predominant character, it is imposed on the basis of gross receipts or gross receipts computed under a method that is likely to produce an amount that is not greater than fair market value. §1.901-2(b)(3)(i). A foreign tax that, judged on the basis of its predominant character, is imposed on the basis of amounts described in §1.9012(b)(3)(i) satisfies the gross receipts requirement even if it is also imposed on the basis of some amounts not described in that paragraph. As is the case with income and gains that are taxed under either the arising basis or the remittance basis, nominated income and gains subject to the RBC generally are based on gross receipts. Therefore, the LTND Levy meets the gross receipts test.

1. Net Income

A foreign tax satisfies the net income requirement if, judged on the basis of its predominant character, the base of the tax is computed by reducing gross receipts to permit recovery of the significant costs and expenses (including significant capital expenditures) attributable, under reasonable principles, to such gross receipts; or recovery of such significant costs and expenses computed under a method that is likely to produce an amount that approximates, or is greater than, recovery of such significant costs and expenses. §1.901-2(b)(4)(i). Since the LTND Levy is imposed on UK-source income and gains, remitted non-UK-source income and gains, and nominated but unremitted non-UK-source income and gains, all of which consist of gross receipts less costs and expenses, the LTND Levy satisfies the net income requirement.

1. Conclusion

Because the LTND Levy is likely to reach net gain in the normal circumstances in which it applies, it has the predominant character of an income tax in the US sense.

HOLDING

Because the LTND Levy is a tax (within the meaning of §1.901-2(a)(2)), and its predominant character is that of an income tax in the US sense, the LTND Levy, including the Remittance Basis Charge (RBC) of £30,000, is an income tax for which a credit is allowable under section 901. However, a credit for the LTND Levy will be available only if the other legal requirements for obtaining a foreign tax credit are satisfied. For example, an amount paid is treated as a compulsory payment of income tax only to the extent the taxpayer applies the substantive and procedural provisions of foreign law, including elective provisions such as those available under UK law relating to the LTND Levy, in such a way as to reduce, over time, the taxpayer's reasonably expected liability under foreign law for income tax. §1.901-2(e)(5).

Taxpayers generally may rely upon revenue rulings to determine the tax treatment of their own transactions and need not request a ruling that would apply the principles of a published revenue ruling to the facts of their own particular cases. However, because each revenue ruling represents the conclusion of the Internal Revenue Service (IRS) as to the application of the law to the specific facts involved, taxpayers, IRS personnel, and others concerned are cautioned against reaching the same conclusion in other cases unless those cases present facts and circumstances that are substantially the same as those in the revenue ruling. §601.601(d)(2)(v)(e). Accordingly, because the provisions of UK law described in this revenue ruling are facts on which this revenue ruling bases its holding, a taxpayer may not rely on the revenue ruling if the relevant provisions have been amended in any material respect, and the taxpayer is responsible for determining whether any such modification has occurred.[57]

The US ruling concludes with a paragraph which one would not find in the UK:

> **DRAFTING INFORMATION**
> The principal author of this revenue ruling is Teresa Burridge Hughes of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Ms. Hughes at (202) 622-3850 (not a toll-free call).

What a good thing it would be if HMRC statements and regulations similarly identified a principal author who would take responsibility - both credit for the good and blame for mistakes![58]

17.12.12 *Individual treaty non-resident*

The RDR Manual provides:

> **RDRM32250 Dual residents - treaty non-resident** [Jan 2019]
> It is possible for individuals to be resident both in the UK and in another country or countries in a tax year. In such a case we look to the provisions of existing Double Taxation Agreements (DTAs) to determine in which country the individual is resident for treaty purposes. So a person may be resident in the UK under UK law, but regarded as

[57] *http://www.legalbitstream.com*

[58] Contrast the rule that a senior accounting officer of large companies must take a personal responsibility for the company's tax returns.

> 'treaty resident' elsewhere and consequently treated for tax purposes as 'not resident' in the UK.
>
> An individual who is, under the terms of a DTA, resident in the other country or territory but is also a long-term resident RDRM32200 in the UK (that is someone who has been resident in the UK in at least seven out of the previous nine tax years) and claims the remittance basis is, if their un-remitted foreign income and gains is £2,000 or more, liable to pay the £30,000 remittance basis charge, or for 2012/13 or later the £30,000 or £50,000 remittance basis charge.

It is considered that DT relief is in principle available against the nominated income/gains charge, but not against the remittance basis deficit charge. The effect of claiming DT relief against nominated income/gains is to reduce the remittance basis claim charge on the nominated income/gains, but to increase the deficit charge by the same amount.

This defeats the spirit of any DTA. It may also breach the DTA itself. But the intention of parliament is clear, and parliament may breach DTAs.[59] In practice treaty partners seem to have accepted this..

The RDR Manual continues:

> **RDRM32250 Dual residents - treaty non-resident** [Jan 2019]
>
> ...
>
> In determining the number of years in which an individual has been resident in the UK for the purposes of the long-term resident provisions, you count all years where the individual is resident in the UK under UK domestic law even if the individual was treaty resident in another territory in some or all of those years.

This is correct.[60] The RDR Manual continues with some tax planning advice:

> In most cases, an individual resident both in the UK and in another country and who under the Double Taxation Agreement with the other country is treated as resident in that other country (for the purpose of applying the provisions of the DTA) will be chargeable to tax in the other country on income and gains that originate in that other country and not in the UK. The treatment of any income and gains that originate in third countries (not the UK or the country of treaty residence) will depend upon the terms of the DTA between the UK and the country of

[59] See *Padmore v IRC (No.2)* [2000] STC (SCD) 356.

[60] See 9.2 (Treaty/UK-law residence).

> residence.
> Where, exceptionally, an individual is chargeable to tax in the UK on such income or gains, they will need to consider whether a claim for the remittance basis of taxation is in their best interests or if, instead, they should pay tax on the arising basis and in the usual way, claim a credit for the tax charged in the other territory.

17.12.13 *Claim charge: Split year*[61]

There is no split-year rule, so the remittance basis claim charge is payable in full if the remittance basis is claimed, even in split years.[62]

What is the reason for that rule? If the remittance basis claim charge is a tax on the nominated income/gains, the split-year rule should logically apply. The reason is that the charge is intended only to take the form of a tax on the nominated income/gains, and it is intended to have the effect of a fixed charge.

17.12.14 *Claim charge administration*

The RDR Manual provides:

> **RDRM32210 Long-term residents and the remittance basis charge - overview** [Jan 2019]
> The remittance basis charge is payable through and collected by the SA regime, and an SA tax return must be filed. The SA109 'Residence, remittance basis etc' supplementary return should be completed and filed for this purpose. Also refer to RDRM32020 'Making a claim'.

So a long-term resident who wishes to claim the remittance basis will need to file an SA tax return in order to pay the remittance basis charge.

Of course the charge could not be collected through PAYE. For one thing, the charge might be a charge to CGT and even if it is income tax it need not be a charge on employment income. Also the claim on which the charge depends will be made in the tax return some time after PAYE is due. HMRC Brief 17/09 provides:

> The rules for nominating income and gains upon which the £30,000 is paid, and the rules for identifying what is taxed if those nominated income or gains are later remitted to the UK, can be complex. To help ensure individuals who pay the £30,000 get the right level of customer

[61] For the distinct issue of the interaction of split-year reliefs and the definition of "long-term UK resident" see 17.12.1 (7 & 12 year residence tests).

[62] See 10.1 (Residence throughout tax year).

support [!] from HMRC, we have decided that most individuals who pay the £30,000, or have paid it in the past, will have their tax affairs dealt with in one HMRC office from 2009-10. This will be the CAR Residency office in Castle Meadow, Nottingham.

Customers who are sent a self assessment return by a different office should make the return to the office issuing that return. Once the return has been received by HMRC we will arrange for the individual's tax records to be transferred to the CAR Residency office in Nottingham and advise the individual and any agent, accordingly. Until such time as individuals or their agents receive such a notification they should continue to deal with their current tax office.

17.12.15 *IT payment on account*

The RDR Manual provides:

> **RDRM32390 Payments on account - interaction with the remittance basis charge** [Jan 2019]
>
> The remittance basis charge is tax on nominated income or nominated gains, (or a mixture of the two) ...
>
> To the extent that the remittance basis charge consists of income tax, the payment on account position for those paying the charge is the same as that for any other SA taxpayer. This means their payments on account are based on their income tax liability for the previous year (TMA1970/s59A(1)).
>
> The SA109 'Residence, remittance basis etc' supplementary pages to the SA tax return must be completed to both claim the remittance basis and nominate income or gains and pay the remittance basis charge.
>
> *Effect and treatment of income*
>
> If paying part or all of the remittance basis charge in respect of nominated income, then income tax will be due. The amount which has been nominated from income and produced income tax will need to be taken into account and included in the overall calculation of payments on account for the following year.
>
> If an insufficient nomination is made to produce the remittance basis charge of either £30,000 or £50,000 (ITA07/s809H(4)) the additional amount treated as nominated will always produce income tax. This also has a bearing on the payments on account position, even though the additional nominated amount is from an unidentified and unspecified amount of income. The additional amount nominated from income will automatically produce income tax that will become part of the individual's payment on account calculation for the following year.
>
> *Effect and treatment of capital gains*
>
> Capital gains tax is not included in computing payments on account, so any of the remittance basis charge that is constituted of nominated capital gains tax will not form any part of the following year's payments on account.
>
> *Example (Ricardo)*
>
> R, a non-domiciled long-term resident has an income tax liability of £200,000

for tax year 2007-08. Subsequently he makes payments of £100,000 on 31 January 2009 and on 31 July 2009 on account of his liability for 2008-09.

His tax liability for 2008-09 is £250,000, which includes for the first time the £30,000 remittance basis charge. The remaining £220,000 is income tax on UK sources. R nominated only £21,000 of his foreign income which led to a charge of £8,400 income tax; he also nominated £120,000 foreign chargeable gains which led to a capital gains tax of charge £21,600. Together these amounts make up his £30,000 remittance basis tax charge.

R's payments on account for 2009-10 will be calculated using the £220,000 income tax paid on UK income sources in 2008-09, plus the £8,400 income tax element of the remittance basis charge. This means that he will make payments on account of £114,200 on 31 January 2010 and on 31 July 2010 on account of liability for 2009-10. ...

RDRM32400 Payments on account – nominations involving chargeable gains [Jan 2019]

Capital gains tax included in the calculation of liability for a year is not included in computing payments on account for the next year. Any part of the remittance basis charge that is tax on nominated foreign gains will not form part of the following year's payments on account.

There is an additional box to complete on the SA109, if a nomination of capital gains is made to ensure that the capital gains tax forming part of the remittance basis charge for a year is ignored for the purpose of calculating the next year's payments on account..

This box is called 'Adjustments to payments on account for capital gains' and must be completed if any nomination of capital gains is made.

This box is not completed if a nomination of income only has been made, as any amount nominated from income will be taken into account in computing the overall payments on account liability for the following year.

The amount entered in the 'Adjustment to payments on account for capital gains' box on the SA109 is required in order for the payments on account to be calculated correctly for subsequent years:

- where a taxpayer calculates their own liability to tax, the amount for capital gains tax entered in the box to adjust payments on account, should be excluded in their calculation of payments on account
- if the tax calculation summary page is used the first payment on account for the following year will not include any part of the amount entered for capital gains tax in the adjustment to payments on account box.

Example involving an amount of capital gains in the 'Adjustment to payments on account for capital gains' box:

R, claims the remittance basis in 2008-09 and nominates both foreign income and foreign gains to pay the £30,000 remittance basis charge.

He nominates as follows:

£21,000 of relevant foreign income	@40%	£8,400
£120,000 of foreign chargeable gains	@18%	£21,600
		£30,000

The amount of £21,600 for capital gains tax should be entered in the 'Adjustment to payments on account for capital gains' box as this amount is excluded in calculating payments on account for the following year. Only the £8,400 tax that is chargeable on nominated income is taken into account when calculating the amount due as payments on account.

If the entire amount nominated to pay the remittance basis charge comes from capital gains then the capital gains tax element of the remittance basis charge is not included in the calculation of the payments of account. In this case the full £30,000 from nominated gains will be entered in the 'Adjustment to payments on account for capital gains' box.

RDRM32410 Payments on account - first-year of paying RBC [Jan 2019]

The remittance basis charge is only payable from tax years 2008-09 onwards by long-term residents making a claim to use the remittance basis.

For example, if a remittance basis claim is made in 2008-09 and the remittance basis charge is due, then the first year that any payments on account can be considered in relation to the remittance basis charge is 2009-10 unless there is a claim to reduce ...

The fact that their tax liability for 2008-09 will be increased for those paying the remittance basis charge has no effect on the payments on account position for 2008-09 (unless there is a claim to reduce them) but, to the extent that the remittance basis charge is income tax, it will be taken into account when calculating payments on account for 2009-10.

The remittance basis charge for 2008-09 is not due for payment until 31 January 2010 when it can be paid as part of any balancing payment for the year

The same principle applies to the payment on account position in relation to the remittance basis charge for any first year that a claim to the remittance basis is made, and the remittance basis charge is due. Payments on account will not generally be affected until after the first year in which they pay the remittance basis charge (TMA70/s59A(2)).

RDRM**32420 Payments on account: no remittance basis charge due in following year** [Jan 2019]

When the remittance basis of taxation is **not** claimed in a year following one where the remittance basis has been claimed and the remittance basis charge was paid, the amount of income used to pay part or all of the remittance basis charge may be excluded from the calculations of payment on account.

To allow this to happen, a claim to reduce payments on account may be made on form SA303. Further information on the rules and the time-limits for making a claim to adjust payments on account can be found in the Self Assessment Manual under SAM1110.

RDRM32430 Claim to reduce Payments on Account (PoA) [Jan 2019]

The payment on account (PoA) position in relation to the remittance basis charge will be affected by any claims to reduce payments on account.

Where the RBC is paid in the previous year on nominated income, the amount feeds through to the individual's payments on account (PoA) for the next year, unless the individual makes a claim to reduce their PoAs on the grounds that their income tax liability for that year will be less than the sum of the two PoAs. For example this could be because they will not claim the remittance basis for the following year. If they subsequently do claim the remittance basis and pay the remittance basis charge in the following year and the income tax due for that year exceeds the sum of the PoAs made we will charge interest on the reduction in the PoA.

This is shown in the example below:

Stage 1

The return shows liability to income tax, which includes the RBC, partly or fully paid in respect of nominated income. The payments on account due on 31 January and 31 July are half of the relevant amount of income tax (TMA70/s59A).

For example, Marie-Clare's 2008-09 income tax liability is £55,000, of which £25,000 related to tax on UK source income, and the remainder is the £30,000 RBC (all in respect of nominated foreign income). Nothing is taxed at source. Her payments on account for 2009-10, payable on 31 January 2010 and 31 July 2010 will each be £27,500.

Stage 2

If the individual does not intend to use the remittance basis for the following year, and so they will not be subject to the remittance basis charge, they can claim to reduce the PoAs.

In the Marie-Clare example, if she does not think she will claim the remittance basis and so will not need to pay the remittance basis charge for 2009-10 she could reduce her payments on account for 2009-10 to £12,500 each, that is 50% of her 2008-09 income tax liability of £25,000 (if the remittance basis charge is excluded). She will of course still have to consider her other income sources and overall expected income tax liability for the year in making this decision.

Stage 3

If the individual subsequently decides to claim the remittance basis and to pay the £30,000 remittance basis charge and a claim to reduce payments on account has been made which resulted in insufficient PoAs being made, then interest will be charged from the due date for the payments on account until a claim to increase payments on account is made or payment is made for the year is paid to stop interest accruing (TMA70/s86).

In the Marie-Clare example, she has claimed to reduce her payments on account to omit the remittance basis charge, so she only makes payments on account of £25,000 (two lots of £12,500). When she files her 2009-10 self-assessment return her UK income has remained, as expected, at £25,000. However she now decides to claim the remittance basis and so she has to pay the remittance basis charge. As she has erroneously claimed to reduce her payments on account in the year, she will be charged interest on the payments that she should have made, that is, on £15,000 from 31 January 2010 and £15,000 from 31 July 2010 until the date these amounts are paid.

Refer to Self-Assessment Manual – Legal Framework SALF303 for further information on claims to reduce payments on account.

Example 1 (Eva)

- E claimed the remittance basis and paid the remittance basis charge in 2008-09, and her income tax liability produces two payments on account for 2009-10 of £120,000 each.
- E has decided that she will not be claiming the remittance basis in 2009-10 so will not pay the remittance basis charge. E makes a claim to reduce the

amount due on account of her tax liability to £200,000 due to a drop in income and because she will not pay the remittance basis charge in 2009-10. When E files her 2009-10 return in September 2010 it shows that the tax due on income is £200,000, but these are provisional figures as E is awaiting some details from her foreign bankers in relation to some foreign transactions.

- The two £100,000 payments on account appear "correct" at this stage. In November 2010 E receives the information from her foreign bankers and decides to amend her return and to claim the remittance basis. She nominates some foreign income and has to pay the remittance basis charge of £30,000, all constituting income tax, bringing her total liability to £230,000.
- E will be charged interest on the £30,000 reduction in her payments on account on the grounds that E should not have reduced them.

Example 2 (Vali)

- V had no foreign income or gains arising in 2008-09, so he did not claim the remittance basis and so he did not need to pay a remittance basis charge in 2008-09.
- V's income tax liability for 2008-09 produces two payments on account of £200,000 for 2009-10. No claim is made to reduce the payments on accounts.
- When V begins to prepare his 2009-10 return he has a liability of £420,000 income tax on UK sources, so his £400,000 payments on account were correct, based on V's previous year's income tax liability.
- V has foreign income arising in 2009-10 and he decides to claim the remittance basis in his 2009-10 return. As a long-term but non-domiciled resident V has to pay the remittance basis charge of £30,000 bringing his total liability to £450,000. Interest will not be charged on the additional £50,000 tax due, as long as this is paid by the proper due date.[63]

17.12.16 *Scottish/Welsh taxpayer*

HMRC say:

> Long-term UK residents who are not domiciled here can pay an annual charge to be taxed under the remittance basis ... This will not be affected by the introduction of the Scottish rate of income tax. Payments of the charge due from Scottish taxpayers will continue to be paid direct to the UK Exchequer.[64]

The rules are in s.809H ITA(3A)(3B) and it is easiest to read them side by side:

[63] See too March 2009 Q&As Q18.

[64] HMRC, "Clarifying the Scope of the Scottish Rate of Income Tax Technical Note" (May 2012) para 61.

Section 809H(3A) ITA	**Section 809H(3B) ITA**
If the individual is a Scottish taxpayer for the relevant tax year, the individual is to be treated for the purpose of calculating income tax charged by virtue of subsection (2) as if the individual were not a Scottish taxpayer for that year.	If the individual is a Welsh taxpayer for the relevant tax year, the individual is to be treated for the purpose of calculating income tax charged by virtue of subsection (2) as if the individual were not a Welsh taxpayer for that year.

17.12.17 *Critique*

The rules set out in this section can only be described as bizarre. Their purpose is to ensure the deduction of the RBC for foreign (in particular, US) tax. HMRC openly acknowledge this:

> 2.99 The Government sees no case for more fundamental simplification of the nominated income rules. The identification rules ensure that non-domiciles cannot gain a tax advantage by remitting their nominated income or capital gains to the UK before other income and capital gains on which they would be taxed. Removing the nominated income rules would call into question the creditability of the RBC for US tax purposes. Therefore, wider simplification of these rules would carry an unacceptable risk.[65]

17.13 Charge on remitted RFI

Section 809F(1) ITA provides:

> This section applies if s.809B, 809D or 809E applies to an individual for a tax year.

That is, the section applies to remittance basis taxpayers. Section 809F(3) ITA provides:

> The individual's relevant foreign income for that year is charged in accordance with s.832 of ITTOIA 2005.

So we turn to s.832(1) ITTOIA which provides somewhat repetitively:

> This section applies to an individual's relevant foreign income for a tax

[65] HMRC & HMT, "Reform of the taxation of non-domiciled individuals: summary of responses to consultation" (2011) *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf*

> year ("the relevant foreign income") if s.809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for that year.

We find the rule at last in s.832(2) ITTOIA:

> For any tax year for which the individual is UK resident, income tax is charged on the full amount of so much (if any) of the relevant foreign income as is remitted to the UK—
> (a) in that year...

17.13.1 *Remittance in split year*

Section 832(2) ITTOIA provides:

> For any tax year for which the individual is UK resident, income tax is charged on the full amount of so much (if any) of the relevant foreign income as is remitted to the UK ...
> (b) in the UK part of that year, if that year is a split year as respects the individual.

Para (b) provides the split-year rule.

Where the drafter wishes to disapply the split-year rule (so that remittances in the overseas part of a split year are taxable) this is done by the opaque (but effective) formula:

> In the application of section 832 of ITTOIA 2005 to [specified income], subsection (2) of that section has effect with the omission of paragraph (b).[66]

17.14 Charge on remitted gains

Section 809F ITA provides:

> (1) This section applies if s.809B, 809D or 809E applies to an individual for a tax year...
> (4) The individual's foreign chargeable gains for that year are charged in accordance with paragraph 1 of Schedule 1 to TCGA 1992.

So we turn to para 1 sch 1 TCGA which provides (somewhat repetitively):

> (1) This paragraph applies in the case of an individual to whom the

[66] For examples, see s.726(5) ITA discussed 49.26.3 (Remittance in split year); s.733(5) ITA discussed 50.39.3 (Remittance in split year); s.735B(4) ITA discussed 50.51 (s.731 settlor-attribution remittance-basis); s.643F(3) ITTOIA discussed 47.24 (s.643A remittance basis).

> remittance basis applies for a tax year if—
> (a) in that year the individual disposes of foreign assets,
> (b) chargeable gains accrue to the individual on the disposal of those assets, and
> (c) the gains are not taken outside the charge to capital gains tax as a result of section 1G (cases where tax year is a split year).
>
> (2) The gains are treated as accruing to the individual only so far as, and at the time when, they are remitted to the UK.
>
> (3) The amount treated as accruing is equal to the full amount remitted to the UK at that time.

For further discussion see 58.9 (CGT remittance basis). Unlike RFI, foreign gains are not chargeable to tax.

17.15 Remittance after income/gains arise

Suppose:

(1) Foreign income/gains accrue to T (a remittance basis taxpayer) on or after 2008/09 and
(2) The sum is remitted in a subsequent year (in which T is still resident).

The income/gains are taxable in the year of remittance. There is no time limit so income/gains may be taxed many decades after they arise.

17.15.1 *Pre-2008 income/gains*

Suppose:

(1) RFI accrues to T before 2008/09 and
(2) The RFI is remitted in 2008/09 or later (when T is still resident).

In the absence of a transitional rule, the income would not be taxable under s.832 ITTOIA because the condition in s.832(1) would not be met. Sections 809B, 809D or 809E did not apply before 2008. Para 83 sch 7 FA 2008 fills that gap for RFI:

> (1) This paragraph applies to an individual's relevant foreign income for the tax year 2007–08 or any earlier tax year ("the relevant tax year") if—
> (a) the individual made a claim under s.831 of ITTOIA 2005 for the relevant tax year, or
> (b) s.65(5) of ICTA (or any earlier superseded enactment corresponding to that provision) applied in relation to the individual for the relevant tax year.
>
> (2) Section 832 of ITTOIA 2005 (as amended by this Part of this

> Schedule) applies in relation to the relevant foreign income as if s.809B of ITA 2007 (claim for remittance basis to apply) applied to the individual for the relevant tax year.

Thus pre-2008 RFI is taxed under s.832(2) if remitted from 2008/09 (as one would expect).

The same applies to gains. In the absence of a transitional rule, pre-2008 gains would not be taxable on remittance after 6 April 2008 because:

Year of remittance	**Reason there would be no charge on remittance**
2008/09 - 2012/13	Requirement in former s.12(1)(a) TCGA not met
2013/14 - 2017/18	Requirement in former s.12(1) TCGA not met
2019/20 -	Requirement in paras 1 and 5(2) sch 1 TCGA not met

The wording has changed 3 times, but the requirement in all cases was that s.809B ITA applied to the individual in the year of disposal.

Para 84 sch 7 FA 2008 filled that gap:

> (1) This paragraph applies if s.12 of TCGA 1992 (or any corresponding superseded enactment) applied in relation to a gain accruing to an individual in the tax year 2007-08 or any earlier tax year ("the relevant tax year").
> (2) Section 12 of TCGA 1992 (as amended by this Part of this Schedule) applies in relation to that gain as if s.809B of ITA 2007 (claim for remittance basis to apply) applied to the individual for the relevant tax year.

The 2019 CGT rewrite should have amended para 84 to refer to the current legislation in sch 1 TCGA, which replaces s.12. But the continuity provisions fill that gap, so it continues to be the position that a remittance of a gain accruing on a pre-2008/89 disposal is chargeable. The reader may think it would have been easier in the absence of the 2019 CGT rewrite; but there it is.

17.15.2 *Income pre-2005/06 remitted pre-2007/08*

Para 150 sch 2 ITTOIA provided:

> A claim may be made under s.831 (claim for relevant foreign income to be charged on the remittance basis) for relevant foreign income to be charged in accordance with s.832 for the tax year 2005–06 or any later tax year, despite that income having arisen in a tax year before the tax year 2005–06; and ss.832 to 834 apply accordingly.

EN ITTOIA Vol 3 para 347 explains:

> This paragraph ensures that Chapter 2 of Part 8 of this Act is not restricted in its operation to income that arose after the tax year 2004–05 (whenever the earlier income is remitted).

Para 150 was not aptly worded, but what it meant was this: if a s.831 claim is made in 2005/06, 2006/07 or 2007/08, pre-ITTOIA income (which was not taxed on receipt because a claim was made under the former s.65 ICTA) is taxed under s.832 ITTOIA if remitted in that year.

17.15.3 *Income pre-2005/06 remitted post-2008/09*

EN FD Draft Clauses 2008 provided:

> 121. Para 47 deletes paras 150 and 151 of Schedule 2 (transitional provisions), which set out transitional arrangements for the application of the remittance basis to certain relevant foreign income arising before the tax year 2005-06. These are now considered obsolete in light of the amendments in this Schedule.[67]

17.16 Remittance when UK domiciled

Suppose:
(1) RFI/gains accrue to T (a remittance basis taxpayer).
(2) T acquires a UK domicile and for that reason ceases to be a remittance basis taxpayer. T remains UK resident.
(3) T subsequently remits the sum.

This is taxable under the ITA remittance code.

17.16.1 *Pre-2008 RFI/gains*

The rule for the pre-2008 RFI remittance basis was that there was no IT charge on a remittance after acquisition of a UK domicile. It is considered that the same applied for the pre-2008 CGT remittance basis, though HMRC did not accept that.
Suppose:
(1) RFI/gains arose to T before 2008/09.
(2) T became UK domiciled before 2008/09.
(3) The income/gains are remitted from 2008/09.

T is taxable on the remitted income under s.832(2) ITTOIA. The tax

[67] The equivalent passage in EN FB 2008 para 380 is less informative.

charge is retrospective in that pre-2008 RFI/gains outside the scope of tax has now fallen within the scope of tax.

What is the position if an individual acquired a UK domicile before 6/4/2008 and remitted the income/gains before then? It is suggested that there is no charge because of the cap on the amount remitted; see 18.42 (Cap on amount remitted).

17.17 Arising basis taxpayer remittance

Suppose:

(1) RFI accrues to T from 2008/09 in a year in which T is a remittance basis taxpayer.

(2) T subsequently remits the income in a year in which T is not a remittance basis taxpayer (because T's foreign income/gains exceed the £2k limit and T does not claim the remittance basis).

T is taxable on the remitted income under s.832(2) ITTOIA.

17.17.1 *Pre-2008 RFI*

The rule for the pre-2008 RFI remittance basis was that there was no charge on a remittance in a year in which no claim was made for the RFI remittance basis. HMRC accepted that (at least for years when ITTOIA applied). The new rule applies to pre-2008 RFI remitted from 2008/09. The tax charge is retrospective in that pre-2008 RFI/gains outside the scope of tax has now fallen within the scope of tax.

If RFI was remitted before 2008/09, it is considered that there is no charge because of the cap on the amount remitted; see 18.42 (Cap on amount remitted).

17.18 Remittance when non-resident

Suppose:

(1) RFI/gains arise to T (a remittance basis taxpayer).

(2) T remits the sum to the UK in a year when non-resident.

RFI is not taxable in the year of remittance, because the condition in s.832(2) ITTOIA is not met.[68] Gains are not taxable in the year of remittance because although the conditions of sch 1 TCGA are satisfied (remitted gains are treated as accruing when remitted) the individual

[68] See 17.13 (Charge on remitted RFI).

(being non-resident) is not subject to tax on chargeable gains treated as accruing to them.

There is a planning point here. If income arises in a UK resident year, and is remitted in a later UK resident year, there is a taxable remittance, even if the individual has in the meantime been non-resident. So it may be better to remit in a non-resident year. If income is remitted to the UK in a non-resident year, without a tax charge, it cannot be remitted again and so cannot become taxable in a later year when the individual is UK resident.[69]

The temporary non-residence rules will apply if the individual is merely temporarily non-resident. This indicates that the planning by a person who is outside the scope of those rules does not in principle constitute tax avoidance. But it would be different if there were an arrangement under which income/gains are remitted to the UK for a short time and then taken out of the UK again.

For employment income, see 34.36 (Receipt/remittance after death). For relevant debts where the borrowed money is remitted when non-resident, see 18.21 (Relevant debt).

17.19 Remittance after death

Suppose:

(1) RFI or gains accrue to T (a remittance basis taxpayer).
(2) T dies, and the sum is received in the UK after the death.

In the following discussion,

"The year of death" is the tax year in which T dies.
"Post-death year" means a subsequent tax year.

If RFI is received in the UK in a post-death year, no IT charge arises because the requirement in s.832(2) ITTOIA is not met: the year of remittance is not one "for which the individual is UK resident".

If gains are received in the UK in a post-death year, no CGT charge arises. Even if para 1(2) sch 1 TCGA operates to treat gains as accruing to the individual who has died, the gains do not accrue to a UK resident.

There is no taxable remittance if funds are received in the UK after the death but in the year of death. Property cannot be received in the UK by T (who is dead) or by a relevant person (there are no relevant persons in

[69] See 18.42 (Cap on amount remitted).

relation to a dead person); so remittance condition A cannot be satisfied.

For employment income, see 34.36 (Receipt/remittance after death).

17.20 Remittance after source ceased

Section 832(3) ITTOIA provides:

> Subsection (2) applies whether or not the source of the income exists when the income is remitted.

17.20.1 *Pre-2008 RFI*

The rule for the pre-2008 RFI remittance basis was that there was no charge on a remittance from a source in a year after the source has ceased. Suppose:

(1) RFI accrued to T before 2008/09.
(2) The source of the RFI ceased before 2008/09.
(3) The RFI is remitted from 2008/09.

Is T taxable on the remitted income under s.832(2) ITTOIA? Yes, the tax charge is retrospective in that pre-2008/09 income previously outside the scope of tax has now fallen within the scope of tax. It does not matter when the income arose or the source ceased: income arising in the 1950s could now come into charge, though all records relating to it would have been long discarded.

STEP rightly comment:

> It appears that any source ceased funds, whenever the source ceased will be caught by the new rules. The effect of this is to retrospectively change the nature of these funds and this is unfair. If this is to be the case then taxpayers who have used this technique may have placed the funds in capital accounts which will, as a consequence of the changes to the rules, now be classified as mixed accounts. Not only do the mixed account rules fail to take into account the change in nature of these funds which were capital on 5 April 2008 and income on 6 April 2008, but there does not seem to be any clear way to separate out these funds now as the mixed account rules only apply to remittances to the UK. Whilst STEP does not object to the change in these rules for the future, we do feel that it is unfair to impose additional tax and reporting burdens on taxpayers who used a technique in the past which HMRC recognised and accepted when they used it.[70]

[70] STEP Representations on the FB 2008.

What if the source ceased and T remitted the income before 2008/09? Even if the transitional rule does not provide relief, it is considered that there is no charge because of the cap on the amount remitted; see 18.42 (Cap on amount remitted).

HMRC accept that there is no charge on pre-2008 deemed gains.[71] The same reasoning must apply here so it is considered that pre-2008 source-ceased income, which was remitted to the UK prior to 6 April 2008, remains non-taxable.

17.21 RFI/gains of non-resident, remitted when resident

Suppose:

(1) A non-resident individual receives RFI or gains. The income/gains are not taxed as they arise.

(2) The individual becomes UK resident, and subsequently remits that sum when taxable under the remittance basis.

RFI remitted is not taxed on remittance as the condition in s.832(1) ITTOIA is not met. Gains remitted are not taxed on remittance because the condition in para 1(1) sch 1 TCGA is not met.

FAQ Remittances (April 2008) correctly states:

> **Where a non-domiciled individual not resident in the UK, has purchased assets abroad out of income that has not been taxed in the UK, then moves to the UK and becomes resident, will the importation of those assets in the first year be taxed as a remittance?**
> No. As the untaxed income arose while the individual was not UK resident, there is no charge unless the proposed new s.832A [ITTOIA][72] applies (temporary foreign residence).

17.22 RFI from Ireland

17.22.1 *Income from 2008/09*

The position for income from 2008/09 is straightforward. The ITA remittance basis treats Irish source income in the same way as any other foreign income. The FA 2008 repealed the rule of the pre-2008 remittance basis which provided (unlawfully and probably ineffectively[73])

[71] See 18.45.2 (Remittance of deemed gain).

[72] The original erroneously refers to ITA 2007.

[73] The point is discussed in the 6th edition of this work para 9.51 and the 2012/13 edition para 9.19 (RFI from Ireland).

that Irish income was taxed on an arising basis.

The UK/Ireland DTA also needs to be considered but that aspect is not discussed here. Similar points arise in relation to earnings: see 34.37 (Earnings from Ireland).

17.22.2 *Pre-2008 Irish income*

This change raised the problem of transition. Para 83 sch 7 FA 2008 provides:

> (1) This paragraph applies to an individual's relevant foreign income for the tax year 2007-08 or any earlier tax year ("the relevant tax year") if—
> (a) the individual made a claim under section 831 of ITTOIA 2005 for the relevant tax year, or
> (b) section 65(5) of ICTA (or any earlier superseded enactment corresponding to that provision) applied in relation to the individual for the relevant tax year. ...
> (3) But nothing in section 832 of ITTOIA 2005 applies in relation to any of the relevant foreign income that arose in the Republic of Ireland.

EN FB 2008 provides:

> 399. Sub-paragraph(3) provides that the new section 832 does not apply to relevant foreign income that arose in the Republic of Ireland. This ensures that no double charge can arise in relation to those tax years during which it was not possible to claim the remittance basis for such income. (This might be relevant for example where income arose in one of those years and was charged on an arising basis but was not remitted to the UK until on or after 6th April 2008.)

Para 83(3) disapplies the remittance basis charge for pre-2008 Irish income. In short, if:
(1) Irish source income arose before 2008/09; and
(2) The income is remitted on or after 2008/09
there is no tax charge on remittance.

This applies even if taxpayers successfully argue that pre-2008 Irish income should as a matter of EU law have been taxed on the remittance basis. But that point will not now often arise.

17.23 Remittance basis for trustees: Pre-2007 transitional rules

From 2007/08 the remittance basis applies only to individuals, so trustees do not qualify.

Before that time, UK resident foreign domiciled trustees did qualify for the remittance basis on RFI[74] (though I am not sure how widely that was appreciated or used). Pre-2007 income of trustees which qualified for the remittance basis when it arose, is not taxable on remittance after 5/4/2007, because s.832 ITTOIA now applies to individuals. This could be something of a windfall for trustees who qualified for the RFI remittance basis before 2007. But the point will not often arise.

17.24 Forward tax agreements

Details of this arrangement were made public in an article by Malcolm Gunn in *Taxation*, 17 May 2001, under the revealing name "subscription rate method of taxation". The taxpayers involved were very wealthy UK resident non-domiciled individuals.

HMRC required disclosure of the taxpayer's worldwide assets. The taxpayer then offered to settle the tax liability on foreign sources for a fixed sum. A starting position was that one estimated the taxpayer's UK living expenses; deducted from that the amount of UK income; the balance then represented funds which would be required annually from overseas, on which tax was expected. The forward tax agreement related to foreign income/gains. UK source income remained taxable in the normal way. Malcolm Gunn explained:

> One may be able to negotiate the annual fixed payment downwards on the starting point figure. ... So in the final analysis, it is down to negotiating a deal which both the taxpayer and the Revenue feel they can live happily with.[75]

In the first edition of this book I said:

> It is likely that publication will stop the practice completely. Those who believe that tax should be governed by law will add: Quite right too.

Since then the courts have tried to stop these agreements by holding them to be *ultra vires*.[76] Where such agreements have been made in the past,

[74] See the 2012/13 edition of this work para 9.21 (Remittance basis for trustees).;

[75] Transition from taxation by agreement to taxation by law raises additional problems discussed in Malcolm Gunn's article.

[76] *Al Fayed v Advocate General* 77 TC 273. *Fayed*-style bargaining is however the basis of taxation of wealthy foreigners in many countries, including, I understand, Switzerland, France and Austria. Even in the UK after *Fayed* the temptation is ever

a taxpayer should have a defence to an assessment if they can show they have suffered prejudice. It is an interesting question how these agreements should deal with transitional issues such as the introduction of the remittance basis claim charge.

17.25 Divorce: Remittance liabilities

In *SA v PA*:[77]

> The husband seeks to include a CGT and/or income tax liability of £240,000 should he remit his Dutch funds here to buy a house. [Counsel for the wife] says:-
>
> > "... this is the usual story – H says this is what his CGT liability would be if he brought all his assets onshore (he is a tax non-dom). As will be seen, he has studiously avoided for many years bringing taxable assets onshore, and there is no likelihood he will now do so. He says he intends to buy a house in the UK, but W considers this entirely unlikely. ... he is much more likely to continue to rent in England and buy in the Netherlands."
>
> ... [There is] no general rule about the inclusion or exclusion of such tax but ... the court must deal in realities and must not make its order on a false basis. ... These taxes cannot be avoided if the funds are brought here, or if they are used indirectly to purchase property under some back-to-back agreement. At present the husband lives a bipolar life between London and Amsterdam. In my judgment it would not be unreasonable for him to buy a home here in which to live with his children when with him. Therefore, it is reasonable in this case to include the liability to tax as a deduction.

For other tax issues in divorce, see:
18.50 (Proceeds of divorce settlement)
50.6 (Benefit in course of divorce)

17.26 Remittance compliance/enquiry

In 2013 HMRC set out standard form letters to UK resident remittance basis taxpayers. These were popularly known as "nudge letters"; the HMRC term was "educational letters". They were controversial in that: (1) HMRC sent the letters directly to its customers even if they had

present to move from the inconvenience of taxation by law to the convenient (but ultimately corrupt) method of taxation by negotiation.

[77] [2014] EWHC 392 (Fam) at [69].

agents acting for them.[78]

(2) The letters stated controversial positions in an unqualified and peremptory way.[79]

The professional bodies understandably objected[80] and (whether or not for that reason) HMRC did not do this again.[81]

In about 2014, HMRC asked agents "what tests and checks did you carry to establish whether or not remittances had been made?". This seems a loaded question.[82] It contains the assumption that accountants are generally expected to conduct tests and checks. But it is correct to say that unguided lay taxpayers will not understand the meaning of remittance, as the term is defined in a wide, complex, and artificial way. Accountants responsible for completing tax returns of remittance basis taxpayers should not merely ask their clients what income/gains have been remitted. They may rely on their clients answers only if they have properly explained the rules. HMRC are entitled to ask how that has been done. Perhaps that is what the question is intended to address.[83]

17.27 Tax return: Unremitted RFI/gains

Unremitted income/gains are not taxable and need not be disclosed:

(1) in a tax return[84] or

(2) in an HMRC domicile enquiry

HMRC say:

> Those using the remittance basis will not be required to make any additional disclosures about their income and gains arising abroad. So long as they declare their remittances to the UK and pay UK tax on them, they will not be required to disclose information on the source of the remittances.

[78] This was a breach of the HMRC Charter ("We'll respect your wish to have someone else deal with us on your behalf, such as an accountant").

[79] See 18.15.4 (Travel to/from UK).

[80] See Ashby, "Tax Adviser" (November 2013), p.16
CIOT "Remittance basis 'educational nudge letter' - CIOT comments"
ICAEW Taxrep 59/13

[81] But see 4.24.1 (Change of HMRC practice).

[82] *http://en.wikipedia.org/wiki/Loaded_question*

[83] See 4.24.1 (Change of HMRC practice); Cassidy "Because I said so", Tax Adviser, September 2014 p.42.

[84] See 123.3 (Quantification of claim).

CHAPTER EIGHTEEN

THE MEANING OF REMITTANCE

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Cross references

The following topics are considered elsewhere:

Topic	**See para**
PAYE repayment not remittance	36.9
Remittance from joint account	94.3.9

18.1 ITA remittance basis: Introduction

This chapter considers what constitutes a remittance, for the purposes of the remittance basis.

The law is in Chapter A1 Part 14 ITA, which sets out what I call the **"ITA remittance basis"**.

The ITA system of numbering sections is idiosyncratic. The provisions of Chapter A1 Part 14 are numbered 809A to 809Z, and, continuing beyond 809Z, are numbered 809Z2 to 806Z10. Subsequently enacted provisions are slotted in between, eg between 809V and 809W we have 15 sections numbered 809VA to 809VO.

However, s.809A is not the first section of ITA whose number begins with 809. Before it are *eight* Chapters of Part 13, (numbered Chapters 5A, 5AA, 5B-5F and 6). These begin with s.809AZA and conclude with s.809ZR.

This does make navigation difficult; but there it is.[1]

18.1.1 *Scope of ITA remittance basis*

Section 809K(1) ITA identifies 6 places where the ITA remittance basis applies:[2]

> Sections 809L to 809Z6[3] apply for the purposes of—

Provision	***Topic***
Chap A1 Part 14 ITA	Meaning of remittance
s.22, s.26 ITEPA	Employment income
Chap 5B Part 2 ITEPA	Employment-related securities
ss.554Z9-554Z11	Disguised remuneration
s.832 ITTOIA	Relevant foreign income
sch 1 TCGA	CGT

This is just a signpost provision, and not quite the full list. The ITA remittance basis is incorporated in these places, and in other places, using whatever formula floats to the drafter's mind:

> See Chapter A1 of Part 14 of ITA 2007 for the meaning of "remitted to the UK" etc.[4]

> "remitted to the UK" has the meaning given in Chapter A1 of Part 14 of

[1] This is due to a misguided application of OPC drafting guidelines; see App.13.3 (Section numbering system).

[2] For clarity, I set this out in a table format, and abbreviate the section descriptions.

[3] The reference to "ss.809L to 809Z6" was slightly strange, as it omitted s.809Z7 (interpretation). Now it is wrong, because FA 2012 added further sections: it should be taken as a reference to "ss.809L to 809Z10".

[4] See s.22(6), 26(5) ITEPA, s.832(4) ITTOIA, s.12(5) TCGA (all inserted 2008); s.648(4) ITTOIA (inserted 2009); s.554Z11(4) ITEPA (inserted 2011); s.41F(10) ITEPA (inserted 2014).

> ITA 2007.[5]
>
> "remitted to the UK" is to be read in accordance with Chapter A1 of Part 14.[6]
>
> any question as to whether, and when, amounts are "remitted to the UK" is determined in accordance with the rules in Chapter A1 of Part 14 of ITA 2007.[7]

This could have been drafted more neatly, but it works. As far as I can see, the ITA remittance basis in Chapter A1 Part 14 applies everywhere the expression "remitted to the UK" is used, ie everywhere the remittance basis applies.

18.1.2 *Why is remittance basis hard*

The difficulty is inherent in the concept of a remittance basis. Although it is an exaggeration to say that "money has no earmark" it is often very difficult to trace or earmark money.[8] The fungibility of income/gains and other assets makes it hard to determine whether any specific asset received in the UK should be regarded as the income/gains. But this is what a remittance basis requires to be done.

Before 2008 the matter was largely left to the courts to sort out. It cannot be said that the courts were entirely successful.[9] In 2008 parliament recast the rules in statutory form. By most measures this has also been unsuccessful. The ITA rules are:

(1) Unstable: they were amended almost every year in the decade after 2008, and even now the law does not seem to be stable.
(2) Complex: the topic which took up 78 pages in the 2007/08 edition of this work needs four chapters and over 400 pages in the current edition.
(3) Record keeping is vastly increased.

No less than before, careful planning is needed to avoid unfairness.

[5] See s.408A(10) ITTOIA, s,689A(6) ITTOIA (both inserted in 2013).

[6] See s.726(7) ITA, s.730(7) ITA (both inserted in 2017).

[7] Para 5(3) sch 1 TCGA.

[8] *Lipkin Gorman v Karpnale* [1989] 1 WLR 1340 at p.1382 (CA). The law of tracing illustrates this.

[9] Thus *Thomson v Moyse* 39 TC 291 at p.328: "this difficult branch of the law"; *Kneen v Martin* 19 TC 33 at p.41: "This subject is always troublesome".

18.1.3 *Pre-2008 remittance rules compared*

The wording of the ITA remittance basis is so different that cases on the pre-2008 remittance basis need careful review to see if they have any relevance to the current law; in practice I have not found any that are still important.

HMRC agree. The RDR Manual provides:

> **RDRM31210. Key differences between 'new' (post 5 April 2008) and 'old' regime (pre 6 April 2008)** [Jan 2019]
> ...The previous case law is now of limited relevance.

There should be no assumption of continuity, ie that the post-2008 law is the same as before. There are many transactions which are taxable remittances which were not caught under the pre-2008 rules; but there are also transactions which were formerly caught but which are not now taxable remittances.[10]

In earlier editions I discussed the enactment history, and differences between the pre-2008 provisions and the current law.[11] I omit that now, because the enactment history sheds no light on the current law, and the differences are of historical interest only. HMRC and taxpayers, and perhaps the Courts, will refer to the pre-2008 law where it supports their view of the current law, and ignore it when it does not. But one should not take that seriously.

18.1.4 *Construction of remittance basis*

Sehgal v HMRC refers to EN FA 2008:[12]

> Where [gains] are in effect remitted to the UK, in such a manner that the individual has the use or enjoyment of them in the UK, the individual should be liable to tax on them.

Seghal continues:

> This ... supports a wide interpretation of the legislation; it was intended to cover any guise in which offshore gains could be "enjoyed" in the UK.

The concept of remittance is clearly intended to be broad. One should not

[10] For example, the remittance reliefs discussed in the next chapter.

[11] See the 16th (2017/18) edition of this work para 12.12.1 (Enactment history, Remittance Condition A) and 12.15.2 (Enactment history, Remittance Condition B).

[12] [2022] UKFTT 312 (TC) at [103].

need to refer to the explanatory notes to see that. But these broad principles operate at a high level of generality, and do not solve the questions which arise in practice. In *Sehgal* itself:[13]

> Both parties suggested that the Tribunal should take a realistic view of the transactions ... but they had very different views of what that reality should be...

That will not surprise readers. It happens all the time.[14] We need to turn to the words of the remittance basis and of the legal documentation. But sometimes, perhaps, an argument leads to such absurd results that these generalities are useful.

For completeness, according to the FTT in *Sehgal*:

(1) Section 809L is an anti-avoidance provision.[15]

(2) Section 809L is intended to close "loopholes", or "a loophole".[16]

As to point (1), s.809L is not in any meaningful sense, an anti-avoidance provision. It simply gives a comprehensive statutory definition to "remittance".[17]

As to point (2), *Sehgal* does not identify what the "loophole(s)" were. Readers who remember the pre-2008 rules will recall that they had some quirks, or "loopholes" if one must descend to the language of the tabloids.[18] That the ITA code has corrected these does not shed much, if any, light on the present law. More significantly, if the old law is relevant to the new, it may be noted that the pre-2008 rules were also widely construed.[19]

The reader may hope that the UT decision is released before these comments are recited in other case law.

18.2 Remittance conditions A to D

Section 809L(1) ITA provides:

[13] at [96].

[14] See App. 7.1 (What do we mean by real).

[15] [2022] UKFTT 312 (TC) at [94].

[16] the plural at [94] and the singular at [103].

[17] Of course there are some provisions in the ITA remittance basis which one can properly call anti-avoidance provisions, such as the mixed-fund TAAR.

[18] See App.1.10 (Loophole/tax break).

[19] See the 6th (2007/08) edition of this work, para 9.25 (Method of remittance does not matter).

> An individual's income is, or chargeable gains are, "remitted to the UK" if—
> (a) conditions A and B are met,
> (b) condition C is met, or
> (c) condition D is met.

Thus there is a remittance if one of three conditions, or (more accurately) sets of conditions, are met. I refer to "**remittance conditions A to D**", and I refer to the income or chargeable gains as "**income/gains**". HMRC sometimes use the abbreviation FIG (foreign income or gains); I leave the word foreign to be understood.

It is considered that s.809L(1) is a comprehensive and not an inclusive definition of remittance. That is, a sum is remitted if and only if one of these three sets of conditions are satisfied. Remittance conditions A to D are so complex, and so broad, that there is no room for any other type of remittance.

In practice, remittance conditions A and B are the most important.

I refer to a remittance within the meaning of s.809L(1) as a **"taxable remittance"**.

18.3 Relevant person: Introduction

Before discussing the remittance conditions, it is necessary to consider the term "relevant person". All four remittance conditions use this term.

"Relevant person" is defined in s.809M ITA. Section 809M(1) ITA provides:

> This section applies for the purpose of this Chapter.[20]

The term "relevant person" is also used in transitional provisions: para 86(2)(3) sch 7 FA 2008. Here the drafter did not supply any definition but the context shows that the s.809M definition must be applied. So the definition applies throughout the remittance provisions.

A relevant person strictly means the individual to whom income/gains accrue, as well as certain persons connected to them. But in the discussion below I generally refer to the specific individual as "the individual" and use the term "relevant person" to mean the others within the statutory definition.

[20] This is duplicated in s.809Z(10) ITA: "In this Chapter ... "relevant person" has the meaning given by section 809M".

Strictly one should not use the term “relevant person” in the abstract. A relevant person can exist only *in relation to an individual*. But where the context is clear it is permissible to refer to a relevant person in isolation (leaving the words “in relation to an individual” and the identity of that individual to be inferred).

Section 809M ITA sets out 8 categories of relevant person. These can be split into three groups: close family, family companies, and family trusts.

18.4 Relevant person: Family

The first four categories of relevant person are close family. Section 809M(2) ITA provides:

> A “relevant person” is—
> (a) the individual,
> (b) the individual’s husband or wife,
> (c) the individual’s civil partner,
> (d) a child or grandchild of a person falling within any of paras (a) to (c), if the child or grandchild has not reached the age of 18.

Section 809M(3) ITA treats cohabitees as married persons, so they and their children/grandchildren may be relevant persons under this definition.[21]

18.5 Relevant person: Companies

The provisions discussed in this section have had a complicated evolution. I omit that here – reluctantly, as the story has amusing aspects – but it is now of historical interest only.[22]

Under s.809M(2)(e) ITA the next category of relevant person is:

> (e) [i] a close[23] company in which a person falling within any other paragraph of this subsection is a participator, or

[21] See App.3.4.1 (Cohabitee treated as spouse).

[22] For a lesson in how not to legislate, see the 9th (2010/11) edition of this work para 10.4, 10.5.

[23] Section 809M(3)(c) ITA provides a referential definition:

> “close company” is to be read in accordance with Chapter 2 of Part 10 of CTA 2010 (see in particular section 439 of that Act).

This is unnecessary as that is the default definition in the ITA: see 104.26 (Close company: Introduction). But it does no harm.

> [ii] a company which is a 51% subsidiary[24] of such a close company.

Under s.809M(2)(f) ITA the next category of relevant person is:

> (f) [i] a company
> [1] in which a person falling within any other paragraph of this subsection is a participator, and
> [2] which would be a close company if it were resident in the UK, or
> [ii] a company which is a 51% subsidiary of such a company

This is intended to catch family companies but it is widely drawn. An individual would not usually know whether any company is a relevant person in relation to them, because they cannot tell whether it might have a participator who is a trustee of a RP trust.

Companies may also be relevant persons as bodies connected to trusts.[25] For charitable companies, see 18.52.1 (Is charity a relevant person).

18.5.1 *"Participator"*

The key term here is "participator". Section 809M(3)(ca) ITA provides:

> "participator",
> [i] in relation to a close company, means a person who is a participator in relation to the company for the purposes of section 455 of CTA 2010 (see sections 454 and 455(5) of that Act), and,
> [ii] in relation to a company that would be a close company if it were resident in the UK, means a person who would be such a participator if it were a close company

Para [i] incorporates the extended definition of "participator".[26]

Para [ii] is unnecessary,[27] but it does no harm.

18.6 Relevant person: Trusts

Under s.809M(2)(g) ITA the next category of relevant person is:

> (g) the trustees of a settlement of which a person falling within any

[24] Section 809M(3)(cb) ITA provides the standard definition: '51% subsidiary' has the same meaning as in the Corporation Tax Acts (see Chapter 3 of Part 24 of CTA 2010). See 64.26 ("51/75/90 % subsidiary").

[25] See 18.7 (Body connected with trust).

[26] See 104.24 (Participator: extended definition).

[27] See 104.23.12 (Participator in non-resident co).

> other paragraph of this subsection is a beneficiary.

This is intended to catch family trusts but it is so widely drawn it covers many if not most trusts in existence.

In the following discussion:

"An RP beneficiary" is a beneficiary falling within any other paragraph of s.809M(2).

"An RP trust" is a trust within s.809M(2)(g), ie one with an RP beneficiary.

Strictly one should not use these terms in the abstract. An RP trust can exist only *in relation to an individual*. But where the context is clear it is permissible to refer to a RP trust in isolation (leaving the words "in relation to an individual" and the identity of that individual to be inferred).

Thus in my terminology, if T (or T's spouse, etc) is a beneficiary, the trust is an RP trust in relation to T, or (in short) it is an RP trust.

Section 809M(3)(e) ITA defines "beneficiary":

> "beneficiary", in relation to a settlement, means any person who receives, or may receive, any benefit under or by virtue of the settlement;

Every trust with an unrestricted power to add beneficiaries (which is a standard form) is an RP trust.

If T and their relevant close family (spouse etc) are all excluded, but the power to add beneficiaries extends to a close company in which T is a participator, then the trust is still an RP trust. The company may be a RP beneficiary even though T has no interest in it.

If the power to add beneficiaries is only exercisable with the consent of an individual, the position is different.

Suppose the beneficiaries are T's children and their issue. If T's children are adult and there are no minor grandchildren, then the trust is not an RP trust. However it becomes a RP trust if a grandchild is born.

A trust is not an RP trust in relation to T just because its terms provide that children or grandchildren of T can benefit after they have reached the age of 18, as long as they cannot benefit before then.[28]

[28] See *Vestey v IRC* 31 TC 1 (known as the first *Vestey* case) which decided that a trust with power to benefit the widow of the settlor was not settlor-interested. At the time that the income arose:

(1) The settlor's wife could not benefit (as she was not a widow).

(2) It was possible that in the future she could benefit (as she might survive the settlor

If T is not a beneficiary, but T lends interest-free to the trust, it is considered that the trust does not become an RP trust in relation to T just because of the loan. T may receive a benefit (on repayment of the loan).[29] However that benefit arises under or by virtue of making the loan to the trustees, (ie, under or by virtue of the loan agreement): T does not receive a benefit under or by virtue of the settlement.[30]

For charitable trusts, see 18.52.1 (Is a charity a relevant person?).

Section 809M(3)(d) ITA provides:

> "settlement" and "settlor" have the same meaning as in Chapter 2 of Part 9.

This brings in the standard IT/CGT definition of "settlement".[31] That is strictly unnecessary, since this definition applies except so far as the context otherwise requires; but it does no harm.[32]

The definition of "settlor" is otiose as the word is not used in the definition of "relevant person".

For completeness: s.809M(3)(f) ITA provides an otiose definition of trustee.[33]

It makes no difference if an individual to whom income/gains arise is a

and so become a widow). That did not matter because the legislation (which is comparable to s.809M) was held to apply only if *at the time that the person received a benefit* she fell within the words "spouse of the settlor".

A different conclusion was reached in relation to s.28 IHTA (employee benefit trusts): see *Barker v Baxendale Walker Solicitors* [2017] EWCA Civ 2056; but the legislation there is not the same as s.809M.

[29] See 47.6.2 ("Settlor-interested" for s.624).

[30] The same point arises in relation to pre-owned assets, where HMRC accept a similar argument: see 83.8 (POA intangible property charge).

[31] See 87.3 (Settlement: Standard IT/CGT definition).

[32] The definition is useful for the avoidance of doubt, since s.809M twice refers to s.993 ITA, where the settlement-arrangement definition applies. Thus the definition makes it clear that the settlement-arrangement definition of settlement is not applicable to s.809M.

[33] Section 809M(3)(f) ITA provides: "'trustee' has the same meaning as in section 993 (see, in particular, section 994(3))". So we turn to s.994(3) ITA which contains what I call the deemed trustee rule; see 87.8.2 (Non-classic trust: Deemed trustee). The deemed-trustee rule deals with the problem where legislation refers to trustees of a settlement-arrangement (which may not have trustees in the trust-law sense). The deemed-trustee rule is not needed where (as here) "settlement" has the standard IT/CGT definition, and so must have trustees in the trust-law sense. But no harm arises.

trustee, or a participator in a corporate trustee, as trustees are deemed to be a separate, notional person (which is not a company).[34]

18.6.1 *Unit trust*

A unit trust is not a settlement, so trustees of a unit trust are not relevant persons under s.809M(2)(g) ITA.

A unit trust is not a company (though it is deemed to be a company for some specific tax purposes) so it is not a relevant person under any other head.

18.7 Body connected with trust

Under s.809M(2)(h) ITA the last category of relevant person is:

> (h) a body connected with such a settlement.

That is, a body connected with an RP trust, within 809M(2)(g): a trust of which some other relevant person is a beneficiary.

18.7.1 *"Connected with" settlement*

Section 809M(3)(g) ITA defines "connected with":

> a body is "connected with" a settlement if the body falls within section 993(3)(c), (d), (e) or (f) as regards the settlement.

This must not be confused with the much more common tax concept of a "connected person".

In order to follow this, one needs to set out the four paragraphs of s.993(3)(c)(d)(e) and (f).

First, s.993(3)(c)(d) ITA provide:

> (3) A person, in the capacity as trustee of a settlement,[35] is connected with ...
>
> (c) any close company whose participators include the trustees of the settlement,
>
> (d) any non-UK resident company which, if it were UK resident, would be a close company whose participators include the trustees of the settlement

[34] See 7.3 (Trustees a distinct person).

[35] "Settlement" in s.993 means settlement-arrangement: see s.994(1) ITA. However for a body to qualify as a relevant person under s.809M(2)(h) there needs to be a settlement within the standard IT/CGT definition.

Section 809M(3)(g) is not elegantly drafted. It refers to a body connected with a settlement; whereas s.993 refers to bodies connected with trustees of a settlement; but the meaning must be the same.

At first sight it seems unnecessary for s.809M(3)(g) to refer to s.993(3)(c) or (d), because any company within (c) or (d) would be a relevant person in any event under s.809M(2)(e) or (f).[36] But this does make a difference as can be seen from the examples below. In any case, one needs to have (c) and (d) in mind in order to understand s.993(3)(e).

"Participator" in s.993(3)(c)(d) is not defined; it is considered that it bears the normal close company meaning.

Section 993(3)(e) ITA provides:

> (e) any body corporate controlled (within the meaning of section 995) by a company within para (c) or (d)

For the s.995 definition of control, see 104.2.3 (Control: Strict sense).

Lastly, s.993(3)(f) ITA provides:

> (f) if the settlement is the principal settlement in relation to one or more sub-fund settlements, a person in the capacity as trustee of such a sub-fund settlement.

It seems unnecessary for s.809M(3)(g) to refer to s.993(3)(f). Possibly the drafter only intended to refer to s.993(3)(c)(d)(e) and the reference to (f) slipped in by mistake. But since the sub-fund regime is dead-letter tax law (hardly ever found in practice) the point does not matter.[37]

18.7.2 *"Body"*

Section 809M(2)(h) ITA refers to a "body" connected with a settlement. The term is wide and somewhat vague. However in order to fall within s.993(3)(c)(d) the body must be a company. In order to fall within s.993(3)(e) the body must be a body corporate. Presumably the word "body" was selected as the apt term to include the (somewhat theoretical) case of trustees of sub-funds under s.993(3)(f).

18.8 Company relevant person: Examples

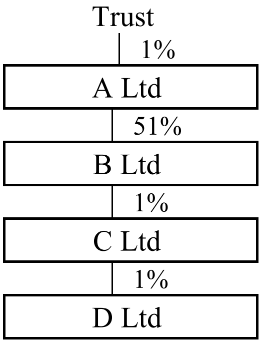
It may be helpful to give some examples of how the relevant person rules apply to trust/company structures. In the following examples:

[36] Because the trustees are participators.

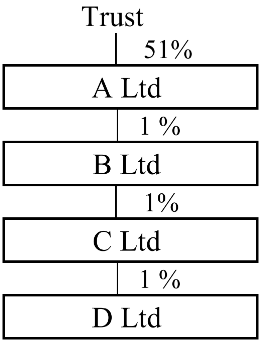
[37] See 63.2 (Sub-Fund regime).

"(e)-company" is a relevant person under s.809M(2)(e)[38]
"(f)-company" is a relevant person under s.809M(2)(f)[39]
"(h)-company" is a relevant person under s.809M(2)(h)[40]
"non-(e) rel. person" is a person who falls within any other paragraph of 809M(2) ie (1) not a person who falls outside 809M and (2) not a person who is *only* within para (e)
"non-(f) rel. person" is a person who falls within any other paragraph of 809M(2) ie (1) not a person who falls outside 809M and (2) not a person who is *only* within para (f)

Example 1



Example 2



Assume the trust is a relevant person (eg the individual is a beneficiary). Assume all the companies are close.

A Ltd is (in my terminology):
- an (h)-company
- an (e)-company if UK resident, or an (f)-company if non-resident.
- a non-(e) rel. person and non-(f) rel person (because it is not *only* within (e)/ (f))

Example 1
Assume first that the companies are all non-resident close companies.
B Ltd is an (f)-company because a non-(f) rel. person - A Ltd - is a participator.
C Ltd is not a relevant person. It is not an (f)-company as it does not meet the requirement in (f) that a person "falling within any *other* paragraph" of s.809M(2) is a participator.

[38] See 18.5 (Relevant person: Companies).
[39] See 18.6 (Relevant person: Trusts).
[40] See 18.7 (Body connected with trust).

The result is the same if all the companies are UK resident close companies, though the statutory references are different:
B Ltd is an (e)-company because a non-(e) rel. person - A Ltd - is a participator.
C Ltd is not a relevant person. It is not an (e)-company as it does not meet the requirement in (e) that a person "falling within any *other* paragraph" of s.809M(2) is a participator.

Suppose however that B Ltd is UK resident and C Ltd is non-resident. In that case C Ltd *is* a relevant person:
B Ltd is an (e)-company because a non-(e) rel. person - A Ltd - is a participator.
C Ltd is an (f)-company as a non-(f) rel. person - B Ltd - is a participator.

It follows that D Ltd is then an (e)-company if UK resident, since a non-(e) rel. person - B Ltd - is a participator.

Example 2

The difference in example 2 is that the trustees are participators in B Ltd[41] so B Ltd is an (h)-company.

18.8.1 *Co relevant person: Critique*

Where any of these companies are relevant persons, so are
- their 51% subsidiaries and
- companies they "control" (in the ultra-wide sense)

It will be apparent that the definition of relevant person for companies is far too wide; it is not realistic to think that the rules are or ever could be applied in practice to large corporate groups of close companies.

18.9 Relevant person: Partnership

A general or limited partnership does not fall within any para of s.809M(2)(a)-(g) ITA.

A general or limited partnership does not fall within s.809M(2)(h) ITA. What if trustees control a partnership? A general or limited partnership may be a body,[42] but even if it is, the partnership is not "connected with"

[41] See 104.23.2 (Chain of wholly-owned co's).

[42] A partnership is a body in the general sense, but it is deemed not to be an entity (and so, perhaps, not a body) for IT purposes: see 85.16 (Partnership transparency: IT/CT).

the settlement within s.809M(3)(g) as it is not a company or body corporate.[43]

So a general or limited partnership as such is never a relevant person. That is not surprising, since a partnership is also not a "person" in the normal legal sense of the word.[44]

The LLP-law analysis of a UK LLP is different from the partnership law analysis of a true partnership, but the end result should be the same. An LLP is not (generally) a company for IT/CGT purposes, so it does not fall within any para of s.809M(2)(a)-(g) ITA. What if trustees control an LLP? The LLP is not connected with the settlement under s.809M(3)(g). An LLP is actually a body corporate, but it should be deemed not to be a body corporate for this purpose.[45]

Of course the members of the partnership may be relevant persons; see 18.49 (Partnerships).

HMRC agree. The RDR Manual provides:

> **RDRM33530. Partnerships** [Jan 2019]
> ... *Offshore partnerships trading or investing in the UK*
> A partnership is not a relevant person RDRM33030. Individuals who are partners together in a partnership are not relevant persons by virtue of their role as a partner (although they may, of course, be relevant persons under other provisions).

18.10 Relevant person: Pre-2008 income/gain

Para 86(4) sch 7 FA 2008 provides a transitional relief for pre-2008 income/gains:

> Subject to sub-paras (2) and (3), in relation to an individual's income and chargeable gains for the tax year 2007-08 or any earlier tax year, section 809L has effect as if the references to a relevant person were to the individual.

This transitional rule amends s.809L, so it applies for remittance conditions A/B, C and D. Corresponding amendments are made elsewhere when required:

But it is not necessary to rely on this point here.

[43] See 85.14 (Partnership: person/body corporate).

[44] See 85.14 (Partnership: person/body corporate).

[45] See 85.22.3 (LLP: Partnership terms applied).

Topic	**Section**	**Amended by**	**See**
Remittance condition C	s.809N ITA	Para 87 sch 7 FA08	18.31
Remittance condition D	s.809O ITA	Para 88 sch 7 FA08	18.34
Settlor-interested trust	s.648 ITTOIA	Para 86(4A) sch 7 FA 08	47.8.5

The para 86(4) transitional rule does not apply in other provisions, in particular: s.809Z2 (Personal use rule); para 86(2)(3) sch 7 FA 2008. The reader may wonder if that is deliberate or an oversight, but it does make sense. These are provisions where it is helpful to have a wide definition of relevant person. The point will not often arise.

Amended as para 86(4) directs, conditions A/B (set out in s.809L(2)(3) ITA) read as follows:

> Condition A is that—
> (a) money or other property is brought to, or received or used in, the UK by or for the benefit of ~~a relevant person~~ the individual, or
> (b) a service is provided in the UK to or for the benefit of ~~a relevant person~~ the individual.
>
> (3) Condition B is that—
> (a) the property, service or consideration for the service is (wholly or in part) the income or chargeable gains,
> (b) the property, service or consideration—
> (i) derives (wholly or in part, and directly or indirectly) from the income or chargeable gains, and
> (ii) in the case of property or consideration, is property of or consideration given by ~~a relevant person~~ the individual[46]

So there is a taxable remittance of pre-2008 income/gains only if brought/received/used in the UK *by the individual.* Receipt (etc) by a relevant person does not count.

The RDR Manual provides:

> **RDRM31480. Relevant persons and foreign income and gains arising before 6 April 2008** [Jan 2019]
> [The Manual summarises the legislation and continues:]
> **Effect**
> This means that the income or gains remitted either as cash or property have to be brought to, received by or used in the UK for the benefit of the individual concerned before there can be a remittance.

[46] I can omit the provisions which follow, relating to relevant debts, as these provisions do not use the expression "relevant person".

The Manual provides a straightforward (if factually implausible) example.[47]

18.11 Relevant person: Compliance

Suppose:
(1) an individual gives income/gains to a relevant person ("R"); and
(2) R remits sums to the UK.

The individual in principle becomes liable to a tax charge. The residence of R does not matter.

However, R is under no duty to inform the individual that R has remitted sums to the UK. R is under no duty to inform HMRC, as any tax liability on the remittance is that of the individual, not of R. But the rules in theory require R to keep records for the lifetime of the individual.

Similar issues arise in relation to remittance condition C. Suppose:
(1) an individual gives income/gains to a non-relevant person ("G", a gift recipient); and
(2) qualifying property is enjoyed by a relevant person (or used in respect of a relevant debt).

The individual in principle becomes liable to a tax charge. The residence of G does not matter. G is under no duty to inform the individual or HMRC. But the rules in theory require G to keep records for the lifetime of the individual.

Similar issues arise in relation to remittance condition D, where any property of any third person ("P") is enjoyed by a relevant person (or used in respect of a relevant debt) and there is a connected operation (as defined). The individual in principle becomes liable to a tax charge. The residence of P does not matter. P is under no duty to inform the individual that P has remitted sums to the UK or to inform HMRC. But the rules in

[47] "Sanjay is a non-domiciled remittance basis user who transferred £10,000 of his foreign employment income from 2007-08 to his 15 year old grandchild's offshore bank account.
In 2008-09 the grandchild then remits £3,000 of this to the UK to buy himself a new computer. [How the 16 year old minor would operate the account and purchase the (rather expensive) computer is not explained, but it does not matter.]
Under the rules at section 809L this would create a taxable remittance of £3,000 by Sanjay because his grandson is a relevant person. However the transitional rule means that there is no taxable remittance of this income because it is employment income from 2007-08."

theory require P to keep records for the lifetime of the individual.

Of course in practice these rules will not (and indeed could not) be observed except in straightforward cases.

The individual has no indemnity against the relevant person, gift recipient or third party.

Under the pre-2008 remittance basis, if A (a remittance basis taxpayer) transferred A's income to any other person ("B") and B receives that income abroad, there was in general no remittance of that income if B subsequently remits the income to the UK. In the 6th edition of this work I said:

> The law could hardly be otherwise, for A will not usually know what B does with his money after it has been transferred to B.

I was wrong about that! My comment assumed that workability was a necessary requirement of UK anti-avoidance provisions. Now it is sufficient if the law is workable in simple cases.

A relevant person who bears a grudge against an individual (eg a separated spouse) may be able to trigger a significant tax charge out of spite, by deliberately remitting income/gains they have received from the individual. They may alternatively blackmail the individual by threatening to remit unless paid not to do so.

What about a gift recipient (such as an estranged adult child)? There is no charge if they remit income/gains they have received from the individual. What if they apply property they have been given for the benefit of a relevant person, eg a minor child or grandchild of the individual? This arguably does not constitute a taxable remittance under condition B, because the sums are not derived property, but it is caught by remittance condition C.

Also see 18.50 (Proceeds of divorce settlement).

The RDR Manual provides:

> **RDRM35030 remittances derived from foreign income or gains** [Jan 2019]
> ... Where an individual gives untaxed foreign income or gains to another person then they should ensure the donee is aware that they must tell the donor if the property or anything subsequently derived from it is bought to the UK in circumstances such that there would be a remittance under ITA07/s809L. ...

There is no statutory obligation to do this but failure will make compliance difficult.

HMRC say in March 2009 Qs & As Q9:

> If
> [1] the record keeping requirements are felt to be too onerous and
> [2] the probability of remittance to the UK is high
> the donor may wish to consider making a gift of taxed income or gains.

If "the probability of remittance to the UK is high" then the donor may indeed prefer a gift of taxed income/gains,[48] quite regardless of record keeping requirements. Conversely, what advice would HMRC give its customers if the record keeping was felt to be onerous but the probability of remittance was low? Or if the donor had insufficient taxed income/gains to make the gift?

18.12 Relevant person: Critique

If an individual remits their own income to the UK, they are able to spend it here and there is some sense in taxing them. The same may be said for an individual's spouse and minor children.

The extension to minor grandchildren (though not to adult grandchildren) is a novel development in tax. The policy is inconsistent with other anti-avoidance provisions, and leads to strange anomalies and nonsense.[49] The intention is perhaps to catch grandparents paying the school fees of their UK resident grandchildren – at least if the school is in the UK. The Brown administration was not supportive of private education. But that is only a surmise, as the Government never published any explanation.

The 2010 coalition administration apparently considered this point:

> 2.128 ... the Government does accept that there is value in giving further consideration to the following suggestions:
>
> - Excluding minor grandchildren from the definition of a 'relevant person'...
>
> 2.129 The Government will undertake further evaluation of these areas with a view to implementing any changes from April 2013.[50]

[48] Or other clean capital.

[49] See 18.47 (School fees).

[50] HMRC & HMT, "Reform of the taxation of non-domiciled individuals: summary of responses to consultation" (December 2011) *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf*

In practice nothing happened.

When a family trust or company remits its income to the UK, the individual (as beneficiary or participator) is not in any way advantaged unless and until the trustees decide to transfer the income to them or to a close family member. In these respects the definition of relevant person is extravagantly wide. What was the thought process that has led to this situation? Needless to say, there was no discussion of policy issues when the rules were announced. I infer that the law is based on a conception that the remittance basis requires funds to be taxed if and when *funds* come to the UK. The policy ought surely to be to charge tax when funds are available *for personal spending* in the UK, not simply because they are invested here. The reader may think it unfortunate that the manner of the 2008 reforms precluded debate or consideration about what the remittance basis was intended to achieve.

For these reasons the definition of relevant person ought to be restricted to the individual and close family.

In the 2010/11 edition of this work I said:

> The main effect of the present rules is to impose a prohibitive tax charge on investment in the UK by the foreign domiciliary or relevant persons.

This is now recognised to an extent by:

(1) The introduction of remittance investment relief in 2012 (though that is a complex and restricted relief)

(2) The introduction of protected-trust reliefs in 2017

It is considered that the way forward is to restrict the definition of relevant person to the individual, spouse, minor children and (perhaps regrettably, but unavoidably) cohabitee. Remittance investment relief could then be abolished; it would not be needed. That would be a significant simplification, enhance UK investment, and not result in any significant loss of tax. The 2008 reform lost sight of what the remittance basis is in fact intended to catch, and overlooked that the remittance basis was, and (if it serves any purpose) still is, intended to attract wealthy foreigners to reside *and invest* in the UK.

18.13 "Property"

18.13.1 *"Property" and "money"*

The remittance basis provisions use the following expressions:

Undefined term		**Used**	**See para**
Money or other property		Often	
Property [*used by itself*]		Often	*Discussed here*
Money [*used by itself*]		809RC, 809UA, 809V	
Defined term	**Definition**	**Used**	
Property	Does not include "Money"	809X-809Z6	19.30.1
Money	Includes specified assets	809X-809Z6, para 86	19.30.2
Partly defined expression		**Used**	
(*Money defined, property not defined*)			
Property (including money)		Para 86(2) sch 7	18.53.1
Property (other than money)		Para 86(3) sch 7	18.53.2

I think it is clear that the word "property" by itself includes money, that is, it is equivalent to "money or other property".[51] In this book I use the word "property" (by itself) to mean money or other property.

When the expression "money or other property" is used, we do not care about the meaning of the word "money" because if an asset is not "money" it will be "other property".

When the expression "money" is used by itself, or in the expression "property other than money", we may have to consider the meaning of the word "money".

Property is not defined in the ITA remittance basis. It has no doubt a wide meaning, but there are limits.

18.13.2 *Sehgal v HMRC*

Sehgal v HMRC[52] is the first case on the ITA remittance basis. It is relevant to the topics of property, services, and derivation. So I refer to it several times in this chapter. I set out the facts here so I can refer to it without repeating the facts elsewhere.

Sehgal concerned convoluted transactions, as commercial transactions often do. In short:

(1) S, a remittance-basis taxpayer,[53] owed £6m to B ("the indemnity debt"). The indemnity debt had arisen in the following circumstances:

(a) A UK company owned by S ("the Debtor Company") owed £6m

[51] It follows that the reference to money is otiose; but the related expression "property of any description including money" is quite common in statutory drafting, and goes back at least to s.4 Trustee Investments Act 1961.

[52] [2022] UKFTT 312 (TC). The case is not yet final. I see little prospect of the taxpayer losing the appeal, but the reasoning may change.

[53] In more detail, there were in fact two taxpayers, but nothing turns on that.

("the inter-company debt"[54]) to another company ("the Creditor Company)

(b) S (the seller) sold Target Co to B (the buyer, an unconnected non-resident company)[55] and in doing so

(c) S gave B an indemnity that the inter-company debt would be paid. Unfortunately Debtor Co had no funds to pay the inter-company debt, so S became obliged to pay the indemnity debt to B.

A foreign chargeable gain accrued to S on the sale of Target Co.

It is very often the case that effectively the same commercial transaction can be carried out in different ways,[56] and that was the case here.

The most straightforward solution was that S simply paid the indemnity debt to B. Then:

- The payment would have been deductible in computing the chargeable gain[57]
- There would have been no remittance, since (among other reasons) no property (or service) would have been received in the UK.

Again, S might simply have transferred £6m to Debtor Co, in order that Debtor co paid its debt. In that case, property (the money) would have been received in the UK by a relevant person, for Debtor Co was a relevant person in relation to S.[58]

But the indemnity debt was satisfied in a third way:

(2) (a) A separate company owned by S ("the payor company") transferred £6m ("the third-party payment") to a company owned by B ("the payee company").[59]

[54] The indemnity debt was not a relevant debt, but the inter-company debt was. So there might also have been an interesting issue concerning relevant-debt remittances, but this aspect was not raised in argument.

[55] The sale was in 2010; it took 12 years for the matter to reach the stage of a FTT decision.

[56] See App 7.9 (Form v substance: Cardinal principle).

[57] See 56.4.9 (Contingent liabilities). Of course the deduction would only matter if the foreign gain was later remitted.

[58] There would still be no taxable remittance as the £6m was not derived from the gain; see 18.17.4 (Remittance of deductible expenses).

[59] It did this by buying assets at£6m above market value. There were said to be accountancy reasons for this contrived transaction, though the reader may wonder about that. But nothing turns on that as far as tax is concerned.

(b) In consideration of the third-party payment:
   (i) Debtor co was released from its obligation to pay the inter-company debt
   (ii) B released S from his obligation to pay the indemnity debt

In short, the inter-company debt, and the indemnity debt, were satisfied, but by a payment from a different person (not the debtor) to a different person (not the creditor).

(3) In order to fund the third-party payment, S transferred £6m out of the proceeds of sale to the payor company.

It was still the case that the £6m payment made by S was deductible for CGT purposes (even though the payment was made from S to the payor co and not to B). The issue was whether this sum was remitted.

It may be helpful to identify the 7 dramatis personae in *Sehgal* by their roles:[60]

My term	**Role**	**Tax status**	**Actual name**
S	Seller/indemnity debtor	Remittance basis user	Sehgal
B	Buyer/indemnity creditor	Non resident co	Centennial
Target Co	Company that S sold to B	Non-resident co	VGL
Debtor Co	Inter-co debt: debtor	UK co	IR
Creditor Co	Inter-co debt: creditor	UK co	Visage
Payor Co	Paid £6m to payee	Non-resident co	SKS
Payee Co	Received £6m from payor	Non-resident co	Miles

With these facts in mind, we can turn to the comments in *Sehgal* on the meaning of "property". HMRC argued that, before the third-party payment:
- S had the right to have the indemnity debt settled by a 3rd party payment
- the debtor company had the right to have the inter-company debt settled by a 3rd party payment

The FTT held that these "rights" (if that word is apt) were not "property" within the meaning of s.809L, as the rights were "conditional" (if that word is apt).[61]

[60] The discussion is easier to follow if one uses my labels, but to follow the decision one needs the actual names.

[61] at [114]. But even if the rights were property, it would be property of nil market value, so it would not matter.

HMRC next argued that after the third-party payment, S and the debtor company received property. This argument failed too. The release of a debt is not property.

The reader may think that these arguments far-fetched. But as the case progresses, we may end up with an illuminating discussion of the meaning(s) of the word "property".

18.14 Remittance condition A: UK link

Remittance conditions A and B go together: condition A requires a link to the UK, and condition B requires a link to the income/gains. Both conditions need to be satisfied to have a taxable remittance under s.809L(1)(a).

Section 809L(2) ITA provides:

> Condition A is that—
> (a) money or other property is brought to, or received or used in, the UK by or for the benefit of a relevant person, or
> (b) a service is provided in the UK to or for the benefit of a relevant person.

There are eight ways to satisfy remittance condition A. The first six are:

(1) Property is:
  (a) brought to the UK
    (i) by a relevant person
    (ii) for the benefit of a relevant person
  (b) received in the UK
    (i) by a relevant person
    (ii) for the benefit of a relevant person
  (c) used in the UK
    (i) by a relevant person
    (ii) for the benefit of a relevant person

I refer to these as the **"brought" limb,** the **"received" limb,** and the **"used" limb** of condition A. I refer to property within (1) as "**property brought/received/used in the UK**".[62]

The last two ways to satisfy condition A are:

(2) A service is:

[62] One might refer to it as "condition A property" or "UK property" but I think it is clearer to use the clumsy expression "brought/received/used". I leave the words "by/for the benefit of a relevant person" to be implied.

(a) provided in the UK to a relevant person
(b) provided in the UK for the benefit of a relevant person

18.14.1 *Property brought to UK*

The first two ways to satisfy remittance condition A are:

(a) Property is brought to the UK by a relevant person
(b) Property is brought to the UK for the benefit of a relevant person

This limb requires one to identify whether property is brought to the UK, and if so who brings it to the UK, or for whose benefit it is brought. If a relevant person brings it, condition A is satisfied. If someone else brings it, para (a) is not satisfied.

For instance, suppose T owns a chattel outside the UK, and wishes to lend it to a non-relevant person, eg an adult child, in the UK.

(1) If T brings the chattel to the child in the UK, there is a taxable remittance.
(2) If the child collects it abroad, or arranges for a courier to bring it, then para (a) does not apply. No other part of condition A applies, so there is no taxable remittance.

What if T instructs a courier to bring the chattel to the child in UK? One might think that T (by instructing the courier) has brought the chattel to the UK. But comparing this with cases (1) and (2) it is considered that the courier (not T) has brought the chattel to the UK, so there is no taxable remittance. It would be strange if the administrative matter of who instructs the courier should determine taxability.[63]

This could be relevant if a remittance basis taxpayer wished to lend to a museum, as it would not usually[64] be necessary to meet the conditions of the public access rule.

Para (b) would apply if N holds property as nominee for T, and N brings the property to the UK. This would apply if N was bare trustee or a trustee of an IIP trust under which T is life tenant.

18.14.2 *Property received in UK*

The next two ways to satisfy remittance condition A are:

[63] This is consistent with the HMRC view discussed in 18.14.5 (Property in transit). For gifts of cash, see 18.14.6 (Gift to non-relevant person).

[64] The public access rule would be needed if the museum was a relevant person.

(c) Property is received in the UK by a relevant person
(d) Property is received in the UK for the benefit of a relevant person

This requires one to ask where property is received (or more precisely, whether property is received in the UK); the answer is by no means obvious. If property is received in the UK, the question is who receives it, or for whose benefit is it received.

We need the "brought" limb as well as "received". T can receive an asset in the UK without bringing it here, eg:

(1) on the purchase of a UK situate chattel
(2) on a bank transfer to a UK account[65]

Can T "bring" an asset to the UK without receiving it in the UK? Perhaps an example is if T acquires a chattel outside the UK, and packs it in T's luggage; or acquires a car outside the UK and drives it to the UK. T "brings" the chattel or car to the UK, but does not "receive" it here.[66] So both these limbs of condition A are needed.

Para (d) would apply if:

(1) N holds property as nominee for T, and N receives the property in the UK. This would apply in particular if
    (a) N is a bare trustee or
    (b) N is a trustee of an IIP trust under which T is life tenant.[67]
(2) A payment is made into an overdrawn account. For instance, suppose a UK bank account of R (a relevant person) is £200 overdrawn, and a payment is made into the account of £100. R's debt to the bank is reduced by £100. R does not receive any property. But the bank receives the property in the UK for the benefit of R.

18.14.3 *Property used in UK*

The next two ways to satisfy remittance condition A are:

(e) Property is used in the UK by a relevant person
(f) Property is used in the UK for the benefit of a relevant person

This requires one to ask whether property is used, where property is used,

[65] See 18.14.6 (Gift to non-relevant person).

[66] It is arguable that an asset can only be received once, so if it is received outside the UK it cannot later be received in the UK, but whether or not that is right, in the case of a chattel or car, there is no identifiable act of "receipt" in the UK.

[67] See 42.5 (Life tenant remittance basis user).

who is the user, and what exactly is the property which is used.

It is suggested that "used" means enjoyed in specie, and property is used where it is situate.

It is difficult at first sight to see the role of the "used" limb of condition A. Normally if T uses property in the UK, T (or a relevant person) will have brought or received it in the UK, so the "brought" or "received" limbs will be satisfied. But there could arguably be a case where property comes to be held by T without being brought or received in the UK by T[68] and in such a case the "used" limb is needed.[69]

If a creditor enforces a debt, and receives money due, one does not say that the creditor is "using" the debt in the normal sense of the word, though the creditor could be said to be using rights attached to the debt. But it is not clear where these rights are used. So it is suggested that the used limb does not apply to debts or other choses in action.

If money is spent, it is "used" in the normal sense of the word.[70] However it is not clear where money (other than cash) is used, so it is not clear how one decides whether it is used in the UK. It is suggested that spending money should be dealt with under the receipt limb, or the brought limb of condition A, or under the relevant debt rule, eg using money to pay a debt may be a relevant-debt remittance of the money; but the used limb does not apply: the money is not used in the UK. Money in a bank account is in law a debt, so that is consistent with the above. In short, in the "used" limb of condition A, "used" means used *in specie*.

18.14.4 *Bank entries*

Where an individual transfers money from their foreign bank account to another foreign bank, that naturally involves entries in records ("books") of both banks. What if those records are kept in the UK?[71] Remittance

[68] See 18.14.8 (Acquisition of UK security).

[69] There could of course be a case where property is brought or received in the UK by a non-relevant person and used by T, eg if T gives RFI to a brother who purchases a house which T occupies. In that case condition A is satisfied under the "used" limb. But condition B is not satisfied (the house is not property of a relevant person) so the question whether condition A is satisfied does not arise. This situation is covered instead by remittance condition C.

[70] That is self evident, but if an example is needed, see s.809VA ITA referring to money being "used" to make an investment.

[71] This is understood to be the position for Channel Island and IoM banks. But nowadays, I expect, accounting records may be duplicated in the cloud, and not kept

condition A is not satisfied: the funds are not brought/received/used in the UK. I think that is self-evident; but for completeness, the RDR Manual confirms the point:

> **RDRM33560 Banking Issues** [Jan 2019]
> **Banking Transactions**
> Transfers between foreign centres often pass through the UK banking system, for example when a sterling payment is made abroad and the payment is cleared through London in the normal banking process.
> In such circumstances HMRC do not regard the passage of funds through the UK as being a taxable remittance.
> The machinery employed is irrelevant provided that, without express provision, the individual has:
> - no right to payment at any intermediate point; and
> - no control over the funds transferred by their foreign bank to secure payment at the agreed point.

Similarly, the EI Manual provides:

> **EIM40302 Meaning of "remitted to the UK"** [Jan 2021]
> [1] Earnings are remitted to the UK if they are paid to the employee in cash in this country or if the employee's bank account here is credited with them. Employees may arrange to have earnings paid into offshore bank accounts to avoid this rule.
> [2] Money that is transmitted from the employer's bank in the UK to the employee's offshore bank is not treated as remitted here. It has been in the banking system all of the time; the employee did not have access to it.

EIM para [1] is obviously correct, and there is no reason to think that the circumstances described in the RDRM amount to a remittance. But the statements (underlined) that money *"passes through the UK"* or *"through the UK banking system"* or that money has *"been in the banking system"* is layman's language. The image is one of coins or banknotes, leaving one bank, and entering into another bank, where they are stored in its vaults for safekeeping, and where they belong to a customer of the bank, in some version of the vault at Gringotts. But this is not how banking works. Banking law draws a different distinction between the accountholder's money and the bank's money. In *Foskett v McKeown*:[72]

in any one identifiable place. .

[72] [2001] 1 AC 102 at p.127.

> We speak of money at the bank, and of money passing into and out of a bank account. But of course the account holder has no money at the bank. Money paid into a bank account belongs legally and beneficially to the bank and not to the account holder. ... there is no money in the account. There is merely a single debt of an amount equal to the final balance standing to the credit of the account holder. No money passes from paying bank to receiving bank or through the clearing system (where the money flows may be in the opposite direction). There is simply a series of debits and credits which are causally and transactionally linked.[73]

18.14.5 *Property in transit*

The same approach is applied in March 2009 Qs & As to physical assets transported by a courier through the UK:

> **Q17:** Will HMRC apply the same principle, expressed in relation to mechanistic banking transfers which pass through the UK in the banking system, in a case where a courier passes through the UK in transit carrying property not covered by the temporary importation exemption?
> **A:** Yes. In principle, where the "passing through" is a mechanistic part of the courier service provision and, no relevant persons have any rights to use or access the property at any intermediate point; and no control over how property is transported to and from the agreed points. In such circumstances the passage of property which merely "touches" the UK would not be regarded as a sum remitted to the UK.

More analytically, remittance condition A is not satisfied because the owner of the property:
(1) does not receive it in the UK;
(2) does not bring it to the UK (the courier brings it; or it is not "brought" at all, in the relevant sense, as its UK presence is transitory).

[73] Likewise, *Foley v Hill* (1848) 2 HLC 28 at p.36:

> "Money, when paid into a bank, ceases altogether to be the money of the principal ... ; it is then the money of the banker, who is bound to return an equivalent by paying a similar sum to that deposited with him when he is asked for it. The money paid into the banker's custody... is then the banker's money; he is known to deal with it as his own; he makes what profit of it he can, which profit he retains to himself, paying back only the principal, ... or the principal and a small rate of interest ..."

I am not aware of differences in other legal systems, and it difficult to see how there could be, as banking is an international activity.

This is consistent with art 26(1) United Nations Convention on the Law of the Sea:

> No charge may be levied upon foreign ships by reason only of their passage through the territorial sea.

In the Dover Strait, the southerly shipping lane is territorial sea, and so counts as part of the UK;[74] but there is no taxable remittance of a foreign ship, or, presumably, property in the ship, unless or until it enters a UK port or inland waters.

18.14.6 *Gift to non-relevant person*

In *Timpson's Executors v Yerbury*[75] (a pre-2008 remittance case):

(1) Mrs Timpson ("T") gave cheques representing her income to her children.
(2) The children cashed the cheques which were credited to their bank accounts in the UK.

Thus the income was received in the UK, but it was not received by T. This was nevertheless held to be a taxable remittance by T. Romer LJ and (I think) Greene LJ decided *Timpson's Executors* on the basis that there was a taxable remittance if:

(1) money is received in the UK by a third party at T's direction, and
(2) immediately before receipt, the money (or funds representing it) belonged to T.[76]

This is not the law under the ITA remittance basis. Remittance condition A requires that property is brought/received/used in the UK *by or for the benefit of a relevant person*. So if a remittance basis taxpayer writes a cheque on a foreign bank account, gives it to a donee (not a relevant person) who pays the cheque into their UK bank account, remittance condition A is not satisfied. The receipt of the cheque is not a remittance.[77] The money is received in the UK by the donee (not by a relevant person); and if it is brought to the UK, it is brought in by the donee.

[74] See App.2.19.5 (Territorial sea).

[75] 20 TC 155 followed in *Walsh v Randall* 23 TC 55.

[76] The judgments are discussed in detail in the 2012/13 edition of this work, but this is now of historical interest only.

[77] See 18.18.17 (Receipt of cheque in UK).

Suppose (instead of a cheque) T makes a gift to a donee (not a relevant person) by electronic transfer from T's offshore account to the UK account of the donee. It is considered that remittance condition A is not satisfied. It would be strange if there were a difference between payment by cheque and a direct electronic transfer. At first sight it seems that T "brought" the money into the UK (even though T did not receive or use it in the UK). But the better view is nothing is *brought* to the UK. One needs to understand the banking law background. A bank transfer involves the destruction of an asset (T's claim against T's bank) and the creation of a new asset (the donee's claim against the donee's bank, which may of course be a different bank).[78] The new asset is received in the UK but not brought to the UK.[79]

In addition, remittance condition B is not met. This requires that the property "is property of ... a relevant person." At the time the property is received in the UK, which is the time which matters,[80] the money is property of a non-relevant person.

[78] "It is something of a misnomer to speak of the transfer of funds, as there is no actual transfer of coins and bank notes from the payer to the payee, and no assignment of the debt owed to the payer by their own bank." Brindle & Cox, *The Law of Bank Payments* (5th ed., 2017), para 3-002; *R v Preddy* [1996] AC 815 at p.841D and p.834: "The question remains, however, whether the debiting of the lending institution's bank account, and the corresponding crediting of the bank account of the defendant or his solicitor, constitutes obtaining of that property. The difficulty in the way of that conclusion is simply that, when the bank account of the defendant (or his solicitor) is credited, he does not obtain the lending institution's chose in action. On the contrary, that chose in action is extinguished or reduced pro tanto, and a chose in action is brought into existence representing a debt in an equivalent sum owed by a different bank to the defendant or his solicitor. In these circumstances, it is difficult to see how the defendant thereby *obtained property belonging to another,* ie to the lending institution....I start with the proposition that the money in a bank account standing at credit does not belong to the account holder. He has merely a chose in action which is the right to demand payment of the relevant sum from the bank. I use the word money for convenience but it is of course simply a sum entered into the books of the bank. When a sum of money leaves A's account a chose in action quoad that sum is extinguished. When an equivalent sum is transferred to B's account there is created in B a fresh chose in action being the right to demand payment of that sum from his bank."

[79] If that is right, it does follow that that the words "bringing of money to the UK" in s.809V ITA are either redundant or informal; see 19.24 (Relief on paying remittance charge). But an argument from redundancy carries little weight; see 2.1.2 (Argument from redundancy).

[80] See 18.26.2 (Condition B).

The practice before 2008 was for remittance basis taxpayers to make the gift abroad (by payment into a foreign bank account of the donee). This will no doubt continue, even though it is not strictly necessary, because HMRC may not agree with this analysis. The RDR Manual provides:

> **RDRM33140 Condition B - direct remittance of income and gains**
> [Jan 2019]
> Example 5 (Tyler)
> T, a remittance basis user, donates an amount of money to a Battersea Dogs Home, a UK charity, by making a payment direct to the charity from his US bank account which contains his relevant foreign income. There has been a direct remittance of T's income into the UK; it does not matter that he or any other relevant person does not benefit personally from the money...

In the usual style of the Manual, the example states a conclusion without addressing the relevant statutory provisions, and it is not likely that the author has considered the technical issues.

If the HMRC view were right, then law reform would be appropriate, as there is no point in forcing donees to open foreign bank accounts. But all that is needed is a statement of practice which recognises the existing law.

See too 18.29.1 (Gift of income/gains: Navigation).

18.14.7 *Arm's length payment to non-relevant person*

Similar points apply to an arm's length payment to a non-relevant person. This might arise if a payment (out of income/gains) is made for a foreign asset. Suppose:

(1) T pays to X the purchase price of an asset which T receives outside the UK.
(2) T subscribes for shares in a non-close[81] offshore company X Ltd.

If T pays the money to the UK bank account of X, there is a tenable argument that there is no taxable remittance, on the grounds that neither condition A nor condition B are satisfied.

As to condition A: The sum is not received in the UK by T. It is considered that the money is not received in the UK for the benefit of T. X receives the money for his own benefit (even though the effect of the payment is to satisfy T's debt). The sum is not used in the UK, and, for

[81] I specify X Ltd is not close, so it will not be a relevant person in relation to T.

the reasons set out above, is not brought to the UK.

As to condition B: Even if the money in X's account derives from T's income/gains (which is debatable) it is not property of a relevant person.

This gives a sensible result. There is no remittance in any real or meaningful sense, and no reason why one would expect a tax charge to arise.

The same applies if the payment is consideration for a service provided outside the UK. A payment which is consideration for a service provided in the UK is taxable wherever received, if the consideration is given by a relevant person (unless foreign services relief applies).

HMRC may not agree. A payment into a foreign account of X is desirable, though it is unfortunate that X must be put to the trouble of opening a foreign bank account. HMRC have argued:[82]

(1) A purposive approach requires a remittance. That depends of course on identifying the purpose. One might think that the purpose of the remittance basis is to tax individuals who have spending money in the UK, not spent money relating to outside assets. HMRC will argue that the purpose is wider. But what is the purpose in forcing the vendor to open a foreign account? Purposive arguments are always vulnerable to the weakness of framing the purpose to fit the desired outcome.[83]

(2) A banking law analysis (that nothing is brought to the UK) is a "technical" argument. No doubt it is. HMRC argue for what may be described as a technical remittance. Allegations of "technical" arguments may go both ways, which tends to suggest doubt as to whether "technical" is a useful analytical concept, or mere pejorative rhetoric, or another synonym of a non-purposive approach.[84]

(3) The provisions should be construed in a real-world commercial manner. If this means anything other than a purposive approach, this lies the realm of rhetoric and not argument.[85] No-one would argue for an unreal and uncommercial manner of construction, but what does that mean and how does one decide which is which?

Note how "real", "technical" and "purposive" are all thrown into the

[82] Private correspondence.

[83] See App 9.4 (Difficulty of ascertaining tax policy).

[84] See App 1.8 (Technical).

[85] See App 7.5 (The real world).

submission pot. Perhaps they are three ways of putting the same point.

(4) The wording of s.809V(1) ITA (relief for payment of remittance basis charge)[86] supports the HMRC view. It assumes that payment to HMRC is bringing money to the UK. That is a more traditional approach of construction, and there is something in this point.

18.14.8 *Acquisition of UK security*

In the following discussion, a **"UK security"** means a security[87] which is UK situate (usually because the company's register is UK situate).

What is the position if T uses RFI to acquire a UK security, eg purchases a security from a third party? I assume for simplicity that:

(1) The company which issued the security is not a relevant person.[88]

(2) The RFI itself is not brought/received/used in the UK by a relevant person (I assume payment is made outside the UK).

The question then is whether the UK security is brought/received/used in the UK.

The "brought" limb of condition A is not satisfied: the UK security is not brought to the UK.

HMRC might rely on the "received" limb. The UK security is "received" by T, but does T receive it *in the UK*?

The ITA remittance basis requires one to identify where property is received. Identifying the place of receipt of property is comparable in two respects to identifying the situs of property or the location of a source of income:

(1) Just as every asset has a situs (and only one situs),[89] and every source of income has a location (and only one location),[90] it is considered that property should have one (and only one) place of receipt.

(2) In the case of tangible property, the place of receipt should be clear. In other cases, just as the situs and source rules, there are no satisfactory solutions and the question can only be answered by somewhat arbitrary selection of connecting factors.

[86] See 19.24 (Relief on paying remittance basis charge).

[87] I use the term here to include shares and debt-securities.

[88] See 18.18.8 (T subscribes for shares in R Ltd).

[89] See 102.3 (Every asset has one situs).

[90] See 16.3 (Approach to locating source).

But while situs and source are old questions, governed by well-established rules, the place of receipt of an asset is a new question on which no guidance is to be found.

Money paid to a beneficiary's bank account is received where the account is kept.

It is considered that a security is received where the security is situated under private international law rules. I have considered whether the security might be received in the jurisdiction whose law governs the transfer or creation of the security. But that relates to how the security is received, and not where it is received.

It is arguable that T does not receive property in the UK: either the security is not received anywhere, or else it is received in the place of the law governing the transfer or creation of the security (which may or may not be a UK law). On that argument, while condition A is satisfied if the individual actually uses the security in the UK, merely acquiring UK situate securities may not be not enough.[91]

HMRC do not agree. One of the RDR Manual's examples of taxable remittances is the receipt of UK securities:

> **RDRM33050 Practical Examples of Remittances to UK** [May 2020]
> [Taxable remittances include:]
> - You buy shares or bonds in a UK registered plc from a foreign broker with your foreign income.

If receipt of a UK security is receipt of an asset in the UK, then there is the surprising consequence that (except for "money", as defined) the temporary importation rule would apply.[92]

In practice the answer is not to acquire UK securities except out of clean capital. In some cases it may be possible to make the security situate outside the UK, by using bearer securities or specialty debts, and arranging that the document is kept outside the UK.

18.14.9 *Disposal of UK security*

If a security is not received in the UK, so remittance condition A is not met on the acquisition of the asset, the question arises whether the asset

[91] If this were wrong then words "used in" in remittance condition C (and perhaps condition A) would arguably be otiose since chattels used in the UK must be received in or brought to the UK.

[92] See 19.34 (Temporary importation rule).

might later be used in the UK. It is arguable that "use" is appropriate to chattels but not to intangible property. Does the sale or redemption of a security amount to "use"? If it does, is the asset used "in the UK" just because the asset is situate here? Or is something else required, and if so what? The difficulties in these questions support the view that the term "use" does not apply to securities.

18.14.10 *Acquisition of UK debt*

Similar issues (but not quite identical) arise in relation to simple debts, ie debts which are not securities.

In the following discussion, a **"UK debt"** means a debt which is UK situate (usually because the debtor is UK resident).

What is the position if T lends RFI to a person ("the debtor")?[93]

I assume for simplicity that:

(1) The debtor is not a relevant person.[94]
(2) The RFI itself is not brought/received/used in the UK by a relevant person (assume payment is made outside the UK).

The question then is whether the UK debt is brought/received/used in the UK.

The "brought" limb of condition A is not satisfied: the UK debt is not brought to the UK.

HMRC might rely on the "received" limb. The UK debt is "received" by T, but does T receive it "in the UK"?

It is suggested that a debt is received where the debt is situated under private international law rules. It is arguable that T does not receive property in the UK: either the debt is not received anywhere, or else it is received in the place of the law governing the transfer or creation of the debt (which may or may not be a UK law). On that argument, while condition A is satisfied if the individual actually uses the assets in the UK, merely acquiring UK situate assets may not be not enough.[95]

There is no HMRC guidance (the RDR Manual passage discussed above refers only to "shares or bonds").

If receipt of a UK debt is receipt of an asset in the UK, then there are

[93] Similar issues arise if T purchases a simple debt, but that is less common.

[94] See 18.18.7 (T lends income/gains to B).

[95] If this were wrong then words "used in" in remittance condition C (and perhaps condition A) would be otiose since chattels used in the UK must be received in or brought to the UK.

some surprising consequences:

(1) There might be a taxable remittance if an individual lends to a UK resident (even if the borrower is not a relevant person) since the lender receives a debt and a debt from a UK resident debtor is usually UK situate.

(2) There might be a remittance if T sells a foreign asset to a UK resident and:

   (a) the sale price remains outstanding for a time as a debt, because the debt is UK situate; or

   (b) the sale price is unascertained, and so a contractual chose in action, as in *Marren v Ingles*,[96] because the contractual right is UK situate.[97]

   In these two cases it is suggested that mere delays in payment should not count as remittences; the debt or contractual right (even if UK situate) should be characterised as merely a step in the mechanism of payment and not as an independent receipt.

(3) In the case of a debt other than "money" (as defined) the temporary importation rule would apply.[98]

A cautious approach where possible is to make the debt situate outside the UK, which might be done by using a specialty debt, and arranging that the document is kept outside the UK.

What if the debtor is non-resident but later becomes UK resident? It is suggested that the debt is received outside the UK, and it is not brought to the UK by (or for the benefit of) a relevant person, so the change of residence of the debtor does not constitute a remittance.

18.14.11 *Disposal of UK debt*

If a debt is not received in the UK, so remittance condition A is not met on the acquisition of the asset, the question arises whether the asset might later be used in the UK. It is arguable that "use" is appropriate to chattels but not to intangible property. Does the calling in a debt amount to "use"?

[96] See 56.4.6 (Chose in action analysis).

[97] See Firth, "A trap for remittance-basis taxpayers: the situs of choses in action" GITC Review, Vol.XI no.2 *http://taxbar.com/wp-content/uploads/2016/01/A_Trap_for_Remittance_-_Basis_Taxpayers_The_Situs_of_Choses_in_Action_Michael_Firth.pdf.pdf*

[98] See 19.34 (Temporary importation rule).

If it does, is the asset used "in the UK" just because the asset is situate here? Or is something else required, and if so what? The difficulties in these questions support the view that the term "use" does not apply to intangible assets.

18.14.12 *Situs of property for condition A*

There are no statutory situs rules for income tax, so the common law/private international law rules apply.[99] So money received in a UK branch of a foreign bank is remitted, but money received in a foreign branch of a UK bank is not remitted.[100] Money is remitted if received in:
(1) a UK account in the name of the taxpayer, and held by them beneficially; or
(2) a UK account held in the name of a third party who holds on trust for the taxpayer.

CGT has statutory situs rules. But it is considered that the effect of para 5(3) sch 1 TCGA[101] is to incorporate the ITA rules, so the CGT situs rules do not apply for the purpose of remittance condition A. That view is supported by s.809W(6) ITA, which applies the CGT situs rules specifically for the purposes of foreign services relief.[102] If that view were wrong, there could be a remittance under the CGT remittance basis when a remittance basis taxpayer:
(1) places sterling in a foreign bank account, as the account is regarded as UK situate for CGT;[103] or
(2) sells and leaves the purchase price outstanding, since the right to the purchase price is a UK situate asset under the CGT situs rules.

18.14.13 *Co with UK asset (secondhand co*)

Suppose T acquires a non-UK company which holds a UK asset. If the UK asset is not enjoyed in specie by T or a relevant person, then Condition A is not satisfied. If the UK asset is (say) a house, which is occupied by T, then remittance condition A is satisfied. However, remittance condition B is not satisfied.[104]

[99] See 102.1 (Concepts of situs).
[100] See 102.23 (Bank account).
[101] See 18.1.1 (Scope of ITA remittance basis).
[102] See 19.26 (Services condn A: Non-UK property).
[103] See 103.12 (Bank account).
[104] See 18.18.11 (T purchases R Ltd (secondhand co)).

18.15 Service provided in UK

The next way to satisfy remittance condition A is:

> *(e) a service is provided in the UK to a relevant person*

Basic planning is to use services provided outside the UK where possible, eg foreign investment advice, foreign accountancy services, foreign travel agencies, and foreign schools. Of course tax is not the only consideration here; and foreign services relief, if applicable, may allow the use of UK-based service providers.[105]

18.15.1 *"Service"*

In *Sehgal v HMRC*, in short,[106] payor co made a payment to payee co in consideration of which, a third person (B):
- released a debt (the indemnity debt) owed by S to B
- procured the release of a debt (the inter-company debt) owed by debtor co to creditor co.

It would not have occurred to me that B was providing a service to S, or to debtor co, by releasing or procuring the release of their debts. But the FTT held that it was:

> 135. Considering the definition of a "service" suggested by the Appellants from the *Richmond on Thames*[107] decision "any self-employed economic activity, normally provided for remuneration" we do not think that it is stretching the meaning of "service" too far to suggest that this was some sort of financial service, in the same way as someone providing a third-party guarantee or credit protection insurance is providing a service.
> 136. From both the Appellants' and IR's perspective the "service" was commercial and for consideration, being the extinguishing of their obligations under the Indemnity (the Appellants) and the waiving of its debt obligations (IR). We think it is clear (!) in this context that an agreement not to take an action or pursue a claim can be a "service".

Reliance on the *Richmond on Thames* case was misplaced, as that concerned legislation with an express definition of "service"; and the analogy of guarantees or insurance is misplaced, as those are ongoing

[105] See 19.25 (Foreign services relief).

[106] For the facts in detail, see 18.13.2 (Sehgal v HMRC).

[107] *R (oao Gaskin) v Richmond Upon Thames BC* [2018] EWHC 1996 (Admin).

liabilities. It did not matter, as the taxpayer won on another point.[108] But as the case progresses, we should end up knowing more about the meaning(s) of the word "service".

18.15.2 *Where are services provided*

The rule requires one to identify the place where a service is provided, or at least whether it is provided in the UK. See 34.30 (Where are duties performed).

In some cases this is straightforward. In other cases there is no obvious answer:[109] the connecting factors could be:

(1) where the work is done
(2) where the supplier is based
(3) where is the property (if any) to which the service relates
(4) where the customer is based

If a service is provided by an individual or individuals at a particular time and place, the service is provided in the place where the individual(s) are when the service is provided. In other words, the connecting factor should be where the work is being done, when that is physical work carried out in a physical location.[110] Thus a person outside the UK who is on the phone/Skype/Zoom/Teams with a person in the UK is providing his services outside the UK. If UK counsel is instructed to appear in a court outside the UK, the service is provided outside the UK. But advisory work or drafting is provided where counsel is based.

Where services are performed by a team of people, and do not involve work in a single location, the services should be said to be provided where the supplier is based. If a supplier is based in two places, the service is provided in the base most closely connected with the supply.

In practice, physical work will generally be done where the supplier is based, so factors (1) and (2) will normally point the same way. But that is not necessarily the case. If one instructs a French firm to do building work in the UK the service is provided in the UK: if one instructs a UK firm to do building work in France, the service is provided out of the UK.

Factor (3) cannot be decisive as foreign services relief assumes that a

[108] See 18.17.4 (Remittance of deductible expenses).

[109] To say that the question is just one of fact is not an answer, but only a way of avoiding the question: see 26.15.1 (Source of interest: Critique).

[110] See 34.30 (Where are duties performed).

service which relates to property situate outside the UK may be a service provided in the UK.[111]

The RDR Manual is consistent with this view. It provides:

> **RDRM34040. Relevant services provided in the UK** [Jan 2019]
> ... A service is regarded as having been provided in the UK if the providers of that service are based in and give that service in the UK....

"Based in" the UK is my factor (2). I understand that the words *"and give that service in the UK"* is my factor (1), where physical work is done. This is therefore an easy case where both factors point the same way.

The RDR Manual goes on to give this example:

> *Example 1 (Chandra)*
> C, a remittance basis user, engages an investment manager based in the UK to manage her portfolio of investments in foreign stocks and shares of overseas concerns. ...
> The service - the management of the portfolio - is provided in the UK to C...[112]

This is a case where there is no physical work within factor (1), so one falls back on factor (2), where the supplier is based.

In *Sehgal*[113] the "service" (if it was a service) was the release of a debt.

[111] See 19.25 (Foreign services relief).

[112] March 2009 Q&As made the same point:

> **Q23**: ... If a service provider engages with the Jersey resident trustees of a trust of which a UK resident but non-domiciled individual is a beneficiary and settlor and provides advice which is prepared and issued from the UK, but received and read in Jersey, it is not clear if this would be "a service provided in the UK."...
> **A**: ... The general rule is that, for the purposes of this condition, a service is regarded as being *provided in the jurisdiction where the providers of that service are based*. Advice which is researched, prepared and issued from the UK would therefore fall within the definition of "provided in the UK" irrespective of where the client might receive it.
> **Q24**: As part of providing advice to clients who have an international aspect to their affairs, a service provider may prepare advice in several different jurisdictions, which may then be issued from only one office, and therefore country, that being the office which has the main relationship with the client.
> **A**: In the case where an offshore service provider provides advice which has been prepared in several different jurisdictions, the same approach will need to be taken to determine whether the test in section 809L is met, and, *because the advisers in your scenario are based in the UK, their service will be provided in the UK.*
> (Emphasis added)

[113] See 18.15.1 ("Service").

This was said to be provided in the UK:

> 137. We then have to determine whether that service was provided in the UK; as far as [debtor co] is concerned, it is in the UK, the agreement is governed by UK law and the relevant debts [the inter-co debts] are between two UK companies. It is hard to see how, if a service has been provided, it can have been provided anywhere other than in the UK; the effect of the service was certainly in the UK, it is [debtor company's] debt obligations in the UK which are waived.
> 138. We also note that the descriptions of services provided in the UK in HMRC's manual suggest that if a service is enjoyed in the UK, it is treated as made in the UK for these purposes (see RDRM 33130).
> 139. The situation for [B] is more complicated, they are not in the UK (?), but the Side Letter is governed by UK law and the SPA [share purchase agreement] was governed by UK law.
> 140. Of the indicia suggested by HMRC to determine the place where services are provided for these purposes, in our view where the services relate to the release of a debt, the most important indicia is where the debt is located; by reference to the normal application of situs rules, the debts owed by the Appellants have a UK situs and therefore the service should be treated as made in the UK.
> 141. For these reasons we have concluded that the release of the obligations of both B and [debtor company] does entail providing a service in the UK under Condition B.

18.15.3 *Identifying the services*

In order to decide where a service is provided, it is necessary to identify the service or services which are provided.

The RDR Manual gives an example:

> **RDRM34040. Relevant services provided in the UK** [Jan 2019]
> ... *Example 5 (Sarah)*
> S, a remittance basis user, purchases an air ticket using her foreign income and gains to travel from Sweden to Holland, using a UK based booking agency. Payment is made into the agency's offshore bank account.
> There is a 'service provided in the UK', which is the agent's booking services, so the part of the cost of the service that relates to the agency's booking fee is a remittance (although not the cost of the flight between Sweden and Holland as no part of this service is provided in the UK). ...

There are two possible ways to understand this:

(1) There are two services, a booking service and a transport service.

(2) There is only one service, but it may be apportioned between the part made in the UK, and the part outside the UK.

These are two routes to the same destination, but I prefer solution (2). Solution (1) raises a distinction between (1) single (though composite) services and (2) multiple (but distinct) services. A similar distinction is drawn for VAT between multiple/composite supplies, but it has proved to be problematic.

In order to decide where a service is provided, it may be necessary to identify who is providing the service. If solicitors instruct counsel, counsel's services are usually provided to the solicitors.[114] But if the solicitors simply provide counsel's services on to the lay client, the position is the same as if counsel's services were provided directly, ie the place where counsel provides the services to the solicitors is the same place where the solicitors provide those services on to the lay client.

18.15.4 *Travel to/from UK*

Where one travels entirely within the UK, the services are provided in the UK and where one travels entirely outside the UK, the services are provided outside the UK. What is the position if the journey begins in the UK and ends outside, or begins outside the UK and ends within? Possible solutions are:

(1) The services are provided in the UK if the journey is wholly or partly in the UK, ("view 1")
(2) The services are only provided in the UK if the journey is wholly in the UK ("view 2")
(3) Apportion the journey into two parts ("view 3").

None of these are satisfactory.

View 1: The statute does not refer to a service which is provided "wholly or in part" in the UK and the fact that that expression is used elsewhere in the same section on *four* occasions suggests view 1 is not correct. Also view 1 is not fair to the taxpayer, particularly in a case where the UK

[114] COMBAR and Bar Council standard terms provide that the contract is between counsel and solicitors, not the lay client. De Voil Indirect Tax Service (looseleaf) para V6.134 provides: "Normally the instructing solicitor is regarded as the barrister's client and the supply will hence be seen as being made to [the solicitor]. However, the principles described in V3.128 on how to identify the recipient of a supply of services will be relevant."

element is small.

View 2 is likewise unfair to HMRC.

View 3 is correct but impractical, as (1) there is only one service and it is not clear that one can divide that into two parts; (2) apportionment of relatively small amounts would be laborious.[115]

The best answer is that in this case factor (1) - where physical work is done - does not provide a solution, and one should rely on factor (2) - where the supplier is based.[116] That will normally be clear.[117]

What is the HMRC view? The RDR Manual provides:

> **RDRM34040. Relevant services provided in the UK** [Jan 2019]
> *... Example 4 (Charlotte)*
> C, a remittance basis user, purchases a return air ticket using her foreign income. The ticket is to travel from the UK to Belgium and return. *The ticket was purchased from a UK company* but payment was made into the company's offshore bank account.

The HMRC analysis is as follows:

> Because part of the travel service was provided in the UK (the journey begins and ends in the UK) there is a remittance to the UK [ie the service is provided in the UK]. ...[118]

This is consistent with my analysis if it is significant that the HMRC

[115] A third possible difficulty arises if there were a flight between two non-UK destinations, but which involved flying over the UK. it is considered that a person flying over the UK is not, for this purpose, "in" the UK; contrast 18.14.5 (Property in transit).

[116] The same considerations led OECD Model to a comparable rule. Art 8(1) OECD Model provides: "Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated."

[117] The position for Eurostar may require further examination.

[118] For completeness: there is another version of this example in RDRM33130 [Jan 2019]:
"*Example 3*
Charlotte, a remittance basis user, purchases an air ticket using her foreign income. The ticket is to travel from the UK to Belgium. The ticket was purchased from an overseas company and payment made into the company's offshore bank account.
Because part of the travel service was provided in the UK (the journey begins and ends in the UK) there is a remittance to the UK."
This is incoherent, since the example states there is a ticket from the UK to Belgium, but the analysis states the journey ends in the UK.

example specified that the purchase was from a UK company. But that is not the way that HMRC express their reasoning. Fact-rich examples in the style of the Manuals make light reading but dim guidance.

In 2013 HMRC set out standard form letters to UK resident remittance basis taxpayers ("nudge letters").[119] The letters gave examples of what constituted a taxable remittance including:

- You buy a return air fare from New York to London overseas using your foreign income.
- You book a holiday with a foreign travel agent to sail from Southampton to New York which you pay for with your foreign income.[120]

One may infer that the HMRC now take view 1, and regard a transport service as provided in the UK if any part of the journey is in the UK. The difficulty in resolving the point is that the sums in any one case are not likely to justify litigation by the individual, but the point is worth litigating by HMRC. However if an individual needs to fight on some other more weighty issues, then this may come to the tribunal as an additional point. Some private jet providers, such as Netjets, render two levels of charges. One is a standing, fixed charge and the other is a charge based on actual usage and is therefore variable. The variable charge is like any other plane ticket. What about the fixed charge? It could be allocated based on a percentage of annual UK to non-UK usage per taxpayer. But the better view is that the fixed charge is provided where the supplier of the service is based.

Some providers sell a block of (say) 25 hours flight, and the actual flights do not take place until later. It could be that the place the service is provided is determined when the fee is paid; in that case the service is provided where the supplier is based. Or one may say that no service is provided until the flight takes place. That would mean that the year of remittance may be different from the year of payment.

18.15.5 *Service for benefit of relevant person*

The last way to satisfy remittance condition A is:

> *(f) a service is provided in the UK for the benefit of a relevant person*

[119] See 17.26 (Remittance basis compliance/HMRC enquiries).

[120] See *https://www.kessler.co.uk/wp-content/uploads/2015/06/HMRC-nudge-letters.pdf*

Does para (f) add anything to para (e), that is, do the words "for the benefit of" add anything? When is a service provided for the benefit of a person but not to that person? An example is if a parent P contracts with a school to educate P's child C. The services are perhaps provided to P (who pays for them) but for the benefit of C. That would matter if C was a relevant person and P was not (which might happen if the income was that of C's uncle, say).

This rule may make it unnecessary to identify the person to whom the services are provided, a question which has given rise to much difficulty in a VAT context.

18.16 Condition B: Link to income/gain

Section 809L(3) ITA provides:

> Condition B is that—
> (a) the property, service or consideration for the service, is (wholly or in part) the income or chargeable gains,
> (b) the property, service or consideration—
> (i) derives (wholly or in part, and directly or indirectly) from the income or chargeable gains, and
> (ii) in the case of property or consideration, is property of or consideration given by a relevant person ... [121]

In condition B:

- "The property" means the property referred to in condition A, that is, in short, the property brought/received/used in the UK.
- "The service" means the service referred to in condition A, that is, in short, the service provided in the UK.

There are eight ways to satisfy remittance condition B. The first two relate to property (ie the property brought/received/used in the UK):

(1) This property:
  (a) is (wholly or in part) the income/gains or
  (b) (i) is derived property and
  (ii) is property of a relevant person

The next four[122] relate to services, ie a service provided in the UK:

[121] Section 809L(3) continues with paras (c) and (d) which relate to debt-remittances, considered separately below.

[122] The remaining two relate to relevant-debt remittances, which are considered separately below.

(2) This service:
 (a) is the income/gains or
 (b) derives from the income/gains or
(3) The consideration for this service:
 (a) is (wholly or in part) the income/gains, or
 (b) (i) is derived property and
  (ii) is consideration given by a relevant person

18.16.1 *Property of relevant person*

Remittance condition B is met in relation to property brought/received/used in the UK if the property:
 (a) is (wholly or in part) the income/gains or
 (b) (i) is derived property and
  (ii) is property of a relevant person

If the property *is* the income/gains, it does not have to meet the requirement that it is property of a relevant person. If the property is *derived from* the income/gains ("derived property"), it does have to meet that further requirement.

Why the distinction? If T transfers income/gains to R, the funds cease to be the income/gains (instead in the hands of R the funds become derived property). That is, if the property *is* the income/gains, the property must necessarily be property of the specific individual (T) (not anyone else who is a relevant person in relation to T), so it is not necessary to impose the requirement expressly. That might be the reason; though if so the matter could have been more simply expressed.

Suppose:
(1) T gives income to S (not a relevant person).
(2) S uses the money to buy property used by T.

Condition B is not satisfied: the purchased property is derived property but it is not the property of T or of any relevant person.[123]

The question whether property either *is* the income/gains or is *derived from* the income/gains also matters for the purposes of s.809P ITA (amount of income remitted).

18.16.2 *Services*

Condition B is met in relation to a service provided in the UK if:

[123] But remittance condition C or D may then apply.

(2) This service:
 (a) is the income/gains or
 (b) derives from the income/gains or
(3) The consideration for this service:
 (a) is (wholly or in part) the income/gains, or
 (b) (i) is derived property and
  (ii) is consideration given by a relevant person

It will be rare to have a case within (2), ie where a *service* is (or derives from) income/gains. Examples may be services which constitute earnings as benefits in kind, or services which constitute benefits taxable under s.731/s.87, which are deemed to derive from income/gains.

Cases will usually fall within (3). The time of remittance is the later of:
(1) the time the consideration is given and
(2) the time the service is provided

We may need to classify what the relevant person receives as (1) property or (2) a service.

In practice it will not generally matter. That is fortunate, as the distinction is not always easy. Suppose T pays rent for use of a picture in the UK. Does T receive a service? It is thought not.[124] Does T receive property and if so what? T does not receive the picture, but receives a contractual right, which is considered to be "property" for present purposes. Or it may be that T makes a payment in respect of a relevant debt. It is considered that there ought to be a taxable remittance under one or other of these routes, though neither analysis is entirely trouble-free.

Condition B refers to property, consideration for services, and to services. But it is impossible to keep referring to all three. For the sake of comprehensibility, I refer to property and leave the references to consideration for services (and to services) to be read in; (more or less) same points apply to each of them.

18.17 Property is the income or gains

The question whether property brought/received/used in the UK is income should be straightforward if the income is *pure* income, such as dividends, interest or income distributions from trusts. The income will usually be easy to identify.

[124] "Service" is widely defined for VAT, but that definition is not applicable here.

18.17.1 *What is trading income*

The question whether property brought/received/used in the UK is *trading* income is more difficult.

Strictly speaking, trading income is not an item of property: it is a figure that emerges as the result of a computation. The gross receipts of a trade are not the trading income. Even the net receipts (ie gross receipts less trade expenses paid out of the receipts) are not the trading income: the quantum of trading income is likely to be different from the amount of net receipts, once one allows for accruals, capital expenditure, and so on.

That is self-evident, but if authority is needed, see *Reed v Young*:

> ... the distinction between the assets of a partnership and its profits for a given period. That distinction is self-evident ... A loss, like a profit, is an accounting measure of the firm's performance over a given period. Liabilities, like assets, vary from day to day. Just as you do not make a profit by acquiring an asset, so you do not sustain a loss by incurring a liability.[125]

Similarly *Anson v HMRC*:

> ... in general an entity will not have particular assets that can be said to be assets which represent the profit which it has made.[126]

However the meaning of words is governed by context, and the context shows that once trading income has arisen, net trading receipts should be taken as being, or including, the trading income,[127] for the purposes of remittance condition B. If net trading receipts are brought/received/used in the UK, therefore, there is a taxable remittance of the trading income. Otherwise the remittance basis does not work. In other words, the distinction between net receipts (assets) and trading income (a computation but not an asset) is disregarded, or at least, is not carried to

[125] 59 TC 196 at p.227.

[126] [2013] EWCA Civ 63 at [59]. The decision was reversed by the Supreme Court, but this point was not contentious. Likewise *Hoey v HMRC* [2022] EWCA Civ 656 at [155]: "we do not see how a mere trading receipt can be equated with the receipt of trading income."

[127] Alternatively the net trading receipts may be said to be derived from the trading income. That may be the better analysis, but it usually makes no difference. For brevity I refer to the sum as constituting trading income rather than derived from trading income.

its logical conclusion, where the conclusion would be absurd.[128]

If the trader receives a proportion of the trading receipts in the UK, there should be an apportionment, eg if half the trading receipts are received in the UK, there is a remittance of half the trading income. The mixed fund rule does not apply, as there is no mixed fund.

Trading income is regarded as arising at the end of an accounting period, not during the period, for it is only then that it can be discovered whether the trade made a profit for the relevant period and if so what the profit is.[129]

Suppose a person carrying on a foreign trade receives the trading receipts in the UK, during the trade accounting period and retains them in the UK. That sum is not trading income, or derived from trading income, at the time of receipt, for no trading income has yet arisen. At the end of the accounting period, when the profits are ascertainable, the sum can be regarded as derived from trading income. The trading income is regarded as remitted at that time.[130]

What if the trader receives trading receipts in the UK, and removes them from the UK in the same accounting period, before any trading income arises? At the time of the receipt the sum received is not trading income. On a strict reading, there is no taxable remittance later when the trading income accrues; though one might construe s.809U ITA loosely,[131] so that there is a remittance of trading income when the trading income arises. The safe course, if trading income is taxed on the remittance basis (typically under the s.720 remittance basis) is to ensure that all sums are received and kept outside the UK.

18.17.2 *What is property income*

The same applies to property income of a property business, which is computed in the same way as trading income.

18.17.3 *What is a gain*

The question of whether property brought/received/used in the UK is a

[128] Similar issues arise in a ToA context: see 48.7 (Income "payable" to person abroad).

[129] *Re Robbins* [1941] Ch 434. Similarly *Anson v HMRC*[2013] EWCA Civ 63 at [59]: "... profits do not arise until an account is struck for a particular period showing that there has been a profit..."; the point was not discussed in the subsequent appeal.

[130] See 18.48 (Remittance before income/gains arise).

[131] See 18.48 (Remittance before income/gains arise).

gain raises a similar question and has a similar answer. Strictly speaking, a gain is not an item of property: like trading income, it is a figure resulting from a computation. The quantum of a gain (generally) depends (in part) on the amount or value of the proceeds of a disposal, but that does not entail that the gain is a part of the proceeds. The proceeds of a disposal are not the gain.

But notwithstanding the jurisprudential nature of a gain, the proceeds of a disposal for full consideration should be regarded as constituting or including the gain for the purposes of remittance condition B.[132]

HMRC agree. The CG Manual provides:

> **CG25380 Mixed funds: introduction** [Nov 2019]
> ... Proceeds received from the disposal of a chargeable asset will include a return of some or all of the capital cost of the asset and may also include an element of gain. If a non-UK asset costing £500 is sold for ... £650, £500 represents capital and £150 represents a gain. The proceeds arise from two sources and therefore constitute a mixed fund in their own right. ...

Similarly, the RDR Manual provides:

> **RDRM35320 Mixed Funds: Example 4 Note 3** [Jan 2019]
> ... unlike income that can be identified separately, a capital gain is merely part of the money received from the sale and has no separate existence within that amount. ...

18.17.4 *Remittance of deductible expenses*

Suppose a person pays deductible expenses out of gross rent. The property income of the person is the net profit (rent less expenses), it is not the gross rent. So if the person brings some of the gross rent to the UK, to pay deductible expenses, that is not a taxable remittance of the property income. The income is the profit (if any) which is left after payment of deductible expenses. That includes interest, so far as deductible.

This view is confirmed in *Sehgal v HMRC*[133] where an individual paid a sum deductible in computing a chargeable gain, in consideration of what the FTT held to be a service received in the UK. The sum paid was

[132] Alternatively the net proceeds of a disposal may be said to be derived from the gain. The position is more difficult for sales at an undervalue: see 18.45.5 (Sale of asset at undervalue).

[133] [2022] UKFTT 312 (TC) at [142] ff. For the facts, see 18.13.2 (Sehgal v HMRC).

remitted, but the gain was not remitted, as the sum paid was not derived from the gain.

18.18 Derived property

18.18.1 *"Derived"*

Remittance condition B (and C and D) refer to property which *derives (wholly or in part, and directly or indirectly)* from income/gains. I refer to this as "**derived property**".

The words "directly or indirectly" show that the drafter did not want the word "derive" to be narrowly construed.

In the following discussion I just use the word "derive" and leave "directly or indirectly" to be understood.

18.18.2 *s.22 TCGA case law*

Some guidance might be drawn from case law on s.22 TCGA ("there is ... a disposal of assets ... where any capital sum is *derived from assets...*").

In *IRC v Montgomery,* trustees sold a policy of insurance, which was valuable because a fire had damaged land insured. The sale proceeds were derived from the policy and not derived from the land:

> What, in the context of [s.22], does "derived" mean? The relevant dictionary meaning of "derivation" is to trace or show the origin, and that is what I think it means here.

A dictionary definition never solves a legal problem.[134] Perhaps it is just a matter of clearing the throat before settling down to work:

> It appears to me quite clear that the capital sum paid by [the purchaser of the policy] was derived from the sale of the rights under the policies, and that *it is not right to go back any further*. If it were legitimate to embark on the exercise of tracing the derivation of assets back in the manner of an abstract of title, I do not know where the line could ever properly be drawn. I think that one must ask the simple (?) question, "From what asset of the trustees was the capital sum ... derived?" and the simple answer is that it was derived from the ... policies of insurance.[135]

In *Zim Properties v Procter*, a taxpayer failed to sell property due to his

[134] See App 2.1.3 (Dictionaries).

[135] 49 TC 679 at p.686.

solicitors negligence. The negligence claim was settled for £70k. The sum was derived from the claim (a chose in action) and not derived from the property:[136]

> a capital sum may be derived from assets ... even though those assets may not be the immediate source of that sum. That is not to say that Walton J. was wrong in holding in *IRC v Montgomery*, that the sum received by the trustees ... was derived from their rights under the policies. It means no more than that it would be a mistake to interpret Walton J.'s decision in that case as authority for the proposition that the asset from which a capital sum is derived must always be the asset that constitutes its immediate source.

Perhaps inevitably, we also have references to the "real" source:

> One has to look in each case for the real (rather than the immediate) source of the capital sum.

But references to reality do not help much, if at all.[137]

Remittance condition B has a different context, and uses the words "directly or indirectly" which are not found in the CGT provision. But I think the general principle is the same in a remittance context, and indeed in any context: the line between what is and what is not derivation must be drawn somewhere, and somewhere practical, and there comes a point where *it is not right to go back any further*. This formulation expresses the principles of derivation at a high level of generality, which may not take us very far when it comes to practical issues. But suppose in *Montgomery/Zim* the underlying asset (land damaged by fire/land unsold due to negligence) had been derived from foreign income. No-one would say that the proceeds of the insurance policy/negligence claim was derived from that income, even indirectly; and there would not be a charge on that income if the proceeds were remitted to the UK.

18.18.3 *Income/gain invested/reinvested*

Suppose T uses income/gains to purchase assets. The purchased assets are

[136] 58 TC 371 at p.391; this case also includes the memorable aphorism that:

> "The interpretation of the capital gains tax legislation requires, as does the interpretation of any legislation, the exercise of common sense, rather than just the brute application of verbal formulae."

The decision was (more or less) reversed by ESC D33, but I do not pursue that here.

[137] See App.7.1 (What do we mean by real); App 7.9.2 (Cardinal principle reaffirmed).

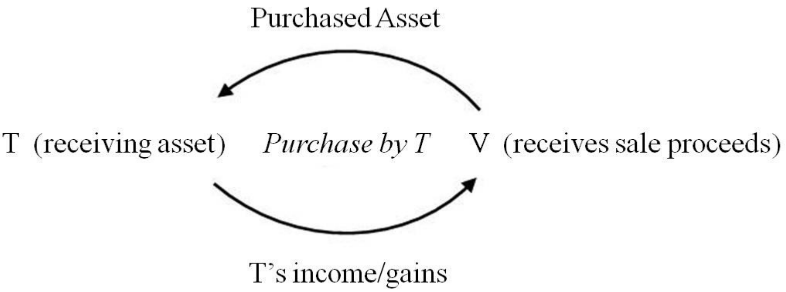
derived from the income/gains. If the purchased assets are sold and the proceeds reinvested in new assets, those new assets are derived from the income/gains indirectly. This tracing process can continue for the lifetime of T.

18.18.4 *T gives income/gain to R*

Suppose T gives income/gains to R. The funds in the hands of R are not the income/gains, but they are derived from the income/gains. If R uses the funds to purchase assets, the purchased assets are derived from the T's income/gains, indirectly, and (as above) that tracing process can continue for the lifetime of T.[138]

18.18.5 *T buys asset from V*

Suppose:
(1) T buys an asset ("the purchased asset") from a vendor ("V") for full consideration.
(2) T uses income/gains to pay the purchase price.



The sale proceeds in the hands of V are derived from the purchased asset, and (indirectly) from property V used to acquire the asset. But the sale proceeds in the hands of V are not derived from T's income/gains. So there is no taxable remittance of T's income/gains if remitted, eg if:
(1) V is a relevant person and brings the sale proceeds to the UK; or
(2) V is not a relevant person but transfers them to a relevant person who brings them to the UK

In these cases, remittance condition B is not satisfied.[139] It does not matter

[138] See too 18.29.1 (Gift of income/gains: Navigation).

[139] Of course the purchased asset in the hands of T is derived from T's income/gains, so there would be a taxable remittance if T brings the purchased asset to the UK.

that sale proceeds may be traceable in specie to the income/gains.

Likewise if V provides a service to T for full consideration, and T uses income/gains to pay the fee. The fee in the hands of V is not derived from T's income/gains.[140]

This is a sensible rule, because if T uses income/gains to purchase an asset from a company, at arm's length, T will often have no way of knowing whether the company is a relevant person, and T can hardly be expected to ask the company what it has done with its own money. Whereas if T *gives* money to a donee, the request is not so unreasonable.

A little support for this view may be found in *Cohen v Petch*. Here:

(1) A building society lent money to T.
(2) T used the borrowed money to purchase an asset from T's mother.
(3) The mother promptly gave or lent the sale proceeds back to T.
(4) T lent the money to a company.

Diagrammatically:

	Building society loan		*Purchase price*		*Gift or Loan*		*Loan*	
Building Society	→	T	→	Mother	→	T	→	Company

T claimed relief for the interest on the building society loan. The Special Commissioner said:

> ... once the money had been borrowed [by] the taxpayer from the society

If my view is wrong, there would be a double charge to tax where:
(1) R (a relevant person in relation to T) receives income/gains (R's income) and uses it to purchase an asset (the purchased asset).
(2) T receives income/gains (T's income) and uses it to purchase the asset from R.
Suppose T brings the purchased asset to the UK. There is a taxable remittance of T's income. But it would be surprising if R's income was also remitted.

[140] Of course, if V provides the service to T in the UK, there is a taxable remittance (subject to foreign services relief) on the basis that T's income/gain is consideration for the service.
If it were the case that an arm's length fee for a service is derived from the income used to pay the fee, there is an (admittedly, subtle) anomaly:
(1) In cases where foreign services relief applies, there is no taxable remittance; see 19.27 (Services condition B: Pay non-UK bank).
(2) In other cases (eg if the service is not provided in the UK) there could be a taxable remittance when V brings the consideration to the UK.

> it was paid to his mother and became her funds. Subsequently, three days later, the sum of £46,600 was returned to the taxpayer by his mother either in the form of a loan or as a gift. *The funds, whether or not they are traceable in specie, were no longer the money borrowed from the society.* They were funds lent or given by [the mother] to her son. *There was no longer any link between the money which the taxpayer eventually lent to the company and the money which he borrowed from the society.*[141]

The questions (simplifying the clumsy language of ICTA) were:

(1) Was the money borrowed from the building society used to lend to the company.

(2) Was the money "applied for some other purpose" before being so used.[142]

This not the same as the wording of the ITA remittance basis ("derived directly or indirectly"). But the words used in the decision ("no longer any link") support the view that the derived condition would not be satisfied.

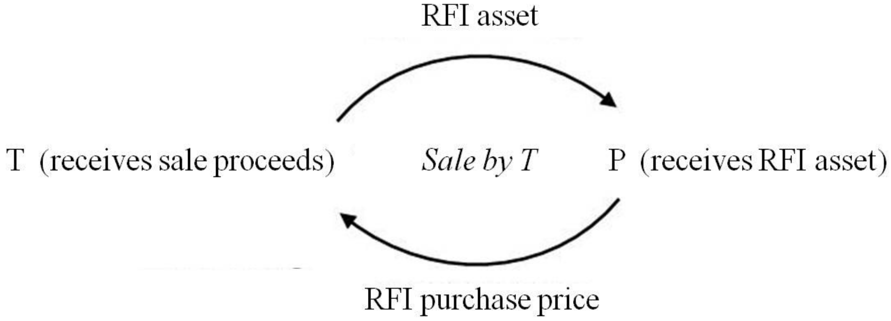
If T consciously pays *more* than full consideration, then the sale proceeds in the hands of V are derived from T's income/gains to the extent of the excess.

18.18.6 *T sells asset to P*

Suppose:

(1) T uses RFI to acquire an asset ("the RFI asset").

(2) T sells the RFI asset to a purchaser ("P") for full consideration.



It is considered that the RFI asset in the hands of P is not derived from T's RFI. So there is no taxable remittance if P brings the RFI asset to the UK:

[141] [1999] STC (SCD) 207 at p.211.

[142] The current provisions are s.385(3) ITA and 392(2) ITA.

remittance condition B is not satisfied.[143]

Similarly, suppose:

(1) T sells an asset to a company within s.720 or s.3, or to a trust within s.624 for full consideration.[144]
(2) The company uses its income (treated as derived from T's s.720 income) or its gains (treated as derived from T's s.3 gains) or the trust uses its income (treated as derived from T's s.624 income) to pay the purchase price.

The sale proceeds in T's hands are not derived from the s.720 income, the s.3 gains or the s.624 income.

18.18.7 *T lends income/gains to B*

Suppose T lends income/gains to a borrower ("B"). Are the funds in B's hands derived from T's income/gains? There are three possible solutions:

(1) B's borrowed money is always derived from T's income/gains.
(2) B's borrowed money is never derived from T's income/gains.
(3) B's borrowed money is sometimes derived from T's income/gains.

There are strong arguments in favour of solution (2):

(1) B's promise to repay the loan is (in principle)[145] full consideration for the money, whether the loan is on commercial terms or interest free repayable on demand (the promise to repay an interest free loan is full consideration). B's borrowed money is derived from that promise.[146]
(2) T acquires an asset (the benefit of the debt) which is derived from the RFI, and it seems surprising that B's borrowed money was also derived from the same income/gains.

The objection to solution (2) is that it is too good to be true; a remittance is too easily avoidable. There is not much point in having a charge on remittances by relevant persons which applies if T *gives* income/gains to

[143] Of course, the sale proceeds in the hands of T are derived from T's RFI, so there would be a taxable remittance if T brings the sale proceeds to the UK.
If my view is wrong, there could be a double charge to tax.

[144] Considerable further thought is required if the sale is for more than full consideration.

[145] The position would be different if the loan is a fixed-term loan at a low rate of interest as then B's promise to repay is not full consideration; that would be unusual and is assumed not to be the case here.

[146] Contrast 83.6 ("Provide").

B, but not if T *lends* income/gains to B interest-free. It is considered that there must be some circumstances in which one should regard B's borrowed money as derived from T's income/gains. The court might then describe the loan as a mere "conduit".[147] However "conduit" is a metaphor which constitutes a conclusion rather than a basis for reaching that conclusion. The difficulty is to find an appropriate method of distinguishing between cases where one does and does not regard borrowed money as derived from income/gains used to make the loan.

It is suggested that one should seek to distinguish between:

(1) loans which have characteristics of an outright payment, where B's borrowed money is regarded as derived from the income/gains; and
(2) loans which do not have those characteristics.

A loan has the characteristics of an outright payment, if, for instance:

(1) There is no intention to repay the loan,
(2) The loan is likely to remain outstanding for a substantial period, such as the lifetime of B, or, perhaps, the period that B is UK resident, or
(3) B has insufficient funds to repay the loan (other than the borrowed money).

Such "loans" (the facts justifying scare quotation marks) are (from the recipient's viewpoint) more or less equivalent to outright payments.

A loan on arm's length terms is less like an outright payment, at least assuming there is in fact an intention to comply with the terms (pay the interest).

A loan made at arm's length is not like an outright payment.

Similar points arise on a sale with the payment left outstanding (which may be regarded as commercially equivalent to a loan, though not a loan in the strict sense of the word).

Remittance condition D might also need consideration.

18.18.8 *T subscribes for shares in R Ltd*

Suppose T uses income/gains to subscribe for shares issued by a company which is a relevant person ("R Ltd").

The shares received by T are derived from the income/gains.

[147] *Harmel v Wright*, 49 TC 149 is a case on the pre-2008 remittance basis, and so not now directly relevant, but it illustrates the point at p.157: "emoluments, which mean money, come in at one end of a conduit pipe and pass through certain traceable pipes until they come out at the other end to the taxpayer".

It is considered that the proceeds of the share subscription received by R Ltd are also derived from the income/gains, at least indirectly, for the following reasons:

(1) This fits the context. There would be little point in providing that companies are relevant persons if that were not so.

(2) If the proceeds of the share subscription held by R Ltd were not derived from the income/gains, what are they derived from? A share issue is unlike a normal sale or similar transaction, as it costs the company nothing to issue shares. The issued shares did not belong to the company before they were issued.

18.18.9 *Double representation*

The two paragraphs above indicate that in cases of loans, and share subscriptions, it is possible to have two distinct assets each of which are derived from the same income/gains: (1) the funds lent or used to subscribe for the shares, and (2) the benefit of the loan or the shares.

One might describe that as **"double representation"**.

Double representation can also arise for foreign s.731 income, which may be treated as derived from two distinct assets:

(1) the benefit to which it relates and (2) the relevant foreign income to which it relates.[148]

There would be a taxable remittance if either of these assets are remitted to the UK. But the income/gains could only be remitted once.

18.18.10 *T subscribes to investment fund*

The position is different if:

(1) T uses income/gains to subscribe for an interest in a collective investment fund, along with other investors.

(2) That fund invests in a portfolio of underlying companies (by way of loan or share subscription) together with other investors in those companies.

T's interest in the collective investment fund is directly derived from the income/gains. But the funds in the underlying companies portfolio should not be regarded as derived from T's income/gains. The commingling of funds at investment fund level, and again at portfolio level, creates a

[148] See 50.39.2 (When is s.731 income remitted).

remoteness sufficient to break the chain of derivation from the original income/gains. The word “derive” (even “indirectly”) requires a sufficient link and the link must break at some point. Derivation must stop at least at the portfolio investment level. T will not be able to keep track of how the original income/ gains are used to fund investments, once they have been pooled together, firstly with the other funds from the other investors in the collective investment fund, and subsequently at the portfolio level. In order for the law to work in practice there has to be a practical limit to the meaning of the phrase “derive indirectly”.

This issue only arises if the underlying companies are close, and so relevant persons, but that can happen, because of the excessive width of the concepts of control and close company.[149]

18.18.11 *T purchases R Ltd (secondhand co)*

Suppose T uses income/gains to purchase shares in R Ltd (a relevant person). R Ltd already owns assets. The assets of R Ltd are not derived property: they do not derive from T’s income/gains.

18.18.12 *T uses income/gains to pay debt*

Suppose:

(1) B borrows from L and receives “the borrowed money”
(2) B uses income/gains (“B’s income/gains”) to repay the debt to L so
    (a) L receives “the repaid money”
    (b) B retains the borrowed money

In the absence of a statutory provision, the borrowed money would not in principle[150] be derived from B’s income/gains. It would not be derived from the income/gains at the time of the borrowing. It would not become derived from the income/gains later when the debt is repaid. However, the s.809R backward-tracing rule alters this.[151]

It is considered that the repaid money in the hands of L is not derived from B’s income/gains. It is derived from the debt, and (indirectly) from

[149] See 104.8 (Ultra-wide control: Critique).

[150] The position should be different if the two steps formed part of an arrangement. In those circumstances, the law recognises “backward tracing”: *Brazil v Durant* [2015] UKPC 35 at [34] - [40].
Of course, if the debt were a relevant debt there would be a relevant-debt remittance of income/gains used to repay the debt.

[151] See 20.7 (Income/gains used to pay debt).

the funds which L used to make the loan to B.

18.18.13 *Refinancing*

Suppose:

(1) L lends "the debt 1 fund" to B ("debt 1")
(2) Subsequently:
  (a) L lends "the debt 2 fund" to B ("debt 2")
  (b) B uses the debt 2 fund to repay debt 1[152]

It is considered that the repaid money in the hands of L:

(1) is derived directly from debt 1
(2) is derived indirectly from the debt 1 fund
(3) is not derived (even indirectly) from the debt 2 fund.

It would be different if B were insolvent and unable to repay debt 2.

If B is a trading company, then Remittance Investment Relief might also be considered, though the relief is not straightforward.

18.18.14 *Loan secured on income/gains*

It is helpful first to consider the position for unsecured loans. Suppose:

(1) T borrows without giving security
(2) T receives the borrowed money in the UK
(2) T owns foreign income/gains and the lender would not lend had T not owned those (or some other) assets

There are three bases on which it may be said that T has remitted the RFI to the UK:

(1) It may be argued that the borrowed money is derived from the RFI.
(2) It may be argued that the income/gains is:
  (a) Used outside the UK in respect of a relevant debt; or
  (b) Used in the UK

The arguments are conceptually distinct, but they overlap, and may be regarded as coming to the same thing. HMRC agree that there is no taxable remittance.[153] In particular, the fact that the lender would not lend if the borrower did not have the RFI (or other assets of sufficient value) does not entail that the borrowed money is derived from the RFI. T's

[152] This would typically happen because B has no liquid assets to repay debt 1.

[153] See 18.24 (Use as security for debt).

borrowed money is derived from T's promise to repay.

Suppose T borrows on the security of income/gains. Is the borrowed money derived from the income/gains? It is considered that in this case the borrowed money is still derived from the promise to repay and not from the foreign income/gains subject to the security. That is still the case even if T could not have borrowed without giving that security. There are three reasons for this view:

(1) The position is analogous to an unsecured loan, where no-one suggests that borrowed money is derived from the borrower's income/gains, even T could not have borrowed were it not for that income/gains, and even if T subsequently charges the loan on income/gains.
(2) A rule which says that borrowed money is derived from a security if and only if the borrower needed the security in order to borrow is not workable: the question whether the security is needed is often imponderable.
(3) The relevant-debt rule[154] is designed to cover this aspect of remittances and that suggests that there would not be a remittance under general principles.

It is considered that the case of *West v Trennery*[155] is not relevant here, since the statutory words on which the decision rests are not present in the remittance basis provisions. In practice HMRC appear to accept this view, though they do contend that there is a relevant-debt remittance; see 18.24 (Use as security for debt).

18.18.15 *Income from income/gains*

Suppose:

(1) T receives £1m ("original income").
(2) T invests the original income and receives £50k ("new income").

It is considered that the new income is not derived from the original income. One must stop tracing the original income at that point. Otherwise various odd results will follow.[156]

[154] See 18.24 (Use as security for debt).

[155] For this case see App.2.9 (Representing assets).

[156] If the new income is derived from the original income, and T remits the £50k new income, T would pay tax on:
(1) The £1m original income and
(2) The £50k new income

The same applies if the original income is invested to produce gains ("new gains"). The new gains are not derived from the old income. So a remittance of the new gains does not constitute a remittance of the old income.

This issue may not arise much in practice, as the original income and the new income/gains may be held in a single mixed fund, in which case the mixed fund rules will apply.

18.18.16 *Gift on to third party*

The position becomes more complex if a second individual is involved. Suppose:

(1) T gives income/gains to A (an individual, who may or may not be a relevant person).[157]

(2) A gives the fund to B (a relevant person).

It is suggested that the funds in the hands of B are derived property if steps (1) and (2) form an arrangement. If there is no connection of that kind between T's gift and the transfer to B, the funds in B's hands are not derived property. The chain of derivation stops there. In particular, if B acquires the funds on the death of A, the funds are not derived property.[158]

If T gives income/gains to a trust and the trustees appoint the fund to B, the same approach should be applied, but the two steps do form an arrangement because the trustees is merely carrying out the intention of the settlor and is not a wholly independent mind.[159] So the funds in the hands of B are derived property.

Similarly, suppose:

(1) T gives £1m original income to R (a relevant person).

(2) R receives £50k new income.

(3) R brings the £50k new income to the UK.

If the new income is derived from the original income:

(a) R will pay tax on the new income (on an arising or remittance basis, depending on whether R is a remittance basis taxpayer; that makes no difference for the purposes of this example).

(b) T would pay tax on the original income, on the remittance of the new income by R.

[157] If A is not a relevant person, A will be a gift recipient, and remittance condition C needs consideration.

[158] This view is supported a little by s.48(3C)(b) IHTA: see 75.16.3 (Purchased equitable interest).

[159] See 87.5.7 (Trust appointment: Filling blanks).

18.18.17 *Receipt of cheque in UK*

Suppose T receives in the UK a cheque which, if cashed, the proceeds would be income/gains. For instance, a cheque representing a dividend from a non-resident company, or a cheque drawn on a foreign account holding unremitted income of T.

A cheque has a twofold character:

(1) It is an instruction to the payor's bank.
(2) It is also a chose in action which entitles the payee to sue on it.[160]

Under neither character is the mere receipt of a cheque a taxable remittance.[161] So far as the cheque is an instruction to pay:

> It is not enough to complete the beneficiary's title to the proceeds of the transfer that the beneficiary [ie payee] or his or her bank receives the payment instruction. This is the case whether the instruction is embodied in a telex or telephone instruction given by the originator [payor] or a standing order or payment order form The instruction only confers on the originator's bank the necessary mandate to make the payment to the beneficiary as his or her agent and to debit his or her account.[162]

So far as the cheque is a chose in action, a promise to pay, it is a different asset from the funds in the account, and so not derived property. Remittance condition B is not satisfied. Also, the chose in action is not UK situate (even if the paper itself is in the UK) unless the cheque is a

[160] Fox, *Property Rights in Money* (1st ed, 2008) para 5.18, 5.64.

[161] This continues the pre-2008 law. The RDR (discussing the pre-2008 remittance basis) provides:
"RDRM36110 Remittance Basis up to 6 April 2008: Cheques received [Jan 2019]
If a taxpayer receives a cheque which represents taxable foreign income, before it is treated as taxable remittance it is necessary for the taxpayer to do something with it after it came into his or her hands.
For example, the cheque might be:
- Credited to a UK bank account
- Exchanged for cash (through a bank or otherwise)
- Accepted by a third party in settlement of a debt owed by the taxpayer
- Given away to a relative

A taxable remittance is not made if a cheque is received in the UK but is then sent abroad and credited to a bank account which the taxpayer has overseas."

[162] Fox, *Property Rights in Money* (1st ed, 2008) para 5.64.

bearer instrument or negotiable.[163] So remittance condition A is also not satisfied.

Even if the cheque is presented to a bank in the UK, there is still no remittance if:

(1) the credit is made to the payee's foreign account, not to a UK account; or

(2) the payee is not a relevant person.[164]

18.18.18 *Betting*

In a conventional bet, the individual puts pays a stake, in advance, to the bookmaker. The winnings (if any) are a mixed fund of the original stake and clean capital (because betting profit is not taxed).

Spread betting is explained in *Spreadex v Battu*:

> Spread betting is not so much or not merely a bet, although it can be described as such, as a form of contract for differences. It enables a customer to take a position on a market (or an event) for a very small stake. Thus, if the Dow Jones index is, say, at 10,000, one can "buy" or "sell" the market at a spread around the index of, for the sake of example, 10 points either way, 9990 to 10,010. If one buys, one is betting that the market will rise above 10,010. If one sells, one is betting that the market will fall below 9990. If one buys and the market rises, one stands to gain £1 for every point that the index exceeds 10,010. If one sells and the market falls, one stands to gain £1 for every point that the index drops below 9990. If, however, one calls the market wrong, then one will stand to lose £1 for every point the market rises above 9990. Until the bet or "trade" is closed, the gains and losses are merely "running" gains or losses. They are real enough, but constantly changing with every change in the index, and have not yet been fixed. Closing the bet will fix the position, win or lose. Unlike a classic bet, the customer can of course lose more than his stake. Indeed, on the example given, of a sales spread point of 9990 when the market is at 10,000, if the market does not move an inch, the customer will lose £10 for every £1 staked. Nor, again unlike a classic bet, are his winnings fixed at the outset by an agreement on odds. In theory, winnings based on rising markets are infinite (in practice, of course, they are not) and losses based on falling

[163] Cheques drawn on UK banks have generally been non-transferable since the Cheques Act 1992.

[164] See 18.14.6 (Gift to non-relevant person); 18.14.7 (Arm's length payment to non-relevant person).

> markets are limited only in so far as they cannot exceed the consequences of a fall in the index to zero.[165]

Pelling explains:

> A spread bet is a form of contract for differences. The client agrees with the firm where he holds his account that each will pay to the other a specified sum per point (the stake) in respect of movements in a nominated index. In financial spread betting the index could be the FTSE 100 or the Dow, or the price of an individual share such as BP or, conceivably, a much smaller floated company, or the price of a commodity or a rate of exchange between specified currencies. If the client is "long" the firm will pay him the stake multiplied by any increase in the index value between opening and closing, but he will have to pay the firm on the same basis if there is a decrease. If he is "short" the opposite applies. The "spread" is the difference between the long and short, or "buy" and "sell" prices at any given time. Spread bets generally have expiry dates built into them but the client is able to close his position before expiry if he chooses to do so. The firm, however, does not have the same discretion. ...
>
> Not all spread betting is on financial indices. Spread betting markets are made by firms on a huge breadth of sporting events, although in this country anecdotal evidence suggests that the biggest individual positions are still taken on financial indices. In this regard spread betting offers certain advantages over more orthodox financial instruments when it comes to profiting from market movements. First, profits on spread bets are taken free of capital gains tax.[166] Secondly, the "geared" or "leveraged" nature of spread bets means that typically the client only has to put up a fraction of the total cost of a position, which means that he can get bigger exposure for a given sum (in hedging the exposure the firm puts up the balance of the cost from its own resources). Thirdly, spread betting offers the client the opportunity to go "short" if he thinks that the market will fall — something that is not always available with a more straightforward brokerage.[167]

In a spread bet, the individual does not put up any stake, but instead incurs a liability to make a possible payment in the future.

[165] *Spreadex Ltd v Battu* [2005] EWCA Civ 855 at [2].

[166] See 72.15.4 ("Gambling").

[167] Pelling, "The long and the short: common issues in spread betting cases" (2012) 1 JIBFL 18.

If an individual takes a spread bet and loses, nothing can be received in the UK[168] and there can be no remittance. If an individual takes a spread bet and wins, the winnings are not derived from any income/gains: they are derived from the (contingent) liability which the individual undertook when making the bet. Accordingly, there is no taxable remittance if the winnings are brought to the UK.

18.18.19 *Proceeds of insurance claim*

In *IRC v Montgomery*[169] the taxpayer sold a policy of insurance, which was valuable because a fire had damaged insured land held by the taxpayer. The sale proceeds were derived from the policy and not derived from the land. So:

(1) If the insured land was derived from income/gains but the insurance policy was not, then the proceeds would not be taxable on remittance.
(2) If the premium on the policy was derived from income/gains, the income/gains spent on the premium would be remitted (but not any income/gains spent on the land).

18.19 Bank errors

In *Duke of Roxburghe's Executors v IRC*[170] a taxpayer[171] received and held offshore:

(1) income subject to UK tax on an arising basis ("taxed income");[172] and
(2) foreign income taxed on the remittance basis, and which was therefore taxed if remitted ("untaxed income").

These were wisely held in separate accounts, and so a remittance out of the taxed income account would not be taxable. The taxpayer correctly directed the bank to make a remittance to the UK out of her taxed income account. Unfortunately the bank carelessly debited the wrong account, so according to the bank records, the sum remitted could (largely) be traced

[168] Assuming payment of the loss is made out of the UK.

[169] The case contains some general comments on the meaning of "derived", see 18.18.1 ("Derived").

[170] 20 TC 711.

[171] More accurately, the wife of the taxpayer: the income of a married woman was at the time deemed to be the income of the husband, so the appellant was the Duke, not the Duchess. But nothing turns on that.

[172] For completeness: this was foreign source income of a class not then qualifying for the remittance basis, and so taxed on an arising basis; but nothing turns on that.

to untaxed income!

The Court of Session identified the sum remitted as taxed income because the taxpayer had *intended* the remittance to come out of taxed income.[173]

The same applies under the ITA remittance basis. In the terms of the ITA remittance basis, one would say that the sum the taxpayer received in the UK was derived from her taxed income. It did not matter that there was a debit, no doubt later corrected, from the untaxed income account. That banking records were wrong, and did not reflect the legal position.

The principle also applies in other circumstances of bank error, eg if

(1) A bank was instructed to pay a dividend into a foreign account and accidentally paid it into a UK account of the same bank

(2) A bank was instructed to pay a dividend into an income account, and accidentally paid it into a capital account of the same bank, creating a mixed fund.

HMRC agree. The RDR Manual provides:

> **RDRM33560 Banking Issues** [Jan 2019]
> *Bank Errors and Mistakes*
> Where
> [1] a bank acts contrary to express instructions by an account holder, and
> [2] that mistake inadvertently results in a taxable remittance to the UK by the account holder,
>
> the account holder and the bank may alter the transaction in line with the original instructions given.
> If the bank does this, HMRC will treat the earlier [mistaken] transaction

[173] "The Duchess was entitled to have the remittance debited against any fund belonging to her and under her control and ... she did so effectually by the *instructions* to debit it against money not derived from the [untaxed] income." Lord Normand at p.726 (emphasis added).
This was also the view of Lord Fleming at p.732: "I base my decision ... on the ground that it was the legal right of the Duchess to make the appropriation against any particular fund belonging to herself, and that in law she made that appropriation when she *directed* the Bank making the remittance to charge it against her funds in their hands which had already borne British Income Tax."
A second ground of the decision was that a remittance out of a mixed fund of taxed and untaxed income is in general to be treated as out of the taxed income first, regardless of the intention of the taxpayer. The second ground is now reversed by the ITA mixed fund rules. In any case, one would not nowadays regard the two accounts as a single mixed fund.

> as not having taken place and the new transaction as being the original transaction in looking at whether there has been a taxable remittance from that account.

The error will normally involve a bank, but the same must apply to a non-banking institution which holds accounts for a customer.

See too 20.19.8 (Accidental remittance of nominated income).

18.20 Relevant-debt remittance

I turn to the second part of remittance condition B. Section 809L(3) ITA provides:

> Condition B is that ...
> (c) the income or chargeable gains are used outside the UK (directly or indirectly) in respect of a relevant debt, or
> (d) anything deriving (wholly or in part, and directly or indirectly) from the income or chargeable gains is used as mentioned in para (c).

There are similar provisions in remittance conditions C and D, but condition B is the most important. I refer to this as "**relevant-debt remittances**" (or just debt-remittances).

In order to have a debt-remittance under condition B, two conditions must be satisfied; in short:

(1) A *relevant debt* (in short, relating to property brought/received/used in the UK).
(2) Income/gains used *in respect of* the debt.

There is no relevant-debt remittance unless both conditions are satisfied, eg there is no relevant-debt remittance if:

(1) a relevant debt is paid out of a sum which does not constitute income/gains; or
(2) income/gains are used to satisfy a debt which is not a relevant debt.

There is no taxable remittance if the income/gains arose when the individual was not UK resident.[174]

A further requirement is that the income/gains are used *outside the UK*; however if the income/gains are used in the UK, there will normally be a remittance under the usual remittance rules, so this is not important in

[174] See 17.21 (RFI/gains of non-resident, remitted when resident).

practice.

For the interaction of relevant-debt remittances and exempt property reliefs, see 19.29 (Exempt property).

18.21 Relevant debt

"Relevant debt" is a key term, which is used in remittance conditions B, C and D. Section 809L(7) ITA provides the definition.

There are six categories of relevant debt:

> In this section "relevant debt" means a debt that relates (wholly or in part, and directly or indirectly) to—
> (a) property falling within subsection (2)(a)
> (b) a service falling within subsection (2)(b)
> (c) qualifying property dealt with as mentioned in subsection (4)(a),
> (d) a service falling within subsection (4)(b),
> (e) qualifying property dealt with as mentioned in subsection (5)(a), or
> (f) a service falling within subsection (5)(b).

To understand this one must read in the words in the six cross-references, thus:

Paragraphs	**incorporate wording from**
(a) and (b)	remittance condition A
(c) and (d)	remittance condition C
(e) and (f)	remittance condition D

When one reads in the words, the text becomes:

> In this section "relevant debt" means a debt that relates (wholly or in part, and directly or indirectly) to—
> (a) property falling within subsection (2)(a) [property brought/received/used in the UK],
> (b) a service falling within subsection (2)(b) [service provided in UK],
> (c) qualifying property dealt with as mentioned in subsection (4)(a) [brought/received/used in UK and enjoyed by a relevant person],
> (d) a service falling within subsection (4)(b) [service enjoyed in UK by a relevant person],
> (e) qualifying property dealt with as mentioned in subsection (5)(a) [brought/received/used in UK and enjoyed by a relevant person], or
> (f) a service falling within subsection (5)(b) [service enjoyed in UK

by a relevant person].

Para (f) is otiose: it only repeats para (d).[175] But it does not matter.

In para (e) "*Qualifying* property dealt with as mentioned in s.809L(5)(a)", the word "qualifying" is meaningless. The expression "qualifying property" is defined for remittance condition C but not for condition D.

The most important category is para (a). The discussion here concentrates on this category. There are two steps in deciding whether a debt is a relevant debt within para (a):

(1) One must identify the property (if any) to which the debt relates. I refer to that as the **"debt-related asset"**.

(2) One must ask if that asset is "property falling within s.809L(2)(a)" ie is the property brought/received/used in the UK by a relevant person.

Strictly one should not use the term "relevant debt" in the abstract. A relevant debt can exist only *in relation to certain persons*. If a debtor borrows, the debt is a relevant debt for:

(1) the individual who brings/receives/uses the money in the UK (who will normally be the debtor); and

(2) persons who are relevant persons in relation to that individual.

For instance, if H borrows and receives the money in the UK, the debt is a relevant debt for the wife of H (who would make a taxable remittance if she used her income/gains to repay the debt). But it is not a relevant debt in relation to the father of H (who would not make a taxable remittance if he used his income/gains to repay the debt).

But where the context is clear it is permissible to refer to a relevant debt in isolation (leaving the words "in relation to a person" and the identity of that person to be inferred).

"Debt" is not defined. It is suggested that it includes any liability to pay money. If an individual holds a lease, the payment of rent is the payment of a debt. If the land is UK situate, the debt is a relevant debt.

The residence of the lender does not matter. A loan from a UK bank is not a relevant debt if the money borrowed is received and retained outside the UK but it is a relevant debt if the money borrowed is received in the UK. However there is a relevant-debt remittance only if income/gains are used *outside the UK* in respect of a relevant debt, which is not likely to

[175] Likewise perhaps para (e).**Do 18**

happen where the loan is from a UK bank: repayment to a UK bank is in principle use of funds in the UK.

A debt may be a relevant debt even though:

(1) the debtor was non-resident when the debt arose, or
(2) the debtor was non-resident when property to which the debt relates was remitted to the UK.[176]

A debt which was not at first a relevant debt(because money borrowed was not brought/received/used in the UK) may later become a relevant debt (because the money is later brought/received/used in the UK).

18.22 Debt "related" to property (debt-related asset)

"Relates" requires some nexus between the debt and the debt-related asset; exactly what that nexus is has been left to the courts to sort out.[177]

The words "directly or indirectly" do not add any clarity; indeed I am not sure that it is altogether coherent to speak in the abstract of direct and indirect relationships, for "relates" requires a relationship and an indirect relationship is a type of relationship. But the word "indirectly" shows that the drafter did not want the word "relates" to be narrowly construed.

In the following discussion I just use the word "relate" and leave "directly or indirectly" to be understood.

18.22.1 *Simple examples*

Suppose T borrows and receives money. The debt relates to the money. If T receives the borrowed money in the UK, the debt is a relevant debt.

If T borrows and receives the borrowed money outside the UK, the debt still relates to the money, but the money is not "property falling within s.809L(2)(a)" so the debt is not a relevant debt. However if T later brings the money to the UK, it becomes "property falling within s.809L(2)(a)" and the debt at that time becomes a relevant debt. HMRC agree.[178]

T may borrow but without receiving money: T may draw down the borrowing under a loan facility, to pay for an asset, the money being paid directly to the vendor. In that case the debt relates to the asset. If at any time T brings/receives/uses the asset in the UK the debt is a relevant debt.

[176] For an example of this, see 18.24.6 (Income/gains from collateral).

[177] See App.2.4.3 (Relating to).

[178] See the example of Ali at 18.22.6 (Borrowing/receipt/repayment by different people).

It makes no difference whether the loan is drawn down first, to provide money, or (which may be more usual) drawn down directly to pay for the asset.

The RDR Manual provides some examples which are consistent with the above. I set out the relevant parts of the text, relegating the full text to footnotes.

Example 1 concerns borrowing to buy UK shares.

> *Example 1 (Katrina)*[179]
> K borrows money to buy shares in a UK company.

The HMRC analysis is as follows:

> This is a relevant debt as it relates to property (shares) in the UK which is for the benefit of a relevant person.

More analytically, the debt is in the HMRC view a relevant debt on the following grounds:

(1) The debt relates to the shares. (This is correct).
(2) The shares are received in the UK by K.[180]

Example 2 concerns borrowing to buy UK residential accommodation:

> *Example 2 (Gary)*[181]
> G borrows money to buy an apartment in the UK which he occupies.

The HMRC analysis is as follows:

[179] The example in full (including its irrelevant detail) is as follows:
"**RDRM33160 Condition B - relevant debt** [Mar 2022]
In May 2006 Katrina, a remittance basis user, borrows money from an overseas bank to buy shares in a UK company. This is a relevant debt as it relates to property (shares) in the UK which is for the benefit of a relevant person (Katrina).
From 6 April 2008 any foreign income or gains that Katrina uses in respect of the loan, for example to service or to repay the loan, are taxable as a remittance."

[180] This assumes a receipt of UK situate property is a receipt in the UK; see 18.14.8 (Acquisition of UK security).

[181] The example in full (including its irrelevant detail) is as follows:
"**RDRM33160 Condition B - relevant debt** [Mar 2022]
On 6 April 2015, Gary, a remittance basis user, borrows money from an overseas bank to buy an apartment in Solihull.
The loan is a relevant debt because money is used in the UK, and it is in respect of property (the apartment) which is used in the UK for the benefit of a relevant person (Gary)."

> The loan is a relevant debt because money is used in the UK, and it is respect of property (the apartment) which is used in the UK for the benefit of a relevant person (G).

More analytically, this is a relevant debt on one or both of the following grounds:

(1) It relates to the flat which is used in the UK by G. (This is correct).

(2) It relates to money which is used in the UK by G. Whether this is correct depends on the details of the purchase arrangement, but it does not matter since the debt is a relevant debt under (1).

Example 3 concerns borrowing to buy a UK chattel for a relevant person.

> *Example 3 (Robina and Mark)*[182]
> R borrows money to buy a car for M, a relevant person.

The HMRC analysis is as follows:

> The loan is a relevant debt because it is respect of[183] property (the car) which is used in the UK by a relevant person (M).

More analytically, there is a relevant debt because:

(1) The debt relates to the car.

(2) The car is used in the UK by a relevant person, M. (Another reason is that the car must have been brought or received in the UK by R or M.)

Example 4 concerns borrowing to pay for two services, one provided in and the other out of the UK; I discuss this at 18.22.12 (Debt relates to property in part).

Example 5 concerns borrowing to purchase an asset given to a relevant person; I discuss this at 18.22.6 (Borrowing/receipt/repayment by different people).

[182] The example in full (including its irrelevant detail) is as follows:
"**RDRM33160 Condition B - relevant debt** [Mar 2022]
In October 2012 Robina, a remittance basis user, borrows money on a fixed-rate loan from an overseas bank to buy a car for Mark, a relevant person. Robina pays £x each month from 1 November 2012, making 24 monthly payments. She uses her foreign chargeable gains to make these repayments.
The loan is a relevant debt because it is respect of property (the car) which is used in the UK by a relevant person (Mark)."

[183] The author of the example probably regarded "relates to" and "in respect of" as synonymous, and perhaps they are; but it is best to use the statutory wording and not a paraphrase.

Example 6 (Francine) is a straightforward example of borrowing to pay for services in the UK which adds nothing and so is not set out here.

For example 7, see 18.22.6 (Borrowing/receipt/repayment by different people).

18.22.2 *Asset derived from debt-related asset*

Suppose:

(1) T borrows and uses the borrowed money to purchase a non-UK asset ("asset 1").

(2) T later sells asset 1 and uses the sale proceeds to purchase a UK asset ("asset 2").

The debt relates to asset 1. It is considered that the debt does not necessarily relate to asset 2. The word "relates" requires more than just a historic tracing exercise. It is suggested that the debt relates to asset 2 if and only if steps (1) and (2) form part of an arrangement.

Suppose:

(1) T borrows.

(2) The borrowed funds (or proceeds representing them) are mixed with other funds.

(3) Some of the mixed funds are used to acquire a UK asset (leaving an amount in the mixed fund which equals the borrowed funds).

Does the borrowing relate to the UK asset or to the amount remaining in the mixed fund? Unless steps (1) to (3) form part of an arrangement, the debt does not relate to the UK asset. If the debt does relate to the asset, some commonsense tracing rules must be devised; the ITA mixed fund regime does not apply.

Suppose T borrows invests the borrowed funds, and receives income from the borrowed funds. It is considered that the debt does not relate to the income. So if the income is remitted, it is in principle taxable, but the debt does not thereby become a relevant debt.

18.22.3 *Debt-related asset leaves UK/ceases to exist*

Suppose:

(1) T borrowed to acquire an asset.

(2) T brings/receives the asset in the UK so the debt is a relevant debt.

(3) T later takes the asset outside the UK.

The debt still relates to the asset. It is suggested that the asset is still "property falling within s.809L(2)(a)" ie property brought/received in the UK by T. So the debt is still a relevant debt. The contrary view would give scope for planning/avoidance. Suppose T wanted to use property/ chattels in the UK:

(1) T borrows funds.
(2) T uses the funds to purchase property in the UK and chattels which T brings/receives in the UK.
(3) Interest (unpaid) rolls up on the debt.
(4) Later when T no longer wants to use the property/chattels, the chattels are taken outside the UK, and the property is sold.
(5) The debt and interest is then repaid.

If my view is wrong, the debt has ceased to be a relevant debt by the time it is repaid so there is no taxable remittance, even though T may have enjoyed substantial benefits in the UK.

Suppose:

(1) T borrowed to acquire an asset.
(2) T brings/receives the asset in the UK so the debt is a relevant debt.
(3) The asset ceases to exist (eg it is a short lease which expires, or money which is spent).

It is considered that the debt remains a relevant debt. That is consistent with relevant debt rule for services, for if T borrows to pay for services provided in the UK, the debt is a relevant debt even after the services have ceased to be provided.

18.22.4 *Borrowing to repay debt*

Suppose:

(1) T borrows to acquire borrowed money or other property; T has a debt ("debt 1") and an asset ("asset 1"). Debt 1 relates to asset 1.
(2) T borrows again ("debt 2") and uses the borrowed funds to repay debt 1, so T retains asset 1.

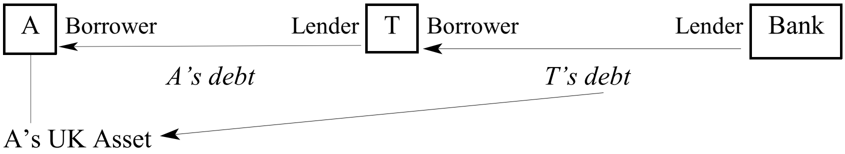
Does debt 2 relate to asset 1? It is considered the answer is yes, if the steps form a scheme or arrangement.

18.22.5 *Borrowed money lent to 3rd party*

The position becomes more complex if borrowed money is lent on to another person. Suppose:

(1) T borrows money from a bank.

(2) T lends the borrowed money to A.
(3) A uses the money to acquire a UK asset ("A's UK asset").


A
Borrower
Lender
T
Borrower
Lender
Bank
A's debt
T's debt
A's UK Asset

Does T's debt relate to A's UK asset?

In this case:
(1) T has a debt: the burden of the debt to the bank ("T's debt"). One needs to ask if it is a relevant debt.
(2) A has a debt: the burden of the debt to T ("A's debt"). One needs to ask if it is a relevant debt.
(3) T has an asset: the benefit of A's debt to T: one needs to ask if it is UK situate.
(4) A has an asset: "A's UK asset".

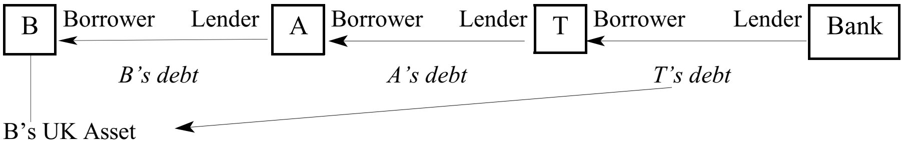
A's debt is a relevant debt: it relates to A's UK asset.

Is T's debt a relevant debt? T's debt relates to the benefit of A's debt. If the benefit of A's debt is a UK situate asset, then T's debt is a relevant debt. Let us assume this is not the case.

T's debt is also a relevant debt if (1) it relates (indirectly) to A's UK asset and (2) A is a relevant person in relation to T. It is considered that T's debt does not relate to A's UK asset if steps (1) and (2) do not form an arrangement. If there is no connection of that kind between T's debt and the UK asset, the debt does not relate to the asset.

If there is an arrangement, it is suggested that T's debt does relate to A's UK asset. The contrary is arguable, since T has another asset which does relate to the debt. Scope for tax avoidance in this conclusion is restricted, since the relevant debt rule applies to A.

If that is so, what would the position be if:
(1) T borrows from a bank and lends to A.
(2) A lends the proceeds of the borrowing to B.


B
Borrower
Lender
A
Borrower
Lender
T
Borrower
Lender
Bank
B's debt
A's debt
T's debt
B's UK Asset

Does T's debt relate to B's UK asset?

(3) B uses the money to acquire a UK asset. How many assets would T's debt relate to, and could T keep track of them all? Perhaps the position depends on the nature of the arrangement. In some cases it would be easy to trace, and in others, less so.

18.22.6 *Borrowing/receipt/repayment by different people*

A relevant-debt remittance requires three conditions:
(1) A debt relating to property
(2) The property is received/brought/used in the UK by a relevant person
(3) A payment in respect of that debt

Normally those three steps will be taken by the same person but that need not be the case. There may be two or three separate persons involved:
(1) A may borrow
(2) B may receive the debt-related asset in the UK
(3) C may repay the debt

The debt is a relevant debt in relation to B and to those who are relevant persons in relation to B.[184]

RDR Manual 33160 gives a straightforward example where A borrows to purchase an asset which is given to a B (a relevant person), B brings it to the UK:

Example 5 (Ali)[185]

[184] As to when the relevant person test must be satisfied, see 18.26.3 (Relevant debt: Becoming/ceasing to be relevant person).

[185] The example in full (including its irrelevant detail) is as follows:
"**RDRM33160 Condition B - relevant debt** [Mar 2022]
Ali, a remittance basis user, purchases a sculpture in Sweden in October 2012 (refer to the earlier example). He takes out an interest-free (!) loan with his US bank to fund this purchase, repayable within 1 year. In November 2012 he gives them to his wife as an anniversary gift.
She initially keeps it at her mother's home in Stockholm, but 6 months later in March 2013 Ali's wife decides to bring the sculpture to the UK to display in her UK garden. In October 2013 Ali arranges with the US bank that he will repay the loan by giving them an oil painting which is currently in his apartment in Miami, which he had purchased in May 2011, using his relevant foreign earnings, and some capital inherited from an uncle.
There is a debt (the loan from the US bank) which relates to property (the sculpture) which is brought to the UK by a relevant person (Ali's wife, in March 2013).
The oil painting which derives, in part, from A's relevant foreign earnings, is used

> A borrows to purchases a sculpture outside the UK.
> A gives the asset to his wife W.
> W brings the asset to the UK.

HMRC correctly analyse why the debt is a relevant debt:

> There is a debt (the loan from the bank) which relates to property (the sculpture) which is brought to the UK by a relevant person (W).

That was a case where the debt-related asset was given to B. Suppose:
(1) T borrows money.
(2) T gives the borrowed money to R (a relevant person in relation to T).
(3) R uses the money to acquire a UK asset ("R's UK asset").

Is T's debt a relevant debt? T's debt is a relevant debt if it relates (indirectly) to R's UK asset. It is suggested that T's debt relates to R's UK asset if and only if steps (1) and (2) form an arrangement. If there is no connection of that kind between T's debt and the R's asset, the debt does not relate to the asset.[186]

The RDR Manual 33160 provides an example where A borrows and income of B (a relevant person) is used to repay the debt:

> Example 7 (Kumar)[187]

outside the UK in respect of this relevant debt.
There is a taxable remittance in 2013-14, the tax year in which the painting is used to pay the relevant debt."
More analytically, remittance condition B is satisfied under s.809L(3)(d): the picture (which derives from RFE) is used in respect of the relevant debt. The example continues:
"The remittance occurs when the foreign income or gains are regarded as used in respect of the relevant debt (2013-14) not when the property is first used in the UK by a relevant person (2012-13). ...
Note: For the purposes of this example assume there is no chargeable gain on the transfer of the painting to the bank."

[186] Contrast 18.18.16 (Gift on to third party).

[187] The example in full (including its irrelevant detail) is as follows:
"**RDRM33160 Condition B - relevant debt** [Mar 2022]
Example 7
Kumar sets up and is a beneficiary of a non resident trust with £1,000,000 capital which the trustees invest in overseas property which produces income that would be chargeable on Kumar if he remitted it to the UK.
The trust borrows £500,000 from an offshore lender to buy a UK asset which Kumar uses in the UK. The trust pays the interest on the loan with the income from the letting of the overseas property.

> K is settlor of a non resident settlor-interested trust.
> The trust borrows to buy an asset which K uses in the UK.

The HMRC analysis is as follows:

> There is a relevant debt (the loan) which is used to purchase an asset in the UK (property used by a relevant person).

More analytically, the debt is a relevant debt since:

(1) It relates to the UK asset.
(2) The asset falls within s.809L(2)(a) for two reasons (either would be sufficient):
    (a) The asset is used in the UK by a relevant person (K).
    (b) The asset must have been brought to or received in the UK by the trustees or by K.

Thus if the trustees repay the debt out of foreign trust income (which is deemed to be the income of K, as income of a settlor-interested trust) then K is chargeable under the s.624 remittance basis. If K repays the debt out of K's own income/gains there is also a taxable remittance of that income/gain.

18.22.7 *Borrowing to acquire co shares*

Suppose T borrows and buys all the shares of a company which owns a UK asset ("the Co's asset"). The debt relates to the shares. At first sight it may seem that the debt also relates to the Co's asset. But note that if T uses income to purchase the shares, the income is not remitted. That being the case, it would be anomalous if there were a remittance if T borrows to purchase the shares and then uses income to pay the debt. So the debt should not be regarded as a relevant debt: the debt does not relate to the Co's asset.[188] One does not lightly pierce the corporate veil.

If that were wrong then anyone who borrows to acquire quoted shares would need to investigate whether UK assets were held by the company; that cannot be right.

The above concerns a share *purchase*. Suppose:

(1) T borrows and *subscribes* for shares in a company.

> There is a relevant debt (the loan) which is used to purchase an asset in the UK (property used by a relevant person). The income used to service the loan is regarded as a taxable remittance, chargeable on Kumar."

[188] It would be different if there were an arrangement under which (1) the company acquired the property and (2) the individual borrowed to purchase its shares.

(2) The company uses the proceeds of the share subscription to acquire UK assets.

Is the debt a relevant debt? It is suggested that the answer is, yes, if the two steps form part of an arrangement; but not otherwise.

18.22.8 *Borrowing for partnership share*

Suppose:

(1) T borrows and buys an interest in a partnership or subscribes for partnership capital

(2) The partnership owns or acquires a UK asset ("the partnership asset")

It is suggested that the debt does not relate to the partnership asset. It relates to the partnership share.[189]

18.22.9 *Debt for unpaid interest*

Suppose T has two debts:

(1) A debt for capital borrowed (the principal debt)

(2) A debt for interest on the principal debt (the interest debt)

The fact that the principal debt is a relevant debt (assume it relates to property brought/received/used in the UK) does not make the interest debt a relevant debt. This follows from the repeal of the former s.809L(8) ITA in 2009. However see 18.23.1 (Payment of interest).

18.22.10 *Debt charged on UK asset*

Suppose:

(1) T borrows and receives the borrowed money abroad

(2) T secures the debt on property brought/received/used in the UK.

It is considered that the debt does not relate to the UK property (within the meaning of s.809L) so the debt is not a relevant debt. The context shows that the colourless word "relate" is intended to apply to the proceeds of the debt, the borrowed money. Otherwise there would be a remittance when the debt is repaid, which is absurd.

18.22.11 *Debt imposed by law*

This section considers debts imposed by law.

[189] See 18.49 (Partnerships). But the position is different if the partnership borrows.

A court order on a divorce is not normally a relevant debt (it does not normally relate to property brought received/used in the UK, though it might do so). Indeed the obligation may not be a "debt". Likewise liabilities arising under a separation agreement. So there will not normally be a relevant-debt remittance.

Similarly, a fine or penalty does not necessarily relate to property brought/received/used in the UK.

A tax liability on income/gains relates to the income or gains. If so a tax liability on income/gains is not necessarily a relevant debt, but a tax liability on UK income/gains, or on remitted foreign income/gains is a relevant debt.

Even if the debt is not a relevant debt, there might be a remittance under ordinary principles when the debt is satisfied.[190]

18.22.12 *Debt relates to property in part*

If a debt relates partly to property brought/received/used in the UK, the entire debt is a relevant debt, the unfairness is avoided by s.809P(10) ITA.[191]

In RDR Manual the facts (stripping out irrelevancies)[192] are as follows:

> *Example 4 (Karen)*
> K borrows:
> - to pay for UK school fees, a service provided in the UK to her minor daughter (a relevant person)
> - to pay for a summer school in France, a service provided outside the UK

The debt is a partly-relevant debt.

> K repays the overdraft from her relevant foreign earnings.

[190] See too 19.24 (Relief on paying remittance charge).

[191] See 18.36 (Debt-remittances); 18.37 (Debt-remittance: P(10) cap).

[192] The example in full (including its irrelevant detail) is as follows:

"**RDRM33160 Condition B - relevant debt** [Mar 2022]

Example 4

In August 2011 Karen, a remittance basis user, uses an interest-free [*sic*] overdraft facility on her Jersey bank account to pay UK school fees for her 14 year old daughter Lauren. She also uses the remainder of the facility to pay for Lauren to attend a summer school in France organised by a French university. Karen repays the overdraft from her relevant foreign earnings between August and November 2011. ..."

The HMRC analysis is:

> There is a debt (the overdraft) which relates in part to a service provided in the UK (the schooling) to a relevant person (the daughter) – this part is a relevant debt. However part of the overdraft facility is not a relevant debt because it does not relate to a service provided to the daughter in the UK, but to a service provided in France.

The author has overlooked the definition of relevant debt in s.809L(7) ITA:

> In this section "relevant debt" means a debt that relates *(wholly or in part,* and directly or indirectly) to—
> (a) property falling within subsection (2)(a) [property brought/ received/used in UK by a relevant person]
> (b) a service falling within subsection (2)(b) [service provided in UK to a relevant person] ...

HMRC conclude:

> The daughter ... has taxable remittances of the relevant foreign earnings used to service and repay the part of the overdraft that is a relevant debt.

More analytically, K has a taxable remittance on the basis that:
(1) Remittance condition A is satisfied: a service is provided in the UK to a relevant person (the daughter)
(2) Remittance condition B is satisfied: the RFE is used outside the UK in respect of a relevant debt
(3) The amount remitted is the part of K's RFE used in respect of the part of the debt that is in respect of the UK services (the UK school fees).[193]

The end result is the same; HMRC have taken the wrong route to the right destination.

18.22.13 *2008 transitional rules for relevant debt*

In the following discussion a **"pre-2008 debt"** is one incurred before 6 April 2008.

Suppose:

(1) A pre-2008 debt which is not a relevant debt (the debt-related property is kept outside the UK).
(2) The debt-related property is brought/received/used in the UK by a relevant person after 2008.

[193] See 18.37 (Debt-remittance: P(10) cap).

The debt becomes a relevant debt at the time the property is brought/received/used in the UK. There is no difference here between a pre-2008 debt and a post-2008 debt.

Suppose:
(1) A pre-2008 debt
(2) The debt-related property is brought/received/used in the UK by the borrower *before* 2008.

It is considered that the debt becomes a relevant debt from 2008/09. In this case there is a transitional relief if the pre-2008 debt is a residential loan.[194]

Suppose:
(1) A pre-2008 debt
(2) The borrower gives the debt-related property to, say, a spouse.
(3) The property is brought/received/used in the UK by spouse before 2008.

Is this a relevant debt? It is arguable that the answer is no, on the grounds that the property was not brought/received/used in the UK by a relevant person. The spouse was not a relevant person at the time the property was brought/received/used in the UK, because the wide concept of relevant person did not then exist. This is consistent with the relevant person transitional rule.[195]

The usual 2008 transitional reliefs applies if pre-2008 income/gains are used to repay a relevant debt (wherever incurred).[196]

18.23 Use "in respect of" debt

Condition B is satisfied if income/gains are used in respect of a relevant debt.

In the discussion below I sometimes refer simply to a debt, rather than a relevant debt; ie it may be assumed the debt is a relevant debt.

Use "in respect of" a debt requires some nexus between the use and the debt; exactly what that nexus is has been left to the courts to sort out.

The words "directly or indirectly" do not add any clarity. Indeed I am not sure that it is altogether coherent to speak in the abstract of use "directly

[194] See 18.54 (Transitional relief: Pre-2008 loans).

[195] See 18.10 (Relevant person: Pre-2008 income/gain).

[196] See 18.10 (Relevant person: Pre-2008 income/gain); 18.53 (Transitional: pre-2008 property).

or indirectly" in respect of a debt, for use indirectly in respect of a debt is use in respect of a debt. The word "indirectly" does show that the drafter did not want the words "in respect of" to be narrowly construed. But (subject to context) the expression always has a wide meaning.[197]

If income/gains are used to pay a debt, this is relevant-debt remittance: money used to pay a debt is used in respect of the debt.

If an asset is transferred in satisfaction of a debt, that is a disposal of the asset. If a gain arises on that disposal, that gain is also used in respect of the debt.

If the benefit of a debt is purchased from the creditor, the purchase price is used in respect of the debt.

18.23.1 *Payment of interest*

Section 809L(9) ITA provides:

> The cases in which property (including income or chargeable gains) is used in respect of a debt include cases where the property is used to pay interest on the debt.

Suppose T has two debts:
(1) A debt for capital borrowed (the principal debt)
(2) A debt for interest on the principal debt (the interest-debt)

It is possible that:
(1) the principal debt is a relevant debt (assume it relates to property brought/received/used in the UK) but
(2) the interest-debt is not a relevant debt.[198]

However if T uses income/gains to pay the interest-debt, the funds are regarded as used in respect of the *principal* debt, and so are regarded as remitted under the relevant debt rule. In other words, it does not matter whether or not the interest-debt is a relevant debt, all that matters is that the principal debt is a relevant debt.

18.24 Use as security for debt

18.24.1 *Unsecured loan*

It is helpful first to consider the position for unsecured loans. If T borrows

[197] See App.2.4.1 (In respect of).

[198] See 18.22.9 (Debt for unpaid interest).

without giving security, T's assets are not used in respect of the debt. That is so even if T owns foreign income/gains and the lender would not lend had T not owned those assets. The fact that the lender only lends because of the foreign income/gains does not by itself entail that the foreign income/gains is used in respect of the debt. HMRC agree:[199]

> HMRC accepts that there is no remittance where
> [1] a loan is unsecured, but
> [2] it is clear that it [the loan] is only given because the lender is aware of the various assets the borrower has (some of which will represent or be derived from FIG [foreign income or gains]).
> Since there is no "contractual matrix" the lender has no right of recovery against the assets representing or derived from FIG, so the FIG cannot be said to be "used" in connection with[200] a relevant debt, HMRC consider that the legislation will not be engaged.
> Although the matter had not been fully considered, HMRC thought that it would not try to argue that there was "use" where a loan is only made as a result of a credit agency check (which would have taken into account the individual's assets representing or derived from FIG).[201]

That must be right. The contrary view could lead the absurd result that if a person borrowed on an unsecured loan, all their foreign income/gains might be regarded as remitted, as it would (in the post-2014 HMRC view) if it were subject to a formal charge.

There could be a remittance if the foreign income/gains is used in some way to satisfy the terms of the loan. There is then, in HMRC's words, a "contractual matrix" (though I am not sure that is a particularly helpful way of putting it).

18.24.2 *Secured loan*

Suppose income/gains are charged as security for a relevant debt. There

[199] Note of meeting between professional bodies & HMRC, 11 Sept 2014 para 15 *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/a1b82d1f-8e06-49a6-98dc-896c9e9cf9cf/Rep%20body%20agreed%20note%20of%2011%20September%20meeting%20after%20HMRC%20comments.pdf*

[200] Author's footnote: the correct statutory term is, used "in respect of" a relevant debt.

[201] There is no reason to think that HMRC have altered their practice on this point. Although the last sentence is expressed tentatively, it clearly follows from the point made in the first sentence of this quote. A commercial lender will always make a credit check, and it can make no difference whether that task is carried out by the lender itself or outsourced to a credit agency.

are various possible views:

(1) One view is that the charge constitutes "use" of the funds, in respect of the debt, within the meaning of the relevant debt rule. On this view, charging funds as security for a relevant debt constitutes a taxable remittance. Nothing more is needed.

(2) Another view is that funds are only "used" in respect of a debt if they are "used up" ie consumed; on this view (unless and until the security is enforced) funds used as security are not "used", and charging funds as security for a relevant debt does not constitute a remittance.

(3) A compromise view is that merely charging funds does not constitute use in respect of the debt: something more is needed, combined with the charge, before the income/gains can be said to be used in respect of the debt. The question then is to identify that "something more". HMRC adopted a form of this compromise view until 2014.

If charging funds does constitute a remittance, the question arises as to whether the remittance is the whole of the charged fund, or only part, and if so which part. I consider that separately below.[202]

18.24.3 *HMRC pre-2014 view*

Until 4 August 2014, the RDR Manual provided:

> ***RDRM33170 collateral in respect of relevant debt*** *[Dec 2011]*
> *Foreign income and gains may be used as collateral for a loan which is brought to the UK or otherwise used for a purpose to which ITA2007/s809L(2) applies (that is, there is a relevant debt).*
> *Such foreign income and gains used as collateral are used 'in respect of' the relevant debt, so there may be a taxable remittance at this point.*
> *[1] The foreign income or gains used as collateral may be used directly, that is, the lender may receive a charge over cash assets in a bank account.*
> *[2] However it is more likely they will be offered indirectly, often in the form of an asset such as a property or bond note that is 'derived from' the foreign income or gains.*[203]
> *[3] This situation only arises where remittance basis users offer their foreign income or gains for use as collateral for a relevant debt,*

[202] See 18.38 (Security for debt: Amount remitted).

[203] Author's footnote: I rather doubt that [2] is "more likely" than [1] and perhaps HMRC agreed, as the current Manual does not make that point; but it does not matter.

> *whether to a UK-based or an offshore lender.*
>
> *[4] In many cases UK property or non-taxable offshore property is offered as collateral in respect of a relevant debt; there is no remittance of this collateral within Condition B (ITA2007 /s809L(3)(c))...*[204]

So far the Manual appeared to take the view that charging as security is use in respect of a debt, but the text went on to qualify that with an exception so large that that the default rule rarely applied:

> *Foreign income and gains used to pay interest on the debt and to repay the borrowed capital are also 'used in respect of' a relevant debt, and will be taxable as a remittance. Thus there are potentially two possible sources of a taxable remittance charge in respect of the relevant debt – the foreign income or gains used as collateral and the foreign income or gains used to repay the debt.*
>
> *In the majority of commercial situations, neither party to the relevant debt transaction expects or intends that the collateral offered as security will be taken by the lender. Instead it is planned that the loan will be serviced and the capital repaid without recourse to the security charge. In such cases using foreign income or gains to regularly service or make capital repayments in respect of the relevant debt effectively 'masks' the collateral being used. In such cases the only taxable remittance will occur as and when the foreign income or gains are used to service or repay the loan. The payments, and thus the taxable remittances, will be spread over the loan period.*

HMRC then specified some exceptions where the default rule would apply, so granting a charge for a debt would be a remittance of the assets charged.[205]

[204] More analytically: There is no taxable remittance in the case of UK property or non-taxable offshore property because remittance condition B is not met.

[205] The Manual provided:

> In some cases, usually involving avoidance or non-commercial arrangements, the relevant debt is not serviced or repaid by the borrower, or only a token amount is offered. In these circumstances the foreign income or gains offered as collateral are being utilised in respect of the relevant debt, that is, to delay or minimise service charges or repayments. As there is only one possible tax charge in respect of the relevant debt, that is the charge HMRC will take. The charge is taken up-front when the collateral is offered. Such arrangements are expected to be rare. This should not be mistaken with interest-only repayment terms, or commercial arrangements that offer payment breaks and so forth. Always check the terms and general availability of the loan arrangements on offer.

In short, on this view, security is not "used in respect of a debt" if the debt is "serviced and repaid" on commercial terms;[206] but in other cases it is so used. I refer to this as the **"pre-2014 HMRC view"**.

18.24.4 *Post-2014 HMRC view*

The RDR Manual was amended on 4 August 2014 and now takes a different view:

> **RDRM33170 collateral in respect of relevant debt** [Jan 2019]
> Foreign income and gains may be used as collateral for a loan which is brought to the UK or otherwise used for a purpose to which ITA2007/s809L(2) applies (that is, there is a relevant debt - see RDRM33160).
> The foreign income and gains used as collateral are used 'in respect of' the relevant debt, so there is a taxable remittance when the loan is brought to the UK.
> The collateral containing the foreign income and gains may be a charge over cash assets in a bank account or other possessions, such as property or financial instruments that are 'derived from' foreign income or gains.
> This situation only arises where remittance basis users offer their foreign income or gains as collateral for a relevant debt, whether to a UK-based or an offshore lender.
> In many cases UK property or non-taxable offshore property is offered as collateral in respect of a relevant debt; there is no remittance of this collateral within Condition B (ITA2007/s809L(3)(c)) as the property used as collateral will not contain foreign income or gains.[207]
> To determine the amount of remittance where foreign income or gains are used as collateral in respect of a relevant debt refer to RDRM35050 Condition B – Collateral in respect of relevant debt.[208]
> Foreign income and gains used to pay interest on the debt and to repay the borrowed capital are also 'used in respect of' a relevant debt, and will be taxable as a remittance. Thus there are potentially two possible

> If you think there is a remittance of foreign income or gains offered as collateral in respect of a relevant debt you should obtain copies of all the relevant arrangements, including all loan agreements and repayment schedules.

The Manual gave examples which I considered in the 2018/19 edition of this work at 12.21.3, but I omit this now as it is of historical interest only.

[206] Likewise if there is other artificial arrangements, such as back-to-back loans.

[207] More analytically: There is no taxable remittance of UK property or non-taxable offshore property because remittance condition B is not met.

[208] See 18.38 (Security for debt: Amount remitted).

> sources of a taxable remittance charge in respect of the relevant debt - the foreign income or gains used as collateral and the foreign income or gains used to repay the debt.

Similarly:

> **RDRM37050 Foreign income and gains as collateral** [Mar 2022]
> **Remittance basis clarifications**
> *When foreign income or gains are used as collateral when does the remittance take place?*
> A remittance will occur if foreign income or gains are used in respect of a relevant debt. HMRC considers that foreign income or gains will be used in respect of a relevant debt, if
> [1] they are used to agree the terms for the loan or
> [2] used to satisfy the terms of a loan.
> If the loan is not a relevant debt initially, the foreign income or gains used as collateral will be remitted at the point the loan becomes a relevant debt.

The Manual then gives an example; the facts (stripping out irrelevancies)[209] are as follows:

> **RDRM33170 collateral in respect of relevant debt** [Mar 2022]
> **Example 1** (John)
> In 2012-13 J, a remittance basis user takes out a loan for £200,000 from

[209] The example in full (including its irrelevant detail) is as follows:

> "**RDRM33170 collateral in respect of relevant debt** [Mar 2022]
> In 2012-13 John, a remittance basis user takes out a loan for £200,000 from a Guernsey bank. John uses the loan to purchase a horse and a stable/paddock in Chester to indulge his young daughter's latest hobby; so the loan is a relevant debt.
> John offers as collateral for the loan a 5-year offshore bond, due to mature in 2015. He purchased this bond in 2010-11 (a year in which he was also a UK resident remittance basis user) using £200,000 of his untaxed relevant foreign income from that year.
> John repays £18,000 of the loan (principal plus interest) in 2012-13, using his relevant foreign earnings from his separate employment in Guernsey.
> John is using the offshore bond as collateral for the loan; the offshore bond derives directly from his foreign income so John is using his relevant foreign income in respect of the relevant debt. However John is also using his relevant foreign earnings to both service and repay the debt capital; both the £200,000 foreign income from 2010-11 and the £18,000 foreign earnings from 2012-13 are regarded as remitted in 2012-13."

> a Guernsey bank. J uses the loan to purchase a horse and a stable/paddock in Chester; so the loan is a relevant debt.
>
> J offers as collateral for the loan a 5-year offshore bond. He purchased this bond in 2010-11 (a year in which he was also a UK resident remittance basis user) using £200,000 of his untaxed relevant foreign income from that year.
>
> J repays £18,000 of the loan (principal plus interest) in 2012-13, using his relevant foreign earnings from his separate employment in Guernsey.

The HMRC analysis is now as follows:

> J is using the offshore bond as collateral for the loan; the offshore bond derives directly from his foreign income so J is using his relevant foreign income in respect of the relevant debt.
>
> However J is also using his relevant foreign earnings to both service and repay the debt capital; both the £200,000 foreign income from 2010-11 and the £18,000 foreign earnings from 2012-13 are regarded as remitted in 2012-13.[210]
>
> **Note** - In the example above, the relevant debt could also be serviced and repaid using non-taxable income or capital sources in which case there would be no taxable remittances of foreign income or gains in respect of the servicing payments.
>
> If you think there is a remittance of foreign income or gains offered as collateral in respect of a relevant debt you should obtain copies of all the relevant arrangements, including all loan agreements and repayment schedules.
>
> **Note** - Previous HMRC guidance did not follow the position given above and suggested (!) that collateral in 'commercial' situations was not taxable if 'regular' servicing payments were made. This guidance was withdrawn on 4 August 2014...

I refer to this as the **"post-2014 HMRC view"**.

18.24.5 *"Use as collateral"*

Extracting the principles from the Manual quotes above, HMRC argue that income/gains are used in respect of a debt if:

- used as collateral for a loan
- offered as collateral for a debt

[210] Author's footnote: However J would not have paid tax on this remittance, because in the relevant year (2012/13), it would have not been regarded as taxable, on the basis of the pre-2014 HMRC view.

- used to agree the terms for the loan or
- used to satisfy the terms of a loan

We need to understand what constitutes "use as collateral".

One should not construe the Manual as though it was a statute. (Nowadays, do we even construe a statute "as though it was a statute"? Discuss.) Nevertheless, "collateral" (which means the same as security) has a clear legal meaning: it is property in which the creditor has a security interest, ie property subject to a charge, mortgage, pledge or lien. It does not include property subject to a right of set-off.[211]

The RDR Manual provides:

> **RDRM37050 Foreign income and gains as collateral** [Mar 2022]
> *... Are foreign income or gains used (and remitted) in respect of a loan if*
> *[1] they are not part of the formal security package, but*
> *[2] can be used by the bank to repay the loan in the event of a default as the result of a general pledge contained in the bank's standard terms and conditions*
> If the loan or the repayment terms are conditional on the availability of the foreign income or gains used as collateral, HMRC considers the foreign income or gains have been used in respect of the debt and there will be a taxable remittance.
>
> *For there to be a remittance, does the customer need to take some positive action to use foreign income or gains as security for the loan?*
> There doesn't need to be some positive action on behalf of the customer for there to be a remittance of foreign income or gains used as collateral.
> For example,
> [1] if, at the point the relevant debt is taken out, the collateral offered is £250,000 capital held in a nominated account.
> [2] £10,000 clean capital is subsequently withdrawn from the account
> [3] but on the same day a foreign gain of £10,000 is paid into the account.
> Although the individual may not have taken a formal step of offering the foreign gain to the lender as collateral, the foreign gain has been used in respect of the relevant debt. The foreign gain has been used in respect of the debt because the payment into the account prevented a

[211] See 82.10.1 (Security/collateral), discussing the statutory phrase "held or made available as security, collateral or guarantee" in an IHT context.

> breach of the terms of the loan.

But it seems to me on those facts that the individual has "taken a formal step of offering the foreign gain to the lender as collateral", simply by paying the sum into the account.

18.24.6 *Income/gains from collateral*

HMRC discuss the position of income/gains arising from the collateral:

> **RDRM37050 Foreign income and gains as collateral** [Mar 2022]
> *... Is it accepted that where*
> *[1] the original collateral remains in place but*
> *[2] that collateral itself generates further overseas income and gains,*
> *there is no additional remittance as a result of the additional income and gains arising, even where the assets representing those income and gains form part of the security for the loan?*
> HMRC considers that the point at which foreign income or gains are remitted will depend on the particular facts.

"Depends on the facts" does not take us far, but it introduces the HMRC answer:

> If
> [1] the loan terms are conditional on the foreign income or gains used as collateral, or
> [2] foreign income or gains are used to satisfy the terms of the loan,
> the foreign income or gains have been used in respect of a relevant debt and there will be a taxable remittance.
> *Would the answer still be the same if, as a result of investment losses, the original collateral (although not having been withdrawn) is reduced below the amount of the loan?*
> If foreign income or gains are used to make up a shortfall in the collateral originally offered, there will be a taxable remittance. At this point, the foreign income or gains have been used in respect of a relevant debt because they have been used to satisfy the terms on which the loan was provided.

So if there is no shortfall, the income/gains are not remitted.

A note of meeting between Professional Bodies/HMRC provides:[212]

[212] "Treatment of loans secured on foreign income or gains by remittance basis users" (Apr 2022) *https://www.tax.org.uk/treatment_of_loans*
ICEAW publish this note as TAXguide 20/21.

> **Question 1:** *Non-resident individual with existing "relevant debt" secured over non-UK portfolio becomes UK resident – is there a remittance of income/gains arising within the portfolio after the individual becomes UK resident?*
>
> A is non-UK resident and domiciled (and has never been resident or domiciled in the UK).
>
> In 2015, he purchases a house in the UK for £1 million. This is funded
>
> [1] as to £400,000 by A from his own resources and
>
> [2] as to the remaining £600,000 by a loan from his bank in Malaysia which is secured by a charge over A's investment portfolio held with the bank which, at the time the security is granted is worth £1.5 million.
>
> There is no restriction on A dealing with the portfolio or making withdrawals although, if the value of the portfolio falls below £900,000, he is required to top up the security so that it has a value of at least £1 million, failing which the bank can call in the loan. Subject to this, the charge is, however, in respect of all assets comprised in the account which holds the portfolio from time to time.

The professional bodies comment:

> As the loan proceeds have been used in the UK, the loan is a "relevant debt".[213]
>
> On the basis of HMRC's interpretation, the portfolio has been "used" in respect of the relevant debt as it has been given a security for the loan. There is however no taxable remittance at the time the loan is put in place as A is non-UK resident.

That is not contentious, but it leads us to the question:

> The question is whether any income or gains which arise within the portfolio after A becomes UK resident (and assuming that he is taxed on the remittance basis) would be treated as remitted as a result of the security arrangements.

The same question would arise if A had been UK resident throughout:[214]

[213] Author's footnote: the debt is a relevant debt even though the debtor was non-resident
(1) when the loan was made, and
(2) when the property to which it relates was received in the UK
See 18.21 (Relevant debt).

[214] Except that in this case, A is (hopefully) more likely to obtain tax advice and avoid this trap.

would income/gains from the charged fund count as remitted?

The professional bodies say the answer is no:

> In our view, although the post-residence income and gains will form part of the security for the loan (as the charge is over the entire contents of the portfolio account from time to time), they cannot be said to have been "used" in respect of the relevant debt. There are two reasons for this:
>
> 1. As long as £900,000 remains in the portfolio, A is free to withdraw the income and gains at any time. As there is no requirement for him to leave the income/gains in the account, they have not been "used" by A in respect of the debt.

HMRC would no doubt respond that the asset is used when subject to the pledge, and ceases to be used if withdrawn.

> 2. The entire portfolio is (according to HMRC) "used" in respect of the relevant debt when it is first given as security. If nothing has been added to the portfolio by A, it is difficult to see how any part of the portfolio can be "used" in respect of the relevant debt a second time. As the post-residence income and gains are part of the existing portfolio (rather than resulting from any addition), there is nothing new which is being "used" in respect of the relevant debt.
>
> The contrary argument of course is that there are now assets in the portfolio which either are, or are derived from, the post-residence income and gains and which have been "used" in respect of the relevant debt as they form part of the security of the loan. However, for the reasons set out above, we do not believe that this is the right analysis.

HMRC do not agree with the professional bodies:

> **HMRC response**
>
> In this scenario the loan is secured by a charge "in respect of all assets comprised in the account which holds the portfolio from time to time''. The £900,000/ £100,000 requirement is an additional layer of security for the loan, but the charge is over all the assets in the investment portfolio.
>
> Foreign income or gains arising in the portfolio after the individual becomes UK resident will be 'used' in respect of a relevant debt because they form part of the security for the loan and there will be a taxable remittance

The professional body's analysis depends on the proposition that the income/gains are "nothing new". That is not correct. The question is whether they are added to the (charged) portfolio. If the fund manager pays the income directly out to the owner, the income is not added to the portfolio and the income is not remitted. But if the fund manager retains the income as part of the portfolio, it is added to the portfolio, and so used in respect of the debt. The same applies to gains, but in practice these are likely to be added to the portfolio.

The moral is that a non-resident should review their banking arrangements before becoming UK resident, along with much other pre-residence planning.[215]

18.24.7 *Debt becomes relevant debt*

A non-relevant debt may become a relevant debt.[216]

Suppose:

(1) T grants a charge over foreign income/gains as security for a non-relevant debt

(2) Later the debt becomes a relevant debt (as the proceeds of borrowing are received in the UK).

In the post-2014 HMRC view, at least, there is a relevant-debt remittance of the foreign income/gains when the debt becomes a relevant debt. That must be on the basis that when the charge is granted, the assets charged continue at all times subsequently to be used in respect of the debt.

18.24.8 *Transitional: Pre-2014 loan*

On the post-2014 HMRC view there is a remittance when a relevant debt is charged on income/gains. But HMRC did not seek to apply this to "arrangements where the loan was brought into or used in the UK before 4 August 2014".[217]

It follows that HMRC cannot say that there is a taxable remittance later when the same income/gains are remitted to the UK (or used to repay the

[215] See 13.1 (UK arrival or departure: Tax checklist).

[216] See 18.21 (Relevant debt).

[217] It is suggested that HMRC's transitional relief practice only applies where there was (on the new HMRC view) a remittance before 4 August 2014. Eg if the loan was brought to the UK before 4 August 2014, but charged on foreign income/gains after that date, the transitional relief would not apply.

debt).[218] A sum (on the post-2014 HMRC view) which is remitted in one year cannot give rise to a remittance charge if remitted again in a second year. As HMRC cannot usually assess the tax in the year of remittance, pre-2014 loans may provide a windfall for the taxpayer, though in practice the mixed fund rules may somewhat restrict the advantage. The point could still arise, but it is now of mainly historical interest.

18.24.9 *The correct view*

The meaning of words is always context dependent, but this is particularly so in the case of broad expressions such as "used" in respect of a debt.

The pre-2014 HMRC view raises few difficulties.

The post-2014 HMRC view leads to more serious difficulties:

(1) Double remittance charge (which was the reason why HMRC adopted its pre-2014 view).

(2) What if the value of the property charged exceeds the amount of the loan? HMRC's view has wavered, but their post-2020 view is that the remittance is not limited to the amount of the loan, which can lead to absurd results.[219]

For these reasons, it is arguable that (in the absence of special circumstances) the mere grant of security is *not* use in respect of the debt, ie that HMRC's pre-2014 view was correct. But it would be a "good win" for the taxpayer, and it is wiser to avoid the issue.

No-one has yet challenged the post-2014 HMRC view. A challenge would be expected if HMRC take the most extreme position as to the amount remitted,[220] but that now seems unlikely.

It is considered that the better view is that:

(1) funds charged are "used" in respect of a debt (and so remitted) if the loan would not be made on substantially the same terms, without the security,

(2) funds are not "used" if the circumstances are that the loan would be

[218] The principle that a concession in one year cannot be used to impose a tax in another year is self-evident; but if authority is needed, see s.284A TCGA (Concessions that defer a CGT charge) which (in short) disapplies the principle for pre-1999 CGT concessions only.

[219] See 18.38 (Security for debt: Amount remitted).

[220] See 18.39 (Amount remitted: post-2020 HMRC view).

made on substantially the same terms, without the security.[221]

There are difficulties in applying this view: The question whether the loan would be made without the security is a hypothetical question which could be imponderable. So this is not an altogether easy solution, but perhaps it is the best that can be done. However, in practice, it will not be common that the loan would be made on substantially the same terms, without the security. So it is not likely to happen often that there is a difference between the HMRC view and the view taken here.

18.24.10 *Policy issues*

Whenever there is a dispute as to what the law is, it is worth pausing to ask: regardless of what the current law is - what should it be? Should the law treat a charge on income/gains as security as a remittance?

It seems to me that there is no right or wrong answer to this: it depends on how generous or stringent a remittance basis one wants, bearing in mind that:

(1) The policy reason for the remittance basis is to make the UK an attractive place for foreign domiciliaries to reside.[222]
(2) One might ask if the income or gains are "in effect remitted to the UK, taking a realistic view"[223]

The pre-2014 HMRC view permits tax planning by allowing the option of borrowing instead of remitting income/gains. However:

(1) There is not usually any tax advantage. Broadly, one exchanges an up-front charge of tax on the sum borrowed for an ongoing charge of tax on interest and repayments (made out of income/gains). There is no overall tax saving, except in the case of a remittance basis taxpayer who:
    (a) dies before repaying the debt, or
    (b) leaves the UK before repaying the debt, and is not just temporary non-resident.

    This is not tax avoidance in the strictest sense of the expression.
(2) Such planning remains possible under the post-2014 HMRC view -

[221] The answer to that question may vary over time, but the test should be applied at the time the debt arises. if a loan would have been made, but on different terms, or in smaller amount, there would be a use in respect of the debt.

[222] See 1.1 (Foreign Domicile Tax Policy: Introduction).

[223] See 18.1.4 (Construction of remittance basis).

at a greater cost - by unsecured borrowing.

The reader may suspect an inconsistency in government policy here. Perhaps some of those responsible for tax administration have no sympathy with government's decisions in 2008 and 2017 to retain the remittance basis; so they seek to adopt as strict an interpretation of the law as is possible, regardless of common sense or fairness.

On any basis:

(1) The double remittance charge involved in the post-2014 HMRC view of debt-remittance is wrong. If charging property as security for a relevant debt is a taxable remittance of the property charged, repaying the relevant debt should not be.[224]

(2) The post-2020 HMRC view (that the amount remitted in the case of a charge is not limited to the amount of the relevant debt) is wrong. If granting a charge over foreign income or gains is a taxable remittance, the amount remitted should be capped to the value of the relevant debt in all cases, not just in some cases. But HMRC may in due course abandon that view.

However, there is little prospect of law reform on that point, at least, at the present time.

18.24.11 *Remittance planning by loans*

Suppose:

(1) a remittance basis taxpayer (T) has an foreign asset which is clean capital but on which a gain would arise if it were disposed of.

(2) T needs short term or medium term funds in the UK,

T could sell and remit the proceeds, but the gain would be subject to CGT. In this case it may be better for T to borrow, charged on the asset. The gain would not be remitted because there is no disposal and no gain accrues. If the charge did not extend to income from the asset, that would not be remitted either. Of course funds used to pay interest, or repay the debt, would be remitted, and the same planning applies to an arising basis taxpayer: it may be better to borrow than to dispose of an asset and realise a gain.

[224] Unless the debt exceeds the value of the security, which will not be the case in ordinary commercial lending.

18.25 Guarantees

It is suggested that a guarantee is not a debt.[225] But if principal debtor defaults, the guarantee can be called on, and a debt comes into existence. So where G guarantees the debt of D, there are, potentially, two debts:

(1) D's debt (the principal debt)
(2) G's debt (the guarantee debt)

Assume D's debt is a relevant debt in relation to D (it relates to UK property received by D). G's debt relates to the same property. It is a relevant debt in relation to G, if D is a relevant person in relation to G.[226] Then if G uses his foreign income/gains to pay G's debt, the income/gains are remitted. This is assumed in transitional relief.[227]

If the guarantee is secured, the security relates (indirectly) to D's debt. So if D's debt is a relevant debt in relation to G, the security is under the post-2014 HMRC view regarded as remitted.[228]

18.26 Becoming/ceasing to be relevant person: Conditions A & B

A person may be a relevant person at one time and not at another time. For instance, a child ceases to be a relevant person on becoming 18; an individual becomes a relevant person on marriage or cohabitation, and ceases to be a relevant person on divorce or separation. A company becomes/ceases to be a relevant person in relation to T if T becomes/ceases to be a participator in the company.

The statute does not expressly address the application of conditions A and B in this situation. We need to find the answer as best we can in the words of the statute.

18.26.1 *Condition A*

Section 809L(2) ITA provides:

> Condition A is that—
> (a) ... property is brought to, or received or used in, the UK by ... a relevant person...

For present purposes there are three ways of satisfying condition A:

[225] See 56.22.2 (Meaning of "debt").
[226] See 18.21 (Relevant debt).
[227] See 18.54 (Transitional relief: Pre-2008 loans).
[228] See 18.24 (Use as security for debt).

property must be (i) brought or (ii) received or (iii) used in the UK by a relevant person. Property is *brought* or *received* in the UK at a particular moment. It is considered that condition A is met if and only if the person is a relevant person at that moment.

Suppose:

(1) T uses income/gains to make a gift of an asset to S (not a relevant person). S brings or receives the asset in the UK. There is no taxable remittance at the time of the gift or at the time of the receipt in the UK.

(2) Later, S becomes a relevant person (eg S becomes a spouse or cohabitee). There is no taxable remittance at that time.[229]

Likewise if:

(1) T uses income/gains to make a gift of an asset to R (a relevant person). R does not remit the asset to the UK. There is no taxable remittance at this time.

(2) Later, R ceases to be a relevant person, and subsequently brings or receives the asset in the UK. There is no taxable remittance at that time.

HMRC agree. RDRM33150 example 5 is an example of a person ceasing to be a relevant person. The facts (stripping out irrelevancies)[230] are:

> In 2013 W uses foreign chargeable gains to purchase a motorcycle

[229] An interesting question arises if there is a second receipt in the UK later. That is, add to those two steps a third step: S subsequently takes the property outside the UK and then (still a relevant person) brings or receives it in the UK for a second time. Is there a taxable remittance on the second receipt? It is suggested that the answer is no, though it needs a somewhat purposive construction to reach that result.

[230] The example in full (including its irrelevant detail) is as follows:
"**RDRM33150 Condition B - remittances derived from income or gain** [Mar 2022]
Example 5
Caroline is a remittance basis user. In August 2013 she realises some foreign assets and so makes some foreign chargeable gains. She uses all the proceeds (and so uses all these gains) to purchase a motorcycle in Paris which she gives to her husband Joel. It is registered in his name. Joel keeps the bike at his French apartment. A few years later Caroline and Joel divorce, and Joel moves from their home in Liverpool to Manchester.
In September 2017 Joel and Caroline's 16 year old son, Joseph wants to learn how to ride a motorcycle, so Joel imports his bike from Paris to his Manchester home for Joseph to use."

> offshore.
> W gives the asset to her husband H. H keeps the bike at offshore. [So there is no remittance at this time].
> Subsequently, H and W divorce, and H moves from their home [ie H ceases to be a relevant person].
> In 2017 H brings his bike to the UK.

The relevant part of HMRC analysis is as follows:

> H and W were married and so H was a relevant person in 2013 when W gave him the motorcycle; he could not therefore have been a gift recipient (see Condition C – Gift recipients cannot be relevant persons).

More analytically, condition C is not satisfied.[231]

> By 2017 they have divorced so H is not a relevant person when he brings in the motorcycle [to the UK].

More analytically, condition A is not satisfied because H is not a relevant person at the time when H brings the asset to the UK.

18.26.2 *Condition B*

Condition B provides (in part):

> Condition B is that—
> (b) the property, service or consideration [received in the UK]—
> (i) derives (wholly or in part, and directly or indirectly) from the income or chargeable gains, and
> (ii) in the case of property or consideration, is *property of or consideration given by a relevant person ...*

It is considered that the requirement in (b)(ii) is met only if the person is a relevant person at the time that condition A is met (ie at the time that the property is brought/received/used in the UK). HMRC agree. The RDRM33120 motorbike example (already discussed just above in connection with condition A) covers the point. The facts (so far as relevant) are as set out above with one additional fact:

> The motorcycle is used in the UK by C who is a minor child of W (a relevant person).

The HMRC analysis is as follows:

[231] See 18.29.2 (Remittance condition C: Gift recipient).

> Here, property has been provided in the UK (the motorcycle) for the use of a relevant person (C) ...

More analytically, condition A is satisfied.

> ...and the property derives directly from W's foreign chargeable gains. However the motorcycle is the property of H, who is not a relevant person [at the time that the property is used by the relevant person C], so there is no taxable remittance for W.

More analytically, condition B is not satisfied because H is not a relevant person when the asset is used by the relevant person, C.

To drive the point home, the RDR Manual 33150 gives another example making the same point on somewhat far-fetched facts. So far as relevant[232] the facts are:

> In 2011 W uses RFI to purchase prints retained outside the UK.
> W gives the prints to her daughter D who is age 16 and so a relevant person. D retains the prints outside the UK [so there is no remittance].
> D ceases to be a relevant person on becoming 18 but in that year (although still a teenager) D has a child GD (who is a relevant person in relation to W).
> In 2016 D enters into an (implausible) agreement under which she transfers the prints (still outside the UK) to the mother of a singing teacher in consideration of the teacher giving singing lessons to GD (age only 3) in the UK.

The HMRC analysis is as follows:

[232] The example in full (including its irrelevant detail) is as follows:
"**RDRM33150 Condition B - remittances derived from income or gain** [Jan 2019]
Example 6
In 2011, while visiting New York, Ros, a UK resident remittance basis user, purchases several art prints by H Marecus, an international artist. Ros uses her relevant foreign income to make the purchase. She gives them to her daughter Rachael, who is at that time living and studying in the US, as a 16th birthday present in February 2011. Rachael returns to the UK in May 2011, but leaves the prints at her uncle's New York apartment.
In June 2016 Rachael's 3 year old daughter Abigail decides to start singing lessons in Newcastle. The singing teacher's mother is a collector of Marecus prints, so the teacher agrees with Rachael to accept one of the prints in exchange for the lessons. Rachael arranges for her uncle to send the print from New York directly to the singing teacher's mother in California."

> A service has been provided in the UK (the singing lessons) for the benefit of a relevant person (GD) ...

More analytically, condition A is satisfied.

> ...and the consideration for the service (the print) derives from W's RFI. However the consideration is given by D, who is not a relevant person [at the time that condition A is satisfied] and so W has not made a taxable remittance of her relevant foreign income. D is 21 years old and so is not a relevant person in June 2016 when she gives the prints in consideration for a service.

More analytically, condition B is not satisfied.

> Note – D was 16 years old and so is a relevant person in 2011 when her mother gave her the prints (see also Condition C – Gift recipients cannot be relevant persons).

More analytically, condition C is not satisfied.

The rule of when one applies the relevant person test may work in favour of HMRC. Suppose:

(1) T uses income/gains to make a gift of an asset to S (not a relevant person). There is no taxable remittance at this time.
(2) S becomes a relevant person, and subsequently brings/receives the asset to the UK. There is a taxable remittance at that time.

HMRC agree. The RDR Manual provides an example where the facts (stripping out irrelevancies)[233] are:

[233] The example in full (including its irrelevant detail) is as follows:
"**RDRM33240 Gift recipients cannot be relevant persons** [Mar 2022]
In June 2010 Sam, a remittance basis user, uses £8,000 of her relevant foreign income to make an overseas purchase of an antique clock from a dealer in Denmark. Sam immediately makes a gift of an antique clock to Chris and Jo, who at that time are living in Denmark. The clock is kept at Chris's family home in Copenhagen. Chris, not being a relevant person, is a gift recipient.
Two years later Jo and Chris split up, and in July 2014, Sam and Chris marry. Chris ceases to be a gift recipient at this time.
In October 2014 Chris brings the antique clock to the UK to the house that is shared with Sam. ..."
The example as published is defective in that it must be assumed (though this is not stated) that Chris gave his interest in the clock to Jo (or perhaps the gift was to Jo and not to Jo and Chris).

> **RDRM33240 Gift recipients cannot be relevant persons** [Mar 2022]
> *Example 2*
> In 2010 T uses RFI to purchase a clock outside the UK.
> T immediately gives the clock to S (not a relevant person) and it is kept outside the UK.
> S, not being a relevant person, is a gift recipient.
> In 2014, T marries S. S becomes a relevant person and ceases to be a gift recipient at this time.
> Subsequently, S brings the clock to the UK.

The HMRC analysis is as follows:

> As S is no longer a gift recipient Condition C is not relevant.
> However as S is now [in 2014] a relevant person there is a taxable remittance chargeable on T when S imports the clock, under Conditions A and B. This is because
> [1] property (the clock) has been brought to the UK by a relevant person (S) [ie condition A is satisfied] and
> [2] that property derives from T's RFI and the property is property of a relevant person (S) [ie condition B is satisfied]

So far we have considered property brought to or received in the UK. That can happen only at a particular moment. On the other hand, property can be *used* in the UK over a period of time. Suppose:

(1) Year 1: T uses income/gains to make a gift of an asset to S (not a relevant person). S uses and continues to use the asset in the UK eg she buys a house which she occupies. There is no taxable remittance at the time of the gift or at the time of the use.

(2) Year 2: S becomes a relevant person (eg a spouse or cohabitee). She continues to use the property.

Is there a taxable remittance in year 2 when S becomes a relevant person? It would be strange if there were a difference between this case and the case of receipt in the UK. It is suggested that the answer is, no.

18.26.3 *Relevant debt: Becoming/ceasing to be relevant person*

Similar principles apply to debt-remittances. A relevant debt is (in short) one which relates to property brought/received/used in the UK by a relevant person. Property is *brought* or *received* in the UK at a particular moment, and *used* (if at all) only at a particular time or period. It is considered that a debt relating to that property is a relevant debt in relation to an individual only if the person who brings/receives/uses the property in the UK is a relevant person in relation to that individual at that time the property is brought/received/used in the UK.

Suppose:

(1) S (not a relevant person in relation to T) borrows money. S brings/receives the money in the UK. The debt is not a relevant debt in relation to T, so there would be no taxable remittance if T repaid the debt out of T's income/gains.
(2) Later, S becomes a relevant person (eg S becomes a spouse or cohabitee of T). The debt is still not a relevant debt, and there is no taxable remittance if T repaid the debt.

Likewise if:

(1) R (a relevant person in relation to T) borrows money. R does not remit the money to the UK. The debt is not a relevant debt.
(2) Later, R ceases to be a relevant person, and subsequently brings or receives the money in the UK. The debt is still not a relevant debt.

The rule of when one applies the relevant person test may work in favour of HMRC. Suppose

(1) R (a relevant person in relation to T) borrows money. R does remit the money to the UK. The debt is a relevant debt in relation to T.
(2) R ceases to be a relevant person in relation to T (eg R and T divorce).

The debt does not cease to be a relevant debt in relation to T. The debt relates to the property, and the property still falls within s.809L(2)(a). So there is a taxable remittance if T repays the debt after divorce.

18.26.4 *Third persons*

The position becomes more complicated when a third person is involved. Suppose:

(1) T gives income/gains to T's spouse W.
(2) There is a divorce and W ceases to be a relevant person.
(3) W transfers the income/gains to a trust under which a minor child of T is a beneficiary. The trustee is a relevant person in relation to T.
(4) The trustee transfers the funds to the minor child who receives them in the UK.

Condition B appears to be satisfied since at the time of the receipt in the UK the funds are the funds of a relevant person. But the trust funds may not be derived income.[234]

18.27 Debt becomes/ceases to be relevant debt

A debt which is not a relevant debt may become a relevant debt. Condition B is (in short) that income is used in respect of a relevant debt. It is considered that there is a taxable remittance only if the debt is a relevant debt at the time income is used in respect of the debt.

Suppose:

(1) Year 1:

   (a) T borrows and receives the borrowed money offshore.

   (b) T uses income/gains to pay the interest (use in respect of the debt).

In year 1 condition B is not satisfied as the income/gains is not used in respect of a relevant debt.

(2) Year 2: T remits the borrowed money to the UK.

In year 2 the debt becomes a relevant debt, but it is considered that the income/gains used to pay interest in year 1 does not become remitted at that time. But if income/gains is used to pay more interest in year 2, that income/gains satisfies condition B.

If a debt is, or becomes, a relevant debt, it is not likely that it can subsequently cease to be a relevant debt (so the tax puzzle of a debt ceasing to be a relevant debt is not likely to arise).[235]

18.28 Conditions C/D: Introduction

The drafter identified gaps in remittance conditions A and B which are addressed by remittance conditions C and D. In outline:

(1) An individual (T) may enjoy property in the UK which:

   (a) is derived from T's income/gains ("derived property") but

   (b) the derived property is *not property of a relevant person*.

   Then condition B is not met.[236]

   Condition C fills this gap by imposing a remittance if T enjoys derived property in the UK property which is property of a third party

[234] See 18.18.16 (Gift on to third party).

[235] See 18.22.3 (Debt-related asset leaves UK/ceases to exist).

[236] It is usually a requirement of condition B that the income/gains are the property of a relevant person; see 18.16.1 (Property of relevant person).

(not a relevant person). This third party must however be a gift recipient.

(2) T may enjoy property in the UK which is *not derived from T's income/gains* ("non-derived property"). Then condition B is not met. Condition C fills this gap by imposing a remittance if T enjoys non-derived property in the UK (in short) by an operation made with reference to the gift. There must again be a gift recipient.

(3) T may enjoy property in the UK which is not property of a relevant person or a gift recipient. Then conditions B and C are not met. Condition D fills this gap by imposing a remittance if:
   (a) T has made a disposition to a third person ("the condition D person)
   (b) T enjoys any property of a condition-D person by reference to that disposition.

Another way to put it is that conditions A/B essentially involve only the taxpayer, T (or at least, they only involve relevant persons). Conditions C/D involve benefits provided to T by a third party, not a relevant person, being either a gift recipient or a condition-D person.

18.28.1 *Conditions C/D compared*

It may be helpful to see the key parts of conditions C/D side by side:

Condition C	**Condition D**
s.809L(4): Condition C is that	**s.809L(5):** Condition D is that
qualifying property of a gift recipient—	property of a person other than a relevant person (apart from qualifying property of a gift recipient)—
(a) is brought to, or received or used in, the UK, and is enjoyed by a relevant person,	[identical]
(b) is consideration for a service that is enjoyed in the UK by a relevant person, or	[identical]
(c) is used outside the UK (directly or indirectly) in respect of a relevant debt.	[identical]
[no equivalent]	in circumstances where there is a connected operation.

s.809N(7): "Qualifying property", in relation to a gift recipient, is—	**s.809O(3):** A "connected operation", in relation to property dealt with as mentioned in section 809L(5)(a), (b) or (c), means
(a) the property that the individual gave to the gift recipient, (b) anything that derives (wholly or in part, and directly or indirectly) from that property, or	[no equivalent]
(c) any other property, but only if it is dealt with as mentioned in section 809L(4)(a), (b) or (c) [in short, enjoyed by T] by virtue of an operation which is effected—	an operation which is effected—
(i) with reference to the gift of the property to the gift recipient, or (ii) with a view to enabling or facilitating the gift of the property to the gift recipient to be made.	(a) with reference to a qualifying disposition,[237] or (b) with a view to enabling or facilitating a qualifying disposition.

Condition C (unlike condition D) requires a gift recipient; but if there is a gift recipient, condition C is wider, as (unlike D) it applies to "qualifying property" which is a wider concept than "connected operation".

18.29 Gift of income/gains

18.29.1 *Gift of income/gains: Navigation*

A gift of unremitted foreign income/gains may raise various issues:

Topic	**See para**
Remittance condition C	*Discussed here*

[237] Section 809O(4) ITA provides:
A "qualifying disposition" is a disposition that—
(a) is made by a relevant person,
(b) is made to, or for the benefit of, the person whose property is dealt with as mentioned in section 809L(5)(a), (b) or (c) [ie made to/for the benefit of the condition-D person], and
(c) is a disposition of money or other property that is, or derives (wholly or in part, and directly or indirectly) from, income or chargeable gains of the individual.

Whether gift is remitted	18.14.6
Derivation issues	18.18.4; 18.18.16
Condition D	18.33
Gift to charity	18.52
Mixed fund issues	20.10

18.29.2 *Remittance condition C: Gift recipient*

Section 809L(4) ITA provides:

> Condition C is that qualifying property of a gift recipient—
> (a) is brought to, or received or used in, the UK, and is enjoyed by a relevant person,
> (b) is consideration for a service that is enjoyed in the UK by a relevant person, or
> (c) is used outside the UK (directly or indirectly) in respect of a relevant debt.

18.29.3 *Enjoyment by relevant person*

The requirements in (a) and (b) are similar but not the same as remittance condition A. The differences are as follows:

Condition C requirement	**Condition A requirement**
Property brought/received/ used in the UK	Property brought/received/used in the UK *by or for the benefit of a relevant person.*
Property *enjoyed* by a relevant person.	No equivalent in condition A (though the requirement that the property is brought/received/ used by or for the benefit of a relevant person is similar.)

The word "enjoyed" in condition C means more or less the same as the word "used" in condition A.[238] I do not think there is a difference though if there were, the vagueness of the words makes it impossible to say what it may be. The reason for the different word is perhaps that parts of condition C are derived from the GWR wording, where the word "enjoyed" is used[239] so the word enjoyed is copied across to condition C.

Enjoyment is a cliff-edge test: any enjoyment (above de minimis) and the entire sum is remitted, even if the sum exceeds the value of the

[238] As to which, see 18.14.3 (Property used in UK).

[239] See 78.1 (GWR – Introduction).

enjoyment.

18.29.4 *Enjoyment disregards*

Section 809N ITA provides definitions and other supplementary provisions for condition C. Section 809N(1) ITA provides:

> This section applies for the purposes of determining whether or not income or chargeable gains of an individual are remitted to the UK by virtue of condition C in section 809L.

Section 809N(9) ITA provides three cases where enjoyment is disregarded. Since enjoyment is a requirement of remittance condition C, the disregards amount to exemption from condition C:

> Enjoyment by a relevant person of property or a service is to be disregarded in any of these cases—
> (a) if the property or service is enjoyed virtually to the entire exclusion of all relevant persons;
> (b) if full consideration[240] in money or money's worth is given by a relevant person for the enjoyment; or
> (c) the property or service is enjoyed by relevant persons in the same way, and on the same terms, as it may be enjoyed by the general public or by a section of the general public.

Para (a) is based on IHT GWR provisions.[241]

Para (b) is the most important of the three disregards, and is also based on GWR.[242] I refer to it as the "**full consideration exemption**". I discuss these two paragraphs in the GWR chapter.

Para (c) concerns charitable or public gifts; it is hard to see that it is needed, but it does no harm.

Suppose:

(1)(a) T gives pre-2008 income/gains to T's spouse (not a relevant person and so a gift recipient) and the spouse uses the money to buy a property jointly with T; or

(b) T gives income/gains to T's brother (a gift recipient) and the brother uses the money to buy a property jointly with T.

(2) The co-owners occupy the property jointly.

[240] See App 4.9 (Market value/full consideration).

[241] See 78.6.4 ("Virtually" excluded).

[242] See 78.7 (Full consideration exemption for GWR).

It is considered T does not "enjoy" the co-owner's half share, so condition C is not satisfied in respect of the gifted income/gains. The same would apply to jointly held chattels.

Suppose:

(1) T gives income/gains to T's adult son S (a gift recipient), and
(2) S uses the money to purchase a UK residence which is occupied by S, not by T.
(3) S has a minor child, GS (a relevant person), who also lives in the property.

It is considered that the property is not "enjoyed" by GS, who is merely a licensee of S. Any "enjoyment" by GS is incidental to the primary use by S, and should be ignored. It is different if S leaves the property and GS becomes the occupier (but since GS is by then likely to be 18, GS ceases to be a relevant person). HMRC agree. RDR Manual provides:

> **RDRM33270 enjoyment by a relevant person ignored** Dec 2021]
> Each case will depend on its particular facts, but broadly, enjoyment by a relevant person is disregarded, and so there is no taxable remittance under Condition C (if there otherwise would be) where the property or service is enjoyed by the gift recipient virtually to the entire exclusion of all relevant person, that is,
> [1] the gift is genuine and
> [2] any enjoyment by a relevant person is incidental...

After this somewhat loose paraphrase of Condition C, the Manual gives the example we are considering:

> For example a minor child may derive benefit from living in the UK with his parents in a house that was purchased using offshore funds gifted by his grandfather (a remittance basis user) to his father, for his father's own use. It is normal for a young child to live with his parents and therefore, in most cases, no advantage over minor children generally is obtained. In this type of circumstance HMRC would generally accept that the minor child's enjoyment of the house was merely incidental to that of his father.

18.29.5 *Gift recipient*

The key terms in remittance condition C are "gift recipient" and "qualifying property".

Section 809N(2) ITA provides:

> A "gift recipient" means a person, other than a relevant person, to whom the individual makes a gift of money or other property that—
>
> (a) is income or chargeable gains of the individual, or
>
> (b) derives (wholly or in part, and directly or indirectly) from income or chargeable gains of the individual.

Strictly one should not use the term "gift recipient" in the abstract. A gift recipient can exist only *in relation to an individual (the donor)*. But where the context is clear it is permissible simply to refer to a gift recipient.

A relevant person cannot be a gift recipient. So in practice gift recipients will be individuals who are not members of the individual's close family, such as parents, adult children, friends and relatives. (Family trusts and companies will generally be relevant persons and where they are not, it is unlikely they would or properly could enter into a transaction caught by condition C.)

If T makes a gift to G, and G gives the property to H, H is not a gift recipient in relation to T.

If T makes a gift to a trust, and the trust appoints the property to B, B is not a gift recipient, as T has not made a gift to B.

18.29.6 *"Gift"*

Section 809N(5) ITA extends "gift" to include a disposal at an undervalue:

> The individual "makes a gift of" property if the individual disposes of the property—
>
> (a) for no consideration, or
>
> (b) for consideration less than the full consideration in money or money's worth that would be given if the disposal were by way of a bargain made at arm's length;
>
> but, in a case falling in para (b), the individual is to be taken to make a gift of only so much of the property as exceeds the consideration actually given.

In the phrase "full consideration in money or money's worth *that would be given if the disposal were by way of a bargain made at arm's length*" do the italicised words add anything? It is thought not; these words are otiose but they do no harm.

Section 809N(6) ITA is intended to widen this:

> A reference to the individual making a gift of property includes a case where—
> (a) the individual retains an interest in the property, or
> (b) an interest, right or arrangement enables or entitles the individual to benefit from the property.

I am unable to make sense of this. The wording is loosely based on s.102A FA 1986 but the context there is different, and s.102A is itself obscure, so that does not shed any light on the matter. Perhaps it is meaningless.

Suppose T makes an interest-free loan to B. The transaction is for full consideration so it is not a gift within s.809N(5). A lender in principle has no interest in the money lent so s.809N(6)(a) does not apply. A loan does not entitle T to benefit from the money lent. B may use that money for himself or herself. It is considered that the loan does not enable T to benefit from the money lent, so s.809N(6)(b) does not apply. B is not a gift recipient.

18.29.7 *"Qualifying property"*

Section 809N(7) ITA defines "qualifying property". There are three categories of qualifying property:

> "Qualifying property", in relation to a gift recipient, is—
> (a) the property that the individual gave to the gift recipient,
> (b) anything that derives (wholly or in part, and directly or indirectly) from that property, or

Para (a) and (b) concern what I call derived property. The definition goes on to include non-derived property which has some nexus to the gifted property:

> (c) any other property, but only if it is dealt with as mentioned in section 809L(4)(a), (b) or (c) [in short, enjoyed by T] by virtue of an operation which is effected—
> (i) with reference to the gift of the property to the gift recipient, or
> (ii) with a view to enabling or facilitating the gift of the property to the gift recipient to be made.[243]

[243] I am not sure that para (ii) adds anything to para (1) as if an operation is made "with a view to enabling or facilitating" a gift, it would be made "with reference to the gift". But nothing turns on that.

Section 809N(8) ITA is intended to widen this:

> In subsection (7)—
> (a) the reference in para (b) to anything deriving from property, and
> (b) the reference in para (c) to other property,
> includes a thing,[244] or property, that does not belong to the individual but which the individual is enabled or entitled to benefit from by virtue of any interest, right or arrangement.

This is misconceived. Qualifying property will not belong to the individual because it has been given to the gift recipient, so it is not necessary to say that property includes property not belonging to the recipient. Here, as in s.809N(6), the drafter's desire to achieve the widest possible generality, and avoid any possible gaps in the legislation, has led to incoherence. But it does not matter.

18.29.8 *Time of remittance*

Section 809L(6) ITA provides a rule which applies for conditions C and D:

> In a case where subsection (4)(a) or (b) [condition C] or (5)(a) or (b)[condition D] applies to the importation or use of property, the income or chargeable gains are taken to be remitted at the time the property or service is first enjoyed by a relevant person by virtue of that importation or use.

18.29.9 *Becoming/ceasing to be relevant person: Condition C*

Section 809N ITA provides:

> (3) The question of whether or not a person is a relevant person is to be determined by reference to the time when a gift is made.
> (4) But, if a person to whom a gift is made subsequently becomes a relevant person, the person ceases to be a gift recipient.

Thus if a gift is made to a relevant person, condition C cannot apply, even if they cease to be a relevant person[245] and so become a gift recipient.

[244] The reference to a "*thing or* property" is meaningless. What non-property "thing" could there be?

[245] See 18.26 (Becoming/ceasing to be relevant person: conditions A & B); 18.32.4 (Becoming/ceasing to be a relevant person: condition D).

If a gift is made to a non-relevant person, condition C ceases to apply if they become a relevant person. That makes sense because in such a case, remittance conditions A and B may apply.

18.30 Examples of condition C

18.30.1 *Enjoyment of gifted asset*

The RDR Manual provides examples numbered (1)(a) and (b); I consider example (b) first as it is the easier of the two. I reword the examples so that T is the taxpayer and G is the gift recipient.

The facts of example 1(b) (stripping out irrelevancies)[246] are:

> *Example 1(b) (Klimt)*
> T gives money derived from chargeable gains to his sister G (a gift recipient).
> G uses the money to buy a car.
> T's wife uses the car in the UK.

Condition C is satisfied. The HMRC analysis is:

[246] The example in full (including its irrelevant detail) is as follows:

> **RDRM33260 Gift recipients - qualifying property** [Mar 2022]
> *"Example 1(b) (Klimt and Helena)*
> In May 2015 K, a remittance basis user, gives some of his foreign chargeable gains for that year to his sister H, a gift recipient. In October 2016 H uses half of this money to buy a car in the UK which she makes available to K's wife to use ..."

There is a similar example in the CG Manual:

> **CG25342 Gifts Of Money And Assets: ITA07/S809L(4)** [Dec 2021]
> *[Torvald and Stig]*
> ... T claims the remittance basis in 2009-10; in that year he sells a property in Norway and uses the proceeds to buy a car which he gives to his business partner S who lives in Oslo. S exports the car to the UK and gives T's wife Helga the keys.
> In terms of ITA07/S809L(4), the car is qualifying property because it was given by T to S. S is a gift recipient because he is not a relevant person and he has received a gift of property (the car) that drives from T's chargeable gain. ... The car is brought to the UK and is enjoyed by a relevant person, T's wife. T's chargeable gain on the disposal of his property has therefore been remitted to the UK to the extent that it was used to buy the car.

The Manual adds:

> Note that it is the cost of the car, not its market value when it comes to be used in the UK, which fixes the upper limit of the remittance.

But this point is contentious, see 18.35.2 (Change in value).

> The qualifying property here is the car, which derives from the money that T gifted to G.
> That qualifying property is used in the UK and is enjoyed by a relevant person (T's wife).
> The use of the gift means there is a taxable remittance on T.

The same applies if:

(1) T gives income/gains to T's adult son S (not a relevant person) and
(2) S uses it to buy the house in the UK in which T lives.

This is not caught by remittance condition B. (The house is derived from the income/gains but it is not property of a relevant person.) The house is qualifying property and is caught by remittance condition C.[247]

18.30.2 *Gift of gifted asset*

The facts of RDR Manual example 1(a) (stripping out irrelevancies)[248] are:

> T gives money derived from chargeable gains to his sister G (a gift recipient).
> G brings the money to the UK and then gives it to T's wife.

In the HMRC view condition C is satisfied. The HMRC analysis is as follows:

> [1] The qualifying property here is the money that T gifted to G.
> [2] That qualifying property is used in the UK and is enjoyed by a relevant person (T's wife).
> [3] The use of the gift means there is a taxable remittance on T.

Is point [2] correct? Condition C is that:

> qualifying property of a gift recipient is ... enjoyed by a relevant person,

The money ceases to be qualifying property "of a gift recipient" when G gives it to T's wife. Thus qualifying property of a gift recipient is brought

[247] See 18.46 (Purchase of family home).

[248] The example in full (including its irrelevant detail) is as follows:
RDRM33260 Gift recipients - qualifying property [Mar 2022]
"*Example 1(a) (Klimt and Helena)*
In May 2015 Klimt, a remittance basis user, gives some of his foreign chargeable gains for that year to his sister Helena, a gift recipient. In October 2016 Helena transfers half of this money to the UK and gives it to Klimt's wife.

to or received in the UK.[249] It might be argued that the property which is enjoyed by a relevant person is not property of a gift recipient. But perhaps that is reading the provision too strictly.

However that may be, on the facts of the example, remittance condition B may be satisfied. That depends on whether the money given to T's wife can be said to derive from T's gains, which would be the case if the two steps of the example are part of a single arrangement.[250]

18.30.3 *Enjoyment of non-derived property*

RDRM35060 [Mar 2022] next provides an example where the property enjoyed in the UK by T is not derived from T's income/gains (in my terminology, "non-derived property"). The facts (stripping out irrelevancies)[251] are:

> There is an arrangement under which:
> (1) T gives RFI to his aunt G (a gift recipient).
> (2) Later,[252] G allows T's wife to use a property in the UK owned by G, without charge.

One analysis of these facts is that T and G have entered into a contract, under which G promises to allow T's wife to use the land in consideration of T's payment (not properly called a "gift") to G. In that case there is a remittance under remittance conditions A and B. It is however assumed that the arrangement is an informal, non-binding, non-contractual one.

[249] Though, contrary to the HMRC analysis, it is not *used* in the UK (unless one says that H "uses" the funds by making a gift to K's wife, which is not a natural meaning of the word "uses").

[250] See 18.18.16 (Gift on to third party).

[251] The example in full (including its irrelevant detail) is as follows:
RDRM35060: Condition C - remittances of relevant income or chargeable gains - property [Mar 2022] *(Adam and Linda)*
L's husband's family has owned a holiday house in Scotland for many years. In February 2012 her nephew A, a remittance basis user transfers some of his foreign income and gains to his aunt, L, the gift recipient, which she uses to book herself on an around-the-world cruise. A gives the money to L on the agreement that L will provide his wife Clare, a keen painter, with access to the Scottish property.
Several months later L provides Clare with an agreement saying that she can use the Scottish house, for which Clare pays nothing.

[252] The example specifies that "several months" pass between step (1) and step (2) to make the point that one cannot avoid the tax consequences of the arrangement by a few months delay.

That would be implausible if G were a stranger, but not in the case of a friend or relative. In that case condition B is not satisfied.

The HMRC analysis is as follows:

> The house cannot be said to "derive from" the income or gains.

More analytically, condition B is not satisfied.

However condition C is satisfied:

> The house is "other property" [ie non-derived property, within s.809N(7)(c)] used in the UK and enjoyed by a relevant person (T's wife).
> As the operation which brought the house within Condition C was done
> [i] with reference to the gift[253] or
> [ii] to enable or facilitate the gift[254]
> it is qualifying property and Condition C is met.
> There is a remittance and tax is chargeable on T.
> The amount of the remittance is determined by s809P(11)(c).[255]

Suppose the order of transactions was reversed:

> (1) G grants allows W to use a property in the UK.
> (2) Later, after W has left the property, T gives RFI to G.

Condition C is not satisfied at stage (1) since G is not at that point a gift recipient. At stage (2) G becomes a gift recipient but condition C does not become satisfied. However condition D would apply: see 18.33 (Condition D: Examples).

18.30.4 *Gifted asset used to pay relevant debt*

The last HMRC example is slightly contrived, in order to illustrate the relevant debt rule in application to remittance condition C. The facts (stripping out irrelevancies)[256] are:

[253] It is not clearly stated in the example that the operation was done with reference to the gift, but that is a reasonable inference.

[254] On the facts, condition [ii] is not met, but it does not matter as condition [i] is met.

[255] See 18.43 (Condition C/D: Amount remitted).

[256] The example in full (including its irrelevant detail) is as follows:
"**RDRM33260 Condition C - relevant debt** [Mar 2022]
(Fraser and Victor)
F, who is a remittance basis user, purchases some non-UK shares in January 2012, using his foreign income and gains. F makes a gift of these shares to his brother, V, a fashion designer.

> T gives property derived from RFI (shares) to his brother G, (a gift recipient.)
> G borrows to purchase furniture.
> T uses the furniture in the UK.
> G uses the property to repay the loan.[257]

The HMRC analysis is as follows:

> T has made a gift of property derived from his foreign income (the shares) to G, a gift recipient. The shares are thus qualifying property of a gift recipient.
> The loan taken out by G to purchase the furniture is a relevant debt because it relates to property (the furniture) brought to the UK for the benefit of a relevant person (T).
> T benefits because he uses the furniture.
> The qualifying property (the shares) of G (a gift recipient) is used outside the UK in respect of this relevant debt. There is a remittance under Condition C.

18.31 Condition C: Pre-2008 income/gain

For pre-2008 income/gains, para 86(4) sch 7 FA 2008 provides that references to relevant person in s.809L have effect as references to the individual.[258]

Amended as para 86(4) directs, condition C (set out in s.809L(4)) provides:

> Condition C is that qualifying property of a gift recipient—
> (a) is brought to, or received or used in, the UK and is enjoyed by ~~a relevant person~~ the individual,
> (b) is consideration for a service that is enjoyed in the UK by ~~a relevant person~~ the individual, or
> (c) is used outside the UK(directly or indirectly) in respect of a relevant debt.

In March 2012 V takes out a loan with an offshore bank to purchase a designer table and chairs. V brings these table and chairs to the London town house that he and his brother F inherited jointly from their father, and where they both now live. F regularly entertains clients and friends at the house.
V uses some of the shares and bonds to pay off the loan.

[257] That is, G sells and uses the proceeds to repay the loan; or (less plausibly) transfers the shares to the creditor in satisfaction of the loan.

[258] See 18.10 (Relevant person: Pre-2008 income/gain).

Para 87 sch 7 FA 2008 makes corresponding amendments to s.809N:

> Section 809N of ITA 2007 (section 809L: gift recipients, qualifying property and enjoyment) has effect in relation to an individual's income and chargeable gains for the tax year 2007-08 or any earlier tax year as if—
>
> (a) the reference in subsection (2) to a relevant person were to the individual,
> (b) subsections (3) and (4) were omitted, and
> (c) the references in subsection (9) to a relevant person, all relevant persons, or relevant persons were to the individual.

Amended as para 87 directs, s.809N(2) ITA reads:

> A "gift recipient" means a person, other than ~~a relevant person~~, the individual to whom the individual makes a gift of money or other property that—
>
> (a) is income or chargeable gains of the individual, or
> (b) derives (wholly or in part, and directly or indirectly) from income or chargeable gains of the individual.

The words "other than the individual" are meaningless because the individual cannot make a gift to himself. So s.809N(2) means:

> A "gift recipient" means a person ... to whom the individual makes a gift of money or other property that—
>
> (a) is income or chargeable gains of the individual, or
> (b) derives (wholly or in part, and directly or indirectly) from income or chargeable gains of the individual.

Para 87 does not restrict the definition of "gift recipient": it *widens* it.

The para 87 deletions of 809N(3)(4) are straightforward amendments consequential on the para 87 amendment to s.809N(2).

The last para 87 amendment is also a straightforward consequential amendment. Amended as para 87 requires, s.809N(9) reads

> Enjoyment by ~~a relevant person~~ the individual of property or a service is to be disregarded in any of these cases—
>
> (a) if the property or service is enjoyed virtually to the entire exclusion of ~~all relevant persons~~ the individual,
> (b) if full consideration in money or money's worth is given by ~~a relevant person~~ the individual for the enjoyment, or
> (c) the property or service is enjoyed by ~~relevant persons~~ the individual in the same way, and on the same terms, as it may be enjoyed by the general public or by a section of the general

public.

The condition C rule for pre-2008 income/gains is not very different from that which applied under the pre-2008 law.

18.32 Condition D: Connected operation

For an introduction to this topic, see 18.28 (Role of remittance conditions C/D).

Section 809L(5) ITA provides:

> [1] Condition D is that property of a person other than a relevant person (apart from qualifying property of a gift recipient)—
> (a) is brought to, or received or used in, the UK, and is enjoyed by a relevant person,
> (b) is consideration for a service that is enjoyed in the UK by a relevant person, or
> (c) is used outside the UK (directly or indirectly) in respect of a relevant debt,
> [2] in circumstances where there is a connected operation.

We need some terminology to grapple with this, and in the following discussion:

A **"condition-D person"** is:
(1) a non-relevant person
(2) whose property is used as set out in (a)-(c), ie (in short) enjoyed by a relevant person
(3) to whom T has made a qualifying disposition, ie (in short), T has made a disposition to the person of his income/gains.

The **"enjoyment requirement**" is the requirement in s.809L(5)[1] (in short, that a relevant person enjoys property of the condition-D person in the UK).

The wording of the enjoyment requirement is (more or less) the same as in remittance condition C.[259] The same enjoyment disregards apply.[260] The same timing rule applies.[261] These aspects need not be considered again here.

[259] See 18.29.3 (Enjoyment by relevant person).

[260] Section 809O(6) ITA repeats s.809N(9) verbatim; see 18.29.4 (Enjoyment disregards).

[261] See 18.29.8 (Time of remittance).

18.32.1 *Condition-D person*

The RDR Manual comments on the identity of the condition-D person:

> **RDRM33430 Connected Operation - definition** [Jan 2019]
> The property that is brought to the UK, or used outside the UK as consideration for a service or in respect of a relevant debt must not be qualifying property of a gift recipient as this will fall within Condition C. However this restriction relates to the property not the individual, so the same person may be a gift recipient under Condition C and, in other transactions, "a person whose property is used" under Condition D.

Could a partnership be a condition-D person? A partnership is not a relevant person. An English law partnership is not a person at all, in the strict sense, but the word person can be used loosely, to include a partnership;[262] and the context suggests that is the case here.

18.32.2 *"Qualifying disposition"*

The key term in remittance condition D is "connected operation", and that term relies on the concept of a "qualifying disposition." Section 809O provides the definitions and other supplemental provisions for condition D.

Section 809O(1) ITA provides:

> This section applies for the purposes of determining whether or not income or chargeable gains of an individual are remitted to the UK by virtue of condition D in section 809L.

Section 809O(4) ITA defines "qualifying disposition":

> A "qualifying disposition" is a disposition that—
> (a) is made by a relevant person,
> (b) is made to, or for the benefit of, the person whose property is dealt with as mentioned in section 809L(5)(a), (b) or (c) [ie made to/for the benefit of the condition-D person], and
> (c) is a disposition of money or other property that is, or derives (wholly or in part, and directly or indirectly) from, income or chargeable gains of the individual.

Section 809O(5) ITA provides an exception:

> But a disposition of property is not a qualifying disposition if the

[262] See 85.14 (Partnership: person/body corporate).

> disposition is, or is part of, the giving of full consideration in money or money's worth for the dealing that falls within section 809L(5)(a), (b) or (c).

I do not see the need for that, since if there is full consideration for "the dealing that falls within section 809L(5)(a), (b) or (c)" (in short, for the enjoyment by the relevant person) then the full consideration exemption applies.[263] But it does no harm.

18.32.3 *Connected operation*

Armed with the term "qualifying disposition" we can turn to the definition of "connected operation". Section 809O(3) ITA provides:

> A "connected operation", in relation to property dealt with as mentioned in section 809L(5)(a), (b) or (c), means an operation which is effected–
> (a) with reference to a qualifying disposition, or
> (b) with a view to enabling or facilitating a qualifying disposition.[264]

Thus in order to have a connected operation, four requirements must be met:

(1) A qualifying disposition (in short, a transfer from T to the condition-D person).
(2) An operation (but that is so wide it scarcely counts as a requirement).
(3) A link between the operation and the qualifying disposition: the operation must be effected with reference to the qualifying disposition.
(4) A link between the operation and the condition-D person's property: the operation must be "in relation to property dealt with as mentioned in s.809L(5)(a)(b)(c)" ie it must relate to the condition-D person's property enjoyed by T.

The RDR Manual comments on requirement (3):

> **RDRM33430 Connected Operation - definition** [Jan 2019]
> It is important to note the words "with reference to" and "with a view to enabling or facilitating a qualifying disposition". The nature of the link

[263] See 18.29.4 (Enjoyment disregards). Perhaps the point is that s.809O(5) provides exemption in a case falling within s.809L(5)(c) (relevant debts).

[264] The wording here is the same as for limb (c) of the definition of "Qualifying property" for condition C; see 18.29.7 ("Qualifying property").

between the connected operation and the qualifying disposition, or even which comes first, is not specified. This means that a taxpayer cannot avoid a charge to tax by setting up complex structures to disguise foreign income or gains, or to try and "break the link" between something enjoyed in the UK and that income or those gains.

18.32.4 *Becoming/ceasing to be relevant person: Condition D*

Section 809O(2) ITA provides:

> For the purposes of section 809L(5) [Condition D], the question of whether or not the person whose property is dealt with as mentioned in para (a), (b) or (c) of section 809L(5) is a relevant person is to be determined by reference to the time when the property is so dealt with.

The same rule applies for condition C: see 18.29.9 (Becoming/ceasing to be relevant person: Condition C).

18.33 Condition D: Examples

18.33.1 *The 3 examples*

I consider three examples which are variants of a single theme. I first make some general comments which apply in each case, and then consider them separately.

In each example T wishes to use UK land owned by X. I assume that X is not a relevant person.

There is an informal, non-binding arrangement under which:

(1) T uses an asset of X in the UK for no consideration (X grants T a gratuitous licence).
(2) T makes a gift of income/gains:
    (a) example 1: T makes the gift to X
    (b) examples 2 & 3: T makes the gift to a company associated with X:
        (i) example 2: T makes the gift to a company owned by X
        (ii) example 3: T makes the gift to the company which owns X (X is a subsidiary company and the gift is to the parent company)

A likely analysis of these facts is that T and X have entered into a contract, under which X leases or licenses the land to T in consideration of T's payment (misdescribed as a "gift"). In that case there is a remittance under remittance conditions A and B, on the basis that:

(1) If the rent is paid in advance: T receives an asset in the UK (a lease

or licence) which is derived from T's RFI; or

(2) If the rent is paid after the grant of the lease: T has used RFI to pay a relevant debt.

Note that the rent would also be taxable.

It is however assumed that the arrangement is an informal, non-binding, non-contractual one. That might be possible if X is a friend or relative of T or a friendly trust or company. In that case condition B is not satisfied.

In each case, the condition D analysis is essentially the same:

- X is the condition-D person.
- The enjoyment requirement is met by T's use of X's asset.
- T's gift to X or the associated company is a qualifying disposition.
- The connected operation is X's licencing T to use the asset.

So condition D is satisfied.

18.33.2 *Example 1: Loan + gift to lender*

The example is:

(1) T uses an asset of X in the UK for no consideration (X grants T a gratuitous licence).

(2) T later makes a gift of income/gains to X.

Condition C will apply if T makes the gift first, but it does not apply here because X is not a gift recipient at the time X allows T to use the asset.

Condition D is not satisfied at stage (1) as there is no connected operation. Could one say that there is no charge at stage (2): one could not say that X's property is enjoyed "in circumstances where there *is* [present tense] a connected operation?" That would probably be reading too much into a tense. But the point may not arise, if (as could well be the case) there is a contract between X and T, as there would be a remittance under conditions A and B.

18.33.3 *Loan/gift for benefit of lender*

The RDR Manual provides a version of example 2. The facts (stripping out irrelevancies)[265] are:

[265] The example in full (including its irrelevant detail) is as follows:

> **RDRM35080 Condition D - remittances of foreign income or chargeable gains** [Jan 2019] *Janet and John*
>
> John personally owns a country estate in Cornwall, in an area of outstanding natural beauty. His friend Janet wishes to use the mansion for several important family functions.

> There is an arrangement under which:
> (1) X allows T to use the land rent free.
> (2) T transfers an asset derived from T's RFI (a yacht) to a company owned by X, at an undervalue.

This is like example (1), except that T transfers the RFI to a company owned by X (not to X directly).

The HMRC analysis first considers condition C:

> X is not a gift recipient (the yacht was given to his company, not to X). Condition C cannot therefore apply.

So we turn to condition D. In my terminology, X is the condition-D person.

> [1] X is not a relevant person in relation to T.[266]
> [2] There is a qualifying disposition because:
> [a] There is a disposal of property (the yacht) which derived from T's income (ITA07/S809O(4)(c))
> [b] The disposal was made by a relevant person (T) (ITA07/S809O(4)(a))
> [c] The disposal was for the benefit of X (although the disposal was not made directly to X, he benefits from it through his ownership of the company) (ITA07/S809O(4)(b))
> [3] X's property [the land] is enjoyed in the UK by a relevant person (T) (ITA07/S809L(5)(a) and ITA07/S809O(4)(b)).
> In this example T's advantage is due to[267] a connected operation[268]

Janet is a remittance basis user. She owns a foreign yacht which she bought using £600,000 of her foreign income and gains. On 2 March she disposes of the yacht to a non-resident company for £150,000.

John has a controlling interest in that non-resident company. In October, with reference to the transfer of the yacht, John allows Janet full and exclusive use of the estate, rent-free.

[266] The HMRC analysis adds that "the company is not a relevant person (as T is not a participator)". In fact, whether the company is a relevant person is not determined by the facts expressly given in the example. The company would be a relevant person if any relevant person is a participator. Perhaps we are meant to assume that X is the sole participator in the company. However it makes no difference whether or not the company is a relevant person (unless the company brings the yacht to the UK).

[267] "Due to" is an inaccurate paraphrase of the statutory language, but it does not matter.

[268] HMRC do not identify the operation, but I think it is X's licencing the land to T; this is indeed a connected operation.

> (ITA07/S809O(3)) and Condition D will be met.
> Some or all of the foreign income used by T to acquire the yacht will be remitted.

The Manual does not consider whether it is some or all of the income which is remitted, which one might have thought an important issue. In principle, all of the income is remitted.[269]

18.33.4 *Loan/gift to parent of co lender*

The CG Manual provides a version of example 3. The facts (stripping out irrelevancies)[270] are:

> T enters into an arrangement with X Ltd (not a relevant person) under which:
> (1) A subsidiary of X Ltd[271] ("the subsidiary") acquires a house and allows T to live in it rent-free.
> (2) T transfers shares (derived from foreign chargeable gains) to X Ltd.

This is like example (2) above, except that T's gift is to the parent of X Ltd (not a company owned by X Ltd).

In my terminology, X Ltd is the condition-D person.

Let us ignore the implausibility of the facts. (In practice, the transfer might be the purchase price, in which case the subsidiary would hold the house on trust for T. Or the transfer might be rent. In those cases there is a remittance under usual principles.) Let us assume that the arrangement is an informal, non-binding, non-contractual one.

[269] See 18.43 (Condition C and D: mount remitted).

[270] The example in full (including its irrelevant detail) is as follows:
Antonella
CG25343 Meaning of remitted to the UK: other reciprocal arrangements [Dec 2021]
A has claimed remittance basis in 2009-10. She realises a foreign chargeable gain of £5 million in that year and uses it to buy shares in a company listed on the Zurich stock exchange. She enters into an agreement with her bank in Naples that an Italian subsidiary of the bank will acquire a house in London and allow A and her family to live in it rent-free: as consideration for this she agrees to transfer her Swiss shares to the bank. The family moves into the house on 3 April 2010 and A transfers the shares on 7 April.

[271] The Manual specifies that X Ltd is a bank. It is not conceivable that a bona fide bank could enter into an arrangement of this kind, but a friendly company might do so.

In that case condition B is not satisfied. The HMRC analysis on this point is:

> Note that the conditions for a basic remittance are not met because the London property is not, and is arguably not derived from, the chargeable gain, and does not belong to a relevant person.

The Manual then makes a comment which relates to remittance condition C:

> The conditions for a remittance after a gift are not met because the gain or property derived from the gain is not gifted to the bank subsidiary but transferred for what we assume is full value.

The HMRC analysis for condition D is as follows:

> T is a relevant person, and she makes a disposition of property which derives from her own chargeable gains. The disposition is made
> [i] to (if it is made directly to the subsidiary) or
> [ii] for the benefit of (if it is made to another company in X Ltd's group)
> the person whose property is used to provide the advantage in the UK. There is therefore a qualifying disposition.

In fact the example specifies that the shares are transferred to X Ltd. The condition-D person (who provides the property) is the subsidiary. The transfer to a parent company is not for the benefit of a subsidiary. So there is no qualifying disposition. The rest of the HMRC analysis does not arise:

> Property belonging to X Ltd's subsidiary is used in the UK and is enjoyed by a relevant person (eg T or her family).
> Furthermore, the process by which the London House is made available is closely linked[272] to the qualifying disposition ie the transfer of the shares to the bank, so it is a connected operation.
> So a chargeable gain of £5m is treated as accruing to T.

The HMRC example raises the timing issue:

> T moves into the house on 3 April 2010 and T transfers the shares on 7 April.

The HMRC analysis states that the gain is treated as remitted in 2009/10. See 18.29.8 (Time of remittance).

[272] This wording is a paraphrase of the statutory language, but it does not matter.

18.34 Condition D: Pre-2008 income/gain

For pre-2008 income/gains, para 86(4) sch 7 FA 2008 provides that references to relevant person in s.809L have effect as references to the individual.[273]

Amended as para 86(4) directs, condition D (set out in s.809L(5) ITA) provides:

> Condition D is that property of a person other than ~~a relevant person~~ *the individual* (apart from qualifying property of a gift recipient)—
>
> (a) is brought to, or received or used in, the UK, and is enjoyed by ~~a relevant person~~ the individual,
>
> (b) is consideration for a service that is enjoyed in the UK by ~~a relevant person~~ the individual, or
>
> (c) is used outside the UK (directly or indirectly) in respect of a relevant debt,
>
> in circumstances where there is a connected operation.

This is consistent with remittance condition A and B rules for pre-2008 income.[274] Since the para 86(4) amendment applies only for s.809L, para 88 sch 7 FA 2008 has to make further amendments to s.809O ITA:

> Section 809O of ITA 2007 (section 809L: dealings where there is a connected operation) has effect in relation to an individual's income and chargeable gains for the tax year 2007-08 or any earlier tax year as if—
>
> (a) subsection (2) were omitted, and
>
> (b) the references in subsections (4) and (6) to a relevant person, all relevant persons, or relevant persons were to the individual.

Amended as para 88 requires, s.809O(4) ITA provides:

> A "qualifying disposition" is a disposition that—
>
> (a) is made by ~~a relevant person~~ the individual,
>
> (b) is made to, or for the benefit of, the person whose property is dealt with as mentioned in section 809L(5)(a), (b) or (c), and
>
> (c) is a disposition of money or other property that is, or derives (wholly or in part, and directly or indirectly) from, income or chargeable gains of the individual.

The last para 88 amendment is also a straightforward consequential

[273] See 18.10 (Relevant person: Pre-2008 income/gain).

[274] See 18.10 (Relevant person: Pre-2008 income/gain).

amendment. Amended as para 88 requires, s.809O(6) ITA reads

> Enjoyment by ~~a relevant person~~ the individual of property or a service is to be disregarded in any of these cases—
> (a) if the property or service is enjoyed virtually to the entire exclusion of ~~all relevant persons~~ the individual,
> (b) if full consideration in money or money's worth is given by ~~a relevant person~~ the individual for the enjoyment, or
> (c) the property or service is enjoyed by ~~relevant persons~~ the individual in the same way, and on the same terms, as it may be enjoyed by the general public or by a section of the general public.

18.35 Amount remitted

Section 809P(1) ITA provides:

> The amount of income or chargeable gains remitted to the UK is to be determined as follows.

Five rules then follow.

18.35.1 *Income/gains remitted*

It is helpful to read the first two rules side by side:

s.809P(2) ITA	**s.809P(3) ITA**
If the property, service or consideration[275] is the income or chargeable gains,	If the property, service or consideration derives from the income or chargeable gains,
the amount remitted is equal to the amount of the income or chargeable gains.	the amount remitted is equal to the amount of income or chargeable gains from which the property, service or consideration derives.

That seems sensible, but problems do arise.

18.35.2 *Change in value*

The RDR Manual provides:

[275] The words "property, service or consideration" relate back to the wording of condition B: property means property brought/received/used in the UK, service means a service provided in the UK, and consideration means consideration for a service provided in the UK.

> **RDRM35030 remittances derived from foreign income/gains** [Jan 2019]
>
> [1] ... Where, as in most cases, the property, service or consideration derives from a foreign currency, the taxable amount is the pounds sterling equivalent value (at time of remittance) of the amount of foreign currency (refer to RDRM31190 Exchange rates) used to acquire or pay for the property or service etc.

Point [1] assumes that one translates foreign currency income into sterling at the time of remittance; this is almost certainly wrong.[276]

> [2] This means that where an item of depreciating value (such as a car) is brought to the UK the amount that is liable to tax is not the current value of the car but the amount of foreign income or gains from which the car derives (example 4).
>
> [3] For the same reason, where an item of appreciating value (perhaps a work of art) is brought to the UK, the taxable amount is the amount of foreign income or gains from which the property derived, and not its current market value (example 5).
>
> [4] The same principle applies where an investment is made in shares or other such financial instruments, and those shares are in, or are otherwise brought, to the UK. The chargeable amount is the amount of foreign income or gains from which the shares derived ...

18.35.3 *Fall in value: Remittance in specie*

Point [2] states that on remittance in specie of an asset purchased from foreign income/gains, the amount remitted is the amount of foreign income/gains and not the value of the asset at the time of remittance, if lower. To hammer the point home, RDR Manual provides a straightforward example where the facts (stripping out irrelevancies)[277] are

[276] See 95.6 (Remittance basis: Conversion date).

[277] The example in full (including its irrelevant detail) is as follows:
"**RDRM35030: Conditions A and B - remittances derived from foreign income or gains** [Jan 2019]
In example 1 above, Marianne, a remittance basis user, used £25,000 of her foreign chargeable gains to purchase a car. The car is regarded as derived from foreign income and gains.
Instead of bringing it straight to the UK, Marianne kept the car at her Italian villa for use on her visits to Italy. A few years later she then decides to bring the car to the UK for her and her daughter to use. At this time the approximate market resale value of the car is £14,000. ..."

as follows:

> **RDRM35030 remittances derived from foreign income or gains** [Jan 2019]
> *Example 4 (Marianne)*
> M purchases a car for £25,000 of foreign chargeable gains.
> M later brings the car to the UK.
> The market value of the car at that time is £14,000.

The HMRC analysis is as follows:

> The amount remitted is still £25,000, that being the amount equal to the chargeable gains from which the property – the car – derived.

This view leads to the absurd result, that if the car was old and only worth £1k, there would still be a taxable remittance of £25k. That is perhaps an extreme case, but on any basis the tax charge is likely to exceed the value of the car when remitted.[278]

18.35.4 *Fall in value: Sale proceeds remitted*

In earlier editions of this work, I raised this challenge:

> The author has not addressed the interesting questions which arise if M sells the car abroad. Suppose on the above facts M had sold the car abroad, and brought the proceeds of (let us say) £14k to the UK.

HMRC amended the Manual to address this, and boldly argue that the same unfairness results:

> This would be the case even if M sold the car in Italy for its market value of £14,000 and brought the sale proceeds to the UK. The taxable remittance is still £25,000 of M's foreign gains as that is what the sale proceeds are derived from.[279]

The Manual gives a straightforward example to hammer the point home where the facts (stripping out irrelevancies)[280] are as follows

[278] The unfairness is slightly masked by the implausible figures given in the example. Average depreciation of a three year old car is about 60% so the tax charge on £25k arises on importation of an asset more likely to be worth £10k than £14k. But the values do not affect the principle.

[279] This passage was added to the Manual in 2014.

[280] The example in full (including its irrelevant detail) is as follows: "**RDRM35030: Conditions A and B - remittances derived from foreign income or gains** [Jan 2019] B purchases shares in a French company using £100,000 of his

> **RDRM35030 remittances derived from foreign income/gains** [Jan 2019]
> Example 6 (Ben)
> B purchases foreign shares for £100,000 from foreign income.
> B later sells the shares for £75,000.
> B remits the sale proceeds to the UK.

The HMRC analysis is as follows:

> Although he has only transferred £75,000 to the UK we need to determine what the money derives from. In this case it derives originally from £100,000 of his unremitted foreign income. As a result of this B has made a taxable remittance of £100,000.

This view leads to an absurd result, that if the asset was sold for £1 which was remitted, there would still be a taxable remittance of £100k.

18.35.5 *Fall in value: Discussion*

It is considered that the concept of derivation is flexible enough to reach the obviously sensible result that the amount remitted does not exceed the value or amount of what is actually remitted. On the facts of example 6 (fall in value, sale and remittance of proceeds of sale) the amount remitted should be capped at the proceeds of sale (in the example, £75k). The balance is attributable to the loss, which is not remitted. This avoids the absurdity noted above, that on the HMRC view, if the shares are sold for £1, which is remitted, there is a taxable remittance of £100k.

This also avoids the anomaly that if the mixed fund rules apply, whatever the constituents of the fund, the amount remitted is capped by the amount or value of the proceeds received in the UK. For instance the remittance would not exceed the amount of the transfer if (varying the facts of example 6):

(1) if the shares were purchased out of RFI and a chargeable gain, or out of RFI of two separate years; or
(2) if the proceeds of sale (in the example, £75k) were mixed with other income or gains, and then remitted.

On the facts of example 4, (fall in value and remittance of asset in specie),

unremitted foreign income. Unfortunately the company performs badly and several years later B sells his entire share holding for £75,000. He transfers the whole of the sale proceeds to his UK account and uses the money to fund his general living expenses in the UK."

it is similarly arguable that the amount remitted should be capped at the value of the asset when remitted (in the example, £14k). The balance is attributable to depreciation which is not remitted. But a remittance in specie is different from the case of a sale and remittance of the proceeds of sale (as example 6), because with a remittance in specie the loss from the fall in value has not been realised. Suppose the asset which fell in value and was then remitted was a chargeable asset, (a picture, say, not a car, which is exempt from CGT). The taxpayer could sell the asset when in the UK and realise an allowable loss. That suggests one should not credit the loss at the time of the remittance, or there would be a double deduction. So M would be best advised to sell her car abroad, and bring the proceeds to the UK. In practice I expect remittances in specie would be relatively uncommon, so this problem will not often arise or will not concern significant sums.

18.35.6 *Asset increases in value*

Point [3] of the RDRM passage set out above states that on remittance of an asset purchased from foreign income/gains, the amount remitted is the amount of foreign income/gains and not the value of the asset at the time of remittance, if higher. That is obviously right. The increase in value comes into charge on a disposal.

18.36 Debt-remittance: Amount remitted

I turn to consider the amount remitted in cases of debt-remittances, that is, where foreign income or gains is used in respect of a relevant debt. Section 809P ITA provides rules for relevant-debt remittances:

s.809P(4)	**s.809P(5)**
If the income or chargeable gains are used as mentioned in section 809L(3)(c), [that is, used in respect of a relevant debt]	If anything deriving from the income or chargeable gains is used as mentioned in section 809L(3)(c),
the amount remitted is equal to the amount of income or chargeable gains used;	the amount remitted is equal to the amount of income or chargeable gains from which what is used derives;
but this is subject to subsection (10).	[Identical]

Apart from the P(10) cap,[281] which only applies to debt-remittances, s.809P(4)(5) (which apply to debt remittances) is the equivalent of s.809P(2)(3) (which apply for general remittances)[282].

The RDR Manual provides some examples. The first example is payment of interest on a relevant debt:

> **RDRM35040 remittances in respect of relevant debt** [Mar 2022]
> **Example 1 (Katrina)**
> In May 2011, K, a remittance basis user, borrows £12,000 from an overseas bank to buy shares in a UK company. This is a relevant debt.
> In tax year 2011-12 K uses £4,600 of her relevant foreign income to pay the interest and to repay some of the amount borrowed.
> The chargeable amount is £4,600.

The second example is payment of interest and repayment of capital of a relevant debt:[283]

> **RDRM35040 remittances in respect of relevant debt** [Mar 2022]
> **Example 2 (Gary)**
> On 6/4/2015 G, a remittance basis user, borrows money from an overseas bank to buy an apartment in the UK.
> In 2015/16 G pays £12k interest out of his relevant foreign earnings.
> In 2016/17 G pays £30k interest and capital from relevant foreign

[281] See 18.37 (Debt-remittance: P(10) cap).

[282] See 18.35.1 (Income/gains remitted).

[283] The example in full (including its irrelevant detail) is as follows:
RDRM35040 remittances in respect of relevant debt [Mar 2022]
Example 2 (Gary)
On 6 April 2015, G, a remittance basis user, borrows money from an overseas bank to buy an apartment in Solihull. Payments are due on the first day of each month from May 2015 onwards. The first 12 payments are on an interest-only basis.
G pays £1,000 interest each month to the overseas lender from his overseas account with the same bank, into which G ensures a sufficient amount of his relevant foreign earnings are paid directly to cover the repayments.
From 1 May 2016 the payments increase to a fixed amount of £2,500 each month as G starts to repay the capital amount of the loan as well as the interest. The payments continue to be met from the same account of relevant foreign earnings.
The loan is a relevant debt because it is respect of property (the apartment) which is used in the UK by a relevant person (G).
G has made taxable remittances in 2015-16 of £12,000, that being the relevant foreign earnings used to service the relevant debt. In 2016-17 G has made taxable remittances of £30,000, being the amount used to both service and repay the relevant debt.

> earnings.

The HMRC analysis is:

> The loan is a relevant debt because it is respect of property (the apartment) which is used in the UK by a relevant person (G).
> G has made taxable remittances in 2015-16 of £12,000, that being the relevant foreign earnings used to service the relevant debt.
> In 2016-17 G has made taxable remittances of £30,000, being the amount used to both service and repay the relevant debt.

The next two examples make the facts a little more complicated but the debt remittance principles are the same:

> **Example 3 (Ali)**
> A, a remittance basis user, borrows money.
> A uses the loan to purchase an asset kept outside the UK.
> A gives the asset to his wife W who keeps the asset outside the UK.
> W brings the asset to the UK.
> A satisfies the loan by transfer of another asset which is outside the UK, and which was purchased with £50,000 RFE and £30,000 of clean capital.[284]

The HMRC analysis is as follows:

> The relevant debt is serviced by the oil painting, which derives, in part, from A's RFE (refer to the earlier example). A has made a taxable remittance in 2013-14 of £50,000.
> Note: For the purposes of this example assume there is no chargeable gain on the transfer of the painting to the bank.
>
> **Example 4 (Francine)**
> F, a remittance basis user, borrows £40,000 which she uses to pay the

[284] The example in full, including its irrelevant detail, is as follows:
"**RDRM35040 remittances in respect of relevant debt** [Mar 2022]
A, a remittance basis user, purchases some sculptures in Sweden in October 2012 for £80,000; he takes out an interest-free (!) loan of £80,000 with his US bank to fund this purchase, repayable within 1 year.
In November 2012 he gives them to his wife as an anniversary gift. She initially keeps them at her mother's home in Stockholm, but 6 months later in March 2013 she decides to bring these sculptures to the UK to display in her UK garden.
In October 2013 A arranges with the US bank that he will repay the loan by giving them an oil painting which is currently in his apartment in Miami. A had purchased the painting in May 2011, using £50,000 of his relevant foreign earnings and £30,000 of capital inherited from an uncle. ..."

> foreign contractor for services provided in the UK.
> F transfers to the creditor a bond purchased out of foreign chargeable gains of £10k, as part repayment of the loan.[285]

The HMRC analysis is as follows:

> The relevant debt is serviced by the German bond which derives wholly from F's foreign chargeable gains, and is used outside the UK in respect of this relevant debt (refer to the earlier examples). F has made a taxable remittance in 2013-14 of £10,000.

18.37 Debt-remittance: P(10) cap

18.37.1 *Wholly/partly relevant debts*

I coin two terms:

Term	**Meaning**
Partly-relevant debt	Relates partly to UK property, eg part of loan remitted
Wholly-relevant debt	Relates wholly to UK property, eg whole loan remitted

18.37.2 *The P(10) cap*

Section 809P(4)(5) (which apply to debt remittances) is the equivalent of s.809P(2)(3) (which apply for general remittances), but in the case of debt-remittances, there is a cap on the amount remitted. Section 809P(10) ITA provides:

> If the debt is only partly in respect of[286]
> [a] the property [ie the property received/brought/used in the UK]
> [b] or service, [ie the service provided in the UK]
> the amount remitted is (if it would otherwise be greater) limited to the

[285] The example in full, including its irrelevant detail, is as follows:
"**RDRM35040 remittances in respect of relevant debt** [Mar 2022]
F, a remittance basis user, has a Spanish-style courtyard created at her house in Brighton. She takes out an unsecured loan of £40,000 from her French bank which she uses to pay the specialist Spanish contractor.
F has several French government bonds, which she purchased entirely from her relevant foreign income, and a German government bond which she acquired using her foreign chargeable gains. These bonds are each worth £10,000.
In September 2010 F gives the German bond to her bank as part repayment of the loan. ..."

[286] Section 809P(10) refers to a debt *in respect of* UK property; the definition of relevant debt is one which *relates* to UK property. It is considered that the expressions are synonymous.

> amount the debt would be if it were wholly in respect of the property or service.

I refer to this as the "**debt-remittance P(10) cap**". This is not an ideal label, but I cannot think of better.

Suppose:

(1) T borrows £10m.
(2) T remits £1m of the borrowed money to the UK.

The debt is a relevant debt, and in my terminology, a partly-relevant debt, and the P(10) cap applies.

(3a) T repays the entire borrowing out of income/gains.
The amount remitted is £1m.

(3b) Suppose instead T only repaid £1m or £2m of the debt.
There is still a remittance of £1m.

This example illustrates a planning point: it may be better to avoid partly relevant debts (which relate *partly* to property brought/received/used in the UK). Instead, T could borrow so as to have two separate debts, one of £1m (remitted to the UK) and one of £9m (unremitted). Then the unremitted debt is *not* a relevant debt and can be repaid out of foreign income/gains.

The RDR Manual provides a straightforward example:

> **RDRM35040 remittances in respect of relevant debt** [Mar 2022]
> **Example 5 (Karen)**[287]
> In 2011/12 K, a remittance basis user, borrows £10,000 from a Jersey bank and uses the borrowed funds to pay
> [1] £8,000 for services provided to a relevant person in the UK, and
> [2] £2,000 for services provided out of the UK.
> K repays the borrowing from her relevant foreign earnings.

The debt is a partly-relevant debt.

[287] The example in full (including its irrelevant detail) is as follows:
"**RDRM35040 remittances in respect of relevant debt** [Mar 2022]
In August 2011 K, a remittance basis user, uses an interest-free £10,000 overdraft facility on her Jersey bank account to pay £8,000 of UK school fees for her 14 year old daughter Lauren. The remaining £2,000 of the facility is used to pay for Lauren to attend a summer school in France organised by a French university.
K repays the overdraft from her relevant foreign earnings between August and November 2011. ..."

The HMRC analysis is as follows:

> K has made a taxable remittance in 2011-12 of £8,000 relevant foreign earnings, that being the part of the debt that is in respect of a service provided in the UK ... which is thus a 'relevant debt'.

What if K also paid interest on the debt out of her foreign income? The example avoids the question by stipulating, implausibly, that the bank borrowing is interest-free.

(1) On the facts of the example of Karen, where the loan is from a non-UK bank, it is suggested that there should be an apportionment, so if Karen pays the interest out of her foreign income, only 80% of the foreign income used to repay the interest is regarded as remitted. It may be better for Karen to take out two distinct loans, to avoid the issue.

(2) If the loan is from a UK bank, then all the foreign income used to pay interest is regarded as remitted, on the basis that the money used to pay the interest is used in the UK or is consideration for a service (the loan) provided in the UK.

18.38 Security for debt: Amount remitted

On the basis that income/gains are used in respect of a relevant debt if charged as security for a relevant debt, the question arises as to the amount of income/gains remitted.

18.38.1 *Pre-2020 HMRC view: general cap*

The RDR Manual formerly provided:

> **RDRM35050 Collateral in respect of relevant debt** [Jan 2019]
> *The amount of the foreign income or gains that are so used in respect of the relevant debt will be restricted to the amount of the capital loaned, together with any accrued interest (where applicable). The amounts due will depend, to some extent on the terms on which the security is offered.*

On this view, which I call the **"pre-2020 HMRC view"**, the amount remitted when foreign income/gains is charged as security for a relevant debt is in all cases capped:

(1) In the case of wholly-relevant debt, the cap is the amount of the debt

(2) In the case of a partly-relevant debt, the P(10) cap applies

HMRC gave a number of examples. The first was a straightforward charge over RFI of £160k to secure a relevant debt of £100k:

> *Example 1 (Freda)*
> *F, a remittance basis user takes out an interest-free loan for £100,000; with allegedly (?) no requirement for repayment until an indeterminate future date.*[288] *She uses the loan to purchase a plot of land in the UK, so the loan is a relevant debt.*
> *F offers as collateral for the loan a French painting, currently in her Parisian apartment. She purchased this painting in an earlier tax year in which she was also a UK resident remittance basis user, using £160,000 of her untaxed relevant foreign income from that year.*
> *The painting is still worth £160,000.*[289]

The HMRC analysis was as follows:

> *F has used her foreign income as collateral, in respect of a relevant debt.*

That is the HMRC post 2014-view.

> *The amount so used is 'capped' at the amount of the debt, which is £100,000 in this case.*
> *The reason for this is obvious if you consider what would happen in the very unlikely event that the lender immediately 'seized' the collateral in the painting to repay the £100,000 debt in full. The lender would realise £160,000 from the painting; the lender would retain £100,000 to satisfy the debt owed and return £60,000 to F (ignoring accrued interest, penalties and service charges). So only £100,000 of the collateral is used in respect of the debt.*

18.38.2 *Charge over single mixed fund*

HMRC considered a mixed fund charged as security for a relevant debt:

> ***RDRM35270 Remittances from mixed funds - collateral in respect of relevant debt*** *[Jan 2019]*
> *When foreign income and gains are used as collateral for a relevant debt they are used 'in respect of' the relevant debt, so there will be a taxable remittance when the loan is brought to the UK....*

[288] The significance of this is that granting the security constitutes use of the painting in respect of a relevant debt, so there is a remittance even applying the pre-2014 HMRC view.

[289] The analysis must be the same if the painting has gone up in value. But this avoids having to consider the position if the value had gone down at the time of the charge.

> *Often the collateral offered will be an asset which is itself a mixed fund. In these circumstances the mixed fund ordering rules at section 809Q(4) apply to the asset offered as security. In such a case, the taxable amount is made up of the same amounts of capital and foreign income and gains that were used to purchase the asset in the first place. The 'transfer' is the offering of the asset as collateral in respect of the relevant debt and any formal charge is registered to the lender (where appropriate). The analysis is carried out on the date immediately before the collateral is so offered.*

This analysis assumes that the charge is a "transfer" from the mixed fund for the purposes of s.809Q(4),[290] so the ITA mixed fund rules apply. Granting a charge (which the author, using layman's language, calls "offering an asset as collateral") is not a transfer in the normal sense of the word but the context suggests that "transfer" might be given a wide meaning, to include anything which constitutes a remittance.

The amount of that transfer is the amount which is remitted.

HMRC gave two more examples which I need not set out here.[291]

18.38.3 *Lender priority respected*

HMRC also considered the case where a debt is charged over several assets (not comprising a single mixed fund):

> *Example 3 (Freda)*[292]
> *F, a remittance basis user receives an interest-free loan*[293] *of £100,000. She uses the loan to purchase a plot of land in the UK, so the loan is a relevant debt.*
> *F gives, as collateral for the loan, a general right to the bank over her many current and savings accounts and investment portfolio held with them.*
> *Ignoring accrued interest, the 'cap' on the amount of collateral regarded as used in respect of the relevant debt is £100,000.*

On the pre-2020 HMRC view, there is a remittance of £100k. It is

[290] See 20.5.2 (Onshore transfer).

[291] See the 2021/22 edition of this work 17.32.5 (Security for debt: Amount remitted).

[292] This is a variant of *Example 1 (Freda)* above.

[293] The grant of an interest-free loan from a bank seems somewhat implausible, unless the bank is owned by F or a connected person. The significance is that the loan is not commercial, so granting security over this kind of loan constitutes a remittance even applying the pre-2014 HMRC view.

necessary to ascertain exactly which income and gains are remitted.

> *The 'transfer' is the offering of the asset as collateral so an analysis of F's accounts over which the charge is granted would be needed to analyse the credits into each account immediately before the date of transfer, in order to determine the constituent parts of each account for s809Q(4) purposes.*
> *In these circumstances the terms and conditions surrounding the loan and the collateral offered should be examined carefully as this may prioritise the order of the accounts against which any 'collateral' charge will be taken; for example it may prioritise current or savings flexible accounts over high-interest period or notice accounts. The s809Q(4) analysis should reflect this priority.*

HMRC repeated the point in a meeting with the professional bodies. The note of meeting provides:

> *HMRC confirmed that generally the examples in RDRM35270 continue to stand, so if there is contractual priority this will be respected.*[294]

18.39 Amount remitted: post-2020 HMRC view

HMRC quietly changed their position in 2020, and adopt what I call the **"post-2020 HMRC view"**.

Under the post-2020 HMRC view, the amount remitted depends on whether there is a wholly or partly relevant debt.

18.40 Wholly-relevant debt: no cap

The Manual now provides:

> **RDRM37050 Foreign income and gains as collateral** [Mar 2022]
> **Remittance basis clarifications** (!)[295] ...
> *Where the overseas income and gains which are used as security for the relevant debt exceed the amount of the debt, is it HMRC's practice to limit the amount of the remittance to the amount of the debt plus any accrued interest?*
> Where the full amount of the loan has been brought to the UK the

[294] Note of meeting between professional bodies & HMRC, 11 Sept 2014 para 15 *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/a1b82d1f-8e06-49a6-98dc-896c9e9cf9cf/Rep%20body%20agreed%20note%20of%2011%20September%20meeting%20after%20HMRC%20comments.pdf*

[295] See App 1.2 (Clarify/modernise/reform). This was published (co-incidentally?) on 18 December, so some time passed before the "clarification" was noticed.

> amount of foreign income or gains taxed as a remittance is not capped at the amount of the loan. The amount of the remittance will be the full amount of foreign income or gains that are used as collateral for the loan...

On the post-2020 HMRC view, where T grants a charge over foreign income/gains as security for a wholly relevant debt, the amount remitted is the total income/gains charged. There is no cap by reference to the amount of the relevant debt. That reverses the view taken previously.

The post-2020 HMRC view leads to the absurdity that if T charges a foreign fund of £10m as security for a wholly-relevant debt of £1, the whole of the £10m is remitted. That cannot be right. So it is considered that the pre-2020 HMRC view is correct. Indeed at the time HMRC thought that was "obvious".[296]

18.40.1 *Partly-relevant debt: P(10) cap*

HMRC accept that their post-2020 view only applies to a wholly-relevant debt. It does not apply to a partly-relevant debt, because of the P(10) cap:[297]

> Where only part of the loan has been brought to the UK, s809P (10) ITA 2007 caps the extent of the amount of the collateral remitted to the total of the loan brought to the UK. S809P (10) ITA 2007 applies only where part of the loan has been brought to the UK.

If T charges foreign income/gains as security for a partly-relevant debt, the position did not change in 2020.

The moral seems to be that if T wishes to charge foreign income/gains as security for a relevant debt, it should be a partly-relevant debt and not a wholly relevant debt, ie borrow and spend or leave £1 of the borrowing offshore. This avoids the need to challenge HMRC's post-2020 view, and the unfairness if HMRC were correct.

The distinction between wholly/partly relevant debts is anomalous (one could use stronger language) and also suggests that the post-2020 HMRC view is wrong about wholly-relevant debts

18.40.2 *Lender priority not respected*

The change of practice also affects debts charged on several assets:

[296] See 18.38.1 (Pre-2020 HMRC view: general cap).

[297] 18.37 (Debt-remittance: P(10) cap).

> *Will HMRC look at any provisions in the arrangements between the taxpayer and the bank as to the priority of any security held by the bank in assessing what has been remitted to the UK?*
> *For example, A borrows £500,000 from a bank to purchase a property in the UK for £750,000. The bank takes a charge over the property but also has security over A's portfolio with the bank in Switzerland. The agreement with the bank however specifies that the bank must attempt to enforce its security over the property before it can enforce against the portfolio. As the value of the property is in excess of the amount of the loan, do HMRC accept that there is no remittance of any foreign income and gains contained in the portfolio?*
> If the provision of the loan or the repayment terms are conditional on the availability of the foreign income or gains used as collateral, the foreign income or gains are used in respect of the debt and there will be a taxable remittance. In the above scenario, there will be a taxable remittance of the foreign income or gains in A's portfolio with the bank in Switzerland.

That also reverses the view taken previously.[298]

18.40.3 *Security over several assets*

The note of meeting between Professional Bodies/HMRC provides:[299]

> **Question 2:** Order of priority where the amount remitted is limited to the amount of the loan which is used in the UK.
> B purchases a property in the UK for £750,000. She takes out a loan outside the UK of £500,000. Of this, she uses £400,000 to assist with the purchase of the property. B uses the remaining £100,000 to purchase a painting which she keeps at her house in Switzerland.

In my terminology, we have a partly-relevant debt.

> B is a UK resident, remittance basis user.
> The £500,000 loan is secured over two separate investment accounts which B holds with the lending bank in Switzerland.
> [1] The first account derives from B's non-UK capital gains and, at the time the loan is put in place, holds assets worth £600,000.
> [2] The investments in the second account derive from B's overseas

[298] See 18.38.3 (Lender priority respected).

[299] "Treatment of loans secured on foreign income or gains by remittance basis users" (Apr 2022) *https://www.tax.org.uk/treatment_of_loans*
ICEAW publish this statement as TAXguide 20/21.

> income and is worth £200,000.
>
> The terms of the agreement between the bank and B provide that the bank must enforce its security over the capital gains account and, only if there is a shortfall, can it recover any excess from the income account.

The remittance is capped at £400k. So the question arises as to what income/gains are remitted:

> Does HMRC agree that, as the capital gains account contains more than £400,000, the remittance should be treated as comprising entirely capital gains or would HMRC take the view that, despite the priority provisions, there is a proportionate remittance of capital gains and income (i.e. £300,000 of gains and £100,000 of income)?

HMRC do not agree:

> **HMRC response** The order in which the bank will enforce its security is not relevant to the remittance position and should not determine the foreign gain/ foreign income split of the capped remittance. The entirety of the funds in B's non-UK capital gains account and B's overseas income account have been used in respect of the relevant debt.
>
> £400,000 of the £500,000 loan has been brought to the UK. The amount of the remittance is capped at £400,000 and the mixed fund ordering rules are applied to the determine the make up of the capped remittance £600,000 foreign gain and £200,000 foreign income has been used in respect of the relevant debt. If the income and the gains are for the same tax year applying the mixed fund ordering rules results in a capped remittance of £200,000 foreign income and £200,000 foreign gain.

There are two points here:

(1) The lender's priority does not affect the position; this has already been noted

(2) The ITA mixed fund rules apply. These rules probably do apply if there is a charge over a single mixed fund. On the facts posited, there are two separate, non-mixed, funds. Perhaps the context shows that everything subject to the charge is to be regarded as one fund; though it is not obvious.

The view of the professional bodies, that lender's priority should be respected, is the better view.

18.40.4 *Post-2020 view: Critique*

There were two major changes of view in 2020, and HMRC's customers may think that ought to have been properly announced. Thought might also have been given to transitional issues.

HMRC deny that there has been a change of view.[300] The reader may be puzzled about that. That that the RDRM has changed its view is undeniable, and while HMRC are not bound by their manuals, it is difficult to accept that what the Manual stated clearly, repeatedly, and at length, was not formerly the HMRC view. But in October 2023 HMRC agreed to review their position, so they may return to their pre-2020 view.[301] Time will tell.

18.41 Post-charge ingredients of mixed fund

Suppose:

(1) A relevant debt of £100

(2) A mixed fund of £200 is charged as security for the debt ("the charged fund"). This involves a remittance of £100 (not £200)[302]

(3) The ITA mixed fund rules apply to determine what part of the debt is remitted (as is the HMRC view) so that (say) £100 of income is remitted.

What are the ingredients of the mixed fund after that? The £100 may be treated as remitted, as a result of the charge, but it is still held in the fund. It is considered that the £100 treated as remitted becomes a capital ingredient of the fund, within category (i), received on the date of the remittance, and the mixed fund rules are applied accordingly. So if the individual later brings £100 from the charged fund to the UK that sum is remitted first (assuming there are no subsequent receipts in the fund) and so is not taxed twice.

[300] "HMRC has applied a consistent approach to the remittance basis treatment of foreign income or gains used as loan security since publication of the HMRC notices on 4 August 2014 and 15 October 2015. The updates to the RDRM made in December 2020 and July 2021 were to clarify and correct existing guidance and were not made because HMRC had changed its position."
"Treatment of loans secured on foreign income or gains by remittance basis users" (Apr 2022) *https://www.tax.org.uk/treatment_of_loans*:
ICEAW publish this statement as TAXguide 20/21.

[301] See *https://www.tax.org.uk/hmrc-to-review-their-position-on-remittances*

[302] This is the case:
(1) On the pre-2020 HMRC view in all cases
(2) On the post-2020 HMRC view if
(a) The debt is a partly-relevant debt; or

18.42 Amount remitted: P(12) cap

Section 809P(12) ITA provides:

> [a] If
> [i] the amount remitted (taken together with any amount previously remitted) would otherwise exceed
> [ii] the amount of the income or chargeable gains,
> [b] the amount remitted is limited to
> [c] the amount which, when taken together with any amount previously remitted, is equal to the amount of the income or chargeable gains.

I refer to this as the **"P(12) cap"** on the amount remitted. That is not an ideal label but I cannot think of better.

How could the amounts remitted (which must derive from the income/gains) exceed the amount of the income/gains?

This could happen in cases of double representation, ie there are two assets which are both derived from the same income/gains,[303] and both assets are remitted.

Another case is if income is remitted twice. Suppose:

(1) Year 1: T (an individual taxable on the remittance basis) receives income in the UK. The income is remitted ("the first remittance") and so subject to tax.

(2) Year 2: The income is used in the UK, or is transferred out of the UK and brought to the UK again ("the re-remittance").

The RDR Manual provides:

> **RDRM35030 remittances derived from foreign income/gains** [Jan 2019]
> When taken together with any amounts that have been previously remitted (or treated as having been remitted), the taxable amount of income or gain that is treated as having been remitted because of these provisions cannot be greater than the amount of the original foreign income and gains (ITA07/s809P(12)).
> Where property is brought to or used in the UK by or for the benefit of a relevant person the amount that is liable to tax is the amount of the underlying foreign income or gains from which the property derives (whether directly or indirectly). The taxable remittance will only occur once; this will usually be the time the asset is first brought to, received

[303] See 18.18.9 (Double representation).

by or used in the UK by a relevant person.

This is right. But the same will apply if the income/gains is *not* taxed on the first remittance, eg:

(1) A remittance by a non-resident of income/gains of a resident period.
(2) A remittance before 2008 of source-ceased income or of property enjoyed in specie.[304]

HMRC agree. December 2008 Q&As provides:

> **Q9** If a taxpayer undertook a source ceasing exercise during the 2006-07 tax year and then remitted the proceeds before the 2008-09 tax year, if those funds were to then be taken back outside of the UK and re-imported, would this constitute a remittance. In other words, would the earlier source ceasing exercise be looked through despite its timing? It is understood that interest/profit from any new investment would be a remittance.
> **A** If the source ceased in 2006-07 and was remitted in 2007-08, then this did not count as a remittance and it will not count as a remittance if it is exported and subsequently re-imported.

HMRC do not cite a statutory authority to justify their answer; s.809P(12) ITA would do, though there are others as well.[305]

18.43 Condition C/D: Amount remitted

Section 809P(6)(7) ITA deal with condition C:

> (6) In a case falling within section 809L(4)(a) or (b), the amount remitted is equal to the amount of the relevant income or chargeable gains.
> (7) In a case falling within section 809L(4)(c), the amount remitted is equal to the amount of the relevant income or chargeable gains; but this is subject to subsection (10).
> ...
> (11) In subsections (6) and (7) "relevant income or chargeable gains" means—
> (a) if the qualifying property falls within section 809N(7)(a), the income or gains—
> (i) of which the qualifying property consists, or

[304] The temporary non-residence rules would need consideration.

[305] Para 86(2) sch 7 FA 2008 would also provide relief here (at least, assuming remittance conditions A/B apply, which is the normal case): see 18.53 (Transitional: pre-2008 property). But the point is now of mainly historical interest.

> (ii) from which the qualifying property derives;
>
> (b) if the qualifying property falls within section 809N(7)(b), the income or gains—
> (i) of which the property given to the gift recipient consisted, or
> (ii) from which that property derived;
>
> (c) if the qualifying property falls within section 809N(7)(c), the income or gains—
> (i) of which the property given to the gift recipient consists, or
> (ii) from which that property derives.

Section 809P(8)(9) ITA make equivalent provision for condition D:

> (8) In a case falling within section 809L(5)(a) or (b), the amount remitted is equal to the amount of the income or chargeable gains referred to in section 809O(4)(c).
>
> (9) In a case falling within section 809L(5)(c), the amount remitted is equal to the amount of the income or chargeable gains referred to in section 809O(4)(c); but this is subject to subsection (10). The RDR Manual offers seven examples but the matter does not seem important enough to be setting out here.

18.44 Sets

Section 809P(13) ITA provides:

> If the property forms part of a set only part of which is in the UK, the amount remitted is such portion of what it would have been had the complete set been brought to, or received or used in, the UK when the part was as is just and reasonable (having regard to the part of the set which is there).

This is a mad level of micro-detail, and should be repealed. But in practice the point will rarely if ever arise.

18.45 Gain on disposal at undervalue

18.45.1 *The CGT background*

Gains are computed as the consideration for a disposal less allowable expenditure. In certain circumstances the consideration for a disposal is deemed to be market value consideration, not the actual consideration (if any).[306] In these cases a gain is deemed to accrue which is not a real gain

[306] See App.4.8 (CGT market value rule).
In certain circumstances a gain is deemed to accrue to an individual even though

(in the sense that the individual does not actually receive a sum which constitutes or represents the gain). I refer to this as a **"deemed gain"**.

The most common case of a deemed gain is a gift. In money terms (one might say, in economic reality, but I do not think that is a helpful concept) a gift cannot give rise to a gain, and normally gives rise to a loss. However, for CGT purposes a gift is treated as made for market value.

18.45.2 *Remittance of deemed gain*

In the absence of express provision, a deemed gain accruing on a gift could not be remitted, because the individual does not have property which is or derives from the gain and which could be received/brought/used in the UK. Accordingly, s.809T ITA provides:

> (1) This section applies if—
> (a) foreign chargeable gains accrue to an individual on the disposal of an asset, and
> (b) the individual does not receive consideration[307] for the disposal of an amount at least equal to the market value[308] of the asset.
> (2) For the purposes of this Chapter [Chapter A1 Part 14, remittance basis], treat the asset as deriving from the chargeable gains.

It is not expressly stated that s.809T only applies on a disposal made by an individual, but this is implied. Eg on a disposal by non-resident close company, conditions (a)(b) are met, if one reads the words literally:
(a) s.3 gains may accrue to an individual who is a participator, and
(b) the individual does not receive the consideration for the disposal.

But s.809T does not apply. Otherwise provisions such as s.3D(3)(a) TCGA would be unnecessary.[309]

HMRC accept that pre-2008 deemed gains cannot be remitted.[310]

For the interaction with s.87, where the gift is to a trust, see 61.7.6 (Payment from unremitted gains).

there is no disposal, but s.809T does not apply to that.

[307] "Consideration" here obviously means actual consideration, as opposed to deemed market value consideration. (Though normally in the legislation the drafter states this expressly; eg s.165(7) TCGA.)

[308] Defined s.809Z10 ITA: "In this Chapter ... "market value" has the same meaning as in TCGA 1992 (see in particular sections 272 and 273 of that Act)."

[309] See 64.23 (Section 3 remittance basis).

[310] See the 2021/22 edition of this work para 17.33.6 (Transitional: Pre-2008 deemed gain).

18.45.3 *Gift of asset*

Suppose:

(1) T (a remittance basis taxpayer) gives an asset (foreign situate) to a trust. A gain is deemed to accrue on the disposal as if the asset were sold for market value (the deemed gain).

(2) T (or a relevant person) receives the asset in the UK.

The deemed gain is remitted.

For the interaction with s.87, see 61.7.6 (Payment from unremitted gains).

18.45.4 *Sale of asset at market value*

Suppose T sells an asset for market value. Then s.809T does not apply. It does not matter if T is connected with the purchaser. The purchase price is or (better) is derived from the gain accruing on the sale, but the asset itself is not (and is not derived from) the gain. So it does not matter if the asset is remitted.

Suppose T sells an asset and the purchase price is left outstanding as a debt. It is considered that T "receives" the consideration, for the benefit of the outstanding debt is the consideration.

18.45.5 *Sale of asset at undervalue*

Suppose T sells an asset at an undervalue. Assume for the purpose of discussion that the asset has a market value of £200 and a base cost of £50. So a deemed gain of £150 accrues on the disposal.

The asset is treated as derived from the deemed gain, and there is a charge if the asset is remitted.

If the asset is sold for base cost, £50, it is suggested that the £50 is not derived from the deemed gain, so the £50 sale proceeds could be remitted tax free. But other views are possible.

What if the asset is sold at an undervalue, but for more than base cost, say for £100? In the absence of s.809T, I would say that the purchase price is in part derived from the gain. One might say that since the sale price is half the market value, half of the sale price represents the gain, ie £75. I prefer the view that the purchase price is £50 more than base cost, so that £50 of the purchase price is derived from gain. Does the rule in s.809T, that the asset is derived from the gain, mean that the sale proceeds are *not* derived from the gain? Logically that should follow, but if that were right then tax could be avoided by sales at a (marginal) undervalue. So the context shows that one should not carry the deeming so far.

The conclusion is that on a sale at an undervalue:

(1) the asset held by the trust derives from the gain *and*

(2) the sale proceeds (in part)

are both derived from the gain. The cap on the amount remitted avoids double taxation.[311]

The s.809T rule applies to all sales at less than market value, even if the undervalue is accidental.

The s.809T rule applies if the sale is less than market value, even if it is 99% of the market value. But any value within the market value range will suffice; it is potentially misleading to refer to "the" market value.[312]

The rule applies even if the disposal is not between connected persons, though in practice this is not likely to arise because:

(1) A disposal between unconnected persons is not likely to be at an undervalue.

(2) If the purchaser brings the asset to the UK, that is not likely to be a taxable remittance (because the purchaser is not likely to be a relevant person in relation to the seller).

18.46 Purchase of family home

Suppose:

(1) T gives income/gains to T's son S, not a relevant person.

(2) S buys the freehold interest of a house and uses the income/gains to pay the purchase price.

The topic raises many remittance issues, discussed throughout this chapter, so it is convenient to draw them together.

18.46.1 *Rent-free occupation*

Suppose S allows T to occupy the house rent-free. It is considered that S "uses" the house (the word "use" is wide enough to cover this even though it would be more normal and better legal English to say S occupies or enjoys the use of the house). Accordingly remittance condition A is satisfied. The house is derived from the income/gains, but condition B is not satisfied because the property is not property of a relevant person.

Remittance condition C is satisfied, since the property is qualifying property of a gift recipient, and is used and enjoyed by a relevant person.

[311] See 18.42 (Amount remitted: P(12) cap).

[312] See App 4.9.4 (Full consideration range).

So the purchase price income/gains is remitted.

18.46.2 *Lease for full consideration*

Now suppose:

(1) T gives income/gains to T's son S, who uses it to buy the freehold interest of a house.

(2) S grants a lease of the property to T for full consideration and T occupies the property. S retains the freehold reversion.

One must ask various questions here.

First, does T use the lease? The answer is that T does "use" the lease (see above). So remittance condition A is satisfied in relation to the lease. However the lease is not derived from the income/gains. So condition B is not satisfied. Of course funds T uses to pay for the lease are regarded as remitted.

Next, does T use the reversion? If so condition A is satisfied in relation to the reversion. However that may be, the reversion is not property of a relevant person so condition B is not satisfied.

Conditions C and D are excluded (even if they could otherwise apply) since the full consideration exemption applies.

18.46.3 *Lease not for full consideration*

Now suppose:

(1) T gives income/gains to T's son S, not a relevant person, who uses it to buy the freehold interest of a house.

(2) S grants a lease of the property to T for no consideration or for less than full consideration, and T occupies the property. S retains the freehold reversion.

One must ask various questions here.

First, does T use the lease? The answer is that T does "use" the lease (see above) So remittance condition A is satisfied in relation to the lease. If the transactions are part of an arrangement, the lease is derived from the income/gains. So condition B is satisfied (as the lease is property of a relevant person). What is the amount remitted? It is the amount from which the lease is derived. It is suggested that that is not the full amount used to pay for the property, but only a part reflecting the value of the lease.

Next, does T use the reversion? If so condition A is satisfied in relation to the reversion. However that may be, the reversion is not the property of a relevant person so condition B is not satisfied.

Turning to remittance condition C, does T enjoy the lease for the purposes of remittance condition C? T does. At first sight this does not matter as the lease is not qualifying property of a gift recipient (it is not property of a gift recipient). The lease may (depending on the facts) however be qualifying property within s.809N(7)(c). If so the amount remitted is all the income/gains(not the value of the lease).

Next, does T use and enjoy the reversion? It is considered that T does, since the lease T enjoys is derived from the reversion, and the lease is the mechanism by which T enjoys the reversion. If that is right, then condition C is satisfied, since the reversion is qualifying property of a gift recipient.

18.46.4 *Another analysis*

Another analysis is that the "property" is the physical house, not the legal interests in the property, but one should not disregard the most basic principles of the law of real property in construing a taxing statute, if any other approach is possible.

18.47 School fees

Suppose T wishes to pay the school fees of minor grandchildren. Assume the grandchildren are at school in the UK (otherwise there is no problem). A direct payment out of income/gains is a remittance as conditions A and B are satisfied.

Suppose T gives funds to T's child (not a relevant person) and the child uses the funds to pay the fees. This is still a remittance as conditions A and B are still satisfied: the funds in the hands of the child are derived from the income/gains.

Suppose there is an informal arrangement under which:

(1) T gives funds to T's child;
(2) the child will use *other* funds to pay the school fees.

This is caught by condition C because the funds used to pay the fees are "qualifying property" within s.809N(7)(c). That is, it is used to pay the school fees by virtue of an operation which is effected "with reference to the gift of the property to the gift recipient".

T must therefore make an unconditional gift to T's child ie a gift such that the payment of the school fees is not with reference to that gift; in that case (assuming the fees are not paid out of the gifted property) there is no taxable remittance.

18.48 Remittance before income/gains arise

Section 809U ITA provides:

> Where—
>
> (a) income or foreign chargeable gains are treated as arising or accruing, and
>
> (b) by virtue of anything done in relation to anything regarded as deriving from the income or chargeable gains, the income or chargeable gains would otherwise be regarded as remitted to the UK before the time when they are treated as arising or accruing,
>
> treat the income or chargeable gains as remitted to the UK at that time.

This provision can apply to s.87 gains[313] where:

(1) Year 1:
  (a) A beneficiary receives a capital payment which is remitted to the UK.
  (b) No s.87 gains accrue in that year, because there are no trust gains to which the capital payment can be matched.

(2) Year 2: Trust gains accrue which are matched to the capital payment, so s.87 gains accrue in year 2.

Similarly, this provision can apply to s.731 income[314] where:

(1) Year 1:
  (a) An individual receives a benefit which is remitted to the UK.
  (b) No s.731 income arises in that year, because there is no relevant income to which the benefit can be matched.

(2) Year 2: Relevant income arises, which is matched to the benefit, so s.731 income arises in year 2

Or

(1) Year 1:
  (a) Relevant income arises which is remitted to the UK.
  (b) No s.731 income arises in that year, because there is no benefit to which the relevant income can be matched.

(2) Year 2: A benefit is received which is matched to the relevant income, so s.731 income arises in year 2.

These are cases where the individual may receive property in the UK

[313] See 61.19 (s.87 remittance basis).

[314] See 50.39 (s.731 remittance basis).

(regarded as deriving from s.731 income or s.87 gains) in a year earlier than the year in which the income/gains are treated as arising.

Section 809U may also apply to accrued income profits, and, it is suggested, to trading income.

18.49 Partnerships

This section discusses two related questions.[315] Assume P (a remittance basis taxpayer) is a member of a partnership.

(1) *Remittance of funds transferred to partnership.* Suppose:
  (a) P receives income/gains.
  (b) P contributes the funds to the partnership, as partnership capital.
  (c) The partnership brings the funds to the UK.

(2) *Remittance of partnership income/gains*. Suppose:
  (a) The partnership receives income/gains.
  (b) The partnership does not distribute the funds to the partners, but brings the funds to the UK.

In these cases, is there a taxable remittance? The partnership itself is not a relevant person[316] but P is a relevant person and P's partners may be relevant persons too.

There are two possible views:

(1) One regards P as owning a *distinct asset* (a chose in action) and not a share of the partnership assets. In that case:
  (a) Funds contributed to the partnership are remitted if P receives the partnership share in the UK (because the partnership share is derived from P's income/gains).[317]
  (b) Partnership income/gains brought by the partnership to the UK are not remitted.

(2) One regards P as owning *a share of the partnership assets*. In that case:
  (a) Funds contributed to the partnership[318] are remitted if the partnership brings the funds to the UK.

[315] Also see 18.22.8 (Borrowing for partnership share); for mixed fund issues, see 20.9.4 (Partnership Income/gains mixed with partnership assets).

[316] See 18.9 (Relevant person: Partnership).

[317] Assuming (which is perhaps arguable) that receipt of a UK situate intangible asset counts as receipt in the UK for the purposes of remittance condition A.

[318] Or at least, the part of the funds attributable to the partnership shares of P and of other partners who are relevant persons.

(b) Partnership income/gains[319] are remitted if the partnership brings the income/gains to the UK.

One might describe the first view as being that partnerships are not transparent for remittance basis purposes, and the second view as one that partnerships are transparent. But that is just a convenient shorthand, not an exact statement of the statutory provisions.

18.49.1 *Partnership opaque for remittance basis*

The starting point is to understand the legal nature of a partnership share; see 85.3 (Nature of partnership share) where I identify two possible analyses of a partnership share, which I call a chose in action analysis and a co-ownership analysis. The choice depends on the context.

In the context of remittances, the RDR Manual adopts the chose in action analysis:

> **RDRM33530. Partnerships** [Jan 2019]
> *Investment into partnerships*
> When a partner makes a capital contribution to a partnership they acquire an asset under partnership law, namely an 'interest' or 'share' in the partnership which gives them rights to share in future profits and distributions (of their capital and any surplus) on dissolution of the partnership.

On this basis the RDR Manual adopts the non-transparent view:

> **RDRM33530. Partnerships** [Jan 2019]
> ... *Offshore partnerships trading or investing in the UK*
> ... Offshore partnerships, whether trading or investment partnerships, may bring partnership funds into the UK to meet trading or investment expenses in the usual course of partnership business. As the funds are brought in by the partnership they are not brought in by a relevant person. In most cases there will be no benefit to a relevant person from the money or other property brought into the UK by the partnership, nor will a service usually be provided in the UK to or for the benefit of a relevant person, so Condition A of ITA07/s809L is not met.[320] Thus there will be no taxable remittance.

In short, in the Manual's view, partnerships are not transparent for

[319] Or at least, the share of the income/gains attributable to partnership shares of P and of other partners who are relevant persons.

[320] This is a loose paraphrase of remittance condition A, but the meaning is clear.

remittance basis purposes (in the sense that remittance by the partnership is not remittance by the partners). The Manual refers to offshore partnerships, but the same must apply to UK partnerships.

The co-ownership analysis would give a different answer. But the context shows that the chose in action analysis is preferable, since in many common partnership situations, tracing from a partnership contribution to the partnership assets is simply impractical.

This conclusion is consistent with the rule that partnership income is regarded as income of the partners; in that sense partnerships are said to be transparent.[321] There is no contradiction, for the issues and statutory provisions are different: there is no general principle of income tax transparency which requires the same answer in every context.[322]

This conclusion is consistent with s.848 ITTOIA (partnership not an entity for IT purposes) as it is based on the nature of a partnership, and does not depend on a conception that a partnership is an entity; in any case, the purpose of s.848 relates specifically to assessment.[323]

For these reasons, the Manual's view is correct.

The RDR Manual adds four qualifications:

> **RDRM33530. Partnerships** [Jan 2019]
> ... [1] In cases where there does appear to be a benefit to an individual partner (or to another relevant person) from money or other property brought into UK by the partnership, or from a service provided in the UK for which the partnership gives consideration then you should examine the transaction and the partnership documents very carefully to identify the source of the partnership funds.

This is considering whether a capital contribution to the partnership is remitted. More analytically, remittance condition A is satisfied if a partnership asset is used in the UK for the benefit of a relevant person, or if the partnership pays the consideration for a service provided in the UK to a relevant person. But remittance condition B is not satisfied, as even if the partnership asset or consideration derived from the individual's income/gains, the property is not property of a relevant person. Instead condition D needs consideration (see below).

The Manual continues:

[321] See 85.16 (Partnership transparency: IT/CT).

[322] See 90.6.1 (Transparent/opaque terminology).

[323] See 85.17 (Entity disregard rule).

> **RDRM33530. Partnerships** [Jan 2019]
> [2] The provision of the property or service by the partnership may be a remittance of that individual's 'share' in partnership profit. To the extent that the individual's share in partnership profit falls to be regarded as relevant foreign income (see below) there may be a remittance.

This is considering whether partnership income/gains are remitted.

The Manual continues:

> **RDRM33530. Partnerships** [Jan 2019]
> [3] You may also need to examine whether there is a true partnership, or whether in fact it is the individual's foreign income or gains that have been remitted.

Whether there is a partnership is a question of partnership law. That should not cause difficulties, if documentation and implementation are correct, but it depends on the facts.[324]

> [4] Alternatively there may be a connected operation to which Condition D of ITA07/s809L(5) applies. ...

The Manual wisely does not explain any further; it is possible that remittance condition D could be satisfied, if the individual enjoys a benefit from partnership property in the UK, though the HMRC argument is not completely straightforward.

Suppose the partnership borrows and brings the borrowed money to the UK. The debt is a relevant debt. If the partnership then repays the debt out of property derived from income/gains of P, there is in principle a relevant-debt remittance.

18.49.2 *Income/gains contributed to partnership*

The RDR Manual 33530 provides:

> **RDRM33530. Partnerships** [Jan 2019]
> ... It follows [from the statement of the partnership law position] that a remittance basis user who uses his foreign income or gains to make a capital contribution to a UK partnership acquires a UK asset; namely a share in the UK partnership, in exchange for his 'equity' subscription in the partnership. Thus the foreign income or gains that he uses to contribute to the partnership will be a taxable remittance within ITA07/s809L.

[324] See 85.5.3 (Formation of partnership).

> This is so even if the individual places his investment into the partnership's overseas account, and the UK partnership is only investing or trading overseas and not in the UK.

The text does not say what it means by "UK partnership" - presumably it means an interest in which is UK situate, on common law/international law principles: that is, a partnership which is managed and controlled in the UK.[325]

It is in principle correct that if a person who is not a partner uses offshore income/gains to acquire a share in a UK situate partnership, there is a taxable remittance.[326]

On the other hand, if all the partners of an existing partnership contribute further partnership capital in proportion to their partnership shares, no-one acquires a larger partnership share than before, and there is nothing received in the UK.

If a partner lends income/gains to a partnership, there might be a taxable remittance if the loan is a UK situate asset.[327]

18.49.3 *Partnership profits remitted*

Where partnership income is RFI[328] the same point arises. There is no taxable remittance if the partnership brings its income to the UK. A partner can only remit income to the UK after it is distributed to them from the partnership.

See too 20.9.4 (Partnership Income/gains mixed with partnership assets): mixed funds.

18.49.4 *Company held by partnership*

Suppose a partnership holds a company. The partners are participators in the company. The company will be a close company (or a non-resident close company), since partners are associates. Accordingly the company is a relevant person in relation to each of the partners. So there is a taxable remittance if income/gains are brought/received/used in the UK by the company; even though there would be no remittance if the same property

[325] See 102.35 (Situs of partnership share).

[326] This assumes that receipt of a UK situate asset is a taxable remittance, ie is a receipt of an asset in the UK. The contrary might be argued: see 18.14.8 (Receipt of UK situate investment asset).

[327] See 18.14.10 (Acquisition of UK debt).

[328] See 85.19 (Partnership income: Remittance basis); 18.17.1 (What is the income?).

was brought/received/used in the UK by the partnership which holds the company! This is the case regardless of the number of partners, because a company held by a partnership is close even if it has hundreds of unconnected partners. Remittance investment relief may mitigate this problem.

18.50 Proceeds of divorce settlement

Suppose T transfers income/gains to W as part of a divorce settlement. It is suggested that the funds in the hands of W are not derived from T's income. They are received for full consideration (in the general sense of that expression).[329] If that is right, remittance condition B is not satisfied even if:

(1) W remits while still a relevant person (before decree absolute);
(2) W applies the funds for the benefit of relevant persons (eg children or grandchildren of T under 18).

However in case HMRC do not agree, W should not bring the funds to the UK until after decree absolute, by which time she has ceased to be a relevant person; and she should ideally not use the funds for the benefit of relevant persons (in relation to H). Then there is clearly no taxable remittance.[330]

18.51 Debit, credit and charge cards

This section considers whether the use of debit, credit and charge cards involves a remittance. The starting point is to understand the legal nature of debit, credit and charge cards. The following analysis draws on *The Law of Bank Payments*.[331]

On the use of a card, three contracts come into being. For present purposes the most important terms of the contracts are as follows:

(1) Cardholder and supplier
This is the contract for goods or services between the cardholder and the person from whom the cardholder purchases goods or services

[329] See App.4.6 (Transfer on divorce).

[330] See 18.26 (Becoming/ceasing to be relevant person: conditions A and B). As to relevant-debt remittances, see 18.22.11 (Debt imposed by law).

[331] Brindle & Cox, (5th ed., 2017), para 4-007. In any particular case it is strictly necessary to review the specific terms governing the card concerned, but I expect that will not usually make any difference in practice. Store-issued cards are not discussed here.

("the supplier"). This contract is the same whether the cardholder pays by card or by cash.

(2) Card-issuer and supplier
The card-issuer undertakes to honour the card by paying the supplier.

(3) Card-issuer and cardholder
   - (a) A *debit* card is issued only by a bank. The contract between the card-issuer bank and cardholder authorises the bank to debit the cardholder's bank account with the amount of the card transaction.
   - (b) Charge and credit cards are different. Here the cardholder is required to make a payment to the card-issuer. A *charge* card requires the cardholder to repay the balance outstanding after a set period.[332] A *credit* card allows the cardholder extended credit.

It is necessary to distinguish between use of cards to obtain (1) cash, and (2) goods or services.

18.51.1 *Card used to obtain cash*

If a debit card is used to obtain cash in the UK from a foreign bank account which is in credit,[333] and the card is used at a branch of the bank which issued the card, then there is clearly a remittance of the money. The same applies if cash is withdrawn from a bank which is not the card-issuing bank, because the third party bank acts as the agent for the card-issuing bank.

The use of a *charge* card to obtain cash in the UK is likewise a remittance. The time of the remittance is when the sum is debited from the individual's bank account (assuming the account is in credit); not when the sahs is obtained by using the card. The position is the same if an individual uses a *credit* card to obtain cash in the UK.

18.51.2 *Card to buy goods/services*

Where a debit card is used to obtain services provided in the UK, remittance condition A is satisfied. Payment to the card issuer out of

[332] In the case of a bank-issued credit card, the issuer is normally authorised to debit the cardholder's bank account to meet a debt due on the card. But in practice this facility is not used unless needed (or the card effectively becomes a debit card).

[333] If the effect of use of the card is to put an account into debit, there is obviously no remittance on ordinary principles, though there will in principle be a relevant-debt remittance when the overdrawn account is repaid.

income/gains satisfies remittance condition B.

Where a debit card is used to obtain goods provided in the UK, remittance condition A is satisfied, but not if the goods are exempt property, which will quite often be the case (clothes, watches, jewellery, or items under £1k).[334] Where that relief does not apply, payment to the card issuer out of income/gains would satisfy remittance condition B.

18.51.3 *HMRC view*

The RDR Manual provides:

> **RDRM36130 Credit Cards and Debit Cards** [Jan 2019]
> *Credit card issued in the UK*
> If a taxpayer who is chargeable on the remittance basis uses a UK credit card to pay for goods or services, either in the UK or overseas and he or she subsequently settles their credit card bill using foreign income or gains, the payment is a taxable remittance.
> The remittance does not have to be received in the UK by the taxpayer, it is sufficient that it is received by the credit card company in the UK.

HMRC do not say why this is so, but perhaps the argument is that the money is used or brought to the UK by a relevant person. This is not the case. [335] However a remittance basis taxpayer should avoid a UK credit card in order to avoid dispute.

> *Credit card issued by an overseas bank or other financial institution*
> Where an overseas credit card is used in the UK, the cardholder is effectively authorising the credit card company to pay the bill for the goods or service in just the same way as if they had instructed the bank to make a payment directly to the person supplying the goods or services.
> The terms of credit card agreements may differ as to the moment of "indebtedness" between the cardholder and the credit card company. However the use of the credit card to pay for goods used or received in the UK, or services provided in the UK by, to, or for the benefit of a relevant person will create a debt.
> The use of the individual's untaxed foreign income or gains to pay the credit card company in respect of the debt will be a taxable remittance. Interest and other such charges should be apportioned accordingly between UK and non-UK goods and services. In most cases a straight proportional split of the interest against each type of expenditure will be

[334] See 19.29 (Exempt property).

[335] See 18.14.3 (Property used in UK).

acceptable; for example if £400 of the debt relates to UK goods which are taxed as a remittance and £600 to non-UK goods and there is an interest charge in relation to that £1,000 debt of £10, then £4 of the interest is also a taxable remittance. However some cards may apply different rates where cash is withdrawn, or depending of date of purchase, in which case the taxpayer will need to compute the interest due on the "relevant debt" part of the payment only.

Note 1: This section may apply to any credit card debt which the individual satisfies using their foreign income or gains, even if they are not the cardholder.

Note 2: If an overseas credit card is used abroad and the account is settled direct to the card company out of overseas income, no liability to UK tax will arise. But if an asset purchased using the card is brought to the UK and subsequently sold here, there will be a taxable remittance, at the date of disposal, up to the amount of any foreign income used to settle the original account.

Debit card issued by an overseas bank or other financial institution

Payments for goods or services that are made using a debit card (for example a Visa debit card or one issued under the brand name "Cirrus") issued by an overseas financial institution are treated in exactly the same way as a cash transaction.

This means that when goods or services are purchased in the UK[336] using a debit card, a taxable remittance is made to the extent of the amount of any overseas income or gains in the bank account. Likewise any cash withdrawals from shops or ATM machines in the UK are taxable cash remittances.

Payment by cheque drawn on an overseas account or by electronic transfer of any kind are also treated in exactly the same way as cash and are potentially taxable remittances of overseas income and gains.

18.52 Gift to charity

A remittance basis taxpayer ("T") making a gift to charity[337] should give:

(1) money (including foreign currency), qualifying for gift aid relief or

(2) foreign assets, qualifying for qualifying investment donation relief.[338]

[336] Author's footnote: More analytically, in the language of condition A, when goods are received in the UK or services are provided in the UK.

[337] This includes some EU and EEA charities: see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), Chapter 3 (Definitions of "Charity"), online version *https://www.taxationofcharities.co.uk*

[338] For these reliefs, see See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), Chapter 15 (Cash Gifts from

The gift may be made out of income/gains, or property derived from income/gains. If the sum given is money the gift should be to a bank account in the name of the charity outside the UK.[339]

For the interaction of gift aid and the remittance basis claim charge, see 17.12.8 (Interaction with Gift Aid).

18.52.1 *Is charity a relevant person*

Suppose:

(1) T gives assets to a charity which receives the assets offshore.
(2) The charity brings the assets to the UK.

There is in principle no taxable remittance, unless the charity is a relevant person in relation to T.

A charitable company would be a relevant person if it is a close company and T or some other relevant person is a participator.[340]

A charitable trust would be a relevant person if T or some other relevant person is a beneficiary.[341] No individual has a legal or equitable (beneficial) interest in a charitable trust, so in the strict sense a charitable trust has no beneficiaries:

> Individuals may benefit from the application of trust moneys but they are not, as individuals, the beneficiaries of the trust and may not enforce its terms.[342]

Individual to Charity (Gift Aid)) and Chapter 21 (Gift of Shares/Land to Charity),online version *https://www.taxationofcharities.co.uk*

[339] I understand that the CAF maintain an offshore account for this purpose (and no doubt some other charities do the same). This is not strictly necessary: see 18.14.6 (Gift to non-relevant person); but HMRC do not agree with that view.

[340] See 18.5 (Relevant person: Companies). There is a reasonable argument that a charitable company cannot be close, but it would be safer to assume that it may be close: see 104.23.10 (Member of charitable co).

[341] See 18.6 (Relevant person: Trusts).

[342] *Re Crown Forestry Rental Trust, Latimer v IRC* [2004] 4 All ER 588 at [29]. Likewise Law Commission, *Capital and Income in Trusts: Classification and Appointment* Consultation Paper No. 175 (2004) para 6.16: "The 'beneficiary' [of a charitable trust] is at all times the public (although the identity of the individuals who incidentally benefit from the carrying out of the charitable purpose may not remain constant)."
Likewise *AG v Cocke* [1988] Ch 414 at p.419: "... the nonsense of alleging that there is any beneficiary in any meaningful sense of that word under a public charitable trust of this nature. It seems probable to me that in almost all charitable trusts there are no individual beneficiaries."

There is a statutory definition but that makes no difference. Section 809M(3)(e) ITA provides:

> "beneficiary", in relation to a settlement, means any person who receives, or may receive, any benefit under or by virtue of the settlement.

It is possible (at least theoretically) that (say) the individual becomes destitute and a charity whose objects include the relief of poverty makes them a grant. However that does not bring the individual within the definition. One must say:
(1) The benefit is incidental (the object of the charitable trust being the relief of poverty, not to benefit the individual) and incidental benefits should be disregarded;[343] or
(2) This possibility is not included in the word "may".[344]

If that were wrong, then (in the absence of a settlor exclusion clause) every charitable trust is within the scope of s.624 ITTOIA is a settlor-interested trust; which cannot be correct. The definition must be read in its context. The purpose is to include discretionary beneficiaries or persons who may be added to the class of beneficiaries.

So a charitable trust is not a relevant person. This is the case even if the individual is a trustee or owner and director of a corporate trustee of the charity. If limited liability is needed, the trust may have a corporate trustee.

What about a company wholly owned by a charitable trust ("a subsidiary company")? The charity trustee is a participator, but it is not a relevant person. For the same reason, s.809L(2)(h) will not apply.[345] So the subsidiary company of a charitable trust is not a relevant person. I mention one exception for completeness: a loan creditor is a participator, so the subsidiary company is a relevant person if the individual (or any other relevant person) is a loan creditor of the subsidiary company. In practice funding for the subsidiary company will usually come from the charity, not from loans directly from the individual or other relevant persons, so this

I stress this because statute does sometimes refer to "beneficiaries" of a charity, eg: s.525(1)(b) ITA, s.561 ITA; s.117 Charities Act 2011. These are examples of the word being used in a loose sense, where it may apply in the context of charitable companies as well as charitable trusts.

[343] See 50.4.9 (School/university fees).

[344] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 13.13 (What does a settlor exclusion clause cover?).

[345] See 18.7 (Body connected with trust).

should not be a problem.

Outstanding loans from the individual to the charity would need further consideration.

18.52.2 *Gifts to charity: Reform*

A rule that a charity is not a relevant person would be sensible and avoid the current illogical distinction between charitable trusts and charitable companies. But if (as advocated in this book) the definition of relevant person was cut back to individuals closely connected to the individual, this problem would fall away.

HMRC say:

> 2.91 A number of responses from the arts and charity sectors suggested that the business investment relief[346] should be extended to allow non-domiciles to bring overseas income and gains to the UK tax-free for the purpose of making donations to, or investments (?) in, UK charities.

I suspect, though it is not completely clear, that the suggestion was that a gift directly to a UK bank account of a charity should not be regarded as a taxable remittance. That reform would make it unnecessary for charities to maintain a foreign bank account. That seems in principle sensible,[347] but HMRC rejected it:

> **Government response**
> 2.92 The Government is committed to encouraging philanthropy. However, there are already tax-efficient ways for non-domiciles to make donations to UK charities[348] and the Government has not seen any

[346] As far as I can see, the proposal has nothing to do with business investment relief; the proposal was framed that way because it was made in the context of a consultation on that relief.

[347] There are two complications. (1) If one is going to change the rule, there is no good reason to limit the change to charities. The same rules should apply to a payment to the bank account of a non-charity, for instance, a gift to a non-relevant person should not have to be made via a foreign bank account. The point illustrates how well meaning reform proposed special interest groups can complicate matters as they may fail to look at the broad picture. (2) The proposal assumes that at present a payment to a UK bank account is a remittance; that is the HMRC view, but it is not correct. see 18.14.6 (Gift to non-relevant person); So what is needed is a change of practice, not a change in the law.
Still, it could all be sorted out easily enough.

[348] It does not say, but presumably this is a reference to planning by a gift to a foreign bank account.

> compelling evidence that extending the business investment relief in the way suggested would lead to a significant increase in the level of donations to UK charities by non-domiciles. It is also very likely that complicated legislation and anti-avoidance provisions would be required. The Government therefore does not intend to take any further action on this issue at the present time...[349]

Thus there is no current prospect of reform.

18.53 Transitional: Pre-2008 property

Para 81 sch 7 FA 2008 provides the starting point:

> The other[350] amendments made by this Part of this Schedule [ie Part 1 which sets out the provisions discussed in this chapter] have effect for the tax year 2008-09 and subsequent tax years.

18.53.1 *Pre-April 08 remittance: Para 86(2) relief*

Under the pre-2008 RFI remittance basis, there was no remittance of RFI if property was remitted *in specie* (not in the form of money). This is now caught by remittance condition B.

Para 86 sch 7 FA 2008 provides a transitional relief:

> (1) Section 809L of ITA 2007 (meaning of "remitted to the UK") has effect subject to this paragraph.
> (2) If, before 6 April 2008, property (including money) consisting of or deriving from an individual's relevant foreign income was brought to or received or used in the UK by or for the benefit of a relevant person[351], treat the relevant foreign income as not remitted to the UK on or after that date (if it otherwise would be regarded as so remitted).

[349] The paragraph concluded "but [the Government] will consider how to increase awareness of ways for non-domiciles to make tax-efficient donations under the existing rules." Nothing was done. Perhaps that was not intended seriously. Or perhaps the Government realised that the current rules are so absurd that the less that is said about them, the better.
HMRC, *Reform of the taxation of non-domiciled individuals: summary of responses to consultation* (2011).
http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf

[350] The word "other" excludes provisions concerning employment-related securities, not discussed here.

[351] The restricted definition of "relevant person" in relation to pre-6 April 2008 income does not apply here; see 18.10 (Relevant person: Pre-2008 income/gain).

I refer to this as **"para 86(2) transitional relief"** and I refer to the asset brought/received/used in the UK as **"the UK asset"**.

The UK asset may be any property, including money. At first sight, the words "including money" seem otiose: the word "property" alone would include money. But para 86(3) transitional relief (discussed below) refers to "property other than money" and (as it was desired to apply para 86(2) transitional relief to money brought to the UK before 2008), it made some sense for the statute refer expressly to property including money, if only for clarity. That avoids any inference that money would not be within para 86(2).

Para 86(2) transitional relief continues to apply even if the UK asset is sold. HMRC appear to accept this in relation to para 86(3) transitional relief (see the example of Heidi, below) and the same must apply in relation to para 86(2). The result is something of a windfall, but there it is.

The RDR Manual provides:

> **RDRM31460 Property derived from RFI not treated as a remittance (1)** [Jan 2019]
>
> *Background*
>
> The introduction of Chapter A1 Part 14 ITA 2007 has extended the meaning and scope of foreign income and gains that become taxable when remitted to the UK. In certain situations, the operation of the previous remittance rules in respect of relevant foreign income meant that it could be brought to the UK without triggering an immediate tax charge. As an example, if an asset such as a car was purchased abroad using relevant foreign income and the car was then brought into the UK, there would be no income or capital gains[352] tax charge when it is brought in. Instead the charge would only occur if/when the asset was sold or otherwise realised for cash in the UK (also refer to RDRM31250 Changes to old regime - cash only).
>
> Property consisting of, or deriving from, relevant foreign income from tax years up to and including 2007-08 may have been brought into the UK prior to 6 April 2008, and the transitional provisions deal with these situations.
>
> ***Transition***
>
> The transitional position is that the new rules contained in s809L do not have effect and that property brought to the UK is not treated as a remittance where:

[352] There is no question of a CGT charge if the car is purchased out of RFI, so the words "or capital gain" are irrelevant. But it does not matter.

> - Property, including money, was acquired either directly or indirectly using relevant foreign income RDRM31140 and was brought to, received, or used in the UK before 6 April 2008.
>
> ***Effect***
>
> Relevant foreign income brought to or used in the UK by the individual or any other relevant person before 6 April 2008 is not regarded as remitted under s809L after 6 April 2008 even if it is still in the UK. So in the example of the car above, even though it is still used in the UK by a relevant person on or after 6 April 2008 it will not be treated as a remittance under s809L.
>
> Also, the same money or property can be sent or taken outside the UK and then brought in again. It will not be regarded as a remittance when brought in a second or subsequent time. ...

The Manual goes on to explain why the transitional relief is restricted to RFI:

> Note: This transitional provision applies only to relevant foreign income because the pre 6 April 2008 position for employment income and capital gains was different. These were always chargeable even if remitted in the form of property rather than cash.

It is debatable whether this correctly states the pre-2008 law, but it does not now matter.

Suppose:

(1) T borrowed to purchase an asset and acquired the asset before 6 April 2008.
(2) T receives the asset in the UK after 6 April 2008.
(3) T repays the borrowing out of RFI after 6 April 2008.

Para 86(2) transitional relief does not apply because the purchased asset is not derived from RFI.

18.53.2 *Pre Mar 08 acquisition: Para 86(3) relief*

Para 86(3) sch 7 FA 2008 provides:

> If, before 12 March 2008, property (other than money) consisting of or deriving from an individual's relevant foreign income was acquired by a relevant person[353], treat the relevant foreign income as not remitted to

[353] The restricted definition of "relevant person" in relation to pre-6 April 2008 income does not apply here; see 18.10 (Relevant person: Pre-2008 income/gain).

> the UK on or after 6 April 2008 (if it otherwise would be regarded as so remitted).

I refer to this as **"para 86(3) transitional relief"**.

Para 86(2) transitional relief applies where property (including "money") was *remitted* before 6 April 2008.

Para 86(3) transitional relief where property (excluding "money") was *acquired* before 12 March 2008, regardless of the date of remittance.

The RDR Manual provides:

> **RDRM31470 Property derived from RFI not treated as a remittance (2)** [Jan 2019]
>
> [The Manual repeats the text of RDR Manual 31460 and continues:]
>
> ***Transition***
>
> The transitional position is that the new rules contained in s809L do not have effect and that property brought to the UK will not be treated as a remittance where:
>
> - property (other than money) was acquired either directly or indirectly by a relevant person using relevant foreign income before 12 March 2008 and is brought to or received in the UK after 5 April 2008.
>
> The exclusion of money is important as it ensures that income arising from sources that have ceased is subject to the rule changes.[354] See s809Y ITA 2007 for the definition of money in these circumstances.
>
> ***Effect***
>
> This provision is similar to that described in RDRM31460. However this provision applies only to the purchase of property abroad before 12 March 2008 using relevant foreign income, where that property remained abroad and was not brought to or used in the UK before 6 April 2008.
>
> ***Example 1*** (Heidi)
>
> H bought a car in Germany on 15 October 2007 using her relevant foreign income.
>
> She kept the car at her German apartment until May 2009 when she decided to bring it to the UK to use here. Under the previous rules there would have been no remittance until the car was sold in the UK.

The HMRC analysis is as follows:

> Under the new rules at s809L the car is regarded as derived from the relevant foreign income and so, without this transitional rule, there would be a taxable remittance of that relevant foreign income in May 2009.

[354] Author's footnote: I am unable to understand this sentence.

> ***Example 1A*** (Heidi)
> As for example 1 but this time H decides that she needs a bigger car. In August 2009 she sells her car in Germany and brings the proceeds to the UK.

The HMRC analysis is as follows:

> The proceeds from the sale of the car derive from H's relevant foreign income and would be regarded as a taxable remittance to the UK under the new rules at s809L. But as H's car (the property) was acquired before 12 March 2008 the transitional rule at paragraph 86(3) applies and what would be regarded as remitted is treated as not remitted. The money from the sale of the car that H brings into the UK is not therefore a taxable remittance.
> There will be no foreign chargeable gain on the disposal of the car because her private motor vehicle is not a chargeable asset.[355]

Since para 86(3) relief applies to property "other than money" the definition of "money" is important. Para 86(5) provides: "money" has the same meaning as in s.809Y ITA; see 19.30.2 ("Money").

If para 86(3) is taken literally, it disapplies the remittance basis for all RFI held in non-"money" form before 12 March 2008! For instance, it would apply to RFI invested in shares.

The possibilities are:

(1) "Property (other than money)" should be taken literally, ie any form of property other than "money" (as defined).

(2) "Property (other than money)" should be taken to refer to chattels (as the drafter of the RDR Manual perhaps assumes).

(1) Solution (1) is far reaching, and the reader may wonder whether it represents the actual intention of the drafter. Of course, the FA 2008 was enacted in such a rush that one can safely say that no-one carefully formulated any intention at all on the extent of para 86.

[355] The RDR Manual is less clear-cut on the position if there is a sale of the asset:
"RDRM36230. Cash only [Jan 2019]
Under the transitional rules introduced in FA 2008 ... any asset purchased out of untaxed relevant foreign income which an individual owned on 11 March 2008 remains exempt from a charge under the remittance basis, for so long as that individual owns it, even if that asset is outside the UK and is imported at a later date. Any asset in the UK on 5 April 2008 is also exempt from a charge under the remittance basis for so long as the current owner owns it, even if that asset is later exported and then re-imported."

(2) One might infer from the RDR Manual that HMRC intended para 86(3) to apply to RFI used to purchase chattels; but the Manual was written much later, and there was no clear statement at the time the Act was passed, so that may be an afterthought. It is also inconsistent with the words "other than money". To read the section in that way amounts to legislation and not construction.

It is considered that solution (1) is to be preferred.

18.54 Transitional relief: Pre-2008 loans

Para 90 sch 7 FA 2008 provides a relief which I call "**transitional loan relief**". Para 90(1) provides:

> This paragraph applies if—
>
> (a) before 12 March 2008, money was lent to an individual outside the UK,
>
> (b) the loan was made for the purpose of enabling the individual to acquire an interest in residential property in the UK (and for no other purpose), and
>
> (c) before 6 April 2008—
>
> (i) the money was received in the UK,
>
> (ii) the individual used the money to acquire an interest in residential property in the UK ("the interest"), and
>
> (iii) repayment
>
> [A] of the debt for the money ("the debt"), or
>
> [B] of payments made under a guarantee of that repayment ("the guarantee"),[356]

[356] Para 90(6) sch 7 FA 2008 defines "guarantee":

"In this paragraph 'guarantee' includes an indemnity, and 'guaranteed' is to be read accordingly."

March 2009 Q&As provides:

Q20: We would also welcome confirmation that the provisions in paragraph 90(1)(c)(iii) apply to a non-UK loan drawn down before 12 March 2008 where there are two (or more) guarantees in place for repayment of the debt, of which only one is secured on the UK residential property.

A: We can only reply in general terms to this query. The way in which this provision will apply will be determined in practice by the details of the particular loan or guarantee transactions in question. We would generally treat repayments of a debt secured on the property itself as falling within the provisions of paragraph 90 regardless of what guarantees might also exist. Likewise, any repayments made under such a guarantee will also be covered by the paragraph. However, any repayments made under a guarantee which is not secured on the UK property will

> was secured on the interest.

Para 90(2) provides the relief:

> Relevant foreign income of the individual used outside the UK before 6 April 2028 to pay interest on the debt is treated as not remitted to the UK.

The individual does not have to occupy the relevant property. However transitional loan relief is restricted in important ways:

(1) The relief applies only to RFI; it does not apply if employment income or gains are used to pay the interest.
(2) The relief applies only to loans for residential property; it does not apply even to loans to pay home improvements or SDLT.
(3) The relief applies only to secured loans.
(4) The relief applies only to loans by individuals, not if the borrowing is by a trust or company.

Suppose:

(1) H borrowed before 2008 to purchase property.
(2) W used her RFI to pay interest on the loan.

Transitional loan relief does not apply as W is not the individual to whom the money is lent.

The effect of the relief in some cases will be to impose a severe tax penalty on a foreign domiciliary who wishes to move house. It also makes re-financing almost[357] impossible as the relief ceases to apply.

18.54.1 *Refinancing pre-2008*

Para 90(4) sch 7 FA 2008 provides:

> If—
>
> (a) before 12 March 2008, money was lent to the individual outside the UK ("the subsequent loan"),
> (b) the subsequent loan was made for the purpose of enabling the individual to repay—
>   (i) the loan mentioned in sub-para (1), or
>   (ii) another loan in relation to which sub-paras (2) and (3) apply (by virtue of this sub-paragraph),

not be covered.

[357] It would be possible for the creditor to assign the benefit of the loan, which may allow some scope for refinancing.

and for no other purpose, and

(c) before 6 April 2008—
  (i) the individual used the money to repay the loan referred to in para (b)(i) or (ii), and
  (ii) repayment of the subsequent loan, or of payments made under a guarantee of that repayment, was secured on the interest,

sub-paras (2) and (3) apply in relation to the subsequent loan (and for this purpose references there to the debt or the loan are to be read as references to the subsequent loan).

18.54.2 *What is loan made for*

March 2009 Q&As provides:

> **Q19:** It would be helpful to understand more fully the meaning of the requirement in paragraph 90(1)(b) that the loan was made for the purpose of acquiring an interest in residential property "and for no other purpose" and in particular to what extent any other purpose might cause the whole loan to fall outside paragraph 90.
>
> In a situation where money is lent before 12 March 2008 from a non-UK bank to an individual (resident but not domiciled in the UK) outside the UK under a facility letter for £5 million. £4.5 million of the facility is initially drawn down and the money used by the individual to purchase a residential property in the UK. Assume for these purposes that the loan was secured on a UK residential property.
>
> Subsequently (and before 12 March 2008) a second tranche of £0.5 million was drawn down under the same loan facility, also outside the UK. The money from the second draw down was used to refurbish the residential property purchased by the first draw down.
>
> **A:** The effect of paragraph 90(1) is to provide transitional provisions for loans made for the purpose of acquiring an interest in residential property in the UK. In this scenario, there are effectively two separate loans, even though they were made under a single facility letter: it is the drawdown of the money rather than the facility letter which constitutes the lending of the money. Therefore the first £4.5m drawn-down was money lent to the individual before 12 March and used to purchase a UK residential property and for no other purpose and was secured on that interest. That being the case, the transitional conditions will apply if, and to the extent which, relevant foreign income is used to pay interest on the debt.
>
> However, because the second £0.5m tranche of money was used to refurbish the property rather than to acquire an interest in it, it is does not

> meet the conditions set out paragraph 90(1)(b). Therefore, any relevant foreign income which is used to pay interest on this part of the debt will be treated as a taxable remittance in the UK.[358]

What if a loan meets the conditions in part? It appears that HMRC accept there can be an apportionment. March 2009 Q&As provides:

> **Q21**: We would welcome guidance on the principles for calculating the interest on that part of the debt which can be paid from relevant foreign income of the individual outside the UK without triggering a taxable remittance (under paragraph 90(2)). We suggest a reasonable approach is to calculate the interest element based on the loan capital ratio (ie that part of the loan which meets the paragraph 90 conditions over total capital of the loan facility), and apply that ratio to the total amount of interest due.
> **A**: The approach you suggest is, in broad terms, one which HMRC would consider acceptable, with the obvious caveat that the actual approach in any specific case would depend entirely on the terms of the loans.

18.54.3 *When is loan made*

December 2008 Q&As provides:

> **Q27 Remittance basis - offshore borrowing** If a mortgage was arranged and contracts for the purchase of the relevant property were exchanged in October 2007 but completion was not until March 31 2008 and the mortgage funds were not drawn down until completion, would this be considered to be an existing mortgage as at 12 March 2008?

HMRC refuse to answer the question:

[358] The RDR Manual provides:
RDRM31501 Transitional Provisions: RFI and offshore loans [Jan 2019]
Example 1 (Jennifer)
Before 11 March 2008 J draws down £100,000 from a mortgage loan with a non-UK bank that is secured on a residential property in the UK, with interest payments made out of relevant foreign income. On 10 March 2008 she draws down a further amount of £21,000 from this mortgage (still secured on the UK property) to fund some home repairs.
Although the full £121,000 has been lent before 12 March 2008, only £100,000 relates to the acquisition on the interest in the property, so it is only the interest payments in relation to the £100,000 draw-down of the loan that are not treated as a remittance.

> **A** The conditions for the grandfathering relief to run would only be met if the "lending" took place before 12 March 2008, providing the funds were received in the UK and used to acquire the interest in the property in question before 6 April 2008. The answer depends on the terms and conditions of the mortgage arrangement, which determine the point at which the funds are regarded as "lent".

The answer does not depend on the terms and conditions of the mortgage arrangement. It depends on when the money was lent which the question states was not until completion. Thus transitional loan relief is not available. This is of course extremely unfair: it may be because of the unfairness that HMRC choose not to answer the question. But the same question is asked later in the Q&As, and receives a straight answer:

> **Q** A UK non-domiciled came to the UK in July 2007. He made an offer to purchase a residential property in the UK in November 2007. The deal became unconditional in February 2008 and entry was agreed for 16 March 2008. He has an offshore mortgage and the loan offer was made prior to 12 March but of course not drawn until 16 March. Does para 90 of Schedule 7 of FA 2008 apply?
> **A** The grandfathering provisions for offshore mortgages apply only where the loan was made before 12 March 2008. This means that the money had to be in the hands of the non-domiciled individual (or for example in the Solicitor's client account) before that date.

18.54.4 *Joint accounts*

March 2009 Q&As provides:

> **Q22:** We would welcome confirmation that the remittance protection in paragraph 90 applies where a husband and wife (or civil partners), both of whom are resident but not domiciled in the UK, have a joint non-UK bank account and a joint offshore mortgage. The offshore mortgage meets the conditions set out in paragraph 90 (1).
> If only one spouse (or civil partner) has relevant foreign income and that spouse makes a payment into a joint non-UK bank account using that relevant foreign income and these funds are then used to pay the interest on the offshore mortgage, then it is our understanding that such payment of interest will not constitute a remittance of any of the relevant foreign income by virtue of paragraph 90.
> **A:** We are not able to provide the confirmation you are seeking because whether there is a taxable remittance in this situation will depend on the composition of the joint account and the way in which the mixed fund rules section 809Q apply to it. Therefore we can again only answer in

> general terms.
>
> Provided the payment of relevant foreign income by one spouse or civil partner into the joint account is the only income within that account (in other words, section 809Q is not in point) which is then used to pay the interest on the mortgage which meets the conditions within paragraph 90(1), then that payment would also fall within paragraph 90.

18.54.5 *"Residential property"*

Para 90(5) sch 7 FA 2008 provides:

> In this paragraph "residential property" has the same meaning as in Part 4 of FA 2003 (see section 116 of that Act).

So we turn to s.116 FA 2003 to find the complex definition:

> (1) In this Part "residential property" means—
>
> (a) a building that is used or suitable for use as a dwelling, or is in the process of being constructed or adapted for such use, and
>
> (b) land that is or forms part of the garden or grounds of a building within para (a) (including any building or structure on such land), or
>
> (c) an interest in or right over land that subsists for the benefit of a building within para (a) or of land within para (b);
>
> and "non-residential property" means any property that is not residential property.
>
> This is subject to the rule in subsection (7) in the case of a transaction involving six or more dwellings.
>
> (2) For the purposes of subsection (1) a building used for any of the following purposes is used as a dwelling—
>
> (a) residential accommodation for school pupils;
>
> (b) residential accommodation for students, other than accommodation falling with subsection (3)(b);
>
> (c) residential accommodation for members of the armed forces;
>
> (d) an institution that is the sole or main residence of at least 90% of its residents and does not fall within any of paras (a) to (f) of subsection (3).
>
> (3) For the purposes of subsection (1) a building used for any of the following purposes is not used as a dwelling—
>
> (a) a home or other institution providing residential accommodation for children;
>
> (b) a hall of residence for students in further or higher education;
>
> (c) a home or other institution providing residential accommodation with personal care for persons in need of personal care by reason

of old age, disablement, past or present dependence on alcohol or drugs or past or present mental disorder;

(d) a hospital or hospice;

(e) a prison or similar establishment;

(f) a hotel or inn or similar establishment.

(4) Where a building is used for a purpose specified in subsection (3), no account shall be taken for the purposes of subsection (1)(a) of its suitability for any other use.

(5) Where a building that is not in use is suitable for use for at least one of the purposes specified in subsection (2) and at least one of those specified in subsection (3)—

(a) if there is one such use for which it is most suitable, or if the uses for which it is most suitable are all specified in the same sub-paragraph, no account shall be taken for the purposes of subsection (1)(a) of its suitability for any other use,

(b) otherwise, the building shall be treated for those purposes as suitable for use as a dwelling.

(6) In this section "building" includes part of a building.

(7) Where six or more separate dwellings are the subject of a single transaction involving the transfer of a major interest in, or the grant of a lease over, them, then, for the purposes of this Part as it applies in relation to that transaction, those dwellings are treated as not being residential property.

(8) The Treasury may by order—

(a) amend subsections (2) and (3) so as to change or clarify the cases where use of a building is, or is not to be, use of a building as a dwelling for the purposes of subsection (1);

(b) amend or repeal subsection (7) and the reference to that subsection in subsection (1).

Any such order may contain such incidental, supplementary, consequential or transitional provision as appears to the Treasury to be necessary or expedient.

18.54.6 *Withdrawal of relief*

Para 90(3) sch 7 FA 2008 provides:

If, at any time on or after 12 March 2008—

(a) any term upon which the loan was made, or any term of the guarantee, is varied or waived,

(b) repayment of the debt, or of payments made under the guarantee, ceases to be secured on the interest,

(c) repayment of any other debt is secured on the interest or is guaranteed by the guarantee, or

> (d) the interest ceases to be owned by the individual,
>
> sub-para (2) does not apply in relation to relevant foreign income used as mentioned there after that time.

I am unable to see the point of conditions (b) and (c).

FAQ Remittances (April 2008) stated that the relief only applies so long as "no further advances are made on or after 12 March". This is not correct, but if any further advances are made care must be taken with the documentation to ensure that there is a new loan (not a variation of an existing one) and the debt is not secured on the individual's interest in the property.

The RDR Manual provides:

> **RDRM31502 Transitional Provisions: RFI and offshore loans - Example 2** [Jan 2019] (Charles)
>
> C is a UK resident remittance basis user and has lived in the UK for several years. He has an existing mortgage that was taken out in 2005 with a non-UK bank that is secured on a house in the UK in which C, his wife and children all live. C pays interest on the loan out of his untaxed relevant foreign income.
>
> The existing mortgage facility includes an open credit facility that allows C to borrow (draw-down) additional funds. On 15 March 2008 C uses the credit facility to borrow a further amount of £100,000 that he intends to use to buy an additional interest in his residential property. The terms and conditions of the original loan facility apply to the further draw-down.
>
> The draw down of additional funds after 12 March 2008 represents a further advance of the mortgage under the original terms, so it is not regarded as 'another debt' secured on the property. It is a 'relevant debt' for the purposes of s809L.
>
> **RDRM31510 Transitional Provisions: Loans in existence before 12 March 2008 - Grandfathering no longer applicable** [Jan 2019]
>
> ...
>
> **Example 1** (Judith)
>
> J is a UK resident, non-domiciled remittance basis user who has an offshore mortgage from an overseas lender that was in place before 12 March 2008 on which she pays interest out of her relevant foreign income.
>
> Under the terms of her loan agreement interest on the loan is at a fixed rate for two years at the end of which J will automatically transfer to the lenders standard variable rate for the remaining ten year period of the loan agreement.

> The ending of the fixed-rate period and the automatic transfer to the variable rate is not regarded as amending or otherwise varying the loan facility, so the 'grandfathering' provision at FA08/para 90 applies to the loan.

In practice in the usual case the move to a floating rate will happen automatically, and the relief will continue to apply.

> **Example 2 (Jane)**
> J is a UK resident, non-domiciled remittance basis user who has an offshore mortgage from an overseas lender that was in place before 12 March 2008 on which she pays interest out of her relevant foreign income.
> Under the terms of her loan agreement the loan is a two-year fixed interest loan. In May 2009, at the end of the two year period, J agrees a new loan with the same bank, for a further period of two years. The new loan has the same terms as her previous loan agreement.
> This is a new loan that is not covered by the grandfathering provisions at FA08/para 90. The new loan is a 'relevant debt'; any payments of interest (or capital) that are made from the Jersey account are a taxable remittance.

18.54.7 *Transitional loan relief: Critique*

No reasons were ever given for the restricted scope of transitional loan relief, so one is left to speculate. If the purpose of the relief is to assist those who have taken out loans on the assumption that the law which existed from 1956 to 2008 would govern the taxation of the interest, and who may now be unable to pay the interest, the restrictions are irrational.

I surmise that the object was specifically to support the residential property market by preventing forced sales by foreign domiciliaries who became unable to repay their mortgages by reason of the new tax charge: If so those who borrowed to buy a house and improve it are particularly unfairly treated. The restriction of relief to RFI is also irrational.[359]

Non-residential property does not qualify for transitional loan relief. Loans to acquire let property had a benevolent treatment under the pre-2008 remittance basis: interest on the loan could be paid out of income without a remittance, but the interest was deductible in computing the profits of the UK property business. Similar points apply to other cases

[359] It was probably based on the erroneous belief that under the pre-2008 rules, employment income or gains used to pay interest were regarded as remitted.

where interest is deductible. Perhaps that was thought to be too generous to justify a transitional relief.

Perhaps the matter was not thought much, if at all, and the only thinking was to provide the smallest possible transitional relief consistent with appeasing the banking lobby or other objectors. Perhaps it was to give the appearance of a transitional relief without much substantial relief. In the absence of any reasons being provided by HMRC, all the above can only be speculation.

18.55 Remittance basis planning

The starting point is not to remit. That must be as old as the remittance basis. Lord Barnett (then Labour Chief Secretary to the Treasury) said:

> I used to advise people not to remit.[360] It was a perfectly legitimate thing to do. It would have been silly to do so. They did not need to do it.[361]

18.55.1 *Avoid mixed fund: Segregation*

In practice individuals may need to bring some funds to the UK. The way to avoid or minimise remittance basis liabilities is to keep funds which are charged at different rates on remittance separate from each other.

The starting point is to segregate clean capital and other funds.[362] Clean capital may consist of:

(1) Funds acquired before arrival in the UK
(2) Gifts[363] and inheritance
(3) Capital distributions from trusts (if not within the many IT and CGT anti-avoidance provisions)
(4) UK income/gains
(5) Foreign income/gains taxed on an arising basis (because no remittance basis claim is made or the individual is deemed domiciled)

[360] In the 1940's and 1950's Barnett was an accountant in private practice.

[361] *Hansard,* Standing Committee A, Finance Bill debate 20 June 1974, col.426. Again HC Deb 22 July 1974 vol 877 cc1114-37: "They avoided tax by not remitting the pension, and that was perfectly proper. There was no need for them to pay the tax and they did not do so." *https://api.parliament.uk/historic-hansard/commons/1974/jul/22/foreign-pensions-or-annuities*

[362] See 18.55.1 (When are funds mixed).

[363] Unless the donor is a remittance basis taxpayer making a gift of income/gains to a relevant person.

If funds are large enough, and there is not enough clean capital alone, it may be worth segregating:

(1) Income taxable on remittance:
 (a) at the top rate
 (b) at the top dividend rate
 (c) at lower rates (because of DT relief)

(2) Chargeable gains taxable on remittance:
 (a) at the full CGT rate
 (b) at lower CGT rates (because of DT relief)

(3) Clean capital

Funds can then be remitted from accounts with a lower or nil rate of tax. Income taxable at the top rate can be used abroad or reinvested. Thus one may need as many as six accounts. The reader may think that a tax system which requires this may benefit from simplification, but HMRC do not agree.[364]

Once an individual has become deemed domiciled (or decides not to claim the remittance basis charge) income is taxed on an arising basis. That may be remitted, and may be paid into a mixed fund (because it comes out of the fund first); but care is still needed not to transfer unremitted income/gains into a clean capital account, under the offshore transfer rules.

HMRC accept this planning. The CG Manual provides:

> **CG25385 Remittance basis: mixed funds: summary** [Nov 2019]
> ... Taxpayers may prefer to create and operate a number of bank accounts so that income and capital from various sources or of various years is always clearly identifiable as such and the mixed fund rules do not apply when transfers are made from those accounts. This is not in principle objectionable...[365]

How does one segregate funds? An easy course is to keep clean capital in a bank account and pay the income into a separate account. The bank

[364] See 20.21 (Mixed funds: Critique).

[365] Another example: HMRC 2018 Cleansing Guidance example 7 provides: "If he wants to safeguard the 3 new accounts and his other 4 cleansed accounts from becoming mixed fund accounts in the future, Hamid will have to ensure that any funds accruing in each account (for example, interest) are paid into a separate account to prevent 'tainting' of the funds."
See *https://www.gov.uk/guidance/cleansing-mixed-funds*

account may be in any currency as currency bank account gains are not taxed.

What if the individual does not want to hold cash for an extended period, and wishes to be able to invest in a wider class of assets? Possible solutions are:

(1) Borrowing charged on investments which are clean capital.
(2) Life insurance policy[366] purchased out of clean capital. The individual may surrender up to 5% of the policy tax free, per annum, and that amount is derived from the clean capital, and can be remitted tax free. The growth in the policy reflects the underlying investments but the gains on those investments do not form a mixed fund. The gain on the ultimate surrender of the policy is taxable, but the proposal may be attractive if it is anticipated that will be when the policyholder is non-resident (and not temporarily non-resident).

18.55.2 *Planning when mixed fund exists*

Suppose T already has a substantial mixed fund holding income and gains. Some planning is still possible. T should begin segregating income from the fund, allowing capital gains to accrue within the fund. Subsequent remittances are regarded as taken from those gains first before the income of earlier years. If the gains are sufficient to exceed the remittances, this will reduce the rate of charge on remittance to CGT rates, as gains of subsequent years are treated as remitted before income of earlier years.

18.56 Reform

HMRC have rejected calls for simplification:

> The Government will not look further at the following:
> *Simplification* Definition of a remittance and the derivation rules
> *Government response* The Government recognises that the definition of a taxable remittance is widely defined but believes any change to narrow the rules would open up opportunities for abuse and an unacceptable risk to the Exchequer.[367]

[366] But not a personal portfolio bond.

[367] HMRC & HMT, “Reform of the taxation of non-domiciled individuals: summary of responses to consultation” (December 2011) para 2.127 *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf*

CHAPTER NINETEEN

REMITTANCE RELIEFS

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19.1 Remittance reliefs: Introduction

This chapter considers 8 reliefs which allow property to be received in the UK without a taxable remittance:

Relief	**See para**
Investment relief	19.2
Paying remittance basis charge	19.24
Foreign services relief	19.25
Exempt property remittance reliefs:	19.29
(a) public access	19.31
(b) personal use	19.32
(c) the repair rule	19.33
(d) temporary importation	19.34
(e) small remittances	19.35

19.2 Remittance investment relief

The ITA remittance basis in its original 2008 form (more or less) prevented remittance basis taxpayers from investing in the UK, either directly or indirectly through trusts and companies.

The coalition government introduced the relief in 2012. It is slotted in after s.809V ITA, so the 15 sections are numbered ss.809VA - 809VO.[1] The statutory heading is "business investment relief". Although it is usually best to adopt statutory terminology, I prefer for clarity to call it **"remittance investment relief"** (or, in this chapter, where the reference is clear, just "investment relief").[2]

The introduction of protected-trust relief in 2017 reduced the need for the relief, because income/gains arising in a protected trust, or underlying company, can in principle be brought to the UK for investment, without a taxable remittance.[3] The relief is only needed if the funds invested in the UK are (or derive from) foreign income/gains of an individual, which would in principle be taxable if remitted. Common examples are:

(1) Income/gains of the individual directly
(2) Income gains of a company held directly (not in a trust) within s.3 or s.720
(3) Benefits taxable under the s.87 or s.731 remittance basis

The development of the relief can be traced through:

- a consultation paper[4]
- consultation response paper[5] (**"consultation response document"**)

[1] See App. 13.3 (Section numbering system).

[2] I guess the more bland and unhelpful label "business investment relief" was chosen for presentational reasons. "Business investment" is a positive spin: who could object to business investment? But presentation is of course important.

[3] See 92.9 (s.624 protected-trust relief); 92.8 (s.720: Protected-trust relief). Protected-trust relief is better, as it does not have the onerous conditions and traps of remittance investment relief.

[4] HMRC, *Reform of the taxation of non-domiciled individuals: a consultation* (2011) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81510/consult_condoc_non_domicile_individuals.pdf*

[5] HMRC, *Reform of the taxation of non-domiciled individuals: summary of responses to consultation* (2011). *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf*

- a guidance note[6]

But these are now of mainly historical interest.

Some of the drafting is loosely derived from other reliefs, such as community investment relief[7] and social investment relief[8].

19.3 Relevant event

Section 809VA(1) ITA sets out three conditions for relief. The first is in para (a):

> (1) Subsection (2) [remittance investment relief] applies if–
> (a) a relevant event occurs,

The term "relevant event" is an opaque label, but it is better to follow the statutory usage as anything else is even more confusing.

There are two types of relevant event.

19.3.1 *Relevant event: Investment*

Section 809VA(3) ITA provides:

> A "relevant event" occurs if money or other property–
> (a) is used by a relevant person to make a qualifying investment[9]

The RDR Manual provides:

> **RDRM34330 Qualifying Investments Overview** [Jan 2019]
> ...Sometimes investments are made in qualifying companies via nominees rather than directly by a relevant person. Strictly this would mean the investment failed to qualify for business investment relief as the investment must be made by a relevant person (section 809VA(3)(a) ITA 2007). However HMRC will not reject a claim to business investment relief in cases where a relevant person subscribes for shares in a qualifying company through a nominee provided that relevant person is able to demonstrate they have beneficial ownership of those shares and that all of the other conditions for the relief are met.

It seems to me that HMRC practice is correct as a matter of law, not

[6] HMRC Guidance Note: Changes to the Remittance Basis (2012) *https://www.gov.uk/government/publications/guidance-note-changes-to-the-remittance-basis*

[7] Part 7 CTA 2010; Part 7 ITA.

[8] Part 5B ITA.

[9] See 19.9 ("Qualifying investments").

concession: an investment made by a nominee counts as made by the beneficial owner.[10] But the issue is not likely to arise.

19.3.2 *Remittance for investment purpose*

Section 809VA(3) ITA provides:

> A "relevant event" occurs if money or other property...
> (b) is brought to or received in the UK in order to be used by a relevant person to make a qualifying investment.

Section 809VA(5) ITA imposes a time limit on the period between bringing the money to the UK and making the investment:

> Subsection (2) [remittance investment relief] applies by virtue of subsection (3)(b) to the extent only that the investment is made within the period of 45 days beginning with the day on which the money or other property is brought to or received in the UK.

Section 809VA(6) ITA deals with the situation where some of the money brought to the UK is used to make the investment:

> Where some but not all of the money or other property is used to make the investment within that 45-day period, the part of the income or gains to which subsection (2) applies is to be determined on a just and reasonable basis.

19.4 Remittance by virtue of relevant event

Section 809VA(1) ITA sets out three conditions for relief. The second is in para (b) but this must be read with para (a) to follow the sense:

> (1) Subsection (2) [remittance investment relief] applies if–
> (a) a relevant event occurs,
> (b) but for subsection (2), income or chargeable gains of an individual would be regarded as remitted to the UK by virtue of that event...

19.4.1 *"Income/gains of individual"*

The relief applies to income treated as arising to an individual under s.624, or s.720, or gains treated as accruing under s.3, even though the income or gains actually arise to a non-resident trust or company and are invested (and so remitted) by the trust or the company. This was deliberate.

[10] See 87.7.4 (Tax treatment of bare trust).

HMRC say:

> 2.34 It is common for non-domiciles to hold money in offshore trusts but the tax treatment of remittances currently deters some offshore trusts and companies from investing in the UK. For this reason, it is not proposed to limit the new tax incentive to investments made directly by the individual. There will be no restriction on individuals remitting overseas income or capital gains which are held in investment vehicles or trusts. This will allow non-domiciles to invest in UK businesses using funds held in offshore companies and trusts without attracting a tax charge on the remittance.[11]

Suppose:
(1) an individual receives a benefit chargeable under the s.87 remittance basis or the s.731 remittance basis and
(2) the individual uses the benefit to make a qualifying investment.

Investment relief applies, as the income or gains invested are the income or gains of the individual.

Similarly, investment relief applies if:
(1) an individual receives a benefit chargeable under the s.731 remittance basis and
(2) the person abroad uses matched relevant income to make a qualifying investment.

It is not a requirement that the income used to make the investment is the income of the individual: just that income of the individual would be regarded as remitted by virtue of the relevant event.

However in these cases, consideration must be given as to whether the benefit is a related benefit.

19.4.2 *"By virtue of" relevant event*

The requirements for relief in s.809VA(1)(b) are:
(1) a relevant event
(2) income/gains remitted to the UK and
(3) the remittance is "by virtue of" the relevant event.

[11] HMT & HMRC, "Reform of the taxation of non-domiciled individuals: a consultation" (2011) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81510/consult_condoc_non_domicile_individuals.pdf*

Suppose:

(1) T lends to a company or subscribes for shares in a company.

(2) The company uses the funds to purchase a property in the UK.

Step (1) is a relevant event. If it is also a remittance to the UK, the position is straightforward: the relief applies.

Suppose step (1) is not a remittance to the UK (in short, because the company is an offshore company which receives the funds outside the UK). There is a taxable remittance at step (2) when the company brings the funds to the UK.[12] However the company does not make a qualifying investment so step (2) is not a relevant event. But it is considered that the remittance is "by virtue of" the relevant event at step (1), so the relief applies. HMRC agree. The RDR Manual provides:

> **RDRM34330: Qualifying investments - overview** [May 2020]
> It is possible for a qualifying investment to be made in a close company which is itself a relevant person [see RDRM33030]. In such cases, where the company subsequently uses the invested funds in the UK, for example to purchase stock or to pay employees, the foreign income and gains will not be treated as a taxable remittance, provided they are not used in a way which would itself be a potentially chargeable event [see RDRM34390].

Suppose:

(1) T borrows to make a qualifying investment. This is a relevant event but no income/gains are remitted to the UK.

(2) T uses income/gains to repay the loan. This is a remittance of the income/gains.

HMRC accept that the relief applies. CIOT say:

> HMRC have confirmed that using foreign income and/or gains to repay loans where those loans, in turn, funded investments made after 6 April 2012, would in principle qualify for the business investment relief.
> Concerns had been expressed on this point because s809VA(1)(b) gives relief only where (in the absence of the relief) income or chargeable gains would be regarded as remitted by virtue of the investment. Where borrowed monies are used to make the investment, it is not the investment which (in the absence of the relief) triggers the remittance; rather it is the subsequent repayment of that borrowing which triggers the

[12] Assume the company is a relevant person (as a close company would be).

> remittance.
>
> However, HMRC have confirmed that they take a wide view of the meaning of 'by virtue of' in this context and there is nothing in s809VA which requires that the remittance which would otherwise have occurred should take place in the same year as the relevant event to which it relates. It therefore follows that the remittance and claim can be in a year or years after the relevant event.
>
> For non-doms wishing to invest in this way, there is therefore scope – through borrowing – to fund that investment through future offshore income/gains.
>
> Claims should be made in the year(s) that the loan is repaid rather than the year the investment is made and careful records will obviously need to be kept for these purposes.[13]

It would have been better if the statutory expression was "in connection with" the relevant event, not "by virtue of" the relevant event. But a generous construction, together with the flexibility inherent in a causation test, has brought us to the same destination.

Section 809VA(4) ITA confirms that relief is available following an exempt property clawback charge:

> Subsection (1)(b) includes a case where income or gains would be treated under section 809Y[14] as remitted to the UK by virtue of the relevant event.

That seems self-evident, though it will rarely if ever happen in practice.

19.5 Claims

The third condition for the relief is in s.809VA(1)(c) ITA which provides:

> Subsection (2) [remittance investment relief] applies if ...
>
> (c) the individual makes a claim for relief under this section.

Section 809VA(8) ITA provides:

> A claim for relief under this section must be made on or before the first anniversary of the 31 January following the tax year in which the income or gains would, but for subsection (2) [remittance investment relief], be regarded as remitted to the UK by virtue of the relevant event.

The claim is made in the tax return. The sidenote to box 38 SA109

[13] Press release 15 August 2012 [2012] STI 2563.

[14] See 19.36 (Exempt property clawback charge).

(2022/23) reads:

> If you are claiming relief from UK tax for foreign income or gains invested in a qualifying business, enter the total amount invested and the Company Registration Numbers below

The RDR Manual provides:

> **RDRM34380 Claiming Business Investment Relief** [Jan 2019]
> ... It is not necessary for an individual to claim the remittance basis in the year the investment is made...

That is self-evident. But of course the individual must have been a remittance basis taxpayer at some point, in order to hold foreign income/gains taxable on the remittance basis.

19.6 The relief

Assuming the three conditions in s.809VA(1) are satisfied, we can turn to the relief, which is in s.809VA(2) ITA; but to follow that one needs to read subsections (1) and (2) together:

> (1) Subsection (2) [remittance investment relief] applies if–
> (a) a relevant event occurs,
> (b) but for subsection (2), income or chargeable gains of an individual would be regarded as remitted to the UK by virtue of that event, and
> (c) the individual makes a claim for relief under this section.
> (2) The income or gains are to be treated as not remitted to the UK.

19.7 Investment relief TAAR

Section 809VA(7) ITA provides:

> Subsection (2) [remittance investment relief] does not apply if the relevant event occurs, or the investment is made, as part of or as a result of a scheme or arrangement the main purpose or one of the main purposes of which is the avoidance of tax.

Section 989 ITA provides:

> The following definitions apply for the purposes of the Income Tax Acts
> ...
> "tax", if neither income tax nor corporation tax is specified, means either of those taxes.

So it does not matter if the purpose of the arrangement is IHT avoidance or CGT avoidance: only IT (or CT) avoidance counts.

The HMRC consultation paper provided:

> 2.53 ... there will be provisions to prevent non-domiciles buying a pre-existing business from themselves by selling it to a new company funded by income remitted from overseas. This would create no new business investment in the UK and would merely transfer legal ownership whilst the individual continues to own the business.[15]

There are no express provisions to this effect, but the arrangement may constitute avoidance and so the relief would be disallowed.

CIOT lobbied for repeal of this TAAR:

> That test is a potential deterrent as nobody can say with certainty what kind of transaction a particular officer of HMRC, or an individual judge, will view as avoidance. ...We would urge removal of section 809VA(7), particularly now that the GAAR has been enacted.[16]

But no-one took any notice of that.

19.8 Investment fails to proceed

A person may bring funds to the UK intending to make an investment which fails to proceed. Then there is no relief under s.809VA(2) ITA as there is no relevant event, but s.809VB ITA provides relief:

> (1) This section applies to any portion of the income or gains to which section 809VA(2) [remittance investment relief] does not apply because the investment was not made within the period mentioned in section 809VA(5) ("the 45-day period").
> (2) That portion is to be treated as not remitted to the UK to the extent that the remaining money or other property is taken offshore within the 45-day period.
> (3) Where some but not all of the remaining money or other property is taken offshore within the 45-day period, the part of the income or gains to which subsection (2) applies is to be determined on a just and reasonable basis.

[15] HMRC, *Reform of the taxation of non-domiciled individuals: a consultation* (2011) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81510/consult_condoc_non_domicile_individuals.pdf*

[16] Business Investment Relief: CIOT comments (2013) *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/f01bc071-e903-4a8c-bd7a-a7cdc76fdf6d/160926%20BIR%20-%20earlier%20CIOT%20and%20HMRC%20correspondence.pdf*

> (4) If any remaining money or other property is taken offshore within the 45-day period, nothing in subsection (2) prevents anything subsequently done in relation to it (or anything deriving from it) from counting as a remittance of the underlying income or gains to the UK at the time when the thing is subsequently done.
> (5) A reference to the "remaining" money or other property is to so much of the money or other property brought to or received in the UK as is not used within the 45-day period to make the investment (which may in some cases be all of it).

19.9 "Qualifying investment"

This is a key term used throughout the remittance investment relief provisions; in particular, a relevant event requires a qualifying investment. Section 809Z10 ITA provides:

> In this Chapter ... "qualifying investment" has the meaning given by section 809VC (and references to making a qualifying investment are to be read in accordance with that section)

So we turn to s.809VC.

19.9.1 *"Investment"*

"Investment" has an artificial meaning. Section 809VC(1) ITA provides:

> For the purposes of section 809VA, a person makes an investment if–
> (a) shares[17] in a company are issued to or acquired by the person, or
> (b) the person makes a loan (secured or unsecured) to a company.

This definition applies only for s.809VA, so it needs to be incorporated when the same term is used elsewhere: s.809VD(4) ITA.

Non-corporate investments do not count as "investment" and do not qualify for relief. HMRC say:

> 2.43 The Government is not yet convinced of the case for including partnerships within the relief. It remains concerned that extending the relief in this way could lead to large scale avoidance unless complex anti-avoidance legislation was introduced. The legislation which will take effect from 6 April 2012 will not allow investment in partnerships.
> 2.44 However, in view of the strength of support for extending the relief

[17] Section 809VC(6) ITA provides: "A reference in this section to "shares" includes any securities." This is an artificial definition of shares; it would have been better drafting to refer to securities and define that term to include shares; but it does not matter.

> to investments in partnerships and the increased investment that this might encourage, the Government will consider this issue further to evaluate whether there is any scope for widening the relief to include investment in partnerships in Finance Bill 2013. The Government will not consider extending the relief to sole traders.[18]

Nothing happened, and OTS floated the same idea three years later.[19] HMRC responded:

> HMRC is considering this proposal in more detail, however, it is very likely that the costs associated with this change will rule out taking this proposal further.[20]

Again nothing happened, and the proposal has been dropped.

Section 809VC ITA provides some terminology:

> (2) The company is referred to as "the target company".
> (3) The shares or the person's rights under the loan (or both) forming the subject of the investment are referred to as "the holding"...

Section 809VC ITA deals with the question of when an investment by way of loan is made:

> (7) If a loan agreement authorises a company to draw down amounts of a loan over a period of time—
> (a) entry into the agreement does not count for the purposes of this section as the making of a loan, but
> (b) a separate loan is to be treated as made each time an amount is drawn down under the agreement.
> (8) Accordingly—
> (a) a separate investment is treated as made each time an amount is drawn down under the agreement, and
> (b) the reference in subsection (3) to the person's rights under the loan applies only to so much of the person's rights as relate to the drawdown of that particular amount.

[18] Consultation Response Document (2011) *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf*

[19] OTS, "Review of partnerships: interim report" (2014) para 3.50 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/274278/PU1619_OTS_Partnerships_Interim_report.pdf*

[20] OTS, "Review of partnerships: final report" (2015) Annex D, p.51. *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/396668/ots_partnerships_report_final.pdf*

19.9.2 *"Qualifying" investment*

Section 809VC(4) ITA provides:

> The investment counts as a "qualifying investment" if conditions A and B are met when the investment is made.

I refer below to **"investment conditions A and B"**.

19.10 Condition A: Trading co/group

Section 809VD(1) ITA provides:

> Condition A is that the target company is–
> (a) an eligible trading company,
> (b) an eligible stakeholder company,
> (ba) an eligible hybrid company, or
> (c) an eligible holding company.

I refer to these together as "eligible companies".

19.10.1 *Trading/stakeholder/hybrid co*

It is helpful to see the definitions side by side:

s.809VD(2) ITA	**s.809VD(3) ITA**	**s.809VD(3A) ITA**
eligible trading company	*eligible stakeholder company*	*eligible hybrid company*
A company is an "eligible trading company" if–	A company is an "eligible stakeholder company" if–	A company is an "eligible hybrid company" if—
(a) it is a private limited company,	(a) it is a private limited company,	(a) it is a private limited company,
		(b) it is not an eligible trading company or an eligible stakeholder company,
(b) it carries on one or more commercial trades or is preparing to do so within the next 5 years, and	(b) it exists wholly for the purpose of making investments in eligible trading companies (ignoring any minor or incidental purposes), and	(c) it carries on one or more commercial trades or is preparing to do so within the next 5 years,
	(c) it holds one or more such investments or is preparing to do so within the next 5 years.	(d) it holds one or more investments in eligible trading companies or is preparing to do so within

	the next 5 years, and
(c) carrying on commercial trades is all or substantially all of what it does (or of what it is reasonably expected to do once it begins trading).	(e) carrying on commercial trades and making investments in eligible trading companies are all or substantially all of what it does (or of what it is reasonably expected to do once it begins operating).

Section 809VD(4) ITA provides:

> The references in subsections (3) and (3A) to making investments is to be read in accordance with section 809VC.[21]

19.10.2 *Eligible holding company*

Section 809VD ITA provides:

> (5) A company is an "eligible holding company" if—
> (a) it is a member
> [i] of an eligible trading group or
> [ii] of an eligible group that is reasonably expected to become an eligible trading group within the next 5 years,
> (b) an eligible trading company in the group is a 51% subsidiary of it, and
> (c) if the ordinary share capital that it owns in the eligible trading company is owned indirectly,[22] each intermediary in the series is also a member of the group.
> (6) "Group" means a parent company and its 51% subsidiaries.[23]
> (7) "Parent company" means a company that—
> (a) has one or more 51% subsidiaries, but
> (b) is not itself a 51% subsidiary of any company.
> (8) A group is an "eligible group" if the parent company and each of its 51% subsidiaries are private limited companies.
> (9) A group is an "eligible trading group" if—
> (a) it is an eligible group, and

[21] See 19.9.1 ("Investment").

[22] Section 809VD(10) ITA provides: "The reference in subsection (5) to owning ordinary share capital indirectly is to be read in accordance with section 1155 of CTA 2010." See 64.26.2 (Indirect ownership).

[23] See 64.26 ("51/75/90 % subsidiary"); 64.24 (CG Group reliefs).

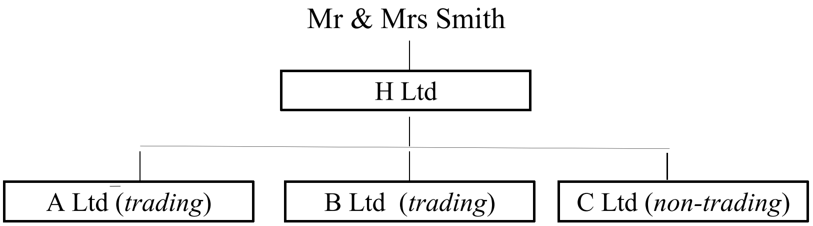
(b) carrying on commercial trades is all or substantially all of what the group does (taking the activities of its members as a whole).

A group may consist of resident and non-resident companies.

The RDR Manual provides:

> **RDRM34355 Eligible Holding Company** [Jan 2019]
> ...All the companies in the group must be private limited companies for the group to be an eligible trading group. The group activities, as a whole, must be the carrying on of commercial trades. It is not necessary for all the members of the group to carry on a trade; the test is that, considering the activities of all the group members together, all or substantially all, of what the group does is carrying on commercial trades.
>
> Whether or not carrying on a commercial trade is all or substantially all of an eligible trading group's activities will depend on a consideration of all the relevant facts. However, where carrying on a commercial trade accounts for at least 80% of an eligible group's total activities, the group will generally be regarded as meeting this requirement ...
>
> *Example 1*
>
> The shares in holding company H Limited are all owned by Mr and Mrs Smith, making it a private limited company. H Limited owns 100% of the share capital in A Limited, B Limited and C Limited. As it is not itself a subsidiary company, and each of its subsidiaries are private limited companies, H Limited is the parent company of an eligible group.

Diagrammatically:



> If the activity of C Limited is negligible, so that substantially all that the group does is carry on a commercial trade, the group will qualify as an eligible trading group. Qualifying investments could be made directly in H Limited (an eligible holding company), A Limited or B Limited (both eligible trading companies); however direct investments in C Limited would not be eligible for relief.
>
> If the activities of C Limited were significant enough to mean that the group was not an eligible trading group. H Limited would not be an eligible holding company. However, investments could still be made

directly in A Limited and B Limited if they were eligible trading companies.[24]

19.10.3 *Substantially trading*

In the following discussion the **"standard definition"** of trading company is the one found in the following contexts:

Context	**Provision**
Hold-over relief	s.165A(3) TCGA
Business asset disposal relief	s.236I(2) TCGA
Substantial shareholding exemption	Para 20(1) Sch 7AC TCGA[25]

It is helpful to consider "eligible trading company" condition (c) together with the standard definition of "trading company". They raise (more or less) the same issues, so guidance on one is relevant on the other:

s.809VD(2) ITA definition	**Standard definition**
A company is an "eligible trading company" if ... (c) carrying on commercial trades is all or substantially all of what it does (or of what it is reasonably expected to do once it begins trading).	"Trading company" means a company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities.

The RDR Manual provides:

> **RDRM34345 Eligible Trading Company** [Apr 2019]
> ... The phrase 'all or substantially all' used in the definition of an eligible trading company is not defined in the legislation. Whether or not carrying on a commercial trade is all or substantially all of a trading company's activities will depend on a consideration of all the relevant facts. However, where carrying on a commercial trade accounts for at least 80% of a company's total activities, the company will generally be regarded as meeting this requirement.

The CG Manual discusses the standard definition:

[24] The Manual has a second example not printed here as it does not add much to the first.

[25] Para 20 differs from the standard definition by adding a definition of "trading activities" which is not found elsewhere.

CG64090: trading company and holding company of a trading group - the meaning of "substantial" [Oct 2020]

... Most companies and groups will have some activities that are not trading activities. The legislation provides that such companies and groups still count as trading if their activities "… do not include to a substantial extent activities other than trading activities". The phrase "substantial extent" is used in various parts of the TCGA92 to provide some flexibility in interpreting a provision without opening the door to widespread abuse. Substantial in this context means more than 20%.

The question to ask is how should a company's non-trading activities be measured to assess whether they are substantial?

There is no simple formula to this but some, or all, of the following are among the measures or indicators that might be taken into account in reviewing a particular company's status. These indicators, adopted for Business Asset Disposal Relief, are the same as those used for the old taper relief and in the Substantial Shareholding Exemption for corporation tax.

Income from non-trading activities

For example, a company may have a trade but also let an investment property. If the company's receipts from the letting are substantial in comparison to its combined trading and letting receipts then, on this measure in isolation, the company would probably not be a trading company.

The asset base of the company

If the value of a company's non-trading assets is substantial in comparison with its total assets then again, on this measure, this could point towards it not being a trading company. If a company retains an asset it previously used, but no longer uses, for the purposes of its trade, this may not be a trading activity (but see above regarding surplus trading premises). In some cases it might be appropriate to take account of intangible assets (e.g. goodwill) that are not shown on a balance sheet in considering a company's assets. Current market value and amounts given by way of consideration for assets may both be appropriate measures of the relative extents of a company's trading and other activities. Which measure is appropriate will depend on the facts in each case.

Expenses incurred, or time spent, by officers and employees of the company in undertaking its activities

For example, if a substantial proportion of the expenses of a company were to be incurred on non-trading activities then, on this measure, the company would not be a trading company. Or a company may devote a substantial amount of its staff resources, by time or costs incurred, to

> non-trading activities.
>
> **The company's history**
>
> For example, at a particular instant certain receipts may be substantial compared to total receipts but, if looked at on a longer timescale, for instance if a company's trade was seasonal, they may not be substantial compared to other receipts over that longer period. Looked at in this context, therefore, a company might be able to show that it was a trading company over a period, even where that period may have included particular points in time when non-trade receipts amounted to a substantial proportion of total receipts.
>
> **Balance of indicators**
>
> The indicators discussed should not be regarded as individual tests to which a 20% "limit" applies. They are factors, or indicators, that may be useful in establishing whether there is substantial overall non-trading activity. It may be that some indicators point in one direction and others the opposite way. You should weigh up the relevance of each in the context of the individual case and judge the matter "in the round" (see approach of the Special Commissioner in the IHT case of *Farmer v IRC*[26]). If you are unable to agree the status of a particular company for a period then the issue could be established only as a question of fact before the First-tier Tribunal.

Allam v HMRC discussed the definition of trading company in the context of entrepreneur's relief:[27]

> 90 ... in this context substantial should be "taken to mean of material or real importance in the context of the activities of the company as a whole".

That does not take us far. The word "real" rarely does.[28]

> Both parties agreed and we agree that the test is qualitative and quantitative. It is necessary to look at both the nature of the activities and to measure in some way the extent of those activities. Further, the company's activities must be looked at as a whole. It is not appropriate to apply any sort of numerical threshold as suggested by HMRC's guidance.
>
> 93 ... What is substantial in the context of trading and non-trading activities should be given its ordinary and natural meaning. Application

[26] [1999] STC (SCD) 321.

[27] [2021] UKUT 291 (TCC).

[28] See App.7.1 (What do we mean by real).

> of the test involves identifying the trading and non-trading activities and then considering how best to measure the non-trading activities to see whether they are substantial in the context of the company's activities as a whole.

The UT rightly dismissed an argument that holding investments should be ignored as that does not involve much (if any) "activity":

> 96. [The taxpayer's] submissions proceeded on the footing that the activities of a company are confined to the actions of its directors and employees; in other words actual human activities. We do not accept that activities in this context are to be construed so narrowly. We accept that the reference to "activities" in s 165A(3) is in the sense of what the company actually does, but the question of what the company actually does must be looked at in commercial terms. In that sense, trading is an activity, but so too is holding an investment property and receiving rents. That is what the FTT meant when it described the activity of holding property and collecting rent as a "passive activity". There may be little action required on the part of directors and employees in such an activity, but it remains an activity in commercial terms. In ordinary language a company might be described as having a principal activity as a holding company. There may be little if any activity on the part of directors and employees as such, but it remains the company's principal activity, even if it also engages in other commercial activities.

The UT then set out the correct test:

> 98. ...in considering the activities of a company, the test is a holistic one. The test is not confined to physical human activity, but requires an overall consideration of what it is that the relevant company does.
>
> 101. In our view, the question of what amounts to an activity in the context of a company is a straightforward question. It is what the company does in commercial terms. The question of how to measure the extent of an activity may be more difficult and will be informed by the statutory context. In the present case, the context is that of a relief from capital gains tax aimed at trading companies. Trading companies are defined in the first instance as companies carrying on trading activities, with an exclusion by reference to the extent of any non-trading activities. ... the purpose of the relief would be defeated if the limitation did not exclude shares in companies having substantial investment holdings. The holding of investments is an activity for these purposes. As we have said, we consider that the FTT was correct not to focus solely on physical activities. Otherwise, shares in a company with a small trading activity would qualify for relief even where it had a large investment business

> involving very little physical activity. Conversely, shares in the same company would not qualify for relief if it had a large investment business involving considerable physical activity. That result makes no sense to us in the context of a relief aimed at shares in companies carrying out trading activities. The measure of an activity for these purposes must be more than a simple measure of the time and work involved in carrying on the activity.
>
> 102. In the context of a relief from tax in relation to the shares of a trading company we consider that Parliament intended financial measures of activity to be taken into account as well as measures of physical activity.
>
> 103 ... whether an asset is income producing or not is not determinative of the availability of relief. The extent to which assets are income producing is only one factor and the circumstances in which a company comes to hold non-income producing assets would also be relevant.

This is all self-evident, but perhaps it is helpful to see it expressed.

19.10.4 *Private limited company*

The term "private limited company" matters for the definitions of eligible trading/stakeholder/holding company.

Section 809VD(11) ITA provides:

> A company is a "private limited company" if–
> (a) it is a body corporate whose liability is limited,
> (b) it is not a limited liability partnership, and
> (c) none of its shares are listed on a recognised stock exchange.[29]

The drafting is odd - why not simply say "a company whose shares are not listed"? Why must liability be limited? But it does not matter.

The company need not be UK resident. This is deliberate. HMRC say:

> 2.38 The Government wants to ensure that non-domiciles can invest in a range of companies, including those incorporated in other countries, and believes this will broaden the positive economic impact of this incentive. Therefore, it does not propose to restrict tax relief to investment in businesses that are resident in the UK or to businesses carrying out trades wholly or mainly in the UK. Relief will be extended to overseas income and capital gains remitted to invest in non-UK resident companies....
>
> 2.41 The Government does not propose to introduce any other restrictions

[29] See App 2.18 (Listed/Recognised stock exchange).

> on the type of holding company that can qualify or the degree of ownership the company has over its subsidiary companies. This means that companies that hold shares in other companies and are resident outside the UK would be included. It also means that private equity companies and venture capital companies could qualify even where they do not have a majority ownership stake in the invested companies....
> 2.52 The Government agrees that restricting investment to non-UK resident companies with a UK PE is not necessary and has decided not to include this restriction.[30]

The company may be a foreign entity. This was deliberate. HMRC say:

> 2.45 Investment in a foreign entity will be eligible for relief where it is a private limited company and the other conditions on qualifying activities are met.

19.10.5 *"Trade"*

Section 809VE ITA provides an extended definition of trade, to include property investment:

> (1) Section 809VD is to be read in accordance with this section.
> (2) A reference to a "trade" also includes—
> (a) anything that is treated for corporation tax purposes as if it were a trade, and
> (b) a business carried on for generating income from land (as defined in section 207 of CTA 2009[31]).

HMRC said:

> 2.33 Businesses undertaking furnished holiday lettings (FHLs) will not be qualifying businesses for the purposes of the relief. Although FHLs are treated as a trade for certain purposes, they are not taxed as such and will therefore not meet the qualifying conditions.[32]

This is not carried through in the legislation since FHL is a property business. Presumably there was a change of mind.

[30] Consultation Response Document *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf*

[31] See 24.2.4 (Generating income from land).

[32] Consultation Response Document *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf*

The residence consultation paper explains:

> **UK businesses**
> 2.38 ... Relief will be extended to overseas income and capital gains remitted to invest in non-UK resident companies ....
> 2.39 While this approach would allow investments to be used for trades outside the UK, non-domiciled investors can already invest in such trades without remitting income or capital gains into the UK. It is therefore likely that in the vast majority of cases, non-domiciles will use the new incentives to invest in UK trades, which they cannot currently do without incurring a tax charge.[33]

19.10.6 *"Commercial" trade*

Section 809VE(3) ITA provides:

> A trade is a "commercial trade" if it is conducted on a commercial basis and with a view to the realisation of profits.

See App 5.1 (Commercial basis/view to profit).

This definition applies only for s.809VD, so it needs to be incorporated when the same term is used elsewhere: s.809VH ITA.

19.10.7 *Research and development*

Section 809VE ITA provides:

> (4) The carrying on of activities of research and development from which it is intended that a commercial trade will be derived, or will benefit, is to be treated as the carrying on of a commercial trade.
> (5) But preparing to carry on activities within subsection (4) is not to be treated as the carrying on of a commercial trade.

19.10.8 *Corporate partner*

Section 809VE(6) ITA provides:

> A company which is a partner in a partnership is not to be regarded as carrying on a trade carried on by the partnership.

What is the reason for this?

[33] HMT & HMRC, "Reform of the taxation of non-domiciled individuals: a consultation" (2011) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81510/consult_condoc_non_domicile_individuals.pdf*

19.11 Condition B: No benefit

Section 809VF(1) ITA provides:

> Condition B is that
> [a] no relevant person has (directly or indirectly) obtained or become entitled to obtain any related benefit, and
> [b] no relevant person expects to obtain any such benefit.

Remittance investment relief has two no-benefit rules:

(1) Investment condition B, which (in short) disapplies the relief if there is a benefit or expected benefit at the time of the investment.

(2) The extraction of value rule which (in short) claws back the relief if there is a receipt of value later, even though not expected at the time of the investment.[34]

Investment condition B is severe in that any benefit disallows relief on the entire investment.

The relief is disapplied even if the benefit is received outside the UK, which is illogical in the context of the remittance basis.

19.11.1 *Benefit*

"Benefit" is not usually defined, but that did not deter the drafter. Section 809VF(2)(a) ITA provides:

> A "benefit"–
> (a) includes the provision of anything that would not be provided to the relevant person in the ordinary course of business, or would be provided but on less favourable terms, ...

Section 809VF(2)(b) ITA provides an exclusion:

> A "benefit" ...
> (b) does not include the provision of anything provided to the relevant person in the ordinary course of business and on arm's length terms.

I think all this is otiose and benefit still has its normal (wide) meaning; but it does no harm.

19.11.2 *"Provision"*

"Provision" is never defined, but that did not deter the drafter. Section 809VF(4) ITA provides:

[34] See 19.14 (Extraction of value rule).

> For the purposes of subsection (2)–
>
> (a) a reference to the provision of anything is to the provision of anything in money or money's worth, including property, capital, goods or services of any kind, and
>
> (b) "provision" includes any arrangement that allows a person to enjoy or benefit from the thing in question (whether temporarily or permanently).

This is again otiose, though it does no harm. One hopes this will not enter parliamentary counsel's handbook, and so become standard practice, like the ubiquitous (but unnecessary) definitions of arrangement.

19.11.3 *"Related" benefit*

Section 809VF(3) ITA provides a wide meaning of "related":

> A benefit is "related" if–
>
> (a) it is directly or indirectly attributable to the making of the investment (whether it is obtained before or after the investment is made), or
>
> (b) it is reasonable to assume[35] that the benefit would not be available in the absence of the investment.

The normal way to draft no-benefit rules is to say that the rule applies if the benefit is received by reason of, or as a result of, or in consequence of, the investment. I am unable to see any difference between those words and the phrase used, *attributable to the investment*. Either way, there is a causation test. Perhaps the drafter though that "attributable" was wider.

As usual, the words "directly or indirectly" do not add much, but they show that the drafter did not want the word "attributable" to be narrowly construed.

Para (b) adds nothing, as if a benefit would not be available in the absence of the investment, the benefit must be attributable to the investment. So it is not significant that this provision is not found in the extraction of value rule which also uses the expression "attributable to the investment".

19.11.4 *HMRC examples*

The RDR Manual provides some straightforward examples:

[35] See App 2.24.1 (Reasonable-to-assume wording).

RDRM34360: Qualifying investments - condition B [May 2020]

Example 1 [Joaquin]

J invests £250,000 in a qualifying company obtaining newly issued shares for his investment. J does not become either a director or an employee of the company.

All of the existing company directors have the use of company vehicles but these are unavailable to any other individual or current employee.

The company wish to thank J and so provide him free of charge with a company vehicle.

J's investment has failed Condition B as the benefit, the company vehicle, is related directly to the making of the investment. It would not have been available at all in the absence of J's investment. Therefore J's £250,000 investment will be a taxable remittance unless he takes the appropriate mitigation steps.

The benefit is not taxable on J as he is not an employee or director of the company. ...

Example 2 [Todd]

In March 2012 T is invited to invest some money in a private limited company, Company B. Company B expects to start trading commercially in the three to four months after T agreeing his investment.

T has been a remittance basis taxpayer for a number of years and decided to invest £500,000 of his foreign income and gains. On 6 April 2012 T transfers the money to his UK bank account and on 1 May 2012 (25 days later) he makes his investment in Company B. In return for this investment T is issued with shares in Company B and he becomes a working director of the company, receiving a salary at a market rate. Company B commences trading on 1 June 2012.

The investment was made within 45 days of T bringing his foreign income and gains to the UK and Company B began commercial trading within two years of the investment having been made. Conditions A and B are both satisfied and so T's foreign income and gains qualify to be treated as not remitted to the UK provided T makes a valid claim on his 2012-13 tax return.

T is in receipt of a salary for his work as a director and, because Company B is profitable, he and other shareholders are paid a dividend on 31 July 2013. These payments would reasonably have been expected to be made to any other similar director and shareholder of the company and are taxable in the UK so are not "benefits" for the purpose of Condition B. T's foreign income and gains continue to be treated as not remitted to the UK.

19.12 Clawback remittance charge

Section 809VG(1) ITA provides:

> Subsection (2) applies if–
> (a) income or chargeable gains are treated under section 809VA(2) as not remitted to the UK as a result of a qualifying investment,
> (b) a potentially chargeable event occurs after the investment is made, and
> (c) the appropriate mitigation steps are not taken within the grace period allowed for each step.[36]

If these conditions are satisfied, we move on. Section 809VG(2) ITA provides:

> The affected income or gains are to be treated as having been remitted to the UK immediately after the end of the relevant grace period.

I refer to this as the **"clawback remittance charge"**.

19.12.1 *"Relevant grace period"*

The "grace period" is the deadline for taking the appropriate mitigation steps. As there are various possible grace periods, statute uses the term "relevant" grace period to fix the date on which the clawback remittance charge arises.

Section 809VG ITA provides:

> (3) Where the step required by section 809VI(2)(a) is not taken within the grace period allowed for that step, "the relevant grace period" is the grace period allowed for that step.
> (4) Otherwise, "the relevant grace period" is the grace period allowed for the step required by section 809VI(1) or (2)(b).

19.12.2 *"Affected income or gains"*

"Affected income or gains" matters as these are the income/gains which are treated as remitted under the clawback remittance charge.

Section 809VG ITA provides:

> (5) "The affected income or gains" means such portion of the income or gains mentioned in subsection (1)(a) [income/gains qualifying for Business Investment Relief] as reflects the portion of the investment

[36] See 19.18 (Grace period).

> affected by the potentially chargeable event.
>
> (6) The portion of the investment affected is—
>
> (a) if the potentially chargeable event is a disposal of a part of the holding (or a part of the remaining holding), a portion equal to the portion of the holding (or remaining holding) being disposed of, and
>
> (b) otherwise, the whole of the investment.

19.12.3 *Investment partly offshore*

Section 809VG(8) ITA provides:

> If a qualifying investment is made using the money or other property mentioned in section 809VA(3) together with other funds ...

What is the property "mentioned in s.809VA(3)" is the money or other property invested.[37] So s.809VG(8) applies if an investment is made partly out of UK funds and partly out of offshore funds.

Assuming the opening words of s.809VG(8) are satisfied, two rules follow:

> (a) that investment is to be treated as two separate investments,
>
> [i] one made using the money or other property mentioned in section 809VA(3) and
>
> [ii] one made using the other funds, and
>
> (b) references in the business investment provisions[38] to "the investment" and "the holding" relate only to the investment made using the money or other property mentioned in section 809VA(3).

The RDR Manual provides:

> **RDRM34535 Order Of Disposals: Qualifying And Non Qualifying Investments** [Jan 2019]
>
> If an investment is made with some funds that would qualify for business investment relief and some that would not, it is treated as two separate investments, one containing the qualifying funds and one containing the non qualifying funds. (s809VG(8) ITA2007)

[37] Section 809VA(3) provides:

> A "relevant event" occurs if money or other property—
>
> (a) is used by a relevant person to make a qualifying investment, or
>
> (b) is brought to or received in the UK in order to be used by a relevant person to make a qualifying investment.

[38] Defined s.809Z10 ITA: "In this Chapter "the business investment provisions" means sections 809VA to 809VO".

> In Example 1 in RDRM34530[39] if Asif's second investment of £100,000 in June 2013 had been funded half from foreign chargeable gains and half from a UK taxed source, this would be treated as two separate investments of £50,000. One of the investments of £50,000 would derive from the foreign chargeable gains and the other from UK taxed income. In any subsequent disposal where the mitigation step is not taken, the investment containing the foreign chargeable gains would be deemed as disposed of before the investment containing the non taxable funds.

19.12.4 *Series of events*

Section 809VG(9) ITA provides:

> If the potentially chargeable event mentioned in subsection (1)(b) is not the first such event to affect the investment, the income or gains mentioned in subsection (1)(a) do not include, as respects that investment—
>
> (a) any part already treated under subsection (2) as remitted to the UK as a result of an earlier event,
>
> (b) any part contained in amounts already taken offshore or reinvested by way of appropriate mitigation steps following an earlier event, or
>
> (c) any part contained in amounts already used to make a tax deposit without which an amount mentioned in paragraph (b) would not have been enough to satisfy section 809VI(1) or (2)(b) (see section 809VK).[40]

19.13 Potentially chargeable event

There are four types of potentially chargeable event:

Potentially chargeable event	**See**
Ceasing to be an eligible company	19.13.1
Disposal of holding	19.13.2
5-year start-up rule	19.13.3
Extraction of value	19.14

19.13.1 *Ceasing to be eligible co*

Section 809VH(1) ITA provides:

> For the purposes of section 809VG, a "potentially chargeable event"

[39] See 19.20.1 (Multiple claims).

[40] See 19.19.1 (Retention to pay CGT).

> occurs if—
>
> (a) the target company is for the first time neither an eligible trading company nor an eligible stakeholder company nor an eligible hybrid company nor an eligible holding company...

An example would be if the company stops trading or becomes quoted.

The RDR Manual provides:

> **RDRM34410 Ceasing To Be An Eligible Company** [Jan 2019]
> ...It is possible for a target company [see RDRM34340] to change its status, yet remain a qualifying company. For example, as a consequence of a share reorganisation, a company changes from being an eligible trading company, eligible stakeholder company, or a eligible holding company, to being one of the other qualifying types of company (e.g. stops being an eligible trading company and starts being an eligible stakeholder company). The investment will be viewed as having been a qualifying investment throughout therefore there is no potentially chargeable event. (s809VH(1)(a) ITA2007)

19.13.2 *Disposal of holding*

Section 809VH ITA provides:

> (1) For the purposes of section 809VG, a "potentially chargeable event" occurs if ...
>
> (b) the relevant person who made the investment ("P") disposes of all or part of the holding

"Dispose" is not defined and so has its natural meaning, not the CGT meaning.[41]

A person does not dispose of assets on death[42] so death is not a potentially chargeable event.

The RDR Manual provides:

> **RDRM34390 Potentially Chargeable Events Overview** [Jan 2019]
> ... **Share for share exchanges**
> During corporate restructuring, old shares can be disposed of and new shares in the same company, or another company, issued in their place. The disposal of the old shares is a potentially chargeable event. However, provided both the old and new shares are qualifying

[41] This is consistent with the rule that CGT statutory situs rules do not apply for remittance purposes: see 18.14.12 (Situs of property for condition A).

[42] Contrast 67.5 (Death of individual).

> investments, the exchange will be treated as an immediate reinvestment in a target company and no potentially chargeable event will occur provided a valid claim is made on the appropriate tax return for the year of the share exchange. The new shares are derived from the original foreign income and gains in the same way as the original shares.

If consideration for a disposal is paid by installments, it may be difficult to re-invest so as to avoid a clawback charge. Section 809VH(8) ITA deals with this:

> If consideration for a disposal of all or part of the holding is to be paid in instalments, the disposal is to be treated for the purposes of this section as if it were separate disposals, one for each instalment (and each giving rise to a separate potentially chargeable event).

19.13.3 *5-year start-up rule*

Section 809VH ITA provides:

> (1) For the purposes of section 809VE, a "potentially chargeable event" occurs if ...
> (d) the 5-year start-up rule is breached.

Section 809VH ITA provides:

> (5) The 5-year start-up rule is breached if—
> (a) immediately after the end of the period of 5 years beginning with the day on which the investment was made, the target company is non-operational, or
> (b) at any time after the end of that period, the target company becomes non-operational.
> (6) The target company is "non-operational" at any time when—
> (a) it is an eligible trading company but is not trading,
> (b) it is an eligible stakeholder company but—
> (i) it holds no investments in eligible trading companies, or
> (ii) none of the eligible trading companies in which it holds investments is trading,
> (ba) it is an eligible hybrid company but is not trading and—
> (i) it holds no investments in eligible trading companies, or
> (ii) none of the eligible trading companies in which it holds investments is trading, or
> (c) it is an eligible holding company but—
> (i) the group of which it is a member is not an eligible trading group, or
> (ii) none of its 51% subsidiaries in the eligible trading group of

> which it is a member is an eligible trading company that is trading.
>
> (7) In subsection (6), "trading" means carrying on one or more commercial trades (including the carrying on of any activities treated under section 809VE(4) as the carrying on of a commercial trade).

19.13.4 *Insolvency relief*

Section 809VH ITA provides:

> (9) An event listed in subsection (1) does not count as a potentially chargeable event if it is due to an insolvency step taken for genuine commercial reasons (but this does not prevent the extraction of any value in connection with the insolvency step from counting as a potentially chargeable event).
>
> (10) For the purposes of subsection (9), an insolvency step is taken if—
>
> (a) the target company enters into administration or receivership or is wound up or dissolved,
>
> (b) the target company is an eligible stakeholder company or an eligible hybrid company and any eligible trading company in which it holds an investment enters into administration or receivership or is wound up or dissolved,
>
> (c) the target company is an eligible holding company and any eligible trading company in the group that is a 51% subsidiary of it enters into administration or receivership or is wound up or dissolved, or
>
> (d) a similar step is taken in relation to a company mentioned in paragraph (a), (b) or (c) under the law of a country or territory outside the UK.

The RDR Manual provides:

> **RDRM34390 Potentially Chargeable Events Overview** [Jan 2019]
>
> *Example 1* (Junaid)
>
> J made a qualifying investment of £500,000 in Bey Motors Limited. Unfortunately Bey Motors is not successful and the company goes into receivership, ceasing trading on the 11 March 2015. At this point there is no chargeable event even though the company has ceased trading; J need take no mitigation steps.
>
> On 5 December 2015 J, as a creditor, receives £40,000 from the disposal of the company's assets. J will need to take the appropriate mitigation steps to prevent a taxable remittance from occurring.

It might be noted that "insolvency step" is a misnomer: administration, receivership, winding-up and dissolution may all occur with solvent as well as insolvent companies.

Conversely, a company which is in financial difficulty and finds itself unable to discharge its liabilities will often (and ought properly to) cease trading before (sometimes well before) taking formal "insolvency steps" as defined here. Does such a company then cease to be an eligible company at an earlier point? This would, in principle, make insolvency relief irrelevant in many cases. HMRC are likely to be take a pragmatic view in straightforward situations.

19.14 Extraction of value rule

Section 809VH ITA provides:

> (1) For the purposes of section 809VG, a "potentially chargeable event" occurs if ...
> (c) the extraction of value rule is breached

Section 809VH(2) ITA provides:

> The extraction of value rule is breached if–
> (a) value (in money or money's worth) is received by or for the benefit of P or another relevant person,
> (b) the value is received from any person in circumstances that are directly or indirectly attributable to the investment, and
> (c) the value is received other than by virtue of a disposal that is itself a potentially chargeable event.

The normal way to draft para (a) would be to say that the extraction of value rule is breached if P (or a relevant person) receives a *benefit*. Is there a difference between receiving a "benefit" and the novel (and somewhat illiterate[43]) expression, receiving *value*?

Perhaps the words are apt to include making or repaying a loan, or redeeming shares, which may not be a benefit as there is full consideration.

[43] I am not sure it is strictly correct to speak of receiving value. One may receive a benefit, or other thing, which has a value; but one does not receive value as such, the value is an attribute of what one receives. I can receive a valuable asset, but what I receive is the asset, not the value. But perhaps the objection is pedantic. One receives value if one receives benefit or other thing which has a value.
The words "in money or money's worth" are unnecessary but they do no harm.
The expression value received is used elsewhere, but with a defined meaning, so that gives no guidance here.

The word attributable is also used in investment condition B: see 19.11.3 ("Related" benefit).

HMRC give some straightforward examples:

> 2.52 ... the Government proposes to introduce a provision to prevent the value of the investment leaking out to the individual either directly through payments or loans which are not arms-length or through transactions designed to pass value to the individual. For example, it would not be permitted for the company to use the funds invested to guarantee loans made to the individual; nor would it be possible to make payments to a third party which are linked to payments made to the individual.[44]

If value is extracted, all the relief is clawed back unless the entire holding is sold and the entire proceeds reinvested or removed abroad. That is the result even if the value extracted is minimal.[45]

The rule applies even if the value is received outside the UK, which is illogical in the context of the remittance basis.

Section 809VH(3) ITA provides a limited exception where the value is income for tax purposes:

> But the extraction of value rule is not breached merely because a relevant person receives value that–
> (a) is treated for income tax or corporation tax purposes as the receipt of income or would be so treated if that person were liable to such tax, and
> (b) is paid or provided to the person in the ordinary course of business and on arm's length terms.

19.14.1 *VCT/EIS relief*

What is the position if the investment confers EIS tax relief? At first sight, there is a problem. The tax relief is a receipt of value. The benefit is received in circumstances which are attributable to the investment.[46] The exemption for income-taxable benefits does not apply.

[44] HMT & HMRC, "Reform of the taxation of non-domiciled individuals: a consultation" (2011) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81510/consult_condoc_non_domicile_individuals.pdf*

[45] See 19.12.2 ("Affected income or gains").

[46] The same conclusion was reached in another context in *Harris v HMRC* [2010] UKFTT 385 (TC).

However the RDR Manual provides:

> **RDRM34385 Interaction of Business Investment Relief with Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS)** [Jan 2019]
> If an individual claims business investment relief, there is nothing to prevent that individual from claiming either EIS or SEIS relief on the investment; provided that the qualifying criteria for all the schemes are met. ...

19.15 "Appropriate mitigation steps"

Where there is a potentially chargeable event, there is (in short) still no remittance clawback remittance charge if the appropriate mitigation steps are taken.

Section 809VI ITA provides:

> (1) If the potentially chargeable event is a disposal of all or part of the holding, the appropriate mitigation steps are regarded as taken if the whole of the disposal proceeds have been taken offshore or reinvested.
> (2) For any other case, the appropriate mitigation steps are regarded as taken if—
> (a) P has disposed of the entire holding (or so much of it as P retains when the potentially chargeable event occurs), and
> (b) the whole of the disposal proceeds have been taken offshore or re-invested.

19.16 "Taken offshore" or "re-invested"

19.16.1 *Scope of definition*

Section 809Z9 ITA provides:

> (1) This section applies to a provision of this Chapter that is satisfied if something (for example, disposal proceeds) is taken offshore or used by a relevant person to make a qualifying investment...
> (10) References in this section to something being "invested" are to something being used by a relevant person to make a qualifying investment.
> (11) The provisions to which this section applies include sections 809UA(2)[47] and 809VB(2)[48], but in those cases—

[47] See 19.24.4 (Payment on account).

[48] See 19.8 (Investment fails to proceed).

> (a) disregard references in this section to investment, and
> (b) in the case of section 809VB(2), the assessment date for the purposes of subsection (5) is the date of the relevant event (see section 809VA(3)(b)).

19.16.2 *"Taken offshore"*

Section 809Z9(2) ITA provides:

> Things are to be regarded as "taken offshore" if (and only if) they are taken outside the UK such that, on leaving the UK, they cease to be available—
> (a) to be used or enjoyed in the UK by or for the benefit of a relevant person, or
> (b) to be used or enjoyed in any other way that would count as remitting income or gains to the UK.

19.16.3 *Taking money offshore*

Section 809Z9(3) ITA explains how money is taken offshore:

> If—
> (a) the thing required to be taken offshore or invested is money and
> (b) it is paid temporarily into an account pending satisfaction of the provision,
> the provision is satisfied only if the money actually taken offshore or invested is taken from the same account.

There is no relief if money is transferred from one account to another, or if money is paid into one account and funds from another account are taken offshore. It is difficult to see the reason for the rule.

The RDR Manual provides:

> **RDRM34460 Taking Proceeds Offshore or Investing Them** [Jan 2019]
> *Example 1* (Ammar)
> A disposes of some of his qualifying investment for £50,000. He deposits the £50,000 proceeds into a joint bank account he holds with his wife Layan. The joint account contains UK taxed income of both A and Layan.
> A fortnight later, A transfers £50,000 from the joint account to an account in his sole name in the Isle of Man.
> A is regarded as having taken the proceeds of the sale of his qualifying investment offshore and thus to have taken the appropriate mitigation steps.

> If A had transferred the £50,000 to the Isle of Man from a different UK bank account, he would not have carried out the appropriate mitigation step and would be taxable on the foreign income or gains used to make his original investment.

Taking property (not money) offshore

Section 809Z9 ITA then deals with property other than money:

> (4) If the thing required to be taken offshore or invested is something in money's worth,[49] the provision may be satisfied—
> (a) by taking the thing offshore or investing it, or
> (b) by taking offshore or investing money or other property of the equivalent value.
> (5) "The equivalent value" is the market value[50] of the thing in money's worth, assessed as at the date of the sale or other disposal in relation to which the provision is triggered.

Perhaps the point is that the consideration might be property which cannot be taken offshore.

Section 809Z9(6) ITA then deals with deemed consideration:

> If the consideration for a disposal is deemed under section 809Z8(4),[51] the provision may be satisfied by taking offshore or investing money or other property of a value equal to—
> (a) the amount of the deemed consideration, less
> (b) any agency fees (within the meaning of section 809Z8) that are deducted before the actual consideration is paid or otherwise made available to or for the benefit of a relevant person.

Section 809Z9(7) ITA deals with the interaction with exempt property rules:

> Subsections (4)(b) and (6) do not apply in the case of other property of the equivalent value if the other property is—
> (a) exempt property under section 809X,[52]
> (b) consideration for the disposal of any such exempt property, or

[49] "Something in money's worth" is a clumsy expression meaning property other than money; the drafter is half remembering the technical expression *consideration of money or money's worth*.

[50] Defined s.809Z10 ITA: "In this Chapter ... "market value" has the same meaning as in TCGA 1992 (see in particular sections 272 and 273 of that Act)."

[51] See 19.17.3 (Deemed consideration).

[52] See 19.29 (Exempt property).

> (c) consideration for the disposal of all or part of the holding (see section 809VC) relating to a qualifying investment.

Section 809Z9(8) ITA deals with the interaction with the mixed fund rules:

> Money or other property taken offshore or invested in accordance with subsection (4)(b) or (6) is to be treated for the purposes of this Chapter—
> (a) as deriving from the thing required to be taken offshore or invested, and
> (b) as having the same composition of kinds of income and capital as that thing.

19.16.4 *Part taken offshore*

Section 809Z9(9) ITA provides:

> A provision to which this section applies may be satisfied—
> (a) by taking the whole thing offshore or investing the whole thing, or
> (b) by taking one part offshore and investing the other part.

19.16.5 *"Re-invested"*

Section 809VI(7) ITA provides:

> Proceeds are "re-invested" if a relevant person uses them to make another qualifying investment (or the proceeds are themselves a qualifying investment) whether in the same or a different company.

An example is a share for share exchange.

19.16.6 *Gain on disposal of investment*

Section 809VI ITA provides:

> (3) But if the disposal proceeds exceed X, subsections (1) and (2)(b) apply only to so much of the proceeds as is equal to X.
> (4) "X" is—
> (a) the sum originally invested,[53] less
> (b) so much of that sum as has, on previous occasions involving the same investment—

[53] This has a commonsense definition in s.809VI:

> (5) "The sum originally invested" means the amount of the money, or the market value of the other property, used to make the investment.
> (6) Market value is to be assessed for these purposes as at the date of the relevant event (see section 809VA).

(i) been taken into account in determining the affected income or gains under section 809VG(2) [clawback remittance charge],

(ii) been taken offshore or re-invested in order to avoid the application of that section, or

(iii) been used to make a tax deposit without which the amount actually taken offshore or re-invested would not have been enough to satisfy subsection (1) or (2)(b) (see section 809VK).[54]

The RDR Manual provides:

> **RDRM34440 Appropriate Mitigation Steps** [Jan 2019]
> *Example 1* (Luther)
> L has made a qualifying investment of £1 million in Nelka Fashions Limited. The company flourishes, and after several years, L decides to dispose of half of his holding. The disposal proceeds are £1,200,000.
> There have been no prior potentially chargeable events so amount X is £1 million (the amount originally invested). This is less than the disposal proceeds of £1,200,000 so L is only required to take £1 million offshore in order to take the appropriate mitigation steps.
> There is also a capital gain of £700,000 (proceeds £1,200,000 less cost of £500,000) that L will report on his Self Assessment tax return for the year of disposal.
> *Example 2* (Rory)
> R brings £1 million of his foreign income to the UK and invests in an eligible trading company for which he acquires 1,000 newly issued shares.
> Twelve months later R sells 250 shares for £325,000. The acquisition cost of these shares is £250,000 so there is a UK capital gain of £75,000. As amount X is £1 million, R must take the entire £325,000 offshore or reinvest it in a target company if he is to avoid a taxable remittance of the £250,000 used to buy the shares. R accordingly takes £325,000 offshore.
> In the following tax year R sells a further 250 shares for £450,000 which gives rise to a UK capital gain of £200,000. Amount X is now £675,000 - that is the original investment of £1 million less the amount of £325,000 previously taken offshore. R must again take the entire proceeds of £450,000 offshore or reinvest in an eligible company to avoid a taxable remittance of £250,000. R takes £450,000 offshore.

[54] See 19.19.1 (Retention to pay CGT).

Five years later R sells his remaining 500 shares for £2,500,000, making a UK capital gain of £2 million. At this point R has taken offshore £775,000 of his original £1 million qualifying investment, amount X is now £225,000. R must therefore take a further £225,000 offshore or reinvest it if he is to avoid a taxable remittance of £500,000. The remaining £2,275,000 can be retained in the UK.

19.16.7 *Liquidation of target company*

Section 809VI(8) ITA provides:

> In cases where a breach of the extraction of value rule occurs in connection with the winding-up or dissolution of the target company—
> (a) subsection (2)(a) does not apply,
> (b) the reference in subsection (2)(b) to the disposal proceeds is to the value received, and
> (c) references in this section and in succeeding provisions of the business investment provisions[55] to the disposal proceeds are to be read as references to the value received.

19.17 "Disposal proceeds"

Section 809Z8(1) ITA provides:

> (1) In this Chapter, in relation to a sale or other disposal, "the disposal proceeds" means—
> (a) the consideration for the disposal, less
> (b) any agency fees that are deducted before the consideration is paid or otherwise made available to or for the benefit of the person making the disposal ("the transferor") or any other relevant person.

19.17.1 *Agency fees*

Section 809Z8 ITA provides:

> (6) In subsection (1), "agency fees" means fees and other incidental costs of the disposal that are charged to the transferor by any person by or through whom the disposal is effected, but excluding any such fees or costs that—
> (a) are charged to the transferor by another relevant person, or
> (b) are to be passed on to or otherwise applied for the benefit of a

[55] Defined s.809Z10 ITA: "In this Chapter "the business investment provisions" means sections 809VA to 809VO".

> relevant person.
>
> (7) The exclusion mentioned in subsection (6) does not apply to the extent that the fees or costs—
>
> (a) relate to a service actually provided by the relevant person to the transferor in connection with effecting the disposal, and
>
> (b) do not exceed the amount that would be charged for that service if it were provided in the ordinary course of business and on arm's length terms.

19.17.2 *Non-cash consideration*

Section 809Z8(3) ITA provides:

> If the consideration is provided in the form of anything other than money, the amount of the consideration is the market value[56] of the thing at the time of the disposal.

19.17.3 *Deemed consideration*

Section 809Z8 ITA[57] provides:

> (4) If the disposal is made other than by way of a bargain made at arm's length, the disposal is deemed to be made for a consideration equal to the market value, immediately before the disposal, of the thing being disposed of.
>
> (5) Without limiting the generality of subsection (4), a disposal made to another relevant person or to a person connected with a relevant person is treated in all cases as made other than by way of a bargain at arm's length.

Usual CGT reliefs such as spouse relief and charity relief do not apply.

19.18 Grace period

There is no clawback remittance charge if "the appropriate mitigation steps" are taken within the "grace period".

Section 809VJ ITA provides:

> (1) The grace period allowed for the step mentioned in section 809VI(2)(a) [disposal of holding] is the period of 90 days beginning—
>
> (a) if the potentially chargeable event is a breach of the extraction of

[56] Defined s.809Z10 ITA: "In this Chapter... "market value" has the same meaning as in TCGA 1992 (see in particular sections 272 and 273 of that Act)."

[57] Flagged by s.809Z8(2) ITA.

> value rule, with the day on which the value is received, and
> (b) otherwise, with the day on which a relevant person first became aware or ought reasonably to have become aware of the potentially chargeable event.

In the case of the extraction of value rule, the grace period is fixed as the date of receipt, even though the investor may not know the rule is breached (because the value may be received by another person. The power to extend time may be useful here.

> (2) The grace period allowed for the step mentioned in section 809VI(1) and (2)(b) is the period of 45 days beginning with the day on which the disposal proceeds first became available for use by or for the benefit of P or any other relevant person.

19.18.1 *Breach of startup rule*

Section 809VJ ITA provides:

> (2A) But subsection (2B) applies instead of subsections (1) and (2) where the potentially chargeable event is a breach of the 5-year start-up rule by virtue of section 809VH(5)(b).
> (2B) The grace period allowed for the steps mentioned in section 809VI(2)(a) and (2)(b) is the period of 2 years beginning with the day on which a relevant person first became aware or ought reasonably to have become aware of the potentially chargeable event referred to in subsection (2A).

19.18.2 *Exceptional circumstances*

Section 809VJ(3) ITA provides:

> An officer of HMRC may agree in a particular case to extend the grace period allowed for an appropriate mitigation step in exceptional circumstances.

HMRC give one example of exceptional circumstances:

> 2.24 In some cases, it may be difficult for an investor to know that a company's activities have changed and to dispose of their investment within the 45-day period. The draft legislation therefore contains a provision to allow HMRC to extend this grace period where exceptional circumstances mean it would be unreasonable to expect the individual to dispose of an investment within 45 days.[58]

[58] Consultation Response Document *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treas*

19.18.3 *Extension of grace period*

Section 809VJ ITA provides:

> (4) An officer of HMRC may agree in a particular case to extend the grace period allowed for an appropriate mitigation step in circumstances specified in regulations made by the Commissioners.
> (5) Regulations under subsection (4) may have effect in relation to investments made before the day on which the regulations are made.
> (6) Nothing in subsection (4) or in regulations made under it limits the power conferred by subsection (3).
> (7) The powers conferred on officers of HMRC by subsections (3) and (4) include power to agree to extend a grace period for a length of time that is indefinite but is capable of becoming definite by means identified in the agreement (such as the satisfaction of conditions).

The regulations are the Business Investment Relief Regulations 2012. It is dispiriting to see the level of micro-detail under a government which claimed to be "determined to cut red tape".[59]

Regulation 2 Business Investment Relief Regulations provides:

> 2. The grace period allowed for an appropriate mitigation step by section 809VJ of the Income Tax Act 2007 may be extended by an officer of HMRC if regulation 3 or 4 applies.
> **Lock-up agreements**
> 3.—(1) This regulation applies if conditions 1 and 2 are met.
> (2) Condition 1 is that—
> (a) the target company has ceased to be a private limited company by virtue of having some or all of its shares listed on a recognised stock exchange; or
> (b) (i) the target company has become a subsidiary of another company ("the new company"); and
> (ii) the new company is a body corporate some or all of whose shares are listed on a recognised stock exchange (or are to be so listed).
> (3) Condition 2 is that P is unable to comply with an appropriate mitigation step without breaching the terms of a lock-up agreement.
> (4) For the purposes of this regulation "lock-up agreement" means a contract—

ury.gov.uk/d/condoc_responses_non_domicile_reform.pdf

[59] *https://webarchive.nationalarchives.gov.uk/ukgwa/20150423095857/http://www.redtapechallenge.cabinetoffice.gov.uk/home/index/*

(a) entered into by P with one or more relevant parties which is directly related to the listing of shares in the target company or, as the case may be, the new company, on a recognised stock exchange; and

(b) that imposes restrictions on the time or manner in which P may—

(i) dispose of some or all of P's holding in the target company; or

(ii) dispose of some or all of any shares in the new company received by P in return for P's holding in the target company.

(5) For the purposes of this regulation "relevant party" means—

(a) the target company;

(b) the new company;

(c) professional advisers retained by the target company or the new company in relation to the listing of the shares of the target company (or, as the case may be, the shares of the new company) on a recognised stock exchange.

Statutory and legal bars

4. This regulation applies if—

(a) P is prevented from taking an appropriate mitigation step by a prohibition imposed by or under any enactment; or

(b) the taking of an appropriate mitigation step by P would breach the terms of an order imposed by any court.

19.19 Effect of mitigation steps

Section 809VL ITA provides:

(1) This section explains the effect for the purposes of this Chapter in cases where section 809VG(2) [clawback remittance charge] does not apply because the appropriate mitigation steps were taken within the grace period allowed for each step.

(2) If disposal proceeds were taken offshore as part of those steps, nothing in section 809VA(2) [remittance investment relief] prevents anything subsequently done in relation to those proceeds (or anything deriving from them) from counting as a remittance of the underlying income or gains to the UK at the time when the thing is subsequently done.

(3) If disposal proceeds were re-invested as part of those steps—

(a) the underlying income or gains continue to be treated under section 809VA(2) as not remitted to the UK, and

(b) the business investment provisions[60] apply to the reinvestment as they apply to the original investment.

(4) In the application of the business investment provisions to the reinvestment—

(a) treat the potentially chargeable event mentioned in section 809VG(1)(b) as the relevant event,

(b) treat the underlying income or gains as the income or gains treated under section 809VA(2) as not remitted to the UK as a result of the re-investment, and

(c) treat the amount used to make the re-investment as the sum originally invested.

(5) If the re-investment is made using more than the minimum amount of disposal proceeds required to satisfy section 809VI(1) or (2)(b)—

(a) that investment is to be treated as two separate investments, one made using the minimum amount of disposal proceeds and one made using the excess, and

(b) references in the business investment provisions to "the investment" and "the holding" relate only to the investment made using the minimum amount of disposal proceeds.

(6) "The underlying income or gains" means the affected income or gains (within the meaning of section 809VG) or, if one part of the disposal proceeds is taken offshore and the other part re-invested, a corresponding proportion of the affected income or gains.

(7) A further claim must be made in accordance with section 809VA in respect of the re-investment and, if no such claim is made on or before the first anniversary of the 31 January following the tax year in which the re-investment was made, section 809VG(2) [clawback remittance charge] applies, as respects the original investment, as if the appropriate mitigation steps had not been taken within the grace period allowed for each step.

(8) Section 809VM makes further provision in cases involving a tax deposit.

19.19.1 *Retention to pay CGT*

Section 809VK ITA provides:

(1) This section applies if—

(a) there is a disposal of all or part of the holding,

[60] Defined s.809Z10 ITA: "In this Chapter "the business investment provisions" means sections 809VA to 809VO".

> (b) the disposal counts as a potentially chargeable event or is part of the appropriate mitigation steps taken in consequence of a potentially chargeable event,
> (c) a chargeable gain (but not a loss) accrues to P on the disposal, (d) P is chargeable to capital gains tax (but not corporation tax) in respect of that gain, and
> (e) the actual disposal proceeds are less than Y.
>
> (2) The difference between the actual disposal proceeds and Y is referred to in this section as "the shortfall".
>
> (3) "The actual disposal proceeds" means the disposal proceeds but disregarding section 809Z8(4).[61]
>
> (4) "Y" is the sum of—
> (a) the amount (if any) that would, but for this section, be required to be taken offshore or re-invested in order to satisfy section 809VI(1) or (2)(b), and
> (b) the amount found by applying the highest potential CGT rate to the amount (computed in accordance with TCGA 1992) of the chargeable gain accruing to P on the disposal.
>
> (5) The highest potential CGT rate is the highest rate specified in section 1H of TCGA 1992 (regardless of the type of the chargeable gain or, if P is an individual, the rate of income tax at which P's income is chargeable).
>
> (6) If this section applies, the amount that is required to be taken offshore or re-invested in order to satisfy section 809VI(1) or (2)(b) is reduced by the permitted amount.
>
> (7) "The permitted amount" is so much of the shortfall as is used, within the grace period allowed for taking the disposal proceeds offshore or re-investing them, to make a deposit in respect of which a certificate of tax deposit is issued to P under section 12 of the National Loans Act 1968.
>
> (8) A reduction may not be made under subsection (6) unless—
> (a) when details of the deposit are confirmed to HMRC, the confirmation letter states that this section is intended to apply to the deposit, and
> (b) the amount of the deposit is no greater than the shortfall.

19.19.2 *Tax deposit*

Section 809VM ITA provides:

> (1) This section applies in cases where—
> (a) section 809VG(2) [clawback remittance charge] did not apply

[61] See 19.17.3 (Deemed consideration).

> because the appropriate mitigation steps were taken within the grace period allowed for each step,
>
> (b) the amount required to be taken offshore or re-invested in order to satisfy section 809VI(1) or (2)(b) had been reduced under section 809VK[62], and
>
> (c) but for that reduction, the amount that was actually taken offshore or re-invested would not have been enough to satisfy section 809VI(1) or (2)(b).
>
> (2) The tax deposit that gave rise to the reduction is referred to in this section as "the tax deposit".
>
> (3) Use of the tax deposit to pay the relevant tax liability[63] does not count as remitting the underlying income or gains to the UK (and, accordingly, section 809VA(2) [remittance investment relief] continues to apply to the income or gains).

19.19.3 *CTD clawback charge*

Section 809VM ITA provides:

> (4) If any of the CTD conditions is breached, the underlying income or gains are to be treated as having been remitted to the UK immediately after the day on which the breach occurs.
>
> (5) "The underlying income or gains" means such portion of the affected income or gains (within the meaning of section 809VG) as is—
>
> (a) represented by the payment, in the case of subsection (3), or
>
> (b) affected by the breach, in the case of subsection (4).

19.19.4 *CTD conditions*

Section 809VM(6) ITA provides:

> The CTD conditions are as follows—
>
> (a) the tax deposit must not be used to pay a tax liability other than the relevant tax liability,
>
> (b) if any of the tax deposit is withdrawn by the depositor, the amount withdrawn must be taken offshore or re-invested within the period of 45 days beginning with the day on which the withdrawal was made, and
>
> (c) any part of the tax deposit that has been neither used to pay a tax

[62] See 19.19.1 (Retention to pay CGT).

[63] Defined s.809VM(8): For the purposes of this section ... (a) "the relevant tax liability" means P's liability to capital gains tax for the tax year in which the disposal took place...

liability nor withdrawn by the due date[64] must be withdrawn by the depositor and taken offshore or reinvested[65] within the period of 45 days beginning with that date.

(7) Where the CTD conditions were not breached because the requisite amount was taken offshore or re-invested within the 45-day period mentioned in subsection (6)(b) or (c)—

(a) section 809VL applies to the amount taken offshore or reinvested as it applies to disposal proceeds, but

(b) read the reference in section 809VL(4)(a) to the potentially chargeable event as a reference to—

(i) the withdrawal,[66] in a case within subsection (6)(b), and

(ii) the due date, in a case within subsection (6)(c).

The RDR Manual provides:

> **RDRM34460 Taking Proceeds Offshore or Investing Them** [Jan 2019]
>
> *Example 2* (Magnus)
>
> M, a UK resident remittance basis taxpayer, loaned £40,000 to a friend's eligible trading company in 2012-13; he makes a valid claim to business investment relief on his Self Assessment tax return.
>
> The £40,000 is made up of £20,000 foreign capital gains and £20,000 foreign income.
>
> The business is successful and in 2014-15 is in a position to repay 50% (£20,000) of the loan back. The £20,000 will retain the ratio of the type of funds originally invested so will comprise £10,000 foreign capital gains and £10,000 foreign income.
>
> As M is looking to upgrade his car, his friend offers him a 6 month old company car which has a market value of £20,000. M takes ownership of the car in repayment of the loan to date.
>
> The car is now treated as deriving from £10,000 foreign capital gains and £10,000 foreign income. M wants to use the car in the UK, so to carry out the appropriate mitigation step he decides to take £20,000 of his UK taxed income offshore instead. Although it is UK taxed income, the £20,000 will now be treated as deriving from the £10,000 foreign capital gains and £10,000 foreign income that M originally invested. If, in the

[64] Defined s.809VM(8): For the purposes of this section ... (b) "the due date" means the date by which the relevant tax liability is required to be paid...

[65] Defined by reference s.809VM(8): For the purposes of this section ... (c) "re-invested" has the meaning given in section 809VI(7)...

[66] Defined s.809VM(8): For the purposes of this section ... (d) references to withdrawal include repayment for whatever reason.

future, these funds are remitted to the UK they will be taxed as M' foreign capital gains and foreign income.

Example 3

In the above example, instead of taking £20,000 of his UK taxed income offshore, M decides to take offshore an antique vase purchased with £25,000 of his UK employment income. The vase has a market value of £30,000 at the time that M takes possession of the car in satisfaction of the part repayment of the loan he made to his friend's company.

M has taken the appropriate mitigation step and no tax under the remittance basis is due on the disposal of his qualifying investment. The vase is now regarded as deriving from M' £10,000 foreign chargeable gains and £10,000 foreign income originally loaned to the company.

If the value of the vase had fallen to £15,000 by the time the loan was repaid, it would not be regarded as fulfilling the mitigation steps. M would have to take additional property offshore to the value of £5,000.

The RDR Manual provides:

RDRM34500 Certificates Of Tax Deposit (CTD) [Jan 2019]

HMRC operates a general Certificate of Tax Deposit scheme. Under the scheme a taxpayer can make tax deposits in advance of tax liabilities becoming due and payable. For information about how to make a tax deposit refer to our website (The Certificate of Tax Deposit Scheme)

An individual, claiming business investment relief, who sells the whole of their investment at a gain, will usually have sufficient proceeds to take the mitigation steps and to pay any Capital Gains Tax on the gain made. That is because, in order to take the appropriate mitigation steps [see RDRM34440], they are only required to take the original invested amount outside the UK and can leave the "gain" element in the UK to pay any resulting tax liability.

However, in the case of a partial disposal where the proceeds received from the sale are less than the amount originally invested, the whole of the disposal proceeds must be taken outside the UK or reinvested in order to take the appropriate mitigation steps. In such a case, there may be no funds available in the UK to pay any resulting Capital Gains Tax liability.

Example 1 (Kylie)

K's initial qualifying investment is £100,000 for which she receives 10,000 shares.

Two years later she sells 5,000 shares for £80,000 giving rise to a capital gain of £30,000 on which she calculates the maximum Capital Gains Tax payable would be £8,400. The proceeds are less than the sum originally invested (£100,000) so the whole of the £80,000 must be taken offshore

> or reinvested in order to take the appropriate mitigation steps. If K does not have sufficient UK funds to pay the Capital Gains Tax liability she could have to remit offshore funds to the UK, which themselves could become taxable as a remittance.
>
> The CTD scheme can be used in situations such as this in order to pay the UK Capital Gains Tax. When taxpayers use some of the proceeds of their disposal to make a tax deposit, which must be made within 45 days of the disposal proceeds being paid [see RDRM34480], the amount of the disposal proceeds that must be taken offshore or reinvested in order to take the appropriate mitigation steps is reduced by the amount of the tax deposit. (s809VK ITA2007)
>
> *Example 2*
>
> Following on from the example above, K makes a tax deposit of £8,400 ten days after receiving the disposal proceeds. The amount that K must take offshore or re-invest in order to carry out the mitigation steps is now £71,600 (£80,000 less £8,400); K has a further 35 days to reinvest this sum or take it offshore.

The RDR Manual provides:

> **RDRM34510 CTD Amount That Can Be Deposited** [Oct 2016]
>
> *Example 1* (Charan)
>
> C pays tax on the remittance basis. In 2012-13 he made a qualifying investment of £1 million in an engineering company and was issued with 20,000 shares. He subsequently makes a claim for the business investment relief on his Self Assessment tax return for the tax year 2012-13, and so does not pay any UK tax on what would otherwise have been a chargeable remittance of £1 million.
>
> In July 2015 C disposes of 10,000 shares for £800,000 making a capital gain of £300,000. To comply with the appropriate mitigation steps C must move the entire £800,000 proceeds offshore or reinvest them in a target company. In this case C can choose to make a tax deposit with HMRC under the CTD scheme and, if he does so, the tax deposit will reduce the amount of the proceeds that must be taken offshore or reinvested.
>
> C calculates the potential maximum Capital Gains Tax liability accruing on the gain from his part disposal as:
>
> £300,000 x 28%* = £84,000
>
> Amount Y is therefore £884,000 (£800,000 plus £84,000). As this is higher than the amount that must be taken offshore to satisfy the mitigation steps, C is able to make a tax deposit of the difference.
>
> If C makes a tax deposit of £84,000, he need only take offshore or reinvest £716,000 (£800,000 less £84,000) to complete the mitigation

steps. C must also confirm, in writing, to HMRC that ITA07/s809VK is intended to apply to the tax deposit.
*Based on Capital Gains Tax rates at May 2012.

Example 2 (Izaak)
I has made a qualifying investment of £1 million. He was issued with 250,000 shares at a cost of £4 per share. He makes a claim for business investment relief on his Self Assessment tax return for the tax year 2012-13, and does not pay any UK tax on what would otherwise have been a remittance of £1 million. I disposes of his holding over several years as illustrated below.

	2012-13	**2013-14**	**2014-15**	**2015-16**
Shares held at start of year	250000	250000	150000	112500
Shares disposed of	-	100000	37500	112500
Disposal proceeds (a)	-	£500,000	£200,000	£700,000
Cost of shares disposed of (b)	-	£400,000	£150,000	£450,000
Chargeable gain: (a)−(b) = (c)	-	£100,000	£50,000	£250,000
Maximum Capital Gains Tax liability (c) × 28% = (d)	-	£28,000	£14,000	£70,000
Amount to be taken offshore or reinvested under mitigation steps (e)		£500,000	£200,000	£30,000
Amount Y - amount to be taken offshore or reinvested plus maximum CGT liability (d) + (e) = (f)		£528,000	£214,000	£370,000
Shortfall - difference between Y and disposal proceeds, unless disposal proceeds are greater than Y (f)−(e) = (g)		£28,000	£14,000	Disposal proceeds greater £0
Amount that I can deposit in CTD within 45 days of disposal		£28,000	£14,000	Not Applicable
Amount I must take offshore or reinvest within 45 days of disposal if he chooses to make the maximum deposit under the CTD scheme (e) - (g) -		£472,000	£186,000	£300,000

There is no requirement for the taxpayer to make a tax deposit if they prefer to meet their capital gains tax liabilities from other funds. If they do not make a tax deposit, the amount to be taken offshore or reinvested is not reduced.

19.20 Pooling investments in co/group

19.20.1 *Multiple claims*

Section 809VN(1) ITA provides:

> Subsection (2) applies if at any time income or chargeable gains of an individual are treated under section 809VA as not remitted to the UK as a result of—
> (a) more than one qualifying investment made in the same target company,
> (b) more than one qualifying investment made in companies in the same eligible trading group, or
> (c) qualifying investments made
> [i] in an eligible trading company and
> [ii] in an eligible stakeholder company or eligible hybrid company that holds investments in that trading company.

Where this condition is met, we turn to s.809VN(2) ITA:

> In the application of section 809VG at that time—
> (a) treat the investments and holdings as if they were a single qualifying investment and a single holding, and
> (b) assume that a disposal of all or part of that deemed single holding affects the deemed single investment in the order in which the qualifying investments were made (that is to say, on a first in, first out basis).

There are two deemings here:

(1) A pooling of the various holdings. If an investor has made multiple investments qualifying for relief in the same company or group, clawback on receipt of a benefit affects all the investments unless they are all taken abroad or reinvested.
(2) Disposals are on a FIFO basis regardless of the asset actually disposed of.

The RDR Manual gives a straightforward example where the facts (stripping out irrelevancies)[67] are as follows:

[67] The example in full (including its irrelevant detail) is as follows:
In tax year 2011-12 A is a UK resident remittance basis taxpayer. He had substantial foreign earnings that year, and in June 2012 he makes an investment of £100,000 of his foreign earnings in K Limited, a private limited trading company. A receives

> **RDRM34530 Order of disposals: Multiple qualifying investments**
> [Jan 2019]
> *Example 1* (Asif and Kadigan Ltd)
> A is a remittance basis taxpayer.
> In June 2012 A makes an investment of £100,000 of his foreign earnings in K Limited. A receives 50,000 newly issued ordinary 'A' shares in the company. A claims remittance investment relief and the £100,000 foreign earnings are treated as not remitted to the UK.
> In June 2013, A makes a further investment of £100,000 that consists of foreign chargeable gains. A receives 40,000 newly issued ordinary 'B' shares. A claims remittance investment relief so the foreign chargeable gains are treated as not remitted to the UK.
> In June 2014, A sells the 40,000 ordinary 'B' shares Limited for £180,000. A does not carry out the appropriate mitigation steps.

The HMRC analysis is as follows:

> There has been more than one qualifying investment by A in K Limited so, for remittance basis purposes, the sale is matched against the 2012/13 investment first, that is A's original purchase of 50,000 ordinary 'A'

50,000 newly issued ordinary 'A' shares in the company in respect of his investment. The conditions applying to the making of his investment under the business investment relief provisions are met and A makes a valid claim on his 2012-13 Self Assessment tax return. The £100,000 foreign earnings are treated as not remitted to the UK.
In June 2013 A makes a further investment of £100,000 that consists entirely of foreign chargeable gains from 2012-13. As the value of K Limited has increased, A receives 40,000 newly issued ordinary 'B' shares for his investment. Once again, A makes a valid claim to business investment relief on his 2013-14 Self Assessment tax return in respect of the £100,000 investment of foreign chargeable gains, which are treated as not remitted to the UK.
In June 2014 A wants to buy a property in the UK and partially finances the purchase by selling the 40,000 ordinary 'B' shares in K Limited for £180,000. As A requires the money in the UK he does not carry out the appropriate mitigation steps and will be taxable on the foreign income or gains used to make the qualifying investment.
There has been more than one qualifying investment by A in K Limited so, for remittance basis purposes, the sale is matched against the June 2012 investment first, that is A's original purchase of 50,000 ordinary 'A' shares. A is taxable on £100,000 of his foreign earnings from 2011-12 and this is regarded as remitted to the UK in 2014-15. A has also made a UK capital gain on the disposal of his ordinary 'B' shares and he reports this on his 2015-16 SA return. The 50,000 'A' shares remaining invested in the company are treated as deriving from £100,000 foreign chargeable gains arising in 2012-13.

shares. A is taxable on £100,000 of his foreign earnings and this is regarded as remitted to the UK in 2014-15.
A has also made a UK capital gain on the disposal of his ordinary 'B' shares.
The 50,000 'A' shares remaining invested in the company are treated as deriving from £100,000 foreign chargeable gains.

19.20.2 *Qualifying & other investments*

Section 809VN(3) ITA provides:

> Subsection (4) applies if at any time—
> (a) income or chargeable gains of an individual are treated under section 809VA as not remitted to the UK as a result of one or more qualifying investments,
> (b) in addition to that investment or those investments, a relevant person holds at least one other investment in
> [i] the same target company,
> [ii] the same eligible trading group or
> [iii] a related eligible company,[68] and
> (c) that other investment is not a qualifying investment.

Where these conditions are met, we turn to s.809VN(4) ITA:

> In the application of section 809VG at that time—
> (a) treat the investments and holdings as if they were a single investment and a single holding, and
> (b) assume that a disposal of all or part of that deemed single holding is a disposal of a holding from a qualifying investment until the holdings from all the qualifying investments have been disposed of.

These are the same two deemings as s.809VN(2) discussed above; though the second of them is slightly differently worded.

The RDR Manual gives an example where the facts (stripping out irrelevancies)[69] are as follows:

[68] Section 809VN (5) provides: "The reference to a "related eligible company"—
(a) in relation to an eligible trading company, is to an eligible stakeholder company or eligible hybrid company that holds investments in that company, and
(b) in relation to an eligible stakeholder company, is to an eligible trading company in which that company holds investments."

[69] The example in full (including its irrelevant detail) is as follows:
E holds 100 shares in a UK trading company he set up in 2004 using £500,000 of his

> **RDRM34535 Business investment relief: Mixed funds** [Oct 2016]
> *Example 1* (Erik)
> E holds 100 shares in a UK trading company set up in 2004 using £500,000 of his UK taxed income. This is not a qualifying investment.
> In June 2012 E invests £500,000 of his foreign income into the company and receives an additional 100 newly issued shares. E claims remittance investment relief and the foreign income is not taxed as a remittance.
> In 2013-14 E sells half of his 200 shares for £750,000.
> E does not carry out the appropriate mitigation steps,

The HMRC analysis is as follows.

> The 200 shares are treated as a single holding and the disposal of 100 of the shares is treated, for remittance basis purposes, as out of qualifying investments first. E is treated as disposing of the investment made in June 2012 first and so will be taxed on £500,000 foreign income on the

UK taxed income. This is not a qualifying investment.
In June 2012 E invests a further £500,000 of his foreign income into the company and receives an additional 100 newly issued shares. As E's investment is a qualifying investment, he makes a claim to business investment relief on his tax return for 2012-13 and the foreign income is not taxed as a remittance.
In 2013-14 E decides to sell half of his 200 shares to help fund the purchase of a property in the UK and receives £750,000 for them.
As E does not carry out the appropriate mitigation steps, the 200 shares are treated as a single holding and the disposal of 100 of the shares is treated, for remittance basis purposes, as out of qualifying investments first. E is treated as disposing of the investment made in June 2012 first and so will be taxed on £500,000 foreign income on the remittance basis. E has also made a capital gain that he declares on his 2013-14 Self Assessment tax return along with the £500,000 foreign income remittance.
Once again, it does not matter whether E or another relevant person makes the investments. All investments are treated as a single holding and disposals will be treated as coming from the qualifying investments first.
If an investment is made with some funds that would qualify for business investment relief and some that would not, it is treated as two separate investments, one containing the qualifying funds and one containing the non qualifying funds. (s809VG(8) ITA2007)
In Example 1 in RDRM34530 if Asif's second investment of £100,000 in June 2013 had been funded half from foreign chargeable gains and half from a UK taxed source, this would be treated as two separate investments of £50,000. One of the investments of £50,000 would derive from the foreign chargeable gains and the other from UK taxed income. In any subsequent disposal where the mitigation step is not taken, the investment containing the foreign chargeable gains would be deemed as disposed of before the investment containing the non taxable funds.

remittance basis.
E has also made a capital gain.

In *Allam v HMRC*:[70]

(1) T lent funds to a company (a qualifying investment).
(2) The company declared a dividend left outstanding as a sum due to T ("the dividend debt")

The question was whether the dividend debt was an investment for the purposes of s.809VN(4) ITA. The FTT held:

> 275. ... There is no definition of "investment" in or for the purpose of s809VN. We therefore agree ... that "investment" in s809VN (and in the other provisions of relating to business investment relief) must be given its ordinary meaning informed by the context in which it is being used...
> 277. The same rationale does not apply to the use of the word "investment" in other parts of the business investment relief rules. For example, there is no reason why the concept of "investment" in those provisions should not encompass any interest in the share or loan capital of a company that a person acquires from a third person. That having been said, in our view, the meaning of "investment" in s809VN (and in other part of the business investment relief rules) must at the very least be informed by s809VC given that the provisions form part of the same code: for example, a (non-qualifying) investment is treated by s809VN(4)(a) as part of the same "holding" as a qualifying investment (for the purposes of s809VC(2)) and the same concepts of "disposal" (in s809VG(1)(b)) should apply to them.
> 278. Against this background, in our view, a normal dividend which is declared (and so becomes due and payable) does not, simply because it is not paid immediately, become an "investment" for the purposes of s809VN. In those circumstances, the dividend is a return on the investment (the shares). It is not a disposal of the investment. In the period before the dividend is actually paid, the obligation to pay the dividend does not (without more) become an "investment" for the purpose of the business investment relief rules so that when it is discharged the payment is treated as a disposal. This interpretation accords with the natural meaning of the words. It also avoids the risk of a dividend on shares becoming both taxable income and, at the same

[70] [2020] UKFTT 216 (TC). The decision had been issued 4 months previously, but the Tribunal subsequently decided they had made a mistake on this point, revoked that decision, and reissued their decision; see at [295].

> time, a potentially chargeable event under the business investment relief rules, which would run contrary to the purpose of those rules, which is to encourage investment in UK trading companies.
>
> 279. By a "normal" dividend in the previous paragraph, we mean a regular dividend paid out of the commercial profits of the company. We can envisage circumstances in which the same conclusion might not be reached – for example, if a dividend is paid out of profits created on a reduction in capital of the company. However, every case will have to be judged on its own facts in the context of all of the circumstances.
>
> 280. In our view, before an outstanding normal dividend can be treated as a further investment, there needs to be some further step which indicates that the shareholder is intending to reinvest the proceeds and put them at the disposal of the company. That may occur in a number of ways, for example, the shareholder and the company may take steps after a dividend has been declared to formalize the debt which is then outstanding between the shareholder and the company by entering into documentation to govern its terms or the shareholder may agree to accept further shares in lieu of the unpaid dividend. We also accept that that, in appropriate circumstances, it may be possible to infer that position has been reached between the company and its shareholders, for example, if a dividend has been left outstanding for a material period of time and/or if interest is charged on the amount due. Whether such an inference can be justified will depend on the circumstances of the case.

So far so good, and this was common ground on the appeal.

The decision is more doubtful when it applies this to the facts of the case:

> 281. If we turn to the facts of this case, in our view, the unpaid dividend declared on 19 December 2012 became an investment before it was paid on 14 March 2013. Steps were taken which indicate that Dr Allam was reinvesting the proceeds (albeit for a relatively short time) and putting them at the disposal of the company. The obligation to pay the dividend was added to the loan account of Dr Allam with the company and taken into account in the balance due to Dr Allam on that account. There was no differentiation made between the dividend and other amounts due to Dr Allam (which were clearly "investments" for these purposes) shown in that account in the respect. Interest was charged on the balance.
>
> 282. The outstanding dividend should therefore be treated as a loan made by Dr Allam and so as part of the same single investment and single holding in Allamhouse as his other qualifying investments (the overseas loans) and any other investments in Allamhouse that he may have had (s809VN(4)(a)).

This was approved by the UT.[71] But there was no loan, as that word is strictly understood.[72]

The tribunal might at least have acknowledged the unfairness which follows from their decision, but arguably that follows necessarily from the strictness of the potentially chargeable event rules.

There is here an important planning point, or trap, not to provide informal short term credit to a company where remittance investment relief has been claimed.

19.20.3 *Investments held by different persons*

Section 809VN(6) ITA provides:

> Subsections (2) and (4) apply whether the investments in question are held by the same relevant person or different ones.

This would apply (for instance) where some investments are made by one close company in which T is a participator, and other investments are made by another.

19.20.4 *Examples*

These rules work in anomolous ways.

Suppose:

(1) An individual ("T") makes an investment (say, a loan) in a company which qualify for remittance investment relief.
(2) T (or a relevant person) purchases other investments (say, shares) in the same company; those purchased shares are not a qualifying investment.
(3) T (or the relevant person) sells the shares.

The two investments are pooled, the sale is treated as a disposal of the loan, so the proceeds must be removed outside the UK.

Suppose:

(1) An individual ("T") makes an investment (say, a loan "the first loan") in a company and does not claim remittance investment relief (eg the loan may have been made before 2012).
(2) T (or a relevant person) lends to the same company ("the second loan") and claims the relief.

[71] [2021] UKUT 291 (TCC).
[72] See App 2.7 (Loan).

Pooling does not apply. Section 809VN(2) does not apply as there is only one claim for relief. Section 809VN(4) does not apply as the first and the second loan are both qualifying investments. (A loan or share subscription may be a qualifying investment even though the investor does not claim the relief.)

19.21 Investment from mixed fund

Section 809VO ITA provides:

> (1) This section applies if—
> (a) but for section 809VA(2) [remittance investment relief], income or gains would have been remitted to the UK by virtue of a relevant event, and
> (b) section 809Q (transfers from mixed funds) would have applied in determining the amount that would have been so remitted.

That is, s.809VO applies if:
(a) Remittance investment relief applies; and
(b) The investment is made out of a mixed fund.

Suppose:

(1) A mixed fund consisted of

capital	£90
income	£10
total	£100

(2) The investment was £10

In the absence of express provision, the onshore transfer mixed fund rule would apply. The investment would represent the £10 income, and the mixed fund would cease to be mixed. That would allow scope for planning. So s.809VO(2) provides:

> The relevant event counts as an offshore transfer for the purposes of section 809R(4).

This applies the offshore mixed fund rule. Thus on the facts of the example above:

(1) The investment is a mixed fund of £9 capital and £1 income.
(2) The offshore fund becomes a mixed fund of £91 capital and £9 income.

Section 809VO ITA provides:

> (3) The holding is to be treated as containing a proportion of each kind

> of income and capital contained in the invested property equal to the fixed proportion.
> (4) "The fixed proportion" is the proportion of that kind of income or capital contained in the invested property by virtue of subsection (2).
> (5) "The invested property" means the money or other property used to make the investment.

19.21.1 *Funds taken offshore*

Section 809VO ITA provides:

> (6) Subsection (7) applies in cases where—
> (a) section 809VG(2) [clawback remittance charge] does not apply because an amount is taken offshore, re-invested or used to make a tax deposit,[73] or
> (b) section 809VM(4) [CTD clawback charge] does not apply because an amount is taken offshore or re-invested.[74]
> (7) The amount taken offshore, re-invested or used to make a tax deposit is treated, immediately after that step, as containing the fixed proportion of each kind of income and capital contained in the holding.
> (8) In cases where section 809VG(2) applies—
> (a) the affected income or gains are so much of the fixed amount of each kind of income or gain mentioned in subsection (1)(a) as reflects the portion of the investment affected by the potentially chargeable event (see section 809VG(6)),
> (b) "the fixed amount" is the amount of that kind of income or gain that the holding is treated as containing by virtue of subsection (3), and
> (c) section 809Q does not apply in determining the affected income or gains.

These rules could still be exploited for tax planning, but the mixed fund TAAR is kept in reserve.[75]

19.22 Clearance

It is possible to seek advance clearance that the relief applies, under CAP1.[76] This is a non-statutory procedure, but a clearance would bind

[73] See 19.12 (Clawback remittance charge).

[74] See 19.19.2 (Tax deposit).

[75] Section 809VO(9) ITA provides: "Section 809R(2) and (3) and section 809S apply for the purposes of this section." See 20.11 (Mixed-fund TAAR).

[76] HMRC, "Non-statutory clearance service guidance".

HMRC, assuming full disclosure.

Annex B CAP1 sets out the points to cover in the application:[77]

Annex B - Business Investment Relief advance assurance checklist

Use this checklist if you want to ask HM Revenue and Customs (HMRC) to give you their view on whether a proposed investment can be treated as a qualifying investment as defined in section 809VC of Income Tax Act (ITA) 2007 ...

It helps us if you follow the order set out in the checklist in your clearance application and use the numbering on any supporting documents.

Send us your request by post to:

Business Investment Relief, HM Revenue and Customs, BX9 1BN

1. Information about the claimant and their request for advance assurance

1.1 The claimant's name, address and customer identification number in full, eg, National Insurance number (NINO) and Self Assessment (SA) Unique Taxpayer Reference (UTR). The claimant is the person whose foreign income and gains will be used to make the investment.

1.2 If you are requesting advance assurance on behalf of the claimant, state the capacity in which you are acting and your authority to do so where HMRC don't already hold this. Provide your contact details for correspondence including your phone number.

1.3 The legislation permits a 'relevant person' to make an investment using the claimant's foreign income or gains. A relevant person is defined in section 809M of ITA 2007. Please provide general information about the 'relevant person' if the 'relevant person' is:

- an individual, tell us the name and address, NINO, UTR and the relationship of the 'relevant person' to the claimant.
- a company, tell us the: registered office, place of tax resident, directors and shareholders (including their names and addresses), any UK tax reference, company registration number and reason for it being a 'relevant person', that is, its relationship to the claimant.

2. Information about the proposed investment(s)

2.1 General information about the company in which the proposed investment is intended to be made: name and registered office address, Company Registration Number, date and place of incorporation and UK tax reference if known

2.2 Details of all trading or other activities which the company, and any subsidiary company(ies), is carrying on or intends to carry on. Please provide detailed information that demonstrates that the company is an eligible trading, stakeholder or holding company ...

2.3 Details of how the investment will be structured.

2.4 Details about any shares to be issued to the claimant or 'relevant person' by the company and/or details of the nature of any loan(s) to be made by the claimant or 'relevant person' to the company.

2.5 Details of any loan or subscription agreement or other side agreement to be entered into by the claimant or 'relevant person'.

[77] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/748413/Annex_B.pdf*

2.6 The anticipated date that the income/gains will be brought to the UK and the date the investment will take place.

2.7 The amount of income/gains to be invested.

2.8 The anticipated SA Return year in which the claimant will claim the relief.

2.9 Copies of all supporting documents including:

- the latest available accounts of the company and of any subsidiary company or investment company, or an explanation of why no accounts are available
- a copy of any prospectus or similar document (such as a business plan or financial projections) issued by the company to potential investors
- an up-to-date copy of the Memorandum and Articles of Association for the company with details of any changes to be made

Please identify any part(s) or passage(s) of the documents that you think are particularly relevant.

2.10 Any other information relevant to the request.

3. Advice requested from HMRC

3.1 The nature of the assurance you are seeking from HMRC – set out your opinion of the tax consequences of the particular investment you want HMRC to consider and how you have arrived at that opinion.

3.2 A clear explanation of any point(s) on which you are uncertain. If you have already received professional advice please explain why you are still unclear and share any advice which you are content to disclose.

3.3 Any legal advice you have already received which you are content to disclose.

4. Claimant's confirmation

Please include with your request confirmations from the claimant (see 4.1 or 4.2 below)

4.1 To the best of their knowledge and belief, no 'relevant person' will (directly or indirectly) obtain or become entitled to obtain any related benefit, and no 'relevant person' expects to obtain any such benefit as a consequence of making the investment.

[For these purposes, a benefit is defined in section 809VF of ITA 2007]

4.2 To the best of their knowledge and belief they have told HMRC about all of the facts relevant to the investment/the advice sought and that these are correct.

5. Tax avoidance schemes

5.1 If there is an avoidance scheme which covers all or part of the transaction please provide details of the arrangement and/or any disclosure made to HMRC with the allocated DOTAS scheme reference number, if applicable.

19.23 Investment relief: Critique

Budget 2011 announced:

> **3.7 Review of non-domicile taxation** ... the rules mean that foreign income and gains are taxed if they are brought to the UK and this is a disincentive to inward investment. The Government will introduce the following reforms:
>
> - remove the tax charge when non-domiciles remit foreign income or capital gains to the UK for the purpose of commercial investment in UK businesses

It is melancholic to compare the aspiration expressed in three lines with the outcome, in 18 dense pages of legislation. The rules are complex, restrictive, and (most seriously, for potential investors) contain many uncertainties, as anyone who tries to apply them will discover.

In the consultation paper, HMRC said:

> 2.48 At the same time the Government recognises that complicated anti-avoidance provisions could deter non-domiciles from using this new incentive and believes that both these risks can be tackled by relatively straightforward provisions....
> The Government recognises that complexity can deter investment. Therefore, to make the investment incentive genuinely appealing to non-domiciles, the Government is clear that it should be free of unnecessary restrictions and be simple to use.[78]

I infer that the minister's intention clashed with the deeply ingrained culture of HMRC, that anti-avoidance is a consideration which trumps every other; and the latter prevailed. In consequence, the legislation has not lived up to the promise.

All else being equal, a remittance basis taxpayer will not wish to rely on this relief to invest in the UK, either directly or indirectly through trusts and companies, as investment elsewhere avoids the burden of the rules discussed in this chapter.

For a simple solution to this problem, see 18.12 (Relevant person rules: Critique).

19.24 Relief on paying remittance charge

19.24.1 *Paying rem. basis charge*

Section 809V(1) ITA provides:

> Subsection (2) applies to income or chargeable gains of an individual if–
> (a) the income or gains would (but for subsection (2)) be regarded as remitted to the UK by virtue of the bringing of money to the UK,
> (b) the money is brought to the UK by way of one or more direct payments to the Commissioners [HMRC], and

[78] HMT & HMRC, "Reform of the taxation of non-domiciled individuals: a consultation" (2011) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81510/consult_condoc_non_domicile_individuals.pdf*

> (c) the payments are made in relation to a tax year to which section 809H [remittance basis claim charge[79]] applies as regards the individual.

Where these conditions are met, s.809V(2) ITA provides the relief:

> The income or chargeable gains are to be treated as not remitted to the UK to the extent that the payments do not exceed the applicable amount (as defined in section 809H).[80]

The RDR Manual provides:

> **RDRM34020. Remittance Basis charge - money paid directly to HMRC** [Jan 2019]
> Money brought into the UK to pay the remittance basis charge (see RDRM32210) is treated as not remitted to the UK if direct payment is made to HMRC (ITA07/s809V). This exemption will only apply if the money is paid:
>
> - in respect of the tax due for the year in which the remittance basis has been claimed, and
> - the remittance basis charge is due for that tax year.
>
> Only remittances that relate to the remittance basis charge are covered by the exemption. Remittances of foreign income or gains to pay any other liability to UK tax, including for example income tax or capital gains tax on remitted amounts, are themselves chargeable to UK tax as remitted income or gains of the tax year in which the tax is paid to HMRC (although see also RDRM35140 - remittances of nominated income). This includes payments to settle enquiry cases by contract settlement except to the extent of any payments of the remittance basis charge included in the contract settlement (but not any interest or penalties on those amounts).
> The remittance basis charge can be paid in one or more amounts. However, the amount that benefits from the exemption provided at s809V is limited to the amount of the charge - that is either £30,000 or £50,000.[81] The amount due can be paid in one lump sum or in several stages, and may form part of the payments on account paid on 31 January or 31 July, or may be paid as a balancing payment. The exemption applies as long as the payment is in relation to the tax year in which the remittance basis charge is due.
> The exemption only applies where the remittance basis charge is paid

[79] See 17.12 (Remittance basis claim charge).

[80] See 17.12.1 (7 & 12-year residence tests).

[81] The text has not been updated for the increase from £50k to £60k in 2015.

> directly from foreign income or gains held outside the UK, the payment must be made direct to HMRC. This can be done either by:
>
> - cheque (drawn on a foreign bank account)
> - electronic transfer of funds.
>
> Taxpayers will need to keep sufficient records to show that payment of the £30,000, or £50,000 remittance basis charge was made directly to HMRC from an overseas account. A copy of a cheque (or cheques) drawn on the foreign bank account, or the relevant bank statement identifying the bank transfer are examples of acceptable evidence.

The Manual gives an example where A remits £40k to pay a £30k remittance basis charge:

> ***Example*** (Alex)
>
> A is a long-term UK resident remittance basis taxpayer. He uses the remittance basis in 2008-09 and plans to use it again in 2009-10. A therefore makes payments on account (see RDRM32390) of £100,000 on 31 January 2009 and on 31 July 2009 in respect of his 2009-10 liability.
>
> In July 2009 he pays £40,000 of that payment on account from his 2008-09 foreign income. Payment is made by cheque drawn on an account at a bank in the Isle of Man that was sent direct to HMRC.
>
> A's tax liability for 2009-10 is £200,000 including the remittance basis charge of £30,000, which has been wholly met from the payments on account that he has made. No further tax is due for this year.
>
> Because £40,000 of the tax that A has paid on account was paid directly to HMRC from an overseas account, £30,000 of the £40,000 income remitted may be treated as not remitted to the UK and is not chargeable to tax, unless A has instructed otherwise. The remaining £10,000 will be taxed as a remittance in the normal way. As it was remitted in July 2009 it will be a taxable remittance for the tax year 2009-10, and should be declared as such.
>
> In this example, all of the £40,000 was remitted in July. However the remittances might be split between the payment on account dates, for example £20,000 remitted on 31 January 2009 and a further £20,000 on 31 July 2009. In such cases, unless the taxpayer specifies otherwise, the £10,000 that is not subject to the exemption and so is a taxable remittance will be treated as having occurred at the later date, as this will usually be in the taxpayer's favour.
>
> Refer to RDRM34030 for example of where the 'remittance basis charge' is repaid to A, or otherwise no longer applies
>
> **Nominated Income or gains**
>
> If taxpayers use nominated income or gains to pay the remittance basis

> charge of either £30,000 or £50,000 it is treated as not remitted to the UK under section 809V. Because none of the individual's nominated income or gains is treated as having been remitted to the UK in that tax year you do not have to apply the 'ordering rules' at ITAs809I and s809J. See RDRM35100 Remittances of nominated income or gains.
> lf the remittance basis charge is repaid by HMRC it is treated as remitted at that point (see RDRM34030) and section 809I will be triggered.

See 20.19.9 (Nominated income used to pay remittance basis charge).

19.24.2 *B pays A's rem. basis charge*

The Manual formerly discussed the somewhat unusual situation where B pays the remittance basis charge due from A:

> ***Example 1*** (Olaf and Giselle)
> O uses the remittance basis in 2008/09 and 2009/10 and 2010/11; but in 2011/12 O chooses not to use the remittance basis.
> In 2011/12 O makes payment of £30,000 direct to HMRC from his foreign income that arose during 2009/10. This payment is to pay the remittance basis charge of his sister G, who is a long term resident of the UK and who has made a claim to the remittance basis in 2011/12.
> The £30,000 remitted by O may be treated as not remitted to the UK under Section 809V ITA 2007 and so is not chargeable to tax provided that the payments made for a particular year do not exceed £30,000.
> The position should be looked at critically if there is evidence of any reciprocity. In the case of doubt or difficulty submit to PTI Advisory Foreign Income and Remittance Basis Team.

This text was removed in January 2014. The Manual formerly provided:

> The £30,000 remittance basis charge may be paid directly from outside the UK to HMRC by a person other than the individual; the most common example will be a payment by an employer on behalf of an employee. In such cases the £30,000 paid to HMRC may form part of the taxpayer's income, for example if paid by his employer the £30,000 will form part of the employee's earnings. To the extent that these are regarded as foreign chargeable earnings this exemption will apply.

This text was removed in June 2016.

19.24.3 *Repayment of rem. basis charge*

Section 809V(3) ITA provides:

> Subsection (2) [relief for payment of remittance basis charge] does not

apply to payments if or to the extent that they are repaid by the Commissioners.

The RDR Manual provides:

> **RDRM34030 repayment by HMRC** [Jan 2019]
> There may be some exceptional circumstances where the £30,000 or the £50,000 remittance basis charge is paid to HMRC but then is later repaid, or is otherwise no longer due.
> Any foreign income or gains remitted to pay the charge and initially covered by the exemption at ITA07/s809V will be regarded as a remittance when the charge is withdrawn and so will be treated as liable to UK tax at that point (ITA07/s809V(2)).
> **Change of claim**
> The £30,000 or £50,000 remittance basis charge is most likely to be withdrawn where an individual, having made a claim for the remittance basis and paid the charge for that year, subsequently decides not to claim the remittance basis for that year and makes an amendment to their Self Assessment return (TMA1970/s9ZA). In such circumstances ITA07/s809H will not apply for that tax year, so the exemption cannot apply either.
> **Change of status**
> The other situation where the £30,000 or £50,000 is likely to be withdrawn or not otherwise due is where it later transpires an individual has claimed the remittance basis for a tax year but was not entitled to do so as they were UK domiciled and ordinarily resident in the UK in that year.
> **Effect**
> If the exemption under section 809V was claimed, the foreign income or gains used to pay the remittance basis charge will not have been subject to tax in the year in which they arose/accrued because the individual used the remittance basis in that year. Due to the exemption the income or gains will also not have been subject to tax when brought into the UK.
> In such situations there are two possibilities:
>
> - the £30,000 or £50,000 payment was made from foreign income or gains from an earlier year in which the individual was entitled to claim the remittance basis and did so. The £30,000 or £50,000 is treated as a taxable remittance and will be taxable in the year in which the remittance to HMRC occurred
> - the £30,000 or £50,000 payment was made from foreign income or gains from the present year or an earlier year in which the individual was not entitled to claim the remittance basis. The income or gains will be taxed on the arising basis for the year in which the foreign

income or gains actually arose. If the return cannot be amended you may need to deal with such assessments under the 'discovery provisions' at TMA70/s29.

Example 1(Alex)

In the example in RDRM34020 above, A's circumstances change and he decides not to claim to be taxed on the remittance basis for 2009-10. His liability for 2009-10 on the arising basis is £195,000.

When A made the payment on account of £40,000 in July 2009 he anticipated that £30,000 of it would be attributed to the remittance basis charge. In the event he did not claim to be taxed on the remittance basis. He does not have to pay the remittance basis charge.

None of the payments on account can therefore be attributed to the remittance basis charge and the £40,000 that A paid from his 2008-09 foreign income (remember that A did use the remittance basis in 2008-09) in July 2009 is a taxable remittance.

Any cases of difficulty should be referred to Specialist PT, Personal Tax International - Advisory, Foreign Income and Remittance Basis Team.

19.24.4 *Payment on account*

The RDR Manual provides:

> **RDRM34030 repayment by HMRC** [Jan 2019]
>
> ... Finance Act 2013 introduced section 809UA ITA 2007 for the years 2012-13 onwards. This legislation allows payments on account made in anticipation of a claim to the remittance basis to continue to be treated as not remitted if no claim to the remittance basis is subsequently made provided an amount equivalent to the foreign income and gains paid directly to HMRC is taken offshore.

Section 809UA ITA provides:

> (1) Subsection (2) applies to income or chargeable gains of an individual if—
>
> (a) the income or gains would (but for subsection (2)) be regarded as remitted to the UK by virtue of the bringing of money to the UK,
>
> (b) the money is brought to the UK by way of direct payments to the Commissioners on account of income tax,
>
> (c) the tax year ("tax year 2") in respect of which the payments on account are made is a tax year for which section 809H (remittance basis charge for long-term UK resident) does not apply as respects the individual, and
>
> (d) that section applied as respects the individual for the previous

> tax year ("tax year 1").

The wording draws on s.809V.

> (2) The relevant amount of income or chargeable gains is to be treated as not remitted to the UK if money equal to the relevant amount is taken offshore by—
> (a) the 15 March following the end of tax year 2, or
> (b) such later date as the Commissioners may allow on a claim made by the individual.
> (3) A claim under subsection (2)(b)—
> (a) may be made only if the individual has made and delivered a return under section 8 of TMA 1970 for tax year 2 and reasonably expects to receive from the Commissioners a repayment of tax paid in respect of that tax year, and
> (b) may be made no later than the 5 April following the end of tax year 2.
> (4) Money that is taken offshore in accordance with subsection (2) is to be treated as having the same composition of kinds of income and capital as the money used to make the payments on account.
> (5) In this section "the relevant amount" means the lower of the following—
> (a) the amount brought to the UK as mentioned in subsection (1)(b), and
> (b) the applicable amount (as defined in section 809H) for tax year 1 ...

19.25 Foreign services relief

Section 809W(1) ITA provides:

> This section applies to income or chargeable gains if—
> (a) the income or gains would (but for subsection (2)) be regarded as remitted to the UK because conditions A and B in section 809L are met,
> (b) condition A in section 809L [remittance condition A] is met because a service is provided in the UK ("the relevant UK service"), and
> (c) condition B in section 809L [remittance condition B] is met because section 809L(3)(a) or (b)[82] applies to the consideration for the relevant UK service ("the relevant consideration").

[82] In short, the consideration derives from the income/gains; see 18.16 (Condition B: Link to income/gain).

I refer to these conditions as "**services relief conditions A and B**".

Section 809W(2) ITA provides the relief:

> The income or chargeable gains are to be treated as not remitted to the UK if the following conditions are met but this is subject to subsection (5).

I refer to this as "**foreign services relief**".

There is no relief if remittance conditions C or D apply, but in practice that will not often happen.

More importantly, there is no relief if s.809L(3)(c) or (d) apply, which deal with debt remittances. Thus suppose:

(1) T borrows and uses the borrowed money to pay for foreign services provided in the UK: the debt is a relevant debt.
(2) T repays the debt.

There is a taxable remittance under the debt remittance rules even though a direct payment for the services would qualify for foreign services relief and so be exempt. This is anomalous. The reason might be the difficulty of applying services relief condition B to a relevant debt case; if so it is not a good reason as services condition B is itself misconceived.

Unless the service is provided in the UK there is no need for foreign services relief.[83] In the following discussion it is assumed that the service is provided in the UK.

19.26 Services cond^n A: non-UK property

Section 809W(3) ITA provides:

> Condition A is that the relevant UK service relates wholly or mainly to property situated outside the UK.

One needs to identify:

(1) The service
(2) The property (if any) to which the service relates
(3) The situs of that property
(4) If the service relates to foreign property and to other things, whether the property relates "mainly" to the foreign property

Situs is relatively straightforward. Section 809W(6) ITA incorporates the

[83] See 18.15 (Service provided in the UK).

CGT situs rules.[84]

19.26.1 *Relating to non-UK property*

EN Clause 23 Sch 7 Remittance Basis Amendment 354 provides some obvious examples:

> 7. Condition A would cover for example,
> [1] fees paid to a UK bank for managing an individual's overseas investment portfolio.
> [2] ... legal or brokerage fees in respect of offshore assets, such as the legal fees on the sale of a foreign house....

This is considering fees paid by the individual, but the same applies to fees paid by a relevant person, such as a settlor-interested trust:[85]

> 13. Among the sort of payments that Condition A might cover would be fees paid by non-UK resident trustees to UK advisers for advice on
> [1] managing the assets held in the trust or
> [2] non-UK assets the trustees are considering purchasing.
> Accountancy fees for preparing non-UK tax returns would also be covered providing the majority of the accountancy services relates to non UK property.

The RDR Manual provides:

> **RDRM34060 Relevant services provided in the UK - location of overseas property** [Jan 2019]
> In applying these rules it is important to determine exactly what the service relates to, not just to whom it is provided.
> For example, services may be said to be provided for non-resident trustees (a relevant person) RDRM33030 in respect of shares that the trust owns in a non-resident company (that would, if it were UK resident, be a 'close' company').[86] However if the service actually

[84] Section 809W(6) ITA provides: "sections 275 to 275C of TCGA 1992 (location of assets) apply for the purposes of subsection (3) as they apply for the purposes of TCGA 1992." See 103.1 (Asset situs for CGT: Introduction).

[85] After 2017 protected-trust relief is likely to be available, so it is not necessary for trustees to rely on foreign services relief.

[86] The author is confused, here and in the examples which follow, in that whether or not the company is a close company is not relevant; though in the kind of case under consideration the company is likely to be close. (In this section I use the expression "close" company loosely, to include a non-resident close company, ie one which would be close if UK resident.)

> relates to that company's underlying UK assets then the service does not relate to property 'outside the UK'.
>
> On the other hand, if the service is in connection with legal obligations between the trustees and the non-resident company in respect of, say the shares that are held, for example updating the share register in the local territory, then this is a service relating to property (the company/shares) wholly situated outside of the UK.
>
> *Example 1 (Petra)*
>
> P, a remittance basis user, is a participator in a Jersey company that would, if it were in the UK, be a close company. The company is a relevant person RDRM33030.[87] The company owns a portfolio of UK real estate. UK-based advisors produce an investment and tax report in respect of the company's UK activities; the advisors fees are paid overseas using P's foreign income.

The example is factually far-fetched since one would normally expect the company to pay for its own advice, out of its gross rental income, and (so far as the expense is deductible) there would in principle be no taxable remittance.[88] But we must assume (as the example requires) that P did pay for the advice. The HMRC analysis is as follows:

> The relevant UK service is the provision of advice in a tax report which relates to the Jersey company's UK activities. It is the UK activities which are the subject of the advice, not the overseas company so the exemption cannot apply. We look through to what the work relates to.

More analytically, the service relates to property, not activities; but it relates to UK property and so HMRC are correct to conclude that the foreign services relief does not apply.

The moral for tax planning is that P should use foreign advisers (who may subcontract to the UK).

> *Example 1(a)*
>
> The Jersey company in example 1 above also has a French property, which makes up only 10% of its business.
>
> UK-based advisors produce a separate marketing report in respect of this property. The advisors fees are paid overseas using P's foreign income.
>
> The service provided in the UK - in this case the preparation of the report - relates to a non-UK property. So the exemption at ITA07/s809W

[87] The facts that the company is close, and a relevant person, are irrelevant; see above footnote.

[88] See 18.17.1 (What is trading income).

> would apply, assuming the other conditions are also met.

This is straightforward.

> **RDRM34040 Relevant services provided in the UK** [Jan 2019]
> *...Example 6 (Micho)*
> M, a remittance basis user, employs UK-based agents to prepare his US tax return. He uses his foreign income to pay for this service, paying directly into the agent's offshore bank account. This is a service provided in the UK.
> Advice on the completion of a non-UK tax return would generally be within the exemption providing the majority of the advice relates to non-UK property; for example:
> 1. M's major source of income is UK salary and other UK employment benefits, and most of the work relates to this.
> This is service work relating to non-asset related income, eg employment income, so whether UK employment or not there is no property so the exemption at s809W cannot apply.

More analytically, an employment contract is property,[89] and the service relates to it. However a contract of UK employment is likely to be subject to UK law, and so UK situate; so the conclusion that foreign services relief does not apply is correct. The moral, again, is that M should use foreign advisers.

The Manual continues:

> 2. Most of the work undertaken is in respect of his UK sources of income and gains, albeit these are small compared to his world wide income and gains.
> The service relates to investment income/gains from UK sources so it is outside the exemption.

More analytically, the issue is CGT situs, not source, but in practice the two are normally the same.

> 3. Most of the work undertaken is in respect of advice relating to investment income/gains from non-UK sources.
> The service provided relates to investment income/gains from non-UK sources, so it is within the exemption if all other conditions are met.

Perhaps more importantly, fees for UK tax advice, and for preparing UK tax returns, will similarly be exempt if they relate mainly to non-UK assets.

[89] *O'Brien v Benson's Hosiery* 53 TC 254.

In some cases, it would be helpful for invoices to identify expressly the property to which the services charged for relate.

19.26.2 *"Wholly or mainly"*

The RDR Manual provides:

> **RDRM34040. Relevant services provided in the UK** [Jan 2019]
> ... For the purposes of applying the exemption "wholly or mainly" means more than half. Wholly or mainly relates to the service provided, not the property, and is, in general, judged by reference to work done, normally time spent.
> However, if advisers value the measurement of work done using a variety of factors, such as, for example a basis of both time and fee rate (eg use of a team specialising in international property), it is appropriate that this should be reflected in the considerations of "wholly or mainly". Other factors may include the fee and time rate if specialist advice was required, split of assets between UK and foreign situs, and the place of research or administration.[90]

The RDR Manual provides an example:

> **RDRM34040. Relevant services provided in the UK** [Jan 2010]
> ... *Example 2 (Ritika)*
> R, a remittance basis user, engages an investment manager based in the UK to manage her investment portfolio which covers assets both in and outside the UK and which changes throughout the year. ... Whether Condition A is met depends on whether the service provided relates wholly or mainly to property situated outside the UK.
> If the advice relates to assets and investments held by R, and/or her obligations that ensue from these (eg completing valuation/ownership details to comply with requirements in the jurisdiction where the assets are based), and the advice relates to both UK-situs and offshore situs assets, it will depend on the split of the assets.
> For example, if she holds, say, 60% foreign assets, and the advice given relates to all of the assets held in the portfolio, then the 'wholly or mainly' test would be met.
> If the advisers are considering changes in R's portfolio or the acquisition of UK assets and their research is UK-centric, then the 'service' provided in the UK is likely to relate to UK property, regardless of what is eventually acquired.

[90] The same point is made in EN Clause 23 Sch 7 Remittance Basis Amendment 354.

The tax planning moral is that R should instruct the investment managers to invest in non-UK property, but in practice she will want to do that for other reasons anyway; or (better) appoint foreign managers and then R can forget about the requirements of foreign services relief.

19.26.3 *Identifying the service*

It is necessary to identify what is the service before identifying what is the property to which the service relates:

(1) There may be one service relating to UK and non UK property, in which case one applies the "wholly or mainly" test.

(2) There may be separate services, one (or more) relating to UK property, and one (or more) relating to foreign property, in which case the services relating to the foreign property only can qualify for the relief.

Of course either analysis may better suit the taxpayer or HMRC, depending on the outcome of the wholly or mainly test. The VAT distinction between single (though composite) and multiple supplies is applicable here.

The RDR Manual provides:

> **RDRM34040. Relevant services provided in the UK** [Jan 2019]
> ... If
>
> [1] the services (and thus the consideration due for that service) can be clearly and specifically identified as relating either to UK assets or to non-UK assets and
>
> [2] it is possible to separately identify this from the fees structure and invoicing,
>
> the work relating to UK assets will not be regarded as meeting the "wholly or mainly" test at Condition A in section 809W.[91] This does not necessarily require a separate advice letter, report or invoice ("split-invoice") to be issued, as long as the individual is clearly able to identify from the invoice to what his payments relate. ...

If that is right, a remittance basis taxpayer should not use a UK investment manager, say, as the commission on the purchase of UK situate securities would not be exempt, even if the securities as a whole are mainly non UK situate. A UK investment manager should be used only if no UK situate

[91] Author's footnote: It follows that the work relating to the foreign assets does meet the wholly or mainly test (even if the foreign assets are a minority of the whole).

securities are purchased.

Where there are two or more separate supplies, some exempt, some not, it is necessary to identify the consideration given for each supply. The RDR Manual discusses apportionment:

> **RDRM34040. Relevant services provided in the UK** [Jan 2019]
> If there is a split contract for services relating to UK and non-UK assets you should accept the computations if the split bears a reasonable resemblance to the actuality of service provided.
> Any attempt to use artificial or otherwise unrealistic cost structures, for example to increase the costs attributed to non-UK property advice work against UK-property advice work should be strongly resisted. ...

See too 18.15.3 (Identifying the services).

19.27 Services condⁿ B: Pay non-UK bank

Section 809W(4) ITA sets out services relief condition B:

> Condition B is that the whole of the relevant consideration is given by way of one or more payments to one or more bank accounts held outside the UK by or on behalf of the person who provides the relevant UK service.

No relief is available if any part of the fees are paid in any other manner, for instance by way of set-off.

The service provider will generally remit the payment to the UK immediately on receipt. That does not affect the customer's tax position. In particular:

(1) If the service provider is not a relevant person, it does not matter whether it subsequently receives money in the UK.

(2) Even if the service provider is a relevant person, it is considered that the money it receives in the UK is derived from the work done in providing the services, and is not derived (even indirectly) from the customer's income.[92]

(3) Even if that were wrong, s.809W(2) is wide enough to provide exemption in this case.

That is sensible, as the customer will not usually know, and cannot be expected to know, what the service provider does with its own money.

[92] See 18.18.5 (T buys asset from V).

19.27.1 *Services condition B: Critique*

I am unable to see the purpose of services relief condition B. It continues the rule in *Timpson's Executors v Yerbury* applicable under the pre-2008 remittance basis. Perhaps the policy was that something which was a remittance under the pre-2008 rules should in principle continue to be a remittance under the ITA remittance rules. If so the policy was misguided. The opportunity should have been taken to create a new and coherent set of rules. As it is, suppliers of services relating to foreign property will need to open foreign bank accounts and the individual must ensure that they pay all the fees into that account; a pointless and inconvenient bureaucratic requirement, but there it is.

In practice it may be easier to appoint foreign advisers, or other suppliers, so as not to have to bother about the relief.

19.28 Services relief: s.730/s.87 benefit

Section 809W(5) ITA provides:

> Subsection (2) does not apply if the relevant UK service relates (to any extent) to the provision in the UK of—
> (a) a benefit that is treated as deriving from the income by virtue of section 735,[93] or
> (b) a relevant benefit within the meaning of section 87B of TCGA 1992 that is treated as deriving from the chargeable gains by virtue of that section.[94]

I refer to a benefit within (a) or (b) as a **"s.731/s.87 benefit"**.

I do not see what the legislation is aiming at here. The following conditions must all be satisfied:

(1) A service is provided in the UK.
(2) The service relates to non-UK property.
(3) The service relates to the provision *in the UK* of s.731/s.87 benefit.

Points (2) and (3) appear to be contradictory.

Is the following a possible (if unlikely) scenario to which the rule might apply?[95]

(1) P transfers (1) RFI and (2) clean capital to an offshore trust.

[93] See 50.39 (Section 731 remittance basis).
[94] See 61.19 (s.87 remittance basis).
[95] I am grateful to John Barnett for this suggestion.

(2) Later P borrows from a UK bank to buy a UK house. The trustees charge the clean capital to guarantee P's borrowing. The trustees employ UK lawyers to advise on the guarantee.

The analysis might be:

(1) The lawyers' service relates:
  (a) wholly or mainly to property outside the UK (the clean capital)
  (b) to a lesser extent, to a s.731/s.87 benefit to P.

In the absence of s809W(5) the trustees could use the RFI to pay the lawyers. Section 809W(5) might prevent this.

Whether this unusual scenario merits specific legislative counteraction is highly doubtful.

It is suggested that s.809W(5) ITA should be repealed.

19.29 Exempt property

Section 809X(1) ITA provides:

> Exempt property which is brought to, or received or used in, the UK in circumstances in which section 809L(2)(a) applies[96] is to be treated as not remitted to the UK.

I refer to this as **"exempt property remittance relief"**.

There are five categories of exempt property:

Exempt property	**See para**
Public access for works of art	19.31
Clothing/footwear/jewellery/watches for personal use	19.32
Property brought to UK for repair	19.33
Temporary importation (275 days)	19.34
Small remittances (under £1,000)	19.35

I deal with the categories in the statutory order, though temporary importantion is the most important; the others are of specialist or de minimis interest only.

The exemptions do not extend to remittance condition C or D, but those conditions will not often apply.

Suppose:

(1) T borrows to purchase exempt property.
(2) The exempt property is brought/received/used in the UK.

[96] Section 809L(2)(a) applies if "money or other property is brought to, or received or used in, the UK by or for the benefit of a relevant person."

Is the debt is a relevant debt? The debt relates to the exempt property, so the question is whether the exempt property "falls within s.809L(2)(a)". It is the old question of how far to carry the deeming.[97] It is considered that since the exempt property is treated as not remitted, it is treated as not falling within s.809L(2)(a), so the debt is not a relevant debt, and repayment out of foreign income or gains is not a taxable remittance. If the property ceases to be exempt, there would be a remittance under s.809R(3).[98]

19.30 Exempt property code: Definitions

Section 809Z6 ITA provides some definitions.

Section 809Z6(1) ITA provides:

> This section applies for the purposes of sections 809X to 809Z5.

These sections cover all the exempt property exemptions.

19.30.1 *"Property"*

Section 809Z6(2) ITA provides:

> "Property" does not include money.

This is an artificial definition of "property" as the word in its natural sense does include money.

In the remittance basis provisions outside s.809X to s.809Z5, the word "property" is used without a definition, and does include money.[99] This breaches the somewhat elementary principle of good drafting, not to use the same word with different meanings. The consequence is to cause confusion and make discussion more difficult, as care is needed in choice of terminology. In this chapter:

– the word *property* (by itself) does include money;
– where I want to refer to "property" in the artificial s.809Z6(2) sense, which applies for exempt property purposes, I use the expression *property (excluding "money").*

19.30.2 *"Money"*

Section 809Z6(3) ITA provides an inclusive definition of money:

[97] See App 8.2 (Deeming provisions: Construction).
[98] See 20.7 (Income/gains used to pay debt).
[99] See 18.13.1 ("Property" and "money").

> In subsection (2) "money" includes—
> (a) a traveller's cheque,
> (b) a promissory note,
> (c) a bill of exchange, and
> (d) any other—
> (i) instrument that is evidence of a debt, or
> (ii) voucher, stamp or similar token or document which is capable of being exchanged for money, goods or services.

Why does the drafting identify these four types of money? It is not following any statutory precedent definition of money.[100] The answer is that it is adopting the concept of money used in the pre-2008 remittance basis. The pre-2008 rule that there was only a taxable remittance if the asset remitted was "money". There was some case law discussing this. In *Scottish Widows Fund Life Assurance Society v Farmer*:[101]

> Now, actual receipt of money, it seems to me, can only be effected in one of two ways. Either the money itself must be brought over in specie, or the money must be sent in the form which, according to the ordinary usages of commerce, is one of the known forms of remittance.

What is a "commercially recognised form of money"? In *Thomson v Moyse*:[102]

> Nor is it necessary that Mr Moyse ... should receive the sums in coins or dollar notes or treasury notes. It is sufficient if he ... receives the sums in England in any of the other forms of money recognized by commercial men, such as bills of exchange, cheques, promissory notes or cash at bank.

The former Inspectors Manual echoed the point:

> ***IM1564 meaning of 'sums received in the UK'*** *[Dec 06]*
> *The receipt may be in any commercially recognised form of money, for*

[100] For completeness: the nearest precedents I can find are:
(1) sch 9 POCA 2002: "cash" defined to include travellers' cheques
(2) s.1102 CTA 2010: "securities" includes a promissory note or other instrument evidencing indebtedness...

[101] 5 TC 502 at p.508, following *Gresham Life v Bishop* 4 TC 464 at p.476. But the question is to some extent a question of fact, not law. Commercial practices change over time. See *Chitty on Contracts* (34th ed., 2021), 24-054 (Mode of payment); and see the 6th edition of this work (2017/18) para 9.26 (UK receipt must be money or commercial equivalent).

[102] 39 TC 291 at p.340.

> *example, cash, notes, cheques, promissory notes, bills of exchange, or financial credit.*

This is the origin of the categories set out in the statutory definition of money.

If that is right, then the definition might only for the avoidance of doubt, as the items specifically mentioned could all be "money" in the general sense; but money has a range of meanings[103] and a definition adds clarity.

"Instrument that is evidence of a debt" should be construed *ejusdem generis* with traveller's cheques, promissory notes, and bills of exchange. These may all be regarded as commercially equivalent to money.

The statutory definition is expressed to apply only for the purposes of s.809Z6(2), through which it applies for the purposes of s.809X to s.809Z5. It is also used in para 86 sch 7 FA 2008 (2008 transitional relief) where it is incorporated by reference.[104]

Elsewhere in the remittance basis provisions the word *money* is used without definition, and has its ordinary meaning. So, strictly, care is needed in use of terminology. In this chapter:
- when the word *money* is used in the defined sense, which applies in the exempt property context, I refer to it as "money" with scare quotation marks.
- when the word *money* is used in its ordinary sense, I write it without quotation marks.

But in practice the statutory definition will not usually make any difference.

19.30.3 *Property "being in the UK"*

Section 809Z6(4) ITA defines "being in the UK":

> References to property being in the UK are references to the property—
> (a) being in the UK after being brought to, or received in, the UK in circumstances in which section 809L(2)(a) applies, or
> (b) being used in the UK in circumstances in which section 809L(2)(a) applies.

Section 809L(2)(a) applies if "money or other property is brought to, or

[103] See 96.5.1 (Terminology: Currency/money).

[104] The definition is also repeated verbatim in s.809Y. That is otiose as the definition in s.809Z6 would apply: that definition applies for s.809X to s.809Z5. But it does not matter.

received or used in, the UK by or for the benefit of a relevant person."

19.30.4 *"Lost, stolen or destroyed"*

Section 809Z6(5) ITA provides:

> References to property being lost, stolen or destroyed are to the property being lost, stolen or destroyed whilst in the UK.

19.30.5 *"Compensation payment"*

Section 809Z6(6) ITA provides:

> "Compensation payment", in relation to property that has been lost, stolen or destroyed, means any payment of compensation (whether under an insurance policy or otherwise) in respect of the property.

19.30.6 *Compensation payment "released"*

Section 809Z6(7) ITA provides:

> A compensation payment is "released" on the day on which it first becomes available for use in the UK by or for the benefit of any relevant person.

19.30.7 *"Recovered"*

Section 809Z6(8) ITA provides:

> Property that has been lost or stolen is "recovered" on the day on which it becomes available to be used or enjoyed in the UK by or for the benefit of a relevant person.

19.31 Public access rule

19.31.1 *Introduction*

Suppose an individual has purchased works of art out of foreign income or gains. It may be possible to lend these works to UK institutions without a taxable remittance[105] but s.809Z ITA provides an additional exemption for works of art brought to the UK for public display. Perhaps it is intended for the case where the institution is a relevant person.

Section 809X(3) ITA provides:

> Property is exempt property if it meets the public access rule (see section 809Z).

[105] See 18.14.1 (Property brought to UK).

Section 809Z(1) ITA provides:

> Property meets the public access rule if conditions B and C are met.

I refer to **"public access conditions B and C"**.

The former conditions A and D were deleted by the FA 2013. Former condition A had restricted the relief (in short) to works of art. It is now available (in short) for any property (excluding money) but the requirement of public display at an approved gallery or museum effectively limits it to chattels of public interest. Former condition D had incorporated VAT rules by reference which required several pages to set out and which the 2012/13 edition of this work had described as "quite pointless".

19.31.2 *Public access*

Section 809Z(3) ITA provides:

> Condition B is that—
> (a) the property is available for public access at an approved establishment,
> (b) the property is to be available for public access at an approved establishment and, in connection with its being so available, is in transit to, or in storage at, public access rule premises, or
> (c) the property has been available for public access at an approved establishment and, in connection with its having been so available, is in transit from, or in storage at, public access rule premises.

The key terms here are "available for public access" and "approved establishment." Both are defined.

19.31.3 *Available for public access*

Section 809Z(4) ITA provides:

> Property is "available for public access" at an approved establishment if the property is—
> (a) on public display at the establishment,
> (b) held by the establishment and made available to the public on request for viewing or for educational use, or
> (c) held by the establishment for public exhibition in connection with the sale of the property.

The RDR Manual outlines the statutory provision and continues:

> **RDRM34140 available for public access - definition** [Jan 2019]
> ... Some property qualifying under the public access rule will be on permanent display at an approved establishment. Other works will have been lent to a museum or art gallery as part of temporary exhibition - perhaps of the work of a particular artist.
> The second bullet above [para (b)] might apply to articles that are too fragile to be on permanent display.
> Prior to 6 April 2012, property brought into the UK for public display in connection with its sale to satisfy the public access rule meant that if that property was sold in the UK a charge arose ....
> Since 6 April 2012, property brought to the UK for public display and subsequently sold in the UK may not result in a UK charge to tax if all of the conditions as set out at s809YA are met ...

19.31.4 *Approved establishment*

Section 809Z(5) ITA defines approved establishment. There are two types:

> An "approved establishment" is—
> (a) an approved museum, gallery or other institution within the meaning of Group 9 of Schedule 2 to the Value Added Tax (Imported Goods) Relief Order 1984, or

If one turns to the VAT (Imported Goods) Relief Order 1984 one might expect to find a definition of "approved museum, gallery or other institution." There is none, but article 2 does say that "approved" means approved by the secretary of state. In practice approval is granted by the National Import Reliefs Unit and its practice is set out in HMRC Notice 361 (Importing museum and gallery exhibits free of duty and VAT).

Section 809Z(5) ITA continues:

> An "approved establishment" is ...
> (b) any other person, premises or institution designated (or of a description designated) by the Commissioners.

The RDR Manual provides:

> **RDRM34130 approved establishment - definition** [Jan 2019]
> ...Any questions about what constitutes an 'approved establishment' or requests for approval as an 'approved establishment' (ITA07/s809Z(5)(b)) should be made to Specialist Personal Tax, PTI Advisory - Remittance Basis Technical Team.
> There is no set form which needs to be completed to request designation as an approved establishment, but all applications should be made in writing and provide sufficient detail about the relevant circumstances

relating to making property available for public access, including particulars of the appropriate person, premises or institution wanting to be designated as an approved establishment and full contact details.

19.31.5 *Public access premises*

Lastly, s.809Z(6) ITA defines public access rule premises:

> "Public access rule premises" are—
> (a) premises in the UK at which the property is to be, or has been, available for public access, or
> (b) other commercial premises in the UK used by the approved establishment for the storage of property in advance of its being, or after its having been, available for public access at the approved establishment.

19.31.6 *Condition C: Time limit*

Section 809Z ITA provides:

> (7) Condition C is that, during the relevant period, the property meets condition B for no more than—
> (a) two years, or
> (b) such longer period as the Commissioners may specify.
> (8) "The relevant period" means the period—
> (a) beginning with the importation of the property, and
> (b) ending when it ceases to be in the UK after that importation.
> (8A) But if the property is lost or stolen—
> (a) the relevant period ends with the time at which it is lost or stolen, and
> (b) a new relevant period begins with its importation or the time at which it is recovered.
> (9) "Importation" means the property being brought to, or received or used in, the UK in circumstances in which section 809L(2)(a) applies.

The definition of "importation" recognises that there may be an importation to the UK to which s.809L(2) does not apply, in which case time does not begin to run. The RDR Manual provides:

> **RDRM34150 Public access rule - Condition C - two year period** [Jan 2019]
> ...
> The relevant period starts with the importation of the property and ends when the property ceases to be in the UK after that importation.
> For these purposes, property is treated as brought into the UK or

imported if it is brought to the UK in circumstances such that it would be treated as a remittance to the UK within Condition A of ITA07/s809L (refer to RDRM33120 Condition A - property) if it were not for this public access rule (or any other rule exempting it) (ITA07/s809Z(9)).

The two year period will not necessarily start with the importation of the property as the property may not have been available for public access when it was first imported into the UK. For example it may be brought in under the temporary importation rule prior to public access.

Again the two year period will not necessarily end when the property ceases to be in the UK as the property may cease to be available for public access before the property actually leaves the UK. For example it may instead qualify under the repair rule after a period of public access.

Example 1 (Faizal)[106]

F is a UK resident remittance basis user. He is asked by a London museum, which is an approved establishment, if he will contribute a vase that he owns to an exhibition that the museum intends to stage. The vase is derived from F's relevant foreign income.

F arranges for the vase to be shipped to the UK from his holiday home in Switzerland. In May the vase is received by the museum and is put into secure storage for one month after which the museum will begin to set up the special exhibition. The exhibition lasts until the following year in October, at the end of which the vase is returned to Switzerland. The vase has been in the UK for 18 months in total. The vase is exempt property so F has not made a chargeable remittance.

Example 2

The circumstances are the same as Example 1 but this time, at the end of the exhibition, the vase is not returned to Switzerland. Instead, F asks for the vase to be sent to a well known restorer in Newcastle to be cleaned. The restorer keeps the vase in his business premises for a further eight months [!] and then in the following June F arranges for it to be sent back to his home in Switzerland.

The vase has been in the UK for 26 months. The vase, purchased using F's relevant foreign income is exempt property under the public access rule for the 18 months from its arrival in the UK in May to the October in the following year.

Between October and the following June it is within temporary importation rule (as it is with the repairer) and so remains exempt property. As the 2 year time 'repair' limit at Condition C has not been exceeded the vase remains exempt property throughout and F has not made a taxable remittance.

[106] I omit a few irrelevancies in setting out the text of this example.

> Any requests under the terms of ITA07/s809Z(7)(b) to extend the period during which property may remain in the UK under the terms of the public access rule should be made to Specialist Personal Tax, PTI Advisory, Foreign Income and Remittance Basis Team.

19.32 Personal use rule

Section 809X(4) ITA provides:

> Clothing, footwear, jewellery and watches are exempt property if they meet the personal use rule (see section 809Z2).

Section 809Z2 ITA provides:

> (1) Clothing, footwear, jewellery or watches meet the personal use rule if they—
> (a) are property of a relevant person[107], and
> (b) are for the personal use of a relevant individual.
> (2) In this section—
> (b) "relevant individual" means an individual who is a relevant person by virtue of section 809M(2)(a), (b), (c) or (d) (the individual with income or gains, or a husband, wife, civil partner, child or grandchild).

The words "*by virtue of section 809M(2)(a), (b), (c) or (d) (the individual with income or gains, or a husband, wife, civil partner, child or grandchild)*" are otiose because an individual who is a relevant person is necessarily a relevant person by virtue of those provisions; but no harm is done.

19.33 Repair rule

Section 809X(5)(a) ITA provides:

> Property is exempt property if— ...
> (a) the property meets the repair rule (see s.809Z3).

Section 809Z3 ITA provides:

> (1) Property meets the repair rule for the whole of the relevant period if, during the whole of that period, the property meets the repair conditions.
> (2) Property meets the repair rule for a part of the relevant period if—

[107] The restricted definition of "relevant person" in relation to pre-6 April 2008 income does not apply here; see 17.9 (Relevant person: Pre-2008 income/gain).

> (a) during the whole of that part of that period, the property meets the repair conditions, and
> (b) during the whole of the other part of that period, or the whole of each other part of that period, the property meets the repair conditions or the public access rule.

19.33.1 *Repair conditions*

Section 809Z3 ITA provides:

> (3) Property meets the repair conditions if the property—
> (a) is under repair or restoration,
> (b) is in transit from a place outside the UK to repair rule premises, in transit between such premises, or in storage at such premises, in advance of repair or restoration, or
> (c) is in storage at such premises, in transit between such premises, or in transit from such premises to a place outside the UK, following repair or restoration.

19.33.2 *Repair premises*

Section 809Z3 ITA provides:

> (4) "Repair rule premises" means—
> (a) premises in the UK that are to be used, or have been used, for the repair or restoration referred to in subsection (3)(b) or (c), or
> (b) other commercial premises in the UK used by the restorer for the storage of property in advance of, or following, repair or restoration of property by the restorer.[108]
>
> (6) Property meets the repair conditions, or the public access rule, during the whole of a period, or the whole of part of a period, if the property meets those conditions or that rule—
> (a) on the whole of, or on part of, the first day of that period or part period,
> (b) on the whole of, or on part of, the last day of that period or part period, and
> (c) on the whole of each other day of that period or part period.
> (7) "The relevant period" has the same meaning as in section 809Z.

The relief applies only to the property being repaired. There is no relief for the cost of repair. A remittance basis taxpayer would not normally bring

[108] Defined ss(5): "Restorer" means the person who is to carry out, or has carried out, the repair or restoration referred to in subsection (3)(b) or (c).

an asset to the UK in order to make use of UK repair or restoration services. Even if the importation of the asset did not give rise to a taxable remittance the payment for the repair would give rise to a taxable remittance. Thus yacht and similar restoration work, for instance, from remittance basis taxpayers is lost to the UK. But there it is.

19.34 Temporary importation rule

Section 809X(5)(b) ITA provides:

> Property is exempt property if— ...
>
> (b) the property meets the temporary importation rule (see s.809Z4)

Section 809Z4(1) ITA provides:

> Property meets the temporary importation rule if the total number of countable days (subject to any increase under subsection (3B)) is 275 or fewer.

19.34.1 *Countable day*

Section 809Z4(2) ITA defines "countable day":

> A "countable day" is a day on which, or on part of which, the property is in the UK by virtue of being brought to, or received or used in, the UK in circumstances in which section 809L(2)(a) applies (whether the current case, or a past case, when the property was so brought, received or used).

One needs to keep a lifetime record for every item of property (except money, which does not qualify for the relief as it is not "property"[109]).

Days before 2008/09 are not countable days, but that will not normally matter because chattels received in the UK before 2008 qualify for transitional relief.[110]

If the property is in the UK but brought/received/used by a non-relevant person, that does not count towards the countable days.

The relief was designed for chattels, but it applies to all forms of property (except "money"). It applies for instance on the acquisition of UK land or securities[111] (other than "money") if the purchase price is received by the

[109] See 19.30.1 ("Property").

[110] See 18.53 (Transitional: pre-2008 property).

[111] The receipt of UK securities is in principle a remittance; see 18.14.8 (Acquisition of UK security).

vendor offshore (and so is not remitted). I have wondered whether the law should be amended so the relief is restricted to chattels, but the relief is essentially a form of de minimis relief: short term UK use should not count. That should logically apply to all forms of property.

Section 809Z4(3) ITA deals with the interaction with other exempt property remittance reliefs:

> A day is not a countable day if, on that day or any part of that day—
> (za) the property meets the public access rule,
> (a) the property meets the personal use rule,
> (b) the property meets the repair rule,
> (ba) subsection (3A) applies to the property [lost or stolen property],
> (c) the notional remitted amount[112] in relation to the property is less than £1,000, or
> (d) all or any part of the income or chargeable gains contained in the property (or from which the property derives) is treated, or continues to be treated, under section 809VA(2), 809Y(8)(b) or 809YC(2) or 809YF(4) as not remitted to the UK.

The RDR Manual provides a straightforward example:

> **RDRM34220 Temporary importation rule - countable days** [Jan 2019]
> ... Example (Jez)
> On 15 January 2010 J, a remittance basis user, brings a rare oil painting into the UK to hang on the wall of his castle. J had purchased the painting two months earlier using his foreign employment income.
> On 1 July 2010 he allows the painting to be put on public display at the National Gallery, London. The painting remains on display for six months, until 31 December 2010, after which it is immediately shipped to J's office in Dubai on 1 January 2011.

The HMRC analysis is as follows:

> The conditions for meeting the public access rule for the period 1 July 2010 to 31 December 2010 have been satisfied.
> Bringing the painting into the UK would ordinarily be a taxable remittance under section 809L but we need to consider the exemption rules. During the period 15 January to 30 June 2009 the painting was not available for public access. This period is immediately followed by a period of public access from 1 July 31 December 2009.
> The 15 January to 30 June 2009 period falls to be considered under the

[112] This term is defined in s.809Z5 ITA: see 19.35 (Small remittance rule).

temporary importation rule (167 days).
For the period 1 July 2009 to 31 December 2009 the property is exempt property under the public access rule and therefore this period does not count towards the 275 day limit.

19.34.2 *Lost/stolen property*

Section 809Z4(3) ITA provides:

> A day is not a countable day if, on that day or any part of that day ...
> (ba) subsection (3A) applies to the property [lost or stolen property]

Section 809Z4(3A)(3B) ITA provides:

> (3A) This subsection applies to the property if—
> (a) it is not available to be used or enjoyed in the UK by or for the benefit of a relevant person because it has been lost, stolen or destroyed,
> (b) (if lost or stolen) it has not been recovered, and
> (c) no compensation payment has been released in respect of it.
> (3B) If—
> (a) property that has been lost or stolen is recovered,
> (b) the first day after the day on which it is recovered is a countable day, and
> (c) excluding that countable day there have already been 231 or more countable days in relation to the property,
> the number of countable days specified in subsection (1) is read as being increased by the number necessary for there to be 45 countable days beginning with the countable day mentioned in paragraph (b).

19.35 Small remittance rule

Section 809X(5)(c) ITA provides:

> Property is exempt property if ...
> (c) the notional remitted amount (see s.809Z5) is less than £1,000,

I refer to this as the **"small remittance rule"**.
Section 809Z5(1) ITA defines "notional remitted amount":

> The "notional remitted amount", in relation to property, is the amount that would be taken to be remitted to the UK in relation to the property (if section 809X did not apply in relation to the property).

Money does not qualify for the relief as it is not "property".[113]

[113] See 19.30.1 ("Property").

Each item of property qualifies for the £1,000 limit. HMRC agree. The RDR Manual provides:

> **RDRM34180 Exempt Property - Notional remitted amount less than £1,000** [Jan 2019]
> ... Example (Jacob)
> J, a remittance basis user, uses his foreign income to purchase a mobile phone for £250 whilst on holiday in Florida. Later in the same trip, while in Singapore he also buys a fountain pen for £485, and a new suitcase at the airport, as a present for his wife. This cost him £630. He brings all the items back to the UK with him upon his return home..
> The mobile phone, pen and suitcase all derive from J's foreign income so would be taxable as remittances when brought into the UK under ITA07/s809L. However each item's notional remitted amount (£250, £485 and £630 respectively) is under the £1,000 limit, so section 809Z5 provides that the phone, the pen and the suitcase are regarded as exempt property. J has not therefore made a chargeable remittance.
> In J's case the total cost of all the property brought to the UK exceeds £1,000. However the exemption limit applies to each item of property, unless it forms part of a set.

£1,000 was quite a substantial limit, but it has not been increased so its real value is gradually being whittled away by inflation.

The passage concludes with a comment on sets:

> Where the property in question forms part of a set and only part of that set is in the UK, a just and reasonable apportionment is made to find the notional value of that part by reference to what the remittance would have been had the whole set been brought to, or received or used in the UK at the same time as the part in question (ITA07/s809P(13)). ...

That issue will rarely if ever arise.

19.36 Exempt property clawback charge

19.36.1 *Clawback charges*

Section 809Y(1) ITA provides:

> Property that ceases to be exempt property is to be treated as having been remitted to the UK at the time it ceases to be exempt property.

I refer to this as the **"exempt property clawback charge"**.

Section 809Y(2) ITA provides:

> Property ceases to be exempt property in any of the following cases.

There are three cases where this may apply.

19.36.2 *Case 1: Sale in UK*

Section 809Y(3) ITA provides:

> The first case is where the whole or part of the exempt property is sold or otherwise converted into money[114] whilst it is in the UK.

An exchange for a non-money asset is not a sale.

19.36.3 *Case 2: Exemption ceases*

Section 809Y(4) ITA provides:

> The second case is where the property—
> (a) is exempt property only because it meets one or more of the relevant rules,[115]
> (b) ceases to meet that rule, or all of those rules, whilst it is in the UK, and
> (c) does not meet any other relevant rule.

19.36.4 *Case 3: Compensation payment*

Section 809Y(4B) ITA provides:

> The third case is where a compensation payment is released in respect of exempt property that has been lost, stolen or destroyed.

19.36.5 *Lost property*

Section 809Y(4A) ITA provides:

> Where exempt property has been lost, stolen or destroyed, the first and second cases do not apply in relation to the property during any period—
> (a) beginning with the time at which it was lost, stolen or destroyed, and
> (b) (if lost or stolen) ending with the time at which it is recovered.

[114] For the definition see 19.30.2 ("Money").

[115] Section 809Y(5) ITA provides:
"relevant rule" means-
(a) the public access rule,
(b) the personal use rule,
(c) the repair rule, and
(d) the temporary importation rule.

19.37 Sales relief

Section 809YA - 809YD ITA provide two reliefs for arm's length sales where the proceeds are taken out of the UK:

(1) Relief from the exempt property clawback charge
(2) The gain on the sale of a UK situate asset is a foreign gain (so the remittance basis can apply)

I refer to this as **"sales relief"**.

Perhaps this reflects some effective lobbying by auctioneers. Of course it is far too complicated.

Section 809YA(1) ITA provides relief from the clawback charge:

> Section 809Y(1) does not apply to property if—
> (a) it ceases to be exempt property because the whole of it is sold whilst it is in the UK, and
> (b) conditions A to F are met.

I refer to **"sales relief conditions A-F"**.

19.37.1 *Sale to 3rd party*

Section 809YA ITA provides:

> (2) Condition A is that the sale is to a person other than a relevant person.
> (3) Condition B is that the sale is by way of a bargain made at arm's length.
> (4) Condition C is that, once the sale is completed, no relevant person—
> (a) has any interest in the property,
> (b) is able or entitled to benefit from the property by virtue of any interest, right or arrangement, or
> (c) has any right (whether conditional or unconditional) to acquire
> [i] any interest mentioned in paragraph (a) or
> [ii] ability or entitlement mentioned in paragraph (b).

19.37.2 *Prompt receipt of proceeds*

Section 809YA ITA provides:

> (5) Condition D is that the whole of the disposal proceeds are released (whether in one go or in instalments) on or before the final deadline.
> (6) "The final deadline" is the first anniversary of the 5 January following the tax year in which the property ceases to be exempt property (within the meaning of section 809Y).

19.37.3 *Proceeds taken offshore/invested*

Section 809YA ITA provides:

> (7) Condition E is that—
> (a) the whole of the disposal proceeds are
> [i] taken offshore or
> [ii] used by a relevant person to make a qualifying investment within the period of 45 days beginning with the day on which the proceeds are released, or
> (b) if the disposal proceeds are paid in instalments, each instalment is taken offshore or used by a relevant person to make a qualifying investment within the period of 45 days beginning with the day on which the instalment is released.
> (8) But if any of the disposal proceeds are released in the period of 45 days ending with the final deadline, Condition E is satisfied, as respects those proceeds, only if they are taken offshore or used by a relevant person to make a qualifying investment on or before the final deadline.

19.37.4 *Qualifying investments*

Section 809YA(9) ITA provides:

> Condition F is that, if Condition E is satisfied wholly or in part by using disposal proceeds to make a qualifying investment, the remittance basis user makes a claim for relief under section 809YC(2) on or before the first anniversary of the 31 January following the tax year in which the property is sold.

Section 809YB ITA provides power to extend the time limit for investment:

> (1) An officer of HMRC may agree in a particular case to extend any period within which disposal proceeds (or instalments) must be taken offshore or used by a relevant person to make a qualifying investment in order to satisfy Condition E.
> (2) The power to agree to an extension is exercisable only in exceptional circumstances and only if the remittance basis user requests such an extension.

19.37.5 *"Released"*

Section 809YA ITA(10) provides a commonsense definition:

> For the purposes of this section, proceeds or instalments are "released"

on the day on which they first become available for use by or for the benefit of any relevant person.

19.37.6 *Sales relief TAAR*

Section 809YA(11) ITA provides:

> This section does not apply if the sale is made as part of or as a result of a scheme or arrangement the main purpose or one of the main purposes of which is the avoidance of tax.

This is an avoidance-purpose TAAR; see 3.2.1 (Types of unallowable purpose).

19.37.7 *Supplemental rules*

Section 809YC ITA provides:

> (1) This section has effect if section 809Y(1) does not apply to property by virtue of section 809YA.
> (2) The income and gains treated under section 809X as not remitted to the UK continue to be treated after the sale as not remitted to the UK even though the property has ceased to be exempt property.
> (3) But nothing in subsection (2) prevents anything done in relation to any part of the disposal proceeds after that part is taken offshore (or used to make a qualifying investment) from counting as a remittance of the underlying income or gains to the UK at the time when the thing is done.
> (4) Treat the disposal proceeds as containing or deriving from an amount of each kind of income and gain mentioned in section 809Q(4)(a) to (h) equal to the amount of that kind of income or gain contained in the exempt property when it was brought to, or received or used in, the UK (as mentioned in section 809X).
> (5) Where Condition E was met by using the disposal proceeds to make a qualifying investment—
> (a) the business investment provisions apply to the income and gains that continue, by virtue of subsection (2), to be treated as not remitted as they apply to income or gains that are treated under section 809VA(2) as not remitted, and
> (b) if the investment was made using more than just the disposal proceeds, treat only the part of the investment made using the disposal proceeds as "the investment" for the purposes of those provisions.

19.37.8 *Relief for gain on sale*

Section 809YD(1) ITA provides:

> This section applies to an individual ("P") if—
> (a) a chargeable gain (but not a loss) accrues to a person on a sale of exempt property,
> (b) but for section 809YA [sales relief], section 809Y(1) [clawback charge][116] would have applied to the property by virtue of the sale, and
> (c) P is either—
> (i) the person to whom the gain accrues, or
> (ii) a person to whom a part of the gain is treated as accruing under section 3 of TCGA 1992 (members of non-resident companies).

In the HMRC view, the relief only applies if there would have been a clawback charge. If the temporarily UK asset is derived from clean capital, the relief does not apply. That seems rather odd. Is it actually right?

If these conditions are met we move on to the relief. Section 809YD(2) ITA provides:

> The relevant UK gain is to be treated for the purposes of this Chapter as if—
> (a) it were a foreign chargeable gain of P, and
> (b) in the case of section 809E, it were not part of P's UK income and gains.

The RDR Manual explains para (b):

> **RDRM34280: chargeable gains on sales of exempt property** [May 2020]
> Some individuals do not need to make a remittance basis claim because they have no UK income or gains and do not remit any foreign income and gains (refer to RDRM32140). For those individuals, the foreign chargeable gain will not be treated as part of their UK income and gains (ITA07/s809YD(2)(b)).
>
> (3) Accordingly, if section 809F [remittance basis] applies to P for the applicable tax year,[117] the relevant UK gain is charged in accordance with paragraph 1 of Schedule 1 to TCGA 1992 as if it were a foreign

[116] See 19.36 (Exempt property clawback charge).

[117] Section 809YD(5) provides: "The applicable tax year is —
(a) if section 1M of TCGA 1992 (temporary non-residents) applies in P's case and the relevant UK gain is within subsection (2) of that section, the tax year that consists of or includes the period of return as defined in that section,
(b) otherwise, the tax year in which the relevant UK gain accrues."

> chargeable gain.
>
> (4) The relevant UK gain is—
>
> (a) in a case falling within subsection (1)(c)(i), the gain accruing to P,
>
> (b) in a case falling within subsection (1)(c)(ii), the part of the gain treated as accruing to P...
>
> (6) In applying this Chapter to the relevant UK gain—
>
> (a) treat the amount of any gains mentioned in section 809Q(4)(e) contained in the disposal proceeds by virtue of section 809YC(4) as increased by the amount of the relevant UK gain,
>
> (b) disregard section 809U,[118] and
>
> (c) anything done in relation to any part of the disposal proceeds before the part is taken offshore or used to make a qualifying investment (or both) does not count as a remittance to the UK of any of the relevant UK gain.
>
> (7) The relevant UK gain is to be treated for the purposes of the following provisions of TCGA 1992 as if it accrued on the disposal of a foreign asset (within the meaning of Schedule 1 to TCGA 1992)—
>
> (a) section 1M,
>
> (b) section 3D, and
>
> (c) Schedule 1.
>
> (8) This section has effect despite section 3D(2) of TCGA 1992.

19.37.9 *Election out of relief*

One can elect out of this relief. Section 809YD(9) ITA provides:

> This section does not apply with respect to a chargeable gain if P gives notice to HMRC under this subsection.[119]

A notice will not usually be advantageous, but it might perhaps in some cases of double taxation relief. HMRC give another example of when a notice might be desirable:

> **RDRM34280: chargeable gains on sales of exempt property** [May 2020]
>
> Where an individual has unremitted foreign income and gains of less

[118] See 18.48 (Remittance before income/gains arise).

[119] Section 809YD(10) provides: “A notice under subsection (9)—
(a) must be in writing and must identify the gain in question,
(b) must be given on or before the first anniversary of the 31 January following the applicable tax year, and
(c) may not be revoked after that first anniversary.”

> than £2,000 they can be taxed on the remittance basis without making a claim (see RDRM32110). Such individuals do not lose access to personal allowances or their annual exempt amount and are not required to pay the annual remittance basis charge regardless of the length of time they have been resident in the UK. Where an individual sells exempt property giving rise to a chargeable gain, treating the gain as a foreign chargeable gain might mean their total unremitted foreign income and gains exceed the £2,000 limit in the year of sale. The individual would need to make a claim to be taxed on the remittance basis under ITA07/s809B and become liable to pay the remittance basis charge if they wanted access to the remittance basis.
> An individual can therefore elect for the foreign gain arising on the sale of exempt property to be treated as a UK chargeable gain...

I have wondered whether a notice is desirable in order that a loss on the disposal is an allowable loss, but that does not seem to be the case. HMRC agree:

> **RDRM34280: chargeable gains on sales of exempt property** [May 2020]
> Where an allowable loss accrues on the sale, the loss will be treated as a UK loss and available to be used against any UK gains under existing rules for capital losses.

19.37.10 *Exempt property invested*

Section 809Y(6) ITA provides:

> Subsection (1) does not apply to property that ceases to be exempt property by virtue of the first or second case if—
> (a) the property, or anything into which it is converted,[120] is used by a relevant person to make a qualifying investment within the period of 45 days beginning with the day on which it ceased to be exempt property, and
> (b) the remittance basis user[121] makes a claim for relief under this

[120] This is given a commonsense definition in s.809Y(7): "The reference in subsection (6)(a) to anything into which property is converted is—
(a) if the property is disposed of, the disposal proceeds, and
(b) if the property is converted into money in some other way, the money into which it is converted, (including where the disposal or conversion occurs after the property ceases to be exempt property)."

[121] Defined s.809Z10: "In this Chapter "the remittance basis user", in relation to income or chargeable gains of an individual, means that individual."

> subsection on or before the first anniversary of the 31 January following the tax year in which the property ceases to be exempt property.

Section 809Y(8) ITA incorporates the investment remittance relief rules:

> (8) If subsection (1) does not apply by virtue of subsection (6)—
> (a) the property (or thing into which it was converted) used to make the investment is to be treated as containing or deriving from an amount of each kind of income and gain mentioned in section 809Q(4)(a) to (h) equal to the fixed amount,
> (b) the income or gains treated under section 809X as not remitted to the UK continue to be treated as not remitted to the UK even though the property has ceased to be exempt property, and
> (c) the business investment provisions[122] apply to the income and gains as they apply to income or gains treated under section 809VA(2) as not remitted to the UK.
> (9) "The fixed amount" is the amount of that kind of income or gain contained in the property when it was brought to, or received or used in, the UK (as mentioned in section 809X).

Section 809Y(10) ITA provides an apportionment rule:

> If the investment is made using more than just the property (or thing into which it was converted), treat only the part made using the property (or thing into which it was converted) as "the investment" for the purposes of the business investment provisions.

19.37.11 *Interaction with gift to nation relief*

For completeness, s.809YE ITA provides:

> (1) Section 809Y(1) [exempt property clawback charge] does not apply to property if—
> (a) it ceases to be exempt property in the second case mentioned in that section, and
> (b) by no later than the time when it ceases to be exempt property, it has been donated in the circumstances described in paragraph 1 of Schedule 14 to FA 2012 (gifts to the nation).
> (2) Where section 809Y(1) does not apply to property by virtue of this section, the property is to continue to be treated as not remitted to the UK even though it no longer meets any of the relevant rules.

[122] Defined s.809Z(10) ITA: "In this Chapter "the business investment provisions" means sections 809VA to 809VO".

19.37.12 *Compensation taken offshore/invested*

Section 809YF ITA provides:

> (1) Section 809Y(1) does not apply to property if—
>
> (a) it ceases to be exempt property because a compensation payment in respect of it is released, and
>
> (b) conditions A and B are met.
>
> (2) Condition A is that the whole of the compensation payment is taken offshore or used by a relevant person to make a qualifying investment within the period of 45 days beginning with the day on which the payment is released.
>
> (3) Condition B is that, if Condition A is satisfied wholly or in part by using the compensation payment to make a qualifying investment, the remittance basis user makes a claim for relief under subsection (4) on or before the first anniversary of the 31 January following the tax year in which the payment is released.
>
> (4) If section 809Y(1) does not apply to property by virtue of subsection (1), the income and gains treated under section 809X as not remitted to the UK continue to be treated after the compensation payment is released as not remitted to the UK even though the property has ceased to be exempt property.
>
> (5) But nothing in subsection (4) prevents anything done in relation to any part of the compensation payment after that payment is taken offshore (or used to make a qualifying investment) from counting as a remittance of the underlying income or gains to the UK at the time when the thing is done.
>
> (6) Treat the compensation payment as containing or deriving from an amount of each kind of income and gain mentioned in section 809Q(4)(a) to (h) equal to the amount of that kind of income or gain contained in the exempt property when it was brought to, or received or used in, the UK (as mentioned in section 809X).
>
> (7) Where Condition A was met by using the compensation payment to make a qualifying investment—
>
> (a) the business investment provisions apply to the income and gains that continue, by virtue of subsection (4), to be treated as not remitted as they apply to income or gains that are treated under section 809VA(2) as not remitted, and
>
> (b) if the investment was made using more than just the compensation payment, treat only the part of the investment made using the payment as "the investment" for the purposes of those provisions.

CHAPTER TWENTY

MIXED FUNDS

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Cross references

The following topics are considered elsewhere:

Topic	**See para**
Remittance basis planning	18.55
OWR mixed funds rule	34.23
BAD relief: Mixed fund	56.19.4
Carried interest: Mixed fund	73.23.2
Remittance from joint account	94.6

20.1 Mixed funds: Introduction

It is helpful first to outline the problems which the mixed fund rules are intended to address.

Suppose a person holds a fund which includes different types of income/gains, or income/gains of different years:

(1) If the person remits part of the fund to the UK, it is necessary to know:
  (a) which type of income or gains have been remitted (as different rates may apply)
  (b) which year's income or gains have been remitted (as different rules may apply to different years).

(2) If the person transfers some assets out of the fund, without remitting

those assets to the UK, there is no immediate tax charge. However if there is a later remittance out of the remaining fund, or the transferred assets, it is necessary to know:

(a) which income/gains are in the remaining fund, and
(b) which income/gains are in the transferred assets.

The mixed fund rules are intended to answer these questions.

I coin the following terminology:

"ITA mixed fund rules" means the rules set out in s.809Q to 809S ITA.
"Pre-2008 mixed fund rules" means the rules applicable before 2008/09.

20.1.1 *Navigation*

The layout of the provisions is as follows:

ITA	**Topic**	**See para**
s.809Q	Onshore transfer rule	20.5
s.809R	Offshore transfer rule	20.6
s.809RA-s.809RD	OWR (employment income) mixed fund rule	34.23
s.809S	Mixed fund TAAR	20.11

20.2 Definition of "mixed fund"

20.2.1 *The statutory definition*

There are two section-wide definitions:

s.809Q(6) ITA	**s.809R(7) ITA**
In this section "mixed fund" means money or other property which, immediately before the transfer, contains or derives from—	In this section 'mixed fund' means money or other property containing or deriving from—
(a) more than one of the kinds of income and capital mentioned in subsection (4), or	(a) more than one of the kinds of income and capital mentioned in section 809Q(4), or
(b) income or capital for more than one tax year.	(b) [Identical]

These are effectively identical definitions, as the words "immediately before the transfer" make no difference to the definition.

One must first identify what is the fund, and then identify the constituents which it contains (or derives from).

20.2.2 *Identifying the fund*

The paradigm example of a mixed fund is a bank account with diverse entries.

A mixed fund need not necessarily be a bank account. If money constituting a mixed fund is invested in an asset, the asset is the mixed fund. For instance, if a person uses foreign income and capital to purchase a foreign property, or shareholding, the foreign property or shareholding is a mixed fund.

A portfolio of securities constitutes a single fund if it is managed by one investment manager and held under one account name and number.

In some cases it may be unclear whether a number of securities should be classified as distinct funds, or together constitute a single fund;[1] in practice, any reasonable analysis consistently adopted ought to be acceptable.

20.2.3 *When are funds mixed*

Funds are distinct, ie, not mixed, if they are held in separate accounts or sub-accounts[2] at one bank. HMRC agree. The RDR Manual provides:

> **RDRM35230 Remittances from mixed funds** [Jan 2019]
> *No Mixed Fund*
> A mixed fund does not exist just because the individual has several accounts with the same banking institution, if each account is separately constituted and contains only one of the relevant types of income from only one year. This will usually include bank accounts set up as sub-accounts under an "umbrella" agreement.
> If income and capital sources from a tax year are maintained separately (sometimes referred to as "kept clean" or "clean capital") no mixed fund is created, and so these rules will not apply.[3]

[1] The question of what is a distinct fund is comparable to the question of what constitutes a distinct trust; for which, see 99.22.2 (Variation or resettlement?).

[2] I suspect that "sub-account" is a commercial term with no precise or significant legal meaning; but it is not necessary to pursue that. The issue is raised in Cleansing Q&As Questions 11 and 12, but HMRC did not answer beyond saying that "Whether a sub account is a separate account will be a question of fact determined by the terms attached to an account."

[3] The Manual then gives a straightforward example: "For example, an individual maintains three separate accounts with the same offshore institution:
Account A into which he pays his relevant foreign earnings for the tax year
Account B into which he pays some inherited money (clean capital)

This is consistent with the banking law background:

> A person's claim to money in his or her account is identifiable by an account name and/or number, and ... is distinct from any other claim he or she may have against the same bank.[4]

Accordingly one can in principle avoid mixing income with other funds by arranging that the income is paid to a separate account. If one does that, it will be possible to remit the other funds, keeping the income unremitted.[5]

The position is different for capital gains. A capital gain has no separate identifiable existence, so the proceeds of a disposal giving rise to a gain are always a mixed fund.[6] For accrued income profits see 28.9 (AIP remittance basis).

20.2.4 *Money paid in & withdrawn*

The RDR Manual provides:

> **RDRM33560. Banking Issues** [Jan 2019]
> *Interest credits to a capital account*
> Often interest on a maturing deposit
> [1] is credited to the same account comprising the principal capital investment, but
> [2] under the bank's normal internal system the interest is then immediately and identifiably transferred to an income account.[7]
> Where a mixed fund such as this is created fleetingly by an operation of the banking system, HMRC will accept that the interest credit will not taint the principal and so the mixed fund rules in ITA07/s809Q to s809S do not apply.

At first sight this statement may seem concessionary. However, it is a sensible commercial construction of the statute to say that a sum only

Account C into which he pays some relevant foreign income for the tax year
As long as these accounts do not become mixed funds, the individual can bring money into the UK from Account B and that will be accepted as a being a transfer of "clean" capital, and so will not be a taxable remittance."

[4] Fox, *Property Rights in Money* (1st ed, 2008), para 1.108 (original footnotes omitted).

[5] See 18.55.1 (Avoiding mixed funds: Segregation).

[6] See 18.17.3 (What is a gain).

[7] I would be interested to know from readers how often this actually happens; and how long interest typically remains in the deposit account.

"fleetingly" in an account should not to be said to become "mixed".

The statement refers to banks, and to interest, but the same should apply to a non-banking institution which holds accounts for a customer, and to other types of income, such as dividends.

See too 18.19 (Bank errors).

20.3 Interaction with share pooling

Cleansing Q&As[8] Question 14 provides:

> How do you carry out a mixed fund analysis where an individual has shares/securities of the same class in more than one portfolio?
> **Suggested Answer**
> Unless the portfolios mirror each other such that the amount taken from each account to acquire the investments is the same as the CGT base cost amount (TCGA 1992, s 104),[9] there are significant mixed fund issues where shares/securities of the same class are held in more than one portfolio. This is because the TCGA 1992, s 104 legislation provides that all shares/securities of the same class that were acquired by an individual in the same capacity are pooled for base cost purposes (provided the 30 day or same day rules do not apply). As such, the base costs used for the CGT computations will be different (possibly significantly so) to the amount used to acquire the shares/securities.
> ***We would strongly suggest that to avoid complexity, shares/securities of the same class are not held in more than one portfolio.***
> However, it is likely that not realising the issues, a number of taxpayers will have shares/securities of the same class in more than one investment portfolio. If the client wants to cleanse it will be necessary to carry out a mixed fund analysis taking this issue into account. This additional problem will make a mixed fund analysis in a real example extremely complex and even more time consuming. Depending on the numbers the divergence between the base cost and the amount used from the mixed fund account to make the purchases could result in significant additions to or depletions from the ITA 2007, s 809Q(4)(i) "other" category. In basic terms clean capital could either be created or depleted.
> **The following is a simplified example to illustrate the point (the acquisition and sales proceeds figures have been specifically chosen such that large gains and losses result in order to show what a significant difference this issue can make to the mixed fund analysis).**
> **Example (Kurt/Raven Inc)**
> K is a UK resident foreign domiciliary.
> On 15 June 2011 he paid a £5 million inheritance (received in 2011/12) into

[8] For this document, see 20.12 (Cleansing mixed funds).

[9] See 56.12.2 (Share-matching).

account C with XYZ Offshore Bank. He used this £5 million to acquire £1 million shares in R Inc (£5 per share). These shares were kept within an investment portfolio with XYZ Offshore Bank with a linked sterling account.

K already held shares in R Inc in a mixed fund portfolio with LMN Offshore Fund Manager. The 2 million shares had been acquired in 2008/2009 for £3.50 per share using £7 million of funds representing K's 2008/09 Remittance Basis relevant foreign earnings.

R Inc operates in a volatile sector, but K feels he has specialist knowledge of the sector and that he can make a profit from investing in the shares despite the volatility.

On 19 October 2014 K sold 1 million of the R Inc shares in his LMN Offshore Fund Manager portfolio for £8 per share.

His base cost per share must take both portfolio holdings into account so is £4 ((£5 million + £7 million) / 3 million).

K is a Remittance Basis User in 2014/15. Proceeds of £8 million are received. This breaks down as:

£3.5 million traceable to K's 2008/09 Remittance Basis relevant foreign earnings (that is 50% of the original £7 million used to acquire the holding of which half has been sold);

£4 million 2014/15 Remittance Basis chargeable gain (proceeds of £8 million less base cost of £4 million); and

£0.5 million – 2014/15 “other” ITA 2007, s 809Q(4)(i) - arisen as the operation of TCGA 1992, s 104 results in a £4 million Remittance Basis Chargeable Gain rather than the £4.5 million gain that would have arisen if pooling was not necessary and the actual amount used from LMN Offshore Fund had been the base cost. As the amount falls into s 809Q(4)(i) it is effectively an addition to clean capital.

Just over a year later, on 24 November 2015 K acquired a further 1 million shares in R Inc in his LMN Offshore Fund Manager portfolio paying £2 per share (this was a low price for the shares and K was confident that they would recover).

K reinvested £2 million of the £8 million he received. This is an offshore transfer:

investment 25%; and (ii) kept in cash 75%.

24 November 2015 acquisition	**New Investment - 1 million holding R Inc shares 25% offshore transfer**	**Bank account 75%**
2008/09 Remittance Basis relevant foreign earnings	£875,000	£2,625,000
2014/15 Remittance Basis chargeable gain	£1 million	£3 million

2014/15 “other” ITA 2007, s 809Q(4)(i)	£125,000	£375,000

The original unsold 1 million R Inc shares in his LMN Offshore Fund Manager portfolio represented £3.5 million of 2008/09 Remittance Basis relevant foreign earnings.

On 5 October 2017 K sold his entire 1 million R Inc shares holding in his XYZ Offshore Bank portfolio for £4.50 per share.

Again, K's base cost per share must take both portfolio holdings into account, so is £3.50 ((£5 million + £3.5 million + £2 million) / 3 million). The base cost of the 1 million shares sold is, therefore, £3.5 million.

K is a Remittance Basis User in 2017/18. Proceeds of £4.5 million are received, the base cost for the £1 million shares is £3.5 million (as calculated above). From a CGT perspective, because of the operation of TCGA 1992, s 104, a £1 million gain has been realised (Remittance Basis no foreign tax credit).

If pooling were not necessary and the actual amount used from XYZ Investment Bank had been used as the base cost there would have been a £0.5 million loss.

There is, therefore, a mixed fund analysis issue, since the funds within the bank account are £1.5 million less than the funds used to acquire the shares and the chargeable gain.

The situation here is different to that in question 13 but again we have a situation where there is £1.5 million less in the mixed fund and nothing in the legislation to assist in terms of how this diminution should be treated. Applying the same just and reasonable methodology as in question 13:

Step 1 – proportionately allocate out the £1.5 million across the original clean capital used to acquire the shares and the Remittance Basis gain on the sale of the shares:

	Amounts Per Category	%	Reduction	Proceeds
Clean Capital	£5 million	83.33%	£1.25 million	£3.75 million
Remittance Basis Gain	£1 million	16.67%	£0.25 million	£0.75 million
	£6 million		£1.5 million	£4.5 million

Step 2 – adjust the step 1 result as the derivation rules mean that the gains figure cannot be reduced.

	Amounts Per Category
Clean Capital s 809Q(4)(i) ITA	£3.75 million
Remittance Basis Gain s 809Q(4)(e)	£1.00 million
	£4.75 million

That is, again as a result of the derivation rules, the mixed fund analysis aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is higher (in this case £0.25 million higher) than the actual proceeds figure.

On 19 February 2018 K uses £4.25 million of the £4.5 million within his XYZ Offshore Bank account to acquire 600,000 shares in R Inc. This is an offshore transfer:

investment 94.4%; and (ii) kept in cash 5.6%.

On 31 May 2018 K sells the 2 million shares in R Inc within his LMN Offshore Fund Manager portfolio for £11 per share.

His base cost per share must take both portfolio holdings into account, so is £3.75 ((£4.25 million + £3.5 million + £2 million) / 2.6 million). The base cost of the 2 million shares sold is, therefore, £7.5 million.

K is a Remittance Basis User in 2018/19. Proceeds of £22 million are received and paid into the same LMN Offshore Fund Manager account as the funds not reinvested from the first sale. The £22 million proceeds breaks down as:

- £ 4,375,000 (£875,000 + £3.5 million) traceable to K's 2008/09 Remittance Basis relevant foreign earnings;
- £1,000,000 2014/15 Remittance Basis chargeable gain;
- £125,000 2014/15 “other” ITA 2007, s 809Q(4)(i);
- £14.5 million (£22 million less £7.5 million) 2018/19 Remittance Basis chargeable gain;
- £2 million 2018/19 “other” ITA 2007, s 809Q(4)(i) - arisen as the operation of TCGA 1992, s 104 results in a £14.5 million Remittance Basis Chargeable Gain rather than the £16.5 million gain that would have arisen if pooling was not necessary and the actual amount used from the LMN Offshore Fund Portfolio account had been the base cost. As the amount falls into s 809Q(4)(i) it is effectively an addition to clean capital.

Note that the LMN Offshore Fund Portfolio account could be cleansed prior to 6 April 2019 and the total £2.5 million ITA 2007, s 809Q(4)(i) “other” (the £375,000 kept in the account and the £125,000 and £2 million above) transferred to a new “clean capital account”.

HMRC Comment

HMRC are OK with the response.

20.4 Ingredients of mixed fund

20.4.1 *Mixed fund categories*

Section 809Q(4) ITA identifies 9 categories of income and capital which may make up a mixed fund:

The kinds of income and capital are—[10]

[10] For clarity I have set this out in tabular form rather than the layout of the statute.

Category	Type of income/capital	Exceptions	Exceptions fall within:
(a)	Employment income	Foreign income	para (b)(c)(f)
(b)	Relevant foreign earnings	Foreign taxed income	para (f)
(c)	Foreign specific employment income	Foreign taxed income	para (f)
(d)	Relevant foreign income	Foreign taxed income	para (g)
(e)	Foreign chargeable gains	Foreign taxed gains	para (h)
(f)	Employment income subject to a foreign tax		
(g)	Relevant foreign income subject to a foreign tax		
(h)	Foreign chargeable gains subject to a foreign tax		
(i)	Income or capital not within another paragraph [residuary category]		

I refer to these as the "**mixed fund categories**".

The order in which these categories are placed is important: I call this the "**mixed fund priority order**".

A remittance basis taxpayer needs to classify every mixed fund into these nine categories for every year from 2008/09. The mixed fund rules require a vast amount of record keeping.

20.4.2 *Income/gains of non-resident*

Income which accrues to a non-resident is not RFI[11] (even if it is foreign income which would be RFI if received by a UK resident). Similarly, earnings received by a non-resident are not employment income.[12] Such income falls into the residuary category (i).

Chargeable gains from non-UK assets which accrue to a non-resident *are* foreign chargeable gains.[13] Such gains will fall within category (e) or (h) depending on whether they are subject to a foreign tax.

One could devise circumstances where these points matter, but in practice it seems unlikely to arise.

20.4.3 *Income/gains of UK resident*

What if a UK resident individual receives foreign income or gains which are taxable in the year of receipt, either because they are remitted to the UK or because no remittance basis claim is made in that year? The sums do not cease to be foreign income or gains, so they remain in their relevant categories (a) to (h).

[11] Because it does not meet the condition in s.830(1)(b) ITTOIA; see 16.9.2 ("Relevant foreign income").

[12] Unless within s.27 ITEPA (duties performed in UK or overseas Crown employment).

[13] See 56.6 (Territorial scope of CGT) and 17.4.3 (Foreign chargeable gains).

20.4.4 *"Foreign tax"*

I refer to income/gains which are subject to a foreign tax as **"foreign-taxed"**. This affects the mixed fund categories in the following way:

	Not foreign-taxed	**Foreign-taxed**
RFE	para (b)	para (f)
FSEI	para (c)	para (f)
RFI	para (d)	para (g)
Gains	para (e)	para (h)

The object is to increase UK tax by deferring the remittance of foreign-taxed items, so deferring foreign tax credits. This (surely unfair) policy comes at a considerable cost in complexity, since it roughly doubles the number of mixed fund categories and the record keeping.

Section 809Q(5) ITA defines "foreign tax":

> In subsection (4) "foreign tax" means any tax chargeable under the law of a territory outside the UK.

At first I thought that tax deducted under the former EU Saving Directive was not "foreign tax". The EU is not a territory outside the UK. But if tax was deducted in, say, Luxembourg, the better view is that the tax was chargeable under the law of *Luxembourg* so the tax is a foreign tax. That is clearly so if the EU directive did not have direct effect in the MS concerned and it would be strange if the position were different when the directive does have direct effect.

20.4.5 *"Subject to foreign tax"*

The RDR Manual provides:

> **RDRM35240 Remittances from mixed funds - Identifying nature of remittance** [Jan 2019]
>
> ...
>
> Occasionally UK resident remittance basis users' UK employment income may be "subject to foreign tax", that is to say another country or government authority (usually their country of nationality or citizenship) will also tax them on this income. In these cases HMRC will accept that the individual's UK source employment income may still be regarded as within Para (a) in the mixed fund, unless the individual requests otherwise, in which case it will remain to fall within Para (f) as employment income subject to a foreign tax.

This is obviously an extra-statutory concession.

> This is only relevant where the other country has in fact subjected the UK employment income under consideration to their tax. In some cases no tax will, in fact, have been due in or paid to the other country due to various exemptions and provisions, (for example the US has a "foreign earned income exclusion" provision to employment income below a certain level), so the UK employment income will be within Para (a) anyway.

This is not correct as it is not consistent with the approach applied elsewhere in deciding what is "subject to tax".[14] But it will normally suit taxpayers to treat UK earnings as category (a) so it will not be contested.

20.4.6 *Cat. (i): Other income/capital*

This is the residuary category.[15] That would include:

(1) Gifts, inheritance
(2) Borrowed money
(3) Gain on a disposal of a UK situate asset
(4) Gain which is not chargeable (eg on disposal of FOTRA security)
(5) Chargeable event gain (eg on surrender of a life policy)
(6) Foreign income of non-residents (including protected s.720 income and protected s.624 income)

Section 809Q(8) ITA provides:

> References in this section and section 809R to anything deriving from income or capital within para (i) of subsection (4) do not include—
> (a) income or gains within any of paras (a) to (h) of that subsection, or
> (b) anything deriving from such income or gains.

If a sum falls into two categories, category (i) and another, then the other category takes priority. How could a sum fall into two categories? Suppose:

(1) RFI arises to A.
(2) A gives the RFI to B, or lends it interest-free to B.

The receipt in B's hands is B's capital (within (i)); and is also derived from A's RFI; it is treated in B's hands as derived from RFI (category (b).

[14] See 108.13 ("Subject to tax").

[15] The *i* indicates the number nine; it is not the Roman numeral representing the number one.

20.4.7 *Finding income/capital for year*

Step 1 in s.809Q(3) ITA provides:

> For each of the categories of income and capital in paragraphs (a) to (i) of subsection (4), find (applying section 809R) the amount of income or capital of the individual for the relevant tax year in the mixed fund immediately before the transfer.

Income for a tax year is not difficult to identify, for the tax system requires one to attribute income to a tax year and provides rules for that purpose. Chargeable gains for a tax year are not difficult to identify, for gains accrue on a particular date, and in particular cases there are rules to identify the date.

It is considered chargeable-event gains are category (i) capital for the year in which they are received. Suppose:

(1) Year 1: T uses RFI to purchase a foreign policy for £1m.
(2) Year 5: T surrenders the policy for £2m and realises a chargeable event gain of £1m (taxable on the arising basis[16]). T remits £1m.

The £1m remitted is category (i) (residuary category) of year 5, so there is no further charge on the remittance.[17]

20.4.8 *Derived property*

Section 809R ITA provides:

> (1) This section applies for the purposes of step 1 of section 809Q(3) (composition of mixed fund).
> (2) Treat property which derives wholly or in part (and directly or indirectly) from an individual's income or capital for a tax year as consisting of or containing that income or capital.

This is needed as step 1 refers to income or capital of the individual, but that must of course be taken to include sums derived from that income or capital.

For instance, suppose:

(1) Year 1: T receives £1m capital and uses it to purchase shares.
(2) Year 2: T sells the shares for £2m (£1m gain).

[16] See 70.5 (No remittance basis).

[17] The £1m remitted is not regarded as derived from the RFI: see 18.18.15 (Income from income/gains).

The proceeds of sale are a mixed fund consisting of:

(1) Gains of year 2 (the gain on the disposal); and
(2) Capital of year 1 (not year 2) because that derives from the capital of year 1.

HMRC agree: see the example of Jason in 20.5.8 (RFI + gain of different years).

20.5 Onshore transfers

20.5.1 *Scope of mixed fund rules*

Section 809Q ITA provides:

> (1) This section applies for the purposes mentioned in subsection (2) ...
> (2) The purposes referred to in subsection (1) are—
> (a) determining whether condition B in section 809L is met, and
> (b) if it is met, determining (under section 809P) the amount of income or chargeable gains remitted.

Accordingly, the mixed fund rules do not apply for the purposes of remittance basis conditions C or D. This is presumably because those conditions do not always require the use of foreign income/gains or property derived from it. Fortunately conditions C and D will not often apply. So in practice the mixed fund rules apply for most remittance purposes. When conditions C and D are in point, one applies the pre-2008 mixed fund rules.

This may allow some tax planning. Suppose:

(1) T has a mixed fund of £2m, consisting of 50% clean capital and 50% gains.
(2) T wishes to bring £1m into the UK to purchase a property.

If T brings in £1m personally, the ITA mixed fund rules apply and there is gains remitted of £1m. If T gives the fund to a non-relevant person, say, an adult child, who purchases the property and allows T to live there, the pre-2008 mixed fund rules apply, and there is a remittance of £0.5m. But the mixed-fund TAAR might apply.

20.5.2 *Onshore transfer*

Section 809Q(1) ITA provides:

> This section applies ... where
> [za] condition A in section 809L is met [property is brought/

> received/used in the UK by a relevant person][18] and—
>
> (a) the property or consideration for the service is (wholly or in part), or derives (wholly or in part, and directly or indirectly) from, a transfer from a mixed fund, ...

Expanding this, and focussing on property rather than services (which are less important) it should be read to mean:

> This section applies where
>
> [za] Condition A is met, [property is brought/received/used in the UK by a relevant person], and—
>
> (a) [i] the property ... is (wholly or in part) ... [property transferred by][19] a transfer from a mixed fund, or
>
> [ii] the property ... derives ... from [property transferred by] a transfer from a mixed fund...

The next part of s.809Q(1) deals with debt remittances:

> This section applies ... where
>
> [za] Condition A is met, [property is brought/received/used in the UK by a relevant person], and ...
>
> (b) [i] a transfer from a mixed fund, or
>
> [ii] anything deriving (wholly or in part, and directly or indirectly) from such a transfer,
>
> is used as mentioned in section 809L(3)(c) [used in respect of a relevant debt].

I refer to a transfer to which s.809Q applies as an **"onshore transfer"**. That term is not wholly apt[20] but it will do as a short label. The RDR Manual occasionally uses the expression "remittance transfer".

In short, there is an onshore transfer in six cases:

(1) A relevant person receives property in the UK which:
 (a) is transferred from a mixed fund or
 (b) is derived from a transfer from a mixed fund

(2) A relevant person receives a UK service, consideration for which:
 (a) is transferred from a mixed fund or

[18] See 18.14 (Remittance condition A: UK link).

[19] The words in square brackets must be implied. The drafter has referred to a transfer but intends to refer to the property transferred by the transfer, which is actually a different thing. But the meaning is clear.

[20] For instance, a transfer of funds received in the UK by a non-relevant person counts as an offshore transfer and not as an onshore transfer.

(b) is derived from a transfer from a mixed fund

(3) Property is used in respect of a relevant debt (eg repaying the debt) and the property is:
(a) transferred from a mixed fund or
(b) property derived from a transfer from a mixed fund.

20.5.3 *"Transfer"*

Transfer is not defined but the context shows that it means any payment or transfer from a mixed fund, whether or not for consideration.

If (the paradigm case) the mixed fund is a bank account, it means any withdrawal from the account.

If the mixed fund is a managed account of securities, it would include any transfer out of the account, but not:

(1) sales where the proceeds are paid into the account; or
(2) purchases where the price is paid from the account

Section 809Q(7) ITA defines the amount of a transfer:

> References in this section to the amount of the transfer include the market value of it.

It would be more accurate to refer to the value of the property transferred, not the value of the transfer, but the meaning is clear. Thus if, say, dollars are transferred to the UK from an offshore dollar account, the amount of the transfer is the value of the dollars at the time of the remittance.

20.5.4 *Onshore transfer mixed fund rule*

We can turn at last to the rule itself. Section 809Q(3) ITA provides:

> The extent to which the transfer is of the individual's income or chargeable gains is to be determined as follows.

Section 809Q(3) ITA then sets out five steps. It is easier to follow the steps if one has an example in mind. Suppose T (a remittance basis taxpayer) receives £100 per annum of each of the mixed fund categories and pays them into one mixed fund:

Category	**Type of income**	**Year 1**	**Year 2**
Para (a)	UK earnings	£100	£100
Para (b)	relevant foreign earnings	£100	£100
Para (c)	FSEI	£100	£100
Para (d)	relevant foreign income	£100	£100
Para (e)	foreign chargeable gains	£100	£100

Para (f)	foreign-taxed earnings	£100	£100
Para (g)	foreign-taxed RFI	£100	£100
Para (h)	foreign-taxed gains	£100	£100
Para (i)	residuary category	£100	£100

There is therefore a mixed fund of £1800. Suppose T remits nothing in year 1 and £1,000 to the UK in year 2. This is an onshore transfer. One follows the steps thus:

> *Step 1*
> *For each of the categories of income and capital in paras (a) to (i) of subsection (4), find (applying section 809R) the amount of income or capital of the individual for the relevant tax year in the mixed fund immediately before the transfer.*
> *"The relevant tax year" is the tax year in which the transfer occurs.*

In the example, the relevant tax year is year 2. I consider this further below but for present purposes assume that "the amount of income or capital of the individual in the mixed fund immediately before the transfer" is as set out in the table above.

> *Step 2*
> *Find the earliest paragraph for which the amount determined under step 1 is not nil.*

The earliest paragraph is para (a) and the amount determined under step 1 is £100.

> *If that amount does not exceed the amount of the transfer, treat the transfer as containing the income or capital within that paragraph (and for that tax year).*

T's transfer is treated as containing £100 employment income category (a) for year 2.

> *Otherwise, treat the transfer as containing the relevant proportion of each kind of income or capital within that paragraph (and for that tax year).*
> *"The relevant proportion" is the amount of the transfer divided by the amount determined under step 1 for that paragraph.*

(Had the transfer been (say) £50 then the relevant proportion would have been £50 ÷ £100 = 50% so the transfer would have been treated as containing £50 employment income category (a) for year 2.)

> *Step 3*
> *Treat the amount of the transfer as reduced by the amount taken into account under step 2.*

The amount of the transfer is reduced to £900.

> *Step 4*
> *If the amount of the transfer (as reduced under step 3) is not nil, start again at step 2.*
> *In step 2, read the reference to the earliest paragraph of the kind mentioned there as a reference to the earliest such paragraph which has not previously been taken into account under that step in relation to the transfer.*

Following this iterative process a total of nine times, the transfer is treated as containing:

(a)	employment income	£100
(b)	relevant foreign earnings	£100
(c)	foreign specific employment income	£100
(d)	relevant foreign income	£100
(e)	foreign chargeable gains	£100
(f)	foreign-taxed employment income	£100
(g)	foreign-taxed RFI	£100
(h)	foreign-taxed gains	£100
(i)	residuary category	£100
Total		**£900**

The amount of the original £1,000 transfer is by this stage treated as reduced to £100. We move to the next step:

> *Step 5*
> *If the amount of the transfer (as reduced under step 3) is not nil once steps 2 and 3 have been undertaken in relation to all paragraphs of subsection (4) for which the amount determined under step 1 is not nil, start again at step 1.*
> *In step 1, read the reference to the relevant tax year as a reference to the tax year immediately before the last tax year for which step 1 has been undertaken in relation to the transfer.*

Thus we repeat step 2 a last and tenth time, reading "the relevant tax year" to mean year 1. So the transfer of £1,000 from the mixed fund is treated as being:

Category	**Type of income**	**Year**	**Amount**
Para (a)	UK earnings	2	£100
Para (b)	relevant foreign earnings	2	£100
Para (c)	FSEI	2	£100
Para (d)	relevant foreign income	2	£100
Para (e)	foreign chargeable gains	2	£100
Para (f)	foreign-taxed earnings	2	£100
Para (g)	foreign-taxed RFI	2	£100
Para (h)	foreign-taxed gains	2	£100
Para (i)	residuary category`	1	£100

In order to reach this answer for one single transfer we have had to carry out 37 steps.[21] Yet it will be common for there to be hundreds or thousands of transfers from mixed funds.

20.5.5 *Drafting style: Critique*

The effect of the onshore transfer mixed fund rule is that transfers from a mixed fund are treated as being made in the mixed fund priority order, taking more recent years before earlier years. Why didn't the statute simply say so? For a discussion of the drafting style, see 61.15.7 (Method statements: Critique). But the fundamental problem is not the drafting, but conception of the mixed fund rule.

20.5.6 *Examples: onshore transfers*

The RDR Manual provides examples. I set them out more or less verbatim, but rearrange and omit some irrelevant detail for clarity.

20.5.7 *Mixed RFE/RFI/EI of 1 year*

The first example involves a single onshore transfer out of a mixed fund containing RFE, RFI and UK employment income of one year.

RDRM 35280 Example 1 (Amelia) [Jan 2019]
A, a remittance basis user, has an offshore account with mixed funds as follows:
– foreign earnings from two employers totalling £40,000 per month, half of which is subject to foreign tax [mixed fund categories (b) and (f)]
– relevant foreign income of £10,000 per quarter, which is not subject to foreign tax [mixed fund category (d)].
– some of her UK employment income (£50,000 per month) which has already been subject to tax in the UK is paid into the same offshore bank account [mixed fund category (a)]

[21] Steps 1–4 were each carried out 9 times and step 5 once.

On 15 October 2010 A purchases an aircraft for £460,000, which she brings to the UK.

Since the account was opened in the tax year, we have an account with 20 credits and one debit (an onshore transfer) thus:

2009-10		**Credit (Debit)**	**Balance**	**Category**
30 Apr	UK salary	£50,000	£50,000	(a)
30 Apr	Overseas salary NFT[22]	£20,000	£70,000	(b)
30 Apr	Overseas salary FT[23]	£20,000	£90,000	(f)
31 May	UK salary	£50,000	£140,000	(a)
31 May	Overseas salary NFT	£20,000	£160,000	(b)
31 May	Overseas salary FT	£20,000	£180,000	(f)
2 Jun	RFI	£10,000	£190,000	(d)
30 Jun	UK salary	£50,000	£240,000	(a)
30 Jun	Overseas salary NFT	£20,000	£260,000	(b)
30 Jun	Overseas salary FT	£20,000	£280,000	(f)
31 Jul	UK salary	£50,000	£330,000	(a)
31 Jul	Overseas salary NFT	£20,000	£350,000	(b)
31 Jul	Overseas salary FT	£20,000	£370,000	(f)
31 Aug	UK salary	£50,000	£420,000	(a)
31 Aug	Overseas salary NFT	£20,000	£440,000	(b)
31 Aug	Overseas salary FT	£20,000	£460,000	(f)
2 Sept	RFI	£10,000	£470,000	(d)
30 Sept	UK salary	£50,000	£520,000	(a)
30 Sept	Overseas salary FT	£20,000	£540,000	(f)
30 Sept	Overseas salary NFT	£20,000	£560,000	(b)
15 Oct	Aircraft purchase	(£460,000)	£100,000	

Step 1 Identify the "amount of transfer" in the relevant year (2010-11) £460,000

Analyse mixed fund to identify the separate amounts of income, capital gains and capital present for each tax year immediately before the date of the transfer:

Para (a) UK employment income	£300,000
Para (b) Relevant foreign earnings (not subject to a foreign tax)	£120,000
Para (d) RFI (not subject to a foreign tax)	£20,000
Para (f) Employment income subject to a foreign tax	£120,000

Step 2 Identify the earliest paragraph above for the relevant year, which has an amount of income or gain in the mixed fund: Para (a) £300,000

Step 3 Where the amount transferred is greater than the amount identified at Step 2 the amount transferred is treated as reduced by the amount identified in Step 2.

£460,000
-£300,000
£160,000

Step 4 Find the next paragraph/amount for that tax year. In the order

[22] Not foreign-taxed.

[23] Foreign-taxed.

of preference listed above repeat Steps 2 and 3.	
Step 2 repeated: Para (b)	£120,000
Step 3 repeated Amount transferred further reduced to:	£40,000
Step 4 In the order of preference listed above repeat Steps 2 and 3.	
Step 2 repeated: Para (d)	£20,000
Step 3 repeated Amount transferred further reduced to:	£20,000
Step 4 In the order of preference listed above repeat Steps 2 & 3.	
Step 2 Para (f)	£120,000
Step 3 If the amount at Step 2 is equal to or more than the remaining amount of the transfer (the last time step 3 was completed) treat the whole of the remaining amount of the transfer as coming from that item of income or gain	£nil

There has been a transfer to the UK of £460,000. Of this, £300,000 is from UK employment income which has already been taxed, so will not be taxed again. There have also been taxable remittances of A's relevant foreign earnings (£140,000 (£20,000 of which was subject to a foreign tax) and relevant foreign income (£20,000)).
£100,000 of taxed foreign employment income (para f) remains in the offshore account fund.

Moral: A should have kept her taxed foreign earnings separate so that they could be remitted. The tax on that remittance would be less because the foreign tax credit would be available. If A had kept all the sources of income separately, she would also have been saved the cost of the computation.

20.5.8 *Mixed RFI/gain of different years*

The next example is a single onshore transfer from a mixed fund with RFI of earlier years and a chargeable gain of a later year.

RDRM35290 Example 2 (Jason) [Jan 2019]
In Year 1 J purchases shares in a foreign company for £8m. The £8m represents J's 'clean' capital, being perhaps an inheritance or similar such windfall.
In Year 3 J later sells the shares for £10m, which produces a £2m chargeable gain. The sale proceeds are credited in Year 3 to his overseas bank account that contains some relevant foreign income from the last two tax years, but no other monies.
There is now a mixed fund, containing:
£8m capital from Year 1,
£2m a foreign chargeable gain from Year 3
relevant foreign income from Years 2 and 3.
Later in Year 3 J, a remittance basis user, brings £5m to the UK from that account. The ordering rules in ITA07/s809Q mean that all of the relevant foreign income and the £2m gain from Year 3 is treated as remitted before any of the capital can be considered as remitted.
If the mixed fund also included other amounts of income or capital gains for that tax year (Year 2 or 3), those amounts must also be taken into account before any of the 'capital'

element of the proceeds, (that is the £8m that is not a gain) realised by the sale of shares can be considered.

Moral: J should have kept the proceeds of the share sale in a separate account. Then the £5m remittance would have been £2m gain and £3m capital.

Better, J should have disposed of the shares by two separate disposals of £5m each, and remitted the proceeds of the first disposal. Then remittance would have been £1m gain and £4m capital.

20.5.9 *Fund accruing over 2 years*

The next example involves a single onshore transfer out of a mixed fund of RFE, RFI and UK earnings and chargeable gains, accruing over a two year period.

RDRM35300 Mixed Funds: Example 3 - single remittance (Jeff) [Jan 2019]
J has:
- UK salary of £10,000 a month paid into an overseas bank account [mixed fund category (a)].
- a salary for overseas employment and his net salary for that work of £5,000 a month is paid into the same bank account [mixed fund category (f)].

Both salaries are paid on the last day of each month.
- Dividends from a shareholding in a foreign company are also paid into the account [mixed fund category (g)].

In Year 0, J had purchased shares in a foreign company for £8m. The £8m is‘clean’ capital [mixed fund category (i)]. J sells the shares in Year 2 for £10m, which produces a £2m chargeable gain [mixed fund category (e)]..

J’s remittances to the UK from this fund in Year 2 are £10m.

His UK salary is credited net of PAYE and NIC. His overseas salary is subject to a foreign tax deducted at source, and is credited net. His overseas dividends are credited net of overseas withholding taxes.

		Credit (Debit)	**Balance**	**Category**
Year 1			£0	
31 Mar	UK salary (net of tax)	£10,000	£10,000	(a)
31 Mar	Overseas salary FT	£5,000	£15,000	(f)
Year 2				
30 Apr	UK salary	£10,000	£25,000	(a)
30 Apr	Overseas salary	£5,000	£30,000	(f)
15 May	Dividend	£2,000	£32,000	(g)
31 May	UK salary	£10,000	£42,000	(a)
31 May	Overseas salary	£5,000	£47,000	(f)
18 Jun	Sale of shares: gain	£2,000,000		(e)
	Sale of shares: capital	£8,000,000	£10,047,000	(i)
30 Jun	UK salary	£10,000	£10,057,000	(a)

30 Jun	Overseas salary	£5,000	£10,062,000	(f)
25 Jul	Dividend	£2,000	£10,064,000	(g)
31 Jul	UK salary	£10,000	£10,074,000	(a)
31 Jul	Overseas salary	£5,000	£10,079,000	(f)
31 Jul	Bank interest	£5,000	£10,084,000	(d)
14 Aug	Transfer to UK account	(£10,000,000)	£84,000	

Applying the ordering rules in S809Q to the account immediately before the transfer:

Step 1 Identify the "amount of transfer" in relevant tax year (Year 2) **£10,000,000**

Analyse mixed fund to identify the separate amounts of income, capital gains and capital present for each tax year immediately before the date of the transfer:

Para (a) Employment income (including UK employment income) not subject to a foreign tax	Year 1: £10,000 Year 2: £40,000
Para (d) Relevant foreign income (not subject to a foreign tax) *Bank interest*	Year 2: £5,000
Para (e) Foreign chargeable gains (not subject to a foreign tax)	Year 2: £2,000,000
Para (f) Employment income subject to a foreign tax	Year 1: £5,000 Year 2: £20,000
Para (g) Relevant foreign income subject to a foreign tax *Foreign dividends*	Year 2: £4,000

Step 2 Identify the earliest paragraph above for the relevant year, which has an amount of income or gain in the mixed fund:

Para (a) £40,000

Step 3 Where the amount of the remittance is greater than the amount identified at Step 2 the amount remitted is treated as reduced by the amount identified in Step 2. £10m less £40k = £9,960,000

Step 4 Find the next paragraph/amount for that tax year.
In the order of preference listed above repeat Steps 2 and 3.

Step 2 **Para (d)** −£5,000
Step 3 £9,955,000

Step 4 In the order of preference listed above repeat Steps 2 and 3

Step 2 **Para (e)** −£2m
Step 3 £7,955,000

Step 4 In the order of preference listed above repeat Steps 2 and 3

Step 2 **Para (f)** −£20,000
Step 3 £7,935,000

Step 4 In the order of preference listed above repeat Steps 2 and 3

Step 2 **Para (g)** −£4,000
Step 3 £7,931,000

At this point all of the income of Year 2 has been matched against the remittance.

Step 5 If the amount of the transfer (as reduced under Step 3) is not nil once steps 2 and 3 have been undertaken for all of the capital, income and gains of the relevant tax year repeat the exercise using the income, capital and gains of the next earliest year (Year 1)

Step 2	**Para (a)**	−£10,000
Step 3		£7,921,000

Step 4 In the order of preference listed above repeat Steps 2 and 3

Step 2	**Para (f)**	−£5,000
Step 3		£7,916,000

At this point all of the income of Year 1 has been matched against the remittance

Step 5 If the amount of the transfer (as reduced under Step 3) is not nil once steps 2 and 3 have been undertaken for all of the capital, income and gains of the relevant tax year repeat the exercise using the income, capital and gains of the next earliest year (Year 0)

Step 2 - If the amount is more than the [residual] 'relevant amount', treat the whole of the remittance as coming from that item of income or gain **Para (i)** £8m

The result of this exercise is that

- All of J's UK salary in tax year 2 is deemed to have been brought to the UK first.
- Similarly all of his foreign income and gains of tax year 2 are treated as remitted to the UK and chargeable to tax at the appropriate rates of tax – allowing credit for foreign taxes charged on that same income as appropriate.
- J's income of Year 1 is also matched against the remittance.
- £7,916,000 capital has also been brought to the UK.

Until such time as further amounts of income and gains are credited to the overseas account, the mixed fund contains £84,000 of capital (from the sale of shares).

The next part of the example has two more transfers from the mixed fund.

RDRM35310: Mixed Funds: Example 3 - (continuation) remittance of funds covering two years) [Jan 2019]

Immediately after the £10m transfer in Year 2 (refer to example 3) J's mixed fund contains £84,000 of capital from Year 0 (from the sale of shares).

For the rest of Year 2, J continues to have his UK salary of £10,000 a month and his 'relevant foreign earnings' of £5,000 a month paid into that same account. Both salaries are paid on the last day of each month. There are no further credits or debits from the account in Year 2.

In Year 3 J purchases shares in a UK company by direct debit from this account (£150,000). He also transfers £5,000 to meet daily living expenses. These amounts are remittances from a mixed fund to which the rules in s809Q apply.

His UK salary is credited net of PAYE and NIC. His overseas salary is subject to a foreign tax deducted at source, and is credited net. His overseas dividends are also credited to the account net of overseas withholding taxes.

J's overseas bank account continuation

		Credit (Debit)	**Balance**	**Category**
Year 2	Balance b/f		£84,000	
31 Aug	UK salary	£10,000	£94,000	(a)
31 Aug	Overseas salary	£5,000	£99,000	(f)
30 Sept	UK salary (net of tax)	£10,000	£109,000	(a)
30 Sept	Overseas salary (net of tax)	£5,000	£114,000	(f)
31 Oct	UK salary	£10,000	£124,000	(a)

31 Oct	Overseas salary	£5,000	£129,000	(f)
30 Nov	UK salary	£10,000	£139,000	(a)
30 Nov	Overseas salary	£5,000	£144,000	(f)
31 Dec	UK salary	£10,000	£154,000	(a)
31 Dec	Overseas salary	£5,000	£159,000	(f)
31 Jan	UK salary	£10,000	£169,000	(a)
31 Jan	Overseas salary	£5,000	£174,000	(f)
28 Feb	UK salary	£10,000	£184,000	(a)
28 Feb	Overseas salary	£5,000	£189,000	(f)
31 Mar	UK salary	£10,000	£199,000	(a)
31 Mar	Overseas salary	£5,000	£204,000	(f)
Year 3				
30 Apr	UK salary	£10,000	£214,000	(a)
30 Apr	Overseas salary	£5,000	£219,000	(f)
15 May	Dividend	£2,000	£221,000	(g)
31 May	UK salary	£10,000	£231,000	(a)
31 May	Overseas salary	£5,000	£236,000	(f)
30 Jun	UK salary	£10,000	£246,000	(a)
30 Jun	Overseas salary	£5,000	£251,000	(f)
30 Jun	Purchase UK shares	(£150,000)	£101,000	
3 Jul	Transfer to UK	(£5,000)	£96,000	

The direct debit on 30 June (£150,000) is a remittance from a mixed fund. Applying the ordering rules in S809Q to the account immediately before the transfer:

Step 1 Identify the "amount of transfer" in the relevant tax year (Year 3) **£150,000**

Analyse mixed fund to identify the separate amounts of income, capital gains and capital present for the relevant tax year (Year 3) immediately before the date of the transfer:

Para (a) Employment income (including UK employment income) not subject to a foreign tax	£30,000
Para (f) Employment income subject to a foreign tax	£15,000
Para (g) Relevant foreign income subject to a foreign tax	£2,000

Step 2 Identify the earliest paragraph above for the relevant year (Year 3), which has an amount of income or gain in the mixed fund:
Para (a) £30,000

Step 3 Where the amount of the remittance is greater than the amount identified at Step 2 the amount remitted is treated as reduced by the amount identified in Step 2. £150,000

-£30,000

£120,000

Step 4 Find the next paragraph/amount for that tax year. In the order of preference listed above repeat Steps 2 and 3.

Step 2 Identify the earliest paragraph: **Para (f)** £15,000

Step 3 Where the amount of the remittance is greater than the amount identified at Step 2 the amount remitted is treated as reduced by the

amount identified in Step 2. £120,000
-£15,000
£105,000

Step 4 Repeat Steps 2 and 3.
Step 2 Identify the earliest paragraph: **Para (g)** £2,000
Step 3 Where the amount of the remittance is greater than the amount identified at Step 2 the amount remitted is treated as reduced by the amount identified in Step 2. £105,000
-£2,000
£103,000

At this stage all of the amounts credited to the account in Year 3 have been matched against remitted amounts. Income and capital of the next previous year (Year 2) must now be considered - so return to Step 1 for Year 2.

Step 1 Identify the separate amounts of income, capital gains and capital present for Year 2 before transfer:
Para (a) Employment income (including UK employment income) not subject to a foreign tax £80,000
Para (f) Employment income subject to a foreign tax
£40,000

Step 2 Identify the earliest paragraph above for the relevant year (Year 2), which has an amount of income or gain in the mixed fund: **Para (a)** £80,000

Step 3 Where the amount of the remittance is greater than the amount identified at Step 2 the amount remitted is treated as reduced by the amount identified in Step 2. £103,000
-£80,000
£23,000

Step 4 Find the next paragraph/amount for that tax year.
In the order of preference listed above repeat Steps 2 and 3.
Step 2 Identify the earliest paragraph: **Para (f)** £40,000
Step 3 If the amount is more than the [residual] "transfer amount", the whole of the remittance comes from that paragraph. £23,000

The £150,000 transfer is therefore regarded as a remittance of:

Amount	**Type of income**	**Category**	**Income of year**
£110,000	UK employment income	(a)	£30k Year 3 + £80k Year 2
£38,000	Relevant foreign income	(f)	£15k Year 3 + £23k Year 2
£2,000	Relevant foreign earnings	(g)	Year 3
£150,000			

Note
The transfer on 3 July of £5,000 to meet daily living expenses will similarly be regarded as coming from the 'earliest paragraph' in the mixed fund, which is paragraph (f) containing £17,000 of relevant foreign earnings from Year 2.

Reconciliation

The mixed fund still contains:

£84,000	Capital of Year 0 (from the sale of shares in Year 2) together with
£12,000	Relevant foreign earnings from Year 2, and
£96,000	

The result of this exercise is that:

- All of J's UK salary in Year 3 (£30,000) is deemed to have been brought to the UK first and is not a taxable remittance. In addition, J has remitted £80,000 of UK employment income from Year 2 that is also not taxable again upon remittance.
- Similarly all of his relevant foreign income (£2,000) and overseas employment income of Year 3 (£15,000) together with £28,000 of relevant foreign earnings from Year 2 are treated as remitted to the UK and chargeable to tax at the appropriate rates of tax

Moral: J should have kept his £150k capital receipt separate and remitted from that. That would have reduced the tax on the remittance and saved the costs of the computation.

20.6 Offshore transfer

Section 809R ITA provides:

> (1) This section applies for the purposes of step 1 of section 809Q(3) (composition of mixed fund)...
> (4) Treat an offshore transfer from a mixed fund as containing the appropriate proportion of each kind of income or capital in the fund immediately before the transfer.
> "The appropriate proportion" means the amount (or market value) of the transfer divided by the market value of the mixed fund immediately before the transfer.

I refer to this as the **"offshore transfer rule"**. The scope of the rule is limited to cases where the onshore transfer rule applies, as to which, see 20.5.1 (Scope of mixed fund rules).

20.6.1 *"Transfer"*

"Transfer" is not defined.

It should have the same meaning as in s.809Q[24] so there is a transfer where the funds in the hands of the transferee are regarded as derived from the mixed fund, but not otherwise. For the meaning of derived in this context, see 18.18 (Derived property).

[24] See 20.5.3 ("Transfer").

20.6.2 *"Offshore" transfer*

Section 809R(5) ITA defines "offshore transfer":

> A transfer from a mixed fund is an "offshore transfer" for the purposes of subsection (4) if and to the extent that section 809Q does not apply in relation to it.

So far the definition seems clear. One must ask whether s.809Q applies. Section 809Q applies (in short) if property from a mixed fund is received in the UK by a relevant person.[25] A transfer to a UK bank account is an onshore transfer. So a transfer to a foreign account appears to be an offshore transfer.

But suppose:
Year 1: A sum is transferred from a mixed fund to a foreign account ("the first transfer").
Year 2: The sum (now in the foreign account) is transferred to a UK account ("the second transfer").

It appears that in year 1 the first transfer is not an onshore transfer, but in year 2 it becomes one.[26] To avoid this result, s.809R(6) ITA provides:

> Treat a transfer from a mixed fund as an "offshore transfer" (and section 809Q as not applying in relation to it, if it otherwise would do) if and to the extent that, at the end of a tax year in which it is made—
> (a) section 809Q does not apply in relation to it, and
> (b) on the basis of the best estimate that can reasonably be made at that time, section 809Q will not apply in relation to it.

If condition (a) and (b) of this subsection are *both* satisfied, there are two consequences:

(1) One must treat the transfer as an offshore transfer.
(2) One must treat section 809Q as not applying in relation to it, if it otherwise would do.

Unless condition (a) and (b) are both satisfied, this subsection does not apply.

The condition in subsection (6)(a) is clear enough. One asks whether s.809Q applies at the end of the tax year. Eg this condition is met if:

[25] See 20.5.2 (Onshore transfer).

[26] Section 809Q applies because (1) remittance condition A is met, and (2) the property received in the UK derives indirectly from the first transfer from the mixed fund.

(1) T transfers a sum from a mixed fund to a new offshore account on 6th April 2008, and
(2) the money is still there on 5th April 2009, or the money has been used to purchase a non UK asset.

Subsection (6)(b) is a challenge. At the end of the tax year, one must ask whether s.809Q will or will not apply in relation to the transfer. In relation to some transfers one can say with certainty that s.809Q will not apply. If the transferor draws a sum from a mixed fund to pay for a dinner outside the UK, then s.809Q will not apply to it because nothing will be received in the UK. That is an offshore transfer.

If a person transfers a sum to an offshore account and does expect to spend it in the UK that is an onshore transfer when remitted to the UK.

20.6.3 *Recomputation problem*

I use the term "**problematic transfer**" (for reasons which will become clear) to describe a transfer made in the following circumstances (by no means unusual):

(1) In year 1 T transfers a sum from a mixed fund to an account outside the UK.
(2) At the end of year 1 the transferred sum is not received in the UK.
(3) T cannot say at the end of the year 1 that "section 809Q will not apply in relation to" the problematic transfer. This may be because:
 (a) At the end of year 1, T does expect to spend the sum in the UK but not until a later year, say, year 5; or
 (b) T has not decided whether to remit the sum to the UK or not.

 At the end of year 1, the problematic transfer is not an onshore transfer. It is an offshore transfer within the definition in s.809R(5). Admittedly it is not within subsection 809R(6) but that subsection does not stop any transfer being an offshore transfer, if applicable it treats onshore transfers as offshore transfers.
(4) Suppose in a later year (say year 5) T transfers the sum to the UK. I refer to this as its **"subsequent remittance**."

On one view, the problematic transfer changes status at the time of its subsequent remittance and becomes an onshore transfer. That is workable if in the meantime T has not made any other onshore transfers from the mixed fund. It is not workable if in the meantime T has made other transfers from the mixed fund, because:

(1) T needed to know at the time what income or gains those other

transfers included.

(2) There cannot be a recomputation of the tax effect of the other transfers in earlier years on the basis that the problematic transfer has turned out to be an onshore transfer after all. I think that is obviously impractical, but for good measure it is also inconsistent with s.809R(9) ITA which provides:

> If section 809Q applies in relation to more than one transfer from a mixed fund, when undertaking step 1 in relation to the second or any subsequent transfer take into account the effect of step 2 of section 809Q(3) (composition of transfer) as it applied in relation to each earlier transfer.

It is difficult to make a coherent and workable tax regime out of this intractable statutory material, which is not surprising given the way in which it was enacted. I think the best solution is to say that s.809R(6)(b) is misconceived, that a problematic transfer is only an onshore transfer if s.809Q applies to it in the year of the transfer. If at the end of the year it is an offshore transfer, its status does not change later. This can be justified on the basis that IT is an annual tax.[27]

The alternative view is that the problematic transfer does change its status and becomes an onshore transfer, on the occasion of its subsequent remittance. One carries through the implications for tax purposes so far as that is possible, so the result is that tax is charged as if the problematic transfer was made after the subsequent transfers.

If that were so, another issue arises. Suppose when asked whether the sum will be remitted, T says (as may well be said) that T will remit it if represents an offshore transfer. The question whether a sum will be remitted to the UK may depend on the tax position, ie if it represents an offshore transfer it will be remitted and if it represents an onshore transfer it will not. It is therefore impossible to answer the s.809R(6)(b) question, whether the sum will be remitted, on the view that a problematic transfer becomes an onshore transfer when remitted; for if it is an offshore transfer it will be remitted (and so is an onshore transfer) but if it is an onshore transfer it will not be remitted (and so is an offshore transfer).

20.6.4 *HMRC explanation*

EN Clause 23 sch 7 Remittance Basis Amendments 463 to 481 explains

[27] See 14.3.4 (IT is an annual tax).

s.809R(4) ITA:

> 7. Amendment 465 introduces a new subsection [4], dealing with cases where transfers are made wholly offshore. The new rules aim to ensure that where a transfer is made offshore from fund A to fund B, and remittances to the UK are then made from fund A or fund B, the normal ordering rules for mixed funds apply, as they would have done had the transfer to Fund B not been made before the remittance.

This is an inaccurate precis of the offshore transfer mixed fund rule. The EN continues:

> 8. So if fund A consisted of equal amounts of untaxed income and capital, and half the fund was transferred to fund B, it cannot be argued that fund A or B consisted solely of capital, and remittances from fund A or B were not therefore taxable. Instead, where there is an offshore transfer, so that the normal mixed fund ordering rules do not apply, fund B is to be treated as containing the same proportion of the different categories of income and capital as the original fund, in relation to the amount transferred.

20.6.5 *Transfer part on/off-shore*

Section 809R(8) ITA provides:

> If section 809Q applies in relation to part of a transfer, apply that section in relation to that part before applying subsection (4) in relation to the rest of the transfer.

In practice this will rarely occur.

20.6.6 *Examples: on/off-shore transfers*

The RDR Manual provides a straightforward example of onshore and offshore transfers from an account with different categories of income and gains:

> **RDRM35430** [Jan 2019], **RDRM35440** [Jan 2019]
> **Example 1** (Ahmid)
> A, a remittance basis user has an offshore bank account into which is paid both UK source (taxed) income and his foreign income and gains. A makes regular **transfers from this account to his UK account to meet his UK living expenses.**

		Credit (Debit)	Balance	Category	Note
10 Apr	XYZ (CI) Ltd – proceeds from sale of shares	£1,000,000	£1,000,000	(e)	1
15 Apr	RFI dividend	£10,000	£1,010,000	(g)	

30 Apr	UK salary	£10,000	£1,020,000	(a)	2
30 Apr	Bank interest	£5,000	£1,025,000	(d)	
30 Apr	Overseas salary[28]	£5,000	£1,030,000	(f)	
3 May	Transfer to UK a/c	(£5,000)	£1,025,000		2
15 May	Offshore dividend	£2,000	£1,027,000	(g)	
31 May	UK salary	£10,000	£1,037,000	(a)	
31 May	Overseas salary	£5,000	£1,042,000	(f)	
31 May	ABC (IoM) Ltd – purchase of shares in foreign company	(£1,000,000)	£42,000		3
3 Jun	Transfer to UK a/c	(£5,000)	£37,000		4
30 Jun	UK salary	£10,000	£47,000	(a)	
30 Jun	Overseas salary	£5,000	£52,000	(f)	
3 Jul	Transfer to UK a/c	(£5,000)	£47,000		5
31 Jul	UK salary	£10,000	£57,000	(a)	
31 Jul	Overseas salary	£5,000	£62,000	(f)	
3 Aug	Transfer to UK a/c	(£5,000)	£57,000		6
15 Aug	Cheque – ZZZ Cars Ltd London	(£25,000)	£32,000		7

Note 1

The sale price of the shares includes a gain over the original purchase price of £150,000 that has not been taxed. The purchase was made long before 6 April 2008 and was made using accumulated foreign income and gains which were treated as clean capital.

The mixed fund provisions do not apply to foreign income or gains that arose or accrued before 6 April 2008 (Sch 7 FA 2008 para 89). This means that it is not possible to apply the "mixed fund" rules to the £850,000 used to buy the shares.

Note 2

Using the ordering rules at ITA07/s809Q(1), the remittance to the UK on 3 May is matched against the UK salary from that tax year credited to the account on 30 April, as this is the "earliest paragraph" of income or gains within the mixed fund.

Working this through this example:

The £5,000 transfer to the UK on 3 May is a "transfer" from a mixed fund within section 809Q. Applying the ordering rules in that section, and analysing the mixed fund to identify the separate amounts of income, capital gains and capital in the account for each tax year immediately before the date of the transfer:

Para (a)	employment income	£10,000
Para (d)	RFI	£5,000
Para (e)	Chargeable gains	£150,000
Para (f)	Earnings subject to a foreign tax	£5,000
Para (g)	RFI subject to tax	£10,000
Para (i)	Income or capital not within another para	£850,000

The remittance is regarded as coming from the "earliest paragraph", that is Para

[28] Net of tax.

(a), so the £5,000 is UK employment income. Although money has been brought into the UK, there is no taxable remittance as the money has already been taxed.

Note 3

The purchase of shares on 31 May is an "offshore transfer"; by the end of the tax year the shares purchase have not, nor on best estimate are they likely to be, a remittance transfer [in my terminology an onshore transfer] so that s809Q applies.

The account is treated as including the amounts of foreign income and gain that were present immediately before the transfer (ITA07/s809R(4)). The transfer has no effect on the amount remitted in the current tax year but may need to be taken into account in a later tax year.

Immediately before the offshore transfer the mixed fund consists of the following

Para (a)	employment income	£ 15,000
Para (d)	RFI	£5,000
Para (e)	Chargeable gains	£150,000
Para (f)	Earnings subject to a foreign tax	£10,000
Para (g)	RFI subject to tax	£12,000
Para (i)	Income or capital not within another para	£850,000
		£1,042,000

The offshore transfer consists of an appropriate proportion of each kind of income, gain or capital, within the mixed fund.

Para (a)	employment income	£14,396
Para (d)	RFI	£4,798
Para (e)	Chargeable gains	£143,953
Para (f)	Earnings subject to a foreign tax	£9,597
Para (g)	RFI subject to tax	£11,517
Para (i)	Income or capital not within another para	£815,739
		£1,000,000

Note 4

The £5,000 transfer on 3 June to the UK is a "transfer" to the UK from a mixed fund, and is within s809Q(1). Applying the ordering rules in that section, and analysing the mixed fund to identify the separate amounts of income, capital gains and capital present for each tax year immediately before the date of the transfer:

Para (a)	employment income	£604
Para (d)	RFI	£202
Para (e)	Chargeable gains	£6,047
Para (f)	Earnings subject to a foreign tax	£403
Para (g)	RFI subject to tax	£483
Para (i)	Income or capital not within another para	£34,261

The transfer is regarded as coming from each of the paragraphs in order; that is £604 from Para (a), and a taxable remittance of £4,396, being £202 from Para (d) and £4,194 from Para (e).

Note 5 and 6

Both of these £5,000 transfers are to the UK. There have been credits to the fund between the last transfer (note 4) and this transfer and the fund now contains some employment income (Para a) and additional amounts of foreign earning subject to foreign tax (Para f) in addition to the residue following the last transfer.

The £5,000 transfers made on 3 July and 3 August are regarded as coming from the earliest paragraph of income, that is Para (a) – £10,000 of UK employment income credited to the account on 30 June.

Note 7

The cheque remittance on 15 August is £25,000. This amount was used to buy a car from a UK company. This is also a remittance within s809Q.

Immediately before the transfer the mixed fund consists of:

Para (a)	employment income	£10,000
Para (d)	RFI	£nil
Para (e)	Chargeable gains	£1,853
Para (f)	Earnings subject to a foreign tax	£10,403
Para (g)	RFI subject to tax	£483
Para (i)	Income or capital not within another para	£34,261

The cheque remittance is regarded as coming from each of the paragraphs in order; that is £10,000 from para (a), £1,853 from para (e) and £10,403 from Para (f), £483 from Para (g) and £2,261 from Para (i).

The remaining £32,000 at 15 August is also within Para (i)

20.6.7 *Example 1(a)*

Example 1(a) – Transfer to another account To continue the offshore account in example 1:

Date		**Credit (Debit)**	**Balance**	**Category**	**Note**
	Balance b/f		£32, 000		
31 Aug	Overseas salary (net of tax)	£5,000		f	
31 Aug	UK salary	£10,000		a	
3 Sept	Transfer to UK a/c	(£5,000)			1
15 Sept	Cheque – XYZ Travel Services (CI) Ltd	(£10,000)			2
30 Sept	Overseas salary (net)	£50,000		f	
30 Sept	Overseas Dividend	£350,000		g	
30 Sept	UK salary	£180,000		a	
3 Oct	Transfer to UK a/c	(£5,000)			3
15 Oct	Transfer to Swiss a/c	(£350,000)			4

Note 1

Immediately before the transfer on 3 September the mixed fund contained:

Para (a)	Employment income	£10,000
Para (f)	Earnings subject to a foreign tax	£5,000
Para (i)	Income or capital not within another para	£32,000

The transfer is regarded as coming from the 'earliest paragraph', that is para (a), so the £5,000 is UK employment income. Although money has been brought into the UK, there is no taxable remittance as the money has already been taxed,

Note 2
The next payment from the account is £10,000 for the family holiday flights to the USA. The full payment is a remittance because the service provided is in the UK – the flights begin or end in London.
The transfer is regarded as coming from each of the paragraphs in order; that is £5,000 from para (a) and a taxable remittance consisting of £5,000 from para (f).
Note 3
Immediately before the remittance on 3 October the mixed fund contained:

Para (a)	Employment income	£180,000
Para (f)	Earnings subject to a foreign tax	£50,000
Para (g)	RFI	£350,000
Para (i)	Income or capital not within another para	£32,000

The transfer is regarded as coming from the 'earliest paragraph', that is para (a), so the £5,000 is UK employment income.
Note 4
The transfer of £350,000 to a new Swiss bank account is an offshore transfer. Immediately before the offshore transfer on 15 October the IoM bank account (mixed fund) is regarded as containing:

Para (a)	Employment income	£175,000
Para (f)	Earnings subject to a foreign tax	£50,000
Para (g)	RFI	£350,000
Para (i)	Income or capital not within another para	£32,000
		£607,000

The offshore transfer consists of an appropriate proportion of each kind of income, gain or capital, within the mixed fund, that is:

Para (a)	Employment income	£100,906
Para (f)	Earnings subject to a foreign tax	£28,830
Para (g)	RFI	£201,812
Para (i)	Income or capital not within another para	£18,452

The Swiss bank account is another 'mixed fund', containing the income, gains and capital of the transferred amount. Assuming nothing else is added or taken away from the Swiss account in the interim, if in a couple of years time A decides to remit £120,000 to the UK from his Swiss bank account, the same ordering rules will apply to the Swiss fund, so the remittance is regarded as consisting of £100,906 from para (a) and £19,094 from para (f).

20.6.8 *Example 2*

The next example has another mix of offshore and onshore transfers.

RDRM 35450 [Apr 2019]
Example 2 (Lorraine)
L, a remittance basis user, opens an offshore bank account in Bermuda into which is paid both UK source (taxed) income and her foreign income and gains. L makes a few transfers from this account to her UK account to meet UK living expenses. She also transfers money from this account to her other offshore account in Jersey, as well as using it for several offshore purchases.

Account 1 Bermuda

		Credit (Debit)	Balance	Category	Note
Year 1					
15 Jan	Capital	£1,000,000	£1,000,000	(i)	1
30 Jan	UK salary	£10,000	£1,010,000	(a)	
30 Jan	Bank interest	£5,000	£1,015,000	(d)	
30 Jan	Overseas salary (net of tax)	£5,000	£1,020,000	(f)	
3 Feb	Transfer to UK a/c	(£5,000)	£1,015,000		2
28 Feb	Dividend	£2,000	£1,017,000	(g)	
28 Feb	UK salary	£10,000	£1,027,000	(a)	
28 Feb	Overseas salary	£5,000	£1,032,000	(f)	
3 Mar	Purchase of shares in foreign company	(£800,000)	£232,000		3
10 Mar	Transfer to UK a/c	(£5,000)	£227,000		4
31 Mar	UK salary	£10,000	£237,000	(a)	
31 Mar	Overseas salary (net of tax)	£5,000	£242,000	(f)	
2 Apr	Transfer to UK a/c	(£5,000)	£237,000		5
Year 2					
30 Apr	UK salary	£10,000	£247,000	(a)	
30 Apr	Overseas salary (net of tax)	£5,000	£252,000	(f)	
3 Mar	Transfer to UK a/c	(£5,000)	£247,000		6
15 Mar	Transfer to UK a/c	(£100,000)	£147,000		7
31 May	UK salary	£10,000	£157,000	(a)	
31 May	Overseas salary (net of tax)	£5,000	£162,000	(f)	
8 Jun	Transfer – A2Z travel services	(£20,000)	£142,000		8

Year 1

Note 1

The £1,000,000 credited to the account on 15 January was inherited under L's great aunt's will, and is "clean" capital.

Note 2

The £5,000 transfer to the UK on 3 May is a "remittance" from a mixed fund within section 809Q(1). Applying the ordering rules in that section, and analysing the mixed fund to identify the separate amounts of income, capital gains and capital in the account for each tax year immediately before the date of the transfer:

Para (a)	employment income	£10,000
Para (d)	RFI	£5,000
Para (f)	Earnings subject to a foreign tax	£5,000
Para (i)	Inherited capital	£1,000,000

The remittance is regarded as coming from the "earliest paragraph", that is para (a), so the £5,000 is UK employment income, so there is no taxable remittance of foreign income nor further tax to pay upon remittance.

Note 3

The purchase of shares on 3 March (£800,000) is an "offshore transfer". By the end of the tax year the shares purchased have not been sold, brought to the UK or otherwise used so that s809Q applies.

The account is treated as including the amounts of foreign income and gain that were present immediately before the transfer (ITA07/s809R(4)). The transfer has no effect on the amount remitted in the current tax year but may need to be taken into account in a later tax year.

Immediately before the offshore transfer the mixed fund consists of the following:

Para (a)	Employment income	£15,000
Para (d)	Relevant foreign income	£5,000
Para (f)	Earnings subject to a foreign tax	£10,000
Para (g)	Relevant foreign income subject to tax	£2,000
Para (i)	Inherited capital	£1,000,000
		£1,032,000

The "offshore transfer" (the shares purchase) consists of an appropriate proportion (100/129) of each kind of income, gain or capital, within the mixed fund, that is:

Para (a)	employment income	£11,628
Para (d)	RFI	£3,876
Para (f)	Earnings subject to a foreign tax	£7,752
Para (g)	RFI subject to tax	£1,550
Para (i)	Income or capital not within another para	£775,194
		£800,000

Note 4

The £5,000 transfer to the UK on 10 March is a "remittance" from a mixed fund within section 809Q(1). Applying the ordering rules in that section, and analysing the mixed fund to identify the separate amounts of income, capital gains and capital in the account for each tax year immediately before the date of the transfer the mixed fund consists of:

Para (a)	employment income	£3,372
Para (d)	RFI	£1,124
Para (f)	Earnings subject to a foreign tax	£2,248
Para (g)	RFI subject to tax	£450
Para (i)	Income or capital not within another para	£224,806
		£232,000

The remittance is regarded as coming from the "earliest paragraph", that is para (a), £3,372, para (d) £1,124 and para (f) £504. Of this amount, £1,124 and £504 are taxable remittances.

Note 5

The next remittance on 2 April is again £5,000. Two further amounts have been credited to the account which now consists of

Para (a)	employment income	£10,000
Para (f)	Earnings subject to a foreign tax	£6,744

Para (g)	RFI subject to tax	£450
Para (i)	Income or capital not within another para	£224,806

The remittance is regarded as coming from the "earliest paragraph", that is para (a), so the £5,000 is UK employment income, so there is no taxable remittance of foreign income nor further tax to pay upon remittance.

The account now consists of:

Para (a)	employment income	£5,000
Para (f)	Earnings subject to a foreign tax	£6,744
Para (g)	RFI subject to tax	£450
Para (i)	Income or capital not within another para	£224,806
		£237,000

At the end of the tax year, L has made taxable remittances of: £1,628 (para (d) £1,124 and para (f) £504). She has also made two offshore transfers:

Year 2

At the start of the next tax year, L continues to make remittances to the UK from the overseas account. The "mixed fund" rules mean that income gains and capital of a tax year are treated in priority to income gains and capital of a previous year.

Note 6

The £5,000 transfer to the UK on 3 May is a "remittance" from a mixed fund within s809Q(1). Applying the ordering rules in that section, and analysing the mixed fund to identify the separate amounts of income, capital gains and capital in the account for tax Year 2 immediately before the date of the transfer:

Para (a)	employment income	£10,000
Para (f)	Earnings subject to a foreign tax	£5,000

The remittance is regarded as coming from the "earliest paragraph", that is para (a), so the £5,000 is UK employment income, so there is no taxable remittance of foreign income nor further tax to pay upon remittance.

Note 7

On 15 May, L transfers £100,000 to her UK bank account. This is a "remittance" from a mixed fund within section 809Q(1).

Applying the ordering rules section 809Q, and analysing the mixed fund to identify the separate amounts of income, capital gains and capital in the account for tax Year 2 immediately before the date of the transfer:

Para (a)	employment income	£5,000
Para (f)	Earnings subject to a foreign tax	£5,000

So £10,000 of the transfer comes from these two paragraphs of Year 2 income. The outstanding balance of £90,000 must be identified by applying the ordering rules section 809Q, and analysing the mixed fund to identify the separate amounts of income, capital gains and capital in the account for tax Year 1 immediately before the date of the transfer:

Para (a)	employment income	£5,000
Para (f)	Earnings subject to a foreign tax	£6,744
Para (g)	RFI subject to tax	£450
Para (i)	Income or capital not within another para	£224,806

So the remaining £90,000 of the transfer will regarded as consisting of monies from para (a) £5,000, Para (f) £6,744, Para (g) £450 and Para (i) £77,806 from

Year 1.
The mixed fund now consists of:

Para (i)	Income or capital not within another para	£147,000

20.7 Income/gains used to pay debt

Section 809R(3) ITA provides:

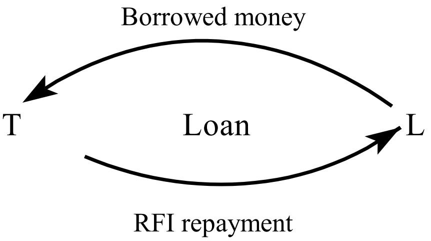
> If a debt relating (wholly or in part, and directly or indirectly) to property[29] is at any time satisfied (wholly or in part) by—
>
> (a) an individual's income or capital for a tax year, or
>
> (b) anything deriving (directly or indirectly) from such income or capital,
>
> from that time treat the property as consisting of or containing the income or capital if and to the extent that it is just and reasonable to do so.

I refer to this as the **"s.809R backward-tracing rule"**.

Suppose:

(1) T borrows from L and receives "the borrowed money" outside the UK.

(2) T uses RFI to repay the debt to L so T retains the borrowed money.



The debt is not a relevant debt, so its repayment is not a taxable remittance under the debt remittance rules.

In the absence of a statutory provision, one would not usually say that the borrowed money was derived from the RFI, or that the borrowed money consists of or contains the RFI.[30] However the debt relates to the borrowed money. So applying the s.809R backward-tracing rule, the borrowed money is treated as consisting of or containing the RFI, so far as is just and reasonable.

When is that just and reasonable? It seems just and reasonable in

[29] The phrase "debt relating ... to property" is taken from the definition of relevant debt; for discussion, see 18.22 (Debt "related" to property (debt-related asset)).

[30] See 20.7 (Income/gains used to repay debt).

principle, and clearly so in cases of avoidance.

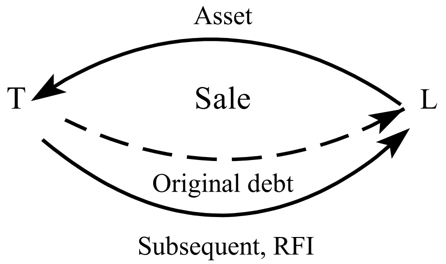
If the debt is satisfied in part by RFI, and in part by clean capital, then it would be just and reasonable to regard the proportionate part of the borrowed money as derived from the RFI.

Cases where it is not just and reasonable to apply the s.809R(3) backward-tracing rule may include:

(1) If the sums involved were small.
(2) If it was not reasonably practical to make that tracing exercise (but the requirement in s.809R(3) that the debt must "relate" to the borrowed money is another route to the same destination).
(3) If the borrowed money was received/brought/used in the UK. Then the debt would be a relevant debt and its repayment is a taxable remittance under the debt remittance rules (or under ordinary principles). The taxpayer cannot argue that s.809R(3) prevents a remittance under the debt remittance rules as that would not be just and reasonable.

The same analysis applies if:

(1) T purchases a non-UK asset from L and left the purchase price outstanding as a debt.
(2) T uses the RFI to repay the debt.



Applying the s.809R backward-tracing rule, the asset will be treated as consisting of or containing the RFI so far as just and reasonable.

It is curious that the s.809R backward-tracing rule has been made a part of the mixed fund rules, and does not apply more generally.

20.7.1 *Backward tracing: example*

The RDR Manual gives an example involving repayment of a loan (not a relevant loan) from a mixed fund.

RDRM35470 [Jan 2019]
Example (Frankie)
... F, a remittance basis user, has a bank account in Jersey into which is paid both UK source (taxed) income and foreign income and gains.
F makes transfers from the Jersey account to his UK account to meet his UK living expenses.
On 28 May, F acquires a loan from his Jersey bank that he uses to purchase an asset in Jersey for £200,000. He repays the loan from this account.

		Credit (Debit)	**Balance**	**Category**	**Note**
6 Apr	Clean capital	£80,000	£80,000	(i)	
15 Apr	RFI NFT	£10,000	£90,000	(d)	
30 Apr	UK salary	£10,000	£100,000	(a)	
30 Apr	RFI interest	£5,000	£105,000	(d)	
30 Apr	RFE NFT	£5,000	£110,000	(b)	
3 May	Transfer to UK a/c	(£5,000)	£105,000		1
15 May	RFI	£2,000	£107,000	(d)	
31 May	UK salary	£10,000	£117,000	(a)	
31 May	Overseas salary	£5,000	£122,000	(b)	
3 Jun	Transfer to UK a/c	(£5,000)	£117,000		2
28 Jun	loan repayment	(£15,000)	£102,000		3 & 4
30 Jun	UK salary	£10,000	£112,000	(a)	
30 Jun	Overseas salary	£5,000	£117,000	(b)	
3 Jul	Transfer to UK a/c	(£5,000)	£112,000		5
28 Jul	loan repayment	(£15,000)	£97,000		6
31 Jul	UK salary	£10,000	£107,000	(a)	
31 Jul	Overseas salary	£5,000	£109,000	(b)	
3 Aug	Transfer to UK a/c	(£5,000)	£102,000		7
15 Aug	Cheque – ZZZ Cars	(£25,000)	£77,000		8
28 Aug	loan repayment	(£15,000)	£62,000		9
31 Aug	Overseas salary	£5,000	£67,000	(b)	
31 Aug	UK salary	£10,000	£72,000	(a)	
3 Sep	Transfer to UK a/c	(£5,000)	£67,000		10

The first two transfers are straightforward:

Notes 1 & 2: £5k UK remittances
Using the ordering rules at ITA07/s809Q, the remittance to the UK on 3 May is matched against the UK salary from that tax year credited to the account on 30 April, as this is the "earliest paragraph" of income or gains within the mixed fund.
The remittance on 3 June is also matched against the UK salary from that tax year credited to the account before that date.

We now turn to the point of the example:

Note 3
The £200,000 used to pay for the assets is borrowed capital and is not

> in itself a remittance or an offshore transfer.

This is correct. The payment of £200k is not an offshore transfer (as defined) because the £200k is not mixed into the mixed fund.[31]

If the £200k had been paid into the account (and withdrawn from there to purchase the asset) the analysis would have been different.

> However, subsequent payments of interest and capital used to repay the loan are offshore transfers.
>
> **Note 4: £15k loan repayment**
>
> At the time immediately before the first repayment of the debt occurs on 28 June, the mixed fund is composed as follows:
>
> | | |
> |---|---|
> | Clean capital | £80,000 |
> | UK salary | £10,000[32] |
> | Relevant foreign earnings | £10,000 |
> | Relevant foreign income | £17,000 |
> | | £117,000 |
>
> The repayment of the monthly bank loan of £15,000 is an offshore transfer, consisting of an appropriate proportion of each kind of income within the mixed fund, that is:
>
> | | |
> |---|---|
> | Clean capital | £10,256 |
> | UK salary | £1,282 |
> | Relevant foreign earnings | £1,282 |
> | Relevant foreign income | £2,180 |
> | | £15,000 |
>
> The property acquired by F using the loan is now regarded as containing this income. ...

The next remittance is straightforward:

> **Note 5**: **£5k UK remittance**
>
> The next remittance on 3 July is again £5,000 that is matched against the UK salary credited to the account before that date.

Now comes the second loan repayment:

> **Note 6: £15k loan repayment**
>
> At the time immediately before the repayment on 28 July, the “mixed fund” is composed as follows:

[31] See 20.6.2 (“Offshore” transfer).

[32] Although £20,000 of F’s UK salary has been credited to the account, £10,000 has already been remitted prior to 28 June (see Notes 1 and 2).

Clean capital	£69,744
UK salary	£13,718
Relevant foreign earnings	£13,718
Relevant foreign income	£14,820
	£112,000

The repayment of the monthly bank loan of £15,000 is an offshore transfer, consisting of an appropriate proportion of each kind of income within the mixed fund, that is:

Clean capital	£9,339
UK salary	£1,838
Relevant foreign earnings	£1,838
Relevant foreign income	£1,985
	£15,000

The property acquired by F is now regarded as containing this income.

Next come two straightforward onshore transfers:

Note 7 and 8: £5k UK remittance & £25k UK remittance
A further £5,000 remittance on 3 August is again matched against UK salary.
The payment of £25,000 to ZZZ Cars is to buy a car and is a taxable remittance. Immediately before the transfer the mixed fund is composed as follows:

Clean capital	£60,405
UK salary	£16,880
Relevant foreign earnings	£16,880
Relevant foreign income	£12,835
	£107,000

This £25,000 remittance is matched firstly against UK salary (£16,880), then against relevant foreign earnings (£8,120).

Next another loan repayment:

Note 9: £15k loan repayment
At the time immediately before the repayment on 28 August, the mixed fund is composed as follows:

Clean capital	£60,405
UK salary	£nil
Relevant foreign earnings	£8,760
Relevant foreign income	£12,835
	£82,000

The repayment of the monthly bank loan of £15,000 is an offshore transfer, consisting of an appropriate proportion of each kind of income within the mixed fund, that is:

Clean capital	£11,049
Relevant foreign earnings	£1,603
Relevant foreign income	£2,348
	£15,000

Note 10: £5k UK remittance

The fifth remittance on 3 September is again £5,000 that is matched against the UK salary from that tax year credited to the account before that date.

The account now contains £77,000, being

Clean capital	£49,356
UK salary	£5,000
Relevant foreign earnings	£12,157
Relevant Foreign Income	£10,487

For the purposes of this example, assume that on 8 September F wins the Jersey local lottery ("clean capital") and uses his winnings to pay off the outstanding loan.[33]

Three years later, F brings the property acquired with the loan to the UK. The property is a mixed fund, and it is regarded as containing the income and capital used to pay off the loan, that is:

UK salary	£3,120
Relevant foreign earnings	£4,723
Relevant foreign income	£6,513
Clean capital	£185,644
Total	£200,000

F has remitted foreign income of £4,723 + £6,513 = £11,236.

The moral which follows from this example is the imperative of not mixing funds of different types of income or gains, so far as possible.

20.8 Fund with different types of RFI

Suppose a person holds in one mixed fund two different types of RFI, both subject to foreign tax, but one subject to a higher rate of foreign tax than the other. It matters which type of income is remitted, because one type qualifies for more foreign tax credit relief than the other.

The ITA mixed fund rules give no guidance because both fall into the

[33] The author does not consider the remittance issues of bets; see 18.18.18 (Betting).

same mixed fund category. It is considered that the *Duke of Roxburghe*[34] approach applies. A remittance from this mixed fund should be regarded as made first out of the income which qualifies for more UK double tax relief.

However, it would be better (if practical, ie if the sums are large enough to bother) to pay the two types of income into separate accounts. Then this issue does not arise and a remittance from the appropriate account can easily be identified as one type of income or the other.

20.9 Income/gains arise to 3rd party

So far we have considered the mixed fund rules where an individual transfers from a mixed fund containing their own income or gains. The position is more complex when another person is involved. This may arise in two ways:

(1) Income/gains received by a third party are treated as arising to the individual
(2) The individual receives income/gains and gives them to a third party

In either case the third party may then mix the funds with their other funds. This paragraph considers point (1) and the following considers point (2).

20.9.1 *s.3 gains mixed with co assets*

Section 3 gains may be mixed with company assets. Suppose:

(1) A gain accrues to non-resident company within s.3 TCGA, so that a s.3 gain accrues to a participator, taxable on the s.3 remittance basis.
(2) That gain forms part of a mixed fund (ie the gain is mixed with other funds of the company).

There is a taxable remittance if the company remits its gain to the UK. If part of the mixed fund is remitted to the UK, it is considered that the mixed fund rules apply to determine whether the part remitted is the participator's gain. Section 809Q(3) ITA provides:

> The extent to which the transfer is of *the individual's income or chargeable gains* is to be determined as follows.

Similarly, step 1 of s.809Q(3) requires one to find the income or gains *of*

[34] 20 TC 711.

the individual. However the gains in the company are treated as derived from the s.3 gains of the individual.[35] So applying s.809R(2) ITA the funds of the company are treated as containing those gains.[36]

If the company is held in a trust, a UK resident individual is not subject to tax under s.3, and this issue does not arise.

20.9.2 *s.720 income mixed with person abroad's assets*

Section 720 income may be mixed with assets of the person abroad. Suppose:

(1) Income arises to a person abroad within s.720, so that s.720 income arises to a transferor, taxable on the s.720 remittance basis.

(2) That income forms part of a mixed fund (ie the income is mixed with other funds of the person abroad).

There is a taxable remittance if the person abroad remits its income to the UK. If part of the fund is remitted to the UK, it is considered that the mixed fund rules apply to determine whether the part remitted is the transferor's income. The reasoning is the same as for s.3 gains. The funds held by the person abroad are treated as derived from the s.720 income of the individual.[37] So applying s.809R(2) ITA the funds of the person abroad are treated as containing that income.[38]

From 2017, the transferor is likely to qualify for protected-trust relief and this issue will not arise.

This view may favour the taxpayer. Suppose:

(1) A company within s.720

(2) An individual is subject to tax by reference to the company income under the s.720 remittance basis.

(3) The company holds a mixed fund consisting of:[39]

Item	**Amount**	**Mixed fund category**
Income of year 1[40]	£100	(i) (the company's income) *and* (b) (the transferor's s720 income)

[35] See 64.23 (Section 3 remittance basis).

[36] See 20.4.8 (Derived property).

[37] See 49.26 (s.720 remittance basis).

[38] See 20.4.8 (Derived property).

[39] In this example it does not matter which category the income falls in; as the year 2 item will be remitted before year 1 items.

[40] This is (1) actual income of the company and (2) treated as derived from s.720 income of the transferor.

Gain of year 2	£100	(e) or (h)
Total fund	£200	

(4) In year 3, the company remits £100 to the UK.

The sum remitted is regarded as the gain, so:

(1) For the purpose of the s.720 remittance basis, the income is not remitted.

(2) If s.3 applies to the individual,[41] the remittance gives rise to a charge on the s.3 gain under the s.3 remittance basis.

Similar points arise for s.731 if a mixed fund contains (1) relevant income and (2) other assets of the person abroad.

20.9.3 *Settlor-interested trust income mixed with trust assets*

Income of a settlor-interested trust may be mixed with trust assets. Suppose:

(1) Income arises to a settlor-interested trust within s.624, so that the trust income arises to the settlor, taxable on the s.624 remittance basis.

(2) That income forms part of a mixed fund (ie the income is mixed with other funds of the trust).

There is a taxable remittance if the trustees remit the income to the UK. If part of the mixed fund is remitted to the UK, it is considered that the mixed fund rules apply to determine whether the part remitted is the settlor's income. The funds in the hands of the trustees are, or are derived from, the s.624 income.[42] So applying s.809R(2) ITA the funds in the hands of the third party are treated as containing that income.[43]

From 2017, a settlor-interested trust is likely to qualify for protected-trust relief and this issue will not arise.

20.9.4 *Partnership income/gains mixed with partnership assets*

Income/gains of a partnership may be mixed with partnership assets. Suppose:

(1) Income/gains arise to a partnership.

[41] In short, if the individual owns the company directly, ie the company is not held in a trust; and the s.3 motive and other defences do not apply.

[42] In this case (unlike the s.3/s.720 cases) there is no statutory rule to treat the trustees funds as derived from the settlor's s.624 income, but none is needed.

[43] See 20.4.8 (Derived property).

(2) The income/gains are initially retained by the partnership but are of course treated as arising to a partner; assume a partner taxable on the remittance basis.
(3) The income/gain forms part of a mixed fund (ie the gain is mixed with other funds of the partnership).
(4) The partnership distributes part of the fund to the partner.

There is a taxable remittance if the partner remits the income/gains to the UK. The partnership distribution is from a mixed fund, and it is considered that the mixed fund rules apply to determine whether the part remitted is the partner's income/gain. The funds in the hands of the partnership are or are derived from the partner's income/gains.[44] So applying s.809R(2) ITA the funds in the hands of the partnership are treated as containing the income/ gains.[45]

In relation to large investment partnerships, the mixed fund rules are not workable, and it is suggested that investor/partners have no option but to accept that a partnership distribution consists of income or capital in accordance with the information given to them by the partnership at the time of the distribution.

20.10 **Gift of income/gains**

This section discusses mixed fund issues arising from gifts. See too 18.29.1 (Gift of income/gains: Navigation).

20.10.1 *A's income/gains mixed with B's property*

Suppose:
(1) An individual ("T") makes a gift to a relevant person ("the donee").
(2) (a) *Case 1:* The gifted property is a mixed fund of T, ie it is derived from income/gains of T,[46] but is not mixed with other funds of the donee.
(b) *Case 2:* The gifted property is mixed with funds of the donee in category (i) (residual capital)
(b) *Case 3:* The gifted property is mixed with funds of the donee in category (a) - (h) (taxable on the donee when remitted)

[44] In this case (unlike the s.3/s.720 cases) there is no statutory rule to treat the partnership funds as derived from the settlor's income/gains, but none is needed.

[45] See 20.4.8 (Derived property).

[46] If a gain accrues on the gift, the gifted property is treated as derived from that gain.

(3) The donee remits part of the mixed fund to the UK.

In each case, the transfer is from a mixed fund, and it is considered that the mixed fund rules apply to determine whether the part remitted is income/gains, and whose income/gains it is.

The mixed fund rule matters for T, but in case 3, it also matters for the donee (assume the donee is also a remittance basis taxpayer). Assume in case 3 that:

(1) T has given £100 of his RFI to the donee
(2) The donee has mixed that with £100 of her RFI, so has a mixed fund of £200
(3) The donee remits £100 from the mixed fund.

Has the donee remitted T's income or the donee's own income? It is in the donee's interest to argue that the donee has remitted T's income, and in T's interest to argue that the donee has remitted the donee's income.

One must categorise the donee's mixed fund into the mixed fund categories. The part derived from the gifted property falls into two categories:

(1) From T's perspective, it is RFI of T, within category (d)
(2) From the donee's perspective, it is residual capital of the donee, within category (i)[47]

I think the best answer to this conundrum is that one applies the mixed fund rules twice, once for the donee and then for T. Take the facts of the example of case 3 above:

(1) Year 2: T has given £100 of his RFI to the donee
(2) The donee has mixed that with:
Case 3(a): £100 of the donee's RFI arising in year 1
Case 3(b): £100 of the donee's RFI arising in year 2

So the donee has a mixed fund of £200 which from the donee's perspective consists of:

Case 3(a): £100 RFI for year 1 and £100 residuary capital for year 2
Case 3(b): £100 RFI for year 2 and £100 residuary capital for year 2

(3) The donee remits £100 from the mixed fund.

[47] I have considered an argument that the gifted property does not fall within the final category (i) since that refers to capital not within another paragraph of this subsection. But that solution does not seem to work.

First the mixed fund rules are applied from the donee's perspective:

Case 3(a) The donee has remitted the donee's £100 residuary capital
Case 3(b) The donee has remitted the donee's £100 RFI

Then one applies the mixed fund rules from the perspective of T to what has been identified as remitted by the donee:

Case 3(a) The donee has remitted the donee's £100 residuary capital, which is derived from T's RFI, and T is taxable on £100 (the donee is not taxable)
Case 3(b) The donee has remitted the donee's £100 RFI, which is not derived from T's income, and T is not taxable (the donee is taxable).

A similar problem arises in the case of a joint account, which may be a mixed fund; see 94.6 (Remittance from joint account).

20.10.2 *Gift to non-relevant person*

Suppose:

(1) Income/gains accrue to an individual ("T")
(2) The individual gives the income/gains to a non-relevant person ("donee").

The common example will be a gift of pre-2008 income/gains to a trust. The donee is not a relevant person in relation to those income/gains. There will only be a taxable remittance if T receives the income/gains. What if the income/gains form part of a mixed fund held by the trustees? It is considered that the mixed fund rules apply just as in the case of a gift to a relevant person.

20.10.3 *Unremitted income/gains given to trust*

Suppose:

(1) A remittance basis taxpayer ("S") receives foreign income/gains ("the old income/gains") which is not remitted to the UK and so not taxed.
(2) S transfers the old income/gains to a non-resident trust.
(3) The trustees make a distribution to S which is received in the UK.

If the distribution is an income receipt of S, it is taxed as an Annual Payment on ordinary principles;[48] that should not count as a taxable remittance of the old income/gains as the receipt of new income should

[48] See 41.3 (Tier 3: Discretionary payment: charge).

not be regarded as derived from the old income/gains.[49]

How do the mixed fund rules in these circumstances? It is considered that the mixed fund rules apply just as in the case of a gift to any other relevant person

For the position where the distribution is a capital payment, see 61.7.6 (Payment from unremitted gains).

20.11 Mixed-fund TAAR

Section 809S contains an anti-avoidance rule which I call the "**mixed-fund TAAR**".[50]

20.11.1 *Mixed-fund TAAR conditions*

Section 809S(1) ITA sets out the conditions for the application of the Mixed-fund TAAR:

> This section applies if,
> [a] by reason of an arrangement
> [b] the main purpose (or one of the main purposes) of which is to secure an income tax advantage or capital gains tax advantage,
> [c] a mixed fund would otherwise be regarded as containing income or capital within any of paras (f) to (i) of section 809Q(4).

There are strictly four requirements or conditions here.

(1) An arrangement.[51] But this term is so wide that point (1) is not so much a requirement as a convenient definition for use in conditions (2) and (4). One cannot identify purpose until one can identify the arrangement.
(2) The arrangement has a main purpose to secure IT/CGT advantages.[52]
(3) A mixed fund would otherwise be regarded as containing income or capital within mixed fund categories (f) to (i).
(4) The state of affairs in (3) is by reason of the arrangement (but this does not add much to requirement (3).

Unpacking the third requirement, "otherwise" must mean:

[49] See 18.18.15 (Income from income/gains).

[50] See 3.1 (TAAR/unallowable purpose test).

[51] Section 809S(3) ITA provides the standard (unnecessary) IT definition: see App 2.2.3 (Definitions of "arrangement").

[52] Section 809S provides the standard definitions of IT/CGT advantage: see 3.19.1 (Tax advantage: Definitions).

(3)(a) If, counterfactually, there had been no arrangement, there would be a mixed fund with income in categories (f) to (i)

(b) Because of the arrangement, there is either no mixed fund, or at least, there is a mixed fund with less income in categories (f) to (i)

Conditions (1) and (2) are standard TAAR wording. Condition (3) is not standard form, and is quite restrictive. But the provision should be taken to mean what it says.

Statute refers to a mixed fund contains (or would contain) income or capital within mixed fund categories (f) to (i). So if a mixed fund consisted of (say) RFI within category (d) and chargeable gains within category (e), the mixed-fund TAAR does not apply. This is a little surprising and it might be that s.809S(4) contains a typographical error, (f) being a slip for (a). But it is not obvious that there has been an error, as there is rather more scope for manipulation of the rules in a mixed account which contains categories (f) to (i). So a court should construe the section to mean what it says. In practice the point is not important, as a mixed fund will usually contain some item within categories (f) to (i).

20.11.2 *Mixed-fund TAAR: Application*

Assuming the conditions of the mixed-fund TAAR are met, we move on. Section 809S(2) ITA provides:

> Treat the mixed fund as containing so much (if any) of the income or capital as is just and reasonable.

Section 809S is primarily intended to override the offshore mixed fund transfer rule, although this is not expressly stated.[53]

Suppose:

(1) T has an account ("account 1") with a mixed fund containing £2m, 50% income and 50% capital.

(2) T transfers £1m (half the total amount) to another account ("account 2") (an offshore transfer). T intends to keep that amount offshore.

(3) T then remits the funds in account 1 to the UK.

Applying the offshore transfer mixed fund rule the first account, which is

[53] The mixed-fund TAAR could also override the *onshore* transfer mixed fund rule, but it is not likely to be just and reasonable to substitute any other set of rules.

remitted, consists of 50% income and capital, so on remittance 50% of the sum received is tax free. In the absence of the offshore transfer, the whole of the £1m remitted would have been subject to income tax.

The offshore transfer is an arrangement which secures an IT advantage. Assuming this was a main purpose, the conditions for the application of the mixed-fund TAAR are satisfied.

One then has to ask what is "just and reasonable". The drafter has given up here and left the courts to sort it out.[54] One might say that it is reasonable to apply the pre-2008 mixed fund rules. That can hardly be described as unjust or unreasonable. But it is considered that the expression "just and reasonable" should be construed in the context of the onshore transfer mixed fund rule. So the arrangement should be disregarded: it would be just and reasonable to raise tax as if the offshore transfer from the first account had not been made. To put it another way, it is just and reasonable that transfers whose main purpose is to obtain a tax advantage should not do so.

20.12 Cleansing mixed funds

This relief was first announced in "Reforms to the taxation of non-domiciles: further consultation" ("**the 2016 consultation paper**").[55] But this paper is now of historical interest only.

There are two reliefs:

(1) Para 44: this is available to all mixed funds

(2) Para 45: this applies where a mixed fund includes pre-2008 items

Cleansing is not an apt term for these reliefs, but it is a convenient shorthand, and it is difficult to think of a better one.

HMRC have issued guidance which I call:

(1) **"2017 cleansing guidance"**[56]

[54] CIOT express the point more strongly in Response to consultation paper "Reform of the taxation of non-domiciled individuals": "Section 809S is so widely drawn as to be almost meaningless." But TAAR drafting noteworthy for vagueness in 2008 has become standard, and no longer excites comment.

[55] *https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles-further-consultation* (2016).

[56] HMRC, "Cleansing of Mixed Funds" (April 2017)
The 2017 guidance was issued when the legislation was still in draft, and needs to be read subject to the subsequently introduced para 45 relief; but it contains useful comments which are not in the 2018 guidance.

(2) **"2018 cleansing guidance"**[57]

The professional bodies have published a set of Q&As with HMRC replies (**"Cleansing Q&As"**).[58] The edition history is:

Version	**Date**	**ICAEW label**
1		
2	October 2018	Taxguide 05/18
3	March 2019	Taxguide 02/19

20.12.1 *Outline of cleansing reliefs*

The 2016 consultation paper provides:

> The government recognises that the mixed fund rules can (!) be complicated, and that these reforms will mean that those non-doms who become deemed-domiciled in April 2017 who were taxed on the remittance basis will have to pay tax in the UK on their offshore income and gains on an arising basis for the first time. It will also mean that an individual with a mixed fund will find it difficult to bring any money from the fund into the UK without paying tax at their top rate of tax when they do so. For some, this will be a punitive outcome, as the fund will be comprised of a mix of both foreign income which would be taxable at the highest rate of tax as well as money that would be taxable at a lower rate; for example, foreign gains which would be taxed at a top rate of 28% or clean capital, which would not be taxable at all even when remitted.
>
> The government has therefore decided to introduce a temporary window in which such individuals will be able to rearrange their mixed funds overseas to enable them to separate those funds into their constituent parts. This window will last for one tax year [later extended to two tax years] from April 2017 and it will provide certainty (!) on how amounts remitted to the UK will be taxed.
>
> During this time, non-doms with mixed funds will be able to rearrange their mixed funds and separate out the different parts. This will mean, for instance, that they will be able to move their clean capital, foreign income and foreign gains into separate accounts, and will then be able

[57] HMRC, "Cleansing mixed funds" (January 2018) *https://www.gov.uk/guidance/cleansing-mixed-funds*

[58] The full title is "Cleansing of Mixed Funds - Professional Bodies Q&As". See *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2019/taxguide-02-19--cleansing-of-mixed-funds.ashx*

> to remit from their accounts as they wish and pay the appropriate amount of tax. There will be no requirement for the non-dom to make a remittance from their newly segregated accounts in any particular order or within any particular time limit. This will mean that an individual who separates their mixed funds may, if they wish, remit funds from each separated fund, even if that remittance takes place in a later tax year after the transitional period has ended.
>
> The special treatment will only apply to mixed funds which consist of amounts deposited in bank and similar accounts. Where the mixed fund takes the form of an asset (for example a valuable painting), it will not qualify for the special treatment. However, an individual will be able to sell any overseas asset during the transitional window and separate the sale proceeds in the same way as any other money.
>
> Cleansing will not be available where an individual is unable to determine the component parts of their mixed fund. The mixed fund rules have always required a remittance basis user to track and monitor their offshore funds in order to benefit from the remittance basis, and while the government is willing to introduce a transitional rule to help people to separate their funds, this will not extend to those who are unable to identify the source of those funds.
>
> This treatment will be available to any non-dom who was not born in the UK with a UK domicile of origin – it will not be restricted only to individuals who have been resident for 15 of the past 20 years who will become deemed-domiciled under the new rules.
>
> An individual need not be resident in the UK in April 2017 to be able to use this protection, but it will only be of any benefit to those individuals who have been UK resident at some point in time and who have used the remittance basis of taxation.

20.13 Para 44 cleansing relief

20.13.1 *Para 44 cleansing relief: scope*

Para 44(1) sch 8 F(no.2) A 2017 provides:

> This paragraph applies for the purposes of the application of section 809Q(3) of ITA 2007 in relation to an individual ("P").

Cleansing relief only applies in relation to an individual, but it can apply to mixed funds of trusts or companies, where they hold income within s.624 or s.720, as that is deemed to be, or to be derived from, the income of an individual. Likewise for s.3 gains of a company so far as they are attributed to an individual who is a participator.

20.13.2 *Cleansing relief conditions*

Para 44 sch 8 F(no.2) A 2017 provides:

> (2) Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund where-

Seven[59] conditions then follow which I call **"para 44 cleansing conditions"**.

20.13.3 *Condition (a): Date of transfer*

Para 44 sch 8 F(no.2) A 2017 provides:

> (2) Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund where-
>
> (a) the transfer is made in the tax year 2017-18 or the tax year 2018-19

Cleansing (unlike 2017 rebasing) was a short term transitional relief. The transfer must be made in 2017/18 or 2018/19, and the relief stopped on 5 April 2019. But it remains necessary to understand the relief in order to analyse mixed funds going forward.

20.13.4 *Condition (b): Money*

Para 44 sch 8 F(no.2) A 2017 provides:

> (2) Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund where ...
>
> (b) the transfer is a transfer of money

"Money" in its normal sense includes foreign currency[60] but not cryptoassets (such as bitcoin).[61]

HMRC say:

> Bitcoins are not considered to be legal tender and therefore not recognised as money.[62]

[59] They are numbered semi-numerically (a) - (f), but para (c) contains two conditions.

[60] See Proctor, *Mann and Proctor on the Law of Money* (8th ed, 2022), para 1.93.

[61] See 96.2 (Cryptoasset terminology).

[62] Charity Tax Forum Action Point Log *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/440570/Action_Point_Log_29_May_2015.pdf*

20.13.5 *Cond. (c): Inter-account transfer*

Para 44 sch 8 F(no.2) A 2017 provides:

> (2) Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund where ...
>
> (c) the mixed fund from which the transfer is made is an account (account A) and the transfer is made to another account (account B)

What constitutes a separate account? See 20.2.2 (Identifying the fund).

20.13.6 *Condition (d): Nomination*

Para 44 sch 8 F(no.2) A 2017 provides:

> (2) Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund where ...
>
> (d) the transfer is nominated by P for the purposes of this subparagraph

2018 Cleansing Guidance provides:

> You must ... make the nomination between 6 April 2017 to 5 April 2019

But that is plainly wrong. The legislation specifies a time limit for the making the transfer, but not for making the nomination, and there is no reason to imply one. However until a nomination is made, the relief will not apply; and a return would be made on that basis; if the nomination is made after the return is submitted, the return would need to be amended, and once the time limits for amendment have passed, it is too late to amend.[63]

2017 Cleansing Guidance provides:

> There is no formal nomination process, but records of all nominations must be retained.[64]

Nomination may even be oral, but in practice a short written memorandum is appropriate, such as:

[63] The position here is similar to a Gift Aid declaration; see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 15.51 (Gift Aid declaration), online version *https://www.taxationofcharities.co.uk*

[64] The guidance subsequently refers to s.12B TMA.

> I nominate the transfer made [date] of [amount] from [account A] to [account B] for the purposes of para [44(2)(d)][65] sch 8 F(no.2)A 2017.[66]

The memorandum should be kept on file. There is no formal claim or election, but the nomination requirement amounts to a claims procedure as it effectively makes the relief optional.

20.13.7 *Cond.(d): 1 nominated transfer*

Para 44 sch 8 F(no.2) A 2017 provides:

> (2) Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund where ...
>
> (e) at the time of the nomination no other transfer from account A to account B has been so nominated

2017 Cleansing Guidance provides:

> Such a nomination can only be made once with respect to any one mixed fund account. All the nominated amounts from the mixed fund account must be transferred to the receiving account(s) at the same time.

Transfers to the same account at different times in principle constitute 2 distinct transfers, which is not allowed. But:

> If an individual gives instruction to their bank to make a transfer, say on a Monday, but the transfer, or part of the transfer, is not effected until Tuesday due to the bank's internal processes and through no fault of the individual, the transfer will be acceptable for cleansing purposes. All transfer instructions to the bank should be retained by the individual.

More than one transfer can qualify for cleansing, but each transfer must be to a separate account. It is difficult to see the point of that.

2017 Cleansing Guidance provides:

> It is not necessary to cleanse all overseas mixed fund accounts at the same time, so long as each account is cleansed within the 2-year window, ending 5 April 2019.
>
> Nor is it necessary to completely empty the original mixed fund account, though once a nominated transfer from an account has happened it cannot be nominated again.

[65] For para 45 cleansing relief say: para 45(1)(e).

[66] The memorandum also needs to specify income/gains: see 20.13.10 (Specifying income/capital).

20.13.8 *(f): Qualifying individual*

Para 44 sch 8 F(no.2) A 2017 provides:

> (2) Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund where ...
>
> (f) P is a qualifying individual.

Qualifying individual is a label for a set of rules (note that the rules are not the same as for the definition of qualifying individual for 2017 rebasing relief).

Para 44 provides:

> (3) P is a qualifying individual if-
>
> (a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applied in relation to P for any tax year before the tax year 2017-18

P must be a remittance basis taxpayer for at least one of the years 2008/9 to 2016/17. That will generally require a remittance basis claim, but for shorter term residents, it need not involve payment of the remittance basis charge.

Para 44 provides:

> (3) P is a qualifying individual if ...
>
> (b) P is not an individual who-
>
> (i) was born in the UK, and
>
> (ii) whose domicile of origin was in the UK.

Formerly-domiciled individuals are, as usual, excluded from relief.

20.13.9 *Effect of para 44 cleansing*

Assuming the para 44 cleansing conditions are met, we move on to the rule. Para 44(2) sch 8 F(no.2) A 2017 provides:

> Section 809R(4) of ITA 2007 does not apply to an offshore transfer from a mixed fund[67] where [the cleansing application conditions are satisfied]

Having disapplied 809R(4), para 44(4) lays out a different rule:

> An offshore transfer to which sub-paragraph (2) applies is to be treated

[67] Para 44(6) applies the standard definitions: "In this paragraph "mixed fund" and "offshore transfer" have the same meanings as in section 809R(4) of ITA 2007."

> as containing such amount of such kind or kinds of income and capital in the mixed fund immediately before the transfer as may be specified in the nomination under sub-paragraph (2)(d).

Para 44 relief applies only if the transfer from the mixed fund is an offshore transfer. If it is an onshore transfer, the relief does not apply.

20.13.10 *Specifying income/capital*

The nomination needs to specify the "amount [or amounts[68]] of such kind or kinds of income and capital in the mixed fund immediately before the transfer;" and these will in principle be the amounts taken to be transferred by the transfer.

The kinds of income and capital which can be specified clearly include the 9 kinds specified in the mixed fund categories, but may be more detailed, for instance, one may specify:

(1) a type of RFI which has DT relief at a higher rate.
(2) income/capital of a particular year.

It is not essential to specify any amount at all (the statute refers to "such amount as *may* be specified in the nomination) but in the absence of a specification the usual offshore transfer rules will apply to the transfer.

"Specified" means unambiguously identified or made clear.[69] It is not strictly necessary to specify a number, but it is doubtful whether "such amount of RFI as is in the account" is sufficiently clear.

20.13.11 *Under-nomination*

The amount(s) specified may be less than the sum transferred. Eg one may transfer £100 and specify £50 as RFI. In that case the usual offshore transfer rules apply to the amount which is not specified.

HMRC agree. Cleansing Q&As Question 6 provides:

> ... Please confirm that cleansing transaction(s) and nomination(s) are valid where there have been under nominations and the original mixed fund account remains mixed when all the transfers have taken place?
>
> **Suggested answer**
>
> In such circumstances the cleansing transaction(s) and nomination(s) will be valid.

[68] The singular "amount" clearly includes the plural.

[69] That is the ordinary meaning, and was adopted in another context in *Re Green* [1985] 3 All ER 455 at p.460.

There is nothing in the legislation that states that for the cleansing transactions to be valid the original mixed fund account must be fully cleansed such that after the cleansing transactions it is no longer a mixed account.

Example

An individual has a mixed fund offshore account (account C). The individual knows that the account was opened initially with £10 million of clean capital but is not sure about other receipts. The mixed fund analysis is, therefore, carried out on the basis that all the other receipts are Remittance Basis income with no foreign tax credit. Having carried out the analysis on this basis there is £7.8 million of clean capital as at 29 July 2018. To be cautious £7.5 million is transferred out to newly established offshore account D and the appropriate nomination made for the clean capital (ITA 2007, s 809Q(4)(i)). The remaining contents of account C are unknown. This is not an issue.

Example

An individual has a mixed fund account (account C) and analysis breaks it down as:

- £1.2 million Remittance Basis relevant foreign income not subject to a foreign tax;
- £2.7 million Remittance Basis foreign gains not subject to a foreign tax; and
- £3.3 million clean capital (inheritances and gifts).

All funds arising after 5 April 2008.

... Three new accounts are opened (accounts B, C and D) and the following cleansing transfers and nominations are made in 2018/19:

- £1 million to account D - a nominated transfer for the purposes of Finance (No 2) Act 2017, sch 7, part 4, para 44(2) with the £1 million transferred to account D representing income within ITA 2007, s 809Q(4)(d) (that is relevant foreign income other than income within paragraph (g)).
- £2.5 million to account E - a nominated transfer for the purposes of Finance (No 2) Act 2017, sch 7, part 4, para 44(2) with the £2.5 million transferred to account E representing gains within ITA 2007, s 809Q(4)(e) (that is foreign gains other than gains within paragraph (h)).
- £3 million to account F - a nominated transfer for the purposes of Finance (No 2) Act 2017, sch 7, part 4, para 44(2) with the £3 million transferred to account F representing income within ITA 2007, s 809Q(4)(i).

The three nominations are valid. Account C remains mixed containing (in accordance with the analysis):

- £200K of relevant foreign income not subject to a foreign tax;
- £200K foreign gains not subject to a foreign tax; and
- £300K clean capital (inheritances and gifts).

HMRC say: HMRC has no problem with this response.

20.13.12 *Over-nomination*

Para 44(5) sch 8 F(no.2) A 2017 provides:

> An amount of a kind of income or capital specified under sub-paragraph (4) may not exceed the amount of that kind which is in the mixed fund immediately before the transfer.

What if one specifies an amount of income/capital which exceeds the amount in the mixed fund? It is considered that the specification should be valid up to the actual amount of income/capital. But HMRC do not agree. 2018 Cleansing Guidance provides:

> If nominated transfers exceed the amount of that kind of income held in the mixed fund account immediately before the transfer then the normal mixed fund rules will apply. Such a nomination would be invalid

If that is right, another nomination could be made. In the meantime, the Guidance explains:

> [The invalid nomination] would have the potential to affect all subsequent nominations possibly invalidating them too...
> **Example 2** (Flavia)
> F has a mixed fund account which contains the following funds immediately before she nominates transfers[70] under the cleansing provisions:

Date	**Nature of receipt**	**Amount**[71]
2014/15	Overseas capital gain	£200,000
2014/15	Clean capital	£150,000
2013/14	Foreign income	£110,000
2013/14	Overseas capital gain	£600,000
2010/11	Foreign income	£850,000
		£1,910,000

> F nominates £1 million foreign income, transferring it to a new account

[70] In fact, in the example as reformulated in March 2018, there is only one transfer.

[71] I have formulated the data into a table, for enhanced clarity.

> (B) on 17 July 2018.
> F leaves the balance of her funds in the original account (A).

The HMRC analysis is as follows:

> The total amount of foreign income immediately before the transfer to account B was £960,000, F's transfer exceeds the total amount of foreign income contained in the account by £40,000.
> This error means that F has breached one of the cleansing conditions, instead of successfully cleansing the original account F has engaged the mixed fund rules at section 809Q and 809R (that is the entire £1 million is taken to be an offshore transfer), creating another mixed fund. She will need to work out by applying these rules the proportion of income, gains and capital that this account contains.

The author, perhaps understandably, preferred not to work through the example numerically.

> F can if she wished subsequently cleanse this account (B) by correctly applying the cleansing provisions so long as she is within the 2 year window.

Alternatively, as noted, F could simply make another nomination.

If the figures are uncertain, the best solution is to transfer the minimum amount of category (i) assets (clean capital) to a new account, with the appropriate nomination and specification, and leave the income/gains (whatever they may come to) in the old account.

20.13.13 *Cleansing joint account*

2018 Cleansing Guidance provides:

> Joint mixed fund accounts can be cleansed even if only one person qualifies.
> Each qualifying person can cleanse their share of the joint account by identifying:
>
> - the funds which are theirs
> - what those funds are, income, capital or chargeable gains

2017 Cleansing Guidance provides:

> There is nothing to prevent the cleansing of a joint mixed fund account. No matter how many named account holders there are there can still only be 1 nominated transfer from the account for mixed fund cleansing purposes.

20.13.14 *Rebasing/cleansing compared*

In outline:

2017 Rebasing[72]	**Cleansing**
Asset held 5/4/17	Asset acquired any time
Disposal any time post 6/4/17	Account transfer 2017/8 or 2018/19
Any asset	Money only
Asset foreign-situate 16/3/16 - 5/4/17	Asset unremitted
Remittance basis charge in 2008/9 - 17/18	Rem. basis claim in 2008/09 - 17/18
P not formerly-domiciled resident	Same
P meets 15-year rule in 2017/18	Not required
Election to disapply	Nomination to apply

20.14 Para 45 cleansing relief

Para 44 and 45 cleansing reliefs overlap, and an individual may effectively claim either, by an appropriate nomination, if the necessary cleansing relief conditions are satisfied.

It is easiest to follow para 45 cleansing relief if it is set out in a format which highlights the differences from para 44 cleansing relief.

Para 45 sch 8 F(no.2) A 2017 provides:

> (1) This paragraph applies to a transfer made by a person ("P") from a mixed fund where—

Seven conditions then follow which I call **"para 45 cleansing conditions"**:

> (a) the transfer is made in the tax year 2017-18 or the tax year 2018-19,
> (b) the transfer is a transfer of money,
> (c) the mixed fund[73] from which the transfer is made is an overseas account[74] (account A) containing pre-6 April 2008 income or chargeable gains,[75] ~~and~~

[72] See 56.16 (2017 rebasing).

[73] Para 45(5) provides: "In this paragraph and paragraph 46—
"mixed fund" has the same meaning as in section 809R(4) of ITA 2007".

[74] Para 45(5) provides: "In this paragraph and paragraph 46 ...
"overseas account" means an account situated outside the UK".

[75] Para 45(5) provides: "In this paragraph and paragraph 46 ...
"pre-6 April 2008 income or chargeable gains" means income or chargeable gains for the tax year 2007-8 or any earlier tax year."

(d) the transfer is made to another overseas account (account B),[76]
(e) the transfer is nominated by ~~P~~ the person for the purposes of this subparagraph,
(f) at the time of the nomination no other transfer from account A to account B has been so nominated, and
(g) P is a qualifying individual.

The only difference here is that the transferor account must contain pre-2008 income/gains.

The definition of qualifying individual is the same: para 45(2).

Cleansing under para 45 (just as para 44) requires the individual to be a remittance basis taxpayer for at least one of the years 2008/9 to 2016/17. Remittance basis treatment in an earlier year will not suffice. That is not logical, but there it is.

Assuming the para 45 conditions are satisfied, we move on to the relief. Para 45(3) provides (highlighting differences from para 44 relief):

> A~~n offshore~~ transfer to which ~~sub-paragraph (2)~~ this paragraph applies is to be treated as containing such amount of such kind or kinds of income ~~and~~ or capital in the mixed fund immediately before the transfer (for example, income or chargeable gains for a particular tax year) as may be specified in the nomination under ~~sub-paragraph (2)(d)~~ subparagraph (1)(e).

The transfer need not be an offshore transfer, though it must be made to an offshore account, which is not quite the same thing.[77] The other differences in wording are not material.

Para 45(4) provides:

> An amount of a kind of income or capital specified under sub-paragraph ~~(4)~~ (3) may not exceed the amount of that kind which is in the mixed fund immediately before the transfer.

This is the same rule as for para 44 relief..

20.14.1 *Pre-2008 payments*

Para 46 sch 8 F(no.2) A 2017 applies only to para 45 relief. It provides rules for pre-2008 payments in/out of the mixed fund.

[76] It does not matter whether account B is a mixed fund or not. That seems self-evident, but the point is also confirmed in Cleansing Q&As Question 8.

[77] See 20.6.2 (“Offshore” transfer).

> (1) This paragraph applies to determine, for the purposes of paragraph 45, the composition of the mixed fund referred to in paragraph 45(1).

Para 46(2)-(5) provide the rules for a payment out of the mixed fund:

> (2) Sub-paragraphs (3) to (5) apply where a transfer of money is made before 6 April 2008 from the mixed fund to another overseas account.
> (3) Take the following Steps—
> *Step 1*. Calculate the total amount of income and chargeable gains in the mixed fund immediately before the transfer ("the total income and gains").
> *Step 2*. Calculate what proportion of the total income and gains is income and what proportion is chargeable gains.
> (4) If the amount transferred does not exceed the total income and gains, the transfer is to be treated as if it consisted of income and chargeable gains in the proportions found under Step 2 in sub-paragraph (3).
> (5) If the amount transferred exceeds the total income and gains, the transfer is to be treated as if it consisted of—
> (a) all the income and chargeable gains that were in the mixed fund immediately before the transfer, and
> (b) in respect of the balance, other capital from the mixed fund.

Cleansing Q&As Question 8 provides:

> Does the reference in the legislation to "the mixed fund" in para 46(2) purely refer to the account being cleansed such that the legislative rules above do not apply for pre-6 April 2008 offshore transfers between two mixed funds i.e. does the reference to "another overseas account" in para 46(2) include a mixed fund account or not?
> **Suggested answer put to HMRC**
> There is nothing in the legislation that suggests that the reference to "another overseas account" must be a reference to an account which is not a mixed fund. Indeed, the second rule specifically suggests that the transfer from the other overseas account to the mixed fund is a transfer between different mixed fund accounts since para 46(7-9) suggests there could be income and gains in the other account.
> **HMRC Comment**
> Agree only for cleansing.

Para 46(6)-(8) provide the rules for a payment into the mixed fund:

> (6) Sub-paragraphs (7) and (8) apply where—
> (a) a transfer of money is made before 6 April 2008 from another overseas account to the mixed fund, and

> (b) there is insufficient evidence to determine the composition of the transfer.
>
> (7) Take the following Steps—
>
> *Step 1*. Calculate the total amount of income and chargeable gains in the other overseas account immediately before the transfer ("the total income and gains").
>
> *Step 2*. Calculate what proportion of the total income and gains is income and what proportion is chargeable gains.
>
> (8) The transfer is to be presumed to consist of income and chargeable gains in the proportions found under Step 2 in sub-paragraph (7).

Para 46(9) provides a rule where there is no evidence as to origin of the funds:

> For the purposes of Steps 1 and 2 in sub-paragraph (7), if there is insufficient evidence to say that an amount is income or that it is chargeable gains, treat it as income.

This only applies for the limited purpose mentioned.

20.15 Loss in mixed fund

Suppose a mixed fund of:

Gains	30
Capital	70
Total fund	100

The fund is invested and a loss is made of 10, leaving a fund of 90. There are (at least) 4 possibilities:

	Deduct loss from gain	**Deduct loss from capital**	**Deduct loss pro rata**	**No deduction**
Gains	20	30	23	30
Capital	70	60	57	70
Total capital/gain	90	90	90	100

The following points are clear:

(1) Losses (like gains) accrue to an individual on a disposal of assets.

(2) Losses may or may not be allowable (depending in particular on whether a loss election has been made)

(3) Losses (unlike gains) cannot be remitted. Or more accurately, tax has a concept of remitting income or gains, but there is no concept of remitting a loss so the question whether or not a loss may be said to be remitted does not arise.

The key statutory provisions are:

(1) The definition of "mixed fund" in s.809Q(6):

> In this section "mixed fund" means money or other property which, immediately before the transfer, contains or derives from
> (a) more than one of the kinds of income and capital mentioned in subsection (4), or
> (b) income or capital for more than one tax year.

(2) Step 1 s.809Q(3):

> For each of the categories of income and capital in paragraphs (a) to (i) of subsection (4), find (applying section 809R) the amount of income or capital of the individual for the relevant tax year in the mixed fund immediately before the transfer.

In the example above, there exists a mixed fund, as defined, ie, property (a fund) "which contains or derives from more than one kind of income/capital". Even if the fund did not "contain" more than one kind of income/capital (say the loss equalled the gain, and assume the loss could be set against the gain) the fund may still be said to *derive* from 30 gain and 70 capital,

So the question is: What is the amount of "income or capital in this mixed fund".

The legislation does not answer this directly, but it is suggested that the loss is simply ignored in computing the amount of income/capital in the fund. The loss erodes neither the capital nor the gain. This is more consistent with the rules that:

(1) The loss is not allowable
(2) A mixed fund need not *contain* income/capital, it is sufficient if it *derives from* mixed income/capital

Any other rule would be difficult to operate in practice as assets are bought and sold; but the remittance basis is often difficult to operate.

Accordingly if (on the example) one remits the whole of the £90 fund, one applies the mixed fund rules and the remittance consists of £30 gain and £60 capital.

However the HMRC view is more generous: capital losses should be deducted from capital gains, in analysing the contents of a mixed fund.[78]

[78] Private correspondence. It would be appropriate to explain the basis of the tax computation in the "white box".

So there would be a remittance of £20 gain and £70 capital.

The issue is raised in Cleansing Q&As Question 13:

Example 1

In the example in the question the funds used to acquire the property break down into Remittance Basis income and clean capital, as follows:

	Amount	%
Relevant foreign income	£1.0 m	40%
Relevant foreign earnings	£1.0 m	40%
Clean capital	£0.5 m	20%
	£2.5 m	

The property is sold for £2 m, so we have a loss of £0.5 m and nothing in the legislation to assist in terms of how this loss should be treated.

Applying just and reasonable methodology one would proportionally reduce each category of income and capital as follows:

	Acquisition Cost	Reductions	Proceeds
Relevant foreign income	£1.0 m	£0.2 m	£0.8 m*
Relevant foreign earnings	£1.0 m	£0.2 m	£0.8 m*
Clean capital	£0.5 m	£0.1 m	£0.4 m
	£2.5 m	£0.5 m	£2.0 m

*Whilst the above is a necessary first step[79] as it deals with the loss, the allocation above cannot be the final position. This is because it is not in accordance with the derivation rules for income and chargeable gains in ITA 2007, Part 14, Chapter A1, which make it clear that such amounts cannot be reduced.[80] This means that for mixed fund analysis purposes there is:

	Amount
Relevant foreign income	£1.0 m
Relevant foreign earnings	£1.0 m
Clean capital	£0.5 m[81]
	£2.5 m

That is, the aggregate total of the s 809Q(4) categories of income and capital is £0.4 m higher than the actual £2 m proceeds figure.

The Q&A then considers the implications for cleansing relief:

[79] Author's footnote: I do not see why this is a necessary step, since the loss deducted at this step is then added back in.

[80] I think the reference is to s.809P(3): see 18.35.2 (Change in property value).

[81] Author's footnote: the original reads £0.4m and gives the total as £2.4m, but I think that is just a slip.

The £0.4 m of clean capital can be cleansed.

Example 2
Initially a painting is acquired for £4.8 m:

	Amount	%
Relevant foreign income	£1.2 m	25%
Foreign gains	£1.2 m	25%
Clean capital	£2.4 m	50%
	£4.8 m	

The painting is sold for £3.6 m realising a loss of £1.2 m.
Step 1 – proportionally allocate out the £1.2 m loss.[82]

	Acquisition cost	Reductions	Proceeds
Relevant foreign income	£1.2 m	£0.3 m	£0.9 m
Foreign gains	£1.2 m	£0.3 m	£0.9 m
Clean capital	£2.4 m	£0.6 m	£1.8 m
	£4.8 m	£1.2 m	£3.6 m

Step 2 – adjust the step 1 result as the derivation rules mean that the income and gains figures cannot be reduced.

	Amount
Relevant foreign income	£1.2 m
Relevant foreign earnings	£1.2 m
Clean capital	£1.8 m
	£4.2 m

That is, the aggregate total of the ITA 2007, s 809Q(4) categories of income and capital is £0.6 m higher than the actual proceeds figure.

So far Q&A example 2 is like example 1, but there is then another transaction of purchase and sale, this time at a profit:

The proceeds are paid into a new offshore account (C) and then reinvested in shares. The shares are sold on 19 May 2018 for £4.4 m and the proceeds paid into account C (which contains no other funds). A Remittance Basis gain of £0.8 m is realised on the sale (£4.4 m less £3.6 m). As such, for mixed fund analysis purposes there is:

	Funds Re-invested	Rem. Basis gain	Amount
Relevant foreign income	£1.2 m	£1.2 m	

[82] As noted, I cannot see the point of Step 1, which is undone by Step 2; but it does not matter.

Foreign gains	£1.2 m	£0.8 m	£2.0 m
Clean capital	£1.8 m	£1.8 m	
	£4.2 m	£0.8 m	£5 m

That is, again as a result of the derivation rules, the mixed fund analysis aggregate total of the s 809Q(4) categories of income and capital is £0.6 m higher than the actual proceeds figure paid into account C.

The Q&A then considers the implications for cleansing relief:

The £1.8 m of clean capital can be cleansed.
The £2 m of foreign gains could also be cleansed (since the current CGT rates are much lower than the Income Tax rates this might be felt to be worthwhile).

HMRC Comment[83]
• Derivation rules do not account for clean capital.
• The derivation rules only apply to foreign income or gains.

I find this comment delphic: does it mean that HMRC agree with the two examples?

20.16 Pre-2008 mixed fund

The ITA mixed fund rules raise transitional issues which the FA 2008 addresses only in general terms, leaving HMRC, taxpayers and the courts to sort the matter out as best they can.

Para 89 sch 7 FA 2008 provides:

> Sections 809Q to 809S of ITA 2007 (transfers from mixed funds) do not apply for the purposes of determining whether income or chargeable gains for the tax year 2007-08 or any earlier tax year are remitted to the UK (or the amount of any such income or chargeable gains so remitted).

20.16.1 *Pre-2008 transfer from fund*

Suppose:
(1) A mixed fund contains pre-2008 income/gains.
(2) A transfer is made from that fund to the UK before 2008.

One obviously applied the pre-2008 mixed fund rules (discussed in the next section) to identify what was remitted at the time of the transfer and the same rules determine what income/gains remain in the fund (which

[83] Footnote original: The HMRC comments are in line with the comments made in the Q&A. However, HMRC does not say whether it agrees with the examples.

may be remitted post 2008).

20.16.2 *Post-2008 transfer from fund with pre-2008 FIG*

Suppose:
(1) A mixed fund contains pre-2008 income/gains (no post-2008 income/gains have been added).
(2) A transfer from that fund is made after 2008.

One needs to determine what part of that fund is remitted to the UK. Para 89 means that one disregards the ITA mixed fund rules (and instead applies the pre-2008 mixed fund rules discussed in the next section).[84] HMRC agree.[85]

20.16.3 *Post-2008 transfer from fund with pre- & post-2008 income/gains*

Suppose:
(1) A mixed fund contains pre-2008 and post-2008 income/gains.
(2) A transfer from that fund is made after 2008.

One needs to determine what part of that fund is remitted to the UK. The analysis comes in two stages.
(1) First one has to determine whether the transfer consists of pre-2008 or post-2008 income/gains.
(2) (a) If the transfer consists of pre-2008 income/gains, one applies the pre-2008 mixed fund rules to identify what is remitted.
(b) If the transfer consists of post-2008 income/gains, one applies the ITA mixed fund rules to determine what is remitted.

Which set of rules apply at stage 1? It is suggested that one first applies the ITA mixed fund rules so far back as 2008/09 and then the pre-2008 mixed fund rules. HMRC agree.[86]

20.17 Pre-2008 mixed fund rules

We can now turn to consider the pre-2008 mixed fund rules. There were few statutory provisions. There were a few old cases, supplemented by

[84] This view is the more natural reading. Also, if it were wrong (so one had to apply the ITA mixed fund rules) it would be necessary to classify the constituents of the mixed fund held at 6/4/08 by date and by the nine mixed fund categories, going back without limit of time. Records in many cases will not exist.

[85] See 20.18.2 (Transfer from fund with pre-and post-2008 entries).

[86] See 20.18.2 (Transfer from fund with pre-and post-2008 entries).

practice, and outside areas governed by clear rules, I expect HMRC would accept any reasonable view.

20.17.1 *Fund: Taxed/untaxed income*

The RDR Manual provides:

> **36320. Remittances from a mixed fund** [Jan 2019]
> ... Where an overseas 'mixed fund' contained an amount that has already suffered UK tax, for example UK salary dealt with under PAYE, the practice (*Sterling Trust v CIR* 12 TC 868) was that a taxpayer was entitled to say that he or she has remitted income which has already suffered UK tax (to the extent that such income exists in the fund) in priority to income which is assessable on the arising basis [ie in priority to income which is assessable if remitted].[87]

This is soundly based on *Duke of Roxburghe's Executors v IRC*.[88]

20.17.2 *Fund: Untaxed/DT relief income*

Suppose an individual holds in one pre-2008 mixed fund:

(1) income which is subject to foreign tax and qualifies for UK double tax relief; and
(2) untaxed foreign income taxable in full on the remittance basis.

It is considered that the *Roxburghe* approach applies. A remittance from this mixed fund should be regarded as made first of all out of the income which qualifies for UK double tax relief.

20.17.3 *Fund: Capital/income*

In *Scottish Provident Institution v Allan* 4 TC 591, the taxpayer held offshore:

(1) Capital which had been invested in secured loans in Australia, and which would not be taxable if remitted; and
(2) Interest arising from those loans, which qualified for the remittance

[87] The same point is made in RDR Manual 35320 [Jan 2019] (Mixed Funds: Example 4 - remittances before 6 April 2008, Note 2).

[88] 20 TC 711 discussed in another context at 18.19 (Bank errors).
Although the taxpayer in *Roxburghe* kept the funds in two accounts at the bank, the result would have been the same if the taxed and untaxed income had been held in a single bank account. This was accepted without argument in *Walsh v Randall* 23 TC 55: see para 3 of the Special Commissioners' decision, and it is accepted in this passage from the RDR Manual.

basis, and which was therefore taxed if remitted.

A sum was remitted to the UK and the question was whether this sum was the untaxed income or the capital. The background was this:

(1) The income and capital had been paid into a single account (mixed).
(2) The remittances (from the Australian agents) had been accompanied by letters stating that the sums remitted represent repayments of the loans, ie capital. The loans had in some cases been repaid only very shortly before the remittance.
(3) The sum remitted (£200,000) was small compared to the amount of the loans and the interest received (each about £1.5m).

It was held that the remitted sum was the income, not capital. The Lord Chancellor said:

> It is obvious that the mere nicknaming the sum received and ascribing to it, because it is so named, the character of capital and not of income, cannot defeat the right of the Crown to have the tax levied upon that which in substance and truth is [income] ...[89]

Two points shine out:

(1) The description of the remittance as capital does not make the remittance capital if "in truth" it is income. This is self-evident: "a rose by any other name *etc*" However, this principle does not address the more fundamental question of *how* the courts determine what is income and what is capital.
(2) The answer to this second question is that the courts look to the substance.

However, it is one thing to look for the substance, and another to find and identify it. Why, in substance, was the remittance from the income, not from the capital? The answer may be found in the speech of Lord Robertson: "The facts of the case must furnish the inference."

The following facts were relevant:

> [1] First of all there is the fact of remittance in two consecutive years

[89] 4 TC 591 at p593. Similarly Lord Davey: "I must say that that is a draft upon my credulity, a strain upon my powers of belief, which they will not bear. I agree that the mere calling it capital for the purpose of the Inland Revenue Department will not make into capital that which is essentially and in truth ... the interest received on the securities."

> ...
> [2] There is no suggestion that any exceptional reason required remittances of capital, in either year or in both.
> [3] On the other hand it is certain that the amount of invested capital left behind in the Colony, after these remittances, is larger than before; so that the capital is fully accounted for.
> [4] Well then, what is done with this so-called capital remitted? The answer is, exactly what would be done with profits.

This is explained by Lord Shand in argument:

> If it is capital you have brought back and distributed as bonus, you have been paying back capital, which I should think you have no authority to do.

This is why Lord Robertson concluded:

> The inference from these facts is that the moneys remitted were in fact profits, [ie income] ...

The former Inspectors Manual para 1566 gave the HMRC view:

> Where a person maintains abroad a fund (for example, a bank account) containing income assessable on the remittance basis, a capital lodgement to the fund is normally considered to lose its identity in the fund. A subsequent remittance from such a mixed fund, therefore, represents income up to the full extent of the income content of the fund (see *Scottish Provident Institution v Allan* 4 TC 409 and 4 TC 591, and especially the Lord Chancellor's remarks on 'mere nicknaming' at 4 TC 593). Only when the income content of the fund is exhausted will any balance remitted be regarded as capital. Where this is not accepted, the full facts of the case should be reported to Revenue Policy, International (Cases IV and V), Victory House.

The Inspectors Manual over-simplified the law as expounded in *SPI v Allan*. There is no rule that the remittance out of a mixed fund of income and capital is to be treated as income first. Suppose a taxpayer remits a substantial amount, exceeding the income, and applies it capital expenditure, such as an investment in the UK, or the purchase of a house. It is considered that the "substance" of the matter, applying Lord Robertson's approach, is that the remittance is one of capital. The position is even stronger if the taxpayer first uses an amount equal to the income of a mixed account on expenditure abroad of an income nature.

The RDR Manual now provides:

> **RDRM36320. Remittances from a mixed fund** [Jan 2019]
>
> For tax years up to 5 April 2008, there are no statutory rules to determine what amounts remitted from 'mixed funds' actually consisted of.
>
> On occasion this created difficulty in determining, for UK tax purposes what a remittance to the UK actually consisted of, for example, was it non-taxable income, employment income, interest, chargeable gains or capital.
>
> *Scottish Provident v Allan*
>
> Broadly HMRC practice was based on House of Lords decisions, in particular that of *Scottish Provident v Allan* (4 TC 409/591). In the Court of Exchequer, Lord McLaren said (page 419)
>
>> 'un-appropriated remittances must be dealt with according to the ordinary course of business, and these remittances must be presumed to be paid in the first place out of interest so far as they are income, and in the second place of principal or capital. I think that rule results from the fact that no prudent man of business will encroach upon his capital for investment when he has income un-invested lying at his disposal'.
>
> The House of Lords considered that the question of whether any amount of income had actually been received in the UK is essentially one of fact, that is, of tracing in the first instance, or, where direct tracing proves to be impossible, of inference from the known facts.
>
> In the absence of any evidence to the contrary, the principle is that where capital and income have been paid into a single fund overseas so that they are no longer distinguishable, remittances to the UK out of the fund will be presumed to be income to the extent that there is income existing in the fund at the time that the remittance was made.
>
> ... Only when the income content of the fund is exhausted will any balance remitted be regarded as capital.[90]

Note that *SPI v Allan* was a case where the mixed fund was capital and income. The case can have no application where the mixed fund consists of different kinds of income or different kinds of capital.

At first sight there is some tension between *SPI v Allan* and *Duke of Roxburghe* 20 TC 711. In the first, "mere nicknaming" was contemptuously dismissed; in the second, it was the "legal right" of the Duchess to direct whether the remittance was from one part of a mixed fund or the other. The cases agree, however, that the matter is one of

[90] The same passage is found in RDRM 35320 Note 2.

"substance". It is suggested that the cases can be reconciled in this way: in a marginal case, the description of the remittance given by the taxpayer may be decisive. Where the substance of the transaction shows that a remittance is one of income or capital, "mere nicknaming" will not alter the position.

20.17.4 *Fund: Gain/clean capital*

Suppose an individual holds in one pre-2008 mixed fund:

(1) capital which does not represent any chargeable gain within the scope of CGT; and
(2) the proceeds of a disposal on which a chargeable gain accrued.

A remittance from this fund should for CGT purposes be treated as coming out of the tax free source first.

20.17.5 *Remittance: gain or base cost?*

Suppose a foreign domiciliary purchases a foreign asset for £1m; they sell it for £3m and realises a pre-2008 chargeable gain of £2m. If they remit the entire £3m proceeds, the entire £2m gain is charged to CGT. But what is the position if they remit only £1m and retain the balance abroad? The RDR Manual provides:

> **RDRM36320. Remittances from a mixed fund** .... [Jan 2019]
> *Capital Gains*
> For years up to 5 April 2008, where a remittance is made to the UK from a mixed fund into which the proceeds from the sale of an asset (such as a shareholding) has been paid the remittance contains a due proportion of any capital and of any capital gain arising from the disposal.
> That is because, unlike income that can be identified separately, a capital gain is merely part of the money received from the sale and has no separate existence within that amount. Refer to the Capital Gains Manual CG25380 onwards (and CG25440 in particular).[91]

The last sentence is correct to say that a capital gain has no separate existence. I do not think it even exists as "part of the money received from the sale". It is not a separate or separable item of property existing at all. The gain is merely the result of a computation. The proceeds of a disposal

[91] The same point is made at para 35320 (Mixed Funds: Example 4 - remittances before 6 April 2008 Note 3).

represent the gain, but they do not constitute the gain, just as trading receipts do not constitute the profits of a trade. So it is considered that the HMRC view is correct.

20.18 Pre-2008 mixed funds: examples

The RDR Manual gives two examples concerning pre-2008 mixed funds.

20.18.1 *Pre-2008 transfer from pre-2008 mixed fund*

The first example involves a pre-2008 transfer from a pre-2008 mixed fund. One therefore applies the pre-2008 mixed fund rules.[92]

> **RDRM35320 Mixed Funds: Example 4 - remittances before 6 April 2008**
> **Example 4** (Martyn) [Jan 2019]
> The "mixed fund" rules in s809Q do not apply to amounts that are in an account before 6 April 2008 (FA2008/para 89).
> M has lived in the UK for many years. He has paid UK tax on the remittance basis for all relevant tax years and has decided that he will do so again for 2008-2009.
> M has his UK salary paid into his overseas bank account. He also has a salary for overseas employment and his net salary for that work of £5,000 a month is paid into the account. Dividends from a shareholding in a foreign company are also paid into the account.
> On 18 March M sold some of his foreign shares as he was thinking of purchasing a new property. He deposited the proceeds of £5,000,000 from the sale into his overseas account. This amount is made up of £4m capital and £1m gain (no deduction of foreign tax).

Tax Year 2007-2008		**Credit (Debit)**	**Balance**	**Note**
	Balance b/f		£47,000	1
31 Dec	UK salary (net of tax)	£10,000	£57,000	
31 Dec	Overseas salary (net of tax)	£5,000	£62,000	
3 Jan	Transfer to UK account	(£5,000)	£57,000	2
31 Jan	UK salary	£10,000	£67,000	
31 Jan	Overseas salary	£5,000	£72,000	
3 Feb	Transfer to UK account	(£12,000)	£60,000	2
15 Feb	Dividend	£2,000	£62,000	
29 Feb	UK salary	£10,000	£72,000	
29 Feb	Overseas salary	£5,000	£77,000	
3 Mar	Transfer to UK account	(£8,000)	£69,000	2
18 Mar	Share Sale £4m capital, £1m gain	£5,000,000	£5,069,000	3[93]
31 Mar	UK salary	£10,000	£5,079,000	
31 Mar	Overseas salary	£5,000	£5,084,000	

[92] See 20.16.1 (Pre-2008 transfer from fund).

[93] For this note, see 20.17.5 (Remittance: gain or base cost?).

3 Apr	Transfer to UK account	(£10,000)	£5,074,000	2

Note 1: Identity of balance brought forward

The balance brought forward of £47,000 is made up of

UK salary	£15,000
overseas salary	£25,000
overseas dividends	£7,000
	£47,000[94]

The Manual then considers the tax analysis of the four UK transfers. The key fact is that M never remitted more than the UK salary already received in the account (the transfers totalled £35k and salary totalled £55k). The Manual provides:

> **Note 2: Transfers to UK account**
> ... So to establish the taxable amount of remittances made in the example above in 2007-2008 the account must be analysed. In this case the analysis is straightforward. M has brought £35,000 to the UK between December 2007 and March 2008 to meet his day to day UK spending needs. Applying the *Sterling Trust v CIR* practice outlined above,[95] the £35,000 can be regarded as remittances consisting solely of his UK salary that has already been taxed under PAYE. Because he has claimed the remittance basis of taxation in respect of his relevant foreign income or foreign earnings for 2007-2008 he has no further amount of UK tax to pay on these amounts that stay in the Offshore account.

The example is repeated in RDR Manual 36330 [Jan 2019] (Remittances from a mixed fund - Example 1).

20.18.2 *Transfer from fund with pre- and post-2008 entries*

The next example is a post-2008 transfer from a mixed fund containing pre- and post-2008 income/gains.

RDRM35330 Remittances from mixed funds involving income/gains before 6 April 2008 - Example 4a [Jan 2019]

Continuing from the example 4 above, on 5 April 2008 M's Offshore account contains:

2007- 2008	UK salary	£20,000
	Overseas salary	£45,000
	Overseas dividends	£9,000

[94] The Manual adds: "all items arising in, and credited during that tax year. M has paid the relevant amount of UK tax based upon his UK sources of income and the amounts of foreign income and gains that he has remitted to the UK." But that is not relevant to the example.

[95] See 20.17.1 (Fund: Taxed/untaxed income).

Sale of shares: Capital	£4,000,000
Sale of shares: Gain	£1,000,000
	£5,074,000

2008-2009		**Credit (Debit)**	**Balance**	**Category**	**Note**
6 Apr	Balance b/f	£5,074,000			
30 Apr	UK salary (net)	£10,000	£5,084,000	Para (a)	
30 Apr	Overseas salary (net)	£5,000	£5,089,000	Para (f)	
3 May	Transfer to UK acc	(£5,000)	£5,084,000		1
15 May	Dividend	£2,000	£5,086,000	Para (g)	
31 May	UK salary	£10,000	£5,096,000	Para (a)	
30 May	Overseas salary	£5,000	£5,101,000	Para (f)	
30 Jun	UK salary	£10,000	£5,111,000	Para (a)	
30 Jun	Overseas salary	£5,000	£5,116,000	Para (f)	
30 Jun	Direct Debit to UK	(£100,000)	£5,016,000		2

Note 1 analyses the £5k remittance made 3 May:

Applying the ordering rules in S809Q to the account **immediately before the** transfer:

Step 1 Identify the "amount of transfer" in the relevant tax year (2008-09) £5,000
Identify the separate amounts of income, gains and capital present for the relevant tax year (2008-09) immediately before the transfer:
Para (a) Employment income not subject to a foreign tax £10,000
Para (f) Employment income subject to a foreign tax £5,000
Step 2 Identify the earliest paragraph above for the relevant year, which has an amount of income or gain in the mixed fund
Para (a) £10,000
Step 3 Where the amount of the remittance is less than the amount identified at Step 2 the amount remitted is treated coming entirely from that paragraph. There is no need to continue to step 4. £5,000

The remittance is regarded as coming from the "earliest paragraph", that is para (a), so the £5,000 is UK employment income, so there is no taxable remittance of foreign income nor further tax to pay upon remittance.

Note 2 analyses the £100k remittance made 30 June. At this point the example becomes more challenging:

M decided to buy a residential property. He remits £100,000 to pay some legal fees [!] for the purchase on 30 June. Although M considers that this amount has come from the sale of shares in 2007-2008 the ordering rules in s809Q require the remittance to be taken into account first against all income and gains of the year in which the remittance is made.

Step 1 Identify the "amount of transfer" in the relevant tax year (2008-2009) £100,000
Identify the separate amounts of income, gains and capital present for the relevant tax year (2008-09) immediately before the transfer:
Para (a) Employment income not subject to a foreign tax £25,000

Para (f) Employment income subject to a foreign tax	£15,000
Para (g) Relevant foreign income subject to a foreign tax	£2,000
Step 2 Identify the earliest paragraph above for the relevant year, which has an amount of income or gain in the mixed fund:	
Para (a)	£25,000
Step 3 Where the amount of the remittance is greater than the amount identified at Step 2 the amount remitted is treated as reduced by the amount identified in Step 2.	£100,000
	- £25,000
	£75,000
Step 4 Find the next paragraph/amount for that tax year. In the order of preference listed above repeat Steps 2 and 3.	
Step 2 Identify the earliest paragraph: **Para (f)**	£15,000
Step 3 Where the amount of the remittance is greater than the amount identified at Step 2 the amount remitted is treated as reduced by the amount identified in Step 2	£75,000
	-£15,000
	£60,000
Step 4 In the order of preference listed above repeat Steps 2 and 3.	
Step 2 Para (g)	£2,000
Step 3	£60,000
	- £2,000
	£58,000

At this stage all of the amounts credited to the account in 2008-09 have been matched against £100,000 remittance transfer [in my terminology an onshore transfer] in that year. But £58,000 has been brought to the UK that has not been "matched" under the s809Q rules (and cannot be matched because of FA2008/para89).

The remaining £58,000 is regarded as coming from the 2007-08 credits to the account. The ordering rules at section 809Q cannot be used, so instead the general principles outlined in Note 2 of example 4 above will apply.

HMRC then explain the applicable pre-2008 mixed fund rules:

This £58,000 will usually be regarded as a remittance of M's income and is, first and foremost (*Sterling Trust* principle) his taxed income and then (*Scottish Provident v Allan* principle) any other income - that is his foreign employment income or dividends - as he selects.

However in this case M may equally be able to demonstrate that the remaining £58,000 comes from the proceeds of the sale of shares, as he particularly sold the shares in order to fund this house purchase. If that is the case, the remaining remittance will consist of £11,600 foreign chargeable gain (1/5 due proportion – refer to note 3 in example 4).[96]

HMRC do not say whether the £58k remittance is income or capital. How is M to "demonstrate that the £58k comes from the proceeds of the sale of

[96] See 20.17.3 (Fund: Capital/income).

shares" given that the payment was out of a mixed fund? The correct approach is to say that the substance is one of a remittance of capital since the purchase is for the house, ie has the nature of capital expenditure.[97] Thus the £58k remittance is capital.

Moral: M should not have paid the proceeds of the share sale into a mixed account. If it had been paid into a separate account, and the £100k paid from there, the position would have been simpler and better.

20.19 Nominated income/gain remitted

20.19.1 *Outline*

EN FB 2008 provides:

> 14... If, in subsequent years, that "nominated" income or gains upon which the RBC has been paid is, in fact, remitted to the UK, then that income or gains will not be taxed again. However, there are ordering rules to ensure that if "nominated" income or gains is, in fact, remitted when other untaxed income and gains remain unremitted, then that unremitted income and gains is treated as being remitted before the "nominated" income and gains.

These rules are not (or not just) mixed fund rules, as they may apply even if funds are not mixed; but it is convenient to deal with them in this chapter.

20.19.2 *"Nominated income"; "nomination year"*

The expression "nominated income and gains" is defined in s.809I(3) ITA:

> In this section the individual's "nominated income and gains" are the total income and chargeable gains nominated by the individual under section 809C for the relevant tax year or any earlier tax year (each such year for which the individual has made a nomination under that section being referred to as a "nomination year").

This is a section-wide definition only, so the drafter repeated the definition in s.809J(3) ITA. (If the definition had been chapter-wide, or ITA-wide definitions, the repetition would not have been needed.)

The definition is discussed in 17.12.2 (Duty to nominate income/gains).

20.19.3 *"Remittance basis income/gains"*

Section 809I(4) ITA gives this term a fairly commonsense meaning:

[97] See 20.17.3 (Fund: Capital/income).

> An individual's "remittance basis income and gains" are the foreign income and gains of the individual for all the tax years (up to and including the tax year mentioned in subsection (1)(a)) for which section 809B, 809D or 809E applies to the individual, apart from the individual's nominated income and gains.

Nominated income/gains do not count as remittance basis income/gains because they are taxed on an arising basis. The drafter must have regarded this as a section-wide definition only, and so repeated the definition in s.809J(4) ITA.[98]

20.19.4 *Nominated income categories*

The taxpayer must classify their remittance basis income and gains into 8 categories, which I call the **"nominated income/gains categories"**. The categories are set out in s.809J(2) ITA. These are almost the same as the 9 mixed fund categories[99] but:

(1) there are casual differences of wording which do not affect the meaning; and

(2) there are (incredibly) small differences (I do not see why – if any reader can suggest a reason I would be interested to know).

I here set out a table which compares the two (the differences are italicised):

Nominated income/gains categories: s.809J	**Mixed fund categories: s.809Q**
	(a) *employment income (other than income within para (b), (c) or (f))*
(a) relevant foreign earnings (other than those subject to a foreign tax)	(b) relevant foreign earnings (other than income within para (f))
(b) foreign specific employment income (other than income subject to a foreign tax)	(c) foreign specific employment income (other than income within para (f))
(c) relevant foreign income (other than income subject to a foreign tax)	(d) relevant foreign income (other than income within para (g))

[98] "In step (1) of subsection (1) the individual's "remittance basis income and gains" are the foreign income and gains of the individual for all the tax years (up to and including the relevant tax year) for which section 809B, 809D or 809E applies to the individual, apart from the individual's nominated income and gains."

[99] See 20.4 (Ingredients of mixed fund).

(d) foreign chargeable gains (other than gains subject to a foreign tax)	(e) foreign chargeable gains (other than chargeable gains within para (h))
(e) *relevant foreign earnings subject to a foreign tax*	(f) employment income subject to a foreign tax
(f) *foreign specific employment income subject to a foreign tax*	
(g) relevant foreign income subject to a foreign tax	(g) relevant foreign income subject to a foreign tax
(h) foreign chargeable gains subject to a foreign tax	(h) foreign chargeable gains subject to a foreign tax
	(i) income or capital not within another paragraph

Section 809J(6) ITA provides a commonsense definition of "foreign tax" for the purpose of the nominated income/gains categories. The same definition is used for the mixed funds categories and I discuss the definition there.[100]

20.19.5 *Nomination rules: Application*

Section 809I(1) ITA provides:

> This section applies if—
> (a) any of an individual's nominated income and gains is remitted to the UK in a tax year,
> (b) any of the individual's remittance basis income and gains has not been remitted to the UK in or before that year, and
> (c) the £10 test is met for that year.

20.19.6 *The £10 test*

Section 809I ITA provides:

> (5) The £10 test is met for the tax year mentioned in subsection (1)(a) ("year X") if, taking each nomination year separately, the cumulative total as respects at least one nomination year exceeds £10.
> (6) In relation to a nomination year–
> (a) "the cumulative total" means the sum, for all the tax years in

[100] See 20.4 (Ingredients of mixed fund).

aggregate up to and including year X, of the amounts of relevant income and gains remitted to the UK in those tax years from that nomination year, and

(b) "relevant income and gains" means the income and chargeable gains nominated by the individual under section 809C for that nomination year.

This is therefore a de minimis rule.

The 2011 remittance consultation paper explains the background:

> 2.67 Non-domiciles who have been UK resident in at least seven of the past nine tax years are liable to an annual charge of £30,000 if they claim the remittance basis. The rules governing the payment of this charge can be very complicated and result in significant administrative burdens and inconvenience for the taxpayer.
>
> 2.68 Those who elect to pay the charge are required to nominate an amount of their overseas income and capital gains which is taxable on the arising basis and is deemed to generate an additional tax charge of £30,000.
>
> 2.69 There are complicated rules to ensure that an individual cannot subsequently remit any of the income or capital gains which they have nominated before other overseas income and capital gains which would be taxed in the UK when remitted. This must be in addition to the UK tax to which they are otherwise liable on income and capital gains arising in the UK or remitted to the UK. This nomination ensures that the £30,000 is a tax charge on overseas income and gains rather than a standalone levy.
>
> 2.70 Individuals can encounter significant administrative difficulties where they fail to keep their nominated income and capital gains segregated from other income and capital gains. In such situations, an individual might inadvertently remit some of their nominated income and capital gains to the UK. This will mean that they become subject to complicated identification rules which trace the origin of each payment and ensure that the nominated amounts are always the last to be remitted. In the absence of these rules, it would be possible for an individual to reduce significantly the amount of tax they pay on the income or capital gains which they remit to the UK.
>
> 2.71 To avoid some of these complexities, it is common for an individual to open an overseas bank account which has the sole purpose of holding funds to generate sufficient income to be nominated for the purposes of the annual charge. Whilst this should allow the individual to avoid the identification rules, the need to set up a special overseas bank account involves additional expenditure and administrative obligations. Moreover, even where an individual has a dedicated bank account for their nomination, it cannot be guaranteed that they would never inadvertently make remittances from the account.

> 2.72 The Government recognises that this can result in excessive and unhelpful complexity which is hard for the taxpayer to understand. It therefore proposes to amend the legislation to allow individuals to remit the first £10 of income or capital gains which they nominate free of tax and without becoming subject to the identification rules. This will enable them to nominate up to £10 of their foreign income or capital gains for the purposes of the £30,000 charge without having to ensure they do not subsequently remit any part of that nominated amount to the UK. Many individuals only nominate a small amount of foreign income or capital gains and so this simplification would remove the risk of them inadvertently remitting the nominated income and triggering the identification rules.
> 2.73 This would significantly reduce the need to maintain an overseas bank account solely for the purposes of nominating income and capital gains, whilst making the nomination rules less administratively onerous.
> 2.74 The remaining rules applying to nominated income and capital gains will remain unaltered.[101]

The EN accompanying the draft clauses provides:

> 130. Where [remittance basis taxpayers] remit the foreign income and gains which they have nominated under section 809C before any other unremitted foreign income and gains, the order in which income and gains are remitted is determined by sections 809I and 809J.
> 131. The amendments made by Part 4 of the Schedule allow such individuals to remit up to £10 each year of their income or gains which they have nominated without having to ensure they do not subsequently remit any part of that nominated amount into the UK.
> 132. An illustration of how the new rules work is set out below.
> 133. In year 1, an individual nominates £5 income and gains from that year which they remit to the UK. As the total amount of nominated income and gains remitted is less that £10, they do not meet the £10 test and section 809I does not apply.
> 134. In year 2, the individual nominates £20 from year 1, of which they remit £7. The amounts of nominated income and gains from year 1 exceeds £10, so section 809I will apply.

The example is somewhat far-fetched, since an individual would either

[101] HMT & HMRC, "Reform of the taxation of non-domiciled individuals: a consultation" (June 2011) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/81510/consult_condoc_non_domicile_individuals.pdf*

nominate a nominal £1 or else nominate a substantial amount. But leaving that aside, para 134 is not correct. The individual cannot (as suggested) nominate, in year 2, £20 of income/gains from year 1 in support of a remittance basis claim in year 2.[102]

Para 237 EN FA 2012 makes the point more accurately:

> Example: in year one, an individual nominates £15 of foreign income or gains and remits £5 of the nominated amount to the UK. As the total amount of nominated income and gains remitted in year one is less than £10, they do not meet the £10 test and section 809I does not apply. In year two the individual remits the balance of nominated income from year one consisting of £10 to the UK. The cumulative total of nominated income and gains from year one remitted to the UK now exceeds £10, so the ordering rules in section 809I will apply.

20.19.7 *Nomination rules*

Assuming that the conditions for the application of the nominated income remittance rules are satisfied, we move on to s.809I(2) ITA which provides:

> Income tax and capital gains tax are charged, for that year and subsequent tax years, as if
>
> [a] the income and chargeable gains treated under section 809J as remitted to the UK by the individual in that tax year had been so remitted
>
> [b] (and income and chargeable gains of the individual that were actually remitted in that year had not been).

So we turn to s.809J ITA, which sets out artificial or fictional remittance rules which I call the "**nominated income remittance rules**". (It would be more accurate to call this "the nominated income/*gains* remittance rules", but for convenience I generally refer to income (rather than income/gains) and leave gains to be understood.)

Section 809J(1) ITA provides:

> If section 809I applies, the following steps are to be taken for the purpose of determining the income or gains treated in a tax year ("the relevant tax year") as remitted to the UK by the individual.

The section sets out six steps. It is easier to follow the steps if one has an

[102] See 17.12.2 (Duty to nominate income/gains).

example in mind.

Suppose T (a remittance basis taxpayer) has remittance basis income and gains of £10k per annum of each of the nominated income/gains categories thus:

Category	**Type of income (in short)**	**Year 1**	**Year 2**
(a)	relevant foreign earnings	£10k	£10k
(b)	foreign specific employment income (FSEI)	£10k	£10k
(c)	relevant foreign income	£10k	£10k
(d)	foreign chargeable gains	£10k	£10k
(e)	foreign taxed relevant foreign earnings	£10k	£10k
(f)	foreign taxed FSEI	£10k	£10k
(g)	foreign taxed RFI	£10k	£10k
(h)	foreign taxed gains	£10k	£10k

Suppose T has in addition to the above £30k nominated income and gains per annum.

T remits nothing in year 1. In year 2 T remits:
(a) £1k from T's nominated income/gains.
(b) £80k from T's remittance basis income/gains.

This brings the nominated income remittance rules into action.

> *Step 1*
> *Find the total amount of—*
> *(a) the individual's nominated income and gains, and*
> *(b) the individual's remittance basis income and gains,*
> *that have been remitted to the UK in the relevant tax year.*
> *This amount is "the relevant amount".*

In the example the relevant tax year is year 2. Applying the facts of the example, the relevant amount is £81k.

> *Step 2*
> *Find the amount of foreign income and gains of the individual for the relevant tax year (other than income or chargeable gains nominated under section 809C) that is within each of the categories of income and gains in paras (a) to (h) of subsection (2).*
> *If none of sections 809B, 809D and 809E apply to the individual for that year, treat those amounts as nil (and accordingly go to step 6).*

"The amount of foreign income and gains of the individual for the relevant tax year (other than income or chargeable gains nominated under section 809C)" means the remittance basis income/gains. (The drafter has forgotten to use the term which was defined (twice) for this purpose; but it does not matter.) The amount in the example is as set out in the table above.

> *Step 3*
> *Find the earliest paragraph for which the amount determined under step 2 is not nil.*

The earliest paragraph is para (a).

> *If that amount does not exceed the relevant amount, treat the individual as having remitted the income or gains within that paragraph (and for that tax year).*

The individual is treated as having remitted £10k relevant foreign earnings, category (a) for year 2.

> Otherwise, treat the individual as having remitted the relevant proportion of each kind of income or gains within that paragraph (and for that tax year).
> "The relevant proportion" is the relevant amount divided by the amount determined under step 2 for that paragraph.

(Had the total remittance been (say) £5k then the relevant proportion would have been £5k÷£10k = 50% so the transfer would have been treated as containing £5k RFE category (a) for year (1).)

> *Step 4*
> Reduce the relevant amount by the amount taken into account under step 3.

The relevant amount is reduced to £71k.

> *Step 5*
> If the relevant amount (as reduced under step 4) is not nil, start again at step 3.
> In step 3, read the reference to the earliest paragraph of the kind mentioned there as a reference to the earliest such paragraph which has not previously been taken into account under that step.

Following this iterative procedure a total of eight times, the transfer is treated as containing:

(a)	relevant foreign earnings	£10k
(b)	foreign specific employment income	£10k
(c)	relevant foreign income	£10k

(d)	foreign chargeable gains	£10k
(e)	foreign taxed RFE	£10k
(f)	foreign taxed SEI	£10k
(g)	foreign taxed RFI	£10k
(h)	foreign taxed gains	£10k
	Total	**£80k**

The relevant amount is by this stage reduced to £1k. We move to the next step:

> *Step 6*
> *If the relevant amount (as reduced) is not nil once steps 3 to 5 have been undertaken in relation to all paragraphs of subsection (2) for which the amount determined under step 2 is not nil, start again at step 2.*
> *In step 2, read the reference to the foreign income and gains of the individual for the relevant tax year as a reference to such of the foreign income and gains of the individual for the appropriate tax year as had not been remitted*[103] *by the beginning of the relevant tax year.*
> *"The appropriate tax year" is the latest tax year which is—*
> *(a) before the last tax year for which step 2 has been undertaken, and*
> *(b) a tax year for which section 809B, 809D or 809E applies to the individual.*

Thus we repeat step 2 a last and ninth time, reading "the relevant tax year" to mean year 1. So the remittance of £81k is treated as being:

(a)	relevant foreign earnings	£11k
(b)	foreign specific employment income	£10k
(c)	relevant foreign income	£10k
(d)	foreign chargeable gains	£10k
(e)	foreign taxed RFE	£10k
(f)	foreign taxed SEI	£10k
(g)	foreign taxed RFI	£10k
(h)	foreign taxed gains	£10k
	Total	£81k

[103] Section 809J(5) ITA provides:
In step 6 of subsection (1) the reference to income or gains being remitted is—
(a) as respects any tax year before section 809I applies, to income or gains being remitted to the UK, and
(b) as respects any tax year in relation to which that section applies, to income or gains treated under this section as so remitted.

March 2009 Qs & As provides:

> **Q3:** HMRC have indicated that individuals do not have to specify which account the nominated income comes from, and from this it could be inferred that without further disclosure of the particulars of the account the taxpayer may be at risk of "tainting" every other source of income of that type. For example if an individual has an account with one bank in Jersey and another bank in a different jurisdiction, he could nominate bank interest on his Jersey account, so that it would be obvious that if he remitted income from his other account, he might not fall foul of re-characterisation provisions. However, this may not be the case if he had three different accounts with the same bank in Jersey and he wishes to nominate income from one of those accounts without disclosing the account number of that account. Can HMRC clarify what their approach to this will be?
> **A:** It is up to the individual to decide how much information to give HMRC on their Self Assessment returns in order to identify the source of the nominated income or gains; if, as in this example, there is more than one account the individual should provide sufficient detail to distinguish between them and identify the "nominated" account. That might be the entire account number, or the account "name", or some other unique identifying feature of the account.

March 2009 Qs & As makes an obvious point:

> **Q6:** If I use nominated income or gains to pay the remittance basis charge of £30,000 it would appear that does not trigger the provisions in sections 809I and 809J. Is that right?
> **A:** If £30,000 of the nominated income or gains is brought to the UK to pay the remittance basis charge, it is treated as not remitted to the UK under section 809V. Therefore section 809I does not apply because none of the individual's nominated income or gains is regarded as having been remitted to the UK in that tax year. If the £30,000 is repaid by HMRC then it is treated as remitted at that point and so section 809I will be triggered.

20.19.8 *Accidental remittance of nominated income/gains*

The RDR Manual provides:

> **RDRM35140 Remittances of nominated income or gains - misc** [Jan 2019]
> *Accidental remittances*
> If an individual accidentally remits any nominated income or gains to the UK then HMRC will (using its discretionary powers) allow them to undo

> their mistake, by reversing the transfer without unreasonable delay and in any event before the end of the tax year, for example by paying the income or gains back to the original account, so that the ordering rules at s809I and s809J will not apply.
>
> HMRC will only use its discretion in such situations as long as there have been no relevant transactions or other benefits conferred on a relevant person in the interim. Otherwise the s809J ordering rules will apply.
>
> For example, if £20,000 is transferred in error from an overseas bank to a UK bank account and two weeks later the account owner realises the mistake and immediately transfers that £20,000 directly back to the overseas bank account, HMRC will accept that s809I and s809J do not apply. However if, for example, the £20,000 was spent in the UK and then £20,000 from another UK account was transferred back to the overseas account then s809I and s809J do apply.

This recognises the unfairness of the nominated income remittance rules. Contrast 18.19 (Bank error).

20.19.9 *Nominated income used to pay remittance basis charge*

The RDR Manual provides:

> **RDRM35140 Remittances of nominated income or gains - misc** [Jan 2019]
>
> *Accidental remittances*
>
> If an individual accidentally remits any nominated income or gains to the UK then HMRC will (using its discretionary powers) allow them to undo their mistake, by reversing the transfer without unreasonable delay and in any event before the end of the tax year, for example by paying the income or gains back to the original account, so that the ordering rules at s.809I and s.809J will not apply.

20.19.10 *HMRC example*

The RDR Manual provides:

RDRM35150 Remittances of nominated income or gains [Apr 2019]
Example 1 (Alexandria)

	Foreign gains	Jersey RFI	Jersey RFE	Nomination
	Para (d)	Para (c)	Para (a)	(from Jersey RFI)
2010-11	£250,000	£75,000	£200,000	£75,000 RFI
2011-12	£300,000	£80,000	£120,000	£75,000 RFI[104]

[104] The author ignores the complication that the rate of income tax has risen to 50%.

2012-13	Nil	£75,000	£280,000	£75,000 RFI
2013-14	£130,000	£80,000	£150,000	£75,000 RFI
Totals	£680,000	£310,000	£750,000	

In 2013-14 A actually and identifiably remits

£30,000	Jersey relevant foreign income that she nominated in 2010-11,
£140,000	foreign chargeable gains from 2011-12 and
£50,000	relevant foreign earnings from 2013-14.

The ordering rules are triggered. The "relevant year" is 2013-14

Step 1 Identify nominated income and gains remitted in the relevant year	£30,000	**Relevant Amount**	£220,000
Identify the remittance basis income and gains remitted in the relevant year	£190,000		
Step 2			
Find the total amount of the individual's foreign income and gains (excluding those nominated) for the relevant tax year	**Para (a)** Relevant foreign earnings (not subject to a foreign tax)		£150,000
	Para (c) Relevant foreign income (not subject to a foreign tax)		£5,000
	Para (d) Foreign chargeable gains (not subject to a foreign tax)		£130,000
Step 3 Identify the earliest of paragraphs (a) to (h) above for which the amount determined in Step 2 is not nil.	**Para (a)**		£150,000
Step 4 Where the relevant amount is greater than the amount identified above the relevant amount is reduced by the amount identified	£220k less £150k = £70,000		

Step 5 If the relevant amount is not nil go back and repeat Step 3. Take the reference to the first of paragraphs (a) to (h) as a reference to the earliest paragraph not previously taken into account under Step 3.

Step 3 repeated	**Para (c)**	£5,000
Step 4 repeated	Relevant Amount reduced to:	£65,000

Step 5 In the order of preference listed above repeat Steps 3 and 4.

Step 3 repeated	**Para (d)**	£130,000

Step 4 If the relevant amount is less than the amount identified, treat the whole of the remaining amount of the transfer as coming from that item of income or gain.

S*o A will be taxed on £220,000 of remittances as if she had actually remitted the following*

		2010-11	**2011-12**	**2012-13**	**2013-14**
Foreign chargeable gains	Accruing in year	£250,000	£300,000	Nil	£130,000
	Actually remitted	£Nil	£140,000	£Nil	£Nil
	Treated as remitted	£Nil	£Nil	£Nil	£65,000
Relevant foreign income Nominated	Arising in year	£75,000	£75,000	£75,000	£75,000
	Actually remitted	£30,000	£Nil	£Nil	£Nil
	Treated as remitted	£Nil	£Nil	£Nil	£Nil
Relevant foreign income Not nominated	Arising in year	£Nil	£5,000	£Nil	£5,000
	Actually remitted	£Nil	£Nil	£Nil	£Nil
	Treated as remitted	£Nil	£Nil	£Nil	£5,000
Relevant foreign earnings	Accruing in year	£200,000	£120,000	£280,000	£150,000
	Actually remitted	£Nil	£Nil	£Nil	£50,000
	Treated as remitted	£Nil	£Nil	£Nil	£150,000

If in future years she actually remits any of these monies, the ordering rules will treat her as having remitted something else instead (refer to RDRM35160 - example 1 continuation).

35160 Remittance of "nominated" income or gains [Jan 2019]
Example 1 - Continued
Moving forward, in 2014-15 A has relevant foreign earnings of £80,000, but no other foreign income or gains. She decides not to use the remittance basis in that year.
In 2014-15 A actually brings into the UK;
£5,000 Jersey relevant foreign income that she did not nominate in 2013-14 (note 1)
£80,000 relevant foreign earnings from 2013-14 and
£80,000 relevant foreign earnings from 2014-15
Although A is not using the remittance basis in 2014-15, the ordering rules at s809J ITA 2007 are still required to determine what she is to be taxed as having remitted in that year. The relevant year is 2014-15.

Ordering rules at 2014-15

Step 1 Identify nominated income and gains remitted in the relevant year (2014-15)	£nil	**Relevant Amount**	£85,000
Identify the remittance basis income and gains remitted in the relevant year	£85,000 (see note 2)		
Step 2 Find the total amount of the individual's foreign income and gains (excluding those nominated) for the relevant tax year If the remittance basis was not used in that year (that is sections 809B, 809D or 809E did not apply), treat those amounts as nil and go to step 6	Nil		

Step 6
If the relevant amount is not nil, start again at step 2. Take the reference to "relevant year" to be a reference to foreign income of gains of the individual for the earliest 'appropriate year' previous to the lat tax year from which Step 2 was undertaken.

Step 2 Find the total amount of the individual’s foreign income and gains (excluding those nominated) for the appropriate tax year (2013-14) (refer to Note 3)	**Para (d)** Foreign	£65,000
Step 3 Identify the earliest of paragraphs (a) to (h) above for which the amount determined in Step 2 is not nil.	**Para (d)**	£65,000
Step 4 Where the relevant amount is greater than the amount identified above the relevant amount is reduced by the amount identified	Relevant Amount reduced to:	£85k less £65k = £20,000

Step 5 If the relevant amount is not nil go back and repeat Step 3. Take the reference to the first of paragraphs (a) to (h) as a reference to the earliest paragraph not previously taken into account under Step 3.

Step 6

If the relevant amount is not nil after Steps 3-5 have been completed for the year, start again at step 2. Take the reference to ‘relevant year’ to be a reference to foreign income of gains of the individual for the earliest ‘appropriate year’ previous to the lat tax year from which Step 2 was undertaken.

Step 2 Find the total amount of the individual’s foreign income and gains (excluding those nominated) for the appropriate tax year (2012-13)	**Para (a)** Relevant foreign earnings (not subject to a foreign tax)	£280,000
Step 3 Identify the earliest of paragraphs (a) to (h) above for which the amount determined in Step 2 is not nil	**Para (a)**	£280,000

Step 4 If the relevant amount is less than the amount identified, treat the whole of the remaining amount of the transfer as coming from that item of income or gain

So in 2014-15 A is treated as having remitted

£20,000	relevant foreign earnings
£65,000	foreign chargeable gains.

NB – The £80,000 relevant foreign earnings from 2014-15 that she brings in will be taxed on the arising basis in that year.

Note 1 In 2013-14 A has £80,000 of Jersey relevant foreign income, of which £75,000 were nominated; if this £80,000 were all in the one single account, and there was nothing else in the account then, under the principle of this section the first £5,000 remitted in 2014-15 is accepted as being “not-nominated” income.

In this example it is of little practical difference because the s809J ordering rules have already been “triggered” in 2013-14 by her remittance of nominated income (from 2010-11).

But if the ordering rules had not already been triggered, then because, this £5,000 Jersey relevant foreign income in 2014-15 can be accepted as being “un-nominated” income first and foremost, so A’s remittance of this £5,000 would not, of itself, have triggered the s809J ordering rules in this year.

Note 2 A’s remittance basis income and gains are her total foreign income or chargeable gains for all tax years up to the “relevant tax year” (2014-15) in which she used the remittance basis under section 809B, section 809D or section 809E. It therefore excludes her relevant foreign earnings from 2014-15 because she is not using the remittance basis in that year.

Note 3 the 'foreign income and gains ‘for’ the appropriate year exclude any:

- 'nominated’ income or gains, or
- income or gains that were actually remitted to the UK before the beginning of the appropriate tax year or
- income or gains that were treated as remitted to the UK previously under section 809J before the beginning of the appropriate tax year.

In A’s case, the £5,000 Jersey relevant foreign income from 2013-14, and the £80,000 relevant foreign earnings from 2013-14 that she actually remitted in 2014-15 were treated as having been remitted in 2013-14 by the ordering rules (refer to the earlier part of example 1 RDRM35150).

Summary

		2010-11	**2011-12**	**2012-13**	**2013-14**	**2014-15**
Foreign chargeable gains	Accruing in year	£250,000	£300,000	£Nil	£130,000	£Nil
	Actually brought to UK	£Nil	£140,000	£Nil	£Nil	£Nil
	Treated as remitted	£Nil	£Nil	£Nil	£130,000	£Nil
Relevant foreign income Nominated	Arising in year	£75,000	£75,000	£75,000	£75,000	£Nil
	Actually brought to UK	£30,000	£Nil	£Nil	£Nil	£Nil
	Treated as remitted	£Nil	£Nil	£Nil	£Nil	£Nil
Relevant foreign income Not nominated	Arising in year	£Nil	£5,000	£Nil	£5,000	£Nil
	Actually brought to UK	£Nil	£Nil	£Nil	£5,000	£Nil
	Treated as remitted	£Nil	£Nil	£Nil	£5,000	£Nil
Relevant foreign earnings	Arising in year	£200,000	£120,000	£280,000	£150,000	£80,000
	Actually brought to UK	£Nil	£Nil	£Nil	£130,000	£80,000
	Treated as remitted	£Nil	£Nil	£20,000	£150,000	£Nil

20.20 Nominated income: Critique

In short, the effect of the nominated income remittance rule is that remittances are treated as being made in the nominated income/gains priority order, taking more recent years before earlier years (regardless of the actual remittances). As in the case of the “steps” of the mixed fund rules, one is tempted to ask: why didn’t the statute simply say so?

But the drafting is the least of the problems of the nominated income remittance rule. The author of the EN anticipates criticism that this is administratively difficult and offers some tax planning advice:

> 14...The rules dealing with this in sections 809I and 809J will require additional records to be maintained from 6 April 2008 or the first year

> of residence in the UK, if later.
> 15. The record keeping necessary for sections 809I and 809J can be avoided if individuals ensure that "nominated" income or gains upon which the RBC is paid are not remitted to the UK, or only remitted after the remittance of all other unremitted income and gains since the first year of residence from April 2008. If an individual is confident they will never need to remit that "nominated" income or gains, paying the RBC will not involve any extra complexity or record keeping.[105]

Even if this advice were correct it would not help the majority of remittance basis taxpayers, but they should not complain: they are responsible for the problem, which they brought on themselves by making a remittance basis claim:

> 16. As mentioned earlier, those eligible can choose whether or not to claim the remittance basis for each particular year, depending on whether it is to their advantage to do so.

But even the administrative inconvenience is not the serious problem of the rule. The effect of the rule is that if the individual remits a penny of their nominated income/gains, one disregards entirely the actual remittances and charges on the basis of the fictional rules. Thus an individual who actually remits gains is taxed as if they remitted income (as long as they also remits a penny of nominated income). It is therefore in principle desirable to take care not to remit any nominated income/gains. The funds may be used abroad or used to pay the remittance basis charge.

20.21 Mixed funds: Critique

The ITA mixed fund rules operate on a daily, indeed minute by minute basis, as the rules must be applied at the time of every onshore and offshore transfer. They do not operate within a given tax year on a pro rata basis (contrast the s.87 or s.731 matching rules). If a client's account contains thousands of entries, the computations must be done thousands of times. The reader who has studied the chapter to here, and who contemplates applying these rules to the actual circumstances of a client, will agree that the mixed fund rules are unworkable.

[105] The last sentence is not correct. It is not enough that an individual is "confident that they will never need to remit that nominated income or gains". The individual must be able to demonstrate to HMRC that they have not remitted, and that requires record keeping.

Joint Forum on Expatriates Tax and NICs Note of Meeting 18 September 2008 records the same view:

> Delegates asked whether HMRC would be prepared to allow for apportionment on an annualised (rather than a monthly) basis. The legislation concentrates on transfers from mixed funds on the occasion of each and every transfer. HMRC did not think it was possible to override the intention of the legislation but agents considered that it would be unworkable to examine each and every debit and credit on the basis envisaged within a new legislation. ...
> The overwhelming view put forward by external delegates was that without the availability of a methodology along the lines of SP 5/84 it would be impractical for any inward expatriate to claim access to the remittance basis because it would not be possible to perform the calculations required by the legislation.[106]

In their defence, HMRC make two points:

> [1] HMRC reminded delegates that use of the remittance basis is voluntary as from 6 April 2008 and
> [2] that HMRC had been asked to bring in rules on remittance from mixed funds and rules relating to overseas transfers.

But as to point [1], the fact that the remittance basis is voluntary is no excuse for unworkable tax law. HMRC here overlook that the remittance basis is intended to make the UK an *attractive* place for foreign domiciliaries to reside. There is no need to comment on point [2].

A few months later HMRC issued SP 1/09 so the step thought impossible proved to be possible after all.[107] But while helping employees who qualify for overseas workday relief, that does not help other remittance basis taxpayers who face the same problems. Why were workday relief employees singled out for special treatment? The reason was presumably down to effective lobbying rather than any rational policy consideration.

The mixed fund legislation needs to be rethought from beginning to end – a challenging task, which could not possibly have been done in the few days available as the FA 2008 hurtled to the deadline for enactment.

In 2011, HMRC rejected the suggestion of reform:

[106] *http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/consultations/expat-mins-180908.htm*

[107] See 34.23 (OWR (recent arrivers) mixed funds).

> In particular, the Government will not look further at the following:
> *Simplification* Reviewing and simplifying the mixed fund rules
> *Government response* Although the Government appreciates that these rules can (!) be complicated to operate, it is essential to be able to identify different types of income, gains and capital as they are remitted from a single account. The Government cannot envisage an alternative approach to achieve this purpose which would not entail similar complexity or a significant Exchequer cost.[108]

But cleansing relief (in 2017) indicates second thoughts, though of a timid and one-off nature.

It is suggested that the rule ought to be that the person remitting from a mixed fund can determine what constituent of the fund the remittance consists of. That would be a significant simplification. The cost to the exchequer could be recovered by an adjustment in the remittance basis claim charge, but the cost (Revenue loss) would be significant.

A variant idea, less of a simplification but less expensive, and so perhaps more attractive, would be that the person remitting can determine what constituent of the fund the remittance consists of, but clean capital has to come out last. Again, the cost could be recovered by by an adjustment in the remittance basis claim charge.

Reform would be especially welcomed by those who actually try to comply with the present rules.

[108] HMRC & HMT, "Reform of the taxation of non-domiciled individuals: summary of responses to consultation" (2011) para 2.127 *http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf*

CHAPTER TWENTY ONE

TRADING INCOME

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21.24 Independent personal services

Cross references

The following topics are considered elsewhere:
12.8 (Trader: Emigration/immigration)
18.17.1 (What is trading income)
32.8 (Trade IP income)

53.1 (Profit fragmentation)

For ToA issues see:
48.7 (Income "payable" to person abroad)
48.16.2 (Trade income/loss of person)
124.2 (Tax collected from UK representatives)

21.1 Trading income: Introduction

The taxation of trading income is governed by Part 2 ITTOIA/Part 3 CTA 2009. A full discussion would require many volumes. I focus on matters closest to the themes of this book.

For the meaning of "trade" see App.2.23 (Trade).

21.2 Charge on trading income

The charge is as follows:

s.5 ITTOIA	**s.35 CTA 2009**
Income tax is charged on the profits of a trade, profession or vocation.	The charge to corporation tax on income applies to the profits of a trade.

The territorial scope of the charge is in s.6 ITTOIA/s.5 CTA 2009, but these provisions are not drafted in the same way and need to be considered separately.

21.3 Profession/vocation

Section 6(3) ITTOIA provides:

> This section applies to professions and vocations as it applies to trades.

The distinction between trade and profession/vocation occasionally matters for tax, but not in s.6, or in the topics discussed here. So in this chapter, reference to "trade" includes a profession or vocation.

21.3.1 *Profession/vocation: Critique*

It is suggested that the distinctions between trade/profession/vocation ought to be abolished: uniform rules should apply to trades, professions and vocations. That would be a worthwhile simplification. It would also solve the problem that no-one actually knows what is meant by "vocation". The meaning of the word has drifted somewhat since it was used in the first Income Tax Act of 1799, but the word does not seem to be used in its ordinary contemporary meaning.

It is generally accepted that a company cannot carry on a profession or vocation, so this change would align CT/IT.

21.4 IT territorial limit: Trading

21.4.1 *UK resident trader: IT*

Section 6(1) ITTOIA provides:

> Profits of a trade arising to a UK resident are chargeable to tax under this Chapter [Chapter 2 Part 2] wherever the trade is carried on.

Section 7 ITTOIA provides:

> (1) Tax is charged under this Chapter on the full amount of the profits of the tax year. …
> (4) This section is subject to Part 8 (foreign income: special rules).

Section 7(4) ITTOIA feeds into s.832, which incorporates the remittance basis if the trading income arises from a source outside the UK. It is therefore necessary to identify the location of the source. Section 7(5) ITTOIA states the test of source of trading income:

> And, for the purposes of section 830 (meaning of "relevant foreign income"), the profits of a trade, profession or vocation arise from a source outside the UK only if the trade, profession or vocation is carried on *wholly* outside the UK.

This is a statutory statement of the pre-ITTOIA case law.[1] It is a strangely wide test of source. Applying this test, if a trade is carried on partly in country A and partly in country B, the source of the income is in country A *and* country B. For the same income to have a source in two different countries is contrary to the natural meaning of "source", and contrary to the purpose of the concept which is to locate a source in one jurisdiction in order to identify one state with jurisdiction to tax. (Similarly an individual can have only one domicile.)

The explanation is that s.7(5) ITTOIA does not provide the natural meaning of "source"; it is an artificial definition. It is fortunate (but not surprising) that commonwealth countries which adopted a UK style income tax did not adopt this rule. Thus Commonwealth cases on the

[1] See Avery Jones, "Taxing Foreign Income from Pitt to the Tax Law Rewrite – The Decline of the Remittance Basis", *Studies in the History of Tax Law* (Vol 1 2004) p.26, *https://www.kessler.co.uk/wp-content/uploads/2013/12/Remittance-basis.pdf*

source of trading income are not relevant here.

If any part of the trade is carried on in the UK then the entire trade has a UK source and does not qualify for the remittance basis. There is not even a *de minimis* rule; contrast the incidental duties disregard which applies to employment income.[2]

21.4.2 *Head & brain test*

The former International Tax Handbook discussed the old case law, which still holds good under ITTOIA:

> **209. San Paulo case**
> [The San Paulo Railway Company (*San Paulo (Brazilian) Railway Company v Carter* 3 TC 407)] ... was a UK incorporated company with its board meetings in London. The whole of its physical undertaking was in South America and while it accepted that it was resident here it argued that its business was carried on wholly abroad where its railway was. The Courts held that the head and brain of the trading venture was here and that the profits were those of a trade partly carried on here and that, accordingly, Case I [UK source] applied. ...
> **210. Trade partly in UK**
> The principle underlying the San Paulo decision is that a trade carried on partly in the UK is within Case I. The factors which decide whether a company is resident in the UK by reason of central management and control are, as will be seen, similar to those which decide whether its trade should be within Case I or Case V [foreign source] and the result is that for many years in the corporate sector the only examples seen of Case V trades were those in which a company is a partner in an overseas trade. ...
> **211. *Ogilvie v Kitton***
> But other cases were to show how difficult it was going to be, except on very exceptional facts, to establish that any trade of a resident person was carried on wholly abroad. There was, for example, Mr Ogilvie in *Ogilvie v Kitton* (5 TC 338). He lived in Aberdeen and ran a shop in Canada. To say that he ran the shop really begs the question because he simply received reports from his manager in Canada and did not in fact intervene actively in the business at all, merely taking a tacit interest in things from the information in the reports. It was held that the head and brain of the trading venture was in Aberdeen and that the profits were assessable under Case 1.

In short, if a sole trader is UK resident it is in practice impossible to arrange that their trading income has a foreign source because the "head and brain" is here. Section 7(4)(5) ITTOIA is dead letter law, as far as UK resident sole traders are concerned. The former International Tax Handbook recognised this at para 209:

[2] See 34.16 (Incidental duties in UK).

> That decision [*San Paulo*] suited the Revenue very well. We no longer had to worry about remittances ... And so we effectively got on to a statutory arising basis for trades which, in everyday language, were wholly overseas and we reached that position purely through the interpretation of the statute by the Courts. ...

See too 8.18 (CMC/trade income source compared).

For completeness: s.95 ITA restricts loss relief for trades carried on wholly outside the UK, but since it is almost impossible to arrange that, the section is also dead letter law, as far as UK resident sole traders are concerned.

Assuming it is desired to retain the present law, it would be sensible to state expressly that UK resident sole traders should not qualify for the remittance basis on foreign source trading income.[3] But perhaps the change is more trouble than it is worth.

21.4.3 *UK resident trader: Planning*

If a remittance basis taxpayer carries on a trade partly in and partly out of the UK, the individual will be taxed on the arising basis and not under the remittance basis. In these circumstances the individual may be able to divide up their activities into two parts– those in and those out of the UK. The individual will then be carrying on two separate activities, of which at least one will yield foreign source income and qualify for remittance basis treatment.

How is this division to be achieved? Overseas activities could be carried on by a partnership controlled abroad. The offshore partner may be a company. This route was successfully taken by Sir David Frost.[4] Alternatively the activities could be carried on by a company or trust. In this way foreign trading income may be converted into foreign employment or dividend income which would enjoy a more beneficial tax treatment.

21.4.4 *Non-resident trader: IT*

A different rule applies to trading income arising to a *non*-resident person.

[3] Similar considerations apply to employment income, see 34.16 (Incidental duties in UK), but the trading rules also need to address partnership trading income, as the remittance basis can apply to a UK resident partner - unless that rule too were to be reconsidered.

[4] *Newstead v Frost* 53 TC 525.

Section 6(2) ITTOIA provides:

> Profits of a trade other than a trade of dealing in or developing UK land[5] arising to a non-UK resident are chargeable to tax under this Chapter [Chapter 2 Part 2] only if they arise—
> (a) from a trade carried on wholly in the UK, or
> (b) in the case of a trade carried on partly in the UK and partly elsewhere, from the part of the trade carried on in the UK.

The pre-ITTOIA wording imposed a charge on non-residents on income arising:

> *from any trade, profession or vocation exercised within the UK.*[6]

The meaning was the same so pre-ITTOIA case law is still relevant.

It is not likely that a non-resident will be carrying on a trade *wholly* in the UK (for the same reasons that a UK resident cannot in practice carry on a trade wholly outside the UK). So we are not concerned with para (a).

Section 6(2)(b) effectively raises two issues: (1) When is a trade carried on partly in the UK? (2) If a trade is carried on partly in the UK, how does one identify the profits from that part?

This is sometimes paraphrased by asking the question whether (or to what extent) the source of the trading income is in the UK. There seems nothing wrong with that; it is the correct and natural meaning of the word "source". Since s.7(5) ITTOIA uses the word "source" in an artificial sense in the rules relating to UK resident traders, I have wondered whether it would aid clarity to avoid the word "source" in the context of the rules for non-residents. But it is not practical to avoid the use of the word "source" here[7] so one simply needs to remember that in the context of trading income, source has distinct meanings, or perhaps more accurately, there are distinct tests of source, for residents/non-residents.

21.4.5 *Trading income of split year*

Section 6(2A) ITTOIA provides a sensible split-year rule:

> If the tax year is a split year as respects a UK resident individual, this

[5] See 22.3 (Dealing/developing UK land).

[6] Section 18 ICTA 1988 (repealed). It was accepted (though not stated in statute) that where a trade was exercised partly in the UK, income was apportioned and only the UK part was taxable.

[7] Since relevant case law and foreign statutes regularly use the word "source".

> section has effect as if, for the overseas part of that year, the individual were non-UK resident.

See too 12.8 (Trader: Emigration/immigration).

21.5 To whom trading income arises

Since different IT rules apply depending on whether trading income arises to a resident/non-resident, it is necessary to identify the person to whom the income arises.

21.5.1 *Trading income of trust*

Suppose:

(1) a non-resident trust is carrying on a trade, and
(2) the trust is not within s.624 or s.720.

In the case of a discretionary trust, the trading income arises to the trustees, they are taxed in accordance with the rules relating to *non*-residents so the trustees would only be subject to UK income tax if the trade was carried on partly in the UK, and then only on the profits (if any) attributable to that part.

However if the life tenant of a transparent (*Baker*-style) trust was resident in the UK, then the profits of the trade arise to a UK resident, and the life tenant is taxed in accordance with the rules relating to UK residents: ie on an arising basis unless the stricter condition is satisfied that the trade is carried on by the trustees wholly outside the UK.

21.5.2 *Trading income: s.624/s.720*

Suppose a trade is carried on by a non-resident settlor-interested trust, or company held by a such a trust.

The question arises whether the income qualifies as protected s.624 income or protected s.720 income. Here, the trading income must meet the condition ("the RFI condition") that:

> it would be RFI if it were income of a UK resident individual.[8]

This is a statutory assumption of UK residence.[9] Applying the statutory

[8] See 92.9.1 (Condition A: RFI); 92.13.1 (Condition (a): RFI). For the reason for the wording ("would be RFI if it were the individual's"), see 16.9.2 (Relevant foreign income).

[9] There are several other examples of that; see 61.6.1 (s.87 residence assumption).

assumption, the RFI condition is met only if the company or trust carries on the trade *wholly* outside the UK.

Suppose protected-trust relief is not available (eg if the company is not held in a trust). The question arises whether the trading income qualifies for the s.720 remittance basis. The statutory wording is similar[10] and again, the remittance basis only applies if the company carries on the trade *wholly* outside the UK.

This fits the purpose of the provisions which is to put the transferor in the same position as if no transfer had been made.[11]

21.6 CT territorial limit: Trading

21.6.1 *UK resident company trader*

Section 5(1) CTA 2009 provides:

> A UK resident company is chargeable to corporation tax on income on all its profits wherever arising (but see Chapter 3A for an exemption from charge in respect of profits of foreign permanent establishments).[12]

21.6.2 *Non-resident company trader*

Section 5(2) CTA 2009 provides:

> A non-UK resident company is within the charge to corporation tax on income only if—
> (a) it carries on a trade of dealing in or developing UK land (see section 5B)[13], or
> (b) it carries on a trade in the UK (other than a trade of dealing in or developing UK land) through a permanent establishment in the UK,[14] ...

21.6.3 *Profit of PE*

Section 5(3) CTA 2009 identifies the amount on which CT is charged:

> A non-UK resident company which carries on a trade in the UK through a permanent establishment in the UK is chargeable to corporation tax on all its profits wherever arising that are chargeable profits as defined in

[10] See 47.8.2 (Remittance basis rule); 49.26.(s.720 remittance basis).

[11] See 49.2 (Purpose of transferor charge).

[12] I do not consider this exemption here.

[13] See 22.3 (Dealing/developing UK land).

[14] The drafting is based on article 7 OECD Model.

> section 19 (profits attributable to its permanent establishment in the UK)...

Section 19 CTA 2009 defines "chargeable profits":

> (1) This section applies if a non-UK resident company carries on a trade in the UK through a permanent establishment in the UK.
> (2) The company's chargeable profits are its profits that are—
> (a) of a type mentioned in subsection (3), and
> (b) attributable to the permanent establishment in accordance with sections 20 to 32.
> (3) The types of profits referred to in subsection (2)(a) are—
> (a) trading income arising directly or indirectly through or from the establishment,
> (b) income from property or rights used by, or held by or for, the establishment, and
> (c) chargeable gains falling within section 10B of TCGA 1992 (non-resident company with UK permanent establishment)—
> (i) as a result of assets being used in or for the purposes of the trade carried on by the company through the establishment, or
> (ii) as a result of assets being used or held for the purposes of the establishment or being acquired for use by or for the purposes of the establishment.

The topic of how profits are attributed to a PE needs a long book to itself; it is not discussed here.

21.7 Where is trading income source

The UK case law is mostly antique, because in practice double taxation treaties often apply and then the issues may not arise. But of course that is not always the case. The former International Tax Handbook is erudite and still helpful.[15] Commonwealth cases on the source of trading income should be helpful[16] though unfortunately these cases are inconsistent.[17]

[15] Tax Bulletin 18 provides a brief summary, not set out here.

[16] See 16.8 (Non-UK cases on source).

[17] See: Littlewood's scholarly article "The Privy Council, the Source of Income and *Stare Decisis*" [2004] BTR 121
Venables, "The Territorial Source of Income" OTPR, Vol 7, p.177, *http://www.khpplc.co.uk/reviews*
Wong, "A comparative study of the taxation of business profits - especially 'online' profits - in Australia and the Hong Kong Special Administrative Region of the

21.8 Place where contract made

The former International Tax Handbook provided:

> **813. *Erichsen v Last***
>
> Another very early case was *Erichsen v Last* [4 TC 422] which was heard in the Court of Appeal in 1881. It is a highly important case and, curiously, was not published in Tax Cases until some twenty years after the decision. It is perhaps a pity that *Erichsen v Last* was concerned with a very special sort of trade – the relaying of telegraph messages. The application of the ideas which emerge from *Erichsen v Last* to other trades is, because of its special facts, rather difficult.
>
> The facts are simple enough. Erichsen was the UK representative of the Great Northern Telegraph Company of Copenhagen. The company was not resident here but it had three cables running across the North Sea to bases in Scotland and it had a staff of operators here. Messages were collected through an arrangement with the Postmaster General. The Post Office collected the money and deducted its agreed remuneration before handing over the messages to the company's operators here. The company's own staff then transmitted the messages across the North Sea. Thereafter, depending on their destination, they passed through cables owned by the Danish and Russian governments to their destinations which might have been as far off as Japan. The company made a weak sort of claim that it was not trading here but it went on to say that if it was, it ought to be taxed only on the profit arising from the relaying of the messages along the main cable to Denmark. It was making the point that some of the profit arose from the transmission along other cables which had absolutely nothing to do with the UK.
>
> The first thing the judgments in the Court of Appeal make clear is that the matter is wholly one of fact. The judgments then separate two questions for decision. First, is there trading in the UK? Brett LJ says this on page 425. His words are important because it is here that the significance of contract – place of contract – begins.
>
>> "Now, I think it would be first of all nearly impossible and second wholly unwise to attempt to give an exhaustive definition of when a trade can be said to be exercised in this country. The only thing that we have to decide is whether upon the facts of this case it can be said that this company is carrying on a profit earning trade in this country. Now I should say that wherever profitable contracts are habitually made in England by or for a foreigner with persons in England, because those persons are in England, to do something for or supply something to those persons, such foreigners are exercising a profitable trade in England, although everything done by or supplied by them in order to fulfil their part of the contract is done abroad.

People's Republic of China" (2009) *https://bridges.monash.edu/articles/thesis/A_comparative_study_of_the_taxation_of_business_profits_-_especially_online_profits_-_in_Australia_and_the_Hong_Kong_Special_Administrative_Region_of_the_People_s_Republic_of_China/4546102/1*

> The profit arises to them from the contract which they make. The profit which they derive can only be derived from the payment which is to be made to them by the person with whom they contract. In the given case they would not have any such contract as they are in the habit of making unless it was a contract made in England with a person who is in England because he is in England. Observe, if the person or someone acting for him were not in England he would not be wanting to send a telegraph message from England".

The language is now over 100 years old and while it may perhaps look a little old fashioned today its meaning seems plain. The Court was saying: "You, the customer, are in England and because you are here you want goods here (or in the case in point, you want a message sent from here). The profit comes from the contract, the contract is here and there is trading in England and it is nonetheless trading in England even though the goods come from abroad or the service is provided through electric cables which are partly abroad". ...

815. First champagne cases

Erichsen v Last was followed by the so-called champagne cases. There were three leading champagne cases. In the first two, the Revenue succeeded in a claim that the French champagne houses concerned were trading in the UK through agents in London. In the Pommery case [*Pommery and Greno v Apthorpe* 2 TC 182] there was no express finding as to where contracts were made but most orders were met from stock held in the UK. In the Werle case [*Werle v Colquhoun* 2 TC 402] the Court of Appeal made it clear that they considered the contracts to be made by the agents here on behalf of their principal.

These two houses were producers of champagne as well as sellers of champagne and it is reasonably clear that the Revenue did not claim to tax the producer's profit. In the Pommery case at page 189, the Judge specifically referred to the difficulty of calculating the profit; he said that there might be some difficulty as to the manner of calculation in deciding what amount of expenditure to put against the profits and wondered whether it would be proper to look at the goods sent over to England and to put a fair valuation upon them as they arrived. That he said was a matter of quantum, a matter for the consideration of persons skilled in such things.

In the Werle case on page 413 Fry LJ had a similar approach, he said

> "A small shopkeeper... is plainly carrying on a trade in the place where the shop is ... The question, however, becomes more difficult when the trade is carried on, as in the present case, in a far more complicated manner ... when the contract may be in one place, the goods in another, the principal in another and the goods may be delivered in some other place. We have, however, simply to do this, to take all the relevant facts and the mode in which the business is carried on, and to ask ourselves whether that business be or be not carried on within the UK. It appears to me that the same business may in some sense be carried on in many places. The Head Office of a firm, the place where the goods are manufactured, the place where the contracts are made, may all of them be places in which the business or parts of the business is or are carried on. Now, in the present case what we find is

> this, that the appellants reside in France, carrying on there the business of vineyard proprietors, champagne makers and champagne merchants, no doubt a large portion of that business is carried on within France, but a portion of that business is that of champagne merchants. Now, that means, as I understand, the selling of champagne and that business they carry into effect in England through the intervention of a firm of agents in this country."

816. Contracts abroad

The last of the champagne cases is *Grainger v Gough* [3 TC 311 and 462] and it is a very significant case. The Court of Appeal made no distinction between this and the earlier cases and found that the champagne house was liable on its trading here. ...

But Lord Esher and his fellow judges were overruled by the House of Lords on the question of whether there was liability at all. That was on the basis that in this particular case, contracts were not made in the UK. Although to the customer there may have been little difference between buying through the agents in the first two cases and buying through the agents in the third, there was a difference in the arrangements which the House of Lords saw as vital in determining the non-resident's liability to UK tax. In finding that the contracts were not made in the UK the House of Lords drew the now classic distinction between trading in the UK which involves liability and trading with the UK which does not. Non-residents with customers here commonly rely on this distinction.

The House of Lords may well have had it in mind that if we sought too strenuously to tax foreigners who sold goods here, we might be faced with hostility by countries to which we were exporters and which might seek to tax those exporters in parallel circumstances. The thought is not directly expressed but there is a hint of it at the end of Lord Herschell's judgment on page 468.

21.9 Place-of-contract test rejected

The former International Tax Handbook provided:

817. Place of contract not decisive

There are later judgments and very important judgments which tend to water down a little the great emphasis on place of contract. Lord Atkin speaking in the Smidth case [*Smidth v Greenwood* 8 TC 193] in 1921 said this

> "It (the place of contract) is obviously a very important element in the enquiry and if it is the only element the assessments are clearly bad. The contracts in this case were made abroad. But I am not prepared to hold that this test is decisive. I can imagine cases where a contract of resale is made abroad, and yet the manufacture of the goods, some negotiation of the terms, and complete execution of the contract take place here under such circumstances that the trade was in truth exercised here. I think that the question is, where do the operations take place from which the profits in substance arise?"

This is sometimes called "the operations test". It is not in fact a "test" as such, because further guidance is needed to identify where the profits in substance arise. It is however a rejection of the place of contract test. The former International Tax Handbook gave one further quote to drive the point home:

> In one of the few fairly modern[18] cases on this subject, the Firestone case [*Firestone Tyre & Rubber v Lewellin* 37 TC 111 at p.142] in 1957, Lord Radcliffe said this
>
> > "But he (Counsel for the Appellants) rightly reminded us that more than once the place where the contract is made has been spoken of as the 'crucial' test or, again, as the 'most vital' element. Speaking for myself, I do not find great assistance in the use of a descriptive adjective such as 'crucial' in this connection. It cannot be intended to mean that the place of contract is itself conclusive. That would be to re-write the words of the Taxing Act, and could only be justified if there was nothing more in trading than the act of sale itself. There is of course much more. But if 'crucial' does not mean as much as this, it cannot mean more than that the law requires that great importance should be attached to the circumstance of the place of sale. It follows, then, that the place of sale will not be the determining factor if there are other circumstances present that outweigh its importance or unless there are no other circumstances that can."

This approach is adopted in the Privy Council. The Hong Kong Revenue have issued useful guidance (the "**Hong Kong guidance note**"[19]) which provides:

> 7. Lord Bridge explained the "broad guiding principle" in *Hang Seng Bank* at 322H to 323A in the following terms: "But the question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. The broad guiding principle, attested by many authorities,

[18] I guess that this passage in the former International Tax Handbook was written in the 1980s.

[19] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

> is that one looks to see what the taxpayer has done to earn the profit in question."
>
> 8. The "operations test" was further elaborated by Lord Jauncey in *HKTVBI* at 407C-D:
>
> > "*Smidth v Greenwood* [1921] 3 K.B. 583 was cited in Hang Seng Bank case and their Lordships do not doubt that Lord Bridge has in mind the judgment of Atkin L. J. in that case and in particular the passage when he said, at p.593: 'I think that the question is, where do the operations take place from which the profits in substance arise?' Thus Lord Bridge's guiding principle could properly be expanded to read 'one looks to see what the taxpayer has done to earn the profit in question and where he has done it.'"[20] ...
>
> 21. When Lord Bridge said in *Hang Seng Bank* that profits from buying and reselling of commodities were derived from the place where "the contracts of purchase and sale were effected", he could not merely mean legally executed (as this would depend on formal legal rules of offer and acceptance). The Department agrees with the approach in *Magna* and will contemplate all the relevant operations carried out to earn the profits, including the solicitation of orders, negotiation, conclusion, trade financing, shipment and performance of the contracts.
>
> 22. The Department does not merely look at the place of contract to determine the geographical source of profits. Where the contract is made by exchange of letters, by fax, or by e-mail, the application of contract law and of private international law as to where the contract is made may result in conclusions that are entirely fortuitous. In *Firestone Tyre and Rubber Co v Lewellin* [1957] 1 WLR 464 (HL) at 471, Lord Radcliffe said such an approach under the conditions of international business and modern facilities of communication was capable of proving a somewhat ingenuous one. Hunter J shared the same view in *Sinolink Overseas v IRC* 2 HKTC 126 at 131.[21]

21.10 Where profits in substance arise

So we turn to the question of where profits in substance arise. The short answer is that there is no short answer. This test does not answer the question of where trading income arises, it merely rephrases it.

The former International Tax Handbook provided:

[20] Similarly Lord Jauncey in *HK-TVBI* at 409D-E:
"The proper approach is to ascertain what were the operations which produced the relevant profits and where those operations took place."

[21] *IRC v Hang Seng Bank* [1990] STC 733 at p.739 though "it may be that there is some marginal difference in the shades of meaning conveyed by the two phrases".

> **820. NRs: profits in substance**
> It is consistent with the words of Brett LJ at the start of the quotation in ITH813 to say that no neat formula to decide what is, and what is not, trading in the UK can be devised. ...

Circumstances vary so widely that it is not possible to devise a single test that fits all cases.[22] The Hong Kong guidance[23] note provides:

> 11. The broad guiding principle has been followed in subsequent cases before the Court of Final Appeal. In *Kwong Mile*, Bokhary PJ summarised the broad guiding principle at 174I to 175E:
>
> > "The ascertainment of the source of a profit is not hindered by technical rules, but is helped by the broad guiding principle that one looks to see what the taxpayer has done to earn the profit and where he has done it. ... In *IRC v Orion Caribbean* [1997] HKLRD 5 924, Lord Nolan emphasised (at p.931F) that '[n]o simple, single, legal test can be employed' when ascertaining the source of a profit. ... The situations in which the source of a profit has to be ascertained are too many and varied for a universal judge-made test. Apart from the words of the statute themselves, the only constant is the need to grasp the reality of each case, focusing on effective causes without being distracted by antecedent or incidental matters."[24]

This is a general principle of international tax law:

> Profits should be taxed where economic activities deriving the profits are performed and where value is created.[25]

It is not, of course, an answer just to say that the question is a question of fact. That simply leaves the issue answered.[26]

21.11 Preparatory/auxiliary activities

The former International Tax Handbook Manual para 849 provided that

[22] "No simple legal test can be employed"; see *IRC v Orion Carribean.*

[23] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

[24] *IRC v Hang Seng Bank* [1990] STC 733 at p.739 though "it may be that there is some marginal difference in the shades of meaning conveyed by the two phrases".

[25] G20 Leaders Declaration (2013) *https://www.oecd.org/g20/summits/saint-petersburg/Saint-Petersburg-Declaration.pdf*

[26] See 26.15.1 (Source of interest: Critique).

activities within OECD Model Convention para 5(4) do not amount to trading in the UK. This states (in short) that preparatory and auxiliary activities do not constitute a PE.[27] That includes in particular:

(1) storage, display or delivery of goods
(2) purchasing goods[28]
(3) collecting information

The Hong Kong guidance note provides:

> ANTECEDENT OR INCIDENTAL ACTIVITIES
> 14. In *ING Baring*at 428, Ribeiro PJ when discussing the legal principle also emphasised the need to grasp the reality of each case, focusing on effective causes without being distracted by antecedent or incidental matters. The focus is on establishing the geographical location of the taxpayer's profit-producing transactions as distinct from activities antecedent or incidental to those transactions.
> 15. Whether an act is an antecedent or incidental activity is a question of fact and would depend on the nature of the transaction. In *IRC v The Hong Kong & Whampoa Dock Co* [1960] 1 HKTC 85, the initial business contact in Hong Kong which set in motion a chain of operations that ultimately led to the salvaging of the vessel was rejected as the relevant operation.[29]
> 16. Comments in a similar vein can be found in *Hang Seng Bank* at 320F-G:
>
> > "The activities of the bank from which the income arose was the buying and selling of this property in overseas market places and not the decision making process in Hong Kong or any other activities in Hong Kong. Likewise the income arose from the trading in property situate outside of Hong Kong and not the moneys of customers situate in Hong Kong."[30]

21.12 Buying from UK sellers

The former International Tax Handbook provided:

> **812. Purchasing is not trading in**
> The mere buying of goods here does not amount to trading here. That

[27] See 106.19 (Preparatory and auxiliary activities).

[28] See 21.12 (Buying from UK sellers).

[29] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

[30] *IRC v Hang Seng Bank* [1990] STC 733 at p.738.

> was decided in the very first case in these matters, *Sulley v AG* [2 TC 149], in 1860. A New York firm purchased goods in England for sale in America. It had an office here where the English resident partner saw to the purchasing and shipping of the goods. The Court of Exchequer (a Court of Appeal) found that "The profits of the firm in America do not accrue in respect of any trade carried on in this country, but in respect of the trade carried on in New York, where the main business is conducted".

Maintaining a purchasing office is also included in the list of auxiliary activities which do not amount to trading in the UK.[31]

The Hong Kong guidance note provides:

> BUYING OFFICE
> 29. A trading company, carrying on business outside Hong Kong, may set up a branch in Hong Kong to act as a buying office for the purpose of purchasing goods or merchandise or of collecting information. The activities of the branch are confined to the purchase of goods or merchandise or of collecting information in Hong Kong and it is not involved in their sale, either in Hong Kong or elsewhere. In such a situation, a liability to Hong Kong profits tax would not arise. The functions of a buying office may also be carried out by a subsidiary company or by an agent (either related or unrelated). However, as for a branch, the subsidiary company or agent must not be involved in the sale of the goods. On the other hand, any commission or other remuneration earned by the subsidiary company or agent for performing its services in Hong Kong will be fully taxable.[32]

21.13 Buying/selling to UK purchasers

The former International Tax Handbook para 820 provided:

> But we do attach much importance to Lord Atkin's approach to the question of "trading in" in the *Smidth v Greenwood* case quoted in ITH817 above – "where do the operations take place from which the profits in substance arise".
> We have come to adopt this test as the principal criterion for determining whether there is "trading in". But it should be borne in mind that the Smidth company was found not to be trading in the UK. Although it had an agent in the UK to advise prospective purchasers and assist with the installation of machinery, the profits in substance arose from the sale of that machinery under

[31] Model convention para 5(4)(d); see 21.11 (Preparatory/auxiliary activities).

[32] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

contracts made abroad. ...

821. Merchanting: Place of sale

The decision in the *Smidth* case supports the conclusion that in the case of merchanting business (buying and selling goods for profit), the trade is normally exercised at the place where the contracts for sale are made – that is where the operations take place from which the profits in substance arise.

It may help, in considering why that should be the relevant place, to put the decided cases aside and to ask what sort of facts could possibly be significant in leading to an answer to the question of whether there is trading in the UK. Where merchanting is concerned – buying and selling – there will often be a central office where questions of policy are considered and finance is arranged. There is the buying of the goods and perhaps the holding of a stock of goods. Then there is the search for customers and there is the actual contract for sale. That contract may be at a price laid down in a distant Head Office or it may be for a price negotiated with some skill on the spot. Finally there is delivery involving the question where does the lawful property in the goods pass from seller to buyer.

Few if any of the elements described above necessarily call for a presence in this country and the functions involved can be located where the trader wishes. Most countries take the same view as we do about buying. The Court in *Sulley's* case simply said “It would be most impolitic thus to tax those who come here as customers.” The place of sale, as identified by the place of contract for sale, is a reasonable means of determining the location of trading; trading profit becomes measurable only when there is a sale and without a sale there can be no profit.

822. Place of sale unreliable

But the place of sale, like other elements, can be moved. Even where the trade is that of buying and selling some qualification is needed to the assertion that there is trading in the UK if the contracts for sale are made here. It is generally taken for granted that it must be so if the sales are to people who are here. But, as is apparent from ITH830–ITH834 below which look at the place of contract, just when and where a contract is concluded can depend on fine distinctions and may even be a matter of chance. If, for example, a non-resident advertises goods for sale in a newspaper here and the customer responds by a telephone call to the non-resident during which agreement is reached or there is an exchange of telexes, the contract may technically be made in the UK even though the non-resident does very little here at all. We do not know what view the Courts would take of that though they have certainly not ruled out the possibility that while there may be contracts here there may nevertheless be no trading here [See *Belfour v Mace* 13 TC 558].

There may be similar doubt when sales are to people who are not resident here. The problem can be illustrated by a simple example. A New York art dealer has a picture which a Frenchman is interested in. The American and the Frenchman happen to meet in London which both are visiting for a few days holiday. In their hotel they agree on a price for the picture and conclude the deal. The contract is made here. Is the American trading in the UK? The matter is considered further on in chapter 9 (ITH947).

> One may devise improbable examples of this kind without doing more than to highlight the difficulties which absolute reliance on the place of contract as a test would involve. Other cases of difficulty are those where there is reason to believe that, although contracts are formally made abroad, everything is really done here short of signing a piece of paper. In such cases we would say that there is trading here. The problem in such a case is largely one of proof. See, for example, the comments in chapters 9 (ITH914) and 10 (ITH1017).

The Hong Kong guidance note provides:

> 18. In *IRC v Magna Industrial Co* [1997] HKLRD 171 at 178, Litton VP recognised that in case of a trading profit the purchase and the sale were the important factors. He further included in his deliberation all of the relevant operations and not just the purchase and sale of the products. When applying the operations test, Litton VP said at 176G:
>
> > "In other words, one looks to see what the taxpayer has done to earn the profits and where he has done it. Obviously the question where the goods were bought and sold is important. But there are other questions: For example: How were the goods procured and stored? How were the sales solicited? How were the orders processed? How were the goods shipped? How was the financing arranged? How was payment effected?"
>
> 19. The obtaining of the buyer's order in Hong Kong and the placing of the order with the seller from Hong Kong are the foundations of a trading transaction since the differential between the selling price and the buying price (i.e. the mark-up) generates the profit. In *Exxon Chemical International Supply SA v IRC* 3 HKTC 57, having decided that the obtaining of the order from the buyer and the placing of the order with the seller, took place respectively in and from Hong Kong, Godfrey J concluded that the profit arose in or was derived from Hong Kong.
>
> 20. In *IRC v Euro Tech (Far East) Limited* 4 HKTC 30, Barnett J doubted that there should be some particular level or threshold of activity on the part of the taxpayer in Hong Kong, such as by bringing the products into Hong Kong and re-exporting them. He observed that in many trading companies the taxpayer was doing no more than bringing together the complementary needs of sellers and buyers. He said if the bringing together was done in Hong Kong the trading profit was sourced in Hong Kong....
>
> 23. On the basis of the various court judgments discussed in paragraphs 18 to 22 above, the Department's views which are reflected in its assessing practice on the locality of profits derived from trading in commodities or goods by a business carried on in Hong Kong can be summarised as follows:
>
> (a) Where both the contract of purchase and contract of sale are effected in Hong Kong, the profits are fully taxable.
>
> (b) Where both the contract of purchase and contract of sale are effected outside Hong Kong, no part of the profits are taxable.
>
> (c) Where either the contract of purchase or contract of sale is effected in Hong Kong, the initial presumption will be that the profits are fully taxable. Matters, such as those mentioned in paragraph 18 above, will be examined to determine the issue.
>
> (d) Where the sale is made to a Hong Kong customer (including the Hong Kong

> buying office of an overseas customer), the sale contract will usually be taken as having been effected in Hong Kong.
>
> (e) Where the commodities or goods are purchased from either a Hong Kong supplier or manufacturer, the purchase contract will usually be taken as having been effected in Hong Kong.
>
> (f) Where the effecting of the purchase and sale contracts does not require travel outside Hong Kong but is carried out in Hong Kong by telephone, fax, etc., the contracts will be considered as having been effected in Hong Kong.
>
> (g) The purchase and sale contracts are important factors but all the relevant operations that produce the trading profits must be looked at to determine the locality of the profits. Persons who are merely trading with Hong Kong by either selling goods to customers in Hong Kong or buying goods from suppliers in Hong Kong will not fall within the ambit of this paragraph. Nor will this paragraph applies to a buying office referred to in paragraph 29 below.
>
> 24. Having regard to the points expressed above, it will be apparent that, in the Department's view, the question of apportionment does not arise in relation to trading profits. Trading profits will be either wholly taxable or wholly non-taxable. There is no room to substitute a mixed source for a Hong Kong source even though there might be some overseas activities.[33]

21.13.1 *Trading stock: land*

In *IRC v HK-TVB* the Privy Council said:

> profits accruing to a resident taxpayer from the sale of foreign immovable property are likely to arise in the country where that property is situated although both the contracts of purchase and sale thereof are made in the country of residence of the taxpayer.[34]

The Hong Kong guidance note provides:

> 45. Subject to specific provisions, the Department regards the locality of the following types of profits to be as follows:
>
> (a) Rental income from real property. *Locality:* Location of the property.

[33] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

[34] [1992] STC 723 at p.729; if further authority is needed, which I doubt, see *Marsh v HMRC* [2017] UKFTT 320 (TC) at [81]: "As all the assets of any trade are situated in the UK and the trade is carried on by the sale in the UK of those assets by contracts having effect under the law of England and Wales it follows that if there is a trade it is carried on in the UK."
However in relation to UK land, this rule is statutory: see 22.3 (Dealing/developing UK land).

> (b) Profits derived by an owner from the sale of real estate. *Locality:* Location of the property.

21.13.2 *Trading stock: securities*

The Hong Kong guidance note provides:

> 45. Subject to specific provisions, the Department regards the locality of the following types of profits to be as follows ...
> (c) Profits from the purchase and sale of listed shares and other listed securities. *Locality:* Location of the stock exchange where the shares or securities in question are traded. Where the purchase and sale took place over-the-counter, the place where the contracts of purchase and sale are effected.
> (d) Profits from the purchase and sale of unlisted shares and other unlisted securities. *Locality:* Place where the contracts of purchase and sale are effected...

21.13.3 *Buying/selling through agent*

SP 1/01 provides:

> 22. If a non-resident carries on a financial trade outside the UK, any transactions carried out through a UK investment manager are likely to amount to trading in the UK. That is so whether there is a discretionary agreement or whether the manager acts on the instructions of the non-resident. The criteria for deciding whether a non-resident financial company is an investment company or a trading company are the same as those which apply to a resident company.

Whether or not this is right does not much matter as in most cases the investment manager exemptions apply, but (even allowing for the qualification in the use of the word "likely") it is too widely expressed. The Hong Kong guidance note provides:

> 25. Cases may arise where it is claimed that contracts of purchase and of sale have been effected wholly outside Hong Kong by employees of the Hong Kong business travelling abroad or by overseas agents. In this context, no operations are carried out in Hong Kong to give effect to the trading transaction; and the employee or overseas agent habitually exercises a general authority to negotiate and conclude contracts on behalf of his principal.
> 26. Normally the activities of an agent and an employee are accorded the same weight if it can be shown that the employee has full authority to conclude contracts without reference to the business in Hong Kong. In considering claims that contracts have been wholly effected outside

> Hong Kong by employees, Assessors will, in addition to facts in paragraph 18 above, require details of travelling, hotel and subsistence expenses in respect of each individual transaction. Where it is claimed that contracts are effected by overseas agents, it will be necessary to provide agency agreements or other evidence to support the claim.[35]

21.14 Services

The former International Tax Handbook continued:

> **826. Where work is done**
> Many trades are not limited to merchanting. Where services are concerned, we tend to give greater weight to the place where the service is provided.[36]

The Hong Kong Guidance Note adopts the same approach:

> 45. The Department regards the locality of the following types of profits to be as follows ...
> (e) Service fee income. *Locality*: place where the services are performed which give rise to the fees.[37]

This raises the question of where the services are performed/provided.[38] Services performed by an individual (whether personally or on behalf of a company or partnership) are performed where the individual is when they provide the services.[39]

Likewise in Australia:[40]

[35] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

[36] The former International Tax Handbook para 826 continued:

> There are particular difficulties with transmission services with which the approach is to say that the service is given where the act of transmission begins, following the case of *Erichsen v Last* already quoted in ITH813.

[37] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

[38] The International Tax Handbook refers to the place where services are *provided* and the HK guidance refers to the place where services are *performed* but the meaning is the same. I think the word performed is clearer.

[39] See 34.30 (Where are duties performed); See too 111.8.2 (Income from services/ trading).

[40] *CT v Resource Capital Fund IV LP* [2019] FCAFC 51 at [52] citing: *FCT v French* [1957] HCA 73; *FCT v Mitchum* [1965] HCA 23; *FCT v Efstathakis* [1979] FCA 28.

> The place of the performance of services is likely to be significant to determine the source of income derived from personal exertion.

In *Brackett v Chater*[41] a surveyor entered into an employment contract with a Jersey company (owned by a Jersey trust that he had made, although this was not material). Clients contracted with the Jersey company but the surveyor did all the work in the UK using facilities available to them at the offices of the firm in which they were previously partners. The Jersey company was held to be trading in the UK.

Where services are performed by a team of people, and do not involve work in a single location, the answer may be less clear.

The Hong Kong guidance note provides:

> It should be noted that in the case of an investment adviser whose organisation and operations are located only in Hong Kong, profits derived in respect of the management of the clients' funds are considered to have a Hong Kong source.
>
> Included in chargeable sums are not only management fees and performance fees but also rebates, commissions and discounts received by the adviser from brokers located in Hong Kong or elsewhere in respect of securities transactions executed on behalf of clients.[42]

21.14.1 *Commissions*

The Hong Kong Revenue guidance provides:

> RE-INVOICING CENTRE
>
> 27. The Department's view is that if a profit is derived from services rendered in Hong Kong, the profit is clearly taxable. Commission income or profit that accrues to a "re-invoicing centre" for services rendered is chargeable to profits tax. Profits derived from the buying and selling of goods are not service income. The transaction involves the taking of commercial risks (e.g. product risks, inventory risks, credit risks, exchange risks, capital risks, etc.) different from those attached to a service. Confirmation of sales and issue of purchase orders are indications that it is a trading transaction. The source of trading profits depends on the locality of the trading operations. Paragraphs 18 to 26 are relevant.
>
> 28. It is not possible to categorise the circumstances under which income or profit derived by a "re-invoicing centre" would be regarded as a service income and not as a trading profit. In each case, the Department would examine the

[41] 60 TC 134 & 639.

[42] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

nature of the operations and the type of risks in question to determine whether they constitute the provision of services or trading. The label "re-invoicing centre" clearly does not in itself provide the answer as it can mean different business structures.

Example 1

Company A, incorporated in Hong Kong, is a re-invoicing centre of a group of companies with a holding company incorporated in the United States, as more particularly described below. It manages in Hong Kong all foreign currency exposures from intra-company trade, guarantees the exchange rates for future orders and manages intra-affiliate cash flows, including lead and lags of payments. Manufacturing affiliates in Mainland China sell goods to Company A, which in turns resells to the distribution affiliates in North America and Europe. Company A resells at cost plus a mark-up for its services. The mark-up covers the cost of the re-invoicing centre and a reasonable return on the services provided. The profits accrue to Company A are service income derived from Hong Kong. The mark-up earned by Company A, which acts as a re-invoicing centre, is chargeable to profits tax.[43]

21.15 Construction/engineering work

The former International Tax Handbook para 826 continued:

> Where construction and engineering works are concerned we say that the construction works are the essential operations and it is normally immaterial where the contract is signed – there is support for this in the Muller case [*WH Muller & Co (London) v Lethem* 13 TC 151].

21.16 Manufacturing

The former International Tax Handbook para 826 continued:

> There may be more than one part of the trade which can be identified as the profit producing part. There can be the case where there is manufacture abroad and selling here or manufacture here, and selling abroad. To look at the first situation, manufacture abroad and selling here, it is reasonably clear from the champagne cases that the Revenue only claimed to tax the selling profit and there is nothing in the judgments to suggest that it was entitled to more. The question is considered more fully in chapter 9 (ITH920). As to the second situation, manufacture on its own is certainly trading, even though there may be no sales here, and the old judgments tend to support the view that we should in such circumstances seek, on some sensible basis, to tax only

[43] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

> the manufacturing profit. There was a Privy Council [*Commissioners of Taxation v Kirk* [1900] AC 588] case in the early part of the century, an Australian case, which supports that idea and it is what we have in fact always done.

See too *IRC v Hang Seng Bank*:

> If he has … engaged in an activity such as the manufacture of goods, the profit will have arisen or derived from the place where ... the profit making activity carried on. There may, of course, be cases where the gross profits deriving from an individual transaction will have arisen in or derived from different places. Thus, for example, goods sold outside Hong Kong may have been subject to manufacturing and finishing processes which took place partly in Hong Kong and partly overseas. In such a case the absence of a specific provision for apportionment in the Ordinance would not obviate the necessity to apportion the gross profit on sale as having arisen partly in Hong Kong and partly outside Hong Kong.[44]

The Hong Kong Revenue guidance note provides:

> MANUFACTURING PROFITS
>
> 30. Lord Jauncey in *HK-TVBI* at 410F has commented on the source of manufacturing profits. He explained:
>
> > "If a manufacturer in Hong Kong sells his goods to a merchant in Manila the payment which he receives is no doubt sourced in Manila but his profit on the transaction arises in and is derived from his manufacturing operation in Hong Kong."
>
> Where goods are manufactured in Hong Kong, the profits arising from the sale of such goods will be fully taxable because the profit making activities are considered to be the manufacturing operations carried out in Hong Kong, which should include the procurement of raw materials, the employment of labour, the design of products and the use of machinery and plant, etc.
>
> 31. The following examples illustrate the Department's views on this subject:
>
> *Example 2*
>
> Company B manufactures goods in Hong Kong and sells them to overseas customers. The fact that Company B has sales staff based overseas does not give a part of the profits an overseas source. This is not a case for apportionment. The whole of the profits are liable to profits tax.
>
> *Example 3*
>
> Company C manufactures in Mainland China and sells the finished goods through a retailing branch in Hong Kong. The retailing branch has sales staff and a fixed place of business, and has registered for business in Hong Kong.

[44] [1990] STC 733 at p.740. The *dictum* to the contrary in *IRC v HK-TVB* [1992] STC 723 at p.730h can be disregarded.

Company C is both a manufacturer and a retailer. Profits are derived from the manufacturing operations in Mainland China and the retailing operations in Hong Kong. It is necessary to apportion the profits derived by Company C. Profits attributable to the Hong Kong retailing branch are chargeable to profits tax.

32. In Mainland China, two types of processing trade normally involve Hong Kong companies: contract processing and import processing. They are two different forms of transaction and require an accurate legal analysis.

CONTRACT PROCESSING

33. In contract processing, the document that governs the contractual relationship among the parties is the processing agreement. It sets out the rights and responsibilities of the Hong Kong company and the Mainland processing enterprise. The Hong Kong company is responsible for the supply of raw materials and machinery without consideration and to provide technical and managerial know-how while the Mainland processing enterprise is responsible for the provision of factory premises, utilities and labour force. 34. In return for the processing service, the Hong Kong company pays a subcontracting charge to the Mainland enterprise. The legal title to the raw materials and finished goods remains with the Hong Kong company. In the Department's view, the Hong Kong company's operations in Mainland China complement its operations in Hong Kong. Recognising the operations of the Hong Kong company in the Mainland, an apportionment of profits on a 50:50 basis is usually accepted.

35. In *D132/99* 15 IRBRD 25, the taxpayer contended that all of its profits were offshore in nature. The Board of Review held that its operations in Mainland China were not dominant operations that overshadowed the activities in Hong Kong and the operations in Hong Kong could not be disregarded.

36. In *D145/99* 15 IRBRD 91, the Board found that the taxpayer was not privy to the processing agreements, which had been entered into by its fellow subsidiaries and the taxpayer should be assessed for profits tax on 100% of its profits for the years of assessment after the processing agreement lapsed. The Board found that the taxpayer's business was the procurement of toys to satisfy sale and purchase contracts and that important operations took place inside Hong Kong: the reaching of purchase agreements; the determination of price; the issue of invoices; the procurement of raw materials and the shipment of finished products.

37. If the Hong Kong company has restricted involvement in the processing arrangement with the Mainland enterprise, the apportionment of profits could not be appropriate. For example, a Hong Kong company has contracted out the assembly work to various contractors in Hong Kong and the Mainland. The jobs are numerous, small in value and of short duration and the Hong Kong company has minimal involvement in the assembly work. Given that the Hong Kong company does not carry out any manufacturing operations outside Hong Kong, its profits should be fully chargeable to profits tax without any apportionment.

38. The apportionment contemplated in paragraph 34 above will also apply to cases where manufacturing activities are undertaken under a similar arrangement in other places.

IMPORT PROCESSING

39. In import processing, the manufacturing operations are carried out by a foreign investment enterprise (FIE) related to the Hong Kong company. An FIE is often a separate legal entity incorporated in the Mainland. The Hong Kong company sells raw materials to the FIE and buys back the finished goods from the FIE. The Hong Kong company engages in the trading of raw materials and finished goods whilst the FIE manufactures the finished goods. The legal title to the raw materials and the finished goods passes to/from the FIE.

40. In import processing, the gross profits arise from trading transactions whereby the Hong Kong company purchases finished goods from an FIE and sells them for a profit. The manufacturing operations of the FIE in the Mainland are not performed on behalf of, or for the account of, the Hong Kong company even though the Hong Kong company and the Mainland enterprise might be within the same group of companies.

41. In *ING Baring*, Lord Millet NPJ said that the source of profits had to be attributed to the operations of the taxpayer which produced them and not to the operations of other members of the group. In D36/06 21 IRBRD 694 which was a typical import processing case, the Board held that the taxpayer's profits were fully chargeable to profits tax. It was ruled that the FIE was not part of the taxpayer and was not an agent of the taxpayer. Hence the FIE's operations were not relevant in determining the source of profits of the taxpayer. The Board of Review rejected the contention of "substance over form" and disagreed with the suggestion that a leasing agreement of production facilities was similar to a contract processing agreement.

42. The Department holds the view that profits which accrued to the Hong Kong company from "trading transactions" carried out in Hong Kong cannot be attributed to the manufacturing operations of the FIE carrying on business in Mainland China. The source of the trading profits must be attributed to the operations of the Hong Kong company which produced them. In *Consco Tradingv IRC* [2004] 2 HKLRD 818, To Deputy J said that it was correct to consider factors such as the finance arrangements, the payment of raw materials and processing fees, the arrangement for receipt of payment from purchasers for the finished product and pre-contract negotiations and the Board was entitled to conclude that, on the evidence, the preponderance of the activities which earned the profits were performed in Hong Kong. The Court of First Instance said the Board correctly excluded the processing activity of the Mainland Chinese entity as not being relevant to the determining of the taxpayer's source of profits which were derived through the sale of processed goods.

43. In *IRC v Datatronic Limited* [2009] 4 HKLRD 675, where the arrangement between Datatronic and the FIE was an import processing arrangement, the Court of Appeal held that the profit-producing transactions were the purchase of goods from the FIE by Datatronic and subsequent sale and that these activities took place in Hong Kong. Thus, the profits were derived from Hong Kong. The Court of Appeal further held that the fact that the FIE, although a wholly-owned subsidiary of Datatronic, is a separate legal entity and that its dealings with Datatronic were not at varm's length would not detract from the reality of the

legal effect of the transactions. It is also worth to note the Court of Appeal's concurrence with the Board's findings that the manufacturing was done by the FIE in the Mainland is substance and not form and that Datatronic's activities (i.e. assisting the FIE in preparing the goods and supplying them to Datatronic) in the Mainland were merely antecedent or incidental to the profit-generating activities.

44. The Department has noticed that a Hong Kong company is sometimes interposed between an overseas company and a Mainland manufacturing enterprise in order to comply with or circumvent the trade barriers imposed by the overseas jurisdiction. In D7/08 23 IRBRD 102, the Board of Review recognised that making the Hong Kong company a customer of the overseas company and of the Mainland enterprise freed the overseas company from the trade barriers. Applying what the Court of Final Appeal held in the Kim Eng case on the effective cause of the production of the profits in question, it was held that the Hong Kong company's relevant activity in Hong Kong however limited was what was done to earn the profits in question and the Hong Kong company did it in Hong Kong.[45]

21.17 Use of UK commodity markets

The former International Tax Handbook provided:

929. Is use of the markets "trading in"?

It is a good thing for this country that these markets exist. There are all sorts of spin-off advantages. Big business has to be financed and insured and there are shipping services and all sorts of peripheral activities which are good both for the people who are involved in them and for the country's balance of payments. Looking at the physical markets the produce concerned may or may not come to this country. A Brazilian plantation owner may sell his cocoa in London although the buyer may be in France. A broker here will sell to another broker acting on behalf of the buyer and the contract will be made here. So the question arises – is the Brazilian producer trading in London and until the end of the last century it never occurred to anybody that this might be so.

Then came clarification by the Courts on the meaning of trading in the UK and the possibility that the fact of a contract being made by an agent in London could involve the principal in UK tax. It appeared open to the Revenue to contend that he principal was carrying on the selling part of his trade in London or even carrying on the whole trade in London. The Revenue had contended neither of those things; to have done so would have frightened off the foreign users of our markets. In any event, in those early days, the non-resident principal could have arranged that his London brokers did not receive the profits or gains.

But in 1915 everything changed because it was then provided that the receipt of

[45] Inland Revenue Department Hong Kong, Departmental Interpretation and Practice Notes No.21 (Revised) Locality of Profits (2012), *https://www.ird.gov.hk/eng/pdf/dipn21.pdf*

the profits or gains would no longer count[46] and the business world was worried. The Revenue said that it had always regarded business done on our markets through brokers as trading with the UK rather than trading in the UK. But the business world was not satisfied. The difficulty was clear enough. If, as some of the early cases might suggest, the bare making of a contract here is such a vital matter, there is a risk that anybody using our markets might be held to be trading here. The Revenue's former view that in normal circumstances that constituted trading with rather than in the UK is not easily defensible.

930. Pt VIII TMA 1970: Trading in: Can there be any profit?

But accepting that a primary producer, a Brazilian plantation owner selling cocoa in London, is trading in the UK, where is the profit? Such commodities have a world market price at any time; it is an essential function of the market to decide exactly what that price is. If it is decided that the Brazilian producer is trading in the UK he must be charged either as a seller of cocoa or as a cocoa grower. If he is not charged as a grower and, to put it no higher it would be stretching things rather to do so, it is hard to see how any profit can be said to arise in London as a seller of cocoa. The position is entirely different from that of the French champagne grower of the type referred to in ITH815 of chapter 8, who may at least be regarded as making a merchanting profit here. In that situation one would look at the market value of the champagne in bulk and then at the price (wholesale or retail) actually realised in this country. But where commodities like bulk tin or rubber or cocoa are concerned, the position is otherwise. These things are traded in our markets precisely to determine what their market value is and to dispose of them at that price.

931. Dealer

In some cases the primary producer may not sell directly in London but sell to an intermediary in the producing country who in turn sells on the London market. The trade here is then clearly that of selling and if the intermediary does not purchase at world prices – there may, for example, be a reserve price – it may be possible to identify a profit or a loss. But if the intermediary sells through a broker within the exemption described in the following paragraphs then the exemption runs just the same. But it sometimes happens that, although the contracts are made through a broker, the seller has a presence here – a branch or an agent – which plays some part in the selling process. It may, for example, instruct the brokers. The question then is whether what is done is sufficient to enable us to say that the non-resident is trading also through that branch or agent. The terminal markets may be used by a non-resident dealer in commodities simply to hedge purchases or sales of raw materials which take place outside the UK. The hedging transactions may amount to trading here but, again, the broker exemption may apply unless the non-resident has a presence here, other than the broker, which is involved with the hedging transactions. If the exemption does not apply, there is then the question of the extent, if any, to which the results of the related transactions outside the UK should be taken into account in

[46] F(no.2)A 1915 introduced the rules under which UK representative are liable for the tax of non-resident principals.

> measuring the taxable profits. This is an area of difficulty and International Division should be consulted in such a case.

In practice the point is not important because the broker exemption applies.[47]

21.18 Hire of chattels

The position for property income from land is governed by statute and trading case law is irrelevant for UK tax.[48]

What about hiring[49] chattels (eg pictures)? It is necessary to consider trading and non-trading cases separately. In the absence of a trade, income from hiring chattels is Misc Sweep-up Income.[50]

If the hiring is a trade, then the income is trading income and the source is the trade, not the assets of the trade. For a non-resident trader, the question is whether the trade is partly carried on inside the UK, and this can be addressed looking at wider factors than just where the asset is situate. But in practice it is suggested that the situs of the chattels will generally be determinative, unless the trade involves chattels situate in more than one country.[51]

21.18.1 *Is chattel hire a trade*

For general discussion of the concept of trade, see App.2.23 (Trade). I consider here whether chattel hire is a trade.

Business Leasing Manual provides:

> **BLM00315. Whether lessor trading** [Dec 2020]
> In general, where chattels are leased, you should accept that the leasing is by way of trade.
> In exceptional cases, however, where the evidence of trading is extremely slight, for example if only one asset has been acquired for leasing and there is no personal involvement by the taxpayer or any semblance of a trading organisation, the taxpayer's activities may be special leasing within CAA01/S19.
> You should not seek to deny trading treatment where, although there is

[47] See 72.1 (Investment Manager exemptions).

[48] See 24.1 (Property income).

[49] References to hire here include a lease and a licence: the distinction does not matter for present purposes.

[50] See 33.7.1 (Hire of chattels); 33.19.1 (Source: Income from assets).

[51] See 21.13.1 (Trading stock: land).

> no personal involvement by the taxpayer, there is trading activity by a manager as agent for the taxpayer.
> The same principle applies to special purpose vehicle lessor companies set up by groups that carry out leasing activities. In such cases it is not unusual for the company to own only one (or a few) assets and be managed by a group member.[52] ...

This is an oversimplification. For instance, when the chattel is acquired by way of gift (not purchase), and when the taxpayer is an individual or trust rather than a commercial company, then trading is much less likely.

A conclusion of trading will usually suit a non-corporate taxpayer and so not be challenged. A conclusion of trading may be a concern to a corporate taxpayer if it were carrying on that trade in the UK through a permanent establishment, which would move it from income tax to the more onerous corporation tax regime.

21.19 Research division/shop windows

The former International Tax Handbook provided:

> **827. Profit producing activities**
> Early in this chapter (ITH811) an illustration was given of the hypothetical maker of refrigerators making them in various places in the world and selling them in those places. One way of describing the split of that trade is as a vertical split with a vertical slice here and other similar vertical slices in other countries. We would wish to tax only the vertical slice of the trade carried on here. The other way in which a trade may be split may be thought of as horizontal, the sort of situation we have just discussed, one horizontal slice of the trade, manufacturing say, being here and another slice, the selling, abroad.

The horizontal/vertical terminology seems strange. The metaphor is also used in competition law but the other way round.[53] The former International Tax Handbook continued:

> The above cases are straightforward enough but difficulty starts to

[52] Very similar wording is found in BI Manual 61190 [Jul 2006].

[53] "Vertical agreements" are those made between two or more undertakings each of which operates at a different level of the production or distribution chain. "Horizontal agreements" are those made between undertakings operating at the same level of the production or distribution chain, covering for example research and development, production, purchasing or commercialisation. See Regulation (EC) no. 2790/1999.

> emerge when what is done here is not clearly identifiable as part of the whole trade in that way. An example is the non-resident stock-broker with a branch in London which merely puts the goods in the shop window.

"Shop window" is another unhelpful metaphor. What does it mean? The former International Tax Handbook explained:

> There may be a research section here with computers and the other paraphernalia of a modern trade of that sort. The branch gives advice to would be customers and when they decide to buy a particular American stock, it tells its head office in New York and there the actual deal is done. If the London branch really is only a shop window and really does take no part in the contracting process then the conclusion is that that is not trading within the UK; there is only one trade which is providing the service of buying or selling stocks and that is done in New York. It is quite possible for a non-resident trader to have an office here employing a substantial number of people and yet not to be exercising the trade here.
>
> Another example might be the manufacturer on a very large scale in America, which has a research division in this country. The work of the research division may be absolutely vital to the trade but if that trade consisted for example in the making and sale of television sets, one could not say that research on, let us say, conductivity constituted a distinct profit producing part of that trade. That is reasonably clear.

This is right because it is difficult to allocate the profits, so they should be regarded as merely auxiliary.[54]

> More difficult is the position of non-resident banks or insurance companies which use the UK for their investment activities but do not carry on the business of banking or insurance here. The questions in this whole area of "trading in" are mainly those of fact and degree and absolute guidelines are simply not possible. International Division will be glad to help in cases of doubt.

21.20 Where is contract made?

If or so far as the place where the contract is made is an important factor, that place has to be identified. The place where a contract is made is, fundamentally, a question of contract law. But the identity of the place where the contract is made is not relevant for the purposes of contract law, so there are no contract law cases discussing the issue. In the reported tax cases the place where the contract was made was fairly obvious, and so the cases do not help us here. We are thrown back to first principles.

[54] See 21.11 (Preparatory/auxiliary activities).

Going back to first principles, a contract in English law[55] is made by acceptance of an offer. The contract takes effect on acceptance and the place where the contract is made is where the acceptance takes place. As a general rule, acceptance takes place when the acceptance is received by the person who makes the offer. There are, however, exceptions to this:

(1) Acceptance by post–acceptance takes place when and where the letter of acceptance is posted, not where received (unless the offer otherwise provides).

(2) When an offer is made, one can specify in the terms of the offer how and when it can be accepted, and this can therefore alter the place where the contract is made.

Offer and acceptance can be difficult to identify. The court will try to impose an offer and acceptance analysis on circumstances which may not lend themselves to that analysis.[56]

There is no case law on email acceptance.[57] The person making the offer can decide how that offer is accepted so if the documentation is correctly drafted a contract can be made abroad by the click of a mouse outside the UK.

The former International Tax Handbook discussed this issue:

> **The making of a contract**
> **830. General**
> There have been many references in this chapter to the making of a contract and to the place where a contract is made. If two people agree specifically on a sale by word of mouth that is the making of a contract and the place of their agreement is the place where the contract is made. A great deal of business is done in that way daily and the place of contract is not changed by the signing of a piece of paper in a tax haven sometime afterwards. The difficulty is one of

[55] Further consideration is needed if the applicable law is not English law.

[56] Some academic writers have suggested abandoning the "offer and acceptance" analysis and replacing it by a contract theory based on reliance. (There is more than a hint of this in Lord Denning's judgment in *Gibson v Manchester City Council*. This decision was reversed by the House of Lords but even Lord Diplock accepted that there would be times when offer and acceptance would be difficult to identify and the "normal analysis of a contract as being constituted by offer and acceptance" might not be appropriate. However that would be exceptional. See [1979] 1 WLR 294 at p.297).

[57] The Law Commission paper (Electronic Commerce: Formal requirements in commercial transactions, December 2001) does not deal with the issue of where a contract made by email is made.

proof as we have already seen in ITH822. But putting difficulties of that sort on one side, if the question where a contract is made becomes of central importance it is one on which we should rely on legal advice – it is pre-eminently a question for the Solicitor and what follows is very general guidance.

831. Acceptance of offer

Offer and acceptance constitute contract. The place of contract is governed by the place of acceptance of the offer and acceptance takes place where it is received. Where acceptance is communicated by letter it is regarded as received at the place of posting rather than at the place of actual receipt. This is because, once a letter has been posted, the Post Office holds it on behalf of the addressee. Where telephone communication is used the place of acceptance is the place where the recipient of the acceptance is. That is the general rule for so-called instantaneous communication. It would apply also to an acceptance sent by telex or fax directly from the acceptor's office to the offeror's office. The general rule may need qualifying when a cable company's services are used. A telegram like a letter is regarded as received when put into the hands of the Post Office.

832. Price lists

The mere sending out of price lists and advertisements does not constitute an offer, it is rather an open invitation for offers to be made. An offer must be quite specific and a price list is not an offer to supply an unlimited amount of goods at the price named. It follows that when a customer buys goods from a supplier the customer makes the offer and the supplier notifies acceptance. That is generally the assumption in cases where place of contract has been decisive in determining a non-resident's liability. But it is not impossible for a price list to amount to an offer, as long as the list details the price, the quantity and gives a definite description of the goods concerned. If in such circumstances the buyer were to put in some amendment not contained in the original offer, then what the buyer does becomes a fresh offer and one which has to be unconditionally accepted before there can be said to be a binding contract. And there may be a series of communications between customer and supplier so that it is a matter of chance as to who makes and who accepts the final offer.

833. Delivery

It is quite common to find that there is no formal acceptance of the offer by the person supplying the goods and, in that situation, delivery itself will normally constitute acceptance; and then it would be important to look at the place of delivery, the place where the lawful property in the goods passes from seller to buyer.

834. Acceptance by agent

There can be widely different circumstances in which contracts are made here. There is the case where the agent or branch in this country really does the job of negotiating the contract. That person settles the deal and terms and makes the contract here and there is no doubt whatever about it. On the other hand, there can be the case where the agent makes the contract in the legal sense, but does so only with the specific authority of the principal. That is to say the agent gets an offer, writes to or rings the principal, obtains approval and then, and only then, accepts the offer. In that case, acceptance would be here and there are at least two cases [For example, *Wilcock v Pinto & Co* 9 TC 111] on that point.[58]

21.21 Trade partly in UK: Apportionment

I turn to the question of how to apportion where part of the trade is in the UK. Of course this overlaps with the question of whether there is a trade partly in the UK. If there are activities in the UK which do not involve trading in the UK there is nothing to apportion.

Tax Bulletin 18 provides:

> It is perhaps less obvious how the profits from the part of the trade carried on in the UK should be measured. They are required to be measured on the arm's length principle set out in the [OECD model tax convention] where a DTA applies which includes the relevant provisions. It is considered that it also follows from the main rule in Schedule D that the same principle applies even if there is no treaty.
>
> There is support for this principle in the early tax cases on non-residents trading in the UK. For example, in *Pommery & Greno v Apthorpe* at 2 TC 189, Denman J said, with regard to the profits chargeable in the UK from merchanting champagne produced in France, that:
>
>> It may be that there may be some difficulty in some respects as to the manner of calculating the amount of expenditure to be put against the profits, whether it would be a proper course to look at the goods sent over to England and then to consider what profit they make, putting a fair valuation on them as they arrive, and as the money is transmitted, or whether it would be necessary in such a case to look more minutely into the profits and losses upon the whole trade carried on partly in France and partly in England. I do not think it is necessary at all at this stage of the case to decide that. That is a matter of quantum, a matter for the consideration of persons skilled in dealing with such matters as assessing profits of trade.
>
> This can be seen as an early description of the arm's length principle and as a recognition of the need to develop methods to apply that principle in practice.[59]

The former International Tax Handbook also touched on this issue:

[58] There is also a brief comment (not worth setting out here) in NI Manual 29013 [Dec 2016].

[59] Author's footnote: See Russo (ed), "The Attribution of Profit to Permanent Establishments" (2005); OECD Report on the Attribution of Profits to Permanent Establishments (2008). *http://www.oecd.org/dataoecd/20/36/41031455.pdf*

814. Measure of profit in *Erichsen v Last*[60]

The second point the case deals with is – what is the chargeable profit? That is a rather special point where the transmission of messages is concerned. What the company claimed was that a great deal of the profit arose from the transmission over cables which were not here at all. The Master of the Rolls gave a simple parallel example of a foreign company running a steam packet between Dover and Calais. He said that as far as carrying passengers from Dover to Calais was concerned that was trading in Dover. There was no need to look at the three mile limit or anything of that sort. One simply had to take the receipts and deduct the expenses. The journey started here and the service was here. That is an idea limited in its application to trades involving the transmission of passengers, goods and information.

21.22 Post-cessation receipts

Until 1960 post-cessation trading receipts were not subject to tax.[61] Hence there is a separate code to deal with this topic.

I do not discuss here:

Debts paid/released after cessation: s.248, 249 ITTOIA
Relief for post-cessation expenditure: s.254, 255 ITTOIA
Election to carry back: s.257 ITTOIA

21.22.1 *Post-cessation receipt: Charge*

s.242 ITTOIA	**s.188 CTA 2009**
Income tax is charged on post-cessation receipts arising from a trade.	The charge to corporation tax on income applies to post-cessation receipts arising from a trade.

21.22.2 *Extent of charge*

s.243 ITTOIA	**s.189 CTA 2009**
(1) A post-cessation receipt is chargeable to tax under this Chapter only so far as it is not otherwise chargeable to income or corporation tax.	(1) A post-cessation receipt is chargeable to tax under this Chapter only so far as it is not otherwise chargeable to corporation or income tax.

[60] Author's footnote: For facts of *Erichsen v Last* 4 TC 422 see 21.8 (Place where contract made).

[61] See 31.4 (Post-cessation trading receipt).

(2) Accordingly, a post-cessation receipt arising from a trade is not chargeable to tax under this Chapter so far as it is brought into account in calculating the profits of the trade for any period.	[identical]

21.22.3 *Territorial limitation*

Section 243 ITTOIA/s.189 CTA 2009 provide:

> (3) A post-cessation receipt is not chargeable to tax under this Chapter if-
> (a) it is received by or on behalf of a non-UK resident who is beneficially entitled to it, and
> (b) it represents income arising outside the UK.
> (4) A post-cessation receipt is not chargeable to tax under this Chapter if it arises from a trade carried on wholly outside the UK, other than a person's trade of dealing in or developing UK land.

Section 243(5) ITTOIA provides:

> A post-cessation receipt is not chargeable to tax under this Chapter in the case of a partner in a firm if-
> (a) it represents income arising outside the UK from a trade carried on by the firm, and
> (b) the partner's share of the firm's income arising out of the UK is treated as relevant foreign income by section 857(3) (partners to whom the remittance basis applies)

21.22.4 *Split year*

Section 243(6) ITTOIA provides:

> If the tax year is a split year as respects a UK resident individual, this section has effect as if, for the overseas part of that year, the individual were non-UK resident.

21.22.5 *Basis of assessment*

Section 244 ITTOIA provides:

> (1) Tax is charged under this Chapter on the full amount of the receipts received in the tax year.
> (2) This is subject to-
> (a) sections 254 and 255 (allowable deductions), and

(b) section 257 (election to carry back).

21.22.6 *"Post-cessation receipt"*

Section 246(1) ITTOIA/s.190(1) CTA 2009 provide:

> In this Part "post-cessation receipt" means a sum-
> (a) which is received after a person permanently ceases to carry on a trade, and
> (b) which arises from the carrying on of the trade before the cessation.

Section 246 ITTOIA provides:

> (2A) If, immediately before a person permanently ceases to carry on a trade, an election under section 25A (cash basis for small businesses) has effect in relation to the trade, a sum is to be treated as a post-cessation receipt only if it would have been brought into account in calculating the profits of the trade on the cash basis had it been received at that time.
> (3) Subsection (4) applies if-
> (a) a firm carries on a trade,
> (b) a person ceases to be a partner in the firm, and
> (c) the departure results in the partner permanently ceasing to carry on the notional trade (see section 852).
> (4) The partner is treated for the purposes of this Chapter as permanently ceasing to carry on the trade.

Section 190 CTA 2009 provides:

> (2) In this Chapter, except in sections 194 and 195, references to a person permanently ceasing to carry on a trade include-
> (a) in the case of a company, the occurrence of an event treated under section 18 of ITTOIA 2005 (companies beginning or ceasing to be within charge to income tax) as the company permanently ceasing to carry on the trade, and
> (b) in the case of a trade carried on by a person in partnership, the occurrence of an event treated under section 246(4) of ITTOIA 2005 (basic meaning of "post-cessation receipt") as the person permanently ceasing to carry on the trade.

21.22.7 *Person liable*

Section 245 ITTOIA provides:

> The person liable for any tax charged under this Chapter is the person receiving or entitled to the receipts.

21.22.8 *Transfer of rights transferee not trading*

s.251 ITTOIA	**s.194 CTA 2009**
(1) This section applies if- (a) a person ("the transferor") permanently ceases to carry on a trade, (b) the transferor transfers to another person ("the transferee") for value the right to receive sums arising from the carrying on of the trade, and (c) the transferee does not subsequently carry on the trade.	(1) This section applies if- (a) a company ("the transferor") permanently ceases to carry on a trade, (b) the transferor transfers to another person ("the transferee") for value the right to receive sums arising from the carrying on of the trade, and (c) the transferee does not subsequently carry on the trade.
(2) The transferor is treated as receiving a post-cessation receipt.	(2) The transferor is treated as receiving a post-cessation receipt.
(3) The amount of the receipt is- (a) the amount or value of the consideration for the transfer, if the transfer is at arm's length, or (b) the value of the rights transferred as between parties at arm's length, if the transfer is not at arm's length.	[identical]
(4) Any sums mentioned in subsection (1)(b) which are received after the cessation of the trade are not post-cessation receipts.	[identical]
(5) This section is subject to- (a) section 252 (transfer of trading stock or work in progress), and (b) section 253 (lump sums paid to personal representatives for copyright etc.).	(5) This section is subject to section 195 (transfer of trading stock).

21.22.9 *Transfer trading stock/work in progress*

Section 252 ITTOIA provides:

> (1) When a person permanently ceases to carry on a trade, a sum

realised by-

(a) the transfer of trading stock, or

(b) the transfer of work in progress,

is not a post-cessation receipt if a valuation of the stock or work is brought into account in accordance with Chapter 12 (valuation of stock and work in progress).

(2) This does not prevent a sum from being treated as a post-cessation receipt as a result of an election under section 185 (election for valuation of work in progress at cost).

(3) In this section-

(a) "trading stock" has the meaning given by section 174, and

(b) "work in progress" and "transfer of work in progress" have the meaning given by section 183.

21.22.10 *PRs lump sum for copyright*

Section 253 ITTOIA provides:

> (1) A lump sum which is paid to the personal representatives of the author of a literary, dramatic, musical or artistic work as consideration for the assignment by them of-
>
> (a) the copyright in the work, or
>
> (b) the public lending right in the work,
>
> is not a post-cessation receipt.
>
> (2) A lump sum which is paid to the personal representatives of the designer of a design in which design right subsists as consideration for the assignment by them of that right is not a post-cessation receipt.
>
> (3) For the purposes of this section it does not matter whether the whole or a part of the right is assigned.

This seems generous.

21.23 DT relief: trading income

Article 7(1) OECD Model provides:

> [a] [i] The profits of an enterprise of a Contracting State shall be taxable only in that State
>
> [ii] unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.
>
> [b] If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

A full discussion of this topic requires at least 3 volumes:

- a volume on the relief in art 7(1)[a][i]
- another on the meaning of PE (such books have been written)
- another on attribution of profits to a PE, the most contentious topic in international taxation

OECD Commentary provides:

> 11. The first principle underlying paragraph 1, i.e. that the profits of an enterprise of one Contracting State shall not be taxed in the other State unless the enterprise carries on business in that other State through a permanent establishment situated therein, has a long history and reflects the international consensus that, as a general rule, until an enterprise of one State has a permanent establishment in another State, it should not properly be regarded as participating in the economic life of that other State to such an extent that the other State should have taxing rights on its profits.

21.23.1 *"Business"*

Article 3(1)(h) OECD Model provides an inclusive definition of "business":

> the term "business" includes the performance of professional services and of other activities of an independent character.

The Model Commentary to Article 3(1)(h) provides:

> 10.2 The Convention does not contain an exhaustive definition of the term "business", which under paragraph 2, should generally have the meaning which is has under the domestic law of the State that applies the Convention.

In the usual UK sense, "business" is very wide. No-one would have doubted that the provision of professional services or other activities of an independent character constitutes a "business" in the ordinary sense. But the definition does no harm, and is there for historical reasons. OECD Commentary provides:

> 8. Before 2000, income from professional services and other activities of an independent character was dealt with under a separate Article, i.e. Article 14.[62] The provisions of that Article were similar to those applicable to business profits but it used the concept of fixed base rather than that of permanent establishment since it had originally been thought that the latter concept should be reserved to commercial and

[62] See 21.24 (Independent personal services).

> industrial activities. However, it was not always clear which activities fell within Article 14 as opposed to Article 7. The elimination of Article 14 in 2000 reflected the fact that there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. The effect of the deletion of Article 14 is that income derived from professional services or other activities of an independent character is now dealt with under Article 7 as business profits. This was confirmed by the addition of a definition of the term "business" which expressly provides that this term includes professional services or other activities of an independent character.

The activity of being an employee, and the activity of making or holding or managing investments, may constitute a business in the wide UK sense of the word, but they are not businesses within article 7.

For further discussion, see *G E Financial Investments v HMRC* [2021] UKFTT 210 (TC).

21.23.2 *"Enterprise"*

The term "enterprise" is frequently used in the OECD Model, in particular:

Article: Topic	**Wording** (in outline)
5: Definition of PE	Fixed place of business through which business of an enterprise is carried on
7: Business profits	Profits of enterprise of Contracting State taxable only in that State
9: Associated enterprises	*Not discussed here*
13(2): Capital gains	Gains from ... business property of PE which an enterprise of a Contracting State has in the other State may be taxed in that other State

Article 3(1) OECD Model defines "enterprise" and "enterprise of a Contracting State":

> For the purposes of this Convention, unless the context otherwise requires...
>
> *c)* the term "enterprise" applies to the carrying on of any business;[63]
>
> *d)* the terms "enterprise of a Contracting State" and "enterprise of

[63] See 21.23.1 ("Business").

> the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State; ...

The term "enterprise" is used in two ways:

(1) to refer to the business, or business activity
(2) to refer to the person or entity which carries on that activity[64]

Usage (2) seems eccentric, if not erroneous, but it does not matter as the meaning is clear. Perhaps the English is influenced by the French version of the model.

OECD Commentary provides:

> 4. The question whether an activity is performed within an enterprise or is deemed to constitute in itself an enterprise has always been interpreted according to the provisions of the domestic laws of the Contracting States. No exhaustive definition of the term "enterprise" has therefore been attempted in this Article. However, it is provided that the term "enterprise" applies to the carrying on of any business. Since the term "business" is expressly defined to include the performance of professional services and of other activities of an independent character, this clarifies that the performance of professional services or other activities of an independent character must be considered to constitute an enterprise, regardless of the meaning of that term under domestic law. States which consider that such clarification is unnecessary are free to omit the definition of the term "enterprise" from their bilateral conventions.

See Avery Jones, "Does 'Enterprises' in OECD Model mean 'Business'?" (2006) 60 Bulletin for International Taxation 476. See too:

Topic	**See para**
What is a separate enterprise	106.10
Is stichting an enterprise	90.40.6
Enterprise of transparent entity	91.6.1

[64] This is self-evident, but if authority is needed, see *Fowler v HMRC* [2016] UKFTT 234 (TC) at [105]: "the words "enterprise" and "business" are only partially defined in [the South Africa/UK DTA, [which follows the OECD Model]. In this connection, it seems to me that the word "enterprise" is wide enough to encompass both the entity carrying on and the activity which can be described as a business. It is true that Article 3(1)(g) tells us the word "enterprise" applies to the carrying on of any business, but that does not, I think, take us very far. It focuses our attention on what is meant by the word "business"."

21.23.3 *"Profits"*

OECD Commentary on art 7 provides:

> 71. Although it has not been found necessary in the Convention to define the term "profits", it should nevertheless be understood that the term when used in this Article and elsewhere in the Convention has a broad meaning including all income derived in carrying on an enterprise. Such a broad meaning corresponds to the use of the term made in the tax laws of most OECD member countries.

21.23.4 *Attribution to PE*

Article 7(2) OECD Model provides:

> For the purposes of this Article and Article [23 A] [23 B], the profits that are attributable in each Contracting State to the permanent establishment referred to in paragraph 1 are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

21.23.5 *Adjustment for attribution*

Article 7(3) OECD Model provides:

> 3. Where, in accordance with paragraph 2, a Contracting State adjusts the profits that are attributable to a permanent establishment of an enterprise of one of the Contracting States and taxes accordingly profits of the enterprise that have been charged to tax in the other State, the other State shall, to the extent necessary to eliminate double taxation on these profits, make an appropriate adjustment to the amount of the tax charged on those profits. In determining such adjustment, the competent authorities of the Contracting States shall if necessary consult each other.

21.23.6 *Interest from third state PE*

OECD Commentary provides:

> 28. [Article 11] Paragraph 5 provides no solution for the case, which it excludes from its provisions, where
> [a] both the beneficiary and the payer are indeed residents of the

Contracting States, but

[b] the loan was borrowed for the requirements of a permanent establishment owned by the payer in a third State and the interest is borne by that establishment.

As paragraph 5 now stands, therefore, only its first sentence will apply in such a case. The interest will be deemed to arise in the Contracting State of which the payer is a resident and not in the third State in whose territory is situated the permanent establishment for the account of which the loan was effected and by which the interest is payable. Thus the interest will be taxed both

[a] in the Contracting State of which the payer is a resident

[b] and in the Contracting State of which the beneficiary is a resident.

But, although double taxation will be avoided between these two States by the arrangements provided in the Article, it will not be avoided between them and the third State if the latter taxes the interest on the loan at the source when it is borne by the permanent establishment in its territory.

29. It has been decided not to deal with that case in the Convention. The Contracting State of the payer's residence does not, therefore, have to relinquish its tax at the source in favour of the third State in which is situated the permanent establishment for the account of which the loan was effected and by which the interest is borne. If this were not the case and the third State did not subject the interest borne by the permanent establishment to source taxation, there could be attempts to avoid source taxation in the Contracting State through the use of a permanent establishment situated in such a third State. States for which this is not a concern and that wish to address the issue described in the paragraph above may do so by agreeing to use, in their bilateral convention, the alternative formulation of paragraph 5 suggested in paragraph 30 below. The risk of double taxation just referred to could also be avoided through a multilateral convention. Also, if in the case described in paragraph 28, the State of the payer's residence and the third State in which is situated the permanent establishment for the account of which the loan is effected and by which the interest is borne, together claim the right to tax the interest at the source, there would be nothing to prevent those two States together with, where appropriate, the State of the beneficiary's residence, from concerting measures to avoid the double taxation that would result from such claims using, where necessary, the mutual agreement procedure (as envisaged in paragraph 3 of Article 25);

> see paragraphs 38.1 and 55 to 55.2 of the Commentary on Article 25).
> 30. As mentioned in paragraph 29, any such double taxation could be avoided either through a multilateral convention or if the State of the beneficiary's residence and the State of the payer's residence agreed to word the second sentence of paragraph 5 in the following way, which would have the effect of ensuring that paragraphs 1 and 2 of the Article did not apply to the interest, which would then typically fall under Article 7 or 21: Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a State other than that of which he is a resident a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment, then such interest shall be deemed to arise in the State in which the permanent establishment is situated.
> 31. If two Contracting States agree in bilateral negotiations to reserve to the State where the beneficiary of the income resides the exclusive right to tax such income,[65] then ipso facto there is no value in inserting in the convention which fixes their relations that provision in paragraph 5 which defines the State of source of such income. But it is equally obvious that double taxation would not be fully avoided in such a case if the payer of the interest owned, in a third State which charged its tax at the source on the interest, a permanent establishment for the account of which the loan had been borrowed and which bore the interest payable on it. The case would then be just the same as is contemplated in paragraphs 28 to 30 above.

21.23.7 *3rd-party relief disapplied*

Section 130 TIOPA provides:

> (1) Subsection (4) applies if double taxation arrangements make the provision, however expressed, mentioned in subsection (2).
> (2) The provision is that the profits of an enterprise within subsection (3) are not to be subject to UK tax except so far as they are attributable to a permanent establishment of the enterprise in the UK.

That includes treaties in OECD Model form, which is the large majority.

> (3) An enterprise is within this subsection if the enterprise—
> (a) is resident outside the UK, or
> (b) carries on a trade, or profession or business, the control or management of which is situated outside the UK.

[65] See 26.27.2 (DTAs with 100% interest relief).

The word "enterprise" here means the person who carries on the enterprise (business).

Assuming the conditions of s.130(1)-(3) are satisfied, we move on to s.130(4) which disallows treaty relief:

> The provision does not prevent income of a person resident[66] in the UK being chargeable to income tax or corporation tax.

In short, treaty relief is only allowed for a person treaty-resident outside the UK, and what I call third-party DT relief[67] is disapplied.

Section 130 applies where an enterprise is carried on by a trust or company which is a resident in a treaty state with a standard business income article; and a UK resident is taxable on the income. The UK resident person does not qualify for DT relief. That may happen:

(1) as life tenant of the trust
(2) under s.624 ITTOIA
(3) under the transactions in land code (though this also has its own treaty override)[68]

For completeness: s.130(5) TIOPA provides an exception:

> Subsection (4)—
> (a) does not apply in relation to income of a person resident in the UK if section 858 of ITTOIA 2005 (UK resident partner is taxable on share of firm's income despite any double taxation arrangements) applies to the income, and
> (b) does not apply in relation to income of a company resident in the UK if section 1266(2) of CTA 2009 (UK resident company that is partner in a firm is taxable on share of firm's income despite any double taxation arrangements) applies to the income.

Section 130 is not needed here as s.858 ITTOIA does the same job; see 85.25 (DT relief: Partnership).

In the 2020/21 edition of this work I said:

[66] Section 130(6) TIOPA defines residence:

> "A person is resident in the UK for the purposes of this section if the person is resident in the UK for the purposes of the double taxation arrangements."

The wording in the definition of treaty-residence is: "a resident *of* the UK", but the preposition does not matter; see 9.1 (Treaty-residence: Introduction).

[67] See 109.1 (Third-party DT relief).

[68] See 22.16.1 (TiL treaty override).

> Section 130 is headed: *Interpreting provision about UK taxation of profits of foreign enterprises*. This rule is however not interpretation or even misinterpretation: it is a treaty override. This section simply disapplies treaty relief for business profits. Breach of treaty agreements has ceased to concern HMRC when on the tax avoidance warpath.

But treaties eventually caught up with the s.130 approach, which is now authorised by the OECD Model/BEPS Savings Clause.[69]

21.24 Independent personal services

Article 14 OECD Model formerly provided:

> *(1) Income derived by an individual who is a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State unless he has a fixed base regularly available in that other State for the purpose of performing the activities. If he has such a fixed base, the income may be taxed in that other State, but only so much of it as is attributable to that fixed base.*
> *(2) The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.*

This article was abolished in 2000, but survives in older treaties.
The INTM provides:

> **INTM153160 Independent personal services** [Jul 2018]
> This Article deals with professional income and income from activities of an independent character, income which in the UK would generally be taxed as trade profits. Such income can only be taxed in the country of which the person deriving the income is a resident, but, if he has a fixed base regularly available to him in the other country, then the other country can tax so much of the income as is attributable to that fixed base. Some agreements provide additionally that, if an individual is present in the other country exceeding a specified number of days (normally 183), that other country can tax so much of the income as is attributable to the services performed in that country in that period.
> The Article was deleted from the OECD Model DTC in 2000 on the basis of a report entitled 'Issues related to Article 14 of the OECD

[69] See 109.5 (Savings Clause).

Model Double Taxation Convention'. That decision reflected the fact that there were no intended differences between the concepts of permanent establishment, as defined in Article 5 and used in Article 7 and fixed base as used in Article 14, or between how profits were computed and tax calculated according to which of Article 7 or 14 applied. In addition, it was not always clear which activities fell within Article 14 as opposed to Article 7. The effect of the deletion of Article 14 from a particular treaty will be that income derived from professional services or other activities of an independent character will be dealt with under Article 7 as business profits.

Of course, a large number of the UK's tax treaties still contain an Article 14. As time goes on and as treaties are renegotiated, this will change. But in the meantime, if there is an Article 14 in a particular treaty then it should be applied as appropriate. The last OECD update which contains a commentary on Article 14 was the one published in June 1998.

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TAXATION OF NON-RESIDENTS AND FOREIGN DOMICILIARIES 2024-25

by

JAMES KESSLER KC

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Chapters 22 - 37 Income by Category

TWENTY FOURTH EDITION

Key Haven Publications Ltd
P. O. Box 669, Oxford, OX3 3AU
Tel: 01865 352121
http://www.khpplc.co.uk

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22.1 Trading in land: Introduction

This chapter considers:
(1) What is trading in land
(2) Non-residents dealing/developing land
(3) Transactions in land code

22.2 What is trading in land

For general discussion of the concept of trade, see App.2.23 (Trade). I consider here what constitutes trading in land.

BIM provides:

BIM60025 land: trading transactions: badges of trade [Jun 2016]
You should consider the established badges of trading and in particular the following:
- whether there have been any previous transactions and, if so, at what intervals;
- whether the way in which the transaction was organised was typical of a land dealer;
- whether a loan was necessary to fund the purchase and, if so, on what terms;
- the character of the land: was it amenity land for the purchaser, suitable for long term investment or ripe for immediate development?
- the length of time the land was held and, particularly, whether there might have been, at the moment of acquisition, a pre-arranged sale.

The badges are summarised in the property dealing context in *Marson v Morton* [1986] 59 TC 381. You should remember that no one factor is determinant. What you are seeking to establish is the overall 'character' of the transaction.

22.2.1 *Intention on acquisition*

BIM provides:

BIM60030 trading transactions: intention on acquisition [Jan 2019]
The purchaser's intention at the moment of acquisition of the land is of great importance. In *Lionel Simmons Properties Ltd v CIR* [1980] 53 TC 461, Lord Wilberforce said at page 491:

> 'Trading requires an intention to trade: normally the question to be asked is whether this intention existed at the time of the acquisition of the asset'.

It is therefore often necessary to demonstrate an intention to trade at the time of acquisition. For land transactions, the exchange of contracts is the moment when the property is acquired. The formal transfer of property or completion follows within a month of completion but is sometimes delayed for commercial, or tax planning reasons.

BIM60035 trading transactions: profit seeking motive [Jun 2016]
An intention to dispose of land at a profit at some time in the future, does not automatically mean there is an intention to trade (*CIR v Reinhold* [1953] 34 TC 389), though in appropriate circumstances such an intention can ensure that a transaction is an adventure in the nature of a trade.

Land may be acquired as a capital asset in the knowledge that it will appreciate in value and realise a 'profit' one day on disposal.

It is not conclusive that the land will produce investment income before eventual sale:

Marson v Morton [1986] 59 TC 381. Accordingly, it will be insufficient to demonstrate a profit seeking motive. A trading intention has to be shown from all the facts of the case.

BIM60040 trading transactions: deal or investment? [Jan 2019]

In practice, it will be rare for someone to say that they are starting a trade in property. Intention may be reasonably inferred from all the circumstances at the time. If you identify the badges of trade in a transaction, these will indicate a trading intention.

It is necessary to examine the transaction objectively. Do the facts suggest a 'deal' or an investment?

If, notwithstanding the purchaser's stated intentions, the facts suggest a trading intention it should be argued that the transaction is part of a trade.

BIM60045 trading transactions: equivocal and unequivocal transactions [Jan 2019]

There may be cases where, on examination of all the facts, it is difficult to decide whether the transaction is part of a trade. A distinction between these 'equivocal' transactions and the 'unequivocal' variety is drawn in the past cases. Examples are *Iswera v CIR* [1965] 1 WLR 668 ... and *Kirkham v Williams* [1991] 64 TC 253.

There are no hard and fast rules as to what makes a transaction equivocal. The matter was considered in *Kirkham v Williams*. In that case Nourse LJ thought an equivocal or ambiguous case was one in which the facts, when viewed on their own, did not tell you whether the land was acquired as trading stock or as a capital asset.

In 'unequivocal' or unambiguous cases the purchaser's actual intention will not be conclusive (see *Iswera v CIR*). Where the transaction is equivocal the purchaser's motive(s) for entering into a transaction may determine the character of the whole transaction.

A purchaser's stated intention of a single capital transaction will constitute evidence that the Tribunal must accept unless sufficient evidence of a trading intention can be adduced by reference to the badges of trade.

This is the principle to be drawn from *Iswera* which was cited with approval in *Kirkham*. As a general rule we should, when the facts allow, argue that the transaction was unequivocal. This means, identifying as many badges of trading as possible.

BIM60050 trading transactions: dual motive transactions [Jun 2016]

Transactions that are 'equivocal' may also be dual motive transactions. A dual motive transaction is a transaction entered into with two objects. An example would be an acquisition of land both to provide accommodation for an existing trade and for eventual development and resale at profit. It would be for the Tribunal to decide as a question of fact in such circumstances whether one of those motives was a trading motive and, if so, to what extent it coloured the whole transaction as being, in essence, a trading transaction. Nourse LJ's comments in *Kirkham v Williams* [1991] 64 TC 253 are relevant.

22.2.2 *Trading stock or capital asset*

In *Simmons v IRC*:[1]

> What I think is not possible is for an asset to be both trading stock and permanent investment at the same time, nor for it to possess an

[1] 53 TC 461.

> indeterminate status, neither trading stock nor permanent asset. It must be one or the other ...

22.2.3 *Supervening trade*

Lionel Simmons Properties v IRC considered a change in intention after purchasing an asset:[2]

> Intentions may be changed. What was first an investment may be put into the trading stock, and, I suppose, vice versa. If findings of this kind are to be made precision is required, since a shift of an asset from one category to another will involve changes in the company's accounts, and, possibly, a liability to tax

BIM provides:

BIM60060 trading transactions: supervening trade [Jun 2016]
... Worthwhile cases should be pursued where it is possible to identify a clear change of intention with regard to the land. Such a change must be shown by reference to objective factors. An example might involve the demolition of a warehouse previously held as a capital asset and the construction for sale of residential flats. It is once again a question of fact and degree. The greater the change in character of the land, the stronger the argument that a supervening trade has commenced.
The change of intention will involve an appropriation of the capital asset to trading stock when the trading activity begins and there will therefore be a deemed disposal at that moment for Capital Gains Tax purposes.[3] The determination of that moment is a question of fact. You should therefore ensure that you examine the history of the project in sufficient detail to be able to identify and, if necessary, to argue for the appropriate date. This date will of course have implications both for the valuation of the land and the expenditure that is allowable as a trade expense or even as pre-trading expenditure under the legislation.
All cases involving supervening trading should be submitted to CTISA before listing for a contentious hearing before the tribunal.
BIM60065 supervening trade: limited development [Jun 2016]
Development of infrastructure alone (for example, the division of land into plots, the construction of access roads and the installation of mains services) is not sufficient to demonstrate the appropriation of land, previously acquired as a capital asset, to stock in trade. Such development is ambiguous as it can point to the preparation of the land for sale. Accordingly, you should obtain more evidence before arguing that a supervening trade has begun. Such development merely enhances the value of the capital asset: *The Hudson's Bay Company Ltd v Stevens* [1909] 5 TC 424.
BIM60070 supervening trade: planning permission [Jun 2016]
The obtaining of planning permission prior to sale does not, in itself, characterise a

[2] 53 TC 461 at p.491. See too *Taylor v Good* 49 TC 277 at p.287; *Page v Lowther* 57 TC 199 at p.217; *Hopscotch v HMRC* [2020] UKUT 294 (TCC).

[3] Author's footnote: see s.161 TCGA.

transaction as a trading transaction: *Taylor v Good* [1974] 49 TC 277. It may, however, provide evidence of intention and thus add weight, in certain circumstances, to a trading argument.

22.2.4 *Trading: Private residence*

BIM provides:

BIM60075 trading transactions: private residences [Jun 2016]
The fact that a dwelling has been used as the person's residence is not automatically fatal to a trading contention: *MacMahon and MacMahon v CIR* [1951] 32 TC 311.
However, to succeed in a trading argument in these circumstances, it is necessary to demonstrate that residential use was incidental to that person's primary objective which was to dispose of it by way of trade.

22.2.5 *Trading: Builders*

BIM provides:

BIM60080 trading transactions: builders [Jun 2016]
Where builders buy and resell land there is a special onus placed on them to show that the transaction is on capital account and not part of the trade, see *Harvey v Caulcott* [1952] 33 TC 159.
This does not mean that builders can never hold land other than as trading stock. It does mean that they have to point to evidence that it was not acquired as trading stock.

22.2.6 *Trading: Losses*

BIM provides:

BIM60085 trading transactions: loss making transactions [Jun 2016]
There may be periods when there is a slump in the property market.
In these circumstances a one off transaction may give rise to a loss. You may be faced with an argument, from a person who is not a land dealer, that the transaction was a trading transaction and the loss is relievable as a trading loss.
The same principles have to be used in determining the character of loss making transactions as profitable ones. Once again the final question is whether the transaction could fairly be described as a 'deal or an investment' (*Marson v Morton* [1986] 59 TC 381), albeit, in the latter case, an investment which went wrong. The key issue is the intention of the purchaser at the time of acquisition: *Lionel Simmons Properties Ltd v CIR* [1980] 53 TC 461...

22.2.7 *Trading: Land acquired as gift*

BIM provides:

BIM60090 trading transactions: land acquired by inheritance or gift [Jun 2016]
Where land is acquired by inheritance or gift, its subsequent disposal will not ordinarily be chargeable as trading income: *Hudson's Bay Company v Stevens* [1909] TC 424 and *Williams v Davies* [1945] 26 TC 371.
A possible exception to this general rule is where, following acquisition, the recipient

decides to use the property to start trading in land. This would be the commencement of a supervening trade (see BIM60060).

22.2.8 *Trading: case law summary*

There are a hundred or so cases on whether a transaction is trading in land. BIM sets out the correct approach to the case law:

> There are numerous decided cases and it is rarely profitable to spend time trying to find one which matches the facts of your case. It is much better to concentrate on the main principles, which can be extracted from the cases listed here.

HMRC's case law reading list is as follows:

BIM60160 trading transactions: useful land cases [Jun 2016]
The following is a list of useful land cases and the points of interest they illustrate....
Marson v Morton [1986] 59 TC 381:
- summary of badges of trading in land context
- the role of case law in arguing and presenting cases
- sale arranged prior to acquisition: a major trade pointer
- trading is a question of fact

Lionel Simmons Properties Ltd (in Liquidation) v CIR [1980] 53 TC 461:
- the importance of establishing intention on acquisition
- assets cannot be acquired with indeterminate status
- assets can change from investment to trading stock and vice versa
- judicial endorsement of concept of supervening trading

Iswera v CIR [1965] 1WLR 1985 ... :
- land bought partly for sale, partly for retention the former to finance the latter: transaction held to be trading
- equivocal/non equivocal transactions

Kirkham v Williams [1991] 64 TC 253:
- discussion of equivocal transactions
- discussion of dual motive transactions

Harvey v Caulcott [1952] 33 TC 159:
- the special position of builders in land transactions

The Hudson's Bay Company v Stevens [1909] 5 TC 421:
- the enhancement of land limited to development of the infrastructure does not entail trading

CIR v Reinhold [1953] 34 TC 389:
- whether adventure in the course of trade
- profit motive not conclusive of trading

Taylor v Good [1974] 49 TC 277, *Page v Lowther* [1983] 57 TC 199:
- supervening trading

Hopscotch Ltd v HMRC [2020] UKUT 294 (TCC) can be added to this list.

22.3 Dealing/developing UK land

The legislation was introduced in 2016. It was put into the Finance Bill at committee stage, so precluding consideration or debate. The professional organisations grumbled (eg the Law Society, "a disturbing precedent of avoiding proper consultation and scrutiny..."). [4] But no-one took any notice.

The background is discussed in an HMRC Technical Note. [5]

The rules relate only to UK land.

In accordance with the policy of the Tax Law Rewrite, the provisions are set out twice, once for IT and again for CT.

s.6(1A) ITTOIA	**s.5(2A) CTA 2009**
Profits of a trade of dealing in or developing UK land arising to a non-UK resident are chargeable to tax under this Chapter wherever the trade is carried on.	A non-UK resident company which carries on a trade of dealing in or developing UK land is chargeable to corporation tax on all its profits wherever arising that are profits of that trade.

In order to understand the significance of this, it may be helpful to review the pre-2016 position.

Income from a non-resident's land dealing/development trade was formerly subject to income tax under general principles if carried on in the UK, but that was likely to be the case. [6] The trade was also likely to have a UK PE. On that basis the trade would have been taxable even pre-2016. However the change may be significant in practice, because it was common before 2016 to seek to arrange that the trade was not carried on in the UK, and so was not taxable; or was carried on without a UK PE, and so could qualify for treaty exemption. In practice, HMRC did not strive to challenge that, and relied instead on the ToA rules. [7]

[4] Law Society Press Release 24 August 2016.

[5] HMRC, "Profits from Trading in and Developing UK Land" (2016) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/507766/1044_Budget_Day_Technical_Note__v2_0__3_.pdf*

[6] See 21.13.1 (Trading stock: land).

[7] See *Davies v HMRC* [2020] UKUT 67 (TCC) discussed at 3.20.5 (Special tax regime).

The provisions now preclude non-residents arguing that a trade of dealing/developing UK land is not subject to income tax, on the grounds that it is carried on outside the UK.

Income from a non-resident company's land dealing/development trade was formerly subject to CT under general principles if carried on in the UK through a UK PE. That was likely to be the case but it was possible for a land dealing trade to have no PE, and the same was at least theoretically possible for a development trade, in which case the non-resident company would be governed by IT rules.

The trend of moving non-resident companies profits from land from IT to CT continued with the FA 2019 CGT/property income reforms.

HMRC describe the charge as an expansion of the territorial scope of IT/CT, which it was, though it is open to question how large the expansion was.

22.3.1 *"Dealing/developing UK land"*

The provisions only apply to a trade of *dealing in or developing UK land.*

Section 6B ITTOIA provides:

> (1) A non-UK resident person's "trade of dealing in or developing UK land" consists of —
>
> (a) any activities falling within subsection (2) which the person carries on ...
>
> (2) The activities within this subsection are—
>
> (a) dealing in UK land;[8]
>
> (b) developing UK land for the purpose of disposing[9] of it.

Section 6B(1)(a) and (2) does not add anything to the natural meaning of dealing or developing.

Section 6B(1) ITTOIA provides:

> A non-UK resident person's "trade of dealing in or developing UK land" consists of ...
>
> (b) any activities from which profits arise which are treated under Part 9A of ITA 2007 [transactions in land] as profits of the

[8] Section 6B(3) ITTOIA (more or less) duplicates the Interpretation Act 1978 definition of land, so it adds nothing; see App 2.20 (Land).
Section 6B(4) ITTOIA provides (for the benefit of a reader unsure of the meaning of "UK"): "In this section ..."UK land" means land in the UK."

[9] Section 6B(4) ITTOIA provides: "In this section "disposal" is to be interpreted in accordance with section 517R of ITA 2007". See 22.22 ("Disposal").

person's trade of dealing in or developing UK land.

See 22.12 (TiL trade).

22.4 Land-dealing TAAR

s.6A ITTOIA	**s.5A CTA 2009**
(1) Subsection (3) applies if a person has entered into an arrangement[10] the main purpose or one of the main purposes of which is to obtain a relevant tax advantage for the person.	(1) Subsection (3) applies if a company has entered into an arrangement the main purpose or one of the main purposes of which is to obtain a relevant tax advantage for the company.
(3) The relevant tax advantage is to be counteracted by means of adjustments.	[Identical]
(4) For this purpose adjustments may be made (whether by an officer of Revenue and Customs or by the person) by way of an assessment, the modification of an assessment, amendment or disallowance of a claim, or otherwise.	[identical]

I refer to this as the **"land-dealing TAAR"**.

22.4.1 *"Relevant tax advantage*"

s.6A(5) ITTOIA	**s.5A(5) CTA 2009**
In this section "relevant tax advantage" means a tax advantage[11] in relation to income tax to which the person is chargeable (or would without the tax advantage be chargeable) by virtue of section 6(1A) [charge on dealing/ developing UK land].	In this section "relevant tax advantage" means a tax advantage in relation to corporation tax to which the company is chargeable (or would without the tax advantage be chargeable) by virtue of section 5(2A) [non-residents dealing/ developing UK land].

[10] Subsection (7) provides the standard (unnecessary) IT definition : see App 2.2.3 (Definitions of "arrangement").

[11] Section 6A(6) ITTOIA sets out the GAAR definition of "tax advantage"; see 3.19.1 (Tax advantage: Definitions).

22.4.2 *Treaty override*

Section 6A(2) ITTOIA/5A(2) CTA 2009 extend the TAAR with a treaty override:

> In subsection (1) the reference to obtaining a relevant tax advantage includes obtaining a relevant tax advantage by virtue of any provisions of double taxation arrangements,[12] but only in a case where the relevant tax advantage is contrary to the object and purpose of the provisions of the double taxation arrangements (and subsection (3) has effect accordingly, regardless of anything in section 6(1) of TIOPA 2010).

The wording is based on the OECD principal purpose test.[13]

Treaty relief would only apply in the absence of a UK PE.[14] When would arranging that be "contrary to the object and purpose" of a DTA? It would presumably suffice if the underlying beneficial owners are in the UK, and there is no commercial reason for using a company set up in the foreign treaty-state.

22.5 Transactions in land: Introduction

This section considers the rules in Part 9A ITA/Part 8ZB CTA 2010 (Transactions in land). I refer to this as the **"TiL code"**.

In accordance with the policy of the Tax Law Rewrite, the provisions are set out twice, once for IT and again for CT. The IT provisions were slotted in after s.517, and so are numbered 517A to 517U. The CT provisions (slotted in after sections numbered 356N to 356NO) are numbered 356OA to 356OT.[15]

22.6 Direct disposal of land

Section 517B(1) ITA/s.356OB(1) CTA 2010 provide:

[12] Section 6A(7) ITTOIA provides the standard commonsense definition: "In this section ... "double taxation arrangements" means arrangements which have effect under section 2(1) of TIOPA 2010 (double taxation relief by agreement with territories outside the UK)."

[13] See 108.8 (OECD principal purpose test).

[14] See 21.23 (DT relief: trading income).

[15] See App 13.3 (Section numbering system).
The 2018/19 ed of this work, para 17.4.1 (Comparison with pre-2016 rules), set out the differences between the current law and the pre-2016 law; but this is now omitted as it is of historical interest only. .

s.517B(1) ITA	**s.356OB(1) CTA 2010**
Section 517C(1) applies (subject to subsection (3) of that section)[16] if—	Section 356OC(1) applies (subject to subsection (3) of that section) if—
(a) a person within subsection (2)(a), (b) or (c) realises a profit or gain from a disposal of any land[17] in the UK, and	[identical]
(b) any of conditions A to D is met in relation to the land.	[identical]

In this chapter:

- A person within (1)(a) is a **"TiL person"**
- I abbreviate "profit or gain" to gain
- Conditions A to D are **"TiL gateway conditions"**:

22.7 TiL person

Section 517B(2) ITA/s.356OB(2) set out 3 categories of TiL person. They are so wide that it is difficult to see how there could be a disposal of land without many TiL persons:

> The persons referred to in subsection (1) are—
> (a) the person acquiring, holding or developing the land,
> (b) a person who is associated[18] with the person in paragraph (a) at a relevant time, and
> (c) a person who is a party to, or concerned in, an arrangement within subsection (3).

22.7.1 *Concerned in arrangement*

Section 517B(3) ITA/s.356OB(3) CTA 2010 provide:

> An arrangement is within this subsection if—
> (a) it is effected with respect to all or part of the land, and
> (b) it enables a profit or gain to be realised—
> (i) by any indirect method, or
> (ii) by any series of transactions.

[16] For this exception, see 22.12.2 (Income receipt exemption).

[17] Section 517S(1) ITA (more or less) duplicates the Interpretation Act definition of land, so it adds nothing; see App 2.20 (Land).

[18] See 22.9.3 ("Associated").

22.7.2 *Slice of action/overage*

BIM provides:

> **BIM60645 'Slice Of The Action' Contracts And Overage Arrangements** [May 2019]
>
> The transactions in UK land rules can be applied to 'slice of the action' contracts.
>
> 'Slice of the action' contracts are so called because they confer upon a landowner (who holds the land as an investment), the right to share in the proceeds of any subsequent development by the purchaser. In these cases, the contract for sale of the land to a builder or developer provides for consideration that is, in whole or in part, contingent upon the successful development of the land.
>
> A common arrangement is for the landowner to receive a fixed sum at the time of the disposal, plus a percentage of the sale proceeds of each building subsequently constructed by the purchaser on the land.
>
> Such 'slice of the action' contracts, and other overage arrangements where the landowner is entitled to receive consideration, if a specified condition is satisfied often fall within the transactions in UK land rules for the following reasons:
>
> - The landowner is included under the definitions of 'person'[19] as the 'slice of the action' contract or other specified contractual condition is an arrangement with the person holding the land.
> - The land has been developed with the main purpose of realising a profit or gain from disposing of the land when developed (condition D in Section 356OB(4)CTA 2010).
>
> **Example 1**
>
> A landowner sells land to a developer for £10m. At the date of sale the land is valued at the same amount.[20] The contract of sale specifies that if the developer makes profits in excess of £5m from developing the land the landowner will receive 10% of subsequent profits. The developer makes £8m profit and pays the landowner £300k.
>
> In this instance the landowner is concerned in an arrangement to develop the land and condition D is met. The £300k will be taxed as trading income.
>
> **Example 2**
>
> A landowner sells land to a developer for £6m. The developer's

[19] Author's footnote: More analytically, the landowner is within s.517B(2)(c) as a person concerned in the arrangement (in my terminology, a TiL person).

[20] This would not normally happen. But it simplifies the example.

> intention is to build a block of flats. The contract stipulates that £3m will be paid to the landowner immediately, and £3m will be paid to landowner at the earlier of 4 years after the date of sale or when 20 of the flats have been sold.
>
> Here the landowner is not concerned in an arrangement to develop the land. The £3m is deferred consideration receivable regardless of whether the land will be developed or not.
>
> ...
>
> **BIM60655 'Slice Of The Action' Contracts: Portion Of Charge May Be Exempt: Example** [May 2019]
>
> In a 'slice of the action' contract the effect of the exemption from the transactions in UK land rules can be significant. Normally, it removes an amount equal to the value of the land at the first intention date from the calculation of income chargeable to tax under those rules.
>
> **Example**
>
> A landowner agrees to sell some fields to a land developer for a fixed payment of £1m and a further payment of £0.5m which is contingent on the properties being built on the site being sold.
>
> - The initial fixed payment of £1m is made on 5/8/2016 ,
> - Further payments of £0.5m contingent on the development are agreed, and
> - The value when the contract is signed on 5/8/2016 (the first intention date) is £1.2m.
>
> The amount excluded from the calculation of the chargeable income is £1.2m, this amount is subject to chargeable gains tax or corporation tax on chargeable gains. The amount of income subject to income tax or corporation tax is £0.3m: the total payments received (£1.5m) less the value of the land at the first intention date (£1.2m).

For completeness: BIM adds:

> If, exceptionally, the first intention date value is less than the fixed initial payment, the amount of the gain taxed as income is the entirety of the contingent payments. The fixed initial payment is not within the calculation of the income since it is not contingent upon the development.
>
> **Example**
>
> A landowner sells land held for investment purposes to a developer for £5.2m. The developer intends to build 10 houses on the land. At the date of sale the land is valued at £5m and in this case this is the first intention date. The contract of sale specifies that £1m will be paid to the landowner when the first house is sold. At the date of sale £5.2m is recognised for capital gains tax purposes. Three years later the first

> house is sold. At this point condition D is met and the £1m will be taxed as trading income.

It is difficult to see how this could happen.

22.8 TiL gateway conditions

22.8.1 *Purpose to realise gain*

Condition A, B, and D relate to a purpose of realising a gain. Section 517B ITA/s.356OB CTA 2010 provide:

Condition A	**Condition B**	**Condition D**
(4) Condition A is that the main purpose, or one of the main purposes,	(5) Condition B is that the main purpose, or one of the main purposes,	(7) Condition D is that (in a case where the land has been developed) the main purpose, or one of the main purposes,
of acquiring the land	of acquiring any property deriving its value from the land	of developing the land
was to realise a profit or gain from disposing of the land.	was to realise a profit or gain from disposing of the land.	was to realise a profit or gain from disposing of the land when developed.

TiL condition A is not likely to arise, as if a main purpose of acquisition is to realise a gain on disposal, there is likely to be a trade on general principles.[21] But conditions B, C and D may arise.

22.8.2 *Trading stock*

Section 517B(6) ITA/s.356OB(6) CTA 2010 provide:

> Condition C is that the land is held as trading stock.

At first sight land held as trading stock would normally meet condition A, but perhaps the drafter was thinking of land acquired for investment and subsequently appropriated to trading stock.

[21] See 22.2 (What is trading in land).

22.8.3 *"Main purpose"*

BIM makes some general comments:

> **BIM60560: Main purpose or one of the main purposes** [May 2019]
> Conditions A, B and D contain a test of whether the "main purpose or one of the main purposes" for acquiring or developing the land, or the property deriving its value from land, was to make a profit or gain from disposal of land. This is a test of purpose, not of benefit or expectation. The concepts of 'the main purpose' and 'a main purpose' are used widely in UK tax law. A person may have more than one main purpose in entering into a transaction, and 'a main purpose' is a wider test than requiring something to be 'the main purpose'. It is therefore important to consider the question of trading alongside a main purpose test when considering whether or not this legislation applies, to ensure that what are genuinely non-trading transactions are not brought within its scope. An example of a type of arrangement where a main purpose test might be invoked would be a fact pattern similar to that in *Ransom v Higgs* [1974] 50 TC 1.

See 3.14 ("Main" purpose).

22.8.4 *Purpose to realise gain*

BIM provides:

> **BIM60555: Amounts treated as profits of a trade of dealing in UK land: Conditions** [May 2019]
> The purpose of this legislation is to ensure that profits from activities which, when looked at in the round, amount to (i) a trade in land or (ii) a trade of developing land, are taxed as trading profits. It is not the purpose of these rules to alter the treatment of activity that is clearly investment.
> The rules effectively look through structures or arrangements which might (?) allow an argument, that on a strict legal analysis, the transactions in question do not amount to a trade.
> These rules do not alter the treatment of or recharacterise investment activities, except where they are part of such a wider trading activity. In particular, they do not apply to transactions such as buying or repairing a property for the purpose of earning rental income, or as an investment to generate rental income and enjoy capital appreciation.
> The legislation should always be understood in the context that it is taxing only what are, in substance, trading profits.

BIM makes some general comments:

> **BIM60560: Main purpose or one of the main purposes** [May 2019]
> ... If a person buys land with the intention of
> [1] building on part of it to retain for their own purposes, and
> [2] of building on the rest of it for sale at a profit [in a manner consistent with trading activity][22],
> it is clear that one of their main purposes is to make a trading profit from development and disposal.
>
> In this instance at the point of acquisition the precise section of the land to be disposed of and the costs relating to that section may not be known. If this is the case profits should be calculated using the original cost of the land apportioned on a just and reasonable basis, subject to the anti-fragmentation provisions.
>
> It may be the case that an investor in UK property expects primarily to benefit from capital growth over time, in addition to obtaining rental yield. The legislation requires that a main purpose of the arrangement is to obtain a gain from disposing of the property. This condition will not be met in the case of straightforward long-term investment, where the economic benefit arising to the owner is the result of market movement from holding that asset rather than transactions that are in the nature of trading.
>
> An owner may also seek to increase the value of their property through improving the quality and security of the property's rental income, for example by negotiating longer leases. Alternatively, they may improve the property through some form of refurbishment in order to attract higher paying tenants, or subdivision of the property to attract more tenants, which again would increase the value of the property. Rental income is often an indicator that the asset is held as an investment, although this is not conclusive - an asset held for trading purposes could produce rental income over a relatively short period, equally an asset held over a longer period may for a number of reasons not produce income but could still be seen as an investment. The facts of each case will determine whether or not one of the main purposes is to make a trading profit from development and disposal.
>
> It is possible for the intention to change over time, at which point the main purpose test would need to be reconsidered (see examples 3, 4 and 5 below).

The HMRC examples are as follows:

[22] Author's footnote: Square brackets are original.

Example/Scenario	**TiL conditions met**
1 Investment + sale 7 years later after repairs	no
2 Development + sale 6 months after development	yes
3 Investment + change of intention after "several" years	yes but 517L relief
4 Purchase investment Co + intention to realise its assets	yes but 517L relief
5 Mixed trading/investment purpose	yes but apportion
6 Investment + redevelopment + sale 5 years later	no
7 Investment + unforeseen sale 2 years later	no
8 Investment + little rent + sale 5 years later	no
9 Investment + unforeseen sale 18 months later	no

> **Example 1 [Investment + sale 7 years later after repairs]**
> A non-resident property investor purchases a property with the primary purpose of realising rental income from the land purchased. When the investor purchased the land one of the factors they considered was likely capital appreciation of the land.
> After letting out the property for 7 years they make some repairs and dispose of the land.

The HMRC analysis is as follows:

> This is an example of an investment not trading transaction. The main purpose of the transaction is the rental income. Whilst the long term capital appreciation could be a reasonable expectation, it is clearly not a profit from a disguised trading transaction and would not therefore meet condition A.
> **Example 2 [Development + sale 6 months after development]**
> A non-resident property investor purchases a property with the intention of developing then selling the property. After developing the property they let it out for 6 months while they wait for the market to pick up.
> In this instance a main purpose of acquiring the land, was to realise a profit from disposing of the land and condition A would be met.
> **Example 3 [Investment + change of intention after "several" years]**
> An individual property investor acquires an old block of flats. They rent the flats out for several years then decide to build new flats on the site. They obtain planning permission for a new development which they complete and sell.
> In this example there has been a change of intention and Section 517L ITA 2007 will apply. Only the profit relating to the period after the change of intention should be taxed as a trading profit. The portion relating to the period where there was an investment intention should

not be included in the tax calculation.

Please see BIM60825 for details on apportionment.

Example 4 [Purchase investment Co + intention to realise its assets]

Company X purchases 100% of the share capital of company Y, which owns a UK property on investment account. Company X has the intention of realising a profit in a manner consistent with trading activity, by procuring company Y that subsequently sells the property. This would fall under Condition B.

In this example there has been a change of intention and Section 356OL CTA 2010 will apply. Only the profit relating to the period after the change of intention should be taxed as a trading profit. The portion relating to the period where there was an investment intention should not be included in the tax calculation.

Please see BIM60825 for details on apportionment.

Example 5 [Mixed trading/investment purchase]

An individual purchases a rundown block of flats. They intend to develop the flats into luxury apartments. After development they intend to keep 55 for rental and sell 45.

In this instance a main purpose of acquiring the land was to realise a profit or gain from disposing of it so condition A would be met. The profit relating to the 45 apartments should be taxed as trading income. Where it is not possible to specifically identify costs relating to the 45 apartments just and reasonable apportionment should be used.

Example 6 [Investment + redevelopment + sale 5 years later]

A non-resident property investor purchases an ageing block of offices in a prime location with the primary purpose of realising rental income from the land purchased. In order to achieve a higher rate of rent and a better quality of tenant, the investor redevelops the offices soon after the acquisition and then lets out the redeveloped offices for a period of 5 years. After such time they dispose of the land at a gain.

In this instance the main purpose of the transaction is the rental income. Whilst the office block is redeveloped, the primary purpose for doing so is to improve the yield from the investment rather than realise a gain.

Example 7 [Investment + unforeseen sale 2 years later]

A non-resident property investor purchases a property with a view to obtaining an income stream from the land purchased. At the time that the investor purchased the land it anticipated holding the property for over 5 years. In fact, after 2 years, the investor suffers a liquidity event and is forced to sell the property. The main purpose of the transaction is the rental income and the sale was motivated by a sudden unforeseen emergency. Condition A would not be met in this instance.

Example 8 [Investment + little rent + sale 5 years later]
A non-resident property investor purchases a property with a view to realising long term capital appreciation from the land purchased. The company will have to wait a significant number of years before the lease ends, or the tenant is prepared to surrender the lease. During the time that the property is held, the rental profits are poor, perhaps due to a rent-free period or vacancy arising from unexpected occupier insolvency. The investor sells the property after 5 years for a significant profit due to a market increase in the value of the land. This is an example of an investment and not trading transaction and condition A would not be met.

Example 9 [Investment + unforeseen sale 18 months later]
A non-resident property investor purchases a property with a view to realising rental income from the land purchased. At the time that the investor purchased the land it anticipated holding the property for over 5 years. In fact, after 18 months, the investor sells the property early as a result of unforeseen circumstances.

In this instance the main purpose of the transaction is the rental income and the sale was motivated by unforeseen circumstances so condition A would not be met.

22.9 Definitions

22.9.1 *"Relevant time"*

Section 517B(8) ITA/s.356OB(8) CTA 2010 provide:

> In this section "relevant time" means any time in the period beginning when the activities of the project begin and ending 6 months after the disposal mentioned in subsection (1).

This only applies for s.517B ITA/s.356OB CTA 2010, so the definition is repeated verbatim in s.517H(6) ITA/s.356OH(6) CTA 2010.

22.9.2 *"The project"*

Section 517B(9) ITA/s.356OB(9) CTA 2010 provide:

> In this section "the project" means all activities carried out for any of the following purposes—
> (a) the purposes of dealing in or developing the land, and
> (b) any other purposes mentioned in Conditions A to D.

This only applies for S.517B ITA/s.356OB CTA 2010, so the definition is repeated verbatim in s.517H(10) ITA/s.356OH(10) CTA 2010.

22.9.3 *"Associated"*

"Associated" person matters because the word is used in:

(1) s.517B(10) ITA/s.356OB(10) CTA 2010: definition of TiL person in direct disposal condition (a)[23]

(2) s.517H(9) ITA/s.356OH(9) CTA 2010: fragmentation rule

s.517B(10) ITA	**s.356OB(10) CTA 2010**
For the purposes of this section a person ("A") is associated with another person ("B") if—	[identical]
(a) A is connected with B by virtue of any of subsections (2) to (4) of section 993 (read in accordance with section 994), or	(a) A is connected with B by virtue of any of subsections (5) to (7) of section 1122 (read in accordance with section 1123), or
(b) A is related to B (see section 517U).	(b) A is related to B (see section 356OT).

This only applies for s.517B/356OB, so the definition is repeated verbatim in s.517H(9) ITA/356OH(10) CTA 2010.

The term "related" is used in the definition of "associated".[24] The definition is in s.517U ITA/s.356OT CTA 2010; see 57.7 ("Related party").

22.10 Indirect disposal of land

s.517D(1) ITA	**s.356OD(1) CTA 2010**
(1) Section 517E(1) applies (subject to subsection (3) of that section) if—	(1) Section 356OE applies (subject to subsection (3) of that section) if—

There follow three conditions, or sets of conditions, which I call indirect disposal conditions (a) to (c).

22.10.1 *Condition (a): Land-rich asset*

s.517D(1) ITA	**s.356OD(1) CTA 2010**
Section 517E(1) applies (subject to subsection (3) of that section) if—	Section 356OE applies (subject to subsection (3) of that section) if—

[23] See 22.7 (TiL person).

[24] See 22.9.3 ("Associated").

(a) a person realises a profit or gain from a disposal of any property which (at the time of the disposal) derives at least 50% of its value from land[25] in the UK	[identical]

I refer to this as an **"indirect disposal of land"** and property within (a) is a "**land-rich asset**".

22.10.2 *Condition (b): Concerned in arrangement*

s.517D(1) ITA	**s.356OD(1) CTA 2010**
Section 517E(1) applies (subject to subsection (3) of that section) if...	Section 356OE applies (subject to subsection (3) of that section) if...
(b) the person is a party to, or concerned in, an arrangement concerning some or all of the land mentioned in paragraph (a) ("the project land")	[identical]

BIM provides:

> **BIM60845: Definitions: Arrangement** [May 2019]
> ... To be in an arrangement[26] it is necessary to be acting together in some way or to have knowledge of the purpose of the arrangement. Where there is a small shareholder who has no or little input into the company which is developing the land, it is unlikely they will be concerned in an arrangement. There is a large spectrum of situations and the specific circumstances will determine whether an individual or company is concerned in an arrangement.
> **Example 1**
> An individual shareholder purchases a small number of shares in one of the UK's largest house builders. After holding these shares for a period they decide to dispose of the shares.
> In this instance it is unlikely the individual is concerned in an arrangement. They are unlikely to be acting together with the house

[25] Section 517S(1) ITA (more or less) duplicates the Interpretation Act 1978 definition of land, so it adds nothing; see App 2.20 (Land).

[26] Author's footnote: This is a loose paraphrase of the statutory term, which is "party to or concerned in" an arrangement. But nothing turns on that.

builder to deal in or develop UK land.

Example 2

An individual purchases 60% of the shares in a company which has been set up to purchase and develop a piece of land. The company will not be selling the land but will be sold to the person who wants to acquire the land. The reason for purchasing the shares was to purchase a portion of the land which will be disposed of after it is developed. When the land is developed the individual sells their shares to a third party.

In this instance it is likely the individual has been concerned in an arrangement to develop the land.

22.10.3 *Condition (c): Purpose of gain*

s.517D(1) ITA	**s.356OD(1) CTA 2010**
Section 517E(1) applies (subject to subsection (3) of that section) if...	Section 356OE applies (subject to subsection (3) of that section) if...
(c) the arrangement meets the condition in subsection (2).	[identical]

Section 517D(2) ITA/s.356OD(2) CTA 2010 provide:

> The condition is that the main purpose, or one of the main purposes, of the arrangement is to—
> (a) deal in or develop the project land, and
> (b) realise a profit or gain from a disposal of property deriving the whole or part of its value from that land.

This is a rough equivalent of the TiL gateway conditions which apply on a direct disposal.[27]

22.11 Deriving/attributing value

These concepts cannot sensibly be defined, but that does not stop the drafter from trying.[28]

22.11.1 *Deriving value*

Section 517S(2) ITA/s.356OR CTA 2010 provide a commonsense definition:

[27] See 22.8 (TiL gateway conditions).

[28] See App 2.9.8 (Derive/represent value).

> In this Part [Part 9A ITA, transactions in land/Part 8ZB CTA 2010, transactions in UK land] references to property deriving its value from land include—
>
> (a) any shareholding in a company deriving its value directly or indirectly from land,
>
> (b) any partnership interest deriving its value directly or indirectly from land,
>
> (c) any interest in settled property deriving its value directly or indirectly from land, and
>
> (d) any option, consent or embargo affecting the disposition of land.

22.11.2 *Attributing value*

For the purposes of the 50% test it is necessary to ascertain how much value one item of property derives from another.

Section 517N ITA/s.356OM CTA 2010 provide a commonsense rule:

> (1) This section applies if it is necessary to determine the extent to which the value of any property or right is derived from any other property or right for the purposes of this Part [Part 9A CTA, transactions in land/Part 8ZB CTA 2010, transactions in UK land].
>
> (2) Value may be traced through any number of companies, partnerships, trusts and other entities or arrangements.
>
> (3) The property held by a company, partnership or trust must be attributed to the shareholders, partners, beneficiaries or other participants at each stage in whatever way is appropriate in the circumstances.

Section 517N(4) ITA/s.536OM(4) CTA 2010 set out foreign-entity definitions of partnership/partner/ trust/beneficiary, but these are otiose; see 90.3.3 (Foreign-entity clauses).

22.12 TiL trade

The rules for direct/indirect disposals are in s.517C/E ITA and s.356OC/E CTA 2010, and it is helpful to read them side by side:

Direct disposal **s.517C ITA**	**Indirect disposal** **s.517E ITA**
(1) The profit or gain [from the disposal of land] is to be treated for income tax purposes as profits of a trade carried on by the chargeable person.	(1) The relevant amount is to be treated for income tax purposes as profits of a trade carried on by the chargeable person.

s.356OC CTA 2010	**s.356OE CTA 2010**
(1) The profit or gain [from the disposal of land] is to be treated for corporation tax purposes as profits of a trade carried on by the chargeable company (see section 356OG).	(1) The relevant amount is to be treated for corporation tax purposes as profits of a trade carried on by the chargeable company.

I refer to the deemed trade as the **"TiL trade"**.

The TiL code does not have its own charging provision: the income falls under the general charge on trading income.

The (deemed) trading income does not qualify as RFI.[29]

Section 517E (indirect disposal) is the same as s.517C (direct disposal) except the quantum of the charge is on the relevant amount, not the gain.

22.12.1 *Deemed development trade*

Direct disposal	**Indirect disposal**
s.517C ITA	**s.517E ITA**
(2) If the chargeable person is non-UK resident, that trade is the person's trade of dealing in or developing UK land (as defined in section 6B of ITTOIA 2005).	(2) If the chargeable person is non-UK resident, that trade is the chargeable person's trade of dealing in or developing UK land.
s.356OC CTA 2010	**s.356OE CTA 2010**
(2) If the chargeable company is non-UK resident, that trade is the company's trade of dealing in or developing UK land (as defined in section 5B of CTA 2009).	(2) If the chargeable company is non-UK resident, that trade is the company's trade of dealing in or developing UK land.

The wording is effectively the same. The point is to bring into effect the anti-avoidance rules relating to dealing/developing UK land by non-residents; see 22.3 (Dealing/developing UK land).

22.12.2 *Income receipt exemption*

It is helpful to compare the rules for direct/indirect disposals, so I set them

[29] See 16.9.2 ("Relevant foreign income").

side by side. The IT/CT rules are substantially identical, but I set out both for completeness:

Direct disposal	**Indirect disposal**
s.517C(3) ITA	**s.517E(3) ITA**
But subsection (1) [deemed trade] does not apply to a profit or gain [from the disposal of land] so far as it would (apart from this section) be brought into account as income in calculating profits (of any person)— (a) for income tax purposes, or (b) for corporation tax purposes	But subsection (1) [deemed trade] does not apply to an amount [ie a relevant amount] so far as it would (apart from this section) be brought into account as income in calculating profits (of any person)— (a) for income tax purposes, or (b) for corporation tax purposes.
s.356OC(3) CTA 2010	**s.356OE(3) CTA 2010**
(3) But subsection (1) [deemed trade] does not apply to a profit or gain [from the disposal of land] so far as it would (apart from this section) be brought into account as income in calculating profits (of any person)— (a) for corporation tax purposes, or (b) for income tax purposes.	(3) But subsection (1) [deemed trade] does not apply to an amount [ie a relevant amount] so far as it would (apart from this section) be brought into account as income in calculating profits (of any person)— (a) for corporation tax purposes, or (b) for income tax purposes.

BIM Manual gives an example in relation to the indirect disposal charge:

> **BIM60575 Disposals Of Property Deriving Its Value From Land** [May 2020]
> ... **Example**
> A new company is set up to acquire land and develop an office building thereon. The land is not held as trading stock. Once the development is completed, the intention is to sell the company shares as a means of disposing of the development (enveloping) rather than selling the land and buildings directly. If all of the conditions at s.356OD CTA 2010 or s.517 ITA2007 are met the rules will apply to tax the profit on disposal of the shares as income.

This is sensible, though far from obvious from the legislation.

22.12.3 *Date income arises*

s.517C(4)/517E(4) ITA	**s.356OC(4)/356OE(4) CTA 2010**
The profits are treated as arising in the tax year in which the profit or gain is realised.	The profits are treated as arising in the accounting period of the chargeable company in which the profit or gain is realised.

BIM provides:

> **BIM60625 Period In Which The Gain Is Taxed** [May 2019]
> The profit or gain is chargeable in the:
>
> - tax year in which the gain arises (where the person liable for the tax is an individual, a trustee or a personal representative), or
> - accounting period in which the gain arises (where the person liable for the tax is a company). Guidance on accounting periods can be found at CTM01410
>
> **Example 1**
> Company X has an accounting period ending on 31 December 2017. It disposes of a property on 12 May 2017. The profit will be taxable in the accounting period ending 31 December 2017.
>
> **Example 2**
> Non-resident Company X was not within the charge to UK taxation prior to the new legislation. At the date the new legislation came into force they were carrying on a trade of dealing in or developing UK land. As the company has first come into charge to corporation tax on the date of the introduction of the new legislation (5th July 2016) a new accounting period will begin on that date.
>
> **Example 3**
> Non-resident Company Y had a permanent establishment in the UK prior to the introduction of the new legislation. As the company has been chargeable to CT throughout this will not cause the cessation of a tax accounting period and the commencement of a new one.

22.12.4 *Capital gain*

Sections 517C(5)/517E(7) ITA and 356OC(5)/356OE(7) CTA 2010 are all identical:

> This section applies in relation to gains which are capital in nature as it applies in relation to other gains.

In contemporary tax usage, the word gain is usually reserved for gains of a capital nature. If the profit (gains) are of an income nature, the TiL code does not apply.

22.12.5 *Relevant amount*

Relevant amount matters as the indirect disposal charge is on the relevant amount.

s.517E ITA	**s.356OE CTA 2010**
(5) In this section the "relevant amount" means so much (if any) of the profit or gain mentioned in section 517D(1) as is attributable, on a just and reasonable apportionment, to the relevant UK assets.	(5) In this section the "relevant amount" means so much (if any) of the profit or gain mentioned in section 356OD(1) as is attributable, on a just and reasonable apportionment, to the relevant UK assets.
(6) In this section "the relevant UK assets" means any land in the UK from which the property mentioned in section 517D(1) derives any of its value (at the time of the disposal mentioned in that subsection).	(6) In this section "the relevant UK assets" means any land in the UK from which the property mentioned in section 356OD(1) derives any of its value (at the time of the disposal mentioned in that subsection).

BIM provides:

> **BIM60590: Relevant amount and relevant assets** [May 2019]
> ...In all calculations, a just and reasonable basis should be used for apportionment.
>
> **Example 1**
>
> A company disposes of its shareholding in a company. The shares were purchased with the intention of dealing in the project land and making a profit from disposing of the shares which derives their value from the land. The shares are worth £10m, £6m of the value relates to a block of flats based in the UK and £4m to a housing development outside the UK. In this instance, and assuming that the acquisition costs of the shares is nil, the block of flats is the relevant UK asset and the relevant amount is £6m. If consideration paid for the shares was £5m, and 60% of that cost related to the UK development, the relevant amount would be £3m (£6m less 60% of £5m).
>
> **Example 2**
>
> An individual purchases shares in a company which is developing a large housing estate. The shares were valued at £10m and the value is derived entirely from UK Land. When the individual purchased the shares they intended to dispose of 40% of the shares to an individual

who wished to purchase the land after development and hold on to the remaining 60% for the capital appreciation. In this instance the relevant UK assets are the £4m of land. The remaining £6m are investment assets, and not subject to the new legislation.

22.13 Chargeable person/company

Chargeable person/company matters because the TiL trade is deemed to be carried on by the chargeable person/company, and so the chargeable person/company is subject to the tax.[30]

s.517G ITA	**s.356OG CTA 2010**
(1) For the purposes of sections 517C and 517E the general rule is that the "chargeable person" is the person ("P") that realises the profit or gain (as mentioned in section 517B(1) or 517D(1)).	(1) For the purposes of sections 356OC and 356OE the general rule is that the "chargeable company" is the company ("C") that realises the profit or gain (as mentioned in section 356OB(1) or 356OD(1)).

Section 517G ITA/ s.356OG CTA 2010 signposts some exceptions:

s.517G ITA	**s.356OG CTA 2010**
(2) The general rule in subsection (1) is subject to the special rules in subsections (4) to (6).	[identical]
(3) But those special rules do not apply in relation to a profit or gain to which section 517H(3) (fragmented activities) applies.	(3) But those special rules do not apply in relation to a profit or gain to which section 356OH(3) (fragmented activities) applies.

22.13.1 *Provider of value*

s.517G ITA	**s.3560G CTA 2010**
(4) If all or any part of the profit or gain accruing to P is derived from value provided directly or indirectly by another person ("B"), B is the "chargeable person".	(4) If all or any part of the profit or gain accruing to C is derived from value provided directly or indirectly by another person ("B") which is a company, B is the "chargeable company".

[30] See 22.12 (TiL trade).

(5) Subsection (4) applies whether or not the value is put at the disposal of P.	(5) Subsection (4) applies whether or not the value is put at the disposal of C.

22.13.2 *Provider of opportunity*

s.517G(6) ITA	**s.356OG(6) CTA 2010**
If all or any part of the profit or gain accruing to P is derived from an opportunity of realising a profit or gain provided directly or indirectly by another person ("D"), D is "the chargeable person" (unless the case falls within subsection (4)).	If all or any part of the profit or gain accruing to C is derived from an opportunity of realising a profit or gain provided directly or indirectly by another person ("D") which is a company, D is "the chargeable company" (unless the case falls within subsection (4)).

BIM provides:

> **BIM60830: Definitions: Realising a gain** [May 2019]
> **... Example**
> Person A ("A") and person B ("B") are related parties.
> If, by a premature sale, A directly or indirectly transmits the opportunity of realising a profit or gain to another B, then A realises B's profit or gain for B.

BIM provides:

> **BIM60820: Definitions: The chargeable company or person** [May 2019]
> ... Since the tax charge is raised on the third party (i.e. someone who is not a party to the transaction in land), clear and convincing evidence is needed to show that this person, as a matter of fact, is the provider of value or the opportunity for gain. The third party may transmit the value or opportunity directly or indirectly.
> When a person has purchased land or an interest in land at market value under a normal commercial arrangement in the absence of other factors the special rules will not apply to regard them as providing the value for a gain to be realised, or the opportunity to derive that value.
> **Example 1** [Transfer at undervalue]
> Mr B transfers developed land at £1m, which is £9m undervalue, to Company A a non UK resident company in which he is the sole shareholder.
> Company A immediately sells the land realising a £9m profit and immediately goes into liquidation.

The HMRC analysis is as follows:

> In this scenario Mr B would be the chargeable person in respect of that £9m gain.

But is it correct that company A has made a £9m gain?

> **Example 2** [Sale of SPV]
> Company B - a wholly owned subsidiary of company A - develops a property as an investment. Company A sells the shares in company B to company C as soon as the development is complete, and the transaction is caught by the enveloping rules. In this situation, company A would remain the chargeable person - not company B (merely because it had developed the property), nor, company C (as the acquirer of the shares).

BIM provides:

> **BIM60580: Disposals of property deriving its value from land** [May 2019]
> ... Where a company or individual are charged by virtue of S356OD CTA 2010 or Section 517D ITA 2007, they may not have started a trade prior to the point of disposal. If this is the case the obligation to notify will arise when the shares are disposed of.
> **Example 1**
> Company X owns 100% of Company Y. Company Y purchases a piece of UK land and carries out the development of a block of flats. Company Y has no other substantial assets so over 50% of the company's value relates to the land. The intention of Company X is for Company Y to develop the land and to immediately dispose of their shares in Company Y when the land is developed. The land is not held as trading stock by Company Y. When the development is completed Company X sells the shares in Company Y to a third party.
> In this example the disposal meets the conditions and is a disposal of property deriving its value from land. The profits should be treated as trading profits of Company X.
> **Example 2**
> Company X purchases 100% of the share capital of Company Y, whose only asset is a dated office block that is held on investment account. Company X purchased the shares in company Y to hold as an investment and yield income.
> After a period of rental there is a change of intention and a decision to redevelop and sell the office block. To carry out this disposal it is

agreed Company X will dispose of its shares in company Y when the redevelopment is complete.

In this example there has been a change of intention and Section 356OL CTA 2010 will apply. Only the profit relating to the period after the change of intention should be taxed as a trading profit. The portion relating to the period where there was an investment intention should not be included in the tax calculation.

Please see BIM60825 for details on apportionment.

22.14 Fragmentation

s.517H ITA	**s.356OH CTA 2010**
(1) Subsection (3) applies if – (a) a person ("P") disposes of any land in the UK,	(1) Subsection (3) applies if— (a) a company ("C") disposes of any land in the UK,
(b) any of conditions A to D in section 517B is met in relation to the land,[31] and	(b) any of conditions A to D in section 356OB is met in relation to the land, and
(c) a person ("R") who is associated[32] with P at a relevant time has made a relevant contribution to activities falling within subsection (2).	(c) a person ("R") who is associated with C at a relevant time has made a relevant contribution to activities falling within subsection (2).
(2) The following activities fall within this subsection— (a) the development of the land, (b) any other activities directed towards realising a profit or gain from the disposal of the land.	[identical]

22.14.1 *Anti-fragmentation rule*

If these conditions are satisfied, s.517H ITA/s.356OH CTA 2010 recomputes the profit/gain:

s.517H ITA	**s.356OH CTA 2010**
(3) For the purposes of this Part	(3) For the purposes of this Part,

[31] See 22.8 (TiL gateway conditions).

[32] See 22.9.3 ("Associated").

[Part 9A ITA, transactions in land], the profit or gain (if any) realised by P from the disposal is to be taken to be what that profit or gain would be if R were not a distinct person from P (and, accordingly, as if everything done by or in relation to R had been done by or in relation to P).	the profit or gain (if any) realised by C from the disposal is to be taken to be what that profit or gain would be if R were not a distinct person from C (and, accordingly, as if everything done by or in relation to R had been done by or in relation to C).
(4) Subsection (5) applies to any amount which is paid (directly or indirectly) by R to P for the purposes of meeting or reimbursing the cost of income tax which P is liable to pay as a result of the application of subsection (3) in relation to R and P.	(4) Subsection (5) applies to any amount which is paid (directly or indirectly) by R to C for the purposes of meeting or reimbursing the cost of corporation tax which C is liable to pay as a result of the application of subsection (3) in relation to R and C.
(5) The amount— (a) is not to be taken into account in calculating profits or losses of either R or P for the purposes of income tax or corporation tax, and (b) is not for any purpose of the Corporation Tax Acts to be regarded as a distribution.	(5) The amount— (a) is not to be taken into account in calculating profits or losses of either R or C for the purposes of income tax or corporation tax, and (b) is not for any purpose of the Corporation Tax Acts to be regarded as a distribution.

22.14.2 *"Relevant contribution"*

s.517H ITA	**s.356OH CTA 2010**
(7) For the purposes of this section any contribution made by P to activities falling within subsection (2) is a "relevant contribution" unless the profit made or to be made by P in respect of the contribution is insignificant having regard to the size of the project.	(7) For the purposes of this section any contribution made by R to activities falling within subsection (2) is a "relevant contribution" unless the profit made or to be made by R in respect of the contribution is insignificant having regard to the size of the project.
(8) In this section "contribution" means any kind of contribution,	[identical]

including, for example—
(a) the provision of professional or
other services, or
(b) a financial contribution
(including the assumption of a risk).

BIM provides:

> **BIM60610: Relevant Contribution** [May 2019]
> The anti-fragmentation rules address the risk that a developer carrying on a trade of dealing in or developing UK land could enter into arrangements to move profits to a connected party, where the connected party is not chargeable to UK tax on the profit that they realise. This could, for example, arise where a firm supplying professional services is allocated a share of the profit from the disposal of the land. It could also arise where interest is paid to a connected party based to any extent on sharing profits from the development.
> ... All contributions are considered to be relevant contributions unless they are insignificant when considered in relation to the size of the project.
> The significance of a contribution in relation to the size of a project will depend on the facts and circumstances of each instance.
> One situation where a contribution is likely to be considered insignificant is if it is a Low Value Added Service (LVAS). This is because the mark-up for a LVAS is typically low, so the cost is not likely to be material in respect of the project.

The Manual gives 3 straightforward examples.

> **Example 1**
> Company X carries on a trade of dealing in or developing UK land. It receives admin services from a group company and pays a mark-up of 2% on the costs. In this instance the contribution would be regarded as insignificant and the fragmentation rules would not apply.
> **Example 2**
> Company Y carries on a trade of dealing in or developing UK land. A group company (Company Z) designs all of the buildings. Company Y pays Company Z 10% of the profits for the provision of architectural services. In this instance the profit made by Y would not be regarded as insignificant with regards to the size of the project and the fragmentation rules will apply.

Example 3
Company A carries on a trade of dealing in or developing UK land. The group has an intra group service centre run by Company B which provides IT and HR services. The costs which relate to Company A are recharged by Company B. In this instance any profit in Company B is likely to be minimal so the contribution will be insignificant.

22.14.3 *Interest*

BIM provides:

BIM60611: Anti-fragmentation: Interest [May 2019]
A financial contribution is considered a relevant contribution where it includes the assumption of risk by the lender. The rules are targeted at loans which aim to transfer a portion of the project profit from the company making the disposal to an associated company.

There is a relevant contribution where there is an intra group loan which results in the lender being entitled to a proportion of the profit or gain from the project (e.g. via a profit participating loan), or an intra group loan which results in the lender taking on a portion of the risk from the project. In both of these instances the interest payments may result in profits being fragmented to the lender.

Whilst interest payments may be at arm's length, they may still be relevant contributions. For example, if there is a mezzanine loan with an interest rate which is high - due to the lender taking on project risk - the loan could be arm's length, but as the high interest rate is linked to the risk of the project, it would be a relevant contribution.

Anti-fragmentation does not relate to senior lending with terms and interest rates commensurate with those available in the open market or to mezzanine debt where there is no participation in the profits/gains and/or no risk premium element; it only applies where and to the extent that significant project risk is taken on by the lender.

It is likely that if the profit is insignificant then this will be because, for example, the other party has not taken on a significant level of risk in relation to the overall project, although - as with all aspects - this has to be considered in the round.

Where a loan is from an unconnected party the anti-fragmentation rules will not apply. The rules will also not apply where lending from an unconnected party has been on-lent in whole or in part on materially the same terms.

Any loan where there is no risk premium reflected in the interest and where the interest is not linked to the profit from the disposal will not be considered a relevant contribution. In these instances the interest payments will be allowable deductions unless they are disallowed by other legislation.

Where there is a loan between connected parties which has both a portion with a risk premium and a portion without a risk premium, only the portion with the risk element will be considered to be a relevant contribution.

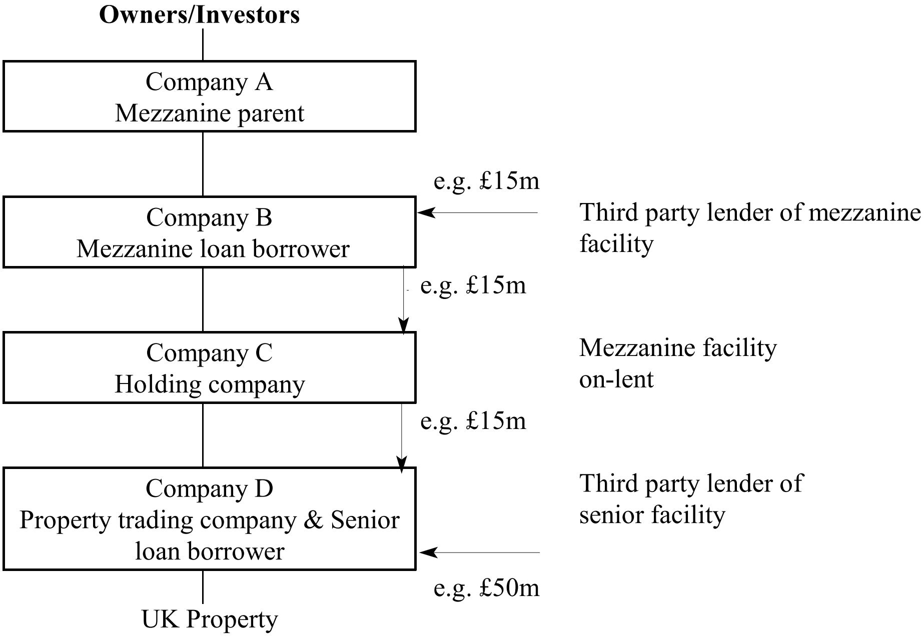
Example 1

Company C has raised as much bank finance as it can, at normal rates, to finance an apartment development. R makes a loan of £300m to Company C with a high interest rate to reflect taking on part of the risk of the project. In this instance the loan is a relevant contribution.

Example 2

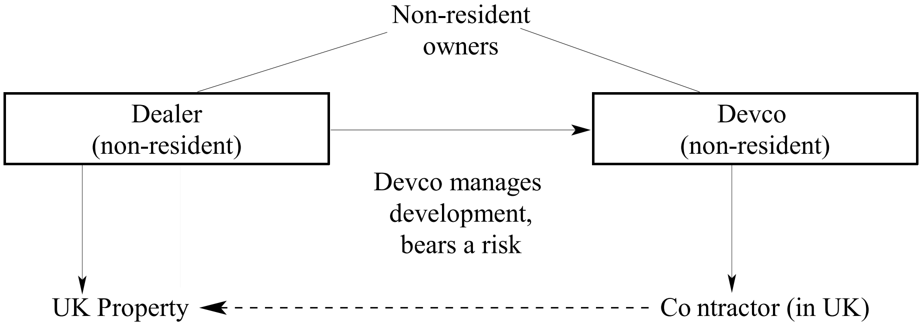
R makes a loan of £100m to Company C, at normal senior rates, and this is 30% of the cost of the land. The loan is made for the initial acquisition of land and there are no unusual terms in the loan. In this instance the loan would not be considered to be a relevant contribution.

Example 3


Owners/Investors
Company A
Mezzanine parent
e.g. £15m
Company B
Mezzanine loan borrower
Third party lender of mezzanine facility
e.g. £15m
Company C
Holding company
Mezzanine facility on-lent
e.g. £15m
Company D
Property trading company & Senior loan borrower
Third party lender of senior facility
e.g. £50m
UK Property

In the example above the interest deductions would not be considered to be relevant contributions as they are all on-lending of external finance. Where there is external funding this can be traced through any number of companies.

BIM60615: Antifragmentation: Example [May 2019]



In the situation above, 'Dealer' is subject to the new charge, as 'Dealer' will realise a profit from the disposal of UK Land.

In this case 'Dealer' does not have the assets (e.g. cash) or employees to manage the risk comprised in the development. Instead, the risks associated with the development are funded by 'Devco'.

In this example 'Devco' performs many of the significant people functions (SPFs), and as such is paid the majority of the profits realised from the sale of the UK property. This is done in a manner that is designed to be compliant with UK transfer pricing methodologies.

The contribution 'Devco' is making to the development of the land is not insignificant and the anti-fragmentation rules will apply in this case.

- 'Dealer' has disposed of land in the UK,
- Condition A is met in relation to the land, and
- 'Devco' has made a relevant contribution to the development of the land by assuming the risk.

Any profit realised by 'Devco' will be taxed on 'Dealer' as if 'Dealer' and 'Devco' were one entity. Only profits of 'Devco' that are directly attributable to Dealer are taxed in that entity, while Devco's other [unrelated] profits remain taxable in 'Devco.'

If 'Devco' is a UK resident Section 356OC(3) CTA 2009[33] would provide relief, so far as the profits would be brought into account as income in calculating profits (of any other person).

22.15 Calculation of gain

s.517I ITA	**s.356OI CTA 2010**
For the purposes of this Part [Part 9A, transactions in land],	For the purposes of this Part [Part 8ZB, transactions in UK land],

[33] See 22.12.2 (Income gain outside TiL).

(a) the profit or gain (if any) from a disposal of any property is to be calculated according to the principles applicable for calculating the profits of a trade under Part 2 of ITTOIA 2005,	(a) the profit or gain (if any) from a disposal of any property is to be calculated according to the principles applicable for calculating the profits of a trade under Part 3 of CTA 2009,
(b) subject to any modifications that may be appropriate	[identical]
(c) (and for this purpose the same rules are to apply in calculating losses from a disposal as apply in calculating profits).	[identical]

Section 517J ITA/s.356OJ CTA 2010 deal with apportionment in a commonsense way:

> Any apportionment (whether of expenditure, consideration or any other amount) that is required to be made for the purposes of this Part [Part 9A ITA, transactions in land/Part 8ZB CTA 2010, transactions in UK land] is to be made on a just and reasonable basis.

BIM provides:

> **BIM60620: Calculation of profit or gain** [May 2019]
> After it has been determined that the profits should be treated as trading profits, Section 356OI CTA 2010 and Section 517I ITA 2007 determine how the profit or loss from the disposal should be calculated. The profits should be calculated in accordance with the normal principles for calculating profits of a trade. These principles can be found at Part 2 ITTOIA 2005 for income tax and Part 3 CTA 2009 for corporation tax.
> Where a deduction would be allowable or receipt taxable, if a UK resident business was carrying out the trade, then the same should apply to a non-resident which has a trade of dealing in or developing UK land.
> Where a non-resident company comes within the scope of corporation tax, stock should be recognised at 'carrying value'.. Where an asset is not held as a trading asset the asset should also be brought in at cost. The deeming provisions in Section 41 CTA 2009 are not sufficient to invoke the provisions of Section 158/160 CTA 2009, in order to determine the opening value of stock.
> The trading profits of the development activity should be calculated

> based on UK GAAP or any other acceptable GAAP.
> Where the non-resident business disposes of UK land as only part of a trade, or if it carries on more than one trade, the profit or loss should be apportioned between the UK land trade and the other trade on a just and reasonable basis.

22.15.1 *Losses*

BIM provides:

> **BIM60620: Calculation of profit or gain** [May 2019]
> Carried forward trade losses will be available for use in the normal way. If a company was carrying on a trade of developing UK land - prior to enactment of the new legislation on 5 July 2016 - and was within the charge to CT by virtue of having a permanent establishment in the UK, Section 45 CTA 2010 applies, as the company will be carrying on the same trade [albeit not within the charge to CT under Section 5B CTA 2009]. Therefore, trading losses that accrued before 5 July 2016 will continue to be available to offset against future income of the same trade under Section 45 CTA 2010.

22.15.2 *Group relief*

BIM provides:

> **BIM60620: Calculation of profit or gain** [May 2019]
> Group relief will be permissible in the normal way. Whilst Section 134 CTA 2010 has a "UK related" condition, Section 1141(1) CTA 2010 provides that a company has a permanent establishment in a territory if it has a fixed place of business there through which the business of the company is wholly, or partly carried on. Section 1141(2)(h) provides that a fixed place of business includes a building site or construction or installation project.[34] HMRC's position is that most UK property development sites will fall under Section 1141(2)(h) CTA 2010 and meet the "UK related" condition at Section 134 CTA 2010.

22.15.3 *Foreign taxation*

BIM provides:

> **BIM60600: Fragmented activities overview** [May 2019]
> ...Where an amount is taxed by another jurisdiction unilateral relief may be available and/or an application for Mutual Agreement

[34] See 106.11.1 (Building/construction site).

Procedure (MAP) may be made.

22.15.4 *Interaction of TiL/CGT*

The general rule is that where the person making a disposal is subject to income tax on the proceeds, IT has priority over CGT, and there is no double charge.[35] This rule does not work where X makes a disposal but the income is treated as the income of Y; s.37(5)/(5A) TCGA deal with this problem:

s.37(5) TCGA	**s.37(5A) TCGA**
If—	If—
(a) because section 517G(4) or (6) of ITA 2007 (transactions in land: the chargeable person) applies, an amount is charged to income tax as income of a person other than the person ("A") by whom the gain was realised, and	(a) because section 356OG(4) or (6) of CTA 2010 (transactions in land: the chargeable company) applies, an amount is charged to corporation tax as profits of a person other than the person ("C") by whom the gain was realised, and
(b) the income tax has been paid,	(b) the corporation tax has been paid,
for the purposes of this section the amount charged to that tax is regarded as having been charged as the income of A.	for the purposes of this section the amount charged to that tax is regarded as having been charged as the income of C.

22.16 TiL TAAR

s.517K ITA	**s.356OK CTA 2010**
(1) Subsection (3) applies if an arrangement has been entered into the main purpose or one of the main purposes of which is to enable a person to obtain a relevant tax advantage.	(1) Subsection (3) applies if an arrangement has been entered into the main purpose or one of the main purposes of which is to enable a company to obtain a relevant tax advantage.
(3) The tax advantage is to be counteracted by means of adjustments.	[identical]

I refer to this as the **"TiL Taar"**.

[35] See s.37 TCGA, discussed at 56.4.12 (Interaction of IT/CGT).

s.517K(4) ITA	**s.356OK(4) CTA 2010**
For this purpose adjustments may be made (whether by an officer of Revenue and Customs or by the person) by way of an assessment, the modification of an assessment, amendment or disallowance of a claim, or otherwise.	For this purpose adjustments may be made (whether by an officer of Revenue and Customs or by the company) by way of an assessment, the modification of an assessment, amendment or disallowance of a claim, or otherwise.

Section 517K(5) ITA/s.356OK(5) CTA 2010 defines "relevant" tax advantage:

> In this section "relevant tax advantage" means an advantage in relation to income tax charged (or which would, if the tax advantage were not obtained, be charged) in respect of amounts treated as profits of a trade by virtue of this Part [Part 9A ITA, transactions in land/Part 8ZB CTA 2010, transactions in UK land].

Section 517K(6) ITA/s.356OK(6) CTA 2010 provide the standard IT/CT/CGT definition of "tax advantage".[36]

BIM provides:

> **BIM60700: Avoidance provisions** [May 2019]
> ...**Example**
> An individual is contemplating disposal of shares which derive 60% of their value from land. Just prior to the disposal the individual injects additional capital into the company to ensure the 50% test at Section 517OD (1)(a) ITA 2007 is not met. The individual argues the profits should not be treated as trading profits as the 50% condition is not met. In this instance the individual has entered into an arrangement with a main purpose of obtaining a relevant tax advantage. The tax which would have been chargeable as a result of Part 9A ITA 2007 has been reduced so an adjustment should be made to counter the tax advantage.

The HMRC analysis is as follows:

> In this instance the individual has entered into an arrangement with a main purpose of obtaining a relevant tax advantage. The tax which would have been chargeable as a result of Part 9A ITA 2007 has been reduced so an adjustment should be made to counter the tax advantage.

[36] See 3.19.1 (Tax advantage: Definitions).

22.16.1 *TiL treaty override*

Section 517K ITA/s.356OK CTA 2010 provide a treaty override, in the same terms as the land-dealing TAAR[37]:

> (2) In subsection (1) the reference to obtaining a relevant tax advantage includes obtaining a relevant tax advantage by virtue of any provisions of double taxation arrangements, but only in a case where the relevant tax advantage is contrary to the object and purpose of the provisions of the double taxation arrangements (and subsection (3) has effect accordingly, regardless of anything in section 6(1) of TIOPA 2010).
> (3) The tax advantage is to be counteracted by means of adjustments.

The wording is again based on the OECD principal purpose test.[38]

22.17 Pre-development gain

The rules for direct/indirect disposals are in s.517L ITA/356OL CTA 2010 and it is helpful to read them side by side:

Direct disposal	**Indirect disposal**
s.517L(1)-(2) ITA	**s.517L(3)-(4) ITA**
(1) Subsection (2) applies if—	(3) Subsection (4) applies if—
(a) subsection (1) of section 517C applies because Condition D in section 517B is met (land developed with purpose of realising a gain from its disposal when developed), and	(a) section 517E(1) applies, and
(b) part of the profit or gain mentioned in that subsection is fairly attributable to a period before the intention to develop was formed.	(b) part of the profit or gain mentioned in section 517E(5) is fairly attributable to a period before the person mentioned in section 517D(1) was a party to, or concerned in, the arrangement in question.
(2) Section 517C(1) has effect as if the person mentioned in section 517B(1) had not realised that part of the profit or gain.	(4) Section 517E has effect as if the person had not realised that part of the profit or gain.

[37] See 22.4.2 (Treaty override).

[38] See 108.8 (OECD principal purpose test).

s.356OL(1)-(2) CTA 2010	**s.356OL(3)-(4) CTA 2010**
(1) Subsection (2) applies if—	(3) Subsection (4) applies if—
(a) subsection (1) of section 356OC applies because Condition D in section 356OB is met (land developed with purpose of realising a gain from its disposal when developed), and	(a) section 356OE(1) applies, and
(b) part of the profit or gain mentioned in that subsection is fairly attributable to a period before the intention to develop was formed.	(b) part of the profit or gain mentioned in section 356OE(5) is fairly attributable to a period before the person mentioned in section 356OD(1) was a party to, or concerned in, the arrangement in question.
(2) Section 356OC(1) has effect as if the person mentioned in section 356OB(1) had not realised that part of the profit or gain.	(4) Section 356OE has effect as if the person had not realised that part of the profit or gain.

s.517L(5) ITA	**s.356OL(5) CTA 2010**
In applying this section account must be taken of the treatment under Part 2 of ITTOIA 2005 (trading income) of a person who appropriates land as trading stock.	(5) In applying this section account must be taken of the treatment under Part 3 of CTA 2009 (trading income) of a company which appropriates land as trading stock.

22.18 Private residence: Til relief

Section 517M ITA provides:

> No liability to income tax arises under this Part [Part 9A, transactions in land] in respect of a gain accruing to an individual if—
>
> (a) the gain is exempt from capital gains tax as a result of sections 222 to 226 of TCGA 1992 (private residences), or

See 60.1 (Private residence relief).

22.19 Indirect arrangements

s.517O ITA	**s.356ON CTA 2010**
(1) In determining whether section 517C(1) or 517E(1) applies, account is to be taken of any method, however indirect, by which—	(1) In determining whether section 356OC(1) or 356OE(1) applies, account is to be taken of any method, however indirect, by which—
(a) any property or right is transferred or transmitted, or	[identical]
(b) the value of any property or right is enhanced or diminished.	[identical]
(2) Accordingly— (a) the occasion of the transfer or transmission of any property or right, however indirect, and	[identical]
(b) the occasion when the value of any property or right is enhanced, may be an occasion on which section 517C(1) or 517E(1) applies	(b) the occasion when the value of any property or right is enhanced, may be an occasion on which section 356OC(1) or 356OE(1) applies.
(3) Subsections (1) and (2) apply in particular— (a) to sales, contracts and other transactions made otherwise than for full consideration or for more than full consideration, (b) to any method by which any property or right, or the control of any property or right, is transferred or transmitted by assigning— (i) share capital or other rights in a company, (ii) rights in a partnership, or (iii)an interest in settled property, (c) to the creation of an option affecting the disposition of any property or right and the giving of	[identical]

consideration for granting it,
(d) to the creation of a requirement for consent affecting such a disposition and the giving of consideration for granting it,
(e) to the creation of an embargo affecting such a disposition and the giving of consideration for releasing it, and
(f) to the disposal of any property or right on the winding up, dissolution or termination of a company, partnership or trust.

22.20 "Another person"

Section 517P ITA/s.356OO CTA 2010 provide:

> (1) In this Part [Part 9A ITA, transactions in land/Part 8ZB CTA 2010, transactions in UK land] references to "other" persons are to be interpreted in accordance with subsections (2) to (4).
> (2) A partnership or partners in a partnership may be regarded as a person or persons distinct from the individuals or other persons who are for the time being partners.
> (3) The trustees of settled property may be regarded as persons distinct from the individuals or other persons who are for the time being the trustees.
> (4) Personal representatives may be regarded as persons distinct from the individuals or other persons who are for the time being personal representatives.

22.21 "Arrangement"

Section 517Q(1) ITA/s.356OP CTA 2010 provide the standard (unnecessary IT definition of "arrangement".[39] But the author tried harder.) Section 517Q(2) ITA/s.356OP CTA 2010 provide:

> For the purposes of this Part [Part 9A ITA, transactions in land/Part 8ZB CTA 2010, transactions in UK land] any number of transactions may be regarded as constituting a single arrangement if—
> (a) a common purpose can be discerned in them, or
> (b) there is other sufficient evidence of a common purpose.

[39] See App 2.2.3 (Definitions of "arrangement").

I doubt if that adds anything to the meaning.

22.22 "Disposal"

Section 517R(1) ITA/s.356OQ(1) CTA 2010 provide:

> In this Part [Part 9A CTA, transactions in land/Part 8ZB CTA 2010, transactions in UK land] references to a "disposal" of any property include any case in which the property is effectively disposed of (whether wholly or in part, as mentioned in subsection (2))—
> (a) by one or more transactions, or
> (b) by any arrangement.

Section 517R(2) ITA/s.356OQ(2) CTA 2010 provide:

> For the purposes of this Part [Part 9A, transactions in land]—
> (a) references to a disposal of land or any other property include a part disposal of the property, and
> (b) there is a part disposal of property ("the asset") where on a person making a disposal, any form of property derived from the asset remains undisposed of (including in cases where an interest or right in or over the asset is created by the disposal, as well as where it subsists before the disposal).

The drafting is based on s.21 TCGA.
BIM provides:

> **BIM60835: Definitions: Disposal** [May 2019]
> ... In a straightforward sale this will be the date of completion. If the date of completion is delayed but the property has effectively been disposed of an earlier date may be applied...
> **Example**
> A developer sets up a company to complete a housing development. The developer intends to dispose of 40% of the properties to a third party and retain 60% of the properties as a longer term investment. When the properties are finished they sell 40% of their shares to the third party. In this instance the 40% is a disposal of property deriving its value from land.

22.23 Definitions

22.23.1 *"Realising a gain"*

s.517T ITA	**s.356OS CTA 2010**
(1) For the purposes of sections 517B(1) and 517D(1) it does not	(1) For the purposes of sections 356OB(1) and 356OD(1) it does not

matter whether the person ("P") realising the profit or gain in question realises it for P or another person.	matter whether the person ("P") realising the profit or gain in question realises it for P or another person.
(2) For the purposes of subsection (1), if, for example by a premature sale, a person ("A") directly or indirectly transmits the opportunity of realising a profit or gain to another person ("B"), A realises B's profit or gain for B.	[identical]

22.23.2 *"Development"*

After some vacillation, BIM now provides:

> **BIM60806: Definitions: Development** [May 2019]
> Whether the land has been developed is a question of fact.
> 'Development' for the purpose of Condition D is not defined but is interpreted to mean any change from the lands position at purchase. In the absence of other factors obtaining planning permission will not constitute land being developed for the purpose of condition D.
> *Example 1*
> A person acquires land with the intention to hold it for investment purposes. After several years planning permission is obtained to build houses on the land. The landowner's intention changes to build and sell housing units on the land. An access road and other infrastructure is built before the landowner gets in financial difficulty and sells the land. Condition D applies, the land has been developed and one of the main purposes of developing the land was to profit from disposing it.
> *Example 2*
> A company carried out research and decided to purchase a plot of land as they have identified the land will be worth significantly more with planning permission. After acquisition they obtain this planning permission and sell the land. The land has not been developed for the purposes of condition D but it is likely that the company has a either a trade in dealing UK land or that Condition A would apply due to the one of the main purposes of acquiring the land was to profit from its disposal.

This is the correct view. Section 55(1) Town and Country Planning Act 1990 provides:

> Subject to the following provisions of this section, in this Act, except where the context otherwise requires, "development," means
> [1] the carrying out of building, engineering, mining or other operations in, on, over or under land, or
> [2] the making of any material change in the use of any buildings or other land.

The significance of the definition for planning is in s.57(1):

> Subject to the following provisions of this section, planning permission is required for the carrying out of any development of land.

It is considered that part [1] of the definition is a succinct statement of the meaning of "development" for TiL purposes. In short, development means building work. Mere change of use (eg using a former shop as a café) is something which needs to be controlled by planning legislation, but is not "development" in the TiL sense.

22.24 Notification and assessment

BIM provides:

> **BIM60900: Notification and assessment** [May 2019]
> Where the legislation applies to a non-UK resident company the company will be treated as having a trade of dealing in or developing UK land. Both resident and non-resident companies and individuals will need to notify chargeability and register to pay tax.
> There are no separate filing or payment rules for this legislation. The normal self-assessment regime for income tax and corporation tax will apply.

CHAPTER TWENTY THREE

PERFORMERS

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23.2.1 "Entertainer" and "performer"
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23.1 Entertainers and sportspeople

This chapter considers the taxation of non-resident entertainers and sportspeople ("performers").

The legislation is scattered: trading income rules are in ITTOIA, withholding tax is in ITA, and the bulk of the rules are in Income Tax (Entertainers and Sportsmen) Regulations 1987 ("ITESR"). I refer to this together as the **"entertainers/sportspeople code"**.

The policy of the Tax Law Rewrite was not to rewrite or update statutory instruments. So ITESR is out of date twice over: it was not updated for the 1988 consolidation in ICTA or for the rewrite in ITTOIA, and retains the references to the original legislation in sch 11 FA 1986.[1] The consequence is that the rewrite left this area of law more difficult to follow

[1] FA 1986 can be found at *http://www.legislation.gov.uk/ukpga/1986/41/pdfs/ukpga_19860041_en.pdf*

than before. When quoting ITESR, I add the current statutory references in brackets.

HMRC have issued guidance which I call "**Performers guidance**".[2]

Section 352 ITEPA provides a deduction from employment income for agency fees paid by "entertainers" but this is not discussed here.

23.1.1 *Purpose of the code*

In *Agassi v Robinson*:

> There were a number of perceived problems in applying to foreign [non-resident] entertainers and sportsmen the charging provisions [relating to trades]. Section 108 [ICTA] imposed a Schedule D charge to tax on the profits or gains of any person, whether or not resident in the UK, from any trade, profession or vocation carried on in the UK.
>
> The first problem related to the concept of carrying on a trade, profession or vocation. Was a person who made only single or infrequent visits to this country, eg, playing in, say, two tennis tournaments, carrying on a trade, profession or vocation in this country?
>
> Second, would income arising from commercial endorsements, eg wearing Nike tennis shoes and playing with a Head tennis racquet, be regarded as part of the profits or gains of carrying on the trade, profession or vocation?
>
> Third, the section 108 charge only applied to the person carrying on the trade, profession or vocation. Would payments made to a foreign company, albeit controlled by the person exercising the trade, profession or vocation, be caught by the charge?
>
> And, fourth, collection of the tax from a foreign entertainer or sportsman, whose visits to this country might be sporadic and who would often have no assets in this country, was not always practicable.
>
> ...
>
> These were the problems that were addressed in the [entertainers/ sportspeople code] ...
>
> The problem of collecting the tax charged ... was addressed by ... paragraph 2(1) (section 555(2) of the 1988 Act) which required a person making a payment which had "a connection of a prescribed kind with the relevant activity" to deduct a sum representing income tax and account to the Inland Revenue for the sum...

[2] HMRC, "A Guide to paying Foreign Entertainers" *https://www.gov.uk/pay-tax-on-payments-to-foreign-performers*

> The problem about the scale of activities that could constitute the conduct of a trade, profession or vocation was addressed by paragraph 6(1) and (4) of the Schedule (section 556(1) of the 1988 Act) and the problem about payments to companies owned and controlled by the entertainer or sportsman was dealt with by paragraph 7 of the Schedule (section 556(2) of the 1988 Act). Paragraph 6 and paragraph 7 each had a sub-paragraph (6(2) and 7(4)) which said that the paragraph was not to apply unless the payment was one to which paragraph 2 applied. These provisions became, on consolidation, the first part of section 556(5).[3]

23.2 Definitions

It is helpful first to deal with some definitions. Because the legislation is scattered, most definitions have to be repeated or cross referenced; but we muddle through.

23.2.1 *"Entertainer" and "performer"*

Reg 2(1) ITESR defines "entertainer":

> In these Regulations unless the context otherwise requires ...
> "entertainer" means any description of individuals (and whether performing alone or with others) who give performances in their character as entertainers or sportsmen in any kind of entertainment or sport;
> and "entertainment or sport" in this definition includes any activity of a physical kind, performed by such an individual, which is or may be made available to the public or any section of the public and whether for payment or not.

ITTOIA and ITA use the expression:

> an entertainer, sportsman or sportswoman[4] of a prescribed description ("a performer")

This incorporates the above definition.

Performers guidance provides:

> **Which entertainers and sportsmen are involved?**
> The following list is not exhaustive. athletes, golfers, cricketers,

[3] [2006] UKHL 23 at [8] - [12].

[4] Note the change from the "sportsmen" of the 1987 regulations: gender neutral drafting was one of the policies of the Tax Law Rewrite.

> footballers, tennis players, boxers, snooker players, darts players, motor racing drivers, jockeys, ice skaters, contestants in chess tournaments, singers, musicians, conductors, models, dancers, actors, TV and radio personalities, variety entertainers. The person may appear alone or with others in a team, choir, band, group, orchestra, opera company, ballet company, troupe or circus.

23.2.2 *Relevant (taxable) activity*

Section 13(8) ITTOIA provides the definition of "relevant activity":

> In this section and section 14—
> "relevant activity" means an activity of a prescribed description[5]

We turn to reg 6(1) ITESR to find the "prescribed description" of a relevant activity:

> Subject to this regulation, any activity performed in the UK by an entertainer (whether alone or involving others) of any of the descriptions in paragraph (2) is an activity of a prescribed description ("relevant activity") for the purposes of paragraph 1 of [Schedule 11 FA 1986], that Schedule and these Regulations.

That is, the definition in reg. 6 applies for all relevant purposes. So we read on to reg 6(2) ITESR:

> A relevant activity to which paragraph (1) refers is an activity
> [a] performed in the UK by an entertainer
> [b] in his character as entertainer
> on or in connection with a commercial occasion or event ...

The regulation goes on to expand this:

> and includes—
> (a) any appearance of the entertainer by way of or in connection with the promotion of any such occasion or event;
> (b) any participation by the entertainer in or for sound recording, films,[6] videos, radio, television or other similar transmissions (whether live or recorded).

[5] Section 966(7)(a) ITA repeats the definition for ITA.

[6] Defined reg. 6(4) ITESR: "film" includes any record (with or without sound), however made, of a sequence or series of one or more visual images, which is a record capable of being used as a means of showing part or all of that sequence or series as a moving or still picture..."

Regulation 6(3) ITESR provides a commonsense definition of "commercial occasion or event":

> A commercial occasion or event to which paragraph (2) refers includes any description of occasion or event—
> (a) for which an entertainer (or other person) might receive or become entitled, for or by virtue of the entertainer's performance of the activity, to receive anything by way of cash or any other form of property; or
> (b) which is designed to promote commercial sales or activity by advertising, the endorsement of goods or services, sponsorship, or other promotional means of any kind.

"Relevant activity" is an opaque term; I gloss it as **"relevant [taxable] activity"**.

23.2.3 *"Payment" and "transfer"*

Section 13 ITTOIA provides:

> (9) In this section and section 14—
> (a) references to a payment include references to a payment by way of loan of money, and
> (b) references to a transfer do not include references to a transfer of money but, subject to that, include references to—
> (i) a temporary transfer (as by way of loan), and
> (ii) a transfer of a right (whether or not a right to receive money).
> (10) This section does not apply to payments or transfers of a kind prescribed in regulations under section 966(6) of ITA 2007.

ITA added s.13(9) ITTOIA but that merely preserved the subsection; it had been in s.555(5) ICTA 1988, which ITA repealed.

23.3 Charge independent of withholding tax

Section 13(8) ITTOIA formerly provided:

> *payment" means a payment from which income tax is to be deducted under section 555(2) of ICTA*
> *"transfer" means a transfer in respect of which income tax is to be accounted for under section 555(3) of ICTA*

In short, unless there was a duty to impose withholding tax, there was no liability on the individual entertainer/sportsperson. The two were linked.

ITA deleted those definitions so there can be a personal liability on the individual even if there is no duty to impose withholding tax (though the two will almost always go together). EN ITA provides:

> **Change 156: Deduction of tax: visiting performers: Schedule 1 (section 556 of ICTA and section 13 of ITTOIA)**
> This change ... gives statutory effect to the majority decision of the House of Lords in *Agassi v Robinson.*[7] ...
> The amendments to section 13 of ITTOIA make it explicit that when a payment or transfer of the type referred to in section 555 of ICTA is made, it is not necessary for there to be a duty to deduct under section 966 of this Act in order for the performer to be liable to income tax on the payment or transfer under Chapter 2 of Part 2 of ITTOIA (income taxed as trade profits). As part of this amendment, section 555(5) of ICTA has been incorporated into section 13[9] of ITTOIA to make clear that there is no link between the primary liability to income tax under Chapter 2 of Part 2 of ITTOIA (income taxed as trade profits) and the duty to deduct tax under section 966 of this Act.

23.4 Deemed UK trade

Section 13(1) ITTOIA provides:

> This section applies if an entertainer, sportsman or sportswoman of a prescribed description (a "performer")—
> (a) is non-UK resident in a tax year, and
> (b) performs a relevant [taxable] activity in the UK in the tax year.

If the conditions of s.13(1) are met, there are three deemings:

(1) A deemed trade, which is:
    (a) deemed to be a UK trade
    (b) deemed to be a separate trade
(2) Payment to prescribed third parties deemed made to performer.

Firstly the deemed UK trade. Section 13(2) ITTOIA provides:

> If a payment or transfer connected[8] with the relevant [taxable] activity is made, the performer is treated for income tax purposes as performing the relevant [taxable] activity in the course of a trade, profession or vocation carried on in the UK.

[7] The EN's explanation of the decision in *Agassi* is not set out here, and is not completely accurate, but the point is of no current interest. For *Agassi*, see App 16.12 (Territorial principle: Application).

[8] See 23.5 (Connected payment/transfer).

I refer to this as the **“notional UK trade”**. ITESR refers to it as “Schedule 11 trade”. I use the word “trade” to include a profession or vocation.

EN ITTOIA explains the reason for this:

> 92. A visiting performer may not be in the UK long enough to become resident for tax purposes. And any relevant activities may not be part of a trade, profession or vocation carried on in the UK. So, without this section, there would be no liability to tax on the activities in the UK.

The income of the notional UK trade is taxed as UK source trading income. The remittance basis does not apply because the income is UK source and the taxpayer is non-resident.

The notional UK trade is deemed to be a separate trade. Section 13(7) ITTOIA provides:

> If—
> (a) income tax is chargeable on profits arising from payments or transfers (made to any person), and
> (b) the payments or transfers are connected with the relevant [taxable] activity,
>
> the tax is charged as if the payments or transfers were received in the course of a separate trade, profession or vocation (distinct from any other trade, profession or vocation carried on by the performer).

I am not quite sure why this is needed; perhaps to emphasise that expenses of non-UK activity cannot be deducted in computing the profits of the notional UK trade.

23.5 Connected payment/transfer

The expression “connected with” the relevant [taxable] activity matters because payments/transfers connected with the relevant [taxable] activity are taxed as part of the notional UK trade, and subject to withholding tax.

Section 13(8) ITTOIA provides:

> In this section and section 14 a payment or transfer is connected with a relevant [taxable] activity if it has a connection of the prescribed kind with that activity.[9]

Regulation 2 IETSR defines the convenient terms connected payment/transfer:

[9] Section 966(7)(b) ITA repeats the definition for ITA.

> 2.—(1) In these Regulations unless the context otherwise requires ...
> a payment or transfer to which reg 3 ITESR applies is described as "connected".

We turn to reg 3(1) ITESR to find the "prescribed kind" of connection:

> This regulation applies for the purposes of and subject to the provisions of [para 2 sch 11 FA 1986], the other provisions of that Schedule and these Regulations.

That is, the definition applies for all relevant purposes. So we read on to reg 3(2) ITESR:

> Subject to paragraph (3) a payment or a transfer made or, in respect of or which in any way derives either directly or indirectly from, the performance of a relevant [taxable] activity, has a connection of a prescribed kind with the relevant [taxable] activity.

Reg 3(3) ITESR provides three exceptions where a payment/transfer is not connected with the relevant [taxable] activity. The significance is to disapply all the rules.

The first exception is where a withholding tax regime already applies:

> (3) The following are descriptions of payments to which paragraph (2) shall not apply—
>
> (a) a payment out of which a sum representing tax is or falls to be deducted under the Taxes Act [1970] apart from [Schedule 11 FA 1986] or these Regulations;

Other withholding taxes have priority over the entertainers/sportspeople code. This would apply to royalties.

The second exception concerns payments to UK residents (which should constitute a taxable receipt of the UK resident):

> (3) The following are descriptions of payments to which paragraph (2) shall not apply...
>
> (b) (i) a payment (to which paragraph (ii) applies) made to a person who is resident in the UK, not being a person who is connected[10] with or an associate[11] of the entertainer concerned;

[10] Regulation 2(2) incorporates the standard definition: "S.533 of the Taxes Act [1970] (meaning of connected persons) applies for the purposes of these Regulations."

[11] Regulation 13 ITESR incorporates the standard definition: "associate" has the meaning given to it by section 303(3) of the Taxes Act [1970]; see 104.6 (Associates).

> (ii) a payment to which paragraph (i) refers is a payment—
>
> (a) which falls to be made for the provision of services ancillary to the performance of a relevant [taxable] activity, and
>
> (b) which is of an amount or value which does not exceed what would be reasonable for that provision between persons dealing with each other at arms' length[12];

The third exception concerns royalties for sound recordings:

> (3) The following are descriptions of payments to which paragraph (2) shall not apply...
>
> (c) any payment made to an entertainer in respect of the proceeds of sale of records[13] deriving from a sound recording made by the entertainer, being payments calculated by reference to those proceeds or payments on accounts of those proceeds.

The reason for this is, perhaps, that (1) records (unlike concerts and sports events) could be made anywhere; or (2) royalties are covered by an entirely different tax regime.

23.6 Activity otherwise taxable

Section 13(4) ITTOIA provides two exceptions where there is no notional UK trade:

> (4) Subsection (2) [deemed notional UK trade] does not apply—
>
> (a) so far as the performer would otherwise be performing the relevant [taxable] activity in the course of a trade, profession or vocation carried on in the UK, or

In this case the charge is on the actual trade, not a notional UK trade. The second exception is:

> (4) Subsection (2) [notional UK trade] does not apply...
>
> (b) if the relevant [taxable] activity is performed in the course of an employment or office.

In this case the charge is on the employment income, not a notional UK trade.

[12] This expression is always written *arm's length*; one arm is all that is required. The reading *arms' length* must be a slip, and the expression has its normal meaning; see App 4.10 (Arm's length).

[13] Defined reg. 6(4) ITESR: "record" in this definition includes video.

These two exceptions disapply the deemed notional UK trade under s.13(2), but not the third party rules under s.13(5) to which I now turn.

23.7 Payment to third parties

Section 13(3) ITTOIA provides:

> It does not matter whether the payment or transfer is made to the performer or anyone else.

Section 13(5) ITTOIA provides:

> If a payment or transfer connected with the relevant [taxable] activity is made to—
> (a) a person other than the performer, and
> (b) that person is of a prescribed description,
> the payment or transfer is treated for income tax purposes as made instead to the performer in the course of a trade, profession or vocation carried on in the UK.

An argument that a territorial principle prevented the application of the charge where the payment was made between non-resident companies was rightly rejected in *Agassi v Robinson*.[14] This is now confirmed by statutory amendment.

I refer to the person of a prescribed description as "**a prescribed third party**".

23.7.1 *Prescribed third parties*

Regulation 7(1) ITESR provides:

> Any description of person in paragraph (2) is a person (not being the entertainer) to whom [para 7(1) sch 11 FA 1986 = s.13(5) ITTOIA] refers.

So we read on to reg 7(2) ITESR. There are four categories of prescribed third party.

The first category is controlled persons:

> (2) The descriptions of persons to whom paragraph (1) refers are-
> (a) any person who is under the control[15] of the entertainer;

[14] 77 TC 678; See 16.12 (Territorial principle: Application).

[15] Reg 2 ITESR incorporates the ultra-wide definition: "control" shall be construed in accordance with s.302(2) to (6) of the Taxes Act [1970]; see 104.3 (Control: Ultra-

The second category is certain non-residents:

> (2) The descriptions of persons to whom paragraph (1) refers are ...
>
> (b) any person who is—
>
> (i) not resident in the UK, and
>
> (ii) not liable to tax by reason of residence, domicile, place of management or otherwise, in a territory outside the UK where the rate of tax charged on the profits or income of such a person is a rate exceeding 25%;[16]

The third category is certain settlements:

> (2) The descriptions of persons to whom paragraph (1) refers are ...
>
> (c) (i) subject to paragraph (ii), any person in receipt (whether directly or indirectly) of
>
> [A] a connected payment or
>
> [B] value transferred[17] by a connected transfer
>
> which is, is treated as, or falls to be included in the computation of, income arising under a settlement in relation to which the entertainer is a settlor;[18]

The fourth category concerns arrangements under which the performer may benefit:

> (2) The descriptions of persons to whom paragraph (1) refers are ...
>
> (d) (i) any person
>
> [A] to whom paragraph (2) of this regulation does not otherwise apply[19]
>
> [B] who receives any connected payment or connected transfer (whether directly or indirectly) at or in respect of a time when there is in force between that person and the entertainer concerned a contract or arrangement

wide sense).

[16] The figure of 25% ought to be reduced in line with the reduction of CT rates since 1987 (when the CT rate was 35%).

[17] Defined reg 2 ITESR: "value transferred" in relation to a transfer means the gross amount to which regulation 17(1) refers.

[18] Para (c)(ii) incorporates the settlement-arrangement definitions of these terms:
"for the purposes of paragraph (i):—
"income arising under a settlement" and "settlor" have the meanings given to them by section 454 of the Taxes Act [1970], and
"settlement" has the meaning given to it by section 444(2) of the Taxes Act [1970]".

[19] Para [A] seems otiose, but it does not matter.

to which paragraph (ii) applies;

(ii) a contract or arrangement to which paragraph (i) refers is a contract or arrangement by or under which it is reasonable to suppose that the entertainer (or other person who is connected with or is an associate of the entertainer) is, will or may become, entitled to receive amounts, whether by way of cash or other value, not substantially less than the appropriate amount of profits or gains arising from the connected payment or connected transfer to which [para 8(1) sch 11 FA 1986 = s.13(2) ITTOIA] applies.

23.8 Notional UK trade: profit computation

Regulation 8 ITESR provides some self-explanatory rules for the computation of the profits of the notional UK trade:

> (1) Subject to the provisions of these Regulations, the profits or gains (to which [para 7(2) sch 11 FA 1986] refers) shall be computed in accordance with the provisions of the Taxes Act [1970] relating to the charging of profits or gains under Case I or II (as the case may be) of Schedule D, so that a just and reasonable amount of such a payment or value transferred by such a transfer is charged to tax as such profits or gains; and
> (2) Notwithstanding any provision of the Taxes Act [1970], in computing the said profits or gains such deductions of expenses incurred by any person (not being the entertainer) in relation to the payment or transfer concerned shall be made as are just and reasonable.

Regulation 16 ITESR provides for apportionment:

> (1) The provisions of paragraph (2) are by way of supplementation of the provisions of section 127 of the Taxes Act [1970] .
> (2) Where, in the case of any payment, value transferred or profits or gains to which Schedule 11 or these Regulations apply, it is necessary, in order to arrive at the appropriate amount of such payment, value or profits or gains for any tax year or other period, to make any apportionment, division or aggregation of any amounts or values, any such apportionment, division or aggregation, shall be made as is just and reasonable.

23.9 Trading loss

Regulation 15 ITESR provides:

> (1) In this regulation–

> (a) "world-wide trade" means a trade of an entertainer which is a trade apart from Schedule 11 and these Regulations, and a "Schedule 11 trade" means a trade which is a separate trade of an entertainer only by virtue of Schedule 11 and these Regulations;
>
> (b) "trade" includes profession or vocation.
>
> (2) For the purposes of section 171 of the Taxes Act [1970] (carry forward of losses) the world-wide trade and the Schedule 11 trade shall be treated as the same trade.
>
> (3) For the purposes of section 174 of the Taxes Act [1970] (carry back of terminal losses) a loss sustained for any relevant period under a Schedule 11 trade (to which otherwise that section would apply) shall not be a terminal loss except where the world-wide trade is permanently discontinued in that period, in which case such a loss in either trade shall be available under that section to be deducted or set off against profits or gains of those trades.
>
> (4) For the purposes of section 30 of the FA 1978 (losses in early years of trade) the world-wide trade and the Schedule 11 trade shall be treated as the same trade, but that section shall ap-ply to any such loss of an entertainer only in the tax year in which the world-wide trade was first carried on and in the next 3 succeeding tax years.

23.10 Withholding tax

Section 966 ITA provides:

> (1) This section applies if—
>
> (a) an entertainer, sportsman or sportswoman of a prescribed description ("a performer") who is non-UK resident for a tax year performs a relevant [taxable] activity in the UK in the tax year, and
>
> (b) a payment or transfer connected with the relevant [taxable] activity is made.
>
> (2) It does not matter—
>
> (a) whether the payment or transfer is made to the performer or anyone else, or
>
> (b) when the payment or transfer is made...
>
> (6) This section does not apply to payments or transfers of such a kind as may be prescribed.

23.10.1 *Deduction on making payment*

Section 966(3) ITA provides:

> If a payment within subsection (1)(b) is made the person who makes the payment must, on making it, deduct from it a sum representing income tax and account to HMRC for the sum.

The Courts rejected an argument that the principle of territoriality prevented this from applying to a non-resident made a payment to another non-resident.[20]

23.10.2 *Deduction on making transfer*

Section 966(4) ITA provides:

> If a transfer within subsection (1)(b) is made the person who makes the transfer must account to HMRC for a sum representing income tax.

23.10.3 *Amount of tax deducted*

Regulation 4(1) ITESR provides:

> Each of the sums mentioned in [para 2(2),(3) sch 11 FA 1986 = s.966(3)(4) ITA] ("tax payment") shall be calculated in accordance with the rules prescribed by this regulation.

Regulation 4(2) ITESR sets out the usual rule:

> Except where
> [a] it is otherwise provided by these Regulations or
> [b] there is an arrangement to which this regulation refers,
> the tax payment shall be a proportion
> [i] of the connected payment or
> [ii] of the value transferred by a connected transfer
> equal to the basic rate of income tax for the tax year in which the payment or transfer is made.

Regulation 17(1) ITESR provides grossing up:

> (a) The actual worth of what is transferred by a transfer to which [para 2(3) sch 11 FA 1986 = s.966(4) ITA] applies ("the net value") shall be treated as a net amount corresponding to a gross amount from which income tax at the basic rate has been deducted; and
> (b) the said gross amount shall be treated as the value of what is transferred for the purposes of paragraph 2(4) of Schedule 11.

Regulation 17(2) ITESR defines net value:

[20] See 16.11 (Territorial principle).

> (a) The net value to which paragraph (1) refers shall be the cost of what is transferred, and
> (b) the cost of what is transferred to which sub-paragraph (a) refers is the cost in or in connection with its provision (including its provision to the person who makes the transfer) or transfer, less so much of that cost which has been borne by the entertainer.

23.10.4 *Personal allowance*

Regulation 4(3) ITESR (in short) exempts payments and transfers within the IT personal allowance:

> (a) Subject to sub-paragraph (b), where the connected payments and the value transferred by connected transfers for a tax year made to an entertainer, or to a person who is connected with him or who is an associate of his, do not together exceed the relevant amount[21] the tax payment shall be a nil amount;

Para 4(3)(b) deals with fragmentation schemes:

> (b) connected payments and the value transferred by connected transfers made by any person who is connected with any other person by whom connected payments or connected transfers are made to the entertainer, or by any associate of such other person, shall together be treated as constituting a single connected payment in determining whether they exceed the relevant amount.

23.11 Arrangements with HMRC

The usual rule in regulation 4(2) ITESR applies unless "there is an arrangement to which this regulation refers." This anticipates regulation 4(4)-(6) ITESR which allow HMRC to make different arrangements:

> (4) An arrangement to which paragraph (2) refers is an arrangement in writing between
> [a] the Board and
> [b] the person by whom the connected payment or connected transfer is made, the entertainer, or the recipient of the connected payment or connected transfer,
>
> made following a decision by the Board on an application to which regulation 5 refers, under which the tax payment is an amount which, as

[21] Reg 2 ITESR defines this: "the relevant amount" means the amount of the personal allowance in section 35(1) ITA 2007 which applies for the tax year in which the payment or transfer is made.

a proportion of the connected payment or value transferred by the connected transfer, is an amount less than the said basic rate ("reduced tax payment").

(5) The reduced tax payment may be arrived at by reference to

[a] a percentage of the connected payment or of the value transferred by a connected transfer or

[b] as a lump sum calculated without reference to any such percentage.

(6) In making an arrangement of the kind to which paragraph (2) refers the Board–

(a) shall, subject to sub-paragraph (b) and paragraph (7) below, at all times aim at securing that the tax payment shall be, as nearly as may be, the amount of the liability to tax of the entertainer or other person arising in relation to the connected payment or connected transfer under the Tax Acts, Schedule 11 and these Regulations, and

(b) may take into account the fact that the liability to the Board for tax has, in a manner satisfactory to them, been secured or otherwise provided for, whether by a guarantee (of whatever person) or other means.

Performers guidance provides:

Application to HMRC to limit the amount of tax withheld

An application may be made in writing by the entertainer or anyone else authorised to do so on their behalf. Where the application is agreed, it allows the payer to deduct an amount other than the basic rate of tax which corresponds as near as to the entertainer's final UK liability on that payment.

An application to HMRC to limit the amount of tax withheld may be made in writing or on form FEU 8. Any letter which advises the Unit that detailed figures are to follow is considered to constitute an advance notification of an application **but does not constitute the application itself**.

Applications to the Foreign Entertainers Unit must be made no less than 30 days before the date the payment is due.

If the application is not agreed tax must be accounted for at the basic rate on all related payments.

How to make a reduced tax payment application (RTPA)

The information required to enable an agreement to be made includes:

- dates of arrival in and departure from the UK
- whether the entertainer is likely to return to the UK again before the 5 April

- a projection of actual or estimated total income due from all sources
- a schedule confirming; the date of each performance/event, the name and address of the venue and the name and address of the promoter
- a schedule of the projected actual or estimated expenses which will be incurred
- a copy of each relevant engagement contract or agreement (these do not need to be signed copies).

The application should give sufficient information to show how figures have been arrived at (including the basis for any estimates) and how expenditure appropriate to several countries has been apportioned.

In some cases you may be authorised to deduct a reduced rate of tax, a fixed sum or no tax from the gross payment. This could apply, for example, where an entertainer has to meet substantial expenditure out of a gross fee thus reducing the expected UK tax liability.

In reaching an agreement the Foreign Entertainers Unit will make allowances for admissible expenses. What can be allowed depends on the general rules covering expenditure allowable in arriving at taxable business profits under Section 34 Income Tax (Trading and Other Income) Act 2005 and the facts of each case. Normally allowances will be made for:

- general subsistence expenses
- commission, manager’s and agent’s fees
- UK travel
- international air fares to and from the UK where the entertainer comes to the UK to perform and returns directly to his or her home country

Other expenses may be allowable. What is allowable in each case will need to be agreed with the Foreign Entertainers Unit including the proportion of any costs appropriate to several countries.

Further information can be obtained about Reduced Tax Payment Applications including further advice regarding the preparation of an entertainer RTPA.

If the point you wish to check is not covered in this guidance or at the above link then contact the Foreign Entertainers Unit.

How do you know that a reduced tax payment has been authorised?

The Foreign Entertainers Unit will authorise you to deduct a reduced amount of tax by sending you a form FEU 4. Even where you have been a party to the agreed arrangement with HMRC you must wait until you get the form FEU 4.

If you have not received an authorisation form FEU 4 by the time the payment is due you must deduct tax at the basic rate on all related payments.

23.12 Chains of payments

Regulation 4(7) ITESR provides:

> Where–
>
> (a) a person makes a connected payment or connected transfer in relation to a relevant [taxable] activity, and
>
> (b) in respect of the same relevant [taxable] activity that person has received a connected payment or connected transfer in respect of which the amount of the tax payment has been paid under these Regulations,
>
> the person concerned shall not be required to deduct out of the connected payment or pay in respect of the connected transfer (to which sub-paragraph (a) refers) any sum to which paragraph 2 of Schedule 11 applies unless, and to the extent that, the tax payment which then falls to be made exceeds the amount of the tax payment to which sub-paragraph (b) refers.

The default rule is that deduction is made at the start of the chain. Performers guidance provides:

> **How do you deal with payment chains?**
>
> Some activities may give rise to a chain of payments. Every payer in the chain must deduct tax as required by law unless the payment is exempt.
>
> *Example*
>
> A concert is arranged at a venue. The venue owners control the box office and pay over the ticket proceeds to the promoter less their costs and Withholding Tax. The promoter is then required to deduct Withholding Tax from the fee payable to the entertainer. The promoter should deal with this as follows:
>
> He must deduct Withholding Tax (where it is due) from the payment made to the entertainer and pay over the net amount.
>
> He must issue a tax deduction certificate form FEU 2, to the entertainer confirming the pay and tax details.
>
> He declares the payment made and the tax deducted on the form FEU 1 (boxes 5 & 6) and shows the tax already withheld from the payment made to him in box 8.
>
> *Example*
>
> A Promoter engages a non-resident entertainer to appear at a UK venue. The Entertainer is the only non-resident entertainer the promoter engages in the quarter. The sequence of payments is as follows:
>
> The Venue pays £100,000 less £20,000 tax to the Promoter
>
> The Promoter pays £60,000 less £12,000 tax to the Entertainer

> The Promoter is liable to account to HMRC for £12,000 but as the payment he has received has had £20,000 Withholding Tax deducted from it he can treat the £12,000 as paid.
>
> *Entries on the Promoter's return form FEU 1*
>
> The amount and income tax columns of the Promoter's return for the relevant period should be completed as follows:
>
> | Payment | Amount | Tax |
> |---|---|---|
> | | 60,000 | 12,000 |
> | Less tax already paid by Venue | | 12,000 |
> | Tax payable now | | Nil |
>
> Evidence of the tax already paid must be provided with the FEU1 return by including part 3 of the FEU2 tax deduction certificate which is supplied by the Venue.

However it is possible to agree a different rule. Regulation 5 ITESR provides:

> (1) Where a connected payment or connected transfer falls to be made subject to a tax payment to which regulation 4(2) refers the person by whom the connected payment or connected transfer is made, the entertainer, or recipient of the connected payment or connected transfer, may make an application in writing to the Board, not later than 30 days before the connected payment or connected transfer falls to be made, that it shall be subject instead to a reduced tax payment (within the meaning of regulation 4).
>
> (2) Unless and until there is in force an arrangement under which such a reduced tax payment falls to be made regulation 4(2) shall at all times continue to apply to the connected payment or connected transfer.

Performers guidance provides:

> **Middleman Applications**
>
> Payers can ask for an arrangement which moves the withholding point further down the chain so that payments between specified payers can be made without deduction of tax. This can only be done with the Foreign Entertainers Unit's approval.
>
> If the concert promoter makes a 'Middleman' application, the Unit may agree to the promoter being the withholding point, therefore the venue will not have to withhold tax. The promoter will then have to deduct tax at basic rate on his or her payment or a reduced amount if an entertainer's application for a reduced tax payment has been made and agreed.
>
> The Unit will ask for certain information in support of any 'Middleman'

> application you make, for example, a copy of any contract, dates of appearances, and probably a copy of the budget. If you are submitting a 'Middleman' application for the first time the Unit will be happy to advise you on the procedure and level of information required....[22]

23.13 Position of payor

Reg 12 ITESR provides:

> (1) Where under these Regulations there is accounted for and paid to the Board an amount of tax which is–
>
> (a) in respect of a connected payment or connected transfer, or
>
> (b) paid under an assessment made under paragraph 11,
>
> that amount shall, subject to this regulation, be treated as a payment of tax on account of the tax liability (of whatever person) in respect of the connected payment or connected transfer concerned.
>
> (2) Where, in respect of a connected payment or connected transfer, there is a liability to tax under the Tax Acts as well as under Schedule 11 or these Regulations, the Board shall allocate any payment made to them to which paragraph (1) refers as is just and reasonable in discharge of some or all of those liabilities of the entertainer or other person concerned to whom these Regulations apply.
>
> (3) Where–
>
> (a) by virtue of paragraph 8 of Schedule 11 and these Regulations a connected payment or the value transferred by a connected transfer falls to be included in the amount of profits or gains to which paragraph 8(1)(a) refers, and
>
> (b) the amount of the connected payment or the value transferred (or an amount in respect of that value) is charged to tax under Schedule E
>
> the amount charged under Schedule E (to which sub-paragraph (b) refers) shall be treated as expenditure which falls to be deducted in computing the profits or gains to which sub-paragraph (a) refers.
>
> (4) Where a payment is a connected payment–
>
> (a) which is, is treated as, or falls to be included in a computation of, income of the entertainer chargeable to tax by virtue of the provisions of Part XVI of the Taxes Act [1970] , or
>
> (b) which is a receipt of a company which provides the services of the entertainer to perform the relevant [taxable] activity, being

[22] *http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/feu/appromers.htm*

> a receipt which falls to be included in the computation of its profits which are chargeable to tax under Schedule D,
>
> the charge under Schedule 11 shall have effect and the charges to which sub-paragraphs (a) and (b) refer shall be disregarded.
>
> (5) A person making a connected payment or connected transfer in respect of which a tax payment has been made by virtue of these Regulations shall furnish the recipient with a certificate showing the gross amount of the payment or the value transferred, the amount of the tax payment, and the amount actually paid.

Performers guidance provides:

> **How are payments dealt with in your Self Assessment or Corporation Tax accounts?**
>
> If the income you receive is attributed to the entertainer under the rules set out in Regulation 7 ITESR then the tax withheld from the payment you receive will be treated as a payment on account of the entertainer's UK liability.
>
> You will not be charged to UK tax on that income and there will be no repayment of the Withholding Tax to you.
>
> But if:
>
> - you are UK resident and
> - the income you receive is not attributed to the entertainer under the above rules then the payment you receive will be a receipt of your own business
>
> The amount of the assessable income will be the payment received plus the amount of the Withholding Tax which has been deducted. You will be able to claim the gross payment you make as a deduction in your UK Income Tax or Corporation Tax accounts.
>
> 'Gross payment' means the payment to the entertainer or intermediary plus the tax accounted for to HMRC.
>
> If you make the payment in a series of payments as described at How to work out the tax, you may be entitled to set off tax withheld from payments you receive against your UK tax liabilities or claim a repayment of tax.
>
> *Example*
>
> A UK Venue pays box office income of £100,000 to a UK Promoter in respect of the performance of a non-UK resident entertainer. The Entertainer is paid a fee of £60,000 by the Promoter
>
> **Withholding Tax**
>
> A venue pays £80,000 to the promoter. This is £100,000 less £20,000 which is 20% tax. The £20,000 tax is paid to HMRC.
>
> The promoter pays £48,000 to the entertainer. This is £60,000 less

£12,000 which is 20% tax. The £12,000 tax is paid to HMRC.

Treatment in the accounts

The Venue is allowed the expense of £100,000 (that is the gross payment shown in his accounts).

The Promoter has a receipt of £100,000 as income and is allowed £60,000 as an expense in its accounts.

Tax set offs

The Promoter can claim to set the excess Withholding Tax of £8,000 against its Income Tax/Corporation Tax liability for that accounting period. i.e. £20,000 less the payment of £12,000.

If the Promoter had a tax liability of less than £8,000 it can claim a repayment of the amount by which £8,000 exceeds its Income Tax/Corporation Tax liability for that accounting period.

Performers guidance provides:

Is Withholding Tax due on payments made to Groups, Theatre Companies, Productions, etc, which include both UK resident and non-resident entertainers?

For example, a music group or a theatre company which includes both UK resident and non-resident performers.

Yes, Withholding Tax is due

Unless advised otherwise by the Foreign Entertainers Unit the payer must account for Withholding Tax on the total payment, including expenses, made to or in respect of the group or theatre company.

If the payee/group/theatre company want the payer to calculate and deduct tax only on the non UK resident performers, the payee/group/theatre company must apply to the Foreign Entertainers Unit for agreement to do this.

How to work out the Withholding Tax

Where you are paying or transferring money it is very straightforward to work out the tax.

Assuming the basic rate percentage for the year of payment is 20 per cent then you should deduct this percentage from each payment made.

Example

Gross Payment	£10,000
Tax (10,000 × 20%)	£2,000
Net amount paid to entertainer	£8,000

The same applies to a loan of money. You should deduct tax from the amount of the loan.

All payments of Withholding Tax made to HMRC must be made in sterling. If you make a payment directly or indirectly to an entertainer in a foreign currency you should calculate the Withholding Tax due using the rate of exchange at the time when the payment is made or at the rate used at the time the foreign currency was purchased. The rate of exchange used should be shown on your return form FEU 1.

If the transfer of an asset is involved (for example, a motor car for a 'hole in one' during a golf competition) you must account for the tax as if the asset's cost to you or in connection with providing it was the net amount of the payment.

Withholding Tax is also due on expenses provided for an entertainer. For example, hotel accommodation, airfares, UK transport etc.

In the absence of an agreement with the Foreign Entertainers Unit, Withholding Tax must be accounted for and paid by the payer, from its own funds, on payments made in respect of expenses provided for an entertainer.

The Withholding Tax due must be calculated as follows:

The cost of the expenses, to the payer, must be grossed up, at the basic rate of tax, to give the true cost of the benefit to the artiste.

Withholding Tax due must be calculated at the basic rate on the grossed up value of the expenses.

The withholding tax calculated must be paid by the payer from its own funds: it must not be deducted from the overall payment made to the artiste.

Example

The airline ticket costs you £1,000. You need to work out the gross amount of the payment and pay tax on that amount. To work out the gross amount you do the following sum.

Net amount of payment £1000 × 20 (basic rate of tax) divided by 80 (100% − 20% basic rate of tax) = £250

Add the tax amount £250 to the net payment £1000 to get the gross payment £1250

Add the result to the net payment to get the gross payment.

£250 + £1,000 = £1,250

Tax (£1,250 × 20%) = £250

VAT Implications

VAT is not chargeable on Withholding Tax and you should therefore exclude the VAT when calculating Withholding Tax due.

When calculating the amount of tax due on a payment to be made either to, or in respect of an entertainer you must not include VAT (if any) charged to you.

If you are a venue paying the gross ticket sales to a promoter or entertainer, the VAT element of each individual ticket price must be taken out.

23.14 Administration

Reg 9 ITESR deals with returns:

> (1) A person who makes a connected payment or connected transfer shall, in accordance with this regulation, make a return to the Board of the connected payment or connected transfer which he makes and of any tax payment (including a nil amount) for which he is accountable to the Board.
> (2) A return shall be made in the tax year for each successive period ending on 30th June, 30th September, 31st December and 5th April.
> (3) The return for each period shall be made within 14 days after the end of the period.
> (4) [This deals with notices requiring information, but is now effectively superseded by more general HMRC information powers]
> (5) The [TMA 1970] shall apply to a return to which this regulation relates as it applies to a return under the Taxes Acts.

Reg 10 ITESR deals with the due date for tax payments:

> (1) A tax payment (including any reduced tax payment), whether any deduction out of a connected payment or provision in respect of a connected transfer has been made or not, shall be due at the time by which the return under regulation 9(1) is to be made ("the due date") and payment shall be made before, or at the time when, that return is made.
> (2) A payment at any time so due shall be payable by the person who makes the connected payment or connected transfer concerned, without the making of any assessment in respect of it.
> (3) Subject to the provisions of regulation 11, tax which has become due and payable under this regulation (whether or not it has been paid when the assessment is made) may be assessed on the per-son from whom it is due if that tax, or any part of it, is not paid on or before the due date.

Reg 11 ITESR deals with assessments, Reg 13 ITESR deals with tax overpayments of tax and reg. 14 incorporates the TMA rules. These need not be set out here.

23.15 DT Relief

Article 17 OECD Model Convention provides:

> 1. Notwithstanding the provisions of Article 15 [Employment income], income derived by a resident of a Contracting State
> [a] as an entertainer, such as a theatre, motion picture, radio or

> television artiste, or a musician, or
> [b] as a sportsperson,
> from that resident's personal activities as such exercised in the other Contracting State, may be taxed in that other State.

This article was amended in 2014 following an OECD report ("the OECD Art.17 report").[23]

I refer to income within article 17(1) as **"entertainment income"**.

OECD Model Commentary explains why there is a special rule for entertainment income:

> 2. This provision [Article 17] makes it possible to avoid the practical difficulties which often arise in taxing entertainers and sportspersons performing abroad.

The commentary does not say what these difficulties are but OECD Art.17 report identifies 2 difficulties:

> ... residence taxation should not be assumed given
> [1] the difficulties of obtaining the relevant information,
> [2] that Article 17 allows taxation of a number of high-income earners who can easily move their residence to low-tax jurisdictions ... [24]

23.15.1 *"Entertainer"/"Sportsperson"*

The International Manual comments on the terminology:

> **INTM153190 Artistes/entertainers/athletes** [Jun 2016]
> This Article is generally entitled artistes and athletes, but the terms entertainers and sportsmen[25] can also be used. We do not consider there is any difference between the terms artistes and entertainers and sportsmen and athletes.

OECD Commentary discusses these terms:

> 3. Paragraph 1 refers to entertainers and sportspersons. It is not possible to give a precise definition of "entertainer", but paragraph 1 includes examples of persons who would be regarded as such. These examples should not be considered as exhaustive. On the one hand, the term

[23] OECD, "Issues related to Article 17 of the model tax convention" (2014) *http://www.oecd.org/tax/treaties/report-article%2017-model-tax-convention.pdf*

[24] OECD Art.17 report para 5.

[25] Author's footnote: In keeping with contemporary values, the 2014 OECD Model update changed to gender neutral language.

> "entertainer" clearly includes the stage performer, film actor, actor (including for instance a former sportsperson) in a television commercial. The Article may also apply to income received from activities which involve a political, social, religious or charitable nature, if an entertainment character is present. On the other hand, it does not extend to a visiting conference speaker (e.g. a former politician who receives a fee for a speaking engagement), to a model performing as such (e.g. a model presenting clothes during a fashion show or photo session) rather than as an entertainer or to administrative or support staff (e.g. cameramen for a film, producers, film directors, choreographers, technical staff, road crew for a pop group etc.). In between there is a grey area where it is necessary to review the overall balance of the activities of the person concerned.
>
> 4. An individual may both direct a show and act in it, or may direct and produce a television programme or film and take a role in it. In such cases it is necessary to look at what the individual actually does in the State where the performance takes place. If his activities in that State are predominantly of a performing nature, the Article will apply to all the resulting income he derives in that State. If, however, the performing element is a negligible part of what he does in that State, the whole of the income will fall outside the Article. In other cases an apportionment should be necessary.
>
> 5. Whilst no precise definition is given of the term "sportspersons" it is not restricted to participants in traditional athletic events (e.g. runners, jumpers, swimmers). It also covers, for example, golfers, jockeys, footballers, cricketers and tennis players, as well as racing drivers.

The Commentary discusses the concept of sports or entertainment:

> 6. The Article also applies to income from other activities which are usually regarded as of an entertainment character, such as those deriving from billiards and snooker, chess and bridge tournaments.
>
> 7. Income received by impresarios, etc. for arranging the appearance of an entertainer or sportsperson is outside the scope of the Article, but any income they receive on behalf of the entertainer or sportsperson is of course covered by it.

23.15.2 *Income from performance*

OECD Commentary provides:

> 8. Paragraph 1 applies to income derived directly and indirectly from a performance by an individual entertainer or sportsperson. In some cases the income will not be paid to the individual or his impresario or agent,

> directly with respect to a specific performance. For instance, a member of an orchestra may be paid a salary rather than receive payment for each separate performance: a Contracting State where a performance takes place is entitled, under paragraph 1, to tax the proportion of the musician's salary which corresponds to such a performance. Similarly, where an entertainer or sportsperson is employed by e.g. a one person company, the State where the performance takes place may tax an appropriate proportion of any remuneration paid to the individual. In addition, where its domestic laws "look through" such entities and treat the income as accruing directly to the individual, paragraph 1 enables that State to tax income derived from performances in its territory and accruing in the entity for the individual's benefit, even if the income is not actually paid as remuneration to the individual.
>
> 8.1 The paragraph applies regardless of who pays the income. For example, it covers prizes and awards paid by a national federation, association or league which a team or an individual may receive in relation to a particular sports event.

The commentary considers the boundary between (1) entertainment income and (2) trading, royalty and employment income:

> 9. Besides fees for their actual performances, entertainers and sportspersons often receive income in the form of royalties or of sponsorship or advertising fees. In general, other Articles would apply whenever there is no close connection between the income and the performance of activities in the country concerned. Such a close connection will generally be found to exist where it cannot reasonably be considered that the income would have been derived in the absence of the performance of these activities. This connection may be related
>
> [1] to the timing of the income-generating event (e.g. a payment received by a professional golfer for an interview given during a tournament in which she participates) or
>
> [2] to the nature of the consideration for the payment of the income (e.g. a payment made to a star tennis player for the use of his picture on posters advertising a tournament in which he will participate).
>
> Royalties for intellectual property rights will normally be covered by Article 12 rather than Article 17 (see paragraph 18 of the Commentary on Article 12), but in general advertising and sponsorship fees will fall outside the scope of Article 12. Article 17 will apply to advertising or sponsorship income, etc. which has a close connection with a performance in a given State (e.g. payments made to a tennis player for wearing a sponsor's logo, trade mark or trade name on his tennis shirt during a match). Such a close connection may be evident from

contractual arrangements which relate to participation in named events or a number of unspecified events; in the latter case, a Contracting State in which one or more of these events take place may tax a proportion of the relevant advertising or sponsorship income (as it would do, for example, in the case of remuneration covering a number of unspecified performances; see paragraphs 9.2 and 9.3). Similar income which could not be attributed to such performances would fall under the standard rules of Article 7 or Article 15, as appropriate. Payments received in the event of the cancellation of a performance are also outside the scope of Article 17, and fall under Article 7 or 15, as the case may be. Various payments may be made as regards merchandising; whilst the payment to an entertainer or sportsperson of a share of the merchandising income closely connected with a public performance but not constituting royalties would normally fall under Article 17, merchandising payments derived from sales in a country that are not closely connected with performances in that country and that do not constitute royalties would normally be covered by Article 7 (or Article 15, in the case of an employee receiving such income).

9.1 Apart from the above examples, there are a number of cases where it may be difficult to determine whether a particular item of income is derived by a person as an entertainer or sportsperson from that person's personal activities as such. The following principles may be useful to deal with such cases:

– The reference to an "entertainer or sportsperson" includes anyone who acts as such, even for a single event. Thus, Article 17 can apply to an amateur who wins a monetary sports prize or a person who is not an actor but who gets a fee for a once-in-a-lifetime appearance in a television commercial or movie.
– As noted in the previous paragraphs, the activities of an entertainer or sportsperson do not include only the appearance in an entertainment or sports event in a given State but also, for example, advertising or interviews in that State that are closely connected with such an appearance.
– Merely reporting or commenting on an entertainment or sports event in which the reporter does not himself participate is not an activity of an entertainer or sportsperson acting as such. Thus, for instance, the fee that a former or injured sportsperson would earn for offering comments during the broadcast of a sports event in which that person does not participate would not be covered by Article 17.
– Preparation, such as rehearsal and training, is part of the normal activities of entertainers and sportspersons. If an entertainer or sportsperson is remunerated for time spent on rehearsal, training or

> similar preparation in a State (which would be fairly common for employed entertainers and sportspersons but could also happen for a self-employed individual, such as an opera singer whose contract would require participation in a certain number of rehearsals), the relevant remuneration, as well as remuneration for time spent travelling in that State for the purposes of performances, rehearsal and training (or similar preparation), would be covered by the Article. This would apply regardless of whether or not such rehearsal, training or similar preparation is related to specific public performances taking place in that State (e.g. remuneration that would be paid with respect to the participation in a pre-season training camp would be covered).

For a US view of the royalty/personal services divide, see *Garcia v Commissioner of Internal Revenue*.[26]

23.15.3 *Performer income computation*

OECD Commentary provides:

> 10. The Article says nothing about how the income in question is to be computed. It is for a Contracting State's domestic law to determine the extent of any deductions for expenses. Domestic laws differ in this area, and some provide for taxation at source, at a low rate based on the gross amount paid to entertainers and sportspersons. Such rules may also apply to income paid to groups or incorporated teams, troupes, etc. Some States, however, may consider that the taxation of the gross amount may be inappropriate in some circumstances even if the applicable rate is low. These States may want to give the option to the taxpayer to be taxed on a net basis. This could be done through the inclusion of a paragraph drafted along the following lines ...

Apportionment issues have often proved controversial. OECD Art.17 report discusses the issue of preparation and training activities:

> 34. One commentator indicated that the practice of the UK tax authorities was "to tax a proportion of income earned under contracts for services – even if that income is earned by a personal service company – on the basis of competition days in the UK." The commentator argued, however, that it would be inappropriate to tax endorsement income of a sportsperson on that basis since a sportsperson has to train the rest of

[26] 140 TC 6 (2013).

the year. Using the example of a marathoner, the commentator argued that "if the athlete was in the UK for a week for the London Marathon and did not return in a given tax year, but could demonstrate that he/she trained on every day of the year (as many marathon runners do) then 1/52 of global income for services should fall within the UK tax net." The Committee, however, disagreed with that suggestion, which does not take into account the consideration for the payments received: where a marathoner derives all of her income from her participation and performance during races held in one country, it is difficult to consider that any part of that remuneration is paid for training in another country. It also disagreed with the argument that the proposal "seems to grant preferential status to employed, rather than self-employed sportspeople": under the proposed interpretation, self-employed individuals who are paid to train or rehearse are treated like employed individuals who are paid to train or rehearse. The Committee simply noted that it seemed more unusual for self-employed entertainers and sportspersons to be paid for training or preparation.

35. Two commentators, however, objected to that last observation and referred to the following situations where they argued that self-employed individuals were paid for preparation or training:

– "Self-employed sportspeople have contracts which include the fact that products must be used in training as well as competition".

- "Actors may need to undertake preparation for specific roles (e.g. a role requiring him/her to ride a horse); in that case they will need to train for the role, but the days spent in training will form part of the work in relation to the film fee."
- Some self-employed persons performing in plays, operas and concerts may be contractually required to participate in rehearsals.

36. Whilst it was unclear, in the first two examples, whether or not the person was paid for the training or preparation period, the Committee agreed that the last example involved payments for preparation made to a self-employed person.

37. Based on these comments, the Committee concluded that the reference to rehearsals and the example of a self-employed person being paid for rehearsing should be added to proposed paragraph 9.1.

The following revised version of the relevant part of the paragraph was therefore adopted by the Committee:

Add the following subparagraphs to proposed paragraph 9.1 (see above) of the Commentary on Article 17:

> [9.1 Apart from the above examples, there are a number of cases where it may be difficult to determine whether a particular item of income is derived by a person as an entertainer or sportsperson from

that person's personal activities as such. The following principles may be useful to deal with such cases:]

- […]
- Preparation, such as rehearsal and training, is part of the normal activities of entertainers and sportspersons. If an entertainer or sportsperson is remunerated for time spent on preparation, rehearsal, training or similar preparation in a State (which would be fairly common for employed entertainers and sportspersons but could also happen for a self-employed individual, such as an opera singer whose contract would require participation in a certain number of rehearsals), the relevant remuneration, as well as remuneration for time spent travelling in that State for the purposes of performances, rehearsal and training (or similar preparation), would be covered by the Article. This would apply regardless of whether or not such rehearsal, training or similar preparation is related to specific public performances taking place in that State (e.g. remuneration that would be paid with respect to the participation in a pre-season training camp would be covered).

23.15.4 *Receipts by third parties*

Para 17(2) OECD Model provides:

> 2. Where income in respect of personal activities exercised by an entertainer or a sportsperson acting as such accrues not to the entertainer or sportsperson but to another person, that income may, notwithstanding the provisions of Article 15, be taxed in the Contracting State in which the activities of the entertainer or sportsperson are exercised.

OECD Commentary provides:

> 11. Paragraph 1 of the Article deals with income derived by individual entertainers and sportspersons from their personal activities. Paragraph 2 deals with situations where income from their activities accrues to other persons. If the income of an entertainer or sportsperson accrues to another person, and the State of source does not have the statutory right to look through the person receiving the income to tax it as income of the performer, paragraph 2 provides that the portion of the income which cannot be taxed in the hands of the performer may be taxed in the hands of the person receiving the remuneration. If the person receiving the income carries on business activities, tax may be applied by the source country even if the income is not attributable to a permanent establishment there. But it will not always be so. There are three main

situations of this kind:

a) The first is the management company which receives income for the appearance of e.g. a group of sportspersons (which is not itself constituted as a legal entity).

b) The second is the team, troupe, orchestra, etc. which is constituted as a legal entity. Income for performances may be paid to the entity. Individual members of the team, orchestra, etc. will be liable to tax under paragraph 1, in the State in which they perform their activities as entertainers or sportspersons on any remuneration (or income accruing for their benefit) derived from the performance; of these activities (see, however, paragraph 14.1 below). The profit element accruing from a performance to the legal entity would be liable to tax under paragraph 2.

c) The third situation involves certain tax avoidance devices in cases where remuneration for the performance of an entertainer or sportsperson is not paid to the entertainer or sportsperson himself but to another person, e.g. a so-called star-company, in such a way that the income is taxed in the State where the activity is performed neither as personal service income to the entertainer or sportsperson nor as profits of the enterprise, in the absence of a permanent establishment. Some countries "look through" such arrangements under their domestic law and deem the income to be derived by the entertainer or sportsperson; where this is so, paragraph 1 enables them to tax income resulting from activities in their territory. Other countries cannot do this. Where a performance takes place in such a country, paragraph 2 permits it to impose a tax on the profits diverted from the income of the entertainer or sportsperson to the enterprise. It may be, however, that the domestic laws of some States do not enable them to apply such a provision. Such States are free to agree to other solutions or to leave paragraph 2 out of their bilateral conventions.

11.1 The application of paragraph 2 is not restricted to situations where both the entertainer or sportsperson and the other person to whom the income accrues, e.g. a star-company, are residents of the same Contracting State. The paragraph allows the State in which the activities of an entertainer or sportsperson are exercised to tax the income derived from these activities and accruing to another person regardless of other provisions of the Convention that may otherwise be applicable. Thus, notwithstanding the provisions of Article 7, the paragraph allows that State to tax the income derived by a star-company resident of the other Contracting State even where the entertainer or sportsperson is not a resident of that other State. Conversely, where the income of an entertainer resident in one of the Contracting States accrues to a person, e.g. a star-company, who is a resident of a third State with which the State of source does not have a tax convention, nothing will prevent the Contracting State from taxing that person in accordance with its domestic laws.

11.2 Paragraph 2 does not apply, however, to prize money that the owner of a horse or the team to which a race car belongs derives from the results of the horse or car during a race or during races taking place during a certain period. In such a case, the prize money is not paid in consideration for the personal activities of the jockey or race car driver but in consideration for the activities related to the ownership and training of the horse or the design, construction, ownership and maintenance of the car. Such prize money is not derived from the personal activities of the jockey or race car driver and is not covered by Article 17. Clearly, however, if the owner or team receives a payment in consideration for the personal activities of the jockey or race car driver, that income may be taxed in the hands of the jockey or race car driver under paragraph 1 (see paragraph 7 above).

23.15.5 *Foreign tax credit relief*

The INTM provides:

INTM168063 Foreign tax paid on trade income: limitation on credit: Artistes/athletes/sportsmen [Jan 2018]

As indicated in INTM153190, the country in which an entertainer or sportsman performs has primary taxing rights over the income he derives from his performances in that country. Many foreign countries impose a withholding tax on the payments made for such performances at a fixed percentage of the gross payments. These are final taxes and normally claims cannot be made to the foreign country to have the expenses incurred in earning the payments deducted from the gross amounts. Where a resident entertainer or sportsman is charged to UK Income Tax on profits or gains arising from any profession or vocation, he is entitled to credit for these foreign taxes against the UK tax on the UK measure of that income, that is, the income less the expenses incurred in earning it. The credit will be the lesser of the foreign tax and the tax at his marginal rate (see INTM165040 onwards).

Where, however, a resident entertainer or sportsman is employed by a service company, the income from his performances is income of that company and he is paid a salary out of that income. Credit for the foreign tax paid on the payments for his performances is due against the Corporation Tax payable by the company on its profits. The income of the entertainer or sportsman is remuneration from the service company and not the original fees paid to the company and he is not therefore entitled to credit for such foreign tax against the UK tax on his salary. Nonetheless, it is possible that that a different treatment may be available where the foreign tax is imposed in a personal capacity on the entertainer etc notwithstanding that the performance payments are made to the service company. This treatment is intended to put the entertainer etc in a similar position when receiving remuneration from a service company in respect of overseas income that can be matched to a particular source, to the one he would have been in had he received the income direct. For instance, if a clear and direct link can be made between the fees for the performance in the overseas country and the income arising to the performer in the form of remuneration from the service company then it may be that the remuneration derived by the entertainer can be identified with the income taxed by the foreign tax authority. Where there such a link can be made, and the interval between the two events is short, it may be possible to allow the tax credit against income tax charged on the entertainer etc. Any credit given to the entertainer etc must be restricted in accordance with TIOPA10/S36 and S37, by reference to expenses (see INTM168010 onwards.)[27]

Please therefore refer to Personal Tax International (PTI) Advisory. (part of Charity, Assets & Residence) where (i) a claim to credit for foreign tax is made by the entertainer or sportsman and (ii) the foreign tax has been imposed on the income received by the service company but (iii) the overseas tax authority has disregarded the existence of the service company and taxed the income as if it belonged to the entertainer or sportsman. This treatment will not be available where a deduction for the foreign tax has been allowed to the company under S112 TIOPA10.

23.15.6 *Cultural exemption*

OECD Model Commentary provides:

> 2. ... too strict provisions might in certain cases impede cultural exchanges. In order to overcome this disadvantage, the States concerned may, by common agreement, limit the application of paragraph 1 to business activities.

About a dozen UK treaties contain a cultural exemption.

[27] See 111.23 (Limit on credit relief).

CHAPTER TWENTY FOUR

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  24.14.7 Record keeping
  24.14.8 Certificate for landlord
24.15 Gross payment of property income
24.16 Credit for withholding tax
24.17 Agent indemnity

Cross references

The following topics are considered elsewhere:

  14.7.3 (Property/trade income overlap).

111.20.2 (FTC: Property income)

24.1 Property income: Introduction

The Taxes Acts use the term "**property income**" to mean income from land.[1] The taxation of property income is governed by Part 3 ITTOIA/Part 4 CTA 2009. A full discussion needs a book to itself. This chapter focuses on matters closest to the themes of this book.

From 2020/21, property income of non-UK resident companies is subject to CT rather than IT.

The development of the rules can be traced through:

- HMRC "Non-resident companies chargeable to Income Tax and non-resident CGT: Consultation Document" (Mar 2017)[2]
- HMRC "Non-resident companies chargeable to income tax and non-resident CGT: summary of responses" (Dec 2017)[3]
- Draft FB clauses (July 2018)

[1] TLR Exposure Draft No. 13 discusses the terminology:

> "*Finding a suitable name*
>
> 223. Letting income has long been referred to as 'Schedule A income' by tax professionals. But that is not an informative label for the non-specialist and we are removing references to the Schedules.
>
> 224. We considered several possible new names for this type of income including 'land income', 'letting income', 'rental income', 'property business income' and 'property income'. We concluded that 'property income' offered the best compromise because:
>
> - it matches the names that are proposed for the other types of income: 'trading income', 'employment income' and 'savings and investment income';
> - for most people, it is likely to appear the most appropriate name; and
> - it links directly with what we think is the most appropriate name for the business activity ('property business'): 'land business' and 'rental business' might be particularly misleading.
>
> 225. The disadvantage is that it might appear to go wider than income just from land; that is, strictly, 'property' means more than just land and buildings. But we do not think that most people will find this confusing as the proposed use corresponds broadly to the popular use."

[2] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/601032/Non-resident_companies_chargeable_to_Income_Tax_and_non-resident_CGT_-_consultation.pdf*

[3] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/664178/Non-resident_companies_chargeable_to_income_tax_and_non-resident_CGT_summary_of_responses.pdf*

But these are now of historical interest only.

The change will add to complexity. CT is a more sophisticated tax than IT, in many respects, in particular:

(1) Treatment of interest (loan relationships)
(2) Corporate interest restriction (cap on debt funding deductions by reference to a percentage of the company's profits); Part 10 TIOPA
(3) Taxation of hybrids

Private client practitioners advising foreign companies will have to master CT rules which hitherto they could leave for corporation tax practitioners. Sarah Squires[4] comments:

> Schedule 5 FA 2019 is not particularly lengthy (14 pages only) - but it just deals with the basics (commencement, transitional provisions and the charge itself). The "consequential" provisions are basically the entirety of the Corporation Tax Acts - and although corporation tax is based on income tax principles, developments since the early 1990s mean that there are significant differences between the two taxes (particularly in relation to financing arrangements) - with these differences extending to compliance. For many non-resident landlords, the move to corporation tax brings with it a rather steep learning curve.[5]

See 121.23 (CT registration).

24.2 Property business terminology

The definitions are in s.263 ITTOIA/s.204 CTA 2009.

The CT definitions are applied (with modifications) in ATED rental business relief.[6]

24.2.1 *"UK property business"*

s.264 ITTOIA	**s.205 CTA 2009**
A person's UK property business consists of—	A company's UK property business consists of—
(a) every business which the person carries on for generating income from land in the UK, and	(a) every business which the company carries on for generating income from land in the UK, and

[4] Barrister, in practice at Taxchambers, 15 Old Square, Lincoln ‘s Inn. I am indebted to Sarah Squires for her comments and assistance on this topic.

[5] Lecture to CIOT Sept 2019.

[6] See 98.18 (ATED rental relief).

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

At first sight para (b) is puzzling. EN ITTOIA explains:

> 1049. … the concept of the "property business" is, to a certain extent, an artificial one. Unlike the term "trade" it may not always correspond to an activity organised in a way that the proprietor would necessarily describe as a business. As such, the term has to cover:
> - "real" businesses where the lettings are organised in a professional way;
> - lettings which are not so organised; and
> - casual and one-off transactions which may have very little of the qualities normally associated with a business.
>
> Then all of these lettings of different types must be treated as part of the same, single business.

24.2.2 *"Overseas property business"*

s.265 ITTOIA	**s.206 CTA 2009**
A person's overseas property business consists of—	A company's overseas property business consists of—
(a) every business which the person carries on for generating income from land outside the UK, and	(a) every business which the company carries on for generating income from land outside the UK, and
(b) every transaction which the person enters into for that purpose otherwise than in the course of such a business.	(b) every transaction which the company enters into for that purpose otherwise than in the course of such a business.

EN ITTOIA explains:

> 1056. The definition is identical to that of "UK property business" except that the land from which the income arises is outside the UK. That is the only difference between a UK and an overseas property business: income from land outside the UK can arise only in an overseas property business; income from land in the UK can arise only in a UK property business.
>
> 1057. For the purpose of deciding whether there is an overseas property business, overseas land law is interpreted in accordance with section

363.

See 24.6 (Overseas property business: loss) for a refinement to this definition.

24.2.3 *"Property business"*

Section 263(6) ITTOIA/s.204(1) CTA 2009 provide a commonsense definition:

> In this Act "property business" means a UK property business or an overseas property business.

ITTOIA/CTA take foreign income of a non-resident out of charge. They adopt the somewhat clumsy technique of amending the definitions of overseas property business/property business (it makes no practical difference):

s.263 ITTOIA	**s.204 CTA 2009**
(4) References in this Act to an overseas property business are to an overseas property business so far as any profits of the business are chargeable to tax under Chapter 3 (as to which see, in particular, section 269).	(2) References in this Act to a property business are to a property business so far as any profits of the business are chargeable to tax under Chapter 3 (as to which see, in particular, the rules about territorial scope in section 5).
(5) Accordingly, nothing in Chapter 4 or 5 is to be read as treating an amount as a receipt of an overseas property business if the profits concerned would not be chargeable to tax under Chapter 3.	(3) Accordingly, nothing in Chapter 4 or 5 is to be read as treating an amount as a receipt of a property business if the profits concerned would not be chargeable to tax under Chapter 3.

24.2.4 *Generating income from land*

Section 266 ITTOIA/s.207 CTA 2009 provide:

> (1) In this Chapter "generating income from land" means exploiting an estate, interest or right in or over land as a source of rents or other receipts.
> (2) "Rents" includes payments by a tenant for work to maintain or repair leased premises which the lease does not require the tenant to carry out.
> (3) "Other receipts" includes—
> (a) payments in respect of a licence to occupy or otherwise use land,

> (b) payments in respect of the exercise of any other right over land, and
> (c) rentcharges and other annual payments reserved in respect of, or charged on or issuing out of, land.
> (4) For the purposes of this section a right to use a caravan or houseboat at only one location is treated as a right deriving from an estate or interest in land.

s.267 ITTOIA	**s.208 CTA 2009**
For the purposes of this Chapter the following activities are not carried on for generating income from land—	[identical]
(a) farming or market gardening in the UK (but see section 9 (UK farming or market gardening treated as trade)),	(a) farming or market gardening in the UK (but see section 36 (UK farming or market gardening treated as trade)),
(b) any other occupation of land (but see section 10 (certain commercial occupation of UK land treated as trade)), and	(b) any other occupation of land (but see section 38 (certain commercial occupation of UK land treated as trade)), and
(c) activities for the purposes of a concern to which section 12 applies (profits of mines, quarries etc).	(c) activities for the purposes of a concern to which section 39 applies (profits of mines, quarries etc).

24.3 Territorial limits: Property income

The charge is as follows:

s.268 ITTOIA	**s.209 CTA 2009**
Income tax is charged on the profits of a property business.	The charge to corporation tax on income applies to the profits of a property business.

The territorial scope of the charge is in s.269 ITTOIA/s.5 CTA 2009, but these provisions are not drafted in the same way.

24.3.1 *IT territorial limits*

Section 269 ITTOIA provides:

> (1) Profits of a UK property business are chargeable to tax under this Chapter whether the business is carried on by a UK resident or a

> non-UK resident.
> (2) Profits of an overseas property business are chargeable to tax under this Chapter only if the business is carried on by a UK resident.
> **270 Income charged**
> (1) Tax is charged under this Chapter on the full amount of the profits arising in the tax year.
> (2) Subsection (1) is subject to Part 8 (foreign income: special rules).

Section 270(2) ITTOIA feeds into s.832 which incorporates the remittance basis.

24.3.2 *Property income of split year*

Section 270(3) ITTOIA provides the usual split-year rule:

> If, as respects an individual carrying on an overseas property business, the tax year is a split year—
> (a) tax is charged under this Chapter on so much of the profits referred to in subsection (1) as arise in the UK part of the tax year, and
> (b) the portion of the profits arising in the overseas part of the tax year is, accordingly, not chargeable to tax under this Chapter.

Section 270(4) (not discussed here) deals with capital allowances.

24.3.3 *CT territorial limits*

The key provision is s.5(3A) CTA 2009, but it is necessary to read this in the context of the whole of section 5:

> (1) A UK resident company is chargeable to corporation tax on income on all its profits wherever arising (but see Chapter 3A for an exemption from charge in respect of profits of foreign permanent establishments).
> (2) A non-UK resident company is within the charge to corporation tax only if—
> (a) [dealing in or developing UK land]
> (b) [trade in UK through a UK PE],
> (c) it carries on a UK property business, or
> (d) it has other UK property income.[7]

[7] Section 5(5) CTA 2009 provides: "In this Part "other UK property income" means income dealt with by any of the following Chapters of Part 4—
(a) Chapter 7 (rent receivable in connection with a UK section 39(4) concern);
(b) Chapter 8 (rent receivable for UK electric-line wayleaves);
(c) Chapter 9 (post-cessation receipts arising from a UK property business)."

> (2A) [concerns dealing in or developing UK land]
> (3A) A non-UK resident company which carries on a UK property business is chargeable to corporation tax on income on all its profits that are—
> (a) profits of that business, or
> (b) profits arising from loan relationships or derivative contracts that the company is a party to for the purposes of that business.

Section 5(3B) CTA 2009 deals with the quantum of the charge:

> (3B) A non-UK resident company which has other UK property income is chargeable to corporation tax on income on all its profits that—
> (a) consist of that income, or
> (b) are profits arising from loan relationships or derivative contracts that the company is a party to for the purposes of enabling it to generate that income.

24.3.4 *Loan relationships charge*

Section 5(3A) CTA 2009 imposes two charges to CT:
(1) s.5(3A)(a): charge on profits of a UK property business
(2) s.5(3A)(b): charge on loan relationship/derivative contract profits

The reason for the second charge is s.211(1) CTA 2009 which provides:

> The profits of a property business are calculated without regard to items giving rise to—
> (a) credits or debits within Part 5 (loan relationships), or
> (b) credits or debits within Part 7 (derivative contracts).

Interest[8] is not taken into account in calculating profits of a UK property business for CT purposes. Instead the loan relationship /derivative codes apply. These give rise to non-trading credits and debits: and hence the need for a specific charging section to apply s.299 CTA 2009.[9]

The CT loan relationship charge applies so that non-trading profits[10] arising to a non-resident company from its loan relationships/derivative contracts are charged to CT - but only where the relevant amounts arise

[8] I use the term loosely, to include other financing amounts.

[9] The position of a non-resident company carrying on a property business is different from a non-resident company dealing/developing UK land, where credits/debits are brought into account as trading receipts/losses; see s.297 CTA 2009.

[10] See s299 and 301 CTA 2009.

from a loan relationship to which the non-resident is party for the purposes of its UK property business.

"For the purposes of" requires a link between interest income and property business. So for example, interest on late rent should be within s.5(3A)(a). But, if say, the non-resident company is also a holding company and has, independently of its property business, made a loan to a subsidiary, interest on that loan would be outside CT (although potentially subject to IT if the interest has a UK source).

Similarly, the loan relationship code governs the deductibility of interest payable by non-resident companies for CT purposes.[11] But again relief under the loan relationship code is only available where the nonresident company is party to the loan/derivative for the purposes of its UK property business.[12]

If a company's non-trading debits exceed its non-trading credits in an accounting period, a nontrading deficit arises - and relief can only be obtained on the making of a claim for sideways relief.[13]

The charge to tax under s.5(3A) CTA 2009 is subject to any applicable DTA.

24.4 Non-resident co: Transitional rules

24.4.1 *Commencement*

Para 35 sch 5 FA 2019 provides:

> This Schedule comes into force on 6 April 2020 ("the commencement date").

Para 49 sch 5 FA 2019 contains a forestalling TAAR, which is not discussed here.

24.4.2 *Accounting period across 6/4/20*

Para 36 sch 5 FA 2019 provides:

> 30 Where a period of account of a company begins before and ends on or after the commencement date, it is to be assumed for the purposes of

[11] See s.464 and s.1301A CTA 2009. Note: s.300(3) CTA 2009 means that a loan relationship can be brought into account under Part 5 CTA 2009 even if it is not itself a source of income.

[12] See s.301 CTA 2009.

[13] See s.463D CTA 2009.

the amendments made by this Schedule-

(a) that the period ("the straddling period of account") consists of two separate periods of account-

(i) the first beginning with the date on which the straddling period of account begins and ending with 5th April 2020, and

(ii) the second beginning with the commencement date and ending with the date on which the straddling period of account ends, and

(b) that separate accounts have been drawn up for each of those separate periods in accordance with generally accepted accounting practice.

24.4.3 *Losses*

Para 37 sch 5 FA 2019 provides:

> (1) This paragraph applies if—
>
> (a) in a tax year ending before the commencement date a company makes a loss in a UK property business that is within the charge to income tax,
>
> (b) relief for the purposes of income tax is not given to the company for an amount of the loss ("the unrelieved amount"), and
>
> (c) on the commencement date the UK property business ceases to be within the charge to income tax and comes within the charge to corporation tax as a result of section 5(3A) of CTA 2009.
>
> (2) Relief for the purposes of corporation tax is given to the company under this paragraph for the unrelieved amount.
>
> (3) For this purpose—
>
> (a) the unrelieved amount is carried forward to post-commencement accounting periods of the company (for so long as the company continues to carry on the UK property business), and
>
> (b) the profits of any such accounting period that are mentioned in subparagraph (4) are to be reduced by the unrelieved amount (so far as that amount cannot be used under this paragraph to reduce the profits of an earlier period).
>
> (4) The profits are—
>
> (a) profits of the UK property business, and
>
> (b) profits arising from loan relationships or derivative contracts that the company is a party to for the purposes of that business.
>
> (5) In this paragraph "post-commencement accounting period" means an accounting period ending after the commencement date.

24.4.4 *Company in partnership*

Para 38 sch 5 FA 2019 provides:

> (1) This paragraph applies if—
> (a) in the tax year 2019-20 a non-UK resident company is a partner in a firm which—
> (i) carries on a trade, and
> (ii) has untaxed income or relievable losses from a UK property business, and
> (b) accordingly, the company is treated under section 854 of ITTOIA 2005 as having a notional business for the tax year.
> (2) The basis period for the notional business for the tax year is taken to end with 5th April in that tax year (if it would not otherwise do so).
> (3) In this paragraph "untaxed income" has the meaning given by section 854(6) of ITTOIA 2005.

24.5 Quantum of property income

The quantum of property income is dealt with in a series of provisions from s.271A ITTOIA/s.210 CTA 009 onward; this is not discussed here, though I hope to address it in a future edition.

24.5.1 *Property income: IT computation*

The Property Income Manual provides:

> **2105. Introduction** [Mar 2018]
> **... Interest rate hedging instruments**
> Where an interest rate hedging contract such as a swap or cap is taken out to hedge interest payments which are deductible in computing the profits or losses of a rental business, then profits or losses on that contract will normally be taxed or relieved as receipts or deductions of that rental business. This is because trading principles are imported into the property income computation rules. Profits and losses on such instruments should normally be computed on an accruals basis so that payments and receipts are allocated to the periods to which they relate, without regard to the periods in which they are made or received or become due and payable, in accordance with normal accounting practice. For more on the tax treatment of swaps held by IT payers see PIM2066.

24.6 Overseas property business: Loss

24.6.1 *Losses from 2008/09*

Chapter 4 Part 4 ITA provides loss relief for a property business. There are three classes of loss relief:

(1) Carry forward against subsequent property business profits: ss.118–119 ITA.

(2) (a) Capital allowance losses and
(b) agricultural estate losses.
Sections 120–124 ITA.

(3) Post-cessation property relief: ss.125–126 ITA.

In this chapter I consider only the first of these reliefs. Section 118 ITA provides:

> (1) Relief is given to a person under this section if the person—
> (a) carries on a UK property business or overseas property business (alone or in partnership) in a tax year, and
> (b) makes a loss in the business in the tax year.
> (2) The relief is given by deducting the loss in calculating the person's net income for subsequent tax years (see Step 2 of the calculation in section 23).
> (3) But a deduction for that purpose is to be made only from profits of the business.[14]

The Property Income Manual correctly summarises:

> **4703 CT** [Apr 2018]
> *Losses*
> As part of the changes made by FA95, the taxable profits and losses of

[14] For completeness, the ITA continues:
"(4) In calculating a person's net income for a tax year, deductions under this section from the profits of a business are to be made before deductions of any other reliefs from those profits.
(5) No relief is to be given under this section so far as relief for the loss is given under section 120.
(6) This section needs to be read with section 119 (how relief works).
119 How relief works
This section explains how the deductions are to be made.
The amount of the loss to be deducted at any step is limited in accordance with section 25(4) and (5).
Step 1 Deduct the loss from the profits of the business for the next tax year.
Step 2 Deduct from the profits of the business for the following tax year the amount of the loss not previously deducted.
Step 3 Continue to apply Step 2 in relation to the profits of the business for subsequent tax years until all the loss is deducted."

> overseas let property were ring fenced for IT purposes. The effect was that:
>
> - losses of an overseas property business cannot, for IT purposes, be set against profits of a UK property business carried on by the same individual,
> - similarly, losses of UK property business cannot for IT purposes be set against profits of an overseas property business carried on by the same individual.

The definitions of UK property business and overseas property business in ITTOIA were only ITTOIA-wide definitions (they do not apply for all the Income Tax Acts) so the drafter of the ITA had to repeat them. Section 989 ITA extends them to the Income Tax Acts:

> The following definitions apply for the purposes of the Income Tax Acts—
>
> "overseas property business" has the meaning given by Chapter 2 of Part 3 of ITTOIA 2005,
>
> "UK property business" has the meaning given by Chapter 2 of Part 3 of ITTOIA 2005

At this point we need to consider s.263(4)(5) ITTOIA which restricts the meaning of "overseas property business":

> (4) References in this Act to an overseas property business are to an overseas property business so far as any profits of the business are chargeable to tax under Chapter 3 (as to which see, in particular, section 269).
>
> (5) Accordingly, nothing in Chapter 4 or 5 is to be read as treating an amount as a receipt of an overseas property business if the profits concerned would not be chargeable to tax under Chapter 3.

I refer to this provision as the **"non-chargeable overseas property business rule".** This rule applies for the purposes of "this Act" (ITTOIA). However it is suggested that this applies for the purposes of loss relief in the ITA, s.989 ITA incorporates the s.263 rule, because it incorporates the definition of Chapter 2 Part 3 ITTOIA, and s.263 is in Chapter 2.

Suppose T carries on an overseas property business and:

(1) Year 1: T is non-resident and realises losses;

(2) Year 2: T is UK resident and realises profits.

The losses of Year 1 are disallowed since the profits of that year are not chargeable under Chapter 3 (or at all) so there is no overseas property business. In short, losses of non-residents are not relievable. *Quaere* whether this would apply if T were resident in an EU member state.

What about an overseas property business carried on by a remittance basis taxpayer? An overseas property business which is taxed under the remittance basis is (from 2008/09) taxed under Chapter 3 (even though the amount of income taxed is determined by s.832 ITTOIA which is not in chapter 3.) So the non-chargeable overseas property business rule does not disallow loss relief. Presumably this change was intentional as it was not desired to introduce an equivalent of the incomprehensible CGT loss rules into this context.[15]

24.6.2 *Losses before 2008/09*

The position was different before 2008/09. This is still relevant in relation to the question of whether pre-2008 losses can be carried forward and set against post 2008 profits. The relevant legislation in ITTOIA provided:

> **268 Charge to tax on profits of a property business**
> Income tax is charged on the profits of a property business.
> **269 Territorial scope of charge to tax**
> (1) Profits of a UK property business are chargeable to tax under this Chapter whether the business is carried on by a UK resident or a non-UK resident.
> (2) Profits of an overseas property business are chargeable to tax under this Chapter only if the business is carried on by a UK resident.
> *(3) But, in the case of an overseas property business carried on by a UK resident to whom the remittance basis applies, the only profits of the business chargeable to tax under this Chapter are those in respect of land in the Republic of Ireland.*
> *(4) For a UK resident to whom the remittance basis applies, see also Chapter 11 (charge to tax on overseas property income other than income arising in Republic of Ireland).*

(Words in italics repealed by the FA 2008.) Thus for a remittance basis taxpayer, and ignoring the special case of land in Ireland,[16] the charge was not under Chapter 3. Instead it was in Chapter 11 (also repealed in the FA 2008). This provided:

> ***357 Charge to tax on overseas property income***
> *Income tax is charged on the overseas property income of a person to*

[15] See 65.16 (Loss of remittance basis taxpayer).

[16] I do not discuss Irish property income here, but note that the pre-2008 legislation was in breach of EU law; see 17.22 (RFI from Ireland).

> *whom the remittance basis applies.*
>
> ***358 Meaning of "overseas property income"***
>
> *In this Chapter "overseas property income", in relation to a person to whom the remittance basis applies, means amounts which*
>
> *(a) are not brought into account in calculating the profits of any overseas property business of the person, but*
>
> *(b) would be if section 269(3) (charge to tax on profits of an overseas property business of a person to whom the remittance basis applies only in respect of land in the Republic of Ireland) were omitted.*
>
> ***359 Income charged***
>
> *Tax is charged under this Chapter on the amount specified by section 832 (relevant foreign income charged on the remittance basis).*

So before 2008, the remittance basis taxpayer did not have an "overseas property business" so there could not be loss relief. In the 2007/08 edition of this book I commented:

> This is consistent with the CGT treatment of losses. It may be desirable for a foreign domiciliary not to claim remittance basis treatment in the year that a loss accrues in order to obtain that loss relief. Though the cost of that claim must be set against the benefit of the remittance basis in that year.
>
> Suppose the loss is allowable in the year it accrues but in a subsequent year the owner claims remittance basis treatment. The loss is not allowable in that year. However, it is suggested that the loss can be carried forward and set against profits of other years if the arising basis applies to those years.

It is suggested that a loss which did not qualify for relief in the year that it accrued cannot be carried forward to 2008/09 or subsequently. HMRC may well agree. The Property Income Manual provides:

> **4705. IT cases up to 2004-05** [April 2018]
>
> No loss can ever arise on income taxed on the remittance basis.

Offshore property business losses from before 1998/99 are allowable under ESC B25, but it seems unlikely that any such losses will still be available to be carried forward to the present time.

24.7 DT relief: Property income

Article 6(1) OECD Model provides:

> Income derived[17] by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.

The significance of this is that income from immovable property does not fall within article 21 ("Other Income", which is taxed only in the state of residence).[18] Instead, it is taxed in the source state with credit given in the state of residence.

OECD Model Commentary provides:

> 1. Paragraph 1 gives the right to tax income from immovable property to the State of source, that is, the State in which the property producing such income is situated. This is due to the fact that there is always a very close economic connection between the source of this income and the State of source. ... Article 6 deals only with income which a resident of a Contracting State derives from immovable property situated in the other Contracting State. It does not, therefore, apply to income from immovable property situated in the Contracting State of which the recipient is a resident within the meaning of Article 4 or situated in a third State; the provisions of paragraph 1 of Article 21 [other income] shall apply to such income.

24.7.1 *"Immovable property"*

The definition of immovable property is important for article 6 and for article 13 (capital gains).

Article 6(2) OECD Model Convention provides:

> [a] The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated.
> [b] The term shall in any case include
> [i] property accessory to immovable property,
> [ii] livestock and equipment used in agriculture and forestry,
> [iii]rights to which the provisions of general law respecting landed property apply,[19]
> [iv] usufruct of immovable property and
> [v] rights to variable or fixed payments as consideration for the

[17] See 15.11.1 ("Deriving" income).

[18] See 33.20 (DT relief: "Other Income").

[19] This wording was designed to address an issue concerning property rights attached to Italian landed estates; see *Royal Bank of Canada v HMRC* [2023] EWCA Civ 695 at [46].

> working of, or the right to work, mineral deposits, sources and other natural resources;[20]
>
> [c] ships, and aircraft shall not be regarded as immovable property.

OECD Model Commentary provides:

> 2. Defining the concept of immovable property by reference to the law of the State in which the property is situated, as is provided in paragraph 2, will help to avoid difficulties of interpretation over the question whether an asset or a right is to be regarded as immovable property or not. The paragraph, however, specifically mentions the assets and rights which must always be regarded as immovable property. In fact such assets and rights are already treated as immovable property according to the laws or the taxation rules of most OECD member countries. ... No special provision has been included as regards income from indebtedness secured by immovable property, as this question is settled by Article 11.[21]

24.7.2 *Property income or other income*

Article 6(3) elucidates "derived from" immovable property:

> 3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

OECD Model Commentary provides:

> 3. Paragraph 3 indicates that the general rule applies irrespective of the form of exploitation of the immovable property....

Mortgage interest is classified as interest income rather than property income.[22]

OECD Model Commentary comments on the border between property income and company distribution income:

> 3. ... Income in the form of distributions from Real Estate Investment Trusts (REITs), however, raises particular issues which are discussed in paragraphs 67.1 to 67.7 of the Commentary on Article 10.

Article 6(4) deals with the overlap of business income and property income:

[20] See *Royal Bank of Canada v HMRC* [2023] EWCA Civ 695 at [54] - [67].

[21] See 26.27.5 (DTA definition of interest).

[22] The definition of interest in OECD Model article 11(3) expressly includes income secured by mortgage: see 26.27.5 (Definition of interest).

> 4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.

OECD Model Commentary provides:

> 3. ... Paragraph 4 makes it clear that the provisions of paragraphs 1 and 3 apply also to income from immovable property of industrial, commercial and other enterprises. ...
> 4. It should be noted in this connection that the right to tax of the State of source has priority over the right to tax of the other State and applies also where, in the case of an enterprise, income is only indirectly derived from immovable property.[23] This does not prevent income from immovable property, when derived through a permanent establishment, from being treated as income of an enterprise, but secures that income from immovable property will be taxed in the State in which the property is situated also in the case where such property is not part of a permanent establishment situated in that State. It should further be noted that the provisions of the Article do not prejudge the application of domestic law as regards the manner in which income from immovable property is to be taxed.

24.8 Non-resident landlord scheme

24.8.1 *Background*

Section 971(1) ITA 2007 provides:

> HMRC may by regulations make provision for—
> (a) the collection, from non-resident landlord representatives of a prescribed description, of prescribed amounts of income tax in respect of non-resident landlord income, and
> (b) the assessment and recovery of the income tax on or from such persons.

This is known as the non-resident landlords scheme ("NRLS").

The regulations are the Taxation of Income from Land (Non-residents) Regulations 1995, which I abbreviate to **NRLR**. The policy of the Tax Law Rewrite was not to rewrite or update statutory instruments, so the regulations retain out of date references to the former legislation in ICTA

[23] *Royal Bank of Canada v HMRC* [2023] EWCA Civ 695 follows this and adds at [48]: "The reference here to "indirectly" is presumably to the fact that, for a trader, the income may simply form a component of the trader's taxable profit, but nonetheless for Article 6 purposes it is not to be treated as losing its character as income from immovable property."

1988, and use the old terminology. (I add the current references in brackets).

HMRC have issued guidance which I call the **"NRLS guidance"**.[24] This guidance was first published in 2014, with the most recent edition published in 2023. However, the former edition is still of interest as it contains guidance not found elsewhere.

See too 26.19 (Withholding taxes: Introduction).

24.8.2 *"Non-resident landlord income"*

Section 971(2) ITA 2007 provides:

> "Non-resident landlord income" means income
> [a] of a person whose usual place of abode is outside the UK ("the non-resident") and
> [b] which is or may become chargeable as the profits of a UK property business under Chapter 3 of Part 3 of ITTOIA 2005 or Chapter 3 of Part 4 of CTA 2009.

24.8.3 *"Landlord representative"*

Section 971(3) ITA 2007 provides:

> "Non-resident landlord representative" means—
> (a) a person by whom any sums are payable to the non-resident which are to be treated as receipts of a UK property business (within the meaning of Chapter 2 of Part 3 of ITTOIA 2005 or Chapter 2 of Part 4 of CTA 2009) carried on by the non-resident, or
> (b) a person who acts on behalf of the non-resident in connection with the management or administration of any such business.

I refer to a person within (a) as the **"tenant"** and a person within (b) is the **"letting agent"**.

24.9 Non-resident landlord

24.9.1 *Partnerships*

The NRLS guidance provides:

[24] HMRC, "The Non-resident Landlords Scheme: Guidance notes for letting agents and tenants" (last updated 10 November 2023) *https://www.gov.uk/government/publications/non-resident-landord-guidance-notes-for-letting-agents-and-tenants-non-resident-landlords-scheme-guidance-notes*

> For the purposes of the NRLS, landlords may include: individuals, companies, trustees, partnerships. Each partner is treated as a separate landlord for their share of the rental income.

24.9.2 *Joint owners*

The PI Manual provides:

> **PIM4810 summary of the non-resident landlord scheme** [May 2020]
> ... For jointly owned property (e.g. husband and wife), each individual is treated as a separate landlord. It is possible for some of those landlords and not others to be NRLs for the purposes of the NRL scheme. For example it is possible for one spouse to be a NRL and within the scheme, while the other lives in the UK and is unaffected by the scheme.

The former NRLS guidance provides:

> **Jointly owned property**
> 2.7 Where a property is jointly owned and one or more of the joint owners has a usual place of abode outside the UK, the share of rental income attributable to those joint owners falls within the NRL Scheme. The share attributable to joint owners who do not have a usual place of abode outside the UK does not fall within the Scheme.

24.9.3 *Husband and wife*

The NRLS guidance provides:

> **Joint ownership by spouses or civil partners**
> The NRLS applies to both spouses and each are treated as a separate landlord, if: the spouses or civil partners jointly own a UK property [and] they both have their usual place of abode outside the UK.
> If they both wish to receive the rental income with no tax deducted, both must complete a separate application form and send it to HMRC.
> Letting agents and tenants only pay rental income with no tax deducted to the person named on a HMRC authorisation.
> You should not pay rent without tax deducted to a person who does not hold authority to do so, even if their spouse or civil partner does.
> If only one spouse or civil partner has a usual place of abode outside the UK, the NRLS applies to only that person's share of the rental income.
> The Scheme will not apply to the rental income belonging to the UK-resident spouse or civil partner. They will not need HMRC approval to receive income without tax deducted, but must notify HMRC that they receive UK property income.

24.9.4 *Armed forces, Crown servants*

The NRLS guidance provides:

> **Members of HM Armed Forces and other Crown Servants**
> Members of HM Armed Forces and other Crown Servants are treated the same as any other non-resident landlord. If they receive UK rental income and have a usual place of abode outside the UK, the NRLS applies to them.
> If their usual place of abode is outside the UK and they wish to receive rental income with no tax deducted, they'll need to apply to HMRC for approval.

24.10 Definitions

24.10.1 *"Agent"*

Reg 2 NRLR provides:

> In these Regulations unless the context otherwise requires—
> "agent" means a person falling within [s.42A(2)(b) ICTA = s.971(3)(b) ITA, a person who acts on behalf of the non-resident in connection with the management or administration of a UK property business]

I use the term **"letting agent"** (following the NRLS guidance). The NRLS guidance provides:

> For example, a solicitor would be an excluded person if their only action in relation to a UK property was either to:
> - receive apportioned rental income or a premium in the course of a conveyance
> - take legal proceedings for the recovery of arrears of rental income.
>
> Solicitors who draw up a lease and collect the rent for the first period are not excluded persons.
> Drawing up a lease is providing a legal service, but collecting the rent means the solicitor is also acting as a letting agent.
> Banks and building societies are not treated as letting agents for the purposes of the NRLS if they only provide an account where:
> - rental income is paid into
> - withdrawals are made from.
>
> People who find tenants for non-resident landlords are not treated as letting agents for the purposes of the Scheme if they either:
> - receive fees for that service but do not handle or control any rental income
> - handle or control income only for short periods - for example, a tenant-finder.

The NRLS guidance provides:

> **Tenant-finders**
>
> Some people enter into arrangements with non-resident landlords where they find a tenant for the landlord's property.
>
> The tenant-finder then collects rent for a period from which they recover the fee. The tenant then pays rental income to the landlord. In these circumstances, the tenant-finder does not have to operate the NRLS for the landlord, provided the:
>
> - period for which rent is collected is no more than 3 months
> - tax which would be payable would be no more than £100.
>
> The non-resident landlord will receive rental income with no tax deducted for a period where tenant-finders:
>
> - collect that period's rent
> - do not have to operate the Scheme
>
> As a result tenants will pay rent directly to the landlord and may have to operate the Scheme. In these circumstances tenant-finders should tell the tenant of their obligations under the NRLS.

The former NRLS guidance provides:

> 3.28 **Example 1**
>
> Janet finds a tenant for a non-resident landlord in respect of a property rented at £500 per month. Janet collects two months' rent in order to recover her fee, £700. The tenant pays the rent direct to the landlord from the third month.
>
> If Janet were required to operate the scheme, her tax calculation would be (see Chapter 4 below):

Rental income received	£1000
Less deductible expenses	£700
	£300
Basic Rate tax on £300	£60
(20% for 2010/11)	

> As the tax is less than £100, Janet does not have to operate the Scheme.
>
> 3.29 **Example 2**
>
> John finds a tenant for a non-resident landlord in respect of a property rented at £2000 a year. John collects six months' rent in advance from which he recovers his fee of £500. John also pays insurance and repairs of £400.
>
> John's tax calculation is (see Chapter 4 below):

Rental income received	£1000
Less deductible expenses	£900
	£100

Basic Rate tax on £100 (20% for 2010/11)	£20

The tax is only £20 but because John collects more than three months' rent he must operate the Scheme. He should deduct the tax of £20 and pay it with his quarterly return (see Chapter 4 below).

24.10.2 *"Non-resident" (place of abode)*

> In these Regulations unless the context otherwise requires—
> "non-resident" means a person who has his usual place of abode outside the UK;

The place of abode matters on two occasions:

(1) The landlord is only within the regulations if their place of abode is outside the UK.

(2) The agent or tenant is only a prescribed person if their place of abode is in the UK.

For the meaning of the expression, see 26.22 (Usual place of abode).

24.10.3 *"Schedule A business"*

Reg 2 NRLR sends the reader on a wild goose chase:

> "Schedule A business" shall be construed in accordance with subsection (8)(a) of section 42A [ICTA 1988]

Section 42A(8) was repealed in 1998: It provided that:

> *This section shall have effect—*
> *(a) as if references in this section to a Schedule A business included references to any activities which would be comprised in a Schedule A business if they were carried on by an individual, rather than by a company...*

That rule was needed for the short period from 1995 when individuals were taxed on the profits of a schedule A business, but companies were still taxed under the former schedule A. Now companies are taxed on a UK property business, as individuals, this rule has no effect.

The Tax Law Rewrite replaced the expression "schedule A business" with "UK property business", which is how the expression must now be understood.

These irritations are bound to arise under the rewrite project, under which statutes were rewritten but statutory instruments were not; but it does not ultimately matter.

24.10.4 *Quarters and other time periods*

Reg 2 NRLR provides:

> "annual period" means the period commencing on 1st April and ending on the following 31st March;
> "quarter" means—
> (a) the period from 6th April 1996 to 30th June 1996;
> (b) any subsequent period of 3 months ending with the last day of September, December, March or June;
> "year" means year of assessment.

24.10.5 *"Payments to the board"*

The regulations refer to payments being made "to the Board" of HMRC. Para 169 sch 2 ITA provides:

> (1) Sub-paragraph (2) applies to any references in the Taxation of Income from Land (Non-residents) Regulations 1995 (SI 1995/2902) to payments to be made to the Board in respect of tax that is or may become chargeable as the income from a business of a non-resident (as defined in those regulations).
> (2) On and after 6 April 2007 those references are to be read as references to income tax to be paid to the Commissioners for Her Majesty's Revenue and Customs in respect of non-resident landlord income (as defined in section 971(2)).

24.11 Prescribed persons

Reg 1(2) NRLR provides:

> These Regulations shall have effect with respect to any payment[25] made on or after 6th April 1996 which—
> (a) constitutes income of a Schedule A [UK property] business carried on by a non-resident, and
> (b) either—
> (i) is made by a person
> [A] falling within subsection 42A(2)(a) ICTA [= s.971(3)(a) [a tenant]
> [B] who is a prescribed person in respect of the non-resident, or
> (ii) is received by an agent who is a prescribed person in respect

[25] For the meaning of payment, see 15.3 (Recognition/attribution: Analysis),

> of the non-resident or by another person at the direction of that agent.

Thus being a prescribed person is a key to the application of the scheme. There are three categories of prescribed person. In order of priority:

(1) Agent or tenant with HMRC notice
(2) Agent without HMRC notice
(3) Tenants without HMRC notice

24.11.1 *Agent/tenant has HMRC notice*

Regulation 3(1) NRLR provides:

> (1) In any case where
> [a] a person falling within [42A(2)(a)(b) ICTA = s.971(3) ITA, an agent or tenant]
> [b] is issued with a notice by the Board stating that he is a prescribed person for the purposes of [s.42A(1) = s.971(1) ITA] in respect of the Schedule A [UK property] business of a non-resident, or a part of that business,
> that person is prescribed for the purposes of subsection (1) of that section in respect of that business or, as the case may be, the part referred to in the notice.

Regulation 3(2) NRLR deals with the content of the notice:

> (2) Except where it relates to a part of a non-resident's Schedule A [UK property] business , a notice under paragraph (1) above need not specify the name of the non-resident concerned or describe his Schedule A [UK property] business.

The NRLS guidance provides:

> You cannot transfer a notice you hold to a new letting agent or tenant if either:
> - a non-resident landlord changes letting agents
> - a tenant does not have a letting agent
>
> In these circumstances, the landlord should write to HMRC with details of the new letting agent or tenant.
> We will then send a notice to the new letting agent or tenant. New letting agents or tenants must deduct tax until they receive a notice from HMRC.

24.11.2 *Agent without HMRC notice*

Regulation 3(3) NRLR provides:

> In any case where—
> (a) no notice has been issued by the Board under paragraph (1) above in respect of a non-resident's Schedule A [UK property] business , or there is a part of his business in respect of which no notice has been issued under that paragraph; and
> (b) a person whose usual place of abode is in the UK—
> (i) is an agent in respect of that business or that part,
> (ii) has power to receive income in respect of that business or that part or has control over the direction of that income, and
> (iii) is not an excluded person,
>
> that person is, subject to paragraph (4) below, prescribed for the purposes of subsection (1) of section 42A in respect of that business or, as the case may be, that part.

Regulation 4 provides protection for lawyers by making them excluded persons:

> (1) In regulation 3—
> (a) "excluded person" means an agent whose activity on behalf of the non-resident in connection with the management or administration of his Schedule A [UK property] business or part thereof (as the case may be) is confined to the provision of legal advice or legal services;

24.11.3 *Power to select agent*

Regulation 3(4) NRLR provides:

> Where in a case falling within paragraph (3) above there is more than one person to whom sub-paragraph (b) of that paragraph applies as respects the same business or the same part of a business, the person who is the elected agent or, if there is no elected agent, the last agent is the person prescribed for the purposes of subsection (1) of section 42A in respect of that business or, as the case may be, that part.

The NRLS guidance provides:

> **Elected letting agents**
> Where there's a chain of letting agents, responsibility for operating the Scheme can be transferred. It can be transferred from the last agent to any other agent in the chain, by making a joint election to transfer.

Regulation 4 provides:

> (1) In regulation 3—

> (b) "elected agent" means the agent who is elected jointly by the last agent and himself to assume the responsibilities of a prescribed person for the purposes of [s.42A(1) ICTA = s.971(1) ITA] in relation to the Schedule A [UK property] business or part thereof (as the case may be);

Regulation 4 then deals with procedural aspects of an election:

> (2) An election shall be made by notice to the Board signed by the last agent and the person to be elected, and any such notice shall state—
> (a) the name and address of the agent elected, and
> (b) the date from which the election has effect, not being a date earlier than the first day of the quarter in which the election is made.
>
> (3) An election may be revoked by notice to the Board given by either of the agents who made the election, and any such revocation shall have effect—
> (a) from the first day of the quarter next following the date on which the notice is received by the Board, or
> (b) after the expiry of 30 days following the date on which the notice is received by the Board,
> whichever is the later to occur.

The NRLS guidance provides:

> To make an election, write to HMRC and give the following details:
> - name and address of the elected letting agent
> - name and address of the other letting agent
> - name and address of the non-resident landlord or landlords
> - date from when the election is to take effect (the letting agents can choose this date but it cannot be before the first day of the quarter in which the election is made).
>
> The election must be signed by both letting agents by either:
> - sending in one letter signed by both parties
> - writing in separately and each providing the same information
>
> There is no special form for making an election.
>
> Letting agents may wish to make an election for only part of a landlord's rental business. They can do this by specifying the property to which the election relates.
>
> Either letting agent may revoke the election by writing to HMRC. This will take effect from whichever date is later, either:
> - the first day of the quarter following the date the notice of revocation is received
> - 30 days after the date the notice of revocation is received

> HMRC will write to both letting agents telling them the date from when the revocation is effective.

In the absence of an election we fall back on the last agent. Regulation 4(1) defines the expression:

> (1) In regulation 3—
>
> (c) "last agent" means the agent by whom sums constituting income from the non-resident's Schedule A [UK property] business or part thereof (as the case may be) are paid directly to the non-resident or to an agent whose usual place of abode is outside the UK or to a person who is not an agent.

24.11.4 *UK tenant*

In the absence of an agent, we fall back on the tenant. Regulation 3(5) NRLR provides:

> In any case where—
>
> (a) no notice has been issued by the Board under paragraph (1) above in respect of a non-resident's Schedule A [UK property] business , or there is a part of his business in respect of which no notice has been issued under that paragraph;
>
> (b) there is no person to whom paragraph (3)(b) above applies in respect of that business or that part; and
>
> (c) a person whose usual place of abode is in the UK—
>
> (i) is a tenant of premises owned by the non-resident in connection with that business or that part, and
>
> (ii) is liable to pay to the non-resident in respect of his occupation of those premises sums exceeding in the aggregate £5,200 per annum or, where he occupies the premises for less than one year, the proportionate amount of that sum which is determined by the duration of his occupation,
>
> that person is prescribed for the purposes of subsection (1) of section 42A [= s.791 ITA] in respect of that business or, as the case may be, that part.

£5200 per annum is equivalent to £100 per week. The figure has not been increased since 1995.

The NRLS guidance provides:

> If you share a property with other tenants and each of you is named on the lease, the £5,200 limit will apply separately to each of you for your share of the rent. This will apply even if each of you are jointly and

> severally liable for all the rent payable under the lease. If you share a property with other tenants but only one of you is named on the lease, the £5,200 limit will apply to that person for all the rent payable.
> The limit of £5,200 applies for each landlord. If you have several non-resident landlords, you must operate the Scheme only for those landlords who you need to pay more than £5,200 per year.

24.11.5 *Prescribed person a partnership*

Regulation 5 NRLR provides:

> In any case where a liability to make any payment to the Board under these Regulations arises from amounts payable or things done in the course of a business carried on by any persons in partnership, that partnership as such shall be treated for the purposes of these Regulations as a person falling within subsection (2)(a) or (b) (as the case may be) of section 42A.

24.11.6 *Agent with multiple principals*

Regulation 6(1) provides:

> In any case where an agent—
> (a) is a prescribed person by virtue of regulation 3 in respect of the Schedule A [UK property] business , or part thereof, of more than one non-resident,
> (b) acts on behalf of those non-residents through branches[26] of his business in circumstances where the average number of non-residents in each branch at the relevant time[27] is not less than five, and
> (c) is a person approved by the Board for the purposes of this regulation,
>
> that person shall be treated for the purposes of these Regulations as if in respect of each branch he were a separate and distinct person.

Each branch puts in its own return. It is not clear to me why the agent should find that useful.

[26] Regulation 6(11) provides a wide definition: "In this regulation ... references to branches of an agent's business are references to the units (of whatever kind) into which the agent has divided his business."

[27] Defined reg 6(11): "In this regulation ... references to "the relevant time" are references to the time at which an application for approval is made by the prescribed person."

The rest of reg 6 deals with the procedure for application and approval:

> (2) An application for approval under paragraph (1) above shall be made to the Board in a form provided or authorised by the Board which shall contain—
>
> (a) such information as is necessary to identify the branches concerned,
>
> (b) the number of non-residents in each branch, and
>
> (c) a declaration by the prescribed person that he does not act on behalf of any non-residents other than those whose business is managed by the branches so identified.
>
> (3) An approval under paragraph (1) above shall, unless revoked or withdrawn, have effect for the quarter following that in which it is given and for any subsequent quarter.
>
> (4) An approval may be revoked by the prescribed person by notice to the Board and, subject to paragraph (5) below, such revocation shall have effect for the quarter following that in which it is given and for any subsequent quarter.
>
> (5) Notwithstanding the revocation of approval under paragraph (4) above, a further application for approval may be made by the prescribed person in accordance with paragraph (2) above at any time following the revocation; and paragraph (3) above shall apply accordingly in relation to an approval given in response to that application.
>
> (6) The Board may, by notice to the prescribed person, refuse approval where they have reason to believe that—
>
> (a) the average number of non-residents in each branch is less than five at the relevant time, or
>
> (b) there is likely to be a failure on the part of the prescribed person to comply with the obligations imposed on him under these Regulations in relation to any branch, or
>
> (c) the declaration given by the prescribed person pursuant to paragraph (2)(c) above is incorrect.
>
> (7) The Board may, by notice to the prescribed person, withdraw approval where they have reason to believe that—
>
> (a) the average number of non-residents in each branch was at the relevant time, or has since become, less than five, or
>
> (b) there has been a failure on the part of the prescribed person to comply with the obligations imposed on him under these Regulations in relation to any branch, or
>
> (c) the declaration given by the prescribed person pursuant to paragraph (2)(c) above was, or has become, incorrect.
>
> (8) The prescribed person may appeal against a notice under paragraph

> (6) above refusing approval, or a notice under paragraph (7) above withdrawing approval, by notice to the Board within 30 days of the date of issue of the notice of refusal or, as the case may be, the notice of withdrawal.
> (10) The tribunal shall, on an appeal notified to it, confirm the notice of refusal or withdrawal unless . . . satisfied that it ought to be quashed.

For the procedure, see the NRLS guidance 'Which agents should operate the Non-resident Landlords Scheme'. It does not seem of sufficient importance to set it out here.

24.11.7 *Agent duty to register*

Regulation 7 NRLR provides:

> (1) The person prescribed by paragraph (2) below shall, within the period of 30 days following the date specified in paragraph (3) below, register with the Board the following details—
> (a) his name and address, and
> (b) his tax office reference, if he has one.
> (2) The person prescribed by this paragraph is any person who is—
> (a) an agent in respect of the Schedule A [UK property] business, or part thereof, of a non-resident, and
> (b) a person prescribed by regulation 3 in respect of that business or that part.
> (3) The date specified in this paragraph is the date on which the agent became a person prescribed by regulation 3 in respect of that business or that part.

Registration is done by form NRL4.

24.12 Tax computation: Agent

The NRLS guidance provides:

> The amount of tax shown on the certificate may not be the same as the non-resident landlord's tax liability for the profits of their rental business. The rules of the NRLS are not the same as the rules for taxing the profits of a rental business.

There are different rules for tenants and for agents. I deal with agents first, as that is the usual case.

Regulation 9(1) NRLR provides:

> An agent who is a prescribed person in respect of the Schedule A [UK property] business , or part thereof, of a non-resident shall calculate for

> each quarter the amount of any payment to be made to the Board in respect of tax which is or may become chargeable on the income from that business or that part.

Regulation 9(2)(3) explains the computation:

> (2) The amount of the payment to be calculated is the amount of tax at the basic rate on the amount which results after deducting from the income specified in paragraph (3) below—
> (a) the expenses specified in paragraph (4) below, and
> (b) any excess amount of expenses falling to be deducted from that income in accordance with paragraph (5) below.
> (3) The income specified is all income which falls to be treated as a receipt of that business or that part, other than income specified in regulation 8(3), and which either—
> (a) was received by the prescribed person in the quarter concerned, or
> (b) was income which it was in his power to receive or over whose direction he had control but which was paid at his direction to another person in that quarter without being received by him.

The exception in reg 8(3) NRLR relates to non-resident companies with a UK branch within the scope of CT:

> The income specified in this paragraph is any income which—
> (a) is attributable to a branch of the non-resident in the UK, and
> (b) is chargeable to corporation tax.

24.12.1 *Rental income*

The NRLS guidance provides:

> You should take into account all rental income received or paid in the quarter, even if it relates to rent due for an earlier or later period. You should not calculate tax for a quarter on rental income that was due in the quarter, but was not paid in the quarter.
>
> ...
>
> **When rental income is received or paid by cheque**
>
> If you're a letting agent you'll receive income by cheque on the day the cheque is paid into your account, not on the day it is cleared. If the cheque is dishonoured, you should not take the amount into account in your calculation of tax due.
>
> If you're a tenant paying rental income by cheque the payment is made on the day you send the cheque to the landlord, not on the day it is cashed or cleared. If the cheque is dishonoured, you should not take the amount into

account in your calculation of tax due.

Examples of rental income

Rental income includes a variety of receipts from land and property. Rental income includes:

- income from letting furnished, unfurnished, commercial and domestic premises, and from any land
- where property is let furnished, any separate sums from the tenant for the use of the furniture
- rent charges, ground rents and feu duties
- premiums and other similar lump sums received on the grant of certain leases
- income arising from the grant of sporting rights, such as fishing and shooting permits
- income arising from allowing waste to be buried or stored on land;
- income from letting others use land - for example, where a film crew pays to film inside a person's house or on their land
- grants received from local authorities or others contributing to expenditure which is an allowable expense, such as repairs to a let property
- rental income received through enterprise investment schemes
- income from caravans or houseboats where these are not moved around various locations
- insurance recoveries under policies providing cover against non-payment of rent
- service charges received from tenants in respect of services ancillary to the occupation of property (other than those falling within Section 42 of the Landlord & Tenant Act 1987).

Premiums

Lump sums received up front for the grant of a lease of 50 years or less are liable to Income Tax. These receipts are generally called 'premiums'. They are treated wholly or partly as rental income.

[The guidance summarises the lease premium rules]

...

Income which is not rental income

There are certain receipts which come from the use of land that are not rental income. These include:

- income from woodlands managed on a commercial basis
- income from the types of concerns listed below
  - mines and quarries (including gravel pits, sand pits and brickfields)
  - ironworks, gasworks, salt springs or works, alum mines or works and water works and streams of water

  - canals, inland navigations, docks, and drains or levels
  - rights of markets and fairs, tolls, bridges and ferries
  - railways and other ways
  - lettings of tied premises by traders
- income from carrying out a trade — for example, running a hotel.

24.12.2 *Expenses*

Deduction is allowed for expenses paid by the agent. Regulation 9(4) NRLR provides:

> The expenses specified are all amounts paid in the quarter by the prescribed person or by another person at the direction of the prescribed person that—
>
> (a) the prescribed person is reasonably satisfied are deductible expenses, and
>
> (b) in relation to financing costs,[28] where the prescribed person elects, do not exceed the financing costs allowance.

The NRLS guidance provides:

> **'Reasonably be satisfied'**
>
> HMRC does not expect you to be a tax expert to operate the NRLS. The test is that an expense should be deducted only where you can 'reasonably be satisfied' that it is allowable in calculating the profits of the landlord's rental business. This provides protection for you in 2 ways:
>
> - Where you have reason to be uncertain whether an expense is an allowable expense of the non-resident landlord's rental business, you are justified under the rules in not deducting it when calculating the tax due.
> - Where you can reasonably be satisfied that an expense is an allowable expense of the non-resident landlord's rental business, you can deduct the expense without fear of being penalised if it is later found that the expense is not allowable.
>
> You cannot reasonably be satisfied that an expense is allowable in calculating the profits of the landlord's rental business solely because the landlord says that it is allowable. If you have reason to believe it may not be an allowable expense you should not deduct it.

[28] Regulation 9(10) NRLR provides: "(10) For the purposes of this regulation, "financing costs" and "the financing costs allowance" have the meanings given in regulation 9A(5)."

There is provision to carry back excess expenses:

> (5) Where in any quarter in an annual period the expenses specified in paragraph (4) above exceed the income specified in paragraph (3) above—
>
> (a) the amount of the excess shall first be deducted from the income specified in paragraph (3) above for previous quarters in that annual period, taking later quarters before earlier quarters, and

Failing that, there is provision for carry-forward of excess expenses:

> (b) any balance remaining of that amount shall be carried forward and deducted from the income specified in paragraph (3) above for subsequent quarters, including quarters after the end of that annual period, taking earlier quarters before later quarters.

The former NRLS guidance gives some examples:

> 4.11 **Example: carry back**
>
> ABC Ltd, a letting agent, acts for a non-resident landlord, Juan. In the quarter to 30 September 2010 it receives rental income of £2000 and pays deductible expenses of £500. In the quarter to 31 December 2010 it receives rental income of £2000 and pays deductible expenses of £3000. ABC Ltd's calculation for the quarter to 31 December 2010 is as follows:
>
> **Quarter to 31.12.10**

Rental income received	£2000
Less deductible expenses paid	£3000
Excess expenses	(£1000)

> ABC Ltd should set off the excess expenses against rental income received in the quarter immediately before the quarter to 31 December 2010, that is the quarter to 30 September 2010. Its revised calculation for that quarter will then be:
>
> **Quarter to 30.9.10**

Rental income received	£2000
Less deductible expenses paid	£500
Less excess expenses brought back from quarter to 31.12.10	£1000
Revised net income on which basic rate tax is due	£500

> ABC Ltd will have paid tax of £300 for the quarter to 30 September 2010 ((£2000 - £500) @ 20%).
>
> Paragraph 4.14 below describes how to recover the repayable amount.
>
> 4.12 **Example: carry forward**
>
> ABC Ltd, a letting agent, receives £2000 rental income for a non-

resident landlord, Juanita, in the quarter ending on 30 June 2010 and pays £3000 deductible expenses. In the quarter to 30 September 2010 it receives £500 and pays no expenses.

Quarter to 30.6.10

Rental income received	£2000
Less deductible expenses paid	£3000
Excess expenses	(£1000)

ABC Ltd cannot carry back the excess expenses because carry back is restricted to earlier quarters in the same year to 31 March.

Quarter to 30.9.10

Rental income received	£500
Less excess expenses brought forward	£1000
Balance of excess expenses available to ABC Ltd to carry forward	(£500)

4.13 Letting agents must not deduct excess expenses paid for one landlord from the rental income of another landlord. In the above examples, ABC Ltd cannot deduct excess expenses paid for Juanita from Juan's rental income.

Carry back allows a reclaim of withholding tax:

(6) Where an amount paid by a prescribed person in a previous quarter becomes repayable as a result of an excess amount being deducted from income pursuant to paragraph (5)(a) above, the amount repayable—

(a) shall first be set off by the prescribed person against payments due under this regulation in respect of other non-residents in respect of whose Schedule A [UK property] business or part thereof he is a prescribed person for the quarter in which the excess amount arises, and

(b) any balance remaining shall, on a claim being made to the Board by the prescribed person, be repaid to him.

The former NRLS guidance gives some examples:

4.15 Example 1

	Landlord A	Landlord B
Quarter to 30.6.10		
Rental income	£1000	£2000
Less deductible expenses	£200	£1000
	£800	£1000
Basic Rate tax (20% for 2010/11)	£160	£200
Total tax payable (£160 + £200)	£360	
Quarter to 30.9.10		
Rental income	£1000	£2000

Less deductible expenses	£1500	£1400
	(£500)	£600
Basic Rate tax (20% for 2010/11)	Nil	£120
Excess expenses carried back	£500	

When the letting agent carries back the excess expenses of £500 to quarter 1, his tax liability for quarter 1 will be reduced by £100 (£500 @ 20%).

He can set off this £100 against the tax calculated for quarter 2, £120. This leaves £20 (£120 less £100) payable.

4.16 Example 2

	Landlord A	Landlord B
Quarter to 30.6.10		
Rental income	£1000	£2000
Less deductible expenses	£600	£1000
	£400	£1000
Basic Rate tax (20% for 2010/11)	£80	£200
Total tax payable (£80 + £200)	£280	
Quarter to 30.9.10		
Rental income	£1000	£2000
Less deductible expenses	£1200	£1950
	(£200)	£50
Basic Rate tax (20% for 2010/11)	Nil	£10
Excess expenses carried back	£200	

When the letting agent carries back the excess expenses £200 to the earlier quarter, his tax liability for that quarter will be reduced by £40 (£200 @ 20%).

He can set off this £40 against the tax calculated for the quarter to 30.9.10, £10. This leaves £30 repayable. The letting agent should show £30 as repayable on his form NRLQ for the quarter to 30.9.10 and the Accounts Office will repay £30.

The rest of the regulation deals with minutiae of a repayment claim:

(7) A claim under paragraph (6)(b) above ("a repayment claim") shall be made in a quarterly return under regulation 10.

(8) An appeal from the Board's decision on a repayment claim shall be brought by giving notice to the Board within 30 days of receipt of notice of the decision.

(9) All such assessments, payments and repayments shall be made as are necessary to give effect to the Board's decision on a repayment claim or to any variation of that decision on appeal.

24.12.3 *Financing costs election*

The background can be found in

- HMRC Policy paper, "Income tax: Changes to the regulations for the Non-residents Landlord Scheme"[29]
- a Guidance note ("the 2020 changes guidance note")[30]

Regulation 9A NRLR provides:

> (1) This regulation applies where an election is made under regulation 9(4)(b).
> (2) The election—
> (a) must be notified to Her Majesty's Revenue and Customs with the annual return which relates to the first quarter to which the election applies, and
> (b) is irrevocable.
> (3) Where in any quarter in an annual period, the financing costs that the prescribed person is reasonably satisfied are deductible expenses exceed the financing costs allowance, the amount of the excess is carried forward and treated as financing costs in the next quarter, including a quarter after the end of that annual period.
> (4) Where in any quarter in an annual period, the financing costs allowance exceeds the financing costs that the prescribed person is reasonably satisfied are deductible expenses, the amount of the excess ("the unused allowance") is carried forward and included in the financing costs allowance in the next quarter, including a quarter after the end of that annual period.
> (5) For the purposes of this regulation—
> "financing costs" has the meaning given in section 544(4) and (5) of the Corporation Tax Act 2010, but in applying subsection (5) the reference to "accounting period" is to be read as a reference to "annual period";
> "the financing cost allowance" for a quarter is the sum of—
> (a) an amount equal to 30% of the relevant amount for that quarter, and
> (b) the unused allowance for the previous quarter;
> "the relevant amount" for a quarter is the greater of—

[29] *https://www.gov.uk/government/publications/income-tax-changes-to-the-regulations-for-the-non-residents-landlord-scheme/income-tax-changes-to-the-regulations-for-the-non-residents-landlord-scheme* (2020).

[30] *https://www.gov.uk/government/publications/income-tax-changes-to-the-regulations-for-the-non-residents-landlord-scheme/guidance-note* (2020).

(a) zero, and

(b) the difference of I-OE,

where—

I is the amount of income for that quarter specified in regulation 9(3), and

OE is the amount of expenses for that quarter specified in regulation 9(4) other than financing costs.[31]

(6) For the purposes of this regulation and regulation 9, in applying the definition of "deductible expense", the reference to the Tax Acts is to be treated as not including Part 10 of the Taxation (International and Other Provisions) Act 2010 (corporate interest restriction).

The 2020 changes guidance note provides:

Once non-UK resident company landlords become chargeable to Corporation Tax from 6 April 2020, Corporate Interest Restriction at Part 10 of TIOPA will apply to them. These rules apply a cap to the amount of financing costs that can be deducted from rental income...

These rules also apply to those non-UK resident company landlords that have an amount withheld on account of tax from their rents under the Non-residents Landlord Scheme. Corporate Interest Restriction is complex and being reasonably satisfied about its application may require an agent to obtain information about the non-UK resident company landlord and its funding arrangements.

Some agents would be able to apply Corporate Interest Restriction but many others may not. For those agents that have difficulties in applying Corporate Interest Restriction, the existing Regulations would typically prevent a deduction for financing costs paid by the agent which would increase the amount to be withheld on account of tax.

Consequently, the non-UK resident company landlord would file a company tax return to directly claim a deduction for its financing costs, resulting in a refund of tax, and increasing the administrative burden on both HMRC and non-UK resident company landlords.

To avoid this, a simpler alternative to Corporate Interest Restriction is provided to enable the agent to calculate the financing cost deduction which is limited to a fixed allowance (30%) of the UK rental income, net of deductible expenses other than financing costs. Any unused allowance may be carried forward from one quarter period to the next. Any

[31] Reg 6 Taxation of Income from Land (Non-residents) (Amendment) Regulations 2020 is a transitional provision:

"(1) Where an election is made under regulation 9(4)(b) of the principal Regulations, inserted by regulation 4(a) of these Regulations, financing costs attributable to any time before 6th April 2020 may be included as a deductible expense but must not be taken into account in determining the extent, if any, to which financing costs exceed the financing costs allowance for any quarter in an annual period.

(2) The amount of financing costs attributable to any time before 6th April 2020 must be determined on a just and reasonable basis."

unused financing costs above the allowance may also be carried forward. It is to be subject to an irrevocable election which is made by the agent.

The rule does not apply to rental income paid by a tenant who is a prescribed person to non-UK resident company landlords since tenants are in a different position under the Regulations.

The non-UK resident company landlord must check whether the amount withheld on account of tax under the Non-residents Landlord Scheme Regulations actually meets its underlying Corporation Tax liability in respect of its UK property income.

Chapter 3: How the alternative Corporate Interest Restriction rule works

3.1 Being reasonably satisfied and Corporate Interest Restriction

The financing costs of a non-UK resident company landlord will be subject to the corporation tax rules on deductibility of financing costs. In particular, the Corporate Interest Restriction rules may give agents who are prescribed persons reason to be uncertain as to whether financing costs (as a non-trade loan relationship deficit) can be set against the profits of the UK property business of the non-UK resident company landlord, and, therefore, whether they may be deducted in determining the amount to withhold under the Non-residents Landlord Scheme.

It is recognised that Corporate Interest Restriction can be complex and further that it may require agents to obtain information from non-UK resident company landlords to be reasonably satisfied that financing costs are not restricted by Corporate Interest Restriction, or if restricted, by what amount. The test that is applied here is one of reasonable satisfaction.

This guidance does not seek to be prescriptive in what constitutes reasonable satisfaction. However, in getting to a position of reasonable satisfaction an agent may make judgements as to the likely position of a non-UK resident company landlord provided that the agent takes reasonable steps to test such judgements, and that the agent does not have knowledge to the contrary.

For instance, agents may make judgements as to the likely application of the de minimis limit in the Corporate Interest Restriction rules taking into account the amount of rental income, the nature of the investment in UK property by, and the investment profile of, the non-UK resident company landlord.

Where agents do not have enough information to be reasonably satisfied that there will not be a restriction under Corporate Interest Restriction, or cannot determine the amount of the restriction, they cannot be reasonably satisfied that the expense is a "deductible expense" and no deduction of the financing costs is permitted.

Agents may choose, instead, to make an irrevocable election to use the alternative rule for Corporate Interest Restriction for the purpose of the Non-residents Landlord Scheme.

When bringing financing costs into account under the alternative rule agents must still be reasonably satisfied that the costs would be deductible for the non-UK resident company landlord if Corporate Interest Restriction were to be disregarded.

3.2 How to make an election

The election can only be made by the prescribed person who:

- is an agent of the non-UK resident company landlord, where either:
- the agent has paid financing costs in the quarter, or
- financing costs have been paid in the quarter by another person at the direction of the agent

The election is irrevocable. It must be notified to HMRC with the annual return that the agent sends to HMRC for the annual period which relates to the first quarter to which the election applies.

3.3 How the alternative to Corporate Interest Restriction works

In all of the following, it is assumed that the agent is reasonably satisfied that the financing costs are tax-deductible, ignoring the effect of Corporate Interest Restriction.

The maximum amount of financing costs that can be deducted ("the financing costs allowance") when calculating the amount to withhold for a particular quarter is calculated as follows:

Step 1:

Apply the following calculation:

30% × (I − OE)

where:

'I' is rental income in that quarter, and 'OE' is total of all deductible expenses for that quarter, other than financing costs.

Step 2:

Add the amount of any unused allowance brought forward from the last quarter to the sum of the above calculation. The result is the financing costs allowance for the quarter.

If the financing costs paid out in a quarter are less than the financing costs allowance, then the full amount of the financing costs can be deducted in that quarter. If there are restricted financing costs that have been carried forward to the quarter, these are added to the financing costs of this quarter when working out the amount of financing costs to deduct and any amount which may be restricted.

If the total financing costs exceed the financing costs allowance, the amount to be deducted in that quarter is capped at the maximum of the financing costs allowance.

3.4 Unused financing costs allowance

Where the financing costs allowance for a quarter is greater than the amount of the financing costs in that quarter, the difference between the two, the unused allowance, is carried forward to the next quarter and added at Step 2 of the calculation to give the financing costs allowance for that next quarter.

3.5 What happens to excess financing costs

To the extent that the amount of financing costs in a quarter is more than the financing costs allowance for that quarter, the excess amount, that is the amount restricted which the agent cannot take into account, is carried forward to the next quarter and added to the financing costs paid out in that quarter.

The calculation shown above at 3.3 is then applied to this total amount to work out the amount of financing costs that can be deducted from the rents in that quarter.

The restricted amount of financing costs cannot be carried back to earlier quarters.

To the extent that the amount of financing costs in a quarter falls within the financing costs allowance, but the agent cannot take them into account against the rental income of that quarter, the agent can take them into account under regulation 9(5).

3.6 Example (John)

J, an agent, acts for a non-UK resident company landlord, ABC Ltd, and elects to apply the alternative financing costs rule.

- in the quarter to 30 June 2020, J collects rental income of £2,000 and pays financing costs of £600 and other expenses of £500 out of those rents.
- in the quarter to 30 September 2020, J receives rental income of £2,000 and pays financing costs of £400 and other expenses of £100.

- in the quarter to 31 December 2020, J receives rental income of £3,000 and pays financing costs £100 and other expenses of £100.
- in the quarter to 31 March 2021, J receives rental income of £500 and pays financing costs £600 and other expenses of £500.

J is reasonably satisfied that all expenses are tax-deductible, ignoring the effect of Corporate Interest Restriction. It is also assumed that there are no financing costs attributable to any time before 6 April 2020.

Quarter to 30 June 2020

The amount of financing costs that can be deducted by J in the quarter to 30 June 2020 is as follows:

Restricted financing costs brought forward (N/A)	£0
Financing costs paid out	£600
Total financing costs for the quarter	£600
Rental income received (I)	£2,000
Less deductible expenses paid, other than financing costs (OE)	(£500)
Net amount of income (I−OE)	£1,500
Initial financing costs allowance calculation (30% × £1,500)	£450
Unused financing costs allowance brought forward	£0
Financing costs allowance for the quarter	£450
Financing costs allowance used for the quarter	£450
Unused financing costs allowance carried forward	£0

The maximum amount of financing costs that can be deducted in the quarter to 30 June 2020 is £450. The remaining £150 of the financing costs that were paid out will be carried forward to the next quarter and added to the financing costs for that quarter.

J's calculation of the amount to withhold for the quarter to 30 June 2020 is as follows:

Rental income received	£2,000
Less deductible expenses (other than financing costs)	(£500)
Total chargeable profits for the quarter	£1,500
Less financing costs	(£450)
Net amount on which basic rate tax is applied	£1,050
Tax withheld £1,050 × 20%	£210
Restricted financing costs carried forward to the next quarter (£600 − £450)	£150
Unused financing costs allowance carried forward	£0

Quarter to 30 September 2020

The amount of financing costs that can be deducted by J in the quarter to 30 September 2020 is as follows:

Restricted financing costs brought forward	£150
Financing costs paid out	£400
Total financing costs for the quarter	£550
Rental income received (I)	£2,000
Less deductible expenses paid, other than financing costs (OE)	(£100)
Net amount of income (I−OE)	£1,900
Initial financing costs allowance calculation (30% × £1,900)	£570
Unused financing costs allowance brought forward	£0
Financing costs allowance for the quarter	£570
Financing costs allowance used for the quarter	£550
Unused financing costs allowance carried forward	£20

Since the financing costs allowance is more than the sum of the financing costs for the quarter, the deduction is allowed for the full amount of financing costs (£550). The unused financing costs allowance £20 (£570 less £550) is carried forward to the next quarter.

J’s calculation of the amount to withhold for the quarter to 30 September 2010 is as follows:

Rental income received	£2,000
Less deductible expenses (other than financing costs)	(£100)
Total chargeable profits for the quarter	£1,900
Less financing costs	(£550)
Net amount on which basic rate tax is applied	£1,350
Tax withheld £1,350 × 20%	£270
Restricted financing costs carried forward to the next quarter	£0
Unused financing costs allowance carried forward	£20

Quarter to 31 December 2020

The amount of financing costs that can be deducted by J in the quarter to 31 December 2020 is as follows:

Restricted financing costs brought forward	£0
Financing costs paid out	£100
Total financing costs for the quarter	£100
Rental income received (I)	£3,000
Less deductible expenses paid, other than financing costs (OE)	(£100)
Net amount of income (I−OE)	£2,900
Initial financing costs allowance calculation (30% × £2,900)	£870
Unused financing costs allowance brought forward	£20
Total financing costs allowance for the quarter	£890
Financing costs allowance used for the quarter	£100
Unused financing costs allowance carried forward	£790

Since the total financing costs allowance available for the quarter is more than the sum of the financing costs for the quarter, the deduction is allowed for the full amount of financing costs (£100). The unused financing costs allowance of £790 is carried forward to the next quarter.

J’s calculation of the amount to withhold for the quarter to 31 December 2020 is as follows:

Rental income received	£3,000
Less deductible expenses (other than financing costs)	(£100)
Total chargeable profits for the quarter	£2,900
Less financing costs	(£100)
Net amount on which basic rate tax is applied	£2,800
Amount withheld £2,800 × 20%	£560
Restricted financing costs carried forward to the next quarter	£0
Unused financing costs allowance carried forward	£790

Quarter to 31 March 2021

The amount of financing costs that can be deducted by J in the quarter to 31 March 2021 is as follows:

Restricted financing costs brought forward	£0
Financing costs paid out	£600

Total financing costs for the quarter	£600
Rental income received (I)	£500
Less deductible expenses paid, other than financing costs (OE)	(£500)
Net amount of income (I−OE)	£0
Initial financing costs allowance calculation for the quarter (30% × £0)	£0
Unused financing costs allowance brought forward	£790
Total financing costs allowance for the quarter	£790

Since the rental income for this period is reduced to zero by the other specified expenses, there is no amount on account of tax to withhold and the initial calculation of the amount of financing costs allowance for this quarter is nil.

However, because it is possible to carry forward unused financing costs allowance, the financing costs allowance for the quarter is £790. J can apply the financing costs allowance brought forward to the amount of financing costs paid in the quarter so that the financing costs become specified expenses for the purposes of regulation 9(4) of the Non-residents Landlord Scheme Regulations.

Financing costs allowance for the quarter	£790
Financing costs allowance used for the quarter	£600
Unused financing costs allowance carried forward	£190

Because there is now an excess of specified expenses above the specified income for this quarter, J can deduct this excess from the income of the previous quarter under regulation 9(5) and claim a repayment when he sends in his quarterly return. The amount of unused financing costs allowance to carry forward to the quarter to 30 June 2021 is reduced to £190.

The revised figures for the quarter to 31 December 2020 become:

Rental income received	£3,000
Less deductible expenses (other than financing costs)	(£100)
Total chargeable profits for the quarter	£2,900
Less unrestricted financing costs as before	(£100)
Net amount on which basic rate tax is applied	£2,800
Less excess specified expenses carried back	£600
Updated net amount on which basic rate tax is applied	£2,200
Amount withheld £2,200 × 20%	£440
Amount previously withheld	£560
Repayment due	£120

Note that the costs carried back under regulation 9(5) are simply deducted against the rental income for the period. There is no need to recalculate the financing costs allowance for the quarter to 31 December 2020. Nor is there any need to include the costs carried back to 31 December 2020 in the tested amount of financing costs for the quarter ended 31 December 2020.

If these circumstances had arisen in the following quarter (quarter to 30 June 2021), any excess of specified expenses could only be carried forward to the next quarter because the quarter ended 31 March 2021 is in a different annual period to the annual period in which the quarter to 30 June 2021 falls. Under regulation 9(5) it is not possible to carry back an amount of specified expense to a quarter period of a different annual period.

When J sends the annual return to HMRC for the annual period ended on 31 March 2021, he must tell HMRC that he has made the election under regulation 9A to use the alternative financing costs rule. He must continue to use the alternative financing costs rule in the next annual period and so on.

24.13 Tax computation: Tenant

If, exceptionally, the agent is not the prescribed person, we turn to reg 8 NRLR which deals with tenants. Regulation 8(1) is the equivalent of regulation 9(1) set out above:

> A person falling within [s.42A(1)(a) ICTA = s.971(3)(a) ITA, the tenant] who is a prescribed person in respect of the Schedule A [UK property] business , or part thereof, of a non-resident shall calculate for each quarter the amount of any payment to be made to the Board in respect of tax which is or may become chargeable on the income from that business or that part.

Regulation 8(2) NRLR explains the computation:

> The amount of the payment to be calculated by that person is the amount of tax at the basic rate on the aggregate of all income which falls to be treated as a receipt of that business or that part, other than income specified in paragraph (3) below, and which either—
> (a) was paid by him in the quarter to the non-resident, or
> (b) was paid by him in the quarter to a person other than the non-resident, not being a payment which he can reasonably be satisfied is a deductible expense.[32]

It is usually better to appoint an agent as prescribed person as:
(1) Withholding tax is (in short) limited to net profits rather than gross rent.
(2) There is provision for carry forward and back of excess expenses.
In any case, tenants will not normally want to take on the duty of payment and quarterly returns.

The former NRLS provides some examples:

> **7.4 Example 1**
> Joan is due to pay rent of £1600 per quarter to a non-resident landlord. In the quarter to 30 September 2010 she can manage to pay only £1000. As the calculation is based on rental income paid (not due), her

[32] Regulation 2 NRLR provides a commonsense definition: "deductible expense" means, subject to regulation 9A(6),
[1] an expense which is deductible under the Tax Acts in computing the profits or gains of a non-resident's Schedule A [UK property] business or
[2] or is capable of being offset against those profits under the Tax Acts".

calculation for the quarter is:

Rental income paid	£1000
Basic Rate tax on £1000 (20% for 2010/11)	£200
	£800

As a result Joan pays £800 to the non-resident landlord and £200 to HMRC.

7.5 Example 2

Jack pays rental income of £1500 per quarter to a non-resident landlord. In the quarter to 30 June 2010 the landlord tells him to pay £400 to a third party in settlement of a loan (which is not a deductible expense) and to pay the £1100 balance to the landlord.

Jack's calculation for the quarter to 30 June 2010 is:

Rental income paid to landlord	£1100
Plus rental income paid away to third party at landlord's direction	£400
	£1500
Basic Rate tax on £1500 (20% for 2010/11):	£300

7.6 Example 3

Julie pays rental income of £1500 per quarter. In the quarter to 30 September 2010 she pays out

- £200 for plumbing repairs;
- £100 to a third party, on the instruction of her landlord, in settlement of a loan (which is not a deductible expense); and
- £1200 direct to her landlord.

As the plumbing repairs are a deductible expense (see Chapter 10 below) but the settlement of the loan is not, Julie's calculation will be:

Rental income paid to landlord	£1200
Plus rental income paid to third parties, where the payment is not a deductible expense	£100
	£1300
Basic Rate tax on £1300 (at 20% for 2010/11):	£260

24.14 Returns and administration

24.14.1 *HMRC letters to tenants*

In August 2019 HMRC sent questionnaires to tenants of property owned by overseas companies. CIOT have published the following Q&A:

1. **It is unclear why HMRC would send this letter and the list of questions to a tenant, as it would seem unlikely the tenant would know the answers to many of the questions (particularly the ones about trusts).**

The letter and questionnaire have been designed to gather information to ensure the correct tax is paid. This includes situations where the tenant may be connected to the offshore entity. In those cases, we would expect the tenant to know the answers to many of the questions asked. The tenant should reply "not known" if they do not know the information.

2. **It is unclear why the tenant is being asked to provide their personal details (NINO and UTR, email address and telephone number for example). Perhaps the form should caveat that not all this personal information is a requirement/it is voluntary.**

The information requested from tenants is required to ensure HMRC can accurately confirm the identity of the tenants and ensure we have the most up-to-date contact details on file. As the tenant may have personal responsibility for deducting tax on the rents paid, it is important that HMRC has the most up-to-date and accurate information.

3. **It would appear that there is no legal obligation on the tenant to respond to the letter and questionnaire. Would HMRC confirm this to be the case, or not?**

There is no legal obligation to respond to the letter and questionnaire but the response will enable HMRC to help the tenant if further action is required or to quickly tell them that no further action is required.

4.**If the tenant is unable or unwilling to complete the questionnaire, would a letter providing the information they know about the tenancy suffice?**

Absolutely. We are asking the questions to help work out whether the correct tax has been paid. Any and all information (regardless of its form) will assist us with this.

5. **A tenant who receives this letter may be worried about how to respond particularly if they do not have enough information or knowledge to answer the questions. Perhaps the letter could have included wording such as "we recognise that you may not be able to answer all the questions we have asked. Please supply the information requested to the best of your ability and knowledge".**

Throughout the letter, we offer support to occupants to help them understand this complicated area of taxation and how it might impact upon them, depending on the circumstances of their rental or occupancy arrangement. Contact details are provided for any occupants who require further information or support in responding to the letter which they have received. The helpline number to call is 03000 554444.

6. **The wording at the end about errors and penalties could alarm the recipient especially if they are not able to answer all the questions.**

It is not our intention to cause distress, we are simply asking occupants of the property to provide information to enable HMRC to ensure the correct amount of tax is paid.

We would not look to charge a penalty if mistakes have been made in the completion of the form attached to the letter to tenants. The penalties mentioned in the letter to tenants are only relevant to situations where the tenant has chosen not to deduct tax at the right time or neglected to do so.

The tenant should answer the questions to the best of their knowledge. If they have any questions or need help, they can phone us on the dedicated helpline.

CIOT follow-up comment: In the perhaps less common situation where there is no letting agent, a third party tenant wholly unconnected to the non-resident landlord may have no knowledge, or means of establishing that deduction of tax is required. In such cases the tenant cannot be said to have chosen not to deduct tax or necessarily have been neglectful in doing so.

It is recognised that if there is no agent, and subject to the de minimis (of an annual rent of £5200 or less), the tenant must withhold basic rate tax and account to HMRC quarterly unless the property owner applies to HMRC for permission to receive income gross. However, we suspect that few tenants, especially those who have no connection with the landlord beyond that of the landlord/tenant relationship, are likely to become aware of these obligations. It is difficult to see, in practical terms, how they might become aware that these obligations exist. The GOV.UK guidance on 'Landlord and tenant rights and responsibilities in the private rented sector' makes no reference to the tax obligations of tenants (except for council tax).

We recognise that there is tax guidance on GOV.UK for Paying tax on rent to landlords abroad . However, there is nothing to point a tenant to that guidance. It was last published in December 2014. There does not appear to have been any efforts to alert tenants to their obligations in advance of the 'nudge' letters and the potential imposition of penalties for failure to meet those obligations that may arise as a consequence of the letters.

HMRC Further Response

We would reiterate that the penalties mentioned in the letter to tenants are only relevant to situations where the tenant has chosen not to deduct tax at the right time or neglected to do so. Therefore, whilst the technical position regarding penalties is correct, we have decided to remove the reference to penalties in any future letters to avoid causing any potential distress to the majority of tenants who have made genuine mistakes. Tenants who didn't make a genuine mistake may still be liable to a penalty.

7. **The tenant may decide to seek professional advice before answering the letter (particularly given the threat of penalties). It might help to mention that if they have an agent, they might want to show it to their agent before responding.**

Customers are always advised to consult tax specialists on any areas of tax with which they are not familiar to ensure they are complying with their tax obligations...

9. **What action will HMRC be taking where no response is received to the letter?**

Where we have had no response from either the tenant or the landlord, our process is to register the property for the ATED charge and to issue the offshore company with a tax determination. The company is liable for this tax demand, not the tenant, however if tenants have any concerns at all they should contact the helpline provided.

10. **What are HMRC intending to do with the information provided by tenants? There is some misgiving amongst our members that the information requested might be used for more than the stated purpose of checking whether tax should be deducted from rents paid.**

It is HMRC's role to ensure that everyone pays the tax they owe to ensure the continued funding of the UK's vital public services. In some cases, the tenants we have contacted may have a beneficial interest in the property which they are renting, requiring follow up activity to understand the tenant's situation in relation to the offshore landlord/company.

11. **Are any further mailings planned, and if so, when?**

HMRC regularly sends letters to customers to educate, remind or prompt them to review their tax affairs, particularly where we have information that suggests there are specific risks to the payment of tax owed.

This is a commonly-used and targeted compliance approach which forms part of HMRC's Promote, Prevent, Respond strategy and has been positively received by many of our customers in helping them ensure their tax affairs are correct and the correct amount of tax is paid on time...

24.14.2 *Quarterly returns*

Regulation 10 NRLR provides:

> (1) In the circumstances specified in paragraph (2) below and within 30 days after the end of a quarter, a prescribed person shall make a return to the Board, in such form as the Board may prescribe, containing the information specified in paragraph (3) below and the declaration specified in paragraph (4) below.
>
> (2) The circumstances specified are where—
>
> (a) an amount is payable by the prescribed person in respect of the quarter, calculated in accordance with regulation 8 or 9 as the case may be, or
>
> (b) a repayment of tax is due under regulation 9(6)(b), or
>
> (c) the Board have issued a notice to the prescribed person requiring a return to be made in respect of that quarter.
>
> (3) The information specified is—
>
> (a) the name and address of the prescribed person;
>
> (b) where the prescribed person is a person falling within [s.42A(2)(a) ICTA = s.971(3)(a), the tenant], the aggregate of the amounts payable by him for that quarter, calculated in accordance with regulation 8, in respect of all non-residents in respect of whose Schedule A [UK property] business es (or parts thereof) he is a prescribed person;
>
> (c) where the prescribed person is an agent, the aggregate of the amounts payable by him for that quarter, calculated in accordance with regulation 9, in respect of all non-residents in respect of whose Schedule A [UK property] business es (or part thereof) he is a prescribed person, after set off of any amounts repayable pursuant to paragraph (6)(a) of that regulation; and
>
> (d) a claim for repayment of an amount pursuant to regulation 9(6)(b), where appropriate.
>
> (4) The declaration specified is a declaration by the prescribed person that the particulars given in the return are to the best of his knowledge correct and complete.

The NRLS guidance provides:

> **Quarterly returns and payment of tax**
>
> You must pay any tax due each quarter to HMRC, using form NRLQ. Quarterly returns are due for the periods ending:
>
> - 30 June
> - 30 September

> - 31 December
> - 31 March
>
> If you do not need to make a payment of tax for any quarter you do not need to complete a quarterly return form. However, you should complete one if you receive a notice from HMRC telling you to do so.
>
> On the return form you must include:
>
> - the total amount of tax due for all your non-resident landlords for that quarter
> - where there is no tax due in the quarter but you are due a repayment, the amount of the repayment claimed
>
> If you act for more than one non-resident landlord you should:
>
> - Calculate the tax due for each landlord separately.
> - You should then add together the amounts due.
> - Then subtract any repayable amount.
>
> You should show the result of this calculation on form NRLQ.
>
> The form explains how to send payment for the amount due to HMRC.
>
> The return form NRLQ must be sent in time to arrive at HMRC no later than 30 days after the end of the quarter to which it relates. For example, form NRLQ for the quarter ending 30 September must arrive by 30 October of the same year.
>
> ...
>
> **Interest payable on late payment**
>
> If you do not pay tax by the due date, HMRC may charge interest from the date when tax became due until it is paid.
>
> If interest is charged for late payment of tax and that tax is later repaid, you cannot recover any of the interest.

24.14.3 *Payment*

Regulation 10(5) NRLR provides:

> The aggregate amount referred to in paragraph (3)(b) or (c) above shall be due at the time by which the return under paragraph (1) above is to be made, and that amount so due—
>
> (a) shall be payable by the prescribed person without the making of an assessment, and
>
> (b) may be assessed on the prescribed person (whether or not it has been paid when the assessment is made) if it, or any part of it, is not paid on or before the due date.

24.14.4 *Interest on tax*

Regulation 10 NRLR provides:

> (6) The amount so due shall carry interest at the rate applicable under section 178 of the FA 1989 to section 87 of the Management Act from the date when the amount becomes due until payment.
>
> (7) Where an amount paid by a prescribed person in a previous quarter is repaid pursuant to a claim under regulation 9(6)(b), the repayment shall not affect interest under paragraph (6) above on the amount repaid for such time as is specified in paragraph (8) below but, subject to that, paragraph (6) above shall apply as if any such amount which is repaid had never become payable.
>
> (8) The time for which interest is not affected is—
>
> (a) any time before the expiration of the period of 30 days from the end of the quarter in which the excess of expenses giving rise to the repayment arose, unless the return for that quarter is made earlier in that period; and
>
> (b) if that return is made earlier in that period, any time ending before the date on which the return is made.

24.14.5 *Assessment*

Regulation 10 NRLR provides:

> (9) If it appears to the Board that there is an amount which ought to have been but has not been included in a quarterly return as payable to the Board, or if the Board are dissatisfied with any quarterly return, they may make an assessment on the prescribed person to the best of their judgment in respect of that amount.
>
> (10) The like provisions as are contained in paragraph 10 of Schedule 16 to the Taxes Act (assessments and due date of tax) shall have effect in relation to an assessment under paragraph (9) above as if—
>
> (a) for references to an assessment under that Schedule there were substituted references to an assessment under paragraph (9) above;
>
> (b) the references to paragraphs 4(1) and 9 of that Schedule were omitted;
>
> (c) sub-paragraph (5) were omitted.
>
> (11) Any income tax due under an assessment made by virtue of paragraph (9) above shall carry interest at the rate applicable under section 178 of the FA 1989 to section 87 of the Management Act from the date when the tax becomes due until payment; and for that purpose the tax shall be treated as having become due at the time when it would have become due if a correct return had been made.

24.14.6 *Annual returns*

Regulation 11 NRLR provides:

> (1) Not later than the 5th July following the end of an annual period, a prescribed person, other than a person specified in paragraph (3) below, shall make a return to the Board for that period—
>
> (a) in respect of the non-resident or, if more than one, each non-resident separately, in respect of whose Schedule A [UK property] business (or part thereof) he was a prescribed person at any time falling within that period, and
>
> (b) containing the information specified in paragraph (4) below and the declaration specified in paragraph (5) below.
>
> (2) A return under paragraph (1) above shall be in such form as the Board may prescribe.
>
> (3) The person specified is any tenant who, as a result of a notice given by the Board under regulation 17(5)(b), was not obligated to make payments to the Board in respect of any payments made to a non-resident in that period.
>
> (4) The information specified is—
>
> (a) the name of the non-resident;
>
> (b) where the non-resident is—
>
> (i) an individual, or
>
> (ii) a trustee other than a corporate or a professional trustee,
>
> the principal residential address of the non-resident;
>
> (c) where the non-resident is a company, the address of its registered office or its principal place of business;
>
> (d) where the non-resident is a professional trustee,[33] the address of his employment or principal place of business;
>
> (e) where the prescribed person is an agent, the amount of income which, before deduction of any expenses, fell to be taken into account in the annual period in calculating under regulation 9 amounts of tax payable by him in respect of the Schedule A [UK property] business (or part thereof) of the non-resident, or which would have fallen so to be taken into account if the non-resident had not been an approved person for the purposes of regulation 17 in that period;

[33] Regulation 11 NRLR provides: a commonsense definition: “professional trustee” means a person who carries on, or is employed by, a business which consists of or includes the management of trusts, and who acts as trustee in the course of that business or employment.

(f) where the prescribed person is a person falling within [s.42A(2)(a) = s.971(3)(a) ITA, the tenant], the aggregate of the following amounts of income—

(i) the amount of income which fell to be taken into account in the annual period in calculating under regulation 8 amounts of tax payable by him in respect of the Schedule A [UK property] business (or part thereof) of the non-resident, or which would have fallen so to be taken into account if the non-resident had not been an approved person for the purposes of regulation 17 in that period, and

(ii) the amount of income which did not fall so to be taken into account because it was paid to a person other than the non-resident in circumstances where the prescribed person could reasonably be satisfied that the amount of the payment was a deductible expense;

(g) except where the non-resident is an approved person for the purposes of regulation 17, the aggregate of—

(i) all amounts paid during the annual period on behalf of the non-resident by or at the direction of the prescribed person which the prescribed person could reasonably be satisfied constituted deductible expenses, and

(ii) amounts carried forward to that period from a previous period pursuant to regulation 9(5)(b);

(h) the aggregate of the amounts specified as payable to the Board in quarterly returns made by the prescribed person for the annual period;

(j) the reference number relating to an approval by the Board of the non-resident under regulation 17.

(5) The declaration specified is a declaration by the prescribed person that the particulars given in the return are to the best of his knowledge correct and complete.

The NRLS guidance provides:

If you have to operate the NRLS you must send an information return to PTI by 5 July for the year to 31 March on form NRLY.

You must provide the following details separately for each non-resident landlord:

- the landlord’s name and address
- the amount of rental income for the year to 31 March, before the deduction of expenses
- if you’re not authorised to pay rental income to the landlord with no

tax deducted:
    - the deductible expenses for the year to 31 March
    - the total of the tax shown as payable in your quarterly returns for the year to 31 March
- if you're authorised to pay rental income to the landlord with no tax deducted, the landlord's approval reference number

If you're unable to download the form or complete the online return, contact HMRC.

Form NRLY may need to be sent with continuation sheets if you have more than 5 landlords to report.

You can attach your own schedules to the form rather than use the continuation sheets. For example, you may want to do this where you can produce computer-generated schedules. However, your schedules must contain all the details needed for each non-resident landlord. In these instances you must use the downloadable form, not the online service.

You should always include on the annual return either an approval reference number, or a figure of deductible expenses (if there were any).

Where you receive a notice authorising you to pay rental income with no tax deducted part way through the year, you should show:

- the approval reference number
- the tax shown on the quarterly returns up to the quarter in which the approval notice was issued

You should provide the landlord's address as follows where the non-resident landlord is:

- an individual, his or her principal residential address
- a trust, the address of one of the trustees and:
    - in the case of a corporate trustee, the address of its registered office or its principal place of business
    - in the case of a professional trustee, the address of his or her employment or principal place of business
    - in any other case, the trustee's principal residential address
- a company, the address of its registered office or its principal place of business.

The former NRLS guidance provides:

5.4 Example

ABC Ltd has to operate the scheme for two non-resident landlords, Jordi and Jan. On 17 March 2009 ABC Ltd receives a notice from the HMRC authorising it to pay rental income to Jordi with no tax deducted. The notice shows that Jordi's approval number is 0123456 (see paragraph 11.12 below). In the year to 31 March 2011, ABC Ltd keeps the following records.

Jan

Quarter to	Rental Income	Deductible Expenses	Tax Due	Repayable Amount
30.06.10	2000	500	£300	
30.09.10	2000	3000	-	£2000
31.12.10	2000	1000	£200	-
31.03.11	2000	1000	£200	-
TOTAL	8000	5500	£700	£200

Jordi

Year to	Rental Income	Deductible Expenses	Tax Due	Repayable Amount
30.03.11	16000	Not applicable*	-	-

* Letting agents do not have to record deductible expenses for landlords who are approved to receive rental income with no tax deducted.

ABC Ltd should complete the annual return as follows:

Name and address	Approval No	Rental Income	Deductible expenses	Tax
Jordi Doe [Address]	0123456	16000		-
Jan Doe [Address]	-	8000	5500	500

The total tax is the amount included in quarterly returns for the year in respect of the non-resident landlord. That is, the tax less any repayable amounts. In this example, the amount for Jan, £500, is the total of the three amounts of tax (£700) less the repayable amount (£200).

5.5 Letting agents should always include on the annual return either an approval reference number, or a figure of deductible expenses (if there were any). Where they receive a notice authorising them to pay rental income with no tax deducted part way through the year they should show:

- the approval reference number; and
- the tax shown on the quarterly returns up to the quarter in which the approval notice was issued.

5.6 Letting agents should provide the landlord's address as follows:

- where the non-resident landlord is an individual, his or her principal residential address;
- where the non-resident landlord is a trust, the address of one of the trustees
  - in the case of a corporate trustee, the address of its registered office or its principal place of business,

  - in the case of a professional trustee, the address of his or her employment or principal place of business
  - in any other case, the trustee's principal residential address;
- where the non-resident landlord is a company, the address of its registered office or its principal place of business.

The former NRLS gives an example where the prescribed person is a tenant:

8.5 **Example**
James is a tenant due to pay rental income of £2000 in each quarter to his non-resident landlord, Julia. For the four quarters in the year to 31 March 2011, James keeps the following records.

Deductible expenses paid (1)	Non-deductible expenses paid (2)	Balance of rental payment (3)	Tax on (2) & (3) @ 20%	Net rent paid to Julia
-	£500	£1500	£400	£1100
£600	£1400	£280	£1120	
-	-	£2000	£400	£1600
-	-	£2000	£400	£1600
£600	£500	£6900	£1480	£5420

James should complete the annual return as follows:

Name and	Approval No	Rental	Deductible	Tax
Address	Income	Expenses		
Julia [Address]	-	£8000 *	£600	£1480

* James must show the total amount he pays, both to Julia and to third parties. In this example he pays out £2000 each quarter, £8000 in total.

24.14.7 *Record keeping*

The NRLS guidance provides:

Records
The rules of the NRLS mean you do not need to use prescribed record keeping systems. Records must show that you have met your obligations under the Scheme. For each non-resident landlord, you should keep:

- a record of rental income received by the letting agent or paid by the tenant
- copies of any correspondence with the landlord regarding his or her usual place of abode.

Unless you are authorised to pay rental income with no tax deducted, you should also keep:

- a record of expenses paid
- invoices and receipts (or copies) to provide evidence of expenses paid.

Landlords need to keep records to allow them to submit correct and complete tax returns.

Failure by a landlord to keep proper records could result in the landlord having to pay a penalty. You should discuss this with a landlord before disposing of any records relating to that landlord's business.

You must keep a record of the rental income you received or paid, which should show the date and amount of each receipt or payment.

The record of expenses should show:

- the date of the payment
- the amount of each payment
- a description of the expense

For example:

- 16 September 2019
- gardening
- £25

You may keep records on:

- microfilm
- microfiche
- any other medium that preserves an exact copy of the original document

If you wish to keep documents in this way, contact HMRC before you destroy the originals.

If possible you should keep records for the last 6 tax years, until 31 March of that year.

However, unless auditors visit you for the first time it's unlikely they will ask to see records older than the last 4 tax years.

24.14.8 *Certificate for landlord*

Regulation 12 NRLR provides:

> (1) Not later than the 5th July following the end of an annual period, a prescribed person who is liable under these Regulations to make any payments to the Board for any quarter falling within that period in respect of tax chargeable on the income of a non-resident, shall provide the non-resident with a certificate which shall include the particulars specified in paragraph (2) below and the declaration specified in paragraph (3) below.
>
> (2) The particulars specified are—
>
> (a) the name of the non-resident;

> (b) where the non-resident is—
> (i) an individual, or
> (ii) a trustee other than a corporate or a professional trustee,
> the principal residential address of the non-resident;
> (c) where the non-resident is a company, the address of its registered office or its principal place of business;
> (d) where the non-resident is a professional trustee, the address of his employment or principal place of business;
> (e) the name and address of the prescribed person;
> (f) the annual period to which the certificate relates;
> (g) the aggregate amount of the liability referred to in paragraph (1) above for all quarters falling within the annual period.
>
> (3) The declaration specified is a declaration by the prescribed person that the certificate is to the best of his knowledge correct and complete.

24.15 Gross payment of property income

Regulation 17 NRLR provides:

> (1) A non-resident may apply to the Board for the obligation imposed under these Regulations to make payments to the Board not to apply in relation to payments falling to be treated as receipts of a Schedule A [UK property] business carried on by him.
>
> (2) An application under paragraph (1) above shall be made on a form provided by the Board and shall contain the information specified in paragraph (3) below and the undertakings specified in paragraph (4) below.
>
> (3) The information specified is—
> (a) the name of the applicant;
> (b) the date of the application;
> (c) where the applicant is—
> (i) an individual, or
> (ii) a trustee other than a corporate or a professional trustee,
> the principal residential address of the applicant;
> (d) where the applicant is a company, the address of its registered office or its principal place of business, and the names and principal residential addresses of its directors;
> (e) where the applicant is a professional trustee, the address of his employment or principal place of business;
> (f) the applicant's national insurance number, if he has one;
> (g) the applicant's UK tax office reference, if he has one;
> (h) the name and address of the prescribed person or, if more than one, each of the prescribed persons by or through whom

payments falling to be treated as receipts of the applicant's Schedule A [UK property] business are made;

(j) a statement that—

(i) the applicant has complied with all obligations imposed on him by or under the Tax Acts or the Management Act prior to the date of the application; or

(ii) the applicant has not had any obligations imposed on him by or under the Tax Acts or the Management Act prior to the date of the application; or

(iii) he does not expect to be liable to pay any amount by way of UK income tax for the year in which the application is made.

(4) The undertakings specified are that—

(a) where the applicant makes a statement falling within paragraph (3)(j)(iii) above, he will notify the Board in writing if he becomes liable to pay any such amount;

(b) the applicant will fully comply with all obligations imposed on him by or under the Tax Acts or the Management Act;

(c) the applicant will inform the Board if his usual place of abode ceases to be outside the UK.

(5) Where the Board approve an application under paragraph (1) above, they shall give—

(a) notice of the approval to the non-resident, and

(b) notice to the prescribed person or, if more than one, each prescribed person, specifying the date from which the obligations referred to in paragraph (1) above shall cease to apply in relation to payments falling to be treated as receipts of the applicant's Schedule A [UK property] business and made on or after that date.

(6) The Board may, by notice to the applicant, refuse an application under paragraph (1) above where—

(a) they are not satisfied that the statement contained in the application and falling within paragraph (3)(j)(i), (ii) or (iii) above, as the case may be, is correct; or

(b) they are not satisfied that the applicant will comply with the undertakings contained in the application.

(7)The applicant may appeal against the Board's refusal of his application under paragraph (6) above by giving notice to the Board within 90 days of receipt of the notice of refusal.

(9) The tribunal shall, on an appeal notified to it, confirm the notice refusing approval unless satisfied that the notice ought to be quashed.

Regulation 19 allows withdrawal of approval:

> (1) An approval of an application under regulation 17 may be withdrawn by the Board by notice to the non-resident by whom the application was made specifying—
>
> (a) the reasons for the withdrawal, and
>
> (b) the date from which the withdrawal of approval shall take effect.
>
> (2) The Board may withdraw their approval of an application where—
>
> (a) they cease to be satisfied that the statement contained in the application and falling within regulation 17(3)(j)(i), (ii) or (iii), as the case may be, is correct; or
>
> (b) they cease to be satisfied that the non-resident will comply with the undertakings contained in the application; or
>
> (c) the non-resident fails to furnish information to the Board in accordance with regulation 18.
>
> (3) Where the Board withdraw their approval of an application under paragraph (1) above, they shall give notice to the prescribed person or, if more than one, each prescribed person, specifying the date from which the obligations imposed under these Regulations to make payments to the Board shall apply in relation to payments falling to be treated as receipts of the applicant's Schedule A [UK property] business and made on or after that date.
>
> (4) A non-resident may appeal against the Board's withdrawal of approval under paragraph (1) above by giving notice to the Board within 90 days of the date of issue of the notice withdrawing approval.
>
> (6) The tribunal shall, on an appeal notified to it, confirm the notice withdrawing approval unless . . . satisfied that the notice ought to be quashed.

The NRLS guidance provides:

> **Sovereign immunity**
>
> You must apply to HMRC to receive your UK rental income with no tax deducted if you're exempt from UK tax because of sovereign immunity. You do not need to complete an application form. You should apply by writing to HMRC. If possible, enclose a copy of the letter in which HMRC confirms your 'sovereign immune' status.
>
> **When an application can be made**
>
> If you're leaving the UK to live abroad you should apply no more than 3 months before you leave the UK.
>
> HMRC cannot consider an application before then. If your usual place of abode is already outside the UK you can apply immediately.

How to complete the application form

There are explanatory notes on the application forms NRL1i, NRL2i and NRL3i. The notes tell non-resident landlords how to complete the forms.

The following information supplements the explanatory notes.

Who can sign the application form

Downloaded Application forms must be signed as follows:

- form NRL1i must be signed by the non-resident landlord
- form NRL2i must be signed by the company secretary or a duly-authorised officer of the company
- form NRL3i must be signed by a trustee

Customers will need to verify their identity before completing the form.

Principal residential address: 'care of' and PO Box addresses

Some non-resident landlords may live in parts of the world where the only address they can provide is a 'care of' or 'PO Box' address. In these circumstances, HMRC will accept a correspondence address instead of a principal residential address. Non-resident landlords should attach an explanation to the form of why they've not given a residential address. Other non-resident landlords may have a principal residential address that is not a postal address. In these circumstances they should provide both the:

- principal residential address
- a correspondence address.

UK Tax Office, tax reference number and National Insurance number

Non-resident landlords should give details of their most recent UK tax reference number, if known. Individual non-resident landlords should also give their National Insurance number, if they have one.

Without this information HMRC may not be able to process applications made on the basis that the non-resident landlord's tax affairs are up to date. Where a non-resident landlord's tax affairs have been dealt with in the past through a letting agent or tenant, the application should show, where known, the reference number for the letting agent or tenant.

Approval of applications

HMRC will normally approve an application if:

- the application form is complete and correct
- it is satisfied that the non-resident landlord making the application will follow all their UK tax obligations.

The approval does not mean the rental income is exempt from UK tax. While the rental income will be paid with no tax deducted, it is still liable to UK tax and the non-resident landlord must include it on any tax return.

HMRC will approve applications after an initial check. Applications will be checked later in more detail. Non-resident landlords may need to supply more information at a later date when the application is checked. Failure to provide extra information may result in the withdrawal of approval.

Who receives notification of approval

HMRC will send a notice of approval to receive rental income without deduction of tax to either the:

- non-resident landlord
- non-resident landlord's account or tax adviser where they hold written authority to do so

They'll also send a separate notice to you if you're named on the application form, authorising you to pay rental income to the non-resident landlord without deducting tax.

These notices will show an approval reference number.

All notices will give the date from when rental income should be paid without deducting tax. The date will usually be on the first day of the quarter where the landlord's application is received.

Refusal of applications for approval

HMRC may refuse an application from a non-resident landlord if it is not satisfied that the:

- information given in the application is correct
- non-resident landlord will follow their UK tax obligations

We will refuse an application by notice in writing. The notice will explain how the landlord can appeal against the refusal. Landlords should appeal in writing within 90 days of the date of the notice. If the appeal cannot be settled by agreement between both parties, an independent appeal tribunal will hear it.

...

Changes of letting agent or tenant

If HMRC has not been told about a change, the new letting agent or tenant will not hold a notice from them that lets them pay rent without deducting tax. In such cases tax should be deducted from the rental income of a landlord that has a valid approval.

If these circumstances apply after 31 March in any year, you as the letting agent or tenant should complete an annual return and provide a certificate showing the tax deducted.

If you receive a notice before 31 March and have deducted tax from the landlord's rental income at any time since the previous 1 April, you can either:

- contact HMRC to discuss the recovery of any tax deducted for the relevant quarters (recording transactions where any money is recovered and paid to the landlord)

- agree with the landlord to issue a certificate after the end of the year to cover the tax deducted and to make no further deductions during the year.

If a non-resident landlord dies

If a non-resident landlord dies, any HMRC approval to pay rent without tax deducted does not apply. If you have to continue paying the same rent to someone else after a landlord's death you should deduct tax unless the new payee either:

- does not have a usual place of abode outside the UK (for example, a UK executor)
- is someone who already holds an approval notice (for example, the landlord's surviving spouse).

The new payees can apply for HMRC approval to receive their rent without deduction of tax.

Use form NRL3i to get UK rental income without deduction of tax if the following apply:

- you're an executor or trustee
- your usual place of abode is outside the UK.

Irish charities, superannuation schemes and insurance companies

Under Article 14A of the UK/Republic of Ireland Double Taxation Convention, the following types of Irish tax-exempt landlords are exempt from UK tax on their rental income:

- charities
- superannuation schemes
- insurance companies (for their pension business).
- These landlords should not fill in forms NRL1i, 2i and 3i.

These landlords should not fill in forms NRL1i, 2i and 3i. They should claim exemption under the Double Taxation Convention by filling in a form Ireland-Company.

24.16 Credit for withholding tax

Regulation 20 NRLR provides:

> Section 59A of the Management Act (payments on account of income tax) ("section 59A") shall have effect in relation to payments to be made to the Board by virtue of section 42A in respect of any tax as if any reference in section 59A to income tax deducted at source included a reference to such payments.

Regulation 21 NRLR provides:

> (1) A non-resident may set off against either of the amounts specified

in paragraph (2) below the aggregate amount of the payments which—

(a) were liable to be made to the Board under these Regulations for each quarter ending in a year by any person who is a prescribed person in respect of the Schedule A [UK property] business (or part thereof) carried on by the non-resident in that year, and

(b) were retained by the prescribed person out of sums due from him to the non-resident in order to meet that liability.

(2) The amounts specified are—

(a) the amount in which the non-resident is chargeable to income tax for the year in question, and

(b) the amount of the first payment on account of his liability to income tax for that year.

(3) Where pursuant to paragraph (1) above an amount is set off against the amount specified in paragraph (2)(a) above, section 59A (as modified by regulation 20) shall have effect as if the reference in subsection (1) of that section to the amount which is the assessed amount were a reference to that assessed amount reduced by the amount set off.

(4) Where pursuant to paragraph (1) above an amount is set off against the amount specified in paragraph (2)(b) above, section 59A (as so modified) shall have effect as if the reference in subsection (2) of that section to the first payment on account were a reference to the amount of that payment reduced by the amount set off.

(5) In any case where—

(a) by virtue of regulation 17 the obligations imposed under these Regulations to make payments to the Board do not apply in any year in relation to payments falling to be treated as receipts of a Schedule A [UK property] business carried on by a non-resident in that year, and

(b) those obligations applied to such payments in the immediately preceding year,

subsection (1) of section 59A (as so modified) shall have effect as if those obligations did not apply in the immediately preceding year.

24.17 Agent indemnity

Section 971 ITA 2007 provides:

(4) A non-resident landlord representative who must pay prescribed amounts of income tax to HMRC under regulations under this section is entitled—

(a) to be indemnified by the non-resident for all such payments, and

(b) to retain out of any sums otherwise due from the representative to the non-resident, or received by the representative on behalf of the non-resident, sums representing income tax sufficient for meeting any liabilities under the regulations to make such payments.

(5) Subsection (4)(b) applies whether the liability is one which the representative has discharged or to which the representative is subject.

CHAPTER TWENTY FIVE

DEDUCTION OF INTEREST FROM PROPERTY INCOME

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Cross references

For questions of the location of the source of interest, and deduction at source, see 26.1 (Interest income)

25.1 Deduction of interest

This chapter considers the deduction of interest for the purposes of income taxation of property income and trading income.

A great deal of tax and planning depends on obtaining that deduction. See *Langsam v Beachcroft LLP* [2011] EWHC 1451 (Ch) for an interesting negligence case, where a dissatisfied remittance basis taxpayer obtained damages against solicitors who failed to advise on tax avoidance possibilities dignified with the label "equity release arrangement".

I do not discuss:

(1) UK resident companies (subject to corporation tax and governed by the loan relationship rules)
(2) Restrictions on interest deduction for residential property[1]

The significance of the topic will greatly decrease in 2020/21, when non-resident companies become subject to corporation tax on UK property income. It will continue to matter for individuals and trusts, but they are not likely to have a significant UK property business.

25.2 Basis for deduction

Section 272(1) ITTOIA is the starting point for property income:

> The profits of a property business are calculated in the same way as the profits of a trade.

Section 272(2) provides a long list of statutory provisions which apply to a property business, including the sections discussed below. Thus I can deal with property income and trading income in the same chapter, though my focus here is on property income.

25.3 Capital expenditure

Section 33 ITTOIA provides:

> In calculating the profits of a trade, no deduction is allowed for items of a capital nature.

In the early days of income tax, the courts ruled that where a loan was used as capital in a trade, interest on the loan was a capital expense and so disallowed.[2] That seems a strange result, but the courts wished to avoid the anomaly, which broadly still holds today, and was a contributing factor to the 2008 financial crisis,[3] that debt finance gives rise to deductible interest but equity finance does not, as there is no deduction for dividends or the cost of share capital.

The old rule was however reversed by statute and s.29 ITTOIA now provides:

[1] Section 272A ITTOIA.

[2] See for instance *European Investment Trust v Jackson* 18 TC 1.

[3] The issue is discussed briefly in Report of the Parliamentary Commission on Banking Standards, *Changing banking for good* (2013) Volume II para 185-188 *http://www.parliament.uk/documents/banking-commission/Banking-final-report-vol-ii.pdf*

> For the purpose of calculating the profits of a trade, interest is an item of a revenue nature, whatever the nature of the loan.

Interest is in principle a deductible expense if incurred wholly and exclusively for the purpose of the property business.

A premium (if not interest) is not deductible for IT purposes. That rule is preserved by s.58 ITTOIA, which allows relief for incidental costs of loan finance, but s.58(4) ITTOIA provides:

> But the following are not incidental costs of obtaining finance ...
>
> (c) the cost of repaying a loan or loan stock so far as attributable to its being repayable at a premium or having been obtained or issued at a discount...

25.4 Wholly and exclusively

Section 34 ITTOIA provides:

> (1) In calculating the profits of a trade, no deduction is allowed for—
>
> (a) expenses not incurred wholly and exclusively for the purposes of the trade,

The Property Income Manual provides:

> **PIM2105. Introduction** [Mar 2018]
>
> ***Overview***
>
> ... For income tax, for tax years up to and including 2016/17, interest payable on loans used to buy land or property which is used in the rental business, or on loans to fund repairs, improvements or alterations, is deductible in computing the profits or losses of the rental business in the same way as other expenses.
>
> Similarly, interest payable under hire purchase agreements or on an overdraft is deductible where the asset is used for business purposes.
>
> [The manual discusses the rules for residential let property, and continues] The normal rental business rules apply, see PIM1100 onwards, including the "wholly and exclusively" rule and the rules governing the timing of relief (see PIM1100 onwards). A taxpayer cannot, for example, deduct interest on a private loan, such as a loan used to buy their private residence. Where part of the taxpayer's own residence is let see PIM2100.
>
> Similarly, the interest on a loan or overdraft may not be allowable, or only part may be allowable, where the taxpayer, for example, uses the borrowing:
>
> - to buy non-rental business investments (which may be shown in the

balance sheet as assets),

- to buy private assets or assets for their family,
- for the provision of private funds to be taken out from the rental business.

Deciding what interest, if any, can be deducted may be difficult, particularly where the taxpayer's account with the business is overdrawn. That is, where the taxpayer has drawn out more money than the profits of the rental business. The loan may have, for example, partly financed the rental business and partly met private living expenses. Interest on a borrowing that is used to fund private living expenses or other non-business expenditure isn't allowable.

For advice regarding the incidental costs of loan finance see PIM2050.

Interest on a partner's capital account with the business isn't deductible. It is merely an allocation of the rental business profit and is taxed as property income.

For more detailed guidance about the deduction of interest see BIM45650 onwards.[4]

Interest payable on property only partly used for rental business

A property may be let for short periods in a tax year or only part of it may be let throughout a tax year (or both); the rest of the time the property is used for private or non-business purposes. Here the interest charged on a qualifying loan on that property has to be split between the rental business use and the private or non-business use. The split is done in whatever way produces a fair and reasonable business deduction, taking account of both the proportion of business use and the length of business use.

You don't have to split the interest if the taxpayer is genuinely trying to let the property but it is empty because they have not been able to find a tenant. In this case the interest will meet the "wholly and exclusively" test. It won't meet this test if they have not been trying to let the property or they have been using it for private or non-business purposes .

[***Interest and rent-a-room*** - *passage not printed here*]

Legislation

The profits of a rental business are calculated in the same way as the profits of a trade. Therefore interest may be deducted in computing the profits of a rental business provided that it meets the following criteria.

- It must be payable wholly and exclusively for the purposes of the rental business.

[4] This material is not set out here for reasons of space, but it is well worth reading, particularly where the interest is deducted from trading income rather than property income.

> [• If it is paid to a person not resident in the UK, the deductible element must not be at more than a reasonable commercial rate - see PIM2130.][5]
>
> Remember that under the rental business rules, relief is given for interest payable on the accruals basis (not interest paid unless, exceptionally, the cash basis is used - see PIM1090).
>
> The guidance on interest as a trade expense at BIM45650 onwards applies equally to interest as a rental business expense.
>
> ***Interest rate hedging instruments*** [See 24.5.1 (Property income: computation)]
>
> **PIM2064. Paid abroad** [Mar 2018]
>
> ***Business deduction and deduction of tax***
>
> The residence status of the lender does not affect the taxpayer's right to an interest deduction in computing the profits or losses of their rental business. But where they pay interest to a lender whose usual place of abode is outside the UK, they should normally deduct IT at the basic rate from the payments they make and account for it to HMRC ...

25.4.1 *Interest at uncommercial rate*

The Property Income Manual provides:

> **PIM2064. Paid abroad** [Mar 2018]
>
> ...
>
> ***Interest paid at uncommercial rates***
>
> Interest paid to a lender not resident in the UK over and above a commercial rate isn't allowable as a deduction even if it would otherwise qualify (perhaps because the loan was used to buy a rental business property). Generally, HMRC will accept the interest charged by the lender as an allowable deduction where it is paid on an arm's length loan made on a normal commercial basis.
>
> Take a broad view of what is a reasonable commercial rate. You should not normally seek an adjustment where the payer and recipient are at arm's length. If interest is payable in the UK on an advance from a foreign bank carrying on a bona fide banking business in the UK through a branch, treat it as if it were interest payable to a UK bank...

This is referring to the former s.74(1)(n) ICTA 1988, which disallowed interest paid to a non-resident so far as it was at more than a reasonable commercial rate. The provision was repealed in 2004, so the Manual is almost a decade out of date. However if interest is paid at more than a

[5] This passage is out of date: see 25.4.1 (Interest at uncommercial rate).

commercial rate, whether or not to a non-resident, the deduction would in principle be disallowable on transfer pricing or on "wholly and exclusively" principles.

25.4.2 *Non-resident co pays interest*

Lastly, for completeness, the Manual refers to (what is now) 1301A CTA 2009:

> In calculating a company's income from any source for corporation tax purposes, no deduction is allowed for interest otherwise than under Part 5 (loan relationships).

That only applies for CT and does not disallow a deduction for interest for IT. HMRC agree. The PI Manual states:

> **PIM2110. Paid abroad** [Jan 2018]
> ...
> ***Non-resident companies***
> ... Section 337A does not preclude a deduction for interest for companies chargeable to IT such as non-resident companies with income from UK property.

25.5 Tax relief schemes

Section 809ZG(1) ITA provides the general rule:

> Relief is not to be given under any provision of the Income Tax Acts to a person in respect of a payment of interest if
> [a] a tax relief scheme has been effected, or
> [b] tax relief arrangements have been made,
> in relation to the transaction under which the interest is paid.

Section 809ZG(2) ITA is a small point:

> Subsection (1) applies whether the tax relief scheme is effected, or the tax relief arrangements are made, before or after the transaction.

I do not see how a transaction could take place before the scheme is effected, but it does not matter.

Section 809ZG(3) ITA defines tax relief scheme:

> A scheme is a tax relief scheme in relation to a transaction for the purposes of subsection (1) if it is such that the sole or main benefit that might be expected to accrue to the person from the transaction is the obtaining of a reduction in tax liability by means of relief under the Income Tax Acts.

Section 809ZG(4) ITA defines tax relief arrangements in the same way:

> Arrangements are tax relief arrangements in relation to a transaction for the purposes of subsection (1) if they are such that the sole or main benefit that might be expected to accrue to the person from the transaction is the obtaining of a reduction in tax liability by means of relief under the Income Tax Acts.

Section 809ZG(5) ITA provides a commonsense definition of relief:

> In this section "relief" means relief by way of—
> (a) deduction in calculating profits or gains, or
> (b) deduction or set off against income.

Corporate Finance Manual provides:

> **CFM39030. Artificial payments of interest: Sole or main benefit** [Nov 2019]
> [The Manual summarises the legislation and continues:] The sole or main benefit test is an objective, rather than a subjective test: the subsection focuses on the result to be expected from the transaction rather than its purpose. (See *The Crown Bedding Co v IRC* 34 TC 107 at pp 115, 118-120, followed in *Ackland & Pratten v IRC* 39 TC 649 at p662, and approved in *IRC v Brebner* 43 TC 705 at p718).
> Ordinary borrowings involving funds, which are genuinely invested or re-lent, are not affected because the tax relief on the interest paid is incidental to the transaction.

The International Manual formerly provided:

> **INTM509120. Section 787 ICTA 1988** [Mar 2012]
> *Part XVII ICTA 1988 includes various anti-avoidance provisions including Section 787. This restricts relief for interest paid under a scheme from which the sole or main benefit which might be expected to accrue is the reduction of tax resulting from the relief, including group relief. Although this appears to be a far reaching section which could be used against many avoidance schemes, its usefulness is somewhat restricted.*
> *The provision was introduced to counteract a specific domestic avoidance scheme to get relief on 'manufactured' interest by paying interest in advance on a borrowing which was effectively immediately repaid. It is necessary to distinguish between an out-and-out avoidance scheme and a judiciously arranged borrowing scheme. The section is not, therefore, easily invoked but it may still be legitimate to use it in some cases involving intra-group funding transactions.*

The entry has been deleted but there seems to be no reason to believe that HMRC practice has changed. HMRC's reluctance to use the section goes back to an assurance given in parliament:

> **Mr. Robert Sheldon (financial secretary to the Treasury)**: The hon. Member for Guildford (Mr. Howell) rightly asked for some assurance that there would be no problems for innocent parties seeking arrangements whereby they undertook to pay interest for genuine business purposes. I can give the hon. Gentleman the assurance that those paying true interest for genuine business purposes will not be caught by this scheme. To give him the definition, which I think also deals with the question put by the hon. Member for Cirencester and Tewkesbury (Mr. Ridley), in a genuine commercial scheme the main benefit is to secure finance. If that is applicable, those people will not be caught by the main benefit test and they will be perfectly free to go about seeking and undertaking any transactions which fall within that definition.
>
> The natural anxiety of the hon. Member for Guildford is that these matters are closely watched. I can give him that assurance. That is to the advantage of the kind of people mentioned in this debate so that we do not entrap those perfectly legitimate and proper cases where people are prepared to pay the interest and get it allowable against tax. We are concerned about people who resort to some of those very peculiar devices of the kind which show an immense amount of ingenuity and, as the hon. Member for Guildford said, with such unfortunate results.[6]

25.6 Transfer pricing/thin capitalisation

The transfer pricing rules are in Part 4 TIOPA, supplemented by OECD transfer pricing guidelines, nearly 700 pages in the 2022 edition. This is a vast topic, and a full discussion would need many volumes. I focus on matters closest to the themes of this book.

Assuming interest is paid at market rates, one would not expect transfer pricing issues to arise. However the effect of some deft deeming provisions is that transfer pricing rules also serve as thin capitalisation rules, ie rules which restrict the deduction of interest by companies funded primarily by borrowing, having limited share capital or net value. It is therefore necessary to consider these rules in some detail.

The International Manual explains the background as it appears to

[6] Hansard, 13 July 1976.

HMRC:

> **INTM413010. Definition of thin capitalisation** [Mar 2022]
> In the commercial world, a company is said to be thinly capitalised when it has more debt than equity, and many thin cap cases boil down to a company with more debt than it could and would have borrowed on its own resources, because it is borrowing either from or with the support of connected persons.
>
> However, the amount of interest payable may be excessive for one or more reasons - interest rate, excessive duration of lending, restrictions on repayment, etc - so all terms and conditions should be considered in a thin capitalisation review. Other less obvious issues of possible interest are the appropriateness of the currency of the loan (e.g. forex risk) and the presence of guarantees. For HMRC, thin cap means looking at every aspect of lending and borrowing from a transfer pricing angle...
>
> **How thin capitalisation arises**
>
> When a company operates at arm's length from its sources of funding, commercial considerations drive the decision to raise funds either through debt, equity, or a mixture of the two. There is a marked difference in tax treatment between debt finance and equity, in that interest on debt is deductible from profits, whereas dividends on shares are not. This is explored in more detail in the Practical Thin Cap Guidance from INTM510000 onwards.
>
> When a company borrows from or with the support of other group companies, funding decisions may not be driven by commercial considerations alone. The connection between the parties involved might allow them to change the way in which the funding is obtained in ways unavailable or unattractive to the borrower at arm's length, or to take on funding risks which an independent borrower would avoid. Factors such as group policy, strategy, and tax planning will sit alongside commercial considerations.
>
> As a result of the differences in tax treatment between interest and dividends, a company which increases its indebtedness, and thereby increases its interest payments, reduces the tax it has to pay.
>
> Thin capitalisation is just a form of transfer pricing, and is not limited to companies, except where the legislation says so, but this guidance concentrates largely on corporate relationships.
>
> **Thin capitalisation and tax planning**
>
> As with transfer pricing more generally, thin capitalisation does not require a tax avoidance motive. The aim of applying transfer pricing legislation is to ensure that arm's length prices are recognised for goods, services, etc, for tax purposes. However, company finance is an easy and attractive way for groups to change the jurisdiction within which profits

arise, and tax planning will be an aspect of the financing plans for any major corporate acquisition.

Corporate thin capitalisation is usually seen in a group context, since it would be counter-productive (though not unheard of) for a company to increase its interest costs payable to a third party, just to reduce its tax liability. Besides, a borrower cannot borrow more (or pay more interest) than an arm's length lender is willing to lend, unless that money is guaranteed, usually by group members. Where the borrowing is intra-group, the interest remains within the group; the group as a whole is no less profitable, but the borrower has paid less tax, and, where the lender is in a country with a lower corporation tax rate than the borrower or has losses to absorb interest received, the group can end up far better off overall. At the same time, there may be arbitrage (INTM590000) or other opportunities to further reduce tax.

With third party borrowing supported by a group guarantee, interest is paid to a third party and value leaves the group, but in that case the issue may be a matter of where it is most tax efficient for the group's interest costs to arise. The inference is that the world-wide group has capacity to borrow but not necessarily within the UK entity, which is where it wishes to place the debt. However, guarantees, including less formal support such as a letter of comfort, can enable a company to borrow more cheaply than would be possible on a standalone basis.

25.6.1 *Thin capitalisation: EU law*

The EC comment on the EU law aspects of thin capitalisation:

> *Thin capitalisation rules*. There are many different approaches to the design of thin cap rules which reflect the different views and legal traditions of MSs. However, the background to these rules is similar. Debt and equity financing attract different tax consequences. Financing a company by means of equity will normally result in a distribution of profits to the shareholder in the form of dividends, but only after taxation of such profits at the level of the subsidiary. Debt financing will result in a payment of interest to the creditors (who can also be the shareholders), but such payments generally reduce the taxable profits of the subsidiary. Dividend and interest may also attract different withholding tax consequences. The difference in treatment between debt and equity financing under national tax law (and at bilateral level), as a result of which the source state's taxing rights on interest are generally more limited than those on dividends, make debt financing considerably more attractive in a cross-border context and can therefore lead to the erosion of the tax base in the state of the subsidiary.
>
> By abolishing their thin cap rules altogether or by carving out dealings with lenders resident in other MSs and EEA States from their scope, the difference in treatment between resident subsidiaries according to the seat of their parent company within the EU/EEA would be removed. The Commission is of the opinion that MSs should, however, be able to protect their tax bases from artificial erosion through structured debt financing, also within the EU/EEA. Following *Lankhorst*, some MSs have tried to avoid

the charge of discrimination by extending the application of their thin cap rules to cover also purely national relations. As discussed above, this is not desirable development.

In *Thin Cap* the ECJ acknowledged that measures to prevent thin capitalisation are not per se impermissible. Their application must however be confined to purely artificial arrangements. This may be achieved by ensuring that the terms of the debt financing arrangements between related companies remain within the limits of what would have been agreed upon between unrelated parties or that they are based on otherwise valid commercial reasons. The Commission considers that the principles laid down by the ECJ in relation to thin cap rules also apply to transfer pricing rules, which are essential to the continued existence of individual national tax systems. MSs cannot operate effective tax systems unless they are able to ensure that their tax bases are not eroded through non-commercial arrangements between associated companies.

4. APPLICATION OF ANTI-ABUSE RULES IN RELATION TO THIRD COUNTRIES

CFC rules determine the tax treatment of the profits of a foreign company controlled by a resident. As such rules are directed at, and thus only affect resident shareholders with definite influence over a foreign company (usually a parent in a corporate group) their centre of gravity lies with the ability of companies (and as the case may be, individuals) to establish themselves, through subsidiaries, in other countries. Similarly, MSs' thin cap rules are directed exclusively at group debt financing arrangements, i.e. they are only applied in situations where a foreign shareholder holds a substantial participation in the resident subsidiary. Thus, the centre of gravity in respect of thin cap rules also lies clearly with the freedom of establishment and as in the case of CFC rules their application is therefore to be examined solely from the perspective of Article 43 of the EC Treaty.[7]

As Community law does not require MSs to avoid discrimination in relation to the establishment of their nationals outside the Community, or the establishment of third-country nationals in a MS[8] the issue of discrimination does not arise in the cases of a controlled company or a creditor/shareholder resident in a third country. MSs should therefore not be precluded from applying CFC and thin cap rules in relation to third countries. Community law does not impose any particular requirements on the legitimacy of the application of such legislation to transactions outside the EU.[9]

However, should the application of those rules not be confined to situations and transactions between companies in a corporate group (or otherwise related parties where one has definite influence over the other) and to the extent that this was the case, they would need to comply with Article 56 of the EC Treaty, and also in relation to third countries, be applied to wholly artificial arrangements only (with the exception of situations where there is no adequate information exchange relationship with the third country concerned).

The corporate tax directives only apply to companies incorporated in the MSs and their

[7] *Lasertec Gesellschaft für Stanzformen v Finanzamt Emmendingen*, C-492/04 at [20].

[8] As the ECJ noted in *ICI v Colmer* C-264/96 at [34]: “When deciding an issue concerning a situation which lies outside the scope of Community law, the national court is not required, under Community law, either to interpret its legislation in a way conforming with Community law or to disapply that legislation.”

[9] Their application may however be precluded by the relevant Double Tax Convention.

overall objective is to create *within the Community* conditions analogous to those of an internal market by removing tax obstacles to cross-border reorganisations and to payments of dividends, interest and royalties. It would therefore not appear to fall within their ambit to, for instance, facilitate arrangements intended to avoid withholding taxes on payments to non-European entities, if such structuring does not serve any commercial purpose.[10]

25.6.2 *Other provisions*

The International Manual provides:

> **INTM413010. Definition of thin capitalisation** [Mar 2022]
> **... Other legislation on finance**
> There is other legislation - and this is not an exhaustive list - which may result in a restriction of the interest deduction, including:
>
> - Arbitrage provisions - see INTM590000
> - Unallowable purpose legislation - s.441-442 CTA - see CFM38010
> - Remaining provisions of pre-2004 legislation (s.209 ICTA) - now around s.1000 CTA - such as interest in excess of a commercial rate of return - see below and CTM15502
> - World-wide debt cap - Part 7 TIOPA 2010 - see CFM90100 onwards
>
> The first two represent anti-avoidance legislation, so the choice of applicable legislation depends on the facts and circumstances of the particular case, and transfer pricing concerns may sit alongside avoidance concerns. Section 155(6) TIOPA says that the CTA10/S1000 list and the world-wide debt cap legislation shall be disregarded when calculating the transfer pricing tax advantage. The debt cap applies after any transfer pricing adjustment has been made.

These provisions concern corporation tax only, and so are not discussed here.

25.7 "The basic pre-condition"

Section 147(1) TIOPA provides:

> For the purposes of this section "the basic pre-condition" is that—
>
> (a) provision ("the actual provision") has been made or imposed as between any two persons ("the affected persons") by means of a transaction or series of transactions,
>
> (b) the participation condition is met (see section 148),

[10] EC Communication "The application of anti-abuse measures in the area of direct taxation" COM(2007) 785
http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52007DC0785

> (c) the actual provision is not within subsection (7) (oil transactions), and
> (d) the actual provision differs from the provision ("the arm's length provision") which would have been made as between independent enterprises.

Thus the "basic pre-condition" actually consists of four conditions or sets of conditions. I refer to them as **"basic pre-conditions (a) to (d)"** though condition (b) has its own label (the participation condition). Condition (c) (which concerns oil transactions) is not discussed here.

Section 151(1) TIOPA defines **"arm's length provision"** in line with the commonsense usage in basic pre-condition (a):

> In this Part "the arm's length provision" has the meaning given by section 147(1).

25.7.1 *Transaction/series*

This expression is used in basic pre-condition (a). Section 150(1) TIOPA provides a wide definition of transaction:

> In this Part "transaction" includes arrangements,[11] understandings and mutual practices (whether or not they are, or are intended to be, legally enforceable).

Section 150 TIOPA provides a wide definition of series of transactions:

> (2) References in this Part to a series of transactions include references to a number of transactions each entered into (whether or not one after the other) in pursuance of, or in relation to, the same arrangement.
> (3) A series of transactions is not prevented by reason only of one or more of the matters mentioned in subsection (4) from being regarded for the purposes of this Part as a series of transactions by means of which provision has been made or imposed as between any two persons.
> (4) Those matters are—
> (a) that there is no transaction in the series to which both those persons are parties,
> (b) that the parties to any arrangement in pursuance of which the transactions in the series are entered into do not include one or

[11] Section 150(5) TIOPA provides (with minor contextual modifications) the standard (unnecessary) IT definition ": see App 2.2.3 (Definitions of "arrangement").

both of those persons, and

(c) that there is one or more transactions in the series to which neither of those persons is a party.

The International Manual provides:

> **INTM413060. Transaction or series of transactions** [Sep 2021]
> Transactions within a series do not have to occur in a recognisable sequence. They may be simultaneous or removed in time from one another, but they have to be part of an overall arrangement or scheme.
> The meaning of series of transactions is further widened by Section 150(4) TIOPA 2010 [the Manual sets out s.150(4) and continues:]
> By recognising a series of transactions, the transfer pricing legislation can apply to more complex and indirect financial structures in the same way that it does to the most straightforward borrower/lender situation.
> However, irrespective of the complexity or number of transactions which make up the "series", it should always be borne in mind that this legislation is still about a provision within TIOPA10/S147 between two persons that results in a tax advantage; see INTM412020 and. INTM413050
> *Examples of "series of transactions"*
> A simple example of indirect finance which would fall within the definition of a series of transactions is a UK borrower being lent money by an entirely unconnected third party bank, with a party connected to the borrower guaranteeing the loan.
> A more complex example is where
> [1] a company in the same group as the UK borrower has provided a guarantee to one bank,
> [2] which then provides a guarantee to a second bank, and
> [3] the second bank then lends money to the UK borrower.
> Here there is a step - between the first and second banks - which does not involve either the parent or the borrower. This is still a series of transactions, and one which, though difficult to detect, would fall within the scope of the thin capitalisation legislation. Apart from the provision of a guarantee, the most likely situations where the provision might consist of a series of transactions would be where an intermediary is acting in a nominee or agency capacity in providing finance cross border between group companies.
> In guarantee cases of this nature, the questions to ask in considering the provision are:
>
> - Without the guarantee(s) would the borrower have been able and willing to borrow on these terms?
> - Had the borrower and the guarantor been at arm's length from one

another, would they have entered into the guarantee?

25.7.2 *Basic pre-condition (a)*

With that definition in mind we can turn to basic pre-condition (a). Section 147(1) TIOPA provides:

> For the purposes of this section "the basic pre-condition" is that—
> (a) provision ("the actual provision") has been made or imposed as between any two persons ("the affected persons") by means of a transaction or series of transactions ...

At first sight, this is not so much a condition as a convenient way of defining the terms "actual provision" and "affected persons".

It is considered that the condition only applies when both persons are carrying on an enterprise, which is sometimes important.[12]

25.8 Participation condition

We turn to basic pre-condition (b), the participation provision.

Section 147(1) TIOPA provides:

> For the purposes of this section "the basic pre-condition" is that ...
> (b) the participation condition is met (see section 148)

Section 148(1) TIOPA provides:

> For the purposes of section 147(1)(b), the participation condition is met if—
> (a) condition A is met in relation to the actual provision so far as the actual provision is provision relating to financing arrangements, and
> (b) condition B is met in relation to the actual provision so far as the actual provision is not provision relating to financing arrangements.

I refer to **"participation conditions A and B"**. It is helpful to consider condition B first.

25.8.1 *Participation condition B*

Section 148(3) TIOPA provides:

> Condition B is that, at the time of the making or imposition of the actual provision—

[12] See 39.42 (Transfer pricing & BiK).

> (a) one of the affected persons was directly or indirectly participating in the management, control or capital of the other, or
> (b) the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the affected persons.

25.8.2 *Participation condition A*

Section 148(2) TIOPA provides:

> Condition A is that, at the time of the making or imposition of the actual provision or within the period of six months beginning with the day on which the actual provision was made or imposed—
> (a) one of the affected persons was directly or indirectly participating in the management, control or capital of the other, or
> (b) the same person or persons was or were directly or indirectly participating in the management, control or capital of each of the affected persons.

Participation condition A is the same as B, except for the underlined words: the participation test can be satisfied at the time of the arrangement in the following 6 months. This wider test applies to financing arrangements. That term is given a commonsense definition in s.148(4) TIOPA:

> In this section "financing arrangements" means arrangements made for providing or guaranteeing, or otherwise in connection with, any debt, capital or other form of finance.

For the participation tests, see 105.1 (Participation).

25.9 The general rule

If the "basic pre-condition" is met, we move on. Section 147(2) TIOPA provides:

> Subsection (3) applies if—
> (a) the basic pre-condition is met, and
> (b) the actual provision confers a potential advantage in relation to UK taxation on one of the affected persons.

If that is the case we come to the general rule:

> (3) The profits and losses of the potentially advantaged person are to be calculated for tax purposes as if the arm's length provision had been

> made or imposed instead of the actual provision.

Similarly if there are several affected persons:

> (4) Subsection (5) applies if—
> (a) the basic pre-condition is met, and
> (b) the actual provision confers a potential advantage in relation to UK taxation (whether or not the same advantage) on each of the affected persons.
> (5) The profits and losses of each of the affected persons are to be calculated for tax purposes as if the arm's length provision had been made or imposed instead of the actual provision.

The International Manual provides:

> **INTM413020. Introduction** [Sep 2021]
> ...Paragraph 1.65 of the OECD Transfer Pricing Guidelines is particularly helpful in finding the appropriate approach towards the arm's length provision in thin capitalisation cases. This says that the basic transfer pricing approach considers economic substance versus form in thin capitalisation cases:
>
> > "[In cases] where the economic substance of a transaction differs from its form... the tax administration may disregard the parties' characterisation of the transaction and re-characterise it in accordance with its substance. An example of this circumstance would be an investment in an associated enterprise in the form of interest-bearing debt when, at arm's length, having regard to the economic circumstances of the borrowing company, the investment would not be expected to be structured in this way. In this case it might be appropriate for a tax administration to characterise the investment in accordance with its economic substance with the result that the loan may be treated as a subscription of capital."[13]
>
> This means that where a borrower obtains an actual loan of £100m from a non-arm's length source, but would only be able to borrow £60m at arm's length, the tax deduction for the interest costs should be restricted to those accruing on £60m of the £100m actually borrowed. The balance would have had to be provided in some other form, most likely as equity. This is an explanation, not a literal recharacterisation in the way that excessive interest was once reclassified as a distribution for tax purposes (see INTM413260). Debt which is found to be excessive may be treated as equity for the purposes of a thin cap analysis, but the interest on the

[13] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and tax Administration* (July 2010).

> £40m excess remains interest for tax purposes; it is simply disallowed in the computation.
>
> There will be variations in the way debt is treated as equity. There may be negotiations which result in an amount of debt being recognised as serving an equity function, as if that debt had actually been permanently converted into equity, but there will be other instances, for example the application of a debt: equity ratio in an advance agreement, where equity will in effect vary from year to year.
>
> This sort of "recharacterisation" should be uncontroversial, assuming the level of disallowance is agreed. It is a case of finding an explanation, should one be needed, for the presence and treatment of funds that have been deemed "excessive" as debt in thin cap terms. However, if the argument goes further, for example towards saying that the loan transaction would not have taken place at all and something different would have happened at arm's length, it is recommended that the matter be discussed with CSTD Business, Assets International Transfer Pricing Team before the case is developed,
>
> It is important to remember that thin capitalisation considerations are not limited to determining simply the amount which would have been borrowed at arm's length, but also extend to the other terms attached to the actual provision, such as the interest rate, duration and repayment terms. Any of these is capable of creating or extending a tax advantage for the UK borrower.

25.9.1 *Separate entity basis*

The International Manual provides:

> **INTM413070. Separate entity basis for determining borrowing capacity** [Sep 2021]
>
> The separate entity principle is part of the basic pre-condition in TIOPA10/S147(1)(d). This defines the arm's length provision as that "which would have been made as between independent enterprises". The arm's length borrowing capacity of the borrower is therefore the debt which it could and would, as a stand-alone entity, have taken on from an independent lender. To establish this, it is necessary to consider the borrower separately from other members of the same group of companies This is the "separate entity" or stand-alone basis for determining borrowing capacity.
>
> This approach is derived from OECD Transfer Pricing Guidelines, as expressed in paragraph 1.6 of the Guidelines:
>
> > By seeking to adjust profits by reference to the conditions which would have obtained between independent enterprises in comparable transactions and comparable circumstances, the arm's

> length principle follows the approach of treating the members of an MNE group as operating as separate entities rather than as inseparable parts of a single unified business. Because the separate entity approach treats the members of an MNE group as if they were independent entities, attention is focussed on the nature of the dealings between those members.[14]

The "borrowing unit"

The main impact of the "separate entity" basis for determining borrowing capacity is that no account is taken of any guarantees, explicit or implicit, from connected companies (INTM413130). However, it is recognised that, without offending the "separate entity" principle, negotiations with a third party lender would include an assessment of the financial strength of the borrower. This would take into account the income, assets and liabilities of the company, but also of its subsidiaries. In broad terms, this will be based on the strength (or otherwise) of the borrower's consolidated balance sheet and profit and loss account, subject to some analysis of what underlies the figures on the face of the accounts. This grouping is known as the "borrowing unit".

HMRC follows a practical approach and, if consolidated accounts are not drawn up as a matter of course, will request a consolidated presentation of the relevant figures. The borrower is not obliged to produce audited consolidated accounts purely for HMRC, so properly drawn up schedules reflecting the consolidated position will be acceptable. This may not be a straightforward task if the exercise embraces companies resident in a number of countries and using a variety of accounting conventions. In such cases it may be helpful to discuss how HMRC may be satisfied without creating major expense and difficulty.

There may be companies that need to be excluded from the consolidation and dealt with according to their own characteristics e.g. finance companies which are likely to have higher proportions of debt to equity than ordinary trading companies. Some subsidiaries may need to be excluded altogether e.g. companies with a dividend block, which a lender might not recognise as assets against which they would be willing to lend. This whole question must be viewed pragmatically.

Further practical guidance on the separate entity measure of borrowing capacity is at INTM542050. The next page gives some background on the pre-2004 treatment; this shows the contrast between the previous statutory approach to the borrowing unit with the practical, analytical

[14] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and tax Administration* (July 2010).

> approach which has been adopted to deal with the separate entity basis. UK companies under common ownership with the borrowing unit may be able to make a compensating adjustment claim if they have spare borrowing capacity...

25.10 "Provision otherwise made"

Section 151(2) TIOPA provides:

> For the purposes of this Part, the cases in which provision made or imposed as between any two persons is to be taken to differ from the provision that would have been made as between independent enterprises include the case in which
> [a] provision is made or imposed as between two persons but
> [b] no provision would have been made as between independent enterprises;
> and references in this Part to the arm's length provision are to be read accordingly.

The International Manual provides:

> **INTM413030. The "would" and "could" arguments** [Sep 2021]
> The test of thin capitalisation is to test the actual borrowing position against the arm's length borrowing position.
> The arm's length principle recognises that connected parties may enter into transactions with each other on terms which differ from those which would be found in the open market between entirely unconnected persons. Where profits arise and the extent to which those profits are taxed may also differ from the arm's length position.
> The application of the arm's length principle requires a judgement on the merit of each individual case to establish what would have happened at arm's length; the terms on which the company in question could have borrowed and would have borrowed (if anything),
>
> - as a separate entity
> - from a third party lender unconnected with the borrower, and
> - without guarantees or other forms of comfort from any party connected with the borrower.
>
> There are two main ways of looking at the borrowing: what the lender would do and what the borrower would do if the circumstances were as outlined above, and these are expressed as:
>
> - the "could" argument - what a lender would have lent and therefore what a borrower could have borrowed - and
> - the "would" argument - what a borrower acting in the best interests of their own business would have borrowed.

The "could" argument

This is generally the less subjective issue. The could argument focuses on what a lender would be prepared to lend to the company and on what terms, taking into account the borrower's capacity to borrow, the risk of default, assets (as security) and liabilities (additional drains on the borrower's resources), and its ability to service the debt: in short, how much and on what terms a lender would lend.

Risk elements will include amount, duration of lending, purpose, security, currency and the economic climate at a sector, national and international level.

The "would" argument

This issue is more subjective, since it can involve the whole basis on which the business is run. The "would" argument considers the borrower's perspective: whether the borrower would have entered into the actual transaction in the absence of a special relationship (INTM412020) with the lender. Therefore, when trying to establish the amount and terms of arm's length debt, the "would" argument relates to how much, and on what terms, the borrower would have borrowed at arm's length bearing in mind the sort of issues mentioned below.

So, the "would" argument requires consideration as to what terms a borrower would have agreed at arm's length, such as

- the amount of debt, and whether that leaves headroom to allow the borrower to absorb cyclical or seasonal variations, an unforeseen event or a fluctuation in interest rates or profits, and ultimately repay the principal;
- the costs of borrowing, and whether forecasts indicate that the borrower is likely to be able to service the debt fully and still have sufficient cash to operate as a profitable going concern;
- whether the other terms, such as the interest rate or provision for early repayment are ones to which the borrower would have agreed in the absence of a special relationship;
- whether the borrower would have taken out the loan at all.

Consideration of all aspects of the "could" and "would" arguments should highlight situations such as where

- an arm's length interest rate is being applied, but the amount of debt is more than the borrower could have borrowed from an independent lender, or
- an arm's length interest rate is applied to an arm's length amount of debt, but the borrower appears to have no purpose of its own for borrowing the money (and therefore no reason to borrow other than the group relationship).

Debt is not necessarily paid down to nil. A certain level of debt is acceptable, even desirable in most companies, and while higher levels of acquisition debt tend to be reduced in the years following the transaction, there is likely to be a level of debt appropriate to the needs of the business, year on year, appropriate to achieving the right balance between debt, equity and profitability...

25.11 Securities (loans)

Section 152 TIOPA provides:

> (1) This section applies where—
> (a) both of the affected persons are companies, and
> (b) the actual provision is provision in relation to a security issued by one of those companies ("the issuing company").
>
> (2) Section 147(1)(d) [the actual provision differs from the arm's length provision] is to be read as requiring account to be taken of all factors, including—
> (a) the question whether the loan would have been made at all in the absence of the special relationship,
> (b) the amount which the loan would have been in the absence of the special relationship, and
> (c) the rate of interest and other terms which would have been agreed in the absence of the special relationship.

The International Manual provides:

> **INTM413040. Summary of sections specific to thin capitalisation** [Sep 2021]
>
> There are specific sections within TIOPA10/Part 4 that apply only to loans between two companies:
>
> - TIOPA10/S152 requires that in the case of lending between companies, certain factors to be considered when comparing the arm's length provision with the actual provisions in TIOPA10/S147(1)(d). See INTM413100
> - TIOPA10/S181 to TIOPA10/S184 sets out the conditions required for a lender to make a valid compensating adjustment claim where a disallowance has been made in the borrower's computations. See INTM413140
> - TIOPA10/S153 deals with the factors that are taken into account when a loan is supported by a guarantee, and the borrower and the guarantor have a special relationship. See INTM413160
> - TIOPA10/S191 to TIOPA10/S194 sets out the conditions required for a guarantor to make a valid compensating adjustment claim. See INTM413150
>
> **Non-corporates**
>
> TIOPA10/Part 4 applies to loans made to companies by non-corporates

> where the participation condition in TIOPA10/S148 is met. However, the explicit instructions regarding factors to be considered as part of evaluating the arm's length provision in TIOPA10/S152 and TIOPA10/S153 do not apply directly as legislation to loans by non-corporates. Even so, the factors that are set out in TIOPA10/S152 and TIOPA10/S153 are generally those which are taken into account by lenders and borrowers acting at arm's length, so in practice the nature of the lender, corporate or non-corporate will have little if any impact on how the arm's length provision is determined.
> Claims for compensating adjustments by non-corporates can be made under the conditions in TIOPA10/S174 to TIOPA10/S178 (Para 6 of Sch 28AA)....

25.11.1 *Disregard: Non-business loan*

Section 152(3) TIOPA introduces two disregards:

> Subsection (2) has effect subject to subsections (4) and (5).

Section 152(4) TIOPA provides:

> If—
> (a) a company ("L") makes a loan to another company with which it has a special relationship, and
> (b) it is not part of L's business to make loans generally,
> the fact that it is not part of L's business to make loans generally is to be disregarded in applying subsection (2).

Why is this needed? The International Manual explains:

> **INTM413100. Special rules for lending between companies** [Sep 2021]
> TIOPA10/S152(4) ensures that the fact that the lender is not generally in the business of making loans cannot be taken into account when evaluating the terms.

25.11.2 *Disregard: Guarantee*

Section 152(5) TIOPA provides:

> (5) Section 147(1)(d) [the actual provision differs from the arm's length provision] is to be read as requiring that, in the determination of any of the matters mentioned in subsection (6), no account is to be taken of (or of any inference capable of being drawn from) any guarantee provided by a company with which the issuing company has a participatory relationship.
> (6) The matters are—

> (a) the appropriate level or extent of the issuing company's overall indebtedness,
> (b) whether it might be expected that the issuing company and a particular person would have become parties to a transaction involving—
> (i) the issue of a security by the issuing company, or
> (ii) the making of a loan, or a loan of a particular amount, to the issuing company, and
> (c) the rate of interest and other terms that might be expected to be applicable in any particular case to such a transaction.

Section 153 TIOPA repeats the same material:

> (1) This section applies where the actual provision is made or imposed by means of a series of transactions which include—
> (a) the issuing of a security by a company which is one of the affected persons ("the issuing company"), and
> (b) the provision of a guarantee by a company which is the other affected person.
> (2) Section 147(1)(d) [the actual provision differs from the arm's length provision] is to be read as requiring account to be taken of all factors, including—
> (a) the question whether the guarantee would have been provided at all in the absence of the special relationship,
> (b) the amount that would have been guaranteed in the absence of the special relationship, and
> (c) the consideration for the guarantee and other terms which would have been agreed in the absence of the special relationship.
> (3) Subsection (2) has effect subject to subsections (4) and (5).
> (4) If—
> (a) a company ("G") provides a guarantee in respect of another company with which it has a special relationship, and
> (b) it is not part of G's business to provide guarantees generally,
> the fact that it is not part of G's business to provide guarantees generally is to be disregarded in applying subsection (2).
> (5) Section 147(1)(d) [the actual provision differs from the arm's length provision] is to be read as requiring that, in the determination of any of the matters mentioned in subsection (6), no account is to be taken of (or of any inference capable of being drawn from) any guarantee provided by a company with which the issuing company has a participatory relationship.
> (6) The matters are—
> (a) the appropriate level or extent of the issuing company's overall

indebtedness,

(b) whether it might be expected that the issuing company and a particular person would have become parties to a transaction involving—

(i) the issue of a security by the issuing company, or

(ii) the making of a loan, or a loan of a particular amount, to the issuing company, and

(c) the rate of interest and other terms that might be expected to be applicable in any particular case to such a transaction.

The International Manual provides:

> **INTM413110. Guarantees - what they do and what they are** [Sep 2021]
>
> As explained in INTM413060, a provision may arise from a series of transactions rather than just a single transaction between two connected companies. A loan from a third party which is guaranteed by a connected person constitutes a provision consisting of a series of transactions. The same would apply to a loan from a connected party which is guaranteed by another connected party. The most common instance will be a single loan supported by a single guarantee but the provision could consist of any number and combinations of loans and cross guarantees.
>
> **The effect of a guarantee**
>
> Guarantees most commonly support third party borrowing, but can be used to support loans between group companies: for example, a European group treasury company might provide finance to a fellow group company resident in the UK, but under guarantee from the UK borrower's parent company.
>
> With the additional comfort offered to the lender by a guarantor, the lender might provide a loan on more advantageous terms than the borrower could have obtained otherwise, because the guarantee will reduce the risk to the lender. In the event of a failing borrower and no guarantee, a third party lender's prospects of recovering its outlay would be at risk. However, with a guarantee in place, the lender should have greater and more immediate success in recovering debt and interest, simply by exercising its rights under the guarantee and seeking payment from the guarantors, than it would by waiting for a distribution of assets in a liquidation, or having to write off all or part of the loan. The guarantor would of course have to demonstrate that it could make good its pledge, and probably provide security in relation to its commitment.
>
> The effect of a guarantee on loan terms is varied. Guarantees may help secure:
>
> - a larger loan

- a lower rate of interest
- an increase in duration
- less demanding covenants on the borrower

Any of these may have implications for the transfer pricing of the transaction e.g. a larger loan may be obtainable, but it may be more than the borrower would be able or willing to take on at arm's length. Also, the guarantee may secure preferable terms as compared to what would be otherwise on offer. A lower interest rate on a larger amount of debt might be regarded as a more attractive and not a more expensive deal. See INTM413120.

The presence of a guarantee does not necessarily signify a change in lending terms, and in any case larger, longer, etc, do not mean "better" for the borrower; a larger loan may be more than the borrower would or could borrow without this help, and therefore more than the borrower could or would borrow at arm's length. Lenders may seek guarantees as part of a "belt and braces" approach: not a crucial factor, but better to have than not have. A typical example being the cross guarantees required by lenders when they lend to a group of companies.

INTM413120. Evaluating guarantees: starting with the arm's length cost of debt [Sep 2021]

TIOPA10/S153 (SCH28AA/Para 1B) is about considering the effect of, and consequently the issue of allowing the costs of pricing guarantees between connected companies. It adopts a similar approach to the way transfer pricing of securities between companies operates - see TIOPA10/S152 (INTM413100). However to understand how the section works it is better to start by looking at the factors that have to be disregarded before looking at the factors that are specifically to be taken into account.

TIOPA10/S153(4) has the same effect for guarantees as TIOPA10/S152(4) has for loans. It ensures that where the guarantor is not generally in the business of making guarantees, that circumstance cannot be taken into account when evaluating what the guarantee fee would be at arm's length.

TIOPA10/S153(5) and (6) ensure that guarantees from connected companies are ignored, so that the borrower's borrowing capacity is evaluated on a separate entity basis (INTM413070). These subsections repeat what was said atTIOPA10/S152(5) and (6), except with different intent. S152 is about how the arm's length provision is calculated for the borrower, for the purposes of testing whether a security is on arm's length terms. S153 repeats the same test, but as a precursor to working out whether a guarantee has an arm's length value to the borrower. The exercise should isolate and exclude the effect of the guarantee to identify what would have been achieved without it.

Looking at the loan whilst ignoring the effect of any guarantees establishes the amount the borrower would have been able to borrow in its own right, and the terms on which it would have done so. The legislation specifically states that guarantees should be disregarded in considering the following specific issues:

- the level or extent of overall debt
- whether a loan would have been entered into
- the rate of interest or other terms

Once this is established, the legislation considers the transfer pricing of the guarantee fee itself - see INTM413110.

INTM413130. Establishing the arm's length value of a guarantee [Sep 2021]

This is about guarantee fees and their worth to the borrower, where the borrower is actually charged for the provision of a guarantee. This is therefore about:

- what value the guarantee brings to the borrower, compared to what it could and would obtain without it
- What is the appropriate level for the guarantee fee which the borrower pays

S153 (Para 1B) first establishes the arm's length price of the loan without guarantees. This does not necessarily mean that guarantees will be permanently ignored in pricing the debt. In considering what guarantee, if any, would have been provided at arm's length. TIOPA10/S153(2) (PARA1B(2)) asks that "all factors" be taken into account in working this out, and particularly asks what would have happened in the absence of the special relationship between the borrower and the provider of the guarantee (i.e. at arm's length):

- would the guarantee have been provided at all
- what amount would have been guaranteed
- what consideration (fee, etc) and other terms would have been agreed

This is simply a matter of applying a transfer pricing test to guarantee costs.

At arm's length, a company would not take on the extra cost of a guarantee unless that guarantee makes the overall cost of finance cheaper than it would be on a stand-alone basis. If the cost of the guarantee itself is greater than the saving it brings, it will be disallowed to the extent that it causes the total finance costs relating to the guaranteed debt to exceed the stand-alone arm's length price.

When does a guarantee provide an arm's length benefit?

The scenarios below set out how TIOPA10/S153 operates for the borrowing company. The "cost of loan" in the headings below refers to actual costs of borrowing excluding guarantee fees and not adjusted by transfer pricing provisions. These scenarios do not demonstrate the arm’s length price of a guarantee, but will show whether the guarantee has brought a benefit when the borrowing is considered on an arm’s length basis.

1. Guarantee fee charged and cost of loan exceeds arm’s length

The borrower is already paying more than it would if borrowing on a separate entity basis. Considered at arm’s length, the value of the guarantee is nil and it simply represents an additional cost. The terms of the loan are adjusted for transfer pricing purposes to the arm’s length amount, the non-arm’s length element of the loan costs is disallowed, and the guarantee fee is disallowed.

There is no apparent benefit from this guarantee, so any claim that there is value meriting a guarantee fee should be subject to a thorough analysis to identify whether the guarantee provides any other, less obvious commercial benefit that would justify the payment of a fee. A guarantee might enable a borrower to spread its finance costs over a longer period, which might be advantageous in certain circumstances.

2. Guarantee fee charged and cost of loan is equal to the arm’s length

The cost of the loan is arm’s length so no adjustment is required with respect to the loan itself, but as in 1 above, it would be difficult to justify a guarantee fee. It appears to provide no benefit by way of cheaper financing and is likely to be disallowed unless some less obvious benefit can be demonstrated.

3. Guarantee fee charged and cost of loan is less than arm’s length

This situation may arise where the guarantee is taken into account in setting the terms of the loan. For example, the presence of the guarantee may have the effect of improving the credit rating of the borrower and achieve a lower interest rate. As the guarantee has reduced the cost of the loan to below the stand-alone cost, there is a clear benefit to the borrower in entering into the guarantee. It is therefore likely that at arm’s length a fee would be paid, as there is a genuine benefit to the borrower. However, the borrower would only agree to pay a fee at arm’s length if there was an overall saving, and the level of the fee should reflect this.

4. No guarantee fee charged and cost of loan is less than arm’s length

Where there is a guarantee in place but no fees have been charged, the guarantee may still provide the borrower with beneficial terms, such as a reduced interest rate. The arm’s length cost of the loan will exceed the actual cost of the loan, because the guarantee reduces finance costs without itself costing anything. It might be argued that, at arm’s length, a fee would be charged for such an effective guarantee, but one cannot be imputed in the computations of the borrower, because transfer pricing legislation operates as a one way street. This scenario creates no tax advantage, so the basic transfer pricing conditions are absent. Of course if the guarantor negotiated a fee, that would be considered on its merits.

> Evaluating the arm's length value of a guarantee fee should be more than a simple mathematical comparison of actual and arm's length costs. It is worth emphasising that all relevant factors should be considered:
>
> - the obligations of the guarantor
> - its ability to fulfil them
> - an analysis of the improvement to the borrower's credit worthiness
> - consideration as to whether the guarantee brings the borrower something beyond the implicit parental or group support provided by passive association with fellow group members.
>
> It may be that the benefits provided by a guarantee, particularly informal understandings, are such that a guarantee fee would not normally be justified. Furthermore, where the guarantor is unable to honour its commitments under the guarantee because of the state of its own finances, the guarantee will in practice have no value.

25.12 Definitions

25.12.1 *Special relationship*

Section 154 TIOPA provides some definitions introduced by s.154(1)

> Subsections (3) to (7) apply for the purposes of sections 152 and 153....

Section 154(3) TIOPA provides:

> "Special relationship" means any relationship by virtue of which the participation condition is met (see section 148) in the case of the affected persons concerned.

The term "special relationship" is used in OECD Model without definition (though discussed in the commentary) but the definition here is narrower.

25.12.2 *Guarantee*

Section 154(4) TIOPA provides:

> Any reference to a guarantee includes—
>
> (a) a reference to a surety, and
>
> (b) a reference to any other relationship, arrangements, connection or understanding (whether formal or informal) such that the person making the loan to the issuing company has a reasonable expectation that in the event of a default by the issuing company the person will be paid by, or out of the assets of, one or more companies.

The International Manual has an interesting passage on implicit guarantees which is not set out here as it is not relevant to the themes of this book.

25.12.3 *Participatory relationship*

Section 154(5) TIOPA provides:

> One company ("A") has a "participatory relationship" with another ("B") if—
> (a) one of A and B is directly or indirectly participating in the management, control or capital of the other, or
> (b) the same person or persons is or are directly or indirectly participating in the management, control or capital of each of A and B.

25.12.4 *Security*

Section 154 TIOPA provides:

> (6) "Security" includes securities not creating or evidencing a charge on assets.
> (7) Any—
> (a) interest payable by a company on money advanced without the issue of a security for the advance, or
> (b) other consideration given by a company for the use of money so advanced,
> is to be treated as if payable or given in respect of a security issued for the advance by the company, and references to a security are to be read accordingly.

Subsection (6) is standard form. However subsection (7) means that all loans are "securities." It would have been clearer to use the word "loan" rather than to (mis)use the word "securities", but there it is.

25.13 Potential advantage for UK tax

Section 155 TIOPA provides:

> (1) Subsection (2) applies for the purposes of this Part.
> (2) The actual provision confers a potential advantage on a person in relation to UK taxation wherever, disregarding this Part, the effect of making or imposing the actual provision, instead of the arm's length provision, would be one or both of Effects A and B.
> (3) Effect A is that a smaller amount (which may be nil) would be taken for tax purposes to be the amount of the person's profits for any chargeable period.
> (4) Effect B is that a larger amount (or, if there would not otherwise have been losses, any amount of more than nil) would be taken for tax

> purposes to be the amount for any chargeable period of any losses of the person.

25.13.1 *Disregarded income*

Section 155(5) provides a disregard for disregarded income:

> In determining for the purposes of subsection (3) or (4) the amount that would be taken for tax purposes to be the amount of the profits or losses for a year of assessment in the case of a non-UK resident, there is to be left out of account any income of that person which is—
> (a) disregarded income within the meaning given by section 813 of ITA 2007 (limits on liability to income tax of non-UK residents), or
> (b) disregarded company income within the meaning given by section 816 of that Act.

Subsection (6) provides two more disregards:

> For the purposes of subsections (2) to (4)—
> (a) Part 7 (tax treatment of financing costs and income), and
> (b) paragraph E of the list in section 1000(1) of CTA 2010 (excessive interest etc treated as a distribution),
> are to be disregarded.

25.14 SME exemption

Section 166(1) TIOPA provides what appears to be a wide exemption, which is then restricted by significant exceptions.

> Section 147(3) and (5) do not apply in calculating for any chargeable period the profits and losses of a potentially advantaged person if that person is a small or medium-sized enterprise for that chargeable period (see section 172).

I refer to this as the "**SME exemption**".

The definition of small and medium-sized enterprises is by reference to EU law.[15] This is not discussed here.

25.15 Election into transfer pricing

I mention the first exception to the SME exemption for completeness. Section 167(1) TIOPA provides:

[15] *http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition/index_en.htm* See s.172 TIOPA.

> (1) Subsections (2) and (3) set out exceptions to section 166(1).
> (2) The first exception is if the small or medium-sized enterprise elects for section 166(1) not to apply in relation to the chargeable period. Any such election is irrevocable.

Why would one want to elect into transfer pricing?

25.16 Non-qualifying territory resident

The next exception to the SME exemption is more important. Section 167(3) TIOPA provides:

> The second exception is if—
> (a) the other affected person, or
> (b) a party to a relevant transaction,
> is, at the time when the actual provision is or was made or imposed, a resident of a non-qualifying territory (whether or not that person is also a resident of a qualifying territory).

In short, residents of non-qualifying territories do not qualify for the SME exemption.

Section 167(4) TIOPA provides some general definitions:

> For the purposes of subsection (3)—
> (a) a "party to a relevant transaction" is a person who, if the actual provision is or was imposed by means of a series of transactions, is or was a party to one or more of those transactions, and
> (b) "qualifying territory" and "non-qualifying territory" are defined in section 173.

Section 167(5) TIOPA defines "resident":

> In subsection (3) "resident", in relation to a territory—
> (a) means a person who, under the law of that territory, is liable to tax there by reason of the person's domicile, residence or place of management, but
> (b) does not include a person who is liable to tax in that territory in respect only of income from sources in that territory or capital situated there.

The drafting is based on OECD Model wording.[16]

25.17 Qualifying territory

Section 173(1) TIOPA provides:

[16] See 9.3 (Residence under art 4(1)); 9.8 (Liable to source tax only).

> In section 167(3)—
> "non-qualifying territory" means any territory which is not a qualifying territory, and
> "qualifying territory" means—
> (a) the UK, or
> (b) any territory in relation to which condition A or condition B is met.

I refer to **"qualifying territory conditions A and B"**.

A similar definition is found in s.931C CTA 2009 (exemption of distributions for CT).

25.17.1 *Condition A: Non-discrimination*

Section 173(2) TIOPA provides:

> Condition A is that—
> (a) double taxation arrangements[17] have been made in relation to the territory,
> (b) the arrangements include a non-discrimination provision, and
> (c) the territory is not designated as a non-qualifying territory for the purposes of this subsection in regulations made by the Treasury.

For the meaning of "Non-discrimination provision" see 112.8 ("Non-discrimination provision").

25.17.2 *Condition B: Designated territory*

Section 173(3) TIOPA provides:

> Condition B is that—
> (a) double taxation arrangements have been made in relation to the territory, and
> (b) the territory is designated as a qualifying territory for the purposes of this subsection in regulations made by the Treasury.

No regulations have been issued, so condition B does not apply.

[17] Section 173(6) TIOPA provides the standard definition: "In this section "double taxation arrangements" means arrangements that have effect under section 2(1) (double taxation relief by agreement with territories outside the UK)."

CHAPTER TWENTY SIX

INTEREST INCOME

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Cross references

The following topics are considered elsewhere:
10.3.1 (Split year: Pt 4/5 ITTOIA Income)
15.6 (When are dividends recognised).
27.1 (Exempt interest: Introduction)
43.5.6 (Savings income rates)
43.10 (Application of savings rates)

26.1 Interest: Introduction

This chapter considers:
(1) The taxation of interest income[1]

[1] One normally refers to interest, not interest income. I use the expression to distinguish two distinct topics: (1) taxation on the receipt of interest, considered in

(2) Interest withholding tax

I go beyond the themes of this book and address the topic as a whole, but a full discussion requires a book to itself.

I do not consider:

(1) Corporation taxation of interest (loan relationships)
(2) EU interest and royalties directive,[2] which applied to interest/royalty payments between associated companies in different member states, and was repealed, in short, from 1 June 2021.[3]

For a brief history of the taxation of interest from 1799, see *re Lehman Bros*.[4]

26.2 Definition of interest

This section considers the meaning of interest in UK law. For the DTA meaning, see 26.27.5 (DTA definition of interest).

26.2.1 *Tax law rewrite*

Most of the cases cited below are pre-ITTOIA cases. The statutory wording has changed, but the old cases are still good law. A Tax Law Rewrite paper provides:

> 2. ... We do not propose to define interest. “Interest” is a concept of common and contract law and has developed its own natural meaning rather than being a concept of the Tax Acts. Decided cases have considered whether particular payments are interest and the qualities needed to make a payment interest but they have not provided a separate meaning of interest for tax purposes.
> 3. The charge to tax in [the old legislation] Schedule D Case III(a) is on “any interest of money, whether yearly or otherwise”. Case law demonstrates that the reference to “of money” is to the debt upon which the interest itself is payable. This comes back to the ordinary meaning of interest. ... We have concluded that the words “of money” add nothing to “interest” and can be dropped.
> 4. We have also decided to dispense with the words “yearly or otherwise”. These follow the historical recognition by tax legislation of

this chapter; and (2) deduction for the payment of interest, considered in the previous chapter.

[2] 2003/49/EC (3 June 2003).

[3] Section 34 FA 2021.

[4] [2016] EWHC 2492 (Ch) (appendix).

a distinction between yearly and short interest. Until the Income Tax Act 1918 there were separate charging rules for yearly interest and short interest. Although these were merged in 1918 the reference to "yearly or otherwise" was retained. The distinction between yearly and short interest is still relevant in some areas, for example the deduction of tax provisions ... but the words do not appear to add anything to the charge to tax on "any interest ..." in Schedule D Case III(a).

5. The removal of the words referred to in paragraphs 3 and 4 is a change in the statute, but not in the underlying law.[5]

26.2.2 *What is not interest*

It is helpful first to clear off the table some items which are not interest. The SAI Manual provides:

> **SAIM2040 Interest: when does interest run?** [Dec 2019]
>
> **Interest cannot be back-dated**
>
> Since interest on a loan or debt can normally only run where there is an agreement to pay interest (SAIM2030), it follows that interest cannot be back-dated.
>
> ***Example (Deborah)***
>
> D is a controlling shareholder in Deb's Fashions Ltd. When the company started in 2011, she made a loan of £10,000 to the company. There was no agreement in 2011 that the loan should pay interest. In preparing the company accounts for year ended 31 December 2015, the company's accountant advises that the company can now afford to pay interest, and accordingly it is agreed on 4 February 2016 that the loan will carry interest at 3% per annum.
>
> The agreement will have effect only from 4 February 2016. The company may make a payment to D to compensate her for the period when she received no interest on the £10,000. Such a payment is not interest, even if it is calculated on a time basis, or if it is described in the company accounts as 'interest'. The tax treatment of such a payment will depend on the exact nature of the arrangements between D and the company.
>
> **SAIM2050 Interest: voluntary payments** [Mar 2017]
>
> **Voluntary payments are not interest**
>
> Since interest can only accrue by virtue of some right, a voluntary or gratuitous payment cannot be interest, even if it is expressed as in lieu of or 'equivalent to half the interest', as in the case of *Seaham Harbour*

[5] *http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/rewrite/exposure/second/p62.htm#1*

> *Company v Crook* (16 TC 333). Rowlatt J's comment that
>
> > "interest or an annual sum which is paid really benevolently each time is merely an allowance, and not taxable at all"
>
> is a reflection of that common-law principle.
>
> Truly voluntary payments are likely to be rare. For instance where compensation is paid, labels such as 'ex gratia' may only mean that the payer settled out of court, or 'without admitting liability'. Such a payment is not voluntary or gratuitous if made in consideration of the claimant giving up the right to take proceedings for the damage suffered. See SAIM2330 for more on compensation or damages generally.

See too 26.35 (Grossing-up: Not interest).

26.2.3 *Label does not matter*

The label does not matter. It rarely does. Interest may be called something else; non-interest may be (mis)described as interest. This is self-evident, but the SAI Manual provides some authorities:

> **SAIM2060 Interest: case law** [Dec 2019]
>
> **... What is interest is a question of substance**
>
> What constitutes interest is a question of legal substance, not terminology. In the *Westminster Bank* case Lord Wright said its 'essential quality…depends on substance not on the mere name'. Lord Simonds, with Lord Porter concurring, said that what needed to be considered was 'what is its intrinsic character'.
>
> That substantive test was reaffirmed in *Re Euro Hotel (Belgravia) Ltd*, in which Megarry J said
>
> > "It has, quite rightly, not been suggested that the language used by the parties to an instrument in describing payments to be made under it can bind the Inland Revenue, or affect the operation of a statute. The question must always be one of the true nature of the payment."
>
> The contract in that case was one in which it was provided that one party would 'pay to the Bank interest'. It was held that what was paid was not 'interest of money' despite the wording of the contract quoted above, because the Bank in question had not advanced money as a loan, but instead as out and out non-returnable payments for building works. The 'interest' was not 'interest of money'.

26.2.4 *What is interest*

The SAI Manual provides:

> **SAIM2030 Interest: meaning of interest** [May 2017]
>
> **The legal concept of interest**
>
> Interest is not defined in the Taxes Acts. It is a concept of common and contract law. Halsbury's Laws of England defines it as follows.
>
> > "Interest is the return or compensation for the use or retention by one person of a sum of money belonging to or owed to another..."[6]
>
> ...
>
> **SAIM2060 Interest: case law** [Dec 2019]
>
> The definition of interest has been the subject of much judicial interpretation over the years. In *Westminster Bank v Riches* (28 TC 159), Lord Wright observed
>
> > "...the essence of interest is that it is a payment which becomes due because the creditor has not had his money at the due date. It may be regarded either as representing the profit he might have made if he had had the use of the money, or, conversely the loss he suffered because he had not had that use. The general idea is that he is entitled to compensation for the deprivation."
>
> The leading case on the meaning of 'interest of money' is now *Re Euro Hotel (Belgravia)* (51 TC 293). In that case, Megarry J considered that in general the case-law showed there were two requirements which had to be satisfied for a payment to amount to interest
>
> - there must be a sum of money by reference to which the payment which is said to be interest is to be ascertained - a payment cannot be 'interest of money' unless there is the requisite 'money' for the payment to be said to be 'interest of';
> - those sums of money must be due to the person entitled to the alleged interest.
>
> He did not suggest that the two requirements are exhaustive or inescapable but that in the ordinary case they sufficed...

The Corporate Finance Manual also discusses this issue; omitting parts

[6] Author's footnote: See *Halsbury's Laws of England* Vol 49 (2021) (5th ed., 2008), para 59 (Interest in general). Halsbury's footnote at this point refers to: *Re Farm Security Act 1944* [1947] SCR 394 at 411; *Dunn Trust Ltd v Feetham* [1936] 1 KB 22; *Bennett v Ogston* 15 TC 374; *Bond v Barrow Haematite Steel Co* [1902] 1 Ch 353; *Westminster Bank v Riches* 28 TC 159; and adds: Money paid in lieu of interest is not itself interest: *Tomkins v Tomkins* (1978) Times, 24 May. See also *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52, [2002] 1 AC 481, [2002] 1 All ER 97 (contractual term that, if the borrower should default on his repayments, interest would continue to be payable at the contractual rate until any judgment obtained by the bank was discharged; held not to be unfair under the Unfair Terms in Consumer Contracts Regulations 1994, SI 1994/3159 (now revoked)).

which repeat the SAI Manual, this provides:

> **CFM33030 what is interest?** [Aug 2018]
> ... The question of what constitutes interest has been the subject of much case law over the years. Perhaps the best known quotation on what interest is comes from Rowlatt J in *Bennett v Ogston* (15 TC 374). He described interest as 'payment by time for the use of money'.
> ... The concept that interest is something that accrues over time is supported by the cases of *Wigmore v Thomas Summerson* (9 TC 577) and *Willingale v International Commercial Bank* (52 TC 242). These cases indicated that true interest accrues from day to day or at periodic intervals.

26.2.5 *Sum indivisible or dissected?*

The SAI Manual provides:

> **SAIM2060: Interest: case law** [Dec 2019]
> **... 'Single indivisible sums'**
> Another important case on the nature of interest is *Chevron Petroleum (UK) v BP Petroleum Development* (57 TC 137). Payments between the companies included 'an interest factor' and were calculated in accordance with a complex formula. BP made the payments to Chevron after deducting income tax from the interest factors. The point at issue was whether the payments were true interest. [Sir Robert] Megarry's view was that the 'interest factor' was, in law, 'interest of money' and that because of the substantive nature of the test the Court would, if necessary, dissect lump-sum payments into interest of money and other sums. He said
> "If in its nature a sum is 'interest of money', I think it retains that nature even if the parties to a contract provide for it to be wrapped up with some other sum and the whole paid in the form of a single indivisible sum. The wrappings may conceal the nature of the contents but they do not alter them. Were the law otherwise, strong contractual wrappings might become remarkably popular."

In *Howard de Walden v Beck*[7] the taxpayer purchased for £250k a series of promissory notes of £3,750, payable at three-monthly intervals over 30 years (total £450k). In *Vestey v IRC*[8] the taxpayer sold shares worth £2m for £5.5m payable by 125 yearly instalments. In each case the payments

[7] 23 TC 384. On the same facts today the deeply discounted security rules would need to be considered.

[8] 40 TC 112.

were expressed to be interest free. but were dissected into interest and capital.

But in *IRC v Church Commissioners* 50 TC 516:

> [*Vestey*] represents, so far, the high water mark of dissection cases ... I would, for myself, accept this decision as correct, even though I would be unable to follow those portions of the judgment in which the learned Judge appears to favour a general rule of dissection wherever there is a deferred payment of a purchase price.

The reader may think this was a good win for the Church Commissioners and less meritorious taxpayers need to stand back from an unclear dividing line.

26.2.6 *Summary*

Pike v HMRC provides a convenient summary of the above:

> It was possible to identify certain characteristics of an amount payable by way of interest. First, it is calculated by reference to an underlying debt. Second, it is a payment made according to time, by way of compensation for the use of money. Third, the sum payable accrues from day to day or at other periodic intervals. Fourth, whilst the payment so accrues, it does not, in order for it to be interest, have to be paid at any intervals: it is possible for interest not to become payable until the principal becomes payable ... Fifth, what the payment is called is not determinative; the question must always be one as to its true nature. Sixth, the fact that an interest payment may be aggregated with a payment of a different nature does not 'denature' the interest payment.[9]

In *Pike*, the CoA regarded the issue as one of fact, concluding: "the FTT was entitled to find that it was interest and made no error of law in doing so." I would have thought the issue one of law: the facts were all recorded in the relevant loan stock document. But the fact/law distinction is fraught.

26.3 Discount

26.3.1 *Meaning of "discount"*

The SAI Manual provides:

[9] [2014] EWCA Civ 824 at [18].

> **SAIM2220 Interest: Specific Inclusions: Discounts** [Dec 2019]
> **Discounts and premiums**
> Paying interest is only one way in which a borrower may 'reward' a lender. Debt securities, such as government or corporate bonds, may be issued at a discount. For example, a 5-year bond may have a nominal value of £1,000, but be issued for £800. When the investor redeems the bond at maturity, he or she will receive £1,000 - the £200 profit, or 'original issue discount', represents the investor's reward for lending. A security that is issued at a discount may carry interest as well, or it may be interest-free (a zero coupon bond).
>
> ...
>
> But many investors will - rather than subscribing for a security and then holding it to maturity - buy and sell securities in the market. The difference between the purchase price and the face value of the security is called 'market discount'.

A Tax Law Rewrite paper explains:

> 4. In *Brown v National Provident Institution* 8 TC 57, the House of Lords held that the whole difference between
> [1] the price paid for a Treasury Bill and
> [2] the sum realised by holding the Bill until maturity, or by selling it or converting it before maturity,
> represented a profit chargeable to income tax under Schedule D Case III and that no part of that profit was an accretion of capital. However, more recent cases ... have made the position less straightforward.
> 5. It is clear that discount is different from interest, although they can be difficult to distinguish. Broadly, "the difference between the price at which the bank buys the bill [of exchange], and the bill's face value is something referred to as 'a discount'".[10] But the cases do not provide an easy definition of the term "discounts" which could be included in the rewritten legislation. Accordingly, we have not attempted to define the term and its meaning must continue to be explained by the case law.[11]

"Discounts" means profits arising from a transaction on a security bought at, or involving, a discount.

Leeds Design Innovation Centre v HMRC[12] should be mentioned for

[10] *Willingale v International Commercial Bank* 52 TC 242, at p.269.

[11] *http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/rewrite/exposure/second/p62.htm#1*

[12] [2014] UKFTT 9 (TC).

completeness but perhaps the less said about it the better. The case states that the meaning of discount in a tax context is different from its commercial meaning.[13] But interest carries its normal (non-tax) meaning, and it is considered that the same should apply to "discount". The concept of discount is quite vague enough already without having to distinguish between tax and commercial meanings of the word. In discussing the meaning of discount, *Leeds Design* wrongly draws on cases such as *Pike* which have nothing to do with discounts. It is doubtful whether on the facts of the case the FTT should have concluded that the payment was interest rather than discount; though the outcome would have been the same in either case.

26.3.2 *Types of discount*

There are three categories of discount:

(1) DDS discount, ie a discount in a deeply discounted security
(2) Non-DDS discount, which may be:
 (a) income
 (b) capital

26.3.3 *DDS discount*

If applicable, the DDS code has priority.[14] Section 367(1) ITTOIA provides:

> Any income, so far as it falls within Chapter 2 (interest) and Chapter 8 (profits from deeply discounted securities), is dealt with under Chapter 8.

26.3.4 *Non-DDS discount*

Section 381(1) ITTOIA provides:

> All discounts, other than discounts in deeply discounted securities, are treated as interest for the purposes of this Act.

EN ITTOIA provides:

> **Change 83: Discounts: charge to tax as interest: clause 381**
> This change provides for discounts currently taxed under section 18(1)(b) of ICTA and Schedule D Case III (b) to be taxed as interest. Discounts have been part of the charge to tax under Schedule D Case III

[13] at [27].
[14] See 29.1 (DDS code).

> since at least 1805. Several tax cases have considered aspects of their tax treatment including the difficulties in determining the nature of a "discount" as compared with "interest". It has emerged from this case law that while the line between the terms can be difficult to identify, they are distinguishable in nature.
>
> Discounts are nevertheless taxed in much the same way as interest. ... Chapter 2 of Part 4 of this Bill [ITTOIA] includes a specific charge to tax for interest which is extended to include other types of income which are currently treated as interest.
>
> Clause 381 provides that discounts, other than those in relevant discounted securities within Schedule 13 to FA 1996 [now, deeply discounted securities], are taxed under Chapter 2 of Part 4 of this Bill as interest, so removing the necessity to distinguish between them for the purposes of the charge to income tax. It follows that the separate charge for these discounts is not rewritten in the Bill.

Section 381(1) is not well drafted. It refers to "all" discounts as that was the wording of the pre-rewrite legislation.[15] "All discounts" means discounts (ie profits from discounts) of an income nature.[16] Profits of a capital nature are not within s.381(1) and so are not subject to IT as deemed interest.

Non-DDS discounts are deemed to be interest only for the purpose of ITTOIA. They are not deemed to be interest for other purposes, so they are not subject to withholding tax (which is in ITA). In this context the discount/interest distinction continues to matter.[17]

26.4 Premium

The SAI Manual provides:

> **SAIM2220 Interest: Specific Inclusions: Discounts** [Mar 2017]
> **Discounts and premiums**
> ... A third way of rewarding an investor is by redeeming the security at a premium. The nominal value of the security is, say, £800, and any interest is calculated on a principal amount of £800, but when the security matures the investor will get back (say) £1,000.

A premium is an additional sum (above the amount borrowed) paid on repayment of the loan.

[15] Section 18 ICTA 1988.

[16] This was accepted in *Healey v HMRC* [2015] UKUT 140 (TCC) at [40].

[17] See Gabbai, "Withholding tax planning: Should it be disclosed and how might it be challenged?" [2020] BTR 335.

There are three types of premium:

(1) A premium may of an income nature. Then it is interest (even if not described as such).

(2) A premium may be of a capital nature. Then it is not interest; it may be:

   (a) A DDS premium (a premium under a deeply discounted security) or

   (b) Not a DDS premium, subject to tax under CGT rules.

A premium commonly arises where a loan is index-linked. The capital/interest-income distinction is fraught here, as so often, but this topic is not considered here, as I have considered it elsewhere.[18]

Sometimes the word premium is reserved to describe only payments within (2), of a capital nature, but I am inclined to think a payment may be correctly described as a premium even though it constitutes interest-income rather than capital. Like a discount, a premium may be of an income or a capital nature. The word itself is neutral. But context will generally show what meaning is intended. See too 33.11.2 (Lender's fee).

26.5 Deemed interest

Section 369(2) ITTOIA provides a list of cases where sums are treated as interest:

ITTOIA	**Topic**	**See para**
s.372	Building society dividends	
s.373	OEIC distributions	
s.376	Authorised unit trust distributions	
s.378A	Offshore fund distributions	68.2
s.379	Registered societies & co-operatives	26.17
s.380	Funding bonds	26.6
s.380A	FSCS payments representing interest	
s.381	Discounts	26.3

See too 26.25 (Disguised interest) and 26.26 (Loan or credit transaction).

26.6 Funding bonds

26.6.1 *Funding bonds: definition*

Section 380(3) ITTOIA/s.413(3) CTA 2009 provides a wide definition:

[18] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), App. 4 (Tax on payment of index-linked nil rate sum).

> In this section “funding bonds” includes any bonds, stocks, shares, securities or certificates of indebtedness (but does not include any instrument providing for payment in the form of goods or services or a voucher).

This is a section-wide definition but it is repeated where needed elsewhere.

26.6.2 *Issue of funding bond*

s.380 ITTOIA	**s.413 CTA 2009**
(1) This section applies to the issue of funding bonds to a creditor in respect of a liability to pay interest on a debt incurred by a government, public institution, other public authority or body corporate.	[identical]
(2) The issue is treated for income tax purposes as if it were the payment of so much of that interest as equals the market value of the bonds at their issue.	(2) The issue is treated for the purposes of the Corporation Tax Acts as if it were the payment of so much of that interest as equals the market value of the bonds at their issue.

This reverses the former rule that the issue of a funding bond would not count as a payment of interest; see 15.5.2 (Issue of bond).
For the deduction at source rules, see s.939-940A ITA 2007.
See too 92.7.10 (Borrower funds interest payment).

26.6.3 *Redemption of funding bond*

Section 414(1) CTA 2009 provides:

> The redemption of funding bonds is not treated as the payment of interest on a debt for the purposes of the Corporation Tax Acts if their issue was treated as the payment of interest on the debt under—
> (a) section 413, or
> (b) section 380 of ITTOIA 2005 (which makes provision corresponding to section 413 for income tax purposes).

Perhaps this is needed in the context of the CT loan relationship rules. There no IT equivalent, but no-one suggests that the redemption of a funding bond would be interest, if the receipt of the bond is interest.

26.7 Part payment: Interest or principal

If a debtor owes both interest and principal (capital), the question may arise as to whether a part payment of the total due is interest or principal. The question is one of general law (contract law) and not tax law, though it may arise most often in a tax context.

A solvent debtor can[19] direct that a part payment is to be treated as a payment of the interest, or a payment of the principal.[20] That is, if the debtor chooses to pay interest, the receipt is interest; if the debtor chooses to repay principal, the receipt is not interest.

Similarly, a solvent debtor who owes two debts can direct that any payment is to be treated as a payment of one debt or a payment of the other.

If the creditor is dissatisfied with that, their remedy is to sue for remaining sums due.

In the absence of a direction, the creditor may chose.

If the debtor is bankrupt, the same applies if the payment is made with the consent of the creditor and the debtor. For instance, if the creditor waives the interest, a payment of the remaining outstanding debt will be principal.

For completeness, there is a complication if:

(1) The creditor is an interest in possession trust
(2) The debtor is bankrupt, and
(3) The trustee-creditor does not expressly agree to attribute a part payment of a debt to interest or to principal.

The position[21] is governed by the rule in *Re Atkinson*.[22] The rule is summarised by Gregory Hill:

> ... the rules in *Re Atkinson* and *Re Bird* ... prescribe apportionments between trust capital and income where the realisation of a fixed interest security, such as a mortgage debt or debenture stock, produces a sum which is less than the total amount owing for principal and arrears of

[19] Unless the contract otherwise provides.

[20] *Cory Bros v Owners of the Turkish Steamship "Mecca"* [1897] AC 286; *Kriticos v HMRC* [2019] UKFTT 0677 (TC) discussed at 122.10.1 (HMRC/taxpayer relationship).

[21] Unless the trust otherwise provides.

[22] [1904] 2 Ch 16.

> interest.
> ... *Re Atkinson* applies where the deficient security was an authorised investment, [this will be usual the case] and requires the amount actually realised (A) to be divided between capital and income in the proportion which the amount due for capital (B) and that due for arrears of interest (C) bear to one another, but the income beneficiary's entitlement to the interest actually received is not in any way affected. The relevant formulae, where the investment was authorised, are thus:
> Capital = (A × B) ÷ (B + C)
> Income = (A × C) ÷ (B + C)[23]

The rule in *re Atkinson* was applied in a case where, under a scheme approved by the court, interest on debentures was cancelled and what was paid was regarded as principal (not interest) for tax purposes.[24] But that was a case where the trustees did not consent to treating the payment in that way (they had no choice in the matter as they held only a small holding of the debenture stock concerned). So the application of the rule was necessary if one was to be fair to the life tenant. But the fairness is not tax-efficient. The life tenant's receipt is not interest but it is subject to income tax under the category of "annual payment".

26.8 Interest: Charge to tax

Section 369(1) ITTOIA imposes the charge on interest:

> Income tax is charged on interest.

Section 370 ITTOIA provides:

> (1) Tax is charged under this Chapter on the full amount of the interest arising in the tax year.
> (2) Subsection (1) is subject to Part 8 (foreign income: special rules).

Section 370(2) incorporates the remittance basis for foreign source interest.

The SAI Manual comments on deductible expenditure:

> **SAIM2440: when interest arises** [Feb 2020]
> ITTOIA05/S370 provides that tax is charged on the full amount of interest arising in the tax year. This means that a person receiving

[23] Hill, "Successive Interests and Deficient Fixed-Interest Securities" [2012] TQR *http://www.step.org/successive-interests-and-deficient-fixed-interest-securities*

[24] *Re Morris* [1960] 1 WLR 1210.

interest cannot set off any interest payable, bank charges or similar amounts against sums chargeable under ITTOIA05/S369.

A reference to the "full amount" of profits or gains, or income, does not preclude deductible expenditure, because the question is, what are the profits or gains (or what is the income).[25] But the wording here refers to the full amount of the *interest* which does seem to preclude deductions. And whatever the reason, no-one doubts that is the rule.

Section 371 incorporates the standard rule that liability rests on the person receiving/entitled to the income: see 15.2.1 (Identifying person liable)' 15.5 (When interest arises).

26.9 Interest: Location of source

I refer to the person paying interest as the "**debtor**" and the recipient as the "**creditor**".

Foreign source interest is outside the scope of withholding tax and qualifies for the remittance basis, so the question of source matters to both creditor and debtor.

For source issues generally, see 16.3 (Approach to locating source) ff.

Statute provides virtually no guidance on the location of a source of interest, so one falls back on principle and case law. There are four rival tests, or approaches, to the source of interest:

Approach	**Outline**	**Application**
Situs approach	Source is in principle[26] the situs of the debt determined by the IHT/international law situs rules (**"debt situs rules"**[27])	Accepted until 1993 but now rejected
Multifactorial approaches[28]	Source is identified by weighing up relevant factors.	Adopted by HMRC in 1993, and (in amended form) 2007; upheld in *Ardmore*

[25] See 25.11 (Sweep-up income: Computation).

[26] I say "in principle" as a situs approach allows for points of detail where the rules for the location of the source may differ from debt situs rules.

[27] For these rules see 102.1 (Concepts of situs).

[28] I use the plural as there are many ways to identify and weigh up relevant factors,

Place of credit test	Source is the place that credit was provided	International case law adopts this test but UK case law does not
OECD model test	Residence of debtor/branch	Used in DTAs

26.10 The situs approach

26.10.1 *Source in pre-ITTOIA legislation*

The situs approach is readily understandable when one recalls the terms of the legislation in force before the ITTOIA rewrite in 2005. Section 18 ICTA 1988 provided (I omit references to trade which are not relevant here):

> (1) The Schedule referred to as Schedule D is as follows:—
> "SCHEDULE D
> Tax under this Schedule shall be charged in respect of—
> (a) the annual profits or gains arising or accruing—
> (i) to any person residing in the UK from any kind of property whatever, whether situated in the UK or elsewhere, and
> (ii) [this concerns trading income] and
> (iii) to any person, whether a Commonwealth citizen or not, although not resident in the UK from any property whatever in the UK ... and
> (b) all interest of money, annuities and other annual profits or gains not charged under Schedule A, B, C or E, and not specially exempted from tax."
>
> (2) Tax under Schedule D shall be charged under the Cases set out in subsection (3) below, and subject to and in accordance with the provisions of the Tax Acts applicable to those Cases respectively.
>
> (3) The Cases are—
> [Cases I and II concern trading income]
> Case III: tax in respect of... any interest of money...[29]
> Case IV: tax in respect of income arising from securities out of the UK...;

[29] Case III was not expressed to have any territorial limitation at all! That had to be read in: interest arising from securities or possessions "outside the UK" was taxed under case IV or case V and did not fall within case III.

Case V: tax in respect of income arising from possessions out of the UK

Case VI: tax in respect of any annual profits or gains not falling under any other Case of Schedule D and not charged by virtue of Schedule A, B, C or E.

Now, the important point to take out of this jumble was that the charge on interest did not apply to a non-resident if the income arose from property in the UK; and (which comes to the same) the charge did not apply to income from securities/ possessions "out of the UK" and so taxed under case IV/V (now, relevant foreign income, but the term was not used in the pre-ITTOIA legislation).[30]

The natural reading of the phrase "in/out of the UK" was *situate* inside/ outside the UK, ie, the situs approach.

The pre-rewrite legislation did not refer to interest arising from a *source* inside/outside the UK. The word *source* was used as a paraphrase of the statutory words, but it was only a paraphrase.

26.10.2 *Consensus until 1993*

From the earliest times, up to about 1993, the situs approach was universally adopted. In argument and in the decisions, the textbooks cited were private international law textbooks on situs; and case law cited was situs case law.

The IR consultative document "Tax Treatment of Interest paid by Companies to Non-residents"[31] confirmed a situs approach to location of a source of interest was applied up to 1979:

> In the case of a simple contract debt it is settled law that the source is where the debtor is resident. Before the ending of exchange control, the Revenue was normally able to accept that interest paid abroad in a foreign currency[32] under a specialty contract (ie a contract under seal governed by foreign law) to a non-resident could have a foreign source, even though the payer was a UK resident company.

The situs approach survives in the Double Taxation Relief Manual (which

[30] For this issue, see too 33.1.1 (Current/previous charging clause); 33.19.2 (Source: Income from services).

[31] January 1983 *https://www.kessler.co.uk/tfd-archive*

[32] The currency is not relevant for situs; but it was relevant for exchange control, as a UK resident needed Bank of England consent to buy, or issue, foreign currency securities.

has not been properly updated since the publication of RI 55 in 1993):

> **DT1730. Interest** [February 2006]
> There is sometimes some difficulty in deciding whether interest is treated as having a UK source where the borrowing is made by a UK branch. ...
> The leading case on this subject is a Privy Council decision on a Hong Kong estate duty matter (*Kwok Chi Leung Karl*[33] (1988) STC 728). The Privy Council decided that where a debtor company has two places of residence where a debt may be enforced, the locality of the debt (and its source for tax purposes in the absence of statutory provision to the contrary) falls to be determined by reference to the place of residence where under the contract creating the debt the primary obligation is expressed to be performed (that is where the creditor would apply first for his money).

The 14th edition of this work gave further references, which are omitted here as the point is now of mainly historical interest.

26.10.3 *Bank of Greece*

Against that background, we can consider the *Bank of Greece* case.[34] The key facts were straightforward:

(1) A Greek bank issued bearer bonds.
(2) The bank defaulted and the guarantor[35] paid the interest.[36]

The Revenue took the situs approach: the "basic test" for the source of interest was the IHT/private international law situs test:[37]

> The basic test for determining whether the payments are income arising in the UK is to be found in *Dicey and Morris on The Conflict of Laws*, 8th ed. (1967), p.508, rule 79, on the determination of the situs of

[33] Author's footnote: *Kwok* is a situs case, see 102.14.2 ("Jurisdiction-residence").

[34] *Westminster Bank Executor and Trustee Co v National Bank of Greece* 46 TC 472.

[35] For completeness: Following an amalgamation, the payments were made by a company which succeeded to the original guarantor, and which was subject to the same obligations as the original guarantor; but that made no difference.

[36] For completeness: it was not completely clear that guarantee payments should be classified as "interest". However even if it was not interest it is sensible that location of the source of guarantee income should be determined on principles similar to those which apply to interest income, and the House of Lords proceeded on the basis that there is no difference.

[37] [1970] 1 QB 256, at p.266; the Revenue were not called on to argue the point in the House of Lords but there is no reason to think they changed their view.

> things.[38]

The Revenue argued that although the debt was originally situate in Greece, it had moved and become situate in the UK:

> Applying that rule here, the debt is enforceable only in England where it is situate and this is the place where the income arises.

The difficulty which the Revenue argument faced - if one accepts the premise of the situs approach - was that the usual test of situs is residence, and the guarantor was not UK resident! The Revenue answer was that where residence and enforceability differed, situs was in the place of enforceability, not residence:[39]

> Residence is important because in most cases it is where the debtor is resident that the debt can be enforced. But the true test is: in what country is the obligation primarily enforceable? The answer to the question: ... this was an English contract governed by English law; and under English law the Income Tax Act, 1952, requires tax to be deducted before payment. *New York Life Insurance Co. v Public Trustee*[40] shows that if the test of residence leaves one with a choice between an English and a Greek situs, the English situs must be preferred because the proper law of the contract is English. It would be patently absurd to attribute a Greek situs to the obligation when Greece is the one country where it has been abolished.[41]

The House of Lords held that the interest had a foreign source. First they summarised the facts:

> [1] I have come to the conclusion that the source of the obligation in question was situated outside the UK.
>
> [a] This obligation was undertaken by a principal debtor which was a foreign corporation.
>
> [b] That obligation was guaranteed by another foreign corporation which, as was conceded before us, had at no time any place of business within the UK.

[38] Now Dicey, Morris & Collins (16th ed., 2022), rule 136; see 102.14.7 (Place-of--enforceability: Synonym of place-of-debtor rule). The text has not materially changed.

[39] Where residence and enforceability differ, the correct view is that situs is in the place of *residence*, not enforceability; but in 1971 the point was arguable.

[40] [1924] 2 Ch 101; *New York Life Insurance* is a situs case; see 102.14 (Simple contract debt).

[41] [1970] 1 QB 256 at p.267

> [c] It was secured by lands[42] and public[43] revenues in Greece.
>
> [d] Payment by the principal debtor of principal or interest to residents outside Greece was to be made in sterling[44] and either at the offices of [UK banks in London] or (at the option of the holder) at the National Bank of Greece in Athens, Greece, by cheque on London. Whichever method of payment was selected, ... discharge of the principal debtor's obligation would have involved in the ordinary course either a remittance from Greece to the paying agents specified in the bond or, at the option of the holder, a cheque issued within Greece though drawn on London, and presumably payable there out of funds remitted by the debtors from abroad.[45]
>
> [e] ... the bond contained no provision for payment by the guarantor at any particular place or in any particular country.

This is a straightforward case of a foreign company raising funds by issuing debentures. Why was it argued the interest had a UK source?

> [2] The only circumstances relied on by the Appellants as supporting their contention that the obligation was located inside the UK were as follows.
>
> [a] Although the original guarantor had no branch in the UK, the present Appellants had acquired one on their universal succession in London.[46]
>
> [b] Moreover, it was urged that, since discharge of the obligations under the bond in Greece had been caught by the moratorium enacted by the Greek Government, it followed that the only place at which the obligation could have been discharged or enforced was in London.

[42] For completeness. The debt was originally secured on land in Greece but these properties were taken over or destroyed following the German and Italian occupation of Greece in 1941. But nothing turns on that.

[43] For completeness: The interest was payable out of income of the Bank of Greece. That is "public" revenues in a loose sense, as the National Bank of Greece was publically owned. The bonds were bank bonds and not government bonds.

[44] For completeness: in 1935 this changed so that Greek residents could only be paid in drachmas: see *National Bank of Greece v Metliss* [1958] AC 509 at p.510. But nothing turns on that.

[45] The point is that payment would in the ordinary course have ultimately derived from funds situate in Greece.

[46] That is, the guarantors who succeeded to the original guarantor acquired a branch in London on their succession to the original guarantor.

That is, circumstances had changed, and

(1) The guarantor (who originally had no branch in the UK) now had a branch in the UK.

(2) The bonds (which were originally enforceable in Greece) were now enforceable in the UK.[47]

These changes (though seemingly fundamental) did not change the location of the source of the interest:

> [3] Speaking for myself, I do not see how an obligation originally situated in Greece for the purposes of British income tax could change its location either by reason of the fact that
>
> [a] one guarantor had been substituted for another, or
>
> [b] ... the second guarantor so substituted subsequently acquired a London place of business, or
>
> [c] ... the Government of Greece had by retrospective legislation altered by moratorium and substitution of a new guarantor for the purposes of Greek law the obligations imposed upon the principal debtor and the guarantor.
>
> The Appellants acquired no obligation different from that of the original guarantors, and that was the obligation imposed on the original guarantors by the terms of the bonds.
>
> [4] In my view, the bond itself is a foreign document, and the obligations to pay principal and interest to which the bond gives rise were obligations whose source is to be found in this document.

Only one (quite narrow) proposition of law can be inferred from this. *Bank of Greece* is authority for the (sensible) proposition that the location of a source of interest is fixed and does not move with changes of circumstances.[48] I refer to that as the **"stability principle"**.

It was clear, and all sides accepted, that interest paid by the principal debtor (the Bank of Greece, which issued the bonds) had a Greek source.[49]

[47] *National Bank of Greece v Metliss* [1958] AC 509.

[48] More accurately, the case is authority for the proposition that the changes which occurred in the *Bank of Greece* case did not change the location of the source. However the changes which occurred there were so fundamental that there will be few if any cases where the location of a source of interest does move.

[49] In the CoA at p.487 "it has been common ground both in this Court and at first instance that if the payments of the coupons had been made by the principal debtors (the Mortgage Bank) they would have fallen within Case IV as being in respect of foreign securities." Likewise the case for the respondents in the House of Lords states at para 6: "It is common ground that if payment of the interest due on presentation of

The question whether the interest on the bonds originally had a UK source was not raised, not argued, and not answered. The practice at the time that interest paid by a non-resident was in principle within case IV or V was applied without need for consideration. In any event, almost[50] all the features of the debt pointed to Greece.

HMRC have argued since 1993, and the taxpayer conceded in *Ardmore* at the CoA, that paragraph [1] of the quoted passage supports a multifactorial approach: all the features listed in the paragraph were relevant, and if different features point in different ways, it is a matter of carrying out a balancing exercise. The CoA said:

> [1] [Bank of Greece] was the only binding authority on the meaning of the statutory phrase "interest arising in the" UK...
>
> [2] Lord Hailsham, with whom the other members of the House of Lords agreed, approached the matter experientially by weighing and comparing the factors, and this process has become known as the multifactorial test.[51]

Both propositions are wrong:

(1) The current statutory phrase "arising in the UK" was not in the law before 2005.

(2) *Bank of Greece* provides no support for a multifactorial approach. That is not surprising, as the House of Lords had no need to say anything about the location of the source of interest paid by the Bank of Greece. The court heard no argument about the principles of identifying the location of the source of interest. The relevant cases were not cited. In short: the passage sets out a list of *facts*, not *factors*.

The CoA misreading in *Ardmore v HMRC* is (more or less) binding, in our doctrine of precedent;[52] so the analysis above is of somewhat academic

the coupons had been made by the principal debtor, those payments would have fallen within case IV of Schedule D as being in respect of foreign securities."

[50] The following features in *Bank of Greece* did not cause the interest to have a UK source:
(1) payment made in sterling
(2) English proper law
(3) interest paid in England.
(4) The loan was "raised in London": 46 TC at p.489.

[51] [2018] EWCA Civ 1438 at [11].

[52] Strictly speaking, a statement in a judgement on a matter that was not the subject of argument is not binding authority. This is basic, but if authority is needed, see

interest. But I think it is still worth pointing out, because a diligent practitioner who actually reads *Bank of Greece* will otherwise emerge very puzzled.

26.10.4 *Hafton Properties*

Hafton Properties v McHugh[53] is another case where the location of the source of interest was straightforward until the circumstances of the debt changed:

(1) Under the original loan agreement, a US company borrowed from a US bank, the loan being secured on US property.
(2) Hafton (UK resident) acquired the property subject to the mortgage. It paid the interest due under the original loan agreement.

At the time of *Hafton Properties* (1986) the Revenue still maintained the situs approach. They argued that IHT/international law situs was the test of source:

> [The Revenue] maintained that, notwithstanding the arrangements made for the servicing of the debt, the residence of the debtor fixed the situs of the debt. See the citation from Atkin LJ's judgment in *New York Life Insurance Company v Public Trustee* [1924] 2 Ch 101 at page 119[54] in Cheshire and North, Private International Law (10th ed.) at page 537[55].

The difficulty for the Revenue was that the debtor (the US company) was not UK resident, so the interest should have been foreign source! The Revenue answer was that the US company was not the debtor:

> [The Revenue] submitted, ... there was a novation of the personal debt: so that Hafton became ... the debtor under the Note. [The Revenue] accordingly submitted that Hafton is the ultimate debtor, that Hafton is resident in the UK, and therefore that the debt is located in the UK. The situs of the debt locates, in her submission, the source of income, and therefore the source of income is a UK source.[56]

Interest under the original loan was not UK source, and the Special

Scrivens v Ethical Standards Officer [2005] All ER (D) 78 (Apr) at [52] citing long established authorities. But in practice one can expect the courts to follow *Ardmore's* lead.

[53] 59 TC 420.

[54] *New York Life Insurance* is a situs case, see 102.14 (Simple contract debt).

[55] See Cheshire and North, *Private International Law* (15th ed., 2017) p.1280.

[56] 59 TC 420 at p.426.

Commissioner held it did not acquire a UK source when the payor changed:

> In one respect the Greek Bank case is different from this one, in that in that case the debtors (both original and substituted) were at all times essentially Greek in character. Nevertheless I collect from Lord Hailsham's speech a clear disinclination to regard sources of income as being peripatetic.[57]

This correctly identifies the basis (or at least, one basis) of *Bank of Greece*: the location of a source of interest does not change. One started here with foreign source interest. The change (a change to the identity of the debtor) did not change the source.

The actual facts of *Hafton Properties* (purchase of property subject to mortgage) are unusual. A mortgage is almost always paid off at the time of purchase. A possible case is on the death of an individual in a civil law jurisdiction, where the heir becomes liable for the debts of the deceased.

A common situation is that an individual who has borrowed funds later changes his or her residence, and continues to pay interest; or the debtor dies and PRs with a different residence continue to pay the interest. The stability principle (the location of a source of interest is fixed and does not move with changes of circumstances) suggests that interest does not become UK source merely because the debtor becomes UK resident. Conversely interest does not cease to be UK source just because a debtor becomes non-resident.

Hafton is only a decision at Special Commissioner level but it neatly illustrates the stability principle, and reminds us it is soundly based on *Bank of Greece*, so the case does continue to have some relevance to the current law.

26.11 Rejection of situs approach

There were some difficulties in applying a situs approach to the source of

[57] 59 TC 420 at p.426. For completeness: The Special Commissioner added that the Revenue argument failed even if Hafton was the debtor, because the situs was still outside the UK:

> "That is fortified, of course, by the fact that the debt was a mortgage debt. Such a debt is regarded for private international law purposes (at any rate) as a speciality debt, the situs of which is to be found where the mortgage deed is to be found. The mortgage deed is, and so far as I know always has been, in the United States."

See 59 TC 420 at p.426.

interest:

(1) There were some discrepancies between a strict situs approach and HMRC practice, which perhaps mattered more after the abolition of exchange control in 1979.

(2) *Bank of Greece* was inconsistent with a strict situs approach. If the basis, or a basis, of the decision is that the source of interest does not move, there is already one inconsistency.[58]

(3) Debt situs rules did not always give a sensible answer to the location of the source of interest. That is not surprising, as the rules were not devised for that purpose, or indeed for any tax purpose.

If it is accepted that the situs approach is to be abandoned, the question arises as to what should be the new test for the source of interest.

HMRC first made the break from the situs approach in RI 58 (1993). This adopted a multifactorial approach.

If the situs approach is rejected, it followed that the old legislation (which suggests a situs test) was not appropriately worded. The Tax Law Rewrite recognised this. EN ITTOIA cited s.18(3) ICTA,[59] and explained why they replaced the expression securities/possessions "out of the UK" with the expression "*source* outside the UK":

> 3079. Section 18(1) and (3) of ICTA require that, for an amount to fall within the charge under[cases IV and V] as opposed to another charging provision, it has to be (a) income, (b) which arises from, (c) securities or possessions, (d) out of the UK ....
> 3080. Case law establishes that "securities" are a sub-set of "possessions". The definition of "relevant foreign income"[60] does not maintain any distinction between income which, in the source legislation, is within Schedule D Case IV and income which is within Schedule D Case V.
> 3081. The definition [in the rewrite legislation, ITTOIA] uses "source" rather than "possessions" (the expression in Schedule D Case V). "Possessions", in the context of Schedule D Cases IV and V, appeared

[58] The security in that case was a bearer security, and under the situs test should have been regarded as situate wherever the document was held. It would obviously be impractical to apply that rule for the source of interest, though I do find it puzzling that the case makes no mention of this difficulty.

[59] See 26.10.2 (Consensus until 1993).

[60] The EN is considering the definition of relevant income in s.830 ITTOIA, but the comments on source apply to the source of interest generally.

> in the first income tax Act of 1799 when the word carried associations with, in particular, colonial property that it no longer has. The definition employs the more widely used term "source".
>
> 3082. The meaning of "possessions" [out of the UK] in Schedule D Case V has been interpreted by case law. It covers any and every source of income arising outside the UK. Income charged to tax under Schedule D Cases IV and V by virtue only of section 18(3) of ICTA (that is, excluding amounts treated as income by another provision in the source legislation and charged under Schedule D Case IV or V) has an identifiable source.
>
> 3083. In *Colquhoun v Brooks* (1889), 2 TC 490 HL (where the subject was how to tax a partner's share of a foreign trade), Lord Macnaghten dealt with the meaning of "possessions" in terms of a source of income (page 508):
>
>> ...The word "possessions" is not a technical word. It seems to me that it is the widest and most comprehensive word that could be used. Why, for instance, should not possessions in Ireland mean everything, every source of income that the person chargeable has in Ireland, whatever it may be? Why should not "profits from possessions out of Great Britain," which is to be found in [Income Tax Act 1842] Schedule G., No. XI., ... mean profits from every source of income abroad? I use the expression "source of income" because it is as a source of income that the Act contemplates and deals with property and everything else that a person chargeable under the Act may have, and the [Income Tax Act 1842] itself, in section 52, uses the expressions "sources chargeable under [this] Act" and "all the sources contained in the said several schedules" as describing everything in respect of which the tax is imposed.

The current wording, referring to interest arising in the UK, removes the inference of the former wording, that a situs approach should be the test for the source of interest. But it sheds no light on what the test for source actually is or ought to be.

26.12 Modern case law

26.12.1 *Multifactorial test established*

The issue finally reached the CoA in *Ardmore Construction v HMRC*.[61] As noted, the CoA adopted a multifactorial test, and even though it was wrong

[61] EWCA Civ 1438

to cite *Bank of Greece* as support,[62] this approach is now established.[63]

26.12.2 *What multifactorial test?*

The question then is: What are the relevant factors, and how does one weigh them up? The court's comments are discouraging:

> ... the correct approach is not merely multifactorial but also acutely fact-sensitive. The court or tribunal must examine all the available facts both singly and cumulatively.

That does not take us very far.

26.12.3 *Fact or law?*

The CoA in *Ardmore* cite the familiar dictum:

> The Legislature in using the word "source" meant, not a legal concept, but something which a practical man would regard as a real source of income. Legal concepts must, of course, enter into the question when we have to consider to whom a given source belongs. But the ascertainment of the actual source of a given income is a practical, hard matter of fact.[64]

The statement that the issue is one of fact is code for saying that (1) the matter is not, or not easily, appealable, and (2) no further attempt is to be made to clarify what the test actually is.[65]

[62] See 26.10.3 (*Bank of Greece*).

[63] Pre-*Ardmore* decisions at tribunal level are now inconsequential and not considered here.

[64] *Nathan v FCT* [1918] HCA 45; [1918] 25 CLR 183 at p.189-190 cited for instance in *Rhodesia Metals v CT* [1940] AC 774 at p.789. The adjectives "practical, hard" are meaningless. The point is made discreetly by Lockhart J at first instance in *CT v Spotless Services* ("... a little opaque..."). For criticism of the "practical man" test see Stack et al, "Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd: A practical problem of source" ("a practical man would say the obvious thing to do was to ask a lawyer... not so much a test as an attitude of mind in which the Court should approach the task of judgment"). *https://www.researchgate.net/publication/331046971_Commissioner_for_Inland_Revenue_v_Lever_Brothers_and_Unilever_Ltd_A_practical_problem_of_source*

[65] See *Tariff Reinsurances v Comr of Taxes* (1938) 59 CLR 194 at p.208: "We are frequently told... that such a question is "a hard, practical matter of fact". This means, I suppose, that every case must be decided on its own circumstances, and that screens, pretexts, devices and other unrealities, however fair may be the legal appearance which on first sight they bear, are not to stand in the way of the court charged with the duty of deciding these questions. But it does not mean that the question is one for a jury or that it is one for economists set free to disregard every legal relation and

In *Ardmore Construction v HMRC* at the Upper Tribunal:

> 62. The jurisdiction of this Tribunal is limited to points of law arising out of a decision...
> 65. The question for us is whether we find any error in the approach of the FTT in *Perrin*. We can identify no material error. [UT reviewed the facts and concluded:] In summary, therefore, the FTT was, in our view, fully entitled on the evidence to find that the substantive source in Mr Perrin's case was in the UK.

CA agree but express themselves more strongly:

> The evaluative nature of the exercise of applying the source principle means also that the appellate tribunal should be slow to interfere, especially as in this case the Tribunals[66] are specialist tribunals. Consequently, in my judgment, Ardmore has to satisfy this Court that the Tribunals were wrong in the sense that they left a material factor out of account or took a matter into account that should have been left out, or misdirected themselves in law or fact or reached a perverse conclusion.[67]

The CoA judgment gives very little indication of how to approach the test. The judgement extensively sets out arguments of HMRC and taxpayer, but without expressing much if any view itself, so that takes us no further. The CoA just makes a few brief comments on specific factors, discussed below, and concludes:

> I see no basis, therefore, for holding that the Tribunals left out of account any material factor or took any immaterial factor into account.

In the circumstances the decision of the Upper Tribunal in *Ardmore* remains the best guidance currently available.

26.13 Relevant factors

There are many possible connecting factors. It is not possible to compile a full list but the main factors are as follows:
(1) The debtor:

penetrate into the recesses of the causation of financial results, nor does it mean that the court is to treat contracts, agreements and other acts, matters and things existing in the law as having no significance."

[66] Footnote added: The reference to "the Tribunals" skates over important issues of the roles and relationship of the first-tier and Upper Tribunals, but it was not necessary or appropriate for the CoA to address that.

[67] at [40].

   (a) residence of debtor
   (b) place where debtor carries on business[68]

(2) The interest:
   (a) place of fund used to pay interest (looking before payment)
   (b) place where interest is received (looking after payment)

(3) The money borrowed or credit provided:
   (a) Place of money used to make loan (looking before payment)
   (b) Place where money is received (looking after payment)
   (c) Place where money is used by debtor (eg if used to purchase UK/non-UK asset or in UK/non-UK business)
   (d) The place where credit is provided

(4) The contract under which interest is paid:
   (a) proper law
   (b) place where contract would be enforced
   (c) place where contract is made

(5) The debt, regarded as an asset: situs under IHT/international law principles (eg location of deed if debt is a specialty)

(6) The security for debt (if any): situs under international law principles

(7) The guarantor (if any): residence of guarantor

(8) The creditor:
   (a) residence of creditor
   (b) place where creditor carries on business

(9) In the case of registered securities, the place of the register

In *Ardmore* the UT described some factors as irrelevant. The CoA thought there was no such thing as an irrelevant factor,[69] but it hardly matters, as there is no effective difference between an irrelevant factor and one of very little weight. Perhaps one should say "generally irrelevant" rather than "irrelevant".

26.13.1 *What is the source?*

One problem in deciding which factors to apply is the difficulty or ambiguity in identifying what actually is the "source" of interest. One might say that the source is:

[68] Place of incorporation is another conceivable connecting factor but no-one has ever suggested it should be relevant.

[69] At [41]: "HMRC urged on us that some factors were "irrelevant" whereas on a multifactorial test a factor is still relevant even if it carries little weight."
But it turns on what one means by "factor".

(1) The debtor who pays the interest
(2) The funds used to pay the interest
(3) The money borrowed or credit provided
(4) The contract
(5) The debt (regarded as an asset)

If one identifies the source as any one of these, then identifying the location of the source may become easier: but of course all of them are intimately connected to the existence of the interest.

In *Ardmore v HMRC*:

> 43. ... in normal cases of a simple loan, the debt which will be the source of the interest, and not any underlying activity of the creditor. That may not hold good in particular circumstances, for example
> [1] where a debt arises in the course of a trade, where the trade might be regarded as the source,
> [2] or in special circumstances, such as those which arose on the *Lever Bros* case,[70]
> but where the case is one of a simple loan, the asset of the creditor, on which the interest arises, is the debt, and it is that debt which will be the source.

26.13.2 *Some principles*

Principle cannot identify the "right" connecting factor(s) but it can identify some approaches to the issue as unsatisfactory, at least in some cases.

The location needs to be known by the debtor (who may have to deduct withholding tax) and creditor (who may be taxable). This suggests no weight should be given to factors not likely to be known by both parties.

Factors which the parties can manipulate without commercial cost or inconvenience are not suitable (at least from HMRC's viewpoint, and the courts will sympathise).

Many of the connecting factors may change, and it is possible that the source of interest can change its location. However, it would not be

[70] *IRC v Lever Bros* [1946] AD 441; 14 SATC 1
https://www.kessler.co.uk/wp-content/uploads/2014/07/1202_001.pdf
But *Ardmore* rejected the source test proposed in *Lever* (where credit was provided). See Stack et al, "Commissioner for Inland Revenue v Lever Brothers and Unilever Ltd: A practical problem of source"
https://www.researchgate.net/publication/331046971_Commissioner_for_Inland_Revenue_v_Lever_Brothers_and_Unilever_Ltd_A_practical_problem_of_source

convenient for location of a source to change very often. There are two ways to deal with this:

(1) to place little or no weight on features which may easily change; or

(2) to look at the situation at the time the debt arises, and to ignore later changes.

The two solutions are not incompatible.

Debts are frequently assigned, and it is suggested that:

(1) assignment should not alter the location of the source; and

(2) facts not likely to be known by an assignee should not affect the location.

26.13.3 *Debtor residence/place of business*

Residence of the debtor, whatever the test of residence, is in principle a satisfactory connecting factor.

In *Ardmore Construction v HMRC* at the Upper Tribunal:

> 49. That the residence of the debtor is a material factor is clear from the Greek Bank case. There is, however, a question as to the weight which should be placed on that factor...
> 52... the residence of the debtor is a factor regardless of whether that place of residence is the jurisdiction in which the parties may bring proceedings [because of an exclusive jurisdiction clause].
> 53. Residence is, on the other hand, only one factor, and it cannot be elevated into the most important factor, whether alone or when combined with the question of the location of the debtor's assets. ... The question is simply a multifactorial one, having regard to all the circumstances and all the relevant factors.[71]

In the case of a dual resident debtor, or joint debtors resident in different places, this test would not work, but other factors such as the place of business connected with the loan would fill the gap.[72]

A difficulty arises if debtors change their residence, which if not common is by no means impossible. This was pointed out in *Philips*.[73] The stability

[71] [2015] UKUT 633 (TCC).

[72] Contrast the situs rules: 94.12.2 (Dual resident debtor); 94.12.4 (Joint debtors).

[73] *IRC v Philips' Gloeilampenfabrieken* [1955] NZLR at p.898: "In my opinion, the fallacy in the able argument presented by [counsel for the Revenue] was exposed when he felt obliged to submit (as indeed he was if he was to be consistent) that if a New Zealand citizen, while in London, found himself in financial difficulties and had to obtain from a London money-lender a loan, which he was able to repay over a

principle would suggests one should ignore subsequent changes of residence.

26.13.4 *The interest*

The next two possible connecting factors are:
(a) place of fund used to pay interest (looking before payment)
(b) place where interest is received (looking after payment)

These could be useful connecting factors if they were stable, but they can and often will change from year to year. This difficulty is noted in *IRC v Philips*' *Gloeilampenfabrieken*:

> It is not sufficient to ascertain the fund out of which the income was in fact paid, which is no more than the reservoir from which it was drawn. It is not whence it was paid, but why it was paid, that is the determining factor. The emphasis is not upon the receipt, but upon the derivation of the income. Consequently, it does not constitute the source within the meaning of the section that the money [used to pay the interest] was drawn from or provided by the trading profits in New Zealand. The New Zealand company [the debtor] was free to obtain the funds with which to perform its obligation anywhere it chose, from deposits in England, if it had any, or from borrowing in England, or from the profits of its trading in New Zealand. That was a domestic matter. The money could "come from" any of these "sources", but none of them would be the source from which the [creditor] derived what it received as income.[74]

In other words, one should not equate the location of the source of the interest with the situs of the *resources* that the debtor uses to pay the interest.

But in *Ardmore v HMRC* the CoA considered this was important:

> The funds paid over as interest derived from funds generated in the UK... The importance of [proper law and jurisdiction] clauses is also undermined by the fact that the enforcement of any judgment following default on assets of Ardmore would be in the UK (and it is not necessary to go further than to note that all the available assets to meet the liabilities to the lender were in the UK).[75]

period of years only after he had returned to his own country, the London money-lender could be assessed with [New Zealand] income tax ..."

[74] See 26.13.7 (Situs of debt).

[75] EWCA Civ 1438 at [42].

Likewise the UT in *Ardmore* identify "the ultimate, or substantive, source of discharge of the debtor's obligation" as a relevant factor for "normal cases of a simple loan".

On the other hand the UT in *Ardmore* identify as irrelevant "the place of payment of the interest".

26.13.5 *Money borrowed/credit provided*

The next possible set of connecting factors are:

(a) Place of money used to make loan (looking before payment)
(b) Place where money is received (looking after payment)
(c) Place where money is used by debtor
(d) In cases where money is not lent, where credit is provided

These seem sensible connecting factors.

It may be objected that place of receipt allows tax planning where money is lent in one jurisdiction and then immediately transferred to another. But the courts could look through transient arrangements of that kind to identify the place where the money is substantially received.

However the UT in *Ardmore* identify as irrelevant "the place where credit was advanced".

26.13.6 *Loan contract*

The next possible set of connecting factors are:

(a) proper law
(b) place a contractual jurisdiction clause requires the contract to be enforced
(c) place where contract is made

These are less suitable connecting factors as they are within the control of the parties.[76] Also the Courts would not want to discourage use of UK proper law and courts, by risking imposing a tax charge on interest.

In *Ardmore* the CoA agreed:

> There was no default and the Gibraltarian exclusive jurisdiction and governing law clauses would only matter if there was default.

[76] Place of enforceability may also be unsuitable as a contract may be enforceable in more than one place, or the place of enforceability may be unclear.
The place the contract is made is also unsuitable because the place the contract is made is sometimes difficult to identify; see 21.20 (Where is contract made).

26.13.7 *Situs of debt*

The situs of a debt under IHT/international law rules is (1) the location of the document if a specialty,[77] or a bearer security or negotiable instrument,[78] or (2) for a simple debt, the residence of the debtor.

The location of a document is obviously an unsuitable connecting factor. The debtor will not have possession of the deed and may not know its location. The location is easily changeable, and the rule would allow easy tax planning.

It is not illogical or inconsistent to say that the situs of a debt for IHT/international law purposes is in one country, but the location of the source of interest on that debt for income tax purposes is in another. This is the case for shares: the source of dividends is the place where the company is resident, but the situs of shares is the place where the shares are registered. One might simply say that the location of a source of income and the situs of assets are distinct concepts governed by distinct rules. Alternatively, and more subtly, one might say that the source of interest (for IT purposes) is not the debt but the transaction which gives rise to the debt (which may be located in a different place from the location of the debt).[79] Either way, the IHT/international law situs rule is not the test of source.

In *Ardmore Construction v HMRC* the UT said:

> 46. In addition, it was accepted before us, and we consider rightly, that the legal situs of the debt is not a relevant factor for income tax purposes. Thus, the fact that the situs of a simple debt is where the debtor resides is not a factor independent of the residence of the debtor itself...
> 47. It would follow from this that the situs of a specialty debt would likewise also be of no relevance. The distinction between the situs of a simple debt and that of a specialty debt was one of the principal reasons why the New Zealand courts in *Philips* rejected the proposition that source should be determined according to situs.[80] Although situs is

[77] See 102.15 (Specialty obligation).

[78] See 102.9 (Bearer documents and negotiable instruments).

[79] *Philips* takes this approach.

[80] "If the location of the debt were to be selected as the test, the source would be located differently according as whether the contract was a simple contract or a specialty; and, in the latter case, its location would arbitrarily change with the actual situation of the deed itself. Such a test would, indeed, be far from the practical commonsense test prescribed by the authorities; and I cannot think it proper to apply it here if some

> relevant in connection with certain taxes... it is not appropriate for source for income tax purposes to depend on whether the debt instrument is a simple contract or by deed.

CA accepted this view (though the less one says about the reasoning the better):

> The parties are agreed that the situs of the debt (that is, the place where a debt is located) for the purpose of the conflict of law rules is of little or no weight as the rules as to situs are legal rules only.[81]

26.13.8 *Situs of security for debt*

A rule that source of interest on a secured debt depends on the location of the property on which the debt is secured is not sensible because in normal circumstances the security will not be called upon. It would often not be appropriate:[82]

(1) The rule does not work if a large debt is secured on an asset of a small value. Would one say that a £100 million debt is situate in Jersey if it is secured on property there worth £100,000? Also, one cannot have a rule where the location of interest depends on the relative value of the debt or the security, which may fluctuate from time to time (though that might be resolved by looking only at the position at the time the debt arises.)
(2) If land determines the location of interest from of a debt secured on land, then a debt charged on (say) shares should be situate where the shares are situate.
(3) A debt may be charged on property in two different countries.
(4) This rule would sometimes allow scope for tax planning.

But the UT in *Ardmore* disagree and identify the residence of the original guarantor as a relevant factor for "normal cases of a simple loan" the location of the security originally provided.[83]

other is available." *IRC v Philips' Gloeilampenfabrieken* 10 ATD 435 [1955] NZLR 868 *https://www.kessler.co.uk/wp-content/uploads/2012/04/CIRvPhilips.pdf*
I discuss *Philips* in detail in the 14th edition of this work para 18.9.1 (*IRC v Philips*). The High Court of Australia rejected the situs approach for similar reasons in *Studebaker Corporation of Australasia v CT*.

[81] at [16].

[82] Similar issues arise for IHT situs of secured debts: see 102.19 (Debt secured on land).

[83] The view that even a former security is a relevant factor is consistent with the stability principle (that the location of a source of interest is fixed and does not move with

26.13.9 *Residence of guarantor*

No weight should be given to the residence of a guarantor, since in the normal course of events a guarantor would not be called on to make any payment. Even if it a guarantee is called on, it does not alter the source of the interest. But the UT in *Ardmore* disagree and identify the residence of the original guarantor as a relevant factor for "normal cases of a simple loan" .

26.13.10 *Residence of creditor*

No weight should be given to the residence of the creditor, since one is looking for the source and not the destination of the interest; also this may change easily as debts are usually assignable and frequently assigned.[84] In *Ardmore v HMRC* CoA agree:

> In this case, however, the conclusion of the Upper Tribunal that the residence of the creditor should carry little weight cannot be criticised. The immediate search is for the source of the interest rather than a search indirectly for the source of the loan.[85]

Likewise the UT in *Ardmore* identify as irrelevant "the residence of the creditor or the place of activity of the creditor".

26.13.11 *Branch/agency/PE*

It seems that a branch is regarded as a separate person. The SAI Manual provides:

> **SAIM9095. Yearly[86] interest: UK source: companies** [Mar 2017]
> *Interest paid by companies*
> In deciding whether or not interest has a UK source, in addition to the factors described in SAIM9090, there are other matters to be taken into account for companies.

changes of circumstances).

[84] A further objection to this factor might be that a single debt may be owed to joint creditors resident in different places, Interest on that debt cannot have two different sources. But that would not preclude any regard to the residence of the creditor where there is only one creditor.

[85] STC 1487 at[42].

[86] Author's footnote: Although the Manual heading refers to yearly interest, the same rules should apply to short interest.

> **Companies and branches**
> Where the debtor is a company it may of course have more than one residence – for example it may be registered in a US state but managed and controlled from the UK.[87] Jurisdiction in relation to a corporation will in general depend on where the corporation does business (except where the EU Regulation or the 1968 Convention apply – see SAIM9090). So for these purposes it will be resident where it carries on business. If a debtor company has a number of places of residence/business then to decide the location of the debt you have to look at the terms of the loan agreement. The loan agreement should say where the interest and loan are payable, which (if the company is also resident in that place) will determine whether or not the interest has a UK source.
> When it comes to considering loans made to a branch of a UK company the source of the interest is overseas if all the following factors apply:
> [1] an overseas branch of a UK resident company has entered into a loan agreement overseas;
> [2] the loan is for the business of the overseas branch;
> [3] the overseas branch pays the interest from its income;
> [4] the loan agreement obligations are enforceable in the jurisdiction in which the branch is situated.

The paragraph does indicate a "safe haven" situation where one may be confident that the interest paid by a person who is UK tax-resident does not have a UK source, at least so far as one can rely on HMRC manuals and practice.

The SAI Manual continues:

> Conversely, where a branch of a non-UK resident company enters into a loan agreement in the UK for the business of its UK branch and the UK branch pays the interest then the interest is regarded as having a UK source.

26.13.12 *Changes in international law*

The background law (that is, private international law) has changed since the date of the situs cases which underlie the HMRC view of the meaning of jurisdiction-residence which is a factor in determining the source of interest. For instance, *New York Life Insurance* was decided in 1924. Jurisdiction is now largely governed by international conventions, under which it is only approximately correct to say that residence of the debtor

[87] The example given is using "Residence" in the sense of jurisdiction-residence.

is the test of jurisdiction, (though in most cases the end result will be the same). In short, it is not the case that the residence or place of business of the debtor is the place the debt will be enforced.[88] So if jurisdiction-residence is the test, or at least a relevant factor in the test, there is a choice. Does interest arise:

(1) in the place where the debtor has jurisdiction-residence; or
(2) in the place where the debt is actually enforceable.

The author of the SAI is aware of the question, but does not give the answer:

> **SAIM9090. Yearly interest: UK source: The general rule** [Dec 2019]
> *Duty to deduct tax from interest with a UK source*
> **EU rules**
> If the debtor is resident within the EU, the Council Regulation (EC) 44/2001 on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial matters, ["Brussels I Regulation"] and the 1968 'Brussels Convention',[89] may have an impact on the general rule described above.

There are different rules for individuals, corporations, and trusts.

> The usual rule is that where an individual is domiciled in a contracting state, then they should be sued in the courts of that state (Article 2 of the Regulation/Convention).[90] Domicile is defined according to the rules of that contracting state but for these purposes only, it is, in the UK, linked to the individual's residence. Under these rules an individual is domiciled in England for example if he is resident there and the nature and circumstances of his residence indicate that he has a substantial connection with England.[91] So an individual resident in England would

[88] See 102.14 (Simple contract debt). In *Bank of Greece* the debt was enforceable in the UK but the interest was not UK source.

[89] Author's footnote: Brussels I Regulation applies in EU Member States. It supersedes the 1968 Brussels Convention except for some territories which fall within the scope of the Convention and which are excluded from the Regulation pursuant to Article 349 TFEU.

[90] Author's footnote: Article 2 Brussels I Regulation provides: "Subject to this Regulation, persons domiciled in a Member State shall, whatever their nationality, be sued in the courts of that Member State."

[91] Author's footnote: Article 59 Brussels I Regulation provides:
"1. In order to determine whether a party is domiciled in the Member State whose courts are seised of a matter, the court shall apply its internal law.
2. If a party is not domiciled in the Member State whose courts are seised of the

> in general terms only be sued in the courts in that country. However this is a complex area and there are exceptions. For example it may be argued that:
>
> [1] the case does not fall within the Regulation;
> [2] another convention or international agreement gives jurisdiction to another state's courts
> [3] proceedings have already begun in another state's courts; or
> [4] it has been agreed under Article 22 of the Brussels Convention[92] that the courts of a particular state have exclusive jurisdiction.

Point [4] is common, as the parties may agree any jurisdiction which suits them. What happens then? The Manual does not say:

> In any case in which it is argued that a UK resident debtor can be sued in a Member State in precedence to the UK courts please refer the case to BAI (Financial Products Team).

The SAI Manual then turns to consider the impact of modern private international law on companies:

> **SAIM9095. Yearly interest: UK source: Companies** [Mar 2017]
> *Interest paid by companies*
> **Companies within the EU**
> Under both the EU Regulation and 1968 Convention, domicile is the main ground of jurisdiction and will, at first sight, determine the rules for the recoverability of debts. EU regulation 44/2001 provides for a definition of domicile for corporations so that the company is domiciled where it has its statutory seat (in the UK its registered office), central administration or its principal place of business.[93] However it is

matter, then, in order to determine whether the party is domiciled in another Member State, the court shall apply the law of that Member State."

In England, s.41(3) CJJA 1982 provides:

"... an individual is domiciled in a particular part of the UK if and only if—
(a) he is resident in that part; and
(b) the nature and circumstances of his residence indicate that he has a substantial connection with that part."

[92] Author's footnote: I think the reference should be Article 23 Brussels I Regulation, which provides:

"1. If the parties, one or more of whom is domiciled in a Member State, have agreed that a court or the courts of a Member State are to have jurisdiction to settle any disputes which have arisen or which may arise in connection with a particular legal relationship, that court or those courts shall have jurisdiction..."

[93] Author's footnote: Article 60 Brussels I Regulation provides:

"1. For the purposes of this Regulation, a company or other legal person or

> important to note that a corporation is not domiciled in a country for these purposes merely because it does business there.

The Manual does express a view on the location of a source in a case where the debtor is jurisdiction-resident in one place but domiciled (in the sense of the Regulation) in another:

> If an EU based company carries on business in a country in which it is not domiciled you have to consider the terms of the loan agreement to determine the situation of the debt. For example, if a company which has its principal place of business in the UK also carries on business in another Member state, where the interest and loan are payable in that other Member state and that member state's courts have jurisdiction then the interest will be non-UK source.
> For branches of EU companies the position is as described above for branches generally.[94]

Thus in the Manual's view, the place of jurisdiction-residence has priority.

In the 14th edition of this work, I said: "it is suggested that the better approach is to pay no regard to modern conflicts law in determining the source of interest, even if the place where the debt is enforceable is not the place where the debtor resides." CoA agree: see above.

26.13.13 *Interest after debtor death*

I refer only for completeness to *IRC v Viscount Broome's Executors*. This was another case where the circumstances of the loan had changed:

association of natural or legal persons is domiciled at the place where it has its:
(a) statutory seat, or
(b) central administration, or
(c) principal place of business.
2. For the purposes of the UK and Ireland 'statutory seat' means the registered office or, where there is no such office anywhere, the place of incorporation or, where there is no such place anywhere, the place under the law of which the formation took place."

Thus Brussels I Regulation provides *three* places where a company is domiciled and may be sued. There is no single place where the debt can be enforced which would serve as a test for the location of a source.

[94] Author's footnote: Article 5(5) Brussels I Regulation provides:
"A person domiciled in a Member State may, in another Member State, be sued:
... 5. as regards a dispute arising out of the operations of a branch, agency or other establishment, in the courts for the place in which the branch, agency or other establishment is situated;"

(1) The original debtor was primarily[95] resident in Kenya.
(2) The original debtor died. His executors were UK resident.
(3) The loan was enforceable in Kenya. The UK executors who became liable for the debt paid the interest in the UK out of funds in the UK.

Both sides agreed, and the judge accepted, that the situs approach was the test of source:

> There was really very little dispute between [counsel for the Revenue] and [counsel for the taxpayer] as to the law (particularly perhaps as to the Income Tax law) which is applicable. There is no doubt at all that if a payment is made by a person here out of a source which is here, then that payment attracts tax. ... This also seems to me to be clear, and it is elaborately explained in the case of the *English, Scottish and Australian Bank, Limited v IRC,*[96] this, I say, was not questioned, that the locality of a simple contract debt is the place where the debtor is to be found.[97]

The dispute concerned where the situs actually was. Since the executors were resident in the UK, one would expect that the situs of the debt would also be in the UK. The taxpayer's argument to the contrary was curtly dismissed:

> I think the executors were resident in this country. Mr. Latter [counsel for the taxpayer] contended that it was not the question of the executors; it was a question of the executorship. I hardly ever fail to understand Mr. Latter, but I am not perfectly certain that I did exactly understand what he meant by the residence of the executorship.[98]

[95] Also UK resident, but that does not matter.

[96] *English, Scottish and Australian Bank* is a situs case, see 102.14 (Simple contract debt).

[97] 19 TC 667 at p.678.

[98] at p.679.
For completeness: The judge added (at p.680):
"There is no doubt at all that if a payment is made by a person here out of a source which is here, then that payment attracts tax. ... I think it was payment out of a source here. The first two payments are perhaps a little more clear, because there the payment was actually made to [the creditor] personally in this country. He happened to be here; he was resident abroad, but he happened to be here, and he was actually paid by the executors in London; and equally [the other payments] were made in London, were sent to a bank in London, and were remitted by the bank in London to Kenya to be paid there. In these circumstances I am of opinion that this was a payment made by persons resident in London out of sources in London."
This passage adopts uncritically the view that the funds used to pay interest constitute

More analytically, an executorship is not a person and does not have a residence. Only executors do.

Broome has no relevance to the current law because it is inconsistent with the subsequent cases of *Bank of Greece* and of course *Ardmore*.

Accepting (as the judge did) that interest on the original debt was not UK source, it should not have changed following the death of the debtor, as interest sources are not peripatetic.

26.13.14 *HMRC view*

As noted, HMRC first adopted a multifactorial approach in RI 58 (1993). HMRC did not announce a change of view, but from 2008 the SAI Manual adopts a revised version of the multifactorial test, and RI 58 is described as "superseded by SAIM 9090 onwards".[99] I take that to be notice that HMRC have withdrawn from it.[100] This version of the multifactorial approach expanded the list of relevant factors from four to eight, and gave an inkling of priority:

SAIM9090	**Comment**
9090. Yearly interest: UK source: The general rule [Dec 2019] ... Whether or not interest has a UK source depends on all the facts and on exactly how the transactions are carried out. HMRC consider the most important factor[s]* in deciding whether or not interest has a UK source to be [1] the residence of the debtor and	SAIM refers to *yearly* interest, but the same rules should apply to short interest.

the source of interest. In the 4th edition of this work, I said: "It is suggested that no guidance should be taken from *Broome* on this point." This view is now supported by *Ardmore.*

[99] See the HMRC online version of Tax Bulletin 9 *webarchive.nationalarchives.gov.uk/20101006151632/http:/www.hmrc.gov.uk/bulletins/tb9.htm* also recorded in Tolley's Yellow Tax Handbook.

[100] INT Manual still supports RI 58:
INTM342030 UK source [May 2019]
The onus is on the payer to decide whether tax is properly to be deducted having regard to settled case law principles [!] and all the facts surrounding the loan. In particular, the payer should refer to the approach and criteria endorsed by the House of Lords in the *National Bank of Greece* case (46 TC 472). HMRC's position in that case is outlined in Tax Bulletin 9 of November 1993 [RI 58].
Presumably this has not been properly updated since 2008.

[2] the location of his/her assets.
Other factors to take into account are

[3] the place of performance of the contract and

[4] the method of payment;

[5] the competent jurisdiction for legal action and

[6] the proper law of contract;

[7] the residence of the guarantor and

[8] the location of the security for the debt

HMRC consider the residence of the debtor to be most important because this, along with the location of the debtor's assets,[101] will influence where the creditor will sue for payment of the interest and repayment of the loan.

* SAIM refers to factor (in the singular) but then refers to 2 distinct factors.

The SAI Manual then defines "residence":

> 'Residence' in these circumstances is not the same as tax residence. Residence of the debtor is residence for the purposes of jurisdiction.

I refer to the concept as "**jurisdiction-residence**" to distinguish it from tax-residence. It seems surprising to use the term residence in a non-tax sense but this arises for historical reasons: the concept comes from common law/IHT debt situs rules[102] which in the past governed the rules for the source of interest.[103]

What is the test of jurisdiction-residence? In the case of an individual it is the same as tax-residence (or as near as makes no difference); but in the case of a company, it is place of business, which may be different from tax-residence.

[101] The location of the debtor's assets will not influence the place where the creditor sues for payment, as to which there may be no choice; but it may influence the place of enforcement. The location of assets which are security for the debt would have an influence on where the creditor seeks recovery of payment of the interest, but that is mentioned separately at [8].

[102] See 102.14.2 ("Jurisdiction-residence").

[103] See 26.10.2 (Consensus until 1993).

26.14 Weighing up factors

In *Ardmore Construction v. HMRC*:

> 60. The FTT took the view that the following factors were relevant:
>
> "(1) The proper law of the agreement. This was that of the Isle of Man. This factor however I judge to be of very little weight.
>
> (2) The place in which payment was actually made, namely, for the two payments at issue, the Isle of Man. I regard this as of little weight.
>
> (3) The jurisdiction in which judgement could be obtained, namely the Isle of Man.
>
> (4) The country in which Mr Perrin was resident, namely the UK.
>
> (5) The country from or in which Mr Perrin's obligations to pay would be contemplated to be enforced or would substantively originate, namely the UK."
>
> 61. The FTT concluded that the interest arose in the UK and did not arise from a source outside the UK. It found that the factors of residence and the source of funds for payment or enforcement outweighed that of jurisdiction and actual payment. As regards the actual payments made by Mr Perrin from his Isle of Man bank account, this factor was discounted by the FTT on the basis that what was required by the Greek Bank case to be ascertained was the source of the obligation and that this was the totality of the loan obligations and not simply the source of payment of the interest.

26.15 Source of interest: Conclusion

Accepting, in the light of *Ardmore*, that a multifactorial approach shouild be adopted, it is suggested that the position should be as follows:

(1) Suppose a debt were wholly non-UK connected but secured on UK land; that is, the UK situate security is the only UK aspect of the debt. For instance, a debt from one non-resident to another non-resident, which arises under a contract governed by a foreign proper law. It is suggested that interest on such a debt has a foreign source. It would be wiser to avoid the issue.

By contrast, suppose a debt was made unsecured (or secured on non-UK assets) and later became secured on UK land. It is considered that this would not turn a non-UK source into a UK source.

(2) Suppose a debt were wholly non-UK connected but paid out of funds derived from UK source income (eg rents of UK land). This cannot be enough to make the interest UK source. The origin of funds used to pay

interest is a weak connecting factor. (I would submit it should not be a connecting factor at all.)

(3) Suppose a debt were wholly non-UK connected but had a UK resident debtor. It is suggested that this alone does not give the source of interest a UK location.

(4) Different considerations apply in the case of securities issued by a company as (particularly in the case of publicly issued securities, held by many investors) many of the other connecting factors do not work so well. In these cases the residence of the company should play a more significant role. The RDR Manual provides:

> **RDRM33550 Remittance Basis: Identifying Remittances: Specific Topics: Accrued Income Scheme** [Jan 2019]
> ... Securities are "foreign" where income (in practice, interest) from them would be relevant foreign income. This will include, for example, a security issued in registered form by a non-UK company, which maintains the register of note-holders outside the UK.[104]

The rule that the source of interest on registered bonds of a foreign company is the location of the register seems a sensible rule but that will normally be the same as the place of residence.

The same applies to bearer securities: that is consistent with *Bank of Greece*.

26.15.1 *Source of interest: Critique*

After reading many pages on this issue, the reader will agree with HMRC who say:

> The current tests in UK law of whether ... payment of interest is made from a UK source are unclear and cause confusion.[105]

That is as true now as when it was written in 2003.[106]

[104] The comment is made in relation to the AIS remittance basis, but the point made here relating to the source of interest has a more general application. The text is also found in EN FB 2008.

[105] Inland Revenue, "Income tax: Meaning of UK Source for Payments of Interest and Royalties" Consultation document (2003), para 1.1.

[106] The difficulty is acknowledged in *CT v Spotless Services* (which adopted a multifactorial approach) at [52]: "Where ... the transaction is complex in terms of its background, its nature and its execution, and where ... important aspects of the transaction have their origin in locations in several different countries, it will usually be difficult to identify the real source of income so generated." 71 ALJR 81; 34 ATR 183; 141 ALR 92

It is not actually an answer to ask what a "practical man" would regard as the "real source". The only way in which a man, practical or otherwise, can locate the source of interest (other than tossing a coin) is to apply a theory as to the priority of rival connecting factors.[107] The exhortation to adopt a "practical approach" is harmless. It is just not helpful. No-one advocates that the law should adopt an impractical approach. Those who stress the practical approach should bear in mind that the first thing that a practical man will ask of the law is that it will provide a clear *answer* to the question of where is a source. There is nothing more impractical than uncertainty. What Kurt Lewin said of psychology is also true of tax: there is nothing so practical as a good theory.

It is not satisfactory to say that many or all factors are relevant, and if different factors point in different ways, it is a matter of carrying out a balancing exercise. We need rules on which factors have priority or there is no law on the subject at all.

The OECD Model source rule is superior to the multifactorial approach (or any other approach).[108] However legislation (with appropriate transitional provisions) would be needed to make this reform. The gap between the existing case law and this solution is too great to be bridged by the courts, except by the Supreme Court, and the Supreme Court ought to follow the international case law rather than adopting a new solution.

A HMRC consultation document in 2003 proposed this sensible reform[109]

http://www.uniset.ca/other/css/96ATC5201.html. I could not find the case on *http://www.austlii.com* so have put it on *https://www.kessler.co.uk/tfd-archive* *Spotless* went on to the High Court of Australia but the Revenue wisely abandoned their appeal on the source issue.

A test which will "usually be difficult" to apply is not a satisfactory one for something as basic as identifying the source of interest.

I discuss *Spotless* in the 2013/14 edition of this work para 20.7.4 (Spotless).

[107] 'Everyone is in the grip of some theory - even those who affect to despise theory'; thus John Kay, when asked why it was not possible to define income using common sense: Kay, "Tax Policy: A Survey" (1990) 100 Economic Journal 18, 20.

See *IRC v Philips' Gloeilampenfabrieken* 10 ATD 435 [1955] NZLR 868 at p.896-6 I discuss *Philips* in detail in the 14th edition of this work, para 18.9.1 (*IRC v Philips*).

[108] See 26.27.6 (Source of interest for DTA). If we adopted OECD Model test one modification might be desirable: that where a debtor changes residence, the source of interest does not change (ie the source is determined and fixed at the time the debt arises). But that point could be argued both ways.

[109] Inland Revenue, "Income tax: Meaning of UK Source for Payments of Interest and Royalties" Consultation document (2003).

but the proposal was quietly dropped. The reason why was never announced. Tax reform generally has winners and losers. Losers cry louder than winners, and that is an obstacle for many tax reforms. It is not clear that this was the problem here. It is hard to identify obvious "losers", ie persons who could say with any confidence that they were not taxable under the present law. But there may have been a lobby on behalf of taxpayers who could argue in favour of foreign source at present, and who would lose under a clearer set of rules. If so, there was never a lobby more misguided.

In 2012 HMRC again promised to consider reform,[110] but if that was ever intended seriously, it was subsequently dropped.

In the 14th edition of this work I discussed the foreign case law in detail, and argued the case for a place of credit test. That still seems to me to be superior to the multifactorial approach. But I omit this now, as *Ardmore* has settled the law for the time being.

26.16 Building society income

Building society income will have a UK source. EN ITTOIA Vol II explains:

> 48. Under [what is now s.14 and s.15 CTA 2009] a society incorporated under the Building Societies Act 1986 will be resident in the UK through incorporation. As long as dividends are paid by a UK resident company they have a UK source under the principle in *Bradbury v The English Sewing Cotton Company* 8 TC 481.
>
> 49. But a society may be non-resident where it satisfies a residence test in the territory of a treaty partner and the treaty awards residence to that other territory. [What is now s.18 CTA 2009] will then apply to treat the society as non-resident. Theoretically dividends paid by a building society may therefore arise from a source outside the UK. This would be most unlikely, however, since a building society may only be incorporated under the Building Societies Act 1986 if its principal office is in the UK. With the place of incorporation and the principal office in the UK a residence test is unlikely to be satisfied in another territory.

26.17 Co-operative & community benefit society income

EN ITTOIA Vol 2 explains the source of income from a co-operative and

[110] HMRC, "Possible Change to IT rules on Interest: Summary of Responses" (2012) para 3.15 accessible *http://webarchive.nationalarchives.gov.uk/20121002231638/http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_032340*

community benefit society:

> 52. Under [what is now s.14 and s.15 CTA 2009] a society registered under the Industrial and Provident Societies Acts[111] will be resident in the UK through incorporation. A society may, however, be non-resident where it also satisfies a residence test in the territory of a treaty partner of the UK and the treaty awards residence to that other territory. [What is now s.18 CTA 2009] will then apply to treat the society as non-resident.
>
> 53. Section 486(4) of ICTA [now s.379 ITTOIA] provides that share or loan interest is chargeable under Schedule D Case III. Theoretically therefore payments by a registered society may arise outside the UK but be charged under Schedule D Case III and not able to benefit from treatment specific to Schedule D Cases IV and V. For the sake of consistency this section [s.369 ITTOIA] treats such income arising outside the UK as relevant foreign income and therefore able to benefit from the special rules in Part 8 of this Act.

See Kessler, Wong & Borlace, *Taxation of Charities & Nonprofit Organisations* (13th ed., 2022-23), chapter 42 (Clubs and Mutual Concerns).[112]

26.18 Non-resident's interest: Outline

The general principle is that non-residents are subject to UK tax on UK source interest, as they are on any other UK source income. There are however exceptions of such breadth that the general principle rarely applies. The exceptions are:

(1) The non-residents IT exemption. By itself, this limits UK tax to withholding tax. Where withholding tax exemptions apply, interest is therefore not taxable at all. There are many such exemptions.
(2) DTA agreements sometimes confer exemption.
(3) FOTRA and similar state issued securities.

Policy issues concerning deductibility of interest overlap with policy issues on the taxability of UK source interest received by non-residents. In short: restrictions on deductibility and extensions of taxability each increase effective capital costs which in principle should have the consequence of reducing investment. Two irreconcilable policy choices are at play here,

[111] Author's footnote: now rebranded Co-operative and Community Benefit Societies and Credit Unions Acts.

[112] *https://www.taxationofcharities.co.uk*

on one hand to collect UK tax from non-residents on UK source income; and on the other to encourage investment in the UK by non-residents.

The former International Tax Handbook para 876 explained the policy reason behind the exemption for non-residents for interest from deposit-takers:

> There were moreover compelling policy considerations. An attempt to tax the interest could have harmed the balance of payments by discouraging foreigners from putting their money into the UK. For the same reason no attempt has been made to require banks to deduct tax from interest paid to non-residents and interest belonging to persons not [ordinarily[113]] resident is now excluded from the arrangements for deduction of tax from bank interest.

In the case of FOTRA and similar state-issued securities, the case for exemption is stronger and this is reflected in the exemptions for FOTRA securities which are wider. OECD summarises:

> 7.5 Where the payer of the interest happens to be the State itself, a political subdivision or a statutory body, the end result may well be that the tax levied at source may actually be borne by that State if the lender increases the interest rate to recoup the tax levied at source. In that case, any benefits for the State taxing the interest at source will be offset by the increase of its borrowing costs. For that reason, many States provide that such interest will be exempt from any tax at source.[114]

The Katz commission makes an interesting comment on the policy issues:

> 6.2.2.1 Most worldwide or residence based systems of taxation subject non-residents to taxation on income derived from a source within their jurisdiction, and, in principle, there should be no objection against doing the same as regards interest accruing to or being received by a non-resident from a South African source. However, in this instance, the high mobility of capital militates against the adoption of a pure approach. Most countries refrain from so taxing interest, at least as regards interest on debts with unrelated parties (so-called portfolio interest). At the same time, most of those systems tax interest flowing between related parties.

[113] Under the SRT reforms, references to ordinary residence in the tax code have been replaced by references to residence. But that change does not affect the point made here.

[114] OECD Commentary to article 11 OECD Model. OECD are considering exemption provided in a DTA, but the policy points to a general exemption.

> The reason is that in the latter situations interest merely represents another form of extracting profits from the jurisdiction where they were earned, and of course would enjoy a deduction in appropriate circumstances. In following these tendencies South Africa will ensure that it remains competitive in international capital markets, while still, like most other countries, protecting the tax base on income arising from South African operations.[115]

The UK however does not adopt this approach: it does not apply a rule that seeks to tax UK source interest paid to non-resident related parties (as distinguished from unrelated parties). Similarly, the UK does not disallow interest deductions paid to related parties. CIOT say:

> There is no reason ... why a well-capitalised and cash rich group headquartered in a relatively low taxed jurisdiction should be penalised by financing a subsidiary by debt, if that subsidiary could raise the debt externally if it were an independent entity.[116]

26.19 Withholding taxes: Introduction

A note on terminology. I use the term **"withholding tax"** (WHT) which seems to me the clearest. Statute uses a variety of expressions which carry the same meaning:

> The duty to deduct a sum representing income tax[117]
> Deduction of tax at source[118]
> The obligation to deduct or account for tax[119]

HMRC guidance refers to WHT as a receipt "with income tax taken off". When withholding tax does not apply, the interest may be said to be **"paid gross"**.

Interest withholding tax is one of a set of withholding taxes. The withholding taxes discussed in this work are:

[115] 5th Report - Basing the South African Income Tax System on the Source or Residence Principle - Options and Recommendations (1997) *http://www.polity.org.za/polity/govdocs/commissions/katz-5.html#6.2.1*

[116] CIOT response paper (2015) para 2.8 *http://www.oecd.org/tax/aggressive/public-comments-action-4-interest-deductions-other-financial-payments-part1.pdf*

[117] Eg s.884(1) ITA.

[118] Eg s.13 TIOPA.

[119] See 3.19.1 (Tax advantage: Definitions).

Type of withholding tax	**See para**
Rent	24.8
UK public revenue dividends	27.3
Annual Payments	31.10
Intellectual property income	32.10
Trust income distributions	41.5

The payment of WHT is not a benefit, eg for the purposes of s.87 or s.731.[120]

Suppose:

(1) X pays interest to Y, and deducts withholding tax, and
(2) Y gets a tax reclaim

It is considered that X does not have a restitutionary claim to recover the tax from Y, even if X has a charge or lien over the interest.

26.20 Interest withholding tax

Interest withholding tax is governed by Chapter 3 Part 15 ITA. Section 874(1) ITA provides:

> This section applies if a payment[121] of yearly interest arising in the UK is made—
> (a) by a company,
> (b) by a local authority,
> (c) by or on behalf of[122] a partnership of which a company is a member, or
> (d) by any person to another person whose usual place of abode is outside the UK.

If these any of conditions are satisfied, we move on; s.874(2) ITA provides:

> The person by or through whom the payment is made must, on making the payment, deduct from it a sum representing income tax on it at the basic rate in force for the tax year in which it is made.

WHT is a collection mechanism for tax payable by the recipient.[123]

[120] Contrast 101.4 (Tax on indemnity payment).

[121] For the meaning of payment, see 15.3 (Recognition/attribution: Analysis).

[122] The words "on behalf of" are otiose. Perhaps the drafter was concerned by the fact that a partnership is not a legal person; if that were the concern, the wording does not seem wholly apt. But it does not matter.

[123] This is self-evident, but if authority is needed, see *HMRC v Lomas (Administrators of Lehman Brothers International* [2017] EWCA Civ 2124 at [6]-[8].

26.20.1 *Non-residents withholding tax*

For individuals, trustees and PRs, withholding tax arises under s.874(1)(d) when the following conditions are satisfied:

(1) Payment
(2) Yearly interest
(3) Interest arises in the UK
(4) Payment to a person whose usual place of abode is outside the UK

In the following discussion:

- a person whose usual place of abode is outside the UK is described (for brevity) as "**outside the UK**"
- Withholding tax under para (d) is **"Non-residents withholding tax"**

Withholding tax is particularly important if the recipient is not UK resident, as non-resident IT relief provides effective exemption except so far as withholding tax applies.[124]

26.20.2 *Collection of withholding tax*

The rules for the collection of withholding tax are in Chapters 15-17 Part 15 ITA, s.945-964 ITA. I do not address them here, though I hope to do so in a future edition.

INT Manual provides:

> **INTM413220 Consequences of failing to deduct withholding tax** [Mar 2020] ...
> ***Assessing the unpaid income tax***
> Chapter 15, Part 15 of Income Tax Act 2007 ... provides for returns and collection of income tax in respect of payments falling within ITA07/S946, which specifically includes payments of yearly interest where a deduction is required under s.874.
> The rules, under ITA07/S951 are that:
> - the income tax at the basic rate on the interest is due on the same date as the return reporting the payment
> - both the return and tax are due within 14 days of the end of the quarter within which the payment of interest was made
> - no assessment is required for collection of this tax.
>
> This means that withholding tax, and where applicable, late payment interest, are due and payable even if HMRC does not raise an assessment.

[124] See 45.1 (Non-resident IT relief – Introduction).

> ITA07/S957 sets out what should happen if it appears that a s.946 payment (which this is) has not been included in a return, and the tax arising on the payment has not been paid:
>
> > (1) This section applies if an officer of Revenue and Customs thinks—
> >
> > (a) that there is a section 946 payment which should have been included in a return under this Chapter and which has not been so included, or
> >
> > (b) that a return under this Chapter is otherwise incorrect.
> >
> > (2) An officer of Revenue and Customs may make an assessment, to the best of the officer's judgement, on the person who made the return, or who should have made one.
>
> Note that the onus is on the payer to fulfil their obligation, and to rectify the position if they do not.

26.21 To whom is interest paid

Since withholding tax arises on a payment to a person who is not in the UK, it is necessary to identify the person to whom the payment is made.[125]

Suppose interest is paid to a transparent (*Baker*-style) IIP trust which is not a settlor-interested trust. It is suggested that the interest is paid "to" the trustees (who have a lien). So if the trustees are in the UK but the life tenant is outside the UK the person paying the interest to the trustees need not deduct; but the trustees must do so when they pay the interest to the life tenant. But if the trustees mandate the income to the life tenant, the payer has an obligation to deduct.

Suppose:

(1) interest is paid to a settlor-interested trust; and
(2) the trustees are outside the UK and the settlor is in the UK.

At first sight, if s.624 applies, there is no obligation to deduct as the interest is treated as income of the settlor "and of the settlor alone". Following the deeming, the payment should be treated as paid to the settlor. Conversely, if the settlor is outside the UK, there is an obligation to deduct even if the trustees are in the UK. It is suggested that that is the correct view. This is consistent with the position for deposit-takers. The former TDSI Guidance Notes provided:

> [2] The current HMRC view is that Stiftungs are Trusts for UK tax purposes. For TDSI purposes, the deposit should be considered to belong

[125] Similar issues arise elsewhere: see 21.5 (To whom trading income arises).

> to the settlor[126] and the TDSI treatment depends on the nature of the settlor – so if the settlor is an individual, BRT [basic rate of tax] must be deducted.
> [3] If the settlor can show that they have not retained an interest, the Financial Institution can treat the Stiftung as an interest in possession trust ... and the TDSI position will depend on the nature of the beneficiary. If the beneficiary is an individual, BRT must be deducted.[127]

This result is surprising: the payer may be expected to know whether the payee is outside the UK, but they cannot be expected to know if the recipient is a settlor-interested trust, and if so, who is the settlor and is the settlor outside the UK. But the trust may be a protected trust, outside the scope of s.624 in which case this problem will not arise.

Section 646(8) ITTOIA provides:

> Nothing in sections 624 to 632 is to be read as excluding a charge to tax on the trustees as persons by whom any income is received.

This is not entirely to the point but it illustrates the view that the deeming of s.624 does not apply in all cases.

Suppose:

(1) interest is paid to a non-resident company within s.720; and
(2) the transferor is in the UK.

The transferor is taxable under s.720 on income treated as arising to them, but the interest is still the income of the company. So there is an obligation to deduct. Of course, if the income of the company is protected company income, s.720 will not apply.

26.22 Usual place of abode

26.22.1 *Introduction*

The expression "usual place of abode" occurs in the context of rent/royalty withholding tax, as well as in the context of interest withholding tax. The

[126] Author's footnote: It is assumed that the Stiftung is a settlor-interested trust.

[127] HMRC, "Tax Deduction Scheme for Interest: Guidance Notes for Financial Institutions (2012) para 2.3.
https://www.gov.uk/government/publications/guidance-notes-for-financial-institutions
TDSI was abolished from 2016/17, and the Guidance Notes withdrawn. But the general point made here remains relevant.

meaning in all cases is the same.[128]

The phrase “settled or usual abode” was often used as an explanation or paraphrase of the concept of tax-residence before the SRT, which was said to mean residence in the normal sense of the word.[129] So one might think that there is no difference between residence (at least in the usual sense of the word) and “usual place of abode”. But there is a difference, though the concepts are close. The SAI Manual provides:

> **SAIM9080. Yearly interest: ‘place of abode’ of recipient** [Mar 2017]
> *Meaning of ‘place of abode’*
> ITA07/S874 (1)(d) requires deduction of tax from a payment to a person “whose usual place of abode is outside the UK”. This phrase is distinguishable from the concept of “residence”...

Likewise EN ITA para 2648:

> The term “usual place of abode” is consciously retained, because it is a technical term, distinct from residence.

One difference is that under the SRT an individual is UK resident (or not) for an entire tax year, but the usual place of abode can change at any time.

26.22.2 *Place of abode: Individual*

The PI Manual provides:

> **PIM4810: summary of the non-resident landlord scheme** [May 2020]
> **Meaning of ‘usual place of abode’**
> ... The rules of the NRL Scheme are concerned with the landlord’s usual place of abode, not their residence status for UK tax purposes. Although there is no statutory definition of ‘usual place of abode’ the NRL Scheme will apply to all landlords leaving the UK for a period that is expected to, or will, exceed six months.
> Individuals have a usual place of abode outside the UK if they usually live outside the UK.
> You should still regard the term as applying to them even if in a

[128] This view is adopted by EN ITA para 2648: “The term ‘usual place of abode’ is consciously retained, *because it is a technical term*, distinct from residence” (emphasis added).

[129] See the 2012/13 edition of this work para 3.8. Some hint of the meaning can also be taken from s.1(1) Immigration Act 1971: “All those who are in this Act expressed to have the right of abode in the UK shall be free to live in, and to come and go into and from, the UK without let or hindrance...”.

> particular year they are resident in the UK for tax purposes, as long as the usual place of abode is outside the UK. (For example the individual may count as resident in the UK in a particular year because of
> [1] a six months' visit, or
> [2] a visit of a shorter time when he or she has a place of abode available in the UK.)[130]
> Do not treat someone as having their usual place of abode outside the UK if they are only temporarily living outside the UK, say for six months or less.

The SAI Manual makes the same point more tersely:

> **SAIM9080. Yearly interest: 'place of abode' of recipient** [Mar 2017]
> An individual's usual place of abode is outside the UK if he or she usually lives abroad, unless that arrangement is temporary.

The NRLS guidance provides:

> The NRLS applies to you if your usual place of abode is outside the UK. This may be the same as your place of residence for tax purposes, but not always.
> For individuals, HMRC normally regard an absence from the UK of 6 months or more as meaning you have a usual place of abode outside the UK. It is possible for you to be resident in the UK but have a usual place of abode outside the UK.

There is some parallel between "usual" place of abode and "ordinary residence, but the analogy does not help, as the concept of ordinary residence was (more or less) abolished for tax purposes in 2013, and even before then its meaning was vague and contested.

The PI Manual formerly provided:

> **PIM4800 Overseas landlords** [deleted 2018]
> *Meaning of 'usual place of abode'*
> ... a person who is not resident in the UK should normally be treated as having their usual place of abode outside the UK.

This passage was deleted in 2018, though there was no announcement to say that HMRC practice has changed.

[130] Author's footnote: Para [2] refers to the supposed "available accommodation rule" which was an aspect of the pre-SRT residence test abolished in 1993. The passage was no doubt written before 1993 and has not been updated since.

26.22.3 *Place of abode: Company*

The PI Manual provides:[131]

> **PIM4810: summary of the non-resident landlord scheme** [May 2020]
> ... Companies that have their main office or other place of business outside the UK, and companies incorporated outside the UK, normally have a usual place of abode outside the UK. However, companies regarded as resident in the UK for tax purposes do not have a usual place of abode outside the UK for the purposes of the scheme, even if incorporated outside the UK. The UK branch of a non-resident company, where that branch is within the charge to Corporation Tax, does not have a usual place of abode outside the UK for the purposes of the scheme.

The SAI Manual addresses the question of UK branches of non-resident companies:

> **SAIM9080 Yearly interest: 'place of abode' of recipient** [Mar 2017]
> *Companies*
> A non-UK resident company that has a UK permanent establishment that is within the charge to corporation tax does not have a usual place of abode abroad.[132]

This practice seems surprising, but it favours the taxpayer so it will not be challenged.

26.22.4 *Place of abode: Trust/PRs*

The SAI Manual provides:

> **SAIM9080 Yearly interest: 'place of abode' of recipient** [Mar 2017]
> *Trustees*
> Trustees, including personal representatives, have a usual place of abode abroad if each trustee, considered as an individual or a company as the case may be, has a usual place of abode there. So if one trustee does not have a usual place of abode abroad, neither does the trust.[133]

[131] NRLS guidance has the same substantial text, albeit phrased differently.

[132] The NRLS guidance likewise provides:
"The usual place of abode is within the UK for the purpose of the NRLS where... a UK branch of a non-resident company must pay Corporation Tax."
https://www.gov.uk/government/publications/non-resident-landord-guidance-notes-for-letting-agents-and-tenants-non-resident-landlords-scheme-guidance-notes

[133] The same point is in NRLS guidance and PIM4810. This view is supported by *Dawson v IRC* 62 TC 301.

This text was probably composed before the statutory residence rules for trustees and PRs. One might have thought that the usual place of abode for trustees and PRs is where they are resident under those rules. But the HMRC practice favours the taxpayer so it will not be challenged. It is also satisfactory for HMRC; as long as one trustee is here, HMRC can collect tax from that trustee and do not need the assistance of a withholding tax.

26.22.5 *Usual place of residence*

Article 56 VAT directive provides in relation to persons not carrying on a business:

> 1. The place of supply of the following services to customers established outside the Community, or to taxable persons established in the Community but not in the same country as the supplier, shall be ... the place where he has his permanent address or usually resides:

Section 9(5) VATA 1994 provides in relation to individuals:

> A person who is not a relevant business person is to be treated as belonging-
> (a) in the country in which the person's usual place of residence or permanent address is ...

VAT is outside the scope of this work, but discussion of this provision may shed some light on residence issues more generally.

VAT Place of Supply of Services Manual provides:

> **VATPOSS04600 Belonging: Usual place of residence** [Aug 2019]
> **Private individual**
> The usual place of residence of a private individual is not defined in the law. We interpret the phrase as meaning the one country where the individual spends most of their time for the period in question. It is likely to be the country where the individual has set up their home, lives with their family and is in full time employment. As far as possible, this should coincide with the actual economic situation. Individuals are not treated as belonging in a country if they are short term, transitory visitors (for example if they are visiting as tourists, to receive medical treatment or for a short term language/other course).
> For VAT purposes, persons who have not been granted a right or permission to remain in the UK should be treated as belonging in their country of origin. This will apply to, for example, asylum seekers and those entering without permission. Belonging in this context involves something more than mere presence. In these circumstances, the country in which individuals have their usual or permanent place of residence can only reasonably be seen to be their country of origin unless and until they are granted the right to remain in the UK.
> Once an individual is granted leave or permission to remain in the UK, then the

place of supply of any services they receive, for example legal services supplied to a person that has been granted asylum in relation to obtaining a work permit, will be on the basis they are regarded as belonging in the UK.

Where an individual is granted the right or permission to remain in the UK and this expires or is subsequently revoked for whatever reason, they should be treated, for VAT purposes, as resident in the UK until such time as the issue is concluded (including the time taken to go through any appeal process). VAT should be charged on all relevant services supplied to such a person, subject to the normal rules.

In exceptional circumstances, an individual may not have had an identifiable country of origin. Such individuals are in effect stateless and should be treated, for VAT purposes, as belonging in the UK. For example, a situation may arise where a person is granted exceptional leave to remain in the UK on the basis that their country of origin is unknown and their claim to be a British citizen cannot readily be verified.

Case law

In the case of *USAA Ltd* (LON/92/1950A) (VTD 10369), the Tribunal considered the meaning of usual place of residence of US Forces personnel living in England. It found that such personnel living in England on a three year term of duty had their usual place of residence in the UK. During the tour of duty, if they had a permanent address in the form of a home in the USA, it was let. If they returned for training to the USA, their families remained in the UK. The US personnel could not therefore be regarded as having their usual place of residence in the USA.

In *Razzak & Mishari* (LON/97/754), [1997] VATTR 392, (VTD 15240), the Tribunal held that the supply of legal services in respect of UK proceedings by a UK solicitor to Mrs Shaik Haseena, a woman of Indian nationality, was received in India and was outside the scope of UK VAT

Mrs Haseena lived with her Kuwaiti employers as a servant for several years, first in Kuwait and later in the UK. She left their employment some three months after their arrival in the UK. She commenced an action through the UK courts for alleged cruelty against her former employers. During the period of these proceedings, some four years, Mrs Haseena lived in the UK and nowhere else.

The Tribunal found that the facts in this case were most unusual. ... It considered that there must be a sufficient degree of permanence and not merely a temporary presence. It held that, in this case, there was insufficient degree of permanence in that

- on arrival in the UK Mrs Haseena expected to stay only one month
- if she had remained in her employers' service and they had remained for the maximum permitted period, her visa was for only six months
- when she left her employers, she was prohibited by immigration law from working
- her entitlement to stay was initially not accepted by the Home Office
- when she was allowed to stay, it was for a limited period and a limited purpose with no guarantee of extension even to pursue the litigation
- during her period in the UK, she stayed in a series of hostels of temporary abode

- correspondence with the Home Office showed that if the visa had not been extended, she would have returned to India, and
- the case was distinguishable from USAA Ltd because Mrs Haseena's stay was not voluntary.

Thus it held that, throughout the relevant period, India was the country where Mrs Haseena had her usual place of residence.

1st Contact v HMRC [2012] UKFTT 84 concerned "working holidaymaker" students on an extended gap year:

> 2... young people, principally from Australia, New Zealand and South Africa, coming to the United Kingdom temporarily for a "working holiday" or "overseas experience". They come with the intention of travelling around this country and other parts of Europe, while taking on incidental, temporary work to pay for their short-term living expenses and travel plans. ... most came under the "working holidaymaker" provisions of the Immigration Rules, which allowed young persons from specified countries to come to the United Kingdom on a "working holiday" for up to two years, during 12 months of which they were permitted to undertake work "incidental to" the holiday. ... Most of the Appellant's customers in fact were in the United Kingdom for 18 to 19 months, on and off between travel elsewhere.
>
> 42. As there is no evidence that the typical customer had a permanent address in either country, for purposes of the present appeal the issue must be to determine the country in which the typical customer "usually resided" for purposes of Article 56(1) of the 2006 Directive, or the country in which the typical customer had "his usual place of residence" within the meaning of [now, s.9(5) VATA].
>
> 43. In relation to the meaning of "usual residence" for present purposes, both parties relied on *Shah*. In argument, attention was drawn to the following passages in the speech of Lord Scarman (with whom the other Lords all agreed):
>
>> Unless, therefore, it can be shown that the statutory framework or the legal context in which the words are used requires a different meaning, I unhesitatingly subscribe to the view that "ordinarily resident" refers to a man's abode in a particular place or country which he has adopted voluntarily and for settled purposes as part of the regular order of his life for the time being, whether of short or of long duration. [At 343G-H]
>>
>> And there must be a degree of settled purpose. The purpose may be one; or there may be several. It may be specific or general. All that the law requires is that there is a settled purpose. This is not to say that the "propositus" intends to stay where he is indefinitely; indeed his purpose, while settled, may be for a limited period. Education, business or profession, employment, health, family, or merely love of the place spring to mind as common reasons for a choice of regular abode. And there may well be many others. All that is necessary is that the purpose of living where one does has a sufficient degree of continuity to be properly described as settled.
>>
>> The legal advantage of adopting the natural and ordinary meaning, as accepted by the House of Lords in 1928 and recognised by Lord Denning M.R. in this case, is that it results in the proof of ordinary residence, which is ultimately a question of fact, depending more upon the evidence of

> matters susceptible of objective proof than upon evidence as to state of mind. Templeman L.J. emphasised in the Court of Appeal the need for a simple test for local education authorities to apply: and I agree with him. The ordinary and natural meaning of the words supplies one. For if there be proved a regular, habitual mode of life in a particular place, the continuity of which has persisted despite temporary absences, ordinary residence is established provided only it is adopted voluntarily and for a settled purpose. [344C-F]
>
> My Lords, the basic error of law in the judgments below was the failure by all the judges, save Lord Denning M.R., to appreciate the authoritative guidance given by this House in Levene v. Inland Revenue Commissioners [1928] AC 217 and Inland Revenue Commissioners v. Lysaght [1928] A.C. 234 as to the natural and ordinary meaning of the words "ordinarily resident." They attached too much importance to the particular purpose of the residence; and too little to the evidence of a regular mode of life adopted voluntarily and for a settled purpose, whatever it be, whether study, business, work or pleasure. [At 347H-348B]
>
> ... "Immigration status" ... may or may not be a guide to a person's intention in establishing a residence in this country: it certainly cannot be the decisive test, as in effect the courts below have treated it. Moreover, in the context with which these appeals are concerned, i.e. past residence, intention or expectations for the future are not critical: what matters is the course of living over the past three years.
>
> A further error was their view that a specific limited purpose could not be the settled purpose, which is recognised as an essential ingredient of ordinary residence. This was, no doubt, because they discarded the guidance of the Levene and Lysaght cases. But it was also a confusion of thought: for study can be as settled a purpose as business or pleasure. And the notion of a permanent or indefinitely enduring purpose as an element in ordinary residence derives not from the natural and ordinary meaning of the words "ordinarily resident" but from a confusion of it with domicile.
>
> I, therefore, reject the conclusions and reasoning of the courts below. And I also reject the "real home" test (and the variant of it) for which the local education authorities contended. In my view neither the test nor the variant is consistent with the natural and ordinary meaning of the words. [At 348D-F]

44. Lord Scarman uses the expression "settled purpose". This expression clearly is not intended to mean a "purpose to settle in a country" in the sense of becoming permanently resident there. Lord Scarman makes clear that a "settled purpose" may be "for a limited period" or "for the time being, whether of short or of long duration", and that it does not mean "real home" or "domicile". Rather, the expression "settled purpose" appears to refer simply to the fact that the person has voluntarily and deliberately gone to a particular place for a particular reason. Lord Scarman makes clear that the reason need not be employment, but might encompass "business, work or pleasure", or even "merely love of the place", that the reason may be specific or general, and that there may be more than one purpose. Lord Scarman also considered it to be necessary is

that there be “a sufficient degree of continuity”, and “a regular, habitual mode of life in a particular place, the continuity of which has persisted despite temporary absences”. Lord Scarman also indicated that ordinary residence, is “ultimately a question of fact, depending more upon the evidence of matters susceptible of objective proof than upon evidence as to state of mind”. Neither party in the present case disputed that this is a question of fact and degree, depending on the circumstances of the case as a whole.

45. In *Shah*, the issue before the House of Lords was whether immigrant students who had studied in the United Kingdom for the previous three years or longer had been ordinarily resident in the United Kingdom during the previous three years. The House of Lords did not itself decide the question, but held that the decisions below contained errors of law. Lord Scarman said in respect of the correct test to be applied that:

> ... it is, therefore, my view that local education authorities, when considering an application for a mandatory award, must ask themselves the question: has the applicant shown that he has habitually and normally resided in the United Kingdom from choice and for a settled purpose throughout the prescribed period, apart from temporary or occasional absences? If a local education authority asks this, the correct, question, it is then for it, and it alone, to determine whether as a matter of fact the applicant has shown such residence. An authority is not required to determine his “real home,” whatever that means: nor need any attempt be made to discover what his long term future intentions or expectations are. The relevant period is not the future but one which has largely (or wholly) elapsed, namely that between the date of the commencement of his proposed course and the date of his arrival in the United Kingdom. The terms of an immigrant student's leave to enter and remain here may or may not throw light on the question: it will, however, be of little weight when put into the balance against the fact of continued residence over the prescribed period - unless the residence is itself a breach of the terms of his leave, in which event his residence, being unlawful, could not be ordinary. [At 349B-E]

46. *USAA* concerned the supply of services to members of the US armed forces serving in the United Kingdom. The typical case was described as a member of the US forces who had arrived in the United Kingdom on a 3 year tour of duty (which might be extended or curtailed), accompanied by spouse and children, who had let out any home they owned back in the USA for the duration of the tour, and who would leave family members in the United Kingdom if returning during the tour of duty to the US for training. The Tribunal said that:

> I do not rule out the possibility that a taxpayer may in some cases have more than one “usual place of residence”. However, it seems to me that an officer who is serving a three year term in the UK whose family are living here in a house or an apartment, whose home in the USA is let, and who may if he goes back to the USA for training leave his wife and family here, has a “usual place of residence” in the UK and has no “usual place of residence” in the USA. Although it was not put to me separately, I also think that an unmarried officer here for three years whose parents (with whom he resided when in the USA) continue to reside there, similarly has a “usual place of

> residence" in the UK being the quarters that he occupies here but not in the USA.
>
> One must concentrate on a point of time, not as in *Levine* and *Lysaght* on a year of assessment. I do not think that it can fairly be said that an officer as described with his three year residence here has "a usual place of residence" in the USA. If his house is let he has no place of residence at all in the USA.
>
> I think the question is really one of fact and degree, and in the typical case put to me I do not think the serving officer, starting without a presumption one way or the other, can fairly say that he has a "usual place of residence" in the USA at the time when, in the UK, he affects motor insurance.
>
> If I am in error in considering that a person may have two usual places of residence, I reach the same conclusion, namely that the only usual place of residence in the circumstances is in the UK.
>
> A retired officer who sets up house here and does not keep a house in the USA is plainly usually resident here. An officer being in the USA and about to move to the UK has in my view a "usual place of residence" in the USA.

47. In *Razzak*, the person to whom services were supplied was found not to be ordinarily resident in the United Kingdom in the following circumstances. She was an Indian national who had been working as a domestic servant for a family in Kuwait. She came with that family to the United Kingdom as a domestic worker on a 6 month visa. She said that she did not want to come, but was told it would be for only a month. She claimed that she was mistreated by her employers and left after 3 months and went to a refuge, where she stayed for 9 months. She brought a claim for damages against her former employers, and was eventually granted exceptional leave to remain in the United Kingdom for purposes of pursuing the claim. The claim was settled some four years after she arrived, and it appears she had left the United Kingdom by the time that the case was decided. The Tribunal said at [47] that:

> In my judgment the words in [now s.9(5) VATA] must be construed as encompassing "the place where he has his permanent address" and in particular the word "permanent", not necessarily in the literal sense but at least as the antithesis of purely temporary and as having a sufficient degree of permanence. Viewed in that way it seems to me that the presence of Mrs Haseena in the United Kingdom was not such as to make this "the country of her normal place of residence". When she arrived in August 1992 she only expected to stay for a month; even if she had remained in the Appellants' service and they had remained for the maximum permitted period, her visa was only for six months; I do not consider that the UK could have properly been described as "the country where she had her usual place of residence". When she left the Appellants she was prohibited by immigration law from working and her entitlement to stay was initially not accepted by the Home Office. When she was allowed to stay it was for a limited period and a limited purpose with no guarantee of extension even to pursue the litigation. During the period from November 1992 Mrs Haseena stayed in a series of different hostels which of their very nature were temporary places of abode. It is clear from the correspondence with the Home Office as early as March 1993 that if the visa had not been extended

> she would have returned to India. In my judgment throughout the relevant period India was the country where she had her usual place of residence although she was temporarily and effectively involuntarily present in the UK.

48. *Martin-Jenkins*, concerned a supply of goods made to a person who had been living in the United Kingdom for some 10 years, but who was in the process of moving to Mauritius where he had a residence permit, and a start date for his employment and his children's schooling. The goods were intended for use in Mauritius. He left the United Kingdom for Mauritius on 31 August 2007. The goods had been delivered to him in the UK some 2 weeks before he left, to be shipped with his other effects to Mauritius. The Tribunal found that he was "resident" in the United Kingdom at the time of the supply, since at the time he was living with his family in his home in the United Kingdom. It was held to be irrelevant that "his mind may well have been in Mauritius", since residence must be established by objective evidence and not subjective intention. It was held that a person can only be resident in one territory at a time, and that *Razzak* was of no assistance since his presence in the United Kingdom was voluntary.

49. Applying the relevant principles derived from this case law to the present case, the Tribunal finds the following.

50. Although a person may be ordinarily resident in a place for a short period, and although the purpose of ordinary residence may be "merely love of the place", an ordinary tourist in the United Kingdom for a period of days or weeks clearly could not generally be said to have their ordinary residence here. Presence in this country as a typical tourist would not be, in the words of Lord Scarman, "for settled purposes as part of the regular order of his life for the time being", and presence here in that capacity would not be a "regular, habitual mode of life in a particular place". A typical tourist would, for instance, have a home and employment in their country of origin. Typically, a tourist would not rent their home out while on holidays, and would be on annual leave from their employment at home and would not be taking up employment in the United Kingdom. However, each case would depend on its own facts. A person who spent a year in this country without working, and who spent the year here travelling and sightseeing, might well be described as a "tourist". Nevertheless, if the person had no home or employment in their country of origin, and if they rented a home in the United Kingdom for the year as a base from which to conduct travels and sightseeing, the conclusion might be reached that the person is ordinarily resident in the United Kingdom for the year in question.

51. The Tribunal finds that *Razaak* is of limited assistance due to its unusual facts. It concerned the supply of services to a person whose presence in the United Kingdom was involuntary, not only in the sense that she said that she did not want to come here in the first place, but in the sense that she remained beyond the one month period for which she initially thought she was coming due to supervening circumstances arising in this country that formed no part of her original purpose in coming here, and which she did not bring upon herself.

52. The case law indicates that a person's particular immigration status is not a particularly significant factor, and that a person's ordinary residence may be in the United Kingdom, regardless of where their "real home" or domicile may be.

The Tribunal finds that the nature of the customers' immigration status is relevant only to the extent that is instructive in establishing material facts. The Tribunal takes into account the evidence that the Appellant's customers came here with the intention to undertake such combination of work and travel that was consistent with the requirements of a working holidaymaker visa, whether they actually had a working holidaymaker visa or had some other immigration status. Apart from this, the immigration case law on working holidaymakers is not considered pertinent.

54. The evidence is that the Appellant's customers came to the United Kingdom intending to have an experience involving a combination of travel and work known as a "working holiday" or "overseas experience", and that they would typically stay some 18 months. In pursuit of that purpose, they remained regularly in the United Kingdom for that period, with temporary absences visiting other countries (including short trips back to their home countries), even if their living arrangements were short-term and transitory. The Tribunal finds that the purpose of having such a "working holiday" or "overseas experience" can in itself be a "settled purpose" in the sense used in *Shah*. A settled purpose can include more than one purpose, and there is no reason why it cannot include a combination of travel and work.

55. The evidence is that the Appellant's customers typically arrived in the United Kingdom with no fixed plans. However, the Tribunal is satisfied on the evidence that they did arrive with a general purpose of having a working holiday, which typically lasted perhaps some 18 months. It may be that they did not know at the time of arrival whether they would leave early if things did not work out, or stay longer if they did and if they could get any necessary extension of their immigration status. However, in *USAA*, the 3 year postings if US service personnel were also capable of being extended and curtailed, such that they would not know at the outset exactly how long they would stay. Lack of certainty of the duration of presence in the United Kingdom is not decisive.

56. The fact that the Appellant's customers intended that they would be in the United Kingdom only temporarily and would return to their "normal" lives in their home countries at the end of a working holiday does not mean that they could not be ordinarily resident in the United Kingdom in the meantime. It was clearly the intention of typical US service personnel in *USAA* to be in the United Kingdom for only a limited period. In *Martin-Jenkins*, the person to whom goods were supplied was actually in the process of moving to Mauritius at the time of the supply, yet was found still to be resident in the United Kingdom.

57. The service personnel in *USAA* were found to be resident in the United Kingdom, notwithstanding that throughout their posting here, they maintained very strong links with the USA. They owned homes there, which they had rented out. They remained in the service of the US armed forces. Their service in the United Kingdom was part of a continuous employment by the US employer, which existed before they came to the United Kingdom and typically continued after they left the United Kingdom.

58. It is true that in *USAA*, the US service personnel brought their spouses and children with them to the United Kingdom. However, the evidence is that the Appellant's customers typically were not married and had no children. There is

> no evidence that the typical customer maintained a home in their country of origin. There is no evidence that the typical customer had, for instance, a job in their country of origin from which they had taken leave of absence in order to have a working holiday. Furthermore, even if customers had homes in their home countries that they had rented out, or previously lived with their parents in their home country, *USAA* indicates that this would not mean that they continued to be resident in their home country while in the United Kingdom.
>
> 59. Although it may be presumed that many or most working holidaymakers have parents, siblings, and other family or friends in their country of origin, that would be equally true of the service personnel in USAA, and of many other people who take up ordinary residence in the United Kingdom. While working holidaymakers may have maintained an intention of returning to their home countries at the end of the working holiday, and although there was evidence that they might return home on short trips during their working holiday, there was no evidence that they maintained any particular types of connections or commitments in their home countries during the period that they were away.
>
> 60. It may be the case that the Appellant's customers did not remain in one place in a single employment like the US service personnel in *USAA*, or have an established home in this country as in *Martin-Jenkins*. However, it is implicit in the wording of section 9(3) VATA and Article 56(1) of the 2006 Directive that the test of residence relates to the country of usual residence, rather than a particular street address. Even if customers changed address and moved from place to place during the working holiday, that is not inconsistent with the United Kingdom being their usual place of residence for the period in question. Throughout that period, they continuously lived a working holidaymaker lifestyle, even if it was a transitory lifestyle involving a combination of travel and work.
>
> 61. The Tribunal is satisfied on the evidence that for the duration of their working holiday, the Appellant's typical customer was in the United Kingdom "for settled purposes as part of the regular order of his life for the time being", and had a "purpose of living where one does has a sufficient degree of continuity to be properly described as settled", and had a "a regular mode of life adopted voluntarily and for a settled purpose".

26.22.6 *Australian guidance*

The Australian revenue have published guidance in TR 2023/1:

> **Usual place of abode outside Australia**
>
> 88. Your usual place of abode is the place you usually live or would live but for being absent from it due to, for example, a transient lifestyle or other temporary circumstances. Despite spending the majority, or even the whole, of the income year in Australia, you may still have your usual place of abode overseas. For example, if you have lived overseas for most of your life, travel to Australia to spend 18 months experiencing Australia in transient accommodation and employment, and then return overseas, you will still have your usual place of abode overseas.
>
> 89. Given the more common situations in which this test applies, a person

will usually have an 'abode' in the sense of a dwelling overseas. However, as with the domicile test, it is not necessary for a person, while in Australia, to have and maintain a physical dwelling overseas in order for their usual place of abode to be outside Australia. For example, if you rented accommodation overseas and terminated your rental agreement before coming to Australia, but you intend to return to the same town or country after your stay in Australia, your usual place of abode is likely to be outside Australia. Ultimately, it is a question of fact. In different circumstances, relinquishing a dwelling overseas may indicate an abandonment of the usual place of abode overseas. Therefore, in determining whether you have your usual place of abode outside Australia, examine the nature and quality of the use made of any place of abode you may have overseas[134]and compare it with your living arrangements in Australia in deciding which is your usual place of abode.[135]

90. Relevant factors in considering whether your usual place of abode is outside Australia include:

- where you lived before and after your time in Australia
- the availability of your overseas dwelling to you (if you have one) while you were in Australia
- where your possessions and assets are
- the type of visa you have and the length of your intended stay
- your purpose of coming to Australia, and
- the travel arrangements you made, including whether you departed from and returned to the same place outside Australia.[136]

91. If you come to Australia and sell your home and personal possessions in the country you came from intending to remain in Australia, it is unlikely your usual place of abode remains outside Australia. However, this needs to be considered in conjunction with the other factors outlined in paragraph 90 of this Ruling.[137] Conversely, if you come to Australia for a certain period and have your overseas home available to you upon your return, and you do return to it, you are likely to have your usual place of

[134] *Commissioner of Taxation v Executors of the Estate of Santha Thevy Subrahmanyam* [2001] FCA 1836; *Applegate and Federal Commissioner of Taxation v Jenkins* (1982) 12 ATR 745.

[135] *Commissioner of Taxation v Executors of the Estate of Santha Thevy Subrahmanyam* [2001] FCA 1836.

[136] *Jaczenko v Commissioner of Taxation* [2015] AATA 125; *Koustrup v Commissioner of Taxation* [2015] AATA 126; *Clemens v Commissioner of Taxation* [2015] AATA 125.

[137] *Commissioner of Taxation v Executors of the Estate of Santha Thevy Subrahmanyam* [2001] FCA 1836.

abode outside Australia.[138]

26.22.7 *Place of abode uncertain*

The PI Manual provides:

> **PIM4810 summary of the non-resident landlord scheme** [May 2020]
> It is for the letting agent or tenant to determine the 'usual place of abode' of the landlord. If this is in doubt, the letting agent or tenant should get more information from the landlord to satisfy themselves on the point. In particular, PO Box numbers and 'care-of' addresses alone should not be relied on as evidence that the scheme does not apply. Where letting agents or tenants have no reason to believe that a landlord has a usual place of abode outside the UK, they are not required to make any special enquiry and they therefore would not have to operate the scheme.

The NRLS guidance provides:

> **How do letting agents and tenants know whether a landlord has a 'usual place of abode' outside the UK?**
> A landlord's usual place of abode will usually be clear without the need for special enquiries. If it is outside the UK, letting agents or tenants should operate the NRLS. If the usual place of abode is in doubt, you should get more information from the landlord. PO Box numbers and 'care of' addresses should not be relied on as evidence that the Scheme does not apply.
> In cases of difficulty, letting agents and tenants can contact HMRC.
> Where you have no reason to believe that a landlord has a usual place of abode outside the UK, you are not required to make any special enquiries. You do not have to operate the NRLS.

26.22.8 *Place of abode: Critique*

Do we need a concept of "usual place of abode" in addition to concepts of residence? For individuals, the statutory residence test provides a definition of "residence" which should be the starting point here and "place of abode" should be abolished. There would need to be some provision for cases where at the time of payment of the interest it is not clear whether the payee is resident or not. In practice, we muddle through.

26.23 Withholding tax: Exceptions

There are about 20 exceptions to interest withholding tax:

[138] *Stockton v Commissioner of Taxation* [2019] FC 1679.

ITA s.	**Exemption**	**See para**
875	Interest paid by building society	
876	Interest paid by deposit-taker	
877	UK public revenue dividends	27.3
878	Interest paid by bank	
879	Interest paid to UK bank	26.23.3
880	Interest paid to building society	
881	National Savings Bank interest	
882	Quoted Eurobond	26.23.7
883	Interest on loan to buy life annuity	
884	Foreign source interest	26.23.1
885	Authorised dealer in financial instruments	
886	Interest paid by recognised clearing house	
887	Payment made by registered society	
888	Statutory interest	
888A	Qualifying private placement	26.23.6
888B	Designated dividends of investment trust	
888C	Interest distribution of OEIC	
888D	Interest distribution of authorised unit trust	
888E	Interest on peer-to-peer lending	
893	Public revenue dividends	22.3

There are further exemptions which apply to interest and other withholding taxes:

933/934	Company within CT	26.24.1
936/937	Exempt recipients	26.24.2, 26.24.3
981	Foreign currency securities	27.8.3

In this work I consider only some of these exemptions, but hope to consider more in a future edition.

26.23.1 *Foreign source interest*

Section 874 ITA imposes the obligation to deduct on making:

> a payment of yearly interest arising in the UK[139]

Foreign source interest is not subject to withholding tax, as one would expect.

Section 884(1) ITA provides:

> The duty to deduct a sum representing income tax under section 874

[139] See 26.19 (Interest withholding tax).

> does not apply to a payment of interest which is chargeable to income tax as relevant foreign income.

This is otiose, because RFI by definition must be income arising from a source outside the UK,[140] so it is not income arising in the UK, and not subject to withholding tax in the first place. But it does not matter.

The SAI Manual provides:

> **SAIM9090 Yearly interest: UK source: The general rule** [Dec 2019]
> ... whether or not tax should be deducted from interest paid on an overseas loan depends on the source of the interest. If the interest has a UK source tax must be deducted, if it does not then tax should not be deducted.

26.23.2 *Withholding: Interest source*

Section 874(6A) ITA provides:

> In determining for the purposes of subsection (1) whether a payment of interest arises in the UK no account is to be taken of the location of any deed which records the obligation to pay the interest

For the purposes of s.874(1) (only) the location of a deed is disregarded; for other purposes it is not. Thus there are two definitions of the source of interest.

The disregard does not apply for the purposes of s.884(1). So if one took the provision literally, the location of the deed is taken into account in determining whether the interest is RFI, and if it is RFI, there is no obligation to deduct.

Fortunately this defect does not matter, as the location of a deed is not relevant to the location of the source of interest.[141] Section 874(6A) is otiose. What a mess!

The reason for the provision is found in a shallow HMRC consultation paper:

> 4.11 For ‘debts under seal’ or ‘specialty debt’ it is sometimes argued that case law supports the view that interest paid on such debts does not have a UK source where the loan agreement is physically held outside the UK, and hence that income tax is not required to be deducted at source.
> 4.12 HMRC does not accept this argument. However, to put the matter beyond doubt, the Government proposes to amend the relevant

[140] See 16.9.2 (“Relevant foreign income”).

[141] See 26.11 (Rejection of situs approach).

> provisions of Chapter 3 of Part 15 of ITA [withholding tax] so that the question of whether or not interest arises in the UK is established without reference to the location of the agreement or deed evidencing the debt.[142]

The need for a statutory definition of source remains unmet.

26.23.3 *Interest paid to UK bank*

Section 879(1) ITA provides:

> The duty to deduct a sum representing income tax under section 874 does not apply to a payment of interest on an advance from a bank[143] if, at the time when the payment is made, the person beneficially entitled[144] to the interest
> [a] is within the charge to corporation tax as respects the interest or
> [b] is a bank that would be within the charge to corporation tax as respects the interest apart from section 18A of CTA 2009 [Exemption for profit of foreign permanent establishment].

This would apply on payment of interest to a UK branch of a non-resident bank, though it may be that such companies do not have their usual place

[142] HMRC, "Possible changes to income tax rules on interest" (2012) *http://webarchive.nationalarchives.gov.uk/20131002164136/http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_031986*
The consultation paper omitted to point out that HMRC formerly accepted the view which they now reject, as did at least one Special Commissioner decision. It contained no discussion of the relevant law (beyond a cursory reference to *Bank of Greece*) and did not mention the 2003 consultation.
See too HMRC, "Possible changes to income tax rules on interest: Summary of Responses" (2012) *http://webarchive.nationalarchives.gov.uk/20131002141406/http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_032340*

[143] For completeness, s.879 provides:
"(2) Section 991 (meaning of 'bank') applies for the purposes of this section.
(3) Subsection (1) applies to the European Investment Bank as if the words from 'if' to the end were omitted.
(4) An order under subsection (2)(e) of section 991 designating an international organisation as a bank may provide that subsection (1) applies to the organisation with the modification mentioned in subsection (3)."

[144] See App. 6.2 (English-law beneficial ownership).

of abode abroad.

This exemption (together with other exemptions from withholding tax not discussed here) rests on tax competition considerations.[145]

26.23.4 *Short interest*

Tax law distinguishes between:

(1) "yearly" or "annual" interest (the terms are synonymous); and
(2) other interest (known as "short" interest).

Withholding tax does not apply to short interest. The distinction between short/yearly interest is therefore important.

The SAI Manual explains the distinction:

> **SAIM9075. Yearly interest: Case law on short and yearly interest** [Aug 2017]
>
> *When is interest "short" or "yearly"?*
>
> Although tax law has made a distinction between yearly and short interest since 1806, there is no statutory definition of yearly interest. The distinction rests wholly on case law.
>
> The classic example of short interest is interest payable on a bank loan for less than a year. In the early case of *Goslings and Sharpe v Blake* (2 TC 450), the Court of Appeal confirmed that interest on such a loan, where there was no provision to extend the borrowing for more than a year, could not be yearly interest, notwithstanding the use of an annual percentage rate.
>
> It is therefore a useful starting point to say that where a loan or debt is for less than a year, there is a presumption that it gives rise to short interest. Conversely, interest on a loan or debt that exists fora year or more is likely to be yearly interest.
>
> But you cannot just apply this as a mechanical rule, with the benefit of hindsight. Particular difficulties may occur where, at the time when a loan or debt comes into existence, it is not clear how long it is going to last.
>
> For example, the case of *Bebb v Bunny* (1854) 1 K&J 216 concerned the payment into court of the purchase price of a property, with interest on the delayed payment. It would have been possible for the interest to have run for more than a year if the purchaser had been particularly late in paying. The judge held that the interest was yearly. On the other hand, the Court of Appeal held, in *Gateshead Corporation v Lumsden* [1914] 2 KB 883, that certain interest which had run for more than a year was nevertheless short interest. The interest in question was statutory interest due to Gateshead Corporation on late-paid contributions towards the cost of making up roads. The court took the view that the mere failure by the Corporation to enforce the debt within a year did not make the interest "yearly interest".
>
> To distinguish interest arising on long-term loans from that arising on apparently

[145] See 1.3 (Other tax competition).

short-term debts, the courts began to lay stress on the debt having “a measure of permanence” or being “in the nature of an investment” as opposed to being merely “temporary accommodation”. Thus in *Corinthian Securities v Cato* (46 TC 93) the Court of Appeal decided that interest on a bank loan, repayable on demand, was yearly interest because the loan had the quality of investment – even though, in the event, the loan was called in after 6 months.

However, the leading case on yearly interest is now considered to be *Cairns v MacDiarmid* (56 TC 556). In this case, the Court of Appeal saw the intention of the parties as the determining factor. If the debtor and creditor intend that the debt should subsist for a year or more, or where there is mutual acceptance that the interest may have to be paid from year to year, the interest will be yearly. This principle was applied in *Minsham Properties v Price* (63 TC 570), where a loan from a parent company, repayable on demand, gave rise to yearly interest because it was regarded by both parties as permanent finance.

It was felt in *Cairns v MacDiarmid* that merely asking whether a loan had the character of an investment was a less useful test – even an overnight deposit of money might be regarded as an “investment”.

SAIM9076. Practical application [Dec 2019]

Applying case law principles

It is always a question of fact whether, in any particular case, interest is yearly or short. The intention of the parties will be the most important factor in deciding the question (see SAIM9075). This will be the case in particular where a loan has a duration of less than 12 months but is ‘rolled over’, once or more than once, to a second year. If the intention of the parties, when the borrowing was first put in place, was for the borrowing term to be less than 12 months, HMRC will require clear evidence that this was the original intention. Without such evidence, HMRC will be unable to accept that the intention of the parties was to have a borrowing term of less than 12 months.

The question of whether interest is short interest, from which the payer has no obligation to deduct tax, is most likely to arise in the context of payments made by a UK resident to a person whose usual place of abode is outside the UK. If the interest is short, there is no need for the recipient to apply under a relevant Double Taxation Agreement to receive the interest gross (or with tax withheld at a reduced rate). There is guidance at INTM505010 onwards.

A UK resident may make a series of loans, each of less than a year, to a non-resident, and claim that the interest is short. HMRC staff should refer to the guidance at INTM413210 in such cases.

Uncertainty may also arise as to whether there is a duty to deduct tax from interest in circumstances comparable to that in *Bebb v Bunny* (SAIM9075) – where a sum of money remains outstanding for a period that may, or may not, be a year or more. For example, a manufacturer might guarantee to refund the purchase price, with interest from the date of claim, if a product proves faulty: such claims may normally be processed speedily but, in disputed cases, may drag on for over a year.

Where the parties intend at the outset that monies due will not be left outstanding for a year or more, the interest will be short – even if, in a few cases, there are delays which prolong the period over which interest accrues. If however the

> parties anticipate at the beginning that the debt will exist for a year or more, or appear to be indifferent as to whether it will or not, the interest is likely to be yearly.
>
> Where the payer of the interest is uncertain about whether it is short or yearly, they may in practice “play safe” by deducting tax. If the recipient of such interest objects to the tax deduction, HMRC staff should advise him or her to take up the matter with the payer, see SAIM9180.
>
> If, conversely, the payer decides that interest is short and pays it gross, HMRC staff should not challenge that view unless
>
> - the decision appears to be completely unjustified on the facts and in the light of relevant case law, or there is reason to suspect a definite intention of avoiding the payment of withholding tax; and
> - material sums of tax are at risk.

Overdraft interest is usually short interest.

Hargreaves Property Holdings Ltd v HMRC[146] offers the most recent discussion of a point on which there is more than a century of case law. In short:

(1) *Duration:* Interest payable in respect of a short loan is not yearly interest .Yearly interest must have a measure of permanence, AKA “a tract of future time”. If a debt is expected to last for less than a year but, in the event, it lasts for a year or longer, that does not make the interest on that debt "yearly". But the expected duration of a debt is established by way of a business-like assessment and is not determined by the terms of the document giving rise to the debt.

(2) *Investment nature:* Yearly interest has the nature of an investment. Though as “investment” is a difficult term to pin down, I am not sure this takes us much further.

Hargreaves was an avoidance scheme where the taxpayer sought to avoid yearly interest/WHT by arranging a series of short term loans. Taken together the loans formed part of long term financing. Each lender made a “continuous provision of finance” to the borrower over a lengthy period, such that the financing from each lender “had a permanency which belied the apparent short-term nature of each loan” This was held to be yearly interest, so the avoidance scheme was not successful.[147]

In 2012, a shallow consultation document proposed to extend WHT to short interest (and so to abolish the yearly/short interest distinction); but

[146] [2023] UKUT 120 (TCC).

[147] The failure of this scheme had been predicted; see Gabbai, “Withholding tax planning: Should it be disclosed and how might it be challenged?” [2020] BTR 335.

the proposal was rightly abandoned.[148]

26.23.5 *Discounts and premiums*

SAI Manual provides:

> **SAIM3070 Taxation: Profit on disposal** [Dec 2019]
> *Deduction of tax*
> Discounts payable on the redemption of relevant discounted securities[149] are not payments of interest. Consequently the payments are made without deduction of tax.

Discounts are not interest and not subject to withholding tax even if not payable on the redemption of a DDS.[150]

A premium may be interest or it may be a capital receipt, in which case it is not subject to withholding tax.

26.23.6 *Qualifying private placements*

Section 888A ITA provides:

> (1) The duty to deduct a sum representing income tax under section 874 does not apply to a payment of interest on a qualifying private placement.
> (2) "Qualifying private placement" means a security—
>
> (a) which represents a loan relationship[151] to which a company is a party as debtor,

[148] HMRC, "Possible changes to income tax rules on interest" (2012) *http://webarchive.nationalarchives.gov.uk/20131002164136/http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_031986*
The paper did not consider the need for the rule, or whether any modification of the rule would be better suited for its purpose. It is in fact a de minimis rule and as such serves an important purpose. The paper also did not consider international practice. Do other countries require deduction at source for interest on transient or short term loans?
HMRC, "Possible changes to income tax rules on interest: Summary of Responses" (2012).
http://webarchive.nationalarchives.gov.uk/20131002141406/http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_032340

[149] The correct term is now deeply discounted securities.

[150] See 26.3 (Discount).

[151] Defined by reference in s.888A(6): "In this section "loan relationship" has the same meaning as in Part 5 of CTA 2009."

> (b) which is not listed on a recognised stock exchange,[152] and
> (c) in relation to which such other conditions as the Treasury may specify by regulations are met.

The regulations are Qualifying Private Placement Regulations 2015. This covers relevant securities between unconnected parties where the value is £10m+ and of less than 50 years duration. Dependent upon the territory in which the lender is resident, the borrower can self-assess that no WHT need be paid.

26.23.7 *Quoted Eurobond*

Section 882 ITA provides the exemption:

> The duty to deduct a sum representing income tax under section 874 does not apply to a payment of interest on a quoted Eurobond (see section 987).

Section 987(1) ITA provides the definition:

> In this Part [Part 15 ITA, withholding tax] "quoted Eurobond" means a security, including a share (in particular any permanent interest bearing share as defined in section 117 of TCGA 1992), that—
> (a) is issued by a company,
> (b) is listed on a recognised stock exchange[153] or admitted to trading on a multilateral trading facility operated by an EEA-regulated recognised stock exchange,[154] and
> (c) carries a right to interest.

Partnership borrowers are excluded from the private placements exemption, and are excluded from the Quoted Eurobonds legislation. However, the Eurobond exemption may apply where a company partner issues a security as the general partner of an LP.

26.24 Excepted payment

Section 930(1) ITA provides:

[152] See App 2.18 (Listed/Recognised stock exchange).

[153] See App 2.18 (Listed/Recognised stock exchange).

[154] Section 882(2) provides the relevant definitions: "For the purposes of this section—
(a) a recognised stock exchange is an "EEA-regulated recognised stock exchange" if it is regulated in the European Economic Area, and
(b) "multilateral trading facility" has the same meaning as in Article 4.1.22 of Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments."

> The duties to deduct sums representing income tax mentioned in subsection (2) do not apply to a payment if—
>
> (a) it is made by a company, local authority or qualifying partnership[155], and
>
> (b) at the time the payment is made, the company, authority or partnership reasonably believes that it is an excepted payment.

Section 930(2) ITA lists the withholding taxes which are disapplied:

> The duties to deduct are those under—

Section	**Topic**[156]
874(2)	Yearly interest
889(4)	Building society securities
901(4)	Annual payments made by persons other than individuals
903(7)	Patent royalties
906(5)	Royalties where the owner lives abroad
910(2)	Proceeds of a sale of patent rights paid to non-UK residents
919(2)	Manufactured interest on UK securities: payments by UK residents
928(2)	Chargeable payments connected with exempt distributions

Section 930 ITA then provides 2 exceptions:

> (3) Subsection (1) has effect subject to any directions under section 931.
>
> (4) Subsection (1) does not apply to a payment made by a company, or qualifying partnership, acting as trustee or agent for another person.

Subsection (4) seems odd because as a trustee is deemed to be a separate notional person. Perhaps it applies to unit trust trustees. The omission of local authorities is also odd. But these questions will rarely arise in practice.

26.24.1 *Payment to company*

Section 933 ITA provides:

> A payment is an excepted payment if the person beneficially entitled[157]

[155] Section 932 ITA provides: "For the purposes of this Chapter a partnership is a "qualifying partnership" if any partner in the partnership is a company or a local authority."

[156] For clarity I have set this out in tabular form and use my own terminology, rather than a precise quote of the statute.

[157] See App. 6.2 (English-law beneficial ownership); 54.2.1 (Income effectively transferable).

> to the income in respect of which the payment is made is a UK resident company.

A UK resident company is not likely to have a place of abode abroad[158] but this can apply to other withholding taxes.

Section 994 ITA deals with a payment to a non-resident company within CT:

> (1) A payment is an excepted payment if each of the following conditions is met in relation to the payment.
> (2) The person beneficially entitled[159] to the income in respect of which the payment is made must be a non-UK resident company.
> (3) The non-UK resident company must carry on a trade in the UK through a permanent establishment.
> (4) The payment must be one that is required to be brought into account in calculating the chargeable profits (within the meaning given by section 19 of CTA 2009) of the non-UK resident company.

26.24.2 *Tax-exempt recipient*

Section 935 ITA deals with ISAs, not considered here.

Section 936 provides:

> (1) A payment is an excepted payment if it is made to, or to the nominee of, a recipient who is specified in subsection (2) as a recipient who is to be paid gross.
> (2) The following recipients are to be paid gross—

There follows a list of 10 categories of what I call "tax-exempt recipients". For clarity I set them out in my own words rather than the words of the statute:

Governmental bodies

(a) a local authority
(b) a health service body within the meaning of section 986 of CTA 2010
(c) a public office or department of the Crown (excluding commonwealth countries specified in s.978(2) ITA)

Charities & NPOs

(d) a charity
(e) four bodies listed in s.468 CTA 2010: National Heritage Memorial Fund, Historic Buildings & Monuments Commission for England, British Museum, Natural History Museum

[158] See 26.22.3 (Place of abode: Company).
[159] See App. 6.2 (English-law beneficial ownership).

(f) scientific research associations (defined s.469(1)(a) CTA 2010, complying with s.469(2)(3))

Pension schemes

(g) the scheme administrator of a registered pension scheme

(h) the sub-scheme administrator of a sub-scheme which forms part of a split scheme pursuant to the Registered Pensions (Splitting of Schemes) Regulations 2006

(i) Parliamentary pension funds within s.613(4) ICTA

(j) Colonial, etc pension funds within s.614(3) ICTA

As these bodies are generally not subject to IT, it makes sense they should not be subject to WHT.

The Treasury have power to alter this list.

26.24.3 *WHT exempt partnership*

Section 937 ITA provides:

> (1) A payment is an excepted payment if each of the following conditions are met.
> (2) A partnership must be beneficially entitled[160] to the income in respect of which the payment is made.
> (3) Each partner in the partnership must be—
> (a) a person or body mentioned in section 936,[161] or
> (b) a person or body to whom one of subsections (4) to (6) applies.[162]
> (4) This subsection applies to a UK resident company.
> (5) This subsection applies to a company that—
> (a) is non-UK resident,
> (b) carries on a trade in the UK through a permanent establishment, and
> (c) is required to bring into account, in calculating its chargeable profits (within the meaning of section 19 of CTA 2009), the whole of any share of the payment that is attributable to it because of Part 17 of that Act.
> (6) This subsection applies to the European Investment Fund.

[160] It would be more accurate to say that the partners are beneficially entitled, rather than the partnership (which is not a legal person); but the meaning is clear. See App. 6.2 (English-law beneficial ownership).

[161] See 26.24.2 (Tax-exempt recipient).

[162] Section 937(7) provides: "The Treasury may by order amend this section to add to, restrict or otherwise alter the persons or bodies falling within subsection (3)(b)."

Section 937 is needed on the basis that partnerships are not transparent for the purposes of withholding tax, ie payment to a partnership is *not* payment to the partners, ie it adopts the chose in action analysis of a partnership share.[163]

26.24.4 *Direction to deduct*

For completeness: s.931 ITA provides:

> (1) An officer of Revenue and Customs may give a direction to a company, local authority or qualifying partnership directing that section 930 is not to apply in relation to any payment that—
> (a) is made by the company, authority or partnership after the giving of the direction, and
> (b) is specified in the direction or is of a description so specified.
> (2) A direction under this section may be given only if the officer has reasonable grounds for believing, as respects each payment to which the direction relates, that the payment will not be an excepted payment at the time it is made.
> (3) A direction under this section may be varied or revoked by a later direction.
> (4) A variation or revocation of a direction under this section has effect only in relation to payments made after the date of the variation or revocation.

But I wonder if this happens much if at all.

26.24.5 *Mistake by payor*

Section 938 ITA provides:

> (1) This section applies if—
> (a) a payment is made by a company, local authority or qualifying partnership without a sum representing income tax on the payment being deducted from it,
> (b) at the time the payment is made, the company, authority or partnership reasonably believes that it is an excepted payment,
> (c) one of the duties to deduct sums representing income tax mentioned in section 930(2) would apply to the payment if the company did not so believe, and
> (d) the payment is not an excepted payment at the time it is made.
> (2) This Part has effect in relation to the payment as if section 930(1) had

[163] See 85.3.1 (English partnership: 2 analyses).

never disapplied the duties to deduct mentioned in section 930(2).

26.25 Disguised interest

Disguised interest is covered in Chapter 2A Part 4 ITTOIA.

Section 381A ITTOIA imposes the charge to tax:

> (1) This Chapter applies where a person is party to an arrangement[164] which produces for the person a return in relation to any amount which is economically equivalent to interest.
> (2) Income tax is charged on the return if the return is not charged to income tax under or as a result of any other provision of this Act or any other Act.[165]

26.25.1 *Economic equivalent to interest*

Section 381A(4) ITTOIA provides:

> For the purposes of this Chapter a return produced for a person by an arrangement in relation to any amount is "economically equivalent to interest" if (and only if)—
> (a) it is reasonable to assume[166] that it is a return by reference to the time value of that amount of money,
> (b) it is at a rate reasonably comparable to what is (in all the circumstances) a commercial rate of interest, and
> (c) at the relevant time there is no practical likelihood that it will cease to be produced in accordance with the arrangement unless the person by whom it falls to be produced is prevented (by reason of insolvency or otherwise) from producing it.

The CFM comments on the equivalent CT provision:

> **CFM42060: returns 'economically equivalent to interest'** [Aug 2018]
> The main feature of the disguised interest rules is to be able to identify interest-like returns or, as the legislation puts it 'a return in relation to any amount which is economically equivalent to interest on that amount.' CTA09/S486A(2) sets out a definition of 'economically equivalent to interest' that runs through three conditions.
> **Basic definition of interest (subsection (a))**
> The return must fit within a basic definition of interest. This basic

[164] Section 318A(6) provides the standard (unnecessary) IT definition: see App 2.2.3 (Definitions of "arrangement").

[165] For this style of charging provision, see 14.7.2 (Priority in charging provision).

[166] See App 2.24 (Reasonable-to-assume).

definition of the meaning of interest is drawn from a number of the indicia commonly cited in cases on the meaning of interest (e.g. *Euro Hotel (Belgravia) Limited* 51 TC 293 and *Bennett v Ogston* 15 TC 374) (CFM33030). This captures the familiar concepts that the return must be:

- by reference to an amount of money. This means HMRC will be looking for an investment of some sort (or an entitlement to payment of something akin to a debt) in order for the legislation to apply; and
- calculated by reference to the time value of money.

Commercial rate of interest (subsection (b))

The return must in all the circumstances be comparable to a commercial rate of interest. There are a couple of features to this condition that are worth noting.

The return must only be 'comparable'. Consequently, the return does not have to be exactly the same as a commercial rate of interest. It therefore provides a range of interest rates within which a return could be 'comparable' to a commercial rate of interest.

In deciding whether an interest rate is comparable to a commercial rate of interest, you should assume that all factors are taken into account. A commercial rate of interest would therefore take into account the identity and creditworthiness of the counterparty. It could also include such features as the relationship between the two parties, the duration of the arrangement and the currency of the transaction(s).

Practical likelihood of the return (subsection (c))

The interest-like return must be predictable. There must be 'no practical likelihood' , when viewed at the 'relevant time' that the return will not be produced in accordance with the arrangement.

It is therefore not enough that an interest-like return results from the arrangements. If the return is the product of chance or could not have been reasonably anticipated at the outset of the arrangement, then it cannot be a return 'economically equivalent to interest'.

In assessing whether there was 'no practical likelihood' that the return will not be produced in accordance with the arrangement you should ignore contingencies such as default outside of the control of the parties. This would include ignoring the possibility of default.

The 'relevant time' (S486B(3))

The 'relevant time' is defined for the purposes of S486B(2)(c), as being the later of the time when the company becomes party to the arrangements or the time when the return begins to be produced. It must therefore be clear at the outset that the return will be produced. Thus, although there is no express requirement for the arrangement to be 'designed' to produce the return, the return must be initially predictable.

26.25.2 *HMRC examples*

The CFM provides:

> **CFM42010 disguised interest: overview** [Aug 2018]
>
> **...Example**
>
> Company A purchases an asset (that is not a security) for £100m from Company B under an arrangement whereby Company A will sell that asset back to Company B in two years' time for £112M.
>
> Assuming that the return of 6% per annum (straight line) is reasonably comparable to a commercial rate of interest, then this transaction provides an interest-like return in a manner that would not, without any special rules, be taxed as interest...
>
> **CFM45020: examples of avoidance schemes** [Aug 2018]
>
> This guidance applies to companies that hold shares up to 21 April 2009
>
> The following two examples show in outline how companies could structure arrangements to generate an interest-like return which for tax purposes does not arise as interest.
>
> **Scheme 1: shares subject to third party obligations**
>
> - On day 1, a UK special purpose vehicle (SPV) company issues 100m £1 ordinary shares to a bank but only 0.001p/share is actually paid up (i.e. £10k in total). Under the terms of the share issue, the bank is obliged to pay up the balance of the capital (£100m less £10k) in one year's time, even if it sells the shares in the meantime.
> - On the same day, the bank sells the shares to UK plc (avoider) for their net present value of (say) £95m. At the end of the year, bank pays up the remaining £100m of share capital, so that the value of the SPV shares is then £100m, being the cash it has.
> - The economic effect is that the bank receives £95m from UK plc on day 1, and pays £100m to SPV (owned by UK plc) on day 365. The figures will be such that the £5m difference represents a year's interest on the initial £95m cash paid by UK plc.
> - The substance is that UK plc has invested £95m for a year and has received £5m of interest, and it is likely that this arrangement will be accounted for as a loan and the profit of £5m shown as interest income.
> - For CT purposes, the only charge would be on a capital gain of £5m (subject to indexation) if UK plc disposes of the shares. It would usually be the case that UK plc would have capital losses to cover the gain.
>
> **Scheme 2: other interest-like shares**
>
> - In this scheme, a UK SPV is set up with share capital of £95m and it uses that cash to acquire a debt of £100m due in a year's time.

£95m is the present value of the debt. This is most likely to have been a structured debt set up for the purposes of the scheme (and to avoid problems with the debt going bad).

- The shares are then sold to UK plc for £95m. UK plc knows the company will be worth £100m in a year's time.
- The substance is exactly the same as scheme 1 in that UK plc would earn a fixed profit of £5m in the form of an unrealised capital gain, it is only the mechanism which delivers the pre-ordained increase in value of the SPV's shares that differs.

The last example concerns dual currency investments:

> **SAIM2800: Disguised interest: examples** [Dec 2019]
> **...Currency movements**
> An investor may receive a return from holding deposits in more than one currency, seeking to take advantage of movements in exchange rates to generate a return. The arrangements may require the investor to enter into options involving the receipt or payment of amounts in the event of the spot rate being above or below a specified level. The return the investor actually receives may be described, for example, as a combination of a 'money market rate' (say 0.5% p.a.) plus an option premium (say 4.5%), giving an overall yield of 5%. This return will fall within the disguised interest provisions.

This is not self-evident: It would need a deeper consideration of the investment background to determine if this is correct. The position may vary from one dual currency investment to another.

26.25.3 *Foreign disguised interest*

Section 381B ITTOIA provides:

> Tax is charged under this Chapter on the full amount of the return, or any part of the return, arising in the tax year.

The remittance basis does not apply: foreign source disguised interest received by a remittance basis taxpayer is taxable on the arising basis.

A non-resident is not taxed on foreign source disguised interest. It is suggested that the test of foreign source should be similar to the test for ordinary interest.

26.25.4 *Interaction of disguised interest/CGT*

The general rule in s.37(1) TCGA is that where the person making a disposal is subject to income tax on the proceeds, IT has priority over

CGT, and there is no double charge.[167] Section 37(2A) TCGA disapplies this rule for disguised interest.[168] Instead, s.381D ITTOIA provides:

> (1) This section applies if at any time a tax other than income tax ("the other tax") is charged in relation to a return on which income tax is charged under this Chapter.
> (2) In order to avoid a double charge to tax in respect of the return, a person may make a claim for one or more consequential adjustments to be made in respect of the other tax.
> (3) On a claim under this section an officer of Revenue and Customs must make such of the consequential adjustments claimed (if any) as are just and reasonable.
> (4) Consequential adjustments may be made—
> (a) in respect of any period,
> (b) by way of an assessment, the modification of an assessment, the amendment of a claim, or otherwise, and
> (c) despite any time limit imposed by or under any enactment.

It would have been simpler to leave the normal rule to apply. I cannot see the justification for a special rule. But it does not matter.

26.26 Loan or credit transaction

Chapter 5C Part 13 ITA rewrites the former s.786 ICTA 1988. This was done by TIOPA in 2010, rather than in 2007 with the rest of ITA, perhaps to link in with work on CTA 2010.[169] The consequence is that the sections were slotted in with clumsy letter/numbering: s.809CZA-809CZC.[170] Throw in the repetitive style of drafting, 6 sections by contrast to the single original, and older practitioners may have preferred to have kept the old section. But there it is.

HMRC say:

> **ICAEW question:** While the section has its history in income tax avoidance, there is no specific limitation on the ambit of the section to

[167] See 56.4.12 (Interaction of IT/CGT).

[168] Section 37(2A) provides: "Subsection (1) is not to be taken as excluding from the consideration so taken into account any money or money's worth which is, or is taken into account in computing, a return on which income tax is charged under Chapter 2A of Part 4 of ITTOIA 2005 (disguised interest) (but see section 381D of that Act)."

[169] The CT equivalent is Chapter 3 Part 16 CTA 2010, but it sits in the very different context of the CT loan relationship code.

[170] See App 13.3 (Section numbering system).

> income tax or to tax avoidance situations. This causes concern and additional complexity in a number of bona fide corporate reorganisations and transactions, including the straightforward refinancing of an insolvent company involving waivers of accrued interest. We would therefore be grateful for confirmation that the Revenue does not regard the section as applying in other than income tax avoidance situations.
>
> **Revenue response** As the Institute recalls, TA 1988 s 786(5) was introduced to tackle schemes of income tax avoidance—specifically, at attempts to circumvent the restrictions on personal tax relief for interest by a debtor substituting other income foregone for interest otherwise payable. We continue to regard the subsection as aimed at situations involving tax avoidance.
>
> Although we cannot rule out in principle its potential application to cases involving corporation tax rather than income tax, we would in practice expect this to be exceptional given the relatively less restricted relief available for interest expense of companies. We would not expect to invoke the provision in the sort of case cited by the Institute—bona fide reorganisations and straightforward refinancing of insolvent companies.[171]

The taxpayer referred to this in *Spritebeam v HMRC* but the point was an unattractive one, as the case concerned a tax avoidance scheme, albeit not the one at which the section was originally aimed. The Upper Tribunal were not impressed:

> HMRC ‘s comments cannot change the clear words of s 786 ... the scope of s 786 cannot be restricted by the mischief at which the provisions seem to have been aimed when no such restriction can be read into the words used.
>
> We note too that HMRC’s answer to the ICAEW’s question is not in any event wholly supportive of [Counsel for the taxpayer’s] analysis. It demonstrates that s.786(5) has the potential to be applied to circumstances outside the apparent mischief.[172]

26.26.1 *“Loan/credit transaction”*

Section 809CZA ITA provides:

> (1) This section defines a loan or credit transaction for the purposes of sections 809CZB and 809CZC.
>
> (2) A transaction is a loan or credit transaction if it is—

[171] [1993] STI p.1333-1334.

[172] [2015] STC 1222 at [26] - [27].

> (a) effected with reference to the lending of money or the varying of the terms on which money is lent, or
> (b) effected with a view to enabling or facilitating an arrangement concerning the lending of money or the varying of the terms on which money is lent.
>
> (3) A transaction is a loan or credit transaction if it is—
> (a) effected with reference to the giving of credit or the varying of the terms on which credit is given, or
> (b) effected with a view to enabling or facilitating an arrangement concerning the giving of credit or the varying of the terms on which credit is given.

Subsections (4)(5) are in the same terms, but one refers to the lending of money and the other to the giving of credit.

In *Spritebeam v HMRC*:

> We do not consider that the phrase: 'any transaction effected with reference to the lending of money or the giving of credit ...' requires the transaction to be something separate from the loan or credit arrangements themselves. It seems to us that this is the plain meaning of the section. Section [809CZA] is worded as it is in order to catch any arrangement for the lending of money however that arrangement may be constructed. We find nothing in its wording which could be read as limiting its application to collateral transactions, and do not agree that the subsection requires the existence of both the loan and a separate transaction if the operative provisions of the section are to be engaged.[173]

Section 809CZA ITA provides:

> (4) Subsection (2) has effect whether the transaction is effected—
> (a) between the lender and borrower,
> (b) between either of them and a person connected with the other, or
> (c) between a person connected with one and a person connected with the other.
>
> (5) Subsection (3) has effect whether the transaction is effected—
> (a) between the creditor and debtor,
> (b) between either of them and a person connected with the other, or

[173] [2015] STC 1222 at [16]. The reader may agree with the first-tier tribunal that the contrary view is the plain reading; but the point seems now settled, at least at the level of the Upper Tribunal.

> (c) between a person connected with one and a person connected with the other.

Subsections (2)(3) are in the same terms, but one refers to lender and borrower, and the other refers to creditor and debtor.

26.26.2 *Annuity deemed interest*

Armed with the definition of "loan or credit transaction" we move on. I mention s.809CZB ITA only for completeness. This provides:

> (1) This section applies if a loan or credit transaction provides for a payment which is not interest but is—
>
> (a) an annuity or other annual payment falling within Part 5 of ITTOIA 2005 and chargeable to income tax otherwise than as relevant foreign income, or
>
> (b) an annuity or other annual payment which is from a source in the UK and chargeable to corporation tax under [Chapter 7 of Part 10 of CTA 2009 (annual payments not otherwise charged) or regulation 15 of the Unauthorised Unit Trusts (Tax) Regulations 2013.
>
> (2) The payment must be treated for the purposes of the Income Tax Acts as if it were a payment of yearly interest (see, in particular, section 874).

The SAI Manual provides:

> **SAIM9110 Artificial Arrangements** [Dec 2019]
> ... An example might be where A grants B an interest-free loan and B grants A an annuity for the life of the loan, or transfers the right to income from an asset to A for the duration of the loan. ...
> If the transaction provides for the payment of an annuity or annual payment, the payment is to be treated as annual interest for all Income Tax (ITA07/S809CZB) and Corporation Tax purposes (CTA10/S778).
> The purpose of this sub-section was to prevent persons from obtaining tax relief by paying an annuity or annual payment where no relief would have been available for payment of interest.
> Since the enactment of ITA07/S900 and ITTOIA05/S727, previously ICTA88/S347A (SAIM9050) which limited the circumstances in which the payer of an annuity or other annual payment can deduct and retain income tax, the tax treatment of annual interest and annuities/annual payments is the same in most circumstances. ...

So far, s.809CZB is dead-letter law.

> However this sub-section is still relevant where the lender is overseas. Payments by individuals and trustees of annual interest to non-residents

> should be made under deduction of tax (SAIM9070), but payments of annuities/annual payments by non-corporates (whose income has been wholly subject to income tax) can be made gross. Without this sub-section there would therefore be the opportunity for a lender to receive gross payment for what is essentially interest.

This dusty corner is outside the scope of this book.

26.26.3 *Charge on transferred interest*

Section 809CZC ITA is potentially of wider import. It provides:

> (1) This section applies if—
> (a) under a loan or credit transaction a person transfers income arising from property,
> (b) the person is not, as a result of Chapter 5B (finance arrangements), chargeable to income tax on the income transferred, and
> (c) the person is within the charge to income tax.
> (2) In such a case—
> (a) income tax is charged under this section,
> (b) the tax is charged on an amount equal to the full amount of the income transferred,
> (c) the tax is charged for the tax year in which the transfer takes place, and
> (d) the person who transfers the income is liable for the tax.
> (3) This section does not prejudice the liability of any other person to tax.

Section 809CZC(4) ITA defines "transfer":

> For the purposes of this section a person transfers income if the person surrenders, waives or forgoes it.

This does not apply to an interest-free loan. One does not "forgo" income by making such a loan. Income is only foregone if it is income to which one is otherwise entitled.[174]

Section 809CZC continues:

> (5) Subsection (6) applies for the purposes of this section if—
> (a) credit is given for the purchase price of property, and
> (b) the rights attaching to the property are such that the buyer's

[174] I would also have said that a loan is not a transaction *effected with reference to* the lending of money. It *is* the lending of money. But that is now harder to maintain after *Spritebeam.*

> rights to income from the property are suspended or restricted during the life of the debt.
>
> (6) The buyer must be treated as surrendering income of an amount equal to the income the buyer in effect forgoes by obtaining the credit.

Section 809CZC(7) ITA quantifies the amount of income:

> For the purposes of this section an amount of income payable subject to deduction of income tax must be taken as the amount before deduction of tax.

The SAI Manual provides:

> **SAIM9110 Artificial Arrangements** [Dec 2019]
> ...If the transaction is one which involves the assignment, transfer or waiver of rights to income from property (for instance a security) without the actual transfer or sale of the property itself then ITA07/S809 (CZC) (2) or CTA10/S779 (2) imposes a charge on the debtor. This charge is to income tax or to corporation tax under Schedule D Case VI on an amount equal to the income assigned. The purpose of this section is to prevent debtors from escaping tax on income corresponding to interest for which they could not have claimed relief. The person to whom the right to the income has been transferred will remain liable to tax on this income.
> ITA07/S809 (CZC) (5) and (6) and CTA10/S779 (5) and (6) provide that, if property is bought on credit and the rights attaching to the property restrict the purchaser's income from the property until it is paid for, so that there is no separate provision for waiver of rights, then the above will apply as if there was an agreement to forgo the relevant amount of income.

Although (what is now) s.809CZC was introduced in 1969, the first and only case in which it was discussed was *Spritebeam* in 2013. Clearly HMRC do not seek to apply it outside interest-avoidance contexts, and the fact that the Manual still refers to the pre-2010 provision suggests it is not considered much if at all.

26.26.4 *Waiver of interest*

It has never been suggested that s.809CZC might reverse the case law decisions[175] which held that a waiver of interest was not taxable.[176] If that

[175] See 15.7 (Waiver).

[176] *Norfolk & Montagu on the Taxation of Interest and Debt Finance* agrees: para 5.399 (looseleaf).

were wrong, then there could be a tax charge on the waiver of interest due from an insolvent debtor, even though the interest would never be paid; which would surely be absurd.

26.27 DT relief: Interest income

26.27.1 *OECD Model*

Article 11 OECD Model provides:

> 1. Interest arising in a Contracting State and paid[177] to a resident of the other Contracting State may be taxed in that other State.
> 2. [a] However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State,
>   [b] but if the beneficial owner[178] of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest.
>   [c] The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

OECD Model Convention does not provide exemption but only a partial relief. UK tax is set against tax in the state of residence. So where the OECD Model rule applies, the effective tax rate is the foreign tax rate or the UK withholding tax rate (10%), whichever is the higher.

26.27.2 *DTAs with 100% interest relief*

About a third of UK DTAs provide full relief, ie UK source interest arising to a person who is treaty-resident in the foreign state is taxable only in the foreign state, and not taxed at all in the UK; this includes France, Ireland, Luxembourg, Switzerland and USA.[179] HMRC publish a convenient digest of DTAs.[180]

26.27.3 *Interest arising in 3rd state*

OECD Commentary provides:

> 6. The Article deals only with interest arising in a Contracting State and

[177] See 15.11.2 ("Paid" and "payment").

[178] See 108.10 (DTA beneficial owner rule).

[179] UK/France Art.11; UK/Ireland DTA Art.12; UK/Luxembourg DTA Art.11; UK/Switzerland DTA Art.11; UK/USA DTA Art. 11.

[180] *https://www.gov.uk/government/publications/double-taxation-treaties-territory-residents-with-uk-income*

> does not, therefore, apply to interest arising in a third State.

Interest arising in a third state (not in either treaty state) falls within the Other Income article and is taxed in the state of residence.[181]

26.27.4 *Transfer pricing*

Article 11(6) OECD Model provide the usual rule for transfer pricing/ special relationships:

> 6. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

OECD Commentary provides:

> 6. ... Interest arising in a Contracting State which is attributable to a permanent establishment which an enterprise of that State has in the other Contracting State may be taxed by the first-mentioned State under paragraph 2 but may also be taxed by the other State under paragraph 1 of Article 7 (see paragraphs 9 and 9.1 of the Commentary on Articles 23 A and 23 B concerning relief of double taxation in such cases).

26.27.5 *DTA definition of interest*

Article 11(3) OECD Model defines "interest":

> The term "interest" as used in this Article means
> [1] income from debt-claims of every kind,
> [a] whether or not secured by mortgage and
> [b] whether or not carrying a right to participate in the debtor's profits,
> [2] and in particular,
> [a] income from government securities and
> [b] income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures.
> [3] Penalty charges for late payment shall not be regarded as interest for

[181] See 33.20 (DT relief: "Other Income").

> the purpose of this Article.

It is necessary to distinguish:
Treaty-interest: interest within this definition
UK domestic-law interest: interest under the UK domestic law definition.

OECD Commentary provides:

> 18. ... The term "debt-claims of every kind" obviously embraces cash deposits and security in the form of money, as well as government securities, and bonds and debentures, although the three latter are specially mentioned because of their importance and of certain peculiarities that they may present. It is recognised, on the one hand, that mortgage interest comes within the category of income from movable capital (*revenus de capitaux mobiliers*), even though certain countries assimilate it to income from immovable property. On the other hand, debt-claims, and bonds and debentures in particular, which carry a right to participate in the debtor's profits are nonetheless regarded as loans if the contract by its general character clearly evidences a loan at interest.

OECD Commentary then considers the interest/dividend borderline:

> 19. Interest on participating bonds should not normally be considered as a dividend, and neither should interest on convertible bonds until such time as the bonds are actually converted into shares. However, the interest on such bonds should be considered as a dividend if the loan effectively shares the risks run by the debtor company (see *inter alia* paragraph 25 of the Commentary on Article 10). In situations of presumed thin capitalisation, it is sometimes difficult to distinguish between dividends and interest and in order to avoid any possibility of overlap between the categories of income dealt with in Article 10 and Article 11 respectively, it should be noted that the term "interest" as used in Article 11 does not include items of income which are dealt with under Article 10.

A premium is not UK domestic law interest, but it falls within the treaty definition:

> 20. As regards, more particularly, government securities, and bonds and debentures, the text specifies that premiums or prizes attaching thereto constitute interest. Generally speaking, what constitutes interest yielded by a loan security, and may properly be taxed as such in the State of source, is all that the institution issuing the loan pays over and above the amount paid by the subscriber, that is to say, the interest accruing plus any premium paid at redemption or at issue. It follows that when a bond

> or debenture has been issued at a premium, the excess of the amount paid by the subscriber over that repaid to him may constitute negative interest which should be deducted from the stated interest in determining the interest that is taxable. On the other hand, the definition of interest does not cover any profit or loss that cannot be attributed to a difference between what the issuer received and paid (e.g. a profit or loss, not representing accrued interest or original issue discount or premium, which a holder of a security such as a bond or debenture realises by the sale thereof to another person or by the repayment of the principal of a security that he has acquired from a previous holder for an amount that is different from the amount received by the issuer of the security). Such profit or loss may, depending on the case, constitute either a business profit or a loss, a capital gain or a loss, or income falling under Article 21.
>
> [For para 20.1, see 28.16 (DT relief for AIP income)]
>
> 21. Moreover, the definition of interest in the first sentence of paragraph 3 is, in principle, exhaustive. It has seemed preferable not to include a subsidiary reference to domestic laws in the text; this is justified by the following considerations:
>
> a) the definition covers practically all the kinds of income which are regarded as interest in the various domestic laws;
>
> b) the formula employed offers greater security from the legal point of view and ensures that conventions would be unaffected by future changes in any country's domestic laws;
>
> c) in the Model Convention references to domestic laws should as far as possible be avoided. ...

There is a comment on swaps:

> 21.1 The definition of interest in the first sentence of paragraph 3 does not normally apply to payments made under certain kinds of nontraditional financial instruments where there is no underlying debt (for example, interest rate swaps). However, the definition will apply to the extent that a loan is considered to exist under a "substance over form" rule, an "abuse of rights" principle, or any similar doctrine.

There is a comment on penalties:

> 22. ... Penalty charges, which may be payable under the contract, or by customs or by virtue of a judgement, consist either of payments calculated pro rata temporis or else of fixed sums; in certain cases they may combine both forms of payment. Even if they are determined pro rata temporis they constitute not so much income from capital as a special form of compensation for the loss suffered by the creditor

> through the debtor's delay in meeting his obligations. Moreover, considerations of legal security and practical convenience make it advisable to place all penalty charges of this kind, in whatever form they be paid, on the same footing for the purposes of their taxation treatment.
> ...

Annuity income is not treaty-interest:

> 23. Finally, the question arises whether annuities ought to be assimilated to interest; it is considered that they ought not to be. On the one hand, annuities granted in consideration of past employment are referred to in Article 18 and are subject to the rules governing pensions. On the other hand, although it is true that instalments of purchased annuities include an interest element on the purchase capital as well as return of capital, such instalments thus constituting "fruits civils" which accrue from day to day, it would be difficult for many countries to make a distinction between the element representing income from capital and the element representing a return of capital in order merely to tax the income element under the same category as income from movable capital. Taxation laws often contain special provisions classifying annuities in the category of salaries, wages and pensions, and taxing them accordingly.

See Avery-Jones et al "The Definitions of Dividends & Interest in OECD Model: Something Lost in Translation?" [2009] BTR 406.

26.27.6 *Source of interest for DTA*

Article 11(5) OECD Model provides:

> [a] Interest shall be deemed to arise in a Contracting State when the payer is a resident of that State.
> [b] Where, however,
> [i] the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment in connection with which the indebtedness on which the interest is paid was incurred, and
> [ii] such interest is borne by such permanent establishment,
> then such interest shall be deemed to arise in the State in which the permanent establishment is situated.

It is necessary to distinguish:
Treaty-source: the source of interest within this definition
UK domestic-law source: the source of interest under UK domestic law

I refer to interest within art 11(5)[b] as **"PE-interest"**.

OECD Commentary on art 11 (interest) provides:

> 26. [Art 11(5)] lays down the principle that the State of source of the interest is the State of which the payer of the interest is a resident. It provides, however, for an exception to this rule in the case of interest-bearing loans which have an obvious economic link with a permanent establishment owned in the other Contracting State by the payer of the interest. If the loan was contracted for the requirements of that establishment and the interest is borne by the latter, the paragraph determines that the source of the interest is in the Contracting State in which the permanent establishment is situated, leaving aside the place of residence of the owner of the permanent establishment, even when he resides in a third State.
>
> 27. In the absence of an economic link between the loan on which the interest arises and the permanent establishment, the State where the latter [ie, the permanent establishment] is situated cannot on that account be regarded as the State where the interest arises; it is not entitled to tax such interest, not even within the limits of a "taxable quota" proportional to the importance of the permanent establishment. Such a practice would be incompatible with paragraph 5.

The Commentary then considers when (in my terminology) interest counts as PE-interest, ie (in short) when is a loan connected to a PE:

> Moreover, any departure from the rule fixed in [art 11(5)[a]] is justified only where the economic link between the loan and the permanent establishment is sufficiently clear-cut. In this connection, a number of possible cases may be distinguished:
>
> a) The management of the permanent establishment has contracted a loan which it uses for the specific requirements of the permanent establishment; it shows it among its liabilities and pays the interest thereon directly to the creditor.
>
> b) The head office of the enterprise has contracted a loan the proceeds of which are used solely for the purposes of a permanent establishment situated in another country. The interest is serviced by the head office but is ultimately borne by the permanent establishment.
>
> c) The loan is contracted by the head office of the enterprise and its proceeds are used for several permanent establishments situated in different countries.
>
> In cases a) and b) the conditions laid down in [art 11(5[a]] are fulfilled, and the State where the permanent establishment is situated is to be regarded as the State where the interest arises. Case c), however, falls outside the provisions of [art 11(5)[b]], the text of which precludes the

> attribution of more than one source to the same loan. Such a solution, moreover, would give rise to considerable administrative complications and make it impossible for lenders to calculate in advance the taxation that interest would attract. ...

See 107.14 (Effectively connected with PE).

26.27.7 *Contracting state PE*

For the overlap between interest income and business profits, see 107.9.3 (Other business profit overlaps).

26.28 Interest: Pre-1963 DTAs

Pre 1963 DTAs[182] do not provide exemption for interest. They do however provide exemption for industrial or commercial profits.

The treaties are in similar form, so I take the Belize DTA as an example. Art 3(2) Belize/UK DTA provides:

> The industrial or commercial profits of a Belize enterprise shall not be subject to UK tax unless the enterprise is engaged in trade or business in the UK through a permanent establishment situated therein. If it is so engaged, tax may be imposed on those profits by the UK, but only on so much of them as is attributable to that permanent establishment.

This confers relief on interest, provided:

(1) The recipient is a Belize enterprise, defined as "an industrial or commercial enterprise or undertaking carried on by a resident of Belize"[183] (eg a Belize bank).
(2) The recipient is not engaged in trade or business in the UK through a PE in the UK (or if it is so engaged, the interest is not profits attributable to that PE).
(3) The interest is or is part of the "industrial or commercial profits".

A person who makes a simple loan by way of investment does not carry on an industrial or commercial enterprise, and interest on such a loan does not constitute industrial or commercial profits. However a business (such as a bank) which includes lending does constitute an industrial or commercial enterprise and the interest is part of its profits.[184] HMRC agree. The

[182] See 107.24 (Pre-1963 DTAs).

[183] Belize/UK DTA art.2(1)(h).

[184] The issue was discussed in more detail in the 6th edition of this work, and HMRC manual passages dealing with Jersey banks were set out in the 2019/20 edition of

International Manual provides:

> **INTM337310. Background to claims by foreign financial concerns** [Jun 2016]
>
> Under a longstanding practice, a claim by an overseas financial concern for interest which bears the character of income arising from their trading activities or forms part of their trading income may be relieved under the Business Profits Article (provided the Business Profits Article doesn't clearly exclude interest for example Kenya) in either of the following circumstances
>
> - there is no interest article, or
> - the conditions of the interest article are not satisfied.
>
> **INTM337330. How to deal with claims from foreign financial concerns** [Jun 2016]
>
> If you receive a claim or correspondence for income which can be considered under the Business Profits Article as outlined in INTM337310 you should deal with it as follows:
>
> Where there is no interest article in the relevant Double Taxation Agreement (DTA) and the claimant is not trading in the UK through a permanent establishment, exemption may be authorised under the business profits article on form 241(Int-Roys).
>
> Where in such circumstances the claimant is trading in the UK through a permanent establishment, necessitating restriction of relief under that article, and in cases where there is an interest article but claims under it are automatically restricted because the claimant is trading in the UK through a permanent establishment, you will need to consult the Officer dealing with the permanent establishment and arrange for any interest attributable to the permanent establishment to be included in his computation of liability. Form 502 should be used for this purpose. Provided the Officer has no objections the interest can then be exempted under the business profits article using form 241(Int-Roys). You should issue form 501 (amended as necessary) with the Officer's copy of the exemption notice where relief is authorised under the business profits article and there is trading in the UK through a permanent establishment. Where there is no trading through a permanent establishment you need to send a memo with the exemption notice explaining the circumstances in which relief has been authorised.
>
> Note: These provisions do not apply where the rate of relief under the business profits article is more favourable than under the interest article

this work para 21.24.7, but I omit that here as it has become less important as the Channel Island/IoM have moved from their pre-1963 treaties to the OECD model form.

and relief is available under the latter.

INTM337340. Requests to extend the provisions to other income [Jun 2018]

If the claimant asks you to extend the concession to dividends or other distributions you should ask the HMRC office for the permanent establishment (PE) to confirm that

- the payments represent trading income; and
- they are not attributable to the PE.

The reason for doing this is because dividends/distributions, unlike interest and royalties, cannot be brought into the charge to corporation tax on the PE (CTA09/S19).

26.29 DT relief: Withholding tax

26.29.1 *Procedure to obtain DT relief*

The legislation is in Double Taxation Relief (Taxes on Income) (General) Regulations 1970 (which I abbreviate to "DTRR"). Regulation 2(1) provides:

> The following provisions of these Regulations shall have effect where, under arrangements having effect under section 497 ICTA 1970 [now s.2 TIOPA], persons resident in the territory with the government of which the arrangements are made are entitled to exemption or partial relief from UK income tax in respect of any income from which deduction of tax is authorised or required by the Income Tax Acts.

This applies where interest qualifies for DT relief.

Regulation 2(2) provides exemption from withholding tax:

> Any person who pays any such income (referred to in these Regulations as "the UK payer") to a person in the said territory who is beneficially entitled[185] to the income (such person being referred to in these Regulations as "the non-resident") may be directed by a notice in writing given by or on behalf of the Board that in paying any such income specified in the notice to the non-resident he shall—
> (a) not deduct tax, or
> (b) not deduct tax at a higher rate than is specified in the notice, or
> (c) deduct tax at a rate specified in the notice instead of at the lower[186] or basic rate otherwise appropriate;

[185] See App. 6.2 (English-law beneficial ownership).

[186] The rate "otherwise appropriate" is always the basic rate, never the lower rate; the drafter has failed to amend the wording of the regulation to keep up with the changes to tax rates in 2008. But no harm arises from this error.

> and where such notice is given, any income to which the notice refers, being income for a year for which the arrangements have effect, which the UK payer pays after the date of the notice to the non-resident named therein shall, subject to the following provisions of these regulations, be paid as directed in the notice...

I refer to this as a **"DTRR notice"**.

Gross payment of interest under the terms of a treaty is permitted only if a direction has been given to the payer under the DTR Regulations.[187]

Regulations 3 DTRR dots some *i*'s and cross some *t*'s:

> 3. Where a notice given under Regulation 2(2) directs the UK payer to deduct tax at a rate specified in the notice, the provisions of the Income Tax Acts under which he would, but for the notice, have been chargeable with or liable to account for all or part of any tax deducted at the [lower or basic] rate shall apply as if those Acts required him to deduct tax at the rate so specified.

26.29.2 *Revocation of DTRR notice*

Of course, a notice is revocable. Regulation 8 DTRR provides:

> Any notice given under Regulation 2(2) may be expressed to become ineffective if certain specified events happen, or, whether so expressed or not, may be cancelled by a notice of cancellation given by or on behalf of the Board, and if to the knowledge of the UK payer any of those events happens or if such notice of cancellation is given, any payment made to the non-resident by the UK payer after the happening of that event becomes known to the UK payer or after the receipt of that notice, as the case may be, shall be subject to deduction of tax in accordance with the Income Tax Acts.

26.29.3 *DTRR notice issued in error*

Regulations 5 DTRR provides:

> 5 The UK payer shall not, in respect of any payment, be charged with or liable to account for any tax which, but for a notice given under Regulation 2(2), he would have been required by the Income Tax Acts

[187] This is self-evident, but if authority is needed, see *Hargreaves Property Holdings Ltd v HMRC* [2023] UKUT 120 (TCC) at [52]-[57]. The use of the word "may" in para 2(2) DTRR is only saying that HMRC have the power to give a direction under the regulations. It is not saying that gross payment may be made even in circumstances where that power is not exercised.

> to deduct and account for on making the payment but in compliance with the notice has not deducted.

Regulation 9 DTRR provides:

> If it is discovered after a notice has been given under Regulation 2(2) that the non-resident is not entitled to exemption or partial relief from tax in respect of income referred to in the notice, any tax which, but for the notice, would have been deductible from any payment made to the non-resident by the UK payer but in compliance with the notice has not been so deducted—
>
> (a) may be assessed on the non-resident under Case VI of Schedule D by an Inspector, or
>
> (b) shall, if a direction to that effect is given by or on behalf of the Board, be deducted by the UK payer out of so much of the first payment made to the non-resident after the date of the direction as remains after the deduction of any tax deductible therefrom under the Income Tax Acts, and any balance which cannot be deducted out of the first such payment shall be deducted, subject to the same limitation, out of the next such payment, and so on until the whole of the tax (the amount of which shall be specified in the direction) has been deducted.
>
> Any tax which the UK payer is required to deduct under paragraph (b) of this Regulation shall be accounted for as if it was tax deductible under section 53 of the Income and Corporation Taxes Act 1970 in respect of the payment from which it is deducted.

The UK payor is not at personal risk from complying with a mistaken notice, but the non-resident payee is at risk of assessment directly.

26.30 Obtaining a DTRR notice

There are two methods to obtain a DTRR notice not to pay WHT: the certified claim route and the DTT passport scheme.

26.30.1 *Certified claim*

The DTTP consultation paper provides:

> This process can be cumbersome for overseas lenders, as a Direction needs to be issued for each loan, and in each case HMRC requires the overseas lender to obtain proof of their residence for tax purposes from their own fiscal authority. This is known as the "certified claim" method. If an overseas lender makes multiple loans to the UK it needs to go through this process each time before HMRC will issue a Direction to

each borrower in the UK.[188]

26.30.2 *Partnership lender*

HMRC say:

> In deciding whether or not HMRC Residency should exercise its discretion in meeting an application for relief at source [ie an application to pay interest without deduction], it must primarily have regard to the risk that the underlying conditions for relief might change over the lifetime of a Direction (which will normally last no longer than five years). Such changes might remove the basis for relief altogether, or in some other way prejudice the amount of tax that the UK is otherwise properly entitled to receive in that period.
>
> Given its duty of care to the UK Exchequer and taxpayer, HMRC Residency have to give particular consideration to the desirability of giving DT treaty relief where transparent concerns such as partnerships and LLCs are concerned. This is because, more often than not, there is a much higher risk that the beneficial owners of such concerns will change. Or that there will be fluctuations in income or profit apportionment that might erode the amount of UK-source income that is attributable to the DT treaty-resident beneficial owners who were identified at the time the application for relief at source was made.
>
> Attention is drawn to the undertaking sought from claimants in the Declaration (Part F of the US/Company 2002) that they will notify HMRC Residency of any changes in the information given on the form. (A similar warning to notify any material changes is given to a UK payer when a Direction is issued to it.)
>
> Without calling into question the good faith of partnership or LLC claimants who give these undertakings, HMRC Residency considers that the problem of monitoring this aspect is particularly acute where there are a very large number of investors, or there is an unfeasible number of layers of participation - partners who are themselves partnerships, which contain yet more transparent partners.
>
> For these reasons, although HMRC Residency is willing to entertain any application for relief at source from partnerships or LLCs, it should be understood that it is likely to give relief in this way chiefly where:
>
> * HMRC Residency are able to accept satisfactory assurances about the monitoring and notification of membership from the claimant concern.
> * The number and type of the concern’s membership is not a problem in the first place - for example, a small and fixed number of participators, such as US corporations engaged in a joint venture. Or where the concern is the business arm of a small number of joint intellectual property owners such as a band or similar collaborative venture.
> * In response to a successful representation of special considerations or factors that would allow us to decide that relief may safely be given in this form.
>
> Each case will be considered on its merits.

[188] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525399/Double_Taxation_Treaty_Passport_scheme_review.pdf* para 1.4

> Otherwise, HMRC Residency will consider giving relief only by meeting discrete repayment claims.[189]

Although this comment is made in relation to the USA DTA, it should apply to partnerships generally. On the other hand, it applies only to American LLCs (which are treated as transparent under the US DTA).

26.30.3 *Debtor outside UK*

HMRC Residency Double Taxation Guidance Note 1 deals with applications for relief at source on interest payments where the borrower is outside the UK:

> This Guidance Note explains how HMRC Residency Nottingham handles applications for relief at source from UK income tax under a double taxation treaty in respect of interest payments where both lender and borrower are outside the UK.
>
> [After some general comments on the law the note continues:]
>
> In its consideration of an application for relief at source in such circumstances, HMRC Residency must be satisfied that all the elements necessary to give relief are present. In the circumstance where the payer of the interest is not situated in the UK, HMRC Residency will need satisfactory evidence that the payer has concluded that the payments are to be considered as UK-source and has formed the intention of deducting and accounting for tax accordingly.
>
> HMRC Residency's claim forms ask claimants to attach copies of relevant loan documentation as part of the normal process. In cases such as those discussed in the previous paragraph, HMRC Residency would also ask claimants to enclose supporting evidence confirming the payers' intentions. This could, for example, be copies of pertinent correspondence with the borrower or other relevant documentation.
>
> Without the comfort afforded by such supporting documentation, HMRC Residency may well take the view that it should not exercise its discretion under SI 1970/488 to authorise relief at source.
>
> However, it would then be open to the non-resident payee to make a repayment claim to HMRC Residency once the interest payments have commenced and tax has been deducted. HMRC Residency will be prepared to keep the application for relief at source open and on file pending this eventuality. If the non-resident payee is then able to forward a certificate of tax deducted completed by the payer, HMRC Residency

[189] "HMRC Residency Double Taxation Guidance Note 3 partnerships and LLCs claiming relief under the 2002 UK/USA DTC."

> may then be able to accept that the UK source categorisation of the payments has been established. Assuming that all the other conditions for Double Taxation treaty relief are present, HMRC Residency should then be in a better position both to repay the tax deducted and consider in a more positive light the appropriateness of issuing a Direction under SI 1970/488 for future payments.[190]

This is the most absurd procedure which could be imagined, for in many cases the payor will want to argue that the interest is not UK source but (since one can rarely[191] be sure) will want a direction to pay gross as a safeguard. Perhaps no-one takes any notice of it in practice.

26.31 DTT passport scheme

The DTTP scheme is intended to streamline the procedure for obtaining a DTRR notice.

The scheme is explained in:

HMRC, "Double Taxation Treaty Passport Scheme" (2017) ("DTTP")[192]
HMRC, "DTTP Scheme: Technical questions and answers" ("DTTP Q&As")[193]

The background can be found in HMRC consultation and response papers:[194]

Double Taxation Treaty Passport scheme review (2016)
Double Taxation Treaty Passport scheme review consultation response (2017)

HMRC, "Double Taxation Treaty Passport Scheme" provides:

[190] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/606556/Double_Taxation_Treaty_Passport_Scheme_-_Terms_and_Conditions_and_Guidance.pdf*

[191] The guidance note states complacently that "The meaning of UK-source in this context will not normally give rise to difficulties." The author has not read the HMRC consultation paper on interest which says: "The current tests in UK law of whether … payment of interest is made from a UK source are unclear and cause confusion." See 26.15.1 (Source of interest: Critique).

[192] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/606556/Double_Taxation_Treaty_Passport_Scheme_-_Terms_and_Conditions_and_Guidance.pdf*

[193] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525399/Double_Taxation_Treaty_Passport_scheme_review.pdf*

[194] *https://www.gov.uk/government/consultations/double-taxation-treaty-passport-scheme-review*

DTTP30000 Introduction and general purpose

The Double Taxation Treaty Passport (DTTP) Scheme is an administrative simplification designed to assist certain foreign lenders in accessing reduced withholding tax rates on interest that are available within the UK's tax treaties with other territories. The scheme is available to all UK borrowers who are required to withhold income tax at the basic rate on certain loan interest payments to overseas lenders.

The scheme is administered by the Double Taxation Treaty Team, who can be contacted at HM Revenue & Customs, DT Treaty Team, Barkley House, Castle Meadow Road, Nottingham, NG2 1BA.

The scheme allows certain overseas lenders to be recognised by HMRC as residents of countries with which the UK has double taxation treaty. Proof of this recognition will be the granting of the status as "treaty passport holder".

Loans dealt with under the scheme can, subject to a direction issued by HMRC, be paid with deduction of withholding tax at the rate specified in the relevant treaty.

The scheme exists as an alternative to the certified claim method for reclaiming tax withheld. This method remains available for those lenders not using the DTTP scheme. Guidance on certified claims is available at

https://www.gov.uk/guidance/double-taxation-relief-for-companies

DTTP30010 Commencement of new rules

Prior 6 April 2017 the scheme was restricted to overseas corporate lenders and UK corporate borrowers.

As announced at Spring Budget 2017 the Government extended the scheme for loans entered into on or after 6 April 2017 - the following are key elements:

- The scheme will be made available to all UK borrowers that have an obligation to deduct withholding tax, including UK partnerships, individuals and charities.
- Transparent entities (including partnerships) will be admitted to the scheme as lenders where all of the constituent beneficial owners of the income are entitled to the same treaty benefits under the same treaty.
- Sovereign wealth funds and pension funds who are utilising withholding tax treaty rates will be admitted into the scheme as lenders.

DTTP30020 Overview

An eligible lender will make an application to HMRC to be awarded passport holder status A passported lender will provide the borrower with its Passport number, and the relevant rate at which it believes income tax should be withheld.

HMRC will review the application by the borrower to withhold income tax at the relevant treaty rate, and if the conditions for relief are met it will issue a Direction for the borrower to do so

DTTP30100 Overview of lender eligibility

All corporate entities and certain transparent entities may, following a successful application, be admitted to the DTTP scheme as lenders.

Transparent entities are eligible to apply under the scheme only if all of the constituent ultimate beneficial owners of the income are entitled to the same treaty benefits under the same treaty.

So any entity who is currently entitled to make use of the certified claim procedure on its own account will be able to apply for a passport under the DTTP scheme unless otherwise excluded.

HMRC retains full discretion on whether to admit these entities to the scheme.

26.31.1 *Corporate lender*

DTTP provides:

DTTP30110 Corporate entities
Any overseas corporate entity – or concern treated by its country of residence as a corporate body for tax purposes - is entitled to apply for a treaty passport as a lender.
A separate passport is needed for each entity in a group, and there are no 'group passports' which can be used at group level.
DTTP30120 Branches and permanent establishments
Where, for double taxation treaty purposes, HMRC regards a branch as being indistinguishable from its head office, then the double taxation arrangements the UK has with the country of residence of that head office governs what relief from UK withholding tax might be available to interest paid to the branch.
That being the case, if a loan is suitable for treaty passport treatment when made by the head office, then it can be considered as so eligible when made by a branch, subject to it meeting all other treaty passport criteria for suitability and any tests (such as subject to tax in the head office residence country) laid out in the relevant double taxation treaty relied on to obtain relief.

26.31.2 *Transparent lender*

DTTP provides:

DTTP30130 Transparent entities including partnerships
Transparent entities can participate in the scheme as lenders if all of the ultimate constituent beneficial owners of the income are entitled to the same treaty benefits under the same treaty.
Overseas partnerships are entitled to apply for a treaty passport, but only where all partners are resident in the same jurisdiction and entitled to the same treaty benefits.
When applying for a treaty passport, a partnership should nominate a partner to be responsible for corresponding with HMRC regarding the passport and notifying any relevant changes.

26.31.3 *S corp/LLC lender*

DTTP Q&As provides:

A United States multi-member LLC which has elected under 'check the box' to be taxed on a simple corporate basis is eligible to apply for and use a passport, as it meets the criteria of both Article 3(1)(b) of the UK/USA Double Taxation Convention and paragraphs 1 and 3 of the Treaty Passport Scheme Terms and Conditions.

That seems self-evident.

HMRC is also prepared to consider issuing a passport to a US LLC which is wholly owned by a US corporate single member, and which is treated for US tax purposes as a disregarded entity, fiscally indistinguishable from its parent.
Although US S-corporations are required to file separate US income tax returns they are

(in broad terms) required to determine and allocate 'tax attributes' (linked to business profits) to their individual owners proportionate to their share ownership; these tax attributes are then brought into account in assessing that owner's overall tax exposure.
Drawing a general analogy with the circumstances of a disregarded entity LLC, HMRC will consider issuing a passport to an S-corporation which is owned by a single US corporate owner, with the entirety of the tax attributes of the S-corporation thus attracted to that single owner.

26.31.4 *Sovereign/pension fund lender*

DTTP provides:

DTTP30140 Sovereign wealth funds and pension funds
Sovereign investors and pension funds who are utilising treaty withholding tax rates may participate in the scheme if the ultimate beneficial owner of the income is entitled to the same treaty benefits under the same treaty.
This process is separate from, and has no impact on, the process for making a claim relating to sovereign immunity.
HMRC will accept applications made by the trustees of the pension fund in their capacity as representatives of the fund's members. A copy of the Pension Trust Deed should be provided in support of the application.

26.31.5 *Syndicated loan (joint lenders)*

DTTP provides:

DTTP30160 Syndicated loans
A syndicate as such cannot be a treaty passport holder. Where the syndicate has chosen to be treated as an entity under the Syndicated Loan Scheme ("SLS"), formerly the Provisional Treaty Relief Scheme, it will be the syndicate manager who conducts the syndicate's dealings with HMRC. Possession of a passport by the overseas lender will help the syndicate manager to judge the availability of double taxation relief available to the syndicate as a whole.
If passport holders are lending members of a syndicate that is outside the SLS, then it is open to them to make use of their passport in substitution for a certified claim (assuming the satisfaction of all relevant DTTP scheme conditions – for example, beneficial ownership where relevant). The UK borrower must then tell HMRC of that use with a DTTP2 notification, leading to the issue of a Direction enabling relief at source on the interest payments to that passport holder.
Overseas lending members of a non-SLS syndicate that do not possess a passport will need to make a certified claim in the normal way.
Where a UK borrower has a loan facility with multiple lenders, and frequent buying into or trading of debt-right, then HMRC recognises that individual DTTP2 notifications may place an undue compliance burden on that borrower. As a consequence, HMRC is willing to consider entering into arrangements with that borrower whereby these individual notifications can be swept up into a monthly consolidated DTTP2A notification. This will still require a passport holder to follow the standard DTTP procedure with the borrower - for example, specifying the rate of double taxation relief it considers itself entitled to - but in a modified form appropriate to the borrower's circumstances. UK borrowers

wishing to enter into such arrangements with HMRC should contact: HM Revenue & Customs, LBS DT Treaty Team, Barkley House, Castle Meadow Road, Nottingham, NG2 1BA, telephone 03000 547584.

26.31.6 *Transfer of loan*

DTTP provides:

DTTP30170 Secondary loan market
Acquisition of a loan by a third party may create a new payer/payee relationship between the UK borrower and the overseas acquirer of the loan.
Where a passport holder acquires a loan for which withholding tax is due on the interest payments, they will be eligible to use the scheme in the normal way where all other requirements are met.

26.32 DTTP scheme: Guarantors

DTTP provides:

DTTP30180 UK guarantors
The exposure of a guarantor of a debt will be contingent on whether it will be called on to act on that guarantee in the case of default by the principal debtor, and assume the responsibility for making interest payments. Any payments not categorised as interest will not be subject to withholding tax and therefore not come into consideration in a treaty passport context.
In the case of such default, a new payer/payee relationship can then be said to exist between the guarantor and the overseas owner of the debt-right, which can then expose the guarantor to a withholding tax obligation. While the loan arrangements giving rise to the guarantee might have existed for some time, and was contracted with a UK borrower other than the guarantor, for the purposes of the DTTP scheme HMRC regards the date from which the guarantee is called upon (and the guarantor assumes liability for payments) as the beginning of a new loan relationship amenable to the use of a passport.
On this footing, and conditional on the guarantor and overseas lender otherwise meeting the conditions of the scheme, and absent any resulting changes in the overseas owner of the debt-right, the latter may make use of its passport in substitution for a certified claim in the usual way.
This is subject to there being no bar to the use of the passport found elsewhere in the DTTP scheme terms and conditions and guidance.

26.33 DTTP scheme: Application process

DTTP provides:

DTTP30200 Application process
Applications for passport holder status are made using a form DTTP1, which is available online for download and postal submission. Applicants must obtain a certificate of residence from the overseas tax authority where they are resident. This residence certificate should have been issued within the last 12 months.
If accepted onto the scheme, each passport holder is given a unique identifying reference number to be used in all DTTP scheme correspondence.

Passports are valid for a period of 5 years, after which point they may be renewed.

The consideration and acceptance of an applicant's request for passport holder status shall be entirely at the discretion of HMRC.

DTTP30300 Register of passport holders

A register of recognised passport holders is kept by HMRC and is available to the general public to verify a passport holder's status. Included on this register is the name of the lender, their unique DTTP scheme reference number and country of residence.

In participating in the DTTP scheme, passport holders agree that HMRC may publish their name and DTTP scheme identification details in the register. A lender can use the certified claims method for obtaining treaty relief to avoid the publication of their details.

26.33.1 *Conditions for use*

DTTP provides:

DTTP30400 Conditions for use

A passport holder will enter into a loan making use of the DTTP scheme only where all conditions for relief under the relevant double taxation arrangements are satisfied.

This will include (but not be restricted to) factors such as:

- where being subject to tax in the passport holder's country of residence is required
- where relief is restricted only to the amount of income remitted to that country of residence (where it is not intended to remit the entirety, then the DTTP scheme will not be available or used)
- where the passport holder cannot reasonably demonstrate that it is the beneficial owner of the interest (in the international fiscal meaning of that term), and where this is a requirement for relief.

HMRC reserves the right not to apply the DTTP scheme facility to a particular loan, in which eventuality it will notify both lender and borrower as early as possible.

26.33.2 *Change of circumstances*

DTTP provides:

DTTP30410 Material changes to lender circumstances

A passport holder will be obliged to notify HMRC if there are any material changes to its form or circumstances.

Examples of material changes include the following:

- a change in its correspondence address
- a change in its business form (such as following a merger)
- a change of its name
- a change in its country of residence
- for non-corporate entities, any changes in the country of residence of any of its constituent members
- for non-corporate entities, any changes in its underlying constituent membership
- any other change of circumstance which would potentially require HMRC's consideration when issuing a passport

Failure to do this may result in the suspension or revocation of passport holder status, at HMRC's discretion.

DTTP30420 Material changes to a loan or its ownership

In certain circumstances, where there is a material change in the terms or ownership of a loan subject to a direction, the lender should notify HMRC to ensure that relief-at-source can continue to apply.

As a general rule, and assuming that all relevant treaty passport criteria are met, if a claim form would previously have been necessary to notify HMRC of a material change in the terms of a loan then lenders may use the treaty passport process instead.

Specifically, this can cover:

- Changes in material circumstances in the lifetime of a Direction. Guidance on what constitutes a material change can be found in DT Guidance Note 2 (reproduced as Appendix C of this guidance).
- Contractual extensions of a loan (being an instance of such a material circumstance).
- The sale or assignment of a loan. If the loan commenced before 06 April 2017 (the date the new DT Treaty Passport scheme rules commenced) and is sold or assigned after that date, HMRC will for passport purposes treat the date of sale or assignment as being the date the loan commenced.
- 'UK-source' applications dealt with by DT Guidance Note 1 (reproduced as Appendix B of this guidance) and allowed for under the DTTP scheme's terms and conditions - (where the borrower believes that it would be liable to UK withholding tax on interest payments).

Where the existing or new lender is a passport holder; a borrower may then submit a DTTP2 notification in place of a claim form (certified or otherwise) from the lender that would otherwise be required.

Lenders should consider all Guidance Notes mentioned above before applying for relief at source through the treaty passport route, as compliance with them will still be incumbent to the parties to a loan.

So far as changes, extensions and transfers of debt-right are concerned HMRC would expect lenders to take particular care to judge whether the material changes involved are potentially of such a nature as would prudently merit a fresh claim or passport application (where, for example, the passport holder's name has changed).

This is a matter for the parties to the transaction to weigh up for themselves, having regard to factors including (but not limited to) the commercial terms of the new or extended loan relationship, and any cross-ownership or community of interest relationship between the parties to a deal.

In regard to the above HMRC reserves power of discretion at all times to ensure that the scheme is used appropriately.

26.33.3 *Securitisation*

DTTP provides:

DTTP30430 Securitisation of contractual debt

In certain circumstances HMRC will accept the use of the DTTP scheme process by a passport holder purchasing or acquiring securitised contractual debt-rights, such as a portfolio of poor performing or toxic debts. The circumstances HMRC is willing to extend the use of the treaty passport facility are:

- the purchase or acquisition of the debt-right by the passport holder is effected in a single transaction, and

- interest payments are gathered in and paid on under a single asset management agreement.

Particular regard should be had as to whether the basic conditions of the DTTP scheme are met, especially concerning beneficial ownership considerations (where pertinent to the availability of relief), by the parties to these sorts of transactions in judging whether the use of a treaty passport is appropriate

26.33.4 *HMRC reviews*

DTTP provides:

DTTP30440 HMRC's right to review passport holder and loan information

It is a requirement of the DTTP scheme that passport holders co-operate with HMRC when it conducts a review of lender status or any other aspect of the scheme. This means providing HMRC with all information requested in connection with such a review.

That co-operation shall extend to providing HMRC with copies of loan documentation, information about any loans entered into using a treaty passport and any other information requested.

The passport holder may be specifically required to provide a schedule of 'passported' loans contracted by it within a specified period; that schedule identifying the UK borrowers, dates of loans and amounts lent.

26.33.5 *Process for borrowers*

DTTP provides:

DTTP30500 Eligibility – borrowers

For loans entered into on or after 06 April 2017 the DTTP scheme may be used to obtain double taxation treaty relief on UK loan interest payments made by any UK resident borrower (or any non-UK resident borrower with UK source income) obliged to withhold income tax under section 874(2) Income Tax Act 2007.

For loans entered into between 1 September 2010 and 5 April 2017 only loan interest payments made by UK corporate borrowers (or non-UK resident borrowers with UK source income) fell within the scheme, subject to the old terms and conditions (see DTTP31000).

DTTP30600 Entering into a passported loan

Simply entering into a loan with a passport holder does not automatically allow the borrower to withhold tax at the treaty rate when making interest payments: the borrower must also notify HMRC that they have entered into the loan using form DTTP2.

DTTP30610 DTTP2 process

Once in possession of a treaty passport, a passport holder then has the potential to enter into a loan agreement that can be dealt with under the DTTP scheme.

The passport holder should in that case provide the borrower with its DTTP scheme reference number (verifiable by reference to the online register of passport holders), and specify the rate of relief applicable under the relevant double taxation treaty in force, so that the UK borrower (or foreign borrower with UK-source interest payments) can enter these details into the DTTP2 notification to HMRC.

The DTTP2 form can be accessed via the Gov.uk website. Borrowers have the option of printing the form and posting it, or of submitting it online.

On receipt of their online submission acknowledgement, borrowers who submit the DTTP2 online may, if they wish, provisionally withhold at the relevant treaty rate in advance of receiving a formal Direction.

If a UK resident borrower (or any non-UK resident borrower with UK source income) applies the wrong rate of relief, they will be obliged to make any corrective payments to HMRC.

HMRC reserves the right not to apply the DTTP scheme facility to a particular loan. In this eventuality the lender and borrower should be notified as soon as possible.

DTTP30630 Directions to pay tax under treaty rate

If on receipt of a DTTP2 form HMRC will check if all conditions for relief under the relevant double taxation treaty are met, the borrower will be sent a Direction under Regulation 2 SI 1970/488, instructing them to either to

- not deduct tax, or;
- not deduct tax at a higher rate than is specified in the notice, or
- deduct tax at a rate specified in the notice instead of at the lower or basic rate otherwise appropriate

The Direction will specify the period it is valid for. This will usually be no longer than 5 years.

DTTP30640 Consequences of failure to notify HMRC of entry into a passported loan

If the UK resident borrower (or non-UK borrower with UK source income) does not notify HMRC that they have entered into a loan from a passport holder that they consider to be a passported loan, they will be required to withhold tax at the basic rate regardless of the passport holder's status.

HMRC reserves the right to request payment of tax and/or interest in such cases.

If the UK borrower does not send a DTTP2 notification to HMRC before the first interest payment, then HMRC can give no assurance that any Direction will be issued in time to be applied to a particular interest payment.

The UK borrower may therefore not get a Direction before it has to make interest payments.

If HMRC is unable to issue a Direction before a particular interest payment is made, the borrower must fulfil its legal obligation to withhold tax, and the passport holder will need to make a certified repayment claim (see DTTP30650).

DTTP30650 Repayments of withholding tax

A claim for repayment of tax shall be made by the passport holder in writing and should include the name of the borrower, date(s) of payment, gross amount(s), amount of tax deducted and repayment instructions.

DTTP30700 Renewals

When granted, a passport will be valid for 5 calendar years from the date of granting.

A passport may be renewed on application to HMRC by letter to HM Revenue & Customs, LBS DT Treaty Team, Barkley House, Castle Meadow Road, Nottingham, NG2 1BA, not less than 3 months before the date of expiry.

If there have been no material changes since the original passport is granted then the passport will be renewed for a further 5 year period subject to HMRC conducting necessary checks. If an application for renewal is not received by the expiry date, then passport holder status shall be withdrawn.

Lenders will take full responsibility for ensuring that renewal applications are made timeously.

DTTP30800 Sanctions for misuse

A passport holder found to be in breach of these terms and conditions may, depending on the gravity of any breach:

- receive a formal warning that a further breach may result in the suspension or removal of their passport status; or
- have their passport status suspended for a fixed period, said period being entirely at the discretion of HMRC; or
- have their passport holder status removed, said removal and any conditions which may be attached thereon, being entirely at the discretion of HMRC.

Determination of whether a breach of these terms and conditions has taken place will be entirely at the discretion of HMRC.

DTTP30810 Effects of cancellation of a passport on an existing Direction

In the event of a lender's passport holder status being withdrawn, the borrower can rely on a Direction in the usual manner unless informed otherwise by HMRC in a notice of cancellation. The content and issuing of a notice of cancellation is entirely at the discretion of HMRC.

For the avoidance of doubt, the loss of passport holder status by a lender will not of itself be viewed as a material change invalidating a Direction.

In a connected party lending scenario, the borrower may be liable to withhold tax if it knew, or might reasonably be expected to know, that the passport holder did not qualify for relief.

DTTP30900 Interaction with other provisions

The DTTP scheme is distinct from Council Directive 2003/49/EC (EU Directive on Interest and Royalties) and s.888A ITA 2007 and SI 2015/2002 (Private Placement legislation).

For the avoidance of doubt the DTTP scheme is an administrative simplification within existing legislation covering withholding tax on payments overseas that are relievable under double taxation treaties, namely s.874 ITA 2007 (as may be amended or re-enacted) and SI 1970/488.

Accordingly the DTTP scheme should not be used in relation to withholding tax in respect of the legislative provisions such as those mentioned above.

...

26.33.6 *Change of circumstances*

DTTP provides:

DTTP31200 Appendix C – Double Taxation Guidance Note 2

Changes of name and business account details during the lifetime of a Double Taxation relief at source

This Guidance Note explains how changes in payer and payee name and business details may affect the validity of an existing Direction for UK payers to make payments of interest/royalties to non-UK residents which incorporate double taxation treaty relief. It sets out the circumstances in which such changes can trigger the need for a fresh application for relief at source from the non-resident.

Background

Under Chapter 3 of Part 15 Income Tax Act 2007 ... there is a general obligation on UK payers of interest and royalties to deduct and account for tax at a stipulated rate to HMRC.

HMRC Residency has the discretion to give Double Taxation (DT) treaty relief at source by directing, under Regulation 2 of SI 1970 No. 488, a UK payer of relievable income to make subsequent payments either without deducting income tax at the statutory rate, or by deducting an amount specified by reference to the DT treaty appropriate to the country of residence of the payee.

In the absence of a Direction, or where it may be reasonably inferred that an existing Direction has become invalid by reference to the conditions under which it was issued, the UK payer is bound to deduct and account for tax in the normal way. Failure to do so may result in the UK payer being assessed for the tax that should have been deducted from the payments in question and being charged to interest and penalties.

Both the UK payer and the non-resident payee are specifically named and identified, using the information supplied to HMRC Residency in the application for treaty relief.

The Direction itself clearly states that it will 'cease to have effect if ... the recipient of the income changes...' In strictness this means the Direction would become invalid by any change in the name or details, no matter how minor, of the account to which payments are being made by the UK payer.

That can't be correct. But the point will not often arise.

Compliance issues

Whilst HMRC Residency has to fulfil its obligations to protect the UK Exchequer and taxpayer, it seeks to keep the compliance and administrative work required from its customers to a minimum.

Changes in the name and business details of either the UK payer or the non-resident payee may signify a more fundamental change to the basis on which DT treaty relief was authorised in the first place. And this could mean that relief is either no longer available or that the terms under which the Direction was issued must be reconsidered.

The key issue that HMRC Residency must have regard to is whether there has been any change in the underlying beneficial ownership of the income in question, and of the relationship between the beneficial owner(s) and the UK payer, that could prejudice the basis on which treaty relief was initially authorised.

The HMRC Residency approach

HMRC Residency adopts the following broad tests in deciding what further action is appropriate where there have been changes in the name and business details of either the UK payer or the nonresident payee.

Changes affecting the UK payer

- If the UK payer changes its name with no change of ownership it will be unable to rely upon the cover of the existing Direction, which was issued to it under a different name. But if it advises of the change, HMRC Residency is willing to consider issuing a replacement Direction in the new name of the payer without a fresh application from the non-resident payee.

Reasoning: the assumption is that a superficial (and thus non-material) change only has taken place.

- If beneficial ownership of the UK payer changes or it is the subject of a merger or other restructuring, and it notifies of the changes, HMRC Residency will ask the UK payer's tax office whether or not there is any objection to the issue of a new Direction, without a fresh application being required. A new Direction would, so far as possible, be worded to provide cover for the UK payer from the time of any changes.

Reasoning: the tax office is alerted to any emerging tax consequences for the UK tax base (for example transfer pricing) and can in return flag up any prejudicial elements for the basis of the DT claim (for example a special relationship question). This should identify at an early stage cases where a fresh application for treaty relief is needed, or where the extent or form of the relief must be otherwise re-assessed.

Changes affecting the non-resident payee

- If the non-resident payee simply changes its name and there is no change of ownership, and advises to this effect, HMRC Residency will ask for documentation of the name change and consider issuing a fresh Direction with the new payee details. Such a Direction would cover the period from the changes in payee details.

Reasoning: no fresh application is likely to be justified, using the same assumptions as within bullet one above.

- If beneficial ownership of the non-resident payee changes or it is the subject of a merger or business restructuring, HMRC Residency will require a fresh application from the payee. It will process this in the normal way, and where it is satisfied treaty relief is due will issue a new Direction, subject to the normal rules about retrospection: see the article ‘Treaty Claims and Loan Interest’ in Tax Bulletin Number 12 of August 1994 - the principles underlying which are now applied to all forms of UK source income, and not just interest.

Reasoning: the overseas concern that was previously successful in claiming treaty relief has changed in a sufficiently substantial and material way as to justify a re-establishment of that entitlement.

Conclusion

UK payers especially should take careful note of the wording and terms of any SI 1970/488 Direction issued to them in order to understand fully their obligations to deduct tax at the appropriate treaty rate.

Prompt notification of changes of name or beneficial ownership etc. will allow HMRC Residency to give fresh consideration to the terms of the Direction and enable it to issue a new notice where appropriate at the earliest opportunity and so give the UK payer or non-resident payee certainty of treatment.

If you consider that you may be affected by such changes, you should contact HMRC Residency caseworkers immediately, quoting the HMRC Residency ‘FD…’ reference given on the Direction or used in correspondence with this office.”[195]

26.34 No notice to pay gross

INT Manual provides:

> **INTM413220 Consequences of failing to deduct withholding tax** [Feb 2020]
>
> ...
>
> An application by the overseas lender under a DTA or under the EU Interest & Royalties Directive (INTM400000), is likely to be made up of

[195] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/606556/Double_Taxation_Treaty_Passport_Scheme_-_Terms_and_Conditions_and_Guidance.pdf*

two elements, depending largely on how promptly the claim follows the making of the loan. These are:

- A clearance application - for S874 no longer to apply (or only to apply to a lower rate of withholding specified in the relevant tax treaty) to a specific loan. If the application is successful, the payer will receive a notice issued under SI488/1970 advising them that they may henceforth, for a specified period, pay interest gross or at the lower rate on the income named in the notice;
- A repayment claim - for the lender to have paid to them tax which the payer of the interest has accounted for to HMRC in compliance with their S874 obligation, prior to the notice being issued.

Forms available on the HMRC website cater for both aspects on a single form.

It is vital to understand that until the payer receives a clearance notice directing them to do otherwise, the payer must continue to withhold and account for the income tax on interest payments made to an overseas lender. The UK payer is not entitled to anticipate either the lender making an application or the outcome of them doing so. It is immaterial whether the lender is a fellow group company to the borrower, or a vast European lending institution for which the borrower is just another customer.

If the payer fails to observe the obligation to withhold and pay, or only does so late, HMRC can assess and recover the tax, and charge late payment interest under TMA70/S87 on the outstanding income tax, running from the tax due date to the date of payment. See INTM413240 for what may happen in circumstances where a valid clearance/repayment claim is received...

Assessing the unpaid income tax

Chapter 15, Part 15 of Income Tax Act 2007 ... provides for returns and collection of income tax in respect of payments falling within ITA07/S946, which specifically includes payments of yearly interest where a deduction is required under s874.

The rules, under ITA07/S951 are that:

- the income tax at the basic rate on the interest is due on the same date as the return reporting the payment,
- both the return and tax are due within 14 days of the end of the quarter within which the payment of interest was made
- no assessment is required for collection of this tax.

This means that withholding tax, and where applicable, late payment interest, are due and payable even if HMRC does not raise an assessment.

ITA07/S957 sets out what should happen if it appears that a section 946

payment (which this is) has not been included in a return, and the tax arising on the payment has not been paid ...
Note that the onus is on the payer to fulfil their obligation, and to rectify the position if they do not.

26.35 Grossing-up: Not interest

If the loan agreement provided for grossing up where withholding tax applies, the creditor may compensate the debtor for over-payment.
INT Manual provides:

> **INTM413220 Consequences of failing to deduct withholding tax** [Feb 2020]
> **Grossing up clauses**
> "Grossing up clauses" appear in loan agreements, requiring borrowers to pay over interest without withholding income tax, irrespective of the clearance position, so that domestic withholding obligations are at the expense of the borrower and the lender gets 100% of their interest. From a loan relationships point of view HMRC accepts that any additional amount paid under a grossing up clause is a loan relationship expense, but it is not interest. If the borrower received the grossing up amount back from the lender, possibly after the lender had made a successful treaty claim, the repayment would be treated as a loan relationship credit.
> If £100 of interest is paid over, representing the full amount of interest due, the withholding tax is £20, assuming the rate to be 20%. There is a school of thought that treats the amount paid over as if it were the net amount, so that the £100 should be "grossed up" to £125 with income tax of £25 (20% × £125). This is incorrect.
> The existence of a grossing-up clause does not affect the obligation to withhold income tax.

26.36 Failure to withhold

INT Manual provides:

> **INTM413230. The interaction between UK taxing rights and double taxation agreements** [Jan 2020]
> ...If the lender obtains clearance before any interest has been paid, then for the period of the clearance all the interest accruing on the loan can be paid without deduction, or paid subject to a lower rate of income tax, depending on the DTA. However, a problem arises when the benefits set out in the DTA have not yet been obtained and the company paying the yearly interest does so - for whatever reason - without withholding and accounting for the income tax.
> Once treaty clearance has been granted (following a successful certified

DTA application), income tax will either no longer be withheld or may be withheld at a lower rate, it must also be recognised that clearance applies only to arm's length interest payments made after the clearance is granted. The obligation to deduct income tax from yearly interest paid prior to clearance will not have been removed, and therefore remains enforceable. For payments of interest made before clearance is notified, double taxation is relieved by the lender making a claim for repayment of the income tax withheld. Forms available on the HMRC website allow repayment claims to be made at the same time as the certified application for treaty benefits, although the repayment relief can only go back 5 years after the 31st January next following the year of assessment to which it relates (TMA70/S43(1)).

TMA70/S87 - late payment interest

In addition to the unpaid income tax remaining due and payable on payments of yearly interest not covered by a treaty clearance notice, late payment interest will accrue under TMA70/S87 on any unpaid tax, from the due date (normally 14 days after the quarter in which the yearly interest was paid) until payment. It will accrue whether or not the income tax has been assessed, and while any income tax paid can be repaid if it is subject to a valid repayment claim from the lender. For non intra EU loans and royalty transactions, there is no relief or discharge from the TMA70/S87 interest charge on the payer.

The TMA70/S87 late payment interest charge is both mechanical and neutral, and accrues at the same rate irrespective of the reason for late payment. While it is not a penalty (though penalties are available for failure to make a return under Part X of TMA70), it stands to reason that if the loan is large, and the tax is outstanding for a long time, the interest charge will be correspondingly greater than in other circumstances.

This is the position for pre-clearance interest payments which have been made gross, even after a DTA clearance application has been made, and clearance granted. While the UK may give up its taxing rights, HMRC does not give up its right to recompense for the late payment of the income tax from the time when it was due. UK taxing rights do not simply disappear following a DTA clearance application, taking with them all associated obligations. HMRC surrenders primary taxing rights to the tax authority of the claimant's country of residence, but retains the power to assess income tax which has not been accounted for and which has not been paid gross under a notice giving permission to do so. Interest payments made before the date on which clearance takes effect are not subject to the clearance. This is the statutory position, unaffected by the fact that assessment and collection of the tax might take place after a certified DTA clearance application has been lodged, in circumstances where it would be immediately repayable to the applicant (assuming a successful claim).

However, in circumstances where there is an established entitlement to repayment, HMRC will by concession, circumvent the assessment and repayment process, and if assessments are raised, they will be "interest only" assessments to collect the TMA70/S87 interest.

Assessing only the TMA70/S87 late payment interest - concession

Despite the existence of the powers mentioned above to recover the tax owing, HMRC considers that in circumstances where it is clear that

- the overseas recipient of the interest has applied for, and has been granted, clearance to receive future interest payments from the source in question without deduction of income tax under SI 1970/488; and
- the lender would be entitled to repayment of the tax for the period for which income tax should have been withheld, so that it is clear that if tax had been accounted for each period concerned, ultimately HMRC would not have retained it

the right to assess and collect the tax will be set aside and only the TMA70/S87 interest will be sought. This will of course be limited to tax which is at the time of the concession both collectible and repayable. For more detail, see the Thin Cap Practical guidance from INTM510000 onwards.

The notion that tax collected from the payer will inevitably be repayable to the overseas recipient is not one that may be assumed. It must be established as a fact and a legal right. It is not a reason for not withholding. ...

26.37 Claim procedure: Critique

The deduction scheme for royalties allows self-certification in all cases. It is suggested that a similar system should be introduced for interest.

CHAPTER TWENTY SEVEN

EXEMPT INTEREST OF NON-RESIDENTS

27.1 Exempt interest: Introduction
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27.1 Exempt interest: Introduction

This chapter considers exemptions for interest received by non-residents on securities issued by the UK or public bodies:

(1) FOTRA securities
(2) Foreign currency securities
(3) International securities

For the policy issues here, see 26.18 (Non-residents on UK interest: Outline).

27.2 “FOTRA securities”

Section 713(2) ITTOIA provides:

> In this Chapter “FOTRA security” means—
> (a) a security issued with a condition about exemption from taxation authorised by section 22 of F(No.2)A 1931,
> (b) a gilt-edged security which was issued before 6th April 1998 and without any such condition (other than 3½% War Loan 1952 Or After), or
> (c) 3½% War Loan 1952 Or After.

FOTRA stands for ‘Free of Tax to Residents Abroad’.

27.2.1 *The exemption condition*

Section 713 ITTOIA provides:

> (3) In this Chapter "the exemption condition" has the meaning given by subsections (4) to (6), according to the kind of FOTRA security involved.
> (4) In relation to a security within subsection (2)(a), it means the condition authorised by section 22 of F(No 2)A 1931.
> (5) In relation to a security within subsection (2)(b), it means a condition with which 7.25% Treasury Stock 2007 was first issued, being a condition treated by section 161(1) of FA 1998 (non-FOTRA securities)—
> (a) as a condition with which the security within subsection (2)(b) was issued, and
> (b) as a condition authorised in relation to its issue by section 22 of F(No 2)A 1931.
> (6) In relation to 31/2% War Loan 1952 Or After, it means a condition of its issue authorised by section 47 of F(No 2)A 1915.

For these provisions see 75.5 (FOTRA exemption conditions).

27.3 Interest withholding tax

Withholding tax on public revenue dividends is governed by Chapter 5 Part 15 ITA. I do not discuss this here in full. However note that s.893(1) ITA provides:

> A payment of a UK public revenue dividend is payable gross if—
> (a) it is a payment of interest on gross-paying government securities, and
> (b) no deduction at source application has effect in respect of the securities at the time the payment is made (see section 895).

Thus there are three conditions for gross payment. First the security must be a UK public revenue dividend, defined s.891 ITA:

> In this Chapter "UK public revenue dividend" means any income from securities which—
> (a) is paid out of the public revenue of the UK or Northern Ireland, but
> (b) is not interest on local authority stock.

Secondly the security must be a gross-paying government security, defined s.893(2) ITA:

> In this Chapter "gross-paying government securities" means—
> (a) gilt-edged securities (see section 1024), or
> (b) securities which are the subject of a Treasury direction under section 894(1) or (3).

Thirdly, holders may ask for tax to be deducted at source. It must be rare to want to apply for tax to be deducted, though it might perhaps be convenient for a basic rate taxpayer who does not otherwise have to put in a return.

See too 26.19 (Withholding taxes: Introduction).

27.4 FOTRA exemption

Section 714 ITTOIA provides:

> (1) No liability to income tax arises in respect of profits from a FOTRA security if conditions A and B are met. ...
> (3) Condition A is that the profits are stated in the exemption condition to be exempt from income tax.
> (4) Condition B is that any requirements for obtaining the exemption imposed by the security's conditions of issue are met.

A non-resident individual or company would qualify for non-resident IT relief on the interest, so the FOTRA exemption only matters in unusual cases, such as split years (where non-resident IT relief does not apply).

27.4.1 *s.624/s.720*

Section 714 ITTOIA provides:

> (5) Whatever the exemption condition provides, amounts charged under the provisions specified in subsection (6) are not exempted by subsection (1).
> (6) The provisions are—
> Chapter 5 of Part 5 (settlements: amounts treated as income of settlor) so far as it applies to income within section 619(1)(a) or (b), and
> Chapter 2 of Part 13 of ITA 2007 (anti-avoidance provisions: transfer of assets abroad).

These anti-avoidance provisions override FOTRA exemption.

27.4.2 *Trading receipts/deductions*

It may happen that:

(1) A non-resident is carrying on a trade in the UK through a UK branch or PE, and
(2) FOTRA interest is a trading receipt.

In these circumstances, the FOTRA exemption in principle applies.[1]
Section 716 ITTOIA provides:

> (1) A person who meets conditions A and B may not bring into account for income tax purposes—
> (a) any amount relating to changes in the value of a FOTRA security, or
> (b) expenses related to holding it or to any transaction concerning it.
> (2) Condition A is that the person is the beneficial owner of the security.
> (3) Condition B is that the person is a person who would be exempt from tax on the security under this Chapter.

The trade receipt may be excluded from computations of profit, but previously, related expenses may still be deductible in computing trade profits; see *Hughes v Bank of New Zealand* 21 TC 472.

27.5 Beneficial ownership

For a general discussion of beneficial ownership, see App. 6.2 (English-law beneficial ownership). The International Manual provides:

> **INTM368040. The FOTRA condition** [Dec 2019]
> ...
> *Beneficial ownership of the security*
> To demonstrate beneficial ownership of the security, the claimant must hold the security on the interest date. In strictness a person who has sold a FOTRA security but receives the next interest payment due (an ex-dividend sale) ceases to be the beneficial owner of the security when he sells it.

It would be strange if an ex-dividend sale caused the interest received post sale to become taxable, and I doubt if that can really be correct. In practice perhaps it does not often happen.[2]

[1] See 71.20 (Characterisation). At one time, gilt prospectuses restricted the FOTRA exemption so it did not apply to interest received as part of a UK trade, but this practice ceased in 1996.

[2] For completeness, The INT Manual continues:
“There is a column on the A1 claim form with the heading ‘If sold, date of sale or

27.6 FOTRA securities: Trust

27.6.1 *Interest in possession trust*

The TSE Manual formerly provided:

> **Interest in possession trust**
> For any beneficiary who is not ordinarily resident in the UK the interest is not taxable. Trustees should not include it on the returns. The authority for this is *Williams v Singer* 7 TC 387 (TSEM7070).
> In any other circumstances the interest is taxable. It must go on the trust returns.

This book formerly commented:

> Thus (although not clear from the statute) all that matters is the residence of the life tenant. That is sensible.

The Manual passage was deleted in 2014. If HMRC wish to change a longstanding practice[3] their customers might reasonably expect a little more than to quietly delete a sentence or two from the Manual. But it is unclear whether HMRC seek to resile from the former Manual position. ESC B18 is consistent with the former HMRC view.[4]

27.6.2 *Discretionary trust*

The position has altered by the abolition of ordinary residence in 2013. In order to follow the transitional rules, one needs to know the original and the current versions of s.715 ITTOIA. It is helpful to set them out in track change format:

> (1) This section applies if—
> (a) a FOTRA security is held on trust, and
> (b) apart from this section, interest payable on the security would

write still held'. Entries in this column will alert you to a sale before the interest date. You should obtain guidance from Technical Advice Group before you take any action if
- a FOTRA security was sold before the interest date
- that column is left blank" ...

This is more than a decade out of date since from 1998 interest is paid gross and claims for repayment of deducted tax (formerly on form A1) are not needed.

[3] I do not know when the practice originated, but it predates the Taxhub archive which started in 2006.

[4] See 41.10 (ESC B18: non-resident trust).

> not be exempt from income tax under section 714 because of the security not being in the beneficial ownership of a ~~person not ordinarily UK resident~~ non-UK resident person.
>
> (2) For the purposes of determining whether the interest is exempt under section 714 it is to be assumed that the security is in the beneficial ownership of a ~~person not ordinarily UK resident~~non-UK resident person if none of the beneficiaries of the trust[5] ~~is ordinarily UK resident at the time when~~is UK resident for the tax year in which the interest arises.

Para 52 sch 46 FA 2013 provides the transitional relief:

> In relation to a FOTRA security issued before 6 April 2013, the amendments made by this paragraph apply only if the security was acquired by the trust on or after that date.

EN ITTOIA change 116 provides:

> **Change 116: Interest from FOTRA securities held on trust: s.715**
>
> This change gives statutory effect to a practice relating to interest arising from FOTRA securities held on trust.
>
> FOTRA exemptions apply where gilt-edged securities are in the beneficial ownership of persons who are not ordinarily resident in the UK. The source legislation, principally section 154 of FA 1996, is rewritten in Chapter 6 of Part 6 of this Act. The beneficial ownership test lies within the definition of "FOTRA security" as it is part of the exemption condition of the securities. (See, in particular, section 22 of F(No 2)A 1931).
>
> Although in the case of bare trusts and trusts with an interest in possession, it is fairly clear where the beneficial ownership lies, in the case of discretionary or accumulation trusts it can be difficult to apply the beneficial ownership test. In some types of trust the beneficial ownership of an asset is, in effect, in suspense. In others, while it may be clear where the beneficial ownership lies, it may belong to a different

[5] Defined in s.715:

> (3) In subsection (2) "beneficiaries of the trust" includes any person known to the trustees as a person—
>
> (a) who is, or will or may become, entitled under the terms of the trust to receive income under the trust, or
>
> (b) to whom or for whose benefit such income may be paid or applied.
>
> (4) In subsection (3) "income under the trust" includes any property held on the terms of the trust and falling to be treated as capital so far as it is or represents amounts received by the trustees as income.

> person from the person entitled to the income.

The author does not have a sound grasp of the English law concept of beneficial ownership, but it does not matter, as the passage continues:

> In practice, where interest from FOTRA securities held in trust arises to trustees and none of the beneficiaries of the trust is ordinarily resident in the UK, the beneficial ownership test is regarded as met whatever kind of trust is involved and no account is taken of whether the trustees themselves are resident or ordinarily resident. So if all the potential beneficiaries of a discretionary or accumulation trust (that is, those who have the right, at the discretion of the trustees, to benefit from the trust income or accumulated income) are not ordinarily resident in the UK, the FOTRA beneficial ownership test is treated as having been met.
> Section 715 of this Act gives effect to this practice. So, for the purposes of determining whether interest arising from a FOTRA security held in trust is exempt from income tax under section 714 of this Act, it is to be assumed that the security is in the beneficial ownership of a person who is not ordinarily resident if none of the beneficiaries of the trust is resident when the interest arises. (See section 715(1) and (2)). Section 715(3) defines "beneficiaries of the trust" widely so as to cover all potential income beneficiaries of discretionary and accumulation trusts. Section 715(4) brings in beneficiaries receiving accumulated income. This change is in taxpayers' favour in principle. But it is expected to have no practical effect as it is in line with current practice.

This applies even to a UK resident trust.

The TSE Manual provides:

> **TSEM3185 Trust income: FOTRA securities - resident trustees** [Mar 2018]
>
> ...
>
> **Trustees of non-bare trusts**
>
> Trustees in receipt of FOTRA income need to know whether or not to Self-Assess liability on the trust return. ITTOIA/S715 provides that where:
>
> - all the beneficiaries are not ordinarily resident in the UK (where securities were acquired before 6 April 2013) or
> - all the beneficiaries are not resident in the UK (where securities were acquired after 5 April 2013).
>
> the trustees are treated as being the beneficial owner of the securities, and exempt from tax on the income. S715(3) and (4) define 'beneficiaries of the trust' widely so as to cover beneficiaries of

> discretionary and accumulation trusts as well as IIP beneficiaries. The trustees should exclude from the income from the trust return income. In any other circumstances the interest is taxable. It must go on the trust returns.

Relief is available under ESC B18 in a case where:

(1) some beneficiaries are UK resident (so the requirements of this relief are not met) but

(2) the trustees distribute income to a non-resident beneficiary.[6]

27.7 FOTRA exemption and DT relief

A person who is treaty-resident in a foreign state may qualify for DT relief on UK source interest. However DT relief is not needed where FOTRA exemption applies or where non-resident IT relief gives exemption. There are a few gaps where DT relief could be useful, for instance, an individual who is UK-law UK resident but is treaty-resident outside the UK (under the tie-breaker). The International Manual provides:

> **INTM368110. FOTRA and DT claims** [Dec 2019]
> A person entitled to exemption from UK income tax on interest payments from a FOTRA security may claim repayment of some or all of the tax deducted under the terms of an interest article in a DTA. You should treat any such claim as a claim under the interest article. It follows that the claimant must satisfy the conditions of the DTA rather than the conditions for FOTRA exemption. In effect the payment loses the label of FOTRA and is treated in the same way as any other interest payment.
> In practical terms it makes no difference if the claimant is entitled to full relief under the DTA. However the person who received the FOTRA interest may be able to claim repayment of the tax deducted by meeting the requirements of the DTA without meeting the beneficial ownership condition for FOTRA exemption.
> If the claimant is only entitled to partial repayment of the tax deducted under the DTA he will probably receive credit for the UK tax retained against his liability to tax on the interest in his country of residence. You should therefore make the payment as claimed because to increase the payment may cause the claimant inconvenience when settling his liability to tax in the country of residence. You could explain to the claimant that full repayment would be available if he made a claim on

[6] See 41.9.2 (ESC B18: UK trust).

form A1.

This is more than a decade out of date since from 1998 interest is paid gross and claims for repayment of deducted tax (formerly on form A1) are not needed. But the underlying points are still correct.

27.8 Exempt foreign currency securities

27.8.1 *Securities qualifying for relief*

Section 755 ITTOIA provides:

> (1) This section applies to interest on—
>
> (a) such foreign currency securities issued by a local authority or a statutory corporation as the Treasury direct, and
>
> (b) such foreign currency loans made to a statutory corporation[7] as the Treasury direct.

I refer to securities within s.755 as "**exempt foreign currency securities**". Section 756 ITTOIA defines "foreign currency" security:

> (1) For the purposes of section 755, a security or loan is a foreign currency one if under its terms the currency to be used for repayment is not sterling.
>
> (2) Subsection (1) is subject to the following qualifications.
>
> [Subsections (3) and (4) are transitional rules for securities issued before 6 April 1982.]
>
> (5) If in the case of a security there is an option as to the currency to be used for repayment, the security is only to be treated as a foreign currency one if the option is exercisable only by its holder.
>
> (6) If in the case of a loan there is an option as to the currency to be used for repayment, the loan is only to be treated as a foreign currency one if the option is exercisable only by the person for the time being entitled

[7] Terms are defined in s.755(4) ITTOIA:

> In this section—
>
> "company" means a company, as defined in section 1(1) of the Companies Act 2006 (c 46),
>
> 'foreign currency', in relation to loans and securities, has the meaning given by section 756, and
>
> 'statutory corporation' means—
>
> (a) a corporation incorporated by an Act (other than a company), or
>
> (b) any other corporation on which functions connected with carrying on an undertaking are conferred by an Act or by an order made under or confirmed by an Act.

to repayment or eventual repayment.

27.8.2 *Tax exemption*

Section 755(2) ITTOIA provides:

> No liability to income tax arises in respect of interest to which this section applies if—
> (a) in the case of interest on a security, its beneficial owner is a non-UK resident, and
> (b) in the case of interest on a loan, the person for the time being entitled to repayment or eventual repayment is a non-UK resident.

A non-resident individual or company would qualify for non-resident IT relief on the interest, so the exemption does not matter in practice.

27.8.3 *Withholding tax exemption*

Section 981 ITA provides:

> Despite the provisions of this Part there is no duty to deduct a sum representing income tax from a payment of interest within section 755(1) of ITTOIA 2005 (interest on foreign currency securities etc owned by non-UK residents).

27.8.4 *Ss.624 and 720*

Section 755(3) ITTOIA provides:

> But interest is not exempt under subsection (2) because a person is a non-UK resident if it is treated as another person's income under—
> Chapter 5 of Part 5 (settlements: amounts treated as income of settlor), or
> Chapter 2 of Part 13 of ITA 2007 (anti-avoidance provisions: transfer of assets abroad).

This is the same as the rule for FOTRA securities.[8]
EN ITTOIA provides:

> Subsection (3) of the section is an anti-avoidance provision. Section 581(3) of ICTA is very widely drafted: "where any income of any person is by virtue of any provision of the Income Tax Acts to be deemed to be income of any other person, that income shall not be

[8] See 27.4.1 (Ss. 624 and 720).

> exempt ..". In fact, there are only two sets of provisions under which this type of income could be deemed to be income of another person. The relevant provisions are listed in subsection (3) of the section.

27.8.5 *Critique*

If the aim is to encourage investment in local authority and similar securities, why should the exemption be limited to foreign currency securities? It seems the object when the rules were introduced in 1969 was to encourage loans from foreign lenders who would not wish to lend in sterling; borrowers fared badly because of the devaluation in the subsequent sterling crisis.

Alignment of the foreign currency security with the FOTRA rules would be a small but worthwhile simplification. However the Treasury when asked for a list of exempt foreign currency securities stated that they did not hold the information and could locate no record of a direction having been given under s.755 ITTOIA! It may well be that no exempt foreign currency securities exist, and the legislation is dead letter law. I would be grateful for readers comments on that.

27.9 International organisation security

27.9.1 *Inter-American Development Bank*

Section 773 ITTOIA provides:

> (1) No liability to income tax arises for a non-UK resident in respect of income from a security issued by the Inter-American Development Bank if the liability only arises because one or more of circumstances A to C apply.
> (2) Circumstance A is that the security is issued in the UK or in sterling.
> (3) Circumstance B is that the income is made payable or paid in the UK or in sterling.
> (4) Circumstance C is that the Bank maintains an office or other place of business in the UK.

This reflects Section 9 of the Agreement Establishing the IDB:

> (c) No tax of any kind shall be levied on any obligation or security issued by the Bank, including any dividend or interest thereon, by whomsoever held:
> (i) which discriminates against such obligation or security solely because it is issued by the Bank; or
> (ii) if the sole jurisdictional basis for such taxation is the place or

> currency in which it is issued, made payable or paid, or the location of any office or place of business maintained by the Bank.
>
> (d) No tax of any kind shall be levied on any obligation or security guaranteed by the Bank, including any dividend or interest thereon, by whomsoever held:
>
> (i) which discriminates against such obligation or security solely because it is guaranteed by the Bank; or
>
> (ii) if the sole jurisdictional basis for such taxation is the location of any office or place of business maintained by the Bank.[9]

27.9.2 *Designated organisations*

Section 774 ITTOIA provides:

> (1) No liability to income tax arises for a non-UK resident in respect of income from a security issued by an organisation if—
>
> (a) the organisation has been designated by the Treasury for the purposes of this section, and
>
> (b) the liability only arises because one or more of circumstances A to C apply.
>
> (2) Circumstance A is that the security is issued in the UK or in sterling.
>
> (3) Circumstance B is that the income is made payable or paid in the UK or in sterling.
>
> (4) Circumstance C is that the organisation maintains an office or other place of business in the UK.

These are the same circumstances as for the IDB. Section 774 ITTOIA continues:

> (5) The Treasury may by order designate for the purposes of this section—
>
> (a) any of the Communities,
>
> (b) the European Investment Bank,
>
> (c) any international organisation that meets conditions A and B.
>
> (6) Condition A is that one of its members is the UK or any of the Communities.
>
> (7) Condition B is that the agreement under which that member became a member provides for the same kind of exemption from tax for income from securities issued by the organisation as this section provides.

See the Bretton Woods Agreement Order in Council, 1946 (SR&O 1946

[9] *http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=781584*

No 36); International Finance Corporation Order 1955; International Development Association Order 1960; International Monetary Fund (Immunities and Privileges) Order 1977; International Organisations (Tax Exempt Securities) Order 1984; European Communities (Tax Exempt Securities) Order 1985; International Organisations (Tax Exempt Securities) Order 1991.

CHAPTER TWENTY EIGHT

ACCRUED INCOME PROFITS

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Cross references

The following topic is discussed elsewhere:
97.11 (Unremittable accrued income profits)

28.1 Accrued income profits

This chapter discusses Part 12 ITA, which I call the **"accrued income code"**.

The subject needs a book to itself. In 2000 the rules were "widely ignored by both taxpayers, their advisers and within HMRC".[1] Is that still

[1] Inland Revenue, "Responses to Consultation Exercise on Reform of the AIP" (2004); consistent with that, several of the worked examples in the SAI Manual are difficult to justify.

the case? Discuss.

This chapter focuses on the questions closest to the themes of this book, but one can only approach those questions after understanding how the provisions operate.

I do not consider specialist topics such as variable rate securities or conversions of securities.

The provisions apply on a transfer of securities. The accrued income code does not apply for corporation tax.

28.2 AIP securities

Section 619(1) ITA defines "securities":

> In this Chapter "securities" includes—
> (a) any loan stock or similar security other than an excluded security, and
> (b) shares in a building society which are qualifying shares for the purposes of section 117(4) of TCGA 1992 (qualifying corporate bonds),
>
> but (subject to para (b)) it does not include any shares in a company.[2]

I refer to securities within this definition as "**AIP securities**". Section 619(3) ITA sets out seven categories of "excluded securities":

> In this section "excluded securities" means—
> (a) national savings certificates (including Ulster Savings Certificates as defined in section 693(7) of ITTOIA 2005),
> (b) war savings certificates,
> (c) uncertificated eligible debt security units as defined in section 986,
> (d) certificates of deposit (see section 1019),
> (e) a security which is a right falling within section 552(1)(c) of ITTOIA

Reform was promised in 2006 but radical change was rejected and the matter was dropped.

[2] Section 619(2) ITA adds:

"(2) For the purposes of subsection (1)(a), it does not matter—
(a) whether the security is of the government of the UK, any other government, any public or local authority in the UK or elsewhere, or any company or other body,
(b) whether or not the security is secured,
(c) whether or not the security carries a right to interest of a fixed amount or at a fixed rate percentage of the nominal value of the security, or
(d) whether or not the security is in bearer form."

This can only be for the avoidance of doubt, because it only expresses the usual meaning of "security". See App 2.11 (Securities).

> 2005 at the time of the transfer in question,
> (f) a security that meets the redemption conditions (see subsection (5))[3], and
> (g) a security that is a deeply discounted security within the meaning of Chapter 8 of Part 4 of ITTOIA 2005.[4]

Thus deeply discounted securities are not AIP securities: (subject to the 2003 transitional rule) the DDS rules take priority over the AIP rules.

28.3 "Transfer"

In outline, the definition is in s.620(1) ITA:

> References in this Chapter to the transfer of securities are—
> (a) to the transfer of securities by way of sale, exchange, gift or otherwise,
> (b) to the conversion of securities in any case where there is no transfer of the securities within para (a),
> (c) to the redemption of variable rate securities in any case where there has been a transfer of the securities at any time before redemption, or
> (d) to a transaction or event treated as a transfer under—
> (i) section 648(1) or (3) (strips of gilt-edged securities),
> (ii) section 649(4) (new securities issued with extra return),
> (iii) section 650(2), (4) or (6) (trading stock appropriations etc),
> (iv) section 651(2) (owner becoming entitled to securities as trustee), or
> (v) section 652(2) (securities ceasing to be held on charitable trusts).

Thus there are altogether eight types of transfer. In this book I focus on the first type, which are transfers in the normal sense of the word. Section 620(2) provides one exception:

> But subsection (1)(a) does not include—

[3] Defined s.619(5) ITA:
"The redemption conditions are that—
(a) the security is redeemable,
(b) the amount payable on its redemption exceeds its issue price, and
(c) no return other than the amount of that excess is payable on it."

[4] Section 619(4) ITA contains a transitional rule for pre-2003 DDS (not discussed here).

(a) the vesting of securities in personal representatives on death...[5]

28.4 Transfer "with accrued interest"

28.4.1 *The commercial background*

The Debt Management Office explains the terminology **"clean"** and **"dirty"** price:

> The following example is taken from the DMO website for 30 November 2004 and shows close of business data for 5% Treasury Stock 2014:
> **5TY145 | Treasury 2014 | GB0031829509 | 103.17 | 104.344033 | 4.592604**
> The first three fields are all means of identifying the gilt. The first is the DMO's internal identifier code and the second a shortened form of the gilt's name. The third field is the ISIN number (the International Security Identification Number – an identifier number used by the London Stock Exchange).
> The next three fields give price and yield information. The two prices shown of £103.17 and £104.344033 are known as the 'clean' and 'dirty' price respectively. Clean prices do not include accrued interest whereas dirty prices do (see the section on accrued interest on page 15). The clean price is typically the price, which is quoted when agreeing a purchasing or selling price. However, the actual amount of money which will change hands is based on the dirty price and will reflect settlement on the business day after the transaction.
> So, on the basis of the reference price on 30 November 2004, every £1,000 nominal of 5% Treasury Stock 2014 was worth £1,043.44.[6]

Note that for tax purposes the consideration for a gilt is "the actual amount of money which will change hands" - the dirty price.

SAI Manual explains the terminology ex-dividend and cum-dividend:

> **SAIM4020. Transfers "with accrued interest" and "without accrued interest"** [Oct 2022]
> **... Sales with accrued interest ("cum div")**
> Most sales of marketable securities are "cum div". That is, the buyer is entitled to the next interest due. As an interest payment date on a security approaches, its market price increases to reflect the increase in

[5] Paragraph (b) is a transitional rule for pre-2003 DDS (not discussed here).

[6] A Private Investor's Guide to Gilts, Dec 2004 *https://docs.londonstockexchange.com/sites/default/files/documents/dmo-private-investor-guide-to-gilts.pdf*

> value of the buyer’s right to the interest. In other words, the price reflects accrued interest.
>
> For example, £100,000 8% Treasury Stock 2002–06 is transferred cum div on 19 April. 14 days’ interest has accrued since interest was last paid on 6 April. Accrued interest is £307 (14/365 × 8% × 100,000)...
>
> **Sales without accrued interest (“ex div”)**
>
> Not all sales of securities are “cum div”. This is because gilt-edged securities, and some corporate bonds, have an “ex div” or “ex coupon” date. The next interest coupon is paid to the person who is registered as the holder of the security at that date. So if the security is sold in the “ex div” period, the seller collects and keeps the next interest due after the sale. For gilts, the “ex div” period is 7 business days before the coupon date. Other securities may have a similar, or shorter, “ex div” period.
>
> Consequently the market price of a security sold “ex div” reflects the fact that the purchaser will own the security for a short period from the date of purchase to the next interest payment date. This is a period over which interest accrues but for which the interest is received not by him but by the seller. The interest accrued over such a period is known as rebate interest. It is treated in the opposite way to the more normal accrued interest associated with a “cum div” sale.
>
> For example, £100,000 8% Treasury Stock 2002–06 is transferred ex div on 29 March. 7 days’ interest has accrued from the day after the transfer to the next interest date, 6 April. Accrued interest is £153 (7/365 × 8% × 100,000). ...

28.4.2 *“With/without accrued interest”*

623(1) ITA: with accrued interest	**s.624(1) ITA: without accrued interest**
The general rule is that securities are transferred with accrued interest for the purposes of this Chapter if they are transferred with the right to receive interest payable— (a) in a case where the settlement day is an interest payment day, on the settlement day, and (b) in any other case, on the first interest payment day after the settlement day.	The general rule is that securities are transferred without accrued interest for the purposes of this Chapter if they are transferred without the right to receive interest payable as mentioned in section 623(1)(a) or (b).

The definitions are comprehensive so every transfer must be with/without accrued interest, and they are simply English paraphrases of the technical expressions *cum/ex dividend* (or cum-div/ex-div).

The terms "interest" "settlement day" and "interest period" are defined but the definitions are not considered here.

Thus whether a market sale is with or without accrued interest depends only on the date of the sale, whether it is before or after the ex div date. Vendors and purchasers have no choice in the matter except by timing the sale. Whether an off-market sale is with or without accrued interest is a matter for the parties to agree.

28.5 Deemed interest/credit/debit

Section 632(1) ITA provides:

> In the case of a transfer of securities with accrued interest, for the purposes of this Chapter a payment is treated as made by the transferee to the transferor in the interest period in which the settlement day falls.

It is useful to have some terminology to describe this. I refer to this payment as a "**deemed interest payment**". The transferor (deemed to receive the payment) has a **"deemed interest credit"**. The transferee (deemed to make the payment) has a **"deemed interest debit"**.

Section 632 then defines the amount of the deemed payment. In outline:

> (2) The amount of that payment depends on whether the transfer is under an arrangement by which the transferee accounts to the transferor separately—
> (a) for the consideration for the securities, and
> (b) for gross interest accruing to the settlement day.
> (3) If the transfer is under such an arrangement, the amount of the payment is the amount of gross interest which the transferee accounts for.
> (4) If—
> (a) the transfer is not under such an arrangement, and
> (b) the settlement day is itself an interest payment day for the securities,
> the amount of the payment is the amount of interest payable on the securities on that day.
> (5) If—
> (a) the transfer is not under such an arrangement, and
> (b) the settlement day is not an interest payment day for the securities,
> the amount of the payment is an amount equal to—
> $I \times (A \div B)$
> where—
> I is the interest payable on the securities on the first interest payment day after the settlement day ("the payment day"),
> A is the number of days in the period beginning with the first day on which that interest accrues and ending with the settlement day, and
> B is the number of days in the period beginning with the first day on which

> that interest accrues and ending with the payment day.

Why are there two alternative methods of ascertaining the amount of the deemed interest payment, in subsections (3) and (4)(5)? SAI Manual provides:

> **SAIM4140. Payments on transfers with accrued interest** [Mar 2022]
> ... The [deemed interest] payment is the amount of the gross interest accruing to the settlement day, which in most cases is shown separately from the consideration for the securities, under the arrangement (that is, the contract note) by which the transferee accounts to the transferor. This is commonly known as the "clean price" basis.
> In exceptional cases – for example, sales off market, gifts, settlements, and deemed transfers – there will be no contract note and it will it be necessary to compute the amount of the [deemed interest] payment. Where this is done, the formula I × A/B is used...

The Manual offers a straightforward example of the two methods of computation on a single sale with accrued interest:

> *Example*
> Harriet sells corporate bonds to Howard on 15 March 2015. Interest is paid on the bonds on 31 March, 30 June, 30 September and 31 December. Howard will receive the interest coupon due on 31 March 2015, that is, the sale is cum div. The interest Howard receives is £200.
> If Harriet agrees to sell the bond to Howard for a "clean price" of £10,000 plus an additional £165 for accrued interest, she is taxable on accrued income profits of £165 in 2014–15. Howard will reduce his accrued income profits by £165.
> Suppose that, instead, Harriet simply agrees to sell the bond to Howard for £10,165. The relevant interest period is 1 January to 31 March 2015, so B is 90 days. The number of days up to and including 15 March (A) is 74. So the "accrued amount" is £200 × 74/90 = £164.44. Again, Harriet's taxable accrued income will be £164, and Howard's reduced by £165 (following the principle of rounding in the taxpayer's favour).

In an arm's length sale the two methods normally give the same result (as is the case in the HMRC example) though there could be cases where the parties account for accrued interest in some manner which is not the same as the formula I × A/B.

It is possible for the amount of the deemed interest payment to be nil, eg in the case of a transfer on the interest payment day.

Section 633 ITA contains corresponding rules on a transfer without accrued interest.

The SAI Manual gives a straightforward example of a sale with accrued interest:

> **SAIM4160. Examples of transfers with and without accrued interest** [Jul 2023]
>
> *Example 1*
>
> Anthony has a holding of £100,000 Treasury Stock 8¼% 2007, a British Government security which pays interest on 16 January and 16 July each year. He arranges for his holding to be sold on the Stock Exchange on 19 March 2006. The contract note from his stockbroker, dated 19 March 2006 contains the following information:
>
> | | |
> |---|---|
> | £100,000 Treasury Stock 8¼% 2007 sold @ 114 | £114,000 |
> | Plus 56 days' accrued interest | £1,315 |
> | Payable to you on 20 March 2006 | £115,315 |
>
> The contract note contains all the information that is needed for the purposes of the AIS.
>
> - Treasury Stock 8¼% 2007 falls within the definition of "securities" – Section 619 ITA 2007
> - the securities have been transferred, and the transfer is treated as taking place on 19 March because there was a contract for their sale made on that date – Section 620 ITA 2007
> - the settlement day for the transfer is 20 March because under Stock Exchange rules bargains in gilt-edged securities are settled on the next business day – Section 674 ITA 2007
> - the transfer is with accrued interest because the purchaser gets the right to the interest payable on 16 July 2006, the next interest payment day to fall after 20 March 2006 – Section 623 ITA 2007
> - under Stock Exchange rules, accrued interest on gilts is accounted for separately from the bargain price, so the accrued amount is £1,315 – Section 632 ITA 2007
> - the interest period in which the settlement day falls is the period 17 January 2006–16 July 2006 – Section 673 ITA 2007.
>
> Accordingly in this interest period Anthony (the transferor) is treated as having received a payment £1,315 and the transferee as having made a payment of £1,315 (Section 632 ITA 2007).

The Manual then gives a straightforward example of a sale without accrued interest (ex-div):

> *Example 2*
>
> Facts as in Example 1, except that the sale takes place on 1 July 2006 which falls within the "ex-dividend" period for the stock.[7] The contract note from the

[7] This is not factually correct: a sale 15 days before the interest payment date would not be ex dividend. That does not spoil the illustrative force of the example but using

> stockbroker shows:
>
> | | |
> |---|---|
> | £100,000 Treasury Stock 8¼% 2007 sold @ 114 | £114,000 |
> | Minus 15 days' rebate interest | - £352 |
> | Payable to you on 2 July 2006 | £113,648 |
>
> The transfer of securities is treated as made on 1 July 2006. The settlement day is 2 July 2006. The transfer is without accrued interest because this is an "ex-div" sale where the seller retains the right to the interest payable on 16 July 2006 (Section 633 ITA 2007). The rebate amount is £352 and the relevant interest period is that from 17 January–16 July 2006
>
> Accordingly in this interest period Anthony (the transferor) is treated as having made a payment of £352 and the transferee as having received a payment of £352.

The Manual then gives a straightforward example of an off-market sale with accrued interest (cum-div):

> *Example 3* (Joe and Matilda)
>
> Stuffed Dodos Ltd is a UK company which has issued unquoted unsecured loan stock paying interest each year on the Tuesday following Easter Day. Thus in 2015 interest is payable on 7 April and in 2016 interest is payable on 29 March. J Smith owns £10,000 nominal of this stock and agrees to sell £4,000 to his aunt M. Under the agreement, which was made on 8 July 2015, M is to pay £5,000 for the stock on 19 August. The interest payable on 29 March 2016 is at the rate of £5.50 per £100 nominal (5.5%).
>
> Even though the loan stock is unsecured, it constitutes 'securities' for the purpose of the scheme. The securities are treated as transferred on 8 July 2015 – ITA07/S620(3).
>
> The settlement day is 19 August because that is the day M has agreed to pay for the securities and it falls before the next interest payment day following the agreement– ITA07/S674 (3). The transfer is with accrued interest (ITA07/S623). Because the accrued interest is not accounted for separately, in calculating the accrued amount, the formula in ITA07/S632 (5) is used. A is the period from 7 April 2015 to 19 August 2015. B is the period from 7 April 2015 to 29 March 2016. I is the interest applicable to the securities for the period (5.5%× £4,000 = £220). The accrued amount is thus 135/361 × £220 = £82.
>
> The interest period in which the settlement day falls is that from 7 April 2015 to 6 April 2016. Accordingly in that interest period J is treated as receiving as payment of £82 and M as having made a payment of £82.

28.6 Accrued income profits and losses

Tax is *not* charged on deemed interest credits. But armed with the concept of deemed interest payments, we can turn to the terms "accrued income profits" (and "accrued income losses") which are defined in ss.628 and

correct figures would emphasise the triviality of the amounts involved, even in substantial transactions.

629 ITA:

> **628 Making accrued income profits and losses: general rule**
> (1) This section sets out the general rule for determining whether a person is treated as making accrued income profits or accrued income losses where securities are transferred by or to the person. ...
> (3) A separate calculation is to be made for each kind of security that is transferred by or to the person and for each interest period of each such kind of security.
> (4) Each such calculation is to find—
> (a) the total amount ("A") of the payments treated under this Chapter as made to the person in the interest period in question in respect of transfers of securities of the particular kind, and
> (b) the total amount ("B") of the payments treated under this Chapter as made by the person in that period in respect of such transfers.
> (5) A person is treated as making accrued income profits in an interest period as a result of transfers of securities of a particular kind if A exceeds B.
> (6) A person is treated as making accrued income losses in an interest period as a result of transfers of securities of a particular kind if B exceeds A. ...
> **629 Calculating accrued income profits and losses where section 628 applies**
> (1) If section 628(5) applies, the amount of the accrued income profits treated as made is equal to the excess mentioned in section 628(5).
> (2) If section 628(6) applies, the amount of the accrued income losses treated as made is equal to the excess mentioned in section 628(6).

Thus deemed interest debits are first set against deemed interest credits of the interest period for securities of the same kind. If or so far as they cannot be set against those interest credits, they constitute accrued income losses.

28.6.1 *Securities "of the same kind"*

This expression is strictly understood. Section 619(6) ITA provides:

> Securities are treated as being of the same kind for the purposes of this Chapter if they—
> (a) are treated as being of the same kind by the practice of a recognised stock exchange,[8] or

[8] See App 2.18 (Listed/Recognised stock exchange).

> (b) would be so treated if dealt in on such an exchange.

SAI Manual provides:

> **SAIM4040 Accrued Income Scheme: what are "securities"** [Mar 2022]
> ... For example, Treasury 5% 2004 is not the same kind as Treasury 5% 2012. This is similar to the capital gains tax concept of securities of a particular class. ...

28.7 Charge on AIP income

I refer to the accrued income profits treated as made under s.628 ITA as "**AIP income**".

Section 616 ITA imposes the charge on AIP income:

> Income tax is charged on accrued income profits.

28.8 Accrued income loss relief

Section 679 ITA allows accrued income losses to be set against interest from securities of the same kind:

> (1) This section applies if—
> (a) a person is liable for income tax on interest on securities of any kind which is due at the end of an interest period of the securities,
> (b) in that period accrued income losses are made as a result of transfers of those securities, and
> (c) the period ends with an interest payment day.
>
> (2) No liability to income tax arises in respect of the interest to the extent that it does not exceed the losses.

SAI Manual provides:

> **SAIM4120. Calculating accrued income profits and losses: relief for losses** [Jul 2023]
> ... In other words, the losses always reduce the interest subsequently received on those securities, and cannot be used to offset accrued income profits for earlier interest periods or arising on securities which have different interest periods. Where the interest period spans the tax year, losses are therefore not allowed until the interest on the securities is taxed in the following tax year.

For the interaction of loss relief and DTR, see 28.16 (DT relief: AIP income).

28.8.1 *HMRC examples*

SAI Manual provides 3 examples. The first example is a straightforward sale and purchase of one kind of security with accrued interest, looking at the position of the seller:

> **SAIM4130 Calculating accrued income profits and losses: examples** [May 2022]
>
> ... Antoinette has £100,000 Treasury Stock 7¾ % 2006, which has interest dates of 8 March and 8 September. She makes the following transactions in the stock.
>
> | **Transaction** | **Profit/loss**[9] |
> |---|---|
> | 19 March 2006 sells £100,000 | £2,107 |
> | 21 March 2006 buys £50,000 | (£1,361) |
> | 12 May 2006 sells £50,000 | (£131) |
> | | **£615** |
>
> The aggregate [accrued income] profit is £615, taxable for 2006–07, the tax year in which the interest period ended, even though two of the transactions occur in 2005–06.

The second example includes purchases and sales, with and without accrued interest, and involving two different kinds of security, looking at the position of the seller:

> Jean made the following transactions in securities between 28 February 2005 and 5 April 2006:
>
> | | |
> |---|---|
> | 19 Mar 2005 | bought £100,000 Treasury Stock 7½% 2006 (interest payment dates 7 June and 7 December) |
> | 26 May 2005 | bought £50,000 Treasury Stock 7½% 2006 ex div |
> | 15 Sept 2005 | sold £20,000 Treasury Stock 7½% 2006 |
> | 22 Sept 2005 | bought £50,000 Treasury Stock 4½ % 2007 (interest payment dates 7 March and 7 September) |
>
> The [accrued income] profits and losses arising on these transactions are:
>
> | **Transaction date** | **Interest period** | **Profit/loss** |
> |---|---|---|
> | 19 March 2005 | 08/12/04–07/06/05 | (£1,395) |
> | 26 May 2005 | 08/12/04–07/06/05 | £82 |
> | 15 Sept 2005 | 08/06/04–07/12/05 | £271 |
> | 22 Sept 2005 | 08/09/04–07/03/05 | (£778) |
>
> The profits and losses for 2005–06 are:
>
> - Loss of £1,313 (£1,395 minus 82) against interest of £3,750 (£100,000 × 7½% × ½) received on Treasury Stock 7½% 2006 on 7 June 2005.

[9] This refers to deemed interest credits/debits, not the commercial profit/loss but I am unable to see how the figures of 2107, 1361 and 131 are derived: can any reader explain?

- Profit of £271 (Treasury Stock 7½% 2006, interest period 8 June 2005–7 December 2005)
- Loss of £778 against interest of £2,250 received on Treasury Stock 4½ % 2007 on 7 March 2006.

The third example is a straightforward sale of a security with accrued interest, looking at the position of the purchaser:

> *Example 3*
> See Example 3 in SAIM4160 [set out below]. J sells £4,000 unsecured loan stock in Stuffed Dodos Ltd to his M on 19 August 2015. Interest is payable on 5 April 2015 and 18 April 2016. Neither J nor M had any other transactions in securities.
> The settlement day falls within the interest period 5 April 2015 to 4 April 2016. J is taxable on £79 for 2015–16 in respect of this interest period.
> M's loss of £79 is carried forward to 2016–17 to be set against the interest receivable for the period 5 April 2015 to 18 April 2016 (Section 637 ITA 2007 – see SAIM4120).

28.9 AIP remittance basis

Section 670A ITA provides:

> (1) This section applies if—
> (a) accrued income profits are made by an individual as a result of a transfer of foreign securities, and
> (b) section 809B, 809D or 809E (remittance basis) applies to the individual for the tax year in which the profits are made.
> (2) Treat the accrued income profits as relevant foreign income of the individual. ...
> (4) For the purposes of this section securities are "foreign" if income from them would be relevant foreign income.

This brings in the remittance basis. AIP income is fictional, deemed income, which could not be remitted. This is dealt with by s.670A(3) ITA which provides different rules depending on whether the individual receiving the AIP income is the transferor (the usual case of a sale with accrued interest) or the transferee. It is helpful to consider these two cases separately.

For the transferor, s.670A(3) ITA provides:

> For the purposes of Chapter A1 of Part 14 (remittance basis)—
> (a) if the individual[10] is the transferor—

[10] That is, the individual to whom the accrued income profits arise.

> (i) treat any consideration for the transfer as deriving from the accrued income profits...

In short, the proceeds of sale of the securities are treated as containing the AIP income.

> (ii) if on the transfer the individual does not receive consideration of an amount equal to or exceeding the market value of the securities, treat the securities as deriving from the accrued income profits

Section 670A(3)(a)(ii) is the equivalent of the CGT rule for deemed gains on non-market value disposals.[11]

For the transferee, s.670A(3) ITA provides:

> (b) if the individual[12] is the transferee, treat the securities as deriving from the accrued income profits.

In short, if the taxpayer is the transferee, the AIP securities in the hands of the transferee are deemed to contain the AIP income. It makes no difference whether or not the sale is for market value.

The SAI Manual provides:

> **SAIM4380 - Accrued Income Scheme: remittance basis** [Dec 2019]
> ... In some cases, a remittance basis taxpayer will make an accrued income profit on a transfer of securities, but will not receive consideration equal to the market value of the securities.
> [1] This may happen when the securities are transferred 'ex-div' and the taxpayer is the transferee.
> [2] It may also happen where the taxpayer is the transferor, and makes a gift of the securities, or where the AIS rules treat an event as a transfer (for example, an appropriation of securities to trading stock).
> In such cases ITA07/S670A(3) provides that the securities themselves are treated as deriving from the accrued income profits. This means that a charge will arise on the taxpayer when they, or some other 'relevant person', either bring the securities to the UK (if they are held in bearer form) or remit money or property deriving from the securities. ...

28.9.1 *Relief for losses*

What about accrued income losses accruing to a remittance basis taxpayer? The SAI Manual provides:

[11] See 18.45 (Gain on disposal at undervalue).

[12] That is, the individual to whom the accrued income profits arise.

> **SAIM4380 - Accrued Income Scheme: remittance basis** [Dec 2019]
> ... Remittance basis taxpayers are able to obtain relief for accrued income losses. Losses arising on transfers of securities of a particular kind are set against interest received on securities of the same kind at the end of the relevant interest period, and will therefore reduce the amount of an individual's interest on those securities. There is an example of the interaction of the accrued income loss rules and the remittance basis rules at SAIM4390.

28.9.2 *Mixed fund: Transferor*

The consideration received by the transferor (vendor) for the sale of AIP securities with accrued interest will be a mixed fund, consisting in part of AIP income, and the mixed fund rules will apply. In strict law one cannot separate the AIP income from the other proceeds of sale. There are three reasons for this.

First, assume that:

(1) P will pay a single sum for the security to V's broker (the total price).
(2) The broker will then divide the total price into two parts (accrued interest and clean price) and pay the two parts into two separate accounts of the vendor.

There is already a mixed fund on receipt of the payment by the broker on behalf of the client at stage (1), and the broker's act in transferring the single payment into two accounts is an offshore transfer under the mixed fund rules. In theory one might avoid this difficulty if P could pay two separate sums, one in respect of accrued interest and one in respect of the clean price; but in practice on a market sale that would not be possible.

Secondly, the AIP income is a fictional, notional amount which is distinct from the sum paid for the accrued interest. It is like the CFC income in *Bricom*.[13]

Even if that were wrong, however, there is a third obstacle in s.670A(3) ITA, which provides:

> For the purposes of Chapter A1 of Part 14 (remittance basis)
> (a) if the individual is the transferor –
> (i) treat *any* consideration for the transfer as deriving from the accrued income profits.

Thus even if (contrary to my view) the amount that V, the transferor,

[13] See 107.22 (Characterisation).

received for the accrued interest could in principle be separated and did in principle constitute the AIP income, the effect of s.670A(4) is that any consideration for the securities sold by V is treated as deriving from the AIP income.

However HMRC do not take that view. The RDR Manual provides:

> **RDRM33550 - Remittance Basis: Identifying Remittances: Specific Topics: Accrued Income Scheme** [May 2022]
>
> Where a security is sold with accrued income and the proceeds paid into an account, the part of the proceeds representing accrued income will be taxable as income and subject to income tax under the Accrued Income Scheme (AIS)....
>
> Where an individual is chargeable on the remittance basis, accrued income profits arising from on transfers of a 'foreign security' are treated as relevant foreign income...
>
> For consistency of treatment between the AIS and the remittance basis regime, HMRC will follow the tax treatment delivered by the AIS and accept that an 'income amount' can be transferred to a separate 'income account' immediately upon transfer, that is, the proceeds are 'split' into two separate accounts immediately upon receipt into the individual's account. This 'income' could then be identified and taxed as such, without creating a mixed fund....
>
> To the extent that the remainder of the proceeds consist of capital or UK or non-taxable income (as opposed to, say, untaxed foreign income or gains) originally used in the purchase of the security ... the remainder of the proceeds could therefore be separately identified and remitted as such.[14] ...

28.9.3 *Mixed fund: Transferee*

The Manual does not expressly consider the alternative situation where a

[14] Similarly SAI Manual:

> "**SAIM4400. Remittance basis: Further examples** [May 2022]
>
> ... The disposal of a bond may be structured such that separate payment is made for the capital and the accrued income elements which may be paid into separate accounts. In this situation Section 632 ITA 2007 provides that the taxable amount shall be taken as the amount of gross interest accruing to the settlement day, which is separately identified as such.
>
> An individual who has received separate payments into two separate accounts in this way will not be regarded as having two mixed funds. In this situation a remittance of the capital element will not be regarded as a remittance of relevant foreign income."

security is sold without accrued interest and the transferee makes an accrued income profit. There is no difference between the two situations, so the purchaser (transferee) could divide up the purchased securities into an AIP income fraction and a clean capital fraction and hold the two in separate security accounts. However the amounts involved will generally be trivial.

28.9.4 *Mixed fund: Actual interest*

A similar problem arises on receipt of the interest payment after the sale. I refer to this as the **"actual interest payment"**. The recipient will be the purchaser (on a sale with accrued interest) or the seller (on a sale without accrued interest). Either way, the recipient will not normally be subject to income tax on the full amount of the interest as an deemed interest debit will normally generate an accrued income loss which can be set against the interest. The actual interest payment will therefore be a mixed fund. It is suggested that one can separate the actual interest payment on receipt into income and capital elements.

28.9.5 *HMRC examples*

The SAI Manual provides:

> **SAIM4390 - Accrued Income Scheme: remittance basis: examples**
> [May 2022]
> The application of the remittance basis to the AIS is not without complication.

The problem is identifying what is or represents the AIP income where there are deemed interest debits (in the statutory terminology, amount B's) to set against deemed income credits (amount A's.) There is no statutory solution.

> The following examples set out line HMRC takes in particular circumstances.
> *Example 1*
> Ann holds foreign securities 'of the same kind' X and Y which are disposed of in an interest period. They realise the following A and B amounts. ...

Security	**Proceeds**	**Amount A**	**Amount B**
X	100	10	
Y	60		(5)

> There is an accrued income profit of £5,000 which will be treated as

deriving from the proceeds of sale of security X. Assuming the proceeds are paid into a new bank account, there will be a mixed fund comprising capital of £95,000 and an accrued income profit of £5,000.

Example 2
Isabelle has 3 holdings of the same kind of foreign security, X, Y and Z. They are disposed of in an interest period and the proceeds are paid into separate accounts. They realise the following A and B amounts.

Security	Proceeds	Amount A	Amount B
X	100	7	
Y	200	-	(10)
Z	70	4	

In this situation there is an accrued income profit of £1,000. If the proceeds of disposal of all 3 bonds are paid into a single account there will be a mixed fund with capital of £369,000 and an accrued income profit of £1,000.

That is the easy case as there is only one possible answer.

If the proceeds were paid into separate accounts HMRC would expect the accrued income profit to be allocated pro rata in proportion to the Amount A of securities X and Z or, if this would create an unreasonable result, by any reasonable method.

Careful time of purchases and sales would avoid the problem. The last example is somewhat theoretical and I set it out for completeness only:

SAIM4400. Remittance basis: Further examples [May 2022]
It is unlikely that there are many situations where UK and foreign securities will be 'securities of the same kind' for the purposes of the AIS scheme. It may, however, happen in the case of bearer securities. The following example outlines such a situation.
Sam has both overseas and UK bonds 'of the same kind' and they are disposed of in the same interest period with the following results.

Example 3

Security	Proceeds	Amount A	Amount B
X (overseas)	100,000	7,000	
Y (overseas)	200,000	-	(10,000)
Z (UK)	70,000	4,000	

In this case the accrued income profit of £1,000 does not arise as the result of a transfer of foreign securities. There is a net Amount B of £3,000 as the result of the transferred foreign securities. There is

> therefore no relevant foreign income which Sam might remit to the UK. There is a UK accrued income profit of £1,000 which is taxable on an arising basis.

There are several odd things in this example. First it is assumed that if the bearer security is in the UK, the interest is UK source. That is not the test of the location of a source of interest. Perhaps it is assumed that the income is received in the UK. Secondly, one would have expected the deemed interest debit (amount B) to be set against the deemed interest credits pro rata, not set against foreign income first. But since in practice the point will never arise, it is not necessary to pursue that further.

28.9.6 *Pre-2008 transitional rules*

Until 2008/09 a foreign domiciled individual was wholly outside the scope of the AIP rules on foreign securities.

Para 160 Sch 7 FA 2008 provides:

> The amendments made by paras 156 to 159 have effect in relation to transfers of securities where the settlement day is on or after 6 April 2008.

The new rules therefore catch all AIP securities even if held before the law changed in 2008.

28.9.7 *AIP remittance basis: Critique*

When one contemplates the complications of the AIP remittance basis, one appreciates the wisdom of the rule, which applied from the inception of the accrued income scheme in 1985 until 2008, under which the accrued interest scheme did not apply to foreign securities of remittance basis taxpayers. CGT filled the gap. The problems were not discussed, and as far as is known were not even considered, when the law was changed in 2008.

Most if not all readers who have studied the text to this point will agree that the current rule does not give sufficient weight to the desiderata of simplicity and administrative workability. The pre-2008 rule ought to be restored. But that is not likely to happen.

28.10 Excluded persons

The AIP exemptions use the concept of excluded transferor/transferee.

Section 638 ITA provides:

> (1) This section applies if there is a transfer of securities in relation to which a person ("P") is an excluded transferor or excluded transferee.
> (2) In determining whether P has made accrued income profits or accrued income losses under section 628 (making accrued income profits and losses: general rule) and the amount of any such profits or losses, no account is to be taken of any payment treated as made by or to P on the transfer.

A person is not an excluded transferor/transferee in isolation. One is excluded in relation to a transfer of securities. An excluded person is broadly outside the AIP scheme.

28.11 AIP arising to non-resident

Section 643 ITA provides:

> (1) A person is—
> (a) an excluded transferor in relation to a transfer by the person, and
> (b) an excluded transferee in relation to a transfer to the person,
> if the person is non-UK resident throughout the tax year in which the transfer occurs.

The exemption avoids the AIP charge on UK and foreign AIP securities.[15] It also withholds the AIP relief. EN ITA explains the policy behind the rule:

> 1897. In practice it would be very difficult to apply the scheme to such non-residents consistently. While non-residents could take the benefit of relief for accrued income losses to get repayments of tax suffered if tax is deducted at source, it would be difficult to enforce the charge to tax on accrued income profits.

A person coming to or leaving the UK might time disposals to obtain AIP relief while UK resident, while making disposals on which a charge would apply while non-resident.

The temporary non-residence rules do not apply. However CGT may fill some of the gap. The gain on the disposal of AIP securities may be subject to CGT if the CGT temporary non-residence rules apply.

[15] Section 1015 ITA (if needed) could also restrict the territorial scope of the AIP charge, but the rules discussed here leave it no room to operate.

28.12 Trusts

28.12.1 *Application to trustees*

The TSE Manual provides:

> **TSEM3325. Do AIS provisions apply to trustee or beneficiary?** [Sep 2021]
>
> ***Accrued Income Scheme charge***
>
> If trustees (other than bare trustee – TSEM3320) transfer securities, any Accrued Income Scheme profit is that of the trustees. The trustees are chargeable at the trust rate, under Sections 481 and 482 ITA.
>
> The Accrued Income Scheme profit on a transfer of securities does not form the income of any beneficiary.
>
> ***Accrued Income Scheme losses***
>
> The treatment of the loss depends on who received the income interest against which relief is due. If the trustees received the interest, they are entitled to the relief.
>
> The trustees may have mandated the interest to a beneficiary. The beneficiary should claim the loss against the interest.

28.12.2 *Transfer to trust*

The TSE Manual provides:

> **TSEM3330.Securities go into trust: Accrued Income Scheme** [Sep 2021]
>
> When securities go into trust there is a transfer, for Accrued Income Scheme purposes. The transfer is from the settlor to the trustee.
>
> This includes:
>
> - a settlor creates a new trust by transferring securities to the trustee
> - a person who holds securities for his own benefit declares he will in future hold them as trustee
> - at the end of an administration period, a personal representative starts to hold securities as trustee of a will trust.

28.12.3 *Transfer from trustees*

The TSE Manual provides:

> **TSEM3335. Beneficial interest in trust changes: Accrued Income Scheme** [Mar 2017]
>
> ***Change results from the terms of the trust***
>
> The terms of a trust may often result in changes in beneficial interests. For example, on the death of a life tenant the trust assets may pass absolutely to another beneficiary. Such changes in beneficial interest

> have no accrued income scheme consequences. Either there is no actual transfer, or the transfer simply produces self-cancelling deemed profits and losses.

SAI Manual makes the same point:

> **SAIM4050. What is a transfer?** [Dec 2019]
> ... The AIS is based on transfers of the legal ownership of securities, not the transfer of the underlying beneficial ownership. Thus, for example, there is no transfer for the purposes of the AIS if a beneficiary under a trust becomes absolutely entitled as against the trustees to securities forming part of the trust fund. ...

Returning to the TSE Manual:

> **TSEM3335. Beneficial interest in trust changes: Accrued Income Scheme** [Sep 2021] ...
> ***Change follows an action by the trustees***
> Sometimes a change is not a direct result of the terms of the deed. Trustees can use their powers to advance interests or appoint property. The exercise of these powers can amount to a transfer.

That seems inconsistent with what was said above.

> ***'Stranded' Accrued Income Scheme loss***
> A change in beneficial owner can result in an Accrued Income Scheme loss being 'stranded'. It is no longer available to set against the interest. For example, the trustee could have bought securities 'cum dividend' (with a right to the dividend). Shortly afterwards a beneficiary could become absolutely entitled to the trust assets following a contingency. The contingency does not involve any transfer for Accrued Income Scheme purposes. This means the trustee's Accrued Income Scheme loss is lost. The beneficiary was never entitled to the loss, so cannot set it against subsequent interest.

28.12.4 *Appointment of new trustees*

The TSE Manual provides:

> **TSEM3340. Accrued income scheme: change of trustees** [Sep 2021]
> ***Trustees remain resident in the UK***
> There are no Accrued Income Scheme consequences when trustees change, but the trustees of the settlement remain resident in the UK. The change simply produces self-cancelling deemed profits and losses.
> ***Trustees change from resident to non-resident***
> As the new trustees are not resident, they do not satisfy the 'residence

> requirement' of the Accrued Income Scheme. The appointment of non-resident trustees is a transfer of the securities by the resident trustees. ...
>
> ***Trustees change from non-resident to resident***
>
> As the old trustees were not resident, they do not satisfy the 'residence requirement' of the Accrued Income Scheme. The change of trustees is a transfer of securities to the resident trustees.

This may have been right before 2006, but now that trustees are treated as a single person (distinct from the actual trustees) it is considered that the appointment of new trustees (wherever resident) is not a transfer for AIS purposes.

28.12.5 *Nominees/bare trustees*

For completeness: s.666 ITA applies for the AIS the bare trust disregard which applies for CGT:[16]

> (1) Transfers of securities by or to a person as nominee for another person ("A") are treated for the purposes of this Chapter as transfers by or to A.
> (2) Transfers of securities by or to a person ("T") as trustee for another person ("B") are treated for the purposes of this Chapter as transfers by or to B if B is absolutely entitled as against T.
> (3) For the purposes of subsection (2) where T is the transferor, B is absolutely entitled as against T if immediately before the transfer B has the exclusive right to direct how the securities are to be dealt with.
> (4) For the purposes of subsection (2) where T is the transferee, B is absolutely entitled as against T if immediately after the transfer B has that exclusive right.
> (5) For the purposes of subsections (3) and (4), a right to direct how securities are to be dealt with is treated as an exclusive right despite being subject to satisfying any outstanding charge, lien or other right of the trustee to resort to the securities for payment of duty, taxes, costs or other outgoings.
> (6) Subsection (1) applies to a transfer of securities by or to a person as nominee for two or more persons as it applies to a transfer of securities by or to a person as nominee for one person, taking the references to A as references to the two or more persons.
> (7) This section applies to a transfer of securities by or to a person as trustee for two or more persons as it applies to a transfer of securities as trustee for one person, taking—
> (a) the references to B as references to the two or more persons, and
> (b) the references to B being absolutely entitled as references to the two or more persons being jointly absolutely entitled.
> (8) The fact that a person is an infant or otherwise lacks legal capacity is to be

[16] See 87.7.3 (Entitled against trustee).

> disregarded in determining for the purposes of this section whether the person is absolutely entitled as against T.

28.13 Settlor-interested trusts

28.13.1 *UK resident trust*

Section 667(1) ITA provides:

> If the trustees[17] of a settlement are treated as making qualifying accrued income profits,[18] those profits are to be taken to be income arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA 2005 (settlements: amounts treated as income of settlor).

I am not sure if this is necessary. Perhaps it could have been argued that although "tax is charged on accrued income profits" (s.616) such profits are nevertheless not "income arising under a settlement". Perhaps the provision is just for symmetry with the provision which follows for non-resident trusts.

The rate of tax in the absence of s.624 is the trust rate, 45%, so s.624 can only reduce the tax rate (or make no difference).

28.13.2 *Non-resident trust*

In the absence of express provision, AIP income of non-resident trustees would not fall within the settlor-interested trust code because the trustees are non-UK resident. However s.667 ITA deals with this and so the provisions apply to AIP income:

> (2) Subsection (3) applies if the trustees of a settlement—
>
> (a) are non-UK resident or domiciled[19] outside the UK throughout a tax year in which an interest period or part of an interest period falls, and

[17] Defined in s.667(4)(b) ITA.

[18] Defined in s.667(4)(a) ITA:

"'qualifying accrued income profits' means accrued income profits which are treated as made—
(i) under section 628(5), or
(ii) under section 630(2) in respect of a transfer of variable rate securities."

The drafting is misleading: as far as I can see, all accrued income profits are "qualifying" accrued income profits.

[19] The references to domicile in s.667(2) are otiose, but they do no harm. They are there for historical reasons, as before 2008 foreign domiciled trustees qualified for the remittance basis on trust income.

> (b) would have been treated as making an amount or an additional amount[20] of qualifying accrued income profits in the interest period if the trustees had been UK resident or domiciled in the UK during a part of each such tax year.
>
> (3) The amount or additional amount of qualifying accrued income profits that the trustees would have been treated as making is to be taken to be income arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA 2005.

Thus the AIP income of a settlor-interested trust is in principle within the scope of s.624 ITTOIA.[21]

Non-resident trustees would not qualify for AIP loss relief,[22] so s.680 ITA extends the relief:

> (1) This section applies if—
>
> (a) the trustees of a settlement are non-UK resident or domiciled outside the UK throughout a tax year in which an interest period or part of an interest period of securities falls,
>
> (b) the trustees' income is or includes interest from those securities,
>
> (c) the interest falls due at the end of that interest period, and
>
> (d) had the trustees been UK resident, or domiciled[23] in the UK, during a part of each such tax year the interest would have been wholly or partly exempt from income tax under section 679.
>
> (2) No liability to income tax arises as a result of Chapter 5 of Part 5 of ITTOIA 2005 (settlements: amounts treated as income of settlor) in respect of so much of the interest as would have been exempt from income tax under section 679.

28.14 ToA rules/AIP income

In the absence of express provision, AIP income would not fall within the transfer of asset abroad provisions because the person abroad would qualify for the AIP non-residence defence (or more accurately, the person abroad would not receive income).[24] However, s.747 ITA deals with this and so the ToA provisions apply to AIP income:

[20] The references to "an additional amount" are otiose but they do no harm.

[21] Subject to s.624 protected-trust relief, if applicable; see 28.15 (AIP: Protected-trust relief).

[22] See 28.8 (Accrued income loss relief).

[23] The references to domicile in ss.667 and 680 ITA is otiose from 2008 but it does no harm.

[24] See 48.15 (Income of person abroad).

> (1) This subsection applies if a person—
>
> (a) would have been treated as—
>
> (i) making qualifying accrued income profits, or
>
> (ii) making qualifying accrued income profits of a greater amount,
>
> in an interest period, but
>
> (b) is not so treated because of being resident or domiciled[25] outside the UK throughout any tax year in which the interest period (or part of it) falls.
>
> (2) If subsection (1) applies, this Chapter applies as if the amount which the person would be treated as making or, as the case may be, the additional amount were income becoming payable to the person.
>
> (3) Accordingly, any reference in this Chapter to income of (or payable or arising to) a person abroad must be read as including a reference to such an amount.

It has been suggested that this leaves a gap where AIP securities are held by a non-resident company. Section 747(1) ITA applies only if the company would have fallen within the AIP rules but did not do so "because of being resident outside the UK". But if the company had been UK resident, it would be within the charge to corporation tax and outside the scope of AIP. That is correct on a literal construction. However, the context shows that the deeming is not intended to be applied to that extent, and a comparable argument in a CGT context was resoundingly dismissed in *de Rothschild v Lawrenson* 67 TC 300 ("I do not believe that our processes of statutory construction are so wanting in technique and imagination ...").[26]

The person abroad (if non-resident) would not qualify for AIP loss relief, so s.747(4)(5) ITA extends the relief:

> (4) This subsection applies if income consisting of interest which falls due at the end of an interest period—
>
> (a) would have been income as respects which a person is entitled to an exemption, or an exemption of a greater amount, from liability to income tax under section 679 (interest on securities involving accrued income losses: general), but
>
> (b) is not such income because it is income of a person who is resident or domiciled outside the UK throughout any tax year in which the interest period (or part of it) falls.

[25] The reference to domicile is otiose from 2008 but it does no harm.

[26] See App 8.2 (Deeming provisions: Construction).

> (5) If subsection (4) applies, for the purposes of this Chapter the interest is treated as reduced by the amount of the exemption or, as the case may be, the additional exemption.

28.14.1 *Definitions*

Section 747 ITA provides definitions for s.747:

> (6) In this section—
> (a) expressions which are also used in Chapter 2 of Part 12 (accrued income profits) have the same meaning as in that Chapter (but see subsection (7)), and
> (b) "qualifying accrued income profits" means accrued income profits which are treated as made—
> (i) under section 628(5), or
> (ii) under section 630(2) in respect of a transfer of variable rate securities.
>
> (7) In the case of qualifying accrued income profits within sub-paragraph (ii) of the definition of that expression in subsection (6)(b)—
> (a) references in subsection (1)(a) to making qualifying accrued income profits in an interest period are to be read as making them in the tax year in which the settlement day falls, and
> (b) the reference in subsection (1)(b) to the interest period is to the period—
> (i) beginning with the day after the last day of the only or last interest period of the securities, and
> (ii) ending with the settlement day.

The expression "qualifying" accrued income profits is misleading: as far as I can see, all accrued income profits are qualifying.

For the interaction with s.731, see 50.21.2 (Stock dividend/accrued income).

28.15 AIP: Protected-trust reliefs

The wording is (more or less) the same as for offshore income gains,[27] which suggests that the position is as follows:

(1) If the settlor/transferor makes a remittance basis claim, AIP income is protected income, and qualifies for s.624/s.720 protected-trust reliefs.

(2) If the transferor does not make that claim (either because they are

[27] See 67.12.2 (OIG: Protected s.720 income?).

deemed domiciled and cannot claim the remittance basis; or because they chose not to do so) then AIP income is not protected income; so it is taxable on the transferor/settlor on an arising basis.

The CIOT argument relating to OIG and deemed source does not arise in this context.[28] But a purposive construction is just about arguable.

28.16 DT relief: AIP income

28.16.1 *DT exemption*

OECD Commentary provides:

> 20.1 The amount that the seller of a bond will receive will typically include the interest that has accrued, but has not yet become payable, at the time of the sale of the bond. In most cases, the State of source will not attempt to tax such accrued interest at the time of the alienation and will only tax the acquirer of the bond or debenture on the full amount of the interest subsequently paid (it is generally assumed that in such a case, the price that the acquirer pays for the bond takes account of the future tax liability of the acquirer on the interest accrued for the benefit of the seller at the time of the alienation). In certain circumstances, however, some States tax the seller of a bond on interest that has accrued at the time of the alienation (e.g. when a bond is sold to a tax-exempt entity). Such accrued interest is covered by the definition of interest and may therefore be taxed by the State of source. In that case, that State should not again tax the same amount in the hands of the acquirer of the bond when the interest subsequently becomes payable.

See 26.27.5 (DTA definition of interest).

28.16.2 *AIP: Foreign Tax Credit*

In the absence of express provision there would be no Foreign Tax Credit, as the AIP income is not taxable in the other state.

Section 10 TIOPA provides relief:

> (1) Subsection (2) applies if—
>
> (a) a person is treated under section 628(5) of ITA 2007 as making accrued income profits in an interest period,
>
> (b) the person would, were the person to become entitled in the

[28] Because that argument rests on s.830(2)(o) ITTOIA, and there is no equivalent provision in s.830(2) for accrued income profits. See 67.12.3 (Deemed source argument).

> relevant tax year[29] to any interest on the securities concerned, be liable in respect of the interest to tax chargeable under ITTOIA 2005 on relevant foreign income, and
>
> (c) the person is liable under the law of the territory to tax in respect of interest payable on the securities at the end of the interest period or the person would be so liable if the person were entitled to that interest.

I cannot see the need for (b) as it will be satisfied whenever (a) is satisfied. Section 10(2) provides the relief:

> (2) Credit is to be allowed against income tax calculated by reference to the accrued income profits.
> (3) The amount of the credit allowed under subsection (2) is given by—
>
> AIP × FTR
>
> where—
> AIP is the amount of the accrued income profits, and
> FTR is the rate of tax to which the person is or would be liable as mentioned in subsection (1)(c)...

Section 39 TIOPA restricts DT relief where there is relief for accrued income losses.[30]

The SAI Manual provides:

> **SAIM4370. Double taxation relief** [May 2022]
> Where an AIS charge arises on a foreign stock on which the interest would have suffered foreign tax eligible for credit relief if interest had been received, credit for foreign tax is allowable for the lower of
>
> - the rate of UK tax charged on the accrued income profit, and
> - the rate of foreign tax suffered on the interest payable at the end of the interest period for which the charge arises.
>
> If there is an accrued income loss to be set against foreign interest, reduce the credit for foreign tax in the proportion which the allowance bears to the interest.
> *Example*
> Taxpayer holds foreign stock on which the interest suffers tax eligible for credit at 15%. Interest paid on 30 June and 31 December.
> In the interest period to 30 June 2015, the taxpayer makes transactions

[29] Defined subsection (5): "In subsection (1)(b) 'the relevant tax year' means the tax year in which, under section 617(2) of ITA 2007, the accrued income profits are treated as made."

[30] See 28.8 (Accrued income loss relief).

resulting in an AIS loss of £200. He receives interest (gross) of £1,000 less £150 foreign tax.
In August 2016 he sells the entire holding and there is an AIS profit of £300. He is liable to UK tax at 22%. His double taxation relief is as follows

Foreign interest		£1,000
Less Accrued Income relief		- £200
		£800
Foreign tax deducted	£150	
Credit restricted to	£1000 −£200 × £150/£1000	= £120
Accrued income profit		£300
Allow credit for foreign tax		
on AIS charge £300 @ 15%		= £45
Total double taxation relief £120 + £45		= £165

The double taxation relief given can exceed the foreign tax suffered (£165 exceeds the £150 suffered).

28.17 AIP/CGT interaction

Section 119(1) TCGA disapplies the normal CGT rules in ss.37 and 39 TCGA:

> (1) Where there is a transfer of securities within the meaning of Chapter 2 of Part 12 of ITA 2007 (accrued income profits)—
>
> (a) if a payment is treated as made to the transferor under section 632 of that Act or by the transferor under section 633 of that Act, section 37 shall be disregarded in computing the gain accruing on the disposal concerned;
>
> (b) if a payment is treated as made by the transferee under section 632 of that Act or to the transferee under section 633 of that Act, section 39 shall be disregarded in computing the gain accruing to the transferee if he disposes of the securities;
>
> but subsections (2) and (3) below shall apply.

Section 119 TCGA goes on to set out its own rules:

> (2) Where the securities are transferred with accrued interest (within the meaning of that Chapter)—
>
> (a) if a payment is treated as made to the transferor under section 632 of ITA 2007, an amount equal to the amount of that payment shall be excluded from the consideration mentioned in subsection (8) below;
>
> (b) if a payment is treated as made by the transferee under that section, an amount equal to the amount of that payment shall be

> excluded from the sums mentioned in subsection (9) below. ...
>
> (8) The consideration is the consideration for the disposal of the securities transferred which is taken into account in the computation of the gain accruing on the disposal.

Section 119(3)(9) contains corresponding rules for a transfer without accrued interest:

> (3) Where the securities are transferred without accrued interest (within the meaning of that Chapter)—
>
> (a) if a payment is treated as made by the transferor under section 633 of ITA 2007, an amount equal to the amount of that payment shall be added to the consideration mentioned in subsection (8) below;
>
> (b) if a payment is treated as made to the transferee under that section, an amount equal to the amount of that payment shall be added to the sums mentioned in subsection (9) below...
>
> (9) The sums are the sums allowable to the transferee as a deduction from the consideration in the computation of the gain accruing to him if he disposes of the securities.

28.18 Foreign currency securities

SAIM provides:

> **SAIM4310. Special calculations: Foreign currency securities** [Dec 2019]
>
> **Foreign securities: Translation into sterling**
>
> Section 664 ITA 2007 provides rules for translation into sterling of the payments made on the transfer of securities where the interest on securities is payable in a currency other than sterling.
>
> If the interest is accounted for separately between transferor and transferee, and the parties specify in their contact what the sterling equivalent of the accrued or rebate interest is, the sterling amount so specified is to be used in the AIS calculations. Otherwise, the amount is to be determined in the foreign currency according to the usual rules, and then translated into sterling at the rate of exchange prevailing on the settlement day for the transfer, calculated by reference to the London closing rate of exchange for the day concerned.
>
> The nominal value of foreign securities is also determined (under Section 677 ITA 2007) as the sterling equivalent of that value on any day, calculated by reference to the London closing rate for that day.
>
> Where unrealised interest is payable in a foreign currency, Section 665 ITA 2007 provides that the amount of the accrued income profits under

Section 631 ITA 2007 is the sterling equivalent on the settlement day, or in the case of interest in default (SAIM4290), the value on the day of receipt.

Although the London closing rate should in strictness be used in all the above cases, figures of rates of exchange supplied by taxpayers or their agents should normally be accepted, provided that they come from a reputable source (for example, an exchange rate quoted by the taxpayer's bank for the day in question) and the basis is used consistently.

CHAPTER TWENTY NINE

DEEPLY DISCOUNTED SECURITIES

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29.1 DDS code

Deeply discounted securities are governed by Chapter 8 Part 4 ITTOIA (**"DDS code"**).

A full discussion of this topic would need a book to itself. This chapter focuses on matters closest to the themes of this work, but the subject can only be understood in the context of the provisions as a whole.

In outline, profits arising on the disposal of a deeply discounted security ("DDS") are subject to income tax (rather than CGT).

The following specialist topics are not discussed:

- securities issued in tranches
- earn-out rights

- strips
- exchanges and conversions

I do not discuss the position of companies which issue or hold deeply discounted securities, which is governed by the loan relationship rules.

29.2 "Deeply discounted security"

For the meaning of "security" see App. 2.17 ("Security" in DDS code).

Section 430(1) ITTOIA provides:

> The general rule is that a security is a "deeply discounted security" for the purposes of this Chapter [Chapter 8 Part 4 ITTOIA, DDS code] if, as at the time it is issued,
> [a] the amount payable on maturity or any other possible occasion of redemption ("A")
> [b] exceeds or may exceed the issue price
> [c] by more than A × 0.5% × Y,
> where Y is the number of years in the redemption period or 30, whichever is the lower.

I refer to this as the **"0.5% DDS test"**.

Section 430 ITTOIA defines "redemption period":

> (2) If the redemption period is not a number of complete years, for the purposes of subsection (1) the incomplete year is expressed as twelfths, treating each complete month and any remaining part of a month as one-twelfth.
> (3) In this section "redemption period" means the period between the date of issue and the date of the occasion of redemption in question.

Interest is disregarded for the purpose of the 0.5% DDS test. Section 430(4) ITTOIA provides:

> Interest payable on an occasion of redemption is ignored in determining for the purposes of this section the amount payable on that occasion.

In other words, the profit on redemption must be a capital premium, rather than interest. For the distinction, see 26.4 (Premium).

SAI Manual gives three examples. The first example is an RPI-index bond. Note that HMRC here accept that RPI indexation is not interest:

> **SAIM3020 Meaning of deeply discounted security** [Dec 2019
> *Example 1*
> Company A issues securities for £1,000 which are redeemable in 10

> years time for the subscription amount increased by the percentage movement in the Retail Price Index over the same period. As the linkage to the RPI may give more than a 5% increase in value (10 years × 0.5%) over that period, the securities are deeply discounted securities.

In the next example there is just a possibility of a fixed premium:

> *Example 2*
> Company B issues a 12-month security for £950. It is redeemable for £950 at maturity or, depending on events, for £1,000 after 6 months. The occasion of early redemption is not disregarded under Section 431 ITTOIA 2005 (SAIM3030). The difference between the issue and early redemption prices is £50 and is therefore more than £2.50 (£1,000 × 0.5% × 6/12). The security is therefore a DDS.

The next example is a FTSE 100 indexed bond:

> *Example 3*
> Bank C issues a 5-year security that is linked to the FTSE 100 share index. Each security has a nominal value to £100. If the index rises, the investor receives on redemption £100 multiplied by the percentage rise in the index. For example, the index has risen to 150% of its starting value, the investor receives £150. If the index falls, the investor is guaranteed to receive back his or her £100, so the security is not an excluded indexed security (SAIM3050). Since the security may give more than a 2.5% increase in value over the period (5 years × 0.5%), it is a DDS, even though there is no certainty as to the redemption amount.

29.3 "Issued"

Savva v HMRC comments on this word:[1]

> What will amount to an "issue" of a security in a given case is likely to be highly fact-specific, and the case law shows that it can be a very difficult question to answer. For present purposes, it is enough to say that, if the rights which Mr Savva received from UBS did constitute a separate security, we doubt whether there is any demonstrable error of law in the FTT's conclusion that the security was "issued" by UBS.

29.4 Foreign currency security

In the following discussion a **"foreign currency security"** is one issued

[1] [2015] UKUT 141 (TCC) at [40].

for a foreign currency and redeemable in that currency.

29.4.1 *Foreign currency security: DDS*

Consider for instance a US Treasury Note issued for $1,000 and redeemable on maturity at $1,000 and carrying interest at a market rate. Is the security deeply discounted? The question (in short) is whether:

> the amount payable on maturity may exceed the issue price

This raises a currency translation issue. If:

(1) "issue price" means the sterling equivalent of the issue price at the time of issue; and

(2) "amount payable on maturity" means the sterling equivalent of that amount at the time of maturity

then a foreign currency security is a DDS, because currency fluctuations could lead to a gain measured by £ sterling.

If "issue price" means the dollar price and "the amount payable on maturity" means the dollar amount, then the two are equal and the security is not a DDS.

The statutory words could be understood either way, so the context must resolve the issue. The context shows that the second view is correct. This is for several reasons. First, the object of the DDS rules is to tax discounts, which are commercially similar to interest. It is not to tax currency fluctuations. The absence of relief on losses would operate very unfairly. Secondly, if that were not the case, all foreign currency securities would be within the DDS regime.[2] That would be surprising (and not EU-law compliant).[3]

HMRC agree. The SAI Manual provides:

> **SAIM3020 Meaning of deeply discounted security** [Mar 2017]
> The test for deep discount is carried out in the currency of issue.

29.4.2 *Foreign currency DDS*

The above paragraph is considering a security whose dollar issue price

[2] Unless they contained a cap to limit the gain to a sterling amount, which would not normally be the case.

[3] The arguments are more fully set out in Ghosh, "Corporate Bonds: If The Cap Does Not Fit" Taxation Magazine, 7 February 2002 p.439; but since HMRC have accepted this view since the publication of Tax Bulletin 9, it is not necessary to consider that here.

equals its dollar maturity price. Of course, a foreign currency security would in principle be a DDS if the redemption price may sufficiently exceed the issue price. It is understood that US treasury bills (which do not carry interest) are normally DDSs. I refer to such a security as a "**foreign currency DDS**".

How does one compute the profit on the disposal of a foreign currency DDS? The profit is:

> the amount by which the amount payable on the disposal exceeds the amount paid by the person to acquire the security.

This raises another currency translation issue. Suppose a person acquires a security on issue for dollars and redeems it for dollars. Is the amount paid to acquire the security:

(1) The sterling equivalent of the purchase price at the time of issue? Or
(2) The dollar amount? If so, it is deducted from the dollar amount payable on disposal, to give a dollar profit, translated into sterling at the time of disposal.

The statutory words could be understood either way, so the context must resolve the issue. The context shows that the second view is correct. This is consistent with the approach to the definition of a DDS: see above. The same point applies: the object of the DDS rules is to tax discounts, which are commercially similar to interest. It is not to tax currency fluctuations.

The solution to the same problem for CGT is different.[4] The reason for this is explained in *Capcount Trading v Evans* 65 TC 545. One important factor in that decision was the provision in the CGT legislation that currency other than sterling is an asset for CGT. There is no similar provision for IT. However HMRC may not agree. SAIM provides:

> **SAIM3070 Taxation: Profit On Disposal** [Dec 2019]
> Where a security is denominated in a foreign currency the profit is the difference between the sterling equivalents of the acquisition and disposal amounts, using the spot rates at the material dates.

29.5 Excluded occasions of redemption

Section 431(1) ITTOIA provides:

> An occasion of redemption of a security other than maturity is ignored

[4] See 95.2 (CGT: currency conversion date).

> for the purposes of section 430(1) if the third-party option conditions or the commercial protection conditions are met.

Section 431(4) ITTOIA provides:

> Subsection (1) does not apply to an occasion just because the occasion coincides or may coincide with an occasion meeting the third-party option conditions or the commercial protection conditions.

29.5.1 *Third-party option conditions*

Section 431(2) ITTOIA provides:

> The third-party option conditions are that—
> (a) the security may be redeemed on the occasion at the option of a person other than its holder,
> (b) the security is issued to a person who is not connected with the issuer, and
> (c) the obtaining of a tax advantage by any person is not the main benefit, or one of the main benefits, that might have been expected to accrue from the provision in accordance with which the security may be redeemed on the occasion.

29.5.2 *Commercial protection conditions*

Section 431(3) ITTOIA provides:

> The commercial protection conditions are that—
> (a) the security may be redeemed on the occasion as the result of an exercise of an option that is exercisable only on the occurrence of—
> (i) an event adversely affecting the holder (see subsection (8))[5], or
> (ii) a default by any person, and
> (b) as at the time of the security's issue it appears unlikely that the option will be exercisable on the occasion.

29.5.3 *Connected third party*

Section 431 ITTOIA provides:

[5] "(8) In this section "event adversely affecting the holder", in relation to a security, means an event the occurrence of which appears, as at the time of the security's issue, likely to have an adverse effect on the interests of its holder at the time of the event if there were no provision for redemption on its occurrence."

> (5) If—
>
> (a) the only reason that a security is not a deeply discounted security is that an occasion on which it may be redeemed is ignored because the third-party option conditions are met, and
>
> (b) at some time after its issue the security is acquired by, or its holder becomes, a person connected with the issuer,
>
> in relation to that time and later this Chapter [Chapter 8 Part 4 ITTOIA, DDS code] applies as if the security were a deeply discounted security.
>
> (6) If a person ("P") who is not connected with the issuer acquires—
>
> (a) a security which is only a deeply discounted security because it was issued to a person connected with the issuer and so fails to meet the condition specified in subsection (2)(b), or
>
> (b) a security within subsection (5),
>
> this Chapter applies in relation to P as if the security ceased to be a deeply discounted security on the acquisition.
>
> (7) For the purposes of the application of this section to a security, the question whether persons are connected is determined without regard to the security or any other security issued under the same prospectus.

29.6 Securities outside DDS code

29.6.1 *Securities under other regime*

Section 432(1) ITTOIA provides:

> The following are not deeply discounted securities—
>
> (a) shares[6] in a company,
>
> (b) gilt-edged securities that are not strips,
>
> (c) life assurance policies, and
>
> (d) capital redemption policies.[7]

29.6.2 *Securitised derivatives*

The SAI Manual provides:

> **SAIM3040. Securities not deeply discounted securities** [Dec 2019] [The Manual sets out s.432(1) and continues:] In practice, therefore, most deeply discounted securities will be securities in the nature of debts, that is, where the issuer has an obligation to make some form of return to the investor.

[6] Defined s.460(1) ITTOIA: "In this Chapter "share", in the case of a share in a company, means any share under which an entitlement to receive distributions may arise, but does not include a share in a building society."

[7] See 70.2.3 ("Capital redemption policy").

Until 2011, this SAI Manual paragraph provided:

> **Securitised derivatives**
> Securitised derivatives present particular problems. These are investment products where the amount which the investor gets back at the end depends on the performance of a share index, or a particular share or shares, or (less commonly) some other asset. The capital initially subscribed by the investor may be completely or partly protected, or it may be possible for the investors to lose the whole of their money.
> Some such products, properly analysed, are options, for which the investor pays a premium (these are often described as 'warrants'). Others may be contracts for differences, or other derivatives. These will not be deeply discounted securities; disposal of an option, or of a financial future within Section 143 TCGA 1992, will give rise to a capital gain or allowable loss. See also SAIM7000 on the tax treatment of derivatives that generate an interest-like return.
> Other securitised derivatives, however, create a debt (in technical terms, they are structured as a debt security plus one or more options or other derivatives). These will be deeply discounted securities, unless they fulfil the stringent conditions to be 'excluded indexed securities' (SAIM3050). You should seek advice from CT & VAT (Financial Products and Services Team) if it is unclear whether or not a particular instrument is a deeply discounted security.

It is, I think, implied that a DDS must be a debt security as opposed to a non-debt security. There are some deep conceptual issues here.

29.7 Excluded indexed security

Section 432(2) ITTOIA provides:

> An excluded indexed security (see section 433) is only a deeply discounted security if treated as such under section 431(5) (acquisition by a person connected with the issuer or holder becoming such a person).

For the s.431(5) exception, see 29.5.3 (Connected third party).

29.7.1 *"Excluded indexed security"*

Section 433(1) ITTOIA provides:

> In this Chapter [Chapter 8 Part 4 ITTOIA, DDS code] "excluded indexed security" means a security under the terms of which the amount

> payable on redemption[8] is determined by applying to the amount for which the security was issued the percentage change (if any) over the security's redemption period in—
> (a) the value of chargeable assets of a particular description, or
> (b) an index of the value of such assets.

The SAI Manual provides:

> **SAIM3050 excluded indexed securities** [Dec 2019]
> ... **The percentage change**
> The percentage change is the full percentage change in the value of the chargeable assets, or of any index of the value of such assets, over the redemption period. The percentage change is to be applied to the full issue price - that is without issue costs having been deducted.

29.7.2 *Capital protection*

Section 433(2) ITTOIA provides for a security which pays at least a minimum amount, but only a small one:

> The fact that the terms under which the security is issued include a provision to the effect that the amount payable on its redemption must be at least a specified percentage of the amount for which it was issued only prevents it from falling within the definition in subsection (1) if that percentage exceeds 10%.

The SAI Manual provides:

> **SAIM3050 excluded indexed securities** [Dec 2019]
> ... **Capital protection**
> The terms of the security may provide for the investor to get back a percentage of his or her original stake money, even if the value of the relevant chargeable assets plummets. This will not prevent it being an excluded indexed security provided the specified percentage is not more than 10% of the issue price. It should be noted this does not mean investors can invest £100 and get a minimum of £110 back; it means they can invest £100 and get not more than £10 back, losing the other £90 of their original capital. Unless they can lose at least 90% of the amount invested it is not an excluded indexed security, and will be a deeply discounted security.

[8] Section 433(7) ITTOIA provides: For the purposes of this section ... (b) "redemption", in relation to a security, does not include its redemption on an occasion which is to be ignored under section 431(1) (excluded occasions of redemption).

> Some products provide that the investor's principal will be fully at risk if an index such as the FTSE 100 falls below a specified threshold. Provided that there is a realistic prospect of such an event occurring, such products will be regarded as having capital protection of 10% or less in determining whether or not they are excluded indexed securities.
> Some products are structured so that the security issued to the investor is linked to the value of shares in a special purpose vehicle, warrants or other instruments. HMRC's view is that the effect of any instruments linked to the security must be taken into account in determining whether or not the terms under which that security is issued includes a provision that provides capital protection.

The SAI Manual provides:

> **SAIM3055 excluded indexed securities: chargeable assets** [Dec 2019]
> ... **Amount payable on redemption**
> The investor must have an entitlement to the issue price increased by the relevant change in the value of the chargeable assets (or index). Where the redemption value is to be satisfied by receipt of the linked chargeable assets themselves, with the result that the investor obtains more than the percentage change, the conditions would not be met. Nor is the condition satisfied if the return to the investor is geared, for example, if on redemption the investor receives twice the increase in the index (or some other multiple).
> **Total return index**
> The value of a 'total return' equity index reflects not only the price of the shares comprised in the relevant index, but also a measure of income in the computation of the level of that index. The value of the index may, for example, reflect an amount in respect of rolled-up dividends. Provided the index is a standard, commercially used index of the total return from shares, HMRC consider that it will be an index of the value of chargeable assets for the purposes of ITTOIA05/S433.

The SAI Manual provides:

> **SAIM3055 excluded indexed securities: chargeable assets** [Dec 2019]
> Where a security is linked to an index of chargeable assets, changes in the components of the index can be ignored so long as the index continues to reflect the population it was set up to mirror.
> Cases where the condition may not be satisfied, for example, where
> [1] a new index is used, or

[2] the linkage is to shares in only one company, which then changes, should be referred to BAI (Financial Products and Services Team).

29.7.3 *Interest payable on redemption*

Section 433(3) ITTOIA provides:

> Interest payable on redemption is ignored in determining for the purposes of this section the amount payable on redemption.

29.7.4 *"Redemption period"*

Section 433(4) ITTOIA provides:

> In subsection (1) "redemption period" means—
> (a) the period beginning with the date of issue and ending with the date of redemption, or
> (b) a period which is or includes almost all that period and only differs from it for purposes connected with giving effect to a valuation in relation to rights or liabilities under the security.

The SAI Manual provides:

> **SAIM3050 excluded indexed securities** [Dec 2019]
> ...**The redemption period**
> This is the period between the date of issue and the date of redemption. The rules allow slightly different dates to be used where there are difficulties in obtaining valuations on the issue or redemption dates, and for no other reason.

29.7.5 *"Chargeable asset"*

Section 433 ITTOIA provides:

> (5) An asset is a chargeable asset for the purposes of subsection (1) if a gain accruing to a person on its disposal would be a chargeable gain for the purposes of TCGA 1992 on the assumptions specified in subsection (6).
> (6) The assumptions are that—
> (a) the asset is an asset of the person,
> (b) the person is not entitled to the exemption conferred by section 100 of TCGA 1992 (exemption for authorised unit trusts etc),
> (c) disposal of the asset by the person would not be treated for income tax purposes as a disposal in the course of a trade, profession or vocation, and
> (d) section 116(10) of TCGA 1992 is ignored (chargeable gains on

subsequent disposals of qualifying corporate bonds acquired in reorganisations, conversions and reconstructions).

29.7.6 *Exclusion of RPI indexation*

Section 433(7) ITTOIA provides:

> For the purposes of this section—
> (a) neither the retail prices index nor any similar general index of prices published by the government of a territory or by an agent of such a government is an index of the value of chargeable assets

29.8 "Disposal"

Section 437(1) ITTOIA provides:

> References in this Chapter [Chapter 8 Part 4 ITTOIA, DDS code] to the disposal of a deeply discounted security are—
> (a) to its redemption,
> (b) to its transfer by sale, exchange, gift or otherwise, including a transfer treated as made by subsection (3) [death of holder], and
> (c) so far as not covered by para (a) or (b), to its conversion under its terms into shares in a company or other securities (including other deeply discounted securities).

29.8.1 *"Person making a disposal"*

Section 437(2) ITTOIA provides:

> The person treated as making a disposal is—
> (a) in the case of a disposal within subsection (1)(a), the person entitled as the security's holder to any payment on the disposal,
> (b) in the case of a disposal within subsection (1)(b), the transferor, and
> (c) in the case of a disposal within subsection (1)(c), the person who would be entitled as the security's holder to any payment on the disposal, if such a payment were made.

29.8.2 *Death of holder*

Section 437(3) ITTOIA provides:

> A person who dies while entitled to a deeply discounted security is treated as transferring it immediately before death to the personal representatives.

29.8.3 *Date of disposal/acquisition*

Section 438 ITTOIA provides:

> (1) This section applies if—
> (a) a transfer or acquisition of a deeply discounted security is made under an agreement, and
> (b) the transferee or the person making the acquisition becomes entitled to the security at the time the agreement is made.
> (2) The transfer or acquisition is treated as occurring at that time.
> (3) For this purpose a conditional agreement is taken to be made when the condition is met.

This is a Plain English rewrite of the CGT rules.[9]

29.9 "Profit"

Section 439 ITTOIA provides:

> (1) A person's profit on a disposal is the amount by which
> [a] the amount payable on the disposal exceeds
> [b] the amount paid by the person to acquire the security.
> (2) No account is to be taken of any incidental expenses incurred in connection with the disposal or acquisition.

I refer to this profit as **"DDS income"**.

29.9.1 *Deemed MV disposal*

Section 440 ITTOIA provides:

> (1) On the disposal of a deeply discounted security by a transfer of a kind specified in subsection (2), for the purposes of this Chapter [Chapter 8 Part 4 ITTOIA, DDS code] an amount equal to the market value[10] at the time of the disposal is treated as payable.
> (2) The transfers are—
> (a) a transfer made otherwise than by a bargain at arm's length,
> (b) a transfer between connected persons,
> (c) a transfer for a consideration which is not wholly in money or money's worth,
> (d) a transfer treated as made by section 437(3) (death), and
> (e) a transfer by personal representatives to a legatee.[11]

[9] See 56.10 (Date of disposal/acquisition).

[10] CGT valuation rules are incorporated by reference: s.460(3) ITTOIA.

[11] The definition of legatee in s.440(6)(7) is a Plain English rewrite of the CGT definition; see 88.7.2 ("Legatee").

Items (a) and (b) are the same as the CGT market value rule[12] but the rest of the list is different.

I refer to the profit on a disposal within this section as "**deemed DDS income**".

29.9.2 *Deemed MV acquisition*

Section 441 ITTOIA provides:

> (1) A person who acquires a deeply discounted security on a disposal of a kind specified in subsection (2) is treated for the purposes of this Chapter as acquiring it by the payment of an amount equal to its market value at the time of the disposal.
> (2) The disposals are—
> (a) a transfer within section 440(2)...[13]

What is the position if a security is issued for no consideration or at an undervalue? One would expect a market value acquisition cost, for the purpose of computing the holder's profit on a disposal; though it needs a purposive construction to reach a sensible conclusion.

29.10 Charge to tax on DDS income

Sections 427 and 428 ITTOIA impose the charge:

> **427 Charge to tax on profits from deeply discounted securities**
> (1) Income tax is charged on profits on the disposal of deeply discounted securities.
> (2) The profits are treated as income for income tax purposes if they would not otherwise be income.
> **428 Income charged**
> (1) Tax is charged under this Chapter [Chapter 8 Part 4 ITTOIA, DDS code] on the full amount of profits arising in the tax year.
> (2) The profits on a disposal are to be taken to arise when the disposal occurs.
> **429 Person liable**
> (1) The person liable for any tax charged under this Chapter is the person making the disposal.

29.11 DDS remittance basis

Section 428(3) ITTOIA provides:

[12] See App 4.8 (CGT market value rule).

[13] Section 441 also deals with conversions but conversions are not discussed here.

> If the profits arise on a disposal of securities that are outside the UK—
> (a) they are treated for the purposes of section 830 (meaning of "relevant foreign income") as arising from a source outside the UK,[14] and
> (b) subsection (1) is subject to Part 8 (foreign income: special rules).

This brings in the ITA remittance basis for a DDS that is outside the UK.

The section uses the words "treated as" because it may be said that DDS income does not have a source, at least in the normal UK tax sense.[15]

How does one decide whether a security is "outside the UK"? The wording is from the former schedule D case III.[16]

In the HMRC view the test is the residence of the issuer. The former Inspectors Manual para 1541 provided:

> Where the security was issued by a UK resident any profit is assessable under Case III of Schedule D. Where the security was issued by a non-UK resident, any profit is assessable under Case IV of Schedule D.

This is not obviously right, but it is as good a test as any other and (in relation to a non-resident issuer) at least we should know where we stand.[17] This passage is omitted in the SAIM but there is no indication that HMRC practice has changed.

This approach is consistent with the rule that interest from a security with a non-resident issuer is (at least generally) regarded as non-UK source income.[18] This will usually come to the same thing and I doubt if the point will ever need to be decided.[19]

[14] For this wording, see 16.6 (No source/deemed source).

[15] See 16.6 (Income without a source).

[16] See 26.10 (The situs approach).

[17] The position should not change if the issuer changes residence is less clear, by analogy with the *Bank of Greece* case: see 26.10.3 (*Bank of Greece*).

[18] See 26.15 (Source of interest: conclusion). Because the rules concerning the location of the source of interest are so unclear, it is impossible to say in what (if any) circumstances the source of the income might be different from the residence of the issuer.

This would be consistent with the AIP scheme, where the test is whether income from the security has a foreign source: see 28.9 (AIP remittance basis). However, the two cases are not the same, because a DDS may not yield any income, so the question whether income from the DDS has a foreign source could be a hypothetical question.

[19] If it mattered, the view that income source was the test should be rejected, for if the drafter intended to apply an income-source test, one would have expected the wording

For completeness: another possible approach is that "outside the UK" means situated outside the UK applying common law situs rules. This view is less attractive since (1) common law situs do not always produce a sensible result; (2) common law situs is not generally relevant for IT; (3) one would have expected the drafter to use the word "situate" if it was intended to incorporate a situs rule.

Strictly, one cannot segregate income from capital (for no identifiable part of the proceeds represents the income). But since HMRC do not apply that rule for the accrued income scheme,[20] they should logically not take the point in this context either. There is however no discussion in the RDR Manual.

Deemed DDS income (eg on a gift) cannot be remitted and so is tax free.[21]

29.12 UK resident trust

29.12.1 *UK trust not settlor-interested*

A UK resident trust is in principle subject to income tax on its DDS income. Tax is charged at the trust rate.[22]

29.12.2 *UK settlor-interested trust*

DDS income accruing to UK trustees is not "income" in the general sense and in the absence of express provision it would not fall within s.624 ITTOIA which only applies to income. However s.427(2) ITTOIA directs that the profits are "treated as income for income tax purposes" so it does fall within s.624 ITTOIA. For good measure, s.457 ITTOIA provides:

> (1) This section applies if profits are taken to arise on a disposal of a deeply discounted security by trustees.
> (2) For the purposes of Chapter 5 of Part 5 (settlements: amounts treated as income of settlor), the profits are to be taken to be income arising under the settlement from the security. ...

Thus DDS income does fall within the settlor-interested trust code.

If the settlor is a remittance basis taxpayer the s.624 remittance basis is

to match that used elsewhere for income-source tests. The wording is not very far from the former case IV in s.18 ICTA 1988 ("income arising from securities out of the UK") but there the words "out of the UK" govern "arising" and not "securities".

[20] See 28.9 (AIP remittance basis).

[21] The CGT rule does not apply here; see 18.45 (Gain on disposal at undervalue).

[22] See 41.2.3 (Trust-rate income).

available, ie the settlor is not taxed on unremitted foreign DDS income.[23]

The rate of tax in the absence of s.624 is the trust rate, ie the top rate, so s.624 can only reduce the tax rate (or make no difference).

29.13 Non-resident individual

Section 368 ITTOIA provides the necessary exemption for non-residents.[24] In short non-resident individuals are not chargeable if the security is out of the UK. They are theoretically chargeable if the security is in the UK but non-resident IT relief is usually available.[25]

29.14 Non-resident trust

In the absence of express provision, non-resident trustees would not be charged on foreign DDS income but could be charged on UK DDS income. However s.458(1) ITTOIA provides:

> Tax is not charged under this Chapter [Chapter 8 Part 4 ITTOIA, DDS code] if the disposal is made by the trustees of a settlement[26] and they are non-UK resident.

So non-resident trusts are not subject to tax on DDS, whether UK or foreign.

It is considered that s.624 applies to non-resident settlor-interested trusts as it applies to UK resident trusts. Section 458 does not provide relief since the charge on settlor-interested trusts is not a charge "under this Chapter".

29.15 Transfer of assets abroad

A DDS profit accruing to a non-resident is not "income" so in the absence of express provision it would not fall within the ToA provisions even if it accrued to a person abroad within s.720 or 731. However s.427(2) ITTOIA directs that the profits are "treated as income for income tax purposes" so it does fall within the ToA provisions. For good measure, s.459 ITTOIA provides:

[23] See 47.8 (s.624 remittance basis).

[24] See 16.2 (Source: IT territorial limit).

[25] See 45.1 (Non-residents IT relief: Introduction).

[26] "Settlement" here means settlement-arrangement: see s.458(3) which provides:
"In this section 'settlement' has the same meaning as in Chapter 5 of Part 5 (see section 620)."

> (1) This section applies if profits are taken to arise on the disposal of a deeply discounted security by a person resident or domiciled outside the UK ("A").
> (2) For the purpose of determining whether a UK resident individual is liable for income tax in respect of the profits, Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) has effect as if the profits, when arising, constituted income becoming payable to A.
> (3) For this purpose it does not matter if A is not liable to income tax under this Chapter [Chapter 8 Part 4 ITTOIA, DDS code] because of section 458 (non-UK resident trustees).

Thus DDS profits do fall within the scope of the ToA provisions.

29.15.1 *s.731 ITA*

The charge is on the actual profit, not a fictional profit. The proceeds of the disposal represent that profit.

How does the rule that distributed income is not relevant income[27] operate in this context? Is it necessary merely to distribute an amount equal to the DDS profit or is it necessary to distribute the entire proceeds of the transfer (sale) of the security? The matter is analogous to the CGT issue which arose when a UK resident foreign domiciled beneficiary sold a non-UK situate asset and realised a chargeable gain. Prior to the 2008 mixed fund rule, if the individual remitted (say) one-half of the proceeds of sale, their were regarded as remitting one-half of the gain.

Inspectors Manual para 1567 explained:

> This is because, whilst the income content of any fund is a separate and distinguishable part of that fund, a capital gain is merely part of the whole proceeds of a disposal transaction that has no separate identifiable existence within those proceeds.

The same reasoning would apply here. Thus the only way to avoid relevant income by distribution would be to distribute the entire proceeds of an arm's length disposal. It is conceivable that HMRC will not apply the law on this point strictly, but do not rely on this without clearance.

If there are only fictional profits, because the market value rule applies[28] then s.731 does not apply because fictional income cannot be used to

[27] See 50.29 (Income distributed as income in year it arises) to 50.27 (Distributed income: HMRC view).

[28] See 29.9 ("Profit").

benefit a beneficiary, so it cannot be relevant income.

29.16 Non-resident company

Section 368 ITTOIA provides the necessary exemption for non-residents.[29] In short, they are not chargeable if the security is outside the UK. They are theoretically chargeable if the security is in the UK, but see 45.1 (Non-resident IT relief). The company DDS income is within the scope of the ToA provisions.

29.17 Interaction with CGT

29.17.1 *DDS is a QCB*

Section 117(1) TCGA provides the usual definition of corporate bond. Section 117(2AA) provides:

> For the purposes of this section "corporate bond" also includes any asset
> [i] which is not included in the definition in subsection (1) above and
> [ii] which is a deeply discounted security for the purposes of Chapter 8 of Part 4 of ITTOIA 2005 (see section 430).

Thus a DDS is a corporate bond.

Section 117(7) TCGA defines "qualifying" corporate bond as (in short) any corporate bond issued after 13 March 1984.

Thus (in short) a DDS is in principle a qualifying corporate bond ("QCB").

29.17.2 *Significance of QCB status*

Section 115(1) TCGA provides exemption for QCBs:

> A gain which accrues on the disposal by any person of—
> (a) gilt-edged securities or qualifying corporate bonds, or
> (b) any option or contract to acquire or dispose of gilt-edged securities or qualifying corporate bonds,
> shall not be a chargeable gain.

The DDS profit is subject to income tax, and so would not be subject to CGT in any event. One consequence of QCB status is that a loss on a DDS is not an allowable loss for CGT purposes. QCB status is also relevant for conversions/reorganisation relief (not discussed here).

[29] See 16.2 (Source: IT territorial limit).

29.18 DDS/CGT compared

Although the DDS code occasionally adopts CGT-type rules, there are many differences, in particular:

(1) Expenses of acquisition/disposal are disallowed.

(2) Death, and transfer from PR to legatee, are occasions of charge.

(3) There is no group relief so an inter-group transfer may give rise to a charge.

CHAPTER THIRTY

DIVIDEND INCOME

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30.17 Dividend taxation: Critique

Cross references

The following topics are considered elsewhere:
10.3.1 (Split year: Pt 4/5 ITTOIA Income)
11.11 (TNR dividend code)
15.6 (When are dividends recognised)
43.5.7; 43.10 (Dividend rates)
55.1 (Transactions in securities)

30.1 Dividends and distributions

A full discussion of the taxation of dividends and distributions needs a book to itself. This chapter focuses on matters closest to the themes of this book.

The taxation of dividends/distributions is scattered across 3 Chapters of ITTOIA:

My term	Type of income	Company	ITTOIA
UK dividend regime	Dividend/distribution	UK resident	Chap 3 Pt 4
Offshore dividend regime	(a) Dividend	Non-resident	Chap 4 Pt 4
	(b) Income-distribution	Non-resident	Chap 8 Pt 5

Unfortunately there are (at least) *five* definitions of dividend/distribution! Each set of provisions discussed here has a distinct definition, with CT (not discussed here) different again. The definition of distribution for company law purposes is different from the tax definitions. I have considered devising distinct terminology, but it is clearest to follow the statutory terminology – as long as one bears in mind that dividend/ distribution have distinct meanings in each context.

Where appropriate I abbreviate dividend/distribution to dividends, leaving distribution to be understood. There are distinctions here, but in general commercial use the two terms are used interchangeably.

I do not discuss the corporation tax treatment of dividends received by UK resident companies.

30.2 Dividends a separate source

Dividend income received by a shareholder is not the same income as that of the company. In *Barnes v Hely-Hutchinson*:[1]

> The English company is taxed on the balance of its profits or gains, that is on its income; the shareholder is taxed on his own income. The shareholder is never taxed on the company's fund of profits, but only on the dividend which comes to him in payment of the debt which is created when the company declares the dividend. The tax is in every case on the individual's income, not on a fund possessed by another person, the company, even though it is the fund of profits of that company, from which the individual's income or part of it will be paid ... The fund which is taxed in the hands of the company and the dividend which is declared by the company in favour of the shareholder are separate items for taxation law. It is only the latter which is the shareholder's income.

In *Vestey v IRC*:[2]

> The income of the company and the income derived from the company by the shareholders are two quite different incomes.

30.3 UK dividend regime

30.3.1 *The charge to IT*

Section 383(1) ITTOIA imposes the charge:

> Income tax is charged on dividends and other distributions of a UK resident company.

It does not matter whether the receipt is a dividend or "other distribution"; hence I refer to "dividends/distributions".

Section 384(1) ITTOIA provides:

[1] 22 TC 655 at p.676.

[2] 54 TC 503 at p.562. Likewise *Canadian Eagle Oil v The King* 27 TC 205 at p.257: "for the purposes of Income Tax, the income of a foreign company and the income received from it in dividends by its British shareholders are not to any extent or effect one and the same income, but are two distinct incomes".
Likewise *Anson v HMRC* [2015] UKSC 44 at [92]:
"A dividend is a paradigm case of income which does not have the same source, under UK or US tax law, as the profits out of which it is paid"
See too 107.4 (Co/shareholder double taxation).

> Tax is charged under this Chapter on the amount or value of the dividends paid and other distributions made in the tax year. ...

There is no reference to the remittance basis rules in Part 8 ITTOIA, so dividends/distributions from UK resident companies are taxed on the arising basis (even for remittance basis taxpayers). This is because dividends/distributions from UK resident companies are regarded as UK source income.[3]

For rates of tax, see 43.10 (Application of dividend rates).

30.3.2 *Dividend of capital nature*

Section 383 ITTOIA extends the charge to distributions of a capital nature, for instance, bonus issues of shares or securities, and purchase of own shares:

> (2) For income tax purposes such dividends and other distributions are to be treated as income.
> (3) For the purposes of subsection (2), it does not matter that those dividends and other distributions are capital apart from that subsection.

30.4 "Distribution"

30.4.1 *Definition in outline*

In ordinary language, dividend and distribution are used synonymously,[4] but in tax the term distribution is defined. The tax definition is different from the definition which applies for company law purposes, though the differences do not usually matter.

Section 989 ITA provides:

> The following definitions apply for the purposes of the Income Tax Acts—
> "distribution" has the meaning given by Chapters 2 to 5 of Part 23 of CTA 2010, disregarding section 1027A of that Act.

I refer to the CTA definition as the "standard tax definition". It is a wide and artificial definition. A full discussion would need a long chapter. I only attempt an outline here. I do not consider the special rules for Building Societies.

[3] For the source of dividend income, see 30.8.1 (Dividend: IT charge).

[4] This is self-evident, but if authority is needed, see *Beard v HMRC* [2022] UKFTT 129 (TC) at [198].

The starting point is s.1000(1) CTA 2010 which provides:

> In the Corporation Tax Acts "distribution", in relation to any company, means anything falling within any of the following paragraphs.

There are 8 paragraphs, numbered A to H:

Para	**Topic**
A	Dividends
B	Other distributions
C, D	Issue of securities
E, F	Interest
G	Transfer of assets/liabilities
H	Bonus issue & repayment

Clipperton v HMRC[5] described the purpose of the distributions code:

> to tax shareholders on value which a company delivers to them out of its assets, directly or indirectly, by some non-prescribed means.

It is helpful first to deal with the definitions used in s.1000.

30.5 "In respect of shares/securities"

These expressions are used in para B (other distributions) and elsewhere. The legislation gives commonsense definitions:

s.1113 CTA 2010: in respect of shares	**s.1114: in respect of securities**
(3) For the purposes of this Part a thing is regarded as done in respect of a share if it is done to a person—	(4) For the purposes of this Part a thing is regarded as done in respect of a security if it is done to a person—
(a) as the holder of the share, or (b) as the person who held the share at a particular time.	(a) as the holder of the security, or (b) as the person who held the security at a particular time.
(4) For the purposes of this Part a thing is also regarded as done in respect of a share if it is done in pursuance of a right granted, or an offer made, in respect of a share.	(5) For the purposes of this Part a thing is also regarded as done in respect of a security if it is done in pursuance of a right granted, or an offer made, in respect of a security.

Section 1117 CTA 2010 provides:

[5] [2022] UKUT 351 (TCC) at [58].

s.1117(7): in respect of shares	**s.1117(8): in respect of securities**
For the purposes of this Part, if something done in respect of shares is done by reference to share holdings at a particular time, it is regarded as done—	(8) For the purposes of this Part, if something done in respect of securities is done by reference to holdings of securities at a particular time, it is regarded as done—
(a) to the then holders of the shares, or (b) to the personal representatives of any holder then dead.	(a) to the then holders of the securities, or (b) to the personal representatives of any holder then dead.

In *Clipperton v HMRC*:[6]

> the requirement for a distribution out of assets to be "in respect of shares" refers to a situation where the relevant asset or value is put into the hands of a shareholder in [the shareholder's] capacity as such, in effect, as a return on or by reference to [the shareholder's] shareholding as an investment in the company, and not in some other capacity and for some other reason.

The textbook *Taxation of Companies & Company Reconstructions* provides:[7]

> even a benefit conferred by a company on a non-shareholder may be "in respect of shares" if it is conferred at the request or wishes of a shareholder. A presumption to this effect may arise if, for example, an asset is transferred to an associate of a member and there is no apparent commercial reason for the transfer other than that person's connection with the shareholder.

There is a multi-factorial test. In *HMRC v Conran*:[8]

> ... the issue will inevitably call for an assessment of all the facts and circumstances.
> That exercise, of looking at the whole picture, would tend to point against the sort of analysis which singles out a particular factor as determinative. As well as the labelling of the payment by the party being inconclusive ... other features which cannot necessarily be assumed to be determinative will include the legal nature of the transaction by

[6] [2022] UKUT 351 (TCC) at [58].

[7] Paragraph E1.2.6) [footnotes omitted].

[8] [2023] UKUT 166 (TCC) at [101]

which the sum is delivered to the recipient, or the means, if different, by which the sum (said to give rise to the distribution) emerges from the relevant company.

30.5.1 *Groups*

Section 1113 CTA 2010 also deals with groups:

s.1113 CTA 2010: in respect of shares	**s.1114: in respect of securities**
(1) In this Part [Part 23 Company Distributions] "in respect of shares in the company", in relation to a company which is a member of a 90% group,[9] means	(1) In this Part "in respect of securities of the company", in relation to a company which is a member of a 90% group, means
in respect of shares in— (a) that company, or (b) any other company in the group	in respect of securities of— (a) that company, or (b) any other company in the group.
(2) Nothing in subsection (1) requires a company to be treated as making a distribution to any company which is in the same group and is UK resident.	[Identical]

30.5.2 *"New consideration"*

New consideration matters for:
(1) Para B (other distributions); and
(2) Para C/D: issue of securities

New consideration is elaborately defined in s.1115 CTA 2010:

> (1) In this Part, unless the context otherwise requires—
> (a) "new consideration" means consideration not provided (directly or indirectly) out of assets of the company, and
> (b) in particular, "new consideration" does not include amounts retained by the company by way of capitalising a distribution.
> But paragraph (a) is subject to the other subsections of this section.
> (2) Subsection (3) applies if—

[9] Defined s.1113(6)/1114(6): "In this section "90% group" means a company and all its 90% subsidiaries."

(a) share capital has been issued at a premium representing new consideration, and
(b) any part ("the applied part") of that premium is afterwards applied in paying up share capital.

(3) The applied part of the premium is also treated as new consideration for that share capital.

But the premium is not so treated so far as it has been taken into account under section 1025(2) so as to enable a distribution to be treated as a repayment of share capital.

(4) The general rule is that no consideration derived from the value of any share capital or security of a company, or from voting or other rights in a company, is to be treated for the purposes of this Part as new consideration.

(5) The general rule in subsection (4) applies unless the consideration consists of—

(a) money or value received from the company as a non-CD distribution,
(b) money received from the company as a payment which for the purposes of this Part constitutes a repayment of the share capital in question, or of the principal secured by the security in question, or
(c) the giving up of the right to the share capital or security on its cancellation, extinguishment or acquisition by the company.

This is subject to subsection (6).

(6) No amount is regarded as new consideration by virtue of subsection (5)(b) or (c) so far as it exceeds—

(a) any new consideration received by the company for the issue of the share capital or security in question, or
(b) in the case of share capital which constituted a non-CD distribution on issue, the nominal value of that share capital.

(7) In this section "non-CD distribution" means any distribution other than one which is a distribution for the purposes of the Corporation Tax Acts only because it falls within paragraph C or D in section 1000(1) (redeemable share capital or security issued as bonus in respect of shares in, or securities of, the company).

30.5.3 *Out of assets*

Section 1117(4) CTA 2010 provides:

For the purposes of this Part consideration is treated as provided out of assets of a company if the cost falls on the company.

30.5.4 *Shares*

Section 1117 CTA 2010 provides:

> (1) In this Part, except where the context otherwise requires—
> "share" includes stock, and any other interest of a member in a company.
> (5) References in this Part to issuing share capital as paid up also apply to the paying up of any issued share capital.

30.5.5 *"Securities"*

On the meaning of "security" see App. 2.13 (Security: 5 statutory definitions).

A money debt which is not a security is effectively deemed to be a security. Section 1114(3) CTA 2010 provides:

> For the purposes of this Part, except where the context otherwise requires—
> (a) interest paid by a company on money advanced without the issue of a security for the advance, or
> (b) other consideration given by a company for the use of money so advanced,
> is treated as if paid, or given, in respect of a security issued for the advance by the company.

Section 1117(6) CTA 2010 provides:

> If securities—
> (a) are issued at a price less than the amount repayable on them, and
> (b) are not listed on a recognised stock exchange,[10]
> then, for the purposes of this Part the principal secured is not taken to exceed the issue price, unless the securities are issued on terms reasonably comparable with the terms of issue of securities listed on a recognised stock exchange.

30.6 Definition of distribution

30.6.1 *Para A: Dividends*

Armed with these definitions we can turn to the definition of distribution.

Section 1000(1) CTA 2010 provides:

[10] See App 2.18 (Listed/Recognised stock exchange).

> In the Corporation Tax Acts "distribution", in relation to any company, means anything falling within any of the following paragraphs.
> A Any dividend paid by the company, including a capital dividend.

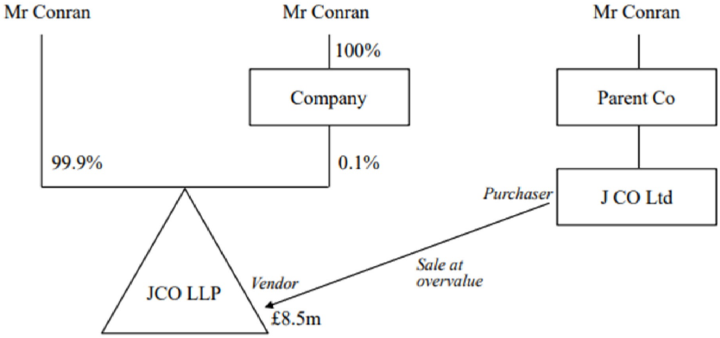
On the meaning of dividend, see 30.8.3 (Definition of "dividend"). But the point does not usually arise, since something which is not a dividend under para A may fall within para B.

30.6.2 *Para B: Other distributions*

Section 1000(1) CTA 2010 provides:

> In the Corporation Tax Acts "distribution", in relation to any company, means anything falling within any of the following paragraphs...
> B Any other distribution out of assets of the company in respect of shares in the company,

"Distribution" in para B[1] presumably has its company law meaning. In *HMRC v Conran*[11] the structure was as follows:



JCO Ltd purchased an asset from JCO LLP at an overvalue. The asset was sold for £8.5m but was found to be worth £1. So £8.5m of value passed from the company to Mr Conran. This was a distribution under para B. The FTT held that the payment was made to the taxpayer in his capacity as partner of JCO LLC and not as shareholder (so the payment was not "in respect of shares"). The UT held the payment was made to him as (indirect) shareholder and not as partner (so it was "in respect of shares"). I would have thought the correct answer was that it was both: it

[11] [2023] UKUT 166 (TCC).

was a payment to Mr Conran as partner *and* as (indirect) shareholder: the two are consistent. But the important point is whether the payment was in respect of shares, and it was:[12]

> (1) A basic point was to step back and recognise Mr Conran's ultimate ownership of the various entities. In relation to the selling LLP, JCO, Mr Conran was a member of the LLP and owner of the other member (JCE). In relation to the purchaser and paying entity JCV Ltd. Mr Conran was also shareholder and sole director. Mr Conran was thus wearing many different hats. HMRC are right to say the taxpayer's case requires him to say that he had no regard to himself as ultimate owner of JCV Ltd when agreeing a price that might have turned out to be excessive.
> (2) There was also no evidence that the OPLA business was offered to anyone other than entities owned and controlled by Mr Conran. In other words Mr Conran was simply moving his assets/ cash around wholly controlled vehicles.

It made no difference that Mr Conran was not an indirect and not a direct shareholder of JCV Ltd.

30.6.3 *Para B: Exceptions*

Para B sets out two exceptions ("Exception B(a) and B(b)"):

> except however much (if any) of the distribution—
> (a) represents repayment of capital on the shares or
> (b) is (when it is made) equal in amount or value to any new consideration received by the company for the distribution.
> For the purposes of this paragraph it does not matter whether the distribution is in cash or not.

Something within exemption B(a) is also not an income-distribution chargeable to IT under s.687.

HMRC comment in relation to this exemption:

> **What is the capital on the shares?**
> For companies incorporated in the UK under the Companies Act 2006 or its predecessors, this will usually comprise nominal share capital. In addition, where shares are issued at a premium Part 23 CTA 2010 (see section 1025), consistently with section 610(4) Companies Act 2006, makes it clear that share premium is treated as part of the share capital

[12] at [112].

for this purpose. Amounts subscribed for share capital or paid as share premium will be treated as "capital on the shares".

For companies that do not have share capital, for example, companies limited by guarantee, Part 23 CTA 2010 extends the definition of share to include stock or any other interest of a member of the company.

For foreign companies, it may be less clear what capital on the shares consists of. The facts may vary between cases, but HMRC would normally expect to treat as a distribution an amount that:

- is distributable in accordance with the relevant company law, and
- is not made on winding up or as part of a procedure under the relevant company law for reducing share capital.

This is subject to section 1027A CTA 2010 which for the purposes of determining whether an amount is a repayment of capital on the shares, treats a distribution out of a reserve arising from a reduction of share capital as if it were made out of profits available for distribution otherwise than by virtue of the reduction. This will depend on whether section 1027A(4) applies or not to the reduction of share capital.

With regard to application of section 1025 CTA 2010, which treats a repayment of share premium as forming part of the share capital where the premium account was created in respect of new consideration received on the issue of the share capital, HMRC will normally, depending on application of the foreign company law, not treat a payment of out of a share premium account as a repayment of share capital in circumstances where under the foreign company law share premium is fully distributable and is not treated as forming part of the share capital.

30.6.4 *Para C/D: Issue of securities*

Section 1000(1) CTA 2010 provides:

> In the Corporation Tax Acts "distribution", in relation to any company, means anything falling within any of the following paragraphs...

Para C: redeemable share capital	**Para D: security**
C Any redeemable share capital issued by the company—	D Any security issued by the company—
(a) in respect of shares in, or securities of, the company, and (b) otherwise than for new consideration (see sections 1003 and 1115).	(a) in respect of shares in, or securities of, the company, and (b) otherwise than for new consideration (see sections 1004 and 1115).

30.6.5 *Para E/F: Interest*

Section 1000(1) CTA 2010 provides:

> In the Corporation Tax Acts “distribution”, in relation to any company, means anything falling within any of the following paragraphs...

Para E: Non-commercial securities	**Para F: Special securities**
E Any interest or other distribution out of assets of the company in respect of securities of the company which are non-commercial securities (as defined in section 1005), except—	F Any interest or other distribution out of assets of the company in respect of securities of the company which are special securities (as defined in section 1015), except—
(a) however much (if any) of the distribution represents the principal secured by the securities, and (b) however much (if any) of the distribution represents a reasonable commercial return for the use of the principal.	(a) however much (if any) of the distribution represents the principal secured by the securities, and (b) however much (if any) of the distribution falls within paragraph E.

I do not pursue the definition of non-commercial/special securities. Non-commercial securities are, broadly, those carrying more than a reasonable commercial return. In *Shinelock v HMRC*:[13]

> the purpose of paragraph F, its purpose is (broadly) to deny treatment as a deductible borrowing cost for payments which are in substance a distribution of profit. It is, to that extent, an example of a dividing line between returns on debt and returns on equity. Its concern is not with whether a payment represents a reasonable return, but with whether it depends on the profits or results of the company’s business. If it does so depend, then the entire amount is treated as a distribution. To take a straightforward example, if a reasonable commercial return on a security was 10%, but that 10% return was expressed to be contingent on the availability of distributable reserves, or the profitability of part of the business, then the entirety of the payment would fall within paragraph F, whereas on [the taxpayer’s] construction it would fall entirely outside the distribution provisions. We therefore reject this argument.

[13] [2023] UKUT 107 (TCC) at [89].

30.6.6 *Para G: Transfer of assets/liabilities*

Section 1000(1) CTA 2010 provides:

> In the Corporation Tax Acts "distribution", in relation to any company, means anything falling within any of the following paragraphs...
> G Any amount treated as a distribution by section 1020 (transfers of assets or liabilities).

That takes us to s.1020 CTA 2010:

> (1) This section applies if on a transfer of assets or liabilities—
> (a) by a company to its members, or
> (b) to a company by its members,
> the amount or value of the benefit received by a member exceeds the amount or value of any new consideration given by the member.
> (2) The company is treated for the purposes of the Corporation Tax Acts as making a distribution to the member of an amount equal to the excess.
> (2A) But the company is not treated as making a distribution under subsection (2) if the transfer of assets or liabilities—
> (a) is a distribution by virtue of paragraph B in section 1000(1), or
> (b) would be such a distribution in the absence of sub-paragraph (a) of that paragraph (distribution representing repayment of capital on the shares).
> (3) For the purposes of subsection (1) the amount or value of a benefit, or of any consideration, is determined in accordance with the market value.

30.6.7 *Para H: Bonus issue & repayment*

Section 1000(1) CTA 2010 provides:

> In the Corporation Tax Acts "distribution", in relation to any company, means anything falling within any of the following paragraphs...
> H Any amount treated as a distribution by section 1022 (bonus issues following repayment of share capital).

That takes us to s.1022 CTA 2010:

> (1) Subsection (3) applies if a company—
> (a) repays or has repaid any share capital, and
> (b) at or after the time of the repayment issues any share capital as paid up otherwise than by the receipt of new consideration.
> (2) But subsection (3) does not apply so far as any provision of the Corporation Tax Acts makes contrary provision.

> (3) The amount paid up as mentioned in subsection (1)(b) is treated for the purposes of the Corporation Tax Acts as a distribution made in respect of the shares on which it is paid up, except so far as that amount exceeds the adjusted amount of the repaid share capital.
> (4) The reference in subsection (3) to the adjusted amount of the repaid share capital is to—
> (a) the amount, or total amount, of share capital repaid as mentioned in subsection (1)(a), minus
> (b) any amounts previously paid up as mentioned in subsection (1)(b) and treated as distributions by virtue of subsection (3).

Section 1023 CTA 2010 sets out a number of exceptions not discussed here.

30.7 Non-resident recipient

Section 399 ITTOIA provides:

> (1) This section applies if—
> (a) a person's income for a tax year includes a distribution of a company, and
> (b) the person is non-UK resident.
> (2) The person is treated as having paid income tax at the dividend ordinary rate on the amount or value of the distribution.
> (6) The income tax treated as paid under subsection (2) is not repayable.

Does s.399 apply if a distribution is received by a person abroad, within the scope of s.720 ITA?

The non-resident recipient should be entitled to credit relief, ie to set the UK IT which is treated as paid against foreign tax in the person's country of residence. But that is a matter for the foreign tax law to determine.

Section 399 does not apply to income of a split year, even if it arises in the overseas part of the year.

Does s.399 apply to foreign source distributions? Presumably not.

30.8 Offshore dividend regime

30.8.1 *Dividend: IT charge*

Section 402(1) ITTOIA imposes a charge to tax on dividends from non-resident companies:

> Income tax is charged on dividends of a non-UK resident company.

Section 403(1) ITTOIA provides:

> Tax is charged under this Chapter on the amount of the dividends arising in the tax year.
>
> (2) Subsection (1) is subject to
>
> [a] section 406(2) and (3) (later charge where cash dividends retained in SIPs are paid over),
>
> [b] section 407(3) (dividend payment when dividend shares cease to be subject to SIP), and,
>
> [c] Part 8 (foreign income: special rules).

Section 403(2)[c] ITTOIA incorporates the remittance basis for foreign source dividends.

30.8.2 *Location of source of dividend*

When do dividends have a foreign source? There are many possible connecting factors, but *Bradbury v English Sewing Cotton*[14] decided that the source of income from shares is situated in the place where the company is resident – not where it is incorporated or where the share register is kept.[15]

Thus the application of a DTA (which affects company residence) may also affect the location of a source. EN ITTOIA discusses the point in relation to OEICs:

> 50. The definition of an open-ended investment company ... carries a limitation that the company should be incorporated in the UK[16] ... All open-ended investment companies within the definition ... are therefore subject to the company residence rule [the incorporation rule]. Open-ended investment company interest distributions treated as made by a UK resident company will be UK source income. [The company DTA residence rule] could in theory also apply to make such companies non-resident ...[17] In that case interest distributions made will be treated as dividends from non-resident companies.

30.8.3 *Definition of "dividend"*

The term "dividend" is (sensibly) undefined so it has its ordinary meaning,

[14] 8 TC 481.

[15] This illustrates how IT source rules may differ from IHT/private international law situs rules. Why a residence test for source? Given that the UK taxes the profits of a UK resident company before distribution, it seems consistent that residence should also determine the source of distributed profits.

[16] See 66.1.2 (Open-ended investment co).

[17] See too 26.17 (Co-operative & community benefit society income).

whatever that is. There is no definition in tax or company legislation. EN ITTOIA provides:

> 187. ... "Dividend" is a widely used and understood term and is defined only in very specific circumstances not applicable in this context... It is not thought appropriate to attempt to define "dividend" here. It will usually be a matter of referring to the relevant company law to determine whether or not a payment made by a company is a dividend.

In *HMRC v PA Holdings*:[18]

> A dividend is a payment-out of a part of the profits for a period in respect of a share in a company.

Beard v HMRC commented:[19]

> (1) The test is to be looked at from the perspective of the paying company.
> (2) The source of the payment is not determinative.
> (3) The labels applied by the paying company are not determinative.
> (4) The broad description of a dividend set out by Harman J in *Esso*[20] is a starting point for the definition of a dividend, providing "general words but not legislation"
> (5) Each case needs to be considered on its particular facts, including, as a relevant fact, whether the "dividend" in question is debited to a capital account.

Section 402(4) ITTOIA provides:

> In this Chapter [Chapter 4 Part 4, dividends from non-UK resident companies] "dividends" does not include dividends of a capital nature.

30.8.4 *Income-distribution: IT charge*

Section 402 only applies to dividends. Depending on how widely one understands the term "dividend", it is possible, or may be possible, to have a receipt from a non-resident company which:

[18] [2011] EWCA Civ 1414 at [46] citing *Esso Petroleum v Ministry of Defence* 62 TC 253 at p.255-6 and *Memec v IRC* 71 TC 77.

[19] [2022] UKFTT 129 (TC) at [187].

[20] *Esso Petroleum Co v Ministry of Defence* [1990] Ch 163 at p.165:
"In ordinary language today among people having some understanding of business a "dividend" refers to a payment out of part of the profits for a period in respect of a share in a company."

(1) is not a dividend and
(2) is of an income nature (not a capital receipt)

This is charged under s.687 ITTOIA (Misc Sweep-up Income).[21] I refer to that as an **"income-distribution"** as the receipt (though not a dividend) will be a distribution in the general sense of the word. (The terminology is not ideal, as a receipt which a distribution in the standard tax sense may not be an income-distribution, ie may be of a capital nature. But I cannot think of better terms.)

The remittance basis applies for foreign source income-distributions.[22] Income-distributions have a foreign source if the company is non-UK resident: the same test applies as for dividends.

Thus we have three distinct charging provisions for receipts from a company:

ITTOIA	**Company**	**Charge on**
s.383	UK resident	Dividends, distributions (in standard tax sense)
s.402	Non-resident	Dividends
s.687	Non-resident	Income-distributions (my term)

EN ITTOIA Vol. II explains why:

> 184. Income which, under the source legislation, is charged to tax under Schedule D Cases IV or V, has, where appropriate, been fully integrated with the equivalent income arising from a UK source. In the case of dividends from non-UK resident companies there is no exact equivalent in terms of UK source income. The closest equivalent is the charge to tax on dividends and other distributions from UK resident companies (section 20 of ICTA, Schedule F in the source legislation). But there is no precise overlap. The UK charge, by the adoption of the definition of "distribution"[23] ... can include dividends or distributions of a capital nature and can also operate to convert payments that would otherwise be treated as interest into distributions. Any charge on distributions from non-UK resident companies must be confined to income only. For this reason ... it is not thought appropriate to integrate the charges. So a separate charge is needed to cover dividends from non-UK resident companies. ...
>
> 186. ... It is possible that a non-UK resident company may make a

[21] See 33.1 (Misc Sweep-up Income).
[22] See 33.18 (Sweep-up income: Remittance basis).
[23] See 30.4 ("Distribution").

> distribution of income which would not fall within Chapter 4 of Part 4 of this Act because it is not a "dividend". But if the distribution comprises income it will fall to be dealt with either under alternative specific charges (eg interest) or within "income not otherwise charged", the charge on which appears in Chapter 8 of Part 5 of this Act.

For non-resident companies, it does not usually matter whether a receipt from a company is classified as

(1) a dividend, chargeable under s.402) or
(2) an income-distribution (my terminology), chargeable under s.687.

In either case the receipt is taxable if it is income and not capital in nature. But there is an important difference between UK companies and non-resident companies, because:

(1) for UK companies the charge is on "distributions" (in the standard tax sense which is very wide)
(2) for non-resident companies the charge is on dividends/income distributions (undefined). That is, for a non-resident company one can ignore the wide standard tax definition of "distribution".

30.9 Non-resident company: Income/capital

30.9.1 *Why income/capital matters*

It is no longer a universal truth that "Income tax is a tax on income"[24] but the principle still applies for the charges on non-resident companies:

(1) The charge on dividends excludes dividends of a capital nature.
(2) The charge on income-distributions applies only to "income"; this comes to the same thing: it excludes receipts of a capital nature.

The question then is how to distinguish income/capital. There is a large body of case law. The discussion here draws on the Law Commission Consultation Paper, "Capital and Income in Trusts".[25]

[24] See 14.5 (Income Tax: a tax on income?)

[25] *https://www.lawcom.gov.uk/project/capital-and-income-in-trusts-classification-and-apportionment/* (2004) part II. The subsequent report (Law Com 315, 2009) contains a shorter discussion. The report lead to the Trusts (Capital and Income) Act 2013 but this Act does not have much effect on the tax issues discussed here.
Scots trust law is discussed in Scot Law Com Discussion Paper No 124, *Apportionment of Trust Receipts and Outgoings* (2003) para 2.2-2.7
https://www.scotlawcom.gov.uk/files/4512/7816/0465/dp124_trust_receipts.pdf
It seems clear that the same principles apply in both jurisdictions.

After 1965, the income/capital distinction ceased to matter for the taxation of distributions from UK resident companies, because distributions of a capital nature were brought into the income tax charge.[26] (The distinction still matters for trust law). However pre-1965 tax cases relating to UK resident companies remain relevant to the classification of distributions from non-resident companies.

30.9.2 *Corpus intact*

This goes back to *IRC v Reid's Trustees*:

> I cannot imagine a safer or better [basis], where the question is as to income arising from a foreign possession, than to ask whether the corpus of the asset remains intact in the hands of the taxpayer. That question can, in the case of the shares here in question, only be answered in the affirmative. The shares the Respondents held before the distribution of dividend they still hold intact. The dividend they received was income arising out of those shares.
> ...the dividend cannot be capital because the Respondents' foreign possessions, the shares, remain intact and. therefore, the dividend must be income. It is admitted that if the money had been paid by way, of reduction of the share capital, that would not have been income; the shares would not have remained the same. It is also admitted that if the surplus profits had been used to create bonus shares, or even it may be bonus debentures, there would have been no receipt of income; new capital assets would have been created. But it is said that, so long as the capital asset abroad remains the same, anything received by the shareholder in this country must be income ...

This is just another version of trees and fruit.[27]

It would be best to avoid the Latin word "corpus" which is (I think) just another word for shares, share capital, or capital (as opposed to income).

30.9.3 *Trust law principles applied*

The income/capital issue first arose in a trust law context: if trustees hold shares on trust for A for life, and receive a distribution from a company, the distribution is payable to A if it is income, and not if it is capital.

Except where there are specific statutory rules, or specific terms in a trust

Discussion in trust law textbooks is also relevant here.

[26] See 30.3.2 (Dividend of capital nature).

[27] See 14.5.2 (Tree and fruit).

(which is not usual), the income/capital distinction is one of the general law. That is, UK tax law adopts UK trust law rules. Hence many of the cases are trust cases, not tax cases.

30.9.4 *Company-law background*

In UK company law, and in jurisdictions which follow UK law, the position is as follows.

(1) Profits of a company may be:
   (a) Income profits (eg trading income)
   (b) Capital profits (ie a gain on the sale of a capital asset)

(2) Both sorts of profit are available for distribution to shareholders; company law does not distinguish between income and capital profits.

(3) Company law does distinguish between:
   (a) share capital[28] (which can only be distributed in a winding up or by an authorised reduction of capital) and
   (b) undistributed profits.

(4) A company which makes a profit (whether an income or a capital profit) has various courses of action:
   (a) *Retention:* It may retain the profits (in accountancy terms, transferring profits to reserves). Since there is no distribution at all, no issue arises.
   (b) *Distribution:* It may distribute the profit to the company's shareholders in the form of a dividend.
   (c) *Capitalisation*: It may "capitalise" the profit by issuing shares to the shareholders (thus increasing the share capital of the company by the amount of profit capitalised).[29]
   (d) *Liquidation/reduction of share capital:* It may put the company into liquidation or (if authorised) reduce its share capital (making payments to shareholders accordingly)

(5) A shareholder has the right to participate in:

[28] See 90.55.4 ("Share capital").

[29] For company law reasons, this has to be done by a convoluted process:
(1) The company declares a dividend
(2) The company simultaneously resolves to apply the dividend in paying up shares which are then issued to shareholders.
This is necessary because a company cannot issue shares by way of gift. The dividend declared prior to paying up and issuing new share capital is regarded as consideration transferred from the shareholders to the company in return for the new shares.

(a) distributable profits while the company is a going concern
(b) the distribution of company assets in a liquidation
(c) a distribution to shareholders on a reduction of share capital[30]

30.9.5 *Company-law approach*

Bouch v Sproule[31] laid down the general rule for classifying receipts from companies as capital or income. The classification in trust law follows company law principles. Profits which are distributed by way of dividend are received as income. Shares allotted following capitalisation are received as capital:

> When a testator or settlor directs or permits the subject of his disposition to remain as stocks or shares in a company which has the power either of distributing its profits as dividend or of converting them into capital, and the company validly exercises this power, such exercise of its power is binding on all persons interested under the testator or settlor in the shares, and consequently what is paid by the company as dividend goes to the tenant for life, and what is paid by the company to the shareholder as capital, or appropriated as an increase of the capital stock of the concern, enures to the benefit of all who are interested in capital.[32]

I refer to this as the **"company-law approach"** to the capital/income distinction. It is commonly called "the rule in *Bouch v Sproule*".

The rule applies to distributions of any assets (not just money or shares).[33]

Courtaulds Investments v Fleming identified the shareholder rights set out in (5) above and summarised the law as follows:[34]

> Anything received under the first head [distributable profits while the company is a going concern] is treated by English law as income of the recipients for both tax purposes and trust purposes (but subject as to the latter to any special provision of the trust) notwithstanding that the source of the distribution may be a profit not of the company's business but on capital account...
>
> Anything received under the second head [liquidation] is treated by

[30] See s.829, 830 Companies Act 2005, and, for point (5), *Courtaulds Investments v Fleming* 46 TC 111 at p.124..

[31] (1885) 12 App Cas 385.

[32] at p.397-398.

[33] *Re Outen's Will Trusts* [1963] Ch 291.

[34] 46 TC 111 at p.124.

> English law as capital both for tax purposes and, subject as aforesaid, for trust purposes. So also is anything received under the third head [reduction of share capital].

In *Hill v Permanent Trustee Company of New South Wales:*

(1) A farming company sold almost all of its land, livestock and other assets, and ceased to carry on business.
(2) Subsequently the company declared a dividend of its (capital) profits.

The dividend was income. *Hill* sets out an oft-cited summary of the rules:[35]

> (1) A limited company when it parts with money available for distribution among its shareholders is not concerned with the fate of those moneys in the hands of any shareholder. The company does not know and does not care whether a shareholder is a trustee of his shares or not. It is of no concern to a company which is parting with money to a shareholder whether that shareholder (if he is a trustee) will hold them as a trustee for A absolutely or as trustee for A for life only.
> (2) A limited company not in liquidation can make no payment by way of return of capital to its shareholders except as a step in an authorised reduction of capital. Any other payment made by it by means of which it parts with money to its shareholders must and can only be made by way of dividing profits. Whether the payment is called “dividend” or “bonus”, or by any other name, it still must remain a payment on division of profits.
> (3) Moneys so paid to a shareholder will (if he be a trustee) prima facie belong to the person beneficially entitled to the income of the trust estate. If such moneys or any part thereof are to be treated as part of the corpus of the trust estate there must be some provision in the trust deed which brings about that result. No statement by the company or its officers that moneys which are being paid away to shareholders out of profits are capital, or are to be treated as capital, can have any effect upon the rights of the beneficiaries under a trust instrument which comprises shares in the company.
> (4) Other considerations arise when a limited company with power to increase its capital and possessing a fund of undivided profits so deals with it that no part of it leaves the possession of the company, but the whole is applied in paying up new shares which are issued and allotted proportionately to the shareholders, who would have been entitled to receive the fund had it been, in fact, divided and paid away as dividend.

[35] [1930] AC 720 at p.730–732. Perhaps influenced by the fact that distribution had taken place immediately prior to liquidation, the court below had held that the dividend was a capital receipt.

(5) The result of such a dealing is obviously wholly different from the result of paying away the profits to shareholders. In the latter case the amount of cash distributed disappears on both sides of the company's balance sheet. It is lost to the company. The fund of undistributed profits which has been divided ceases to figure among the company's liabilities; the cash necessary to provide the dividend is raised and paid away, the company's assets being reduced by that amount. In the former case the assets of the company remain undiminished, but on the liabilities side of the balance sheet (although the total number remains unchanged) the item representing undivided profits disappears, its place being taken by a corresponding increase of liability in respect of issued share capital. In other words, moneys which had been capable of division by the company as profits among its shareholders have ceased for all time to be so divisible, and can never be paid to the shareholders except upon a reduction of capital or in a winding up. The fully paid shares representing them and received by the trustees are therefore received by them as corpus and not as income.[36]

Similarly, in *IRC v Reid's Trustees*:[37]

(1) The company realised capital gains on the sale of properties.
(2) The company distributed the capital gains by dividend.

The dividend was of an income nature.

> There are many ways in which a company can deal with its profits. If it adopts certain methods, the result is the creation of new capital assets. If it adopts other methods, the result is the receipt of income by its shareholders. In either case it is immaterial whether the profits were trading profits or capital profits...
> if a foreign company chooses to distribute its surplus profits as dividend, the nature and origin of those profits does not and cannot be made to affect the quality of the receipt for the purposes of income tax.[38]

30.9.6 *Form not substance*

In *Hill v Permanent Trustee Company of New South Wales*:[39]

> moneys paid in respect of shares in a limited company may be income or corpus of a settled share according to the procedure adopted, ie

[36] [1930] AC 720 at p.730–732.

[37] 30 TC 431 at p.446.

[38] 30 TC 431 at p.450. This is the first of the three categories identified in *Courtaulds Investments*. If further authority is needed, see *re Doughty* [1947] Ch 263.

[39] [1930] AC 720 at p.730–732.

> according as the moneys are paid by way of dividend before liquidation or are paid by way of surplus assets in a winding up

In *Rae v Lazard*:[40]

> In deciding whether a shareholder receives a distribution as capital or income our law goes by the form in which the distribution is made rather than by the substance of the transaction.

In *Beard v HMRC*:[41]

> the critical question which determines the character of a payment from a company to its shareholders is the mechanism by which the payment is made

In *Associated Insulation Products v Golder*: [42]

> It is for the company which proposes to make a distribution to decide whether or not the distribution is to take the form of a capital distribution or an income distribution and to translate its decision into action. Its decision so translated into action is conclusive. The action taken by the company, considered in relation to the surrounding circumstances, is the decisive matter.

It is necessary to decide whether a company has distributed profits or capitalised them by issuing shares. One might think that is always clear, but sometimes it is not. In *Bouche v Sproule:*

(1) For several years the company transferred profits to reserve.
(2) The company then issued partly paid up bonus shares to its shareholders of a value equivalent to that reserve. It did so by a roundabout route: it declared a dividend and a new issue of shares, giving the shareholders the option of taking the dividend in the form of cash or shares.[43]

The Court of Appeal considered that this procedure did not amount to capitalisation of profits. Although no rational shareholder would choose

[40] 41 TC 1 at p.26.

[41] [2022] UKFTT 129 (TC) at [245].

[42] Payment by issue of note; for the facts of this case see 15.5.12 (Payment by issue of note).

[43] This was done for company law reasons. It was necessary to declare a dividend because a company may not use its own funds to pay up its shares, or issue them by way of gift. Unless the dividend was declared, no consideration would be transferred from the shareholders to the company.

to receive the dividend in the form of cash there was in principle an option to do so. The House of Lords disagreed, concluding that the option was illusory and that the company's intention was to capitalise the profits. The outcome on the facts in *Bouch v Sproule* had regard to the substance of what the directors achieved by their resolutions, and was not illogical.

30.9.7 *Company statement*

A company's statement that a distribution is not to be treated as dividends or as income is irrelevant to the proper classification. The court looks to the intention of the company as manifested by its actions (i.e. resolutions) rather than its words.

In *Re Bates*[44] a company operated steam trawlers. It sold some of its vessels realising a capital gain (a company profit). It distributed these profits to shareholders as cash dividends and sent a circular to shareholders explaining that the payments were made out of capital and were not in the nature of a dividend or bonus upon the shares. The company's intention in making this statement was to protect the shareholders from liability for income tax. The dividend was income notwithstanding that the profits themselves were of a capital (rather than trading) nature.

In *Hill v Permanent Trustee Company of New South Wales*,[45] the company stated that:

> the dividend is being paid out of profits arising from the sale of breeding stock, being assets of the company not required for resale at a profit, and that is free of income tax.

What mattered was what the company showed "not by its statements, but by its acts".

In *Associated Insulation Products v Golder*:[46]

> any statement made by the company as regards the distribution is relevant and must be taken into account, though a statement which does not correspond with the reality of the distribution in fact made is of little, if any, value. The company may paint the picture but not decide that it is a masterpiece. The substance of the transaction is to be looked

[44] [1928] Ch 682.

[45] [1930] AC 720 at p.732.

[46] Payment by issue of note; for the facts of this case see 15.5.12 (Payment by issue of note).

at and its nature ascertained by the Court.

30.9.8 *Reduction in share value*

Reduction in share value is not relevant. In *IRC v Reid's Trustees*:

> This may seem a technical argument which neglects the real fact that the capital value of the Respondents' foreign asset has been reduced by the making of the payment. But a company can, and often does, reduce considerably the market value of its shares by paying a dividend out of accumulated trading profits, and there. can be no doubt that such a dividend would fall within Case V, if it came from a foreign company.[47]

Re Sechiari[48]is one of several cases arising from the nationalisation of transport in 1947:

(1) Tilling Ltd was obliged to sell its road transport interests in return for stock in the British Transport Commission.[49]

(2) The company distributed this stock to its shareholders as a capital profits dividend. As a result the value of Tilling shares fell from £6 to under £2.

Although the value of the shares fell by over 75% the distribution was held to be income.

30.9.9 *Exceptions*

There are exceptions or apparent exceptions to the rule that a dividend is income:

(1) A distribution will be treated as capital when the life tenant assented to the purchase of the original shares *as a capital investment* in the knowledge that the investment was motivated by the contemplated distribution.[50]

(2) When a distribution is made after the testator's death but relates to a transaction completed before the testator's death, income must be treated as accruing before death.[51]Accordingly the distribution of a dividend relating to a period which ended before the testator's death

[47] 30 TC 431 at 449.

[48] [1950] 1 All ER 417.

[49] The British Transport Commission was not a success and was in turn abolished in 1963.

[50] Re Maclaren's Settlement Trusts [1951] 2 All ER 414 (Harman J).

[51] Re Winder's Will Trust [1951] Ch 916.

should be treated as trust capital.

(3) A dividend in breach of company law is not income. Where a company purports to accumulate profits as capital although it has no power to increase its capital, such profits when distributed by way of dividend are received by trustee-shareholders as capital.[52]

(4) Similarly, a dividend to trustees is a capital receipt if the trustees act in breach of trust in procuring what would otherwise be an income distribution. *Hill* itself is an example.[53] In *Re Rudd's Will Trusts*[54]the trustees again held shares in Tilling Ltd. Following an announcement by the company, the trustees could have sold the trust's shareholding cum dividend, but they had not realised that the distribution of British Transport Stock would be income. The capital beneficiaries contended that this was a breach of trust and, as a result, that there should be an apportionment between the capital and income of the trust, but failed to show that the trustees ought to have sold the stock cum dividend.

30.9.10 *Issue of debenture/loan stock*

An issue of debenture stock, or unsecured loan stock, is capital.[55] This is

[52] Irving v Houston (1803) 4 Paton Sc App 521 (HL), distinguished in *Bouch v Sproule* on the basis that the company in the earlier case (the Bank of Scotland) had no power to increase its capital. See 15.9 (Income recognition: Breach of trust).

[53] *Hill v Permanent Trustee* [1933] NSWStRp 52.

[54] [1952] 1 All ER 254.

[55] *Re Outen* [1963] Ch 291. The probability of redemption of the stock was irrelevant provided that capitalisation had taken place. *IRC v Blott*, 8 TC 101; *Whitmore v IRC* 10 TC 645; *IRC v Fisher's Executors*, 10 TC 302; *IRC v Wright* 11 TC 181. The former Inspectors Manual provided:

> **1615. Dividend reinvestment plans** [Published: 9/95]
> Some foreign companies, particularly in North America and Australia, establish dividend reinvestment plans for their shareholders. Such plans can be structured in a number of different ways, some of which result in liability under Case V when a dividend is declared, and others which do not. At one extreme is the pure bonus issue, when a dividend is declared payable in shares with no option for the shareholder to take cash. Alternatively a company may arrange for cash dividends to be paid to a third party, typically a bank, which then applies the dividends in the purchase of additional company shares in the market on behalf of the shareholder. The first situation falls within the principle of IRC v Blott (8 TC 107) – see IM1612. The second gives rise to a Case V charge because the reinvestment in the company is regarded as a voluntary application of income which has already arisen to the shareholder.

so even if the period during which redemption is postponed is short so the issue is economically similar or identical to a distribution of income.[56]

30.9.11 *Role of foreign law*

Foreign law plays its usual role. It does not determine the capital/income issue. In *First Nationwide*:

> It will be noted that, under our approach and analysis, the categorisation under Cayman law of the share premium account as capital or profit is not relevant. Nor is it relevant whether Cayman law would treat a dividend paid out of the share premium account as income or capital in the hands of the recipient.

30.9.12 *Demerger*

In a direct demerger Company A distributes the shares of Company B in specie to its shareholders by way of dividend. These shares are received by shareholders as income, though s.2 Trusts (Capital and Income) Act 2013 alters the position if it applies.

In an indirect demerger:

(1) Company A transfers the shares in Company B to another holding company ("Company C").
(2) In consideration for this transfer of shares, Company C issues its own shares to the shareholders of Company A.

This arose in *Sinclair v Lee*/.[57] ICI wished to demerge its bioscience activities:

(1) ICE consolidated its bioscience activities into a wholly owned subsidiary company.
(2) ICI transferred the shares of this subsidiary company to a newly created holding company ("Zeneca").
(3) Zeneca then issued its own shares to ICI shareholders.

It was held that the Zeneca shares were received by the shareholders as capital. This avoided an absurd result.

> Between these two extremes lies a variety of situations, each of which must be considered by reference to their own facts to determine whether a Case V charge arises...

[56] *Commissioner of Income-Tax, Bengal v Mercantile Bank of India Ltd* [1936] AC 478.

[57] [1993] Ch 497.

30.9.13 *Scrip dividends*

Scrip dividends are dividends which offer shareholders the choice of being paid in the form of cash or shares. When a company declares a conventional scrip dividend each shareholder has the option to take the dividend in cash or in additional shares of equal value. Such dividends will almost always be treated as income in the hands of the shareholder whichever option is chosen.

The situation is more complicated when the company declares an "enhanced" scrip dividend. Enhanced scrip dividends give shareholders the option of taking the distribution either in cash or in additional shares of greater value than the cash alternative. If (unusually) the shareholder opts for cash the receipt will clearly be income under the rule in *Bouch v Sproule*. The position is more difficult if the shareholder takes the option of receiving shares. In the majority of cases, especially where (as is common practice) the company arranges for a third party to offer to purchase the new shares at market value to enable shareholders to realise their cash value immediately, the substance of the arrangement will be such that the shares will be received as income.

On occasion, the courts have retreated from the strict dichotomy of the general rule and ordered an apportionment of receipts from scrip dividends between income and capital. In *Re Malam*[58] the company resolved to increase its capital by the issue of new shares. The directors were empowered to offer new shares to existing shareholders in satisfaction of a dividend. The company declared a dividend. The company would have been able to meet its obligations to shareholders in cash. In respect of half the declared dividend shareholders were offered the option of shares or cash. The trustees accepted the allotment of shares.

It was held that the company intended to distribute its accumulated profits as a dividend and not to capitalise them. Prima facie the rule in *Bouch v Sproule* would demand that such receipts be treated as income. However following the distribution there had been a sharp fall in the value of the shares as a result of the distribution of the accumulated profits. The court decided that in these circumstances the tenant for life should only be entitled to a lien in respect of the amount of cash dividend foregone. The balance was attributable to capital. Stirling J proceeded on the basis that the shares had been bought partly by the cash dividend foregone and partly

[58] [1894] 3 Ch 578.

by the fall in the value of the original shares.

The classification of scrip dividends is therefore uncertain. It is unclear whether the solution in *Re Malam* will always be correct or whether it is limited to the precise facts of that case. *Re Malam* also raises the issue of how tax will be levied in such circumstances, although HMRC have stated that they will accept all reasonable decisions by trustees.[59] Identifying the intention of the company is not always easy since there are competing considerations. Shareholders can usually be expected to opt for the share option in an enhanced scrip situation. This suggests that the company intended to capitalise.[60] In the past, however, enhanced scrip dividends were declared in order to avoid the payment of advance corporation tax on simple dividends.[61] This would point towards a distribution of income.

30.9.14 *Partial liquidation*

In *Rae v Lazard Investment Co*, a Maryland company hived off part of its business by a procedure, unknown to UK company law, called partial liquidation: shares in a new company to which the hived off business was sold were distributed to shareholders in the Maryland company. The House of Lords held that the receipt by the shareholders on the partial liquidation was of a capital nature, not income:

> In deciding whether a shareholder receives a distribution as capital or income, our law goes by the form in which the distribution is made rather than by the substance of the transaction. Capital in the hands of the company becomes income in the hands of the shareholders if distributed as a dividend, while accumulated income in the hands of the company becomes capital in the hands of the shareholders if distributed in a liquidation. In the present case, the form of the distribution was one unknown to our law - distribution in a partial liquidation. By the law of

[59] Statement of Practice 4/94, para 6.

[60] On the basis that the terms of the offer make it so unrealistic that any shareholder would take the cash option, this option is in fact illusory. This was the view that the House of Lords took in *Bouch v Sproule* (although that distribution did not take the form of an enhanced scrip dividend since only partly paid-up shares were available).

[61] Advance corporation tax has now been abolished but it was stated in "Capital and Income of Trusts" (1999) Trust Law Committee Consultation Paper, para 2.3 that this change "will not make the position any clearer. It and other tax changes may well breed new ways of making distributions to shareholders that will throw up new questions about whether they are capital or income of a trust, to which the existing principles will not prove strong or clear enough to give any certain answers."

> Maryland, which governs the company and which authorised this distribution, the shares distributed were capital in the hands of the shareholders. Why, then, should we regard them as income? It is said that, if this had been an English company and it had done what [the Maryland company] did, these shares would have been income in the hands of the shareholders. But an English company could not do what [the Maryland company] did, for it could not distribute in a partial liquidation.[62]

30.9.15 *Burden of proof*

In *Associated Insulation Products v Golder*:[63]

> the burden of making out that the transaction intended and made, when considered in light of the surrounding circumstances, is in truth a capital distribution, lies upon those who assert it.

I would have thought that the usual rule should apply, ie the burden is on the taxpayer. But the burden of proof is not likely to be important.

30.10 Share premium/share capital

30.10.1 *UK Company*

A company's share premium account consists of the amount by which its issued shares are paid up in excess of their value. In *Re Duff*[64] the Court of Appeal held that any distribution made from a company's share premium account will constitute capital in the hands of shareholders. The court held that such a distribution is tantamount to an authorised reduction of capital.

In *HMRC v First Nationwide:*[65]

> 11. In the UK, prior to 1948, share premium was freely distributable as 'profits'. It was not assimilated to paid-up share capital. It did not fall within the scope of rules designed to protect against reduction of capital...

UK company law changed in 1948:

> 12. By [what is now s.610 Companies Act 2006] share premium was

[62] 41 TC 1 at p.26.

[63] Payment by issue of note; for the facts of this case see 15.5.12 (Payment by issue of note).

[64] [1951] Ch 923 at p.929.

[65] [2012] EWCA Civ 278. I omit some references in the original.

> assimilated to a company's subscribed capital and protected as if it were the paid-up capital of the company. ... in *Re Duff's Settlement*[66] ... concerned the question whether payments out of share premium account should be treated as income or capital, lies in the emphasis the courts placed upon the mechanism of payment in order to draw the distinction between capital and income. By virtue of [s.610], the repayment of share premium, in that case, was made by order of the court on a petition under that section. It followed, the courts agreed, that in contrast to the position before the 1948 Act... the payments out of share premium account were payments of capital and not income.
>
> 13. [Section 610 is] the essential provision on which the distinction between share capital and divisible profit depends.
>
> > "... A company ... can ... make a distribution amongst its members (otherwise than in a winding-up) in one of two ways - but only in one of two ways: that is
> >
> > [a] by a distribution of divisible profit, that is, by way of dividend; and
> >
> > [b] by way of a return of capital pursuant to an order of the court upon a petition for reduction of capital in accordance with the Act."
>
> 14. The court continued by reflecting upon the nature of share premium. It recognised that it was essentially capital profit and not income. But,
>
> > "if distributed in cash before [s.610] came into operation (it) would…have been income in the hands of the shareholders, notwithstanding its capital character when considered as a receipt of the company".

30.10.2 *Italian company*

The same applies for an Italian company, where the company law is similar to post-1948 UK law. In *HMRC v First Nationwide:*[67]

> 18.The principle that it is the machinery by which the assets are distributed which determines whether they are capital or income finds expression, yet again, in *Courtaulds Investments Ltd. v Fleming* 46 TC 111. Italian law identified the distribution from a share premium reserve as a distribution of capital. It brought share premium within the scope of the rules for protection of capital in a manner similar to [s.610 Companies Act 2006]. Share premium could not be distributed while the legal reserve fell below 20% of the company's capital. Italian law

[66] [1951] Ch 923.

[67] [2012] EWCA Civ 278. I omit some references in the original.

> introduced a new tax on the payment of dividends. To avoid that tax, the Italian company transferred profits of the year, which would have been distributed as dividends, to the legal reserve and thereby freed the share premium for distribution to shareholders. Such a distribution was, under Italian law, a distribution of capital free from the new imposta cedolare. ... Buckley J rejected the Revenue's contention that once the share premium was freely distributable it was, as in the UK before 1948, income. Italian law regarded the distribution as capital, and grafted the share premium onto the paid-up capital of the company.

30.10.3 *Cayman company*

The position is different for a Cayman Island company whose law is similar to pre-1948 UK law. In *HMRC v First Nationwide:*

> 19. Cayman Island Companies Law has followed the reverse route to that adopted under UK company law. Prior to 1989, the law protected share premium as if it were paid-up share capital, in the same way as it was protected after [what is now s.610] was introduced in the UK. But by amendment in 1989, share premium was distributable by dividend. ...
> 20. If, as is clear, prior to 1948 share premium was distributable by way of dividend as income in the UK, it seems equally plain that it was distributable as income in the Cayman Islands following the freedom from restriction in 1989...
> 25. The character of the payment in the hands of First Nationwide is a matter for UK law, the law of the Cayman Islands being relevant, not determinative... UK law recognises only two species of payment in respect of shares: capital or income payments. Further, the jurisprudence establishes that it is the form by which the payments are made which determines their character. It is true that, under Blueborder's Articles of Association, had the First and Second Preference Dividends not been paid, the share premium would have been returned as capital on a winding-up or on a redemption. It is also true that, since those dividends were paid, the value of the capital rights which remained, on a winding-up or otherwise, was drastically diminished to £1m. But those features tell one nothing other than, had the mechanism or machinery adopted for distribution of the share premium account been a return of capital on a winding-up or otherwise, the payments would have been capital. Since the payments were made adopting the mechanism of distribution by way of dividend ... that mechanism dictates the conclusion that the payments were income and not capital.

30.10.4 *Delaware company*

For completeness: in *Buckingham v HMRC*[68] a dividend was held to be partly income and partly capital. However the authority of the case is limited, as neither party was represented by Counsel, there was no expert evidence. It is unclear how far this case should be followed on another occasion.

30.10.5 *No restriction on distributing capital*

What is the position if the applicable foreign company law is different, and a company *can* distribute in excess of its distributable profits? In Jersey, BVI, and many other offshore jurisdictions, a distribution is (in short) permitted as long as the company remains solvent. The principle of maintenance of capital is of very limited application in these countries. The discussion of share premium suggests that a dividend should be treated as income, even if it is actually paid out of share capital. These countries have assimilated share capital to distributable profits. But perhaps the issue will not often arise, as such companies are not likely to have a substantial share capital.

30.11 Consolidation of accounts

HMRC say:

> **Fiscal and Administrative consolidation (Organschaft)**
> Some jurisdictions provide for individual entities to enter into arrangements enabling those entities to consolidate their results for tax or administrative purposes. Such arrangements often involve the transfer or payment of amounts between the parties to consolidate results. HMRC takes the view that payments or transfers made as part of such arrangements and under the terms of a contract can be distributions provided that the:
>
> - arrangement is dependent on the existing shareholder relationship for its existence, and
> - payments / transfers between the members of the consolidated unit are made in respect of shareholdings (such that transfers or payments are in proportion to shareholdings).[69]

[68] [2023] UKFTT 358 (TC).

[69] *http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/specialist/guidance-payments-uk-companies.pdf* published December 2012.

30.12 Co law approach: Critique

In some cases the company-law approach produces the right result:

(1) When a company capitalises its profits by an issue of shares (whether income or capital profits), the company-law approach reflects the commercial reality. The capitalised profits remain within the company. The sum total of the company's assets remains unchanged. As the overall number of issued shares increases so the value of each individual share decreases. In these circumstances it would be wrong to classify the additional allotted shares as income.

(2) Income profits, distributed to shareholders as dividends reasonably promptly after they arise, should be considered income; what the company received as income is distributed as income.

In some cases the company-law approach produces the wrong result.

(1) Where a company distributes long-accumulated profits to shareholders by way of dividend. The company-law approach classifies these dividends as income even though the capital value of the company falls as a result of the distribution. Where a shareholder has purchased shares in the company after the profit has arisen, but before it is distributed, the price paid is likely to reflect the value of the reserves. The accumulated trading profits may represent a large proportion of the value of a company. The distribution of these profits may drastically reduce the value of the shares. Treating such distributions as income can operate to the serious disadvantage of those beneficiaries entitled to capital.

(2) Where the distribution is of capital profits, the rule may cause greater unfairness.

The Law Commission say:

Questionable relevance of company law principles
2.41 ... the rule in *Bouch v Sproule* conflates the concepts of share capital and trust capital. There is no reason why only those profits which become share capital (following capitalisation) should be treated as trust capital. Share capital, which cannot be returned to shareholders except by way of an authorised reduction or during a winding up, exists to protect creditors and other people who deal with a limited company. Trust capital on the other hand represents the full extent of the trust property. Where trust property consists of shares the capital value of the fund will be the combined market value of all the shares which are held. The value of those shares is in turn influenced by the total worth of the underlying companies. The total value of a company is not limited to the

> nominal value of the issued share capital. A company will often accumulate profits which are capable of distribution to use as "working capital". If these accumulated profits are distributed as a dividend the share price of the company is likely to fall significantly with the result that the capital value of the trust fund will be diminished. Under the rule in *Bouch v Sproule* the distribution will nevertheless be treated as income....
>
> C***omplexity and uncertainty in application to novel rearrangements of capital***
>
> Whether or not they operate fairly, the legal principles on which the rule in *Bouch v Sproule* is based are at least relatively clear. However, the application of the rule in *Bouch v Sproule* to particular novel factual situations becomes far less certain as corporate law develops new ways of rearranging capital in order to obtain commercial or tax advantages.
>
> As a result of this uncertainty, trustees may be forced to apply to the court for directions as to the proper classification of corporate receipts in new situations. The expense of such an application, which may be considerable, will usually be borne by the trust fund to the detriment of all beneficiaries. Alternatively, trustees may seek to avoid such difficulties by selling their shareholding before the rearrangement of capital takes place. The upshot of this is that trustees may sell a potentially lucrative investment in order to maintain a fair balance between the life tenant and the remainderman.
>
> ***Ignorance or disregard of the rule***
>
> Although it is not practical to measure compliance, it is questionable how often in practice trustees allocate corporate receipts in accordance with the strict rules in *Bouch v Sproule*. It seems likely that in many cases trustees (especially those who are not legally advised) will, as a matter of practice, allocate in accordance with common sense rather than the technical analysis set out in this Part.

That is a critique of the company-law approach as applied to trusts. The same points apply where the same rules are applied for tax. It is certainly true that the rules do not produce satisfactory answers, because capital-like distributions are categorised as income.

The application of the company-law approach may be defended. It can at least be said to be a practical rule. In *IRC v Reid's Trustees*:[70]

> The officers of the Crown do not know and do not care what is the character of the sources from which the money comes. ... as a general rule, the Inland Revenue authorities cannot have the same facilities for investigating the affairs of a foreign company and checking its statement that a dividend is paid out of "capital profits". They must work upon a broader basis

[70] 30 TC 431 at p.440.

Today, it may be less difficult to establish what are the capital profits of a company, and whether a dividend was paid out of them, but it would still be far from easy.

One might say that we have a formal rule rather than a substantive one.[71] It is the usual trade-off between rules which are easy to apply and rules which better track the economic reality. It is not obvious, to say the least, that any other capital/income rule would work better. The Law Commission did not come up with answers to solve the problem, but only tinkered with the position on demergers.

In a tax context, the current rules produce a closer alignment between the taxation of UK distributions (where all capital distributions are taxed) and foreign distributions (where capital distributions are not taxed, but capital is understood very narrowly).

However that may be, the law is settled.

There is something to be said for aligning the taxation of UK/foreign dividends, by extending the distribution rules which apply to UK companies to foreign company distributions. We would then tax all foreign distributions as income, whether income or capital, except for winding up and such other distributions as are recognised as capital receipts in the case of UK companies. That would be a simplification. We should avoid the income/capital distinction so far as we can. As the economist John Hicks observed, these are "bad tools, which break in our hands".

30.13 Gift to non-shareholder

30.13.1 *UK company law background*

A gift from a company to a non-shareholder is not a dividend.

The question arises as to whether it might be a distribution for company law purposes. The question arises because of the UK company law rule that a distribution must be made out of distributable profits, and in the absence of distributable profits, there is an unlawful (invalid) distribution.[72] It is well established UK company law that:

[71] See 16.5 (Formal/substantive source rules).

[72] The rule that a sale at an undervalue is a company law distribution has been modified by s.845 CA 2006, to facilitate sales at book value. But that does not affect the rule that
(1) a payment from a company to a non-shareholder
(2) a sale for less than book value

(1) Whether a transaction constitutes a distribution is not a matter of form (unlike the question of whether a payment is a dividend, for which certain formalities are required).
(2) The label which the parties use (eg gift, sale or remuneration) is not decisive.
(3) A transaction between a company and a non-shareholder may constitute a distribution, if the company and the non-shareholder have the same ultimate beneficial owner.[73]

The classic cases involve a sale at an undervalue from one company to another with the same ultimate beneficial owner. A fortiori, a gift to or for the benefit of a shareholder or ultimate beneficial owner in principle constitutes a distribution.[74] See *Clydebank Football Club Ltd v Steedman*:

> "Distribution" is not further defined than by [s.829 CA 2006] but it would appear that generally a distribution will be a transfer without consideration given by the recipient. The object of the statutory code is to prohibit the (gratuitous) return to shareholders, other than by specified means, of subscribed capital or assets representing the same. However, ... a transfer involving the passing of some consideration may in certain circumstances give rise to a distribution. That is because a transfer, albeit some consideration is given, may involve in substance a gift of capital to the transferee.[75]

How does one reconcile this with s.829 CA 2006 which provides:

> In this Part [Part 23 CA 2006] "distribution" means every description of distribution of a company's assets *to its members*...

The word "to" might be read loosely, as "to or at the direction of" or "to or for the benefit of". Alternatively as there are two sets of company law rules governing distributions, statutory rules and common law rules, a distribution to a non-shareholder could be said to be a "distribution" for the purposes of the latter.

may be classified as a distribution for UK company law purposes, and so unlawful, in the absence of distributable profits.

[73] See *Aveling Barford v Perion* [1989] BCLC 626: "The fact that the distribution was to Perion rather than to Dr. Lee or his other entities which actually held the shares in Aveling Barford is in my judgment irrelevant."

[74] Further consideration is needed in the case of a charitable gift.

[75] [2000] ScotCS 250 at [55] approved in *Progress Property v Moorgarth Group* [2010] UKSC 55.

This does not mean that all gifts by companies are distributions. For instance, a gift by a company to a charity (not its shareholder) is not a distribution.[76] But where one draws the line does not seem to be at all clear.

30.13.2 *Relevance of company law to company gift*

What is the tax position when a non-resident company makes a gift to a non-shareholder? The question is whether the receipt is of an income nature, in my terminology, an income-distribution.

On analogy with the company-law approach, one might have thought that company law principles apply to answer this question: if the gift is a distribution, for company law purposes, it is an income receipt. But this was not the approach adopted in *Kerrison v HMRC*.[77] Capital/income is decided by reference to a broad review of the facts. This seems a better solution because the relevant company law seems somewhat obscure and vague.

30.14 Winding-up TAAR

Section 396B/404A ITTOIA provide an exception to the general rule that a distribution in a winding up is a capital receipt:

s.396B(1): UK co	**s.404A(1): non-UK co**
For the purposes of this Chapter, a distribution made to an individual in respect of share capital in the winding up of a UK resident company is a distribution of the company if—	For the purposes of this Chapter, a distribution made to an individual in respect of share capital in a winding up of a non-UK resident company is a dividend of the company if—
(a) Conditions A to D are met, and (b) the distribution is not excluded (see subsection (7)).[78]	[identical]

I refer to this rule as the "**winding-up TAAR**", and the conditions are

[76] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 17.9 (Position of charity receiving company gift) online version *https://www.taxationofcharities.co.uk*

[77] [2019] UKUT 8 (TCC). See 32.5 (Source/voluntary transaction). See too 30.15.10 (Benefits to non-shareholder).

[78] See 29.8.5 (Excluded distribution).

“**winding-up conditions A to D**”. It is sometimes called the “phoenixing TAAR”.

A distribution in a winding up is a transaction in securities, and so the TiS rules also need consideration.[79]

The winding-up TAAR does not apply to a distribution made to a trustee or other non-individual, but in cases where the winding-up TAAR does not apply, the TiS rules may still apply.

The deemed dividend is RFI and so may qualify for the remittance basis.

The winding-up TAAR was preceded by shallow HMRC consultation and response documents[80] but these shed little light on the provisions.

HMRC have published guidance in the CTM, but this has had poor reviews from the profession[81] and is not set out in detail here.

30.14.1 *Condition A: 5% interest*

Section 396B/404A ITTOIA provide:

> (2) Condition A is that, immediately before the winding up, the individual has at least a 5% interest in the company.

s.396B(9): UK co	**s.404A(9): non-UK co**
(9) For the purposes of this section, an individual has at least a 5% interest in a company if—	For the purposes of this section, a person[82] has at least a 5% interest in a company if—
(a) at least 5% of the ordinary share capital of the company is held by the individual, and	(a) at least 5% of the ordinary share capital of the company is held by the individual, and
(b) at least 5% of the voting rights in the company are exercisable by	(b) at least 5% of the voting rights in the company are exercisable by

[79] See 55.1 (Transactions in securities).

[80] HMRC, “Company distributions: consultation document” (2015) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483547/Company_distributions_-_consultation_document__7029_.pdf*
HMRC, “Company distributions: summary of responses” (2016) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/510263/Company_distributions_-_summary_of_responses.pdf*

[81] “Almost universally panned”, “pretty atrocious”, and “disgracefully jejune”: see Miller, “HMRC's guidance on the company winding up TAARs” Tax Journal, 4 Aug 2017. But it seems to me that those who expect HMRC guidance to clarify vague anti-avoidance legislation will always be disappointed.

[82] This appears to be a slip for “individual”, but it does not matter.

the individual by virtue of that holding.	the individual by virtue of that holding.

Section 396B/404A ITTOIA provide:

> (10) For the purposes of subsection (9) if an individual holds any shares in a company jointly or in common with one or more other persons, he or she is to be treated as sole holder of so many of them as is proportionate to the value of his or her share (and as able to exercise voting rights by virtue of that holding).

A life tenant would not meet condition A.

30.14.2 *Condition B: Close company*

Section 396B/404A ITTOIA provide:

> (3) Condition B is that the company—
> (a) is a close company when it is wound up, or
> (b) was a close company at any time in the period of two years ending with the start of the winding up.

Section 404A(8) ITTOIA provides:

> In this section—
> "close company" includes[83] a company which would be a close company if it were a UK resident company;

30.14.3 *Condition C: Phoenixing*

Section 396B/404A ITTOIA provide:

> (4) Condition C is that, at any time within the period of two years beginning with the date on which the distribution is made—
> (a) the individual carries on a trade or activity which is the same as, or similar to, that carried on by the company or an effective 51% subsidiary of the company,[84]

[83] This is standard form wording; see 104.29.1 (Non-resident close company). In the context of s.404A, which only concerns non-resident companies, the standard form is slightly inapt. The word "includes" means "means"; that is, this is an exclusive definition, not an inclusive definition. But it does not matter and perhaps the objection is pedantic. There is no equivalent in s.396B, as it is not needed.

[84] Defined by reference in s.396B(8)/404A(8) ITTOIA incorporates the standard definition: "In this section ... "effective 51% subsidiary" has the meaning given by section 170(7) of TCGA 1992".See 64.26 ("51/75/90 % subsidiary").

"Similar" is a vague term.

> (b) the individual is a partner in a partnership which carries on such a trade or activity,
>
> (c) the individual, or a person connected with him or her, is a participator[85] in a company in which he or she has at least a 5% interest and which at that time—
>
> (i) carries on such a trade or activity, or
>
> (ii) is connected with a company which carries on such a trade or activity, or
>
> (d) the individual is involved with the carrying on of such a trade or activity by a person connected with the individual.

"Involved with" is an un-lawyerlike expression. Presumably it means personally involved, in which case an individual is not involved if they only provide a loan.

30.14.4 *Condition D: Motive defence*

Section 396B/404A ITTOIA provide a motive defence:

> (5) Condition D is that it is reasonable to assume,[86] having regard to all the circumstances, that—
>
> (a) the main purpose or one of the main purposes of the winding up is the avoidance or reduction of a charge to income tax, or
>
> (b) the winding up forms part of arrangements[87] the main purpose or one of the main purposes of which is the avoidance or reduction of a charge to income tax.

"Avoidance or reduction of a charge to tax" is one of the four limbs of the standard definition of tax advantage.[88] It is strange that the usual definition of tax advantage is not set out in full, but perhaps it makes little difference.

The requirement is to test (a) the purpose of the winding up *and* (b) the purpose of the arrangements is non-standard wording; para (a) is needed

[85] Section 396B(8)/404A(8) ITTOIA incorporates the standard definition: "In this section ... "participator" has the meaning given by section 454 of CTA 2010"; see 104.22 (Definitions of participator).

[86] See App. 2.24 (Reasonable-to-assume).

[87] Section 396B(8)/404A(8) ITTOIA provides the standard (unnecessary) IT definition of "arrangements"; see App 2.2.3 (Definitions of "arrangement").

[88] See 3.19.1 (Tax advantage: Definitions).

for the case where the arrangement consists only of the winding up, ie it is not part of wider arrangements.

There must be IT avoidance: avoidance of IHT or CGT would not count.

Conditions C and D to some extent overlap, as phoenixing is suggestive of avoidance. The CTM makes some general comments which deal with them together:

> **CTM36340: company winding up TAAR: condition D** [Sep 2018]
> Ultimately, the legislation is asking whether the recipient of the distribution is continuing what amounts to the same business having extracted the accumulated profits in a capital form. This is inevitably a question of judgment to be made on the basis of facts in individual cases. The following issues are likely to be relevant:
>
> - Is there a tax advantage, and if so, is its size consistent with a decision to wind-up a company to obtain it?
> - To what extent does the trade or activity carried on after the winding-up resemble the trade or activity carried on by the wound-up company?
> - What is the involvement in that trade or activity by the individual who received the distribution? To what extent have their working practices changed?
> - Are there any special circumstances? For example, is the individual merely supplying short-term consultancy to the new owners of the trade?
> - How much influence did the person that received the tax advantage have over the arrangements? Is it a reasonable inference that arrangements were entered into to secure this advantage?
> - Is there a pattern, for instance have previous companies with similar activities been wound-up?
> - What other factors might be present to lead to a decision to wind-up? Are these commercial and independent of tax benefits?
> - Are there any events apparently linked with the winding-up that might reasonably be taken into account? For example, was the only trade sold to a third party, leaving just the proceeds of the sale?
>
> It is impossible to give an exhaustive list or comprehensive examples as individual facts and circumstances will be paramount. The aim is to establish whether it is reasonable to assume that the company was wound-up as a way of converting into a capital transaction what would otherwise have been paid out as income. The essential question is whether an individual may reasonably be regarded as carrying on or continuing to be involved in the carrying on of the same business as before, having extracted the profits in a capital form. ...

30.14.5 *Excluded distribution*

Section 396B(1)/404A(1) ITTOIA provides a distribution in a winding up is a dividend if:

> ... (b) the distribution is not excluded (see subsection (7)).

"Excluded" is a label for two distinct reliefs.

Section 396B/404A ITTOIA provide:

> (7) A distribution to an individual is excluded if or to the extent that—
> (a) the amount of the distribution does not exceed the amount that would result in no gain accruing for the purposes of capital gains tax, or

Thus distributions will not be treated as income to the extent that they represent the CGT base cost.

Section 396B/404A ITTOIA provides:

> (7) A distribution to an individual is excluded if or to the extent that ...
> (b) the distribution is a distribution of irredeemable shares.

Thus the TAAR should not apply to a demerger which takes the form of liquidation and distribution of irredeemable shares. It is suggested that distribution is used informally to include an issue of shares; though since demergers will generally have HMRC clearance for other reasons, the point is probably academic.

30.14.6 *Clearance*

The CTM provides:

> **CTM36350 Requests For Clearance** [Feb 2018]
> ITTOIA05/S396B/404A provides no statutory clearance procedure. Although there is a non-statutory clearance procedure (see the ONSCG manual), the applicant would not be uncertain about purpose, (!) which is a subjective matter.[89] It follows that a clearance application would not be appropriate unless it is limited to the application of specific rules in the legislation where there is genuine uncertainty about their application to a specific proposed transaction.

See 55.18 (TiS clearance).

[89] Author's footnote: Note that HMRC do not consider the words "reasonable to assume, having regard to all the circumstances" impose an objective test.

30.14.7 *Sale of company: GAARable?*

HMRC say:

> Some scheme promoters claim to have come up with schemes that avoid the Income Tax charge and get around the TAAR legislation.
>
> They claim that by making an artificial modification of the arrangements aimed at defeating the intention of the legislation (by selling the company to a third party rather than winding it up, for example) the TAAR will not apply.
>
> These schemes do not work because:
>
> - in many cases, the actual outcome is that the individual is receiving distributions in a winding up - as the individual carries on trading using a different vehicle these schemes are within the scope and purpose of the TAAR legislation
> - phoenixism arrangements that claim to involve payments to shareholders taxed as capital instead of income are caught by the TAAR, or other provisions
>
> HMRC will investigate any attempts to avoid the Income Tax charge.
>
> If it's claimed that the phoenixism TAAR does not cover the arrangements, HMRC will consider whether the GAAR applies to these schemes.[90]

This gives only a vague indication of the arrangement which HMRC regard as caught by the GAAR. But it suggests that a relatively straightforward sale of a company with undistributed profits might be regarded as the same as a liquidation and so potentially within the TAAR. If that were right it would be pushing the boundaries of the GAAR far beyond what has hitherto been regarded as abusive.[91] The transactions envisaged seem far from the themes of this book, but the outcome could have far-reaching implications for every aspect of taxation: it illustrates how in tax, everything is connected.

There have been no material developments since publication of this statement, so perhaps that was not what HMRC had in mind, or at least, HMRC do not pursue the point.

[90] HMRC, Spotlight 47 (2019) *https://www.gov.uk/guidance/attempts-to-avoid-an-income-tax-charge-when-a-company-is-wound-up-spotlight-47*
The following three paragraphs, not set out here, threaten various penalties.

[91] See 2.4.2 (Why distinctions matter). For well-aimed criticism, see Miller, "Misplaced spotlight" Taxation Magazine, 21 Feb 2019, p.10.

30.15 DT relief: Dividend income

It is necessary to consider separately:

(1) A person treaty-resident in a foreign State who receives UK source dividends.

(2) A person treaty-resident in the UK who receives dividends from a company resident in the foreign State; the person may be entitled to tax relief in the foreign State, but that is not discussed here.

(3) A person who is UK-law UK resident but treaty-resident in a foreign State, and who receives dividends from a company resident in a third country.

30.15.1 *OECD Model art10*

Article 10 OECD Model provides:

> 1. Dividends paid[92] by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
>
> 2. [1] However, dividends paid by a company which is a resident of a Contracting State may also be taxed in that State according to the laws of that State,
>
> [2] but if the beneficial owner[93] of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
>
> a) 5% of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends;
>
> b) 15% of the gross amount of the dividends in all other cases...

I use the following terms:
Source State: the State where the company is resident
Residence State: the State where the shareholder is resident
Treaty cap: the 5/15 % limit on tax contained in art 10(2)

Thus there are two types of shareholder:

Label (traditional)	Form	Treaty Cap	Capital Holding	See
Direct investor	Company	5%	at least 25%	art10(2)(a)
Portfolio investor	Any person	15%	if co, under 25%	art10(2)(b)

[92] See 15.11.2 (“Paid” and “payment”).

[93] See 108.10 (DTA beneficial owner rule).

The traditional labels, “direct/portfolio investors”, are opaque; but it is best to follow the established usage. Where used in connection with actual treaties (as opposed to the OECD Model) the details vary according to the wording of the treaty concerned.

Art 10 may be easier to follow if one specifies which State is which:

Company UK resident; shareholder non-resident:

> 1. Dividends paid by a company which is a resident of the UK to a resident of the foreign State may be taxed in the foreign State.
> 2. However, dividends paid by a company which is a resident of the UK may also be taxed in the UK ... , but if the beneficial owner of the dividends is a resident of the foreign State, the tax so charged shall not exceed [the 5%/15% cap]

Company non-resident; shareholder UK resident:

> 1. Dividends paid by a company which is a resident of the foreign State to a resident of the UK may be taxed in the UK.
> 2. However, dividends paid by a company which is a resident of the foreign State may also be taxed in the foreign State ... but if the beneficial owner of the dividends is a resident of the UK, the tax so charged shall not exceed [the 5%/15% cap].

30.15.2 *2017 changes to art 10*

The wording of the treaty cap changed in 2017:

Pre-2017 Model art 10(2)(a)	**Post-2017 Model art 10(2)(a)**
5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which holds directly at least 25 per cent of the capital of the company paying the dividends;	5 per cent of the gross amount of the dividends if the beneficial owner is a company ~~(other than a partnership)~~ which holds directly at least 25 per cent of the capital of the company paying the dividends throughout a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that period, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);

There are two changes.

(1) The words "other than a partnership" are deleted.[94]

(2) The minimum 365 day holding period. Article 8 BEPS MLI[95] proposed this, to prevent avoidance via dividend transfer transactions, but the UK opted out of that. There are no current treaties with this wording, and it seems unlikely that the wording will be used much in future UK treaties.

30.15.3 *Treaty-resident in foreign State*

In practice, non-resident individuals and non-resident companies do not need usually treaty relief for their UK dividends. They qualify for non-resident IT relief.[96] Treaty relief is relevant to:

(1) Non-resident trusts (if they do not qualify for non-resident IT relief, because they have UK resident beneficiaries)[97]

(2) Individuals who are UK-law UK resident, but treaty-resident in the foreign State (under the tie-breaker)

(3) Tax year of arrival and departure

30.15.4 *Company: DTA definition*

"Company" is defined, and the term is used in four places in the OECD Model:

Article	**Topic**	**See para**
10	Dividends	*Discussed here*
5(7)	Permanent establishment	106.18
16	Directors' fees	37.19
3	Definition of person	9.4

I discuss the definition here, as the article 10 context is the most important; OECD Commentary states that "The definition is drafted with special regard to the Article on dividends."

Article 3(1)(b) OECD Model provides:[98]

> 1. For the purposes of this Convention, unless the context otherwise requires ...

[94] See 30.15.4 (Partnership restriction).

[95] See 107.15 (BEPS multilateral instrument).

[96] See 45.1 (Non-resident IT relief – Introduction).

[97] See 45.10 (Trusts: UK beneficiary rule).

[98] The USA/UK DTA definition is identical.

> b) the term "company" means
> [i] any body corporate or
> [ii] any entity that is treated as a body corporate for tax purposes;

OECD Commentary provides:

> 3. The term "company" means in the first place any body corporate. In addition, the term covers any other taxable unit that is treated as a body corporate for the purposes of the tax laws of the Contracting State of which it is a resident.

Thus "company" within the DTA definition means:
(1) any body corporate (in the normal sense of the word)
(2) any entity treated as a body corporate
  (a) for the purposes of UK tax (thus the standard tax definition of company applies); and
  (b) for the purposes of tax in the foreign State.

See 90.49 (US limited partnership).

30.15.5 *Partnership restriction*

The direct investor treaty cap in its pre-2017 form restricted this relief to a company "other than a partnership".[99] I refer to this as the **"partnership restriction"**.

This wording is not in the current Model. But even before the change, the UK preferred not to include the partnership restriction, which is found only in a few pre-2017 treaties.[100] OECD Commentary provides:

> 11. Before 2017, [art 10(2)(a)] referred to a company "other than a partnership". That exception was deleted in recognition of the fact that if a partnership is treated as a company for tax purposes by the Contracting State in which it is established, it is appropriate for the other State to grant the benefits of subparagraph a) to that partnership.
> Indeed, an entity or arrangement (e.g. a partnership) that is treated as a company for tax purposes qualifies as a company under the definition

[99] See 30.15.2 (2017 changes to art 10).

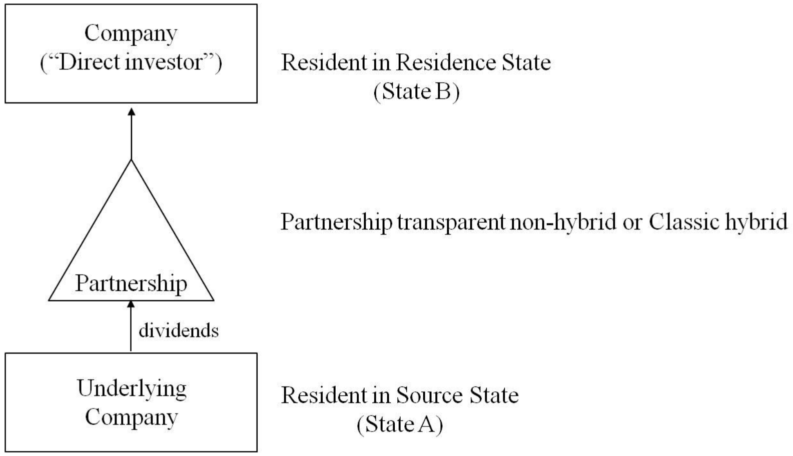
[100] 11 UK treaties have this wording: Austria, Denmark, Faroes, Germany, Iceland, Israel, Korea, Turkmenistan, Uruguay, Zambia. Presumably the treaty partner wanted it. For discussion of the wording see "Some Reflections on the Proposed Revisions to the OECD Model and Commentaries, and on the Multilateral Instrument, with respect to Fiscally Transparent Entities" [2017] BTR 295 at p.338.

in [art 3(1)(b)[101]] and, to the extent that it is a resident of a Contracting State, is therefore entitled to the benefits of [art 10(2)(a), direct investor treaty cap] with respect to dividends paid by a company resident of the other State, as long as it holds directly at least 25% of the capital of that company.[102]

This conclusion holds true regardless of the fact that the State of source of the dividends may regard that entity or arrangement as fiscally transparent. That conclusion is confirmed by the provision on fiscally transparent entities in [art 1(2), hybrid entity rule[103]].

30.15.6 *Receipt via transparent entity*

OECD Commentary considers a direct investor holding an underlying company through a partnership, thus:


Company
("Direct investor")
Resident in Residence State
(State B)
Partnership transparent non-hybrid or Classic hybrid
Partnership
dividends
Underlying
Company
Resident in Source State
(State A)

11.1[Art 1(2), hybrid entity rule] ensures that the part of the dividend received by a fiscally transparent entity or arrangement that is treated as the income of a member of that entity or arrangement for purposes of taxation by the State of residence of that member will be considered as a dividend paid to that member for the purposes of Article 10 (see paragraph 12 of the Commentary on Article 1).[104]

Where, for example, a company resident of State A pays a dividend to a partnership that State B treats as a transparent entity, the part of that dividend that State B treats as the income of a partner resident of State

[101] See 30.15.4 (Company: DTA definition).

[102] But if that is right, would the partnership restriction ever apply?

[103] See 91.4 (DTA hybrid-entity rules).

[104] See 91.6.1 (Considered as income: Effect).

> B, will, for the purposes of [art 10(2)] of the convention between States A and B, be treated as a dividend paid to a resident of State B.
> Also, for the purposes of the application of [art 10(2)(a)] in such a case, a member that is a company should be considered to hold directly, in proportion to its interest in the fiscally transparent entity or arrangement, the part of the capital of the company paying the dividend that is held through that entity or arrangement and, in order to determine whether the member holds directly at least 25% of the capital of the company paying the dividends, that part of the capital will be added to other parts of that capital that the member may otherwise hold directly.[105]

In the case of a partnership, it is possible to say that the partners hold the capital if one adopts a co-ownership analysis of a partnership share.[106]

30.15.7 *"Dividends"*

Article 10(3) OECD Model defines dividends:

> The term "dividends" as used in this Article means
> [a] income from shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or other rights, not being debt-claims, participating in profits, as well as
> [b] income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

I think the correct reading of para [a] is:

> income from
> [i] shares, "jouissance" shares or "jouissance" rights, mining shares, founders' shares or
> [ii] other rights, not being debt-claims, participating in profits

[105] The Commentary goes on to consider the 365-day rule (though that is not likely to be relevant for the UK):
"In that case, for the purposes of the application of the requirement that at least 25% of the capital of the company paying the dividends be held throughout a 365 day period, it will be necessary to take account of both the period during which the member held the relevant interest in the fiscally transparent entity or arrangement and the period during which the part of the capital of the company paying the dividend was held through that entity or arrangement: if either period does not satisfy the 365 day requirement, subparagraph a) will not apply and subparagraph b) will therefore apply to the relevant part of the dividend..."

[106] See 85.3.1 (English partnership: 2 analyses).

That is, the words "not being debt-claims, participating in profits" govern "other rights" but do not govern the 5 categories within [i].

See Avery-Jones et al "The Definitions of Dividends & Interest in OECD Model: Something Lost in Translation?" [2009] BTR 406.

For the dividend/capital gain boundary, see 56.23.7 (Share buy-back/liquidation).

OECD Commentary provides:

> 1. By "dividends" is generally meant the distribution of profits to the shareholders by
> [a] companies limited by shares, [*Sociétés anonymes*]
> [b] limited partnerships with share capital, [*Sociétés en commandite par actions*]
> [c] limited liability companies [*Sociétés à responsabilité limitée*] or
> [d] other joint stock companies [*Sociétés de capitaux*].
> Under the laws of the OECD member countries, such joint stock companies are legal entities with a separate juridical personality distinct from all their shareholders. On this point, they differ from partnerships insofar as the latter do not have juridical personality in most countries.
> 2. Many States consider that the profits of a business carried on by a partnership are the partners' profits derived from their own exertions; for them they are business profits. So these States treat the partnership as fiscally transparent and the partners are ordinarily taxed personally on their share of the partnership capital and partnership profits.
> 3. The position is different for the shareholder; he is not a trader and the company's profits are not his; so they cannot be attributed to him. He is personally taxable only on those profits which are distributed by the company (apart from the provisions in certain countries' laws relating to the taxation of undistributed profits in special cases). From the shareholders' standpoint, dividends are income from the capital which they have made available to the company as its shareholders.

OECD Commentary provides:

> 23. In view of the great differences between the laws of OECD member countries, it is impossible to define "dividends" fully and exhaustively. Consequently, the definition merely mentions examples which are to be found in the majority of the member countries' laws and which, in any case, are not treated differently in them. The enumeration is followed up by a general formula....
> 24. The notion of dividends basically concerns distributions by companies within the meaning of subparagraph b) of paragraph 1 of

> Article 3. Therefore the definition relates, in the first instance, to distributions of profits the title to which is constituted by shares, that is holdings in a company limited by shares (joint stock company). The definition assimilates to shares all securities issued by companies which carry a right to participate in the companies' profits without being debt-claims; such are, for example, "jouissance" shares or "jouissance" rights, founders' shares or other rights participating in profits.
> ... debt-claims participating in profits do not come into this category (see paragraph 19 of the Commentary on Article 11); likewise interest on convertible debentures is not a dividend.
> 25. Article 10 deals not only with dividends as such but also with interest on loans insofar as the lender effectively shares the risks run by the company, i.e. when repayment depends largely on the success or otherwise of the enterprise's business. Articles 10 and 11 do not therefore prevent the treatment of this type of interest as dividends under the national rules on thin capitalisation applied in the borrower's country. The question whether the contributor of the loan shares the risks run by the enterprise must be determined in each individual case in the light of all the circumstances, as for example the following:
>
> – the loan very heavily outweighs any other contribution to the enterprise's capital (or was taken out to replace a substantial proportion of capital which has been lost) and is substantially unmatched by redeemable assets;
> – the creditor will share in any profits of the company;
> – repayment of the loan is subordinated to claims of other creditors or to the payment of dividends;
> – the level or payment of interest would depend on the profits of the company;
> – the loan contract contains no fixed provisions for repayment by a definite date.

30.15.8 *Distribution by partnership*

OECD Commentary provides:

> 26. The laws of many of the States put participations in a *société à responsabilité limitée* (limited liability company) on the same footing as shares. Likewise, distributions of profits by co-operative societies are generally regarded as dividends.
> 27. Distributions of profits by partnerships are not dividends within the meaning of the definition, unless the partnerships are subject, in the State where their place of effective management is situated, to a fiscal treatment substantially similar to that applied to companies limited by

> shares (for instance, in Belgium, Portugal and Spain, also in France as regards distributions to *commanditaires* in the *sociétés en commandite simple*). ...

30.15.9 *Non-cash dividends*

OECD Commentary provides:

> 28. Payments regarded as dividends may include not only distributions of profits decided by annual general meetings of shareholders, but also other benefits in money or money's worth, such as
> [1] bonus shares,
> [2] bonuses,
> [3] profits on a liquidation or redemption of shares (see paragraph 31 of the Commentary on Article 13) and
> [4] disguised distributions of profits.
> The reliefs provided in the Article apply so long as the State of which the paying company is a resident taxes such benefits as dividends. It is immaterial whether any such benefits are paid out of current profits made by the company or are derived, for example, from reserves, i.e. profits of previous financial years.
> Normally, distributions by a company which have the effect of reducing the membership rights, for instance, payments constituting a reimbursement of capital in any form whatever, are not regarded as dividends.

30.15.10 *Benefits to non-shareholder*

OECD Commentary provides:

> 29. The benefits to which a holding in a company confer entitlement are, as a general rule, available solely to the shareholders themselves. Should, however, certain of such benefits be made available to persons who are not shareholders within the meaning of company law, they may constitute dividends if:
> – the legal relations between such persons and the company are assimilated to a holding in a company ("concealed holdings"); and
> – the persons receiving such benefits are closely connected with a shareholder; this is the case, for example, where the recipient is a relative of the shareholder or is a company belonging to the same group as the company owning the shares.
>
> 30. When the shareholder and the person receiving such benefits are residents of two different States with which the State of source has concluded conventions, differences of views may arise as to which of

> these conventions is applicable. A similar problem may arise when the State of source has concluded a convention with one of the States but not with the other.

The Commentary has no solution to offer:

> This, however, is a conflict which may affect other types of income, and the solution to it can be found only through an arrangement under the mutual agreement procedure.

30.15.11 *Company capital*

This term matters because a direct investor only qualifies for the lower treaty cap if it is a company holding at least 25% of the company capital. OECD Commentary provides:

> 15. In [art 10(2)(a), direct investor treaty cap], the term "capital" is used in relation to the taxation treatment of dividends, i.e. distributions of profits to shareholders. The use of this term in this context implies that, for the purposes of subparagraph a), it should be used in the sense in which it is used for the purposes of distribution to the shareholder (in the particular case, the parent company).
>
> a) As a general rule, therefore, the term "capital" in subparagraph a) should be understood as it is understood in company law. Other elements, in particular the reserves, are not to be taken into account.
>
> b) Capital, as understood in company law, should be indicated in terms of par value of all shares which in the majority of cases will be shown as capital in the company's balance sheet.
>
> c) No account need be taken of differences due to the different classes of shares issued (ordinary shares, preference shares, plural voting shares, non-voting shares, bearer shares, registered shares, etc.), as such differences relate more to the nature of the shareholder's right than to the extent of his ownership of the capital.
>
> d) When a loan or other contribution to the company does not, strictly speaking, come as capital under company law but when on the basis of internal law or practice ("thin capitalisation", or assimilation of a loan to share capital), the income derived in respect thereof is treated as dividend under Article 10, the value of such loan or contribution is also to be taken as "capital" within the meaning of subparagraph a).
>
> e) In the case of bodies which do not have a capital within the meaning of company law, capital for the purpose of

> subparagraph a) is to be taken as meaning the total of all contributions to the body which are taken into account for the purpose of distributing profits.

30.15.12 *Dividend paid through PE*

For the overlap between dividends and business profits, see 107.9.3 (Other business profit overlaps).

30.15.13 *Dividend to foreign State co*

Article 10(5) OECD Model provides:

> Where a company which is a resident of a Contracting State derives[107] profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the company, except
> [a] insofar as such dividends are paid to a resident of that other State or
> [b] insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment situated in that other State,
> nor subject the company's undistributed profits to a tax on the company's undistributed profits,
> even if the dividends paid or the undistributed profits consist wholly or partly of profits or income arising in such other State.

30.15.14 *Co in 3rd State: Dual resident shareholder*

A person who is UK-law UK resident but treaty-resident in a foreign State may receive dividends from a company which is not a resident of the foreign State.

A person in this category does not qualify for relief under article 10. However relief from UK tax is available under art 21 OECD Model ("Other Income").[108]

Dividends from companies in third countries are within the Other Income article, as they are "not dealt with in the foregoing Articles".

The OECD Commentary provides:

> 8. [Art 10] deals only with dividends paid by a company which is a resident of a Contracting State and does not, therefore, apply to dividends paid by a company which is a resident of a third State. Dividends paid by a company which is a resident of a Contracting State

[107] See 15.11.1 ("Deriving" income).

[108] See 33.20 (DT relief: "Other Income").

> which are attributable to a permanent establishment which an enterprise of that State has in the other Contracting State may be taxed by the first-mentioned State under [art 10(2)] but may also be taxed by the other State under paragraph 1 of Article 7 (see paragraphs 9 and 9.1 of the Commentary on Articles 23 A and 23 B concerning relief of double taxation in such cases).

30.16 Dividend nil rate/DTA interaction

30.16.1 *UK dividends of non-resident*

HMRC say:

> **Question**
> 24.1 Please can HMRC confirm how the treaty cap should be applied in the case of a treaty non-resident individual who has UK source dividend income in excess of £5,000?[109]
> We believe there are two possible approaches. Either:
> a. the treaty cap applies to the total UK source dividend income paid, so for example, someone with £15,000 of dividends paying £3,250 UK tax (being 32.5% on £10,000) is subject to a treaty cap of £2,250 (being 15% of £15,000 and assuming a 15% treaty cap rate applies); or
> b. the treaty cap applies to only the UK source dividend income that is chargeable to UK tax at more than 0%, so in the same example the 15% treaty cap would limit the UK tax to £1,500
> (being 15% of the £10,000 UK dividend income remaining after deducting the £5,000 dividend allowance).[110]
> In cases where the treaty non-resident individual is UK resident under SRT they may receive a combination of UK source dividend income and non-UK source dividend income.
> **Answer**
> Non-UK resident individuals with UK source income can be taxed in two ways. Under the normal rules, they are subject to income tax on dividends in the same way as UK residents. The first £5,000 of dividends is tax free. The balance will be subject to tax but will be restricted in accordance with the treaty which limits the rate of tax to be applied.
> Alternatively, non-UK residents can use the special rules in ITA 2007,

[109] ie the income qualifies for the dividend nil rate. From 2018/19 the figure of £2,000 replaces the figure of £5,000. See 43.10.2 (Dividend nil rate).

[110] Author's footnote: The statutory term is dividend nil rate, not dividend allowance, but it does not matter.

> s 811 to s 814. These limit the non-resident's UK income tax liability to tax paid at source on investment and pension income. In particular, no UK tax is payable on dividends from UK companies because the tax credit is treated as paid at source. All other UK income, such as employment income, is taxed in full, but no personal allowance can be claimed (assuming a claim for personal allowances is available).[111]

This summary of the taxation of UK dividends of non-residents is not correct. But as non-residents do not pay IT on dividends (after allowing for the tax credit) it is true to say that the issue of the dividend nil rate does not arise.

30.16.2 *Foreign dividends DTA exempt*

HMRC say:

> **Question**
> 24.2 - Assuming the non-UK source dividend income is exempt from UK tax under the treaty, do HMRC accept that it does not use up any dividend allowance because it is not included in "net income" as calculated at Step 2 s23 ITA 2007 (ITA)? If that is correct, can we assume that the existence of treaty exempt non-UK source dividend income would not change the way the treaty cap applies to the UK source dividend income?
> **Answer**
> If the treaty provides full relief on dividends then they will be exempt and will not be brought into the computation. The dividend allowance will still be available to use against other dividends.[112]

This question will hardly ever arise, as circumstances in which a UK resident qualifies for treaty exemption on dividends are extremely rare. The OECD Model generally provides that the residence State has a taxing right. But if it did happen,[113] it is correct to say that the exempt dividends

[111] Expatriate Forum Minutes Oct 2019 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/855596/Expat_Forum_minutes_10_October_2019.pdf*

[112] Expatriate Forum Minutes Oct 2019 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/855596/Expat_Forum_minutes_10_October_2019.pdf*

[113] Exemption from tax on foreign dividends of a UK resident might arise in two circumstances: (1) a non OECD Model form treaty might provide exemption. (2) Exemption may be applicable under the Model treaty to an individual who is UK resident under UK domestic law, but treaty non-resident; see 30.15.14 (Co in 3rd

do not affect the dividend nil rate.

30.17 Dividend taxation: Critique

In *Shirley v HMRC*:[114]

> it is not possible to ascertain a consistent and logical basis in the legislation for the taxation of dividends. Whilst there might have been some sort of logical underpinning to the basis of taxation of dividends in the early 1970s, when the partial imputation system was introduced (with ACT and tax credits)—any such logic had long disappeared as a result of the many amendments to dividend taxation in the period leading to the enactment of ITTOIA. Parliament has chosen to legislate for a system of great complexity, involving different tax rates, tax credits, deemed payments of tax, grossing up and various other matters. There are no logically consistent principles (as it were) underpinning the taxation of dividends, against which the result of a literal interpretation can be compared—in order to reach a judgment that a literal interpretation results in an anomaly or absurdity.

There was subsequently another round of reform, introduced in breach of the Tax Consultation Framework,[115] but this gloomy assessment remains broadly valid. If one can ignore the dividend nil rate, the law is conceptually simpler than it was pre-2016; but the administrative work is greater than before as basic rate taxpayers have to pay tax, and submit returns, which they did not have to do before 2016.

Having said that, it is easier to criticise the present system than to propose a better one. As indicated by the many approaches to company tax which have been devised over the years, there is no wholly satisfactory solution to the issue of how to tax companies and shareholders,

State: Dual resident shareholder).

[114] *Shirley v HMRC* [2014] UKFTT 1023 (TC) at [108].

[115] See 1.12.2 (Compliance with Framework).

CHAPTER THIRTY ONE

ANNUAL PAYMENTS

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Cross references

The following topics are considered elsewhere:

Topic	**See**
Split year: Pt 4/5 ITTOIA Income	10.3.1
Annual Payments: transfer of income stream	54.5.1

31.1 Annual Payments: Introduction

"Annual Payment" is an opaque technical term: it is a label for a category (or perhaps a set of categories?) of income, the meaning of which is discussed in a large and in parts difficult body of case law. I write this term with initial capitals, to reflect the technical nature of the expression.

Annual Payments are subject to a set of rules which I call the " **Annual Payment code"**. The provisions are scattered across the Taxes Acts:

Topic	**Part/Chapter**	**Principal ss**	**See para**
Tax charge on payee	Chap 7 Pt 5 ITTOIA	s.683	31.5
Withholding tax on payor	Chap 6 Part 15 ITA	ss.900/901	31.10

Deduction for payor	Chap 4 Pt 8 ITTOIA	ss.448/449	31.11

The Annual Payment code gives a favourable outcome if:
(1) the payor obtains a deduction; and
(2) the payee is exempt, or the payee's tax rate is less than the payor's

This code can apply whether the payors are individuals, trusts or companies; but its application to individuals, once common, is now rare; application to trusts is also rare; so the most common case now would be its application to company payors.

I go beyond the themes of this book and address the topic as a whole.

31.2 Charge on income

In order to understand the law, one needs to understand the historical term "charge on income", and its tax treatment and rationale.

In *IRC v Frere*:[1]

> ... the annuity which is by legal right charged upon property, income primarily, capital by way of resort. A man comes in to the right to that income subject to the charge of the annuity. Under the tax system, as in ordinary thinking, his own income is reduced by the amount of the charge. The gross income accruing to him is divided in ownership right, a part equal to the annuity figure belonging to the annuitant, the balance to him. The reality of this situation was recognised and allowed for by the tax system, because, while the payer of the annuity was assessed and charged on the gross income, he was from the earliest days allowed to deduct from his payments [of the annuity] a proportionate part of the tax which he had borne or was to bear on the total. By this means his true taxable income was treated as being the residue left after the charge of the annuity, the burden of the tax being shifted from payer to recipient by the former's statutory right to recoup himself out of the payment due to the latter.
>
> This recognition of a division of ownership between two or more persons entitled to rights in a single "fund" of income was not, however, confined to such cases as those where there was ... an annuity charge. ... the tax system can be seen to go further than this, for it applied the same idea of division of proprietary right to situations in which legal distinctions draw no dividing line. Thus an annual payment secured by personal covenant only, involving no charge on any actual security, whether income or capital, was treated in the same way for tax purposes.

[1] [1965] AC 402

So the expression “charge on income” has two main senses:

(1) By etymology, and in property law, it suggests a right secured by a legal charge (or mortgage or similar security) over a right to income.

(2) In tax law, the meaning is extended to include an Annual Payment, payable out of income, under a personal covenant even though not secured by a legal charge.[2]

The history since 1969 has been a gradual reduction of charges on income within the former deduct and retain regime. Interest was taken out in 1969; and most Annual Payments were taken out by the Annual Payment exemption introduced in 1988. Gift Aid payments were taken out by the Tax Law Rewrite. Just a few dusty corners now remain.

In the Tax Law Rewrite, the term “charge on income” was sensibly retired,[3] and the old system of deduction and retention of tax was replaced by a system of deduction and relief (which is a simpler route to the same outcome).[4]

This is the historical context in which the meaning of the term Annual Payment has had to be ascertained. In taxation, as in life, the past is (almost) always present.

31.3 Annual Payment: Meaning

In *Hargreaves Lansdown v HMRC*:

> Section 683 ITTOIA 2005 imposes the charge on “annual payments” not otherwise charged but does not define the term. The predecessor legislation to section 683 did not define the term either, though an indication to its interpretation can be found to an extent in the previous language, which referred to “interest, annuities and other annual payments”, and, following the separate taxation of interest, “any annuity or other annual payment”.[5]

In the same case in the UT:

[2] The term “security” has seen a similar extension, originally suggesting secured debts but now including some unsecured debts.

[3] EN CTA 2010 comments on the old terminology: “749. For corporation tax purposes charges on income are now reduced to charitable donations only (see section 338A(2) of ICTA). A more accurate description [qualifying charitable donations] has therefore been substituted for "charges on income". The term "charges on income" was dispensed with for income tax purposes by ITA and this Act now follows that path.”

[4] See EN ITTOIA Change 82.

[5] [2018] UKFTT 127 (TC) at [39].

> [39] The term 'annual payment' is not further defined in legislation and its meaning is to be found in case law. ... the authorities establish that an annual payment is a payment which has four characteristics, as follows:
> (1) It must be payable under a legal obligation.[6]
> (2) It must recur or be capable of recurrence, although the obligation to pay may be contingent.
> (3) It must constitute income and not capital in the hands of the recipient.
> (4) It must represent 'pure income profit' to the recipient.

31.3.1 *Annual/capable of recurrence*

The word "annual" is misleading. It just means "of an income nature". Section 582(7) ITTOIA (encapsulating earlier case law) provides:

> The frequency with which payments are made is ignored in determining whether they are annual payments for the purposes of subsection (1).[7]

Hargreaves Lansdown v HMRC discusses "capable of recurrence":

> The authorities identify the characteristic in the context of establishing that a payment is not a "one-off" payment in the nature of capital, but has the "quality" of a payment which will or may recur. ...
> [74] The Loyalty Bonus payments were not only "capable of recurrence", but they did recur, over many months and for the periods in this appeal. They are not prevented from being recurrent by depending on a contingency, and, per *Smith v Smith*, were not prevented from being annual because they were made monthly provided they might continue beyond a month.[8]

31.3.2 *Pure income profit*

An Annual Payment must be assessed in the hands of the recipient as an Annual Payment. It must not be a mere item in an account from which the profits of the recipient are ascertained. This is expressed by saying the Annual Payment must be "pure income profit".[9]

In *Hargreaves Lansdown v HMRC* the FTT said:

[6] See 33.3 (Source/voluntary transaction).

[7] This only applies for the purposes of s,582(1) ITTOIA but the provision is repeated elsewhere where needed; see s.683(3) ITTOIA.

[8] This passage was approved by the UT at [43].

[9] *Earl Howe v IRC* 7 TC 289; *Re Hanbury* 38 TC 588.

> [77] The requirement for the receipt to be pure income profit lies at the heart of what is meant by an "annual payment". It is therefore critical to understand the underlying rationale which led the courts to lay down this principle. It does not focus on the position of the payer, and in particular does not depend on an element of gratuity or bounty on the part of the payer. Rather, it is driven by the application of the deduction at source mechanism to annual payments. Under that mechanism someone other than the taxpayer (namely the payer) must collect and discharge all or part of the taxpayer's liability for the receipt. That mechanism would operate improperly if the payment comprised anything other than a gross receipt of the payee. The rather archaic phrase "pure income profit" is no more than shorthand for this principle.

The UT approved this and said:

> 59. ... the category of annual payments is limited and the reason for the limitation lies in the fact that annual payments have been inseparably associated with payments from which tax is deductible. It has been thought to be inconsistent with the idea of tax being deducted at the source to allow payments that are likely to be gross receipts of the payee and not "pure income profit" to be classed as annual payments...[10]
> 60. Where the payee is a trader, the concept is easy to grasp in principle. ... the much-quoted example given by Scrutton LJ in *Earl Howe v CIR* 7 TC 289 at page 303:
>
> > It is not all payments made every year from which Income Tax can be deducted. For instance, if a man agrees to pay a motor garage £500 a year for five years for the hire and upkeep of a car, no one suggests the person paying can deduct Income Tax from each yearly payment. So, if he contracted with a butcher for an annual sum to supply all his meat for a year, the annual instalment would not be subject to tax as a whole in the hand of the payee, but only that part of it which was profits.
>
> 61. ... the question becomes more difficult where, as in this appeal, the recipient is not a trader. [Counsel for the taxpayer] relies on what was said by the Court of Appeal in *CIR v National Book League* 37 TC 455, a case concerning covenants entered into by members of the League to pay their subscriptions and whether payments made under those covenants were annual payments. The Crown had contended that the payments were received in consideration of the annual provision of goods and services and were not annual payments. At page 473 Lord

[10] See *CIR v Whitworth Park Coal Co* 38 TC 531 at p.575.

Evershed MR placed emphasis on the counter-stipulations on the part of the League to provide membership benefits as follows:

> "The question, therefore, as I see it, turns first upon this: looking at the substance and reality of the matter, can it be said that those who entered into these covenants have paid the sums covenanted without conditions or counter stipulations? On the whole I have come to the conclusion that they cannot so say. It seems to me that against the special background of this case, and having regard to the terms of the letter, there was here, in a real sense, a condition or counter stipulation on the part of the League against which the covenant was entered into. Without repeating what I said at the beginning of this judgment, I must guard myself again saying that whenever you find a covenantor in favour of a charity getting aloud to him certain privileges it therefore follows that such a covenant or no longer can say that he has paid without conditions or counter stipulations."

62. However, it is clear that the presence of counter stipulations is only one of the circumstances to be considered. This point was emphasised by the House of Lords in *Campbell v CIR*:

> "The truth is, in my opinion, that one cannot resolve the problem whether a payment is an annual payment… simply by asking the questions "Must the payee give or do something in return?" or "Did the payer make some counter-stipulation or receive some counter-benefit?" or "Was it pure bounty on his part?" Such questions come more easily to the mind perhaps where, as here, payment to a charity is involved. But there is no warrant in the Income Tax Acts for applying a special test in the case of charities. The test must be applicable to all annual payments; and the problem must continue to be resolved, in my opinion, on the lines laid down by Scrutton LJ in *Earl Howe's* case. One must determine, in the light of all the relevant facts, whether the payment is a taxable receipt in the hands of the recipient without any deduction for expenses or the like—whether it is, in other words, "pure income" or "pure profit income" in his hands, as those expressions have been used in the decided cases. If so, it will be an annual payment ... If, on the other hand, it is simply gross revenue in the recipient's hands, out of which a taxable income will emerge only after his outgoings have been deducted, then the payment is not such an annual payment…The test makes it necessary to decide each case on its own facts."[11]

[11] 45 TC 427 at p.475.

How precisely does one decide whether a payment is pure income, or whether it is a "mere item in an account from which the profits of the recipient are ascertained"?

It has been said that one must look at the "quality and nature" of the payments but that by itself does not take the matter very much further.

Where the recipient is carrying on a trade, and the payment is a trading receipt then the payment obviously cannot be pure income. The colourful examples of Scrutton LJ are in this category

British Commonwealth International Newsfilm Agency Ltd v Mahany 40 TC 550 is another example of trading receipts. Payments to subsidise losses of the agency were held to be trading receipts. The payments were not for consideration and the payer did not receive any direct benefit; this might have suggested the payments were Annual Payments, but was overridden by other factors: both payer and payee were traders; the documentation suggested the payments were trade receipts; the payee was not a charity and not restricted to charitable activity.

However, the test is not simply to ask whether a receipt is a trading receipt. While no trading receipt can be an Annual Payment, other factors may show that a non- trading receipt may also fail to qualify as an Annual Payment. In *Essex County Council v Ellam* 61 TC 632 covenanted payments were made to the council which used them to pay a child's school fees. It was held that the council could deduct the school fees from its receipt under the covenant; so the covenanted payments were not "Annual Payments". The key factor in the decision, it is submitted, was that (i) the payments were "earmarked" for the purpose: (ii) the covenanted payment was fixed by reference to the school fees and (iii) there was no benevolent or charitable intention.

There are two cases on the other side of the line, both reported in 34 TC. Both were trading cases; in each case the Annual Payment was held not to be a trading receipt and to qualify as "pure income".

The first is *IRC v Corporation of London (as Conservators of Epping Forest)* 34 TC 293. Here the recipient received payments to cover its losses in managing Epping Forest. The receipt was an Annual Payment. The deciding factor was that the payments were not in return for services, but"of a benevolent nature... primarily to achieve a public benefit of a charitable nature."

The other case is *Leahy v Hawkins* 34 TC 28. Here a doctor received payments in lieu of a pension scheme. It was a condition of the payment that the doctor paid his own pension premiums. The payment was an Annual Payment. The deciding factor was that the amount of the payment bore no close relation to the amount the doctor had to pay under his own pension arrangements.

Unfortunately for taxpayers and their advisers, the Courts have declined to follow "the slippery slope of trying to define what 'Annual Payment' means".[12] It seems there is no single general principle at all, but rather, a number of different considerations which may apply in different circumstances. The best guidance in the context of normal charitable covenants is in Lord Reid's speech in *Epping Forest*, where he drew a distinction between:

(1) "business payments, whether or not the payor gets any direct return" and

(2) "payments of a benevolent nature - not of a business nature".

It has to be said that this is a vague test. In a marginal case, the charity fundraising literature will be relevant and should be reviewed by someone familiar with the law before fundraising commences.

The mere fact that a person receives a benefit as a consequence of making a covenant does not of itself prevent the covenanted payment from qualifying as an Annual Payment.

Ball v National & Grindlays Bank is an illustration. In this case, the bank made covenants to children of employees. The CoA noted that the bank had obtained "very considerable benefit" thereby, it had "good value for its money". Nevertheless, it was accepted that the covenanted payments were "Annual Payments".

Duke of Westminster v IRC offers another illustration. The Duke made covenants to employees. He received a benefit in consequence: the employees accepted less than their full salary, because they received the covenanted payments. However, the Duke's payments under the covenants were "Annual Payments".

The source of confusion is *IRC v The National Book League* 37 TC 455 where the judgment of Lord Evershed MR is confused and confusing. At one point he expounded the Earl Howe rule in these words:

> Looking at the substance and reality of the matter, can it be said that those who entered into these covenants have paid the sums covenanted without conditions or counter-stipulations?

[12] Harman J in *Leahy v Hawkins*.

This formula was adopted as the correct test in *Taw & Torridge Festival Society v IRC* 38 TC 603. It might be taken as support for a pure bounty rule. That was, however, rejected by the House of Lords in Campbell.

Even in *The National Book League* Lord Evershed rejected a pure bounty rule:

> I must guard myself against saying that whenever you find a covenantor in favour of a charity getting allowed to him certain privileges it therefore follows that such a covenantor no longer can say that he has paid without conditions or counter-stipulations.

The question was settled by the House of Lords in *Campbell v IRC.* Campbell raises a number of difficulties. However, there is no doubt that the pure bounty rule - for which the Revenue contended - was decisively rejected. Thus Lord Donovan at p 475:

> The truth is, in my opinion, that one cannot resolve the problem whether a payment is an annual payment within Case III simply by asking the questions 'must the payee give or do something in return?' or 'did the payer make some counter-stipulation or receive some counter-benefit?' or was it 'pure bounty on his part?' Such questions come more easily to the mind perhaps where, as here, payment to a charity is involved. But there is no warrant in the Income Tax Acts for applying a special test in the case of charities. The test must be applicable to all annual payments: and the problem must continue to be resolved, in my opinion, on the lines laid down by Scrutton LJ in *Earl Howe's* case. One must determine, in the light of all the relevant facts, whether the payment is a taxable receipt in the hands of the recipient without any deductions for expenses or the like - whether it is, in other words 'pure income' or 'pure profit income' in his hands, as those expressions have been used in the decided cases. If so, it will be an annual payment under Case III. If, on the other hand, it is simply gross revenue in the recipient's hands, out of which a taxable income will emerge only after his outgoings have been deducted, then the payment is not such an annual payment.[13]

[13] Lord Guest made a similar comment: "It is apposite to note that Lord Normand [in the *Epping Forest* case 34 TC 293] did not say that if the payment was made with a condition or stipulation of a non-contractual character the payment would not be an annual payment. I can see no ground or reason or authority why there should be such a narrow construction of 'annual payment'..."
Viscount Dilhorne made similar comments at p 460, and Lord Upjohn at p 472.

31.3.3 *Dividend not Annual Payment*

In *Canadian Eagle Oil Co v The King*:[14]

> dividends, even dividends upon preference shares... are not "annual payments", their distribution depending in every instance upon a specific declaration by the company.

But this is now of historical interest only, as a new system of taxation of dividends was introduced in 1965.

31.3.4 *HMRC examples*

SAIM8050 provides 4 examples:

Example:	**Facts**	**Comment**
1:	Royalty after death of trader	See 31.4 (Post-cessation trade receipt)
2:	Foreign source covenanted payments	Annual Payments
3:	Credit card cashback	Not Annual Payments
4:	Murabaha (Islamic interest-substitute)	Annual Payments

> **Example 2** (Vivienne - Covenanted payments for consideration)
> V, a UK resident, travels to the US to negotiate with a boat-building company, and buys an ocean-going yacht from them for $2.6 million. In order to clinch the deal, the salesman makes an offer (later confirmed in writing by the company) to pay V $60,000 a year for the next 5 years. Although the payments are expressed as a contribution towards the running costs of the yacht, there is no obligation on V to spend them in any particular way. She accepts the offer.
> The agreement constitutes a legally enforceable contract, even though it is only documented informally. The payments are made in consideration of V's purchase of the boat. Once she has made the purchase, however, she does not have to do anything further in order to receive the payments (see the discussion of conditions and counter-stipulations at SAIM8040). They are therefore annual payments. Since the payments do not originate in the UK, V does not receive them with income tax taken off, and she must pay tax at both basic and higher rates on the income (although she can claim relief for any US withholding tax).

More analytically, since the payments do not arise in the UK, the Annual Payment exemption does not apply.

[14] 27 TC 205 at p.245.

Example 3 (William - Credit card cashback)
W signs up for a credit card offering a 'cashback' feature. Twice a year, the issuer credits to the card an amount equal to 1% of the payments W has made in the previous 6 months. Such credits are not annual payments. Each payment is contingent on his having charged amounts to the credit card in the previous period. In essence, each payment represents a one-off rebate of amounts that W has paid to the card issuer. Any future cashback received will be dependent on the cardholder making more purchases with the card and no further cashback will be received if there are no future card transactions.

Example 4 (Tariq & Mohammed - Murabaha (Islamic interest-substitute) outside alternative finance code)
T, a carpenter, requires £12,000 to build a workshop on to his house, for the purposes of his trade. His uncle, M, agrees to advance him the funds, but for religious reasons he does not wish to make an interest-bearing loan to T. They therefore enter into a murabaha contract (see CFM11130). Under the agreement, M buys commodities for £12,000 and sells them to T, who immediately sells the commodities back into the market for £12,000, thus realising the necessary funds. However, under the terms of his purchase from M, he is granted 'credit terms', paying 48 monthly instalments of £275, a total of £13,200.
The arrangement does not fall within the alternative finance arrangement legislation in at ITA07/S564C, because M is not a 'financial institution'. M does not habitually deal in commodities: while it is possible for an isolated transaction of purchase and resale to be a trading transaction (see BIM20230) and each case must be judged on its own merits, the return of £1,200 which he derives from the transaction is unlikely to be a trading profit.
If it is not trading income, the £300 received by M each year, which is over and above 'repayment' of the capital sum advanced, will be an annual payment - it is pure income profit in M's hands.

31.4 Post-cessation trading receipt

A number of old (pre-1960) cases discuss the position after a cessation of trade. In each case the cessation was on the death of a trader (the PRs or legatee did not carry on the deceased's trade). But the same would apply on a retirement.

31.4.1 *Post-cessation receipt formerly exempt*

Until 1960 there was no charge on post-cessation receipts, so the question was not to chose between two categories of taxable income, but whether the receipt was taxable at all. See *Bennett v Ogston*:

> When a trader or a follower of a profession or vocation dies or goes out of business - because [Counsel] is quite right in saying the same observations apply here - and there remain to be collected sums owing for goods supplied during the existence of the business or for services rendered by the professional man during the course of his life or his business, there is no question of assessing those receipts to Income Tax; they are the receipts of the business while it lasted, they are arrears of that business, they represent money which was earned during the life of the business and are taken to be covered by the assessment made during the life of the business, whether that assessment was made on the basis of bookings or on the basis of receipts.[15]

31.4.2 *Post-cessation interest*

In *Bennett v Ogston* the taxpayer carried on the trade of moneylender, and during his lifetime, interest was treated as a receipt of the trade, not as interest.[16] But interest received after the death was taxable as interest:

> When you are dealing with interest, it is true that under certain circumstances, in this case among others ... though you may treat the interest as the mere receipts of a trade and not as interest itself, I think it is quite impossible to say that interest which has to be borne next year, although you may have to secure it by a dealing this year, can be treated as a profit of this year. I do not understand that; I do not think that is possible. I think when you deal with interest as a receipt of a trade you must deal with it year by year, and the interest, as it comes in in the year as a receipt from the trade, if you like. If the trade stops then the securities which are outstanding which bear interest become securities apart from the trade, and interest upon them must bear Income Tax.[17]

31.4.3 *Post-cessation Annual Payments*

Bennett v Ogston sets the scene for 3 cases concerning professional actors/authors.

[15] 15 TC 374 at p.378. This passage was approved in *Purchase v Stainer* 32 TC at p.410 and at p.412.

[16] But during the trader's lifetime, the choice between interest/trading receipt would not have made a great deal of difference.

[17] At p.379. But in *Purchase v Stainer* HL had "some doubt" as to whether this was a correct application of the principle set out just above; and in *Carson v Cheyney*, Lord Reid shared that doubt: 38 TC at p.265.

The first was *Purchase v Stainer*. This concerned the actor/film director Leslie Howard.[18] His executors received contractual payments for his work. These were held not to be Annual Payments:

> How else could these sums come to the hands of Mr. Howard or his executors than as the remuneration for his professional activities, the reward for services rendered by him during his life and unpaid for at his death? It appears to me wholly irrelevant that they were not payable until after his death and equally so that they were not and could not be quantified until after that event. They retained the essential quality of being the fruit of his professional activity...
>
> The source of these payments was the professional activity of Mr. Howard: it was never anything else. It is true that his remuneration took the form of annual payments which, if other conditions were satisfied, might fall within Case III. But other conditions were not satisfied, for *ex hypothesi* the source of the remuneration was the exercise of a profession falling within Case II.

The decision is that these payments were not Annual Payments.

And again:

> If Mr. Leslie Howard had stipulated for payment in blocks of shares or bonds, or any other instruments which by their independent vitality generate income, the dividends or interest might well have been taxable in the hands of his executors. The contracts in the present case enjoy, in my view, no such independent vitality. The consideration for what Mr. Howard was to do - to act or manage - was not the grant of a contract or contracts but the payment of money under the terms of those contracts. Mr. Howard acted for money: he did not act for contracts. The contracts were mere incidental machinery regulating the measure of the services to be rendered by him on the one hand, and on the other, that of the payments to be made by his employers: they were not the source but the instrument of payment. and his death, in my view, did nothing to divest them of that character.[19]

In two subsequent cases the Courts expanded the scope of this principle (or, depending on one's perspective, they chose not to restrict it). I refer to these as the authorship cases.

The first of the two is *Carson v Cheyney*. This concerned the author

[18] His stage name was Leslie Howard; his full name was Leslie Howard Stainer. Howard is best known for his role as Ashley Wilkes in *Gone with the Wind*.

[19] at p.412.

Peter Cheyney, a detective fiction writer. The difference between *Stainer* and *Cheyney* was that Stainer concerned mere contractual payments for services as an actor; Cheyney received *royalties for his copyright.* An author, unlike an actor, generally holds the copyright. But it made no difference to the outcome. In both cases, the payments were post-cessation receipts of the profession, not Annual Payments, and they did not become Annual Payments after the death:

> In *Stainer's* case it could not be denied that the taxpayer acquired under his contracts certain contractual rights nor that those rights could in a certain context be called property. So it was argued that the payments were the income and the contracts were the "income-bearing assets". ... What else were these payments than the fruit of Peter Cheyney's professional activities? How is it relevant that in order to reap his harvest he had to enter into contracts under which he acquired rights and incurred obligations...? And how is it relevant that it was a term of those contracts that there should be vested in the publishers a right created by the law to protect him in the exploitation of his work? It was by entering into such contracts that he was able to carry on his profession gainfully. It was cause he did so that he was assessable to tax under Case II of Schedule D. I reject therefore the plea that the royalty payments could, whether during the carrying on of the 'profession or after its discontinuance, be regarded as "income from property" constituting "a substantive subject matter of taxation under Schedule D" - I use the words of the Crown's formal Case. I will only add, in deference to the ingenious argument of the Attorney-General, that the realities of the situation are not changed by saying that the royalties were throughout paid in consideration of the grant of a licence to use copyright and were therefore the income of property, that during the carrying on of the profession they could be regarded as income under Case VI, but that having always the character of income of property they became taxable in that character when the profession was no longer carried on. This is really only saying the same thing in other words and is to be similarly answered. First and last and all the time the payments are professional earnings, whatever be the mechanism through which they are paid.[20]

And again:

> An author is not in my opinion making a contract for services by entering into an agreement for the publication of a book already created

[20] 38 TC 240 at p.259.

by him. The position may approximate to a contract for services where the author binds himself to write a book and to transfer the copyright to a publisher, but I do not find in the agreements here any obligation to write a book. ... I prefer to treat the case from the angle of approach taken by the learned Attorney-General, that these are agreements relating to property of Mr. Cheyney already in existence or to come into existence.

In principle there is no difference between the case where an author sells the copyright and the case where he retains the copyright. What he has produced is not copyright but a book. Copyright is an incident attached by law to the book, fortifying that which he has produced and giving it a value which it would not have if it could be reproduced illegitimately in the shape of pirated editions. The property then from which the author obtains his income is the work produced by him, and the method by which that work can be turned to profit during his life is in his own hands and is but a projection of his professional activities, the means by which he earns his livelihood from his professional work. If I take the case where he retains the rights in his work and takes the profits to himself, it seems to me clear that when he dies any profits that come in afterwards from any issue published during his life are still the profits of what was his profession. It is not possible to say that they are mere income of property, "pure income profit" as it has been called. They are profits not only from writing the book but from bearing all the expenses of selling the book to the public, including the expenses of printing and publishing. They are akin to the profits of a trade but are more properly called the profits of a profession. So it is in my opinion where he sells his rights in return for royalties. It is quite unreal to regard these royalties merely as a return from property. They are the reward for all he has put into his work, his labour, his thought, his skill as a writer, and the expenses incurred in creating his book. The position is materially different where rights in a book in return for royalties are granted by another than the author. The elements to which I have referred are entirely absent in such a case. The book is there already made, and the idea of royalties as merely the income of property is a more intelligible conception. In Mr. Cheyney's case the position is in my opinion accurately and concisely summed up in the words of Jenkins, L.J., when he says

"it was just as much part of his profession to turn his literary lab ours to account by licensing the copyright he had created to publishers as it was to write the books in which the copyright subsisted."

He was treated by the Crown as earning money in the exercise of his profession by means of the contracts he made. It is not now said, nor

> could it in my opinion be said, that any change in the character of the payments received took place on his death.

The second of the authorship cases is *Home v Asquith*. This concerned the author Sir James Barrie, best known for *Peter Pan*. Barry bequeathed his copyrights (though not Peter Pan) to his secretary Lady Asquith. Lady Asquith assigned them to her son. So the difference between the earlier two cases and *Asquith* was that the payments were not received by the PRs. They were received by a legatee, (or more accurately, by an assignee of the legatee, but nothing turned on that.) The income was *still* not Annual Payments, and not still chargeable under sch D III (or at all):

> Once the royalty contract comes into the hands of someone else, it is said, then the reasoning in *Stainer's* case and *Cheyney's* case has no application, one is left with a simple contract under which annual sums are payable, and in the hands of the owner of that contract the contract is a source of taxable income. I find it impossible to accept that contention consistently with the reasoning in the two cases. The reasoning in the two cases, as I understand it, is that, where an author enters into such a contract, that contract represents merely the machinery whereby he collects the return for his professional activities... It seems to me that, if that was the quality of the contracts in the hands of the author himself and of his personal representatives, who are in the same position, there could be no change in the quality of the contracts by reason of the fact that the benefit of the contracts passed from the personal representatives to a beneficiary under a will, or at a later stage from the beneficiary to someone in whose favour he disposes of the benefit of the contracts. If, immediately before the assent in favour of the beneficiary, a royalty contract possessed no in dependent vitality and was merely incidental machinery for the recovery of the payments due to the author, it seems to me that immediately after the assent the quality of the royalty contract was exactly the same. I do not see how it can be said that by reason of the assent in favour of the beneficiary the royalty contract in some way changed its character. What the beneficiary received upon the assent was a piece of machinery[21] for collecting outstanding payments due to the deceased author. Unless the contract possesses independent vitality as a source of income, it is perfectly clear that payments received under it, representing as they do no more than outstanding receipts of the discontinued profession, do not possess the

[21] See App.1.7 (Machinery/mechanism metaphor).

character of taxable income in the hands of anyone.[22]

31.4.4 *The policy background*

The reader may find these 3 decisions surprising. Of course the Courts were not then applying the contemporary purposive approach, but even a traditional approach could have gone the other way. It is likely that one factor behind the decisions was an unspoken policy consideration, that tax free post-cessation receipts were a form of retirement benefit, at a time when there was no general scheme for retirement benefits for the self-employed.[23]

There is now a charge on post-cessation receipts, which would apply to executors, legatees and assignees. However the author cases are relevant to withholding tax. They do show that the receipts are not Annual Payments, and are not subject to withholding tax as Annual Payments. They are also said to show that professional receipts in the circumstances of *Stainer*, *Cheyney* and *Asquith* are not royalties, and so not subject to withholding tax as royalties.[24]

31.4.5 *HMRC example*

The SAI Manual provides this example:

> **SAIM8050 examples of annual payments**
> **Example 1** (Peter & Teresa - Royalty after death of trader)
> P carries on a trade as a software developer and software consultant. In the course of the trade, he develops a suite of computer programs in which there is commercial interest. He sets up a company, of which he and his wife T are directors, to exploit and market the software.
> P enters into a licensing agreement granting the company a 25-year licence on the source code and intellectual property rights in the software, in exchange for a licence fee paid quarterly. The agreement does not require him to further develop or maintain the software, or supply technical advice to users - this is all done by the company.
> The licence fees received by P are agreed to form part of the income of his trade as a software developer, and are included in the amount he returns as trading profits. However, P dies, and under the terms of his will, the intellectual property and the benefit of the licence agreement

[22] 45 TC 251 at p.265.

[23] Royal Commission on the Taxation of Profits and Income Cmd. 9474 (1955) chapter 12.

[24] See 32.14 (Professional authors).

> pass to T.
>
> T does not carry on a trade of her own, and any work she does in connection with the software is done in her capacity as a director of the company. In her hands, the licence fees are annual payments. This is because the company is legally obliged under the licensing agreement to pay them, they are recurrent, and - in particular - they represent pure income profit to T. She does not have to do anything to earn them, and does not have to set outgoings against them.
>
> The company is now making annual payments, and must deduct income tax at the basic rate from the licence fee payments and account for it on form CT61 (see SAIM9000 onwards).
>
> T must enter the annual payments received in a tax year as 'other taxable income' on her self assessment return. If she is liable to tax only at the basic rate, she has no more tax to pay on the sums she receives.

In the light of the authorship cases, this is not correct. The receipts are not Annual Payments, but they are in principle taxable as post-cessation receipts. Has the author of this passage overlooked those cases? or chosen to ignore them? The author of the BIM acknowledges the question but does not stay for an answer:

> **BIM50725 Authors And Royalties To Person Other Than Author**
> [Jan 2019]
>
> Where it is claimed that royalties are not chargeable because of the decision in *Hume v Asquith* [1968] 45 TC 251, the case should be referred to Business Profits (Technical).

31.5 Charge on Annual Payments

Charging provisions on Annual Payments are scattered across ITTOIA:

ITTOIA	**Applies to**	**See para**
s.589	Royalties	32.5
Chapter 7 Part 4	Purchased life annuity	38.18
Chapter 4 Part 5	Telecommunication rights	-
s.683	Annual Payment not otherwise charged	*Discussed here*

Section 683(1) ITTOIA provides:

> Income tax is charged under this Chapter [Chapter 7 Part 5 ITTOIA] on annual payments that are not charged to income tax under or as a result of any other provision of this Act or any other Act.[25]

[25] For this style of charging provision, see 11A.3.1 (Priority in charging provision).

31.5.1 *Beneficiary on remittance basis*

Section 684 ITTOIA provides:

> (1) Tax is charged under this Chapter on the full amount of the annual payments arising in the tax year.
> (2) Subsection (1) is subject to Part 8 (foreign income: special rules).

This brings in the ITA remittance basis if the Annual Payments have a foreign source.

Section 684(3) ITTOIA provides:

> The amount charged under this Chapter in the case of certain payments made by trustees in the exercise of a discretion is subject to section 494 of ITA 2007 (grossing up of discretionary payments from trusts).

31.5.2 *Reliefs for AP charge*

Section 683(4) signposts a list of reliefs against this charge:[26]

ITTOIA	**Outline**	**See para**
ss.727 -730	Annual Payments exemption (for individuals)	31.6
s.731	Personal injury damages	
s.732	Compensation awards	
s.734	Payments from trusts for injured persons	
ss.735 - 743	Health and employment insurance	
ss.744 - 747	Payments to adopters	
ss.757 - 767	EU Interest royalty directive	
s.776	Scholarship income	

Most of the reliefs in this list are of somewhat specialist interest, and not discussed here.

31.5.3 *Source of Annual Payments*

The location of the source of Annual Payments matters for the usual reasons, in particular:

(1) A non-resident is not taxed on foreign source Annual Payments

(2) Foreign source Annual Payments are RFI and qualify for the remittance basis

(3) Foreign source Annual Payments are outside the scope of withholding tax

[26] For clarity I have set this out in tabular form rather than the layout of the statute.

As the Annual Payment exemption only applies to UK source Annual Payments, it may happen that a taxpayer argues an Annual Payment has a UK source, and HMRC argue for foreign source.

There is not much authority. In *Bingham v IRC* 36 TC 254 a Dutch court ordered a UK resident individual to make maintenance payments to his ex-wife resident in the Netherlands. The payments were not UK source income.[27]

If Annual Payments are made in respect of the use of royalties, the situs should be the situs of the copyright.[28]

31.6 Annual Payment exemption

Section 727 ITTOIA provides:

> (1) No liability to income tax arises under Part 5 [ITTOIA Miscellaneous Income] in respect of an annual payment if it–
> (a) is made by an individual,[29] and
> (b) arises in the UK.
> (3) Subsection (1) also applies to a payment made by an individual's personal representatives if–
> (a) the individual would have been liable to make it, and
> (b) that subsection would have applied if the individual had made it.

I refer to this as the **"Annual Payment exemption"**.

The consequence of exempting Annual Payments is that withholding tax does not apply. That may suit the payor as well as the payee.

31.7 Commercial Annual Payment

Section 728 ITTOIA provides:

> A payment by an individual is not exempt from income tax under section 727(1) if it is made for commercial reasons in connection with the individual's trade, profession or vocation.

The paradigm example is an annuity payable to a retiring partner on

[27] Had the wife been UK resident, she would now qualify for the relief for foreign maintenance payments.

[28] See 32.7 (Source of non-trade IP income).

[29] Section 727(4) ITTOIA provides: "For the purposes of subsection (1) and section 728, "individual" includes a Scottish partnership if at least one partner is an individual." Strange.

purchase of a partnership share by the continuing partners. This used to be a common practice, I think. It is commercially attractive to the continuing partners, as they avoid the cash flow problems of raising a lump sum, and obtain an IT deduction. If the retiring partner's marginal IT rate is less than the continuing partners, it would be attractive from a fiscal viewpoint, and otherwise it is at least neutral in IT terms; and it avoids CGT on the disposal. But I wonder how often it is done, nowadays.

See 31.10.3 (Imposition of withholding tax).

31.8 Non-taxable consideration

Section 729 ITTOIA provides:

> (1) A payment that meets condition A is only exempt from income tax under section 727(1) if condition B or C is met.
> (2) Condition A is that–
> (a) the payment is made under a liability incurred at any time for consideration in money or money's worth, and
> (b) some or all of the consideration is not required to be brought into account in calculating the payer's income for income tax purposes.

If condition A is met, we turn to the escape conditions B and C:

> (3) Condition B is that the payment is income within section 627(1) (payments on dissolution or separation) in the recipient's hands.[30]
> (4) Condition C is that the payment is made to an individual under a liability incurred at any time in consideration of the individual surrendering, assigning or releasing an interest in settled property[31] to or in favour of a person with a subsequent interest.

Conditions B and C are of somewhat specialist interest. So an Annual Payment under a covenant made for non-taxable consideration is a trap which may unexpectedly bring the Annual Payment code into effect.

31.9 Foreign maintenance payments

The Annual Payment exemption only applies to UK source income: can

[30] See 47.6 (Settlor-interested trust: Reliefs).

[31] Section 729(5) deals with Scots terminology: "In the application of subsection (4) to Scotland, the reference to settled property is to be read as a reference to property held in trust." Is this actually necessary?

any reader explain why? The restriction may not be EU-law compliant; but the point is not likely to arise.

So s.730 ITTOIA provides a further relief, but limited to foreign maintenance payments:

> (1) No liability to income tax arises under Part 5 in respect of an annual payment if–
>
> (a) it is a maintenance payment,[32]
>
> (b) it arises outside the UK, and
>
> (c) had it arisen in the UK it would be exempt from income tax under section 727 (certain annual payments by individuals).[33]
>
> (6) Subsection (1) also applies to a payment made by an individual's personal representatives if–
>
> (a) the individual would have been liable to make it, and
>
> (b) that subsection would have applied if the individual had made it.

31.10 Annual-Payment withholding tax

For a general introduction to withholding taxes, see 26.18 (Withholding taxes: Introduction).

Section 903 ITA deals with patent royalties: I do not discuss this here.

31.10.1 *Qualifying Annual Payment*

This term matters because "qualifying Annual Payments" are subject to Annual-Payment WHT.

Section 899 ITA provides:

> (1) In this Chapter [Chapter 6 Part 15, Annual Payments withholding tax] "qualifying annual payment" means an annual payment that meets the conditions in subsections (2) to (5).

[32] Defined in ss(2) "In subsection (1) "maintenance payment" means a periodical payment which meets conditions A and B.
(3) Condition A is that the payment is made under a court order or a written or oral agreement.
(4) Condition B is that the payment is made by a person–
(a) as one of the parties to a marriage or civil partnership to, or for the benefit of, and for the maintenance of, the other party,
(b) to any person under 21 for that person's own benefit, maintenance or education, or
(c) to any person for the benefit, maintenance or education of a person under 21."

[33] See 33.5 (Settlor-interested trust: Reliefs).

(2) The payment must arise in the UK.

Subsections (3)/(4) deal with non-company/company recipients.[34] It is helpful to see them side by side:

Non-company recipient: s.899(3) ITA	**Company recipient: s.899(4)**
(3) If the recipient is a person other than a company, the payment[35] must be—	(4) If the recipient is a company, the payment must be—
(a) a payment charged to income tax under— (i) Chapter 7 of Part 4 of ITTOIA 2005 (purchased life annuity payments), (ii) section 579 of that Act (royalties etc from intellectual property), (iii) Chapter 4 of Part 5 of that Act (certain telecommunication rights: non-trading income), or (iv) Chapter 7 of Part 5 of that Act (annual payments not otherwise charged), or	(a) a payment charged to income tax as mentioned in subsection (3)(a), [This can only apply to a non-resident company recipient as UK companies are charged to CT] or
(b) a payment charged to income tax under Part 9 of ITEPA 2003 because section 609 or 611 of that Act applies to it (certain employment-related annuities).	
	(b) a payment which is— (i) required to be brought into account under Part 5 of CTA 2009 (loan relationships) as a non-trading credit, or
	(ii) from a source in the UK and chargeable to corporation tax under [a] Chapter 7 of Part 10 of that Act (annual payments not otherwise charged) or [b] regulation 15 of the Unauthorised Unit Trusts (Tax) Regulations 2013.

31.10.2 *Annual Payments outside WHT*

Section 899(5) ITA sets out 6 categories of payments which are not

[34] So it is necessary to ascertain the recipient; see 26.21 (To whom is interest paid).

[35] For the meaning of payment, see 15.3 (Recognition/attribution: Analysis).

qualifying, and so not subject to Annual-Payment WHT:

The payment must not be—[36]

Para	Type of payment
(a)	Interest
(b)	Corporate gift aid: qualifying payment for Chapter 2 Part 6 CTA 2010
(c)	Individual gift aid: qualifying donation for Chapter 2 Part 8 ITA
(d)	Discretionary trust income: within s.494(3) ITA[37]
(e)	A payment which would fall within paragraph (d) but for the fact that the trustees making the payment are non-UK resident
(f)	Annual payment for dividends or non-taxable consideration: s.904 ITA

Items (a)-(c) are not Annual Payments, so these paragraphs are otiose. They are there for historical reasons.

31.10.3 *WHT on Annual Payments*

Withholding tax on qualifying Annual Payments is imposed by s.900/901 ITA for individuals/non-individual payors, and it is convenient to read them side by side:

Individual payor: s.900 ITA	Non-individual payor: s.901 ITA
(1) This section applies to any payment made in a tax year if—	(1) This section applies to any payment made in a tax year if—
(a) it is a qualifying annual payment,	[identical]
(b) the person who makes it is an individual, and	(b) the person who makes it is not an individual.
	(2) But this section does not apply if— (a) an individual's personal representatives make the payment, (b) the individual would have been liable to make it if the individual had not died, and (c) the payment would not have been made for genuine commercial reasons in connection with the individual's trade, profession or vocation, had it been made by the individual.

[36] For clarity I set this out in tabular form, and in the terminology of this book, rather than the layout of the statute.

[37] See 41.4.1 (UK resident trust).

(c) it is made for genuine commercial reasons in connection with the individual's trade, profession or vocation.

The circumstances in which an individual is subject to Annual-Payment WHT are very limited. The paradigm example is an annuity payable to a retiring partner on purchase of a partnership share by the continuing partners.

Assuming Annual-Payment WHT does apply, we move on:

Individual payor: s.900 ITA	**Non-individual payor: s.901 ITA**
(2) The individual must, on making the payment, deduct from it a sum representing income tax on it at the basic rate in force for the tax year.	(3) If the person who makes the payment has some modified net income for the tax year (see section 1025)— (a) the person must, on making it, deduct from it a sum representing income tax on it at the basic rate in force for the tax year, and
(3) Income tax equal to the sum required to be deducted is to be collected through the individual's self-assessment return (see Chapter 17).	(b) income tax equal to the sum required to be deducted is to be collected through the person's self-assessment return (see Chapter 17).
	(4) If the person who makes the payment has no modified net income for the tax year the person by or through whom the payment is made must, on making it, deduct from it a sum representing income tax on it at the basic rate in force for the tax year in which the payment is made.

31.10.4 *Annual-Payment/Royalty WHT: Priority*

Section 906(8) ITA provides:

> If a payment to which this section applies is also one to which a provision of Chapter 6 applies, it is treated as not being a payment to

which a provision of Chapter 6 applies.

So if a payment falls within Chapters 6 and 7, then Chapter 7 has priority. See 32.10 (Royalty withholding tax).

31.11 Relief for payor within WHT

Relief for individual: s.448 ITA	**Relief for non-individual: s.449 ITA**
(1) This section applies to a payment made in a tax year if— (a) the person who makes it is an individual, (b) a sum representing income tax is required by section 900(2) (deduction from annual payments) to be deducted from it, and (c) the payment is not deductible in calculating the individual's income from any source.	(1) This section applies to a payment made in a tax year if— (a) the person who makes it is not an individual, (b) a sum representing income tax is required by section 901(3) (deduction from annual payments) to be deducted from it, and (c) the payment is not deductible in calculating the person's income from any source.
(2) The individual is entitled to relief for the tax year equal to the gross amount of the payment.	(2) The person who makes the payment is entitled to relief for the tax year equal to the gross amount of the payment.
(3) But this is subject to the restrictions in subsection (4)	(3) But this is subject to the restrictions in subsections (4)[38] and (5)
(4) The total amount of relief given under this section to an individual for a tax year cannot be greater than the amount of the individual's modified net income for the tax year (see section 1025).	(5) The total amount of relief given under this section to a person for a tax year cannot be greater than the amount of the person's modified net income for the tax year (see section 1025).
(5) The relief is given by deducting the amount of the relief in calculating the individual's net income for the tax year (see Step 2 of the calculation in section 23).	(6) The relief is given by deducting the amount of the relief in calculating the person's net income for the tax year (see Step 2 of the calculation in section 23).

[38] See 31.11.1 (Non-individual: additional rule).

31.11.1 *Non-individual: additional rule*

Section 449(4) ITA provides:

> Relief is not given for the payment so far as it is ineligible for relief (see section 450).

That takes us to s.450 ITA:

> (1) This section sets out the circumstances in which a payment to which section 449 applies, or part of it, is ineligible for relief.
> (2) The payment is ineligible for relief if, or so far as, it can lawfully be made only out of—
> (a) capital, or
> (b) income that is exempt from income tax.
> (3) If the payment or any part of it is charged to capital, the payment or that part is ineligible for relief.
> (4) If—
> (a) the person who makes the payment treats it or any part of it as made out of income that is exempt from income tax, and
> (b) the rights or obligations of any person are or may in the future be different from what they would have been if the payment or part had not been so treated,
> the payment, or the part concerned, is ineligible for relief.
> (5) If the payment or a part of it is not ultimately borne by the person who makes it, the payment or the part concerned is ineligible for relief.
> (6) But subsection (5) does not apply to a payment or part of a payment if—
> (a) the person who makes the payment is liable to income tax on an amount, and
> (b) it is because the person receives that amount or benefits from it in some other way that the payment or the part concerned is not ultimately borne by that person.

For the reasons for this, see EN ITA Change 82. But it will rarely if ever apply, so I do not set this material out here.

31.12 Annual Payment from RFI

Section 839 ITTOIA provides:

> (1) In calculating the amount of relevant foreign income to be charged to income tax for a tax year, a deduction is to be allowed for an annual payment other than interest if it meets conditions A, B1 or B2 and C.

> (2) Condition A is that the payment is payable out of the relevant foreign income.
>
> (3) Condition B1 is that, had the payment arisen in the UK, it would have been chargeable to income tax under one of the following provisions –
>
> section 579 (charge to tax on royalties and other income from intellectual property),
>
> Chapter 4 of Part 5 (certain telecommunication rights: non-trading income),
>
> Chapter 7 of Part 5 (annual payments not otherwise charged) , or
>
> regulation 15 of the Unauthorised Unit Trusts (Tax) Regulations 2013.
>
> (3A) Condition B2 is that, had the payment arisen in the UK it would have been–
>
> (a) required to be brought into account under Part 5 of CTA 2009 (loan relationships) as a non-trading credit, or
>
> (b) chargeable to corporation tax under Chapter 7 of Part 10 of that Act (annual payments not otherwise charged) or regulation 15 of the Unauthorised Unit Trusts (Tax) Regulations 2013.
>
> (4) Condition C is that the payment is made to a non-UK resident.

Section 839(5) ITTOIA disapplies the relief if the remittance basis applies:

> Subsection (1) does not apply if–
>
> (a) the relevant foreign income is received in the UK, or
>
> (b) it is charged for the tax year in accordance with section 832 (relevant foreign income charged on remittance basis).

No deduction is needed when the remittance basis applies, as income used in making the Annual Payments will not be remitted.

31.13 Annual Payments: Critique

The reader who has studied the text to here will agree that there is scope for simplification.

It is suggested that the Annual Payment code ought to be abolished. In specific circumstances where a charge is needed, there ought to be an express charge, or it could fall under Misc Sweep-up Income. Annual-Payment WHT is not needed.

CHAPTER THIRTY TWO

INTELLECTUAL PROPERTY INCOME

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Cross references

The following topics are considered elsewhere:
10.3.1 (Split year: Pt 4/5 ITTOIA Income)

32.1 IP income: Introduction

This chapter considers the income taxation of intellectual property (IP).

I focus on matters closest to the themes of this book, but it is necessary to consider the topic in the round. I do not consider:

(1) Corporation tax on IP (intangible fixed assets code)[1]
(2) EU interest and royalties directive,[2] which applied to interest/royalty payments between associated companies in different member states, and was repealed, in short, from 1 June 2021.[3]
(3) Diverted profits tax, Part 3 FA 2015
(4) Averaging fluctuating profits of creative works, Chap 16 Part 2 ITTOIA
(5) Disposal of know-how, s.584-596 ITTOIA
(6) Sale of patents, s.587 - 599 ITTOIA

I hope to address some of these items in a future edition.

The current law has a long history. Background to the 2002 reforms can be found in Inland Revenue consultation and response papers:

- Innovating for the Future: Consultation Document (1998)
- Reform of the Taxation of Intellectual Property: Technical Note (1999)
- Reform of the Taxation of Intellectual Property, Goodwill and other Intangible

[1] Part 8 CTA 2009. "Intangible fixed assets" includes royalties but excludes shares /financial assets. The intention was to avoid borderline issues between intellectual property and other intangible fixed assets; and to align the taxation of intangibles with the accountancy treatment.
For the interaction of this code and s.3 TCGA, see 64.5.5 (Derivatives and intangibles).

[2] 2003/49/EC (3 June 2003).

[3] Section 34 FA 2021.

Assets: the New Regime, Technical Note (June 2000)
- Reform of the Taxation of Intellectual Property, Goodwill and other Intangible Assets: the New Regime: the Next Stage Technical Note (November 2000)
- Taxation of Intellectual Property, Goodwill and other Intangible Assets: the New Regime, Technical Note (March 2001)

The focus of these papers is the CT regime, but there are also comments on IT, and they float the 2016 reforms which eventually came to pass.

HMRC have issued a technical note on the 2016 reforms ("**the Royalties Technical Note**").[4]

32.2 IP: Terminology

32.2.1 *IP income/royalties*

Section 579 ITTOIA refers to "royalties and other income from intellectual property". I refer to this as **"IP income"**.

Apart from the special cases of sale of patents/know-how, and trading, it is difficult to imagine income from IP which is not royalties. But the precise definition of royalties in s.579 does not normally arise.

OECD Model uses the term "royalties" in a defined sense which is (more or less) the same.

32.2.2 *Intellectual property*

Section 579(2) ITTOIA defines intellectual property:

> In this section "intellectual property" means—
> (a) any patent, trade mark, registered design, copyright, design right, performer's right or plant breeder's right,
> (b) any rights under the law of any part of the UK which are similar to rights within paragraph (a),
> (c) any rights under the law of any territory outside the UK which correspond or are similar to rights within paragraph (a), and
> (d) any idea, information or technique not protected by a right within paragraph (a), (b) or (c).

I refer to this as the "s.579 definition". This definition only applies for the purposes of s.579, so it has to be incorporated by reference in s.577A(5) ITTOIA.

[4] HMRC, "Deduction of income tax at source: Royalties - Updated Technical Note" (June 2016) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/532314/M1070_revised_TN_final.pdf*

32.2.3 *Copyright*

This is not the place to set out definitions of all IP terminology. However a note on copyright may be helpful. Section 1(1) Copyright, Designs and Patents Act 1988 provides:

> Copyright is a property right which subsists in accordance with this Part in the following descriptions of work—
> (a) original literary, dramatic, musical or artistic works,
> (b) sound recordings, films [or broadcasts], and
> (c) the typographical arrangement of published editions.

Section 3(1) Copyright, Designs and Patents Act 1988 provides:

> In this Part—
> "literary work" means any work, other than a dramatic or musical work, which is written, spoken or sung, and accordingly includes—
> (a) a table or compilation other than a database,
> (b) a computer program,
> (c) preparatory design material for a computer program and
> (d) a database

Thus computer program royalties are treated in the same way as more conventional literary work.

32.3 Types of IP income

IP income is classified for income tax purposes in one of three ways. Statute does not provide much terminology, so I coin the following terms:

My term	**Outline**	**See para**
Non-trade IP income	Not trade income, divided into:	32.4
(a) Annual Payment	Annual Payments	
(b) Non-Annual Payment IP income	Not Annual Payments	
Trade IP income	Trading receipts	32.8

These are not ideal labels, but I cannot think of better.

The three categories are recognised in *Noddy Subsidiary Rights v IRC*:

> It seems to me that, where you have this position, that a person owns an asset of any kind, whether physical or not, and grants licences under it,
> [1] the activities which he carries on in connection with the grant of those licences may amount to a trade and then Case I of Schedule D applies [trading income].
> [2] On the other hand, at the other end of the scale, the activities may amount to the mere holding of an investment, so that the receipt of

income is in the nature of pure income profit and then Case III of Schedule D applies [Annual Payments].

[3] There may be intermediate cases in which Case VI of Schedule D might apply [now non-annual payment IP income or Misc Sweep-up Income].[5]

ITTOIA replaced the schedular scheme with its own categorisation scheme. It retained the 3 distinctions identified here, but IP income from the category of Misc Sweep-up Income to its own category, taxable under s.579 ITTOIA.

32.3.1 *Trade/non-trade border*

For general discussion of the concept of trade, see App.2.23 (Trade). I consider here what constitutes a trade in the context of IP income.

One example of a non-trade is casual authorship. In 1923, *Ryall v Hoare* considered "an instance which is particularly familiar at the present moment, perhaps":

> the case of casual authorship. Now, a man may carry on no business and no profession; he may not be a journalist, he may not be an author, but he may be called upon to write an article for a paper for reward. He may find that there would be a demand for a single book from his pen, as a traveller, a soldier, a sailor, or a statesman, or what not. Now, it seems to me that all cases of that kind... are instances of casual profits [ie, not trading] ...[6]

The BI Manual provides:

> **BIM100205 authors** [Jun 2016]
> An author who:
> - organises their life so as to regularly spend time on their writing to produce work which has a commercial value, and
> - combines this with a persistent and systematic marketing of the work for their own financial benefit,
>
> is carrying on a profession and the profits are chargeable as trading income.
> Someone who writes a book or article who is not carrying on a profession is taxable on their literary earnings under the sweep-up charge as miscellaneous income.

[5] 43 TC 458 at p.474.

[6] 8 TC 521 at p.527.

> [The Manual cites the passage from *Ryall v Hoare* set out above and continues]:
> Traditionally the type of author whose activities would not amount to a trade would include those whose prime motive may be the desire for fame or personal satisfaction, what is sometimes called 'vanity publishing'.
> It also includes those motivated by the desire to enhance their reputation in a particular field or the desire to leave the benefit of their knowledge to posterity.
> **Modern technology and self publishing**
> Modern technology provides many options for small scale publication. Computers enable more people to self publish, with the availability of 'print on demand' allowing production of small numbers of books.
> The technology used does not change the position, and the same principles apply. Where the activities do not amount to a profession, any profits are taxable under the Miscellaneous Income provisions.

Another example of a non-trade is a casual inventor. In *IRC v Sangster* the taxpayer was an engineer and inventor. He received royalties for his patents, but manufacturing was done by his company, or other companies to whom he granted licences. He was not carrying on a trade or business. It would have been different if he had sold the patents he created:

> It is said ... in the argument in reply for the Crown, that it is all very well, but by giving these licences you are putting your patent on the market. So you are; but so is the man who builds a house and lets it putting it on the market, It seems to me that carrying on a business involves in a case like this the disposal of the article which you produce, as opposed to the retaining of it as a valuable thing in itself which you can treat itself as an investment, just as much as you could have treated what you bought with the money which you got for it if you had sold it.[7]

While it is well established that casual authorship is not a trade, it may be less clear whether the income should be regarded as:
(1) Payment for services, taxed as Misc Sweep-up Income;[8] or
(2) IP income

The answer should depend on the terms of the contract under which the

[7] 12 TC 208 at p.217.

[8] See 33.6 (Types of misc sweep-up income).

income arises. But HMRC seem to accept option (1); see 32.14 (Professional authors).

The BIM provides:

> **BIM50725 Authors And Royalties To Person Other Than Author**
> [Jan 2019]
> Copyright royalties received by an individual other than the author, composer etc (unless they form part of the receipts of a trade or represent post-cessation receipts - see BIM50740), are chargeable to Income Tax as miscellaneous income. A deduction should be given, where appropriate, for agents' commission...

32.4 Charge on non-trade IP income

The income taxation of IP income is governed by Chapter 2 Part 5 ITTOIA.

Section 579(1) ITTOIA provides the charge to tax:

> Income tax is charged on royalties and other income from intellectual property.

EN ITTOIA provides:

> 2262.[Section 579] sets out a new provision creating a specific charge to tax on royalties and other income from intellectual property. The source legislation uses general principles to tax such income. In the source legislation, income from intellectual property is charged:
> - as annual payments under Schedule D Case III;
> - as profits of a trade under Schedule D Case I;
> - as annual profits or gains under Schedule D Case VI; or
> - as income arising from possessions out of the UK under Schedule D Case V.
>
> The new charge covers income charged in the source legislation under the heads mentioned above, except that trading income derived from intellectual property is to be taxed not under section 579 but under Part 2 [ITTOIA]. The rules set out in the section are not intended to widen or restrict the scope of the charges under Schedule D in the source legislation.
> 2263.The charge embraces royalties which are
> [1] UK source annual payments (Schedule D Case III in the source legislation),
> [2] overseas income from intellectual property (Schedule D Case V in the source legislation) and
> [3] casual profits of an income nature from the exploitation of

> intellectual property outside the course of a trade (Schedule D Case VI in the source legislation).

Thus the charge under s.579 applies to IP income whether Annual-Payments or Non-annual Payments.

The distinction between (non-trade) Annual-Payment/ Non-Annual Payment IP income matters for:

(1) *Non-resident IT relief:* Annual-Payment IP income constitute disregarded income and qualify for that relief. Non-Annual Payment IP income does not.[9]

(2) *Withholding tax:* UK source IP income paid to a UK resident is subject to WHT if Annual-Payments, but not if it is non-Annual-Payment IP income.[10]

Section 580 ITTOIA provides:

> (1) Tax is charged under section 579 on the full amount of the income arising in the tax year.
> (2) Subsection (1) is subject to Part 8 (foreign income: special rules).
> ...

This incorporates the remittance basis for foreign-source royalty income; foreign source royalty income qualifies as RFI whether or not an Annual Payment.[11]

32.5 IP income: Income/capital

32.5.1 *Income/capital receipt: Trade*

BIM provides:

> **BIM50705 Authors And Receipts** [Jan 2016]
> Where the author etc. is chargeable to Income Tax on the profits of a profession, the profits are to be computed inclusive of all receipts from copyright and other sources, including lump sums received for the outright assignment of copyright (for example the assignment of copyright as a whole, or of serial rights or of rights in particular editions, or of film, television or radio rights). This is because the author's brain is his or her fixed capital. Copyright is a product of the author's brain. It is circulating capital and exploiting it gives rise to

[9] See 45.7 (Disregarded Annual Payments).

[10] See 31.10 (Annual-Payment withholding tax).

[11] See 16.9.2 11B("Relevant foreign income").

> income. Similarly sales of manuscripts give rise to income *(Wain v Cameron* [1995] 67 TC 324). For more on the capital/revenue divide as it relates to authors, see BIM35725 - BIM35735.

The 18th century terms circulating/fixed capital are not helpful, and they are not much used in modern case law, but the general proposition that an author's sale of copyright is an income receipt was established already by the time of the Report of the Departmental Committee on Income Tax (1905):

> 44. The profits that an author derives from the publication of his work may be received by him in more ways than one. But the more usual forms are two, viz., (a) A royalty on copies as sold, (b) A lump sum paid to him by the publisher for the purchase outright of his entire interest in the work.
> 45. Under the first plan no question can arise as regards the proper method of charging income tax. The receipts in each year constitute profits and gains for the year, and fall to be assessed in accordance with the rules of Schedule D.
> 46. Under the second, or lump sum, alternative, there is room for question whether when the purchase is made in respect of works of a permanent character the payment is not of the nature of capital rather than of income. For in that case it represents the estimated present value of a future income. There is much to be said for this view, which, in fact, is in accordance with the principle adopted in dealing with all other transactions of a similar character. But in practice it has become the well-established rule to treat such payments for copyright as income to the author, and to assess them in accordance with the rules of Schedule D...
> 48...it must be remembered as regard's the author that large payments for copyright are earned only by those who make literature their profession, either in whole; or in large part, and the money so earned is clearly in the nature of income derived from a profession, even though it is received at irregular intervals and in varying amounts.

32.5.2 *Income/capital receipt: Non-trade*

BIM provides:

> **BIM50705 Authors And Receipts** [Jan 2016]
> Where the author's income is chargeable as miscellaneous income, the profits should be similarly computed, except that lump sums received for the assignment of copyright only (see *Nethersole v Withers* [1948] 28 TC 501), as distinct from lump sum and similar payments associated

> with services (see *Hobbs v Hussey* [1942] 24 TC 153, and *Housden v Marshall* [1958] 38 TC 233), should be excluded. In this connection:
> • a lump sum does not include a sum received on account of royalties or an amount arrived at by reference to a minimum or estimated number of copies of a book or performances of a work;
> • an assignment, that is a transfer of ownership of a copyright, should be distinguished from a licence which permits the licensee to use copyrighted matter but does not involve any change in the ownership of the copyright;
> • a lump sum payment not chargeable as miscellaneous income should be considered for Capital Gains Tax liability.
> If, in an assignment case, the question of liability to Income Tax turns on whether or not a profession is being exercised, consideration should be given to the taxpayer's activities both before and after the assignment.

32.6 Deductible expenditure

Expenses are deductible from non-Annual Payment royalties. Section 582 ITTOIA provides:

> (1) This section applies for calculating the amount of income charged under section 579 other than annual payments.
> (2) Expenses wholly and exclusively incurred for the purpose of generating the income are deductible...[12]

There is no equivalent for Annual-Payment royalties, because Annual Payments by definition have no deductible expenses: they are pure income profit.

32.7 Source of non-trade IP income

The location of the source of IP income matters for the usual reasons, in particular:

(1) A non-resident is not taxed on foreign source IP income
(2) Foreign source IP income is RFI and qualifies for the remittance basis
(3) Foreign source IP income is outside the scope of withholding tax[13]

So the question of source matters to both payor and recipient, though in

[12] This is a statutory codification of earlier case law: see 33.17 (Sweep-up income: Computation).

[13] Because Royalty WHT condition A(c) is not met; see 32.10 (Royalty WHT conditions A & B).

many cases a DTA may make the issue irrelevant.

What is the test to determine the source of non-trade IP income?[14]

Looking at the matter from first principles, it makes good sense to say that the source of the income is the situs of the copyright or other IP; just as the source of income from land or chattel rentals is the location of the land or chattels. The situs of copyright is where it can be exploited or enforced.[15]

This view is also supported by authority. In *Curtis Brown v Jarvis,* three authors not resident in the UK entered into contracts with UK publishers. (One of them was DH Lawrence, who contracted in 1920 to write "Women in Love"). The publishers paid royalties for the right to publish the books in the UK and elsewhere.

The authors were not carrying on a trade/profession/vocation even partly in the UK.[16] But the income was from "property in the UK" and taxable under sch D Case VI. The taxpayers' main argument seems to have been that copyright was not property; which seems strange, but presumably that was not as clear in 1929 as it is now.

The Court commented on the question of whether the copyright was property in the UK:

> whether the copyright is property within the UK, within the meaning of the enactment. Copyright is an intangible piece of property. It takes effect only as a right, it has no extension in space; but its taking effect, and its operation, is limited by locality, and when we speak, as we do in common parlance, of copyright in the UK, it seems to me that that phrase is absolutely accurate, it limits the extent - if I use the word "limits" I am using it in its technical sense - it defines the property as existing, perhaps, among places, in the UK.[17]

[14] For source issues generally, see 16.3 (Approach to locating source).

[15] See 102.30 (Intellectual property).

[16] Special Commissioners decision para 12, p.747; see 32.8.2 (Source of trade IP income).

[17] 14 TC 744 at p.751. On the question of whether the profession was carried on in the UK, it is relevant to note that (1) that the publishing contracts were made outside the UK; (2) all the writing work was done outside the UK.
For completeness: The assessment was on Curtis Brown as agent for the authors, under rule 5 of the ITA 1918 General Rules; the current UK representative rules are different. Copyright withholding tax also came in later, in s.25 FA 1927. But nothing turns on those points.

The Court did not consider whether the *contracts* might have been property in the UK. It is suggested that the contracts were mere machinery for the exploitation of the authors' copyright, and had no independent vitality, so the Revenue were right not to take that as an alternative argument.[18]

The Court did not consider whether (so far as the books were published outside the UK) the income might have been from copyright outside the UK. Perhaps the bulk of the sales were in fact made in the UK. Or perhaps the assessment was limited to UK sales, though the report does not discuss the point.

Curtis Brown v Jarvis was a pre-ITTOIA case where the issue was whether IP income was income from "property in the UK". This is not necessarily identical to the issue of source under the contemporary legislation. But the issues may be regarded as analogous. It is a small step from one to the other. Indeed the difference could be completely overlooked by a non-historically minded court.[19] So *Curtis Brown* is a case which at least supports the view that the source of income is the situs of the copyright.

The INT Manual provides:

> **INTM342520 Copyright royalties** [Jun 2018]
> If the copyright is exploited in the UK the royalty payment will be regarded as having a UK source and therefore within the provisions of [what is now s.906 ITA, withholding tax]. This is irrespective of the law governing the contract.

I refer to this as the place of exploitation test. This test is also supported in Hughes & Payne, "Payments for the use of computer software and the deduction of income tax therefrom" [2000] BTR 5 at p.10.

Another passage in the INT Manual proposes a different test:

> **INTM161130. The source rule – concessions** [Jan 2018]
> ... If the owner of a right such as a patent, trademark or copyright is not engaged in any trade to which the right relates but derives income by exploiting that right, the source of the income may be regarded for the purpose of credit as located in the country where the right is enforceable. ..

[18] The taxpayer did not argue that payment was for services, rather than a royalty for copyright; but if, hypothetically, that had been the case, the question whether the contract was the source of income would have arisen.

[19] See 26.10.1 (Source in pre-ITTOIA legislation).

I refer to this as the place of enforcement test. But in relation to copyright, at least, place of enforcement may generally be the same as place of exploitation; if so this is (generally) the same test. If the place of enforcement is different, the place of exploitation should be preferred.[20]

It is considered that the multi-factorial test applicable to interest should not be adopted for the source of IP income. The situs of a debt is determined by arbitrary factors, such as the deed. So debt situs rules do not give a sensible answer to the location of the source of interest. For interest, there is no simple solution which works. The source of interest hard to pin down. IP income is different in all these respects.

There is a statutory territorial limitation for the charge on the sale of patents, but this does not shed much light on the source of IP income.[21]

The Hong Kong Inland Revenue Department give the following guidance:

> ***Where the IPR is purchased by the licensor***
> 74. If a taxpayer has purchased the proprietary interest of an IPR and licenses that IPR to another party for use outside Hong Kong, the royalties so derived will generally be regarded as non-Hong Kong sourced income and hence will not be subject to Hong Kong tax... [22]

This is (more or less) the same as the UK position for non-trade IP income, a place of exploitation test.

32.8 Trade IP income

32.8.1 *Trading rules apply*

Trade IP income has a dual character: both a trading receipt and IP income. The charge on trading has priority.[23]

[20] See 26.13.12 (Changes in international law).

[21] Section 587 ITTOIA provides:
"(1) Income tax is charged on profits from sales of the whole or part of any patent rights.
(2) The tax is charged if–
(a) the seller is a UK resident, or
(b) the seller is a non-UK resident and the patent is granted under the laws of the UK."

[22] Departmental Interpretation and Practice Notes No. 49 (2012) *https://www.ird.gov.hk/eng/pdf/dipn49.pdf* See Mariani, "On the source and taxation of royalties in Hong Kong" Asia Pacific Tax Bulletin, 2016, Vol.22, No.3.

[23] See 11A3.8 (Part 5 ITTOIA/trade income).

32.8.2 *Source of trade IP income*

The question whether trading income has a UK source is naturally to be decided according to the rules which apply to trades/professions. This is so even if the trading receipts are or include IP income.

Thus a UK resident trader has UK source trading profits even if the IP income comes from abroad, since the trade is at least in part carried on in the UK.[24]

What about a non-resident trader? The source is where the profits substantially arise.[25] There is commonwealth authority. In *Millin v IRC* the distinguished South African author Sarah Millin received royalties from foreign publishers for books which were written by her in South Africa, but printed and published in England and the USA. This was trading income (or more accurately, professional income but the trade/profession distinction should not matter here). The Appellate Division held that the income arose wholly from a source within South Africa:

> ... the source of the whole amount received for royalties was in the Union.[26] It is true that in this case no capital in the ordinary sense of that term was employed by Mrs. Millin. It was the exercise of her wits and labour that produced the royalties. They were employed in the Union, and it matters not, on the analogy of the *Overseas Trust* case,[27] that the grant to her publishers of the right to publish her book was contained in a contract made in England. Her faculties were employed in the Union both in writing the book and in dealing with her publishers, and, therefore, on the test applied in the cases cited, the source of the whole of her income would be in the Union.[28]

A cynical reader may wonder if the same decision would be reached by a tribunal sympathetic to the Revenue:

(1) If the same facts were litigated in the UK; or

(2) If the case was litigated in South Africa, but facts were reversed, and

[24] See 21.4.1 (UK resident trader: IT).

[25] See 21.4 (IT territorial limit: Trading); 16.9 (Where is trading income source).

[26] The Union of South Africa (1910-1961) was the predecessor to the present Republic of South Africa.

[27] *Overseas Trust Corporation v IRC* [1926] AI 444, 2 SATC 71.

[28] [1928] AD 207 at p.216. The point mattered for a resident of South Africa, because at the time South Africa taxed its residents only from income from a source in South Africa, not on their worldwide income.

> Mrs Millin wrote in England but received royalties from publishers in South Africa.

In *Curtis Brown v Jarvis*, non-resident authors receiving UK royalties were likewise held not to be carrying on a profession even partly in the UK, But an assessment to UK tax was upheld on other grounds.[29]

The Hong Kong Inland Revenue Department give the following guidance:

> 72. ... The Department's views regarding the source of royalty income are set out in the following paragraphs.
>
> ***Where the IPR is created or developed by the licensor***
>
> 73. If an IPR is created or developed by a taxpayer carrying on business in Hong Kong and is licensed by the taxpayer to another party for use outside Hong Kong, the royalties so derived will generally be regarded as Hong Kong sourced income and hence will be subject to Hong Kong tax. This is because the royalty income is primarily generated by the taxpayer using his wits and labour to create or develop the IPR in Hong Kong...

The wording ("wits and labour") show that the author has read and is following *Millin*.

> ***Where the IPR is not owned by the licensor***
>
> 75. If a taxpayer only obtains a licence to use an IPR from its owner (i.e. the taxpayer has not obtained the proprietary interest of the IPR) and then sub-licenses the IPR to another party for use outside Hong Kong, the Department will, in ascertaining whether the royalties so derived are Hong Kong sourced income, take the place of acquiring and granting the licence as the source of income. As such, if the taxpayer acquires in Hong Kong the licence for use of the IPR, and grants a sub-licence also in Hong Kong, the royalties derived from sub-licensing the IPR will be regarded as derived from Hong Kong...

This is also a case of trading.

> 76. The above are some general examples which illustrate the Department's views on the application of broad guiding principle. It must be emphasised that whether royalties derived from the licensing of IPRs by taxpayers carrying on business in Hong Kong are subject to tax will be a question of fact to be determined by the totality of the facts

[29] See 32.7 (Source of non-trade IP income).

> and circumstances in each case.[30]

This is (more or less) the same approach as the UK for trades carried on by a non-resident.[31]

32.8.3 *IP income from UK PE*

Section 577A(1) ITTOIA provides:

> References in section 577[32] to income which is from a source in the UK include income arising where—
> (a) a royalty or other sum is paid in respect of intellectual property by a person who is non-UK resident, and
> (b) the payment is made in connection with a trade carried on by that person through a permanent establishment[33] in the UK.

In the following discussion:
The **IP income deemed-source rule”** is the rule in s.577A(1)
I refer to IP income within this rule as **“IP income from a PE”**
A **“UK trade”** means a trade carried on through a UK PE

This is based on the OECD model.[34]

Section 577A ITTOIA addresses apportionment when the trade is partly a UK trade:

> (2) Subsection (3) applies where a royalty or other sum is paid in respect of intellectual property by a person who is non-UK resident in connection with a trade carried on by that person only in part through

[30] Departmental Interpretation and Practice Notes No. 49 (2012) *https://www.ird.gov.hk/eng/pdf/dipn49.pdf*

[31] See 21.7 (Where is trading income source).

[32] Section 577 concerns the territorial scope of the charge under Section 579(1) ITTOIA. In particular, s.577(2) provides: “Income arising to a non-UK resident is chargeable to tax under this Part [Part 5 ITTOIA] only if it is from a source in the UK.” See 16.2 (IT territorial limit).

[33] Section 577A(5) ITTOIA applies the UK-law definition: “In this section ... “permanent establishment”—
(a) in relation to a company, is to be read (by virtue of section 1007A of ITA 2007) in accordance with Chapter 2 of Part 24 of CTA 2010, and
(b) in relation to any other person, is to be read in accordance with that Chapter but as if references in that Chapter to a company were references to that person.”
See 106.2 (PE: UK-law/OECD Model meanings).

[34] See 107.9.3 (Other business profit overlaps).

> a permanent establishment in the UK.
> (3) The payment referred to in subsection (2) is to be regarded for the purposes of subsection (1)(b) as made in connection with a trade carried on through a permanent establishment in the UK to such extent as is just and reasonable, having regard to all the circumstances.

There are strictly two distinct questions:
- whether a payment is made in connection with a UK trade: ss (1)
- the amount of the payment made in connection with the trade: ss(2)(3)

But in practice the two questions may overlap. The royalties technical note provides:

> 4.8 Royalties payable under licence agreements between independent parties are typically determined by reference to sales made by the licensee from using IP rather than the profits the licensee made. In most cases therefore it will be appropriate to determine the quantum of the royalty that has a UK source, because it is connected with the activity carried on in the UK through the UK PE, by reference to sales made by the non-resident through the UK PE.
> 4.9 Where the royalty is determined by reference to a factor other than sales, it might, depending on the activity carried on in the UK PE, be appropriate to determine the quantum of the royalty that comes from a source in the UK on a basis other than sales. However, in all cases the obligation to pay a royalty must be connected with the activities carried on in the UK by the UK PE in order for it to be considered that the royalty comes from a source in the UK.
> 4.10 In all cases, however, there will be no direct link between the separate rules
> [a] for attributing profits to a UK PE under section 19 CTA 2009 and
> [b] the rules for determining whether a royalty paid by a non-resident comes from a source in the UK.
>
> The test is not for a royalty to be considered to come from a source in the UK only when it is deductible directly or indirectly in computing the profits of a UK PE that are chargeable to corporation tax. Rather, the approach is for a royalty to be considered to have a UK source when the obligation of a non-resident person to make the royalty payment is connected with the activities that the non-resident person carries on in the UK through the UK PE.

32.8.4 *IP income connected to PE*

> 4.11 Where the activity carried on in UK relates to the sale of goods, services or other property by the non-resident, the obligation of the

non-resident to pay the royalty must arise because of the exploitation of the IP in carrying out those sales activities in the UK through the UK PE. That connection will be clear to see with dependent agent PEs because it is the activity of the non-resident person in concluding contracts for sale that creates the PE in the first instance. Any obligation of the non-resident to pay a royalty is clearly connected to the sales activity carried on through the UK PE.

4.12 There are other circumstances where activities carried on through the UK PE are connected to the sales by the non-resident but do not result in the conclusion of a sales contract between the non-resident and the customer. This could be, for example, because the sales process is automated and the contract is concluded online but it is the activities of personnel in the UK PE that have contributed to that customer entering into the online contract with the non-resident. The obligation of the non-resident to pay the royalty is connected to the trade it carries on in the UK through the UK PE because the activity it carries on through the UK PE that has contributed to the making of a sale by the non-resident that in turn leads to its obligation to pay a royalty.

4.13 Similarly where the activity carried on in the UK through the UK PE is to market goods, services or other products provided by the non-resident or to manage relationships with customers, that activity will be connected with the obligation of the non-resident to pay the royalty where the activity carried on through the UK PE is a part of the process that leads to a sale of goods, services or other property by the nonresident in respect of which the royalty is paid.

32.8.5 *Apportionment*

4.14 The royalty payable by the non-resident is unlikely to be restricted to sales made through the UK PE and will typically be in respect of a licence to use the IP across a wider geographical area. Subsections (2) and (3) of new section 577A ITTOIA provide that where a royalty payment is made in connection with a trade of a non-resident only carried on in part through a UK PE, only that part connected with the activities of the non-resident carried on in the UK will be considered to come from a source in the UK. In the case of a royalty related to sales made by a non-resident, only the proportion of the royalty payable in respect of sales in which the UK PE has played a part will be considered to come from a source in the UK.

4.15 Subsection (3) of new section 577A ITTOIA provides that the apportionment of a royalty to amounts connected with a trade carried on only in part in the UK through a UK PE should be calculated on a just and reasonable basis, having regard to all the circumstances. In the

> case of a royalty related to sales made by a non-resident, such a just and reasonable apportionment should be made on the basis of the proportion of the non-UK resident's total sales arise compared to the proportion of the sales in respect of which the royalties arise that are made through, or that are connected to the trade carried on through, the UK PE. This is illustrated through the following example:

The royalties technical note provides an extremely simplified example:

> The non-UK resident has income in respect of sales as follows:[35]

sales through PE in the UK	£30m
sales through PE in France	£30m
sales through PE in Germany	£30m
sales in country of residence	£30m
Total	£120m

The non-UK resident makes a royalty payment of £40m. This royalty relates only to the goods sold through its PEs in the UK and France and not those sold through its PE in Germany or in its country of residence.
A just and reasonable apportionment allocates £20m of the royalty to a UK source with reference to that part of the sales of the non-resident that create the obligation to pay the royalty. That is:

> Total royalty (£40m) × UK PE Sales (£30m) ÷ Total sales (£60m) = £20m

32.8.6 *IP income from UK PE: TAAR*

Section 577A(4) ITTOIA provides:

> In determining for the purposes of section 577 whether income arising is from a source in the UK, no regard is to be had to arrangements[36] the main purpose of which, or one of the main purposes of which, is to avoid the effect of the rule in subsection (1).

This TAAR only applies for the purposes of s.577/577A (territorial limitation), but there is another TAAR for IP withholding tax.

32.9 IP/AP WHT: Introduction

For a general introduction to withholding taxes, see 26.19 (Withholding taxes: Introduction).

[35] I have set out the date in tabular form for clarity.

[36] Section 577A(5) ITTOIA provides the standard (unnecessary) IT definition of "arrangements": see App 2.2.3 (Definitions of "arrangement").

Withholding taxes are contained in Part 15 ITA. The provisions relevant to IP income are:

Topic	**Chapter:** section	**Payment to**
Annual Payment WHT	**6**: ss.899-905	Resident or non-resident; see 31.10
IP WHT	**7:** ss.906-909	Non-resident
DTAs	**8:** ss.911-917A	

I do not discuss patents, but list the references here for completeness:

Use of patent	**6:** s.903	Resident or non-resident
Sale of patent	**7:** ss.910	Non-resident

In this book I coin the following terms:

IP WHT: withholding tax on IP income under post-2016 Chapter 6
Annual-Payment WHT: withholding tax on Annual Payments under Chapter 7[37]
Pre-2016 copyright WHT: withholding tax on (in short) copyright royalties under s.906 in its pre-2016 form

There is a set of general WHT exemptions discussed at 26.23 (Withholding tax: Exceptions).

Copyright WHT was introduced in 1927, following recommendations of the Royal Commission on Income Tax (1920),[38] and extended to IP WHT in 2016.

32.9.1 *IP/AP WHT compared*

IP WHT only applies if the payment is to a person whose usual place of abode is outside the UK. If the payment is an Annual Payment, Annual Payment WHT will in principle apply, on a payment to a UK resident.

32.10 IP WHT conditions A&B

Section 906(1) ITA provides:

> This section applies to any payment[39] made in a tax year where condition A or condition B is met.

I refer to "**IP WHT conditions A and B**".

[37] See 31.10 (Annual-Payment withholding tax). This include Annual-Payment IP income, if not caught by IP WHT.

[38] Para 160. The Royal Commission deal with the topic in a couple of brief sentences.

[39] For the meaning of payment, see 15.3 (Recognition/attribution: Analysis).

Conditions A and B are in fact sets of conditions. Condition B is a variant of condition A, in cases of assignment of intellectual property, and it is convenient to see them side by side:

Condition A: s.906(2) ITA	**Condition B: s.906(3) ITA**
Condition A is that—	Condition B is that—
(a) the payment is a royalty, or a payment of any other kind, for the use of, or the right to use, intellectual property (see section 907),	(a) the payment is a payment of sums payable periodically in respect of intellectual property,
	(b) the person entitled to those sums ("the assignor") assigned the intellectual property to another person,
(b) the usual place of abode[40] of the owner of the intellectual property is outside the UK, and	(c) the usual place of abode of the assignor is outside the UK, and
(c) the payment is charged to income tax or corporation tax.	[identical]

32.10.1 *"Intellectual property"*

This term is key to the application of WHT conditions A/B. Section 907(1) ITA provides:

> In section 906 "intellectual property" means—
> (a) copyright of literary[41], artistic or scientific work,
> (b) any patent, trade mark, design, model, plan, or secret formula or process,
> (c) any information concerning industrial, commercial or scientific experience, or
> (d) public lending right in respect of a book.

This is not worded the same way as the (standard) s.579 definition of IP;[42] but (except for films) the differences do not seem to matter.

[40] See 26.22 (Usual place of abode).

[41] `"Literary" should have the wide sense used in copyright law; see 32.2.3 (Copyright).

[42] See 32.2.2 (Intellectual property).

32.10.2 *2016 extension of IP WHT*

The royalties technical note provides:

> 1.9 ... the government decided to bring the definition of UK royalties on which non-residents are taxable into line with the internationally-accepted definition contained in the OECD model tax treaty.[43] It will do this by applying the familiar withholding requirements to those payments that are classified as royalties for the purposes of the OECD model tax treaty. At present, for example, payments for the right to use trade names and trademarks are subject to a royalty withholding tax only if they are "annual payments". Under the new approach, all such payments will be subject to withholding tax.
>
> 1.10 One effect of conforming the UK's rules to the internationally-accepted definition of royalties is that the reciprocal balance in the UK's tax treaties will be better maintained. Where a bilateral treaty preserves the right of the source state to tax a royalty payment, in whole or in part, the UK will now be able to tax the same categories of payments as its treaty partner. And where a treaty is being abused, and its benefits are disapplied by the anti-abuse rule, the UK will be able to tax in full all royalty payments, as it would where no tax treaty was in existence. ...
>
> 3.10 The clause replaces the definition of a 'relevant intellectual property right' in section 907 ITA with a broader definition of 'intellectual property'. This will follow the definition of rights, payments in respect of which are defined as royalties by the OECD model tax treaty. The withholding rules will therefore be broadly aligned with the taxing rights allocated to the UK under its tax treaties. It follows from this alignment that the UK will consider the commentary to Article 12 of the OECD model tax treaty in determining whether a payment is one to which the deduction of tax applies by virtue of the amended section 906 and 907 ITA.
>
> ...
>
> 3.12 The change will simplify (!) the rules relating to payments of royalties by requiring deduction of tax from all types of payment. Withholding will no longer depend on whether a particular type of royalty is an annual payment.

The wording of IP WHT condition A and the definition of Intellectual Property both (broadly) follow the wording of the OECD Model, and the

[43] See 32.16.1 ("Royalties").

OECD Commentary will be relevant.

The wording of IP WHT condition B was left unchanged, and follows the pre-2016 form. I wonder if that was deliberate. But it will not often matter.

32.10.3 *Films*

Section 907(2) ITA provides:

> In this section "copyright of literary, artistic or scientific work" does not include copyright in—
> (a) a cinematographic film or video recording, or
> (b) the sound-track of a cinematographic film or video recording, except so far as it is separately exploited.

This retains the exemption from copyright WHT in the pre-2016 law. The exemption goes back to the beginning of copyright WHT, in FA 1927, when the film industry was in its early days.

32.11 Application of IP WHT

Assuming IP WHT conditions A or B are satisfied, s.906(5) ITA imposes the withholding tax:

> The person by or through whom the payment is made must, on making it, deduct from it a sum representing income tax on it at the basic rate in force for the tax year. ...

32.11.1 *Exported copies*

Section 906(4) ITA provides:

> But this section does not apply if the payment is made in respect of copies of works, or articles, which have been exported from the UK for distribution outside the UK.

This point was discussed when copyright WHT was introduced in 1927, and Hansard gives some idea of the quality of tax debate a century ago:

Captain Macmillan:[44] "It is quite clear that the sums which are received as royalties in respect of sales effected in the United Kingdom should be subject to Income Tax if the author or owner is resident abroad, but the argument seems to me to be strained when you say that those who reside abroad and draw profits for the sales of their works abroad should contribute through the Income Tax

[44] Author's footnote: This is how Harold Macmillan was named in Hansard.

towards the general taxation of the country. It may not be within the knowledge of the Treasury that the publishing business in this country carry on their trade in many parts of the world; and what we are seeking to provide is that the sums payable to non-residents, or foreign authors, should not be liable to English Income Tax, merely because of the fact that their works are published by English publishing firms. If an English publishing house is carrying on business in France, or India, or Egypt, and a native of one of these countries, by the mere fact that he is doing business with a firm whose headquarters are in London, makes himself liable to Income Tax in this country, the result would be to drive away the business for English publishing houses, which would mean a loss to the Treasury and the publishing business. At present an English business carrying on a large part of its work in foreign countries, the profits on the business abroad and in England are subject to English Income Tax. We want to ensure that while in respect of the sales in this country it is right that Income Tax should be deducted for royalties paid to non-resident authors, there should not be brought about by this Clause a situation abroad which would reflect injuriously on the business carried on by such firms who have had the enterprise to carry their work into different parts of the world. ... I am sure it is not the intention of the Treasury to enact a Clause, the result of which would be to deprive English business firms of the opportunity of competing, in this respect, on equal terms with firms native to the countries where they are working. ... we are only seeking to tax non-resident authors in respect of the sums which they draw from sales of their works to the public of the United Kingdom.

It may be necessary to add that certain complications arise from the fact that in the case of many books by foreign authors, English publishers try to retain, where possible, the Dominions market as well as the United Kingdom market. For instance, many American books are sold to English publishers who handle them in the Canadian and Australian markets as well as in the English market. If the royalties in respect of sales made in Australia were made subject to English Income Tax—

Mr Couper: The hon. and gallant Member is referring to some Income Tax which is unknown in this country...

Captain MacMillan: I am sorry if I have offended the hon. Member. If the mere fact of dealing with a British house made the author in that case liable to British Income Tax, the tax could easily be evaded by not giving the books in question to the British firms for marketing in the Dominions. That would be a loss both to the firms and to the Treasury.

The Attorney-general (Sir Douglas Hogg): My hon. and gallant Friend has accurately stated the intention of the Government in introducing this Clause. It is to carry out the recommendations of the Royal Commission on Income Tax to ensure that foreign authors who get royalties from the sale of their works in this country shall not escape the effective charge of Income Tax. It is certainly not the intention of the Government that, under the guise of a Clause to tax foreign authors' royalties in this country, we should do anything to discourage the printing and publishing in this country of foreign works which are going to be sold in the Dominions or abroad.[45]

32.11.2 *IP WHT: TAAR*

Section 40(5) FA 2016 provides a TAAR:

> In determining whether section 906 of ITA 2007 applies to a payment, no regard is to be had to any arrangements the main purpose of which, or one of the main purposes of which, is to avoid the effect of the amendments made by this section.

The unallowable purpose which triggers this TAAR is an arrangement which seeks to avoid the effect of the *amendments* made by s.40, that is, to seek to avoid WHT which would apply under the post-2016 IP WHT, but not under the pre-2016 copyright WHT. The amendments, in short, extended the scope of withholding tax.[46] A purpose to seek to avoid the consequences of the rule in the pre-2016 s.906 is not caught. The reader may think that rather odd. Fortunately, the point will not often arise. Perhaps a purposive construction should be applied.

If the unallowable purpose condition is met, the consequence is to disregard the arrangement. In my terminology, this is a disregard-style TAAR; see 3.2.3 (Consequence of TAAR).

[45] Hansard, 30 June 1927 *https://api.parliament.uk/historic-hansard/commons/1927/jun/30/clause-23-payment-of-income-tax-on*

[46] For this purpose it could therefore be necessary to compare the pre/post-2016 law. In brief, the two versions of s.907(1) ITA are:

Post-2016 wording	**Pre-2016 wording**
In section 906 "intellectual property" means—	In section 906 "a relevant intellectual property right" means—
(a) copyright of literary, artistic or scientific work,	(a) a copyright,
(b) any patent, trade mark, design, model, plan, or secret formula or process,	(b) a right in a design, or
(c) any information concerning industrial, commercial or scientific experience, or	
d) public lending right in respect of a book.	(c) the public lending right in respect of a book.

32.11.3 *Deduction for commission*

Section 908 ITA provides a deduction for commissions:

> (1) If—
> (a) a payment to which section 906 [IP withholding tax] applies is made through an agent who is UK resident, and
> (b) the agent is entitled as against the owner of the right to deduct a sum as commission for services provided,
> section 906(5) and Chapters 8 (deduction at special rates), 15 and 16 (collection) apply as if the amount of the payment were the amount net of the sum deductible as commission.
> (2) But if the person by or through whom the payment is made does not know the commission is payable, or does not know its amount—
> (a) the sum representing income tax required to be deducted under section 906 must be calculated in the first instance on the total amount of the payment, and
> (b) the return to be made under Chapter 15 or the account of the payment under Chapter 16, must be based on that total amount.

32.11.4 *Timing*

Section 909(1) ITA is a timing provision:

> A payment to which section 906 [withholding tax] applies is treated for all income and corporation tax purposes as made when it is made by the first person who makes it, not when it is made by or through any other person.

32.11.5 *Contracting out*

Section 909(2) ITA prevents contracting out:

> If, under section 906, a sum representing income tax must be deducted from a payment, any agreement to make the payment without deduction of that sum is void.

32.12 IP WHT: DT relief

The UK operates a self-certification system. Section 911 ITA provides:

> (1) This section applies if—
> (a) a company pays a royalty from which it is required to deduct a sum representing income tax under Chapter 6 or 7,
> (b) the income tax in respect of the payment is collectible under Chapter 15 or 16, and

> (c) the company reasonably believes that, at the time the payment is made, the payee is entitled to relief in respect of the payment under double taxation arrangements.
>
> (2) The company may calculate the sum to be deducted from the payment under Chapter 6 or 7 by reference to the treaty rate.[47]
>
> (3) But, if the payee is not at the time entitled to such relief, this Part has effect as if subsection (2) had never applied in relation to the payment.

This only applies to company payors. In other cases, advance clearance is needed under the procedure discussed in the context of interest.[48]

Section 912 ITA allows HMRC to require withholding:

> (1) This section applies if an officer of Revenue and Customs is not satisfied that the payee will be entitled to relief under double taxation arrangements in respect of one or more payments of royalties that a company is to make.
>
> (2) The officer may direct the company that section 911 is not to apply to the payment or payments.
>
> (3) A direction under subsection (2) may be varied or revoked by a later direction.

Section 913 provides supplementary definitions:

> (1) In sections 911 and 912 "royalty" includes—
>
> (a) a payment received as consideration for the use of, or the right to use, a copyright, patent, trade mark, design, process or information, and
>
> (b) the proceeds of the sale of the whole or part of any patent rights.
>
> (2) In sections 911 and 912 "payee" means the person beneficially entitled to the income in respect of which the payment is made.32.13

32.13 IP WHT: Treaty override

Section 917A ITA provides what HMRC describe as an anti-treaty shopping provision.

The royalties technical note provides:

[47] Defined s.911(4) ITA: "In this section "the treaty rate" means the rate of income tax appropriate to the payee under the arrangements." Where the OECD model form is followed, 100% relief is available, and the treaty rate is 0%

[48] See 26.29 (DT relief: Withholding tax).

> 1.3 It is a feature of most countries' tax systems that non-residents are taxable on certain types of income that arise in that country. Royalties typically fall within those types of income and, to enforce their taxing right, countries will generally require the payer of the royalty to withhold tax from the payment and account for it to the tax authorities. The UK is no exception to this practice.
>
> 1.4 The tax treatment of cross-border payments of royalties is governed by ... tax treaties, also known as double taxation agreements or DTAs, of which the UK has over 120. Many of these DTAs follow the OECD model tax treaty, which stipulates that royalties are taxable only in the country of residence of the beneficial owner of the royalties. A provision of this sort therefore removes the taxing right of the country in which the royalty arises, on a reciprocal basis. The Government thinks that that this is an appropriate treatment, which removes tax obstacles to cross-border investment and provision of services.
>
> 1.5 However, countries give up their taxing rights in these circumstances in the expectation that the royalties will be paid for the benefit of a resident of a treaty partner. It is a frustration of the purpose of a tax treaty if a person resident in a third country uses a bilateral tax treaty with the UK to extract tax-free royalties from the UK, especially if no tax is paid on the receipt and no substantive activity is taking place in that third country. It is for this reason that tax treaties contain anti-abuse provisions to prevent so called "treaty shopping" by these third country residents.
>
> 1.6 In a world economy where multinational groups derive large sums from the exploitation of intellectual property (IP), cross-border royalty payments have become increasingly prevalent, and the need to ensure that they are taxed in an appropriate way is more important than ever.
>
> 1.7 The Government is concerned that some multinational groups have put in place arrangements under which IP is held by a group company in a jurisdiction where no tax is paid and no substantive activity takes place, and have structured the payments of royalties to that company in a way that takes advantage of the UK's tax treaties with other countries. This deprives the UK, as the country in which the royalty arises, of the right to tax. Had the royalty been paid direct to that ultimate jurisdiction, the UK would have retained its taxing rights on the basis that there was no treaty in place between the UK and that jurisdiction.

Section 917A(1) ITA provides:

> This section applies if and to the extent that—
>
> (a) a person ("the payer") makes an intellectual property royalty

> payment,[49]
>
> (b) the payment is received[50] by a person ("the payee") who is connected with the payer, and
>
> (c) the payment is made under DTA tax avoidance arrangements.

Where these conditions are met, s.917A(2) provides a treaty override:

> (2) Any duty under Chapter 6 or 7 to deduct a sum representing income tax at any rate applies without regard to any double taxation arrangements.
>
> (3) Any income tax deducted by virtue of subsection (2) may not be set off under section 967 or 968 of CTA 2010.

32.13.1 *"Connected"*

Section 917A(5) ITA provides a non-standard definition:

> For the purposes of this section the payer is connected with the payee if the participation condition[51] is met as between them.

It is poor drafting to use the expression "connected with" in a non-standard sense, but no harm is done.

32.13.2 *DTA avoidance arrangement*

Section 917A(4) ITA provides:

> In this section—
>
> "DTA tax avoidance arrangements" means arrangements[52] where, having regard to all the circumstances, it is reasonable to conclude that—

[49] Defined s.917A(4) ITA: In this section ... "intellectual property royalty payment" means a payment referred to in section 906(2)(a) or (3)(a)".
For these references, see 31.10 (Annual-payment withholding tax); 32.10 (Non-annual IP WHT).

[50] Widely defined in s.917A(4): "In this section ... "receive" means receive—
(a) directly or indirectly;
(b) by one payment or by a series of payments".

[51] Section 917A(6) incorporates the standard definition by reference: " Section 148 of TIOPA 2010 (when the participation condition is met) applies for the purposes of subsection (5) as for the purposes of section 147(1)(b) of that Act, but as if references to the actual provision were to the provision made or imposed between the payer and the payee in respect of the arrangements under which the payment is made."
See 105.1 (Participation).

[52] Section 917A(4) provides the standard (unnecessary) IT definition of "arrangements": see App 2.2.3 (Definitions of "arrangement").

> (a) the main purpose, or one of the main purposes, of the arrangements was to obtain a tax advantage[53] by virtue of any provisions of a double taxation arrangement, and
> (b) obtaining that tax advantage is contrary to the object and purpose of those provisions;

The royalties technical note provides:

> 2.8 ... the rule in new section 917A is modelled closely on the OECD anti-abuse rule (principal purpose test or PPT) that was designed as part of the OECD/G20 BEPS project.[54] [The OECD] commentary will help to explain how the rule will operate and how it is to be interpreted. HMRC will follow that commentary when applying new section 917A. However, the OECD rule covers treaty abuse of all types, whereas the domestic rule in new section 917A is a targeted provision confined to royalty payments between connected parties. The section 917A rule will therefore operate in a similar manner to the existing "main purpose" tests contained in the dividend, interest, royalty and other income articles of many of the UK's bilateral tax treaties. It is therefore likely that if those tests do not presently apply to a transaction or arrangement, the section 917A rule will not apply either.

Example 1 concerns a conduit arrangement:

> 2.9 An example of a case where the section 917A rule (and therefore an existing "main purpose" treaty rule) would apply would be where the payer of a UK royalty paid it as part of a conduit arrangement. Here, the payee could be a resident of a country with which the UK had a DTA that assigned exclusive taxing rights over royalties to the state where the beneficial owner was a resident. But if that person (even though he was the beneficial owner[55]) paid the royalty on, perhaps through a licence/sub-licence agreement, directly or indirectly, to an affiliate in another jurisdiction, and the main purpose of the arrangement was to obtain a tax advantage by virtue of a provision of the DTA, section 917A would apply.

Example 2 is an inter-group transfer:

[53] Defined by reference in s.917(A(4): "In this section ... "tax advantage" is to be construed in accordance with section 208 of FA 2013." See 3.19.1 (Tax advantage: Definitions).

[54] See 108.8 (Principal purpose test).

[55] Author's footnote: But as the beneficial owner rule has been hijacked to become an anti-conduit rule, the recipient in this example is not likely to be a beneficial owner.

> 2.10 Another example of circumstances where the rule could apply is where a multinational group assigned IP to an affiliate in a country with which the UK had a treaty providing for residence state only taxation of royalties. Even if that affiliate had a substantive operation and, for example, had a large R&D function of its own, if, on the facts of the case, one of the main purposes of the transfer of the IP was to obtain a tax advantage by virtue of a provision of the DTA, section 917A would apply.
>
> 2.11 In both cases, the section 917A rule would not apply where the person could show either that no tax advantage was obtained or that granting the benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the DTA.

The technical note considers cases where the TAAR "might not apply". In example 3 there is no UK tax advantage:

> This might be the case in the following example. A multinational group develops and holds IP in Country X whose DTA with the UK provides for the taxation of royalties only in the residence state. The group then decides to consolidate its IP in a regional hub and chooses Country A, whose DTA with the UK also provides for residence state only taxation, in preference to Country B, whose treaty with the UK allows a source state taxing right. Even though one of the reasons for transferring the IP to Country A rather than Country B might have been to obtain the benefits of the DTA between Country A and the UK, section 917A would not be likely (?) to apply to deny those treaty benefits as there was no tax advantage as a result of the transfer of IP from the first country.

In example 4 there is " substantive economic activity":

> 2.12 It might also be the case in the following example. A multinational group wants to establish a research and development centre through a subsidiary in Europe. This subsidiary will develop IP in its country of residence through staff engaged for that purpose which it is then expected to licence either to other group companies or third parties. In deciding to establish its subsidiary in State Y, the group considers a number of factors, including the availability of staff with the appropriate skills, infrastructure, reliable legal system, the local tax regime and the comprehensive DTA network of State Y, including its DTA with the UK. In this example, merely reviewing the effect of the DTA between State Y and the UK on future payments of royalties does not enable a conclusion to be drawn about the purposes of the group in establishing

> the State Y subsidiary. The subsidiary will conduct substantive economic activity in State Y using real assets and controlling the economically significant risks, and will conduct that activity through its own staff located in State Y. As a result, the granting of a treaty benefit in these circumstances would be likely (?) to be in accordance with the object and purpose of the DTA and section 917A would not apply to deny treaty benefits in respect of future royalty payments unless the State Y subsidiary enters into other specific transactions to which section 917A would apply.

32.14 Professional authors

The International Manual provides:

> **INTM342590. Professional authors** [Jun 2018]
> Copyright royalties that are payable to an author/originator of a literary, dramatic, musical or artistic work that has been created in the ordinary course of his profession (an "author by profession") fall into the same category as fees for professional services and do not come under [withholding tax rules]. Payments that are made to an author by profession who usually lives overseas are therefore not subject to deduction of UK income tax at source. This follows the decisions in *Carson v Cheyney's Executor* (38 TC 240) and *Hume v Asquith* (45 TC 251) ...
> A Professional Author can be classed as such if he is clearly the originator of the work(s) concerned. If the claimant is not the originator of the work but has acquired the rights from that person they may not be treated as a professional author. ...

This practice was confirmed in a parliamentary statement in 1969:

> Mr Ashton asked the Chancellor of the Exchequer what steps he takes to recover tax on fees[56] paid to British Nationals living abroad by publishers in this country.
> Mr Roy Jenkins: [Withholding tax for royalties] requires any person making such payments to deduct tax at the [basic] rate and to pay it over to the Inland Revenue. I am advised that this does not apply to payments made to those who are authors by profession... [57]

[56] Note that Joe Ashton carefully used the word "fees" rather than "royalties".

[57] Hansard HC debate (10 November 1969) vol 791 col 31
https://hansard.parliament.uk/Commons/1969-11-10/debates/287b6ab7-aab4-48ac-8d46-c57bab8d26e3/OverseasBritishNationals(PublicationFees)
In *Curtis Brown v Jarvis* 14 TC 744 a non-resident author was taxed on UK royalties

It is obviously correct that IP withholding tax only applies to IP income, and not to fees for services. A barrister who writes an Opinion receives a fee for services, not IP income, and the fee paid to a non-resident barrister would not be subject to IP withholding tax. But the proposition that professional authors receive fees for services, rather than IP income, is a curious one. *Cheyney* and *Asquith* the cases decided a different point, that post-cessation receipts of professional authors were not taxable as Annual Payments or Misc Sweep-Up Income (then, sch D Cases III and VI); I wonder if it necessarily followed that receipts are not royalties for the purposes of IP withholding tax.

Certainly this practice, if correct, frustrated the intention of parliament in introducing copyright withholding tax in 1927, which was aimed specifically at non-resident authors.[58]

It only matters in practice where the author is resident in a jurisdiction without a DTA conferring relief. That may be unusual, which may explain why the practice has survived.

The same rule must apply to post-cessation receipts. Payments to the executors of an author which are exempt from IP withholding tax during the life of the author, (because they are not IP income) should continue to be exempt from IP WHT after the death of the author.

Hughes and Payne say:

> In terms, only professional authors are covered but it is generally considered that the scope extends to professionals other than authors, for example, professional photographers and designers whose works are also protected by copyright. It is also thought that it should extend to individuals whose profession consists in writing computer programs. They are, after all, properly called authors and their output is protected by copyright.

A similar distinction has been reached in South Africa. The South African Institute of Chartered Accountants say:

> In *Millin v CIR*,[59] it was held that the true source of royalties accruing from a book was the author s wits, labour and intellect. Therefore if

under sch D case VI (now, in my terminology, non-Annual Payment royalties); but this would not be the case under current HMRC practice and understanding of *Cheyney* and *Purchase v Stainer* 32 TC 367; see [2000] BTR 10 at p.12. But *Curtis Brown* is still cited on other points.

[58] See 32.11.1 (Exported copies).

[59] See 32.8.2 (Source of trade IP income).

> these activities are carried out in the Republic, the true source is in the Republic. The principle from Millin s case also applies to royalties accruing to inventors from patents and similar assets. If the inventor applies his wits, labour and resources in the Republic, any resulting income accruing to him is from a true source in the Republic.
>
> When a royalty is earned by a person who is not the original author or inventor, for example, by a person who has purchased the royalty-producing asset from the original author or inventor, since the royalties would then be derived not from the wits, labour or intellect of the recipient but from the ownership of the royalty-producing asset...

32.14.1 *Company authors*

Hughes and Payne consider the position of companies:

The question is: does the principle of the *Stainer* and *Cheyney* cases extend to such a trading company, with the result that the royalties would not be subject to UK tax at all? The argument in support would have to proceed along the lines that:

(a) just as copyright royalties of an overseas, professional author are not subject to UK tax because such royalties are professional earnings taxable only under Case II, which does not extend to non-residents if the profession is carried on entirely outside the UK; so also,

(b) copyright royalties of an overseas trading company are not subject to UK tax because such royalties are trading income taxable only under Case I, which does not extend to non-residents if the trade is carried on entirely outside the UK.

The phrase "taxable only under Case II" was emphatically endorsed again and again throughout the *Cheyney* and *Stainer* cases by the House of Lords because the source of the copyright royalties was held to be nothing but the professional activity of the individuals concerned. Can it be said that copyright royalties of a trading company are taxable only under Case I because the source of the royalties is nothing but the trading activity of the company? If so, with which activity of the company can the source of copyright royalties be identified?

In the cases of the professional individuals, the activity identified as the source of the royalties was held to be the actual writing of the books or the producing of or acting in the films. In the case of a professional author of computer programs, the identified activity (and therefore source) would be the actual writing of the programs.

... The parallel with the *Cheyney* and *Stainer* cases would then imply that royalties sourced from such activities were taxable only as Schedule D Case I trading income, with the result that, if the activity was carried on entirely overseas by a non-resident company, the profits would not be subject to UK taxation.

That sort of situation, where the overseas trading company itself (albeit through employees or contractees) generates copyrights in the course of its activities is at one end of a spectrum of possibilities. Towards the other end is an example such as *Noddy Subsidiary Rights Limited* referred to above. In that case the company did not actually generate any copyrights itself in the course of its activities, but it was still held to be taxable under Case I on its royalty receipts because it was actively engaged in exploiting the copyrights that it had licensed from other parties.

The authors consider that, if an overseas company operated in the same way as Noddy Subsidiary Rights Limited and received UK copyright royalties as part of its trading income, the principle of the *Cheyney* and *Stainer* cases would not extend to debar a charge to UK taxation on the grounds that the royalties were taxable by the UK only as trading income under Case I, which would not apply in the absence of a UK trade. This is because there would be no overseas activity equivalent to the professional activity in the *Cheyney* and *Stainer* cases that could be identified as the non-UK source of the company's royalties. If the principle in the *Stainer* and *Cheyney* cases did not apply, the royalties would remain taxable under Case VI as annual profits or gains arising from property within the UK. Between the two extremes there will obviously be a range of possibilities and it will be a matter of facts and circumstances as to how close to the principle in the *Cheyney* and *Stainer* cases any particular arrangements would lie.

As an analogy, take the case of an overseas bank that carries on its trade entirely outside the UK but also lends to UK borrowers. The interest on the loans is readily accepted as being UK source and a Case III assessment on the interest income of the overseas bank therefore seems entirely appropriate even though, had the bank been operating within the UK, the interest income would normally have been assimilated with its other trading income and assessed under Case I. This supports the conclusion that the principle of the *Cheyney* and *Stainer* cases does not apply generally to the trades of companies so that, if those profits include interest income or copyright royalties, it will remain open to the Inland Revenue to assess that element under Case III or Case VI as appropriate.

This is consistent with the provisions of the OECD Model Tax Convention and most UK tax treaties. Under the terms of the Business Profits Article a non-resident is not taxable in the source country if the enterprise does not carry on business there. But, if the business profits include interest or royalties, the non-resident cannot usually claim exemption under the Business Profits Article from source country tax on these items because it will usually be provided that the Interest and Royalties Articles take precedence, so that the withholding tax rates stipulated can apply. Thus, under the terms of its typical treaties, the UK retains the right to tax the UK-source interest and royalty income of non-resident businesses not carrying on business in the UK, even where those items of income constitute business profits.

While the matter is not free from doubt, the authors' conclusion is that in the same way domestic law allows the UK to charge income tax on UK-source interest income of non-residents not carrying on a trade in the UK, even where that income constitutes trading income of the non-resident, so, also, domestic law allows the UK to tax the UK copyright royalty income of non-residents not carrying on a trade in the UK, even where those royalties constitute trading income of the non-resident. Case law, however, has established that the right of the UK to tax UK-source copyright royalties does not extend to royalties of non-resident, professional authors because, on the principle of the *Stainer* and *Cheyney* cases, such royalties are professional earnings taxable only under Case II, which does not apply to non-residents. The authors consider that this principle can extend to non-resident trading companies but only if the royalties derive from copyrights generated in the course of the company's trading activity. The principle would not, however, extend generally to trading income of non-resident companies, in particular it would not apply where the royalties arose from acquired copyrights, even if those copyrights were actively exploited in the course of a trade.[60]

These issues should be covered by clear statutory rules. But there seems little prospect of that.

32.15 Films and sound recordings

Special rules apply to the exploitation of films and sound recordings. Section 609 ITTOIA provides:

> (1) Income tax is charged on income from a business involving the exploitation of films or sound recordings where the activities carried on do not amount to a trade.
> Such a business is referred to in this Chapter as a "non-trade business".
> (2) Expressions which are used in this Chapter and in Chapter 9 of Part 2 (trade profits: films and sound recordings) have the same meaning in this Chapter as they do in that Chapter.

Section 610 ITTOIA provides:

> (1) Tax is charged under this Chapter on the full amount of the income arising in the tax year. ...
> (3) This section is subject to Part 8 (foreign income: special rules).

The charge applies to UK and foreign source income, but this incorporates

[60] [2000] BTR 1.

the remittance basis for foreign source income.

Section 612 ITTOIA provides:

> (1) This section applies for calculating the amount of income charged under this Chapter.
> (2) Expenses wholly and exclusively incurred for the purpose of generating the income are deductible. ...

Section 613 ITTOIA provides:

> The provisions of Chapter 9 of Part 2 apply in relation to non-trade businesses as they apply in relation to trades but as if—
> (a) references to a basis period were to a tax year, and
> (b) references to anything not constituting trading stock of a trade were omitted.

32.16 DT relief: Royalties

Article 12 OECD Model Convention provides:

> 1. Royalties arising in a Contracting State and beneficially owned[61] by a resident of the other Contracting State shall be taxable only in that other State.

In short, the right to tax rests with the residence state and not the source state.

OECD Commentary on art 12 provides:

> 5. The Article deals only with royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State. It does not, therefore, apply
> [1] to royalties arising in a third State as well as
> [2] to royalties arising in a Contracting State which are attributable to a permanent establishment which an enterprise of that State has in the other Contracting State
> (for these cases see paragraphs 4 to 6 of the Commentary on Article 21).

32.16.1 *"Royalties"*

Article 12(2) OECD Model Convention provides:

> The term "royalties" as used in this Article means payments[62] of any kind received as a consideration for the use of, or the right to use,

[61] See 108.10 (DTA beneficial owner rule).

[62] See 15.11.2 ("Paid" and "payment").

> [a] any copyright of literary, artistic or scientific work including cinematograph films,
>
> [b] any patent, trade mark, design or model, plan, secret formula or process, or
>
> [c] for information concerning industrial, commercial or scientific experience.

See Avery Jones & Bobbett, "The Treaty Definition of Royalties" 60 Bulletin for International Taxation 1 (2006).

32.16.2 *"Consideration for use"*

OECD Commentary on art 12 provides:

> 8. [The commentary refers to the art 12(2) definition of royalties and continues:] The definition applies to payments for the use of, or the entitlement to use, rights of the kind mentioned, whether or not they have been, or are required to be, registered in a public register. The definition covers both payments made under a license and compensation which a person would be obliged to pay for fraudulently copying or infringing the right.
>
> 8.1 The definition does not, however, apply to payments that, whilst based on the number of times a right belonging to someone is used, are made to someone else who does not himself own the right or the right to use it (see, for instance, paragraph 18 below).

32.16.3 *Sale of IP*

OECD Commentary on art 12 provides:

> 8.2 Where a payment is in consideration for the transfer of the full ownership of an element of property referred to in the definition, the payment is not in consideration "for the use of, or the right to use" that property and cannot therefore represent a royalty. As noted in paragraphs 15 and 16 below as regards software, difficulties can arise in the case of a transfer of rights that could be considered to form part of an element of property referred to in the definition where these rights are transferred in a way that is presented as an alienation. For example, this could involve the exclusive granting of all rights to an intellectual property for a limited period or all rights to the property in a limited geographical area in a transaction structured as a sale. Each case will depend on its particular facts and will need to be examined in the light of the national intellectual property law applicable to the relevant type of property and the national law rules as regards what constitutes an alienation but in general, if the payment is in consideration for the alienation of rights that constitute distinct and specific property (which

> is more likely in the case of geographically-limited than time limited rights), such payments are likely to be business profits within Article 7 or a capital gain within Article 13 rather than royalties within Article 12. That follows from the fact that where the ownership of rights has been alienated, the consideration cannot be for the use of the rights. The essential character of the transaction as an alienation cannot be altered by the form of the consideration, the payment of the consideration in instalments or, in the view of most countries, by the fact that the payments are related to a contingency.

32.16.4 *Royalties paid through PE*

For the overlap between royalty income and business profits, see 107.9.3 (Other business profit overlaps).

32.16.5 *Transfer pricing*

Article 12(4) OECD Model Convention provides the usual rule:

> Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

32.16.6 *Foreign tax credit: royalties*

It can happen that:

(1) IP income are trading receipts, received by a person subject to UK tax on the trading profits

(2) Foreign tax may be deducted at source from the IP income

In these circumstances, ESC B8 provides:

> **B8 Double taxation relief: income consisting of royalties and "know-how" payments**
> Payments made by a person resident in an overseas country to a person carrying on a trade in the UK as consideration for the use of, or for the privilege of using, in the overseas country any copyright, patent, design, secret process or formula, trademark or other like property
> [1] may in law be payments the source of which is in the UK,
> [2] but are nevertheless treated for the purpose of credit (whether under

> double taxation agreements or by way of unilateral relief) as income arising outside the UK except to the extent that they represent consideration for services (other than merely incidental services) rendered in this country by the recipient to the payer.

[1] is wrong or poorly expressed. The payments are not "payments the source of which is in the UK". They are receipts of a trade, and the *trading profits* (which are distinct from the payments) is income whose source is in the UK.
[2] is law and not concession, but it does not matter.
INT Manual expands on this:

> **INM161130. The source rule – concessions** [Jan 2018]
> *(B) Extra-Statutory concession ESC/B8 - DTR: royalties and 'know how' payments*]
> [The Manual sets out ESC B8 and continues:]
> b) Traders resident in the UK are not entitled to claim credit for any tax which is levied in the foreign country in respect of payments for services which are rendered in the UK and are not merely incidental services. In any such case the net amount of the payment (after deduction of any foreign tax borne by them on the payments) is included in the computation of profits for UK tax purposes.
> The prohibition on credit for foreign tax charged on payments for services rendered in the UK may be overruled by the terms of those double taxation agreements which have a royalties Article which includes technical services in the definition of royalties (see INTM153130) or a separate technical fees Article (see INTM153140) and those agreements deem the source of such payments to be in the country of which the payer is a resident. In such cases, even though the services are rendered in the UK, credit is due for the foreign tax charged on these payments. ...

32.16.7 *Source of royalties for DTA*

The royalties technical note provides:

> 1.12 The OECD model tax treaty contains no definition of source for royalties because it was thought that one was unnecessary – on the basis that sole taxing rights belong to the state of residence of the beneficial owner. However, a definition is necessary where, for example, an anti-abuse measure is applied and the taxing rights are returned to the state of source.
> 1.13 In the comparable interest article of the OECD model (which provides for a 10% rate of source state taxation), the source of the

> interest payment is defined as the country where the payer is resident, except where the payer has a PE in one of the treaty partners, the interest is borne by that PE, and the debt is connected with it. In that case, the source of the interest is the state where the PE is situated.[63]
>
> 1.14 The Government has introduced a similar treatment for royalties under domestic law, so that a royalty will have a UK source where the payment is connected to a PE that the payer has in the UK. Royalties paid by a non-resident to another non-resident which are connected to a trade carried on through a UK PE of the payer will now be taxable in the UK and the non-resident payer will be expected to withhold tax and account for it to HMRC. But where there is a tax treaty between the UK and the country of residence of the beneficial owner, that treaty will govern the taxation of the payment. Where that treaty follows the OECD model and the anti-abuse rule does not apply, taxation rights will belong exclusively to that other country.

Some DTAs apply the same rule as the OECD Model applies to interest,[64] ie royalties arise in the source where the payer is resident (except for royalties from a PE). That is sensible.

Formerly, it was presumably considered that this source rule was not needed, because the royalties article provided 100% exemption (apart from interest from PEs); so the source did not matter. But as the 100% exemption is restricted by the Savings Clause and a Limitation of Benefit clause, the question of source will now arise.

32.17 Offshore receipts from IP

The code for Offshore Receipts in respect of Intangible Property (ORIP) was introduced in 2019 and is found in Chapter 2A Part 5 ITTOIA.

The provisions are numbered 806A to 806Z, with subsequent provisions slotted in.[65]

The background can be found in:

> Consultation and response papers
> HMRC policy paper "Income Tax: Offshore receipts in respect of intangible property", October 2019[66] ("ORIP policy paper")

[63] See 26.27.6 (Source of interest for DTA).

[64] In short, the source is the residence of the payer, See 26.27.6 (Source of interest for DTA).

[65] See App 13.3 (Section numbering system).

[66] *https://www.gov.uk/government/publications/income-tax-changes-to-offshore-receipts-in-respect-of-intangible-property/income-tax-offshore-receipts-in-respect-of-i*

HMRC have issued draft guidance ("ORIP draft guidance").[67]

32.17.1 *Policy objective*

ORIP draft guidance provides:

> **1.2 ORIP - Purpose and design**
> ORIP was conceived as an extension to UK withholding tax on royalties that would apply to all payments made by resident and non-resident companies in respect of low tax IP that has been used to make UK sales. However, following consultation, the measure was amended to provide for a direct income tax charge on persons in low tax territories that hold IP and where income arises from that IP where it is used to support UK sales.
> ...The measure is consistent with the UK's international obligations, and thus respects the situations in which the UK has ceded taxing rights over the income of a nonresident person under a double taxation agreement.

The ORIP policy paper provides:

> The policy targets multinational groups that generate significant income from intangible property through UK sales, and have made arrangements such that the income is received in offshore jurisdictions where it is taxed at no or low effective rates. The rules tax the proportion of that income which is referable to the sale of goods or services in the UK.
> This measure will reduce the opportunities for large multinationals to gain an unfair competitive advantage by holding their intangible property in low tax offshore jurisdictions, levelling the playing field for businesses operating in UK markets.

The rules may be aimed at multi-national groups, but they apply more widely.

32.18 ORIP charge

Section 608A ITTOIA provides:

> (1) This section applies if-
> (a) at any time in a tax year, a person is not UK resident and is not resident in a full treaty territory, and

ntangible-property

[67] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/839609/Draft_technical_guidance_Offshore_Receipts_in_respect_of_Intangible_Property__October_2019_.pdf*

> (b) UK-derived amounts arise to the person in the tax year.
>
> (2) Income tax is charged on the UK-derived amounts.

Section 608A(4) ITTOIA provides:

> References in the Tax Acts to income from a source in the UK include UK-derived amounts.

Why does source matter, given that there is a self-standing charge?

Section 608B ITTOIA imposes the charge on the arising basis in standard form:

> Tax is charged under section 608A on the full amount of the UK-derived amounts arising in the tax year.

Section 608C ITTOIA identifies the person liable in standard form:

> The person liable for any tax charged under section 608A is the person receiving or entitled to the UK-derived amounts.

32.19 Residence

Residence matters as the charge only applies to a person who is:

(1) not UK resident and

(2) is not resident in a full treaty territory

UK residence is decided by general principles of UK residence. Resident in a territory needs definition.

32.19.1 *Resident in a territory*

Section 608D ITTOIA provides a definition based on OECD model:[68]

> (1) This section applies for the purposes of this Chapter.
>
> (2) A person is "resident" in a territory if, under the laws of the territory, the person is liable to tax there-
>
> (a) by reason of the person's domicile, residence or place of management, but
>
> (b) not in respect only of-
>
> (i) income from sources in that territory or capital situated there, or
>
> (ii) such income and capital, and amounts remitted to or otherwise received in the territory.

Section 608D(3) ITTOIA provides

> Where-

[68] See 9.3 (Residence under art 4(1)).

> (a) a person is resident in a territory outside the UK generally for the purposes of the laws of the territory or for particular purposes under those laws, and
> (b) the laws of the territory have no provision for a person to be resident there for tax purposes,
>
> the person is "resident" in the territory.

That may be relevant for states with no direct tax, such as Saudi Arabia, and states which only tax income from sources in that state, such as Singapore and Hong Kong.

32.19.2 *DTA which excludes relief*

Section 608D(4) ITTOIA provides:

> Despite subsections (2) and (3), a person is treated as not resident in a full treaty territory if-
> (a) the double taxation arrangements made in relation to the territory contain provision expressly excluding persons of a particular description from relief under the arrangements, and
> (b) the person is of that description.

A Limitation of Benefit clause does not count for this purpose. Section 608D(5) ITTOIA provides:

> In subsection (4) the reference to provision of the kind mentioned there does not include provision corresponding to the provision made by paragraphs 1 to 7 of article 29 of the OECD Model Tax Convention on Income and on Capital (entitlement to benefits), published on 21 November 2017.

See 110.1 (Limitation on Benefits)

32.19.3 *Full treaty territory*

Section 608E(1) ITTOIA provides:

> For the purposes of this Chapter a territory is a "full treaty territory" if-
> (a) double taxation arrangements have been made in relation to the territory, and
> (b) the arrangements contain a non-discrimination provision.

For the meaning of "Non-discrimination provision" see 112.8 ("Non-discrimination provision").

32.20 UK-derived amount

The tax charge is on UK-derived amounts.

Section 608F ITTOIA provides:

> (1) For the purposes of this Chapter an amount is a "UK-derived amount" if-
>
> (a) it is an amount (whether of a revenue or capital nature) in respect of the enjoyment or exercise of rights that constitute any intangible property, and
>
> (b) the enjoyment or exercise of those rights (or of any rights derived, directly or indirectly, from those rights) enables, facilitates or promotes UK sales (directly or indirectly).
>
> (2) It does not matter whether the amount relates to UK sales in the tax year mentioned in section 608A or any other tax year.

32.20.1 *UK sales*

Section 608F(3) ITTOIA provides:

> In this Chapter "UK sales" means any services, goods or other property-
>
> (a) provided in the UK, or
>
> (b) provided to persons in the UK.

32.20.2 *Provision for resale*

Section 608F ITTOIA provides:

> (4) In subsection (3) the reference to anything being provided does not include it being provided for resale.
>
> (5) For the purposes of subsection (4) a thing is provided "for resale" where it is provided to a person who obtains it for the purpose of providing it to another person in the following circumstances-
>
> (a) there is no change in the thing itself, and
>
> (b) if what is provided differs in any way from what was obtained, the difference is merely incidental to the provision of the thing.

32.20.3 *Online advertising*

Section 608F(6) ITTOIA provides:

> For the purposes of this Chapter a service consisting of the provision of online advertising constitutes a UK sale so far as the advertising is targeted at persons in the UK.

32.21 Apportionment

Section 608G ITTOIA provides:

> (1) This section applies where-
>
> (a) a person receives or is entitled to an amount in respect of the

> enjoyment or exercise of rights that constitute any intangible property, and that enjoyment or exercise enables, facilitates or promotes UK sales and other sales, or
>
> (b) a person receives or is entitled to an amount in respect of-
>
> (i) the enjoyment or exercise of rights that constitute any intangible property, where that enjoyment or exercise enables, facilitates or promotes UK sales, and
>
> (ii) anything else.
>
> (2) The amount is to be regarded for the purposes of this Chapter as constituting a UK-derived amount to such extent as is just and reasonable.
>
> (3) In a case within subsection (1)(a) it is to be presumed, unless the contrary is shown, that the proportion of the amount that is just and reasonable is-
>
> (X) / (X + Y)
>
> where X is the value of UK sales and Y is the value of other sales.

32.22 De minimis rule

Section 608GA ITTOIA provides:

> (1) This section applies where-
>
> (a) a person (A) receives or is entitled to a UK-derived amount,
>
> (b) the services, goods or other property in question are not provided in the UK, or to persons there, by A or a person connected with A, and
>
> (c) the UK sales in question are enabled, facilitated or promoted to an insignificant extent by the enjoyment or exercise of the rights in question.
>
> (2) For the purposes of this Chapter no account is to be taken of A's receipt of, or entitlement to, the UK-derived amount.
>
> (3) For the purposes of subsection (1)(b), anything provided by a reseller (including anything treated as so provided by virtue of this subsection) is to be treated as provided by the person who provided it to the reseller.
>
> (4) For this purpose "reseller" means a person to whom a thing is provided for resale (within the meaning of section 608F(5)).

32.23 "Intangible property"

"Intangible property" matters because a "UK-derived amount" it is an amount in respect of the enjoyment or exercise of rights that constitute any intangible property,

Section 608H ITTOIA provides:

> (1) In this Chapter "intangible property" means any property except-

A set of 6 exceptions then follow:

> (a) tangible property,
> (b) an estate, interest or right in or over land,
> (c) a right in respect of anything within paragraph (a) or (b),
> (d) a financial asset,
> (e) a share or other right in relation to the profits, governance or winding up of a company, or
> (f) any property of a prescribed[69] description.

32.23.1 *Financial asset*

A financial asset is not "intangible property". The terminology seems strange to a lawyer, but there it is.

Section 608H(2) ITTOIA provides:

> In this section-
> "financial asset" has the meaning given by section 806 of CTA 2009

That takes us to s.806(2) CTA 2009:

> In this Part "financial asset" has the same meaning as it has for accounting purposes.

That takes us to FRS 102 which defines financial asset as follows:

> Any asset that is:
> (a) cash;
> (b) an equity instrument of another entity;
> (c) a contractual right:
> (i) to receive cash or another financial asset from another entity, or
> (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
> (d) a contract that will or may be settled in the entity's own equity instruments and is:
> (i) a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

[69] Section 608H(2) CTA 2009 provides: "prescribed" means prescribed by regulations made by the Treasury.

> (ii) a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments

Section 806(3) CTA 2009 provides:

> "Financial asset" includes—

There follows a list of 5 types of asset:

Para	**Asset**	**See para**
(a)	loan relationships (see Parts 5 and 6)	64.5.1
(b)	derivative contracts (see Part 7)	*Not discussed*
(c)	contracts or policies of insurance or capital redemption policies	70.2
(ca)	assets so far as they are derived from, or are referable to, contracts or policies of insurance or capital redemption policies, and	
(d)	rights under a collective investment scheme within the meaning of FISMA 2000 (see section 235 of that Act)	App 66.3

These types of assets are governed by separate tax regimes.

32.24 Exemptions

The ORIP code provides the following exemptions:

Section	**Exemption**	**See para**
608J	UK sales under £10m	32.25
608JA	Co resident in specified territory	32.26
608K	Business undertaken in territory of residence	32.27
608L	Foreign tax at least half of UK tax	32.28
608MA	Opaque partnership taxable in full treaty territory	32.29
608MB	Body corporate transparent in full treaty territory	32.30
608MC	Double taxation within control group	32.31

32.25 UK sales below £10m

Section 608J ITTOIA provides:

> (1) Section 608A does not apply in relation to a person for a tax year if the total value of the person's UK sales in that tax year does not exceed £10,000,000.
> (2) Where-

> (a) a person (A), or a person connected with A, receives or is entitled to an amount (whether of a revenue or capital nature), and
> (b) the amount relates (wholly or in part, and directly or indirectly) to the provision of services, goods or other property constituting UK sales,
>
> the UK sales are regarded for the purposes of subsection (1) as A's UK sales.

£10m is a substantial sum, though the reader may doubt whether the figure will ever be increased for inflation.

32.26 Company in specified territory

Section 608JA ITTOIA provides:

> (1) Section 608A does not apply in relation to a company for a tax year if-
> (a) the company is resident in a specified territory throughout the tax year,
> (b) UK-derived amounts arising to the company in the tax year are chargeable to tax under the laws of the territory,
> (c) where those amounts are chargeable only if remitted or otherwise received in the territory, the amounts are remitted or otherwise received there in the tax year,
> (d) the amount of tax which is paid in the territory in respect of the UK-derived amounts is not determined under designer tax provisions, and
> (e) the company is not, at any time in the tax year, involved in an arrangement the main purpose, or one of the main purposes, of which is to obtain a tax advantage for itself or any other person.

32.26.1 *Residence*

Section 608JA ITTOIA incorporates the s.608D definition with amendments:

> (2) For the purposes of this section-
> (a) section 608D (meaning of residence) applies as if subsections (2)(b), (4) and (5) were omitted;

Amended as directed, the relevant part of the definition provides:

> (2) A person is "resident" in a territory if, under the laws of the territory, the person is liable to tax there-
> (a) by reason of the person's domicile, residence or place of

management,

(3) Where-

(a) a person is resident in a territory outside the UK generally for the purposes of the laws of the territory or for particular purposes under those laws, and

(b) the laws of the territory have no provision for a person to be resident there for tax purposes,

the person is "resident" in the territory.

32.26.2 *Specified territory*

(b) "specified territory" means a territory specified in regulations made by the Commissioners.

32.27 Business undertaken within territory of residence

Section 608K ITTOIA provides:

(1) Section 608A does not apply in relation to a person ("the relevant person") for a tax year if-

(a) the relevant person is resident in a territory throughout the tax year,

(b) all (or substantially all) relevant activity in relation to relevant intangible property is, and has at all times been, undertaken in that territory,

(c) there is no relevant connection between relevant intangible property and a related person, and

(d) the person makes a claim under this section.

(1A) For the purposes of this section, section 608D (meaning of residence) applies as if subsections (2)(b), (4) and (5) were omitted.

(2) For the purposes of this section intangible property is "relevant" if any UK-derived amount arising to the person in the tax year relates to it.

(3) In subsection (1)(b) "relevant activity", in relation to relevant intangible property, means anything done (by any person)-

(a) for the purpose of creating, developing or maintaining any of the relevant intangible property; or

(b) for the purpose of generating, for the relevant person, amounts (whether of a revenue or capital nature) that relate, wholly or in part and directly or indirectly, to the enjoyment or exercise of rights that constitute any of the relevant intangible property.

(4) For the purposes of subsection (1)(c) there is a "relevant connection" between relevant intangible property and a related person if any relevant intangible property-

(a) has been transferred (directly or indirectly) from a person related to the relevant person,
(b) derives (directly or indirectly) from anything so transferred, or
(c) derives (directly or indirectly) from intangible property held by a person related to the relevant person.

(5) See section 608T for the meaning of two persons being "related" .

32.28 Foreign tax at least half of UK tax

Section 608L ITTOIA provides:

> (1) Section 608A does not apply in relation to a person for a tax year if-
> (a) the person is resident in a territory outside the UK in that year,
> (b) the amount of tax ("the local tax amount") which is paid in the territory in respect of UK-derived amounts arising in the tax year is at least half of the corresponding UK tax, and
> (c) the local tax amount is not determined under designer tax provisions.
>
> (2) See section 608M for provisions about the local tax amount.
>
> (3) "The corresponding UK tax" means the amount of income tax that would be charged under this Chapter in respect of UK-derived amounts arising in the tax year, calculated on the following basis-
> (a) section 608A applies in relation to the UK-derived amounts, and
> (b) the person is not entitled to any relief or allowance for the tax year.
>
> (5) For the purposes of this section, section 608D (meaning of residence) applies as if subsections (2)(b), (4) and (5) were omitted.

32.28.1 *Local tax amount*

Section 608M ITTOIA provides:

> (1) This section applies for the purposes of section 608L.
>
> (2) Where an amount of tax is paid in the territory in respect of-
> (a) UK-derived amounts arising in the tax year, and
> (b) other amounts,
>
> the amount of tax is to be apportioned between the amounts mentioned in paragraph (a) and paragraph (b) on a just and reasonable basis.
>
> (3) Where-
> (a) in the territory any tax falls to be paid in respect of UK-derived amounts arising in the tax year,
> (b) under the laws of the territory, a repayment of tax, or a payment in respect of credit for tax, is made to any person, and
> (c) that repayment or payment is directly or indirectly in respect of

the whole or part of the tax mentioned in paragraph (a),

the local tax amount is to be reduced by the amount of that repayment or payment (but this is subject to subsections (4) and (5)).

(4) Subsection (5) applies if the repayment or payment mentioned in subsection (3)(b) is in respect of-

(a) the tax mentioned in subsection (3)(a), and

(b) other tax.

(5) The amount of the repayment or payment is to be apportioned between the tax mentioned in subsection (3)(a) and the other tax on a just and reasonable basis, and the reduction under subsection (3) is limited to the amount apportioned to the tax mentioned in subsection (3)(a).

(6) Any reduction under subsection (3) is to be undertaken after any apportionment under subsection (2).

32.29 Opaque partnership taxable in full treaty territory

Section 608MA ITTOIA provides:

(1) This section applies where-

(a) under the laws of a full treaty territory, a partnership is regarded for tax purposes as an entity separate and distinct from the partners,

(b) the partnership is resident in the territory throughout a tax year,

(c) UK-derived amounts arise to the partnership in the tax year, and

(d) the UK-derived amounts are chargeable to tax under the laws of the territory.

(2) In the application of section 608A to a partner for the tax year, no account is to be taken of the UK-derived amounts.

(3) For the purposes of subsection (1)(b), the partnership is "resident" in a territory if (and only if) it is resident there by virtue of section 608D(2) (references there to be a person being read as references to the partnership).

32.30 Body corporate transparent in full treaty territory

Section 608MB ITTOIA provides:

(1) This section applies where-

(a) a body corporate formed under the laws of a full treaty territory ("the relevant territory") is not regarded under those laws, for tax purposes, as an entity separate and distinct from its members,

(b) the body is not resident, at any time in a tax year, in a territory that is not a full treaty territory,

(c) UK-derived amounts arise to the body in the tax year, and
(d) each relevant member is resident in the relevant territory throughout the tax year.

(2) In the application of section 608A to the body for the tax year, no account is to be taken of the UK-derived amounts.

(3) The relevant members are to be determined as follows-
(a) each member of the body is a relevant member (subject to paragraph (b));
(b) if a body corporate that meets the conditions in subsection (4) would otherwise be a relevant member, that body's members are relevant members (and that body is not a relevant member);
(c) paragraph (b) applies in relation to a body that would otherwise be a relevant member by virtue of that paragraph (as well as in relation to a body that would otherwise be a relevant member by virtue of paragraph (a)).

(4) The conditions referred to in subsection (3)(b) are-
(a) that the body is formed under the laws of the relevant territory;
(b) that under those laws, the body is not regarded for tax purposes as an entity separate and distinct from its members;
(c) that the body is not resident, at any time in the tax year, in a territory that is not a full treaty territory.

32.31 Double taxation on control group

Section 608MC ITTOIA provides:

(1) This section applies where-
(a) two persons (A and B) are in the same control group throughout a tax year,
(b) neither A nor B is, at any time in the tax year, involved in an arrangement the main purpose, or one of the main purposes, of which is to obtain a tax advantage for A, B or any other person,
(c) income tax is charged under section 608A on a UK-derived amount arising to A in the tax year, and A is not entitled to any relief in respect of the UK-derived amount,
(d) the UK-derived amount is a direct or indirect payment from B to A in respect of rights ("relevant rights") that-
(i) constitute any of B's intangible property, and
(ii) derive, directly or indirectly, from rights that constitute any of A's intangible property.

(2) In the application of section 608A to B for the tax year, the amount of any UK-derived amount arising to B in the tax year in respect of B's relevant rights is to be reduced (but not below nil) by the amount of the UK-derived amount mentioned in subsection (1)(c).

(3) For the purposes of this section where a UK-derived amount is in respect of relevant rights and anything else, the amount is to be regarded as being in respect of relevant rights to such extent as is just and reasonable.

32.32 Collection from control group

Section 608O ITTOIA provides:

> (1) This section applies where-
> (a) an amount of income tax has been assessed on a person ("the taxpayer") for a tax year by virtue of this Chapter, and
> (b) the whole or any part of that amount, or of any interest on that amount, is unpaid at the end of the period of 6 months after the relevant date.
> (2) A designated officer may give a notice to a relevant person requiring that person, within 30 days of the giving of the notice, to pay any unpaid tax and interest.
> (3) The notice must state-
> (a) the amount of income tax and interest that remains unpaid,
> (b) the date when the income tax first became payable, and
> (c) the relevant person's right of appeal.
> (4) A notice under this section may not be given more than 3 years and 6 months after the relevant date.
> (5) In this section "relevant person" means any person who was in the same control group as the taxpayer at any time in the tax year (see section 608S for the meaning of being in the same "control group").
> (6) In this section "the relevant date" means-
> (a) in relation to an amount of income tax determined under section 28C of TMA 1970, the date on which the determination was issued;
> (b) in relation to an amount of income tax under a self-assessment in a case where the taxpayer's return under section 8 or 8A of TMA 1970 was delivered after the last day for delivering it in accordance with that section, the date on which the return was delivered;
> (c) in any other case, the date the amount mentioned in subsection (1)(a) became due and payable.
> (7) A notice may be given anywhere in the world, to any relevant person (whether or not UK resident).
> (8) In this section-
> "assessment" : any reference to an amount of income tax that has been assessed on a person includes an amount of income tax that has been determined under section 28C of TMA 1970 in relation to the person;

> "designated officer" means an officer of Revenue and Customs who has been designated by the Commissioners for the purposes of this Chapter.

32.32.1 *Payment notice: effect*

Section 608P ITTOIA provides:

> (1) This section applies where a notice under section 608O is given to a person.
> (2) For the purposes of the recovery from the person of any unpaid tax and interest (including interest accruing after the date of the notice), the person is treated as if-
> (a) the amount of income tax assessed as mentioned in section 608O(1)(a) had been assessed on the person,
> (b) that amount became due and payable when the tax mentioned in section 608O(1)(a) became due and payable, and
> (c) any payments made in respect of the amount mentioned in section 608O(1)(a) (or in respect of interest on that amount) had been made in respect of the amount treated as assessed by virtue of paragraph (a) of this subsection (or in respect of interest on that amount).
> (3) Nothing in subsection (2) gives the person a right to appeal against the assessment mentioned in section 608O(1)(a) (or against any assessment treated as made by virtue of subsection (2) of this section).
> (4) Any appeal by the taxpayer against the assessment mentioned in section 608O(1)(a) does not affect the liabilities arising by virtue of the giving of the notice.

32.32.2 *Payment notice: appeal*

Section 608Q ITTOIA provides:

> (1) This section applies where a notice under section 608O is given to a person.
> (2) The person may appeal against the notice, within the period of 30 days beginning with the date on which it is given, on the ground that the person is not a relevant person (as defined by section 608O).
> (3) Where an appeal is made, anything required by the notice to be paid is due and payable as if there had been no appeal.
> (4) Section 56 of TMA 1970 (payment of tax where further appeal) applies in relation to any further appeal against the notice, but the relevant court or tribunal may, on the application of Her Majesty's Revenue and Customs, direct that section 56(2) does not apply to anything required by the notice to be paid.
> (5) A direction may be given if the relevant court or tribunal considers

> it necessary for the protection of the revenue.
> (6) In this section "relevant court or tribunal" has the same meaning as in section 56 of TMA 1970.

32.32.3 *Effect of making payment*

Section 608R ITTOIA provides:

> (1) This section applies where a notice under section 608O is given to a person.
> (2) A person who pays an amount in pursuance of the notice may recover that amount from the taxpayer.
> (3) In calculating the person's income, profits or losses for any tax purposes-
> (a) a payment in pursuance of the notice is not allowed as a deduction, and
> (b) the reimbursement of any such payment is not regarded as a receipt.
> (4) Any amount paid by the person in pursuance of the notice is to be taken into account in calculating-
> (a) the amount unpaid, and
> (b) the amount due by virtue of any other notice under section 608O relating to the amount unpaid.
> (5) Similarly, any payment by the taxpayer of any of the amount unpaid is to be taken into account in calculating the amount due by virtue of the notice (or by virtue of any other notice under section 608O relating to the amount unpaid).

32.33 Control group

Section 608S ITTOIA provides:

> (1) Two persons are in the same control group at any time if-
> (a) they are consolidated for accounting purposes for a period which includes that time,
> (b) one of them has a 51% investment in the other at that time, or
> (c) a third person has a 51% investment in each of them at that time.

"51% investment" is defined in s.698U ITTOIA; see 105.8 (% investment tests).

32.33.1 *Consolidated for accounting purposes*

Section 608S(2) ITTOIA provides:

> Two persons are consolidated for accounting purposes for a period if-

> (a) their financial results for the period are required to be comprised in group accounts,
> (b) their financial results for the period would be required to be comprised in group accounts but for the application of an exemption, or
> (c) their financial results for the period are in fact comprised in group accounts.
>
> (3) In this section "group accounts" means accounts prepared under-
> (a) section 399 of the Companies Act 2006, or
> (b) any corresponding provision of the law of a territory outside the UK.

32.33.2 *Related person*

Section 608T ITTOIA provides:

> (1) Two persons are "related" at any time if-
> (a) at that time-
> (i) they are in the same control group,
> (ii) one of them has a 25% investment in the other, or
> (iii) a third person has a 25% investment in both of them, or
> (b) at any time in the period of 6 months beginning or ending at that time-
> (i) one of them directly or indirectly participates[70] in the management, control or capital of the other, or
> (ii) a third person directly or indirectly participates in the management, control or capital of both of them.

See 105.8 (% investment tests).

32.34 Offshore IP receipts: TAAR

Of course there is a TAAR. Section 608W ITTOIA provides:

> (1) This section applies if a person has entered into any arrangements[71]

[70] Section 608T(2)/s.608V ITTOIA incorporate the definition by reference:

> "(1) This section applies for the purposes of section 608T.
> (2) A person is directly participating in the management, control or capital of another person at a particular time only if section 157 of TIOPA 2010 so provides.
> (3) A person is indirectly participating in the management, control or capital of another person at a particular time only if section 159 or 160 of TIOPA 2010 so provides.

See 105.1 (Participation).

[71] Section 608Z ITTOIA provides the standard (unnecessary) IT definition of "arrangements": see App 2.2.3 (Definitions of "arrangement").

> the main purpose, or one of the main purposes, of which is to obtain a tax advantage[72] for the person as a result (wholly or partly) of-
>
> (a) anything not being subject to the charge under section 608A, or
>
> (b) any provisions of double taxation arrangements having effect in a case where the advantage is contrary to the object and purpose of the provisions.
>
> (2) The tax advantage is to be counteracted by the making of such adjustments as are just and reasonable.
>
> (3) The adjustments may be made (whether by an officer of Revenue and Customs or the person) by way of an assessment, the modification of an assessment, amendment or disallowance of a claim, or otherwise.
>
> (4) Where this section applies by virtue of subsection (1)(b), the counteraction has effect despite section 6(1) of TIOPA 2010.

This is a counter-action style TAAR: see 3.2.3 (Consequence of TAAR). The treaty-override is based on the OECD principal purpose test.[73]

32.35 Interaction with other provisions

Section 608X ITTOIA provides:

> (1) This section applies where section 608A applies in relation to a person for a tax year (or would apply, if the following provisions of this section applied).
>
> (2) Part 6 (exempt income) does not apply in relation to UK-derived amounts arising to the person in the tax year.
>
> (3) For the purposes of calculating the person's liability to income tax for the tax year-
>
> (a) Chapter 1 of Part 14 of ITA 2007 (limits on liability to income tax of non-residents) does not apply in relation to UK-derived amounts arising to the person in the tax year;
>
> (b) accordingly, the person's liability is the sum of-
>
> (i) the person's liability as regards UK-derived amounts (with that Chapter not applying), and
>
> (ii) the person's liability as regards anything else (with that Chapter applying, to the extent it would otherwise apply).

32.36 ORIP appeals

Section 608Y ITTOIA provides:

[72] Section 608W(5) sets out the GAAR definition of "tax avoidance"; see 3.19.1(Tax advantage: Definitions).

[73] See 72.7 (OECD principal purpose test).

(1) This section applies where a person ("the taxpayer") makes an appeal in relation to an amount of income tax charged on the taxpayer under section 608A.
(2) Section 55(3) to (8A) of TMA 1970 (application for postponement of payment of tax pending appeal) do not apply in relation to the tax charged (and no agreement as to the postponement of payment of any of that tax, or of interest on it, may be made).
(3) In the case of a further appeal, the relevant court or tribunal (as defined by section 56 of TMA 1970) may, on the application of Her Majesty's Revenue and Customs, direct that section 56(2) of TMA 1970 does not apply to the tax charged.
(4) A direction may be given if the relevant court or tribunal considers it necessary for the protection of the revenue.
(5) Nothing in this section applies in relation to a liability arising as a result of the giving of a notice under section 608O.

32.37 Definitions

Section 608Z ITTOIA provides:

In this Chapter-

"control group" has the meaning given by section 608S;
"designer tax provisions" means provisions which appear to the Commissioners to be designed to enable persons to exercise significant control over the amount of tax which they pay in respect of UK-derived amounts;
"double taxation arrangements" means arrangements that have effect under section 2(1) of TIOPA 2010;
"full treaty territory" has the meaning given by section 608E;
"intangible property" has the meaning given by section 608H;
"related": references to two persons being related are to be read in accordance with section 608T;
"resident": references to being resident in a territory are to be read in accordance with section 608D;
"tax": any reference (however expressed) to tax payable or paid under the laws of a territory outside the UK is a reference to a tax which-
(a) is charged on income, and
(b) corresponds to income tax or corporation tax;
and for this purpose tax may correspond to income tax or corporation tax even though it is payable under the laws of a province, state or other part of a country or is levied by or on behalf of a municipality or other local body;

“tax advantage” has the meaning given by section 608W(5);

“UK-derived amount” has the meaning given by section 608F;

“UK sales” has the meaning given by section 608F.

CHAPTER THIRTY THREE

MISC SWEEP-UP INCOME

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33.1 Misc Sweep-up Income

This chapter deals with income taxed under Chapter 8 Part 5 ITTOIA/ Chapter 8 Part 10 CTA 2009 ("Income not otherwise charged"). I go beyond the themes of this book and address the topic as a whole.

Statute does not provide a name for income in this category. The heading of Part 5 is "miscellaneous income".[1] The drafter describes this

[1] For the general scheme of income categorisation in the taxes acts, see 14.6.2 (ITTOIA/CTA income categories).

category of income as “miscellaneous income: income not otherwise charged”. It is, one might say, *miscellaneous* miscellaneous income. HMRC refer to Chapter 8 as “miscellaneous income sweep-up provisions”. I refer to income within s.687/979 as **“Misc Sweep-up Income”**. That is a clumsy label, but it is difficult to think of a better one. I use initial capitals, to reflect the technical nature of the expression.

Some categories of income are charged as Misc Sweep-up Income by statute, such as OIGs[2] and gains from funds invested in non-reporting offshore funds.[3] These have nothing in common with the case law categories of Misc Sweep-up Income, and are not discussed in this chapter.

Some types of income categorised as Misc Sweep-up Income before the tax law rewrite are now taxed under other provisions; for instance, non-trade Non-Annual Payment royalties.[4]

I do not discuss:

- the small allowance in Part 6A ITTOIA
- misc sweep-up losses

33.1.1 *Current/previous charging clause*

The current law is as follows:

s.687(1) ITTOIA	**s.979(1) CTA 2009**
Income tax is charged under this Chapter on income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act.[5]	The charge to corporation tax on income applies to income that is not otherwise within the application of that charge under the Corporation Tax Acts.

In order to follow the older cases, one needs to bear in mind that the pre-rewrite legislation was different, or at least differently worded, from the current legislation:

The term “miscellaneous income” might also be used for income of the types listed in s.1015 ITA, which includes Misc Sweep-up Income in a ragbag of about 40 types of income.

[2] See 68.4 (Taxation of reporting-fund income).

[3] Reg 85N Authorised Investment Funds (Tax) Regulations 2006.

[4] See 32.3 (Types of IP income).

[5] For this style of charging provision, see 14.7.2 (Priority in charging provision).

s.18 ICTA 1988 (sch D case VI)	**Current law: s.687 ITTOIA**
Tax under this Schedule shall be charged in respect of ...	Income tax is charged under this Chapter on
(b) all interest of money, annuities and other annual profits or gains not charged under Schedule A, B, C or E, and not specially exempted from tax (2)Tax under Schedule D shall be charged under the Cases set out in subsection (3) below... (3)The Cases are ... Case VI: tax in respect of any annual profits or gains not falling under any other Case of Schedule D and not charged by virtue of Schedule A, B, C or E.	income from any source that is not charged to income tax under or as a result of any other provision of this Act or any other Act.

There are two differences or apparent differences:

(1) "Annual profits or gains" (ICTA) has become "income" (in ITTOIA)

(2) ITTOIA requires that the income is "*from any source*": this is new

Of these two changes, the move from "annual profits and gains" to "income" is not significant: that phrase has always been understood to mean income[6], and is best regarded as just an archaic term for income. One only needs to bear the old terminology in mind in order to understand the older cases and modern cases which discuss them.

The new (ITTOIA) reference to source does seems significant, but pre-rewrite cases refer to "source" even though the word was not in the legislation before 2005.[7] So perhaps it only states expressly what was previously understood.

33.1.2 *Income from a source*

It is clear from the words of the charging provision that:

(1) There must be "income"; and

(2) For IT,[8] the income must be "from any source" ie:

(a) there must be a source; and

[6] See 14.2 (Terminology: Income/gains/profit).

[7] See eg the quote from *AG v Black* in 33.2 (General principles).

[8] The CT provision lacks the words "from any source" but that can be implied.

(b) the income must be from that source

EN ITTOIA provides:

> 1187. The charge under this Chapter is restricted to amounts that are "income" on first principles. That is, they are "annual profits or gains" under section 18(1) of ICTA, as that phrase has been interpreted by case law, and are not profits or gains of a capital nature ...
> This is indicated
> [1] by the use in section 687(1) of the words "from any source" and
> [2] by the disapplication of the definition of "income" in section 878(1) [ITTOIA] by section 687(4).

I would have thought that the rule that the charge only applies to amounts that are income is indicated by the word "income"; and the two points listed seem rather obscure ways to indicate that (if indeed they do). The drafter of the CTA provision possibly agreed, at least as to point [1], since it omits the words "from any source". But it does not matter.

33.1.3 *Deemed income*

s.687 ITTOIA	**s.979 CTA 2009**
(4) The definition of "income" in s.878(1) does not apply for the purposes of this section.[9]	(2) Subsection (1) does not apply to ... (c) deemed income.

Deemed income will generally be expressly charged under some other provision. But there might be deemed income without a charge (s.731 income of non-residents, for instance) and it does no harm to expressly exclude this from the Misc Sweep-up Income charge.

33.1.4 *Priority rules*

Statute sets out some priority rules:

s.687(2) ITTOIA	**s.979(2) CTA 2009**
Subsection (1) does not apply [i] to annual payments or [ii] to income falling within Chapter 2A of Part 4 [Disguised interest].	Subsection (1) does not apply to- (a) annual payments ...

[9] The disapplied definition states:
'Income' includes amounts treated as income (whether expressly or by implication).

Those types of income are taxed elsewhere.[10]

s.687 ITTOIA	**s.979 CTA 2009**
(3) Subsection (1) does not apply to income that would be charged to income tax under or as a result of another provision but for an exemption.	(2) Subsection (1) does not apply to ... (b) income in respect of which no liability to corporation tax arises because of an exemption, or

That prevents the charge from overriding tax exemptions.

33.2 General principles

33.2.1 *Income*

It is clear that the charge is on income, as the post-rewrite charging provisions says so. So case law is not needed to make the point, but the pre-rewrite case law is still traditionally cited.[11] So while it is no longer a universal truth that "Income tax is a tax on income" the principle still applies for Misc Sweep-Up Income. This raises the question on how to draw the troublesome distinction.[12]

33.2.2 *Ejusdem generis*

In *AG v Black*:[13]

> The words in [sch D case VI] are very extensive. My Brother Martin says, "It seems impossible that any net could be extended more widely; every possible source of income seems included." Not, however, that every kind of income derived by a corporation, in whatever way it may come to them, would be included in it. They would not be liable except in respect of something of the same nature and kind as what had been previously mentioned [sch D cases I - V].

[10] See 26.25 (Disguised interest); 31.1 (Annual Payments: Introduction).

[11] Authorities commonly cited on this point are *Leeming v Jones* 15 TC 333 at p.359.; *Ryall v Hoare* 8 TC 521 at p.525:

> "it is quite clear that anything in the nature of a capital accretion is outside the words "profits or gains", as used in these Acts; that, of course, follows from the scope of the Act, and it is sanctified by the usage now of a century."

[12] See 14.4 (Income Tax: a tax on income?)

[13] (1871) L.R. 6 Exch 308 at p.309, quoting Martin B at first instance (1871) LR 6 Exch 78 at p .85. The case went to a further appeal, dismissed very briefly, reported in 1 TC 54, but the TC report does not include these earlier judgments.

And in *Leeming v Jones*:

> The limitations of the words "profits and gains" were pointed out by Lord Blackburn long ago in the case of the *Attorney-General v Black* when he said that profits and gains in Case VI must mean profits and gains ejusdem generis with the profits and gains specified in the preceding five cases.

HMRC v BlueCrest Capital Management has extended this:[14]

> the necessary analogy may be found in any head of charge under the Income Tax Acts, including at least those specified in the latest version of section 18 of ICTA 1988 which section 687 replace

"Analogous" may mean little or much. The Latin terminology - to be deprecated in modern law - masks the imprecision. The UT thought the analogy was with the Misc Sweep-up Income charge on services; CoA thought the analogy was with employment income. I would have said that if the receipt is income, that is enough. It is suggested that the *ejusdem generis* rule has no role in post-ITTOIA law.

33.2.3 *Annual*

In *Andrew v HMRC*:[15]

> 147.Case VI applies to "annual profits or gains" that are not taxed under the other Cases of Schedule D. However, as Viscount Dunedin pointed out in *Leeming v Jones*, ... the word "annual" in the phrase "annual profits or gains"' does not require that a receipt or profit recurs year after year. However, it does require that the receipt must be of the nature of income...
> 149.On that basis, and as the House of Lords held in *Leeming v Jones* itself, a profit arising from an isolated purchase and sale of an asset could not fall within Schedule D Case VI. Such a profit could only be subject to tax as income if the transaction was in the nature of a trade and so within Case I ... If not, the profit arising would be of a capital nature and so not within Case VI.
> 150.The same may not apply where the transaction is not an isolated transaction but is repeated over a number of years (see *Cooper v Stubbs*) offers another example.

[14] [2023] EWCA Civ 1481 at [101].
[15] [2019] UKFTT 177 (TC).

"Profits or gains" means "income", and the word "annual" means "of an income nature":[16] it is clear that the word adds nothing. It was sensibly deleted in the tax law rewrite.

33.2.4 *Summary*

Kerrison v HMRC reviewed the old (pre-rewrite) authorities and came up with this:[17]

> The receipt must:
> (1) have the nature of "annual profits". That simply means that the receipts must be capable of being "calculated in any one year". It does not mean that the income must recur every year;
> (2) be of an income nature;
> (3) be analogous to some other head of charge under what was previously Schedule D – this is the *eiusdem*[18] *generis* principle;
> (4) be the recipient's income[19]

But points (1), (2) and (4) are 3 different ways of saying the same thing, or more or less the same thing, and they are self-evident from the current (post-rewrite) statutory words, so they need no authority.[20]

33.3 Source/voluntary transaction

33.3.1 *Source requirement*

Since the charge is on "on income from any source" it is clear that the income must (at least after ITTOIA) be from a source.[21] But the words

[16] See 14.2 (Terminology: Income/gains/profit); 31.3.1 (Annual/capable of recurrence).

[17] [2019] UKUT 8 (TCC) at [68] referring to: *Ryall v Hoare* 8 TC 521 at p.526; *Leeming v Jones* 15 TC 333 at p .359.

[18] The spelling *ejusdem* is more common, but both are found.

[19] *Spritebeam v HMRC* [2015] UKUT 75 (TCC) at [54]; reported at first instance under the name *Versteegh v HMRC* [2013] UKFTT 642 (TC). Would it not be convenient if cases did not change their name when they went on appeal?

[20] For points (1) and (2), see 33.1.2 (Income from a source); for point (4) see 15.2.1 (Receipt/entitlement basis of liability).

[21] See 33.1.2 (Income from a source). For completeness: *Kerrison v HMRC* is slightly tentative on the point:

> "... s. 687(1) expressly refers to "income from any source" which suggests (?) to us that in order for income to be taxable ... it requires a source ... although we would be minded to accept that a receipt taxable under s.687(1) ITTOIA must have a source, it is not necessary for us to reach a decision on this point."

[2019] UKUT 8 (TCC) at [70]. But even if there was doubt on this point before the *income* and *source* and *from* (suggesting a causation/derivation test) all need elucidation.

Spritebeam v HMRC concerned a CT avoidance scheme where (in short) a lender lent money to a borrower, on terms that the borrower paid interest, not to the lender but to a third party (Spritebeam).[22] The *lender* was able to enforce the borrower's obligation to pay, but did not receive anything. The third party Spritebeam received the payments, but was not entitled to enforce them.

It was common ground that the loan agreement was a source. The unusual feature in *Spritebeam* was Spritebeam did not own this property or have any interest in it. The taxpayer argued that there was a charge only if it had an interest in the source (which it did not). The reader may think that was uncontroversial. But no:

> the required connection between taxpayer and source need not be limited to legal rights but can include the situation where the payment is made pursuant to any legal duty owed by the payer.[23]

That is a sensible outcome. But what in fact is the connection required between taxpayer and source? The UT stated that what is needed is "sufficient connection" to the source (a "sufficient-connection test"). No-one had ever suggested that before: *Spritebeam* is new law.

"Sufficient connection" is evaluative and vague, and all we know that it was sufficient connection that the borrower was obliged to pay to Spritebeam. There is some risk of outcome-dependent analysis: that a tribunal first decides the outcome, and then determines the issue, whether there is a sufficient connection test, in order to reach that outcome. Income is not taxable because the tribunal decides it has has sufficient connection: it has sufficient connection because the tribunal decides it should be taxable.

For instance: No-one says that a payment from a charitable trust, or charitable company, to a beneficiary of the charity, is taxable (either as Misc Sweep-up Income or as an Annual Payment). Before *Spritebeam* one would have said that there was no charge as a beneficiary of a charity has no interest in the charity, but we now know that is not a requirement.

tax law rewrite, there can be no doubt about it now.

[22] All companies were in the same group, so the transaction made commercial sense, but nothing turned on that for present purposes.

[23] at [84].

Presumably there is insufficient connection. But why is there an insufficient connection? Perhaps because there is no equivalent of the lender, in *Spritebeam*, who could enforce the obligation. But the Charity Commission and Attorney General can enforce the charity's duties.[24] Why should that not be enough?

Spritebeam raised the example a contract between employer and employee requiring payments to a third party, and EBT:

> The employment contract obliges the employer to make contributions to an approved retirement benefit scheme. The trustees are not parties to the contract but have an absolute obligation to the employee. Trustees are not taxed on the contributions to the scheme and [Counsel for Spritebeam] maintained that this was because the trustees did not have the necessary connection to the employment contract source. However, without expressing a concluded view, we would maintain that the case ... is probably distinguishable. Even if (a moot point) the payments are regarded as the trustees' income, the basis for the employer's payment is to settle income on the employee in the form of a trust. This basis may well be insufficient to generate the necessary connection between the trustees and the source.[25]

No-one doubts the outcome; but the reader may think this a feeble analysis.

33.3.2 *Position post-ITTOIA*

Spritebeam was a pre-ITTOIA case. After ITTOIA, unlike the pre-rewrite legislation, the charge on Misc Sweep-up Income requires income *from* a source: this suggests a causation/derivation test. So *Spritebeam* might have been decided the same way today, but on the basis that its income was derived from the source (the obligations of the borrower). Though causation/derivation tests are themselves evaluative and vague, so I am not sure whether this approach could be said to be more precise, or whether it would ever give a different outcome from a sufficient connection test.

In *Kerrison*, a post-rewrite case, the UT uncritically adopted the *Spritebeam* "sufficient link" test.[26] So a "sufficient-link" test (or sufficient connection, the meaning is the same) seems settled at FTT level, likely to be followed at UT level, though still open to review at the level of the

[24] assuming English law or English law principles apply.

[25] at [87].

[26] see eg at [65].

CoA. But even if the "sufficient-link" test may be agreed, the question of what "sufficient link" actually means remains open for argument.

HMRC v BlueCrest Capital Management[27] suggests that the source must exist in the year of assessment, though the point was not necessary for the decision, and that may be doubted.

33.4 Gift/voluntary transaction

In *Ryall v Hoare*:[28]

> The other class of case that one can rule out is that of gifts. A person may have an emolument by reason of a gift ... It seems to me that all that class of cases must be ruled out, because they are not profits or gains at all.

In *Stepford v Below*:[29]

> it has been held again and again that a mere voluntary gift ... is not, in the true sense of the word, income. It is merely a casual payment which depends upon somebody else's good will... [30]

It is well established that a voluntary transaction (for brevity I use the term gift) is not taxable:

(1) as Misc Sweep-up Income or
(2) as an Annual Payment[31]

But is that because:
(1) a gift is not income (though gifts may be income for accountancy purposes)? or
(2) a gift does not have a source (though the donor's benevolence could be called a source)?

The answer is, surely, both. The concepts of gift/source/income are conceptually distinct, but they interrelate, and discussion easily segues from one to another. Having decided that a gift is not taxable, subsequent cases may simply ask if there is a gift, and may not consider the analysis

[27] [2023] EWCA Civ 1481 at [102]; but see 14.4 (Need for a source?).

[28] 8 TC 521 at p.525.

[29] 16 TC 505 at p.521

[30] This is so even for a series of gifts, which might look more like income: at p.521 "The case is only an instance of a succession of voluntary payments, each of which is voluntary and none of which need necessarily be continued."

[31] See 31.3 (Annual Payment: Meaning).

further.

Unfortunately, the concept of gift itself needs elucidation. On a number of occasions taxpayers have argued that payments are voluntary, and so not taxable; sometimes successfully and sometimes not.

Early in the history of income tax, it was argued that payments from a discretionary trust were voluntary, and so not taxable, but no:

> I do not assent to the proposition that a voluntary payment can never be charged,[32] but it is enough to say that these were not voluntary payments in any relevant sense. They were payments made in fulfilment of a testamentary disposition for the benefit of the children in the exercise of a discretion conferred by the will.[33]

Emphasis added: the underlined words recognise, which is important to remember, that "voluntary" has a range of meanings.

In *Spritebeam*, discussed above, it was argued that the company received a voluntary payment and so not taxable as Misc Sweep-up Income. But the argument failed:[34]

> it is immaterial that the recipient cannot enforce payment; what matters is whether there is an obligation on the payer to pay... the obligation was in no sense voluntary.[35]

33.5 Disposal of asset

In *Ryall v Hoare*, the income requirement for Misc Sweep-up Income:[36]

> rules out, of course, the well-known case of a casual profit made upon an isolated buying and selling of some article; that is a capital accretion, and unless it is merged with other similar transactions in the carrying on of a trade, and the trade is taxed, no tax is exigible in respect of a transaction of that kind.

Similarly *Leeming v Jones*:[37]

[32] Author's footnote: When might voluntary payments be charged? Perhaps the point here is that a gift might be charged as trading income or employment income. But there needs to be something more than just a gift.

[33] *Drummond v Collins* 6 TC 525 at p.539. The point was re-argued, hopelessly, in *Cunard's Trustees v IRC* with the same outcome: 27 TC 112 at p.133.

[34] It could not be taxed as interest for reasons related to the loan relationship rules.

[35] at [68], [85]. I would prefer to say that the payment was in one sense voluntary, but not in the relevant sense.

[36] 8 TC 521 at p.525.

[37] 15 TC 333 at p.354 in a passage approved on appeal.

> It seems to me in the case of an isolated transaction of purchase and resale of property there is no middle course open. It is either an adventure in the nature of trade, or else it is simply a case of sale and resale of property.

The BI Manual provides:

> **BIM100135 isolated sales of assets** [Jun 2016]
> Casual profits made from the isolated buying and selling of assets may be taxable as trading income: see BIM20230 for further guidance.
> If the activity falls short of a trade then the question is whether the profits come from the increase in value of a capital asset. A capital profit is not taxable as miscellaneous income.
> **Sales of single assets**
> A profit on the sale of a single item that is not a trading venture will be a capital accretion and not taxable as miscellaneous income...

The courts have found the trade/non-trade border difficult to define. *Andrew v HMRC* was a variant of a straightforward purchase and sale:

(1) Trustees were given an asset (an option over gilts)
(2) The trustees were paid a sum to release the option

The profit was not taxable as Misc Sweep-up Income:

> the transactions are akin to the isolated transaction which was the subject of the House of Lords decision in *Leeming v Jones*. The NA Trustee acquired rights to the Call Option and disposed of its rights in a single transaction by electing to cancel the Call Option for the cash cancellation price. There is no evidence before the Tribunal that these transactions were part of a repeated pattern of behaviour (as in *Cooper v Stubbs*). The receipt of the cash cancellation price was capital in nature and so cannot fall within Schedule D Case VI. The timing of the transactions, and in particular the short timeframe between the acquisition and disposal of the option rights, and the short term nature of the option rights themselves do not disturb that conclusion.[38]

33.6 Types of Misc Sweep-up Income

HMRC offer a helpful taxonomy of types of Misc Sweep-up Income:

(1) Income from services *eg:*
Providing information
Photography

[38] at [153].

Film and TV
Commission for introducing customers; cash-backs

(2) Income from finance *eg:*
Guarantee fees
Lender's fees
Swaps

(3) Income from assets *eg:*
Hire of chattels
Stock loans
Payment for allowing filming
Tolls
Distributions from a non-resident company[39]

(4) Restraint of trade

This is not a comprehensive list: one should add a "miscellaneous" category to cover income not fitting into the above neat categorisation.

33.7 Income from assets

33.7.1 *Hire of chattels*

The BI Manual provides:

> **BIM100220 hire of equipment** [Jan 2019]
> The profits from the hire of movable objects, whether or not of a casual or occasional nature, are taxable under the miscellaneous income sweep-up provisions where they are not otherwise taxable, for example because the activity does not amount to a trade.

33.7.2 *Payment to permit filming*

The BI Manual provides:

> **BIM100245 film and television** [Jun 2016]
> If someone receives a fee for allowing a property to be used for filming, then this is chargeable under the miscellaneous income sweep-up provisions if it is not taxable as income from property.

This is a straightforward licence fee for use of the property.

> However, funds paid out to local residents as compensation for the disturbance caused by filming are likely to be of a gratuitous nature and so will not be taxable as miscellaneous income.

[39] See 30.8.4 (Income-distribution: IT charge).

The point is that the victims of disturbance had no legal claim for compensation. But I wonder how often such payments are made.

33.7.3 *Tolls*

The BI Manual provides:

> **BIM100250 tolls** [Jan 2019]
> Income from tolls, dues etc which arises because the taxpayer owns or occupies the land is taxed as trading income: see BIM60201.
> Profits derived from tolls, dues etc which do not arise from the ownership or occupation of lands etc and therefore are not taxable as trading income are taxable as miscellaneous income under the sweep-up provisions.
> In the case of *CIR v The Forth Conservancy Board* [1931] 16 TC 103 the Conservancy Board was empowered to levy dues on vessels, goods and passengers coming within its jurisdiction.
> In the House of Lords it was held that the Conservancy Board's surplus revenues from these dues were profits within the sweep-up provisions.
> It was not disputed that the assessment could not be greater than the surplus of the dues over the Conservancy Board's expenses.

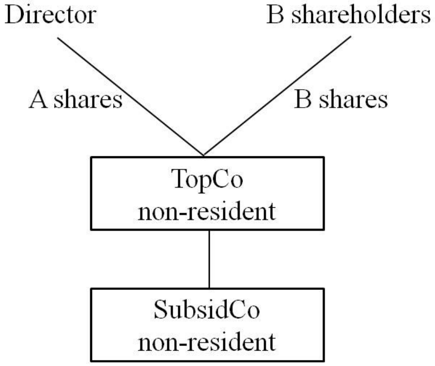
33.8 Income from company

Income distributions from a non-resident company are taxed as misc sweep-up income; see 30.5.4 (Income-distribution: IT charge).

33.8.1 *Loan waiver by company*

Kerrison v HMRC[40] concerned an avoidance scheme intended to generate a tax loss. So far as relevant here, the facts were:

(1) A company with A and B shares held a subsidiary ("SubsidCo"):



[40] [2019] UKUT 8 (TCC).

(2) In June 2006 SubsidCo made a loan of £155m to the B shareholders in order for them to purchase B shares in TopCo.
(3) In November 2006 SubsidCo waived the loan (and the shares became more or less worthless).

This was therefore a case of a gift from a company to individuals who:
(1) were not direct shareholders, but
(2) were indirect shareholders; the B shareholders no doubt held (more or less) all the value of SubsidCo

The question was whether this gift was an income receipt, and the answer was no, for the following set of reasons:[41]
(1) The waiver was voluntary; though this was just "a factor".
(2) The waiver was a one-off event.
(3) The waiver was for a capital purpose, because the waived loan was itself made for a capital purpose, (namely, to repay an earlier loan which the B shareholders had taken out at an earlier stage of the scheme)
(4) It did not matter that:
    (a) Ordinary shares in TopCo remained intact after the waiver,
    (b) there was no reduction or repayment of capital,
    (c) TopCo approved the waiver,

Apparently there was no analogy between the waiver and a distribution in respect of the shares of TopCo. In any case, the waiver was apparently not made in respect of the shareholders' B shares.

The reader may think HMRC had the better argument. The loss scheme failed on other grounds (value shifting) and underling the decision might perhaps have been the unstated consideration, with which many (though not all) may agree:[42] that although the taxpayer should not obtain a loss from a circular (self-cancelling) transaction, nor should they pay tax when, taking the scheme as a whole, they had not received anything. Though of course the decision was not expressed in those terms, nor could it be.[43]

33.8.2 *Gift by non-resident company*

Suppose:

[41] at [72] ff.

[42] That view is not self-evident, because the taxpayer was playing with fire; see 2.5.4 (Pro-avoidance rationale).

[43] See App 7.9.2 (Cardinal principle affirmed).

(1) a non-resident company is owned by A, an individual ("the shareholder"), and
(2) the company makes a gift to B.

The shareholder (if UK resident) will be chargeable to tax on the distribution if a person receiving or entitled to the dividend.[44] Appropriate documentation would of course achieve this, but in the absence of a payment to the shareholder, it is wrong to regard them as receiving or entitled to income.

After *Kerrison,* it seems clear that B is also not in receipt of income.

This is why the rules for UK resident close companies extend the meaning of distribution to include benefits to associates of participators.

What if the company is owned by a discretionary trust, and the company makes a gift to B, a beneficiary? There are six possible solutions:

(1) The gift is income of the trustees in the form of a distribution and it is:
    (a) income of B in the form of an annual payment
    (b) income of B in the form of a distribution, or
    (c) a capital receipt by B
(2) The gift is *not* income of the trustees, but it is:
    (a) income of B in the form of an annual payment
    (b) income of B in the form of a distribution, or
    (c) a capital receipt by B

Appropriate documentation would of course bring the matter into any of solutions (1)(a)(b)(c) but it seems be wrong to regard them as receiving or entitled to income, in the absence of:

(1) a payment to the trustees, or
(2) a payment at the direction of the trustees[45]

Solution (2)(b) seems sensible but is inconsistent with the rule that discretionary trusts are not transparent.[46]

[44] See 15.6.7 (Offshore dividend regime). In the tax avoidance case of *McGuckian v IRC* 69 TC 1, a shareholder-trustee sold the right to a dividend of £400k for £396k (99% of the value) to a third party purchaser. The receipt of the sale price was held to be a receipt of income, but the trustees (and life tenant) were subject to income tax on the amount the trustees (and life tenant) received, ie the sale price; not the (slightly) greater amount of the dividend (which was received by the purchaser).

[45] See 42.3 (Income mandated).

[46] See 41.3.1 (Source/categorisation of income).

The choice is therefore between solutions (2)(a) or (c).

It seems clear that:

(1) A company held by a trust may make a capital payment (within the s.87 definition) to a beneficiary[47]

(2) A company may make a transfer of value (for IHT purposes)[48]

That is assumed in CGT and IHT provisions (which will need separate consideration).[49]

It is considered that the gift may be Annual Payment income of B (solution (2)(a)), or a capital receipt (solution (2)(c)), depending on the circumstances of the distribution: the same principles apply as any trust distribution: what power are the trustees using when they authorise the company to make the distribution?[50]

The position is different if a company held by a *Baker* IIP trust makes a gift to a life tenant. The trust is transparent, the life tenant has an interest in the company, and the distribution is taxable as an income-distribution. See 29.7 (Gift to non-shareholder).

33.9 Services

In *Ryall v Hoare*:[51]

> ... where an emolument is received, or, rather, where an emolument accrues, by virtue of some service rendered by way of action or permission, or both, at any rate that is included within the words "profits or gains" [now, Misc Sweep-up Income].

The paradigm cases of this category of Misc Sweep-up Income involve activity which comes close to a trade of providing services but falls short. The term used here is "casual income", which is an apt label. Of course,

[47] See 61.10 (Payment from close co: s.96(1)). But capital payment for that purpose would include allowing a beneficiary to use or occupy property owned by the company, which is not a distribution for IT purposes; so the CGT provision does not shed much light on the issue discussed here.

[48] See 81.2 (Transfer of value by close co). The transactions in securities code may also need to be considered.

[49] See 79.14 (Transfers to/from underlying co).

[50] See 41.8 (Trust payment: Income/capital). Could it make a difference if the distribution was to the ultimate beneficial owner of the company?

[51] 8 TC 521 at p.525. The word "emolument" nowadays would be reserved for employment income; but the meaning is clear, and nothing turns on the use of that word.

if the activity passes the trading borderline, then the trading income charge takes priority.

The BI Manual provides:

> **BIM100110 scope of the provisions: services** [Jan 2019]
> A casual receipt is taxable under the miscellaneous income sweep-up provisions where it is received for a service performed as agreed/arranged for reward. This contrasts with a simple gift as a 'thank you', for example, after performing a casual service where there was no agreement/arrangement/common expectation that such was for reward. Voluntary gifts are not taxable under the miscellaneous income provisions. This can be a difficult area depending on the facts of the specific case. The treatment contrasts with treatment of voluntary receipts from a trade or profession, see BIM41801.
> The distinction was set out by Lord Hanworth MR in *Brocklesby v Merricks* [1934] 18 TC 576 at p.584:
>
> > 'He was in a position to say: "A part of the profit which has been earned does, under the arrangement made between us, in fact belong to me."'
>
> ...

33.9.1 *Significance of contract*

The BI Manual provides:

> **BIM100115 services - contracts and arrangements** [Jun 2016]
> The distinction which determines whether income is within the miscellaneous income sweep-up charge is between a gratuitous payment and a payment where it was agreed that the service would be for reward.
> **Contracts**
> Clearly if the payment is made under a contract for services, this shows that it is not gratuitous. The contract can be in writing or it can be verbal. The importance of the contract is that it shows that it was agreed that the service was not gratuitous and that there was going to be a reward.
> It is important to remember that the fact that a payment is made under a contract is not enough to make the payment taxable under the miscellaneous income sweep-up provisions. Lord Denning MR said, in *Scott v Ricketts*:[52]
>
> > 'The judge seems to have thought that, as the payment was made under a contract, that was enough to bring within [the charge]. I

[52] 44 TC 303 at p.321.

> cannot agree with him. It must be a contract for services or facilities provided, or something of that kind.'

For payments under a contract to be taxable under the sweep-up provisions, the contract must be one that produces income.

Implied contracts

In cases where there is no express contract, a party may still be able to take action in the courts to obtain a payment where there is evidence that shows that the work was not to be done gratuitously.

An example is a quantum meruit payment - a payment by reference to what the work carried out was worth. A contract may be 'implied in fact' if it is suggested by the facts and circumstances that there is a mutual intention to contract.

If a realistic view of the facts shows that a service was provided for reward, it is not a gratuitous payment and is taxable under the sweep-up provisions.

Void contracts

A contract or agreement may be void for reasons of public policy, for example because it is illegal and therefore not enforceable, but this does not alter the fact that there was an intended agreement that a service was to be provided for reward and thus a taxable source.

Brightman J in *Alloway v Phillips* [1980] 53 TC 372 at p.381 dismissed the argument that a sum was not taxable because the contract was unenforceable as void:

> 'Nor have I been referred to any authority for the proposition that money received and retained under a contract void as against public policy escapes taxation for that reason.'

The comment was not a necessary part of the decision, and so *obiter*, ie non-binding. On the appeal the CoA laid stress on the existence of a valid contract. But the issue of void contracts will rarely if ever arise.

Arrangements

The parties may have entered an arrangement under which one would pay the other for a service. A payment under such an arrangement is not gratuitous and is taxable under the miscellaneous income sweep-up provisions.

[The Manual makes some general comments on the meaning of "arrangement" and continues:]

BIM100120 services - amount of work done [Jan 2019]

That an agreement does not require much work to be done does not affect the fact that the sum received is a payment for services, and is chargeable under the miscellaneous income sweep-up provisions.

> However, lack of proportion may be an indication that, where there is some other potential reason for the payment, the payment comes from that alternative reason and not from the service.
>
> That the service being provided does not need to be large can be seen from the judgment of Finlay J in *Brocklesby v Merricks* [1934] 18 TC 576. In this case the taxpayer had got a favourable contract because he had previously rendered voluntary services. Finlay J said (in a judgment approved by the Court of Appeal) at p.583:
>
> > 'It seems to me that it was a payment made to the appellant for services rendered. It is perfectly true that he did very little ... but I cannot doubt that this was a contract for remuneration in respect of services rendered.'
>
> Similarly in the case of *Bradbury v Arnold* [1957] 37 TC 665 Upjohn J said at p.669:
>
> > 'There is no doubt that a contract for services may, and clearly does, form a matter for assessment under [the sweep-up provisions] and not the less so that the services to be rendered are trivial or that they are to be rendered once and for all so that the remuneration may be regarded as a casual profit arising out of a single and isolated transaction.'
>
> Upjohn J confirmed the point that, where the payment is large and the services trifling, the Tribunal may draw the inference that there was some other reason for payment:
>
> > 'It was submitted on behalf of Mr. Arnold, amongst other things, that any services of introduction of the kind rendered to Major Martineau by Mr. Arnold could not have been other than trifling and that a payment of £9,000 would not be attributable to such services. The Commissioners make no finding on that point, but I think ... they must have accepted that view and I do not understand Counsel for the Crown seriously to challenge that.'
>
> This shows the importance of establishing all the facts around the payment.

In *Andrew v HMRC* a transaction was intended to yield a benefit for the settlor, (a tax loss on the grant of the option); but that did not amount to providing a service:

> 155.... the NA Trustee was provided with a valuable asset (its rights under the Call Option Agreement) and then realized its value. The provision of the valuable asset to the NA Trust was a key aspect of the scheme, but I find it difficult to characterize the provision of that asset to the trust or the subsequent realization of that asset through its cancellation as a reward for a separate service beyond the transactions

themselves ... [53]

33.10 Examples of services

33.10.1 *Providing information*

The BI Manual provides:

> **BIM100130 Sweep-up - judicial comment** [Jun 2016]
> **...Income from "property"**
> The case of *Alloway v Phillips* [1980] 53 TC 372 involved the wife of one of the Great Train Robbers. Whilst living in Canada, she received £39,000 from a newspaper. It was not in dispute that she had provided information to the newspaper which led to the newspaper publishing a series of articles. It was found that she had entered into an agreement, governed by English law, to assist the newspaper.

This was clearly Misc Sweep-up Income.[54]

The BI Manual provides:

> **BIM100230 newspaper stories** [Jan 2019]
> Fees received for providing information to a newspaper are assessable as miscellaneous income under the sweep-up provisions if not otherwise taxable.
> In *Hobbs v Hussey* [1942] 24 TC 153 it was held that a solicitor's clerk, who had never carried on the profession of an author, was chargeable in respect of a payment received from a newspaper for the serial rights of his life story. It was contended for the taxpayer that the transaction was a sale of the copyright of the series of articles and, therefore, resulted in a sale of capital and not a revenue receipt. At p.156, Lawrence J held that the fact that a service involved an element of the sale of a capital asset did not prevent it being a service.
>
> > '... it is also true, in my opinion, that the performance of services, though they may involve some subsidiary sale of property (e.g., dentures sold by a dentist), are in their essence of a revenue nature, since they are the fruit of the individual's capacity which may be regarded in a sense as his capital but are not the capital itself.'
>
> The question then was: what is the nature of the transaction?
>
> > 'Does then the fact that the present transaction involved the sale of the copyright in the Appellant's series of articles, constitute

[53] [2019] UKFTT 177 (TC) at [155]. For another aspect of this case, see 33.5 (Disposal of asset).

[54] The issue was the location of the source: see 33.19.2 (Source: Income from services).

> therefrom capital; or is the sale merely subsidiary to what was in its essence a performance of services by the Appellant? In my opinion, the true nature of the transaction was the performance of services. The Appellant did not part with his notes or diaries or his reminiscences.'

As Hobbs was being paid for his services, he was taxable under the miscellaneous income sweep-up provisions.

The case of *Housden (Inspector of Taxes) v Marshall* [1958] 38 TC 233 differed in that Marshall, a famous jockey, did not write the articles. He agreed to make available, to a newspaper, reminiscences of his racing career together with certain documents relating to it. The agreement granted the newspaper the first British serial rights in the reminiscences and gave the right to publish the article under the taxpayer's name and to use a facsimile of his signature. In return, the taxpayer was to receive two payments of £750.

Subsequently, a journalist employed by the newspaper wrote four articles about the taxpayer. These articles were written as a result of the journalist's own researches and the taxpayer's only contribution was to suggest certain minor amendments. Because of a national newspaper strike only one article was published and the taxpayer received only one of the two proposed £750 payments.

The taxpayer appealed against an assessment under the miscellaneous income provisions in respect of the £750 payment. The Special Commissioners held that the agreement provided predominantly for a sale of publication rights, any services rendered being incidental and subsidiary, and that the £750 was therefore not assessable.

Harman J held that the Special Commissioners had misunderstood the agreement with the newspaper:

> 'I do not think that he sold any publication rights in his reminiscences. He had no reminiscences of which he could sell the rights. The reminiscences which he communicated to the journalist, if they had been used - which in the upshot they were not - were as I say not his; he had no secrets to impart, his life was open. He was not selling anything of which he had the property like the copyright. He was not selling anything secret. He was merely talking to the journalist and allowing the journalist's write-up to be put forward as his.'

As a result he reversed their decision holding that the £750 was assessable under the miscellaneous income sweep-up provisions as a payment for services.

This case shows the importance of understanding exactly in relation to what is money being paid. It is not simply a case of reading the agreement; it is important to see what was actually done as a result. Giving a judgment in the High Court of Australia in the case of *Brent v FCT* [1971] 71 ATC 4195, Gibbs J said that:

> 'I have not been referred to any case in which it has been held that information which was not acquired or used in connection with a business should be treated as a capital asset whose disposal would result in the receipt of a capital gain rather than of income.'

He distinguished information from copyright saying that:

> 'In *Trustees of Earl Haig v. I.R. Commrs*. (1939) 22 TC 725, the trustees who had the right to publish the war diaries of Earl Haig gave to an author the right to make full use of the diaries so far as the public interest permitted and the sum received by the trustees as consideration for so doing was held to be a capital payment and not assessable to income tax. However, in that case, the trustees had the copyright in the diaries, which was indubitably property, and they did not merely sell information to the author, but in effect partially realised their copyright.'

33.10.2 *Photography*

The BI Manual provides:

> **BIM100235 photography** [Jan 2019]
>
> If someone, other than by way of trade, makes a profit by selling a photograph they are chargeable under the miscellaneous income sweep-up provisions.
>
> However if they sell the copyright then it is a capital transaction if the sale is not done as part of a trade and they are not liable under those provisions.
>
> This comes from the decision of Lord Simon in *Nethersole v Withers* [1948] 28 TC 501 at p.517 where he said that the assignment of copyright in a film:
>
> > 'amounts to a sale of property by a person who is not engaged in the trade or profession of dealing in such property, and the proceeds of such a sale is, for Income Tax purposes, in the nature of untaxed capital and not in the nature of taxable revenue.'

33.10.3 *Commission for introduction*

SP 4/97 (Taxation of commission, cashbacks and discounts) provides:

> **Case VI—receipts**
>
> 19 Commission etc may sometimes be received by a person as consideration for introducing a customer to a supplier of goods or

> services, other than in circumstances where the commission would be taxable as income under Case I or II of Schedule D (see para 11 above) or as employment income (see para 25 below). Subject to para 20 below, if the commission arises under an enforceable contract, it should be brought into account as a taxable receipt in calculating the profit from the transaction under Case VI of Schedule D...
>
> **Case VI—deductions**
>
> 21Where, in the circumstances described in para 19 above, some or all of the commission etc in question is passed on to the customer, a deduction is due where the customer requires the commission to be passed on as a condition of entering into the transaction or where for some other reason the payment is necessary to earn the commission.

33.10.4 *Cashback*

Commissions for introduction must be distinguished from cashbacks to the customer/client.

SP 4/97 (Taxation of commission, cashbacks and discounts) provides:

> **Case VI—receipts**
>
> 20 A sum, however described, which is received by an ordinary retail customer as consideration for the purchase by the customer of goods or services should not be regarded as a taxable receipt in computing profits under Case VI. This is the case whether the payer is the provider of the goods or services or another party with an economic interest in ensuring the transaction takes place.

The BI Manual provides:

> **BIM100210 cash-backs** [Jan 2019]
>
> ... When a customer, not carrying on a trade or property business, decides to take their business to one concern rather than another, they are not providing that concern with a recognisable service such as to bring them within the scope of the miscellaneous income sweep-up provisions. This applies even if a commission or cash-back which may be received by the customer as consideration for the purchase of goods or services is paid under an enforceable contract separate from the contract for the supply of the goods or services itself.
>
> However, if someone is paid for introducing some other customer to the supplier of goods or services then they are taxable under the miscellaneous income sweep-up provisions if:
>
> - they are not otherwise chargeable; and
> - the payment is not gratuitous (see BIM100110).

One-off cash-backs should be distinguished from regular payments, which are not Misc Sweep-up Income, but may be Annual Payments.[55]

33.10.5 *Partnership bonus scheme*

In *HMRC v BlueCrest Capital Management*[56] a partnership bonus scheme was set up so that:

(1) Profits intended for partners bonuses were received in the first instance by a corporate company

(2) When the bonus was allocated and relevant conditions were satisfied, the bonus was paid from the company to the partner.

At stage (1) the company paid corporation tax on the profits as a partner. But at stage (2) the bonus received by the partners were taxed again as Misc Sweep-up Income:[57]

> Although we have found that individual partners did not have the right to receive PIP Awards [partnership bonus] as part of the profit-sharing arrangements of the Partnership, [and so were not taxed on the individual partners as partnership income] this does not prevent those awards falling within Case VI. The FTT found that the PIP was intended to reward individual partners for their contribution to the success of the Partnership, because of the services they provided and to incentivise them for the future. In our judgment, the FTT was also entitled to find that these services were eiusdem generis with the services listed within the other Cases in Sch D.

It followed that the scheme, one of whose purposes was tax avoidance (reducing tax from individual to corporate rates) in fact led to a marked increase in taxation: tax at CT rates on the company's partnership income *and* tax on the partners' bonuses when distributed at the partners individual rates. But that is not regarded as objectionable double taxation.[58]

I would have favoured the view that the payment from the company was

[55] See HMRC Brief 4/13 (Payments of "trail commission" on investment products); *HMRC v Hargreaves Lansdown Asset Management* [2019] UKUT 246 (TCC).

[56] [2023] EWCA Civ 1481. *Bluecrest* is one of a trio of what should turn out to be leading cases; the other two are *Odey Asset Management v HMRC* [2021] UKFTT 31 (TC); *HFFX v HMRC* [2021] UKFTT 36 (TC). But further discussion should wait until these decisions are final.

[57] at [117].

[58] See 105.3 (Types of double taxation).

a distribution and taxed at dividend rates, which are less than the top individual rates. The source was the company and not the partnership. The partners haed an interest in the source, or at lease, there was sufficient connection. It is significant that the company was held by a purpose trust whose purposes included the advancement of the BlueCrest business, and to facilitate the BlueCrest incentive scheme; so the partners were effectively beneficiaries. But no-one argued for that.

33.11 Income from finance

Income from finance may be regarded as a particular kind of service, but it is convenient to consider it here as if it was a separate category.

33.11.1 *Guarantor fee*

The BI Manual provides:

> **BIM100215 guarantees** [Jun 2016]
> If a person agrees to act as guarantor in return for a reward, then they are chargeable under the miscellaneous income sweep-up provisions, if they are not otherwise chargeable.
> In *Sherwin v Barnes* [1931] 16 TC 278, a guarantee was given in respect of an overdraft in return for the payment of a bonus of £1,000. The guarantor was assessed to Income Tax in respect of his share of that £1,000. Rowlatt J said at p.280-281:
>
> > ... Earning a commission by pledging your credit was held, and considered rightly held, in *Ryall v Hoare*, to be in the nature of income. There it is, and I cannot get away from that.'

33.11.2 *Lender's fee*

The BI Manual provides:

> **BIM100225 loans** [Jan 2019]
> If a person makes a loan or provides money and receives a reward not otherwise chargeable to Income Tax, this is taxable as miscellaneous income under the sweep-up provisions.
> This can be seen from the case of *Ruskin Investments Ltd v Copeman* [1943] 25 TC 187. In this case, the company had made a loan to a builder. The debt was settled by the builder transferring the ground rents of properties to the company.
> The difference between the amount of the loan and the value of the ground rents received was held to be taxable as miscellaneous income.
> In his judgment at p.198, Scott LJ stated:
>
> > 'The result was that the reversion and ground rents of the 249 plots

> were received primarily in repayment of the capital loan of £15,000; the balance of their rather speculative value was the Company's remuneration for the service of the loan, taxable [as miscellaneous income].'

In the case of *Wilson v Mannooch* [1937] 21 TC 178, the taxpayer was a partner in a firm of solicitors. He verbally agreed with a building company, who were clients of the firm, that, in consideration of the respondent personally lending or arranging for the loan to the company of the purchase price of certain property, the respondent should receive, on the re-sale of the property, one-third of any resulting profit, with a limit of £500. The greater part of the purchase money was provided on first mortgage by certain clients of the respondent's firm, and the remainder on second mortgage carrying interest at 6 per cent by the respondent personally. The sum of £500 was duly paid to the respondent. Lawrence J said at p.185:

> 'In my judgment, the sums received in the present case are not analogous to the appreciation of capital upon the sale of an article, but are, in reality payments to the Respondent for the finding of money, and have the character of income, and not capital.'

But see 26.4 (Premium).

33.12 Futures and options

33.12.1 *Derivatives: Terminology*

The meaning of "derivative" is as follows:

> A transaction under which the future obligations of one or more of the parties are linked in some specified way to another asset or index, whether involving the delivery of the asset or the payment of an amount calculated by reference to its value or the value of the index. The transaction is therefore treated as having a value which is separate (although derived) from the values of the underlying asset or index. As a result, the parties' rights and obligations under the transaction can be treated as if they constituted a separate asset and are typically traded accordingly.[59]

The definition in FRS102 is as follows:

[59] *Lomas v JFB Firth Rixson* [2012] EWCA Civ 419 at [2] citing Firth's "important monograph" *Derivatives Law and Practice* (looseleaf) para 1.004 (What are derivatives?).

> A financial instrument or other contract with all three of the following characteristics:
>
> (a) its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable (sometimes called the 'underlying'), provided in the case of a non-financial variable that the variable is not specific to a party to the contract;
>
> (b) it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
>
> (c) it is settled at a future date.

I do not think the differences between these definitions are material.

Firth states:

> All derivatives transactions fall into one of three basic categories:
> (1) swaps and related products,
> (2) options and swaptions and
> (3) futures and forwards.[60]

33.12.2 *Futures/Options: IT relief*

Section 779(1) ITTOIA provides:

> No liability to income tax arises as a result of Chapter 8 of Part 5 (income not otherwise charged) in respect of a gain arising to a person in the course of dealing[61] in—
>
> (a) commodity or financial futures,
>
> (b) traded options, or
>
> (c) financial options.

In short, futures and options are excluded from the Misc Sweep-up Income charge. These transactions must either be trading or capital transactions. This makes obsolete some antique case law under which

[60] Firth, *Derivatives Law and Practice* (looseleaf) para 1.005 (Categories of transaction).

[61] Defined s.779(2) ITTOIA: "The reference in subsection (1) to a gain arising in the course of dealing in commodity or financial futures includes a gain regarded as so arising under section 143(3) of TCGA 1992 (gains arising from transactions otherwise than in the course of dealing on a recognised futures exchange, involving authorised persons)."

transactions in futures were held to be non-trading but constituted Misc Sweep-up Income.

It is therefore necessary to consider the meaning of these terms.

33.12.3 *"Commodity/financial future"*

Section 779(3) ITTOIA provides a partial definition:

> In this section—
> "commodity or financial futures" means commodity futures or financial futures that are for the time being dealt in on a recognised futures exchange[62]

That leaves the terms substantially undefined.

SP 3/02 provides:

> 1 This statement of practice sets out the HMRC's views on the tax treatment of transactions in futures and options of the sorts defined in TCGA 1992 s 143 and relating to shares, securities, foreign currency or other financial instruments.
> [The SP specifies some purposes for which the SP does not apply, not relevant here. and continues:]
> 4 "Financial futures" is a wide term. It includes-
> [a] contracts for future delivery of shares, securities, foreign currency or other financial instruments;
> [b] [i] contracts that are settled by payment of cash differences determined by movements in the price of such instruments (including contracts where settlement is based on the application of an interest rate or a financial index to a notional principal amount),
> [ii] as well as contracts settled by delivery; and
> [c] both exchange traded and over the counter contracts.

See 33.13 (Swaps).

33.12.4 *Traded/financial options*

Section 779(3) ITTOIA provides:

> In this section ...

[62] Defined s.288(6) TCGA: "In this Act "recognised futures exchange" means the London International Financial Futures Exchange and any other futures exchange which is for the time being designated for the purposes of this Act by order made by the Board."

> "financial option" has the meaning given by section 144(8)(c) of TCGA 1992, and
> "traded option" has the meaning given by section 144(8)(b) of that Act.

So we turn to s.144(8) TCGA:

> (b) "traded option" means an option which, at the time of the abandonment or other disposal, is listed on a recognised stock exchange[63] or a recognised futures exchange; and
> (c) "financial option" means an option which is not a traded option, as defined in paragraph (b) above, but which, subject to subsection (9) below—

The definitions are best read side by side:

(i) relates to currency, shares, securities or an interest rate and	(ii) relates to shares or securities which are dealt in on a recognised stock exchange and	(iii) relates to currency, shares, securities or an interest rate and	(iv) relates to shares or securities which are dealt in on a recognised stock exchange and
is granted (otherwise than as agent) by a member of a recognised stock exchange, by an authorised person within the meaning given by section 143(8); or	is granted by a member of such an exchange, acting as agent; or	is granted to such an authorised person as is referred to in sub-paragraph (i) above and concurrently and in association with an option falling within that sub-paragraph which is granted by that authorised person to the grantor of the first-mentioned option; or	is granted to a member of such an exchange, including such a member acting as agent.

33.13 Swaps

Firth defines a swap as follows:

> A swap is a contract which involves an exchange of payment streams,

[63] See App 2.18 (Listed/Recognised stock exchange).

> each of which is calculated on a different basis from the other.
> The classic example of such a contract is the interest rates swap, under which one party pays a variable or floating rate of interest on a specified notional amount and the other party pays a fixed rate on the notional amount, or a floating rate calculated on a different basis. Typically, the notional amount is not exchanged between the parties ... and so unlike a loan, no borrowing is involved.[64]

Income from swaps not otherwise taxable is Misc Sweep-up Income. RI 263 (Swaps held by non-corporates, 2003) provides:

> 5 Our general view is that profits or losses on a swap held by a non-corporate, if they are not within Case I of Schedule D, will fall within Case VI.
> 6 Case I takes priority over any other possible charge to tax. [The SP discusses when swaps constitute trading and continues:]
> 7 Where a swap is taken out by a non-corporate to hedge interest payments which are deductible in computing the profits or losses of a Schedule A business [now called a UK property business], then profits or losses on that contract will normally be taxed or relieved as receipts or deductions of that Schedule A business. ...
> 8 Profits or gains that are not of a capital nature, and which are not within Case I or Schedule A, will constitute "annual profits or gains not falling under any other Case of Schedule D" and will therefore be chargeable under Case VI (unless, exceptionally, they are within Case V). Periodic payments under a swap are not annual payments within Case III because they are not pure income profit—the person who receives them has counter-obligations under the swap contract. It follows that such sums are payable without deduction of income tax....
> 10 Users of swaps may sometimes receive or pay lump sums. For example, one party may pay a premium to enter into a swap, or a lump sum representing the net present value of outstanding rights and obligations under the contract may change hands if a swap is assigned or terminated early. Such lump sums will also be within Case VI if they are on revenue account. Whether a receipt or payment is capital or income is a question of fact in any particular case. But in general all cashflows made or exchanged under or in connection with a swap will be income, whether they take the form of periodic payments or are rolled up into a lump sum payable at any point.

If a swap were a listed "financial future" it would be taken out of the Misc

[64] Firth, *Derivatives Law and Practice* (looseleaf) para 1.006 (Swaps - meaning).

Sweep-up Income charge.[65] But a swap is not a future. RI 263 (Swaps held by non-corporates, 2003) provides:

> 11 It is sometimes contended that certain swaps are "financial futures" that, if not within Case I [trading], are taken out of [IT] by [s.779 ITTOIA] and are chargeable to capital gains tax by virtue of TCGA 1992 s 143. Statement of Practice 3/02 ... is sometimes quoted in support of this view.
> 12 We do not agree. Paragraph 4 of SP 3/02 makes the point that the statutory phrase "financial futures" is a wide term, encompassing cash-settled contracts as well as those settled by delivery, and over the counter contracts (including forward rate agreements) as well as exchange-traded contracts.[66] But, wide as it is, it can only cover derivatives that are "futures". The word "future" must be interpreted in its normal commercial sense. And—while there is some fluidity in commercial usage—the market will generally see swaps as falling into a different category from futures.[67]

33.14 Restraint of trade

The BI Manual provides:

> **BIM100240 restraint of trade** [Jan 2019]
> A payment for agreeing not to do something may be chargeable as miscellaneous income under the sweep-up provisions.
> The case of *Higgs v Olivier* [1952] 33 TC 136 relates to a payment made to Sir Laurence Olivier. Following the making of the film of Henry V, Olivier agreed not to act in, produce or direct a film for any other person for a period of eighteen months in return for a payment of £15,000. This was held not to be taxable as income from his profession as an actor/director.
> It was considered that a payment not to do something was not a trading receipt (see BIM35600), however the question of whether such a payment was taxable under the sweep-up provisions was not considered in this case.
> Judicial comments in later cases have indicated that such payments are a payment for a service chargeable under the sweep-up provisions.
> In *Murray v ICI Ltd* [1967] 44 TC 175, Cross J said at p.207:
> 'The Crown made no alternative argument under [the sweep-up

[65] See 33.12.2 (Futures/Options: IT relief).

[66] See 33.12.3 ("Commodity/financial future").

[67] See 33.12.1 (Derivatives law terminology).

> provisions] on the basis that the £15,000 was a payment for a service rendered by Sir Laurence Olivier at the request of the film company. Had it done so, then the question might well have arisen whether it was a casual profit of a revenue nature or a payment for parting with a capital asset: see the judgement of Rowlatt J. in *Ryall v Hoare* 8 TC 521. It may be - I say no more - that, had the claim been put that way, the Crown would have succeeded.'

The Court of Appeal approved Cross J's judgment in full.

33.15 US economic impact payments

Economic Impact Payments are made under the [USA] Coronavirus Aid, Relief, and Economic Security Act 2020 to eligible US citizens and green card holders.

The minutes of the Joint Expatriate Forum on Tax & NICs provide:

> **Question**: The vast majority of Americans in the UK will be entitled to an economic impact payment from the US if they haven't already received it. It is $1,200 per individual and $500 for children. I am aware that one individual has had correspondence confirming that HMRC would not view these payments as subject to UK tax, but the basis for this is not entirely clear... This is likely to affect over 100,000 people in the UK.
> **HMRC Answer:** You are correct that the answer we provided was that the economic impact payments are not taxable as income in the UK.
> **Question**: The technical reason why the US Stimulus payments are not taxable in the UK is that they are an advance refund of 2020 US taxes, and US tax refunds are not taxable in the UK.[68]

33.16 Tax avoidance cases

A number of misc sweep-up income cases have involved unsuccessful avoidance schemes. The BI Manual provides:

> **BIM100130 sweep-up - judicial comment** [Jun 2016]
> ...The Special Commissioners' case of *Property Company v Inspector of Taxes* [2004] SpC433 concerned a series of transactions including a tax avoidance scheme.
> Under a 'business sale agreement', 'Property Company' agreed to sell to another company in the C Group, all its assets excluding a payment

[68] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/897729/HMRC_Joint_Expat-Forum-Tax_NICs_minutes-11-June-2020.pdf*

of rental income (the retained rent payment), recoverable tax and cash. 'Property Company' was then sold out of the C Group.

At that point 'Property Company' had the right to the retained rent payment, less the expected tax thereon, and a liability in respect of an inter-group debt which was paid off out of the rent. The intention was to offset the retained rent payment by creating a deduction in 'Property Company', the benefit of the tax saving from which would be split between the C Group and the new owners of 'Property Company'. However, the proposed tax avoidance scheme to create a deduction did not work.

The question was whether 'Property Company' was taxable on the retained rent payment either as property income, or alternatively under the miscellaneous income sweep-up charge.

The Commissioners determined that part of the money was a post cessation receipt from its letting business, but the remainder was not income from land, but arose from the agreement, and was taxable under sweep-up provisions:

> 'The balance arises solely from the business sale agreement. The balance stands in the shoes of the remainder of the retained rent payment but it is not rent and it has no legal connection with land because the effect of the [Landlord and Tenant (Covenants) Act 1995] is that it is not possible to retain such an interest in land. The only property right relates to CGP's ownership of land that it, as successor in title to the appellant, has exploited by continuing to let it to CGI pursuant to the 1996 Agreement for Lease. The balance is a sum equal to the rent receivable from CGI but the fact that it is measured by reference to rent does not give it the necessary connection with land so as to be able to say that the source of it is derived from land. It is in the nature of income that is ejusdem generis with [property] income and, not being taxable under any other [provision], is accordingly taxable under [the miscellaneous income provisions].'

The case of *Black Nominees Ltd v Nicol* [1975] 50 TC 229 involved an elaborate scheme designed to reduce the taxable income of the actress, Julie Christie. As part of the scheme, Julie Christie entered into a service agreement under which she became an employee. The Court held that Black Nominees were not carrying on a trade of exploiting the professional services as an actress of Julie Christie, nor were they taxable as receiving profits of gains from a profession as Julie Christie had ceased to carry on her profession when she entered the service agreement. Templeman J held that:

> 'Tax is charged under [the sweep-up charge] in respect of annual

> profits or gains not falling under any other [provision]. In my judgment, the moneys received by Black Nominees in consequence of the transactions entered into in December 1965 fit within this description. If it were not for the trick with the £475,000, no one would suggest that the moneys received by Black Nominees were capital. Once the trick is exposed the moneys are seen to be what they are: namely, annual profits or gains. They escape any other [provision] and fall into [the sweep-up charge].'

Templeman J further held that:

> 'The sources of the moneys received by Black Nominees were the contracts between Cymbeline as assignee of Rosebroom and the film or theatrical companies for the services of Miss Christie, not the contract between Rosebroom and Miss Christie which, together with the transfer agreement, enabled Cymbeline to fulfil its contractual obligations to the film and theatrical companies by making available the services of Miss Christie.'

Templeman J held that the income was taxable under the sweep-up provisions...

33.17 Sweep-up income: Computation

Section 688(1) ITTOIA provides:

> Tax is charged under this Chapter on the amount of the income arising in the tax year.

This gives no guidance on how to quantify the amount of income. In *Curtis Brown v Jarvis* expenses of collecting royalties (then assessable as Misc Sweep-up Income) were deductible:

> I do not feel very much impressed by the words "full amount of profits and gains" in [what is now s.688 ITTOIA] because the question is, what are the profits and gains? ... I do not feel justified in differing from the Commissioners. After all, it is the right thing to do, if I may put it that way. The annual profits and gains derived from property in this country seem to me prima facie to indicate what can be got in the ordinary course of business from the property in this country, what can be received by it abroad - I will not say received abroad, but sent off from here to abroad, which is perhaps a more accurate way of putting it."

The Tax Law Rewrite replaced the former wording, "full amount", with the current wording, "amount"; which is perhaps more apt in the light of that decision.

RI 263 provides:

> The case of *Curtis Brown v Jarvis* (14 TC 744) makes it clear that in assessing receipts under Case VI it is permissible to deduct associated payments. And, under s 69 [ICTA],[69] income tax under Case VI is charged on the full amount of profits or gains for the year of assessment. So the amount to be taxed under Case VI (or the Case VI loss) for a year of assessment will be the net amount receivable (or payable) under the swap contract in that year. If, however, the non-corporate prepares accounts and accounts for the swap on either an accruals or a mark to market basis, there is no objection to using the accounts figure as the measure of the "full amount of profits or gains", provided that the accounts bring in the full economic profit on the swap over the life of the contract.

The BI Manual provides:

> **BIM100150 calculating the profits** [Jun 2016]
> For Income Tax, the sweep-up charge is on income arising in the tax year. For Corporation Tax, the sweep-up charge is on income arising in an accounting period...
> **Non Cash Receipts**
> As with trading income, the miscellaneous income sweep-up provisions charge money or money's worth.
> *Example*
> A non-transferable holiday offered as an alternative to a sum of money as payment for a 'story' by a newspaper is taxable as miscellaneous income. The sum for assessment being the amount of the cash alternative.
> A non-transferable holiday provided, with no cash alternative, as payment for a 'story' by a newspaper is not taxable as miscellaneous income as it cannot be converted into money....
>
> **BIM100155: Miscellaneous income: deductions** [Jan 2019]
> **Expenses**
> Expenses are allowable in computing income within the sweep-up charge, but there is only limited legislation on exactly what expenses are deductible. For example, there are rules disallowing business entertaining expenditure (similar to those which apply to trade profits - see BIM45000) where the activity concerned is a business.

[69] Now rewritten in different terms in s.688(1) ITTOIA, but I think without changing the law on this point.

> In practice you should follow the rules governing trade profits, so far as they are applicable (see the speech of Rowlatt J in *Curtis Brown Ltd v Jarvis* [1929] 14 TC 744 at pages 752-753).
>
> **Capital Allowances**
>
> There is normally no entitlement to capital allowances in respect of miscellaneous income. You should refer any case of doubt or difficulty to Business Profits.
>
> **Interest**
>
> Interest paid is normally not an allowable deduction in arriving at the profits chargeable under the miscellaneous income sweep-up provisions. This is because in the case of profits of a casual or occasional nature it is difficult for interest to satisfy the 'wholly and exclusively' test, and raising funds to support the activity would itself point to trading.
>
> **VAT**
>
> If any expenses deductible in computing miscellaneous income have borne VAT, which is irrecoverable, the deduction should be the amount inclusive of VAT. Otherwise, if the VAT is recoverable, then the allowable expense is the amount net of VAT.

It is considered that income should be computed by reference to accountancy principles.

33.18 Sweep-up income: Remittance basis

Section 688 ITTOIA provides:

> (1) Tax is charged under this Chapter on the amount of the income arising in the tax year.
> (2) Subsection (1) is subject to ...[70]
> (c) Part 8 (foreign income: special rules).

Section 688(2)(c) ITTOIA incorporates the remittance basis for foreign source Misc Sweep-up Income.

33.19 Misc Sweep-up Income: Source

The location of the source matters for the usual reasons, in particular:
(1) A non-resident is not taxed unless there is a UK source
(2) Foreign source royalties are RFI and qualify for the remittance basis[71]

[70] The exceptions in (a)(b) are specialist topics (rent a room relief and qualifying care relief) not discussed here.

[71] For source issues generally, see 16.3 (Approach to locating source).

There is very little authority on the location of the source of Misc Sweep-up Income. As there are many different types of sweep-up income,[72] the test will vary according to the type of income. The different types of sweep-up income have little in common except the absence of a charge under any other provision. It would be absurd to apply the same test to all types of the income. There is no single test to apply to all types of sweep-up income.

33.19.1 *Source: Income from assets*

Where the income arises from the exploitation of assets, the source is where the assets are situated.

If there is a simple hire[73] of an asset (without a trade) the source of income is the asset (not the contract) and one would expect the location of the income source to be where the asset is situate.

In *IRC v Hang Seng Bank*, the Privy Council said:

> If the profit was earned by the exploitation of property assets as by letting property ... the profit will have arisen in or derived from the place where the property was let ...[74]

But this was tactfully "explained" in *IRC v HK-TVB*:

> When Lord Bridge used the words "place where the property was let" he must have been referring to the place where the property was situated and not to the place or places where the lease happened to have been signed.[75]

Although the comment was made in the context of immovable property, it is considered that the same applies to chattels and other personal property.

Likewise in Australia:[76]

> The location of the property will be significant [to determine the source of income when the income is derived from property

[72] See 33.6 Types of misc sweep-up income).

[73] References to a hire here include a licence: the distinction does not matter for present purposes.

[74] [1990] STC 733 at p.740b.

[75] [1992] STC 723 at p.729e.

[76] *CT v Resource Capital Fund IV LP* [2019] FCAFC 51 at [52] citing: *FCT v United Aircraft Corporation* [1943] HCA 50.

It is true that chattels may be moved, but most chattels do not move often. If (say) a picture (subject to an existing chattel lease) was moved permanently, it is unclear whether the source changes. It is tentatively suggested that the source changes with a permanent move, but not with a temporary one.

If the chattel were a mobile asset (a plane or yacht) then it is suggested that one should not adopt the rule that the source is where the asset is situated. It is rational to have a separate rule for ships and aircraft. The IHT/CGT situs rules are also different for such assets.

If the hiring constitutes a trade, then trading principles apply to determine the source; see 21.18 (Hire of chattels).

33.19.2 *Source: Income from services*

Alloway v Phillips concerned a payment for services: the taxpayer, wife of a great train robber, received a fee for providing information to a journalist. The taxpayer was non-resident in the year that the income arose but payment was made under a contract which was a UK situate chose in action (UK resident payor and enforceable in the UK).

Section 108(1) ICTA 1970 then provided:

> Tax under this Schedule [schedule D] shall be charged in respect of -
> (a) the annual profits or gains arising or accruing …
> (iii) to any person, whether a British subject or not, although not resident in the UK, from any property whatever in the UK …

Alloway was a pre-ITTOIA case where the issue was whether a payment was income from "property in the UK" (a subtly different question from source under the contemporary legislation[77]):

> This contract gave to Mrs. Alloway a number of rights in which she could have sued in the UK if necessary. She had no property in Canada capable of producing profits. The information about her husband was not property. It required this contract to convert it into property. This sum of £39,000 was in my opinion a profit or gain arising from property in the UK. It is entirely within s.108(1)(a)(iii) [ICTA 1988]. It does not fall within any other class of Schedule D, and therefore is correctly charged under Case VI.[78]

[77] See 21.8.1 (Source in pre-ITTOIA legislation).

[78] 53 TC 372 at p.389. Lord Denning made the same point at p.387: "This case comes under Case VI of Schedule D. It seems to me clear that this wife had property in the

Alloway concerns the provision of services. It would be a mistake to say that *Alloway* governs the location of the source of other types of (what is now) Misc Sweep-up Income, such as income from assets. The court stressed that Mrs Alloway had no property in Canada. The only property was a contractual right (a chose in action) situated in the UK. These two points are related: it was because *Alloway* concerned the provision of services that the taxpayer had no property in Canada. She did not need property to provide those services.

Even in relation to the source of Misc Sweep-up Income from the provision of services, ie the facts of *Alloway* itself, the law has changed since *Alloway* was decided in 1980:

(1) In the case of the source of interest, the courts have moved from the view that the location of the source depended on the situs of the debt (or something very close), to a multi-factorial approach.[79]

(2) The charge under the pre-rewrite legislation depended on the location of property in the UK.[80] It made some sense that the courts applied a situs test, both for interest and in *Alloway*. But the charge under ITTOIA depends on the location of the source of the income. The statutory test is now different.

It may be said that *Alloway* is one of those result-determined cases where the court decided the result first and the reasoning second.[81] The reader may have some sympathy for the argument, rejected by the court that the contract was mere machinery for collection of a payment for services. But however that may be, the decision is no longer relevant. The law has changed.

If the same facts arose today, Mrs Alloway should claim relief under the UK/Canada DTA. When her income arose she was treaty-resident in

UK. She had a chose in action here. [Lord Denning referred to Dicey & Morris, *The Conflict of Laws* and continued:] The truth is that she had a chose in action in England. It was property in England: but she had no property at all in Canada. She had no copyright there. She only had the information in her head which she told to the newspaper reporter. That is not a species of property known to the law of England ...."

[79] See 26.9 (Interest: Location of source).

[80] See s.18(1) ICTA 1988 previously s.108 ICTA 1970, set out above.

[81] "If the criminals or their wives get money by relating their stories to newspapers, they ought to pay tax on their profits and gains. That is this very case. The wife is now in England. She is outside the jurisdiction of the Canadian courts. She received the money here and ought to pay tax here ..."; 53 TC 372 at p.387.

Canada, and even if the income were UK source it would not be taxable in the UK.[82]

It is considered that the correct test for the source of Misc Sweep-up Income for the provision of services is now in principle the place where the work is done, the same as the trading test: where does the profit substantially arise.[83]

33.19.3 *Source: futures and swaps*

Bayfine v HMRC discussed the source of income from a forward contract between a US and a UK company:

> [36] [Counsel for the taxpayer] submits that ... the broad guiding principle is that the source is treated where the service was rendered or the profit-making activity was carried on. Thus in the case of a forward contract the court should attach great weight to the place where the contract was performed.[84] In the case of investment income (which, as I understand it, would include investment income earned from short-term contracts such as the forward contracts in this case), factors such as the identity of the debtor, the law governing the debt instrument, the location of the assets to which the investment relates and currency of payment may have greater weight than in trading asset cases.[85] In this case ... this was US source income. The counterparty to this was a US resident operating from the US and the forward contract was negotiated in part in the US. It was executed in the US, governed by US law and related to assets with a US situs and it was enforceable in the US. It also had to be settled in US dollars. All of those factors point to the US. The only factor that points the other way is that one of the contracting parties ... was a UK resident. The fact that a party is a UK resident does not mean that its income has a UK source. Otherwise there would be no distinction between the source of a profit as a basis of taxation and residence.
>
> [54] As to source, if domestic law principles had applied ... I would have preferred the submissions of [counsel for the taxpayer] ... that the

[82] See 33.20 (DT relief: "Other Income"). The DTA in force at the relevant time did not contain an "Other Income" article, and it was unlikely that any treaty exemption applied.

[83] See 21.14 (Services).

[84] The Court cited: *IRC v Hang Seng Bank* [1990] STC 733 at p.740.

[85] The Court cited what is taken (though wrongly) to be the leading case on the source of interest: *National Bank of Greece v Westminster Bank Executor and Trustee Co* [1971] AC 945 at p.954–955.

> source of the ... profit was not in the state of residence [of the taxpayer] but in the US, where the profit was substantially generated.
> [63] [Counsel for the Revenue] ... refers to the test ... 'Where do the operations take place from which the profits in substance arise?'[86] He argues that on the basis of this test the profit was profit arising in the UK. However, in my judgment this argument is unpersuasive, even on [that test] when all the factors ... are taken into account. Thus, I consider that the ... profit was income 'arising' outside the UK for the purposes of [unilateral tax credit relief].[87]

This identifies two tests of source:
(1) The test for the source of interest
(2) The test for the source of trading income

These are two distinct tests, but so far as they both apply a multi-factorial approach, they may be regarded as a common test.

Interest is not closely analogous, as an important factor in the source of interest is what the borrowed money is used for. There is no equivalent in the case of a derivative. The source of trading income is closely analogous, as Misc Sweep-up Income is only just short of amounting to a trade (requiring a payment for services or in relation to assets) and is computed in a similar manner to trading income, ie receipts net of expenses. So the test is where the profits substantially arise. That can be difficult to apply, but it works quite well here.[88]

In relation to derivatives, it is suggested that the most significant factor should be the asset (if there is one) to which the derivative relates. A swap relating to a particular security is situate where that share is situate. That is where the profit is generated. A swap relating to an index such as the S&P 500 is situate in the US, as that is where substantially all the securities in the S&P 500 are situate. A swap relating to interest rates has no underlying asset, and one falls back on place of enforceability.

Residence of the debtor is clearly not the decisive test of source. Otherwise then the profit would be UK source if the market moved one

[86] The Court cited the classic trading source cases: *Smidth v Greenwood* 8 TC 193 at p.203–204, and *Yates v GCA International* 64 TC 37 at p.55–56.

[87] *Bayfine v HMRC* [2011] STC 717 at [36], [54]. See 111.1 (Credit for foreign tax). For completeness: The issue in *Bayfine* was source for the purposes of the US/UK DTA, but there is nothing in the DTA to suggest that treaty-source for this type of income is distinct from domestic-law source.

[88] See 16.11 (Where profits in substance arise).

way and the UK company received the profit, and US source if the market moved the other way and the US company received the profit; that would be an odd result.

33.20 DT relief: "Other Income"

Article 21(1) OECD Model provides:

> Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

I refer to income within this article as **"Other Income"**, with initial capitals to reflect the technical nature of the term.

Article 21(2) deals with the overlap between the Other Income article and business income.[89]

Article 21 includes more than Misc Sweep-up Income. For other contexts where the Other Income article is important, see:

Topic	**See para**
Discretionary trust/estate income	41.12 (UK trust, non-resident beneficiary)
s.720	49.30.3 (Transferor treaty non-resident)
s.731	50.61.2 (Beneficiary treaty non-resident)
Income from third State	30.15.14 (Co in 3rd State: Dual resident shareholder)

[89] See 107.9.3 (Other business profit overlaps).

CHAPTER THIRTY FOUR

EMPLOYMENT INCOME

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34.44 Accountancy services benefit

Cross references

The following topics are considered elsewhere:

Topic	**See**
PAYE – Introduction	36.1
Employment Income DT Relief	37.2
The benefits code	39.2
Employment-related loans	40.2
National insurance contributions	46.1

34.1 Employment income: Introduction

The taxation of employment income is mainly governed by ITEPA. Though dwarfed by the CTAs 2009 and 2010, ITEPA was for its day (2003) a mammoth Act: the table of contents was 36 pages long. How many dozen volumes would be required for a full discussion?

The drafter of ITEPA was fond of signpost provisions, preferred repetition to cross referencing, and believed very firmly in the value of dotting *I*'s and crossing *T*'s. That may be useful to a non-lawyer reading the statute unmediated by any other assistance: that reader needs all the help they can get! I find this approach makes a textbook exposition rather more difficult, as there is more statutory text to navigate than need have been. Behind what appear to be stylistic issues lie deeper questions: who are tax statutes written for? and how best to cater for readers with different needs? Be that as it may: we must take the text as we find it.

This chapter focuses on matters closest to the themes of this work, but the subject can only be understood in the context of the provisions as a whole, so I begin with a general outline. Most readers will no doubt cut to the chase, but they will later find themselves referring back to these fundamentals.

I do not discuss employment-related securities, or employment income provided through third parties (disguised remuneration), though I hope to do so in a future edition.

34.2 Employment income Parts

Section 3(1) ITEPA provides:

The structure of the employment income Parts is as follows-[1]

Part	**Content**
2	Charge to tax, computation of charge, who is liable
3	Earnings
4	Exemptions
5	Deductions
6	Miscellaneous ITEPA income: retirement benefits, termination payments
7	Employment-related securities
7A	Employment income provided through 3rd parties (disguised remuneration)

Section 3(2) ITEPA provides:

> In this Act "the employment income Parts" means this Part [Part 2] and Parts 3 to 7A.

[1] For clarity I have set this out in tabular form, in my own words, rather than the layout and wording of the statute.

34.3 Employment/employer/employee

Traditional employment-law terminology is somewhat opaque:

"**Contract of service"** means a contract of employment, ie between employer and employee; I prefer to use the term **"contact of employment"**

"**Contract of services"** (in the plural) means a contract which is not an employment, ie between an independent contractor/self-employed person and their client

Section 4 ITEPA provides an inclusive definition:

> (1) In the employment income Parts[2] "employment" includes in particular—
>
> (a) any employment under a contract of service,
>
> (b) any employment under a contract of apprenticeship, and
>
> (c) any employment in the service of the Crown.
>
> (2) In those Parts "employed", "employee" and "employer" have corresponding meanings.

Employment/contract of service are employment law terms which are is elucidated in case law rather than the statutory provision. This topic needs a book to itself; it is too far from the themes of this book to discuss here.

EN ITEPA comments on the definition of employment:

> ... the decisions of the courts have given rise to a number of different tests, none of which has proved to be definitive. Given the diversity of approach in the courts it seems unlikely that an exhaustive definition of "employment" could be produced, or indeed that one could produce more than an incomplete list of criteria that might or might not be useful in a given case for determining whether an employment exists.
>
> On the other hand it is thought that it would be helpful to have a non-exhaustive explanation which gave an indication of the core meaning of "employment" by listing certain arrangements that on any view constitute an employment. As such, it would not attempt to delineate the boundary between employment and self-employment.
>
> Section 4 of the Act contains such an explanation. [The EN summarises the section and continues:]
>
> The reference to "any employment in the service of the Crown" is specifically included because it is not settled that all Crown servants have contracts of service.

[2] Parts 2-7A ITEPA; see 34.2 (Employment income Parts).

The OECD Commentary uses similar terminology:

> "employment relationship (contract of service)"
> "services rendered in an employment relationship"

But the concept is slightly different; see 37.9 (Labour-hire arrangement).

Salaried partners may be treated as employees under s.863A ITTOIA. This topic needs a chapter to itself, and is not discussed here.

34.3.1 *Offices*

Section 5 ITEPA extends the term "employment" to include an office. The most common example is company directorship. This is needed because a company director need not as a matter of employment law have an employment (a contract of service):

> (1) The provisions of the employment income Parts[3] that are expressed to apply to employments apply equally to offices, unless otherwise indicated.
> (2) In those provisions as they apply to an office—
> (a) references to being employed are to being the holder of the office;
> (b) "employee" means the office-holder;
> (c) "employer" means the person under whom the office-holder holds office.

Section 5(3) ITEPA provides an inclusive definition of "office":

> In the employment income Parts "office" includes in particular any position which has an existence independent of the person who holds it and may be filled by successive holders.

EN ITEPA comments on the definition of office:

> The concept of an "office" is one that has also been considered by the courts: see in particular *Great Western Railway Company v Bater* (1922) 8 TC 231 and *Edwards v Clinch* (1981) 56 TC 367. But in this case it does seem possible to construct a definition based on the guidelines established by the courts. However, since these are only guidelines, any explanation can, again, only be non-exhaustive.
> Section 5(3) of the Act contains such an explanation. ....

I refer to the definition of employment (etc) in s.4, 5 ITEPA as the

[3] Parts 2-7A ITEPA; see 34.2 (Employment income Parts).

"standard ITEPA definition[4]**"**.

A shadow director does not hold an office, and so (in the absence of a contract of employment) is not an employee within the standard ITEPA definition.[5]

All these definitions are expressed to apply only in the employment income Parts, so elsewhere they have to be repeated verbatim,[6] or incorporated by reference.[7] (If there were taxes-act-wide definitions, that would not be necessary.)

34.4 Employment income/earnings

This section considers the following ITEPA terminology:

Term	**See para**
Ordinary earnings (my term)	34.4.1
General earnings	34.4.2
Specific employment income	34.4.3
Employment income	34.4.4

Items (2)-(4) are opaque technical terms, defined in s.7 ITEPA which begins:

> (1) This section gives the meaning for the purposes of the Tax Acts of "employment income", "general earnings" and "specific employment income".

34.4.1 *"Ordinary" earnings*

Section 62 ITEPA defines "earnings".

Section 62 is the only section in Chapter 1 Part 3 ITEPA. The legislation refers on a number of occasions to earnings "within Chapter 1 of Part 3" (or "as defined in Chapter 1"). This seems a rather cumbersome way of referring to s.62, but there it is.

Section 62 ITEPA provides:

> (1) This section explains what is meant by "earnings" in the employment income Parts[8].

[4] For employment/employee in the OECD model, see 37.9 (Labour-hire arrangement).

[5] A shadow director is not an employee unless expressly specified, eg as in the benefits code; see 39.6.4 (Application of the benefits code to shadow directors).

[6] See eg 38.4.1 ("Pension").

[7] See eg 6.26.1 ("Employment").

[8] Parts 2-7A ITEPA; see 34.2 (Employment income Parts).

> (2) In those Parts "earnings", in relation to an employment, means—
> (a) any salary, wages or fee,
> (b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth,[9] or
> (c) anything else that constitutes an emolument of the employment.

"Earnings" is not an ideal label, and I call it **"ordinary" earnings** to distinguish it from the (wider) concept of "general earnings" discussed below.

34.4.2 *"General earnings"*

"General earnings" is a technical term. Section 7(3) ITEPA provides:

> "General earnings" means—
> (a) earnings within Chapter 1 of Part 3, [ordinary earnings][10] or
> (b) any amount treated as earnings (see subsection (5)),
> excluding in each case any exempt income.

Section 7(5) ITEPA specifies 5 categories of earnings, or deemed earnings, classified as general earnings:

> Subsection (2)(b) or (3)(b) refers to any amount treated as earnings under—[11]

Provision	**Topic**	**See para**
Chap 7-10 Part 2	Agency worker/intermediary/managed service company	
Chap 2-10 Part 3	The benefits code	39.2
Chap 12 Part 3	Misc payments treated as earnings	*Not discussed*
s.402B	Termination awards (Post-employment notice pay)	34.38
s.262 CAA 2001	Balancing charge treated as earnings	*Not discussed*

34.4.3 *"Specific employment income"*

Section 7(4) ITEPA provides:

> "Specific employment income" means any amount which counts as employment income (see subsection (6)), excluding any exempt

[9] Defined in s.62(3) ITEPA: "For the purposes of subsection (2) "money's worth" means something that is—
(a) of direct monetary value to the employee, or
(b) capable of being converted into money or something of direct monetary value to the employee."

[10] See 34.4.1 ("Ordinary" earnings).

[11] For clarity, I set this out in a table format, and abbreviate the section descriptions.

> income...

Section 7(6) ITEPA sets out four categories of deemed employment income classified as specific employment income:

> Subsection (2)(c) or (4) refers to any amount which counts as employment income by virtue of—[12]

Provision	**Topic**	**See para**
Part 6 ITEPA	"Income which is not earnings or share-related":	
	Retirement benefits	
	Termination payments	34.36
Part 7 ITEPA	Employment-related securities	39.8
Part 7A ITEPA	Disguised remuneration	*Not discussed*
Any other enactment		

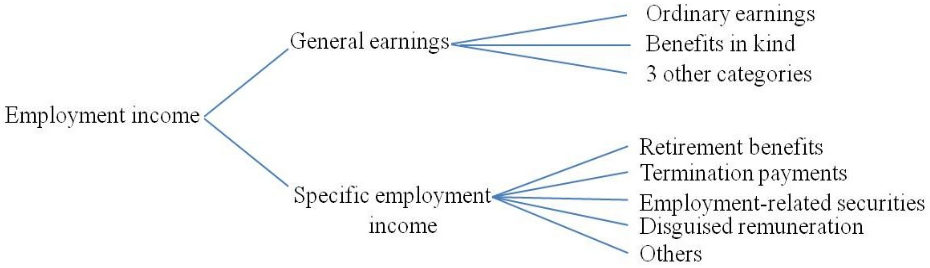
Specific employment income includes some important if specialist categories. The focus of this chapter is on general employment income, but I hope to cover these topics in a future edition.

34.4.4 *"Employment income"*

Section 7(2) ITEPA provides:

> "Employment income" means—
> (a) earnings within Chapter 1 of Part 3 [ordinary earnings][13],
> (b) any amount treated as earnings (see subsection (5)) [other general earnings], or
> (c) any amount which counts as employment income (see subsection (6)) [specific employment income].

In summary:


Employment income
General earnings
Ordinary earnings
Benefits in kind
3 other categories
Specific employment income
Retirement benefits
Termination payments
Employment-related securities
Disguised remuneration
Others

[12] For clarity, I set this out in a table format, and abbreviate the section descriptions.
[13] See 34.4.1 ("Ordinary" earnings).

34.5 Earnings causation tests

Statute provides two causation or derivation tests:

Test applies to	**Statutory wording/Pre-rewrite wording**	**See para**
Ordinary earnings	Emoluments *of* employment/*from* employment[14]	*Here*
Benefits in kind	Benefit provided *by reason of* employment	39.10

In each case there must be a nexus between the employment and the earnings/benefit, but what that nexus must be has been left to the Courts to sort out.

EIM provides:

> **EIM20503: The benefits code** [Jan 2021]
> ... Section 62 is based on what was previously Section 19 ICTA 1988, which charged to tax emoluments "from an employment". Case law shows that the phrase "by reason of the employment" [in the benefits code] has a wider meaning than "from the employment" (EIM00600). The words "from the employment" are not reproduced in Section 62 but earnings chargeable under that section include emoluments "of the employment" and in this context "of the employment" has the same meaning as "from the employment"...

The tax law rewrite, unhelpfully, changed the preposition, from *therefrom* (s.19 ICTA) to *of* (s.62 ITEPA). But there is no change of meaning: the old case law continues to apply.[15] HMRC agree:

> **EIM00600 earnings are not taxable unless they are from the employment** [Jan 2021]
> Section 19(1)1 ICTA 1988 referred to taxable emoluments, or earnings, as "emoluments therefrom". That is, emoluments that come from the employment and not from elsewhere. Section 62(2) ITEPA 2003 refers to earnings as "anything that constitutes an emolument of the employment". The words have changed, but not their meaning. So we can still use the case law relating to Section 19 ICTA 1988 (and its statutory predecessors) to help us decide if a particular payment is or is not earnings within Section 62(2) ITEPA 2003.

I refer to that as "**s.62 case law**". This case law is voluminous: EIM

[14] Section 19 ICTA 1988 provided: "Schedule E: Tax under this Schedule shall be charged in respect of any office or employment on emoluments therefrom".

[15] If authority is needed, see *Uniplex v HMRC* [2010] UKFTT 422 (TC) at [29]: "Although the statutory words are now slightly different the same principle applies today."

devotes more than 60 pages to the topic.

34.5.1 *Latin causation test rejected*

We start with *Hochstrasser v Mayes*:[16]

> the issue turns ... upon whether the fact of employment is the *causa causans* or only the *sine qua non* of benefit, which perhaps is only to give the natural meaning (!) to the word "therefrom" in the Statute,

Latin terminology is not (or at least, not nowadays) a helpful way to express a causation test. *Causa sine qua non* is simply an erudite way to refer to a "but for" test and *causa causans* means, I think, the same as operative or proximate cause (which is itself an elusive and evaluative concept).

Criticism of this Latin terminology has a long history. In *Pritchard v Arundale* (1971):[17]

> I cannot help deprecating the use of Latin or so called Latin phrases in this way. They only distract the mind from the true problem which is to apply the principles of English law to the realities of the case. ... English law can furnish in its own language expressions which will more fitly state the problem in any case of this type...
> ... the expression causa causans ... has no certain meaning for legal purposes, or, if it has, ... its use in some cases was catachrestic. It can be a dress for what would otherwise be a naked *petitio principii* (!).

HMRC v PA Holdings puts the point more curtly:[18]

> questions of causation are not to be cloaked in the obscurity of a classical tongue

34.5.2 *What is the test?*

EIM starts with basic principles and avoids Latin:

> **EIM00600 earnings are not taxable unless they are from the employment** [Jan 2021]
> ... In *Laidler v Perry* (42 TC 351), Lord Reid put succinctly the question

[16] 38 TC 673 at p 705; likewise at p.709: "The Court must be satisfied that the service agreement was the causa causans and not merely the causa sine qua non of the receipt of the profit."

[17] 47 TC 680 at 687; see too 39.9.2 (What is the test?).

[18] [2011] EWCA Civ 1414 at [38].

> that has to be answered in all cases:
>
> > "Did this profit arise from the employment? The answer will be no if it arose from something else."[19]
>
> Judges have tried to explain the meaning of the words from the employment in various ways. As Lord Radcliffe pointed out in *Hochstrasser v Mayes* their attempts help to illustrate the idea expressed in the words of the statute but they do not replace those words. He went on to say:[20]
>
> > "For my part I think that their meaning is adequately conveyed by saying that, while it is not sufficient to render a payment assessable that an employee would not have received it unless he had been an employee, it is assessable if it has been paid to him in return for acting as or being an employee."
>
> In *Shilton v Wilmshurst* (64 TC 78), Lord Templeman explained the statutory words in this way.
>
> > "An emolument from employment means an emolument from being or becoming an employee. The authorities are consistent with this analysis and are concerned to distinguish in each case between an emolument which is derived from being or becoming an employee on the one hand, and an emolument which is attributable to something else on the other hand.
>
> Note that to be taxable as earnings a payment does not have to be remuneration or a reward for services (see EIM00610). Many other types of payment fall within the statutory definition of earnings.

This is in effect a capacity test. Perhaps it is the best that can be done; but one person may have many capacities and matching an act to a capacity is not so easy.[21]

> **EIM00610 earnings from employment: important principles** [Jan 2021]
>
> ... Section 62 is not restricted to payments such as salaries, wages and tips in return for the performance of services. It also taxes other types of employment related payment, such as:
>
> - payments made to employees solely in recognition of changes made in their conditions of service. Such payments relate to the employment and to nothing else. They are from the employment. They come to the employee because he or she is an employee and

[19] 42 TC 351 at p.363.

[20] 38 TC 673 at 707.

[21] Such as Pooh-Bah in *The Mikado;* see 9.21.1 (Trust law background).

for no other reason (see EIM00600) and

- payments made solely for the purpose of inducing a prospective employee to enter into a contract of employment. Payments of this kind usually come from the prospective employer, but they may also be paid by a third party who has no interest in the performance of the services which the employee will undertake under his contract of employment (see EIM00700).

In the High Court in *Hochstrasser v Mayes* (38 TC 673) Upjohn J said that to be a profit from the employment a payment "must be in the nature of a reward for services past, present or future". Decisions in later cases have shown that the words "reward for services" should not be taken literally. In *Bray v Best* (61 TC 704) Lord Oliver said:

> "I cannot read the phrase reward for services as anything more than a conventional expression of the notion that a particular payment arises from the existence of the employer-employee relationship and not, to use Lord Reids words in *Laidler v Perry* (42 TC 351), from something else" (page752).

Other decided cases that demonstrate that taxable earnings do not have to be remuneration or reward for services include *Brumby v Milner* (51 TC 583) (see EIM00740) and *Hamblett v Godfrey* (59 TC 694) (see EIM00690).

- Payments for services under a contract of employment are taxable. A sum that an employee receives for her services under her contract of employment is taxable as earnings within Section 62 whatever the payment is called. There is more about this at EIM00630.
- Taxable earnings may be paid by a person who is not the employer. A payment may be from the employment and therefore taxable as earnings within Section 62, even if it is paid by somebody other than the employer. What matters is that the payment is made because the recipient holds the employment, or as a reward for services provided in the employment, and not for any personal reasons. Some tax cases that illustrate this principle are shown in the table below.
- Payments made voluntarily can be taxable earnings. The cases listed below also demonstrate that the absence of a legal obligation on a person to make a payment does not prevent it being taxable as earnings within Section 62. A hairdressers tip is an example of earnings that are paid voluntarily. A voluntary payment is taxable as earnings if it is from the employment (see EIM00600). The mere fact that it stems from the generosity of the payer on whom the employee has no legal claim does not prevent it being taxable. A gift that does not come from the employment is not taxable under Section 62 (see EIM01460). But there may be a charge under the

> benefits code ...

But once we have agreed the words which express the causation test, which must be general words, we then have to apply them to the facts of individual cases; and as the following 60 pages of the Manual can attest, that is where the real difficulty lies, and that is where the effective guidance can be found.

The decision on the facts of *Hochstrasser v Mayes* (reimbursement of loss on a disposal of property occasioned by moving work location - not taxable) should be seen as out of line with subsequent decisions, though the lower courts continue to pay lip service to it.[22]

34.6 Charge on employment income

One might expect ITEPA to begin with a provision saying that income tax is charged on employment income. In fact this is implied rather than expressed; s.6(1) ITEPA provides:

> **Nature of charge to tax on employment income**
> (1) The charge to tax on employment income under this Part is a charge to tax on—
> (a) general earnings, and
> (b) specific employment income.

Still, the imposition of the charge is clear enough.

34.7 Amount charged to tax

Section 6(2) provides:

> The amount of general earnings or specific employment income which is charged to tax in a particular tax year is set out in section 9.

So we turn to s.9 ITEPA which provides:

> (1) The amount of employment income which is charged to tax under this Part for a particular tax year is as follows.
> (2) In the case of general earnings, the amount charged is the net taxable earnings from an employment in the year....
> (4) In the case of specific employment income, the amount charged is the net taxable specific income from an employment for the year.

[22] See *HMRC v Murphy* [2022] EWCA Civ 1112, reversing the UT decision which the 2023/24 edition of this work described as “doubtful”.

Thus the legislation draws a distinction between:
(1) What is charged: employment income; and
(2) The amount which is charged; that is:
  (a) net taxable earnings (or net taxable specific income)
  (b) from an employment.

ITTOIA adopts a similar distinction.[23]

"Taxable" earnings is a label which brings in a large number of rules, for in the various situations where the statute desires to bring earnings into charge in a year it provides that they are "taxable" earnings from the employment in that year.

"Net" taxable earnings is a label which brings in rules relating to deductions, not discussed here.

Section 9(6) ITEPA provides:

> Accordingly, no amount of employment income is charged to tax under this Part for a particular tax year unless—
> (a) in the case of general earnings, they are taxable earnings from an employment in that year ...

34.8 "Taxable earnings"

Section 10 ITEPA provides the starting point of the definition:

> (1) This section explains what is meant by "taxable earnings" and "taxable specific income" in the employment income Parts[24].
> (2) "Taxable earnings" from an employment in a tax year are to be determined in accordance with Chapters 4 and 5 of this Part.

So we move on to Chapters 4 and 5 Part 2 ITEPA. The pace is leisurely. We eventually find four sections that identify amounts of taxable earnings: ss.15, 22, 26 and 27 ITEPA. There are four bases of taxation of employment income.
(1) UK residents: the arising basis applies (unless one of the remittance bases applies)
(2) Foreign domiciled UK residents: a remittance basis applies to two types of earnings:
  (a) Chargeable overseas earnings **("COE"**)
  (b) Overseas Workday Relief earnings **("OWR earnings")**

[23] See 2.3.1 (Unremitted RFI "chargeable").

[24] Parts 2-7A ITEPA; see 34.2 (Employment income Parts).

These might be considered two routes to qualify for the remittance basis; but the remittance basis rules differ so much between the two that they are better considered as distinct remittance bases:

Remittance basis (my term)	**See para**
COE remittance basis	34.13
OWR remittance basis	34.22

(3) Non-residents: charged on UK earnings only 34.29

The taxation of general earnings can be summarised in this table:

	UK Resident	**UK Domicile**	**Taxable earnings**	**ITEPA Section**	**Part 2 Chap**
Arising basis	Yes	n/r	All earnings: AB	15	4
COE Rem. Basis	Yes	No	(1) COE: RB (2) Other earnings: AB	22(2) 15	5
OWR Rem. Basis	Yes	No	(1) OWR earnings: RB (2) Other earnings: AB	26(2) 15	
Non-resident	No	n/r	(1) Foreign earnings: no tax (2) UK earnings: AB	27 –	5

Key AB: Arising basis
COE: Chargeable Overseas Earnings
OWR: Overseas Workday Relief
RB: Remittance basis

34.9 Earnings for year/from employment/received

ITEPA uses three distinct expressions:

Term	**Section**	**See para**
Earnings *"for" tax year*	16, 29	34.10
Earnings *from employment in tax year*	18-19	
Earnings *received in tax year*		

Earnings which are "for" one year may be earnings from the employment in a different year.

34.10 Earnings "for" tax year

It is clumsy to refer to the year which earnings are "for". ITEPA sometimes resorts to quotation marks to help the reader grasp the elusive preposition. I adopt the statutory usage as a paraphrase is even more confusing; but sometimes a paraphrase such as earnings "attributable to" or "relating to" or "earned in" a year would be easier to follow.

The concept is fundamental as the taxability of earnings depends on the employee's residence and domicile in the year which the earnings are "for". The policy behind this is that the timing of receipt may be arranged to ensure receipt in a year of non-residence; but one cannot so easily modify the year which earnings are "for".

The concept is (slightly) elucidated in s.16 ITEPA:

> (1) This section applies for determining whether general earnings are general earnings "for" a particular tax year for the purposes of this Chapter.
> (2) General earnings that are earned in, or otherwise in respect of, a particular period are to be regarded as general earnings for that period.
> (3) If that period consists of the whole or part of a single tax year, the earnings are to be regarded as general earnings "for" that tax year.
> (4) If that period consists of the whole or parts of two or more tax years, the part of the earnings that is to be regarded as general earnings "for" each of those tax years is to be determined on a just and reasonable apportionment.
> (5) This section does not apply to any amount which is required by a provision of Part 3 to be treated as earnings for a particular tax year.[25]

Since this section only applies for the purposes of Chapter 4, it has to be repeated verbatim in s.29 ITEPA for Chapter 5. (If there had been an ITEPA-wide definition the duplication would not have been necessary.)

This is only intended to set out the natural meaning that would have applied in the absence of a definition. EN ITEPA Note 6 provides:

> Sections 16 and 29 of the Act therefore spell out that general earnings are "for" a particular period consisting of the whole or part of a tax year if they are general earnings earned in or otherwise in respect of that period. It is thought that this reflects the meaning that a court would give to "for" if the point ever arose.

The EI Manual provides:

EIM40008. The year that earnings are "for" [Nov 2019]
... This question has no relevance when deciding the tax year in which the tax charge arises. Earnings are assessed to tax in the tax year in which they are "received". The definition of "received" is set out in Section 18 (see EIM42200).

[25] This is a reference to s.72(2) ITEPA; see too s.222(2) ITEPA and 223(4) ITEPA for definitions in specialist circumstances.

Why is it important to know the tax year that earnings are "for"?

Section 16 establishes the year that earnings are "for". Once this has been done, the next step is to decide which of the rules in Part 2 Chapters 4 and 5 apply to calculate taxable earnings.

For the majority of UK Resident and Ordinarily Resident (R/OR)[26] and domiciled employees, the question of the year earnings are "for" has little consequence. This is because all of their earnings are chargeable to UK income tax in consequence of their residence and domicile status. In addition, most earn and receive their earnings in the same tax year. However, for those employees who are other than R/OR and UK domiciled and who receive earnings in different years from those in which they earn them, the question continues to be relevant.

Principles from case law

The absence of statutory provision in ICTA 1988 and earlier enactments resulted in various cases being litigated through the 20th century.

- *Edwards v Roberts* (19 TC 618)
- *Hunter v Dewhurst*, (*Henry v Foster*) (16 TC 605)
- *Draycup v Radcliffe* (27 TC 188)
- *Heasman v Jordan* (35 TC 518)
- *Board of Inland Revenue v Suite* ([1986] 2 All ER 577)
- *Griffin v Standish* (67 TC 317)
- *Bray v Best* (61 TC 705)

Before 1989, the year that earnings were "for" also dictated the year in which income tax was assessed. "Receipts basis" replaced "earnings basis" in 1989.

The case of *Bray v Best* (61 TC 705), was heard by the House of Lords in 1988. Lord Oliver set out the preferred approach at page 752:

> "The period to which any given payment is attributed is a question to be determined as one of fact in each case, depending upon all of the circumstances, including its source and the intention of the payer so far as it can be gathered either from direct evidence or from the surrounding circumstances."

Lord Oliver's approach to determining the year that earnings are "for" continues to apply. Section 16 simply confirms the recommended approach.

EIM40009. The year that earnings are "for" - arrangement of guidance [Nov 2019]

In 2007 and 2008, HMRC consulted with professional advisers with particular expertise regarding the treatment of foreign nationals coming to work in the UK and UK residents leaving the UK to work abroad. Many of the advisers' clients have complex remuneration packages. Some are members of Long Term Incentive Plans or participants in other deferred remuneration schemes. The aim of the exercise was to establish principles for determining the tax year that earnings, delivered by these arrangements, are "for".

The guidelines set out on the following pages were adopted by HMRC with effect from 28 February 2008. They are intended to be comprehensive but do not claim to cover every plan and set of circumstances that will arise.

... The guidance sets out general principles and indicates the views HMRC is likely to take in specified circumstances. It is intended to aid and inform fact finding and decision

[26] The Manual has not been revised following the abolition of ordinary residence in 2013, but that does not affect the points made here.

making. It is not a substitute for obtaining all of the relevant information and exercising good judgment by applying the principles to the facts. This is not an easy task as you may be required to balance one set of conditions against others. (This content has been withheld because of exemptions in the Freedom of Information Act 2000)...

EIM40011. The year that earnings are "for" - the approach to take [Nov 2019]

[The Manual repeats the quote from *Bray v Best* set out in EIM 40008 above, and continues;]

Finding out the facts

An essential starting point is to obtain contemporaneous evidence. This may include all or any of the following:

- An understanding of the intention of the employer in developing the incentive programmes
- Bonus plans
- Award letters
- Notes of meetings
- Correspondence between the parties
- Obtain an analysis of amounts paid out
- An explanation of how awards are treated in the employer-company accounts

These documents may indicate the understanding of the parties regarding the performance period that awards are intended to be "for". The intention of the employer as disclosed to the employee and the understanding of the employee are particularly significant.

Unsubstantiated recollections of the employee regarding intention should be considered but given less weight than contemporaneous documented statements.

If plan documents and contemporaneous information do not provide clarity, it's reasonable to make inferences from available evidence.

You may ask the Large Business Team or Customer Compliance Manager dealing with the Corporation Tax affairs of the employer company how the bonus awards have been treated in the employer company accounts. The company may claim a deduction for a single year or may create provisions to spread the deduction over a longer period. This may indicate the period the employer considers the award to be "for". The accounting treatment is not conclusive, but it is significant. In the absence of clear statements in the plan documents the accounting treatment may be evidence of the employer's understanding of what the scheme was intended to achieve.

Lump sums may be made up of amounts arising from different bonus periods and different deferred remuneration plans. If component amounts are "for" different tax years, different rules within Part 2 Chapters 4 and 5 may apply, to produce different liabilities to income tax.

EI,M0012. Annual bonuses awarded for meeting corporate, team or personal targets [Nov 2019]

Many employers operate annual bonus schemes for their employees. There are usually performance criteria. These may require employees to meet corporate, team or individual targets.

Bonuses may be paid out by the employer or through a trust - usually an employee benefit trust (EBT). The identity of the payer is not relevant when determining the year that the award is "for". However, see the guidance below on "discretion".

In some schemes, particularly those referenced to company performance, employees may accrue entitlement to receive bonuses as the performance period passes. In others, entitlement is conditional on remaining in employment until a specified date (see below). The performance period and therefore the period that the bonus is "for" may be set out in the scheme documents.

If the performance period spans more than one tax year, Section 16(4) ITEPA 2003 applies. The bonus should be apportioned to the relevant tax years on the basis of a just and reasonable apportionment.

Section 16 attributes general earnings to one or more tax years. You should not accept that awards can be "for" a shorter period, even a day, to which the rules in Part 2 Chapters 4 and 5 can be applied. Employers may spontaneously award "spot-bonuses" to all employees in post on a particular date, or entitlement to a performance bonus may crystallise when a particular performance factor is satisfied. Even though these events make take place on a particular day, the resultant awards should be treated as general earnings "for" the tax year in which the event occurred.

Unless there is evidence to the contrary, HMRC takes the view that performance bonuses are "for" the performance period. This may be a calendar year or the company accounting period. In the case of specific projects, it may be the period beginning on the date when work started and ending when the specified outcomes were achieved.

Impact of Extra Statutory Concession A11 (ESC A11)[27]

ESC A11 is a non-statutory concession that permits tax years to be split. It is usually relevant to years in which individuals arrive in or depart from the UK. In consequence of arrival or departure, there are discrete periods of non-residence (NR) and ordinary residence (OR) for tax purposes. If the conditions are satisfied, the tax year is split and each part treated as a separate tax year.

Where entitlement to spot bonuses or conditional bonuses arises on a single day the advice set out above indicates that the award is to be treated as earnings "for" the year in which that days falls. In ESC A11 cases this will be that part of the split year in which the relevant day falls.

Evidence suggests spot bonuses and similar payments are relatively unusual and will be seen infrequently. If you suspect that the timing of entitlement has been manipulated to gain a tax advantage from the use of ESC A11, HMRC may decide to set aside the Concession and treat the individual as resident in the UK for the whole tax year. ...

EIM13. Bonuses and deferred remuneration plans - the effect of conditionality and employer's discretion [Nov 2019]

Conditionality

Many bonus schemes are referenced to performance periods, but awards will not be paid unless employees are in employment on the date of payment. For example, a bonus is referenced to company profits for year ended 31 December but is not paid until the following 30 June. Employees who worked for the employer during the performance year forfeit their entitlement if they leave employment before 30 June.

Up to 28 February 2008, HMRC took the view that the bonus award could only be "for" the year in which unfettered entitlement to receive it arose. The year that the bonus was "for" was the year in which the employment condition was satisfied. Since 28 February 2008, HMRC has adopted the principles set out in EIM40008 and subsequent pages.

[27] The Manual has not yet been revised for the 2013 changes which have put the ESC on to a statutory basis, but the general points made here still apply.

Good and bad leavers

Many of the plans with employment conditions identify "good" and "bad" leavers and prescribe different treatments for the 2 categories. "Good leavers" are employees who cease employment before the bonus payment date through retirement, redundancy or ill-health. "Bad leavers" are those who are dismissed for cause or resign to join a competitor.

It's possible to take various views on the year that such bonus awards are "for" where there is an employment condition:

- The performance period
- The performance period plus the period from the end of the performance period to the date of payment, sometimes referred to as the "vesting period"
- The year in which the date of payment falls

Your decision should take account of what the bonus scheme is intended to achieve. If this is not clear from the documents, you may base judgments on how the employer treats good and bad leavers.

Plans that:

- are designed to provide incentives to employees for performance periods, but,
- do not pay out unless the participants are still in employment at the specified date, but,
- do not specify any additional performance conditions in the period beginning after the original performance period and ending on the payment date,

are likely to pay out awards that are "for" the original performance period. However, if the plan introduces additional performance conditions for the second period the period that the award is "for" is likely to be the aggregate of both periods.

If "good leavers" are entitled to receive awards; that may indicate that the awards are "for" the original performance period. Entitlement to pro-rated awards may indicate that entitlement is "for" the performance and the vesting periods.

Some schemes provide for deferred bonuses to be paid out when ownership of the company changes hands. This may be an indicator that the bonus is earned by that date and is "for" the relevant performance period.

Even though these contingencies may not occur for all or any of the plan participants, their existence may shed light on the period the bonus is intended to be "for".

It is sometimes argued that the employment condition is never just about being in employment on the specified date; that the intention of the employer in introducing this condition is to obtain satisfactory performance in the period ending on the date of payment. This may well be the case. If evidence can be found to support the contention you should accept that the period the awards from the plan are "for" is the combined performance and vesting periods.

Employers' discretion

Some bonus schemes give the employer absolute discretion to award or refuse to award bonuses. The discretion may lie with the trustees if an Employee Benefit Trust (EBT) pays out the awards. The courts have held that, whatever the plan says, an employer's discretion in awarding or withholding a bonus is not unfettered. However wide the discretion appears to be, the employer is required to exercise his discretion rationally and in good faith, and not irrationally or perversely.

There may be a pattern of awards that may indicate the year the awards are "for". Employees may also have an understanding of how the bonus scheme works, and the period awards are referenced to, while accepting the employer's discretion.

A discretionary bonus may therefore be "for" the performance period, the combined performance and "vesting" period or the year in which discretion is exercised and payment is made. It is important to consider all of the relevant information.

EIM14. Long Term Incentive Plans and Deferred Remuneration [Nov 2019]

Various schemes exist to reward and provide incentives to employees. Not all intended outcomes will be the same. The intention of the employer and the intended behavioural effect will influence the design of the scheme. For example, plans may be intended to:

- Tie-in valued employees and create a disincentive for leaving and moving to a competitor, or,
- Motivate and reward outstanding performance by aligning the interests of employees with those of the shareholders

Schemes intended to aid retention may include the following features:

- Bonuses are paid after 3 – 5 years of satisfactory employment
- The employer has discretion to award or deny bonuses for good or bad leavers
- Part bonuses are paid year on year with other entitlement remaining in the Plan
- Part entitlement to bonuses "vests" each year, but is not paid until a later year

Schemes intended to motivate and reward outstanding performance may include:

- Employment targets linked to growth in the company's:
  - share price
  - turnover
  - net profits
  - expansion of certain markets
  - market share
- Granting employees real stocks and shares or "phantom" shares in the company. (In the phantom schemes, no stocks or shares are assigned to the employees. Bonus entitlement is calculated by reference to a notional share portfolio.)

Payments may be made up of amounts arising from different bonus periods and different deferred remuneration plans. If component amounts are "for" different tax years, different rules within Part 2 Chapters 4 and 5 may apply, to produce different liabilities to income tax.

Awards from both types of schemes are likely to be "for" the whole performance or reference period. If this is greater than one tax year then the final award should be apportioned over the tax years falling into the performance period on a reasonable basis.

EIM15. The year that awards from Long Term Incentive Plans and other deferred remuneration arrangements are "for" [Nov 2019]

Entry to Long Term Incentive Plans (LTIPs)

If employees perform exceptionally well, they may be invited to participate in an LTIP. LTIPs run for pre-determined period that can be as long as 10 years. This process may repeat year after year so that employees are simultaneously members of several Plans. In any particular year they may receive part awards from some and entire awards from others.

The initial investment is often funded by part of the participant's bonus for the previous year. The employee may be obliged to defer all or part of the previous year's bonus or may do so voluntarily. Plans may require a mixture of the two. The initial contribution may be guaranteed, in the sense that it cannot be lost, and/or it may have the potential to increase and decrease dependant on what the Plan tracks, for example, share price or company turn-over.

Other plans, particularly phantom share schemes, may simply award notional stock without any requirement for deferral from an earlier bonus.

In addition to the anticipated growth in the share price that adds value to the participants' awards, employers may make additional awards of stock to increase the value of the notional portfolio. These "matching awards" may be granted throughout the life of the scheme at times specified in the plan document.

Deferred bonuses and matching awards

Employers may defer the payment of bonuses and make eventual payment subject to conditions. For example, the employer awards a bonus of £100,000 referenced to a performance period. £75,000 is paid in cash immediately following the bonus year; £25,000 is to be paid three years later in cash or shares, if the employee has not resigned or been dismissed before the vesting date. Such a deferral may be imposed by the employer, or it may be entered into voluntarily by the employee. To develop the example, the £25,000 deferral may be required by the employer but the employee has the choice of voluntarily deferring a further £25,000. In both scenarios, the employer may offer an enhancement or matching award. The matching award may be delivered in the form of shares or cash. The matching award may be added to the LTIP at the beginning of the period. Additional matching awards may be added at specified dates during the deferral or vesting period.

What year are LTIP awards "for"?

It is important to consider all of the relevant facts. The deferred bonus may be "for" the original bonus year, or for the whole deferral period. If there is particular emphasis on the employee remaining in service at a future date, it may be for the tax year in which that condition is met. However, this feature is unlikely to exist in isolation as the employer wants to motivate the employee to perform well while remaining in employment. In order to determine the period that the deferred bonus is "for", it is necessary to consider all of the relevant information and weigh the emphasis given to each factor.

In general terms, simple deferred bonuses will remain earnings for the original bonus period, and growth or matching awards will be "for" the deferral period. In more sophisticated schemes where the deferred bonus is "awarded" and "vests" after the bonus year, and especially where there are further performance conditions relating to this period, the deferred bonus may be earnings for the period between award and vest.

There may also be circumstances where "growth" in the value of the fund is treated as being "for" the performance period of the original deferred bonus. This view is likely where no additional performance criteria are imposed during the deferral period or, if there are, the conditions are the same as for the deferred bonus.

If the conditions are significantly different, e.g. the matching awards are conditional upon new performance criteria, the "growth" or matching awards are likely to be "for" the deferral or vesting period itself.

If the conditions of the matching award are referenced solely to the employee remaining in employment on the vesting or payment date in order to receive payment, the matching award is likely to be earnings for the tax year in which entitlement to receive the award matures.

Enhancements or matching awards may be paid out of LTIPs at the same time as deferred bonuses. Awards may be aggregated amounts that are "for" different periods. It is important to understand how sums are calculated and whether different performance periods should be considered.

> **EIM16. Long Term Incentive Plans and Deferred Remuneration – staged vesting** [Nov 2019]
> Some Long Term Incentive Plans (LTIPs) pay out awards in tranches. The details of different schemes will vary. For example, an LTIP fund containing deferred bonuses and matching awards may pay out 20% per annum over five years or nothing in Years 1 and 2 and 33% per annum in Years 3 to 5. Entitlement may be conditional upon participants meeting performance conditions and remaining in employment.
> The period that each tranche is "for" has to be determined. If the evidence shows that the Plan is intended to reward performance over the period from award to vest, each part of the final payment is "for" the period from the original award date until it vests, calculated as per Section 16(4) on a just and reasonable apportionment. In the first example, 20% is "for" Year 1; 20% is "for" Years 1 and 2, and so on. Alternatively, if there are no performance conditions and the Plan emphasises being in employment at each vesting date, each payment may be treated as earnings "for" the tax year of receipt.

34.11 Pre/post-employment earnings

There are special rules for pre-commencement and post-cessation earnings. Section 17 ITEPA provides:

> (1) This section applies for the purposes of this Chapter in a case where general earnings from an employment would otherwise fall to be regarded as general earnings for a tax year in which the employee does not hold the employment.
> (2) If that year falls before the first tax year in which the employment is held, the earnings are to be treated as general earnings for that first tax year.
> (3) If that year falls after the last tax year in which the employment was held, the earnings are to be treated as general earnings for that last tax year.
> (4) This section does not apply in connection with determining the year for which amounts are to be treated as earnings under Chapters 2 to 11 of Part 3 (the benefits code).

Since this section only applies for the purposes of Chapter 4, it has to be repeated verbatim in s.30 ITEPA for Chapter 5.

The EI Manual provides:

> **EIM40005. Special rules for determining the year that general earnings are "for": Pre-commencement and post-cessation earnings** [Nov 2019]
> ...
> It's unlikely the rules will often apply in practice because general earnings can normally be attributed to periods in which the job is held.

> **EIM40006. Effect of non-residence on pre-commencement and post-cessation earnings** [Apr 2015]
> Where the special rules in [s.17 ITEPA] EIM40005 apply, instead of being taxable when they are received, general earnings will be taxable in the last or first year the taxpayer held the job if the provisions in sections 15 or 27 apply.
> ...
> **EIM40007. Effect of non-residence on pre-commencement and post-cessation earnings: Examples** [Nov 2019]
> This page provides examples of how the above sections apply. ...

The first example concerns pre-commencement earnings of an employee who is resident and domiciled throughout:

> ***Example 1***
> An employee is approached by another employer. She is offered a job by the new organisation. As an inducement to change jobs she is paid £50,000 on 1 April 2013. She commenced work for the new employer on 1 May 2013. The employee is resident and domiciled in the UK so the relevant charging provision is Section 15 in Part 2 Chapter 4.
> Section 17 operates to make the payment earnings of the year in which the employment commences. Even though paid in tax year 2012/2013 they are earnings "for" the year 2013/2014.

The Manual then considers whether domicile makes any difference:

> The result will be the same if the employee is resident but not domiciled in the UK.

It is assumed that the earnings are not chargeable overseas earnings.[28] The Manual now considers someone becoming UK resident:

> ***Example 2***
> An employee worked in Singapore for many years for a UK resident company. The employment ceased on 31 December 2012. For 10 years prior to that date the individual was not resident and not ordinarily resident although domiciled in the UK. On 6 April 2013 the employee returned to the UK. From the date of arrival he became resident.
> 6 months after the job ended the employer made a payment of £50,000 to the former employee in recognition of the contribution he had made to the expansion of business in the Far East.
> Section 17 makes the payment earnings of the year in which the

[28] See 34.13 (COE remittance basis).

employment was last held, 2012-2013. In that year the employee was not resident in the UK and performed all of the duties in Singapore. In consequence, the payment does not fall into any of the charging provisions in Part 2 Chapters 4 and 5 and is therefore not chargeable to tax as general earnings.

34.12 UK resident/dom employee

Section 15 ITEPA provides:

> (1) This section applies to general earnings for a tax year for which the employee is UK resident ...[29]
> (2) The full amount of any general earnings within subsection (1) which are received in a tax year is an amount of "taxable earnings" from the employment in that year.
> (3) Subsection (2) applies whether or not the employment is held when the earnings are received.

Section 15 sets out the general rule: in short, earnings of a UK resident are "taxable earnings", taxed on receipt, on an arising basis.

"Receipt" is defined in ss.18, 19 ITEPA (not discussed here).

The s.15 rule has two exceptions:

(1) COE remittance basis[30]
(2) Overseas Workday Relief[31]

34.12.1 *Employment income: Split year*

Section 15(1)(1A) ITEPA need to be read together:

> (1) This section applies to general earnings for a tax year for which the employee is UK resident except that, in the case of a split year, it does not apply to any part of those earnings that is excluded.
> (1A) General earnings are "excluded" if they—
> (a) are attributable to the overseas part of the split year, and
> (b) are neither—
> (i) general earnings in respect of duties performed in the UK,[32]

[29] The omitted words deal with split years and are considered below.

[30] See 34.13 (COE remittance basis).

[31] See 34.22 (Overseas Workday Relief).

[32] Defined by reference: Section 15(5) ITEPA provides:
"The following provisions of Chapter 5 of this Part apply for the purposes of subsection (1A)(b) as for the purposes of section 27(2) ...
(b) sections 38 to 41 (which contain rules for determining the place of performance of duties of employment), and

> nor
>
> (ii) general earnings from overseas Crown employment subject to UK tax...[33]

Section 15(4) ITEPA deals with attribution:

> Any attribution required for the purposes of subsection (1A)(a) is to be done on a just and reasonable basis.

34.13 COE remittance basis

This section considers the chargeable overseas earnings (COE) remittance basis, which is the first of the two remittance bases which may apply to earnings of a UK resident foreign domiciled individual.[34]

Section 809F ITA provides:

> (1) This section applies if section 809B, 809D or 809E applies to an individual for a tax year.
> (2) The individual's relevant foreign earnings for that year are charged in accordance with section 22 or 26 of ITEPA 2003.

So we turn to s.22 ITEPA which (somewhat repetitively) provides:

> (1) This section applies to general earnings for a tax year, to the extent that they are chargeable overseas earnings for that year, if—
>
> (a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the employee for that year, and
>
> (b) the employee does not meet the requirement of section 26A [recent arrival] for that year.

The point of para (b) is that Overseas Workday Relief (which is more generous) has priority, if it applies.

> (2) The full amount of any general earnings within subsection (1) which are remitted to the UK in a tax year is an amount of "taxable earnings" from the employment in that year. ...

(c) section 41ZA (which is about determining the extent to which general earnings are in respect of UK duties)."

[33] Defined by reference: Section 15(5) ITEPA provides:
"The following provisions of Chapter 5 of this Part apply for the purposes of subsection (1A)(b) as for the purposes of section 27(2)—
(a) section 28 (which defines "general earnings from overseas Crown employment subject to UK tax")"
See 34.40 (Overseas Crown employment).

[34] See 34.8 ("Taxable earnings").

In short, the remittance basis applies to chargeable overseas earnings. Section 22(7) ITEPA provides:

> Section 15(1) does not apply to general earnings within subsection (1).

Thus earnings which are not chargeable overseas earnings continue to fall under the s.15 arising basis.

34.13.1 *Pre-2008 earnings*

Suppose:

(1) Chargeable overseas earnings accrue to T before 2008/9 and
(2) The earnings are remitted in 2008/9 or later (when T is still resident).

In the absence of a transitional rule, the earnings would not be taxable under s.22 ITEPA because the condition in s.22(1)(a) would not be met. Sections 809B, 809D or 809E did not apply before 2008. Para 82(2)(a) Para 82 sch 7 FA 2008 fills that gap:

> (1) This paragraph applies in relation to an individual's general earnings for the tax year 2007–08 or any earlier tax year ("the relevant tax year") if the individual—
> (a) was UK resident in that year, but
> (b) was not domiciled in the UK, or was not ordinarily UK resident, in that year.
>
> (2) Section 22 or 26 of ITEPA 2003 (as amended by this Part of this Schedule) applies in relation to the general earnings as if—
> (a) section 809B of ITA 2007 (claim for remittance basis to apply) applied to the individual for the relevant tax year and
> (b) section 22(7) or 26(6) of ITEPA 2003 were omitted.

I think para 82(2)(b) is misconceived, though it does no harm.

34.14 Chargeable overseas earnings

The expression "chargeable overseas earnings" is a label which brings in two sets of requirements: the earnings must be "overseas" earnings and they must be "chargeable". The key part of the definition is "overseas earnings".

34.14.1 *"Overseas" earnings*

Section 23(2) ITEPA provides:

> General earnings for a tax year are "overseas earnings" for that year if—

> (a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the employee for that year,
> (aa) the employee does not meet the requirement of section 26A [recent arrival] for that year,
> (b) the employment is with a foreign employer, and
> (c) the duties of the employment are performed wholly outside the UK.

34.14.2 *"Chargeable" overseas earnings*

The concept of "chargeable" overseas earnings brings in rules for deductible expenses and associated employments. Section 23(3) ITEPA provides:

> (3) To calculate the amount of "chargeable overseas earnings" for a tax year—
> *Step 1*
> Identify—
> (a) in the case of a tax year that is not a split year, the full amount of the overseas earnings for that year, and
> (b) in the case of a split year, so much of the full amount of the overseas earnings for that year as is attributable to the UK part of the year.
> *Step 2*
> Subtract any amounts that would (assuming they were taxable earnings) be allowed to be deducted from the earnings identified under step 1 under—
> (a) section 232 or Part 5 (deductions allowed from earnings),
> (b) sections 188 to 194 of FA 2004 (contributions to registered pension schemes), or[35]
> (d) section 262 of CAA 2001 (capital allowances to be given effect by treating them as deductions from earnings).
> *Step 3*
> Apply any limit imposed by section 24 (limit where duties of associated employment performed in UK).
> The result is the chargeable overseas earnings for the tax year.

Section 23(4) ITEPA provides:

> Any attribution required for the purposes of step 1 or step 2 in subsection (3) is to be done on a just and reasonable basis.

[35] Para (c) has been deleted.

34.14.3 *Pre-2008 earnings*

Suppose earnings accrue before 2008/09. At first sight the earnings cannot be "chargeable overseas earnings" within the definition of s.23(2) ITEPA since they do not meet the condition in s.23(2)(a): section 809B, 809D, or 809E did not apply before 2008/09. Moreover, para 82 which fills that gap in s.22 does not fill the gap in s.23. Construed strictly, therefore, pre-2008 earnings which were not remitted before 6 April 2008 have fallen out of charge!

However, I expect that the courts will to strive to construe the section avoid that result. After all, it is obvious (and para 82 confirms) that this result was not intended. One way to do that is to say that if income arises before 2008, the question of whether it constitutes chargeable overseas earnings is to be decided by reference to the legislation in the year that it arises and not the legislation in the year that it is remitted. It has to be said that para 82(3) sch 7 FA 2008 would not then be necessary. The alternative is to read para 82(2) as if it applied to s.23 as well as to s.22 and 26. Neither of these solutions is comfortable reading, but the conclusion that all pre-2008 earnings fall out of charge seems even worse. This is only one of many infelicities in the 2008 legislation: but a modern court will strive to make it work.

34.15 Foreign employer

Section 23(2) ITEPA provides:

> General earnings for a tax year are "overseas earnings" for that year if ...
> (b) the employment is with a foreign employer...

The definition is in s.721(1) ITEPA:

> "foreign employer" means an individual, partnership or body of persons resident outside the UK and not resident in the UK.

EI Manual provides:

> **EIM40106 Calculation of Chargeable Overseas Earnings - Section 23 ITEPA 2003** [Nov 2019]
> *Practical issues*
> An employee may maintain that general earnings are chargeable overseas earnings taxable on remittance under section 22 rather than on receipt ... This is likely to lead to a significant reduction in the amount of taxable earnings. You should examine the facts closely before accepting that earnings are chargeable overseas earnings within section 22. In particular

> you should find out whether the employer has any place of business in the UK.

While tax rules often turn on whether a person is resident in the UK, it is rare to see a requirement that they must be resident outside the UK.[36] It is suggested that this should be removed so that the only requirement is that the employer is non UK resident. It should not matter whether or not they are resident elsewhere. In practice I doubt it is possible to be non UK resident without being resident outside the UK, so this simplification makes no practical difference and has no cost implication.

34.16 Incidental duties in UK

Section 23(2) ITEPA provides:

> General earnings for a tax year are "overseas earnings" for that year if ...
> (c) the duties of the employment are performed wholly outside the UK.

Section 39 ITEPA qualifies "wholly" oustide the UK:

> (1) This section applies if in a tax year an employment is in substance one whose duties fall to be performed outside the UK.
> (2) Duties of the employment performed in the UK whose performance is merely incidental to the performance of duties outside the UK are to be treated for the purposes of this Chapter as performed outside the UK.

In short, UK duties may be ignored if they are "merely incidental". What are incidental duties? HMRC guidance is in:

(1) A paper entitled "Dual contracts: record keeping, enquiries, completion of Self Assessment Returns and interpretation of 'merely incidental' duties" the **("HMRC dual-contracts paper")**.[37]

(2) EI Manual:
   (a) EIM 40203 (Aug 2012), EIM 40204 (Aug 2012): this is a shorter version of the material in the HMRC paper, so it is not set out here.
   (b) EIM77030: this was withdrawn in February 2016 but some aspects are discussed here as it may still reflect HMRC practice.[38]

[36] For an exception, see 48.6 ("Resident outside the UK").

[37] (2012) *https://www.gov.uk/government/publications/dual-contracts*

[38] An earlier version of the text was in Tax Bulletin 76 (also classified as RI 273). See Ladkin, "Domicile: Working at Home and Abroad" Taxation Magazine, 27 March 2003, p.632.

The HMRC dual-contracts paper provides:

> **Background to the exception for merely incidental duties**
> 15. The Royal Commission Report [on the Taxation of Profits and Income][39] published in 1955 stated (paragraph 300)
>
> *"We recommend that work is not the less to be treated as performed wholly in one country because certain* ***merely incidental duties,*** *such as returning for report, to acquire samples, etc., are carried out in another."*
>
> 16. [HMRC set out s. 11(3) FA 1956, now s.39 ITEPA, and continue:]
> 17. However, the term "merely incidental" duties was not defined in FA1956 or in subsequent legislation. Following a common dictionary definition of "incidental", as something that is minor, casual or subordinate in nature, the Inland Revenue (as it was at the time) considered that a duty that formed part of the essential or fundamental requirements of the employment could not be incidental.
> **Robson v Dixon (48 TC 527)**
> 18. This is the only case where the courts have considered the meaning of "merely incidental" duties. It was decided in the High Court in 1972 and concerned section 10 and 11 of the FA 1956. Mr Robson was an airline pilot who lived in the UK but commuted to work in Amsterdam, where he was employed by a Dutch airline.
> 19. Robson flew aircraft on scheduled flights from Amsterdam to various parts of the world, mainly North and South America. None of the flights in the years under appeal commenced in the UK but of 811 take-offs and landings, 38 were made in the UK of which 16 were charter flights, which were outside his normal duties (he made in total only 22 charter flight landings and take-offs).
> 20. Robson contended that as his duties were performed substantially outside the UK, any duties in the UK were therefore merely incidental to his substantive duties abroad. Pennycuick VC disagreed –
>
> *"The expression "merely incidental" is a striking one, and effect must be given to the natural meaning of the words. The words "merely incidental to" are upon their ordinary use apt to denote an activity (here the performance of duties) which does not serve any independent purpose but is carried out in order to further some other purpose.*
>
> The judge set out the duties performed by Robson and went on:
>
> *In the present case, the duties performed by the taxpayer, apart from his duties on the ground at Schiphol, mainly consisted (putting it shortly) of taking a plane up at Schiphol, flying it to whatever its destination was and then bringing it down. In the case of the flights from Schiphol to some destination (normally in America) on which there was a stop at England, his duties consisted of taking the plane up at Schiphol, flying it to England, bringing it down at Heathrow or elsewhere, and then taking it up again and flying it again to the next destination, in America. With the best will in the world, I find it impossible to say that the activities carried on in or over England are merely incidental to the performance of the comparable activities carried on in or*

[39] Cmd 9474.

> *over Holland or in or over the ultimate destination, in America. The activities are precisely co-ordinate, and I cannot see how it can properly be said that the activities in England are in some way incidental to the other activities. Going back to the words of the section, when one asks, 'What exactly are the other duties outside the UK to which the performance of the duties are incidental?', no satisfactory answer can be given. The other duties are simply co-ordinate duties.*

21. Pennycuick was clear as well that the test of "merely incidental duties" is one of quality not quantity –

> *"Again, I think it is impossible to construe s 11(3) in the way in which it was sought to construe it in the taxpayer's contentions in the case stated, as indicating merely relatively short periods of employment in the UK in relation to the period of employment outside the UK. It would have been quite simple for the section so to provide; and it may well be that if the condition were imported only by the expression 'in substance', that would be the result. But the second requirement is expressed in quite different terms and cannot, I think, be treated as referring merely to what has been described as a quantitative, in contra-distinction to a qualitative, basis. ...*
>
> *It would be tempting to say that all the duties performed by a pilot are incidental to the purpose of transporting passengers from one place to another, but that approach clearly would not help here. What has to be shown is that the particular duties in the UK are incidental to the performance of other particular duties outside the UK."*

22. Consequently duties performed in the UK that are the same or similar in nature to those performed overseas are not merely incidental to the overseas duties, even if performed for only a very short time. They are, in Pennycuick's words, "precisely co-ordinate" and therefore of equal importance to the duties performed overseas.

Tax Bulletin 76

23. Inland Revenue published a Tax Bulletin article in April 2005 titled "Non-domiciled employees: dual contract arrangements" which referred to a range of issues relating to dual contract arrangements, including "merely incidental" duties and to the decision in *Robson v Dixon*.

24. TB76 explained that given the ease and speed of twenty first century communications, an employee who performs duties of one employment overseas and another in the UK, is liable to find it increasingly difficult whilst working in the UK to avoid performing substantive duties of their overseas employment. For example, HMRC take the view that an employee working in the UK under a UK contract to service the needs of UK clients, but also responsible under their overseas contract for servicing the business needs of overseas clients, who responds to a telephone call or email from an overseas client performs a substantive duty of the overseas employment. A response sent from the UK to an overseas client, is no different from a response sent from abroad to the same client. It represents a "precisely co-ordinate" duty.

Statement of Practice A10 – de minimis

25. In *Robson v Dixon*, Inland Revenue accepted that a landing in the UK caused by an emergency (e.g. due to weather conditions or mechanical trouble) might be

regarded as incidental to duties performed outside the UK.

26. After the decision was handed down, counsel for Robson asked if the de minimis principle could apply to one of the years under appeal in which Robson completed only one take-off and landing in the UK. Despite his decision that the test of "merely incidental" duties was one of quality and not quantity, Pennycuick agreed that this would be "proper" for a single event in a year. SP A10 was published in 1975 as a response to Pennycuick's comments.[40]

> *"Where only a single take-off and landing in this country occurred in a year, the Inland Revenue will normally disregard this on de minimis grounds in considering whether any duties were performed in this country."*

27.However, in another year, in which Robson performed four take-offs and landings in the UK (two for emergencies, plus two others for unspecified reasons) the Judge declined to accept the request for a de minimis exclusion.

Director - duties never merely incidental

28. The general principle in relation to a company director is that the management of a company is vested collectively in the board of directors. Therefore when a director attends a meeting of the board, HMRC takes the view that he or she performs a fundamental duty which is not "merely incidental" to other duties.

29. Consequently a director who in substance performs his duties overseas, except for visits to the UK to attend a meeting (whether as part of a formal board meeting or otherwise) cannot, in the view of HMRC, be within the exception in s39 [ITEPA]. Attendance at board meetings is part and parcel of a director's core duties and therefore if performed in the UK cannot be incidental to duties performed abroad. A director's attendance at other meetings (e.g. finance, strategy, personnel) is also likely to represent a substantive duty, because the director would not attend these meetings unless participation was deemed necessary.

[Para 30-32 discuss the former s.830 ITA; this concerns residence, not employment income.

Examples of duties that are "merely incidental"

33. To determine whether duties performed in the UK are "merely incidental" to duties performed overseas, it is necessary to consider both the nature of the duties performed in the UK and their relationship to the duties performed abroad.

34. Ultimately each case will depend on its particular facts but the types of activities, if performed in the UK in relation to the duties of an overseas employment, which can be regarded as "merely incidental" duties include –

- arranging meetings and business travel;
- feedback on employee performance and/or business results, if this does not involve the employee concerned in preparation or analysis whilst in the UK and as long as responsibility for these matters is not part of the employee's core duties of employment;
- input to team restructuring and staff matters, provided that the employee does not have a management role; and

[40] Author's footnote: SP A10 is now officially withdrawn; but there has been no announcement that HMRC adopt a different practice, and in view of its origin in the judge's comments, it is likely that it will continue. That will no doubt

- reading generic business emails that do not relate directly to the employee's role/responsibilities.

35. The examples below illustrate some situations where duties are regarded by HMRC as "merely incidental" -

A. A junior employee who works for an overseas subsidiary of a UK company who, on occasional visits to the UK headquarters, presents a report prepared by the overseas business to report on trade conditions or results overseas, and/or receive instructions for the next tour of duty overseas. The employee performs no other duties in the UK and has no control over the overseas activities on which he reports and is required only to pass on the report from his overseas employer and to take instructions from the UK company to take back to the overseas employer. These duties are regarded as "merely incidental" to his overseas duties.

B. An overseas employee visits the UK and whilst here arranges a meeting with a client overseas and the associated travel. As long as the employee does no more than arrange the meeting and travel, the duties performed are regarded as "merely incidental".

C. Whilst in the UK, an employee of an overseas subsidiary receives an email documenting the employer's global business results for the year. The employee is provided with the results for his information and is not required to take any further action or feedback to the sender of the email. The reading of such an email is "merely incidental" to those duties performed overseas. However, if the employee had any role or responsibility in producing the global results, and/or was involved in feedback or in confirming the results, reading the email is not a "merely incidental" duty.

Examples of duties that are not "merely incidental"

36. Types of activities performed by an employee that are not regarded as "merely incidental" duties include -

- instructions and/or guidance to colleagues and/or team members;
- work carried out on issues or projects that do not come to fruition;
- reporting on performance/business results where these matters are part of the employee's core duties;
- analysis of reports/information with the intention to produce results/recommendations that can be reported upwards in the organisation;
- preparation work carried out prior to discussions, meetings or presentations with customers/clients, colleagues, board members or shareholders and follow-up work after such discussions, meetings or presentations;
- discussions and meetings (including by telephone, teleconference or video conference) with customers/clients, colleagues, board members or shareholders; and
- applying generally expertise in any role or function which the employee is contracted to perform in his or her duties for the employer.

37. The examples below illustrate some situations where duties are not "merely incidental" -

A. A courier for a tour operator visits many countries in the course of the employment. Visits to the UK, however few and however short, are of the same nature to the job as visits to other countries and therefore cannot be "merely incidental".

B. Preparation in advance of a presentation to, and/or a meeting/discussion with, customers or potential customers, or actions subsequently which result from decisions taken in the presentation or meeting/discussion are not merely incidental to other duties, as preparation in advance and follow-up work afterwards are essential to an employee's effective participation in a presentation and/or meeting/discussion.

C. A company director, who works overseas for a UK based multinational company, usually participates by video conference in board meetings held each month in the UK. However, sometimes the director visits the company headquarters in the UK and attends in person at monthly board meetings. As attendance at board meetings is a core function and fundamental joint duty of a board of directors to manage the company, attendance at a board meeting cannot represent "merely incidental" duties, regardless of the fact that the director does not normally attend the meeting in person.

D. A company director who is resident in the UK has two directorships within the same overseas based group. One role is as CEO of the UK subsidiary and the other as a board member of the overseas parent company. The parent company's board meetings are held monthly in the overseas location and the director usually attends in person. However, sometimes he participates in the board meetings by telephone or video conference from the UK. As attendance at board/directors' meetings is a fundamental and joint duty of a board of directors to manage the company, participation from the UK in the parent's board meetings can not be "merely incidental" to duties performed overseas.

E. An employee of an international bank based in Frankfurt, visits a UK branch of the bank. Whilst in the UK branch, the employee responds to an investment enquiry sent by email from a customer of the bank in Germany. This represents a duty of his employment in Germany and by answering the email from the UK he performs a duty that is "precisely co-ordinate" with his duties in Germany. Consequently this cannot be a "merely incidental" duty.

Merely incidental duties: HMRC policy

38. Over more than half a century since the Royal Commission Report was published in 1955 and the introduction of the term "merely incidental" duties in FA1956, working arrangements have changed considerably.

39. At that time it was unusual for one employee to perform duties of two or more employments in different countries. Where such arrangements existed, there was likely to be a physical separation of duties between the two roles because of the restricted availability of effective international communications.

40. Clearly that is no longer the case but should the enormous advances in communications which allow an employee now to perform duties of an overseas employment and an UK employment consecutively, if not concurrently, be sufficient reason for HMRC to change its interpretation of, and policy for, "merely incidental" duties? The Royal Commission provided the example of a junior employee working in one country, returning to another country to report or to collect samples, as the type of duties that it considered should be "merely incidental". These duties would be still regarded as such today – see Example A in paragraph 35 above.

41. On the other hand, where duties performed in the UK are the same as, or

> similar to, duties performed overseas, they cannot be "merely incidental" because they are "precisely co-ordinate" duties.
> 42.HMRC accepts that it may be difficult in some circumstances for an employee to avoid performing co-ordinate duties unless, for example, the employee declines whilst in the UK to answer a mobile telephone, or respond to an email, from an overseas client.
> 43. However, to apply a broader interpretation of "merely incidental" to duties performed in the UK, than would apply otherwise to similar duties performed overseas, in HMRC's view would be not consistent with the Royal Commission in 1955, the case law in *Robson v Dixon* or the legislation.
> 44. Consequently HMRC does not believe there is good reason to revise its interpretation of"merely incidental" duties set out in the Tax Bulletin in 2005 and reiterated in this paper.

It is in practice just about impossible for a UK resident to satisfy the "incidental duties" requirement if it is understood in this way. Through the rigorous statutory interpretation of *Robson v Dixon,* HMRC have (more or less) achieved an arising basis for employment income which, in everyday language, is income of an overseas employment and so foreign income.[41]

This rule applies even though presence in the UK is due to Covid.[42]

If that is the policy, it would be sensible to repeal the COE remittance basis, which would be a simplification.

34.16.1 *Contract not to work in UK*

EIM formerly provided:

> **EIM77030 Appendix 3: Non domiciled employees: Dual contract arrangements** [Nov 2019]...
> Where the commercial reality shows the existence of separate employment contracts, it is sometimes argued that contractual terms that prohibit the performance in the UK of duties connected with the business of the overseas employer, preclude HMRC offices from arguing that the employee has performed duties of the overseas employment in the UK. These arguments are based on the UK duties being "ultra vires".
> HMRC does not consider that the presence of such clauses allows the

[41] A similar process applied to bring foreign trading income on to the arising basis: see 21.4 (UK resident trader: IT). On the meaning of "incidental" see too *HMRC v Dolphin Drilling* [2024] EWCA Civ 1.

[42] ICAEW Taxguide 08/21 para 6.4 *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2021/taxguide-0821-covid-19-displaced-expatriate-employees.ashx*

> performance of duties in the UK that clearly benefit the overseas employer to be ignored. To that end, both employers ought to be closely monitoring the employee's UK activities. For example, where the employee has performed substantive duties in the UK that directly benefit the overseas employer, HMRC would expect the UK employer to mark the fact that the employee is effectively abusing its time and take appropriate disciplinary action. And if the UK work in question was valuable, the overseas employer should take it into account when calculating bonus entitlement. It is possible that clauses like this are frequently waived or ignored and may be inserted to create a misleading impression.

This is in principle correct. If the contact of employment formally prohibits UK work, but UK work is done, with the knowledge and tacit consent of the employer, then it is likely that the contract term has been varied by agreement of the parties, and so has no effect.

34.17 Dual contract arrangements

Unless the OWR remittance basis applies, all earnings from an employment with duties performed in and outside the UK are taxable on an arising basis. Prior to 2014, it was common for an employee in this situation to have two employment contracts:

(1) a contract covering the performance of duties in the UK and
(2) a contract covering duties performed outside the UK.

The intention was that earnings from employment contract (2) should be chargeable overseas earnings and therefore taxable on the remittance basis.

34.18 Dual-contract rule

FA 2014 introduced what I call the **"dual-contract rule"**. It will prevent use of dual contracts in most cases. This is perhaps why the lengthy discussion of dual contracts formerly in EIM77030 was withdrawn in 2016.

Development of the rule can be traced through draft legislation, together with a TIIN published in January 2014, but that is now of historical interest only.

HMRC have issued guidance **("HMRC dual-contract guidance")**.[43]

[43] Restrictions on the remittance basis – dual contracts (2014) *https://www.gov.uk/government/publications/remittance-basis-of-taxation-dual-contracts-restrictions-for-foreign-domiciled-employees*

34.18.1 *Relevant employer/employee; UK employment*

It is helpful first to deal with some straightforward definitions. Section 24A(4) ITEPA provides:

> In this section—
> (a) "the relevant employee" means the employee in respect of the relevant employment,
> (b) "the relevant employer" means the employer in respect of the relevant employment, and
> (c) "UK employment" means an employment the duties of which are not performed wholly outside the UK and "UK employer" is to be read accordingly...

34.18.2 *Dual-contract rule*

Section 24A(1) ITEPA provides:

> This section applies in relation to an employment ("the relevant employment") for a tax year ("the relevant tax year") if—
> (a) one or more of the paragraphs in subsection (5) applies,[44]
> (b) conditions 1 to 4 are met, and
> (c) condition 5 is not met.

I refer to **"dual-contract conditions 1 - 5"**.
Section 24A(2) ITEPA provides:

> The consequences of this section applying are set out in sections 23(1A), 41C(4A), 41H(5) and 554Z9(1A).

[44] This will normally be the case. Section 24A ITEPA provides:
(5) The paragraphs referred to in subsection (1)(a) are—
(a) general earnings from the relevant employment which are for the relevant tax year would, apart from section 23(1A) and Step 3 in section 23(3), be "chargeable overseas earnings" under section 23(3);
(b) employment income in respect of the relevant employment which is treated as accruing in the relevant tax year under section 41C(2) would, apart from sections 41C(4A), 41D and 41E, be "foreign" under section 41C(3);
(c) employment income in respect of the relevant employment which is treated as accruing in the relevant tax year under section 41H(2) would, apart from sections 41H(5), 41I and 41L, be "chargeable foreign securities income" under section 41H(3);
(d) section 554Z9(2) would, apart from section 554Z9(1A) and (4) and (5), apply to employment income in respect of the relevant employment which corresponds to the value of a relevant step, or a part of the value of a relevant step, which is "for" the relevant tax year as determined under section 554Z4."

The main rule is in s.23(1A) ITEPA which provides:

> But none of an employee's general earnings from an employment for a tax year are to be "chargeable overseas earnings" if section 24A applies in relation to the employment for the tax year.

This disapplies the remittance basis and brings the earnings back to the arising basis.

Section 24A(3) ITEPA provides a restriction relating to PAYE:

> But, for the purpose of determining if, and the extent to which, any provision of Part 11 (PAYE), or of PAYE regulations, applies in relation to any income, the application of any provision mentioned in subsection (2) in relation to the income is to be ignored.

34.18.3 *Condition 1: UK employment*

Section 24A(6) ITEPA provides:

> Condition 1 is that the relevant employee holds a UK employment—
> (a) at a time in the relevant tax year when the relevant employee also holds the relevant employment, or
> (b) if the relevant tax year is a split year as respects the relevant employee, at a time in the UK part of the relevant tax year when the relevant employee also holds the relevant employment.

34.18.4 *Cond. 2: Associated employer*

Section 24A(7) ITEPA provides:

> Condition 2 is that the UK employer is the same as, or is associated with, the relevant employer.

Section 24A(4) ITEPA provides:

> ...the rules in section 24(5) ("associated" persons) apply for the purposes of this section.[45]

34.18.5 *Cond. 3: Related employment*

The definition of related employment is wide and vague. Section 24A ITEPA provides:

> (8) Condition 3 is that the UK employment and the relevant employment are related to each other.

[45] See 34.21.1 (Associated employment).

> (9) Without prejudice to the generality of subsection (8), the UK employment and the relevant employment are to be assumed to be related to each other if one or more of the following paragraphs applies—
>
> (a) it is reasonable to suppose that—
>
> (i) the relevant employee would not hold one employment without holding the other employment, or
>
> (ii) the employments will cease at the same time or one employment will cease in consequence of the other employment ceasing;
>
> (b) the terms of one employment operate to any extent by reference to the other employment;

HMRC dual-contract guidance provides:

> **When might the terms of employments operate by reference to each other?**
> Employments might operate by reference to each other in lots of different ways, and will depend on the individual circumstances. You should take into consideration the terms of your employment contract, as well as the commercial reality of the relationship between your employments.
> For example, the contracts may take into account hours worked or leave taken under the other contract or may refer directly to duties performed under the other contract. There may be other circumstances in which the employments deal with the same customer or clients, so you will need to consider your individual circumstances.

Section 24A(9) ITEPA continues:

> Without prejudice to the generality of subsection (8), the UK employment and the relevant employment are to be assumed to be related to each other if one or more of the following paragraphs applies...
>
> (c) the performance of duties of one employment is (wholly or partly) dependent upon, or otherwise linked (directly or indirectly) to, the performance of duties of the other employment;

HMRC dual-contract guidance provides:

> **How can the duties of different employments be linked?**
> Generally, employment duties will be linked where one employment's duties enables the other employment duties to be carried out. For example, where an individual carries out research under one

> employment, and under their other employment carries out marketing work made possible by the research. Duties of different employments may be linked in a number of different ways, and will depend on the facts of your individual circumstances.

Section 24A(9) ITEPA continues:

> Without prejudice to the generality of subsection (8), the UK employment and the relevant employment are to be assumed to be related to each other if one or more of the following paragraphs applies...
> (d) the duties of the employments are wholly or mainly of the same type (ignoring the fact that they may be performed (wholly or partly) in different locations);

HMRC dual-contract guidance provides:

> **When might the duties of the employments be of the same type?**
> Where the duties of two or more employments are the same, but the client base or geographical location differs, the duties of the employments are of the same type. For example, marketing under a UK contract to UK clients has duties of the same type to an overseas contract involving marketing to clients in the rest of the world. There may be other circumstances in which the duties of the employments are of the same type, and you will need to consider your individual circumstances.

Section 24A(9) ITEPA continues:

> Without prejudice to the generality of subsection (8), the UK employment and the relevant employment are to be assumed to be related to each other if one or more of the following paragraphs applies...
>
> (e) the duties of the employments involve (wholly or partly) the provision of goods or services to the same customers or clients;

HMRC dual-contract guidance provides:

> **When do employments deal with the same customer or clients?**
> The employments will deal with the same customer or clients where duties are performed in the provision of goods or services to the same customer or client. For example, if you give financial advice to a client under one employment and manage that client’s investments under another employment. This might apply equally to an individual client, a group of clients or a client base. There may be other circumstances in

> which the employments deal with the same customer or clients, and you will need to consider your individual circumstances.

Section 24A(9) ITEPA continues:

> Without prejudice to the generality of subsection (8), the UK employment and the relevant employment are to be assumed to be related to each other if one or more of the following paragraphs applies...
>
> (f) the relevant employee is—
>
> (i) a director (as defined in section 67) of the UK employer or the relevant employer who has a material interest (as defined in section 68) in the UK employer or the relevant employer,
>
> (ii) a senior employee of the UK employer or the relevant employer, or
>
> (iii) one of the employees of the UK employer or the relevant employer who receives the higher or highest levels of remuneration.

The term "senior employee" is not defined; it is a novel concept in tax law (or indeed in any area of the law). HMRC dual-contract guidance provides:

> **What does the term senior employee mean?**
> Whether you are a senior employee will depend on the facts of your case, taking into account your responsibilities and the size, nature and structure of your employer's organisation. HMRC will generally consider that employees involved in higher-level management and decision-making will be senior. For example, the following might be classed as activities of senior employees:
>
> - you are responsible for implementing higher-level or global business strategies
> - you participate in higher-level decision-making relating to management issues, finance, corporate restructuring or governance
>
> These indicators are not intended as a definitive list and you will need to consider your individual circumstances.
>
> **What does higher or highest paid mean?**
> The higher or highest levels of pay refers to the total pay from your UK and overseas employments, and whether your pay level is high relative to other employees in the same group of companies. There is no absolute level of pay that is relevant – rather it is a matter of comparing your overall remuneration from all your related employments to that of your

> fellow employees. HMRC considers that if you would be liable to tax at the additional rate on your combined pay (ignoring personal reliefs like donations to charities), it will be a good indication of an employee who is higher or highest paid. The UK additional rate of Income Tax is the highest rate for the tax year. Follow this link to see the UK's Income Tax rates and taxable bands. Pay includes any amounts which would constitute earnings, an amount treated as earnings or specific employment income.
>
> (10) In subsection (9)(f) references to the UK employer or the relevant employer include references to—
>
> (a) any person with which the UK employer or the relevant employer (as the case may be) is associated, and
>
> (b) if the UK employer or the relevant employer (as the case may be) is a company, the following companies taken together as if they were one company—
>
> (i) the UK employer or the relevant employer (as the case may be), and
>
> (ii) all the companies with which the UK employer or the relevant employer (as the case may be) is associated.

The statute includes a power to amend this by statutory instrument.[46] I am not sure if that is because the drafter did not have complete confidence in this definition, or to anticipate criticism as to its breadth. I do not expect that the power will ever be used.

It is hard to see that many, if any, dual contracts would not be caught by the dual-contract conditions 1 - 3.

34.18.6 *Cond. 4: 65% foreign tax credit*

Section 24A ITEPA provides:

> (13) Condition 4 is that X% is less than Y%.
>
> (14) "X%" is given by the following formula — (C÷I) × 100%
>
> See section 24B for the definitions of "C" and "I".
>
> (15) "Y%" is 65% of the additional rate for the relevant tax year.
>
> (16) The Treasury may by regulations amend this section so as to amend the definition of "Y%".

So we turn to s.24B ITEPA for the definitions of C and I. In short:

C is foreign tax **C**redit.

I is the dual-contract **I**ncome.

[46] Section 24A(11)(12) ITEPA.

In full detail, s.24B ITEPA provides:

> (1) This section applies for the purposes of section 24A(14).
> (2) "C" is the total amount of credit which would be allowed under section 18(2) of TIOPA 2010 (double taxation relief by way of credit) against income tax in respect of all the employment income falling within section 24A(5)(a) to (d) were none of that income to be, as relevant—
> (a) "chargeable overseas earnings",
> (b) "foreign",
> (c) "chargeable foreign securities income", or
> (d) income to which section 554Z9(2) applies.
> (3) For this purpose, assume—
> (a) that all relief is claimed within the applicable time limit given by section 19 of TIOPA 2010, and
> (b) that all reasonable steps are taken to minimise any amounts of tax payable as mentioned in section 33 of that Act.
> (4) "I" is the total amount of all the employment income falling within section 24A(5)(a) to (d).

This takes out cases where the foreign tax rate is 65% × 45% = 29.25%. The effective overseas tax rate will be lower than the headline rate and in practice I expect that few arrangements will be excluded by this condition.

HMRC dual-contract guidance provides a straightforward worked example:

Overseas employment income for duties in country Z	£500,000
Country Z tax paid on overseas employment income for duties in country Z (Foreign Tax Credit Relief)	£120,000
Effective rate of country Z tax £120,000 / £500,000 × 100%	24% (X%)
UK additional rate	45%
UK additional rate × 65%	29.25% (Y%)

As X% is less than Y% Condition 4 is met.

CIOT commented:

> There will also be timing issues in regard to working out available foreign tax credits and in allowing sufficient time for amendments to Self-Assessment returns. In particular, if the arising basis is used on a return and later on it is determined that the remittance basis could be claimed, eg because the final foreign tax credit proves to be higher than expected (which given that the UK and overseas territories will not have coterminous tax years could take a couple of years or so to determine)

then might not the taxpayer out of time to amend their return?[47]

HMRC dual-contract guidance provides:

> **What if I do not know the foreign tax amount when I have to submit my UK Self Assessment tax return?**
> Different tax laws in overseas territories may mean that you have to file a provisional UK tax return based on expected overseas taxes. When the actual amount of foreign tax is known you should submit an amended Self Assessment return, if necessary. You must do this within 12 months of the 31 January that follows the tax year in question.
> **What should I do if I have paid too much or too little tax to the foreign tax authorities?**
> You must tell HMRC as soon as possible so that any under or overpayment of UK Income Tax can be corrected.
> **What should I do if I have paid the Remittance Basis Charge but my overseas employment income becomes taxable on the arising basis?**
> If you are within the time frame to amend your return you may withdraw your claim to the remittance basis.

34.18.7 *Cond. 5: Offshore work*

Section 24A(17) ITEPA provides:

> Condition 5 is that—
>
> (a) were the duties of the relevant employment to be duties of the UK employment instead, all or substantially all of them could not lawfully be performed in the relevant territory (whether on the meeting of any condition or otherwise) by virtue of any regulatory requirements imposed by or under the law of that territory, and
>
> (b) were the UK duties of the UK employment to be duties of the relevant employment instead, all or substantially all of them could not lawfully be performed in the part of the UK in which they are performed (whether on the meeting of any condition or otherwise) by virtue of any regulatory requirements imposed by or under the law of that part of the UK.
>
> (18) In subsection (17)—
>
> "the relevant territory" means the territory in which the duties of the relevant employment are performed, and
>
> "UK duties" means duties performed in the UK.

[47] CIOT, "Artificial use of dual contracts by non-domiciles: Response" (2014).

HMRC dual-contract guidance provides:

> Examples of regulatory requirements include:
>
> - in order to get a work permit in some countries, you have to have an employment contract in that country
> - in order to provide certain types of financial services in the UK, you have to be employed by a person authorised by the Financial Conduct Authority

34.18.8 *Dual-contract rule: Critique*

ICAEW stated:

> Given that internationally mobile senior employees are the decision makers in a multi-national organisation targeting them in this manner could have significant long term implications for the competitiveness of the UK.[48]

The dual-contract rule was introduced on the grounds that dual contracts were (in general) artificial. One might debate whether that is so. But the policy issue is, or should be, not whether dual contracts are artificial, but what inducements the UK should offer for foreign domiciliaries to reside in the UK. The purpose of the remittance basis is to make the UK an attractive place for foreign domiciliaries to reside and to work.

I suspect there has been an inconsistency in government policy here. Those responsible for the HMRC dual-contracts paper in 2012 had little or no sympathy with the government policy decision in 2008 to accept and retain the principle of the remittance basis; so they sought to adopt as strict an interpretation of the law as was possible. When that statement did not produce the desired effect of preventing dual-contracts, this school of thought succeeded in introducing the s.24A dual-contract rule, which did. But there it is.[49]

34.19 Dual contract outside s.24A rule

In cases where the dual-contract rule does not apply, HMRC may attack the planning in the following ways:

(1) That what purport to be two contracts of employment are in fact only

[48] TAXREP 14/14.

[49] I discussed this topic at greater length in the 14th edition of the work para 22.16.9, but omit that now as it has become of historical interest only; there seems little current prospect of reform.

one contract of employment, of which some duties are performed in the UK.

(2) Some duties of the overseas employment are performed in the UK

(3) Incorrect apportionment of earnings between the two employments

Points (1) and (2) were formerly discussed at some length in EIM77030, parts of which were doubted in former editions of this work.[50] HMRC may have agreed, as the passage is now withdrawn. In brief:

(1) Whether there is one or two contracts of employment is a question of contract/employment law, and should not be a problem if the matter is properly documented.

(2) Whether duties are performed in the UK, depends on the terms of the employment contracts, and other facts.

There remains a legacy of pre-2014 dual contract arrangements currently being negotiated with HMRC.

34.19.1 *Record keeping*

The HMRC dual-contracts paper provides:

> 4. For the purpose of enquiries into dual contract arrangements, HMRC considers it is reasonable to require access to the following documents, for some or all of the period under review:
> - diaries
> - emails
> - expenses claims and supporting receipts
> - telephone records
> - client files.
>
> 5. A document means anything in which information of any description is recorded. This includes records held on a computer, on magnetic tape, optical disk (CD-ROM/DVD), hard disk, memory stick, flash drive, floppy disk or other recording media.
>
> 6. Where such records are in the possession of the employee, HMRC would expect the individual to comply with Section 12B TMA 1970 and retain any documents or information that would have enabled him or her to deliver a complete and correct return, until the later of either the closure of the enquiry window or, if applicable, the date an enquiry into the return is closed.

Section 12B(1) TMA provides:

[50] See the 14th edition (2015/16) para 22.15 (dual contract arrangements).

> Any person who may be required by a notice under section 8, 8A or 12AA of this Act to make and deliver a return for a year of assessment or other period shall—
>
> (a) keep all such records as may be requisite for the purpose of enabling him to make and deliver a correct and complete return for the year or period; and
>
> (b) preserve those records until the end of the relevant day ...

HMRC continue:

> 7. However where the employee does not have power or possession of the documents, HMRC will consider approaching the employer for the records they hold.
>
> 8. HMRC has sometimes experienced difficulty in obtaining documents which have not been retained by the employer. In a spirit of collaborative engagement HMRC asks all employers who utilise dual contract arrangements to implement a retention policy that will retain relevant documents for at least two years from the end of the tax year to which the document relates.
>
> 9. HMRC has also sometimes experienced difficulties in obtaining documents which have been retained by the employer or the employee. HMRC will not hesitate to use the powers in Schedule 36 FA 2008 to require production of documents. Where the individual is employed by an overseas employer and the information is not available to the individual, HMRC will make full use of Exchange of Information powers with the relevant overseas authorities.
>
> **Multiple risks**
>
> 10. HMRC will address all avenues of enquiry into dual contract arrangements (e.g. those relevant to both employee and employer) as equal risks from the outset of the enquiry; no risks will be deferred pending the outcome of enquiries into others. This should serve to mitigate some of the delays and other problems sometimes faced in obtaining the relevant records.

34.19.2 *Dual contract: Disclosure*

The HMRC dual-contracts paper provides:

> **Self Assessment**
>
> 11. An employee who has dual (or multiple) contracts of employment is required to complete a separate Employment page of the Self Assessment Tax Return for each employment, as specified at page EN1 of the Tax Return Guide [now page EN 1 of the Employment Notes 2016/2017].

34.19.3 *Implications for employer*

The employer will need to consider the following points before entering into dual contract arrangements:

(1) Deductibility: Is the cost of remunerating the individual under the contract for overseas duties effectively borne by a UK company and can it be claimed as a deduction for Corporation Tax?

(2) CFC and transfer of income abroad issues: Do the individual's activities under the contract for overseas duties generate income, and if so to whom does it accrue? Is income which would otherwise accrue to a company liable to Corporation Tax being routed to an overseas company?

(3) Transfer pricing: If the profits of a company within Corporation Tax are computed on a cost plus basis, are the costs being depressed by reason of the split employment?

34.20 Dual-contract apportionment

Section 24 ITEPA prevents an unreasonable attribution of income between the two employments in favour of the foreign employment. I refer to this as the **"dual-contract apportionment rule")**. It can only arise where the dual-contract rule does not apply, so it now has a relatively small role, but I discuss it here for completeness.

Section 24(1) ITEPA provides:

> This section imposes a limit on how much of an employee's general earnings are chargeable overseas earnings for a tax year under section 23 if—
>
> (a) in that year the employee holds
>
> [i] associated employments as well as
>
> [ii] the employment to which subsection (2) of that section applies ("the relevant employment"), [ie an employment which gives rise to chargeable overseas earnings, taxable on the remittance basis]
>
> (b) the duties of the associated employments are not performed wholly outside the UK.

34.20.1 *Overseas earnings limit*

Assuming the conditions of s.24(1) are met, we move on to s.24(2) ITEPA which sets out the limit on chargeable overseas earnings:

> The limit is the proportion of the aggregate earnings for that year from all the employments concerned that is reasonable having regard to—

> (a) the nature of and time devoted to each of the following—
> (i) the duties performed outside the UK, and
> (ii) those performed in the UK, and
> (b) all other relevant circumstances.

Section 24(3) ITEPA defines "aggregate earnings":

> For the purposes of subsection (2) "the aggregate earnings for a year from all the employments concerned" means the amount produced by aggregating the full amount of earnings from each of those employments for the year mentioned in subsection (1) so far as remaining after subtracting any amounts of the kind mentioned in step 2 in section 23(3).

Section 24(7) ITEPA provides:

> If an amount of chargeable overseas earnings is reduced under step 3 in section 23(3) as a result of applying any limit imposed by this section, the amount of general earnings corresponding to the reduction remains an amount of general earnings within section 15(1).

Of course, even in a case where the conditions of s.24(1) are not met, HMRC may in an appropriate case be able to say that sums which are purport to be earnings are in fact something else.

34.21 *Split year*

Section 24(2A) ITEPA provides:

> If the tax year is a split year as respects the employee, subsection (2) has effect as if for "the aggregate earnings for that year from all the employments concerned" there were substituted "so much of the aggregate earnings for that year from all the employments concerned as is attributable to the UK part of that year".

Amended as s.24(2A) directs, s.24(2) reads:

> The limit is the proportion of ~~the aggregate earnings for that year from all the employments concerned~~ so much of the aggregate earnings for that year from all the employments concerned as is attributable to the UK part of that year that is reasonable having regard to—
> (a) the nature of and time devoted to each of the following—
> (i) the duties performed outside the UK, and
> (ii) those performed in the UK, and
> (b) all other relevant circumstances.

Section 24(3A) ITEPA provides:

> Any attribution required for the purposes of subsection (2A) is to be done on a just and reasonable basis.

34.21.1 *Associated employment*

The definition of associated employment matters for the s.24A dual-contract rule, as well as for the dual-contract apportionment rule.

Section 24 ITEPA provides:

> (4) In this section—
> (a) "the employments concerned" means the relevant employment and the associated employments;
> (b) "associated employments" means employments with the same employer or with associated employers.
>
> (5) The following rules apply to determine whether employers are associated—
>
> *Rule A* An individual is associated with a partnership or company if that individual has control of the partnership or company.
>
> *Rule B* A partnership is associated with another partnership or with a company if one has control of the other or both are under the control of the same person or persons.
>
> *Rule C* A company is associated with another company if one has control of the other or both are under the control of the same person or persons.
>
> (6) In subsection (5)—
> (a) in rules A and B "control" has the meaning given by section 995 of ITA (in accordance with section 719 of this Act), and
> (b) in rule C "control" means control within the meaning given by sections 450 and 451 of CTA 2010 (meaning of expressions relating to close companies).

34.22 Overseas Workday Relief

This section considers the second of the two remittance bases which may apply to UK resident foreign domiciled employees.[51] HMRC call this **"Overseas Workday Relief"**. That label is not particularly apt, though the number of overseas workdays will generally be a relevant matter. I use the term **"OWR remittance basis"**. I refer to those who qualify for the relief as **"OWR Employees"**.

The development of the relief can be traced in the residence consultation

[51] See 34.8 ("Taxable earnings").

papers[52] but that is now of historical interest only.

HMRC have issued guidance in RDR4.[53]

The OWR remittance basis does not require a specific claim or election,[54] but where the relief applies the individual must tick box 2 in SA109 (Residence, remittance basis etc) (2022/23). The rubric to this box provides: "If you are eligible for Overseas Workday Relief... put 'X' in the box." The individual must also claim the remittance basis.

Where OWR is available, it may be better to be an employee than a self-employed sole trader, where there is no equivalent relief.

34.22.1 *OWR remittance basis*

Section 26(1) ITEPA provides:

> This section applies to general earnings for a tax year where
> [i] section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the employee for that year and
> [ii] the employee meets the requirement of section 26A [recent arrival] for that year,
> if the general earnings meet all of the following conditions—
> (a) they are neither—
> (i) general earnings in respect of duties performed in the UK, nor
> (ii) general earnings from overseas Crown employment subject to UK tax,[55] and
> (b) if the tax year is a split year as respects the employee, they are attributable to the UK part of the year.

Statute frequently refers to:

> general earnings within section 26(1) of ITEPA

[52] See 6.1 (Concepts of residence).

[53] HMRC "Guidance Note: Overseas Workday Relief" *https://www.gov.uk/government/publications/rdr4-overseas-workday-relief-owr/overseas-workday-relief-rdr4*

[54] The EIM recognises this:
EIM77020: General earnings in respect of duties performed in the UK [May 2020]
Although the amount that is not taxable is sometimes referred to as "overseas workday relief", it is not a statutory relief from tax subject to the claims machinery in Section 42 TMA 1970.

[55] See 34.40 (Overseas Crown employment).

On one occasion this is abbreviated to "section 26(1) earnings." For clarity I gloss this as **"OWR earnings"**.

Section 26(2) ITEPA provides the remittance basis for OWR earnings:

> The full amount of any general earnings within subsection (1) which are remitted to the UK in a tax year is an amount of "taxable earnings" from the employment in that year.

Section 26(6) ITEPA provides:

> Section 15(1) does not apply to general earnings within subsection (1).

Thus OWR earnings are taken from the arising basis (s.15) and moved the remittance basis; so earnings which do not qualify for OWR remittance basis continue to fall under the s.15 arising basis.

In short, a remittance basis taxpayer who qualifies for OWR remittance basis pays tax:

(1) on an arising basis on general earnings in respect of duties performed in the UK; and
(2) on a remittance basis on other earnings.

If the s.26A requirements (recent arrival) are met, it is easier to qualify for OWR than the COE remittance basis:

(1) It is not necessary to have a foreign employer
(2) It is not necessary that duties are performed *wholly* outside the UK

Much of the wording of the OWR remittance basis repeats that found in the COE remittance basis; so the reader is referred back to 34.13 (COE remittance basis).

See too 34.23 (OWR mixed fund rule).

34.22.2 *s.26A conditions: 3-year cap*

Section 26A ITEPA provides:

> (1) An employee meets the requirement of this section for a tax year if the employee was—
> (a) non-UK resident for the previous 3 tax years, or
> (b) UK resident for the previous tax year but non-UK resident for the 3 tax years before that, or
> (c) UK resident for the previous 2 tax years but non-UK resident for the 3 tax years before that, or
> (d) non-UK resident for the previous tax year, UK resident for the tax year before that and non-UK resident for the 3 tax years

> before that.
>
> (2) The residence status of the employee before the 3 years of non-UK residence is not relevant for these purposes.

Statute frequently refers to:

> the requirement of section 26A

For clarity I gloss this as [recent arrival].

If someone who has never been in the UK comes to the UK and remains:

Year	**Qualifies**	**s.26A(1) para**
1 (year of arrival)	Yes	(a)
2	Yes	(b)
3	Yes	(c)
4	No	-

That applies even if year 1 (or year 4) is a split year.

RDR4 provides:

> 6. The number of tax years you can be eligible for OWR in your lifetime is not limited. As long as there's a period of three consecutive tax years where you weren't resident in the UK, you may be eligible for OWR even if you've already previously benefited from the relief.

That all seems quite straightforward, but RDR4 gives four examples to hammer the points home. I think they can be conveniently summarised in a table:

	A		**B**		**C**		**D**	
Year	*Resid*	*OWR*	*Resid*	*OWR*	*Resid*	*OWR*	*Resid*	*OWR*
2010/11-2012/13	NR	n/a	NR	n/a	R in 2010/11		NR	n/a
2013/14	Split R	Yes	NR	n/a	Split R	No	R	No*
2014/15	R	Yes	R	Yes	R	No	NR	n/a
2015/16	R	Yes	R	Yes	R	No	Split R	Yes
2016/17	R	No	R	Yes	R	No	R	No
2017/18	NR	n/a	NR	n/a	NR	n/a	R	No

Key: R: Resident
NR: Non-resident
Spilt R: Split resident year
* *does not claim remittance basis*

> **Example 1 (Abdul)**
>
> A arrives in the UK on 1 February 2014 to begin a work secondment. He hasn't previously been to the UK and so has not been resident here before. He leaves the UK on 5 April 2017.
>
> Under the SRT, A is resident in the UK for the tax year 2013 to 2014 and

> is eligible for split year treatment. The UK part of his split year begins on 1 February 2014.
>
> A is also resident in the UK for the tax years 2014 to 2015, 2015 to 2016 and 2016 to 2017. He claims the remittance basis of taxation for the tax years 2013 to 2014, 2014 to 2015, 2015 to 2016 and 2016 to 2017. He isn't resident in the UK for the tax year 2017 to 2018.
>
> A's foreign earnings for 2013 to 2014 (from 1 February 2014), 2014 to 2015 and 2015 to 2016 are eligible for OWR and are only taxable in the UK if and when they're remitted to the UK. In 2016 to 2017 A isn't eligible for OWR as he's received the relief in the three preceding tax years. As such his foreign earnings for 2016 to 2017 are fully taxable in the UK.
>
> Provided A remains not resident in the UK for three consecutive tax years following 2016 to 2017 he may be eligible for OWR again from the 2020 to 2021 tax year.

A would have done better to postpone his arrival so he did not become resident until 2014/15; then he would qualify for OWR remittance basis in 2016/17. HMRC quietly make the point in example 2:

> **Example 2 (Burril)**
>
> B arrives in the UK on 1 March 2014 to begin a work secondment. He hasn't been to the UK previously and so has not been resident here. He leaves the UK on 5 April 2017.
>
> He is not resident in the UK under the SRT for the tax year 2013 to 2014. He's resident in the UK for the tax years 2014 to 2015, 2015 to 2016 and 2016 to 2017. He claims the remittance basis of taxation for the tax years 2014 to 2015, 2015 to 16 and 2016 to 2017. He isn't resident in the UK for the tax year 2017 to 2018.
>
> B's foreign earnings for 2014 to 2015, 2015 to 2016 and 2016 to 2017 are eligible for OWR and are only taxable in the UK if and when they are remitted to the UK.
>
> Unlike A, B isn't resident in the UK in 2013 to 2014 (the tax year in which his UK secondment commenced). B is therefore eligible for OWR for 2016 to 2017 because this is the third year for which he is UK resident.
>
> Provided B remains not resident in the UK for three consecutive tax years following 2016 to 2017 he may be eligible for OWR from the 2020 to 2021 tax year.
>
> **Example 3 (Colar)**
>
> C arrives in the UK on 1 February 2014 to begin a work secondment. He's previously been resident in the UK. He ceased to be resident in the

> UK on 5 April 2011.
> He was not resident in the UK for the tax years 2011 to 2012 and 2012 to 2013. He leaves the UK on 5 April 2017.
> He's resident in the UK for the tax year 2013 to 2014 under the SRT and is eligible for split year treatment. The UK part of his split year begins on 1 February 2014.
> He's resident in the UK for the tax years 2014 to 2015, 2015 to 2016 and 2016 to 2017. He claims the remittance basis of taxation for the tax years 2013 to 2014, 2014 to 2015, 2015 to 2016 and 2016 to 2017. He is not resident in the UK for the tax year 2017 to 2018.
> C has not been non-resident in the UK for three consecutive tax years immediately prior to his secondment to the UK. He's not eligible for OWR for 2013 to 2014, 2014 to 2015, 2015 to 2016 or 2016 to 2017. If he remains not resident in the UK for three consecutive tax years following 2016 to 2017 he may be eligible for OWR from the 2020 to 2021 tax year.

C would have done better to postpone his arrival so as to become resident in 2014/15. In that case he would have qualified for OWR.

The last example concerns an employee who does not claim the remittance basis. The point is that a failure to claim the remittance basis in one year does not allow an extension of the OWR remittance basis in a later year:

> **Example 4 (Drey)**
> D is employed by a US company and has visited the company's group office in the UK on short business projects on a number of occasions in each of several tax years prior to 2013 to 2014. He has not been UK resident prior to 2013 to 2014.
> In 2013 to 2014 D works on a short business project in the UK and is resident for the year under the SRT. He has further business visits to the UK during 2014 to 2015 but is not resident in the UK for that year. He's seconded to work at the company's group office in the UK for three years from 1 May 2015. D leaves the UK on 5 April 2018.
> D is resident in the UK for the tax year 2015 to 2016 and is eligible for split year treatment. The UK part of his split year begins on 1 May 2015. He is resident in the UK for the tax years 2016 to 2017 and 2017 to 2018. He does not claim the remittance basis of taxation for 2013 to 2014. He claims the remittance basis of taxation for 2015 to 2016, 2016 to 2017 and 2017 to 2018.
> In 2013 to 2014 D was not eligible for OWR because, even though he wasn't resident in the UK for the three previous consecutive tax years, he

> hadn't claimed the remittance basis of taxation for that year.
> D's foreign earnings for (the UK part of) 2015 to 2016 are eligible for OWR because 2015 to 2016 is one of three tax years immediately following three consecutive tax years for which he was not resident.
> His earnings for 2016 to 2017 and 2017 to 2018 are not eligible for OWR because neither year is one of three tax years immediately following three consecutive tax years for which he was not resident.

34.22.3 *Split years*

RDR4 provides:

> 7. Where the tax year for which OWR applies is a split year for you, OWR will only apply to foreign earnings which relate to the UK part of the year. For these purposes it doesn't matter whether the year is split into a UK part and then an overseas part of the year or the other way round.
> 8. Where the tax year for which OWR applies isn't a split year, OWR will apply to foreign earnings relating to duties in any part of that tax year.

This sets out the rules in s.26 ITEPA.

> 9. OWR doesn't apply to earnings which relate to duties you perform overseas in the overseas part of a split year. Such earnings aren't taxable in the UK, even if they're remitted. Earnings which relate to duties you perform in the UK in the overseas part of a split year are taxable in full unless they're exempt from UK tax under the terms of a Double Taxation Arrangement.
> 10. OWR doesn't apply to earnings which relate to duties you perform overseas in a tax year for which you're not resident in the UK. Such earnings aren't taxable in the UK, even if they're remitted. Earnings which relate to duties that you perform in the UK in a tax year for which you're not resident in the UK are taxable in full unless they're exempt from UK tax under the terms of a Double Taxation Arrangement.

34.22.4 *Earnings the year is "for"*

RDR4 provides:

> 12. Earnings are usually received shortly after you earn them. However you may receive some earnings in a year, such as a bonus, which is for an earlier period because it relates to duties you performed in that period.
> 13. You may perform duties in one tax year but receive some of the earnings for those duties in a later tax year. Or you may perform duties

> in an overseas or UK part of a split year, but receive payment in the other part of the split year (UK or overseas), or indeed in another tax year altogether.
>
> 14. It's your circumstances in the period that the earnings are for that determine your eligibility to OWR in relation to those earnings, and not, if they're different, your circumstances in the year you receive them.
>
> 15. The following examples demonstrate how the rules apply in practice. In each example, unless otherwise stated, the individual is not domiciled in the UK throughout the period and performs employment duties partly in the UK and partly overseas.
>
> **Example 5 (Drey)** [This continues on from example 4 above]
> In January 2017 D receives his 2016 performance bonus which is in respect of his duties throughout the calendar year 2016.
> He isn't eligible for OWR for 2016 to 2017 when he receives his bonus but as part of it was earned in respect of duties performed in 2015 to 2016, that part is eligible for OWR.

See 34.10 (Earnings "for" tax year).

34.22.5 *Deemed domicile/OWR interaction*

A deemed domiciled individual cannot claim the remittance basis and cannot claim OWR. RDR4 gives 2 straightforward examples:

> **Example 10** (Guy)
> G arrives in the UK on 6 August 2017. He performs his duties partly in the UK and partly abroad, and he claims OWR.
> G leaves the UK on 2 September 2020, having claimed OWR for 2017 to 2018, 2018 to 2019 and 2019 to 2020. He cannot claim OWR for 2020 to 2021, the year of his departure (OWR is only available for the first 3 years).
> G remains overseas for the following 3 full UK tax years – 2021 to 2022, 2022 to 2023 and 2023 to 2024, and returns to the UK on 8 July 2024. He claims OWR for the next 3 years, and leaves the UK on 10 August 2027.
> If G continues his pattern of working both overseas and in the UK indefinitely the maximum number of years G will be resident in the UK in any 20 year period is 12 years and so he will never meet Condition B of the deemed domicile legislation [15-year rule].
>
> **Example 11** (Francoise)
> F was born in the UK with a UK domicile of origin.
> F moved to New Zealand with her family at age 14 and acquires a

domicile of dependency there which became a domicile of choice. She doesn't return to the UK until 12 October 2015 when she is 24 and takes up employment based partly in the UK and partly in Germany.

F meets the pre 6 April conditions for claiming OWR, and claims it for the 2015 to 2016 tax year (a split year), the 2016 to 2017 tax year (year of arrival plus 1).

However due to the changes applicable from the 6 April 2017 F will not be able to claim OWR for 2017 to 2018. She meets Condition A of Section 835BA, and will be treated as deemed domicile from 6 April 2017. She cannot therefore claim remittance basis and so fails the conditions necessary to make a valid claim to OWR.

F will be taxable for both those duties performed in the UK and those in Germany, in the UK from 6 April 2017.

34.23 OWR mixed funds

This section considers the position where:

(1) An OWR Employee receives earnings for duties performed partly in and partly out of the UK
(2) The earnings are received abroad

The earnings constitute a mixed fund consisting of:

(1) Earnings taxed on an arising basis under s.15 ITEPA
(2) Earnings taxed on the remittance basis under s.26 ITEPA ("OWR earnings")

Under the usual mixed fund rules, in short:[56]

(1) s.15 earnings (UK earnings, mixed fund category (a)) are remitted before s.26 earnings (OWR earnings, mixed fund category (b)); but
(2) Later years' earnings are remitted before earlier years

So employees who wish to avoid taxable remittances would generally need:

(1) to pay each year's earnings in a separate account and
(2) not remit more than the UK earnings in that account

In the past, relief was allowed by concession. After consultation and response papers[57], FA 2013 introduced a statutory rule. This was slotted

[56] See 20.1 (Mixed funds: Introduction).

[57] HMRC, "Reform of the taxation of non-domiciled individuals: a consultation" (2011). HMRC, "Legislation of Statement of Practice 1/09 (SP1/09): summary of responses and draft legislation" (2012).

in after s.809R, so the provisions are numbered s.809RA - 809RD ITA. The heading to s.809RA is "Special mixed fund rules" but for clarity I prefer the term **"OWR mixed fund rules"**.

Section 809Q(1A) ITA provides:

> But this section must be read subject to section 809RA.

Thus the OWR mixed fund rules have priority over the normal mixed fund rules.

HMRC have issued 11 pages of guidance under the title FAQs; ("**OWR mixed fund FAQs**").[58]

34.24 OWR: Qualifying account

The OWR mixed fund rules apply to payments out of a qualifying account and it helpful to consider this concept first.

Claire Lillie reports:

> We have seen a lot of recent focus from HMRC on SMF account eligibility, particularly around whether qualifying criteria for the SMF account is maintained, and there has been little leniency from HMRC when individuals do not carefully follow SMF conditions. Some recent examples of HMRC challenges have been regarding the correct nomination of the SMF account in the tax return (which must be done by the normal filing date without extension for the amendment window) and a focus on prohibited sums being deposited to the SMF account (without corrective action being taken) during the qualifying period. Given the popularity of reliance on SMF conditions applying, it is important that both individuals and advisors remain vigilant of the rules, and for the qualifying status of the account to be regularly reviewed.[59]

The starting point is that an individual may nominate their qualifying account. Section 809RB ITA provides:

https://www.gov.uk/government/consultations/reform-of-the-taxation-of-non-domiciled-individuals

HMRC, "Legislation of Statement of Practice 1/09 (SP1/09): second summary of responses and draft legislation" (2013)

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/88349/09__-_Second_Summary_of_responses.pdf

[58] Issued July 2013, updated October 2013 [2013] STI Issue 40 (10 Oct 2013) *https://www.gov.uk/government/publications/residence-domicile-and-remittance-basis-rules-uk-tax-liability*

[59] Tax Journal, 5 July 2019.

> (1) An individual may by notice to the Commissioners nominate an account to be a qualifying account of the individual for the purposes of section 809RA.
> (2) The notice must specify the qualifying date for the account.

34.24.1 *How to nominate*

Nomination is a formal matter. Section 809RB(7) ITA provides:

> A notice under subsection (1) or (6) must be in writing and include such information as the Commissioners may reasonably require.

OWR Mixed Fund FAQs provide:

> **How do I tell HMRC which account is my qualifying account?**
> You can notify HMRC which account was your qualifying account for the tax year in the whitespace notes of your tax return. Where you have changed qualifying accounts part way through the year, you must include details of all qualifying accounts which you have used during the year. You will need to set out which accounts you have used as qualifying accounts for the tax year and the dates on which each account was a qualifying account.

34.24.2 *"Qualifying date"*

The concept of qualifying date is relevant for several purposes:

(1) It is the date from which the account is a qualifying account
(2) It is a date on which various conditions must be satisfied
(3) It is relevant to the time limit for nominating an account

Section 809RB ITA provides:

> (3) "The qualifying date" for the account is the first date on which there is paid into the account sums falling within subsection (4) which (in total) are more than £10.
> (4) A sum falls within this subsection if it is, or derives wholly (whether directly or indirectly) from, general earnings of the individual from an employment for a tax year which is a relevant tax year in relation to the employment.

Section 809RB(5) ITA defines "relevant tax year":

> A tax year is a "relevant" tax year in relation to an employment if the general earnings which the individual has for the tax year from the employment include both
> [a] general earnings within section 15(1) of ITEPA 2003 [UK earnings] and

> [b] general earnings within section 26(1) of that Act [OWR earnings].

34.24.3 *Change of nomination*

The nomination may be changed. Section 809RB(6) ITA provides:

> The individual may withdraw the nomination by giving a further notice to the Commissioners, specifying the date with effect from which the nomination is withdrawn.

A new account can then be nominated.

OWR mixed fund FAQs provides:

> ***Can an account that has been my qualifying account in the past be my qualifying account again in the future?***
> If an account has been your qualifying account in the past but then ceased to be your qualifying account for whatever reason, it cannot later be used as your qualifying account again. This is because an account can only become a qualifying account on its "qualifying date". An account can only have one qualifying date, and so cannot become a qualifying account a second time. ...
> Note that you may use the same qualifying account from one year to the next - a qualifying account does not automatically cease to be a qualifying account at the end of the tax year.

34.24.4 *Time limit for nomination*

There are time limits for:

(1) Nominating a qualifying account
(2) Withdrawing a nomination

Section 809RB(8) ITA provides:

> A notice under subsection (1) or (6) must be given no later than—
> (a) 31 January in the tax year following the tax year in which falls, as the case may be—
> (i) the qualifying date for the account, or
> (ii) the date with effect from which the nomination is withdrawn, or
> (b) such later date as the Commissioners may allow.

OWR mixed fund FAQs provides:

> ***What happens if I arrive and become resident in the UK part way through the tax year?***
> If, part way through the tax year you become UK resident for that year,

> you will need to consider whether the qualifying date for the account that you wish to nominate as your qualifying account has already passed. This might be the case if, for example, you are continuing the same employment that you had prior to becoming resident and your salary prior to that date was being paid into that account.
> If the qualifying date for an account has passed you will have to nominate a different account as your qualifying account.

HMRC say:

> *Please can HMRC explain the circumstances in which a late nomination for a Special Mixed Fund will be accepted as valid? Could HMRC be more flexible on this matter for tax years prior to 2018-19 given the requirement to nominate only came in with effect from 2013-14?*
> 5.2 HMRC explained this has been checked with technical colleagues locally. Notification should be made to the Commissioners by 31 January following the end of the tax year. The Commissioners take into account factors in SACM10040 in regard to the acceptance of a late claim. HMRC does not anticipate flexibility on the date of accepting a late notification. Exceptional circumstances are detailed in the Claims manual, however HMRC doesn't envisage circumstances other than being incapacitated by illness or accident.
> 5.3 If there is no acceptance of a late notification, HMRC expect a consequential claim to be made via S43A TMA 1970 and S36(2) TMA1970. To be accepted, the claimant (and anyone representing them) would have to demonstrate that they took reasonable care (as S43C restricts any claims if an individual or their representative has been careless). This is the current approach, and HMRC do not see any flexibility in regard to years prior to 2018-19.[60]

There was a small Covid-related extension for returns for the year 2019/20 (due by 31 January 2021):

> 5.1 ... the SA Filing deadline remained as 31 January 2021 for the 2019-20 tax returns. However, the £100 late filing penalty was not chargeable on any tax returns filed on or before 28 Feb 21.
> 5.2 HMRC advised that following this easement, it received some queries related to the late filing of returns and their contents.
> 5.3 One query was around the nomination of a qualifying special mixed

[60] Joint Expatriate Forum on Tax and NICs (April 2019) *https://www.gov.uk/government/groups/joint-forum-on-expatriate-tax-and-national-insurance-contributions*

> fund account (S809RB(8)(b)ITA2007) which are usually made on the SA Return and need to be nominated by 31 January (or a date by which the Commissioners can allow). HMRC confirmed that it is able to allow nominations of qualifying special mixed fund accounts within returns if they are made on or before 28 February 2021.[61]

34.24.5 *Ordinary bank account*

Section 809RB(10) ITA provides:

> The account is not to be a qualifying account at all if—
> (a) at any time on the qualifying date, the account is not an ordinary bank account held by and for the benefit of the individual (alone or jointly with others)

Section 809RB(15) ITA provides a commonsense definition of "ordinary bank account:

> For the purposes of this section an account is an "ordinary bank account" if it is a cash account in a bank (whether a current or savings account) where sums standing to the credit of the account from time to time represent a debt owed by the bank to the account-holder.

The object is presumably to exclude accounts holding securities.

34.24.6 *No funds at qualifying date*

Section 809RB(10) ITA provides:

> The account is not to be a qualifying account at all if...
> (b) immediately before the qualifying date, the account has a credit balance of more than £10.

The object is to prevent other funds taking advantage of the OWR mixed fund rule.

HMRC mixed fund FAQs provides:

> ***I could have been using the new rules since the beginning of the tax year, but have only just found out about them. Can I use the account that I've been having my salary paid into as my qualifying account?***
> If the account had a balance of no more than £10 on the qualifying date for that account, then it may be nominated as a qualifying account from

[61] Joint Expatriate Forum on Tax and NICs (April 2021) *https://www.gov.uk/government/groups/joint-forum-on-expatriate-tax-and-national-insurance-contributions*

> that date. If not you will need to use a different account, or open a new account, in order to use the special mixed fund rules.

34.24.7 *OWR remittance basis foreign earnings in year*

Section 809RB(11) ITA provides:

> The account is not to be a qualifying account at all if the qualifying date falls in a tax year—
>
> (a) for which the individual has no general earnings within section 26(1) of ITEPA 2003

It is necessary to have s.26 earnings (OWR earnings) in each year. But if the employee does not have such earnings, they do not need the OWR special mixed fund rules.

HMRC say:

> *Question*
>
> [The question refers to the FAQ statement that the only funds that can be paid into the account are *general earnings from an employment for a tax year when the individual is resident, qualifies for OWR and performs duties of that employment both in the UK and overseas (if the year is a 'split year' for residence purposes, then those duties must be performed in the UK part of the year).*]
>
> The question is - does this mean you have to qualify for OWR and perform UK + non UK duties in the year you receive the earnings, or the year you earned the earnings, or both?
>
> For instance if you have to qualify for OWR and have worked in and out of the UK in the year you receive the income, this would mean if you received a bonus in year 4 when you couldn't qualify for OWR but which was at least partly earned in an earlier year while you did qualify for OWR, you would not be able to pay this into a special mixed fund rules qualifying account and so avoid the normal mixed fund rules.
>
> If on the other hand, they're saying you look to the period when the income was earned, and if you qualified for OWR and worked in and out of the UK throughout that period, then you're ok and can get paid into a special mixed fund rules qualifying account after you cease to qualify for OWR on your current year earnings.
>
> [The question refers to the FAQ which addresses the issue of bonuses[62] and continues:]
>
> So that would mean you would be OK paying in a bonus in year 1 part

[62] See 34.28.1 ("Prohibited sum").

> of which was earned before you became resident, but implies that after the end of the three year initial OWR period, any earnings paid subsequently which were earned while the taxpayer still qualified for OWR (bonus, share related remuneration, etc) cannot be paid into a special mixed fund rules qualifying account even though could still claim OWR?
> *HMRC answer:*
> An account ceases to qualify in any year the individual has no general earnings within section 26(1) ITEPA 2003 (see section 809RB(9)(v) ITA 2007). General earnings under section 26(1) ITEPA 2003 will only arise when the individual meets the requirements of section 26A ITEPA 2003. In year 4 the section 26A ITEPA 2003 requirements will not be met so the account will no longer be a qualifying account. Any prior year bonuses containing section 26(1) ITEPA 2003 income paid into the account will be dealt with under the existing mixed fund rules ...[63]

34.24.8 *Breach of deposit rule*

Section 809RB(11) ITA provides:

> The account is not to be a qualifying account at all if the qualifying date falls in a tax year...
> (b) in which there is a breach of the deposit rule which is not remedied or cannot be remedied.[64]

See 34.28 (The deposit rule).

34.24.9 *Only 1 qualifying account*

Section 809RB(13) ITA provides:

> If, apart from this subsection, an individual might have nominated two or more accounts for which the qualifying date would be the same, the individual may nominate only one of those accounts.

HMRC mixed fund FAQs provides the reason for this rule:

> If multiple qualifying accounts were permitted, there are situations where it would be impossible to calculate the tax liability. For this reason, the

[63] Joint Expatriate Forum on Tax and NICs (July 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/347913/140731_Expat_Forum_Minutes.pdf*

[64] Section 809RB(12) ITA provides: "Subsection (9)(b)(iv) or (11)(b) (as relevant) is to be ignored if the breach occurs on or after a date falling within subsection (9)(b)(i) to (iii)."

rules are restricted to having only one qualifying account.

34.24.10 *Joint account*

Section 809RB(14) ITA provides:

> If, apart from this subsection, an account would be a qualifying account of two or more individuals at any time, it is not to be a qualifying account of either or any of them at that time or any other time.

OWR mixed fund FAQs provides:

> ***I have a joint account with my partner. Can I use that as my qualifying account?***
> Yes, provided that the account meets all the conditions for being a qualifying account, and that your partner doesn't make any financial contribution to the account (that is, they do not make any deposits to the account apart from their share of interest earned by the account).
> The same is true for accounts held jointly with anyone, not just those held jointly with a spouse or partner.
> But if you have nominated a joint account as a qualifying account, nobody else can nominate that account as their own qualifying account.
> ***I already have an overseas sterling bank account. Can I use that as my qualifying account?***
> Provided it meets the criteria set out above, any bank account may be used as a qualifying account. You will need to make sure the account balance is no more than £10 before qualifying earnings are first paid into the account.

34.24.11 *Qualifying account period*

Section 809RB(9) ITA provides:

> If an individual nominates an account under this section, the account is a "qualifying account" of the individual throughout the period—
> (a) beginning with the qualifying date, and
> (b) ending with the date before the earliest of the following dates—
> (i) the date on which the account is
> [A] closed or
> [B] ceases to be an ordinary bank account held by and for the benefit of the individual (alone or jointly with others);
> (ii) the date with effect from which the nomination is withdrawn under this section;
> (iii) the qualifying date for another qualifying account of the

individual;

(iv) 6 April in a tax year in which there is a breach of the deposit rule which is not remedied or cannot be remedied;[65]

(v) 6 April in a tax year for which the individual has no general earnings within section 26(1) of ITEPA 2003 [OWR earnings].

HMRC say:

> *Question:*
> Client qualifying account was set up on the 13th Sept.
> He was paid into the account on the 30th Sept but his income paid into the account was for the full month of Sept.
> Per the rules the account is considered a qualifying account from the date on which the first deposit of earnings is paid into it. Therefore as these earnings are for the month of Sept I would think it reasonable to calculate OWR from 1 Sept. Or should we only be calculating OWR from 30th Sept? We believe it is 1 September but please can this be confirmed?
> *HMRC answer:*
> We agree that all salary payments made to a qualifying account will be eligible for the special mixed fund rules provided all other qualifying conditions are met.[66]

34.24.12 *Minor definitions*

Section 809RA(11) ITA provides:

> For the purposes of this section and sections 809RB to 809RD—
> (a) "employment" is to be read in accordance with section 4(1) of ITEPA 2003, and includes an office (as read in accordance with section 5(3) of that Act),
> (b) whether general earnings are "for" a tax year is to be determined as for the purposes of the employment income Parts of ITEPA 2003[67] (see section 3(2) of that Act),
> (c) a reference to anything "paid into" an account includes anything credited to the account by whatever means, and

[65] Section 809RB(12) ITA provides: "Subsection (9)(b)(iv) or (11)(b) (as relevant) is to be ignored if the breach occurs on or after a date falling within subsection (9)(b)(i) to (iii)."

[66] Joint Expatriate Forum on Tax and NICs (July 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/347913/140731_Expat_Forum_Minutes.pdf*

[67] Parts 2-7A ITEPA; see 34.2 (Employment income Parts).

(d) references to a breach of the deposit rule are to be read in accordance with section 809RC.

34.25 OWR mixed fund rule

34.25.1 *Requirements for relief*

Section 809RA ITA provides:

> (1) This section applies if—
> (a) an individual has general earnings from an employment for a tax year,
> (b) those earnings include both
> [i] general earnings within section 15(1) of ITEPA 2003 ("section 15(1) earnings") and
> [ii] general earnings within section 26(1) of that Act ("section 26(1) earnings"),
> (c) at least some of the section 15(1) earnings, or sums deriving (wholly or in part, and directly or indirectly) from at least some of the section 15(1) earnings, are paid into an account in that tax year at a time (a "relevant time") when the account is a qualifying account of the individual, and
> (d) at least some of the section 26(1) earnings, or sums deriving (wholly or in part, and directly or indirectly) from at least some of the section 26(1) earnings, are also paid into the account in that tax year at a relevant time.

OWR Mixed Fund FAQs provide:

> **I no longer qualify for Overseas Workday Relief but I still have money in what was my qualifying account. Can I still use the Special Mixed Fund rules?**
> No. You are only eligible to use the Special Mixed Fund rules where the conditions set out in the answer to Q1 are met. As one of the conditions is that you qualify for OWR, the special mixed fund rules can't apply to the account after you have ceased to qualify for OWR.

Before turning to the rule, it is necessary to set out two more definitions.

34.25.2 *"Condition A transfer"*

Section 809RA(6) ITA provides:

> A transfer from the account is a "condition A transfer" if and to the extent that—

> (a) condition A in section 809L is met,[68] and
> (b) either—
> (i) the property or consideration for the service is (wholly or in part), or derives (wholly or in part, and directly or indirectly) from, the transfer, or
> (ii) the transfer, or anything deriving (wholly or in part, and directly or indirectly) from the transfer, is used as mentioned in section 809L(3)(c) [used in respect of relevant debt].

In short, a condition A transfer is an onshore transfer from the account.

34.25.3 *"Other transfer"*

Section 809RA(7) ITA provides:

> A transfer from the account is an "other transfer" if and to the extent that it is not a condition A transfer.

Section 809RA(8) ITA provides:

> Treat a transfer as an "other transfer" if and to the extent that, at the end of the tax year—
> (a) it is not a condition A transfer, and
> (b) on the basis of the best estimate that can reasonably be made at that time, it will not become a condition A transfer.[69]

In short, an "other transfer" is an offshore transfer from the account.

34.25.4 *OWR mixed fund rule*

Armed with these definitions, we can at last turn to the OWR mixed fund rule.

Section 809RA ITA provides:

> (2) If this section applies, the composition of each transfer made from the account in that tax year at a relevant time is to be determined as follows—
> *Step 1* Suppose that all the condition A transfers made from the account in the tax year at a relevant time had been a single transfer made from the account at the end of the tax year.
> *Step 2* Suppose that all the other transfers made from the account in the tax year at a relevant time had been a single offshore transfer made at the

[68] In short, property is received in the UK: see 18.14 (Remittance condition A: UK link).
[69] This is the equivalent of s.809R(6) ITA; see 20.6.2 ("Offshore" transfer).

end of the tax year immediately after the single transfer mentioned in step 1.

Step 3 Applying those suppositions—

(a) find under section 809Q(3) the extent to which the single transfer mentioned in step 1 is of the individual's income or chargeable gains, and

(b) find under section 809R(4) the content of the single offshore transfer mentioned in step 2.

Step 4 Each transfer made from the account in the tax year at a relevant time is to be treated as containing the specified proportion of each kind of income or capital contained in the relevant deemed transfer.

"The specified proportion" is the amount of the transfer divided by the amount of the relevant deemed transfer.

"The relevant deemed transfer" is—

(a) if the transfer is a condition A transfer, the single transfer mentioned in step 1, and

(b) otherwise, the single offshore transfer mentioned in step 2.

(3) Subsection (2) applies in determining the composition of a transfer for the purposes of sections 809Q and 809R but it does not otherwise affect the date on which a transfer is considered to occur for the purposes of this Chapter [Chapter A1, remittance basis].

OWR mixed fund FAQs provide a summary:

> If the employee uses the Special Mixed Fund rules they will not have to operate the normal mixed fund rules on each transaction from their qualifying account in order to determine whether any remittance they make is taxable. Instead they can total up all the remittances to the UK for the tax year and treat that as a single remittance made at the end of the year. Likewise, they can total the amount of offshore transfers made in the tax year and treat that as a single offshore transfer made at the end of the year...
>
> ***How do the Special Mixed Fund rules work?***
>
> Under the Special Mixed Fund rules, all remittances and offshore transfers made from a qualifying account in a tax year are treated as a single remittance and a single offshore transfer, both made at the end of the year.
>
> In other words, instead of applying the normal mixed fund rules to each transfer from the account as it is made over the year to work out the composition of each transfer from the account, at the end of the year the individual must—
>
> - work out the proportion of UK income and overseas income in the account for the year (this is normally based on the proportion of UK

and overseas workdays)

- identify all the different categories of income and gains in the account
- add together all remittances made to the UK from the qualifying account during the year and treat them as having been a single remittance made from the account at the end of the tax year
- add together all of the offshore transfers made from the account during the year and treat them as having been a single offshore transfer made from the qualifying account at the end of the tax year
- apply the normal ordering of the mixed fund rules to the single remittance in the third bullet point above
- apply the normal ordering of the mixed fund rules to the single offshore transfer in the fourth bullet point above

34.25.5 *Benefit in kind*

HMRC mixed fund FAQs provide:

> ***I receive UK and overseas benefits from my employer—how do I deal with these?***
> You add the value of the benefits to the rest of your income, and apportion as normal. UK benefits are treated as having been remitted to the UK, and that remittance is treated as coming primarily from the earnings of the employment relating to UK duties. Overseas benefits are treated as consisting primarily of earnings from the employment relating to overseas duties.
> You should note that because the value of the benefit has been included in the calculation of the apportionment of your earnings, this will mean that the ratio of earnings for UK and non-UK duties that are in your qualifying account may differ from your UK/ non-UK workday split.
> ***Example***
> Mr C has an employment where he performs 75% of his duties in the UK and 25% of his duties overseas.
> Mr C receives an annual salary of £150,000 and has a UK based benefit of £30,000 in respect of his children's school fees.

The HMRC analysis is as follows:

> First Mr C must apportion his earnings between UK and non-UK duties, based on work days. Based on this Mr C has:
> Total earnings for apportionment: £180,000 (£150,000 salary + £30,000) benefit.
> £135,000 relating to UK duties (£180,000 × 75%)
> £45,000 relating to non-UK duties (£180,000 × 25%)

> The UK benefit is treated as having been remitted to the UK and consists primarily of earnings relating to UK duties. As Mr C has more than £30,000 of earnings relating to UK duties, all £30,000 of the UK benefit is treated as being from those earnings.
> Therefore Mr C's remaining earnings consist of:
> £105,000 relating to UK duties.
> £45,000 relating to non-UK duties.

34.25.6 *Account becomes/ceases qualifying*

An account may become a qualifying account. Section 809RA(4) ITA provides:

> If the tax year is the tax year in which the account becomes a qualifying account, for the purpose of applying section 809Q(3) in relation to the single transfer mentioned in step 1 of subsection (2), treat the part of the tax year falling before the qualifying date for the account as a separate tax year.

An account may cease to be a qualifying account. Section 809RA(5) ITA provides:

> If the account ceases to be a qualifying account of the individual during the tax year other than as a result of a breach of the deposit rule—
> (a) subsection (2) has effect as if references to the end of the tax year were to the end of the day on which the account ceases to be a qualifying account, and
> (b) for the purpose of applying section 809Q(3) in relation to the single transfer mentioned in step 1 of subsection (2), treat the part of the tax year falling after the day mentioned in paragraph (a) as a separate tax year.
> (9) If the account ceases to be a qualifying account of the individual during the tax year other than as a result of a breach of the deposit rule, subsection (8) has effect as if the reference to the end of the tax year were to the end of the day on which the account ceases to be a qualifying account.

OWR mixed fund FAQs provides:

> When you change your qualifying account during the year, you should treat the date on which you changed the account as if it is the end of the tax year for the purposes of the special mixed fund rules, so that the single remittance and single offshore transfer are deemed to be made on that date. In other words, you will have to work out how the rules applied to the first qualifying account until the point that it ceased to be a

qualifying account (part way through the year), and must work out how they applied to the later qualifying account from the point it becomes a qualifying account to the end of the tax year.

But you can still apportion your earnings between UK and overseas duties for the whole year.

At the actual end of the tax year you will need to carry out the same procedure for the income in the new qualifying account - the single remittance and single offshore transfer will cover transactions made in the period between the date you first used the new qualifying account and the end of the tax year.

Can an account that has been my qualifying account in the past be my qualifying account again in the future?

If an account has been your qualifying account in the past but then ceased to be your qualifying account for whatever reason, it cannot later be used as your qualifying account again. This is because an account can only become a qualifying account on its "qualifying date". An account can only have one qualifying date, and so cannot become a qualifying account a second time. ...

Note that you may use the same qualifying account from one year to the next - a qualifying account does not automatically cease to be a qualifying account at the end of the tax year.

34.26 Two or more employments

HMRC FAQs provide:

I have more than one employment for which I perform duties both in the UK and overseas. I pay the earnings for all of these employments into my qualifying account. When I apportion my earnings, can I add together the workdays from all of my employments for calculating what proportion of my workdays were overseas?

No You have to apportion the income from each of the employments individually.

Example[70]

Ms B has two employments. For the first employment, Ms B performs 25% of the duties in the UK and 75% overseas, and has an annual salary of £40,000. For the second employment Ms B performs 50% of the duties in the UK and 50% overseas, and has an annual salary of £30,000.

Ms B must apportion the earnings from each employment separately between UK and non-UK duties.

[70] I have altered the layout for clarity.

So from the first employment Ms B has:

relating to UK duties (£40,000 × 25%)	£10,000
relating to non-UK (£40,000 × 75%)	£30,000
total	£40,000

And from the second employment Ms B has:

relating to UK duties (£30,000 × 50%)	£15,000
relating to non-UK duties (£30,000 × 50%)	£15,000
total	£30,000

34.27 Salary paid into 2 accounts

HMRC mixed fund FAQs provides:

> **If my pay is paid partly in the UK and partly overseas, how do I calculate what I have remitted?**
>
> Payments into a UK account will be a remittance and so will be primarily UK taxable income following the ordering in section 809Q(4) ITA 2007. The composition of the overseas account will be the remainder of the apportioned income
>
> ***Example***
>
> Mrs B has a salary of £100,000 of which £60,000 is paid into a UK account for general living expenses and £40,000 is paid into an overseas account. The workday split calculated at the end of the year is 75% UK workdays; 25% overseas workdays. Of the £75,000 UK earnings, £60,000 will have been paid into the UK account and the balance of £15,000 will be in the overseas account together with the £25,000 foreign earnings.
>
> If the workday split had been 50:50 the UK account would have contained £50,000 UK income and £10,000 overseas employment income which would be regarded as remitted.
>
> **If my pay is paid into two separate overseas accounts, one of which is my qualifying account, how will the mixed fund rules apply to remittances from the qualifying account**
>
> Each payment of salary will be a mixture of UK and overseas earnings however the proportion of each can not be calculated until the workday apportionment is completed at the end of the year. In addition the mixed fund rules operate by giving preference to remittances to the UK over offshore transfers (section 809R(5) ITA 2007). Although the technical analysis of the accounts is complicated the result is that remittances from the qualifying account will come first from the UK earnings
>
> ***Example***[71]
>
> Mr C is paid a salary of £1,000,000 in the year split equally between a

[71] I have altered the layout for clarity.

qualifying Jersey account and a non qualifying USA account. The workday apportionment determines that £750,000 of the salary relates to UK duties. Mr C remits £400,000 to the UK in the year from the qualifying account. The special mixed fund rules will look first at the combined £400,000 remittance which will, because section 809Q ITA 2007 takes preference over section 809R ITA 2007, consist entirely of UK earnings. The balance of £600,000 will be split proportionally between the amounts remaining in the 2 accounts.

So the £100,000 remaining in the qualifying account will consist of

UK earnings	£58,333
overseas earnings	£41,667
total	£100,000

the £500,000 in the USA account will be

UK earnings	£291,667
overseas earnings	£208,333
total	£500,000

HMRC mixed fund FAQs provides:

My salary is paid into two separate accounts, one in my home country and one sterling overseas account. The sterling account is my qualifying account. How do I decide how much of the salary in the sterling account relates to my UK workdays?

Where your salary is paid into two separate accounts in a “split-payroll” scenario the normal mixed fund rules determine what earnings are paid into each account.

In general, if you remit income from your qualifying account it will relate to income from your UK workdays in preference to income from your overseas workdays, provided that you receive more income relating to your UK workdays for that year than the amount you remit.

If earnings relating to UK duties from the employment remain after taking account of all remittances from the qualifying account, then how those earnings are split between your qualifying account and your non-qualifying account depends on whether you have made any remittances (directly or indirectly) from your non-qualifying account.

If you have not made any remittances from your non-qualifying account, then the proportion of the earnings in your sterling account which relate to UK earnings (after the remittance but before the single offshore transfer) can be calculated using the formula:

$(U - R) / (E - R)$

Where

U is the total of your earnings from the employment for the year that relate to UK duties,

R is the amount of the remittance, and
E is your total earnings from the employment for the year.

34.27.1 *Non-qualifying account*

The minutes of the Joint Forum on Expatriate Tax and NICs provide:

Question

Assumptions

Individual is paid £120,000 p.a., £10,000 pcm via the US payroll.

He is paid 60% into a qualifying US account (US$) and 40% into a non-qualifying account in Jersey (GBP)

Despite the fact that the Jersey account is non-qualifying, the only monies that have ever been paid into the account are assignment related earnings

The individual is entitled to OWR and performs 20% of his duties outside of the UK

The only money remitted to the UK is £3,600 pcm from the Jersey account.

Assumed UK tax position

There are no remittances from the US qualifying account so the SMFRs [OWR special mixed fund rules] are not in point.

Per HMRC's analysis, the amount credited to each account would, in the first instance be:

- US qualifying account - £4,800 of s.15 income and £1,200 of s.26 income pcm
- Jersey non-qualifying account - £3,200 of s.15 income and £800 of s.26 income pcm

However, £3,600 is remitted to the UK from the Jersey account each month so s.809R(4) is overridden by s.809R(5) such that the rules in s.809Q are applied. The remittance of £3,600 pcm is less than the amount of s.15 income received each month and so all of the amount remitted is regarded as s.15 income

This analysis is repeated each month so the balance on the Jersey account is:

Month	**s.15**	**s.26**
April	£3,600	£400
Less remittance	-£3,600	0
Balance	£0	£400
May	£3,600	£400
Less remittance	-£3,600	0
Balance	£0	£800

Etc

> The amounts remaining in each account at the end of the tax year are:
>
> - U S qualifying account – £52,800 of s.15 income and £19,200 of s.26 income
> - Jersey non-qualifying account - £0 of s.15 income and £4,800 of s.26 income
>
> The above assumes that you do not re-apportion the balance of the two accounts at year end.
>
> *HMRC answer*: We would agree with the analysis on the facts given and the assumption there are no "other transfers" from the qualifying account. However there may be a different result if there were "other transfers" from the qualifying account. Because the qualifying account must be looked at in priority to the non-qualifying account "other transfers" would reduce the amount of s.15 and s.26 income available to remit from the non-qualifying account.
>
> To take an example, if you assume that all of the payments made to the qualifying account were spent overseas in the year (£72,000 in total) it would remove £57,600 s.15 income and £14,400 s.26 income as an "other transfer" within section 809RA(2) ITA. The only monthly amounts available for remittance from the non-qualifying account would be £3,200 s.15 income and £800 s.26 income credited to it. Each monthly remittance of £3,600 on a transactional basis would therefore consist of £3,200 s.15 income and £400 s.26 income.

The Joint Forum on Expatriate Tax and NICs returned to this issue in July 2014. HMRC say:

> *Question:* I'm afraid that we don't completely understand how the rules are being interpreted and applied.
>
> The first example deals with the position where payments are made by the employer into two non-UK accounts, one of which is a qualifying account. We agree that each account should be treated as containing the same pro-rata share of s.15 and s.26 income. We also agree that remittances from the non-qualifying account are from s.15 income in that account in priority to s.26 income. We don't however understand the statement, "Because the qualifying account must be looked at in priority to the non-qualifying account, "other transfers" would reduce the amount of the s.15 and s.26 income available to remit from the non-qualifying account." HMRC's example shows that if all the funds in the US qualifying account are spent outside the UK, that reduces the funds in that account pro-rata, in accordance with the rule in s.809RA(2). Consequently the £72,000 spent from the qualifying account would be £57,600 s.15 earnings and £14,400 s.26 earnings. According to the

example, the £4,000 (s.15 £3,200 and s.26 £800) credited to the non-qualifying account are not affected by the offshore transfer from the qualifying account, which appears to contradict the sentence quoted above. Could HMRC please explain or clarify this?

HMRC answer:

The qualifying account is looked at in priority to the non-qualifying account because of section 809Q(1A) ITA 2007.

In the original question there were no remittances or offshore transfers from the qualifying account. The subsequent remittances from the non-qualifying account will follow the ordering rules in sections 809Q and 809R ITA 2007 as described in the second part of the question below. Each monthly remittance of £3,600 will therefore have a pool of £8,000 s.15 ITEPA 2003 and £2,000 s.26 ITEPA 2003 income for the mixed fund rules to operate on (i.e. the total amount deposited monthly to both accounts). The monthly remittance of £3,600 will therefore consist of s.15 ITEPA 2003 income (section 809Q(4)(a) ITA 2007).

In HMRC's original response we contrasted the above position with one where all of the money paid to the qualifying account was the subject of an offshore transfer in the year. As the qualifying account is looked at in priority to the non-qualifying account all of the income in the qualifying account is regarded as removed from it under the single offshore transfer in section 809RA ITA 2007. On subsequently dealing with the non-qualifying account using the transaction by transaction mixed fund rules, the monthly pool of income available for remittance is only £3,200 s.15 ITEPA 2003 and £800 s.26 ITEPA 2003 income. Each monthly remittance from the non-qualifying account therefore consists of £3,200 s.15 ITEPA 2003 and £400 s.26 ITEPA 2003 income under the normal operation of section 809Q ITA 2007. We are not entirely sure what the problem here is and suspect it may just be one of the language we used in the original response. Of course the offshore transfers do not *reduce* what is in the non-qualifying account in any way. We hope this further explanation is helpful in your understanding of the legislation.

34.27.2 *Example: Qualifying/non-qualifying accounts*

The minutes of the Joint Forum on Expatriate Tax and NICs provide:

Question

Assumptions

Individual is paid £120,000 p.a., £10,000 pcm via the US payroll.

He is paid 60% into a qualifying US account (US$) and 40% into a non-qualifying account in Jersey (GBP)

Despite the fact that the Jersey account is non-qualifying, the only monies that have ever been paid into the account are assignment related earnings

The individual is entitled to OWR and performs 20% of his duties outside of the UK

The individual remits £3,600 pcm to the UK from the Jersey account and also makes a one-off remittance of £20,000 to the UK from the qualifying US account in December after the earnings for November have been paid into the account but before the earnings for December have been added.

Assumed UK tax position

There is a remittance from the US qualifying account so the SMFRs [OWR (recent arrivals) mixed fund rules] are in point

Per HMRC's analysis, the amount credited to each account would, in the first instance be:

- US qualifying account - £4,800 of s.15 income and £1,200 of s.26 income pcm or £57,600 of s.15 income and £14,400 of s.26 income per annum
- Jersey non-qualifying account - £3,200 of s.15 income and £800 of s.26 income pcm

The SMFRs take precedence over the normal MFRs and so the position on the US account needs to be analysed first.

	s.15	**s.26**
Apportionment of earnings for the year	£57,600	£14,400
Less remittance	£20,000	0
Position after applying s.809RA but before s.809R	£37,600	£14,400

The next step is to analyse the Jersey account which must be analysed on a month by month basis. The starting point for the Jersey account is that £3,200 of s.15 and £800 of s.26 income is paid into the account each month. However, s.809R(4) is overridden by s.809R(5) which allows us to apply s.809Q to the monthly remittance. This is where we run into difficulty because of the interaction with the SMFRs that have been applied to the US qualifying account. We do not know how HMRC intend to apply the rules but one possible approach is to say that if you ignored the SMFRs there would have been £38,400 of s.15 income in the US qualifying account immediately prior to the one-off remittance of £20,000. This leaves £18,400. The amount of 'extra' s.15 income we need to allocate to the non-qualifying Jersey account is £400 per month and £18,400/8 is £2,300 which is more than £400 and so the amount remitted each month from the Jersey account is regarded as s.15 income only, i.e.

Month	**s.15**	**s.26**
April	£3,600	£400
Less remittance	-£3,600	
Balance	£0	£400
May	£3,600	£400
Less remittance	-£3,600	
Balance	£0	£800
Etc.		

The amounts remaining in each account at the end of the year are:

- US qualifying account – £32, 800 of s.15 (£57,600 – £20,000 –(£400×12*)) and £19,200 of s.26
- Jersey account - £0 of s.15 and £4,800 of s.26

*£400 is the amount reallocated each month from the US account to the Jersey account as a result of s.809R(5).

Our analysis of the example is as follows:

a) We agree you must look at the qualifying account first

b) After the £20,000 condition A transfer has been accounted for, the balance of income remaining is £76,000 s.15 income and £24,000 s.26 income (£100,000 total) - assuming there are no "other transfers" (see example (a)).

c) HMRCs view is the income is apportioned between the 2 accounts proportionately (see the final example in the FAQs) following the offshore transfer rule in section 809R ITA. Of course that will only total £100,000 (£76,000 + £24,000) so the £20,000 already identified as a remittance from the qualifying account must be included to match the apportionment with the amounts paid into the 2 accounts on a monthly basis. For the purposes of this example we will call this "remitted income" as it has already been identified as remitted s.15 income.

d) Each monthly salary payment to the qualifying account will consist of:
   - £3,800 s.15 income
   - £1,200 s.26 income
   - £1,000 "remitted income"

e) Each monthly salary payment to the non-qualifying account will consist of:
   - £2,533 s.15 income
   - £800 s.26 income
   - £667 "remitted income"

f) There is enough s.15 income in the monthly payments to the

> offshore accounts to ensure the £3,600 monthly remittance is entirely of s.15 income. This is the same result as CIOTs calculation, but arrived at via a slightly different methodology.
>
> g) We believe this methodology ensures the transfers identified by the special mixed fund rules are not double counted when looking at remittances from the non-qualifying account and the transaction by transaction basis of the normal mixed fund rules can be calculated accurately.
>
> h) For example, if the condition A transfers from the qualifying account totalled £72,000 rather than £20,000 the monthly payments to the qualifying account would be £1,200 s.15 income:
>
> - £1,200 s.26 income and
> - £3,600 "remitted income"
>
> Monthly payments to the non-qualifying account would be:
>
> - £800 s.15 income,
> - £800 s.26 income and
> - £2,400 "remitted income".
>
> The £3,600 monthly remittance from the non-qualifying account would consist of £2,000 s.15 income (£1,200 + £800) and £1,600 s.26 income.[72]

The Joint Forum on Expatriate Tax and NICs returned to this issue in July 2014. HMRC say:

> In the second example (remittances from both the qualifying and non-qualifying accounts) we find it difficult to understand the method applied. We agree that the first step is to identify the remittance of £20,000 from the qualifying account, which is all s.15 income. However, we do not understand why the remaining £100,000 is apportioned in the way it is on a monthly basis between the qualifying and non-qualifying accounts. For instance, if the £20,000 is remitted from the qualifying account, why is it subsequently split between the qualifying and non-qualifying accounts (pro-rata to the overall allocation of payments between them)? At f) HMRC say that there is enough s.15 income in the monthly payments to the offshore accounts to ensure the £3,600 monthly remittance is entirely of s.15 income. However, on HMRC's figures at e) the unremitted monthly s.15 income in the non-qualifying Jersey account is only £2,533. The only way in

[72] 29 January 2014 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/302475/140326_Expats_Forum_Jan_14_Minutes_FINAL.pdf*

which the individual's monthly remittance of £3,600 from the non-qualiyfing account can be treated as entirely s.15 is to look across to the qualifying account and bring in the s.15 income in that account. Is that HMRC's interpretation?

Looking at HMRC's variation to the second example, where £72,000 is remitted from the qualifying account, it is again not clear how the earnings attributed to each account match with the funds in it. For instance, we're told that after factoring in the £72,000 remittance (which it appears is all s.15 income) we have to identify the monthly income credited to the qualifying account as s.15 £1,200, s.26 £1,200 and £3,600 remitted. In fact there is only £4,000 left in the account after the £72,000 remittance, so for HMRC's approach to work we have again to "borrow" s.15 income from the non-qualifying account and in effect treat the two accounts as one for the purpose of identifying the s.15 and s.26 income in them. Is that the intention?

In summary, it would be helpful to have a clear statement of the principles applied where there are two or more offshore accounts from both of which remittances are made to the UK and from both of which offshore transfers are also made. Please consider

- Condition A transfer from a qualifying account
- "Other transfers" from a qualifying account
- Remittances from a non-qualifying account
- Offshore transfers from a non-qualifying account.

HMRC answer:

It is HMRC's view that the mixed fund rules begin to apply to a salary payment at a point just before it is paid to employee. As each salary payment is a mixture of s.15 ITEPA 2003 and s.26 ITEPA 2003 income, the mixed fund rules will apply to determine the composition of each offshore account. As section 809R(5) ITA 2007 gives priority to section 809Q ITA 2007 the composition of each salary payment can not finally be determined until the single remittance from the qualifying account (and the single offshore transfer if there is one) has been dealt with. It is not possible to know in real time what the composition of either account is. The proportional rule in section 809R(4) ITA 2007 applies to the balance remaining after the single end of year condition A transfer. Having determined the composition of each salary payment into the accounts, the mixed fund rules will apply to each transaction from the non-qualifying account on a transaction by transaction basis through the year. It is HMRC's view that dealing with the accounts in this way will avoid any potential double counting of income when dealing with the non-qualifying account on the transaction by transaction basis.

On the second point, again because HMRC's view that the mixed fund rules begin to apply at a point just before it is paid to the employee and the legislation gives priority to section 809Q ITA 2007, a remittance from the non-qualifying account will be s.15 ITEPA 2003 income to the extent that such income has been paid into either offshore account at that time. This was the basis of the original question 1 where only £3,200 s.15 ITEPA 2003 income was paid into the non-qualifying account but each monthly remittance of £3,600 was treated as remitted. This is HMRC's view of the correct operation of the mixed fund rules in sections 809Q and 809R ITA 2007 in these circumstances and we do not recognise the concept of "borrowing" mentioned in the question.

HMRC's view on when the mixed fund rules begin to apply in a situation where salary is split between accounts should, in most circumstances, be beneficial to employees. It ensures remittances from the qualifying account will be of s.15 ITEPA 2003 income to the extent that such income has been paid into either offshore account and from the non-qualifying account to the extent that either account contains s.15 ITEPA 2003 income at the time of the remittance.[73]

34.28 The deposit rule

34.28.1 *"Prohibited sum"*

Section 809RC(6) ITA provides:

> A "prohibited sum" is anything other than a sum that is, or derives wholly (whether directly or indirectly) from, any of the following kinds of income or capital—

There are 5 permitted categories and everything else is prohibited. The permitted categories are:

> (a) general earnings of the individual from an employment for a tax year which is a relevant tax year in relation to the employment,
> (b) general earnings of the individual from an employment which consist of money and are paid in a tax year which is a relevant tax year in relation to the employment,
> (c) an amount of specific employment income which, by virtue of Part 6, 7 or 7A of ITEPA 2003 or any other enactment, counts as

[73] Joint Expatriate Forum on Tax and NICs (July 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/347913/140731_Expat_Forum_Minutes.pdf*

> employment income of the individual in respect of an employment for a tax year which is a relevant tax year in relation to the employment,
>
> (d) interest on the account, or
>
> (e) consideration for the disposal of employment-related securities or employment-related securities options in the circumstances described in subsection (7).

HMRC say:

> (25.3) If an employer pays an expense reimbursement into a Special Mixed Fund, and the expense reimbursement is exempt under Part 4 ITEPA 2003, can HMRC confirm that the payment is not a breach of the deposit rule as defined by s809RC ITA?
>
> **Answer**
>
> (25.3) We can confirm that a payment of an exempt expense into a Special Mixed fund will not be a breach of the deposit rule.[74]

Section 809RC(7)(8) ITA deals with employment-related securities, a topic not discussed here.

Section 809RC(9) ITA defines "relevant tax year":

> For the purposes of this section a tax year is a "relevant" tax year in relation to an employment if—
>
> (a) the individual has general earnings from the employment for the tax year,
>
> (b) those earnings include both general earnings within section 15(1) of ITEPA 2003 ("section 15(1) earnings") and general earnings within section 26(1) of that Act ("section 26(1) earnings"),
>
> (c) at least some of the section 15(1) earnings, or sums deriving (wholly or in part, and directly or indirectly) from at least some of the section 15(1) earnings, are paid into the account in the tax year, and
>
> (d) at least some of the section 26(1) earnings, or sums deriving (wholly or in part, and directly or indirectly) from at least some of the section 26(1) earnings, are also paid into the account in the tax year.

[74] Expatriate Forum Minutes Oct 2019 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/855596/Expat_Forum_minutes_10_October_2019.pdf*

34.28.2 *Deposit rule*

Section 809RC(1) ITA provides:

> There is a breach of the deposit rule if a prohibited sum is paid into the account on or after the qualifying date.

34.28.3 *30-day grace period*

The employee should take care not to pay (say) dividend income into the qualifying account. But it is (just) possible to remedy a breach of the deposit rule. Section 809RC ITA provides:

> (2) A breach of the deposit rule is remedied if, within 30 days beginning with the day on which the individual became or ought reasonably to have become aware of the payment of the prohibited sum, the required amount is transferred out of the account by way of a single one-off transfer.
> (3) "The required amount" is an amount equal to—
> (a) the prohibited sum, plus
> (b) all the other prohibited sums (if any) that have been paid into the account since that sum was paid in.

The policy seems to be "three strikes and you are out". Section 809RC(4) ITA provides:

> If there are 3 breaches of the deposit rule in any 12 month period, subsection (2) does not apply to the third breach and, accordingly, the third breach cannot be remedied.

Section 809RC(5) ITA provides:

> The payment of a prohibited sum ("the later prohibited sum") into the account does not result in a breach of the deposit rule if—
> (a) a breach resulting from an earlier payment of a prohibited sum into the account is remedied, and
> (b) the later prohibited sum is represented by the required amount in relation to that breach.

The drafting is clumsy but it works. The point is that if there is an error, all errors must be cleared by the remedial steps.

OWR mixed fund FAQs offers a straightforward example:

> Mr A has a qualifying account at the beginning of 2015/16 into which his employment income is paid.
> On 15 May 2015 Mr A deposits some rental income from a property he

> has in Spain.
>
> This is a breach of the deposit rule. Realising this could affect the qualifying status of the account, Mr A transfers the full amount deposited to another of his offshore accounts on 29 May 2015. As the breach has been remedied within the 30 day period allowed, the account remains a qualifying account.
>
> On 30 June Mr A receives some dividends from a foreign company (not connected to his employment) and deposits them into his qualifying account. This is again a breach of the deposit rule and, once again, realising his mistake, Mr A transfers the full amount of the dividend to another offshore account within the 30 day period. The qualifying account again remains a qualifying account.
>
> On 15 September a further sum of income from the property in Spain is deposited into the qualifying account. As this is the third breach of the deposit rule in a 12 month period it can not be remedied and the account is treated as a normal mixed fund from 6 April 2015. The simplified mixed fund rules will no longer apply to the account for the year 2015/16.

OWR mixed fund FAQs provides:

> ***If I breach the deposit rule, do I need to report it to HMRC?***
>
> You do not need to report a breach of the deposit rule to HMRC. You will however need to remedy the breach within 30 days of finding out about it if you can do so and want to maintain the qualifying account status. If you do not remedy the breach the account will operate as a normal mixed fund for the whole tax year in which the breach occurred.

HMRC mixed fund FAQs provides:

> **I have one employment with UK duties, and one with overseas duties. Can I use the Special Mixed Fund rules for both?**
>
> No The Special Mixed Fund rules can only be used in relation to employments where the individual performs UK and overseas duties in the same tax year for the same employment.
>
> **I have one employment which requires me to work in the UK and overseas, and another employment where I only work overseas. Can I pay the salaries for both employments into my qualifying account?**
>
> No Income from an employment for which you have only UK or only overseas duties would be a prohibited sum, and cannot be deposited into a qualifying account.
>
> **My employer paid last year's bonus into my qualifying account. Does that count as an error?**

> No Any earnings from the employment that are paid in a year when you qualify for Overseas Workday Relief and have both UK and overseas duties of that employment can be deposited into the qualifying account, even where those earnings are for an earlier year.

34.28.4 *30-day deadline met*

Section 809RD ITA provides:

> (1) This section applies if the required amount in relation to a breach of the deposit rule was transferred out of the account in accordance with section 809RC(2).
> (2) Sections 809Q and 809R have effect as if—
> (a) the intervening transactions had never taken place, and
> (b) each prohibited sum represented by the required amount had instead been transferred directly (at the time that sum was paid into the qualifying account) into the account or other property into which the required amount was transferred by virtue of the single one-off transfer.
> (3) Each of the following is an "intervening transaction"—
> (a) each payment into the qualifying account of a prohibited sum represented by the required amount, and
> (b) the single one-off transfer out of the qualifying account.
> (4) If it is supposed under step 1 or 2 of section 809RA(2) that a single transfer had been made in the intervening period, re-apply section 809Q or 809R in relation to that transfer taking account of subsection (2).
> (5) "The intervening period" is the period—
> (a) beginning with the day on which the breach occurred, and
> (b) ending with the day on which the single one-off transfer was made in accordance with section 809RC(2).
> (6) If more than one transfer of a sum equal to the required amount was transferred out of the qualifying account within the 30-day grace period, the first of those transfers is assumed to be the single one-off transfer.
> (7) "The 30-day grace period" is the period of 30 days mentioned in section 809RC(2).

34.29 Non-resident employee

Section 27 ITEPA provides:

> (1) This section applies to general earnings for a tax year for which the employee is not resident in the UK if they are—
> (a) general earnings in respect of duties performed in the UK, or
> (b) general earnings from overseas Crown employment subject to

> UK tax.[75]
>
> (2) The full amount of any general earnings within subsection (1) which are received in a tax year is an amount of "taxable earnings" from the employment in that year.
>
> (3) Subsection (2) applies whether or not the employment is held when the earnings are received.

This applies regardless of domicile. DTA short-term business visitors relief may override this charge.[76]

There are two concepts in para (1)(a):

(1) Duties performed in the UK; and
(2) Earnings in respect of those duties.

It is best to consider these separately.

The employer will also need to consider whether the non-resident employee constitutes a foreign permanent establishment.

34.30 Where are duties performed

The question of where duties are performed (or at least, whether they are performed in the UK) is relevant for two purposes discussed in this chapter:

Purpose	**Why it matters**	**See para**
Workday relief	Arising/remittance basis	34.22
Non-resident employee	Taxable/tax-free earnings	34.29

The expression is one of a cluster of (more or less) identical terms or concepts:

Expression	**Matters for**	**See para**
Where duties performed	*See above*	*Discussed here*
Where employment exercised	DT relief	37.5
Where work done	Statutory residence test	6.23
Where services provided	Remittances	18.15
Where services performed	Foreign tax credit; DIMF	108.8.2, 73.14
Where trading income arises	Source of income from services	21.14

There are differences of context and statutory wording, but discussion on one of these expressions is generally helpful in considering the others.

Duties are performed in the place where the employee is physically

[75] See 34.40 (Overseas Crown employment).
[76] See 37.6 (Short-term business visitors).

present when performing the activities. Thus an employee outside the UK who is on the phone/Skype/Zoom/Teams with a person in the UK is performing his duties outside the UK.

Duties are performed in the UK even if the employee is stranded here because of Covid. That is self-evident. EIM explains why HMRC do not allow a concession on this point:

> **EIM77045 COVID-19 considerations for non-residents and non-domiciled employees for 2020 to 2021** [Jan 2021]
>
> For UK residents eligible for Overseas Workday Relief (that is UK resident employees with a period of non-residence within the 3 previous tax years) a day spent working in the UK will continue to be treated as a UK workday, even if they have been prevented from leaving the UK as a result of COVID-19 travel restrictions.
>
> The rationale for this is as follows:
>
> The UK has a claim to tax the worldwide income of UK resident employees, but has chosen to restrict that right for those who meet the conditions of section 26 ITEPA, allowing them to receive Overseas Workday Relief. OWR allows for employment income which relates to duties performed overseas to be taxable only to the extent that it is remitted to the UK, provided certain relevant conditions are met. It is a condition of s26(1)(a) that the income eligible for OWR cannot be 'general earnings in respect of duties performed in the United Kingdom'. Therefore, if a UK resident performs duties related to their employment in the UK, even if they are stranded in the UK as a result of COVID-19 travel restrictions, the requirements of s26 will not be met and they will be ineligible for OWR on income earned during those days.
>
> Only the UK can establish any rights to tax the income for the period or periods the UK resident taxpayer spends in the UK, it is therefore reasonable for the UK to charge tax on its residents for work performed in the UK as no other state will have a claim to tax any earnings for such work.
>
> With regards to taxpayers chargeable under section 22 with a dual contract, the duties of the overseas employment cannot be performed in the UK without removing the earnings from treatment as overseas chargeable earnings (subject to sections 38 and 39). As this is effectively an all or nothing charge, section 41ZA is not relevant.

34.30.1 *Absence from employment*

During a period of absence from employment, the employee is not actually performing duties in the UK or anywhere else. However s.38 ITEPA

provides:

> (1) This section applies if a person ordinarily performs the whole or part of the duties of an employment in the UK.
>
> (2) General earnings for a period of absence from the employment are to be treated for the purposes of this Chapter as general earnings for[77] duties performed in the UK except in so far as they would, but for that absence, have been general earnings for duties performed outside the UK.[78]

EI Manual provides a straightforward example:

> **EIM40202 Location of duties: Absence from duties** [Nov 2019]
> ... *Example*
> An employee who is not [ordinarily][79] resident in the UK performs the duties of the employment in Manchester. Illness meant that a holiday in Florida was unexpectedly extended so the days normally spent in the UK were lost. The Inspector received a calculation of earnings chargeable under s.15 [ITEPA][80] that excluded salary attributable to the days of absence.
> The Inspector successfully contended that s.38 [ITEPA] applied on the basis that the duties of the employment were normally performed in the UK. The earnings that had been excluded were therefore UK-based earnings within s.15 [ITEPA]

34.31 Earnings "in respect of" UK duties

The identification of earnings in respect of UK duties is relevant for two purposes:

Purpose	**Why it matters**	**See para**
Workday relief	Arising/remittance basis	34.22
Non-resident employee	Taxable/tax-free earnings	34.29

Section 41ZA ITEPA provides:

[77] Section 38 refers to earnings "for" duties performed in the UK, whereas ss.26, 27 ITEPA refer to earnings "in respect of" duties performed in the UK, but the meaning must be the same.

[78] Special rules apply for:
(1) duties on board vessels or aircraft: s.40 ITEPA
(2) duties performed in the UK sector of the Continental Shelf: s.41 ITEPA

[79] The Manual has not been revised following the abolition of ordinary residence in 2013, but that does not affect the point made here.

[80] The reference from 2008/2009 is now s.26 ITEPA.

> The extent to which general earnings are in respect of duties performed in the UK is to be determined under this Chapter [Chapter 5 Part 2, Remittance basis & non-resident employees] on a just and reasonable basis.

This provision was introduced in 2013, as part of the project to put SP 1/09 on a statutory footing.[81] The pre-2013 guidance and case law will continue to apply.

SP1/09 provides:

> 13. Where the duties of a single office or employment are performed both in and outside the UK, an apportionment is required to determine how much of the general earnings are attributable to the UK duties. Apportionment of general earnings is essentially a question of fact, but for many years HMRC has accepted time apportionment, based on the number of days worked abroad and in the UK, except where this would clearly be inappropriate.
> For example, in the case of an employee with 200 working days in the UK and 50 working days outside the UK, the proportion of general earnings attributable to UK duties would be 200/250.[82]

It is difficult to see what other rule there could be.

There have been two cases discussing whether earnings are "in respect of" duties performed in the UK. I discuss them in more detail elsewhere:

Case	**Topic**	**See para**
Taylor v Provan	International business travel	34.31.2
Perro v Mansworth	Tax equalisation	34.43

EI Manual provides an outline:

> **EIM77020. Appendix 2: General earnings in respect of duties performed in the UK** [Nov 2019]
> ... In *Taylor v Provan* (49 TC 579), the courts agreed that the touchstone must be the wording of the statute. In that case, travel expenses paid to a director to come to the UK in order to perform duties here were considered to be "emoluments in respect of duties performed in the

[81] The reader may wonder whether s.41ZA was really needed; but it is here now, and does no harm. For the SP 1/90 consultation and response papers, see 34.23 (OWR mixed funds); but the purpose (if any) of s.41ZA is not discussed.

[82] SP 1/90 continues: "This practice does not, of course, apply where the charge arises under Section 15 ITEPA and relief is due under Part 5 Chapter 6 ITEPA (Deductions from seafarers' earnings)."

> UK". In *Perro v Mansworth* [2001] (SpC286), a Special Commissioner found that the payment by an employer of an employee's liability to tax on UK-based earnings (Case II Schedule E) was itself "an emolument in respect of duties performed in the UK".
>
> Where an attribution is required, Statement of Practice 5/84[83] approves time apportionment according to the number of days worked abroad and in the UK except where this would clearly be inappropriate. The *Perro* case is an example of where time apportionment is not appropriate. The starting point for the SP5/84 approach to time apportionment is that the employee's contractual right to earnings for the work performed usually accrues from day to day.

There have also been some cases on the former relief for UK resident employees who worked 30 or more days abroad.[84] But as was pointed out in *Perro v Mansworth*, the wording of that relief is not the same, and the context is different, so little if any guidance is to be had from those cases. EIM77020 does however refer to them:

> Authority for this view comes from *Varnam v Deeble* (58 TC 501), although that case was not directly concerned with attributing earnings to UK duties for the purposes of the charge to UK tax. In *Platten v Brown* (59 TC 408), it was held that correct attribution on a time apportionment basis should employ units of days rather than hours.
>
> The courts have consistently taken the view that time apportionment should not be applied to earnings that can be specifically allocated either to duties performed in the UK or to duties performed elsewhere. So time apportionment would be inappropriate in a case where the contract of employment specifically allocated earnings to periods spent working in the UK or overseas. Provisions in a contract of employment that regulate the amount of time to be devoted to the employment, dealing with matters such as the number of days to be worked, the length of holidays or how to calculate compensation do not amount to an allocation of particular parts of remuneration to particular days of work.
>
> This appendix gives examples of how the time apportionment approach envisaged by SP5/84 applies in practice. Self-Assessment Helpsheet IR211[85] approaches apportionment by calculating the earnings from the

[83] Author's footnote: This was later replaced by SP 1/09.

[84] *Varnam v Deeble* 58 TC 501; *Platten v Brown* 59 TC 408; *Coxon v Williams* 60 TC 659. The relief survives in an attenuated form for seafarers, not discussed here: see Part 5 Chapter 6 ITEPA.

[85] Now HS211 (Employment - residence and domicile issues (2017))

employment that are not taxable in the UK. The total earnings are multiplied by a fraction where the numerator is the number of days worked outside the UK and the denominator is the number of days worked in pursuit of the employment during the tax year. Where there are no UK-based earnings taxable under either section 25 or section 27 ITEPA, the resultant figure will be entered at Box 1.31 on the employment page as foreign earnings not taxable in the UK...

Note 4 to IR211 clarifies what is meant by days worked overseas. They are defined as those days that have been spent outside the UK substantially performing the duties of the employment.[86] "Substantially" should be taken as meaning "for the most part".

In *Platten v Brown* there is the example of an employee who spends a whole day working in the UK but then leaves the country that evening on an overseas business trip. It would be difficult to say as a matter of contract that the employee's earnings for that day were not attributable on a time apportionment basis to duties performed in the UK. It follows that the earnings for a day spent working overseas before returning to the UK in the evening will be attributable to duties performed overseas.

There are two questions of fact to be addressed in order to attribute the earnings for a particular day. These are:

- whether the day has been spent substantially performing the duties of the employment
- where those duties have been performed.

Employees should retain evidence such as travel documents and business diaries to demonstrate how they have calculated the earnings from overseas workdays...

34.31.1 *HMRC example*

EI Manual provides:

EIM77020 General earnings in respect of duties performed in the UK [Nov 2019] ***Example** (Monica)*

M is resident but not ordinarily resident in the UK. Her salary of £100,000 is paid directly into an offshore bank account. Her contract of employment provides for a five-day 40-hour working week with 22 days holiday plus public holidays - a total of 230 workdays.

During 2005-06, her employer sent her to work at its branch in India for the whole of October and November, a period of 45 weekdays. She also

[86] Now Note 5 HS211, which provides: "Days worked overseas are those days which have been spent outside the UK substantially performing the duties of the employment."

attended the branch office in India on the first Saturday and Sunday in October and spent three other Saturdays working on her employer's Indian premises. She received a special bonus of £15,000 awarded solely in recognition of her work in India.
In addition, she attended her employer's Munich office on five separate occasions during the year. On four of these occasions, she left the UK after work and stayed overnight before returning to the UK on the following evening. On the final occasion, she left the UK on a Friday evening and spent the weekend in Munich. She spent three hours of the Sunday reading papers relevant to a meeting on the following day. She returned to the UK on Monday evening.

The HMRC analysis is as follows:

M was substantially performing the duties of her employment on the five non-weekdays spent working in India, giving a total 50 workdays in India. The Sunday in Munich was not an overseas workday so her duties in Germany encompassed five workdays. The special bonus was on the facts solely attributable to the performance of duties in India.
Time apportionment produces the following result –
UK duties - Salary 100,000 × 180/235 = 76,595 (Section 25 ITEPA)
Overseas duties - Salary 100,000 × 55/235 = 23,405 + 15,000 = 38,405

Example - variation A
Following her return to the UK, M's employer gave her time off in lieu of the weekends spent working in India. The denominator in the fraction would become 230 and not 235.
UK duties - Salary 100,000 × 175/230 = 76,086 (Section 25 ITEPA)
Overseas duties - Salary 100,000 × 55/230 = 23,914 plus 15,000 = 38,914

Example - variation B
Facts are as variation A plus M spent the whole of Sunday 30 September travelling to India and was granted a further day off in lieu when she returned to the UK. That day should also be counted as an overseas workday increasing the numerator by one to 56.
UK duties - Salary 100,000 × 174/230 = 75,652 (Section 25 ITEPA)
Overseas duties - Salary 100,000 × 56/230 = 24,348 + 15,000 = 39,348

34.31.2 *International travel*

Taylor v Provan concerned reimbursed travel expenses of a non-resident employee:[87]

[87] 49TC 579 at p.607. The deductibility of the expenses was a separate issue; see 35.14 (Travel in performance of duties).

> It was submitted that the taxpayer's travelling expenses to and from the United Kingdom ... were ... not emoluments in respect of duties performed in the United Kingdom'. I am unable to accept this submission. The taxpayer was not resident in the United Kingdom, and when he travelled to and from the United Kingdom in order to perform such part of his duties as had to be performed in the United Kingdom he was reimbursed his travelling expenses. I consider that the sums that he received were emoluments 'in respect of' his duties performed in the United Kingdom.

Note 5 HS211 provides:

> Days worked overseas are those days which have been spent outside the UK substantially performing the duties of the employment. This may include travelling, where the journey is itself part of the duties.

This is not exactly guidance. EI Manual provides something more specific:

> **EIM77020 General earnings in respect of duties performed in the UK** [Nov 2019]
> ***... international business travel***
> The time of departure or arrival and the duration of international business travel can make it extremely difficult to decide whether a particular day should be regarded as a UK or an overseas workday. In these specific circumstances, HMRC is prepared to accept that the following treatment provides a reasonable basis for determining the status of such a day:
> International flight or journey lasting no more than seven hours
> - Morning arrival – UK workday
> - Morning departure – overseas workday
> - Afternoon arrival – overseas workday
> - Afternoon departure – UK workday
>
> International flight or journey lasting more than seven hours
> - Morning arrival – half UK workday and half overseas workday
> - Morning departure – overseas workday
> - Afternoon arrival – overseas workday
> - Afternoon departure – half UK workday and half overseas workday
>
> A morning or afternoon arrival or departure is judged according to the time that the aircraft, vessel or train actually arrives or departs, not the scheduled times.
> Where a journey involves more than one international flight, a one hour transfer addition may be added to the actual flight times to determine

> whether the total flight time lasts more than seven hours. International business travel that takes place on a Saturday, Sunday or Bank Holiday is subject to the same treatment as any other day.
> Note: HMRC may accept alternative approaches to quantifying overseas workdays if the available evidence indicates that such an approach better reflects the facts.

34.31.3 *Work in UK due to Covid*

HMRC guidance provides:[88]

> **If you're a non-UK resident and were stuck in the UK because of coronavirus (COVID-19)**
> If you could not leave the UK when you intended because of coronavirus, you will not have to pay UK tax on employment income that:
>
> - you earned between the dates you intended to leave and when you actually left
> - you paid tax on in your home country
>
> **Example**
> You missed your departure flight because you were self-isolating and you worked in the UK until you could rearrange a flight home. As long as you pay tax on your wages in your home country, you will not have to pay tax in the UK.
> You must file a Self Assessment tax return, together with a completed SA109 form. Use the 'other information' section of your SA109 to include:
>
> - the dates you were stuck in the UK because of coronavirus
> - what you earned in that time
> - confirmation you paid tax on these earnings in another country
>
> ...HMRC may ask you for proof that you:
>
> - could not leave the UK when you intended, for example an NHS isolation note
> - paid tax in another country on what you earned while stuck in the UK
> - left the UK as soon as you reasonably could
>
> You may have to pay tax in the UK if you cannot prove you were unable

[88] HMRC, "Tax on your UK income if you live abroad" *https://www.gov.uk/tax-uk-income-live-abroad*
EIM77045 (COVID-19 considerations for non-residents and non-domiciled employees for 2020 to 2021) refers to this, but it does not provide further details so it need not be set out here.

to leave the UK and did not leave as soon as you could.

HMRC say:

> 5.5 HMRC advised that, since the last forum meeting, it has received a few queries regarding the guidance Tax on your UK income if you live abroad, which HMRC previously referred to as "s41ZA guidance" at previous forum meetings.
> 5.6 This is the guidance which means that, in certain circumstances, individuals will not have to pay UK tax on employment income relating to days stuck in the UK because of Coronavirus.
> 5.7 HMRC advised that, following feedback from the forum, the guidance page has been amended to make it clear that this relates to non-residents. The rationale for only applying to non-residents is held at the EIM Appendix which was previously shared...
> 5.9 A claim can only be made by an individual on a Self-Assessment Tax Return. HMRC specialists have confirmed that the guidance cannot be used to determine the amount on which PAYE is operated.
> 5.10 Therefore, when operating PAYE, an employer should not anticipate any claim which may be made by the employee and should instead operate PAYE as normal i.e. not excluding any employment income relating to days stuck in the UK because of Coronavirus. Employees should then file a tax return if they wish to make a claim for PAYE tax deducted to be refunded.
> 5.11 A consequence of this is that employees on an Appendix 8 scheme, who would not normally be required to submit a tax return, will need to file a return to make a claim.
> 5.12 Another consequence is that the days 'stuck' in the UK because of Coronavirus will count towards the 60 or less UK workdays criteria of an Appendix 8 scheme.

34.32 Remitting after year earnings are for

Suppose:

(1) T receives earnings for year 1; the earnings are taxed on the remittance basis and are not remitted in that year.

(2) The earnings are remitted in year 2.

For the COE remittance basis, s.22 ITEPA provides:

> (1) This section applies to general earnings for a tax year, to the extent that they are chargeable overseas earnings for that year, if—
> (a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the employee for that year, and

> (b) the employee does not meet the requirement of section 26A [recent arrival] for that year.
>
> (2) The full amount of any general earnings within subsection (1) which are remitted to the UK in a tax year is an amount of "taxable earnings" from the employment in that year. ...

Similarly, for the OWR remittance basis, s.26 ITEPA provides:

> (1) [a] This section applies to general earnings for a tax year where section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the employee for that year and the employee meets the requirement of section 26A [recent arrival] for that year, if
>
> [b] the general earnings are neither—
>
> (a) general earnings in respect of duties performed in the UK, nor
>
> (b) general earnings from overseas Crown employment subject to UK tax.
>
> (2) The full amount of any general earnings within subsection (1) which are remitted to the UK in a tax year is an amount of "taxable earnings" from the employment in that year.

The earnings are "taxable earnings from the employment in that year" ie year (2). In year (1) the earnings are not "taxable earnings" (as defined).

34.33 Remittance after employment

Section 22(3) ITEPA provides:

> Subsection (2) [charge on remittance of COE] applies whether or not the employment is held when the earnings are remitted.

Section 26(3) ITEPA provides the same rule for the OWR remittance basis.

34.34 Earnings for year employee non-resident

To be "overseas earnings" the earnings must be "for" a year of assessment in which the employee was resident in the UK. Accordingly, any earnings "for" a year during which the employee was not UK resident can be remitted at any time without a charge to tax.

34.35 Remittance when non-resident

Suppose earnings taxable on the remittance basis are remitted in a year when the employee is non-resident. In the HMRC view the earnings are taxable. EI Manual provides:

> **EIM42371. Foreign earnings taxed at time of receipt in UK: *Example*** [Nov 2019]
> An employee is resident in the UK and meets the conditions of section 26A in 2014/15. She has earnings for that year of £10,000 in respect of duties performed outside the UK. She is paid the £10,000 in New York in 2015/16. In 2016/17 she remits £5,000 of those earnings to the UK. The result is that this employee is chargeable under Section 26(2) ITEPA 2003 on £5,000 in 2016/17.
> This employee is likely to be resident in the UK in the year of remittance but she is assessable on the remittance even if she is not. What matters is her residence status in the year when the money was earned (see EIM42201). She will also be assessable on any further remittances out of the £5,000 balance that remains.
> Note that the employee is chargeable on any remittances to the UK even if her employment ceases in 2015/16 (see EIM42370).

Is this correct? It is a surprising anomaly compared to the position for RFI, and enforcement may be difficult, but this is the natural reading of the legislation. The TNR rules are drafted on that basis: hence they apply to RFI but not to employment income.

34.36 Receipt/remittance after death

Section 13(4) ITEPA provides:

> If the tax is on general earnings received, or remitted to the UK, after the death of the person to whose employment the earnings relate, the person's personal representatives are liable for the tax.

EI Manual provides:

> **EIM42380. Basis of assessment for general earnings: earnings received after the death of an employee or office holder** [Nov 2019]
> When an employee or office holder dies, earnings received (or, if the employee was subject to the special rule for certain foreign earnings, received in the United Kingdom) after the date of death are assessable on the personal representatives in the same way as if they had been received by the employee or office holder (see generally EIM42201). The earnings will, of course, all have been earned in periods before the date of death and in many cases, adopting the statutory position could place an additional burden upon the personal representatives and family of the deceased but may not result in materially different overall tax liability. Sensible administrative procedures should be used in this type of case and a review should be undertaken to determine the assessing

basis which is most financially beneficial to the personal representative.
Note. The strict basis of assessment should always be applied when requested, and follow EIM42390.

When no request to apply the strict basis has been received and it is beneficial not to apply the strict basis you should take the pay and tax shown on the deceased's P45 as received in the period before the date of death (see generally EIM74101 for taxation of all pensions and annuities). Furthermore, when the death occurs close to the end of the tax year, a payment received in the year following death should also be treated in the way most beneficial to the estate. This is particularly relevant if the deceased was not liable to tax up to the date of death.

Note: State pension is treated as accrued income and is treat as income received prior to the date of death irrespective whether it is paid after.

The tax chargeable on the personal representatives is a debt due from and payable out of the deceased's estate.

As regards:

If it is contended that earnings cannot be attributed to any particular period during the lifetime of the deceased employee or office holder, see EIM40005.

So it is the place where duties were performed and the residence and ordinary residence status of the employee when the remuneration was earned that counts. The residence position of the personal representatives at the time the earnings are received (or, where the special rules for certain foreign earnings apply, received in the United Kingdom) is irrelevant.

In cases where an employee or office holder has died the employer will follow the instructions at page 12 of the Employer's Further Guide to PAYE. By following those instructions the employer will account for tax in the following way:

- when payments are made in a tax year following that in which the employee died the employer will prepare a new deductions working sheet and will use code OT Week1/Month1.

EIM42390 earnings received after the death of an employee or office holder: the charge on personal representatives [Nov 2019]

If an employee or office holder dies and earnings are received after the date of death, the personal representatives are charged to tax on them (see EIM42380). They are charged:

- at the OT rate only
- in the year the earnings are received (or, where the special rules for certain foreign earnings apply, received in the United Kingdom)
- without any allowances, deductions or reliefs except for the deductions, reliefs and exemptions that would have been due to the

employee had they lived.

The personal representatives cannot claim deductions for expenses that they incur separately themselves. The main deductions due are therefore:

- expenses within Sections 336 to 338 ITEPA 2003 incurred by the employee or office holder (see EIM31620 onwards)
- balancing allowances due to the employee or office holder; balancing charges will also fall on the personal representatives (see EIM36500 onwards)
- foreign travel and accommodation expenses within Sections 341, 342 and 370 to 376 ITEPA 2003 incurred by the employee or office holder (see EIM34000 onwards)
- professional fees and subscriptions within Sections 343 and 344 ITEPA 2003 (see EIM32880 onwards)
- where a lump sum is assessable under the "golden handshake" provisions the various exemptions that are available under Sections 404 to 414 ITEPA 2003 (see EIM13500 onwards).

A deduction that is due is not limited to expenses actually paid by the deceased. The personal representatives can have a deduction for an expense that the deceased was due to pay but that the representatives actually settle.

As regards:

- the time limit for assessing personal representatives, see EIM42400
- the treatment of earnings received up to the date of death, see EIM42410.

Where the arising basis applies, there is clearly a tax charge for earnings received after death by the PRs.

Where the remittance basis applies, it is difficult to see how there could be a charge on earnings received in the UK after the death of the employee, since the tax charge only arises on receipt by a relevant person, and there are no relevant persons after the death of an employee.

34.37 Earnings from Ireland

In the following discussion:

"Irish earnings" means earnings from an Irish resident employer; it is assumed that the conditions for the remittance basis are in principle all met (duties performed outside the UK, etc).

"Pre-2008 earnings" means earnings arising before 6 April 2008.

The UK/Ireland DTA also needs to be considered but it is not discussed here.

Similar points arise in relation to RFI; see 17.22 (RFI from Ireland).

34.37.1 *Earnings from 2008/09*

The position for earnings from 2008/09 is straightforward. The ITA remittance basis treats Irish earnings in the same way as any other foreign earnings. The FA 2008 repealed the rule of the pre-2008 remittance basis which provided (unlawfully and probably ineffectively) that Irish earnings were taxed on an arising basis.

34.37.2 *Pre-2008 earnings*

This change raised the problem of transition. Para 82 sch 7 FA 2008 provides:

> (1) This paragraph applies in relation to an individual's general earnings for the tax year 2007–08 or any earlier tax year ("the relevant tax year") if the individual—
> (a) was UK resident in that year, but
> (b) was not domiciled in the UK, or was not ordinarily UK resident, in that year...
> (3) In relation to the general earnings, the definition of "foreign employer" in section 721(1) of ITEPA 2003 has effect as if at the end there were inserted "and not resident in the Republic of Ireland".

Amended as para 82(3) directs, s.721(1) ITEPA provides:

> "foreign employer" means an individual, partnership or body of persons resident outside the UK and not resident in the UK *and not resident in the Republic of Ireland*.

Thus (although this might surprise the residents of Eire) an Irish resident employer was not (for this purpose) a "foreign employer" so pre-2008 Irish earnings were not "chargeable overseas earnings" so the remittance basis does not apply to them. Para 82(3) is simply a roundabout way of disapplying the remittance basis charge for pre-2008 Irish earnings.

EN FB 2008 provides:

> 395. Subsection (3) ensures that the existing restriction on the application of the remittance basis in the case of employment income from employers resident in the Republic of Ireland continues to apply in relation to the remittance on or after 6 April 2008 of general earnings arising before that date. This will prevent double taxation as the general earnings have already been taxed when they arose.

In short, if:
(1) Irish earnings arose before 2008/09; and
(2) The earnings are remitted on or after 2008/09
there is no tax charge on remittance.

34.37.3 *Why is para 82(3) needed?*

Before 2008, s.721 ITEPA provided:

> *"foreign employer" means*
> *(a) in the case of an employee resident in the UK, an individual, partnership or body of persons resident outside the UK and not resident in the UK* ***or the Republic of Ireland,***

Under this definition, earnings from an Irish resident employer could not have been chargeable overseas earnings so at first it seems that para 82(3) is not needed. It may be that para 82(3) is otiose; it is inserted by mistaken analogy with para 83(3) (which is needed). However para 82(3) is needed on the assumption that where
(1) earnings arose before 2008/09 and
(2) the earnings are remitted from or after 2008/09
the question of whether the earnings qualify as chargeable overseas earnings is to be determined by the legislation as it stands in the year of remittance, and not by the legislation as it stood at the time that the earnings arose.

34.37.4 *Pre-2008 Irish earnings: Position pre-2008/09*

As noted above, according to statute, the remittance basis did not apply if the employer was resident in the Republic of Ireland: pre-2008 Irish earnings were taxable on the arising basis and not the remittance basis. The discrimination against Ireland was contrary to EU law.[89] Under para 82(3) discussed above, pre-2008 Irish source income which was not remitted before 2008/09 escapes UK tax altogether, since unremitted Irish source income was not lawfully taxable when it arose and it is not (from 2008/09) taxable on remittance. But the point will not now often arise.

34.38 Termination payments

A termination payment is charged under Part 6 ITEPA. A full discussion would need a long chapter.

[89] The point was discussed in the 6th edition of this book para 9.51 and 10.4.2.

Special rules which apply to seafarers are not discussed here.

34.38.1 *Post-employment notice pay*

Certain termination awards (post-employment notice pay) are taken out of s.403, and taxed as general earnings: s.402A-402E ITEPA. I hope to consider this in detail in a future edition.

Expat log Q&A provides:

> **Question**: The query that I raised yesterday is confirmation of HMRC's views on the period for which PENP general earnings is earned, for the purposes of the ITEPA 2003 sections that assess general earnings. FA (2) 2017 s 5(2) imported the s 402B PENP into the ITEPA 2003 s 7(5) list of amounts treated as general earnings (in sub-para (ca)). In HMRC's view, is the PENP earned for assessment purposes by reference to the period for which it is calculated as set out in the ITEPA 2003 s 402E rules?
>
> As another Forum attendee mentioned, HMRC's views would also be appreciated on the meaning of basic pay in s 402D(1) for PENP calculation in expatriate employee situations (in particular, taxequalised individuals).
>
> **HMRC answer**: PENP is 'for' the year it is received, unless the employment is not held in that year in which case s17 or s30 ITEPA will apply. In practice, this means that PENP will always be 'for' the year of termination.
>
> If the year of termination is a split year, PENP may be within s15 or it may be excluded earnings if it is attributable to the overseas part of the split year. Employers should decide to what extent PENP is attributable to the overseas part of the split year by considering where the employee would have worked during the period of notice, in line with Paragraph 2.6 of the commentary to the OECD model.
>
> For a tax-equalised employee, basic pay will be the total of:
>
> • The net amount of pay stipulated by the employment contract or assignment agreement
>
> • Any gross-ups on basic pay
>
> • Any gross-ups on disregarded amounts (e.g. allowances)[90]

The law in this area is to change next year. HMRC have published a policy paper, "Changes to the treatment of termination payments and

[90] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/897729/HMRC_Joint_Expat-Forum-Tax_NICs_minutes-11-June-2020.pdf*

post-employment notice pay for Income Tax" (July 2020). In short, the new rule is to be that non-residents are charged to tax and NICs on PENP to the extent that they would have worked in the UK during their notice period.

34.38.2 *Charge on termination payments*

In outline, s.401(1) ITEPA provides:

> This Chapter [Chapter 3 Part 6, termination payments] applies to payments and other benefits[91] which are received[92] directly or indirectly in consideration or in consequence of, or otherwise in connection with—
>
> (a) the termination of a person's employment
> (b) a change in the duties of a person's employment, or
> (c) a change in the earnings from a person's employment,
>
> by the person, or the person's spouse or civil partner, blood relative, dependant or personal representatives.

The charge is on the amount of the benefit: s.403(1) ITEPA provides:

> The amount of a payment or benefit to which this Chapter applies counts as employment income of the employee or former employee for the relevant tax year if and to the extent that it exceeds the £30,000 threshold.

34.38.3 *Territorial exemption*

Termination payments are categorised as specific employment income rather than general earnings. The consequence is to disapply the usual territorial rules. Instead, s.413(1) ITEPA provides a different territorial exemption:

> (A1) This section applies to a payment or other benefit if—
> (a) the payment or other benefit is within section 401(1)(a), and the employee or former employee is non-UK resident for the tax year in which the employment terminates, or
> (b) the payment or other benefit is within section 401(1)(b) or (c).
>
> (1) This Chapter [Chapter 3 Part 6, termination payments] does not apply if the service of the employee or former employee in the employment in respect of which the payment or other benefit is

[91] Benefit is defined in s.402 ITEPA (not considered here).

[92] Receipt is defined in s.401(3) ITEPA (not considered here).

> received included foreign service comprising—
> (a) three-quarters or more of the whole period of service ending with the date of the termination or change in question, or
> (b) if the period of service ending with that date exceeded 10 years, the whole of the last 10 years, or
> (c) if the period of service ending with that date exceeded 20 years, one-half or more of that period, including any 10 of the last 20 years.

The key term is "foreign service". The definition covers the entire history of the taxation of employment income. Section 413(2) ITEPA provides:

> (2) In subsection (1) "foreign service" means service to which subsection (2A), (3), (4) or (6) applies.
>
> (2A) This subsection applies to service in or after the tax year 2013-14—
> (a) to the extent that it consists of duties performed outside the UK in respect of which earnings would not be relevant earnings, or
> (b) if a deduction equal to the whole amount of the earnings from the employment was or would have been allowable under Chapter 6 of Part 5 (deductions from seafarers' earnings).
>
> (3) This subsection applies to service in or after the tax year 2003–04 but before the tax year 2013-14 such that—
> (a) any earnings from the employment would not be relevant earnings, or
> (b) a deduction equal to the whole amount of the earnings from the employment was or would have been allowable under Chapter 6 of Part 5 (deductions from seafarers' earnings).
>
> (3ZA) In subsection (2A)(a) "relevant earnings" means earnings for a tax year that are earnings to which section 15 applies and to which that section would apply even if the employee made a claim under section 809B of ITA 2007 (claim for remittance basis) for that year.
>
> (3A) In subsection (3)(a) "relevant earnings" means—
> (a) for service in or after the tax year 2008–09, earnings—
> (i) which are for a tax year in which the employee is ordinarily UK resident,
> (ii) to which section 15 applies, and
> (iii) to which that section would apply, even if the employee made a claim under section 809B of ITA 2007 (claim for remittance basis) for that year, and
> (b) for service before the tax year 2008–09, general earnings to which section 15 or 21 as originally enacted applies.
>
> (4) This subsection applies to service before the tax year 2003–04 and

> after the tax year 1973–74 such that—
>
> (a) the emoluments from the employment were not chargeable under Case I of Schedule E, or would not have been so chargeable had there been any, or
>
> (b) a deduction equal to the whole amount of the emoluments from the employment was or would have been allowable under a foreign earnings deduction provision.
>
> (5) In subsection (4) "foreign earnings deduction provision" means—
>
> (a) paragraph 1 of Schedule 2 to FA 1974,
>
> (b) paragraph 1 of Schedule 7 to FA 1977, or
>
> (c) section 192A or 193(1) of ICTA.
>
> (6) This subsection applies to service before the tax year 1974–75 such that tax was not chargeable in respect of the emoluments of the employment—
>
> (a) in the tax year 1956–57 or later, under Case I of Schedule E, or
>
> (b) in earlier tax years, under Schedule E,
>
> or it would not have been so chargeable had there been any such emoluments.

A payment satisfying the above conditions can be remitted free of income tax to the UK. It is a moot point why the payment does not give rise to CGT, but in practice HMRC do not take that point.

Section 414 ITEPA provides:

> (1) This section applies if—
>
> (za) either—
>
> (i) the payment or other benefit is within section 401(1)(a), and the employee or former employee is non-UK resident for the tax year in which the employment terminates, or
>
> (ii) the payment or other benefit is within section 401(1)(b) or (c),
>
> (a) the service of the employee or former employee in the employment in respect of which the payment or other benefit is received includes foreign service, and
>
> (b) section 413(1) does not except the payment or other benefit from the application of this Chapter.
>
> (2) The taxable person may claim relief in the form of a proportionate reduction of the amount that would otherwise—
>
> (a) be treated as earnings by section 402B(1), or
>
> (b) count as employment income as a result of section 403.
>
> (3) The proportion is that which the length of the foreign service bears to the whole length of service in the employment before the date of the termination or change in question.

(4) A person’s entitlement to relief under this section is limited as mentioned in subsection (5) if the person is entitled—

(a) to deduct, retain or satisfy income tax out of a payment which the person is liable to make, or

(b) to charge any income tax against another person.

(5) The relief must not reduce the amount of income tax for which the person is liable below the amount the person is entitled so to deduct, retain, satisfy or charge.

(6) In this section “foreign service” has the same meaning as in section 413(2).

EIM13680 Section 401 ITEPA 2003: Exceptions: Foreign Service: General [Jan 2020]

Section 413 ITEPA 2003

A payment or other benefit which falls within section 401 ITEPA 2003 is excepted from charge to income tax if a sufficient proportion of the employee’s, or former employee’s service in the employment in respect of which the payment or other benefit is received counts as ‘foreign service’. EIM13690 explains the rules for determining whether the employment included sufficient ‘foreign service’. Foreign service has a special meaning for this purpose (see EIM13690).

With effect from 6 April 2018, this exception is no longer available for payments and other benefits that fall within section 401(1)(a) ITEPA 2003, if all of the following criteria are met:

- the employee or former employee is UK resident for the tax year in which the employment terminates (see EIM42800)
- the employment is terminated on or after 6 April 2018
- the payment, or other benefit is received after 13 September 2017

…

EIM13692 explains how to treat termination payments that are no longer excepted from a charge to income tax because the employee, or former employee is UK resident for the tax year in which the employment was terminated.

Where the exception is available, it applies to:

- termination awards not benefiting from the £30,000 threshold and treated as general earnings
- a payment or other benefit which is chargeable to income tax as specific employment income by section 403 ITEPA 2003

In order to determine whether a sufficient proportion of the employee’s or former employee’s service counts as ‘foreign service’ it’s necessary to obtain the following information:

- the relevant date (this is the date of the termination (or change) in question) and
- the amount of foreign service during the employment down to that relevant date - EIM13690 explains how to do this

EIM13690 Section 401 ITEPA 2003: Exceptions: ‘Foreign Service’: Definition [Jan 2020]

Section 413 ITEPA 2003

EIM13680 explained that a payment or other benefit which falls within section 401

ITEPA 2003 may be fully excepted from a charge to income tax if a sufficient proportion of the employee's service counts as 'foreign service'. Foreign service has a special meaning for this purpose.

Meaning of 'foreign service'

For a payment or other benefit within section 401 ITEPA 2003 to which the exception may apply, it is necessary to establish whether a sufficient proportion of the employee's service counts as 'foreign service'. 'Foreign service' means service to which a), b), c) or d) below apply:

a) Service in or after the tax year 2013 to 2014 to the extent that it consists of duties performed outside the United Kingdom in respect of which earnings would not be relevant earnings.

b) Service in or after the tax year 2013 to 2014 if a deduction equal to the whole amount of the earnings from the employment was or would have been allowable under Chapter 6 of Part 5 ITEPA 2003 (deductions from seafarers' earnings) (see EIM33000).

c) Service in or after the tax year 2003 to 2004 but before the tax year 2013 to 2014 such that any earnings from the employment would not be relevant earnings.

d) Service in or after the tax year 2003 to 2004 but before the tax year 2013 to 2014 such that a deduction equal to the whole amount of the earnings from the employment was or would have been allowable under Chapter 6 of Part 5 ITEPA 2003 (deductions from seafarers' earning) (see EIM33000).

This guidance deals only with the legislation relating to periods of service after 5 April 2003. If service before 6 April 1974 is involved, see EIM13705.

If there is a period of service when there are no earnings from the employment, apply the guidance as if there were.

Up to 5 April 2008, 'relevant earnings' means earnings to which section 15 or section 21 ITEPA 2003 as then enacted applies (see EIM40002). So if the earnings fall within any other provision, the period counts as 'foreign service'.

From 6 April 2008, 'relevant earnings' means earnings which are for a tax year in which the employee is ordinarily resident in the UK and to which section 15 ITEPA 2003 applies (see EIM40002). So if any other situation applies to the earnings, the period counts as 'foreign service'.

Combine the periods within the duration of the employment that count as 'foreign service by applying the definitions above and then give the full exception if any one of the requirements from the table below are met (see example EIM13970).

Total period of service down to the relevant date	**Requirement for full exception to be given**
All cases of whatever duration	Three-quarters or more of the whole period of service comprises of foreign service.
More than 10 years	The whole of the last 10 years comprises of foreign service.
More than 20 years	One-half or more of the whole period of service (including any 10 of the last 20 years) comprises of foreign service.

For this purpose treat successive employments with different members of the same group of companies as if they were a single continuing employment where the payment takes account of that service, see example EIM13975.

With effect from 6 April 2018, the exception from income tax is no longer available where certain criteria are met. EIM13680 lists these criteria and the circumstances in which the exception is no longer available.

EIM13692 explains how to treat termination payments that are no longer excepted from a charge to income tax for 'foreign service' because the employee, or former employee was UK resident for the tax year in which the employment was terminated.

Note: a taxpayer with some foreign service who does not meet the requirements in the table above may be able to claim a foreign service reduction instead, see EIM13700.

EIM13692 Foreign Service: Interaction With PENP [Jan 2020]

With effect from 6 April 2018, 'termination awards' (see EIM13872) are split into 2 elements:

- termination awards not benefiting from the £30,000 threshold and treated as general earnings (see EIM13874)
- termination awards subject to section 403 ITEPA 2003 (see EIM13876)

With effect from 6 April 2018, exception from and reduction of income tax are no longer available where certain criteria are met. EIM13680 and EIM13700 list these criteria and the circumstances in which the exception and reduction are no longer available.

Where the exception from and reduction of income tax for "foreign service" are no longer available because the employee or former employee is UK resident for the tax year in which the employment was terminated consider the following treatment.

Post-employment notice pay (PENP)

Post-employment notice pay (PENP) is part of the element of the termination award which does not benefit from the £30,000 threshold and which is chargeable to income tax as general earnings for the tax year in which the employment ended. Section 15 ITEPA 2003 applies to general earnings for the tax year in which the employee is resident in the UK (see EIM40101 and RDR1 for further guidance on the application of split year treatment). In the case of a split year, a charge to income tax does not arise if the general earnings are attributable to the overseas part of the split year. Any attribution should be done on a just and reasonable basis.

Termination awards subject to section 403 ITEPA 2003

Termination awards subject to section 403 ITEPA 2003 are chargeable to income tax as specific employment income. The rules in Chapters 4 and 5 of Part 2 ITEPA 2003 don't apply to specific employment income. The amount of the termination award is chargeable to income tax irrespective of the employee, or former employee's residence status. However, in these circumstances it is necessary to consider any double taxation agreement (DTA) provisions in place (see EIM40601 and EIM13695) and the OECD commentary in Article 15 in respect of termination payments as appropriate (see EIM13698). These documents will determine which country has taxing rights over the income and how employers should comply with UK PAYE and foreign withholding tax requirements.

Foreign Service Relief is only available where the employee is non-UK resident for the tax year in which the employment terminates. EIM13877 explains the chargeability of post-employment notice pay for non-UK resident employees.

EIM13700 Section 401 ITEPA 2003: Foreign Service: Reduction Of Charge [Jan 2020]

Section 414 ITEPA 2003

EIM13690 explained that if an employee whose service includes 'foreign service' fails to satisfy the conditions for full exception, the employee might still qualify for a reduction in the charge to income tax for payments and other benefits that fall within section 401 ITEPA 2003.

Eligibility for reduction

With effect from 6 April 2018, the same restrictions apply to the availability of this reduction as apply to the full exception for "foreign service" (see EIM13680). A reduction of the charge to income tax is no longer available for payments or other benefits that fall within section 401(1)(a) ITEPA 2003, where all of the following criteria are met:

- the employee, or former employee is UK resident for the tax year in which the employment terminates (see EIM42800)
- the employment is terminated on or after 6 April 2018
- the payment or other benefit is received after 13 September 2017

However, the legislation, which removes the reduction in the circumstances above does not apply if the service of the employee or former employee includes 'foreign seafaring service' (see EIM33101). So, on, or after 6 April 2018, a reduction in the charge to income tax remains available for payments, or benefits received in connection with the termination of a person's employment if that employment included 'foreign seafaring service'. EIM13685 includes the definition of 'foreign seafaring service'.

If service before 6 April 1974 is involved, see EIM13705.

EIM13702 explains how the reduction applies where the employee or former employee is eligible for the reduction and their employment included 'foreign seafaring service'.

Calculation of reduction

Where an employee or former employee is eligible for the reduction and their employment included 'foreign service' follow the rules below.

The reduction for 'foreign service' applies to both the element of any termination payment that is post-employment notice pay (PENP) (see EIM13874) and the element which is subject to section 403 ITEPA 2003 (see EIM13872).

However, the reduction of each element must be calculated separately (see the examples at EIM13985).

The amount of the reduction in PENP is the amount of PENP multiplied by the length of 'foreign service' and divided by the length of total service before the relevant date (the meaning of relevant date is the same as in EIM13680).

EIM13877 explains the chargeability of post-employment notice pay for non-UK resident employees.

For the element which is subject to section 403 ITEPA 2003, the £30,000 threshold must be deducted before calculating the reduction (see example EIM13980). The excess over the threshold is called the 'amount charged to tax' (in section 414(2) ITEPA 2003 it is called the amount that would otherwise count as employment income).

The amount of the reduction is the 'amount charged to tax' multiplied by the length of 'foreign service' and divided by the length of total service before the relevant date. The result can be deducted from the 'amount charged to tax' if the qualifying conditions are met.

Note

The taxpayer can claim the foreign service reduction by notice in writing at any time up to 4 years from the end of the year of assessment to which the claim relates (for claims made before 2 April 2010 the limit is 5 years after 31 January following the end of the relevant year of assessment).

34.39 Relocation expenses

Section 271(1) ITEPA provides a somewhat limited relief for relocation expenses.

> (1) No liability to income tax in respect of earnings arises by virtue of—
> (a) the provision of removal benefits to which this section applies, or
> (b) the payment or reimbursement of removal expenses to which this section applies.

A full discussion of this relief requires a chapter to itself, but one point is relevant here. Section 271(2) ITEPA disapplies the relief for employees taxed on the remittance basis:

> Subsection (1) does not apply if (disregarding this section) the earnings are general earnings to which either of the following sections applies—
> (a) section 22 (chargeable overseas earnings for year when remittance basis applies and employee outside section 26), or
> (b) section 26 (foreign earnings for year when remittance basis applies and employee meets section 26A requirement).

However this is relaxed by informal concession:

> HMRC were asked to clarify whether or not the exemption for relocation expenses within Section 271 ITEPA 2003 was available against earnings taxed on the remittance basis. HMRC confirmed that the current legislation does not provide for relocation exemption to be available where the remittance basis is claimed. However HMRC were aware of existing practice whereby the relocation exemption was applied before apportionment in respect of non-UK workdays. Although this methodology was not consistent with the existing legislation HMRC were content to allow the practice to continue.[93]

34.40 Overseas Crown employment

General earnings from overseas Crown employment subject to UK tax[94]

[93] Joint Forum on Expatriates Tax and NICs Note of Meeting (September 2008) *http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/consultations/expat-mins-180908.htm*

[94] The expression "general earnings from overseas Crown employment subject to UK tax" is defined in s.28 ITEPA.

are taxed on an arising basis, regardless of residence, domicile and place of work. In the case of UK resident and ordinarily resident employees, such earnings are charged in the normal way under s.15 ITEPA and excluded from the remittance basis because the Crown is not a foreign employer. In the case of a UK resident employee, the earnings are charged in the normal way under s.15 and excluded from OWR by s.26(1)(b) ITEPA.[95] In the case of a non-resident employee, the charge is under s.27 ITEPA.[96]

The 1955 Royal Commission Report explains the reason:

> International comity does not permit the salary of the servant of one State to be taxed by another State: consequently a Crown servant, even if spending his whole time on work abroad, is not amenable to the local taxing jurisdiction and, if he is to be taxed at all, must be taxed by the UK taxing authority. No doubt the scale of remuneration for Crown servants abroad is fixed with these considerations in mind.[97]

34.40.1 *Low paid crown employee*

The EI Manual provides:

> **EIM40209: text of Board's Order under section 28(5)** [Nov 2019]
> ... On 19th June 2003 the Commissioners of Inland Revenue made an Order ("the 19th June Order") in exercise of the powers conferred upon them by section 28(5) of the Income Tax (Earnings and Pensions) Act 2003 ("the Act").
> The Commissioners for Her Majesty's Revenue and Customs now make this revised Order in exercise of the powers conferred upon them by section 28(5) of the Act.
> **Interpretation**
> In this Order
> "General earnings" has the same meaning as in Section 7(3) of the Act.
> "Overseas Crown employment" has the same meaning as in Section 28 of the Act.
> **General earnings excepted from the operation of section 27(2) Income Tax (Earnings and Pensions) Act 2003**
> General Earnings from overseas Crown employment in respect of an employee who-

[95] See 34.22 (Overseas Workday Relief).
[96] See 34.29 (Non-resident employee).
[97] Cmd 9474 para 307.

a. is not resident in the United Kingdom;
b. was engaged outside the United Kingdom; and
c. is employed in a grade the maximum rate of pay of which is less than the maximum rate of pay of a senior executive officer (or equivalent) employed in the same department of the United Kingdom Civil Service and working in inner London,

is excepted from the operation of Section 27(2) of the Act."

Amendments made to the 19th June Order by the Commissioners for Her Majesty's Revenue and Customs on 13th June 2006 and 26th March 2008 under section 28(5) of the Act continue to have effect so that paragraph 2 of this Order shall not apply to:

a. Queen's Gurkha Officers or any other members of the Brigade of Gurkhas who were recruited for that Brigade in Nepal; and
b. Members of the Royal Gibraltar Regiment.

34.41 Seafarers

The rules relating to seafarers and duties performed on vessels and aircraft are not considered here; see s.39(3), s.40, s.372 and Chapter 6 Part 5 ITEPA.

34.42 Lower-paid employee exemption

BN55 (22 April 2009) provides:

> Individuals with small amounts of foreign employment income
> 5. Individuals employed in the UK are currently required to file a Self Assessment tax return if they have also received income from overseas employment in the same tax year. This is the case even where there is little or no tax to pay in the UK because the overseas employment income has already been subject to tax in the other country.
> 6. This obligation to file a return will be removed with effect from 6 April 2008 where such individuals have overseas employment income of less than £10,000 and overseas bank interest of less than £100 in any tax year, all of which is subject to a foreign tax.

EN FB 2009 provides:

> 11. This clause introduces a new income tax exemption for low-income employees working in the UK who meet certain conditions. Such individuals will typically be migrant workers employed in seasonal work in the agricultural or service sectors in UK and in other countries in the same tax year and whose overseas income is subject to tax where it is earned. Previously they were required to file a Self Assessment tax return, even in situations where there was no, or very little, tax to pay.

> This exemption removes that requirement in most cases.

According, s.828A ITA provides:

> This Chapter provides for an exemption from liability to income tax for an individual for a tax year if-
> (a) the individual is UK resident in the tax year but not domiciled in the UK in the tax year,
> (b) section 809B does not apply to the individual for the tax year, and
> (c) conditions A to F in section 828B are met.

I refer to these conditions as "**LPE conditions A to F**".

Section 809B will only apply if the individual makes a claim under s.809B, which where the LPE conditions are satisfied will never happen, so the important requirements are the LPE conditions.

34.42.1 *LPE cond. A: UK employment*

Section 828B(1) ITA provides:

> Condition A is that in the tax year the individual has income from an employment the duties of which are performed wholly or partly in the UK.

Section 828D ITA defines "employment":

> (1) This section applies for the purposes of this Chapter.
> (2) "Employed" and "employment" have the same meaning as in the employment income Parts of ITEPA 2003[98]: see Chapter 1 of Part 2 of that Act.

If these were income-tax wide definitions it would not be necessary to say this here.

34.42.2 *LPE cond. B: Cap on RFE*

Section 828B(2) ITA provides:

> Condition B is that, if the individual's income for the tax year consists of or includes relevant foreign earnings—
> (a) the amount of the relevant foreign earnings does not exceed £10,000, and
> (b) all of that amount is subject to a foreign tax.

[98] Parts 2-7A ITEPA; see 34.2 (Employment income Parts).

Section 828D(5) defines "relevant foreign earnings":

> "Relevant foreign earnings", in relation to an individual, means what would be the individual's relevant foreign earnings for the purposes of Chapter A1 of this Part if section 809B applied to the individual (see section 809Z7(3)).

Section 828D(4) ITA defines "foreign tax":

> "Foreign tax" means any tax chargeable under the law of a territory outside the UK.

See 108.13 ("Subject to tax").

The £10k limit for relevant foreign earnings applies for the full year and is not affected by split year treatment. So an individual who has already earned more than £10,000 abroad in the UK tax year before he or she arrived is not eligible.

The £10k limit has not changed since 2008.[99]

34.42.3 *LPE cond. C: Cap on interest*

Section 828B(3) ITA provides:

> Condition C is that, if the individual's income for the tax year consists of or includes income that is relevant foreign income by virtue of section 830(2)(e) of ITTOIA 2005—
> (a) the amount of that income does not exceed £100, and
> (b) all of that amount is subject to a foreign tax.

In order to understand the reference to s.830(2)(e) ITTOIA one needs to read it together with s.830(1):

> (1) In this Act "relevant foreign income" means income which—
> (a) arises from a source outside the UK, and
> (b) is chargeable under any of the provisions specified in subsection (2) (or would be so chargeable if section 832 did not apply to it).
> (2) The provisions are ...
> (e) Chapter 2 of Part 4 (interest)

34.42.4 *Cond. D: No other income/gains*

Section 828B(4) ITA provides:

[99] See 43.19 (Inflation/fiscal drag).

> Condition D is that the individual has no other foreign income and gains[100] for the tax year.

34.42.5 *Cond. E: Higher rate taxpayer*

Section 828B(5) ITA provides:

> Condition E is that the individual would not for the tax year be liable to income tax at a rate other than
> [a] the basic rate,
> [b] the savings basic rate,
> [c] the savings nil rate,
> [d] a Scottish rate below the Scottish basic rate,
> [e] the Scottish basic rate,
> [d] the Scottish intermediate rate or
> [e] the starting rate for savings
> if this Chapter did not apply to the individual for the tax year.

34.42.6 *LPE cond. F: No tax return*

Section 828B(6) ITA provides:

> Condition F is that the individual does not make a return under section 8 of TMA 1970 for the tax year.

Since a return is due if HMRC choose to require it, the position is that HMRC have a power to withdraw the exemption (by requiring a return). The rule is thus: no tax is due unless HMRC happen to ask for it. This is a new development in tax policy; one hopes it does not become standard. HMRC say:

> HMRC sought to clarify the intention behind the new legislation which was to remove the obligation on overseas migrant workers on low incomes to file an SA return in cases where there was little or no tax to pay in the UK. It was true that such individuals would no longer qualify for the tax exemption if they filed a return to claim a tax repayment, but the tax exemption was merely the vehicle for delivering the administrative saving. External delegates failed to understand why the

[100] Section 828D(3) ITA incorporates the standard commonsense definition of "foreign income and gains":
""Foreign income and gains", in relation to an individual, means what would be the individual's foreign income and gains for the purposes of Chapter A1 of this Part if section 809B applied to the individual (see section 809Z7(2))."

> exemption should also be lost if the individual filed not a tax return but an R40 to claim repayment of PAYE on UK income.[101]

In fact, the R40 form is not a tax return under s.8 TMA: *Osborne v Dickinson* [2004] STC (SCD) 104.

The RDR Manual provides:

> **RDRM32070 - Remittance Basis: Accessing the remittance basis: Claiming the remittance basis: Calculation of income tax liability - exemption for non-domiciles with small amounts of foreign employment income** [Jan 2019]
>
> Individuals employed in the UK are usually required to file a Self Assessment tax return if they have also received income from overseas employment in the same tax year. However in many cases there is little or no tax to pay in the UK because the overseas employment income has already been subject to tax in the other country.
>
> From 6 April 2008 there is no obligation for individuals who are resident but not domiciled in the UK for a tax year to file a return as long as the individual is not claiming the remittance basis under ITA07/s809B and meets all of the following conditions (ITA07/s828A).
>
> [The Manual summarises conditions A - F and continues:] If all of these conditions apply, the individual receives an exemption from liability to income tax, in so far as that liability is attributable to the individual's foreign income or gains for the tax year (termed the 'relevant amount'). Broadly, the relevant amount is deducted from what would otherwise be the amount of the individual's liability to income tax for the tax year under ITA07/s23.
>
> This means that the individual is automatically taxed on the Arising Basis for that tax year, and does not have to complete a return.
>
> Most individuals who fulfil Conditions A to F are expected to use the Arising Basis and not complete a return. However there may be a small number of non-domiciled individuals who fulfil these conditions but who wish to use the remittance basis in respect of their foreign income and gains and are within the 'below £2,000 threshold' user group (ITA07/s809D). Such individuals will have to complete a return in order to claim the remittance basis under s809D; this will of course mean that Condition F of ITA07/s828A is no longer met, refer to RDRM32110 Unremitted foreign income and gains below £2,000 threshold. ...

[101] Joint Forum on Expatriates Tax and NICs July 2009 *http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/consultations/expat-mins-160709.htm*

34.42.7 *The exemption*

Section 828C ITA provides:

> (1) The exemption is given by deducting the relevant amount from what would otherwise be the amount of the individual's liability to income tax for the tax year under section 23.
> (2) "The relevant amount" is so much of the amount of the individual's liability to income tax as is attributable to the individual's foreign income or gains for the tax year.

I refer to this as the "**Lower-paid employee exemption**."

34.42.8 *Restriction on exemption*

Section 828C ITA provides:

> (3) But if for the tax year the individual's total income is reduced by any deductions which fall to be made at Step 3 of the calculation in section 23 from the individual's foreign income or gains for the tax year, subsection (2) has effect as if the individual's foreign income or gains for the tax year were reduced by the amount of the deductions.
> (4) And if the individual is entitled under.
> (a) sections 2 and 6 of TIOPA 2010(double taxation arrangements: relief by agreement), or
> (b) section 18(1)(b) and (2) of that Act (relief for foreign tax where no double taxation arrangements),
> to a tax reduction in respect of the individual's foreign income or gains for the tax year, what would otherwise be the relevant amount is reduced by the amount of that reduction.

34.42.9 *Administration: Avoid SA return*

HMRC say:

> HMRC stressed that, whilst the exemption was not designed for employees on inter-company transfers, it had become clear that the exemption could be applied to certain assignees, in particular those from India and China.
> 3 The main issue was the difficulty in identifying the relevant individuals. Unless informed that they qualify for filing exemption, HMRC would issue SA returns, thereby preventing them from taking advantage of s828A. HMRC had designed an election letter for Expats to meet this need: agents should submit this letter at the same time as the 64-8, and after the P46 (Expat) had been filed, which would ensure that

> no SA return is issued.

This is essential as if a SA return is issued, the relief is lost. For the form of the letter, see Fisher, "Expat Exemption", *Taxation* 3 March 2011 p.18. HMRC continue:

> There was a separate issue with employers using EPM App 6 with a month 12 adjustment to eliminate any residual liability whose employees are required to submit a SA return. However, as some had very simple tax affairs, there was a case for allowing them to use s828A whilst remaining within EPM6. HMRC will seek to engage with such employers to reach a suitable agreement for their employee base. In such cases, the election letter will need to be completed but retained by the employer. If there are individuals who do not qualify, the employer or agent will need to submit an SA1 to request a return.
> A similar case existed for NR individuals who submit SA returns to get personal allowances under DTAs.[102]

34.42.10 *Critique*

Almost every requirement of the lower-paid employee exemption is anomalous. If the aim is to remove obligations to file a return where there is little or no UK tax at stake, why is it so limited? The provision presumably reflects effective lobbying by special interest groups concerned with lower-paid employees rather than a serious attempt to address compliance cost issues.

34.43 Tax equalisation

The EIM provides:

> **EIM77040. Appendix 4: Not ordinarily resident employees: Tax equalisation** [Nov 2019]
> ... In addition to salaries and benefits, employers may also provide their employees with the benefit of tax equalisation. This usually means that the employer undertakes to meet on the employee's behalf any additional tax payable above the tax that the employee would have paid in his home country. It is well established that such payments made on behalf of employees form part of their earnings. But before 2002, there was a difference of view between the then Inland Revenue and a number of accountancy firms about the extent to which such tax equalisation payments represent earnings in respect of duties performed in the UK.

[102] Joint Expatriate Forum on Tax and Nics: 29 July 2010 Meeting Note *http://webarchive.nationalarchives.gov.uk/20130410172938/http://www.hmrc.gov.uk/consultations/expat-mins-290710.pdf*

The issue matters for NOR and NR employees: see 34.29 (Non-resident employee).

The view taken by the Inland Revenue and subsequently by HMRC is that tax equalisation payments represent earnings wholly referable to duties performed in the UK where the underlying tax liability is similarly wholly referable to duties performed in the UK. Therefore, where an employer pays a tax liability arising under section 25 on an employee's behalf, that payment will itself represent earnings wholly chargeable under section 25.

This view was approved by a Special Commissioner in 2001 in the case of *Perro v Mansworth* [2001] STC (SCD) 179. The Special Commissioner stated that it was an inescapable fact that the payment of tax by the appellant's employer was an emolument (earnings) in respect of UK duties since that tax was only payable because of the performance of duties in the UK.

Ms Perro's net earnings were time apportioned in accordance with SP5/84 in order to find the net attributable to UK duties as there was no specific attribution of salary or other benefits between UK and overseas duties. Following *Perro*, it has been accepted practice to gross up this net figure on the basis that the payment of tax on UK-based earnings represents additional earnings wholly referable to duties performed in the UK.

The Special Commissioner did not consider the treatment of reimbursement of tax on income other than employment income chargeable under what is now section 25. The employer of a tax-equalised employee may reimburse UK tax on investment income or capital gains. Employers may also pay foreign tax liabilities on the employee's behalf. Following the decision in *Perro*, the Inland Revenue was asked to give its view on the treatment of such reimbursements.

When apportioning earnings between sections 25 and 26, it is necessary first to consider whether those earnings are wholly referable to UK or non-UK duties on the facts. Clearly if this is so, there is no need to consider time apportionment. If the earnings are not wholly referable either to UK or non-UK duties, then time apportionment will be necessary in accordance with SP5/84.

If an employer reimburses personal tax liability arising on non employment income[103] such as bank interest, dividends or capital gains, then the first question is whether that reimbursement is a payment of earnings that relates wholly to either UK or non-UK duties. We do not consider that the physical presence of the employee in the UK in order to perform employment duties is sufficient justification for treating such reimbursements as wholly in respect of duties performed in the UK. In the absence of unusual facts, we believe that such earnings should be time apportioned. This will produce net section 25 earnings that will then need to be grossed up. The gross up will be on the basis that the payment of UK tax on earnings within section 25 is itself a payment of earnings wholly chargeable under section 25.

[103] Author's footnote: Employees are likely to claim the remittance basis so the tax charge is only on remitted income and remitted foreign gains. It is not clear that the employer ought to pay the charge on remitted income or gains as remittance is a decision of the employee. However it may be appropriate to do so.

With regard to foreign tax payments, the attribution between sections 25 and 26 will depend upon the facts and circumstances. If the foreign tax relates solely to overseas duties, then the payment of that tax by the employer will comprise earnings wholly referable to duties performed outside the UK that cannot be charged to tax under section 25. Alternatively, the foreign tax may be charged on worldwide income so that time apportionment is likely to provide the only practical mechanism for determining the attribution between sections 25 and 26.

With regard to the treatment of employer payment / reimbursement of tax chargeable under section 26, SP5/84 states that provided the earnings chargeable under section 25 are arrived at in a reasonable manner; HMRC is prepared to accept that a charge under section 26 will arise only where the aggregate of earnings received in the UK exceeds the amount chargeable under section 25 for that year. The amount chargeable under section 26 is therefore restricted to the excess of the aggregate over the amount chargeable under section 25.

Where the employer meets UK tax liability under section 26, the payment of that tax to HMRC will clearly be remitted to the UK. It is logical that the payment of the section 26 liability will itself be a payment of earnings chargeable under section 26 and as the tax payment will be remitted to the UK, the related gross up will also be wholly chargeable under section 26.

There can be significant practical difficulties in identifying whether earnings relate solely to non-UK duties and therefore fall within section 26. In such cases, HMRC would not generally dispute time apportionment between sections 25 and 26 on the basis of working days. If any earnings were allocated solely to section 26 as attributable wholly to non-UK duties, evidence should be available to justify the attribution, in the event of an HMRC enquiry.

Non resident employees

Some tax-equalised employees are not resident in the UK. They may perform substantive duties of their employment in this country. Unless the specific terms of a Double Taxation Agreement confer an exemption from UK tax on UK source employment income, such employees will be liable under section 27 ITEPA on earnings in respect of duties performed in the UK. Earnings for duties performed outside the UK will fall outside of the charge to UK tax on employment income. HMRC adopts the same approach to tax equalisation for non-resident employees as for those resident but not ordinarily resident employees whose earnings are apportioned between sections 25 and 26.

The following simple examples are intended to illustrate the basic approach to tax equalisation earnings described in this appendix. It is recognised that many cases will have much more complex facts and that the ensuing calculations will be similarly complex.

Example (Tanya)

T has been sent to the UK to work at her employer's UK branch for two years from 1 January 2005. She is resident but not ordinarily resident in the UK from the day of her arrival. In addition to her UK duties, her employer requires her to make regular and extensive visits to an overseas branch of its business in order to monitor an important project. Whilst assigned to the UK, T is subject to her employer's policy on tax equalisation which provides for her to receive the same net salary and benefits as if she had remained in her home state.

During 2005-06, T performed the duties of her employment on 225 days. She spent 158 days working in the UK and 67 days working overseas. Net salary and benefits from her employment were £100,000 of which £60,000 was received in the UK. Her employer was obliged to pay her tax liabilities in accordance with its tax equalisation policy. For simplicity, all calculations assume that T's income is chargeable to UK tax at 40%.

Scenario 1

T's only tax liability was incurred in the UK on the earnings from her employment.

Calculation of UK tax for 2005-06	
Net salary and benefits	100,000
Less amount attributable to overseas workdays – 67/225 (30%)	(30,000)
Attributable to the performance of UK duties	70,000
Gross up for UK tax at 4/6	46,666
UK-based earnings taxable under section 25 ITEPA	116,666
Tax at 40%	46,666
Remitted to the UK - 60,000 plus section 25 tax of 46,666	106,666
Section 26 ITEPA - SP5/84	Nil

Scenario 2

Facts as above but T's employer also paid UK tax liability of £5,000 on her investment income. As the £5,000 is not directly referable to the performance of duties inside or outside the UK, it falls to be time apportioned in accordance with SP5/84. Therefore, the £5,000 has been added to net salary and benefits before calculating and deducting the amount attributable to overseas workdays.

Calculation of UK tax for 2005-06	
Net salary and benefits	105,000
Less amount attributable to overseas workdays – 67/225 (30%)	(31,500)
Attributable to the performance of UK duties	73,500
Gross up for UK tax at 4/6	49,000
UK-based earnings taxable under section 25 ITEPA	122,500
Tax at 40%	49,000
Remitted to UK - 60,000 + s.25 tax 49,000 + other UK tax 5,000	114,000
Section 26 ITEPA - SP5/84	Nil

Scenario 3

Additionally, T's employer pays overseas tax liability of £5,000 direct to an overseas tax authority. The overseas tax is referable solely to the performance of duties outside the UK and is therefore excluded from the section 25 calculation.

Calculation of UK tax for 2005-06	
Net salary and benefits	110,000
Less overseas tax payment	(5,000)
Salary and benefits to be time apportioned	105,000
Less amount attributable to overseas workdays – 67/225 (30%)	(31,500)
Attributable to the performance of UK duties	73,500
Gross up for UK tax at 4/6	49,000
UK-based earnings taxable under section 25 ITEPA	122,500
Tax at 40%	49,000
Remitted to UK - 60,000 + s.25 tax 49,000 + other UK tax 5,000	114,000

Section 26 ITEPA - SP5/84	Nil

Scenario 4

Facts are the same as in Scenario 2 except that £70,000 out of the £100,000 net salary and benefits has been remitted to the UK.

Calculation of UK tax for 2005-06	
Net salary and benefits	105,000
Less amount attributable to overseas workdays – 67/225 (30%)	(31,500)
Attributable to the performance of UK duties	73,500
Gross up for UK tax at 4/6	49,000
UK-based earnings taxable under section 25 ITEPA	122,500
Tax at 40%	49,000
Remitted to UK - 70,000 + s.25 tax 49,000 + other UK tax 5,000	124,000
Net section 26 ITEPA - SP5/84	1,500
Gross up for UK tax at 4/6	1,000
Foreign earnings taxable under section 26	2,500
Total taxable earnings (sections 25 and 26)	125,000
Tax at 40%	50,000

34.44 Accountancy services benefit

Joint Forum on Expatriates Tax and NICs records a discussion on tax return preparation fee benefits:

> It was made clear that these discussions and any proposals or guidance based on them will relate only to circumstances where:
>
> - due to tax equalisation arrangements, the employer pays for accountancy services relating to the preparation and submission of the individual assignees' Tax Returns
> - tax return preparation is part of a wider bundle of services provided by the adviser as negotiated with the employer
> - S9A enquiry services are not included as part of the bundle
>
> In such circumstances HMRC accept that the level of benefit in kind should be arrived at by apportionment based on the facts. The mechanics of how the apportionment should be calculated are an operational issue and CPTT had already shared with delegates (within the meeting notes of 30 August 2007) an exchange with Ernst & Young LLP on this topic. CPTT did not have authority to agree fixed round sum figures applicable in all cases. Indeed, it was clear from the evidence submitted that there is no 'one size fits all'. However, CPTT were prepared, in due course, to provide some clarity of the level at which they perceive there to be a risk worthy of enquiry.
>
> The intention therefore would be to:
>
> - establish a level of tax return preparation benefit which if returned or exceeded will not prompt any enquiry
> - continue to allow for different figures to be reported based on the

available facts

- highlight that where levels of tax return preparation benefits are reported below this level it remains open to HMRC/CPTT to enquire into the precise figures and apportionment methodology to check the accuracy of Returns submitted

CPTT is still analysing the information provided but Martin Dwyer was able to say that the available evidence suggested that a level of around £600 per head would be reflective of a situation where a home and host country Return was completed.

HMRC remain of the view that any accountancy fees paid in respect of S9A enquiry work should be reported as benefits in kind. HMRC will continue to look for evidence of the payment of such fees and their position will be as clarified within the meeting notes of the Forum held on 30 August 2007, as follows:

> 'Where we find evidence to indicate that the costs of accountancy services related entirely to resolving the S9A enquiry, we will regard these costs as giving rise to a taxable benefit in kind. If your clients are unable to accept this treatment, we will need to refer an appropriate case to the Commissioners.'

Subsequent to the meeting HMRC has now completed its analysis of the information provided. From this we conclude that the levels of benefits which appear both realistic and reasonable are £650 per head where a home and host country Return is completed and £250 per head where only the host country (UK) Return is completed. Under existing circumstances these figures will represent levels which if returned or exceeded will not prompt an enquiry from CPTT. However, it has been recently highlighted by external representatives that the proposed levels of analysis necessary to support access to the remittance basis from 6 April 2008 is likely to lead to increases in the costs charged for UK Tax Return preparation where the remittance basis is claimed. If this proves to be the case there would be a need to recognise this and revise the figures for 2008-09 onwards accordingly.

HMRC reiterate that the sums quoted above are not intended to represent an agreed level of benefits which must be reported across the board. We recognise that there is unlikely to be consistency in the precise make up of the bundle of accountancy services provided across different cases and by the variety of advisers involved. Rather, the aim is to indicate a level at which CPTT perceive the level of risk to be worthy of enquiry.[104]

[104] Note of Meeting 18 September 2008 *http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/consultations/expat-mins-180908.htm*

A subsequent meeting of the forum records:

> **Q10: Accountancy fees in regard to partially tax-equalised employees**
> It is not clear which partially tax-equalised cases are covered by the agreement announced in the 18 September 2008 forum notes. By 'partially tax-equalised' we mean when the employer agrees to tax-equalise part of the employee's income/gains but not the whole. This is very common, often employers will tax equalise only employment income and even then might exclude elements such as share options.
>
> The notes mention 'due to tax equalisation arrangements, the employer pays for accountancy services' which perhaps suggests the precise nature of the equalisation arrangements is not in point. However, Appendix 6 of HMRC's Employment Procedures Manual – 'Modified PAYE' arrangements – says that those arrangements may be applied only to tax-equalised employees and, for that purpose, 'tax-equalised' means that:
>
> > ' ... the employer must equalise liability to UK Income Tax on all general earnings (see note) subject to the rules in part 2 Chapters 4 and 5 ITEPA applying to employees resident, ordinarily resident or domiciled outside the UK.
> >
> > Note: Where the employee is tax-equalised on all general earnings but not, for example, on taxable awards of securities options or the award of securities at undervalue (which is specific employment income) the employee may still be included within the arrangement as long as all the other conditions are satisfied'.
>
> It would seem rather restrictive to take the same approach in relation to accountancy fees as an employee's tax equalisation computations can be just as (possibly more) complex if only part of the earnings are equalised.
>
> **HMRC Answer:** It is the case that the guidance contained within the Forum meeting notes of 18 September 2008 was intended to relate to 'fully' tax equalised cases including those capable of inclusion within an EP Appendix 6 agreement.
>
> Where partial tax equalisation applies it seems to me that the extent to which the accountancy advice directly benefits the individual rather than the employer must increase and I would expect this to be reflected within the level of benefits reported.
>
> As in the case of tax equalised individuals, where HMRC wishes to check the amounts reported we will look at the amounts paid for the basket of services provided and seek to establish those parts of this basket which directly benefit the employer. It should then be possible to calculate a benefit in kind figure by reference to the balance on a per

> head basis.
>
> ...
>
> HMRC were asked to give clarification regarding whether or not the levels of accountancy fees, clarified at the meeting held on 18 September 2008, could be applied in respect of the 2008-09 SA Tax Returns. Martin Dwyer confirmed that these amounts were intended to reflect levels below which HMRC perceive there to be a risk and above which it was unlikely that HMRC would make an enquiry into the matter of accountancy fees relating to Tax Return preparation. They were not intended to represent mandatory levels of benefits which should be included on Tax Returns as HMRC accept that there will be cases where the true level of benefit varies from the figures provided for guidance. Against this background, however, HMRC confirmed that the same guidance could be extended to apply to 2008-09 SA Returns. As was confirmed in the answer to Q10, however, that guidance was intended to relate to fully tax equalised cases, including those capable of inclusion within an EP Appendix 6 agreement. Whilst it was accepted that this would include cases where tax equalisation applied to all employment income other than share based remuneration, the guidance was not intended to apply to circumstances where partial tax equalisation arrangements are in place which can often apply to a small proportion of the overall compensation package.[105]

The figures have since been increased:

> HMRC has .. taken a view to increase the levels for 2014-15 benefits in kind to £275 for one return and £700 for a home and host country return. The next review will be in April 2016.
>
> Members were reminded that the amounts are applied to fully tax equalised employees and are for tax return preparation fees only. Further benefits in kind should be reported where employers also bear the agent's fees for dealing with Section 9A enquires.[106]

[105] Note of meeting July 2009 *http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/consultations/expat-mins-160709.htm*

[106] Joint Expatriate Forum on Tax and NICs (29 April 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/327284/140704_Expat_Forum_Minutes_FINAL.pdf*

CHAPTER THIRTY FIVE

TRAVEL EXPENSES: EMPLOYMENT INCOME

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35.1 Introduction

The deduction of travel expenses matters for two purposes:

(1) Taxation of employment income, obviously; and also

(2) Residence: time travelling counts as working if travel expenses are deductable, and time spent working in/out of the UK is important in ascertaining residence.[1]

Thus rules drafted for one purpose have been made to apply to a completely different purpose, for which they are rather less suitable.

The rules are set out in ss.337 - 342 ITEPA.

The development of the law can be traced through a series of consultation papers:

- Employee Travel & Subsistence (May 1996)

[1] See 6.22.8 (Travel).

- Tax relief for travel expenses: temporary workers and overarching employment contracts[2]

These are now of historical interest only.

OTS have issued two reports[3] and HMRC issued a consultation paper in 2015, but announced in Budget 2016 that it had decided not to make any changes.[4]

HMRC have issued guidance: Booklet 490 (Employee travel)[5] which I call "**HMRC travel guidance**" and the EI Manual contains almost 100 pages of guidance.

In outline, travel is deductable if the employee's attendance is necessary. There are two disallowance rules which override the general rule:

(1) Ordinary commuting
(2) Private travel

It may be helpful to have a summary:

Journey from/to	**Home**	**Temp workplace**	**Permanent workplace**	**Non-workplace**
Home		Deductible	Ordinary commuting	Private Travel
Temp workplace	Deductible	Deductible	Deductible	Deductible
Perm workplace	Ord commuting	Deductible	Deductible	Ord commuting
Non-workplace	Private travel	Deductible	Ordinary commuting	Private travel

In this chapter a journey is "**deductible**" if the expenses of travel are deductible from earnings.

I first consider the definitions of workplace, temporary and permanent.

[2] *http://webarchive.nationalarchives.gov.uk/20080924231230/http://www.hm-treasury.gov.uk/media/F/2/travelexpenses_210708.pdf* (July 2008)

[3] OTS, "Review of employee benefits and expenses: Interim report" (August 2013) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/227088/ots_employee_benefits_interim_report.pdf*
OTS, "Review of employee benefits and expenses: final report" (July 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/227088/ots_employee_benefits_interim_report.pdf*

[4] HMRC, "Travel and subsistence: discussion paper*"* (2015) *https://www.gov.uk/government/consultations/travel-and-subsistence-framework-discussion-paper/travel-and-subsistence-discussion-paper*
HMRC, "Travel and Subsistence Summary of Responses" (March 2016) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/510330/Travel_and_Subsistence_-_summary_of_responses.pdf*

[5] *https://www.gov.uk/government/collections/tax-and-national-insurance-contributions-for-employee-travel-490*

35.2 "Workplace"

Section 339(1) ITEPA provides:

> In this Part "workplace", in relation to an employment, means a place at which the employee's attendance is necessary in the performance of the duties of the employment.

A home may be a workplace, but it does not matter because of the disallowance for ordinary commuting.

Workplaces are divided into permanent and temporary.

35.2.1 *Necessary attendance*

Necessity comes up twice in the provisions:

(1) In the definition of workplace: somewhere that "attendance is necessary" in general.
(2) In the attribution requirement: deductible expenses must be attributable to the employee's "necessary attendance" at a place.[6]

These rules may overlap but one may apply without the other.

Suppose the employee goes to visit an aunt, not in the performance of their duties, then:

(1) the aunt's house is not a workplace; and
(2) the attribution requirement is not met.

Suppose the employee goes to the office just to meet a friend, then:

(1) the office is a workplace; but
(2) the attribution requirement is not met.

Suppose the employee goes from X to office in order to work.

(1) W is (assume) a permanent workplace and the attribution condition is met.
(2) However deductibility depends on the status of X: the expense is deductible if X is a temporary workplace but not if it is a home or a non-workplace.

It is therefore best to consider separately the questions:

(1) whether a place is a workplace
(2) whether a journey is necessary.

[6] See 35.8 (Deduction rule).

> **EIM32270 The Necessary Attendance Rule** [Nov 2019]
> A workplace is defined by Section 339(1) ITEPA 2003 to mean a place at which the employee's attendance is necessary in the performance of his or her duties, see EIM32055.
> This means that a deduction for the cost of travel to a temporary workplace[7] will only be due where the employee can demonstrate that his or her attendance at that place was necessary on that occasion, in a real sense, to perform the duties of that employment.
> Usually the position will be straightforward and the requirement of the duties will be identical to the requirements of the employer. However, the strict test for a deduction is that the travel must be dictated by the duties of the employment. A deduction is only due where the travel or the attendance is an objective requirement of those duties, see EIM31647. T he personal convenience of the employee, or the employer, is not the factor that determines whether a deduction is due, see example EIM32271. ...

> **EIM32271 The Necessary Attendance Rule: Example** [Nov 2019]
> A technical writer normally works at his employer's head office. However, to enable him to look after an aunt who is unwell, his employer tells him[8] to work at his aunt's home for a few weeks.
> The employee's attendance at his aunt's home is not an objective requirement of the duties of his employment, see EIM32270. Even though he works from his aunt's home it is not a workplace, see EIM32055. ...

That is correct

> Therefore, no deduction is due for the cost of travel between his home and his aunt's home.

More analytically, there are two grounds for non-deduction (either of which would suffice): the attribution requirement is not met, and the private travel rule.

> **EIM32272 The Necessary Attendance Rule: Example** [Nov 2019]
> An employee works for a firm of estate agents that has branches across the West Midlands. She lives in Wolverhampton and works at the branch

[7] Author's footnote: or indeed any other travel cost.

[8] Author's footnote: It seems more likely that the employer would *permit* the employee to work at the aunt's home rather than *instruct* the employee to do so. But the result is the same either way.

> in Coventry. She has a number of business phone calls to make that can be made at any time during the day. Her employer tells her to stop off at the Birmingham branch on the way to her permanent workplace in Coventry in order to make some of the phone calls.
> No deduction is due for the cost of her travel from Wolverhampton to Birmingham. Her ordinary commuting journey does not become a business journey because she stops off at the Birmingham branch. The Birmingham branch is not a workplace on this occasion because her visit is not an objective requirement of the duties of her employment, see EIM32270.

More analytically, whether or not the Birmingham branch is a workplace, there is no deduction as the attribution requirement is not met.

It is not correct to say that the Birmingham branch is not a workplace "on this occasion." If it is a workplace as defined, it does not cease to be on the occasion of this visit. We are not told enough to say whether it is a workplace or not.

> Similarly, she is not entitled to relief for the cost of her journey from Birmingham to Coventry. Birmingham is not a workplace on this occasion and so the travel to her permanent workplace in Coventry is ordinary commuting, see EIM32055.

More analytically, there are two possibilities:

(1) The Birmingham branch might be a non-workplace. In that case the Birmingham to Coventry travel is disallowed under the ordinary commuting rule.

(2) The Birmingham branch might be a workplace, temporary or permanent. In that case the travel is disallowed as substantially ordinary commuting, since Birmingham is more or less on the commuting route from home (Wolverhampton) to the permanent workplace (Coventry).

35.3 "Permanent" workplace

Section 339(2) ITEPA provides:

> In this Part "permanent workplace", in relation to an employment, means a place which-
> (a) the employee regularly attends in the performance of the duties of the employment, and
> (b) is not a temporary workplace...

35.3.1 *"Regularly"*

The EI Manual provides:

> **EIM32070 Permanent Workplace: Regular Attendance** [Nov 2019]
> An employee regularly attends a particular workplace if the attendance is frequent, or it follows a pattern, or if the place is one at which the employee usually attends for all or almost all of the period for which he or she holds, or is likely to hold, that employment.
> The proportion of an employee's working time spent at a particular workplace is a factor in determining whether or not it is treated as a permanent workplace but it is not the only factor. Even if the employee attends the workplace only on one or two days a week, if it is on a regular basis, the workplace may still be a permanent workplace.

The last sentence is confirmed by *Kirkwood v Evans* where the employee worked four days a week at home, and one day a week in an office. The office was a permanent, not a temporary workplace.

35.4 "Temporary" workplace

The rule that travel to a temporary workplace is deductible is sometimes known as temporary workplace relief.

Section 339(3) ITEPA provides:

> In subsection (2) "temporary workplace", in relation to an employment, means a place which the employee attends in the performance of the duties of the employment-
> (a) for the purpose of performing a task of limited duration, or
> (b) for some other temporary purpose.

There are few words more vague than "temporary".[9] Section 339 restricts the concept specifying that three situations are not a temporary workplace (so they are classified as a permanent workplace). These relate to:

(1) Base of operations: s.339(4)
(2) Period of continuous work: s.339(5)
(3) Area of operations: s.339(8)

The second of these is the most important.

35.4.1 *Temporary purpose*

HMRC understand this quite liberally:

[9] "Permanent" is also surprisingly flexible; see 9.12.2 ("Permanent").

EIM32150 Attendance For A Temporary Purpose [Jan 2020]

...An employee may attend a workplace regularly and perform duties there that are not of limited duration without that workplace becoming a permanent workplace, provided that the purpose of each visit is temporary.

Where a visit is self-contained (that is, arranged for a particular reason rather than as part of a series of visits to the same workplace for the continuation of a particular task) it is likely to be for a temporary purpose.

HMRC give four examples of a temporary purpose:

EIM para	Job title	Frequency of Visit
32151	Safety Officer	Monthly
32152	Finance Director	Monthly
32153	Company Director	Monthly
32154	Teacher	Bi-weekly

EIM32151 Attendance For A Temporary Purpose: Example [Nov 2019]

An employee is a safety officer. He regularly visits a particular factory every month to carry out a safety check. His responsibility for that factory has been a duty of his employment for a period already spanning twenty years (so it is not of limited duration). However, the tasks he performs on each visit are self-contained and the purpose of each visit, considered alone, is temporary. So a deduction is due for the full cost of his travel.

He visits the factory regularly for the performance of his duties. So it will be a permanent workplace if it is not a temporary workplace, see EIM32065. His attendance is not of limited duration (see EIM32080) but each visit is for a temporary purpose, see EIM32150. So the factory is a temporary workplace.

EIM32152 Attendance For A Temporary Purpose: Example [Nov 2019]

An employee is finance director of a large company based in Scunthorpe. Once a month her duties take her to the company's production unit in the south east. Her visits are to consider individual investment proposals but she takes the opportunity to discuss local welfare issues as a representative of senior management. A deduction is due for the full cost of travel between her home and the production unit.

She visits the production unit regularly for the performance of her duties.

So it will be a permanent workplace if it is not a temporary workplace, see EIM32065. Her attendance is not of limited duration (see EIM32080) but each visit is for a temporary purpose, see EIM32150. So the production unit is a temporary workplace.

EIM32153 Attendance For A Temporary Purpose: Example [Nov 2019]
An employee lives in Sidcup and has a permanent workplace in Broadstairs. He is a director of a company that has a number of regional offices. He has to attend a directors meeting on the last Friday of each month in Farnham. A deduction is due for the cost of travel between his home and Farnham.
He visits Farnham regularly for the performance of his duties. So it will be a permanent workplace if it is not a temporary workplace, see EIM32065. His attendance is not of limited duration (see EIM32080) but each visit is for a temporary purpose, see EIM32150. So Farnham is a temporary workplace.

EIM32154 Attendance For A Temporary Purpose: Example [Nov 2019]
An employee is employed as a school teacher in Oswestry, which is a permanent workplace. Every fortnight she goes to an education authority meeting in Bridgnorth. A deduction is due for the full cost of travel between her home and Bridgnorth.
She visits Bridgnorth regularly for the performance of her duties. So it will be a permanent workplace if it is not a temporary workplace, see EIM32065. Her attendance is not of limited duration (see EIM32080) but each visit is for a temporary purpose, see EIM32150. So Bridgnorth is a temporary workplace.

35.5 Period of continuous work

Section 339(5) ITEPA provides:

> A place is not regarded as a temporary workplace if the employee's attendance is-
> (a) in the course of a period of continuous work at that place-
> (i) lasting more than 24 months, or
> (ii) comprising all or almost all of the period for which the employee is likely to hold the employment, or
> (b) at a time when it is reasonable to assume that it will be in the course of such a period.

A short term (ie temporary) job can and usually will have a "permanent" workplace.[10]

Section 339(6) ITEPA provides:

> For the purposes of subsection (5), a period is a period of continuous work at a place if over the period the duties of the employment are performed to a significant extent at the place.

The EI Manual provides:

> **EIM32080 Limited Duration, The 24 Month Rule** [Nov 2019]
> ...you should treat duties as performed to a significant extent at any workplace if the employee spends 40% or more of his or her working time at that place. ...
> The test is whether the employee has spent, or is likely to spend, 40% or more of his or her working time at that particular workplace over a period that lasts, or is likely to last, more than 24 months. Where that is the case the workplace is not a temporary workplace and so it is a permanent workplace. Travel between that place and home will be ordinary commuting and so is not deductible....
>
> **EIM32081 Temporary Workplace: Example** [Nov 2019]
> An employee has worked for 5 years at her employer's head office in Warrington. She is sent by her employer to perform duties at a branch office in Wigan for 18 months. A deduction is available for the full cost of her travel between home and the workplace in Wigan.
> Although the period in Wigan is a period of continuous work, because it is 40% or more of her working time (see EIM32080), that period does not exceed 24 months and so Wigan is a temporary workplace.

The next example is a straightforward application of the 24 month rule:

> **EIM32082 Temporary Workplace: Example** [Nov 2019]
> An employee has worked for his employer for 10 years and is sent to perform full-time duties at a workplace for 28 months. No deduction is due for the cost of travel between his home and that workplace because it is ordinary commuting.
> The workplace is capable of being a temporary workplace because his attendance is for a limited duration, see EIM32075. However, the workplace is excluded from being a temporary workplace by the further

[10] This is self-evident but if authority is needed see *Kirkwood v Evans* [2002] STC 231 at [15]: "Commuting to and from work at a temporary job is ... ordinary commuting because the locus in quo is a 'permanent workplace' within [s.339(2)] and not a temporary one."

rule explained in EIM32080. His attendance is in the course of a period of continuous work (he works there for 40% or more of his working time) and it is known from the outset that it will exceed 24 months. So the workplace is treated as a permanent workplace.

The next examples illustrate the expectation test:

> **EIM32083 Temporary Workplace: Example** [Nov 2019]
> An employee has worked for her employer for 3 years and is sent to perform full-time duties at a workplace for 28 months, but the posting is unexpectedly ended after 18 months. No deduction is due for the cost of travel between her home and the workplace, because her attendance is expected to exceed 24 months (even though in fact it does not).
> The workplace is capable of being a temporary workplace because her attendance is for a limited duration, see EIM32075. However, the workplace is excluded from being a temporary workplace by the further rule explained in EIM32080. Her attendance is in the course of a period of continuous work (she works there for 40% or more of her working time) and it is expected at the outset that it will exceed 24 months. So the workplace is treated as a permanent workplace. The workplace is a permanent workplace even though, as it turned out, her actual attendance does not exceed 24 months.
>
> **EIM32084 Temporary Workplace: Example** [Nov 2019]
> An employee has worked for his employer for 3 years. He is sent to perform full-time duties at a workplace for 18 months. After 10 months the posting is extended to 28 months. A deduction is due for the full cost of travel to and from the workplace during the first 10 months but not after that.
> The workplace is capable of being a temporary workplace because his attendance is for a limited duration, see EIM32075. At the outset the workplace is not excluded from being a temporary workplace by the further rule explained in EIM32080. Although his attendance is in the course of a period of continuous work (he works there for 40% or more of his working time) it is not expected at the outset that it will exceed 24 months. So the workplace is a temporary workplace at that time.
> After 10 months the expectation changes. The workplace is now excluded from being a temporary workplace by the further rule. His attendance is in the course of a period of continuous work and that period is expected to exceed 24 months. Therefore after 10 months the workplace becomes a permanent workplace.

In the next example the expectation test cuts both ways:

> **EIM32085 Temporary Workplace: Example** [Nov 2019]
> An employee has worked for her employer for 7 years and is sent to perform full-time duties at a workplace for 28 months. After 10 months the posting is shortened to 18 months. No deduction is due for the cost of travel to and from the workplace during the first 10 months but a deduction is available for the full cost of travel during the final 8 months.
> The workplace is capable of being a temporary workplace because her attendance is for a limited duration, see EIM32075. At the outset the workplace is excluded from being a temporary workplace by the further rule explained in EIM32080. Her attendance is in the course of a period of continuous work (she works there for 40% or more of her working time) and it is expected at the outset that it will exceed 24 months. So the workplace is a permanent workplace at that time.
> After 10 months the expectation changes. The workplace is no longer excluded from being a temporary workplace by the further rule. Her attendance is still in the course of a period of continuous work but it is no longer expected that the period will exceed 24 months. Therefore after 10 months the workplace becomes a temporary workplace.

In the next example the employee has two workplaces, one temporary and one permanent:

> **EIM32086 Temporary Workplace: Example** [Nov 2019]
> An employee lives and works in New Brighton where he is employed as an engineer. His employer sends him to work in Wrexham for 1½ days a week for 28 months. For the rest of the week he continues to work in New Brighton. A deduction is due for the full cost of travelling between the employee's home and Wrexham but not for the cost of travelling between his home and the workplace in New Brighton.
> New Brighton is and remains a permanent workplace of the employee. He attends it regularly for the performance of the duties of his employment and that attendance is not to perform a task of limited duration or for a temporary purpose, see EIM32065.
> Wrexham is capable of being a temporary workplace because his attendance is for a limited duration, see EIM32075. Wrexham is not excluded from being a temporary workplace by the further rule explained in EIM32080. His attendance in Wrexham is not in the course of a period of continuous work because he does not work there for 40% or more of his working time. The 24-month test does not need to be considered. Wrexham is a temporary workplace and the employee is entitled to a deduction for the full cost of travel there and back.

In the next example the employee has two workplaces, both permanent:

> **EIM32087 Temporary Workplace: Example** [Nov 2019]
> An employee is employed as a food scientist by a manufacturer of ice cream cones. She lives in Porthmadog and works in Dolgellau. Her employer opens a new plant in Llandrindod Wells. She is sent to work there 4 days a week and expects to be there for 30 months. No deduction is due for the cost of travel between her home and Llandrindod Wells, or for travel between her home and Dolgellau.
> Dolgellau remains her permanent workplace. She attends it regularly to perform the duties of her employment and that attendance is not to perform a task of limited duration or for a temporary purpose, see EIM32065.
> Llandrindod Wells is capable of being a temporary workplace because her attendance is for a limited duration, see EIM32075. However, it is excluded from being a temporary workplace by the further rule explained in EIM32080. Her attendance is in the course of a period of continuous work (she works there for 40% or more of her working time) and it is known from the outset that it will exceed 24 months. So the workplace is treated as a permanent workplace.
>
> **EIM32088 Temporary Workplace: Example** [Nov 2019]
> An employee is employed as a financial adviser working in Brighton. His employer sends him to an office in Bournemouth for one day a week over a 10 month period. He travels to Bournemouth directly from his home in Hastings. A deduction is due for the full cost of his travel between his home and Bournemouth but not for the cost of travel between his home and Brighton.
> Brighton remains his permanent workplace. He attends it regularly to perform the duties of his employment and that attendance is not to perform a task of limited duration or for a temporary purpose, see EIM32065.
> Bournemouth is capable of being a temporary workplace because his attendance is for a limited duration, see EIM32075. Bournemouth is not excluded from being a temporary workplace by the further rule explained in EIM32080. His attendance is not in the course of a period of continuous work because he does not work there for 40% or more of his working time. The 24 month test does not need to be considered. Bournemouth is a temporary workplace.

In the next example the employee retains a permanent workplace and acquires a temporary workplace:

EIM32091 Temporary Workplace: Example [Nov 2019]

An employee is employed as a seal doctor at a zoo on the south coast. She is sent to Morecambe to supervise a seal sanctuary for one day each month. She was originally asked to undertake this task for 5 years. A deduction is due for the cost of travel between her home and Morecambe.

The south coast zoo remains her permanent workplace. She attends it regularly to perform the duties of her employment and that attendance is not to perform a task of limited duration or for a temporary purpose, see EIM32065.

Morecambe is capable of being a temporary workplace because her attendance is for a limited duration, see EIM32075. Morecambe is not excluded from being a temporary workplace by the further rule explained in EIM32080. Her attendance is not in the course of a period of continuous work because she does not work there for 40% or more of her working time. The 24 month test does not need to be considered. Morecambe is a temporary workplace.

EIM32092 Temporary Workplace: Example [Nov 2019]

An employee lives in Knaresborough and has a part-time employment working two days a week in Harrogate as a telephonist for an insurance company. He is asked to spend one of his two working days covering for a colleague at a branch in Ripon for a period of 32 months. No deduction is due for the cost of travelling between his home and Ripon or between his home and Harrogate.

Harrogate remains his permanent workplace. He attends it regularly to perform the duties of his employment and that attendance is not to perform a task of limited duration or for a temporary purpose, see EIM32065.

Ripon is capable of being a temporary workplace because his attendance is for a limited duration, see EIM32075. However, Ripon is excluded from being a temporary workplace by the further rule explained in EIM32080. His attendance is in the course of a period of continuous work (he works there for 40% or more of his working time) and it is known from the outset that the period will exceed 24 months. So Ripon is treated as a permanent workplace.

This example shows that the percentage of working time at a workplace is determined by reference to the employee's actual working time and not by reference to a notional amount of working time appropriate to a full-time worker.

35.5.1 *24 month rule: Evidence*

The EI Manual provides:

> **EIM32100 The 24 Month Rule: How To Find Out The Expected Period Of Time At A Workplace** [Nov 2019]
>
> Usually it will be clear whether or not an employee expects to spend more than 40% of his or her working time at a particular workplace over a period of 24 months. Where there is some uncertainty you should decide cases on the facts that you can uncover.
>
> An obvious starting point is what the employer has told the employee. Another point to consider may be whether the employee has moved home as a result of the change in workplace. An employee may be less likely to relocate for a posting that is expected to last for less than 24 months and more likely to relocate for one that is expected to last longer. That is not to say that, if someone does move home as a result of a change of workplace, it necessarily means they expect the new workplace to be permanent, or that if they do not move home they necessarily expect the new workplace to be temporary. Moving home is not a test, it is only one factor to be taken into consideration, but it is an important one.
>
> You should look at each case in the round and consider not only any statements made by the employee and the employer, but also the expected duration of any project to which the employee is seconded and any agreements between the parties, whether or not they have been committed to writing. You may wish to look in more detail at any case in which the employee spends more than 24 months at a workplace and we had been told that he or she would not.
>
> In some cases there may have been a change in circumstances that has led to a change in the length of the secondment. The workplace will be a temporary workplace during any time in which the reasonable expectation was that the secondment would be for a period not exceeding 24 months, see EIM32080. Therefore we cannot conclude in all cases that a continuation of the secondment beyond the 24 month limit must mean that the workplace could not have been a temporary workplace at some stage. ...

35.5.2 *Continuous work*

The EI Manual provides:

> **EIM32105 The 24 Month Rule: Breaks In Attendance** [Nov 2019]
>
> ...A period of continuous work can remain continuous even where there is a break in attendance. This is illustrated by the examples beginning at EIM32106.

In the next example a 1 week break does not affect continuity:

> **EIM32107 The 24 Month Rule: Breaks In Attendance: Example** [Nov 2019]
> An employee is employed to work full-time on a construction contract that is expected to last for 6 years. Each time he gets close to having worked on the site for nearly two years his employer moves him to another workplace for a week before returning him to the long term project site. No deduction is due for the cost of travel between his home and the long term construction site.
> The site is capable of being a temporary workplace because his attendance is for a limited duration, see EIM32075. However, the site is excluded from being a temporary workplace by the further rule explained in EIM32080. His duties are performed to a significant extent (he works there for 40% or more of his working time) and the period on site is greater than 24 months. So the site is treated as a permanent workplace.

In the next example a 3 month break does not affect continuity:

> **EIM32108 The 24 Month Rule: Breaks In Attendance: Example** [Nov 2019]
> An employee is employed as a human resources consultant. She works full-time at a client's site for 17 months developing a new staff appraisal system and then deals with unexpected priority work elsewhere for 3 months. She then returns to the client's site for a further 6 months to co-ordinate the roll-out of the new system, as had been planned from the outset of the project. A deduction is due for the full cost of travel from her home to the client's site for the first 17 months but no deduction is due for travel costs for the further 6 months.
> The client's site is capable of being a temporary workplace because her attendance is for a limited duration, see EIM32075. For the first 17 months the client's site is not prevented from being a temporary workplace by the further rule explained in EIM32080. Her attendance is in a period of continuous work (she works there for 40% or more of her working time) but it is not expected at the outset that the period will exceed 24 months. So for the first 17 months the client's site is a temporary workplace.
> For the further 6 month period the expectation has changed. She now expects to spend 40% or more of her working time at the client's site for a period that exceeds 24 months (17 + 3 + 6 = 26). Therefore, for the further 6 months the client's site is treated as a permanent workplace.

35.5.3 *Change of temporary/permanent status*

The EI Manual provides:

> **EIM32221 workplace ceases to be permanent: example** [Nov 2019]
> A full-time bank employee is sent to work for 6 months in a newly opened branch in another town. At the end of that period she accepts a promotion and stays at the new branch.
> For the first six months the new branch is a temporary workplace. Her attendance is for a limited duration, see EIM32075. A deduction is due for the full cost of travelling between her home and the new branch.
> After 6 months the new branch becomes a permanent workplace. Her attendance is not for a limited duration or for a temporary purpose, see EIM32065. A deduction is no longer due for her travel costs.
> Two years later she is asked to return to the old branch for 2 months to cover for an absent colleague. The old branch is now a temporary workplace because her attendance is for a limited duration, even though the old branch was a permanent workplace the last time she worked there. Her circumstances have changed and she is entitled to a deduction for the full cost of travelling between her home and the old branch.

35.6 Minor workplace changes

Section 339(7) ITEPA provides:

> An actual or contemplated modification of the place at which duties are performed is to be disregarded for the purposes of subsections (5) and (6) [period of continuous work at a place] if it does not, or would not, have any substantial effect on the employee's journey, or expenses of travelling, to and from the place where they are performed.

The EIM gives a straightforward example:

> **EIM32089 Temporary Workplace: Example** [Nov 2019]
> A computer consultant is the only employee of a company that she controls. She is a specialist in banking systems. She spends 18 months working full-time at the headquarters of a merchant bank in Lombard Street in the City of London. She then moves next door to design a new computer system for a different bank where she expects to stay working full-time for 22 months. After that assignment she moves to a bank close by on Cheapside for 17 months. The employee expects to work continuously in the City of London albeit on the premises of different banks. Her travel from home to work will be broadly the same every day. No deduction is due for the cost of travel between her home and any of these workplaces.
> ...Each of these workplaces would be capable of being a temporary workplace because her attendance is for a limited duration, see EIM32075. Each workplace taken in isolation would not be excluded

from being a temporary workplace by the further rule explained in EIM32080. Her attendance is in the course of a period of continuous work (she works at each workplace for 40% or more of her working time) but her time at each workplace taken in isolation does not exceed 24 months. However, when we ignore the change of workplace and consider the length of time spent at the three workplaces as if they were a single workplace, the total time spent does exceed 24 months. Therefore each of these workplaces is a permanent workplace.

EIM32280 Changes To A Workplace [Nov 2019]

An employee may change his or her workplace without that change having any substantial effect on his or her journey to work. If a change of workplace does not have any substantial effect on the employee's journey, or the expense of that journey, the change is ignored for the purposes of

- the 24 month rule (see EIM32100) and
- the fixed term appointment rule (see EIM32125).

The two workplaces are treated as a single workplace. So if an employee changes his workplace from Cardiff to Edinburgh that change would be recognised, while if the change is only to the office next door it would not be recognised.

The effect of this rule may be, for example, that two temporary workplaces are treated as a single permanent workplace. There will then be no deduction for the cost of travelling between the employee's home and either workplace because it will be treated as ordinary commuting.

Sometimes it may be difficult to decide whether a change of workplace should be recognised. The basic principle is that a change in the location or the boundaries of a workplace will be recognised as a change of workplace where the change has a substantial effect on:

- the journey an employee has to make to get to work and, in particular,
- the cost of that journey.

In practice you should recognise the change of workplace in all cases except where the change has made no significant difference to the commuting journey.

Where these conditions are met the new location is a new workplace even if it is close to the old workplace. The practical application of this rule is examined in examples EIM32281, EIM32282 and EIM32283.

EIM32281 Changes To A Workplace: Example [Nov 2019]

An employee is employed on a construction site for a period that is expected to last no longer than 18 months. At the end of that time his employer buys an adjacent plot to extend the site. The employee moves to work on the new plot and is expected to remain there for a further 9 months. His journey to work (and, in particular, its cost) does not change significantly.

The first site is a temporary workplace. His attendance is for a limited duration, see EIM32075. The site is not prevented from being a temporary workplace by the further rule explained in EIM32080. Although he attends it in a period of continuous work (40% or more of his working time), the period is not expected to last more than 24 months. So he can deduct the cost of travel between his home and the first site for that 18 month period.

The second site is not recognised as a new workplace because the change of site has no substantial effect on the employee's journey to work, see EIM32280. The two sites are treated as a single workplace. Although the attendance at that single workplace is for a limited duration the workplace is prevented from being a temporary workplace by the further rule explained in EIM32080. The attendance is in a period of continuous work that is expected to last for more than 24 months (18 + 9 = 27 months).

EIM32282 Changes To A Workplace: Example [Nov 2019]

An employee works for an employer who has several offices close to each other in London. Her employer rotates staff around the offices every 18 months. She works at one office and is then moved to another. She travels to work on the Underground and, although she now gets off ten stops further on than previously, her journey is largely unaltered and the price of her ticket does not change.[11]

The new office is not recognised as a new workplace because the change of site has no substantial effect on her journey to work, see EIM32280. Although her attendance at the new office is expected to be for a limited duration it will not be a temporary workplace. Her expected attendance at the single workplace represented by the two offices will be in a period of continuous work that is expected to exceed 24 months, see EIM32080. The new office is a permanent workplace and she cannot deduct the cost of travel between her home and the new office.

EIM32283 Changes To A Workplace: Example [Nov 2019]

An employee is employed on a major bridge construction project. To begin with he works on the north shore for a period that is not expected to exceed 16 months. At the end of that period he is transferred to the south shore for a further 16 months. Crossing the river is inconvenient

[11] Author's footnote: This seems unlikely.

(which is why a new bridge is needed) and it takes him longer to travel to the south shore than it did to travel to the north shore. It also costs him more. The two sites are not far apart as the crow flies and could be described as a single construction site. However the move from one part of the site to another has had a substantial effect on his journey to work. The two sites are separate workplaces and are not treated as the same workplace, see EIM32280. His attendance is for a limited duration and the sites are not prevented from being temporary workplaces by the further rule in EIM32080 because he does not expect to be at either for more than 24 months. So a deduction is due for the full cost of travel between his home and each site.

EIM32285 Changes To A Workplace: A Change In The Journey With No Change In Cost [Nov 2019]
The test for a change of workplace has two conditions, see EIM32280. So far we have focussed on a change in the cost of the journey.
However, where the journey to the new workplace is significantly different to the journey to the old workplace we can recognise a change of workplace even where the cost of the two journeys is similar. This is illustrated by example EIM32286.

EIM32286 Changes To A Workplace; A Change In The Journey With No Change In Cost: Example [Nov 2019]
An employee lives near Ludlow. Each day she used to drive 25 miles north to her workplace in Shrewsbury. Her job is moved and she now drives 25 miles south each day to her new workplace in Hereford.
Her mode of transport is the same, the time taken is the same and the cost of her journey is the same. However, this is an accidental consequence of where she lives. If she lived elsewhere the change in workplace might have had a substantial effect on the cost of her travel. The location of her new workplace is significantly different from the location of her old and her commuting journey is also significantly different. The new location is a new and different workplace, see EIM32285.

35.7 Workplace a base

Section 339(4) ITEPA provides:

> A place which the employee regularly attends in the performance of the duties of the employment is treated as a permanent workplace and not a temporary workplace if-
>
> (a) it forms the base from which those duties are performed, or
>
> (b) the tasks to be carried out in the performance of those duties are allocated there.

The EIM has a discussion which is not set out here.

35.8 Deduction rule

Section 338(1) ITEPA provides:

> A deduction from earnings is allowed for travel expenses if-
> (a) the employee is obliged to incur and pay them as holder of the employment, and
> (b) the expenses are attributable to the employee's necessary attendance at any place in the performance of the duties of the employment.

I refer to s.338(1)(b) as the "**attribution requirement**." The place at which the employees attendance is necessary will *ex hypothesi* be a workplace (as defined). But the relief applies not just to travel to that workplace, but to travel expenses *attributable* to that attendance. That would in principle include travel to the workplace and travel back from the workplace. Suppose an employee in California needs to attend a director's meeting in Peterborough. They may fly to London, and then catch a train to Peterborough the next day. One might say there are two journeys, California/London and London/Peterborough. But even if that is so, the California/London journey may be deductible on the grounds that the expense is attributable to the attendance at the meeting in Peterborough.

35.8.1 *Necessary attendance on occasion of travel*

The EI Manual provides:

> **EIM32270 The Necessary Attendance Rule** [Nov 2019]
> ...A deduction is only available where the employee **has** to attend a temporary workplace on that particular occasion in order to carry out the duties of the employment, see example EIM32272.
> There will be cases where the position is not clear cut. You should closely examine any case where an employee appears to have been sent by his or her employee to a temporary workplace just to get a deduction for travel expenses.

35.9 Ordinary commuting

Section 338(2) ITEPA provides:

> Subsection (1) does not apply to the expenses of
> [a] ordinary commuting or

> [b] travel between any two places that is for practical purposes substantially ordinary commuting.

Section 338(3) defines ordinary commuting:

> In this section "ordinary commuting" means travel between-
> (a) the employee's home[12] and a permanent workplace, or
> (b) a place that is not a workplace and a permanent workplace.

The disallowance applies even if the home is a workplace.[13]

35.9.1 *Substantially ordinary commuting*

The EI Manual provides:

> **EIM32300 Journeys Treated As Ordinary Commuting** [Nov 2019]
> Sometimes an employee may travel to a temporary workplace without that journey being significantly different from his or her ordinary commuting journey. A journey that is for practical purposes substantially the same as the employee's ordinary commuting journey is treated as if it were also ordinary commuting. Therefore, no deduction is allowed for the journey, see EIM32055.
> This is intended as a common sense rule that applies where the journey between home and a temporary workplace is broadly the same as the employee's ordinary commuting journey. In particular, it will deny relief where employees or employers seek to turn an ordinary commuting journey into a business journey to try to get a tax deduction.
> Applying this rule will depend on the facts of the particular case and some common cases are illustrated by the examples beginning with example EIM32301. However, you should not try to argue that a journey to or from a temporary workplace is substantially ordinary commuting where the extra distance involved is 10 miles or more each way, see example EIM32306.
> A journey to a temporary workplace that takes the employee in a completely different direction to his or her ordinary commuting journey is not substantially ordinary commuting even if the distance is the same. Conversely, a journey that is made in broadly the same direction and is substantially the same length as the ordinary commuting journey is

[12] See 6.20 ("Home").

[13] This is self-evident, but if authority is needed, see *Kirkwood v Evans:* "The fact that his home was also a 'workplace' does not prevent it from being his home. [Section 338(3)](a) and (b) are alternatives. They do not both have to be satisfied for the definition of 'ordinary commuting' to apply."

> substantially ordinary commuting even if the employee takes a different route. The effect of this rule is illustrated by the examples beginning with example EIM32307.

The EI Manual gives 10 straightforward examples. In summary:

EIM no	**Temp/Permanent workplace distance**	**Special features**	**Relief**
32301	0.3 mile		no
32302	12 miles		yes
32303	15 miles	on route to permanent workplace	yes
32304	1.5 miles	on route to permanent workplace	no
32305	1.5 miles	different mode of transport	no
32306	11 miles beyond permanent workplace	drove past PW on the route	yes
32307	1 mile		no
32308	1 mile	two commuting routes	no
32309	15 miles		yes
32310	0.5 mile	outside normal working hours	no

In the first example the temporary workplace is 450 metres away from the permanent workplace:

> **EIM32301 Journeys Treated As Ordinary Commuting: Example** [Nov 2019]
> A health and safety inspector lives in Leicester and is employed in an office in Nottingham. His office is 500 yards from a bean processing plant that he has to inspect. He travels direct from home to the plant.
> Although the plant is a temporary workplace his journey to the plant is substantially the same as his ordinary commuting journey. Therefore his travel is treated as ordinary commuting and the cost is not deductible, see EIM32300.

In the next example the distance is 12 miles further:

> **EIM32302 Journeys Treated As Ordinary Commuting: Example** [Nov 2019]
> An employee lives in Pudsey and works 5 miles away in Leeds as a reprographics manager. One day she is asked to go to Ilkley to stand in for a colleague who is sick and so she travels an extra 12 miles.
> Ilkley is a temporary workplace and her journey to Ilkley is very different to her ordinary commuting journey to Leeds. The journey to Ilkley is not substantially ordinary commuting and so she is entitled to a deduction for the cost of the journey, see EIM32300.

In the next example the temporary workplace is on the commuting route but not close to the permanent workplace:

> **EIM32303 Journeys Treated As Ordinary Commuting: Example** [Mar 2020]
>
> An employee is a production manager. He normally drives to a permanent workplace 18 miles from his home. One day he has to visit a client to discuss in detail the specifications for a new product. The client's office is 3 miles along his ordinary commuting route. After he has seen the client he drives the remaining 15 miles along his ordinary commuting route to his permanent workplace.
>
> The client's office is a temporary workplace. The 3-mile journey to that workplace is on the same route as the employee's ordinary commuting journey but it is much shorter. So it is not substantially ordinary commuting, see EIM32300. The cost of the remaining 15-mile journey from the client's office to the employee's permanent workplace is also deductible as he is travelling between 2 workplaces, see EIM32360. The employee is entitled to mileage allowance relief for the full 18-mile journey, see EIM31330.
>
> This example can usefully be contrasted with example EIM32304.

In the next example the temporary workplace is on the commuting route and close to the permanent workplace:

> **EIM32304 Journeys Treated As Ordinary Commuting: Example** [Nov 2019]
>
> An employee is a housing officer who normally drives to a permanent workplace 4½ miles from her home. One day she has to visit a client who lives 3 miles along her ordinary commuting route. After seeing the client she drives the remaining 1½ miles along her ordinary commuting route to her permanent workplace.
>
> Her client's home is a temporary workplace. The journey to that workplace is along the same route as her ordinary commuting journey and is substantially the same length. So it is substantially ordinary commuting, see EIM32300. No deduction is due for the cost of the journey.
>
> This example can usefully be contrasted with example EIM32303. Although the two visits to clients are journeys of a similar length the outcome is different. The journeys have to be considered by reference to the ordinary commuting journey and cannot be considered in isolation.

The next example the temporary workplace is 1.5 miles from the permanent workplace:

> **EIM32305 Journeys Treated As Ordinary Commuting: Example** [Nov 2019]
>
> An employee is a teacher who normally travels the 15 miles to his school by moped. One day he has to visit a parent of one of his pupils to discuss the child's end of term report. The parent lives 1½ miles beyond the school. To save time he takes his car and drives along his ordinary commuting route, past the school and on to the parent's home. After his discussion with the parent he drives the 1½ miles back to school.
>
> The parent's home is a temporary workplace. The journey from home to the parent's home is along the same route as the employee's ordinary commuting journey and is substantially the same length. So it is substantially ordinary commuting, see EIM32300. No deduction is due for the cost of the journey.
>
> The fact that the employee uses a different mode of transport from normal does not effect the outcome. Regardless of the mode of transport this is substantially ordinary commuting.

In the next example the distance is 11 miles:

> **EIM32306 Journeys Treated As Ordinary Commuting: Example** [Nov 2019]
>
> An employee is a human resources manager who normally drives 9 miles to the office that is her permanent workplace. One day she has to visit a factory to discuss possible redundancies. The factory is 11 miles beyond her office. She drives the 20 miles to the factory along her ordinary commuting route and past her permanent workplace.
>
> The factory is a temporary workplace. The journey from home to the factory is along the same route as her ordinary commuting journey but is substantially longer. So it is not substantially ordinary commuting. She is entitled to mileage allowance relief for the whole journey.
>
> This example illustrates the practice of not treating a journey from home to a temporary workplace as ordinary commuting where the extra distance is 10 miles or more each way, see EIM32300.

In the next example the distance is one mile:

> **EIM32307 Journeys Treated As Ordinary Commuting: Example** [Nov 2019]
>
> An employee is a customer support manager for a computer company. He normally drives the 9 miles to his permanent workplace. One day he has to visit a client to sort out some problems with a computer. The client's premises are only a mile from his permanent workplace. His journey to the client is the same length as his ordinary commuting journey and is in almost exactly the same direction, although he does not follow exactly

> the same route.
> The client's premises are a temporary workplace. The employee's journey to the client is in almost exactly the same direction as his ordinary commuting journey and it is the same length. So it is substantially ordinary commuting, see EIM32300. No deduction is due for the cost of his travel.

In the next example the employee uses two commutes:

> **EIM32308 Journeys Treated As Ordinary Commuting: Example** [Nov 2019]
> An employee is a clerk in an insurance company. She works flexi-time and normally drives to the office that is her permanent workplace. The route she takes depends on what time she leaves the house. If she leaves before 8am she drives 8 miles along the A road. If she leaves later she drives 10 miles along the B road and drops her daughter off at school on the way. One day she has an early morning meeting with clients at their office which is 9 miles along the B road from her home. The early start means she cannot take her daughter to school.
> The client's office is a temporary workplace. The employee's journey from home to the client's office is along the same route as one of her ordinary commuting journeys and is substantially the same length. It is therefore substantially ordinary commuting, see EIM32300. No deduction is due for the cost of the journey.
> The fact that she has more than one commuting journey and that the journey to the client's office does not follow the route that she would take at that time is irrelevant. The journey is substantially an ordinary commuting journey.

In the next example the distance is 15 miles

> **EIM32309 Journeys Treated As Ordinary Commuting: Example** [Mar 2020]
> An employee is a senior executive in a publishing company. He normally drives 5 miles north from his home to the office that is his permanent workplace. One day he has to visit a client to discuss proposals for a new magazine. The client's office is 5 miles south of his home. After the meeting he drives 10 miles to his permanent workplace.
> The client's office is a temporary workplace. The 5-mile journey from home to the client's office is the same length as the employee's ordinary commuting journey but is in a completely different direction. So it is not substantially ordinary commuting, see EIM32300. He is entitled to mileage allowance relief for that journey. The cost of his 10-mile journey from the client's office direct to his permanent workplace is also

deductible because it is a journey between 2 workplaces, see EIM32360. The employee is entitled to mileage allowance relief on the full 15-mile journey, see EIM31330.

EIM32310 Journeys Treated As Ordinary Commuting: Example [Nov 2019]
An employee is an accountant. She normally works from Monday to Friday and drives the 20 miles to the office that is her permanent workplace. She needs to see a client who lives ½ mile away from her office. The client can only find time to discuss his accounts at the weekend. So one Saturday she drives to the client's home, travelling 19½ miles along her ordinary commuting route. After she has seen the client she carries on to her office to catch up on some paperwork.
The client's home is a temporary workplace. The journey to the client's home is along the employee's ordinary commuting route and is substantially the same length. So it is ordinary commuting, see EIM32300. No deduction is due for the cost of the travel.
This example is a reminder that a journey can be ordinary commuting, or substantially ordinary commuting, even if it is made outside the employee's normal working hours, see EIM32240.

35.10 Private travel

Section 338(4) ITEPA provides:

Subsection (1) does not apply to the expenses of
[a] private travel or
[b] travel between any two places that is for practical purposes substantially private travel.

Section 338(5) ITEPA defines private travel:

In subsection (4) "private travel" means travel between-
(a) the employee's home[14] and a place that is not a workplace, or
(b) two places neither of which is a workplace.

Para (a) is only needed where the home is a workplace.

Travel between a non-home and a workplace is not private travel, but it may be substantially private travel.

35.10.1 *Substantially private travel*

The EI Manual provides:

[14] See 6.20 ("Home").

> **EIM32320 Journeys Treated As Private Travel** [Nov 2019]
> ... Substantially private travel means journeys where the business purpose of the journey is merely incidental to some private purpose, or the journey is made substantially for private purposes rather than business purposes. ...

This adopts a purpose test, which is not the statutory test, but perhaps it is a reasonable way of approaching it, and in practice it should lead to the same result.

The EIM sets out some (apparently) straightforward examples of journeys with/without a main business purpose:

> **EIM32321 Journeys Treated As Private Travel: Example** [Nov 2019]
> An employee is harbour master at Larne. One day he travels to Belfast to visit his elderly mother but while he is there he calls in at a colleague's office to deliver some new charts of the Irish Sea.
> The purpose of the visit to Belfast was private and the trip to his colleague's office was merely incidental. So the journey is private travel, see EIM32320. No deduction is due for the cost of the journey.

More analytically, the journey was substantially home to Belfast (non-workplace); and so substantially private travel.

> **EIM32322 Journeys Treated As Private Travel: Example** [Nov 2019]
> An employee works in a dry cleaners in Carlisle. Her employer sends her to the Darlington branch to repair a machine that has been damaging clothes. While there she visits her ex- husband to discuss maintenance arrangements. She spends a longer time dealing with her private affairs than in fixing the machine.
> Her main purpose in going to Darlington was to fix the machine. The discussion with her ex- husband was time consuming but was merely incidental to her business travel. So this is not substantially private travel, see EIM32320. She can deduct the cost of travel between her home and Darlington.[15]

[15] There is another similar example, which does not add anything:
"EIM32324 Journeys Treated As Private Travel: Example [Nov 2019]
An employee lives and works in Norwich, where he is an administrator for a manufacturing company. His sister lives in Peterborough and he visits her there in February. Two months later he has to return to Peterborough to attend a meeting of the company's focus group. The meeting takes all day and he visits his sister for 2 hours in the evening.
His main purpose in visiting Peterborough is to attend the focus group meeting. The

More analytically, the journey was substantially Carlisle (home or maybe non-workplace) to Darlington (non-workplace); and so substantially private travel.

The second example is made easier as it identified the main purpose. But who is to say whether the main purpose was the ex-husband or the machine? The EI Manual acknowledges the problem:

> **EIM32320 Journeys Treated As Private Travel** [Nov 2019]
> ... You should not use this rule to deny a deduction where comparatively small sums and short distances are involved, see example EIM32325.
> It is sometimes not straightforward to identify journeys that are substantially private travel. It is easy enough to identify journeys that are substantially ordinary commuting because you can compare the journey to the ordinary commuting journey, see EIM32300. You do not have the same point of comparison to identify substantially private travel.
> As a result you may need to ask an employee about the purpose of particular journeys. Such enquiries need to be handled sensitively.

In the HMRC view:

(1) whether travel is substantially ordinary commuting depends on the geographical difference between the actual travel and the ordinary commute.

(2) whether travel is substantially private travel depends on identifying the main (substantial) purpose of the travel.

The first example involves a (relatively) short business extension or detour to a long private journey (US - home):

> **EIM32323 Journeys Treated As Private Travel: Example** [Nov 2019]
> An employee lives in Banbury and is employed as a systems analyst at an office in Aylesbury. He has a 3 week holiday in the USA. At the end of the holiday he flies back from New York to Heathrow. Instead of going home he drives direct from Heathrow to visit a client in Warwick who needs to see him urgently. The total cost of the journey from New York to Warwick is £2,500.[16]

visit to his sister on the same day is merely incidental to that business purpose. So the visit is not substantially private travel, see EIM32320. He can deduct the cost of his travel. It does not matter that he made the same journey for a private reason in February. That earlier journey was private travel but it does not follow that all travel by him to Peterborough must be private travel."

[16] Author's footnote: Presumably this employee travelled first class. The point of the figure is that it is not the "small sum" where can be disregarded.

> Although the employee had to visit his client, the reason for the greatest part of the journey, and for its cost, was private, his return from holiday. His journey was substantially private travel, see EIM32320. No deduction is due for the £2,500 that the travel cost.

More analytically, the journey was substantially New York (non-work) to Banbury (home); and so substantially private travel. Another way to reach the same conclusion would be to rely on the attribution requirement, and say that the expense is not attributable to the work, it is attributable to the holiday. The concept of attribution is flexible enough to reach the intuitively right result. But it is not necessary for HMRC to rely on that point.

> **EIM32325 Journeys Treated As Private Travel: Example** [Nov 2019]
> An employee lives in Cannock and has a permanent workplace in West Bromwich. One weekend she visits her grandmother in Lichfield. On Monday morning she drives from Lichfield direct to visit a client in Stafford.
> Although the employee began her journey from Lichfield for personal reasons, and her journey is 6 miles longer than it would otherwise have been, the journey is primarily made for a business reason. So it is not substantially private travel, see EIM32320. She is entitled to mileage allowance relief for that journey, see EIM31626.
> This example shows that you should not use the rule against substantially private travel to deny a deduction where small sums and small distances are involved.

More analytically, the journey was Lichfield (non-workplace) to Stafford (workplace); it was not substantially Cannock (home) to Stafford (which would be substantially private travel).

35.11 What is the journey?

In order to apply the ordinary commuting and private travel rules, one has to identify the journey.

> **EIM32230 Passing Work On The Way To Somewhere Else** [Nov 2019]
> An employee may pass a permanent workplace on the way to or from a temporary workplace. If the employee stops and performs substantive duties at the permanent workplace then there are two journeys; ordinary commuting between home and the permanent workplace and a business journey between the permanent workplace and the temporary workplace. A deduction will be due under Section 337 ITEPA 2003 for the cost of

the second of these journeys, but there is no deduction for the first.
If the employee does not stop at the permanent workplace, or any stop is incidental to the journey to the temporary workplace, the whole of the journey is a single journey. A deduction will be due under Section 338 ITEPA 2003, because the single journey is to a temporary workplace, unless the journey is substantially ordinary commuting, see EIM32300. See also example EIM32231.

EIM32231 Passing Work On The Way To Somewhere Else: Example [Nov 2019]
An employee drives each day between his home in Southampton and his office in Winchester. One day he has to travel on business to Birmingham. He travels directly from home to Birmingham but stops off at his office to collect some papers.
His stop in Winchester is incidental to his business journey to Birmingham. Therefore the whole of the travel between Southampton and Birmingham is treated as a single journey to a temporary workplace, see EIM32075. A deduction is available for mileage allowance relief, see EIM31626.

35.12 Workplace an area

Section 339(8) ITEPA provides:

> An employee is treated as having a permanent workplace consisting of an area if-
> (a) the duties of the employment are defined by reference to an area (whether or not they also require attendance at places outside it),
> (b) in the performance of those duties the employee attends different places within the area,
> (c) none of the places the employee attends in the performance of those duties is a permanent workplace, and
> (d) the area would be a permanent workplace if subsections (2), (3), (5), (6) and (7) referred to the area where they refer to a place.

Amended as s.339(8)(d) directs, s.339 provides:

> (2) In this Part "permanent workplace", in relation to an employment, means ~~a place~~ *the area* which—
> (a) the employee regularly attends in the performance of the duties of the employment, and
> (b) is not a temporary workplace.
> This is subject to subsections (4) and (8).
> (3) In subsection (2) "temporary workplace", in relation to an employment, means ~~a place~~ *the area* which the employee attends in the

performance of the duties of the employment—

(a) for the purpose of performing a task of limited duration, or

(b) for some other temporary purpose.

This is subject to subsections (4) and (5).

(4) ~~A place~~ *The area* which the employee regularly attends in the performance of the duties of the employment is treated as a permanent workplace and not a temporary workplace if—

(a) it forms the base from which those duties are performed, or

(b) the tasks to be carried out in the performance of those duties are allocated there.

(5) ~~A place~~ *The area* is not regarded as a temporary workplace if the employee's attendance is—

(a) in the course of a period of continuous work at that ~~place~~ *area*—

(i) lasting more than 24 months, or

(ii) comprising all or almost all of the period for which the employee is likely to hold the employment, or

(b) at a time when it is reasonable to assume that it will be in the course of such a period.

(6) For the purposes of subsection (5), a period is a period of continuous work at ~~a place~~ *the area* if over the period the duties of the employment are performed to a significant extent at the ~~place~~ *area*.

(7) An actual or contemplated modification of the ~~place~~ *area* at which duties are performed is to be disregarded for the purposes of subsections (5) and (6) if it does not, or would not, have any substantial effect on the employee's journey, or expenses of travelling, to and from the ~~place~~ *area* where they are performed.

The EIM has a discussion which is not set out here.

35.13 Remittance basis taxpayer

Section 335 ITEPA provides:

(1) The availability of certain deductions under this Chapter depends on whether the earnings are earnings charged on receipt or earnings charged on remittance.

(2) Sections 336 to 342-

(a) only apply if the earnings from which the deduction is to be made are earnings charged on receipt, and

(b) apply subject to section 354(1) if the earnings from the employment also include other earnings.

(3) Section 353 (which provides for a deduction for expenses of the kind to which sections 336 to 342 apply)-

(a) only applies if the earnings from which the deduction is to be

> made are earnings charged on remittance, and
>
> (b) applies subject to section 354(2) if the earnings from the employment also include other earnings.
>
> (4) In this Part-
>
> "earnings charged on receipt" means earnings which are taxable earnings under section 15 or 27, and
>
> "earnings charged on remittance" means earnings which are taxable earnings under section 22 or 26.

That takes us to s.354 ITEPA which provides:

> (1) If the earnings from an employment for a tax year include both earnings charged on receipt and other earnings (except earnings charged under section 22), no deduction is allowed under sections 336 to 342 from the earnings charged on receipt for an amount paid in respect of duties of the employment to which the other earnings relate.
>
> (2) If the earnings from an employment for a tax year include both earnings charged on remittance under section 26 and other earnings, no deduction is allowed under section 353 from the earnings charged on remittance for an amount paid in respect of duties of the employment to which the other earnings relate.
>
> (3) This section is to be disregarded for the purposes of the deductibility provisions.

35.14 Travel in performance of duties

Section 337(1) ITEPA provides:

> A deduction from earnings is allowed for travel expenses if-
>
> (a) the employee is obliged to incur and pay them as holder of the employment, and
>
> (b) the expenses are necessarily incurred on travelling in the performance of the duties of the employment.

This is very narrow.

> **EIM32171 Employees Who Work At Home: Example** [Nov 2019]
>
> An employee is employed to train animals to help disabled people. It is essential that these animals are familiar with a normal domestic environment and so most of the training takes place in his home. It is an objective requirement of his employment that his duties are carried out at his home.
>
> The employee's home is a workplace. A deduction is due for the cost of travel between his home and other workplaces that he attends to carry out the duties of his employment. A deduction is due whether those other

workplaces are permanent or temporary workplaces, see EIM32170.

EIM32172 Employees Who Work At Home: Example [Nov 2019]
An employee's duties are such that she often has to work late into the evenings. At such times she has no access to her employer's premises (her permanent workplace) and so she takes work home with her. It is nonetheless still a matter of personal choice where the work is done (it is not an objective requirement that it be done at home rather than elsewhere).

Her home is not a workplace. No deduction is due for the cost of travel between her home and her employer's premises because that is a permanent workplace. A deduction will be due for the cost of travel between her home and any workplace that is a temporary workplace, see EIM32170.

EIM32173 Employees Who Work At Home: Example [Nov 2019]
An employee works in his employer's office for 4 days every week but the requirements of the job dictate that he must work at home every Friday. It is accepted that his home is a workplace on Friday, see EIM32170.

His travel from home to his employer's office on Monday to Thursday is ordinary commuting because those premises are a permanent workplace, see EIM32065. His travel costs on those days are not deductible.

If he is unexpectedly required to visit the employer's premises on Friday to carry out the duties of his employment his travel costs are deductible under Section 337 ITEPA 2003. On that day he is travelling between two workplaces, see EIM32360.

EIM32351 Introduction [Nov 2019]
Section 337 ITEPA 2003 permits relief for travelling expenses necessarily incurred in travelling in the performance of the duties of the employment.

This was the original rule for employee travel expenses and was the only rule under which expenses could be deducted before 6 April 1998. It is a very restrictive rule because it is limited to travel that is carried out in the course of performing the duties of the employment, see EIM31650.

The extension of the rules for employee travel expenses from 6 April 1998 to include travel to temporary workplaces, see EIM32005, means that this rule is now only relevant to:

- travel between workplaces, see EIM32360 and
- travelling appointments, see EIM32366, and
- travel between home and work where

- home is a workplace (see EIM32760), and
- the place where the employee lives is dictated by the requirements of the job (see EIM32370).

EIM32356 Home To Work Travel [Nov 2019]

The Courts have established as a clear general principle that the cost of travelling from an employee's home to his or her normal place of work is not travel in the performance of the duties, see EIM31650. The expense merely puts the employee into a position to perform his or her duties.

The cases that have established this principle are:

Cook v Knott	2 TC 246
Revell v Directors of Elworthy Bros & Co Ltd	3 TC 12
Andrews v Astley	8 TC589
Ricketts v Colquhoun	10 TC 118, see EIM31641
Nolder v Walters	15 TC 380
Burton v Rednall	35 TC 435
Parikh v Sleeman	63 TC 75, see EIM32360
Miners v Atkinson	68 TC 629, see EIM32380
Kirkwood v Evans	74 TC 481, see EIM32374

The only exceptions to this rule are:

- travel from home to a temporary workplace, see EIM32000
- where the employee has a travelling appointment, see EIM32366
- where the employee's home is a place of work and the place where the employee lives is dictated by the requirements of the job, see EIM32370
- where the duties of the employment are carried out wholly or partly outside the UK, see EIM34020
- where a non-domiciled employee is working in the UK, see EIM35030
- emergency call-outs see EIM32386.

EIM32360 Between Places Of Work [Nov 2019]

Where an employee is required to travel between two places of work, in the same employment, in order to carry out the duties of that employment, the cost of travel is incurred in the performance of the duties.

The Courts have approved this practice, for example in *Taylor v Provan* (49 TC 579). On page 611 Lord Wilberforce commented:

> "If a man has to travel from one place of work to another place of work, he may deduct the travelling expenses of this travel, because he is travelling on his work, but not those of travelling from either place of work to his home or vice versa."

Note though that the expenses of travelling between two workplaces are not normally allowable when one of those places is the employee's home. See EIM32370.

Travel between two different employments

Where an employee has two employments and the duties of those employments are performed at different places, the cost of travelling between them is not travel in the performance of the duties of the employment.

This point is confirmed by the case of *Parikh v Sleeman* (63 TC 75), which concerned a doctor who had separate employments at three hospitals. When he was travelling between the hospitals he was not performing the duties of any of them and so no deduction could be given.

There is an exception to this rule for individuals who are directors of two or more companies within a group of companies, see EIM32035.

EIM32366 Travelling Appointments [Nov 2019]

An employee who holds a travelling appointment can deduct all of their business travelling expenses as travel in the performance of the duties of the employment, even where the journey starts from home.

There is little guidance in case law about what constitutes a travelling appointment but a commercial traveller can be said to be typical. A commercial traveller is travelling on his or her work, as distinct from travelling to it, from the moment of leaving home. Another example is a service engineer who moves about from place to place during the day carrying out repairs to domestic appliances at clients' premises. Such employees are often described as itinerant.

If an employee has to report to and work at a particular office at the start and end of the day, travel between there and home is not travel in the performance of the duties, unless the calls at that office are fortuitous or incidental.

Whether an employee is truly itinerant, or merely has two or more fixed places of work, is essentially a question of fact. There are bound to be marginal cases.

Many jobs require mobility, in the sense that an employee will have to work at a number of different places from week to week or month to month. But this does not mean that the duties themselves inherently involve travelling, merely that the employee will not always incur the same cost in getting to (or staying near) work. Clearly the frequency with which such changes take place is of major importance. There will be a strong presumption that anyone required to go to a number of different sites each day on an irregular basis will have a travelling appointment. Other factors, however, also need to be taken into account, such as the nature of the work itself and whether, for pay purposes, the employee is treated as starting work only on reaching each site.

It is important, therefore, when an employee considers that he or she has a travelling appointment, to obtain as much information as possible about work patterns. If necessary, ask for a record covering a typical period of weeks or months.

Even if the employee does not have a travelling appointment it is likely that for many such employees every place that they attend is a temporary workplace. So relief for their business travel is likely to be due under Section 338 ITEPA 2003, see EIM32005.

EIM32368 Travelling Appointments: Deductible Expenses: Responsibility For An Area [Nov 2019]

Where an employee has a travelling appointment the cost of travel between home and the place where work is done is usually travel in the performance of the duties of the employment, see EIM32366.

There is an exception where the employee's duties cover a particular area (for example, a county) but he or she chooses to live a significant distance outside that area.

In these circumstances the cost of travel between home and the boundary of the area is not travel in the performance of the duties. However, if the employee is travelling to a temporary workplace relief will be available for the full journey under Section 338 ITEPA 2003, see EIM32010.

A similar practice applies to travel for necessary attendance, see EIM32190.

EIM32370 Travel To And From Home Where It Is A Place Of Work [Nov 2019]

Where an employee's home is itself a place of work, the cost of travel between there and other permanent workplaces may sometimes be deductible under Section 337 as travel in the performance of the duties.

A detailed explanation of the circumstances in which you can accept that an employee's home is a place of work is at EIM32760.

Note though that the fact that an employee's home is treated as a workplace for tax purposes is not enough, on its own, to enable the employee to obtain relief under Section 337 for the expenses of travelling to another permanent workplace. For most people, the place where they live is a matter of personal choice. So the expense of travelling from home to any other place is a consequence of that personal choice, not an objective requirement of their job. The case law discussed in the following pages demonstrates that the expenses of travelling from home to another workplace do not qualify for relief under Section 337 unless the location of the employee's home is itself dictated by the requirements of the job.

Even where that condition is met, the cost of travel between the employee's home and another permanent workplace is only deductible during those times when the home is a place of work, see EIM32170.

Employees who work at home are of course entitled to a deduction for the expenses of travelling to a temporary workplace in the same way as any other employee, see EIM32170.

EIM32371 Travel To And From Home Where It Is A Place Of Work: Case Law [Nov 2019]

The Courts have considered employees' home to work travelling expenses on a number of occasions. Recent examples include *Miners v Atkinson* (68 TC 629), which concerned a director of a one-man service company, see EIM32380, and *Kirkwood v Evans* (74 TC 481), which concerned an employee who agreed to be based at home under a homeworking scheme, see EIM32374.

In two cases the House of Lords has accepted that in certain exceptional circumstances an employee's home to work travelling expenses qualified for relief under Section 337. The cases are:

- *Taylor v Provan* (49 TC 579), see EIM32372 and
- *Pook v Owen* (45 TC 571), see EIM32373.

EIM32372 Travel To And From Home Where It Is A Place Of Work: *Taylor v Provan* [Nov 2019]

The case of *Taylor v Provan* (49 TC 579) illustrates how difficult it can be for an employee to obtain a deduction under Section 337 ITEPA 2003 for the expenses of travelling between their home and another workplace.

Mr Taylor lived in Canada and was agreed to have unique and unrivalled knowledge and experience of arranging mergers of brewery companies. The terms on which he was employed acknowledged his unique experience and required him to perform his duties as far as he could from his home in Canada. The case concerned a deduction for the costs of travel from his home to other workplaces, costs that the Courts in *Ricketts v Colquhoun* had held to be not deductible as a general rule, see EIM31641.

In *Taylor v Provan* the Courts held that this general rule applies where the employee has to do part of his or her work at home. Lord Reid commented at page 605E:

> "If the holder of an office or employment has to do part of his work at home the place where he resides is generally still his personal choice. If he could do his home work equally well wherever he lived then I do not see how the mere fact that his home is also a place of work can justify a departure from the Ricketts ratio."

However, the Courts felt that an exception could be made in the very unusual circumstances of Mr Taylor's case. Lord Morris commented at page 609D:

> "The office or the employment was very special. There was probably no-one else who could have filled it. It was an office created to be held by one particular person."

In effect, the view of the Courts was that Mr Taylor's location was an integral, unavoidable and accepted element in determining the nature of the office or employment that he held. Mr Taylor was uniquely qualified to fill that post and his personal circumstances were central to the terms of his employment. Very few employees will be in a similar position.

EIM32373 Travel To And From Home Where It Is A Place Of Work: *Pook v Owen* [Nov 2019]

The other key case dealing with deductions under Section 337 ITEPA 2003 is *Pook v Owen* (45 TC 571). Dr Owen was a general practitioner who also had a part-time appointment at a nearby hospital. His duties required him to be available for emergency call-outs from home. He would be contacted by telephone and then took responsibility for the patient as soon as he took the call. The Courts held that he was entitled to a deduction for the cost of travel between home and the hospital while on call-out. This case forms the basis for the guidance at EIM32386 .

The reason for the decision is not easy to follow from the judgements. It is best explained in a comment by Lord Reid in *Taylor v Provan* at page 605F:

> "I am sure that the majority did not intend to decide that in all cases where the employee's contract requires him to work at home he is entitled to deduct travelling expenses between his home and his other place of work. Plainly that would open the door widely for evasion of the rule. There must be something more. I think that the distinguishing fact in Owen's case was that there was a part time employment and that it was impossible for the employer to fill the post otherwise than by way of appointing a man with commitments which he would not give up. It was therefore necessary that whoever was appointed should incur travelling expenses."

Thus it is not enough that there should be a contractual obligation to work from home. It is not enough that there should actually be work at home. What is required is something more; that the nature of the employment itself must necessarily require the employee to live in a particular location.

EIM32374 Travel To And From Home Where It Is A Place Of Work: *Kirkwood v Evans* [Nov 2019]

The case of *Kirkwood v Evans* (74 TC 481) illustrates the approach of the Courts to employees working at home under a voluntary homeworking scheme.

Mr Evans was a civil servant who lived in King's Lynn and worked in Leeds. His employer introduced a voluntary homeworking scheme under which Mr Evans was permitted to work at home and to travel to Leeds on one day each week. Under the scheme Mr Evans lost his office space in Leeds but was provided with equipment to support an office at home. Either Mr Evans or his employer could terminate the homeworking agreement.

Mr Evans argued that travel between his home and Leeds was travel in the performance of the duties of the employment, see EIM32360. The High Court reviewed the cases discussed at EIM32372 and EIM32373, rejected that argument and commented:

> "his choice to live in King's Lynn rather than Leeds was historical and is unconnected with any term of his employment. The necessity of travelling to Leeds is dictated by his choice of the place where he lives and not by the nature and terms of the job itself."

The High Court also rejected the Commissioners' apparent finding that Leeds was not a permanent workplace for the purpose of section 339(2) (see EIM32070). Mr Evans put forward no such argument, and conceded that the Commissioners' finding on the point was wrong.

Finally, Mr Evans argued that he was entitled to relief for the additional household costs he incurred while working at home. This was rejected because:

> "the homeworking scheme was optional. Mr Evans was permitted to work from home but he was not required to do so. He took up the option because for perfectly understandable reasons it was more convenient for him to remain at home for most of the week rather than to travel to Leeds. Working at home was not therefore a necessary incident of his employment."

The principle that underlies this decision is that sections 336 and 337 ITEPA 2003 only permit relief for those expenses that are incurred by a necessity arising from the nature of the employment, see EIM31641. They do not permit relief for expenses incurred out of choice, or because of the personal circumstances of the individual employee.

EIM32380 Travel To And From Home Where It Is A Place Of Work: Service Companies: *Miners v Atkinson* [Nov 2019]

Directors of small companies operating in service industries such as computer consultancy frequently contend that their home is a place of work (see EIM32760). As a consequence the director will ask for a deduction for the cost of travel from home to the various places at which the company is required to provide services, together with accommodation costs if the director needs to stay away from home. In very many cases, those expenses will not qualify for relief under Section 337 ITEPA 2003. The reason can be illustrated by the case of *Miners v Atkinson* (68 TC 629).

Mr Miners was a computer consultant who provided his services through his own service company. The registered office of the company was at Mr Miners' home, 4 Sandringham Road. Most of Mr Miners' duties were carried out at the sites of the clients of his company but he did some work at home. The case concerned a deduction under Section 337 ITEPA 2003 for Mr Miners' travel expenses from his home to the sites at which he worked.

A deduction was not permitted. The duties that Mr Miners carried out at home were not the substantive duties of his employment, see EIM32780. However, the focus of the decision in the High Court was on whether there was an objective requirement that any work carried out by Mr Miners at home had to be carried on at that place.

The question that needed to be answered, and will need to be answered in similar cases, was expressed in these terms:

> "The starting point is that 4 Sandringham Road was the appellant's home. On the authorities, it seems to me that one must ask whether the appellant was working at home out of choice."

In answer to that question the Special Commissioner had concluded that:

> "it was not necessary for the work which Mr Miners carried out at 4 Sandringham Road to be done at that precise address. It could have been done anywhere."

There was a clear finding by the High Court that there was no objective requirement for the work to be carried out at Mr Miners' home. This conclusion applies in the same way to the great majority of one-man service companies. However, in very unusual circumstances, there may be exceptions. There is some practical advice at EIM32800.

The effect of this case is illustrated by examples EIM32805 and EIM32806.

Remember that even where relief for travel expenses cannot be permitted under Section 337 ITEPA 2003 it will still be available under Section 338 ITEPA 2003 where the place to which the employee is travelling is a temporary workplace, see EIM32170.

EIM32385 Employee On Standby [Nov 2019]

The fact that an employee is on stand-by, or may be called out to work as and when needed, does not in itself affect the treatment of his or her travelling expenses.

In *Pook v Owen* (45 TC 571) Lord Wilberforce commented at page 595:

> "The mere fact of being on stand-by duty is not enough"... [to qualify for a deduction] ... "Nor, in my opinion, is the mere fact sufficient that he might be called upon, or might volunteer, to give some professional advice on the telephone before setting out. There are persons who hold positions of importance, who carry their responsibility with them wherever they are: they too may be called to their offices after working hours.....But this does not mean that they have more than one working place: cf. Newsom v Robertson (33 TC 452). What is required is proof to the satisfaction of the fact-finding Commissioners that the taxpayer, in a real sense, in respect of the office or employment in question, had two places of work, and that the expenses were incurred in travelling from one to the other in the performance of his duties".

The same principle applies to travel for necessary attendance, see EIM32250.

EIM32386 Emergency Callout [Nov 2019]

No deduction is due for the cost of travel between an employee's home and his or her permanent workplace even where the employee is on stand-by, see EIM32385. In the same way, no deduction is due for the cost of travelling on an emergency call-out between an employee's home and his or her permanent workplace.

There is one exception. The cost of emergency call-out travel between an employee's home and his or her permanent workplace is deductible where the employee's home is a place of work, see EIM32760 and all of the following conditions are met:

- the employee must give advice on handling the emergency before starting the journey and
- responsibility for those aspects appropriate to the employee's duties must be accepted from that time and
- the employee must have a continuing responsibility for the emergency while travelling to the workplace.

35.15 Wholly and exclusively

The EI Manual provides:

> **EIM31811 General: Introduction: Expenses Do Not Have To Be Wholly And Exclusively Incurred: Example** [Nov 2019]
>
> An employee has to travel to New York on business for two weeks. While she is there she has a free weekend and spends it taking a break in Boston. The cost of her flight to New York and any other necessary travelling expenses are deductible. They have been necessarily incurred in travelling to a temporary workplace. The fact that the break in Boston means that the travelling expenses have not been incurred wholly and exclusively for business does not matter.
>
> The costs of the break in Boston, such as travelling to Boston from New York and the cost of staying in Boston, are not deductible. These expenses are not attributable to attendance at the temporary workplace.
>
> You can find detailed instructions about the expenses incurred in attending overseas conferences, seminars or study tours at EIM31950

35.16 Conferences and seminars

The EI Manual provides:

> **EIM31960 General: Overseas Conferences, Seminars And Study Tours: Getting Evidence** [Nov 2019]
>
> Before a deduction can be permitted for the cost of an overseas conference, seminar or study tour it needs to be demonstrated that attendance was necessary to carry out the duties of the employment of the person attending.
>
> Some overseas trips are merely an incentive to reward or motivate employees, see EIM31970. This may be particularly the case where the trip is provided by a third party, see EIM31975.
>
> An itinerary should be available for the trip showing precisely what activities were involved. It is not enough that the trip was authorised, or even required, by the employer. It is necessary to be able to demonstrate that the duties of the employment could not be performed without it, see EIM31647.
>
> The insertion into an itinerary of a token business element, such as a meeting that could equally well have taken place at the employer's premises in the United Kingdom, does not make the travel cost necessarily incurred, see example EIM31991.
>
> It is not enough to demonstrate that a trip had a personal educational value. Expenditure incurred by an employee to improve his or her qualifications for doing the job, or to keep his or her knowledge up to date, are not deductible, see EIM31650. This is illustrated by example EIM31990.
>
> You should be particularly wary of those cases where the trip is made to

an exotic or desirable location that appears to be unrelated to the subject matter of the trip, for example, a dentists convention in St Lucia. You need to consider critically the reason for the trip. ...

EIM31965 General: Overseas Conferences, Seminars And Study Tours: Apportionment [Nov 2019]

If you accept that a particular overseas trip has been made necessarily to carry out the duties of the employment you may still find that some expenses are not deductible. For example, a short break may be taken during an overseas conference.

You should not accept an apportionment of the total cost of the trip on a percentage basis, calculated by looking at the relative time spent on business and non-business activities. There is no basis in law for such an apportionment, see EIM31660. Instead you should examine the expenses individually and permit a deduction only for those that are necessarily incurred.

The correct approach is illustrated by example EIM31811.

EIM31970 General: Overseas Conferences, Seminars And Study Tours: Overseas Trips As Incentives [Nov 2019]

Overseas trips that are variously described as conferences, conventions or seminars are often no more than incentives intended to reward past performance or to motivate employees for the future. Commonly the business element is minimal, for example an address by a company executive. The itinerary will consist largely of social occasions, excursions and leisure activities. No deduction should be permitted for the cost of such trips, see example EIM31991.

A deduction is only due in the circumstances described in EIM31950. It can generally be demonstrated that the cost of incentive trips is not incurred necessarily by the participants, less successful colleagues doing the same or similar jobs will not have needed to incur the expense. Nor is it a duty of the employment to attend.

Any enquiries from the promoters of such events about the potential tax liabilities for participants should be dealt with in accordance with EIM11235 onward.

EIM31990 General: Overseas Conferences, Seminars And Study Tours: Example [Nov 2019]

A consultant neurologist attends the annual conference of the World Council of Neurology. The conference takes place in Geneva and takes 4 days. The conference consists of a series of meetings, lectures and seminars on medical matters. The neurologist’s employer encourages her to attend and the conference is directly relevant to her work.

No deduction can be permitted for the cost of attending the conference. Attendance at the conference is not necessary expenditure, see EIM31950. Attendance at the conference is not one of the duties of her employment, see EIM31650.

CHAPTER THIRTY SIX

PAYE

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36.1 PAYE: Introduction

A full discussion of PAYE needs a book to itself. This chapter focuses on matters closest to the themes of this book.

The law is mostly contained in the Income Tax (Pay As You Earn) Regulations 2003 (which I call the "**PAYE regulations**").

There is guidance in the PAYE Manual and CWG2 (Employer further guide to PAYE & NIC).

36.2 Relevant payment

The key term is "relevant payment". "Relevant payment" is a label for a number of rules.

There is the usual cascade of definitions. Subject to some exceptions, not discussed here, reg. 4(1) PAYE regulations provides:

> In these Regulations, any reference (however expressed) to relevant payments means payments[1] of, or on account of, net PAYE income...

36.2.1 *Net PAYE income*

Regulation 3(1) PAYE regulations provides:

> Net PAYE income means PAYE income less any—
> (a) allowable pension contributions, and
> (b) allowable donations to charity.

"Net" PAYE income is a label to introduce rules for deductions, not discussed here.

36.2.2 *PAYE income*

Section 683(1) ITEPA defines "PAYE income":

> For the purposes of this Act and any other enactment (whenever passed) "PAYE income" for a tax year consists of—
> (a) any PAYE employment income for the year,
> (b) any PAYE pension income for the year, and
> (c) any PAYE social security income for the year.

36.2.3 *PAYE employment income*

Section 683(2) ITEPA defines "PAYE employment income":

> "PAYE employment income" for a tax year means income which consists of—
> (a) any taxable earnings from an employment in the year (determined in accordance with section 10(2)),[2] and
> (b) any taxable specific income from an employment for the year (determined in accordance with section 10(3)).[3]

[1] For the meaning of payment, see 15.3 (Recognition/attribution: Analysis).

[2] See 34.8 ("Taxable earnings").

[3] For completeness: s.683 (3ZA) provides two narrow exceptions:

> "PAYE employment income" for a tax year does not include any taxable specific income treated as paid or received in that tax year by section 394A or 554Z4A (temporary non-residents).

These relate to temporary non-residence charges for employer-financed retirement

I do not address the topics of PAYE pension/social security income.
See too 36.6.3 (Deemed PAYE income).

36.3 Employment/employer/employee

Regulation 2(1) PAYE regulations incorporates the standard ITEPA definitions[4] with amendments:

> "employment", subject to regulations 10 to 12, has the meaning given in sections 4 and 5 of ITEPA; and "employer" and "employee" have corresponding meanings

Regulation 12(1) PAYE regulations provides:

> For the purposes of these Regulations—
> (a) other payers are treated as employers;
> (b) other payees are treated as employees; and
> (c) an other payee's "employment" with an other payer starts when relevant payments start and ends when relevant payments end.

Where it is necessary to distinguish between usual sense and the PAYE sense of employer/employee it is helpful to refer to "Paye-employer/employee".

36.3.1 *Payer/payee*

Regulation 2(1) PAYE regulations provides:

> "payee" means an employee, agency worker, pensioner or other payee;
> "payer" means an employer, agency, pension payer or other payer;

36.4 Duty to deduct PAYE

Armed with these definitions, we can turn to the obligation to deduct PAYE. Reg 21(1) PAYE regulations provides:

> On making a relevant payment to an employee during a tax year, an employer must deduct or repay tax in accordance with these Regulations by reference to the employee's code, if the employer has one for the employee.

36.5 Employee works for non-employer

I do not discuss:

benefits and disguised remuneration, where operating PAYE is obviously impractical.

[4] See 34.3 (Employment/employer/employee).

ITEPA	**Topic**
s.688	Agency workers
s.688A	Managed service companies
s.688AA	Workers' services provided through intermediaries

36.5.1 *Application conditions*

Section 689(1) ITEPA provides:

> This section applies if—
> (a) an employee during any period works for a person ("the relevant person") who is not the employer of the employee,
> (b) any payment of, or on account of, PAYE income of the employee in respect of that period is made by
> [i] a person who is the employer or
> [ii] an intermediary of the employer or of the relevant person,[5]
> (c) PAYE regulations do not apply to
> [i] the person making the payment
> [ii] or, if that person makes the payment as an intermediary of the employer or of the relevant person, the employer, and
> (d) income tax and any relevant debts are not deducted, or not accounted for, in accordance with the regulations by
> [i] the person making the payment
> [ii] or, if that person makes the payment as an intermediary of the employer or of the relevant person, the employer.

I refer to this as the **"s.689 application conditions"**.

The employer, being non-resident, may chose to operate PAYE but is not required to do unless the employer has a "UK presence".[6]

36.5.2 *General rule*

Assuming the application conditions are satisfied, s.689 ITEPA provides:

[5] Section 689(5) provides: "For the purposes of this section a payment of, or on account of, PAYE income of an employee is made by an intermediary of the employer or of the relevant person if it is made—
(a) by a person acting on behalf of the employer or the relevant person and at the expense of the employer or the relevant person or a person connected with the employer or the relevant person, or
(b) by trustees holding property for any persons who include or class of persons which includes the employee."

[6] *Clark v Oceanic* 56 TC 183; see 16.12 (Territorial principle: Application). HMRC accept this; see ICAEW Taxguide 08/21 para 6.3: "If there is no PAYE presence for an overseas employer in the UK, there will be no requirement to operate PAYE."

> (2) If subsection (1C) does not apply, the relevant person is to be treated, for the purposes of PAYE regulations, as making a payment of PAYE income of the employee of an amount equal to the amount given by subsection (3).
> (3) The amount referred to is—
> (a) if the amount of the payment actually made is an amount to which the recipient is entitled after deduction of income tax and any relevant debts due under the PAYE regulations, the aggregate of the amount of the payment and the amount of any income tax and any relevant debts deductible due, and
> (b) in any other case, the amount of the payment.

36.5.3 *"Work"*

Section 689(6) ITEPA provides:

> [a] In this section and sections 690 and 691 "work", in relation to an employee, means the performance of any duties of the employment of the employee and
> [b] any reference to the employee's working is to be read accordingly.

See 6.22.2 (Employment-work).

36.5.4 *"Work for"*

HMRC discuss the concept of "working for":

> 4.15 HMRC has previously described "working for" as "paid by, working on behalf of, or to the benefit of". HMRC does not regard "working for" as simply meaning "working for the benefit of".
> 4.16 There must be an element of control or management akin to an employee employer relationship for Section 689 to apply. This is not a new concept and has been the basis of "working for" for S689 purposes and its predecessor ...
> 4.17 There will be straightforward situations where the employee is clearly working for his overseas employer whilst in the UK - a simple example being an employee of a US car plant manufacturer who installs equipment in the UK as part of the contract between the UK and US Companies.
> 4.18 HMRC does understand that individuals sent from group companies may be working for their foreign employer whilst working at the premises of separate UK entity. In the above example, the entities may be part of a multi national group.
> 4.19 In connection with employment services for treaty purposes, the OECD commentary on Article 15 at 8.13 refers to services which are

> integral to the business of and bearing the responsibility or risk for the results produced by the individual's work.[7] HMRC does not regard the comments to be relevant in determining whether there is a domestic PAYE obligation although the concepts are similar and may result in the same conclusion.
>
> 4.20 It is the responsibility of the UK Company to decide whether there is a PAYE obligation based on the particular facts.[8]

36.5.5 *Special cases*

There are a number of exceptions to the general rule which are not discussed here:

s.689	**Topic**
(1ZA)	Oil and gas workers on the continental shelf
(1A)(4)(4A)	Disguised remuneration

The next provision relates to intermediaries of intermediaries:

> (1B) Subsection (1C) applies if—
> (a) the employee worked for the relevant person during the period under or in consequence of arrangements made between the relevant person and a third person,
> (b) the third person did not make the payment of, or on account of, PAYE income of the employee, and
> (c) PAYE regulations would apply to the third person if the third person were to make a payment of, or on account of, PAYE income of the employee.
>
> (1C) The third person is to be treated, for the purposes of PAYE regulations, as making a payment of PAYE income of the employee of an amount equal to the amount given by subsection (3).

36.6 PAYE clearance: s.690 direction

In the following cases it may be unclear how much employment income is taxable and so PAYE income:

(1) Non-resident employee
(2) Employee qualifying for overseas workday relief (recent arriver)
(3) Split years

[7] See 36.13 (PAYE exemption: EP App 4).

[8] Joint Expatriate Forum on Tax and NICs (July 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/347913/140731_Expat_Forum_Minutes.pdf*

Section 690 ITEPA provides a clearance mechanism:

> (1) This section applies in relation to an employee in a tax year if the employee—
>
> (a) [i] is either non-UK resident for the tax year or
> [ii] is UK resident but meets the requirement of section 26A for the tax year,[9] and
>
> (b) works or will work in the UK and also works or is likely to work outside the UK.
>
> (1A) This section also applies in relation to an employee in a tax year if it appears to an officer of Revenue and Customs that—
>
> (a) the tax year is likely to be a split year as respects the employee, and
>
> (b) the employee works or will work in the UK and also works or is likely to work outside the UK.

Assuming one of these conditions is met, we move on to the relief:

> (2) If in relation to an employee to whom this section applies and any tax year it appears to an officer of Revenue and Customs that—
>
> (a) some of the income paid to the employee by the employer[10] is PAYE income, but
>
> (b) some of that income may not be PAYE income,
>
> an officer of Revenue and Customs may, on an application made by the appropriate person,[11] give a direction for determining a proportion of any payment made in that year of, or on account of, income of the employee which is to be treated as PAYE income.

I refer to this as a **"s.690 direction."**

> (2A) For the purposes of subsection (2) as it applies in relation to an employee who is UK resident for a tax year but not domiciled in the UK in that tax year, the officer may treat section 809B of ITA 2007 (remittance basis) as applying to the employee for that year, even if no claim under that section has been made.

[9] See 34.22.2 (s.26A conditions: 3-year cap).

[10] Section 690(3)(b) ITEPA provides:
"any reference to a payment made by the employer includes a reference to a payment made by a person acting on behalf of the employer and at the expense of the employer or a person connected with the employer."

[11] Section 690(3)(a) defines appropriate person: "In this section—
(a) "the appropriate person" means the person designated by the employer for the purposes of this section and, if no person is so designated, the employer..."

HMRC Brief 17/09 explains s.690(2A) ITEPA is to correct an oversight in 2008:

> **Section 690 ITEPA directions**
> Prior to April 2008 non-domiciled individuals and not ordinarily resident individuals were automatically taxed on the remittance basis on their foreign employment income. However since April 2008 individuals have to make an annual claim to the remittance basis. Section 690 ITEPA was amended in FA 2008 to reflect this change for not ordinarily resident employees. Prior to April 2008 employers were able to ask for a section 690 direction which permitted them not to apply PAYE to certain employment income paid to not ordinarily resident employees entitled to be taxed on the remittance basis. These rules have been amended to allow this procedure to continue.

36.6.1 *Application for s.690 direction*

Section 690 ITEPA continues:

> (4) An application under subsection (2) must provide such information as is available and is relevant to the application.
> (5) A direction under subsection (2)—
> (a) must specify the employee to whom and the tax year to which it relates,
> (b) must be given by notice to the appropriate person, and
> (c) may be withdrawn by notice to the appropriate person from a date specified in the notice.
> (6) The date so specified may not be earlier than 30 days from the date on which the notice of withdrawal is given.

36.6.2 *Effect of s.690 direction*

Section 690(7) ITEPA provides:

> If—
> (a) a direction under subsection (2) has effect in relation to an employee to whom this section applies, and
> (b) a payment of, or on account of, the income of the employee is made by the employer in the tax year to which the direction relates,
> the proportion of the payment determined in accordance with the direction is to be treated for the purposes of PAYE regulations as a payment of PAYE income of the employee.

36.6.3 *Deemed PAYE income*

Section 690 ITEPA continues:

> (8) If in any tax year—
>
> (a) no direction under subsection (2) has effect in relation to an employee to whom this section applies, and
>
> (b) any payment of, or on account of, the income of the employee is made by the employer,
>
> the entire payment is to be treated for the purposes of PAYE regulations as a payment of PAYE income of the employee.
>
> (9) Subsections (7) and (8) are without prejudice to—
>
> (a) any assessment in respect of the income of the employee in question, and
>
> (b) any right to repayment of income tax overpaid and any obligation to pay income tax underpaid.

HMRC say:

> **Question:** This is a query with regard to inbound expats (business travellers), who are taxable on their UK workdays:
>
> Background – business travellers (Non-resident in the UK), who are taxable on their UK workdays (e.g. because of economic employment in the UK) and for whom there is a "deemed employer" for PAYE withholding purposes (e.g. as required per s689, ITEPA).
>
> HMRC guidance (CWG2, Page 70) states –
>
>> "Where, because work is performed both in the UK and abroad, it is unclear at the time of making a payment how much of the payment will ultimately be assessable as PAYE income, the whole payment should be subjected to PAYE unless we have directed otherwise."
>
> The question is, however, what one means by "unclear" in the above guidance. For example, some of our clients will obtain full UK / nonUK workday calendars from their business traveller population on a live basis each month. Such data, can be required, for example, to ensure that the overseas withholding (e.g. in Germany) is correctly calculated. As such, such employers do have a clear understanding of exactly what income relates to UK workdays. The question therefore is whether it is acceptable from an HMRC perspective to only account for PAYE withholding on the actual UK workdays in this case – or should they still be getting a s690 ruling from HMRC for example (even though the s690 ruling would only be based on estimated data and is therefore innately less definitive than the live calendars that the employees provide each month).

> **HMRC answer:** The legislation at s690(8) ITEPA 2003 is clear that where no direction under s690 (2) has effect, the entire payment is to be treated for the purposes of PAYE regulations as a payment of PAYE income of the employee.
>
> However, in the case of a short term business visitor (STBV) who is taxable in the UK in relation to their UK workdays only, a s690 may not be appropriate. This could be, for instance, an STBV from a non-treaty country or from an overseas branch of a UK Company. The "relevant payment" processed through the UK shadow payroll would simply be the employment income relating to the UK workdays, and therefore a s690 is not required. In this example, there is no part of what would be considered to be the "relevant payment" which can be deemed to not be PAYE income, and so s690 is not applicable.[12]

36.6.4 *HMRC practice*

The PAYE Manual provides:

> **PAYE81545. UK employer's duties** [Jun 2020]
>
> ...
>
> **The employee works both inside and outside the UK and is not resident in the UK or, is resident, the remittance basis applies and the requirement of Section 26(A) ITEPA are met (a three year period of non residence)**
>
> The employer can apply under Section 690 ITEPA 2003 for a direction from HMRC to operate PAYE only on the percentage of the employee's total earnings that are for work in the UK. This applies to all payments made by the employer including termination payments and share based remuneration. An application for a direction must be sent to Self Assessment, HMRC, BX9 1AS UK, or Charities, Savings & International 3 HMRC, BX9 1AJ (see PAYE81555)
>
> **PAYE: apply for a Section 690 or informal treaty direction (S690)**
>
> The Section 690 application is only an estimate of the work done in and outside the UK and the employee should complete an SA return to report the actual position. See PAYE81555 - PAYE81565 on how to handle applications under Section 690 ITEPA 2003.
>
> If an employer does not make an application under Section 690 ITEPA 2003, then unless the employee is within an EP Appendix 6

[12] Expatriate Forum Minutes Oct 2019 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/855596/Expat_Forum_minutes_10_October_2019.pdf*

arrangement (see PAYE81740),[13] they must operate PAYE on all payments made to the employee for work done both in and outside the UK. The employee can claim a repayment of the tax deducted on earnings for work done outside the UK on their SA Return.

You must set up an SA record for an employee who works both in and outside the UK, whether or not a Section 690 application is made.

If the employer provides Tax Equalisation arrangements for the employee, you should refer to PAYE81740.

Amendments to S690 Directions where individual's travel has been restricted due to COVID-19

Where employees have suffered significant delay in travel restrictions caused by COVID-19, HMRC will allow employers to request amendments for the proportion of time to be changed in an existing S690 Direction. Requests should be made in writing to HMRC and sent to the relevant address contained within PAYE81555...

PAYE81550 PAYE Operation: Do Any Special Rules Apply For NICs? [May 2020]

Arrivals in the UK

The employer may ask you whether any special rules apply for NICs for a new arrival. Refer the employer to the CWG2 Employer Further Guide to PAYE and NICs, which provides specific guidance and points of contact for further help.

The employer should be advised that

- The rules governing tax and NICs are different and must be applied separately And
- HMRC decides whether the new arrival is liable to UK tax and NICs, and how PAYE should be applied

(Note: A direction under Section 690 ITEPA applies to the payment of income tax only.)

PAYE81555. Applications under Section 690 ITEPA 2003 - Who deals with the application? [May 2020]

Arrivals in the UK

On receipt of an application for a direction under Section 690 ITEPA 2003 you must decide which office is responsible for reviewing the application. Use the following table to determine the office and pass the application to them immediately.

Situation	**Responsible Office**
The employee is an Expat	Charities, Savings & International
All other employees	PT Operations

[13] See 36.15 (Tax equalisation: EP App 6).

PAYE81560. Applications under Section 690 ITEPA 2003 - reviewing the application [May 2020]

Arrivals in the UK

Use the flowchart[14] to review an application under Section 690. It contains links to a number of draft letters you should use depending on the circumstances of the case. These letters are available on SEES Forms and Letters, in the general subdirectory 'Regulation/Payment letters'.

When an application is accepted, you must take the following action

- Set up an SA record for the employee if there is not one already
- Arrange for an SA return with the non-residence and employment pages to be issued for the year(s) the application covers
- Make an SA note as follows 'Sec 690 approval given for [year] for earnings from [employer's name]. PAYE to be operated on [%].'
- If the employee is resident/not ordinarily resident, the remittance basis applies and the requirements of Section 26A ITEP are met (a three year period of non-residence
  - Amend their tax code to remove the basic personal allowance (and blind person's allowance if claimed)
- Place all the Section 690 papers in an SA Post batching range

PAYE81565. Applications under Section 690 ITEPA 2003 - At the end of the tax year [May 2020]

The employer must complete the employee's form P14, End of Year Summary or FPS, to show only

- The pay on which the employer has operated PAYE (this will include the amount representing the UK duties agreed by HMRC under Section 690 ITEPA and any other taxable pay) and the tax deducted from that pay

The employee should, when completing their SA return enter

- The earnings from their P60 / P45 in box 1 on the Employment page including any cash earnings from that employment that have not been included on the P60 / P45
- The tax deducted from their P60 / P45 in box 2 on the Employment page
- The remainder of their earnings in box 3 on the Employment page including paid earnings overseas from an earlier year which were not liable to UK income tax unless they were remitted to the UK during the Tax Return year
- The amount of their total earnings which relates to work done abroad in box 12 under the section 'Share Scheme and Employment Lump Sum, Compensation and Deduction' on the 'Additional

[14] See *http://www.hmrc.gov.uk/manuals/pommanual/paye81560.htm*

Information Page' (SA101)

No equivalent rule is needed for other UK resident non-domiciled employees, whose income is either taxable entirely on the remittance basis, or on the arising basis.

HMRC say:

> **Section 690 agreements**
> *Question:* (28.1) Can HMRC allow employers to operate PAYE on the basis of a s690 percentage in advance of an actual s690 notice being issued, provided the employer submits the s690 request to HMRC within a reasonable time period following the date of the first payment? We would suggest a two month period would be reasonable. Where the percentage used is not the percentage later agreed by HMRC the employer could be obliged to correct the position in the next PAYE period following receipt of the notice from HMRC.
> (28.2) Can HMRC allow employers to adjust the s690 percentage unilaterally during the tax year to more accurately reflect the employee's actual work pattern? The employer could be obliged to provide HMRC with written confirmation of the adjusted final percentage following the end of the tax year.
> **HMRC answer**
> (28.1) An application for a direction under Section 690 ITEPA 2003 must be sent to HMRC to operate PAYE on a particular percentage of an employee's earnings. If an employer does not make an application under S690, then unless the employee is within an EP Appendix 6 arrangement, they must operate PAYE on all payments made to the employee for work done both in and outside the UK.
> (28.2) The agreed s690 percentage cannot be adjusted unilaterally during the tax year without HMRC's agreement. If the employee's work pattern drastically changes during the year then the office which approved the initial direction should be contacted. This should be done as soon as it becomes apparent that there are any changes to the employee's circumstances that could affect the limited operation of PAYE that has been agreed.[15]

36.6.5 *Covid*

ICAEW Taxguide 08/21 (Covid-19: Displaced Expatriate Employees)[16]

[15] Expat Forum Q&A log (July 2019) (informally circulated).

[16] *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2021/taxguide-0821-covid-19-displaced-expatriate-employees.ashx*

provides:

> **6.1 S690 Determinations**
> Many s690 determinations that were issued will now, with hindsight, be invalid due to stranded employees working in the wrong country. Could HMRC consider a temporary measure of allowing employers to adjust the determination percentage as they discover more accurate data regarding the location of their employees? There would obviously need to be an audit trail of why any revised percentage was used and the guidance could cover records that HMRC would expect to be kept if an employer used such a concession.
> **Reply from HMRC**
> HMRC published updated guidance[17] on 20 October 2020.
> This confirmed that, if there is already a s690 agreement with HMRC in place, a customer will be able to ask to amend it, if the measures that have been introduced to stop the spread of coronavirus mean an employee has been unable to leave or return to the UK.
> This will mean if the employee:
> • has been unable to leave the UK in the 2020-2021 tax year, PAYE can be operated on 100% of their earnings (or another reasonable estimate)
> • is unable to return to the UK indefinitely, UK tax could be reduced or may not be due, depending on the employee's circumstances.

36.7 Leaving UK: PAYE

HMRC say:

> **Form P85 leaving the UK**
> In the past form P85 has been used in advance of an expat leaving the UK for the purposes of generating an NT code where appropriate, to be in place by the time the individual leaves. We note that the form has recently been updated to say that it should only be used "when you have left" whereas the previous version also stated it could be used "when you are leaving".
> Can form P85 still be submitted in advance of departure to request an NT code?
> **Answer:**
> HMRC's operations team have confirmed that normally form P85 would be rejected if there is still a continuing source of UK income. However, if the customer is leaving to work full time abroad for a UK employer for a period of at least a complete tax year, the form P85 can be

[17] *https://www.gov.uk/guidance/new-employee-coming-to-work-from-abroad*

> completed to enable to customer to receive code NT.[18]

See 10.16.2 (Departure: Form P85).

36.8 PAYE if no personal allowance

RDR1 provides:

> **What should you do if you have UK tax allowances and choose to use the remittance basis?**
> 8.9 If you decide during a tax year that you're going to use the remittance basis and you're still getting UK personal allowances through the PAYE system, you may not be paying enough UK tax.[19]
> 8.10 If you contact HMRC, we can arrange to amend your tax code to one which doesn't give relief for personal allowances, thus reducing any potential tax bill arising from you getting the benefit of allowances you're no longer entitled to. Your employer can't do this for you as your tax affairs are confidential between you and HMRC. Until they receive a new tax code from us, your employer will continue to deduct tax from you based on the code we originally issued before you were claiming the remittance basis.

It is hard to imagine anyone wishing to do this, but it may save the need for submitting a tax return. HMRC say:

> Employers have expressed concern that the P46 (Expat) does not allow them to operate a 0T code (no personal allowance) even where they are aware that the employee will claim the remittance basis or has income in excess of £100K.
> HMRC said that it was not the responsibility of employers to withdraw personal allowances and, if they did so, the New PAYE System (NPS) might reinstate the allowances when the P14 is filed and make a repayment to the individual.
> HMRC said that, if employers agree with their employee that they will claim the remittance basis or if the individual's earnings will exceed £100K, they should request a formal change of code number from the Expat Team. This would ensure that HMRC records mirror those of the employer when the P14 is submitted.
> HMRC confirmed that the Modified PAYE rules in EPM6 allows PAs to be withdrawn from remittance basis users but it would be sensible for Employers to notify the Expat Team of situations where that applies.

[18] Expat Forum Q&A log (July 2019) (informally circulated).

[19] See 57.5 (Allowances: remittance basis user).

> They agreed to make the necessary changes to the EPM6 agreement to make this clear.[20]

36.9 PAYE repayment not remittance

The minutes of the Joint Expatriate Forum record:

> HMRC had circulated a note explaining that the existing non-statutory practice could continue whereby remittances arising as a result of repayments of overpaid PAYE to non tax-equalised employees were disregarded. This statement was based on new legal advice and meant there was no need to provide for this treatment in primary legislation.[21]

This note is dated 7 October 2011 and provides:

> HMRC's long standing practice in relation to repayments of income tax for employees who remain not ordinarily resident in the UK has been to treat PAYE tax overpaid as not constituting a remittance in cases where:
>
> - under tax equalisation arrangements it would be refunded to the employer; or
> - the employee instructs HMRC to refund the money to an overseas account.
>
> The practice is however not consistent with the FA 2008 remittance basis legislation.
>
> At a Expats Forum sub group meeting held on 18 May 2011, HMRC confirmed that repayments of tax overpaid to an employer under a tax equalisation arrangement would not constitute income as the employee is contractually entitled to net remuneration and the actual UK taxes due on that remuneration. The repayment of the tax overpaid is in effect a refund of overpaid earnings by employee to employer.
>
> However, for gross paid employees, PAYE repayments represent a part repayment of earnings delivered in the UK and as such a remittance to the UK under section 809L ITA. HMRC agreed to consider the views expressed and how the matter could be resolved. In the meantime, the existing practice would continue until at least 5 April 2012.
>
> The suggestion was made at the subgroup that, if the practice was ultra vires HMRC's management discretion, it should be legislated, possibly

[20] Joint Expatriate Forum on Tax and NICs: (May 2010) Meeting Note *http://webarchive.nationalarchives.gov.uk/20130410172938/http://www.hmrc.gov.uk/consultations/260510-epf-minutes.pdf*

[21] Joint Expatriate Forum on Tax and NICs (October 2011) *http://webarchive.nationalarchives.gov.uk/20130410172938/http://www.hmrc.gov.uk/consultations/expat-mins-oct-2011.pdf*

as part of the current review of non domiciled taxation.
HMRC has since taken further legal advice on this matter. This has confirmed that the current informal practice can continue as an informal concession. As such, there is no need for any legislative fix.

36.10 International employee schemes

The PAYE Manual sets out several special PAYE arrangements for internationally mobile employees/short term business visitors.

Some of these are known, confusingly, as "EP App [no. 4, 5, 6 etc]", after the appendices used in the Employment Procedures Manual. That Manual was withdrawn in 2011, and the material is now in the PAYE Manual, but these labels have survived. It would be sensible to use new names, but it does not matter.

In outline:

Arrangement	**For**	**Relief**	**See para**
NT code	STBV with DTA relief	Individual PAYE exemption	36.11
EP App 8	STBV with no DTA relief	Annual PAYE	36.12
EP App 4	STBV with DTA relief	General PAYE exemption	36.13
EP App 5	Provisional foreign tax credit relief		36.14
EP App 6	Tax equalisation		36.15

Two further arrangements deal with NIC:

EP App 7A: For employees subject to an EP App 6 agreement, who are assigned to work in the UK from abroad and have an employer or host employer in the UK liable for secondary UK NICs. The employee pays NICs on earnings in this employment above the annual upper earnings limit (UEL) for the year or on earnings at or above the UEL in each earnings period throughout the year

EP App 7B For employees employed by a UK employer who are assigned to work abroad for a period of limited duration, but for more than a complete tax year, who have an ongoing liability to UK NICs whilst abroad. The employee will be paid above the UEL in every earnings period throughout the tax year and will receive some earnings and benefits derived from the employment from sources other than the UK employer. The employee will not be liable to UK tax on the earnings from employment

36.11 DTA relief: PAYE NT code

The PAYE Manual provides:

> **PAYE81625: employee's earning paid for by overseas employer: double taxation relief** [May 2020]
> **Arrivals in the UK**
> Where a new arrival's UK earnings are paid by an overseas employer, Double Taxation relief might be due. If so, you may be able to issue code NT to the UK employer. But before you do so, ensure that a claim has been made. It is up to the employee to make a claim for Double Taxation relief and prove this claim...
> Always send any correspondence about Double Taxation relief claims to the employee, not the employer.
> If you do issue code NT to cover UK earnings
> - Send a separate instruction to the employer to confirm the date from which the tax code operates
> - Tell the employer to refund any tax already deducted
> - Do not carry code NT forward to the second year's coding - apply a cumulative tax code to all earnings

36.12 PAYE 60-day rule: EP App 8

36.12.1 *History and background*

This topic has been discussed in HMRC consultation and response papers:

> Consultation on short-term business visitors: Consultation document (May 2018) (**"the STBV consultation paper"**)
> Tax and Administrative Treatment of Short Term Business Visitors from Overseas Branches: Summary of Responses (Aug 2018) (**"the STBV consultation response paper"**)[22]

The current rules replace the scheme introduced in 2015. PAYE Manual provides:

> **PAYE81950: PAYE special arrangement for short term business visitors** [May 2020]
> The PAYE special arrangement for STBV introduced in 2015 under regulation 141 ceased on 5 April 2020. For information concerning the

[22] For these documents see *https://www.gov.uk/government/consultations/tax-and-administrative-treatment-of-short-term-business-visitors-from-overseas-branches*

> previous arrangement see PAYE81949.
> ... This arrangement has been agreed under Regulation 141 of the Income Tax (PAYE) Regulations 2003. This regulation allows HMRC to arrange for the collection of tax in respect of PAYE income, if the normal operation of PAYE is considered 'impracticable'.
> The arrangement is a contractual agreement between the employer and HMRC ...

This scheme is confusingly called "EP App 8" (though the EP, withdrawn in 2011, never actually had an appendix 8).

36.12.2 *Who may benefit*

This scheme is for short term business visitors (as defined) who do not qualify for DTA relief.

The PAYE Manual provides:

> **PAYE81950: PAYE special arrangement for short term business visitors** [May 2020]
> ... **Who does it cover?**
> UK based employers who operate internationally. Many countries will be covered by a Double Taxation Treaty with the UK, but not all. These employers may also have branches overseas.[23] It will often be normal business practice to require non-resident employees to come into the UK to work for them and a liability to UK PAYE will arise.
> However, in most cases these non-resident employees will only work in the UK for a short period of time usually no more than a few days or weeks. There can be a significant employer burden in monitoring employee movements and keeping all the records that are required so that PAYE can be reported in real time. If the employees are eligible for personal allowances, then in most cases there is ultimately no UK tax liability.
> This arrangement allows the employer to return the information at month 12. This means that employees with no overall liability do not need to have tax deducted and apply for repayments through Self Assessment.

There are two exceptions where the annual PAYE arrangement does not apply:

> However, any STBVs who meet the conditions for EP Appendix 4

[23] Author's footnote: Employees of the foreign branch do not qualify for STBV relief; see 37.14 (Employer foreign PE of UK co).

> should be reported under that arrangement.[24] ...
> Non-resident directors of the UK company must not be included in this arrangement.

Why are directors excluded? Perhaps they are assumed likely to have substantial earnings, or at least exceeding the personal allowance? The way forward for directors with taxable earnings under the personal allowance would be to seek a NT code; see 36.11 (DTA relief: PAYE NT code).

36.12.3 *Operation of EP App 8*

The PAYE Manual continues:

> **What does it cover?**
> The special arrangement covers relevant payments of PAYE income and / or taxable benefits in kind provided to the STBV for the tax year that the arrangement is signed and any subsequent tax years until it is either terminated or reviewed.
> The UK employer will total all relevant payments made by both the UK employer and home country employer to the STBV for UK workdays in the year and pay the tax due to HMRC. This will take into account Personal Allowances where appropriate, based on the tax tables at month 12 of the relevant tax year. If the employee is covered by employer tax equalisation arrangements, the tax must be grossed up within the calculation.
> If the UK employer provides a benefit in kind to a STBV, they are not required to prepare a Form P11D in respect of that benefit. However, they must include the cash equivalent of the benefit and any other benefit provided by the home country employer (calculated in accordance with relevant sections of the Income Tax (Earnings and Pensions Act 2003) within any month 12 calculations they are making for the PAYE income paid to these employees.
> If the employer bears the tax on the provision of the benefit in kind, the amount of the tax must also be grossed up within the calculation.

36.12.4 *60 UK workdays cap*

The PAYE Manual continues:

> The arrangement only applies to a STBV whose UK workdays in the tax year total 60 days or less.[25]

[24] See 36.13 (DTA PAYE exemption: EP App 4).

[25] The limit increased from 30 to 60 days in 2020/21; see 36.12.7 (2020 changes).

This is a different test from the DTA 60-day rule[26] because:

(1) One counts workdays, not days of presence.

(2) The 60 days may form part of a more substantial period (eg straddling a tax year).

> This limit will not be relaxed and the employer will not be able to pay any tax via other methods, such as PAYE Settlement Agreement. The employer must include any STBV whose UK workdays total more than 60 days in their regular payroll or, if applicable, in accordance with EP Appendix 6 [tax equilisation scheme] payroll.
>
> The 60 UK workdays does not include any day where the conditions for a PAYE Special Arrangements under EP Appendix 4 are met in respect of a whole day.[27]
>
> Employers must determine whether days of travel to or from the UK are to be counted as UK workdays. Employers may apply the rule of thumb at EIM77020.[28]
>
> However, where the STBV undertakes UK work other than travel on the particular day, overseas workday should be replaced by half UK workday and half overseas workday.

HMRC say:

> *Question:* How are the work days counted in respect of the STBV Special Arrangement for the following circumstances: an STBV with 2 distinctive roles, 1 of which can be included on the EP Appendix 4 (as the economic employer remains overseas), and the other role which results in taxable workdays in the UK.
>
> Are all days counted? Or just those relating to the taxable role?
>
> *HMRC answer:* The Special Arrangement at PAYE81950 defines a "UK Workday" within the arrangement as "a day (or part day) where duties are carried out in the United Kingdom for the UK Employer."[29]
>
> This means that, for the purposes of the Special Arrangement, the days relating to the duties/role performed for the overseas employer (and so qualifying under EP Appendix 4) are not counted as part of the 30 UK workdays, except where duties of the taxable role are performed on the same day. This is on the understanding that the facts do indeed support the basis that the individual remains economically employed by the

[26] See 37.10 (DTA 60-day rule).

[27] See 36.13 (PAYE exemption: EP App 4).

[28] See 26.30.2 (International business travel).

[29] Author's footnote: Where does it say this?

> overseas entity for the duties for which PAYE is relaxed under EP Appendix 4.[30]

36.12.5 *Annual PAYE*

The PAYE Manual continues:

> **Annual PAYE scheme**
> Upon receipt and acceptance of the Appendix 8 application, HMRC will set up an annual PAYE Scheme to enable the employer to account for the tax on the payments made and the cash equivalent of any benefits provided to employees covered by this arrangement.
> The UK employer must report the relevant payments made and/or the cash value of any benefits in kind provided for the UK workdays to one or more STBV(s) in that tax year on an RTI submission. These schemes RTI submissions must be delivered to HMRC by 31 May following the end of the relevant tax year up until the scheme is closed by HMRC or the employer. If there are no employees eligible to be included in a tax year, a nil submission must be filed by the deadline of 31 May.
> The return must be made using an approved method of electronic communications.
> Only one Appendix 8 scheme is permitted per each individual UK company or UK branch of an overseas company covered by this arrangement.
> **Payment of tax**
> Tax is due on the payments made and any benefits provided by 31 May following the end of the relevant tax year.
> The payment must be made using a 17-character reference, which is made up of the 13-character Accounts Office reference, followed by the last two digits of the year and the month of the tax period. The month used should always be 12.
> For example, using tax year ending 2021, the reference format would be 123PP001234562112.
> Interest will be charged on any tax due which is paid late.
> **Treatment of any taxable benefits in kind**
> The employer must gross up the tax liability on the benefits in kind unless they recover the tax from the employee. A gross up of tax on PAYE income will only be required where the STBV is covered by employer tax equalisation arrangements.

[30] Expatriate Forum Minutes Oct 2019 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/855596/Expat_Forum_minutes_10_October_2019.pdf*

36.12.6 *Making/ending the agreement*

The PAYE Manual continues:

> **Ending the Special Arrangement**
> Both the employer and HMRC can terminate the Special Arrangement. The employer is entitled to cancel the arrangement by giving HMRC written notice of the cancellation. This will take effect from a date agreed by the parties or, if the parties cannot agree, the earlier of the end of a period of 3 months from the date of issue of the notice or 6 April following the tax year in which the cancellation notice is given.
> If the employer terminates the arrangement, the PAYE Regulations will apply to the relevant payments and form(s) P11D must be prepared in respect of benefits in kind provided to a STBV by the UK employer from the date that the cancellation notice takes effect.
> If there is
> - an amendment to legislation which has a consequential effect on the arrangement;
> - any change to a material fact which was a relevant factor in HMRC's decision to enter into the arrangement; or
> - any operational difficulty which arises as a result of operating this arrangement.
>
> HMRC can review the arrangement and where it considers the employer has not complied with its terms, it can cancel it by giving a cancellation notice in writing. This will take effect from a date agreed or, if not agreed, the earlier of the end of a period of 3 months from the date of issue or 6 April following the tax year in which the cancellation notice is given.
> Following cancellation, the employer will be required to submit:
> - Payments in real time, and
> - Form(s) P11D in respect of any benefits in kind provided
>
> **Self Assessment**
> HMRC does not expect employees under this arrangement to submit SA returns unless they have another UK tax liability.
> If a STBV needs to complete a UK tax return for other reasons, then the STBV would also need to include all Appendix 8 earnings within the Employment page.
> **National Insurance contributions**
> The arrangement is agreed under the authority of the PAYE Regulations and there is no equivalent legislation for National Insurance. Any STBV who has a Class 1 NICs liability cannot be included and any Class 1 NICs must be paid within the relevant earnings period.
> Any requests to review this decision should be referred to the Expat

> Team within Business Tax & Customs.

36.12.7 *2020 changes*

The STBV consultation response paper provides:

> 3.1. On 29 October 2018, the government announced that two changes would be made to the PAYE special arrangement to better ease the administrative burden of operating PAYE on STBVs from foreign branches.
> 3.2. Firstly, the UK workday rule will be increased from 30 days or less to 60 days or less.
> [1] This will open up the PAYE special arrangement to a greater number of STBVs from branches, and
> [2] it will reduce the need for employers to monitor or restrict business travel when STBVs approach the 30 workday limit.

Perhaps the less said about the wording of point [2] the better.

> 3.3. Secondly, the existing PAYE reporting and payment deadlines of 19 April and 22 April will be changed to 31 May to allow employers more time to gather relevant information about their STBVs to operate PAYE accurately. It was clear that these deadlines are too restrictive to businesses and are making it difficult for them to comply with their obligations.
> 3.4. Both changes will be introduced from 6 April 2020.

HMRC Employer Bulletin provides:

> If you are using the current PAYE special arrangement, you will need to sign-up to the new Appendix 8. We will write to you with more information on how to do this later this year.
> Please note that the filing and payment deadlines for 2019 to 2020 annual return will remain as 19 April 2020 and 22 April 2020 respectively. The UK workday limit for the 2019 to 2020 tax year will remain as 30 workdays.[31]

But the PAYE Manual provides:

> **PAYE81950: PAYE special arrangement for short term business visitors** [May 2020]
> Important Note: Due to the recent COVID-19 outbreak and

[31] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/839773/English.pdf* (Oct 2019).

> accompanying advice the Prime Minister and HM Government have issued, we recognise most customers and agents may either be in self-isolation or will be working from home, therefore access to your usual resources may be limited. Therefore, we've reassessed our position and outline the following:
>
> - The deadline to return the end of year report has been extended from 31 May 2020 to 31 July 2020.

36.13 PAYE exemption: EP App 4

The STBV consultation paper provides a summary:

> 1.5 In the UK an administrative easement is available to UK companies with STBVs arriving from their overseas subsidiaries. The UK company can apply to relax their obligation to operate Pay As You Earn (PAYE) on the relevant earnings of an individual who is:
>
> - tax resident in a country with which the UK holds a DTA;
> - coming to the UK to work for a UK company for less than 183 days in any twelve month period; and
> - economically employed by a non-resident entity

The PAYE Manual provides:

> **PAYE 82000 PAYE operation: international employments: EP appendix 4: criteria for short term business visitors** [Jun 2020]
>
> **... Short Term Business Visitor Arrangements**
>
> The CWG2 Employer Further Guide to PAYE and NICs advises employers that it may be possible to relax strict PAYE requirements for employees on short-term business visits to the UK, and tells employers to contact their HMRC Office.
>
> This arrangement provides that PAYE can be disregarded in certain circumstances.
>
> If an employer has only one or two employees potentially affected they may like to consider applying for an NT code (see PAYE81625) on an individual basis instead.[32]

36.13.1 *PAYE exemption: Conditions*

The PAYE Manual continues:

> **Conditions**
>
> This arrangement must only be applied where individuals are
>
> - Resident in a country with which the UK has a Double Taxation

[32] See 36.11 (DTA relief: PAYE "NT" code).

> Agreement under which the Dependent Personal Services / Income from Employment Article (Article 15 or the equivalent) is likely to be competent
> - Coming to work in the UK for a UK company or the UK branch of an overseas company, or are
> - Legally employed by a UK resident employer, but economically employed by a separate non resident entity
> - Expected to stay in the UK for 183 days or less in any twelve month period
>
> Provided that it can be shown that for specifically named employees whose presence in the UK is 60 days or more, the UK Company or branch will not in fact ultimately bear the remuneration specified.

In short, the arrangement applies where an employee can expect DT relief on UK source employment income. For DT relief, see 37.2 (Employment income DT relief).

> Where agreement is reached and in all other aspects the employee falls within the guidelines, then that part of the remuneration not ultimately borne by the UK Company or branch can fall within this arrangement. See also the three 'Notes: Definitions' below regarding employees receiving some remuneration that is ultimately borne by the Company or branch and some which is not.
>
> These arrangements will not apply where the expense of the remuneration is passed on to another UK Company or branch and not recharged overseas.
>
> For those whose presence in the UK is 59 days or less, it is only necessary to show that the employees were paid via a non resident employer's payroll.
>
> This arrangement must not be applied where individuals are employed by a UK resident employer including an overseas branch of a UK resident employer except where the individuals are sent abroad to work for a separate non resident entity and return to perform duties in the UK solely for that non resident employer. Such individuals are not covered by the 60 day rule.

36.13.2 *Remuneration ultimately borne by non-resident*

The PAYE Manual continues:

> **Notes: Definitions**
>
> Where used in this arrangement, the term remuneration has its widest possible meaning and includes salary, wages, benefits, allowances and expenses
>
> Where an employee otherwise falling within this arrangement receives

> remuneration borne by companies in different countries then
>
> 1. Remuneration not ultimately borne in the UK - falls within this agreement[33]
> 2. Remuneration ultimately borne in the UK - does not fall within this agreement unless the presence in the UK is for 59 days or less and those days do not form part of a longer period (see below) or HMRC Office has agreed a dispensation for it. It is therefore possible for an employee falling within this arrangement to also have a PAYE liability. If otherwise appropriate this PAYE liability can be met using modified PAYE procedures as described in EP Appendix 6, PAYE82002[34]
>
> 'Ultimately borne' means the company finally bearing the cost after all recharging of any nature
>
> Although employee remuneration ultimately borne by the UK Company (except in 2 above) is not normally covered by this particular arrangement, the OECD commentary provides examples of situations where the UK Company would not be regarded as the economic employer and treaty exemption may therefore apply, including where the employee is present for 60 days or more. Employers may request agreement from HMRC for specified circumstances where these arrangements may be applied and PAYE deductions need not be made. Failing such agreements, a separate claim for treaty relief should be made by the employee. This further relaxation is initially for a trial period and may be withdrawn.

The employee does not have to claim treaty relief where a STBV scheme is in operation.[35]

HMRC refer to the last sentence, and say:

> The trial period is continuing with no specific end date. HMRC will continue to monitor the position and will endeavour to liaise with Forum members before any further changes are made.[36]

The PAYE Manual continues:

> **PAYE 82000 EP appendix 4: criteria for short term business visitors** [Jun 2020]
>
> **...**
>
> Full Payment Submissions do not need to be completed for EP

[33] This is consistent with the OECD Model: see 37.3 (Salary/wages/ remuneration).

[34] See 36.15 (Tax equalisation: EP App 6).

[35] See STBV scheme consultation document para 3.16.

[36] Expat Forum Q&A log (July 2019) (informally circulated).

Appendix 4 employees

The PAYE manual next discusses the various rules for application of treaty relief, but that need not be set out here, as it is fully discussed elsewhere.[37]

36.13.3 *Terms of EP App 4 agreement*

General principles of an EP Appendix 4 arrangement

1. It applies where there would otherwise under PAYE regulations be a requirement on the part of the host employer, UK branch or legal employer to make PAYE deductions
2. It only applies to employees who have not become UK resident for tax purposes or if UK resident, are treaty resident in the treaty partner country
3. In all cases involving short-term assignment of employees to the UK, the employer will put in place some form of internal reporting system to keep as accurate as possible a record of employees visiting the UK on business. It is expected that this system will have the following minimum requirement
   - Employees will periodically report days spent in the UK on business to the central point controlling this arrangement
   - Employees should not spend more than 30 days intermittently in the UK in any 12 month period without reporting to that central point
4. All records that are kept under this arrangement are within Regulation 97 IT (Pay As You Earn) Regulations 2003 and so must be retained for the time limits that apply and produced for inspection
5. Where liability is subsequently found to arise on payments of PAYE income made to an employee, the employer will be expected to pay the tax that ought to have been deducted from or otherwise paid in respect of each payment. Late payment of PAYE tax will attract interest in the usual way. Late filing and late payment penalties will not apply where HMRC accepts that the employer backdated the PAYE and filed the FPS as soon as could be reasonably expected following a change in circumstances preventing an employee from being included in this arrangement
6. Should it become apparent that PAYE is not being applied in the case of employees who do not satisfy the relevant criteria, HMRC reserves the right to insist that PAYE be operated strictly for all employees from day 1
7. Any employee who cannot fulfil the conditions set out below should have PAYE operated from day 1
8. The treatment for NICs purposes of employees coming to the UK is covered in the CWG2 Employer Further Guide to PAYE and NICs

The time limits given in EP Appendix 4 are administrative only and are over-ridden by any legislative time limits. For example if a taxpayer needs to complete a Self Assessment return then the normal rules relating to Self Assessment apply.

[37] See 37.13.2 (Counting days).

Visitors to the UK covered by the 60 day rule[38] for 1 - 30 days

No requirements for either employer or employee to fulfil other than where the period is part of a longer period of 60 days or more.

Visitors to the UK covered by the 60 day rule for 31 - 59 days

For an employee who spends no more than 59 days in the UK during the tax year, PAYE can be disregarded provided it is confirmed that

1. there is no formal contract of employment with the UK employer
2. the 59 days do not form part of a more substantial period. (See DT1922 and above regarding the 60 day rule.)

All visitors to the UK not covered by the 60 day rule for 1 - 90 days and other visitors to the UK for 60 - 90 days

For an employee in the UK for not more than 90 days in the tax year, PAYE can be disregarded provided that the employer supplies the information below by 31 May following the end of the tax year

- Full name of employee
- Last known UK and overseas addresses of employee
- Nature of duties undertaken
- Date commenced
- Date ceased
- To which country a tax return covering worldwide income is submitted

And confirms that the UK Company does not

- Ultimately bear the cost of the employee's remuneration
- Function as the employee's employer during the UK assignment. (See DT1922 for further information)

Visitors to the UK 91 to 150 days

For an employee in the UK for a period of 91 days but not exceeding 150 days in the tax year PAYE can be disregarded provided that

1. All of the information requested for visitors up to 90 days is provided and in addition
2. In the case of non-US citizens and Green Card holders, the employee provides a statement from the overseas Revenue authority confirming residence in the other state for tax purposes throughout the period in the UK. This statement should be passed to the HMRC Office by 31 May following the end of the relevant overseas tax year. This arrangement is only provisional until the relevant certificate is received.

In the case of US citizens and Green Card holders it will only be necessary for the employee to provide evidence of continuing residence in the US. (See DT19861A for further information.)

Visitors to the UK 151 to 183 days

Applications will be made on a named individual basis for authority to include the employee in this arrangement. The application will be made as soon as it can reasonably be anticipated that the employee will be present in the UK for more than 150 days. The application will include

1. All of the information requested for visitors up to 90 days and confirmation

[38] See 37.10 (The 60-day rule).

that the statement from the overseas Revenue authority will follow by the relevant 31 May

2. A statement by the employee giving reasons why he/she considers himself/herself to be treaty resident in the treaty partner country by reference to the appropriate article in the Double Taxation Treaty

Helpsheet HS302 provides more information about dual residence generally and the tests to be applied to determine the country of tax residence.

HMRC will consider the circumstances and will

1. Notify the employer that the individual can be included in the Appendix 4 arrangement, or
2. Authorise code NT and issue a Self Assessment tax return, or
3. Confirm that PAYE should be applied and issue a Self Assessment tax return

Signed [etc]

Authorised on behalf of HMRC: Signed [etc]

Applications should be sent to: Charities, Savings & International 3, HM Revenue and Customs, BX9 1AJ

36.13.4 *EP App 4: Mistakes*

The minutes of the Joint Forum on Expatriate Tax and NICs provide:

> 3.9 Another common area that HMRC find errors is in respect of EP Appendix 4 Arrangements, particularly the practical operation.
>
> 3.10 The arrangement only applies where individuals are:
>
> - Resident in a country with which the UK has a double Taxation Agreement under which the Dependent Personal Services/Income from employment article is likely to be competent.
> - Coming to work in the UK for a UK company or the UK branch of an overseas company, or are
> - Legally employed by a UK resident employer, but economically employed by a separate non-resident entity.
> - Expected to stay in the UK for 183 days or less in any 12 month period.
>
> 3.11 HMRC has found the most common error is when individuals have been included even if the country in which they are resident has no DTA with the UK.
>
> 3.12 Recently a case has come to light where a customer came the UK from Hong Kong as a STBV. Whilst the UK and HK do have a DTA, there is a fourth condition within Article 14 Paragraph 2 which is not present in other DTAs. It states: d) the remuneration is taxable in the first-mentioned Party according to the laws in force in that Party. This means that for STBVs in the UK, the remuneration has to be taxable in Hong Kong for condition d) to be met and hence for double taxation relief to be claimed.
>
> 3.13 If an employee is employed by a Hong Kong company to work in

> Hong Kong then their full income is chargeable in Hong Kong even if part of the duties are carried on outside Hong Kong. However, they may claim exemption of income or relief from tax under certain circumstances on a year-by-year basis.
>
> 3.14 In the case in question an employee of a UK employer that was assigned to work in Hong Kong made visits to the UK as a STBV.
>
> They were included in an appendix 4 arrangement but subsequently the employer realised that the UK duties would not be assessable in Hong Kong and as such condition d) of para 2 Article 14 is not satisfied and treaty relief is not available. The remuneration from their duties in the UK should therefore be taxed in the UK.
>
> 3.15 HMRC wanted to flag this up to employers as there may be similar problems with STBVs coming from Singapore as this DTA contains a similar clause to the Hong Kong DTA[39]

36.13.5 *EP App 4: Administration*

HMRC say:

> Unfortunately, Appendix 4 returns can no longer be filed via the mailbox. The available methods for filing are either via the postal system or via shared workspace.[40]

The minutes of the Joint Forum on Expatriate Tax and NICs provide:

> 5.2 Please do not send EP Appendix 4 reports to us using more than one source. The preferred method is through our digital mail system, the postal address is:
>
> HMRC Personal Tax International Operations S0733 PO Box 203 BOOTLE L69 9AP
>
> We have received a number of emails stating that the agent or employer has also sent a hardcopy of the report. This is not required – as it just duplicates our work and as this time of year is extremely busy for us, it creates major delays in us dealing with more pressing issues.
>
> 5.3 we will no longer be acknowledging all EP 4 reports. If we need any further information we will write out and ask for it. This means that for

[39] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/642764/JOINT_EXPATRIATE_FORUM_ON_TAX_AND_NICS_-_Minutes_12_July_2017.pdf* (12 July 2017)

[40] Expats Forum: Q & A Log *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/897729/HMRC_Joint_Expat-Forum-Tax_NICs_minutes-11-June-2020.pdf*

reports only recording STBVs of less than 60 days no acknowledgement will be issued.
5.4 Not all Business areas within HMRC can accept and receive post via email. The reason being that not all emails are secure. Operations have been receiving an increasing amount of unsolicited emails from agents where correspondence really should be coming through DMS or through Shared Workspace.
5.5 HMRC can still receive post by fax. The fax number is 03000 533121.
5.6 Customer calls now go through to staff on another team. These customer operations staff have been trained to deal with general expat issues, however anything technical will still be dealt with by out expat operations team.
5.7 Finally when submitting information to HMRC regarding new starters, please:

- Supply the (correct) date of birth.
- Provide us with the correct PAYE ref for the employer
- Confirm when (if applicable) the first Full Payment Submission was made.[41]

36.14 Foreign tax credit: EP App 5

The PAYE Manual provides:

> **PAYE82001: EP appendix 5: net of foreign tax credit relief** [May 2020]
> ... **Employer required to deduct foreign tax**
> The CWG2 Employer Further Guide to PAYE and NICs, advises employers to contact HMRC if they have to do this. If they do, HMRC considers the position as set out in PAYE81715.
> PT Operations North East England, BX9 1BX are responsible for authorising the employer to operate an Appendix 5 arrangement.
> Appendix 5 arrangements
>
> - Only apply to UK employers who are required to deduct foreign tax from payments being made to employees sent to work abroad whilst continuing to deduct UK PAYE from an employee's pay using their UK tax code and UK tax tables
> - Allow provisional relief for double taxation for employees who must pay both UK tax (by a PAYE deduction) and foreign tax from the same payment of earnings
> - Should not be followed by the employer or agent for any other contract(s) or employees not notified to HMRC without prior application and

[41] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/642764/JOINT_EXPATRIATE_FORUM_ON_TAX_AND_NICS_-_Minutes_12_July_2017.pdf* (12 July 2017)

authorisation

All PAYE and NIC reporting requirements must still be fulfilled by the employer. There can be no question of abandoning PAYE/NIC altogether for the duration of the overseas contract.

Double taxation

If the employee has to pay foreign tax direct to an overseas Revenue authority on payments taxed through PAYE, advance DTR can be given through the PAYE code (see PAYE81715).

In many overseas contract situations, where an employee is abroad for less than 6 months no overseas tax is ultimately found to be due. This is because the employee will usually have personal protection under the terms of many Double Taxation Agreements (DTA).

However, it cannot be assumed that DTA protection is available on the basis that the employee works in an overseas country for less than 183 days. The relevant DTA and the other authority should be consulted. In particular, the 183 day protection may not be available where

- The employee works for a resident of the overseas country who functions as their employer

Or

- Their contractual employer has an identifiable `permanent establishment' in the overseas country

Or

- The DTA says so

If these circumstances apply, or where no DTA exists, overseas tax is due from day 1. The overseas country may also impose withholding at source obligations on the employer even though the UK employer is still required to operate PAYE/NIC on payments made to the employee.

It is in these specific circumstances or where the 183 days period is exceeded but the taxpayer remains UK resident, that HMRC may then authorise an Appendix 5 arrangement.

Note: If foreign tax is paid by the employer on the emploee's behalf, HMRC would not authorise an Appendix 5 arrangement. Payment in this manner could also constitute a pecuniary liability.

Employers responsibilities under this arrangement

The employer must only give credit by this method for foreign tax actually payable on and deducted from the employee's wages and paid to the overseas authority. Credit is given by reducing the amount of UK PAYE due from wages by the amount of foreign tax deducted in the same tax period.

- The credit is restricted to the amount of UK PAYE tax due from the employee's wages (NICs deductions and contributions are not affected in any way)
- Any net UK PAYE tax balance remaining due should be reported and paid to HMRC by the normal payment date with all the NICs due
- Any UK PAYE refunds due during the year because of a change of code number must be restricted to the net UK PAYE deducted from the employee during the tax year
- The employer and/or the employee must advise HMRC where any foreign

tax has been refunded

If an employer advises that foreign tax is paid by the employer on the employee's behalf, HMRC would not authorise Appendix 5 if an application is made. Payment in this manner could also constitute a pecuniary liability.

Employee redeployed, no longer overseas

For employees who cease to work overseas but continue in the same employment in the UK or another location, the employer must

- Ensure details of pay and UK tax deducted up to the date of redeployment together with the foreign tax credit are reported
- Operate the employee's existing code on the Week 1 or Month 1 basis

Employee leaves employment or dies

Employers should take the following action where an employee leaves the employment or dies

- Submit a final FPS for the employee showing the date of leaving or death as appropriate and showing the code as if it had been operated on a Week 1 / Month 1 basis
- Any P45 issued to a leaver should be completed as if the tax code has been operated on the Week 1 or Month 1 basis, showing the net UK tax deducted. This is to ensure that any new employer does not operate it on a cumulative basis

A statement of the overseas tax deducted, for which credit has been given against UK PAYE, should be issued to the departing employee and it should contain

- The Total Taxable Pay to date
- The Total Foreign Tax deducted or paid
- The amount of UK PAYE that has been offset by the foreign tax

HMRC action once Appendix 5 is authorised

Where Employer Technical team authorise an Appendix 5 they

- Must confirm this in writing
- Request the name and NINO of each employee to be included in it (retrospective addition of employees cannot be authorised)
- Ask the employer to provide a quarterly tax year update of any changes in the number of employees included
- Use EBS Function AMEND EMPLOYER NOTES to record that an Appendix 5 arrangement has been agreed
- Record the employers details on a database spreadsheet

At the end of the tax year

At the end of the tax year the employer should send HMRC a statement showing

- The name and NINO of each employee included in the arrangement
- The total payment which both PAYE and foreign tax was operated on
- The total foreign tax deducted which was set off against that employees UK PAYE deductions due (foreign tax credit relief)
- The amount of foreign tax paid to the overseas authority - the employer should also provide evidence the foreign tax has been paid.

This information should be sent to a separate Employer technical team that completes an end of year tax review. Their address is HMRC, Appendix 5 team, The Triad, Stanley Road, Bootle, L75 1HW

This team takes the following actions in PAYE Service upon reviewing all employees in the arrangement

- Enter a Contact History note; 'employee is included in an Appendix 5 arrangement'
- Set the inhibit automatic reconciliation signal for CY and CY+1 (this should be set on the record for every year until the employment ceases)
- Set the PAYE direction indicator on the Employment details screen

For redeployments, leavers and deceased cases on receipt of the P45(1) or equivalent on each employee record

- Enter a Contact History note; 'Total tax to date (enter date of leaving or redeployment) is net of Foreign Tax Credit Relief'
- Update the current year's record to add a Week 1 / Month 1 basis to the latest code on the record

Errors

Employers should have included any net UK tax deducted on their employees Full Payment Submissions throughout the year and any errors should have been corrected before the end of the tax year.

If an error has not been corrected in the final FPS on or before 19 April, the employer must submit an Earlier Year Update (EYU).

Note: Employers should not use the FPS or EYU process to recover deductions of tax, where they discover the employee has overpaid foreign or UK tax.

Correction by FPS or submission of an EYU is only in respect of actual errors made by the employer. For instance showing a tax deduction of £1000 as £100, when £1000 was the amount actually deducted from pay – the employer would amend to increase tax by £900.

36.14.1 *Action once agreement authorised*

The PAYE Manual continues:

Following an agreement to the relaxation of PAYE in accordance with Appendix 5, you must take the following action

- On the employers record, use EBS Function AMEND EMPLOYER NOTES to record that an arrangement under Appendix 5 has been agreed
- The Employers Technical Team will update the database spreadsheet that records these schemes

Notification of employees included in the arrangement

The employer must send details of employees included in this arrangement and keep you up to date with changes to those details on a regular basis (at intervals agreed between you and the employer).

On receipt of these details, you must take the following action to ensure that the taxpayer's liability is reviewed at the end of the year.

In all cases on each employee's record

- Enter a note on Contact History that the employee is included in an arrangement under Appendix 5
- Set the inhibit automatic reconciliation signal on the PAYE Service record for CY and CY+1 (this should be set on the record for every year until the employment ceases)
- Set the PAYE direction indicator on the Employment details screen

For redeployments, leavers and deceased cases on receipt of the P45(1) or equivalent on each employee record

- Enter the following note on Contact History 'Total tax to date (enter date of leaving or redeployment) is net of Foreign Tax Credit Relief'
- Update the current year's record to add a Week 1 / Month 1 basis to the latest code on the record

Note: A cumulative code for these cases cannot normally be restored in-year. If you receive a request for a cumulative code or an in-year repayment, you should tell the customer that this is not possible. If they press the matter you should contact Personal Tax Customer, Product & Process, PAYE Technical, Shipley for advice.

At the end of the tax year

The introduction of PAYE reporting in real time does not change the application of Appendix 5, where the employee is liable to pay foreign tax as well as UK PAYE.

Employers should have included any net UK tax deducted on their Full Payment Submissions throughout the year and any errors should have been corrected before the end of the tax year. If not corrected on the last FPS or by 19 April, the employer will have to submit an Earlier Year Update (EYU).

At the end of the tax year the employer should send HMRC a statement showing

- The name and NINO of each employee included in the arrangement
- The amount of income subjected to both PAYE and foreign tax
- The total foreign tax deducted
- The amount of foreign tax deducted and remitted to the overseas authority which was set off against that employees UK PAYE deductions due (foreign tax credit relief)

The employer should also provide evidence that the foreign tax has been paid.

This information should be sent in the first instance to

HMRC, Appendix 5 team, The Triad, Stanley Road, Bootle, L75 1HW.

Action at employer level

When the employer submits details of the foreign tax credit given with the evidence of foreign tax paid for each employee included in the arrangement, Bootle will follow their existing guidance and risk assess the cases by checking NPS and SA as appropriate.

Action at employee level

On receipt of details provided by the employer, for each employee you should

- Make a note on Contact History to record the foreign tax credit given by that employer in that year
- Proceed in accordance with the guidance at PAYE93038. ...

HMRC say:

Individuals claiming FTCs with no other Self-assessment criteria

We have recently had some conflicting advice from HMRC in relation to the claiming of FTCs for groups of individuals with no other Self-Assessment criteria. These were relatively low paid employees and the Appendix 5 net of foreign tax credit relief scheme was not used. For one client, HMRC processed individual repayment claims without tax returns but HMRC has confirmed that Self-Assessment tax returns must be sent in response to a similar request on behalf of another client. In both cases, the employees were entitled to relief for relatively small amounts of foreign tax paid on earnings which were also fully taxed in the UK via RTI. Most claims were for no more than a few hundred pounds and relevant data/ repayment mandates were provided. Please let us whether HMRC is willing to continue to consider claims without returns in these circumstances and if so the information which should be supplied as part of the claim.

HMRC Answer

A claim to Foreign Tax Credit Relief is not one of the SA criteria, the criteria for SA is someone having any foreign income other than dividends of £300 or less. For Appendix 5 employees, however, though they might carry out the duties of their employment abroad their earnings are paid in the UK through a UK payroll to a UK resident so we don't interpret them as being foreign income. We won't, therefore, put someone in SA just because they are in an Appendix 5 arrangement. If they don't meet the SA criteria for any other reason we will give them Foreign Tax Credit Relief through the NPS calculation.[42]

36.15 Tax equalisation: EP App 6

See 26.42 (Tax equalisation).

The PAYE Manual provides:

> **PAYE82002 - PAYE operation: international employments: EP appendix 6: modified PAYE in tax equalisation cases** [May 2020]
>
> **Application for modified PAYE for tax equalised expatriate employees from 6 April 20__**
>
> Tax equalisation generally describes an arrangement between an employer (see Note 1) and a foreign national employee who comes to the UK to work. Under the terms of an agreement, the employee (see Note 2) is entitled to specified net cash earnings and non-cash benefits. The employer undertakes to meet the UK Income Tax liability arising from the earnings and to ensure that the employee's UK tax affairs will be handled by a professional adviser or by an in-house specialist experienced in tax equalisation issues.
>
> **For an employee to be included in an arrangement established under this application, the employer must equalise liability to UK Income Tax on all general earnings subject to the rules in part 2 Chapters 4 and 5 ITEPA applying to employees resident, or domiciled outside the UK.**
>
> An application indicates that the employer agrees to operate PAYE on a gross-up of cash earnings and non-cash benefits for all employees eligible to be included

[42] Expat Forum Q&A log (July 2019) (informally circulated).

in this arrangement and has undertaken with the employees to pay any residual UK liability on earnings based on each employee's self assessment. Employers should ensure that employees complete their self-assessment returns in accordance with the guidance in Help Sheet IR212.

Note 1: For the purposes of this application, 'employer' includes a 'relevant person' for whom an employee works in terms of section 689 Income Tax (Earnings and Pensions) Act 2003 (ITEPA).

Note 2: For the purposes of this application, 'employee' includes an 'office holder'.

Note 3: Where the employee is tax equalised on all general earnings but not on specific employment income, for example, on taxable share related events, or on restricted securities which are taxed both as general earnings on award and subsequently as specific employment income when restrictions are lifted, the employee may still be covered by the arrangement as long as all the other conditions are satisfied.

Note 4: Employers who payroll actual rather than estimated benefits in kind (excluding living accommodation, vouchers and credit cards , interest free and low interest (beneficial) loans) may register for the online Payrolling Benefits in Kind (PBIK) service. Where the PBIK service is used, forms P11D will not be required under paragraphs 15. and 16. below.

Employer name:…………………………………

Employer address: …………………………………

Employer PAYE reference: …………………………………

Calculation of estimated PAYE on tax equalised earnings

1. We will prepare a best estimate of all earnings including cash allowances and non-cash benefits for the year at the beginning of each year, grossed-up for tax purposes and calculate PAYE tax without restriction for the 50 per cent 'overriding limit'. We will use the Scottish rates of income tax for employees who are Scottish taxpayers. The best estimate will include, where relevant, the annual salary, any cash bonus awards made to 5 April and non-cash benefits provided by a home country employer.
2. We will undertake an in-year review during the period December to April to take account of any material changes, and in particular, to ensure that
   1. Calendar or tax year end bonuses are accounted for
   2. Taxable share related events are accounted for
3. Where we do not equalise liability in respect of awards under 2(b) above
   1. PAYE must be applied in accordance with all relevant statutory provisions and regulations and
   2. In the case of notional payments, where an employee does not make good the due amount within the period of 90 days specified by section 222(1) (c) ITEPA 2003, we will include additional earnings in this arrangement equivalent to the due amount. These additional earnings will be grossed-up for tax purposes.
4. We will update the estimated PAYE calculation during the year to reflect arrivals and departures of employees subject to this application.
5. We will exclude from the estimated PAYE tax calculation contributions we

make (employer contributions) to a qualifying overseas pension scheme in respect of an employee who is a relevant migrant member of that scheme. Subject to the conditions specified in paragraph 51 of Schedule 36 to the Finance Act 2004, we will exclude employer contributions to an overseas pension scheme in relation to which the employee received corresponding relief in 2005-06. We will also exclude employer contributions to overseas schemes where the employee is entitled to relief from UK tax under the terms of a Double Taxation Agreement.

6. We will take into account employee contributions to the overseas pension schemes referred to in paragraph 5 where we know the amounts involved and are satisfied that each employee is entitled to relief for contributions as a relevant migrant member or with pre-commencement entitlement to corresponding relief or under the terms of a Double Taxation Agreement.

7. Where we give provisional relief for overseas workday relief based on each employee's workday history or as anticipated by the employees where they join during the tax year, we will withdraw personal allowances, apply code 0T, or SOT for Scottish taxpayers and notify HMRC accordingly. Any tax gross-up will0 be applied after the earnings have been apportioned between UK and non-UK duties. We will enter code 0T, or S0T as applicable on the payroll record and Full Payment Submissions.

8. Where paragraph 7 does not apply, we will give personal allowances by applying the emergency code on a cumulative basis using the S prefix for Scottish taxpayers where applicable when calculating PAYE tax. We will enter that code on the payroll record and Full Payment Submissions.

9. We will take relief for foreign tax into account in respect of UK residents working abroad where an agreement has been reached with HM Revenue and Customs (HMRC) in accordance with the PAYE Manual EP Appendix 5. We note in particular the requirement that an overseas country imposes a withholding at source obligation on earnings that are subject to PAYE.

10. We will not apply PAYE to the earnings of a tax-equalised employee covered under separate arrangements in EP Appendix 4 of the PAYE Manual. Where it later appears that such earnings are not exempt from UK tax under the terms of the relevant Double Taxation Agreement, we will include the employee in this arrangement and notify HMRC accordingly.

11. We will send one FPS each month no later than the 19th of the month following the end of the tax month. The FPS will show the estimated earnings and income tax calculated in accordance with this agreement. The FPS will include an entry in the Late Reporting Reason field to prevent late filing warning letters. Enter A – Notional payment: Payment to Expat by third party or overseas employer. We undertake to pay 1/12th of the estimated PAYE for the tax year each month by the 19th or 22nd of the following month (depending upon the payment method). Where the number of employees covered by this arrangement at any one time is five or fewer, we undertake to pay 3/12ths of the estimated PAYE tax on or before the 19th or 22nd (depending upon the payment method) of July, October, January and April ('the quarterly basis'). If the number of employees covered by this arrangement increases to more than 5 at any one time in the course of a year and is likely to remain at that higher level, we will make

payments of estimated PAYE by the 19th or 22nd of each month from the start of the following tax year. If the number of employees covered by this arrangement at any one time reduces to five or fewer in the course of a year and is likely to remain at that lower level, we will make payments of estimated PAYE on the quarterly basis from the start of the following tax year. Late payment penalties under schedule 56 of the Finance Act 2009 will not apply to payments under this arrangement providing that tax is paid at the agreed time. Schedule 56 penalties will be charged if the estimated tax is not paid as specified in this paragraph.

12. We agree that making an Earlier Year Update (EYU) is not appropriate for employees included in this arrangement. If a self-assessment tax return is submitted with an incorrect PAYE tax figure we undertake to ensure the return is amended, to reflect the correct figure, if we are within the amendment time limit (12 months from the original return deadline). If we need to amend the PAYE tax figure after the amendment limit we agree to

1. Write to HMRC to make an overpayment relief claim
2. Write to HMRC to make a disclosure of any further PAYE tax due

Arrivals and departures

13. We shall submit a Full Payment Submission which will confirm for each employee covered by this agreement

- That the employee is included in a EPM6 agreement
- A relevant starting date
- The length of time the seconded employee intends to work in the UK and if they intend to live here
- If they are from the European Economic area
- A leaving date - the actual leaving date may be entered on the final Full Payment Submission for the year where a month 12 reconciliation is undertaken. In these circumstances, the Irregular Employment Pattern Indicator should be set to keep the record open.

Year end requirements

14. Forms P60 will be given to the employees by 31 May after the end of each tax year. The figure of pay for each employee will comprise all cash payments and non-cash benefits in respect of which PAYE tax has been calculated after grossing-up. The figure of tax will be the total amount of PAYE tax paid under this arrangement in respect of the employee concerned.

15. We accept that due to the inherent nature of these modified arrangements, over and underpayments of tax may arise compared with the amount of tax that would otherwise have been due if normal PAYE procedures had been applied. Provided that the procedures as outlined in these arrangements are followed, interest will not be charged in accordance with the PAYE regulations in respect of any residual income tax liabilities as shown by the employees' tax returns. However, it is accepted that interest will run on any part of the estimated PAYE for a tax year due to have been paid under this agreement which (depending upon the payment method) reaches HMRC after 19 or 22 April, as appropriate, following the end of the tax year.

16. We shall submit in respect of each employee covered by these arrangements a form P11D, or an approved substitute, and associated form P11D(b) by 31

January following the end of the tax year. We acknowledge that where all statements are not submitted by 31 January following the end of the tax year, penalties under Section 98 TMA 1970 may arise. This is on the basis that the earnings in question ought to have been provided on forms P11D or approved substitutes before 7 July following the end of the tax year.

Submission of employee's self assessment tax return and calculation of tax liability

17. We will have systems and procedures in place to ensure that each employee's self assessment will include actual cash remuneration, all benefits and reimbursed expenses payments and other amounts chargeable to tax as employment income, grossed up on a current year basis. Each employee's tax return will include a note in the notes section of the relevant Employment Page to the effect that the employee is tax equalised and Modified PAYE has been applied.

Payment of residual Income Tax liability

18. We will pay any additional tax found to be due under these arrangements following the submission of the employee's tax return by 31 January following the end of the tax year. Alternatively, if a refund is due, the appropriate repayment claim mandated to us or (if different) to the employee's contractual employer will be submitted. We understand that as a consequence of these arrangements there will be no requirement to make payments on account of tax liabilities. We acknowledge that a tax return for an employee covered by these arrangements should incorporate a claim to cancel payments on account. We further understand that HMRC should not issue Statements of Payments on Account to employees included under these arrangements.

19. We understand that for employees who receive overseas workday relief any overpayments of PAYE will not be treated as a remittance of foreign earnings where repayment is mandated to an employer in the UK.

National Insurance Contributions

20. These arrangements do not apply to National Insurance Contributions (NICs). In cases where the employee is liable for Class 1 NICs and taxable benefits are provided that attract Class 1A NICs, NICs must be accounted for in the normal way unless separate arrangements are agreed with HMRC as set out in EP Appendix 7A of the HMRC PAYE Manual.

Statement

21. We acknowledge that HMRC reserve the right to review / cancel these arrangements as a result of changes in the law or should operational difficulties arise or the arrangements are seen to be deficient, for example

1. Where significant and / or regular underpayments of income tax on employment income have arisen in respect of employees' self assessment returns and in the opinion of HMRC that tax ought to have been accounted for in the calculation of estimated PAYE provided for under these arrangements
2. Where an employer fails to pay tax on time and / or to ensure that returns and P11Ds are filed on time such that a liability arises to pay interest and / or penalties.

We accept that as a result of a decision to cancel these arrangements, HMRC may require the strict operation of PAYE. Similarly, we reserve the right to cancel these arrangements and adopt the strict operation of PAYE. Cancellation by either party will be confirmed by written notice and will be effective from the following 6 April or an earlier date, as agreed by the parties. If a date cannot be agreed, cancellation will be effective on the earlier of the previously stated 6 April or 3 months from the date when the written notice was given.

Application made by:
Name: ………………………………..……………………
Capacity: ……………………….……………………
Signature: ……………………………………………
On behalf of (name of employer): ……………….……
Date: ……………………….…………………………
Application agreed on behalf of HM Revenue and Customs
Name: ………………………………………………..
Signature: ………………..……………………………..
Date: ……………………...……………………………..

36.16 NIC arrangements

PAYE82003: PAYE operation: international employments: EP appendix 7a: modified class 1 and class 1a national insurance contributions (NICs) for expatriate employees subject to an EP appendix 6 agreement [May 2020]

Application for modified NICs for expatriate employees from 6 April 20__
Employer name: ……………………………………..
Employer address: ……………………………………..
Employer PAYE reference: .…………………………………

Part 1 - Scope of agreement

1. This application applies only to those employees who

1. Are subject to an EP Appendix 6 agreement, and
1. Are assigned to work in the UK from abroad and have an employer or host employer in the UK liable for secondary UK NICs liabilities, and
1. Pay NICs on earnings in this employment, above the annual upper earnings limit (UEL) for the year, or on earnings at or above the UEL in each earnings period throughout the year. If an employee joins, commences liability part way through an earnings period, or leaves the employment part way through an earnings period, that shall not invalidate the agreement, provided that

* For employees with monthly earnings periods, NICs are calculated and paid on earnings at or above the UEL in all months other than the month in which the employee joined or left

* For employees with an annual earnings period, NICs are calculated and paid on earnings to the person’s pro-rata annual or annual UEL. (If an employee with an annual earnings period starts after tax week 1 they will have an annual pro-rata earnings period. If a person starts before or during tax week 1 they will have an annual earnings period irrespective of if and when they leave the employment)

Part 2 - Operation of agreement

2. We will calculate and pay Class 1 NICs on a best estimate of those elements

of earnings that are subject to Class 1 NICs. At the beginning of each year, or if liability commences after the beginning of the year, in the month when NICs liability first occurs, we will prepare the best estimate. The best estimate will include all world-wide earnings paid from whatever source, including where relevant, the annual salary, any cash bonus awards made to 5 April, and any non-cash benefits that attract Class 1 NICs liability.

3. In accordance with Part 3 of this agreement, we will calculate and pay Class 1 NICs on all the estimated earnings which are subject to NICs.

4. We shall for each employee, in respect of every tax month estimated earnings are calculated for that employee, complete and maintain a payroll record and include the details about the payment, the National Insurance category letter and NICs data items on a Full Payment Submission (FPS). The FPS must be submitted to Her Majesty's Revenue and Customs (HMRC) no later than the 19th of the month following the end of the tax month.

5. We will undertake an in-year review during the period December to 5 April to take account of any material changes and in particular, will ensure that amounts that are earnings, as defined in sections 3 and 4 of the Social Security Contributions and Benefits Act 1992, which

* Must be included in the computation of a person's earnings when assessing Class 1 NICs, and
* Are bonuses and / or NICs due on amounts which count as employment income in relation to employment-related securities to which sections 698 or 700 of the Income Tax (Earnings and Pensions) Act 2003 applies, for example, share related events

are accounted for.

We will update the Class 1 NICs payable immediately following the review, amend payroll records and

* When completing the next FPS for submission to HMRC, adjust the year to date NICs data items to show the revised values to date, and
* Adjust the next payment to HMRC if too much or too little NICs have been paid.

6. During the year, we will update the estimated Class 1 NICs to be paid to reflect arrivals and departures of employees who are subject to this application, and changes in the scope of these arrangements as they apply to one or more employee.

7. We understand that where we have employees who are not ordinarily resident in the UK and who meet the conditions set out in Tax Bulletin 79 as workers for whom salary can be apportioned between UK and non-UK days, we can initially compute earnings for Class 1 NICs on the basis of an estimate of UK and non-UK workday that we have used for income tax purposes. When we complete our NIC Settlement Return, this initial estimate must be corrected using the statutory NICs rules for non-UK days set out in Tax Bulletin 79 and the correct NICs must be paid before 31 March following the end of the tax year.

Note: Due to the recent COVID-19 outbreak and accompanying advice from the Prime Minister and HM Government, we recognise most customers and agents may either be in self-isolation or will be working from home, with limited access to usual resources. To help with this, the 31 March 2020 deadline has been extended to 31 May 2020.

Part 3 - Payment of Class 1 NICs to HM Revenue and Customs (HMRC)

8. We undertake to pay to HMRC each month, the Class 1 NICs due on 1/12th of the estimated earnings. These payments will be made each month, by the 19th or 22nd of the following month (depending upon our payment method).

9. Where the number of employees covered by this arrangement at any one time is 5 or fewer, we undertake to pay the Class 1 NICs due on 3/12ths of the total estimated earnings for the tax year, on or before the 19 or 22 (depending upon the payment method) of July, October, January and April (the quarterly basis).

10. If the number of employees covered by this agreement increases to more than 5 at any one time in the course of the year, and is likely to remain at the higher level, we will make the payments of Class 1 NICs by the 19 or 22 of each month, from the start of the following year. If the number of employees covered by this agreement at any one time reduces to five or fewer in the course of the year and is likely to remain at the lower level, we will make payments of Class 1 NICs on the quarterly basis, from the start of the following year.

11. If the NICs are paid in accordance with the terms of this agreement, late payment penalties under Schedule 56 of the Finance Act 2009, will not apply to payments under this arrangement. Schedule 56 penalties will be charged if the NICs due on the estimated earnings are not paid as specified in Part 3 of this agreement.

Part 4 - Arrivals and departures

12. We will notify HMRC of our intention to include new arrivals to the UK covered by this agreement. Similarly, we will notify HMRC of our intention to exclude an employee from the agreement in the event of the employee no longer being subject to PAYE under EP Appendix 6. We will make these notifications to HMRC in writing before the end of the relevant tax year.

Part 5 - Interest

13. We accept that due to the inherent nature of these modified arrangements, over and underpayments of Class 1 NICs may arise, compared with the amount of Class 1 NICs that would otherwise have been due if normal NICs procedures had been applied. Provided that the procedures outlined in these arrangements are followed, interest will not be charged in accordance with the NICs regulations in respect of any residual Class 1 NICs liabilities as shown by the employer's 'NIC Settlement Return'. However, it is accepted that interest will run on any part of the NICs due on estimated earnings for a tax year due to have been paid under this agreement, which (depending upon the method of payment) reaches HMRC after 19 or 22 April following the end of the tax year.

14. It is accepted that if the payment of Class 1 NICs, due on estimated earnings payable by 19 or 22 April is paid late, HMRC will charge interest on amounts paid late.

Part 6 - Class 1A NICs

15. We understand that for individuals covered by this agreement we will have until 31 January following the end of the tax year in which to submit our P11D(b). By the normal statutory time of 19 July following the end of the tax year we will make a payment of Class 1A NICs based on a best estimate of Class 1A NICs due. We will calculate and pay to HMRC the correct amount of Class

1A by 31 March following the end of the tax year. However, we understand that when we make our best estimate of earnings for Class 1 NICs, it is permissible to include non-cash benefits that would statutorily attract a Class 1A NICs charge. Where our best estimate for Class 1 NICs includes payments and benefits that attract Class 1A NICs under the normal statutory provisions, and we have paid Class 1 NICs using that estimate, we are not then required to pay Class 1A NICs by the normal statutory time of 19 July. Where our best estimate of earnings for Class 1 NICs purposes includes non-cash benefits that would normally be subject to Class 1A NICs, we must correct this after the tax year end and pay the right amount of Class 1 NICs and Class 1A NICs using our NIC Settlement Return. The right amount of Class 1A NICs must be paid by 31 March following the end of the tax year.

16. We will submit form P11D(b) at the latest by 31 January following the end of the tax year. The P11D(b) will show the correct benefits for the tax year computed using the statutory rules. We will annotate the P11D(b) 'Appendix 7A' applies.

17. We understand that if we do not pay the Class 1A NICs due by the date set out in this agreement, then regulation 67B of the Social Security (Contributions) Regulations 2001 may apply (late payment penalties).

18. We understand that where the P11D(b) is not submitted by 31 January following the year end, penalties may arise under Regulation 81(1) Social Security (Contributions) Regulations 2001 and that interest under Regulation 76(1) Social Security (Contributions) Regulations 2001, will accrue from the original 19 July statutory date.

We understand that where we submit an incorrect return under the terms of this agreement, penalties may arise under Regulation 81 of the Social Security (Contributions) Regulations 2001

* On the Class 1A NICs due for payment no later than 19July following the end of the year in which benefits were provided; and
* That the earnings in question ought to have been included on forms P11D or approved substitutes and form P11D(b) before 7 July following the end of the tax year.

Part 7 - Payment of residual Class 1 and Class 1A NICs Liability - NIC Settlement Return

19. We accept that where additional Class 1 or Class 1A NICs are found to be due and are paid after 31 March following the end of the tax year, or errors in the NIC Settlement Return are discovered, interest and penalties will be charged in accordance with the legislation.

20. No later than 31 March following the end of the tax year we will carry out an exercise to establish the correct amount of Class 1 and Class 1A NICs due on all the employee's earnings and benefits both from the UK and abroad. We will calculate and pay to HMRC any additional Class 1 NICs and / or Class 1A NICs found to be due under these arrangements by the 31 March following the end of the tax year concerned. Any additional Class 1 or Class 1A NICs will be paid over to HMRC via a 'NIC Settlement Return' (NSR). An NSR will also account for any NICs due on any primary NICs paid on the employees' behalf under these arrangements, unless already accounted for.

Note: Due to the recent COVID-19 outbreak and accompanying advice from the Prime Minister and HM Government, we recognise most customers and agents may either be in self-isolation or will be working from home, with limited access to usual resources. To help with this, the 31 March 2020 deadline has been extended to 31 May 2020.

21. We agree that making an Earlier Year Update (EYU) is not appropriate for employees included in this arrangement. If an underpayment is identified after the submission of the NSR we agree to write to HMRC to make a disclosure of any further NIC due.

22. We will set out in the NSR the correct Class 1 and Class 1A NICs due for the year for each employee covered by this agreement taking into account what has been paid previously under parts 3 and 7 of this agreement. We will send HMRC the NSR no later than 31 March following the end of the tax year in which earnings were paid.

Note: Due to the recent COVID-19 outbreak and accompanying advice from the Prime Minister and HM Government, we recognise most customers and agents may either be in self-isolation or will be working from home, with limited access to usual resources. To help with this, the 31 March 2020 deadline has been extended to 31 May 2020.

23. We understand that where the employee is social security equalised, the payment of the primary NICs on the 'best estimate' of gross earnings will represent a payment of earnings. Therefore, earnings should be grossed up to take account of these NICs met on the employee's behalf. Where primary NICs are met on behalf of the employee in respect of earnings included in the NSR, the earnings on the return should be grossed up to take account of the primary NICs met on the employee's behalf.

Part 8 - Overpaid Class 1 NICs

24. We understand that if we discover that NICs have been overpaid in relation to the 'best estimate' we can complete the NSR to reflect any secondary (employers) Class 1 or Class 1A NICs overpaid. We can also claim a refund of any primary (employees) Class 1 NICs overpaid on the 'best estimate', but only where:

- The Class 1 NICs paid by the employer are paid as part of the equalisation process and have not been recovered from the employee's earnings, or
- The Class 1 NICs have been paid by the employer and recovered from the employee and the employee mandates the repayment to the employer in writing.

25. We agree that making an Earlier Year Update (EYU) is not appropriate for employees included in this arrangement. If an overpayment is identified after the submission of the NSR we agree to write to HMRC to make a NIC refund claim.

26. We understand that, in all other cases, the NSR must be submitted together with a covering letter asking for a refund. This will be passed to HMRC Personal Tax International for processing. We understand that under this agreement, we cannot recover overpayments by deducting the amounts from future payments to HMRC or by offsetting overpayments of primary NICs in respect of one employee against NICs due in respect of another.

Part 9 - Statement

27. We acknowledge that HMRC reserve the right to review / cancel these arrangements as a result of changes in the law, or should operational difficulties arise, or the arrangements are seen to be deficient, for example

- * Where significant and / or regular underpayments of Class 1 and Class 1A NICs have arisen in respect of one or more employees and, in the opinion of HMRC, the Class 1 and Class 1A NICs ought to have been accounted for in the calculation of the estimated Class 1 and Class 1A NICs provided for under these arrangements
- * Where an employer fails to pay the Class 1 or Class 1A NICs on time and / or to ensure that returns are filed on time, such that a liability arises to pay interest and / or penalties.

28. We accept that as a result of a decision to cancel these arrangements, HMRC will require the strict operation of the payment of Class 1 and Class 1A NICs. Similarly, we reserve the right to cancel these arrangements and adopt the strict operation of Class 1 and Class 1A NICs.

29. We agree that a separate employer record will be opened with HMRC for this scheme in the name '[Company Name] (Appendix 7A)' under which we will submit the NSR.

30. Cancellation by either party will be confirmed by written notice and will be effective from the following 6 April or an earlier date, as agreed by the parties. If a date cannot be agreed, cancellation will be effective on the earlier of the aforementioned 6 April or 3 months from the date when the written notice was given.

Application made by:
Name: …………………………………………………
Capacity: ………………………………………………
Signature: ………………………………………………
On behalf of (name of employer):………………………
Date: …………………………………………………
Application agreed on behalf of HM Revenue and Customs
Name: …………………………………………………..
Signature: ……………………………………………….
Date: …………………………………………………..

PAYE82004: PAYE operation: international employments: EP appendix 7b: modified class 1 national insurance contributions (NICs) for employees assigned from the UK to work overseas [Oct 2019]

Application for modified NICs for expatriate employees from 6 April 20__
Employer name:………………………………………..
Employer address: ……………………………………..
Employer PAYE reference: ……………………………

Part 1 - Scope of agreement

1. This application applies only to those employees who

- Are employed by a UK employer and are assigned to work abroad for a period of limited duration, but for more than a complete tax year, and
- Have an ongoing liability to UK National Insurance contributions (NICs) whilst abroad; and

- Earn above the upper earnings limit (UEL) in every earnings period throughout the tax year. (I understand that it shall not invalidate this agreement if an employee earns less than the UEL in the pay period they join the company, or in the pay period in which they leave, if in all other pay periods during the year, the UEL is exceeded. However, in the case of employees with annual pay periods, covered by the agreement, their earnings must exceed the annual UEL); and
- Not liable to UK tax on their earnings from employment; and
- Receive some earnings and benefits derived from the employment from sources other than the UK employer.

Part 2 - Operation of agreement

2. We will calculate and pay Class 1 NICs on a best estimate of those elements of earnings that are subject to Class 1 NICs. At the beginning of each year, or if liability starts after the beginning of the year, in the month when NICs liability first occurs, we will prepare the best estimate. The best estimate will include all world-wide earnings paid from whatever source, including where relevant, annual salary, any cash bonus awards made to 5 April, and any non-cash benefits that attract Class 1 NICs liability.

3. We shall for every payment of estimated earnings calculated for each employee, complete and maintain a payroll record and include the details about the payment, the National Insurance category letter and NICs data items on a Full Payment Submission (FPS). The FPS must be submitted to Her Majesty's Revenue and Customs (HMRC) on or before the payment of regular earnings by the UK employer or no later than the 19th of the month following the end of the tax month where all earnings are paid by the overseas employer.

4. We will undertake an in-year review during the period December to 5 April to take account of any material changes and in particular, will ensure that amounts that are earnings, as defined in sections 3 and 4 of the Social Security Contributions and Benefits Act 1992, which

* Must be included in the computation of a person's earnings when assessing Class 1 NICs, and
* Are bonuses and / or NICs due on amounts which count as employment income in relation to employment-related securities to which sections 698 or 700 of the Income Tax (Earnings and Pensions) Act 2003 applies, for example, share related events

are accounted for.

We will update the Class 1 NICs payable immediately following the review, amend payroll records and

* When completing the next FPS for submission to HMRC, adjust the year to date NICs data items to show the revised values to date, and
* Adjust the next payment to HMRC if too much or too little NICs have been paid

Part 3 - Payment of Class 1 NICs to Her Majesty's Revenue and Customs

5. We undertake to pay to HMRC each month, the Class 1 NICs due on 1/12th of the total estimated earnings for the tax year. These payments will be made each month by the 19 or 22 of the following month (depending upon our payment method).

6. If the NICs are paid in accordance with the terms of this agreement, late payment penalties under Schedule 56 of the Finance Act 2009, will not apply to payments under this arrangement. Schedule 56 penalties will be charged if the NICs due on the estimated earnings are not paid as specified in Parts 2 and 3 of this agreement.

Part 4 - Arrivals and departures

7. We will notify HMRC of our intention to include any new employees entering the agreement by providing details of the employees' departures from the UK. Similarly we will notify HMRC of our intention to exclude an employee from the agreement by providing details of the employee's return to the UK. We will make these notifications to HMRC in writing by the end of the relevant tax year.

8. We accept that in cases where an employee is repatriated to the UK before he/she has been overseas for a complete tax year and, as a result, his/her general earnings from the employment become chargeable to UK Income Tax, this agreement will no longer apply to that employee. In such cases, we will cease to use estimates in respect of all earnings paid and benefits received after the employee has returned to the UK, and use the statutory basis of calculating and returning both Class 1 and Class 1A NICs. We will carry out an exercise before the end of the tax year, to establish the correct amount of the earnings in the period covered by our earlier estimate.

For these employees, we will include on a Full Payment Submission for every payment of earnings subject to Class 1 NICs paid after the employee returns to the UK and the NICs data items relating to each payment, on or before each payment is made to HMRC. For these same employees, no later than the 19th April following the end of the tax year we will

* Record the correct earnings and NICs details for the period before the employee returned to the UK on that employee's payroll records, and
* Send a Full Payment Submission to HMRC to adjust the year to date NICs totals for each category letter to show the correct details for the year.

Forms P60 will be given to the employees by 31 May after the end of each tax year.

If the correct figures for Class 1 NICs exceed our earlier estimates, we will pay the balance to HMRC with our final payment for the year. Where Class 1A NICs becomes payable, we will make a P11D(b) return and pay Class 1A by 19 July following the end of the tax year.

Part 5 - Year end requirements

9. Forms P60 will be given to the employees by 31 May after the end of each tax year.

Where an employee leaves the UK part way through a tax year, we will

* Calculate Class 1A NICs payable to the date the employee left the UK
* Send HMRC a P11D(b) by the 19 July following the end of the tax year, and (For 2012-13 and later years, this concession will be withdrawn and so the P11D(b) filing date will be 6 July)
* Pay HMRC any Class 1A NICs due by 19 July following the end of the tax year

Part 6 - Interest

10. We accept that, due to the inherent nature of the modified arrangements, over and underpayments of Class 1 NICs may arise compared with the amount of Class 1 NICs that would otherwise have been due if normal NICs procedures had been applied. Provided that the procedures outlined in these arrangements are followed, interest will not be charged in accordance with the NICs regulations in respect of any residual Class 1 NICs liabilities as shown by the employer's 'NIC Settlement Return' - See Part 8. However, it is accepted that interest will run on any part of the NICs due on the estimated earnings to have been paid under this agreement which (depending upon the method of payment) reaches HMRC after the 19 or 22 of April following the end of the tax year.

11. It is accepted that if the payment of Class 1 NICs, due on estimated earnings payable by 19 or 22 April, is paid late, HMRC will charge interest on amounts paid late.

Part 7 - Impact of HMRC dispensation

12. We accept that the terms of a dispensation will not apply to employees who do not have a 'taxable employment' as defined in Part 2 of the Income Taxes (Earnings and Pensions) Act 2003. Therefore, the 'best estimate' will reflect the total amount of earnings liable to Class 1 NICs taking into account any payments that can be disregarded from Class 1 earnings under the provisions of Regulation 25 and Schedule 3 of the Social Security (Contributions) Regulations 2001.

Part 8 - Class 1A NICs

13. With the exception of paragraph 12 of this agreement, we understand that any benefits provided to employees covered by this agreement will not fall to be chargeable to income tax under ITEPA as 'general earnings', therefore, liability for Class 1A NICs will not arise.

Part 9 - Payment of residual Class 1 NICs liability - NIC Settlement Return

14. No later than 31 March following the end of the tax year we will carry out an exercise to establish the correct amount of Class 1 NICs due on all the employee's earnings, both from the UK and from abroad. We will calculate and pay to HMRC Class 1 NICs on the difference between the correct figures for the year and those figures that we submitted to HMRC on our full payment submissions. Payment of the Class 1 NICs will be made by 31 March following the end of the tax year concerned. Any additional Class 1 NICs payable will be shown on our 'NIC Settlement Return' (NSR).

15. We will set out in the NSR the correct Class 1 NICs due for the year for each employee covered by this agreement taking into account what has been paid previously under parts 3 and 7 of this agreement. We will send HMRC the NSR no later than 31 March following the end of the tax year in which earnings were paid.

16. We accept that where the additional Class 1 NICs found to be due are paid after 31 March following the end of the tax year, or errors in the NSR are discovered, interest and penalties will be charged in accordance with legislation.

Part 10 - Overpaid Class 1 NICs

17. We understand that, if we discover that Class 1 NICs have been overpaid in relation to the 'best estimate', we can complete the NSR to reflect any secondary (employers) Class 1 NICs overpaid. We can also claim a refund of any primary

(employees) Class 1 NICs overpaid on the best estimate but only where

- The Class 1 NICs were paid by the employer and have not been recovered from the employee, or
- The Class 1 NICs are paid by the employer and recovered from the employee, and then only if the employee mandates the repayment to the employer in writing.

18. We understand that, to claim the overpayment, the NSR must be submitted together with an application for a refund. This will be passed to HMRC Payment Reconciliation in the National Insurance Contributions and Employer Office for processing. We understand that under this agreement, we cannot recover overpayments by deducting the amounts from future payments to HMRC or offsetting overpayments in respect of one employee against underpayments in respect of another employee.

Part 11 - Statement

19. We acknowledge that HMRC reserve the right to review / cancel these arrangements as a result of changes in the law, or should operational difficulties arise, or the arrangements are seen to be deficient, for example, where

- Significant and / or regular underpayments of Class 1 NICs have arisen in respect of one or more employees and, in the opinion of HMRC, the Class 1 NICs ought to have been accounted for in the calculation of the estimated Class 1 NICs provided for under these arrangements
- An employer fails to pay the Class 1 NICs on time and / or to ensure that returns are filed on time such that a liability arises to pay interest and / or penalties.

20. We accept that, if a decision is made by HMRC to cancel these arrangements, HMRC will require the strict operation of the payment of Class 1 NICs. Similarly, we reserve the right to cancel these arrangements and adopt the strict operation of Class 1 NICs.

21. We agree that a separate employer record will be opened with HMRC for this scheme in the name '[Company Name] (Appendix 7B)' under which we shall submit the NSR.

22. Cancellation by either party will be confirmed by written notice and will be effective from the following 6 April, or such earlier date as is agreed by the parties. If a date cannot be agreed, cancellation will be effective on the earlier of the aforementioned 6 April or 3 months from the date when the written notice was given.

Application made by:
Name: ………………………………………………………
Capacity: ……………………………………………………
Signature: …………………………………………………
On behalf of (name of employer): ………………………………
Date: ……………………………………………………………

Application agreed on behalf of HM Revenue and Customs
Name: ……………………………………………………………..
Signature: ………………………………………………………..
Date: ……………………………………………………………..

HMRC say:

> **Appendix 6 payroll**
> **Question:** Guidance has been issued that Earlier Year Updates (EYUs) should not generally be used for EP Appendix 6 payrolls. The references seem to be for individuals who have been included in the arrangements, but needing to make amendments to the submissions made. Where there is a case that an individual has not been included in the Payroll for the year and should have been (eg 'failed STBV' type employees), what is the best action to take to correct the position?
> The EYU still seems a reasonable route to take to ensure that some payroll reporting is undertaken and PAYE is paid across at the earliest point, with the final position still reconciled via a tax return, but this would seem to disagree with the guidance on first view. If that were the case, what would be the recommended alternative?
> **HMRC Answer** HMRC does not consider EYUs to be appropriate for Modified PAYE/NICs schemes. This is also the case in situations where individuals were not included in the Modified payroll but should have been – i.e. using your example of 'failed' STBVs. Under the terms of the Modified PAYE arrangements (PAYE82002) any additional tax found to be due should be accounted for via the individual's self-assessment tax return – please refer to section 18 of the agreement. Alternatively a disclosure can be made and these should be sent to HMRC using the following address:
> *eddisclosures.international@hmrc.gsi.gov.uk* [43]

HMRC say:

> **PAYE for tax equalised UK outbound assignees who remain UK treaty resident**
> It is not that unusual for a UK employee to be sent on an overseas assignment but, for various reasons, the employee remains UK treaty resident. Normally this means that the UK employer must continue to operate PAYE withholding. If the employee is tax equalised for the assignment period, so they are contractually entitled to an amount of net pay after deduction of hypothetical tax, it can be difficult for the employer to operate the PAYE correctly.
> PAYE is problematic for an employee who is tax equalised because the amount of PAYE calculated using the normal tax code approach is unlikely to match the final UK tax liability as determined following the tax reconciliation at the end of the tax year. These issues usually arise

[43] Expat Forum Q&A log (July 2019) (informally circulated).

> for a UK inbound assignee and are managed by using an Appendix 6 modified payroll. The issues are the same in the case of a UK outbound tax equalised assignee who happens to remain UK treaty resident and subject to PAYE but with the possible additional complexity of also requiring an appendix 5 net of tax agreement.
>
> (26.1) Would HMRC allow the employer to include such individuals on an Appendix 6 modified payroll for the period they are on assignment and are tax equalised? If HMRC would not allow this, how should the employer manage the PAYE issues?
>
> **Answer**
>
> HMRC guidance at PAYE81900 states that the Modified PAYE arrangement can only be used for employees assigned to work in the UK from abroad who are tax equalised.
>
> If employees of a UK employer are seconded abroad and their particular circumstances mean they continue to be liable to UK tax so the issue of a NT tax code is not appropriate, the employer is obliged to continue to deduct tax under PAYE.
>
> If your question relates to a particular case, please provide HMRC with the full facts and details including a more detailed explanation of the specific nature of the difficulties. Please also state how and where the employees are paid.[44]

HMRC say:

> **Interest charges on postponed payments on account**
>
> Question: HMRC's systems are applying late interest charges to individuals on modified payrolls who have postponed payments on account which later become due. Can this be stopped from happening?
>
> Payments on account should not be reduced, in modified cases, via the tax return. The self-assessment system cannot recognise modified cases and consequently the normal rules are applied. The correct way to reduce payments on account is to write to HMRC separately, providing the customer's name and UTR and request that the payments on account are reduced.
>
> UPDATE 27/07/2018
>
> We are aware of the guidance contained within the Modified PAYE agreement (PAYE82002) which, at the time was correct. In the past, before internet filing, when self-assessment tax returns were processed, HMRC were able to remove payments on account where the return indicated it was a Modified PAYE case. With the advancement of

[44] Expat Forum Q&A log (July 2019) (informally circulated).

online filing, fewer returns are manually processed and as such HMRC no longer have the chance to remove payments on account in appropriate cases.[45]

[45] Expats Forum: Q & A Log *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/897729/HMRC_Joint_Expat-Forum-Tax_NICs_minutes-11-June-2020.pdf*

CHAPTER THIRTY SEVEN

EMPLOYMENT INCOME: DT RELIEF

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37.1 DT employment reliefs

I usually deal with DT relief for each category of income in the chapter on that type of income. But employment income DT relief needs a chapter to itself; a full discussion would require a book.

OECD Model has 4 DT reliefs which may apply to employment income:

Model article	Topic	See para
15	*Employment income*	
15(1)	Employment income generally	37.2
15(2)	Short term business visitors (STBV)	37.6
16	Directors fees	37.19
19	Government service	37.20

37.2 Employment income DT relief

Article 15(1) OECD Model provides:

> [A] Subject to the provisions of Articles
> [i] 16, [directors][1]
> [ii] 18 [pensions][2] and
> [iii] 19 [government service][3],
> salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State
> [B] unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

In this chapter:
"The residence State" is the State where the employee is resident
"The work State" is the State where the employment is exercised; OECD Commentary uses the term "source State".

To follow art 15 one must keep in mind which Contracting State is which. It may be easier to follow if rewritten with this terminology thus:

> 1. ... salaries, wages and other similar remuneration derived by a resident *of the resident State* in respect of an employment shall be taxable only in that State

[1] See 37.19 (DT relief: Directors).

[2] See 38.8 (DT relief: Pension income).

[3] See 37.20 (DT relief: Government service).

> unless the employment is exercised *in the work State*. If the employment is so exercised *in the work State* such remuneration as is derived therefrom may be taxed *in the work State*.

In outline:

(1) The general rule is that tax is charged only in the residence State: art 15(1)[A].

(2) The work State may also charge tax: art 15(1)[B] but:

  (a) This is subject to short term business visit relief, if that relief applies tax is in residence State only): art 15(2).

  (b) If the work State charges tax, the residence State gives foreign tax credit relief.[4]

37.3 Salary/wages/remuneration

Article 15 refers to "salaries, wages and other similar remuneration".

It is convenient to have a short label for this concept, and where context permits I call it **"art 15 remuneration"** or just **"remuneration"**.

For the remuneration/pension borderline, see 38.8.4 (Pension or employment income?).

37.3.1 *Derived in respect of employment*

The remuneration must derived by a person in respect of an employment. But that is not a separate requirement, because if a sum is remuneration it must by definition be derived in respect of an employment.

37.3.2 *What is remuneration?*

The OECD model does not define "salaries/wages/similar remuneration". So we look to the UK tax law meaning of those words,[5] but it seems to me that such UK material as has been found does not tell us anything which we would not have known from the ordinary meaning.

The OECD Commentary provides:

> 2.1 Member countries have generally understood the term "salaries, wages and other similar remuneration" to include benefits in kind received in respect of an employment (e.g. stock-options, the use of a residence or automobile, health or life insurance coverage and club memberships).

[4] See 111.18.1 (FTCR: Employment income).

[5] See 107.12 (Undefined treaty terms).

The DTR Manual presumably had that in mind:

> **DT1920 Employment** [May 2020]
> ... The words 'salaries, wages and other similar remuneration' should be understood in the broadest sense as covering all income from an employment, including benefits and share option gains ...

The question whether a sum constitutes remuneration can be problematic, and is discussed at some length in the OECD Commentary:

> 2.3 In some cases, it may be difficult to determine which part of salaries, wages and other similar remuneration paid to an individual is derived from the exercise of employment in a given State.
> ...
> Regardless of the terminology used to describe these payments, it is essential to identify the real consideration for each such payment on the basis of the facts and circumstances of each case in order to determine
> [1] whether the payment constitutes "salaries, wages or other similar remuneration" and
> [2] the extent to which the payment, or part thereof, may be considered to derive from the exercise of employment in a given State...

37.4 *Pay for work when employed*

This is straightforward. The OECD Commentary provides:

> 2.4 Any remuneration paid after the termination of employment for work done before the employment was terminated (e.g. a salary or bonus for the last period of work or commissions for sales made during that period) will be considered to be derived from the State in which the relevant employment activities were exercised.

37.4.1 *Holiday/sick pay*

The OECD Commentary provides:

> 2.5 A payment made with respect to unused holidays / sick days that accrued during the last year of employment is part of the remuneration for the period of work that generated the holiday or sick leave entitlement.
> An employee may also be entitled, at the end of employment, to the payment for holidays and sick days related to a number of previous years that were unused during these years. Absent facts and circumstances showing otherwise, a payment received after termination of employment as compensation for holidays and sick days related to

> previous years that were unused during these years should be considered to have been a benefit for which the employee was entitled for the last 12 months of employment, allocated on a pro-rated basis to where the employment was exercised during that period. One situation where a different conclusion would be justified would be where it would be established, on the basis of the taxpayer's employment records, that these holidays and sick days clearly relate to specific periods of past employment and that the payment constitutes remuneration for these periods of employment.
>
> States should take account, however, of the fact that the former employee may have been previously taxed on these holidays and sick days at the time of their accrual. Assume, for instance, that under a State's domestic tax law, holidays and sick days granted with respect to periods of work performed on the territory of that State are treated as a benefit taxable during the fiscal year during which the relevant work was performed and are taxed accordingly. In such a case, the State of residence of the former employee at the time of the subsequent payment with respect to the holidays / sick days would need to provide relief of double taxation for such tax and any State in which the former employee may have worked during his last year of employment should similarly consider that any payment for previous years' unused holiday / sick days that were already taxed on an accrual basis did not relate to employment activities exercised during the last year.

37.4.2 *Pay in lieu of notice*

For the background to this and related topics, see OECD, "Tax Treaty Treatment of Termination Payments Discussion Draft" (2013).[6]

A payment in lieu of notice was held to constitute art 15 remuneration,[7] a view now supported by the OECD Commentary:

> 2.6 In some cases, the employer is required (by law or by contract) to provide an employee with a period of notice before terminating employment. If the employee is told not to work during the notice period and is simply paid the remuneration for that period, such remuneration is clearly received by virtue of the employment and therefore constitutes remuneration "derived therefrom" for the purposes of paragraph 1. The remuneration received in such a case should be considered to be derived from the State where it is reasonable to assume that the employee would

[6] *https://www.oecd.org/ctp/treaties/Termination_Payments.pdf*

[7] See *Squirrell v HMRC* [2005] STC (SCD) 717 and 37.4.4 (Compensation for breach of employment contract).

have worked during the period of notice. The determination of where it is reasonable to assume that the employee would have worked during the period of notice should be based on all facts and circumstances. In most cases it will be the last location where the employee worked for a substantial period of time before the employment was terminated; also, it would clearly be inappropriate to take account of a prospective employment period in a State where the employee might have been expected to work but did not, in fact, perform his employment for a substantial period of time.

37.4.3 *Redundancy/severance pay*

OECD Commentary provides:

> 2.7 A different situation is that of a severance payment (also referred to as a "redundancy payment") which an employer is required (by law or by contract) to make to an employee whose employment has been terminated. Such a payment is often, but not always, calculated by reference to the period of past employment with the employer. Absent facts and circumstances indicating otherwise, such a severance payment should be considered to be remuneration covered by the Article for the last 12 months of employment, allocated on a pro-rated basis to where the employment was exercised during that period; as such it constitutes remuneration derived from that employment for the purposes of the last sentence of paragraph 1.

Expat forum Q&A log provides:

> **Question**: Termination Payments
> We frequently come across scenarios where an employer's policy (sometimes driven by local labour laws) provides for a payment to be made on termination of employment by the employer calculated by reference to the total service in the employment. The amount payable might be subject to an overall cap or a maximum service period. This is a bit like UK statutory redundancy but the payments are not limited to redundancy cases and are often payable where the employer decides to terminate the employment for any reason (usually with an exception for cases of misconduct). The payments are not made if the employee chooses to resign so they are by no means guaranteed.
> Our question is how HMRC would expect to source such payments for the purposes of the employment income article under a double tax treaty? A related question is how HMRC would expect to source the payment under UK domestic law?
> In most cases we would expect these payments to be considered

> contractual and, therefore, taxable as earnings in the UK, but we would look to the OECD guidance on severance payments to determine treaty sourcing. Would HMRC expect to source these payments across the whole period of employment in respect of which the quantum of the payment is calculated? Or would HMRC take the view that although the payments are calculated by reference to the length of service they are not in fact earned unless and until the employer chooses to terminate the employment, so that they are earnings for the final tax year of employment only? For treaty purposes, does this common scenario fall into the OECD default "last 12 months" sourcing rule or is this the type of payment where the relevant facts and circumstances point to the longer alternative sourcing period?
>
> **HMRC answer**: [HMRC refer to para 2.7 OECD Commentary and continue:] HMRC would therefore expect these payments to be sourced based on the last 12 months of employment, regardless of whether they fall to be taxed as s62 earnings or as specific employment income under s401-s403.

37.4.4 *Damages for breach of contract*

The OECD Commentary provides:

> 2.8 An individual whose employment is terminated may have legal grounds to claim that the employment was terminated in violation of the contract of employment, the law or a collective agreement; there may also be other legal grounds for claiming damages depending on the circumstances of the termination. This individual may receive a judicial award or settlement as damages for breach of the relevant contractual or legal obligations. The tax treaty treatment will depend on what the damage award seeks to compensate. For instance, damages granted because an insufficient period of notice was given or because a severance payment required by law or contract was not made should be treated like the remuneration that these damages replace.
>
> Punitive damages or damages awarded on grounds such as discriminatory treatment or injury to one's reputation should, however, be treated differently; these payments would typically fall under Article 21 [Other Income].

37.4.5 *Payment for restrictive covenant*

The OECD Commentary provides:

> 2.9 Under the provisions of an employment contract or of a settlement following the termination of an employment, a previous employee may

receive a payment in consideration for an obligation not to work for a competitor of his ex-employer. This obligation is almost always time-limited and often geographically-limited. Whilst such a payment is directly related to the employment and is therefore "remuneration ... derived in respect of an employment", it would not, in most circumstances, constitute remuneration derived from employment activities performed before the termination of the employment. For that reason, it will usually be taxable only in the State where the recipient resides at the time the payment is received.

Where, however, such a payment made after the termination of employment is in substance remuneration for activities performed during the employment (which might be the case where, for example, the obligation not to compete has little or no value for the ex-employer), the payment should be treated in the same way as remuneration received for the work performed during the relevant period of employment.

Also, in some States, part of an employee's monthly salary during employment constitutes consideration for an obligation not to work for a competitor during a certain period of time after termination of the employment so that no separate payment for non-competition is made after the termination of the employment; in such a case, the guidance in the first part of this paragraph is not applicable and the part of the remuneration received during the employment that is attributable to that obligation should be treated in the same way as the rest of that remuneration.

37.4.6 *Deferred remuneration*

The OECD Commentary provides:

> 2.11 Payments may be made after the termination of employment pursuant to various deferred remuneration arrangements. Such a payment should be treated as remuneration covered by Article 15 and, to the extent that it can be associated to a specific period of past employment in a given State, it should be considered to be derived from the employment activities exercised in that State. Since many States would not allow the deferral of tax on employment remuneration even if the payment of that remuneration is deferred, it will be important for States that will tax deferred remuneration payments received after the termination of employment to ensure that double taxation is relieved.

37.4.7 *Post-employment benefits in kind*

The OECD Commentary provides:

> 2.13 An employee may be entitled to medical or life insurance coverage

> for a certain period after termination of his/her employment. He/she may also be entitled to other benefits, such as the services of an employment consultant or agency. Absent facts and circumstances indicating otherwise, such benefits should be considered to be remuneration covered by the Article which is derived from the State where the employment was exercised when the employment was terminated (and when, therefore, the obligation to pay these benefits arose).

37.4.8 *Compensation for loss of earnings*

The OECD Commentary provides:

> 2.14 Another type of payment that could be made on or after termination of an employment is a compensation payment for loss of future earnings following injury or disability suffered during the course of employment. The tax treaty treatment of such a payment would depend on the legal context in which it was made. For instance, payments under a social security system such as a worker's compensation fund could fall under Article 18 [pensions], 19 [Government service] or 21 [Other Income] (see paragraph 24 of the Commentary on Article 18).[8]
>
> A payment that would constitute a pension payment would be covered by Article 18. A payment made because the employee has legal grounds for claiming damages from his employer with respect to a work-related sickness or injury would typically fall under Article 21. A payment made by the employer pursuant to the terms of the employment contract even though the sickness or injury is not work-related or the employer is not responsible for that sickness or injury should be dealt with in the same way as a severance payment: absent facts and circumstances indicating otherwise, such a payment should be considered to be remuneration covered by the Article for the last 12 months of employment, allocated on a pro-rated basis to where the employment was exercised during that period.
>
> A short-term disability payment made in the course of employment, however, should be treated in the same way as the payment of sick days during the course of employment; such a payment would be covered by Article 15 (Article 17 in the case of entertainers and sportspersons) and taxable in the State in which the employee normally exercised the employment before becoming sick or being injured.
>
> 2.15 After termination of employment, a salesperson may receive a payment in relation to the loss of future commissions. The tax treaty treatment of such a payment will depend on the legal context in which

[8] See 38.8.5 (Social security income).

the payment is made. Depending on the circumstances, this payment

[1] could constitute deferred remuneration to which the salesperson was entitled in relation to previous sales or

[2] could be made pursuant to a provision of the employment contract according to which the salesperson has a right to commissions on any future sales to a client that the salesperson brought to the employer;

in both cases, the payment should be dealt with as remuneration for the employment services that gave rise to the entitlement to the commissions.

A payment that would constitute a compensation for future commissions that the salesperson would likely have earned if she had continued to work for the same employer may also constitute a compensation for unlawful dismissal or a form of severance payment; where that is the case, the payment should be dealt with accordingly.

37.4.9 *Garden leave*

The OECD Commentary provides:

> 2.16 As part of a transitional arrangement leading to the termination of employment, an employee may receive a full or reduced salary for a period during which that employee will not work. Where the salary is paid by the employer for a period during which the employee is not required to work even though the employment has not been terminated, the salary is still received by virtue of the employment and therefore constitutes remuneration "derived therefrom" for the purposes of paragraph 1. The remuneration received in such a case should be considered to be derived from the State where it is reasonable to assume that the employee would have worked during that period, which will most often be the State where the employment activities were performed before the cessation of work.

37.4.10 *Covid payments (furlough)*

OECD Covid guidance[9] provides:

> ***Income of cross-border workers that cannot perform their work due to COVID-19 restrictions (e.g. wage subsidies to employers)***
> 49. Where a government has stepped in to subsidise the keeping of an

[9] *https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic*
See 105.27.1 (OECD Covid guidance).

> employee on a company's payroll during the COVID-19 pandemic despite being unable to work, the income that the employee receives from the employer should be attributable to the place where the employment used to be exercised. In the case of employees that work in one jurisdiction but commute there from another jurisdiction where they are resident (cross-border workers), this would be the jurisdiction they used to work in.
>
> 50.Some stimulus packages adopted or proposed by governments (e.g. wage subsidies to employers) are designed to keep workers on the payroll during the COVID-19 pandemic despite restrictions to the exercise of their employment. To the extent these may be the last payments received in respect of the employment, the payments resemble termination payments. These are discussed in paragraph 2.6[10] of the Commentary on Article 15 of the OECD Model, which explains that they should be attributable to the place where the employee would otherwise have worked. In most circumstances, this will be the place the person used to work before the COVID-19 pandemic. Alternatively the payments may resemble those which are routinely received during paid periods of absence the entitlement to which arises in connection with where the work was performed. Examples of such other routine payments include vacation pay, paid sick leave, or paid furlough, none of which have been known to cause difficulties in international taxation...
>
> 52. In conclusion, where an employee resident in one jurisdiction and who formerly exercised an employment in another jurisdiction receives a COVID-19 related government subsidy from the work jurisdiction to maintain the relationship with the employer, the payment would be attributable to the work jurisdiction under Article 15 of the OECD Model.

HMRC follow this.[11]

37.4.11 *Pure termination payment*

HMRC say:

> Attention was drawn to the agreement published in Germany in December 2011, whereby termination payments were to be treated as

[10] See 37.4.2 (Pay in lieu of notice).

[11] ICAEW Taxguide 08/21para 6.5.1. *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2021/taxguide-0821-covid-19-displaced-expatriate-employees.ashx*

> remuneration falling within the employment services article of the double tax treaty. HMRC confirmed that this treatment would not apply for the purposes of treaties other than the UK/German treaty.[12]

In *Resolute Management Services v HMRC*[13] a taxpayer received an ex gratia payment, after leaving her employment. For ITEPA purposes, it was not general earnings but it was a termination payment within Part 6 ITEPA.[14] For DT purposes, it was not art 15 remuneration. The ITEPA classification did not affect this:

> 35. ITEPA does not treat a termination payment as ordinary earnings (within which fall salary and wages and other similar remuneration) but as "an amount that counts as employment income".[15] The categorization of termination payments as "specific employment income" does not indicate that such payments are not "other similar remuneration" because income related to share incentives and share options within Part 7 of ITEPA (which the Treaty parties and OECD member countries regard as other similar remuneration) also falls within the category of specific employment income rather than ordinary earnings. Nevertheless, the statutory description of items within Part 6 of ITEPA ("Income which is not earnings or share related") suggest that items within that Part (e.g. termination payments) are not part of what would ordinarily be regarded as "salaries, wages and other similar remuneration". In other words, the context of ITEPA at least indicates that termination payments are not what the Act regards as ordinary earnings (as salary and wages and other similar remuneration would ordinarily comprise) even though termination payments are taxed within the framework of ITEPA as something counting as employment income.

The termination payment qualified for exemption under the Other Income article.

Expat forum Q&A log provides:

> **Termination payments and DTAs**
> **Question**: Now that foreign service relief is gone from termination payments to UK residents can we re-confirm whether HMRC's standard

[12] Minutes of Joint Expatriate Forum on Tax and NICs (January 2012) *http://webarchive.nationalarchives.gov.uk/20130410172938/http://www.hmrc.gov.uk/consultations/epf-mins-jan12.pdf*

[13] [2008] UKSPC SPC00710.

[14] See 34.38 (Termination payments).

[15] See 34.4 (Employment income/earnings).

view is that these are subject to employment income article of the treaty (and hence eligible for FTC offset) rather than the other income article and only taxed in country of residence (I assume this hasn't been an issue since the OECD change back in 2014 but was beforehand). However how will the issue of any conflicting domestic and treaty sourcing periods be resolved?

HMRC answer: A termination payment may comprise several elements, and these may be treated differently under UK tax legislation and/or international treaties. Paragraphs 2.4 to 2.16 of the OECD commentary on Article 15 explain how some of the more common elements should be treated.

Paragraph 2.7 says that a severance or redundancy payment required by contract or statute should be considered to be remuneration covered by Article 15 for the 12 months prior to the date of termination.

Paragraph 2.8 says that a compensatory payment should be treated like the remuneration that the damages replace.

In most cases, an "ex-gratia" termination payment will represent compensation for the loss of future earnings from the employment. In accordance with Paragraph 2.8 of the commentary, we consider that such a payment should be attributed to the State where the employee would have worked if not for the termination, using a similar method to that described in Paragraph 2.6 (concerning PILONs). In most cases this will be the last location where the employee worked for a substantial period of time before the employment was terminated.

HMRC would suggest the following approach:

1. Identify amounts for which the commentary mandates a particular treatment, such as:

- Arrears of earnings (para 2.4)
- Accrued holiday (para 2.5)
- Payments in lieu of notice (para 2.6)
- Statutory redundancy pay and similar (para 2.7)
- Consideration for restrictive undertakings (para 2.9)

2. Calculate PENP, which should be attributed to the State where notice would have been worked in line with Paragraph 2.6.

3. Attribute any remaining (ex-gratia) payment to the State(s) where the employee would have worked in future, as described above.

Where there is a conflict, relief should be given via Foreign Tax Credit Relief in the first instance.[16]

[16] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/897729/HMRC_Joint_Expat-Forum-Tax_NICs_minutes-11-June-2020.pdf*

37.5 Where is employment exercised

OECD Commentary on art 15(1) provides:

> 1. ... Employment is exercised in the place where the employee is physically present when performing the activities for which the employment income is paid.

This comment was followed in *Kljun v HMRC*.[17]

OECD Commentary provides:

> 2.2 The condition provided by the Article for taxation by the State of source is that the salaries, wages or other similar remuneration be derived from the exercise of employment in that State. This applies regardless of when that income may be paid to, credited to or otherwise definitively acquired by the employee.

37.5.1 *Work abroad due to Covid*

OECD Covid guidance[18] provides:

> ***Teleworking from abroad i.e. working remotely from one jurisdiction for an employer of the other jurisdiction.***
> 59. A change in the place where the employment is exercised may give rise to a change in the allocation of taxing rights under the current treaty rules.
> 60. Accordingly, if the jurisdiction where employment was formerly exercised should lose its taxing right following the application of Article 15, additional compliance difficulties would arise for employers and employees. Employers may have withholding obligations, which are no longer underpinned by a substantive taxing right. These would therefore have to be suspended or a way found to refund the tax to the employee. The employee would also have a new or enhanced liability in their jurisdiction of residence, which would result in new filing obligations.
> 61. Some examples illustrating changes in allocation of taxing rights over employment income are included below:
>
> - Before the COVID-19 pandemic, an employee resident in Jurisdiction A normally exercised their employment in Jurisdiction B. The employee began to exercise his employment from

[17] [2011] UKFTT 371 (TC) at [18]. See 34.30 (Where are duties performed).

[18] *https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic*
See 106.14.1 (OECD Covid guidance).

Jurisdiction A due the COVID-19 pandemic. According to Article 15:

  - if the employer was resident in Jurisdiction B, Jurisdiction B is entitled to tax the income derived from the period during which the employee was physically present in Jurisdiction B (i.e., a reduction in Jurisdiction B's taxing right);
  - if the employer was not resident in Jurisdiction B or did not bear the cost of the employee's remuneration through a PE in that jurisdiction, Jurisdiction B would likely lose its taxing right under a treaty if the employee spent less than 183 days there (i.e., a complete loss of Jurisdiction B's taxing rights)

- Before the COVID-19 pandemic an employee was resident in Jurisdiction A, became stranded in Jurisdiction B and began to exercise his employment there. Under Article 15, Jurisdiction B would be permitted to tax the employment income if the employer was also resident in that jurisdiction or bore the cost of the employee's remuneration through a PE in that jurisdiction. In cases where the employer was resident elsewhere, Jurisdiction B would be entitled to tax the employment income only if the employee exceeds the 183 day threshold.

62. Exceptional circumstances call for an exceptional level of coordination between jurisdictions to mitigate the compliance and administrative costs for employees and employers associated with an involuntary and temporary change of the place where employment is performed. Where relevant, MAP should be applied efficiently and pragmatically to help resolve issues arising out of the COVID-19 pandemic. Jurisdictions have issued useful guidance and administrative relief to mitigate the unplanned tax implications and potential new burdens arising due to effects of the COVID-19 pandemic. A sample of that guidance is included in Box 4.

63. In conclusion, changes in the jurisdiction where an employee exercises their employment can impact where their employment income is taxed: new taxing rights over the employee's income may arise in other jurisdictions and those new taxing rights may displace existing taxing rights. As payroll taxes are often withheld at source, addressing the change will result in compliance and administrative costs for the employer and employee. Some jurisdictions have issued guidance and administrative relief to mitigate the additional burden.

37.6 Short-term Business Visitors

This takes us to art 15(2) OECD Model:

> 2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
>
> a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and
> b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
> c) the remuneration is not borne by a permanent establishment which the employer has in the other State.[19]

To follow this one must keep in mind which Contracting State is which. It is easier to follow if rewritten with my terminology thus:

> 2. ... remuneration derived by a resident of the resident State in respect of an employment exercised *in the work State* shall be taxable only in the *resident* State if:
>
> a) the recipient is present in *the work State* for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and
> b) the remuneration is paid by, or on behalf of, an employer who is not a resident *of the work State*, and
> c) the remuneration is not borne by a permanent establishment which the employer has *in the work State*.

I refer to this as **"STBV relief"** (short-term business visitors).[20] The three conditions are **"STBV conditions (a) - (c)"**; and conditions (b) and (c) are the **"STBV payment conditions"**.

For PAYE issues, see 36.13 (PAYE exemption: EP App 4). For Hong Kong/Singapore, which have non-standard DTAs, see 36.13.4 (EP App 4: Mistakes).

[19] For completeness, art 15(3) continues: "Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic, or aboard a boat engaged in inland waterways transport, may be taxed in the Contracting State in which the place of effective management of the enterprise is situated."
This is not discussed here; see OECD Commentary para 9.

[20] The OECD term is: "the exception of paragraph 2 of Article 15". This relief should not be confused with the annual PAYE scheme which is available to short term business visitors (differently defined) who do not qualify for DTA relief.

37.6.1 *STBV relief: Policy*

OECD Commentary on art 15(2) provides:

> 8. There is a direct relationship between the principles underlying the exception of [art 15(2), STBV relief] and Article 7 (business profits). Article 7 is based on the principle that an enterprise of a Contracting State should not be subjected to tax in the other State [the source State] unless its business presence in that other State has reached a level sufficient to constitute a permanent establishment.[21] The exception of [art 15(2), STBV relief] extends that principle to the taxation of the employees of such an enterprise where the activities of these employees are carried on in the other State [the source State] for a relatively short period.

This neatly explains STBV condition (a) (183 day rule).[22]

OECD Commentary on art 15(2) provides:

> 6.2 The object and purpose of subparagraphs b) and c) of paragraph 2 are to avoid the source taxation of short-term employments to the extent that the employment income is not allowed as a deductible expense in the State of source because the employer is not taxable in that State as it neither is a resident nor has a permanent establishment therein. These subparagraphs can also be justified by the fact that imposing source deduction requirements with respect to short-term employments in a given State may be considered to constitute an excessive administrative burden where the employer neither resides nor has a permanent establishment in that State.

37.7 STBV payment condition (b)

It is helpful first to consider STBV payment condition (b).

Article 15(2)(b) OECD Model provides:

[21] See 21.23 (DT relief: trading income).

[22] The Commentary continues with an explanation of the policy behind STBV payment conditions which I find harder to follow:

> "Subparagraphs b) and c) make it clear that the exception [STBV relief] is not intended to apply where the employment services are rendered to [ie, the individual is an employee of] an enterprise the profits of which are subjected to tax in a State either
>
> [a] because it is carried on by a resident of that State or
>
> [b] because it has a permanent establishment therein to which the services are attributable."

> 2. ... remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if ...
> (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the UK [the work State],

Unpacking paragraph (b), 3 issues arise:

(1) Identify the employer
(2) Identify the residence of the employer (that may be easy once the employer is identified)

STBV relief only applies if there is a non-resident employer (ie not resident in the work State)

(3) Does that employer pay the remuneration (directly or by someone on his behalf)?

These are logically distinct questions, but (1) and (3) may overlap because the question who pays remuneration may be relevant to identifying the employer.[23] I consider first some general comments on what amounts to paying remuneration, and then who is the employer.

37.8 Who pays remuneration

37.8.1 *"Ultimately borne"*

The requirement is:

> b) the remuneration is *paid by, or on behalf of*, an employer who is not a resident of the other State [ie not a resident of the work State]

DTR Manual provides:

> **DT1922 Employment** [May 2020]
> **'On behalf of'**
> Payments may be made 'on behalf of' a non-resident employer in cases where the payment is physically made by a UK company. It may be accepted that remuneration has been paid or benefits provided 'on behalf of' a non-resident employer if that non-resident ultimately bears the cost of such remuneration and benefits.

[23] See item [3] in OECD Commentary para 8.14, set out at 37.9.9 (Identifying effective employer).

"Ultimately borne" is a paraphrase but perhaps a useful one. That has been explained in turn as meaning "the employer finally bearing the cost after all recharging of any nature."[24]

Recharging (ie reimbursement) can work both ways. A UK person might pay remuneration directly and be reimbursed by the non-resident employer. Then the remuneration is ultimately borne by the non-resident, and STBV condition (b) is met. Conversely the non-resident employer might pay remuneration directly and be reimbursed by a UK resident. Then the remuneration is not ultimately borne by the non-resident and STBV condition (b) is not met.

HMRC say:

> **Question:** Do HMRC agree that a recharge, or series of recharges, whereby a cost is ultimately borne in the UK, is only relevant for Appendix 4 purposes [STBV PAYE scheme] [25] if that cost can be linked to both the specific employee's remuneration (as defined in Appendix 4) and the period that the employee in question spent working in the UK? If HMRC do not agree, please can you explain why a cost borne in the UK that cannot be linked to both of these factors would be relevant to the question of whether treaty exemption is available (and therefore to the application of Appendix 4)?
>
> **HMRC answer:** PAYE82000 defines 'Ultimately Borne' as the company finally bearing the cost of the employees work in the UK after all recharging of any nature. This could either be by a direct recharge or as part of a management charge made by the non-resident employer.
>
> If the formal employer charges the UK employer an amount that represents the remuneration, employment benefits and other employment costs for their time in the UK then this could be considered a direct recharge and therefore ultimately borne in the UK.
>
> If the formal employer charges the UK employer an amount, or a series of amounts, representing a management charge that includes an employees' remuneration relevant to their time in the UK then this could be considered being ultimately borne in the UK.[26]

[24] See 36.13.2 (Remuneration ultimately borne by non-resident).

[25] See 36.13 (Short-term visitor PAYE scheme).

[26] Expatriate Forum Minutes Oct 2019 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/855596/Expat_Forum_minutes_10_October_2019.pdf*

37.8.2 *Employer deduction in work State*

Clearly, if the remuneration is ultimately borne by a non-resident employer, no person in the work State can claim a deduction.

There is a certain sense in allowing STBV relief and disallowing the deduction in the work State.

The DTR Manual provides:

> **DT1922 Employment** [May 2020]
>
> Where it is argued that remuneration has been paid 'on behalf of' an overseas employer, even though a UK company has paid the individual's remuneration and the overseas employer has not reimbursed the cost, it should be pointed out that it is unlikely that, in these circumstances, the cost of the remuneration could be regarded as wholly and exclusively incurred for the purposes of the UK company's trade and that, therefore, no deduction should be claimed for the cost of the remuneration in computing the UK company's taxable profit. Reference should be made to the tax case of *Robinson v Scott Bader and Co Ltd* (54 TC 757) which considers the inadmissibility of remuneration paid on behalf of another employer.
>
> The decision in the *Scott Bader* case makes clear that the object of the person making the payment is decisive in determining whether or not a deduction is permissible in accordance with [s.34 ITTOIA/s.54 CTA 2009, wholly & exclusively test].
>
> In relation to seconded employees there are three possible situations
>
> - the payment to the employee is made solely in the interests of the overseas company;
> - the payment is made partly in the interests of the UK company and partly in the interest of the overseas company or
> - the payment is made solely in the interests of the UK company.
>
> Only in the third case is a deduction available to the UK company in computing its profits.

37.8.3 *DT relief: Benefits in kind*

A benefit in kind such as the occupation of land is not in the strict sense "paid" but the word should construed loosely, to include providing benefits in kind.[27] The question is then who "pays" the benefit in kind. The DTR Manual provides:

[27] See 15.11.2 ("Paid" and "payment").

> **DT1922 Employment** [Nov 2019]
> **Benefits**
> Even where basic remuneration continues to be paid by the overseas employer it is common for benefits (for example, the use of a flat) to be provided at the cost of the UK employer to whom the employee has been seconded. Subject to the other conditions in the Article, the basic remuneration may be exempt from UK tax but the condition in Article 15(2)(b) is not satisfied in relation to benefits in these circumstances because they are not 'remuneration paid by, or on behalf of,' the overseas employer (unless the cost of the benefits is borne by the overseas employer through a recharge).

37.8.4 *HMRC practice*

The DTR Manual provides:

> **DT1922 Employment** [May 2020]
> ... Not only must the claimant remain an employee of the overseas company but the remuneration in respect of which the exemption is claimed must be paid by the overseas employer and not, for example, by a UK subsidiary company to whom the employee may have been seconded. Any statement on this aspect of a claim should be checked to ensure that it is consistent with
> i) other information in the papers (for example what does the return show?) and
> ii) the position in other similar cases involving the same UK employer.
> If there is any doubt you should ask the agents to provide a statement from the UK company or the overseas employer, to confirm the extent to which, if at all, the overseas employer has continued to pay the claimant's remuneration either directly or by reimbursing the UK company...
> Claims should not be admitted where
> [1] a UK company pays remuneration or incurs the cost of benefits and
> [2] does not receive reimbursement from the overseas employer.
> Such payments and costs are incurred in the interest of the UK company and not on behalf of the overseas employer.
> Unless the claimant offers evidence that the UK company was reimbursed the cost of the taxpayer's remuneration and benefits by the non-resident employer (and this can be checked with the relevant HMRC corporation tax specialist or Customer Compliance Manager dealing with the UK company's Corporation Tax affairs) a claim under Article 15(2) should be resisted.

37.9 Labour-hire arrangement

An "employment" is essential to art 15, and (if there is one) the identity of the employer is, as noted, essential for STBV payment condition (b).

The terms employment/employer are not defined. Except for a few marginal points, there never is a definition. It has been left for the Courts to sort out.

37.9.1 *Labour-hire terminology*

For the purposes of discussion we need some neutral terms, which may apply to employment/non-employment relationships. In this chapter:
The **"worker"** is the individual supplying service(s) whether employed/ self employed[28]
The **"client"** is the person to whom the worker's services are supplied

A **"labour-hire"** arrangement is one under which there are two[29] contracts:

(1) A contract of employment[30] between the worker and an **"intermediary",** under which the intermediary is (or at least is expressed to be) the employer of the worker.
(2) A contract between the intermediary and the **"end user"**, under which the intermediary provides the services of the worker to the end user. The worker is not (or at least is not expressed to be) a party to this contract.

The state of the end user is therefore the work State.

Other terminology which might be used includes:
- Secondment; and the worker is called a secondee

[28] This is not the usual employment law terminology, where "worker" has a narrower meaning; it means in short an individual who works under (a) a contract of employment, or (b) any other contract, whereby the individual undertakes to work personally for another person whose status is not that of a client or customer of a profession or business carried on by the individual; see s.230 Employment Rights Act 1996.

[29] There could be more than one intermediary, with a series of contracts between them, but that would be unusual and I do not consider it here.

[30] This contract might alternatively be a contract under which the worker is (or at least is expressed to be) self-employed, and provides business services to the intermediary; but in the discussion below I assume this contract is (or is at least expressed to be) a contract of employment.

- Outsourcing
- A trilateral arrangement

If the worker and the intermediary are not resident in the work State (the State of the end user), that may be called an **"international labour-hire arrangement"**.

OECD Commentary uses different terminology:

My term	**OECD term**
Worker	*The individual*
End user	*The enterprise that acquires the services*
Intermediary	*Formal employer/enterprise by which the individual is formally employed*

It may happen that form and substance diverge, so:

(1) The intermediary is the *formal* or *de jure* employer

(2) The end user is the *effective/economic*[31]*/functional* or *de facto* or *real*[32] employer

I refer to these as the formal/effective employer, or the employer in form/in substance.

The question then is which of the two is the "employer" for DTA purposes.

If (as I will conclude) the treaty has an autonomous meaning, it would be necessary to distinguish:

"Domestic-law employer": the employer as a matter of domestic employment law

"Treaty-employer": the employer for the purposes of the DTA

The same distinction is relevant in identifying the personnel of an enterprise, for the personnel condition of a PE.[33]

37.9.2 *Employer: OECD Commentary*

The Commentary has changed over time. In the following discussion:

"1992 Commentary" means the Commentary in its 1992 form

[31] See App.7.7.1 (Economic terms with antonym).

[32] The expression "real employer" was used in the 1992 OECD Commentary, but (wisely) dropped from the 2010 Commentary.

[33] See 106.9.1 (Formal v effective employment).

“2010 Commentary” means the 2010 form, which is the current form[34]

Prior to 1992 there was no discussion of labour-hire arrangements.

37.9.3 *1992 Commentary*

The 1992 Commentary was concise:

> *8.[Article 15(2) STBV relief] has given rise to numerous cases of abuse through adoption of the practice known as “international hiring-out of labour”. In this system, a local employer wishing to employ foreign labour for one or more periods of less than 183 days recruits through an intermediary established abroad who purports to be the employer and hires the labour out to the employer. The worker thus fulfils prima facie the three conditions laid down by [art 15(2)] and may claim exemption from taxation in the country where he is temporarily working.*
> *To prevent such abuse, in situations of this type, the term “employer” should be interpreted in the context of [art 15(2)].*[35] *In this respect, it should be noted that the term “employer” is not defined in the Convention but it is understood that the employer is the person having rights on the work produced and bearing the relative responsibility and risks. In cases of international hiring-out of labour, these functions are to a large extent exercised by the user. In this context, substance should prevail over form, i.e. each case should be examined to see whether the functions of employer were exercised mainly by the intermediary or by the user.*

37.9.4 *2010 Commentary*

The 2010 Commentary now divides States into 2 categories. Firstly:

> 8.2 In some States, a formal contractual relationship would not be questioned for tax purposes unless there were some evidence of manipulation and these States, as a matter of domestic law, would consider that employment services are only rendered where there is a formal employment relationship.

[34] For pre-2010 discussion see: Avery Jones, “Short-term Employment Assignments under Article 15(2) of OECD Model” (2009) 63 Bulletin for International Taxation 1,6.

[35] This might perhaps be interpreted to mean that the form over substance approach only applied in cases of abuse, though that does not seem the most natural reading. The point does not now arise: the 2010 Commentary does not limit the substance-over form approach to cases of abuse.

The reference to "manipulation" gives plenty of wiggle-room. This is the only place in the OECD Commentary that the word is used. What does it mean? Is it the same as abuse?[36] Would a case with a formal employer distinct from an effective employer (at least) normally involve "manipulation"? If so, the distinction between form-over-substance States (within para 8.2) and substance-over-form States (within para 8.4) will (at least) normally not arise. For "manipulation" is essentially a substance-over-form concept.

However that may be, States in the second category do not have to consider what amounts to manipulation because they apply the substance-over-form approach proposed in the 1992 Commentary:

> 8.4 In many States, however, various legislative or jurisprudential rules and criteria (e.g. substance over form rules) have been developed for the purpose of distinguishing
> [1] cases where services rendered by an individual to an enterprise should be considered to be rendered in an employment relationship (contract of service) from
> [2] cases where such services should be considered to be rendered under a contract for the provision of services between two separate enterprises (contract for services) [ie the contract between the intermediary and the end user].

In the following discussion:
"Form-over-substance States" are those within para 8.2 (employment requires a formal contractual relationship)
"Substance-over-form States" are those within para 8.4

In short, the 1992 Commentary assumed that all States were form-over-substance states. But some States did not accept that, and the 2010 amendments were designed to accommodate them.

37.9.5 *Employment law background*

Where does the UK fall in this categorisation, in para 8.2 or 8.4? Is our law formal? or does substance prevail over form? The question is too broad, it does not have a yes or no answer at that level of generality. The answer depends on the issue which is being considered.

In short:

[36] See 108.7 (OECD-concept abuse).

(1) *Is a contract an employment contract?* If the question is whether a contract made between A and B is one of employment/non-employment, the English[37] employment law approach is one of substance, not form (ie the parties' description of the arrangement, or the wording of the contract, is not decisive).

(2) *Who are the parties to the contract?* If the question is whether under a labour-hire arrangement, there is a contract of employment between the worker and the end user, the English employment law approach is better described as one of form,[38] and the parties' description of the arrangement and the wording of the contracts is decisive (unless a contract written formally is varied orally, or a sham, which would not be lightly inferred).

This is why there is legislation dealing with labour-hire arrangements in Part 2 ITEPA:

Chapter	**Topic**
7	Agency workers
8	Intermediaries
9	Managed service companies

This view is supported by *The Independent Workers' Union, (R, oao) v Central Arbitration Committee*.[39] In this case the University of London (the end user) outsourced its front of house (security guards, receptionists etc, "the workers"). The workers had a formal contract of employment with a third party ("the intermediary"). The question was whether the University was the employer of the workers. The University did not have a contract with the workers. It did have significant involvement in determining their terms and conditions of employment.[40] The Court said:

> A *de facto* employer is not a known or recognised concept... Organisations are entitled to adopt outsourcing arrangements, should

[37] Further consideration would be needed for Scots or foreign law. Oxford Pro Bono Publico, "Joint Employers and Agency Workers" (2017) considers the position in USA, Canada, South Africa, New Zealand and Ireland; see *https://www.law.ox.ac.uk/sites/files/oxlaw/3._joint_employers_and_agency_workers.pdf*

[38] Though a substance/form dichotomy is not as straightforward or clear cut as those terms may suggest.

[39] [2019] EWHC 728 (Admin).

[40] It was assumed that the University substantially determined the terms and conditions of the workers.

> they wish to do so, as a legitimate means of organising their activities.[41]

Likewise in Australia. *Wilton & Cumberland v Coal & Allied Operations*[42] considered whether workers provided through a labour-hire arrangement were employees of the end user. The end user did not discuss essential contractual terms with the workers. The workers did not act in a way that indicated they regarded themselves as being employed by the end user. The Court held that there was no employment relationship between the workers and the end user. There was no contract between them at all.

37.9.6 *Do domestic-law rules apply?*

OECD Commentary continues:

> That distinction [form-over-substance/substance-over-form] keeps its importance when applying the provisions of Article 15, in particular those of subparagraphs 2 b) and c). Subject to
> [a] the limit described in paragraph 8.11 and
> [b] unless the context of a particular convention requires otherwise,
> it is a matter of domestic law of the State of source to determine whether services rendered by an individual in that State are provided in an employment relationship and that determination will govern how that State applies the Convention.

Thus where the UK is the work State, the question whether the end user is the employer, which is key for STBV relief in labour-hire arrangements, is said in principle to be a matter of UK domestic law.[43] But this is subject to two wide exceptions:

(1) Where the context of a particular convention requires otherwise. This does not refer to the case where a convention does not have standard OECD Model wording; it refers to a case where the domestic law of a State (which applies to undefined treaty terms) requires some other interpretation of OECD Model wording.
(2) The limit described in para 8.11: see 37.9.8 (Limit on work State powers).

In short, UK domestic law is not the only consideration in determining the

[41] [2019] EWHC 728 (Admin) at [74], [81].
[42] [2007] FCA 725.
[43] See 107.12 (Undefined treaty terms); 34.3 (Employment/employer/employee).

meaning of the term ‘employer’, and the identity of the employer, for the purposes of STBV relief. The context, object and purpose of the relief, and the payment conditions in particular, need to be considered in interpreting the term ‘employer’.

37.9.7 *Effective employment*

OECD Commentary provides:

> 8.5 In some cases, services rendered by an individual to an enterprise may be considered to be employment services for purposes of domestic tax law even though these services are provided under a formal contract for services between,
> [1] on the one hand, the enterprise that acquires the services, and,
> [2] on the other hand, either
> [a] the individual himself
> [b] or another enterprise [the Intermediary]
> [i] by which the individual is formally employed or
> [ii] with which the individual has concluded another formal contract for services.

The focus of discussion is on case 2[b][i], ie what I call labour-hire arrangements.

> 8.6 In such cases, the relevant domestic law may ignore the way in which the services are characterised in the formal contracts. It may prefer to focus primarily on the nature of the services rendered by the individual and their integration into the business carried on by the enterprise that acquires the services to conclude that there is an employment relationship between the individual and that enterprise.
> 8.7 Since the concept of employment to which Article 15 refers is to be determined according to the domestic law of the State that applies the Convention (subject to the limit described in paragraph 8.11 and unless the context of a particular convention requires otherwise),[44] it follows that a State which considers such services to be employment services will apply Article 15 accordingly. It will, therefore, logically conclude that the enterprise to which the services are rendered [the end user] is in an employment relationship with the individual so as to constitute his employer for purposes of subparagraphs 2 b) and c) [STBV payment conditions].

The OECD Commentary supports that approach:

[44] See Commentary para 8.4, set out at 37.9.2 (Employment: OECD Commentary).

> That conclusion is consistent with the object and purpose of [art 15(2), STBV relief] since, in that case, the employment services may be said to be rendered to a resident of the State where the services are performed.
> ... 8.10 The approach described in the previous paragraphs therefore allows the State in which the activities are exercised [the work State] to reject the application of [art 15(2), STBV relief]
> [1] in abusive cases and
> [2] in cases where, under that States's domestic law concept of employment, services rendered to a local enterprise by an individual who is formally employed by a non-resident are rendered in an employment relationship (contract of service) with that local enterprise.

37.9.8 *Limit on work State powers*

In short, the work State may refuse STBV treaty relief if it determines that the end user is the employer, rather than the intermediary. But the model treaty does not allow the work State an unfettered power to determine the "who is the employer" issue in an arbitrary way:

> 8.11 The conclusion that, under domestic law, a formal contractual relationship should be disregarded must, however, be arrived at on the basis of objective criteria. For instance, a State could not argue that services are deemed, under its domestic law, to constitute employment services where, under the relevant facts and circumstances, it clearly appears that these services are rendered under a contract for the provision of services concluded between two separate enterprises. The relief provided under paragraph 2 of Article 15 [STBV relief] would be rendered meaningless if States were allowed
> [1] to deem services to constitute employment services in cases where there is clearly no employment relationship or
> [2] to deny the quality of employer to an enterprise carried on by a non-resident where it is clear that that enterprise provides services, through its own personnel, to an enterprise carried on by a resident.

This conclusion has a knock-on effect for taxation of the intermediary:

> Conversely, where services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises, that State should logically also consider that the individual is not carrying on the business of the enterprise that constitutes that individual's formal employer; this could be relevant, for example, for

> purposes of determining whether that enterprise has a permanent establishment at the place where the individual performs his activities.[45]

37.9.9 *Identifying effective employer*

If we adopt an effective employment test, how do we determine whether there is an employment relationship between the worker and the end user? The 1992 Commentary provided:

> *It is therefore up to the Contracting States to agree on the situations in which the intermediary does not fulfil the conditions required for him to be considered as the employer within the meaning of [art 15(2)2, STBV relief].*
> *In settling this question, the competent authorities may refer not only to the above-mentioned indications [who has rights to work produced/who bears responsibility and risks] but to a number of circumstances enabling them to establish that the real employer is the user of the labour (and not the foreign intermediary).*[46]

The 2010 Commentary is longer, and there are some differences of detail between the 1992 and 2010 Commentary, but the 1992 Commentary no longer matters. The 2010 Commentary provides:

> 8.12 It will not always be clear, however, whether services rendered by an individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises. Any disagreement between States as to whether this is the case should be solved having regard to the following principles and examples (using, where appropriate, the mutual agreement procedure).
> 8.13 The nature of the services rendered by the individual will be an

[45] See 106.9.1 (Formal v effective employment).

[46] The pre 2010 Commentary then gave a list of factors which are an earlier version of the factors in the current OECD Commentary:
[1] Responsibility/risk for results produced by the employee's work; now Commentary para 8.13
[2] Authority to instruct the worker; now Commentary 8.14 [1]
[3] Control/responsibility of place where work performed; now Commentary 8.14 [2]
[4] Remuneration to the hirer calculated on the basis of the time utilised/or in other ways a connection between this remuneration and wages received by the employee; now Commentary 8.14[3]
[5] Provision of tools and materials; now Commentary 8.14[4]
[6] Number/qualifications of employees; now Commentary 8.14[5]

> important factor since it is logical to assume that an employee provides services which are an integral part of the business activities carried on by his employer. It will therefore be important to determine whether the services rendered by the individual *constitute an integral part of the business of the enterprise* to which these services are provided. For that purpose, a key consideration will be which enterprise *bears the responsibility or risk for the results* produced by the individual's work.

The tests offered here (emphasis added) are (1) whether the worker is an integral part of the enterprise, and (2) responsibility/risk. These are evaluative tests and may not offer much help in practice.

> Clearly, however, this analysis will only be relevant if the services of an individual are rendered directly to an enterprise. Where, for example, an individual provides services to a contract manufacturer or to an enterprise to which business is outsourced, the services of that individual are not rendered to enterprises that will obtain the products or services in question.

This seems rather shallow. What constitutes outsourcing is not explored.

> 8.14 Where a comparison of
> [a] the nature of the services rendered by the individual with
> [b] the business activities carried on
>   [i] by his formal employer and
>   [ii] by the enterprise to which the services are provided
> points to an employment relationship that is different from the formal contractual relationship, the following additional factors may be relevant to determine whether this is really the case:
> [1] who has the authority to instruct the individual regarding the manner in which the work has to be performed;
> [2] who controls and has responsibility for the place at which the work is performed;
> [3] the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided (see paragraph 8.15 below);[47]

[47] OECD Commentary para 8.15 explains the term "directly charged":
Where an individual [the worker] who is formally an employee of one enterprise [the intermediary] provides services to another enterprise [the end user], the financial arrangements made between the two enterprises will clearly be relevant, although not necessarily conclusive, for the purposes of determining whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided. For instance, if the fees charged by

[4] who puts the tools and materials necessary for the work at the individual's disposal;
[5] who determines the number and qualifications of the individuals performing the work;
[6] who has the right to select the individual who will perform the work and to terminate the contractual arrangements entered into with that individual for that purpose;
[7] who has the right to impose disciplinary sanctions related to the work of that individual;
[8] who determines the holidays and work schedule of that individual.

37.9.10 *OECD examples*

The OECD Commentary gives 6 examples.[48] I consider these in the following order:

Eg no.	Facts	STBV relief	Residence State	Work State
1	Training co provides trainer	Yes	Aco	Bco
2	Group co provides market strategist	Yes	Cco	Dco
6	Group co provides HR manager	Yes	Eco	Fco

the enterprise that formally employs the individual
[1] represent the remuneration, employment benefits and other employment costs of that individual for the services that he provided to the other enterprise,
[2] with no profit element or with a profit element that is computed as a percentage of that remuneration, benefits and other employment costs,
this would be indicative that the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided.
That should not be considered to be the case, however,
[1] if the fee charged for the services bears no relationship to the remuneration of the individual or
[2] if that remuneration is only one of many factors taken into account in the fee charged for what is really a contract for services (e.g. where a consulting firm charges a client on the basis of an hourly fee for the time spent by one of its employees to perform a particular contract and that fee takes account of the various costs of the enterprise),
provided that this is in conformity with the arm's length principle if the two enterprises are associated.
It is important to note, however, that the question of whether the remuneration of the individual is directly charged by the formal employer to the enterprise to which the services are provided is only one of the subsidiary factors that are relevant in determining whether services rendered by that individual may properly be regarded by a State as rendered in an employment relationship rather than as under a contract for services concluded between two enterprises.

[48] See too the Australian version of the examples in TR 2013/1EC.

		Form	*Substance*		
3	Group co provides receptionist	Yes	No	Gco	Hco
4	Agency engineer	Yes	No	Ico	Jco
5	Engineering co provides engineer	Yes	No	Kco	Lco

We start with 3 cases (no. 1, 2 and 6) where labour hire arrangements are effective, ie the effective employer is the intermediary, not the end user:

> 8.16 **Example 1 [**Training co provides trainer**]**:
> Aco, a company resident of State A, concludes a contract with Bco, a company resident of State B, for the provision of training services. Aco is specialised in training people in the use of various computer software and Bco wishes to train its personnel to use recently acquired software. X, an employee of Aco who is a resident of State A, is sent to Bco's offices in State B to provide training courses as part of the contract.

The OECD analysis is as follows:

> 8.17 In that case, State B could not argue
> [1] that X is in an employment relationship with Bco or
> [2] that Aco is not the employer of X for purposes of the convention between States A and B.
> X is formally an employee of Aco whose own services, when viewed in light of the factors in paragraphs 8.13 and 8.14, form an integral part of the business activities of Aco. The services that he renders to Bco are rendered on behalf of Aco under the contract concluded between the two enterprises. Thus, provided that X is not present in State B for more than 183 days during any relevant twelve month period and that Aco does not have in State B a permanent establishment which bears the cost of X's remuneration, the exception of [art 15(2) STBV relief] will apply to X's remuneration.

That seems straightforward.

The next two examples concern company groups:

> 8.18 **Example 2**:[Group co provides marketing strategist]
> Cco, a company resident of State C, is the parent company of a group of companies that includes Dco, a company resident of State D.
> Cco has developed a new worldwide marketing strategy for the products of the group. In order to ensure that the strategy is well understood and followed by Dco, which sells the group's products, Cco sends X, one of its employees who has worked on the development of the strategy, to work in Dco's headquarters for four months in order to advise Dco with respect to its marketing and to ensure that Dco's communications department understands and complies with the worldwide marketing

> strategy.

The OECD analysis is as follows:

> 8.19 In that case, Cco's business includes the management of the worldwide marketing activities of the group and X's own services are an integral part of that business activity. While it could be argued that an employee could have been easily hired by Dco to perform the function of advising the company with respect to its marketing, it is clear that such function is frequently performed by a consultant, especially where specialised knowledge is required for a relatively short period of time. Also, the function of monitoring the compliance with the group's worldwide marketing strategy belongs to the business of Cco rather than to that of Dco. The exception of [art 15(2) STBV] should therefore apply provided that the other conditions for that exception are satisfied.
>
> 8.26 **Example 6**: [Group co provides HR manager]
> Kco, a company resident of State K, and Lco, a company resident of State L, are part of the same multinational group of companies. A large part of the activities of that group are structured along function lines, which requires employees of different companies of the group to work together under the supervision of managers who are located in different States and employed by other companies of the group.
> X is a resident of State K employed by Kco; she is a senior manager in charge of supervising human resources functions within the multinational group. Since X is employed by Kco, Kco acts as a cost centre for the human resource costs of the group; periodically, these costs are charged out to each of the companies of the group on the basis of a formula that takes account of various factors such as the number of employees of each company. X is required to travel frequently to other States where other companies of the group have their offices. During the last year, X spent three months in State L in order to deal with human resources issues at Lco.

The OECD analysis is as follows:

> 8.27 In that case, the work performed by X is part of the activities that Kco performs for its multinational group. These activities, like other activities such as corporate communication, strategy, finance and tax, treasury, information management and legal support, are often centralised within a large group of companies. The work that X performs is thus an integral part of the business of Kco. The exception of paragraph 2 of Article 15 [STBV] should therefore apply to the

> remuneration derived by X for her work in State L provided that the other conditions for that exception are satisfied.

Note that in example 2, marketing services are "frequently performed by a consultant" and in example 6, HR is "often centralised within a large group of companies."[49] There is a normative test lurking here; labour-hire arrangements which are regarded as standard practice within company groups are acceptable.

I turn to consider the 3 OECD examples of labour-hire arrangements where the intermediary is the formal employer, but the end user is the effective employer. These are examples no. 3, 4 and 5:

> 8.20 **Example 3** [Group co provides receptionist]
> A multinational owns and operates hotels worldwide through a number of subsidiaries.
> Eco, one of these subsidiaries, is a resident of State E where it owns and operates a hotel. X is an employee of Eco who works in this hotel.
> Fco, another subsidiary of the group, owns and operates a hotel in State F where there is a shortage of employees with foreign language skills. For that reason, X is sent to work for five months at the reception desk of Fco's hotel. Fco pays the travel expenses of X,[50] who remains formally employed and paid by Eco, and pays Eco a management fee based on X's remuneration, social contributions and other employment benefits for the relevant period.

The OECD analysis is as follows:

> 8.21 In that case, working at the reception desk of the hotel in State F, when examined in light of the factors in paragraphs 8.13 and 8.14, may be viewed as forming an integral part of Fco's business of operating that hotel rather than of Eco's business. Under the approach described above, *if*, under the domestic law of State F, the services of X are considered to have been rendered to Fco in an employment relationship, State F could then logically consider that Fco is the employer of X and the exception of paragraph 2 of Article 15 [STBV] would not apply.
>
> 8.22 **Example 4** [Agency provides engineer]
> Gco is a company resident of State G. It carries on the business of filling temporary business needs for highly specialised personnel.

[49] Is this in fact correct? and would it need to be proved by evidence to a tribunal, or would a tribunal be expected to know what is normal for international groups?

[50] Author's footnote: The analysis would not be different if Eco pays the travel expenses.

> Hco is a company resident of State H which provides engineering services on building sites. In order to complete one of its contracts in State H, Hco needs an engineer for a period of five months. It contacts Gco for that purpose. Gco recruits X, an engineer resident of State X, and hires him under a five month employment contract. Under a separate contract between Gco and Hco, Gco agrees to provide the services of X to Hco during that period. Under these contracts, Gco will pay X's remuneration, social contributions, travel expenses and other employment benefits and charges.

The OECD analysis is as follows:

> 8.23 In that case, X provides engineering services while Gco is in the business of filling short-term business needs. By their nature the services rendered by X are not an integral part of the business activities of his formal employer. These services are, however, an integral part of the business activities of Hco, an engineering firm. In light of the factors in paragraphs 8.13 and 8.14, State H *could* therefore consider that, under the approach described above, the exception of paragraph 2 of Article 15 [STBV] would not apply with respect to the remuneration for the services of the engineer that will be rendered in that State.
>
> 8.24 **Example 5**: [Engineering co provides engineer]
> Ico is a company resident of State I specialised in providing engineering services. Ico employs a number of engineers on a full time basis.
> Jco, a smaller engineering firm resident of State J, needs the temporary services of an engineer to complete a contract on a construction site in State J. Ico agrees with Jco that one of Ico's engineers, who is a resident of State I momentarily not assigned to any contract concluded by Ico, will work for four months on Jco's contract under the direct supervision and control of one of Jco's senior engineers. Jco will pay Ico an amount equal to the remuneration, social contributions, travel expenses and other employment benefits of that engineer for the relevant period, together with a 5% commission. Jco also agrees to indemnify Ico for any eventual claims related to the engineer's work during that period of time.

The OECD analysis is as follows:

> 8.25 In that case, even if Ico is in the business of providing engineering services, it is clear that the work performed by the engineer on the construction site in State J is performed on behalf of Jco rather than Ico. The direct supervision and control exercised by Jco over the work of the engineer, the fact that Jco takes over the responsibility for that work and

> that it bears the cost of the remuneration of the engineer for the relevant period are factors that could support the conclusion that the engineer is in an employment relationship with Jco. Under the approach described above, State J *could* therefore consider that the exception of paragraph 2 of Article 15 [STBV] would not apply with respect to the remuneration for the services of the engineer that will be rendered in that State.

In these 3 cases, OECD do not say that the end user *is* the employer. They say that the work State *could* consider the end user to be an employer, *if* it is a substance-over-form State. (The emphasis has been added to make the point.) But the UK is a substance-over-form State.

None of the examples involve tax avoidance or abuse: they are (as far as one can tell from the facts given) commercial, non-tax motivated arrangements.

In each of the examples the intermediary (the formal employer) carried on a genuine independent enterprise, and did not lack substance; but the effective employer was the end user. The focus is on the circumstances of the individual employee.

In making the form/substance distinction, the examples do not systematically identify and review the 8 factors identified in para 8.14 of the Commentary. Most of the factors are not expressly mentioned, though in some cases one might make an inference. The focus is almost exclusively on the two key factors of integration/risk:

Example	**Trainer**	**Marketing analyst**	**Group HR manager**	**Receptionist**	**Agency Engineer**	**Surplus Engineer**
Example no	1	2	6	3	4	5
Integral part of end user business	no	no	no	yes	yes	infer yes
End user responsibility/ risk	-	-		-	-	yes
End user may instruct	-	-		-	-	yes
End user controls place of work	infer yes	infer yes	infer yes	infer yes	infer yes	infer yes
Remuneration directly charged on end user	-	-	no	yes	infer yes	yes
End user provides tools/materials	-	-	-	-	-	-
End user determines worker no/qualifications	-	-	-	-	-	-
End user may hire/fire	-	-	-	-	-	-
End user has disciplinary sanctions	-	-	-	-	-	-

End user determines holiday/work schedule	-	-	-	-	-	-
Conclusion: end user employee	no	no	no	yes if …	yes if …	yes if …

37.9.11 *Economic employer: HMRC view*

In 1995 HMRC changed its practice to adopt the 1992 Commentary’s effective employment test. Tax Bulletin 15 (1995) provides:

> [The Bulletin refers to art 15(2) (STBV relief) and continues:] In many cases, it is clear that the employer is the non resident company for whom the taxpayer was working before he or she came to the UK. In other cases, the employee may have been seconded by his or her overseas employer to work for a UK company, or the overseas employer may carry on a business of hiring out staff to other companies. A formal contract of employment remains with the overseas employer, but the employee works in the business of the UK company, which obtains the benefits and bears any risks in relation to the work undertaken by the employee. In economic terms this state of affairs is recognised by the overseas employer recharging the cost of the employee's remuneration to the UK and the UK company might be described as the "economic employer".
>
> As mentioned in paragraph 1920(b) of the Inland Revenue's recently published Double Taxation Relief manual,[51] we have in the past accepted, other than in cases involving tax avoidance, that where the employee continued to be paid by the overseas employer and had no contract of employment with the UK company, the condition that the employee's remuneration must be "paid by or on behalf of an employer" who is not resident in the UK, was met regardless of the relationship between the employee and the UK company.
>
> More recently, the question of the identity of the employer in cases like these has been the subject of guidance in the 1992 and 1994 Editions of the Commentary on the OECD Model Double Taxation Convention. The Commentary concludes that the context of the provision concerning exemption for short stay employees requires that it is the "economic employer", and not the formal employer, who should be considered as the employer for the purposes of applying the provision.
>
> The UK is a member country of the OECD and the terms of modem UK

[51] I expect this refers to the text now in DT1922, see 37.11 (Labour-hire: Avoidance motive).

> double taxation agreements, including the condition concerning payment of remuneration, are based on the OECD Model Convention. The Revenue seeks, as far as possible, to apply double taxation agreements consistently with the guidance in the Commentary on the Model Convention. Consequently, the Revenue now intends to take an approach consistent with the guidance in the Commentary on the Model Convention in cases where remuneration is paid by a non-resident but the cost of that remuneration is borne by an "economic employer" in the UK. Inspectors dealing with claims to exemption from employees who commenced a work assignment in the UK after I July 1995 and with all claims for 1996-97 onwards, will take into account the terms of the Commentary on the OECD Model Convention. They will not accept claims where the cost of an employee's remuneration is borne by a UK company which acts as the "economic employer".[52]

This made sense in the light of the 1992 Commentary, which adopted an effective employment rule and did not offer any alternative.

The 2010 Commentary recognised that some States did not adopt this rule;[53] but HMRC practice has not changed.[54]

There is some support for this in *Kljun v HMRC.*[55] For a number of reasons, the authority of the case is quite weak. HMRC were not represented by Counsel, and the taxpayer was not represented at all. This was a case where the individual did not pay tax in the residence State and the Tribunal seems to have regarded that as significant.[56] More fundamentally, the treaty in point was in non-OECD model form, best seen in comparison with the OECD Model form:

[52] HMRC adopted the view that changes in the Commentary affect existing as well as future treaties; see 107.11.2 (Post-DTA Commentary changes).

[53] See 37.9.4 (2010 Commentary).

[54] See the STBV consultation paper which states that STBV relief does not apply where the individual is "legally employed by a UK resident employer, but economically employed by a separate non-resident entity".
https://www.gov.uk/government/consultations/tax-and-administrative-treatment-of-short-term-business-visitors-from-overseas-branches para 1.5, 3.7.
Similarly PAYE Manual:

> **82000 PAYE operation: international employments: EP appendix 4: criteria for short term business visitors** [Jun 2020]: “the OECD commentary provides examples of situations where the UK Company would not be regarded as the economic employer and treaty exemption may therefore apply”.

[55] [2011] UKFTT 371 (TC). The name is pronounced *Kleón.*

[56] Though that is considered to be wrong; see 107.6 (Double non-taxation).

Art 15(2)(b) Yugoslavia DTA (1981)	Art 15(2)(b) OECD Model
the remuneration is paid by, or on behalf of, a person to whom, or for whose benefit, the relevant dependent personal services are rendered and who is not a resident of the other State;	the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State

The Yugoslavia treaty wording (which is unusual)[57] is wider. But the Tribunal considered that made no difference:

> The Tribunal finds that "person" is capable of wider interpretation than "employer" but the test for paragraph 2(b) is essentially the same insofar as the entity which receives the economic benefit of the Appellant's work requires to be identified and therefore the Commentaries are of assistance.[58]

Lastly, the case concerned years before the 2010 changes to the Model Commentary and (though argued after the 2010 changes) did not refer to them. The reference was to the 1992 form of the Commentary.[59]

Still, it is clear that the Tribunal fully accepted that "employer" in the context of STBV relief meant the economic employer. On the facts it was reasonably clear that the UK end user was the economic employer, and so the claim to STBV relief was refused.

37.9.12 *Basis of HMRC view*

The point could be argued, but it is considered that a Court is likely to approve of HMRC's approach. If UK employment law does not have an effective employment test, as argued above, this entails the conclusion that DTA employer is different from the employer as determined by UK domestic employment law.

One could simply say that treaty-employment has an autonomous meaning,[60] but that is not supported by the 2010 Commentary which

[57] This wording now survives only in what is left of the Yugoslavia treaty, which applies in Serbia.

[58] *Kljun* at [17].

[59] See at [22] citing the text of the 1992 version of the Commentary. The treaty in point was made before the change to the Commentary; but this aspect was not noticed, or if noticed, was not considered worth mentioning.

[60] Dziurdz, "Article 15 of the OECD Model: The 183-day rule and the meaning of "employer" [2013] BTR 95.

states that domestic tax law meanings apply.

I think the best argument in support this view is that the UK tax code offers (at least) two definitions of employer:

- The standard ITEPA definition[61]
- PAYE definition[62]

The PAYE definition effectively includes an economic employer. But given the variety of UK tax definitions, the way is easy to say that the default rule (undefined treaty terms have UK tax meanings) does not have much strength, and the context supports an effective employer approach.

37.9.13 *Practice in Australia*

This is also consistent with the practice in Australia which adopts an effective employment test. The Australian Revenue comment:

> Even though ... an employment contract is not to be implied lightly, the substance over form approach may lead to a conclusion that an entity other than the party specified in the written contract of employment should be regarded as the employer for the purposes of the short-term visit exception where:
>
> [1] the conduct of the parties is not consistent with the terms of the written contract of employment or another contract with a third party... or
>
> [2] under the contractual terms, the true nature of the relationship(s) between the parties are misrepresented or disguised.[63]
>
> 85. The terms and conditions of the contract, whether express or implied, are of considerable importance to the proper characterisation of the relationship.
>
> 86. However, the parties cannot deem the relationship between themselves to be something that it is not. The parties to an agreement cannot alter the true substance of the relationship by simply giving it a different label...

[1] and [2] may fall under what OECD Commentary calls “manipulation”.[64]

The Australian Revenue discuss the issue at some length. I set out here

[61] See 34.3 (Employment/employer/employee).

[62] See 36.3 (Employment/employer/employee); 36.5 (Employee works for non-employer).

[63] Author’s footnote: Points [1] and [2] appear to amount to the same thing.

[64] See 29.9.4 (2010 Commentary).

the main part, though the whole of it is worth study:

88. In *Damevski*, the Federal Court found that a worker remained an employee despite his employer's attempt to end the employment relationship and deal with the employee as a contractor through a labour hire agency. In this case, the interposition of the labour hire agency was not genuine. The true nature of the relationship was that the worker remained an employee of his putative former employer because the labour hire agency did nothing more than pay his wages, while the putative former employer continued to direct the employee

89. In some circumstances, an intermediary firm may perform an agency role to bring about a contractual relationship between the worker and the end user. In this case, the worker will be an employee of the user enterprise, not the intermediary. However, the manner in which the relationship is described is not conclusive of the nature of the legal relationship between the parties. In *Swift Placements*, the Industrial Relations Commission rejected the argument that the relationship between Swift Placements and the worker was one of agency, notwithstanding that the business of Swift Placements was described as an employment agency.

Key indicators of employment relationship

90. While the factors discussed below are key indicators of whether an individual is an employee or independent contractor at common law, they are also relevant in determining who should be regarded as the employer for the purposes of the short term visit exception.

91. No one factor is determinative and not all factors will be relevant in a particular case...

Control

92. An important factor to consider is the degree of control which an enterprise engaging an individual to perform work has over that individual in terms of what, how and where work is to be done...

93. However, the importance of control lies in the right of the employer to exercise it, rather than its actual exercise, even though the actual exercise can still be relevant...

96. ... it is the ultimate or legal control over the individual non-resident which is most relevant, rather than practical control.

97. Ultimate control would, amongst other things, enable the relevant entity to withdraw the worker from an assignment and terminate the contract with the worker.

98. However, specifying in detail how contracted services are to be performed does not of itself necessarily imply an employment relationship.

99. Similarly, in international labour hire arrangements, it will not necessarily be inferred that the user enterprise is the employer for the purposes of the short-term visit exception merely because the user enterprise exercises practical control over the individual by having the work performed at the premises of the

user enterprise and under their direction...

Integration

101. It is relevant to consider the nature of the services rendered by the individual and whether they are an integral part of the business activities carried on by the enterprise to which the services are provided.

102. ... the distinction between an employee and independent contractor is 'rooted fundamentally in the difference between a person who serves his employer in his, the employer's business, and a person who carries on a trade or business of his own.'...

104. Where the facts indicate that individuals are not working on their own account, this points to the relationship being one of employment.

105. Furthermore, Mason J in *Stevens v. Brodribb* described the relevance of the integration test:

> ....For my part I am unable to accept that the organization test could result in an affirmative finding that the contract is one of service when the control test either on its own or with other indicia yields the conclusion that it is a contract for services. Of the two concepts, legal authority to control is the more relevant and the more cogent in determining the nature of the relationship.

106. In relation to international labour hire arrangements, it will not necessarily be inferred that the user enterprise is the employer for the purposes of the short-term visit exception merely because the work is being performed for the benefit of the user enterprise rather than the intermediary...

107. Accordingly, a non-resident individual engaged by an intermediary may be directed to work for the benefit of the user enterprise without the user enterprise becoming the employer for the purposes of the short-term visit exception.

Remuneration

108. The identity of the entity paying remuneration to an employee for their work is a factor to consider in determining the identity of the employer...

110. However ...payment of wages by a third party, or .. an 'intermediary', is not fatal to the existence of a contract of employment between a worker and a putative employer.

111. The identity of the entity that determines the amount of the remuneration will also be relevant...

Terms of engagement

112. ... the actual terms and terminology in the contract will be of considerable importance to the proper characterisation of the relationship between the parties, particularly where the criteria are balanced. ...

113. However, how the arrangement between the parties is labelled in a written contract is not conclusive of the nature of the legal relationship...

114. Terms of engagement also refers to such matters as length of assignment and the relevant role of the worker, rates of pay, workers compensation insurance, deduction of PAYG, superannuation contributions and other employee benefits.

Risk

115. A key consideration of whether there is an employment relationship is who bears the responsibility or risk for the individual's work...

Results

118. The notion of 'payment for result' is a strong (but not conclusive) indication that the contract is one for services, rather than of service. ... Undertaking the production of a given result has been considered to be a mark, if not the mark, of an independent contractor...

119. However, this notion is not necessarily inconsistent with a contract of service. ..

120. To the extent such a contract involves an employment relationship, who determines the results to be achieved is a factor to take into account in determining the identity of the employer.

Provision of tools and equipment and payment of business expenses

121. The provision of assets, equipment and tools and the incurring of expenses and other overheads by an individual have been held to be an indicator that the individual is an independent contractor.

122. However, the provision of necessary tools and equipment is not necessarily inconsistent with an employment relationship. ...

Delegation

124. The power to delegate or subcontract (in the sense of the capacity to engage others to do the work, or parts of the work) is a significant factor to determine whether a worker is an employee or an independent contractor. For example, if a worker is required contractually to perform work personally, then this is an indication that the worker is an employee.

125. In international labour hire arrangements, the power of delegation may be relevant in determining the nature of the relationship between the intermediary and the worker. The contract between the labour hire agency and the worker in most cases would require the worker to perform the relevant work for the client themselves with no ability to delegate the work to others...[65]

The assumption here is that the well established criteria which determine whether a contract is one of employment/self-employment can also be used to identify where there is clearly an employment, and the question is which of two competing parties are the employer. But the questions are

[65] TR 2013/1EC; footnotes omitted.

entirely distinct. If that is right the definition of employer proposed in this passage is not the domestic (in this case, Australian) employment law definition. But that does not matter if the treaty term has an autonomous meaning under which the DTA-employer may be different from the domestic-law employer.

37.9.14 *Hybrid employment/enterprise*

The OECD Commentary continues:

> This approach ensures that relief of double taxation will be provided in the State of residence of the individual even if that State does not, under its own domestic law, consider that there is an employment relationship between the individual and the enterprise to which the services are provided.

This is considering a hybrid employment/enterprise, ie an activity which is categorised as
(1) an employment in the work State
(2) an enterprise (in UK tax terms, a trade) in the residence State.

> Indeed, as long as
> [1] the State of residence acknowledges that the concept of employment in the domestic tax law of the State of source or
> [2] the existence of arrangements that constitute an abuse of the Convention allows that State to tax the employment income of an individual in accordance with the Convention,
> it [the residence State] must grant relief for double taxation pursuant to the obligations incorporated in Articles 23 A and 23 B [foreign tax credit relief] (see paragraphs 32.1 to 32.7 of the Commentary on these Articles).[66]
> The mutual agreement procedure provided by paragraph 1 of Article 25 will be available to address cases where the State of residence does not agree that the other State has correctly applied the approach described above and, therefore, does not consider that the other State has taxed the relevant income in accordance with the Convention.

It is possible that the residence and work States may agree there is an employment but take different views as to who is the employer:

[66] See 111.9 (Tax in accordance with DTA).

Work state				**Residence State**		
Approach	*Employer is*	*STBV relief*	*Source State tax*	*Approach*	*Employer is*	*Residence State tax*
Form over substance	Intermediary	Yes	No	Substance over form	End user	Yes
Substance over form	End user	No	Yes	Form over substance	Intermediary	Yes

In the second case, the income is taxable in both states; but there should not be double taxation, as the residence State should give credit for work State tax.

37.10 DTA 60-day rule

Tax Bulletin 68 provides:

> **Non-Residents Working In The UK For Short Periods: The "60-Day" Rule**
> ... [Tax Bulletin 25 stated] that the Inland Revenue would not consider that a short term business visitor was sufficiently integrated into the business of a UK company for it to be regarded as the employer where:
> [1] the employee concerned is in the UK for less than 60 days in a tax year; and
> [2] that period does not form part of a more substantial period when the taxpayer is present in the UK.
> This has become known as the "60-day rule".

I refer to this as the **"DTA 60-day rule"**.

The point is that if the conditions of the DTA 60-day rule are met, HMRC will accept that the formal (foreign) employer is the employer, and the UK company is not the effective employer, for the purposes of the STBV payment conditions, so the conditions for STBV relief can be met.

> **Does the worker have to be from a country with which we have a full double tax agreement for the 60-day rule to apply?**
> The 60-day rule is framed in terms of accepting without enquiry that the conditions in a DTA for short-term business visitors to be solely taxed in their country of residence have been satisfied. That exemption, and consequently the 60 day rule, is therefore only relevant if the person is resident in a country with which we have signed a comprehensive double tax agreement. If not, domestic legislation will apply in full.

Obviously.

> **Is the 60-day exemption available if the employee is on the UK payroll?**
> No. The FST's statement was made in the context of workers who were

> paid via a non-resident employer's payroll but whose economic employer might be in the UK.

"On the UK payroll" is layman's language. In legal terms, it is here assumed to mean (1) the worker is an employee of the UK company, and (2) the UK company pays the remuneration. On that basis the answer is self-evident.

37.10.1 *How to count 60 days*

The question is whether the employee "is in the UK for less than 60 days in a tax year". Tax Bulletin 68 provides:

> **How do you count the days for the 60-day rule?**
> It is based on physical presence in the UK in the same way as the 183 days are counted for the purposes of Article 15(2) of the OECD model Tax Convention.[67]

The test is days of presence, not just workdays.

37.10.2 *Position if 60 days exceeded*

Tax Bulletin 68 provides:

> **Is the 60 days a fixed limit? For example, an employer has a succession of people who work for him and he bears their wages, but they may be in the UK up to 90 days.**
> The 60-day rule represents a balance between a loss of tax revenue which may be due to the UK and the compliance costs to both employers and the Revenue of ascertaining and collecting such tax for very short-term visitors. There are no plans for it to be altered. However individuals working in the UK may be exempt under the relevant DTA anyway, for example if their earnings are
> [1] paid by an overseas company,
> [2] not recharged in any form to [ie, reimbursed by] a UK company or permanent establishment[68] and
> [3] no UK company acts as their employer.

37.10.3 *60-day rule for PE*

Tax Bulletin 68 provides:

[67] See 37.13 (STBV condition a: 183-day rule).

[68] See 37.8.1 ("Ultimately bourne").

> **Is the 60-day rule available where the earnings have been recharged [ie reimbursed] to a UK permanent establishment rather than a UK-resident company?**
> Although not covered in the actual wording of the 1996 statement, the Revenue accepts the 60-day rule should apply in these circumstances also.

37.10.4 *Part of substantial period*

The requirement is that:

[1] The employee is in the UK for less than 60 days in a tax year; and

[2] That period does not "form part of a more substantial period" when the taxpayer is present in the UK.

Tax Bulletin 68 provides:

> **How should the phrase "part of a more substantial period" be interpreted?**
> The aim is to provide consistency:
>
> - Between very short-term workers, regardless of the particular dates involved; and
> - Between short-term workers seconded from overseas and the normal workforce of the UK employer.
>
> The most obvious example met is where less than 60 days are worked up to 5th April and less than 60 days after, but the overall period is more than 60 days. In these circumstances, the 60-day exemption will not be available, to be consistent with periods of more than 60 days worked over, say, November to January.
>
> **What if there is a gap between two shorter periods of employment?**
> To consider whether the 60-day period has been exceeded, the following factors may be relevant:
>
> - Is there an expectation that the employee will return to the UK when they depart initially?
> - How long is the gap between visits in comparison to the length of those visits?
> - How frequently does the employee return to the UK?
> - How integral to the business are the duties performed?
>
> It is impossible to give an exact formula that will cover all circumstances. However, the following examples should assist in seeing how the Revenue will approach this question.

HMRC give 5 examples. In outline:

Number: Facts	**Part of substantial period**
1a: 35 UK days Feb/Mar; short holiday; + 40 days Apr/May (planned)	Yes
1b: as 1a, but no plan to return in Apr/May	Yes but from April only
2: 35 UK days year 1; 7 month gap; 40 UK days year 2 (unplanned)	No
3: Financial controller works 55-59 UK days p/a (planned)	Yes
4: 50 UK days in year 1; 15 UK days in year 2	Yes but for year 2 only

> **Example 1 (Alain)**
> **A visits the UK for 35 days in Feb/March 2003, then returns to Austria for a fortnight's holiday, and returns again to the same contract for 40 days in April/May.**
> The 75 days would be regarded as one period. The gap here is insignificant compared to the two periods either side and liability to UK tax would be consistent with a person who works for 75 days here continuously. As the periods are part of the same contract, the employer would be expected to operate PAYE from day one.

That is an easy example. Perhaps the point is to introduce the next example:

> [**Example 1(b)**] If there had been no expectation of returning during the first 35 days we would expect PAYE to be operated only for the second period even though liability to UK tax would exist for both for A. This is because the 60 days is an objective test whilst PAYE is based on "reasonable expectation" that payments are liable to UK tax.[69]

> **Example 2 (Beatrice)**
> **B visits the UK for 35 days in Year 1. She returns to Belgium but unexpectedly is asked to return in Year 2, after a 7 month gap, and does so for 40 days.**
> Each episode in the UK would be regarded as separate periods of less than 60 days. B's return was unexpected, and after a relatively long gap. So there is no UK liability for either and no PAYE is due.

That is an easy example.

> **Example 3 (Cedric)**
> **C is the financial controller for a Canadian group. Each year he visits the UK subsidiary for 55-59 days.**
> Once there is an expectation that this will be the work pattern, the Revenue would consider that the episodes of work here were part of a more substantial period. A financial controller will be significantly integrated into the business, whether this is of the UK subsidiary or possibly a permanent establishment of the parent company. PAYE will

[69] See 36.13.3 (Terms of EP App 4 agreement).

> apply from when it is clear that visits will recur as part of a regular and integrated pattern, although C may have to consider whether he is also liable under self assessment to UK tax for an earlier period of work, as for A in Example 1.[70]

That is not self-evident. But for the purposes of the DTA 60-day rule, the requirement that the 60-days does not form "part of a more substantial period" has to be understood in the light of HMRC's explanation.

What if C's work pattern was less that 55-59 days? It is suggested that if it was less than 20 days, so it would need 4 years to reach the 60 day cap, it does not form part of a more substantial period. The same might apply if it was less than 30 days (requiring 3 years to pass the 60 day cap).

> **Example 4 (Danielle)**
> **D spends 50 days working in UK between 10 April and 15 January, with visits averaging 3 days each. Then from 1 June to 6 October a further 15 days are spent visiting UK for business meetings on the same piece of work.**
> [1] Although D is taxable from the very start, we would not expect either her or the company to be able to recognise this.
> [2] However, the Revenue would expect PAYE to be operated in Year 2.

That is far from self-evident. On point [1] is it assumed that the 15 days in year 2 were not expected in year 1?

37.11 Labour-hire: Avoidance motive

The DTR Manual provides:

> **DT1922 Employment** [Nov 2019]
> ... Claims should not be admitted where payment by an overseas company forms part of an arrangement to avoid UK tax. PAYE Technical will advise in cases where, for example,
> [1] the overseas employer is based in a tax haven or
> [2] the employee is nominally employed by a company which exists to provide his services to the UK user of those services.
> Cases where an employment which existed prior to the employee's assignment to the UK continues during that assignment usually do not cause difficulty. Cases where the employee has taken up a new formal

[70] The passage concludes with a rhetorical flourish: "C and the group will then be able to decide the duration and timing of visits to the UK on business grounds rather than for individual tax considerations." But there is no need to pursue that.

> employment with an overseas company at the time of assignment should be reviewed critically.

An avoidance motive prevents relief under the DTA 60-day rule.

OECD Commentary provides:

> 8.1 ... While the [1992] Commentary previously dealt with cases where arrangements were structured for the main purpose of obtaining the benefits of the exception of paragraph 2 of Article 15 [STBV relief],[71] it was found that similar issues could arise in many other cases that did not involve tax-motivated transactions and the Commentary was amended to provide a more comprehensive discussion of these questions.

In cases where the requirements of the 60 day-rule are not met, the question is who is the effective employer, and avoidance as such is not necessary; though in practice where the effective employer is not the formal employer, avoidance is quite likely to be present.

37.12 STBV payment condition (c): PE

Article 15(2)(c) provides:

> 2. ... remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if ...
>
> c) the remuneration is not borne by a permanent establishment which the [non-resident] employer has in the UK [the work State].

There is no practical difference between remuneration *paid by or on behalf of*, in para (b), and remuneration *borne by,* in para (c). The thinking is that a PE (not being a legal person) cannot directly *pay* remuneration, but it can *bear* remuneration.[72]

The issues for payment condition (c) are:

(1) Does that employer have a PE in the work state, and if so

(2) does the PE bear the remuneration

See Dziurdz, "Article 15 of the OECD Model: The 183-Day Rule and the Meaning of Borne by a Permanent Establishment" Bulletin for International Taxation (2013).

[71] See 37.9.3 (1992 Commentary).

[72] See App.2.3.2 (Bear tax by deduction or otherwise).

37.12.1 *PE deduction in work State*

OECD Commentary on art 15(2) provides:

> 7. ... The phrase "borne by" must be interpreted in the light of the underlying purpose of subparagraph c) of the Article, which is to ensure that the exception provided for in [art 15(2), STBV relief] does not apply to remuneration that could give rise to a deduction, having regard to the principles of Article 7 and the nature of the remuneration, in computing the profits of a permanent establishment situated in the State in which the employment is exercised.[73]

It makes sense that a remuneration which qualifies for STBV relief should not be deductible by a PE in the work State. Although that is not stated expressly in the OECD Model, it would follow from the rule that the PE must not bear the remuneration.

> 7.1 The fact that the employer has, or has not, actually claimed a deduction for the remuneration in computing the profits attributable to the permanent establishment is not necessarily conclusive since the proper test is whether any deduction otherwise available with respect to that remuneration should be taken into account in determining the profits attributable to the permanent establishment. That test would be met, for instance, even if no amount were actually deducted as a result
> [1] of the permanent establishment being exempt from tax in the source country or
> [2] of the employer simply deciding not to claim a deduction to which he was entitled.
>
> The test would also be met where the remuneration is not deductible merely because of its nature (e.g. where the State takes the view that the issuing of shares pursuant to an employee stock-option does not give rise to a deduction) rather than because it should not be allocated to the permanent establishment.

Para (c) applies where there is a UK PE of a foreign company (the foreign company is the employer).

The DTR Manual provides:

> **DT1923 Employment** [Nov 2019]
> ... [Payment condition (c)] should be considered carefully in all cases where the employee has not apparently been assigned to work in the UK for a UK-resident company. If an employee has simply been seconded

[73] See 37.6.1 (STBV relief: Policy).

by his overseas employer to work here for a UK-resident company it will not usually be necessary to consider this condition. [Instead payment condition (b) is relevant.]
[The Manual makes some comments on what is a PE and continues] If operations in the UK are carried out through a permanent establishment, it should be assumed in the absence of evidence to the contrary that the cost of remuneration of an employee seconded to the permanent establishment is a deduction in computing the profits of the permanent establishment. This will be the normal basis of allocating costs in accordance with international tax principles. The permanent establishment should therefore be regarded as bearing the cost of that individual's remuneration unless there is evidence that the overseas Head Office continues to pay the employee and the cost is not allocated to the UK permanent establishment for UK tax purposes. A permanent establishment cannot be said to 'bear the remuneration' unless it is charged against its profits without a corresponding credit, for example by way of a management charge. In doubtful cases advice may be sought from the Inspector dealing with the accounts of the permanent establishment.
Sometimes dealing with the PAYE District may be the first contact which an overseas company has with the UK Revenue and it may not yet have been established whether or not the company has a permanent establishment in the UK. If the company has had no prior contact with the Revenue the Corporation Tax District which would have responsibility for the company (the District dealing with the area where the business premises of the company are located) should be asked to advise whether or not a permanent establishment exists in the UK (see DT1715 in cases of difficulty).

37.13 STBV condition a: 183-day rule

Article 15(2)(a) provides:

> 2. ... remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
> a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, ...

37.13.1 *The 12 month period*

OECD Commentary on art 15(2) provides:

> 4. ... The first condition is that the exemption is limited to the 183 day

period. It is further stipulated that this time period may not be exceeded "in any twelve month period commencing or ending in the fiscal year concerned". This contrasts with the 1963 Draft Convention and the 1977 Model Convention which provided that the 183 day period should not be exceeded "in the fiscal year concerned", a formulation that created difficulties where the fiscal years of the Contracting States did not coincide and which opened up opportunities in the sense that operations were sometimes organised in such a way that, for example, workers stayed in the State concerned for the last 5 ½ months of one year and the first 5½ months of the following year. The present wording of subparagraph 2 a) does away with such opportunities for tax avoidance. In applying that wording, all possible periods of twelve consecutive months must be considered, even periods which overlap others to a certain extent. For instance, if an employee

[1] is present in a State during 150 days between 1 April 01 and 31 March 02 but

[2] is present there during 210 days between 1 August 01 and 31 July 02,

the employee will have been present for a period exceeding 183 days during the second 12 month period identified above even though he did not meet the minimum presence test during the first period considered and that first period partly overlaps the second.

4.1 The reference to the "fiscal year concerned" must be interpreted as a reference to a fiscal year of the Contracting State in which a resident of the other Contracting State has exercised his employment and during which the relevant employment services have been rendered. Assume, for example,

[1] that the fiscal year of State S runs from 1 January to 31 December and

[2] that a resident of State R is present and performs employment services in State S between 1 August 00 and 28 February 01.

For the purposes of subparagraph 2 *a*), any twelve month period that begins between 1 January and 31 December 00 or ends between 1 January and 31 December 01 and that includes any part of the period of employment services would be relevant. For instance, the twelve month period of 1 August 00 to 31 July 01, which begins in the fiscal year 00 and during which the person was present in State S for more than 183 days, would include the employment services rendered in that State between 1 August and 31 December 00; similarly, the twelve month period of 1 March 00 to 28 February 01, which ends in the fiscal year 01 and during which the person was present in State S for more than 183 days, would include the employment services rendered in that State between 1 January and 28 February 01. The taxation of the remuneration

> for the relevant services need not take place in the fiscal year concerned: as explained in paragraphs 2.2 above and 12.1 below, the Article allows a State to tax the remuneration derived from employment exercised in that State in a particular year even if the remuneration for these employment services is acquired, or the tax is levied, in a different year.

37.13.2 *Present in the State*

> 5. Although various formulas have been used by Member countries to calculate the 183 day period, there is only one way which is consistent with the wording of this paragraph: the "days of physical presence" method. The application of this method is straightforward as the individual is either present in a country or he is not. The presence could also relatively easily be documented by the taxpayer when evidence is required by the tax authorities. Under this method the following days are included in the calculation: part of a day, day of arrival, day of departure and all other days spent inside the State of activity such as Saturdays and Sundays, national holidays, holidays before, during and after the activity, short breaks (training, strikes, lock-out, delays in supplies), days of sickness (unless they prevent the individual from leaving and he would have otherwise qualified for the exemption) and death or sickness in the family. However, days spent in the State of activity in transit in the course of a trip between two points outside the State of activity should be excluded from the computation. It follows from these principles that any entire day spent outside the State of activity, whether for holidays, business trips, or any other reason, should not be taken into account. A day during any part of which, however brief, the taxpayer is present in a State counts as a day of presence in that State for purposes of computing the 183 day period.

This is similar to SRT rules.

> 5.1 Days during which the taxpayer is a resident of the source State should not, however, be taken into account in the calculation. Subparagraph a) has to be read in the context of the first part of paragraph 2, which refers to "remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State", which does not apply to a person who resides and works in the same State. The words "the recipient is present", found in subparagraph a), refer to the recipient of such remuneration and, during a period of residence in the source State, a person cannot be said to be the recipient of remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State. The following examples illustrate this conclusion:

> *Example 1:*
>
> From January 01 to December 01, X lives in, and is a resident of, State S.
>
> On 1 January 02, X is hired by an employer who is a resident of State R and moves to State R where he becomes a resident.
>
> X is subsequently sent to State S by his employer from 15 to 31 March 02.
>
> In that case, X is present in State S for 292 days between 1 April 01 and 31 March 02 but since he is a resident of State S between 1 April 01 and 31 December 01, this first period is not taken into account for purposes of the calculation of the periods referred to in subparagraph a).
>
> *Example 2:*
>
> From 15 to 31 October 01, Y, a resident of State R, is present in State S to prepare the expansion in that country of the business of ACO, also a resident of State R.
>
> On 1 May 02, Y moves to State S where she becomes a resident and works as the manager of a newly created subsidiary of ACO resident of State S.
>
> In that case, Y is present in State S for 184 days between 15 October 01 and 14 October 02 but since she is a resident of State S between 1 May and 14 October 02, this last period is not taken into account for purposes of the calculation of the periods referred to in subparagraph a).

The DTR Manual provides:

> **1921 Short term visitor exemption 183 day rule** [Nov 2019]
>
> ...From 6th April 2009 onwards, when counting to 183 days under Article 15(2)(a), any part of a day, day of arrival, day of departure, and all other days spent in the UK such as Saturdays, Sundays, national holidays, holidays before during and after the period of work, short breaks (training, strikes, lock-out, delay in supplies), days of sickness (unless they prevent the individual from leaving and he would otherwise have qualified for the exemption) and death and sickness in the family should be included in the calculation as a day the person is present in the country of activity.
>
> Days spent in the UK in transit in the course of a trip between two non-UK points should be excluded from the computation.
>
> From 2008/09 onwards (this overlaps for a year with the previous day counting method), days during which the tax payer is a resident of the UK should not be included in the calculation. The conditions in the treaty are for remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State and does not apply to a person who is resident and works in the same State.

> For example if a person is a resident of the UK but is hired by an employer in another State, moves to that State where he becomes resident and is subsequently sent to work for a short period in the UK by his employer, we would only include days in the UK after the taxpayer became a resident of the other State for the purposes of computing whether they had exceeded 183 days in the UK. Days in the UK when the taxpayer was a resident of the UK should not be included.
>
> Similarly if a non-resident taxpayer is seconded to the UK for a short period by their employer and subsequently moves to and becomes a resident of the UK, days in the UK after they became a resident here should not be taken into account for the purposes of the calculation of the 183 days.

37.13.3 *183-day rule: Older version*

The DTR Manual provides:

> **1921 Short term visitor exemption 183 day rule** [Nov 2019]
>
> The first condition for exemption under Article 15(2) is that the employee must not be present in the UK for more than 183 days either
>
> [1] 'in the tax year concerned' (as in Article 15(2)(a) of the 1980 UK/USA agreement) or
>
> [2] 'in any period of 12 months' (found in Article 15(2)(a) of the 1985 UK/Norway agreement).

I refer to wording type [1] as modern wording and wording type [2] as the old wording.

The 2001 USA/UK DTA now uses the modern wording However the Manual is still relevant to DTAs which use the old wording.

> It is important to distinguish between these formulae. The latter formula is a much tighter test than that used in the agreement with the USA.
>
> For example, a US resident seconded to work in the UK for a two year assignment arrives here on 15 October 1990 and leaves the UK on 1 October 1992. Depending on all the circumstances, he could be taxable in the UK only for the year 1991-92. For the years 1990-91 and 1992-93 he could meet the condition in Article 15(2)(a) because in both periods he was not present in the UK for 183 days 'in the tax year concerned'.
>
> By contrast, a Norwegian resident working in the UK would be taxable here throughout the period 15 October 1990 to 1 October 1992 under the test in the agreement with Norway.
>
> Our agreements with Azerbaijan, Belgium, Bolivia, Denmark, Estonia, France, Ghana, Guyana, Iceland, Indonesia, Ivory Coast, Kazakhstan, Korea, Latvia, Malta, Mexico, Mongolia, Pakistan, Papua New Guinea, Sweden, Uganda, Ukraine, Uzbekistan, Venezuela and Vietnam also use

the wording of the Norwegian agreement; and the agreement with New Zealand is similar. Most of the UK's agreements, however, use the tax/fiscal year formula.

37.13.4 *Presence due to Covid*

OECD Covid guidance[74] provides:

> ***Stranded worker: exceeding days of presence threshold due to travel restrictions***
> 53. The COVID-19 pandemic has caused individuals who are resident in one jurisdiction and exercised an employment in another jurisdiction to become stranded in that other jurisdiction. Where an individual resident in one jurisdiction and exercising employment activities in another jurisdiction:
> a) is prevented from leaving that other jurisdiction by COVID-19 restrictions, and
> b)would otherwise have left that other jurisdiction and qualified for the exemption from source taxation in Article 15(2), some jurisdictions believe it is appropriate, given the exceptional circumstances, to disregard days to which these conditions apply when asserting a taxing right under the 183-day test ...
> 54. Where a person is resident in one jurisdiction and is exercising an employment in the other jurisdiction (the source jurisdiction), the source jurisdiction may tax the remuneration from the employment in certain circumstances –one of which is where the employee is present in the source jurisdiction for more than 183 days. Paragraph 5 of the Commentary on Article 15 explains that all days of presence count (working days or not) –and provides several examples, one of which is "days of sickness". But it contains an exception: if those days of sickness "prevent the individual from leaving and he would have otherwise qualified for the exemption", they do not count towards the days of presence test in Article 15(2)(a).
> 55. Given the nature of the COVID-19 public health measures of many governments, the exception can be understood to apply where conditions (a) and (b) above are satisfied. This may cover situations where an employee is prevented from travelling because they are in quarantine due to exposure to the COVID-19 virus. In addition, it may cover situations where either government has banned travelling and

[74] *https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic*
See 105.27.1 (OECD Covid guidance).

cases where it is, in practice, impossible to travel due, for example, to cancellation of flights. This may not cover the situation where an individual does not travel based on a mere recommendation by the governments involved to avoid unnecessary travel. Any decision to disregard days spent in a source jurisdiction as a result of COVID-19 restrictions may result in the source jurisdiction not exercising taxing rights allocated to it under the terms of a double tax treaty which it would be entitled to do.

56. In conclusion where an employee is prevented from travelling because of COVID-19 public health measures of one of the governments involved and remains in a jurisdiction, it would be reasonable for a jurisdiction to disregard the additional days spent in that jurisdiction under such circumstances for the purposes of the 183 day test in Article 15(2)(a) of the OECD Model. Some jurisdictions may however take a different approach or may have issued specific guidance outlining their approach to such ...

Special provisions in some bilateral treaties that deal with the situation of cross-border workers

57. A change of place where cross-border workers exercise their employment may also affect the application of the special provisions in some bilateral treaties that deal with the situation of cross-border workers. These provisions apply special treatment to the employment income (and in some cases replacement income such as short-time work compensation) of cross-border workers and may often contain limits on the number of days that a worker may work outside the jurisdiction they regularly works before triggering a change in their status.

58. Some jurisdictions have agreed special treaty provisions with neighbouring jurisdictions to which employees frequently commute for work. These provisions allocate the taxing rights in a different way to Article 15 of the Model Convention. For example, under some of those provisions employees commuting to a neighbouring jurisdiction are taxable on their employment income only in the home jurisdiction provided any employment activity carried on elsewhere is limited to a maximum stated period (typically ranging from 4 to 6 working weeks). Some of those treaties include provisions according to which teleworking days are considered working days within the work jurisdiction. Some jurisdictions have agreed to treat the COVID-19 pandemic as force majeure or an exceptional circumstance and, accordingly, the time spent by the employee teleworking in their home jurisdiction will not be included in the calculation of the maximum work days outside the work jurisdiction limitation for the purposes of the treaty.

HMRC say:

> the sickness is required to be that of the employee, rather than a relative or the pandemic in general.[75]

HMRC say:

> periods where an individual is forced to self-isolate will also count as days of 'sickness' for the purpose of counting 183 days. As with all exemptions/relaxations, individuals should ensure they have evidence to support any position they take.[76]

37.14 Employer foreign PE of UK co

HMRC say:

> Whereas an overseas subsidiary of a UK Company is a separate legal entity and is regarded as a 'person' within the meaning of a Double Taxation Convention, that is not the case for an overseas Branch of the UK Company. The Branch is not a separate legal entity and is not resident in the other country. It is merely part of a UK resident Company that carries out the business of the UK Company in that country.

In short, an overseas PE of a UK company is excluded from STBV relief. It is hard to see any good reason for that rule, but the position is clear.[77]

The 2018 STBV consultation paper suggested extending the relief to cover this, but the proposal was abandoned. The STBV response paper provides:

> 2.31.The government recognises that the contrasting tax treatment of STBVs from branches and subsidiaries creates different administrative obligations for some employers. However, this position is determined by the UK's double taxation treaties, which follow the OECD Model Tax Convention replicated across the globe.
> 2.32.A unilateral tax exemption on the employment income of STBVs would remove the underlying difference in tax treatment, particularly if this applied to STBVs from both branches and subsidiaries in the same

[75] Joint Expatriate Forum on Tax and NICs (Sep 2020) *https://www.gov.uk/government/groups/joint-forum-on-expatriate-tax-and-national-insurance-contributions*

[76] Joint Expatriate Forum on Tax and NICs (Dec 2020) *https://www.gov.uk/government/groups/joint-forum-on-expatriate-tax-and-national-insurance-contributions*

[77] See 106.1 (PE: Introduction).

> way.
>
> 2.33.It would also remove the obligation for UK companies to operate PAYE on the remuneration of STBVs from foreign branches. This would reduce administrative burdens and costs, and would prevent UK companies from restricting business travel to the UK. It would particularly benefit key business sectors, including financial services and asset management.
>
> 2.34.However, the UK generally has the primary taxing right under DTAs where the STBV comes from a foreign branch. A tax exemption would mean that the UK would be unilaterally giving away its taxing right and its tax revenue to foreign jurisdictions without reciprocation.
>
> 2.35.Whilst the tax exemption might make the UK a more attractive place to do business, there is little evidence to suggest that it would influence the decision of multinational businesses to headquarter in the UK.
>
> 2.36.The government must consider its wider commitments to reducing the deficit. Such a tax exemption would only benefit a relatively small number of UK businesses, but would cost many millions of pounds each year. The government thinks this does not represent good value for money. The government will continue to consider the points raised by respondents to the consultation and will keep the area under review.[78]

37.15 Employer a partnership

OECD Commentary on art 15(2) provides:

> 6.1 The application of the second condition in the case of fiscally transparent partnerships presents difficulties since such partnerships cannot qualify as a resident of a Contracting State under Article 4 ...[79] While it is clear that such a partnership could qualify as an "employer" ... the application of the condition at the level of the partnership regardless of the situation of the partners would therefore render the condition totally meaningless.
>
> 6.2 ... In order to achieve a meaningful interpretation of subparagraph b) that would accord with its context and its object,[80] it should therefore be considered that, in the case of fiscally transparent entities or arrangements such as partnerships, that subparagraph applies at the level

[78] For the consultation and response papers, see *https://www.gov.uk/government/consultations/tax-and-administrative-treatment-of-short-term-business-visitors-from-overseas-branches*

[79] See 9.22.2 (Partnership "liable to tax").

[80] See 37.6.1 (STBV relief: Policy).

> of the partners or members. Thus, the concepts of "employer" and "resident", as found in subparagraph b), are applied at the level of the partners or members rather than at the level of a fiscally transparent entity or arrangement. This approach is consistent with the approach under paragraph 2 of Article 1[81] under which the benefit of other provisions of tax conventions must be granted with respect to income that is taxed at the partners' or members' level rather than at the level of an entity or arrangement that is treated as fiscally transparent.

This raises less difficulty for English partnerships, because as a matter of English employment law, employees are employees of the partners and not of the partnership as such.

The OECD Commentary continues:

> While this interpretation could create difficulties where the partners or members reside in different States, such difficulties could be addressed through the mutual agreement procedure by determining, for example, the State in which the partners who own the majority of the interests in the entity or arrangement reside (i.e. the State in which the greatest part of the deduction will be claimed).

OTS say:

> There is a technical argument that treaty relief under Article 15 (income from employment) is not available to employees of a partnership as they could be argued not to have a non-resident employer[82]. This could mean it may be argued that a short-term secondee from another country does not qualify for treaty protection even if their remuneration is borne by the non-UK branch of the same company.[83] We understand that in practice, HMRC do sometimes accept treaty relief is available.
> ... In practice, HMRC has treated the employer as a non-UK one if the individual is under the control and instruction of non-UK resident partners.... HMRC also told us that there is no general policy of denying this exemption to employees of partnerships. Eligibility will depend on whether the employing partnership is resident outside the UK based on the residence status of the partners.[84]

[81] See 103.3.2 (OECD hybrid-entity rules).

[82] Author's footnote: More analytically, the argument is that the employer is not a "resident of the foreign state", within the meaning of the treaty.

[83] Author's footnote: This sentence is muddled, but the passage makes sense if one ignores it.

[84] OTS, "Review of partnerships: final report" (2015) para 4.30-31. *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/396*

37.16 Deemed employment/non-employment

37.16.1 *Deemed non-employment*

In *Fowler v HMRC*[85] the taxpayer was an employed diver, whose employment was exercised in the UK, and so his remuneration was in principle taxable in the UK. There is a special rule for North Sea divers: for IT purposes their employment is treated as a trade. But the deemed trade fiction did not apply for treaty purposes. I discuss this point in 107.22.1 (Deemed classification).

Section 6(5) ITEPA provides:

> Employment income is not charged to tax under this Part if it is within the charge to tax under—[86]

Section		**Topic (in outline)**
ITTOIA	*CTA 2009*	
s.15	-	Divers and diving supervisors
s.16A	-	Voluntary office with public body: compensation for incidental trading loss
s.16B	40A	Company directorship incidental to professional partnership
s.16C	40B	Office/employment incidental to professional partnership

Would the principle in *Fowler* apply to the other cases, ie those to which s.16A-16C applies? That is, would income within those cases be classified as employment income or trading income for DT purposes? The difference is that in the s.16A-16C cases, unlike *Fowler*, the individual is carrying on an actual trade/profession. The income concerned has a dual character. Sections 16A-16C merely reverse the usual priority rule that ITEPA prevails over trading income.[87] On that basis it is suggested that income within s.16A-16C should be categorised as business income for DT purposes and falls within the scope of OECD Model art 7.

The amounts involved are not likely to be substantial.

37.16.2 *Deemed employment*

What about disguised employment? Section 863A ITTOIA provides:

668/ots_partnerships_report_final.pdf

[85] [2020] UKSC 22.

[86] For clarity I have set this out in tabular form and with my own wording, rather than that in the statute.

[87] See 11A.3.9 (Trade/employment (ITEPA) income).

> (1) Subsection (2) applies at any time when conditions A to C in sections 863B to 863D are met in the case of an individual ("M") who is a member of a limited liability partnership in relation to which section 863(1) applies [ie the LLP is treated as a partnership for tax purposes].
> (2) For the purposes of the Income Tax Acts—
> (a) M is to be treated as being employed by the limited liability partnership under a contract of service instead of being a member of the partnership, and
> (b) accordingly, M's rights and duties as a member of the limited liability partnership are to be treated as rights and duties under that contract of service.

Is the income of M employment income or business income for DT purposes?

37.17 Share options

37.17.1 *Grant of share option*

Share options granted by reason of employment are in principle earnings and subject to income tax on the grant of the option.[88] For UK resident employees, s.475 ITEPA overrides that charge. That does not however apply to non-resident employees, and it is not uncommon to find non-resident employees who have taxable duties in the UK. In this case, the grant of an option falls outside of chapter 5 of part 7 ITEPA 2003 and therefore in principle subject to income tax on the grant of the option. DT relief is however likely to be available if the employee is resident in a jurisdiction with a DT relief in OECD Model form. In particular, the requirement of article 15(2)(c) is met: the remuneration is will not be borne by a permanent establishment which the employer has in the UK. For the remuneration is not borne by the company over whose shares the share option is issued. If anyone, it is the shareholders in that company who bear the burden of the remuneration.

37.17.2 *Exercise of share option*

Some gains on shares or share options are taxed as employment income. The profit (to use a neutral term) falls within the employment income article as earnings, and within the CG article as gains,[89] but some commentators take the view that the earnings article has priority and

[88] *Abbott v Philbin* 39 TC 82.

[89] See 56.23.2 (Gain subject to income tax).

excludes the CG article.[90]

The USA/UK DTA (more or less) follows OECD form. The Exchange of Notes for this treaty provides:

> With reference to Article 14 (Income from employment)—
> it is understood that any benefits, income or gains enjoyed by employees under share/stock option plans are regarded as "other similar remuneration" for the purposes of Article 14.
> It is further understood that where an employee—
>
> (a) has been granted a share/stock option in the course of an employment in one of the Contracting States;
> (b) has exercised that employment in both States during the period between grant and exercise of the option;
> (c) remains in that employment at the date of the exercise; and
> (d) under the domestic law of the Contracting States, would be taxable by both Contracting States in respect of the option gain,
>
> then, in order to avoid double taxation, a Contracting State of which, at the time of the exercise of the option, the employee is not a resident will tax only that proportion of the option gain which relates to the period or periods between the grant and the exercise of the option during which the individual has exercised the employment in that Contracting State.
> With the aim of ensuring that no unrelieved double taxation arises the competent authorities of the Contracting States will endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of Article 14 and Article 24 (Relief from double taxation) in relation to employee share/stock option plans.

37.18 DT claims & procedure

The DTR Manual provides:

> **DT1920: Employment** [May 2020]
> ... claims to exemption from UK tax in respect of employment income are made as part of the taxpayer's self assessment on the claim form attached, depending on the circumstances, to either Help Sheet IR302 (Dual-Residents) or Help Sheet IR304 (Non-Residents - Relief under Double Taxation Agreements). Both forms require the taxpayer to establish the fact of his residence in the other country for the purpose of the agreement (see INTM154000) and to declare that the relevant provisions of the particular agreement are considered to have been fulfilled. All claims under Article 15(2) should be checked carefully by

[90] See 107.9.4 (Other DTA category overlaps).

> reference to terms of the agreement and, where appropriate, to the guidance at DT1921 - DT1923, and enquiries raised in suitable cases.

The DTR Manual makes a few administrative comments:

> **DT1924 Employment** [May 2020]
> Refer to Employment Income Technical all claims to the exemption of employment income from UK tax (DT1920 onwards) where
>
> - the tax at stake in that case exceeds £50,000, or
> - the company claimed to be the employer is apparently based in a tax haven, or
> - difficulty is experienced in applying the guidance at DT1920 onwards in a particular case...

See 107.20 (Claim for DT relief).

37.19 DT relief: Directors

Article 16 OECD Model provides:

> Directors' fees and other similar payments derived [91] by a resident of a Contracting State in his capacity as a member of the board of directors of a company[92] which is a resident of the other Contracting State may be taxed in that other State.

OECD Commentary on art 16 provides:

> 1. This Article relates to remuneration received by a resident of a Contracting State, whether an individual or a legal person, in the capacity of a member of a board of directors of a company which is a resident of the other Contracting State.

The main significance of the provision is that STBV relief is not available for directors.

37.19.1 *Fees and similar payments*

OECD Commentary on art 16 provides:

> 1.1 Member countries have generally understood the term "fees and other similar payments" to include benefits in kind received by a person in that person's capacity as a member of the board of directors of a company (e.g. stock-options, the use of a residence or automobile, health or life insurance coverage and club memberships).

[91] See 15.11.1 ("Deriving" income").

[92] See 30.15.4 (Company: DTA definition).

See 37.3 (Salary/wages/remuneration).

> 2. A member of the board of directors of a company often also has other functions with the company, e.g. as ordinary employee, adviser, consultant, etc. It is clear that the Article does not apply to remuneration paid to such a person on account of such other functions.

While it is clear that a director may be an employee,[93] disentangling the duties and remuneration for the two roles is another matter. Documentation will be important, though not necessarily decisive, in determining whether a payment is made in the capacity as a director.

37.19.2 *Directors share options*

OECD Commentary on art 16 provides:

> 3.1 Many of the issues discussed under paragraphs 12 to 12.15 of the Commentary on Article 15 in relation to stock-options granted to employees will also arise in the case of stock-options granted to members of the board of directors of companies. To the extent that stock-options are granted to a resident of a Contracting State in that person's capacity as a member of the board of directors of a company which is a resident of the other State, that other State will have the right to tax the part of the stock-option benefit that constitutes director's fees or a similar payment (see paragraph 1.1 above) even if the tax is levied at a later time when the person is no longer a member of that board. While the Article applies to the benefit derived from a stock-option granted to a member of the board of directors regardless of when that benefit is taxed, there is a need to distinguish that benefit from the capital gain that may be derived from the alienation of shares acquired upon the exercise of the option. This Article, and not Article 13, will apply to any benefit derived from the option itself until it has been exercised, sold or otherwise alienated (*e.g.* upon cancellation or acquisition by the company or issuer). Once the option is exercised or alienated, however, the benefit taxable under this Article has been realised and any subsequent gain on the acquired shares (*i.e.* the value of the shares that accrues after exercise) will be derived by the member of the board of directors in his capacity of investor-shareholder and will be covered by Article 13. Indeed, it is at the time of exercise that the option, which is what the director obtained in his capacity as such, disappears and the recipient obtains the status of shareholder (and usually invests money in order to do so).

[93] *Lee v Lee's Air Farming Ltd* [1961] AC 12.

37.19.3 *Directors DT relief: Critique*

Why distinguish directors (Model art 16) from employees (art 15)? OECD Commentary provides:

> Since it might sometimes be difficult to ascertain where the services are performed, the provision treats the services as performed in the State of residence of the company.

It is no more difficult to ascertain where directors services are exercised than where employees services are exercised; and UK domestic law treats directors and employees in (more or less) the same way. But there it is. Instead we have to ascertain the meaning of director, and whether earnings are received in the capacity of director. Both questions are "sometimes be difficult to ascertain".

Perhaps the reasoning was that directors services (unlike non-director employees) are likely to be in the same State as the company. That was more likely to be the case formerly than now. There is something to be said for removing art 16, and treating directors/employees in the same way; but established treaty rules are difficult to change, and the change is not worth the trouble involved.

37.20 DT relief: Government service

Article 19 OECD Model provides:

> 1. a) Salaries, wages and other similar remuneration paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.
>   b) However, such salaries, wages and other similar remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who:
>   (i) is a national of that State; or
>   (ii) did not become a resident of that State solely for the purpose of rendering the services.
>
> 2. [This deals with pensions; see 38.8.7 (Government pension)]
>
> 3. The provisions of Articles 15, 16, 17, and 18 shall apply to salaries, wages, pensions, and other similar remuneration in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

OECD Commentary on art 19(1) provides:

> 2.2 Member countries have generally understood the term “salaries, wages and other similar remuneration ... paid” to include benefits in kind received in respect of services rendered to a State or political subdivision or local authority thereof (e.g. the use of a residence or automobile, health or life insurance coverage and club memberships).

Of course remuneration includes benefits in kind; the point is that such benefits may be said to be “paid”, ie “paid” is not construed narrowly; see 15.11.2 (“Paid” and “payment”).

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TAXATION OF NON-RESIDENTS AND FOREIGN DOMICILIARIES 2024-25

by

JAMES KESSLER KC

VOLUME FOUR

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Chapters 41 - 46 IT: General
Chapters 47 - 53 IT Avoidance Codes

TWENTY FOURTH EDITION

Key Haven Publications Ltd
P. O. Box 669, Oxford, OX3 3AU
Tel: 01865 352121
http://www.khpplc.co.uk

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38.1 Pensions & annuities: Introduction

This chapter considers:

(1) Pension income

(2) Annuity income

(3) Alimony (maintenance)

Pension taxation has a technical language of its own, and needs a book to itself. I would focus on matters closest to the themes of this work, but the subject can only be understood in the context of the provisions as a whole.

The legislation is in part 9 ITEPA. This follows the format of the charge on employment income in Part 2.[1] One might expect Part 9 to begin with a provision saying that income tax is charged on pension income. In fact this is implied rather than expressed. Section 566(1) ITEPA provides:

> **Nature of charge to tax on pension income and relevant definitions**
> (1) The charge to tax on pension income under this Part is a charge to tax on that income excluding any exempt income.

38.2 Pension income of split year

Section 575(1A) ITEPA provides:

> [a] If the person liable for the tax under this Part [Part 9 ITEPA] is an individual and the tax year is a split year as respects that individual, the taxable pension income for the tax year is the full amount of the pension income arising in the UK part of the year,
> [b] subject to
>   [i] subsection (3) [remittance basis] and
>   [ii] section 576A [temporary non-residents].

This applies to all types of pension income.

38.3 Types of pension scheme

38.3.1 *"Occupational pension scheme"*

Section 150(5) FA 2004 provides:

> In this Part "occupational pension scheme" means a pension scheme established by an employer or employers and having or capable of having effect so as to provide benefits to or in respect of any or all of the employees of—
> (a) that employer or those employers, or
> (b) any other employer, whether or not it also has or is capable of having effect so as to provide benefits to or in respect of other persons).

[1] See 34.6 (Charge on employment income) and following.

38.3.2 *"Registered pension scheme"*

Section 989 ITA provides:

> The following definitions apply for the purposes of the Income Tax Acts...

So we turn to s.150(2) FA 2004:

> A pension scheme is a registered pension scheme for the purposes of this Part at any time if it is at that time registered under Chapter 2.

38.4 s.569 UK pension

Section 569 ITEPA provides:

> (1) This section applies to any pension paid by or on behalf of a person who is in the UK.
> (2) But this section does not apply to a pension if any provision of Chapters 5 to 14 of this Part applies to it.

I refer to this as "**a s.569 UK pension**". Registered pension schemes fall within chapter 5A, rather than under this residual category.

The EI Manual provides:

> **EIM74003 UK pensions** [Nov 2019]
> ...Section 569 ITEPA 2003 charges pensions paid by or on behalf of a person in the UK. This includes pensions payable by the Crown. Section 569 does not apply to pensions charged under any other provision of Part 9 ITEPA 2003. For example, section 579A ITEPA 2003 charges pensions under registered pension schemes.
> Annuities paid by the Crown generally have the character of pensions and will therefore be chargeable to tax under section 569. See example EIM74004, which describes two payments charged by section 569.
> **Payments to residents of another country**
> The charge includes payments to people who live abroad as well as payments within the UK. Examine carefully claims for double taxation exemption or relief. These payments may be in respect of Government service and the UK usually retains primary taxing rights. ...
> **EIM74005 Pensions paid by or on behalf of a person who is in the UK** [Nov 2019]
> ...The legislation does not consider the residence status of the pensioner. If a pensioner is resident in another state it is necessary to consider the terms of the relevant double taxation treaty...

> **EIM74004 - Examples of United Kingdom pensions paid by the Crown** [Nov 2019]
> The following types of income payable by the Crown fall within the definition of pension and are therefore chargeable as UK pensions under Section 569 ITEPA 2003:
>
> - pensions paid to certain seamen under the Greenwich Hospital Act 1865
> - life annuities paid to certain farmers who have given up uncommercial holdings of land under the Agriculture Act 1967.

38.4.1 *"Pension"*

Section 570 ITEPA provides a short, inclusive, definition of "pension" for the purposes of s.569 UK pensions:

> In this Chapter "pension" includes a pension which is paid voluntarily or is capable of being discontinued.

The definition (perhaps for historical reasons) is different from the definition which applies for s.573 foreign pensions.

The EI Manual provides:

> **EIM74002 The meaning of pension and annuity** [Nov 2019]
> A pension is a periodical payment made by or on behalf of an employer, usually in recognition of past services. It may be paid either to the person who provided those services or to his or her spouse or any dependant.
> A recipient of a pension will usually be entitled to it under his or her contract of employment or under the rules of a pension scheme...
> **EIM74005 Pensions paid by or on behalf of a person who is in the UK** [Nov 2019]
> **... Voluntary pensions**
> The cases of *Benyon v Thorpe* (14 TC 1) and *Stedeford v Beloe* (16 TC 505) established the principle that pensions paid voluntarily by a former employer were not chargeable as income because they had the character of gifts. Section 570 ITEPA 2003 ensures that section 569 will apply to any pension, which is voluntary or capable of being discontinued. Isolated gifts to former employees are unlikely to be pension income but could possibly be chargeable as employment income either as general earnings or because they are in connection with the termination of the employment ...

Section 571 ITEPA provides:

> If section 569 applies, the taxable pension income for a tax year is the full amount of the pension accruing in that year irrespective of when any amount is actually paid.

Thus (as one would expect) a UK pension is taxed on an arising basis.

38.5 Foreign pension

Chapter 4 deals with foreign pensions. Section 573(1) ITEPA provides:

> This section applies to any pension paid by or on behalf of a person who is outside the UK to a person who is resident in the UK.

I refer to this as **"a s.573 foreign pension"**.

Section 573(2) ITEPA provides:

> But this section does not apply to a pension if any provision of Chapters 5 to 14 of this Part applies to it.

Chapter 10, in particular, has priority over this chapter. So in practice I expect that not many pensions fall within the s.573 category.

I do not discuss s.840 ITTOIA (relief for backdated pensions charged on arising basis).

38.5.1 *"Pension"*

Section 574 ITEPA sets out an inclusive definition of "Pension" for the taxation of s.573 foreign pensions. The definition (perhaps for historical reasons) is different from the definition which applies for UK pensions. Section 574(1) ITEPA sets out five types of foreign pension which are included in the term:

> For the purposes of this Chapter "pension" includes—
> (a) an annuity under, or purchased with sums or assets held for the purposes of, or representing acquired rights under, a relevant non-UK scheme or an overseas pension scheme,

The next three categories concern income withdrawals:

> (b) an amount paid under a relevant non-UK scheme or an overseas pension scheme which, if the scheme were a registered pension scheme, would be income withdrawal (within the meaning of paragraph 7 of Schedule 28 to FA 2004),
> (ba) an amount paid under a relevant non-UK scheme or an overseas pension scheme which, if the scheme were a registered pension scheme, would be dependants' income withdrawal or nominees'

> income withdrawal (within the meaning of paragraphs 21 and 27D of Schedule 28 to FA 2004),
>
> (bb) an amount paid under a relevant non-UK scheme or an overseas pension scheme which, if the scheme were a registered pension scheme, would be successors' income withdrawal (within the meaning of paragraph 27J of Schedule 28 to FA 2004), and
>
> (c) if conditions A and B are met, a pension which is paid voluntarily or is capable of being discontinued.

I refer to voluntary pension conditions A and B. Section 574 ITEPA then sets out those conditions:

> (2) Condition A is that the pension is paid to—
>
> (a) a former employee or a former office-holder,
>
> (b) the widow or widower or surviving civil partner of a former employee or a former office-holder, or
>
> (c) any child, relative or dependant of a former employee or a former office-holder.
>
> (3) Condition B is that the pension is paid by or on behalf of—
>
> (a) the person—
>
> (i) who employed the former employee, or
>
> (ii) under whom the former office-holder held the office, or
>
> (b) the successors of that person.

Section 574(4) sets out supplemental definitions:

> In this section—
>
> "office" includes in particular any position which has an existence independent of the person who holds it and may be filled by successive holders;[2]
>
> "overseas pension scheme" has the same meaning as in Part 4 of FA 2004 (see section 150(7) of that Act);
>
> "relevant non-UK scheme" is to be read in accordance with paragraph 1(5) of Schedule 34 to FA 2004.

Section 575(1) ITEPA provides:

> If section 573 applies, the taxable pension income for a tax year is the full amount of the pension income arising in the tax year, but subject to
> [a] subsections (1A)[split years] and
> [b] [subsection] (3) [remittance basis].

[2] This is the standard form definition: see 34.3.1 (Offices).

The FA 2017 removed the 10% deduction formerly allowable from foreign pensions, a reform which this book had advocated for many years.

38.5.2 *Remittance basis*

Section 575(3) ITEPA provides:

> The full amount of the pension income arising in the tax year, or (as the case may be) the UK part of the tax year, is treated as relevant foreign income for the purposes of Chapters 2 and 3 of Part 8 of ITTOIA 2005 (relevant foreign income: remittance basis and deductions and reliefs).

The significance of treating the income as RFI is that the foreign pension income can qualify for the remittance basis.

38.6 Employment-related pension

38.6.1 *Annuity for dependants*

Section 609 ITEPA provides:

> (1) This section applies to any annuity which was granted for consideration consisting in whole or in part of sums—
> (a) which, in the tax year 2012-13 or an earlier tax year, satisfied the conditions for relief under section 273 of ICTA or section 459 of ITA 2007 (obligatory contributions to secure an annuity for the benefit of dependants), or
> (b) which fall within subsection (3).
> (2) But this section applies to an annuity which arises from a source outside the United Kingdom only if it is paid to a person resident in the United Kingdom.
> (3) A sum falls within this subsection if—
> (a) in the tax year 2013-14 or a later tax year, the sum is paid by an individual, or is deducted from an individual's earnings,[3] under an Act or the individual's terms and conditions of employment,
> (b) the sum is for the purpose of—
> (i) securing a deferred annuity after the individual's death for the individual's surviving spouse or civil partner, or
> (ii) making provision after the individual's death for the individual's children, and
> (c) the individual—

[3] Defined by reference in s.609(5): "In subsection (3)(a) "earnings" has the meaning given by section 62."

> (i) is UK resident for the tax year in which the sum is paid or deducted, or
> (ii) at any time in that tax year, falls within any of paragraphs (a) to (f) of section 460(3) of ITA 2007 (matters relating to residence).[4]

38.6.2 *Non-registered occupational pension scheme annuity*

Section 610 ITEPA provides:

> (1) This section applies to—
> (a) any annuity paid under an occupational pension scheme[5] that is not a registered pension scheme, and
> (b) any annuity acquired using funds held for the purposes of such an occupational pension scheme.
> (2) But this section applies to an annuity which arises from a source outside the United Kingdom only if it is paid to a person resident in the United Kingdom.

Section 610(3) deals with an overlap of pension schemes:

> (3) This section does not apply to an annuity to which Chapter 5A of this Part applies.

Section 610 originally referred to a sponsored superannuation scheme; and s.610(3) originally provided:

> This section does not apply to an annuity to which any provision of Chapter 6, 7, 8 or 9 of this Part applies.

EN ITEPA provides:

> 2434. Subsection (3) ensures there is no overlap with other sections in the pension income Part. The definition of "sponsored superannuation scheme" in section 624(1) of ICTA predates the introduction of approved retirement benefits schemes in Chapter 1 of Part 14 of ICTA. An approved retirement benefits scheme is likely to be within the

[4] Section 609(4) provides: "Subsection (3)(a) does not cover contributions paid by a person under—
(a) Part 1 of the Social Security Contributions and Benefits Act 1992, or
(b) Part 1 of the Social Security Contributions and Benefits (Northern Ireland) Act 1992."

[5] Section 610(4) ITEPA provides a referential definition: "In this section "occupational pension scheme" has the same meaning as in Part 4 of FA 2004 (see section 150(5) of that Act)."

definition of "sponsored superannuation scheme". In ICTA an annuity paid by an approved retirement benefits scheme is taxed under Schedule E. The annuities identified in this section are taxed under Schedule D. A Schedule E charge takes priority over a Schedule D charge. This subsection preserves that order of priority.

38.6.3 *Annuity for another's services*

Section 611 ITEPA provides:

> (1) This section applies to any annuity purchased by any person in recognition of another person's services in any office or employment.
> (2) But this section applies to an annuity which arises from a source outside the United Kingdom only if it is paid to a person resident in the United Kingdom.
> (3) This section does not apply to an annuity to which Chapter 5A of this Part applies.
> (4) For the purposes of this section "office" includes in particular any position which has an existence independent of the person who holds it and may be filled by successive holders.

38.6.4 *UK source annuities*

Section 612 ITEPA provides:

> (1) The taxable pension income for an annuity to which section 609, 610 or 611 applies is determined in accordance with this section if the annuity arises from a source in the United Kingdom.
> (2) The taxable pension income for a tax year is the full amount of the annuity arising in that year.

38.6.5 *Foreign source annuities*

Section 613 ITEPA provides:

> (1) The taxable pension income for an annuity to which section 609, 610 or 611 applies is determined in accordance with this section if the annuity arises from a source outside the United Kingdom.
> (2) The taxable pension income for a tax year is the full amount of the annuity arising in the tax year, but subject to subsection (4).

38.6.6 *Remittance basis*

Section 613(4) ITEPA provides

> The annuity is treated as relevant foreign income for the purposes of Chapters 2 and 3 of Part 8 of ITTOIA 2005 (relevant foreign income:

remittance basis and deductions and reliefs).

The significance of treating the income as RFI is that the foreign pension income can qualify for the remittance basis.

For completeness, s.613(5) ITEPA provides:

> But if the annuity arises in the Republic of Ireland, section 839 of that Act (annual payments payable out of relevant foreign income)[6] applies with the omission of conditions B1 and B2 (and the reference to them in subsection (1) and subsection (5)(a)).

This specialist topic is not pursued here.

I do not discuss s.840 ITTOIA (relief for backdated pensions charged on arising basis).

38.7 Commonwealth pension

Section 615(1) ITEPA provides:

> This section applies to a pension if conditions A, B and C are met.

I refer to **"commonwealth pension conditions A - C"**.

Section 615(7) ITEPA provides:

> In this Chapter "pension" includes a pension which is paid voluntarily or is capable of being discontinued.

I refer to pensions within this definition as "**commonwealth pensions**" (though that is not a wholly accurate label).

I would be interested to hear from readers with experience in this area whether there are in fact many commonwealth pensions still payable.

38.7.1 *Commonwealth condition A*

Section 615 ITEPA provides:

> (2) Condition A is that the pension—
> (a) is payable—
> (i) to a person who has been employed in overseas government service, or
> (ii) to the widow, widower, surviving civil partner, child, relative or dependant of a person who has been employed in overseas government service, and
> (b) is payable in respect of that service...

[6] See 31.12 (Annual Payment from RFI).

> (6) In condition A the references to a person being employed in overseas government service are to the person being employed outside the UK—
>
> (a) in the service of the Crown, or
>
> (b) in service under the government of a country or territory which falls within subsection (4).

38.7.2 *Commonwealth condition B*

Section 615 ITEPA provides:

> (3) Condition B is that the pension—
>
> (a) is payable in the UK, and
>
> (b) is payable to a person who is resident in the UK.

38.7.3 *Commonwealth condition C*

Section 615 ITEPA provides:

> (4) Condition C is that the pension is payable by or on behalf of the government of—
>
> (a) a country which forms part of Her Majesty's dominions,
>
> (b) any other country which is for the time being mentioned in Schedule 3 to the British Nationality Act 1981, or
>
> (c) any territory under Her Majesty's protection.
>
> (5) But condition C is not met if the pension is payable out of the public revenue of the UK or Northern Ireland.

There are 55[7] countries in schedule 3:

Antigua and Barbuda
Australia
The Bahamas
Bangladesh
Barbados
Belize
Botswana
Brunei
Cameroon
Canada
Republic of Cyprus
Dominica
Eswatini
Fiji
Gabon
Ghana
Grenada
Guyana
India
Jamaica
Kenya
Kiribati
Lesotho
Malawi

[7] There are 56 Commonwealth countries, including the UK. However, there is often a delay between a country withdrawing from the Commonwealth and a consequential amendment to Sch 3. For present purposes, it is Sch 3 that is determinative. There is currently one country on the list that is not a member of the Commonwealth: Zimbabwe withdrew in 2003 but reapplied to join in May 2018; that application is not yet successful. The Gambia is not on the list, despite being a member of the Commonwealth.

Malaysia
Maldives
Malta
Mauritius
Mozambique
Namibia
Nauru
New Zealand
Nigeria
Pakistan
Papua New Guinea
Rwanda
Saint Christopher and Nevis
Saint Lucia
Saint Vincent and the Grenadines
Seychelles
Sierra Leone
Singapore
Solomon Islands
South Africa
Sri Lanka
Tanzania
Togo
Tonga
Trinidad and Tobago
Tuvalu
Uganda
Vanuatu
Western Samoa
Zambia
Zimbabwe

The EI Manual provides:

> **EIM75500. The taxation of pension income: foreign pensions** [Feb 2024]
>
> ...
>
> Certain overseas governments may pay pensions in the UK through any public department, officer or agent. Where the following conditions are met, these pensions are chargeable to Income Tax under section 615 ITEPA 2003, and not section 573 like other foreign pensions:
>
> ...
>
> - the pension is payable by or on behalf of the government of a country that is listed at schedule 3 of the British Nationality Act 1981 or a British Overseas Territory
> - the pension is paid to an individual who was employed outside the UK in service of the Crown, or the government of a country that is listed at schedule 3 of the British Nationality Act 1981 or a British Overseas Territory, or to the widow, widower, surviving civil partner, child, relative or dependant of that former employee.

Section 50(1) of the British Nationality Act 1981 provides:

> “ British overseas territory ” means a territory mentioned in Schedule 6...

Schedule 6 lists the following:

> Anguilla; Bermuda; British Antarctic Territory; British Indian Ocean Territory; Cayman Islands; Falkland Islands; Gibraltar; Montserrat; Pitcairn, Henderson, Ducie and Oeno Islands; St Helena, Ascension and Tristan da Cunha, South Georgia and the South Sandwich Islands, The Sovereign Base Areas of Akrotiri and Dhekelia (that is to say the areas mentioned in section 2(1) of the Cyprus Act 1960); Turks and Caicos

> Islands; Virgin Islands.

There are no longer any protectorates or protected states.

38.7.4 *Commonwealth pension: Charge*

Section 616 ITEPA provides:

> If section 615 applies, the taxable pension income for a tax year is the full amount of the pension accruing in that year irrespective of when any amount is actually paid.

The remittance basis is not applicable, perhaps because the pensions are "payable within the UK" and so regarded as received here.

Section 617 ITEPA provides for a 10% deduction:

> A deduction of 10% is allowed from an amount of taxable pension income determined under section 616 (see section 567).

This seems to have been overlooked by the drafter of the FA 2017 which otherwise abolished the former 10% deduction.

38.8 DT relief: Pension income

Article 18 OECD Model Convention provides:

> Subject to the provisions of paragraph 2 of Article 19 [government service],[8] pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

Where context permits, I use the word pension to include "other similar remuneration".

38.8.1 *Reason for residence taxation*

Why does OECD Model choose to tax pensions in the state of residence, rather than the state of source? OECD Commentary provides:

> 1... Various policy and administrative considerations support the principle that the taxing right with respect to this type of pension, and other similar remuneration, should be left to the State of residence. For instance, the State of residence of the recipient of a pension is in a better position than any other State to take into account the recipient's overall ability to pay tax, which mostly depends on worldwide income and

[8] See 38.8.7 (Government pension).

> personal circumstances such as family responsibilities. This solution also avoids imposing on the recipient of this type of pension the administrative burden of having to comply with tax obligations in States other than that recipient's State of residence.

These two arguments are invalid as they apply equally to every type of income, not just pensions. But the commentary later gives a better reason, the old difficulty of identifying the location of the source:

> 19. ... alternative provisions under which there is either exclusive or limited source taxation rights with respect to pensions require a determination of the State of source of pensions. Since a mere reference to a pension "arising in" a Contracting State could be construed as meaning either a pension paid by a fund established in that State or a pension derived from work performed in a State, States using such wording should clarify how it should be interpreted and applied.
> 19.1 Conceptually, the State of source might be considered to be the State in which the fund is established, the State where the relevant work has been performed or the State where deductions have been claimed. Each of these approaches would raise difficulties in the case of individuals who work in more than one State, change residence during their career or derive pensions from funds established in a State other than that in which they have worked. For example, many individuals now spend significant parts of their careers outside the State in which their pension funds are established and from which their pension benefits are ultimately paid. In such a case, treating the State in which the fund is established as the State of source would seem difficult to justify. The alternative of considering as the State of source the State where the work has been performed or deductions claimed would address that issue but would raise administrative difficulties for both taxpayers and tax authorities, particularly in the case of individuals who have worked in many States during their career, since it would create the possibility of different parts of the same pension having different States of source.

OECD Model adopts the pragmatic solution, but it is not surprising that there is a wide variety of provision in actual treaties. Some possibilities are discussed in OECD Commentary, but that need not be set out here.

Some pre-OECD Model treaties confer relief only if the income is subject to tax in the foreign state; see 108.13 ("Subject to tax").

38.8.2 *Pension/similar remuneration*

OECD Commentary provides:

> 3. The types of payment that are covered by the Article include not only pensions directly paid to former employees but also to other beneficiaries (e.g. surviving spouses, companions or children of the employees) and other similar payments, such as annuities, paid in respect of past employment. The Article also applies to pensions in respect of services rendered to a State or a political subdivision or local authority thereof which are not covered by the provisions of paragraph 2 of Article 19.

38.8.3 *One-off payment*

OECD Commentary provides:

> 5. While the word "pension", under the ordinary meaning of the word, covers only periodic payments, the words "other similar remuneration" are broad enough to cover non-periodic payments. For instance, a lump-sum payment in lieu of periodic pension payments that is made on or after cessation of employment may fall within the Article.

38.8.4 *Pension or employment income?*

OECD Commentary discusses the pension/employment income boundary:

> 6. Whether a particular payment is to be considered as other remuneration similar to a pension or as final remuneration for work performed falling under Article 15 is a question of fact. For example, if it is shown that the consideration for the payment is the commutation of the pension or the compensation for a reduced pension then the payment may be characterised as "other similar remuneration" falling under the Article. This would be the case where a person was entitled to elect upon retirement between the payment of a pension or a lump-sum computed either by reference to the total amount of the contributions or to the amount of pension to which that person would otherwise be entitled under the rules in force for the pension scheme. The source of the payment is an important factor; payments made from a pension scheme would normally be covered by the Article. Other factors which could assist in determining whether a payment or series of payments fall under the Article include: whether a payment is made on or after the cessation of the employment giving rise to the payment, whether the recipient continues working, whether the recipient has reached the normal age of retirement with respect to that particular type of employment, the status of other recipients who qualify for the same type of lump-sum payment and whether the recipient is simultaneously eligible for other pension benefits. Reimbursement of pension

> contributions (e.g. after temporary employment) does not constitute "other similar remuneration" under Article 18. Where cases of difficulty arise in the taxation of such payments, the Contracting States should solve the matter by recourse to the provisions of Article 25 [mutual agreement].

38.8.5 *Social security income*

OECD Commentary provides:

> 24. Depending on the circumstances, social security payments can fall under this Article as "pensions and other similar remuneration in consideration of past employment", under Article 19 as "pension[s] paid by, or out of funds created by, a Contracting State [...] in respect of services rendered to that State..." or under Article 21 as "items of income [...] not dealt with in the foregoing Articles". Social security pensions fall under this Article when they are paid in consideration of past employment, unless paragraph 2 of Article 19 applies.[9] A social security pension may be said to be "in consideration of past employment" if employment is a condition for that pension. For instance, this will be the case where, under the relevant social security scheme:
>
> — the amount of the pension is determined on the basis of either or both the period of employment and the employment income so that years when the individual was not employed do not give rise to pension benefits,
>
> — the amount of the pension is determined on the basis of contributions to the scheme that are made under the condition of employment and in relation to the period of employment, or
>
> — the amount of the pension is determined on the basis of the period of employment and either or both the contributions to the scheme and the investment income of the scheme.
>
> 25. Paragraph 2 of Article 19 will apply to a social security pension that would fall within Article 18 except for the fact that the past employment in consideration of which it is paid constituted services rendered to a State or a political subdivision or a local authority thereof, other than services referred to in paragraph 3 of Article 19.
>
> 26. Social security payments that do not fall within Articles 18 or 19 fall within Article 21. This would be the case, for instance, for payments made to self-employed persons as well as a pension purely based on resources, on age or disability which would be paid regardless of past

[9] See 38.8.7 (Government pension).

employment or factors related to past employment (such as years of employment or contributions made during employment).

38.8.6 *Consideration: Past employment*

The INTM provides:

> **INTM153200 Pensions** [Jan 2018]
> ... Social security and old age pensions are not paid in consideration of past employment and do not, therefore, come within the pensions Article. They are within the other income Article (INTM153240). However, two agreements (Denmark, Finland) provide for sole source state taxation and two others (Luxembourg and Sweden) provide that pensions paid under social security legislation may be taxed by the source country.

OECD Commentary provides:

> 3... [Article 18] only applies, however, to payments that are in consideration of past employment; it would therefore not apply, for example, to an annuity acquired directly by the annuitant from capital that has not been funded from an employment pension scheme. The Article applies regardless of the tax treatment of the scheme under which the relevant payments are made; thus, a payment made under a pension plan that is not eligible for tax relief could nevertheless constitute a "pension or other similar remuneration" (the tax mismatch that could arise in such a situation is discussed below)...
> 7. Since the Article applies only to pensions and other similar remuneration that are paid in consideration for past employment, it does not cover other pensions such as those that are paid with respect to previous independent personal services. ...

38.8.7 *Government pension*

Article 19 OECD Model provides:

> 2. a) Notwithstanding the provisions of paragraph 1 [government service],[10] pensions and other similar remuneration paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.
>   b) However, such pensions and other similar remuneration shall be

[10] See 37.20 (DT relief: Government service).

> taxable only in the other Contracting State if the individual is a resident of, and a national of, that State.
>
> 3. The provisions of Articles 15, 16, 17, and 18 shall apply to salaries, wages, pensions, and other similar remuneration in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

38.9 Australia/UK DTA

Article 17(1) Australia/UK Convention provides:

> Pensions (including government pensions) and annuities paid to a resident of a Contracting State shall be taxable only in that State.

The Australian Revenue have given two rulings concerning compensation payments.

> **Income tax: are periodic workers' compensation payments made by Comcare, 'pensions' for purposes of the pensions articles in Australia's double taxation agreements?**
>
> 1. Yes. The term 'pension' is not defined in any of the DTAs and therefore takes the meaning it has under domestic law. A pension is defined in the Macquarie Dictionary as '1. a fixed periodical payment made in consideration of past services, injury or loss sustained, merit, poverty etc. 2. an allowance or annuity.' The meaning of the term 'pension' was considered by Hill J. in the Federal Court in *Tubemakers of Aust Ltd v FCT* 93 ATC 4207. His Honour concluded that the essential characteristic of a pension is only that there be periodical payments. Payments made by Comcare under [a statutory compensation scheme] are fixed periodical payments made in consideration of injury or loss of wages. They are therefore pensions within the ordinary meaning of that term and fall within the operation of the Pensions Article in Australia's DTAs.
>
> 2. Under Australia's DTAs, pensions paid by the Australian Government are generally included in the Pensions Article and are taxable only in the country of residence of the recipient. Although, in some DTAs, government pensions paid in respect of services rendered to that government are dealt with under the Government Services Article rather than the Pensions Article, this does not affect the treatment of Comcare payments made under section 19. This is because the Comcare payments are made in consideration of injury or loss of wages and not for past services to the Government.[11]

[11] TD 93/151 *https://www.ato.gov.au/law/view/pdf/pbr/td1993-151.pdf*

The second ruling is as follows:

> **Facts** A non-resident individual (the taxpayer) who is a UK resident for the purposes of the [Australia] UK Convention, received loss of earnings payments from Australia as a result of injury suffered in a transport accident in the State of Victoria.
>
> The payments comprised weekly statutory compensation payments [under a statutory compensation scheme]... for loss of income due to the injury.
>
> The payments are calculated by reference to the recipient's pre-accident earnings.
>
> **Reasons for Decision**
>
> [The ruling cites art.17 of the DTA and continues:] Therefore, pensions paid from Australia to an individual who is a resident of the UK shall be taxable only in the UK.
>
> Article 3(3) of the UK Convention provides that any term not defined in the Convention shall, unless the context requires otherwise, have the meaning it has under the domestic laws in respect of the taxes to which the Convention applies.[12] The term 'pension' is not defined in the UK Convention or in Australia's domestic taxation law.
>
> [The ruling referred to the authorities cited in Taxation Determination TD 93/151 and continued:]
>
> The loss of earnings payments made under [the statutory compensation scheme] have the essential characteristic of a 'pension' as per Hill J. in *Tubemakers* and fall within the Macquarie dictionary definition of 'pension' as they are fixed periodic payments made in consideration of injury or loss sustained. Accordingly, the periodic compensation payments made to the taxpayer ... are a 'pension' for the purposes of the Pension Article of the UK Convention.
>
> Therefore, the Pension Article applies to give the UK, as the country of residence of the taxpayer, sole taxing rights over the compensation payments.[13]

It is different if OECD Model wording is used, which only applies to pensions "in consideration of past employment".

38.10 USA/UK DTA: Pension income

OECD Model only deals with pension income. The commentary considers other aspects of cross border pensions: taxation of contributions,

[12] Author's footnote: this is OECD Model form; see 107.12 (Undefined treaty terms).

[13] ATO ID 2008/145.

relief for contributions, income arising in the scheme, transfers between schemes. I here consider the USA/UK DTA which addresses these issues.

38.10.1 *"Pension scheme"*

Article 3(1)(o) USA/UK DTA provides a restrictive definition of "pension scheme":

> the term "pension scheme" means any plan, scheme, fund, trust or other arrangement established in a Contracting State which is—
> (i) generally exempt from income taxation in that State; and
> (ii) operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements.

I refer to this as a **"pension scheme (as defined in the treaty)"**. This is not the OECD Model wording but there are some similarities.[14]

The DTA Exchange of Notes provides:

> With reference to sub-paragraph (o) of paragraph 1 of Article 3 (General definitions)—
> it is understood that pension schemes shall include the following and any identical or substantially similar schemes which are established pursuant to legislation introduced after the date of signature of the Convention—
> (a) under the law of the UK,
> [i] employment-related arrangements (other than a social security scheme) approved as retirement benefit schemes for the purposes of Chapter I of Part XIV of ICTA 1988, and
> [ii] personal pension schemes approved under Chapter IV of Part XIV of that Act; and
> (b) under the law of the United States,
> [i] qualified plans under section 401(a) of the Internal Revenue Code,
> [ii] individual retirement plans (including
> [A] individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k),
> [B] individual retirement accounts,
> [C] individual retirement annuities,
> [D] section 408(p) accounts, and

[14] See 9.24 (Treaty-residence: Pension fund).

[E] Roth IRAs under section 408A),
[iii] section 403(a) qualified annuity plans, and
[iv] section 403(b) plans.

This is an inclusive definition.

The DT Manual provides:

> **DT19876B. Pension Contribution** [Jan 2020]
> ... The term "pension scheme" is defined for the purposes of the treaty at Article 3(1)(o). This means that Treaty benefits are for approved schemes only. As section 615 ICTA 1988 schemes [now Chapter 18 Part 9 ITEPA], which are UK established trusts for non-residents, are not approved they do not come within the definition of "pension scheme" in Article 3(1)(o) because they are not "generally exempt from income taxation in that State". They are therefore not included in the list in the Exchange of Notes.
> So called US section 401(k) plans are included within the definition of a pension scheme as they are within the definition of a pension scheme in Article 3(1)(o) because they are a type of section 401(a) plan.

The requirement that a pension fund must be "established in" a treaty state requires some nexus between the pension fund and the state, but the exact meaning is not precisely expressed.

The Upper Tribunal has held that the World Bank pension scheme was "established in" the US and so was a pension scheme (as defined in the treaty):

(a) "established in" refers to a pension scheme's physical location and
(b) a pension scheme need not necessarily be "generally exempt from taxation" as such.[15]

The word "physical" is not apt for a non-tangible thing such as a pension scheme, but the important point is the rejection of the HMRC argument that a pension is "established" in a state if it is established in conformity with that State's tax legislation relating to pension schemes.

The Australian Revenue takes a similar approach on whether a pension fund is "established in Australia" for the purposes of domestic (Australian) legislation:

> 100. ... there appears to be no case law which provides guidance on the location of the establishment of a superannuation fund. In the absence

[15] *Macklin v HMRC* [2015] UKUT 39 (TCC) at [46].

> of such guidance, it is considered that a superannuation fund will be established in Australia when the initial contribution that establishes the fund is paid to and accepted by the trustee in Australia.[16] It is not necessary that the deed for the fund is signed and executed in Australia. Whether the initial contribution to establish the fund occurred in Australia is a question of fact which is determined by reference to the circumstances of each case.
> 101. If there is a situation where the initial contribution to establish the fund occurred outside Australia, notwithstanding that one or more of the signatories executed the deed in Australia, the fund will not be established in Australia.[17]

It seems to me that this is the natural meaning of a trust being "established in" a state. The difficulty of applying the natural meaning in the treaty definition is that some arrangements which the DTA Exchange of Notes recognises would not be included.[18] A court could well have found that a pension scheme was established in a state if it was set up there *or* if it qualified for pension exemption there. The treaty and international law background of the World Bank might also benefit from examination. It seems anomalous that employment income of World Bank employees should be exempt, but pension income, which is deferred remuneration, is taxable.

38.10.2 *DTA relief for pension*

Article 17(1) USA/UK DTA provides:

> (a) Pensions and other similar remuneration beneficially owned by a resident of a Contracting State shall be taxable only in that State.

The DTA Exchange of Notes provides:—

> With reference to paragraph 1 of Article 17 ... it is understood that a payment shall be treated as a pension or other similar remuneration

[16] Footnote original: Those superannuation schemes that are established by or under the law of the Commonwealth, or of a State or Territory - see paragraph (a) of the definition of 'public sector superannuation scheme' in section 10 of the SISA - are established in Australia.

[17] Taxation Ruling TR 2008/9, "Income tax: meaning of 'Australian superannuation fund' in subsection 295-95(2) of the Income Tax Assessment Act 1997" *https://www.ato.gov.au/law/view/document?DocID=TXR/TR20089/NAT/ATO/00001*

[18] EU companies may establish registered schemes, and these are not likely to be set up by a payment in the UK.

> under paragraph 1 of Article 17 if it is a payment under a pension scheme as defined in sub-paragraph (o) of paragraph 1 of Article 3 (General definitions) of the Convention.

This is an exclusive definition, that is, if a payment is not under a pension scheme (as defined in the treaty) then it does not count as a pension for treaty purposes (even if it is a pension in the normal sense of the word.)[19]

In the case of payments which are not from pension schemes (as defined) the Other Income article may apply, though that (unlike article 17(1)) is subject to the US Savings Clause.

38.10.3 *Exemption recognition*

Article 17(1) USA/UK DTA continues:

> (b) Notwithstanding sub-paragraph (a) of this paragraph, the amount of any such pension or remuneration paid from a pension scheme established in the other Contracting State that would be exempt from taxation in that other State if the beneficial owner were a resident thereof shall be exempt from taxation in the first-mentioned State.

It is easier to follow a paraphrase identifying which Contracting State is which, and filling in the reference in the word "such":

> (b) ... the amount of any pension or remuneration [beneficially owned by a resident of the UK] paid from a pension scheme established in [the USA] that would be exempt from taxation in [the USA] if the beneficial owner were a resident [of the USA] shall be exempt from taxation in [the UK].

The USA/UK DTA Technical Explanation provides:[20]

> ... Thus, for example, a distribution from a U.S. "Roth IRA" to a U.K. resident would be exempt from tax in the UK to the same extent the distribution would be exempt from tax in the United States if it were distributed to a U.S. resident. The same is true with respect to distributions from a traditional IRA to the extent that the distribution

[19] If this view were wrong, the provision in the Exchange of Notes would not be necessary. This view is consistent with the approach in the commentary to the US Model Treaty: "The phrase "pensions and other similar remuneration" is intended to encompass payments made by *qualified* private retirement plans...". *https://home.treasury.gov/system/files/131/Treaty-US-Model-TE-2006.pdf*

[20] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> represents a return of non-deductible contributions. Similarly, if the distribution were not subject to tax when it was "rolled over" into another U.S. IRA (but not, for example, to a U.K. pension scheme), then the distribution would be exempt from tax in the UK.

The Tribunal has said:

> We do not accept that the purpose of the exemption under article 17(1)(b) of the DTA is to provide equal treatment for pensioners resident in either Contracting State with regard to the taxation of pension income. It is, as we discern it, to give exemption in both Contracting States to pension income which the parties to the DTA have chosen to exempt from income taxation under their respective domestic laws because they are schemes operated principally to administer or provide pension or retirement benefits, etc.[21]

38.10.4 *Savings clause and art 17(1)*

The USA/UK DTA Technical Explanation provides:[22]

> [Article 17(1)(a)] is subject to the saving clause of paragraph 4 of Article 1 (General Scope)[23] while subparagraph 1(b) is not, by reason of the exception in subparagraph 5(a) of Article 1. Thus, a U.S. citizen who is a resident of the UK and receives a pension will be subject to U.S. tax on the payment, notwithstanding the rules in those paragraphs that give the State of residence of the recipient the exclusive taxing right. However, a U.S. citizen who receives a distribution from a pension scheme established in the UK will be taxable on only the portion of the pension distribution that is taxable in the UK.

38.10.5 *Lump sum payment*

Article 17(2) USA/UK DTA continues:

> Notwithstanding the provisions of paragraph 1 of this Article, a lump-sum payment derived from a pension scheme established in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in the first-mentioned State.

It may be easier to keep track of this by identifying the states expressly. In the case of a UK resident:

[21] *Macklin v HMRC* [2014] SFTD 290 at [110].

[22] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[23] See 109.5 (Savings Clause).

> ... a lump-sum payment derived from a pension scheme established in [the USA] and beneficially owned by a resident of [the UK] shall be taxable only in [the USA].

In the case of a US resident:

> ... a lump-sum payment derived from a pension scheme established in [the UK] and beneficially owned by a resident of [the USA] shall be taxable only in [the UK].

The USA/UK DTA Technical Explanation provides:[24]

> Paragraph 2 is intended to deal with a particular type of double non-taxation that arose under the prior Convention because the UK does not tax lump-sum distributions from pension funds. Under the prior Convention, a lump-sum payment was treated in the same way as any other pension, and was taxable only in the country of residence of the beneficial owner. Accordingly, a person who anticipated receiving a lump-sum distribution from a U.S. pension scheme with respect to employment in the United States could avoid U.S. withholding tax on the distribution by establishing residence in the UK for the year in which he received the distribution. The person would not be subject to tax in either the United States or the UK with respect to the lump-sum distribution, resulting in a significant windfall.
>
> Paragraph 2 prevents this unanticipated benefit by providing that, notwithstanding the exclusive residence-country taxation of paragraph 1, any lump-sum payment derived by a resident of a Contracting State from a pension scheme established in the other Contracting State shall be taxable in that other State.

This problem arises because of the exemption for lump sum payments from UK pension schemes, which may be politically unassailable even if economically unjustifiable.

38.10.6 *US Savings Clause*

The USA/UK DTA Technical Explanation provides:[25]

> Paragraphs 2 and 4 of Article 17 also are subject to the saving clause. Accordingly, a U.S. citizen who is a resident of the UK will be subject to U.S. tax on a lump-sum distribution from a pension scheme or an annuity, notwithstanding the rules in those paragraphs that give

[24] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[25] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> exclusive taxation rights to the State of source or residence, as the case may be.

The DTR Manual provides:

> **DT19876A. Pensions from 2003** [Jan 2020]
> ... ***Lump Sums***
> Under the old Agreement, a lump-sum payment from a pension scheme was taxable only in the country of residence. So if an individual moved from the US to the UK before receiving a lump sum from a US pension scheme, they would be taxable on the lump sum neither in the US (because of the treaty) nor in the UK (which does not tax lump sums anyway).
> The new provision prevents this occurring by providing that a lump-sum payment derived by a resident of one State from a pension scheme established in the other State shall be taxable only in that other State.
> The provision preserves the exemption from income tax of a lump sum relevant benefit where it is paid by a UK approved pension scheme to a beneficial owner who is a US resident. However, Article 1(4) will apply in respect of US citizens as the provisions of Article 17(2) are not amongst those listed at Article 1(5). So the US are able to tax lump sums received by US citizens from UK schemes.

38.11 Income of pension fund

Article 18(1) USA/UK DTA provides:

> Where an individual who is a resident of a Contracting State is a member or beneficiary of, or participant in, a pension scheme established in the other Contracting State, income earned by the pension scheme may be taxed as income of that individual only when, and, subject to paragraphs 1 and 2 of Article 17 (Pensions, social security, annuities, alimony, and child support) of this Convention, to the extent that, it is paid to, or for the benefit of, that individual from the pension scheme (and not transferred to another pension scheme).

It may be easier to keep track of this by identifying the states expressly. In the case of a UK resident, in short:

> Where an individual who is a resident of [the UK] is a member or beneficiary of, or participant in, a pension scheme established in [the US], income earned by the pension scheme may be taxed as income of that individual only when ... it is paid to, or for the benefit of, that individual from the pension scheme (and not transferred to another

pension scheme).

The USA/UK DTA Technical Explanation provides:[26]

> Thus, for example, if a U.S. citizen contributes to a U.S. qualified plan while working in the United States and then establishes residence in the UK, paragraph 1 prevents the UK from taxing currently the plan's earnings and accretions with respect to that individual. When the resident receives a distribution from the pension scheme, that distribution may be subject to tax in the State of residence, subject to paragraphs 1 and 2 of Article 17 (Pensions, Social Security, Annuities, Alimony, and Child Support).

The DTR Manual provides:

> **DT19876A. Pensions from 2003** [Jan 2020]
> ***IRAs***
> ...An IRA is a trust (or similar arrangement known as a custodial account) set up for the exclusive benefit of the taxpayer and, on his death, nominated beneficiaries, which satisfies certain conditions imposed by United States tax law. Contributions to an IRA are tax deductible in the United States and the funds can be invested in a wide range of investments. IRA funds can be withdrawn at any time, but if withdrawals are made before the taxpayer reaches the age of 59½ he must pay an additional penalty tax of 10% unless he is disabled.
> ...
> ***IRAs: Year 2003/04 et seq.***
> ... The new Agreement ... will mean that no liability will arise until it would have done so under US tax law. Under US law, this will be when distributions are made. As indicated above, this will generally not be before age 59½ but must be before age 70½. The important point to note is that income will no longer be assessable in the UK on the basis of income arising within the IRA. Any case of doubt or difficulty should be referred to HMRC, Customs & International, Tax Treaty Team.

The taxation of the pension scheme itself is outside the scope of this book, but note that the term "person" is defined in the DTA to include pension schemes and employee benefit trusts and arrangements. This is now also in the OECD Model.[27]

[26] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*
[27] See 9.24 (Treaty-residence: Pension fund).

38.11.1 *US Savings Clause*

The USA/UK DTA Technical Explanation provides:[28]

> Paragraph 1 is not subject to the saving clause of paragraph 4 of Article 1 (General Scope) by reason of the exception in subparagraph 5(a) of Article 1. Accordingly, a U.S. citizen who is a resident of the UK will not be subject to tax in the United States on the earnings and accretions of a U.K. pension fund with respect to that U.S. citizen.

38.12 Transfer between schemes

The minutes of the Joint Forum on Expatriate Tax and NICs provides:

> **UK tax charges and transfers to US**
> *Question*: It is common practice for funds to be transferred between US pension schemes, particularly from a 401(k) to an IRA (individual retirement account). Although it is not necessarily a requirement, most people transfer their pension savings when they move employment.
> [The minutes refer to article 18 and continue]
> Where Article 18(1) is otherwise in point, is it HMRC's position that any unauthorised payments charge applies to the whole of the UK tax-relieved contributions deemed to be transferred to the IRA, treating those as transferred in priority to any fund income, or does Article 18(1) somehow confer total or partial exemption from this charge (if so, how)? The cumulative rate of charge on UK tax-relieved contributions (unauthorised payment charge and surcharge) is 55%, which is more than the tax relief originally given on the contributions. Does this mean that part of the tax represents a charge on fund growth, which would be prevented by Article 18(1) if the treaty is allowed to have any application to Schedule 34 FA 2004 charges? Or is Article 17 the provision that would relate to a transfer from a 401(k) to an IRA?
> *HMRC answer*: The provisions of the UK/US double taxation convention will not apply where both the individual and the pension scheme are in the US.
> Where a member of a US pension scheme is resident in the UK and receives UK tax relief on their pension savings that part of their pension savings will be subject to the provisions of Schedule 34 FA 2004 (the member payment provisions). If a transfer is made between a 401(k) and an IRA and the IRA is not a qualifying recognised overseas pension scheme (QROPS), the transfer will be an unauthorised payment. Any tax charge will be on the UK element of the pension savings and not to the

[28] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> investment growth in relation to the contributions. The wording of Article 18 refers to "income earned by the pension scheme" (in this case the US 401(k)). However, the income earned by the pension scheme would not be subject to UK tax charges.
>
> We do not see a transfer between pension schemes as being within Article 17 of the UK/US double taxation convention.[29]

38.13 Relief for pension contribution

Article 18(2) USA/UK DTA provides:

> Where an individual who is a member or beneficiary of, or participant in, a pension scheme established in a Contracting State exercises an employment or self-employment in the other Contracting State—
>
> (a) contributions paid by or on behalf of that individual to the pension scheme during the period that he exercises an employment or self-employment in the other State shall be deductible (or excludable) in computing his taxable income in that other State

The USA/UK DTA Technical Explanation provides:[30]

> Paragraph 2 [of article 18] provides certain benefits with respect to cross-border contributions to a pension scheme, subject to the limitations of paragraphs 3 and 4 of the Article. It is irrelevant for purposes of paragraph 2 whether the participant establishes residence in the State where the individual renders services (the "host State"). The benefits provided in paragraph 2 are similar to the benefits the U.S. Model provides with respect to contributions.
>
> Subparagraph (a) of paragraph 2 allows an individual who exercises employment or self-employment in a Contracting State to deduct or exclude from income in that Contracting State contributions made by or on behalf of the individual during the period of employment or self-employment to a pension scheme established in the other Contracting State. Thus, for example, if a participant in a U.S. qualified plan goes to work in the UK, the participant may deduct or exclude from income in the UK contributions to the U.S. qualified plan made while the participant works in the UK. Subparagraph (a), however, applies only to the extent of the relief allowed by the host State (e.g., the UK in the example) for contributions to a pension scheme established in that State.

[29] 29 January 2014 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/302475/140326_Expats_Forum_Jan_14_Minutes_FINAL.pdf*

[30] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

38.13.1 *Contribution by employer*

Article 18(2) USA/UK DTA provides:

> Where an individual who is a member or beneficiary of, or participant in, a pension scheme established in a Contracting State exercises an employment or self-employment in the other Contracting State ...
>
> (b) any benefits accrued under the pension scheme, or contributions made to the pension scheme by or on behalf of the individual's employer, during that period shall not be treated as part of the employee's taxable income and any such contributions shall be allowed as a deduction in computing the business profits of his employer in that other State.
>
> The reliefs available under this paragraph shall not exceed the reliefs that would be allowed by the other State to residents of that State for contributions to, or benefits accrued under, a pension scheme established in that State.

The USA/UK DTA Technical Explanation provides:[31]

> Subparagraph (b) of paragraph 2 provides that, in the case of employment, accrued benefits and contributions by or on behalf of the individual's employer, during the period of employment in the host State, will not be treated as taxable income to the employee in that State. Subparagraph (b) also allows the employer a deduction in computing business profits in the host State for contributions to the plan. For example, if a participant in a U.S. qualified plan goes to work in the UK, the participant's employer may deduct from its business profits in the UK contributions to the U.S. qualified plan for the benefit of the employee while the employee renders services in the UK.
>
> As in the case of subparagraph (a), subparagraph (b) applies only to the extent of the relief allowed by the host State for contributions to pension schemes established in that State. Therefore, where the United States is the host State, the exclusion of employee contributions from the employee's income under this paragraph is limited to elective contributions not in excess of the amount specified in section 402(g). Deduction of employer contributions is subject to the limitations of sections 415 and 404. The section 404 limitation on deductions is calculated as if the individual were the only employee covered by the plan.

[31] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

38.13.2 *US Savings Clause*

The USA/UK DTA Technical Explanation provides:[32]

> Paragraph 2 is not subject to the saving clause by reason of subparagraph 5(b) of Article 1. Accordingly, the benefits of paragraph 2 will be available to residents of the United States who are not citizens of the United States nor admitted for permanent resident ("green card" holders) in the United States.

The DT Manual provides:

> **DT19876B. Pension Contribution** [Jan 2020]
> ...It is a feature of several UK treaties from 2003 onwards that pension contributions made in one country are recognised for tax purposes in the other.
> The general premise of these is that if a member of a pension scheme established in one country goes to work (as an employee or in a self-employed capacity) in the other country, the state of residence will not tax the scheme member on income earned by the scheme unless it is paid to him (or for his benefit). Nor will tax be payable if income is transferred to another pension scheme until the benefits are actually received.
> Under the new Agreement, contributions to the scheme by that member (or those paid on his behalf) will be tax-deductible in the state of residence. In the same way, benefits accrued under the scheme, or employer contributions to the scheme, will not be treated as part of his taxable income and those contributions will be tax-deductible for the employer. The reliefs available cannot exceed those allowed by the state of residence for contributions of the same amount to a scheme established in the state of residence.
> The conditions for getting the relief are as follows
>
> - contributions were made by or on behalf of the individual or (in the case of an employee) his employer to the pension scheme (or to a similar scheme for which it was substituted) before the individual began to exercise an employment or self-employment in the other contracting state, and
> - the competent authority of the other State agrees that the pension scheme generally corresponds to a pension scheme established in that other State. ...

[32] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

38.13.3 *Pre-existing scheme*

Article 18(3) USA/UK DTA provides:

> The provisions of paragraph 2 of this Article shall not apply unless—
>
> (a) contributions by or on behalf of the individual, or by or on behalf of the individual's employer, to the pension scheme (or to another similar pension scheme for which the first-mentioned pension scheme was substituted) were made before the individual began to exercise an employment or self-employment in the other State

The DT Manual provides:

> **DT19876B. Pension Contribution** [Jan 2020]
>
> ...
>
> Where someone comes to work in the UK we will regard the first condition as having been met if the individual was a member of the US scheme before beginning to exercise an employment or self-employment in the UK. ...

The USA/UK DTA Technical Explanation provides:[33]

> Paragraph 3 limits the availability of benefits under paragraph 2. Under subparagraph (a) of paragraph 3, paragraph 2 does not apply to contributions to a pension scheme unless the participant already was contributing to the scheme, or his employer already was contributing to the scheme with respect to that individual, before the individual began exercising employment in the State where the services are performed (the "host State"). This condition would be met if either the employee or the employer was contributing to a scheme that was replaced by the scheme to which he is contributing. The rule regarding successor schemes would apply if, for example, the employer has been taken over by a company that replaces the existing scheme with its own scheme, rolling membership in the old scheme over into the new scheme.

38.13.4 *Corresponding scheme*

Article 18(3) USA/UK DTA provides:

> The provisions of paragraph 2 of this Article shall not apply unless...
>
> (b) the competent authority of the other State has agreed that the pension scheme generally corresponds to a pension scheme

[33] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> established in that other State.

The DTA Exchange of Notes provides:

> With reference to sub-paragraph (b) of paragraph 3 and sub-paragraph (d) of paragraph 5 of Article 18 (Pension schemes)—
> it is understood that the pension schemes listed with respect to a Contracting State in this exchange of notes in connection with sub-paragraph (o) of paragraph 1 of Article 3 (General definitions)[34] shall generally correspond to the pension schemes listed in this exchange of notes with respect to the other Contracting State.

The USA/UK DTA Technical Explanation provides:[35]

> In addition, under subparagraph (b) of paragraph 3, the competent authority of the host State must determine that the recognized plan to which a contribution is made in the other Contracting State generally corresponds to the plan in the host State. According to the notes, it is understood for this purpose that U.S. pension schemes eligible for the benefits of paragraph 2 include qualified plans under section 401(a), individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k)), individual retirement accounts, individual retirement annuities, section 408(p) accounts and Roth IRAs under section 408A), section 403(a) qualified annuity plans, and section 403(b) plans.

38.13.5 *Contribution relief: Remittance basis*

Article 18(4) USA/UK DTA provides:

> Where, under sub-paragraph (a) of paragraph 2 of this Article, contributions to a pension scheme are deductible (or excludable) in computing an individual's taxable income in a Contracting State and, under the laws in force in that State, the individual is subject to tax in that State, in respect of income, profits or gains, by reference to the amount thereof which is remitted to or received in that State and not by reference to the full amount thereof, then the relief that would otherwise be available to that individual under that sub-paragraph in respect of such contributions shall be reduced to an amount that bears the same proportion to that relief as the amount of the income, profits or gains in respect of which the individual is subject to tax in that State bears to the amount of the income, profits or gains in respect of which he would be

[34] See 38.10.1 ("Pension scheme").

[35] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> subject to tax if he were so subject in respect of the full amount thereof and not only in respect of the amount remitted to or received in that State.

The USA/UK DTA Technical Explanation provides:[36]

> Paragraph 4 limits the availability of benefits under paragraph 2 of this article. Paragraph 4 provides a special rule in cases where income dealt with by the Convention is taxable to a resident of a Contracting State only if and to the extent it is remitted to or received by that person. In such cases, paragraph 4 reduces proportionately the deduction or exclusion of contributions to a pension scheme under subparagraph (a) of paragraph 2 based upon the amount of income subject to tax in the State of residence. Although this rule is written in bilateral fashion, it presently applies to residents of the UK only, because the United States does not tax on a remittance basis. Paragraph 4 would apply, for example, if a U.S. citizen resident in the UK earns income in the United States that is not subject to tax in the UK because the income is not remitted to the UK. In this case, paragraph 4 would reduce proportionately the amount of any deduction or exclusion allowed in the UK to the U.S. citizen by subparagraph (a) of paragraph 2 for contributions to a U.S. pension scheme.

The DT Manual provides:

> **DT19876B. Pension Contribution** [Jan 2020]
> ...Relief will be restricted where contributions to a pension scheme are deductible or excludable in computing a person's taxable income in the host country if he is subject to tax there not on his total income but only on amounts remitted to that country. Relief is available only on a corresponding proportion of the pension contributions.
> *An example*

Individual's total income, profits and gains	£100,000
Income, profits and gains remitted to the UK	£90,000
Individual's contributions to US pension scheme	£5,000

> Contributions deductible in computing individual's UK taxable income - £4,500 (i.e. 90% of individual's total contributions). ...

38.14 Cross border contribution relief

Article 18(5) USA/UK DTA provides:

[36] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> (a) Where a citizen of the United States who is a resident of the UK exercises an employment in the UK the income from which is taxable in the UK and is borne by an employer who is a resident of the UK or by a permanent establishment situated in the UK, and the individual is a member or beneficiary of, or participant in, a pension scheme established in the UK,
>
> (i) contributions paid by or on behalf of that individual to the pension scheme during the period that he exercises the employment in the UK, and that are attributable to the employment, shall be deductible (or excludable) in computing his taxable income in the United States; and
>
> (ii) any benefits accrued under the pension scheme, or contributions made to the pension scheme by or on behalf of the individual's employer, during that period, and that are attributable to the employment, shall not be treated as part of the employee's taxable income in computing his taxable income in the United States.
>
> This paragraph shall apply only to the extent that the contributions or benefits qualify for tax relief in the UK.

The USA/UK DTA Technical Explanation provides:[37]

> Paragraph 5 generally provides U.S. tax treatment for certain contributions by or on behalf of U.S. citizens resident in the UK to pension schemes established in the UK that is comparable to the treatment that would be provided for contributions to U.S. schemes. Under subparagraph (a) of paragraph 5, a U.S. citizen resident in the UK may exclude or deduct for U.S. tax purposes certain contributions to a pension scheme established in the UK. Qualifying contributions generally include contributions made during the period the U.S. citizen exercises an employment in the UK if expenses of the employment are borne by a U.K. employer or U.K. permanent establishment. Similarly, with respect to the U.S. citizen's participation in the U.K. pension scheme, accrued benefits and contributions during that period generally are not treated as taxable income in the United States.

There are three restrictions.

38.14.1 *Cap by US tax rules*

Article 18(5) USA/UK DTA provides:

[37] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> (b) The reliefs available under this paragraph shall not exceed the reliefs that would be allowed by the United States to its residents for contributions to, or benefits accrued under, a generally corresponding pension scheme established in the United States.

The USA/UK DTA Technical Explanation provides:[38]

> The U.S. tax benefit allowed by paragraph 5, however, is limited to the lesser of the amount of relief allowed for contributions and benefits under a pension scheme established in the UK and, under subparagraph (b), the amount of relief that would be allowed for contributions and benefits under a generally corresponding pension scheme established in the United States.

Article 18(5) USA/UK DTA provides:

> (c) For purposes of determining an individual's eligibility to participate in and receive tax benefits with respect to a pension scheme established in the United States, contributions made to, or benefits accrued under, a pension scheme established in the UK shall be treated as contributions or benefits under a generally corresponding pension scheme established in the United States to the extent reliefs are available to the individual under this paragraph.

The USA/UK DTA Technical Explanation provides:[39]

> Subparagraph (c) provides that the benefits an individual obtains under paragraph 5 are counted when determining that individual's eligibility for benefits under a pension scheme established in the United States. Thus, for example, contributions to a U.K. pension scheme may be counted in determining whether the individual has exceeded the annual limitation on contributions to an individual retirement account.

Article 18(5) USA/UK DTA provides:

> (d) This paragraph shall not apply unless the competent authority of the United States has agreed that the pension scheme generally corresponds to a pension scheme established in the United States.

The USA/UK DTA Technical Explanation provides:[40]

[38] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[39] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[40] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> Under subparagraph (d), paragraph 5 does not apply to pension contributions and benefits unless the competent authority of the United States has agreed that the pension scheme established in the UK generally corresponds to a pension scheme established in the United States. The notes provide that certain pension schemes have been determined to "generally correspond" to schemes in the other country. Since paragraph 5 applies only with respect to persons employed by a U.K. employer or U.K. permanent establishment, however, the relevant U.K. plans are those that correspond to employer plans in the United States. Accordingly, it applies with respect to retirement benefit schemes for the purpose of Chapter I of Part XIV of ICTA1988.

38.14.2 *US Savings Clause*

The USA/UK DTA Technical Explanation provides:[41]

> Paragraph 5 is not subject to the saving clause of paragraph 4 of Article 1 by reason of the exception in subparagraph 5(a) of Article 1. Accordingly, U.S. citizens who are resident in the UK will receive the benefits provided by paragraph 5 with respect to contributions made to pension schemes established in the UK.

38.15 Canadian RRSP and RRIF

The DT Manual formerly provided:

> **DT4617 Withdrawals from Canadian RRSPs/RRIFs** [Jun 2016 - Feb 2017]
> Canadian Registered Retirement Savings Plans (RRSPs) and Registered Retirement Income Funds (RRIFs)
> Where a UK resident makes a lump sum withdrawal from an RRSP or an RRIF, Canada imposes a 25 per cent withholding tax. No tax credit relief is allowable in the UK in respect of the tax withheld, however, because the Canadian tax is imposed upon the lump sum withdrawal (which does not itself give rise to a tax charge in the UK), whereas any UK tax charge is on the disposal of assets held within the Plan or Fund to enable the lump sum to be withdrawn (and no tax is levied on the disposal of fund assets in Canada). The Elimination of Double Taxation Article (Article 21) obliges the UK to give credit for Canadian tax paid only against UK tax computed by reference to the same profits, income or chargeable gains by reference to which the Canadian tax is computed. Since no UK tax is computed by reference to the subject of Canadian tax (that is, the

[41] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> withdrawal), no tax credit relief is allowable. Similarly, where the disposal of fund assets to facilitate a withdrawal gives rise to a UK tax charge, no tax credit relief is allowable since the disposal does not attract a tax charge in Canada.

This passage was withdrawn Feb 2017[42] and may now be of historical interest only.

Expat Q&A log provides:

> **Canadian RRSPs**
> **Question**: Does HMRC regard an RRSP as an "overseas pension scheme" under FA 2004 s150? Does the treatment set out in the IM1622 with regard to an RRSP still apply?
> If an RRSP is not an overseas pension scheme, is the group version of it an employer-financed retirement benefits scheme for the purposes of s393A ITEPA?
> **HMRC Answer**
> The response provided on 27/11/06 above[43] remains appropriate for periods prior to 6th April 2017. Subsequent to this date, HMRC consider that if the funds accrue in an RRSP or RRIF then we will tax them in the UK as a foreign pension. This change in approach regarding lump sums stems from the introduction of taxation of lump sums to UK residents from all foreign pension schemes introduced in FA 2017. If the funds have accrued in an RRSP or RRIF since 6 April 2017 they may be liable to tax in the UK (as a pension) and therefore from a treaty perspective we would rely on the conditions set out in the Pensions article of the UK/Canada Tax treaty. Prior to 6 April 2017 our position is outlined in the guidance at DT4605.[44]

38.16 Annuity income: Introduction

I would concentrate on the themes of this book, but the subject can only be understood in the context of the provisions as a whole.

[42] The passage is still online, see
https://www.gov.uk/hmrc-internal-manuals/double-taxation-relief/dt4617
But it does not appear in the index pages so someone browsing the manuals will not find it. It may be an accidental leftover or it may still be current.

[43] The text is set out in the original 2020/21 edition para 30.15 (Canadian RRSP and RRIF) but is now of historical interest only.

[44] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/897729/HMRC_Joint_Expat-Forum-Tax_NICs_minutes-11-June-2020.pdf*

Annuity income may be:

(1) pension income
(2) non-pension annuity income:
  (a) income from a purchased life annuity (see below)
  (b) misc sweep-up income
  (c) exempt (tax free)

The ITEPA charges on pension income have priority over the ITTOIA charge on annuity income.[45]

Non-pension annuities should perhaps be placed in a different chapter, but it is convenient to deal with them here.

A contract for a purchased life annuity in principle falls within the chargeable event rules.[46] So chargeable-event gains arising from the contract are in principle taxable.

I do not discuss deduction at source rules.

38.17 Annuity terminology

38.17.1 *"Annuity"*

The word "annuity" is used in many tax contexts and as far as I know, never defined. IPT Manual discusses the meaning:

> **IPTM1130. What is an annuity?** [Jun 2016]
> There is no single definition in the taxes acts. There is an ancient definition in Stroud's Judicial Dictionary, quoting Coke on Littleton:
>
> > An annuity is a yearly payment of a certaine summe of money granted to another in fee, for life, or yeares, charging the person of the grantor onely.[47]
>
> From an early case called *Foley v Fletcher*[48] the judgment of Watson B at 784-5 is often quoted:
>
> > But an annuity means where an income is purchased with a sum of money, and the capital has gone and has ceased to exist, the principal having been converted into an annuity.
>
> From this and other cases, notably *Southern-Smith v Clancy*, 24 TC 1, the following factors emerge as needing to be present
>
> - the payments must be made under a legal obligation

[45] See 14.7.7 (S & I Income/ITEPA income).

[46] See 70.2.4 ("Life annuity"); 70.3.1 (Policies within charge).

[47] *Stroud's Judicial Dictionary of Words and Phrases* (9th ed., 2016) pp. 129.

[48] (1858) 157 ER 678; 28 LJ Ex 100; 3 H & N 769 accessible *http://www.commonlii.org/uk/cases/EngR/1858/1107.pdf*

- those payments must be 'pure income profit'
- they must be capable of being characterised as 'annual', so being capable of recurrence on a periodic basis by reference to an annual time frame
- the purchase sum must pass absolutely to the provider
- no debtor/creditor relationship is created in relation to that sum; it is replaced by the annuity
- the annuitant's only right is to demand payments when due
- the payments must not be instalments of pre-existing debt.

38.17.2 *"Purchased life annuity"*

Section 423 ITEPA provides:

> (1) In this Chapter [Chapter 7 part 4 ITTOIA] "purchased life annuity" means an annuity—
>
> (a) granted for consideration in money or money's worth in the ordinary course of a business of granting annuities on human life, and
>
> (b) payable for a term ending at a time ascertainable only by reference to the end of a human life.
>
> (2) For this purpose it does not matter that the annuity may in some circumstances end before or after the life.

The definition of "annuity contract" in s.554V ITEPA is in the same terms.

In the UK, only insurance companies and friendly societies carry on the business of granting annuities. Outside the UK, a wider range of bodies may do so.

The IPT Manual discusses condition (1)(b) ("a term ending at a time ascertainable only by reference to the end of a human life") and identifies three types of annuity which meet this condition:

> **IPTM4210 guaranteed and temporary annuities** [Jun 2016]
>
> Annuities are flexible products and may take several forms.
>
> [1] A life annuity may, for example, be guaranteed to run for a specified period, even if the life ends before that period comes to an end, but will continue as a life annuity if the life survives the period.
>
> [2] Alternatively, there may be a guarantee that the purchase consideration will always be returned in full, even if the life ends before the end of the expected term. In this situation, the balance of the purchase price will usually continue to be paid out as continuing annuity payments following death. Naturally, all these potential benefits will be factored into the price of the annuity on actuarial principles.

> [3] Another variation is a temporary annuity, where the annuity comes to an end if the life survives beyond a specified period but otherwise terminates on the dropping of the life.
> For tax purposes, these arrangements are still dependent on human life, there is a life contingency, and payments made will be treated as purchased life annuities rather than as annuities certain, including those payments made in consequence of the guarantee, after the life has dropped.

38.17.3 *"Annuity certain"*

The IPT Manual provides:

> **IPTM4200 - Purchased life annuities: different types of annuity: annuities certain** [Jun 2016]
> Annuities certain provide a series of payments, usually in return for a single lump sum, that is payable for a fixed term. In particular, the term is not subject to alteration by the death of any person. In other words, there is no life contingency. If such an annuity is purchased from an insurance company or friendly society, part of each annuity payment is treated as a return of capital. This result, unlike the situation in relation to a life annuity, follows from first principles as determined by the Court - see *Perrin v Dickson* (1929), 14 TC 608. The reasoning is that, as the term is known from the start, it is straightforward and correct to determine the amount of exempt capital comprised within each payment. Only the interest, or income, element is treated as income for tax purposes. And it is taxed as interest rather than as an annual payment. Annuities certain are not annuities in the true sense at all. The tax treatment of the payments is thus similar to that of purchased life annuities, but they are not within the scheme described at IPTM4300 as the dissection arises on first principles. If written by an insurance company they are in fact a variety of capital redemption policy, see IPTM1120, and consequently are potentially within the chargeable events regime, see IPTM3300, though they are not likely to give rise to chargeable events, see IPTM3400.A UK-resident insurance company will deduct tax at the basic rate from the payments it makes, but from the interest parts only. In total, the interest parts will be equal to the amount by which the sum of the annuity payments exceeds the purchase price of the annuity.

The author is right to say that "annuities certain are not annuities in the true sense" and it would be better not to use the term annuity in this context.

38.18 Purchased life annuity: Charge

This is dealt with in Chapter 7 Part 4 ITTOIA.

Section 422(1) ITTOIA provides:

> Income tax is charged on annuity payments made under a purchased life annuity.

Section 424 ITTOIA provides:

> (1) Tax is charged under this Chapter on the full amount of the annuity payments arising in the tax year.
> (2) Subsection (1) is subject to Part 8 (foreign income: special rules).

Subsection (2) incorporates the remittance basis for foreign source annuity income.

Section 422(2) ITTOIA lists exemptions:

> For exemptions, see in particular—
> (a) section 717 (exemption for part of purchased life annuity payments),
> (b) section 725 (annual payments under immediate needs annuities),
> (c) section 731 (periodical payments of personal injury damages), and
> (d) section 732 (compensation awards).

These exemptions are not discussed here.

The IPT Manual explains:

> **IPTM4100 - Purchased life annuities: background** [Jun 2016]
> ...In 1956, following the 1954 Report of the Committee on the Taxation Treatment of Provisions for Retirement, legislation was introduced that ... provides for the creation of what ICTA88 calls a 'capital element', and ITTOIA05 an 'exempt sum', or 'exempt proportion', depending on the type of calculation involved, see IPTM4310. It reflects the amount of exempt capital comprised within each of the annuity payments. In broad terms, the exempt capital amount is obtained by dividing the purchase price of the annuity by the subject's life expectation, determined according to prescribed mortality tables.

CHAPTER THIRTY NINE

BENEFIT IN KIND: FAMILY HOME AND CHATTELS

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39.1 Home/chattels owned by company

Until 2013 it was common for the family home to be acquired by a company and occupied by individuals with some interest in the company. IHT (excluded property) was often (perhaps generally) the main reason, but there were other advantages including confidentiality and limited liability.

Following the introduction of ATED in 2013, acquisition by companies became less attractive. The 2017 IHT residential-property code removed the IHT advantage, and ECTEA has removed the confidentiality. Corporate acquisition will now be rare. There remain a significant, if decreasing, number of companies holding properties acquired before 2013.

It is still common for valuable chattels to be held by companies.

Corporate ownership raises many tax issues. The main topics are covered in 3 chapters:

Topic	**Chapter**
Employment income benefits in kind	*This chapter*
IHT residential-property code and tax planning	82.1
ATED and ATED-SDLT	98.1

39.2 The benefits code

The "benefits code" is the statutory term for the provisions which charge benefits in kind (**"BiK"**) in Part 3 ITEPA.

Section 63(1) ITEPA lists them, non-numerically:

In the employment income Parts “the benefits code” means:[1]

Chapter	**Topic**	**See**
2	General	
3	Expenses payments	*Not discussed*
4	Vouchers and credit-tokens	*Not discussed*
5	Living accommodation	*Discussed here*
6	Cars, vans and related benefits	*Not discussed*
7	Loans	40.2
10	Residual benefit in kind charge	*Discussed here*

Thus there are six categories of benefits in kind. Part 3 is best regarded as six distinct sub-codes: each Chapter provides a (more or less) self-contained code. They share a few definitions and other rules, but they do not have much in common. Perhaps “benefit codes” (in the plural) would be a more apt label; but using the singular shows at least an aspiration to coherence.

This chapter deals with two of these codes:

(1) Chapter 5: (“**accommodation BiK charge**”)

(2) Chapter 10: I call this the “**benefit BiK charge**” and leave “residual” to be understood. This catches the benefit of use of chattels (except cars, which come under Chapter 6). Common examples are works of art, yachts and aircraft.

I go beyond the themes of this book and address these topics as a whole, in the following order:

(1) Property law background

(2) Definitions applying to the benefits code generally

(3) BiK codes:

  (a) Accommodation BiK code

  (b) The benefit BiK code

(4) Remittance basis, non-residence, and other issues which apply to the benefits code generally

39.3 Property law background

A company may hold property:

(1) Beneficially

(2) As nominee/bare trustee, for an individual, or other person, as a result of:

[1] I recast the statutory text into a table easier to follow.

(a) A declaration of nomineeship
(b) A resulting trust
(c) Sham (an ineffective trust)
I refer to that as **“corporate nomineeship”**.

39.3.1 *Company ownership: Home*

In *Prest v Petrodel Resources*:[2]

> Whether assets legally vested in a company are beneficially owned by its controller is a highly fact-specific issue. It is not possible to give general guidance going beyond the ordinary principles and presumptions of equity, especially those relating to gifts and resulting trusts.

Having issued the disclaimer, the court went on to give its guidance:

> But I venture to suggest, however tentatively, that in the case of the matrimonial home, the facts are quite likely to justify the inference that the property was held on trust for a spouse who owned and controlled the company.

The court gives two or three reasons for this view:

> [1] In many, perhaps most cases, the occupation of the company’s property as the matrimonial home of its controller will not be easily justified in the company’s interest, especially if it is gratuitous.
> [2] The intention will normally be that the spouse in control of the company intends to retain a degree of control over the matrimonial home which is not consistent with the company’s beneficial ownership.
> [3] Of course, structures can be devised which give a different impression, and some of them will be entirely genuine. But where, say, the terms of acquisition and occupation of the matrimonial home are arranged between the husband in his personal capacity and the husband in his capacity as the sole effective agent of the company (or someone else acting at his direction), judges exercising family jurisdiction are entitled to be sceptical about whether the terms of occupation are really what they are said to be, or are simply a sham to conceal the reality of the husband’s beneficial ownership.[3]

[2] [2013] 2 AC 415 at [52].

[3] The third reason is just an example or facet of the second.
A sham argument was rejected in *Skyparks v Marks* [2001] WTLR 607. But sham depends on the facts in each case.

In *Prest*, the refusal to co-operate by the companies concerned was said to evidence in favour of corporate nomineeship. It seems to me an exaggeration to say corporate nomineeship will *normally* be the intention where a company owns legal title to the family home. I have wondered whether there is a divide between the family and chancery divisions of the High Court, despite protestations to the contrary;[4] but perhaps corporate nomineeship is more common in those family law cases which come before the courts, while not typical of the whole. It would need some empirical research to answer that.

However that may be, there should be no difficulty in arranging beneficial ownership in the company, if that is what is desired, given proper advice to the client, proper documentation, and competent company directors who can attest that they know and fulfil their duties as directors. Proper conveyancing, company accounts and a lease or licence agreement between the company and the occupier are important indicators of corporate beneficial ownership.

In some cases the taxpayer may wish to argue that the company *does* hold property as nominee, to avoid benefit in kind, ATED and other charges associated with corporate ownership. In particular, if a person is a shadow director, that supports the view that the company is not beneficial owner,[5] which may be helpful from a tax viewpoint.

39.3.2 *Company ownership: Chattels*

Similar issues may arise as for the family home, but there may be a further conveyancing issue. The Bills of Sale Act 1878 (in short) applies where a person makes a transfer of goods (a "bill of sale" is widely defined) and retains possession of the goods. This could apply on a transfer from an individual to a trust or to a company. The transfer is void as against the trustees in bankruptcy of the transferor unless the bill of sale is registered in a public register. This is to prevent fraud on creditors. However, it really does not matter if a transfer of chattels is void as against a trustee in bankruptcy, in the event that the individual became bankrupt. After all, every gift and transaction at an undervalue can in principle be set aside

[4] *Prest* at [37]: "Courts exercising family jurisdiction do not occupy a desert island in which general legal concepts are suspended or mean something different. If a right of property exists, it exists in every division of the High Court and in every jurisdiction of the county courts. If it does not exist, it does not exist anywhere."

[5] *M v M* 16 ITELR 391 at [214].

within two years,[6] but no-one suggests that has significant tax implications for solvent taxpayers. Thus registration of a transfer of chattels (the bill of sale) is not necessary, and in practice it is never done.

39.4 "Family" and "household"

39.4.1 *"Family"*

Section 721(4) ITEPA defines "family":

> For the purposes of this Act the following are members of a person's family—
> (a) the person's spouse or civil partner,
> (b) the person's children and their spouses or civil partners,
> (c) the person's parents, and
> (d) the person's dependants.

Stepchildren are excluded, as are parents-in-law. They will however still qualify as family if they are dependants.

Illegitimate children do not count as "children"; see s.721(6) ITEPA.[7] This is unacceptable by contemporary standards, but it will not often matter, and the parent is not likely to complain. Section 721(6) should obviously be repealed.

39.4.2 *"Household"*

Section 721(5) ITEPA provides:

> For the purposes of this Act the following are members of a person's family or household—
> (a) members of the person's family,
> (b) the person's domestic staff, and
> (c) the person's guests.

39.4.3 *Which family*

In *Baylis v HMRC*[8] a benefit (care home fees) was provided to a non-employee who was:

(1) spouse of one employee ("the husband")
(2) mother of another employee ("the daughter")

[6] Section 339 Insolvency Act 1986.

[7] In Scots law there are no illegitimate children, so this does not apply to Scots domiciled individuals; see 4.18.5 (Abolition of illegitimacy).

[8] [2017] SFTD 217.

It seemed that:

(1) The husband was taxable as there was a benefit to his family (to his spouse) under s.721(4)(a).
(2) The daughter was taxable as there was a benefit to her family (to her mother) under s.721(4)(c).

But they could not both be taxable, so which was it to be? HMRC argued that the employer had the right to choose! but that could not be right. The tribunal inventively found the solution in the order in which the relationships were listed in s.721(4), so the husband was taxable in priority to the daughter.

The decision ought to be confirmed by statute, and it leaves a few loose ends, but it seems as good a solution as any other.

39.5 "Director"

Section 67(1) ITEPA provides:

> In the benefits code "director" means--
> (a) in relation to a company whose affairs are managed by a board of directors or similar body, a member of that body,
> (b) in relation to a company whose affairs are managed by a single director or similar person, that director or person, and
> (c) in relation to a company whose affairs are managed by the members themselves, a member of the company,[9]
>
> and includes [a shadow director, discussed in the next section below].

39.6 Shadow directors

39.6.1 *"Shadow director"*

Section 67(1) ITEPA provides:

> In the benefits code "director" ... includes any person in accordance with whose directions or instructions the directors of the company (as defined above) are accustomed to act.

Such a person is referred to as a **"shadow director"**.[10]

[9] When are the affairs of a company managed by the members themselves? An example is an unincorporated association which is a company for UK tax purposes but which may have members but no directors. Likewise some foreign law entities, for instance, perhaps, a foreign law LLP.

[10] A note on terminology. This useful and familiar label was first used in the Companies Act 1980. The wording of the concept behind the label goes back to the Companies

In *Secretary of State for Trade and Industry v Deverell* Morritt LJ comments in numbered paragraphs:[11]

> (1) The definition of a shadow director is to be construed in the normal way to give effect to the parliamentary intention ascertainable from the mischief to be dealt with and the words used. In particular, as the purpose of the Act is the protection of the public and as the definition is used in other legislative contexts, it should not be strictly construed because it also has quasi-penal consequences in the context of the Company Directors Disqualification Act 1986.

This suggests that the comments in *Deverell* will apply in all contexts where the standard definition of shadow director is used, including tax contexts. It is difficult to argue that the shadow director concept should have a different meaning in a tax context than in the director disqualification context of *Deverell*. But *Deverell* is considering "shadow directorship" in the context of a commercial trading company. The position of a relatively quiescent property holding company is different.

> ... (2) The purpose of the legislation is to identify those, other than professional advisers, with real influence in the corporate affairs of the company.

This paraphrase does not take us very far because it only raises the question as to what is meant by "real[12] influence".

> But it is not necessary that such influence should be exercised over the whole field of its corporate activities. ...

This is uncontentious. The BiK charge could apply where a trust held a company holding both a home and investments, even though the shadow director did not give instructions relating to the investments but only to the home.

> (3) Whether any particular communication from the alleged shadow director, whether by words or conduct, is to be classified as a direction

(Particulars as to Directors) Act 1917.

[11] [2001] Ch 340 at p.354. In his readable memoir, Kerr LJ deprecates "quotable pontific paragraphs, preferably numbered": *As Far as I Remember* (2006), p.285. Passages of that kind can be useful, but the point is not to elevate them to a higher status than other types of case law.

[12] The dangerous and beguiling word "real" is normally an indicator of vague if not sloppy legal thinking. See App 7.1 (What Do We Mean by "Real"?).

> or instruction must be objectively ascertained by the court in the light of all the evidence.

Obviously.

> In that connection I do not accept that it is necessary to prove the understanding or expectation of either giver or receiver. In many, if not most, cases it will suffice to prove the communication and its consequence. Evidence of such understanding or expectation may be relevant but it cannot be conclusive.

This is extraordinary. "Directions or instructions" are a subset of "communications" and the feature that distinguishes them is that a person giving instructions expects them to be followed and the person receiving them understands this.

> Certainly the label attached by either or both parties then or thereafter cannot be more than a factor in considering whether the communication came within the statutory description of direction or instruction.

This at least is correct.

> (4) Non-professional advice may come within that statutory description. The proviso excepting advice given in a professional capacity[13] appears to assume that advice generally is or may be included.

This is extraordinary, for the concept of "directions or instructions" is the antithesis of "advice". The distinguishing feature is that the former is mandatory and the other is not. This is confirmed (if confirmation was necessary) by Hansard. When (what is now) the proviso was proposed, the Lord Chancellor (Viscount Cave) said:

> it is unnecessary, because in my view the expression "any person in accordance with whose directions or instructions the directors are accustomed to act" does not include a person who merely gives them advice. Directors do not act by the directions or on the instructions of their solicitor or their auditor. Those persons advise them, but do not direct or instruct them.[14]

[13] See s.67(2) ITEPA:
"... a person is not to be regarded as a person in accordance with whose directions or instructions the directors of the company are accustomed to act merely because the directors act on advice given by that person in a professional capacity."

[14] *https://api.parliament.uk/historic-hansard/lords/1927/may/26/companies-bill-hl*

The clause was added for clarity. Lord Banbury said:

> This seems to me to be an extremely complicated Bill and therefore any Amendment which makes it clearer should, I venture to say, be accepted. The Amendment of the noble Earl makes it quite clear that any person who ... gives advice professionally shall not be included as a director. The Lord Chancellor says that is not necessary because it is already the meaning and interpretation of the Bill, but speaking only as an ordinary layman, I am not at all sure if I were asked to give my opinion on that, that I should think that really was so. Consequently there might be a certain number of people who would take advantage of this to go to law, spend money in bringing an action and then find they had no grounds for their case. ... I do think it would be an advantage if some words were put in to make the section quite clear.[15]

Of course, advice may slide imperceptibly into directions. For instance, if a solicitor advises a company that a particular act is required by law, and there is no option but too adopt it. Such advice may arguably be characterised as a direction or an instruction, and here the proviso may be useful.

The proviso excepting advice given in a professional capacity, properly understood, does not shed any light on the general meaning of shadow director.

The court in *Deverell* continued:

> Moreover the concepts of "direction" and "instruction" do not exclude the concept of "advice" for all three share the common feature of "guidance".

The less said about this line of reasoning the better.

> (5) It will, no doubt, be sufficient to show that in the face of "directions or instructions" from the alleged shadow director the properly appointed directors or some of them cast themselves in a subservient role or surrendered their respective discretions. But I do not consider that it is necessary to do so in all cases. Such a requirement would be to put a gloss on the statutory requirement that the board are "accustomed to act" "in accordance with" such directions or instructions. It appears to me that Judge Cooke, in looking for the additional ingredient of a subservient role or the surrender of discretion by the board, imposed a qualification beyond that justified by the statutory language.

[15] *https://api.parliament.uk/historic-hansard/lords/1927/may/26/companies-bill-hl*

If the statutory language were: "in accordance with whose *wishes* the directors were accustomed to act" this would be a fair comment. But the expression "directions or instructions" shows that the position must be one where the shadow director commands and the properly appointed directors obey.

The points made in the passage are wholly negative. That is, in determining the issue of "shadow directorship":

(1) The understanding or expectation of the parties is *not* conclusive.
(2) The label attached by the parties is *not* conclusive.
(3) The fact that the communication is "advice" is *not* conclusive (except in the case of professional advice).
(4) The fact that the properly appointed directors surrender their discretions or act in a "subservient" role is *not* essential.

This does not answer the question: how *does* one identify a shadow director? The mere fact that there is a stream of communications from the individual to the company, which is acted on by the company, is not conclusive. The author regularly sends "communications" to Amazon, and Amazon act on those communications without fail. Yet the author is not a shadow director of Amazon. The author regularly sends directions (a cheque is a direction) to his bank and the bank act on those directions without fail. Yet the author is not a shadow director of the bank. In the 4th edition of this work I concluded:

> one can expect some back-tracking, refinement or qualification from the Courts in cases they regard as more meritorious than that of Mr. Deverell.

This has now been confirmed by *Ultraframe v Fielding*:[16]

> 1267 ... where the alleged shadow director is also a creditor of the company, he is entitled to protect his own interests as creditor without necessarily becoming a shadow director.
> 1268 [Counsel] submitted that it is critical to distinguish the position of a lender (whether or not also a shareholder) from that of a director. A lender is entitled to keep a close eye on what is done with his money, and to impose conditions on his support for the company. This does not mean he is running the company or is emasculating the powers of the

[16] [2005] EWHC 1638, [2007] WTLR 835.

> directors, even if (given their situation) the directors feel that they have little practical choice but to accede to his requests. Similarly with customers who may, because of their buying power, be able effectively to dictate conditions to their suppliers (or the other way around). In other words a position of influence (even a position of strong influence) is not necessarily a fiduciary position. To find otherwise would place a wholly unfair and unnatural burden on men of business. In broad terms, I accept this submission.

The approach which applies to a creditor of the company also applies to a beneficiary of a trust which holds the company: they are entitled to protect their own interests … without necessarily becoming a shadow director … In other words a position of influence (even a position of strong influence) is not necessarily a a shadow directorship.

HMRC have in the past argued that where someone resides in a property held by a company which is held by a trust of which that person is a beneficiary, it is (at least) highly likely that that person must be a shadow director.[17] This is unjustified for the reason set out in *Ultraframe*.

Suppose a person treats the property owned by the company as their own and has no dealings with the directors: they just ignore them. They do nothing (except perhaps charge their fees). In such a case the company may be a sham (or nomineeship). Whether or not that is so, the individual is not a shadow director. They give no instructions.

A non-resident person may be a shadow director, but may fall outside the BiK charge for other reasons.[18]

The definition of shadow director is restricted to those who control all or the majority of the directors on a company's board. Control of a minority of directors does not suffice.

39.6.2 *Agent as shadow director*

It is suggested that an agency agreement under which the occupier of a property is responsible for routine maintenance matters on behalf of the company would not make the individual a shadow director as long as the decision to enter into contract was properly made by the directors and the

[17] Note that there is no support for this view in the HMRC Manuals. Employment Income Manual 11413 [Apr 2022] states correctly that *where* an individual residing in property is a shadow director, there is a BiK charge. It does *not* state that the mere fact of occupation makes a shadow directorship "highly likely".

[18] See 39.40 (Benefits in kind: Non-resident).

directors properly supervise the work of the individual.[19] This should not be difficult if the directors understand their duties are to all beneficiaries of the trust (not just to the settlor) and if the individual occupier of the property also understands this. It would be different if the agency agreement covered matters not usually delegated by an investment company to an agent.

39.6.3 *Occupier as shadow director*

Suppose an existing company purchases a home or chattels for use by a UK resident foreign domiciliary. The choice of a home and its chattels is a personal one and the individual would normally have to give at least a"communication" to the company which raises at least potential shadow directorship issues.

The position is different if:

(1) trustees purchase property directly, and
(2) the trustees transfer the property to a foreign company on their own initiative and without reference to the occupier.[20]

In this scenario the decision involving the company's acquisition is that of the trustees, not the individual.

It would be best if the directors and trustees were separate persons. All communications should be through the trustees and not the directors of the company.

If the foreign domiciliary desires to sell and, perhaps, purchase another home, they should communicate their wishes to the trustees. Then:

(1) The trustees may put the company into liquidation. The liquidator would sell the property.
(2) Alternatively, the trustees may sell the company.

In these circumstances it would be difficult to argue that the occupier was a shadow director.

39.6.4 *Charge on shadow director*

The House of Lords decided in *R v Dimsey*[21] that the benefits code applies

[19] This is consistent with the rule that the activities of an agent appointed by trustees to manage the day to day affairs of a trust were not relevant in determining the place of general administration (which was formerly important for determining CGT trust residence).See the 5th edition of this book, para 5.6.2.

[20] In the case of land, this may be done between contract and completion.

[21] [2001] UKHL 46. The reasoning continues to apply under ITEPA.

to shadow directors. In the context of a company holding a residence, the charge is unfair to a shadow director who (typically) does no work for the company. Income tax is, or should be, a tax on income, or at least a tax on something. This is a tax on nothing. But there it is.[22]

EI Manual states:

> **EIM11413 Avoidance area: shadow directors** [Apr 2022]
> A person in accordance with whose directions or instructions the directors of a company are accustomed to act is deemed to be a director of that company by s.67(1) ITEPA 2003. Where such a person (known as a shadow director) is provided with living accommodation by the company the individual will be within Part 3 Chapter 5 ITEPA 2003 in the same way as if the individual had held a formal appointment as a director. Section 67(1) defines director in relation to the benefits code and s.63 ITEPA 2003 includes Part 3 Chapter 5 within the benefits code. This interpretation was supported by the House of Lords in October 2001 in the case of *R v Allen*. Lord Hutton held that
>
> > "it was the intention of Parliament in enacting the concluding part of [what is now s.67(1) ITEPA] s.168(8) that accommodation and benefits in kind received by a shadow director should be taxed in the same way as those received by a director."
>
> ...Many shadow directors are individuals who, although not domiciled in the UK, have come to work and reside here. In order to avoid a possible charge to inheritance tax, which could be imposed if such an individual died whilst working in the UK, an arrangement is made to set up an offshore company that owns the UK property in which the individual lives. Where the individual is a shadow director of that offshore company s.97(2) ITEPA 2003 deems the UK property to be provided to the shadow director by reason of the deemed employment.

In practice taxpayers (if they have considered the matter at all) generally seem to have taken the view on their facts that they are not shadow directors. HMRC have to take the initiative to identify the cases suitable for investigation. In the author's experience even accommodation cases that HMRC have tentatively identified are not pursued with much gusto if at all. One wonders why. Perhaps the unfairness of the charge holds

[22] The problem did not unduly concern the House of Lords because of the countering unfairness to HMRC of the case where the services of a shadow director were as valuable as an actual director ([2001] UKHL 46 HL at [19]; two wrongs made a right to tax.

HMRC back.[23] Perhaps it is the consideration that if cases are identified, the taxpayer can still avoid a charge by belated reimbursement.

R v Allen[24] was an accommodation case. In law, the same points apply to the benefits code generally. In practice HMRC may well not pursue the point, and it is noteworthy that the only references to shadow directors in the EI Manual are in the context of accommodation.

HMRC practice may change without notice, and taxpayers cannot rely on it. Taxpayers cannot plan on the assumption that HMRC's benign neglect of the provisions will apply to them.

39.7 "Employment" & related terms

Section 66 ITEPA provides:

> (1) In the benefits code—
> (a) "employment" means a taxable employment under Part 2, and
> (b) "employed", "employee" and "employer" have corresponding meanings...
>
> (3) For the purposes of the benefits code an employment is a "taxable employment under Part 2" in a tax year if the earnings from the employment for that year are (or would be if there were any) general earnings to which the charging provisions of Chapter 4 or 5 of Part 2 apply.
>
> (4) In subsection (3)—
> (a) the reference to an employment includes employment as a director of a company, and
> (b) "earnings" means earnings as defined in Chapter 1 of this Part.[25]

Why does the benefits code not use the standard ITEPA definitions?[26] The definitions are the same. The reason lies in the long and convoluted history of the provisions.

Section 66(2) dots *I*'s and crosses *T*'s:

> Where a Chapter of the benefits code applies in relation to an employee—

[23] Conceivably (this is surmise) HMRC "officially" took the accommodation BiK point to deter IHT planning, but at the same time did not pursue it in practice because of the unfairness. If so, the tactic (while contrary to the Rule of Law) worked up to a point.

[24] [2001] UKHL 46.

[25] See 34.4.1 ("Ordinary" earnings).

[26] For this definition, see 34.3 (Employment/employer/employee).

(a) references in that Chapter to "the employment" are to the employment of that employee, and
(b) references in that Chapter to "the employer" are to the employer in respect of that employment.

Was it really necessary to say that?

39.8 Accommodation/benefit charge

There is similar wording used in the following:[27]

Topic	**ITEPA gateway provision**
Accommodation	s.97
Benefit BiK charge	s.201
Employment-related securities	s.421B
Securities options	s.471

Employment-related securities/options need a book to themselves, and this work does not cover them. But I discuss all four provisions here because guidance on one may be relevant to the others.

The gateway provision offers two tests which I call:

Test (my term)	**Accommodation/benefits**	**Securities/security option**
Employment-causation test	s.97(1)/s.201(2)	s.421B(1)/471(1)
Employer-provision test	s.97(2)/s.201(3)	s.421B(3)/s.471(3)

39.9 Employment-causation test

Accommodation: s.97(1)	**Benefits: s.201(1)**	**Securities: s.421B(1)**	**Security option: s.471(1)**
This Chapter [Chapter 5 Part 3] applies to living accommodation provided	In this Chapter [Chapter 10 Part 3] ... "employment-related benefit" means a benefit, other than an excluded benefit, which is provided in a tax year—	Subject as follows (and to any provision contained in Chapters 2 to 4A) those Chapters apply to securities, or an interest in securities, acquired by a person	This Chapter applies to a securities option acquired by a person
for— (a) an employee, or (b) a member of an employee's family	(a) for an employee, or (b) for a member of an employee's family	[No express equivalent!]	[No express equivalent!]

[27] This is not a full list.

or household,	or household,		
by reason of the employment.	by reason of the employment.	where the right or opportunity to acquire the securities or interest is available by reason of an employment of that person or any other person.	where the right or opportunity to acquire the securities option is available by reason of an employment of that person or any other person.

The main requirements here are in short:

(1) (a) Accommodation/benefit is provided for an employee or
(b) Securities/option acquired by a person under right available
(2) (in each case) by reason of employment.

39.9.1 *The two causation tests*

There are two distinct causation tests, or so it has been said, and if that is right we need labels for them:

Causation test	**Statutory wording**	**See**
Benefit in kind causation test	By reason of employment”	*discussed here*
Ordinary earnings causation test	“therefrom” ie from the employment	34.4.1

That these are distinct tests is supported by high authority. In *Wicks v Firth*:[28]

> It seems to me that the words “by reason of” are far wider than the word “therefrom” in [s.19 ICTA 1988]. They are deliberately designed to close the gap in taxability which was left by the House of Lords in *Hochstrasser v Mayes*[29].

And in *Mairs v Haughey*:[30]

> I respectfully agree ... that the words “by reason of” in s 154 are wider than the word "therefrom" in s 19(1) [ICTA].

There is in fact no perceptible difference between:

[28] p363; Watkins LJ agreed : p.372 . This point was not considered on the appeal.

[29] 38 TC 673.

[30] 66 TC 273 at p.312.

(1) *by reason of* an employment, the wording of the benefit in kind causation test; and
(2) *from* an employment, the wording of the ordinary income causation test.

What happened was that the Courts wished to step back from the wrong turn which the law took in *Hochstrasser v Mayes* and seized on the difference in wording to justify it. But since the ordinary income causation test has moved on since *Hochstrasser v Mayes* I am still not sure that there is much difference.

However that may be, a satisfactory tax system would have only one employment-causation test, the same applying for ordinary earnings and for benefits in kind. That change cannot be achieved by statute without a change of wording which would lead to a review of all the existing case law, which is a high price for coherence and simplicity. But the Supreme Court could bring coherence to the topic, and merge the two tests, if the opportunity arises.

39.9.2 *What is the test?*

Since we have a causation test in the benefit in kind code, we need to define it. In *Wicks v Firth*, Lord Denning said:[31]

> [1] The words cover cases where the fact of employment is the *causa sine qua non* of the fringe benefits, that is, where the employee would not have received fringe benefits unless he had been an employee.
> [2] The fact of employment must be one of the causes of the benefit being provided, but it need not be the sole cause, or even the dominant cause. It is sufficient if the employment was an *operative cause* - in the sense that it was a condition of the benefit being granted. In this case the fact of the father being employed by ICI was a condition of the student being eligible for an award.

Oliver LJ said:

> Speaking only for myself I do not, in the case of this legislation, find the philosophical[32] distinction between a "causa causans" and a "causa sine

[31] p363; Watkins LJ agreed : p.372 . This point was not considered on the appeal.

[32] "Philosophical" here is used rhetorically and pejoratively. But the reader may think the law needs more rather than less philosophy when grappling with causation, which HLA Hart sought to provide in his influential *Causation in the Law* 2nd ed, (1985).

> qua non" helpful.

Distinctions between different concepts or tests of causation are certainly necessary. Latin terminology is not (or at least, not nowadays) a helpful way to express them.[33] But with or without the use of Latin terminology, what *is* the benefit in kind causation test? Oliver LJ put it this way:

> One is directed to see whether the benefit is provided by reason of the employment and in the context of these provisions that, in my judgment, involves no more than asking the question "what is it that enables the person concerned to enjoy the benefit?" without the necessity for too sophisticated an analysis of the operative reasons why that person may have been prompted to apply for the benefit or to avail himself of it.

I am not sure that there is much (if any) difference between the two judges, because although Lord Denning at [1] appears to put forward a simple "but for" test, the test is somewhat refined at [2]. But case law has generally perceived a difference, and favoured Oliver LJ's approach to the meaning of "by reason of".[34] It is sufficient to cite *Mairs v Haughey*:[35]

> I prefer, with respect, the test suggested by Oliver L.J. which involves asking the question "what is it that enables the person concerned to enjoy the benefit?" than the *causa sine qua non* test suggested by Lord Denning.
> ... if one does not apply to [benefits in kind] the *causa causans* test approved by the House of Lords in relation to s 19(1) [ICTA],[36] a *causa sine qua non* may constitute a "reason" for the provision of a benefit. But I consider, with respect, that the *causa sine qua non* test suggested by Lord Denning is too wide and could let in a factor in the past which, in ordinary language, would not constitute a "reason" for the provision of the benefit.

Vermilion v HMRC offers generalities:[37]

[33] See 34.5.1 (Latin causation test rejected).

[34] See *HMRC v Vermilion Holdings* [2023] UKSC 37 at [12], citing 3 cases:
Mairs v Haughey [1992] STC 495 at p.525
Wilcock v Eve [1995] STC 18 at p.29
Charman v HMRC [2022] 1 WLR 2277 at [47]

[35] 66 TC 273 at p.312.

[36] The reference is to *Hochstrasser v Mayes* 38 TC 673 at p 705 but see 33.5.1 (Latin causation test rejected).

[37] [2020] UKUT 162 (TCC) at [71]. In the appeal to the Supreme Court, the causation test was not considered.

> What we take from *Wicks v Firth* is that the phrase "by reason of employment" is to be given its ordinary meaning (!) and must be considered in the circumstances of the particular case. We note also that the employment need not be the sole reason: it is enough that the employment was a condition of a benefit being granted.

Once we have agreed the words which express or explain any causation test, which whatever they are, must be general words, we then have to apply them to the facts of individual cases; that is where the real difficulty lies, and that is where such guidance as exists must be found.[38] In *Wicks v Firth*, if there was substantial disagreement on the benefit in kind causation test (which I doubt), there was at least agreement on the outcome. In that case the benefit in kind was a scholarship under a scheme limited to employees' children, and this benefit was provided by reason of employment:[39]

> In this case the fact of the father being employed by ICI was a condition of the student being eligible for an award. There were other conditions also, such as that the student had sufficient educational attainments and had a place at a university. But still, if the father's employment was one of the conditions, that is sufficient.

39.10 Employer-provision test

Accommodation: s.97(2)	**Benefits: s.201(3)**	**Securities: s.421B(3)**	**Security option: s.471(3)**
Living accommodation provided for any of those persons	A benefit provided	A right or opportunity to acquire securities or an interest in securities made available	A right or opportunity to acquire a securities option made available
by the employer	by an employer	by a person's employer, or by a person connected with a person's employer,	by a person's employer, or a person connected with a person's employer,
is to be regarded as provided by reason	is to be regarded as provided by reason	is to be regarded for the purposes of	is to be regarded for the purposes of

[38] *Charman v HMRC* [2021] EWCA Civ 1804; *Vermilion v HMRC* (not yet final).

[39] p363.

of the employment...	of the employment...	subsection (1) as available by reason of an employment of that person ...	subsection (1) as available by reason of an employment of that person...

[Personal relationship exemption: see 79.9 (Personal relationship exemption)]

The main requirements here are in short:

(1) Accommodation/benefit is provided by the employer or

(2) Securities/option acquired under a right made available by the employer

There is no requirement that the provision is actually by reason of employment. In this case, causation is not relevant. However accommodation/benefits do have to be "provided by" the employer and securities/options have to be "made available by" the employer/connected person.

In *HMRC v Vermilion Holdings*:[40]

> It is not difficult to ascertain the purpose of the deeming provision in section 471(3). The causation questions which can arise under section 471(1) may be difficult and may give rise to disagreement among judges as has occurred in this case. To avoid such difficult questions, subsection (3) creates a bright line rule: if a person's employer (or a person connected to that person's employer) provides the employee the right or opportunity to acquire a securities option, that right or opportunity is conclusively treated as having been made available by reason of the employment of that person (unless subsections (a) and (b) apply). This involves a straightforward examination of the agreement or transaction to ascertain who conferred the right or opportunity. The question is not concerned with the reason why the employer conferred the right or opportunity.

The facts of *Vermilion* were:

(1) The taxpayer (at the time, a consultant) was granted a share option which was not provided by reason of employment, or provided by an employer, so was outside the income tax charge.

(2) Subsequently under a reorganisation carried out for commercial reasons, that option was abandoned and a new one granted, at a time

[40] [2023] UKSC 37 at [24], reversing the Court of Session decision which had been criticised in the 2023/24 edition of this work.

when the taxpayer was an employee.

In these circumstances a number of judges in the lower courts thought that the income tax charge was anomalous, absurd and unjust. The supreme court found that it was none of these.[41] One might conclude that anomaly, absurdity and injustice are matters on which opinion may differ; but I think it would be more accurate to say that these are expressions commonly used (or misused) for rhetorical or adversarial purposes. The reader may think the truth lies between these two extremes: the outcome was somewhat unfair. I only say "somewhat" unfair because it should have been possible to retain the existing option, perhaps in varied form, rather than cancel it and grant a new one. The moral is that more care needed to be taken in the drafting. It is often the case that drafting determines outcomes.[42]

But however one assesses the level of unfairness, it is in the nature of a bright line test that outcomes can be unfair. The alternative is uncertainty, which may be worse than unfairness.[43]

[41] at [33].

[42] See app 4.3 (Contract states consideration).

[43] In the 2023/24 edition, I criticised the Court of Session decision [2021] CSIH 45 for this reason, saying:

> In *Vermilion v HMRC*, by a majority decision, the Court of Session gave an narrow reading to the scope of the employer-provision test. The Court raised the example of a bank making a securities option available to customers, some of whom would be employees and others not. Even HMRC did not argue the bank's employees were taxable, though if one takes the words literally, they must be. As an exercise in advocacy this concession was no doubt a tactically wise one. So everyone agreed that this was not within s.471(3); but what then is the test of taxability?
>
> Lord Malcolm floated a capacity test:
>
> > In the bank example mentioned above the benefit was made available by the employer, but not in that capacity; not as the recipient's employer.
>
> That is probably the best solution. Though if this test is met, the securities option would be available "by reason of" employment, and the provision test would not add anything.
>
> HMRC proposed a "real link" test (at [66]). References to reality do not much assist us, see App 7.1 (What do we mean by real), so that amounts to a sufficient-link test by a more attractive name; but it would not possible to know what amounts to a real or sufficient link until we have many more decided cases. So that is no more satisfactory, and the reader looking for certainty may think, much less.
>
> Or perhaps the test is whether the tax charge is "anomalous, absurd and unjust". Two of the 3 judges thought that this was the case, and one disagreed; which only shows that this is not a clear test either.

I concluded: "Let us hope the final decision leaves the law in a clearer state." And

39.10.1 *Causation/provision tests compared*

In short:

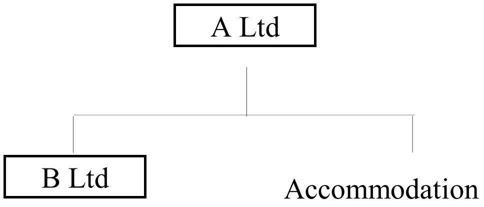
(1) Where accommodation/benefit is provided by the employer, it does not matter if it is actually provided by reason of employment: it is deemed to be so provided.

(2) Where accommodation/benefit is not provided by the employer, the charge only applies if the accommodation is actually provided by reason of the employment.

Suppose a company A Ltd owns:

(1) accommodation which it provides to T,

(2) another company, B Ltd:



If T is an employee of A Ltd, the accommodation is deemed to be provided by reason of the employment.

If T is an employee of B Ltd, T is only taxed if the accommodation is actually provided by reason of T's employment.

B Ltd is (by definition) a person "involved" in providing the accommodation[44] but B Ltd is not deemed to provide the accommodation.

39.10.2 *Made available - to whom?*

The accommodation/benefit rules apply when the accommodation/benefit is made available to employees or their families.

In the security/security option rules, there is a remarkable gap: the legislation does not say to whom the securities/options right must be made available. Where the right is provided by reason of employment, this does not matter. The causation test does the work and is sufficient. But what is the position under the provision test (deemed causation)? The legislation cannot apply where an employer/connected person makes the right

so it has.

[44] See 39.17.1 (Involved in providing).

available to anyone at all. The courts will need to read in some appropriate restrictions here, or else read the deeming provision restrictively. This is one of those (fortunately, rare) situations referred to in *Drummond v Collins*:[45]

> The Income Tax Acts are framed in very general terms. ... But Courts of Law have cut down or even contradicted the language of the Legislature when on a full view of the Act, considering its scheme and its machinery and the manifest purpose of it, they have thought that a particular case or class of cases was not intended to fall within the taxing clause relied upon by the Crown.[46]

Perhaps the provision (deemed causation) test only applies where the person to whom the right is made available is the employee.

39.10.3 *Who provides benefit*

If a benefit is provided, it is necessary to ask who provides it. For the benefit BiK charge, this is addressed by statute. Section 209 ITEPA provides:

> For the purposes of this Chapter [Chapter 10 Part 3] the persons providing a benefit are the person or persons at whose cost the benefit is provided.

The EI Manual provides:

> **EIM21220 who is the person providing a benefit?** [May 2022]
> [The Manual refers to s.209 and continues:]
> That person need not necessarily be the one who physically "hands over" the benefit to the director or employee so long as they are, ultimately, the source of the funds used to pay for the benefit, see *Wicks v Firth* (56 TC 318).
> In most cases it will be the employer who is paying for, and therefore providing, the benefit. If the benefit is provided by the employer, in other words he is incurring the cost of providing it, it is automatically deemed to have been provided by reason of the employment under Section 201(3) ITEPA 2003 (EIM20502).

[45] 6 TC 525 at p.538.

[46] The passage gives the example of *Colquhoun v Brooks* 2 TC 490, now of historic interest only; a currently relevant example is the addition of a bounty requirement to the definition of settlement-arrangement; see 87.4 (Settlement-arrangement definition).

> If the employer is a company and the employee gets the benefit from a subsidiary company it is the employer who is providing the benefit if the subsidiary charges the expense to the parent company.
> Occasionally the benefit will be provided by a third party. For example, a motor manufacturer may incur expense in providing benefits for the employees of dealers who sell the manufacturer's cars. ...

39.11 Personal relationship exemption

There is one exception to the employer-provision test:

Accommodation/benefits: s.97(2)/s.201(3)	**Securities/options: s.421B(3) /s.471(3)**
unless—	unless—
(a) the employer is an individual, and	(a) the person by whom the right or opportunity is made available is an individual, and
(b) the provision is made in the normal course of the employer's domestic, family or personal relationships.	(b) the right or opportunity is made available in the normal course of the domestic, family or personal relationships of that person.

39.12 Former employee

Former employees are not within the accommodation charge. HMRC agree. The EI Manual provides:

> **EIM11408 meaning of by reason of the employment: provided by someone other than the employer** [Dec 2021]
> ...Part 3 Chapter 5 ITEPA 2003 does not apply to a pensioner or a former employee. But if the continued use of living accommodation is provided after termination of employment see EIM12805 onwards [Termination payments and benefits]...

The rules for disguised remuneration, and EFURBS, would also need consideration.

39.13 Market rent

If a market price is paid for something, there is no benefit in the normal sense. The payment of a market price for something in the residual category takes the (non)benefit out of charge. The courts held that this principle applies to Chapter 6 of the benefits code (cars), and the reasoning would apply to the accommodation BiK charge.[47] The decision was a

[47] *HMRC v Apollo Fuels*; see 39.35.4 (Fair bargain rule).

surprising win for the taxpayer, but it is now of historical interest only. From 2016/17, the charge applies in the case of arm's length rent. Section 97(1A) ITEPA provides:

> In determining for the purposes of this Chapter whether this Chapter applies to living accommodation provided for an individual it is immaterial whether or not the terms on which it is provided constitute a fair bargain.

39.14 Accommodation: The charge

Section 102(1) ITEPA provides:

> If living accommodation to which this Chapter applies is provided in any period—
> (a) which consists of the whole or part of a tax year, and
> (b) throughout which the employee holds the employment,
> the cash equivalent of the benefit of the accommodation is to be treated as earnings from the employment for that year.

This is not, strictly, a charging section, but it feeds into the general charge to tax on employment income.[48]

As to the meaning of "living accommodation" see 6.21.4 (Home/living accommodation compared).

39.15 Available but not used

EIM provides:

> **EIM11405 Living accommodation: meaning of provided:** [Dec 2021]
> ... Provided is not defined in the legislation and its meaning has not been considered by the Courts in relation to a charge under [what is now] Part 3 Chapter 5 ITEPA 2003. The word provided must be given its ordinary dictionary meaning of supplied or furnished with a thing.

This paraphrase does not take us far, but we move on:

> In some cases provided will mean available for use whereas in others it will mean actually used .... The meaning of provided is often an issue in the case of provided holiday living accommodation.
> **EIM11406 Meaning of provided: practical considerations** [Apr 2022]
> ... In deciding in a particular case whether provided means available for use, or means actually used, the following questions should be asked.

[48] See 34.4.2 ("General earnings"); 34.6 (Charge on employment income).

> - Who can use the living accommodation? We accept that if living accommodation is genuinely available for use by more people than could actually use it at any one time then provided only means the periods actually used. For example if five unrelated employees were allowed to use an employer owned two bedroom holiday villa we would only seek a provided living accommodation charge on each employee for the period in which that employee actually used the villa.
> - Why was the living accommodation bought or rented and how has it been used since acquisition? If the living accommodation was bought as holiday accommodation for a director and family, provided is likely to mean available for use. By contrast if it was bought as a genuine letting business by the employer and has been let out commercially then provided will only mean the periods of actual use by the employee. ...

EIM11421 to 11423 provides three examples. In the first example accommodation is provided as a holiday home solely for husband and wife directors:

> **EIM11421 Meaning of provided: Example 1** [Jan 2021]
> ... A UK company purchases a flat in a French ski resort for £200,000. It is agreed that a market rental for the property would be £500 per week during the 6 month skiing season and £100 per week during the rest of the year. A husband and wife who are both directors of the company use the flat for holidays with their children for 3 weeks during the ski season and one week in the rest of the year. Their children are neither employees nor directors of the company.
> *The employer advises that the sole reason the property was bought was as a holiday home for the husband and wife. It has only been used by them as a holiday home.*[49]

The HMRC analysis is as follows:

> We would argue in this case that provided is equivalent to available for use. Assuming that the flat was habitable for the whole of the year we would seek a benefit under Part 3 Chapter 5 measured on availability for the whole of the year.
> The employer may argue that the husband and wife work full time and that this prevents them using the flat for more than the 4 weeks in the year of actual use and so they are effectively only provided with it for 4 weeks. We do not accept that argument.

[49] Author’s footnote: Emphasis added to show how example 1 differs from the others.

> If the cost of the accommodation exceeds £75,000, then the amount of the cash equivalent would be calculated in accordance with s.106 ITEPA 2003 (see EIM11472). As the annual value is based on the open market rental, under ESC A91 the cash equivalent of the benefit is restricted to step 1 of s.106. This would mean that the cash equivalent for the tax year would be £15,600 (£500 × 26 + £100 × 26). Under s.108 that would be split between the husband and wife in whatever way was just and reasonable, presumably half each in this case (see EIM11472).

In the second example, the property was purchased for holiday letting, and used for that purpose for 12 weeks, though the directors also used it for 4 weeks:

> **EIM11422. Meaning of provided: example 2** [Jan 2021]
> ... A UK company purchases a flat in a French ski resort for £200,000. It is agreed that a market rental for the property would be £500 per week during the 6 month skiing season and £100 per week during the rest of the year. A husband and wife who are both directors of the company use the flat for holidays with their children for 3 weeks during the ski season and one week in the rest of the year. Their children are neither employees nor directors of the company.
> *The company bought the property to let as a commercial letting business. They have employed professional agents to let the property and have managed to let the property for 12 weeks of the year in addition to the period it was used by the husband and wife directors.*[50]

The HMRC analysis is as follows:

> In this case we would accept that provided is equivalent to actual use.
> If the cost of the accommodation exceeds £75,000, then the amount of the cash equivalent would be calculated in accordance with s.106 ITEPA 2003 (see EIM11472). As the annual value is based on the open market rental, under ESC A91 the cash equivalent of the benefit is restricted to step 1 of s.106. This would mean that the cash equivalent for the tax year would be £1,200 (£15,600 × 4/52). Under s.108 ITEPA 2003 that would be split between the husband and wife in whatever way was just and reasonable, presumably half each in this case (see EIM11472).
> You may ask why the s.105 ITEPA 2003 charge is not £1,600 (being 3 weeks at £500 in the skiing season and 1 week at £100 outside the season). The answer is that the wording of s.105(3) requires us to look at a proportion of the annual rent rather than the rent for the actual weeks it

[50] Author's footnote: Emphasis added to show how the example differs from the others.

> was used.

In the third example, the employer claimed that the property was purchased for holiday letting, but it was not actually used for that purpose, so the employer's narrative might reasonably be open to question:

> **EIM11423. Meaning of provided: example 3** [Jan 2021]
> ... A UK company purchases a flat in a French ski resort for £200,000. It is agreed that a market rental for the property would be £500 per week during the 6 month skiing season and £100 per week during the rest of the year. A husband and wife who are both directors of the company use the flat for holidays with their children for 3 weeks during the ski season and one week in the rest of the year. Their children are neither employees nor directors of the company.
> *The employer says that the property was bought to let commercially and for the use of other employees of the company. In fact there have been no commercial lettings during the year and it has only been used for one week of the year by an employee of the company who was the director's secretary.*[51]

The HMRC analysis is as follows:

> This is a case where in practice we would seek to test whether what the employer was telling us was correct. For example, what if any evidence is there of attempts to let the property commercially or to advise other employees of the company of its availability for use by them? Based on that evidence it is then a matter of judgement whether in reality the sole reason the property was bought was as a holiday home for the husband and wife directors, in which case the tax consequences would be as in example EIM11421. Or it may be that genuine attempts have been made to let the property commercially and make it available for use by other employees of the company, in which case the tax consequences in example EIM11422 will follow.

39.16 Cash equivalent: Computations

The charge is on the "cash equivalent". Section 103 ITEPA provides:

> (1) The cash equivalent is calculated—
> (a) under s.105 if the cost of providing the living accommodation does not exceed £75,000; and
> (b) under s.106 if the cost of providing the living accommodation exceeds £75,000.

[51] Author's footnote: Emphasis added to show how the example differs from the others.

Thus there are two methods of calculating the cash equivalent, here called **"s.105 and s.106 computations"**. This is for historical reasons, the s.106 computation having been introduced in 1983 to supplement the ancestor of s.105. This structure makes the law twice as complicated as it need be. OTS noted the problem, but their conclusion was banal[52] and nothing has changed.

39.17 Cost of providing accommodation

One needs to know the "cost of providing living accommodation":
(1) in order to decide between the s.105 and s.106 computation;
(2) in order to make the s.106 computation (if applicable, as it usually is).

This expression is defined in s.104 ITEPA:

> **General[53] rule for calculating cost of providing accommodation**
> For any tax year the cost of providing living accommodation is given by the formula A + I – P

In short, *A* is **A**cquisition cost, *I* is **I**mprovement cost, and *P* is **P**ayment of reimbursement. In full detail:

> *A* is any expenditure incurred in acquiring the estate or interest in the property held by a person involved in providing the accommodation,
> *I* is any expenditure incurred on improvements to the property which has been incurred before the tax year in question by a person involved in providing the accommodation, and
> *P* is so much of any payment or payments made by the employee to a person involved in providing the accommodation as represents—
> (a) reimbursement of A or I, or
> (b) consideration for the grant to the employee of a tenancy or sub-tenancy of the property.

I consider reimbursement further in 39.25 (Settlor finance).

[52] OTS, "Review of employee benefits and expenses: Interim report" (2013): **Conclusions**... 6.32 The calculation of the benefit, for those who are charged is outdated and anomalous. Logic would suggest it should be based on the current market value of the property but that has obvious practical issues as well as significant transitional impacts that need to be evaluated."
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/227088/ots_employee_benefits_interim_report.pdf

[53] For the exception see 39.21 (Revaluation: delayed occupation).

39.17.1 *Involved in providing accommodation*

This phrase is only used in the definition of "cost of providing living accommodation".[54] Section 112 ITEPA provides a wide definition:

> For the purposes of this Chapter [Chapter 5 Part 3] "person involved in providing the accommodation" means any of the following—
> (a) the person providing the accommodation;
> (b) the employee's employer (if not within para (a));
> (c) any person, other than the employee, who is connected with a person within para (a) or (b).

EN ITEPA explains:

> 412. This definition makes it clear that it is necessary to look beyond the employer and the apparent owner of an interest in the accommodation. This is anti-avoidance legislation to counter schemes which depress the cost to the employer by using intermediate owners of interests.

39.18 Home sub-£75k: Computation

Section 105 applies where the cost of providing accommodation does not exceed £75,000. This was a meaningful figure when the legislation was introduced in 1983 but inflation, the Chancellor's friend, has whittled away the real value of this limit so it must be exceptional now to find a purchase of less than £75,000. One might think the s.105 computation was a dead letter and one can turn directly to s.106. But s.106 refers back to s.105 so one needs to make the s.105 computation even in a s.106 case.

Section 105 ITEPA provides:

> (1) The cash equivalent is to be calculated under this section if the cost of providing the living accommodation does not exceed £75,000.
> (2) The cash equivalent is the difference between—
> (a) the rental value of the accommodation for the taxable period, and
> (b) any sum made good , on or before 6 July following the tax year which contains the taxable period, by the employee to the person at whose cost the accommodation is provided that is properly attributable to its provision.

The key concepts are "rental value of the accommodation" and "making good".

[54] See 39.17 (Cost of providing accommodation) and 39.21 (Revaluation: delayed occupation).

39.18.1 *"Rental value"*

Section 105 ITEPA provides:

> (3) The "rental value of the accommodation" for the taxable period is (subject to subsections (4) and (4A) the rent which would have been payable for that period if the property had been let to the employee at an annual rent equal to the annual value. ...
> (4) Subsection (4A) applies where—
> (a) a rental amount is payable by the person ("P") at whose cost the accommodation is provided in respect of the whole or part of the taxable period ("the relevant period"), and
> (b) the amount so payable is payable at an annual rate greater than the annual value.
> (4A) Where this subsection applies—
> (a) subsection (3) does not apply to the relevant period, and
> (b) instead the "rental value of the accommodation" for the relevant period is the rental amount payable by P in respect of the relevant period.
> (4B) A reference in subsection (4) or (4A) to a rental amount payable by P in respect of the relevant period is to the sum of—
> (a) any rent for the period payable by P, and
> (b) any amount attributed to the period in respect of a lease premium (see sections 105A and 105B)
> (5) If the rental value of the accommodation for the taxable period does not exceed any sum made good by the employee as mentioned in subsection (2)(b), the cash equivalent is nil.

The key expression is "annual value". This is defined in s.110 ITEPA but it is not usually necessary to refer to that for UK property. ITEPA Explanatory Note states:

> 404. [Section 110] does not affect the Inland Revenue practice of using the gross rateable value as a proxy for "annual value". That practice will continue. The main use of this section is to provide guidance on how to arrive at the annual value of properties for which rent is not paid and in practice is only needed in cases where no gross rateable value can be found.[55]

[55] Likewise the EN at Change 23:
"These provisions [ss.110 and 207 ITEPA] will clarify how to find annual values in respect of those properties for which the practice of using gross rateable values or a proxy for them is inapplicable – for example overseas properties. In the case

The EI Manual provides:

> **EIM11434 Meaning of annual value for UK properties** [Mar 2022]
> ... The amount of annual value for UK properties is set out in the table below.
>
> | **Country** | **When first valued** | **Annual value to take** |
> |---|---|---|
> | England & Wales | All cases | The 1973 gross rating value |
> | Northern Ireland | All cases | The 1976 gross rating value |
> | Scotland | | 100/270 × 1985 gross rating value |
> | Anywhere in UK | No gross rating value set | Ask the appropriate District Valuer to confirm any estimated figure provided by the employer that you want to check.[56] |
>
> For the formula to convert a net rating value figure to a gross rating value figure see EIM11438.

Thus for most purposes the s.105 computation is rateable value less sums "made good" to the employer. That is usually a trivial amount which has no relation to the value of the benefit of the accommodation. It is a substantial amount in two cases:

(1) where the company employer pays a market rent for the property;
(2) where the property is not UK situate (and so there is no rateable value).

This practice (which is concession not law) exists for historical reasons. It is not surprising the Tax Law Rewrite did not think it appropriate to express all this in ITEPA. The rules are incoherent.

39.19 "Making good"

The concept of making good is relevant to the accommodation and the residual benefit BiK charges so I consider both together in this section.

39.19.1 *Making good: Meaning*

The EI Manual provides:

> **EIM21120 What is meant by "making good"** [Jan 2024]
> "Making good" simply means giving something in return for the benefit. What is being made good is the expense incurred by the employer or

of both these and other properties, all the current practices used in quantifying the cash equivalent of the benefit of living accommodation will continue."

[56] The Manual continues:
"If no such estimate is provided or the estimate is not acceptable the District Valuer will provide a (not negotiated) figure. If the taxpayer does not accept that figure the District Valuer will try to agree a figure with the taxpayer. For the procedure for referring to the District Valuer see EIM11437."

> other person providing the benefit. It follows that in order to make good that expense the employee will give money, or something that can be measured in money. Usually the employee will "make good":
>
> - by a direct payment or
> - by deduction from salary or
> - by a suitable debit to the employee's current account in the employer's books and records.
>
> Any of these methods is acceptable.
>
> The giving of services by the employee, or anything that is not measured in money terms is not "making good", see *Stones v Hall* (60 TC 737). (This content has been withheld because of exemptions in the Freedom of Information Act 2000)[57]
>
> As regards "making good" by waiver of remuneration see EIM21122.

It is clearly "making good" if:

(1) the company pays the costs of maintenance and insurance; and

(2) the individual reimburses the company by a cash payment.

Does the employee make good the cost if they pay the cost of maintenance and insurance directly? Section 110 ITEPA envisages that this expenditure will be paid by the employer. In addition, the maintenance of the building is probably not a "sum" made good. EIM Manual is equivocal:

> **EIM11439. Annual value of UK property: Employee responsible for repairs or insurance.** [Apr 2022]
>
> ... An employee may be responsible for the cost of repairs or insurance under the terms of his or her lease or employment. *(This content has been withheld because of exemptions in the Freedom of Information Act 2000.)*[58] As regards the discharge of the employee's pecuniary liability in respect of such items *see* EIM00580.

Note that the payment of a sum "making good" may constitute taxable property income of the company which receives it. The IHT and CGT

[57] Author's footnote: The "text withheld" announcement was added in June 2006. Previously the Manual stated "In any case where the taxpayer argues that an interest-free loan has been made to this employer specifically to make good the cost or value of a benefit, make a submission to Personal Tax (Technical), Solihull." That instruction probably survives in the withheld text.

[58] The text formerly read:
"If an employee claims an adjustment to the annual value (derived from the table in EI Manual 11434) because the facts of an employee's case are not those envisaged by s.110 ITEPA, make a full report to Personal Tax (Technical), Solihull."
It seems a safe bet that that passage survives in the withheld text.

implications may also need to be considered, but the sums involved may not be significant.

39.19.2 *Making good: Timing*

The time limit is 6 July following the tax year which contains the taxable period.[59]

39.20 Home over £75k: Computation

Section 106 ITEPA provides:

> **Cash equivalent: cost of accommodation over £75,000**
> (1) The cash equivalent is calculated under this section if the cost of providing the living accommodation exceeds £75,000.
> (2) To calculate the cash equivalent—
> *Step 1* Calculate the amount that would be the cash equivalent if s.105 applied (cash equivalent: cost of accommodation not over £75,000).

See 39.18 (Home sub-£75k: computation).

> *Step 2* Calculate the following amount ("the additional yearly rent")—
> ORI × (c) – £75,000)

In short, *ORI* is **O**fficial **R**ate of **I**nterest; *C* is **C**ost. In full detail:

> ORI is the official rate of interest in force for the purposes of Chapter 7 of this Part (taxable benefits: loans) on 6 April in the tax year, and
> C is the cost of providing the accommodation calculated—
> (a) in accordance with s.104 (general rule for calculating cost of accommodation),[60] or
> (b) in a case where s.107 applies (special rule for calculating cost of providing accommodation), in accordance with that section instead.[61]

The label "additional yearly rent" is misleading: the "additional yearly rent" calculated in this way will not bear a close relationship with the actual market rent.

[59] This rule was introduced in 2017. For the background, now of historical interest only, see HMRC, "Alignment of dates for 'making good' on benefits-in-kind" (2016) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/544638/Alignment_dates_making_good_benefits-in-kind_consultation.pdf*

[60] See 39.17 (Cost of providing accommodation).

[61] See 39.21 (Revaluation: delayed occupation).

> *Step 3* Calculate the rent which would have been payable for the taxable period if the property had been let to the employee at the additional yearly rent calculated under step 2.

This step reduces the "additional *yearly* rent" to that for the "taxable period" (defined in s.102(2)).

> *Step 4* Calculate the cash equivalent by—
> (a) adding together the amounts calculated under steps 1 and 3, and
> (b) (if allowed by subsection (3)) subtracting from that total the excess rent paid by the employee.

Section 106(3) ITEPA provides:

> In step 4—
> (a) para (b) only applies if, in respect of the taxable period, the rent paid—
> (i) by the employee,
> (ii) in respect of the accommodation,
> (iii) to the person providing it, and
> (iv) on or before 6 July following the tax year which contains the taxable period,
>
> exceeds the rental value of the accommodation for that period as set out in s.105(3) or (4)(b), as applicable, and
> (b) "the excess rent" means the total amount of that excess.

In short, the charge is (1) the s.105 computation (rateable value) and (2) (official rate of interest on purchase price less £75,000) less rent.

This works (more or less) where the s.105 computation is based on the nominal amount of rateable value. It gives double taxation where the s.105 computation is based on actual market rental value. ESC A91 gives relief here:

> *Living accommodation provided by reason of employment*
> This concession applies to living accommodation treated as earnings under ITEPA 2003 Part 3, Chapter 5. Where ITEPA 2003 s.106 applies and the cash equivalent of the benefit of the accommodation is calculated by reference to the annual rent the property might fetch on the open market, the Inland Revenue will disregard "the additional yearly rent". If "the additional yearly rent" is disregarded then the amount of "the excess rent" is deemed to be nil.[62]

[62] I do not understand the point of the last sentence, for if the additional yearly rent is disregarded, the "excess rent" is irrelevant.

39.21 Revaluation: Delayed occupation

Normally the s.106 computation is based on the employer's acquisition cost (ie historic cost). Market value of the property later is not relevant. This rule could favour HMRC, but as time passes it is likely to favour the taxpayer. In one case only there is an adjustment to market value. Section 107(1) ITEPA provides:

> This section contains a special rule for calculating the cost of providing living accommodation which—
> (a) operates for the purposes of step 2 of s.106(2) (calculating the additional yearly rent), and
> (b) accordingly only operates where the cost of provision for the purposes of s.106(1) (as calculated under s.104) exceeds £75,000.

In practice condition (b) will almost always be satisfied (except perhaps for property purchased many years ago).

Section 107(2) ITEPA provides:

> This section applies if, throughout the period of 6 years ending with the date when the employee first occupied the accommodation ("the initial date"), an estate or interest in the property was held by a person involved in providing the accommodation.
> It does not matter whether it was the same estate, interest or person throughout.

In short, this condition is that the property has been owned by the company for six years before the employee moves in.

Section 107(3) ITEPA provides:

> For any tax year the cost of providing the living accommodation for the purposes mentioned in subsection (1)(a) is given by the formula—
> MV + I – P

In short, *MV* is **M**arket **V**alue; *I* is **I**mprovement cost; *P* is **P**ayments in return. In full detail:

> MV is the price which the property might reasonably be expected to have fetched on a sale in the open market with vacant possession as at the initial date,
> I is any expenditure incurred on improvements to the property which has been incurred during the period—
> (a) beginning with the initial date, and
> (b) ending with the day before the beginning of the tax year, by a person involved in providing the accommodation, and

> P is so much of any payment or payments made by the employee to a person involved in providing the accommodation as represents—
> (a) reimbursement (up to an amount not exceeding MV) of any expenditure incurred in acquiring the estate or interest in the property held on the initial date,
> (b) reimbursement of I, or
> (c) consideration for the grant to the employee of a tenancy or sub-tenancy of the property.

This may arise where:

(1) a foreign domiciliary (or trust) purchases a company holding a property acquired more than six years previously;
(2) an individual then occupies the property and becomes a shadow director.

Next is an anti-avoidance provision to block an obvious scheme to devalue MV. Section 107(4) ITEPA provides:

> In estimating MV no reduction is to be made for an option in respect of the property held by—
> (a) the employee,
> (b) a person connected with the employee, or
> (c) a person involved in providing the accommodation.

Lastly, for completeness, there is transitional relief where the employee first occupied the property before 31 March 1983: para 21 sch 7 ITEPA.

39.22 Home for more than 1 employee

Section 108 ITEPA provides:

> **Cash equivalent: accommodation provided for more than one employee**
> (1) If, for the whole or part of a tax year, the same living accommodation is provided for more than one employee at the same time, the total of the cash equivalents for all of the employees is to be limited to the amount that would be the cash equivalent if the accommodation was provided for one employee.
> (2) The cash equivalent for each of the employees is to be such part of that amount as is just and reasonable.

EIM provides at 11411:

> **EIM11411 Provided to more than one employee in the same period: practical points** [Apr 2022]
> The following is an example of how s.108 ITEPA 2003 works.

An employer provides a 10-room house for the shared use of 3 unrelated employees. Each employee has sole use of a bedroom and shared use of the other 7 rooms. Without s.108 the cash equivalent of the benefit of the living accommodation provided to each employee would be 80% of the whole house. However s.108 limits the sum of the charges on the 3 of them to one full charge on the whole house. If there are no special factors each employee will be chargeable on the cash equivalent of a benefit of 33.3% of the cash equivalent for the whole house.

Section 108 is not relevant in some family situations. For example, a husband and wife both work for the same employer and live together in a house provided by their employer. The husband's job is the one that has accommodation provided with it and the wife's does not. The true construction here is that the living accommodation is only provided by the employer to the husband and the wife lives in it with her husband as part of normal domestic arrangements. So the full living accommodation charge would be on the husband with no charge on the wife.

By contrast, for an example of s.108 being relevant in a family situation, see example EIM11421.

39.23 Accommodation charge: Planning

Ways to avoid the entire accommodation BiK charge are (in short):

(1) to ensure that the occupier is
   (a) not an officer (ie not a director or company secretary), which is straightforward;
   (b) not an employee (which should be straightforward); and
   (c) not a shadow director; or
(2) not to use a company; or
(3) to reimburse the company for its expenditure.

39.24 Reimbursement solution

Reimbursement of "A" and "I" will solve the s.106 charge if it reduces the "cost of providing the accommodation" to nil (or at least to below £75,000).

Reimbursement does not avoid the s.105 charge (but that may be trivial, or avoided by "making good", or by arranging that the individual is not a shadow director).

39.24.1 *Who reimburses?*

Reimbursement is only deductible if it is made by the employee. For example, if

(1) a company purchases property;
(2) an individual (F) reimburses the cost;
(3) another individual (G) comes to occupy the property (and is a shadow director);

then F's reimbursement will not reduce the s.106 computation for G. Again, if a member of the family or household of the shadow director occupies the property, and that member of the family or household reimburses the company, that reimbursement will not reduce the s.106 computation for the shadow director. In practice this is not likely to happen often.

The IHT and CGT implications of making the reimbursement need to be considered.

39.25 Settlor finance

Sometimes a company structure is set up specifically for the purpose of purchasing the home. That is, there is an arrangement under which:

(1) The individual agrees in principle to purchase a property.
(2) The individual:
    (a) lends the purchase price to a company, or
    (b) transfers the purchase price to a trust which lends the purchase price to a wholly-owned company.
(3) The company makes the purchase.

This section considers whether an arrangement of this kind offers a defence to the accommodation BiK charge.

39.25.1 *Settlor finance: Making good*

The s.105 computation allows a deduction for:

> any sum made good by the employee to the person at whose cost the accommodation is provided that is properly attributable to its provision.

The taxpayer would have to show that the interest forgone on the interest-free loan from the individual (directly or indirectly to the company):

(1) is a "sum", and
(2) "makes good" the provision of the accommodation.[63]

Whether the interest forgone "makes good" the provision of

[63] It is assumed that the interest forgone exceeds the annual or rateable value of the accommodation, which will normally be the case.

accommodation is a question of fact. Assuming the reason the interest is forgone is to enable the company to provide the accommodation, this condition should be satisfied.

Whether the interest forgone is a "sum" is a question of law; it is suggested that the word should not be construed strictly or technically, and an amount of interest forgone may be a "sum". See 39.19 ("Making good").

Sums "made good" are not deductible as such in the s.106 computation. Rent is deductible in a s.106 computation but the interest forgone on an interest-free loan is not rent. No-one suggests that the company would be taxable on the interest forgone as property income!

39.25.2 *Settlor finance: Reimbursement*

In computing the "cost" of providing the accommodation one may deduct payments representing reimbursement. This deduction would reduce the s.106 computation.[64] However, interest forgone on a loan is not "reimbursement". In addition, it is also not a "payment".

A possible solution would be for the individual to release the debt due from the company.

Statute requires a "payment" representing a reimbursement. It is a moot point whether release of a debt constitutes a "payment". One should take the cautious view that it may not be. The matter should be dealt with as follows:

(1) The individual transfers the funds to the company. They should be received in the company's bank account. This should be accompanied by a letter to the company saying: "I have today procured the payment of £X to your account. This is reimbursement for the expenditure you have incurred in acquiring [the property]. However, I require repayment of the debt due to me of £X."
(2) The company may then use its funds to repay its debt due to the individual.

Although this is a circular transaction (the payment being matched by immediate repayment) that does not nullify it for tax purposes: compare *MacNiven v Westmoreland* [2001] STC 237.

If the company incurs additional improvement expenditure in the future, this should be matched by further reimbursements so the total cost of

[64] See 39.24 (Reimbursement as solution).

providing the accommodation (A+I–P) remains less than £75,000.

The reimbursement of the company is not a transfer of value for IHT purposes if the individual is (or is treated as) the beneficial owner of the company. For the same reason the reimbursement is not a disposal by way of gift and so is outside the scope of s.102 FA 1986 (gifts with reservation). In other cases IHT needs consideration.

The effect of the gift (the reimbursement) is to increase the value of the shares of the company without any corresponding rise in the CGT base cost. So the gift increases the chargeable gain on the disposal.

39.25.3 *Reimbursement: Timing*

When must reimbursement be made? It is considered that reimbursement must be done within a reasonable time of the taxpayer becoming aware that the accommodation BiK charge can be reduced by reimbursement. HMRC accepted this in practice, before the introduction in 2017 of a time limit for making good.[65] Since there is no provision imposing a time limit for reimbursement, that should continue to be the case.

39.26 Co-ownership of home

This section considers the position where an individual owns a share in the property jointly with the company.

Co-ownership raises similar but not identical issues for all provisions which charge tax on benefits, such as s.87 TCGA, s.731 ITA, s.203 ITEPA, and IHT gift with reservation rules as well as the accommodation charge. The discussion here is limited to the case where an individual and a company are co-owners. Similar but not identical issues arise with these provisions where an individual and a trust are co-owners.

39.26.1 *Land law background*

The starting point is to ascertain the rights of the co-owners as a matter of land law. Co-owned land in England and Wales is always held on trust. The person(s) holding legal title to the land are here called "the trust-of-land trustees".[66] The position is governed by the Trusts of Land and

[65] See 39.19.2 (Making good: Timing).

[66] (The term used in the legislation is "the trustees of land".) The company may be the (or one of the) trust-of-land trustees; it makes little practical difference and no difference at all for tax. (If the company is not a trustee it can apply to court to require the trustees to exercise their powers.) The shares in the company may also be held on trust but that trust is not relevant here.

Appointment of Trustees Act 1996.[67] Section 12(1) TOLATA provides:

> A beneficiary who is beneficially entitled to an interest in possession in land subject to a trust of land is entitled by reason of his interest to occupy the land at any time if at that time—
> (a) the purposes of the trust include making the land available for his occupation (or for the occupation of beneficiaries of a class of which he is a member or of beneficiaries in general), or
> (b) the land is held by the trustees so as to be so available.

Prior to 1997, a co-owner of land had a right to occupy that land, in the absence of any contrary indication or agreement with the other co-owners:

> It has been well established law ... that a tenant-in-common under a trust for sale has the right to occupy the whole property without payment of rent ...[68]

This co-ownership right has been superseded and replaced by s.12 TOLATA. In *IRC v Eversden*, Lightman J explained:

> On and after 1 January 1997 when the TOLATA came into force, a tenant in common in equity ... was no longer automatically entitled ... to occupation of the property purchased. Section 12 of the TOLATA provided that he should only become so entitled if one of two alternative conditions were satisfied…[69]

While arguments might be advanced to the contrary this analysis should be followed, because it is a clear and workable rule. Otherwise it would be necessary to consider the pre-1997 law and try to work out the combined effect of that when read with s.12.[70]

[67] Further consideration is needed for:
(1) Land outside England and Wales.
(2) Jointly owned chattels.
TOLATA does not apply in Northern Ireland. I would be grateful to any reader who could inform me of the position in Scotland.

[68] *IRC v Lloyds Private Banking* [1998] STC 559 at p.561; likewise *City of London Building Society v Flegg* [1988] AC 54 at p.81.

[69] [2002] STC 1109 at [24] reported 75 TC 340 under the name *IRC v Greenstock's Executors*.

[70] Barnsley "Co-owner rights to occupy land" [1998] CLJ 123 is a minority view; contrast Smith, *Plural Ownership* (2005) p.136.
This conclusion is not affected by *Re Byford* [2003] EWHC 1267. In this case the co-owners were a wife and her former husband's trustee in bankruptcy. The issue was the relative size of their shares. The wife claimed a larger share because she had paid

In the following discussion, the entitlement to occupy land conferred by s.12(1) is called the "statutory occupation right".

The individual will obviously have a statutory occupation right to occupy the property under s.12 because:

(1) They are a beneficiary under the trust-of-land.
(2) They are beneficially entitled to an interest in possession in the land.
(3) Both conditions (a) and (b) of s.12(1) are satisfied:[71]
    (a) the purposes of the trust-of-land include making the land available for their occupation; and
    (b) the land is held by the trust for land trustees so as to be available for the purpose.

The company does not have a statutory occupation right. It does not meet the conditions of s.12(1). No third person would have a statutory occupation right even if the company sold or sub-let their interest under the trust-of-land to that person. The third person would not satisfy conditions (a) or (b) of s.12(1).[72]

The trust-of-land trustees have various powers, but they do not have power to override the individual's occupation right or to require them to pay an occupation rent. This is fundamental so I set out the provisions in detail.

Section 13(1) TOLATA provides:

> Where two or more beneficiaries are (or apart from this subsection would

the mortgage since her husband's bankruptcy. The issue is not covered by any provision in TOLATA. So the common law principles (known as "equitable accounting") applied. The general principle of equitable accounting is that one co-owner cannot take the benefit of an increase in the value of the property without making an allowance for what has been expended by the other in order to obtain it. Thus the wife had credit for her payments of mortgage capital and improvement expenditure. She wanted credit for interest payments, but it was held that she must set against that credit the benefit of occupation (the wife had occupied the property and the trustee in bankruptcy of course had not occupied). There is nothing in this which affects rights of occupation or other rights under ss.12, 13 TOLATA; though note Helen Conway's criticism in [2003] *The Conveyancer* 533.

[71] Though it would suffice if only one of the conditions of s.12(1) were satisfied. Section 12(2) provides: "Subsection (1) does not confer on a beneficiary a right to occupy land if it is either unavailable or unsuitable for occupation by him." This will not apply here.

[72] Also s.12(2) TOLATA would probably apply, though it is not necessary to rely on that.

> be) entitled under s.12 to occupy land, the trustees of land [ie the trust-of-land trustees] may exclude or restrict the entitlement of any one or more (but not all) of them.

The trust-of-land trustees cannot under s.13(1) override the individual's statutory occupation right because it is not the case that "two or more beneficiaries are … entitled under s.12 to occupy land".

Section 13(6) TOLATA provides:

> Where the entitlement of any beneficiary to occupy land under s.12 has been excluded or restricted, the conditions which may be imposed on any other beneficiary under subsection (3) include, in particular, conditions requiring him to—
> (a) make payments by way of compensation to the beneficiary whose entitlement has been excluded or restricted, or
> (b) forgo any payment or other benefit to which he would otherwise be entitled under the trust so as to benefit that beneficiary.

The trust-of-land trustees cannot require the individual to pay compensation (an occupation rent) to the company under s.13(6) because the company has no statutory occupation right: s.13(6) assumes that compensation can only be required in a case where:

(1) a co-owner had such a right; and
(2) the right was excluded or restricted (which can only be done under s.13(1)).

Section 13(3) TOLATA provides another power:

> (3) The trustees of land [ie the trust-of-land trustees] may from time to time impose reasonable conditions on any beneficiary in relation to his occupation of land by reason of his entitlement under s.12.
> …
> (5) The conditions which may be imposed on a beneficiary under subsection (3) include, in particular, conditions requiring him—
> (a) to pay any outgoings or expenses in respect of the land, or
> (b) to assume any other obligation in relation to the land or to any activity which is or is proposed to be conducted there.

The trust-of-land trustees can do little under s.13(3) except to require the individual to pay outgoings.[73]

[73] In particular, the trust-of-land trustees cannot use this power to require the individual to pay an occupation rent, as that must be done under s.13(6) or not at all. Otherwise s.13(6) would be entirely otiose. There is a further restriction in s.13(7) but that is not

It is reasonably clear that ss.12–14 TOLATA are a comprehensive code and there is no common law right to an occupation rent except in a case of ouster.

The trust-of-land trustees also have power to sell the property but the court has discretion either to prevent or to require a sale.[74] The question here is whether the court would require a sale of the property if the individual did not want a sale but the company did. In my opinion a court would not do so, unless either the individual no longer wished/ceased to occupy the property, or the company had a good reason for a sale, eg it was insolvent. Section 15(1) TOLATA provides:

> The matters to which the court is to have regard in determining an application for an order under s.14 include—
>
> (a) the intentions of the person or persons (if any) who created the trust,
>
> (b) the purposes for which the property subject to the trust is held,
>
> (c) the welfare of any minor who occupies or might reasonably be expected to occupy any land subject to the trust as his home, and
>
> (d) the interests of any secured creditor of any beneficiary.

None of these factors would support a sale.[75]

In short, the company, although co-owner, can do almost nothing while the individual remains in occupation, except require them to pay the outgoings.

Since this is the case, then the fact that the company does nothing, and the individual remains in occupation, does not mean that the company has provided accommodation, or conferred a benefit, in the years in which the individual occupies. This is because the individual has the right of

so important here.

[74] Sections 6, 14 TOLATA.

[75] An individual's position is even stronger if they have more than a 50% share, as s.11(1) TOLATA normally gives them further support. This provides:

> "The trustees of land shall in the exercise of any function relating to land subject to the trust—
>
> (a) so far as practicable, consult the beneficiaries of full age and beneficially entitled to an interest in possession in the land, and
>
> (b) so far as consistent with the general interest of the trust, give effect to the wishes of those beneficiaries, or (in case of dispute) of the majority (according to the value of their combined interests)."

See too s.15(3) TOLATA which requires a court to have regard to the beneficiary with a majority share. But it is not necessary to rely on this.

occupation independently of anything the company does or can do.

In *IRC v Eversden*[76] the settlor gave a trustee co-owner a 95% share in a house, the settlor retaining 5%. The settlor continued to occupy. It was held that the trustee had not provided a benefit as the settlor was entitled to occupy. This took place before the TOLATA 1996 but the position would be the same under the TOLATA.

The matter is made more complicated by *Christensen v Vasili* 76 TC 116. This concerned a co-owned car. The question was whether there was a tax charge under (what is now) s.144 ITEPA which applies where a car is "made available" to an employee. The Special Commissioner held that the car was not made available:

> As co-owners the employer and employee each have the right to use the car, but they each have that right because they are each owners, not because one has "made available" the car to the other.[77]

This conclusion was plainly right. Unfortunately it was flatly if unconvincingly rejected in the High Court:

> In their ordinary sense, the question "who made the car available to Mr. Vasili?" must be answered in the sense that his employer did so ...[78]

It is suggested that *Vasili* must be distinguished from the normal co-ownership situation because:

(1) in *Vasili* both employer and employee were entitled to possession of the car: in the co-ownership situation considered here the company is not entitled to occupation;

(2) in *Vasili* the car belonged to the employer before he sold a 5% share to the employee. In that sense the employer made the car available. The position would have been different if the car had been purchased in those shares from the outset.

It is unfortunate that *Eversden* was not cited in *Vasili* since the two cases are difficult to reconcile.

39.26.2 *Employment-related benefit*

It might be argued that the company co-owner provides a benefit other than accommodation:

[76] [2002] STC 1109 reported 75 TC 340 under the name *IRC v Greenstock's Executors*.

[77] 76 TC 116 at p.124, para 22.

[78] 76 TC 116 at p.131, para 13.

(1) If the company is the trustee, by not exercising its powers of sale (or to require the individual co-owner to pay an occupation rent); or
(2) If the company is not sole trustee, by consenting to the trustees not exercising those powers.

There is normally no benefit here because the trustees have no such powers. If there were a benefit, the value of the benefit is "the expense incurred in or in connection with the provision of the benefit". The company incurs no expense, so the value of the benefit for tax purposes is nil.[79]

If the company incurs costs of maintenance, that is an employment related benefit.

39.26.3 *Starting co-ownership charge*

It follows that the company provides a significant benefit to the individual when and if it uses its funds to acquire a share as co-owner (unless it pays a discounted price for the share). Could this benefit be taxable?[80]

In *IRC v Eversden (Greenstock's Executors)* trustees purchased a 95% share in a house ("Meadows"), and the settlor purchased 5%. The judge said:

> Under the agreement with the trustees (providing as it did for the settlor to pay 5% of the purchase price of Meadows and acquire in consequence a right of occupation) *the trustees conferred on the settlor the right to occupy Meadows for an indefinite period rent free.*[81]
> (Emphasis added)

This took place before the TOLATA 1996, but the position would be the same now.

In a case where the company provides its funds towards a joint purchase of a new property, and the individual holds as co-owner, the company has provided a benefit of indefinite rent-free occupation; more accurately the

[79] It is considered that this particular benefit does not "consist of an asset being placed at the disposal of the employee" so the valuation is not in accordance with s.205 ITEPA.

[80] This issue does not arise where the company receives its share of the land gratuitously.

[81] 75 TC 340, [2002] STC at p.1129. The point was rightly not appealed. Prior to purchasing Meadows another house in joint ownership had been sold. The position for Meadows would be different if the sale of the first house had been conditional on the purchase of Meadows (the new one), that is, if the settlor only agreed to join in the sale of the first if the trustee agreed to join in the purchase of Meadows.

benefit is giving the individual the opportunity to acquire a right to indefinite rent-free occupation at a "knockdown price". The benefit is provided at the time the company completes the contract to purchase the land as co-owner.

The benefit would in principle be chargeable in co-ownership cases under s.87 TCGA or s.731 ITA. Since there are no express valuation rules the charge would be on the market value, which would have to be ascertained as best as one can in the light of the circumstances.

For employment income purposes the position is different. It is arguable that:

(1) The benefit is not the provision of accommodation.
(2) The value of the benefit for IT purposes is nil because:
    (a) The company incurs no expense in connection with its provision. (The purchase price is not such an expense, because the money going out is matched by a property share coming in.)
    (b) The special valuation rules of ss.205, 206 ITEPA do not apply.

39.26.4 *HMRC view*

The EI Manual provides:

> **EIM11414 Avoidance area: co-ownership cases** [Jan 2024]
> *Part 3 Chapter 5 ITEPA 2003*
> In these cases the employer and employee co-own the living accommodation. The usual arrangement is that the employer and employee own the property as tenants in common through a trust.
> A tenant in common has a legal right to use 100% of the property 100% of the time even though a tenant in common may only own a much smaller interest in the property (say 30%). It is argued against us in such a case that the employee's rights to use the living accommodation come from the employee's legal rights as a tenant in common. So it is argued that no living accommodation has been provided by reason of the employment.
> There are arguments to support a benefit charge within Part 3 Chapter 5 ITEPA 2003 in these cases and the strength of those arguments will depend on the facts of the case. (This content has been withheld because of exemptions in the Freedom of Information Act 2000).

It is interesting to note that HMRC accept that there is not always a charge in co-ownership cases: "it depends on the facts of the case". That is consistent with the view taken here.

In the context of s.87 TCGA, the current HMRC view is that there is an annual benefit which is the difference between:

(1) the rental value of the property in question; and

(2) the hypothetical rental value of a hypothetical property of a value equal to the proportionate value of the taxpayer's share in the property, ie if the taxpayer holds a 50% share, one looks to the rental value of a property worth 50% of the actual property.[82]

But this view is very difficult to defend.

39.27 Defences to home BiK charge

39.27.1 *Caretaker*

Section 99 ITEPA provides:

> (1) This Chapter [Chapter 5 Part 3] does not apply to living accommodation provided for an employee if it is necessary for the proper performance of the employee's duties that the employee should reside in it.
>
> (2) This Chapter does not apply to living accommodation provided for an employee if—
>
> (a) it is provided for the better performance of the duties of the employment, and
>
> (b) the employment is one of the kinds of employment in the case of which it is customary for employers to provide living accommodation for employees.

It has been suggested that one can use this to avoid the charge. The idea is to enter into a contract whereby the individual who is to occupy the property does so as caretaker for the company. This does not work. While it may normally be necessary or customary for a caretaker to reside in accommodation, a person does not become a "caretaker" just by being labelled as such. If the individual is occupying an extremely valuable property with only nominal caretaking duties, this is not the same "type of employment" as a normal caretaker. The EI Manual rightly provides:

> **EIM11342 Living accommodation exemption: necessary for proper performance of the duties: types of employee** [Jan 2021]
>
> *Section 99(1) ITEPA 2003*
>
> Part 3 Chapter 5 ITEPA does not apply to living accommodation provided for an employee if it is necessary for the proper performance of the duties that the employee live in the accommodation provided (see

[82] Private correspondence.

> EIM11341).
> The following types of employee may be accepted as being within the exemption: ... Caretakers living on the premises. This only covers those with a genuine full time caretaking job ...

39.27.2 *Payment of rent*

The payment of rent will count as "making good" for the s.105 computation and reduce the s.106 computation. However, this proposal raises the problems of IT on the rent. Also, to reduce the s.106 computation to zero, the rent may have to exceed the market rent, especially for very valuable properties.

39.27.3 *Lease premium*

This is the subject of the long and complex provisions of s.105A, 105B ITEPA, which I hope to consider in a future edition.

The EIM suggests an argument that premiums should sometimes be treated as rent. This was discussed in detail in the 2008/09 edition of this work, but I expect that HMRC will not pursue that point now (if indeed they ever took it seriously).

39.28 Foreign homes relief

Section 100A(1) ITEPA provides a relief which I call "**foreign homes relief**":

> This Chapter [Chapter 5 Part 3] does not apply to living accommodation outside the UK provided by a company for a director or other officer of the company ("D") or a member of D's family or household if—
> (a) the company is wholly-owned by D or D and other individuals (and no interest in the company is partnership property), and
> (b) the company has been the holding company of the property at all times after the relevant time.

I refer to the company providing the property as the "**provider company**". I refer to the condition in (1)(a) as the "**wholly-owned condition**" and the condition in (1)(b) as the "**holding company condition**". Thus the relief applies where:

(1) The provider company provides accommodation for a director[83] of the

[83] Or other officer; for brevity references to "directors" in this section include other officers.

provider company ("D") or a member of D's family or household. If the accommodation is provided for an employee who is not a director (or a member of a director's family or household) of the provider company the relief will not apply. In practice that is not likely to matter.

(2) The provider company meets the wholly-owned condition.
(3) The provider company meets the holding company condition.

39.28.1 *Wholly-owned condition*

The relief does not apply if any shares in the provider company are held by a trust or partnership, or if some of the shares are held by a company. The position for 100% subsidiaries is considered below.

39.28.2 *Holding company condition*

Section 100A(4) ITEPA defines "relevant interest in the property":

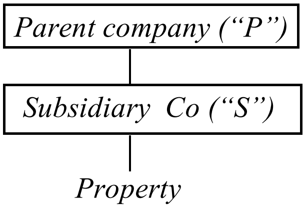
> "Relevant interest in the property" means an interest under the law of any territory that confers (or would but for any inferior interest confer) a right to exclusive possession of the property at all times or at certain times.

Armed with this definition, we can turn to the definition of "holding company" of the property. Section 100A(2) ITEPA provides:

> The company is "the holding company of the property" when—
> (a) it owns a relevant interest in the property,
> (b) its main or only asset is that interest, and
> (c) the only activities undertaken by it are ones that are incidental to its ownership of that interest.

39.28.3 *Subsidiary holding property*

Suppose the property is held via a subsidiary company thus:



S is in principle the holding company of the property but it does not meet the wholly-owned condition. P is not the holding company of the property within s.100A(2). However s.100A(3) ITEPA provides:

> The company is also "the holding company of the property" when—
> (a) a company ("the subsidiary") which is wholly owned by the company [*ie the parent company*] meets the conditions in paras (a) to (c) of subsection (2),
> (b) the company's [*ie the parent company's*] main or only asset is its interest in the subsidiary, and
> (c) the only activities undertaken by the company [*ie the parent company*] are ones that are incidental to its ownership of that interest.

Thus P also qualifies as "the holding company of the property." Strictly this does not help as P is not the company providing the accommodation but in practice the relief is clearly intended to apply here.

39.28.4 *"The relevant time"*

Section 100A(5)(6) ITEPA defines "relevant time":

> (5) "The relevant time" is the time the company first owned a relevant interest in the property; but this is subject to subsection (6).
> (6) If—
> (a) none of D's interest in the company was acquired directly or indirectly from a person connected with D, and
> (b) the company owned a relevant interest in the property at the time D first acquired an interest in the company,
> "the relevant time" is the time D first acquired such an interest.

39.28.5 *Exceptions*

Section 100B ITEPA sets out three wide exceptions to this narrow relief:

> (1) Section 100A(1) does not apply if subsection (2), (3) or (4) applies.

The first two exceptions concern connected[84] companies:

> (2) This subsection applies if—
> (a) the company's interest in the property was acquired[85] (directly or

[84] "Connected" is very widely defined in s.100B(9) ITEPA:
"In this section 'connected company' means—
(a) a company connected with D, with a member of D's family or with an employer of D, or
(b) a company connected with such a company."

[85] Section 100B(5) ITEPA provides a commonsense definition:
"In subsection (2), references to the acquisition of an interest include the grant of an

> indirectly) from a connected company at an undervalue, or
>
> (b) the company's interest in the property derives from an interest[86] that was so acquired.
>
> (3) This subsection applies if, at any time after the relevant time—
>
> (a) expenditure in respect of the property has been incurred (directly or indirectly) by a connected company, or
>
> (b) any borrowing of the company (directly or indirectly) from a connected company has been outstanding (but see subsection (7).
>
> ...
>
> (7) For the purposes of subsection (3)(b), no account is to be taken of—
>
> (a) any borrowing at a commercial rate, or
>
> (b) any borrowing which results in D being treated under Chapter 7 (taxable benefits: loans) as receiving earnings.

Lastly there is an all-purpose tax motive restriction:

> (4) This subsection applies if the living accommodation is provided in pursuance of an arrangement[87] the main purpose, or one of the main purposes, of which is the avoidance of tax or national insurance contributions.

39.28.6 *Critique*

Foreign homes relief would serve as a case study for what has gone wrong with tax reform in recent years. Almost every restriction on this relief is anomalous. Why should there be a relief for a company owning land and not for chattels? Yachts and aeroplanes are generally held through companies. Why should the relief apply to companies held by individuals and not by trusts? We need rationalisation and simplification, not yet another narrowly targeted relief. But there it is.

interest."

[86] Section 100B(6) ITEPA provides a commonsense definition:

"For the purposes of that subsection [subsection (2)], an interest is acquired at an undervalue if the total consideration for it is less than that which might reasonably have been expected to be obtained on a disposal of the interest on the open market; and 'consideration' here means consideration provided at any time (and, for example, includes payments by way of rent)."

[87] Section 100B(8) ITEPA provides the definition:

"In subsection (4) 'arrangement' includes any scheme, agreement or understanding, whether or not enforceable."

The wording is slightly different from the standard (unnecessary) definition, see App 2.2.3 (Definitions of "arrangement"); but there is no practical difference.

39.29 Other planning

More complex possibilities involve:
(1) acquiring a property,
(2) granting (say) a ten-year lease to trustees or to the individual, and
(3) transferring the freehold reversion to a company. Watch SDLT.
The accommodation charge would not apply, because the company would not be providing accommodation. Similar arrangements can be carried out with options. In practice, arrangements of this complexity would not often be needed.

39.30 BiK/general earnings: Interaction

Section 109 ITEPA provides:

> (1) This section applies if—
> (a) under this Chapter [Chapter 5 Part 3] the cash equivalent of the benefit of living accommodation is to be treated as earnings from an employee's employment for a tax year, and
> (b) under Chapter 1 of this Part an amount would, apart from this section, constitute earnings from the employment for the year in respect of the provision of the accommodation.
> (2) The full amount of the cash equivalent is to be treated as earnings from the employment for that year under this Chapter.
> (3) The amount mentioned in subsection (1)(b) is to constitute earnings from the employment for the year under Chapter 1 of this Part only to the extent that it exceeds the amount mentioned in subsection (2).

This is the opposite of the rule which applies to other classes of benefits in kind.

39.31 Planning for home charge

Many company structures have been set up in the past. The risk of an accommodation charge depends on the facts of each case, but in practice it is often a concern. What can be done?

39.31.1 *Winding-up company*

If practical, the safest course is to extract the property from the company so as to put an end to the charge (or risk of a charge) under the benefit in kind rules. One way to do this is to liquidate the company.

The liquidation may give rise to a capital gain which may rule out this course. But SDLT and CGT may rule out this course.

Another possibility may be to reimburse the company for the cost of providing the accommodation. Watch the CGT implications.

39.31.2 *Planning without winding-up*

CGT may make it impractical to wind up the company. In that case the solution may be to take steps to ensure that the individual is not a shadow director.

39.32 Home BiK: HMRC enquiries

In practice, as *Al Fayed v Advocate General* frankly reports,[88] shadow directorship arguments before the decision in *R v Dimsey* were "settled by horse trading as opposed to on any strict statutory basis". It is likely that this will continue to be the case. Except for companies which were carefully set up and run, HMRC will at least be able to exact a sum equal to the cost of litigating the issue before the first-tier tribunal or beyond.

39.33 Home BiK: Critique

Anyone who has followed the text to this point will agree that the law in this area is defective. It is unnecessarily complicated, rests to a large part on formal and informal concessions, and is sometimes so very unfair that HMRC do not exert themselves to apply the law correctly set out in the Manuals. The following reforms should solve these problems:

(1) Abolish the s.105 charge and extend s.106 to cover the first £75,000 of acquisition cost. All the concessions would then drop away.

(2) The application of the charge to shadow directors who do no real work for the company is a nonsense. Given the widespread use of holding companies to hold wealth, *Dimsey & Allen* is arguably one of the worst tax decisions made by the House of Lords. Simply to abolish the charge (reversing *R v Dimsey*) would go too far the other way, since it is fair that a shadow director who receives what is in reality remuneration from a company should be charged. The solution is to restrict the rule that any benefit from an employer is deemed to be "by reason of employment". The deeming should not apply to a shadow director (whose connection with the company may be tenuous). That would strike the right balance.

[88] [2002] STC 910 para 44.

My impression is that the BiK rules have been used by HMRC as a threat or weapon in two ways:

(1) in tax investigations, and

(2) to discourage IHT planning (placing homes in companies for IHT reasons). That is not the purpose for which the BiK rules were designed, and it is not surprising that they did not succeed in preventing that planning. But the IHT residence-property rules now prevent planning of this kind.

39.34 SDLT on accommodation charge

Para 12 sch 4 FA 2003 provides:

> (1) Where a land transaction is entered into by reason of the purchaser's employment, or that of a person connected with him, then—
>
> (a) if the transaction gives rise to a charge to tax under Chapter 5 of Part 3 of the ITEPA (taxable benefits: living accommodation) and—
>
> (i) no rent is payable by the purchaser, or
>
> (ii) the rent payable by the purchaser is less than the cash equivalent of the benefit calculated under s.105 or 106 of that Act,
>
> there shall be taken to be payable by the purchaser as rent an amount equal to the cash equivalent chargeable under those sections;
>
> (b) if the transaction would give rise to a charge under that Chapter but for s.99 of that Act (accommodation provided for performance of duties), the consideration for the transaction is the actual consideration (if any); ...

This will not usually affect a foreign domiciliary who occupies a UK home through a company, even if the foreign domiciliary is a shadow director and within the BiK provisions. The reasons are:

(1) The acquisition of a licence (as opposed to a lease) is not a land transaction. The distinction between lease and licence is fraught but usually the individual will occupy under licence and not a lease.

(2) Even if the shadow director acquires a lease, they will not usually do so by reason of their employment. The extended definition in the benefits code[89] does not apply here.

[89] See 39.10 ("By reason of employment").

39.35 Benefit BiK charge

39.35.1 *Benefit BiK: The charge*

Section 201(1) ITEPA provides:

> This Chapter [Chapter 10 Part 3] applies to employment-related benefits.

The effective charge[90] is in s.203(1) ITEPA:

> The cash equivalent of an employment-related benefit is to be treated as earnings from the employment for the tax year in which it is provided.

The key expressions are "employment-related benefit" and "cash equivalent".

39.35.2 *"Employment-related benefit"*

See 39.8 (Accommodation/benefit charge).
The relief for excluded benefits is not considered here.

39.35.3 *"Benefit"*

Section 201(2) ITEPA provides:

> In this Chapter [Chapter 10 Part 3]—
> "benefit" means a benefit[91] or facility of any kind;

EI Manual provides:

> **EIM21002 What is meant by a "benefit"** [May 2022]
> ... The definition of what is a benefit is thus very wide and includes everything that confers a special bounty of any description on the recipient.

HMRC do not argue that the word "facility" applies to a facility which is not a benefit in the ordinary sense. Thus s.201(2) is a non-definition of benefit: it only says that "benefit" means benefit. But non-definitions are common in tax legislation.

39.35.4 *Fair bargain rule*

There is no benefit – and so no charge – if full consideration is paid for

[90] This is not, strictly, a charging section, but it feeds into the general charge to tax on employment income: see 34.4.2 ("General earnings"); 34.6 (Charge on employment income).

[91] For the meaning of "benefit" see 50.4 (Benefit).

anything which would be a benefit if provided at an undervalue. This is so even if the full consideration is less than the "cash equivalent", which is often, perhaps usually, the case.[92]

There is no benefit - and so no charge - if what is paid is less than full consideration, as long as the transaction is a "fair bargain". I refer to that as the **"fair bargain rule"**.

The EI Manual provides:

> **EIM21004 benefits and fair bargain** [May 2022]
> Although the definition (?) of "benefit" in Section 201(2) is extremely wide, it does not cover everything that may be provided by an employer to someone who happens to be an employee or director of that employer. As a general principle, a benefit must provide an element of "special bounty" to the recipient. In other words the employee must get something over and above what the employer gives as a **fair bargain,** or would be prepared to give as a fair bargain, to a member of the public, or other independent third party, dealing on arms length terms with the employer...[93]
> The principle of "fair bargain" in relation to a benefit arose in the case of *Mairs v Haughey*,[94] which concerned a payment to an employee in return for giving up rights under an enhanced redundancy scheme. The Special Commissioners held that the payment was not a benefit because it did not overvalue the employee's contingent right to receive a payment from the scheme ...In the Court of Appeal (Northern Ireland) Lord Chief Justice Hutton supported the Commissioners' view:
>
>> "The respondent received the payment .... in return for surrendering his contingent right to receive payment under the enhanced redundancy scheme and the Special Commissioners held that the payment did not overvalue that right. Therefore I consider that the Respondent did not receive a "benefit" .... where the money received was paid to him by way of **fair bargain,** in consideration of his surrender of a right to receive a larger sum on the event of the contingency of redundancy occurring."[95]

By the time *HMRC v Apollo Fuels* reached the CoA, it was common

[92] FA 2016 reversed this rule in relation to accommodation, cars and loans, but the fair bargain rule continues to apply for the benefit BiK charge.

[93] These words are copied into the decision in *Excel Computer Systems v HMRC* [2018] UKFTT 346 (TC).

[94] 66 TC 273.

[95] *Id.* at 406.

ground "that fair bargains are excluded from the meaning of 'employment-related benefit' in s.203 for the purposes of Ch 10 of Pt 3".[96]

39.35.5 *Unintendedly bad bargain*

Whether arrangements constitute a "fair bargain" is a question of fact. The EIM provides:

> **EIM21004 benefits and fair bargain** [May 2022]
> **... Wilson v Clayton**[97]
> This case concerned an employee who was dismissed by his employer for failing to agree to withdrawal of his entitlement to an Essential Car User Allowance (ECUA). He was immediately re-employed on the same terms except that he was no longer entitled to receive ECUA. An Employment Tribunal found that he had been unfairly dismissed and ordered the employer to reinstate the ECUA, and to pay him the arrears of ECUA due since it had been withdrawn. The Tribunal also ordered the employer to pay him a "Basic Award" of compensation.
> Under the Employment Rights Act 1996 the Tribunal had no authority to order the compensation payment but the employer paid it. Arguably the payment to the employee was a pure windfall to him as it had no statutory basis and the employee was not entitled to receive it. Nevertheless the employer paid it in order to avoid further litigation and consequently it was paid as part of a genuine compromise agreement made at arm's length.
> The Court of Appeal held that in these particular circumstances the payment of compensation was not a benefit, as it represented a "**true bargain**" between employer and employee. Gibson, LJ held that –
>
> > "Where parties at arm's length arrive at a genuine compromise in settlement of hostile litigation, it would be an extremely difficult task for any tribunal or court to unpick the constituent parts of the bargain and to put a value on those parts."[98]
>
> Consequently the value of the "bargain" agreed by an employer and an employee **in a genuine compromise agreement at arm's length** is not generally relevant to determining whether the bargain represents a "fair bargain". But this principle does not apply where, as Gibson LJ set out,
>
> > "the reason for the payment was to confer a gratuitous benefit within a compromise agreement.. ."

[96] [2016] STC 1594 at [41].
[97] 77 TC 1.
[98] at [50].

> Following *Wilson v Clayton*, where it is claimed that the payment represents a fair bargain, you must investigate carefully the reason for a payment made as a result of a compromise agreement at arm's length. If it was a genuine compromise agreement it will probably be a fair bargain. On the other hand, if it was intended purely to provide a benefit, it will be chargeable as such. The decision does not have any read across to payments made under a compromise agreement not made at arm's length.

These decisions were approved in *HMRC v Apollo Fuels:*

> *Mairs v Haughey* and *Wilson v Clayton* are authorities establishing that fair bargains are excluded from the regime for taxing benefits conferred on employees because there is no benefit which is properly subject to tax.[99]

The fair bargain rule is not limited to compromise agreements in litigation; it applies to any unintendedly bad bargain, that is, where both sides intended to reach a fair bargain, ie to give full consideration, but owning to some mistake, the price reached was not an informed market value. A unintendedly bad bargain is not a benefit for the purposes of the benefit BiK charge.

The fair bargain rule is based on the meaning of benefit, in the general sense, so it also applies for the purposes of s.731 and s.87, though in the latter case it overlaps with arm's length transaction relief.[100]

39.35.6 *Benefit available to all*

The EI Manual provides:

> **EIM21004 benefits and fair bargain** [May 2022]
> ... something provided by an employer, on identical terms both for employees and for the general public (for example, "free" refuse collection or state education), does not become a benefit within the legislation simply because it is provided for people who happen to be employees of that employer. The employees receive on the same terms exactly what they would have received if they had not been employees. That indicates that what they get is a fair bargain and there is therefore no "benefit".
> It is not necessary that the employer actually does deal with members of the public for this principle to apply. If an employer provides something

[99] *HMRC v Apollo Fuels* [2014] UKUT 95 (TCC) at [71].

[100] See App.4.10.4 (Bad/fair bargain).

> to an employee, and they would be prepared to provide it to any member of the public on exactly the same terms, then that is a fair bargain and not a benefit.

This is a purposive construction, but it must be correct. The reason given is not persuasive: in what sense is the provision of refuse collection or state education a "bargain"? But the context shows that this sort of benefit does not count. This is the reason that the HMRC Manual refers to benefit as a *special* bounty, ie a benefit not available to all.

39.35.7 *Cash payment*

The EI Manual provides:

> **EIM21006 cash payments can be benefits: Wicks v Firth** [May 2022]
> The statutory definition of a benefit is wide enough to include a cash payment which a director or an employee ... receives by reason of the employment and which is not chargeable to income tax under some other provision. ...
> For example, in *Wicks v Firth*[101] payments made as scholarships to the children of an employee within the benefits code were held to be benefits within Section 201 ITEPA 2003.
> In that case the payments were exempt from charge by Section 331 ICTA 1988 (this exemption was subsequently removed in most cases by Section 212 ITEPA 2003) but that does not alter the general principle that cash payments can be a chargeable benefit.
> The decision in *Mairs v Haughey* (EIM21004) is further support for the view that a cash payment can be a chargeable as a benefit.

That seems self-evident.

39.35.8 *Employer self-interest*

The EI Manual provides:

> **EIM21003 Motive of employer is irrelevant** [May 2022]
> [The Manual refers to the definition of "benefit" and continues:] It does not matter whether in providing a benefit an employer is intending to benefit himself rather than, or as well as, the employee. So long as the employee or a member of his family or household (Section 721(5) ITEPA 2003) is provided with a benefit by reason of his employment, a tax charge will arise.

[101] 56 TC 318.

> In *Rendell v Went* (41 TC 641) the company took over and paid for the defence of a director against a dangerous driving charge. It did so because it feared the loss of the director's services if he was sent to prison. The full amount paid by the company was held to be a chargeable benefit. The fact that the company spent the money primarily for its own benefit and only as a by-product benefited the director, did not prevent the payment giving rise to a chargeable benefit.

The legal costs (including leading counsel) amounted to £641 (in 1958 prices).[102] It seems the money was well spent, as the director was acquitted.

> The decision in the House of Lords was unanimously in the Crown's favour. [The Manual cites a comment of Lord Reid, and continues:] Viscount Radcliffe made the same point in more succinct terms (page 656):
>
> > "But an expenditure is not the less advantageous to a director because it suits or advantages his company to make it."

39.35.9 *"Excluded benefit"*

Section 202(1) ITEPA provides:

> A benefit is an "excluded benefit" for the purposes of this Chapter [Chapter 10 Part 3] if–
>
> (a) any of Chapters 3 to 9 of the benefits code applies to the benefit,
>
> (b) any of those Chapters would apply to the benefit but for an exception,[103] or
>
> (c) the benefit consists in the right to receive, or the prospect of receiving, sums treated as earnings under section 221 (payments where employee absent because of sickness or disability).

Other Chapters of the benefits code (such as accommodation) have priority, and only benefits not caught elsewhere fall into the residuary benefits charge. For this reason the label "employment-related benefit" is not particularly apt, but it is hard to think of a better one.

39.35.10 *Former/prospective employee*

Section 201 ITEPA provides:

[102] The equivalent value in 2023 is about £15,130: see *http://www.measuringworth.com*

[103] Section 202(2) ITEPA provides a commonsense definition: "In this section "exception", in relation to the application of a Chapter of the benefits code to a benefit, means any enactment in the Chapter which provides that the Chapter does not apply to the benefit..."

> (4) For the purposes of this Chapter [Chapter 10 Part 3] it does not matter whether the employment is held at the time when the benefit is provided so long as it is held at some point in the tax year in which the benefit is provided.
> (5) References in this Chapter to an employee accordingly include a prospective or former employee.

39.35.11 *When is benefit provided*

The time that the benefit matters as it may affect the year of the charge or whether there is a charge at all.

In *Templeton v Jacobs*:

> In January 1991 Jacobs agreed to become an employee of a company in May 1991 and it was agreed between the parties that Jacobs would work from home and that the prospective employer would pay for the costs of converting the loft in Jacobs' home into an office. Before 6 April 1991 the employer entered into a contract with, and paid, a builder for the conversion work. The work was started in July 1991 and the loft conversion was available for use as an office in September 1991.

The question was when the benefit was provided: when the work was paid for or when the work was completed. The judge accepted the argument of HMRC:

> Suppose ... that the taxpayer had been employed continuously throughout the years 1990-91 and 1991-92. If the [benefit was in 1990/91] a charge to tax would arise during the earlier of those two years when the employer company entered into the building contract or alternatively paid the consideration under it. Yet the work might never be carried out, with the result that no benefit ever became available to the taxpayer for his use and enjoyment. This could have happened for a number of reasons: the liquidation of the building contractor or even simply an agreement between the builder and employer not to proceed with the contract.[104]

So:

> No benefit is provided for the purposes of Section 154(1) until the benefit in question becomes available to be enjoyed by the taxpayer. Prior to that

[104] 68 TC 735 at p.743. The possibility that the builder and employer may have agreed not to proceed would not have arisen if the employee had been party to the contract. But that would have made no difference, as the possibility of liquidation of the builder would still remain.

> point in time there can be no relevant benefit to the taxpayer in respect of which a charge to tax can arise under Section 154(1). The arrangements made by the employer, or the steps taken by him, or the cost which he has incurred are not the relevant touchstones for determining whether or not a benefit has been provided. There can be no benefit until the relevant benefit is available to the taxpayer.[105]

39.36 "Cash equivalent"

This is defined in s.203(2) ITEPA:

> The cash equivalent of an employment-related benefit is
> [a] the cost of the benefit less
> [b] any part of that cost made good[106] by the employee, to the persons providing the benefit, on or before 6 July following the tax year in which it is provided.

This takes us to the elaborate definition of "cost of the benefit". Section 203(3) ITEPA sets out the three rules and their priority:

> The cost of an employment-related benefit is determined in accordance with section 204 unless—
> (a) section 205 provides that the cost is to be determined in accordance with that section, or
> (b) section 206 provides that the cost is to be determined in accordance with that section.

Thus s.204 ITEPA contains the default rule which applies unless trumped by s.205 or 206. I refer to that as the "**s.204 default cost rule**". There are two cases where the s.204 default cost rule does not apply:

(1) Asset made available without transfer: the **"s.205 cost rule"**.
(2) Transfer of used or depreciated asset: the **"s.206 cost rule"**. This is not discussed here.

39.36.1 *s.204 default cost rule*

Section 204 ITEPA provides:

> The cost of an employment-related benefit is the expense incurred in or in connection with provision of the benefit (including a proper proportion of any expense relating partly to provision of the benefit and partly to other matters).

[105] 68 TC 735 at p.744.
[106] See 39.19 ("Making good").

39.37 s.205 cost rule

Section 205(1) ITEPA provides:

> The cost of an employment-related benefit ("the taxable benefit") is determined in accordance with this section if—
> (a) the benefit consists in—
> (i) an asset being placed at the disposal of the employee, or at the disposal of a member of the employee's family or household, for the employee's or member's use, or
> (ii) an asset being used wholly or partly for the purposes of the employee or a member of the employee's family or household, and
> (b) there is no transfer of the property in the asset.

In particular, the s.205 cost rule applies on the use of chattels, which is the main focus in this chapter. Where that is the case, the cost rule is in s.205(2) ITEPA:

> The cost of the taxable benefit is the higher of—
> (a) the annual value of the use of the asset, and
> (b) the annual amount of the sums, if any, paid by those providing the benefit by way of rent or hire charge for the asset,
> together with the amount of any additional expense.

Section 205(3) ITEPA defines "annual value of the use of the asset":

> For the purposes of subsection (2), the annual value of the use of an asset is—
> (a) in the case of land, its annual rental value;[107]
> (b) in any other case, 20% of the market value[108] of the asset at the time when those providing the taxable benefit first applied the asset in the provision of an employment-related benefit (whether or not the person provided with that benefit is also the person provided with the taxable benefit). ...[109]

Section 205(4) ITEPA defines "additional expense":

> In this section "additional expense" means the expense incurred in or in

[107] "Annual rental value" is defined in s.207 ITEPA. This only applies to land other than accommodation, so in practice it is less important.

[108] "Market value" is has a commonsense definition in s.208 ITEPA.

[109] There is transitional relief where those providing the taxable benefit first applied the asset in the provision of an employment-related benefit before 6 April 1980.

> connection with provision of the taxable benefit (including a proper proportion of any expense relating partly to provision of the benefit and partly to other matters), other than—
>
> (a) the expense of acquiring or producing the asset incurred by the person to whom the asset belongs, and
>
> (b) any rent or hire charge payable for the asset by those providing the asset.[110]

Note that there is a reference to "a proper proportion" in the computation of the additional expense, but not in the computation of the annual value.

39.37.1 *Available for part of year*

Where the asset is available for part of a year, there clearly has to be a time apportionment. Section 205A ITEPA provides:

> (1) A deduction is to be made under section 205(1C)(b) if the asset mentioned in section 205(1) has been unavailable for private use on any day during the tax year concerned.
>
> (2) For the purposes of this section an asset is "unavailable" for private use on any day if—
>
> (a) that day falls before the day on which the asset is first available to the employee,
>
> (b) that day falls after the day on which the asset is last available to the employee,
>
> (c) for more than 12 hours during that day the asset—
>
> (i) is not in a condition fit for use,
>
> (ii) is undergoing repair or maintenance,
>
> (iii) could not lawfully be used,
>
> (iv) is in the possession of a person who has a lien over it and who is not the employer, not a person connected with the employer, not the employee, not a member of the employee's family and not a member of the employee's household, or
>
> (v) is used in a way that is neither use by, nor use at the direction of, the employee or a member of the employee's family or household, or
>
> (d) on that day the employee—

[110] EIM states at 21631 [May 2022]:

> This will include expenditure on running costs and could include expenditure on alterations or improvements, repairs, maintenance, etc depending on whether it was incurred for the purpose of providing the benefit. It would not include interest paid on a loan to acquire the asset.

(i) uses the asset in the performance of the duties of the employment, and

(ii) does not use the asset otherwise than in the performance of the duties of the employment.

(3) The amount of the deduction is given by—

(U/Y) × A

where—

U is the number of days, in the tax year concerned, on which the asset is unavailable for private use,

Y is the number of days in that year, and

A is the annual cost of the benefit of the asset determined under section 205(2).

(4) The reference in subsection (2)(a) to the time when the asset is first available to the employee is to the earliest time when the asset is made available, by reason of the employment and without any transfer of the property in it, for private use.

(5) The reference in subsection (2)(b) to the time when the asset is last available to the employee is to the last time when the asset is made available, by reason of the employment and without any transfer of the property in it, for private use.

The EIM gives an example:

EIM21890 Example of Calculating the Unavailable for Private Use Deduction [May 2022]

... A director is provided with the use of a helicopter I a tax year. The market value of the helicopter when it was first made available for the director' private use is £800,000.

The asset was used for a mixture of business and private purposes and was first provided on 6 July in that tax year (91 days after the start of the tax year). During the rest of the year there were 10 days when the helicopter is only used for the duties of the employment (and so is treated as unavailable for private use under section 205A(2)(d)) and 10 days when another employee had sole use of the asset (and so is treated as unavailable for private use on the day under section 205A(2)(c)(v)).

The employee pays £6,000 towards the use of the asset before 6 July following the end of the relevant tax year.

There are 365 days in the relevant tax year (Y).

20% market value when first available	£160,000
Additional expenses associated with its provision	£20,000
Annual cost of the asset (A)	£180,000

Number of days in the tax year before the benefit was provided 91 days

Number of days the asset was only used for employment 10 days

> Number of days when the asset was used only by another employee 10 days
> Total number of days the asset was unavailable for private use during the tax year (U) 111 days
> Deduction from annual cost: U/Y × A = 111 /365 × 180,000 = £54,740
> Chargeable cost of the asset is £180,000 −£54,740 which is £125,260.
> As the employee has made good part of the cost by paying £6,000 and it was paid before 6 July following the end of the relevant tax year the cash equivalent of the benefit for both tax and Class 1A NICs is £119,260.

39.37.2 *Shared use*

Section 205B ITEPA provides:

> (1) This section applies where the cost of an employment-related benefit ("the taxable benefit") is to be determined under section 205.
> (2) If, for the whole or part of the tax year concerned, the same asset is available for more than one employee's private use at the same time, the total of the amounts which are the cost of the taxable benefit for each of those employees is to be limited to the annual cost of the benefit of the asset determined in accordance with section 205(2).
> (3) The cost of the taxable benefit for each employee is determined by taking the amount given by section 205(1C) and then reducing that amount on a just and reasonable basis.
> (4) For the purposes of this section, an asset is available for an employee's private use if it is available for private use by the employee or a member of the employee's family or household.

39.38 Ordinary earnings/BiK border

The expression "general earnings" includes:
(1) Ordinary earnings, and
(2) BiK earnings[111]

So it may not often matter whether earnings are classified one way or the other. But clearly there should not be a double charge, and sometimes the distinction does matter.

Section 64 ITEPA defines the border:

> (1) This section applies if, apart from this section, the same benefit would give rise to two amounts ("A" and "B")—
> (a) A being an amount of [ordinary] earnings as defined in Chapter

[111] See 34.4.2 ("General earnings") and 34.6 (Charge on employment income).

> 1 of this Part,[112] and
>
> (b) B being an amount to be treated as earnings under the benefits code.
>
> (2) In such a case—
>
> (a) A constitutes earnings as defined in Chapter 1 of this Part, and
>
> (b) the amount (if any) by which B exceeds A is to be treated as earnings under the benefits code.

A different rule applies for accommodation:

> (3) This section does not apply in connection with living accommodation to which Chapter 5 of this Part applies.
>
> (4) In that case section 109 applies to determine the relationship between that Chapter and Chapter 1 of this Part.[113]

The EI Manual provides:

> **EIM20503 third party benefits** [Jan 2021]
>
> **... Interaction of "by reason of the employment" with s.62 ITEPA**
>
> It is important to understand the distinction between
>
> [1] Section 62 [ordinary earnings] on the one hand, and
>
> [2] Sections 70(1) [expenses payments BiK earnings] and 201(2) [benefit BiK earnings] on the other hand.
>
> Section 62(1) applies to earnings "in relation to an employment", including anything that is an "emolument of the employment" (Section 62(2)(c)). Section 70(1) and Section 201(3) apply to expense payments and benefits provided "by reason of the employment". Section 62 is based on what was previously Section 19 ICTA 1988, which charged to tax emoluments "from an employment". Case law shows that the phrase "by reason of the employment" has a wider meaning than "from the employment" (EIM00600). The words "from the employment" are not reproduced in Section 62 but earnings chargeable under that section include emoluments "of the employment" and in this context "of the employment" has the same meaning as "from the employment".

39.39 BiK: Remittance basis

This section deals with the position of a remittance basis taxpayer who is an employee, director or shadow director, and receives benefits in kind. The same points arise for the accommodation and the benefit BiK charges. In each case, a specified amount (the cash equivalent) is "treated as

[112] See 34.4.1 ("Ordinary" earnings).

[113] See 39.30 (BiK/general earnings: Interaction).

earnings from the employment".[114] I refer to this as **"BiK earnings"**. BiK earnings can qualify for the remittance basis in one of two ways:

(1) Under the COE remittance basis[115]
(2) Under the OWR (recent arrivers) remittance basis[116]

It is best to consider these separately.

39.39.1 *OWR (recent arrivers)*

This remittance basis applies if the general earnings are not "in respect of duties performed in the UK".
Thus one has to ascertain:

(1) What are the duties?
(2) Where are they performed?
(3) Are the BiK earnings "in respect of" those duties?

What are the duties?
To ascertain the duties of an employee is a matter of employment law, and the contract of employment, and the question is relatively straightforward.

To ascertain the duties of a formally appointed director is a matter of company law, and employment law (if the director has a contract of employment), and is also generally straightforward.

To ascertain the duties of a shadow director is more complicated. Assuming UK law principles apply,[117] the starting point is Part 10 Companies Act 2006, which is headed "A director's duties". The law was amended on 26 May 2015.[118] Before that date s.170(5) Companies Act 2006 provided:

> *The general duties apply to shadow directors where, and to the extent that, the corresponding common law rules or equitable principles so apply.*

Section 170(5) Companies Act 2006 now provides:

> The general duties apply to a shadow director of a company where and to the extent that they are capable of so applying.

[114] See 39.14 (Accommodation: the charge); 39.35.1 (Benefit BiK: The charge).

[115] See 34.14 (Chargeable overseas earnings).

[116] See 34.22 (Overseas workday relief).

[117] Further consideration would be needed if the relevant company law was significantly different.

[118] See s.89 Small Business, Enterprise and Employment Act 2015.

The Explanatory Notes comment on this change:

> At present the general duties of directors can only apply to shadow directors in the same way as the corresponding common law rules and equitable principles can. In future, the starting point for shadow directors will be that the general duties apply to them unless they are not capable of applying (removing the current restriction). This is achieved by replacing section 170(5) of the CA 2006. This change in default position is neither intended to preclude the courts from looking at the application of the duties on a case by case basis, nor from drawing on existing case law in any given case.

The position therefore continues to be that there is no clear statement of the general duties of a shadow director.

There are seven general duties:

(1) Duty to act within powers
(2) Duty to promote the success of the company
(3) Duty to exercise independent judgment
(4) Duty to exercise reasonable care, skill and diligence
(5) Duty to avoid conflicts of interest
(6) Duty not to accept benefits from third parties
(7) Duty to declare interest in proposed transaction or arrangement[119]

Duties (1) - (4) are expressed in general terms which do not identify specific duties. Duties (5) - (6) are negative duties (duties not to do something) which are not performed in any particular place. Duty (7) will rarely if ever arise.

It can be argued that a shadow director has no "duties". The director may choose to give instructions and directions, but is not under any duty to do so. I think the better view is that if a shadow director is deemed to have an employment, it follows that they should be deemed to have some duties. The question is: what are the duties of a shadow director? The duties may be regarded as the instructions or directions which the shadow directors give to the company. Another possible view is that everything that the shadow director does for the company (or its assets) is regarded as part of their "duties"; or alternatively everything they do if their actions concern matters which would (apart from them) be the responsibility of the actual directors.

[119] Sections 171-177 Companies Act 2006.

Where are the duties performed? Where these duties are performed is a question of fact, but in most cases it is likely that at least some of the duties will be performed outside the UK. It may help to have a contract of employment which sets out the duties (all of which are to be performed abroad) - but only if the duties are in fact performed abroad.

Are the BiK earnings in respect of the duties? Are BiK earnings "in respect of" the duties of a shadow director? In the case of a standard property owning company, it is considered that the answer is "no". Certainly if there were no duties there would be no shadow directorship and so no BiK earnings, but that is not enough. The benefit of accommodation (which the earnings represent) would arise independently of the duties. The fiction that the benefit is deemed to be received by reason of the employment does not entail that the earnings are in respect of the employment.

There is no income tax avoidance possibility here, because in the case where actual, substantial services were provided by a shadow director (comparable to the services of a properly appointed director) then the earnings could and probably would be in respect of the duties.[120]

If I am wrong on "in respect of", and some of the duties are performed in the UK, there is an apportionment. The difficulty of apportionment is immense, which suggests that my interpretation of "in respect of" is the correct one.

Similar points apply to an a properly appointed director (not a shadow director) who is owner, or ultimate beneficial owner, of a company. While such a person clearly has duties, the benefit in kind may be attributable to the share ownership, not to the duties, and so not "in respect of" the duties.

For these reasons it is considered that BiK earnings can in principle qualify for the OWR (recent arrivers) remittance basis.

39.39.2 *COE remittance basis*

This remittance basis applies if the duties of the employment are performed wholly outside the UK.

Thus one has to ascertain:
(1) What are the duties?
(2) Where are they performed?

In a accommodation case, where a company holds a UK dwelling house, it

[120] See *R v Dimsey* [2002] 1 AC 509 at [19].

would be difficult in practice for a UK resident remittance basis taxpayer to ensure that his duties are performed *wholly* outside the UK. However, it should be possible in other cases, eg where the BiK consists of non-UK situate accommodation or chattels, or for the BiK of employment-related loans. It may help to have a contract of employment which sets out the duties (all of which are to be performed abroad).

For these reasons it is considered that BiK earnings may qualify for the COE remittance basis.

39.39.3 *BiK earnings remitted to UK*

If BiK earnings qualify for the COE or OWR remittance basis, they are taxable only if remitted to the UK.

BiK earnings are not on any view remitted to the UK if:

(1) The accommodation is not in the UK; or
(2) The benefit is not received/used/brought to the UK by a relevant person.

If the accommodation or benefit is in the UK, common sense suggests that there ought to be a taxable remittance. But there is a sound technical argument that the deemed earnings cannot be remitted, because they do not exist. The tax charge arises only if the earnings are remitted. The property (or benefit) is not the same as the earnings.

HMRC do not agree. The EI Manual provides:

> **EIM20507 expenses and benefits from non-resident employers** [Mar 2022]
> The residence of the employer has no effect on whether benefits and expenses within the rules in the benefits code are chargeable.
> The residence of any other person providing benefits or expenses payments within those rules similarly has no effect.
>
> **EIM20508 Expense payments to and benefits provided for a director or employee whose earnings are taxable on remittance** [Mar 2022]
> **Sections 22 and 26 ITEPA 2003**
> The earnings of a director or employee, (except for 2015/16 and earlier in an excluded employment (EIM20007)), who is chargeable on remittances to the UK under either s.22 or s.26 ITEPA include
>
> - expenses payments remitted to the UK
> - expenses paid in the UK
> - *benefits provided or enjoyed in the UK (for example, a motorbike available for use in the UK)...*

> **EIM40303 Meaning of "remitted to the UK": benefits in kind ...** [Apr 2022]
> **Sections 809L ITA 2007 (inserted by Finance Act 2008)**
> **Benefits in kind**
> The definition of "remitted to the UK" in Section 809L ITA 2007 (see EIM40302) includes general earnings brought to, received in or used in and enjoyed in the UK in a form other than money. The benefits code as defined by Section 63(1) ITEPA 2003 provides a number of examples of earnings that are capable of satisfying the definition including taxable benefits arising from the provision of:
> - living accommodation
> - loans
> - cars available for private use.

This view was doubtful before 2008, but it is even harder to defend under the ITA remittance basis because where there is deemed income or gains, the statute specifically deals with the issue by identifying specific assets which are deemed to be derived from those income or gains.

39.40 Benefits in kind: Non-resident

This section deals with the position of a non-resident individual who is an employee, director or shadow director and receives benefits in kind. The same points arise for the accommodation and the benefit BiK charges. Earnings are taxable only if they are in respect of duties performed in the UK.[121]

Thus one has to ascertain:

(1) what are the duties
(2) where are they performed
(3) are the BiK earnings "in respect of" those duties

These questions are discussed above.[122] I conclude even if a shadow director has duties, and even if the duties are performed in the UK, the BiK earnings are not *in respect of* those duties, and so a non-resident shadow director is not taxable.

This conclusion is consistent with the POA exemption for non-residents[123] (though consistency between different tax codes does not count for much).

In practice, so far as the author is aware, HMRC do not assess non-

[121] See 34.29 (Non-resident employee).
[122] See 39.39.1 (OWR (recent arrivers)).
[123] See 39.10 (Non-resident individual).

resident individuals on benefits in kind. Of course, in many cases, collection of tax would be problematic. But it is significant that EI Manual in this context refers specifically to directors who "reside here" (ie, in the UK).[124]

39.41 Section 731 charge

One should arrange, if possible, that any trust or company holding the family home and chattels has no relevant income within s.731. Otherwise the use of the property would be a benefit, which in principle would rise to an income tax charge on a UK resident user.[125] This only applies if the benefit is not otherwise chargeable to income tax. If there is a BiK charge, there is no charge under s.731. One possibility may be to arrange that the amount of the BiK charge is a small one (eg by a reimbursement of the company's expenditure). Whatever the charge is, it should avoid a taxable benefit under s.731.

39.42 Transfer pricing & BiK

The transfer pricing code (in short) deems transactions between persons under common control to be at arm's length prices.[126]

HMRC formerly accepted that transfer pricing rules apply only to transactions between two "enterprises".[127] The INT Manual provided two reasons for this view.

The first is based on s.147(1) TIOPA, which sets out the "basic pre-condition" for transfer pricing. This provides (so far as relevant):

> ... "the basic pre-condition" is that—
> (a) provision ("the actual provision") has been made or imposed as between any two persons ... by means of a transaction or series of transactions...
> (d) the actual provision differs from the provision ... which would have been made *as between independent enterprises*.

From 2006 to 2012, the INT Manual provided:

> ***INTM412030. The affected persons: Enterprises*** *[Jun 2018]*
> *Section 147 TIOPA 2010 refers to provision made or imposed between*

[124] See 39.6.4 (Charge on shadow director).

[125] See 50.10 (Benefit of loan).

[126] See 25.6 (Transfer pricing/thin capitalisation).

[127] Accepting the argument in Venables, "The Transfer Pricing Provisions and Benefits from Offshore Structures" 8 OTR 165 *http://www.khpplc.co.uk/reviews*

> *any two (connected) persons, suggesting a broad scope for the schedule, as the term persons includes bodies corporate, partnerships and individuals. The reference in S147(1)(d) requires the actual provision to be compared with the arm's length provision that would have been made between independent enterprises.*

The second argument is based on s.164 TIOPA which provides:

> (1) This Part is to be read in such manner as best secures consistency between—
> (a) the effect given to sections 147(1)(a), (b) and (d) and (2) to (6), 148 and 151(2), and
> (b) the effect which, in accordance with the transfer pricing guidelines, is to be given, in cases where double taxation arrangements incorporate the whole or any part of the OECD model,[128] to so much of the arrangements as does so...

OECD Model applies to enterprises. Article 9(1) OECD Model provides:

> Where
> *a)* an *enterprise* of a Contracting State participates directly or indirectly in the management, control or capital of an *enterprise* of the other Contracting State, or
> *b)* the same persons participate directly or indirectly in the management, control or capital of an *enterprise* of a Contracting State and an *enterprise* of the other Contracting State,
>
> and in either case conditions are made or imposed between the two *enterprises* in their commercial or financial relations which differ from those which would be made between independent *enterprises*, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

From 2006 to 2012, the INT Manual said:

> ***INTM412030 The affected persons: Enterprises***
> *Section 164 TIOPA 2010 requires Part 4 to be construed in accordance with the OECD model convention, as interpreted by the OECD transfer*

[128] Defined s.164(3): "In this section "OECD model" means—
(a) the rules which, at the passing of ICTA (which occurred on 9 February 1988), were contained in Article 9 of the Model Tax Convention on Income and on Capital published by OECD, or
(b) any rules in the same or equivalent terms."

> *pricing guidelines. Article 9 of the convention sets out the arm's length principle by reference to conditions made or imposed between enterprises.*

The INT Manual concluded:

> *This suggests that Part 4 TIOPA 2010 should be applied only where both parties are enterprises*

As to what is an enterprise, see 21.23.2 ("Enterprise"); but it is clear that an individual not carrying on a business is not an enterprise.

It is also worth noting that the pre-1998 transfer pricing rules did not apply in this situation: they referred to buyers and sellers (not persons).

HMRC held this view (more or less) from the inception of the current provisions. Tax Bulletin 46 (April 2000) provided:

> ***Will a charge be imputed on a non-resident landlord providing rent-free residential accommodation within the UK to a UK individual who is a participant?***
> *It will not be Inland Revenue practice to impute a charge under Sch 28AA [ICTA] [now Part 4 TIOPA] in these circumstances.*

However the INT Manual was rewritten in 2012 and now takes the opposite view:

> **INTM412030 Transfer pricing: ... meaning of 'person'** [Sep 2021]
> Section 147 TIOPA refers to provision made or imposed between any two (connected) persons, suggesting a broad scope for the schedule, as the term persons includes bodies corporate, partnerships and individuals.
> The reference in S147(1)(d) requires the actual provision to be compared with the arm's length provision that would have been made between independent enterprises. This merely requires that the comparison is with the transaction that would be entered into by independent enterprises; it does not require that the persons themselves must be enterprises.
> Consequently, for example, charities will meet the basic pre-condition of s.147(1)(a) TIOPA - see INTM412020 - as they are 'persons' within the meaning of 147 TIOPA regardless of the fact that they will not usually be enterprises.
> The basic transfer pricing rule of s.147(3) or (5) TIOPA will not apply to charities in respect of any of their profits which are exempted from tax (under, for example s.478 CTA) as they will then fail to meet the 'potential advantage' requirement of s.147(2)(b) or 4(b) TIOPA.
> A person includes both individuals and legal persons such as companies. Person also includes a body of persons.

> Section 164 TIOPA requires Part 4 to be construed in accordance with the OECD Model Tax Convention, as interpreted by the OECD Transfer Pricing Guidelines. Article 9 of the convention sets out the arm's length principle by reference to conditions made or imposed between enterprises. Article 3 defines enterprise as "the carrying on of any business".

It is considered that the former HMRC view was correct. Many difficulties arise if it is not.

In practice, HMRC do not take the transfer pricing point in relation to individuals. If they want to seek to change their practice, that should be announced in a public statement, such as an HMRC brief; not quietly slipped into the text of a Manual rewrite.

Transfer pricing rules could apply in the (unusual, perhaps only theoretical) case where:

(1) a company provides accommodation or chattels in the course of its enterprise, and

(2) the individual uses the accommodation or chattels in the course of an enterprise carried on by the individual.

CHAPTER FORTY

BENEFIT IN KIND: LOANS FROM NON-RESIDENT COMPANIES

40.1 Loans from non-resident company
40.1.1 Loan from company: Navigation
40.2 Employment-related loan
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40.6.1 Post-employment release
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40.7 Death of employee
40.8 Loan to participators
40.9 Benefit to participators
40.10 Company loans: GAAR

Cross references
The following topics are considered elsewhere:
55.1 (Transactions in Securities)

40.1 Loans from non-resident company

A dividend (or other income distribution) from a non-resident company will often cause an income tax charge:

(1) A dividend received by a UK resident, directly or through an IIP trust, will be taxable on the arising or remittance basis.
(2) A dividend received by a non-resident discretionary trust or company will be income for the purposes of s.624/ToA provisions (if they apply)

By contrast a loan, even if interest-free, does not constitute an income receipt and so will avoid these charges. Loans therefore seem an attractive method of extracting funds from companies. However, they raise tax issues of their own. This chapter considers:

(1) Employment-related loans
(2) Loans and benefits to participators in close companies

40.1.1 *Loan from company: Navigation*

Loans from companies raise further issues which are discussed elsewhere:

Topic	**See**
General law issues	App 2.5
Benefits for s.731/s.87	50.10
UK receipt a taxable remittance ,if sum lent derives from:	
- s.624/s.720/s.731 income of settlor/transferor	47.8; 49.26; 50.39
- foreign income/gains of individual	18.18.7
Loan to transferor/settlor: 727 ITA/s.641 ITTOIA	49.23; 47.14
Loan to trustees: sch 4B CGT	62.10
Loan may trigger transactions in securities rules	55.3.1
Liability to repay may be non-deductible for IHT	80.1
Tainting protected trusts	92.7.7

Loans may be relevant for disguised remuneration; I do not discuss that topic in this book though I hope to do so in a future edition.

Loans *to* non-resident companies raise different issues, not discussed here.

40.2 Employment-related loan

The benefit of an employment-related loan is charged under the benefits code.[1]

Section 175(1) ITEPA provides:

> The cash equivalent of the benefit of an employment-related loan is to be treated as earnings from the employee's employment for a tax year if the loan is a taxable cheap loan in relation to that year.

This will in principle apply on a loan from a company to an employee, director, or shadow director.[2]

Section 173(1A) ITEPA provides:

> Where this Chapter applies to a loan—
> (a) the loan is a benefit for the purposes of this Chapter (and accordingly it is immaterial whether the terms of the loan constitute a fair bargain)

Although a "fair bargain" is outside the residual benefits in kind charge,[3]

[1] See 39.2 (The benefits code).

[2] See 39.6 (Shadow directors).

[3] See 39.35.4 (Fair bargain rule).

it is within the scope of employment-related loans. But that was the position even before s.173(1A) was enacted.[4]

A discussion of the meaning of "taxable cheap loan" and the computation of the cash equivalent is not discussed here. For DT relief see 37.8.3 (DT relief: Benefits in kind).

The BiK earnings of an employment-related loan may be chargeable overseas earnings or may qualify for overseas workday relief. In the case of a shadow director who is a remittance basis taxpayer, it is suggested that the earnings cannot be remitted so no tax charge can arise.[5]

40.2.1 *Shadow director: HMRC practice*

Where living accommodation is provided by a company, HMRC say that they take the somewhat unmeritorious point that the occupier of the property may be a shadow director of the company, so that a benefit in kind charge arises.[6] In relation to interest-free loans from offshore companies, the same point arises. However in this case HMRC do not seem to take the point. There are various possible explanations for this:

(1) The motivation for taking, or purporting to take, the living accommodation point may have been to discourage IHT planning on the family home (prior to the introduction of the IHT residential-property code). That consideration does not apply to interest-free loans.

(2) Borrowers are less likely to be shadow directors than occupiers. It is of course a question of fact in each case. But as a general rule, perhaps, a person occupying a home purchased by the company is more at risk of becoming a shadow director, because the company's acts to acquire the home and allow the individual to occupy are inherently more likely to be at the direction of the individual. By contrast, to put a beneficiary in funds, by way of loan (just as by way of distribution) is in the normal course of events a matter for the directors and (while no doubt made in conjunction with the trustees and beneficiary) there is less general reason to suspect the directors are acting at the direction of the beneficiary.

[4] See 50.4.1 (Arm's length transaction).

[5] See 39.39 (BiK: Remittance basis). If that is wrong, imponderable questions arise as to what happens if the money lent is remitted here and spent. Contrast 50.40.2 (Beneficial loan).

[6] See 39.6.4 (Charge on shadow director).

40.3 "Employment-related loan"

40.3.1 *"Loan"*

Section 173(2)(a) ITEPA provides:

> "loan" includes any form of credit

EIM para 26108 provides:

> **EIM26108. Meaning of loan** [Nov 2019]
> Loan means more than just lending money. It includes any form of credit. It follows that any kind of advance by reason of the employment is covered. For example, any amount shown in the employer's books or records as owed by an employee will count as a loan.
> *Grant v Watton*
> The case of *Grant v Watton* (71 TC 333) concerned credit extended by a company of which Grant was a director, to his sole trade and later to a partnership in which Grant was the general partner. In the High Court Pumfrey J. considered the meaning of credit –
>
> > "... credit is granted where payment is not demanded until a time later than the supply of goods to which the payment relates. Credit is the deferral of payment of a sum which, absent agreement, would be immediately payable."
>
> Regarding the application of Section 175 ITEPA 2003 to an overdrawn director's loan account see EIM26505.

40.3.2 *"Making" a loan*

Section 173(2)(b) ITEPA provides:

> references to making a loan (and related expressions) include arranging, guaranteeing or in any way facilitating a loan.

EIM26110 summarises this and continues:

> **Loan made by a third party – employee benefit trust** [Nov 2019]
> It is not uncommon for a third party, such as an employee benefit trust (EBT), to make a loan to a beneficiary who is also an employee of the employer which is associated with the EBT. It is sometimes suggested that the loan is not an "employment-related loan" (EIM26113) because the definition of that term does not include a loan provided by a third party.
> Whilst it is true that the definition includes no reference to a third party loan provider, HMRC does not accept that the loan is not an employment-related loan. The definition of "employment-related loan"

> includes a loan made by an employee's employer. As "making" a loan includes "in any way facilitating" a loan, if the employer provides the money to fund the EBT, the employer is regarded as making the loan. Consequently for the purposes of the loan benefit rules, the EBT is ignored and the loan is treated as made directly by the employer to the employee. It follows that the loan is an employment-related loan.

Suppose:

(1) A company is held by a trust, and lends funds to the trustees ("loan 1").

(2) The trustees lend funds to a beneficiary who is a shadow director ("loan 2").

At first sight this would not be an employment-related loan because it is not made by the "employer". But if loan 1 is made in order to allow the trustees to lend to the beneficiary, it may be said that the company has facilitated loan 2. The same applies to a back-to-back loan, ie if the company deposits funds with a bank, the trustees borrow from the same bank on the security of that deposit, and the trustees then lend to the beneficiary.

Section 174(4) ITEPA provides:

> References in this section to a loan being made by a person extend to a person who—
>
> (a) assumes the rights and liabilities of the person who originally made the loan, or
>
> (b) arranges, guarantees or in any way facilitates the continuation of a loan already in existence.

EIM para 26111 provides:

> **Loans taken over from another person** [Nov 2019]
>
> If the rights over an existing loan are taken over by another person the loan will remain within the charge if it was within the charge when it was first made.
>
> A loan within the scope of the charge cannot be removed from it by the original lender handing his or her rights over to another person.
>
> But a loan that was not within the charge when it was first made can be brought within it if it is taken over by a person mentioned in EIM26113.

40.4 "Employment-related"

Section 174(1) ITEPA defines "employment-related".

> For the purposes of this Chapter an employment-related loan is a loan—
> (a) made to an employee or a relative of an employee, and
> (b) of a class described in subsection (2).

There are two conditions, or sets of conditions.
Para (a) (the "**borrower condition**") specifies the borrower must be the employee or relative.
Para (b) (the "**specified lender condition**") specifies the lender must be the employer (or certain connected persons).

Section 174(3) ITEPA extends the definition of employer and employee:

> In this section—
> "employee" includes a prospective employee,[7] and
> "employer" includes a prospective employer...

40.4.1 *Borrower condition*

Section 174(1) ITEPA provides:

> For the purposes of this Chapter an employment-related loan is a loan—
> (a) made to an employee or a relative of an employee...

Section 174(6) ITEPA defines "relative" quite widely:

> For the purposes of this section a person ('X') is a relative of another ('Y') if X is—
> (a) Y's spouse or civil partner,
> (b) a parent, child or remoter relation in the direct line either of Y or of Y's spouse or civil partner,
> (c) a brother or sister of Y or of Y's spouse or civil partner, or
> (d) the spouse or civil partner of a person falling within para (b) or (c).

40.4.2 *Specified lender condition*

Section 174(1) ITEPA provides:

> For the purposes of this Chapter an employment-related loan is a loan...
> (b) of a class described in subsection (2).

So we turn to s.174(2) ITEPA which provides:

> For the purposes of this Chapter the classes of employment-related loan are—

[7] For the definition of "employee" see 34.3 (Employment/employer/employee).

A A loan made by the employee's employer.
B A loan made by a company or partnership over which the employee's employer had control.
C A loan made by a company or partnership by which the employer (being a company or partnership) was controlled.
D A loan made by a company or partnership which was controlled by a person by whom the employer (being a company or partnership) was controlled.
E A loan made by a person having a material interest[8] in—
(a) a close company which was the employer, had control over the employer or was controlled by the employer, or
(b) a company or partnership controlling that close company.

"Control" means control in the strict sense.[9]

40.4.3 *By reason of employment*

There is no requirement that the loan has to be made by reason of the employment. In this respect the employee-related loan code is unlike the other benefit in kind codes. But two other rules may lead to the same outcome as the "by reason of employment" causation test: personal loan exemptions, and the rule that a person who facilitates a loan is regarded as having made it.[10]

40.4.4 *Personal loan exemptions*

Section 174(5) ITEPA provides:

> A loan is not an employment-related loan if—
> (a) it is made by an individual in the normal course of the individual's domestic, family or personal relationships, or
> (b) it is made to a relative of the employee and the employee derives no benefit from it.

I refer to these rules as the **"personal loan exemptions"**. These are quite wide exemptions. In particular, straightforward loans to relatives of employees are not caught.

40.4.5 *Change in employee status*

What if a loan is made to someone who is not an employee (as defined) or

[8] "Material interest" is defined in s.68 ITEPA.
[9] See 104.2.2 (Definitions of "control").
[10] See 40.3.2 ("Making" a loan).

prospective employee, but later becomes a shadow director? At first sight, leaving an existing loan outstanding would not give rise to a tax charge even after the borrower becomes a shadow director. However, if the loan is repayable on demand, not calling in the loan amounts to a "form of credit". Thus there will be an income tax charge on the benefit in kind of loan repayable on demand if a borrower becomes a shadow director (and so becomes an "employee").

What is the position if a loan is made to a shadow director who ceases to be a shadow director? There is no charge on a loan to a former employee. This was deliberate. EN ITEPA provides:

> 76. Where the Schedule E legislation provides that an amount shall be treated as an emolument of an employment only if provided in a year when the employment is held, this Act reproduces that limitation. The sections in the benefits code make it clear that such amounts or benefits will only be treated as earnings if they are paid/provided in a year in which the employment is held. If they are paid/provided at any other time they will not be treated as earnings and will be outside the "general earnings" to which section 17 [ITEPA] applies.

The rules for disguised remuneration, and EFURBS, would also need consideration.

40.4.6 *Employee coming to UK*

The EI Manual provides:

> **EIM26105. Loans in foreign currencies: Taxation of overseas loans** [Nov 2019]
> ... *Taxation of overseas loans in foreign currencies*
> An employment-related loan (see EIM26102) made to an employee who comes to work in the UK is within the scope of the beneficial loans rules if:
>
> - the loan is made at a time when the employee's earnings are already chargeable to UK income tax as employment income (for example, if a loan is made after the employee has taken up employment in the UK and is resident and ordinarily resident in the UK for the year in which the loan is made); or
> - the loan is made in contemplation of the employee working or living in the UK (for example, if the loan is made as part of a package with a view to the employee working in the UK); or
> - the employee, at a time when the employee's earnings are chargeable to UK income tax as employment income, in any way facilitates the continuation of a loan which was already in existence before the

employee came to work in the UK.

As far as the final bullet is concerned, this is relevant where, for example, the loan is made not by the employer but by a third party such as a bank which is not connected with the employer and where the capital repayments and interest are deducted from the employee's salary. In these circumstances, the question is whether the loan continues when the employee is in the UK without any further involvement by the employer, or whether the employer does something which makes it easier for the employee to continue to have the loan.

An employer would not be facilitating the continuation of a loan merely because

- the loan is conditional on the employee continuing in the employment, or
- the employer deducts the interest and repayments of capital from the employee's salary.

If the employer pays a subsidy to the lender – for example, by paying annual interest on behalf of the employee – that would not necessarily mean that the employer was facilitating the continuation of the loan. The subsidy itself might however be taxable as an employment-related benefit under Section 201 ITEPA.

On the other hand the employer would be facilitating the continuation of the loan if

- the loan was conditional on the employer continuing to make regular payments to subsidise the interest which the employer might cease to make at any time, or
- the employer chose month by month or year by year whether to subsidise the loan.

40.5 Official rate of interest

Section 181(1) ITEPA provides:

> "The official rate of interest" for the purposes of this Chapter means the rate applicable under section 178 of FA 1989 (general power of Treasury to specify rates of interest).

Section 178 authorises regulations, and the law is in reg 5(1) Taxes (Interest Rate) Regulations 1989:

> Subject to paragraph (2), the rate applicable under section 178 for the purposes of Chapter 7 of Part 3 of the Income Tax (Earnings and Pensions) Act 2003 ("Chapter 7") shall, on and after 6th April 2020, be 2.25% per annum.

40.5.1 *Foreign currency loan*

There is (somewhat miserly) provision for foreign currency loans. Reg 5(2) Taxes (Interest Rate) Regulations 1989 provides:

> In relation to a loan outstanding for the whole or part of a year of assessment where—
>
> (a) the loan was made in the currency of a country or territory specified in the Table below,
>
> (b) the benefit of the loan is obtained by reason of the employment of a person who normally lives in that country or territory, and
>
> (c) that person has lived in that country or territory at some time in the period of six years ending with that year,
>
> the rate applicable under section 178 for the purposes of [Chapter 7] and the date on and after which that rate has effect shall be ascertained from the entries in the Table below relating to the country or territory concerned.

Country or territory	**Date on and after which applicable rate has effect**	**Applicable Rate**
Japan	6th June 1994	3.9% per annum.
Switzerland	6th July 1994	5.5% per annum.

The EIM provides:

> **EIM26106. Official rates for certain foreign currencies** [Nov 2019]
> ... There has been no change in either rate since 1994.
> [The Manual summarises s.181 and continues:] The intention of these rules is to give relief for employees working temporarily in the UK, where interest rates in the overseas country are lower than interest rates in the UK (!). The relief does not apply to employees who come to the UK and live here permanently.
> The expressions "normally lives" and "lived" have their natural commonsense meaning. An employee who came to work in the UK for four years and who returned home after the four years can be said to "normally live" in the home country. It is not necessary to maintain a residence in the overseas country during the period of employment in the UK. The terms "lives" and "has lived" connote a degree of continuance if not permanence. A holiday in the home country for an employee working in the UK would not in itself be sufficient to establish that the employee had "lived" in the overseas country within the meaning of these rules. "Living" implies more than returning for a short holiday.

40.6 Loan released/written off

A release may be earnings and taxed under usual principles.

Section 188(1) ITEPA provides:

> If—
>
> (a) the whole or part of an employment-related loan is released or written off in a tax year, and
>
> (b) at the time when it is released or written off the employee holds the employment in relation to which the loan is an employment-related loan ("employment E"),
>
> the amount released or written off is to be treated as earnings from the employment for that year.

What constitutes a release is not as simple as it might seem, but I do not pursue that here.[11]

40.6.1 *Post-employment release*

Section 188(2) ITEPA provides

> But if the employment has terminated or become lower-paid employment as a minister of religion and there was a time when—
>
> (a) the whole or part of the loan was outstanding,
>
> (b) the employee held the employment, and
>
> (c) it was not lower-paid employment as a minister of religion,
>
> subsection (1) applies as if the employment had not terminated or become lower-paid employment as a minister of religion.

40.6.2 *Replacement loans*

Section 188(3) ITEPA provides

> (3) Where subsection (2) applies, any loan which replaces directly or indirectly the employment-related loan is to be treated as an employment-related loan in relation to employment E if—
>
> (a) it would, if employment E had not terminated or become lower-paid employment as a minister of religion, have been an employment-related loan in relation to employment E, and
>
> (b) it is not an employment-related loan in relation to other employment.

[11] *Esprit Logistics Management v HMRC* [2018] UKFTT 287 (TC); *England v HMRC* [2023] UKFTT 00313 (TC).

Section 189(1) ITEPA[12] deals with double charges:

> Section 188 (loan released or written off: amount treated as earnings) does not apply if, by virtue of any other provision of the Income Tax Acts, the amount released or written off—
> (a) is employment income of the employee, or
> (b) is or is treated as income of the employee (or of the employee as a borrower) which is not employment income and upon which that person is liable to pay income tax.
> This is subject to subsections (2) and (3).

Section 189(2) ITEPA deals with a release in relation to a termination of employment:

> If, as a result of subsection (1), Chapter 3 of Part 6 (payments and benefits on termination of employment etc) would be the only provision by virtue of which the amount released or written off would be income of the employee—
> (a) section 188 does apply, and
> (b) accordingly Chapter 3 of Part 6 does not apply.

Section 189(3) ITEPA deals with the settlor-interested trust code:

> If—
> (a) an amount is treated as the employee's income under section 633 of ITTOIA 2005 (capital sums paid to settlor by trustees of settlement) in respect of a capital sum paid in relation to the release or writing-off of the loan, and
> (b) the amount released or written off exceeds the amount so treated as income,
> section 188 does apply but only the amount of the excess is to be treated as earnings from the employment for the tax year in question under that section.

40.7 Death of employee

Section 190 ITEPA provides:

> (1) On the employee's death a taxable cheap loan is to be treated—
> (a) for the purposes of this Chapter as ceasing to be outstanding, and
> (b) for the purposes of section 182 (normal method of calculating interest at the official rate) as being discharged on the date of death.

[12] Flagged by s.188(4) ITEPA.

(2) Section 188 (loan released or written off: amount treated as earnings) does not apply in relation to a release or writing off which takes effect on or after the death of the employee.

40.8 Loan to participators

Section 455 CTA 2010 imposes a charge where a close company lends money to (in short) a participator or an associate of a participator.[13]

There is no charge under this section provided the company is not UK resident (and so not close) at the time the loan is made. It does not matter if the company later becomes UK resident.

Section 415 ITTOIA imposes a charge if a loan chargeable under s.455 CTA 2010 is released or written off; again that would not apply if the loan is not within s.455 (non-resident lender); however the release may be a dividend or income distribution taxable under general principles.

40.9 Benefit to participators

Section 1064 CTA 2010 imposes a charge where a "close company incurs an expense in, or in connection with, the provision for any participator[14] of ... benefits or facilities of any kind". This does not affect a loan from a non-resident company, for two reasons (either of which would suffice):

(1) A company does not "incur expense" in making a loan or in leaving the loan outstanding.
(2) A non-resident company is not close.

The same applies to the charge under s.464A CTA 2010 (avoidance arrangements conferring benefit on participator or associate).

40.10 Company loans: GAAR

A loan (instead of a dividend) is not an artificial transaction.[15] So one can be confident that a straightforward loan is not caught by the GAAR. But of course a loan may form part of a set of transactions which is caught.[16]

[13] See 104.6 (Associates).

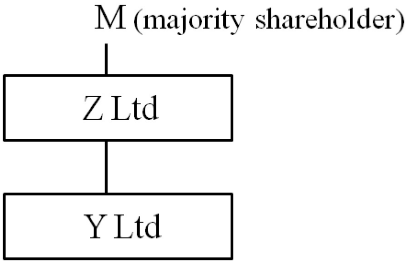
[14] "Participator" has the extended definition; see s.1068 CTA 2010 and 104.24 (Participator: Extended definition). It also includes associates of a participator: s.1069 CTA 2010; see 103.6 (Associates).

[15] See 3.21.2 ("Artificial/devices").

[16] *https://www.gov.uk/government/publications/gaar-advisory-panel-opinion-of-17-november-2017-extraction-of-cash-or-equivalent-through-trust-interests* It seems surprising that the taxpayer thought this worth arguing before the panel.

The GAAR panel opinion notice of 26 April 2022 concerned a scheme to avoid the charge on loans to participators.[17] Only limited weight can be given to GAAR panel decisions, as the panel is not a judicial body, and its decisions are short and without much detail. However these decisions are all the guidance on the GAAR that we currently have.

The company structure was:



Z Ltd had lent £10m to M, and the charge under s.455 CTA 2010 would arise if the loan was outstanding 9 months later, on 28/2/2017. In order to avoid this:

(1) Y Ltd lent £10m to M (at a commercial rate of interest)[18]
(2) M repaid his debt to Z Ltd

The panel found:

(1) The loans were not contrived or abnormal ("as Y Ltd had substantial assets of its own"). The fact that the loans carried interest made them a more reasonable course of action.[19] Repayment of the debt to Z Ltd was also not contrived or abnormal.
(2) The arrangement did exploit a shortcoming in the legislation (lack of provisions dealing with recycling loans round company groups).

[17] See 40.8 (Loan to participators). For the decision, see *https://www.gov.uk/government/publications/gaar-advisory-panel-opinion-of-26-april-2022-repayment-of-a-participator-loan-through-transactions-involving-group-companies*

[18] For completeness: The loan was in two tranches, and one suspects that the first loan found its way back to the company to finance the second loan; but the panel did not investigate that.

[19] The loans would have carried interest in order to avoid a benefit in kind charge on beneficial loans, and for company law reasons as M was only a majority shareholder, but the panel did not mention these points.

(3) However the arrangement was reasonable and not abusive. “Not covering group loans does seem a big and obvious matter and it does not seem to us that the GAAR can be used to cover such a gap.”

Eight months later the company did the same again, recycling the loans from Y Ltd back to Z Ltd. HMRC did not argue that this was part of the same arrangement; the reader may think they might have done. Had there been a single arrangement, the panel said “we might have come to a different conclusion”. So there is not much guidance there, but I would plan on the basis that the GAAR can apply to a series of recycled loans.

CHAPTER FORTY ONE

DISCRETIONARY TRUSTS: INCOME TAX

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Cross references

The following topics are considered elsewhere:
16.2 (Source: IT territorial limit)
10.3.1 (Split year: Pt 4/5 ITTOIA Income)

I do not consider:
- the vexed topic of trust expenses; but see 41.10.1 (ESC B18: HMRC example)
- the standard rate band, which gives relief for the first (small) slice of trust income

- corporate beneficiaries
- share incentive plans

41.1 Discretionary trusts: Introduction

This chapter is concerned with the income taxation of discretionary trusts. The topic needs a book to itself. This chapter focuses on the matters closest to the themes of this work but it is necessary to review the general rules to understand these matters in their context.

The starting point is to appreciate that a receipt from a discretionary trust may in the hands of the recipient be:
(1) income ("income distribution" or "income receipt") or
(2) capital ("capital distribution")

I use the term **"discretionary income payment"** to refer to a payment from a discretionary trust to a beneficiary, which is income (not capital) in the hands of the beneficiary. The statutory term is "discretionary payment" (it is assumed that the payment is an income distribution).

The legislation in Part 9 ITA (settlements and trustees). Section 462 ITA provides an overview. Perhaps we need it:

Chapter	**Topic**
2	General provisions and definitions
3	Trust rates
4	Trust expenses
5	Approved share incentive plans
6	First slice of trust income exempt from trust rate
7	Trust distributions

In this chapter when I refer to a trust, I am referring to a discretionary trust, and assume that the trust is not settlor-interested (or if it is, that s.624 does not apply). I do not consider the rules for trust expenses or the small relief for the first slice of trust income.

41.1.1 *Outline: 3 tiers*

In outline, there are three tiers of IT charges:

Tier:	**My term**	**Paid by**	**When paid**
1:	Trust charge	Trustees	On receipt of income
2:	Trust withholding tax	Trustees	On discretionary income payment
3:	Beneficiary charge	Beneficiary	On discretionary income payment

Tier 1: Trust charge: on receipt of income

At this tier it is necessary to distinguish resident/non-resident trustees:

(a) UK resident trustees are charged on all their income
(b) Non-resident trustees are charged on UK source income only

Tier 2: Trust withholding tax: on making discretionary income payment
At this tier it is also necessary to distinguish resident/non-resident trustees:
(a) UK resident trustees pay trust withholding tax
(b) Non-resident trustees do not pay this

Tier 3: Beneficiary charge: on receiving discretionary income payment
At this tier it is necessary to distinguish resident/non-resident *beneficiaries*:
(a) UK resident beneficiaries: charge on all trust income
(b) Non-resident beneficiaries: charge on UK source trust income (ie from UK resident trusts) only

Trustees may consider creating an interest in possession to avoid these rules, and move to the simpler system under which there is a single tax charge. (This move generally has no IHT consequences.)

41.1.2 *Trust tax-credit systems*

The 3 tiers of taxation would generally result in triple taxation, but two distinct tax credits generally avoid this:
(1) Tax paid at tier 1 enters a "tax pool" and is allowed as a credit against withholding tax at tier 2. If the tax pool is large enough, no WHT is paid at tier 2. I refer to this as **"trust tax-pool credit"**.
(2) Withholding tax at tier 2 is allowed as a credit for Beneficiary tax at tier 3. So for a UK trust (subject to WHT at tier 2) no additional tax is paid at tier 3. On the contrary, a beneficiary who is not a top rate taxpayer, or who is entitled to some relief, may reclaim tax. I refer to this as **"beneficiary WHT (withholding tax) credit"**.

I refer to this together as the **"trust tax-credit systems"**.

In a purely domestic situation (UK trust, UK beneficiaries, UK source income) the trust tax credit systems work, so there is effectively a single tax charge and not a double or triple tax charge.[1]

Where there is a foreign element (non-resident trust, non-resident beneficiary, or foreign source income) the trust tax credit-systems would

[1] See 41.7 (Examples).

not work, and so needs to be supplemented by further reliefs:
(1) s.111 TIOPA (UK trust, foreign source income)
(2) ESC B18

41.2 Tier 1: Trust charge on income receipt

The starting point is that trustees are persons, and so when trustees receive income they are subject to income tax under the usual charging provisions. There is no special charging provision for trustees. Accordingly:
(1) UK trustees are subject to tax on all their income
(2) Non-resident trustees are subject to tax on UK source income (except so far as non-resident IT relief is available)

41.2.1 *Discretionary-trust IT rates*

There are special rules dealing with the rates of income tax. Section 479(1) ITA provides:

> This section applies if—
> (a) accumulated or discretionary income arises to the trustees of a settlement, and
> (b) the income does not arise under a charitable trust.

The key term is "accumulated or discretionary income". Section 480 ITA provides:

> (1) Income is accumulated or discretionary income so far as—
> (a) it must be accumulated, or
> (b) it is payable at the discretion of the trustees or any other person,
> and it is not excluded by subsection (3).
> (2) The cases covered by subsection (1)(b) include cases where the trustees have, or any other person has, any discretion over one or more of the following matters—
> (a) whether, or the extent to which, the income is to be accumulated,
> (b) the persons to whom the income is to be paid, and
> (c) how much of the income is to be paid to any person.

This covers common form discretionary trusts. Assuming we have a trust in that form, we read on. Section 479 ITA provides:

> (2) Income tax is charged on the income at the rates referred to in this section instead of at the rates which would otherwise apply (for which see Chapter 2 of Part 2 (rates at which income tax is charged)).
> (3) Income tax is charged on the income at the dividend trust rate so far

> as the income is dividend income.
> (4) Otherwise, income tax is charged on the income at the trust rate.

The rates are the top income tax rates (the Blair/Brown administrations disapproved of trusts and subsequent administrations have not changed the policy). Section 9 ITA provides:

> (1) The trust rate is 45%.
> (2) The dividend trust rate is 38.1%.

41.2.2 *Settlor-interested trust*

Section 480 continues with 3 exceptions, of which only the first is relevant here.[2] Section 480(3) ITA provides:

> Income is excluded for the purposes of subsection (1) so far as—
> (a) before being distributed, it is the income of any person other than the trustees...

I would have thought that this applies to the income of a settlor-interested trust, within s.624 ITTOIA applies, but HMRC do not agree. If that is right, when does s.480(3)(a) ever apply?

41.2.3 *Trust-rate income*

Section 481 ITA provides:

> (1) This section applies if—
> (a) the trustees of a settlement are liable for income tax on an amount of a type set out in section 482,
> (b) the trustees are not trustees of a unit trust scheme,[3] and

[2] The other exceptions are of specialist interest. For completeness, s.480 continues:
(3) Income is excluded for the purposes of subsection (1) so far as ...
(b) it is income from property within subsection (4), or
(c) it is income from service charges which are paid in respect of dwellings in the UK and are held on trust.
(4) Property is within this subsection if it—
(a) is held for the purposes of a superannuation fund to which section 615(3) of ICTA (superannuation funds relating to undertakings outside the UK) applies, but
(b) is not held as a member of a property investment LLP.
(5) In subsection (3)(c) "service charges" has the meaning given by section 18 of the Landlord and Tenant Act 1985 (but as if that section also applied in relation to dwellings in Scotland and Northern Ireland).

[3] Para (1) is otiose as unit trust trustees are not "trustees of a settlement",

> (c) the amount is not income arising under a charitable trust.
>
> (2) Income tax is charged on the amount at one of the rates referred to in this section instead of at the rate which would otherwise apply (for which see Chapter 2 of Part 2 (rates at which income tax is charged)). This is subject to subsection (5).
>
> (3) If the amount is within Type 1 or Type 12 as set out in section 482, [purchase of own shares/arrangements offering a choice of income or capital return] income tax is charged on the amount at the dividend trust rate.
>
> (4) Otherwise, income tax is charged on the amount at the trust rate.

I refer to types of income within s.482 as **"trust-rate income"**.

This rule applies to all trusts, IIP as well as discretionary, but it is convenient to deal with it here.

Section 481 continues with 4 exceptions:

> (5) Income tax is not to be charged as mentioned in subsection (2) so far as the amount—
>
> (a) is accumulated or discretionary income,
>
> (b) would be accumulated or discretionary income apart from section 480(3)(a) or (c), or
>
> (c) is income from property within subsection (6).
>
> (6) Property is within this subsection if it is held for the purposes of a superannuation fund to which section 615(3) of ICTA (superannuation funds relating to undertakings outside the UK) applies.

41.2.4 *Types of trust-rate income*

Section 482 ITA provides:

> The types of amount referred to in section 481 are as follows.

Section 482 goes on to specify 12 types of income, mostly fairly exotic categories, which constitute capital for trust purposes but income for tax purposes. In outline:

Type	Type of income
1	Purchase of own shares
2	Accrued income profits
3	Offshore income gains
4	Employee share ownership trusts
5	Lease premiums
6	Deeply discounted securities
7	Life insurance gains
8	Transactions in deposits

9 Futures & options
10 Foreign dividend coupons
11 Transactions in land
12 Arrangements offering a choice of income or capital return

In full detail:

Type 1: Purchase of own shares

A payment—

(a) which is made to the trustees or to which the trustees are entitled, and

(b) which is made by way of distribution by a company on the redemption, repayment or purchase of shares in the company or on the purchase of rights to acquire such shares.

Type 2: Accrued income profits

Accrued income profits treated as made by the trustees under section 628(5) or 630(2) [ITA].

Type 3: Offshore income gains

Income treated as arising to the trustees under regulation 17 of the Offshore Funds (Tax) Regulations 2009.

Type 4: Employee share ownership trusts

Income which the trustees are treated as receiving under section 68(2) or 71(4) of FA 1989 (which relate to employee share ownership trusts).

Type 5: Lease premiums

A sum to which Chapter 4 of Part 3 of ITTOIA 2005 (which provides for certain amounts to be treated as receipts of a property business) applies.

Type 6: Deeply discounted securities

A profit in relation to which the trustees are liable for income tax under section 429 of ITTOIA 2005 (profits from deeply discounted securities).

Type 7: Life insurance gains

A gain in relation to which the trustees are liable for income tax under section 467 of ITTOIA 2005 (gains from contracts for life insurance etc), other than a gain to which subsection (7) of that section applies.

Type 8: Transactions in deposits

A profit or gain in relation to which the trustees are liable for income tax under section 554 of ITTOIA 2005 (transactions in deposits).

Type 9: Futures & options

A profit or gain—

(a) in relation to which the trustees are liable for income tax under section 557 of ITTOIA 2005 (disposals of futures and options), and

(b) which does not meet any of conditions A to C in section 568 of ITTOIA 2005.

Type 10: Foreign dividend coupons
Proceeds in relation to which the trustees are liable for income tax under section 573 of ITTOIA 2005 (sales of foreign dividend coupons).

Type 11: Transactions in land
Income treated as arising to the trustees under Part 9A of this Act [ITA] (transactions in land).

Type 12: Arrangements offering a choice of income or capital return
Income treated as arising to the trustees under section 396A of ITTOIA 2005 (arrangements offering a choice of income or capital return).

41.3 Tier 3: Discretionary payment charge

41.3.1 *Source/categorisation of income*

In short: where the trust is a common form discretionary trust, and a beneficiary receives trust income in the exercise of the trustees' discretion:

(1) The trust is the source (not the underlying trust assets).

(2) The income is categorised as Annual Payments.

This applies regardless of the type of income received by the trustees, out of which they may make the payment.

In *Memec v IRC*:

> A discretionary trust ... is not transparent. No beneficiary is entitled unless and until the trustees exercise their discretion in his or her favour, and the trustees' exercise of discretion is regarded as ... creating a new source of income...[4]

[4] 71 TC 77 (HC) at p.95. The same point was made in *IRC v Berrill* 55 TC 429 at p.444.
For completeness: Venables expressed a dissenting view in "*Memec* and the Source of Discretionary Income Payments from Trusts" PTPR (1999) Vol. 7 p.87 *http://www.khpplc.co.uk/reviews;* and Venables, *Non-Resident Trusts* (8th ed., 2000), para 16.3 (Taxation of Beneficiary):
"Where there are discretionary trusts of income ...and the trustees distribute income in the exercise of their discretion, the taxability of the recipient beneficiary is a matter of some controversy. My own opinion is that in exercising their discretion the trustees simply perfect the settlor's gift so that the position at the end of the day is the same as if the trust instrument had expressly provided that the beneficiary

The TSE Manual provides:

> **TSEM3756. Individual beneficiary receives discretionary income payment from a resident trust (not settlor-interested)** [Sep 2021]
> In the case of trusts or settlements that are not settor-interested a discretionary income payment is treated as an amount that is net of tax at the trust rate. The beneficiary's income is the net amount grossed at the trust rate. It carries tax credit at that rate. It is available for relief or repayment.
> The gross amount is an annual payment. It is a new source of income, usually not identified with the underlying trust income. *Cunard's Trustees v IRC* (27 TC 122) supported the view that when the trustees exercised their discretion, a new source of income came into existence.
> ...

For completeness: If a discretionary trust becomes interest in possession in form, the trustees' discretion over income comes to an end and the source has ceased.[5] But the cessation of a source is not now significant for tax purposes.

41.3.2 *Annuity income*

For completeness, *Memec* also considers annuities:

> Similarly, the rights of an annuitant under a trust are regarded as a source of income distinct from that of the underlying trust investments.[6]

But trust annuities are now rarely, if ever, found; so this is of academic

should receive the income. Thus, the income which the beneficiary receives is the same income as that which the trustees received, the beneficiary's source is the same as the trustees' source and any tax paid by the trustees is to be treated as having been paid on account of the beneficiary."

Before 1973 this view might have been held. (Venables cites *Drummond v Collins* 6 TC 525 though it seems to me that this point was not considered. But in *Cunard's Trustees v IRC* 27 TC 122 at p.134 the payments are described as sch D case III.) However that may be, the discretionary trust code introduced in FA 1973, now Chapter 7 Part 9 ITA, clearly assumes that a discretionary trust is a separate source, and so provides a statutory basis (if needed) to confirm the view that discretionary trusts are not transparent.

The argument was mentioned in the CoA in *Memec*, but not addressed: 77 TC at p.111.

[5] *IRC v Berrill* at p.444.

[6] See too *R v Special Comrs ex p. Shaftesbury Homes & Arethusa Training Ship* 8 TC 367; *Inchyra v Jennings* 42 TC 388.

interest only.

41.3.3 *Charge on income*

Annual payments (including income from a discretionary trust) are charged under Chapter 7 Part 5 ITTOIA.[7] But although the charge is housed under Chapter 7, many of the rules which apply to Annual Payments are disapplied or amended for trust income distributions, so this is in some ways like a category of income in itself.

The income is not categorised as dividend income, so (obviously) it does not qualify for the dividend nil rate, or other dividend rates.

41.3.4 *Location of source*

Where the trust is the source, how does one decide its location? There are (as usual[8]) a variety of possible connecting factors, including: the residence of the trustees, the country in whose courts the trust will be enforced, the place where the discretion is exercised. It is suggested that trust residence is the deciding factor, and this is consistent with s.493(1)(b) ITA and s.899(5)(d) ITA.[9] HMRC agree. Normally all these factors will point the same way so the issue will not arise.

41.3.5 *When income arises*

In almost all cases:
(1) the trustee resolution to distribute income of a discretionary trust and
(2) payment of income to the beneficiary
will occur at the same time.

This is because:

(1) In the absence of a formal resolution, payment itself in principle constitutes an informal exercise of the trustees power to distribute income. (Indeed, in practice, payment without making a formal resolution is probably more usual than not.)
(2) A formal resolution will typically have the effect that the trustees hold the income on trust for the beneficiary, and that amounts to "payment". (There will subsequently be a bank transfer, transferring legal title to the beneficiary, but that step does not matter for tax

[7] See 31.1 (Annual Payments: Introduction). This is assumed in 685A(1) ITTOIA; see 47.10.1 (Beneficiary relief conditions).

[8] For source issues generally, see 16.3 (Approach to locating source) ff.

[9] See 31.10.2 (Annual Payments outside WHT).

purposes, as payment has already been made.)

It could happen that payment is made without a valid resolution (the payment itself not constituting a valid resolution, perhaps because some necessary consent is not obtained, or because the payment is made to a person who is not a beneficiary, or some other mistake). In that case nothing happens for tax purposes until a valid resolution is made, as until then the recipient would hold the payment on trust for the trustees.

It could happen that a resolution is made which did not amount to payment (it might give the beneficiary a right to a payment, but so that the trustees did not hold the income on trust for the beneficiary). In that case it is suggested that:

(1) The beneficiary does not receive income, and so is not subject to tax, until payment is actually made.

(2) The payment is treated as made on the actual payment date (not the resolution date), and (if it has changed) the "trust rate" is the rate at the time of the actual payment, not the rate at the time of the trustee resolution.

(3) The income is income of the beneficiary on the actual payment date, not on the resolution date.

This aligns with the treatment of interest paid late.[10]

I think the HMRC Manual is consistent with this view.[11]

[10] See 15.5.2 (Interest due, not paid).

For completeness: There are rules that certain types of payment which, if made after the due and payable date, are treated as made on the due and payable date (known as "relating back"). Examples are dividends, some payments made under deduction of tax at the basic rate, and income from specific legacies. But these rules do not apply here. See 15.6 (When are dividends recognised); 89.5 (Income from specific legacy); and (though the decision is obsolete, as the law changed long ago) *IRC v Crawley* 59 TC 728.

[11] TSEM provides:

> **TSEM3759. Beneficiary receives discretionary income payment from a resident trust: when payment made** [Mar 2018]
>
> For tax purposes the beneficiary receives a payment on
>
> [1] The date the trustees made the payment or
>
> [2] The date the beneficiary became legally entitled to require the trustees to pay over the income. This could be when the payment indefeasibly vested, following the trustees' resolution.

The Manual refers to *Cunard's Trustees v IRC* 27 TC 122 but this does not discuss the timing issue, and, more generally, cases decided before the current regime was

41.3.6 *Tax return: Trust income*

Discretionary trust income from non-resident trusts is entered in box 41 of the Foreign pages of the tax return, SA106 (2022/23): the side note to this box refers to "discretionary income from non-resident trusts".

HMRC Helpsheet 262 (2023) provides:

> If you've received a discretionary payment from the non-UK resident trust, enter all of the income in box 41 on page F6 of the 'Foreign' pages...[12]

For UK resident trusts, the income is entered in box 1 of the Trusts etc pages, SA107 (2022/23).

41.3.7 *Scottish beneficiaries*

HMRC say:

> 46. Income flowing through [discretionary] trusts loses its character - in other words, irrespective of whether the income arising to the trust was savings or non-savings income all the income would be treated as non-savings income in the hands of the beneficiaries. Income payments from discretionary trusts will therefore be liable at the Scottish rate when paid to Scottish beneficiaries.[13]
>
> 47. In broad terms the trustees of non-resident discretionary trusts are only liable to income tax at the trust rate on the UK source income that they receive. They are not liable to UK income tax on foreign source income although they may be liable to tax on this income in the overseas jurisdiction. Discretionary income distributions from non-UK resident trusts are treated as untaxed income of the beneficiary irrespective of whether the trustees have suffered tax on the trust income. The beneficiary may if certain conditions are met claim credit for some of the tax paid by the trustees. Such income should be included by Scottish taxpayer beneficiaries as part of their total income in the normal way, and this would be liable at the Scottish rate of income tax. This would be consistent with the current tax treatment and simple (!) to

introduced in 1973 need careful review to ascertain whether the points they decided apply to discretionary trusts now.

[12] The helpsheet continues: "... unless the situation mentioned in the next paragraph applies." The next paragraph refers to the special rules for settlor-interested trusts; see 47.10.2 (Relief for non-settlor).

[13] See 43.5.2 (Scottish rates).

administer.[14]

41.4 Beneficiaries tax credit

41.4.1 *UK resident trust*

The tax credit is in s.494 ITA, which is introduced by s.493 ITA:

> (1) Sections 494 and 495 apply for income tax purposes if—
> (a) in a tax year the trustees of a settlement make an annual payment to a person ('the beneficiary') in the exercise of a discretion (whether exercisable by the trustees or any other person),
> (b) the trustees are UK resident for the tax year, and
> (c) condition A or condition B is met.

The usual case is condition A. Section 493(2) ITA provides:

> Condition A is that what is paid to the beneficiary is, only because of the payment, income of the beneficiary for income tax or corporation tax purposes. 'Income' does not include employment income.

Condition B relates to payments to minor children of the settlor.[15]

Section 494 ITA provides the beneficiaries tax credit and grossing up. Grossing up comes first:

> (1) The discretionary payment is treated as if it were made after the deduction of a sum representing income tax at the trust rate on the grossed up amount of the discretionary payment.
> (2) The grossed up amount of the discretionary payment is the actual amount of the discretionary payment grossed up by reference to the trust rate.

Then the beneficiaries tax credit:

> (3) The person mentioned in subsection (4) is treated as having paid income tax of an amount equal to the sum deducted as mentioned in subsection (1).

[14] HMRC, "Clarifying the Scope of the Scottish Rate of Income Tax Technical Note" (May 2012) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/395155/technote-scot-taxrate.pdf*

[15] Section 494(3) ITA provides: "Condition B is that the payment is treated for income tax purposes as the income of a settlor under section 629 of ITTOIA 2005 (income paid to relevant children of settlor)." See 47.15 (Payment to settlor's child.

> (4) That person is—
> (a) if condition A in section 493 is met, the beneficiary, and
> (b) if condition B in section 493 is met, the settlor.

41.4.2 *Non-resident trust*

The beneficiary WHT credit (along with withholding tax at tier 2) only apply if the trustees are UK resident: s.493(1)(b) ITA.

EN ITA Change 89 provides:

> This change makes it explicit that the Chapter dealing with the taxation of discretionary payments by trustees applies only to payments made and tax suffered while the trustees are UK resident.
>
> ... section 493 contains the condition that it only applies to UK resident trustees. It follows that where a payment is made by non-UK resident trustees:
>
> - the payment does not carry any tax credit in the hands of the beneficiary; and
> - the trustees are not liable for any tax in respect of the payment.
>
> As a corollary to the provisions of section 687 of ICTA not applying to non-UK resident trustees, tax only enters the trustees' tax pool if it is tax suffered on income arising while the trustees are UK resident - see section 497.
>
> This change does not affect the operation of ESC B18, which enables UK resident beneficiaries who receive discretionary payments to have a credit for the tax paid by non-UK resident trustees on UK source income.

41.5 Tier 2: Trust withholding tax

Although a trust distribution is an Annual Payment, the payment is taken out of the scope of Annual-Payment withholding tax.[16] Instead, s.496 ITA provides the trust withholding tax:

> (1) Income tax is charged for a tax year if—
> (a) in the tax year the trustees of a settlement make payments as a result of which income tax is treated as having been paid under section 494,[17] and
> (b) amount A is greater than amount B.
>
> (2) Amount A is the total amount of the income tax treated under

[16] See 31.10.2 (Annual Payments outside WHT); 26.19 (Withholding taxes: Introduction).

[17] That is, under s.494(3): see 41.4 (Beneficiaries tax credit).

> section 494 as having been paid.
> (3) Amount B is the amount of the trustees' tax pool available for the tax year (see section 497).
> (4) The amount of the tax charged under this section is equal to the difference between amounts A and B.
> (5) The trustees are liable for the tax.

I do not discuss the special case where the trust income is employment income or the trust is an EBT; s.496A, 496B ITA.

41.6 Trust tax-pool credit

Section 497(1) ITA deals with the trust tax pool:

> Take the following steps to calculate the amount of the trustees' tax pool available for a tax year ('the current tax year').
> This is subject to subsections (2) and (3).
> *Step 1* Take the amount of the trustees' tax pool available for the previous tax year and deduct from that amount (but not so that it goes below nil)—
> (a) the total amount of income tax treated under section 494 as having been paid as a result of payments made by the trustees in the previous tax year, and
> (b) the amount to which the trustees are entitled under section 496B [relief for payments by discretionary trust taxable as employment income] in respect of the previous tax year.
> *Step 2* Add together all amounts of income tax for which the trustees are liable for the current tax year and which are of a type set out in section 498.
> *Step 3* Add the sum calculated at Step 2 to the amount resulting from Step 1.

Section 498 ITA provides the list of types of income which qualify for the tax pool. It is (more or less) all the income tax paid by the trustees. In full detail:

> (1) The types of amount referred to at Step 2 in section 497 are as follows.
> *Type 1* The amount of any tax on income (other than income of a kind mentioned below in relation to Type 3A) charged at the dividend trust rate or at the trust rate...
> *Type 4* The amount of any tax on income on which tax is charged as a result of section 491 [£1k discretionary trust allowance].

The remaining rules concern specialist topics:

> *Type 3A* The amount of tax at the nominal rate[18] on any amount in respect of which—
> (a) the trustees are liable to income tax under section 467 of ITTOIA 2005 (gains from contracts for life insurance etc),
> (b) the trustees are liable to income tax at the trust rate by virtue of section 482 above, and
> (c) tax at the basic rate is treated as having been paid by virtue of section 530 of ITTOIA 2005 (life insurance).
>
> *Type 5* The amount of tax on any income determined in accordance with section 26 of FA 2005 (special tax treatment for trusts for the benefit of vulnerable persons).
>
> (3) In relation to Types 1 to 4, references to income do not include income the tax on which is reduced in accordance with section 26 of FA 2005.

41.6.1 *Immigrant/new trusts*

Section 497(2) ITA deal with the special cases of immigrant trusts and new trusts:

> If the trustees were non-UK resident for the previous tax year, references in subsection (1) to the previous tax year are to be read as references to the last tax year prior to the current tax year for which the trustees were UK resident.

Section 497(3) ITA deal with the special cases of new trusts:

> If—
> (a) the current tax year is the tax year during which the settlement is established, or
> (b) the trustees have been UK resident for no tax year prior to the current tax year,
>
> ignore Steps 1 and 3 and, accordingly, the trustees' tax pool available for the current tax year is the sum calculated at Step 2.

41.6.2 *Pre-2008 transitional rule*

ITA 2007 sch 2 para 104 provides:

> (1) Section 497 applies with the following modifications in relation to the trustees of a settlement established prior to the tax year 2007–08 if the current tax year is the tax year 2007–08.

[18] Defined in s.498(2A): "In relation to Type 3A, the reference to the nominal rate is a reference to a rate equal to the difference between the trust rate and the basic rate."

(2) It also so applies if—

(a) the current tax year is a tax year subsequent to the tax year 2007–08, and

(b) the trustees have been UK resident for no tax year prior to the current tax year or the last tax year prior to the current tax year for which they were UK resident is a tax year prior to the tax year 2007–08.

(3) It applies as if in subsection (1) for Step 1 there were substituted—

'Step 1

Take the amount of the trustees' final section 687(3) tax pool and deduct from that amount (but not so that it goes below nil) the total of all tax (if any) treated under section 687(2)(a) of ICTA as being paid as a result of payments made by the trustees in the tax year 2006–07.

'The amount of the trustees' final section 687(3) tax pool' is the total amount—

(a) available to the trustees under section 687(3) of ICTA for setting against tax assessable on them under section 687(2)(b) of that Act for the tax year 2006–07, or

(b) which would have been so available had tax been so assessable.'

(4) It applies as if subsections (2) and (3) were omitted.

41.7 Examples

41.7.1 *UK trust, dividend income*

Here is an example from Taxation Magazine.[19] Suppose a UK discretionary trust has dividend income of £9k in 2016/17. To simplify matters, assume there are no trust expenses.

Tier 1: Tax on dividend income	£1,000	7.5%	£75
	£8,000	38.1%	£3,048
Total	£9,000		£3,123
Tier 3: Tax paid by beneficiary			
Net payment to beneficiary:	£4,950		
Gross up at trust rate 45%	£9,000		
Tax paid by beneficiary	£9,000	45%	£4,050
less beneficiary tax credit			-£4,050
Tax due			£0

[19] 27 October 2016 (Mark Wallace).

Tier 2: Trust withholding tax	
Amount A: Beneficiary tax credit	£4,050
Amount B: Tax pool	-£3,123
Tax charge	£927

Total tax payable to HMRC	
On dividend	£3,123
On distribution	£927
Total	£4,050

41.7.2 *TSE Manual example*

The TSE Manual provides an example from 2010/11 (when dividends carried tax credits):

> **TSEM3024 The tax pool - trustees calculate maximum discretionary payment** [Mar 2018]
> In this example, in the tax year 2010-2011 a trustee of a discretionary trust receives a net dividend of £1,350 (tax credit £150). The trustee is chargeable at 42.5%, which is partly covered by the 10% non-payable tax credit.

Description		
Dividend received	£1,350	
Plus non-payable tax credit	£150	
Gross income	£1,500	
Tax at 10% on first £1,000 (standard rate band)		£100
Tax at 42.5% on the remainder £500×42.5%		£212.50
Total tax		£312.50
Less non-payable tax credit		- £150
Tax payable by trustee - goes into tax pool		£162.50
Net income after tax		£1187.50

> The trustee now has net income of £1,187.50 (net dividend of £1,350 less tax paid of £162.50). Only £162.50 of the total tax goes into the tax pool because the £150 dividend tax credit is not payable.
> If the trustee pays the net income of £1,187.50 to the beneficiary, the tax credit of 50% on that net payment is £1,187.50 (gross amount of £2,375 at 50%). But if the tax pool has nothing brought forward from the previous year and there is no other income on which tax has been paid, the tax pool of £162.50 will not cover the tax credit of £1,187.50 on the payment made. Under s.496 the trustee would have to pay £1,187.50 less £162.50 = £1,025, but there are no funds available.
> Instead, the trustees can calculate the maximum amount of discretionary

payment as follows:-

Description	
Net income after tax	£1,187.50
Add tax in tax pool	£162.50
Total amount to cover payment to beneficiary & tax credit @50%	£1,350.00

Tax credit at 50%	£ 675.00	£675.00
Less tax paid in tax pool		£162.50
Additional tax to be paid by trustee		£512.50
Net payment to beneficiary	£ 675.00	

The beneficiary is paid net income of £675 with a tax credit of £675, which is equivalent to gross income of £1,350 with tax credit at 50%. The trustee pays a total of £675 tax to HMRC, £162.50 tax on the dividend received and the additional £512.50 under S496. So if the trustee is relying on the dividend income to fund both the payment to the beneficiary and the additional tax there are sufficient funds to release only 50% of the actual dividend, that is £1,350×50% = £675.

HMRC offer an online tax pool calculator to do the computations, in simple cases.

41.8 Trust payment: Income/capital

It is no longer a universal truth that "Income tax is a tax on income"[20] but the question whether a trust distribution is an Annual Payment (ie, income) or not (ie, capital) continues to matter:

(1) The IT charge on a beneficiary receiving the distribution (tier 3) applies if the distribution is income.
(2) Trust withholding tax (tier 2) applies if the distribution is income.
(3) Section 87 and s.731 apply if the distribution is capital.[21]

The position depends on the terms of the power under which the payment is made.

41.8.1 *Power over income*

A common form discretionary trust[22] provides this type of power over trust income:

[20] See 14.5 (Income Tax: a tax on income?)

[21] See 50.16 (s.731 capital condition); 61.7.4 (Chargeable to IT).

[22] For discussion of the drafting, see Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), Chap 15 (Discretionary Trust).

> The Trustees may pay or apply the trust income to or for the benefit of any Beneficiaries, as the Trustees think fit.

If trustees receive income and make a payment under such a power, the receipt is income and not capital. This has never been doubted.

41.8.2 *Power over capital*

A common form discretionary trust also provides this type of power over trust capital:

> The Trustees may pay or apply the capital of the Trust Fund to or for the advancement or benefit of any Beneficiary.

If trustees make a payment under such a power the receipt is capital and not income. This is the case even if:
(1) the payments satisfy an "income purpose", eg maintenance of a beneficiary; and
(2) the payments are recurrent (eg annual or even monthly).

This follows from *Stevenson v Wishart*.[23]

41.8.3 *Accumulated income paid as capital*

Suppose:
(1) trustees accumulate income and add it to capital; and
(2) the trustees pay that capital to a beneficiary in exercise of a power like that in para 41.8.2 (Power over capital).

The receipt is still capital and not income. This follows from *Stevenson v Wishart*. In that case the distributions which HMRC sought to tax as income represented original trust capital and not accumulated income. It is considered that this makes no difference. *Stevenson v Wishart* is authority for the proposition that the income/capital question is governed by the terms of the power concerned.[24]

It might be different in an extreme case, where for tax planning reasons there was an arrangement under which:

[23] 59 TC 740. The judgment of Knox J is clearer on this point than the CoA; this view is adopted in *Pierce v Wood* [2010] WTLR 253 at [29] "An appointment or advance of trust capital, in exercise of a power over capital, even if it were to meet an income need of the beneficiary, is normally a capital receipt in the beneficiary's hands."

[24] Provisions such as ss.631(1)(2) and 633 ITTOIA assume this is correct (deeming payments out of accumulated income to be treated as income).

(1) income was accumulated;
(2) the trustees pay that capital to a beneficiary (by exercise of a common form power of advancement or appointment) shortly afterwards.

HMRC would have an attractive argument that the receipt should be regarded as income under general principles (or perhaps under the GAAR but it would not be necessary to rely on that).

In practice it should be possible to avoid this by ensuring that advances of capital are not neatly identifiable with accumulated income.

41.8.4 *HMRC view*

HMRC agree with the views set out above. The TSE Manual provides:

> **TSEM3781 - Trust income and gains: beneficiaries: payment from trust capital - normally capital in beneficiary's hands** [Nov 2018]
> A payment made out of trust capital including
> - accumulated income
> - a capital receipt that is deemed to be income for tax purposes
>
> is normally regarded as capital of the beneficiary and so is not taxable. This view was supported in the case of *Stevenson v Wishart* (59 TC 740).
> Where
> - there is no pre-existing interest in income, or
> - the payment is made under an interest in capital that is separate from an interest in income payments out of trust capital constitute capital in the hands of the recipient.
>
> Examples that illustrate the normal rule are:
> - Anthony has no interest in income at all. But the trustees may advance capital to or for him at their discretion. Payments are capital and not taxable on him.
> - Barbara has a discretionary interest in income. The trustees may also advance capital to or for her at their discretion. Payments are capital and not taxable on her.
> - Carina has an annuity of £10,000 and in addition, the trustees have the power to apply capital at their discretion for her benefit. Payments are capital and not taxable on her.

The Manual notes three exceptional cases:

> **TSEM3783 - Trust income and gains: beneficiaries: payment from trust capital - exceptions to normal rule** [Nov 2018]
> There are certain circumstances in which payments from trust capital are treated as income of the beneficiary. They are:

> [1] express gift of an annuity (TSEM3784)
> [2] payments to supplement or augment an income interest (TSEM3785)
> [3] compensation for loss of income (where beneficiary entitled to compensation) (TSEM3786)

Exceptions [1] and [3] are of specialist interest and not considered here. The Manual explains the second exception in this way:

> **TSEM3785 payment to supplement or augment income** [Jul 2020]
> The cases of *Cunard's Trustees v IRC* (27 TC 122) and *Brodie v IRC* (17 TC 432) established that where there is a pre-existing income interest (whether in the form of an annuity or interest in possession) payments out of trust capital to supplement or augment income constitute income in the hands of the recipient.
> Where the beneficiary has a pre-existing annual income entitlement, and the trustees can or have to supplement or augment the trust income out of capital:
> - if they can use capital in this way, i.e. it is discretionary, ITA/S494 will apply
> - if they have to use capital in this way, the annual payments treatment will apply.
>
> **Example:**
> *Dilwar*
> D lives rent-free in trust property. The deed provides for income to be used to pay rates and other property expenses, while the rest of income is to be used for his benefit. If the income is insufficient, the trustees are empowered to use capital at discretion to keep the beneficiary at same level of comfort as in the past. D has a pre-existing income entitlement, so the payment from capital is treated as income in his hands. ITA/S494 applies to the capital payments.
> *Elena*
> E has an annuity of £10,000 a year. If the trust income is less than £10,000, the trustees have to make up the shortfall from trust capital. E has a pre-existing income entitlement, so the payment from capital is treated as income in her hands. The whole £10,000 is taxable as income and the annual payments treatment applies.

In practice UK trusts today do not use wording of the kind considered in these examples, though the issue might arise for foreign trusts.

41.8.5 *Accumulated income paid as income*

The Manual considers the special case of a payment of trust capital under s.31(2) Trustee Act 1925. In order to follow this, it is necessary to set out the terms of s.31. The section is intricate, and I set out the relevant parts as they normally apply:

> (1) Where any property is held by trustees in trust for any person for any interest whatsoever... then...
>
> (i) during the infancy of any such person, ... the trustees may... apply for or towards his maintenance, education, or benefit, the whole or such part, if any, of the income of that property as the trustees may think fit ...
>
> (2) During the infancy of any such person... the trustees shall accumulate all the residue of that income ... and shall hold those accumulations as follows ...
>
> (ii) In any other case the trustees shall ... hold the accumulations as an accretion to the capital of the property from which such accumulations arose, and as one fund with such capital for all purposes, ...
>
> [iii] but the trustees may, at any time during the infancy of such person ... apply those accumulations, or any part thereof, as if they were income arising in the then current year.[25]

The Manual argues that a payment under s.31(2)[iii] is a capital receipt:

> **TSEM3782 payment from trust capital - normally capital in beneficiary's hands - S31 Trustee Act 1925** [Nov 2018]
>
> The concluding words of Section 31(2) Trustee Act 1925 allow the trustees to apply accumulations 'as if they were income arising'.
>
> These words do not have the effect of de-capitalising the accumulations concerned. Once accumulated income is forever capitalised. Where such accumulations have been released the money must therefore have been received by the beneficiary as capital. The phrase 'as if they were income arising in the then current year' should be regarded as simply meaning that the trustees are bound by the proviso to Section 31(1), just in the same way as they would be if they were deciding whether or not to release current income to or for the benefit of the minor.
>
> When paid by virtue of this provision the payment is capital in the beneficiary's hands, so it would not fall within ITA/Ss493-494, i.e. there is no tax credit to the beneficiary. Such a payment may be subject to the application of ITTOIA/S629 to charge the amount as income of

[25] The provision has been amended by the Inheritance and Trustees' Powers Act 2014 but the amendments make no difference to the capital/income issue discussed here.

the settlor - see TSEM4300+.

The payment of a sum under s.31(2) TA 1925 seems to me a clear case of an income receipt, under the principle of *Cunard's Trustees* to which HMRC refer in the Manual passage set out above. HMRC are correct to say that the accumulated income is capitalised, ie it becomes and remains capital in the hands of the trustees. But that does not answer the question as it is clear that a payment out of trust capital may still constitute income in the hands of the beneficiaries. The important point is that the terms of the relevant provision of the settlement link the payment with an income interest of a beneficiary.[26]

I have wondered if it might perhaps be clearer if the trust accounts recorded an "Accumulated Income Fund" (instead of recording accumulated income as increasing the capital fund). However, the accounting treatment should make no difference.

The view that the receipt is a capital receipt will more often favour HMRC, but sometimes it will favour the taxpayer. The taxpayer cannot be criticised for adopting HMRC's official view when it suits them.

It has been said that two Special Commissioner decisions from the 1970s have held that the exercise of the s.31(2) power did not have the effect of making the payments income in the hands of the beneficiary.[27] But unreported Special Commissioner decisions cannot be cited as precedents.[28]

A common form discretionary trust generally has express powers similar to s.31. This allows trustees to accumulate income, adding it to trust capital, and typically gives the trustees power "to apply the accumulations as if they were income arising in the then current year". If trustees make a payment out of trust capital under such a power it is considered that the receipt is an income receipt of the beneficiary.

41.9 Discretionary trust transparency reliefs

In some cases discretionary trusts are treated as transparent in order to confer some relief.

[26] See the comment of Knox J in *Stevenson v Wishart* 59 TC 740 at p.757D.

[27] Sheasby, "Accumulations of Income" [2000] TACT Review issue 11 *https://www.tactweb.org/the_tact_review/accumulations-of-income/*

[28] See *Ardmore v HMRC* [2014] UKFTT 453 (TC) at [9] - [23]. The point was not discussed on the appeal.

41.9.1 *UK trust, foreign income: s.111 relief*

Where UK trustees receive foreign income, subject to foreign tax, they will in principle qualify for foreign tax credit relief. That reduces the UK tax that they pay at tier 1, but it also reduces the tax pool, and so reduces the tax pool credit available for trust withholding tax, tier 2. The trust tax-credit systems would not work, and the benefit of the foreign tax credit relief would effectively be lost.

Section 111 TIOPA deals with this:

> (1) Subsection (6) applies if each of conditions A to D is met.
> (2) Condition A is that a payment is made by trustees of a settlement.
> (3) Condition B is that income tax is treated under section 494 of ITA 2007 (treatment of discretionary payments by trustees) as having been paid in relation to the payment.

The reference to s.494 restricts s.111 relief to UK resident trusts.[29]

> (4) Condition C is that the income arising under the settlement includes taxed overseas income.[30]
> (5) Condition D is that the trustees certify—
> (a) that the payment is one made out of income consisting of, or including, taxed overseas income of an amount, and from a source, stated in the certificate, and
> (b) that the amount of taxed overseas income arose to the trustees not earlier than 6 years before the end of the tax year in which the payment is made.

Where these conditions are satisfied, s.111(6) TIOPA provides the relief:

> The person to whom the payment is made may claim that the payment, up to the certified amount, is to be treated for the purposes of this Part [Part 2 TIOPA, double taxation relief] as income received by the person—
> (a) from the certified source, and
> (b) in the tax year in which the payment is made.

The beneficiary's income is deemed to come from the foreign source, and so the beneficiary enjoys the benefit of the DT relief. The trust is treated as transparent in the sense that the source of the beneficiary's income is

[29] See 41.4 (Beneficiaries tax credit).

[30] This term is defined in s.111(7) TIOPA: "In this section "taxed overseas income", in relation to a settlement, means income in respect of which the trustees are entitled to credit under this Part for tax under the law of a territory outside the UK."

the underlying asset and not the trust.

The deeming only applies for the purposes of DT relief. For instance, the beneficiary's income does not qualify for the remittance basis, because it is UK source income and the s.111 deeming does not alter that.

The TSE Manual discusses when a payment is made out of taxed overseas income:

> **TSEM3675. Relief for overseas tax: expenses of discretionary trust** [Mar 2018]
>
> If trustees are claiming relief for overseas tax they will usually regard expenses as paid out of UK income. This means they can certify the overseas income to the beneficiaries [what is now s.111 TIOPA].
>
> They may sometimes regard expenses as paid from overseas income. This could be because there is not sufficient UK income to cover the expenses. Or maybe certification is not advantageous to the beneficiary. Trustees cannot certify, under [s.111 TIOPA], the overseas income they set against the expenses.
>
> **TSEM3680. Trustee's certificate of overseas taxed income** [Mar 2018]
>
> ...
>
> **Limits of the amounts certified**
>
> The trustees must ensure that:
>
> - the amounts they certify do not exceed the gross equivalent of the payments they made
> - the gross amounts they certify do not exceed, in the aggregate, the gross income they received.
>
> Trustees can accumulate, for future certification, overseas income that they have not paid out. Income ceases to be available for certification six years after the start of the tax year in which it arose.
>
> **TSEM3685. Relief for overseas tax: mixed trust** [Mar 2018]
>
> A mixed trust has both a discretionary interest and an interest in possession.
>
> The trustees may claim double taxation relief in respect of overseas tax that qualifies for relief. The instructions at TSEM3655 apply to income that the beneficiary is entitled to receive. The instructions at TSEM3670 apply to the balance of the income.

41.9.2 *ESC B18: UK trust*

ESC B18 provides:

> **UK resident trusts**
>
> A beneficiary may receive from trustees a payment to which [s.494(1)

> ITA] applies.[31] Where that payment is made out of the income of the trustees in respect of which, had it been received directly, the beneficiary would—
> [1] have been entitled to exemption in respect of FOTRA securities issued in accordance with [s.714 ITTOIA]; or
> [2] have been entitled to relief under the terms of a double taxation agreement; or
> [3] not have been chargeable to UK tax because of their [ie the beneficiary's] not resident [and/or not ordinarily resident[32]] status
> the beneficiary may claim that exemption or relief or, where the beneficiary would not have been chargeable, repayment of the tax treated as deducted from the payment (or an appropriate proportion of it).
> For this purpose, the payment will be treated as having been made rateably out of all sources of income arising to the trustees on a last in first out basis.

There are three reliefs (or sets of reliefs) here:

(1) Relief for interest on FOTRA securities (beneficiary non-resident)
(2) DT relief (beneficiary treaty-resident outside the UK)[33]
(3) Other exemptions for non-residents[34]

ESC B18 goes on to specify the conditions for the relief:

> Relief or exemption, as appropriate, will be granted to the extent that the payment is out of income which arose to the trustees not earlier than six years before the end of the year of assessment in which the payment was made, provided the trustees—
> [1] have made trust returns giving details of all sources of trust income and payments made to beneficiaries for each and every year for which they are required, and
> [2] have paid all tax due, and any interest, surcharges and penalties arising; and
> [3] keep available for inspection any relevant tax certificates.
> Relief or exemption, as appropriate, will be granted to the beneficiary on a claim made within five years and ten months of the end of the year of assessment in which the beneficiary received the payment from the

[31] The reference to s.494 restricts this relief to UK resident trusts. See 41.4 (Beneficiaries tax credit).

[32] Author's footnote: Ordinary residence is not relevant from 2013.

[33] But s.111 TIOPA covers this.

[34] See 45.1 (Non-Residents Income Tax Relief).

> trustees.[35]

The INT Manual expands on B18 and provides a worked example. The Manual is not up to date, for example in the tax rates; I omit text referring to the position before 2004.

> **INTM367790. What methods of relief are available on discretionary payments from UK resident trustees** [Dec 2019]
> The way in which relief is calculated will depend on the terms of the treaty under which relief is claimed.
> - Under an "other income" article which does not exclude payments from trusts, relief is given in full.[36]...
> - Where there is no other income article or the article excludes trust income, relief is given by "looking through" to the underlying sources of the income. The way in which we "look through" is determined by ESC B18
> - Because payments are made at the discretion of trustees, it is not possible to allow relief at source to a beneficiary of a discretionary trust.
>
> ...
> **INTM367820. Extra Statutory Concession B18** [Dec 2019]
> Under ESC/B18, income underlying a discretionary payment is treated as arising from the sources of income received by the trustees in the tax year that the payment is made. Income is considered as arising rateably from the sources of income. By rateably we mean the beneficiary's payment contains the same proportion of each strand of income as the total received by the trustees.
> If there is not enough income arising in the year the payment is made to fund all of the payments made by the trustees (that is, if the trustees are drawing on accumulations – that is, income received by trustees in excess of payments out of trust income – made in previous years) we need to apply the proportions of trustees' income from the year(s) in which the accumulations were made. This is known as "spreading back" (see INTM367910).
> **INTM367830. ESC/B18 and dividends taxed at the dividend trust rate** [Dec 2019]
> When the Schedule F trust rate (now the dividend trust rate) was introduced in 1999/2000 at 25%, the wording of ESC/B18 was revised to exclude the element of tax credit included in that tax. For example, where trustees receive a dividend of £90, with a tax credit of £10, their liability is £15 (that is, £25 less £10 tax credit). However, when applying a beneficiary's share of dividends to a dividend article of a treaty, the tax credit is excluded from the calculation. Therefore for the purposes of ESC/B18, the 'gross' to which the restriction in the dividend article is applied is £90, the tax £15, and the net £75.

This is superseded now by the 2016 dividend tax reforms, which abolished

[35] Author's footnote: This time limit is out of line with the standard claim time limit, now 4 years, but it does not matter.

[36] See 41.12.1 (Other Income article).

the tax credit for UK residents.

A dividend article with a 15% restriction would apply to the dividend element underlying a beneficiary's distribution as follows:

- Restriction: £90 × 15% = £13.50
- Tax £15 less restriction £13.50 = £1.50

INTM367840. ESC/B18 and trustees' tax returns [Dec 2019]

It is a condition of ESC/B18 that in order to allow a beneficiary's claim to repayment, the trustees must have made their tax return for the year of the distribution, and paid over any tax due to HMRC.

It is therefore possible that a beneficiary's claim form can be received before the conditions of ESC/B18 are satisfied.

INTM367850. ESC/B18 and Self Assessment [Dec 2019]

As the conditions for relief under ESC/B18 include actions by trustees, we do not consider a claim as being valid until these actions have been carried out. We cannot accept that the beneficiary has made a valid claim until the trustees have met the conditions set out in ESC/B18.

In practical terms this means that a beneficiary's claim is not valid until the trustees have sent in their tax return for the year in which the distribution was made and paid any tax due.

INTM367860. Dealing with claims by non-resident beneficiaries of UK discretionary trusts under ESC/B18 [Dec 2019]

How to identify a repayment claim

The claim will usually be supported by a tax certificate on form R185, or an equivalent certificate prepared by the payer, showing tax deducted from the payment at 40%...

If the tax certificate is missing, the schedule will show that tax on the income is at 40% ...

Exceptionally, you may receive a claim on a payment from a UK discretionary trust where tax is not shown as having been paid at the Rate Applicable to Trusts (see INTM367950).

Procedure

You will need to request the trust file (the UTR for this should be quoted on the tax certificate) together with the trustees' tax return for the year of the distribution and all earlier years in date for time limit purposes during the year of distribution (you will need these if a 'spreadback' calculation is necessary).

You will need to advise the claimant or their agent that you have requested information from the trust's tax office to enable you to deal with the claim.

INTM367870. Calculating relief due under ESC/B18 [Dec 2019]

When the trust file is received the information concerning trust income and distributions provided by the trustees in their returns is extracted and used to calculate the relief due to the beneficiary.

Due to the complexity of the calculations, a computer program is used to apportion the trust income to the beneficiary's share.

If necessary a calculation can be made manually (INTM367890).

INTM367880. How to manually calculate relief due under ESC/B18 [Dec 2019]

Although the apportionment of the income will normally be performed using a computer program, if necessary the calculation can be performed manually, as follows:

1. Deduct any expenses and other obligations, for example Trust Management Expenses (see INTM367920) and annuities (see INTM367770), from the income received by the trustees.

2. For each income source (after deductions at 1 above) calculate the net amount available for distribution, that is the amount after deduction of tax at the rate applicable to trusts or the dividend trust rate as appropriate.

3. Calculate the total net distribution made to the discretionary beneficiaries.

4. Check that the total net distribution made to the discretionary beneficiaries is less than (or equal to) the total net available for distribution. If it is greater than the total net available for distribution, you will need to apply a 'spreadback' calculation (see INTM367910).

5. Allocate the net amount of each source of income arising to the trustees to the beneficiary's net distribution, by the following formula (each source of income must be treated separately because of the different tax rates to which the trust income is subjected):

(a ÷ b) × c =beneficiary's share of income source, where

- a = net income from source
- b = total income available to distribute
- c = beneficiary's net distribution

6. Calculate the beneficiary's gross share of each income source by reference to ESC/B18. For UK dividends the calculation for 2004–05 onwards is

(a ÷ 67.5) × 90 = beneficiary's gross share of dividends for the purposes of ESC/B18, where

- a = beneficiary's share of dividends

...

For other income (including foreign dividends) the calculation for 2004–05 onwards is

(a ÷ 60) × 100 = beneficiary's gross share of dividends for the purposes of ESC/B18, where

- a = beneficiary's share of income

...

7. Calculate the tax applying to each income source under ESC/B18 by deducting the net (calculated at 4) from the gross (calculated at 5).

8. Calculate the repayment due by reference to the relevant treaty articles, and/or UK legislation allowing relief to non-residents. Where repayment is restricted under a double taxation agreement, calculate the amount to restrict as a percentage of the ESC/B18 gross (calculated at 5) and deduct it from the tax (calculated at 6).

INTM367890. Non-resident beneficiaries of UK trusts [Dec 2019]

Example of a manual calculation under ESC/B18

In the tax year 2004–2005 a trust had income from the sources shown below (gross except for dividends paid). The trustees made net distributions of £1000 each to one beneficiary in Canada (who has made a claim to us) and to one beneficiary in the UK.

[Trust income is:]

• UK dividends paid	£1292
• UK interest	£1000
• Rents	£500
• Foreign dividends	£880
• Foreign interest	£1000

Trustees net management expenses were £500

First, deduct trust management expenses from dividends: 1292 less 500 = 792

Then calculate income available for distribution:

Dividends	792
plus (tax credit at one ninth of the dividend)	88
less (dividend trust rate 25%)	−220
	660

Interest	1000
less (tax at rate applicable to trusts 34%)	−340
	660

Rents	500
less (tax at rate applicable to trusts 34%)	-170
	330

Foreign dividends	880
less (tax at dividend trust rate 25%)	−220
	660

Foreign interest	1000
less (tax at rate applicable to trusts 34%)	−340
	660

Total available for distribution: 2970

Distribution: (2 × 1000) = 2000; this is less than the total available for distribution, so no spreadback required

Allocation to beneficiary:

Dividends:	(660 ÷ 2970) × 1000 = 222.22
Interest:	(660 ÷ 2970) × 1000 = 222.22
Rents:	(330 ÷ 2970) × 1000 = 111.11
Foreign dividends:	(660 ÷ 2970) × 1000 = 222.22
Foreign interest:	(660 ÷ 2970) × 1000 = 222.22

Grossing up and deducting net to find tax attributable under ESC/B18:

Dividends:	(222.22 ÷ 75) × 90 = 266.66 − 222.22 = tax 44.44
Interest:	(222.22 ÷ 66) × 100 = 336.70 − 222.22 = tax 114.48

Rents: (there is actually no need to calculate this, as there is no relief, but the calculation would be as follows)

(111.11 ÷ 66) × 100 = 168.35 − 111.11 = tax 57.24

Foreign dividends:	(222.22 ÷ 66) × 100 = 336.70 – 222.22 = tax 114.48
Foreign interest:	(222.22 ÷ 66) × 100 = 336.70 – 222.22 = tax 114.48

Calculating the repayment due

In this example the claimant is claiming under the Double Taxation Convention with Canada on dividends and interest, and under UK legislation applying to non-residents on foreign income. Under the treaty there is a 15% restriction on dividends and a 10% restriction on interest.

Dividends: Gross 266.64 × 15% = 40 restriction	Tax 44.44 less 40 =	4.44
Interest: Gross 336.70 × 10% = 33.67 restriction	Tax 114.48 less 33.67 =	81.21
Foreign dividends: Gross 336.70	Tax	114.48
Foreign interest: Gross 336.70	Tax	114.48
Total repayment		314.61

This content has been withheld because of exemptions in the Freedom of Information Act 2000.

INTM367900. Notes on types of underlying income in a discretionary trust
[Dec 2019]

- UK dividends: includes stock dividends.
- UK interest
- Dividends and interest are the most common types of income that you will see in discretionary trusts. With the exception of UK dividends, all of the tax associated with a particular source is considered for the purposes of ESC/B18 to be tax on that source. You may also see:
- Foreign income: relief is given under domestic legislation. Although foreign dividends are taxed in the hands of the trustees at the dividend trust rate of 32.5% ... , the beneficiary is treated as having been taxed at 40% ...
- Rental income: there are no double taxation agreements that allow relief to individuals on rental income. No repayment is due on any part of the tax applicable to rental income.
- Accrued income: income returned under the 'accrued income' scheme cannot be relieved under double taxation agreements.
- Royalties: these are unusual in discretionary trusts. Relief is given at the appropriate agreement rate.
- FOTRA securities: you may be considering relief under an agreement which has an interest article that restricts relief. However, income shown on the trust return as interest may be derived from FOTRA securities on which full relief is available to non- residents. As there is no indication in the trust return that income is derived from FOTRA securities, you will not usually be able to consider repayment on this as a separate source from interest. However, if there is any indication of the amount of FOTRA securities in the papers submitted with the return, or in figures originating from the trustees and provided by the claimant or their agent, you should use these to allow relief on the FOTRA securities.

41.9.3 *Carry back (spreadback)*

The INT Manual continues:

> **INTM367910. What happens if the total net distributed in a year exceeds the total net available for distribution ('overdistribution')** [Dec 2019]
>
> It the trustees have distributed more money in one year than is available to distribute from the income received in that year, you will need to analyse the balance from undistributed income arising in earlier years.
>
> This is known as a 'spreadback' calculation. The income arising in earlier years can be analysed using the trust report program.
>
> When spreading back we start with the most recent year in which income has been accumulated. If the trustees have over-distributed in earlier years we may have already made a spreadback calculation and used income accumulated in an earlier year. It is important that we do not use that accumulation again in the current spreadback. You cannot go back more than six years before the year in which the distribution was made. So if the trustees have made an excess distribution in 2003/04 you can only go back to 1998/99. But you only go back to accumulations made in that year if you have used up all the income accumulated in 2002/03, then 2001/02 and so on. The residence position of the beneficiary in the year(s) that the income was accumulated is not relevant.

41.9.4 *Confidentiality*

The INT Manual provides:

> **INTM367630. Claims by non-resident beneficiaries of non-resident discretionary trusts** [Dec 2019]
>
> ...
>
> *Confidentiality when advising a beneficiary or agent about a payment*
>
> A beneficiary of a discretionary trust has no rights against the income of the trust. Trustees may favour one potential beneficiary rather than another. Therefore, to provide information to a beneficiary about the income of a trust that you have used to calculate relief due under ESC/B18 will infringe the confidentiality of the trustees.
>
> Because of this we cannot provide a breakdown of the underlying income comprising the repayment. The claimant (and their agent) only has a right to the final figure of the repayment we have calculated. However, if the beneficiary obtains the written permission of a trustee we can release information concerning the underlying trust income.
>
> Sometimes a trustee will act as the nominated agent of the beneficiary. In that case you can release details of the computation to the trustee without seeking further written permission. If you are providing this information, you will need to show a full calculation. If the original apportionment of income was calculated using the computer program, you will need to make a full manual calculation (see INTM367890).

It is a strange state of affairs where a taxpayer is not entitled to know how their tax is computed, or whether it is correctly computed, and it is considered that HMRC could properly disclose the information.[37] No doubt a tribunal would order disclosure in an appropriate case.

41.9.5 *Tax return: ESC B18 claim*

HMRC say:

> It is a stand-alone claim and does not affect how the beneficiary completes his or her Self Assessment tax return.[38]

I think the point is that there is no box in the tax return for the figures to be entered.

41.10 ESC B18: Non-resident trust

Where a non-resident trust has UK source income, and makes a payment to a *UK* beneficiary, then:

(1) The foreign trustees are subject to UK tax on their income.
(2) They are not subject to trust withholding tax (tier 2) on making a distribution.
(3) The UK beneficiary is subject to tax on the distribution, but does not receive the beneficiary WHT credit.

The trust tax-credit systems do not operate, and there would effectively be double taxation.

Where a non-resident trust has UK source income, and makes a payment to a *foreign* beneficiary, then:

(1) The foreign trustees are subject to UK tax on their income.
(2) They are not subject to trust withholding tax (tier 2) on making a distribution
(3) The foreign beneficiary is not subject to tax on the distribution

The trust tax-credit systems do not operate. If the foreign beneficiary would have been entitled to some relief on the trust income, had it been received directly, the benefit of that relief is lost.

ESC B18 deals with these two problems. It provides:

> **Non-resident trusts**
> A similar concession will operate where a beneficiary receives a payment from discretionary trustees which is not within [what is now s.494(1) ITA, trust withholding tax] (ie where non-resident trustees

[37] See 51.20 (Taxpayer confidentiality).
[38] “HMRC Residency: Non-resident trusts” *https://www.gov.uk/non-resident-trusts*

> exercise their discretion outside the UK).
>
> [1] Where a non-resident beneficiary receives such a payment out of income of the trustees in respect of which, had it been received directly, it would have been chargeable to UK tax, then the beneficiary—
>
> [a] may claim relief under [now s.56 ITA] (personal reliefs for certain non-residents); and
>
> [b] may be treated as receiving that payment from a UK resident trust but claim credit only for UK tax actually paid by the trustees on income out of which the payment is made.
>
> [c] The beneficiary may also claim exemption from tax in respect of FOTRA securities issued in accordance with [what is now s.714 ITTOIA] to the extent that the payment is regarded as including interest from such securities.[39]
>
> [2] A UK beneficiary of a non-resident trust may claim appropriate credit for tax actually paid by the trustees on the income out of which the payment is made as if the payments out of UK income were from a UK resident trust and within [s.494(1) ITA] .

There are three distinct sets of reliefs here:

(1) Personal reliefs for non-resident beneficiaries
(2) Credit for tax paid by the trust as if the trust were UK resident
(3) Relief for interest on FOTRA securities: I suspect that this is in practice academic, though strictly it applies if:
(a) the trust receives income from FOTRA securities;
(b) the trustees are outside the FOTRA exemption for trustees;[40]
(c) the income is paid to a beneficiary who is not UK resident and so is within the FOTRA exemption; and
(d) the trust complies with UK tax requirements

ESC B18 goes on to specify the conditions for the relief, which are similar to the conditions for UK resident trusts:

> This treatment will only be available where the trustees—
>
> – have made trust returns giving details of all sources of trust income and payments made to beneficiaries for each and every year for which they are required; and
>
> – have paid all tax due and any interest, surcharges and penalties arising; and

[39] Para (c) assumes that FOTRA interest is exempt if payable to a non-resident life tenant: see 27.6 (FOTRA securities: Trust).

[40] Because there are UK beneficiaries: see 27.6.2 (Discretionary trust).

> – keep available for inspection any relevant tax certificates.
>
> Relief or exemption, as appropriate, will be granted to the beneficiary on a claim made within five years and ten months of the end of the year of assessment in which the beneficiary received the payment from the trustees.
>
> No credit will be given for UK tax treated as paid on income received by the trustees which would not be available for set off under s 687(2) if that section applied, and that tax is not repayable (for example on dividends). However, such tax is not taken into account in calculating the gross income treated as taxable on the beneficiary under this concession.

There is no reference to a time limit here, and the relief is not limited to a payment out of income which arose to the trustees within 6 years before.[41]

41.10.1 *ESC B18: HMRC example*

The TSEM provides a worked example:[42]

TSEM10455 ESC B18 - example [Aug 2019]
Non-resident discretionary trust
Trust income for year 2013-14:

	Income	*Basic rate IT deducted at source*
UK Property Income	£10,000	£2,000
UK Bank Interest	£20,000	£4,000
Foreign Bank Interest	£1,000	0
Total	£31,000	£6,000

Allowable trust management expenses = £5,000
Discretionary income payment to UK resident beneficiary 2013-14 = £4,000

On these simple facts we turn to the complex computations:

Amount of income on which the trustees are chargeable to income tax, and income tax chargeable (In my terminology, the tier 1 charge)

Income taxed at basic rate	*Amount*	*Rate*	*Tax*
1st slice of income (interest)	£1,000	20%	£200

[41] I would have described that as self-evident but the High Court reached the opposite conclusion in a decision criticised in the 2023/24 edition of this work and reversed by CoA: *Murphy v HMRC* [2023] EWCA Civ 497.

[42] I have slightly amended the wording and layout for the sake of clarity.

trust management expenses[43]	£6,049	20%	£1,209.80
total	£7,049		£1,409.80
Income taxed at trust rate			
UK Bank Interest	£19,000		
UK Property Income	£10,000		
Total	£29,000		
Less trust expenses	£6,049		
Chargeable at trust rate	£22,951	45%	£10,327.95
Total tax chargeable			£11,737.75

Tax paid at source = £6,000.00
Tax due = £5,737.75

Expenses computation
The expenses are to be reduced by the proportion of income arising to trustees which is untaxed foreign income (ITA/S487(2)):

	Income
UK Property Income	£10,000
UK Bank Interest	£20,000
Foreign Bank Interest	£1,000
Total	£31,000

Expenses relating to foreign bank interest:
(£1,000 × £5,000) × £31,000 = £161

Expenses allowed in arriving at income chargeable to Income Tax at the special trust rates are £4,839 (£5,000 – £161).

Allowance due = £6,049 (£4,839 grossed up by reference to basic rate on savings income - ITA/S486(1) - Step 5). (See TSEM8245)

Amount of available income for each source of income, out of which discretionary income payment treated as made:

UK Bank Interest	*Amount*	*Rate*	*Tax*
Trust Management Expenses:	£6,049	20%	£1,209.80
Standard rate band	£1,000	20%	£200.00
Special trust rate	£12,951	45%	£5,827.95
Total	£20,000		£7,237.75

UK Bank interest	£20,000
Less trust management expenses[44]	- £4,839

[43] Trust management expenses are set against income to arrive at the amount chargeable to Income Tax at the special trust rates. [See expenses computation].

[44] Footnote original: Although the expenses have been grossed up for purposes of computing tax due, it is the actual amount of expenses paid by trustees which is to be

total	£15,161
Less tax charge	- £7,237.75
Net available	£7,923.25

UK Property Income	*Amount*	*Rate*	*Tax*
	£10,000	45%	£4,500

UK property income	£10,000
Less tax charge	- £4,500
Net available property income	£5,500

Foreign Bank Interest	£1,000
Less trust management expenses	-£161
Net available foreign income	£839

net available income

UK interest	£7,923.25
UK prop income	£5,500
Foreign interest	£839
Total	£14,262.25

The discretionary income payment of £4,000 is treated as met out of the following income:

Net available

UK Bank Interest: (£7,923.25 × £4,000) ÷ £14,262.25	£2,222
UK Property Income: (£5,500 × £4,000) ÷ £14,262.25	£1,543
Foreign Bank Interest: (£839 × 4,000) ÷ £14,262.25	£235
Total	£4,000

Relief due to beneficiary under ESC B18:

UK Bank Interest: (£2,222 × 7,237.75) ÷ £7,923.25	£2,030
UK Property Income: (£1,543 × £4,500) ÷ £5,500	£1,262
Total tax credit	£3,292

41.10.2 *Claim procedure*

After considering the case of a settlor-interested trust[45] the International Manual continues:

> **INTM339550. Claims by non-resident trustees of discretionary trusts** [Sep 2021]
> You may receive a claim or application from non-resident trustees of a

taken into account in arriving at the amount of income available, out of which a payment could be made to beneficiary.

[45] See 60.19.2 (Settlor treaty-resident outside UK).

> discretionary trust. ... If the trust's entitlement to claim is not clear from previous papers, you will need to ask for details of the trust to establish whether relief is due. The necessary information is requested on the form 4467(trustee)/FD...
>
> ***What to do if one or more beneficiaries of the trust has a residential address in the UK***
>
> If the completed form 4467(trustee)/FD shows any beneficiaries with UK residential addresses, Specialist Personal Tax, PT International Advisory will refer the papers to Specialist PT, Trusts & Estates, who will consider whether the trustees will need to make UK tax returns.
>
> ***What to do if all of the beneficiaries are resident in the same country as the trustees and the settlor of the trust is excluded from benefit***
>
> If all of the beneficiaries of the trust are resident in the same country as the trustees and the settlor of the trust is excluded from benefit, you can allow relief to the trustees.

Helpsheet 262 (Income and benefits from transfers of assets abroad and income from Non-Resident Trusts, 6 April 2023) provides:

> If you wish to make a claim under Extra Statutory Concession B18, you should contact HMRC Trusts.[46] In addition, you should advise your tax office that you are making a claim under Extra Statutory Concession B18 and, in the 'Any other information' box, box 19, of your tax return, enter details of the name of the trust from which the income payment was received and the tax reference of the trust.
>
> If part or all of the income distribution has already been charged to tax in the UK on the settlor of the trust, see page TN 1 of the 'Trusts etc. notes'. Instead of entering the amount so charged in box 41 of the 'Foreign' pages, include it in box 2 of the 'Trusts etc' pages. If you are the settlor and already chargeable on the income arising to the trustees, there is no need to include in box 41 or box 2 in the 'Trusts etc' pages any discretionary payments made to you by the trustees.
>
> The amount you enter either in box 41 of the 'Foreign' pages or in box 2 of the 'Trusts etc' pages should take account of the effects of your residence or domicile status.

41.11 s.629 income: Settlor's child

For this topic generally, see 47.15 (Payment to settlor's child).

ESC A93 provides the equivalent of ESC B18:

> Income arising to a trust within the scope of Section 686 ICTA 1988 is

[46] *https://www.gov.uk/government/organisations/hm-revenue-customs/contact/trusts*

charged to tax on the trustees at the rate applicable to trusts or the Schedule F trust rate. Where such income is distributed to or for the benefit of an unmarried minor child, of the settlor, it is treated as the income of the settlor and becomes chargeable on them for the year in which it is distributed under Section 660B ICTA 1988.

Section 687 ICTA 1988 provides for the settlor of a resident trust to be given full credit against tax due from them under Section 660B for tax paid by the trustees at the rate applicable to trusts in respect of income distributed. Section 687 does not, however, apply where the trustees exercise their discretion outside the UK. The settlor of such a trust could therefore be liable to tax under Section 660B without being able to claim credit against their liability for any tax paid by the trustees.

By concession, the settlor will be able to claim credit against their liability to tax under Section 660B for tax paid by the trustees, as if the payments out of UK income were from a UK resident trust. This will apply to the extent that the distribution is made out of income which arose to the trustees not earlier than 6 years before the end of the year of assessment in which the distribution was paid.

For this purpose, the distribution will be treated as having been made rateably out of the total of the various sources of income arising to the trustees on a last in first out basis. Credit will be given to the settlor for the tax paid by the trustees on the income to the extent that:

- the distribution is regarded as being made from income chargeable to UK tax; and
- such income has not previously been allocated to earlier distributions on a last in, first out basis.

This concession will only apply where the trustees:

- have made trust returns, giving details of all sources of trust income and payments made to beneficiaries for each and every year for which they are required; and

  -have paid all tax due, and any interest, surcharges and penalties arising; and
- keep available for inspection any relevant tax certificates.

Credit will be granted to the settlor on a claim made within five years and ten months of the end of the year of assessment in which the beneficiary received the payment from the trustees.

No credit will be given for UK tax treated as paid on income received by the trustees which would not be available for set-off under Section 687(2) if that section applied, and that tax is not repayable (for example on dividends). However, such tax is not taken into account in calculating the gross income treated as taxable on the settlor under this concession.

41.12 UK trust, non-resident beneficiary: DT relief

41.12.1 *Other Income article*

OECD Model article 21(1) (**"Other Income article"**) provides:

> Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

This wording would apply to UK source income from a UK discretionary trust so with a treaty in this form, a beneficiary who is treaty-resident will qualify for treaty relief on all their discretionary trust income (the tier 3 beneficiary charge).

After some vacillation, HMRC agree. SP 3/86 provides:

> **Payments to a non-resident from UK discretionary trusts..**
> **Introduction**
> 1 This statement explains how relief from UK tax under double taxation agreements will be given in respect of payments made to a non-resident [from] a UK discretionary trust or a UK estate.
> **Background**
> ***Discretionary trusts***
> 2 Generally speaking, a non-resident beneficiary receiving payments from a UK discretionary trust is not entitled to repayment of the tax paid by the trustees on the trust income. However, under concession B18 (which embodies a longstanding practice) HMRC 'looks through' the trust income to the underlying component parts of that income. The purpose of this 'looking through' is to allow the recipient of the income any relief that would have been available to him under the Taxes Acts had the income come to him direct instead of through the trustees.
> 3 Where the beneficiary is resident in a country with which the UK has a double taxation agreement, further relief under the 'looking through' principle may be due. Thus, for example, if the agreement provides for a withholding rate on interest of 15% and interest liable to UK tax formed part of the trust income which had suffered tax at 40% (ie the rate applicable to trusts)[47] then, under the 'looking through' principle, the beneficiary would be repaid the amount of tax suffered in excess of the withholding rate, in this case 25%.
> 4 Some of the UK's double taxation agreements include an 'other income' Article. The purpose of this Article is to determine in which

[47] Now 45%.

> country income not expressly dealt with elsewhere in the agreement should be taxed. In the UK's agreement the article sometimes gives sole taxing rights in respect of such income to the recipient's country of residence.
>
> 5 It has been the practice of HMRC to apply the 'looking through' principle to all cases where relief in respect of the discretionary payment was sought and to refuse claims where full repayment of UK tax was claimed under the provision of [the] 'other income' Article in the agreement.
>
> [Para 6 deals with estates: see 89.17 (Non-resident beneficiary of UK estate: DT relief).]
>
> **Change of practice**
>
> 7 Following a review of their practice in these two areas, HMRC have accepted that if a payment made by trustees out of a UK discretionary trust falls to be treated as a net amount in accordance with TA 1988 s 687(2) [now s.494 ITA], the 'looking through' principle is not appropriate where the beneficiary is resident in a country with which the UK has a double taxation agreement and the 'other income' Article gives sole taxing rights in respect of such income to that country. (This will usually be the case where income from trusts is not specifically excluded from the Article.) This means that tax paid by the trustees in respect of the discretionary payment will be repayable to the beneficiary, provided that any conditions set out in the 'other income' Article are met. For example, the recipient may be required to show that he is subject to tax on the income in his country of residence.
>
> 8 [This deals with estates]
>
> 9 Where the 'other income' Article does not give sole taxing rights to the country of residence in respect of the trust or estate income or there is no double taxation agreement with the country concerned, the existing 'looking through' practice will continue to be applied where it is to the advantage of the beneficiary.

The DTAs which confer relief under the Other Income article on discretionary payments made by UK resident trustees are mostly the older generation of treaties. I think the reason is that before 1973, discretionary trusts were regarded as transparent, so distributed income of discretionary trust was not regarded as falling under the Other Income article.[48] DTAs made from the 1980's onwards usually exclude trust and estate income from the Other Income article.

[48] See 41.3.1 (Source/categorisation of income).

The International Manual sets out a list of the countries whose DTAs provide relief for discretionary payments made by UK resident trustees. It is not however up to date and for convenience I divide it into two parts:

> **INTM367800 - DT applications and claims: Non-resident beneficiaries of UK trusts** [Dec 2019]
>
> DTAs where relief is available under the 'other income' article on discretionary payments made by UK resident trustees
>
> Armeia (to 5/4/2002) [1]
> Austria
> Barbados
> Belarus [1]
> Bosnia Herzegovina [2]
> Cote d'Ivoire
> Croatia [2]
> Egypt
> France
> Georgia (to 5/4/2002) [1]
> Germany
> Hungary
> Israel
> Jamaica
> Kenya
> Kyrgyzstan (to 5/4/2002) [1]
> Lithuania (to 5/4/2002) [1]
> Macedonia [2]
> Moldova (to 5/4/2002) [1]
> Montenegro [2]
> Morocco
> Namibia
> Portugal
> Romania
> Serbia [2]
> Slovenia [2]
> South Africa (to 5/4/2002)
> Spain
> Sudan
> Swaziland
> Tajikistan [1]
> Tunisia
> Tukmenistan [1]
> Zambia
>
> [1] Armenia, Belarus, Georgia, Kyrgyzstan, Lithuania, Moldova, Tajikistan, Turkmenistan: relief is given under the terms of the UK/USSR Double Taxation Convention.
>
> [2] Bosnia-Herzegovina, Croatia, Macedonia, Montenegro, Serbia, Slovenia: relief is given under the terms of the UK/Federal Republic of Yugoslavia Double Taxation Convention.

The following countries are still mentioned in the INT Manual list but should be deleted following new treaties (date of treaty in brackets):

Barbados (2012)
Hungary (2011).
France (2008)
Germany (2010)
Macedonia (2007)
Poland (2006)
Slovenia (2007)
South Africa (2002)
Spain (2013, in force 12/6/2014)

41.12.2 *Other Income article restricted*

UK DTAs from the 1980's onwards mostly exclude trust and estate income from the Other Income article. Art 23(1) of the France/UK DTA is typical:

> Items of income beneficially owned by a resident of a Contracting State, wherever arising, which are not dealt with in the foregoing Articles of this Convention, *other than income paid out of trusts or the estates of deceased persons in the course of administration*, shall be taxable only in that State.

This leaves relief to be claimed under ESC B18.

Interestingly, the UK/Germany treaty (2010) deals with the point expressly.[49] Article 21 provides:

> 1) Items of income beneficially owned by a resident of a Contracting State, wherever arising, which are not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.
> 2) Notwithstanding the provisions of paragraph 1, the following provisions shall apply with respect to income paid out of trusts or the estates of deceased persons in the course of administration:
> Where such income is paid to a beneficiary who is a resident of Germany by trustees or personal representatives who are residents of the UK out of income received by those trustees or personal representatives which would, if those trustees or personal representatives had been residents of Germany, have fallen within other Articles of this Convention, the beneficiary shall be treated as having received an amount of the income received by the trustees or personal representatives corresponding to the income received by him and any tax paid by the trustees or personal representatives on that amount shall be treated as having been paid by the beneficiary.

Why? Presumably the German authorities do not like German residents to be taxed by law and untaxed by HMRC extra-statutory concessions such as ESC B18 and A14. Those who believe that tax law should be statutory and not concessionary will approve.

It is curious that the programme to legislate ESCs, which has legislated many trivial ESCs, has not covered the important ESC B18. No explanation has been given, so it is tempting to speculate. Perhaps it has been filed as too difficult; perhaps HMRC are planning changes to the law; perhaps legislation will come eventually.

[49] Barbados (2012) is the same, so perhaps this will be the new standard form.

In the USA/UK DTA the treaty excludes trust and estate income in the standard wording, and point is dealt with by the DTA Exchange of Notes:

> With reference to paragraph 1 of Article 22 (Other income)—
> it is understood that the purpose of the exclusion from the paragraph for income paid out of trusts or the estates of deceased persons in the course of administration is to allow a recipient of such income the relief that would have been available to him under the provisions of the Convention had he received the income direct instead of through the trust or estate.

More accurately, the purpose is to prevent the recipient of such income from receiving more than the relief that would have been available to a person under the provisions of the Convention and ESC B18 had they received the income direct instead of through the trust or estate. But it comes to the same thing.

41.13 Dual-resident trustees

Suppose

(1) Trustees are dual resident (resident in the UK and in another state); but treaty-resident in the state (treaty non-resident under the tie-breaker).

(2) The beneficiary is solely resident in the UK

(3) The trustees receive income which is not subject to UK tax under the treaty

Tier 1: The trustees qualify for treaty relief for the charge at tier 1. That reduces the UK tax that they pay at tier 1., but it also reduces the tax pool, and so reduces the tax pool credit available for trust withholding tax (tier 2).

Tier 2: The distribution is subject to trust withholding tax. There is no double taxation relief for that charge.

Tier 3; The beneficiary is subject to tax on the distribution. There may be some foreign tax credit relief, under s.111 TIOPA, but not the full relief which applies to a treaty non-resident.

In short, for dual-resident trusts the trust tax-credit systems do not fully work, and the benefit of the DT relief may effectively be lost.

CHAPTER FORTY TWO

IIP TRUSTS: INCOME TAX

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42.1 Introduction and terminology

This chapter considers the income taxation of interest in possession trusts (**"IIP trusts"**), that is, in short, trusts which a beneficiary is entitled to the trust income. I call that beneficiary the **"life tenant"**; HMRC use the term "IIP beneficiary" which may be more accurate, but perhaps more opaque. The trustees may be called **"IIP trustees"**.

In *Crawley v IRC*:[1]

> The treatment of trustees in the Income Tax Acts is not altogether satisfactory. The legislation gives rise to serious problems as to the circumstances in which a trustee is liable for tax on income which is not actually received by him or which belongs beneficially to a beneficiary and as to the manner in which trustees are to be assessed.

[1] 59 TC 728.

That continues to be the case. But in practice we muddle through.

42.2 Taxation of IIP trustees

The starting point is that trustees are persons, and so if trustees receive/are entitled to income they are in general liable to income tax under the standard receipt/entitlement basis of liability.[2]

In general:

(1) UK trustees are subject to tax on all their income
(2) Non-resident trustees are subject to tax on UK source income (except so far as non-resident IT relief is available)

This applies even to IIP trustees.[3] But IIP trustees enjoy a number of exceptions to the general rule:

Exception	**See para**
Income mandated	42.3
Life tenant non-resident	42.4
Life tenant remittance basis user	42.5

Trustees liability to tax on interest will often be covered by a tax credit. Before 2016, trustees liability on dividend income was covered by a tax credit, but that is no longer the case for UK resident trusts, so the administrative burden has become much greater. Simplification would be appropriate.

42.2.1 *Rates of IT on trustees*

In the absence of express provision, the rates of tax payable by IP trustees are the Default Basic Rate, or for dividends, the dividend ordinary rate.[4]

42.3 Income mandated

The TSE Manual provides:

> **TSEM3040 trustees - beneficiary receives trust income directly** [Jul 2020]
> Sometimes there are instructions or arrangements for income to bypass the trustees of an interest in possession (IIP) trust. If trust income passes directly or indirectly to a beneficiary without going via the trustees, for

[2] See 15.2.1 (Receipt/entitlement basis of liability).

[3] See 15.8 (Receipt by nominee/trustee).

[4] See 43.6.5 (Application of Default Rates); 43.10.4 (Dividends: Non-individual); See too 42.10 (Scots IT rates).

> example income passes through an investment manager to the IIP beneficiary, there is no statutory basis for charging the trustees to income tax in respect of this income, because the trustees are neither entitled to it nor in receipt of it (TSEM3761).
> Trustees of interest in possession trusts (IIPs) (TSEM1564) exclude such income from the Trust and Estate Tax Return.
> See TSEM3763 about the beneficiary's and settlor's positions.[5]

CIOT say:

> CIOT and ICAEW, in response to questions raised by members sought HMRC's view as to what actually constitutes "mandated income". Our view is that (until it is revoked) any standing instruction given by the trustees as to the payment of income before it falls entirely under their control would constitute a mandate. HMRC were asked to consider the following examples:
> 1. The registrar of a company is given a mandate to pay the dividends directly to the beneficiary's bank account
> 2. The bank/building society is instructed to pay the interest as it arises into the beneficiary's bank account
> 3. The investments are held by an investment manager in nominee accounts the manager is instructed to pay the income as it arises into the beneficiary's bank account
> 4. The investments are held by an investment manager in nominee accounts and the manager has a standing instruction to pay the income periodically, say quarterly, into the beneficiary's bank account
> 5 The registrar of a company is given a mandate to pay the dividends directly to the trustees' bank account and the trustees forward the income to the beneficiary
> 6. The bank/building society is instructed to pay the interest as it arises into the trustees' bank account and the trustees forward the income to the beneficiary
> 7. The investments are held by an investment manager in nominee accounts and the manager is given ad hoc instructions to pay the income into the beneficiary's bank account.
> 8. Land where the life tenant manages the property including repairs, and collects and returns the rent directly
> **HMRC response**
> In simple terms the IIP trust income is mandated to the beneficiary when the beneficiary will receive that income directly from the source.

[5] Also see 47.11 (Trustees of settlor-interested trust).

> So, any scenario where the trust income does not go via the trustees' bank account, but straight to the beneficiary's is one within TSEM 3763. In these circumstances there is no basis for taxing the trustees, because they are not in receipt of the income. The beneficiary is chargeable on the income because they are entitled to it.
>
> The examples given in your question are all within the TSEM 3763, except numbers 5 and 6 where the trustees receive the income directly from the source, they are therefore taxable as being in receipt of the income. They therefore include this on the Trust and Estate tax return (SA900).
>
> The term 'mandated' has been causing the confusion so we are in the process of amending our guidance to clarify this matter.

Strictly, the correct question, in the words of the statute, is not whether the trustees have *mandated* income, but whether they have *received* income.[6] In cases of doubt, one should focus on the concept of receipt. But in general, "mandating income" is a convenient paraphrase for trustees "not receiving income".

The principle that IIP trustees are not taxable on mandated income was assumed without question in *Trustees of the Paul Hogarth Life Interest Trust v HMRC*[7] which discusses the implications of the rule in the context of penalties for failing to deliver a tax return.

IP trustees will normally mandate income to the life tenant, but with the consent of the life tenant it could be mandated to anyone.

42.4 Life tenant non-resident

This section considers the position of IIP trustees where:

(1) The trustees are UK tax-resident; and
(2) The life tenant is not UK tax-resident

The taxation of IIP trustees is affected by the residence of the life tenant. TSE Manual provides:

> **TSEM3160. Resident trustees with trust income from abroad: beneficiary is not resident** [Jul 2020]
>
> These instructions apply only if the beneficiary has an absolute interest in trust income (TSEM6204). This includes a life tenant and an annuitant.
>
> The trustees' income tax liability is based on the beneficiary's residence

[6] See 15.2.1 (Person liable: receiving/entitled).

[7] [2018] UKFTT 595 (TC).

> position. Trustees are not chargeable in respect of the share of income from abroad payable to the non-resident beneficiary. They exclude it from the Trust and Estate Tax Return. [See] *Williams v Singer* 7 TC 387

IIP trustees are not taxed on income which is paid to the life tenant, if the life tenant is not taxable:

(1) Foreign source income payable to a non-resident life tenant
(2) UK source dividend income payable to a non-resident life tenant[8]
(3) Income for which the life tenant qualifies for non-residents IT relief

This applies even if the trustees are UK resident, and even if the income is received by them before it is paid on to the life tenant (ie it is not mandated to the life tenant directly).

UK resident IIP trustees are taxable on such income if it is not payable to a non-resident life tenant. Examples are:

(1) income used for trust expenses
(2) a receipt which is income for tax purposes but capital for trust purposes

42.5 Life tenant remittance basis user

This section considers the position of IIP trustees where:

(1) The trustees are UK tax-resident; and
(2) The life tenant is a remittance basis taxpayer

The taxation of trustees of an IIP trust similarly depends on whether the life tenant is a remittance basis taxpayer. TSE Manual provides:

> **TSEM3165. Resident trustees with trust income from abroad: beneficiary is resident but not domiciled** [Jul 2020]
> These instructions apply only if the beneficiary has an absolute interest in trust income (TSEM6204). This includes a life tenant and an annuitant.
> The trustees' income tax liability is based on the beneficiary's domicile. The beneficiary must make a claim for any year that the remittance basis is to apply.
> If in any year the beneficiary claims the remittance basis the trustees' liability on the share of income from abroad payable to the beneficiary is limited to the amount remitted to the UK. Trustees exclude from the Trust and Estate Tax Return any such overseas income that is not

[8] See 30.7 (Non-resident recipient).

> remitted to the UK.
> If in any year the beneficiary does not claim the remittance basis the trustees are assessable on the amount arising.
> [See] *Williams v Singer* 7 TC 387

So IIP trustees are not taxed on unremitted foreign source income which is payable to a resident non-domiciled life tenant who is a remittance basis taxpayer. This applies even if the trustees are UK resident. The trustees would be taxable if the income is received by them in the UK, or otherwise remitted. What if income is remitted in a year after receipt? The trustees would only be taxable if the income was received by them. So there would be no charge on the trustees if the income was received out of the UK, paid to the life tenant, and the life tenant later remitted it to the UK by payment, say, to his own bank account. That makes sense, as the trustees would not know whether income has been remitted by the life tenant, unless they actually receive it.

Form SA904 Notes on Trusts & Estate Foreign 2022/23 provides:

> If the beneficiaries of the trust has an absolute interest in the trust (including a life tenant) and it's known that they will make a claim for the tax year to be taxed only on the amount of their foreign income and gains that is remitted to the UK, then do not include these amounts of foreign savings income remitted to the UK on page TF 2.

42.6 Taxation of life tenant

42.6.1 *Grossing up*

The TSE Manual provides:

> **TSEM3764. Beneficiary entitled to trust income - grossing up** [Jul 2020]
> If the trustees receive income that is taxed at source, or if they pay tax on it under self assessment, the beneficiary will receive a net amount. But he or she is entitled to the gross amount. Consequently he or she is taxable on the gross amount.
> For example, the trustees have gross bank interest of £1,000 on which tax is deducted at source £200.They pay £800 to the beneficiary. The beneficiary is entitled to the gross amount £1,000, and is taxable on that amount

42.6.2 *Beneficiary's credit for trustees tax*

The TSE Manual provides:

> **TSEM3765. Beneficiary entitled to trust income - credit for trustees' tax** [Jul 2020]
> If the trustees have paid tax or have received income with tax taken off, the beneficiary is given credit for that tax.
> For example, in 2009-10
> the trustees have gross rental income of £2,000 on which they pay tax £400.
> They pay £1,600 to the beneficiary.
> The beneficiary is entitled to the gross amount £2,000, and is taxable on that amount. He or she is given credit for the £400 tax paid by the trustees.
> If the beneficiary is a higher rate taxpayer, he or she will have further tax to pay see example in TSEM3766. If the beneficiary is a non-taxpayer, he or she may claim a repayment.
> The beneficiary is given credit for trustees' tax only if the beneficiary is taxable on the same item. If the IIP trustees receive an amount that is capital in trust law and deemed to be income for tax purposes (see TSEM3201 and TSEM3768), the beneficiary is not given credit for the trustees' tax. The IIP beneficiary would not be entitled to such a receipt, as it would not be trust income, and would not be taxable on the receipt...

I refer to this system as **"pay & reclaim"**. The trustees pay tax and the beneficiary reclaims it.[9]

42.6.3 *HMRC example*

The TSE Manual provides:

> **TSEM3766 Beneficiary entitled to trust income - grossing up and credit for trustees' tax example** [Jul 2020][10]
> An IIP trust where the Settlements legislation does not apply (see TSEM3765) receives income in 2009-2010:
> - rental income £2,000
> - bank interest £800 (basic rate tax of £200 deducted at source).

[9] The same system applies non-settlor interested IIP trusts, where trustees likewise pay tax and the settlor has a credit for that tax; see 47.11 (Trustees of settlor-interested trust).

[10] Author's footnote: I have slightly altered the wording of the examples to enhance clarity.

Trustee's position

	Rent	Interest
gross income	2,000	1,000
tax due	400	200
net income	1,600	800

The trustee receives credit for the tax deducted at source from the bank interest (£200) so has to pay £[400][11] tax.

Beneficiary's position (***Beneficiary is a higher rate taxpayer***)

	Rent	Interest
net income (as above)	1,600	800
grossed up (@ 20%)	2,000	1,000
tax at 40%	800	400
less credit	-400	-200
further tax to pay[12]	400	200

For an example involving TMEs, see TSEM8345-8350.

TSEM3767. Beneficiary entitled to trust income - form R185 (Trust Income) [Jul 2020]
In the example in TSEM3766 the entries on the form R185 (Trust Income) given by the trustees to the beneficiary would be:

	Net amount	Tax paid
Box 3 non-savings income	£1600	£400
Box 4 savings income	£800	£200

The beneficiary uses the information on form R185 (Trust Income) to make his or her tax return or to claim repayment.

42.6.4 *Completing tax return*

The TSE Manual later expands on this:

TSEM3763 beneficiary receives trust income directly, the beneficiary's return [Jul 2020]
Sometimes there are instructions or arrangements for income to bypass the trustees of an interest in possession (IIP) trust. If trust income passes directly or indirectly (for example, through an investment manager) to a beneficiary without going via the trustees the beneficiary needs to ensure that it is returned correctly on their tax return:
The beneficiary should return all income on the relevant pages of their tax return, in addition to their direct personal income. For example,

[11] Author's footnote: The Manual erroneously states the amount as £220.

[12] Author's footnote: If the beneficiary is a basic rate taxpayer, there is no further tax due.

include:

- dividends and interest on the SA100;
- rental income on the SA105 (UK property);
- foreign income on the SA106 (Foreign)

However, if income bypasses the trustees and the trust:

- is settlor interested (TSEM4200 onwards), or
- is not settlor interested but the trust income passes directly to the settlor's relevant minor child (TSEM4300 onwards)

then the settlor includes the income on his or her personal return. Other beneficiaries do not.

See TSEM3040 about the trustee's position.

Income received via the trustees

The beneficiary should use the SA107 (Trusts etc) to return all other trust income, which will have passed through the trustees (with the exception of foreign income, which is returned on the SA106 (Foreign).

42.7 Trustees expenses

42.7.1 *Deduction for trustees*

The TSE Manual provides:

> **TSEM8310. IIP trustees: basic rate, etc tax** [Jul 2020]
>
> In taxing the trustees of an IIP trust at rates up to basic rate, the usual deductions against various sources of income (e.g. deductions to arrive at net trading profit or rental income) are allowed. But the trustees do not get relief at those rates of tax for any 'trustees' expenses' whatsoever. The tax case of *Aikin v Macdonald's Trustees* (3 TC 306), concerned with income remitted to the UK from abroad, confirmed the general principle that trust management expenses are not to be taken into account in arriving at the measure of taxable income of the trustees. The case found that the full amount of income received in the UK was taxable without any deduction in respect of expenses incurred in this country in managing the trust. As Lord McLaren said, 'the only kind of deductions allowed is expenditure incurred in earning the profits there is no deduction under any circumstances allowable for expenditure incurred in managing profits which have already been earned and reduced into money' (p309).
>
> **TSEM8315. IIP trustees: deemed income** [Jul 2020]
>
> Unlike the trustees of accumulation/discretionary trusts, the trustees of IIP trusts are not normally chargeable to the special trust rates. Consequently there is generally no equivalent question of allowing TMEs against the special trust rates - but see 'Practical considerations' below.

For IIP trusts, there are certain items that are capital in trust law but deemed to be income for tax purposes, and are also taxable at the special trust rates. (See TSEM3201.)

...

From 6 April 2007 Section 484 ITA provides for all the deemed income items in ITA/482, now including accrued income, to be given relief for allowable TMEs

Practical considerations

In practice, if an IIP trust incurs allowable TMEs, they will reduce the beneficiary's entitlement to trust income and will not normally be taken into account for the trustees' deemed income purposes. A capital receipt would normally not find its way into the hands of an IIP beneficiary, as it would not be trust income. (But see exceptions in TSEM3786 to TSEM3787.) So, the fact that the trustees were liable to the special trust rates on certain receipts would have no direct effect on the income beneficiary, and Section 484 ITA TMEs would not come into question. But if there is a high enough level of allowable income expenses such that they reduce the IIP beneficiary's entitlement to nil, and at the same time there is deemed income taxable on the trustees at the special trust rates, excess income expenses could be used against the trust rate income.

42.7.2 *Deduction for life tenant*

The TSE Manual provides:

TSEM8320. IIP beneficiaries: case law [Jul 2020]

There is case law in *Murray v CIR* (11 TC 133), *MacFarlane v CIR* (14 TC 540), and *CIR v Dewar* (16 TC 93-94). A beneficiary with an absolute interest in income (for example a life tenant) is entitled to the amount arising to the trustees that is available after any management and administration expenses etc. of the trustees have been provided for. Consequently the beneficiary is taxable on the net amount - *CIR v Hamilton of Dalzell (Lord)* (10 TC 406).

TSEM8325. IIP beneficiaries: TMEs not a tax deduction [Jul 2020]

In an IIP trust, the income beneficiary is entitled to the income as it arises out of trust assets, with the exception of any part of that income that is properly paid away on trust expenses and some other items (see TSEM3762). TMEs are considered as part of establishing what net income the beneficiary is entitled to in law. That entitlement then provides the measure on which to tax the beneficiary. So, 'allowable' TMEs for an IIP beneficiary do not constitute a tax deduction or a tax relief, because they represent sums of money that the beneficiary was not

> entitled to in the first place.
>
> **TSEM8330. IIP beneficiaries: tax law** [Jul 2020]
>
> ITA Sections 499 to 503 provide generally for the IIP beneficiary's income to be reduced by allowable TMEs for tax purposes.
>
> ITA Sections 501 and 502 provide for relief for allowable TMEs for non-resident IIP beneficiaries.

Section 500 ITA provides:

> (1) Expenses of the trustees can be used to reduce the beneficiary's income for income tax purposes only so far as—
>
> (a) the expenses are incurred by the trustees in the current tax year or in an earlier tax year, and
>
> (b) as a result of the expenses being chargeable to income as mentioned in subsection (2) or (3), the beneficiary's entitlement to the beneficiary's income is reduced by reference to the expenses.

"Chargeable to income tax" is defined in s.500 ITA:

> (2) Expenses are chargeable to income for the purposes of subsection (1)(b) if they are chargeable to income by the trustees under a term of the settlement (subject to any overriding law which prevents the expenses from being so chargeable).
>
> (3) Expenses are also chargeable to income for the purposes of subsection (1)(b) if they—
>
> (a) are not chargeable to income by the trustees under a term of the settlement, but
>
> (b) are chargeable to income by the trustees in accordance with any law (subject to any overriding term of the settlement which prevents the expenses from being so chargeable).

Section 500(4) ITA prevents double counting (for the avoidance of doubt):

> Expenses cannot be used to reduce the beneficiary's income for income tax purposes so far as they are expenses which have fallen, or may fall, to be taken into account for the purpose of calculating the trustees' liability to income tax for any tax year.

42.7.3 *Non-resident beneficiaries*

Section 501 ITA provides:

> (1) This section applies if—
>
> (a) expenses of the trustees are to be used to reduce the beneficiary's income for income tax purposes, and

> (b) a proportion of the beneficiary's income is untaxed income (see section 502).
>
> (2) A proportion of those expenses is not to be so used.
>
> (3) That proportion is the same as the proportion of the beneficiary's income which is untaxed income.
>
> (4) In subsection (3) the references to the beneficiary's income and untaxed income do not, in either case, include so much (if any) of that income as is equal to the amount of income tax, or of any foreign tax, for which the trustees are liable on that income.
>
> (5) "Foreign tax" means any tax which—
>
> (a) is of a similar character to income tax, and
>
> (b) is imposed by the laws of a territory outside the UK.

Section 502 ITA provides a commonsense definition of "untaxed income":

> (1) For the purposes of section 501 the beneficiary's income is untaxed income so far as the beneficiary is not liable to income tax on it wholly or partly because the beneficiary—
>
> (a) has been non-UK resident, or
>
> (b) has been treated as resident in a territory outside the United Kingdom under double taxation arrangements.
>
> (2) If the income tax charged on the beneficiary for the beneficiary's income is limited under Chapter 1 of Part 14 (limits on liability to income tax of non-UK residents), the untaxed income includes so much of the beneficiary's income which is disregarded income (within the meaning of that Chapter) except so far as the disregarded income is within subsection (3).
>
> (3) The disregarded income is within this subsection so far as—
>
> (a) sums representing income tax have been deducted from the income, or
>
> (b) sums representing income tax have been treated as deducted from or paid in respect of the income.

Against which income does one set expenses? This question did not arise when all types of income were taxed at the same rates. Now we need s.503 ITA which provides the answer:

> (1) This section applies if the beneficiary's income is to be reduced for income tax purposes by expenses of the trustees.
>
> (2) The beneficiary's income is to be reduced in the following order—
> first, reduce dividend income within subsection (3) (if any),
> second, reduce dividend income not within that subsection (if any),
> third, reduce savings income (if any), and
> fourth, reduce other income (if any).

(3) Income is within this subsection so far as it is—

(a) chargeable under Chapter 3 of Part 4 of ITTOIA 2005 (dividends etc from UK resident companies),

(b) chargeable under Chapter 5 of that Part (stock dividends from UK resident companies), or

(c) chargeable under Chapter 6 of that Part (release of loan to participator in close company).

(4) If the trustees are liable for income tax charged on a component of the beneficiary's income at a particular rate, then any reduction of that component is to be made in accordance with the steps set out in subsection (5).

(5) Here are the steps.

Step 1 Deduct from the component the amount of income tax charged on it at the particular rate for which the trustees are liable.

Step 2 Take the result from Step 1 and reduce it (but not below nil) by the amount of the trustees' expenses so far as they have not already been used to reduce other components of the beneficiary's income.

Step 3 Take the result from Step 2 and gross it up by reference to the particular rate. The result is the reduced amount of the component of the beneficiary's income.

ITA change 91 provides:

Change 91: Settlements: trustees' expenses reducing beneficiary's income: sections 500, 503 and Schedule 1 (section 646A of ITTOIA)

This change makes explicit some of the rules about the way expenses incurred by trustees in connection with income to which a beneficiary is entitled reduce the amount of the beneficiary's income for tax purposes.

There are only two provisions in ICTA that concern the tax treatment of expenses in relation to income to which a beneficiary is entitled before it is distributed (where the beneficiary is regarded as having an interest in possession). These are:

- section 689A, which deals with the disregard of some expenses in the case of a non-resident beneficiary; and
- section 689B, which concerns the order in which expenses reduce the beneficiary's income.

While there are additional provisions in section 686(2AA) of ICTA that give some rules on the treatment of trustees' expenses in relation to accumulation or discretionary income, there is no corresponding provision for interest in possession trusts. The practices that have become established and which are reflected in these sections are based on the principle that the income of a beneficiary is the income arising to the trustees so far as the beneficiary is entitled to it.

There are two ways in which this principle operates.

First, if the trustees' expenses are chargeable to income under a provision of the settlement, then irrespective of whether they would be so chargeable in the absence of that provision, the expenses are to be taken into account. This is subject to the existence of any law that in a particular case (for example by way of a court order) overrides the provision in the trust deed.

This is different from the rule that operates in relation to accumulated or discretionary income where the terms of the settlement are to be ignored, and from what it appears that section 689A of ICTA provides for in this context.

If the deed is silent on whether a particular expense is chargeable to income then the expense is taken into account if it would be chargeable to income under general trust law.

These rules are reflected in section 500. They mean that an expense is allowable if it is chargeable to income under the trust deed, even if it would be chargeable to capital under general trust law. Conversely, in cases where general trust law would require an expense to be charged to income, but the trust deed charges it to capital, then the change means that the expense is not allowable.

The second area concerns how trustees' expenses are taken into account in such cases.

The expenses do not affect the amount of income on which the trustees are chargeable to tax, but operate to reduce the amount of the beneficiary's income. It is not that the beneficiary gets relief for the expenses as such; it is simply that the beneficiary is not entitled to the income used to pay the expenses. So, the beneficiary's income (as reduced by allowable expenses) is grossed up at the normal rate appropriate to that income to arrive at the gross amount which is to be treated as part of the beneficiary's total income.

This is not set out in the source legislation but, based on the decision in *CIR v Lord Hamilton of Dalzell* (1926), 10 TC 406 CS, it is the accepted way that expenses are taken into account. Section 503 reflects this.

This change also provides rules about cases where the trustees' expenses exceed a beneficiary's income. Section 500(1) applies in relation to the tax year in which the beneficiary's entitlement to income is reduced, whether the expense was incurred in that tax year or an earlier tax year. The reference to an earlier tax year means that the section covers cases where the trustees' expenses in an earlier tax year exceed the income in that earlier year and so the trustees are carrying forward the excess.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with current practice.

The TSE Manual continues:

TSEM8335. IIP beneficiaries: tax law: Section 500 ITA [Jul 2020]

S.500 provides that if, as a result of the expense being chargeable to income it reduces the beneficiary's entitlement to income, it reduces the measure of the beneficiary's income for tax purposes.

An expense can reduce the beneficiary's entitlement in two ways:

If it is chargeable to income under general trust law and there is no specific provision about the expense in the trust deed.

If it is chargeable to income under the trust deed, whether it is chargeable to income or capital in general trust law.

In cases where general trust law would require an expense to be charged to income, but the trust deed charges it to capital, the expense is not allowable, as it does not reduce the beneficiary's entitlement to income

In sum:

- if an expense is properly chargeable to capital in general trust law, but charged to income under the trust deed, the expense is allowed;
- if an expense is properly chargeable to income in general trust law, but charged to capital under the trust deed, the expense is not allowed.

The legislation for interest in possession trusts specifies that one must give priority to the provisions of the trust deed over general trust law when establishing whether the expense is an allowable trust management expense for tax purposes. In practical terms the provisions result in the IIP beneficiary being taxed on his or her entitlement to income.

TSEM8340. IIP beneficiaries: trust deed [Jul 2020]

The IIP beneficiary is taxed on the income of the trust net expenses properly chargeable to income.

'Properly chargeable to income' in the IIP trust context means properly chargeable to income under all four sources of trust law referred to in TSEM8020. By contrast with discretionary trusts, where Section 484 ITA specifically excludes provisions in the trust deed, this term for IIP beneficiaries includes expenses whose final incidence falls on income by virtue of the terms of the trust deed - Section 500(2) ITA.

So if an IIP trust deed allows the trustees to pay what are normally capital expenses out of income, those expenses reduce the measure of the beneficiary's income. If an IIP trust deed allows trustees to pay what are in general trust law income expenses out of capital, again the trust deed has priority over general trust law, and consequently the IIP beneficiary's income is not reduced by such expenses.

In the absence of a specific provision in the trust deed, general trust law applies. If the trustees pay expenses out of income that are properly chargeable to capital in general trust law, then the IIP beneficiary is taxable on the amount of income used to pay the expenses, even though he or she does not receive it.

TSEM8345. IIP beneficiaries: measure of income: net and gross amounts [Jul 2020]

Tax is charged on the beneficiary's entitlement. The beneficiary receives

- income net of tax and income expenses including TMEs (that receipt referred to below as ‘the net amount’), but is actually entitled to
- the untaxed amount of the income, net of income expenses including TMEs (that entitlement referred to below as ‘the gross amount’).

So the net amount is grossed up at the appropriate tax rates to arrive at the amount included in the beneficiary’s income for income tax purposes.

Example

Trustees income is £1,000; allowable TMEs are £250, income tax due is £200 (£1,000 at 20%).

The ‘net amount’ is £550

The ‘gross amount’ is £687.50 (£550 grossed up × 100 ÷ 80).

TSEM8350. IIP beneficiaries: measure of income: tax paid by trustees [Jul 2020]

The income tax paid by the trustees on that part of the income used for TMEs and other items excluded from the IIP beneficiary’s entitlement is not part of the beneficiary’s entitlement, because the income out of which the tax is paid is not part of the beneficiary’s entitlement. But the rest of the tax paid by trustees represents income to which the IIP beneficiary is entitled.

The beneficiary is given credit for the tax already paid by the trustees (or deducted at source) on the amount included in the beneficiary’s income for income tax purposes. That credit, i.e. tax already paid on the income to which the beneficiary is entitled, will necessarily be represented by the difference between the gross amount and the net amount as described in TSEM8345.

TSEM8355. IIP beneficiaries: Section 500 ITA: basis of allowance [Jul 2020]

Section 500(1)(a) ITA provides that allowable TMEs are allowed on the ‘incurred’ basis. So the beneficiary’s entitlement in any tax year is income arising less allowable TMEs incurred.

Section 500 provides for unused allowable TMEs incurred in an earlier year to be used against the current tax year. In a year where allowable TMEs incurred exceed income arising the beneficiary’s income entitlement will be nil. The excess allowable TMEs will be taken into account in later year/s.

For an expense to be properly chargeable to income in trust law the trustees must have authority to put the final burden of that expense on the income fund. Which fund they use to pay it out of temporarily is not relevant.

In a year where there is not enough income, trustees may borrow from capital to pay income expenses, and in the next year reimburse capital from income.

If an expense is properly chargeable to income, but the trustees pay all or part of it from trust capital in year 1 because there is no income or not enough income that year, the beneficiary’s net income in year 1 will be reduced to nil. If in year 2 the trustees reimburse capital from income, that amount will be allowable against the beneficiary’s income for tax purposes in year 2.

Example

Year 1, trust income £1,000, allowable TMEs £2,000.

Trustees pay £1,000 TMEs out of income, and £1,000 out of capital. Beneficiary's taxable income £1,000 less TMEs £1,000 = nil.

Year 2, trust income £3,000, allowable TMEs £1,000.

Trustees pay £1,000 TMEs of current year out of income, and reimburse capital £1,000 for income expenses of previous year.

Beneficiary's taxable income £3,000 less £2,000 = £1,000.

TSEM8360. IIP beneficiaries: tax law: order of set-off [Jul 2020]

Section 503(2) ITA provides the order of set-off for TMEs to reduce the income of an IIP beneficiary. The order of set-off of TMEs in an IIP beneficiary's tax calculation is the same as for accumulation/discretionary trustees (TSEM8250). But there is no grossing up of expenses as there is for accumulation/ discretionary trustees.

TSEM8365. IIP beneficiaries: tax law: order of set-off [Jul 2020]

Example

An IIP trust receives income in 2010-11:

rental income £1,000

bank interest £800 (basic rate tax of £200 has been deducted at source).

Trustee pays TMEs properly chargeable to income of £250.

Trustee's position

	Rent	Interest
Gross income	£1,000	£1,000
Tax due	£200	£200
Net income	£800	£800

The trustee receives credit for the tax deducted at source from the bank interest (£200) so has to pay £200 tax on the rent. TMEs do not affect the trustee's position.

Beneficiary's position

	Rent	Interest
Net income (as above)	£800	£800
Minus TMEs (set first against savings income)		–£250
	£800	£550
grossed up (@ 20%)	£1,000	£687.50

TSEM8370. IIP beneficiaries: tax law: form R185 (Trust Income) [Jul 2020]

In the example in TSEM8365 the entries on the form R185 (Trust Income) given by the trustees to the beneficiary would be:

	Net amount	Tax paid
Box 3 non-savings income	£800.00	£200.00
Box 4 savings income	£550.00	£137.50

The beneficiary uses the information on form R185(Trust Income) to make his or her tax return or to claim repayment.

42.7.4 *Mandated income: Expenses*

The TSE Manual continues:

> **TSEM8375. IIP beneficiaries: mandated income** [Jul 2020]
> Where
> [1] trustees mandate income (see TSEM3762) and
> [2] the beneficiary pays TMEs that are properly chargeable to income, such a beneficiary may set the TMEs against income chargeable at higher rate only.
> This practice of charging such income at no higher than the basic rate necessarily follows from the case law propositions that
> - there is no income tax relief at basic rate for income used to meet TMEs (see TSEM8310)
> - although an IIP beneficiary receives income mandated to him, to the extent that it is used to meet expenses properly borne by income it is not a part of his entitlement (see TSEM8325).

42.8 Life tenant's foreign tax credit

The TSE Manual provides:

> **TSEM3655. Relief for overseas tax: beneficiary entitled to trust income** [Jul 2020]
> These instructions apply to taxed overseas trust income that is treated as a beneficiary's income as it arises.
> The trustees can claim, and receive, tax credit relief on behalf of the beneficiary. The amount is based on the beneficiary's marginal rate and residence status. INTM367730+ onwards has instructions about tax credit relief.
> If the trustees do not claim relief, the overseas income chargeable is the net amount after deduction of overseas tax.
> A paying agent may have allowed provisional tax credit relief on overseas income. If that provisional relief is excessive, the beneficiary accounts for the excessive relief.

The Manual continues with a comment on annuities, but that does not arise in practice.

42.9 Life tenant: Source of income

42.9.1 *Source of income of beneficiary*

It is necessary to identify the source of income of a life tenant. For instance, a life tenant is subject to tax on income received from the trust if it is UK source income or if the life tenant is UK resident; and rates of tax may vary depending on the source.

The choice is between:

(1) regarding the trust as the source of trust income; or

(2) regarding the trust assets as the source, in which case one "looks through" the trust and it is described as "transparent".[13]

The answer depends on the terms of the trust, construed in accordance with the proper law of the trust.

Similar issues arise for unit trust income, see 69.1 (Unit Trusts – Introduction).

For the position where the life tenant pays the income (eg pays interest or rent to the trustees) see 50.10.6 (Loan to life tenant).

42.9.2 *England and "Baker" trusts*

The source of the life tenant's income is the underlying trust assets (not the trust) if, under the terms of the trust, construed in accordance with the proper law of the trust, the beneficiary is entitled to the income of each trust asset as it arises. This is the case for a standard form interest in possession trust governed by English law.[14] In other words, an IIP trust is transparent for IT purposes.

The TSE Manual provides:

> **TSEM10425 Non-resident trusts: beneficiary's chargeability: trust income - interest in possession trust: foreign law - Baker type trust**
> [Jul 2020]
> The beneficiary of a Baker type trust is entitled to his or her share of each source of income arising to the trust, less any amounts to which the beneficiary is not entitled (see (TSEM3762).
> Credit may be given to the beneficiary for tax deducted at source or paid by the trustees on the income. This includes tax credit relief where tax has been paid by the trustees on trust income in another jurisdiction.

[13] See 90.6 (Transparency issues).

[14] *Baker v Archer-Shee* 11 TC 749. This issue has given rise to academic debate ever since the House of Lord's 3:2 decision in *Baker*. See Waters, "The Nature of the Trust Beneficiary's Interest" (1967) 45 Can Bar Rev 219; Schabe, "The Trust Conduit Principle: A Foundationless Theory?" [1999] Journal of Australian Taxation 17 *http://www.austlii.edu.au/au/journals/JATax/1999/17.html*

Example
Interest in possession beneficiary has entitlement to all income of non-resident trust

Year 2013-14 - Trust income

UK Property Income	£10,000
Tax paid	£2,000
Net income	£8,000
Trust management expenses £1,000	

Trustees' position

Gross UK Property Income	£10,000
Less tax due	- £2,000
Less expenses	- £1,000
Net income	£7,000

Beneficiary's position - TSEM8345
Net UK Property Income = £7,000
Grossed amount (£7,000 × 100 ÷ 80) = £8,750
The beneficiary will need to include the amount of £8,750 property income as his or her income for income tax purposes, and will receive credit for £1,750 tax paid by trustees.

Rather surprisingly, this applies even if the life interest is subject to an annuity: *Nelson v Adamson* 24 TC 36. But in practice annuities are not used so the point is of academic interest only.

For completeness: it has been suggested in a tentative and *obiter* (non-binding) comment, that this does not apply to trading income, at least for the purposes of DTAs.[15] However there is no sound basis for that distinction and the correct view is that the transparency principle applies generally.

It is possible to draft an English law trust so that under the terms of the trust the beneficiary is not entitled to a proprietary interest in the income as it arises, but merely has the right to call on the trustees to transfer to them a sum equal to the net income.[16] Then the trust (not the underlying

[15] *Huitson (R, oao) v HMRC* [2010] STC 715 at [54]. The point was not considered on appeal, see [2011] STC 1860.

[16] *R v Special Comrs ex p Shaftesbury House & Arethusa Training Ship* 8 TC 367 appears to be an example. But that case was decided before *Baker*, and it should be decided differently now.

assets) will be the source. In practice this is not normally done.[17]

42.9.3 *New York and "Garland" trusts*

Common form interest in possession type trusts governed by some foreign trust laws do not give the beneficiary the right to income as it arises, but only the right to recover a sum from the trustees.[18] The right is *in personam* not *in rem*. In this case the trust is not transparent and the beneficiary's income is classified as an Annual Payment (regardless of the type of income arising to the trustee).[19] The location of the source is where the trustee is resident.

This is so even if the beneficiary is described as "life tenant" and is, in economic reality, in the same position as a life tenant under an English law trust. In this respect, a *Garland* trust is like an English law estate of a deceased person, not an English law trust.

The TSE Manual provides:

> **TSEM10430 interest in possession trust - foreign law - Garland type trust** [Jul 2020]
> The beneficiary of a Garland type trust is entitled to his or her share of the net trust income remaining after the trustees have ascertained the balance available after meeting the expenses of administering the trust. The nature of the income that arose to the trustees is irrelevant, and the amount to which the beneficiary is entitled is regarded as an untaxed source of foreign income. Consequently, in the example at TSEM10425,[20] the entitlement of the interest in possession beneficiary would be to foreign income (untaxed) of £7,000 and not to UK property income.
> If the trustees have paid tax on some of the income chargeable, and the beneficiary wishes to obtain credit for the tax, refer to Trusts & Estates Nottingham.

[17] Except perhaps unit trusts: see 69.7 (Unauthorised UT: Foreign trustees).

[18] This assumes that the trust income consists of money. What if there is income in specie, such as a dividend of an asset in specie? Presumably the beneficiary has the right to demand that the trustees transfer the asset. It is a matter of foreign law, but if the asset is non-fungible and unique, eg shares in a private company, the life tenant might have the right to receive *that* asset in specie, which would suggest a right to that asset; ie one would apply a *Baker* analysis rather than a *Garland* analysis. That supports the view that *Garland/Baker* is a strange distinction to draw.

[19] *Garland v Archer Shee* 15 TC 693.

[20] See 42.9.2 (England and "Baker" trusts).

42.9.4 *Scots trusts*

A liferent (the Scottish term for a life interest) under a Scots trust in common form is not transparent.[21]

This has been reversed for UK resident Scots trusts; s.464 ITA provides:

> (1) This section applies if—
> (a) income arises to trustees under a trust having effect under the law of Scotland,
> (b) the trustees are UK resident, and
> (c) a beneficiary under the trust ("B") would have an equitable right in possession to the income if the trust had effect under the law of England and Wales.
>
> (2) B is treated for income tax purposes as having an equitable right in possession to the income (even though B has no such right under the law of Scotland).

It is difficult to see why the statutory rule only applies to UK resident trusts. It is difficult to see why it applies to Scotland and no other *Garland* jurisdictions. The reason is that it is not part of a coherent

[21] *Inland Revenue v Clark's Trustees* [1939] SC 11 at p.24:

> "There is no difference between the law of Scotland as regards the beneficiary's rights and the law which is admitted in the record to be the law of the State of New York;" "the right of property in the estate of the trust is vested in the trustees to the exclusion of any competing property, and the right of the beneficiary, ... as under the law of New York, is merely a right *in personam* against the trustees to enforce their performance of the trust."

https://www.kessler.co.uk/wp-content/uploads/2012/04/CIR-v-ClarksTrustees.pdf approved *Leedale v Lewis* 56 TC 501 at p.538. See too Scottish Law Commission, *Discussion Paper on the Nature and the Constitution of Trusts* (2006) para 2.5:

> "The beneficiary has a … right to compel the trustee to administer the trust funds in accordance with the provisions of the declaration of trust. This is a personal right. It is axiomatic that in Scots law the beneficiaries do not have a real right or a quasi-real right in the trust property. They have no proprietary interest in the trust fund."

http://www.scotlawcom.gov.uk See Smith, "Scottish trusts in the common law" [2013] Edin LR 283.

For the background to the distinct English/Scots laws of trusts, see *AG for Scotland v Murray Group Holdings* [2015] ScotCS CSIH 77 at [50]: "the theoretical nature of a trust is different, being based on the notion of legal estate and equitable interest in England, whereas in Scotland it is based on the notion of dual patrimonies of the trustee." The passage continues: "Nevertheless the practical results are similar, and the institution of the trust fulfils similar functions in both jurisdictions" but in this case the outcome is different.

regime for the taxation of trusts but a late Finance Bill amendment to deal with a narrow domestic anomaly.[22] In practice it will not often matter.

One can create a transparent Scots law trust with appropriate wording.[23]

42.9.5 *Critique*

The tax rules strictly require one to ask whether every trust jurisdiction is:

(1) a *Baker* jurisdiction (where the life tenant of a standard form IIP trust has a right to income as it arises); or

(2) a *Garland* jurisdiction (where the life tenant only has a right against the trustee).

That is a somewhat metaphysical question as it is difficult to pin down any practical consequence (other than tax) which arises from the answer.

The distinction between *Baker* and *Garland* trusts should be abolished. It has no economic substance and precious little legal basis. It is to a large extent undone by concession. This could easily be done by extending s.464 ITA to apply to all *Garland* trusts.[24]

42.10 Scots IT rates

HMRC say:

> Payments from interest in possession trusts and from deceased estates are subject to a deduction of tax at the basic rate when they are made to beneficiaries by trustees and personal representatives respectively. This means that beneficiaries who are basic rate taxpayers will have no further tax to pay.
>
> The Technical Note[25] proposed that the deductions by trustees and personal representatives should continue to be made at the UK basic rate (irrespective of whether the beneficiary was a Scottish taxpayer), but also that the income should always be taxed at UK rates in the hands of the beneficiary. This was to avoid basic rate taxpayer beneficiaries facing potentially small over or underpayments of tax if the Scottish

[22] See Scottish Law Commission, *Discussion Paper on Apportionment of Receipts and Outgoings* (2003) para 4.5 *http://www.scotlawcom.gov.uk/download_file/view/49/*

[23] "Scottish Trust beneficiaries are not entitled to specific items of trust property *unless that is expressly provided for in the Trust Deed*." Discussion Paper on Apportionment of Receipts and Outgoings para 4.5.

[24] For a precedent, see 90.11.3 (Garland trust: SDLT).

[25] HMRC, "Clarifying the Scope of the Scottish Rate of Income Tax Technical Note" (May 2012).

> basic rate differed from the UK basic rate.
>
> However, when preparing the legislation to achieve this, it has proved extremely complex to identify this income separately in the hands of the beneficiary so that a different treatment can be applied to it – in law, such income is currently grouped with any other income of the same type arising to the beneficiary (e.g. property income from a trust in this scenario is not distinct from property income arising to the individual in their own right).
>
> Given the degree of complexity for taxpayers that the necessary legislative changes would have brought about, the Government has instead decided that income from interest in possession trusts and deceased estates should be taxed at the Scottish rates when arising to Scottish taxpayer beneficiaries (no legislative change is required to achieve this).
>
> This decision has been taken on the basis that, although it is recognised that this could cause some administrative issues if the Scottish and UK rates diverge in future, such an eventuality is preferable to making an already complex area of legislation even more challenging for taxpayers.[26]

42.11 DT relief

In relation to trusts, three states may be concerned:

(1) The state where trust income arises
(2) The state where the trustees are resident
(3) The state where the beneficiary is resident

In this book I only consider the matter from a UK perspective: it will be necessary to consider foreign law viewpoints but that is outside the scope of this book.

In this chapter "beneficial ownership" is used in the treaty sense.[27] See Avery Jones, "The Treatment of Trusts under the OECD Model Convention [1989] BTR 65.

42.11.1 *Beneficial ownership reliefs*

Article 10 OECD Model convention provides:

[26] HMRC, "Clarifying the Scope of the Scottish Rate of Income Tax Technical Note" (Dec 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/389889/SRIT_Consequential_TechNote_vFinal.pdf*

[27] See App 6.1 (Beneficial ownership: Meanings).

> 1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.
> 2. However, dividends paid by a company which is resident of a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:
> a) 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends through a 365 day period that includes the day of the payment of the dividend (for the purpose of computing that periods, no account shall be taken of changes of ownership that would directly result from a corporate reorganisation, such as a merger or divisive reorganisation, of the company that holds the shares or that pays the dividend);
> b) 15 per cent of the gross amount of the dividends in all other cases.

Thus relief for UK dividends requires that the beneficial owner of the dividends is treaty-resident in the foreign jurisdiction.

Article 11 OECD Model convention provides:

> 1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.
> 2. However, interest arising in a Contracting State may also be taxed in that State according to the laws of that State, but if the beneficial owner of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount of the interest.

Thus relief for UK interest similarly requires that the beneficial owner of the interest is treaty-resident in the foreign jurisdiction.

Article 12(1) OECD Model convention provides:

> Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State.

Thus relief for UK royalties similarly requires that the beneficial owner of the royalties is treaty-resident in the foreign jurisdiction.

In some treaties beneficial ownership is added as a requirement even where it is not in OECD Model.

42.11.2 *Baker trusts*

In the case of Baker trusts, for the purposes of DT reliefs:

(1) The trust is transparent ie the underlying trust income is regarded as the income of the beneficiary.

(2) The life tenant is the beneficial owner of the trust income payable to the life tenant. So if the trust receives (say) interest income, the income of the beneficiary is classified as interest, and if the beneficiary is treaty-resident in a treaty jurisdiction with an article providing exemption from UK source interest, the income qualifies for this DT relief.

(3) The trustees (if otherwise taxable) qualify for DT relief to the extent that the beneficiary qualifies for the relief. This is another case of the trustees enjoying reliefs applicable to life tenants.

(4) The position is different for a receipt which is income for tax purposes and capital for trust law purposes: in that case the trustees are the beneficial owner of the income.

HMRC agree. International Manual provides:

> **INTM339540. Baker and Garland Trusts** [May 2020]
> ...
> ***Baker trusts***
> Where 'Baker' applies, you cannot treat the trustees as being beneficial owners of a trust's income as it arises. Instead it is the beneficiaries who are the beneficial owners.

That is correct. The Manual continues:

> Strictly, each beneficiary should claim in his or her own right.

This is not strictly correct. A trustee could in principle claim third-party DT relief in a case where a beneficiary failed to do so.[28] But nothing turns on that since HMRC do not apply what they identify as the strict law:

> In practice it is acceptable to allow relief to the trustees, provided that you can be satisfied that the beneficiaries are entitled to relief under the same double taxation agreement as that under which the trustees have claimed. If this is not the case you may allow partial relief to the trustees by reference to the percentage of the interests that are relievable under the same DTA as the trustees. The beneficiaries who are not resident in the same country as the trustees will need to make their own claims against the income distributed to them.

[28] See 109.1 (Third-party DT relief).

42.11.3 *Garland trusts*

In the case of *Garland* trusts, for the purposes of DT reliefs:

(1) The trustee is the beneficial owner of the trust income.

(2) The income of the beneficiary will qualify for DT relief under the "Other Income" article in OECD Model form (but not under the UK preferred form): see 41.12 (UK trust - non resident beneficiary: DT relief).

(3) Point (2) would cause great difficulties. However by concession HMRC will regard a *Garland* trust as transparent *Baker* trust for DT purposes. I refer to this as the "**Garland concession**".

International Manual provides:

> **INTM339540. Baker and Garland Trusts** [May 2020]
> ...
> ***Garland trusts***
> Where 'Garland' applies, you can, for the purposes of the double taxation agreement, treat the trustees as the beneficial owners of trust income as it arises and allow relief. This treatment is given because we consider that the beneficiary's right to income from the trust is against the trustees, rather than in the underlying assets held in trust. However, you should still establish the identity and residence of the beneficiaries. If any beneficiary is in the UK you should notify their tax office.

International Manual provides:

> **INTM166030. Garland trusts** [May 2020]
> In the case of income of a non-discretionary foreign trust of the type considered in the case of *Garland v Archer Shee* 15 TC 693, the beneficiaries are not concerned with the source of the trust income and whether or not it has borne UK tax. It is the practice to allow relief to beneficiaries, other than annuitants, in respect of the proportion of the income assessable as foreign income which is regarded as being derived from trust income which has borne United Kingdom tax. It is a condition of the relief that the amount of the income for higher rate purposes is to be treated as the sum of the amount assessable and the amount of tax on a grossed up basis which is applicable to the part of the assessment on which relief has been given.
> Submit the first claim from a beneficiary for this relief to CSTD, BAI, Assets Residence & Valuation before admitting the claim.
> **INTM166040. Foreign tax** [May 2020]
> Where foreign tax has been paid on trust income (including, in the case

> of dividends, any underlying tax where, exceptionally credit for such tax is due under the terms of an agreement – see INTM164410), it is the practice, in the case of a trust of a type referred to in INTM166030, to allow credit relief to beneficiaries, other than annuitants, for that foreign tax. Credit relief is given in the same way and to the same extent as if each beneficiary were entitled to his proportionate share of the underlying investments of the trust.

42.12 Baker or Garland trust jurisdiction?

The English courts assume that foreign trust jurisdictions apply English law principles in the absence of evidence to the contrary. But the Scottish courts will, I expect, assume Scots law principles, in the absence of evidence, with the opposite result. In practice HMRC have helpfully published a list which would constitute evidence which (in the absence of other evidence) a tribunal should be expected to accept.[29] This list only represents the HMRC view and could be challenged on the basis of expert evidence. The list assumes the trust has standard form wording. It is in principle possible to draft a non-transparent trust in a *Baker* jurisdiction. It may be possible to draft a transparent trust in a *Garland* jurisdiction by using non-standard wording.

The HMRC list is as follows. The endnotes are my own.

Argentina	No Trust Law	Denmark	Garland
Australia[1]		Egypt	Baker
New South Wales	Baker	Estonia	Baker
Queensland	Baker	Fiji	Baker
South Australia	Baker	France[4]	No Trust Law
Victoria	Baker	Ghana	Baker
Western Australia	Baker	Gibraltar	Baker
Bahamas	Baker	Guernsey	Baker
Barbados	Baker	Guyana	Baker
Belgium	No Trust Law	Hong Kong	Baker
Belize	Baker	Hungary	Baker
Canada[2]		India	Garland[5]
British Columbia	Baker	Ireland, Republic of[6]	Baker
Nova Scotia	Baker	Isle of Man	Baker
Ontario	Baker	Italy	No Trust Law[7]
Saskatchewan	Baker	Japan	No Trust Law
Quebec	Garland[3]	Jersey	Baker[8]
Cayman Islands	Baker	Kenya	Baker

[29] TSEM10423 [Jul 2020].

Latvia	Baker
Liechtenstein	Garland[9]
Lithuania	Baker
Luxembourg	Baker
Malaysia	Baker
Malawi	Baker
Malta	No Trust Law[10]
Monaco	No Trust Law
Montserrat	Baker
Namibia	Garland
Netherlands	No Trust Law[11]
New Hebrides	Baker
New Zealand	Baker
Nigeria	Baker
Norway	Garland
St Helena	Baker
St Vincent	Baker
Singapore	Baker
South Africa	Garland[12]
South Yemen	Baker
Spain	No Trust Law
Sri Lanka	Baker
Sweden	Garland
Trinidad & Tobago	Baker
Uganda	Baker
USA[13]	
New York	Garland
Minnesota	Garland
Montana	Garland
North Dakota	Garland
South Dakota	Garland
Wisconsin	Garland
All other states[14]	Baker
Zambia	Baker
Zimbabwe	Garland

[1] The list omits Tasmania, Northern Territory and Australian Capital Territory. It is considered that these are *Baker* jurisdictions.

[2] This seems correct: see *Minister of National Revenue* [1956] SCR 49 especially [1953] Ex CR 292 at p.297 *https://www.kessler.co.uk/wp-content/uploads/2012/04/Minister-of-National-RevenuevTrans-Canada.pdf* The list of Canadian jurisdictions omits Alberta, Manitoba, New Brunswick, Newfoundland and Labrador, Northwest Territories, Nunavut, Prince Edward Island and Yukon. It is suggested that these are the same as the other Canadian common law jurisdictions, i.e. *Baker* jurisdictions.

[3] This seems well founded in Art. 1261 Code Civil Québec:

Le patrimoine fiduciaire, formé des biens transférés en fiducie, constitue un patrimoine d'affectation autonome et distinct de celui du constituant, du fiduciaire ou du bénéficiaire, sur lequel aucun d'entre eux n'a de droit réel.	The trust patrimony, consisting of the property transferred to the trust, constitutes a patrimony by appropriation, autonomous and distinct from that of the settlor, trustee or beneficiary *and in which none of them has any real right*.

See also Gretton, "Trusts without Equity" (2000) 49 ICLQ 599 reprinted in Valsan (ed), *Trusts and Patrimonies* (2015) chap 5.

[4] France was omitted (accidentally?) from the version of the list published 1 April 2008, but the comment in the earlier version of the list is printed here as it is correct.

[5] *Duncan's Executors v Adamson* (1935) 14 ATC 22 so held. This seems soundly based on s.3 [India] Trusts Act 1882: "The 'beneficial interest' or 'interest' of the beneficiary is his right against the trustee as owner of the trust-property."

[6] The list omits Northern Ireland: this is a *Baker* jurisdiction.

[7] This is wrong: Italy does have a trust law.

[8] Harriet Brown agrees: see *Jersey Law of Trusts* (4th ed., 2013), 2.52.

[9] This will apply to a Treuhandschaft and *a fortiori* to other Liechtenstein entities classified as trusts; see 90.14 (Foundation: Stiftung); 90.16 (Treuunternehmen/Trust Enterprise). But in the case of a Treuhandschaft, the position may not be clear, as art 910(3) PGR does give a beneficiary some rights *in rem*.

[10] This is wrong: Malta has had a trust law since at least 1989. Section 9 [Malta] Trusts and Trustees Act 1989 provides: " A beneficiary has an entitlement, called a beneficial interest, in or to the trust property..."; so Malta is a *Baker* jurisdiction.

[11] This is wrong: The Netherlands does have a trust law.

[12] Honoré agrees: *South African Law of Trusts* (6th ed., 2018), para 302.

[13] New York was (rather implausibly) found to be a *Garland* jurisdiction in *Garland v Archer-Shee* 15 TC 693. The finding of fact in *Garland* was also made in *Timpson's Executors v Yerbury* 20 TC 155 at p.157, and was accepted as common ground in *Astor v Perry* 19 TC 255. See "Taxing Foreign Income from Pitt to the Tax Law Rewrite – The Decline of the Remittance Basis", Avery Jones in *Studies in the History of Tax Law*, 2004 p.46, *https://www.kessler.co.uk/wp-content/uploads/2013/12/Remittance-basis.pdf* for contrary views as to US law. Since foreign law is a question of fact, a court would not be bound by those decisions, but in practice they are not likely to be challenged.

[14] This may not be correct for all the other states. In particular, Ohio and New Jersey have been found to be *Garland* jurisdictions. See *The Marchioness of Ormond v Brown* 17 TC 333 at p.341, *Kelly v Rogers* 19 TC 692 at p.696. But see the above footnote. In *Lawson v Rolfe* 46 TC 199 it was common ground that California was a *Baker* jurisdiction.

CHAPTER FORTY THREE

RATES OF INCOME TAX/CGT/CT

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Cross references

The following topics are considered elsewhere:
41.2.1 (Discretionary-trust IT rates)

43.1 IT rates: Introduction

Rates of income tax vary according to:

(1) The type of income:
  (a) Savings Income
  (b) Dividend Income
  (c) Other income (not Savings/Dividend Income)
(2) The type of person receiving the income:
  (a) Individuals:
    (i) Scottish/Welsh taxpayers
    (ii) Other UK residents: England/Northern Ireland taxpayers
    (iii) Non-residents
  (b) Non-individuals:
    (i) Trusts
    (ii) Others
(3) The amount of income of an individual

This topic requires a book to itself.

43.2 IT rates in outline

IT rates on individuals are as follows:

Name	**Rate**	**Charge on amount**	**Applies to**
Main Rates			England/N. Ireland
Basic rate	20%	up to basic rate limit	
Higher rate	40%	above basic rate limit	
Additional rate	45%	above higher rate limit	
Default Rates			Non-residents
Default Basic Rate	20%	up to basic rate limit	
Default Higher Rate	40%	above basic rate limit	
Default Additional Rate	45%	above higher rate limit	
Dividend rates			Everywhere
Dividend nil rate	0%		
Dividend ordinary rate	8.75%	up to basic rate limit	
Dividend upper rate	33.75%	above basic rate limit	
Dividend additional rate	39.35%	above higher rate limit	
Savings Income rates			Everywhere
Starting rate for savings	0%	up to starting rate limit	
Savings nil rate	0%		
Savings basic rate	20%	up to basic rate limit	
Savings higher rate	40%	above basic rate limit	
Savings additional rate	45%	above higher rate limit	
Scottish rates			Scotland
Scottish starter rate	19%	up to £2,306	
Scottish basic rate	20%	£2,306 - £13,991	

Scottish intermediate rate	21%	£13,991 - £31,092	
Scottish higher rate	42%	£31,092 - £62,430	
Scottish advanced rate	45%	£62,430 - £125,140	
Scottish top rate	48%	above £125,140	
Welsh rates			Wales
Welsh basic rate	20%	up to basic rate limit	
Welsh higher rate	40%	above basic rate limit	
Welsh additional rate	45%	above higher rate limit	

It is therefore necessary to distinguish:

(1) The *names* of IT rates, of which we have 24

(2) The *numbers* ie *percentages*, of which we have 11:

(a) Everywhere: 0%; 8.75%, 20%, 33.75%, 39.35%, 40%, 45%

(b) and in Scotland, also: 19%, 21%, 42%, 48%

In outline, the rates are imposed as follows:[1]

Type of taxpayer	**Rates on**		
Individuals	*Savings Income*	*Dividend Income*	*Other income*
England/N Ireland	Savings rates	Dividend rates	Main Rates
Scottish taxpayer	Savings rates	Dividend rates	Scottish rates
Welsh taxpayer	Savings rates	Dividend rates	Welsh rates
Non-UK resident	Savings rates	Dividend rates	Default Rates
Non-individual			
IP trust/non-res. co.	Default Basic Rate	Dividend ord. rate	Default Basic Rate
Discretionary trust	Trust rate	Dividend trust rate	Trust rate

43.2.1 *Names of rates: Terminology*

The terminology used for the rates is unhelpful:

(1) The 5 rates called "additional" rates are in fact the top rates.[2]

(2) The 5 rates called "higher" rates are in fact intermediate rates, in the sense that they fall between the lowest rates and the top rates.

(3) Similarly, the dividend "upper" rate is an intermediate rate, in the sense that it falls between the dividend ordinary rate (which is not "ordinary") and the top dividend rate.

(4) The Scottish "intermediate" rate is intermediate, in the sense that it falls somewhere between the lowest and the top Scottish rates, but it is one of 4 rates which do that, any of which could be described as

[1] This is a reworked version of the summary table in s.9A ITA.

[2] The terminology is better in Scotland, which uses the term "top rate" and does not use the term "additional rate".

intermediate.

(5) The 3 rates called "Default Rates" are not "default" in the normal sense of the word: they do not apply by default. They apply to non-resident individuals and non-individuals.

(6) The term "Main Rates" (used to describe the basic/higher/additional rates) is inapt: they are not "main" in the normal sense of the word.

(7) The starting rate for savings is 0%, and so would more naturally be called a nil rate; but that term has already been taken by the savings nil rate.

I adopt the statutory terminology, as anything else would be even more confusing, but for clarity:

- I refer to the 5 "additional" rates as **"additional (top) rates"**
- I write Main Rates/Default Rates with initial capitals

When studying this topic it is important to keep these points of terminology in mind, or the reader may become confused.

For distinctions between nil-rates and allowances, see 44.1.1 (Allowances terminology).

43.3 Devolution issues

43.3.1 *Why devolve IT rates?*

The Institute for Government provide some wider context:[3]

> The choice of which taxes to devolve to Scotland and Wales reflects several constraints. The easiest taxes to devolve are those relating to land or property, given that revenue is very easy to attribute geographically, and these fixed assets cannot easily be moved in search of jurisdictions with lower tax. Of the larger taxes, income tax was judged to be the best option for devolution, partly because of its high visibility to taxpayers, but also because of difficulties that would have arisen from devolving other taxes. The UK-wide system for national insurance would have been particularly complicated to break up due to the link between the National Insurance Fund and benefit payments (which are not devolved in Scotland and Wales). Meanwhile, devolving control of VAT rates would not have been compatible with EU law, and would also have created new costs for businesses operating across the

[3] Institute for Government, "Devolution at 20" (2019) *https://www.instituteforgovernment.org.uk/sites/default/files/publications/Devolution%20at%2020.pdf*

UK's four nations, and corporation tax was ruled out as an option for devolution in Scotland and Wales as it could (?) have resulted in unwelcome tax competition within Great Britain.[4]

43.3.2 *Complexity*

While devolution requires separate Scottish/Welsh rates, why do we have *four* types of basic rate (basic rate and Scottish/Welsh/Default basic rates); and likewise for the higher and additional (top) rates? This is to satisfy constitutional proprieties:

(1) The Scots/Welsh rates allow Scotland/Wales to set different tax rates
(2) The basic/Default Rates satisfied the requirements of EVEL (English votes for English laws)[5]; it allowed the Main Rates (which affect England/Northern Ireland) to be voted on separately from the Default Rates (which do not).

It is complicated; but devolution and simplicity are conflicting values. CIOT anticipated the complexity:

> 3.5 Scottish taxpayers will face a more complex system than taxpayers in the rest of the UK, since
> [1] their savings [and dividend] income will be subject to UK income tax rates and
> [2] their [non-savings non-dividend] income will be subject to Scottish income tax rates... This could make it difficult for many Scottish taxpayers to fully understand their tax calculations and liabilities.[6]

[4] IfG cite: Smith Commission, Report of the Smith Commission for Further Devolution of Powers to the Scottish Parliament, Smith Commission, 2014, p. 23, *https://webarchive.nationalarchives.gov.uk/ukgwa/20141209040654/http://www.smith-commission.scot/wp-content/uploads/2014/11/The_Smith_Commission_Report-1.pdf*
Commission on Devolution in Wales (Silk Commission), Empowerment and Responsibility: Financial powers to strengthen Wales, Commission on Devolution in Wales (Silk Commission), 2012, p. 83
https://webarchive.nationalarchives.gov.uk/20140605075122/http://commissionondevolutioninwales.independent.gov.uk

[5] EVEL was introduced in 2015 and abolished in 2021; see
https://en.wikipedia.org/wiki/English_votes_for_English_laws

[6] CIOT response to the paper implausibly entitled "Scotland in the United Kingdom: An enduring settlement" (2015)
https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/361e31bb-1780-4237-ad32-7df71f0f5538/150331%20Scotland%20in%20the%20United%20Kingdom%20-%20An%20enduring%20settlement%20-%20CIOT%2

In the 2018/19 edition of this work I said:

> This comment implies that UK taxpayers outside the Scottish rate system "fully understand" their tax calculations which readers of this chapter may think highly improbable.

But the challenge is not just for taxpayers but also for HMRC. In 2019 HMRC issued a number of tax calculations to Scottish taxpayers which incorrectly apply UK-wide rates instead of specific Scottish rates.[7] Readers might speculate whether HMRC would consider penalties appropriate, if a taxpayer made a similar mistake.

43.3.3 *Public understanding*

CIOT comment plaintively on public understanding of the Welsh rates:

> ... awareness and understanding of the WRIT by the public in Wales remains low despite considerable efforts to engage the public. Low levels of understanding in relation to the tax system are a national not just a devolved taxes issue. ... Realistically it is however challenging to generate interest when rates are aligned so the practical effect for most Welsh taxpayers is limited to the PAYE C code.[8]

Would anyone expect otherwise? It is rational to be clueless about the Welsh rates of income tax. There is no financial penalty for being wrong. The same is often true of the tax system more generally.

43.3.4 *IT competition within UK*

The Scottish Government have considered this:

> On the one hand, behavioural effects between Scottish and rUK taxpayers may be even more significant than standard assumptions because labour mobility between Scotland and the rest of the UK could be larger than between the UK and, say, the rest of Europe. This is because there are no cultural or language barriers and many individuals have much closer ties with the rest of the UK and may therefore relocate easily. In addition, many top rate taxpayers may be able to

0comments.pdf
Also see Eden, "All fur coat and nae knickers" [2018] BTR 25.

[7] CIOT News Service for CTAs (11 Jan 2019).

[8] CIOT, "The fifth Welsh Parliament" Mar 2021 *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/ec887d7a-5f7c-4182-a91d-3e7aa9256f22/210308-fifth-welsh-parliament.pdf*

> choose their residency within the UK, particularly if they are employed or working in UK–wide businesses. It would also be possible for individuals to live in England but continue to work in Scotland or vice versa. In addition, instead of migrating physically, high-income Scottish taxpayers could move their residence by rearranging their domestic affairs – for example by deciding to spend more time at a London flat than in an Edinburgh house, and making the flat their base.
>
> On the other hand, income tax in Scotland will apply to non-savings non-dividend income only. Since this is largely income from employment, there are fewer opportunities for individuals to artificially minimise their tax liabilities compared to income from savings and dividends. Therefore, for those serving the Scottish market or based in Scottish institutions, it may be more difficult to engage in behaviours that reduce their Scottish tax burden. This could reduce the scale of the potential behavioural response.[9]

The practical effect of these considerations was to prevent the Scottish Government from raising the Scottish rate of income tax to 50%.[10] But the higher and top rates increased one further percentage point in 2023 and the top rate increased again in 2024. Perhaps the thinking is that incremental changes will not have the same effect. We will have to wait and see.

For some individuals with homes in Scotland and rUK, it can be finely balanced whether they are Scottish taxpayers or not: a small change in lifestyle may make the difference. In computing the loss to Scotland of a taxpayer moving jurisdiction, or incorporating an unincorporated business, one must bear in mind that the loss to Revenue Scotland is not the (relatively small) difference between the Scots/rUK rates; it is the whole of the income tax payable by that individual (which after migration is credited to rUK, not to Scotland).[11]

Similar considerations apply in Wales.[12]

[9] The Scottish Government, "The impact of an increase in the additional rate of income tax from 45p to 50p in Scotland" (2016)

[10] 2018 saw the Scots higher/additional rates nudge up to 41%/46%, but an increase to 50% was again rejected for the same reason: Scottish Government, "The Role of Income Tax in Scotland's Budget" at p.23 *http://www.gov.scot/Resource/0052/00527052.pdf*

[11] Except so far as Scotland may benefit from an increased grant, under the Barnett formula.

[12] See Welsh Parliament Finance Committee, "Impact of variations in national and sub-national income tax" (2020)

43.3.5 *Devolved rates: DTAs*

HMRC say:

> As the Scottish rate of income tax is not a discrete tax[13] it remains covered by existing UK double taxation agreements.[14]

43.4 Dividend/Savings Income

It is helpful next to consider the definitions of these terms.

43.4.1 *"Dividend Income"*

Dividend Income is defined in s.19 ITA:

> (1) This section applies for the purposes of the Income Tax Acts.
> (2) "Dividend income" is income which is—

There are 5 categories of Dividend Income:[15]

ITTOIA	Type of income	See para
Chap 3 Part 4	Dividend/distribution of UK resident company	30.3
Chap 4 Part 4	Dividends of non-UK resident company	30.8.1
Chap 5 Part 4	Stock dividends of UK resident company	*Not discussed*
Chap 6 Part 4	Release of loan to participator in close co	*Not discussed*
Chap 8 Part 5	Relevant foreign distributions[16]	30.8.4

That applies to distributions of non-resident companies other than dividends (which are Dividend Income as they are within Chapter 4). The drafting is cumbersome, but it works.

"Dividend Income" is not wholly apt to describe these categories of income, but it serves as a short label. "Dividend-type income" would be

https://senedd.wales/laid%20documents/cr-ld13276/cr-ld13276-e.pdf

[13] Author's footnote: This is self-evident, but if authority is needed, see *London County Council v Attorney General* 4 TC 265.

[14] HMRC, "Clarifying the Scope of the Scottish Rate of Income Tax Technical Note" (2012).

[15] For clarity I have set this out in tabular form and use my own terminology, rather than a precise quote of the statute.

[16] Defined s.19(3) ITA:
"In subsection (2) "relevant foreign distribution" means a distribution of a non-UK resident company which—
(a) is not chargeable under Chapter 4 of Part 4 of ITTOIA 2005, but
(b) would be chargeable under Chapter 3 of that Part if the company were UK resident."

slightly more accurate but it seems best to adopt the statutory terminology. I write it with initial capitals to reflect the technical nature of the term.

43.4.2 *"Savings Income"*

Savings Income is defined in s.18 ITA:

> (1) This section applies for the purposes of the Income Tax Acts.
> (2) "Savings income" is income—
> (a) which is within subsection (3) or (4), and
> (b) which is not relevant foreign income charged in accordance with section 832 of ITTOIA 2005 (relevant foreign income charged on the remittance basis).

There are five categories of Savings Income within s.18(3) and (4). Section 18(3) ITA lists interest and interest-like income:

> Income is within this subsection if it is—

There are 4 categories of income within s.18(3):[17]

Provision	**Type of income**	**See para**
ITTOIA		
Chap 2 Part 4	Interest	26.1
Chap 7 Part 4	Purchased life annuity payments[18]	*Not discussed*
Chap 8 Part 4	Deeply discounted securities	29.1
ITA		
Chap 2 Part 12	Accrued income profits	28.1

Section 18(4) ITA is chargeable event income:[19]

> Income is within this subsection if—
> (a) it is chargeable under Chapter 9 of Part 4 of ITTOIA 2005 (gains from contracts for life insurance etc), and
> (b) an individual is, or personal representatives are, liable for income tax on it (under section 465 or 466 of that Act).

"Savings Income" is not apt to describe these categories of income, but it serves as a short label and there is no better term. I write it with initial capitals to reflect the technical nature of the term.

[17] For clarity I have set this out in tabular form and use my own terminology, rather than a precise quote of the statute.

[18] other than income from annuities specified in s.718(2) ITTOIA (annuities purchased from certain life assurance premium payments or under wills).

[19] See 70.1 (Policies: Introduction).

There is again no good short term to describe these categories. "Earned income" is misleading, though it might be used as a shorthand term in some simple contexts.

43.4.3 *Savings/Dividends top of income*

Section 16 ITA(1) provides:

> This section has effect for determining—[20]

The section then identifies six purposes for which s.16 rules apply, numbered, non-numerically of course, (za) to (b):

Para	**Topic**
(za)	which part of a Scottish taxpayer's income consists of savings income
(zb)	the rate at which IT would be charged on the non-savings income of a Welsh taxpayer apart from s.11B ITA
(a)	the extent to which income up to the starting rate limit for savings consists of savings income,
(aa)	the extent to which income above the starting rate limit for savings consists of savings income, and
(ab)	the rate at which IT would be charged on savings income above the starting rate limit for savings apart from sections 11D and 12A,
(b)	the rate at which IT would be charged on dividend income apart from s.13.

Section 16(1) is just a signpost provision; s.16(2) ITA applies the s.16 rules more widely:

> It [s.16] also has effect for all other income tax purposes except for the purposes of—
>
> (a) section 491 (special rates not to apply to first slice of trustees' trust rate income), and
>
> (b) sections 535 to 537 of ITTOIA 2005 (gains from contracts for life insurance etc: top slicing relief).

Section 16 ITA then provides the rules:

> (3) If a person has savings income but no dividend income,[21] the

[20] For clarity I have set this out in slightly abbreviated tabular form, rather than a precise quote of the statute.

[21] Section 16(7) ITA provides: "References in this section to dividend income do not include dividend income which is relevant foreign income charged in accordance with section 832 of ITTOIA 2005 (relevant foreign income charged on the remittance basis)."

> savings income is treated as the highest part of the person's total income.
>
> (4) If a person has dividend income but no savings income, the dividend income is treated as the highest part of the person's total income.
>
> (5) If a person has both savings income and dividend income—
>
> (a) the savings income and dividend income are together treated as the highest part of the person's total income, and
>
> (b) the dividend income is treated as the higher part of that part of the person's total income.

In short, Dividend Income comes at the top, then Savings Income, then other income.

Section 16(6) ITA provides:

> See section 1012 for the relationship between—
>
> (a) the rules in this section, and
>
> (b) other rules requiring particular income to be treated as the highest part of a person's total income.[22]

43.5 IT rates: Figures

This paragraph sets out the provisions which specify the *amounts* or *percentages* of the 23 IT rates; the paragraphs which follow identify identifies the types of income to which each of those rates apply.

43.5.1 *Main Rates*

Section 6(1) ITA defines the expression "Main Rates":

> The main rates at which income tax is charged are–
>
> (b) the basic rate,
>
> (c) the higher rate, and
>
> (d) the additional rate.

What are the rates? Section 6(2) ITA provides:

> The basic rate, higher rate and additional rate for a tax year are the rates determined as such by Parliament for the tax year.

So we turn to s.2 F(no.2)A 2024:

> For the tax year 2024-25 the main rates of income tax are as follows—
>
> (a) the basic rate is 20%;
>
> (b) the higher rate is 40%;

[22] See App.2.25 (Highest part of income).

(c) the additional rate is 45%.

Section 989 ITA provides:

> The following definitions apply for the purposes of the Income Tax Acts—
> "basic rate" means the rate of income tax determined in pursuance of section 6(2),
> "higher rate" means the rate of income tax determined in pursuance of section 6(2),
> "additional rate" means the rate of income tax determined in pursuance of section 6(2)

In other words, references to basic/higher/additional rates are, unless otherwise indicated, references to the Main Rates.

43.5.2 *Scottish rates*

Section 80C(1) Scotland Act 1998 provides:

> The Scottish Parliament may by resolution (a "Scottish rate resolution") set the Scottish basic rate, and any other rates, for the purposes of section 11A of the Income Tax Act 2007 (which provides for the income of Scottish taxpayers which is charged at those rates).

The resolution was made 22 February 2024, and provides:

> That the Parliament agrees that, for the purposes of section 11A of the Income Tax Act 2007 (which provides for Income Tax to be charged at Scottish rates on certain non-savings and non-dividend income of a Scottish taxpayer to be charged above the personal allowance), the Scottish rates and limits for the tax year 2024-25 are as follows—
> (a) a starter rate of 19 per cent, charged on income up to a limit of £2,306,
> (b) the Scottish basic rate is 20 per cent, charged on income above £2,306 and up to a limit of £13,991,
> (c) an intermediate rate of 21 per cent, charged on income above £13,991 and up to a limit of £31,092,
> (d) a higher rate of 42 per cent, charged on income above £31,092 and up to a limit of £62,430,
> (e) an advanced rate of 45 per cent, charged on income above £62,430 and up to a limit of £125,140, and
> (f) a top rate of 48 per cent, charged on income above £125,140.

Scottish tax rates are distinct not just in amount but also by distinct

Scottish bands. The new 45% ‘advanced’ rate of tax for incomes below the top rate is an innovation of 2024/25.

43.5.3 *Scots rates: Analysis*

The starter rate is symbolic. In round terms, a 1% discount on the first £2k of income saves the taxpayer some £20.

Different rates raise the issue of tax equalisation for those posted to Scotland (and in due course, Wales).[23] Until 2018, tax equalisation was only an issue for those posted abroad.[24]

See too 1.3.1 (Tax competition within UK).

43.5.4 *Welsh rates*

Section 116D(1) Government of Wales Act 2006 provides:

> The Assembly may by resolution (a “Welsh rate resolution”) set one or more of the following—
> (a) a Welsh rate for the purpose of calculating the Welsh basic rate;
> (b) a Welsh rate for the purpose of calculating the Welsh higher rate;
> (c) a Welsh rate for the purpose of calculating the Welsh additional rate.

Section 6B(1) ITA provides:

> The Welsh basic rate, the Welsh higher rate and the Welsh additional rate for a tax year are calculated as follows.
> *Step 1* Take the basic rate, higher rate or additional rate.
> *Step 2* Deduct 10 percentage points.
> *Step 3* Add the Welsh rate (if any) set by the National Assembly for Wales for that year for the purpose of calculating the Welsh basic rate,

[23] The issue arose in the context of the armed forces: “The UK government is looking at ways to “counter tax rises” for armed forces personnel based in Scotland.... Gavin Williamson (then defence secretary) confirmed an “urgent review” is under way to look at how to counter “the unjustified raid on pay packets”: (2018) *http://www.bbc.co.uk/news/uk-scotland-43363923*
But the wording was tendentious and the story was political, not fiscal. Just as “the art of taxation consists in so plucking the goose as to procure the largest quantity of feathers with the least possible amount of hissing”, the art of opposition is to maximise the hiss.

[24] See 34.43 (Tax equalisation).

> the Welsh higher rate or the Welsh additional rate (as the case may be).

The relevant resolution provides:

> a) the proposed Welsh rate for the basic rate of income tax is 10p;
> b) the proposed Welsh rate for the higher rate of income tax is 10p; and
> c) the proposed Welsh rate for the additional rate of income tax is 10p.[25]

So the Welsh basic higher/additional rates are the same as for England/ Northern Ireland.

The Welsh rules are based on the Scottish Variable Rate, which was introduced by the Scotland Act 1998 but later replaced by the current Scottish rules.

43.5.5 *Default Rates*

Section 6C ITA provides:

> The default basic rate, default higher rate and default additional rate for a tax year are the rates determined as such by Parliament for the tax year.

So we turn to s.3(1) F(no.2)A 2024:

> For the tax year 2024-25 the default rates of income tax are as follows—
> (a) the default basic rate is 20%;
> (b) the default higher rate is 40%;
> (c) the default additional rate is 45%.

Note that s.989 ITA provides:

> "basic rate" means the rate of income tax determined in pursuance of section 6(2)[26]

That is, a reference to the basic rate is not a reference to the (so called) default basic rate.

43.5.6 *Savings Income rates*

Section 7 ITA provides:

[25] The same rate has been proposed for 2024-2025.
https://www.gov.wales/written-statement-welsh-devolved-taxes-and-welsh-rates-income-tax-draft-budget-2024-25
The rate might more clearly be expressed as 10%, not 10p, but it does not matter.

[26] See 43.5.1 (Main Rates).

> (1) The starting rate for savings is 0%.
> (2) The savings nil rate is 0%.

Section 7A ITA provides:

> The savings basic rate, savings higher rate and savings additional rate for a tax year are the rates determined as such by Parliament for the tax year.

So we turn to s.3(2) F(no.2)A 2024:

> For the tax year 2024-25 the savings rates of income tax are as follows—
> (a) the savings basic rate is 20%;
> (b) the savings higher rate is 40%;
> (c) the savings additional rate is 45%.

I refer to these together as **"savings rates"**.

43.5.7 *Dividend rates*

Section 8 ITA provides:

> (A1) The dividend nil rate is 0%.
> (1) The dividend ordinary rate is 8.75%,
> (2) The dividend upper rate is 33.75%.
> (3) The dividend additional rate is 39.35%.

I refer to these together as **"dividend rates"**.

43.6 IT rates: Application

Armed with the relevant terminology, I turn to identify the types of income to which each IT rate applies.

43.6.1 *Application of Main Rates*

Section 10 ITA imposes the charge at the Main Rates (basic/higher/additional rates):

> (2) Income tax on an individual's income up to the basic rate limit is charged at the basic rate.
> (3) Income tax is charged at the higher rate on an individual's income above the basic rate limit and up to the higher rate limit.
> (3A) Income tax is charged at the additional rate on an individual's income above the higher rate limit.

So the Main Rates apply to an individual's income, ie they apply generally unless disapplied by other provisions. They are, in a sense, default rates (though the term Default Rates is used elsewhere, and there are so many exceptions that the Main Rates are frequently disapplied.

Section 10(4) ITA signposts exceptions. In short:

Section	**Topic**
s.11A	Scottish rates
s.11B	Welsh rates
s.11C	Default Rates: non-UK residents
s.11D	Savings basic/higher/additional rates
s.12	Starting rate for savings
s.12A	Savings nil rate
s.13	Dividend rates

43.6.2 *"Basic/higher rate limits"*

Section 10(5) ITA provides the figure for the basic rate limit:

> The basic rate limit is £37,700.

This figure is frozen until 2028.[27]

Section 10(5A) ITA provides a formula for the higher rate limit:

> The higher rate limit for a tax year is equal to—
> (a) twice the amount specified in subsection (1) of section 35 (personal allowance) for the tax year, plus
> (b) the amount specified in subsection (2) of that section (amount at which personal allowance starts to be withdrawn).

Section 6(4) F(nol.1)A 2023 provides the figure:

> For each of the tax years 2023-24, 2024-25, 2025-26, 2026-27 and 2027-28, the amount of the higher rate limit is £125,140.

For the effect of freezing these limits, see 43.19 (Inflation/fiscal drag).

43.6.3 *Application of Scottish rates*

Section 11A ITA provides:

> (1A) Income tax is charged at Scottish rates on the non-savings income of a Scottish taxpayer.[28]

[27] Section 5(1) FA 2021, as amended.

[28] See 6.43 (Scottish/Welsh taxpayers).

> (4) For the purposes of this section, “non-savings income” means income which is not savings income.

So the Scottish rates apply to Scottish taxpayers non-Savings income unless disapplied by other provisions. Section 11A(5) ITA signposts exceptions; the main one is s.13 (dividend rates).[29] So Scottish rates apply to non-Savings/Dividend Income of a Scottish taxpayer.

43.6.4 *Application of Welsh rates*

Section 11B ITA provides:

> (1) Income tax is charged at the Welsh basic rate on the income of a Welsh taxpayer[30] which—
> (a) is non-savings income, and
> (b) would otherwise be charged at the basic rate.
> (2) Income tax is charged at the Welsh higher rate on the income of a Welsh taxpayer which—
> (a) is non-savings income, and
> (b) would otherwise be charged at the higher rate.
> (3) Income tax is charged at the Welsh additional rate on the income of a Welsh taxpayer which—
> (a) is non-savings income, and
> (b) would otherwise be charged at the additional rate.
> (4) For the purposes of this section, “non-savings income” means income which is not savings income.

Section 11B(5) ITA signposts exceptions; the main one is s.13 (dividend rates).[31] So Welsh rates apply to non-Savings/Dividend Income of a Welsh taxpayer.

43.6.5 *Application of Default Rates*

Section 11(1) ITA provides:

> Income tax is charged at the default basic rate on the income of persons other than individuals.

So the Default Basic Rate applies to:

[29] The remittance basis charge is another exception, see 17.12.16 (Scottish/Welsh taxpayer).

[30] See 6.43 (Scottish/Welsh taxpayers).

[31] The remittance basis charge is another exception, see 17.12.16 (Scottish/Welsh taxpayer).

(1) trustees where the trust rates does not apply
(2) non-resident companies where subject to IT
(3) PRs

The Default Basic Rate applies unless disapplied by other provisions. Section 11(2) ITA signposts exceptions, in short:
(1) s.14 ITA (dividend ordinary rate)
(2) Chapters 3 to 6 Part 9 ITA (trusts[32])

Section 11C ITA provides:

> (1) Income tax on a non-UK resident individual's income up to the basic rate limit is charged at the default basic rate.
> (2) Income tax is charged at the default higher rate on a non-UK resident individual's income above the basic rate limit and up to the higher rate limit.
> (3) Income tax is charged at the default additional rate on a non-UK resident individual's income above the higher rate limit.

The Default Rates apply to non-UK resident individual's income unless disapplied by other provisions. Section 11C(4) ITA signposts exceptions, in short:

Section	**Topic**
s.11D	savings basic/higher/additional rates
s.12	starting rate for savings
s.12A	savings nil rate
s.13	dividend rates

43.7 Application of savings rates

Section 11D ITA provides:

> (1) Income tax is charged at the savings basic rate on an individual's income which–
> (a) is saving income,[33] and
> (b) would otherwise be charged at the basic rate or the default basic rate.

Since the savings basic rate, the basic rate and the Default Basic Rate are all 20%, this does not have any effect.

[32] For rates of tax on trustees, see 41.2 (Tier 1: Income receipt: trust charge).
[33] This is a slip for Savings Income.

> (2) Income tax is charged at the savings higher rate on an individual's income which–
>
> (a) is savings income, and
>
> (b) would otherwise be charged at the higher rate or the default higher rate.

Since these rates are all 40%, this does not have any effect.

> (3) Income tax is charged at the savings additional rate on an individual's income which–
>
> (a) is savings income, and
>
> (b) would otherwise be charged at the additional rate or the default additional rate.

Since these rates are all 45%, this does not have any effect.

These savings rates apply to Savings Income unless disapplied by other provisions. Section 11D(4) ITA provides:

> Subsections (1) to (3)–
>
> (a) have effect after sections 12 and 12A [starting rate for savings/savings nil rate] have been applied (so that any reference in subsections (1) to (3) to income which would otherwise be charged at a particular rate does not include income charged at the starting rate for savings or at the savings nil rate), and
>
> (b) are subject to any other provisions of the Income Tax Acts (apart from sections 10 and 11C [Main Rates, Default Rates]) which provide for income to be charged at different rates of income tax in some circumstances.

Section 11D(6) ITA provides:

> In relation to an individual who is a Scottish taxpayer or Welsh taxpayer, references in this section to income which would otherwise be charged at a particular rate are to be read as references to income that would, if the individual were neither a Scottish taxpayer nor a Welsh taxpayer (but were UK resident), be charged at that rate (and subsection (5) is to be read accordingly).

43.8 Starting rate for savings

Section 12(1) ITA provides:

> Income tax is charged at the starting rate for savings on so much of an individual's income up to the starting rate limit for savings as–

> (a) is savings income, and
> (b) would otherwise be charged at the basic rate or the default basic rate.

As the starting rate for savings is 0%, this is in effect an allowance or exemption.

Section 12(3) ITA provides:

> The starting rate limit for savings is £5,000.

As to how one identifies an individual's "income up to the starting rate limit", see 43.4.3 (Savings/Dividends top of income).

In short, the starting rate for savings is not available to a taxpayer who has non-Savings Income in excess of the starting rate limit for savings. So in practice the benefit of the starting rate for savings is limited to:

(1) UK resident individuals with very low income
(2) Non-resident individuals with very low UK source income

The starting rate for savings applies to Savings Income unless disapplied by other provisions. Section 12(2) ITA provides:

> This is subject to any provisions of the Income Tax Acts (apart from section 10) which provide for income of an individual to be charged at different rates of income tax in some circumstances.

43.9 Savings nil rate

43.9.1 "*Step 3 income*"

The legislation uses the term "Step 3 income", defined s.12A(7) ITA:

> For the purposes of this section, an individual's "Step 3 income" is the individual's net income less allowances deducted at Step 3 of the calculation in section 23.

The allowances deducted are the personal allowance and the blind person's allowance.

43.9.2 *The nil rate*

Section 12A(1) ITA provides:

> (1) This section applies in relation to an individual if—
> (a) the amount of the individual's Step 3 income is greater than £L, where £L is the amount of the starting rate limit for savings, and

"L" stands for the starting rate **L**imit [£5k].

> (b) when the individual's Step 3 income is split into two parts—
> (i) one ("the individual's income up to the starting rate for savings") consisting of the lowest £L of the individual's Step 3 income, and
> (ii) the other ("the individual's income above the starting rate limit for savings") consisting of the rest of the individual's Step 3 income,
>
> some or all of the individual's income above the starting rate limit for savings consists of savings income (whether or not some or all of the individual's income up to the starting rate limit for savings consists of savings income).

Section 12A(2) ITA defines two more letters. In short:

"A" is the individual's savings **a**llowance
X (for "**ex**cess") is Savings Income above A (the individual's savings allowance). In full detail s.12A(2) ITA provides:

> In this section—
> £A is the amount of the individual's savings allowance (see section 12B),
> "the excess" is so much of the individual's income above the starting rate limit for savings as consists of savings income, and
> £X is the amount of the excess.

Armed with the meaning of these letters, we can turn to the relief. Section 12A ITA provides:

> (3) If £X is less than or equal to £A, income tax is charged at the savings nil rate (rather than the basic, higher or additional rate) or the default basic, default higher or default additional rate on the excess.
> (4) If £X is more than £A, income tax is charged at the savings nil rate (rather than the basic, higher or additional rate) or the default basic, default higher or default additional rate on the lowest £A of the excess.

The reader may think that this could have been more clearly expressed. The savings nil rate applies unless disapplied by other provisions. Section 12A(5) ITA provides:

> Subsections (3) and (4) are subject to any provisions of the Income Tax Acts (apart from sections 10 and 11C) which provide for income to be charged at different rates of income tax in some circumstances.

43.9.3 *Amount of savings allowance*

Section 12B ITA provides:

> (1) Subsections (2) to (4) determine the amount of an individual's savings allowance for a tax year.
> (2) If any of the individual's income for the year is additional-rate income, the individual's savings allowance for the year is nil.
> (3) If—
> (a) any of the individual's income for the year is higher-rate income, and
> (b) none of the individual's income for the year is additional-rate income,
> the individual's savings allowance for the year is £500.
> (4) If none of the individual's income for the year is higher-rate income, the individual's savings allowance for the year is £1,000.

These are cliff-edge rules, so an additional £1 income may cost £100 in tax. But anything else would have been even more complicated.

Section 12B(8)(a)(b) ITA define additional-rate/higher rate income. The definitions follow the same template so it is helpful to consider them side by side:

(8) For the purposes of this section—

(a) each of the following is "additional-rate income"—	(b) each of the following is "higher-rate income"—
(i) income on which income tax is charged at the additional rate, default additional rate or dividend additional rate,	(i) income on which income tax is charged at the higher rate, default higher rate or dividend upper rate,
(ii) income on which income tax would be charged at the additional rate, or default additional rate, but for section 12A (income charged at savings nil rate),	(ii) income on which income tax would be charged at the higher rate, or default higher rate, but for section 12A (income charged at savings nil rate),
(iii) income on which income tax would be charged at the dividend additional rate but for section 13A (income charged at dividend nil rate), and	(iii) income on which income tax would be charged at the dividend upper rate but for section 13A (income charged at dividend nil rate), and
(iv) income of an individual who is a Scottish taxpayer or Welsh taxpayer	(iv) income of an individual who is a Scottish taxpayer or Welsh taxpayer

which would, if the individual were not a Scottish taxpayer or Welsh taxpayer (as the case may be), be income on which income tax is charged at the additional rate or default additional rate	which would, if the individual were not a Scottish taxpayer or Welsh taxpayer (as the case may be), be income on which income tax is charged at the higher rate or default higher rate.

43.9.4 *Interest under remittance basis*

If the remittance basis applies, foreign interest income[34] (if remitted) is taxed at

(1) the Main Rates, ie, at 20%, 40%, 45%, or
(2) for Scottish/Welsh taxpayers, the Scottish/Welsh rates

This is achieved by the clumsy but effective technique of providing that such income is not Savings Income. But in practice the amount at stake will be trivial, or most likely, nil.

43.10 Application of dividend rates

43.10.1 *Dividend rates for individuals*

Section 13(1)-(2A) ITA adopt the same template so it is helpful to consider them side by side:

Dividend ordinary rate	**Dividend upper rate**	**Dividend additional rate**
(1) Income tax is charged at the dividend ordinary rate on an individual's income which—	(2) Income tax is charged at the dividend upper rate on an individual's income which—	(2A) Income tax is charged at the dividend additional rate on an individual's income which—
(a) is dividend income,	[identical]	[identical]
(b) would otherwise be charged at the basic rate or the Welsh basic rate and	(b) would otherwise be charged at the higher rate or the Welsh higher rate, and	(b) would otherwise be charged at the additional rate or the Welsh additional rate, and
(c) is not relevant foreign income	(c) is not relevant foreign income	[identical to 2]

[34] Including the interest-like income of the other categories specified in s.18(4) ITA.

charged in accordance with section 832 of ITTOIA 2005 (relevant foreign income charged on the remittance basis).	charged in accordance with section 832 of ITTOIA 2005.

These rates apply unless disapplied by other provisions. Section 13(3) ITA provides:

> Subsections (1) to (2A) are subject to any provisions of the Income Tax Acts (apart from section 10 or 11A or 11B) which provide for income to be charged at different rates of income tax in some circumstances.

Section 13(4) ITA provides:

> Section 16 has effect for determining the extent to which an individual's dividend income would otherwise be charged at the basic, higher or additional rate or the Welsh basic, higher or additional rate.

See 40.4.3 (Savings/Dividends top of income).

Section 13(5) ITA provides:

> In relation to an individual who is a Scottish taxpayer, references in this section to income that would otherwise be charged at a particular rate are to be read as references to income that would, if the individual were not a Scottish taxpayer, be charged at that rate (and subsection (4) is to be read accordingly).

The scheme of s.13 is to replace the basic/higher/additional rates with different rates. Thus the rates of tax on UK Dividend Income are the dividend ordinary/upper/additional rates: 8.75%, 33.75%, 39.35%. I refer to that as **"dividend rates"**.

Foreign Dividend Income is taxed at the dividend rates when the arising basis applies.

43.10.2 *Dividend nil rate*

SA110 Notes (Tax calculation summary notes) 2022/23 provides:

> Where an individual receives dividend income that would otherwise be chargeable at the dividend ordinary, upper or additional rate, and the income is less than or equal to £2,000,[35] the dividend nil rate will apply

[35] For 2023/24 the £2,000 figures is reduced to £1,000.

> to all of the dividend income. Where the dividend income is above £2,000, the lowest part of the dividend income will be chargeable at 0%, and anything received above £2,000 is taxed at the rate that would apply to that amount if the dividend nil rate did not exist.

The rules are in s.13A ITA, which refers to:
D: Dividends charged at **D**ividend ordinary rate[36]
U: Dividends charged at dividend **U**pper rate
M: M = D - £1,000[37]
A: Dividends charged at dividend **A**dditional rate
X: X = (D + U) - £1,000

Section 13A ITA provides:

> (1) Subsection (2) applies if, ignoring this section, at least some of an individual's income would be charged to income tax at the dividend ordinary rate, the dividend upper rate or the dividend additional rate.
> (2) Income tax is charged at the dividend nil rate (rather than the dividend ordinary rate, dividend upper rate or dividend additional rate) on one or more amounts of the individual's income as follows—
> *Step 1*
> Identify the amount ("D") of the individual's income which would, ignoring this section, be charged at the dividend ordinary rate.
> *Rule 1A:* If D is more than £1,000, the first £1,000 of D is charged at the dividend nil rate (rather than the dividend ordinary rate), and is the only amount charged at the dividend nil rate.
> *Rule 1B:* If D is equal to £1,000, D is charged at the dividend nil rate (rather than the dividend ordinary rate), and is the only amount charged at the dividend nil rate.
> *Rule 1C:* If D is less than £1,000 but more than nil, D is charged at the dividend nil rate (rather than the dividend ordinary rate).
> *Step 2*
> If D is less than £1,000, identify the amount ("U") of the individual's income which would, ignoring this section, be charged at the dividend upper rate.
> *Rule 2A:* If the total of D and U is more than £1,000—
>
> (a) the first £M of U is charged at the dividend nil rate (rather than the dividend upper rate), where £M is the difference between £1,000 and D, and

[36] **"O"** would have been a better choice of letter.
[37] What is **"M"** meant to stand for? Perhaps Middle; or Muddle.

(b) the amounts charged under this Rule and Rule 1C are the only amounts charged at the dividend nil rate.

Rule 2B: If the total of D and U is equal to £1,000, U is charged at the dividend nil rate (rather than the dividend upper rate), and the amounts charged under this Rule and Rule 1C are the only amounts charged at the dividend nil rate.

Rule 2C: If the total of D and U is less than £1,000 but more than nil, U is charged at the dividend nil rate (rather than the dividend upper rate).

Step 3

If the total of D and U is less than £1,000, identify the amount ("A") of the individual's income which would, ignoring this section, be charged at the dividend additional rate.

Rule 3A: If the total of D, U and A is more than £1,000, the first £X of A is charged at the dividend nil rate (rather than the dividend additional rate), where £X is the difference between—

£1,000, and

the total of D and U,

and the amounts charged under this Rule, and Rules 1C and 2C, are the amounts charged at the dividend nil rate.

Rule 3B: If the total of D, U and A is less than or equal to £1,000, A is charged at the dividend nil rate (rather than the dividend additional rate), and the amounts charged under this Rule, and Rules 1C and 2C, are the amounts charged at the dividend nil rate.

Why is the drafting so convoluted? It appears to be a clumsy application of step-based drafting.[38]

The dividend nil rate is sometimes called the dividend allowance, but it is better to use the statutory term.[39]

The figure of £1k is reduced to £500 from 2024/25, at which point the dividend nil rate becomes trivial.

See too 30.16 (Dividend nil rate/DTA interaction).

43.10.3 *Dividends: Remittance basis*

Foreign Dividend Income taxed on the remittance basis does not fall within:

(1) s.13 (dividend rates): it does not meet the condition in s.13(1)(c) or s.13(2)(c) or s.13(2A)(c). The Main Rates apply (which are higher).

[38] See 61.15.7 (Method statements: Critique).

[39] See 44.1.1 (Allowances terminology).

(2) s.13A (dividend nil rate): it does not meet the condition in s.13A(1).

The amounts involved may be substantial. The result is that for a remittance basis taxpayer who remits, foreign Dividend Income is taxed more heavily than UK Dividend Income.

The discrimination was contrary to EU law. But the issue may not arise post-Brexit.

43.10.4 *Dividends: Non-individual*

Section 14(1) ITA provides:

> Income tax is charged at the dividend ordinary rate on the income of persons other than individuals which—
> (a) is dividend income,
> (b) would otherwise be charged at the basic rate, and
> (c) is not relevant foreign income charged in accordance with section 832 of ITTOIA 2005 (relevant foreign income charged on the remittance basis).[40]

This applies to:
(1) trustees where the trust rates do not apply
(2) non-resident companies
(3) PRs

See too 30.7 (Non-resident recipient).

43.11 Settlor-interested trust IT rate

Section 619 ITTOIA provides (so far as relevant):

> (1) Income tax is charged on—
> (a) income which is treated as income of a settlor as a result of section 624 (income where settlor retains an interest),
> (b) income which is treated as income of a settlor as a result of section 629 (income paid to relevant children of settlor)...
> (2) For the purposes of Chapter 2 of Part 2 of ITA 2007 (rates at which income tax is charged), where income of another person is treated as income of the settlor and is charged to tax under subsection (1)(a) or (b) above, it shall be charged in accordance with whichever provisions of the Income Tax Acts would have been applied in charging it if it had

[40] Section 14(1)(c) is otiose from 2008, since the remittance basis can only apply to individuals; but it does no harm.

arisen directly to the settlor.

What about foreign Dividend Income which qualifies for the s.624 remittance basis, but is later remitted and becomes taxable under the s.624 remittance basis?[41] This is taxable at the dividend rates.

43.12 s.720: transferor IT rate

The starting point is that s.720 income is taxed at:
(1) the Main Rates or
(2) for a Scots/Welsh taxpayer, the Scots/Welsh rates

Section 745(4) ITA applies the dividend rates where the income of the person abroad is Dividend Income. The wording is convoluted. First, s.745(1)(1A)(1B)(2) provide the transferor's credit.[42] With this in mind we can continue to s.745(3)(4):

> (3) Subsection (4) applies to income treated as arising to an individual under section 721 or 728 so far as none of subsections (1), (1A) and (1B) applies to it.
> (4) The charge to income tax under section 720 or 727 operates by treating the income as if it were income within section 19(2) (meaning of "dividend income") if the income mentioned in section 721(2) or 728(1)(a) [the income of the person abroad[43]] would be dividend income were it the income of the individual.

Dividend Income is taxed at the rates applicable to dividends: the dividend ordinary/dividend upper rates. What about foreign dividends of the person abroad, taxed under the s.720 remittance basis? That is still Dividend Income, so is still taxed at the dividend rates.

Section 745 ITA provides a special rule for Dividend Income. It says nothing about Savings Income. Accordingly, interest and other Savings Income within s.720 is taxed at the main (or Scottish/Welsh) rates.

43.13 CGT rates: Introduction

43.13.1 *Summary*

Rates of CGT vary according to:
(1) The type of gain:

[41] See 47.8 (s.624 remittance basis).
[42] See 51.2.1 (Transferor's credit).
[43] See 49.14 (Condition A: Power to enjoy).

(a) Ordinary gain
(b) Residential property/carried interest gain

(2) The type of person receiving the gain:
(a) Individuals
(b) Non-individuals:
(i) Trusts
(ii) Others

(3) The amount of income/gains of the individual

There are five rates of CGT:

Rate	**Basic rate taxpayer**	**Higher rate taxpayer/trust/PRs**
10%	Ordinary gain	
18%	Residential/carried interest gain	
20%		Ordinary gain
24%		Residential gain
28%		Carried interest gain

There are three types of gain:

Type of gain	**Definition**	**See para**
Residential property gain	sch 1B TCGA	57.37
Carried interest gain	s.1H TCGA	73.19
Other gain ("Ordinary gain")	-	-

The 24% rate was introduced in 2024. Another complication. According to Spring Budget 2024:

> This will encourage landlords and second home-owners to sell their properties, making more available for a variety of buyers including those looking to get on the housing ladder for the first time, while also raising revenue over the forecast period.

I doubt if anyone was intended to take that seriously.

The predicted yield from this change also seems strange:

2023-24	2024-25	2025-26	2026-27	2027-28	2028-29
-70m	+310m	+350m	+45m	+50m	+5m

But there it is.

43.14 CGT rates: Individuals

Section 1H(1) TCGA provides:

> This section makes provision about the rates at which capital gains tax

> is charged but has effect subject to—
>
> (a) section 169N (business asset disposal relief: rate of 10%), and
>
> (b) section 169VC (investors' relief: rate of 10%).

43.15 *Residential gain*

Section 1H(1A) TCGA provides:

> (1A) Residential property gains (see Schedule 1B) accruing in a tax year to an individual are charged to capital gains tax at a rate of 18% or 24%.
>
> (4A) Residential property gains accruing in a tax year to the personal representatives of a deceased individual are charged to capital gains tax at a rate [of][44] 24%.

43.15.1 *Carried interest gain*

Section 1H(2) TCGA provides:

> Chargeable gains accruing in a tax year to an individual that are—[45]
>
> (b) carried interest gains (see subsections (9) to (11)),
>
> are charged to capital gains tax at a rate of 18% or 28%.

43.15.2 *Individual: Ordinary gain*

I refer to gains which are not residential/carried interest gains as **"ordinary gains"**.

Section 1H TCGA provides:

> (3) Other chargeable gains accruing in a tax year to an individual are charged to capital gains tax at a rate of 10% or 20%.
>
> (4) The question as to which of the rates applies to the gains concerned is determined by section 1I (income taxed at higher rates or gains exceeding unused basic rate band).

43.15.3 *Basic/higher CGT rates*

This takes us to s.1I TCGA which provides:

> (1) If any of an individual's income for a tax year is chargeable to income tax at a higher income tax rate,[46] gains accruing to the

[44] This word is accidentally missing from the F(no2) Bill.

[45] There is no para (a).

[46] Section 1J(1) TCGA provides:
(1) For the purposes of section 1I—

individual in the tax year are charged—

(za) at the rate of 24% (if they are residential property gains),

(a) at the rate of 28% (if they are carried interest gains), or

(b) at the rate of 20% (if they are other kinds of gains).

(2) If—

(a) none of an individual's income for a tax year is chargeable to income tax at a higher income tax rate, but

(b) the individual is chargeable to capital gains tax for the tax year on an amount that exceeds the unused part of the individual's basic rate band,

the excess ("the higher rate excess") is charged at the rate of 24% (so far as comprising residential property gains), at the rate of 28% (so far as comprising carried interest gains) or at the rate of 20% (so far as comprising other kinds of gains).

(3) The remainder of this section sets out special rules which apply depending on the nature of the gains within subsection (2)(b).

[Subsections (4) to (6) concern business asset disposal relief not discussed here]

(7) The individual may allocate so much of the unused part of the individual's basic rate band as then remains to—

(a) any residential property gains or carried interest gains, or

(b) any other gains.

(8) The effect of the allocation is that the gains to which the allocation is made are charged—

(a) at the rate of 18% (if they are residential property gains or carried interest gains), or

(b) at the rate of 10% (if they are other kinds of gains).

(9) Any gains to which no allocation is made are charged—

(za) at the rate of 24% (if they are residential property gains),

(a) at the rate of 28% (if they are carried interest gains), or

(b) at the rate of 20% (if they are other kinds of gains).

43.15.4 *Scots/Welsh CGT payers*

Section 1J(6) TCGA provides:

In the application of section 1I in the case of any individual it is to be assumed that the individual is not a Scottish or Welsh taxpayer.

a "higher income tax rate" means—

(a) the higher rate or the default higher rate,

(b) the savings higher rate, or

(c) the dividend upper rate

CGT rates tax depend on the UK rates and thresholds. So, a Scottish taxpayer with earned income and chargeable gains has to consider UK and Scottish rates and thresholds. CIOT comment:

> ... this is something that could make it difficult for many taxpayers to fully understand their tax calculations and liabilities.[47]

But there it is.

43.16 CGT rates: PRs

Section 1H TCGA provides:

> (5) Chargeable gains accruing in a tax year to the personal representatives of a deceased individual that are—[48]
> (b) carried interest gains,
> are charged to capital gains tax at a rate of 28%.
> (6) Other chargeable gains accruing in a tax year to the personal representatives of a deceased individual are charged to capital gains tax at a rate of 20%.

43.17 CGT rates: Trusts

Section 1H TCGA provides:

> (7) Residential property gains accruing in a tax year to the trustees of a settlement are charged to capital gains tax at a rate of 24%.
> (8) Other chargeable gains accruing in a tax year to the trustees of a settlement are charged to capital gains tax at a rate of 20%.

UK trusts are treated in the same way as higher rate taxpayers.

43.18 CGT rates: Critique

FA 2016 made a significant reduction in CGT rates. HMRC say:

> The government wants to create a strong enterprise and investment culture. Cutting the rates of CGT for most assets is intended to support companies to access the capital they need to expand and create jobs.

[47] CIOT response to the paper implausabily entitled "Scotland in the United Kingdom: An enduring settlement" (2015) *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/361e31bb-1780-4237-ad32-7df71f0f5538/150331%20Scotland%20in%20the%20United%20Kingdom%20-%20An%20enduring%20settlement%20-%20CIOT%20comments.pdf*

[48] There is no para (a).

> Retaining the 28% and 18% rates for residential property is intended to provide an incentive for individuals to invest in companies over [residential] property.[49]

This is not serious policy analysis: it is advocacy. That is not to say that it might not be right, as far as the reduction concerns gains from shares.

Complexity, and, for upper rate assets, the CGT lock-in effect, are serious issues, but not addressed.

43.19 Inflation/fiscal drag

I consider tax rates in this chapter and allowances in the next. But for policy discussion one needs to consider them together. IFS comment:

> The personal allowance has risen by almost 60% in real terms over the past decade, reducing income tax revenue by an eye-watering £25 billion per year and meaning that 40% of adults do not pay any income tax at all. The planned freeze, representing a 7% real-terms cut, undoes only a small share of that rise, and brings another 1.3 million people into the income tax system.
>
> By contrast, the higher-rate threshold is already 9% below its 2009 peak in real terms, and the freeze will bring it 16% below. It has not kept up with earnings growth over recent decades, meaning that steadily more and more people have become subject to it. While fewer than 4% of adults paid higher-rate tax in 1990, by the time the freeze is over that figure will likely be more than 10%.[50]

The rising number of people subject to the higher rate was a point that Boris Johnson raised in his campaign for Conservative Party leadership, with a uncosted headline proposal to raise the threshold to £80k. But nothing came of that, and perhaps it was not meant to be taken seriously.

The former £150k higher rate limit had not been increased since introduced in 2009.

IFS say:

> Unlike many other countries, the UK routinely – and sensibly – uprates the cash values of most tax thresholds and benefit rates each year in line with inflation, in order to maintain their real value.

[49] HMRC, "Overview of Tax Legislation and Rates" (2016) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/513073/OOTLAR_complete_for_publication.pdf*
The passage also appears in EN FB 2016.

[50] *https://ifs.org.uk/collections/spring-budget-2021-0*

In a number of cases, however, this routine uprating has now been cancelled for extended periods:

- The inheritance tax threshold has been fixed at £325,000 since 2009–10.
- The VAT registration threshold has been frozen at £85,000 since April 2017, and the last Budget announced that it would remain frozen until April 2022.

Some of these policies raise revenue; others give money away[51]. But in neither case is it sensible policymaking.

When George Osborne announced a four-year freeze to benefit rates in his 2015 post-election Budget, he presumably did not intend that this would lead to an average loss among benefit recipients of zero in year 1 and £70 in year 2 before jumping to £270 in year 3 and £420 in year 4 as inflation rose. The government might believe that benefits should be more or less generous, but the extent of any change in generosity should be thought through and justified, not the arbitrary and accidental result of what the rate of inflation turns out to be.

Yet at least these cases are ostensibly temporary...

Perhaps more insidious is the gradual retreat from the assumption that inflation adjustments are the norm. When governments introduce new thresholds into the tax system, they are increasingly tending to build in the assumption that these thresholds will not routinely keep pace with inflation.

There have always been some thresholds that have not kept pace with inflation. Thresholds for SDLT, for example, are not increased routinely in line with inflation (let alone property price growth); instead, the rather unsatisfactory approach seems to be that the thresholds are kept frozen in cash terms until the number of purchases being dragged into tax reaches levels deemed unacceptable, and the threshold is then suddenly doubled (as happened in both 1993 and 2005, in both cases after more than a decade of being essentially frozen).

But over the past decade or so, this has moved from being a rare exception to being commonplace. New features of the tax landscape – from the apprenticeship levy allowance to the employment allowance in National Insurance, from the lifetime allowance for entrepreneur's relief to the personal savings allowance and the dividend allowance [dividend nil rate]– are frozen by default. In all of these cases, this builds in an assumption of rising taxes over time – tax rises which are both opaque (some would say stealthy) and depend arbitrarily on the rate of inflation...

[51] Author’s footnote: but that is quite rare.

> As for the withdrawal of the personal allowance, the number of people affected is growing much more rapidly as the bottom of the 60% band is frozen while the width of the band rises twice as quickly as the personal allowance, which the government has not merely been uprating with inflation but increasing rapidly in real terms.[52]

The list of non-indexed amounts mentioned above is just a start. The £2k and £10k remittance basis claim limits have not been increased since introduced in 2008. CGT allowable expenditure (base cost) is not indexed, so CGT is a tax on inflationary gains as well as economic gains.

The IFS are right, and the point is worth making. But taxation by stealth is a difficult temptation to refuse, and it would need a strong norm in favour of indexation to overcome that. Rates and allowances are at the heart of the interface of taxation and politics: they are salient and (relatively) easy to state.

As far as tax is concerned, inflation is the chancellor's friend.

43.20 Rates of CT

Section 3(1) CTA 2010 provides:

> Corporation tax is charged at the rate set by Parliament for the financial year[53] as the main rate.

That takes us to s.12 F(no2)A 2024 which provides:

> (1) Corporation tax is charged for the financial year 2025.
> (2) The main rate of corporation tax for that year is 25%.

The main rate applies to profits over £250k. Companies with profits of up to £50k may qualify for the small profits rate of 19%.

43.20.1 *Small profits rate*

The legislation is in Part 3A CTA 2010, slotted in after s.18, so the sections are numbered s.18A - s.18N. I consider this in outline only.

Section 18A CTA 2010 provides:

> (1) Corporation tax is charged at the standard small profits rate on a company's taxable total profits of an accounting period which are not

[52] Extracts from: IFS, "Dragging people into higher rates of tax" IFS Briefing Note BN247 (2019) *https://ifs.org.uk/sites/default/files/output_url_files/BN247.pdf*
I have omitted references to benefits and other matters outside the focus of this book.

[53] See 14.3.2 (Tax year/Financial year).

> ring fence profits if—
> (a) the company is UK resident in the accounting period,
> (b) it is not a close investment-holding company in the period, and
> (c) its augmented profits of the accounting period do not exceed the lower limit.
>
> (2) In this Act "the standard small profits rate" means a rate that—
> (a) is lower than the main rate, and
> (b) is set by Parliament for the financial year as the standard small profits rate.

That takes us to s.13 F(no2)A 2024 which provides:

> For the purposes of Part 3A of CTA 2010, for the financial year 2025—
> (a) the standard small profits rate is 19%, and
> (b) the standard marginal relief fraction is 3/200ths.

The small profits rate was abolished in 2014, providing a significant simplification, rare in UK tax. But it was restored in 2023 as a result of the increase in corporation tax rates and so we have returned to its complexities.

Companies with profits of £50k - £250k will pay at the main rate reduced by a marginal relief providing a gradual increase in the effective Corporation Tax rate. The relief is restricted for associated companies.[54]

The issue of LLP *v* company structure choice needs to be recomputed.

43.20.2 *Close investment-holding company*

Section 18N CTA 2010 provides:

> (1) For the purposes of this Part, a close company ("the candidate company") is a close investment-holding company in an accounting period unless throughout the period it exists wholly or mainly for one or more of the permitted purposes set out in subsection (2).
> There is an exception to this rule in subsection (5).
>
> (2) The candidate company exists for a permitted purpose so far as it exists—
> (a) for the purpose of carrying on a trade or trades on a commercial basis,
> (b) for the purpose of making investments in land, or estates or interests in land, in cases where the land is, or is intended to be, let commercially (see subsection (3)),

[54] For the definition of this term, see 104.17.1 ("Associated company").

(c) for the purpose of holding shares in and securities of, or making loans to, one or more companies each of which—

(i) is a qualifying company, or

(ii) falls within subsection (4),

(d) for the purpose of co-ordinating the administration of two or more qualifying companies,

(e) for the purpose of the making of investments as mentioned in paragraph (b)—

(i) by one or more qualifying companies, or

(ii) by a company which has control of the candidate company, or

(f) for the purpose of a trade or trades carried on on a commercial basis—

(i) by one or more qualifying companies, or

(ii) by a company which has control of the candidate company.

(3) For the purposes of subsection (2)(b), any letting of land is taken to be commercial unless the land is let to—

(a) a person connected with the candidate company ("a connected person"), or

(b) a person who is—

(i) the spouse or civil partner of a connected person,

(ii) a relative of a connected person, or the spouse or civil partner of a relative of a connected person,

(iii) a relative of the spouse or civil partner of a connected person, or

(iv) the spouse or civil partner of a relative of the spouse or civil partner of the connected person.

(4) A company falls within this subsection (see subsection (2)(c)(ii)) if—

(a) it is under the control of the candidate company or of a company which has control of the candidate company, and

(b) it exists wholly or mainly for the purpose of holding shares in or securities of, or of making loans to, one or more qualifying companies.

(5) If a company is wound up and was not a close investment-holding company in the accounting period that ends (by virtue of section 12(2) of CTA 2009) immediately before the winding up starts, the company is not treated for the purposes of this Part as being a close investment-holding company in the subsequent accounting period.

(6) In this section "qualifying company" means a company which—

(a) is under the control of the candidate company or of a company which has control of the candidate company, and

(b) exists wholly or mainly for either or both of the purposes mentioned in subsection (2)(a) or (b).

(7) In this section—

“control” has the meaning given by section 450, and

“relative” means brother, sister, ancestor or lineal descendant.

CHAPTER FORTY FOUR

PERSONAL ALLOWANCES

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Cross references

The following topics are considered elsewhere:
36.8 (PAYE to recover personal allowance)
App. 11.2.4 (Visiting forces: Personal allowances)

44.1 Personal allowances: Introduction

This chapter considers:
(1) IT personal allowances
(2) CGT annual exemption

CGT is relatively straightforward, but a full discussion of IT personal allowances would need a short book. I focus on the aspects closest to the themes of this book.

An HM Treasury consultation paper (the **"PA Consultation Paper"**), though now dated, provides some interesting background.[1]

[1] HM Treasury, "Restricting non-residents' entitlement to the UK personal allowance" (2014) *https://www.gov.uk/government/consultations/restricting-non-residents-*

I do not consider the £500 exemption for low income estates and trusts.[2]

44.1.1 *Allowances terminology*

Act	**Statutory term**	**My Term**
ITA	Personal allowances	IT personal allowances
TCGA	Annual exemption	CGT annual exemption

I refer to these together as "**IT/CGT personal allowances**".

CIOT comment on the term "allowance":

> [The term "allowance"] is commonly understood to mean an amount that can be deducted from income, before calculating the tax on that income, for example, in the case of the personal allowance.
> However, the personal savings allowance and dividend allowance[3] ... cause confusion, because they are not allowances in the commonly understood sense of the term. Rather, they are 0% bands of tax. That is, the taxpayer does not deduct them from income before working out their tax; instead, they apply them when they are calculating the actual tax due using the rates and bands of income tax.
> Another example is the marriage allowance. Although the giver of the marriage allowance transfers part of their personal allowance to their partner (say £1,250 in 2020/21), the recipient does not receive additional personal allowance. Rather, they receive 20% of the amount transferred (say £250 in 2020/21), which they can offset against their income tax liability – it is thus a tax reducer or a tax credit in the hands of the recipient, rather than an allowance.[4]

Is that criticism pedantic? Discuss.

The meaning of "allowances" could matter if a statutory provision contained references to "allowances" (undefined), but I cannot think of any actual example.

entitlement-to-the-uk-personal-allowance/restricting-non-residents-entitlement-to-the-uk-personal-allowance

[2] Section 24B ITA.

[3] See 43.8 (Starting rate for savings); 43.9 (Savings nil rate). The terms "dividend allowance" and "personal savings allowance" were used in the 2016 press releases, but not in the legislation, so perhaps PCO agreed.

[4] CIOT, Response to consultation The future of Welsh law: classification, consolidation, codification (Jan 2020).

44.2 CGT annual exemption

44.2.1 *Annual exemption: Individuals*

Section 1K(1) TCGA provides the CGT annual exemption:

> If an individual is (or, apart from this section, would be) chargeable to capital gains tax for a tax year on chargeable gains, the annual exempt amount for the year is to be deducted from those gains (but no further than necessary to eliminate them).

This applies to resident and non-resident individuals, though non-residents are less likely to pay CGT, so they may not need the exemption.

Unlike the IT personal allowance, a claim is not needed. But a person who has gains (even within the annual exemption) is required to notify HMRC, if they do not otherwise put in a tax return.[5]

Section 1K(2) TCGA specifies the amount:

> The annual exempt amount for a tax year is £6,000.

The amount for 2024/05 and subsequently is to be £3,000.[6]

Assuming the rate of CGT remains at 20%, the amount of tax at stake then reduces to £600, and the allowance ceases to be of much importance.

Section 1K(4) TCGA deals with the interaction with loss relief:

> The deduction of the annual exempt amount—
> (a) is made after the deduction of allowable losses accruing in the tax year, but
> (b) is made before the deduction of allowable losses accruing in a previous tax year or, if section 62 applies, in a subsequent tax year.

44.2.2 *Annual exemption: PRs*

Section 1K(7) TCGA provides:

> For the tax year in which an individual dies and for the next two tax years, this section applies to the individual's personal representatives as if references to the individual were to those personal representatives.

44.2.3 *Exemption used in best way*

Section 1K(5) TCGA provides:

[5] See 121.3 (Duty to notify: Exemption).

[6] Section 8 F(no.1)A 2023.

> The annual exempt amount may be deducted from gains in whatever way is most beneficial to a person chargeable to capital gains tax (irrespective of the rate of tax at which the gains would otherwise have been charged).

Contrast 63.9 (Losses used in best way).

44.2.4 *Annual exemptions: Trusts*

Para 5 sch 1C TCGA 1992 provides:

> (1) This paragraph applies if settlement is not a settlement for the benefit of a disabled person for a tax year.
> (2) Section 1K applies in relation to the trustees of the settlement for the year[7] as it applies in relation to an individual for the year but as if the annual exempt amount for the year were one-half of the amount available for the individual for the year.
> (3) This paragraph needs to be read be with—
> (a) paragraph 6 (cases where settlement is qualifying UK settlement comprised in a group), and
> (b) paragraph 8 (sub-fund settlements).

For application to s.87 gains, see 61.6.5 (CGT annual exemption).

44.2.5 *Grouped trusts*

Para 6 sch 1C TCGA provides:

> (1) This paragraph reduces the annual exempt amount for trustees of a settlement for a tax year if the settlement is one of two or more qualifying UK settlements comprised in a group.
> (2) [This concerns disabled trusts, not discussed here.]
> (3) In the case of any other settlement, the annual exempt amount for the year is to be reduced so that it is equal to—
> (a) one-tenth of an individual's amount for that year, or
> (b) the amount resulting from dividing half of an individual's amount for that year by the number of settlements in the group,
> whichever is the greater.
> (4) In this paragraph "an individual's amount", in relation to a tax year, means the annual exempt amount applying to an individual for the year

[7] Para 1 sch 1C TCGA provides:
> (4) In this Schedule any reference to the application of section 1K in relation to an individual for a tax year is to its application in relation to an individual who is resident and domiciled in the United Kingdom for the year.

> under section 1K.
> (5) For the purposes of this paragraph all qualifying UK settlements in relation to which the same person is the settlor constitute a group.
> (6) If—
> (a) two or more persons are settlors in relation to a settlement, and
> (b) a settlement is consequently comprised in two or more groups comprising different numbers of settlement, sub-paragraphs (2)(b) and (3)(b) have effect by reference to the largest group.

Para 7 sch 1C TCGA provides:

> (1) In this Schedule "qualifying UK settlement", in relation to a tax year, means any settlement in relation to which both of the following conditions are met—
> (a) the trustees of the settlement are resident in the United Kingdom during any part of the tax year, and
> (b) the property comprised in the settlement is not held for a charitable or pensions purpose.
> (2) Property comprised in a settlement is held for a charitable purpose if (and only if)—
> (a) it is held for charitable purposes only, and
> (b) it cannot become applicable for other purposes.
> (3) Property comprised in a settlement is held for a pensions purpose if (and only if) it is held for the purposes of—
> (a) a registered pension scheme,
> (b) a superannuation fund to which section 615(3) of the Taxes Act applies, or
> (c) an occupational pension scheme (within the meaning of section 150(5) of the Finance Act 2004) that is not a registered pension scheme.
> (4) For this purposes of any provision of this Schedule other than paragraph 8 a settlement is not a qualifying UK settlement if—
> (a) in the case of one for the benefit of a disabled person, it was made before 10 March 1981, or
> (b) in any other case, it was made before 6 June 1978.

44.3 IT personal allowances

Chapter 2 Part 3 ITA contains two allowances, the personal allowance and the blind person's allowance. I do not consider the latter.

Section 35(1) ITA provides:

> An individual who makes a claim is entitled to a personal allowance of £12,570 for a tax year if the individual meets the requirements of

> section 56 (residence etc).

The personal allowance had political salience, as a result of which it increased substantially. But it is now frozen until 2028. [8] The full picture, as always in tax, is more complicated.[9]

The PA consultation paper claimed that the UK has the highest personal allowance in the G20 and one of the largest in OECD and the EU.[10] No attempt was made to explain the basis of that claim. I expect it was based on a simple comparison of headline rates. That is likely to mislead, because what matters is not only the amount of the allowance but also the terms on which it is available. It is like comparing headline rates of tax without considering the tax base. A serious study of the point would paint a more complicated picture. I do not attempt that here.

44.4 Allowance in year of birth/death

Section 41(1) ITA provides:

> Any allowance to which an individual is entitled under this Chapter for any tax year, including the tax year in which the individual dies, is given in full.

That seems a generous rule, but it makes for simplicity.

44.5 IT allowances: high earners

Section 35(2) ITA provides:

> For an individual whose adjusted net income exceeds £100,000, the allowance under subsection (1) is reduced by one-half of the excess.

Thus (at 2021/22 rates) taxpayers with "adjusted net income" between £100k and £125,000 the marginal rate of income tax is 60% (61.5% in Scotland).

The £100k limit has not been increased since introduced in 2009.[11]

This rule was a parting shot from the Blair/Brown administration. It has

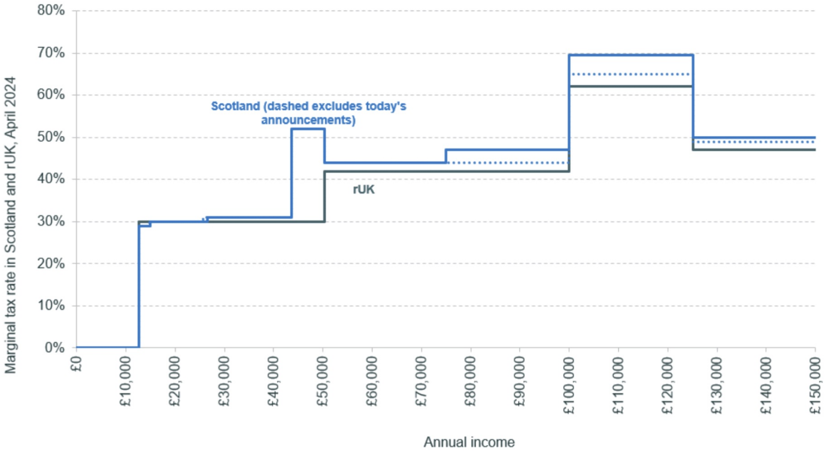
[8] Section 5(2) FA 2021 (as amended).

[9] See 43.6.2 ("Basic/higher rate limits").

[10] HM Treasury, "Restricting non-residents' entitlement to the UK personal allowance" (July 2014) para 3.1. *https://www.gov.uk/government/consultations/restricting-non-residents-entitlement-to-the-uk-personal-allowance/restricting-non-residents-entitlement-to-the-uk-personal-allowance*

[11] See 43.19 (Inflation/fiscal drag).

incurred strong criticism from the IFS[12] ("the absurd and arbitrary marginal income tax band"). And IFS as usual have done the graph for us:[13]



But no-one has taken any notice.

The definition of "adjusted net income" is best approached in three stages:

Term	**Definition**	**See para**
Total income	s.23 ITA Step 1	41.5.1
Net income	s.23 ITA Step 2	41.5.2
Adjusted net income	s.58 ITA	41.5.3

44.5.1 *Total income*

Section 23 ITA provides:

> To find the liability of a person ("the taxpayer") to income tax for a tax year, take the following steps.
> *Step 1* Identify the amounts of income on which the taxpayer is charged to income tax for the tax year.
> The sum of those amounts is "total income".
> Each of those amounts is a "component" of total income.

In *Asplin v White*:[14]

[12] IFS, *Tax By Design* (2011) para 4.3.1. (A Straightforward Income Tax Schedule).

[13] Differences in marginal tax rates between Scotland and the rest of the UK (2024-25) *https://ifs.org.uk/articles/initial-ifs-response-scottish-budget*

[14] 49 TC 93; for further discussion of this case, see 15.8 (Receipt by nominee/trustee).

> "total income" is necessarily beneficial income, and so sums received in a fiduciary capacity could not be included

44.5.2 *Net income*

Section 23 ITA provides:

> *Step 2* Deduct from the components the amount of any relief under a provision listed in relation to the taxpayer in section 24 to which the taxpayer is entitled for the tax year.
> See sections 24A and 25 for further provision about the deduction of those reliefs.
> The sum of the amounts of the components left after this step is "net income".

This takes us to s.24 ITA which has a list of about 20 reliefs (some quite obscure):[15]

ITA	**Relief**
s. 72	early trade losses relief
Chap 6 Part 4	share loss relief
Chap 3 Part 8	gift of securities/land to charity
s.457/458	trade unions or police organisations
s. 64	trade loss relief against general income
s. 83	carry-forward trade loss relief
s. 89	terminal trade loss relief
s. 96	post-cessation trade relief
s. 118	carry-forward property loss relief
s. 120	property loss relief against general income
s. 125	post-cessation property relief
s. 128	employment loss relief
s. 152	loss relief: misc. income
Chap 1 Part 8	interest payments
Chap 1A Part 8	irrecoverable peer-to-peer loans
Chap 4 Part 8	Annual Payments
s.574	manufactured dividends
s. 579	manufactured interest
Other Acts	**Relief**
s. 193(4) FA 2004	pension schemes
s. 194(1) FA 2004	pension schemes

[15] For clarity, I set this out in a table format, and abbreviate the relief description; I set out the list for individuals; a different list applies for non-individuals.

s.258 CAA 2001	plant/machinery
s.479 CAA 2001	patent allowances
s. 555 ITEPA	liabilities of former employment
s. 446 ITTOIA	government security strips: losses
s. 454(4) ITTOIA	listed securities held 26/3/2003: losses
s. 600 ITTOIA	patent expenses

44.5.3 *Adjusted net income*

"Adjusted net income" is defined in s.58(1) ITA:

> For the purposes of Chapters 2 and 3, an individual's adjusted net income for a tax year is calculated as follows.

There are 3 adjustments. In short:

Step	**Adjustment**
2	Deduct gross gift aid donations
3	Deduct pension relief
4	Add back relief for payments to trade unions/police organisations

In full detail:

> *Step 1* Take the amount of the individual's net income for the tax year.
> *Step 2* If in the tax year the individual makes, or is treated under section 426 as making, a gift that is a qualifying donation for the purposes of Chapter 2 of Part 8 (gift aid) deduct the grossed up amount of the gift.
> *Step 3* If the individual is given relief in accordance with section 192 of FA 2004 (relief at source) in respect of any contribution paid in the tax year under a pension scheme, deduct the gross amount of the contribution.
> *Step 4* Add back any relief under section 457 or 458 (payments to trade unions or police organisations) that was deducted in calculating the individual's net income for the tax year.
> The result is the individual's adjusted net income for the tax year.
> (2) The grossed up amount of a gift is the amount of the gift grossed up by reference to the basic rate for the tax year.
> (3) The gross amount of a contribution is the amount of the contribution before deduction of tax under section 192(1) of FA 2004.

Gift aid relief (including carry-back relief) makes it possible to avoid the worst unfairness of the withdrawal of allowances for high earners, as a donor with income marginally above £100k can avoid the 60% band by gift aid donations.

44.6 Allowances: remittance basis user

Section 809G ITA disapplies IT personal allowances for remittance basis claimants:

> (1) This section applies if s.809B (claim for remittance basis to apply) applies to an individual for a tax year.
> (2) For that year, the individual is not entitled to-
> (a) any allowance under Chapter 2 of Part 3 (personal allowance and blind person's allowance),
> (b) any tax reduction under Chapter 3 of that Part (tax reductions for married couples and civil partners), or
> (c) any relief under s.457 or 458 (payments for life insurance etc).

This does not apply to remittance basis taxpayers in the de minimis categories (sub-£2k taxpayers and non-taxpayers): they retain their allowances.

The editor of *Taxation* commented acerbically on s.809G(2)(c):

> So what are these valuable reliefs which it would be unfair to allow those claiming the remittance basis to enjoy? They are relief from tax on half of the premiums paid to trade unions and police organisations for superannuation, life insurance or funeral benefits, or to the employer so that benefits can be paid after the employee's death to their dependants, but limited to £100 a year of relief in each case.
> What on earth is the point of removing a relief like that for the non-domiciles? It is pointless complexity for the sake of a few tenners in tax which will have no impact whatsoever on the non-domiciles concerned. Unless there is some issue related to European law, or human rights (which seem to be the normal culprits in these situations) I really cannot see why the parliamentary draftsman should have been troubled with the need to include them. And, frankly, if there is some such problem, then given the minuscule levels of relief they offer even to those not on the remittance basis, wouldn't it be simpler to just abolish the sections altogether? That would at least be simplification.[16]

Likewise s.1K(6) TCGA disapplies the CGT annual exemption:

> An individual is not entitled to an annual exempt amount for a tax year if section 809B of ITA 2007 (claim for remittance basis) applies to the individual for the year.

[16] Mike Truman, *Taxation* 21 Feb 2008 p.161.

A DTA will occasionally restore the personal allowances and the CGT annual exemption, which are otherwise disapplied for remittance basis claimants.[17]

Individuals with income above £125k are not concerned with the loss of IT personal allowances since these are withdrawn anyway; they only suffer the loss of the CGT annual exemption.

The IT personal allowance and the CGT annual exemption are only lost in the year that a remittance basis claim is made. So an individual who has unremitted gains from earlier years, but who does not make a remittance basis claim in later years, may remit the exempt amount each year and set it against the CGT annual exemption.[18]

44.7 Entitlement to IT personal allowances

There are ten categories of individuals who qualify for IT personal allowances under Chapters 2 and 3 Part 3 ITA. In short:

(1) UK residents
(2) Non-residents:
 (a) Seven categories listed in s.56(3) ITA
 (b) Those entitled under DTAs
 (c) Visiting forces[19]

44.7.1 *History and rationale*

Originally, personal allowances were available to non-residents and residents alike. The Departmental Committee on Income Tax 1905 recommended personal allowances should not be available to non-residents and explains why:

> 128. First, while persons resident in, the United Kingdom obtain their total income from all sources is within the prescribed limits, in the case of persons resident abroad only the income derived from ths United Kingdom is taken into account. Thus a foreign millionaire who derives an income of £160, and no more, from investments in the United Kingdom is granted exemption on that £160, and similarly as regards abatements. This view of the law ... appears to us, on grounds of justice and common sense, indefensible.
>
> [The Committee note the issue of fraudulent tax reclaims by non-

[17] See 44.8.2 (Personal allowances under DTAs: remittance basis claimants).

[18] Note that a CGT loss election may also disapply the CGT annual exemption: see 65.18 (Effect of loss election).

[19] See App.11.2.4 (Visiting forces: Personal allowances),

> residents, and continue]:
> 129. Further, one of the main motives of equity in granting relief to persons in receipt of small incomes is that such persons contribute to the public revenue by means of indirect taxation in fair proportion to their taxable capacity. This ground for relief does not apply to residents abroad. We therefore recommend that the grant of exemption or abatement by reason of smallness of income should be abolished in the case of persons resident outside the United Kingdom. We believe that very few (if any) of the foreigners who invest in British securities have total incomes within the prescribed limits. If it be thought well to make an exception for British subjects residing abroad, relief should be granted only on a certificate from a British Consular officer (or, in a British colony, from the colonial fiscal authorities) that the claimant has produced proper evidence showing that his income from all sources is within the limits.[20]

Restrictions were first introduced in F(1919-10)A 1910, though not adopting the recommendation in the last sentence; with further reforms subsequently.[21]

44.7.2 *IT allowances: UK resident*

Section 56(2) ITA sets out the first category of individuals who qualify for IT personal allowances, which is UK residents:

> The individual meets the requirements of this section if the individual—
> (a) is UK resident for the tax year...

44.7.3 *IT allowances: Non-resident*

Section 56(2) ITA continues:

> The individual meets the requirements of this section if the individual...
> (b) meets the condition in subsection (3).

So we turn to s.56(3) ITA which sets out the next seven categories, which apply to non-residents. Non-residents who do not fall within one of these categories do not qualify for personal allowances.

In many but not all cases, the significance of personal allowances to non-residents is limited or nil.[22]

[20] The proposal was more straightforward at a time when there were no progressive rates of tax and IT was mainly collected at source.

[21] For further historical background, see para 61-66 Royal Commission on the Income Tax Cmd.615 (1920).

[22] See 44.9.1 (Non-residents allowances: Reform).

44.7.4 *IT allowances: UK/EEA national*

Section 56(3) ITA provides:

> An individual meets the condition in this subsection if, at any time in the tax year, the individual—
>
> (za) is a national of the United Kingdom or a national of an EEA state

44.7.5 *IT allowances: Misc*

The remaining categories are a strange ragbag. Section 56(3) ITA provides:

> An individual meets the condition in this subsection if, at any time in the tax year, the individual ...
>
> (a) is resident in the Isle of Man or the Channel Islands,[23]
>
> (b) has previously resided in the UK and is resident abroad for the sake of the health of—
>
> (i) the individual, or
>
> (ii) a member of the individual's family who is resident with the individual,
>
> (c) is a person who is or has been employed in the service of the Crown,
>
> (d) is employed in the service of any territory under Her Majesty's protection,[24]
>
> (e) is employed in the service of a missionary society, or
>
> (f) is a person whose late spouse or late civil partner was employed in the service of the Crown.

There is scope here for simplification: there is a strong case for repeal of s.56(3)(a)-(f), ie the entire list apart from EEA nationals (subject to some transitional relief).

44.7.6 *Commonwealth citizens*

Before 2010/11 there was an additional category: Commonwealth citizens. The Tax Law Rewrite considered that this was not Human Rights

[23] This category has been included since 1910: I would be grateful for any reader who could suggest the reason.

[24] British Protectorates ceased to exist well before the date of the ITA, so this provision has lapsed. The last British protectorate was the Solomon Islands which became independent in 1978. The last British protected state was Brunei which became independent in 1984.

compliant.[25] Accordingly this category was deleted by the FA 2009. The objection was that granting personal allowances solely on the grounds of Commonwealth citizenship (and denying the allowances to non-Commonwealth citizens) was unlawful discrimination on the grounds of nationality.[26] The Rewrite team did not consider that providing allowances to EEA nationals was unlawful discrimination, as discrimination between EEA nationals and the rest of the world was justified by the relationship which the UK had with the EEA.[27] That argument should logically be reviewed post-Brexit, but no doubt there are higher priorities, so the status quo may continue indefinitely.

This rule was just about the last remaining example of special treatment for Commonwealth citizens in UK tax legislation, so the issue does not have immediate tax implications in other areas, but it does illustrate two interesting points: a significant restriction on the UK's ability to impose tax; and the insignificance of the Commonwealth, at least in a Human Rights context. The Tax Law Rewrite rejected the argument that the UK's relationship with the Commonwealth would justify the discrimination.

44.8 Personal allowances under DTAs

The last category of individuals entitled to personal allowances relates to DTAs.

44.8.1 *Non-residents*

OECD Model Convention does not affect the rule that personal allowances are limited to UK residents (and other specific categories).[28] However most UK treaties are different. The PA consultation paper explains the position:

> Most tax treaties between the UK and other states extend entitlement to UK Personal Allowances to nationals of those states who are not entitled to claim a UK Personal Allowance under UK domestic statute. This is

[25] EN ITA para 135.

[26] Article 14 ECHR (Prohibition of discrimination) in conjunction with art 1 protocol 1 (Right to property).

[27] Private correspondence.

[28] OECD Model Convention art. 24(3) provides:
"This provision [non-discrimination] shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents."

> because of the interaction between the UK domestic statute and the UK's obligations under the non-discrimination articles in those tax treaties.
>
> Current UK statute provides that UK nationals are entitled to UK Personal Allowances wherever they are resident. The non-discrimination provisions found in most UK tax treaties extend the entitlement to UK Personal Allowances to nationals of the treaty partner state who are also resident there. Some of the UK's tax treaties also expressly provide that UK Personal Allowances will be granted to residents of the partner state regardless of nationality, or nationals of the partner state wherever they are resident....
>
> The UK's tax treaties do not all entitle overseas residents to a UK Personal Allowance. Some, such as that with the United States, do not contain a non-discrimination article of this sort or specifically exclude entitlement to Personal Allowances from the non-discrimination article.[29]

For instance, art. 25(1) Austria/UK DTA provides:

> Subject to the provisions of paragraph (3) of this Article, individuals who are residents of Austria shall be entitled to the same personal allowances, reliefs and reductions for the purposes of UK tax as British subjects[30] not resident in the UK. ...

Non-resident British subjects qualify for personal allowances as they are nationals of an EEA state (the UK) so individuals who are treaty-resident in Austria will likewise do so.

Sometimes there is a restriction. Article 25(3) Austria/UK DTA provides:

> Nothing in this Convention shall entitle an individual who is a resident of a Contracting State [Austria] and whose income from the other Contracting State [UK] consists solely of dividends, interest or royalties (or solely of any combination thereof) to the personal allowances, reliefs and reductions of the kind referred to in this Article for the purposes of taxation in that other Contracting State.

[29] HM Treasury Consultation Paper, "Restricting non-residents' entitlement to the UK personal allowance" (July 2014) *https://www.gov.uk/government/consultations/restricting-non-residents-entitlement-to-the-uk-personal-allowance/restricting-non-residents-entitlement-to-the-uk-personal-allowance*

[30] Defined in s.51 British Nationality Act 1981.

One could avoid the restriction by procuring income other than dividends, interest and royalties (maybe Annual Payments) but the amounts involved are small.

A list of DTAs which confer personal allowances on non-residents is set out in SA109 (Notes), with more details in HMRC, "Digest of Double Taxation Treaties".

The relief is claimed in form SA109 or else in form R43.

The practical significance of DTAs conferring personal allowances on non-residents is limited, since in many cases a claim for the relief is effectively cancelled by non-residents IT relief.[31] Also of course the personal allowance is only needed for UK source income which remains taxable in the UK under the treaty.

44.8.2 *Remittance basis claimants*

Remittance basis claimants (who would in principle qualify for personal allowances as they are by definition UK resident) lose their IT/CGT personal allowances on making a remittance basis claim.[32] This disallowance is overridden (so the right to IT/CGT personal allowances is restored) by a DTA if applicable.[33] The treaties which confer personal allowances are those set out in the lists mentioned above, with the exception of Greece and Myanmar.[34]

This treaty relief only affects remittance basis taxpayers who make a remittance basis claim, ie where:

(1) the individual is UK resident (so a remittance basis claim is made); and
(2) the individual is treaty-resident in the jurisdiction concerned (so that DT relief applies).

So this point will not be a common one, though it will arise from time to time.

[31] See 45.3 (Amount B (disregarded income and reliefs).

[32] See 44.6 (Withdrawal of IT personal allowances & CGT annual exemption for remittance basis claimants).

[33] Jane Kennedy (Financial Secretary to the Treasury) accepted this in the public Bill committee debate on the Finance Bill, Hansard 19 June 2008 col 818 *http://www.publications.parliament.uk/pa/cm200708/cmpublic/finance/080619/am/80619s05.htm*

[34] The antique treaties of Myanmar and Greece only grant personal allowances to residents of Myanmar/Greece who are not UK-law UK resident; they do not help UK-law UK residents even if also residents of Myanmar/Greece.

44.9 Non-residents allowances: Reform

44.9.1 *Nonresidents allowances: Significance*

The proposal discussed here is abolition of the IT personal allowances for non-residents. Reform proposals first require an analysis of the significance of personal allowances for non-residents. Needless to say, the picture is a complicated one. The PA consultation paper provides:

> **6.1 Impact on individuals**
> HMRC estimate there to be at least 400,000 individuals claiming Personal Allowances in the UK who are non-resident for tax purposes. Based on the data available, if non-residents were not entitled to the UK Personal Allowance most of them would face increased UK tax liabilities. However most of these individuals would be able to claim relief overseas either in the form of a credit for tax paid in the UK or exemption from tax in their home state. Therefore most individuals would not generally pay more tax overall than they do now. However this will depend on the relative level of tax rates and allowances between the UK and their country of residence. Those living in low tax jurisdictions are likely to pay more tax overall than they do now if they were not able to claim the UK Personal Allowance than they do now...
> **6.2 High income individuals**
> Around 5,000 high earning non-residents already have their Personal Allowance tapered away because their UK income is greater than £100,000...
> **6.3 Middle income individuals**
> There are more than 110,000 migrant taxpayers with incomes over the level of the Personal Allowance and a significant proportion of this group are middle income non-residents. This includes, for example, professionals or managers seconded to the UK for a few months to work on specific projects. Individuals in this cohort who are not tax resident in the UK but pay UK tax on their earnings are likely to earn in excess of the Personal Allowance, so they have UK tax to pay on their earnings.

Actually there are two classes of non-resident employees who perform some duties in the UK:

(1) Those who qualify for DTA relief as short term business visitors. These do not need UK allowances.

(2) Those who do not qualify (or do not fully qualify) for DTA relief, who do need the allowances.[35]

[35] See 36.12 (Short-term visitor PAYE scheme).

The paper is interested in group (2):

> Even without any policy change they are likely to claim double taxation relief in their country of residence to offset the UK taxation on their UK earnings. These individuals will not generally face a significant cash loss from the withdrawal of the UK Personal Allowance;

Instead the loss falls on the foreign Revenue authority; as often happens when the UK imposes tax on non-residents. It would be relevant to consider the converse situation: does the foreign state allow a personal allowance to residents in the UK who work in the foreign state (and so increasing UK tax revenues). If so, would the result of abolishing UK personal allowances be to encourage the foreign state to abolish theirs?

> however this will depend on the relative level of tax rates and allowances between the UK and their country of residence. Those living in low tax jurisdictions may face a cash loss...
>
> **6.4 Low income individuals**
>
> Around 250,000 migrants, many of whom are non-residents, receive UK income below the Personal Allowance. Although some will have higher incomes overseas, some of this group will have a very low overall income. This group includes a significant group who may not pay sufficient tax overseas to claim relief for any UK tax payable and might face a cash loss if their entitlement to a UK Personal Allowance is withdrawn.
>
> **6.5 Non-resident landlords and others with UK property income**
>
> There are around 175,000 non-UK resident taxpayers with rental income. Non-resident landlords will generally be taxed on their UK rental income in their country of residence as well as the UK. Although some may currently not need to claim double taxation relief as their UK income is below the Personal Allowance, many non resident landlords would be able to claim double taxation relief and so should not face an overall cash loss without a UK Personal Allowance...
>
> **6.6 Pensioners**
>
> Pensioners who live overseas are a significant group of British national expatriates, estimated by DWP at around 1,200,000 individuals. Most UK national pensioners living overseas would not be affected by any restriction on non-residents entitlement to the Personal Allowance. This is because:
>
> - some are still resident in the UK for tax purposes and so would not be affected by any change
> - provisions of tax treaties generally mean that UK state pensions, personal pensions or private sector occupational pensions are only

> taxable in recipients' states of residence and not in the UK
> - many non-resident UK national pensioners do not have any other income (i.e. employment or property) which is taxable in the UK and would not be affected by losing their Personal Allowance
>
> However, under double tax treaties, UK sourced government service pensions (a wide category which includes, amongst others, some NHS staff and those employed by local authorities) are generally only taxed in the UK, regardless of recipients' residence status. This can also be the case with some other forms of income under specific treaties. The withdrawal of the UK personal allowance from non-residents in receipt of a UK government service pension would result in them paying more tax overall as there is no overseas tax liability against which the additional UK tax could be relieved.

In addition, in relation to UK investment income, the practical significance of allowances for non-residences is limited, since in many cases any claim for a personal allowance is effectively cancelled by non-residents IT relief.[36]

44.9.2 *Nonresidents allowances reform*

Budget 2014 announced:

> **Personal allowances for non-residents** – To ensure the UK personal allowance remains well targeted, the Government intends to consult on whether and how the allowance could be restricted to UK residents and those living overseas who have strong economic connections in the UK, as is the case in many other countries, including most of the EU.

The issue has become more important because of the increase in personal allowance in recent years. But proposal is an old one, first proposed in 1905.[37] I wonder if the authors of the proposal were aware of that. But this time the withdrawal of allowances was intended to be targeted:

> The government is concerned that individuals, like those in receipt of government service pensions, who are not eligible for double taxation relief, would be disproportionately affected by the removal of the UK Personal Allowance.
>
> The government does not intend to raise taxes on vulnerable groups or in situations where the UK is the principal taxing authority and an individual has no recourse to relief as a result of the UK having sole

[36] See 45.3 (Amount B: Non-disregarded income/reliefs).

[37] See 44.7.1 (History and rationale).

> taxing rights under a tax treaty. If the government were to restrict non-residents' entitlement to the Personal Allowance, it would intend this to apply to types of income which are taxable both in the UK and overseas (such as that from immovable property) but to retain the Personal Allowance on income that is taxable exclusively in the UK.[38]

The Autumn Statement 2014 put the reform back to 2017[39] and in earlier edition of this work I commented:

> Withdrawal of allowances for non-residents poses particularly difficult problems in the case of employers, who will need to know how to operate PAYE for employees whose residence may be difficult to ascertain or may simply be unknown until after the end of the tax year. I expect that nothing will happen.

That prediction seems to have been correct.

[38] HM Treasury Consultation Paper, "Restricting non-residents' entitlement to the UK personal allowance" (July 2014) *https://www.gov.uk/government/consultations/restricting-non-residents-entitlement-to-the-uk-personal-allowance/restricting-non-residents-entitlement-to-the-uk-personal-allowance*

[39] *https://www.gov.uk/government/collections/autumn-statement-2014-hm-revenue-and-customs* (November 2014).

CHAPTER FORTY FIVE

NON-RESIDENTS INCOME TAX RELIEF

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45.1 Non-residents IT relief: Introduction

This chapter considers the IT relief for UK source income of non-residents. I use the following terminology:

Term	ITA	Applies to
Non-resident individual/trustee relief	s.811	Individuals/trustees
Non-resident company relief	s.815	Companies

I refer to these together as "**non-residents IT relief**".

In accordance with the principles of the Tax Law Rewrite, the two reliefs are written out separately, though the rules are more or less the same.

In the absence of relief:

(1) Non-resident individuals and trustees are subject to tax on UK source income at the same rates as UK residents. So non-resident individuals may be subject to income tax at higher/additional rates, and non-resident trustees may be subject to tax at the trust rate.

(2) Non-resident companies are in principle subject to income tax on UK source income at the basic rate/dividend ordinary rate.

In short, the relief is that UK source interest, dividend and pension income of non-residents is not subject to UK tax beyond withholding tax (where applicable).

Section 811/815 ITA provide the relief:

s.811(1) ITA (individuals/trusts)	**s.815(1) ITA (companies)**
This section applies to income tax to which— (a) a non-UK resident, other than a company, is liable, or (b) a non-UK resident company is liable as a trustee.[1]	This section applies to income tax to which a non-UK resident company is liable, otherwise than as a trustee.

The relief is as follows:

s.811(3) ITA (individuals/trusts)	**s.815(2) ITA (companies)**
The non-UK resident's liability to income tax for a tax year is limited to the sum of amounts A and B.	The non-UK resident company's liability to income tax for a tax year is limited to the sum of amounts A and B.

There is no equivalent CGT relief but that is not needed as a non-resident is not usually subject to CGT. It is possible to envisage a case where a non-resident would be subject to CGT on gains made through an investment manager, but it would be unusual, in practice no-one would expect compliance, and HMRC probably turn a blind eye. The former International Tax Handbook stated at ITH970:

> *it would be very rare to find a situation where a non-resident would be liable on capital gains made through an investment manager.*

We next need to ascertain amounts A and B.

45.2 Amount A: Tax deducted at source

s.811(4) ITA (individuals/trusts)	**s.815(3) ITA (companies)**
Amount A is the sum of—	Amount A is the sum of—
(a) any sums representing income tax deducted from the non-UK resident's disregarded income for the tax year (see section 813), and	(a) any amounts representing income tax deducted from the non-UK resident company's disregarded company income for the tax year, and

[1] Section 811(1)(b) is strictly otiose since a trustee is a separate person for income tax, and that person is not classified as a company (even if the actual trustee happens to be a company); see 7.3 (Trustees a distinct person). But it does no harm.

(b) any sums representing income tax that are treated as deducted from or paid in respect of that income.	(b) any amounts representing income tax that are treated as deducted from or paid in respect of that income.

The wording is effectively the same.

The disregard in para (a) is:

(1) for non-companies: "the non-UK resident's disregarded income"

(2) for companies: "the non-UK resident co's disregarded company income"

But the meaning is more or less the same. I refer to such income as **"disregarded income"**. I refer to other income as "**non-disregarded income**" which is a clumsy term but I cannot think of better.[2]

Simplifying slightly: amount A is tax deducted at source on disregarded income.

45.3 Amount B: Non-disregarded income/reliefs

We turn to amount B. Section 811(5) ITA provides:

s.811(5) ITA (individuals/trusts)	**s.815(4) ITA (companies)**
Amount B is the amount that, apart from this section, would be the non-UK resident's liability to income tax for the tax year,	Amount B is the amount that, apart from this section, would be the non-UK resident company's liability to income tax for the tax year
if the following were left out of account— (a) the non-UK resident's disregarded income for the tax year, and	if the non-UK resident company's disregarded company income for the tax year were left out of account.
(b) any relief mentioned in subsection (6) to which the non-UK resident is entitled for the tax year as a result of— (i) section 56(3) or 460(3) of this	

[2] The attentive reader will also note that (for no good reason) the word *sums* has become *amounts*.

Act (residence etc of claimants), or
(ii) double taxation arrangements.

I refer to the reliefs within s.811(5)(b) as "**disregarded reliefs**".

The wording is effectively the same except that for companies there is no reference to the disregarded reliefs (which makes sense as those reliefs only apply to individuals).

Thus one has a hypothetical tax computation which differs from the individual's normal tax computation by ignoring two matters:

- Ignore disregarded income: the effect is to decrease the tax liability
- (For individuals): Ignore disregarded reliefs: the effect is to slightly increase the tax liability.

Since one only ignores disregarded income in computing amount B, UK tax on non-disregarded income is included in computing amount B, ie tax on non-disregarded income remains payable in full.

Moreover although amount B is computed by ignoring disregarded income, tax deducted at source on disregarded income comes into amount A, so the result at the end of the day is that UK tax on disregarded income is limited to withholding tax. The wording is convoluted, but it works.

45.4 Disregarded reliefs

Section 811(6) ITA sets out the list of disregarded reliefs:

The reliefs referred to in subsection (5) are– [3]

Para	**Relief**	**Reference**	**See para**
(a)	Personal allowance, blind person's allowance	Chap 2 Part 3 ITA	44.8.1
(b)	Tax reduction for spouse born before 1935	Chap 3 Part 3 ITA	
(c)[4]	Trade union/police organisation subscriptions	s.457, 458 ITA	
(e)	Life assurance premium relief (pre-1984 policies)	s.266 ICTA	

The most important item in this list is the personal allowance.[5] The others are not likely to be significant.

These reliefs are not disapplied. The individual can in theory claim them. But that claim increases amount B, so reduces the benefit of non-residents IT relief. A higher rate taxpayer will often be no better off at all;

[3] For clarity I set this out in tabular form, and in the terminology of this book, rather than the layout of the statute.

[4] There is no para (d).

[5] See 44.8 (Personal allowances under DTAs).

sometimes there may be a small saving but it may be insufficient to justify the accountancy cost of making the claim.

In short, a non-resident individual must choose between (1) personal allowances and (2) non-residents IT relief: they cannot have both.

45.5 Disregarded income

The definition of "disregarded income" is crucial since disregarded income qualifies for non-residents IT relief and other income does not.

In practice, the most important categories are dividends and interest.

The definition is complex. There are six categories of disregarded income:

s.813(1) ITA (individuals/trusts)	**s.816 ITA (companies)**
For the purposes of this Chapter [Chapter 1 Part 14 ITA] income arising to a non-UK resident is "disregarded income" if it is—	(1) For the purposes of this Chapter [Chapter 1 Part 14 ITA] income arising to a non-UK resident company is "disregarded company income" if it is—
(a) disregarded savings and investment income (see section 825),[6]	[identical]
(b) disregarded annual payments (see section 826),[7]	[identical]
(c) disregarded pension income, (d) disregarded social security income,	[no equivalent]
(e) disregarded transaction income (see section 814),[8] or	(c) income arising from a transaction carried out through a broker in the UK acting as an agent of independent status in the ordinary course of the broker's business, (d) income arising from a transaction carried out through an

[6] See 45.6 (Disregarded savings & investment income).

[7] See 45.7 (Disregarded Annual Payments).

[8] See 72.3 (IME non-resident IT relief); 72.5.3 ("Transaction income").

	investment manager in the UK acting as an agent of independent status in the ordinary course of the investment manager's business,[9] or
(f) income of such other description as the Treasury may by regulations designate for the purposes of this section. [No regulations have been made].	(e) [identical to (f)]

The wording for companies is effectively the same. There are two apparent differences:

(1) References to pension or social security income are omitted (as they do not apply to companies).

(2) There are differences in the wording of s.816(1)(c)(d) which are the equivalent of the individual's exemption for "transaction income" but I cannot see they are of any significance.

Thus we have to turn to another five definitions. But first, s.813(2) ITA brings in an important exception:

> But income in relation to which the non-UK resident has a UK representative for the purposes of Chapter 2B is not disregarded income.

See 124.3 (UK representative).

45.6 Disregarded savings & investment income

Section 825(1) ITA provides the definition:

> For the purposes of this Chapter [Chapter 1 Part 14 ITA] income is "disregarded savings and investment income" if—

There are two categories of disregarded savings & investment income: dividends and interest.

45.6.1 *Dividends*

Section 825(1) ITA provides:

> For the purposes of this Chapter [Chapter 1 Part 14 ITA] income is "disregarded savings and investment income" if—

[9] See 72.1 (Investment manager exemptions).

> (a) it is chargeable under Chapter 3 or 5 of Part 4 of ITTOIA 2005 (dividends etc from UK resident companies and stock dividends from UK resident companies)

Non-residents IT relief is not needed for dividends arising to:
(1) individuals who are not higher rate taxpayers
(2) non-resident companies
(3) interest in possession trustees

Persons in these categories pay only at the dividend ordinary rate,[10] and they qualify for a dividend tax credit which covers that.[11]

But non-residents IT relief is relevant for non-resident individuals who are higher rate taxpayers, and to discretionary trusts.

45.6.2 *Interest*

Section 825(1) ITA continues:

> For the purposes of this Chapter [Chapter 1 Part 14 ITA] income is "disregarded savings and investment income" if ...
> (b) [i] it is within subsection (2) and
> [ii] is not relevant foreign income[12].

So we turn to s.825(2) ITA, which deals with interest and interest-like income:

> Income is within this subsection if it is chargeable under—[13]

Para	**ITTOIA Part 4**	**Type of income**
(a)	Chapter 2	Interest
(b)	Chapter 7	Purchased life annuity payments
(c)	Chapter 8	Deeply discounted securities
(e)[14]	Chapter 11	Transactions in deposits
(f)	Reg 15 UUTTR[15]	Distributions from unauthorised unit trusts

The terminology is not ideal, as "Savings & Investment Income" is a technical term best used as a label for income within Part 4 ITTOIA

[10] Or, for an individual with income of less than £2k, at the dividend nil rate, but the end result is the same.
[11] See 30.7 (Non-resident recipient).
[12] Why is para [ii] needed?
[13] For clarity I set this out in tabular form, and in the terminology of this book, rather than the layout of the statute.
[14] There is no para (d).
[15] Unauthorised Unit Trusts (Tax) Regulations 2013.

(which is headed Savings & Investment Income). But no harm arises as long as one remembers that the term does not carry quite that meaning here:
(1) it includes item (f), which is not in Part 4, and
(2) it does not include some categories of income which are in Part 4:

Topic	**Part 4 Chap**	**Comment**
Disguised interest	2	Accidental omission, perhaps
Non-UK dividends	4	Relief not needed
Life policies: chargeable-event gains	9	Relief not needed

45.7 Disregarded Annual Payments

Section 826 ITA provides the definition:

> For the purposes of this Chapter [Chapter 1 Part 14 ITA] income is "disregarded annual payments" if it is not relevant foreign income and is chargeable under—
> (a) section 579 of ITTOIA 2005, so far as it relates to annual payments (royalties etc from intellectual property),
> (b) Chapter 4 of Part 5 of that Act, so far as it relates to annual payments (certain telecommunication rights: non-trading income), or
> (c) Chapter 7 of Part 5 of that Act (annual payments not otherwise charged).

Thus royalties which are Annual Payments are disregarded income, but royalties which are not Annual Payments are not.[16] In practice DT relief will often apply, so the distinction may not matter. But it is submitted all royalties ought to be treated in the same way.

45.8 Disregarded pension/social security income

Section 813(3) ITA provides:

> Income is "disregarded pension income" if it is chargeable under Part 9 of ITEPA 2003 (pension income) because any of the following provisions of that Act applies to it—
> section 577 (UK social security pensions),
> section 579A (pensions under registered pension schemes) (but see subsection (4) below),[17]

[16] For the distinction, see 32.4 (Non-trade royalties).

[17] Section 813(4) ITA provides:
"Income chargeable under Part 9 of ITEPA 2003 because section 579A of that Act

> section 609 (annuities for the benefit of dependants),
> section 610 (annuities under non-registered occupational pension schemes), or
> section 611 (annuities in recognition of another's services).

Section 813(5) ITA provides:

> Income is "disregarded social security income" if—
> (a) it is a taxable benefit listed in Table A in section 660 of ITEPA 2003, other than income support or jobseeker's allowance, and
> (b) it is chargeable under Part 10 of that Act (social security income).

45.9 Individuals: Split years

Section 810(4) ITA provides:

> In relation to an individual—
> (a) a reference in this Chapter [Chapter 1 Part 14 ITA] to a non-UK resident's liability to income tax is a reference to the liability of someone who is non-UK resident for the tax year for which the liability arises, and
> (b) accordingly, enactments under which income arising to a UK resident in the overseas part of a split year is treated as arising to a non-UK resident are of no relevance to this Chapter.

Thus non-residents IT relief does not apply for a split year of an individual. This seems unfair and inconsistent with the general scheme of the split-year rules. Perhaps the reason is that a tax return is needed for the split year, one object of the relief is to save the need for a tax return, so the relief is not appropriate in a split year.

The planning moral is that where possible leavers should defer UK source income until after the end of a split year; and arrivers should arrange UK source income to accrue before the beginning of a split year.

45.10 Trusts: UK beneficiary rule

Section 812(1) ITA provides:

applies to it is disregarded pension income only if the registered pension scheme in question—
(a) falls within para 1(1)(f) of Schedule 36 to FA 2004, and
(b) was, immediately before 6 April 2006, a retirement annuity contract to which section 605 of ITEPA 2003 applied."

> Section 811 does not apply to income tax to which non-UK resident trustees are liable for a tax year, if there is a beneficiary of the trust who is—
> (a) an individual who is UK resident, or
> (b) a UK resident company.

I refer to this as the "**UK beneficiary rule**". One UK beneficiary may disqualify the entire trust from the relief.

Non-resident's IT relief is available if:

(1) The trust is settlor-interested and the settlor is non-UK resident as the income is treated as the income of the settlor, not the trustees.[18]

(2) The trust is an IIP trust and the life tenant is non-resident.

It does not matter if the trustees do not qualify for relief in their own capacity, due to the UK beneficiary rule. The trustees may take the benefit of the non-resident individual's IT relief applicable to the settlor or life tenant.

45.10.1 *"Beneficiary"*

Section 812 ITA defines "beneficiary":

> (2) For the purposes of subsection (1) a person is a beneficiary of the trust if—
> (a) the person is an actual or potential beneficiary of the trust, and
> (b) condition A or B is met in relation to the person.
> (3) Condition A is that the person is, or will or may become, entitled under the trust to receive some or all of any income[19] under the trust.
> (4) Condition B is that some or all of any income under the trust may be paid to or used for the benefit of the person in the exercise of a discretion conferred by the trust.

At first sight it appears that a trust with power to add beneficiaries would not qualify for relief, since UK residents are potential beneficiaries. But such powers are standard form in offshore trusts, so if that were right, offshore trusts would not normally qualify. In practice I understand that HMRC do not take that point. But it would be different if there are UK

[18] See 47.9.2 (Non-resident trust, non-resident settlor).

[19] Income is in turn defined in s.812(5) ITA:

> "The references in subsections (3) and (4) to any income under the trust include a reference to any capital under the trust so far as it represents amounts originally received by the trustees as income."

residents:

(1) who expect to benefit (eg the settlor under a settlor-interested trust, or any other beneficiary under a letter of wishes); or
(2) who have benefited from the trust, and been excluded, but may be added to the class of beneficiaries again in the future.

45.10.2 *HMRC example*

The TSE Manual provides a straightforward example:

> **TSEM10220 effect of ITA/S811** [Aug 2019]
> ... *Example*
> Year 2013-14
> Income of non-resident trust:
> UK bank interest = £1,000. Tax deducted at source = NIL
> UK property income = £2,000. Tax deducted = NIL
> The trust is within ITA/S479, and all the beneficiaries (income and capital) are not resident in the UK for the year 2013-14. The provisions of ITA/S811 apply to cap the liability to income tax on bank interest.
> Income tax liability is limited to the sum of:
> (a) (ITA/S811(4) the income tax deducted from bank interest ('disregarded income') -NIL and
> (b) (ITA/S811(5) the income tax liability on property income - £2,000:
>
> Income chargeable at the standard rate band is £1,000 @ 20% = £200.
> Income chargeable at the trust rate = £1,000 @ 45% =£450
> The Income Tax liability is £650 for the year 2013-14.

45.11 Critique

Non-residents IT relief originated in a long standing concession, put on a statutory basis in 1995. As far as I know, no public discussion of the reasons for non-residents IT relief has taken place. Several different policy aspects can be identified.

(1) Tax competition considerations:
   (a) Non-residents are not likely to invest in UK securities if they had to pay progressive IT rates.
   (b) Even the imposition of basic rate tax may be a deterrent; this is typically dealt with by withholding tax exemptions which (together with non-residents IT relief) result in total exemption.[20]

[20] See 1.3 (Other tax competition).

(2) The practical difficulty in seeking to collect tax in excess of tax deducted at source. Tax collection would be possible in countries which have mutual assistance agreements so this is less of a problem than it once was. But perhaps collection may still not be easy. Also it would perhaps be odd to have one rule for the those countries and another for the rest of the world.

(3) Various policy considerations tend to suggest that higher and additional rates of UK tax ("progressive IT rates") are not appropriate for non-resident individuals:

   (a) Progressive rates of UK tax would not be applied to all non-residents income (most of their income may be foreign source income and not subject to UK tax).

   (b) Non-resident individuals are likely to be taxed in their country of residence, with credit for UK tax.

   (c) If every country applied its own progressive rates, taxpayers would have to fill in tax returns in as many countries as they held investments, which would be impractical for a worldwide portfolio.

   (d) Insofar as the right to tax is justified by the benefit principle,[21] the benefit provided to a non-resident individual is less than that provided by a UK resident.

These considerations form the basis for a general international acceptance that progressive rates are mainly a matter for the country of residence.[22]

Two important categories of UK income are not disregarded income: employment income and property income. These types of income do not qualify for non-residents IT relief and are therefore subject to progressive rates of tax if received by an individual.

The treatment of employment income is understandable since (1) tax competition may be less of a concern; (2) PAYE makes collection of tax easy in most cases; and (3) disparity compared to other employees might be regarded as unacceptable.

The treatment of property income is strange. Deduction at source on rent is limited to the basic rate, though enforcement of progressive rates would

[21] That is, the principle that in an equitable tax system, taxpayers should contribute in proportion to the benefits they receive from government expenditure.

[22] This view is expressed in "A Platform for Consultation" (Australia) para 30.61 (2010).

theoretically be possible because of the situation of assets in the UK (not to mention mutual enforcement treaties). In the past, the Inland Revenue did not attempt to collect progressive rates on UK property income of non-residents.[23] This is not the current practice, at least officially. However one wonders how often tax strictly due is actually collected. Of course well-advised non-residents will generally hold investment properties in non-resident companies, so there will not often be much progressive rate tax even strictly due.

Logically:

(1) the collection of tax at source rules on UK property ought to be extended to progressive rates, where land is vested in an individual or a trust; or (if this is thought to be too onerous to administer)

(2) property income ought to be disregarded income and so qualify for non-residents IT relief. Tax would be limited to deduction at source.

This aspect of non-residents IT relief reflects a lack of consistent thinking or an uneasy compromise between conflicting policy considerations.

The rule that non-residents IT relief effectively disallows personal allowances ensures that what can be deducted at source is retained in full, and simplifies administration for HMRC and for taxpayers.

[23] The point arose in *Burns v HMRC* [2009] UKSPC SPC00728 where HMRC argued that transfers of land from (supposedly) non-resident individuals to non-resident companies in 1980 and 1982 were made to avoid higher rate income tax on UK property income. The taxpayers argued that could not be correct, since the Inland Revenue did not collect higher rate tax. The Special Commissioner stated that in the 1980's there was "a certain level of expectation" that HMRC did not seek to collect higher rate tax on UK source rental income of non-residents. The practice was perhaps a routine blind eye, rather than anything more formal; though a thorough review of Inland Revenue files would be needed to find the answer.

CHAPTER FORTY SIX

NATIONAL INSURANCE CONTRIBUTIONS

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46.1 NICs: Introduction

Of course NICs are a tax:

> It is now a common view, accepted by virtually all tax experts outside of HMRC and HM Treasury, that NICs are no more than an additional tax on earnings. There is just the slightest relationship between whether they are paid and rights to some benefits. There is almost no relation-

> ship at all between how much is paid and rights to anything. They are a tax.[1]

NICs should be regarded as a collection of seven (more or less) distinct taxes. They are numbered semi-numerically. Section 1(2) SSCBA summarises them but it is easier to read in a table:

Class: Section	**Payable by**
Earnings-related	
(a) *Class 1*: s.6	
(i) Primary class 1	employed earners
(ii) Secondary class 1	employers/persons paying earnings
(b) *Class 1A*: s. 10	persons liable to pay secondary Class 1 contributions/certain others
(bb) Class 1B: s.10A	persons accountable in accordance with a PAYE settlement agreement;
Flat-rate	
(c) *Class 2*: s.11	self-employed earners;
(d) *Class 3*: s.13, 13A	earners and others voluntarily, to obtaining benefits;
(da) *Class 3A*: s.14A	eligible people voluntarily, to obtain units of additional pension
(e) *Class 4*: s.15	in respect of profits/gains of a trade, profession or vocation, or
s.18	in respect of equivalent earnings.

The Institute of Directors say:

> To promote tax transparency, and in advance of ultimately merging income tax and national insurance contributions, the employees' contribution should be re-named 'earnings tax' and the employers' contribution 'employment tax'.[2]

That would be a good idea, and it might prevent misleading claims such as "We will take everyone earning less than £12,500 out of Income Tax altogether";[3] but there seems little prospect of it happening.

Each class of NIC needs a book to itself, except for class 1 which requires many volumes. I focus on matters closest to the themes of this book. I do not consider the special rules for mariners, aircrew, diplomats and service personnel.

SSCBA does not apply in Northern Ireland[4] so it refers to "Great

[1] Johnson, "Tax without Design: Recent Developments in UK Tax Policy" (2014) Fiscal Studies vol 35, p.243.

[2] Institute of Directors, "GE2015: The IoD's Key Priorities for Tax Reforms" (2015)

[3] Conservative Party Manifesto, 2015.

[4] Section 177(6) SSCBA provides: "Except as provided by this section, this Act does not extend to Northern Ireland."

Britain". (Northern Ireland has its own legislation, not discussed here.) SSCR applies throughout the UK, so it usually refers to the UK, or to "GB and Northern Ireland".

46.2 Employment/employed/self employed

46.2.1 *Employment/employed*

Section 122(1) SSCBA provides an artificial definition:

> "employment" includes any trade, business, profession, office or vocation and "employed" has a corresponding meaning

46.2.2 *Employed/self employed earner*

Section 2(1) SSCBA provides:

> In this Part of this Act and Parts II to V below—
> (a) "employed earner" means a person who is gainfully employed in Great Britain
> [i] either under a contract of service, or
> [ii] in an office (including elective office)[5] with general earnings; and
> (b) "self-employed earner" means a person who is gainfully employed in Great Britain otherwise than in employed earner's employment (whether or not he is also employed in such employment).

SSCBA, confusingly, (mis)defines the word "employment" to include trades and professions. But the terms "employed/self employed earner" are given (more or less[6]) their ordinary meanings.

In this chapter I use the word **"employee"** to mean an "employed earner" and **"self-employed"** means a "self-employed earner".

46.3 "Secondary contributor"

Section 6(4) SSCBA provides:

> The primary and secondary Class 1 contributions referred to in subsection (1) above are payable as follows—
> (a) the primary contribution shall be the liability of the earner; and

[5] The odd expression "elective office" is not defined and the words in brackets are otiose.

[6] To add to the confusion, SSCER deems some persons actually self-employed to be employees for NIC purposes and vice versa.

> (b) the secondary contribution shall be the liability of the secondary contributor; …

The identity of the secondary contributor is clearly crucial. Section 7(1) SSCBA provides:

> For the purposes of this Act, the "secondary contributor" in relation to any payment of earnings to or for the benefit of an employed earner, is—
>
> (a) in the case of an earner employed under a contract of service, his employer;
>
> (b) in the case of an earner employed in an office with earnings, either—
>
> (i) such person as may be prescribed in relation to that office; or
>
> (ii) if no person is prescribed, the government department, public authority or body of persons responsible for paying the earnings of the office...

SSCER reg. 5(1) prevents avoidance by foreign employers seconding to the UK:

> For the purposes of section 4 of the Act[7] (Class 1 contributions), in relation to any payment of earnings to or for the benefit of an employed earner in any employment described in any paragraph in column (A) of Schedule 3 to these regulations, the person specified in the corresponding paragraph in column (B) of that Schedule shall be treated as the secondary Class 1 contributor in relation to that employed earner.
>
> ...

Column (A) [Employment]	**Column (B)** [Secondary Contributor]
9 Employment- (a) (not being an employment described in sub-paragraphs (b) to (f)) by a foreign employer where the employed person, under an arrangement involving the foreign employer and the host employer, provides, or is personally involved in the provision of services, to a host employer;	9 Where the employment is- (a) employment within paragraph 9(a) of column (A), the host employer;

[7] Section 4 Social Security Act 1975 is now s.7 SSCBA.

(b) under or in consequence of a contract between a foreign agency and an end client where the worker provides services to that end client;	(b) employment within paragraph 9(b) of column (A), the end client;
(c) by a foreign employer where the worker provides services to an end client under or in consequence of a contract between that end client and a UK agency;	(c) employment within paragraph 9(c) of column (A), the UK agency who has the contractual relationship with the end client;
(d) by a foreign agency where the worker provides services to an end client under or in consequence of a contract between that end client and a UK agency;	(d) employment within paragraph 9(d) of column (A), the UK agency who has the contractual relationship with the end client;
(e) by a UK employer where the worker provides services to a person outside the UK under or in consequence of a contract between that person and a UK agency and the worker is eligible to pay contributions in the UK in relation to that employment; or	(e) employment within paragraph 9(e) of column (A), the UK employer or UK agency who has the contractual relationship with the person outside the UK; or
(f) by a foreign employer where the worker provides services to a person outside the United Kingdom under agency who has the contractual or in consequence of a contract relationship with the person between that person and a UK agency and the worker is eligible to pay contri-butions in the UK in relation to that employment.]	(f) employment within paragraph 9(f) of column A, the UK agency who has the contractual relationship with the person outside the United Kingdom;
	(g) employment within paragraphs 9(c) or (d) of column (A) and the end client provides at any time to the UK agency fraudulent documents in connection with the control, direction or supervision

Where the employment is as a mariner, this paragraph only applies where the duties of the employment are performed wholly or mainly in category A, B, C or D waters.]	which is to be exercised over the employed person, the end client; or (h) employment within paragraphs 9(c) or (d) of column (A) and a person who is resident in Great Britain (who is not the end client) with a contractual relationship with the UK agency provides at any time to the UK agency fraudulent documents in connection with the purported deduction or payment of contributions in connection with the employed person, the person who provides the fraudulent document.]

46.4 Territorial limitation: Outline

There are three categories:

(1) EU, EEA and Switzerland now governed by Brexit treaties
(2) Countries governed by specific bilateral Social Security agreements (Reciprocal Agreements & Double Contribution Conventions)
(3) Rest of the World: where neither TCA nor bilateral agreements apply.

46.5 Bilateral social security agreements

The NI Manual provides:

> **NIM33010 What is a Reciprocal Agreement?** [Apr 2019]
> A Reciprocal Agreement country is a country outside the EEA, including Switzerland, with which the UK has a bi-lateral convention on Social Security matters.
> The Social Security Conventions are more commonly referred to as Reciprocal Agreements.
> There are two types of Social Security Conventions:
> - A full Social Security Agreement which may include some benefit and health care provisions; or
> - A Double Contributions Convention (DCC) - these relate to contribution matters only and have no benefit or health care provisions.

> The countries with whom the UK has DCCs are: Canada, Japan, Republic of Korea, Chile
>
> Reciprocal Agreements are made between two countries to:
>
> - Give equality of treatment to people who are insured in one country and live or work in another country; and
> - Ensure that a person is not liable to pay Social Security Contributions in both countries for the same period.
>
> Each agreement is different.
>
> For a full list of all the countries with who the UK have agreements see NIM33012
>
> The UK also has Reciprocal Agreements with some countries in the EEA. In situations where it is not possible to apply European legislation then the Reciprocal Agreements may apply.
>
> **NIM33012 Reciprocal Agreement Countries** [Jul 2019]
>
> Barbados Bermuda Canada Chile Isle of Man Israel Jamaica Japan Jersey and Guernsey Republic of Korea Mauritius Philippines Turkey USA
>
> Republic of Former Yugoslavia (includes Bosnia-Herzegovina, Serbia, Kosovo, Montenegro, and the Republic of Macedonia). Croatia and Slovenia joined the EU in 2013 and 2004 respectively so the EC Regulations apply to those countries instead of the RA...
>
> **Isle of Man**
>
> The Isle of Man agreement is limited and liability is generally determined under place of residence.
>
> Contributions can only be paid in one country. As a general rule an employee will be insurable in the country where they work. Where a person falls within UK legislation they are treated as being ordinarily resident in the UK and are liable for Class 1 from the outset of employment in the UK.

I do not discuss reciprocal agreements in this book.

46.6 ROW: Employed in GB

I turn to consider what the NI Manual calls "ROW" (rest of the world) rules.

Unless the individual is employed *in* GB, they are not an employed or self-employed earner, and so in principle no NIC liability arises.[8] I refer to this as the "**GB employment rule**".

Tax Bulletin 79 explains:

[8] See 46.2.2 ("Employed" and "self-employed").

> This requires that employment duties take place here. However, this is wide enough to allow for some temporary or incidental duties of the employment to be performed outside the UK, if the UK is the place where the employment duties are usually performed.

46.6.1 *UK board meetings concession*

CA44 (2023/24) (National Insurance for company directors) provides:

> A director, who is neither resident nor ordinarily resident in the UK:
> - comes to the UK from a country with which the UK does not have a social security agreement
> - the only work the director does in the UK is to attend board meetings
>
> We'll not seek payment of UK NICs if:
> - they attend no more than 10 board meetings in a tax year and each visit to the UK during which a board meeting takes place lasts no more than 2 nights
> - there is only 1 board meeting in a tax year and the visit to the UK during which that board meeting takes place lasts no more than 2 weeks
>
> If the director's attendance for board meetings does not fit the criteria above, the special concession will not apply.

46.6.2 *First year abroad*

Reg. 146 SSCR provides an extension to the GB employment rule:

> (1) Where
> [a] an earner is gainfully employed outside the UK, and
> [b] that employment, if it had been in Great Britain or Northern Ireland, would have been employed earner's employment,
>
> that employment outside the UK shall be treated as employed earner's employment for the period for which under para (2)(a) contributions are payable in respect of the earnings paid to the earner in respect of that employment provided that—
>
> (a) the employer has a place of business in Great Britain or Northern Ireland (as the case may be);
> (b) the earner is ordinarily resident in Great Britain or Northern Ireland (as the case may be); and
> (c) immediately before the commencement of the employment the earner was resident in Great Britain or Northern Ireland (as the case may be).
>
> (2) Where, under para (1), the employment outside the UK is treated as an employed earner's employment, the following provisions shall apply

in respect of the payment of contributions—

(a) primary and secondary Class 1 contributions shall be payable in respect of any payment of earnings for the employment outside the UK during the period of 52 contribution weeks from the beginning of the contribution week in which that employment begins to the same extent as that to which such contributions would have been payable if the employment had been in Great Britain or Northern Ireland (as the case may be);

(b) subject to regulations 148 and 148A, any earner by or in respect of whom contributions are or have been payable under sub-para (a) shall be entitled to pay Class 3 contributions in respect of any year during which the earner is outside the UK from and including that in which the employment outside the UK begins until that in which he next returns to Great Britain or Northern Ireland (as the case may be);

(c) Class 1A contributions and Class 1B contributions shall be payable in respect of the period specified in sub-para (a).

In short, employment outside the UK is treated as employment in the UK (and so subject to NIC) for 52 weeks, provided the following conditions are satisfied:

(1) The employer has a place of business in the UK.
(2) The employee is ordinarily resident in UK.
(3) The employee was UK resident immediately before the employment commenced.

NI Manual provides:

> **NIM33535 people going to or coming from abroad: row: change of employment** [Dec 2018]
>
> **Change of employment overseas with the same employer**
>
> The 52 week period of continuing liability may cease when an employee changes employment. Whether or not an employee has entered into a new employment will be a question of fact. The contracts of employment will indicate if this were so.
>
> **Example**
>
> - Ralph was posted by the UK company to work in Australia for a period of 2 years as a General Manager of the Sydney office
> - After 6 months he applied for promotion as a Overseas Sales Executive with a separate department of the UK company
> - He was successful and immediately took up his new position in Malaysia
>
> The subsequent posting from Australia to Malaysia would be considered

> to arise in connection with the new employment with the UK Company. The 52 week period would cease.
>
> Had the UK employer simply posted him to Malaysia in connection with the original occupation/employment as a General Manager then the 52 week period would have continued in full.

The position depends on the documentation relating to the contract of employment.

HMRC say:

> The 52 week contributions rule will not apply to individuals working between the UK or an EU/EEA State or Switzerland after Brexit. Payment of National Insurance will be determined under the retained EU social security coordination rules.[9]

46.7 ROW: Residence requirements

Section 1(6) SSCBA provides a supplement to the GB employment rule:

> No person shall—
>
> (a) be liable to pay Class 1, Class 1A, Class 1B or Class 2 contributions unless he fulfils prescribed conditions as to residence or presence in Great Britain;
>
> (b) be entitled to pay Class 3 contributions unless he fulfils such conditions; or
>
> (c) be entitled to pay Class 1, Class 1A, Class 1B or Class 2 contributions other than those which he is liable to pay, except so far as he is permitted by regulations to pay them.

Reg. 145 SSCR provides five different sets of residence requirements.

46.7.1 *Primary Class 1 NIC*

Reg. 145(1)(a) SSCR provides that the requirement is:

> as respects liability of an employed earner to pay primary Class 1 contributions in respect of earnings for an employed earner's employment, that the employed earner is
>
> [i] resident or present in Great Britain or Northern Ireland
>
> [ii] (or but for any temporary absence would be present in Great Britain or Northern Ireland)
>
> at the time of that employment or
>
> [iii] is then ordinarily resident in Great Britain or Northern Ireland (as

[9] Expat forum EU Exit QA log, May 2019 (circulated informally).

the case may be).

There are four possible territorial connections, and if any one of them is satisfied Primary Class 1 NIC is in principle payable:

(1) Residence in UK.
(2) Presence in UK.
(3) Temporary absence from UK.
(4) Ordinary residence in UK.

Tax Bulletin 79 explains:

> The effect of Regulation 145 (1) SSCR 2001 is to provide for a kind of constructive presence for periods outside the UK which are merely a "temporary absence". This concept of temporary absence requires that:
>
> i. the person's absence be temporary,
> ii. that if he were not absent he would be present in the UK.
>
> This means that an employee who has employment based in the UK who goes abroad for a time on a short business trip or holiday abroad, and who departs from or returns to the UK, can continue to be within the UK scheme.
>
> An example of this would be the person who flies to a board meeting outside the UK and then returns to their UK based employment.

That seems obvious. The Bulletin continues:

> Taken together, Section 2(1)(a) SSCBA 1992 and Regulation 145 (1)(a) SSCR 2001 is enough to keep a person within Class 1 NIC if their employment is based here and their absence abroad is of a temporary or incidental nature. However, crucially, an employee who is not ordinarily resident in the UK and who normally works overseas cannot be said to be merely "temporarily absent" from employed earners employment in the UK if they are departing overseas for a time, to work for their foreign employer. In such a situation, the person is not performing duties which is merely incidental to the employed earner's employment in the UK but is returning to an employment based outside the UK. In the absence of an express contractual provision as to the attribution of the earnings, the earnings must be apportioned between the employed earner employment in the UK and the overseas duties for the foreign employer.

46.7.2 *First year in UK exemption*

Reg. 145(2) SSCR provides an exception, in a sentence so long and convoluted that it almost makes one appreciate the style of the Tax Law

Rewrite:

> Where
> [1] a person is ordinarily neither resident nor employed in the UK and,
> [2] in pursuance of employment which is mainly employment outside the UK by an employer whose place of business is outside the UK (whether or not he also has a place of business in the UK) that person is employed for a time in Great Britain or Northern Ireland (as the case may be) as an employed earner and,
> [3] but for the provisions of this paragraph, the provisions of sub-para (a) of para (1) would apply,
> [4] the conditions prescribed in that sub-paragraph and in sub-para (b) of that paragraph shall apply subject to the proviso that—
>
> (a) no primary or secondary Class 1 contribution shall be payable in respect of the earnings of the employed earner for such employment;
> (b) no Class 1A contribution shall be payable in respect of something which is made available to the employed earner or to a member of his family or household by reason of such employment; and
> (c) no Class 1B contribution shall be payable in respect of any PAYE settlement agreement in connection with such employment,[10]
>
> after the date of the earner's last entry into Great Britain or Northern Ireland (as the case may be) and before he has been resident in Great Britain or Northern Ireland (as the case may be) for a continuous period of 52 contribution weeks from the beginning of the contribution week following that in which that date falls.

In short, employment in the UK is not subject to NIC for 52 weeks provided the following conditions are satisfied:

(1) employee not ordinarily resident in UK;
(2) employee not ordinarily employed in UK;
(3) employment mainly outside the UK;
(4) employer has a place of business outside the UK.[11]

[10] I have corrected a disastrous typographical error in the SSCR by inserting a paragraph break here. The last paragraph (beginning "after the date") governs paras (a), (b) and (c). This can be seen to be correct from context and by comparing the predecessor, reg.119(2) SSCR 1979.

[11] It might be inferred that the relief only applies if the employer's principal place of business is outside the UK, but the better view is that any place of business outside the UK is sufficient, and this is consistent with reg.146(2).

NI Manual provides:

NIM33515 people going to or coming from abroad: row: exemption [Jul 2019]

Regulation 145(2) SSCR 2001

This regulation provides exemption from the payment of primary and secondary Class 1 NICs for posted workers arriving in GB for a continuous period of 52 contribution weeks provided the worker is

- not ordinarily resident in GB; and
- not ordinarily employed in GB; and
- in pursuance of an employment that is mainly outside the UK;
- by an employer with a place of business outside the UK; and
- is employed for a time in GB as an employed earner

The exemption lasts until the employee has been resident in GB for a continuous period of 52 weeks starting from the beginning of the contribution week following the week in which the worker arrives in GB to take up employment.

A further 52 week period may commence where an employee returns to the overseas employment and then commences a new secondment in GB

The exemption does not apply to:

- EEA nationals as this would contravene the principle behind Regulation 883/04 see NIM33020
- RA countries where a person is treated as being ordinarily resident in the UK if they fall within UK domestic legislation see NIM33400
- To decide whether a person coming to the UK is ordinarily resident in the UK for NIC purposes, apply the tests suggested in NIM33505 and NIM33510.

NIM33520 example [Feb 2017]

A doctor works for a hospital in Egypt as a surgeon and sees an advert in a medical journal for surgeon's position in Newcastle for a 2 year period. The position will enable him to obtain further advanced surgical qualifications.

He applies and is successful. The Egyptian employer agrees to keep his employment position open until he returns. The doctor signs a contract of employment with the hospital in Newcastle for two years.

In this case the 52 week exemption tests are satisfied. He is not ordinarily resident or employed in GB. He is employed for a time in GB as an employed earner. A major indicator in this example is the continuing employment in Egypt and the employee being able to return after the period of employment in GB.

In order to satisfy the "in pursuance of employment" test the employment in GB must be related to the particular employment that the employee has outside of GB. The fact that the employee may be pursuing their own goals is not relevant. It is characteristic of much skilled work that the employer's interests in a person's improved skills will coincide with the employee's interest in advancing their career and marketability. Provided that the facts support that the employment in GB and obtaining of advanced qualifications (in this case advanced surgical qualifications) are required for the employment abroad then the test may apply

A different conclusion may have been reached if the employment and qualifications obtained in GB were diverse from the employment in Egypt.

46.7.3 *Secondary Class 1, 1B, NICs*

Reg. 145(1)(b) SSCR provides that the requirement is:

> as respect[12] liability to pay secondary Class 1 contributions, Class 1A contributions or Class 1B contributions
>
> [i] that the person who, but for any conditions as to residence or presence in Great Britain or Northern Ireland (as the case may be and including the having of a place of business in Great Britain or Northern Ireland),[13] would be the secondary contributor or the person liable for the payment of Class 1B contributions (in this Case referred to as "the employer") is
>
> [A] resident or
>
> [B] present
>
> in Great Britain or Northern Ireland when such contributions become payable or
>
> [C] then has a place of business in Great Britain or Northern Ireland (as the case may be),
>
> [ii] so however that nothing in this paragraph shall prevent the employer paying the said contributions if he so wishes.

Thus there are three possible connecting factors and if any of them is satisfied, secondary Class 1 NIC is due:

(1) employer resident in UK
(2) employer present in UK
(3) employer has a place of business in UK

The first year in UK and student exemptions may apply.

46.8 Class 1 NIC: HMRC examples

Tax Bulletin 79 provides:

[12] This is a slip for "*as respects* …" but nothing turns on that.

[13] The long phrase beginning "but for" (and continuing to the close of brackets which follows) appears to be otiose. The paragraph means:

> "as respects liability to pay secondary Class 1 contributions, Class 1A contributions or Class 1B contributions that the person who is the secondary contributor or the person liable for the payment of Class 1B contributions (in this Case referred to as 'the employer') is resident or present in Great Britain or Northern Ireland when such contributions become payable or then has a place of business in Great Britain or Northern Ireland …"

Example 1 (Angus)

Sent from ROW country to work in the UK - contractual employer in ROW country but seconded to the UK "host" employer.

An Australian employer assigns A, who normally works in Australia to the UK for 2 years. Residence status is resident in the UK but not ordinarily resident in years 1 and 2.

A meets the criteria for a 52 weeks exemption from NIC because he is not ordinarily resident in the UK and he is not ordinarily employed in the UK and is working for his overseas employer and is in the UK in continuance of that employment. His Australian employer has no place of business in the UK.

Once the first 52 weeks period in Regulation 145(2) SSCR 2001 has expired, A will become liable for contributions in the UK. As his contractual employer has no place of business in the UK, the UK "host" employer to whom personal service is made available is the secondary contributor - liable for the employer part of the National Insurance. [Para 9 to Regulation 3, Social Security Categorisation of Earners Regulations 1978].

When he is in the UK, A is in employed earner's employment and meets the residence criteria in Regulation 145 (1) SSCR 2001 because he is present in the UK at the time of his employment.

A makes a short trip back to Australia in year 2 to brief the Australian company.

After 14 months in the UK, A returns to Australia for the month of June - 20 days holiday and 5 days working for the Australian company. He then returns to the UK to complete the rest of his assignment. A remains under contract to the Australian company and the costs of his employment in the UK is met by the Australian employer. There is no apportionment of salary specified in the contract. There can be apportionment of his salary for the days working outside the UK.

When A is in earners employment in the UK he is liable for NICs on his salary because he meets the criteria of residence and presence in Regulation 145 (1) SSCR 2001.

When in Australia, A is not in employed earners employment in the UK - his employment is one which is normally based outside the UK - so that the days working in Australia are not an incidental part of employed earners employment in the UK.

What if the employment had been funded by the UK company?

We would consider this a strong indicator that A was performing his duties in Australia for the purposes of the business of the UK "host" employer and his time in Australia was merely a "temporary absence" from employed earner's employment for the purposes of Regulation 145(1) SSCR 2001.

What if there is a letter of secondment - attaching A to his UK employer?

We consider that this would be a strong indicator that A's normal base is the UK and he can be considered to be merely "temporarily absent" for the purposes of Regulation 145(1) SSCR 2001 - the duties in Australia are incidental to the employment in the UK for which he is paid his salary.

What if A had travelled to China for 3 days to act on behalf of the UK company?

A's normal base is the UK and he can be considered to be merely "temporarily absent" for the purposes of Regulation 145(1) SSCR 2001 - the duties in China are incidental to the employment in the UK. No apportionment is required.

What if A had travelled to China for 3 days to act on behalf of the Australian company?

The duties are not further to the employment in the UK and cannot be regarded as merely a temporary absence. An apportionment is required.

What if A has been sent to the UK and become ordinarily resident here?

If A's normal base is the UK he will be in employed earner's employment in Great Britain. As he is ordinarily resident he meets the residence criteria in Regulation 145(1) SSCR 2001 - the duties in Australia are merely incidental to the employment in the employed earner's employment in the UK for which he is paid his salary. No apportionment is required.

Exactly how many days amounts to a "temporary absence"?

Whether an absence is a temporary absence is a question of fact and degree, which depends upon the nature of the circumstances. Examples of what we would consider to be temporary absence would include short business trips or holidays.

Method of Time Apportionment

In the absence of contractual provision, there is to be an apportionment between UK and non-UK workdays under Section 2 of the Apportionment Act 1870. Under the Apportionment Act, salary accrues on a daily basis. The earnings are to be multiplied by a fraction where the numerator is the number of days working overseas in the overseas employer's business and the denominator is the total number of days in employment – in a full year this will be 365 days.

Where the employee is monthly or weekly paid, the computation has to take account of the "pay period" basis for computing NIC.

Example 2 (Patel)

Mrs P is ordinarily resident in India and is sent to the UK by her employer to work in the UK at the offices of a UK company which is part of the group. She remains under contract to the Indian employer and the Indian employer bears the cost of the employment. Her salary is £100,000. Her employer recalls her to India to advise on a hostile take-over for a period of 5 days - From 1 June until 5 June. The substantial part of 2 of those days is spent flying to India and back.

The earnings are multiplied by a fraction where the numerator is the number of days working overseas in the overseas employer's business and the denominator is the total number of days in employment.

If Mrs P has an annual pay period, then the appropriate fraction can simply be applied to her annual salary.

Gross Pay £100,000×5/365

Amount attributable to overseas workdays less £1369.87

NIC is operated on the gross pay attributable to the UK £98,630.13

However, if Mrs P is monthly paid, the employer has to account for NIC each month as a payment is made, and is unable to "look back" over a year and know what percentage needs to be applied. So the apportionment has to be done in the monthly pay period.

In June, no NICs are due on the salary paid in respect of the work in India.

The earnings on which NICs are to be calculated are those for the month of June – after an apportionment to take account of the 5 days which were not in respect of the employed earners employment.

Monthly salary £8333.33×5/365×100,000 less £1369.87

Amount attributable to non-UK workdays £1369.87

NIC is operated on the monthly gross pay attributable to the UK **£6963.46**

Holidays

If Mrs P were to take a holiday in India, the holiday may need to be brought into the calculation of non-UK workdays in the apportionment – depending on the contractual provisions and whether the holiday is attributable to the UK or overseas employment.

In Example 2, if in June Mrs P took 10 days holiday in India – in the absence of contractual provisions setting out how holiday accrues, these would be added to the 5 days working in India:

Salary £8333.33×15/365×£100,000

amount attributable to non-UK workdays = £4109.59

Earnings in the Month on which NIC must be operated = £4223.74

What about part of a day worked in the UK and part overseas?

We operate the practice in SP 5/84 with regard to days spent working partly in the UK and partly outside the UK. That is to say, if a day is substantially worked overseas for the overseas business then it will count as a non-UK work day in the apportionment computation. Where an employee spends a whole day working in the UK but then leaves the country that evening on an overseas business trip, it would be difficult to say as a matter of contract that the employee's emoluments for that day were not attributable on a time apportionment basis to duties performed in the UK. It follows that the emoluments for a day spent working overseas before returning to the UK in the evening will be attributable to duties performed overseas.

Records

Employees are required to retain evidence such as travel documents and business diaries to demonstrate how they have calculated non-UK workdays for tax. Where records of "non-UK workdays" for tax have been kept, these may be used as the basis for identifying non-UK days for National Insurance.

Expats forum Q&A log provides:

Employee of UK company who is based overseas, but visits the UK

Question: We have recently received several queries from different UK companies regarding the National Insurance position in relation to employees who are based overseas and usually perform their work duties in a country which is outside the EU and does not have a reciprocal social security agreement with the UK (for example, South Africa). However, these employees are required to visit the UK for a small number of days each year (between 10 and 30 workdays per annum).

Based on our understanding of the facts, all of the employees concerned are not ordinarily resident in the UK. This is because they continue to live overseas, together with their family, and maintain a home overseas, and merely stay in hotels in the UK when required to stay overnight for work purposes. However, we understand the 52 week exemption under regulation 145(2) of Social Security (Contributions) Regulations 2001 would not apply, as they are employed by a company with a place of business in the UK.

In accordance with our review of the applicable legislation and the publication Tax Bulletin 79, we understand that there is no liability to pay Class 1 National Insurance unless there is an employed earners employment (or employment treated as employed earners employment) here in the UK. Accordingly, an individual is defined as an "employed earner" by Section 2(1)(a) of the Social Security Contributions and Benefits Act, which states:

… "employed earner" means a person who is gainfully employed in Great Britain either under a contract of service, or in an office (including elective office) with general earnings…

As such, in order to confirm whether a liability to Class 1 National Insurance is applicable, we have concluded it is necessary to determine whether such employees fulfil the criteria of being 'gainfully employed in Great Britain' under their UK employment contract. We understand this phrase is not defined in legislation, and therefore takes its ordinary meaning.

A view as to the meaning is expressed in Tax Bulletin 79 (which, although archived, is not marked as superseded), as follows:

An employed earner is defined in Section 2(1)(a) as a "person who is gainfully employed in Great Britain either under a contract of service, or in an office (including elective office) with general earnings chargeable to income tax under ITEPA 2003".

This requires that employment duties take place here. However, this is wide enough to allow for some temporary or incidental duties of the employment to be performed outside the UK, if the UK is the place where the employment duties are usually performed. Based on above interpretation provided in Tax Bulletin 79, we understand that the employees concerned would be 'gainfully employed in Great Britain' only when the employment duties physically take place in the UK and are usually performed here. In this regard, any temporary or incidental duties performed in the UK would be ignored.

In addition, the employees concerned would not be captured by reg. 146, as they are not ordinarily resident in the UK and therefore cannot be treated as performing an employed earner's employment here. Therefore, we should be grateful if you could confirm our opinion that the employees concerned would not be liable to pay Class 1 National Insurance on their earnings from the UK company.

HMRC answer:

Each case must be considered on its own facts however, Regulation 145 of the SSCR sets out, for the purposes of section 1(6) of the Social Security Contributions and Benefits Act 1992, the conditions as to residence or presence in Great Britain or Northern Ireland for the purposes of liability or entitlement to pay National Insurance contributions. Regulation 145(2) of the SSCR also provides for a limited exemption from paying Class 1 NICs (for up to 52 weeks) for workers coming to work in the UK for a time from a country outside of the

European Economic Area (EEA), or with whom there is no reciprocal agreement on social security - in other words those coming to the UK from somewhere we categorise as being a "rest of the world" country.

In order for the exemption at regulation 145 (2) of the SSCR to apply, all of the following conditions must be met:

- The person is not ordinarily resident in the UK, and
- The person is not ordinarily employed in the UK, and
- In pursuance of employment which is mainly employment outside the UK by an employer whose place of business is outside the UK, and
- The person is employed in the UK for a time

From the information provided, the employees referred to would not meet all of the above criteria for the exemption in regulation 145 (2) of the SSCR to apply. In particular, whilst working in the UK they are not pursuing employment which is mainly employment outside the UK by an employer whose place of business is outside the UK. In fact, whilst back in the UK working they are actually working in the UK for their UK employer. As such, the exemption provided by regulation 145(2) would not apply. Furthermore, whilst in the UK they will be 'present' in the UK for the purposes of regulation 145(1)(a) SSCR which provides that a liability for primary (employee) Class 1 NICs will arise on any earnings they receive. The UK employer, having its place of business here, would also have a liability for secondary Class 1 NICs on those earnings under regulation 145(1)(b) SSCR.[14]

46.9 ROW: Class 2 NIC

Reg. 145(1) SSCR provide that the requirements are:

> (c) as respects entitlement of a self-employed earner to pay Class 2 contributions, that that earner is present in Great Britain or Northern Ireland (as the case may be) in the contribution week for which the contribution is to be paid;
>
> (d) as respects liability of a self-employed earner to pay Class 2 contributions, that the self-employed earner is ordinarily resident in Great Britain or Northern Ireland (as the case may be), or, if he is not so ordinarily resident, that before the period in respect of which any such contributions are to be paid he has been resident in Great Britain [or Northern Ireland][15] (as the case may be) for a period of at least 26 out of the immediately preceding 52 contribution weeks under the Act, the Social Security Act 1975 or the National Insurance Act 1965 or under some or all of those Acts.

[14] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/897729/HMRC_Joint_Expat-Forum-Tax_NICs_minutes-11-June-2020.pdf*

[15] These words are omitted (presumably accidentally) from the SSCR but the context requires them.

Thus there are two possible connecting factors and if either is present, Class 2 NIC is due:

(1) ordinary residence in UK;
(2) residence for 26 out of 52 contribution weeks.

46.10 ROW: Class 3 NIC

Reg. 145(1)(e) SSCR provides that the requirement is:

> as respects entitlement of a person to pay Class 3 contributions in respect of any year, either that—
>
> (i) that person is resident in Great Britain or Northern Ireland (as the case may be) throughout the year,
>
> (ii) that person has arrived in Great Britain or Northern Ireland (as the case may be) during that year and has been or is liable to pay Class 1 or Class 2 contributions in respect of an earlier period during that year,
>
> (iii) that person has arrived in Great Britain or Northern Ireland (as the case may be) during that year and was either ordinarily resident in Great Britain or Northern Ireland (as the case may be) throughout the whole of that year or became ordinarily resident during the course of it, or
>
> (iv) that person not being ordinarily resident in Great Britain or Northern Ireland (as the case may be), has arrived in that year or the previous year and has been continuously present in Great Britain or Northern Ireland (as the case may be) for 26 complete contribution weeks, entitlement where the arrival has been in the previous year arising in respect only of the next year.

46.11 Place of business in UK

Tax Bulletin 49 provides:

> **Place of business in UK**
>
> We would normally accept as a strong indication that there is a place of business in the UK if a company is registered under the Companies Act 1985.[16] But whether there is a place of business in the UK is a question of fact based on the individual case. Case law has shown that a company establishes a place of business in the UK if it carries on part of its business here. Such business activity need not be either a substantial

[16] [Author's Note] Regulations made under s.1043 Companies Act 2006 impose a registration duty on a foreign incorporated company which establishes a place of business in GB; Northern Ireland has equivalent legislation.

> part of, or more than incidental to, its main objects (*South India Shipping Corporation v Export-Import Bank of Korea* [1985] 2 AER 219). However there must be a more or less permanent location, not necessarily owned or leased by the company but associated with the company, from which its business is conducted habitually or with some degree of regularity (*Re Oriel* [1985] 3 AER 216). In Canadian law the premises of a group company are not sufficient in themselves to be a place of business for another group member (*Imperial Oil v Oil Workers International* 69 WWR 702).
>
> We would not seek to claim in isolation that there is a place of business where the overseas provider legally, and in exchange for a payment commensurate with the service, sub-contracts services to a UK business.[17]

46.12 Residence and ordinary residence

The NIC legislation does not define residence or ordinary residence. For residence, the NI Manual states:

> **NIM29009 DL Conditions of domicile or residence** [Feb 2017]
>
> You should operate Residence, Domicile and Remittance Basis Manual guidance in deciding whether a person is domiciled or resident. Any difficulties on residence should be submitted to Marine NICs in Cardiff (see NIM29034).

For residence, the pre-SRT IT rules should strictly speaking be applied, but in practice I expect close regard will be had to the SRT (which is supposed to represent the former common law rules).

For ordinary residence, the NI Manual states:

> **NIM33560 Meaning of "ordinarily resident" – Factors to consider** [Jul 2019]
>
> ... In considering whether a person is "ordinarily resident", you should take into account the following factors,
>
> - Will the person be returning to Great Britain or Northern Ireland during the period of employment abroad?
> - Will the person's family - spouse/partner and/or children - be staying in the UK?
> - Will the person retain a home in Great Britain or Northern Ireland during their period abroad?

[17] This has been flagged as no longer current, however the author is not currently aware of this passage being moved elsewhere.

> - If the person retains a home, will it be available for their use when they return?
> - Will the person be returning to Great Britain or Northern Ireland at the end of the period abroad?
>
> The list is not exhaustive but, answering yes to any, or all, of the above questions is an indicator the individual remains "ordinarily resident". Answers of no would indicate it is less likely that the person will remain ordinarily resident.
>
> Additional questions you could consider include;
>
> - How long has the person lived in Great Britain or Northern Ireland prior to going abroad?
> - What will be the purpose(s) of the any return visit(s)?
>
> For guidance on the definition of "ordinarily resident" for tax purposes, see the Residence, Domicile and Remittance Basis Manual, RDRM.

The seven factors are unhelpful as no guidance is given how to deal with the practical problems when different factors point in different directions.

There are no statutory provisions on ordinary residence so case law is all we have. The leading case is *R v Barnet LBC ex p Shah.*[18] This is not a tax case but the expression “ordinary residence” is said to have a natural and ordinary meaning which is the same in tax and non-tax contexts.[19]

In *Shah* the House of Lords noted that ordinary residence was distinct from domicile and rejected a “real home” test (which was similar to a domicile test).

What is the test? A number of dicta were approved, saying (more or less) the same thing in different words:

> I think that [ordinary residence] connotes residence in a place with some degree of continuity and apart from accidental or temporary absences.[20]

> “Ordinarily resident” refers to a man’s abode in a particular place or country which he has adopted voluntarily and for settled purposes as part of the regular order of his life for the time being, whether of short or long duration.[21]

The important requirement is the residence must have the degree of

[18] [1983] 2 AC 309. The case is noteworthy for the fact that oral argument over the two words "ordinarily resident" lasted 9 days.

[19] *Shah* at p.340.

[20] *Shah* at p.341 citing Viscount Sumner in *Lysaght v IRC* 13 TC 511 at p.528.

[21] *R v Barnet LBC ex p. Shah* [1983] 2 AC 309 at p.343. This passage has often been cited with approval.

continuity, or in other words, it must be "for settled purposes." What does that mean?

> There must be a degree of settled purpose. The purpose may be one; or there may be several. It may be specific or general. All that the law requires is that there is a settled purpose. This is not to say that the "propositus" intends to stay where he is indefinitely; indeed his purpose, while settled, may be for a limited period. Education, business or profession, employment, health, family, or merely love of the place spring to mind as common reasons for a choice of regular abode. And there may well be many others. All that is necessary is that the purpose of living where one does has a sufficient degree of continuity to be properly described as settled.[22]

46.12.1 *Accommodation*

Turberville at [9] notes that accommodation held long term is consistent with being non-ordinarily resident:

> We consider the retention of the house and flat in the UK as fairly neutral; he had retained these (or predecessor properties) throughout the time he was working abroad.

Accommodation is however a relevant factor in deciding whether a person is "settled".

46.12.2 *Minimum period*

One would have thought that if a person settled in a country, they became ordinarily resident immediately. This was the view expressed in HMRC. In *Tuczka v HMRC*[23] however the Upper Tribunal suggested that there was a minimum time (though the minimum is not very long):

> 12. ...After referring also to the dicta in the tax cases, Lord Slynn concluded that it was "plain that as a matter of ordinary language a person is not habitually resident in any country unless he has taken up residence and lived there for a period." Lord Slynn continued (at 1942G-1943B):
>
> > "It seems to me impossible to accept the argument at one time advanced that a person who has never been here before who says on landing, "I intend to settle in the UK" and who is fully believed is

[22] *Shah* at p.344.

[23] [2011] UKUT 113 (TCC).

> automatically a person who is habitually resident here. Nor is it enough to say I am going to live at X or with Y. He must show residence in fact for a period which shows that the residence has become "habitual" and, as I see it, will or is likely to continue to be habitual...
>
> The requisite period is not a fixed period. It may be longer where there are doubts. It may be short (as the House accepted in *In re S (A Minor) (Custody: Habitual Residence)* [1998] A.C. 750, my speech at p.763A, and *F (A Minor) (Child Abduction)* [1992] 1 FLR 548, 555, where Butler-Sloss L.J. said: "A month can be ... an appreciable period of time")."
>
> 13. Even assuming for the purpose of argument that "habitually" and "ordinarily" mean the same thing, we do not regard *Nessa* as in any way departing from Lord Scarman's clear rejection of any requirement to establish an intention to reside permanently or for an indefinite period. All that *Nessa* established in that regard is that a person would not qualify as "habitually resident" immediately on arrival, save in a case where he resumed his previous habitual residence. Some period of time is therefore needed to establish "habitual residence". But the fact that this period need not be long can be seen not only from Lord Slynn's reference to the observation of Butler Sloss LJ quoted above but from the resolution of the *Nessa* case itself. The House of Lords upheld the decision of the Court of Appeal that the case be remitted for rehearing before a social security appeal tribunal to determine whether the claimant had established habitual residence by the date of the initial tribunal hearing (ie, 6 December 1994, and thus less than four months after her arrival in the UK) or "even earlier": see at 1943D.

This overlooks the fact that the question of ordinary residence is determined with an element of hindsight: see 9.16.2 (Enquiry period: Habitual abode). It is considered that there is no minimum period.

46.12.3 *Intention*

In *Shah*, Lord Scarman said:

> There are two, and no more than two, respects in which the mind of the "propositus" is important in determining ordinary residence. The residence must be voluntarily adopted. Enforced presence by reason of kidnapping or imprisonment, or a Robinson Crusoe existence on a desert island with no opportunity of escape, may be so overwhelming a factor as to negative the will to be where one is.

The "voluntary" requirement does not have much practical role to play, as it only concerns imprisoned, kidnapped or shipwrecked taxpayers.[24]

The speech continues:

> And there must be a degree of settled purpose. The purpose may be one; or there may be several. It may be specific or general. All that the law requires is that there is a settled purpose. This is not to say that the "propositus" intends to stay where he is indefinitely; indeed his purpose, while settled, may be for a limited period. Education, business or profession, employment, health, family, or merely love of the place spring to mind as common reasons for a choice of regular abode. And there may well be many others. All that is necessary is that the purpose of living where one does has a sufficient degree of continuity to be properly described as settled. The legal advantage of adopting the natural and ordinary meaning, as accepted by the House of Lords in 1928 and recognised by Lord Denning M.R. in this case, is that it results in the proof of ordinary residence, which is ultimately a question of fact, depending more upon the evidence of matters susceptible of objective proof than upon evidence as to state of mind. Templeman L.J. emphasised in the Court of Appeal the need for a simple test for local education authorities to apply: and I agree with him. The ordinary and natural meaning of the words supplies one. For if there be proved a regular, habitual mode of life in a particular place, the continuity of which has persisted despite temporary absences, ordinary residence is established provided only it is adopted voluntarily and for a settled purpose.

In *Tuczka v HMRC* [2010] UKFTT 53 the tribunal said:

> The test requires objective examination of immediately past events, and not intention or expectation for the future ([1983] 2 AC 309 at 345).

It is considered that the concept of being "settled" necessarily requires an examination of intention or expectation for the future.

46.12.4 *Acquiring ordinary residence*

In *Tuczka v HMRC* [2011] UKUT 113 (TCC) the taxpayer came to the UK to work and intended to stay 33 months (2.5 years). There were other facts which suggested he was settled, in particular that his girlfriend came

[24] "The residence must be voluntarily adopted. Enforced presence by reason of kidnapping or imprisonment, or a Robinson Crusoe existence on a desert island with no opportunity of escape, may be so overwhelming a factor as to negative the will to be where one is." *Shah* at p.344.

to join him.

It was argued that an intention to reside here for that period was too short to constitute a "settled purpose". The argument was rejected. Even a period of just over one year could be sufficient.[25]

46.12.5 *Losing ordinary residence*

In *Turberville v HMRC* [2010] UKFTT 69 the taxpayer left the UK in July 2001 to work abroad. The taxpayer remained ordinarily resident until July 2001 even though he had formed the intention to leave earlier, in February 2001:

> 8. In relation to 2001-02, while it was clear in February 2001 that he would go to Dallas in July 2001 we do not consider that this changes the quality of his residence between 6 April 2001 and 30 June 2001, which was a continuation of his residence during the previous four tax years. Although it was then known that such residence would cease about 1 July 2001 it was nevertheless part of his residence for settled purposes and the fact that the Appellant's state of mind was such that he would be leaving the UK at around that time does not, until his actual departure, alter the position.

In July 2001 the taxpayer ceased to be ordinarily resident.

In October 2001 the taxpayer unexpectedly lost his job, but remained non-ordinarily resident. The judgment at [8] continues:

> From the date of actual departure, we consider that in deciding whether there was then a distinct break one should look at the position as it was in July 2001 without the benefit of hindsight. The three-year employment contract coupled with his expenditure on furnishing the apartment rented by his employer point to a distinct break.

In the absence of purchase of accommodation, three years has traditionally been regarded as the period of residence which is sufficient to amount to settled.

46.12.6 *Habitual/ordinary residence compared*

Schuz explains the concept of "Habitual residence"

> Habitual residence has been chosen as the main connecting factor in

[25] At [17] citing relying on *Reed v Clark* quoted at [15]; but *Clark* was not considering ordinary residence of the taxpayer (which was not an issue).

> many of the multinational conventions concluded under the auspices of the Hague Conference on Private International Law for nearly one hundred years.[26] It is now also used in other international conventions and in the domestic legislation of a number of countries, including England and Canada. However, there was very little discussion as to the meaning of the concept until the explosion of litigation under the Hague Convention on the Civil Aspects of Child Abduction began in the 1980s. Under this Convention, the determination of habitual residence is often critical to the outcome of an application for the return of the child in international abduction cases.[27]

The term is not found in tax legislation.

If the concept was the same as "ordinary residence" then cases on habitual residence might be valuable for tax. In principle the terms habitual residence and ordinary residence could be regarded as synonymous. The natural meaning of the two expressions is the same (or at least, equally vague). However the case law has not been consistent. In some cases the expressions are regarded as the same.[28] Some cases suggest that habitual residence is "something more than" ordinary residence,[29] though that "something more" is elusive. It has been said that the concepts merely share a "common core of meaning".[30] In the context of the Hague Abduction Convention, at least, "habitual residence" has been held to have an autonomous meaning (ie a meaning distinct from that in the domestic law of the parties to the Convention) and the Supreme Court refused to follow *Shah*.[31]

While it would be desirable that a person's habitual residence and ordinary residence should be in the same place for all purposes, the desire for conceptual simplicity should not override the need to give effect to the purpose of the legislation in question.

In any case, the authorities on "habitual residence" do not provide a clear

[26] It was first used in the Hague Convention on Guardianship in 1902, and is the main connecting factor in the Hague Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters.

[27] Schuz, "Policy Considerations in Determining the Habitual Residence of a Child and the Relevance of Context" (2001) 11 Journal of Transnational Law and Policy 101, *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=270991*

[28] *Mark v Mark* [2005] UKHL at [33].

[29] *Cruse v Chittum* [1974] 2 All ER 940 at p.943.

[30] *Nessa v Chief Adjudication Officer* [1999] 1WLR 1937 at p.1941.

[31] *A v A* [2014] AC 1 at [54].

definition or explanation of the term, and the authorities on the Abduction convention are best understood in the light of the policy considerations relevant to abduction.[32] In borderline cases, at least, the meaning of the term will vary according to the context. In a family law context, at least, the words are regarded as distinct:

> ... the Law Commissions deliberately adopted "habitual" rather than "ordinary" residence, because the latter frequently occurred in tax and immigration statutes and they thought that its use in the wholly different context of family law was a potential source of confusion.[33]

46.12.7 *Residence/ordinary residence compared*

Tuczka significantly reduced the difference between residence (the common law, pre-SRT concept) and ordinary residence or (if one prefers) it shows that the difference is not as great as had generally been thought:

> [18] Nor is it correct to suggest that a finding that Dr Tuczka was ordinarily resident in the UK in the tax year 1998-99 erodes a fundamental distinction between the concepts of residence and ordinary residence. The distinction is not as wide or as basic as the present appellant seeks to suggest. Hence, in *Levene*, Viscount Cave LC stated at p507:
>
> > "The expression "ordinary residence" is found in the Income Tax Act of 1806 and occurs again and again in the later Income Tax Acts, where it is contrasted with the usual or occasional or temporary residence; and I think that it connotes residence in a place with some degree of continuity and apart from accidental or temporary absences. So understood, the expression differs little in meaning from the word "residence" as used in the Acts..."

Unless the courts step back from this, HMRC6 was more generous than the law on the subject.

Ordinary residence needs to be reviewed in the light of *Carey v HMRC* [2015] UKFTT 466; *Ward v HMRC* [2016] TC 04902; *Milton Keynes*

[32] Habitual residence is "a question of fact to be determined by the circumstances of each case": [2014] AC 1 at [36]; and see Schuz, "Policy Considerations in Determining the Habitual Residence of a Child and the Relevance of Context" (2001) 11 Journal of Transnational Law and Policy 101. *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=270991*

[33] *A v A* [2014] AC 1 at [38], see Law Com. No 138 *Family law, custody of children : jurisdiction and enforcement within the United Kingdom* (1985) para 4.15.

Council [2015] CSOH 156; *Mackay v HMRC* [2018] BTC 529.

46.13 EU/EEA/Switzerland

46.13.1 *Outline*

In summary: Cross-border workers are only liable to pay social security contributions in one state at a time:

(1) *General rule:* this will be in the country where work is undertaken, regardless of (a) whether the worker resides in the EU or the UK, and (b) whether the employer is based in the EU or the UK.

(2) *"Detached worker" rule:* UK workers sent by their employer to work temporarily in an EU Member State pay social security contributions in the UK only. Similarly, if an EU worker is sent by their employer to work temporarily in the UK from a Member State they pay contributions in that EU Member State only.

The rules were formerly in Regulation 883/2004 on the coordination of social security systems, and are now in the Protocol on Social Security Coordination ("SSC") which is part of the TCA.

These agreements also cover social security benefits but this chapter only considers the NIC aspects.

I focus here on the SSC but hope to cover EEA and Switzerland in a future edition.

The rules, unsurprisingly, continue the approach which formerly applied under and similar pre-Brexit rules. But there are changes, and I set out the old Reg 883/2004 rules side by side, so the changes can be identified.

The transitional protection for those who started working abroad before 1/1/2021 is not discussed here.

HMRC have published guidance ("**NIC guidance**")[34] and pre-2021 guidance is also useful, though it needs to be reviewed to check whether the law has changed.

46.14 Definitions

Art SSC.1: provides:

> For the purposes of this Protocol, the following definitions apply:
>
> (a) "activity as an employed person" means any activity or equivalent situation treated as such for the purposes of the

[34] *https://www.gov.uk/tax-right-retire-abroad-return-to-uk*

social security legislation of the State in which such activity or equivalent situation exists;

(b) "activity as a self-employed person" means any activity or equivalent situation treated as such for the purposes of the social security legislation of the State in which such activity or equivalent situation exists;...

(t) "period of employment" or "period of self-employment" mean periods so defined or recognised by the legislation under which they were completed, and all periods treated as such, where they are regarded by that legislation as equivalent to periods of employment or to periods of self-employment;

(v) "period of residence" means periods so defined or recognised by the legislation under which they were completed or considered as completed;

(aa) "residence" means the place where a person habitually resides;

46.15 Persons covered

Article SSC.2

This Protocol shall apply to persons, including stateless persons and refugees, who are or have been subject to the legislation of one or more States, as well as to the members of their families and their survivors.[35]

Art 2 reg 883/2004

1. This Regulation shall apply to nationals of a Member State, stateless persons and refugees residing in a Member State who are or have been subject to the legislation of one or more Member States, as well as to the members of their families and to their survivors.

2. It shall also apply to the survivors of persons who have been subject to the legislation of one or more Member States, irrespective of the nationality of such persons, where their survivors are nationals of a Member State or stateless persons or refugees residing in one of the Member States.

[35] In the UK, NICs (other than the voluntary Class 3 NIC) are only paid by employed or self-employed, so the reference to "members of their families and their survivors" is irrelevant for NIC, though it may be relevant for other purposes.

46.16 General rules

Article SSC.10(1) provides there can only be one charge to tax:

> 1. Persons to whom this Protocol applies shall be subject to the legislation of a single State only. Such legislation shall be determined in accordance with this Title.

Art SSC.10(2) defines "pursuing an activity":

> 2. For the purposes of this Title, persons receiving cash benefits because or as a consequence of their activity as an employed or self-employed person shall be considered to be pursuing the said activity. This shall not apply to invalidity, old-age or survivors' pensions or to pensions in respect of accidents at work or occupational diseases or to sickness benefits in cash covering treatment for an unlimited period.

Article SSC.10(3) provides the general rule:

> 3. Subject to Articles SSC.12 [Pursuit of activities in two or more States] and SSC.13 [Voluntary insurance or optional continued insurance]:
>
> (a) a person pursuing an activity as an employed or self-employed person in a State shall be subject to the legislation of that State;

The article continues with some more specialist rules:

> (b) a civil servant shall be subject to the legislation of the State to which the administration employing them is subject;
>
> (c) any other person to whom points (a) and (b) do not apply shall be subject to the legislation of the State of residence, without prejudice to other provisions of this Protocol guaranteeing them benefits under the legislation of one or more other States...

46.17 Detached workers

Article SSC.11 provides:

> 1. By way of derogation from Article SSC.10(3) [General rules] and as a transitional measure in relation to the situation that existed before the entry into force of this Agreement, the following rules as regards the applicable legislation shall apply between
>
> [i] the Member States listed in Category A of Annex SSC-8 [Transitional provisions regarding the application of Article SSC.11][36] and

[36] This wording was to allow Member States to opt in to the detached worker rules; but all Member States chose to opt in: Official Journal 16 Feb 2021

[ii] the United Kingdom:

We move on to the rule. It may be helpful to compare SSC and its predecessor:

SSC art 11 (post 1/1/21)	**Art 12(2) Reg 883/2004 (pre 1/1/21)**
(a) a person who	A person who
[A] pursues an activity as an employed person in a State for an employer which normally carries out its activities there	pursues an activity as an employed person in a Member State on behalf of an employer which normally carries out its activities there
[B] and who is sent by that employer to another State to perform work on that employer's behalf	and who is posted by that employer to another Member State to perform work on that employer's behalf
shall continue to be subject to the legislation of the first State, provided that:	shall continue to be subject to the legislation of the first Member State, provided that
(i) the duration of such work does not exceed 24 months; and	the anticipated duration of such work does not exceed twenty-four months and
(ii) that person is not sent to replace another detached worker.	that he is not sent to replace another person.

The term "posted" is replaced by "sent" but the meaning is the same. There are other changes.

There is now no power to extend the 24 month period.

SSC continues:

> (b) a person who normally pursues an activity as a self-employed person in a State who goes to pursue a similar activity in another State shall continue to be subject to the legislation of the first State, provided that the anticipated duration of such activity does not exceed 24 months.

This provides a rough equivalent of the ROW year abroad rule for employees, but the period here is 2 years.

https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=OJ%3AC%3A2021%3A055%3AFULL

EC guidance on the pre-brexit rules remains useful.[37]

46.17.1 *Where activities normally carried out*

The NI Manual provides:

> **NIM33080 Meaning of "Which normally carries out its activities there"** [Nov 2019]
> The expression "which normally carries out its activities there" means an undertaking which ordinarily carries out substantial activities in the territory of the Member State in which it is established. If the undertakings activities are confined to internal management, the undertaking will not be regarded as normally carrying out its activities in that Member State. In determining whether an undertaking carries out substantial activities, account must be taken of all criteria characterising the activities carried out by the undertaking in question. The criteria must be suited to the characteristics of each undertaking and the real nature of the activities carried out.
> The following factors are of particular importance
> - the place where the posting undertaking has its registered office and its administration.
> - the number of administrative staff present in the posting State compared to the State of employment.
> - the place of recruitment of the postal worker.
> - the place where the majority of contracts with clients are concluded.
> - the law applicable to the contracts signed by the posting undertaking with its clients and with its workers.
> - The turnover achieved by the posting undertaking in the posting State and in the State of employment during an appropriate typical period (e.g. turnover of approximately 25% of total turnover in the posting state could be a sufficient indicator, but cases where turnover is under 25% would warrant greater scrutiny).
>
> But the list of criteria outlined above is not an exhaustive.

46.17.2 *Sent to perform work*

The NI Manual provides:

> **NIM33085 Meaning of "Direct Relationship"** [Nov 2019]
> A direct relationship must continue to exist between the posting

[37] "Practical guide on posting" *https://op.europa.eu/en/publication-detail/-/publication/8ac7320a-170f-11ea-8c1f-01aa75ed71a1/language-en*

undertaking and the posted worker throughout the period of posting. There are some indicators of the existence of such a direct relationship, including:

- It must be evident that the contract was and still is applicable to the parties involved in drawing it up and stems from the negotiations that led to the recruitment;
- The power to terminate the contract of employment (dismissal) must remain exclusively with the posting undertaking;
- The posting undertaking must retain the power to determine the nature of the work performed by the postal worker, not in terms of defining the details of the type of work to be performed and the way it is to be performed, but in the more general terms of determining the end product of that work or the basic service to be provided;
- The obligation with regard to the remuneration of the worker rests with the undertaking which concluded the contract, irrespective therefore of who actually makes the payment.

There are some situations where it is impossible for someone to remain insured in the sending Member State under [Article SSC.11]:

- The undertaking to which the worker has been posted places him/her at the disposal of another undertaking in the Member State in which it is situated;
- The undertaking to which the worker is posted places him/her at the disposal of an undertaking situated in another Member State;
- The worker is recruited in a Member State in order to be sent by an undertaking situated in a second Member State to an undertaking in a third Member State;
- The worker is recruited in one Member State by an undertaking situated in a second Member State in order to work in the first Member State.

46.17.3 *Hire for immediate posting*

The NI Manual provides:

NIM33090 Workers hired for immediate posting [Apr 2019]

There are some additional restrictions in place in relation to workers hired and then immediately posted.

The rules on posting may also apply to workers recruited in one Member State with a view to being posted in another provided certain conditions are met.

One of these conditions is that:

- Immediately before the start of his/her employment the person is already subject to the legislation of the Member State in which the

> undertaking which employed him/her is established.

That is not quite what the legislation now says,[38] but it will not often matter.

> A period of at least one month can be considered as meeting this requirement, with shorter periods requiring a case by case evaluation taking account of all the factors involved.
>
> The other posting conditions also have to be met. So the "posting" undertaking must normally carry out its activities there and the worker must pursue an activity on behalf of the employer, there must exist throughout the period of posting a direct relationship between the posting employer and the posted worker, the posting undertaking must also be one which carries out substantial activities in the posting State, and so on.
>
> The point here is that the person does not need to have been employed by that particular employer before they are sent to work abroad, but they should have been in the UK and been insured when they are hired to be sent abroad. They can be UK insured by paying contributions, or because they are in receipt of UK benefits if out of work, or simply by being resident in the UK if they are not working and not in receipt of benefits. The purpose of the posting regulation is to let someone continue their existing contribution and benefit record in the sending Member State.

46.18 Forms

46.18.1 *Pre-brexit forms*

The NIC guidance discusses pre-brexit forms:

> The EU Regulations provide for a system of forms so that employers and employees can demonstrate that they are entitled to operate the legislation of one Member State and be exempt contributions under the legislation of another...
>
> For employees coming to the UK from the other Member States, you should operate National Insurance contributions from the start of the employment unless you hold a valid E101 (or from 1 May 2010 Form A1 or an E101) showing that they are exempt National Insurance in the UK and subject to the legislation of another Member State.
>
> For employees going to work in another Member State, you should apply to HMRC NIC&EO to find out whether the employee should remain in UK National Insurance and you can be issued Form E101 (or Form A1

[38] See 46.15 (Persons covered by SSC).

> after 1 May 2010). As long as the UK's legislation continues to apply, you should continue to operate employer and employee National Insurance rather than the contributions of the other Member State.

The NI Manual provides:

> **NIM33065 Posted workers general information** [Nov 2019]
> ... In certain circumstances a person who is sent by their employer in one Member State to work temporarily in another Member State can continue to pay contributions only in their home state.
> A system of portable documents (A1) exists within the European Union to ensure that the worker does not also have to pay contributions in the Member State they are posted to.
> A worker sent to the UK claiming to be exempt under Article 12 should be able to produce to HMRC a Portable Document A1 issued by the authorities in the Member State they have come from as proof of this exemption. If they do not then you should charge primary and secondary National Insurance until they produce the Portable Document A1.
> You should give the worker and their employer a reasonable amount of time to produce an A1. A delay of several months is not uncommon for the other Member States to issue the form.
> (This content has been withheld because of exemptions in the Freedom of Information Act 2000)
> **NIM33070** [Apr 2019]
> ... PT Ops International Caseworker (ICW) deals with people posted from the UK to other Member States and are in charge of issuing Portable Documents A1.
> You should liaise with NIC&EO International Caseworker before giving advice on whether a worker posted from the UK should continue to pay UK National Insurance -
> International Caseworker, PT Operations North East England, HM Revenue and Customs, BX9 1AN
> A worker who meets the conditions for posting at NIM33065 will continue to be liable for Class 1 National Insurance whilst abroad throughout the period of the posting.
> Where these posting rules apply, the residence rules at NIM33505 and NIM33510 do not apply

46.18.2 *Forms from 1 Jan 2021*

HMRC say:[39]

[39] *https://www.gov.uk/guidance/national-insurance-for-workers-from-the-uk-working-in-the-eea-or-switzerland*

Your circumstances	**Form to complete**
Your employer sends you to work temporarily in the EU, Iceland, Liechtenstein, Norway or Switzerland.	Form CA3822
You're normally self-employed in the UK and you're going to temporarily carry out some activities in the EU, Iceland, Liechtenstein, Norway or Switzerland.	Form CA3837
You're working in 2 or more of the UK, EU, Iceland, Liechtenstein, Norway or Switzerland.	Form CA8421
You're flight or cabin crew with a home base in the UK.	Form CA8421
You're a UK civil servant or other government worker	Form CA3822
You're a UK resident who works on a vessel at sea with a UK flag or an EU, Norwegian, Icelandic or Swiss flag but you're paid by someone based in the UK.	Form CA3822

46.19 Activity in 2 states: Tie-breaker

The place of employment rule needs a tie-breaker if there are two places of employment.

46.19.1 *2 places of employment*

Article SSC.12 provides:

> 1. A person who normally pursues an activity as an employed person in one or more Member States as well as the United Kingdom shall be subject to:
>
> (a) the legislation of the State of residence if that person pursues a substantial part of their activity in that State; or
>
> (b) if that person does not pursue a substantial part of their activity in the State of residence:
>
> (i) the legislation of the State in which the registered office or place of business of the undertaking or employer is situated if that person is employed by one undertaking or employer; or
>
> (ii) the legislation of the State in which the registered office or place of business of the undertakings or employers is situated if that person is employed by two or more undertakings or employers which have their registered office or place of business in only one State; or
>
> (iii) the legislation of the State in which the registered office or place of business of the undertaking or employer is situated other than the State of residence if that person is employed by two or more undertakings or employers, which have their registered office or place of business in a Member State and the United Kingdom, one of which is the State of residence; or
>
> (iv) the legislation of the State of residence if that person is

employed by two or more undertakings or employers, at least two of which have their registered office or place of business in different States other than the State of residence.

46.19.2 *Two places of self-employment*

Article SSC.12 provides:

> 2. A person who normally pursues an activity as a self-employed person in one or more Member States as well as the United Kingdom shall be subject to:
>
> (a) the legislation of the State of residence if that person pursues a substantial part of their activity in that State; or
>
> (b) the legislation of the State in which the centre of interest of their activities is situated, if that person does not reside in one of the States in which that person pursues a substantial part of their activity.

46.19.3 *Substantial*

What is "substantial"? The NI Manual provides:

> **NIM33100 Normally working in two or more Member States** [Dec 2018]
>
> ... In assessing whether a substantial part of the activity is carried out in the Member State of residence, a number of criteria are taken into account including:-
>
> - Working time
> - Remuneration
>
> If it is apparent that at least 25% of working time or earnings arise in the Member State of residence, this shall indicate that the substantial part of the activities is pursued in that Member State.
>
> Other relevant criteria can also be taken into account when making this assessment.
>
> Marginal activities which account for less than 5% of working time or remuneration in a Member State are not taken into account in making this assessment.

46.19.4 *Employment & self-employment*

Article SSC.12 provides:

> 3. A person who normally pursues an activity as an employed person and an activity as a self-employed person in two or more States shall be subject to the legislation of the State in which that person pursues an

> activity as an employed person or, if that person pursues such an activity in two or more States, to the legislation determined in accordance with paragraph 1.
>
> 4. A person who is employed as a civil servant by a State and who pursues an activity as an employed person or as a self-employed person in one or more other States shall be subject to the legislation of the State to which the administration employing that person is subject.

46.19.5 *Two employers*

Article SSC.12 provides:

> 5. A person who normally pursues an activity as an employed person in two or more Member States (and not in the United Kingdom) shall be subject to the legislation of the United Kingdom if that person does not pursue a substantial part of that activity in the State of residence and that person:
>
> (a) is employed by one or more undertakings or employers, all of which have their registered office or place of business in the United Kingdom;
>
> (b) resides in a Member State and is employed by two or more undertakings or employers, all of which have their registered office or place of business in the United Kingdom and the Member State of residence;
>
> (c) resides in the United Kingdom and is employed by two or more undertakings or employers, at least two of which have their registered office or place of business in different Member States; or
>
> (d) resides in the United Kingdom and is employed by one or more undertakings or employers, none of which have a registered office or place of business in another State.
>
> 6. A person who normally pursues an activity as a self-employed person in two or more Member States (and not in the United Kingdom), without pursuing a substantial part of that activity in the State of residence, shall be subject to the legislation of the United Kingdom if the centre of interest of their activity is situated in the United Kingdom.
>
> 7. Paragraph 6 shall not apply in the case of a person who normally pursues an activity as an employed person and as a self-employed person in two or more Member States.
>
> 8. Persons referred to in paragraphs 1 to 6 shall be treated, for the purposes of the legislation determined in accordance with these provisions, as though they were pursuing all their activities as employed or self-employed persons and were receiving all their income in the State concerned.

46.20 Class 4 contributions

Section 15 SSCBA provides:

> (1) Class 4 contributions shall be payable for any tax year in respect of all profits which—
>
> (a) are immediately derived from the carrying on or exercise of one or more trades, professions or vocations,
>
> (b) are profits chargeable to income tax under Chapter 2 of Part 2 of the Income Tax (Trading and Other Income) Act 2005 for the year of assessment corresponding to that tax year and
>
> (c) are not profits of a trade, profession or vocation carried on wholly outside the UK.
>
> (2) Class 4 contributions in respect of profits shall be payable—
>
> (a) in the same manner as any income tax which is, or would be, chargeable in respect of those profits (whether or not income tax in fact falls to be paid), and
>
> (b) by the person on whom the income tax is (or would be) charged,
>
> in accordance with assessments made from time to time under the Income Tax Acts...
>
> (3A) Where income tax is (or would be) charged on a member of a limited liability partnership in respect of profits arising from the carrying on of a trade or profession by the limited liability partnership, Class 4 contributions shall be payable by him if they would be payable were the trade or profession carried on in partnership by the members.
>
> (5) For the purposes of this section the year of assessment which corresponds to a tax year is the year of assessment (within the meaning of the Tax Acts) which consists of the same period as that tax year.

A trade carried on wholly outside the UK is exempt from class 4 NIC. This is almost impossible for a sole trader, though it may be possible for a partnership.[40] But in such a case the self-employed earner would not be employed in the UK, and so would be exempt anyway.

What about unremitted trading profits of a remittance basis taxpayer? It is considered that unremitted profits of a remittance basis taxpayer, (un)taxed on the remittance basis, do not count as "chargeable"[41] so a remittance basis taxpayer pays class 4 NIC on taxable (remitted) profits only. That is consistent with the general scheme of the remittance basis.

[40] See 21.4 (UK resident trader: IT).

[41] See App 2.3.1 (Unremitted RFI "chargeable").

46.21 Partnerships

Para 4 sch 2 SSCBA provides:

> (1) Where a trade or profession is carried on by two or more persons jointly, the liability of any one of them in respect of Class 4 contributions shall arise in respect of his share of the profits of that trade or profession (so far as immediately derived by him from carrying it on); and for this purpose his share shall be aggregated with his share of the profits of any other trade, profession or vocation (so far as immediately derived by him from carrying it on or exercising it).
> (2) Where sub-paragraph (1) above applies, the Class 4 contributions for which a person is liable in respect of the profits of the trade or profession carried on jointly (aggregated, where appropriate, as mentioned in that sub-paragraph) shall be charged on him separately.

The BI Manual provides:

> **BIM82060 Sleeping And Inactive Partners: Nics** [Jun 2016]
> Following a change of view taking effect from 6 April 2013, HMRC consider that sleeping and inactive partners in a partnership are gainfully employed as self-employed earners and so are liable to Class 2 and Class 4 National Insurance Contributions....
> **BIM82150 Limited Liability Partnership: NIC** [Jun 2016]
> The NIC position of members of a LLP is the same as that of partners in an ordinary partnership. Thus the members of a LLP are liable to Class 2 and Class 4 NIC as appropriate.

CHAPTER FORTY SEVEN

SETTLOR-INTERESTED TRUST CODE

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47.37.7 Series of gifts ending with settlor/close-family
47.37.8 Misc
47.38 s.643A onward-gift remit. basis

Cross-references

The following topics are considered elsewhere:

Topic	**See**
Settlor-interested trust IT rate	43.11
s.720/s.624 interaction	49.27
Transfer of income stream to trust	54.9
Definitions of "settlement"	87.1
s.624 spouse exemption	93.15
Who is the settlor?	99.1
Trust with multiple settlors	100.1
Settlor's statutory tax indemnity	101.1

I deal elsewhere with specialist types of settlor-interested trust income:

Type of income	**See**
Chargeable event gain	70.11
Offshore income gain	67.8.2 (UK trust); 67.10.1 (Non-resident trust)
Accrued income profits	28.1
Deeply discounted securities	28.13.1 (UK trust); 29.14 (Non-resident trust)

This chapter considers the IT rules. For CGT see 60.1 (Gains of non-resident settlor-interested trusts).

47.1 Settlor-interested trust code

Chapter 5 Part 5 ITTOIA contains a set of loosely related anti-avoidance rules:

Rule	**ITTOIA**	**See para**
Settlor-interested trust	s.624	47.5
Income paid to child of settlor	s.629	47.15
Capital sum paid to settlor by trust/connected body	s.633/641	47.14
Added by protected-trust regime in 2018:		
- s.643A charge: benefit to settlor/close-family	s.643A - G	47.19
- s.643A settlor-attribution/onward-gift rules	s.643H - N	47.28/47.31

These were formerly called the **"IT settlement provisions"**. Now that Chapter 5 is just one of many dealing with settlements, this label is opaque and potentially confusing. I coin the term **"settlor-interested trust code"**, which is not wholly accurate, but no short label could encapsulate these disparate charges.[1]

Settlement has the settlement-arrangement meaning.[2]

[1] The heading of Chapter 5 is now: "Settlements: amounts treated as income of settlor or family".

[2] See 87.4 (Settlement-arrangement definition).

The code has a century-long history (it dates back to 1922) and a large case law (some of which is now obsolete). The rules were recast in 1995, following the proposals of the Trusts Consultative Document (1991), but the consultative document is now of historical interest only.

47.2 "Income" arising under a settlement

"Income arising under a settlement" is a term used throughout the settlor-interested trust code. One might abbreviate that to **"Settlement Income"** but I prefer to use the statutory term.

In this section I consider what is income, and quantum of income; and in the next section I consider what is meant by income "arising under a settlement".

Section 648(1) ITTOIA provides what is in effect a referential definition of income:

> References in this Chapter [Chapter 5 Part 5, the settlor-interested trust code] to income arising under a settlement include— [3]
> (a) any income chargeable to income tax by deduction or otherwise,[4] and
> (b) any income which would have been so chargeable if it had been received in the UK by a person domiciled and resident there.

EN ITTOIA provides:

> In consequence [of this definition] the appropriate measure of income chargeable and the tax year of charge are provided by the charging sections of other Chapters of this Act (or the appropriate sections of the Income Tax Acts).

So "income" means "income for income tax purposes" which is a different concept from "income for trust law purposes" or "income for accountancy purposes".

The points made in 48.15 (Capital receipts deemed to be income) and 48.16 (Income of person: Quantum) apply also for ascertaining "income arising under a settlement".

Income may arise under the settlement (and so may be treated as the income of the settlor) even if the settlor is paying the income (eg if the

[3] The context suggests this is an exhaustive definition, ie the word "include" really means "mean", and only items within (a) and (b) fall within the expression "income arising under a settlement".

[4] See App.2.3.2 (Bear tax by deduction or otherwise).

settlor pays rent or interest to a settlor-interested discretionary trust).[5]

47.2.1 *Property business income*

The Property Income Manual discusses how to calculate property income for the purposes of the settlor-interested trust code:

> **PIM1045. Life interest trusts** [Jan 2023]
> ... Where the income [within s. 624] is property income, the normal property income rules apply in calculating the income. (S.623 ITTOIA)....

This is correct. It follows that interest paid by the trustees is in principle deductible in computing property income for s.624 purposes.

47.2.2 *Property business losses*

The Property Income Manual considers the treatment of losses:

> **PIM1045. Life interest trusts** [Jan 2023]
> *Trusts and the settlor - losses*
> ... The more common case is where the trustees carry on the rental business but the settlor is caught by Section 619(1). Under these circumstances the settlor can't set any trust rental business losses against personal rental business income.
> Similarly the settlor can't merge personal rental business losses and the trust rental business profits, which are deemed to be the settlor's income and charged under Section 619(1). Thus:
>
> - Where the trustees have a rental business loss and the settlor has a personal rental business profit, the trust loss is carried forward and the settlor is taxed on their personal rental business profit; the amount of the trustees' rental business profit charged on the settlor in the following year under Section 619(1) will be reduced by the trust loss carried forward.
> - Where the trustees have a rental business profit and the settlor has a personal rental business loss, the settlor is taxed on the trust rental business profit under Section 619(1); the settlor's personal rental business loss can't be merged with the trust profit; but, as a separate matter, the settlor may in some cases be able to set a personal rental business loss sideways against other income, including any Section 619(1) income deemed to arise from the trustees' rental business;

[5] See *Ang v Parrish* 53 TC 304. But it is different if the settlor is also life tenant; see 50.10.6 (Loan to life tenant).

> see PIM 4220.
>
> The position is different where the taxpayer is:
>
> - the settlor, and
> - the life tenant, and
> - carries on the rental business.
>
> Under these circumstances the settlor can merge their personal property losses with the deemed income from the trust and vice versa. ...

This is thought to be correct. See too 24.6 (Losses of overseas property business).

47.2.3 *Trust expenses*

Section 624(1A) ITTOIA provides:

> If the settlement is a trust, expenses of the trustees are not to be used to reduce the income of the settlor.

EN ITA provides:

> 3323.New subsection (1A) makes it explicit that trustees' expenses are not taken into account in measuring the income of a settlor under section 624 of ITTOIA. This follows from the fact that it is the income arising that is deemed to be the settlor's and the income arising is the gross amount out of which the trustees may pay expenses.

This is important because if s.624 does not apply, expenses do reduce the income of the life tenant.[6]

47.2.4 *Income must be ascertainable*

Section 624 assumes that one can *ascertain* the amount of income which arises under the settlement. If that is not possible then it is considered that s.624 does not operate.[7] In straightforward cases ascertaining the amount of income is not a problem. The issue can arise where there are two settlors[8] or on the supply of services.[9]

47.3 Arising under a settlement

There must be a link between the income and the settlement-arrangement;

[6] See 42.7 (Trustees expenses).

[7] The same point applies to the ToA provisions; see 48.9.2 (Income must be identifiable).

[8] See 100.2.2 (Loan/guarantee/paying trust expenses).

[9] See 99.25 (Provision of services).

exactly what that link is has been left to the Courts to sort out.

47.3.1 *Property comprised in settlement*

The wording of (what is now) s.624 has changed over time. In the 1938 version, what was treated as income of the settlor was:[10]

> any income arising under the settlement from the property comprised in the settlement

The underlined phrase was dropped in the ICTA 1988 consolidation. Under the current law, what is treated as income of the settlor is:

> income which arises under a settlement

Presumably the underlined phrase was thought to be unnecessary, as "income arising under the settlement" and "income from the property comprised in the settlement" were two ways of saying the same thing. Although the wording has changed, the meaning is the same.

I set out this history because it is necessary to have the older wording in mind when considering pre-1988 case law, such as *Chamberlain*. These cases focus on the (now deleted) phrase "property comprised in the settlement". Once that property is identified, the income arising under the settlement (which is treated as income of the settlor) is identified: it is income from that property. These cases are still relevant under the current legislation.

The term "property comprised in the settlement" is still found in the s.643A code, and a few dusty corners of the current legislation. It also has a statutory definition,[11] though that is not applicable where "settlement" has the settlement-arrangement meaning.

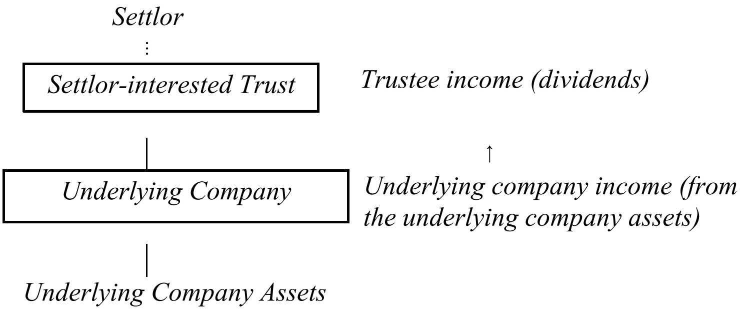
Nowadays, the more usual expression is "*property from which the income* [ie the Settlement Income] *arises*". Under this wording one first needs to identify "the income arising under the settlement", and then the property from which that income arises. But the expressions "property from which the income arises" and "property comprised in the settlement" should be regarded as synonymous.

47.3.2 *Underlying company income*

Suppose a settlor-interested trust holds an underlying company, thus:

[10] Section 38 FA 1938.

[11] See 87.3.1 (Property comprised in settlement).


Settlor
Settlor-interested Trust
Trustee income (dividends)
Underlying Company
Underlying company income (from the underlying company assets)
Underlying Company Assets

The trustees' income (dividends) is income arising under a settlement and taxed under s.624.

The company's income is not "income arising under the settlement" and not within the scope of s.624. This was decided in *Chamberlain v IRC*.[12]

Simplifying to bare essentials, *Chamberlain* concerned an arrangement with just two key steps. The settlor:

(1) transferred assets to the underlying company in exchange for securities; and
(2) transferred some shares in the underlying company to a trust.[13]

Chamberlain is a case on the 1938 version of the settlement provisions, where the relevant wording was "income arising under the settlement from the property comprised in the settlement". The issue was whether the "property comprised in the settlement" was:

(1) the underlying company assets or
(2) the trust fund (the underlying company shares).

But this also determines the issue of whether (adopting the current statutory term) the "income arising under the settlement" is:

(1) the underlying company income or
(2) the trustee income (dividends).[14]

Lord Thankerton gave the speech of the majority;[15] Macmillan and Romer agreed with the outcome, but their speeches are less important and Macmillan's has different reasoning.[16]

[12] 25 TC 317. For another aspect of this case, see App 2.2.7 (Pre-arrangement steps).

[13] In point of detail, the settlor transferred cash to 5 trusts which subscribed for shares in the underlying company; but nothing turns on that.

[14] See 47.3.1 (Property comprised in settlement).

[15] Viscount Simon and Lord Atkin agreed with this speech.

[16] Macmillan took the view that the arrangement consisted of the classic trust alone, and the first step (transfer of assets to the underlying company in exchange for an issue

The answer was that the property comprised in the settlement was the trust property, the underlying company shares; not the underlying company assets. The passage begins with a disclaimer:

> I may premise that, in seeking the due application of [s.38 FA 1938, now s.624], each case is apt to depend on its own facts, and other cases are not likely to be of material assistance.

Some wiggle room there.[17] But we move on to the analysis:

> Did the property comprised in the settlement consist of
> [1] the whole assets of Staffa [the underlying company], or
> [2] is the property comprised in the settlement to be found separately comprised in each of the five deeds of settlement [ie the shares in the underlying companies held by the 5 trust funds]...
> My Lords, I am of opinion that the latter alternative provides the correct view ... the sums settled under [the trust] deeds were the funds provided for the purpose of the settlement within the meaning of [what is now s.620 ITTOIA, the definition of settlor]. Staffa [the underlying company], though controlled by the Appellant, did not, in my opinion, hold its assets as part of the provisions settled on the children. I am of opinion that the whole assets of Staffa [the underlying company] did not constitute the property comprised in the settlement ...[18]

This was followed in the first *Vestey* case:[19]

of shares) was "merely preparatory". See App 2.2.4 (Identifying the arrangement). But this was a minority view.

[17] Likewise the first *Vestey* case, *Vestey v IRC* 31 TC 1 at p.120:
"I do not think that any hard and fast rule is laid down in *Chamberlain's* case. The ingenuity of those who devise these schemes is such that it might be rash to say that property can never be comprised in a settlement unless it is charged with rights in favour of others, but I think that as a general rule this must now be the test".

[18] *Vestey v IRC* 25 TC 317 at p.329.

[19] 31 TC 1 at p.89; likewise at p.107:
"I do not dissent from the Crown's contention that the lease and the deed of trust together constitute an "arrangement" within Section 41 (4) (b) of the Act of 1938 and are consequently a "settlement" for the purposes of Part IV of that Act. In my view, however, whether one looks for this purpose at the deed of trust alone, or at the deed of trust and the lease together, the only property comprised in the settlement" at any time was the rent payable by Union under the lease, together with any property resulting from the investment of the rent and from the accumulation of the income arising from such investment."
But the rule is not absolute. At p.120:
"I think that *Chamberlain's* case shews that the most profitable course to follow is

> even if the lease and the deed of settlement may both be properly treated as components of the "arrangement", yet the property "comprised in the settlement" is the property settled by the deed of settlement, that is the [trust property].

HMRC agree. In explaining why s.624 protected-trust relief[20] applies to a trust but not to its underlying company, they say:

> The settlor charges under the settlements legislation will not need to be dis-applied to foreign income of any corporate structure underlying the settlement, because the settlements legislation only applies to income arising to a settlement.[21]

HMRC only seek to apply the settlor-interested trust code to the dividends and not to the income of the underlying company.

What is the reason for this? One might think that a trust and the underlying company could in principle constitute one arrangement, so that both the company income and the trust income (dividends) could be described as income arising under the settlement-arrangement. *Chamberlain* gives the answer but no clear reason for that answer. It is considered that the context supports their conclusion.

47.3.3 *Use of co: Tax policy*

The policy background is that the use of a UK company to save the difference between IT and CT rates on sums retained in the company is not regarded as objectionable, in the absence of further features. This is so even if the arrangement involves:

(1) A key employee or contractor providing services to the company at an undervalue (so increasing income subject to CT and decreasing income subject to IT)[22]

first to determine what was the property comprised in the settlement, and that the way to find that property is to look for property charged with rights in favour of beneficiaries."

[20] See 92.10 (s.624 protected-trust relief).

[21] Reforms to the taxation of non-domiciles: response to further consultation (2016) para 2.3.3. *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574450/non_doms_consultation_response_final.pdf*

[22] This is now subject to limited exceptions: (1) the mixed partnership code, see 86.4 (Mixed partnership code); (2) disguised employment income. But the exceptions confirm the general rule.

(2) Extracting profits taxed at rates less than the marginal rate of the key employee

In the film star case, *Crossland v Hawkins*:[23]

> The heavy incidence of Surtax [now higher rate income tax] on large incomes has for some time led artistes and others in the world of entertainment to adopt the device of forming a limited company which they control, and giving the company, by means of a service agreement, the right to their services. In return the company pays the artiste some modest salary. The company then hires the artiste out to whomsoever requires his services and itself obtains the consideration for them. ... In this way Surtax on the whole of the artiste's earnings is reduced to Surtax on the salary he gets from the company plus such dividend as is distributed to him; and when eventually the company is wound up the accumulated reserves of past years will come to him as capital.[24]
> All this is perfectly legitimate and indeed, in the case of persons whose high earnings may be short-lived, understandable.

That this is still the policy is confirmed by the repeal of the former s.681(2)(b) ICTA (which had deemed income of an underlying close company to be "income arising under a settlement").[25]

It is considered that income of a unit trust held by trustees is similarly not "income arising under a settlement" (unless the unit trust is transparent in which case the income arises to the trustees).[26]

The position is different where trustees are members of a partnership. Insofar as income is distributed from the partnership to the trust it clearly constitutes income arising under the settlement. But even if income is retained by the partnership, the trustees share of the partnership income is

[23] 39 TC 493 at p.502.

[24] If winding up the company now, one would need to consider Chapter 4 Part 13 ITA (sale of occupation income) and 30.14 (Winding-up TAAR).
At the time of *Crossland v Hawkins* there were close company apportionment rules, to prevent avoidance IT by retaining income in a company. But they were not so harsh. The court explained: "From its profits the company must distribute a reasonable dividend if it is to avoid Surtax on the whole of its profits - see s.245 Income Tax Act 1952 - but it is allowed to make such reserves as are required for the maintenance and development of the business; and where the business depends on the fortunes of a particular artiste these reserves may be considerable."

[25] See sch 17 FA 1989. This was part of the repeal of the former close company apportionment provisions.

[26] See 69.7 (Unauthorised unit trust: Foreign trustees).

income of the trustees, since partnership income is regarded as arising to the partners.[27]

Income of a non-resident company or unit trust which is not "income arising under a settlement" may fall within the ToA rules.

47.3.4 *Underlying Co subject to CT*

For completeness: If the underlying company is subject to corporation tax (eg if the company is UK resident) there is an additional argument why the settlor-interested trust code does not apply. Section 3(1) CTA 2009 provides:

> The provisions of the Income Tax Acts relating to the charge to income tax do not apply to income of a company if—
> (a) the company is UK resident, or
> (b) the company is not UK resident and it is chargeable to corporation tax in respect of the income, or would be so chargeable but for an exemption.

Section 624 is a "provision of the Income Tax Acts relating to the charge of income tax;" so it does not apply to income subject to corporation tax. This makes good sense, because if the income is subject to corporation tax, HMRC do not need the settlor-interested trust code. But if it is correct that company income generally is not income arising under a settlement, this particular point does not arise here.[28]

47.3.5 *Income of life tenant (not settlor)*

Income payable under the trust to a life tenant is "income arising under a settlement". Admittedly, such income is usually regarded for tax purposes as the income of the life tenant, not of the trustees.[29] But that is not relevant, because:

(1) The expression is "income arising under a settlement", not "income arising to trustees".
(2) "Settlement" has the very wide meaning of settlement-arrangement.[30]

This can be seen to be the case by considering a trust made by S, revocable

[27] See 85.16 (Partnership transparency: IT/CT).

[28] I discuss this point in more detail in the context of ToA, where it is important: see 51.3.1 (Corporation tax override).

[29] See 42.9 (Life tenant: Source of Income).

[30] See 87.4 (Settlement-arrangement definition).

by S, under which income is payable to B for life. It could hardly be argued that such income falls outside the scope of s.624 ITTOIA.

47.3.6 *Income of life tenant settlor*

Where the settlor has an interest in possession, trust income actually received by the settlor is not within s.624 ITTOIA. It is subject to income tax under general principles. But the rates of tax are the same in either case,[31] so the issue does not now arise.[32]

47.4 Settlor deductions/reliefs

Section 623 ITTOIA provides:

> For the purpose of calculating liability to tax under this Chapter [Chapter 5 Part 5, the settlor-interested trust code] (but for no other purpose), a settlor shall be allowed the same deductions and reliefs as if any amount treated under this Chapter as income of the settlor had actually been received by the settlor.

The legislation does not identify what deductions and reliefs are applicable. The wording derives from s.5 FA 1914, where it was understood to allow the costs of collection and payment of foreign income. It was copied from there to FA 1938 which is the original version of the settlor-interested trust code. But now these costs are deductible whether or not the income is actually received.[33] As far as I can see, this provision survives only for historical reasons, and has no effect: it should be repealed.

47.5 Settlor-interested trust

Section 624(1) ITTOIA provides:

> Income which arises under a settlement is treated for income tax purposes as the income of the settlor and of the settlor alone if it arises—
> (a) during the life of the settlor, and

[31] See 43.11 (Settlor-interested trust IT rate).

[32] The point was discussed in the 4th ed. of this work at 11.4.3 (Income of life tenant settlor). Trust income not received by the life tenant settlor is within s.624 ITTOIA. Examples are (1) income used for trust expenses, and (2) income for tax purposes which is capital for trust law purposes.

[33] See 16.10 (RFI collection costs). The background is set out in EN ITTOIA Change 137 and 138.

(b) from property in which the settlor has an interest.

I refer to income which is treated as the settlor's income under this section as **"s.624 income"**. Section 624 raises a number of issues:

Issue	**See para**
Identify the settlement (settlement-arrangement):	
What is the arrangement	App 2.2.4
Is there bounty (so the arrangement is a "settlement")	87.5
Identify the settlor	99.2
Identify income arising under the settlement	47.2
Identify property from which that income arises	47.3.1
Whether the settlor has an interest in that property	47.6
Do reliefs apply:	
Protected-trust relief	92.10
s.624 spouse exemption	93.15
Minor s.624 reliefs	47.7

I refer to this as the "**s.624 issue list**". In the case of a settlement-arrangement that is a classic trust, that is generally straightforward. More thought is needed for a settlement-arrangement which is not, or not just, a classic trust.[34] Tax cases often involve more than one of these issues. For clarity of thought it is necessary to consider them separately, though the consequence is that the same case has to be discussed in several separate places in this work.

47.6 Meanings of "settlor-interested"

47.6.1 *Concepts of "settlor-interested"*

The term "settlor-interested", first coined in the FA 2000, is used in connection with various provisions, of which the most important are:[35]

Context	**See**
IT settlor-interested trust code	*discussed here*
CGT settlor-interested trust rules	60.5

[34] See 87.4.1 (Non-trust arrangement); 87.4.2 (Trust + steps arrangement).

[35] Other examples, not discussed in this work, are:

Context	**See**
Hold-over relief restriction on gift to settlor-interested trust	s.169B-G TCGA
Disposal of interest in a settlor-interested trust	sch 4A TCGA

"Power to enjoy" in the ToA code is a similar concept with a different label. GWR is a comparable but not identical concept.

Consistent with the patchwork nature of UK tax, these provisions have significant differences, though they share a common framework. "Settlor-interested" is a convenient label, but not a wholly accurate one.

47.6.2 *"Settlor-interested" for s.624*

Section 625(1) ITTOIA provides:

> A settlor is treated for the purposes of section 624 as having an interest in property if there are any circumstances in which the property[36] or any related[37] property—
>
> (a) is payable to the settlor or the settlor's spouse or civil partner,
>
> (b) is applicable for the benefit of the settlor or the settlor's spouse or civil partner, or
>
> (c) will, or may, become so payable or applicable.

This is of course a wide definition. In particular, a settlor has an "interest" in property given outright to their spouse. When the definition is used in this context, scare quotation marks are appropriate.

Section 625(2)(3) ITTOIA contain half a dozen exceptions, which are not discussed here as they rarely arise. In practice, under a classic trust the settlor and spouse are usually expressly included as beneficiaries or expressly excluded.[38]

A trust is not settlor-interested merely because:

(1) The trustees may lend to the settlor, or purchase an asset from the settlor, on commercial terms; or

(2) The trustees do lend to the settlor, or purchase an asset from the settlor, on commercial terms.

Those transactions involve a payment of the money lent or the purchase price but "payable" in para (a) means payable in a manner conferring a benefit. That is why there needs to be a separate provision dealing with

[36] "The property" refers back to s.614: it means the property from which the Settlement Income arises.

[37] "Related property" is defined in s.625(5) ITTOIA:

> In this section "related property", in relation to any property, means income from that property or any other property directly or indirectly representing proceeds of, or of income from, that property or income from it.

See App 2.9 ("Representing" assets).

[38] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), Chapter 13 (Settlor Exclusion Clauses and Default Clauses).

capital sums paid to the settlor.[39]

47.6.3 *"Spouse" in settlor-interested trust code*

Section 625(4) ITTOIA gives the expression "spouse" an artificial and slightly narrow meaning:

> In subsection (1) "the settlor's spouse or civil partner" does not include—
> (a) a spouse or civil partner from whom the settlor is separated under an order of a court or a separation agreement,
> (b) a spouse or civil partner from whom the settlor is separated where the separation is likely to be permanent,[40]
> (c) the widow or widower or surviving civil partner of the settlor, or
> (d) a person to whom the settlor is not married but may later marry or a person of whom the settlor is not a civil partner but of whom the settlor may later be a civil partner.

The ToA provisions and the s.86 provisions do not contain the same provision, which is anomalous, but that is the patchwork nature of UK tax. Fortunately it does not often matter.

For the general meaning of spouse, see App 3.2 ("Spouse").

47.6.4 *Beneficial loan or guarantee*

Beneficial loans and guarantees to trustees raise three distinct questions, so far as settlor-interested trusts are concerned:[41]

(1) Is the lender/guarantor a settlor by virtue of the loan/guarantee? (This question generally arises only if the lender/guarantor is not the original settlor, though it could also arise if one had to consider whether the settlor has provided additional property and so tainted the settlement).

(2) If so, what property has the lender/guarantor provided?

(3) Does the lender/guarantor have an interest in the trust property by virtue of the loan/guarantee? (This question does not arise if the lender/guarantor already has an interest in the trust property.)

[39] See 47.14 (Settlor receives capital sum).

[40] Para (a)(b) copies standard form wording to refer to a separated spouse: see App 3.4.3 (Living together: married couple). It could have been expressed more economically by taking advantage of the ITA definition, but it does not matter.

[41] For other issues raised by loans, see 62.1.1 (Loan tax issues: Navigation).

It is necessary to distinguish between loans which are (1) interest-free (2) beneficial but not interest-free, eg, at low interest; and (3) commercial loans. Guarantees are not the same as loans, but the issues overlap, so I also consider them in this section.

There are many possible permutations, which makes an exposition rather more difficult.

To start with the simplest case: suppose the settlor lends interest-free to a trust from which he or she is otherwise excluded. The HMRC view is that the trust is settlor-interested as the settlor may benefit by repayment of the loan:

> In *Jenkins v IRC* (26 TC 265) the Court of Appealfound that the making of an interest-free loan brought the settlement into what is now [s.624]. In the *Jenkins* case, the dispute was about whether certain income received by the trustees of the settlement could be assessed on the settlor under the provisions of FA 1938 s38(4). That provision contained an extended definition of retaining an interest in income that is in similar terms to the definition [in s.624].
>
> The effect of the decision in *Jenkins* was that a settlor who has made an interest-free loan to his/her trust has brought himself or herself within the scope of s38(4), and by implication [s.624] (albeit that there would be no charge [under s.624] unless income actually arose to the trustees).[42]

The contrary is faintly arguable[43] but for practical purposes this should be accepted as correct.

The same applies if the settlor lends on terms which are beneficial but not interest-free, eg at a low rate of interest. However a settlor (if otherwise excluded) has no interest if the loan is on commercial terms, as repayment of such a loan is not a benefit.

If an individual other than the original settlor lends interest-free to a trust, the loan makes the lender a settlor.[44] There is then a trust with two settlors, the original settlor and the lender. The lender will be within the scope of s.624 on the income originating from the lender, if one can

[42] Letter from HMRC to the Association of British Insurers, September 2004 *https://www.kessler.co.uk/tfd-archive*

[43] The point was conceded in *Jenkins v IRC* 26 TC 265 but the concession was held to be correct in *Wachtel v IRC* 46 TC 543. So the issue remains (just) arguable at the level of the CoA.

[44] A person who is not otherwise a settlor in principle becomes a settlor by virtue of making an interest-free loan: see 99.26 (Loans).

identify it.[45]

If an individual other than the original settlor lends on terms which are beneficial but not interest-free, eg at a low rate of interest, the loan still makes the lender a settlor. However the lender will not be within the scope of s.624 unless one can identify the income originating from the lender, which is not usually the case.[46]

If the settlor ("the guarantor") guarantees a loan or other obligation of the trustees, the trust is not settlor-interested (assuming the settlor is otherwise excluded). A guarantor's claim against a solvent trust would only arise if the trustees failed to meet their primary contractual obligations and the words "in any circumstance whatsoever" do not extend to a breach of contract of that kind.

If someone other than the settlor gives a guarantee, the guarantor would not fall within s.624, unless:

(1) one could identify the income originating from the guarantor (which is not usually the case) and
(2) the guarantor had an interest in that income under the trust (the existence of the guarantee alone does not constitute an interest).

47.6.5 *Settlor interest in part of trust*

The IT settlor-interested trust provisions only apply to income from property in which the settlor has an interest.[47] So if the settlor is excluded from part of the trust fund, the IT provisions do not apply to that part. HMRC agree. The TSE Manual provides:

> **TSEM4200 settlor retains an interest** [Sep 2021]
> ...**Settlement only partially settlor-interested**
> Where the settlor has retained a clearly defined interest in a distinct part of the settlement, for example in one fund forming part of a trust, only a corresponding part of the income is caught. In other cases of a settlor retaining a partial interest in a trust, you should submit the case to Trusts Technical for advice.

The TSE Manual provides:

> **TSEM4513 - Tax paid by trustees where trust is not wholly settlor interested** [Feb 2022]
> The income tax paid by trustees for a tax year may be paid partly on

[45] See 100.2.2 (Beneficial loans, guarantees, payments of trust expenses).
[46] See 100.2 (Just & reasonable apportionment).
[47] See 47.6 (Settlor-interested trust),

income attributable to a settlor and partly on income from property from which a settlor is excluded from benefit. The tax paid on income attributable to the settlor does not enter the tax pool - see TSEM4512. Tax paid on other income enters the tax pool in the normal way - see TSEM3756 onwards,

Example

A settles property into the A discretionary settlement. The settlement consists of two funds.

Fund A contains a house which is let and a block of shares in A plc.

Fund B contains a block of shares in B plc.

Under the terms of the settlement the settlor and any spouse or civil partner of the settlor are excluded from benefiting from Fund B.

In 2009-2010 the income of the trustees (and tax paid on that income) is as follows:[48]

Fund A	*Amount*	*Rate (2009/10)*	*Tax*
Rental Income	£1,000	20%	£200
	£9,000	40%	£3,600
Dividend Income	£ 5,000	32.5% (but10% tax credit)[49]	£1,625
Total			£5,425

The settlor is given credit for the tax paid on the income attributable to the settlor - £5,425. Where the tax paid by the trustees exceeds the settlor's own income tax liability the tax (excluding the £500 non payable tax credit attached to the dividends) may be repaid to the settlor.

Fund B			
Dividend Income	£15,000	32.5% (but 10% credit)	£4,875
Total			£4,875

As the settlor is excluded from benefiting from Fund B, this tax is not available to the settlor. The normal rules apply and £3,375 of the tax paid (£4,875 less £1,500 non payable tax credit attached to the dividends) enters the tax pool.

47.6.6 *Settlor-interest ceases*

If the settlor originally had an interest in trust property but is later excluded (together with the settlor's spouse) then s.624 ITTOIA ceases to apply to income arising after the date of the exclusion.[50]

[48] Author's footnote: I have slightly changed the layout for greater clarity.

[49] The tax credit was abolished 2016, so the Manual is out of date, but this does not spoil the point being made here.

[50] A different rule applies for ToA and for s.86; If a settlor is excluded, s.86 and s.720 continue to apply for the rest of the tax year. see 49.14 (Condition A : Power to

If the settlor is excluded from part of the trust fund, then they are within the scope of s.624 only on the income arising from the part in which they still have an interest.

The TSE Manual provides:

> **TSEM4513 - Tax paid by trustees where trust is not wholly settlor interested** [Feb 2022]
>
> ... **Trust ceases to be, or becomes, settlor interested**
>
> A trust may cease to be settlor interested part way through a tax year, for example when the settlor dies.
>
> Similarly, a trust may become settlor interested part way through a tax year, for example the settlor may marry or enter into a civil partnership with an existing beneficiary of the trust.[51]
>
> Where this happens the tax paid by the trustees should be apportioned on a time basis so the part is available to cover the settlor's liability and the other part dealt with in the normal way.
>
> **Example**
>
> In 2009-2010 the income of the trustees (and tax paid on that income) is as follows:[52]

	Amount	*Rate (2009/10)*	*Tax*
Savings Income	1,000	20%	£200
	9,000	40%	£3,600
Total	10,000		£3,800

> The settlor of the trust dies on 5 January 2010. The trust ceases to be settlor interested on that date because ITTOIA/S624 applies only to income arising under a settlement during the life on the settlor.
>
> The settlor is taxed on £7,500 and is given credit for £2,850 (75% of £3,800).
>
> The balance of the tax, £950 goes into the tax pool.

I would have expected to apportion by reference to the date income arises, not by time apportionment, but the in many cases the end result will be the same or similar.

47.6.7 *Transfer to new trust*

If the trust fund is transferred to a new settlement from which the settlor

enjoy); 60.5 (Settlor-interested condition).

[51] Author's footnote: In theory it is possible for a trust to become settlor-interested, on marriage of the settlor to a beneficiary. But in practice this is unlikely to happen; and standard form trusts would exclude the settlor and spouse from benefit.

[52] Author's footnote: I have slightly changed the layout for greater clarity.

is not excluded, then s.624(1) ITTOIA continues to apply. The original settlor is the settlor of the new trust.[53]

If the entire trust fund is transferred to a new trust from which the settlor (and spouse) are excluded then s.624 ceases to apply, and if they are excluded from part, it ceases to apply in part.

47.6.8 *Settlor-interested: non-trust*

In *Vandervell v IRC*,[54] the taxpayer gave shares to a third party[55] subject to an option which allowed the settlor to repurchase them. This was a settlor-interested settlement.

TSEM gives a similar example:

> **TSEM4200 Settlor Retains An Interest** [Sep 2021]
> *Example 3- gifted shares with conditions attached*
> Mr C is a higher-rate taxpayer who owns all the 100 issued shares in C Ltd. He wants to give his brother, a basic rate taxpayer £25,000 but Mr C's money is tied up in the company. To avoid a higher-rate charge on dividends paid out of the company, Mr C transfers 50 shares to his brother on the understanding that the shares are to be returned to him a month later. Mr C declares and the company pays a dividend of £500 per share so that £25,000 is paid to each shareholder. ...

The HMRC analysis is as follows:

> The plan, under which the gifted property is expected to return to the donor is an arrangement where the donor or settlor has retained an interest in the property so the income paid to the brother is deemed to be Mr C's under ITTOIA/S624.

That would clearly be the case if the "understanding" constituted a contract. What if the arrangement was non-contractual? It seems difficult to say that C has an interest. But the GAAR might perhaps apply.

The income-stream code also needs consideration here.[56]

47.7 Minor s.624 reliefs

Section 626 ITTOIA provides a relief for inter-spouse transfers, discussed elsewhere.[57]

[53] See 99.11.2 (Appointment rule conditions).

[54] 43 TC 519.

[55] In fact the gift was to a charity, but nothing turned on that.

[56] See 54.1 (Transfer of income streams).

[57] See 93.15 (S.624 spouse exemption).

Section 627 contains a further set of reliefs which I mention here for completeness. Section 627(1) deals with divorce situations:

> The rule in section 624(1) does not apply to income which—
> (a) arises under a settlement made by one party to a marriage or civil partnership by way of provision for the other—
> (i) after the dissolution or annulment of the marriage or civil partnership, or
> (ii) while they are separated under an order of a court, or under a separation agreement, or where the separation is likely to be permanent, and
> (b) is payable to, or applicable for the benefit of, the other party.

Section 627(2) ITTOIA provides:

> The rule in section 624(1) does not apply to income which consists of—
> (a) annual payments made by an individual for commercial reasons in connection with the individual's trade, profession or vocation

This is unnecessary, as these Annual Payments would not constitute a settlement. Perhaps it is there for historical reasons.[58]

> (b) qualifying donations for the purposes of Chapter 2 of Part 8 of ITA 2007 (gift aid), or

This ceased to be needed when qualifying donations ceased to be a charge on income.

> (c) a benefit under a relevant pension scheme.[59]

A relevant pension scheme is not likely to constitute a settlement.

Section 628 ITTOIA provides a relief for temporary charitable trusts, which I doubt is ever used in practice.[60]

47.8 s.624 remittance basis

47.8.1 *Scope of s.624 remittance basis*

Section 648 ITTOIA provides a relief for a settlor who is a remittance basis taxpayer; I call this the "**s.624 remittance basis**".

It will be rare for this to apply, because in almost all cases where the

[58] See 31.7 (Commercial Annual Payment).

[59] Defined in ss(3) but I need not set that out here.

[60] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 31.5 (Settlor-interested trusts).

conditions for the s.624 remittance basis are met, protected-trust relief will be available.[61]

47.8.2 *Remittance basis rule*

The legislation uses the clumsy but effective drafting technique of restricting the definition of "income arising under a settlement". That term has a commonsense definition in s.648(1)[62] but s.648(3) ITTOIA then provides:

> [a] And if, for a tax year, section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the settlor

That is, if the settlor is a remittance basis taxpayer.

> [b] references in this Chapter [Chapter 5 Part 5, the settlor-interested trust code] to income arising under a settlement include in relation to any relevant foreign income arising under the settlement in that tax year
> [c] only such of it as is remitted to the UK (in that tax year or any subsequent tax year)
> [d] in circumstances such that, if the settlor remitted it, the settlor would be chargeable to income tax.

This applies to relevant foreign income arising under the settlement. Foreign source income of a non-resident settlor-interested trust is in general RFI.[63]

There are two aspects to this: unremitted income is not taxed, and remitted income is taxable.

In practice this mainly concerns settlor-interested discretionary trusts.

[61] See 92.10 (s.624 protected-trust relief).
For completeness: An example of an exceptional case where protected-trust relief does not apply, but the remittance basis may still apply, is:
(1) At a time when the settlor is deemed domiciled, the trust is "tainted" by an addition of property (from the settlor or a connected trust) so it ceases to be a protected trust.
(2) The settlor ceases to be UK resident and ceases to be deemed domiciled.
(3) The settlor subsequently becomes UK resident again.

[62] See 47.2 ("Income" arising under a settlement).

[63] See 16.9.2 (Relevant foreign income). I have wondered whether income of a non-resident settlor-interested trust meets the condition in s.830(1)(b) ITTOIA, that it is chargeable under one of the specified provisions. Foreign income of a non-resident is not in principle chargeable. But income of a non-resident settlor-interested trust is treated as income of the settlor, so this requirement is satisfied.

Income of a trust where the settlor has an interest in possession is in principle outside the scope of s.624;[64] though s.624 could apply:

(1) If the trustees have a receipt which is income for tax purposes but capital for trust purposes.
(2) If the trustees have expenses deductible from the life tenant's income.

47.8.3 *Charge on remitted s.624 income*

The charge under s.648(5) arises if two conditions are satisfied:

(1) The income "is remitted to the UK".
(2) The circumstances are "such that, if the settlor remitted it, the settlor would be chargeable to income tax".

For post-2008 income, the usual ITA remittance basis applies, so s.624 income is treated as remitted if it is brought/received/used in the UK by a relevant person (including the trustees).

The same rule applies to s.629 income (income of minor child of settlor). Receipt by the child in the UK after the child has reached the age of 18 is not in principle a taxable remittance, because the child is then not a relevant person in relation to the settlor.

47.8.4 *Remittance basis timing rule*

Section 648(5) ITTOIA provides an artificial timing rule:

> Where subsection (3) [s.624 remittance basis] applies the remitted income is treated for the purposes of this Chapter as arising under the settlement in the tax year in which it is remitted.

In the protected-trust regime this rule is disapplied, with the standard form (repeated whenever required):

> Section 648(3) to (5) (relevant foreign income treated as arising under settlement only if and when remitted) do not apply for the purposes of this section.[65]

47.8.5 *Pre-2008 s.624 income*

In the following discussion I use the term **"pre-2008 s.624 income"** to mean foreign income arising under a settlor-interested trust before 6 April 2008, which:

[64] See 47.3.6 (Income of life tenant settlor).

[65] s.628A(13) ITTOIA; s.628C(3) ITTOIA; s.630A(3) ITTOIA.

(1) fell within s.624 ITTOIA, but
(2) qualified for relief under the s.624 remittance basis.

There was no tax charge when the income arose if it was not received in the UK.

For pre-2008 income/gains, para 86(4) sch 7 FA 2008 provides that references to relevant person in s.809L have effect as references to the individual.[66] So there is a taxable remittance of pre-2008 s.624 income only if it is brought/received/used in the UK *by the settlor*. Receipt (etc) by a relevant person does not count.[67]

For this purpose it is necessary to decide whether s.624 income is income of the individual for the tax year 2007/08 or before. The artificial remittance basis timing rule[68] might treat pre-2008 income as post-2008 income and so disapply the transitional relief. Para 86(4A) sch 7 FA 2008 deals with this:

> For the purposes of sub-paragraph (4), section 648(2) to (5) of ITTOIA 2005 (and corresponding earlier enactments) do not apply (so that relevant foreign income which arose under a settlement in the tax year 2007-08 or any earlier tax year is to be treated as income for the tax year in which it arose).

The RDR Manual provides:

> **RDRM31490 Relevant persons and foreign income and gains arising to a settlement before 6 April 2008** [Jan 2019]
> ... Where a settlor claims to use the remittance basis, section 648 provides for the trust income to be treated as arising in the year in which it is remitted. Because of the narrower definition of remittance which applied before 6 April 2008 this would produce an inequitable result where relevant foreign income that arose to a settlement before 6 April 2008 is remitted and becomes chargeable on the settlor after 6 April 2008.
> *Transition*
> The transitional rule provides that in establishing whether there has been a remittance of an individual's income and gains for 2007-08 or any earlier year Conditions A and B, Condition C and Condition D at s.809L ITA ... are applied as if references to 'relevant person' are to the

[66] See 18.10 (Relevant person: Pre-2008 income/gain).
[67] See 18.10 (Relevant person: Pre-2008 income/gain).
[68] See 47.8.4 (Remittance basis timing rule).

> individual.
>
> For the purpose of applying this transitional rule only, that is, for the purpose of determining whether there is any benefit under the provisions of paragraph 86(4) only the income is treated as arising in the year that it arose to the settlement.
>
> *Effect*
>
> This means that income arising under a settlement in tax years prior to 5 April 2008 but which is remitted after 6 April 2008 is not treated as remitted by the settlor unless it has been brought to, received by or used in the UK for his benefit.

I had thought that under the pre-2008 rules, there was taxable remittance if trustees of a settlor-interested trust brought s.624 income to the UK - even though the settlor did not receive the income. However HMRC presumably did not agree, as that is not now the position for pre-2008 s.624 income. There is a remittance only if the settlor actually becomes entitled to the pre-2008 s.624 income and brings/receives/uses it in the UK.

47.9 Non-resident settlor

The legislation again uses the clumsy but effective drafting technique of restricting the definition of "income arising under a settlement". That term has a commonsense definition in s.648(1)[69] but s.648(2) provides:

> [a] But if, in a tax year, the settlor is not UK resident,
>
> [b] references in this Chapter [Chapter 5 Part 5, the settlor-interested trust code] to income arising under a settlement do not include
>
> [c] income arising under the settlement in that tax year in respect of which the settlor, if actually entitled to it, would not be chargeable to income tax by deduction or otherwise[70] because of not being UK resident.

I refer to this as the **"s.648(2) rule"**, and income within the rule is **"excluded income"**.

In short, where the settlor is non-resident, UK source trust income is within the scope of s.624, but foreign income is not.[71] Contrast s.720 ITA which does not apply at all unless the transferor is resident.

[69] See 47.2 ("Income" arising under a settlement).

[70] See App.2.3.2 (Bear tax by deduction or otherwise).

[71] This is self-evident, but if authority is needed, see *IRC v Countess of Kenmare* 37 TC 383.

47.9.1 *UK resident trust, non-resident settlor*

The trustees are taxed in full on foreign source trust income. The s.648(2) rule prevents s.624 applying where it might benefit the taxpayer.

However the settlor is taxed on UK source trust income. This is beneficial if:

(1) the settlor's marginal rate is less than the top rate of income tax, or
(2) non-resident IT relief applies[72]

This is not an anomaly because the object of the legislation, like the object of ToA, is to put the settlor in the same position as if the settlement had not been made.

47.9.2 *Non-resident trust, non-resident settlor*

Neither the trustees nor the settlor are taxed on foreign source income.

The settlor is taxed on UK source income. This is beneficial if:

(1) The settlor's marginal rate is less than the top rate of income tax.
(2) Non-resident IT relief is available to the settlor and not to the trustees, which could happen because of the UK beneficiary rule.[73]

If the settlor is UK resident but the year is a split year, the income of the offshore part of the year will qualify for split year treatment.

47.9.3 *Remittance of trust income*

Where the settlor is non-resident, it does not matter if trust income is remitted.

Suppose:

(1) Foreign income arises to the trustees of a settlor-interested trust while the settlor is non-resident (**"non-resident period income"**).
(2) The income is remitted by the trustees when the settlor is resident and a remittance basis taxpayer.

Section 648(3) ITTOIA provides that where the settlor is a remittance basis taxpayer:

> ... references in this Chapter to income arising under a settlement include in relation to any relevant foreign income arising under the settlement in that tax year only such of it as is remitted to the UK (in

[72] See 45.1 (Non-resident IT relief).
[73] See 45.1 (Non-resident IT relief).

> that tax year or any subsequent tax year) in circumstances such that, if the settlor remitted it, the settlor would be chargeable to income tax...
> (5) Where subsection (3) applies the remitted income is treated for the purposes of this Chapter as arising under the settlement in the tax year in which it is remitted.

It may seem at first sight that the non-resident period income is caught as it is treated under s.648(5) as arising in the year of remittance. However that is not the case, for two reasons:

(1) The circumstances are not "such that, if the settlor remitted the non-resident period income, the settlor would be chargeable to IT". Unless the settlor is UK resident when the income arises, the settlor would not be taxed on it when remitted later, even if it had been the settlor's income all along.
(2) Non-resident period income is not "income arising under the settlement" by virtue of s.648(2).

The result is sensible and consistent with rule that income of an individual arising during a non-resident period is not taxable if remitted during a resident period.[74]

47.10 s.624 double-charge relief

If income of a settlor-interested trust is distributed to a beneficiary there might in principle be a double charge to tax:

(1) The settlor is taxed under s.624 on the trust income
(2) The beneficiary could be taxed under normal trust tax principles

Section 685A ITTOIA avoids the double charge by giving relief to the beneficiary; I refer to this as **"s.624 double-charge relief"**.

For tax return disclosure when this relief applies, see 41.3.6 (Tax return: Trust income).

47.10.1 *Beneficiary relief conditions*

Section 685A(1) ITTOIA provides:

> This section applies if—

3 conditions then follow, which I call "beneficiary relief conditions":

> (a) a person receives an annual payment in respect of income from the

[74] See 17.21 (RFI/gains of non-resident, remitted when resident).

> trustees of a settlement,
> (b) the payment is made in the exercise of a discretion (whether of the trustees of the settlement or any other person), and
> (c) a settlor is charged to tax under section 619(1) on the income arising to the trustees of the settlement (whether in the current year of assessment or in a previous year of assessment) out of which the annual payment is made.

The wording of (b) is based on s.494 ITA; see 41.4 (Beneficiaries tax credit).

A settlor is not charged to tax, within the meaning of (c), if:

(1) s.624 protected-trust relief applies; or
(2) the s.624 remittance basis applies and the income is (un)taxed under the remittance basis.

In these cases, s.624 double-charge relief does not apply.

Section 685A(2) ITTOIA provides:

> This section applies only in respect of that proportion of the annual payment which corresponds to the proportion of the total income arising to the trustees of the settlement in respect of which a settlor is chargeable to tax under section 619(1).

Section 685A(2) may apply where:

(1) A settlement is partly settlor-interested (because there are two settlors or the settlor is partly excluded).
(2) A non-resident settlor is charged on part of the trust income (UK source income only).
(3) A remittance basis taxpayer settlor is charged on part of the trust income (UK source and remitted income only).

47.10.2 *Relief for non-settlor*

Section 685A(3) ITTOIA provides beneficiary relief by way of a tax credit:

> If and in so far as this section applies, the recipient of the annual payment shall be treated for the purposes of this Chapter [Chapter 5 Part 5, the settlor-interested trust code] as having paid income tax at the applicable rate[75] in respect of the annual payment.

[75] Defined s.685A(3A): “For the purposes of subsection (3), the “applicable rate” means—

Section 685A(4) ITTOIA prevents the beneficiary from using the tax credit except against the charge on the trust income:

> But—
>
> (a) tax which the recipient is treated by virtue of this section as having paid is not repayable,
>
> (b) tax which the recipient is treated by virtue of this section as having paid may not be taken into account in relation to a tax liability of the recipient in respect of any other income of his...

EN FB 2008 provides:

> 10. Section 685A ITTOIA 2005 provides that income paid by trustees of a settlor-interested trust to (non-settlor) beneficiaries comes with a non-repayable 'notional' tax credit ... which covers all the tax liability on that income.

The TSE Manual provides:

> **TSEM4570 Payments to beneficiary other than the settlor** [Sep 2021]
> ... The amount of the actual payment (it is not grossed up) should be shown in the beneficiary's return and it is included in the calculation of that person's total income. The tax credit ensures the beneficiary has no further liability in respect of the payment but it is ring-fenced so that no part of it can be repaid or set against liability arising from any other income of the beneficiary.

Section 685A(5A)(5B) ITTOIA provide:

> (5A) If the recipient of the annual payment is treated by subsection (3) as having paid income tax in respect of the annual payment, the amount of the payment is treated as the highest part of the recipient's total income for all income tax purposes except the purposes of sections 535 to 537 (gains from contracts for life insurance etc: top slicing relief).
> (5B) See section 1012 of ITA 2007 (relationship between highest part rules) for the relationship between—
>
> (a) the rule in subsection (5A), and
>
> (b) other rules requiring particular income to be treated as the highest part of a person's income.[76]

(a) in the case of a Scottish taxpayer, the highest Scottish rate,
(b) in the case of a Welsh taxpayer, the Welsh additional rate, or
(c) in any other case, the additional rate."

[76] See App.2.25 (Highest part of income).

EN FB 2008 explains subsections (5A)(5B):

> 10. Section 685A ITTOIA 2005 provides that income paid by trustees of a settlor-interested trust to (non-settlor) beneficiaries comes with a non-repayable 'notional' tax credit ... which covers all the tax liability on that income.
> 11. However, under current statutory ordering rules income from a trust is charged before savings and/or dividend income. The result is that a beneficiary of such a trust who also has savings and/or dividend income may find that the non-trust income is pushed into higher rates so that more tax is due overall.
> 12. The measure amends this ordering rule, so that income from a settlor-interested trust is treated within section 1012 ITA 2007 as one of the highest slices of income instead of being treated as part of the lowest slice.
> 13. The amending legislation backdates the correct position to 6 April 2006 to ensure that those affected are not disadvantaged by the omission.

The problem arose because s.624 double-charge relief takes the form of a non-repayable tax credit rather than an exemption for the trust distribution (which comes to the same thing but seems simpler). The reason for that drafting technique is not clear to me.

Two points arise from this which ought to raise serious questions about the Rule of Law in relation to UK tax. First the tax system is so complex that it took two years for the error in the FA 2006 to be noticed. (I confess I did not notice it myself.) Secondly, the error was corrected by casual retrospective legislation.

47.10.3 *Relief for settlor*

Section 685A(5) ITTOIA provides:

> If the recipient of the annual payment is a settlor in relation to the settlement, if and in so far as this section applies the annual payment shall not be treated as his income for the purposes of the Income Tax Acts (and subsection (3) does not apply).

The TSE Manual provides:

> **TSEM4570 Payments to the settlor** [Sep 2021]
> Where you tax the settlor on the income arising to the trust, discretionary payments out of the trust to the settlor are not further taxable. [The Manual comments on the position up to 2005-06 and then continues:] For 2006-07 onwards discretionary payments made by the

trustees to the settlor are taken out of charge by ITTOIA/S685A(5).

The legislation distinguishes between non-settlor beneficiaries and the settlor. Beneficiaries are given a credit but the settlor is exempt. At first sight this seems strange, but a reason will emerge.

The payment to the settlor is not a capital payment for s.87 purposes: see 61.7.4 (Chargeable to IT).

47.10.4 *Life tenant (not settlor) of settlor-interested trust*

Suppose a settlor-interested trust under which a beneficiary ("B", not the settlor) has an interest in possession. Section 624 beneficiary relief only applies to discretionary trusts. But if a trust confers an interest in possession (not on the settlor) then no relief is needed: the life tenant is not taxable as the trust income is the income of the settlor and of the settlor alone, so that B cannot be taxable on it.

If the settlor is non-resident, B is taxable on foreign income as that is not within s.624.

If the settlor is a remittance basis taxpayer, B is taxed on unremitted foreign trust income as that is not within s.624. The settlor will be taxed on the same income in a later year in which the income is remitted. Once remitted in that later year, the income will become "income arising under the settlement" and therefore income of the settlor and of the settlor alone B can then reclaim tax wrongly paid, at least if in time to do so. This may not work in practice, as B will not necessarily know when a settlor has remitted the income, but no doubt we muddle through.

47.11 Trustees of settlor-interested trust

47.11.1 *Tax on trust income*

If s.624 applies, the trust income is the income of the settlor "and of the settlor alone". So one might think that the trustees are not subject to tax on the income.[77] However s.646(8) ITTOIA provides:

> Nothing in sections 624 to 632 is to be read as excluding a charge to tax on the trustees[78] as persons by whom any income is received.[79]

[77] For completeness: that would be supported by a comment of Lord Russell in *Perry v Astor* 19 TC 255 at p.282 considering identical wording in a predecessor provision; this was a dissenting judgement, but the majority did not disagree on that point.

[78] In the case of a "settlement" which was not a trust, context suggests that "trustee" should be understood to include a deemed trustee; see 87.8.2 (Non-classic trust:

Thus:

(1) The trustees are in principle liable to tax under the receipts basis
(2) The settlor is *also* liable to tax under the entitlement basis[80]

Tax is paid the appropriate rates, in short:

Taxpayer	**Rates**	**See para**
Trust		
Discretionary trust	Trust rate or dividend trust rate	41.2.1
IIP trust	Basic or dividend ordinary rate	42.2
Settlor	Appropriate personal rates	43.1

47.11.2 *Settlor credit for trustees' tax*

Clearly there should not be double taxation on the same income. The tax paid by the trustees is regarded as paid on account of the settlor, ie the settlor gets a credit for, or refund of, the trustees' tax. I refer to this as the **"pay & reclaim"** system.[81]

TSEM provides:

> **TSEM4512 tax paid by trustees where income is treated as that of the settlor** [Sep 2021]
> Income arising under a settlement where the settlor retains an interest is treated as that of the settlor and the settlor alone. ITTOIA/S646(8) provides that where the income arises to trustees they are liable to tax on the income as recipients. Tax paid by the trustees in these circumstances is treated as paid on behalf of the settlor and is available to be used against the settlor's own tax liability.

47.11.3 *Excess credit returned to trust*

It can happen that the tax paid by the trustees on the trust income exceeds the tax which the settlor pays. This may be because the settlor is not a top rate taxpayer or because of the settlor's allowances or reliefs. The settlor can then reclaim the difference, but must return the repayment to the trustees. Section 646 ITTOIA provides:

Deemed trustee). But the issue will rarely (if ever) arise.

[79] See 15.2.1 (Receipt/entitlement basis of liability).

[80] This is self-evident, but if authority is needed, see *Rogge v HMRC* [2012] UKFTT 49 (TC) at [41].

[81] The same system applies for non-settlor interested IIP trusts, where trustees likewise pay tax and the life tenant has a credit for that tax; see 42.6.2 (Beneficiary's credit for trustees tax).

> (4) Subsection (5) applies if a settlor chargeable to tax under section 624 or 629 obtains a repayment by reason of the payment of the tax by—
> (a) any trustee, or
> (b) any other person to whom the income is payable by virtue of or as a result of the settlement.[82]
>
> (5) The settlor must pay an amount equal to the repayment to—
> (a) the trustee, or
> (b) the other person to whom the income is payable by virtue of or as a result of the settlement.
>
> (6) If there are two or more such persons, the amount must be apportioned among them as the case may require.

47.11.4 *Amount of tax*

For the purpose of this indemnity, it is necessary to ascertain the amount of any tax paid by the settlor which became chargeable on the settlor under section 624 or 629. The position is governed by s.619A ITTOIA:

> (1) This section applies to income which is treated as income of a settlor as a result of section 624 (income where settlor retains an interest) or 629 (income paid to unmarried minor children of settlor).
>
> (2) The income is treated as the highest part of the settlor's total income for the purposes of section 619 (so far as it relates to the income).
>
> (3) See section 1012 of ITA 2007 (relationship between highest part rules) for the relationship between—
> (a) the rule in subsection (2), and
> (b) other rules requiring particular income to be treated as the highest part of a person’s total income.

Contrast 64.20.1 (Amount of distribution tax) - s.3 distribution relief.
The TSEM provides:

> **TSEM4550: trustee or beneficiary entitled to share tax repayment**
> [Feb 2022]
> Where the operation of the settlements legislation results in a repayment to the settlor in excess of any repayment otherwise due, the settlor should pay that excess to the trustee or other person who received the

[82] The wording in para (b) would apply:
(1) In relation to a settlor-interested trust under which a 3rd person (not the settlor) had an interest in possession
(2) In relation to a settlement-arrangement which was not a classic trust; see 87.8.2 (Non-classic trust: Deemed trustee)

income. For years to 2009-10, the settlor was obliged to pass any repayment made in respect of settlement where that arose because of an ‘allowance or relief’ set against that income. For 2010-11 onwards the legislation was amended so that it applies to such a repayment of tax for any reason. The change was made because it was recognised that the increase in the trust rate to 50% would result in many settlors receiving repayments of tax paid by the trustees. Tax paid by trustees will usually be that paid on their income under ITTOIA/S646(8) but it will also include any money they may have paid to the settlor under ITTOIA/S646(1) (see TSEM4505)).

ITTOIA/S624 and 629 are deeming provisions. In recognition of the fact that a settlor will be taxed on income that does not belong to him or her, ITTOIA/S646(1) provides for the trustees to provide the settlor with money to enable him or her to pay the tax due to HMRC. Where the tax paid by the trustees exceeds that due from the settlor, he or she is required to return the excess to the trustees. The amount of tax to be returned to the trustees will be:

Tax paid by trustees under ITTOIA/S646(8)

plus Any money to pay tax provided to the settlor under ITTOIA/S646(1)

less The amount of tax charged on the settlor in respect of settlement income

It is not necessary for an actual repayment to be made for the legislation to apply. The reference to a ‘repayment’ includes a set-off of tax ultimately borne by the trustees.

Example[83]

Trustees’ income in 2010-11:	**Band**	**Rate**	**Tax**
Trustees income: £10,000			
Tax due from trustees (646(8))			
Basic rate band	£1,000	20%	£200
	£9,000	50%	£4,500
Total tax paid			£4,700

Settlors income in 2010-11	
Income from Property	£50,000
‘Settlement' Income	£10,000
Total income:	£60,000

Tax due from settlor		
Personal allowance	£6,475	0%

[83] I have amended the format of the example for greater clarity.

	£37,400	20%	£7,480
	£16,125	40%	£6,450
Total			£13,930

(tax includes £4,000 on settlement income)

Tax due from settlor

Total tax due	£13,930
Less tax credit from trustees	-£4,700
Tax due per settlor's self assessment	£9,230

Here there will be no actual repayment made by HMRC but the tax due from the settlor is reduced by the tax credit of £4,700 of which only £4,000 has been used against settlement income.

£700 should be paid by the settlor to the trustees. That is made clearer if we consider the tax position of the settlor in the absence of the settlement income:

Settlors income in 2010-11

Income from Property £50,000 *ignoring settlement income*

Tax due from settlor

(personal allowance)	£6,475	0%	
	£37,400	20%	£7,480
	£6,125	40%	£2,450
Total			£9,930

The £700 difference between £9,930 and £9,230 is the tax 'overpaid' by the trustees

For years 2010-11 onwards, ITTOIA/S646 is amended so that if the settlor has difficulty in working out the amount of the 'repayment' to be paid to the trustees he or she can require HMRC to issue a certificate showing the amount of the repayment due to the settlor in respect of the income treated as belonging to him or her. If you are approached by the trustees you must not divulge information concerning the settlor's tax affairs without the permission of the settlor.

To request a certificate the settlor should submit a copy of form R185(Settlor) or any other notification of income and tax paid by the trustees to the settlor. You will not be able to issue the certificate until the settlor's liability for the year has been calculated, i.e. their tax return or R40 has been processed.

The R185(Settlor) should confirm the information already declared on the tax return or R40. If the total liability for the year has been calculated the certificate can be issued.

Section 646 ITTOIA provides:

> (6A) For the purpose of subsection (5), the settlor may require an officer of Revenue and Customs to provide the settlor with a certificate specifying—
>
> (a) that the settlor has obtained a repayment as mentioned in subsection (4), and
>
> (b) the amount of the repayment.
>
> (6B) A certificate provided under subsection (6A) is conclusive evidence of the facts stated in it.

This is standard drafting; see 101.2.1 (Certificate of tax paid).

47.11.5 *Planning: Mandating income*

Mandating income can avoid the liability on IIP trustees.[84] HMRC Trusts and Estates Newsletter (December 2010) provides:

> **Trusts and Estates - mandated income of settlor-interested trusts**
> ... that where income is mandated to an IIP beneficiary of a settlor-interested trust there is no statutory basis for taxing the trustees as being in receipt of the income. The settlor is taxed on any income (or income from property) in which he or she has a retained interest...
> HMRC will no longer require a fully completed return from trustees of settlor interested trusts in respect of income that is mandated to an IIP beneficiary.[85]

A discretionary trust which wishes to distribute all income to a beneficiary (typically, but not necessarily, the settlor) may consider creating a non-estate IIP and mandating the income to the life tenant,[86] in order to reduce the administrative costs.

47.11.6 *Pay & reclaim: Critique*

Malcolm Gunn (former editor of Taxation Magazine) described the pay & reclaim system as “ridiculous”,[87] and the reader will probably agree; but there it is. It is suggested that for settlor-interested trusts:

(1) The settlor should be liable

(2) If HMRC need further protection - I am not sure why they should - the trustees should become liable only if the settlor fails to pay on time

[84] See 42.3 (Income mandated).

[85] *https://www.gov.uk/government/publications/hm-revenue-and-customs-trusts-and-estates-newsletters* accepting the argument in Malcolm Gunn’s article.

[86] Or indeed to anyone else, at the direction of the life tenant.

[87] See Gunn, “Tax Charge Doubled!” Taxation Magazine, 22 Feb 2007.

Similarly, for non-settlor-interested IP trusts, where the same pay & reclaim system currently applies:

(1) The life tenant should be liable
(2) If HMRC need further protection, the trustees should be liable only if the life tenant fails to pay on time

IHT liability rules offer a precedent.

47.11.7 *Trust withholding tax*

There is usually a charge on trustees making an income distribution from a discretionary trust (trust withholding tax).[88] Section 685A(6) ITTOIA confers relief:

> Sections 494 and 495 of ITA shall not apply in relation to an annual payment if and in so far as this section applies.

47.12 Interaction of s.624/CGT

The general rule is that where the person making a disposal is subject to income tax on the proceeds, IT has priority over CGT, and there is no double charge.[89] This rule does not work where X makes a disposal but the income is treated as the income of Y; this is the case when s.624 applies, the income is treated for IT purposes as income of the settlor and not the trustees!

HMRC suggest a creative application of s.32 TMA may solve the problem. CG Manual provides:

> **CG14304. Sums chargeable as income** [Jun 2019]
> This exclusion does not apply to … situations where the income in question is not treated as the income of the person making the disposal. Typically this is a case of a settlor interested trust where the income is taxed on the settlor. If in this situation the settlor is assessable to both income tax and capital gains tax then relief may be available under s.32 TMA 1970.

Suppose a settlor-interested discretionary trust. Income accrues to the trustees. The settlor pays income tax. What stops the trustees realising a chargeable gain, on which the trustees may be chargeable if UK resident, or which may be s.1(3) amounts (trust gains) if the trust is not UK

[88] See 41.5 (Tier 2: Trust withholding tax).
[89] See s.37 TCGA, discussed at 56.4.12 (Interaction of IT/CGT).

resident? This solution does not lie in s.32 TMA as it is not the case that the settlor is assessable to both IT and CGT. There is nothing obvious to stop the trustees realising a chargeable gain. But no-one suggests that there is a charge. The solution must be in a general implied rule that receipts of an income nature are not within the scope of CGT.

47.13 s.624/s.720 compared

Sections 624 ITTOIA and 720 ITA cover similar ground. For a full comparison one would need to read all the relevant sections in this book. It may be helpful to summarise the major differences:

Difference	**Section 624**	**Section 720**
Applies to:	trusts	non-resident trusts & companies
Requires:	settlement-arrangement	transfer of assets
Tax on:	settlor	transferor[90]
Bounty:	bounty required	bounty not required
Motive defence:	does not apply	motive defence applies
Indemnity:	settlor indemnity	no indemnity for transferor
Non-resident:	applies to non-resident settlor	n/a to non-resident transferor
Income not taxed:	after settlor excluded	after tax year transferor excluded

The rates of tax are slightly different, a (probably accidental) result of the FA 2006.[91]

Section 624 has priority over s.720: see 49.27 (Interaction of s.720 /s.624).

See too 49.12 (Transferor/settlor compared).

47.14 Settlor receives capital sum

Section 633 ITTOIA provides:

> (1) Any capital sum[92] paid directly or indirectly in any tax year by the trustees of a settlement to the settlor[93] is treated for income tax purposes as follows.
> (2) The sum is treated as the income of the settlor for the tax year so far as the amount of the sum falls within the amount of income available up to the end of the year.

[90] See 49.12 (Transferor/settlor compared).

[91] See 43.11 (Settlor-interested trust IT rate).

[92] The definition of "capital sum" is in s.634 ITTOIA, which is set out and discussed at 49.24.2 ("Capital sum"), with the ToA definition which is (more or less) the same.

[93] Section 634 ITTOIA provides a wide definition of "paid to the settlor" which is the same as for s.87: see 61.8 (Receipt from trustees).

47.14.1 *"Available income"*

The key term is "available income." Section 635 ITTOIA provides the definition:

> (1) For the purposes of section 633 the amount of income available up to the end of any tax year is, in relation to any capital sum paid as mentioned in subsection (1) of that section by the trustees of a settlement, calculated as follows.
> (2) Add together the amount of unprotected[94] income arising under the settlement in that year and any previous year which has not been distributed.
> (3) Deduct from that figure—
> (a) the amount of that income taken into account under section 633 in relation to that sum in any previous year or years,
> (b) the amount of that income taken into account under section 633 in relation to any other capital sums paid to the settlor in any year before that sum was paid,
> (c) any income arising under the settlement in that year or any previous year which has been treated as income of the settlor under section 624 or 629 ...

Section 633 is generally irrelevant to settlor-interested trusts, because, in short:

(1) Trust income will be treated as accruing to the settlor under s.624, or
(2) If the income is protected income, neither s.624 nor s.633 apply, or
(3) If the settlor is non-resident, or if (which will be rare after 2017) the s.624 remittance basis applies, the income will not be "income arising under the settlement".

In each case, there is no "available income".

Section 633 is (in short) intended to catch capital sums paid to the settlor from a trust which is not settlor-interested. It is the settlement provision equivalent of the s.727 capital sum charge, which applies where a transferor does not have power to enjoy but receives a capital sum.[95] Accordingly I shall not discuss the section further here.

[94] Section 635(4) ITTOIA provides: "In subsection (2) "unprotected income" means income which is not protected foreign-source income, and sections 628A(2) to (13) and 628B (meaning of "protected foreign-source income") have effect also for this purpose." See 92.10 (s.624 protected-trust relief).

[95] See 49.23 (Transferor receives capital sum).

47.14.2 *Sum paid by connected company*

Section 641 ITTOIA expands the scope of s.633:

> (1) This section applies if—
> (a) a capital sum is paid to the settlor in a tax year by any body corporate connected with the settlement in that year, and
> (b) an associated payment has been, or is, made directly or indirectly to the body by the trustees of the settlement.
> (2) The capital sum is, in accordance with this section, treated for the purposes of section 633 as having been paid to the settlor by the trustees of the settlement.

47.14.3 *Capital sum: Critique*

There is no need for the capital sum provision, at least for UK trustees who now pay IT at the top rate. STEP note the point:[96]

> In our view, the capital sum provisions are not required at all where we are dealing with a trust that is onshore and the settlor lends to the trust and the loan is repaid. Imposing an income tax charge on the settlor who lends rather than gives to the trust, but is excluded from any benefit, is counter intuitive and causes frequent mistakes.

47.15 Payment to settlor's child

Section 619(1)(b) ITTOIA imposes the charge:

> (1) Income tax is charged on ...
> (b) income which is treated as income of a settlor as a result of section 629 (income paid to relevant children of settlor)

I refer to income which is treated as the settlor's income under this section as **"s.629 income"**.

So we turn to s.629 ITTOIA:

> (1) Income which arises under a settlement is treated for income tax purposes as the income of the settlor and of the settlor alone for a tax year if, in that year and during the life of the settlor, it—
> (a) is paid to, or for the benefit of, a relevant child of the settlor, or

[96] STEP Scoping Document Response: OTS review of its approach to simplification and its aims, approach and priorities (Apr 2022). *https://www.step.org/sites/default/files/2022-04/step-response-to-ots-review-of-simplification.pdf*

> (b) would otherwise be treated (apart from this section) as income of a relevant child of the settlor...[97]
>
> ...
>
> (7) In this section and sections 631 and 632—
> (a) "child" includes a stepchild,
> (b) "minor" means a person under the age of 18 years, and "minor child" is to be read accordingly,
> (c) references to payments include payments in money's worth, and
> (d) "relevant child" means a minor child who is unmarried or not in a civil partnership.

The TSE Manual provides:

> **TSEM10315 - Non-resident trusts: settlor's chargeability: income tax - minor unmarried child** [Sep 2021]
> [The Manual summarises s.629 and continues:]
> Where the payment is made from income, because the provisions of ITA/S493 do not apply to non-resident trusts, there is no grossing up and no tax credit. The payment is regarded as untaxed foreign income (TSEM10255) and should be taken into account by the settlor when considering his or her liability to income tax for the year - but see TSEM10320 regarding the operation of ESC A93.

Where there is a discretionary trust, see 41.4.1 (UK resident trust); 41.11 (s.629 income: settlor's child).

47.15.1 *"Paid"*

Section 629(7) ITTOIA provides a wide meaning:

> (7) In this section and sections 631 and 632 ...
> (c) references to payments include payments in money's worth ...

For completeness, s.632 ITTOIA deals with offshore income gains held by nominees:

> (1) This section applies if—
> (a) an offshore income gain accrues in respect of a disposal by a

[97] I mention for completeness two very minor exemptions:
Section 629(5) ITTOIA provides: "Subsection (1) does not apply so far as provided by section 630 (exception for gifts to charities)." I cannot see how this could ever apply; but it does not matter.
Section 629(8) ITTOIA provides: "Subsection (1) is subject to section 28A of FA 2005 [vulnerable persons trusts]." But this rarely if ever arises.

> trustee of assets held by the trustee for a minor, and
> (b) the minor would be absolutely entitled as against the trustee but for being a minor.
>
> (2) The income which, under regulation 17 of the Offshore Funds (Tax) Regulations 2009 (SI 2009/3001) (charge to tax), is treated as arising by reference to that gain is treated for the purposes of sections 629 and 631 as paid to the minor.
>
> (3) In this section "offshore income gain" has the same meaning as in Chapter 5 of Part 2 of those Regulations.

47.15.2 *Interaction of s.624/s.629*

Section 629(2) ITTOIA provides:

> Subsection (1) does not apply to income which is treated as income of the settlor under section 624.

Thus the settlor-interested trust rule has priority.

47.15.3 *De minimis rule*

Section 629 ITTOIA provides:

> (3) Subsection (1) does not apply in relation to a child's relevant settlement income in any tax year if, in that year, the total amount of that income does not exceed £100.[98]
>
> (4) In subsection (3) a child's "relevant settlement income" means income—
> (a) which is paid to or for the benefit of, or otherwise treated as income of, the child, and
> (b) which (apart from subsection (3)) would be treated as income of the settlor under subsection (1).

47.16 Corporate settlor

It is common for a company to make a settlement in the standard CGT/IT sense. These are typically commercial trusts (pension trusts or employee benefit trusts) so the trust is not a settlement in the settlement-arrangement sense, for lack of bounty.[99] However it is possible (albeit not usual) for a company to make a settlement in the settlement-arrangement sense.

Section 627(4) ITTOIA provides:

[98] This limit was set in 1995, see s.660B(5) ICTA 1988, so the relief, which was never very large, has been allowed to die by inflation.

[99] See 99.39 (Pension/employee benefit trust).

> The rule in section 624(1) does not apply in relation to income which—
> (a) arises under a settlement, and
> (b) originates from any settlor who was not an individual.

This provision was introduced in 2012. EN FA 2012 provides:

> The purpose of the amendments to the settlements legislation is to confirm that income arising under a settlement is treated as that of the settlor only where the settlor is an individual. The proposed changes would close avoidance schemes that seek to exploit the settlements legislation by using corporate settlors of 'interest in possession' settlor-interested trusts to try to avoid income tax at higher or additional rates which would otherwise be due on dividends paid by a subsidiary of the corporate settlor. The amendments would ensure that the relevant provisions do not apply to settlors who are not individuals and hence that the income would not be treated as that of the settlor in those situations.

For completeness: the position was the same even before the enactment of this provision in 2012.[100] It is helpful to have clarified the law, even if the reason for the change was to stop a tax avoidance scheme which did not work anyway.[101]

47.17 Tax return: s.624 income

The trustees may inform the settlor of the s.624 income by completing form R185(Settlor) (Statement of trust income chargeable on settlor).

The settlor reports s.624 income in boxes 7-15 of form SA107 (Trusts etc) 2022/23. SA107 Notes (2022/23) provides:

> **Income chargeable on settlors**
> Use the figures in boxes 7 to 15 on your R185 (Settlor) to fill in this section. If you do not have this, ask the trustees for the details.
> If you've received income from a residential property, the trustee will supply you with details of the figure to include in box 25 'Amount of residential property income or restricted finance costs' where applicable. Use the working sheet on page TN 4 to help complete box 25.
> Do not include any foreign income in these boxes. Fill in the 'Foreign' pages instead.

[100] For the pre-2012 law, see the 10th edition of this work para 24.16 (Corporate Settlor). But the point is now of historical interest only.

[101] Namely, *Clipperton*, discussed 87.5.8 (No intention to benefit others).

47.18 DT relief: s.624 income

In the case of a settlor-interested trust, there are four states potentially involved:

(1) the state where the settlor is resident (here assumed to be the UK)
(2) the state where the trustees are resident
(3) the state where a beneficiary is resident
(4) the state where the source of the income arises

There are several ways s.624 could lead to double taxation:

(1) The settlor will be taxed if UK resident or if the trust has UK source income
(2) The trustees may be subject to foreign tax in another state
   (a) on income with a source in that state
   (b) on any income if they are resident in that state
(3) In the case of an IIP trust, the life tenant may be subject to foreign tax in another state
   (a) on income with a source in that state
   (b) on any income if they are resident in that state

47.18.1 *Foreign tax credit relief*

Where trust income is subject to a foreign tax, foreign tax credit relief in principle applies for the benefit of a settlor within s.624. That follows from first principles but if authority were needed, see s.623 ITTOIA.[102] HMRC agree. The TSE Manual provides:

> **TSEM4017 Calculation of Income - S623 ITTOIA** [Sep 2021]
> ITTOIA/S623 allows the settlor 'the same deductions and reliefs' the settlor would have been entitled to had the settlor actually received the income. Thus reliefs which can only be set against a particular type of income, such as a credit under a DTA for foreign tax suffered by the trustees on foreign source income, is available to the settlor even though the charge on the settlor is under ITTOIA/Part 5 ('Miscellaneous Income'). ...

I doubt if it is necessary to rely on s.623 to reach this result,[103] but it does not matter.

The INT Manual considers the position where a beneficiary is taxed in

[102] See 47.4 (Settlor deductions/reliefs).
[103] See 47.4 (Deductions & reliefs).

the UK and a settlor is taxed in some other country under a foreign equivalent of s.624:

> **INTM161040. Same income** [Sep 2021]
> The credit Article in an agreement and the corresponding provision for unilateral relief in s.9 TIOPA 2010 are concerned with relief from double taxation on income or gains. For credit to be allowed, it is not a requirement that the foreign tax on income or gains has to be borne by the same person who is liable to UK tax on the same income or gains. For example, if the foreign country taxes a settlor on the income of a UK resident beneficiary, who is chargeable to UK tax on that income, credit may be given to the beneficiary for the foreign tax paid by the settlor. However, it must be the same income which is being taxed in both countries. ...

47.18.2 *Trustees treaty-resident outside UK*

Suppose:

(1) A settlor-interested trust within s.624.
(2) The trustees are treaty-resident in a foreign State whose DTA has a standard form interest and dividend articles.
(3) The settlor is UK tax-resident and not treaty-resident in a foreign State.

The question is whether the settlor qualifies for third party DTA relief.[104] Where a Savings Clause applies, the answer is no.

What if the treaty does not have a Savings Clause? The settlor is subject to tax under s.624. It is considered that the settlor can in principle claim third-party DT relief.

Section 619 and 624 ITTOIA must be read together:

> **619(1)** Income tax is charged on ... (a) income which is treated as income of a settlor as a result of section 624 (income where settlor retains an interest) ...
> **624(1)** Income which arises under a settlement is treated for income tax purposes as the income of the settlor and of the settlor alone...

Section 624 imposes a deeming which changes the recipient, that is, the income which actually arises to the trustees is deemed to accrue to the settlor. The character of the income is not altered. That is, the income which is "treated as the income of the settlor" is the actual income of the

[104] See 109.1 (Third-party DT relief).

trustees, and not different (notional) income.

It follows that the settlor can in principle claim third-party DT relief provided that the income is of a type which qualifies for DT relief.

Why in fact is there a charge to tax under s.619? If the settlor is treated as receiving (say) interest income, the income would be chargeable to tax under the charging provisions relating to interest. No separate charge to tax is needed. The drafter is in my view slightly muddled as to whether the income of the settlor is the settlement income or notional income. The confusion is understandable, for the distinction between the two is metaphysical: they amount to exactly the same thing.

It might be argued that since the income is deemed to be the income of the settlor and of the settlor alone, it is deemed not to be the income of the trustees, so the deeming disapplies the DT exemption. But that construction would put the UK in breach of the treaty, so it should not be regarded as correct. Section 624 is not a defence to trustees from an assessment.[105]

47.18.3 *Settlor treaty-resident outside UK*

This section considers whether DT exemptions are available where:

(1) income accrues to a settlor-interested trust whose trustees are not treaty-resident in a foreign state (so the settlor cannot claim indirect treaty relief).
(2) The settlor is treaty-resident in a foreign state.

The settlor is in principle subject to tax under s.624. It is considered that the settlor can claim DT exemption directly.

In some cases, DT exemption only applies if the income is "beneficially owned" by the settlor. In the case of a common form settlor-interested discretionary trust, the income is not "beneficially owned" by the settlor as a matter of English property/trust law. But since for tax purposes it is deemed to be the income of the settlor, this requirement is deemed to be satisfied. OECD Commentary is helpful here:

> The term "beneficial owner" is not used in a narrow technical sense (such as the meaning that it has under the trust law of many common law countries[106]), rather, it should be understood in its context and in light of

[105] See 47.11 (Trustees of settlor-interested trust).

[106] Footnote original: For example, where the trustees of a discretionary trust do not distribute royalties earned during a given period, these trustees, acting in their

> the object and purposes of the Convention ....[107]

In the US/UK DTA, this is expressly dealt with: see 91.7.8 (s.624/720 income; s.3/86 gain).

47.18.4 *HMRC view*

The TSE Manual provides:

> **TSEM3665. Relief for overseas tax: trust income deemed not to be the beneficiary's** [Sep 2021]
> For tax purposes, income may be deemed to be that of someone other than a beneficiary. For example, the anti-avoidance provisions may treat trust income as that of the settlor. The trustees can claim tax credit relief on the income.
> If the trustees do not claim relief, the overseas income chargeable is the net amount after deduction of overseas tax.

The International Manual raises some of these questions but does not tell us what HMRC regard as the answers:

> **INTM339550 DT applications and claims: Applicants/claimants - Trusts** [Sep 2021]
> **Claims by non-resident trustees of discretionary trusts**
> You may receive a claim or application from non-resident trustees of a discretionary trust. For specific information about claims by non-resident trustees see the country specific pages. If the trust's entitlement to claim is not clear from previous papers, you will need to ask for details of the trust to establish whether relief is due. The necessary information is requested on the form 4467(trustee)/FD.
> ***What to do if the settlor of a discretionary trust is not excluded from benefit under the trust***
> Where the settlor of a non-resident discretionary trust is not excluded from benefit under the trust, the trust may be subject to the provisions of [s.624 ITTOIA]. In this situation the trust may be described as a 'caught settlement'. The settlor will be chargeable on the income of the trust as their own personal income, regardless of whether the income is accumulated or distributed.
> Where we have a claim or application from trustees of a discretionary

capacity as such (or the trust, if recognised as a separate taxpayer) could constitute the beneficial owners of such income ... even if they are not the beneficial owners under the relevant trust law.

[107] See 108.10 (DTA beneficial owner rule).

> trust from which the settlor is not excluded from benefiting, Specialist Personal Tax, PT International Advisory will need to refer the papers to Specialist PT, Trusts & Estates for advice. They will also consider whether the settlor or the trustees need to make a UK tax return.
> If the settlement is caught, a claim by the trustees will not be valid.
> (This content has been withheld because of exemptions in the Freedom of Information Act 2000) ...

47.19 s.643A charge: Outline

This section discusses the close-family charge. This is one of the charges introduced by the protected-trust regime.[108]

In outline, where the settlor/close-family of the settlor receive a benefit from a protected trust, the recipient is subject to tax. I refer to this as the **"s.643A close-family charge"**.

Where the close-family beneficiary is non-resident (and so outside the scope of the charge) the settlor (if UK resident) is liable instead. I refer to this as the **"s.643A settlor-attribution charge"**.

Before 2018, where there was a foreign domiciled settlor-interested trust, there were income tax charges on:

(1) income distributions to UK beneficiaries
(2) remittance of s.624 income

However it was in principle possible to provide some benefits to the settlor or close-family, without those charges . From 2018, benefits are in principle chargeable.

47.19.1 *Section 643A/s.731 compared*

Sections 643A ITTOIA and 731 ITA cover similar ground: they apply on the receipt of a benefit not otherwise chargeable to income tax. It may be helpful to summarise the main differences:

	s.643A	**s.731**
Basic requirement	settlement-arrangement	transfer of assets abroad
Applies to	protected trusts	all trusts & companies
Tax on benefit to	settlor/close family	anyone
Tax limited by ref to	available protected income	relevant income
Motive defence	no	yes

Section 731 has priority over s.643A. So the main case where s.643A

[108] See 92.1 (Protected-trust regime).

applies will be benefits from protected trusts, with income at trust level (eg no underlying company), where the motive defence applies for s.731.

47.20 s.643A application conditions

Section 643A(1) ITTOIA is easier to follow if it is split into parts, the first part setting out the conditions for the application of the rule, and the second part containing the rule.

The first part of s.643A(1) ITTOIA provides:

> [a] If an individual [settlor/close-family beneficiary][109]
> [b] has an untaxed benefits total for a settlement for a tax year (see section 643B),
> [c] [i] an amount
> [ii] equal to so much of that total as does not exceed the settlement's available protected income up to the end of the year (see section 643C)
> [iii] is [s.643A income]

We can regard para [a] and [b] as a set of conditions for the s.643A charge and I refer to it as the **"s.643A application conditions"**.

The amount specified in s.643A(1)[c] is "**s.643A income"**.[110]

The amount of s.643A income is the lower of:

(1) Untaxed Benefits Total
(2) Available Protected Income

Although not the statutory usage, I write these expressions with initial capitals, to reflect the technical nature of the expression.

The definitions require:

(1) Settlor/close-family receive a benefit
(2) Protected s.624 income

The benefit does not have to be provided out of the protected income, or derived from it, or matched with any particular item of the income.

47.21 Untaxed Benefits Total

Untaxed Benefits Total (UBT) matters for two reasons:

[109] Section 643A(1)[a] appears to apply to any individual. But the effect of the definition of Untaxed Benefits Total is that it only applies to an individual who is the settlor or close-family; so I gloss it as "individual [settlor/close-family beneficiary]".

[110] The statutory term is "deemed income".

(1) The amount of s.643A income is the lower of:
(a) Untaxed Benefits Total and
(b) Available Protected Income

(2) If the UBT is nil, there is no s.643A income, because the condition in s.643A(1)[b] is not met.

Section 643B(1) ITTOIA provides:

> For the purposes of section 643A, whether an individual has an untaxed benefits total for a settlement for a tax year ("the current year"), and (if so) its amount, are determined as follows-

The subsection sets out four steps:
1: Identify benefit to settlor/close-family beneficiary
2: Value the benefit
3: Deductions where benefit otherwise taxed
4: Conclusion

The drafting and terminology is loosely based on the computation of s.731 income, in s.733 ITA.[111]

47.21.1 *"Provided by trustees"*

UBT Step 1 refers to benefits "provided by the trustees". Benefits provided by other persons do not count. Before considering the steps, it is helpful first to set out the definition of this phrase. As one would expect, it is widely defined.

Section 643B ITTOIA provides two definitions: (4) defines "provided by the trustees" and (5) defines "provided by trustees to an individual". It is easier to follow if the provisions are read side by side with differences highlighted:

Provided by trustees: s.643B(4)	**Provided by trustees to individual: ss(5)**
In this section and sections 643C to 643M, a reference to	[same]
a benefit provided by trustees of a settlement is to-	a benefit provided by trustees of a settlement to an individual is to-
(a) a benefit treated by	(a) a benefit treated by subsection (6)

[111] See 50.18 (Computation of s.731 income).

subsection (6) as provided by the trustees, or	as provided by the trustees to the individual, or
(b) any other benefit if it is provided by the trustees directly, or indirectly, out of-	(b) any other benefit if it is provided by the trustees to the individual directly, or indirectly, out of-
(i) property comprised in the settlement,[112] or	(i) [same]
(ii) income arising under the settlement.	(ii) [same]

Subsections (4) and (5) say (more or less) the same thing. It could have been more neatly expressed, but it works.

47.21.2 *Provided by trustees: IIP trust*

Section 643B(6) ITTOIA provides:

> Where-
> (a) income arises under a settlement, and
> (b) the income, before being distributed, is the income of a person other than the trustees,
> a benefit
> [i] is for the purposes of subsection (4)(a) treated as provided by the trustees and
> [ii] is for the purposes of subsection (5)(a) treated as provided by the trustees to the person.

The wording at (b) is drawn from s.480 ITA.[113] It seems a clumsy way to refer to an interest in possession trust.

Income within s.643B(6) will normally be taxable, so it will not be added to the untaxed benefits total.[114] But this subsection may be needed for the case where the life tenant is non-resident and the income is foreign source income, so it is not taxable.

Section 643B(7) ITTOIA provides:

> A benefit treated as provided by subsection (6) is treated-
> (a) as consisting of the income mentioned in that subsection, but

[112] See 47.3.1 (Property comprised in settlement).

[113] See 41.2.2 (Settlor-interested trust).

[114] See 47.21.5 (Step 3: Benefit liable to IT).

after any reduction in accordance with Chapter 8 of Part 9 of ITA 2007 for trustees' expenses, and

(b) as provided at the time that income arises.

47.21.3 *Step 1: Identify benefits*

Armed with the definitions of "provided by trustees", we can turn to UBT Step 1 in s.643B(1) ITTOIA. The rule depends on whether the benefit is provided to the settlor or to a close-family beneficiary. It is easier to follow if the two provisions are read side by side:

Benefit to settlor	**Benefit to close-family of settlor**
If the individual [settlor/close-family beneficiary] is the settlor,	If the individual [settlor/close-family beneficiary] is not the settlor
identify each benefit provided by the trustees to the individual at a time-	[identical]
(a) when the individual is not relevantly [-taxable] domiciled,[115] and	(a) when the individual is a close member of the settlor's family (see section 643H),[116] and
(b) in a tax year that is the current year or an earlier tax year[117].	[identical to (b)]

If the settlor is relevantly-taxable domiciled, the s.624 charge would usually apply. It is possible to envisage cases where the settlor will be better off if UK domiciled, but that will be rare.

It does not matter where the close-family beneficiary is domiciled.

Benefits to persons other than the settlor or close-family do not count.

[115] Section 643B(2) ITTOIA provides the definition:

> "For the purposes of Step 1 in subsection (1), an individual is "relevantly domiciled" at any time if at that time-
> (a) the individual is [actually] domiciled in the UK, or
> (b) the individual is regarded for the purposes of section 809(1)(b) of ITA 2007 as domiciled in the UK as a result of section 835BA of ITA 2007 having effect because of Condition A in that section being met [formerly domiciled resident]."

The wording also used in the equivalent ToA rule; for discussion, see 50.15.1 ("Relevantly domiciled"). I refer to this as **"relevantly-taxable domiciled"**.

[116] See 61.27 ("Close Family").

[117] Pre-2018/19 years are ignored: see 47.27 (s.643A commencement).

47.21.4 *Step 2: Value benefits*

Section 643B(1) ITTOIA provides:

> *Step 2*
> Identify the amount or value[118] of each benefit identified in the individual's [settlor/close-family beneficiary's] case at Step 1, and calculate the total of those amounts and values.

This is (relatively) straightforward.

47.21.5 *Step 3: Benefit liable to IT*

Section 643B(1) ITTOIA provides four deductions to avoid double taxation:

> *Step 3*
> Take the total calculated at Step 2 and deduct from it the following-
> (a) any part of it on which the individual [settlor/close-family beneficiary] is liable to income tax[119] otherwise than under section 643A,
> (b) any income treated by
> [i] section 643A or
> [ii] [section] 643J[120] or
> [iii] [section] 643L[121]
> as arising, to a person for a tax year earlier than the current year, by reference to any of the benefits identified in the individual's [settlor/close-family beneficiary's] case at Step 1,
> (c) where the whole or part of a benefit identified in the individual's [settlor/close-family beneficiary's] case at Step 1 is taken into account in charging income tax under Chapter 2 of Part 13 of ITA 2007 [ToA s.731], the amount or value of so much of the benefit as is taken into account in doing that

Section 731, if applicable, has priority over s.643A.

[118] Section 643B(3) ITTOIA incorporates the ToA statutory valuation rules:
"Sections 742C to 742E of ITA 2007 (value of certain benefits) apply for the purpose of calculating the value of a benefit for the purposes of this section as they apply for the purpose of calculating an income tax charge under Chapter 2 of Part 13 of ITA 2007."
See 50.9 (Statutory valuation rules).

[119] See App 2.3 (Chargeable/liable to tax),

[120] See 47.34 (s.643A onward-gift donee charge).

[121] See 47.36 (S.643A onward-gift settlor-attribution rule).

(d) any amount required to be deducted by section 643D(2) (gains treated as accruing in a year before the current year).

47.21.6 *Benefit taxed under s.87*

UBT Step 3(d) takes us on to s.643D ITTOIA, which provides:

> (1) Subsection (2) applies if-
> (a) in the case of a settlement, benefits provided to an individual [settlor/close-family beneficiary] as mentioned at Step 1 in section 643B(1) are received in a tax year, and
> (b) chargeable gains[122] are treated by
> [i] section 87,
> [ii] 87K, [Onward-gift CGT rule]
> [iii] 87L [Onward-gift to close-family] or
> [iv] 89(2) [s.87 charge for immigrating trusts] of,
> [v] or paragraph 8 of Schedule 4C [sch 4C charge] to,
> TCGA 1992 as accruing to a person in that or a subsequent tax year by reference (direct or indirect) to the whole or part of any benefits so provided.
>
> (2) In the calculation under section 643B of the individual's [settlor/close-family beneficiary's] untaxed benefits total for the settlement for any tax year after the one in which such chargeable gains are so treated, the amounts to be deducted at Step 3(d) of that calculation include the amount of those gains.

This arises if:

(1) A close-family beneficiary receive a benefit which:
  (a) is not taxed under s.643A because there is no Available Protected Income
  (b) is taxed under s.87, as it is matched with trust gains
(2) Available Protected Income arises later

[122] Section 643D(3) ITTOIA extends the deduction to offshore income gains:

> "References in this section to chargeable gains treated as accruing to an individual include offshore gains treated as arising to the individual (see regulations 20 and 22 to 24 of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/3001))."

For completeness, para 22 sch 10 FA 2018 provides: "The new section 643D(3) of ITTOIA 2005 is to be treated as inserted by the Treasury under the powers to make regulations conferred by section 354 of TIOPA 2010." I think the point of that is that the provision could be repealed or amended by regulations, without an Act of Parliament.

In these circumstances, sensibly, the s.87 charge has priority over s.643A. This is an approximate equivalent of s.734 ITA.[123]

47.21.7 *Result: Untaxed Benefits Total*

Section 643B(1) ITTOIA provides:

> *Step 4:*
> If the result of the calculation at Step 3 is an amount greater than nil, that amount is the individual [settlor/close-family beneficiary]'s untaxed benefits total for the settlement for the current year.

47.22 Available Protected Income

Available Protected Income matters because the amount of s.643A income is the lower of (1) Untaxed Benefits Total and (2) Available Protected Income. If there is no API, there is no s.643A income.

Section 643C(1) ITTOIA provides:

> [a] For the purposes of the application of section 643A(1) in the case of an individual [settlor/close-family beneficiary] and a settlement,
> [b] the settlement has available protected income up to the end of a tax year if-
> PFSI − TOAA > TI
> [c] and, if the settlement has available protected income up to the end of a tax year, its amount is given by-
> PFSI − TOAA − TI

That is clumsy drafting, but it works.

In short:

Term	*Stands for*
PFSI	**P**rotected **F**oreign-**S**ource **I**ncome
TOAA	**T**ransfer **O**f **A**ssets **A**broad **A**mount
TI	**T**axable **I**ncome

47.22.1 *PFSI*

Note that the term PFSI does not have the same meaning as the term "protected foreign-source income" (which itself has 3 distinct definitions).[124] This is bad drafting; but it is best to adopt the statutory terminology as anything else is even more confusing.

[123] See 50.19 (Deduction for s.87 charge).

[124] See 92.8 ("Protected income: Terminology").

There are two types of PFSI, which I call **"s.624 PFSI"** and **"s.629 PFSI"**. They are easier to follow if set out side by side. PFSI is the total of-

s.624 PFSI: s.643C(2)(a)	**s.629 PFSI: s.643C(2)(b)**
(a) any protected foreign-source income[125] -	(b) [identical]
(i) arising under the settlement in the year or in any earlier tax year,[126]	(i) [identical]
(ii) that would be treated under section 624 as income of the settlor but for section 628A [s.624 protected-trust relief],[127]	(ii) that would be treated under section 629 as income of the settlor but for section 630A, [s.629 protected-trust relief][128] and
(iii) that can be used directly or indirectly to provide benefits for the individual,[129] and	[no equivalent]
(iv) on which the individual is not liable to income tax (ignoring for this purpose any liability under section 643A)	(iii) on which the relevant child concerned (see section 629) is not liable to income tax (ignoring for this purpose any liability under section 643A)

Section 643C(3) ITTOIA disapplies the artificial remittance basis timing rule.[130]

[125] In my terminology, this is protected s.624 income; s.643C(3) ITTOIA provides the definition by reference: "protected foreign-source income" has the meaning given by sections 628A(2) to (13) and 628B. See 92.9 (Protected s.624 income).

[126] Pre-2018/19 years are ignored: see 47.27 (s.643A commencement).

[127] See 92.10 (s.624 protected-trust relief).

[128] See 92.11 (s.629 protected-trust relief (child of settlor)).

[129] The wording is derived from the definition of relevant income; see 50.20 ("Relevant income": Definition).

[130] Section 643C(3) provides: "As regards the definition of PFSI in subsection (2)-

(a) section 648(3) to (5) (relevant foreign income treated as arising under settlement only if and when remitted) do not apply for the purposes of that definition,

(b) that definition has effect as if section 648(3) to (5) do not apply for the purposes of sections 624 and 629."

See 47.8.4 (Remittance basis timing rule).

If the settlor is non-resident, there is no PFSI.

It may be possible to avoid API by distributing trust income. That may be advantageous if the beneficiary receives benefits in the UK, but the trust income is (un)taxed under the remittance basis.

47.22.2 *TOAA*

TOAA (ToA amount) is deducted in computing Available Protected Income.

Section 643C(2) ITTOIA provides:

> In this section ...
>
> TOAA is so much of PFSI as is, in respect of benefits provided by the trustees in the year or in an earlier tax year[131], taken into account in charging income tax under Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) for the year or any earlier tax year

47.22.3 *TI*

TI (taxable income) is deducted in computing Available Protected Income.

Section 643C(2) ITTOIA provides:

> In this section ...
>
> TI is the total of-
>
> (a) so much of PFSI as is, by reference to benefits provided by the trustees to the individual [settlor/close-family beneficiary], are treated by
> [i] section 643A or
> [ii] [section] 643J[132] or
> [iii] [section] 643L[133]
> as income for any earlier tax year[134], and
>
> (b) so much of PFSI as is, by reference to benefits provided by the trustees to other individuals [settlor/close-family beneficiary], are treated by
> [i] section 643A or
> [ii] [section] 643J[135]
> [iii] [section] 643L[136]

[131] Pre-2018/19 years are taken into account: see 47.27 (s.643A commencement).

[132] See 47.34 (s.643A onward-gift donee charge).

[133] See 47.36 (S.643A onward-gift settlor-attribution rule).

[134] Pre-2018/19 years are ignored: see 47.27 (s.643A commencement).

[135] See 47.34 (s.643A onward-gift donee charge).

[136] See 47.36 (S.643A onward-gift settlor-attribution rule).

> as income for the year or any earlier tax year[137].

47.23 s.643A income charge

Assuming the s.643A application conditions are met,[138] we can move on to consider the charge on s.643A income.

Section 643A(1) ITTOIA provides:

> ...[139]
>
> [s.643A income] is
>
> (a) where the individual is UK resident for the year, treated for income tax purposes as income of the individual [settlor/close-family beneficiary] for the year, subject to subsections (2) to (5).
>
> (b) where the individual is non-UK resident for the year, treated for the purposes of
>
> [i] subsection (2) and
>
> [ii] sections 643I to 643L
>
> [iii] (but no other purpose)
>
> as income of the individual for the year,
>
> [c] subject to subsection (5).

Thus there are two types of s.643A income. I coin the following terminology:

(1) **UK resident's s.643A income**: s.643A income accruing to a UK resident. This is **chargeable s.643A income** under para (a)

(2) Non resident's s.643A income: s.643A income accruing to a non-UK resident. This is **non-chargeable s.643A income**

Section 643A(7) ITTOIA provides:

> If-
>
> (a) an enactment other than this section contains a reference (however expressed) to-
>
> (i) income treated as arising by this section, or
>
> (ii) an amount treated as income by this section, and
>
> (b) the reference mentions this section without mentioning any particular provision of this section,
>
> the reference is (in accordance with subsection (1)(b)) to be read as

[137] Pre-2018/19 years are ignored: see 47.27 (s.643A commencement).

[138] See 47.20 (s.643A application conditions).

[139] The omitted words contain the s.643A application conditions: see 47.20 (s.643A application conditions).

> not including amounts treated as income by subsection (1)(b) [non-chargeable s.643A income] except so far as they are treated as income of the settlor of a settlement by subsection (3) or (4).

47.23.1 *No double charge*

Section 643A(5) ITTOIA provides:

> If there is a choice about the individuals in whose case income is to be treated as arising by subsection (1) (before the application of subsections (3) and (4))-
> (a) income is to be treated as arising to such one or more of them as appears to an officer of Revenue and Customs to be just and reasonable, and
> (b) if more than one, in such respective proportions as appears to the officer to be just and reasonable.

The wording is based on ToA double-counting relief.[140]

47.24 s.643A remittance basis

Section 643F ITTOIA applies the remittance basis for:
(1) Close-family beneficiaries taxed under s.643A(1); and
(2) the settlor taxed under the s.643A settlor-attribution rule[141]

Section 643F(1) ITTOIA provides:

> This section applies where-
> (a) in the case of a settlement, income ("the deemed [s.643A] income") is treated by section 643A as arising to an individual for a tax year, and
> (b) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for that year.

Assuming these conditions are satisfied, we read on. Section 643F(2) ITTOIA provides:

> The deemed [s.643A] income is treated as relevant foreign income of the individual.

The significance is that this incorporates the remittance basis.
Section 643F(3) ITTOIA provides:

[140] See 51.9 (Double-counting relief).

[141] See 47.28 (s.643A settlor-attribution rule: Outline).

> In the application of section 832 to the deemed [s.643A] income, subsection (2) of that section has effect with the omission of paragraph (b).

The significance is that (contrary to the usual rule) s.643A income is taxable if it is remitted during the overseas part of a split year.[142] There is no good reason for this, but it is consistent with the s.731 rule.[143]

Section 643F(4) ITTOIA provides:

> For the purposes of Chapter A1 of Part 14 of ITA 2007 (remittance basis) treat
> [a] a benefit, or
> [b] any protected income,[144]
> that relates[145] to any part of the deemed [s.643A] income as deriving from that part of the deemed income.

This wording is drawn from s.735 ITA: for a discussion, see 50.39 (s.731 remittance basis).

47.25 s.643A income matching rule

Section 643F(5) ITTOIA provides:

> In subsection (4) "relates" has the meaning given by section 643G.

So we move on to s.643G(2) ITTOIA. This begins:

> For the purposes of section 643F(4) ...

But s.643G(2) is applied by reference in all circumstances where it is necessary to match (relate) s.643A income and benefits. This is achieved by a clumsy formula, referring to s.643A income which:

[142] See 17.13.1 (Remittance in split year).

[143] See 50.51 (s.731 settlor-attribution remittance-basis).

[144] Section 643F(6) ITTOIA provides: "In this section and section 643G-
"protected income" means the income that forms PFSI in the calculation of the settlement's available protected income in the case of the relevant individual for the year, and
"the relevant individual"-
(a) where the deemed income is treated as income of an individual by section 643A(1)(a) both before and after the application of section 643A(3) and (4) [settlor-attribution], means that individual, and
(b) where the deemed income is treated as income of the settlor by section 643A(3) or (4) [settlor-attribution] after having been treated as income of another individual by section 643A(1), means that other individual."

[145] See 47.25 (s.643A income matching rule).

> would, if section 643G applied also for this purpose, be matched under that section with the benefit

The wording of the s.643A matching rule is based on s.735A ITA, the s.731 matching rule. I abbreviate the discussion here, for a more detailed discussion, see 50.42 (s.731 matching rules).

Section 643G(2) ITTOIA provides:

> For the purposes of section 643F(4)–

Place benefits in date order

> (a) place the benefits identified at Step[146] 1 in the order in which they were received by the individual (starting with the earliest benefit received),

Deductions from benefits

> (b) where a deduction is allowed by any of paragraphs (a), (c) and (d) of Step 3[147] by reference to the whole or part of any of those benefits, reduce the benefit by the amount of the deduction,

Place protected income in order

> (c) place the protected income in the order in which it arose (starting with the earliest income to arise),

Deduction from protected income

> (d) where the whole or part of an item of the protected income is, in respect of benefits provided by the trustees in the year or in any earlier tax year, taken into account in charging income tax under Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) for the year or any earlier tax year, reduce the item by so much of itself as is so taken into account,
>
> (e) where the whole or part of an item of the protected income is, by reference to benefits provided by the trustees to individuals other

[146] Section 643G(1) ITTOIA provides: "In this section - (a) references to a step are to a step under section 643B(1) as it applies in the case of a year and the relevant individual...". See 47.21.3 (Step 1: Identify benefits).
(b) "protected income" and "the relevant individual" have the meaning given by section 643F(6), and
(c) "the settlement" and "the year" mean, respectively, the settlement and tax year mentioned in section 643F.

[147] See 47.21.5 (Step 3: Benefit liable to IT).

than the relevant individual, treated by section 643A or 643J[148] or 643L[149] as income for the year or any earlier tax year, reduce the item by so much of itself as is so treated,

s.643A income in date order

(f) place the income treated by section 643A(1) (before the application of section 643A(3) and (4)) as arising to the relevant individual in respect of the benefits referred to in paragraph (a) in the order in which it is treated as arising (starting with the earliest income treated as having arisen), and

The matching rule

(g) treat the income mentioned in paragraph (f) as related to-
(i) the benefits referred to in paragraph (a), and
(ii) the protected income,
by matching the income mentioned in paragraph (f) with those benefits and the protected income (in the orders mentioned in paragraphs (a), (c) and (f)).

47.25.1 *s.643A/s.731 matching compared*

It may be helpful to set the two rules side by side:

s.643G(2) ITTOIA	**735A(1) ITA**
For the purposes of section 643F(4)—	For the purposes of section 735—
(a) place the benefits identified at Step 1 [of s.643B(1), ie benefits within s.643A] in the order in which they were received by the relevant individual (starting with the earliest benefit received),	(a) place the benefits mentioned in Step 1 [of s.733(1), ie benefits within s.731] in the order in which they were received by the individual (starting with the earliest benefit received),
(b) where a deduction is allowed by any of paragraphs (a), (c) and (d) of Step 3 [of s.643B(1)], by reference to the whole or part of any of those benefits, reduce the benefit by the amount of the deduction,	(b) deduct from those benefits so much of any benefit within section 734(1)(b) as gives rise as mentioned in section 734(1)(d) to chargeable gains or offshore income gains,
(c) place the protected income in the order in which it arose (starting with the	(c) place the income mentioned in Step 3 [of s.733(1)] for the tax years

[148] See 47.34 (s.643A onward-gift donee charge).
[149] See 47.36 (S.643A onward-gift settlor-attribution rule).

earliest income to arise),	mentioned in Step 4 [of s.733(1)] (“the relevant income”) in the order determined under subsection (3),
(d) where the whole or part of an item of the protected income is, in respect of benefits provided by the trustees in the year or in any earlier tax year, taken into account in charging income tax under Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) for the year or any earlier tax year, reduce the item by so much of itself as is so taken into account,	
(e) where the whole or part of an item of the protected income is, by reference to benefits provided by the trustees to individuals other than the relevant individual, treated by section 643A or 643J or 643L as income for the year or any earlier tax year, reduce the item by so much of itself as is so treated,	(d) deduct from that income any income that may not be taken into account because of section 743(1) or (2) (no duplication of charges),
(f) place the income treated by section 643A(1) (before the application of section 643A(3) and (4)) as arising to the relevant individual in respect of the benefits referred to in paragraph (a) in the order in which it is treated as arising (starting with the earliest income treated as having arisen), and	(e) place the income treated under section 732(2) as arising to the individual in respect of the benefits in the order in which it is treated as arising (starting with the earliest income treated as having arisen), and
(g) treat the income mentioned in paragraph (f) as related to— (i) the benefits referred to in paragraph (a), and (ii) the protected income,	(f) treat the income mentioned in paragraph (e) as related to— (i) the benefits, and (ii) the relevant income,
by matching the income mentioned in paragraph (f) with those benefits and the protected income (in the orders mentioned in paragraphs (a), (c) and (f)).	by matching that income with the benefits and the relevant income (in the orders mentioned in paragraphs (a), (c) and (e)).

The matching rules are similar but not identical. For s.643A, protected income is set out in date order, which amounts to matching on a FIFO basis. For s.731, relevant income is set out in the order specified in s.735A(3), which is a modified FIFO basis. It would have been better if the rules had been aligned; but there it is.

Section 643G(3) ITTOIA provides:

> For the purposes of subsection (2)(d), the whole or part of an item of the protected income is to be treated as taken into account in respect of a benefit so far as the item or part-
>
> (a) is matched under section 735A of ITA 2007[150] with notional income with which the benefit is matched under that section, or
>
> (b) would be matched under that section (if it applied also for this purpose) with notional income with which the benefit would be matched under that section (if it applied also for this purpose),
>
> and here "notional income" means income which is treated as arising under section 732 of ITA 2007

47.26 s.643A charge on non-resident?

47.26.1 *Settlor benefits when non-resident*

Suppose:

(1) A benefit is received by non-resident settlor.[151]

(2) The benefit is matched to Protected Income.[152]

Is this chargeable? That would be surprising. It is suggested that the territorial limitation must be applied.[153]

If (contrary to the view taken here) there were a charge on a non-resident, DT relief can apply on the basis that s.643A income falls within the Other Income article.[154]

47.26.2 *Settlor becomes UK resident*

Suppose:

[150] Section 735A is the s.731 matching rule: see 50.42 (s.731 matching rules).

[151] Similar issues might arise where (1) the income is received by non-resident close family, and (2) the settlor is not UK resident.

[152] If the settlor has never been UK resident, there is no Protected Income, and this question does not arise; see 92.13 (Protected s.720 trust income). The situation in which this question arises is if:
(1) The settlor is UK resident for a period of time and Protected Income arises.
(2) The settlor ceases to be UK resident.
(3) The settlor then receives a benefit.

[153] See 16.11 (General territorial principle).

[154] See 50.61.2 (Individual treaty-resident outside UK).

(1) Year 1:
 (a) A benefit is received by non-resident settlor
 (b) There is no Available Protected Income to which the benefit can be matched
(2) Year 2:
 (a) The settlor becomes UK resident
 (b) Available Protected Income arises

Taking s.731(1A) literally, this would appear to be chargeable. The benefit is matched to the Protected Income. But context suggests not.

47.27 s.643A commencement

Para 21 sch 10 FA 2018 provides:

> (1) Subject as follows, the amendments made by paragraphs 3 to 19 have effect for the tax year 2018-19 and subsequent tax years.
> (2) [a] None of the references to an earlier tax year
> [i] in Step 1 of the new section 643B(1) of ITTOIA 2005, or
> [ii] in new section 643C(2) of ITTOIA 2005,
> includes any tax year earlier than the tax year 2018-19
> [b] except that, in the phrase "benefits provided by the trustees in the year or in an earlier tax year" in the definition of "TOAA" in new section 643C(2) of ITTOIA 2005, the reference to an earlier tax year does include tax years earlier than the tax year 2018-19.

The cross references here are:

ITTOIA	**See para**
s.643B(1) Step 1	47.21.3
s.643C(2)	47.22

47.28 s.643A settlor-attribution rule: Outline

Section 643A(2)(3) ITTOIA introduces what I call the **"s.643A settlor-attribution rule"**. This is one of a set of three rules which I call s.731/s.643A/s.87 settlor-attribution rules; see 50.4.11 (Settlor-attribution rules: Introduction).

In outline, this rule applies where:

(1) A close-family beneficiary receives a benefit
(2) The close-family beneficiary is outside the s.643A charge (non-resident or remittance-basis exempt)
(3) The settlor is UK resident (and so potentially chargeable)

The charge is on the lower of the value of the benefit and the amount of protected income.

It will be rare (though not unknown) for the s.643A settlor-attribution rule to apply, as it requires:

(1) Benefit to a close-family beneficiary who is non-resident or a remittance basis taxpayer (and so not directly charged)

(2) A settlor of a protected trust who is UK resident and not remittance basis exempt

A benefit to the settlor is not caught by the s.643A settlor-attribution rule, but it will usually be within s.643A under general principles.[155]

47.29 s.643A attribution conditions

Section 643A(2) ITTOIA provides:

> Subsections (3) and (4) apply if-

A set of 6 conditions then follow, which I call "**s.643A attribution conditions**".

47.29.1 *Cond. (a): s.643A income*

Section 643A(2) ITTOIA provides:

> Subsections (3) and (4) apply if-
> (a) [i] an amount ("the [s.643A] deemed income") is treated by subsection (1),
> [ii] before the application of subsections (3) and (4) [s.643A settlor-attribution rule],
> [iii] as income of an [close-family][156] individual for a tax year

47.29.2 *Cond. (b): not settlor*

Section 643A(2) ITTOIA provides:

> Subsections (3) and (4) apply if...
> (b) the [close-family] individual is not the settlor

47.29.3 *Cond. (c): close-family non-resident/rem. basis user*

Section 643A(2) ITTOIA provides:

[155] See 50.15 (Taxable-transferor defence).

[156] Section 643A(2)(a)[iii] appears to apply to any individual. But the individual must be close-family of the settlor, in order to receive s.643A income; see 47.20 (s.643A application conditions). So I gloss it as "[close-family] individual".

> Subsections (3) and (4) apply if ...
>
> (c) either-
>
> (i) the [close-family] individual is non-UK resident for the year, or
>
> (ii) the [close-family] individual is UK resident for the year and one of sections 809B, 809D and 809E of ITA 2007 (remittance basis) applies to the [close-family] individual for the year

47.29.4 *Cond. (d): Settlor UK resident*

Section 643A(2) ITTOIA provides:

> Subsections (3) and (4) apply if ...
>
> (d) the settlor is UK resident for the year

47.29.5 *Cond. (e)(f): Non-dom Settlor*

Section 643A(2) ITTOIA provides:

> Subsections (3) and (4) apply if ...
>
> (e) there is no time in the year when the settlor is domiciled in the UK, and
>
> (f) there is no time in the year when the settlor is regarded for the purposes of section 809B(1)(b) of ITA 2007 as domiciled in the UK as a result of section 835BA of ITA 2007 having effect because of Condition A in that section being met [formerly domiciled resident[157]].

47.29.6 *Settlor-attribution: Commencement*

Para 21(1) sch 10 FA 2018 provides:

> Subject as follows, the amendments made by paragraphs 3 to 19 have effect for the tax year 2018-19 and subsequent tax years.

47.29.7 *IT attribution rules compared*

643A(1)	**733A(1)**	**s.643A condition**	**s.731 condition**
a	a	s.643A income	s.731 income
	b		match with protected income
b		not settlor	
	c		Non-resident trust
c		Close-family recipient is non-resident/rem. basis user	-

[157] See 5.4.2 (IT/CGT formerly-dom resident rule).

d	d	Settlor UK resident	*same*
e+f	e+f	Settlor domicile	*same*

47.30 s.643A settlor-attribution rule

Assuming the s.643A application conditions are satisfied, we move on to the rule.

Section 643A(3)(4) ITTOIA deal with 2 situations:

(1) The close-family beneficiary may be fully exempt because they are non-resident, or because they are a remittance basis taxpayer and none of the income is remitted.

(2) The close-family beneficiary may be partly exempt because they are a remittance basis taxpayer and only part of the income is remitted.

It is easier to follow if the provisions are read side by side:

Beneficiary wholly exempt	**Beneficiary partly exempt**
(3) If the case is one- (a) where the condition in subsection (2)(c)(i) is met [beneficiary non-resident], or	(4) If the case is one-
(b) where [i] the condition in subsection (2)(c)(ii) is met [beneficiary remittance basis taxpayer] and	(a) [identical]
[ii] none of the deemed [s.643A] income is remitted to the UK in the year,	(b) part only of the deemed [s.643A] income is remitted to the UK in the year,
the deemed income is to be treated for income tax as income of the settlor for the year and, in a case within paragraph (b), not as income of the individual for the year	the remainder of the deemed income is to be treated for income tax purposes not as income of the individual for the year but as income of the settlor for the year.

This is the equivalent of s.733A(3)(4) ITA.[158]

The remittance basis can apply: see 47.24 (s.643A remittance basis).

Statute frequently refers to an amount:

> treated by section 643A(1), before/after the application of section 643A(3) and (4), as income of an individual

[158] See 50.48 (s.731 settlor-attribution rule).

For clarity, I gloss that as [attribution to settlor].

47.31 s.643A onward-gift rule

Section 643I(1)(a) ITTOIA introduces what I call the **“s.643A onward-gift rule”**.

This is one of a set of three rules which I call s.643A/s.731/s.87 onward-gift rules; see 61.30 (Onward-gifts: Introduction).

It is helpful to review some (relatively commonsense) definitions. Three of these are (more or less) the same as the s.87 onward-gift definitions:

	s.643A	**s.87**
Term	**see para**	**see para**
Gift year	47.31.1 (s.643A “gift year)	61.32.3 (“Gift year”)
Matching year	47.31.2 (s.643A “matching year”)	61.32.2 (“Matching year”)
Charging year	47.31.3 (s.643A “charging year”)	-

47.31.1 *s.643A “gift year*”

Section 643I(7) ITTOIA defines gift year:

> In this section (and sections 643J to 643L)—
> “the gift year” means the tax year in which the onward payment is made (but see subsection (4))

47.31.2 *s.643A “matching year*”

Section 643I(1)(a) ITTOIA defines matching year:

> If ... an amount is treated by section 643A(1),
> before the application of section 643A(3) and (4) [settlor-attribution rule], as income of an individual ... for a tax year (“the matching year”),

47.31.3 *s.643A “charging year*”

Section 643I(7) ITTOIA defines charging year:

> In this section (and sections 643J to 643L)—
> “the charging year” means the gift year or, if later, the matching year,

47.32 s.643A onward-gift conditions

Section 643I(1) ITTOIA provides:

> Sections 643J to 643L apply if-

A set of 8 conditions then follow, which I call “**s.643A onward-gift conditions**”.

47.32.1 *Cond. (a): s.643A income*

Section 643I(1) ITTOIA provides condition (a):

> Sections 643J to 643L apply if-
> (a) in the case of a settlement, an amount—
> (i) [a] is treated by section 643A(1)(a)[s.643A charge[159]],
> [b] both before and after the application of section 643A(3) and (4)[160] [settlor-attribution rule],
> [c] as income of an individual ("the original beneficiary") for a tax year ("the matching year"), or
> (ii) [a] having been treated by section 643A(1) [s.643A charge] before the application of section 643A(3) and (4) [settlor-attribution rule] as income of an individual ("the original beneficiary") for a tax year ("the matching year"),
> [b] is treated by section 643A(3) or (4) [settlor-attribution rule] as income of the settlor for the matching year, or
> (iii)[a] is treated by section 643A(1)(b) [non-chargeable s.643A income of non-resident][161], before the application of section 643A(3) and (4) [settlor-attribution rule], as income of an individual ("the original beneficiary") for a tax year ("the matching year")
> [b] but is not treated by section 643A(3), and is not treated by section 643A(4), as income of the settlor for the matching year

This is a model of how to create obscurity by excessive statutory cross referencing. Some readers may use stronger language. It is easier to follow if set out in a table:

Sections 643J to 643L apply if-
(a) in the case of a settlement, an amount—

Para (i)	***Para (ii)***	***Para (iii)***
is treated by section 643A(1)(a)[s.643A charge[162]],	having been treated by section 643A(1) [s.643A charge]	is treated by section 643A(1)(b) [non-chargeable s.643A income of non-resident][163],

[159] See 47.23 (s.643A income charge).
[160] See 47.36 (S.643A onward-gift settlor-attribution rule).
[161] See 47.23 (s.643A income charge).
[162] See 47.23 (s.643A income charge).
[163] See 47.23 (s.643A income charge).

both before and after the application of section 643A(3) and (4)[164] [settlor-attribution rule],	before the application of section 643A(3) and (4) [settlor-attribution rule]	before the application of section 643A(3) and (4) [settlor-attribution rule],
as income of an individual ("the original beneficiary") for a tax year ("the matching year"), or	as income of an individual ("the original beneficiary") for a tax year ("the matching year"),	as income of an individual ("the original beneficiary") for a tax year ("the matching year")
	is treated by section 643A(3) or (4) [settlor-attribution rule] as income of the settlor for the matching year, or	but is not treated by section 643A(3), and is not treated by section 643A(4), as income of the settlor for the matching year

This limits the scope of the s.643A onward-gift rule. There must be a gift from close family to close-family. I wonder if the drafter really intended that.

The s.643A onward-gift rules refer to this section extensively. For clarity, I gloss the cross references thus:

Statutory expression	***Term in this book***
the amount mentioned in subsection (1)(a)	s.643A income
a case within ss.(1)(a)(i)	directly-received s.643A income
a case within ss.(1)(a)(ii)	settlor-attributed s.643A income

47.32.2 *Cond. (b): Match with benefit*

Section 643I(1) ITTOIA provides condition (b):

> Sections 643J to 643L apply if ...
> (b) [i] under section 643G (if it applied also for this purpose)[165]
> [ii] the amount [s.643A income] would be matched with
> [iii] a benefit provided in the matching year, or an earlier tax year, to the original beneficiary [donor]

s.643A onward-gift conditions (a)(b) are the rough equivalent of s.87 onward-gift condition (a)[166] but with the important difference that:

[164] See 47.36 (S.643A onward-gift settlor-attribution rule).

[165] Section 643G is the s.643A income matching rule: see 47.25 (s.643A income matching rule).

[166] See 61.31.1 (Cond. (a): Payment to donor).

(1) CGT condition (a) applies to all payments from non-resident trusts
(2) s.643A condition (a)(b) requires:
    (a) Close-family s.643A income (which requires a benefit to settlor/close-family beneficiary) and
    (b) the close-family s.643A income is matched with a benefit received by the donor

Section 643I(3) ITTOIA provides:

> The amount mentioned in subsection (1)(a) [s.643A income] need not be—
> (a) the whole amount that in the case of the settlement is treated by section 643A(1), before the application of section 643A(3) and (4)[167] [settlor-attribution rule], as income of the original beneficiary [donor] for the matching year;
> (b) the whole amount that would be matched with the benefit mentioned in subsection (1)(b).

47.32.3 *Cond. (c): Intention to give*

Section 643I(1) ITTOIA provides:

> Sections 643J to 643L apply if ...
> (c) at the time the benefit is provided to the original beneficiary [donor]-
> (i) there are arrangements[168], or there is an intention, as regards the (direct or indirect) passing-on of the whole, or part, of the benefit to another person, and
> (ii) it is reasonable to expect that, in the event of the whole or part of the benefit being passed on to another person as envisaged by the arrangements or intention, that other person will be UK resident when they receive at least part of what is passed on to them,

This is effectively identical to s.87 onward-gift condition (c).[169]

47.32.4 *Cond. (d): Gift & time limit*

Section 643I(1) ITTOIA provides:

[167] See 47.30 (s.643A settlor-attribution rule).

[168] Section 643I(7) ITTOIA provides the standard (unnecessary) definition; see App 2.2.3 (Definitions of “arrangement”).

[169] See 50.53.4 (Cond (c): Intention to give).

> Sections 643J to 643L apply if ...
>
> (d) the original beneficiary [donor] makes, directly or indirectly, a gift ("the onward payment") to a person ("the subsequent recipient") [donee]-
>
> (i) [A] at the time the benefit is provided to the original beneficiary [donor],
>
> [B] or at any later time in the 3 years beginning with the day containing the start time, or
>
> (ii) at any time before the benefit is provided to the original beneficiary [donor] and, it is reasonable to assume, in anticipation of the benefit being provided,

Statute frequently refers to an onward payment (gift) "made as mentioned in subsection (1)(d)(ii)". I refer to such a gift as a **"pre-benefit gift"**. This is effectively identical to s.87 onward-gift condition (c).[170]

47.32.5 *Cond. (d): "Start time"*

In outline, there are 3 possible start times:

Para	***Circumstances***	***Start time***
(5)(a)(i)	Normal	When benefit provided to donor
(5)(a)(ii)	Indirect gift to settlor/close family	When original benefit provided
(5)(b)	s.643A onward-gift rule	First occasion

The start times are best read side by side; s.643I(5) ITTOIA provides:

> For the purposes of subsection (1)(d)(i)—

(a) if the amount mentioned in subsection (1)(a) [s.643A income] is not one that is treated as arising by section 643K, [For s.643K, see 47.34 (s.643A onward-gift donee charge).	(b) if the amount mentioned in subsection (1)(a) [s.643A income] is one that is treated as arising by section 643K in connection with the operation of this section and section 643K on a previous occasion,
"the start time"— (i) is the time the benefit mentioned in subsection (1)(b) is provided to the original beneficiary [donor], or	"the start time" is the time given by this subsection as the start time on that occasion.

[170] 61.31.3 (Condition (c): Gift & time limit). Section 733B(13) provides the standard wide definition of making a gift, the same as s.87G(15) TCGA.

(ii) where that benefit is one that section 643M(3) treats as provided, is the time the original benefit in that case (see section 643M(1)(a)) is provided
[For s.643M, see 47.37 (Indirect gift to settlor/close family).

47.32.6 *Cond. (e): Gift from benefit*

Section 643I(1) ITTOIA provides:

> Sections 643J to 643L apply if ...
> (e) the gift is of or includes-
> (i) the whole or part of the benefit,
> (ii) anything that (wholly or in part, and directly or indirectly) derives from, or represents, the whole or part of the benefit, or
> (iii) any other property, but only if the benefit is provided with a view to enabling or facilitating, or otherwise in connection with, the making of the gift of the property to the subsequent recipient [donee],

This is effectively identical to s.87 onward-gift condition (d).[171]

The s.643A onward-gift rules frequently refer to this provision with the formula:

> so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 643I(1)(e)

For clarity, I gloss that as [gifted benefit].

47.32.7 *"Relevantly remitted"*

Conditions (f)(g) use the term "relevantly remitted". Section 643I(7) ITTOIA provides:

> In this section (and sections 643J to 643L)—
> [a] "relevantly remitted" means remitted to the UK in a tax year for which the original beneficiary [donor] is UK resident
> [b] but, in a case within subsection (1)(a)(ii) [settlor-attributed s.643A income], means remitted to the UK in a tax year for

[171] See 47.32.6 (Cond. (e): Gift from benefit).

> which the settlor is UK resident.

The point is that income which is relevantly remitted is taxable on the remittance. (A remittance by a non-resident is not taxable.[172]) "Taxably remitted" would be a more transparent term. I refer to it as **"relevantly/taxably remitted"**.

47.32.8 *Cond. (f)/(g): Non-chargeable s.643A income*

Section 643I(1) ITTOIA provides:

> Sections 643J to 643L apply if ...

It is easier to follow if conditions (f) and (g) are read side by side:

(f): Directly received s.643A income	**(g) Settlor-attributed s.643A income**
in a case within paragraph (a)(i) [directly-received s.643A income], either—	in a case within paragraph (a)(ii) [settlor-attributed s.643A income],
(i) the original beneficiary [donor] is non-UK resident for the matching year, or	
(ii)[A] section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the original beneficiary [donor] for the matching year and	[A] section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the settlor for the matching year and
[B] none of the amount [s.643A income] is relevantly [taxably] remitted in the matching year or in any tax year later than the matching year but not later than the tax year in which the onward payment [gift] is made	[B] [identical]

47.32.9 *(h): Donee settlor/close family*

Section 643I(1) ITTOIA provides:

> Sections 643J to 643L apply if ...
> (h) the subsequent recipient [donee]-

[172] See 17.18 (Remittance when non-resident).

(i) is the settlor, or
(ii) is a close member of the settlor's family (see section 643H)
[A] at the time the onward payment [gift] is made or,
[B] where that time is given by subsection (4),[173] at either or both of the time so given and the actual time the onward payment [gift] is made.

There is no CGT equivalent.

47.32.10 *Onward gifts commencement*

Para 21(3) sch 10 FA 2018 provides:

> New sections 643I to 643L and 643N of ITTOIA 2005 have effect only in relation to onward payments [gifts] made on or after 6 April 2018.

47.33 s.643A misc rules

47.33.1 *Relief for donor/settlor*

Section 643I(2) ITTOIA provides:

> [a] Where, in a case within subsection (1)(a)(i) [directly-received s.643A income] and by reference to the amount mentioned in subsection (1)(a), income is treated by section 643J or 643L as arising to a person for a tax year, the original beneficiary is not liable to tax for any later tax year on so much of the amount mentioned in subsection (1)(a) as is equal to that income;
> [b] and where, in a case within subsection (1)(a)(ii) [settlor-attributed s.643A income] and by reference to the amount mentioned in subsection (1)(a), income is treated by section 643J as arising to a person for a tax year, the settlor is not liable to tax for any later tax year on so much of the amount mentioned in subsection (1)(a) as is equal to that income.

47.33.2 *Pre-benefit gift: date of onward payment*

Section 643I(4) ITTOIA provides:

> Where the onward payment is made as mentioned in subsection (1)(d)(ii), [pre-benefit gift] the onward payment is to be treated—
> (a) for the purposes of the provisions of this section following subsection (1)(d), and
> (b) for the purposes of sections 643J to 643L,

[173] See 47.33.2 (Pre-benefit gift: date of onward payment).

> as made immediately after, and in the tax year in which, the benefit is provided to the original beneficiary [donor].

47.33.3 *Valuation of benefits*

Section 643I(8) ITTOIA provides:

> Sections 742C to 742E of ITA 2007 (value of certain benefits)—
> (a) apply for the purpose of calculating the value of the onward payment for the purposes of sections 643J to 643L as they apply for the purpose of calculating an income tax charge under Chapter 2 of Part 13 of ITA 2007, and
> (b) apply for that purpose as if their references to a benefit provided were references to a gift made.

47.33.4 *Meaning of remittance*

Section 643I(9) ITTOIA provides:

> Sections 809L to 809Z6 of ITA 2007 (remittance basis: rules about when income is remitted)—
> (a) apply for the purposes of this section and sections 643J to 643L, and
> (b) apply for those purposes in relation to references to remittance of the onward payment as if the onward payment were relevant foreign income of the subsequent recipient.

47.34 s.643A onward-gift donee charge

Assuming the s.643A onward-gift conditions are satisfied, we move on to the onward-gift rule in s.643J.

The layout is: s.643J (1)(2) set out application conditions; s.643J(3) sets out the rule where those conditions are satisfied. It is easier to follow if the 643J application conditions are read side by side:

Donee arising basis taxpayer	**Donee remittance basis taxpayer and benefit remitted**
(1) Subsection (3) applies if—	(2) Subsection (3) also applies if—
(a) this section applies [s.643A onward-gift conditions are met] (see section 643I(1)), and	(a) [identical] and
(b) the subsequent recipient [donee] is UK resident for the gift year, and	(b) [identical] and

(c) the subsequent recipient [donee] is UK resident for the matching year if that is later than the gift year, and	(c) [identical] and
(d) none of sections 809B, 809D and 809E of ITA 2007 (remittance basis) applies to the subsequent recipient [donee] for the charging year.	(d) section 809B, 809D or 809E of ITA 2007 [remittance basis] applies to the subsequent recipient [donee] for the charging year, and
	(e) the whole, or part only, of the onward payment [gift] is remitted to the UK in the charging year.

Assuming the 643J application conditions are satisfied, we move on to the rule. Section 643J(3) ITTOIA provides the s.643A onward-gift charge:

> For income tax purposes, an amount of income—
> (a) equal to the amount or value of so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 643I(1)(e) [gifted benefit], or
> (b) where
> [i] this subsection applies because of subsection (2) [donee remittance basis user] and
> [ii] part only of that much of the onward payment [gift] is remitted to the UK in the charging year,
> equal to the amount or value of that part,
> is treated as income of the subsequent recipient [donee] for the charging year, subject to subsection (4).

47.34.1 *Donee otherwise taxable*

Section 643J(4) ITA provides:

> The amount given by subsection (3) (before adjustment under this subsection) is to be adjusted as follows—
> (a) deduct any part of the amount on which the subsequent recipient [donee] is liable to income tax otherwise than under this section

47.34.2 *Gift exceeds donor's benefit*

Section 643J(4) ITA provides:

> The amount given by subsection (3) (before adjustment under this subsection) is to be adjusted as follows ...
>
> (b) if following any adjustment under paragraph (a) the amount exceeds the amount mentioned in section 643I(1)(a) [s.643A close-family income], deduct the excess.

47.35 Donee not taxable: s.643A onward-giftable amount

The layout is: s.643K(1)(2) ITTOIA set out application conditions; s.643K(3) sets out the rules where one of those conditions is satisfied. It is easier to follow if the 643K application conditions are read side by side:

Donee non-resident	**Donee on remittance basis, gift remitted**
(1) Subsection (3) applies if	(2) Subsection (3) also applies if—
[x] this section applies (see section 643I(1)) [s.643A onward-gift conditions are met] and—	(a) [identical to [x] opposite]
(a) the subsequent recipient [donee] is non-UK resident for the gift year, or	(b) the subsequent recipient [donee] is UK resident for the gift year, and
(b) the matching year is later than the gift year and the subsequent recipient [donee] is UK resident for the gift year but non-UK resident for the matching year.	
	(c) the subsequent recipient [donee] is UK resident for the matching year if that is later than the gift year, and
	(d) section 809B, 809D or 809E of ITA 2007 [remittance basis] applies to the subsequent recipient [donee] for the charging year, and
	(e) none, or part only, of the onward payment [gift] is remitted to the UK in the charging year.

Assuming the 643K application conditions are satisfied, we move on to the rule. Section 643K(3) ITTOIA provides:

Section 643I(1)(a) has effect—

(a) as if the subsequent recipient [donee] were an individual to whom, in the case of the settlement, income is treated by section 643A(1)(a), both before and after the application of section 643A(3) and (4) [settlor-attribution rule[174]], as arising for the charging year, and

(b) as if, subject to subsection (4), the amount of that income—

(i) [A] were equal to the amount or value of so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 643I(1)(e) [gifted benefit] and

[B] is not treated as arising to the settlor as a result of the operation of section 643L,[175] or

(ii) were, where

[A] this subsection applies because of subsection (2) [donee remittance basis user] and

[B] part only of that much of the onward payment [gift] is remitted to the UK in the charging year,

equal to the amount or value of the remainder of that much of the onward payment [gift].

The difference between 643J and 643K is:

643J: chargeable s.643A income arises to donee/settlor

643K: non-chargeable s.643A income arises to donee/settlor which is taken into account for a future onward-gift charge.

It may be helpful to look at the s.643J/K rules side by side, with the key differences underlined:

Section 643J(3)	**Section 643K(3)**
For income tax purposes, an amount of income—	Section 643I(1)(a) has effect— (a) as if the subsequent recipient [donee] were an individual to whom, in the case of the settlement, income is treated by section 643A(1) as arising for the charging year, and
	(b) as if, subject to subsection (4), the amount of that income—

[174] See 47.30 (s.643A settlor-attribution rule).

[175] See 47.36 (S.643A onward-gift settlor-attribution rule).

(a) equal to the amount or value of	(i) were equal to the amount or value of
so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 643I(1)(e) [gifted benefit], or	[A] so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 643I(1)(e) [gifted benefit] and [B] is not treated as arising to the settlor as a result of the operation of section 643L, or
(b) where [i] this subsection applies because of subsection (2) [donee remittance basis user] and	(ii) were, where [A] [identical to [i] opposite] and
[ii] part only of that much of the onward payment [gift] is remitted to the UK in the charging year,	[B] [identical to [ii] opposite]
equal to the amount or value of that part,	equal to the amount or value of the remainder of that much of the onward payment [gift].
is treated as income of the subsequent recipient [donee] for the charging year, subject to subsection (4).	

47.35.1 *Gift exceeds s.643A income*

Section 643K(4) ITTOIA provides:

> The amount given by subsection (3) (before adjustment under this subsection) is to be adjusted as follows: if that amount exceeds the amount mentioned in section 643I(1)(a) [s.643A income] in the case of the original beneficiary [donor], deduct the excess.

47.35.2 *Prior year s.643A charge*

Section 643K(5) ITTOIA provides:

> Where the amount mentioned in section 643I(1)(a) is treated as arising

by this section in connection with the operation of section 643I and this section on a previous occasion, section 643I(1) has effect—

(a) with the omission of its paragraphs (b) and (c),

(b) as if the references in its paragraph (d) to the benefit mentioned in its paragraph (b) were, instead, to what was the onward payment [gift] on that previous occasion,

(c) as if the references in its paragraph (d) to when that benefit is provided were, instead, to when that onward payment [gift] was made, and

(d) as if the references in its paragraph (e) to that benefit were, instead, to so much of that onward payment [gift] as was on that previous occasion within any of sub-paragraphs (i) to (iii) of that paragraph [gifted benefit].

47.36 s.643A Onward-gift settlor-attribution rule

For a general introduction to onward-gift settlor-attribution rules, see 61.26 (Settlor-attribution: Introduction).

Suppose an onward gift is made to a donee (not close-family). A direct benefit to close-family may be treated as made to the settlor, under the s.643A settlor-attribution rule.[176] Section 643L ITTOIA ensures that the same applies in the case of an onward gift to close-family. I refer to this as the **"s.643A OG settlor-attribution rule"**.

The layout is: s.643L(1)(2) set out application conditions; s.643L(3) sets out the rules where one of those conditions is satisfied. It is easier to follow if the 643L application conditions are read side by side:

Donee remittance basis user: s.643L(1)	**Donee non-resident: s.643L(2)**
(1) Subsection (3) applies if—	(2) Subsection (3) also applies if—
(a) this section applies (see section 643I(1)) [s.643A onward-gift conditions are met],	(a)[identical]
(b) the subsequent recipient [donee] is a close member of the settlor's family (see section 643H) when the onward payment [gift] is made,	(b) [identical]
(c) the subsequent recipient [donee] is UK resident for the charging year,	(c) the subsequent recipient [donee] is non-UK resident for

[176] See 61.26 (Settlor-attribution: Introduction).

	the charging year,
(d) section 809B, 809D or 809E of ITA 2007 [remittance basis] applies to the subsequent recipient [donee] for the charging year,	
(e) none, or part only, of the onward payment [gift] is remitted to the UK in the charging year,	
(f) there is a time in the charging year when the settlor is UK resident,	(d) [identical to (f)]
(g) there is no time in the charging year when the settlor is domiciled in the UK, and	(e) [identical to (g)]
(h) there is no time in the charging year when the settlor is regarded for the purposes of section 809B(1)(b) of ITA 2007 as domiciled in the UK as a result of section 835BA of ITA 2007 having effect because of Condition A in that section being met [formerly domiciled resident].	(f) [identical to (h)]

Assuming the 643L application conditions are satisfied, we move on to the rule. Section 643L(3) ITTOIA provides:

> For income tax purposes, an amount of income—
>
> (a) equal to the amount or value of so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 643I(1)(e) [gifted benefit], or
>
> (b) where this subsection applies because of subsection (1) in a case where part only of that much of the onward payment [gift] is remitted to the UK in the charging year, equal to the amount or value of the remainder of that much of the onward payment [gift],
>
> is treated as arising to the settlor for the charging year, subject to subsection (4).

Section 643L(5)(6) ITTOIA provides the settlor with the standard settlor-attribution indemnity.[177]

47.36.1 *Settlor otherwise taxable/gift exceeds benefit*

Section 643L(4) ITTOIA provides:

> The amount given by subsection (3) (before adjustment under this subsection) is to be adjusted as follows—
> (a) deduct any part of the amount on which the settlor is liable to income tax otherwise than under this section, and
> (b) if following any adjustment under paragraph (a) the amount exceeds the amount mentioned in section 643I(1)(a), deduct the excess.

47.37 Indirect gift to settlor/close family

47.37.1 *Trust to A to settlor/close-family*

Section 643M(1) ITTOIA provides:

> Subsection (3) applies if—

A set of 8 conditions then follow which I call **"indirect-gift conditions"**

47.37.2 *Benefit to non settlor/close family*

Section 643M(1) ITTOIA provides:

> Subsection (3) applies if—
> (a) the trustees of a settlement provide a benefit ("the original benefit") to an individual ("the original recipient"),
> (b) the original recipient is not the settlor,
> (c) at the time the original benefit is provided, the original recipient is not a close member of the settlor's family (see section 643H),

47.37.3 *Beneficiary not taxable*

Section 643M(1) ITTOIA provides:

> Subsection (3) applies if ...
> (d) the original recipient is not taxed on the original benefit (see subsection (7))

[177] Section 643L(5) ITA provides: "Where any tax for which the settlor is liable as a result of subsections (3) and (4) is paid, the settlor is entitled to recover the amount of the tax from the subsequent recipient [donee]." See 61.28 (Settlor-attribution indemnity).

That takes us to s.643M(7) ITTOIA which provides:

> [a] For the purposes of subsection (1)(d), the original recipient is taxed on the original benefit if the original recipient is liable to income tax, or capital gains tax, by reference to the amount or value of the original benefit;
> [b] and where the original recipient is so liable by reference to the amount or value of part only of the original benefit, this section applies as if the two parts of the original benefit were separate benefits.

47.37.4 *Onward-gift conditions satisfied*

Section 643M(1) ITTOIA provides:

> Subsection (3) applies if ...
> (e) at the time the original benefit is provided—
> (i) there are arrangements, or there is an intention, as regards the (direct or indirect) passing-on of the whole, or part, of the original benefit to another person, and
> (ii) it is reasonable to expect that, in the event of the whole or part of the original benefit being passed on to another person as envisaged by the arrangements or intention, that other person will be UK resident when they receive at least part of what is passed on to them,
> (f) the original recipient makes, directly or indirectly, a gift ("the onward payment") to a person ("the subsequent recipient")—
> (i) [A] at the time the original benefit is provided to the original recipient,
> [B] or at any later time in the 3 years beginning with the day containing that time, or
> (ii) at any time before the original benefit is provided to the original recipient and, it is reasonable to assume, in anticipation of the original benefit being provided,
> (g) the gift is of or includes—
> (i) the whole or part of the original benefit,
> (ii) anything that (wholly or in part, and directly or indirectly) derives from, or represents, the whole or part of the original benefit, or
> (iii) any other property, but only if the original benefit is provided with a view to enabling or facilitating, or otherwise in connection with, the making of the gift of the property to the subsequent recipient [donee], and

This repeats s.643A onward-gift conditions (c), (d), (e).[178]

47.37.5 *Subsequent recipient is settlor/close family*

Section 643M(1) ITTOIA provides:

> Subsection (3) applies if ...
> (h) the subsequent recipient [donee]—
> (i) is the settlor, or
> (ii) is a close member of the settlor's family
> [A] at the time the onward payment [gift] is made or,
> [B] where that time is given by subsection (4), at either or both of the time so given and the actual time the onward payment [gift] is made.

47.37.6 *Indirect-gift rule*

Assuming the indirect-gift conditions are satisfied, we move on to the rule. Section 643M(3) ITTOIA provides:

> So much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of subsection (1)(g) [gifted benefit] is treated for the purposes of Step 1 in section 643B(1) as a benefit provided by the trustees to the subsequent recipient [donee] at the time the onward payment [gift] is made.

This brings s.643A into play and imposes s.643A income on the donee.

47.37.7 *Series of gifts ending with settlor/close-family*

Section 643M(2) ITTOIA provides:

> Where—
> (a) there is a series of two or more gifts,
> (b) the first gift in the series is made, directly or indirectly, by the original recipient—
> (i) [A] at the time the original benefit is provided,
> [B] or at any later time in the 3 years beginning with the day containing that time, or
> (ii) at any time before the original benefit is provided and, it is reasonable to assume, in anticipation of the original benefit being provided,

[178] See 47.32.3 (Cond. (b): Match with benefit); 47.32.4 (Cond. (d): Gift & time limit); 47.32.6 (Cond. (e): Gift from benefit).

> (c) the recipient of a gift in the series is the person who makes, directly or indirectly, the next gift in the series,
>
> (d) the recipient of the last gift in the series is the settlor or, at the time that last gift is made, is a close member of the settlor's family,
>
> (e) as regards any earlier gift in the series, its recipient—
>
> (i) is not the settlor, and
>
> (ii) is not, at the time that earlier gift is made, a close member of the settlor's family, and
>
> (f) the condition in subsection (1)(g) is met in relation to each gift in the series,
>
> the last gift in the series is to be treated for the purposes of subsection (1)(f) as if its maker were the original recipient (and not its actual maker).

47.37.8 *Misc*

Section 643M ITTOIA provides:

> (4) Where the onward payment [gift] is made as mentioned in subsection (1)(f)(ii) [pre-benefit gift], the onward payment [gift] is to be treated, for the purposes of subsections (1)(h) and (3), as made immediately after, and in the tax year in which, the original benefit is provided to the original recipient.
>
> (5) Where subsection (1)(f) to (h) are met in any case, it is to be presumed (unless the contrary is shown) that subsection (1)(e) is also met in that case.[179]
>
> (6) Where the benefit mentioned in section 643I(1)(b) is one that subsection (3) of this section treats as provided, section 643I(1) has effect with the omission of its paragraph (c).

47.38 s.643A onward-gift remit. basis

Section 643N ITTOIA provides:

> (1) This section applies in relation to income if—
>
> (a) the income is treated as arising to an individual for a tax year—
>
> (i) by section 643J(3) and (4) where section 643J(3) applies because of section 643J(2), or
>
> (ii) by section 643L,[180] and
>
> (b) section 809B, 809D or 809E of ITA 2007 (remittance basis)

[179] For this presumption, see 61.31.2 (Cond. (b): Intention to give).

[180] See 47.36 (S.643A onward-gift settlor-attribution rule).

> applies to the individual for that year.
>
> (2) The income is treated as relevant foreign income of the individual.
>
> (3) For the purposes of Chapter A1 of Part 14 of ITA 2007 (remittance basis) treat the onward payment [gift], or (as the case may be) the part of it whose amount or value is equal to the amount of the income, as deriving from the income.
>
> (4) In the application of section 832 in relation to the income, subsection (2) of that section has effect with the omission of its paragraph (b).

This follows the drafting of the s.643A remittance basis, in s.643F.[181] It should not have been necessary to set out the s.643A remittance basis twice over; but there it is.

[181] See 47.24 (s.643A remittance basis). This in turn follows the drafting of the s.731 remittance basis: see 50.39 (s.731 remittance basis).

CHAPTER FORTY EIGHT

TRANSFER OF ASSETS ABROAD: INTRODUCTION

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48.1 ToA: Introduction

Non-resident trusts and companies pay no UK tax on foreign income. A non-resident company may pay less tax on UK income. These rules present an obvious means of income tax avoidance. HMRC's first answer to this is Chapter 2 Part 13 ITA, entitled "Transfer of assets abroad" (the **"ToA provisions"**).

There are two main[1] charging provisions:

(1) The **"s.720 charge"** on the transferor; the INT Manual calls this "the income charge".

(2) The **"s.731 charge"** on individuals who receive benefits; the INT Manual calls this "the benefits charge".

This chapter considers requirements these charges have in common. The next two chapters consider them individually.

The provisions are "highly complex".[2] In 1955, the Royal Commission picked out ToA as an example of anti-avoidance legislation obscurely worded and more widely drawn than its purpose requires.[3] But no-one took any notice of that.

In *Fisher v HMRC,* CA held the ToA rules were EU-law compliant.[4] SC did not discuss the issue as it decided the case on other grounds. But post-Brexit, the issue should not arise.

48.1.1 *ToA guidance*

Earlier editions of this work grumbled about a dearth of HMRC guidance.[5] Be careful what to wish for! In 2009 HMRC published guidance on the ToA remittance basis. This is headed TAH, presumably for **T**ransfer of **A**ssets **H**andbook, which appeared to have been a project never completed. In 2013 HMRC published 150 pages of draft guidance[6] and,

[1] There is a third charging provision in s.727 ITA but that is is only a minor supplement to s.720. Some commentators regard the charge under enjoyment condition C as a separate charge, in which case there are said to be four charging provisions; but I would classify that as a sub-rule of the s.720 charge.

[2] *Hoey v HMRC* [2022] EWCA Civ 656 at [201].

[3] See 2.7 (Avoidance legislation 1955 critique).

[4] [2021] EWCA Civ 1438, reversing the UT on this point.

[5] Kessler, *Taxation of Non-Residents and Foreign Domiciliaries* (2013/14 edition), para 28.1.

[6] *https://www.gov.uk/government/consultations/reform-of-an-anti-avoidance-provision-transfer-of-assets-abroad*

a decade later, a lightly revised version of this guidance was published in the INTM. But the most difficult issues are hardly addressed and almost every important statement is qualified by words such as *normally, generally, likely, usually, broadly, depending on,* etc. Overall, I do not think public knowledge of the provisions is much improved. Perhaps it was naive to expect otherwise.

48.2 Construction of ToA provisions

48.2.1 *ToA code: Broad*

The provisions are broad and the courts construe them broadly. In *IRC v Brackett*:[7]

> [What is now Chapter 2 Part 13 ITA] is a broad spectrum anti-avoidance provision which should not be narrowly or technically construed.

That is self-evident; no-one would argue otherwise.

48.2.2 *ToA code: Penal*

In *Howard de Walden v IRC* (1941) the CoA went further:[8]

> The Section is a penal one and its consequences whatever they may be, are intended to be an effective deterrent which will put a stop to practices which the Legislature considers to be against the public interest. For years a battle of manoeuvre has been waged between the Legislature and those who are minded to throw the burden of taxation off their own shoulders on to those of their fellow subjects.[9] In that battle the Legislature has often been worsted by the skill, determination and resourcefulness of its opponents, of whom the present Appellant has not been the least successful.[10] It would not shock us in the least to find that the Legislature has determined to put an end to the struggle by imposing the severest of penalties. It scarcely lies in the mouth of the taxpayer who plays with fire to complain of burnt fingers.

[7] 60 TC 134 at p.136.

[8] 25 TC 121 at p.134.

[9] As this sentence illustrates, the fundamental issue of attitudes to avoidance lies behind the construction of the ToA provisions; as to which, see 2.5.2 (Judicial view in the past).

[10] The reader may wonder what this success was. The Court wisely did not explain. The point may be that the transfer of assets abroad was made in 1923, so the income of the person abroad remained untaxed until the enactment of the ToA code in 1936.

Broad is one thing and penal is another. In peacetime, *Vestey v IRC* stepped back from the unfairness. In the High Court:[11]

> I conceive it to be in the national interest, in the interest not only of all individual taxpayers - which includes most of the nation - but also in the interests of the Revenue authorities themselves, that the tax system should be fair. Absolute equity is, of course, impossible to achieve, and nobody would cry for the moon. But rank, blatant injustice, of the kind and on the scale exemplified in
> [1] s 408 ITA 1952
> [2] s 412(1) ITA 1952 in some circumstances, and
> [3] s 412(2) on the Crown's construction of it,[12]
> is another matter.
> Like Lord Upjohn in *IRC v Bates,*[13] I am quite unable to understand upon what principle of the law the Crown, as he said, "realising the monstrous result of giving effect to the true construction", or what it assumes to be the true construction, of these sections, feels itself entitled to mitigate their monstrosity by such concessions as it chooses to make. One should be taxed by law, and not be untaxed by concession. ...
> I am afraid they must have failed to realise the deep, brooding resentment felt by every taxpayer who is not charged simply upon his own income (including, of course, what he himself could have had by way of his own income had he so chosen). A tax system which enshrines obvious injustices is brought into disrepute with all taxpayers accordingly, whereas one in which injustices, when discovered, are put right (and with retrospective effect when necessary) will command respect and support.

And in HL:[14]

> One [argument] much used by the Revenue is that the section is a penal section. But this cuts both ways. In a case such as *Howard de Walden v IRC* this argument has much force. The transferor in that case, who derived a comparatively small benefit from the transferred assets, was taxed in respect of the whole income. It was an entirely valid argument ... in support of so severe a liability, to say that the section was penal and

[11] 54 TC 503 at p.544.

[12] The references are now s.633 ITTOIA, s.720 and 727 ITA; but the unfairness relating to the ToA provisions was removed by the HL decision on appeal.

[13] 44 TC 225, at p.268.

[14] 54 TC 503 at p.583-584.

> meant to deter transfers abroad. In such a context his metaphor of burnt fingers is completely apposite.
> But the argument turns the other way when so draconian a tax ("astonishingly severe" were [Counsel for the Crown's] words) is sought to be imposed upon persons who had no hand in the transfer, who may never benefit from it, who cannot escape from it, who remain under liability so long as they live or the settlement lasts. In relation to such persons equity and principle suggests that Parliament intended no such thing - or at least cannot be assumed from the veiled language used to have intended any such thing. To penalise is one thing, to visit the sins of the transferor on future generations is quite another. Given the choice between a fair and an unfair outcome, the correct construction is to prefer the former where possible.

The provisions are only penal in certain contexts or in certain ways.

It also depends on what one means by "penal". The outcome in *Howard de Waldon* is in line with other anti-avoidance provisions. A settlor who retains a small benefit under a trust is taxed on the whole of the trust income and gains. That is not normally described as penal. It might be that we are inured to unfairness by familiarity. But one might say that the policy of requiring complete exclusion is rigorous but not, in fact, unfair.

The pendulum swung back, or appeared to, in *Hoey v HMRC*:[15]

> Lord Wilberforce, delivering the leading speech [in *Vestey*], explicitly upheld the approach adopted by Lord Greene MR in *Lord Howard de Walden* ...

Not at all: Lord Wilberforce was much more nuanced. But having paid verbal tribute to Lord Greene in *Howard de Waldon*, the CoA in *Hoey* was, the reader may think, inconsistently, concerned to avoid unfairness in the form of double taxation; and it ultimately held that the ToA provisions did not apply.[16]

What is "penal" is a matter of degree, and it would help clarity of analysis to avoid the word, and to focus on the issue in point. While the provisions are broad, it continues to be the case that "given the choice between a fair and an unfair outcome, the correct construction is to prefer the former where possible." But who can resist the rhetoric and metaphor

[15] [2022] EWCA Civ 656 at [145], citing another sentence of Lord Wilberforce out of context.

[16] See 51.9 (Double-counting relief)..

of "burnt fingers"?

This discussion of principles of interpretation operates at a high level of generality. Would the more refined analysis proposed here affect outcomes? Probably not. But it is good to know what we are talking about.

48.2.3 *Priority and discretionary application*

The ToA provisions are expressed in mandatory terms, and do not only apply at the option of HMRC. This view was rightly accepted by HMRC (despite the irritation of the judge) in *Anson v HMRC*.[17] What is sauce for the goose is sauce for the gander.

48.2.4 *Target: Pre-1936 schemes*

It is relevant to note the pre-1936 schemes against which the ToA provisions were originally targeted:

> The device at which [s.18 FA 1936, now s.720] is aimed ... In its simplest form it consists of a transfer of assets, for a consideration payable in debentures, to a foreign company in which all but a nominal proportion of the share capital is held by the transferor. ... the company is controlled abroad ... so as to be for tax purposes not resident in the UK.[18] The assets transferred either are, or are exchanged into, investments of which the income is not liable to British tax in the hands of a non-resident.
>
> The income of the investments provides cash from which debentures can from time to time be redeemed to the extent required to satisfy the transferor's current requirements. The sums so received by the transferor do not attract tax in his hands, since they are of the nature of a capital repayment.
>
> The company declares no dividends... Surplus income is accumulated by the company and is available for distribution as capital whenever the time may be thought opportune for a winding up.
>
> So long as the company is kept in being the transferor, as debenture holder, is merely getting back his capital, but tax-free income is, in effect, being accumulated for his benefit as shareholder whenever he chooses to appropriate it by means of a winding up...

[17] [2012] UKUT 59 (TCC) at [18]. For the difficulties which would arise on any other view, see 52.36 (Motive/EU defence: Disclaimer).

[18] Author's footnote: Canada was the usual jurisdiction of choice.

There are many possible variations of such schemes.[19]

48.3 "Relevant transfer"

The key concept is "relevant transfer". The ToA charges only apply if a relevant transfer occurs.

Section 716(1) ITA provides:

> A transfer is a relevant transfer for the purposes of this Chapter if—
> (a) it is a transfer of assets, and
> (b) as a result of—
> (i) the transfer,
> (ii) one or more associated operations, or
> (iii) the transfer and one or more associated operations,
> income becomes payable to a person abroad.

This sets out the following basic conditions:

(1) *A transfer of assets*

(2) *Income becomes payable to person abroad*

(3) *Causation*: Condition (2) is caused by (i) the transfer, or (ii) associated operations, or (iii) both. I refer to this as "**relevant transfer causation conditions (i), (ii) or (iii)**", or together, the "**relevant transfer causation conditions**".

These conditions are the subject of this chapter. However the fact that there is a relevant transfer is not sufficient in itself to cause a tax charge. The further conditions in one of the charging sections must be satisfied. These are considered in the next two chapters.

48.4 "Transfer" of "assets"

48.4.1 *Assets*

Section 717(a) ITA provides a commonsense definition of "assets":

> In this Chapter [Chapter 2 Part 13 ITA] —
> (a) "assets" includes property or rights of any kind

48.4.2 *Transfer*

Section 716(2) ITA provides an extended definition of "transfer":

[19] Stein & Marks, *Tax avoidance: An interpretation of the provisions of the Finance Act, 1936, relating to transfers of assets, companies' sur-tax, children's settlements* (1936) p.2.

> In this Chapter "transfer", in relation to rights, includes the creation of the rights.

Where the word is used in this sense, it may be appropriate to use scare quotation marks. Thus:

- The issue of shares is a "transfer" of assets.[20]
- If two parties enter into a contract there are *two* "transfers" of assets, as both parties acquire rights.

Note that there may be a "transfer of assets" in circumstances where there is no individual who is the "transferor".

48.4.3 *Contract of employment*

In *Brackett v Chater*[21] T entered into a contract of employment with an offshore company. This was held to be a transfer of assets:

> The Revenue submit that by entering into the contract of employment the taxpayer created rights vested in Drishane which were valuable and capable of being turned to account, and that by virtue of those rights, together with the associated operation of carrying on a trade as business consultant, income became payable to Drishane.
> The Special Commissioners ... said that the taxpayer's earning capacity was not an asset in respect of which rights could be transferred to or created in favour of Drishane.

This is a non-sequitur, because although the earning capacity is not an asset, it does not follow that the contract of employment is not an asset. Or as the Judge put it:

> This suggests that the "rights of any kind" which can constitute assets under [what is now s.717(a) ITA] must be rights in rem subsisting over some other assets. I can see no basis for this restrictive interpretation.
>
> Second, the Special Commissioners said that the rights acquired by Drishane were not created by the taxpayer because they came into existence under a contract to which he was only one party.

This was at least a tenable argument. But it did not succeed:

> This, too, is in my view an unduly restrictive construction. The contract

[20] This is self-evident, but if authority is needed, see *Dunsby v HMRC* [2020] UKFTT 271 (TC) at [159].

[21] 60 TC 134 at 147.

> of employment is no doubt a bilateral transaction by which each party undertakes obligations and thereby confers rights on the other. In the context of [the ToA code], and in particular the extended meaning of "assets" contained in [s.717(a) ITA], it seems to me appropriate to describe the rights of one party under the contract as having been created by the other.

Hoey v HMRC wrongly doubted this:[22]

> ... we have some misgivings about treating the entry into a contract of employment as involving the creation by the employee of rights vested in the employer ... However, we will not pursue these doubts any further, because there is no issue between the parties on the point, and we have not heard full argument on it.

This would have been a solution to the problem of double taxation raised in *Hoey*; but that problem was solved in a better way.[23] It is considered that it continues to be the law that entering into a contract is a "transfer" of assets.

If B borrows from L there are two transfers of assets, for B acquires the money borrowed and L acquires the benefit of the debt. If L is non-resident, then the interest is income arising to a person abroad.

48.5 "Person abroad"

Section 718(1) ITA provides:

> In this Chapter "person abroad" means—
> (a) a person who is resident outside the UK, or
> (b) an individual who is domiciled[24] outside the UK.

A UK resident foreign incorporated company is not a person abroad.[25]

In practice persons abroad take the form of trusts or companies. An individual could be a person abroad if, say, they entered into contractual arrangements with a UK transferor, without constituting a trust; but that is not likely to happen in practice.

See too 51.3.1 (CT on person abroad's income).

[22] [2022] EWCA Civ 656 at [148].

[23] See 51.9 (Double-counting relief).

[24] Section 718(3) ITA provides: "Section 835BA (deemed domicile) applies for the purposes of subsection (1)(b)." This is the standard wording to apply the deemed domicile rules.

[25] For the law before 2012/13, see the 2013/14 edition of this work para 28.4.1.

48.6 "Resident outside the UK"

Tax legislation usually refers to a person as being "resident in the UK" or "not resident in the UK" and those are well understood expressions. "Resident outside the UK" is unusual, though not unknown.[26] It is not the same as "not resident in the UK".

For when a company is resident outside the UK, see 8.20 (Residence outside UK). ToA has statutory rules for where the person abroad is a trustee or a personal representative.

48.6.1 *Trustees resident outside UK*

Section 718(2) ITA provides:

> For the purposes of this Chapter, the following persons are treated as resident outside the UK–
>
> (b)[27] the person treated as non-UK resident under section 475(3) (trustees of settlements)[28]

This is needed because the statutory provision tells us that trustees are UK resident, or non-UK resident, but it does not (or at least not expressly) tell us when trustees are "resident outside the UK." It might perhaps have been argued that trustees who are not resident in the UK are not resident anywhere else, so they are not "resident outside the UK."

What if the trustees are UK resident but also resident in another state, ie dual resident?

48.6.2 *PRs resident outside UK*

Section 718(2) ITA provides:

> For the purposes of this Chapter, the following persons are treated as resident outside the UK...
>
> (c) persons treated as non-UK resident under section 834(4)

[26] Other examples are:

(1) Section 721(1) ITEPA: "foreign employer" defined as an individual, partnership or body of persons "resident outside the UK and not resident in the UK."

(2) Section 355(1) TIOPA: "Offshore fund" defined as a mutual fund constituted by a body corporate "resident out of the UK".

(3) Section 162(5) IHTA: IHT deduction for liability to person resident outside the UK.

[27] There is no para (a).

[28] See 7.4 (Trust residence for IT/CGT).

(personal representatives).[29]

In practice persons abroad take the form of companies or trusts, not PRs, so this is somewhat theoretical. It is, perhaps, needed to avoid leaving a gap but it is not necessary to discuss the topic further.

48.7 Income "payable" to person abroad

The condition here is that income becomes payable to a non-resident or foreign domiciled person (the person abroad).

48.7.1 *Trading/partnership income*

In *Latilla v IRC*:[30]

(1) A partnership of individuals carried on a trade (mining in Rhodesia).
(2) Three of the 5 partners (who were UK resident) transferred their partnership shares to a company abroad.
(3) The company received its share of the partnership's trading profits.[31]

The taxpayer raised two arguments:

(1) An argument based on the nature of trading income: Trading income is not income *payable* to the persons carrying on a trade. Trading income is the result of a computation made in trading accounts. The receipts of the trade are not the trading income. The income may be said to income *arising* to or *received* by the company, but not *payable* to it.
(2) Arguments based on the nature of partnership income:
    (a) Trading income (if it is *not* payable to the trader) does not become payable because it is received from a partnership.
    (b) If trading income *is* payable to the partnership, it is still not payable to the partners.

These seem to me distinct issues, though they all depend on giving a narrow meaning to the word payable.

The court curtly dismissed both arguments in a single sentence. The word "payable" was wide enough to apply to trading income received by

[29] See 89.3 (Residence of PRs for IT).

[30] 25 TC 107. For another aspect of this case see 48.11.3 ("In relation to" assets).

[31] If the same arrangement was made today it would be necessary to consider the mixed partnership code; see 86.4 (Mixed partnership code); 86.13 (A (transferor) not partner: s.850D).

partners of a trading partnership:

> If this is not income "payable" to the company, we do not know what it is.[32]

It seems surprising today that the point was thought arguable, but the 1936 textbook on the ToA provisions had supported the taxpayer's side of the argument.[33] It is easy to forget how far the pendulum has swung from literal to purposive construction.

The court did not stop to analyse the nature of trading income, or partnership income, but it is clear that both arguments are wrong:

(1) Trading income is "payable" to the persons or person[34] carrying on the trade.[35]

(2) Partnership income is "payable" to the partners. In modern terminology, one would say that a partnership is transparent for ToA purposes (consistent with the general IT treatment of partnerships).[36]

In short, "payable" is equivalent to "arising" or "receiving or entitled".[37]

48.7.2 *Transferred asset used to pay debt*

Suppose T transfers money to a person abroad, and the person abroad uses the funds to repay a debt. In principle, no income arises to the person abroad as a result of the transfer, so the transfer does not satisfy the

[32] The same conclusion was reached for the word "receipt" in *IRC v Thompson* 20 TC 422 at p.429: "[The taxpayer's argument] was that "income" in that Rule meant the balance of profits and gains, and that the Receiver in receiving the money of the Company as it came in from time to time was not receiving the balance of profits and gains, and that therefore he was not the person who received within the meaning of that Rule. But there appears to me to be nothing in that contention. The Receiver in fact receives the proceeds of all the assets of the Company, whether they are capital or whether they are income, and in receiving the proceeds of assets which are income assets he receives the income within the meaning of that Rule."

[33] Stein & Marks, *Tax avoidance: An interpretation of the provisions of the Finance Act, 1936, relating to transfers of assets, companies' sur-tax, children's settlements* (1936) p.6.

[34] In *Latilla* the person abroad was trading in partnership; but trading income is also "payable" to a sole trader: *Brackett v Chater* 60 TC 134 and 639, at p.147.

[35] See 18.17.1 (What is trading income).

[36] See 85.16 (Partnership transparency: IT/CT).

[37] Thus the definition of relevant income is income which *arises* to a person abroad, see 50.20 ("Relevant income": Definition), but the meaning is obviously the same. See too 15.3 (Recognition/attribution: Analysis).

transfer of asset provisions.[38]

48.7.3 *Person abroad transfers to another*

Suppose assets are transferred from one person abroad to another, eg from offshore trustees to an offshore company. Can one argue that there is no relevant transfer because one cannot say that income *becomes* payable to a person abroad? It was payable to *a* person abroad even before the transfer! The argument is linguistically possible, but the context shows that it is wrong. If the argument was right then a transfer by a non-resident or foreign domiciled transferor would never be a relevant transfer, which is certainly not the case.

The condition is also satisfied where the transfer is to a UK resident and domiciled person who later becomes non-resident or foreign domiciled.[39]

48.8 Situs of asset transferred

The Chapter heading "transfer of assets abroad" might suggest a requirement that a UK situate asset must become non-UK situate; but that is obviously not the case. After all, the creation of rights may be a transfer of assets, and newly created assets are not situate anywhere before the transfer.

HMRC agree. The INT Manual provides:

> **INTM600280: Location of assets** [Jul 2023]
> The location of assets either before or after a transfer does not affect the application of the provisions if one of the required outcomes of a transfer is present. Those outcomes are discussed in more detail elsewhere in this guide (for example, see INTM600340).
> The heading of Chapter 2, Part 13 Income Tax Act 2007 is 'Transfer of Assets Abroad' but in fact there is nothing within the legislation itself requiring that assets must be located outside the UK or moved abroad from the UK.
> In his decision in the case of CIR v Willoughby (70 TC 57) at page 81, the Special Commissioner appears to share this view, saying
>
> > In my opinion, and so I hold, this language may be satisfied whether

[38] The example is based on the facts of *Fynn v IRC* 37 TC 629 where the Revenue did not argue that s.720 applied, presumably because they accepted this view. Instead the Revenue argued s.727 applied: see 49.24.3 ("Connected with transfer").

[39] This is self-evident, but if authority is needed, see *Congreve v IRC* 30 TC 163 (a gift to a company which became non-resident), approved on this point in *IRC v Willoughby* 70 TC 57.

> the assets are transferred from the UK to outside the UK, or being outside the UK they are transferred to a person outside the UK.

The taxpayer in *Willoughby* wisely abandoned this argument on appeal.

48.9 Transfer for full consideration

A relevant transfer may be made for full consideration[40] and need have no element of bounty (gratuitous intent). (Contrast the settlor-interested trust code).[41]

HMRC agree. The INT Manual provides:

> **INTM600240 What is a transfer?** [Jul 2023]
> ... The fact that an individual may receive a payment or consideration in full for a movement of some form of property from one person to another does not prevent that action from being a transfer for the purposes of the transfer of assets rules.

Two principles[42] restrict what would otherwise be the unworkably wide extent of this rule:

(1) Income must *become payable* to the person abroad as a result of the transfer

(2) Income of the person abroad arising as a result of the transfer must be *identifiable*

48.9.1 *Income "becomes payable"*

A requirement of a relevant transfer is that income "becomes payable" to the person abroad as a result of the transfer.

Suppose T buys an asset from a person abroad for cash ("the purchase price"). At first glance, the payment of the purchase price is a relevant transfer. The payment is a transfer of assets. As a result of the payment, income (from the cash) will normally arise to the person abroad. However, it is considered that the transfer is not a relevant transfer if:

(1) the asset would otherwise have yielded income to the person abroad;[43]

(2) the purchase price does not exceed the value of the asset.

[40] See 48.9.4 (Transfer for issue of securities).

[41] See 87.4 (Settlement-arrangement definition).

[42] Double-counting relief might also apply, see 51.9 (Double-counting relief). But if the analysis in this section is correct, it is not necessary to rely on that.

[43] The position would be different if T transfers assets to an offshore company in consideration of an issue of shares or debentures, or a life policy.

In these circumstances, the person abroad:

(1) acquires the income arising from the purchase price which T transfers to them, but

(2) loses the income arising from the asset which they sell to T.

If the two income streams are broadly equivalent, they cancel each other out, so it cannot be said that income "becomes payable" to the person abroad.

The same applies if T sells an asset to a person abroad for cash.

If that is right, the transfer of asset conditions are not satisfied every time someone sells an asset to (or buys an asset from) a non-resident person. That would be a sensible result, for two reasons:

(1) If T sells assets to an offshore trust, say, or to an offshore company, it would be surprising if T's only defence to ToA was the motive defence.[44]

(2) Suppose a straightforward series of acquisitions and disposals:
    (a) A transfers the trust fund to a non-resident trust with standard form power to add beneficiaries.
    (b) The trustees purchases an asset from B.
    (c) The trustees sell the asset to C.
    (d) The trustees use the purchase price to purchase an asset from D
    (e) The trustees sell the asset to E ... *etc*

It would be surprising if A, B, C, D and E were *all* transferors, *any* of whom could in principle be taxable on *all* the trust income under s.720 (and two more transferors may come into charge on every further transaction of sale and purchase).

48.9.2 *Income is identifiable*

Sections 720/731 require that one must *identify* the amount of income which arises to the person abroad as a result of the transfer. If that identification is not possible then s.720/731 do not - indeed cannot - operate.[45] One might go further and say that transactions are only relevant

[44] In such cases T would often have "power to enjoy". Unless this is right, there is double taxation. T may be liable under s.720 for income tax on the income arising from the asset sold to the person abroad. T is also liable to income tax on income arising from the proceeds which T receives on the sale of the same asset.
If my view is wrong, then the motive defence should be generously applied in cases of a sale for full consideration.

[45] Likewise for s.624; see 47.2.4 (Income must be identifiable).

transactions if the amount of income arising as a result of them is identifiable, but it is sufficient to say that "income payable" means ascertainable income.

Avery Jones raises this question:

> What about buying a ticket from a foreign airline, buying a meal or paying for a hotel room when abroad? There is a transfer of assets and it is clear that "income becoming payable" includes the receipt of sums which form part of the recipient's trading profits. Oh, and there is my IFA subscription, my subscription to *European Taxation*, my purchase of that overpriced new edition of *OECD Model Tax Convention*, and the new edition of *Klaus Vogel on Double Taxation Conventions* direct from the publisher. Foreign entities all of them. I expect if I think for a moment I shall think of lots more. What about my (foreign) car? Did I buy it from an agent for the manufacturer or from a UK subsidiary, and does it make any difference anyway?[46]

These payments are all transfers of assets, as a result of which (additional) trading[47] income in principle becomes payable to the person abroad. But neither s.720 nor s.731 apply, because one cannot identify the amount of income which becomes payable as a result of them.[48]

An individual who enters into a contract of employment with a non-resident employer makes a transfer of assets, but (except for a one-man company) one cannot usually identify what income becomes payable to the employer as a result of that transfer, so s.720/731 do not apply.

The question whether one can identify the income which arises to the person abroad as a result of a transfer sometimes overlaps with the question whether one can identify a transferor. In *IRC v Pratt*[49] where a company made a transfer, the taxpayers were held not to be transferors because one could not identify income arising to the person abroad from what each individual taxpayer had contributed or done.[50] But the two questions are in principle distinct.

[46] [1998] BTR 392.

[47] Except in the case of a purchase of the foreign car from a UK subsidiary, where the income arising to the person abroad would be the dividend (if any) from the subsidiary.

[48] Of course in practice considerations of materiality might also arise.

[49] 57 TC 1.

[50] See 49.5 (A procurement test).

48.9.3 *Deposit in offshore bank*

Suppose T deposits money with a non-resident bank. The deposit (in legal terms, a loan) is a transfer of assets but s.720/731 do not apply, because one cannot identify the amount of income which becomes payable to a person abroad as a result of it:

(1) The trading income of the bank is increased. The increase may be reduced or almost cancelled by the interest the bank pays to T, but the bank's income is still increased, assuming the bank is profitable. However the amount of that increased income cannot be identified.

(2) T receives interest, but T is not a person abroad.

Contrast the position if T lends money to a trust or underlying offshore company: that would be caught.

48.9.4 *Transfer for issue of securities*

Suppose T transfers an asset to a foreign company in exchange for the issue of loan notes (debentures) in that company (set up for the purpose and wholly owned by a trust or structure set up by T). This may well be transfer for full consideration. It is nevertheless a relevant transfer. Indeed it is the paradigm ToA case.[51]

The same applies to a transfer in exchange for an issue of shares.

Contrast the position if T subscribes for shares or debentures in (say) a quoted foreign company or collective investment scheme. This is not a relevant transfer as one cannot identify the income which arises as a result of the transfer. So an individual who subscribes for shares in (say) Microsoft Corp makes a transfer of assets, but one cannot identify what income becomes payable to Microsoft as a result of that transfer, so the ToA provisions do not apply. Likewise an individual who subscribes for a small interest in a collective investment scheme.

48.9.5 *Transfer for issue of life policy*

The same applies if T pays a premium for a life policy issued by a large foreign institution (or subscribes for a contract or bond of a similar nature) . One cannot normally identify the income arising to the institution as a result of the transfer so this is not a relevant transfer. However, if the policy is linked to particular investments actually made by the institution

[51] See 48.2.4 (Target: Pre-1936 schemes).

(as is typically the case for a personal portfolio bond), it would in principle be possible to identify the income, and there would be a relevant transfer.

48.10 Income of person abroad: Causation

It is not sufficient for a relevant transfer that (1) there is a transfer of assets and (2) income becomes payable to a person abroad. The income must become so payable as a result of the transfer (or associated operations). The test is one of causation.

In *Rialas v HMRC*[52] the facts were:

(1) The taxpayer ("R") transferred £10 to constitute an offshore trust ("the nominal cash transfer").
(2) Then:
    (a) The trust acquired an underlying company ("F").
    (b) A third party sold shares in a company ("A") to F. F borrowed the $15m purchase price.
    (c) F received dividends from the shares.[53]

No income arose as a result of the nominal cash transfer. The UT referred to the causation requirement and continued:[54]

> ... the establishment of [the Trust] and that trust's acquisition of the subscriber shares in F were necessary preconditions to the transfer of [the third party's] shares as those steps were important to the acquisition structure that R put in place. However, that is not the same thing as saying that A paid dividends to F in "by virtue or in consequence of" the establishment of [the Trust] or that trust's acquisition of the subscriber shares, or a combination of both. Put another way, the establishment of [the Trust], and the acquisition of the subscriber shares in F, did not themselves enable F to receive dividends on the Argo shares. The receipt of such dividends could only be guaranteed once [the third party] had, additionally, agreed to sell those shares and F had funds to pay the purchase price due.

48.10.1 *Individual buys secondhand co*

Suppose T (UK resident) buys the shares of an already existing non-

[52] [2020] UKUT 367 (TCC). The case is not yet final.

[53] The steps at (2) were not associated operations in relation to the nominal cash transfer, as they were not "effected in relation to the assets transferred" by the nominal cash transfer; see at [53].

[54] at [52].

resident company ("**a secondhand company**"). Assume the company owns assets. That purchase involves a transfer of assets by T – payment of the purchase price[55] – which is described in the following discussion as the "**purchase-price transfer**".

It is the case that income arises to a person abroad (the company). However, it cannot be said that the income became payable to the company as a result of the purchase-price transfer. The company merely continues to receive the income from its own assets, as it did before, and that is not in any way affected by the change in ownership of its shares. Thus if the seller is UK resident and domiciled, the purchase-price transfer is not a relevant transfer.

Now suppose T purchases the shares from a person abroad. In that case the purchase-price transfer may be a relevant transfer because the seller may invest the proceeds of sale and receive income as a result of that transfer. However, the income arising as a result of the purchase-price transfer would be the income arising to the seller, not the company's income. If the seller is not connected to T, it is not likely that T will have power to enjoy the income.

In these cases there will have been (at least) one other transfer of assets, the transfer of assets to the secondhand company (eg on a subscription for the company's shares). I call this the "**company-funds transfer**". The company-funds transfer is a relevant transfer. If T is the transferor of that transfer then T will in principle be within s.720 and taxed on the secondhand company's income.[56] T may alternatively be subject to tax under s.731 if T receives benefits (unless the company-funds transfer qualifies for the motive defence).

The secondhand company may later make a relevant transfer.[57] If T procures that transfer, T is the transferor in relation to that transfer.

48.10.2 *Company buys secondhand co*

Now suppose:

(1) T transfers assets to H Ltd, a non-resident company ("**T's transfer to**

[55] The sale in fact involves two transfers of assets: payment of the purchase price to the seller and transfer of the shares to T.

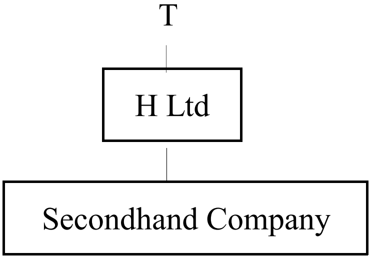
[56] As to whether T is the transferor, see 49.4 (Who is the transferor).

[57] For instance, a transfer to a non-resident subsidiary. A straightforward sale of assets by the company may not be a relevant transfer because no income becomes payable; see 48.9.1 (Purchase from person abroad).

H”).

(2) H uses its funds to purchase a secondhand company (the “**purchase-price transfer**”).

Thus the position is:



A similar analysis applies:

(1) T’s transfer to H is in principle a relevant transfer. However, no income arises to a person abroad as a result of that transfer.[58]

(2) The purchase-price transfer is not a relevant transfer. No income arises to the secondhand company as a result of that transfer. Income does arise to the secondhand company, but not as a result of T’s transfer to H or the purchase-price transfer.

Suppose H Ltd then lends[59] funds to the secondhand company (**“the inter-group transfer”**). T will then be subject to tax under s.720 on the income arising to the secondhand company from the additional funds, if that income can be identified, on the basis that:

(1) The inter-group transfer is an operation associated with T’s transfer to H, and income arises to the secondhand company as a result of T’s transfer to H and that operation; or

(2) T may also be a transferor of the inter-group transfer on the basis that T procured that transfer. (But if the associated operations rule applies, it is not necessary for HMRC to rely on that point.)

48.11 Associated operation: Definition

Section 719(1) ITA provides just about the widest definition the drafter could devise:

> In this Chapter [Chapter 2 Part 13 ITA] “associated operation”, in relation to a transfer of assets, means an operation of any kind effected

[58] Assume no income arises to H (the secondhand company does not pay a dividend).

[59] The same analysis applies if H Ltd subscribes for shares in the secondhand company.

by any person in relation to—

(a) any of the assets transferred,
(b) any assets directly or indirectly representing[60] any of the assets transferred,
(c) the income arising from any assets within para (a) or (b), or
(d) any assets directly or indirectly representing the accumulations of income arising from any assets within para (a) or (b).

I refer to items (a) to (d) as the **"assets transferred"**.

An associated operation does not exist in isolation: it exists in relation to a transfer of assets ("the principal transfer"). I refer to that as being **"associated with"** the transfer. There are two requirements. The associated operation must be:

(1) an "operation".
(2) "effected in relation to" the assets transferred by the principal transfer.

The term "associated operation" is also used in IHT. The IHT definition is similar in some respects, and IHT cases will sometimes provide assistance.[61]

48.11.1 *"Operation"*

"Operation" is (rightly) not defined but is clearly a word of wide import.

A transfer of assets is an operation, but an operation need not be a transfer of assets.

A company becoming non-resident is an operation.[62] Death is not an operation, but that does not matter because the act of making a will is an

[60] "Representing" is defined in s.717(b) ITA:

> "references to assets representing any assets, income or accumulations of income include references to—
> (i) shares in or obligations of any company to which the assets, income or accumulations are or have been transferred, or
> (ii) obligations of any other person to whom the assets, income or accumulations are or have been transferred."

Suppose:
(1) T transfers assets to a company and
(2) T transfers the shares in the company to another person.

The second transfer is an associated operation in relation to the first. This would not have been clear without the definition at (i).

I would be grateful to any reader who could find a cogent example of the application of the definition at (ii).

[61] See 74.11.2 (ToA/IHT assoc ops compared).

[62] *Congreve v IRC* 30 TC 163.

operation.[63]

In *Herdman v IRC* 45 TC 394:

(1) An individual transferred (sold) assets to an Irish company.
(2) The company then "accumulated" income and "managed" its assets so as to be able to repay a loan to the transferor.

The steps at (2) were held to be "operations" by most of the judges but this is *obiter* (non-binding) and difficult to accept. Unlike IHT, operation does not include an omission. A company does not "accumulate" income (in the legal sense). If "management" is an operation then everything is an operation (all assets must be "managed") and the expression makes no sense. Lords Pearce and Reid (more judiciously) left open the question of whether these were "operations".

48.11.2 *Effected "by any person"*

The INT Manual provides:

> **INTM600300 Associated operations** [Jul 2023]
> ... An operation effected by someone other than the transferor can be an associated operation as the legislation states it can be effected by any person...

This is self-evident. The guidance gives a couple of examples:
Corbett's Executrices v IRC where the associated operations were:

(1) An individual transferred assets to a UK resident company
(2) The company subsequently sold some of the assets to a non-resident company[64]

Herdman v IRC where the associated operations were:

(1) An individual transferred assets to a company
(2) The company accumulated/managed the assets[65]

48.11.3 *"In relation to" assets*

In *Fynn v IRC*:[66]

[63] *Bambridge v IRC* 36 TC 313. This case contains the aphorism: "Death, as we know, is an awfully big adventure, but even the Crown admits that it is not an associated operation." More prosaically, death is not an associated operation as it is not "effected by a person in relation to assets".

[64] See 48.13.1 (A to B + B to C: Clean-break test).

[65] See 48.11.1 ("Operation").

[66] 37 TC 629. *HMRC v Rialas* [2020] UKUT 367 (TCC) at [53] offers a further, similar example; see 48.10 (Income of person abroad: Causation).

(1) In 1948 T transferred assets to an Irish company (the principal transfer).
(2) In 1952 T lent money to the company ("the 1952 loan").

The 1952 loan was not an operation associated with the principal transfer, because it was not effected "in relation to" the assets transferred by the principal transfer.

In *Carvill v IRC*:[67]

(1) T transferred assets to a Bermudian company (B Ltd) in exchange for shares, and so became a majority shareholder in B Ltd ("the principal transfer").
(2) T became a 100% shareholder in B Ltd by
    (a) T purchasing shares and
    (b) B Ltd purchasing its own shares.
(3) B Ltd entered into arrangements to remunerate T via a personal services company and a brokerage sharing agreement.

Steps (2) and (3) were not operations associated with the principal transfer, as they were not effected in relation to the assets transferred by the principal transfer.

On the other hand, in *Latilla v IRC*:[68]

(1) Partners transferred a share in a trading partnership to a company abroad (the principal transfer)
(2) The company received its share of the partnership's trading profits.

The taxpayer argued that income became payable to the company not as a result of the transfer, but as a result of the subsequent activities of the partnership. One might have doubted that, as a matter of causation; but the court curtly held that the partnership activities were operations associated with the principal transfer, which is another route to the same destination.

48.11.4 *Operation precedes transfer*

Section 719(2) ITA provides:

> It does not matter whether the operation is effected before, after, or at the same time as the transfer.

[67] [2000] STC (SCD) 143 at [80]-[85], 75 TC 477 (Special Commissioners).
[68] 25 TC 107. For another aspect of this case see 48.7.1 (Trading/partnership income).

This provision (introduced 2006) gives statutory effect to the view previously expressed in RI 201.[69]

One can envisage an operation effected before the transfer. For instance, suppose an arrangement under which:

(1) An individual transported a chattel from the UK to outside the UK (an operation but not a transfer).
(2) The individual then transferred the chattel to a person abroad.

But I cannot think of a case where s.719(2) would actually matter in practice, for the purposes of the ToA rules.

48.11.5 *Mere historical association*

On a simple reading of the definition, an operation can be associated with an earlier transfer even if the two were not part of a single plan or arrangement, and many years apart. Suppose:

(1) A transfers an asset to B (who is UK resident) in 1970 ("A's transfer")
(2) B transfers the asset in the year 2020 to an offshore trust under which A may benefit.

On a simple reading, B's disposition is an operation associated with A's transfer even though:

(1) They are not part of a single arrangement.
(2) A is unaware of B's disposition.
(3) B's disposition is itself a relevant transfer
(4) One or both transfers is a disposal at arm's length.

The same would apply if A's transfer was made in 1870 or 1670. Indeed, anyone who purchases or disposes of an estate in English land is only effecting the most recent operation of a series of associated operations (dispositions of land) which may perhaps be traced back to the Norman Conquest, if not before; and only a lack of records prevents one tracing the sequence of associated operations to the dawn of civilisation. This simple reading obviously cannot be right, and a clean-break test should be implied.[70]

[69] "... an associated operation does not necessarily have to take place after a transfer of assets. A transaction undertaken 'in relation to' a transfer of assets can precede the transfer."
That seemed right. The FA 2006 gave no thought to transitional provisions but in the circumstances it does not matter.

[70] See 48.13.1 (A transfers to B + B to C: Clean-break test).

48.12 Why associated operations matter

It is not enough to establish that there is an operation associated with a transfer. This is just a first step. One must then go on to ask what (if anything) follows.

The term "associated operations" is used in two key definitions:

(1) *Relevant transfer:* s.716(1) ITA provides:

> A transfer is a relevant transfer for the purposes of this Chapter if—
> (a) it is a transfer of assets, and
> (b) as a result of—
> (i) the transfer,
> (ii) one or more associated operations, or
> (iii) the transfer and one or more associated operations,
> income becomes payable to a person abroad.[71]

(2) *Relevant transaction:* s.715(1) ITA provides:

> A transaction is a relevant transaction for the purposes of this Chapter if it is—
> (a) a relevant transfer, or
> (b) an associated operation.

The existence of associated operations is therefore relevant to:

(1) Provisions referring to relevant transfers:
   (a) *Section 720(1) ITA*: referring to avoiding of IT by individuals by means of relevant transfers[72]
   (b) *Section 721(2) ITA*: Individual has "power to enjoy" as a result of a relevant transfer and/or associated operations
   (c) *Section 732 ITA*: Individual receives benefit as a result of the relevant transfer or associated operations[73]
   (d) *Section 733 ITA*: "Relevant income" is income which can as a result of the relevant transfer or associated operations be used for providing a benefit[74]

(2) Provisions referring to relevant transactions:
   (a) *Section 729 ITA*: Individual receives capital sum connected with a relevant transaction

[71] See 48.3 ("Relevant transfer").

[72] See 48.13 (Income received as indirect consequence of transfer).

[73] See 50.13 (Benefit causation condition).

[74] See 50.35 (Income of co held by trust).

(b) *Section 729A*: Definition of protected s.727 company income
(c) *Motive defence*: All relevant transactions must satisfy the motive test[75]

Statute often refers to a relevant transfer and/or associated operations; but since the definition of relevant transfer includes associated operations, the second reference to associated operations may be otiose.

The INT Manual provides:

> **INTM600300 Associated operations** [Jul 2023]
> ... The same associated operations do not have to be taken into account in every context where it is necessary to consider 'associated operations'. For example, a transfer together with an associated operation may result in income becoming payable to a person abroad, but it may be an entirely different associated operation in relation to a transfer that results in an individual having the power to enjoy that income.

This is self-evident, though it is hard to find a practical example.

48.13 Income received as indirect consequence of transfer

48.13.1 *A to B + B to C: Clean-break test*

Suppose:

(1) In 1970 A transfers an asset to B (who is a UK resident individual) ("A's transfer").
(2) In 2000 B transfers the asset to an offshore trust ("B's trust") under which A may benefit ("B's transfer").
(3) A's transfer and B's transfer are not part of a single arrangement, and A is unaware of B's transfer.

B's transfer is clearly a relevant transfer. The question is whether A's transfer is a relevant transfer.

It may be helpful to recap the definition. Section 716(1) ITA provides:

> A transfer is a relevant transfer for the purposes of this Chapter if—
> (a) it is a transfer of assets, and
> (b) as a result of—
> (i) the transfer,

[75] See 52.27 (Pre-2005 associated operations) and 52.28 (Post-2005 transfer + associated operations).

(ii) one or more associated operations, or
(iii) the transfer and one or more associated operations,
income becomes payable to a person abroad.

I refer to part (b) of the definition, paras (i) to (iii), as **"transfer causation conditions (i) to (iii)"**.

A's transfer meets part (a) of the definition: it is a transfer of assets.

Income becomes payable to a person abroad. Transfer causation condition (i) is not satisfied, that is, it is not as a result of A's transfer alone that income has become payable to the offshore trustees. However, B's transfer is at first sight an operation associated with A's transfer. It seems at first sight that transfer causation condition (ii) is satisfied: income becomes payable to the trustees as a result of the associated operation (B's transfer); so A's transfer is a "relevant transfer" and A is taxable under s.720 on the income of B's trust! This clearly cannot be right; but why not? The motive defence is not a satisfactory solution to this problem:[76] one must conclude that A's transfer is not a relevant transfer, that is, it does not satisfy transfer causation condition (ii) or (iii). How do we reach this result?

The best solution, now[77] the key to understanding associated operation rules, is to say that mere historical association is not enough to constitute "associated operations" for ToA purposes. There must be something more.[78] Parliament has not identified that "something more" and has left the job to the courts. The position is reminiscent of the definition of "settlement" (the settlement-arrangement definition) which includes any disposition, leaving the courts to devise their own test for what is caught (in that case, the courts eventually settling on a "bounty" test).

It is suggested that the test for associated operations is the "clean-break"

[76] The motive defence could not help if either A's transfer or B's transfer was made for tax avoidance reasons; or even if B's transfer was innocent but A was unable to prove it: see 52.27 (Pre-2005 associated operations).

[77] The provisions have a complex history: see the 2014/15 edition of this work para 28.11.2 (Position before 2007/08). But the obscurities of the pre-2007 law do not shed much light on the obscurities of the current law.

[78] Contrast the approach to "disposition by associated operations" in *IRC v Brandenburg* [1982] STC 555, where Special Commissioners added a gloss that a disposition made by associated operations (for IHT purposes) must be "put in train" by one person: see Venables, "Gifts by Associated Operations" 5 PTPR 11 *http://www.khpplc.co.uk/reviews*

test, ie is A a settlor of B's trust, did A provide the property indirectly?[79] If not, the operations are not associated.

This view is supported in *Corbett's Executrices v IRC*,[80] where:

(1) Individuals transferred assets to a UK company (Woodgate) in exchange for shares and debentures (the principal transfer)

(2) The UK company sold the assets to a person abroad (the sale)

The time gap between these steps was about 1½ years.

> The interval during which the beneficiaries were thinking out their "associated operations" could not make any difference to the legal conclusion, *unless the Special Commissioners had found as a fact that it negatived the "conjunction" or association between the two operations* - the transfer to and the transfer by Woodgate.[81]

Thus although the sale was associated with the principal transfer, the position would have been different if some (more substantial) break had broken the "association" between the two steps. What amounts to a sufficient break is a question of fact.

HMRC v Fisher said that

> a taxpayer could not avoid the operation of section [720] by simply transferring his income-producing assets to a UK company prior to the transfer of the same assets by the company to a foreign company....

Two reasons are offered for this proposition:

(1) The interposition of the UK company would be regarded as a device, and the substance of the transaction would still be a transfer of those assets by the individual to the foreign entity.

(2) If a UK company was deliberately set up to circumvent a liability to income tax, that scenario might be treated as falling within one of the recognised exceptions to the distinct legal personality of the company.[82]

These are shots from the hip; the point cannot have been fully argued. The proposition is correct, but the correct reason for it is the associated operations rule. There is no need to rely on substance over form or

[79] See 99.7 (A gives to B, B gives to trust).

[80] 25 TC 305.

[81] 25 TC 305 at p.314.

[82] [2023] UKSC 44 at [87].

exceptions (recognised or novel) to the principle of corporate personality; perhaps the less said, the better.

48.13.2 *Transfer to trust + trust migration pre-2006*

Suppose:

(1) In 1990, A transfers assets to a discretionary trust with UK trustees ("A's transfer");

(2) In 2020, the UK trustees appoint foreign trustees and transfer the trust assets to them ("the appointment of foreign trustees").

The appointment of foreign trustees is a relevant transfer. (The appointment of foreign trustees involves a transfer of assets, as a result of which income arises to the non-resident trustees.) The question is whether A's transfer does likewise. That is, is it a relevant transfer?

A's transfer meets part (a) of the definition: it is a transfer of assets.

A's transfer alone does not satisfy transfer causation condition (i). Income becomes payable to a person abroad. But transfer causation condition (i) is not satisfied because it is not as a result of A's transfer alone that income has become payable to the offshore trustees.

However, the appointment of foreign trustees is an operation associated with A's transfer. Although a clean-break test is implied (to make the section work, as discussed above), in this example there is no clean break.[83]

48.13.3 *Transfer to trust + transfer to co*

This is in principle the same as 48.13.2 (Transfer to trust + trust migration pre-2006). This applies whether the transfer by the trustees is gratuitous or in exchange for shares, debentures or an offshore life policy. If the

[83] A fiduciary thread binds the transfer and the operation: see 87.5.7 (Trust appointment: Filling blanks)
The position in 48.13.1 (A transfers to B + B to C: Clean-break test) is different. There, B's transfer is independent in a way that trustees are not, because trustees are constrained by the fiduciary nature of their powers.
This view is supported by a comment in *Congreve v IRC* 30 TC 163. This concerned a gift to a UK company which became non-resident. This was a relevant transfer without the association operations rule. See 48.7 (Income "payable" to person abroad). But the House of Lords also held (at p.206) that the company becoming non-resident was an associated operation; and (by inference) income arose to the company abroad as a result of the transfer and associated operation.

investment is for wholly commercial reasons, it might be argued that is not the case and so the income of the underlying company is not within the ToA provisions; but the better view is that there is no clean break here.

48.13.4 *Transfer to co + co migration*

This is a relevant transfer even without the associated operations rules.[84]

48.13.5 *Transfer to trust + trust migration post-2006*

Suppose the facts of 48.13.2 (Transfer to trust + trust migration pre-2006), but assume the migration occurred after 6 April 2006. The trustees are deemed to be a single continuing person.[85] The analysis is therefore different. The appointment of foreign trustees does not involve any transfer. Instead the analysis is the same as 48.13.4 (Transfer to co + co migration). The end result is the same, though the route to that destination is different.

48.14 Income of person abroad

The concept of "income of the person abroad" is relevant for several purposes of the ToA provisions:

(1) There is a relevant transfer only if "income becomes payable" to a person abroad. If *no* income becomes payable then there is no relevant transfer and the ToA provisions do not come into effect.

(2) The *identity* of the income payable to the person abroad as a result of the transfer is relevant:
   (a) for s.720 ITA, as one must ask whether the transferor has power to enjoy that income;
   (b) for s.731 ITA, as one must ask whether that income can be used to benefit an individual.

(3) The *amount* of income payable to the person abroad as a result of the transfer is relevant as ascertaining that amount is the first step in computing the amount of s.720 income, and the amount of relevant income for s.731.

There are different concepts of income, or, to put it another way, different codes of rules for computing income:

- income for income tax purposes

[84] See above footnote.

[85] 7.3 (Trustees a distinct person).

- income for corporation tax purposes
- income for trust law purposes
- income for accountancy purposes

The transfer of asset rules refer to “income”. This means income for income tax purposes, because the transfer of asset rules are part of the Income Tax Acts.[86]

48.15 Capital receipts deemed income

The INT Manual provides:

> **INTM600400 Income** [Jul 2023]
> ... As well as items that are specifically treated as income there are also items treated as income for some income tax purposes but which may not be income of a person abroad for the purpose of transfer of assets. In considering whether any item is income it is relevant to consider its character in the hands of the person who actually receives it. In the absence of a specific provision that identifies a particular item as income for all UK tax purposes or specifically for the purpose of the transfer of assets legislation, if it is not income in the hands of the person abroad who actually receives it then it is unlikely to be income for the purpose of transfer of assets....

48.15.1 *Dividends, etc*

Section 383(1) ITTOIA provides the charge on dividends and other distributions of a UK resident company and s.383 continues:

> (2) For income tax purposes such dividends and other distributions are to be treated as income.
> (3) For the purposes of subsection (2), it does not matter that those

[86] That is self-evident, but if authority is needed, see *Chetwode v IRC* [1977] 1 WLR 248 at p.251:

> It is first to be noticed that this section forms part of the UK tax code – it was part of the Income Tax Act 1952 which dealt comprehensively with all aspects of income tax in the UK. Moreover, it is concerned with individuals ordinarily resident in the UK and aims at taxing them: it would be a misconception to regard it as concerned with the taxation of companies resident abroad. This means that one should start with a disposition to interpret "income" as that word is used in our tax legislation.

Unfortunately that does not take us very far. The passage continues:

> It is notorious that there is not and never has been any definition of income in the UK tax code. What, as income, is chargeable with income tax is left to be determined according to particular heads of charge under the Schedules.

> dividends and other distributions are capital apart from that subsection.

This applies for ToA purposes and for s.624 ITTOIA, so the distribution on a purchase of own shares, for instance, is income for those purposes[87] even though it is a capital receipt for trust law purposes. Likewise a gain deemed to be income under the transactions in land rules.

The same applies to income deemed to arise under s.410 ITTOIA on a stock dividend of a UK company to a trust. HMRC point out that this provision does not however apply on a stock dividend to a company. The INT Manual provides:

> **INTM601160 Measure of income: stock or scrip dividends** [Jul 2023]
> Where an individual owns shares in a UK resident company that makes a stock or scrip dividend payment (see CTM17005) in respect of those shares, that individual is treated for UK income tax purposes as having received an amount of income equal to the appropriate amount in cash. The amount is however only regarded as the income of the individual and is not regarded as income for all purposes of the Taxes Acts. Thus if the person abroad is, for example, a company, that stock dividend from a UK company would not on the face of it be income in the company's hands. As such it would not be taken into account as income that becomes payable to a person abroad for the purposes of transfer of assets.
> The position for a stock dividend from a foreign company may however be different. The provisions relating to stock dividends in Chapter 5 Part 4 ITTOIA only apply in respect of stock dividends from UK companies. In considering such an item received from a foreign company regard would need to be taken of the relevant foreign law as well as the character in the hands of the receiver. If it is not income in the hands of the person abroad or otherwise specifically treated as income it will fall outside the transfer of assets provisions.

On gains from offshore funds: see 67.10 (OIG arising to non-resident trust). On gains from life policies see 70.10 (ToA: chargeable-event gains).

Suppose the person abroad enters into a transaction which might otherwise be caught by the Transactions in Securities rules in Chapter 1 Part 13 ITA. The rules authorise an officer of Revenue and Customs to

[87] This is assumed to be the case in the drafting of s.482 ITA.

counteract the income tax advantage by making adjustments. They do not deem income to arise to the person abroad. In principle, HMRC would issue the counteraction notice to the UK transferor or beneficiary chargeable under the ToA provisions. But, as seen in 57.17.3(Non-chargeable person: Head (c), there can be no counteraction against the transferor/beneficiary if they are not a party to the transaction.

48.16 Income of person: Quantum

This section considers the amount of the income arising to the person abroad as a result of the transfer and associated operations.

48.16.1 *Administration costs*

In *Chetwode v IRC* 51 TC 647 an offshore company received dividends and interest of about £3,000 per annum. The transferor was taxed on the gross amount of that income, without deduction for (i) investment advice fees, (ii) management fees, (iii) safekeeping charges, (iv) security handling fees and bank charges, (v) registered office and executive office fees, totalling about £1,000 per annum. The approach of *Chetwode* was that s.720 should be construed so as to put the transferor in the same position as if they had retained the assets. Had he done so he could not have deducted these investment costs for the purposes of calculating his income. So there was no deduction for s.720 purposes. This is consistent with s.624.[88]

A deduction is allowed for the cost of collecting foreign income which would have been incurred had the investment income been instead received by the transferor in person.[89] But that does not come to much.

For s.731 purposes, expenses will be deducted in computing relevant income.

48.16.2 *Trade income/loss of person*

Trading income can be calculated:

(1) by accountancy principles, under which statutory non-deduction provisions such as s.34 or s.45 ITTOIA would not apply, and depreciation would in principle be allowed; or

(2) by income tax principles applicable to calculating trading profits.

[88] See 47.2.3 (Trust expenses).

[89] See 16.10 (RFI collection costs).

ToA is an income tax code, in the Income Tax Acts, and so IT principles apply.[90]

HMRC agree. The INT Manual provides:

> **INTM601120 Measure of income: trading companies** [Jul 2023]
> The income of a trading company which is to be taken into account for the purposes of the income charge is generally the balance of profits that would be chargeable to tax in the UK. Therefore in arriving at this amount regard should be had to the provisions in Part 2 ITTOIA 2005 [which govern trading income].
> It may be that deductions are claimed in respect of emoluments paid by a company to the individual who is subject to the income charge. If a deduction is allowable under 'normal principles' as above then, although the amount within the income charge is effectively reduced, emoluments are within the direct income tax charging rules.

Hoey v HMRC [2022] EWCA Civ 656 offers a straightforward example, if one is needed:

> The measure of the income of a trading company featured prominently in *Hoey v HMRC* ([2022] EWCA Civ 656). Mr Hoey worked in the UK as an IT contractor for UK clients under arrangements with two offshore entities that employed him. Via intermediaries, these offshore employers received trading receipts for providing Mr Hoey's services to UK clients and paid most of Mr Hoey's remuneration into offshore employee benefit trusts (EBTs).[91] The trustees of the EBTs then made regular interest-free loans - which were not expected to be repaid - to Mr Hoey.
> In this case, the question arose whether the payments made by the offshore employers into the EBTs in respect of Mr Hoey's remuneration should properly be deducted in computing the employers' trading profits. HMRC argued that the payments into the EBTs were not deductible because they could not have been made wholly and exclusively for the purposes of the employers' trades and were

[90] If authority is needed, see *Chetwode* at p.687 "In the case of a trade, it is necessary to strike a balance, in respect of a period, before any taxable "income" arises;" *Vestey v IRC* 54 TC at p.528 (Special Commissioners).
Trading income arises at the end of an accounting period; see 18.17.1 (What is trading income). Thus income for an accounting year ending (say) 30 June 2015 will be treated as arising in 2015/16.

[91] See 52.25 (Employee benefit trusts).

> ultimately tainted by an additional purpose: that of assisting Mr Hoey to avoid UK income tax.
>
> The Court of Appeal disagreed, concluding, at paragraph [198] of their judgment, that HMRC had not displaced the
>
> > strong prima facie inference that the whole amount of the payments into the EBTs in respect of Mr Hoey's services was properly deductible as expenditure wholly and exclusively incurred for the purposes of the Employers' trade.
>
> The result of this conclusion was that the quantum of the trading income of the offshore employers was nil.

Profits are computed on a current year basis[92] but that does not much matter after the abolition of the preceding year basis (which formerly applied to trading income).

For losses, RI 201 provides:

> The Revenue's practice is only to allow trading losses to be carried forward and set against future trading profits. They cannot be offset against investment income of the same, previous or future years.[93]

The INT Manual makes the same point:

> **INTM601120 Measure of income: trading companies** [Jul 2023]
>
> ...In circumstances where an offshore company's trading expenses exceed its income the result will be a loss. The transfer of assets provisions are charging provisions only and, specifically, charge income treated as being that of the individual. There is no provision for treating such a loss as that of the individual.
>
> However, it is HMRC's practice to allow an offshore company's trading losses to be carried forward and to be set off against the future profits of the company. They cannot be offset against the company's investment income of the same, previous or future years. ...

For s.731, losses will be deducted in computing relevant income if paid out of relevant income.

There is no group relief.

48.16.3 *Property income*

The rules for measuring property income of the person abroad are the

[92] *Vestey v IRC* 54 TC at p.528 (Special Commissioners).

[93] This is consistent with the position for property income losses. See 47.2.2 (Property business losses).

same as for the settlor-interested trust code; see 47.2.1 (Property business income). Transfer pricing may also need consideration here.

The INT Manual provides:

> **INTM601280 Measure of income: income from property** [Jul 2023]
> Where there is rental income, any profits should be arrived at in accordance with the rules in Part 3 ITTOIA 2005.

48.16.4 *Loan relationship and Forex income*

Since income is computed on IT principles, "income" does not include profits computed under loan relationships and Forex rules, which apply for CT and not for IT purposes. This is so even if the person abroad is a company.

HMRC agree. The INT Manual provides:

> **INTM601120 Measure of Income: trading companies** [Jul 2023]
> It should be noted that forex and loan relationship rules apply for Corporation Tax purposes only.

The same would apply for the CT intangible fixed assets code.

48.16.5 *Exchange rate profits/losses*

The INT Manual provides:

> **INTM601260 Measure of income: profit on exchange** [Jul 2023]
> If the accounts of a person abroad show a profit on exchange, this should not be treated as income of the person abroad for the purposes of the income charge. The profit usually derives from a difference between the exchange rates in force:
>
> - when the income is credited in the accounts of the person abroad, and
> - when that income is actually remitted to the person abroad, or if not remitted, at the date to which the accounts are made up.
>
> The income as it arises to the person abroad is to be deemed to be that of the individual (*Chetwode v IRC*, 51 TC 647), and we are therefore concerned only with the exchange rates in force at the time when the income is receivable by the person abroad. A profit on exchange is merely a book-keeping entry necessary to ensure that the cash position of the person abroad tallies with the income actually remitted, or which could be remitted at the date at which the accounts are made up.
> On the same basis, any loss on exchange should not reduce the income of person abroad in arriving at the income charge.

48.17 Genuine transaction defence

Section 724A ITA contains what I call the **"genuine transaction defence"**. This was introduced for EU-law compliance reasons.[94]

Section 742A(1) ITA provides:

> Subsection (2) applies for the purpose of determining the liability of an individual to tax under this Chapter by reference to a relevant transaction if—
> (a) the transaction is effected on or after 6 April 2012, and
> (b) conditions A and B are met.

If these conditions were satisfied, s.742A(2) ITA provides the relief:

> Income is to be left out of account so far as the individual satisfies an officer of revenue and customs that it is attributable to the transaction.

Section 742A(3) ITA provides:

> Condition A is that—
> (a) were, viewed objectively, the transaction to be considered to be a genuine transaction having regard to any arrangements under which it is effected and any other relevant circumstances, and
> (b) were the individual to be liable to tax under this Chapter by reference to the transaction,
>
> the individual's liability to tax would, in contravention of a relevant treaty provision, constitute an unjustified and disproportionate restriction on a freedom protected under that relevant treaty provision.

The hypotheses in 742A(3)(a)(b) add nothing:

(a) Para (a) repeats Genuine transaction condition B.
(b) If there is no liability (para (b)) then the genuine transaction defence is not needed.

So condition A amounts to the condition that:

> the individual's liability to tax [under the ToA provisions] would, in contravention of a relevant treaty provision, constitute an unjustified and disproportionate restriction on a freedom protected under that relevant treaty provision.

The relevant treaty is TFEU or the EEA agreement.[95] Post-Brexit, there

[94] Related changes were made to s.3 TCGA; see 64.1.2 (2013 changes).

[95] Section 742A(4) ITA provides: "In subsection (3) "relevant treaty provision" means—

is no freedom protected under these treaties, so condition A will never be satisfied. If that is right, though, then s.742A ought obviously to be repealed as it can never have effect. The provision is discussed in the 2023/24 edition of this work para 48.18 but I omit that here as it is of historical interest only.

48.18 Spouse of transferor

Section 714(4) ITA provides:

> In this Chapter [Chapter 2 Part 13, ToA provisions] references to individuals include their spouses or civil partners.

There are many references to individuals in the ToA provisions.

Definitions take effect subject to context. This extended definition cannot be intended to apply where statute provides that income is treated as accruing to an individual, whether to the transferor under s.721 or to a beneficiary under s.732: income should not be treated as accruing to the individual *and* the spouse.

The main purpose of the extended definition is no doubt to ensure that if the spouse has power to enjoy, then the transferor is regarded as having power to enjoy and so can fall within s.720.[96] But in other places where the word individual is used, the extended definition should similarly apply, unless the context otherwise requires. For instance, the transferor's spouse may qualify for the taxable-transferor defence to s.731.[97]

See too 93.16 (Gift to spouse: s.720).

48.19 ToA information notices

Section 748 ITA provides:

> (1) An officer of Revenue and Customs may by notice require any person to provide the officer with such particulars as the officer may reasonably require for the purposes of this Chapter.
> (2) The officer may direct the time within which the particulars must be provided and that time must be at least 30 days.
> (3) The particulars which a person must provide under this section, if

(a) Title II or IV of Part Three of the TFEU,
(b) Part II or III of the EEA agreement, or
(c) the provision of any subsequent treaty replacing a provision mentioned in paragraph (a) or (b)."

[96] See 49.18.3 (Spouse has power to enjoy).

[97] See 50.15.7 (Spouse of taxable-transferor).

> required to do so by a notice under subsection (1), include particulars about—
>
> (a) transactions with respect to which the person is or was acting on behalf of others,
>
> (b) transactions which in the opinion of the officer should properly be investigated for the purposes of this Chapter even though in the person's opinion no liability to income tax arises under this Chapter, and
>
> (c) whether the person has taken or is taking any part and, if so, what part in transactions of a description specified in the notice.
>
> (4) A relevant lawyer is not treated as having taken part in a transaction for the purposes of subsection (3)(c) merely because of giving professional advice to a client about it.
>
> (4A) In this section "relevant lawyer" means a barrister, advocate, solicitor or other legal representative communications with whom may be the subject of a claim to professional privilege or, in Scotland, protected from disclosure in legal proceedings on grounds of confidentiality of communication.
>
> (5) [This flags the exceptions for lawyers and banks, see below]

This provision dates back to 1936 and exists for historical reasons. HMRC now have the general power to obtain information under sch 36 FA 2008 and that is the starting point for HMRC investigations. Section 748 is rarely used, but a s.748 notice was issued in *Hitchins v HMRC* because the officer of HMRC:

> had become frustrated with the Schedule 36 process: the fact that the taxpayer had rights of appeal, and that he had had to withdraw notices that he had previously given. In contrast, notices given under s748 cannot be appealed.[98]

It is unsatisfactory (the reader may use a stronger word) that the checks and balances of the sch 36 notice procedure can be bypassed in this way. The s.748 notice procedure ought to be repealed.

48.19.1 *Lawyers*

For completeness: s.749 ITA provides:

> (1) In relation to anything done by a relevant lawyer on behalf of a client who does not consent to the information otherwise required from the relevant lawyer

[98] [2023] UKFTT 00127 (TC) at 15. The taxpayer still has the remedy of judicial review.

> under section 748 being provided, the relevant lawyer may not be compelled under that section to do more than—
>
> (a) state that the relevant lawyer is or was acting on behalf of a client, and
>
> (b) give the name and address of the client and any relevant person.
>
> (2) In the case of anything done by the relevant lawyer in connection with the transfer of any asset by or to an individual who is UK resident to or by a closely-held company whose business does not consist wholly or mainly of the carrying on of a trade or trades, the transferor and the transferee are relevant persons.
>
> (3) In the case of anything done by the relevant lawyer in connection with any associated operation in relation to any such transfer, the persons concerned in the associated operations are relevant persons.
>
> (4) In the case of anything done by the relevant lawyer in connection with the formation or management of a closely-held company whose business does not consist wholly or mainly of the carrying on of a trade or trades, the body corporate is a relevant person.
>
> (5) In the case of anything done by the relevant lawyer in connection with—
>
> (a) the creation of any settlement as a result of which income becomes payable to a person abroad, or
>
> (b) the execution of the trusts of any such settlement,
>
> the settlor and that person are relevant persons.
>
> (7) In this section—
>
> "relevant lawyer" means a barrister, advocate, solicitor or other legal representative communications with whom may be the subject of a claim to professional privilege or, in Scotland, protected from disclosure in legal proceedings on grounds of confidentiality of communication;
>
> "settlement" and "settlor" have the meanings given by section 620 of ITTOIA 2005.
>
> (8) In the application of this section to Scotland, any reference to the trusts of a settlement is a reference to the purposes of the settlement.

48.19.2 *Banks*

For completeness: s.750 ITA provides:

> (1) Section 748 does not oblige a bank to provide any particulars of any ordinary banking transactions between the bank and a customer carried out in the ordinary course of banking business, unless subsection (2) or (3) applies.
>
> (2) This subsection applies if the bank has acted or is acting on behalf of the customer in connection with—
>
> (a) the creation of any settlement as a result of which income becomes payable to a person abroad, or
>
> (b) the execution of the trusts of any such settlement.
>
> (3) This subsection applies if the bank has acted or is acting on behalf of the customer in connection with the formation or management of a closely-held company whose business does not consist wholly or mainly of the carrying on of a trade or trades.
>
> (4) In this section—

“bank” has the meaning given by section 991, and

“settlement” has the meaning given by section 620 of ITTOIA 2005.

(5) In the application of this section to Scotland, any reference to the trusts of a settlement is a reference to the purposes of the settlement.

CHAPTER FORTY NINE

TRANSFER OF ASSETS ABROAD: TRANSFERORS

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Cross references

The following topics are considered elsewhere:
43.12 (s.720: Transferor tax rate)
47.13 (s.624/s.720 compared)
92.15 (s.720: Protected-trust relief)

49.1 Transferor charge: Introduction

This chapter considers two IT charges on transferors:

ITA	**Applies if:**	**My term**
s.720	Transferor has power to enjoy income of person abroad	s.720 charge
s.727	Transferor receives/entitled to receive capital sum	s.727 charge

I refer to them together as the transferor charge, though one might refer to "charges" (in the plural), or to "s.720/727 transferor charges". The INT Manual uses the term "income charge"[1] but I think my terminology is clearer.

I also coin a term for the income charged under these sections:

[1] The INTM provides:
"INTM600540 The income charge: Introduction [Jan 2023]
There are two separate transfer of assets income charges, and for the purpose of this guide we will describe them as:
- income charge - power to enjoy, and
- income charge - receipt of/entitlement to capital sums
or, collectively, as 'the income charge' as both broadly lead to the same result."

Charge	**Income**
s.720 charge	s.720 income
s.727 charge	s.727 income

49.2 Purpose of transferor charge

Section 720(1)/727(1) ITA are identical:

> The charge under this section applies for the purpose of preventing the avoiding of liability to income tax by individuals who are UK resident by means of relevant transfers.

In *Chetwode v HMRC*, Lord Wilberforce said:[2]

> The purpose of [s.720] is to prevent tax being avoided through the transfer of assets abroad, so that income is received by a person resident or domiciled abroad, and to charge the transferor with tax as if the income has been received by him in the United Kingdom.

Lord Dilhorne said:

> I do not myself find [s.720(1)] of any assistance in arriving at the answer to the question in dispute. It states the purpose of the section. That is readily discernible from the subsections it contains.

It is true that one hardly needs s.720(1) to work out the purpose of the provision. But the approach of Lord Wilberforce, which suggests that the purpose of s.720 is to put the transferor in the position as if no transfer had been made, often offers a helpful way to approach s.720 issues.

49.3 Charge on transferor

Section 720 ITA provides:

> (1) The charge under this section applies for the purpose of preventing the avoiding of liability to income tax by individuals who are UK resident by means of relevant transfers.
> (2) Income tax is charged on income treated as arising to such an individual under section 721 (individuals with power to enjoy income as a result of relevant transactions)...

So far we have a charge, and (unusually) a reason is given for it. Who is liable? We read on to s.720(5):

> The person liable for any tax charged under this section is the individual

[2] (Lord Wilberforce, with whom 3 other judges agreed).

> to whom the income is treated as arising.

Thus s.720 does not tell us directly who is liable. We need to read on to s.721(1). But we find a further referential provision:

> Income is treated as arising to such an individual as is mentioned in section 720(1) or 720A(1) ...

The charge is imposed on "such an individual as is mentioned in s.720(1) or 720A(1)"[3]. So we turn back to s.720(1) to see who is the individual there mentioned.

The wise words of Garner are worth quoting here:

> *Such* is a deictic (pointing) term that must refer to a clear antecedent.[4]

Failure to observe this point – obvious though it may seem – has given rise to a good deal of litigation.

There are broadly two possible views of what is required to be "such an individual" as is mentioned in s.720(1):

(1) Individuals who are UK resident, and no more: ("the widest *(Congreve)* view"), or
(2) Individuals who:
    (a) are UK resident; and in addition:
    (b) avoid liability to IT "by means of relevant transfers"
    ("the limited view")

The intention of the ITA rewrite was to rewrite the law, and so far as the law was unclear, to retain its ambiguity. It is because the rewrite had such limited remit that it achieved so little. Or perhaps if its remit had been wider, its work could not have been achieved at all?

However that may be, EN ITA provides:

> 2144. Sections 739(2) and (3) of ICTA indicate the person liable by using the expression "such an individual" – but do not make it clear how

[3] For s.720A, see 49.6.4 (Charge on participator).

[4] Garner, *Dictionary of Legal Usage* (3rd ed., 2011), entry under *Such*.
Pinter exploits the ambiguity in *No Man's Land*:
"... there are some people who appear to be strong, whose idea of what strength consists of is persuasive, but who inhabit the idea and not the fact. What they possess is not strength but expertise. They have nurtured and maintain what is in fact a calculated posture. Half the time it works. It takes a man of intelligence and perception to stick a needle through that posture and discern the essential flabbiness of the stance. I am *such a man*."

> much of section 739(1) is implied by that expression. [Sections 721] and 728 ITA, which are based on section 739(2) and (3) ICTA, reproduce the expression "such an individual", which has been the subject of case law: see, in particular, *Vestey v IRC* 54 TC 503.

After some vacillation, the question of what is meant by the expression "such an individual" has this answer: the widest (*Congreve*) view is not correct. In *Vestey v IRC*:[5]

> There are undoubtedly two possible interpretations of [s.720], particularly having regard to the preamble [s.720(1)].
> The first is to regard it as having a limited effect: to be directed against persons
> [1] who transfer assets abroad;
> [2] who by means of such transfers avoid tax,
> [3] and who yet manage when resident in the UK to obtain or to be in a position to obtain benefits from those assets [ie have power to enjoy].
> For myself I regard this as being the natural meaning of the section...
> The second is to give the whole section an extended meaning, so as to embrace all persons, born or unborn, who in any way may benefit from assets transferred abroad by others [ie have power to enjoy]. ... This I regard as a possible but less natural meaning of the section.
> ... the better interpretation of the section is ... one limiting its operation and charging effect to the transferors of assets.

There are two distinct points here.

(1) The court rejected the widest (*Congreve*) view.
(2) The court understood the words in s.720(1), which under the limited view are incorporated by s.720(5)/s.721(1), require the individual to be charged to be "the transferor of assets", in short, the transferor.

I thought that point (1) was settled law. But in *HMRC v Fisher*[6] HMRC re-argued the point. *Vestey* was a case on the ITA 1952 and the law had since been consolidated by ICTA 1988, and so, HMRC argued, *Vestey* had no application to the current law. That is the boldest submission in a tax

[5] 54 TC 503 at p.583- 584. This passage is from the speech of Lord Wilberforce with which 2 others agreed.
HMRC v Rialas [2020] UKUT 367 (TCC) at [30] - [49] considered that other speeches in *Vestey* offered a different reason for their decision; but they accepted that the passage cited here should be taken as the reasoning binding on them.

[6] [2023] UKSC 44.

dispute since the eccentric Mr Trull contended he was exempt from tax by virtue of letters patent issued by Henry VII in 1508.[7] Unsurprisingly, the SC did not agree to discard a century and half of case law.[8]

Next, HMRC contended the position was changed in 1981 by (what is now) s.744 ITTOIA; but this too did not succeed:

> ... section [721/727 ITA] construed as part of the overall TOAA code is limited to charging individuals who are ordinarily resident in the United Kingdom and who transfer the assets which generate the income which is then deemed to be their income under section [720] or which generates the capital triggering the charge under section [727].
>
> It is true that their Lordships in Vestey regarded the absence of an apportionment mechanism as a strong pointer in favour of such an interpretation. But Lord Wilberforce's primary reason for deciding that Congreve was wrong was that he regarded the narrower interpretation as the natural meaning of the words...
>
> I respectfully agree with Lord Wilberforce that the most natural meaning of the words is the meaning he gave to the earlier provision in Vestey. The reference in section [720(2)] to "such an individual", being the individual who has power to enjoy the income of the overseas person, requires one to consider what characteristics of the individuals referred to in section [720(1]) are thereby brought into subsection (2). There is no reason to pick out one of those characteristics (the fact that the individual is ordinarily resident in the UK) and ignore the others (that they are trying to avoid liability to income tax by means of transfers of assets).
>
> The presence of section [743 ITA] does not mitigate the features of the charge that led to it being described as penal and harsh. It is still the case, following Lord Howard de Walden, that a single individual caught by section [720] can be charged tax on the whole of the income of the overseas transferee if they have power to enjoy that income, even if they have received little or no actual income from which to defray that tax. The Court of Appeal in *Lord Howard de Walden* posited a case where the assets were transferred to an existing overseas corporation with very large assets and income of its own. The income attributable to the assets transferred might be a very small proportion of the overseas company's total income. Lord Greene MR recognised that the effect of the provision was that it would be the total income that was deemed to be the income of the individual and subject to tax. This is why he described

[7] See 122.4 (Properly-arguable standard).

[8] at [30].

> the provision as "the severest of penalties" imposed on those who were minded to throw the burden of taxation off their own shoulders on to those of their fellow citizens. That burden is certainly thrown by the transferor of the assets but that is not an apt description of someone who was not the transferor.

There was an opportunity to restate the law with greater clarity in the 2024 reforms, but it was missed. The reader may think that a pity, but there it is.

49.4 Who is the transferor

What is required to be a transferor? Or in other words: what is the required link between the individual and the transfer? Before considering the case law I make some general observations.

A person cannot be a transferor in the abstract. A person is a transferor in relation to some particular transfer. But where the context is clear it is permissible to refer to a transferor in isolation, leaving the transfer concerned to be understood.

If an arrangement involves several transfers, it is necessary to consider them separately.

It is difficult to imagine a transfer of assets without a transferor. But a company may be the transferor, so the transferor need not be an individual. If there is no individual who is a transferor, the s.720 charge does not apply. An individual who is not a transferor (such as the successful appellants in *Pratt* and in *Fisher*) may instead fall within s.731, if they receive benefits.

There is next to no guidance in the statute. That refers to individuals who achieve a certain result "by means of relevant transfers". The matter is left for the Courts to sort out.

The rule that s.720 requires a transferor is a judicial gloss, because the statute does not use the word "transferor".[9] So the word, or concept, of transferor should not be (or at least, need not be) interpreted rigidly.[10]

49.5 Transferor: Procurement test

In *Congreve v IRC* the question of who is a transferor did not arise, because the court adopted the widest view, that s.720 applied to non-

[9] This is self-evident, but if authority is needed, see *HMRC v Fisher* [2021] EWCA Civ 1438 at [65]: "the limitation of liability to "transferors" might ... be termed a "gloss"."

[10] See 87.5.2 (A judicial gloss).

transferors (this point was reversed in *Vestey*). But the court commented:[11]

> But even if we were prepared to accede to the argument that the preamble [now s.720(1) ITA] connoted activity by the individual concerned, we think this condition would be fulfilled if the execution of the transfer were procured by the individual concerned, even though it was not actually executed by him or his agent.

Pratt adopted the procurement test.[12]

The term used in *Pratt* for someone who procures a transfer is "quasi-transferor". In general I use the term "transferor" to mean anyone to whom s.720 applies, that is, both those who make a transfer and those who procure it. But sometimes it is helpful to distinguish between:

(1) the **"direct transferor"** (who *makes* a transfer of assets) and

(2) a **"quasi-transferor"** (who *procures* a transfer made by a direct transferor)

When there is a quasi-transferor, there must necessarily also be a direct transferor.

Another way to put it would be to say that:

(1) The transfer made by the direct transferor is *attributed* to another person (the quasi-transferor)

(2) A person is regarded as a transferor if they make a transfer directly or indirectly

The second is the best formulation. It is consistent with the concept of a settlor, who is a person who directly or indirectly provides property. It seems to me to be rather a forced or unnatural understanding of the word transferor to make it include a quasi-transferor. But the use of the term "quasi-transferor", first coined in *Pratt*, seems well established.

While it is, I think, settled law that a person who procures a transfer is a quasi-transferor, and so within s.720, the question is then what is meant by "procure"? This is entirely judge-made law; there is nothing to help in the statute.

49.6 Shareholder transferors

Where a company makes a transfer, the question arises whether a

[11] 30 TC 163 at p.197. The House of Lords agreed: see at p.204.

[12] See quote in 49.7.1 (Transferor: Reality test?).

shareholder ("T") is a quasi-transfer, if:

(1) T owns all the shares in a company (a 100% shareholder)
(2) T has control of a company (a controlling shareholder)
(3) T does not have control (a minority shareholder)

49.6.1 *Pre-2024 income*

In *Fisher*, there were four minority shareholders: no shareholder had control. But *Fisher* also considered the position of a controlling shareholder:[13]

> I would reject the idea that even a "controlling" shareholder in the company is to be treated as procuring the transfer of assets by the company.

The reasons do not matter for ToA purposes, particularly since we now have a statutory rule overriding *Fisher*, but they are relevant for more general questions such as who is the settlor. They are are as follows:

Reason 1: No apportionment provision:

It is not clear how one would apportion the income of the person abroad to the controlling shareholder (or other shareholders, if caught):

> The points that their Lordships made in *Vestey* about the absence of an apportionment mechanism apply here too. Lord Wilberforce (p 1173G) contrasted the absence of such a mechanism with other areas of the tax code where Parliament had expressly conferred the power to apportion and laid down the principles according to which apportionment is to be made...
> HMRC say again that the existence now of section [743 ITA, double counting relief] allowing apportionment can overcome the problem of multiple transferors and hence in large part overcomes the problem of each shareholder of the company being treated as a quasi-transferor. ...
> I do not agree that section [743 ITA] is the answer for the same reasons as I do not regard it as undermining the construction of these provisions supported by *Vestey.*[14]

Reason 2: No definition of "control"

If we have a rule for controlling shareholders, we need to know what is

[13] at [77].

[14] See 49.3 (Charge on transferor). But this does not explain why the reason applies in this context.

meant by control, but we statute does not explain this.

> ... there are many places in the tax code where Parliament has carefully defined the circumstances where an individual is treated as controlling a company. [SC gives examples and continues:] Those sections also contain many subsections and draw in words and phrases which are in turn given complex definitions in other sections.

Reason 3: Difficult to divide active/knowledgeable shareholders from passive ones

A rule which distinguishes active/knowledgeable shareholders from passive ones is a difficult line to draw, and statute does not provide explain what test to apply:

> it was not clear ... exactly what it was that Stephen and Peter had done which amounted to "procuring" the transaction. It appeared to entail no more than that they each supported the making of the transfer qua minority shareholder, whether by formal vote or otherwise. ... Minority shareholders have no power themselves to procure any outcome, having to abide by the majority decision. Most (if not all) decisions of companies will, by definition, be taken by or with the underlying support of shareholders who, collectively, hold a controlling interest in the relevant company. If being part of a group of minority shareholders who vote in favour of a transaction is sufficient to render them all quasi-transferors, that must apply to thousands of shareholders in a PLC. ... [Counsel for HMRC] struggled to express what was needed in order for a shareholder to become a transferor.

Shareholders may be partly or wholly disengaged from the process.

Reason 4: Motive defence difficulties

> One might have thought that the existence of the motive defence in section [s.737 ITA] would serve to distinguish between active, knowledgeable shareholders who should be treated as quasi-transferors procuring the company to transfer its assets and passive shareholders who do not know anything about the transfer or do not agree with it. The latter would not have a tax avoidance purpose. That is not the case since it was accepted by both parties that the motive defence ... focuses on the purpose for which the *transfer* was effected not the purpose of each individual whom HMRC seek to charge to tax. If a minority shareholder is treated as a quasi-transferor then he or she can be taxed even if they did not have any tax avoidance purpose, provided that the transfer was

> carried out with a tax avoidance purpose by the other transferors.[15] ... this point [throws] "another spanner into the works" of the operation of the provisions if there were multiple transferors ...
> ...On HMRC's case, the motive defence is the sole escape route for a minority shareholder from a potential substantial tax charge but that escape route is not available for such a person even if they did not themselves have a tax avoidance purpose at all and regarded the transfer as an entirely bona fide commercial transaction.

The SC concludes:[16]

> What is ... clear (!) is that the shareholders of a company, even if they are also the directors, are not quasi-transferors and do not procure the transfers made by the company.

Fisher did not have to consider the position of a 100% shareholder. Reasons 1, 3 and 4 do not apply here, and reason 3 does not seem so convincing. But the SC said that even a 100% shareholder is not a transferor:[17]

> Any attempt to draw a bright line by saying, for example, that someone who owns 100% of the shares, or 51% of the shares is caught does not avoid the problem. If the owner of 100% of the shares is itself a corporate body, is the owner of that parent, or of the parent of that parent caught?

In favour of the SC's view one might add that:
(1) It would be anomalous if a 100% shareholder was a transferor and a 99.9% shareholder was not.
(2) Since the problem is being left for Parliament to deal with, it makes sense not to try to deal with a 100% shareholder by case law.

While these are not an overwhelming set of reasons, the law is clear: that a 100% shareholder is not a transferor in relation to a transfer made by the company (for pre-2024 income).

Avoidance schemes based on the rule would not work.[18] But in any case, the rule is changed from 2024.

[15] See 3.7.2 (Multiple minds: ToA transfer),
[16] at [86].
[17] at [78].
[18] See 48.13.1 (A to B + B to C: clean-break test).

49.6.2 *Shareholder transferor: Post-2024 income*

As was to be expected, the law was changed in 2024. The law is set out twice, s.720A ITA governs s.720; and 727A ITA governs s.727. These are in the same terms so it is sufficient to consider s.720A.

49.6.3 *"Closely-held company"*

The post-2024 law applies to closely-held companies. This term is defined in s.719A ITA:

> In this Chapter [chapter 2 Part 13] –
> "closely-held company" means-
> (a) a close company for the purposes of the Corporation Tax Acts (see Part 10 of CTA 2010), or
> (b) a company that would be a close company if section 442(a) of CTA 2010 were ignored (non-UK resident company not to be treated as close);

Thus "closely-held company" means a UK resident or a non-resident close company. This is clumsy, non-standard drafting,[19] but it works.

49.6.4 *Charge on participator*

Section 720A(1) ITA provides:

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

This adopts the style and wording of s.720(1). Effectively, the participator is treated as a transferor and so within the s.720 charge.[20] In practice the participators will normally be shareholders.

Section 720A(2) ITA imposes two conditions:

> But the charge only applies in those circumstances if-
> (a) the individual is involved in the company, and
> (b) the avoidance condition is met.

I refer to the condition in (2)(a) as "the involvement condition".

[19] See 104.29.1 (Non-resident close company).

[20] See 49.3 (Charge on transferor).

49.6.5 *Qualifying interest*

Section 720A(3) ITA provides a very wide definition:

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

49.6.6 *Involvement condition*

Section 720A(4) ITA provides

> For the purposes of this section, an individual with a qualifying interest in a company is to be treated as being involved in the company unless the individual satisfies an officer[21] of Revenue and Customs that
> [i] neither the individual
> [ii] nor (in a case where the individual is not the relevant participator) the relevant participator
> has any direct or indirect involvement in the decision making of the company.

49.6.7 *Avoidance condition*

Section 720A(5) ITA provides:

> The avoidance condition is met if-
> (a) the relevant participator did not object to the making of the relevant transfer, and
> (b) it is reasonable to draw the conclusion, from all the circumstances of the case, that the relevant participator was aware, or ought reasonably to have been aware-
> (i) of the transfer, and
> (ii) that one of the direct or indirect consequences of the transfer is the avoidance of a liability to taxation[22].

Where this condition is not met, it is still possible to argue that *the*

[21] See 52.34.1 ("Satisfies an officer").

[22] Section 720A(9) provides:
"In this section... "taxation" has the meaning it has in section 737."
See 52.9.2 (Taxation in New Conditions A/B).

transfer qualifies for the motive defence.

49.6.8 *"Relevant participator"*

Section 720A(6) ITA provides:

> For the purposes of subsections (4) and (5) the "relevant participator" means-
>
> (a) in a case where the individual's qualifying interest arises as a result of a nominee of the individual being a participator[23] in a company, the nominee, or
>
> (b) otherwise, the individual.

Section 719A ITA gives "nominee" a wide definition:

> In this Chapter [Chapter 2 Part 13] ...
>
> "nominee", in relation to an individual, means a person-
>
> (a) who possesses any rights or powers on behalf of the individual, or
>
> (b) who may be required to exercise any rights or powers on the individual's direction or behalf

The drafting is based on the close-company rules.[24]

49.6.9 *Involvement/avoidance condition TAARs*

Section 720A ITA provides two further TAARs. They may conveniently be read side by side:

s.720(7): involvement condition TAAR	**s.720A(8): avoidance condition TAAR**
Any arrangements to secure that a person has no direct or indirect involvement in the decision making of a company are to be disregarded if the main purpose, or one of the main purposes, of the arrangements is to secure that the condition in subsection (2)(a) [the involvement condition] is not met.	Any arrangements that would result in the avoidance condition not being met are to be disregarded if the main purpose, or one of the main purposes, of the arrangements is to secure that the avoidance condition is not met.

[23] Section 719A incorporates the standard definition: "In this Chapter ... "participator" is to be construed in accordance with section 454 of CTA 2010"; see 104.22 (Definitions of participator).

[24] See 104.5.1 (Nominee-attribution rule).

In my terminology these are arrangement-disregard TAARs.[25]

Section 720A(8), taken literally, is too wide, but it remains to be seen how it is applied.

49.6.10 *Rule applies to post-2024 income*

Section 22(10) F(no2)A 2024 provides:

> The amendments made by this section [which introduced s.720A] have effect in relation to income arising on or after 6 April 2024.

The new rules apply to pre-2024 transfers but only in relation to post-2024 income. It will be necessary to apply the involvement and the avoidance test to arrangements which took place in the distant past.

49.7 Quasi-transferor: Other cases

In *Vestey v IRC*, the question of who is a transferor did not arise, because the taxpayers (beneficiaries of a discretionary trust)had not been involved in any way with the transfers. They were clearly not quasi-transferors.

The House of Lords discussed the question in passing, and the answer was expressed in a variety of different ways. Lord Wilberforce said s.720 applies:

> only where the person sought to be charged
> [1] made [the transfer]
> [2] or, may be, was associated with, the transfer.[26]

The context shows that the meaning at [2] is that Lord Wilberforce was floating a possible view that a person could be charged if they were associated with the transferor, but did not commit himself to that view: "may be" means "possibly".[27] Nor did he elaborate on what is meant by "associated".

Lord Wilberforce was not saying:

(1) that there *would* be a s.720 charge if the taxpayer was associated with the transfer. He expressed a doubt on the point.

[25] See 3.2 (Types of TAAR). Section 720A(8) ITA provides the standard (unnecessary) IT definition of arrangement; see App 2.2.3 (Definitions of "arrangement").

[26] 54 TC 503 at p.587A. Lord Salmon agreed. Lord Keith said he agreed with Lord Wilberforce but in his speech he actually put the matter differently.

[27] The STC and All ER versions of the report change this (slightly literary) use of the words "may be" into the more usual form "maybe".

(2) that there would be a s.720 charge if the taxpayer may be associated (= was possibly associated) with the transfer.

In *Fisher:*

> As to what Lord Wilberforce meant when he referred to an individual being "associated with" the transfer as contrasted with someone "who had no hand in" the transfer, that must, in my judgment, be left to be explored in another case. A set of facts may arise in future where HMRC can properly argue that someone who is not the owner or the legal transferor of the assets has nonetheless procured the transfer or used an agent to transfer the assets. I agree with Walton J's approach in Pratt to the wiggle room apparently left by their Lordships in the speeches in Vestey. Those words, Walton J said, are not to be treated as if they were in a statute.

49.7.1 *Transferor: Reality test?*

Perhaps inevitably, we have references to a "real" transferor. This goes back to *Pratt v IRC*:[28]

> notwithstanding that the transfer was a transfer made by [the company] itself, was the reality of the matter that somebody else was the real transferor?

But references to reality do not help much, if at all.[29] Reality needs to be identified. *Pratt* continues:

> To answer that question, nobody has so far produced a better suggestion than that of 'procurement'. It may not be completely apt, but it is far nearer an apt definition than anything else which has so far been suggested.

Pratt was *not* proposing a reality test of who is a transferor. Reality was a stepping stone towards the test actually adopted in *Pratt* which was a procurement test. This was a mistake taken by the UT in *Fisher* which actually favoured a reality test:[30]

[28] [1982] STC 756 at p.792.

[29] See App.7.1 (What do we mean by "Real"?); App 7.9.2 (Cardinal principle reaffirmed).

[30] *Fisher v HMRC* [2020] UKUT 62 (TCC) at [72], [78]. This view of the UT decision in *Fisher* is supported by *HMRC v Rialas* [2020] UKUT 367 (TCC) at [42]: "the Upper Tribunal [in *Fisher*] held that the relevant question in such a case was 'who was the real transferor?'."

> ... a director who is not a shareholder cannot be treated as being, in substance, the 'real' Transferor of the company's assets, and a director who is a shareholder but who does not have a controlling interest cannot be treated as the 'real' Transferor instead of the company, merely because he or she participated in the decision of the Board to agree to the sale, voted in favour, or took steps on behalf of the company to implement it...
>
> None of the Fishers, individually or collectively, did anything which would justify treating each of them as being the 'real' Transferor of SJA's assets.
>
> ... The transfer in this case was made by [the company] and not by any of its individual shareholders or directors; there is no basis for treating any of them as the 'real' Transferor and [the company] as merely an instrument by which they effected the transfer of the assets.

The scare quotation marks (which are in the original judgment) indicate that the UT felt some unease with the word real; CoA did not adopt a reality test and nor did the SC. I think the less said about reality the better.

49.8 X pays Y to make transfer

One arrangement may involve two transfers, eg:

Case 1

(1) X transfers asset 1 to Y (transfer 1), in consideration for which:

(2) Y transfers asset 2 to a person abroad (transfer 2)

Case 2

(1) X transfers assets to a company (transfer 1), in consideration for which:

(2) The company issues shares to a person abroad (transfer 2)[31]

In case 1, X is a direct transferor in relation to transfer 1. In relation to transfer 2, Y is the direct transferor, and X is a quasi-transferor.

In case 2, X is again a direct transferor in relation to transfer 1. In relation to transfer 2, X is a quasi-transferor and the company is a direct transferor.

Case 3:

(1) X (an employee entitled to a bonus) waives the right to the bonus, in consideration for which:

[31] The issue of shares is a "transfer" of assets as defined.

(2) The employer transfers assets to a pension scheme abroad.

In this case X has not directly made a transfer (waiver is not a transfer) but X has procured the transfer made by the employer, so X is a quasi-transferor. The employer is the direct transferor.

In each of cases 1-3:

(1) X is within the scope of s.720.
(2) So are Y (in case 1) and the employer (in case 3) if they are individuals.
(3) The two steps are also associated operations. It is not necessary to rely on the associated operations rules to assess X, though that would be another route to the same destination.

49.9 Quasi-transferor when individual is direct transferor

In *Carvill v IRC*:

(1) T transferred a majority shareholding to a person abroad, and
(2) Minority shareholders transferred their shares.

The minority shareholders were direct transferors (but perhaps outside s.720 as they had no power to enjoy). HMRC argued that T was a quasi-transferor because he had procured that transfer. But this was rejected:

> For an individual to be the transferor in relation to a transfer by another individual would be a considerable extension of this principle. However, there might be cases where, as a matter of fact, one individual's influence over another was so strong that he was the transferor of the other's share but this would clearly be an exceptional case. ...
> 72. [HMRC] contends that the taxpayer was the transferor of the old minority shares. In order to find that this was an exceptional case where the taxpayer did in effect force his will on the other shareholders so as to become the transferor of their shares, one would need strong evidence that this was so. Of course, the taxpayer as majority shareholder and one of the founders of a company bearing his name was in a position of some influence. However, the influence did not go as far as telling other shareholders what to do with their shares. Here the decision by the old minority to transfer their shares was one which they came to after discussion, having started with different points of view as to the merits of the transfer. There is no evidence that the taxpayer leaned on any of them heavily, for example, by threatening to sack them if they did not.

> ... there is no evidence that the taxpayer did anything in relation to the old minority shares which would make him the transferor of them, and I find that he was not the transferor of the old minority shares.[32]

In *Rialas v HMRC*[33] the taxpayer ("R") provided an opportunity to the person abroad. The facts were:

(1) R contributed £10 to constitute an offshore trust.
(2) The trust acquired an underlying company (F).
(3) An unconnected individual ("the vendor") sold 50% of Argo Capital Management ("Argo") for $15m to F ("the share transfer").
(4) F borrowed the purchase price.[34]
(5) Argo paid dividends (used to repay the loan in part).
(6) 18 months later, F sold its Argo shares for $25m.

The vendor was the direct transferor of the share transfer. HMRC argued that R was a quasi-transferor, ie, that he procured the transfer of the Argo shares to F, because:

(1) R established the trust/corporate structure to acquire the Argo shares, by providing funds (£10) for the creation of the Trust and its acquisition of its underlying company.
(2) R recommended that the trust acquired the Argo shares.
(3) R approached the lender to lend the necessary funds for the share purchase, agreed the terms of the loan, and introduced the lender to F.
(4) R guaranteed an income stream to F in the form of dividends, where possible.[35]

The FTT rejected HMRC's argument:[36]

> ... Mr Rialas orchestrated the purchase side of the transaction... his was the controlling mind. It is however stretching the meaning of the word "procure" beyond breaking point to suggest that the fact that he organised the purchasing structure means that he dictated to whom [the vendor] should sell his shares.

[32] *Carvill v IRC* [2000] STC (SCD) 143 at [71]-[72].

[33] [2020] UKUT 367 (TCC). The case is not yet final.

[34] It seems incautious, to say the least, for a lender to lend 100% of the purchase price. But in this case the decision turned out to be justified, as the lender was repaid and perhaps the interest rate reflected the risk.

[35] If this guarantee had been a legal obligation it would have been a transfer of assets; it must have been an informal arrangement.

[36] [2019] UKFTT 520 (TC) at [65], upheld on appeal [2020] UKUT 367 (TCC).

49.9.1 *Direct/quasi-transferor individuals*

In a case where there is a quasi-transferor *and* a direct transferor what is the position of the direct transferor under s.720?

The question does not arise if the direct transferor is a company because

(1) Following *Fisher* a shareholder is not a transferor, and

(2) In any event, the company is not within s.720, which only applies to individuals.

So the question only arises when the direct transferor:

(1) is an individual; and

(2) has power to enjoy (but a transfer to a trust, or a company held by a trust, is likely to meet this requirement as offshore trusts generally have a wide power to add beneficiaries)

In practice there has not yet been a reported case where there has been a direct transferor and a quasi-transferor who are both individuals, so the question has not arisen. It would have arisen if HMRC had succeeded in *Rialas* or in *Carvill.* The solution must be that only the quasi-transferor counts, and the direct transferor is ignored; or else they are both transferors, but double-counting relief[37] protects the direct transferor and imposes the charge on the quasi-transferor. These are two routes to the same destination.

49.10 Trustees/fiduciaries: Transferors

A trustee may make a direct transfer of assets (eg transferring trust property to a foreign company) and it may perhaps procure a transfer of assets (eg paying X to make a transfer abroad). Section 720 cannot apply to the trustee because (among other reasons) a trustee is not an individual, so not within s.720. That follows (among other reasons) from the distinct-person rule.[38]

Suppose an individual ("an appointor") has power of appointing new trustees. The appointor may procure a transfer of assets, eg by appointing foreign trustees the individual procures the transfer of assets from the old trustees to the new trustees. In this case the distinct-person rule does not apply (assume the appointor is not a trustee). That "get out of jail" card is not available. But no-one suggests that s.720 could apply to the appointor. It is considered that the reason is that a person who exercises

[37] See 51.9 (Double-counting relief).

[38] See 7.3 (Trustees a distinct person).

a fiduciary power is not a quasi-transferor.[39] Since the appointor obviously does "procure" a transfer, in the normal sense of the word, this illustrates how the concept of "transferor", or of procurement, must be used in a flexible manner.

What if an individual (perhaps a principal beneficiary but not the settlor) requests and encourages trustees to make a transfer? The individual (not being in control of the trust) cannot be said to procure the transfer made by the trustees, so the individual is not a quasi-transferor.

49.11 Co-owner transferors

There are two main types of co-ownership in English law[40] and it is necessary to consider them separately.

49.11.1 *Tenancy in common*

Under a *tenancy in common*, each co-owner effectively has a separate share.[41] So if they together transfer their interest to a person abroad, each is transferor of their share. The point is made in *IRC v Pratt*:

> Suppose, for example, A and B hold land as joint legal tenants upon trust for themselves beneficially in equal shares,[42] and they then make a transfer of that land abroad. I see no difficulty in regarding, for the purposes of [s.720], A as the transferor of his beneficial half share therein, and B as the similar transferor of his beneficial half share.[43]

[39] Another explanation is that a person is not a transferor unless they have made or procured a transfer of a *beneficial* interest. *IRC v Pratt* 57 TC 1 at p.49:

> "I think that for the purposes of s [720], it must be the beneficial transfer - the transfer of the beneficial interest - which is in question, and not the bare transfer of the legal title. A trustee, for example, who was directed by his beneficiaries to effect a transfer would not, even if he knew full well what was on foot, become himself liable to fall foul of the section merely on that account."

It is of course right that the trustee in this example would not fall within s.720. But I think it is more helpful to focus on the capacity (fiduciary or not) of the individual concerned, rather than the nature (beneficial or not) of the asset transferred.

[40] In Scots law the terminology is different, but I am not aware of any differences relevant for present purposes.

[41] The terminology of co-ownership is technical and opaque. The shares of tenants in common are traditionally described as "undivided shares".

[42] The words "in equal shares" mean that the co-owners hold as tenants in common. It is beneficial ownership rather than legal ownership which matters here.

[43] 57 TC 1 at p.49. That is straightforward, and HMRC agree. The INT Manual provides a similar example where the asset is company shares rather than land:

49.11.2 *Joint tenancy*

Under a *joint tenancy*, each co-owner is (at least in legal theory, and at least for some purposes) regarded as the owner of the whole. *Pratt* goes on to consider this case without deciding it:

> The difficulties are increased, however, if in the example given A and B hold the land upon trust for themselves as beneficial joint tenants. In substance, there is no difference between that and the example given, yet here we have two transferors of one subject matter.

The only sensible conclusion is that A and B should be regarded as each transferring half the land, and later in the judgment, the judge was inclined to accept that view:

> I can well see that if A and B own an asset jointly, and transfer it abroad, then one might for this purpose be able to separate out their beneficial interests as being equal...[44]

It is true that in legal theory (which to a non-property lawyer seems very strange) *each* joint owner is regarded as owner of the whole. But that does not prevent this conclusion, as there are other cases where the same theory is not (and indeed could not be) carried to its logical extent.

The reason that co-ownership examples were discussed in *Pratt* is not because anyone has any doubt of the answers; it was hoped that the answers might shed light on the problems which arises where co-

> **INTM600800 The individual: Multiple Income charges** [Jul 2023]
> ... HMRC's practice where the same assets are transferred by several individuals is to assess the transferors in proportion to their shares of the assets transferred. For example, where shares of a UK company are held by three individuals in the proportions of 40%, 40% and 20%, and there is a liability under ITA07/S720 in respect of an overseas person to which the shares are transferred, the liability is assessed on each of the three individuals in proportion to their respective holdings.

More analytically: the facts of the example are not quite clear. It may be implied that all the shares are registered in the names of the 3 individuals jointly; but they hold beneficially as tenants in common (they cannot hold beneficially as joint tenants, as a joint tenancy requires co-owners to have equal shares.) If so, this is a case of co-ownership but not a case where "the *same* assets are transferred by several individuals" as each individual transfers their (separate) beneficial interest. Alternatively it may be that each shareholder is registered as sole owner of their own shares. That is not a case of co-ownership at all, strictly speaking. But whatever the analysis, the answer is the same.

[44] 57 TC 1 at p.51.

shareholders procure a company transfer. However I do not think the answers take us anywhere. There is no analogy. Joint owners are direct transferors, not quasi-transferors.

49.11.3 *Gift to T + transfer by T*

Suppose:
(1) X transfers assets to Y for no consideration (transfer 1)
(2) Y (an individual) transfers assets to a person abroad (transfer 2)

X is a transferor in relation to transfer 1. Y is a transferor in relation to transfer 2. X is not a quasi-transferor in relation to transfer 2 (unless, exceptionally, X has some way of forcing Y to make the transfer). The important question for X is whether transfer 2 is an associated operation in relation to X's transfer, transfer 1.[45]

49.12 Transferor/settlor compared

In practice it is generally the case that a settlor is a transferor and vice versa. That makes sense so far as possible to apply the same test for settlor and for transferor, as the objects of the ToA and the settlor-interested trust code are the same, or at least closely comparable. However there are differences.

In the case of a transfer for full consideration, a person may be a transferor but not a settlor, because settlor/settlement requires bounty (gratuitous intent).

In the case of a transfer by a company, the company is a settlor and a shareholder may be an indirect settlor, but, following *Fisher*, not a transferor.

49.13 Must transferor (intend to) avoid IT

49.13.1 *The statutory provisions*

Section 720 ITA provides:

> (1) The charge under this section applies for the purpose of preventing the avoiding of liability to income tax by individuals who are UK resident by means of relevant transfers.
> (2) Income tax is charged on income treated as arising to *such an individual* under section 721. ...

[45] See 48.13.1 (A to B + B to C: clean-break test).

The Special Commissioners say:

> 186. In our view ... such an individual" is an individual ordinarily resident in the UK who, *by means of a transfer* of assets in consequence of which income becomes payable to a non-resident, *avoids liability to income tax apart from the operation of these provisions*.[46]

If that is right,[47] the question arises whether the requirement that the transferor is a person who "avoids liability to income tax" means:

(1) the transferor in fact avoids income tax (in the absence of the ToA provisions); or
(2) the transferor intends to avoid IT (whether or not they in fact do so); or
(3) the transferor both intends to avoid and in fact avoids IT.

Section 721(5) ITA provides:

> It does not matter for the purposes of this section ...
> (c) whether the avoiding of liability to income tax is a purpose for which the transfer is effected.

There are four permutations: In outline:

Case no	**Purpose to avoid IT**	**IT avoided in fact**	**Can s.720 apply?**
1	Yes	Yes	Yes, clearly
2	No	No	Yes, according to CoA in *Fisher* but ...
3	Yes	No	Yes: *McGuckian*
4	No	Yes	Yes: s.721(5) ITA

Cases 3 and 4 may seem rare: normally the purpose and the avoidance in fact would both be present or absent. But it does happen.

In *Fisher* the CoA held that s.720 can apply in case 3. The reader may think that the argument to the contrary (which was also supported by HMRC guidance) was the better; but the point is now academic. Subject to a further appeal, the law is now settled, and I omit the discussion here as it is not of general interest. Parliament retained the statutory words set

[46] *IRC v Botnar* 72 TC 205. Although the case was finally decided in 1999, it concerned tax years before the 1996 reforms.

[47] Sometimes statutory provisions are used to give gravitas to political or moral commitments and it would be a mistake to give them legal effect: see Feldman, "Legislation Which Bears No Law" (2016) 37 (3) SLR 212. However no-one suggests that is the case here.

out in 49.13.1 (The statutory provisions), which refer to avoiding income tax, but the words do not mean anything.

49.14 Condition A: Power to enjoy

Section 721(1) ITA provides:

> Income is treated as arising to such an individual as is mentioned in section 720(1) in a tax year for income tax purposes if conditions A to C are met.

I refer to "**s.721 conditions A to C**".

Section 721(2) sets out condition A:

> Condition A is that the individual has power in the tax year to enjoy income of a person abroad as a result of—
> (a) a relevant transfer,
> (b) one or more associated operations, or
> (c) a relevant transfer and one or more associated operations.

The s.720 charge only applies if the transferor has "power to enjoy" the income of the person abroad. The charge may however apply even though the individual does not actually enjoy the income, and might never do so.

If the transferor has power to enjoy during part of the tax year, condition A is satisfied for the whole of the tax year.[48] This means that IT planning by excluding the transferor needs to be carried out some time in advance.

The drafter frequently uses a clumsy formula which refers to:

> the income mentioned in section 721(2); *or*
> the income mentioned in section 721(2) or 728(1)(a)

This means the income of the person abroad, or that part over which the individual has power of enjoyment. But power to enjoy over part will be rare, and for clarity, I gloss that formula as [the income of the person abroad].

[48] The usual case will be if the settlor has power to enjoy and is then excluded and so ceases to have power to enjoy; but it could also happen that the settlor acquires power to enjoy during the tax year.
A similar rule applies for CGT but not for settlor-interested trusts: If a settlor is excluded s.624 ITTOIA ceases to apply from the date of the exclusion, but s.720 continues to apply for the rest of the tax year. see 47.6.6 (Settlor-interest ceases); 60.5 (Settlor-interested condition). The reason might be that s.720 is intended to be stricter, perhaps penal; or maybe no-one thought about it.

On a transfer from a UK domiciled person to their foreign domiciled spouse, see 93.14 (Marriage of dom/non-dom or resident/non-resident: IT planning).

49.15 "Power to enjoy"

Section 722 ITA provides:

> (1) For the purposes of section 721, an individual is treated as having power to enjoy income of a person abroad if any of the enjoyment conditions are met.
> (2) In subsection (1) "the enjoyment conditions" means conditions A to E as specified in section 723.

I adopt the statutory terminology and refer to "**enjoyment conditions A to E**".

Section 722(1) states that an individual is *treated* as having power to enjoy if any of the enjoyment conditions are met. It is considered that this is a comprehensive definition of "power to enjoy";[49] but it is impossible to think of any power to enjoy (in the general sense) which does not also fall within one of the enjoyment conditions, so the point is academic.

"Power to enjoy" is elaborately defined and has given rise to a large case law. But in practice it is not often an issue. In outline, the transferor has "power to enjoy" if they may possibly enjoy any of the income of the person abroad. A transferor has no power to enjoy if they (and their spouse) are excluded from benefit and have no power of control.

The test is slightly wider than that of a "settlor-interested" trust for the purposes of s.624[50] though for most practical purposes they are the same. It is hard to see the reason for the distinction, but that is the patchwork nature of income tax.

With an economy of drafting, similar "power to enjoy" wording is used in other contexts:

Context	**See para**
Profit fragmentation	53.8
Mixed membership partnerships	86.10
Disguised investment management fees	73.17.1
Disguised trading	s.23F ITTOIA

[49] See App 8.4 (Deemed/treated misused).
[50] See 47.6 (Meanings of "settlor-interested").

The enjoyment conditions frequently use the word "benefit". For the meaning of "benefit" in the context of s.731 and s.87 see 50.4 (Benefit). Most of that discussion is relevant here, but there is one difference. In those sections one had to ascertain the value of the benefit. In the case of power to enjoy, all that matters is that there is a benefit, regardless of its value: the value of the benefit does not usually matter.

Statutory tax indemnities do not confer power to enjoy.[51]

49.15.1 *Substance*

Section 722(3) ITA provides:

> In determining whether an individual has power to enjoy income for the purposes of section 721, regard must be had to the substantial result and effect of all the relevant transactions.

Section 722(4) ITA provides:

> In making that determination all benefits which may at any time accrue to the individual as a result of the transfer and any associated operations must be taken into account, irrespective of—
> (a) the nature or form of the benefits, or
> (b) whether the individual has legal or equitable rights in respect of the benefits.

In the first *Vestey* case:[52]

> the direction that regard shall be had "to the substantial result and effect of the transfer and any associated operations" does not in my view authorise any laxity in construing any of the documents by which the transfer or the associated operations are effected. The Court must first determine the meaning and effect of the documents before this provision is applied and it must then consider whether their effect, though in form not beneficial to the settlor, is so in substance. The contrast is between substance and form, so if it can be shown in the present case that the effect of the transfer and the associated operations is to vest a benefit in (for example) a company over which the settlor has complete control, the Court may then say that, though in form the company benefits, in substance the company and the settlor are one and the settlor therefore

[51] See 101.4 (Statutory tax indemnity).

[52] *Vestey v IRC* 31 TC 1 at p.89. See too App.7.6 (Real nature of transaction); App.7.11 (Essence/substance in tax statutes).

> benefits. But the Court cannot take this last step unless it is shown that the settlor has himself the legal control and no reliance must be placed on his influence over others who are not in law bound to follow his directions.

The example of a benefit to a company is not a case where s.722(3) is in point. A benefit to the company held by the beneficiary would constitute power to enjoy under usual principles. The reader may think that the drafter is simply striving for effect, or expressing exasperation. But I think the drafter is stressing that the provisions should not be narrowly construed. Nowadays that would go without saying, but that was not the case when the provision was enacted.

Could s.722(4)(b) ITA ever make any difference? An example is a Cayman Island exempted trust, under which it is said that a beneficiary has no rights,[53] or perhaps a Cayman Island STAR trust.[54]

Perhaps there could be cases where the form over substance approach may assist the taxpayer, where the formal legal analysis might be said to confer some benefit on the settlor, but that is not so in substance. But the point is not likely to arise.

49.15.2 *Time of enjoyment*

Section 721(4) ITA provides:

> For the purposes of subsection (2), it does not matter whether the income of the person abroad may be enjoyed immediately or only later.

49.16 Enjoyment conditions A-D

49.16.1 *Condition A: Income benefits T*

Section 723(1) provides:

> Condition A is that the income is in fact so dealt with by any person as to be calculated at some time to enure for the benefit of the individual, whether in the form of income or not.

[53] See s.83 [Cayman] Trusts Law (2009 Revision); exempted trusts were introduced in the [Cayman] Trust Law 1967 specifically in the hope of avoiding the ToA rules which then applied if the transferor had “rights”. The UK responded in 1969 removing the requirement of”rights” from the ToA provisions and adding (what is now) s.722(4)(b).

[54] It has been suggested that a beneficiary of a Foundation has no rights, but that is doubtful; see 90.13 (Beneficiary rights).

"Calculated..."

The Special Commissioners discussed the nuance of this un-lawyer-like expression in *Botnar v IRC*:[55]

> 222. [Enjoyment condition A] is concerned with how particular income is dealt with when it arises. [Counsel for the taxpayer] however conceded that this is not confined to its immediate handling on receipt or even to what happens in the year of assessment, if for example it is received late in the year, but that we should look at how it is dealt with within a reasonable time of receipt. ...
> 224. It seems to us that, when the word "calculated" is considered in the context that it refers to income which is "in fact so dealt with", the meaning "likely" is to be preferred to "thought out" in the sense of "intended"; however we are not sure that either "likely" or "intended" gives exactly the same flavour as "calculated". "Calculated" here combines an element of objectivity with an element of forethought.
> 225. It may not however make much difference because if any income was intended to enure for the benefit of [the transferor] it is obviously more probable that it was likely to so enure and that it would be seen objectively as likely to so enure.

The INT Manual provides:

> **INTM600880 Power to enjoy - condition A** [Jul 2023]
> ... The meaning of the word 'calculated' in this test was considered briefly by Mr Justice Walton in *Vestey v CIR* (54 TC 503 at p.555) where he observes
>
> > that it was submitted to me that "calculated" … meant "likely". This is, of course, one of its possible meanings, although a glance at the Shorter Oxford English Dictionary makes it quite clear that this is not a precise translation of the word "calculated". On the other hand, its primary meaning is "reckoned, estimated, or thought out", and I would think that this is the meaning which is intended here.
>
> Walton J went on to say that he thought a stricter interpretation than "likely" is called for; that is the approach which HMRC have continued to follow in relation to this test.

"...to enure for the benefit"

The INT Manual provides:

[55] 72 TC 205. The wording is also discussed in *Vestey v IRC* 54 TC 503 at p.555G.

> **INTM600880 Power to enjoy - condition A** [Jul 2023]
> ... The benefit may be present or future. It may be in the form of income or not and may include a payment of any kind. Prior to April 2007 the transfer of assets code included a meaning of 'benefit' for the purposes of the legislation saying: "benefit" includes a payment of any kind. Therefore, provided some benefit enures to the individual it need not be a money payment at all. In this context 'enure' means to take or have effect or serve to the use, benefit, or advantage of a person.
> Some examples taken from case law illustrate this point.
> In *Latilla v CIR* (25 TC 107), a non-UK company paid over income to the individual by repaying debentures held by her. Such a capital payment, if it results from dealing with the income of the person abroad, may come within this test. A capital payment may also trigger the [s.727] income charge - receipt of/entitlement to capital sums; this is further dealt with at INTM601020 onwards.

That is no doubt correct, though *Latilla* is not authority for these propositions, as it was common ground that the transferor had power to enjoy the income of the person abroad, and the points were not discussed.

> In *Lord Chetwode v CIR* (51 TC 647), the whole share capital of a Bahamas company was held by the Bahamas trustee of a settlement for the benefit of Lord Chetwode and his family. Lord Chetwode had a life interest in the trust fund and had very wide powers, including power to remove or appoint trustees, and to re-vest in himself the title to the trust fund. The House of Lords said in their judgement that, in view of the terms of the settlement, in addition to power to enjoy under other conditions, the income of the underlying company was so dealt with as to be calculated to enure for Lord Chetwode's benefit, and thus he had power to enjoy under this condition.

49.16.2 *Condition B: Asset value increases*

Section 723(2) ITA provides:

> Condition B is that the receipt or accrual[56] of the income operates to increase the value to the individual—
> (a) of any assets the individual holds, or
> (b) of any assets held for the individual's benefit.

First one must identify an asset held by T or for T's benefit. Having

[56] The words "or accrual" appeal to be otiose, but it does not matter.

identified the asset, one asks whether the receipt of the income increases the value of that asset.

The concept of an asset "held by T" is straightforward but what about an asset held "for T's benefit"? In *Howard de Walden v IRC*[57] a promissory note held by trustees on trust for T for life was considered to be held for T's benefit. One could reach the same result by a different route since T's life interest in the note was itself an "asset" held by T. The same would apply if T's interest was subject to an overriding power of appointment.

If the asset is held on a discretionary trust under which T is merely a beneficiary, it is probably not held "for T's benefit".

The second requirement is that the receipt of the income must increase the value of the asset. This was also considered in *Howard de Walden*. Here T held:

(1) a life interest in promissory notes issued by offshore companies and
(2) the benefit of debt due from the companies (T had lent money to the companies)[58]

The CoA held:

> The receipt of the income by each company operates to increase the value of the notes and of the deposit debt...[59]

However it is a question of fact in each case. The question is whether there was a risk of default which is reduced by the receipt of further income. If a debt is sufficiently covered by existing assets of a company, the receipt of further income by the company does not increase the value of the debt and enjoyment condition B is not satisfied. It will not usually matter, as s.727 is likely to apply in cases of this kind.[60]

The INT Manual provides:

> **INTM600900 Power to enjoy - condition B** [Jul 2023]
> ... This heading covers, for example, situations where:

[57] 25 TC 121.

[58] In some but not all cases T also held a few shares in the companies. The CoA did not rely on this because if it had held that T was caught only by virtue of these shares, T would not have been assessable on the income of all the companies.

[59] 25 TC 121 at p.133. *Brackett v Chater* 60 TC 134 & p.639 is another example: see at p.148. The receipt of income of the person abroad increased the value of (1) rights to payment by instalments for a property sold to the person abroad, and (2) a right to a salary.

[60] See 49.23 (Transferor receives capital sum).

- the individual holds shares in a foreign company and the accrued income or profits of the company increase the value of its shares;
- the individual receives debentures in exchange for transferred assets - see Howard de Walden v CIR (25 TC 121);
- the consideration for the transferred assets is left as a debt owing to the individual by the company - see Ramsden v CIR (37 TC 627).

In these examples, the receipt of income by the foreign company increases the value of the shares, debentures or debt, so income need not be remitted, nor even accumulated, for the benefit of the individual. If in fact the income is received by or accrues to the person abroad and operates to increase the value of any assets held by or for the benefit of the individual, then the test may be considered met for the purpose of applying the income charge.

... In the *Ramsden* case (37 TC 619), an individual transferred assets to a foreign company and left the cost of the assets credited to his account. Although it was held that the income charge - receipt of/entitlement to capital sums did not apply as the unpaid purchase money was not a loan, nevertheless the power to enjoy condition was met under this heading, and so an income charge arose. The individual's right to recover his debt was an asset held by him, and the value of that right was increased by anything tending to increase the value of the company's assets (that is, by the company's receipt of income). Under this heading therefore the individual would have "power to enjoy" income of the company while the debt remained unpaid.

In the *Lord Chetwode* case (51 TC 647), a trust for the benefit of *Lord Chetwode* held shares in a non-UK resident company which received dividends. The House of Lords found that in the circumstances of that case the receipt of dividends by the underlying company operated to increase the value to Lord Chetwode of the assets held by the trustees for his benefit. He therefore had power to enjoy within this heading as well as within other heads of the test.

49.16.3 *Condition C: T receives benefit*

Section 723 ITA provides:

> (3) Condition C is that the individual receives or is entitled to receive at any time any benefit provided or to be provided out of the income or related money.
>
> (4) In subsection (3) "related money" means money which is or will be available for the purpose of providing the benefit as a result of the effect or successive effects—
>
> (a) on the income, and

> (b) on any assets which directly or indirectly represent the income, of the associated operations referred to in section 721(2).

For completeness, this question also arose in *Howard de Walden*. The CoA said:

> ... the payments made and to be made in respect of the notes and deposits are "benefits" within the meaning of (c) since "benefit" as defined ... includes a payment of any kind.

There are two issues here. First, is the payment of a debt to T (or payment of the promissory note) a "benefit" in the general sense? The CoA rightly thought it was not, since they relied on the former definition clause.[61]

Secondly, did the former statutory definition of benefit extend the meaning of benefit to include a payment that is not a benefit in the normal sense? The CoA held that it did. On this point the law has changed: the ITA does not contain the definition of benefit on which the court relied, so this argument no longer arises. However the repayment of an interest-free loan is in principle a benefit.[62]

See 49.22.3 (Quantum: Enjoyment cond. C).

The INT Manual provides:

> **INTM600920: Power to enjoy - condition C** [Jan 2023]
> [The Manual sets out condition C and continues:] This test is designed to cover, for example, the individual who holds redeemable debentures, or who is entitled to other capital payments, where these are satisfied out of income or out of assets representing income, and also cases where a chain of companies is involved or a shareholder is entitled to receive dividends.
> One example is the case of *Earl Beatty's Executors v CIR* (23 TC 574). The Special Commissioners took the view that a capital sum payable to an individual by annual instalments in consideration for the transfer of assets to a foreign company met this condition and gave a power to enjoy income, as the test was not confined to payments which left the company as income. The test includes a sum received as capital as well as any income received. In such a case the [s.727 charge] may also apply.
> The case of *Earl Beatty's Executors v CIR* also dealt with the situation where assets were transferred by a series of transactions to a non-

[61] For the meaning of "benefit" see 50.4 (Benefit).

[62] See 47.6.4 (Beneficial loan or guarantee).

> resident company in consideration for the issue of debentures repayable in successive years without interest. It was argued that, since these debentures were to be repayable only to the extent of the value of the assets transferred to the company, the individual was getting back nothing but his capital; that is, he was receiving no benefit from the income derived from the assets transferred. It was held that since the debentures were charged on both the income and capital of the issuing company, the individual must be deemed to be entitled to a benefit provided out of income within the meaning of this condition.
>
> This decision was approved in *Howard de Walden v CIR* (25 TC 121). In that case the individual had a life interest in certain promissory notes issued by a non-resident company, and also had an interest in certain sums of cash on deposit with the company and repayable on demand. It was held that the payments made, and to be made, in respect of the notes and deposits were benefits provided out of the income of the company, the whole of which income could be traced to the assets originally transferred.
>
> A final example of where this condition applies is that of an individual who is a shareholder of a non-UK resident company.
>
> In *Lee v CIR* (24 TC 207), the individual, as a result of a transfer of assets, held shares in a non-resident company which because of the rights attached to them entitled him to receive a dividend out of the income of the company. This was held to be a benefit provided, or to be provided, out of the income of company within this condition. Similarly, in the *Lord Chetwode* case (51 TC 647), the House of Lords found that the terms of the deed of settlement entitled Lord Chetwode to receive a benefit out of the income received by the underlying company. Thus, he had power to enjoy within this condition as well as within other heads of the power to enjoy provisions...

49.16.4 *Condition D: Possible benefit*

Section 723(5) ITA provides:

> Condition D is that the individual may become entitled to the beneficial enjoyment of the income if one or more powers are exercised or successively exercised.

Section 723(6) ITA extends this:

> For the purposes of subsection (5) it does not matter—
>
> (a) who may exercise the powers, or
>
> (b) whether they are exercisable with or without the consent of another person.

The paradigm case is a discretionary trust where T is a beneficiary or could be added to the class of beneficiaries.

"Income" here includes any asset representing the income, even if that asset does not constitute the actual income (in the strict sense) of the person abroad. In *Vestey v IRC*:

(1) The individual could receive accumulated trust income. Walton J held that the individual had no power to enjoy the trust income within enjoyment condition D because what the individual could receive was trust capital and so no longer "income".[63]

(2) The trust held a company. Walton J held that the individual had no power to enjoy the company's income within enjoyment condition D because what they could receive was dividends from the company and that was not the same as the income of the company.[64]

This is bizarre and in the House of Lords Viscount Dilhorne rejected it.[65] It is considered that Dilhorne's reasoning is to be preferred.

The INT Manual provides:

> **INTM600940: Power to enjoy - condition D** [Jan 2023]
> [The Manual states Condition D and continues:]
> This definition of the power to enjoy was amended by the Finance Act 1981 and these notes cover only the position after that amendment.
> This test includes the case in which the power to enjoy depends on the exercise of some joint power.
> Perhaps the most common example of where this test may apply is to the income of a company underlying a settlement whose shares are acquired by the settlement trustees. The individual who made the settlement remains a beneficiary and as such has power to enjoy the income of such a company, by becoming entitled to its beneficial enjoyment through the successive exercise of powers. For example, the declaration of a dividend by the company of which the trustees are shareholders, followed by an exercise of discretion as to the application of the dividend by the trustees.
> In another example, *CIR v Botnar* (72 TC 205), the individual's counsel argued that even if the individual did become entitled to the beneficial

[63] *Vestey v IRC* 54 TC 503 at p.555.

[64] *Vestey v IRC* 54 TC 503 at pp.562-3.

[65] p.595. Strictly, Dilhorne only rejected point (1). He did not address point (2). But the reason is the same in both cases so it logically follows he rejected Walton's view on both points. No other judge considered this aspect.

> enjoyment of income which could be traced to the companies underlying the settlement involved, it had not been the income of those companies when it was beneficially enjoyed. The HMRC argument, which was accepted by the Court of Appeal, was that the income which the individual beneficially enjoyed had simply to have been the income of the companies at some earlier stage. It was not necessary that it still possessed the characteristics of being income of the underlying companies when it was beneficially enjoyed. What this condition is concerned with is the beneficial enjoyment in the future of what in the past was the income of the companies.

49.17 Enjoyment condition E: Control

Section 723(7) ITA provides:

> Condition E is that the individual is able in any manner to control directly or indirectly the application of the income.

Some of the discussion on corporate control is also relevant here: see 104.2.3 (Control: Strict sense).

49.17.1 *Control over trust income*

Control is not defined. It means non-fiduciary control.

Trustees are treated as a separate notional person.[66] So an individual who is a trustee, even sole trustee, does not have control of the trust income in their personal capacity. But even ignoring that point, a trustee does not have control as their powers are fiduciary.

A protector does not have control, as the powers of a protector are (in general) fiduciary powers.

The power to appoint trustees does not confer control of trust income, both because the power itself is fiduciary, and because the trustees (once appointed) are subject to fiduciary obligations:

> But the question in the instant case is not whether the settlor was likely to be able to influence or even to exercise a decisive influence over the exercise by the trustees of their fiduciary powers. The question is whether he was able to control the application of the income, and to answer that question affirmatively it must in my judgment be possible to say at least that he was in a position to ensure that the trustees would act in accordance with his wishes without themselves giving any

[66] See 7.3 (Trustees a distinct person).

> independent consideration and accordingly to act in disregard of their fiduciary duty.[67]

That state of affairs would nowadays suggest a sham or an illusory trust.[68] The INT Manual provides:

> **INTM600960 Power to enjoy - condition E** [Jul 2023]
> ... However, the Special Commissioners decided in the case of *CIR v Schroder* (57 TC 94) that on the particular facts in that case the test was not met. They found that
>
> > Mr Schroder was able to appoint trustees who…could be expected to deal with the trust income in accordance with his wishes: but he could not compel them to do so and there is no suggestion that any of them would have acted in breach of their fiduciary duties under the settlements.
>
> In dismissing HMRC's appeal against the Commissioners' decision The High Court appears in effect to have distinguished a position of influence from a position of control.

The Special Commissioners discussed this topic in *Botnar v IRC*:

> 261. In our judgment the ability to control must go beyond an assumption that those controlling the companies will comply with the transferor's wishes and the fact that they do comply is immaterial. We accept the question posed by [counsel], viz whether [the transferor] was in a position to ensure that the companies would act in accordance with his wishes.

The Special Commissioners then applied this principle to the facts of the case:

> 262. There was in fact no material before us to indicate that [the transferor] could have done anything if Dr. Lenz had declined to do what he wanted. The position might have been different if Dr. Lenz was for example an employee who might have been dismissed in the event of failing to cooperate. There was however no evidence to suggest this. We are satisfied that the directors of the companies would have carried

[67] *IRC v Schroder* 57 TC 94 at p.125.

[68] See 87.11 (Illusory trust); 87.14 (Sham). *Schroder* did not use these terms, but it was decided before the modern concepts of sham/illusory trust began to receive attention. In the case of a sham or illusory trust, enjoyment condition E would no doubt be satisfied, as would other enjoyment conditions, but the income may not be payable to a person abroad.

> out his instructions. We have no doubt that [the transferor] was justified in assuming that Dr. Lenz would do what he wanted. However we do not consider that the mere fact that Dr. Lenz was in the saddle of the settlement meant that [the transferor] was able to ensure that the income would be applied for his benefit. On the authority of *Schroder* even decisive influence is not enough.
> 263. We readily accept [counsel's] submission that [the transferor] wished to ensure that the shares would remain in friendly hands. In a sense it could be said that he did in fact control the settlement and the Companies because in fact Dr. Lenz did comply with his wishes: there was no evidence of any action by Dr. Lenz which was contrary to [the transferor]'s wishes. That is not however the same as [the transferor] having the ability, even indirectly, to ensure that the income would be applied in accordance with his wishes.[69]

49.17.2 *Control over company income*

In *Lee v IRC* 24 TC 207, the transferor held management shares conferring votes (and so power to appoint and dismiss directors) even though the shares conferred no right to dividends or capital. Condition E was satisfied. At first sight it seems illogical that a power to appoint/remove directors of a company should constitute a power to enjoy the company income, when power to appoint/remove trustees does not constitute a power to enjoy trust income. Directors and trustees are both fiduciaries. But the management shares in *Lee* conferred more than just a power to appoint/remove directors: *IRC v Schroder* explains:

> Mr. Lee had power to appoint and remove directors. That power was not a fiduciary power. He could have appointed himself. ... directors do not owe any fiduciary duty to the shareholders. They are trustees of their powers for the company. Mr. Lee was for all practical purposes the company. He controlled the majority of votes in general meeting. No dividend could be declared save by resolution of the "A" shareholders, and the "B" shareholders had no other prospect of receiving any income or capital save in a winding-up of the company, which again would require a resolution of the "A" shareholders. Thus the "B" shareholders had no measure of control over the company except their right to bring a minority shareholders' action to prevent misuse by the directors of

[69] 72 TC 205 (Special Commissioners) at p.250. A similar approach applies to the test of corporate residence (central management & control); see 8.10.7 (Influence v control).

> their powers or ... oppression by the "A" shareholders. Thus Mr. Lee was in practice securely in the saddle. Not only could the "B" shareholders obtain nothing save at his direction; he could within the broad limits of what a director could honestly believe to be proper in the interests of the company ensure that ... the income of the company was used for his own ends. He could, for instance, have appointed himself and his wife directors and have procured [the company] to enter into a service agreement with him.[70]

49.17.3 *Non-fiduciary power*

A power to appoint the capital or income of a fund among a class (not including the appointor) does not satisfy enjoyment condition E, even if the power is not a fiduciary power.[71]

[70] *IRC v Schroder* 57 TC 94 at p.123. If further authority is needed, see *Holt v Holt ,* [1990] 1 WLR 1250 at p.1253, a valuation case concerning farming company shares with (more or less) all the votes but no right to distributions:

> "He can appoint himself sole director ... He can occupy the farmhouse as a family home, he can run the estate as he thinks fit. Unlike a farming manager he cannot be dismissed and is not obliged to consult or take instructions from anyone.... He cannot sell capital assets and put the money in his pocket, he cannot commit waste and he cannot artificially increase the profits of the farm for his own benefit by allowing the condition and state of repair of the estate to deteriorate. But if he would like to farm the estate and enjoy the advantages of being a farmer in the Wairau Valley as long as he likes, drawing reasonable remuneration, he cannot be interfered with.
>
> ... the B shareholder can obtain nothing without the co-operation of the A shareholder. If the farming business became so prosperous that the profits exceeded all that was necessary for repairs and for reasonable remuneration for the A shareholder then any surplus would be devoted by the control of the A shareholder towards the improvement of the farm property or could be distributed in the form of a dividend. Such a surplus would have to be unforeseeably large before the B shareholders could successfully urge that a dividend ought to be paid."

[71] *IRC v Schroder* 57 TC 94 at p.116 cites the first *Vestey* case: *Vestey v IRC* 31 TC 1:

> "I do not think, however, that this limited power of appointment gave [the transferor] power 'to control the application' of any income, within the meaning of [enjoyment condition E]. He could only make an appointment 'in the shape of a capital payment' in favour of one or more of his issue or their spouses and if such a power were intended to be caught ... 1 think that it would have been included in [enjoyment condition D], which deals expressly with powers of appointment. That Sub-clause is, however, limited in its operation to powers which enable the individual to obtain the beneficial enjoyment of income."

Schroder concludes: "the first *Vestey* case is conclusive authority for the proposition that the donee of a special power to appoint an interest in the capital or income of a

49.17.4 *Limited role of condition E*

In *Lee*, enjoyment condition B was also satisfied, as company income would tend to increase the value of the management shares (voting shares do have some value). Enjoyment condition D was also satisfied.[72] In practice it is difficult to think of a case where enjoyment condition E is satisfied and none of the other enjoyment conditions would be satisfied. The INT Manual makes the same point:

> **INTM600960 Power to enjoy - condition E** [Jul 2023]
> ... In most cases it is unlikely that satisfaction of the power to enjoy test will rest on the basis of this condition alone.

49.17.5 *Must control confer benefit*

Schroder raised a further question on the scope of enjoyment condition E which remains open:

> [Counsel for the taxpayer] submitted that ... para (e) was not intended to apply unless the taxpayer is able to secure that income is applied in a way which produces at least an indirect benefit or in the words of Lord Morton in the first *Vestey* case that his control over the application of income is a power which he is entitled to use to serve his own ends ...

The judge found the Revenue's response "less than compelling" but did not decide the issue:

> ... the question whether para (e) applies to a case where a settlor has a power to direct the application of income for the benefit of others and to the exclusion of any benefit direct or indirect to himself does not arise for decision, and I express no concluded opinion upon it.[73]

The INT Manual shows that HMRC continue to take that point:

> **INTM600960 Power to enjoy - condition E** [Jul 2023]
> ... However, the test does not require that the individual is able to derive personal benefit from the power of control. Therefore, if in fact a settlor of a settlement, for example, does continue to have power to direct the application of income for the benefit of others, even though he himself

fund amongst a defined and ascertainable class is not by virtue of that power able to control the application of that income within the meaning of [enjoyment condition E]."

[72] See 49.16.3 (Individual receives benefit).

[73] *IRC v Schroder* 57 TC 94 at p.125-126.

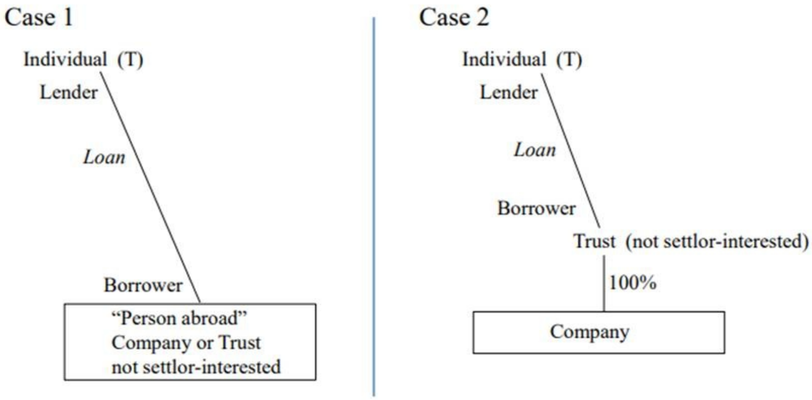
may be specifically excluded from benefit, this power to enjoy condition may well be met.

The fact that this point remains undecided only goes to show the limited importance of enjoyment condition E. But if the point did arise, the HMRC view seems right, as if a benefit was required there would be no need for enjoyment condition E.

49.18 Power to enjoy: Topics

Some structures can involve more than one of the enjoyment conditions, and it may be helpful to draw the threads together

49.18.1 *Power to enjoy: Loans*


Case 1
Individual (T)
Lender
Loan
Borrower
"Person abroad"
Company or Trust
not settlor-interested
Case 2
Individual (T)
Lender
Loan
Borrower
Trust (not settlor-interested)
100%
Company

INTM600960 In case 1 the person abroad (trust or company) owes a debt to T. Assume T has no interest in the person abroad other than the loan.

(1) T has power to enjoy the income of the person abroad (trust or company):
  - (a) If the loan is on beneficial terms (under enjoyment condition C and D[74]; or
  - (b) If receipt of income by the person abroad (trust or company) increases the value of the loan (under condition B)

(3) T does not have power to enjoy if:
  - (a) the loan is on arm's length terms *and*
  - (b) receipt of income does not increase the value of the loan

[74] And potentially, condition A and B, but HMRC do not need to rely on those.

In short, a loan to a trust will generally (but not necessarily) confer power to enjoy the income of the trust, and likewise a loan to a company.

In case 2 the *trust* owes a debt to T. Assume T has no interest in the company, and no interest in the trust other than the loan.

(1) T has power to enjoy the income of the *company*:
  (a) If the loan is on beneficial terms (the income of the company may be paid to the trust as dividends, and then used to repay the loan, so Condition D applies)
  (b) If receipt of income by the *company* increases the value of the loan, (condition B applies)

(2) T does not have power to enjoy the income of the *company* if:
  (a) the loan is on arm's length terms *and*
  (b) receipt of income by the company does not increase the value of the loan

In short, a loan to a trust which holds a company will generally (but not necessarily) confer power to enjoy the income of the company. But if the trust disposes of the company, the transferor will in principle cease to have power to enjoy income of the company.

49.18.2 *Minority shareholding*

If T holds a majority shareholding in an offshore company, T has power to enjoy all the income of the company since enjoyment condition E is satisfied. The same applies if T and T's spouse together have a majority shareholding.

What is the position if T has a minority shareholding, say, 10% of the ordinary shares? At first sight one might think that T has power to enjoy all the income of the company, under enjoyment condition B, since the income of the company increases the value of T's minority shareholding. But it is suggested that T has only power to enjoy one tenth of the company's income. This was assumed in *Bambridge v IRC*.[75]

49.18.3 *Spouse has power to enjoy*

Section 714(4) ITA provides:

> In this Chapter [Chapter 2 Part 13, ToA provisions] references to individuals include their spouses or civil partners.

[75] 36 TC 313. See Boyd, "Requiem for a Man of Straw" [1980] BTR 442 at p.457.

Thus if the transferor is married, excluded from benefit, but the transferor's spouse has power to enjoy, the transferor is treated as having power to enjoy. A widow or widower of the transferor may be included as a beneficiary because a widow is not a spouse.[76]

What if the settlor is unmarried but there is no provision excluding a future spouse? In *Tennant v IRC*, the settlor had power to appoint to any person excluding the settlor. The settlor was divorced, but if she remarried, she could have appointed in favour of her husband. Section 38(4) FA 1938 provided (for present purposes) identical words to the current s.624. The settlor had an interest in the trust property if:

> any ... property which may at any time arise under or be comprised in that settlement is, or will or may become, payable to or applicable for the benefit of the settlor or the wife or husband of the settlor in any circumstances whatsoever:

The judge dealt with the point briefly:[77]

> It is contended ... for the Crown that the property in question may become payable to the husband in certain circumstances within the meaning of the Subsection, namely, if the Respondent marries again and revokes the settlement in her husband's favour. I am of opinion that the contention of the Crown is correct. Such marriage and revocation are circumstances which might occur and which would, it seems to me, achieve the purpose which the Section is designed to prevent.

For s.624 purposes, this was reversed by statute in 1995: references to a spouse no longer include a future spouse.[78] The question for s.720 is whether the individual "may become entitled" to the income "if one or more powers are exercised." The words of emphasis and extension, "in any circumstances whatsoever" are not included. It is suggested that power to enjoy condition D is not met. For the transferor (or rather, his spouse) to become entitled, it is not sufficient that one or more powers are exercised. There is a further requirement, which is not the exercise of a power: It is necessary that the transferor marries. This view leaves the law in a (slightly) more coherent state, and explains why the 1995 reform did not amend s.720.

[76] See App 3.2 (Spouse).

[77] 24 TC 215 at p.220.

[78] See 47.6.3 ("Spouse" in settlor-interested trust code).

49.19 Power to enjoy: Causation

It is not sufficient that the transferor has power to enjoy the income of the person abroad. A causation condition must also be satisfied. Section 721(2) ITA provides:

> Condition A is that the individual has power in the tax year to enjoy income of a person abroad *as a result of*—
> (a) a relevant transfer,
> (b) one or more associated operations, or
> (c) a relevant transfer and one or more associated operations.

Suppose:

(1) In 1970 A transfers an asset to a non-resident company wholly owned by B, who is not UK resident ("A's transfer").
(2) In 2010 B transfers the company to an offshore trust under which A may benefit[79] ("B's transfer").

A has made a relevant transfer. However, before 2010, A is not within s.720 since A does not have power to enjoy the income of the company.

From the date of B's transfer in 2010, A does have "power to enjoy". A does not have that power as a result of A's transfer alone. B's transfer appears at first sight to be an associated operation in relation to A's transfer.[80] It seems at first sight that s.721 condition A is satisfied and A is in principle taxable under s.720 on the income of B's trust! This clearly cannot be right, but why not? This raises questions similar to those discussed in para 48.13.1 (A transfers to B + B to C: clean break test). Assuming there is a "clean break" between A's transfer and B's transfer (the same test as applies elsewhere), it is suggested that there are two reasons for this (either one would suffice):

(1) B's transfer is not an operation associated with A's transfer; and
(2) A does not have power to enjoy as a result of A's transfer, but only as a result of B's transfer.

Suppose:

(1) In year 1, T transferred assets to an offshore company ("the original transfer of assets"). T has no interest in the shares of the company,

[79] If B's trust is in standard form there will be a common form power to add beneficiaries, so A will have power of to enjoy.

[80] See 48.11 (Associated operation: definition).

and no power to enjoy its income; and so is outside s.720.

(2) In year 2, T lent money to the company interest-free (“ the loan”).

In year 2, T probably does have power to enjoy the income of the company by virtue of the interest-free loan.[81] However T is not taxed on the income arising from the original transfer of assets in year 1, since that power to enjoy does not arise *as a result* of the transfer or any associated operation. The loan is not an associated operation.[82]

However, T is in principle subject to tax under s.720 on the income arising to the offshore company as a result of the loan in year 2 (if there is any) as the loan is itself a transfer of assets.[83]

On the same facts, if income is used to repay the loan, then enjoyment condition A is satisfied. (So is enjoyment condition C, but that does not matter.)

49.20 s.721 income chargeable to IT

I turn to s.721 condition B. Section 721 ITA provides:

> (1) Income is treated as arising to such an individual as is mentioned in section 720(1) in a tax year for income tax purposes if conditions A to C are met...
> (3) Condition B is that the income of the person abroad would be chargeable to income tax if it were the individual’s and received by the individual in the UK.

This condition would matter if:

(1) Income of the person abroad would not be chargeable to income tax, if received by a UK resident individual in the UK; and yet

(2) In the absence of condition B, the transferor would otherwise be chargeable under s.720.

It is (just) possible to find a situation where point (1) is met. A UK resident diplomat, for instance, would not be chargeable on foreign

[81] Inter alia, enjoyment condition D is satisfied as income may be used to repay the loan, and (depending on the facts) enjoyment condition B may also be satisfied.

[82] See 48.11.3 (“Effected in relation to” the assets transferred). The example is based on the facts of *Fynn v IRC* 37 TC 629 where the s.720 point was not argued, presumably, because the Revenue accepted this view was correct. For the s.727 issues raised by a loan, see 49.24.3 (Connected with transfer).

[83] This point did not arise on the facts of *Fynn* as the loan was used to repay a debt, so no income arose to the offshore company as a result of the loan.

income.[84] But it is difficult to find a situation both points are met.

Diplomatic immunity, for instance, would also extend to s.720 income, so diplomats do not need to rely on condition B.[85]

Interest on National Savings Certificates is exempt from income tax by virtue of s.692 ITTOIA which provides: "No liability to income tax arises in respect of income from authorised savings certificates." But in the unlikely event that a person abroad within s.720 held National Savings Certificates, the wording is wide enough to cover a s.720 charge.[86]

What about a case where interest is due but unpaid; which (1) would be recognised as income in the accounts of an offshore company, but (2) would not be recognised as income (until paid/received) for IT purposes[87]? The answer is that what is income of the person abroad is determined by IT principles,[88] so s.720 is not applicable to unpaid interest, and condition B is not in point.

I have wondered whether condition B had some historical purpose when enacted in 1936 which has since been lost; but the authors of a 1936 textbook were equally puzzled.[89]

In practice condition B will always be satisfied. So it does not matter that s.727 has no equivalent condition. It would be a minor simplification to repeal the condition, but that would probably be more trouble than it is worth, except in the context of a wider review of ToA.

49.21 s.721 Cond. C: Transferor UK resident

Turning to s.721 condition C, s.721(3A) ITA provides:

> Condition C is that the individual is UK resident for the tax year.

[84] Section 2 Diplomatic Privileges Act 1964 provides: "the Articles set out in Schedule 1 to this Act … shall have the force of law in the UK". Article 34 provides: "[a] diplomatic agent shall be exempt from all dues and taxes, personal or real, national, regional or municipal".

[85] One possible case (prior to the abolition of ordinary residence in 2013) was a transferor who was ordinarily resident but not resident in the UK. If that was possible (which was doubtful) the individual could have benefited from condition B as (being non-resident) they would not have been chargeable on foreign income.

[86] See 2.4.1 (In respect of).

[87] See 15.5 (When is interest recognised).

[88] See 48.16 (Income of person: Quantum).

[89] Stein & Marks, *Tax avoidance: An interpretation of the provisions of the Finance Act, 1936, relating to transfers of assets, companies' sur-tax, children's settlements* (1936) p.13.

49.21.1 *Income arises when transferor non-resident*

Section 720 does not apply to income which arises in a year for which the transferor is not resident in the UK.

A non-resident individual is subject to tax at their personal rates on their UK rental income. That individual may transfer UK land to an offshore company in order to avoid higher rate income tax.[90] (It is not usually necessary for a non-resident individual to transfer other assets to a company in order to avoid higher rate tax as income of a non-resident from most other sources is not subject to tax at the higher rates.)[91]

If the individual later becomes UK resident they do not retrospectively become liable under s.720 for income accruing in non-resident years. This is consistent with the usual IT position.[92]

49.21.2 *Income arises in split year*

There is no express split-year rule, so the default rule applies: s.720 income is taxable even if it arises during the overseas part of a split year of the transferor.[93] There is no good reason for that. Section 720 income ought to be taxed in the same way as ordinary foreign income. But DT relief should be available if the transferor is treaty-resident in a foreign state during part of a tax year.[94]

49.21.3 *Transferor non-resident when transfer made*

The intention of those responsible for the legislation was that s.720 should only apply if the transferor was (ordinarily) resident in the UK at the time of the transfer.[95] After some vacillation, this was upheld in *IRC v Willoughby*.[96] But that is only of historical interest, as the position is now governed by s.721(5)(b) ITA:

> It does not matter for the purposes of this section ...
>
> (b) whether the individual is UK resident for the tax year in which

[90] Of course, CGT, VAT, IHT and SDLT all need consideration.

[91] See 45.1 (Non-residents income tax relief: Introduction).

[92] See 17.21 (RFI/gains of non-resident, remitted when resident).

[93] See 10.1 (Residence throughout tax year).

[94] See 49.30.3 (Transferor treaty non-resident).

[95] "There has to be a transfer of assets abroad by an individual resident in this country." (W.S. Morrison, then Financial Secretary) 313 HL Official Reports 5th series col 685, cited *IRC v Willoughby* 70 TC 57 at p.113.

[96] 70 TC 57 reversing *Herdman v IRC* 45 TC 394.

> the relevant transfer is made (if different from the tax year mentioned in subsection (1))...

Thus non-residence at the time of the transfer is not a defence: s.720 may apply to a person after they become resident, regardless of residence at the time of the transfer. This applies to income from 1996 regardless of the date of the transfer.[97]

49.22 Amount of s.720 charge

49.22.1 *Power to enjoy part of income*

Section 720 ITA provides:

> (2) Income tax is charged on income treated as arising to such an individual under section 721 (individuals with power to enjoy income as a result of relevant transactions)...
> (3) Tax is charged under this section on the amount of income treated as arising in the tax year.

Section 721(3B) ITA provides:

> The amount of the income treated as arising under subsection (1) [the amount of s.720 income] is (subject to sections 724 and 725[98]) given by the following rules-
> *Rule 1*
> The amount is equal to the amount of the income of the person abroad if the individual [the transferor]-
> (a) is domiciled in the UK at any time in the tax year, or
> (b) is at any time in the tax year regarded for the purposes of section 718(1)(b)[99] as domiciled in the UK as a result of section 835BA having effect because of Condition A in that section being met [formerly domiciled resident[100]].

Rule 2 is a relief for protected s.720 income.[101]

Prior to 2013, s.720 did not tell us *what* is the amount of income treated

[97] Also see 50.15.5 (Transferor non-resident when transfer made; pre-1996 income).

[98] The exceptions referred to in brackets are rarely if ever invoked. They are:

Section	**Topic**	**See**
s.724	Enjoyment condition C	49.22.3
s.725	CFC rules	51.19

[99] See 48.5 (“Person abroad”).

[100] See 5.4.2 (IT/CGT formerly-dom resident rule).

[101] See 92.15 (s.720 protected-trust relief).

as arising. Construction and common sense had to fill the gap.[102] Now we have s.721(3B) but it does not clearly address the problems which arise.

A person may have "power to enjoy" (as defined) over all the income of an offshore person even though their power to enjoy (in the natural sense of that expression) is limited to an unidentifiable part[103] or even none[104] of the income. In such a case T is taxed on all the income. The s.720 income is not limited to the income that T is actually entitled, or able, to receive. Section 721(3B) ITA confirms the pre-2013 law.[105]

However, if T has power to enjoy (as defined) over only part of the income, T is only taxed on the income which T has power to enjoy:

> The only question is: What income of the non-resident does the resident individual have power to enjoy by reason of the transfer either alone or in conjunction with associated operations? It is that income which is deemed to be income of that individual for all purposes of the Income Tax Acts.[106]

It is suggested that s.721(3B) ITA has not altered this.

49.22.2 *Person abroad has other source of income*

Suppose:

(1) T transfers assets to an offshore company.
(2) The offshore company has two sources of income:
  (a) income from the assets transferred by T;
  (b) income from other sources which have nothing to do with T.
(3) T has power to enjoy all the income of the offshore company.

What income is treated as arising to the individual. Is it any income of the person abroad? Or is it only the income which arises as a result of the transfer of assets or associated operations?

The relevant provisions are in s.721:

> (1) Income is treated as arising to such an individual as is mentioned in

[102] See Boyd "Requiem for a Man of Straw" [1980] BTR 442. See also 48.15 (What is income of person abroad?) and 48.16 (The amount of income of person abroad).

[103] eg if T transfers assets to a company in which T holds debentures. If all the income of the company increases the value of the debentures just a little, T has "power to enjoy" all the income within enjoyment condition B.

[104] eg if T has control within enjoyment condition E.

[105] *Howard de Walden v IRC* 25 TC 121.

[106] *Congreve v IRC* 30 TC 163 at p.199.

> section 720(1) in a tax year for income tax purposes if conditions A to C are met.
> (2) Condition A is that the individual has power in the tax year to enjoy income of a person abroad as a result of—
> (a) a relevant transfer,
> (b) one or more associated operations, or
> (c) a relevant transfer and one or more associated operations...
> (3B) The amount of the income treated as arising under subsection (1) is equal to the amount of the income of the person abroad (subject to sections 724 and 725).

RI 201 states:

> It has not been determined by the Courts whether all the income of the overseas person should be assessed, or only the income of that person to the extent that it arose by virtue or in consequence of the relevant transfer of assets and any associated operation(s). It has been the Revenue's practice (since the decision in *Vestey v IRC* 54 TC 503) to assess on the second of these two possible bases.

The Revenue practice is correct, though in fact the issue has been determined by the courts: the view that all the income of the person abroad is taxed was dismissed as "quite ridiculous".[107]

This view is supported by s.714(2) ITA which provides:

> The charges apply only if a relevant transfer occurs, and they operate by reference to income of a person abroad that is connected with the transfer or another relevant transaction.

This clearly rejects the view that all income of the person abroad is caught. It suggests however that the measure of income caught is not that which arises as a *result* of the relevant transfer or associated operation, it is income which arises that is *connected* with the transfer or associated operation. "Connected" is not defined. However, while the wording was perhaps designed to give HMRC scope to take one step back from the position stated in RI 201, I cannot think of a case where it would arise in practice.

[107] Walton J in vehement form in *Vestey v IRC* 54 TC 503 at p.562, followed in *Carvill v IRC* [2000] STC (SCD) 143 at [97] - [98]. The point had been left open in *Howard de Walden v IRC* 25 TC 119. Although the contrary view is suggested in a passing comment in *Fisher* [2023] UKSC 44 at [57] the relevant authorities and arguments were not fully considered.

It is considered that s.721(3B) has not altered this. The reference to "the income of the person abroad" must be taken as a reference to the income within s.714(2).

In *Fisher v HMRC,* following a transfer of a business, the income of the person abroad included income from new businesses developed by the person abroad, to the extent that it derived from the transferred business or associated operations. The new business ventures were associated operations as income from the transferred business was used to finance them. The position was no different than if the profits from the transferred business were invested in shares.[108]

49.22.3 *Quantum: Enjoyment cond. C*

A special rule applies for a transfer who has power to enjoy under enjoyment condition C.[109] Section 724 ITA provides:

> (1) This section applies if an individual has power to enjoy income of a person abroad for the purposes of section 721 because of receiving any such benefit as is referred to in section 723(3) (benefit provided out of income of person abroad).
> (2) Despite anything in section 720, the individual is liable to income tax under that section for the tax year in which the benefit is received on an amount equal to the whole of the amount or value of that benefit.
> (3) But subsection (2) does not apply so far as it is shown that the benefit derives directly or indirectly from income by reference to which the individual has already been charged to income tax for that tax year or a previous tax year under this Chapter [Chapter 2 Part 13, ToA].

This was introduced in 1969 and upsets the reasoning of *de Walden* where repayment of a loan was held to fall within enjoyment condition C. Since the charge is now on the value of the benefit, and the value of a payment for full consideration (such as the repayment of a loan) is nil, there would be no charge under s.720 by reference to enjoyment condition C.

In *Botnar* the Special Commissioners said:

> 245. ... Where the power to enjoy arises the tax is charged not on the income which the taxpayer has power to enjoy but on the value of the benefit. This may bear no relationship whatsoever to the income of the non-resident as long as it originated from it even indirectly. We do not

[108] [2020] UKUT 62 (TCC) at [97] to [102] and the point was not doubted on appeal.

[109] See 49.16.3 (Individual receives benefit).

> accept that [s.724 ITA] only operates where the benefit received in a year exceeds the relevant income.

It is considered that the charge is on the lower of the value of the benefit and the amount of income of the person abroad. The value of a benefit in excess of the income does not come into charge, and if the transferor has power to enjoy the income apart from enjoyment condition C, then this provision does not apply.[110]

The INT Manual provides:

> **INTM600980: Power to enjoy - special rule relating to benefits** [Jan 2023]
>
> [The Manual summarises s.724 and continues:] This provision [s.724] does not apply if it is shown that the benefit derives directly or indirectly from income on which the individual has already been charged to income tax under the transfer of assets provision for that tax year or a previous tax year.
>
> This provision was considered in the case of *CIR v Botnar* (72 TC 205). Although it did not affect the outcome in that case, there is some helpful comment on it. The views expressed there appear to confirm that in the case of actual receipt of a benefit (as opposed to mere entitlement to receive), the provision is determinative of the charge to tax which could produce a radically different result than what might otherwise be the charge under the income charge. Further, that where the power to enjoy arises on this basis, the tax is charged not on the income which the individual has power to enjoy but on the value of the benefit. This may bear no relationship whatsoever to the income of the person abroad as long as it originated from it even indirectly. The Commissioner rejected the view that the provision only operates where the benefit received in a year exceeds the income of the person abroad.
>
> From this, where the conditions are met, the provision may have the effect of increasing the charge for a particular tax year to more than the actual income of the person abroad. This could occur if, for example, the value of the benefit received exceeded the income arising to the person abroad as a result of the transfer. In these circumstances the amount charged would be the value of the benefit received.
>
> Alternatively, if the benefit received in a particular tax year was less than the income arising to the person abroad as a result of the transfer, then the charge would be lower than the income as it would be limited

[110] See Venables, "Section 739 and benefits in kind", OTPR Vol 11 Issue 3 p.1, *http://www.khpplc.co.uk/reviews*

> to the value of the benefit received.

These points only arise where enjoyment condition C is met and other conditions are not met, which in practice only happens rarely if at all. The law would be simpler and more rational if s.724 were repealed. I wonder if it ever applies in practice.

49.22.4 *Transferor deductions/reliefs*

Section 746 ITA provides:

> (1) This section applies for the purpose of calculating the liability to income tax of an individual charged under section 720 or 727.
> (2) For the purpose of determining the deductions and reliefs allowed to the individual, the individual is to be treated as if the individual had actually received the amount by reference to which the income treated as arising to the individual under section 721 or 728 is determined.

The legislation does not identify what deductions and reliefs are applicable. An example might be foreign tax credit relief, which (strictly speaking) would not have been available in the absence of s.746, on the basis that the transferor's s.720 income is not the same as the income of the person abroad.[111]

49.23 Transferor receives capital sum

Section 727 ITA is an independent charging section. It applies, in short, where a transferor receives a capital sum.

Howard de Walden v IRC explains its purpose:

> The provision was made ... to meet devices by which a transferor took care to give himself no "power to enjoy" any income of a non-resident transferee company within the meaning of [s.723 ITA], but obtained the money he required, for example, by borrowing from the company, all the shares being vested (for example) in his children.[112]

The paradigm case is a non-resident trust or underlying company making an (arm's length) loan to a transferor who is excluded from benefit.

Many of the rules applying to s.720 also apply to s.727. In ITA they are set out twice, but I do not discuss them again here.

It is helpful to set out the provisions side by side. The important

[111] See too 47.4 (Settlor deductions/reliefs).
[112] 25 TC 121 at p.135.

differences are underlined:

Power to enjoy: s.720 ITA	**Receipt of capital sum: s.727 ITA**
(1) The charge under this section applies for the purpose of preventing the avoiding of liability to income tax by individuals who are UK resident by means of relevant transfers.	(1) [identical]
(2) Income tax is charged on income treated as arising to such an individual under section 721 (individuals with power to enjoy income as a result of relevant transactions).	(2) Income tax is charged on income treated as arising to such an individual under section 728 (individuals receiving capital sums as a result of relevant transactions).
(3) Tax is charged under this section on the amount of income treated as arising in the tax year. ...	(3) [identical]
(5) The person liable for any tax charged under this section is the individual to whom the income is treated as arising.	(4) [identical to (5)]
Power to enjoy: s.721 ITA	**Receipt of capital sum: s.728 ITA**
(1) Income is treated as arising to such an individual as is mentioned in section 720(1) in a tax year for income tax purposes if conditions A to C are met.	(1) Income is treated as arising to such an individual as is referred to in section 727(1) in a tax year for income tax purposes if—
(2) Condition A is that the individual has power in the tax year to enjoy income of a person abroad as a result of—	(a) income has become the income of a person abroad as a result of—
(a) a relevant transfer, (b) one or more associated operations, or (c) a relevant transfer and one or more associated operations.	[identical]
	(b) the capital receipt conditions are met in respect of the individual in the tax year (see section 729) , and
(3) Condition B is that the income of the person abroad would be chargeable	[No equivalent but condition B is not important as it is always met.]

to income tax if it were the individual's and received by the individual in the UK.	
(3A) Condition C is that the individual is UK resident for the tax year.	(c) the individual is UK resident for the tax year.
(3B) The amount of the income treated as arising under subsection (1) is (subject to sections 724 and 725) given by the following rules—	(1A) The amount of the income treated as arising under subsection (1) is (subject to subsection (2)) given by the following rules—
Rule 1 The amount is equal to the amount of the income of the person abroad if the individual— (a) is domiciled in the UK at any time in the tax year, or (b) is at any time in the tax year regarded for the purposes of section 718(1)(b)[113] as domiciled in the UK as a result of section 835BA having effect because of Condition A in that section being met formerly-domiciled resident].	*Rule 1* [Identical]
Rule 2 In any other case, the amount is equal to so much of the income of the person abroad as is not protected foreign-source income (see section 721A).	*Rule 2* In any other case, the amount is equal to so much of the income of the person abroad as is not protected foreign-source income (see section 729A).
(3BA) In a case in which rule 2 of subsection (3B) applies, so much of the income of the person abroad as is protected foreign-source income for the purposes of that rule counts as "protected income" for the purposes of section 733A(1)(b)(i).	(1B) In a case in which rule 2 of subsection (1A) applies, so much of the income of the person abroad as is protected foreign-source income for the purposes of that rule counts as "protected income" for the purposes of section 733A(1)(b)(i).
(3C) Subsection (1) does not apply if— (a) the individual is liable for income tax charged on the income of the person abroad by virtue of a charge not	(2A) [identical to (3C) opposite]

[113] See 48.5 ("Person abroad").

> contained in this Chapter [Chapter 2 Part 13, ToA], and
> (b) all that income tax has been paid.

49.23.1 *Nature of s.727 income*

EN ITA Change 111 provides:

> Section 739(3) ICTA [now s.727] does not deem the capital sum to be income; instead, it takes income which has become payable to persons abroad as a result of the transfer and deems that income to be the transferor's.

The amount of the capital sum does not matter. In *Vestey v IRC*:

> It is "any income" of the foreign transferees which is deemed to be the income of the recipient of a capital sum, [*indeed of each and every recipient of any capital sum*,][114] small or large, whenever received. From these words there is no escape.[115]

49.23.2 *s.727/settlor-interested trust overlap*

There is considerable overlap between s.727 and the settlor-interested trust code. Where a settlor receives a capital sum, it is necessary to consider the settlor-interested trust code even if the settlor is excluded.[116] A settlor who is entitled to receive a capital sum may have an interest under the settlement by virtue of that entitlement. But the settlor-interested trust code only applies to income at trust level, not a company level.

49.23.3 *s.720/s.727 overlap*

A transferor who receives a capital sum, may also be within s.720 on the basis that the transferor has power to enjoy. A transferor who is entitled to receive a capital sum may have power to enjoy simply by virtue of that entitlement. So there is considerable overlap between s.720 and s.727. The INT Manual provides:

> **INTM600680 which charge applies?** [Jan 2023]
> It is possible that for the same tax year an individual could meet the

[114] The words in italics are wrong, since s.727 is limited to the transferor; there might conceivably be two transferors who each receive a capital sum.

[115] 54 TC 503 at p.580.

[116] See 47.14 (Settlor receives capital sum).

> conditions to be potentially chargeable under both of the income charge provisions. The 'no duplication of charge' provisions described at INTM602360 ensure that the same income cannot be taken into account more than once for the purpose of an income charge. The result would be that, if the conditions for both charges were in fact met, only one charge would be made.

This was the case even before double-counting relief was enacted in 1981:

> [Sections 720 and 727 ITA] are ... concurrent and not cumulative. A person cannot be taxed in any one year on the same sum under both [s.720 and also s.727]. Like Warren Hastings, the Crown, in making this concession, doubtless stood amazed at its own moderation ... but make it it did.[117]

Before 2017 it was rare for s.727 to apply in a case where s.720 does not, that is, the transferor receives a capital sum without having power to enjoy. So it was rare to have to look at s.727. But this has changed as a result of a mismatch between the s.720/727 protected income rules.[118]

49.24 Capital receipt conditions

Section 729(1) ITA provides:

> For the purposes of section 728(1), the capital receipt conditions are met in respect of the individual in a tax year ("the relevant year") if—
> (a) either—
> (i) in the relevant year the individual receives or is entitled to receive any capital sum, whether before or after the relevant transfer, or
> (ii) in any earlier tax year the individual has received any capital sum, whether before or after the relevant transfer, and
> (b) the payment of that sum is (or, in the case of an entitlement, would be) in any way connected with any relevant transaction.

It is considered that "entitled to receive" requires a present entitlement and not a contingent or future entitlement. A person is not "entitled to receive" a sum until it is due. So if a transferor lends to a person abroad, on terms that the loan is repayable on a fixed date, the capital receipt

[117] *Vestey v IRC* 54 TC 503 at p.556.

[118] See 92.16 (s.727 protected-trust relief).

condition is not met before that date.[119] But if the debt is repayable on demand, the transferor is entitled to receive it even if they have not formally demanded it: a notice of demand is a merely administrative matter.

49.24.1 *Receipt by third party*

Section 729(4) ITA provides:

> For the purposes of subsection (1), a sum is treated as a capital sum which the individual ("A") receives or is entitled to receive if another person receives or is entitled to receive it—
> (a) at A's direction, or
> (b) as a result of the assignment by A of A's right to receive it.

49.24.2 *"Capital sum"*

The term "capital sum" is used here and in the settlor-interested trusts code. The definitions are (more or less) the same so it is convenient to consider them both here.

ToA: 729(3) ITA	**Settlor-interested trust: s.634(1) ITTOIA**
In subsection (1) "capital sum" means—	In this Chapter "capital sum" means—
(a) any sum paid or payable by way of loan or repayment of a loan, and	(a) any sum paid by way of loan or repayment of a loan, and
(b) any other sum paid or payable— (i) otherwise than as income, and (ii) not for full consideration in money or money's worth.	(b) any other sum which— (i) is paid otherwise than as income, and (ii) is not paid for full consideration in money or money's worth.[120]

This is an artificial definition, and it should perhaps be written with initial capitals, to reflect the technical nature of the expression.

If a person lends to T, T receives a capital sum. If T lends to a person, repayment of the loan to T is a capital sum. But loan is not defined and

[119] So in the definition of control, express provision is needed to deal with this; see 104.3.11 ("Entitled to acquire"). But an individual with a contingent or future entitlement may have power of enjoyment; see for instance 49.16.2 (Income increases value of asset).

[120] There are further rules in s.634 ITTOIA which are not discussed here.

has been given its strict meaning here.[121]

If T sells an asset at market value, leaving the purchase price outstanding, subsequent payment of the purchase price to T is not a capital sum, as defined, as:

(a) There is no loan
(b) There is full consideration

HMRC agree. The INT Manual provides:

> **INTM601060: Examples of capital sum** [Jan 2023]
> ... **Examples of situations where there may not be a capital sum for the purpose of this charge**
> - an individual transfers assets to a person abroad for full consideration and leaves the cost of the assets credited to his account with that person; the unpaid purchase money will not normally [?] be regarded as a loan following the decision in *Ramsden v CIR* (37 TC 619); however, although the capital sum test may not be met for the purpose of this income charge, the presence of an account with a person abroad to which sums are credited may be indicative of that individual having the power to enjoy income, for example as in the *Ramsden* case through [Enjoyment] Condition B in INTM600900.
> - promissory notes or debentures payable on demand are issued to the individual as part of the consideration for the transfer of assets; the amount payable under the notes, not being payable by way of loan and being payable for full consideration, is unlikely [?] to be a capital sum for this purpose, as was found in the case of *Lee v CIR* (24 TC 207); however, as discussed at INTM600900, such an issue of promissory notes may give rise to a power to enjoy the income of the person abroad and bring the individual within that income charge.

It is considered that the context shows that the expression "sum paid" should be construed broadly and includes transfer of an asset.[122]

In *Botnar v IRC* the Special Commissioners say:[123]

> In our judgment the entitlement to use the flat is not a capital sum within the definition in [s.729(3)]; in particular we hold that the

[121] See App.2.5 (Loan). The reader may wonder if the a Court today would have reached the same conclusion. But fortunately the doctrine of precedent means that the issue is not likely to arise.

[122] See 15.2.3 (Payment: WHT, PAYE).

[123] 72 TC 205 at p.266.

> entitlement to use was not a "sum" within any normal use of English.

The INT Manual provides:

> **INTM601060: Examples of capital sum** [Jan 2023]
> **...Other examples of situations where there may be a capital sum for the purpose of this charge**
>
> - the situation where an asset is transferred to a person abroad at an inflated price; where an individual transfers an asset and receives full consideration in money or money's worth, even though by general nature that consideration may be a 'capital' receipt, it would not be a 'capital sum' for the purpose of these provisions because of the specific wording in the legislation defining the meaning of the term for this purpose; hence it is only where an inflated price is received that there could be a capital sum for this purpose.
> - a capital distribution from a foreign company; a foreign company may, under the law of the jurisdiction in which it is established, be able to make a so-called 'capital distribution'; where such a distribution received by the individual is found in fact not to be an income receipt, and so satisfies the condition to be any other sum payable otherwise than as income, it can be a capital sum for this purpose; in considering whether any such payment or entitlement from a 'foreign possession' (the shareholding that results in the payment), is a capital sum, due regard must be had to UK tax law dealing with 'income' from foreign possessions.

These are indeed examples of a capital sum, but in each case the transferor would also have power to enjoy, and so s.720 would also apply.

49.24.3 *Connected with transfer*

The capital receipt conditions are only met if (in short) the payment of the capital sum is "in any way connected" with the transfer of assets abroad (or associated operations). I refer to this as the **"connection requirement"**.

"Connected with" is of course a broad expression.[124] The words "in any way" do not strictly add anything, but they show that the words are not to be construed narrowly.

In *Fynn v IRC*:[125]

(1) In 1948, T transferred assets ("the original assets") to an Irish

[124] See App 2.4.2 (In connection with).

[125] 37 TC 629.

company ("the original transfer").
(2) The company charged the assets for a debt ("the charge").
(3) In 1952/53, T lent the company £12,000 ("T's loan").

T was assessed on the income accruing to the company in 1951/52 and 1952/53 under (what is now) s.727.[126]

During those years T was entitled to receive a capital sum (repayment of T's loan). However, the (hypothetical) payment of that sum was not "connected" with the original transfer or the charge (an operation associated with the original transfer). So the connection requirement was not satisfied, so the capital receipt conditions were not satisfied, and s.727 did not apply.

Suppose the same facts but the loan were repaid out of the original assets. In that case T actually receives a capital sum, and the actual receipt is connected with the original transfer; so it is considered that the capital receipt condition would satisfied. (This did not happen in *Fynn*: T wisely released the loan, two years after it was made.)

The definition of capital sum is the only place where the expression "connected with" is used in the ToA provisions (though the definition of associated operations uses the comparable expression "in relation to" and it is suggested that the meaning is the same).

49.24.4 *Loan to transferor*

Section 729(2) ITA provides:

> But subsection (1)(a)(ii) does not apply merely because of the receipt of a sum by way of loan if the loan is wholly repaid before the relevant year begins.

This applies, in short, where:
(1) A person abroad lends to the transferor (T)
(2) The transferor repays the loan

The INT Manual provides a straightforward example:

> **INTM601040 Meaning of capital sum** [Jul 2023]
> ... Example
> In years 1 to 4 income arises to a person abroad as a result of a relevant transfer by an individual. The individual does not have any power to

[126] These facts raise interesting s.720 issues, which were not discussed in the case; see 49.19 (Power to enjoy: Causation).

> enjoy the income or entitlement to a capital sum, but in year 2 receives a loan. In year 3 the loan is repaid in full, and there is no ongoing entitlement to further loans or other capital sums. In these circumstances there would be an income charge in years 2 and 3.
>
> There would also be an ongoing charge for year 4 but for the proviso above relating to repayment of a loan, where that is in effect the only feature that triggers the income charge - receipt of entitlement to capital sums.

49.24.5 *Loan to person abroad*

The capital receipt condition in s.729(1) (so far as relevant) requires that:

> either—
>
> (i) in the relevant year the individual receives or is entitled to receive any capital sum, whether before or after the relevant transfer, or
>
> (ii) in any earlier tax year the individual has received any capital sum, whether before or after the relevant transfer

The condition in (a) is satisfied in a year if the individual receives *or is entitled to receive* a capital sum in that year. The condition is satisfied in a year if the individual received a capital sum in an earlier year.

The condition is not satisfied if:

(1) the individual was entitled to receive a capital sum in an earlier year but

(2) the entitlement has ceased[127] and the individual did not actually receive anything.

This was deliberate. EN ITA Change 111 provides:

> But the wording of section 739(3) of ICTA [now s.727] leaves the timing of the charge rather unclear. It reads:
>
> > Where, whether before or after any such transfer, such an individual receives or is entitled to receive any capital sum …
>
> Section 739(6) ICTA [now s.729(2) ITA] provides that income is not deemed to be the individual's under section [727] for any tax year "by reason only of his having received a sum by way of loan if that sum has been wholly repaid before the beginning of that year".[128] Therefore income may be deemed to be the individual's in other cases where there

[127] An assignment by the transferor does not count: see 49.24.1 (Receives or entitled to receive).

[128] See 49.24.4 (Loan to transferor).

> has been an actual receipt of a capital sum in a previous tax year. But [the source legislation] makes no provision about whether section [727] imposes a charge if the individual was merely entitled to receive a capital sum in a previous tax year. In practice, where entitlement to a capital sum has ceased HMRC do not pursue further liability under section [727]. Section 729 ITA gives effect to this practice by providing that the individual must either receive or be entitled to receive a capital sum in the tax year or have received a capital sum in an earlier tax year.

However it must be rare that a transferor is entitled to receive a capital sum without ever receiving a capital sum. An example would be if a transferor lent money to the person abroad and later waived the right to repayment.

The INT Manual considers the position of a loan from the individual to the person abroad:

> **INTM601040 Meaning of capital sum** [Jul 2023]
> ... It is not only the receipt of a loan by an individual that is a capital sum. The making of a loan by an individual to a person abroad can also satisfy this meaning, as it carries with it the entitlement to repayment. This entitlement would be an entitlement to a capital sum, and thus the condition would be met from the time that the loan is made to the person abroad. Any repayment of such a loan would itself be the receipt of a capital sum by the individual. This capital sum is not itself a loan and consequently ITA07/S729(2) does not apply (as this only applies to loans to the transferor), and so the repayment of the loan by the person abroad will not in itself stop the income charge from running in the years following repayment.

49.25 Time extent of s.727 charge

49.25.1 *Historic income*

It can happen that at one time the capital receipt conditions are not satisfied, and later they become satisfied. A simple example would be if the person abroad makes a loan to the transferor who is otherwise excluded from benefit: until the loan is made the transferor may not have received (or been entitled to receive) a capital sum; but on making the loan, the transferor does receive a capital sum so the capital receipt conditions become satisfied at that time.

A transferor who receives a capital sum is not taxed under s.727 on income arising to the person abroad in a year before the year that the capital receipt conditions are satisfied ("historic income"). Section 727 is not in that sense retrospective. In *Vestey v IRC*:[129]

> While the income of the non-resident trustees would be deemed to be the income of [the taxpayer] on her receipt of the £100,000 [capital sum] on 2 May 1966, *in that and subsequent financial years*, I see nothing in [s.727] which gives it retrospective effect. It does not provide that the income of the non-resident in any year before the person receives or is entitled to receive is to be deemed to be that person's income.

HMRC agree. The INT Manual provides:

> **INTM600660 General conditions: entitlement to capital sum** [Jul 2023]
> ... It should be noted that no liability can arise under this charge for a tax year before receipt or entitlement to a capital sum.

The alternative views would not be workable:

(1) In theory, s.727 might apply so that the historic income should retrospectively be deemed to be income of the transferor in the year that the income actually arose. That would require an unlimited number of past years to be reopened.

(2) In theory, s.727 might apply so that the historic income should be deemed to be the income of the transferor in the year of the receipt of the capital sum. That would still require all the past years of the person abroad to be reviewed. There is also the conundrum of how to treat income arising to the person abroad if the transferor was not UK resident during some of those years.

The rule that historic income is not taxed explains why the capital receipt conditions are satisfied if a transferor wh has no power to enjoy is merely entitled to receive a capital sum, even though they have not actually received anything. The application of s.727 makes sense here because on the subsequent (actual) receipt of the capital sum, the historic income would not otherwise be caught.

Walton J proposed a sensible solution to this issue in *Vestey* at first instance. He said that the charge under s.727 should limited to the amount of the capital sum. This view was rejected by two judges in the House of Lords who commented on the point.[130] However it remains arguable, as

[129] 54 TC 503 at p.594.

[130] See the comment of Lord Wilberforce set out in 49.23.1 (Nature of s.727 income).

the comments in *Vestey* were not necessary for the decision and so were not binding, the approach to statutory construction is now more purposive, and the problems which arise were not explored.

49.25.2 *Present and future income*

The s.727 charge applies to income arising in the year in which the capital receipt condition is met. Once that condition is met in one year, it is generally met in all future years, so s.727 in principle applies to the income of the person abroad in the year that the capital receipt condition is first met and all future years.

There are two narrow exceptions to this rule:

(1) a loan to the transferor which the transferor has repaid.[131]
(2) a loan to the person abroad which the transferor later waives.[132]

In general, therefore, the capital receipt conditions are met in a year if the transferor has received a capital sum in an earlier year.

HMRC agree. The INT Manual provides:

> **INTM600660 General conditions: entitlement to capital sum** [Jul 2023]
> ... But where there is such a receipt or entitlement, liability continues for any subsequent year for which there is income (there need be no further receipt of a capital sum). However, if entitlement to a capital sum completely ends and there are no other grounds for an income charge, liability under this charge will not normally be extended beyond the tax year in which that entitlement ceases.
> Where this charge applies for the first time, it is the whole of any income of the tax year that is potentially chargeable, not merely income arising from the date of receipt or entitlement to the capital sum. The same is the case for any tax year where entitlement to ends; the whole of any income of the tax year is potentially chargeable.

This seems harsh, but it makes sense, because once a transferor who has no power to enjoy has received one capital sum, it is reasonable to assume that they may receive more. Without this rule, income of the person abroad arising after the first capital sum, but before the second, would not otherwise be caught.

The position is different if a transferor who *does* have power to enjoy

[131] See 49.24.4 (Loan to transferor).
[132] See 49.24.5 (Loan to person abroad).

receives a capital sum. The receipt of the capital sum does not give rise to any charge under s.727 since all the income is taxed as the transferor's anyway. Suppose the transferor is subsequently excluded from benefit and ceases to have power to enjoy.

It has been suggested in these circumstances that all future income arising in the company will be deemed to be that of the unfortunate transferor. That would be absurd. In editions up to 2023 I said: "In practice HMRC do not take that point." But HMRC now float the possibility in a paragraph added when the former draft guidance was published in 2023. The INT Manual provides:

> **INTM600680 which charge applies?** [Jan 2023]
> ... It makes little practical difference which one of the two charges is assessed. For example, in a year when both provisions applied, the income may be assessed on the basis that the individual had power to enjoy. But in a future year, perhaps the power to enjoy conditions no longer applied, such that the income charge under ITA07/S720 was not applicable. If the income could continue to be assessed for later years under the capital sum conditions, the income would continue to be assessed but under ITA07/S727.

It is suggested that s.727 does not normally apply in a situation where s.720 applies, so a capital sum received at that time should be disregarded. A court would no doubt look at the matter differently if there were arrangements under which the transferor effectively enjoyed the income of future years.

The same problem arises if:

(1) Trustees hold a company under which the transferor has power to enjoy, and under which they are taxed under s.720 ITA.
(2) The transferor receives a capital sum.
(3) The trustees then sell the company to a third party.

It has been suggested that all future income arising in the company will be deemed to be that of the unfortunate transferor (though they may not have a right to know what that income will be). That would be absurd. In practice HMRC do not take that point."

It is suggested that s.727 does not normally apply in this situation. A court would no doubt look at the matter differently if there were arrangements under which the transferor effectively enjoyed the company's future income.

49.26 s.720 remittance basis

Section 726(1) ITA provides:

> This section applies in relation to income treated under section 721 as arising to an individual in a tax year ("the deemed income") if section 809B, 809D or 809E (remittance basis) applies to the individual for that year.

I call this the "**s.720 remittance basis**".

For clarity I gloss the expression "deemed income" as "deemed [s.720] income".

Section 726(2) ITA defines the term "foreign" deemed income:

> For the purposes of this section the deemed [s.720] income is "foreign" if (and to the corresponding extent that) the income mentioned in section 721(2) [the income of the person abroad[133]] would be relevant foreign income if it were the individual's.[134]

49.26.1 *The relief*

Assuming the condition in s.726(1) is met, and armed with these definitions, we move on to the relief. Section 726(3) ITA provides:

> Treat the foreign deemed [s.720] income as relevant foreign income of the individual.

Section 720 income is fictional income distinct from the actual income of the person abroad. Since fictional income cannot be remitted, the remittance basis would not work. So s.726(4) ITA provides:

> For the purposes of chapter A1 of part 14 (remittance basis), treat so much of the income within section 721(2) as would be relevant foreign income if it were the individual's as deriving from the foreign deemed [s.720] income.

In short, the remittance basis applies as if the income accruing to the person abroad were the income of the transferor. There is a tax charge if the income of the person abroad is received/brought/used in the UK by the transferor or by a relevant person (in relation to the transferor).

It is desirable for trusts and companies within s.720 to segregate (1)

[133] See 49.14 (Condition A: Power to enjoy).

[134] For the reason for the wording ("would be RFI if it were the individual's"), see 16.9.3 (Relevant foreign income).

foreign income and (2) capital. They can then remit capital (IT-free) rather than income (chargeable at IT rates). If they fail to do so then the mixed fund rules will apply.

49.26.2 *When is s.726 needed?*

It will be unusual to need the s.720 remittance basis, from 2017/18, because in most cases where the conditions for the s.720 remittance basis are met, s.720 protected-trust relief will be or at least could be available.[135] The s.720 remittance basis is still needed where protected-trust relief is not available. The most common case is where income arises to a company abroad in which T has a direct interest (in short, the company is not held in a trust).

49.26.3 *Remittance in split year*

Section 726(5) ITA provides:

> In the application of section 832 of ITTOIA 2005 to the foreign deemed [s.720] income, subsection (2) of that section has effect with the omission of paragraph (b).

The significance is that (contrary to the usual rule) s.720 income is taxable if it is remitted during the overseas part of a split year.[136]

There is no good reason for that.[137] The s.720 remittance basis ought to operate in the same way as for ordinary foreign income. But the point will not often arise.

49.26.4 *Payment of s.720 income to transferor when non-resident*

Suppose:

(1) Year 1: Income ("company income") accrues to a company within s.720.

Tax analysis: In practice the company income will often be protected s.720 income, so s.720 does not apply and no issue arises. But assume for the purposes of the example that the company income is not protected s.720 income (eg the company is not held in a trust, or, perhaps, the trust is tainted). So the transferor ("T") receives s.720 income ("T's s.720 income). Assume that T's s.720 income is (un)taxed under the s.720

[135] See 92.15 (s.720: Protected-trust relief).

[136] See 17.13.1 (Remittance in split-year).

[137] The same (unfair) rules applies for s.731: see 50.39.3 (Remittance in split year).

remittance basis.

(2) Year 2:
   (a) T becomes non-resident.
   (b) The company distributes its income by way of dividend ("the company dividend"; similar points arise if the distribution is by way of liquidation).

Tax analysis: Because the company dividend is received in a non-resident year, it is not taxed on receipt.

(3) Year 3:
   (a) T becomes UK resident.
   (b) T remits the company dividend to the UK.

Tax analysis: In practice the company dividend will often be taxed at this point as TNR income. But assume for the purposes of the example that T is not caught by the TNR rules (eg T is not a temporary non-resident, not having been in the UK for four of the previous seven years).

The question then is whether the dividend received in the UK in year 3 constitutes a remittance of the s.720 income of year 1. Is the dividend which the individual received derived from the s.720 income? The answer is that the dividend received is derived from the income of the person abroad, and so is taxable on receipt in the UK in year 3.[138]

In short, one cannot "wash" income taxable on the s.720 remittance basis by a distribution to T in a year of T's non-residence. That view fits the object of s.720 which is to put the transferor in the same position as if they had not made the transfer: see 49.2 (Purpose of transferor charge).

49.26.5 *Pre-2008 s.720 income*

In the following discussion I use the term **"pre-2008 s.720 income"** to mean foreign income arising before 6 April 2008, which

(1) fell within s.720 ITA or its predecessor, s.739 ICTA, but
(2) qualified for relief under s.726 (in its 2007/08 form), or its predecessor, s.743(3) ICTA, a kind of remittance basis which in earlier editions of this work I called "the foreign domicile defence."

There was no tax charge when the income arose if it was not received in the UK.

[138] See s.726(4) discussed at 49.26 (s.720 remittance basis). This seems even clearer if one remembers that distribution relief would be available, had the dividend in fact been taxable; see 51.5 (Distribution relief).

Before 2008/09 it is considered that there was no charge under these sections if such income was received outside the UK but later brought to the UK. This was so whether the income was brought to the UK by:

(1) the person abroad who received it; or
(2) the transferor (if they received the income outside the UK from the person abroad).[139]

Para 170 schedule 7 FA 2008 provides:

> The amendments made by paras 161 to 179 have effect for the tax year 2008-09 and subsequent tax years.

Pre-2008 s.720 income remitted after 2008/09 is not caught by s.726 in its current form, as the condition in s.726(1)(a) is not met.[140] So there is still no charge on the remittance of pre-2008 s.720 income. This is right and fair, since there was no charge on remittance before 2008. However (given the retrospective operation of some other 2008 reforms) this may have been an oversight. A passage in the TAH suggests its author thought that pre-2008 s.720 income is taxable on remittance after 6 April 2008.[141] But it seems to me that this is clearly wrong.

Pre-2008 s.720 income may also qualify for relief as "transitionally protected income".[142]

[139] See *Taxation of Foreign Domiciliaries* 6th ed para 16.14 (s.720 foreign domicile defence). There were good reasons for this: see *Taxation of Foreign Domiciliaries* 6th ed para 14.12 (Critique of s.648 clawback). Needless to say, no reason was given for changing the position.

[140] Contrast the usual RFI remittance basis, where para 83 sch 7 FA 2008 fills that gap: see 17.16.1 (Pre-2008 RFI/gains).

[141] TAH para 1224 provides:

> "The provisions described in TAH 1223 [including the current s.720 remittance basis] have effect for the tax year 2008-09 and subsequent years. There are no specific transitional arrangements for introduction of the new provisions. As the [s.720] income charge only looks at income arising to the person abroad in the tax year it should not be necessary to have regard to income of earlier years in determining whether there is an amount that is to be regarded as foreign deemed income. However if there is foreign deemed income then in considering any possible charge under Part 8 ITTOIA it will be appropriate to consider all sums remitted to the UK in the tax year even if they arise, for example, from income of periods prior to the introduction of these provisions. Those remittances will fall to be tested against the rules in Chapter A1 Part 14 ITA 2007 as to whether they are taxable remittances."

[142] See 92.15.3 (Pre-2017 s.720 income).

49.26.6 *s.720 income 2005-08*

In the following discussion I use the term "**2005-2008 s.720 income**" to mean foreign income arising in the years 2005/06 to 2007/08 (inclusive), which fell within (what was then) s.739 ICTA.

TAH para 1222 records the bizarre view that ITTOIA absent-mindedly abolished the foreign domicile defence, formerly in s.743(3) ICTA, so that in the years 2005-2008, s.720 income was always charged on an arising basis:

> Following the Tax Law Rewrite [ITTOIA] new and separate charging provisions were introduced for all types of foreign income replacing the general charge under what was Case IV/V of Schedule D. The new provisions, included in ITTOIA, also provided, on a claim, an alternative basis for calculating certain income categorised as 'relevant foreign income' and the amount on which an individual would be taxed.
> From the introduction of ITTOIA non-UK domicile status could impact this relevant foreign income and resulted broadly speaking in the income subject to the claim being taxed only when received in the UK.
> Apart from minor adjustments consequential upon the introduction of ITTOIA the transfer of assets provisions giving exclusion from charge for certain income of non-UK domiciled individuals remained largely unchanged. However the exclusion [s.743(3) ICTA] was only for income that would not be chargeable to tax on the basis of domicile status alone.
> It could be argued that following the new charging provisions brought into effect by ITTOIA, which carried no distinction on the basis of domicile, that from 6 April 2005 there was no such income that fell to be excluded on the basis of domicile under the transfer of assets provisions.

I have not come across any reference to this argument before the publication of the TAH in 2009, nor do HMRC say expressly whether they regard it as correct. I find it hard to imagine that anyone could take the argument seriously. But in practice the point is academic as HMRC will not usually take any notice of it:

> However the introduction of ITTOIA was not intended to change the law under transfer of assets in this way and as a result HMRC continues to operate the income charge provisions in this interim period in the same way that they were operated prior to April 2005, subject to cases where there appears to be manipulation of the interaction of the new provisions.
> Where you identify a case that appears to involve manipulation refer it to the Transfer of Assets Technical Adviser in CAR (Residency)

Offshore Personal Tax Team.

The years 2005-2008 are (in short) out of time to assess. But the point is not entirely academic, as there will be UK resident individuals who were remittance basis taxpayers in those years, and whose 2005-2008 s.720 income is still held offshore. If the argument were actually right, so that income was by law taxed on an arising basis, without any foreign domicile defence, then HMRC could not assess the income in a subsequent year when it was remitted. One could envisage circumstances when taxpayers would want to raise the argument. Similar issues would arise in relation to the s.624 remittance basis. However I doubt if these wider ramifications of the argument will ever need to be considered.

49.27 s.720/s.624 interaction

Section 721(3C) ITA provides:

> Subsection (1) does not apply if—
> (a) the individual [the transferor] is liable for income tax charged on the income of the person abroad by virtue of a charge not contained in this Chapter [Chapter 2 Part 13, ToA], and
> (b) all that income tax has been paid.

If a settlor/transferor creates a non-resident settlor-interested trust, the charge on trust income is under s.624 ITTOIA, which has priority over s.720 which might otherwise apply.[143] That matters as s.624 confers a statutory tax indemnity,[144] which s.720 does not.[145]

[143] Section 721(3C) is not strictly needed, because under s.624 the income arising under the settlement is the income of the settlor and of the settlor alone. Thus the person abroad (the non-resident trust) does not have any income. So the position was the same even before the enactment of s.721(3C) ITA. The point is now of historical interest only, but if authority is needed for years prior to 2013, the point is confirmed in *Dunsby v HMRC* [2020] UKFTT 271 (TC) at [173].
HMRC do not seem to agree. The INT Manual provides:

> **INTM600940: Power to enjoy - condition D** [Jan 2023]
> This power to enjoy and with it the income charge can apply notwithstanding that income arising to the trustees of a settlement may be deemed to be that of the settlor under the Settlements Legislation, (Chapter 5, Part 5 ITTOIA 2005). See INTM602360 where more than one set of charging provisions may appear to apply in relation to the same income.

[144] See 101.2 (Settlor trust-tax indemnities).

[145] The 2018/19 edition considered the position previous to s.721(3C) but I omit that here as it is now of historical interest only.

Dunsby v HMRC[146] considered the position if the settlor and the transferor were different persons:

(1) G (settlor), a non-resident, created a settlor-interested trust and (UK source) income was treated as arising to her under s.624; and
(2) T (the transferor) had power to enjoy the income.

In these circumstances s.720 could apply. It seems straightforward: T has power to enjoy income of a person abroad (namely G). T would enjoy the usual transferor's credit for tax paid by G.

49.28 No indemnity for transferor

The transferor has no indemnity against the person abroad for tax paid under s.720:

(1) There is no statutory indemnity.[147]
(2) There is no indemnity under English (common law) principles of restitution (even assuming, in the transferor's favour, that the English court has jurisdiction, or that the relevant jurisdiction applies similar principles).

49.29 Tax return: s.720 income

S.720 income is returned in boxes 10-13 in the Foreign pages (form SA106) 2022/23. The rubric to these boxes is "Dividend income received by a person abroad" and "All other income received by a person abroad and any remitted 'ring fenced' foreign income".

SA106 Notes 2022/23 provides:

> ***Dividends and all other income received by a person abroad***
> **Boxes 10 to 13**
> You may need to fill in boxes 10 to 13 if you transferred or have taken part in the transfer of assets so that a person abroad received income. Put all items chargeable as income under the transfer of assets provisions in this section.

Helpsheet 262 (Income and benefits from transfers of assets abroad and income from Non-Resident Trusts - 2021) provides:

[146] For the facts of this case, see App.2.2.7 (Pre-arrangement steps).

[147] The absence of a statutory indemnity is sensible, as an indemnity would not be appropriate in all the circumstances where s.720 might apply.

> **Reporting income**
>
> Unless you're completing box 46 [the motive defence box[148]] on page F6 of the 'Foreign' pages' report the amount of income as follows:
>
> - enter in box 11 on page F3 of the 'Foreign' pages details of all dividends received on which you are chargeable including any allowable foreign tax credit
> - enter in box 13 on page F3 of the 'Foreign' pages all other income including any tax paid on that income
>
> You should enter details of the relevant transactions that have given rise to the income, and the offshore structures involved, in the 'Any other information' box, box 19 on page TR 7 of your tax return.
>
> You should enter all income that's chargeable to tax under the transfer of assets provisions at boxes 11 and 13 of the 'Foreign' pages, not in the corresponding boxes elsewhere in the return for the type of income involved. For example, if interest income arose to a foreign company and that income is treated as yours under the transfer of assets provisions, then you should enter the income at box 13, not in the relevant boxes for interest.
>
> If you are non-UK domiciled and the income arising to the person abroad is not 'protected foreign income' (see the section on Trust Protections and Protected Foreign Income) you have to report the income arising to the person abroad exactly as described above. There is, however, an exception for this if the remittance basis applies or has applied to you.

This reflects the rule that s.720 income is distinct from the income of the person abroad. Boxes 11 and 13 make sense, but I am not sure what boxes 10 and 12 are for.

49.30 DT relief: s.720 income

49.30.1 *Foreign tax credit relief*

Where income of the person abroad is subject to foreign tax, foreign tax credit relief in principle applies for the benefit of the transferor.

HMRC Helpsheet HS262[149] provides:

[148] See 52.33.1 (When disclosure required).

[149] Income and benefits from transfers of assets abroad and income from Non-Resident Trusts (2024) updated 6 April 2024 *https://www.gov.uk/government/publications/income-and-benefits-from-transfers-of-assets-abroad-and-income-from-non-resident-trusts-hs262-self-assessment-helpsheet/hs262-income-and-benefits-from-transfers-of-assets-abroad-and-incom*

> **Tax paid on the income**
> If you are claiming relief for foreign tax, and you want to claim Foreign Tax Credit Relief (FTCR)(read page FN3 of the 'Foreign' notes), enter the following on the schedule:
> Column A — Country or territory code
> Column B — Amount of income arising or received before any tax is taken off
> Column C — Foreign tax taken off or paid
> Column E — That you wish to claim FTCR and the rate of tax allowed (read page FN3 of the 'Foreign' notes)
> Column F — Amount included in boxes 11 and 13, which should be the amount arising before any tax is taken off
> If you do not want to claim FCTR for foreign tax, do not make an entry in Column E. The amount you include in boxes 11 and 13 should be the income after foreign tax.

49.30.2 *Person abroad treaty non-resident*

This section considers whether third-party DT relief is available where:

(1) Income accrues to a person abroad who is treaty-resident in a foreign state.
(2) The transferor is UK tax-resident and not treaty-resident in a foreign state.
(3) The transferor is in principle subject to tax under s.720.[150]

Under the pre-ITA wording, I think the generally held view among practitioners was that s.739 ICTA deemed income of the transferor was the same as the income of the person abroad. It followed that the transferor could in principle claim DT exemptions provided that the income qualified for the relief. The same applied under ITA in its pre-2013 form. However HMRC took the opposite view, which was upheld, rightly or wrongly, in *Davies v HMRC,*[151] so the pre-2013 law is now

e-from-non-resident-trusts-2024

[150] Similar points apply to s.727; see 49.23.1 (Nature of s.727 income).

[151] [2020] UKUT 67 (TCC) at [78]:

> "The transfer of assets abroad provisions deem the profits of ABP to be the income of the Appellants and then charge the deemed income of the Appellants to tax. However, those provisions charge the income to tax as income of a miscellaneous character and not as trading profits arising 15 to the Appellants. The Appellants are not relieved against that tax under Article 7 of the Treaty because the UK is not taxing the profits of ABP but is taxing something different,

settled.[152]

The 2013 changes were intended to ensure that the s.720 income of the transferor was not the same as the income of the person abroad. So it is now clear that the transferor does not qualify for third-party treaty relief.[153]

EN FB 2013 provides:

> 25.New subsection 721(3A) clarifies that the income that is treated as arising to the individual in subsection 721(1) is not the income that the individual abroad receives, but an amount that is equal to it...
> 57. ... a change that clarifies[154] how the transfer of assets rules operate in relation to reliefs under double taxation agreements. This will make it clear that neither a treaty provision nor the transfer of assets legislation can allow a relief that would not otherwise be due.

In addition, the Savings Clause would now disapply treaty relief, by a more direct and satisfactory route.[155] But that solution, implemented by the BEPS MLI, was not available in 2013.

49.30.3 *Transferor treaty non-resident*

This section considers whether DT reliefs are available where:

(1) Income accrues to a person abroad who is not treaty-resident in a foreign state

(2) The transferor is UK-law UK resident but treaty-resident in a foreign state

namely, the deemed income of the Appellants. It is nothing to the point that the deemed income of the Appellants is computed by reference to the profits of ABP. It remains the case that the deemed income of the Appellants is not the profits of ABP; 20 and it remains the case that the trading profits of ABP are taxed by Mauritius and not by the UK."

[152] See 109.4.2 (Characterisation: Courts view). See too 91.7.8 (s.624/720 income; s.3/86 gain).

[153] See 109.1 (Third-party DT relief).

[154] The "clarification" constituted a change in the law, at least as most practitioners understood it to be at the time. But there is a long tradition of misdescribing substantial tax changes as clarification; see App.1.2 (Clarify/modernise/reform). The rewriting of the ToA rules required to achieve the "clarification" has left the statutory wording more complicated, and difficult to follow. Since the object was simply to deny DT relief where the person abroad was treaty non-resident, why did the drafter not just say so? The reasons were, perhaps, to support the HMRC view that that was the position before 2013, and, perhaps, to disguise a treaty breach. But all this is now of historical interest only.

[155] See 109.5 (Savings Clause).

(3) The individual is in principle subject to tax under s.720.

Can the transferor claim DT exemptions? On the basis that s.720 income is distinct from the income of the person abroad, the transferor may do so under the "Other Income" article, regardless of the type of income which accrued to the person abroad; even if, say, the income of the person abroad is of a type which would not normally qualify for DT exemption, such as UK source property income.[156]

In some treaties, the "Other Income" exemption only applies if the income is "beneficially owned" by the transferor. The point is the same as for s.624.[157] Section 720 income is not "beneficially owned" by the transferor as a matter of property law. But since for tax purposes it is deemed to be the income of the transferor, this requirement is deemed to be satisfied.

In the US/UK DTA, this is expressly dealt with: see 91.7.8 (s.624/720 income; s.3/86 gain).

[156] See 50.61.2 (Individual treaty-resident outside UK); 33.20 (DT relief: "Other Income").

[157] See 47.18.3 (Settlor treaty-resident outside UK).

CHAPTER FIFTY

TRANSFER OF ASSETS ABROAD: BENEFITS

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50.1 s.731 charge/s.731 income

This chapter considers the IT charge under s.731 ITA.

Section 731(1) ITA imposes the charge to tax:

> Income tax is charged on income treated as arising to an individual under section 732 (individuals receiving a benefit as a result of relevant transactions).

In this book "**s.731 charge**" is the charge under this section. The INT Manual calls it "the benefits charge".[1]

Statute frequently refers to:

> income treated as arising under s.732[2]

I refer to this as "**s.731 income**"**.** (It might be called "s.732 income" but the charge is under s.731.) Statute sometimes uses the term "deemed income" which I gloss as "deemed [s.731] income".

50.2 s.731 application conditions

The s.731 charge applies if income is treated as arising under s.732, to which we turn as the second stage of our journey. Section 732(1) ITA begins:

> This section applies if—

Five conditions then follow, which I call "**s.731 application conditions**". The conditions are as follows:

> *(a) a relevant transfer occurs*

I call this the "**relevant transfer condition**".

> *(b) an individual receives a benefit in a tax year*

I refer to the individual as the **"individual [beneficiary]"**.

[1] A note on terminology: The s.731 charge is not the only ToA charge on benefits, but it is the principal one. So the accurate label would be **"s.731 benefits charge"**. I abbreviate that to "s.731 charge". This is not a transparent label, but there is no short descriptive label which does justice to the complexities of this charge.
I formerly described the s.731 charge as the "non-transferors charge", because it applied to individuals other than the transferor. From 2017 the charge may also apply to the transferor, so this label ceased to be apt.

[2] Occasionally the wording is: *Income treated under section 732 as arising...*

> *(c) the benefit is provided out of assets which are available for the purpose as a result of—*
> *(i) the transfer, or*
> *(ii) one or more associated operations*

I call this the **"benefit causation condition"**.

> *(d) where there is a time in the year when the individual [beneficiary] is relevantly domiciled, the individual is not liable to income tax under section 720 or 727 by reference to the transfer*

I call this the **"taxable-transferor defence"**.

> *(e) the individual [beneficiary] is not liable to income tax, under any provision that is none of*
> *[i] section 731 of this Act and*
> *[ii] sections 643A, 643J and 643L of ITTOIA 2005,*
> *on the amount or value of the benefit.*

I call this the **"capital-benefit condition"**.

Where these conditions are met, and the motive defence does not apply, I describe the individual/person abroad as being **"within section 731"**.

In summary:

Para	**s.731 application condition**	**See para**
(a)	relevant transfer	50.3
(b)	benefit	50.4
(c)	benefit caused by transfer	50.13
(d)	taxable-transferor defence	50.15
(e)	capital benefit	50.16

50.3 Relevant transfer condition

The first s.731 application condition is the relevant transfer condition. Section 732(1) ITA provides:

> This section applies if—
> (a) a relevant transfer[3] occurs

Despite the present tense ("occurs") this condition is met in a year if a relevant transfer occurred in an earlier year. Grammarians call this "the historic present".[4]

[3] See 48.3 ("Relevant transfer") .

[4] *https://en.wikipedia.org/wiki/Historical_present*

50.4 Benefit

The second s.731 application condition requires that the individual receives a benefit. Section 732(1) ITA provides:

> This section applies if ...
> (b) an individual *receives a benefit* in that tax year.

The word benefit is common in tax statutes and in other areas of law.[5] So there is plenty of material for discussion. But the meaning, particularly at the boundaries, varies according to the context. In this section I focus on the meaning of "benefit" in the context of s.731 and s.87 TCGA; in these provisions the issues are (more or less) the same.

Similar issues arise in other contexts. It is not practical to write a full list, but they include:

Topic	**See**
Tax charges on value of a benefit:	
Benefit from retirement benefit scheme	s.394 ITEPA
Employment-related benefits in kind	39.35
Payment on termination of employment	34.38
Tax charges if possibility of benefit (regardless of value):	
s.624 (settlor-interested trusts)	
s.86 (settlor-interested trusts)	
s.720 (power to enjoy)	49.16.4 [6]

There is (sensibly) no statutory definition of benefit for ToA purposes.[7]

The starting point is that "benefit" is a word of wide import.

For the benefit of funding a beneficiary's tax appeal, see 52.35 (Appeals).

50.4.1 *Full consideration/arm's length*

In its natural sense, the word benefit does not include a transaction for

[5] For discussion of "benefit" in a trust law context see Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 13.13 (What does a settlor exclusion clause cover?).

[6] It is self-evident that the meaning of benefit is the same in s.720/731; but for completeness, RI 201 confirms this:

> "Benefit" for the purposes of [s.731] is treated as including all benefits taken into account in determining whether an individual has power to enjoy income for the purposes of [s.720 ITA].

[7] For completeness: The pre-ITA legislation stated that "benefit" included a payment of any kind: s.742(9)(c) ICTA. This had (more or less) no effect, and was sensibly omitted in the ITA rewrite.

which a person gives full consideration.[8] This is so even if the transaction is between connected persons.

Likewise the term benefit in its natural sense does not include an arm's length transaction. Of course an arm's length transaction will normally be made for full consideration; but it is suggested that an arm's length transaction is not a benefit even if, owing to some mistake, the individual gives less than full consideration.[9] It is sufficient that there is no gratuitous intent.

However, context may show that "benefit" may include a transaction for full consideration. The boundaries of the word "benefit" can reach that far. One example is the employment-related loan rules:

> In *Williams v Todd*,[10] Peter Gibson J was concerned to construe the word 'benefit' in the expression 'a loan … of which the benefit is obtained by reason of his employment' [and] in the expression 'an amount equal to whatever is the cash equivalent of the benefit of the loan for that year'. It is a perfectly ordinary use of language to speak of a borrower receiving the benefit of a loan, even if it is at a full commercial rate ...[11]

50.4.2 *Conferring equitable interest*

RI 201 provides:

> For the purposes of [s.731 ITA] a benefit is treated as not including ... the giving of a life interest to a beneficiary...

Without wishing to be pedantic, I think a trust lawyer would prefer to say "confer" a life interest rather than "give" a life interest. Trustees do not make "gifts": they are fiduciaries. But nothing turns on which term is used.

Conferring a life interest is not a benefit if the interest is revocable (or else the value of the benefit is nil). If the interest is not revocable, then its

[8] This is self-evident; but if authority is needed, see *IRC v Lactagol* 35 TC 230 and the employment-related benefit in kind cases discussed at 39.35.3 (Benefit).
For CGT the position is dealt with by statute, but only for the avoidance of doubt: see 61.7.8 (Arm's length relief). Note the reference to arm's length transactions in the passage from *Cooper* cited at 50.4.5 (Benefit on termination of trust).

[9] See *Wilson v Clayton* 77 TC 1 discussed at 39.35.3 (Benefit).

[10] [1988] STC 676. The case concerned the predecessor to the employment-related loan rules.

[11] *HMRC v Apollo Fuels* [2016] EWCA Civ 157 at [67].

receipt is in the widest sense a benefit, but for ToA purposes it should be regarded as a right to a future benefit, rather than an immediate benefit. To tax a "benefit" of this kind is clearly outside the scheme of the ToA code. Otherwise there would be a double charge, eg,

(1) when trustees appoint assets to a beneficiary contingently on attaining the age of 21 and again
(2) when the beneficiary reaches 21 and becomes absolutely entitled.[12]

Although RI 201 refers to a *life* interest, the same reasoning must apply to any interest under a settlement.

The usual way to confer a life interest is by the trustees exercising a power of appointment. Other possible ways are by exercise of a power of advancement or re-settlement. It makes no difference for tax purposes how the interest is conferred.

50.4.3 *Sale of equitable interest*

RI 201 states:

> For the purposes of [s.731 ITA] a benefit is treated as not including ... the receipt by a beneficiary of the proceeds of selling a life interest.

A sale of a life interest is outside the scope of s.731 because a sale at market value is not a "benefit" to the vendor, or because the value of the "benefit" (if there was one) is zero.[13]

If the purchase price is knowingly more than market value the purchaser provides a benefit to the vendor, but the benefit is not provided out of trust assets so it is not within s.731.

Although RI 201 refers to a *life* interest, the same reasoning must apply

[12] The Special Commissioners reached this conclusion in the context of employment-related benefits: *Dextra Accessories v Macdonald* [2002] UKSC SPC00331 at [9]-[12]. The point was not appealed. But that is no longer the law: *RFC 2012 Plc (formerly Rangers Football Club) v AG* [2017] UKSC 45 at [57].
In the context of s.731, one could also reach the same conclusion by saying that the "benefit" (if there was one) was not "provided out" of trust assets. In the context of s.87 TCGA, one might reach the same conclusion by saying that the "benefit" (if there was one) is not "from the trustees". But the better analysis is simply that conferring an interest under the settlement is simply not a "benefit" within the meaning of the statutory provisions.

[13] The drafter of FA 1984 sch 14 para 5(4) reached the same conclusion for the purpose of (what is now) s.87 TCGA.

to any interest under a settlement.[14]

What about an avoidance scheme where:

(1) The trustees appoint an interest to a beneficiary contingent on the beneficiary surviving a short period.

(2) The beneficiary sells the interest to a non-resident purchaser.

The object is to reduce tax rates from IT to CGT. This would fail on the GAAR, or *Ramsay,* and indeed technically, on the basis that the general principle that conferring an equitable interest is not a benefit would not apply to a benefit conferred with a view to selling it rather than retaining it.[15]

50.4.4 *Sale of company within s.731*

The same reasoning applies on the sale of shares or securities in a company within s.731. This leads to an interesting anomaly:

(1) An individual ("B") holds shares in a company which has accumulated relevant income within s.731. B sells the shares.
No charge arises under s.731 as B does not receive a benefit (either on the sale, or on receipt of the proceeds of sale, or on spending them).

(2) Trustees hold shares in a company which has accumulated relevant income. They sell the company.
The sale proceeds represent the relevant income[16] and so if the trustees appoint the proceeds to B, B receives a benefit taxable under s.731.

50.4.5 *Benefit on termination of trust*

Suppose:

(1) A beneficiary is entitled to trust property absolutely subject to satisfying some contingency (eg attaining the age of 25).

(2) The contingency is satisfied (the beneficiary reaches 25 and becomes entitled to the trust property).

There is a "capital payment" for the purposes of s.87 TCGA: see s.97(2)

[14] On a sale of an equitable interest, watch:
(1) CGT on the disposal of the interest; and
(2) schedule 4A TCGA.

[15] The idea is not a new one, and (in a different context) a variant of it failed in *Chinn v Collins*; see 87.5.7 (Trust appointment: Filling blanks).

[16] See 50.33 (Income reinvested: Tracing).

TCGA.[17] There is no equivalent provision in the ToA rules. However, it is considered that the beneficiary does receive a "benefit" and the value of the "benefit" is equal to the value of the trust property. The boundaries of the concepts of "value" and "benefit" can reach that far (perhaps only just);[18] and any other view would be inconsistent with the scheme of the ToA provisions.

This view is supported by *Cooper v Billingham*:[19]

> The whole scheme of the legislation requires the Court to see what benefit a beneficiary actually receives, in cash or in kind, otherwise than as income or under an arm's-length transaction. Any pre-existing beneficial interest belonging to the beneficiary is irrelevant. The Judge dealt with this point shortly[20] but there was no need for him to say more.

Similarly, if L is entitled to a life interest, and a trust asset is transferred to L absolutely, the value of the benefit received is the value of the asset, not the value of the reversionary interest in the asset.[21]

50.4.6 *Benefit: liquidation/redemption*

A similar point arises where:

(1) A shareholder holds shares in a company within s.731.

(2) The shareholder receives assets of the company on the liquidation of the company or on the redemption of its shares.

It is arguable that the shareholder does not receive a "benefit" since they merely receive the property to which they are entitled in the liquidation or redemption; or (which comes to the same thing) that the value of the "benefit" is nil. After all, a sale of the shares would not be a benefit, and is commercially similar. And no-one would say that there is a benefit for the purposes of employment income benefit in kind rules. On the other

[17] See 61.7.3 (Termination of settlement).

[18] Contrast *R v Allen* [2000] 2 All ER 142 where the CoA understood the word in a comparable way in order to uphold a confiscation order. *https://www.kessler.co.uk/wp-content/uploads/2015/02/R-v-Allen.pdf*

[19] 74 TC 139 CoA at [39].

[20] The judge said: "The recipient's existing interest under the trust has to be left out of the calculation for the purpose of valuing the benefit" *Cooper v Billingham* 74 TC 139 at p.155.

[21] This was stated by the judge in *Cooper v Billingham* 74 TC 139 at p.155. It is the converse of the rule that conferring a life interest is not a benefit: see 50.4.2 (Conferring equitable interest).

hand, the liquidation is more analogous to becoming entitled under a trust than a sale.[22] The better view, consistent with the scheme of the Act, is that the receipt of funds from the company is a "benefit" for the purposes of s.731. If that were not so, it would be possible to avoid s.731 by an arrangement under which:

(1) T transfers assets to a company.
(2) T transfers the shares in the company to another person (say, a child) absolutely.

It would be surprising if the company was a s.731 free vehicle which would allow the child to enjoy its accumulated income by liquidation or redemption of shares.

Similar points apply on the redemption of debt securities.

It may be objected that there could then be a double charge to tax. Suppose:

(1) A trust within s.731 owns a company. Relevant income has accrued to the trust and to the company.
(2) The trust transfers the company to a beneficiary, B.
(3) B liquidates the company and receives its assets.

There should not be a benefit on both the transfer and the liquidation, leading to a double charge. I suggest the solution is to say that one does not have a double benefit. If the value of the company has not changed since the date of the transfer to B, B receives no further benefit on the liquidation and distribution of the assets. The first benefit franks the second. But if the value of the company has increased (assume there is a delay between the transfer and the liquidation and income accrues to the company in the meantime) the benefit, or the value of the benefit, is the difference between the acquisition value and the actual receipt from the company. The concepts of benefit and value are sufficiently flexible to produce the right result.

If the shares are held by the transferor, however, s.720/727 would in principle apply.

50.4.7 *Payment of IHT*

No individual receives a benefit when trustees pay IHT charges on the trust. This is the case for IHT 10-year charges and the IHT charges on the

[22] See 98.24.4 ("Chargeable consideration").

termination of an estate IIP, but it is necessary to consider them separately:

(1) *IHT 10-year charges* are payable by the trustees of the settlement concerned.[23]

Beneficiaries[24] who receive capital payments are also liable for the IHT, but:

(a) They have a right to recover from the trust fund: s.212 IHTA.

(b) They are only liable if the tax remains unpaid after it ought to have been paid: s.204(5) IHTA.

Accordingly the payment of IHT 10-year charges by the trustees (or by anyone else) is not a benefit to any individual beneficiary.

This is so even if that beneficiary was (secondarily) liable for the tax under.

(2) *IHT on termination of an estate IIP (during the life of the life tenant[25] or on the death of a life tenant)*[26] This is likewise payable by the trustees of the settlement concerned: s.201(1)(a) IHTA.[27] But the same points apply:

(a) The life tenant has a right to recover from the trust fund: s.212 IHTA.

(b) The life tenant is only liable if the tax remains unpaid after it ought to have been paid: s.204(5) IHTA.

Accordingly the payment of IHT by the trustees (or by anyone else) is not a benefit to the life tenant. It cannot be a benefit to be relieved of a secondary liability of this kind, where one has an effective right of indemnity. Further, in the case of a wide common form trust, even if the class of beneficiaries as a whole may be said to receive a benefit, no individual receives a quantifiable benefit.

50.4.8 *Moral/sentimental/hard to value benefit*

The word "benefit" is used with two distinct meanings, a strict or narrow meaning, and a wide meaning:

(1) *Financial advantage only* In the narrow sense, "benefit" means a benefit which can be valued, that is, it can quantified in financial terms. The usual case will be the provision to a person of an asset, or

[23] See 125.3.4 (Liability for trust IHT).

[24] For non-resident trusts, settlors are also liable.

[25] See 125.3.4 (Liability for trust IHT).

[26] See 125.3 (Who is liable for IHT).

[27] In this case the life tenant is also liable for the IHT, under s.201(1)(b) IHTA.

services, where the benefit to the person is quantifiable as the value of the asset, or the value of the services.

(2) *Non-financial benefit also* In the wide sense, "benefit" also includes non-financial advantages, ie something which confers some mental satisfaction, such as meeting a moral obligation, or which may be described as indirect or intangible.

An example is a contribution of (say) £5,000 to charity. The charity receives a financial advantage of £5k, a straightforward benefit in the narrow sense. Someone who wishes to support that charity, or feels a moral obligation to do so, may receive a benefit in the wide sense. The payment may satisfy their wish or moral obligation; but one cannot value their benefit as £5k. It is a non-financial benefit.

A similar example is the provision of a fund for the benefit of a person's children.

Another example is the payment of (say) £5,000 school fees. The child receives a service (education). This is a straightforward benefit in the narrow sense; it can be valued at £5k.[28] The parent (assuming the parent wants the children to be privately educated) receives a benefit in the wide sense. They have a wish or moral obligation satisfied; but one cannot value their benefit as worth £5k. It is a non-financial benefit.

The context must decide which meaning of "benefit" is applicable.

In the *trust* law context of common form powers of advancement or appointment, such as a power to apply for the advancement or benefit of a beneficiary, the word "benefit" has the wide meaning. Thus a power to apply funds for the benefit of a beneficiary can in principle be exercised by making a payment to a charity which the beneficiary wishes to support.[29]

In a *tax* law context, the narrow meaning is normal and the wide meaning is exceptional. For instance, the word "benefit" in the context of s.624 ITTOIA or s.86 TCGA (settlor-interested trusts), or the IHT gift with reservation provision, refers to financial benefits only. No-one has ever suggested that a payment for a person's minor children could be a "benefit" to the parent, so as to bring those sections into application,

[28] But the detail of the basis of valuation of the benefit does not alter the point being made here, that the benefit is one of a financial nature, which can be valued.

[29] The leading case is *Re Clore* [1966] 1 WLR 955; see Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 11.10 (Power of advancement used to create new trusts).

though it normally would be a benefit in the wide (non-financial) sense: one would normally expect the parent to be gratified by the payment.[30] (It may alternatively be said that if the parent receives a benefit, its value is nil. I would prefer the view that a "benefit" of nil value should not be called a "benefit" at all. But the end result would be the same, at least in a s.731 or s.87 context, where the charge is on the value of the benefit.)

If a power to apply funds for the benefit of a beneficiary is exercised by making a payment to a charity which the beneficiary wishes to support, the payment is a benefit (in the narrow sense) to the charity so s.87 gains may accrue to the charity (though the charity should qualify for CGT charity relief).

These wide/narrow meanings of benefit are neatly illustrated in *Children's Investment Fund Foundation v AG*. The Foundation was a family charity. Following a divorce W resigned as director. The Foundation proposed to transfer funds to a new charity (controlled by W). The question whether this transfer would constitute a benefit for W arose for two distinct purposes:

(1) *Benefit for charity law/company article*: The Foundation's articles provided:

> A Trustee must not receive any payment of money or other material benefit[31] (whether directly or indirectly) from [the Foundation] except ... in exceptional cases, other payments or benefits (but only with the written approval of the Commission in advance).

The question was whether there was a benefit for W, within the meaning of this article. The value of this benefit would not matter.

(2) *Benefit for tax:* The question was whether there was a benefit for the charge on a termination payment, which is on the amount of the benefit.[32]

The judge stressed the importance of context to the meaning of benefit. For the company article issue:

> ... one has to consider first the purpose of clause 5.2, which is ... to

[30] If it were a benefit to one parent, it would similarly be a benefit to the other parent, and indeed grandparents, godparents and family friends; that can hardly be right.

[31] Defined in the articles: "a benefit which may not be financial but has a monetary value". This is a standard form: the current Charity Commission model articles are very similar.

[32] See 34.38 (Termination payments).

> prevent trustees from receiving benefits except ... with the approval of the Commission. ... This is not an absolute bar, but only a procedural pre-condition. In these circumstances, it would be wrong to construe the clause too narrowly. An appropriate benefit will only have to surmount the hurdle of Commission approval, which would allow proper independent scrutiny and transparency to protect the charity's assets. The situation is very different from the cases relied upon by the trustees that concerned incidental benefits to trustees that risked jeopardising charitable status.[33]

W reduced her financial claim against H in consideration of this transfer: it was something she strongly wanted. With that in mind, the judge held that W received a benefit, within the meaning of the relevant company article. I find that analysis a little surprising. I would have said:

(1) W did *not* receive a benefit within the meaning of the article (ie a benefit with monetary value)
(2) H *did* receive a benefit (a reduction in W's claim for financial relief)

But that analysis would not affect the outcome of the case.

For the tax issue there was no benefit, or its value was nil. Discussion was curtailed as HMRC had accepted that view, so the only issue was whether they might change their mind:

> ... [HMRC] would be highly unlikely ultimately to determine that the Grant would be taxable. This is because ... HMRC would not regard any intangible benefits that [W] might achieve by being the member or trustee of a charity with assets augmented by the Grant as being taxable benefits caught by [s.401 ITEPA]. There would be no value in [W's] membership of [the charity], which has exclusively charitable objects.
>
> I can say expressly that I have not determined that [W] will achieve any personal financial benefit from the making of the Grant, notwithstanding that I have accepted that she would have been prepared to forfeit other financial benefits to allow the Grant to be made.[34]

If further authority is needed, see *Burton v HMRC*:

> [60] 'Benefit' in s 97(5)(b) [TCGA] must be construed in the context of these taxing provisions rather than for the purpose of deciding the validity of an advancement or appointment under powers contained in

[33] [2017] EWHC 1379 (Ch) at [72].

[34] [2017] EWHC 1379 (Ch) at [124]. Neither point was considered on appeal.

> a settlement. The legislation forms a detailed self-contained code to impose a tax charge on capital payments received by a beneficiary. This requires the benefit received or treated as received to be identifiable and quantifiable if there is to be sufficient certainty to impose a tax charge for any particular year of assessment....
> [62] The wider concept of benefit is difficult to apply in the context of s 87 in a way that the concept of a benefit which is identifiable and quantifiable is not. For example, a gift to charity by the trustees of a settlement may not give rise to a charge to tax on the trustees so as to create trust gains, but has been held to be for the benefit of a beneficiary as regards validity as it discharges a moral obligation (*Re Clore ...* [1966] 1 WLR 955). The beneficiary is surely not chargeable in those circumstances under s 87... What has been received or treated as received in those circumstances by the beneficiary for tax purposes notwithstanding its validity as being for the benefit of the beneficiary? Nothing in the sense of a capital payment received other than possibly a moral satisfaction has materially benefited the beneficiary such that a tax charge can be imposed in respect of it.... [35]

Burton concerned a s.86 flip-flop scheme.[36] HMRC argued that the beneficiary received a benefit in a year ("year 1") of a very subtle nature: the avoidance of a CGT liability under s.86 on a disposal anticipated in the following tax year ("year 2"). So this was not a case of mental satisfaction benefit, though it was a case of a benefit whose value was difficult or impossible to quantify. The two-judge Tribunal disagreed on whether that was a "benefit" at all, but both judges agreed that if it were, the value of the benefit *in year 1* (the year assessed) was nil, so there was no s.87 charge.[37] But these facts are not likely to recur; so it is not necessary to consider this aspect further.

50.4.9 *School/university fees*

Suppose trustees pay school fees for a child in circumstances where the parents have no obligation to pay the fees. The child receives a benefit from the trust. The parents merely receive an intangible, non-financial advantage (if they regard the education with approval). I have already noted that this is not a "benefit" to the parents for tax purposes.

Suppose trustees pay school fees in circumstances where a parent has a

[35] *Burton v HMRC* [2009] SFTD 682; Judge Wallace took a similar view at [44].

[36] See 62.2 (Flip-flop schemes).

[37] HMRC's argument that the benefit was an outright payment was rightly rejected.

family law obligation to meet the fees (such as may arise on a divorce or in other family law proceedings). It might be said that the parent receives a benefit (being relieved of legal obligation). However it is considered that the benefit to the parent is outside the scope of s.731 because it is merely incidental.[38]

Suppose trustees pay school fees in circumstances where a parent (or both parents) are under a contractual obligation to pay the school fees (ie the parent has entered into the contract with the school). The position here depends on the facts:

(1) It may be that the parent is entitled to reimbursement from the trustees (eg if the parent entered into the contract at the request of the trustees and on terms that the trustees will meet the fees, or as agent for the trustees). In that case the trustees provide the benefit to the children and the parent does not receive a benefit from the reimbursement.[39] It does not matter that the school are not party to the arrangement (eg the parent may be acting as agent for an undisclosed principal).

(2) It may be that the trustees are voluntarily meeting a liability of the parent; in that case, the parent is providing the benefit to the child, and the trustees are providing a benefit to the parent.

In practice (assuming it is desired to arrange that the benefit is received by the child, not the parent) it is recommended that the contract should be between the trustees and the school, or (if that is not desired) there should be an agency agreement between the trustees and the parent. Then the position should be clear.[40]

If a parent is the settlor, also consider the settlor-interested trust code,[41] and the close-family attribution rules.[42]

See too App.12.2 (Student grants: DT relief).

50.4.10 *Asset used by connected person*

Suppose a house (or chattels) is provided to a life tenant (or other

[38] See 50.6.2 (Divorce payment: H not a beneficiary).

[39] Contrast 101.4 (Statutory tax indemnity).

[40] For cases where the Court had to determine whether liability for school fees rested on the parent or on his employer, see *Ableway v IRC* [2002] STC (SCD) 1; *Frost Skip Hire v Wood* [2004] STC (SCD) 387. But if the matter had properly documented, this litigation would not have been necessary.

[41] See 47.15 (Payment to settlor's child).

[42] See 61.26 (Settlor-attribution rules: Introduction).

beneficiary) who then allows their spouse (or partner or children) to live there (and to enjoy the chattels). The same analysis applies. The indirect benefit which the spouse (or partner or children) receive is not a "benefit" for tax purposes, or, alternatively, the benefit is disregarded as merely incidental.

50.4.11 *"Benefit" in breach of trust*

Suppose trustees transfer[43] an asset to a person in breach of trust. In principle the recipient holds the asset on constructive trust for the trustees, so the transfer is not a benefit, or (if it were a benefit) the value of the benefit is nil. Likewise if a company transfers an asset to a person in breach of company law.[44]

It is possible for an act which is a breach of trust to confer a benefit on the recipient, eg if trustees allow their claim against the recipient to become time barred.

Trustees may confer a benefit in breach of trust without transferring an asset, eg allowing an individual who is not a beneficiary to occupy trust property. Whether that confers a benefit on the individual depends on whether the trustees have a claim against the individual to recover the value of the benefit.

Thus whether an act in breach of trust constitutes a benefit requires an examination of the rights of the parties; it cannot be answered yes or no as a general proposition.

The context may show that the word benefit is (mis)used to include a transfer of an asset which the transferee is required to return to the transferor. An example is *Clark v HMRC*[45] which concerned a transfer of money from a pension scheme. Legal title to the money was transferred, but the beneficial interest was held on resulting trust for the transferor, because the recipient scheme was void for uncertainty.[46] This was held to

[43] I use the word "transfer" loosely. Although there may be a transfer of the bare legal title, it would be more accurate to refer to a purported transfer, or to use scare quotation marks.

[44] See too 15.9 (Income recognition: Breach of trust).

[45] [2020] EWCA Civ 204. *Clark* concerned the word "payment" not benefit; but that is not in itself so significant, particularly as "payment" was defined to include a transfer of assets and any other transfer of money's worth.

[46] The scheme promoters did not understand what they were doing. This is not unusual in avoidance schemes, notwithstanding high fees, and it is an argument in favour of the GAAR.

constitute an "unauthorised member payment" giving rise to an unauthorised payment charge. In reaching that conclusion it was important that:

(1) An unauthorised transfer will often be made in breach of trust.
(2) The unauthorised payment charge was intended to have a deterrent effect. It would deprive the charge of effect in cases where it is needed, if the taxpayer could subsequently escape liability by restoring assets to the fund.[47]

These considerations do not apply here, so it is considered that *Clark* has no relevance in the context of ToA and s.87 benefits.

50.4.12 *Waiver of liability*

The INT Manual provides:

> **INTM601640 Examples of amount or value of a loan** [Jul 2023]
> If repayment of interest (or capital) is waived, then this will be regarded as a benefit received by the individual for the year in which waiver takes place.

That is correct.

The value of the benefit is not the face value of the debt waived, but the market value. If the beneficiary is insolvent and wholly unable to pay the debt, its value is nil.

50.4.13 *Brackett v Chater*

For completeness: In *Brackett v Chater*[48] the benefits provided on the transferor ("T") were said to be:

(1) the provision of liquidity, in the form of
    (a) cash payment for properties which could not be sold on acceptable terms on the open market
    (b) repair of the property (once purchased), which the T could not otherwise have afforded
(2) salary
(3) discharge of moral obligations to provide for T's close family

These benefits were said to give T power to enjoy under condition C. Point (1) goes too far if it said that market value payments count as

[47] See [2020] EWCA Civ 204 at [45]; [79]-82].

[48] 60 TC 134 at p.148.

benefits; but the explanation is that the payments were not in fact at market value. Point (2) is equally doubtful, assuming that the salary was at market value. Point (3) on moral benefits is, with respect, clearly wrong, or every family trust is within s.720 even if the settlor/spouse is excluded. It is relevant to note that the taxpayer appeared in person, and the issues were not thoroughly discussed, and T also had was power to enjoy under condition B.[49]

50.4.14 *Benefit not from relevant income*

The benefit does not have to be made out of the relevant income or traceable to the relevant income. The INT Manual provides:

> **INTM601700 Relevant income** [Jul 2023]
> *Example 3*
> A foreign trust has no income of its own but owns a foreign company which has rental income of £100,000. The trustees make a payment of £30,000 out of trust capital to a beneficiary.
> In considering what is relevant income for the purposes of the benefits charge, the income of both the company and the trustees is taken into account. The relevant income will thus be £100,000 as it is income that can indirectly be used for providing a benefit. The payment out of the trust does not impact that.[50]

But see 50.13 (Benefit causation condition).

50.5 Who receives the benefit?

It is important to identify the recipient of a benefit because the individual who receives the benefit is in principle the one who is taxable. It is especially important where some beneficiaries are and others are not UK resident, or remittance basis taxpayers, because the identity of the recipient may affect not only who pays the tax but whether any tax is payable at all.

There may be scope for tax saving by arranging that the benefit is received by the beneficiary who is non-resident or a remittance basis taxpayer. But settlor-attribution and onward-gift rules would need consideration here.

[49] See 49.16.2 (Condition B: Asset value increases).

[50] The example does not explain how the trustees (who we are told had no income) obtained the £30k to pay to the beneficiary. Presumably we are to assume they held the shares and this additional sum of cash.

There are s.87 rules for benefits received by close companies, but these have no s.731 equivalent.

There are many possible permutations of circumstances and the documentation is very important.

50.5.1 *Who receives use of asset*

Suppose trust property is held by a common form discretionary trust:

(1) *The property is occupied by H and W (who are living together).*

  (a) If the trustees grant a H licence to occupy, W occupying jointly, but as licencee of H, then the benefit from the trust is received by H.

  (b) If the trustees grant a licence to H and W, each receives the benefit of joint occupation. How does one value that? In normal cases, the value of each benefit is half the value of sole occupation.

(2) *The property is occupied by H (or H and W) together with C (a child of H).* If the trustees grant a H licence to occupy, the benefit is enjoyed by H alone, not by C.

(3) The property is occupied by C (an adult) alone. If the trustees grant a licence to H, who permits C to occupy, the correct analysis should be that C has received the benefit indirectly (for s.87 purposes) or as a result of an associated operation (for s.731 purposes);[51] also the onward-gift rules need consideration.

The same applies if the property is held by a company held by the discretionary trust (except the licence would be granted by the company at the direction of the trustees).

Suppose property is held on trusts under which H has an interest in possession. If H occupies, he receives the benefit. If H and W occupy, H alone receives the benefit. What if H chooses not to occupy? In such a case H may not be entitled to occupy in which case there will be no benefit. If H permits C to occupy alone, C has received the benefit indirectly.

Suppose property is held on trusts under which H and W have joint interests in possession. If they both occupy they receive the joint benefit equally. Suppose H and W have interests in possession in unequal shares.

[51] See 50.13 (Benefit causation condition).

It is suggested that they receive the benefit of occupation equally, notwithstanding the inequality in their interests in possession.

In all these cases the position is of course different if the person in occupation is required to pay some form of compensation to the trustees or to the life tenant or joint life tenant.

50.5.2 *Who receives money payment*

Likewise with money. If the trustees pay a capital sum to H, and H uses it for family expenditure, the benefit is received by H; but if paid by H under an arrangement whereby it is transferred on to W, or to a child, the benefit may be received indirectly by the child (for s.87 purposes) or as a result of an associated operation (for s.731 purposes); and onward-gift rules need consideration.

For the purposes of s.87 TCGA charge, the concept of "receipt" is explained by s.97(5) TCGA.[52] There is no statutory equivalent for s.731 but it is suggested that the same rules apply: s.97(5) merely states the natural meaning of "receipt".

As the discussion of school fees above illustrates, the question of who receives a benefit may overlap with the question of whether there is a benefit at all.

50.6 Benefit in course of divorce

50.6.1 *Divorce payment: H a beneficiary*

Suppose a trust where H is a beneficiary and W is not.

(1) A court orders H to make a payment to W.
(2) A trust makes a payment to H to allow him to meet the obligation.[53]

That is a straightforward benefit to H. W does not receive a benefit; she gives full consideration.[54]

Suppose a slightly different step (2): The trust makes the payment to W directly in satisfaction of H's obligation. The result is the same. A payment made to satisfy H's liability is a benefit to H.

Suppose a slightly different step (1): the court order requires that H shall *pay or cause to be paid* to W a specified sum. That is the standard form

[52] See 61.8 (Receipt from trustees).

[53] As a matter of trust law, this is permitted even though H is not a beneficiary.

[54] It is important to understand the family law background, as to which see App.4.6 (Transfer on divorce).

of order. But the result is the same.[55]

The same applies if H and W are both beneficiaries.

50.6.2 *Divorce payment: H not a beneficiary*

Suppose:

(1) W is a beneficiary of the trust and H is not.
(2) A court orders H to make a payment to W.
(3) The trust makes the payment to W.

I find it difficult to see how this could arise. The trustees could make a payment to W but not in satisfaction of the court order, as H cannot *cause* the payment to be made.[56] There is also a benefit to H, which would be a breach of trust.

The trust law case of *Fuller v Evans*[57] seems at first sight to contradict this analysis. In this case the court had ordered:

> [H] do pay or cause to be paid to [W] … periodical payments
> (a) for [the children's] general maintenance £9,000 per annum
> (b) such amount as is sufficient to defray their school fees...

There was a common form accumulation and maintenance trust for the children. H was the settlor, and so excluded. The judge said:

> 4. The issue before me is whether the trustees may in their discretion exercise their power to provide moneys out of the trust to pay for the children's maintenance and education, though the effect of such payment may be in whole or in part to relieve the settlor from the burden of his obligations under the consent order to pay for his children's maintenance and education.

The judge concluded:

> 9 [The settlor exclusion clause under which H was excluded from benefit] does not preclude the trustees from exercising the power conferred upon them by reason of any incidental (and unintended)

[55] See the Family Order Project House Rule 16: "An obligation to do an act as provided for in an order shall be taken to include causing the act to take place. Thus the phrase "or cause to be paid", shall not be included in an order."
http://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Reports/annex-c-family-orders-project-house-rules.pdf

[56] If H is a trustee it may be said that he causes the payment to be made, but the conflict of interest would in principle make the payment void.

[57] [2000] 1 All ER 636.

> conferment of relief on the settlor. This conclusion of course does no more than leave it open to the trustees to exercise a discretionary power to make provision for the education and maintenance of the two children out of the settlement funds. The trustees can only exercise that power if they consider that to do so is in the best interests of the beneficiaries despite the existence of the consent order and the obligations of the settlor thereunder. The trustees must have regard to the obligation of the settlor to provide for the beneficiaries' maintenance and education when undertaking the decision-making process but the existence of that obligation is no more than a consideration to which due weight must be given .... If the trustees reach the conclusion that it is in the best interests of the beneficiaries to make such provision out of trust funds, they are free to do so.

No doubt trust income applied for school fees or maintenance of the children would in principle[58] be the income of the children. This decision gives a sensible result. It would be surprising if the effect of the common form court order was to sterilise trust funds which prior to the divorce had been intended for the maintenance and education of the children. Moreover if the trust bore the cost then H had to be discharged from the court order: the children did not need two sets of school fees. But that case represents a high water mark: payments from H to W are different from payments for the maintenance of children. If the trust makes the payment to W, it is considered that H would not be discharged. If H were discharged, the benefit to H from the trust if it makes a payment to W is not "incidental".

50.6.3 *Court order against company*

The 2012/13 edition of this work considered the position where a court orders a company within s.731 to transfer property to the spouse of the shareholder. But it seems that the court does not have jurisdiction to make an order of that kind, except in the case where the company is a nominee,[59] so this issue should not arise.

50.7 Valuation of benefits: Principles

50.7.1 *Why valuation matters*

The amount of s.731 income depends on the "amount or value" of the

[58] In practice s.629 ITTOIA would need consideration.

[59] *Prest v Petrodel Resources* [2013] 2 AC 415.

benefit.[60] "Amount" refers to cash benefits (outright payment of money) and "value" refers to non-cash benefits.[61]

The amount of s.87 gains depends on the amount of the capital payment and s.97(4) TCGA provides:

> For the purposes of sections 86A to 96 and Schedule 4C the amount of
> [a] a capital payment made by way of loan, and
> [b] of any other capital payment which is not an outright payment of money,
> shall be taken to be equal to the value of the benefit conferred by it.

In this section I discuss valuation of benefits for the purposes of s.731 and s.87 TCGA, as the issues are (more or less) the same.[62]

50.7.2 *Market value: Principles*

In *Heaton v Bell*:

> "Value" is an elusive word: it may mean market value, it may mean value in money to the owner, or it may have other meanings like the value of the work necessary to produce it, or even sentimental value.[63]

In *IRC v Botnar*:

> 28. It seems to us that the whole of the value of a non-convertible benefit should, in the absence of any other objective means of valuation, be measured by reference to what it would have cost the individual receiving it. ... When measuring what benefit an individual receives it is not in our view relevant to ask whether he would have purchased the benefit himself. If that were the test a penurious individual receiving a non-money benefit under [enjoyment condition C] would escape tax however substantial the benefit since he could not have paid for it.

Arguments that the value of the benefit is nil tend to overlap with arguments that there is no benefit at all.

50.7.3 *Payment for benefit*

The INT Manual provides:

> **INTM601620 Examples of amount or value of benefit** [Jul 2023]
> ... If the individual receiving a benefit makes any contribution towards

[60] See 50.18.2 (Step 1: Total Benefits).

[61] See App.4.2.4 ("Amount or value").

[62] See App.4.9 (Market value/full consideration).

[63] *Heaton v Bell* 46 TC 211 at p.246.

> that benefit, the contribution will normally be taken into account in determining the amount or value of the benefit.

The INT Manual provides a straightforward example:

> For example, an individual is provided with accommodation that is a benefit for the purpose of the benefits charge. It is agreed that the value of the use of the accommodation based on rental is £10,000 for the tax year. In that year the individual pays a rental of £5,000. It will be appropriate to take account of the contribution such that the amount or value of the benefit is regarded as £5,000.

This should apply to a payment in advance or in arrears.
If authority is needed, see *IRC v Botnar*:[64]

> The measurement of the benefit by reference to what it would have cost the individual will take account of the terms on which it was provided. In this case ... the use of the property was provided on the footing that Mr and Mrs Botnar bore the recurrent outgoings.

This principle is subject to exceptions if the 2017 statutory valuation rules apply.

50.8 Benefit not loan/use of property

It is usually straightforward to ascertain the market value of benefits other than loans/use of property.

50.8.1 *Receipt of money*

The INT Manual provides:

> **INTM601620 Examples of amount or value of benefit** [Jul 2023]
> ... Where the benefit received is money, generally speaking the amount or value of the benefit is likely to be the amount received. As INTM601580 explains, where the payment is received in foreign currency, the amount or value will generally be determined by applying the appropriate sterling exchange rate at the date of receipt.

That is self-evident.

50.8.2 *Transfer of asset*

The INT Manual provides:

[64] 72 TC 205 p.256 (Special Commissioners decision, at para [29].

> **INTM601620 Examples of amount or value of benefit** [Jul 2023]
> ... Where the benefit received is in the form of an asset, other than cash, and the ownership of that asset actually passes to the individual as opposed to an asset being made available for use which remains in the ownership of the provider. The amount or value of the benefit is likely to be determined by reference to the value of the asset at the point in time when it is received by the individual. In most cases this is likely to be similar to the approach that may be adopted for capital gains purposes where it may be appropriate to determine the open market acquisition value of the asset to the individual.

That is self-evident.

50.8.3 *Satisfying a debt*

The INT Manual provides:

> **INTM601620 Examples of amount or value of benefit** [Jul 2023]
> ... Where the benefit received takes the form of a personal debt or liability of the individual being settled on the individual's behalf, the amount or value of the benefit is likely to be determined as if the individual had received an equivalent amount of money. There are a variety of circumstances that may come under this heading, from the provision of credit or debit cards, making direct payments to a third-party service provider (such as for children's school fees), or the settling of an outstanding personal liability (such as a utility bill or personal tax liability for example).

50.8.4 *Repayment of loan*

Repaying a loan on commercial terms is not a benefit (or the value of the benefit is nil). The statutory valuation rule does not apply to a repayment.

50.9 Statutory valuation rules

There are statutory valuation rules for three types of benefit:

Benefit	**s.731 valuation rule**	**s.87 valuation rule**	**See para**
Loan	s.742C	s.97A	50.10
Use of chattel	s.742D	s.97B	50.11
Use of land	s.742E	s.97C	50.12

I refer to these as the "2017 statutory valuation rules".

The s.643A code incorporates the s.731 rules by reference.[65] The s.87

[65] See 47.21.4 (Step 2: Value benefits).

code sets out the rules in full, using (more or less) the same words as the s.731 rules; the differences are to ensure that the s.87 code follows wording used elsewhere in the s.87 code, but there is no difference in meaning.

The statutory valuation rules are introduced as follows:

s.742B ITA	**s.97(4) TCGA**
Sections 742C to 742E apply where it is necessary, for the purpose of calculating a charge to income tax under the preceding provisions of this Chapter [chapter 2 part 13, ToA provisions], to determine the value of a benefit provided to a person by way of— (a) a payment by way of loan (see section 742C), (b) making available movable property without any transfer of the property in it (see section 742D), or (c) making available land for use without transferring the whole interest in it (see section 742E).	For the purposes of sections 86A to 96 and Schedule 4C the amount of a capital payment made by way of loan, and of any other capital payment which is not an outright payment of money, shall be taken to be equal to the value of the benefit conferred by it (see sections 97A to 97C for the value of benefits conferred by a capital payment made by way of loan or by way of making movable property or land available).

It is necessary to distinguish:

(1) **"Statutory value"** (under the statutory valuation rules) and

(2) **"Market value"**

Market value is relevant so far as the 2017 statutory valuation rules do not apply, which includes:

(1) Benefits other than loans and use of property

(2) Pre-2017 benefits (even if matched with post-2017 relevant income/ trust gains)[66]

(3) Valuation issues outside s.731/s.87/s.643A, such as what constitutes "full consideration"[67]

Types of loan/lease/licence

I use the following terminology:

[66] See 50.10.7 (Pre-2017 loan).

[67] See App.4.9 (Market value/full consideration).

Term	**Meaning**
Beneficial loan	Interest-free or beneficial terms
Commercial loan	A loan for full consideration (not a beneficial loan)
On-demand loan	Repayable on demand of the lender
Fixed-term loan	Not repayable for a fixed term (not an on-demand loan)

Similar terms can be used for a lease/licence of chattels/land.

50.9.1 *"Benefit" for full consideration*

The statutory valuation rules apply to determine the value of a *benefit* by way of loan/use of property. If there is no benefit the statutory valuation rules do not apply.

A beneficial loan is of course a benefit.[68] However it has been suggested that a commercial loan is not a benefit, so the statutory valuation rules do not apply.

> ... sections 742B and 742C [ITA] only apply where the loan in question actually constitutes a "benefit" to the borrower. If the loan does not confer a "benefit" on the borrower then the new provisions should not apply. There must be an actual "benefit" before one is required to value anything. That, on any fair reading, is what sections 742B and 742C say. Accordingly, if the terms of the loan made to X ... were such that there was no "benefit" to him, he should not in my view be caught by the new provisions.
>
> I am fortified in this view by the absence of a provision corresponding to the recently inserted s.173(1A)(a) ITEPA. Section 173(1A)(a) is intended to, and does, tax the so-called "benefit" of employer-related 'rolled up interest' loans which do not actually confer any benefit. The draftsman recognised the 'no benefit' problem and circumvented it by providing that where you have an employer-related loan:
>
> > the loan is a benefit for the purposes of this Chapter (and accordingly it is immaterial whether the terms of the loan constitute a fair bargain)[69]
>
> Job done! But, as I say, there is no corresponding provision in the context of the new sections 742B and 742C.[70]

In one sense of the word, a commercial loan is not a benefit. That is self-

[68] This is self-evident, but if authority is needed, see *Cooper v Billingham* 74 TC 139.

[69] See 40.2 (Employment-related loan).

[70] Flesch, "No Benefit. No Tax – True Or False?" GITC Review Vol.xiv No.2 March 2018 *http://taxbar.com/wp-content/uploads/2018/04/MF-No-benefit-No-tax.pdf*

evident, but if authority is needed, see the first *Vestey* case:[71]

> … a loan may well benefit a person even if it is made at a commercial rate of interest, as it may tide him over a difficult period, but I do not think that if money is so lent it is applied "for the benefit" of the debtor within [the forerunner of s.624].
> ...I find it impossible to hold that a sum of money lent at a commercial rate of interest is "payable to or applicable for the benefit of" the borrower in the sense of this Section.

However, the word "benefit" can also be used to refer to a loan on commercial terms.[72] It is considered the better view is that this is the case in the statutory valuation rules. So a loan (or use of property) on commercial terms is within the statutory valuation rules.

The INT Manual also takes the view that a commercial loan *is* a benefit, though the market value of the benefit is nil:

> **INTM601640 Examples of amount or value of loan** [Jul 2023]
> A loan made to an individual for full commercial consideration is a 'benefit', but such a loan would in practice normally be regarded as a nil benefit, and therefore have no taxable value.

Before the 2017 statutory valuation rules, this was simply a different route to the same destination. But the difference matters for after 2017, because if a loan is a benefit (even of nil value) the statutory valuation rule applies; if a loan is not a benefit, the rule does not apply.

The position is slightly different for s.87, because it has a relief for arm's length transactions.[73] That relief does not apply for s.731. This might be described as an anomaly, but it is an anomaly which arises from the fact that the relief which applies for s.87 does not apply for s.731.

50.9.2 *Statutory/market value compared*

Statutory value is in general more than market value, but not in every case; for instance:

(1) The statutory value of use of a car may be less than market value, because a car (unlike, say, a work of art) is a depreciating asset.

(2) The statutory value of use of a chattel may be less than market value where the asset was purchased and first used a long time ago.

[71] *Vestey's Executors v IRC* 31 TC 1 at p.114, 121.

[72] See 50.4.1 (Full consideration/arm's length).

[73] See 61.7.8 (Arm's length relief).

50.9.3 *Enactment history*

The casual chutzpah (some readers may use a stronger word) of EN FB 2017 deserves to be recorded:

> During the consultation process it became clear that the rules for valuing certain benefits was unclear. Schedule 14 [Finance Bill] sets out the procedures to be followed when valuing these benefits for both capital gains and income tax purposes.

But perhaps no-one is expected to take that seriously.

50.10 Benefit of loan

For general law loan issues, which can of course matter greatly for tax, see App 2.5 (Loan).

50.10.1 *Statutory value: Loan*

Section 742C(1) ITA/s.97A(1) TCGA provide:

s.742C(1) ITA	**s.97A(1) TCGA**
The value of the benefit provided to a person (P) by a payment by way of loan to P is,	For the purposes of section 97(4), the value of the benefit conferred on a person (P) by a capital payment made by way of loan to P is,
for each tax year in which the loan is outstanding, the amount (if any) by which— (a) the amount of interest that would have been payable in that year on the loan if interest had been payable on the loan at the official rate,[74] exceeds	[identical]

[74] Defined by reference (and see 40.5 (Official rate of interest)):

s.742C(2) ITA	**s.97A(2) TCGA**
In this section and section 742D	In this section and section 97B
the "official rate", in relation to interest, means the rate applicable from time to time under section 178 of the Finance Act 1989 for the purposes of Chapter 7 of Part 3 of ITEPA 2003.	[Identical]

(b) the amount of interest (if any) actually paid by P in that year on the loan.

Payment of interest by a person other than P does not reduce the statutory value.

Payment of interest before or after the year does not reduce the statutory value. That is a harsh rule, but it does prevent planning for those coming to/leaving the UK, who might otherwise arrange to pay the interest in a year of non-residence.

The statutory valuation rule applies to a fixed-term loan. Eg, if in 2020/21 trustees grant a 3 year fixed term loan at no interest to a beneficiary, the value of the benefit is taxed under the statutory valuation rule in each of the years 2020/21, 2021/22 and 2022/23.

"Loan" is not defined, so in the statutory valuation rule it bears its strict meaning: loan of money.[75]

50.10.2 *Market value: Loan*

After 2017, the market value of a loan may not matter, for s.731/s.87 purposes, but the market value of leaving a debt (other than a loan) outstanding still matters, so the point is important.

The INT Manual provides:

> **INTM601640 Examples of amount or value of loan** [Jul 2023]
> One of the most common examples of a benefit involves loans of one form or another. These loans can take the following forms:
> - interest free loans
> - loans made charging interest at a rate below commercial rates
> - loans made charging interest at a commercial rate
> - loans made charging interest which remains unpaid
> - back-to-back arrangements
>
> Interest free loans are considered to be within the provisions, the charge being calculated by reference to the amount of interest forgone by the lender. This position was challenged in the courts where it was argued that in effect where a loan was repayable on demand there was no benefit. The judges disagreed with this and said that the focus needed to be not on the making of the loan but on the Trustees successive acts in not calling the loan in (*Cooper v Billingham* 74 TC 139). Similarly,

[75] See App 2.5 (Loan).

> where there are loans at interest rates lower than those that would be charged by banks or other commercial lenders a benefit may arise.

The INT Manual provides:

> **INTM601640 Examples of amount or value of loan [**Jul 2023]
> ... In the case of an interest free loan made to the individual, the amount of the benefit would normally be considered to be equivalent to the interest payable at a commercial rate on a similar loan from an unconnected third party. For this purpose, we treat the 'official rate' of interest as being the appropriate rate to use.[76] Where interest is paid but at less than commercial rates, the amount of the benefit will be that interest payable at a commercial rate less the interest paid.

The use of the official rate is a pragmatic solution, but strictly, the benefit is valued by reference to market rate for a loan on the same terms to the borrower, which will depend on:

- the security (if any) for the loan
- the financial strength of the debtor (the strength of the covenant)
- in the case of a foreign currency loan, the foreign currency market rate

It is sometimes in the interest of the taxpayer to argue that the value of the benefit is greater than the official rate. But where the statutory valuation rule applies, this does not arise.

50.10.3 *Impaired loan*

An "impaired loan" is one where the borrower is unable to repay the loan. Under the statutory valuation rule, the value of an impaired loan is the same as any other loan - as long as it is in fact a loan.

Cooper v Billingham discusses the market value of the benefit of an interest-free loan:

> [Counsel] argued that the value of the benefit conferred as required for the purposes of s.97(4) [TCGA] would vary according to the circumstances of the borrower, for example how creditworthy he might be and therefore his ability to borrow at better or worse rates on the market, and that those circumstances might differ from time to time.
> That may be true and could in theory cause difficulties of qualification in a particular case.[77]

[76] See 40.5 (Official rate of interest).

[77] 74 TC at p.155.

The beneficiary may be insolvent, ie unable to repay the loan immediately after it is made. This would typically arise if there are a series of loans to the beneficiary which are used to meet current expenditure. At the time of later loans in the series, at least, the beneficiary would be insolvent.

There are two possible analyses:

(1) The purported loan might take effect as an absolute transfer and not a loan; in other words, the documentation may be a sham so far as it suggests that there is a loan.[78]

(2) The transaction may take effect as a loan, but the market value of the benefit in the year the loan is made would be equal to the sum loaned, because an arm's length lender would not agree to lend (if "lend" is the word) for any less. No benefit arises in subsequent years if the "loan" is left outstanding (as an arm's length lender should not require a greater consideration than that).

I prefer the first analysis[79] but it depends on the facts.

It is theoretically possible that the trust which makes the loan could put the borrower in funds to make the repayment, which would make a difference - if that were the intention.

The borrower may be solvent (ie able to repay) when the loan is made but become insolvent. This would typically arise if there are a series of loans to the beneficiary which are used to meet current expenditure. At the time of first loan at least, or at the time of earlier loans in the series, the borrower may still be solvent. A similar analysis applies. If the transaction is a loan, the market value of the benefit in the year of the loan is what an arm's length lender would require for making the loan (which is likely to be the amount lent); or else the market value of the benefit in subsequent years is what an arm's length lender would require for leaving the loan outstanding.

50.10.4 *Interest unpaid*

What if interest at a commercial rate is rolled up unpaid? There is no income tax charge on unpaid interest.[80]

Under the statutory valuation rule the unpaid interest is disregarded and

[78] See App 2.5.2 (Loan or outright payment?).

[79] Assuming that the loan is governed by a law with a doctrine of sham similar to English law.

[80] See 26.26.4 (Waiver of interest).

does not reduce the value of the benefit. But the market value of the benefit is nil.

The INT Manual considers unpaid interest:

> **INTM601640 Examples of amount or value of loan** [Jul 2023]
> If the interest payable on [a loan for full commercial consideration] is not paid, consideration should be given as to whether the 'unpaid' interest in each year should be the amount of benefit in each year. Regard should be had to the circumstances under which the interest is unpaid. For example, has the payment of interest been waived?[81]

50.10.5 *Back-to-back loan*

The expression "back-to-back loan" is imprecise: it covers a variety of arrangements, with different tax consequences. The INT Manual is sketchy:

> **INTM601640 Examples of amount or value of loan** [Jul 2023]
> ...There may be instances of so called 'back-to-back' arrangements which should be carefully considered. For example, an individual who is a beneficiary of a trust may borrow money from a bank at commercial rates of interest. The trustees may deposit substantial funds with the bank (lender) as collateral for the loan. The arrangements may mean that repayments of capital and interest on the bank loan are rolled up and, on maturity, the loans are either renegotiated or replaced by larger loans from other banks.
> The result is that the individual, although legally responsible for the repayments of capital and interest payments, has had, perhaps for many years, the benefit of substantial loans without a cost.[82] In such circumstances, the value of the benefit may be considered on the basis that the loans were interest free and the benefit arrived at as referred to above.

On these facts, the benefit provided by the trustees is the deposit with the bank. Valuation may not be straightforward, but will be possible.

50.10.6 *Loan to life tenant*

As a matter of property/trust law a life tenant is entitled to trust income. It follows that it is in general not possible to have an interest-bearing loan

[81] See 50.4.12 (Waiver of liability).

[82] Author's footnote: That is not necessarily the end result of the arrangements described.

to a life tenant, under a transparent *Baker*-type[83] trust, because a person cannot pay interest to themself.[84]

Accordingly one cannot argue that a loan to a life tenant has a nil statutory value, by purporting to pay interest;[85] or that a loan to a life tenant has a nil market value, by purporting to pay or to roll up interest.

It would be different if:

(1) interest was payable after the death of the life tenant;
(2) the loan was issued at a discount instead of at interest;
(3) the trustees had expenses which were met by the interest (so the interest was not paid to the life tenant).

The fact that the borrower is life tenant (and so entitled to interest on the loan) is disregarded in determining the market value of the loan benefit. This is not stated expressly but follows from the scheme of the Act.[86]

50.10.7 *Pre-2017 loan*

Para 3 sch 9 F(no.2)A 2017 provides:

> The amendments made by this Schedule [statutory valuation rules] have effect in relation to capital payments or benefits received in the tax year 2017-18 and subsequent tax years.

Flesch considers a case where:

(1) Trustees made a fixed-term loan for no consideration before the statutory valuation rules were made (say a five year term loan made in 2016/17)
(2) The loan is still outstanding after the statutory valuation rules take effect (from 2017/18)

[83] It would be different if the trust was a non-transparent *Garland*-type trust. See 42.9 (Life tenant: Source of Income).

[84] For completeness: if interest rolls up unpaid and the life tenant dies, the position alters and outstanding interest becomes payable to the trust (unless Apportionment Act 1870 principles apply, which will be rare).

[85] Even if the parties go through a ceremony under which:
(1) the life tenant pays, or purports to pay, "interest" to the trustees; and
(2) the trustees return it to the life tenant.
Even if the parties do this there is no IT charge on the "interest": *Styles v New York Assurance* 2 TC 460. This point was overlooked in *Rogge v HMRC* [2012] UKFTT 49 (TC) (where the taxpayer was not represented by counsel).

[86] *Cooper v Billingham* 74 TC at p.154F. The reasoning was upheld by the CoA.

> Clearly X would have received a "benefit" when the loan was made, and the benefit would have been taxed under section 731 et seq in 2016-17.[87] I hope that no one – not even HMRC – would seriously suggest that X received further taxable benefits in the five succeeding years, by virtue of sections 742B and 742C.[88]

Flesch uses this to support his argument that a commercial loan is not a benefit within the scope of the statutory valuation rule.[89] But it is suggested that the reason that the 5 year term loan is not taxed in later years is the principle against double taxation, so the example does not support the argument that a commercial loan is not a benefit, and so is outside the statutory valuation rules.[90]

50.10.8 *Loan to estate/deceased borrower*

Suppose:

(1) A trust (within s.731) makes a loan to an individual

(2) The individual dies. The PRs of the estate become liable for the loan.

(3) The trust leaves the loan outstanding.

The PRs receive a benefit, but it is not within s.731 because the PRs are not individuals. There would be a capital payment for the purposes of s.87, giving rise to a CGT charge on the PRs if they are UK resident.

[87] Author's footnote: It is assumed that X is UK resident and there is sufficient relevant income to match to the benefit.

[88] Flesch, "No Benefit. No Tax – True Or False?" GITC Review Vol.xiv No.2 March 2018, citing *Billingham v Cooper* [2000] STC 122, at p.129h and p.134a.

[89] See 50.9.1 ("Benefit" for full consideration). Flesch says: "Now let us suppose that it transpires that the loan actually made to X in June 2016 contained a small element of benefit, because the agreed rate of rolled up interest was marginally too low to constitute a 'fair bargain'. Again, any such benefit should have been taxed in 2016/17 and should not be taxed again in subsequent years. That being so, it surely cannot be right in X's actual case – where his loan was a 'fair bargain' and did not confer any 'Day 1 benefit' – that he should be taxed by virtue of the new provisions. X's 'benefit' – or nonbenefit – must equally have been received before 2017-18." *http://taxbar.com/wp-content/uploads/2018/04/MF-No-benefit-No-tax.pdf*

[90] Even if that is wrong, the argument from unfairness is not a strong one, because:
(1) There is unfairness built into the statutory valuation rule, in that it only allows a deduction for interest paid in the year, not for interest paid before or after the year.
(2) The unfairness is somewhat theoretical, as in practice fixed term loans to beneficiaries are not made, except where there is thought to be some tax advantage.

50.11 Use of chattel

RI 201 provides:

> ["Benefit"] includes for example ... the use of trust property at less than an open market rental.

That is self-evident.

50.11.1 *Statutory value: use of chattel*

Section 742D ITA/s.97B TCGA provide:

s.742D(1) ITA	**s.97B(1) TCGA**
The value of the benefit provided by making movable property[91] available, without any transfer of the property in it, to a person (P) is, for each tax year in which the benefit is provided to P—	For the purposes of section 97(4), the value of the benefit conferred by a capital payment consisting of making movable property available, without any transfer of the property in it, to a person (P) is, for each tax year in which the benefit is conferred on P—
$\frac{(CC \times R \times D)}{Y} - T$	[Identical]

In short:
CC is the **C**apital **C**ost
D is the number of **D**ays the property is available
R is the official **R**ate of interest
T is the **T**otal paid by P
Y is the number of days in the tax **Y**ear

In full detail, s.742D(1) ITA/s.97B(1) TCGA provide:[92]

> CC is the capital cost of the movable property on the date when the property is first made available to P in the tax year,
> D is the number of days in the tax year on which the property is made available to P (the relevant period),
> R is the official rate of interest for the relevant period (but see subsection (3)),

[91] Defined s.7442D(4) ITA/s.97B(4) TCGA: "In subsections (1) and (2), "movable property" means any tangible movable property other than money."

[92] I here set out the ITA wording. The TCGA wording is identical except where indicated in footnotes.

> T is the total of the amounts (if any) paid in the tax year by P—
>
> (a) to the person providing[93] the benefit, in respect of the availability of the movable property, or
>
> (b) so far as not within paragraph (a), in respect of the repair, insurance, maintenance or storage of the movable property, and
>
> Y is the number of days in the tax year.

Section 742D(2) ITA/s.97B(2) TCGA define "capital cost":

> In subsection (1), in the meaning of CC, the "capital cost" of the[94] movable property means an amount equal to the total of—
>
> (a) the amount which is the greater of—
>
> (i) the amount or value of the consideration given for the acquisition of the movable property by, or on behalf of, the person (A) providing the benefit, and
>
> (ii) its market value at the time of that acquisition, and
>
> (b) the amount of any expenditure wholly and exclusively incurred by, or on behalf of, A for the purpose of enhancing the value of the movable property.

Section 742D(3) ITA/s.97B(3) TCGA concern changes in the official rate:

> If the official rate of interest changes during the relevant period, then in subsection (1) R is the average official rate of interest for the period calculated as follows.
>
> *Step 1*
>
> Multiply each official rate of interest in force during the relevant period by the number of days when it is in force.
>
> *Step 2*
>
> Add together the products found in Step 1.
>
> *Step 3*
>
> Divide the total found in Step 2 by the number of days in the relevant period.

Many of the comments above on the statutory value of loans also apply here. In particular: Payment of a licence fee/rent by a person other than P does not reduce the statutory value. Payment of a licence fee/rent before or after the year does not reduce the statutory value. The statutory

[93] For completeness: on the occasions where the ITA valuation rule reads: "providing the benefit", the TCGA valuation rule reads: "conferring the benefit". This is because s.732 ITA refers to providing a benefit whereas s.97(2) TCGA refers to conferring a benefit. But the words provide/confer are synonymous.

[94] For completeness: TCGA omits the word "the" here; but nothing turns on that.

valuation rule applies to a fixed-term licence agreement. Eg, if in 2020/21 trustees enter into a 3 year fixed term licence agreement at no interest to a beneficiary, the value of the benefit is taxed under the statutory valuation rule in each of the years 2020/21, 2021/22 and 2022/23.

50.11.2 *Market value: use of chattel*

After 2017 the market value of use of chattels may not matter, for s.731/ s.87 purposes, but I set out the the INT Manual for completeness:

> **INTM601620 Examples of amount or value of benefit** [Jul 2023]
> ... The principles to be applied where an asset is made available for use by an individual are likely to be similar to those described above for rent free accommodation.[95] Where the benefit provided is on an ongoing and continuous basis it will generally be appropriate to look at the tax year as a whole and consider the "annual value" of the use of the asset in relation to that tax year (or part thereof), together with any ongoing costs to the person providing the benefit of its provision for use by the individual. It may also be appropriate to reduce the value of the benefit where the individual meets costs associated with the asset that would normally be incurred by the owner of the asset. Subject to obtaining any necessary professional valuation advice, as a rule of thumb it may be appropriate to adopt a methodology for the benefits charge regarding the use of assets similar to that applied in the employment-related benefits field where an asset is made available for the use of an employee (see for example ITEPA05/S205[96]).

The statutory valuation rules in the employment-related benefits code are not the correct way to ascertain market value; and this was tacitly acknowledged by the enactment of the 2017 statutory valuation rules.

See too 4.9.5 (Market value: use of chattel).

50.12 Use of land

50.12.1 *Statutory value: use of land*

Section 742E(1) ITA/s.97C(1) TCGA provide:

s.742E(1) ITA	**s.97C(1) TCGA**
The value of the benefit provided by making land available for the use	For the purposes of section 97(4), the value of the benefit conferred

[95] See 50.12.2 (Market value: use of land).

[96] See 39.36 ("Cash equivalent").

of a person (P) is, for each tax year in which the benefit is provided to P, the amount by which—	by a capital payment consisting of making land available for the use of a person (P) is, for each tax year in which the benefit is conferred on P, the amount by which—
(a) the rental value of the land for the period of the tax year during which the land is made available to P, exceeds (b) the total of the amounts (if any) paid in the tax year by P—	[identical]
(i) to the person providing the benefit, in respect of the availability of the land, or	(i) to the person conferring the benefit, in respect of the availability of the land, or
(ii) so far as not within sub-paragraph (i), in respect of costs of repair, insurance or maintenance relating to the land.	[identical]

"Making land available" is equivalent to the benefit in kind wording, "providing" living accommodation; for discussion, see 39.15 (Available but not used).

Section 742E(2) ITA/s.97C(2) TCGA provide:

s.742E(2) ITA	**s.97C(2) TCGA**
Subsection (1) does not apply in the case where the person providing the benefit transfers the whole of the person's interest in the land to P.	Subsection (1) does not apply in the case where the person conferring the benefit transfers the whole of the person's interest in the land to P.

Section 742E ITA/s.97C TCGA define rental value:

> (3) In subsection (1) "the rental value" of the land for a period means the rent which would have been payable for the period if the land had been let to P at an annual rent equal to the annual value.
> (4) For the purposes of subsection (3) "the annual value" of land is the rent that might reasonably be expected to be obtained on a letting from year to year if—
>
> (a) the tenant undertook to pay all taxes, rates and charges usually paid by a tenant, and

> (b) the landlord undertook to bear the costs of the repairs and insurance and the other expenses (if any) necessary for maintaining the property in a state to command that rent.
>
> (5) For the purposes of subsection (4) that rent—
>
> (a) is to be taken to be the amount that might reasonably be expected to be so obtained in respect of a letting of the land, and
>
> (b) is to be calculated on the basis that the only amounts that may be deducted in respect of services provided by the landlord are amounts in respect of the costs to the landlord of providing any relevant services.
>
> (6) In subsection (5) "relevant service" means a service other than the repair, insurance or maintenance of the property.

The wording is taken from the employment income benefit in kind rules.[97]

This may not differ much from the market value.

Many of the comments above on the statutory value of loans also apply here.

50.12.2 *Market value: use of land*

After 2017 the market value of the use of land may not matter, for s.731/s.87 purposes, but I deal with the point for completeness.

In *IRC v Botnar* the Special Commissioners discuss the market value of living accommodation:

> 30. It may be that it will not be easy for a valuer to assess what the cost of a benefit such as this would have been since it is wholly hypothetical there being no market for such benefits. However, it seems to us that one approach may be to take the open market rental and to adjust this by reference to the lack of security of tenure, non-assignability and outgoings born by Mr and Mrs Botnar and any other special factors.[98]

The INT Manual provides:

> **INTM601620 Examples of amount or value of benefit** [Jul 2023]
> ... Where the benefit received is the provision of accommodation without charge to the individual, the amount or value of the benefit is likely to be determined from a consideration of the market rental that the property

[97] See 39.18.1 ("Rental value").

[98] 72 TC 205 at p.262 (Supplementary Special Commissioners Decision). The question arose in the context of (what is now) ToA enjoyment condition C, where the charge is on the value of the benefit; see 49.22.3 (Amount of charge under enjoyment condition C). But the same applies for s.731 and s.87.

may have fetched at the time the benefit is received.

It must be kept in mind that the language of the provision is of an individual who 'receives' a benefit. Therefore where, as in the case of rent free accommodation, the individual goes on receiving the benefit by continuous occupation of the property there is in effect an ongoing and continuous benefit. As taxation of a benefits charge is for a tax year, it will generally be appropriate to consider the amount or value of the benefit for that entire period, where there is a continuous provision of a benefit for the whole or part of that period. It will therefore be appropriate in such instances to consider the 'annual value', or appropriate proportion thereof, of the benefit received, not merely any value at the point of first receipt. Thus, in the case of rent free accommodation, it will not only be appropriate to consider the amount or value of the benefit during the particular tax year, but if that benefit continues to be provided, to consider its value for each subsequent period during which there is continuing provision, and to have regard to any changes that may occur in the value of the benefit (for example because of changes in marketplace for rental values). These principles of continuous provision are likely to apply to most situations where an asset is made available for use over a period of time.

50.13 Benefit causation condition

The third s.731 application condition is the benefit causation condition. Section 732(1) ITA provides:

> This section applies if ...
> (c) the benefit is provided out of assets which are available for the purpose as a result of—
> (i) the transfer, or
> (ii) one or more associated operations ...

There are two alternative conditions here:

(i) the benefit is provided out of assets which are available for the purpose as a result of the transfer; or

(ii) benefit is provided out of assets which are available for the purpose as a result of associated operations.

I refer to these as benefit causation conditions (i) and (ii). They are comparable to the relevant transfer causation conditions.

Thus, not every benefit that an individual receives falls within s.731: there must be a causal nexus between the benefit and the transfer.

Contrast the s.87 charge which applies where a beneficiary receives a benefit directly or indirectly from the trustees. The wording is different but the concept is similar.[99]

50.13.1 *B1 gives benefit to B2*

Suppose:

(1) A discretionary trust within s.731 has accumulated relevant income.

(2) In 1980, a beneficiary ("B1") receives a trust asset ("B1's asset"). Although B1 receives a benefit assume B1 does not pay tax under s.731 because he is non-resident, or qualifies for the s.731 remittance basis.[100]

(3) In 2010 B1 (independently and not as part of a prior arrangement) gives the asset to another beneficiary[101] ("B2") who is UK resident. This seems on a simple reading to be an operation associated with the transfer of assets to the trust.

B2 has received a benefit. Benefit causation condition (i) is not satisfied. However, it seems at first sight that benefit causation condition (ii) is satisfied, so B2 is at first sight subject to tax under s.731. This clearly cannot be right; but why not? It is necessarily part of the scheme of s.731 that when one beneficiary ("B1") receives a benefit, and uses the benefit to benefit another ("B2") only the first benefit counts. Otherwise what should be regarded in economic reality as a single benefit may give rise to a series of tax charges as it passes from one beneficiary to another and to another.[102] But why is this the case? The best answer is that the gift from B1 to B2 is not an operation associated with the original transfer. Mere historic association is not enough. These must be something more.[103] It is suggested that the principles to apply are those of a "clean break"

[99] See 61.8.1 (Indirect receipt from trust).

[100] Although strictly the position of B2 is the same even if B1 *is* taxed on B1's benefit, whether as a capital benefit under s.731 or as an income benefit under ITTOIA.

[101] If B1 transfers the asset to a person ("C") who is not a beneficiary of the trust (in the sense that trust income cannot be used to benefit C) then C cannot be subject to tax under s.731 as there is no relevant income in relation to C. But in a standard form discretionary trust there is a wide power to add beneficiaries; so trust income is relevant income in relation to every person in the world (whether or not they are specifically identified as "Beneficiaries" in the trust deed).

[102] Assume there is sufficient relevant income.

[103] The argument would be the same as in 48.13 (Income received as indirect consequence of transfer).

test.[104]

In *Denny v HMRC*:

(1) S (son of the taxpayer T) created a trust in the 1990's.
(2) The trust property was appointed to S (then non-resident); the date of this is not recorded.
(3) In 2000 S used the funds to lend £0.5m to his father, T. (T repaid over the following year but nothing turns on that.)

HMRC argued that T was subject to tax under s.731. The Tribunal dealt with this in a single sentence:

> We find that section [731] does not have effect because even if the loan to [T] could be considered a "benefit" within [s.732] it was not provided out of "assets which were available for the purpose", but rather from funds owned by [S] available for his own purposes. No charge arises under its provisions.[105]

The onward-gift rules also need to be considered.[106]

50.13.2 *Transfer between trusts*

Section 90 TCGA provides a code dealing with transfers between settlements for the purposes of s.87.[107] This is needed because a s.1(3) amount (trust gain) is computed in relation to settlements. Each settlement has a s.1(3) amount attributed to it.

Section 731 by contrast has no such need. Relevant income is *not* computed in relation to settlements. It is computed in relation to individuals and to transfers.[108] Thus a transfer of relevant income from trust 1 to trust 2 does not reduce the relevant income of beneficiaries of trust 1 who are also beneficiaries of trust 2.

Suppose:

(1) A trust ("trust 1") within s.731 has accumulated relevant income.
(2) Trust 1 transfers funds ("the transferred funds") to a new UK trust on similar terms ("trust 2").
(3) A beneficiary ("B") receives a benefit from trust 2 out of the

[104] See 99.7 (A gives to B, B gives to trust).

[105] [2013] UKFTT 309 (TC) at [96]. There is no detailed analysis, but this was a case where the taxpayer appeared in person, and HMRC did not instruct counsel.

[106] See 50.52 (s.731 onward-gifts).

[107] See 61.39 Transfer between trusts).

[108] See 50.20 ("Relevant income": Definition).

transferred funds.

The transfer from trust 1 to trust 2 is an operation associated with the earlier transfer to trust 1.[109] B has received a benefit and the benefit is provided out of assets which are available as a result of the transfer and the associated operation. So B is taxed under s.731. The benefit causation condition is satisfied.[110]

Suppose trust 2 was an established trust with a trust fund ("fund 2"). If B receives a benefit from fund 2, B is not taxable under s.731 because that fund is not available as a result of the transfer of assets to trust 1.

It follows that a transfer between settlements will not in principle avoid s.731 charge. There is no reason why it should (except a misconceived analogy with the s.87 rules which have no equivalent in the ToA code).

50.14 Benefit causation: 2 transfers

Suppose:

(1) A settlor by a single disposition transfers assets to a trust within s.731.
(2) Part of the trust fund is invested in assets which yield relevant income.
(3) Another part of the trust fund consists of a house occupied rent-free by B.

B pays tax on the benefit by reference to the relevant income.

By contrast, suppose:

(1) A settlor by *two* separate transfers creates *two* trusts within s.731:
    (a) a trust which holds income-producing assets and accumulates relevant income; and
    (b) a trust which holds the family home.
(2) B enjoys the benefit of free occupation in the home.

B is not subject to tax under s.731 as there is no relevant income in relation to this benefit. Thus the use of two trusts may avoid a tax charge under s.731 which would have arisen if there were one.

Indeed, it is not necessary to use two trusts. The same applies if there are two separate transfers of assets to one trust.

[109] A transfer between trusts is not a "clean break". After all, trustees are expected to pay close attention to the wishes of the settlor, and in doing so they are merely filling in the blanks left by the settlor: see 87.5.7 (Trust appointment: Filling blanks).

[110] If authority is needed, which I doubt, see *HMRC v Parry*, discussed at 74.5 (Omission: Deemed disposition).

50.15 Taxable-transferor defence

50.15.1 *"Relevantly domiciled"*

The fourth s.731 application condition is the taxable-transferor defence. Statute uses the term "relevantly domiciled" and it is convenient to consider this first. Section 732(4) ITA provides:

> For the purposes of subsection (1)(d), the individual [beneficiary] is "relevantly domiciled" at any time if at that time—
> (a) the individual is [actually] domiciled in the UK, or
> (b) the individual is regarded for the purposes of section 718(1)(b)[111] as domiciled in the UK as a result of section 835BA having effect because of Condition A in that section being met [formerly-domiciled resident[112]].

"Relevantly domiciled" is a opaque term; I refer to it as **"relevantly-taxable domiciled"** as a transferor who is relevantly domiciled does not qualify for s.720 protected-trust relief.

An individual is not relevantly-taxable domiciled if they are:

(1) not actually UK domiciled; and
(2) not a formerly-domiciled resident

It may be easier to follow in a table:

Actual dom	**Formerly-dom resident**[113]	**Relevantly-taxable domiciled**
yes	n/r	yes
no	yes	yes
no	no	no

The reader may think of several ways that the legislation could have been more simply drafted; in particular, the reader may wish that the drafter had not coined this opaque terminology. But there it is.

50.15.2 *Taxable transferor*

Section 732(1) ITA provides:

> (1) This section applies if ...
> (d) [i] where there is a time in the year when the individual [the beneficiary] is relevantly [taxably] domiciled,

[111] See 48.5 ("Person Abroad").

[112] See 5.4.2 (IT/CGT formerly-dom resident rule).

[113] The 15-year rule is irrelevant here.

[ii] the individual is not liable to income tax under section 720 or 727 by reference to the transfer[114]

Thus there are two classes of transferor; and in principle:

Relevantly-taxable domiciled	***s.720***	***s.731***
Yes	yes	no (taxable-transferor defence applies)
No	no	yes (defence does not apply)

The taxable-transferor defence is sensible. A transferor who is relevantly-taxable domiciled is within s.720. There is no need to apply s.731 to a transferor to whom s.720 applies. The application of s.720 gives HMRC all they should need.

50.15.3 *Transferor not relevantly-taxable domiciled*

For most transferors - those not relevantly-taxable domiciled - the protected-trust regime has:

(1) restricted s.720 (by introducing s.720 protected-trust relief); and
(2) widened s.731 (by removing the former transferor defence and replacing it by the narrower taxable-transferor defence).

A transferor who is not relevantly-taxable domiciled may be taxed under s.731 by reference to relevant income which arose before 2017/18, even though in earlier years the transferor qualified for the taxable-transferor defence. So there is an element of retrospectivity in the 2017 extension of the scope of s.731.

A transferor who is deemed UK domiciled under the 15-year rule is not relevantly-taxable domiciled and so is within s.731. The transferor is *likely* to be outside s.720. But the two sets of rules are not completely aligned. If the trust has been tainted, for instance, the transferor is within s.720 and *also* within s.731. I wonder if that is intended.

50.15.4 *Pre-2017 benefit*

Suppose a transferor receives benefits before 6 April 2017 which were not

[114] Prior to 2017, s.732(1) ITA provided:

> "This section applies if ...
>
> (d) [i] the individual [the beneficiary] is not liable to income tax under section 720 or 727 by reference to the transfer
>
> [ii] and would not be so liable if the effect of sections 726 and 730 [remittance basis] were ignored ..."

It is possible to envisage cases where the deletion of para (1)(d)[ii] (underlined) could make a difference, but it will not happen much if at all.

taxable under s.731 under the former transferor's defence. The benefits are not subsequently matched with relevant income under s.731. That is, the post-2017 s.731 charge on the transferor only applies to post-2017 benefits. Section 733(1) ITA provides:

> To find the amount (if any) of the income treated as arising under section 732(2) for any tax year in respect of benefits provided as mentioned in section 732(1)(c) take the following steps.
> Step 1 Identify the amount or value of such benefits received by the individual in the tax year and in any earlier tax years in which section 732 has applied.

In the earlier years, section 732 did not apply to the settlors: the condition in s.732(1)(d) was not met.

HMRC agree. HS262 provides:

> benefits provided to a transferor before 6 April 2017 will not be included in the calculating the transferors benefits for earlier years.[115]

50.15.5 *Transferor non-resident: pre-1996 transfer*

It has never been a requirement of s.731 that the transferor was (ordinarily) resident, at the time of the transfer, but this was a requirement of s.720 until 1996.[116]

RI 201 provides:

> ... a transferor of assets who is outside the charge to tax under Section 739 ICTA [now s.720 ITA] in respect of income arising before 26 November 1996 through being not ordinarily resident in the UK at the time of the transfer, is not assessed under [what is now s.731 ITA].

This is looking at a transferor "T" (wherever domiciled) who:
(1) makes a transfer of assets before 26 November 1996;
(2) is not UK (ordinarily) resident when T made the transfer;
(3) later becomes UK (ordinarily) resident.

T was not taxable under s.720 until 26 November 1996. I refer to income

[115] HS262, "Income and benefits from transfers of assets abroad and income from Non-Resident Trusts" (2023), updated 6 April 2023
The contrary view would lead to retrospective taxation, as a benefit received before 2017 could easily be taxed in 2017/18 wholly by reference to relevant income received before 2017.

[116] See 49.21.3 (Transferor non-resident when transfer made).

arising before that date as "pre-1996 income". If T receives a benefit after 26 November 1996[117] T is not taxable under s.731. This is right because the taxable-transferor defence does not apply to *income* liable to tax under s.720. It applies to an *individual* liable to tax under s.720. In the example, T (once resident and after 26 November 1996) becomes an individual who is "liable to tax under s.720". This is something of a windfall for T, but of course others may be taxed as the pre-1996 income is relevant income.

50.15.6 *Transferor non-resident at other times*

RI 201 does not address the situation where T is outside the scope of s.720 only because T is not resident for a period. Suppose:
(1) T is resident when T makes the transfer;
(2) T is non-resident for a period ("the non-resident period")
(3) T returns to the UK and is relevantly-taxable domiciled

The reasoning above shows that on these facts T is also outside s.731; T qualifies for the taxable-transferor defence in relation to income of the non-resident period as well as the income arising while resident.

The same applies if T becomes relevantly-taxable domiciled.

50.15.7 *Spouse of taxable-transferor*

The spouse of a relevantly-taxable domiciled transferor qualifies for the taxable-transferor defence, because references to the transferor include the spouse.[118] That only applies during the life of the transferor as after the death of the transferor, the widow/er is not a "spouse" (and the survivor of two civil partners is not a "civil partner").[119]

What is the position where:
(1) The transferor is non-resident
(2) The spouse is UK resident

The spouse may be liable under s.731. The taxable-transferor defence does not apply, because "the individual is not liable to income tax under s.720". Although the word "individual" includes the spouse:
(1) The spouse is not liable under s.720 (because s.720 liability rests only on the individual who is transferor)

[117] I need not now consider the position if the benefit was received before 26 November 1996 but the result was probably the same.

[118] See 48.18 (Spouse of transferor).

[119] See App 3.2 ("Spouse") and App 3.3 ("Civil partner").

(2) The transferor is not liable under s.720 being non-resident.

This is a somewhat selective application of the rule that of "individual" includes a spouse; but it gives the result which accords with the purpose of the taxable-transferor defence.

50.16 Capital-benefit condition

The fifth s.731 application condition is (in my terminology) the capital-benefit condition. Section 732(1) ITA provides:

> This section applies if ...
> (e) the individual [beneficiary] is not liable to income tax, under any provision that is none of
> [i] section 731 of this Act and
> [ii] sections 643A, 643J and 643L of ITTOIA 2005,
> on the amount or value of the benefit.

The drafting is ungainly, but it does not matter.

If the individual (beneficiary) *is* liable to IT, there is in general no need to apply s.731 to the benefit. The IT liability is all that HMRC should need.

The effect of para [ii] is that s.731 has priority over s.643A/J/L.[120]

If a non-resident receives income, that is not a capital payment for s.87 purposes.[121] There is no express equivalent for s.731. Before 2017 this was not needed, because benefits received by non-residents were outside s.731. Now there ought to be such a rule and it is arguably implied by a purposive construction.

50.16.1 *Benefit remittance-basis exempt*

What is the position if a trust makes an income distribution[122] to a remittance basis taxpayer, which is not remitted? The capital-benefit condition is not met. The payment is "liable" to income tax even if no tax is paid because of the remittance basis.[123] In short, an income receipt from a trust is taxed (if at all) under general principles[124] and not under s.731.

[120] See App.2.3 (Chargeable/liable to tax); 47.21.5 (Step 3: Benefit liable to IT).

[121] See 61.7 (Capital payment).

[122] For what is an income distribution, see 41.8 (Trust payment: Income/capital).

[123] See 2.3.1 (Unremitted RFI "chargeable").

[124] See 41.3 (Tier 3: Discretionary payment charge).

This question arises because the s.731 remittance basis is more limited than the ordinary ITA remittance basis. For instance, suppose:

(1) A discretionary trust within s.731 receives UK source income (or both UK and foreign source income).

(2) A remittance basis taxpayer ("B") receives income ("unremitted foreign trust income") from the trust.

B is taxable on the unremitted foreign trust income on the ITA remittance basis but assume the income is not remitted, so no tax is due. Can HMRC argue that B is subject to tax on the unremitted foreign trust income under s.731?[125] The answer is, no, because B is "liable" to IT on the benefit. By contrast, if B had received capital instead of income from the same trust, B would have been subject to tax on the benefit under s.731!

Of course, the word "liable" (like all words) takes its meaning from the context. So perhaps here HMRC may argue that unremitted foreign income is not "liable" to income tax, for the purposes of the capital-benefit condition? There is no good reason to construe the word in that wide way. This result is consistent with the rule that the taxable-transferor defence applies even to income which is remittance-basis exempt.[126] Anti-avoidance provisions, like hypotheses, should not be multiplied unnecessarily.

50.17 s.731/s.87 interaction

ToA wording: s.732(1)(e) ITA	**s.87 wording: s.97(1) TCGA**
This section applies if ...	"capital payment" —
(e) the individual [beneficiary] is not liable to income tax...	(a) means any payment which is neither—
	(i) chargeable to income tax on the recipient ...

The wording of these two provisions is effectively the same: *liable* (s.732)

[125] The s.731 remittance basis is not in point if the benefit relates to UK source relevant income: see 50.39 (s.731 remittance basis).

[126] See 50.15 (Taxable-transferor defence). A further objection to this HMRC argument is that there may be a double charge to tax:
(1) Tax under s.731 on receipt of the unremitted foreign trust income.
(2) Tax under general principles when the foreign trust income is later remitted to the UK.
Arguably, double-counting relief applies: see 51.9 (Double-counting relief). But there is no provision allowing tax paid under s.731 to be reclaimed.

and *chargeable* (s.87) are used interchangeably.[127] Before the tax law rewrite, s.740 ICTA (the predecessor to s.731) used the word "chargeable" and the rewrite change to "liable" has not altered the meaning.

The definition of "capital payment" for s.87 purposes is discussed in 61.7 (Capital payment).

In the following discussion "**a non-capital payment**" is a payment which is not a capital payment.

50.17.1 *Benefit matched on receipt*

The pre-ITA position was straightforward. Section 740 ICTA was, I think, a tax on the benefit.[128] If a person received a benefit which was subject to tax in the year of receipt, under s.740 (ie assume there was relevant income) then the benefit was a non-capital payment for CGT purposes.

It is not immediately obvious that the position is the same from 2007/08. For s.731 is not expressed as a charge on the benefit. It appears at first sight to be a charge on fictional, deemed income: the amount or value of the benefit is merely an element in the computation of the amount of the s.731 income. However it cannot be the case that the same benefit gives rise to CGT on the benefit and deemed income on an amount equal to the benefit. HMRC agree. The CG Manual provides:

> **CG38625: Capital payments** [Jul 2019]
> The exclusion for amounts chargeable to Income Tax includes both actual income receipts and amounts deemed to be income for tax purposes. For example:...
> [3] Capital distributions taxed as income under ITA07/S733 [in my terminology, s.731 income]. If section 733 applies after the year in which the benefit is received that benefit may be treated as a capital payment in the earlier years, TCGA92/S97(3).

A strained construction is needed to reach that result. There are two possible solutions:

(1) Either (contrary to first appearances) s.731 is in fact a charge on

[127] See App 2.3 (Chargeable/liable to tax).

[128] Section 740(2) ICTA provided (in short)

> "(2) ... the amount or value of any such benefit as is mentioned in subsection (1) above ... shall -
> (a) ... be treated for all the purposes of the Income Tax Acts as the income of the individual for that year..."

benefits; or

(2) The reference (in the definition of capital payment) to a payment which is "chargeable to IT" should be read as including a benefit giving rise to deemed income.

Section 97(3) TCGA (see below) adopts the first view and so does s.734(1)(c) ITA.[129] Ultimately it makes no difference for present purposes which solution one adopts, but the better view is that s.731 is a tax on the benefit.

50.17.2 *Benefit matched after receipt*

The pre-ITA position was straightforward. In the absence of express provision, a benefit which is not taxable under s.740 ICTA only for lack of relevant income might arguably have been a non-capital payment. But this argument was ruled out by s.97(3) TCGA. I set out the text of s.97(3) indicating the ITA amendments in track-change format:

> The fact that the whole or part of a benefit is by virtue of ~~section 740(2)(b) of the Taxes Act~~ section 733 of ITA 2007 treated as the recipient's income for a year of assessment after that in which it is received—
>
> (a) shall not prevent the benefit or that part of it being treated for the purposes of sections 86A to 96 and Schedule 4C as a capital payment in relation to any year of assessment earlier than that in which it is treated as his income; but
>
> (b) shall preclude its being treated for those purposes as a capital payment in relation to that or any later year of assessment.

Post ITA this wording is not apt because under s.731 (on a first reading) a benefit is not "treated as the recipient's income". Section 731 is a charge on deemed income. But it is obviously intended that a benefit outside s.731 (for lack of relevant income) is a capital payment for CGT; and it is considered that s.731 should be regarded as a tax on the benefit.

Thus suppose a benefit is conferred, but is not subject to s.731 in year of receipt for lack of relevant income :

(1) The benefit can be taxed as a capital payment in year of receipt.

(2) If the benefit is not subject to s.87 in year of receipt, for lack of s.1(3) amounts (trust gains) the s.731 charge in the following year has priority over the s.87 charge in that year; and so on.

[129] See 50.19 (Deduction for s.87 charge).

50.17.3 *Benefit remittance-basis exempt*

A benefit which falls within s.731 but qualifies for the s.731 remittance basis is taxed on the remittance basis, but is nevertheless "chargeable" to tax, so it is a non-capital payment.[130] HMRC agree. Residence and Domicile: FAQ provides:

> **Q** Could it be clarified that where a payment has been made - such as one under s731 which has attracted relevant income but has been protected from tax by non remittance - such a payment will not be regarded as a capital payment for s87 purposes?
> **A** Where a payment (benefit) results in an amount becoming taxable by virtue of s731 ITA 2007, but the charge is deferred by a remittance basis claim because no relevant amount has at that time been remitted to the UK, the benefit will not also be taken into account for the purpose of s87 TCGA.[131]

By contrast, s.731 does not apply to a benefit which does not meet any one of the five s.731 application conditions and such a benefit is a capital payment.

50.17.4 *Benefit: Motive defence applies*

Where the motive defence applies, the individual who receives a benefit is not *liable* to income tax under the ToA provisions. It might be argued that the benefit is chargeable (even if the individual is not liable). But the context shows that liable and chargeable here have the same meanings. So a benefit where the motive defence applies is a capital payment: it is not chargeable to IT within the meaning of the capital payment definition.[132]

50.18 Computation of s.731 income

50.18.1 *Introduction*

Section 733 ITA does two things:

[130] See 2.3.1 (Unremitted RFI "chargeable").

[131] *https://www.gov.uk/tax-foreign-income/non-domiciled-residents* The rubric to the FAQ provides: "Most of the FAQs have now been incorporated into the new guidance. Those that have not are reproduced below."

[132] This is consistent with the pre-2006 wording that "Sections 739 and 740 shall not apply" where the motive defence applied, so it was clear that a benefit where the motive defence applied could be a capital payment.

(1) it tells us the amount of s.731 income. I refer to the computation made under s.733 as the "**s.733 computation**".
(2) It tells us the year that s.731 income arises.

Section 733 is only a computation/timing provision. It does not apply unless the five s.731 application conditions are met.

In outline, where an individual receives a benefit, s.731 income is the lesser of:
(1) the value of the benefit; and
(2) the amount of relevant income[133]

The rewrite legislation was defectively drafted (it reproduced defects from the source legislation and added some new ones). It could serve as a case study as to how much obscurity can be found in method-statement drafting, an innovation of the Tax Law Rewrite in their search for clarity.[134] The 2017 reforms made matters even more obscure.

The task here is to find a construction which (if loose) will yield a workable scheme of taxation.

There are six steps in the computation:

Step	**Topic**
1	Total Benefits
2	Total Untaxed Benefits
3	Relevant income
4	Total Relevant Income
5	Available Relevant Income
6	Conclusion: amount of s.731 income

I write most of these terms with initial capitals, to reflect the technical nature of the expression.

50.18.2 *Step 1: Total Benefits*

In order to follow Step 1, we need to read it together with s.732 and the opening words of s.733. So far as relevant this provides:

> **732(1)** This section applies if—
> (a) a relevant transfer occurs,
> (b) an individual receives a *benefit* in a tax year.

[133] Contrast s.720, which (in principle) imposes a charge on the whole of the income accruing to the person abroad.

[134] See 61.15.7 (Method statements: Critique).

> (c) the *benefit* is provided out of assets which are available for the purpose as a result of—
> (i) the transfer, or
> (ii) one or more associated operations,
> (d) [taxable-transferor defence]
> (e) the individual is not liable to income tax on the amount or value of the *benefit*...

Assuming these conditions (which I call "the s.731 application conditions") are satisfied, we read on to s.732(2):

> Income is treated as arising to the individual [beneficiary] for income tax purposes for any tax year for which section 733 provides that income arises.

With that in mind, we can turn to the s.733 computation:

> **733(1)** To find the amount (if any) of the income treated as arising under section 732(2) [s.731 income] for any tax year in respect of *benefits provided as mentioned in section 732(1)(c)* take the following steps.
>
> *Step 1 [Total Benefits]*
> Identify the amount or value of *such benefits* received by the individual
> [1] in the tax year and
> [2] in any earlier tax years *in which section 732 has applied.*
> The sum of those amounts and values is "the total benefits".

I adopt the following terminology:
Total Benefits: benefits within Step 1 (this is the statutory term)
Present year Total Benefits: benefits within Step 1[1]
Earlier year Total Benefits: benefits within Step 1[2]

There are two obscure references in Step 1:

(1) Which benefits of the current year are counted as Total Benefits? One does not identify *all* benefits received by the individual, but only "such benefits". The drafter has overlooked the rule that "such" ought only to be used when it refers to a clear antecedent.
   (a) The narrow view: "such benefits" refers back to the words in the first sentence of s.733(1): "benefits provided as mentioned in s.732(1)(c)". So "such benefits" means all benefits which meet the benefit causation condition.
   (b) The wider view: "such benefits" refers back to s.732(1) which uses the word benefit three times. "Such benefits" means

benefits in respect of which all five s.731 application conditions are satisfied (not just the benefit causation condition).

On the narrow view an income-taxable benefit can count as "such benefits"; on the wider view an income-taxable benefit does not count (because of the capital-benefit condition)

The wider view is to be preferred as it yields more sensible results.[135]

(2) Which benefits from earlier years are Total Benefits? One does not count *all such benefits* received by the individual, but only such benefits in tax years "in which s.732 has applied". It is not of course enough that *section 732 applies*, for the section no doubt applies every year to some taxpayer or other. Section 732 must apply having regard to the circumstances of the transfer or the individual in the earlier year.

HMRC paraphrase Step 1 as:

> Add together the benefits received in the tax year and in any earlier year in which benefits charge could or has applied.[136]

If this is right, the definition of "Total Benefits" can be expanded to mean the following:

[1] *Present year Total Benefits* must meet the following conditions (in order to be "such benefits"):

(a) a relevant transfer has occurred
(b) an individual("B") receives a benefit in the present tax year
(c) the benefit is provided out of assets which are available for the purpose as a result of—
(i) the transfer, or
(ii) one or more associated operations,
(d) B is not a relevantly/taxable domiciled transferor; and
(e) B is not liable to income tax on the benefit (apart from section 731).

[2] *earlier year benefits* must meet the following conditions (in order to be "such benefits" and to meet the requirement that s.732 applies in the year):

[135] If one adopted the first view one could avoid the problems which arise by a generous application of s.743 ITA (no duplication of charges); but it is better to avoid that solution since the relief depends on HMRC discretion.

[136] See 50.18.8 (s.733 computation example).

(a) The relevant transfer has occurred

(b) B received a benefit in the earlier year ("the earlier year benefit").

(c) the earlier year benefit is provided out of assets which are available for the purpose as a result of -
(i) the same transfer as [1] (a) above, or
(ii) the same associated operations as [1] (c) above

(d) Pre 2017 benefits: B is not the transferor; post 2017 benefits: B is not a relevantly-taxable domiciled transferor

(e) B is not liable to income tax on the earlier year benefit (apart from section 731).

50.18.3 *Step 2: Total Untaxed Benefits*

Step 2 provides:

[1] Deduct from the total benefits the total amount of income treated as arising to the individual under section 732(2) [s.731 income] for earlier tax years as a result of the relevant transfer or associated operations

[2] except that,
[a] where any of that income [s.731 income] is matched deemed income for the purposes of section 731(1A),[137]
[b] that matched deemed income is to be deducted only so far as it is matched deemed income on which tax has been charged under section 731 for an earlier tax year.

The result is "the total untaxed benefits".

We need a label to describe the deduction, as it is impossible to follow a discussion which refers more than once to "the total amount of income treated as arising to the individual under section 732(2) for earlier tax years as a result of the relevant transfer or associated operations". I refer to the deduction as "**prior-year s.731 income**".

A straightforward example is:

Year 1: B receives benefit	£100
Year 2: B receives benefit	£100
Total Benefits	£200

But assuming in year 1 B was treated as receiving £100 s.731 income, then the prior-year s.731 income is deducted, so Total Untaxed Benefits is computed thus:

[137] See 50.45.1 (Matched s.731 Income).

Total Benefits	£200
Prior-year s.731 income	-£100
Total Untaxed Benefits	£100

Section 734 ITA provides for another deduction from Total Untaxed Benefit: since this only arises infrequently I deal with it separately below; see 50.19 (Deduction for s.87 charge).

50.18.4 *Steps 3/4: Total Relevant Income*

Steps 3 and 4 concern relevant income and Total Relevant Income, and are discussed as a separate topic.

50.18.5 *Step 5: Available Relevant Income*

Step 5 provides:

> Deduct from total relevant income—
> (a) the amount deducted at Step 2 [ie prior-year s.731 income], and
> (b) any other amount which may not be taken into account because of section 743(1) and (2) (no duplication of charges).
> The result is "the available relevant income".

The deduction in Step 5(b) is discussed in 51.9 (Double-counting relief).

What is the reason for the deduction in Step 5(a)? EN ITA explains a double taxation problem in the pre-ITA law:

> Section 740 of ICTA [now s.731 ITA] leaves several questions unanswered.
> It provides that
> [a] if the relevant income exceeds the benefit, the amount or value of the benefit is chargeable to income tax in the individual's hands,
> [b] but does not make provision about the treatment of the excess of the relevant income over that amount.
> [c] Taken literally and in isolation, section 740(2)(a) suggests that whenever a benefit is received the amount or value of the benefit must be compared with *all* the relevant income that has arisen on or after 10 March 1981, regardless of whether the receipt of previous benefits has involved charges by reference to that income before.[138]

[138] Section 740(2) ICTA provided so far as relevant:
" ... the amount or value of any such benefit as is mentioned in subsection (1)

For instance, if the relevant income is only £100, and T receives benefits of £100 annually, T would appear to be taxed each year on £100, so the relevant income in effect comes into charge again and again. I refer to this as the **"RI multiple-counting problem"**. I confess I had not noticed the problem, but point [c] seems correct if one takes the words "literally and in isolation" (which is of course never the right approach).

The EN then give two independent reasons why no problem arose, that is, it identifies two pre-ITA solutions to the RI multiple-counting problem:

> But
> [1] relevant income is defined as income that can directly or indirectly be used to provide a benefit in the tax year [ie in the year that the tax charge arises], and
> [2] section 744(1) and (2)(c)[139] of ICTA [now s.743 ITA] prevent the same relevant income being taken into account more than once.
> It is therefore considered that the *surplus* relevant income *(if it continues to be available)* has not been taken into account and so must be carried forward year by year until extinguished by a benefit or benefits. Section 733 of this Act gives effect to this view by providing [only] for *surplus* relevant income to be carried forward.[140]

Note that it is assumed in solution [1] that in order to identify the amount of relevant income, one asks whether income can be used to provide a benefit at the time the tax charge arises, ("if it continues to be available") not at the time that the relevant income accrues.

Example 1: one beneficiary

Suppose a trust with Total Relevant Income of £200 and:
(1) Year 1: B receives a benefit (£100) and £100 s.731 income. Assume the benefit is not paid out of relevant income.
(2) Year 2: B receives another benefit (£200).
The computation in year 2 is:

Step 1: The Total Benefits of B are £300.
Step 2: The Total Untaxed Benefits of B are computed thus:

above, ... shall— (a) to the extent to which it falls within the amount of relevant income of years of assessment up to and including the year of assessment in which the benefit is received, be treated for all the purposes of the Income Tax Acts as the income of the individual for that year".

[139] The original erroneously reads: (2)(b).

[140] Change 1113, p.472; emphasis added.

Total Benefits	£300
Prior-year s.731 income	- £100
Total Untaxed Benefits:	£200

Steps 3 and 4: The Total Relevant Income is £200.
Step 5: The Available Relevant Income is computed thus:

Total Relevant Income	£200
Prior-year s.731 income	- £100
Available Relevant Income:	£100

Step 6: the amount of s.731 income in year 2 is the lower of Total Untaxed Benefits and Available Relevant Income = £100.

That is fair and reasonable and Tax Law Rewrite's solution to the RI multiple-counting problem has worked.

Example 2: two beneficiaries

Now suppose a trust with Total Relevant Income of £200 and:

(1) Year 1: B receives a benefit (£100) and £100 deemed income under s.731
(2) Year 2: C (not B) receives a benefit (£200)

The computation for C in year 2 is:
Step 1: The Total Benefits of C are £200.
Step 2: The Total Untaxed Benefits of C are £200 (nothing is deducted).
Step 5: Total Available Income = £200: There is no deduction from the Total Relevant Income under Step 5(a) because nothing is deducted at Step 2.

Here the Step 5(a) deduction does not prevent double taxation. The Tax Law Rewrite team have only partly solved the RI multiple-counting problem which (on a literal reading and taken in isolation) they identified. They have solved the problem where the *same* beneficiary receives benefits in different years. They have not solved it where *different* beneficiaries receive benefits in different years. Why is C not taxed on £200?

C must fall back on one of the two pre-ITA solutions identified by the Tax Law Rewrite team:

(1) that distributed income ceases be relevant income (because it ceases to be available); so the amount of relevant income is only £100 (assuming B's benefit is a distribution of relevant income); or (if relevant income is not distributed):

(2) Step 5(b): double-counting relief.

Solution (2) applies if the distribution to B did not consist of relevant income. It depends on HMRC discretion, but that was the position before the ITA rewrite, so nothing has changed.

Example 3: one beneficiary receives a distribution of relevant income

The second difficulty is that the rewrite team solution – a deduction for prior-year s.731 income – does not link in with the first of the pre-ITA solutions to the RI multiple-counting problem. Suppose a slight variant to example 1: a trust with Total Relevant Income of £200 and:

(1) Year 1: B receives a benefit (£100) and £100 s.731 income. Assume the benefit *is* paid out of relevant income.[141]

(2) Year 2: B receives another benefit (£200).

The computation in year 2 is:

Step 1: The Total Benefits of B are £300.

Step 2: The Total Untaxed Benefits of B is computed thus:

Total Benefits	£300
Prior-year s.731 income	- £100
Total Untaxed Benefits:	£200

Steps 3 and 4: The Total Relevant Income is £100 (because £100 has already been distributed and is not available to provide a benefit.)

Step 5: The Available Relevant Income appears to be:

Total Relevant Income	£100
Prior-year s.731 income	−£100
Available Relevant Income:	£0??

B should have £100 s.731 income in year 2, not £0! I think that the best solution is to say that where relevant income is distributed, no further deduction is allowed at Step 5, so there is no double deduction. Though this is reading a good deal into the provision.

50.18.6 *Computation under s.731 remittance basis*

Where the s.731 remittance basis[142] applies, s.731 income is still treated as accruing to the foreign domiciled individual under s.731, even though not remitted. So the s.731 remittance basis does not prevent a deduction

[141] For instance, trust income is accumulated and then paid to the beneficiary as capital.

[142] See 50.39 (s.731 remittance basis).

under Step 2 (and Step 5(a)) if applicable.

Suppose the facts of example 1 or 3 above, but the benefit which B received in year 1 was a foreign benefit which qualified for the s.731 remittance basis. The computations are exactly the same. Thus benefits to B within the s.731 remittance basis reduce Available Relevant Income in relation to B (whether or not made out of relevant income) just as where the arising basis applies.

Suppose the facts are as in example 2 above, but the benefit which B received in year 1 was a foreign benefit which qualified for the s.731 remittance basis. There is as before no deduction under Step 2 or Step 5, but C must fall back on the two pre-ITA solutions to the RI multiple-counting problem:

(1) that distributed income ceases be relevant income (because it ceases to be available); or (if relevant income is not distributed):
(2) Step 5(b): double-counting relief.

Solution (2) depends on HMRC discretion, but it is considered that the relief ought to apply to relieve C. Of course, B may not agree. Suppose a variant of example 2:

Example 4: two beneficiaries, one remittance basis user

Suppose a trust with Total Relevant Income of £200 and:

(1) Year 1: B receives a benefit (£100) and £100 deemed income under s.731. B is a remittance basis taxpayer and does not remit the benefit so no tax is due.
(2) Year 2: C receives a benefit (£200).
(3) Year 3: B receives the benefit in the UK.

The computation for C in year 2 is the same as example 2:
Step 1: The Total Benefits of C are £200.
Step 2: The Total Untaxed Benefits of C are £200 (nothing is deducted).
Step 5: Total Available Income = £200: There is no deduction from the Total Relevant Income under Step 5(a) because nothing is deducted at Step 2.

Is C taxed on £200? C must fall back on one of the two pre-ITA solutions identified by the Tax Law Rewrite team:

(1) that distributed income ceases be relevant income (because it ceases to be available); so the amount of relevant income is only £100 (assuming B's benefit is a distribution of relevant income); or (if

relevant income is not distributed):

(2) Step 5(b): double-counting relief.

If the distribution to B did not consist of relevant income solution (2) is the only one available. It depends on HMRC discretion but it is considered that it ought to be allowed. It follows that C will be taxed in year 3. C may argue that B ought to be taxed and B's may be subject to tax remittance should be tax free, but that seems less "just and reasonable". That is consistent with the s.87 rules where a s.1(3) amount (trust gain) may be matched with a capital payment to a remittance basis taxpayer.

50.18.7 *Step 6: Computation of charge*

We have at last reached the final step of the s.733 computation. Step 6 is as follows:

> Compare the total untaxed benefits and the available relevant income.
> The amount of the income treated as arising under section 732(2) [s.731 income] for any tax year is the total untaxed benefits unless the available relevant income is lower.
> If the available relevant income is lower, it is the amount of income treated as so arising.

That is, the s.731 income is the lesser of:

(1) Total Untaxed Benefits; and

(2) Available Relevant Income

See too 51.15 (Benefits exceed relevant income).

50.18.8 *s.733 computation example*

ToA guidance provides:

> **INTM601760 The benefits charge: Example**[143]
> This example assumes all years are after April 2007 but before April 2013 and that all of the conditions necessary for a benefits charge to apply are met.
> A transfer of assets is made in Year 1 as a result of which income arises to a person abroad. An individual who is resident in the UK and who did not make the transfer receives cash benefits, as set out below, out of assets which are available for the purpose as a result of the transfer and associated operations. The benefits are not otherwise liable to income tax and the individual is not liable to an income charge [the s.720 charge].

[143] I have slightly tweaked the layout for clarity:

Year	Relevant income	Benefits received	s.731 income[144]
1	£10,000	£5,000	£5,000
2	£20,000	£10,000	£10,000
3	£10,000	£10,000	£10,000
4	£10,000	£5,000	£5,000
5	£50,000	£100,000	

Step 1 – 'the total benefits'

Add together the benefits received in the tax year (Year 5) and in any earlier year in which benefits charge could or has applied. The earlier years to take into account are Years 1 – 4.

Year 5	Benefit	£100,000
Years 1 – 4	Benefits	£30,000
The total benefits		£130,000

Step 2 – 'the total untaxed benefits'

Deduct from the total benefits, the amount of income treated as arising to the individual in any earlier tax years:

The total benefits		£130,000
Income for benefits charge	Years 1 - 4	- £30,000
The total untaxed benefits		£100,000

Step 3 – 'the relevant income of the tax year'

The income of year 5 which can be used for providing a benefit for the individual is £50,000, which is 'the relevant income of the tax year'.

Step 4 –'total relevant income'

Add together the relevant income of year 5 and the relevant income of years 1-4.

Relevant income of year 5	£50,000
Relevant income of yr 1-4	£50,000
Total relevant income	£100,000

Step 5 – 'the available relevant income'

Deduct from the total relevant income, the amount deducted at Step 2. In this example there are no other deductions to be taken into account.

Total relevant income	£100,000
Deducted at Step 2	- £30,000
The available relevant income	£70,000

Step 6 – the amount of income treated as arising for the tax year

Compare the result of Step 2 with the result of Step 5:

Total untaxed benefits	£100,000
Available relevant income	£70,000
The lower of the two is	£70,000

The amount treated as income arising to the individual in year 5 is therefore £70,000. This is neither the relevant income of that year nor the benefits received in that year.

[144] [From original text] To determine whether there is income treated as arising to the individual in Year 5 and if so what amount apply the Steps formula. Assume for this that the formula was also applied in Years 1 – 4 and resulted in income being treated as arising as set out here.

It may be noted that there are still £30,000 of benefits unmatched in this example therefore if for example there was further relevant income in a subsequent year a further Steps calculation would be made for that year.

50.18.9 *Computation: Motive defence lost*

The second example concerns a case where the motive defence formerly applied but was lost following an associated operation with an avoidance purpose.[145]

ToA guidance provides:

> **INTM601780 Example - where modifications apply**[146]
> The income and benefits set out in the table below result from a transfer of assets in 2000-01. It is agreed that an exemption applies to the transfer such that there is no income or benefits charge.
> Following the death of the transferor a transaction is undertaken in 2007-08 in relation to the assets of the fund, designed for the purpose of tax avoidance. It is agreed no exemption applies to prevent a potential benefits charge for 2007-08.
> What is the benefits charge for that year?
>
> | **Year** | **Relevant income** | **Benefits received** |
> |---|---|---|
> | 2000-01 | £50,000 | £10,000 |
> | 2001-02 | £50,000 | £10,000 |
> | 2002-03 | £50,000 | £10,000 |
> | 2003-04 | £50,000 | £10,000 |
> | 2004-05 | £50,000 | £10,000 |
> | 2005-06 | £50,000 | £10,000 |
> | 2006-07 | £50,000 | £10,000 |
> | 2007-08 | £5,000 | £10,000 |
>
> First there is no charge under either the income or benefits charge for 2000-01 to 2006-07 as an exemption [motive defence] applies in relation to the original transfer
> For 2007-08 there would be no benefits charge if an exemption applies.
> As there are both pre-5 December 2005 and post-4 December 2005 transactions, the relevant exemption is in section 740 ITA 2007. (see INTM602840).
> As the transaction after 4 December 2005 does not meet the conditions for exemption section 740(3) requires the modifications described at INTM601740 to apply for the purpose of the benefits charge.
> To determine the amount of income (if any) to be treated as arising to the individual for 2007-08 the Steps approach has to be applied and with the specified modifications (INTM601720).
> **Step 1 – 'the total benefits'**
> Add together the benefits received in the tax year (2007-08) and in any earlier

[145] See 52.32 (Pre-2005 transfer; post-2005 operation).

[146] I have slightly tweaked the layout for clarity:

year in which benefits charge could or has applied.

In this example there are two possible approaches to 'earlier years'. Either that there are no earlier years to be taken into account under this Step as there was an exemption and thus the provisions did not apply (all earlier years were pre-ITA 2007). Or that the benefits of all earlier years have to be taken into account and that the modifications provided by section 740(6)-(7) ITA 2007 apply to this Step. The modification if applied in this way would seem to require 2000-01 – 2004-5 benefits to be left out and that for 2005-06 to be time apportioned. If applied in this way the benefit received in 2006-07 would also be taken into account so that "the total benefits" would then become £10,000 + £10,000 plus £3,333 (4/12 × £10,000). Such an approach would not seem to be consistent with an exemption applying for 2006-07, as it would in effect bring those benefits back into the calculation in 2007-08 and result in an equivalent amount of income being charged. HMRC take the view that the apportionment required by section 740(7) will only be relevant where there are transactions in 2005-06 post-4 December, with a pre-5 December transaction in that or an earlier year. In this example therefore there are no earlier years to take into account in this Step as there are no earlier years to which a benefits charge applied, or to which a benefits charge would have applied but for an insufficiency of relevant income to match against benefits.

2007-08	Benefit	£10,000
2000-01 to 2006-07	Exemption for all yrs	£0
The total benefits		£10,000

Step 2 – 'the total untaxed benefits'

Deduct from the total benefits, the amount of income treated as arising to the individual in any earlier tax years:

The total benefits		£10,000
Income for benefits charge	2000-01 – 2006-07	£0
The total untaxed benefits		£10,000

Step 3 – 'the relevant income of the tax year'

The income of 2007-08 which can be used for providing a benefit for the individual is £5,000, which is 'the relevant income of the tax year'.

Step 4 –'total relevant income'

Add together the relevant income of 2007-08 and the relevant income of years 2000-01 – 2006-07. The modification provided by section 740(5) requires the earlier years' income be taken into account even though there was an exemption.

Relevant income of 2007-08	£5,000
Relevant income of 2000-1 to 2006-07	£350,000
Total relevant income	£355,000

Step 5 – 'the available relevant income'

Deduct from the total relevant income, the amount deducted at Step 2. In this example there are no other deductions to be taken into account.

Total relevant income	£355,000
Deducted at Step 2	£0
The available relevant income	£355,000

Step 6 – the amount of income treated as arising for the tax year

Compare the result of Step 2 with the result of Step 5:

Total untaxed benefits	£10,000
Available relevant income	£355,000
The lower of the two is	£10,000

The amount treated as income arising to the individual in 2007-08 is therefore £10,000.

If in this example the 'tainting' transaction had taken place after 4 December 2005 and before 5 April 2006, then even though the ITA 2007 Steps approach did not apply for that year (see INTM601800) the effect would have been the same and applying the 'modifications' would have resulted in a comparison of time apportioned benefits of 2005-06 with relevant income of that and all earlier years. If the facts above for 2007-08 had been those of 2005-06 the result would have been a benefits charge of £3,333 for 2005-06 regardless of when after 4 December 2005 (and before 5 April 2006) the tainting transaction took place.

50.18.10 *s.733 computation: Critique*

The reader who has laboriously followed the text to this point will agree that s.733 needs to be rethought and rewritten.

50.19 Deduction for s.87 charge

Section 734 ITA provides:

> (1) This section applies if—
>
> (a) benefits provided as mentioned in section 732(1)(c) are received in a tax year,

That is, the benefit is in principle taxable under s.731.

> (b) for that tax year the whole or part of any benefits so provided is a capital payment to which section 87 or 89(2) of, or para 8 of Schedule 4C to, TCGA 1992 applies (chargeable gains: gains attributed to beneficiaries),

That is, the benefit is in principle taxable under s.87.

> (c) it is such a payment because the total untaxed benefits[147] exceed the available relevant income (see Step 6 in section 733(1)) and so it is not treated as income arising to the individual under section 732(2), and

That is, the benefit was not subject to income tax for lack of relevant income.

[147] Section 734(4) provides:

"In this section 'the total untaxed benefits' and 'the available relevant income' have the same meaning as in section 733(1) (see Steps 2 and 5)."

> (d) because of that capital payment chargeable gains are treated as accruing to the individual in that or a subsequent tax year under any of the provisions referred to in para (b) [s.87, 89(2), para 8 sch 4C].

The CGT charge applies under the rules set out in 50.17 (s.731/s.87 interaction).

> (2) For any tax year after one in which such chargeable gains are so treated, the amount of income treated as arising to the individual under section 732(2) [s.731 income] in respect of benefits provided as mentioned in section 732(1)(c) as a result of the transfer or operations in question is calculated as follows.
> (3) The amount is calculated under section 733(1) as if the total untaxed benefits were reduced by the amount of those gains.

This ensures that a benefit charged under s.87 is not later also charged to IT.

50.20 "Relevant income": Definition

"Relevant income" is a central but perplexing concept. The absence of litigation on the subject is because HMRC have in practice generally applied the legislation in a way which leads to a sensible result.

Section 733(1) Step 3 provides the definition:

> *Step 3*
> Identify the amount of any income which—
> (a) arises in the tax year to a person abroad, and
> (b) as a result of the relevant transfer or associated operations can be used directly or indirectly for providing a benefit for the individual.
>
> That amount is "the relevant income of the tax year" in relation to the individual and the tax year.

The condition in Step 3(a), that income arises to a person abroad, is the same as in the transfer of asset conditions.[148]

Strictly one should not use the term "relevant income" in the abstract. Relevant income can exist only *in relation to an individual.* There may be relevant income in relation to A which is not relevant income in relation to B (eg income of a discretionary trust under which A can benefit and B cannot). There may be relevant income in relation to anyone in the world (eg income of a discretionary trust with a power to benefit anyone

[148] See 48.7 (Income "payable" to person abroad).

in the world). But where the context is clear, one may refer to "relevant income" in isolation (leaving the words "in relation to the individual" and the identity of that individual to be inferred).

The s.731 concept "relevant income" must not be confused with "relevant foreign income."

50.20.1 *Pre-1981 income*

Para 133 sch 2 ITA provides:

> (1) Section 732 (non-transferors[149] receiving a benefit as a result of relevant transactions) applies whenever the relevant transfer referred to in that section took place.
> (2) But the relevant income referred to in section 733(1) (by reference to which the amount of income treated as arising under section 732 [s.731 income] is determined) does not include income that arose before 10 March 1981.

50.21 Deemed income of person abroad

50.21.1 *Capital treated as income*

Although the statute refers to "income", capital receipts of the person abroad are sometimes treated for tax purposes as income of the person abroad, and such receipts can therefore be relevant income.[150]

50.21.2 *Stock dividend/accrued income*

Suppose non-resident trustees receive a stock dividend from a UK company. In that case "income is *treated* as arising to the trustees": see s.410(3) ITTOIA. The amount is deemed "income" for ToA purposes, but it is considered that it is not relevant income. The amount is fictional so one cannot say that it "can" be used for the benefit of any beneficiaries. The shares issued in the stock dividend can be used for that purpose, but they are not the same income.[151] The distinction between a gain and an amount equal to the gain is one on which HMRC insist in a DTA context;[152] here the distinction between the actual stock dividend and the fictional income is similar but clearer.

[149] The reference to non-transferors is inaccurate after 2017, but it does not matter.

[150] See: 48.15 (Capital receipts deemed income); 70.10.2 (Non-resident co/institution); 67.10 (OIG arising to non-resident trust).

[151] See to 48.15 (Capital receipts deemed income).

[152] See 107.22 (Characterisation).

The same point arises if a person abroad is treated as receiving AIP income. The amount is treated as income becoming payable to the person abroad for ToA purposes[153] but it is considered that it is not relevant income. The amount is fictional so one cannot say that it "can" be used for the benefit of any beneficiaries. The proceeds of the AIP securities can be used for that purpose, but that is not the same income.

HMRC may argue that one should carry through the deeming:[154] if the person abroad is treated as receiving income, the (deemed) income must be treated as if it can be used to benefit beneficiaries (even though it does not exist). If that were right, however, two difficulties would arise:

(1) How would the rule that distributed income is not relevant income[155] operate in this context? In order to distribute the AIP income would it be necessary to distribute the entire proceeds of the transfer (sale) of the security? Perhaps the matter would be analogous to the DDS scheme.[156] Then the only way to avoid relevant income by distribution would be to distribute the entire proceeds of the securities. Perhaps a division would be possible as it is under the mixed fund rules.[157]
(2) How does one deal with AIP loss relief? This tends to support the view that AIP income is not relevant income.

50.22 Life tenant: Relevant income

Consider an interest in possession trust: one where the trust income is payable to a beneficiary ("L").

If L is UK domiciled and resident, the trust income is not relevant income because it does not meet the condition in Step 3(a). It does not arise to a person abroad.

If L is not UK domiciled then the condition in Step 3(a) is satisfied. Nevertheless, the trust income is not relevant income because it is distributed.[158]

[153] See 28.14 (ToA rules /AIP income).

[154] For the general approach to deeming provisions, see App 8.2 (Deeming provisions: Construction).

[155] See 50.29 (Income distributed as it arises) to 50.27 (Distributed income: HMRC view).

[156] See 29.15.1 (s.731 ITA).

[157] See 28.9.2 (Mixed funds: Sale with accrued interest).

[158] See 50.29 (Income distributed as it arises). Even if that were wrong:
(1) The trust income is not relevant income in relation to L. One would not say in

There is nothing surprising in this conclusion: there is no need for s.731 in these circumstances, and one would not expect it to apply. If it did apply there could be double taxation – L being taxed on the income L receives, and on other benefits (if L receives any) to the value of the relevant income.

50.23 Settlor-interested trust: Relevant income

One must consider UK resident and domiciled settlors separately from those who are non-resident or domiciled.

50.23.1 *UK resident and dom settlor*

Suppose:

(1) a non-resident discretionary trust within s.731;

(2) a UK resident and domiciled settlor ("S") has an interest in the trust.

All the trust income is within the scope of s.624 ITTOIA. Section 624 ITTOIA provides in such a case:

> Income which arises under a settlement is treated for income tax purposes as the income of the settlor *and of the settlor alone ...*
> (Emphasis added)

The trust income is not relevant income as it does not meet the condition in Step 3(a): the income is treated by s.624 as accruing to S, so it cannot be regarded as arising to a person abroad. This is so even if S (wrongly) fails to pay the tax due on the income.

50.23.2 *UK resident non-dom settlor*

Now suppose:

(1) a non-resident discretionary trust within s.731;

(2) a UK resident but not UK domiciled settlor ("S") has an interest in the trust; and

(3) the trust income is actually subject to tax under s.624 ITTOIA (the s.624 remittance basis does not apply).[159]

ordinary language that the trust income *can* be used for providing a benefit for L. The income *is* the property of L.

(2) The trust income is not relevant income in relation to any other person. Since the income belongs to L, one cannot say that the income "can" be used to benefit anyone else. See 50.25 (Income which "can" be used to benefit another).

[159] This may be because there is UK source income, or foreign income is received in the UK, or S does not claim the remittance basis. See 47.8 (Section 624 remittance

In this case the condition in Step 3(a) is satisfied since even applying s.624 the income is treated as accruing to S. However, it is considered that the condition in Step 3(b) is not satisfied: if the income is treated as that of S, and of no other person, it is not income which "can be used for providing a benefit" for anybody else. So the income is not relevant income.

The position is different if and to the extent that the income is within the s.624 remittance basis. Section 624 does not apply to income which qualifies for the s.624 remittance basis.[160] Accordingly the trust income can, in principle, be relevant income for s.731. What happens then if the income is later remitted, so it becomes taxable on S under s.624? It is tentatively suggested that the income retrospectively ceases to be relevant income, so that tax paid under s.731 can be recovered by a beneficiary. In practice this could arise only in fairly unusual circumstances, eg where:

(1) Year 1
  (a) a beneficiary ("B") receives a benefit;
  (b) foreign source income arises on which the settlor ("S") is not subject to tax as the s.624 remittance basis applies. This is relevant income in relation to B, so B pays tax under s.731.
(2) Year 2: that income is remitted to the UK, so S pays tax under s.624.

Where s.720 applies (as well as s.624) see 50.24 (s.720 income: Relevant income).

50.23.3 *Non-resident settlor*

Suppose now:
(1) a non-resident discretionary trust within s.731; and
(2) a non-resident settlor ("S") has an interest in the trust.

Section 624 does not apply to foreign source trust income.[161] Accordingly foreign source income may in principle be relevant income.

Section 624 does apply to UK source income. Here too it is submitted that the condition in Step 3(b) is not satisfied: if the income is treated as that of S, and of no other person, it is not income which "can be used for providing a benefit" for anybody else. So UK source income is not relevant income.

basis).

[160] See 47.8 (s.624 remittance basis).

[161] See 47.9 (Non-resident settlor).

50.23.4 *HMRC practice*

RI 201 provides:

> ... income will not in practice be charged on both the beneficiary under s 740 and the settlor under the settlements legislation, where an assessment could in strictness be made on each of them in a case involving income that is accumulated within a discretionary offshore trust in which the settlor retains an interest, and then paid to a beneficiary as capital.[162]

This does not grapple with the technicalities of the legislation, but one can collect a sensible intention to avoid double taxation.

50.24 s.720 income: Relevant income

The analysis is different if income falls within s.720 and not s.624 because the wording of the provision is different.

The application of s.720 does not prevent income from being relevant income, as the s.720 income is different income from the income of the person abroad.[163]

Double-counting relief prevents a double charge.[164] This is surprising, because it is not clear who qualifies for the relief: the transferor or a beneficiary who receives a benefit. But it is difficult to construe the legislation any other way.

50.25 Income "can" be used to benefit

An essential feature of the definition of relevant income in relation to an individual is the condition in Step 3(b) that the income "can be used for providing a benefit" for the individual.

"Can", like most common words, has a variety of meanings, but the meaning here must be:

[162] RI 201 continues: "However, in both cases this is subject to the proviso that the Revenue may sometimes raise alternative assessments, for example where a taxpayer has not provided full information." But there can be no objection to that.

[163] See 49.30 (DT relief: s.720 income). For pre-2013 income, the analysis was different but the end result was the same: the income of the person abroad was deemed to accrue to the transferor, but it also accrued to the person abroad. See the 2012/13 edition of this work para 29.18.

[164] See 51.14 (s.720/s.731 overlap).

> Expressing a possible contingency; = May possibly.[165]

The INT Manual provides:

> **INTM601700 Relevant income** [Jul 2023]
> It is likely to be largely a question of fact whether income can be used for providing a benefit, and regard should be had, where necessary, to relevant documentation of the person abroad, as well as any applicable foreign law that may have a bearing on the way the person abroad acts and operates.

50.25.1 *Income of individual*

Of course, any income "can" be used for the benefit of any individual in the world if it is received by a beneficial owner who so directs. That contingency must plainly be ignored or the definition does not work.[166]

50.25.2 *Income of co held by individual*

Suppose an individual, T, transfers assets to a non-resident company wholly owned by T. Assume the transfer does not qualify for the motive

[165] *Oxford English Dictionary* (2nd ed., 1989). Another meaning of "can" is "to be able; to have the power, ability or capacity". This meaning applies where one says that a *person* "can" do something. This meaning is not applicable here where the subject of "can" is the income. *Income* does not have any power, ability or capacity: only a *person* does. There is a fine discussion of *can* in Williams, *Tradition & Change in Legal English* (2005), at 2.8.

[166] The issue is not so much the meaning of the word "can": if income is paid to A it is obvious that it "can" (in the sense of "may possibly") be paid to B if A so directs. The better way to put the issue is: which hypothetical contingencies should be taken into account in order to ask the question whether or not income "can" be used for providing a benefit?
The question is similar to the issue which arises for the purposes of s.624 (settlor-interested trusts), whether income "may" be used to benefit the settlor "in any circumstances whatsoever". These words do not include the possible circumstance that there may be "a mere voluntary application of income by a beneficiary to the settlor": see *Glyn v IRC* 30 TC 321 at p.329. A similar question arose in reverse in *Inglewood v IRC* [1983] STC 133. The question was whether one could say that a beneficiary "will" become entitled to an interest in possession: held that one should ignore the contingency that the beneficiary may not become entitled by virtue of the beneficiary voluntarily assigning the interest to another person.
Another way to reach this conclusion is to say that the income "can" be used to benefit the individual, but not "as a result of the relevant transfer or associated operations" (the application of the income by the beneficial owner not counting as an associated operation).

defence. So long as T remains owner of the company, the income of the company is not relevant income in relation to any person (other than T).

For the position if T later gives the company to a trust, see 50.35 (Income of co held by trust).

50.25.3 *Income payable on contingency*

Now consider this type of trust,[167] divided into two sub-funds:

(1) A's sub-fund: income to be applied for the benefit of A or accumulated; capital to be paid to A at the age of 25; if A dies under 25, the share accrues to B's share.

(2) B's sub-fund is held on similar terms: income to be applied for the benefit of B or accumulated; capital to B at 25 with accrual to A if B dies under 25.

Suppose income is accumulated on A's sub-fund. It is relevant income in relation to A. Is it relevant income in relation to B? It is payable to B only on the contingency that A dies under 25. It is suggested that this income is not relevant income in relation to B. One would not, in normal language, say that the income "can" be used to benefit B just because A may die under 25. The contingency is too remote.

If A dies under 25:

(1) income of A's sub-fund arising after the death of A is (of course) relevant income in relation to B;

(2) income of A's sub-fund arising before the death of A subsequently becomes relevant income in relation to B if the "timing" issue discussed below is correctly answered.

If this is correct, the concept here is not the same as in s.624 ITTOIA, where the issue is whether income "may become payable" to the settlor *in any circumstances whatsoever*.[168] Applying (as one should) a purposive approach, this is the fair and just result and consistent with the general scheme of s.731. A settlor or transferor has the opportunity to exclude themselves completely in a straightforward manner, and is taxed if they

[167] This was a common form before the abolition of relief for Accumulation and Maintenance trusts in 2006.

[168] See Williams, *op. cit.* p.139; *may* (compared with *can*) "tends to convey a more hypothetical degree of possibility". Arguably, the drafter of the ToA provisions did not copy the language of the settlor-interested trust code because a different result was intended.

fail to do so. A beneficiary (not the settlor/transferor) does not have the same opportunity. To tax B on income of A's fund (on the facts of the above example) would not be just or fair.[169]

50.25.4 *Income of discretionary trust*

Conversely, consider a common form discretionary trust. In principle, all trust income "can" (in the sense of "may possibly") be used to benefit any beneficiary, if the trustees exercise their discretion, and that is a contingency which should be taken into account. Trust income is relevant income in relation to all beneficiaries.

Suppose, however, the trustees (perhaps guided by a letter of wishes) regard the fund as divided into (say) two shares for separate families. If there is no practical possibility that more than one half of the income will be used for one particular beneficiary, there is a reasonable argument that only one half of the income is relevant income in relation to that beneficiary.

Trustees of a common form discretionary trust have power to benefit anyone in the world. However, in practice the trustees will wish to identify a more limited class, and it is arguable that trust income is not relevant income in relation to other (theoretically) potential beneficiaries.

50.26 When does one ask: Timing issue

One must ask whether income "can" be applied for the benefit of an individual. *At what moment in time does one ask this question?*

(1) It often happens that, at the moment it arises, income can be used to provide a benefit for a person, ("B"), but at a later point in time it cannot be so used; for instance if income of a discretionary trust or company is:
   (a) distributed
   (b) transferred to another trust (under which B cannot benefit) or
   (c) retained by the trustees, but on terms under which B cannot benefit or
   (d) used to pay trust expenses

[169] Some support can be found in the discussion of "can" (albeit in a different context) in *Mandla v Dowell Lee* [1983] 2 AC 548 at p.565. A similar unfairness does arise for CGT under s.87 TCGA. However, it is possible to avoid that by transfers to another settlement.

(2) The converse also sometimes happens: at the moment it arises income cannot be used to provide a benefit for B, but at a later time it can be so used; for instance, if:
  (a) B is born after the income arises
  (b) One share of a trust fund later accrues to another share (eg on the death of a beneficiary)[170]
  (c) (Arguably) if a company within s.731, wholly owned by A, which has accumulated income during A's ownership, is later given to B or to a trust under which B can benefit[171]

So it is often important to ask at what moment in time one puts the question. I refer to this as the **"timing issue"**. There are in principle several possible answers:
(1) The moment that the income arises
(2) The moment that the benefit is provided, if later than (1)
(3) After a "reasonable" period (whatever that might be)
(4) The end of the tax year in which either (1) or (2) or (3) occurs
(5) Some combination of the above

An important consequence of all solutions except (1) is that trustees of a discretionary trust or company within s.731 would usually have some period of time after income has accrued, during which they may:

(1) distribute income; or
(2) apply the income in the payment of expenses.

Then the income will not be relevant income in relation to the beneficiaries because *at the moment when one asks the question* it is no longer income which "can" be applied for the benefit of the beneficiaries.

To answer the timing question we must return to the legislation. Section 733 ITA Steps (3) and (4) provide:

> *Step 3*
> Identify the amount of any income which—
> (a) arises in the tax year to a person abroad, and
> (b) as a result of the relevant transfer or associated operations can be used directly or indirectly for providing a benefit for the individual.

[170] See 50.25.3 (Trust income payable to B on remote contingency).
[171] But see 50.35 (Income of co held by trust).

> That amount is "the relevant income of the tax year" in relation to the individual and the tax year.
> *Step 4*
> Add together the relevant income of the tax year and the relevant income of earlier tax years in relation to the individual (identified as mentioned in Step 3).
> The sum of those amounts is "total relevant income".

The key phrase is "identified as mentioned in Step 3". What is the rule which those words bring in? Step 4 can be read in various ways:

> *Step 4*
> Add together
> [1] the relevant income of the tax year *being the amount of any income which—*
> *(a) arises in the tax year to a person abroad, and*
> *(b) as a result of the relevant transfer or associated operations can be used directly or indirectly for providing a benefit for the individual.*
> and
> [2] the relevant income of earlier tax years in relation to the individual *being the amount of any income which—*
> *(a) arises in the [earlier] tax year to a person abroad, and*
> *(b) as a result of the relevant transfer or associated operations can*
> *[i] [at any time in that earlier year]* **or**
> *[ii] [at the end of the earlier year]* **or**
> *[iii] [at the time that the benefit is conferred, or the time that the income arises if later]*[172]
> *be used directly or indirectly for providing a benefit for the individual.*

(In this quote the words in normal font are the words of Step 4; the words in italics are the words of Step 3; the words underlined are added; note that some words must be imported by the words "identified as mentioned in step 3".

It is considered that one looks to the position at the later of:
(1) the end of the tax year in which the relevant income has accrued, or
(2) the end of the tax year in which the benefit is received.
One asks whether *at that time* the income:

> can ... be used for providing a benefit for the individual.

[172] In clause [2][b] readings [i] [ii] [iii] are alternatives.

Another way to put it is that one asks the question with the benefit of hindsight, taking into account facts known at the time that the question matters.

The main reason for this view is that it is more sensible to ask the question at the time it matters.

The moment the income arises is not a suitable moment to ask the question. In some cases it is impossible to ascertain the moment at which income arises and all that the tax system attempts is to attribute income to an accounting period or year of assessment.[173] In other cases it is only possible to ascertain a moment at which income arises by rules of a somewhat arbitrary kind.[174] Similarly, the moment that the benefit arises is not a suitable moment. Some benefits (such as beneficial loans) arise over a period. Moreover it is not practical to compute relevant income on every separate occasion that a benefit is provided during the year.

The legislation does not provide an express answer, but it does offer a hint in support of this view. Step 3 does not refer to "relevant income" in isolation. It refers to relevant income *of the tax year in relation to ... the tax year*. It is obviously necessary to attribute relevant income to a tax year, eg to deal with the situation where:

(1) an individual receives a benefit in year 1;
(2) the benefit is not taxed because there is no relevant income in year 1;
(3) relevant income arises in year 2.

There is only relevant income *of year 2* and so the s.731 charge arises in year 2 and not in year 1. However, the reference in Step 3 is to income of the tax year *in relation to the tax year*. These extra words suggest that the relevant income of tax year 2 in tax year 2 may be different from the relevant income of tax year 2 in tax year 3. In year 3 one must ask again what is the relevant income of year 2.[175]

The Tax Law Rewrite agree. EN ITA provides:

> It is therefore considered that surplus relevant income (*if it continues to be available*) has not been taken into account and so must be carried forward year by year until extinguished by a benefit or benefits.[176]

[173] eg trading or property income.

[174] eg the rules in ss.18–19 ITEPA (When general earnings are received).

[175] I have considered whether any guidance is to be found in the principle that income tax is an annual tax. However, that does not shed much light on the problem. See 14.3.4 (IT is an annual tax).

[176] The EN passage is discussed in 50.18.5 (Step 5: Available Relevant Income).

50.27 Distributed income: HMRC view

RI 201 provides:

> For the purposes of Section 740(3) ICTA [now s.733 ITA] the measure of "relevant income" is treated as not including such part of the income as has already been genuinely paid away to a beneficiary or to a bona fide charity.
>
> Once relevant income has arisen *and continues to be available to provide a benefit*, it must in the Revenue's view be carried forward year by year until extinguished by such a benefit, even if it is capitalised in the accounts of the overseas person.
>
> (Emphasis added)

The INT Manual provides:

> **INTM601700 Relevant income** [Jul 2023]
>
> ... As it is only income that can be used which is taken into account, in most cases, it will be appropriate to look at any factors that may prevent income being so used. For example, any part of the income that has been genuinely paid away may not be capable of being termed as income that can be used for providing a benefit.
>
> It should be kept in mind that relevant income has to be considered on a tax year by tax year basis, so that once an amount has been determined as being relevant income of a tax year it will fall to be taken into account as relevant income in any subsequent year's benefits charge calculation. It cannot be amended by, for example, a subsequent disbursement, neither will it cease to be relevant income if, for example, it ceases to be regarded as income within the structure perhaps because it has been capitalised.
>
> In considering whether any part of the income has been genuinely paid away in a manner such as it could not be regarded as income that can be used for providing a benefit, there are three broad categories of disbursements that will generally be taken into account:
>
> - income genuinely paid away in meeting legitimate expenses
> - income distributions paid out of income
> - taxes paid by the person abroad in respect of the income
>
> ...

50.28 Relevant income spent

HMRC practice is that using income to pay trust or company administration expenses will reduce relevant income.

The INT Manual provides:

> **INTM601700 Relevant income** [Jul 2023]
> *Example 1* [income used to pay expenses]
> A foreign company with investment business has interest income of £100,000 for a tax year. It pays costs for the management of the company of £25,000 out of its income.
> As management costs for the company are deductible expenditure and assuming that all other conditions for a benefits charge are met, the relevant income of this company for that purpose would be considered to be £75,000 - the amount that can be used for providing a benefit.

This applies even to income used for capital (rather than income) expenditure. Income used to meet a statutory indemnity ceases to be relevant income (even a CGT indemnity, ie a capital liability):

> **CIOT Letter (extract)**
> It would also be helpful if the Revenue could confirm that if the trustees do in fact make a payment to the settlor in response to a request for reimbursement, either under [s.646 ITTOIA] or under para 6 of Schedule 5 to TCGA, such a payment would not be regarded as: ...
> (b) Taken into account for [s.731 ITA] purposes...
> **Revenue reply** ...
> (b) *it will reduce the relevant income if paid out of income* but will not be a payment [ie not a benefit].[177]

Income used to pay a sum in lieu of interest ceases to be relevant income (even though the payment is of a capital nature). Tax Bulletin 8 provides:

> ESC D41 allowed, inter alia, demand loans made to offshore trustees on better than commercial terms before 19 March 1991 to be put on commercial terms after that date. This enabled a trust to remain outside the condition in para 9(3), Schedule 5, TCGA 1992. In order to meet the terms of this concession, it may have been necessary to pay a sum in lieu of interest in respect of periods ended 5 April 1992. Where this was the case, such a payment would ... qualify as a deduction *...for the purposes of [s.731 ITA] provided it was paid out of trust income.*
> Where the amount in lieu of interest was paid to a person who is not a beneficiary under the terms of the trust, it would nevertheless be treated as a capital payment to that individual under TCGA 1992, Section 97.

[177] *Taxation Practitioner*, April 1996 p.25 *https://www.kessler.co.uk/wp-content/uploads/2012/05/TaxationPractitioner-199604.pdf* emphasis added. For other issues relating to reimbursement, see 100.5 (Failure to claim indemnity).

> If the amount in lieu of interest was paid by a company underlying the trust, that payment would not qualify for a deduction from the profits of that company [because it is capital and not income].

Thus income used to pay interest ceases to be relevant income. Income used to repay borrowed capital also ceases in principle to be relevant income. However if there were an arrangement under which:
(1) The person abroad borrowed a sum equal to relevant income
(2) The person abroad used the relevant income to repay the loan
then the sum borrowed might be regarded as representing the relevant income.[178]

Note that the s.731 position is different from s.720: expenses of the person abroad are not in principle deductible for s.720 purposes.

50.29 Income distributed as it arises

Suppose income ("the trust income") accrues to trustees of a discretionary trust within s.731, and is distributed (as income) to a beneficiary, "B1", in the same tax year.

50.29.1 *Position of other beneficiaries*

The trust income is not relevant income in relation to any other beneficiary, since the income was distributed to B1. One cannot say that the income "can" be applied for the benefit of anyone else – if my answer to the timing issue is correct. This is significant for the other beneficiaries who receive a benefit within s.731 (whether before or after the year in which the income arises and is distributed). They will not pay tax on the benefit by reference to the distributed income, because it is not relevant income. (They may pay tax on the benefit by reference to other relevant income if there is any.)

That must be correct, because otherwise there could be double taxation (B1 taxed on trust income and another beneficiary taxed under s.731).[179]

50.29.2 *Position of recipient*

It is suggested that the income is not relevant income in relation to B1: it is not income which *can* be used for B1's benefit; it is income which *is*

[178] See 50.33 (Income reinvested: Tracing).

[179] Arguably s.743 ITA would provide relief: see 51.9 (Double-counting relief). This seems a less satisfactorily solution.

used for B1's benefit.[180] This may be significant for B1. Suppose:
(1) B1 is a remittance basis taxpayer, and
(2) B1 received a benefit in the UK, and
(3) the trust income is paid to B1 and not remitted to the UK.

B1 is taxed on the ITA remittance basis on the income B1 receives from the trust. B1 is not taxed on the benefit by reference to the distributed income, because it is not relevant income. (B1 may pay tax on the benefit by reference to other relevant income if there is any.)

50.30 Income distributed after it arises

Suppose income accrues to trustees of a discretionary trust, within s.731, and is retained (without being accumulated) in that tax year, but is distributed (as income) to beneficiary B1 in a subsequent year. If:
(1) a UK resident beneficiary ("B2") had received benefits in a past year, and
(2) had not paid tax under s.731 in the past year, for lack of relevant income,
B2 will pay tax under s.731 in the year in which the income arises.

Suppose, however, that there have been no earlier benefits so this is not in point. The position is then the same as above, if my answer to the timing issue is correct:
(1) The income is not relevant income of B1.
(2) The income is not relevant income of any other beneficiary.

It seems that this is the generally held view. STEP say:

> In our experience, most advisers take the view that, where actual income
> [1] has been segregated[181] and
> [2] in a future year is used to pay a disbursement or to make an income distribution to an individual,
> it will cease to be relevant income in relation to other individuals because it is no longer available to provide a benefit to them. HMRC have been known to accept this view.
> In practice, trustees often do not pay all relevant disbursements or make decisions regarding the use of income during the tax year in which the

[180] The same argument as 50.22 (Income of life tenant: Relevant income) but not so strong.

[181] Author's footnote: it is doubtful whether segregation of income is necessary; see 50.34 (Relevant income in mixed fund).

> income arises, preferring to wait until the trusts accounts have been finalised. This may not be until some time after the tax year end and it seems inequitable to treat beneficiaries differently on the basis that the trustees have taken this view.[182]

In the INT Manual, HMRC express a slightly more restricted view.

> **INTM601700 Relevant income** [Jul 2023]
> As mentioned above, relevant income should be calculated for each tax year, and is usually only reduced once calculated when matched with benefits received, as set out in the six steps referred to in INTM601740. However, it is recognised that such an approach may lead to the same amount of income of the person abroad being taken into account for tax more than once. This may occur, for example, if
> [1] an income distribution is made to a beneficiary in a later year, and
> [2] the relevant income is not reduced to take into account such a distribution that has been subject to tax in the beneficiary's hands.
> In order to prevent this, the relevant income should be reduced by income distributions made out of an earlier year's relevant income, to the extent that it can be demonstrated that the income distributions have been subject to tax, either in the UK or some other jurisdiction. In order to reduce the amount of relevant income by such income distributions, the individual who is subject to a potential benefits charge should reasonably believe that any income distribution made out of the relevant income of an earlier year has been subject to tax either in the UK or another jurisdiction.
> The individual subject to the benefits charge may be reliant on information from trustees or other third parties. While it is accepted that such trustees may not have a detailed knowledge of beneficiaries' tax affairs, they will be in a position to make a reasonable assumption as to whether an income distribution should be subject to tax and should compute relevant income accordingly. Provided relevant income is calculated on such a reasonable assumption HMRC will not seek to challenge it.
> The only other circumstance where relevant income is reduced once calculated for a tax year is where income is paid to a charity recognised as such for tax purposes by HMRC. The amount of relevant income is reduced by the amount of income paid to the charity...
> The following examples may help to illustrate how relevant income will generally be determined.

HMRC give an example of a trust distribution

[182] Response to HMRC Consultation "Reform of an anti-avoidance provision: Transfer of Assets Abroad" (2013).

> *Example 4*
> A foreign trust has accumulated income from year one of £100,000 and retains this in a segregated account. A beneficiary of the trust approaches the trustee for funds in year two and the trustees make an income distribution to the beneficiary in year two of £20,000. The trustees have no income in year two from which to make the distribution so use the income held on account from year one. The trustees are aware that the beneficiary is resident and domiciled in the UK. It is therefore reasonable for them to assume that UK income tax will be paid on the income distribution, and thus the relevant income for year one will be reduced to £80,000 when calculating any future benefits charge.

In example 4, the same result would follow if the beneficiary was not UK-domiciled and taxed on the remittance basis. It is considered that the same result would follow if the beneficiary was non-resident, even if not subject to foreign income tax on the distribution, though the author of the Manual does not seem to agree.

50.31 Accumulated income

50.31.1 *Accumulate on wide discretionary trusts*

If a common form discretionary trust accumulates income, it remains relevant income in relation to all beneficiaries as long as it is retained by the trustees, because the trust capital (which represents the accumulated income) can be used to benefit any beneficiaries.

50.31.2 *Accumulate on narrower trusts*

The position would be different if under the terms of the trust:

(1) B was in the class of beneficiaries to whom income could be paid; but
(2) B could not benefit in any way from income after it had been accumulated.

Accumulated income would cease to be relevant income in relation to B.

This may happen automatically under the terms of the trust; for instance, a formerly common form of accumulation and maintenance trust provided:

(1) Income as it arises may be used for the benefit of any beneficiary under 25 (“B1”, “B2” or “B3”).
(2) If not so used, it is accumulated and added to the share of one particular beneficiary (B1) and can only be used for the benefit of B1 (not B2 or B3).

On receipt the income is relevant income in relation to B1, B2 and B3. After accumulation it is relevant income only in relation to B1.

A similar point arises in relation to a common form discretionary trust. Accumulated income is relevant income in relation to all the beneficiaries. Suppose the trustees exercise their overriding power to exclude B from the accumulated income, not from other trust capital. The income ceases to be relevant income in relation to B. It makes no difference whether this is done in the year of receipt or later.

Similar points may arise if the income is transferred to a new trust, or if the income of a company within s.731 is capitalised by the issue of bonus shares.

50.31.3 *Accumulate, distribute as income*

It has been suggested that once income is accumulated, it is forever relevant income in relation to all the beneficiaries to whom it could have been paid. Subsequent distribution is irrelevant (unless it gives rise to a s.731 charge). This view gives rise to anomalies:

(1) Some receipts which are capital for trust law purposes are treated as income for s.731,[183] and these cannot be "accumulated" in the normal trust sense. It would be odd if they were treated differently from ordinary income for s.731 purposes.
(2) Income of a company within s.731 cannot be "accumulated" in the trust sense. It would be odd if companies were treated differently from trusts.

It is considered that the act of accumulation does not by itself make any difference to the s.731 position. If income of a common form discretionary trust is accumulated, and later distributed as income to B1, it ceases to be relevant income in relation to other beneficiaries. This only applies if the sum distributed is (or represents) the accumulated relevant income. This raises tracing issues discussed below.

50.31.4 *Accumulate, distribute as capital*

Suppose income of a common form discretionary trust is accumulated and distributed as capital to a beneficiary, B. It is considered that the income ceases to be relevant income in relation to any beneficiary except B. (It is relevant income in relation to B so that B is in principle subject to tax

[183] See 48.15 (Capital receipts deemed income).

under s.731 if B is resident in the UK. Any other conclusion would have absurd consequences.)

A capital distribution out of accumulated relevant income to a UK resident individual is taxable under s.731. It is not a capital payment and so does not reduce s.1(3) amounts (trust gains). However the same payment to a charity or a non-resident individual will reduce s.1(3) amounts and relevant income.

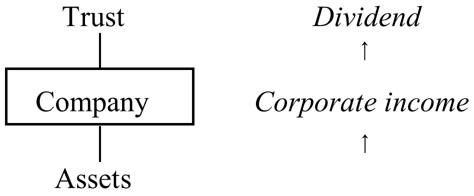
50.32 Company income distributed

Suppose a company within s.731 is held by a common form discretionary trust within s.731:

(1) the company receives income ("**corporate income**");

(2) the corporate income is distributed by way of dividend and retained by the trustees.

Thus:



The corporate income ceases to be relevant income but the dividend income is relevant income; so it is not counted twice. One cannot say that the corporate income and the dividend income are *both* available to provide a benefit.[184]

Suppose:

(1) A company within s.731 is held by a common form discretionary trust.

(2) The company's income is distributed by way of liquidation and retained by the trustees.

Double-counting relief does not apply. It is suggested that the trustees receipt may be said to represent the relevant income, so the liquidation does not affect the s.731 position. (Any other view would allow tax avoidance and not be attractive to a court.)

[184] Even if that were wrong, it is suggested that double-counting relief means that the corporate income and the dividend income do not both count as relevant income; see 51.9 (Double-counting relief).

> **INTM601700 Relevant income** [Jul 2023]
> *Example 2*
> [A company with profit after expenses of £75k] decides at the end of the tax year to add its 'net profit' of £75,000 to its reserves.[185] Two years later it makes a payment of £50,000 and contends this reduces relevant income.
> As relevant income has to be considered on a tax year by tax year basis HMRC would take the view that relevant income of the tax year remained £75,000 ...

In example 2, it is presumably assumed that the payment is not distributed as income, otherwise the outcome would to be different.

50.33 Income reinvested: Tracing

The requirement is that "income" can be used to provide a benefit. "Income" here includes any asset representing income, even if that asset does not constitute "income" (in any sense) of the person abroad.[186] Thus it makes no difference if the relevant income is invested in another asset. Suppose:

(1) A non-resident company held by a trust has received relevant income (the "**corporate relevant income**").
(2) The trustees sell the company to a purchaser.

It has been suggested that the corporate relevant income ceases to be relevant income in relation to the beneficiaries, because (after the sale) that income can no longer be used to benefit them. That would be absurd, but there is no difficulty in construing the legislation to avoid that absurdity. The proceeds of sale represent the corporate income, so the sale has not affected the relevant income position at all: as long as those proceeds can still be used for the benefit of the beneficiaries there is still relevant income in relation to the beneficiaries.

50.34 Relevant income in mixed fund

The principle that distributed income ceases to be relevant income applies only if the asset distributed constitutes or includes the relevant income.

[185] I wonder if the author is acting under a misconception here. A company does not "decide" to add its profit to its reserves: that happens automatically unless the profit is distributed. But perhaps that does not affect the example.

[186] Similar principles apply for the ITA remittance basis; see 17.5 (Income/capital in remittance basis). A similar principle applies in ascertaining what is income for the definition of power to enjoy; see 49.16.4 (Condition D: Possible benefit).

Whether or not this is the case raises questions of tracing.

The ideal approach is for a trust or company within s.731 to keep relevant income in a separate account. Then funds distributed from that account must be identified as the relevant income.

This section considers what happens if relevant income is mixed with other funds, and there is a distribution from the mixed fund. This is unchartered territory, but it is suggested that the law should follow the case law and practice on pre-2008 remittance basis mixed fund rules.

50.34.1 *Distribution from trust within s.731*

Suppose:

(1) Trustees of a discretionary trust within s.731 receive relevant income and pay it to a mixed fund (ie holding income and trust capital together).

(2) They pay a sum out of that fund in exercise of a power over trust income.

It is considered that the sum distributed would be (or represent) the relevant income. Income comes out first.

Suppose:

(1) The trustees receive relevant income, accumulate it and pay it into a mixed fund (ie holding accumulated income and trust capital together).

(2) They pay a sum out of that fund in exercise of a power to apply accumulated income as income.

It is suggested that the sum distributed would be (or represent) the relevant income.

Suppose:

(1) The trustees receive relevant income, accumulate it and pay it into a mixed fund (ie holding accumulated income and trust capital together).

(2) They pay a sum out of that fund in exercise of a power to distribute capital.

It is suggested that the trustees could by appropriate documentation identify the sum distributed as the relevant income.[187] Otherwise there must be an apportionment. Segregating income would avoid the tracing

[187] See 20.17.1 (Fund: taxed/untaxed income).

issue.

50.34.2 *Distribution from co within s.731*

Suppose:

(1) A company within s.731 receives relevant income and pays it into a mixed fund (ie holding relevant income and other company funds together).

(2) The company declares a dividend.

In the absence of documentation, it is suggested, on analogy with a trust, that income comes first out of the mixed fund. If the company has only received income (ie has not realised capital gains), the dividend clearly represents the relevant income rather than share capital.

Suppose:

(1) A company within s.731 receives relevant income and pays it into a mixed fund (ie holding relevant income and other company funds together).

(2) The company repays a loan or buys in redeemable shares out of that fund.

In principle the repayment of a loan or a share buy back comes out of capital. It is tentatively suggested that the company could by appropriate documentation earmark the sum repaid as the relevant income. In that case relevant income could be distributed by repayment of a loan and so cease to be relevant income.

50.34.3 *Distribution of company shares*

Suppose a non-resident company held by a trust has received relevant income (the "**corporate income**"). If the trust transfers the company to an individual, the corporate income ceases to be relevant to beneficiaries (except the individual). If the trust transfers the company to a new trust, the corporate income is relevant income in relation to the beneficiaries of the new trust but not in relation to beneficiaries of the old trust who cannot benefit under the new trust. This is a sensible rule as it allows different branches of a family to separate their interests fairly.

50.35 Income of co held by trust

50.35.1 *Income after trust holds co*

Suppose a trust with a common form power of appointment holds an underlying company to which s.731 applies.[188] Income of the company is in principle relevant income in relation to all beneficiaries. It remains so as long as the company retains the income.

50.35.2 *Income before trust holds co*

Suppose:

(1) An individual ("T") owns all the shares of a company within s.731.
(2) T gives the shares to a trust with a common form power of appointment.

Income of the company arising after T's gift is in principle relevant income in relation to the beneficiaries of the trust.

What is the status of income arising before the gift ("old income")? HMRC say that old income is also relevant income in relation to all the beneficiaries. HMRC's argument is: at the relevant time (when benefits are received) the old income "can" be used for the benefit of beneficiaries. The tax consequences of this are so severe that one feels it cannot be right, but what is the flaw in the argument?

At the time when the old income accrued to the company, that income "can" only be used to benefit T, the sole shareholder, so it is not relevant income in relation to anyone else. After the company has been given to the trust the same income "can" be used to benefit others. That is sufficient to meet the "can" condition, if my answer on the timing issue is correct.

However, it is not enough that income "can" be used to benefit a person. The definition of "relevant income" requires that the income can be used to benefit an individual:

> *as a result of*
> (i) the relevant transfer or
> (ii) associated operations.[189]

I refer to this as "**relevant income causation conditions (i) and (ii)**".

Now, in this case there are two transfers:

(1) The transfer of assets to the company ("transfer 1").
(2) The transfer of the shares in the company to the trust (an associated operation) ("transfer 2").

[188] For the possible application of the motive defence on a transfer to the company, see 52.21 (Transfer: Trust to underlying co).

[189] The reference here is to the reference to associated operations in s.732(1)(c).

It is suggested that where the two transfers are not part of a single arrangement, but independent, transfer 2 is not an associated operation in relation to transfer 1. So relevant income causation condition (ii) is not satisfied. Relevant income causation condition (i) is not satisfied since transfer 1 is not the cause of the fact that the income can be used to benefit the beneficiaries. The reasoning is the same as 48.13.1 (A transfers to B + B to C: clean-break test).

50.36 Non-beneficiary when income arises

50.36.1 *Unborn beneficiary*

Suppose:

(1) In Year 1 a discretionary trust within s.731 receives and accumulates relevant income.

(2) In Year 2 a beneficiary is born.

Is the income accumulated in year 1 before the birth relevant income in relation to that beneficiary? The answer depends on the timing issue. If my view is right, undistributed income accumulated before birth can be relevant income in relation to the newborn beneficiary, and that view does make more sense, having regard to the general scheme of the legislation.

50.36.2 *Non-beneficiary when income arises*

Suppose:

(1) In Year 1 a discretionary trust within s.731 receives and accumulates relevant income. The class of beneficiaries consists of the issue of the settlor and their spouses.

(2) In Year 2 an individual ("W") marries a beneficiary and so joins the class of beneficiaries.[190]

Is the income accumulated in year 1 before the marriage relevant income in relation to W? The answer depends again on the timing issue. If my view is right, undistributed income accumulated before the marriage can be relevant income in relation to W. Those who take the view that pre-birth income is not relevant income might consistently take the view that this pre-marriage income is not relevant income. This is not quite a *reductio ad absurdum*, but it is a bold view. If necessary, a court would

[190] It is assumed there is no power to add beneficiaries so the income could not be applied for the benefit of the individual before the marriage.

hold that W "can" benefit in year 1 because of the possibility that W might marry a beneficiary in year 2. See *IRC v Tennant* 24 TC 215. But this contingency may be very remote, so my preferred analysis is less artificial.

50.36.3 *Deceased beneficiary*

Now suppose the opposite situation:

(1) Year 1: a beneficiary receives a benefit from a trust (which is not taxable for lack of relevant income).
(2) Year 2: the beneficiary dies.
(3) Year 3: relevant income accrues.

Here it is plain that there is no tax charge on the beneficiary. Income cannot be deemed to have accrued to them once they are dead.

The same applies in relation to income which accrues in the tax year of death, but after the death. Income accruing after the death of a person cannot be applied for their benefit.

50.36.4 *Person excluded from benefit*

Income arising after a former beneficiary is excluded from benefit cannot (on any view) be relevant income in relation to that (former) beneficiary. It is not necessary that the beneficiary should be excluded from benefit altogether: just that they are excluded from benefit from the income.

50.37 Avoid relevant income: Planning

One possible approach is:

(1) distribute all income (from a discretionary trust or underlying company within s.731) to a foreign domiciled settlor immediately it arises;
(2) the settlor may re-settle the income on the same trusts.

This avoids relevant income in the trust or company.[191] It would be better to have an interest in possession trust so income at the trust level will be distributed automatically. Watch the GAAR, and avoid provocative circularity.

A variant of this idea is to distribute income to a beneficiary who is not the settlor/transferor, but who is non-resident (or domiciled) and so outside s.731. Watch the GAAR here, and the onward-gift rules.

[191] Also this ensures that the settlor receives the benefit of distribution relief (if applicable); see 51.5 (Distribution relief).

50.38 Tax of person abroad

This topic is not difficult to understand – at least it does not seem difficult once one has understood it. But it is impossible to summarise briefly.

In order to understand the law one must carefully distinguish three concepts:

(1) The actual income of the person abroad
(2) Relevant income for s.731
(3) The income which is deemed under s.731 to accrue to the UK resident individual who receives a benefit ("s.731 income")

These must not be confused!

The *actual income* of the person abroad is taxed (if at all) under general principles.

Relevant income is not taxed as such: it is merely something computed as a part of the process of ascertaining the amount of s.731 income.

Section 731 deemed income (for short, s.731 income) is taxed at the beneficiaries marginal rate.

This section considers the complications which arise if the actual income of the person abroad is subject to UK tax or foreign tax. How does this affect the s.731 income? What (if anything) is there to prevent double taxation: (1) tax on the person abroad and (2) tax on the beneficiary.

It is necessary to consider separately the position where the person abroad is:

(1) A discretionary trust.
(2) Any trust, on the purchase of own shares.
(3) A company owned by an individual.
(4) A company owned by a non-resident trust.

50.38.1 *Tax of trust within s.731*

A non-resident discretionary trust will normally pay tax on its actual UK source income at the rate applicable to trusts. The amount of tax paid reduces the relevant income so that if the gross income is £100 and tax is 45%, the relevant income is reduced to £45. However, s.731 makes no further allowance for a beneficiary. So if a beneficiary receives a benefit of £55, taxable under s.731, they pay tax at their marginal rate on the £55. The effective rate of tax on the actual income of the person abroad can therefore reach 69.75%. Section 743 ITA probably does not help. It would be much better if the beneficiary received an income receipt from the trust.[192] Then s.731 would not apply[193] and instead the beneficiary will effectively obtain some credit for the UK tax paid by the offshore trust under the regime of Chapter 7 Part 9 ITA.[194]

The same point applies where the income accruing to the offshore trustees is subject to foreign tax which can qualify for double taxation relief in the UK under ESC B18. It is best to arrange that the income is received by a UK resident beneficiary in the form of income, avoiding s.731 income where the possibility of any double taxation relief is lost.

An IIP trust is better still for dividend income.

50.38.2 *Purchase of own shares*

The receipt on a purchase of own shares by a UK company is income.

Any trust, discretionary or IIP, is subject to additional rate tax on a purchase of own shares. This raises the same tax problems as income of a discretionary trust under ss.481, 482 ITA. One solution is to alter the terms of the trust before the purchase, so the proceeds of sale belong to the life tenant. Another solution may be to make the trust UK resident for income tax purposes.

50.38.3 *Tax of company within s.731*

A non-resident company will normally pay tax on its actual UK source income at the basic rate. The amount of tax paid reduces the relevant income so that if the gross UK source income is £100 and tax is 20%, the relevant income is reduced to £80. Once again, s.731 makes no further allowance. So if an individual receives a benefit of £80, on which they are taxed under s.731, they pay tax at the appropriate rate on the £80. The effective rate of tax on the actual income of the person abroad is therefore nearly 52% for a higher rate taxpayer and 60% for an additional rate taxpayer.

A similar point arises in relation to dividend income, which is not taxable in the hands of the company.

It would be slightly more efficient if the beneficiary received a dividend from the company. Then s.731 would not apply. The individual may still not receive any credit for the tax paid by the offshore company but their

[192] As to how to achieve this, see 41.8 (Trust payment: Income/capital).

[193] See 50.16 (Capital-benefit condition).

[194] Unfortunately the credit is less than full credit in the case of dividend income. The regime is too complex to set out here.

dividend income would at least be taxed at the slightly lower dividend rates.

50.38.4 *Planning by UK resident co*

Further tax planning is to make the company UK resident (or to acquire a UK resident company). Then the actual income of the company is paid out by way of dividend (assuming this is possible as a matter of company law) and taxed at the dividend upper rate with the benefit of the UK tax credit. Watch s.1071 CTA 2010. The benefit of this kind of planning varies with the applicable rates of tax which depend on the circumstances of the beneficiaries and whether it is s.731 or s.87 which would apply on a capital payment.

50.38.5 *s.731 foreign tax credit: Critique*

In the 2006/07 edition of this book I said:

> These are harsh rules, but the unfairness of s.731 is generally avoidable in practice and any other rule would certainly be extremely complicated to draft and to administer.

The complexity arises in matching s.731 income with the taxable income of the person abroad. But now the FA 2008 has introduced matching rules. (Complexity was not a serious concern to the architects of the 2008 reforms.) What is sauce for the goose is sauce for the gander. If the matching rules must be retained, fairness requires that there should also be a system of credit for tax on the relevant income.

The better solution would be the rough and ready but simpler rules which took effect from 1981 to 2008, but at present we have the worst of both worlds: complexity and unfairness.

50.39 s.731 remittance basis

50.39.1 *Terminology*

Section 735 ITA provides what I call the "**s.731 remittance basis**". Section 735(1) ITA provides:

> This section applies in relation to income treated under section 732 as arising to an individual in a tax year ("the deemed income") if section 809B, 809D or 809E (remittance basis) applies to the individual for that year.

In short, the relief applies to remittance basis taxpayers.

In order to understand the law, one must carefully distinguish:
(1) relevant income (income arising to the person abroad)
(2) s.731 income; statute calls this "income treated under section 732 as arising to an individual" or "deemed income"

The legislation distinguishes between two types of relevant income and two types of s.731 income. I coin the following terminology.

Relevant income may be:
(1) **"foreign relevant-income"** or
(2) "**UK relevant-income**"

Foreign relevant-income means, in short, RFI.[195]

s.731 income may similarly be:
(1) foreign: the statutory term is "foreign deemed income" but I use the term "**foreign s.731 income**"
(2) not foreign (which I call **"UK s.731 income"**)

Section 735(2) ITA provides:

> For the purposes of this section the deemed [s.731] income is "foreign" if (and to the extent that) the relevant income to which it relates would be relevant foreign income if it were the individual's.[196]

In short, in my terminology, s.731 income is foreign s.731 income (qualifying for the remittance basis) if the relevant income to which it relates is RFI.

The word "relates" brings in matching rules; see 50.42 (s.731 matching rules).

Assuming we have identified foreign s.731 income, we can turn to s.735(3) ITA which provides:

> Treat the foreign deemed [s.731] income as relevant foreign income of the individual.

This incorporates the ITA remittance basis.

[195] I use the label "foreign relevant-income" with slight hesitation, as it is not the same as "relevant foreign income" (RFI); but I cannot think of better.

[196] For the reason for the wording ("would be RFI if it were the individual's"), see 16.9.2 (Relevant foreign income).

50.39.2 *When is s.731 income remitted*

Section 731 income (being fictional) does not exist, and cannot be remitted. So s.735(4) ITA provides:

> For the purposes of chapter A1 of Part 14 (remittance basis) treat
> [a] relevant income, or
> [b] a benefit,
> that relates to any part of the foreign deemed income as deriving from that part of the foreign deemed income.

This means (in short):

(1) Treat relevant income that relates to foreign s.731 income as deriving from that s.731 income; *and*

(2) Treat benefits that relate to foreign s.731 income as deriving from that s.731 income.[197]

I refer to this as the "**derivation fiction**".

Thus we have three fictions:

(1) We pretend the individual receives s.731 income: this is the basic s.731 fiction.

(2) We pretend the s.731 income is RFI: s.735(3).

(3) We pretend certain benefits, and certain relevant income,[198] derive from that s.731 income (the derivation fiction).

I discuss the remittance of benefits in the next section, and the remittance of relevant income in the one after that.

50.39.3 *Remittance in split year*

Section 735(5) ITA provides:

> In the application of section 832 of ITTOIA 2005 to the foreign deemed

[197] That is, in s.735(4), the phrase "that relates to any part of the foreign deemed income" qualifies "relevant income" as well as "benefit"; and the word "or" means "and".
Thus the s.731 remittance basis is an example of what I call double representation, see 18.18.9 (Double representation).

[198] Contrast the solution adopted for the s.87 remittance basis, where the capital payment (corresponding to the remittable benefit) is deemed to derive from the s.87 gains, but the trust gains (corresponding to relevant income) is not. So there is no charge on the remittance of trust gains, only on remittance of property derived from the capital payment.

> income, subsection (2) of that section has effect with the omission of paragraph (b).

The significance is that (contrary to the usual rule) s.731 income is taxable if it is remitted during the overseas part of a split year.[199]

There is no good reason for that.[200] But the point will not often arise.

50.39.4 *2008 transitional rules*

Para 170 sch 7 FA 2008 provides:

> The amendments made by paras 161 to 169 have effect for the tax year 2008-09 and subsequent tax years.

Section 735 does not apply to s.731 income arising before 2008/09 because the condition in s.735(1) is not met.

50.40 When is benefit remitted to UK

50.40.1 *Where benefit received not the test*

Section 731 income is deemed to be derived (inter alia) from the benefit (the derivation fiction).

One might think that the s.731 remittance basis imposes a tax charge if a s.731 benefit is received in the UK; that is, remittance depends on the place of receipt of the benefit. But that is not quite the way that the remittance basis works. There is a taxable remittance if (in short):

(1) *Property*[201] is brought/received/used in the UK (remittance condition A); and
(2) That property is derived (indirectly) from foreign income (remittance condition B).

The derivation fiction in s.735(4) does not affect remittance condition A. It relates to condition B. It is necessary to identify:

(1) The s.731 benefit (which may or may not be "property")
(2) Property derived from the s.731 benefit

If property received in the UK is:

(1) the s.731 benefit or
(2) derived from the s.731 benefit

[199] See 17.13.1 (Remittance in split year).

[200] The same (unfair) rule applies for s.720: see 49.26.3 (Remittance in split year).

[201] Or services, but for clarity I refer only to property. I also assume that the property is brought/received/used by a relevant person.

then the property is deemed to be derived (indirectly) from the s.731 income, so remittance condition B can be satisfied. That is just a matter of following through the logic of the deeming.[202]

On this analysis, it is not necessary to identify the place of receipt of a benefit.[203]

See too 18.48 (Remittance before income/gains arise).

50.40.2 *Beneficial loan*

Suppose the s.731 benefit is an interest-free loan or a loan on beneficial terms. It is considered that there is a taxable remittance of the s.731 income if the money lent is received in the UK, on the grounds that:

(1) the money lent (although not the benefit itself) is derived from the benefit;[204] or

(2) the benefit is used in respect of a relevant debt.

What would happen if the money was expended, but the loan remained outstanding in subsequent years? The s.731 benefit remains taxable, if property received from it was received in the UK in the earlier year.[205]

50.40.3 *Use of property*

Suppose the s.731 benefit is rent-free (or low-rent) use of a chattel or UK land. The chattel or land does not derive from the s.731 benefit: the s.731 benefit may be said to derive from the chattel or land, but that is another matter. But the right to use the chattel or land is a licence or lease which is itself property. So there is a taxable remittance of s.731 income if the land is in the UK, or if the chattel is used in the UK.[206]

50.40.4 *Waiver of debt*

Suppose:

(1) money is lent to a beneficiary;[207]

[202] See App 8.2 (Deeming provisions: Construction).

[203] That raised questions discussed in the 14th edition of this work, but which have no clear answer: where (if anywhere) is the benefit of a loan, guarantee, or waiver of a debt received?

[204] Contrast 18.18.7 (T lends income/gains to B).

[205] See 18.48 (Remittance before income/gains arise).

[206] See too 61.19.2 (Example: Use of property).

[207] It makes no difference whether the loan is at a commercial rate (not a benefit), or an interest-free loan (which confers the separate benefit of interest foregone while the

(2) the trustees waive the debt (a benefit).

What is derived from the waiver?

If the debt is charged on an asset, it is suggested that the asset (or an interest in it) is derived from the waiver.

If there is an arrangement under which:

(1) trustees make a loan and
(2) they waive the loan,

then the two steps (the loan and the waiver) may be considered as one item, in which case the money lent under the loan is derived from the waiver.

But in other circumstances, it is arguable that no property is derived from the waiver.[208]

50.40.5 *Payment of debt*

Suppose:

(1) A beneficiary owes money to a third party.
(2) The debt is paid by the person abroad (a s.731 benefit).

If the debt is a relevant debt, then there is a taxable remittance of the s.731 income under the debt remittance rules.

50.40.6 *Benefit later remitted*

Suppose:

(1) a remittance basis taxpayer receives a benefit in the form of the transfer of money (or a chattel) outside the UK, and
(2) later brings that money (or chattel) to the UK.

There is a taxable remittance of s.731 income.

For this reason, the tax consequence of a benefit received by one beneficiary may depend on whether *other* beneficiaries have remitted their benefits (and so used up relevant income). One might expect one beneficiary (with access to trust documents) to be able to find out what benefits other beneficiaries have received and where. But a beneficiary is not entitled to find out, and often will be unable to find out, whether benefits received by other beneficiaries have been remitted. The legislation is in many cases unworkable. But in 2008 workability was not

loan is outstanding).

[208] See too 20.7 (Income/gains used to pay debt).

regarded as a requirement of anti-avoidance legislation.

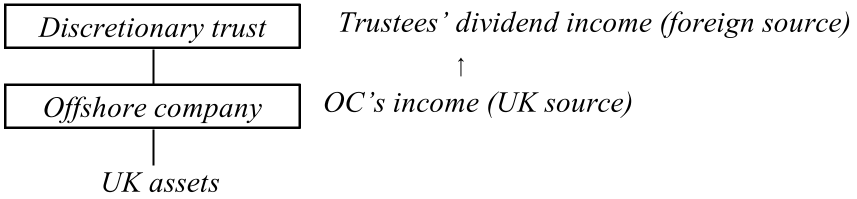
If the beneficiary is not resident when they receive the benefit but resident when it is received in the UK, there is in principle no tax charge.

50.41 When is relevant income remitted

Section 731 income is deemed to be derived (inter alia) from the matched relevant income (the derivation fiction).

50.41.1 *Distribution of UK source income*

Suppose an offshore company ("OC") within s.731 is owned by a trust within s.731:



If OC receives and retains UK source income, that is not foreign relevant-income. If a benefit is matched to that income the s.731 income does not qualify for the remittance basis: in my terminology, it is not foreign s.731 income.

Suppose before the matching, OC distributes its income to the trust, OC's income ceases to be relevant income. Instead the income of the trust is relevant income (unless itself distributed). But this income is foreign source income and so in principle foreign relevant-income. So where UK source income is received by an underlying company, the s.731 remittance basis can be made available by distribution of that income from the company. This seems generous. However, s.731 provides a rough justice in other areas where that favours HMRC, so it is not altogether surprising if on occasion an anomaly may favour the taxpayer.

Similar points arise if OC receives foreign income which is remitted to the UK.

50.41.2 *Relevant income remitted when beneficiary non-resident*

Suppose:

(1) Year 1: B is non-resident when foreign relevant-income is remitted.
(2) Year 2: B becomes UK resident and receives a benefit which is matched to that foreign relevant-income.

B receives s.731 income in year 2. The income is foreign s.731 income, but is treated as remitted.[209]

50.42 s.731 matching rules

50.42.1 *Why matching matters*

Section 731 income is the lower of (1) benefits and (2) relevant income, so one can say that benefits have to be matched to relevant income, or vice versa. But more precise matching (matching particular benefits to particular items of income) is not generally required.

Matching is needed for the following:

(1) The s.731 remittance basis:
   (a) To identify foreign s.731 income, which qualifies for the remittance basis, we need to identify the items of relevant income to which the s.731 income "relates", to see if it is foreign relevant-income.
   (b) If we have identified foreign s.731 income, taxable under the remittance basis, we need to know if it has been remitted, and for this purposes we need to identify:
      (i) the benefit to which the s.731 income relates, and
      (ii) the items of relevant income to which the s.731 income relates[210]

(2) for other purposes:
   (a) s.731(1A); see 50.45.1 (Matched s.731 Income)
   (b) s.733A (onward gift rules); see 50.54.3 (Cond (b): Match benefit)

50.42.2 *The matching rules*

The matching rules are set out in s.735A ITA. This begins:

> For the purposes of section 735—

So the matching rules apply for the purposes of s.735 (s.731 remittance basis). Where matching is wanted in other circumstances, the s.735A rules are incorporated thus:

[209] See 18.48 (Remittance before income/gains arise).

[210] Although statute uses the word "relate" the applicable rules are best described as matching rules.

s.731(1A)(a) ITA	**s.731(1B)(a) ITA**	**s.733A ITA**
[s.731 income] would under section 735A (if it applied also for this purpose) be matched with an amount of relevant income	[s.731 income] would, if section 735A applied also for this purpose, be matched under that section with the benefit	under section 735A (if it applied also for this purpose) [s.731 income] would be matched- (i) with an amount of relevant income and (ii) with a benefit...

This is exceptionally clumsy wording, but it works.

50.42.3 *Put benefits in date order*

Section 735A works in four stages. Section 735A(1) ITA provides:

> For the purposes of section 735—
> (a) place the benefits mentioned in Step 1 [of s.733(1)[211], ie Total Benefits within s.731] in the order in which they were received by the individual (starting with the earliest benefit received)

Some benefits are not received at any particular point in time, eg the benefit of rent-free accommodation, and it is not possible to place them in the order in which they are received. Perhaps there should be a time apportionment.

One then makes certain deductions from the benefits:

> (b) deduct from those benefits so much of any benefit within section 734(1)(b) as gives rise as mentioned in section 734(1)(d) to chargeable gains or offshore income gains.

See 50.19 (Deduction for s.87 charge).

50.42.4 *Put relevant income in date order*

Section 735A(1) ITA continues:

> (c) place the income mentioned in Step 3 [of s.733(1)] for the tax years mentioned in Step 4 [of s.733(1)] ("the relevant income") in the order determined under subsection (3)

Note that Steps 3 and 4 in para (c) refer to the steps in s.733; confusingly

[211] Section 735A(2) ITA provides:
"In subsection (1) references to a step are to a step in section 733(1)."

the reference is not to the steps in s.735A(3) which immediately follow.

This takes us to s.735A(3) ITA:

> The order referred to in subsection (1)(c) is arrived at by taking the following steps.
> *Step 1 [Relevant income of earliest year]*
> Find the relevant income for the earliest tax year (of the tax years referred to in subsection (1)(c)) [ie the tax years where s.731 applies]
> *Step 2 [UK relevant-income in date order]*
> Place so much of that income [relevant income] as is not foreign[212] in the order in which it arose (starting with the earliest income to arise).
> *Step 3 [Foreign relevant-income in date order]*
> After that, place so much of that income as is foreign in the order in which it arose (starting with the earliest income to arise).

In order to carry out Steps 2 and 3 it is necessary to distinguish between:
(1) foreign relevant-income; and
(2) other relevant income (“**UK relevant-income**”).

It is then necessary to ascertain the date that the relevant income arises. Some income is not received at any particular moment in time, eg trading and property income, where the income is computed as a net figure after allowing deductions. Section 735A(5) ITA deals with this:

> For those purposes [for purpose of putting relevant income into date order] treat income for a period as arising immediately before the end of the period.

This is in fact the general rule used when it is necessary to identify the date when trading or property income arises.[213]

TAH para 1234 provides:

> ... For example, business profits accrue over an accounting period to say 31 December so for the purpose of this provision the income would be treated as arising on 31 December. Therefore if in a tax year there was say interest income arising on 30 September and business profits accruing over an accounting period to 31 December, for the purpose of this provision they would be placed in the order interest first and profits second.

[212] Section 735A(4) ITA gives a commonsense definition to “foreign” relevant income: “For the purposes of subsection (3) relevant income is ‘foreign’ where it would be relevant foreign income if it were the individual’s.”

[213] See 18.17.1 (What is trading income).

The author probably assumed that interest is not "income for a period" and so the interest is not affected by s.735A(5). In fact, interest is income for a period to which it relates, even though tax is only charged when interest arises. But interest is normally paid in arrears, ie interest arising on (say) 30 September is for a period ending 30 September, so the end result is the same.

Then one carries out Steps 1–3 for subsequent years, year by year:

> *Step 4*
> Repeat Steps 1 to 3.
> For this purpose, read references to the relevant income for the earliest tax year as references to the relevant income for the first tax year after the last tax year in relation to which those Steps have been undertaken.

Amended as step 4 requires, steps 1-3 provide:

> *Step 1*
> Find ~~the relevant income for the earliest tax year~~ the relevant income for the first tax year after the last tax year in relation to which those Steps [Steps 1-3] have been undertaken (of the tax years referred to in subsection (1)(c)) [ie the tax years where s.731 applies]
> *Step 2*
> Place so much of that income [relevant income] as is not foreign in the order in which it arose (starting with the earliest income to arise).
> *Step 3*
> After that, place so much of that income as is foreign in the order in which it arose (starting with the earliest income to arise).

50.42.5 *Deduction from rel. income*

Section 735A(1)(d) ITA provides:

> (d) deduct from that income any income that may not be taken into account because of section 743(1) or (2) (no duplication of charges),

Section 735A(6) ITA provides:

> Subsection (1)(d) does not apply if the income may not be taken into account because the individual has been charged to income tax under section 731 by reason of the income.

50.42.6 *Put s.731 income in date order*

Section 735A(1)(e) provides:

> place the income treated under section 732(2) as arising to the individual in respect of the benefits [s.731 income] in the order in which it is treated as arising (starting with the earliest income treated as having arisen),

50.42.7 *The matching rule*

Having identified the benefits, the relevant income, and the s.731 income, and placed them all in date order, we can at last turn to the matching rule itself. Section 735A(1)(f) ITA provides:

> treat the income mentioned in para (e) [s.731 income] as related to—
> (i) the benefits, and
> (ii) the relevant income,
> by matching that income with the benefits and the relevant income (in the orders mentioned in paras (a), (c) and (e)).

The orders mentioned in these paragraphs are:

Para	**Concerns**	**Order**	**See**
(a)	Benefits	Date order (earliest first)	50.42.3
(c)	Relevant income	Date order by year, UK before foreign	50.42.4
(e)	s.731 income	Date order	50.42.6

50.42.8 *Matching: a type of FIFO*

In short, the matching rules are:

(1) Match with relevant income of earlier years before later years. This might be called a FIFO basis: first in, first out.

(2) Within the years, match with UK relevant-income before foreign relevant-income. This modifies what would otherwise be a more straightforward FIFO basis.

Why does the legislation not simply say that? See 61.15.7 (Method statements: Critique).

The rule is arbitrary, but any matching rule is to some extent arbitrary.

50.42.9 *Matching example 10*

TAH gives a number of examples, most of which are self-evident, but two are worth setting out here. Para 1234 Example 10 involves

- UK and foreign relevant-income (7 items of income altogether) and
- Non-UK benefits (2 benefits altogether):

			Relevant income		**Benefits**[214]	**s.731 income**
Item	**Date**		UK	Foreign	eg 10a *(eg 10b)*	eg 10a *(eg 10b)*
1	*Year 1*	30 Sept	500			
2		31 Dec		500		
3	*Year 2*	31 Dec		1,000	750	750
4	*Year 3*	30 Sept		500		
5		31 Dec	500			
6	*Year 4*	30 Sept		500		
7		31 Dec	500		750 *(1,500)*	750 *(1,500)*

The HMRC analysis of example 10a is:

> There are potential transfer of assets benefits charges in Yr 2 of 750 and Yr 4 of 750.

More analytically, the individual receives s.731 income of £750 in years 2 and 4.

> In Yr 2, 250 will be foreign deemed income and ring fenced to be charged under Part 8 ITTOIA as and when there is an amount remitted to the UK. 500 is charged under transfer of assets.

I am not sure that "ring fenced" is entirely apt to describe income taxed on the remittance basis, but it does not matter.

More analytically, the £750 s.731 income of year 2 is matched as follows:

- £500 is matched with income item 1: that £500 is not deemed RFI and so is charged on an arising basis.
- £250 is matched with income item 2: that £250 is deemed RFI and taxed on the s.731 remittance basis, ie on a future remittance of the benefit or the foreign relevant-income. I would not use the term "ring-fenced" to describe this, but it might serve as a loose metaphor.

> In Yr 4 the whole 750 will be deemed foreign income [*recte* foreign deemed income].

More analytically, the £750 s.731 income of year 4 is matched with the remaining unmatched £250 of item 2 and to the first £500 of item 3. The £750 is deemed RFI and taxed on the s.731 remittance basis.

Turning to example 10b:

> If however the benefit in Yr 4 was 1500, then only 1250 would be ring

[214] All benefits are foreign benefits.

fenced as foreign deemed income and 250 would be charged under transfer of assets.

More analytically, if the benefit in Yr 4 was 1500, the individual receives s.731 income of £1,500 in year 4. That is matched as follows:

- £250 is matched with the remaining unmatched part of income item 2
- £1,000 is matched with income item 3

The total of £1,250 is foreign s.731 income and taxed on the s.731 remittance basis.
£250 is matched with income item 5 and is taxed on the arising basis.

50.42.10 *Matching example 11*

TAH para 1236 Example 11 is a slightly more complex example with:

- UK and foreign relevant-income (12 items altogether)
- UK and foreign benefits (4 benefits altogether)

An individual who is ordinarily resident, but not domiciled, in the UK has received cash benefits from an offshore structure in circumstances where the conditions for the transfer of assets provisions to apply are met. The 'remittance basis' of taxation applies for each year.

			Relevant income		**Benefits**		**s.731 income**
Item	**Date**		*UK*	*Foreign*	*UK*	*Foreign*	
1	*Year 1*	30 Sept	500				
2		31 Mar		800		1,000	1,000
3	Year 2	31 Mar	100			1,400	1,400
4		31 Mar		1,000			
5	Year 3	31 Mar		500			
6		31 Mar	500				
7		31 Mar	500				
8	Year 4	30 Sept	200		1,000		1,000
9		31 Mar		500			
10	Year 5	30 Sept	500			600	600
11		30 Sept		100			
12		31 Mar		400			

The HMRC analysis is, one might say, informal in its terminology and it should be recast along the lines of example 10. This is done here by adding only brief comments in italics as the text is long and the reader will have the idea.

Year 1
The potential benefits charge [*s.731 income*] is 1000 (being the lesser of 1300

relevant income and 1000 benefits received).

As all of the conditions for Section 735 to apply are met, consider whether any of the potential charge [*s.731 income*] is foreign deemed income *[foreign s.731 income]*. The principles in Section 735A are used for this purpose.

- First match the 1000 with the UK [*relevant*] income of 500. As this income cannot be relevant foreign income then 500 cannot be foreign deemed income *[foreign s.731 income]* and thus is charged under the transfer of assets benefits charge [*on an arising basis*].
- The remaining benefit [*£500 s.731 relevant income*] is then matched with the foreign [*relevant*] income of 800. This [*relevant*] income would be relevant foreign income if it was the individual's and thus 500 of the deemed amount [*s.731 income*] is foreign deemed income *[foreign s.731 income]*. This is treated as relevant foreign income and becomes potentially chargeable under Part 8 ITTOIA 2005 [*ie is taxed on the s.731 remittance basis*].
- There is a balance of 300 relevant income that remains unmatched.

Where any amount is remitted to the UK during that or any subsequent year which is a remittance for Chapter A1 Part 14 ITA 2007 (the Remittance Basis) then part or all of the ring fenced amount may be charged under Part 8 ITTOIA in the year of remittance, subject as appropriate to the rules on remittances from mixed funds.

The total taxable amount for the year under transfer of assets benefits charge is therefore 500.

Year 2

The potential benefits charge [*s.731 income*] is 1400 (being the lesser of the total relevant income 2400 and the total benefits 2400 less 1000 already charged).

Calculate how much of the total potential charge [*s.731 income*] can be regarded as foreign deemed income *[foreign s.731 income]* applying Section 735A-

The potential chargeable amount [*s.731 income*] is in effect matched with-

(a) 300 of foreign [*relevant*] income from year 1. This gives foreign deemed income *[foreign s.731 income]* of 300 chargeable [*on the s.731 remittance basis*] under Part 8.

(b) 100 UK income of year 2. As this income cannot be relevant foreign income this amount of 100 remains chargeable [*on an arising basis*] under the transfer of assets benefits charge.

(c) The foreign [*relevant*] income of year 2 of 1000. As this would be relevant foreign income if it were the individual's this amount can [*must*] be regarded as foreign deemed income *[foreign s.731 income]* and so chargeable [*on the s.731 remittance basis*] under Part 8.

The result is that of the potential charge [*s.731 income*] of 1400, 100 is charged under transfer of assets benefits charge [*on the arising basis*] and 1300 is ring fenced and treated as relevant foreign income *[foreign s.731 income]* chargeable [*on the s.731 remittance basis*] under Part 8 ITTOIA.

The total charge under the transfer of assets benefits charge is therefore 100. Where any amount is remitted to the UK during that or any subsequent year which is a remittance for Chapter A1 Part 14 ITA 2007 (the Remittance Basis) then part or all of the ring fenced amount may be charged [*on the s.731 remittance basis*] under Part 8 ITTOIA in the year of remittance, subject as appropriate to the rules on remittances from mixed funds.

Year 3

Although there is further relevant income in this year there are no unmatched benefits so there can be no potential charge [*s.731 income*] under transfer of assets benefits charge so a consideration of S735 is not applicable.

Year 4

The potential charge [*s.731 income*] is 1000 (being the lesser of the total relevant income 4100 and the total benefits 3400 less 2400 already charged).
Work out the deemed foreign income [*foreign s.731 income*] applying Section 735A-
The potential chargeable amount [*s.731 income*] is in effect matched with
(a) The UK relevant income 500 from year 3.
(b) The foreign [*relevant*] income of 500 from year 3.
The total amount charged under the transfer of assets benefits charge is therefore 500.
500 is ring fenced as foreign deemed income and treated as relevant foreign income *[foreign s.731 income charged on the s.731 remittance basis*].
Where any amount is remitted to the UK during that or any subsequent year which is a remittance for Chapter A1 Part 14 ITA 2007 (the Remittance Basis) then part or all of the ring fenced amount may be charged [*on the s.731 remittance basis*] under Part 8 ITTOIA in the year of remittance, subject as appropriate to the rules on remittances from mixed funds.
There is 700 of unmatched relevant income to take forward.

Year 5

The potential charge [*s.731 income*] is 600 (being the lesser of the total relevant income 5100 and the total benefits 4000 less 3400 already charged).
Work out the deemed foreign income [*foreign s.731 income*] applying Section 735A-
The potential chargeable amount [*s.731 income*] is in effect matched with
(a) The UK relevant income 200 from year 4.
(b) 400 of the foreign relevant income from year 4.
The total amount charged under the transfer of assets benefits charge is therefore 200.
400 is ring fenced as foreign deemed income *[foreign s.731 income]* and treated as relevant foreign income [*charged on the remittance basis*].

Where any amount is remitted to the UK during that or any subsequent year which is a remittance for Chapter A1 Part 14 ITA 2007 (the Remittance Basis) then part or all of the ring fenced amount may be charged [*on the s.731 remittance basis*] under Part 8 ITTOIA in the year of remittance, subject as appropriate to the rules on remittances from mixed funds.
As the benefit was received in the UK a minimum of the ring fenced amount of this year will be charged under Part 8 ITTOIA and consideration would need to be given to whether there are further untaxed amounts of ring fenced income that would be charged for this year applying the relevant remittance basis rules.
There is 1100 of unmatched relevant income to take forward.

50.42.11 *Planning implications*

Where the s.731 remittance basis applies the best planning is to arrange that the person abroad (the foreign trust or company):
(1) does not have any UK source income and
(2) does not remit its foreign income.

Then there is no need to worry about the complex s.735A matching rules. The relatively simple position is reached, that there is a remittance if property derived from the benefit is received in the UK.

This also avoids the double charge to UK tax which arises if benefits are matched with UK source relevant income which is itself taxable.

50.43 s.731 remittance basis: Critique

The reader who has followed the text to this point will agree that the s.731 remittance basis is unworkably complicated. The rule should simply be that there is a tax charge if the benefit is remitted, and the matching rules abandoned. That would be fairer, consistent with the principle of the remittance basis, consistent with the s.87 remittance basis, and a simplification. It would also facilitate UK investment by the person abroad.

The 2013 ToA consultation raised a proposal to amend the matching rules, but this was not adopted.[215]

[215] HMRC, "Reform of an anti-avoidance provision: Transfer of Assets Abroad Outcome of Consultation" (2013): "Having carefully considered the views put forward in the consultation and through the working group, the Government has decided not to pursue legislative change to the matching rules at present."
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/267976/Transfer_of_assets_outcome_of_consultation.pdf

50.44 "Protected Income"

50.44.1 *Why Protected Income matters*

"Protected Income" matters in two s.731 contexts:

ITA	**Context**	**See para**
731(1A), 733A(1)(b)	settlor-attribution rule: benefit received by non-resident	50.45.2
s.733B(1)(b)	onward gifts	50.53.2

In short, the rules are:

(1) s.731 settlor-attribution applies only so far as s.731 income of a non-resident is matched to relevant income which is Protected Income[216]

(2) s.731 onward-gifts rule applies only so far as s.731 income is matched to relevant income which is Protected Income[217]

Section 721(3BA) ITA defines "Protected Income":

> In a case in which rule 2 of subsection (3B) applies [non-dom transferor[218]], so much of the income of the person abroad as is protected foreign-source income for the purposes of that rule counts as "protected income" for the purposes of section 733A(1)(b)(i).

This definition is expressed to apply "for the purposes of section 733A(1)(b)(i)", ie, for the purposes of the s.731 settlor-attribution rule.[219] But the same definition is incorporated by reference in other places where the term "Protected Income" is used:

s.733A(1)(b)(i)/s.733B(1)(b)(i) refer to	**s.731(1A)(a) ITA refers to:**
an amount of relevant income that is protected income for the purposes of this sub-paragraph (see sections 721(3BA) and 728(1B))	an amount of relevant income that is protected income for the purposes of section733A(1)(b)(i) (see sections 721(3BA) and 728(1B))

This is clumsy drafting (the reader may use a stronger word), but it works.

Why does the statute have separate definitions of:

(1) protected foreign-source income: s.721A and 729A ITA

(2) Protected Income: s733A(1)(b)(i) and s733B(1)(b)(i)) ITA

[216] See 50.53.2 (Cond (b): match Protected Income).

[217] See 50.53.2 (Cond (b): match Protected Income).

[218] See 92.15.2 (Transferor not UK domiciled).

[219] See 50.50 (s.731 settlor-attribution: Outline).

as the definition of Protected Income seems simply to incorporate the definition of protected-foreign source income?

John Barnett explains:

> I think that the difference is that "Protected Income" is any income which has benefitted from rule 2 (of either 721(3B) or 728(1A)). Or, putting it another way, income which has benefitted from the switching off of the settlor-charge by the protected trust regime.
>
> I think that the distinction can be seen if you have a UK resident, non-domiciled settlor, where the settlor and spouse are completely excluded (and therefore don't have power to enjoy). I think in that case that any income arising to the trust would, technically, be protected foreign-source income. But it would not be benefitting from rule 2 as rule 2 only applies to determine the amount of income arising under s721(1)/s728(1) and those sub-sections only apply if inter alia condition A (power to enjoy) is met. So you would not have "Protected Income" even though you have protected foreign-source income.
>
> The policy rationale for this (which certainly chimes with many consultation meetings which I attended) seems to be that HMRC, in switching-off s721 for protected trusts, didn't want to open a back door to avoidance. So any income which has benefitted from this switching-off, might be caught by one of the package of anti-avoidance measures (closely-related family member s733A; onward gift s733C). But if s721 didn't need switching-off (because, due to no power to enjoy, it was never switched on in the first place) then the anti-avoidance rules aren't needed.

On this analysis, the s.731 rules are consistent with the s.643A charge, which is (slightly) better worded. The s.643A equivalent of Protected Income is PFSI, which is defined as income:

> that would be treated under section 624 as income of the settlor but for section 628A [s.624 protected-trust relief][220]

On this analysis, the statutory terminology is highly confusing:

(1) The label "protected foreign-source income" seems apt for a settlor-interested trust where the settlor is UK resident and in principle within s.624/720. In this case, s.624/720 protected-trust reliefs disapply the s.624/720 charge. But it also applies where those charges are not in point.

[220] See 47.22.1 (PFSI).

(2) The label "Protected Income" means income which has been protected once, by s.720 protected-trust relief specifically, but by that reason falls within the scope of other anti-avoidance provisions. "Untaxed income" would have been clearer.

It is probably best to adopt the statutory terminology, as anything else is even more confusing, but these points must be kept in mind in order to understand the provisions.

Although not the statutory usage, I write the term Protected Income with initial capitals, to reflect the technical nature of the term.

Income is not Protected Income if:

- it arises before 6 April 2017[221]
- it arises when the transferor/settlor is non-resident[222]
- it arises when the transferor/settlor and spouse are excluded from benefit

50.45 Non-resident receives benefit

Section 732(1) formerly provided:

> This section applies if ... (b) an individual *who is UK resident for a tax year* receives a benefit in that tax year

FA 2017 made two changes:

(1) It deleted the words in italics, so it now reads:

> This section applies if ... (b) an individual receives a benefit in that tax year

(2) It added s.731(1A) ITA. This is where the relief for non-residents who receive benefits is now to be found.

Section 731(1A) is hard to follow, even by the refined standards of contemporary anti-avoidance legislation. We begin our journey with s.731(1):

> Income tax is charged on income treated as arising to an individual under section 732 [s.731 income].

Section 731(1A) then qualifies this rule with a relief for non-residents ("s.731 non-residents relief"):

[221] See 92.18 (Protected-trusts: Commencement).

[222] See 92.13.1 (Condition (a): RFI).

> But where the individual [the beneficiary] is non-UK resident for the tax year in which a benefit is received, there is a charge to tax under this section on any matched deemed [s.731] income...

The wording which follows is easier to understand if one approaches it in three stages:

(1) Identify "matched deemed income" (which I call **"Matched s.731 Income"**)

(2) Two conditions (**"s.731(1A) conditions"**) must be met for a charge:
  (a) Matched s.731 Income matches to Protected Income
  (b) Benefit is received by settlor/close-family

If these conditions are both met, then there may be a s.731 charge on a benefit received by a non-resident.

If either of these conditions are not met, there is no s.731 charge on a benefit received by a non-resident. That would be the case even if:

(1) The non-resident later became UK resident; and

(2) The benefit is then matched to relevant income (eg if there was no relevant income at an earlier stage).

50.45.1 *Matched s.731 Income*

The legislation uses the term "matched deemed income" (which I call **"Matched s.731 Income"**).

Section 731(1B) ITA provides the definition:

> For the purposes of subsection (1A)—
> (a) "matched deemed [s.731] income" means income which—
> (i) is treated by section 732 as arising to the individual [beneficiary] [s.731 income]
> (ii) would, if section 735A [matching rules] applied also for this purpose,[223] be matched under that section with the benefit [ie the benefit received by the non-resident beneficiary]

If the benefit received by the non-resident is the only benefit conferred, then all their s.731 income is Matched s.731 Income. That is, Matched s.731 Income is the same as s.731 income. So this definition only really matters if there are (at least) two benefits, and

(1) One benefit is received by the individual when resident and another when non-resident; or

[223] See 50.42 (s.731 matching rules).

(2) Benefits are received by different individuals

Otherwise we can ignore the definition and for "matched deemed income" (in my terminology, Matched s.731 Income) we can simply read "s.731 income". The two would come to the same thing.

50.45.2 *s.731 income matched to Protected Income*

Armed with the definition of Matched s.731 Income, we turn to the condition in s.731(1A)(a). Section 731(1A) ITA provides:

> But where the individual [the beneficiary] is non-UK resident for the tax year in which a benefit is received, there is a charge to tax under this section on any matched deemed [s.731] income
> (a) only so far as
> [i] that matched deemed [s.731] income would under section 735A [s.731 matching rules] (if it applied also for this purpose)[224] be matched with
> [ii] an amount of relevant income that is protected income for the purposes of section733A(1)(b)(i) (see sections 721(3BA) and 728(1B))[225] ...

Thus there are two matching exercises:

(1) We match s.731 income to the benefit, to ascertain Matched s.731 Income.
(2) Then we match Matched s.731 Income to relevant income, and ask if that relevant income is Protected Income.

If so the condition in s.731(1A)(a) is met. The condition is not met if the Matched s.731 Income is matched to non-Protected Income.

50.45.3 *Benefit to settlor/close family*

We turn to the second of the two conditions. Section 731(1A) ITA provides:

> But where the individual [the beneficiary] is non-UK resident for the tax year in which a benefit is received, there is a charge to tax under this section on any matched deemed [s.731] income...
> (b) only if—
> (i) the individual [beneficiary] is the settlor of the settlement concerned, or

[224] For s.735A see 50.42 (s.731 matching rules).

[225] See 50.44 ("Protected Income").

> (ii) the benefit is received by the individual [beneficiary] at a time when the individual is a close member[226] of the family of the settlor of that settlement.

If the individual receiving the benefit is not the settlor/close-family, the condition in s.731(1A)(b) is not met, so the individual qualifies for s.731 non-residents benefit relief.

50.45.4 *Interaction with onward-gift rules*

Section 731(1C) ITA provides two exceptions to s.731 non-residents relief:

> Subsection (1A) does not restrict the charge to tax under this section on income treated as arising to the individual by section 733C or 733E (onward gifts: recipient or settlor treated as individual to whom income is treated as arising).

The statutory references here relate to the onward-gift rules:

Section	**Topic**	**See**
733C	s.731 onward-gift donee charge	50.55
733E	onward-gift settlor-attribution	50.57

50.45.5 *Purpose of s.731(1A)*

HMRC protected-trust guidance provides:[227]

> 3.25... An additional subsection S731(1A) ITA 07 has also been introduced which states that if an individual is not resident in the UK in a particular tax year then that individual will not be chargeable to tax in respect of any income arising under this section. The subsection has been introduced to prevent a charge arising on a non-resident individual which was previously covered by S732(1)(b) ITA 07 ...
> However, S731(1A) ITA 07 does allow for the possibility of another individual being liable to tax on this income if S733A ITA 07 (settlor liable for section 731 charge on closely-related beneficiary) provides for such a charge...
> 3.27 In [s.732(1)(b)] the reference to
>
> the individual being resident in the tax year in[228] which they receive a

[226] Section 731(1B) ITA provides the standard definition (in short, spouse/cohabitee and minor children); see 61.27.2 ("Close-family").

[227] For this document, see 92.1.1 (Protected-trust guidance).

[228] For completeness: I have corrected a typo here. The original reads:
the individual being resident in the tax *in* year which they receive a benefit

benefit

is removed and is replaced by

an individual who receives a benefit in a tax year.

This amendment has been referred to in paragraph 3.25 above and the change has been made in order to enable a charge to arise on a settlor if a person who is a close family member of the settlor receives a benefit in a tax year in which they are non-resident.

50.46 s.731 income arising to non-resident

50.46.1 *Benefit to UK resident, matched when non-resident*

Suppose:

(1) Year 1: An individual (B) receives a benefit when UK resident, but there is no s.731 charge as there is no relevant income.

(2) Year 2: Relevant income arises which is matched to the benefit.

If B is UK resident in year 2, there is obviously a s.731 charge in year 2. What if B is non resident in year 2? There is no express relief in this situation. The only express territorial limitation is when a benefit is received by a non-resident. However no-one suggests that s.731 imposes a charge on the non-resident. The general territorial limitation must be implied.[229]

50.46.2 *Benefit to non-resident, matched when non-resident*

Suppose:

(1) A benefit is received by non-resident settlor[230]

(2) The Matched s.731 Income is matched to Protected Income when the settlor is non-resident.[231]

This meets the conditions of s.731(1A). Is the settlor therefore chargeable? That would be surprising. It is considered that the same

[229] See 16.11 (General territorial principle).

[230] Similar issues might arise where (1) the income is received by non-resident close family, and (2) the settlor is not UK resident.

[231] If the benefit is matched to non-Protected income, it is not taxed:
If the settlor has never been UK resident, there is no Protected Income, and this question does not arise; see 92.13 (Protected s.720 trust income). The situation in which this question arises is if:
(1) The settlor is UK resident for a period of time and Protected Income arises.
(2) The settlor ceases to be UK resident.
(3) The settlor then receives a benefit.

territorial limitation must be applied.[232]

Para 24 Protected-trust Note agrees:[233]

> Section 731(1A) prevents a charge where the recipient is non-resident when he receives the benefit. On a literal reading this does not apply where
> [1] the person abroad is a settlement or underlying company[234] and
> [2] the recipient of the benefit is the settlor.
> It is considered that section 731(1A) is intended to be read with section 733A [s.731 settlor-attribution rule] and ensure the settlor can be charged on a benefit received by the settlor's non-resident spouse or minor child but not if the non-resident is the settlor.
> It follows that section 731(1A) should only be applied to tax the settlor if payments are made to the settlor's non-resident close family member and the settlor is UK resident, not where the settlor himself is non-resident and payments are made to him (or a close family member).[235]
> This appears to be the approach adopted by HMRC.[236]

This view is supported by s.733(1) step 2[2][237] which assumes that Matched s.731 Income is not necessarily taxed.

If (contrary to the view taken here) there were a charge on s.731 income arising to a non-resident, DT relief can apply, on the basis that s.731 income falls within the Other Income article.[238] But this point should not arise.

50.46.3 *Benefit to non-resident matched when resident*

Suppose:

(1) Year 1:

   (a) A benefit is received by non-resident settlor ("a pre-residence benefit")

[232] See 16.11 (General territorial principle).

[233] For this document, see 92.1.1 (Protected-trust guidance).

[234] The example posits that the persona abroad is a trust or underlying company, because if the person abroad is a company which is not held in a trust, the company's income would not be Protected Income.

[235] The text adds at this point "An alternative reading would put the settlor in a worse position than a UK domiciliary becoming non-UK resident particularly as the remittance basis could not apply." But I am not sure about that.

[236] See 50.45.5 (Purpose of s.731(1A)).

[237] See 50.18.3 (Step 2: Total Untaxed Benefits).

[238] See 50.61.2 (Individual treaty-resident outside UK).

   (b) There is no relevant income to which the benefit can be matched
(2) Year 2:
   (a) The settlor becomes UK resident
   (b) Protected Income arises which is matched to the benefit

Taking s.731(1A) literally, this would appear to be chargeable. The pre-residence benefit is matched to the Protected Income. But context suggests that, as the professional bodies argue:

> section 731(1A) is intended to be read with section 733A [s.731 settlor-attribution rule] and ensure the settlor can be charged on a benefit received by the settlor's non-resident spouse or minor child but not if the non-resident is the settlor.

On this somewhat purposive construction there would be no charge.

If that is wrong, then whether or not the benefit is matched to Protected Income is somewhat arbitrary so there may be some scope for planning.

50.47 s.731 income of split year

There is no express split-year rule. So the usual s.731 rules apply[239] even if:

(1) a benefit is received during the overseas part of a split year of a beneficiary; or
(2) the relevant income matched to the benefit arises during the overseas part of a split year

The rule ought to be that benefits conferred on a beneficiary during the overseas part of their split year are treated like benefits of a year of non-residence, ie (generally) disregarded.[240]

However DT relief should be available if the individual is treaty-resident in a foreign state during part of a year, on the basis that s.731 income falls within the Other Income article.[241]

50.48 s.731 settlor-attribution: Outline

Section 733A introduces what I call the **"s.731 settlor-attribution rule"**.

This is one of a set of three rules which I call s.731/s.643A/s.87 settlor-

[239] See 10.1 (Residence throughout tax year).
[240] The same point arises for s.87, see 61.18.1 (s.87 split year: Critique).
[241] See 50.61.2 (Individual treaty-resident outside UK).

attribution rules; see 50.4.11 (Settlor-attribution rules: Introduction).

In outline, this rule applies where:

(1) A beneficiary receives a benefit
(2) The beneficiary is:
    (a) close-family
    (b) outside the s.731 charge (non-resident or remittance-basis exempt)
(3) The settlor is UK resident (and so potentially chargeable).

The charge is on the lower of the value of the benefit and the amount of Protected Income.

It will be quite rare for the s.731 settlor-attribution rule to apply, as it requires:

(1) Benefit to close-family who are non-resident or remittance-basis exempt (and so not themselves charged)
(2) A settlor of a protected trust who is UK resident and not remittance-basis exempt

A benefit to the settlor/transferor is not caught by the s.731 settlor-attribution rule, but it should fall within s.731 under general principles.[242]

50.49 s.731 attribution conditions

Section 733A(1) ITA provides:

> Subsections (2) and (3) apply if-

A set of six conditions then follow, which I call **"s.731 settlor-attribution conditions"**.

50.49.1 *Cond (a): s.731 income*

Section 733A(1) ITA provides:

> Subsections (2) and (3) apply if-
> (a) an amount of income [s.731 income] is treated as arising to an individual under section 732 for a tax year.[243]

The usual s.731 application conditions must be met.

[242] See 50.15 (Taxable-transferor defence).

[243] Section 733A(4) ITA provides: "The amount mentioned in subsection (1)(a) may be the whole, or part only, of the amount treated as arising to the individual under section 732 for the year in the case of the relevant transfer and its associated operations."

I refer to this individual as the [close-family] individual as the conditions require that the individual is close-family of the settlor, or as the **"beneficiary"**, as this individual must receive a benefit (in order to receive s.731 income).

50.49.2 *Cond (b): Match Protected Income*

Section 733A(1) ITA provides:

> Subsections (2) and (3) apply if...
> (b) under section 735A[244] (if it applied also for this purpose) that amount [of s.731 income] would be matched—
> (i) with an amount of relevant income that is protected income for the purposes of this sub-paragraph (see sections 721(3BA) and 728(1B)),[245] and

If relevant income accrues to a company not held in a trust, the income is not Protected Income, and the s.731 settlor-attribution rule does not apply.

50.49.3 *Cond (b): Match with benefit*

Section 733A(1) ITA provides:

> Subsections (2) and (3) apply if...
> (b) under section 735A[246] (if it applied also for this purpose) that amount [of s.731 income] would be matched ...
> (ii) with a benefit received by the individual [the beneficiary] at a time when the individual [the beneficiary] was a close member (see subsection (7))[247] of the family of the settlor of the settlement concerned.

50.49.4 *Cond (c): Non-resident trust*

Section 733A ITA(1) provides:

> Subsections (2) and (3) apply if...
> (c) there is no time in the year when the trustees of the settlement are resident in the UK.

50.49.5 *Cond (d): Settlor UK resident*

Section 733A(1) ITA provides:

[244] Section 735A is the s.731 matching rule: see 50.42 (s.731 matching rules).

[245] See 50.44 ("Protected Income").

[246] Section 735A is the s.731 matching rule: see 50.42 (s.731 matching rules).

[247] See 61.27 ("Close-family").

> Subsections (2) and (3) apply if...
>
> (d) there is a time in the year when the settlor is resident in[248] the UK.

50.49.6 *Cond (e)(f): Settlor non-dom*

Section 733A(1) ITA provides:

> Subsections (2) and (3) apply if...
>
> (e) there is no time in the year when the settlor is [actually] domiciled in the UK, and
>
> (f) there is no time in the year when the settlor is regarded for the purposes of section 718(1)(b)[249] as domiciled in the UK as a result of section 835BA having effect because of Condition A in that section being met [formerly domiciled resident[250]].

50.50 s.731 settlor-attribution rule

Assuming the s.731 settlor-attribution conditions are met, we move on to the attribution rule.

Section 733A(2)(3) ITA deal with 2 situations:

(1) The beneficiary may be wholly exempt, because
  (a) they are non-resident, or
  (b) they are a remittance basis taxpayer and none of the income is remitted.

(2) The beneficiary may be partly exempt, because they are a remittance basis taxpayer and only part of the income is remitted.

It is easier to follow if the provisions are read side by side:

Beneficiary wholly exempt: s.733A(2)	**Beneficiary partly exempt: 733A(3)**
If – (a) the [close-family] individual is not resident in the UK at any time in the year, or	If –
(b) [i] section 809B, 809D or 809E (remittance basis) applies to the [close-family] individual for the	(a) [identical to (b)[i] opposite]

[248] The correct expression for residence of individuals is resident *for* the year; but it does not matter.

[249] See 48.5 ("Person Abroad").

[250] See 5.4.2 (IT/CGT formerly-dom resident rule).

year and	
[ii] none of the amount mentioned in subsection (1)(a) of this section [s.731 income] is remitted to the UK in the year,	(b) part only of the amount mentioned in subsection (1)(a) of this section [s.731 income] is remitted to the UK in the year,
[A] the settlor is liable for the tax charged under section 731 on that amount as if that amount were income arising to the settlor in the year	[A] the settlor is liable for the tax charged under section 731 on the remainder of that amount as if that remainder were income arising to the settlor in the year
[B] (and the [close-family] individual] is not liable in any later year for income tax on that amount).	[B] (and the [close-family] individual is not liable in any later year for income tax on that remainder).

Para [B] is not relevant if the (close-family) individual is non-resident, but it is relevant if the individual is remittance-basis exempt: its effect is that the close-family individual is not taxed if they later bring the benefit to the UK. That may be advantageous where:

(1) a benefit is provided to a minor child of the settlor
(2) the remittance basis applies to the child and to the settlor
(3) Once the child reaches the age of 18, they bring the property to the UK

The child is not taxed; and neither is the settlor, since on the child becoming 18, it ceases to be a relevant person in relation to the settlor.

Statute frequently refers to a case:

> where an individual is liable as a result of section 733A(2) or (3) for the tax charged under section 731 on the amount mentioned in s.733B(1)(a) [s.731 income]

For clarity, I gloss that as [attribution to settlor].

50.51 s.731 settlor-attribution remittance-basis

Section 735B(1) ITA provides:

> This section applies in relation to income if—
> (a) the [s.731] income is treated by section 732 as arising to an individual ("the beneficiary") for a tax year,

> (b) another individual ("the settlor") is under section 733A(2) or (3) [attribution to settlor[251]] liable for tax on the income, and
> (c) section 809B, 809D or 809E (remittance basis) applies to the settlor for that year.

Assuming these conditions are met, we move on to s.735B(2) ITA:

> The income ("the transferred-liability deemed income") is treated as relevant foreign income of the settlor.

This applies the remittance basis to the s.731 income attributed to the settlor.

Section 735B(3) ITA provides:

> If, for the purposes of section 735 as it applies in relation to the beneficiary, any benefit or relevant income relates to any part of the transferred-liability deemed income then, for the purposes of Chapter A1 of Part 14 as it applies in relation to the settlor, that benefit or relevant income is to be treated as deriving from that part of the transferred-liability deemed income.

This adopts the usual rule for the s.731 remittance basis.[252]

Section 735B(4) ITA provides:

> In the application of section 832 of ITTOIA 2005 in relation to the income, subsection (2) of that section has effect with the omission of its paragraph (b).

The significance is that (contrary to the usual rule) the s.731 income attributed to the settlor is taxable if it is remitted during the overseas part of a split year.[253] This is consistent with the rule which applies generally for ToA[254] though there is no good reason for the rule.

50.52 s.731 onward-gifts

Sections 733B - 733D set out what I call the **"s.731 onward-gift rule"**. This is one of a set of three rules which I call s.731/s.643A/s.87 onward-gift rules; see 61.30 (Onward-gifts: Introduction).

It is helpful first to review some definitions.

[251] See 50.50 (s.731 settlor-attribution rule).
[252] See 50.39 (s.731 remittance basis).
[253] See 17.13.1 (Remittance in split-year).
[254] See 50.47 (Split year: s.731 income).

50.52.1 *Charging, matching, gift year*

The first two definitions are the same as in the s.643A onward-gift rules, so it is not necessary to repeat them here:

Term	**Definition**	**s.643A equivalent, see:**
Gift year	s.733B(7)	47.31.1
Charging year	s.733B(7)	47.31.3

The definition of matching year is differently worded but effectively the same. Section 733B(7) ITA provides:

> In this section ...
> "the matching year" means the first tax year in which the matching mentioned in subsection (1)(b)[255] would occur,

50.52.2 *Settlor*

Section 733B(7) ITA provides:

> In this section ...
> "the settlor" means the settlor of the settlement, mentioned in
> [a] section 721A(3) or (4)[256] or
> [b] [section] 729A(3) or (4),
> which because of subsection (1)(b)(i) is the settlement concerned.

This definition applies for s.733B, so it is repeated in s.733E(7) ITA. What is the point of the last phrase?

50.53 s.731 onward-gift conditions

Section 733B(1) ITA provides:

> Sections 733C to 733E apply if-

A set of 7 conditions then follow, which I call **"s.731 onward-gift conditions"**.

50.53.1 *Cond (a): s.731 income*

Section 733B(1) ITA provides:

> Sections 733C to 733E apply if-
> (a) [i] an amount of income is treated as arising under section 732

[255] See 50.53.2 (Cond (b): match Protected Income).

[256] See 92.12 (Protected s.720 income).

[s.731 income] to an individual ("the original beneficiary" [donor]) in a tax year ("the arising year")

[ii] but neither by section 733C nor by section 733E

The statutory references in para [ii] are:

Section	**Topic**	**See**
733C	s.731 onward-gift donee charge	50.55
733E	onward-gift settlor-attribution	50.57

The s.731 onward-gift rules frequently refer to "the amount mentioned in s.733B(1)(a)". For clarity, I gloss that as [s.731 income].

50.53.2 *Cond (b): Match Protected Income*

Section 733B(1) ITA provides:

> Sections 733C to 733E apply if...
> (b) under section 735A [matching rules] (if it applied also for this purpose)[257] that amount [the s.731 income] would be matched-
> (i) with an amount of relevant income that is protected income for the purposes of section 733A(1)(b)(i) (see sections 721(3BA) and 728(1B))[258]

The s.731 onward-gift rule can only apply if the s.731 income is matched with relevant income which is Protected Income.

S.731 income is (in short) matched with the oldest relevant income, under a type of FIFO basis. For trusts which were in existence before 2017, the s.731 onward gift rules may not apply for the foreseeable future, as s.731 income will be matched with pre-2017 income (which is not Protected Income).

50.53.3 *Cond (b): Match benefit*

Section 733B(1) ITA provides:

> Sections 733C to 733E apply if...
> (b) under section 735A [matching rules] (if it applied also for this purpose)[259] that amount [the s.731 income] would be matched
> ...

[257] See 50.42 (s.731 matching rules).

[258] For these sections and the definition of Protected Income, see 50.44 ("Protected Income").

[259] See 50.42 (s.731 matching rules).

> (ii) with the whole or part of a benefit received by the original beneficiary [donor]

50.53.4 *Cond (c): Intention to give*

Section 733B(1) ITA provides:

> (1) Sections 733C to 733E apply if...
> (c) at the time that benefit is received by the original beneficiary [donor] ("the distribution time")-
> (i) there are arrangements, or there is an intention, as regards the (direct or indirect) passing-on of the whole or part of that benefit to another person, and
> (ii) it is reasonable to expect that, in the event of the whole or part of that benefit being passed on to another person as envisaged by the arrangements or intention, that other person will be UK resident when they receive at least part of what is passed on to them

This is effectively equivalent to s.87 onward-gift condition (c).[260]

50.53.5 *Cond (d): Gift & time limit*

Section 733B(1) ITA provides:

> Sections 733C to 733E apply if...
> (d) the original beneficiary [donor] makes, directly or indirectly, a gift ("the onward payment") to a person ("the subsequent recipient" [donee])-
> (i) [A] at the distribution time,
> [B] or at any later time in the 3 years beginning with the start time, or
> (ii) at any time before the distribution time and, it is reasonable to assume, in anticipation of receipt of the benefit mentioned in paragraph (b)(ii)

Statute frequently refers to an onward payment (gift) "made as mentioned in subsection (1)(d)(ii)". I refer to that as a **"pre-distribution gift"**.

Onward-gift condition (d) is effectively equivalent to s.87 onward-gift condition (c).[261]

[260] See 50.53.4 (Cond (c): Intention to give).

[261] See 61.31.3 (Condition (c): Gift & time limit). Section 733B(7) provides the standard wide definition of making a gift, the same as s.87G(15) TCGA

50.53.6 *Cond (d) "start time"*

"Start time" matters as the 3 year gift time limit runs from the start time. In outline, there are 2 possible start times:

Para	***Circumstances***	***Start time***
733B(4)(a)	Direct gift	When benefit provided to donor
733B(4)(b)	Chain of gifts	Time of first gift

The start times are best read side by side. Section 733B(4) ITA provides:

> For the purposes of subsection (1)(d)(i)—

(a) if the amount mentioned in subsection (1)(a) [s.731 income] is not one that is treated as arising by section 733D, [for s.733D, see 50.56 (Donee not taxed)]	(b) if the amount mentioned in subsection (1)(a) [s.731 income] is one that is treated as arising by section 733D in connection with the operation of this section on a previous occasion,
"the start time" is the time the benefit mentioned in subsection (1)(b) is provided to the original beneficiary [donor],	"the start time" is the time given by this subsection as the start time on that occasion.

50.53.7 *Cond (e): Gift from benefit*

Section 733B(1) ITA provides:

> Sections 733C to 733E apply if...
> (e) the gift is of or includes-
> (i) the whole or part of the benefit mentioned in paragraph (b)(ii),
> (ii) anything that (wholly or in part, and directly or indirectly) derives from, or represents, the whole or part of that benefit, or
> (iii) any other property, but only if the benefit mentioned in paragraph (b)(ii) is provided with a view to enabling or facilitating, or otherwise in connection with, the making of the gift of the property to the subsequent recipient [donee]

This is substantially equivalent to s.87 onward-gift condition (d).[262] The s.731 onward-gift rule frequently refers to this provision with the formula:

[262] See 61.31.6 (Condition (d): Gift from capital payment).

> so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 733B(1)(e)

For clarity, I gloss that as [gifted benefit].

50.53.8 *"Relevantly remitted"*

Onward-gift conditions (f)(g) use the term "relevantly remitted". Section 733B(7) ITA provides:

> "relevantly remitted"
> [a] means remitted to the UK in a tax year for which the original beneficiary [donor] is UK resident
> [b] but, where
> [i] an individual is liable as a result of section 733A(2) or (3)[263] [settlor-attribution rule]
> [ii] for the tax charged under section 731
> [iii] on the amount mentioned in subsection (1)(a) [s.731 income],
> means remitted to the UK in a tax year for which that individual [the settlor] is UK resident

I refer to this as **"relevantly/taxably remitted"**. The definition is equivalent to the s.643A definition.[264]

50.53.9 *Cond (f)(g): Donor outside s.731*

Section 733B(1) ITA provides:

> Sections 733C to 733E apply if...

It is easier to follow if conditions (f) and (g) are read side by side:

(f): Directly received s.731 income	**(g) Settlor-attributed s.731 income**
except where an individual is liable as a result of section 733A(2) or (3) [settlor-attribution rule] for the tax charged under section 731 on the amount mentioned in paragraph (a) [s.731 income], either- (i) the original beneficiary [donor] is non-UK resident for the arising year, or	where an individual [the settlor] is liable as a result of section 733A(2) or (3) [settlor-attribution rule] for the tax charged under section 731 on the amount mentioned in paragraph (a) [s.731 income],

[263] See 50.50 (s.731 settlor-attribution rule).

[264] See 47.32.7 (s.643A "relevantly remitted").

(ii)[A] section 809B, 809D or 809E (remittance basis) applies to the original beneficiary [donor] for the arising year and	[A] section 809B or 809D or 809E [remittance basis] applies to that individual for the arising year and
[B] none of the amount mentioned in paragraph (a) is relevantly [taxably] remitted before the end of the charging year.	[B] [identical]

This is approximately equivalent to s.643A onward-gift condition (f)(g).[265]

50.54 s.731 misc rules

50.54.1 *Donee on remittance basis, remits part of income*

Section 733B(2) ITA provides:

> If—
>
> (a) the amount mentioned in subsection (1)(a) [s.731 income] is not treated as arising by section 733D (and neither by section 733C nor by section 733E),

The statutory references here are:

Section	**Topic**	**See**
733C	s.731 onward-gift donee charge	50.55
733D	Donee not taxed	50.56
733E	onward-gift settlor-attribution	50.57

> (b) except where an individual is liable as a result of section 733A(2) or (3)[266] [settlor-attribution rule] for the tax charged under section 731 on that amount, section 809B or 809D or 809E [remittance basis] applies to the original beneficiary [donor] for the arising year,
>
> (c) where an individual is liable as a result of section 733A(2) or (3)[267] [settlor-attribution rule] for the tax charged under section 731 on that amount, section 809B or 809D or 809E [remittance basis] applies to that individual for the arising year, and
>
> (d) part only of that amount is relevantly remitted before the end of the charging year,

[265] See 47.32.8 (Cond. (f)/(g): No s.643A charge).

[266] See 50.50 (s.731 settlor-attribution rule).

[267] See 50.50 (s.731 settlor-attribution rule).

> subsection (1)(a) is to be treated as referring instead only to the remainder of that amount.

50.54.2 *Pre-distribution gift: date of charge*

Section 733B(5) ITA provides:

> Where the onward payment [gift] is made as mentioned in subsection (1)(d)(ii), [pre-distribution gift] the onward payment [gift] is to be treated—
>
> (a) for the purposes of the provisions of this section following subsection (1)(d), and
>
> (b) for the purposes of sections 733C to 733E,
>
> as made immediately after, and in the tax year containing, the distribution time.

50.54.3 *Relief for donor/settlor*

Section 733B(3) ITA provides:

> [A] The original beneficiary [donor] is not liable to tax for any year after the charging year on so much of the amount mentioned in subsection (1)(a) [s.731 income] as is—
>
> (a) treated as arising to the subsequent recipient [donee] by section 733C, or
>
> (b) treated as arising to the settlor by section 733E;
>
> [B] and the settlor is not is liable under section 733A(2) or (3)[268] [settlor-attribution rule] to tax for any year after the charging year on so much of the amount mentioned in subsection (1)(a) [s.731 income] as is treated as arising to the subsequent recipient [donee] by section 733C.

50.54.4 *Start time adjustment*

Section 733B(4) ITA provides:

> For the purposes of subsection (1)(d)(i)—
>
> (a) if the amount mentioned in subsection (1)(a) [s.731 income] is not one that is treated as arising by section 733D,[269] "the start time" is the time the benefit mentioned in subsection (1)(b) is provided to the original beneficiary [donor], and
>
> (b) if the amount mentioned in subsection (1)(a) [s.731 income] is

[268] See 50.50 (s.731 settlor-attribution rule).

[269] See 50.56 (Donee not taxed).

> one that is treated as arising by section 733D[270] in connection with the operation of this section on a previous occasion, "the start time" is the time given by this subsection as the start time on that occasion.

s.733B(8)(9) are identical to the s.643A rules, and need not be set out again here: see 47.33.3 (Valuation of benefits) and 47.33.4 (Meaning of remittance).

50.55 s.731 onward-gift donee charge

Assuming the s.731 onward-gift conditions in s.733B are satisfied, we move on to the onward-gift rules in s.733C.

The layout is: s.733C(1)(2) set out application conditions; s.733C(3) sets out the rule where those conditions are satisfied.

The s.733C application conditions are substantially identical to the s.643A onward-gift rule, but I set them out again here for convenience. It is easier to follow if the two conditions are read side by side:

Donee on arising basis: 733C(1)	**Donee on remittance basis + some income remitted: s.733C(2)**
Subsection (3) applies if—	Subsection (3) also applies if—
(a) this section applies (see section 733B(1)), [s.731 onward-gift conditions are met] and	(a) [identical]
(b) the subsequent recipient [donee] is UK resident for the gift year, and	(b) [identical]
(c) the subsequent recipient [donee] is UK resident for the matching year if that is later than the gift year, and	(c) [identical]
(d) none of sections 809B, 809D and 809E [remittance basis] applies to the subsequent recipient [donee] for the charging year.	(d) section 809B, 809D or 809E [remittance basis] applies to the subsequent recipient [donee] for the charging year, and
	(e) the whole, or part only, of the onward payment [gift] is remitted to the UK in the charging year.

[270] See 50.56 (Donee not taxed).

Assuming the s.733C application conditions are satisfied, we move on to the rule. Section 733C(3) ITA provides the s.731 onward-gift charge:

> Section 731 has effect—
> (a) as if the subsequent recipient [donee] were an individual to whom [s.731] income is treated as arising under section 732 for the charging year, and
> (b) as if, subject to subsection (4), the amount of that income—
> (i) were equal to the amount or value of so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 733B(1)(e) [gifted benefit], or
> (ii) were, where
> [A] this subsection applies because of subsection (2) [donee on remittance basis] and
> [B] part only of that much of the onward payment [gift] is remitted to the UK in the charging year,
> equal to the amount or value of that part.

50.55.1 *Donee otherwise taxable*

Section 733C(4) ITA provides:

> The amount given by subsection (3) (before adjustment under this subsection) is to be adjusted as follows—
> (a) deduct any part of the amount on which the subsequent recipient is liable to income tax otherwise than under this section

50.55.2 *Gift exceeds donor's benefit*

Section 733C(4) ITA provides:

> The amount given by subsection (3) (before adjustment under this subsection) is to be adjusted as follows ...
> (b) if following any adjustment under paragraph (a) the amount exceeds the amount mentioned in section 733B(1)(a), deduct the excess.

50.56 Donee not taxed

The layout is: s.733D(1)(2) set out application conditions; s.733D(3) sets out the rules where one of those conditions is satisfied. The s.733D application conditions are substantially identical to the s.643A rule, but I set them out again here for convenience. It is easier to follow if the s.733D application conditions are read side by side:

Donee non-resident	**Donee on remittance basis**
(1) Subsection (3) applies if	(2) Subsection (3) also applies if—
[x] this section applies (see section 733B(1)) [s.731 onward-gift conditions are met] and—	(a) [identical to [x] opposite]
(a) the subsequent recipient [donee] is non-UK resident for the gift year, or (b) the matching year is later than the gift year and the subsequent recipient [donee] is UK resident for the gift year but non-UK resident for the matching year.	(b) the subsequent recipient [donee] is UK resident for the gift year, and
	(c) the subsequent recipient [donee] is UK resident for the matching year if that is later than the gift year, and (d) section 809B, 809D or 809E [remittance basis] applies to the subsequent recipient [donee] for the charging year, and (e) none, or part only, of the onward payment [gift] is remitted to the UK in the charging year.

Assuming the s.733D application conditions are satisfied, we move on to the rule. Section 733D(3) ITTOIA provides:

> Section 733B(1)(a) has effect—
> (a) as if the subsequent recipient [donee] were an individual to whom income is treated as arising under section 732 for the charging year, and
> (b) as if, subject to subsection (4), the amount of that income—
> (i) were equal to the amount or value of so much of the onward payment [gift] as
> [A] is within any of sub-paragraphs (i) to (iii) of section 733B(1)(e) [gifted benefit] and
> [B] is not treated as arising to someone other than the subsequent recipient [donee] as a result of the

operation of section 733E, or

(ii) were, where

[A] this subsection applies because of subsection (2) and

[B] part only of that much of the onward payment [gift] is remitted to the UK in the charging year,

equal to the amount or value of the remainder of that much of the onward payment [gift].

The difference between 733C(3) and 733D(3) is:

733C: chargeable s.731 income arises to donee/settlor

733D: non-chargeable s.731 income arises to donee/settlor, which is taken into account for a future onward-gift charge

It may be helpful to look at the s.733C/D rules side by side, with the key differences underlined:

Section 733C(3)	**Section 733D(3)**
Section 731 has effect— (a) as if the subsequent recipient [donee] were an individual to whom income is treated as arising under section 732 for the charging year, and	Section 733B(1)(a) has effect— (a) [identical]
(b) as if, subject to subsection (4), the amount of that income— (i) were equal to the amount or value of so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 733B(1)(e) [gifted benefit], or	(b) as if, subject to subsection (4), the amount of that income— (i) were equal to the amount or value of so much of the onward payment [gift] as [a] is within any of sub-paragraphs (i) to (iii) of section 733B(1)(e) [gifted benefit] and [B] is not treated as arising to someone other than the subsequent recipient [donee] as a result of the operation of section 733E, or
(ii) were, where [A] this subsection applies because of subsection (2) [donee on remittance basis] and	(ii) were, where [A] [identical]
[B] part only of that much of the onward payment [gift] is remitted	[B] [identical],

to the UK in the charging year,	
equal to the amount or value of that part.	equal to the amount or value of the remainder of that much of the onward payment [gift].

50.56.1 *Gift value exceeds s.731 income*

Section 733D(4) ITA provides:

> The amount given by subsection (3) (before adjustment under this subsection) is to be adjusted as follows: if that amount exceeds the amount mentioned in section 733B(1)(a) [s.731 income] in the case of the original beneficiary [donor], deduct the excess.

50.56.2 *Prior year s.731 charge*

Section 733D(5) ITA provides:

> Where the amount mentioned in section 733B(1)(a) is one treated as arising by this section in connection with the operation of section 733B and this section on a previous occasion, section 733B(1) has effect—
> (a) with the omission of its paragraphs (b) and (c),
> (b) as if the reference in its paragraph (d) to the benefit mentioned in its paragraph (b)(ii) were, instead, to what was the onward payment [gift] on that previous occasion,
> (c) as if the references in its paragraph (d) to the distribution time were, instead, to the time when that onward payment [gift] was made, and
> (d) as if the references in its paragraph (e) to the benefit mentioned in its paragraph (b)(ii) were, instead, to so much of that onward payment [gift] as was on that previous occasion within any of sub-paragraphs (i) to (iii) of its paragraph (e) [gifted benefit].

Amended as s.733D(5) directs, s.733B(1) provides:

> (1) Sections 733C to 733E apply if—
> (a) an amount of income is treated as arising under section 732 to an individual ("the original beneficiary") in a tax year ("the arising year") but neither by section 733C nor by section 733E,
> ~~(b) under section 735A (if it applied also for this purpose) that amount would be matched—~~
> ~~(i) with an amount of relevant income that is protected income for the purposes of section 733A(1)(b)(i) (see sections 721(3BA) and 728(1B)), and~~
> ~~(ii) with the whole or part of a benefit received by the original beneficiary,~~

~~(c) at the time that benefit is received by the original beneficiary ("the distribution time")—~~

~~(i) there are arrangements, or there is an intention, as regards the (direct or indirect) passing-on of the whole or part of that benefit to another person, and~~

~~(ii) it is reasonable to expect that, in the event of the whole or part of that benefit being passed on to another person as envisaged by the arrangements or intention, that other person will be UK resident when they receive at least part of what is passed on to them,~~

(d) the original beneficiary makes, directly or indirectly, a gift ("the onward payment") to a person ("the subsequent recipient")—

(i) at the distribution time, or at any later time in the 3 years beginning with the start time, or

(ii) at any time before ~~the distribution time~~ the time when that onward payment [gift] was made and, it is reasonable to assume, in anticipation of receipt of ~~the benefit mentioned in paragraph (b)(ii)~~ what was the onward payment [gift] on that previous occasion,

(e) the gift is of or includes—

(i) the whole or part of ~~the benefit mentioned in paragraph (b)(ii)~~ so much of that onward payment [gift] as was on that previous occasion within any of sub-paragraphs (i) to (iii) of its paragraph (e) [gifted benefit],

(ii) anything that (wholly or in part, and directly or indirectly) derives from, or represents, the whole or part of that benefit, or

(iii) any other property, but only if ~~the benefit mentioned in paragraph (b)(ii)~~ so much of that onward payment [gift] as was on that previous occasion within any of sub-paragraphs (i) to (iii) of its paragraph (e) [gifted benefit] is provided with a view to enabling or facilitating, or otherwise in connection with, the making of the gift of the property to the subsequent recipient,

(f) except where an individual is liable as a result of section 733A(2) or (3) for the tax charged under section 731 on the amount mentioned in paragraph (a), either—

(i) the original beneficiary is non-UK resident for the arising year, or

(ii) section 809B or 809D or 809E (remittance basis) applies to the original beneficiary for the arising year and none of the amount mentioned in paragraph (a) is relevantly remitted before the end of the charging year, and

(g) where an individual is liable as a result of section 733A(2) or (3) for the tax charged under section 731 on the amount mentioned in paragraph (a), section 809B or 809D or 809E applies to that individual for the arising year and none of the amount mentioned in paragraph (a) is relevantly remitted before the end of the charging year.

50.57 s.731 onward-gift settlor-attribution rule

The s.731 onward-gift settlor-attribution rule is one of a set of three rules which

I call settlor-attribution rules. For a general introduction see 61.26 (Settlor-attribution: Introduction).

Suppose an onward gift is made to a donee (not close-family). A direct benefit to close-family may be treated as made to the settlor, under the s.731 settlor-attribution rule.[271] Section 733E ITA ensures that the same applies in the case of an onward gift to close-family. I refer to this as the **"s.731 OG settlor-attribution rule"**.

The layout is: s.733E(1)(2) set out application conditions; s.733E(3) sets out the rules where one of those conditions is satisfied. It is easier to follow if the 733E application conditions are read side by side:

Donee on remittance basis: s.733E(1)	**Donee non-resident: s.733E(2)**
Subsection (3) applies if— (a) this section applies (see section 733B(1)) [s.731 onward-gift conditions are met],	Subsection (3) also applies if— (a) [identical]
(b) the subsequent recipient [donee] is a close member of the settlor's family when the onward payment [gift] is made,	(b) [identical]
(c) the subsequent recipient [donee] is UK resident for the charging year,	(c) the subsequent recipient [donee] is non-UK resident for the charging year,
(d) section 809B, 809D or 809E [remittance basis] applies to the subsequent recipient [donee] for the charging year,	
(e) none, or part only, of the onward payment [gift] is remitted to the UK in the charging year,	
(f) there is a time in the charging year when the settlor is UK resident,	(d) [identical to (f)]
(g) there is no time in the charging year when the settlor is domiciled in the UK, and	(e) [identical to (g)]
(h) there is no time in the charging year	(f) [identical to (h)]

[271] See 61.26 (Settlor-attribution: Introduction).

> when the settlor is regarded for the purposes of section 718(1)(b) [definition of person abroad] as domiciled in the UK as a result of section 835BA having effect because of Condition A in that section being met.

Assuming the 733E application conditions are satisfied, we move on to the rule. Section 733E(3) ITA provides:

> Section 731 applies—
> (a) as if the settlor were an individual to whom income is treated as arising under section 732 for the charging year, and
> (b) as if, subject to subsection (4), the amount of that income—
> (i) were equal to the amount or value of so much of the onward payment [gift] as is within any of sub-paragraphs (i) to (iii) of section 733B(1)(e) [gifted benefit], or
> (ii) were, where this subsection applies because of subsection (1) in a case where part only of that much of the onward payment [gift] is remitted to the UK in the charging year, equal to the amount or value of the remainder of that much of the onward payment [gift].

50.57.1 *Settlor otherwise taxable*

Section 733E(4) ITA provides:

> The amount given by subsection (3)(b) (before adjustment under this subsection) is to be adjusted as follows—
> (a) deduct any part of the amount on which the settlor is liable to income tax otherwise than under this section, and
> (b) if following any adjustment under paragraph (a) the amount exceeds the amount mentioned in section 733B(1)(a), deduct the excess.

Section 733E(5)(6) ITA provides the standard settlor-attribution indemnity.[272]

> (7) In this section—
> (b) "close member", in relation to the family of the settlor, is to be read in accordance with section 733A(7) and (8).

[272] See 61.28 (Settlor-attribution indemnity).

This is the s.731 equivalent of s.87L: see 61.34 (Onward-gift to close-family: s.87 settlor-attribution rule).

50.58 Responses to s.731: Summary

(1) Avoid relevant income by
- (a) distributing income:
  - (i) as it arises; or
  - (ii) in a year before a beneficiary receives a benefit; or
- (b) using interest in possession settlements in preference to discretionary; or
- (c) not using trusts and companies where inappropriate

(2) Motive defence

(3) Remittance basis

(4) Arrange that foreign domiciled beneficiaries receive benefits of an income nature (outside s.731)

50.59 Record keeping

On this topic, see 61.58 (Record keeping for s.87/s.731).

50.60 Tax return: s.731 income

Section 731 income is returned in Box 42 in the Foreign pages (form SA106) 2022/23 The note by this box reads:

> If you've received a benefit from a person abroad, or you're chargeable on a benefit received by you, a close family member, or you're the recipient of an onward gift that is matched to protected foreign source income, enter the value of the payment. If you're omitting income from this section because you're claiming an exemption, see box 46. If you're the settlor or close family member of the settlor and you've received, or are treated as having received, a benefit from a trustee of the settlement, or you're the recipient of an onward gift, and the benefit or onward gift does not exceed the settlement's available protected income, enter the amount treated as your income. Include full details in the 'Any other information' box on your tax return- read the notes.

The reference to a benefit is a reference to an income taxable benefit, so if a foreign domiciled individual received a benefit which is not subject to IT (because of the remittance basis or for lack of relevant income) then the figure here should be nil. HMRC agree.

Helpsheet 262 (Income and benefits from transfers of assets abroad and income from Non-Resident Trusts - 2021) provides:

> **Reporting benefits as a result of a relevant transaction made by another individual**
> Unless you're completing box 46 of the 'Foreign' pages [motive defence[273]] you should enter the amount from Step 6, in box 42 of the 'Foreign' pages.
> Enter in the 'Any other information' box, box 19 on page TR 7 of your tax return:
> - the full name and address of the person abroad receiving the available relevant income
> - the details of the relevant transactions that have given rise to the income
> - how you've calculated the benefits included on the return
>
> Where the benefit has come from a UK resident trust in the circumstances described in the previous section, also give details of those circumstances including the full name of any other trust involved.

50.61 DT relief: s.731 income

50.61.1 *Person abroad treaty-resident outside UK*

This section considers whether DT reliefs are available where:

(1) income accrues to a person abroad who is treaty-resident in a foreign state
(2) an individual is UK-law UK resident and not treaty-resident in a foreign state
(3) the individual is in principle subject to tax under s.731.

DT exemption is not applicable for s.731 ITA. EN ITA provides:

> 2170. The method statement [s.733 ITA 2007] makes it clear that "relevant income" in relation to an individual is not actually taxable income of the individual, but is an element in the calculation of taxable income. "Relevant income" is actual income arising to a person abroad; the income charged under section 731 is income treated as arising to the individual in question. This deemed income may be more or less than "the relevant income of the tax year" in relation to the individual and the tax year identified at Step 3.

The INT Manual makes the same point:

[273] See 52.33 (Tax return: Motive defence).

> **INTM601720 Measure of benefits charge** [Jul 2023]
> The benefits charge is a charge on 'income treated as arising' to the individual and it is a charge by reference to the amount treated as arising.
> Whether income is treated as arising, and if so the amount of it, is determined by the application of a formulaic approach which, in effect, compares benefits received by the individual with the income of a person abroad that can be used for providing a benefit (the relevant income of the tax year).
> This is neither a charge on the actual income of the person abroad, nor on the benefits received: rather, it is an amount determined by comparison of both elements over time.

Section 731 may be regarded as a charge on a benefit, or a charge on fictional income, but it is not a charge on the income arising to the person abroad.[274]

There is no foreign tax credit relief. However, income used to pay foreign tax is not relevant income as it cannot be used to benefit a beneficiary.

50.61.2 *Individual treaty-resident outside UK*

This section considers whether DT reliefs are available where:

(1) an individual is UK-law UK resident and treaty-resident in a foreign state
(2) the individual is in principle subject to tax under s.731.

Can the individual claim treaty relief directly?[275]

Most UK treaties restrict this relief by adding: *other than income paid out of trusts or the estates of deceased persons in the course of administration*. That exclusion does not prevent relief for s.731 income. It has an entirely different purpose.[276] Section 731 income is fictional income and not "paid out of trusts" even if relevant income accrues to a trust and the benefit is received from a trust.

Some DTAs restrict this relief to income *beneficially owned* by a resident of a Contracting State.[277] That restriction does not prevent relief

[274] See 109.1 (Third-party DT relief).

[275] See Wattel & Marres, "Characterization of Fictitious Income under OECD-Patterned Tax Treaties", 43 European Taxation 3 (2003), p.66: see 33.20 (DT relief: "Other Income").

[276] See 41.12.2 (Other Income article restricted).

[277] Eg art.22 USA/UK DTA.

for s.731 income for one of two reasons:

(1) As a matter of property law, s.731 income is not "beneficially owned" by the individual or anyone else: it is fictional income which does not exist. But since for tax purposes it is deemed to be the income of the individual, this requirement is deemed to be satisfied.[278]

(2) Section 731 income is "beneficially owned" by the individual because s.731 is a tax by reference to a benefit which is beneficially owned by the individual.[279]

Suppose s.731 income arises where a beneficiary enjoys the benefit of occupying land in the UK. Article 6 OECD Model provides (so far as relevant):

> 1. Income derived by a resident of a Contracting State from immovable property ... situated in the other Contracting State may be taxed in that other State...
> 3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property

It is considered that s.731 income is not "income derived from immovable property" even if the charge is by reference to the occupation of UK land.

[278] This point is the same as for s.624. See 47.18.3 (Settlor treaty-resident outside UK).

[279] See 50.17.1 (Benefit matched on receipt).

CHAPTER FIFTY ONE

TRANSFER OF ASSETS ABROAD: RELIEF FROM OVERLAPPING CHARGES

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Cross references

This chapter considers rules which prevent double UK taxation; for the separate issue of DTAs and foreign tax credit relief, see:
 49.30 (DT relief: s.720 income)
 50.61 (DT relief: s.731 income)

51.1 Overlapping ToA charges: Relief

The transfer of asset rules could often give rise to double UK taxation, and there are a number of reliefs to prevent this. Statute does not provide names for the reliefs, so I coin the following terminology:

Name of relief	**ITA**	**Outline of relief**
Transferor's tax credit:	*s.745(1)*	*Credit:*
Transferor's IT credit		- for income tax paid by person abroad
Transferor's CT credit		- for corporation tax paid by person abroad
Person-abroad's credit	*unclear*	Credit for income tax paid by transferor
Distribution relief	s.743(2A/B)	Relief on distribution to transferor
Double-counting relief	s.743(1)	Broad relief against double charges

The courts have a strong inclination, which one might elevate to the status of a rule of construction, that double taxation should be avoided.[1] This underlies and perhaps supplements the statutory reliefs.

51.1.1 *When reliefs are needed*

Protected-trust relief reduced the scope of the s.720 charge, and so reduced the overlapping charges and the need for these reliefs. But there are of course circumstances where s.720 still applies eg, protected-trust relief does not apply to:

- UK source income
- Offshore income gains
- a transferor actually domiciled in the UK
- a company not held in a trust

51.2 IT on person abroad's income

Suppose an offshore company ("OC") receives and retains income subject to income tax.[2] If s.720 ITA did not apply, there would be one charge to tax: income tax borne by OC. However, if s.720 applies, there are possible charges to income tax at two levels:

(1) OC may pay income tax at the basic rate under ordinary principles.
(2) The transferor ("T") may pay IT under s.720 on (effectively) the same income.

What is there to prevent double taxation?

51.2.1 *Transferor's IT credit*

Section 745 ITA provides relief for T:

[1] For examples, see 51.17 (Other s.720 overlaps).

[2] For instance, a non-resident company pays income tax on UK source interest.

s.745(1) ITA *English/NI transferor*	**s.745(1A) ITA** *Scots transferor*	**s.745(1B) ITA** *Welsh transferor*
Income tax at [a] the basic rate, or [b] the starting rate for savings when that rate is more than 0%,	Income tax at a Scottish rate[3] [a] above 0% and [b] below, or equal to, the basic rate	Income tax at the Welsh basic rate[4] when that rate is [a] above 0% and [b] below, or equal to, the basic rate
is not charged under section 720 or 727 in respect of any income	[identical]	[identical]
if (and to the corresponding extent that) the income mentioned in section 721(2) or 728(1)(a) [the income of the person abroad[5]] has borne tax at that rate by deduction or otherwise.[6]	if (and to the corresponding extent that) the income mentioned in section 721(2) or 728(1)(a) has borne tax at the basic rate.	[identical to Scots provision]

I refer to this as "**transferor's IT credit**".

Double-counting relief[7] may also apply, where the transferor's credit covers the same ground, double-counting relief would not be needed.

HMRC Helpsheet HS262[8] explains how the relief is claimed in form SA106 (Foreign pages):

> **Tax paid on the income**
> You may be able to claim a deduction against your liability for tax credits or other tax paid on the income of the person abroad. You can do this if the amounts you enter in boxes 11 and 13 of the 'Foreign'

[3] See 43.5.2 (Scottish rates).

[4] See 43.5.4 (Welsh rates).

[5] See 49.14 (Condition A: Power to enjoy).

[6] See App. 2.3.2 (Bear tax by deduction or otherwise).

[7] See 51.9 (Double-counting relief).

[8] Income and benefits from transfers of assets abroad and income from Non-Resident Trusts (2024) updated 6 April 2024 *https://www.gov.uk/government/publications/income-and-benefits-from-transfers-of-assets-abroad-and-income-from-non-resident-trusts-hs262-self-assessment-helpsheet/hs262-income-and-benefits-from-transfers-of-assets-abroad-and-income-from-non-resident-trusts-2024*

> pages include any such taxes. You can only claim relief for tax paid by the person abroad:
> - if it is tax on 'the same' income
> - to the extent that the tax was paid by, and not refunded to, the person abroad
>
> You should include the amount of tax for which you can claim relief:
> - in column C
> - in box 2 of the 'Foreign' pages
>
> You should note Column E of your claim.
>
> You should also send a schedule with the 'Foreign' pages. The schedule should show:
> - the amount of each item of income you included in boxes 11 and 13, and column C
> - tax credit and tax paid on the income you included in boxes 11 and 13, and column C
>
> ...[9]

The helpsheet addresses the issue that the tax paid by the person abroad may not be known:

> You can use an estimate of the amount of credit available if you do not know the final amount of tax paid by the person abroad. If you do this, you must:
> - explain in box 19 of your tax return why you used an estimate
> - amend your tax return when you know the final details
>
> You may be liable for interest on tax paid late if any additional tax becomes payable after you amend your return.

For completeness: s.745(2) ITA provides:

> Subsections (1) and (1A) do not affect the tax charged if section 724(2) applies (benefit provided out of income of person abroad charged in year of receipt).[10]

51.3 CT on person abroad's income

Suppose an offshore company ("OC") receives and retains income subject to corporation tax.[11] If s.720 ITA did not apply, there would be one charge to tax: corporation tax borne by OC. However, if s.720 applies, there are two possible charges to tax:

[9] The passage omitted here concerns FTCR; see 49.30.1 (Foreign tax credit relief).

[10] This is rare; see 49.22.3 (Amount of charge: enjoyment condition C).

[11] For instance, a non-resident company pays corporation tax on UK source rent.

(1) OC may pay corporation tax at CT rates under ordinary principles.
(2) The transferor ("T") may pay IT under s.720 on (effectively) the same income.

What is there to prevent double taxation?

51.3.1 *Corporation Tax Override*

Section 3(1) CTA 2009 provides:

> The provisions of the Income Tax Acts relating to the charge to income tax do not apply to income of a company if—
> (a) the company is UK resident, or
> (b) the company is not UK resident and it is chargeable to corporation tax in respect of the income, or would be so chargeable but for an exemption.

Assume a non-resident company chargeable to corporation tax on its income. Sections 720 (and s.731) ITA are provisions of the Income Tax Acts and relate to the charge of income tax. So they "do not apply" to the income of the company. The plain meaning is, as the sections "do not apply" to that income, an individual cannot be charged by reference to it. In short, the CT charge overrides and excludes the ToA charge. I refer to this view as the **"Corporation Tax Override"**.

The Corporation Tax Override makes sense, because if the company profits are chargeable to corporation tax, HMRC do not need the ToA provisions. Tax saving when a *UK resident* company is used to reduce the tax on the income from individual to corporation tax rates is regarded as unobjectionable;[12] though it must be admitted that the analogy is imperfect, because non-resident companies do enjoy certain advantages over UK companies. For instance, there is a charge on a loan to a participator from a UK resident close company.

The CT Override is consistent with the CFC position where CT under the CFC rules overrides the ToA charge.[13]

51.3.2 *Winners/losers and history*

Section 3 CTA 2009 dates back to the origin of corporation tax[14] so the issue of the Corporation Tax Override has existed since 1965.

[12] See 47.3.3 (Use of co: Tax policy).
[13] See 51.19 (CFC rules/s.720 interaction).
[14] Section 46 FA 1965.

However until 2020 it did not usually matter. The Corporation Tax Override arises where a company is:

(1) subject to corporation tax; and
(2) is a "person abroad" within ToA.

There are 4 types of income which meet these requirements:

Type of income	**See**	**ToA issue**
Trading income of UK PE	21.6	Rarely arises intentionally
UK resident foreign incorporated co,1965-2012	48.5	Rarely arose intentionally
Trading income: deal/develop UK land	22.3	May arise, from 2016
UK property income	24.3.3	Common, from 2020

At first glance the taxpayer benefits substantially from the Corporation Tax Override because CT rates are much lower than IT rates. But while that is true now, it was not the case in 1965 when CT was introduced.[15]

While there may be tax savings under the Corporation Tax Override, it is not all one way. Suppose the company (the person abroad) is subject to CT, and distributes its profits to the transferor. The taxpayer does *better* under the HMRC view than if the Corporation Tax Override view is correct:[16]

(1) On the CT Override view:
    (a) The company pays CT on its income
    (b) The transferor pays IT (at dividend rates) on the distribution
    (c) Section 720 does not apply and the transferor does not qualify for the transferor's CT credit

    There are therefore two charges to tax.

(2) On the HMRC view:
    (a) The company pays CT on its income

[15] *CT rate:* Corporation Tax was introduced by s. 46(1) FA 1965 "at such rate as Parliament may hereafter determine". Subsequently, s.26 FA 1966 set the rate at 40% for the financial years 1964 and 1965.
Surtax rate: s.18 FA 1966 set the rate for 1965-66 to be the same as the previous year's rate, which in turn refers to the rate in the year before that and so on. back to s.16 FA 1951, which specified the top Surtax rate as 10 shillings in the pound (i.e. 50%).
So the difference between CT and IT was originally only a modest 10 percentage points (Subsequently, s.15 FA 1967 retrospectively amended s.18 FA 1966 and increased the rate by 10%, making the highest rate of surtax 55%., so the difference increased to 15 percentage points.)

[16] See 51.6.3 (Direct company ownership: Conclusion).

(b) The transferor pays IT on the company income, but with a credit for the CT paid by the company
(c) The transferor does not pay tax on the distribution because distribution relief applies

There is therefore only one charge to tax.

51.3.3 *HMRC counterarguments*

HMRC do not accept that corporation tax overrides the ToA charge. I here set out HMRC's best points.

HMRC cannot (or should not) say that when CT was extended to rental income of non-resident companies they did not intend, or envisage, that the consequence will be to override ToA. That is no doubt the case; but tax depends on what Parliament says, not on what HMRC intend, and unanticipated consequences happen all the time in tax. Still, unarticulated considerations of this kind may resonate.

In favour of the HMRC view is *R v Dimsey*.[17] This concerned a UK resident foreign incorporated company where:

(1) The company was chargeable to corporation tax
(2) It was also within s.720[18]

HMRC argued that the company was chargeable to corporation tax (in order to uphold the defendant's conviction for failing to declare and pay the CT). The defendant argued, ingeniously but unmeritoriously, that the application of s.720 entailed that the company was not subject to corporation tax. They argued, in short, not for a *CT* Override, but for a *s.720* override: that s.720 income tax charge overrode and excluded the CT charge. This argument failed.

In the course of the judgment Lord Scott (with whom the rest of the court agreed) addressed the double taxation issue (CT and IT on the same income). He cited what is now s.745(1) ITA (transferor's credit)[19] and continued:

> 53. ... It is worth repeating that in 1936 income tax was payable by individuals and by companies. This provision [s.745(1)], too, did not

[17] [2001] UKHL 46.

[18] At the time a foreign incorporated UK resident company counted as person abroad. If the same facts arose today, the company would not be a person abroad, and s.720 would not apply.

[19] See 51.2.1 (Transferor's IT credit).

> distinguish between individual transferees and company transferees. It did not need to.

That is correct. The passage continues:

> 54. In 1965, when companies became liable to corporation tax, the provision [s.745(1)] should, I think, have been amended so as to prevent a transferor being charged tax on deemed [s.720] income where the transferee had paid corporation tax on the actual income...
> 55. The provision... does not cover, expressly at any rate, the case of a company transferee that has paid corporation tax on the income. It seems to me clear (!) that this must be the result of an inadvertent oversight.

The point was not argued, and may seem less clear to the reader. Lord Scott continued:

> If the point ever arose for decision I would be attracted by the view that [s.745(1) ITA] should be construed so as to cover income which had been included in the computation of profits on which a company had paid tax. That construction would, in my opinion, accord with the Parliamentary intention. But it is not necessary to decide the point now...

In short, s.745 ITA (the transferor's IT credit) was extended beyond IT to give the transferor credit for CT paid by the person abroad.[20] The important point here is that HL assumed that the CT charge did not override ToA.

Importantly (the reader may think, unfortunately) the CT Override argument was not put to the Court. It was against the interest of the defendant (the taxpayer) to put the point, as if accepted it would *defeat* their argument (that s.720 overrode the CT charge). It would have been in the interest of the prosecution (HMRC) to argue the point. But HMRC did not do so. It is a matter of speculation whether this was because they did not think of it, or because the outcome would not suit them in other cases.

How does the taxpayer respond? Strictly speaking, a case is not

[20] An argument that a reference to income tax at the basic rate includes corporation tax at the CT rate seems an extremely loose construction. And there are other references to IT in s.743 which must all presumably be read as including corporation tax. But Scott took similar liberties in other tax cases, eg, *O'Rourke v Binks* 65 TC 165.

authority against an argument which was not put. But it is true to say that if the Corporation Tax Override was right, the discussion in *Dimsey* about extending the transferor's tax credit to CT was misconceived, and HMRC's practice since 1999 has been wrong. That would be a bold submission.

HMRC's next point is based on the original definition of person abroad. Section 718 ITA formerly provided:[21]

> *(1) In this Chapter [Chapter 2 Part 13] "person abroad" means a person who is resident or domiciled outside the UK.*
> *(2) For the purposes of this Chapter, the following persons are treated as resident outside the UK—*
> *(a) a UK resident body corporate that is incorporated outside the UK...*

This assumes that a company subject to CT is also within ToA. What is the taxpayer's answer? Strictly speaking, a provision introduced in 1965 is not to be construed by reference to a provision introduced in 2007, and repealed five years later. The Tax Law Rewrite were not infallible. Still, HMRC can say that the Rewrite supported their view.

51.3.4 *Some indecisive arguments*

The Corporation Tax Override was raised in *IRC v Levy.*[22] In this case:
(1) Income arising to a UK company was subject to corporation tax, and
(2) HMRC sought to assess an individual on the income of the company, as settlor, under the settlor-interested trust code.

The taxpayer argued that the CT charge overrode and excluded the IT settlor-interested trust charge. The issue was (more or less) the same.[23] HMRC's response relied on s.9(5) ICTA 1988, which is still in force:

> Where any enactment applies both to income tax and to corporation tax—
> (a) [i] it shall not be affected in its operation by the fact that they are distinct taxes
> [ii] but, so far as is consistent with the Corporation Tax Acts, shall apply in relation to income tax and corporation tax as if they were one tax,

[21] For the current text, see 48.5 ("Person abroad").

[22] 56 TC 68.

[23] See 47.3.2 (Underlying company income).

> [iii] so that, in particular, a matter which in a case involving two individuals is relevant for both of them in relation to income tax shall in a like case involving an individual and a company be relevant for him in relation to that tax and for it in relation to corporation tax;[24]

But it is not obvious how this helps. Section 720 is not "an enactment which applies both to IT and to CT".

In *Levy,* HMRC failed for another reason: there was no settlement-arrangement, and the taxpayer was not a settlor.[25] So it was not necessary to address the CT Override point and the court chose not to do so.[26] The Court in *Levy* must have thought it was an arguable point.

HMRC correctly point out that:

(1) Under the ToA code, the charge to income tax is on an individual and the amount of that charge is computed by reference to the income of a person abroad.

(2) Section 720 does not tax the income of the company, but a different, notional amount.[27]

But this does not help. Section 3 CTA 2009 does not say (in the manner of a DTA) that profits of a company subject to CT are exempt from IT. It says that the provisions of the IT Acts relating to the charge to income tax, including s.720, *do not apply* to income of a company. That is wider. Read in its normal sense, s.3 does disapply s.720; otherwise one *is* applying a provision of the IT Acts to the income of the company.

Does a purposive construction help? EN CTA 2009 identifies the purpose of s.3(1):

> 46. [Clause 3] ensures that income of a company within the charge to corporation tax is not chargeable to income tax as well as corporation tax.

The taxpayer might rely on that because if s.720 applies, the income is

[24] For completeness: s.9(5) continues:

> "(b) for that purpose references in any such enactment to a relief from or charge to income tax, or to a specified provision of the Income Tax Acts shall, in the absence of or subject to any express adaptation, be construed as being or including a reference to any corresponding relief from or charge to corporation tax, or to any corresponding provision of the Corporation Tax Acts"

[25] See 85.6.3 (Bounty: Meaning).

[26] 56 TC 68 at p.87.

[27] See 49.30.2 (Person abroad treaty non-resident).

effectively taxed twice. HMRC may rely on it as the s.720 charge is not on *technically* same income. But this only illustrates the weakness of purposive construction, for one can reach the result one wants by framing the purpose one way or another.[28]

The original form of s.3 CTA provided:

> ... the provisions of the Income Tax Acts relating to the charge of income tax other than surtax shall not apply to income of[29] a company (not arising to it in a fiduciary or representative capacity) if—
>
> (a) the company is resident in the United Kingdom; or
>
> (b) the income is, in the case of a company not so resident, within the chargeable profits of the company as defined for purposes of corporation tax.

The reference to surtax was deleted in 1971, when higher rate tax replaced surtax. I do not expect this sheds any light on the issue of the Corporation Tax Override, though one would to review the surtax system to consider this fully, which would be a labourious exercise.

51.3.5 *CT Override: Conclusion*

The CT Override view is the better technical argument. But in a case where there is much to be said on both sides, I think that success would be a "good win" for the taxpayer. Taxpayers have won more surprising cases, of course, and *Vestey* and *Fisher* come to mind.

In practice, the solution may be to make the companuy UK resident, so it is not a "person abroad".

51.3.6 *Transferor's CT credit*

Although HMRC do not accept that the CT Override view is correct, they do accept that the transferor can claim credit for CT paid by the offshore company. This can be justified under s.745 ITA (the transferor's IT credit) on the basis of Lord Scott's comment that the reference to IT may include CT.[30]

HMRC Helpsheet HS262[31] deals with the mechanics of claiming the CT

[28] See App 9.4 (Difficulty of ascertaining tax policy).

[29] The unidiomatic (or perhaps, erroneous) proposition "of" was changed to "to" in ICTA 1988, but nothing turns on that.

[30] See 51.3.3 (HMRC counterarguments).

[31] Income and benefits from transfers of assets abroad and income from Non-Resident Trusts (2024) updated 6 April 2024

credit. After noting the boxes in form SA106 which need to be filled,[32] the Helpsheet refers specifically to CT:

> If you are claiming a deduction for UK Corporation Tax, you should also enter the following in box 19 ('Any other information') of your tax return:
> - the full details of how you calculated the amount of credit claimed
> - the name, address and, where appropriate, the tax reference number of the person or company which paid the tax

51.4 Person-abroad's credit

R v Dimsey identifies a limitation of transferor's credit:[33]

> Section [745(1)] ... is looking at the double taxation problem from the point of view of the transferor on whom the liability to pay tax on deemed income is being imposed. There is no comparable provision protecting the transferee [the person abroad] in a case where, under [s.720], the transferor has paid tax on his deemed [s.720] income.

In the course of argument in *R v Dimsey*, HMRC announced a practice to address this problem:

> **The Inland Revenue's Practice on section [720]**
> [1] If in any case tax is paid by the transferee, the Inland Revenue will give credit for that tax against any charge to tax on the transferor under section [720 ITA] on the same income;
> [2] and conversely, if in any case tax is paid on any income by the transferor under section [720], the Inland Revenue will not tax the transferee on that income.
> So that in every case, the Treasury received in all the full amount of tax chargeable on the transferor as if he were the only person liable.

Point [1] is the transferor's credit. I refer to point [2] as the "**person-abroad's credit**". The consequence is that *either*:
(1) T pays all the tax on the income (and OC pays none); *or*
(2) (a) OC pays tax (at the basic or dividend ordinary or CT rate); and

https://www.gov.uk/government/publications/income-and-benefits-from-transfers-of-assets-abroad-and-income-from-non-resident-trusts-hs262-self-assessment-helpsheet/hs262-income-and-benefits-from-transfers-of-assets-abroad-and-income-from-non-resident-trusts-2024

[32] See 51.2.1 (Transferor's IT credit).

[33] [2001] UKHL 46 at [56].

(b) T has the credit for tax paid by OC (so in short, T pays higher/additional rate tax only).

This statement does not say *which* of (1) or (2) is to be the case. As far as HMRC are concerned it does not generally matter because the amount of tax collected will in practice be the same. If T is the beneficial owner of OC, it may likewise not make much economic difference to T whether T or OC pay the tax. But T may have "power to enjoy" the income of OC while only having a remote and not particularly valuable interest in it.[34] One can imagine a situation where T and OC each ask HMRC to assess the other! There is no mechanism for tax paid by T to be recovered from OC or vice versa. HMRC have a broad discretion, subject to judicial review if they act unreasonably. How in practice should HMRC collect tax? It is suggested that HMRC's starting point should be that tax is to be borne by OC, where tax is reasonably collectible from OC, ie if:

(1) tax is deducted at source; or
(2) OC is tax compliant (completing returns and paying tax due).

It is fair that OC, which receives the income, should pay the tax on it. Then T receives the credit for that tax. Only in cases where OC refuses to pay should all the tax be collected from T. This seems consistent with the extract from "Notes on Foreign" set out above.

It is suggested that double-counting relief[35] is the statutory basis for the person-abroad's credit. If that is correct, the person-abroad's credit is law and not a concession.

The person-abroad's credit applies whether the person abroad pays income tax or corporation tax on its income.

51.5 Distribution relief

Section 743 ITA provides:

> (2A) Subsection (2B) applies if—
> (a) in the case of an individual, an amount of income is taken into account in charging income tax under section 720 or 727, and
> (b) the individual subsequently receives that income.
> (2B) The income received is treated as not being the individual's income for income tax purposes.[36]

[34] For instance, if OC owes T a small debt.

[35] See 51.9 Double-counting relief).

[36] A historical note. FA 2013 rewrote distribution relief, which was formerly in s.743(4) ITA. This was part of the project to ensure that s.720 income was distinct from the

I refer to this as "**distribution relief**".

There are three conditions for this relief to apply ("**distribution relief conditions**"):

(1) *s.720 charge:* Income (the income of the person abroad) is taken into account in charging income tax under s.720.
(2) *Transferor receives income:* The transferor receives income.
(3) *Identity of income:* The income which the individual subsequently receives is "that income", ie the same as the income taken into account in charging IT under s.720, ie the same as the income of the person abroad.

Double-counting relief[37] may also apply, but where distribution relief covers the same ground, double-counting relief would not be needed.

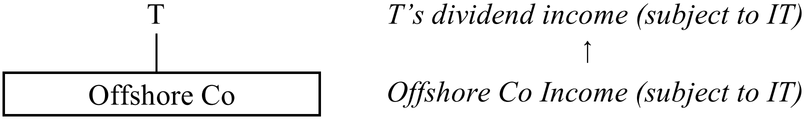
51.6 Direct company ownership

51.6.1 *Company subject to IT*

Suppose:

(1) An offshore company (the person abroad, "OC") within s.720 receives income ("OC's income") subject to income tax
(2) T owns all the shares in OC[38]
(3) The income of OC is distributed by way of dividend to T ("T's dividend income")

I refer to this as **"direct company ownership"**. Diagrammatically:


T
Offshore Co
T's dividend income (subject to IT)
↑
Offshore Co Income (subject to IT)

There are possible charges to tax here at two levels:

(1) IT on OC's income, paid by T under s.720[39]

income of the person abroad, in order to override DT relief, see 49.30.2 (Person abroad treaty non-resident). As far as concerns the double UK tax issues discussed in this chapter, it is considered that the changes have made no difference.

[37] See 51.9 (Double-counting relief).

[38] The position is similar if:
(1) the shares in OC are held in a trust under which T has an interest in possession; and
(2) OC is within s.720 (but in practice protected-trust relief is likely to apply.

[39] Alternatively:
(1) (a) IT on OC's income is paid by OC

(2) IT on the dividend, paid by T on normal principles

Does distribution relief apply? Of the 3 distribution relief conditions:

Condition (1) (income taken into account for s.720) is in principle satisfied.[40]

Condition (2) (receipt of income) is satisfied as the individual receives s.720 income.

That leaves condition (3): identity of income.

51.6.2 *Identity of income condition*

At first sight, distribution relief condition (3) is more doubtful. The income which the individual actually receives is the s.720 income. The income which is taken into account in charging IT under s.720 is the income of the person abroad, OC's income. Are the two the same income?

In order to answer the question, it is necessary to understand that there are two possible analyses of the nature of dividend income:

(1) *Formalistic view*: On this analysis:
  (a) income accruing to a company, and
  (b) the shareholders (dividend) income
  are regarded as distinct, not the same income.
  This is the usual analysis for tax purposes.[41]

(2) *Broad economic view:* On this analysis, a shareholder's (dividend) income is the same as the company income out of which it is paid. They are the same in substance or economic reality.

Thus there is *economic* double taxation but not *juridical* double taxation where:[42]

(1) a company pays tax (typically corporation tax) on its profits, and
(2) a shareholder pays income tax on the dividend.[43]

For the purpose of distribution relief, one applies the broad economic

(b) IT on OC's income is also paid by T
(c) Transferor's credit avoids double taxation.

That makes no difference for the purpose of this example. It is assumed here that T is not a remittance-basis taxpayer.

[40] See 51.11.1 ("Charging" IT).

[41] See 30.2 (Dividends a separate source).

[42] See 107.3 (Types of double taxation).

[43] Of course there have over the years been a variety of arrangements to avoid or mitigate the economic double taxation.

view, not the formalistic view. This would be reasonably clear even in the absence of authority, because (on the formalistic view) it is (more or less) impossible for T to receive the same income as OC.[44] But if authority is needed, see *Aykroyd*, discussed below.

HMRC agree. The INT Manual provides:

> **INTM602440 Subsequent receipt of income** [Jul 2023]
> ... Issues can arise when
> [1] an individual has been taxed under ITA07/S720 or S727 in relation to the income of a non-resident trust or company, and
> [2] the entity concerned makes a subsequent distribution of income to the individual.
> HMRC accept that generally the reference to income in ITA07/S743(4), S743(2A) and S743(2B) can be construed to cover such situations. However, where distributions are paid out of accumulated income, it will be appropriate to consider to what extent the accumulated income has been charged to tax on the individual under the income charge in the preceding years.
> If issues regarding double charging on the subsequent receipt of income arise within specific cases, you should refer the case to Personal Tax International, Liverpool in accordance with the instructions at INTM604440.

51.6.3 *Direct company ownership: Conclusion*

Thus, even though OC's income is distributed to T:

(1) There is only one charge to income tax, the charge under s.720.
(2) T has the benefit of tax credits or DT Relief relating to OC's income.

At first sight this seems anomalous. If s.720 did not apply (eg because the individual owning OC was not the transferor or because the motive defence applied) then the position is different:

(1) If OC's income is UK source, there will be two charges to tax:

[44] The broad economic (as opposed to formalistic) view of income identity is also applied in other contexts. In *Vestey v IRC* Walton J held that a shareholder had no "power to enjoy" the income of the company in which he held shares because (applying the formalistic view of income identity) the shareholders had power to enjoy *different* income! However, this view was rejected in the House of Lords. See 49.16.4 (Condition D: Possible benefit).
Similarly, the court looked at the economic substance in order to determine whether two assets were "the same" for the purposes of stamp duty subsale relief; see *Fitch Lovell v IRC* [1962] 1 WLR 1325. See too 111.5.1 (The same: pragmatic approach).

   (a) income tax on OC’s income paid by OC under ordinary principles; and
   (b) income tax on the dividend paid to T.

(2) If OC’s income is foreign source, T does not have the benefit of foreign tax credit relief relating to OC’s income.

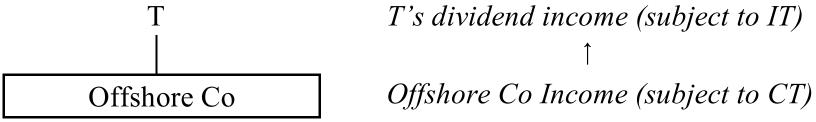
On reflection, this is not an anomaly. The object of s.720 is to put the transferor in the same position as if they had not made the transfer.[45] This view is rightly accepted by HMRC (despite the irritation of the judge in *Anson v HMRC*[46] but the issue may not have been fully explained to him).

51.6.4 *Company subject to CT*

Take the same facts as above, but assume the company is subject to corporation tax and not to IT. That is:

(1) An offshore company (the person abroad, “OC”) within s.720 receives income (“OC’s income”) subject to corporation tax
(2) T owns all the shares in OC
(3) The income of OC is distributed by way of dividend to T (“T’s dividend income”)

Diagrammatically:


T
Offshore Co
T’s dividend income (subject to IT)
↑
Offshore Co Income (subject to CT)

There are possible charges to tax here at 2 levels:

(1) IT on OC’s income, paid by T under s.720[47]
(2) IT on the dividend, paid by T on normal principles

Distribution relief applies, just as when the company is subject to income tax.

51.6.5 *Chain of companies*

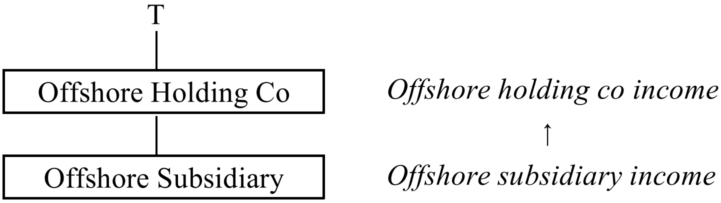
Suppose an offshore holding company (within s.720) which holds an

[45] See 49.2 (Purpose of transferor charge).

[46] [2012] UKUT 59 (TCC). For motive defence aspects of this case, see 52.36 (Motive/EU defence: Disclaimer).

[47] Alternatively:
(1) (a) Corporation tax on OC’s income is paid by OC
   (b) IT on OC’s income is also paid by T
   (c) Transferor’s CT credit avoids double taxation.

offshore subsidiary (within s.720). Diagrammatically:[48]



These are the facts of *Aykroyd v IRC*[49] where:

(1) In 1936/7 the offshore subsidiary received income within s.720 ("the offshore subsidiary income").
(2) In 1937/8 the offshore subsidiary paid that income by way of dividend to the offshore holding company ("the offshore holding co income"). This income was also within s.720.
(3) The transferor ("T") was assessed on the offshore holding co income in 1937/8. T was not assessed on the offshore subsidiary income in 1936/7.

The distribution relief identity issue is (more or less) the same as for direct company ownership.

T argued that:

(1) T could be assessed at stage (1) (which was correct)
(2) So T could not be assessed at stage (2), because of distribution relief.

Aykroyd accepted that distribution relief could apply to the sequence of two dividends:

> If the Appellant had in fact been charged in the year 1936–37, he could not have been charged again in the year 1937–38.

More analytically, the 3 distribution relief conditions are satisfied:

(1) Income is taken into account in charging income tax under s.720. This is the offshore subsidiary income.
(2) The individual receives income. In this case (unlike direct company ownership) the individual does not in fact receive anything. However the individual is deemed to receive s.720 income.
(3) The income which the individual receives (or more accurately, is deemed to receive) is "that income", ie

[48] More accurately, there were several holding and subsidiary companies, but nothing turns on that.

[49] 24 TC 515.

> (a) the offshore subsidiary income; and
> (b) the s.720 income which the individual is deemed to receive
>
> are the same income. They are not the same income on the formalistic view, but they are the same income on the broad economic view, and that is the approach which is applied here.

HMRC agree. The INT Manual provides:

> **INTM602380 Income to be taken into account once** [Jul 2023]
> ... Income that arises to a person abroad may be distributed to another person who is also a person abroad – for example, a group company may make a distribution to its parent company. HMRC generally accept that in such situations the legislation should not be construed to effectively duplicate the amount of income that may be taken into account for the transfer of assets provisions. In such situations it will be appropriate to consider to what extent the distribution and the underlying income from which it is paid are the same income. A similar situation may occur if a non-resident company makes a distribution to a non-resident trust. Again, HMRC will generally accept that legislation should not be construed to effectively duplicate the amount of income to be taken into account for the purposes of the legislation.
> Specific cases of difficulty concerning the amount of income to be taken into account should be referred to Personal Tax International, Liverpool in accordance with the instructions at INTM604440.

Akroyd concerned distribution relief, because at that time double-counting relief did not exist. But double-counting relief would now be another, perhaps easier, route to the same destination.

51.7 Distribution to non-transferor

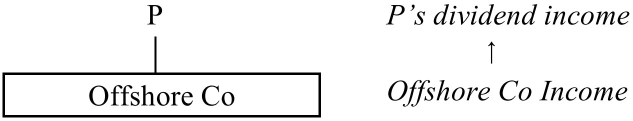
Suppose:

(1) An offshore company ("OC") within s.720 receives income ("OC's income")
(2) The transferor ("T") is not a shareholder in OC but has power to enjoy the income[50]
(3) P (a UK resident third party) owns all the shares[51]
(4) The income of OC is distributed by way of dividend to P

[50] T may have power to enjoy by holding a debenture or through being a beneficiary of the trust which holds OC. Similar points arise if T receives a capital sum.

[51] The position is not materially different if the shares in OC are held in a trust under which P is life tenant, and to which s.624 ITTOIA does not apply.

Diagrammatically:



There are tax charges here at two levels:

(1) OC's income is subject to tax in the hands of T (or T and OC) under s.720.

(2) P is subject to tax on the dividend.

Distribution relief does not apply because that relief only applies where OC's income is subsequently received by the transferor, T. The transferor's credit and the person-abroad's credit do not cover this situation. However, double-counting relief applies.

Before the enactment of double-counting relief in 1981, there was economic double taxation in these circumstances. In *Howard de Walden v IRC*:[52]

> [Counsel] pointed out that in so far as the right to enjoy income of the four companies is vested in the Appellant's son, who holds the majority of the shares,
> [1] income received by the son will be taxed in his hands in the ordinary way and
> [2] at the same time the Appellant will be liable to tax on the whole income of the companies which is deemed to be his.
> This, said [counsel], involves double taxation since no relief is afforded by [distribution relief, now s.743(2B) ITA]. There is a short answer to this argument. There is no double taxation since the subject-matter of tax is different, the income of the son being one thing and the income of the companies being another.

Counsel and judge were both right, but the answer depended on what was meant by double taxation. The situation is one of economic but not juridical double taxation. However, since the purpose of distribution relief is to avoid economic double taxation, fairness and the scheme of the Act suggest that double-counting relief should do the same work in this situation. It is considered that Lord Greene's comment does not support the contrary view.[53]

[52] 25 TC 121 at p.131.

[53] *Howard de Walden* is of limited authority; see 48.2 (Construction of ToA provisions). And if it were right that there were "no double taxation" it is difficult to see the

In practice this situation is rare. Normally, either T has no "power to enjoy" and so is outside s.720, or else T is life tenant/shareholder, and receives the dividends personally, so distribution relief applies.

51.8 Identifying relievable income

In the following discussion, "relievable income" means income which qualifies for distribution relief, in short, income within s.720. Distribution relief applies only so far as the transferor receives the income of the company has been taken into account in charging IT under s.720.

Distribution relief does not apply where a dividend is paid out of pre-2008 income which qualified for the s.720 remittance basis, as that income was not taken into account in charging income tax.

It may happen that:

(1) the income of OC for company law purposes is greater than:
(2) the income of OC for tax purposes
(eg because of capital allowances).

For example, OC may have taxable income of 10, but accounting profits of 100. Only 10 is relievable income. If OC declares a dividend of 100, then the charges to tax are:

(1) IT on OC's income of 10 on T under s.720.
(2) IT on the dividend on the amount of 90 (ie 100–10).

51.8.1 *Mixed fund of person abroad*

OC may have a mixed fund of:

(1) income charged under s.720 (relievable income) and
(2) funds not charged under s.720.

It is considered that the company can by an appropriate resolution determine whether a distribution is from relievable income or not.[54]

Suppose OC receives £100 and spends £20 on expenses, but, the company having other assets available for distribution, £100 is nevertheless distributed. It is suggested that the dividend of £100 should be identified with OC's income of £100 and so qualifies for distribution relief in its entirety. The £20 spent on expenses is attributed to other assets, even though as a matter of tracing it was paid for out of the s.720 income.

rationale for the statutory distribution relief.

[54] See App 2.10 (Withdrawal from mixed fund).

If an offshore company pays a dividend out of a mixed fund which qualifies for distribution relief, it counts as an offshore transfer for the purposes of the remittance basis mixed fund rules.

51.8.2 *Planning: Distribute if tax free*

Where distribution relief is available, it is generally worthwhile distributing income to the transferor ("T").[55] This may (in particular) apply where:

(1) The person abroad has UK income (which is not protected income); or
(2) The person abroad has foreign income within s720, eg if T is actually UK domiciled, so neither s.720 protected-trust relief nor the remittance basis apply.

Following the distribution, T (if not UK domiciled) may in principle re-settle the income, if desired.

If the income of the person abroad is not distributed to T during T's life, the benefit of distribution relief is lost, as distribution relief will not apply later.

51.9 Double-counting relief

Section 743(1) ITA provides:

> No amount of income may be taken into account more than once in charging income tax under this Chapter [Chapter 2 Part 13].

I refer to this as "**double-counting relief**". It was introduced in 1981; pre-1981 cases need to be reviewed with this in mind, as they would not have considered this relief.

This applies where two tax charges both come under the ToA rules:

(1) Two individuals may be chargeable under s.731; ie where two different individuals receive benefits. The s.733 computation usually prevents a double charge[56] but if it fails to do so, then double-counting relief fills the gap.
(2) The transferor may be charged under s.720 and a non-transferor charged under s.731.[57]

[55] This may also be done to avoid relevant income accumulating in a company held by a trust; see 50.35 (Income of co held by trust).

[56] See 50.18.5 (Step 5: Available Relevant Income).

[57] Before 2017, it was unusual that income could be taken into account under s.720 and s.731. Examples might be:

(3) Where two individuals are charged under s.720; ie there are two transferors in relation to the same income of the person abroad. This could happen if:
   (a) There are two transferors in relation to the same transfer, eg co-shareholder transferors
   (b) Income arises to an individual as a result of two transfers by two individuals, eg if:
      (i) T1 transfers money to a person abroad, and
      (ii) T2 sells an asset to the person abroad (the purchase price being paid out of the money which T1 transferred).

It is considered that double-counting relief also applies where one charge is under the ToA rules and another charge is under other rules. I refer to this as the **"Wide View"** of double-counting relief. Examples are:

(4) Two individuals may be charged, one under general principles and the other under s.720 or s.731.

(5) One individual may be charged twice, once under s.720 and again under general principles.

51.10 Charge on two individuals

In many cases the double tax charge concerns two different individuals. Section 743(2) ITA provides:

> [A] If there is a choice about the persons in relation to whom any amount of income may be taken into account in charging income tax under this Chapter [Chapter 2 Part 13],
> [B] it is to be taken into account—
> (a) in relation to such one or more of them as appears to an officer of Revenue and Customs to be just and reasonable, and
> (b) if more than one, in such respective proportions as appears to the officer to be just and reasonable.

In *HMRC v Fisher*:[58]

(1) If income accrues which is not within s.720 because it is not remitted to the UK, then there is a charge under s.731, and then there is a remittance.
(2) If s.720 does not apply (because the transferor has no "power to enjoy") but subsequently there is a capital payment within s.727.
(3) Another possible case is in 50.24 (s.720 income: Relevant income).
After 2017 there are more circumstances where this could happen.

[58] [2023] UKSC 44 at [54].

> [Section 743] achieves three important things. It prevents the sum to which the tax charge is applied under [s.720 and 731] adding up to more than the total of the income of the overseas person. In fact, as is shown by this case, HMRC do not have to apply the tax charge to all the income of the overseas person. In the Fishers' case, only 76% of the profits of [the person abroad] were subject to the charge because they disregard the shares held by the non-resident, Dianne Fisher. Secondly, it confers on HMRC a discretion to apportion the tax charge in such a manner as appears to HMRC to be just and reasonable. Thirdly, it provides for an appeal against that apportionment.

For the appeal procedure, see 52.35 (Appeals).

51.11 "Taken into account for IT"

Distribution relief applies to income *taken into account in charging IT under s.720/727*; and double-counting relief applies to income *taken into account in charging IT under Chapter 2 Part 13 (ToA).* Section 744 ITA defines the expression(s):

> (1) References in section 743 (no duplication of charges) to an amount of income taken into account in charging income tax are to be read as follows.

It is convenient to read the three definitions side by side:

s.720 charge: s.744(2)	**s.727 charge: s.744(3)**	**s.731 charge: s.744(4)**
In the case of tax charged on income under section 720 (charge where income enjoyed as a result of relevant transactions)—	In the case of tax charged on income under section 727 (charge where capital sums received as a result of relevant transactions),	In the case of tax charged under section 731 (charge to tax on income treated as arising to non-transferors[59] where benefit received as a result of relevant transfers[60]),
(a) if section 724(1) (benefit provided out of income of person abroad) applies, they are references to an amount	they are references to the amount of the income mentioned in section 728(1)(a) [the income of the person abroad].	they are references to the amount of relevant income taken into account under section 733 (income charged

[59] The reference to non-transferors is inaccurate after 2017, but it does not matter.

[60] The words in brackets are not an accurate description of the s.731 benefits charge, following the extension of s.731 to transferors in 2017; but it does not matter.

of the income out of which the benefit is provided equal to the amount charged,[61] and (b) otherwise they are references to the amount of the income mentioned in section 721(2) [the income of the person abroad[62]].	under section 731) in calculating the amount to be charged in respect of the benefit for the tax year in question.

51.11.1 *"Charging" IT*

Distribution relief condition (1) requires that the income of the person abroad must be "taken into account in charging IT under section 720". In *Aykroyd*[63] T failed because T had not been "charged":

> It was suggested that, if the [offshore subsidiary's income] were liable to assessment for the year 1936–37, that provision [s.743(2B)] prevented them being chargeable in the following year. But that argument depended on the substitution of the word "chargeable" for the word "charged". There is no ground that I can see for making any such substitution. ... as he had not been charged in the previous year, there was nothing to prevent him being charged in the year in question.

"Charged" here means "paid". This is not the normal meaning, but it fits the context.

This does not mean that HMRC have an unfettered discretion:

(1) to assess T on the subsidiary company's income; or
(2) to assess T on the holding company's income.

Under self-assessment, T will normally self-assess T's income and should in principle return the income of the offshore subsidiary as T's income and distribution relief applies. However, where T does not pay tax due on the offshore subsidiary's income HMRC can collect tax on the offshore holding company's income and distribution relief does not apply.

Often it may not matter whether tax is charged on the offshore subsidiary's income or the offshore holding company's income.

[61] This is rare; see 49.22.3 (Amount of charge: enjoyment condition C).

[62] See 49.14 (Condition A: Power to enjoy).

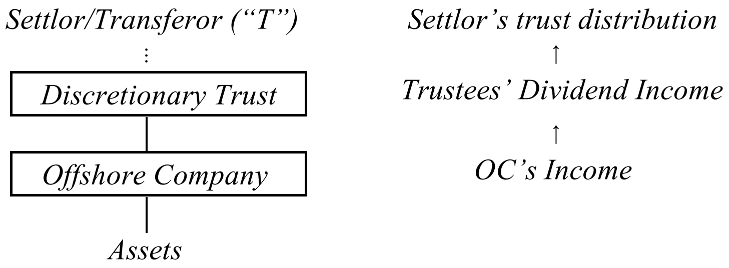
[63] See 51.6.2 (Identity of income condition).

However, it may matter:

(1) For identifying the source of the income to which s.720 applies. Is the transferor taxed under s.720 in respect of the subsidiary's income or the holding company's income? This may affect:
    (a) Rates of tax, eg if the underlying company receives interest or rental income it may makes the difference between the higher/additional rates and the dividend upper/additional rates)
    (b) Availability of transferor's credit for UK tax paid by the company and double tax relief
    (c) Source of income
(2) It may also affect the year in which the income is subject to tax.

51.12 Trust/co structure

So far we have been considering the situation of an offshore company (or chain of companies) held directly by an individual (or an IIP trust). We now turn to consider the common position, where a non-resident settlor-interested discretionary trust holds an offshore company. That is, trustees of a discretionary trust within s.624 ITTOIA hold a non-resident company within s.720. Diagrammatically:



I refer to this as a **"trust/co structure"**.

Suppose:

(1) OC receives income ("OC's income")
(2) The trustees receive a dividend from OC ("the trustees' dividend income")
(3) The settlor receives an income distribution from the trustees (settlor's trust distribution)

Possible charges to tax here are at 3 levels:[64]

[64] If protected-trust relief does not apply there is only one charge, but assume it does not; see 51.1.1 (When reliefs are needed).

(1) OC's income, charged under s.720
(2) The trustees' dividend income charged under:
  (a) s.624 or
  (b) s.720, if s.624 does not apply, but that would be very rare
(3) The settlor's trust distribution, charged under basic principles

Distribution relief prevents double taxation at stage (2) (if necessary, but that would be rare). It will be recalled that distribution relief applies if:[65]
(1) OC's income is within s.720
(2) The trustees' dividend income is received by T
(3) The trustees' dividend income is the same income as OC's income

Condition (1) is satisfied. Condition (2) is satisfied because income is treated as received by T. Condition (3) is also satisfied: see 51.6.2 ("The same" income).

If s.624 applies at stage (2)(a), there is relief from the further round of tax at stage (3).[66] Or if, exceptionally, s.624 does not apply but s.720 does, at stage (2)(b) then distribution relief applies again.

51.12.1 *Trust/co structure: HMRC practice*

RI 201 provides:

> where income arises in an offshore company underlying a settlement and the income is not paid up immediately to that settlement the provisions of section [720 ITA] will be invoked[67] where necessary to assess the income of the underlying company.

Under this practice, the position depends on whether income is paid up "immediately".

(1) *If the income is **not** paid up immediately*: The provisions of s.720 will be invoked. This is relatively straightforward.
(2) *If the income **is** paid up immediately*: RI 201 implies that:
  (a) s.720 will not be applied so the settlor/transferor will not be taxed on OC's income; and

[65] See 51.5 (Distribution relief).

[66] See 47.10 (s.624 double-charge relief). If, exceptionally, s.720 applies at stage (2)(b) then distribution relief again prevents double taxation at stage (3). The trust income is received by T, and it is, for the purposes of distribution relief, the same income as OC's income.

[67] The reference to "invoking" s.720 draws on *McGuckian,* decided 1997, two years before the publication of RI 201 in 1999; see 51.17.2 (s.720/s.730 ICTA overlap).

(b) the settlor will be taxed on the trust income (generally, under s.624) instead.

If so, an number of questions arise. When exactly is the moment when one moves from (1) to (2): what is the meaning of "immediately"? Does it mean within a day? Or a week? Or the same tax year? Or any time before the relevant returns are due, or submitted? Do HMRC have a discretion? Does the answer depend on the type of income? One must bear in mind that some forms of income cannot be quantified until the end of an accounting period (eg trading and rental income).

If income is distributed immediately, is the settlor taxed on OC's income or on the dividend? By implication if s.720 is not "invoked" then the tax should be charged on the dividend. It makes a difference because OC's income may have a tax credit and the rates of tax may be different.

Perhaps HMRC are not concerned what the answers are, as long as they can see that the income comes into tax, promptly, in one form or another.

51.12.2 *Trust/co structure: Expenses*

Suppose in the trust/company structure illustrated above, the company:
(1) receives £100 income;
(2) spends £20 on expenses (not deductible for s.720 purposes); and
(3) distributes £80 which the trustees distribute to the settlor.

RI 201 suggests states HMRC assess £20 at stage (1) under s.720 and £80 at stage (3). One might otherwise have thought that £100 is taxable at stage (1) and the £80 is tax free at stages (2) and (3). But it makes little difference in practice.

51.13 s.731 charge & income distribution

I turn to consider double UK taxation issues relating to s.731. The transferor's credit, the person-abroad's credit and distribution relief only apply to s.720, so they have no relevance here. But double-counting relief may apply.

Suppose:
(1) Trustees of a trust receive income and do not distribute it (so it is relevant income).
(2) A beneficiary receives a benefit taxable under s.731.
(3) The trustees later distribute the relevant income to the beneficiary as income.

It is understood that the distributed income is not taxed. This might be regarded as informal concession but the better view is that double-counting relief applies here. That follows from the Wide View of the relief.[68] The untaxed distribution of income will however be a benefit received by the beneficiary, available to be matched with future relevant income.

51.14 s.720/s.731 overlap

Suppose:

(1) A transferor ("T") is taxed on income of a person abroad under s.720
(2) A beneficiary ("B") within s.731 receives a benefit.

The starting point is that the income of the person abroad (although within s.720) is also relevant income;[69] but double-counting relief applies.

There are four permutations:

(1) T and B are both arising-basis taxpayers
(2) T is a remittance-basis taxpayer and B is an arising-basis taxpayer
(3) T is an arising-basis taxpayer and B is a remittance-basis taxpayer
(4) T and B are both remittance-basis taxpayers

51.14.1 *T and B arising-basis taxpayers*

EN ITA provides:

> Where a non-UK domiciled individual transfers assets but is not chargeable to tax under section 739 ICTA [now s.720 ITA] owing to section 743(3) ICTA [the s.720 remittance basis, now replaced by the somewhat different s.735 ITA], there is no bar in HMRC's view on the application of section 740 ICTA [now s.731] to others who did not themselves make the transfer but were beneficiaries of it. HMRC interpret section 732 ITA in the same way.[70]

It appears from this that where the s.720 remittance basis does not apply (so the transferor is taxed under s.720 on an arising basis) there is a bar on taxing the beneficiaries under s.731. The reason is not given, but could have been:

(1) The income of the person abroad was not relevant income; (but this was doubtful and is not the case from 2013)
(2) Double-counting relief

[68] See 51.9 (Double-counting relief).
[69] See 50.24 (s.720 income: Relevant income).
[70] See Change 105 in EN ITA Vol III, annex 1. The same point was made in RI 201.

For completeness: In the INT Manual the rule to charge the transferor in priority to the beneficiary is said to be the normal rule but not an absolute one:

> **INTM602480 Just and reasonable basis** [Jul 2023]
> Where there is a choice of individuals in relation to whom any amount of income of a person abroad may be taken into account in arriving at the amount of an income charge or benefits charge, it can sometimes be difficult to determine the amount of income taxable on each individual. To alleviate such difficulties, the legislation provides for the income to be apportioned on a 'just and reasonable' basis.

This is a sloppy summary of the issue, but what matters is the text which follows:

> How this is done will depend on the circumstances. For example,
> [1] individual A [the transferor] may be chargeable on the whole of the income of an overseas company under the income charge.
> [2] Individual B may receive a benefit from the same company that falls to be charged under the benefits charge.
> In this situation the income of the company should only be taken into account once (INTM602380).
> This aspect of the legislation was considered in the case of Fisher & Others v HMRC ([2021] EWCA Civ 1438) wherein apportionment of a transfer of assets charge due to the existence of multiple transferors featured. The Court of Appeal held that two individuals were quasi-transferors to whom the transfer of assets provisions applied. At paragraph [69] of the judgment, Newey LJ commented:
>
> > 'Machinery now exists, therefore, under which no more than a proportion of income need be attributed to either a transferor or a quasi-transferor. The [Upper Tribunal] noted that [the apportionment provision] could apply where the same income could be the subject of charges under both [the income charge] and [the benefits charge], but, whether or not the proponents of what has become [the apportionment provision] had that sort of overlap in mind, it is reasonable to assume that the provision was (also) intended to address the position of multiple transferors (and quasi-transferors)'
>
> It will normally be just and reasonable to include the whole of the income arising as an income charge, as the individual who has sought to avoid tax in setting up the structure in the first place will be charged to income tax and will therefore suffer no inequity in bearing the full brunt of the legislation. In this example, individual B may not have a benefit charge for the particular tax year, although the benefit may be subject to a charge in a subsequent year (INTM601720).

> However, there may be exceptional circumstances where the benefit charge is seen as being just and reasonable, for example where the income charge arises due to an individual receiving a loan from the person abroad which is repaid after a very short period so that there is no continuing liability on that individual.[71]
> ... Each case must be dealt with on its merits and the 'just and reasonable' basis is that which appears to be so to an officer of HM Revenue and Customs. Appeals against such decisions are the jurisdiction of the Tribunal ...

In practice there will be few if any cases where the beneficiary is taxed instead of the transferor.

51.14.2 *T on remittance basis, B on arising basis*

The EN ITA passage cited above shows that HMRC have historically regarded B as taxable. Before the 2008 reforms T was wholly exempt on income not received in the UK, so that was sensible and probably correct. Since 2008 the position has changed, as T is now taxable on the income on a remittance basis. It is probably just and reasonable to tax B on an arising basis, in accordance with standard practice.

From 2017 this will not usually arise, as s.720 protected-trust relief will usually prevent a s.720 charge.

51.14.3 *T/B remittance basis users*

There is no guidance on the position where T is taxed on the s.720 remittance basis and B is taxed on the s.731 remittance basis. It is suggested that it is just and reasonable to tax whoever is first taxable, ie to tax T if the income is remitted but to tax B if the benefit is remitted without a remittance of the income. The contrary is arguable.

From 2017 this will not usually arise, as s.720 protected-trust relief will usually prevent a s.720 charge.

51.15 Benefits exceed relevant income

The INT Manual provides:

> **INTM602480 Transfer of assets: General provisions: Just and reasonable basis** [Jul 2023]
> ...
> Where more than one individual is subject to the benefits charge in

[71] Author's footnote: This does seem factually unlikely.

> respect of benefits which they receive in the same year, it will be necessary to apportion the relevant income (INTM601700) among the individuals. Only by considering the facts of the particular case will it be possible to decide fairly the amount of income to be treated as arising to each individual and subject to the benefits charge.
>
> In cases where the total benefits are fully covered by the relevant income, each individual will be potentially subject to charge on the amount or value of the benefits received.
>
> Where the relevant income is less than the total amount or value of the benefits, the most appropriate apportionment of the relevant income is by reference to the ratio of the benefits received by each individual in the year, to the total of the benefits provided in the year.
>
> If more than one individual subject to the benefits charge receive benefits in different tax years, but relevant income arises only in later years, it will be necessary to apportion the relevant income between the individuals. It will only be by considering the facts that a reasonable apportionment can be achieved in such a situation. Where there is sufficient relevant income arising in the later year to cover all of the benefits arising in the years concerned, a benefits charge will arise on each of the individuals. If the relevant income in the later year is less than the total benefit overall arising in that year, in earlier years the most appropriate apportionment of the relevant income will be by reference to the ratio of the benefits each individual has received to the total benefits.
>
> When considering benefits provided to beneficiaries in different years, you should not lose sight of the fact that benefits arising in earlier years may have been subject to capital gains tax under TCGA92/S87 (see INTM601520) and as such will need to be deducted from total untaxed benefits in line with the steps set out in ITA07/S733(1).

The Manual struggles to give an example where that is not the right solution:

> However, in a case where it was clearly intended that A's benefit be provided out of the relevant income of the year, and B's benefit out of that of a subsequent year, e.g.,
>
> [1] A's benefit was paid three quarters through the year and represented the whole income of the year,[72] while
>
> [2] B's benefit was paid nearly at the end of the year to deal with some unexpected contingency)
>
> then A might justifiably be taxed on the whole of the benefit in the year

[72] If "A's benefit represented the whole income of the year", it may well constitute income of A, in which case it is taxable under ordinary principles and not under s.731.

of receipt, and B taxed in the subsequent year.

In practice that will rarely if ever arise.

51.16 Co-transferors within s.720

The INT Manual provides:

> **INTM602480 General provisions: Just and reasonable basis** [Jul 2023]
> ...
> When looking at the just and reasonable basis for apportionment, where there is more than one individual with power to enjoy the income of the person abroad, account should be taken as to who actually made, procured or was associated with the transfer, as these parameters may affect the quantum and the nature of the charge. In addition, it is necessary to have regard to the intended outcome of the arrangements and to the assets transferred which have resulted in income becoming payable to a person abroad.
> For example, if
> [1] individual X subscribes for shares in a Jersey company for £1000 and
> [2] individual Y enters into a service agreement with that company,
> then each individual may be subject to the income charge.[73] However, it may well be that the asset of real value is the service agreement and that should be reflected in any apportionment of the income between the individuals.

I would have said that:

(1) The £1k was nominal and no income arose as a result of that transfer.

(2) The service agreement is (one can assume) substantial and all the income of the person abroad arose from that transfer and is assessable on Y.[74]

There is no double charge, and double-counting relief is not needed. The more interesting question is if X's subscription is not nominal, but the Manual does not address that.

The Manual continues:

> Where the same assets are transferred by several individuals acting together in concert, the transferors would normally be assessed in

[73] Author's footnote: It is assumed X and Y have power to enjoy.

[74] See 48.10 (Income of person abroad: Causation).

> proportion to their share of the assets transferred.
>
> For example, where shares of a UK company are held by three individuals in the proportions 40%, 40% and 20% and there is liability under ITA07/S720 in respect of the income of an overseas person to which the shares are transferred, the liability is assessed on each of the three shareholders in proportion to their respective holdings. This example demonstrates both the requirement to avoid duplication of charge (INTM602380) and the 'just and reasonable' basis.

This example is not a case where "the same assets are transferred by several individuals". Again, double-counting relief is not needed as there no overlap here: each transferor is only charged on income arising as a result their own transfer. The end result is the same.

51.17 Other s.720 overlaps

51.17.1 *Employment income/s.720 overlap*

In *Hoey v HMRC* a misguided taxpayer ("T") entered into an EBT scheme, under which, in short:

(1) T worked as an IT contractor for UK entities ("end users").

(2) The end users paid fees to an offshore company that employed T ("the employer").

(3) The employer paid most of these fees to an employee benefit trust ("EBT") for the benefit of T.

(4) The trustees of the EBT made interest free loans to T. It was not of course expected that the loans would be repaid.[75]

HMRC argued for two heads of charge:

(1) Employment income: the contributions paid by the employer to the EBT constituted employment income of T (this was correct).

(2) s.720: T was taxed on the income of the employer under s.720, on the grounds that:

   (a) T was the transferor (which he was) and had power to enjoy (which he did); and

   (b) The income of the employer was equal to the end user's payments.

HMRC's s.720 argument failed at step (2)(b) as the employer's income was (1) payments received from end users less (2) payments made to the

[75] In more detail: there were two employers and EBTs, but nothing turns on that. The PAYE aspects of *Hoey* (not discussed here) are going on to the Supreme Court.

EBT. That is, the payments to the EBT were deductible trading expenses, so the quantum of trading income was nil. But ignoring that, if one can, there would have been (1) tax on T's employment income and (2) tax on the employer's income (the end user's payments).

The CoA said that this argument:[76]

> lead to the conclusion that the employee may be chargeable under the TOAA provisions in respect of income of the employer which he has power to enjoy, for example by receipt of a salary, even though the salary will also be chargeable to income tax in his hands as employment income. We were not referred to any provisions which would be effective to prevent economic double taxation of the employee in circumstances...

The solution to this problem is that double-counting relief does apply, adopting the Wide View. This is much more satisfactory than the suggestion of the CoA that entering into a contract of employment is not a transfer of assets.[77] But however that may be, the Court was not prepared to contemplate double taxation:

> it was part of HMRC's case before the UT that any charge to tax on Mr Hoey under the TOAA legislation would take priority over any liability to tax under the employment income provisions of ITEPA. The UT accepted this submission, and held that the FTT had erred in holding that it was not obliged to go on to consider the alternative assessments to tax under the TOAA provisions once it had held that Mr Hoey was liable under the income tax provisions. It was not at all clear to us on what basis HMRC contended that the TOAA charge to tax would take priority, and it would in our view be an extraordinary position to reach if it were indeed the case that the highly complex and potentially penal provisions of the TOAA code had logically to be considered first in any case involving employment income where they might potentially be engaged. Furthermore, such an approach would in all probability raise the unwelcome spectre of economic double taxation, potentially giving rise to concurrent liabilities arising out of the same transactions.
> ... we respectfully suggest that it would generally be in accordance with the intentions of Parliament that the TOAA provisions should be kept in reserve for deployment in cases of tax avoidance which cannot effectively be countered in any other way. If, as in the present case, the

[76] [2022] EWCA Civ 656 at [201].

[77] See 48.1.1 (Contract of employment).

> transactions in question give rise to a straightforward liability to tax on employment income, that should normally be the end of the matter. It is fortunately unnecessary for us to say any more on the subject, however, because HMRC wisely conceded, at the beginning of the fourth day of the hearing, that the TOAA provisions do not have priority over the charge to tax on employment income under ITEPA, although they do have a role to play as a fallback head of charge. [Counsel] also explicitly undertook on behalf of HMRC that they would seek not to impose a double charge to tax, in the event that both sets of provisions applied. She informed us that the precise mechanism to avoid the possibility of a double charge in such circumstances was a question of some complexity, which required the input of numerous stakeholders, but as we understood it the undertaking which she offered on behalf of her clients was in substance unqualified. The only question was precisely how it should be given effect.
> ... we welcome this clarification and commend the willingness of HMRC to take appropriate steps to avoid the possibility of economic double taxation in cases of the present type...

51.17.2 *s.720/s.730 ICTA overlap*

In *McGuckian v IRC* concerned an overlap between (1) s.720 and (2) s.470 ICTA 1970, an anti-avoidance provision now replaced by the transfer of income stream code.[78] There should not have been an overlap for two reasons, either of which would have been sufficient: (1) it was held that s.470 did not in fact apply; and (2) had it applied, it had priority by statute. But Lord Steyn considered the position in general:[79]

> The sensible construction is that [s.720] can be applied even if there are other provisions which could be invoked to prevent the avoidance of tax. That the revenue authorities should have overlapping taxation powers is an unremarkable consequence. And such a construction cannot cause any unfairness to the taxpayer since he cannot be taxed twice in respect of the same income.

51.18 Life policy/s.720 overlap

In *IRC v Willoughby* 70 TC 57 Professor Willoughby ("T") transferred assets to a non-resident life insurance company as a premium for a life policy, a personal portfolio bond. T was not taxed on the income accruing

[78] See 54.1 (Transfer of income streams).
[79] 69 TC 1 at p.82.

to the insurance company as the motive defense applied. Had the defense failed, there would in principle have been charges to tax at two levels:

(1) T would pay income tax on income arising to the life insurance company under s.720 (to the extent that it arose as a result of T's premium); and
(2) T would pay income tax on the gain arising from the policy under the chargeable event provisions.

HMRC argued that relief was available under two provisions: s.547(2) ICTA and distribution relief.

The Special Commissioner rightly rejected the argument that distribution relief applied:

> ... [s.743(2B) ITA] only relieves from tax income which is subsequently received by an individual whose income it has been deemed to be in earlier years under [s.720 ITA].[80]

The s.720 income is not the same as the chargeable event income.

Section 547(2) ICTA then provided:

> Nothing in subsection (1) above [deeming chargeable-event gains to be taxable income] shall apply to any amount which is chargeable to tax apart from that subsection.

The Commissioner rightly dismissed the argument that this conferred relief:

> So far as double taxation is concerned, in my view s.547(2) [ICTA does] not provide relief. [It] gives relief if the amount of the gain arising in connection with a policy on the happening of a chargeable event, which is deemed to form part of the individual's total income for the year in which the event happens, is chargeable to tax apart from subs (1) of s 547. This does not provide relief for the taxation of income under [s.720] in the years before the chargeable event occurs.

That is not the end of the story, as the Tax Law Rewrite expanded the scope of the relief. Section 527 ITTOIA now provides:

> (1) This section applies if the whole or part of any receipt or other credit item is taken into account in calculating both—
> (a) the amount of a gain treated as arising under this Chapter, and
> (b) an amount on which income tax is charged otherwise than under

[80] *IRC v Willoughby* 70 TC 57 at p.84.

> this Chapter or on which corporation tax is charged.
> (2) The amount of the gain on which tax is charged under this Chapter is reduced by so much of the amount of that receipt or other credit item as is taken into account in both those calculations.

It appears from EN ITTOIA change 95 that this change was intended to benefit traders in policies[81] but it could arguably apply here. There is also a hint in *Willoughby* at p.84 that relief may be available by concession, but that would not bind HMRC. In practice, fortunately, it will be rare for the ToA rules apply to income arising as a result of policy premiums or other payments to life companies.[82]

51.19 CFC/s.720 overlap

Section 725 ITA provides:

> (1) This section applies if—
> (a) under Part 9A of TIOPA 2010 (controlled foreign companies), the CFC charge is charged in relation to a CFC's accounting period,
> (b) an amount of income is treated as arising to an individual under section 721 for a tax year, and

[81] "**Change 95: Gains from contracts for life insurance etc: reductions for sums chargeable to tax apart from section 547(1) of ICTA: section 527**
This clarifies the meaning of the exception from the charge to tax under section 547(1) of ICTA given by section 547(2) of ICTA for any amount chargeable to tax apart from section 547(1) of ICTA.
Section 547 of ICTA deals with the method of charging chargeable event gains to tax. This differs according to the person who is interested in the policy. For example, under section 547(1) of ICTA where the rights in a policy or contract are held by an individual as beneficial owner the gain forms part of the individual's total income. However, section 547(2) of ICTA states "Nothing in subsection (1) shall apply to any amount which is chargeable to tax apart from that subsection.".
In practice, the words "amount which is chargeable to tax" in section 547(2) of ICTA are taken to mean the amount of the receipts and credits taken into account for the purposes of ascertaining the overall taxable profit under another provision, rather than the actual amount that is charged to tax under another provision, which in the case of a trader, for instance, will be the net profits of the trade.
Section 527 which rewrites section 547(2) of ICTA makes it clear that the amount chargeable to tax under Chapter 9 of Part 4 of this Act is reduced by the amount of the receipt or other credit item that is taken into account in calculating the amount on which income tax is charged otherwise than under Chapter 9 of Part 4 or the amount on which corporation tax is charged."

[82] See 70.10.5 (Income of life company).

(c) the income mentioned in section 721(2) is or includes a sum forming part of the CFC's chargeable profits for that accounting period.

(2) The amount of income so treated is reduced by—

S × (CA÷CP)

where—

S is the sum forming part of the CFC's chargeable profits for that accounting period,

CA is the CFC's chargeable profits for that accounting period so far as apportioned to chargeable companies at step 3 in section 371BC(1) of TIOPA 2010, and

CP is the CFC's chargeable profits for that accounting period.

(2A) In a case in which section 724 applies, the reference to S in the formula in subsection (2) is to be read as a reference to X% of S.

(2B) "X%" is determined as follows—

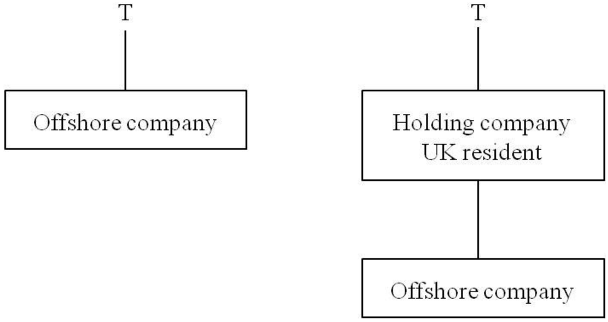
100% × (A / I)

where—

A is the amount on which the individual is liable as determined under section 724(2), and

I is the amount of the income mentioned in section 721(2).

(3) Terms used in this section which are defined in Part 9A of TIOPA 2010 have the same meaning as in that Part.



In case 1, T is subject to income tax on the income of the offshore company under s.720.

In case 2, Holdco is subject to corporation tax on the income of the offshore subsidiary and T is not subject to income tax.

51.20 Taxpayer confidentiality

Use of the reliefs for overlapping charges require that the transferor/ person abroad knows details of tax paid by some other person. Section 18 CRCA 2005 authorises HMRC to disclose this information:

(1) Revenue and Customs officials may not disclose information which is held by the Revenue and Customs in connection with a function of the Revenue and Customs.

(2) But subsection (1) does not apply to a disclosure—

(a) which—

(i) is made for the purposes of a function of HMRC, and

(ii) does not contravene any restriction imposed by the Commissioners...

CHAPTER FIFTY TWO

TRANSFER OF ASSETS ABROAD: MOTIVE DEFENCE

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52.37 Abolish the 2006 rules

Cross references

The following topics are considered elsewhere:

Topic	**See para**
s.3/ToA motive defence compared	64.16.6
TiS/ToA motive defence compared	55.11.3

52.1 Motive defence: Introduction

Sections 736 - 742 ITA provide a defence to the ToA provisions which I call the "**motive defence**" (or where comparing it to other unallowable purpose tests, "the ToA motive defence"). The INT Manual calls it "the avoidance purpose exemption". It is an early example, perhaps the first, of what would now be called a TAAR.[1]

52.1.1 *Motive defence terminology*

Section 736(3) ITA provides two self-explanatory terms:

> In this section and sections 737 to 742—
>
> "**post-4 December 2005 transaction**" means a relevant transaction effected on or after 5 December 2005, and
>
> "**pre-5 December 2005 transaction**" means a relevant transaction effected before 5 December 2005.

In this chapter:

(1) "**Old Conditions A and B**" are conditions A and B in s.739 ITA (applying to pre-5 December 2005 transactions).

(2) "**New Conditions A and B**" are conditions A and B in s.737 ITA (applying to post-4 December 2005 transactions).

[1] See 3.2.1 (Types of unallowable purpose).

References to Condition A or B (without more) means either the old or the new version of the Conditions.

There have been two explanations of the 2006 clauses:

EN Draft Clauses (2005): Explanatory Notes on Draft Clauses, 5/12/05
EN FB 2006: Explanatory Notes on the Finance Bill 2006

I distinguish between:

(1) An "**innocent**" transaction, which satisfies the motive defence (in short, no tax avoidance purpose)
(2) A "**tainted**" transaction, which does not satisfy the motive defence

For the definition of "**relevant transactions**" see 48.12 (Why associated operations matter).

52.2 Motive defence conditions

The position depends on the date of the relevant transactions:

s.737 ITA: New conditions	**s.739 ITA: Old conditions**
(1) This section applies if all the relevant transactions are post-4 December 2005 transactions.	(1) This section applies if all the relevant transactions are pre-5 December 2005 transactions.
(2) An individual is not liable to income tax under this Chapter for the tax year by reference to the relevant transactions if the individual satisfies an officer of Revenue and Customs—	(2) [Identical]
(a) that Condition A is met, or (b) in a case where Condition A is not met, that Condition B is met.[2]	that condition A or B is met.

52.3 Motive defence condition A

Section 737(3)/739(3) ITA set out Condition A:

[2] The reader may think this is rather a clumsy way to say "A or B". No doubt "or" can have an inclusive and an exclusive sense: so "A or B" can mean "A or B or both" or "A or B but not both". But the context will normally clarify the meaning, as it does in Old Condition A. But there it is.

s.737(3): New condition A	**s.739(3): Old condition A**
Condition A is that it would not be reasonable to draw the conclusion, from all the circumstances of the case,[3] that	Condition A is that
the purpose of avoiding liability to taxation was the purpose, or one of the purposes, for which the relevant transactions or any of them were effected.	the purpose of avoiding liability to taxation was not the purpose, or one of the purposes, for which the relevant transactions or any of them were effected.

52.4 Motive defence condition B

Section 737(4)/739(4) ITA set out Condition B:

s.737(4): New Condition B	**s.739(4): Old Condition B**
Condition B is that—	Condition B is that the transfer and any associated operations—
(a) all the relevant transactions were genuine commercial transactions (see section 738), and	(a) were genuine commercial transactions, and
(b) it would not be reasonable to draw the conclusion, from all the circumstances of the case,[4] that any one or more of those transactions was more than incidentally designed for the purpose of avoiding liability to taxation.	(b) were not designed for the purpose of avoiding liability to taxation.

52.5 Enactment history

The original wording was much simpler. It provided exemption if:

> the transfer and any associated operations were effected mainly for some purpose other than the purpose of avoiding liability to taxation.[5]

[3] See App.2.24 (Reasonable-to-assume).

[4] See App.2.24 (Reasonable-to-assume).

[5] Section 18 FA 1936. Section 28 FA 1938 substituted the text which is now Old Conditions A and B.

Sir Terence O'Connor (then Solicitor-General) explained why the text was changed in 1938 to (what is now) Old Conditions A & B:

> A taxpayer[6] transferred a large amount – he was not one of the small people for whom my hon. and learned Friend was pleading – of foreign securities to a trust company abroad on certain trusts under which the income was to be accumulated until the death of the taxpayer. There was a discretion to the trustees to pay certain portions of the income to the taxpayer or to his son. The deed gives to the taxpayer and his son power, with the consent of the trustees, to revoke the trust, or, alternatively, they can withdraw all or any part of the trust property for their own benefit. The trust income has been accumulated, and none of it has been distributed.
>
> The vigilant Revenue authorities pursued this taxpayer, and he contended, successfully, as it transpired, on appeal, that the foreign trust was born because of his fears as to the financial position of this country and the dangers of the situation on the Continent ... in 1936. ... The Special Commissioners decided that the main purpose of the transaction was occasioned by A's pessimistic view of the European situation at the time; that, arising out of that, his main intention was to make provision for his family in a safer country; and that, if there was any intention of avoidance of taxation, it was incidental to the main purpose. They therefore decided that there was no liability under Section 18 FA 1936. That instance has only to be cited to the Committee for the Committee to realise that on this particular matter the hon. Member for Chesterfield (Mr. Benson) was a true prophet in 1936, when he said that the word "mainly" would be too wide.[7]

[6] The Inland Revenue accepted at that time that (what is now) s.720 only applied if the transferor was UK resident at the time of the transfer. If the transferor was UK resident, one can see why the Revenue found the successful motive defence claim troubling.

The remittance basis position in the case is unclear. It is reasonable to guess that the taxpayer (had he not made the transfer of assets) would have been taxed under the remittance basis, but accepted that the remittance basis did not apply under the then transfer of asset rules; the current s.720 remittance basis was only introduced in 1981. That unfairness would have made the taxpayer's claim for the motive defence more attractive.

Conceivably, the taxpayer (had he not made the transfer of assets) would have been taxed on the arising basis (eg if the income in point was UK source income) in which case the successful motive defence claim would have been even more troubling.

[7] Hansard 27 June 1938, col 1610. It is noteworthy that an income tax dispute on the FA 1936 provision was resolved by a Special Commissioners' decision by early 1938

If a case on similar facts could be imagined today, it might still succeed, but the test is stiffer. The taxpayer would need (in short) to show that tax avoidance was not even one of the purposes of the transfer.

52.6 Mixed tax/non-tax purposes

A transfer may have more than one purpose.

52.6.1 *Condition A*

Condition A depends on whether the purpose of avoiding liability to taxation was the purpose *or one of the purposes* for which the transfer or associated operations were effected. If *one* of these purposes is tax avoidance, the transfer fails condition A. It does not matter what the other purposes are.[8] The tax avoidance purpose does not have to be a main purpose (unlike standard TAAR wording).[9]

52.6.2 *Old Condition B*

Old Condition B contains two requirements; both must be satisfied. The first is that the transfer (and associated operations) are commercial transactions. Secondly that the transfer (and associated operations) are not designed for the purpose of avoiding liability to taxation.

What happens if a commercial transaction has two or more purposes? HMRC say in RI 201:

> The Revenue's view is that one of the essential conditions of s [old condition B] would not be satisfied where there was a significant element of tax avoidance purpose in the design of the transfer and any associated operations.

This paraphrase is rather[10] too generous to HMRC. In *Carvill v IRC*:[11]

> One must ask in para (b) whether the transfer was designed for the purpose of avoiding tax or not. This seems to me to require that the

(even allowing for the fact that the 1936 Act operated retrospectively to 1935/36). If the same facts arose today, one would also need to consider s.624 (but protected-trust relief is likely to apply) and s.643A.

[8] This is self-evident, but if authority is needed, see *Philippi v IRC* 47 TC 75 at p.110.

[9] See 3.14 ("Main" purpose).

[10] Depending to an extent what nuance one gives to the malleable word "significant".

[11] [2000] STC (SCD) 143 at [89]. The passage was approved in *HMRC v Fisher* [2021] EWCA Civ 1438 at [83].

> main purpose was not tax avoidance because if one has to categorise a transaction as being either designed for the purpose of tax avoidance or not, when it is clearly accepted that a transaction may be designed for more than one purpose, the only way to categorise the design into one purpose is to look at the main purpose of the design. I think, therefore, that the taxpayer's contention of sole purpose is too loose a test and the Revenue's contention of significant purpose is too stringent a test although it will in practice be difficult to determine the difference between a significant and a main purpose.

The point of Condition B is that (if one passes the "commercial" requirement) the "no tax avoidance" requirement is easier to satisfy. Otherwise there is no reason to have two Conditions.

52.6.3 *New Condition B*

The wording has changed in New Condition B. The test is now whether:

> any one or more of those transactions was *more than incidentally* designed for the purpose of avoiding liability to taxation.

This brings the law into line with RI 201.[12] At first I thought (like the Special Commissioner) the difference is relatively slight. But (depending what nuance is given to the malleable word "incidentally") the change does make a difference. Since a merely incidental motive is not likely to amount to a "purpose" at all, a claim which fails Condition A will rarely (if ever) qualify under Condition B. For this reason (and because the "commercial" requirement in New Condition B is so narrow) New Condition B is dead letter law.

52.6.4 *Condition B: Critique*

Why did parliament not simply repeal Condition B, rather than amend it out of existence in a way which needs pages to analyse and discuss? Perhaps the full extent of what was done was not realised. Perhaps it was, but it was thought that repeal would raise objections. However that may be, the rational course would either be to repeal Condition B completely and gain the benefit of simplicity or to return to old Condition B, which had a role to play in aiding commercial life and the economy.

[12] I take "more than incidental" in New Condition B to have the same meaning as "significant" in RI 201.

52.7 "Commercial": Undefined sense

Commercial is a requirement for Condition B but not Condition A.

In Old Condition B the term is not defined. For a general discussion see App.5.2 (Commercial). In New Condition B there is a complex definition which is considered in the next section.

52.7.1 *Making/managing investments*

RI 201 provides:

> The expression "bona fide commercial" in [Old Condition B] is taken to apply
> [1] only to the furtherance of trade or business, and
> [2] not to the making or managing of investments.[13]

The INT Manual confirms this is still the HMRC view:

> **INTM603020 Commercial transactions** [Jan 2023]
> In this context, HMRC have treated 'commercial' as applying only to the furtherance of trade or business, and not to the passive holding of investments.

Proposition [2] (that "commercial" does *not* apply to making or managing investments) is untenable:

(1) The statement does not say what the position is if the making or management of investments constitutes a business. A transfer may be both in the furtherance of a business *and* in the course of making or managing investments.[14] The intended meaning seems to be that investment transactions in the course of a business are commercial, but investment transactions which are not in the course of a business are not commercial. The (elusive) concept of business is distinct from the concept of what is commercial.

[13] RI 201. This was perhaps the view of the drafter of s.724 CTA 2010 which refers to transactions:

"(a) for genuine commercial reasons *or* (b) in the ordinary course of making or managing investments."

But para (b) might have been added for the avoidance of doubt, or for some exceptional case, and it is not clear that the drafter really thought that making or managing investments would not usually be commercial.

[14] The proposition that making or managing investments may constitute a business is self-evident; but if authority is needed, see s.105(3) IHTA which refers to the business of making or holding investments; and s.1218 CTA 2009 which refers to "a company whose business consists wholly or partly of making investments".

(2) More fundamentally, making or managing investments *is* generally regarded as "commercial" even if it does not constitute a business. What can be more "commercial" than the management to maximise investment return? This point is recognised in *Lewis v IRC*:

> It is trite law that in exercising their duties trustees must use as much diligence as a prudent man of business ... Faced with the self-investment problem their duty was to act in a business-like manner: this they did. Put another way, they acted commercially as was their duty. In our view it would be construing the statute too narrowly to hold that they did not carry out the transactions for bona fide commercial reasons, unless an investment decision cannot be for commercial reasons.[15]

(3) Section 738(4) ITA assumes that making/managing investments may be "commercial" (in the ordinary sense of the word).[16]

Proposition [1] (that the expression "commercial" applies *only* to the furtherance of trade or business) was put to the Commissioners in *Carvill*, where it obtained some support.[17] Nevertheless, it is too narrow. In practice, commercial transactions will normally further trades or businesses so the issue will not often arise. But there are counter examples, as discussed above: making or managing investments is in principle a commercial transaction even if it is not in the course of a business.

The most that can be said is that a transaction which is not in furtherance of a trade/business is less likely to be commercial than one which is in furtherance of a trade/business, but this factor is not decisive.

52.7.2 *Commercial: Whose viewpoint?*

From whose viewpoint does one assess commerciality? The answer is that it should be looked at from the viewpoint of the transferor, but it would be an unusual transaction under which one party is and another party is not acting commercially. In *IRC v Willoughby* HMRC accepted that bonds were commercial transactions for Royal Life who issued them, but argued that they were not for Professor Willoughby who acquired them. The

[15] [1999] STC (SCD) 349 at p.362.

[16] See 52.8.3 (Investments restriction).

[17] See App 5.2.3 (Business transaction).

Special Commissioner did not agree:

> If a contract is entered into by two people and it is a bona fide commercial transaction for one of them, it cannot be not a bona fide commercial transaction for the other party to the contract in the absence of any reason for impeaching the latter's good faith.[18]

The point was not discussed on appeal. But the reference to "good faith" gives sufficient wiggle-room, if a Court wishes to avoid the reasoning.

52.8 "Commercial" in New Condition B

Section 738 ITA contains a definition of "commercial" for the purposes of New Condition B. The definition is artificial in that it excludes some transactions that are "commercial" in the normal sense of the word. So New Condition B is narrower than Old Condition B.

Section 738(1) ITA provides:

> For the purposes of section 737, a relevant transaction is a commercial transaction only if it meets the conditions in subsections (2) and (3).

Is s.738 an *exhaustive* definition of "commercial" or is it merely a partial, exclusory definition? That is, if a transaction meets the requirements set out in the section, is it necessarily "commercial" or must the transaction also be "commercial" in the ordinary sense of the word? The wording in s.738(1) ("a ... transaction is a commercial transaction only if ...") could be read as an exhaustive or a partial exclusory definition. It is suggested that s.738 is an exhaustive definition. The legislation is intended to make the law clearer, and a partial definition does not do that. In practice it is difficult to think of a transaction which meets the definition which is not commercial in the ordinary sense of the word, so the issue may not arise.

52.8.1 *Course of business*

Section 738(2) ITA sets out the first requirement of "commercial":

> It [the relevant transaction] must be effected—
> (a) in the course of a trade or business and for its purposes, or
> (b) with a view to setting up and commencing a trade or business and for its purposes.

In the following discussion I use the word "business" to mean "trade or

[18] 70 TC 57 at p.86H.

business".[19]

At first sight this more or less encapsulates the natural meaning of "commercial". But in fact it is restrictive. An individual may make an investment which is not in the course of a business, eg a purchase of a company. This is commercial in the general sense of the word, but it is not "commercial" within the new definition. Section 738(2) thus gives effect to HMRC's view of the meaning of "commercial" in Old Condition B.[20]

If a transaction is made between X and Y, it may be in the course of a business of X but not in the course of a business of Y. For example, if Y (an individual) subscribes for shares in X Ltd, an investment company, the issue of shares may be in the course of the business of X Ltd. That is sufficient to meet the requirement of s.738(2).

52.8.2 *Arm's length requirement*

Section 738(3) ITA sets out the second requirement of "commercial":

> It [the relevant transaction] must not—
> (a) be on terms other than those that would have been made between persons not connected with each other dealing at arm's length, or
> (b) be a transaction that would not have been entered into between such persons so dealing.

The drafting is based on IHT arm's length transaction relief[21] but that does not shed much light on the issues here.

Taken literally, this would seem to exclude an interest free loan to a wholly-owned company (even if it is a trading company). Such loans are commercial in the normal sense of the word. One wonders whether that was foreseen by the drafter. EN Draft Clauses (2005) claims that the change merely "clarifies and confirms" the correct interpretation of the existing statute. But I don't think anyone should take any notice of that.[22] It is suggested that the provisions should be construed purposively, so that an interest free loan to a wholly-owned company *is* a commercial transaction.

[19] For HMRC views on what constitutes a business, see CG Manual para 65715 [April 2011] and Shares and Assets Valuation Manual para 111110 [July 2013].

[20] See 52.7.1 (Making/managing investments).

[21] See 74.13 (Arm's length disposal relief).

[22] See App.1.2 (Clarify/modernise/reform).

A dividend is a commercial transaction, as such transactions are often entered into between companies and minority shareholders (who are in principle not connected to the company).

In *Hoey v HMRC* an interest-free loan from an offshore EBT to a beneficiary was held to meet this requirement; but on appeal the decision (described in this book as "surprising") was held to be flawed.[23]

The INT Manual provides:

> **INTM603020 Commercial transactions** [Jan 2023]
> ... The above provisions [s.738(2)(3)] ensure that transactions taking place other than at arm's length will not satisfy the terms of Condition B. This will prevent individuals claiming exemption on contrived grounds of 'commerciality'.
> [1] An example of this might be where an offshore company is established as a conduit or 'money box' for personal fee income.

The metaphors of conduit and moneybox are imprecise, but I take this example as a reference to the arrangement in *Brackett v Chater*,[24] where the transfer of assets was that T entered into a service contract, at an undervalue, with a non-resident company which was held by a settlor-interested discretionary trust made by T. This is an example of a transfer which fails the commerciality test of s.738(3)(a). On the other hand, that contract was not a commercial transaction in the ordinary sense, and the commissioners rejected the taxpayer's argument that the motive defence applied, so this is not a case where the new definition was needed, or would have made any difference.

> [2] It will also prevent claims that the establishment of a non-resident family trust was for 'commercial' reasons.

The statutory definition is not needed here: no-one suggests that the establishment of a family trust is "commercial" in any sense.[25]

> [3] HMRC accept that the creation of some trusts will satisfy the 'commerciality' tests, for example an employee benefit trust established for the benefit of a group of employees and funded on arm's length terms...[26]

[23] [2019] UKFTT 489 (TC) at [159]; [2021] UKUT 82 (TCC) at [243]-[246]. For other aspects of this case, see 52.25 (Employee benefit trusts).

[24] 60 TC 134 & 639.

[25] See App.5.2.2 (Bounty (gratuitous intent)).

[26] See 52.25 (Employee benefit trusts).

52.8.3 *Investment managers*

Section 738(4) ITA restricts the definition of commercial by restricting the definition of "trade or business":

> For the purposes of subsection (2),
> [1] making investments,
> [2] managing them or
> [3] making and managing them
> is a trade or business only so far as—
> (a) the person by whom it is done, and
> (b) the person for whom it is done,
> are persons not connected with each other and are dealing at arm's length.

The INTM provides:

> **INTM603020 Commercial transactions** [Jan 2023]
> ...The aim of this is to distinguish between asset management activity (which is a business chargeable for reward) and merely holding assets for possible increase in value.

Section 738(4) uses layman's language, but I think the references to making/managing investments by one person for another are references to the activities of an investment manager[27], because an investment manager makes/manages investments for another person. So:

(1) If the person abroad is a company carrying on the business of making investments through an investment manager:
   (a) the person by whom it (the investment business) is done is the investment manager
   (b) the person(s) for whom it (the business) is done is the company,

(2) If (less likely) the person abroad is a company carrying on the business of an investment manager:
   (a) the person by whom it (the investment management business) is done is the company
   (b) the person(s) for whom it (the business) is done is the customers (principals) of the company

In each case, a transfer to the company is only commercial if the two are

[27] or broker; in this section I use the term "investment manager" to include a broker.

unconnected and at arm's length.

In the person abroad carries on business without an investment manager, it is suggested that this paragraph does not apply and can be ignored.[28]

If s.738(4) applies, the making/managing of investments is only business "so far as" it is done for unconnected persons. Normally an activity is or is not a business: it cannot be a business to a limited extent. Perhaps the activity is to be split and regarded as part business and part non-business.

What if a business is initially carried on through connected persons and later becomes carried on through unconnected persons, (or vice versa)? It is suggested that the question whether a transfer is commercial is decided by the circumstances at the time of the transfer, though one might look at the position in the round including considering how later matters were then intended and actually took place.

The subsection does not apply to a company *trading* in financial assets since these are not "investments".[29] But a company carrying on an financial trade with a UK investment manager needs to consider the IME, which imposes requirements comparable to being unconnected.

Suppose T subscribes for shares or debentures in (or makes a loan to) an investment company. The transaction satisfies s.738(2) since the company is carrying on a trade or business. The transaction satisfies s.738(3) if it is on arm's length terms. The business satisfies s.738(4) unless the company's business is conducted through connected agents. It does not matter that T and the company are connected.

52.8.4 *"Commercial": Critique*

When one contemplates the difficulties raised by the statutory definition, one appreciates the wisdom of the 1938 drafter in leaving "commercial" undefined. The word "commercial" is often used motive defence tests[30] and nowhere else is it defined. It is suggested that the definition of commercial in s.738 ITA serves no useful purpose, and unless some purpose can be identified, it should be repealed.

[28] Except in the case of a business carried on by an agent, a business is not in normal English "done for" anyone. For example, a property business it is not done for the tenants; the business of buying and selling shares is not done for counterparty vendors and purchasers.

[29] See 72.15.1 ("Investment": Terminology).

[30] See 3.1 (TAAR/unallowable purpose test).

52.9 Meaning of "taxation"

52.9.1 *Taxation in Old Conditions A/B*

"Taxation" in Old Conditions A and B means any form of UK taxation, and not only income tax.

In *Sassoon* v *IRC*:[31]

> Death duties, National Defence Contribution, perhaps other taxes or duties would all be within the Revenue's mind in deliberately choosing the wide word 'taxation', in order to make sure that their concession of transfers for other purposes should not be used to deprive the Revenue of other taxes than Income Tax or Sur-tax.

The International Manual provides:

> **INTM600040 Transfer of assets abroad** [Feb 2020]
> **Overview of ITA 2007/S736 - 742 - exemption from liability**
> ..In the context of this test "taxation" includes any UK tax liability, for example, Inheritance Tax, Capital Gains Tax, Corporation Tax as well as Income Tax.

Sassoon, though criticised,[32] is a decision of the CoA. While it could be

[31] 25 TC 154 at p.158 cited in the INT Manual para INTM603000. *Sassoon* was a 2nd world war decision (1943), which may possibly explain why the court referred to the *Revenue's* mind, when nowadays one would refer to the mind, or intention, of parliament.
For completeness: *Sassoon* was followed in *Fisher v HMRC,* holding that betting duty constituted "taxation" and "the fact that betting duty would at the time have been under the care and management of the Commissioners for Customs and Excise and not the Commissioners for Inland Revenue does not affect this view": [2020] UKUT 62 (TCC) at [136]. This was common ground in the subsequent appeal: [2021] EWCA Civ 1438 at [84].

[32] For the following reasons:
(1) The rule that an intention to avoid (say) stamp duty should have *income* tax consequences gives rise to obvious anomalies. The usual principle is that each tax must be considered separately. This is the approach usually adopted by anti-avoidance provisions: eg s.682 ITA (transactions in securities), or s.137 TCGA. But see s.75(5)(a) FA 1986 for an exception.
(2) Since *Sassoon* was decided, the word "tax" has been given a limited definition. Section 989 ITA provides:
"'tax', if neither income tax nor corporation tax is specified, means either of those taxes".
There are two reasons why this statutory change does not affect the position:
(a) A definition of *tax* does not in principle determine the meaning of the

reversed by the Supreme Court, that should not be expected, because:
(1) The Court should be slow to reverse a long standing decision.
(2) *Sassoon* has had statutory endorsement in the context of new conditions A and B.

Foreign tax is not "taxation" for this purpose. The House of Lords assumed that this was so without argument in *Herdman v IRC*.[33] This must be right since (1) it is illogical that the purpose of avoiding foreign taxes should have UK tax consequences and (2) it would be impractical to apply an avoidance/mitigation distinction to foreign taxes (where the distinction would depend on the foreign tax culture and attitudes).

HMRC agree. The INT Manual provides:

> **INTM603000 Avoidance purpose exemption: Taxation** [Jul 2023]
> The *Sassoon* case also established that 'taxation' meant UK taxation. If it is intended to avoid foreign tax and only foreign tax is avoided, the transfer of assets provisions will not apply.

52.9.2 *Taxation in New Conditions A/B*

For the purposes of New Conditions A and B these rules are set out in s. 737(7) ITA:

> In this section—
> "revenue" includes taxes, duties and national insurance contributions,
> "taxation" include any revenue for whose collection and management the Commissioners for HMRC are responsible.

This is an inclusive, not an exhaustive definition. This is relevant if there

cognate word *taxation*. (Would a definition of "engine" determine the meaning of the cognate word "engineer"?)

(b) The decision in *Sassoon* was given the implied approval of parliament in the 1952 consolidation and it is not likely that the 1970 consolidation was intended to alter that.

(3) Section 720(1) ITA refers only to the avoidance of income tax; but see s.721(5)(c) ITA.

(4) Dicta in *Vestey v IRC* 54 TC 503 are said to be inconsistent with *Sassoon*; but this point was not an issue in *Vestey*.

(5) A reversal of *Sassoon* would cut down considerably the multitude of issues that the motive defence currently raises: see 52.10 (Practical examples: introduction).

While of course "context is king", the word "taxation" is used elsewhere to mean any UK tax; see for instance s.22 F(No 2)A 1931.

[33] 45 TC 394.

is a change in the responsibilities of HMRC. For instance, LBTT is managed by Revenue Scotland,[34] and LTT by the Welsh Revenue Authority,[35] but these still constitutes "taxation".

It continues to be the case that the word "taxation" does not include foreign taxes.

52.10 Practical examples: Introduction

For the general principles which apply to the motive defence and other TAARs, see 3.1 (TAAR/unallowable purpose test). I here seek to apply them in some practical cases involving the ToA motive defence. There is no test like the test of practice.

I first consider transfers to non-resident trusts (**"trust transfers"**) in six sets of circumstances:

(1) Trusts where settlor is excluded:[36]
  (a) Foreign settlor: UK and foreign beneficiaries;
  (b) Foreign settlor: only UK beneficiaries;
  (c) UK settlor: UK beneficiaries;
  (d) UK settlor: foreign beneficiaries.

("Foreign" here refers to someone not resident or domiciled in the UK and not expecting to become resident or domiciled.)

(2) Trusts where the settlor is a beneficiary:
  (a) Settlor foreign domiciled but UK resident;
  (b) Settlor foreign domiciled and non-UK resident.

This by no means covers all the possible circumstances of trust transfers, but one can extrapolate from these to others which may arise.

It may be helpful to summarise the questions that arise on a trust transfer. One must ask: Is the purpose to avoid (1) income tax? (2) CGT? (3) inheritance tax? It is obviously necessary to consider each tax separately; I will consider CGT and IT, and then IHT. Thus what seemed like a single issue (is there tax avoidance?) raises 3 sub-issues; that is an inevitable consequence of the rule that taxation includes any tax.[37]

However, a tax charge does not arise in isolation, but is charged in

[34] Section 54 Land and Buildings Transaction Tax (Scotland) Act 2013.

[35] Section 2 Land Transaction Tax and Anti-avoidance of Devolved Taxes (Wales) Act 2017.

[36] It is assumed that the spouse of the settlor is also excluded.

[37] See 52.9 (Meaning of "taxation").

different ways on the settlor, trustees[38] or beneficiaries. It is best to consider these three classes of taxpayer separately, though the issues partly overlap. So in the case of a trust transfer one must ask whether the purpose is avoidance of IT/CGT/IHT liabilities of (1) the settlor; (2) the trustees; (3) the beneficiaries. Thus what seemed like a single issue raises nine sub-issues. Further, post-*Willoughby* one must consider whether there is a factual subjective purpose to reduce any of these tax liabilities and then whether the purpose (if present) is to be classified as avoidance or mitigation. So what seemed like a single issue (is the purpose of a trust transfer to avoid taxation?) actually turns out to raise 18 sub-issues (is the purpose to save IT/CGT/IHT by settlor/trustees/beneficiaries and, if so, is it mitigation or avoidance?).

52.11 Trust: Settlor excluded

Transfers to a trust from which the settlor is excluded have two common features which are relevant for the motive defence:

52.11.1 *No avoidance of settlor's tax*

The trust transfer will usually bring a tax advantage to the settlor (compared to the position if there is no transfer). If a settlor is excluded from the trust, any tax advantage they might obtain is mitigation not avoidance. It is not in principle the intention of parliament that a settlor should pay tax in respect of income/gains/capital from which they are excluded.[39] However, HMRC rightly say that the purpose of a trust transfer may be to avoid tax liabilities of the trustees and beneficiaries and here closer investigation is needed.

52.11.2 *Non-tax reason for trust*

There will usually be non-tax reasons for the settlor to make a trust, rather than making absolute gifts. The advantages are asset protection in the broadest sense: protecting the trust fund from profligate beneficiaries, divorcing spouses, and sometimes forced heirship or foreign exchange

[38] It may be said that in economic reality trustees pay tax on behalf of beneficiaries. But the rules for taxation of trustees are distinct from the rules for taxation of beneficiaries so it is best to consider trustees separately.

[39] This is self-evident, but if authority is needed, see Lord Templeman's comment in 3.20.7 (Economic consequences). The exceptional case of s.86 TCGA is discussed below.

control. These are good reasons but not commercial ones. So a trust transfer must pass Condition A, not Condition B, but it does so in the context of a transaction which is not usually wholly tax driven. In the absence of tax considerations the usual form would normally be (and in practice generally is) a discretionary trust.

52.12 Foreign settlor; UK/non-UK beneficiaries

This section considers a transfer to a trust whose beneficiaries include (but are not primarily) UK resident and domiciled beneficiaries, and exclude the settlor.

52.12.1 *Avoidance of trustees' tax*

In deciding whether the trust transfer yields a tax advantage for the trustees, one obviously cannot compare the actual position (appointment of foreign trustees) with the position if the transfer had not taken place. One must compare it with something else the settlor might have done (which in this context must be the appointment of UK trustees). That seems a reasonable comparable; the settlor has a choice: to transfer to trustees in the UK or elsewhere and they must do one or the other. In the absence of UK tax, there will often be no reason to prefer the one to the other.

The choice of UK trustees (rather than foreign trustees) would not in principle yield any greater CGT before 2007/08.[40] There is no question of CGT avoidance for dispositions before the FA 2006.

The position is slightly more complicated for dispositions after 2006. The choice of exclusively UK trustees of a discretionary trust will yield CGT (and income tax on foreign source income) not due from non-resident or mixed resident trustees.[41] However, assuming a settlor who is non-UK domiciled and non-resident, if one trustee (even a minority trustee) is not UK resident, the trustees are not (in short) subject to CGT or income tax on foreign income.[42] In this way, Parliament assists in the appointment of non-resident trustees, suggesting that this cannot be

[40] As long as the UK trustees were professionals: see the 4th edition of this book at 5.8 (Professional trustees treated as non-resident).

[41] See 7.4 (Trust residence for IT/CGT). The IT position for trustees before 1989 was thought by HMRC to be the same, and was held in *Dawson v IRC* 62 TC 301 to be only slightly (and for present purposes not materially) different.

[42] See 7.6 (Mixed-resident trustees).

contrary to the intention of parliament. To hold otherwise would be to suggest that the settlor has a duty to maximise UK income tax and CGT liability. Any tax saving here must be mitigation. It is relevant to note that the reason for the abolition of the former rule that professional trustees should be regarded as non-resident was not to prevent avoidance: it was to avoid a breach of EU State Aid law.[43]

52.12.2 *Avoidance of beneficiary IT*

In deciding whether the trust transfer yields an income tax advantage for the beneficiaries, one obviously cannot compare the actual position (transfer to trust) with the position if the transfer had not taken place. One must compare it with something else the settlor might have done.

The actual position of UK resident and domiciled beneficiaries is that they will pay tax on income distributions from the trust, but no tax on accumulated income and (in the absence of s.731 ITA) no income tax on capital payments. This is a clear income tax advantage if the transfer to a discretionary trust is compared with a transfer to the beneficiaries or to a transfer to an interest in possession trust.

Is the purpose of the transferor to obtain this advantage? Normally their purpose will be to obtain non-tax advantages, and even foresight of the tax advantage may not constitute purpose, but it depends on the facts.[44]

The actual position of UK resident foreign domiciled beneficiaries is that they will pay tax on remitted income distributions from the trust, and (in the absence of s.731 ITA) no income tax on capital payments even if remitted. This could be an income tax advantage if the transfer to a discretionary trust is compared with a transfer to the beneficiaries or to a transfer to an interest in possession trust, but the advantage may be small or nil.

Is the purpose of the transferor to obtain this advantage? Normally their purpose will be to obtain non-tax advantages, and even foresight of this somewhat attenuated tax advantage will not constitute purpose.

52.12.3 *Avoidance or mitigation*

Returning to the practical example of a transfer to a trust by a foreign settlor, with both UK and foreign beneficiaries. Is the purpose (if it exists) of saving income tax by the beneficiaries to be classified as avoidance?

[43] HMRC announcement 23 March 2006.

[44] See 3.11 (Foresight/purpose distinction).

The difference between being a beneficiary of a discretionary trust and owning capital outright is normally[45] a difference with "economic consequences". On an economic consequences test this should be mitigation.

There is another indication that the intention of parliament is not infringed. If s.731 ITA applies, in this class of case, the result is unfair and sometimes extremely unfair. The UK beneficiaries will pay income tax on capital payments on an amount by reference to relevant income which may greatly exceed their "share" of the income of the trust computed on any just and reasonable basis.

If there is avoidance of UK tax there is likely to be avoidance of tax in every other jurisdiction where beneficiaries are resident;[46] it is impossible for the settlor to make a discretionary trust anywhere without tax avoidance elsewhere – which, if not absurd, is somewhat startling.

52.12.4 *Avoidance of beneficiary CGT*

The CGT position is complicated by tax reforms. Before 1998, capital payments from the trust would be free of tax to the beneficiaries (because the usual charge did not apply to a trust with a foreign domiciled settlor). This was expressly set out in s.87 TCGA.[47] One must take that as a special tax regime intended by parliament. Pre-1998 transfers cannot be regarded as involving CGT avoidance by the beneficiaries.

After 1998, capital payments to UK domiciled beneficiaries give rise to CGT by reference to trust gains regardless of the domicile of the settlor and in 2008 the charge was extended further. This could be taken to suggest that post-1998 transfers constitute CGT avoidance by the beneficiaries. But the points made in relation to IT avoidance/mitigation apply here too. For dispositions before 2006, s.69(2) TCGA is even stronger than it is now. So the better view is that any CGT saving is mitigation.

52.13 Foreign settlor; UK beneficiaries

The next case to consider is a transfer to a trust whose beneficiaries are all UK resident and domiciled. A trust transfer primarily motivated by non-

[45] It would be different if the trustees (perhaps guided by a strongly worded letter of wishes) closely follow the wishes of a beneficiary.

[46] Assuming they are in a jurisdiction with a tax system comparable to the UK.

[47] And in the predecessor legislation: s.17 Capital Gains Tax Act 1979.

tax advantages (asset protection) should not normally be regarded as having the purpose of tax reduction.

In an unusual case, however, that might be one of the settlor's purposes. Indeed, it could be their primary purpose. It can happen that the settlor creates a trust primarily for a UK beneficiary, and the only reason they do this is tax considerations. Asset protection does not concern every settlor. They would make an absolute gift to a UK beneficiary but for UK tax reasons only they make a transfer to a trust for their benefit. The transfer is solely UK tax driven.[48]

In these (factually unusual) circumstances the question arises whether the tax saving purpose is avoidance or mitigation. The rule for mixed-resident trustees shows the intention of parliament to be that the choice of foreign trustees by a non-resident and non-domiciled settlor should not be regarded as avoidance of trustees' IT or CGT. These sections apply regardless of the residence and domicile of the beneficiaries. The inference should probably be carried across that there is likewise mitigation not avoidance of beneficiaries' IT and CGT liabilities; but the point is arguable.

52.14 UK settlor and UK beneficiaries

Contrast now a settlor who is UK resident and domiciled, making provision for UK beneficiaries. Assume the settlor is not to be a beneficiary. Again, they will often prefer a trust to outright gifts, for non-tax reasons, and the choice is UK or non-resident trustees. If they choose the latter, their purpose (or one of their purposes) is likely to be to reduce CGT or Income Tax and this purpose will be tax avoidance rather than mitigation. This is not an invitation to partake in a statutory regime; we all know that this income tax saving is what s.731 is intended to stop.

The distinction is therefore between:

(1) foreign settlors (whose offshore trusts are not in principle regarded as tax avoidance), and

(2) UK settlors (whose offshore trusts are in principle regarded as tax avoidance).

This distinction is clearly drawn in the 1974 Green Paper on Wealth Tax:

[48] This might be made evidentially clear by contemporary correspondence, or if, perhaps, the settlor's gift to a UK child is settled and their gift to other children outside the UK is absolute; but such details only go to identify the settlor's purpose, and are not otherwise significant for tax.

> **Overseas trusts**
> 22. Trusts where the trustees are not resident in the UK and the administration of the trust is ordinarily carried on outside this country fall into two broad categories.
>
> **"Genuine" overseas trusts**
> 23. The first category includes all those trusts set up with non-resident trustees by settlors who have little or no connection with this country. *In such a case even if there are one or more beneficiaries or discretionary objects resident in this country there are no grounds on which it would be right to bring the trustees or the whole of the trust assets within the charge to the tax.* But a UK resident individual with an interest in such a trust, whether in possession or reversion, has a realisable asset which should be included in his personal wealth at its actuarial value. If such a trust is discretionary however its objects generally have no interests in the trust assets on which they should be assessed.
>
> **"Artificial" overseas trusts**
> 24. The second category includes those trusts where a *UK settlor* arranges for the trustees to be non-resident or where the administration of an existing resident trust passes overseas. The legal ownership of the settled property is thus vested in persons outside UK jurisdiction and *the arrangement is very frequently prompted by tax avoidance considerations*. Accordingly, where settled funds are provided directly or indirectly by a person who at the time the funds were provided was domiciled or ordinarily resident in the UK, the trustees will be liable to the same extent as if the trust had been resident.[49]

While the Paper was addressing the issue of what the Wealth Tax should cover, this passage illustrates very well the general understanding of the concept of tax avoidance in the context of offshore trusts.

Note the terminology of genuine *v.* artificial to describe tax avoidance. The author of the Green Paper had sufficient intellectual rigour to recognise the difficulties in these words and put them in quotation marks accordingly.[50] If only this were done more often!

52.15 UK settlor; foreign beneficiaries

Now consider a UK settlor making a trust (from which they are excluded) for foreign beneficiaries.

[49] Wealth Tax, Cmnd 5704, 1974 paras 22–4 (emphasis added). The fact that the Wealth Tax proposal was abandoned does not affect the relevance of the passage.

[50] See 3.21.2 ("Artificial"/"devices"); 3.21.3 ("Genuine").

What about liabilities of the beneficiaries? Since they are not UK resident, they are largely outside the scope of IT and CGT, so there is no avoidance.

In deciding whether the trust transfer yields a tax advantage for the trustees, one can again compare the actual position (appointment of foreign trustees) with the appointment of UK trustees. UK trustees would pay IT if the trust were discretionary but not (for all practical purposes) if it were an interest in possession. Any IT saving must be mitigation. CGT is different: UK trustees will pay the tax, and foreign trustees will not. However, trustees are in economic reality paying tax on behalf of the beneficiaries. Where the beneficiaries are not within the scope of the tax then any tax saving by the trustees must be mitigation. This is consistent with the rule that the anti-avoidance provisions of s.87 TCGA and s.731 ITA will not in principle apply on payments to beneficiaries outside the scope of CGT and IT.

52.16 UK settlor; UK/foreign beneficiaries

Where there is a mixture of UK and non-UK beneficiaries I suggest the starting point is that one would expect the settlor to make their trust here, so a transfer to foreign trustees would be regarded as avoidance. (In such a case there is something to be said in income tax terms for the creation of two separate trusts for two separate classes of beneficiaries, the residents and the non-residents, so one at least qualifies for the motive defence. But CGT considerations point the other way.)

52.17 Trust transfer; settlor beneficiary

52.17.1 *Remittance basis settlor-beneficiary*

The next case concerns a remittance basis taxpayer settlor who transfers assets to a non-resident trust under which they are the principal beneficiary.

Income tax is not avoided since trust income continues to be taxed on a remittance basis under s.624 ITTOIA. There may be an IT reduction after the death or exclusion of the settlor but it will not (normally) be the purpose (or even one of the purposes) of the settlor to obtain that (normally very long term) advantage, quite apart from the question of whether the advantage is avoidance or mitigation.

There is in principle a CGT advantage in that the settlor moves from the remittance basis to the s.87 capital payment remittance basis. To obtain that advantage may well one of the purposes of the trust. If so, is it CGT "avoidance"? It must have been a decision of parliament *not* to apply s.86 TCGA to a foreign domiciled settlor and the decision was confirmed in 2008 (where a proposal to extend s.86 to foreign domiciled settlors was contained in FD Draft Clauses (January 2008) and dropped in the Finance Bill). It is suggested that there is no CGT "avoidance". This is a "statutory invitation" in plain terms.

52.17.2 *Non-resident non-dom settlor-beneficiary*

Where the settlor is the principal beneficiary and neither domiciled nor resident then UK tax saving is not likely to be a purpose during the life of the settlor, because no saving in fact arises. After the death of the settlor there may be a saving if there are UK beneficiaries. The position then becomes like that of a trust where the settlor is excluded, and the discussion above is relevant.

52.18 Appointing non-UK trustees

Similar principles apply. One case is where the settlor and beneficiaries are wholly UK based, the settlor has created a UK trust, and foreign trustees are later appointed. The inference that the appointment has the purpose of saving UK income tax or CGT is very strong and this purpose is avoidance, not mitigation.

At the other end of the scale is the case where the settlor and the principal beneficiaries have gone to live abroad permanently and local trustees are appointed. One reason for the export of the trust is that the settlor may (or may continue to be) a trustee. If so, the appointment may have no tax saving purpose at all. But if (as is likely) it has a tax saving purpose, that is mitigation and not avoidance.

What if all the beneficiaries are abroad but the settlor remains in the UK? The same tax savings could in principle be had by winding up the trust with outright appointment to beneficiaries, and that transfer is not likely to constitute avoidance. So the appointment of foreign trustees should not be avoidance.

What if the settlor goes abroad and the beneficiaries remain in the UK? It is tentatively suggested that a tax saving purpose (if it exists) is likely to be avoidance.

A more borderline case is where the settlor and beneficiaries go to live abroad for a medium term period (say five years[51]). Non-UK resident trustees are appointed with the intention that the trust will continue to be non-resident even after the settlor returns to the UK. This is probably to be classified as tax avoidance, albeit long-term tax avoidance, but views may differ, especially if the time spent abroad is longer than five years.

52.19 Trust transfer: IHT avoidance

52.19.1 *Situs change*

The transfer of money by a foreign domiciled individual from a UK bank to a foreign bank, in order to make the money excluded property, is an act of tax mitigation, not avoidance.[52] The same would apply if the transfer is made by trustees of a trust with a non-domiciled settlor. The same would apply to a sale of UK situate property and re-investment in non-UK situate property.

52.19.2 *Transfer to trustees*

The residence of trustees is almost wholly irrelevant for IHT.

A gift by a settlor to a trust from which they are excluded is mitigation of their own IHT[53] but it is also necessary to consider the IHT savings of trustees and beneficiaries.

If a foreign domiciled settlor gives, and the trustees retain, non-UK property, any IHT saving purpose which may exist is mitigation. This is so even if the beneficiaries are UK domiciled (so an absolute gift to them would have brought the trust property into the scope of IHT). Section 48 IHTA provides that foreign property in a trust made by a foreign domiciliary is excluded property. Any IHT advantage conferred by the trust, so far from being contrary to the evident intention of parliament, would appear to be in accordance with parliament's evident intention. The argument to the contrary amounts to an argument that the settlor has a duty to maximise IHT liabilities.[54]

[51] There is no particular significance in selecting five years as illustrative of a medium term period, but it is consistent with the CGT temporary non-residence rules; see 11.1 (Temporary non-residence).

[52] See *Beneficiary v IRC* [1999] STC (SCD) 134 at p.145.

[53] See 52.11.1 (No avoidance of settlor's tax).

[54] The avoidance/mitigation issue did not arise in connection with the gift to a trust in *Beneficiary v IRC*, because it was said that reducing tax was not a purpose in the mind of the transferor/settlor; though that seems implausible as it was a consideration for

A gift by a settlor to a trust from which they are not excluded, in circumstances where the settlor is anticipating becoming UK domiciled, is borderline. Section 48 IHTA makes it plain that such a gift carries substantial IHT advantages. But is it "contrary to the evident intention of parliament" to enjoy these advantages? The author tentatively suggests that such a gift should be regarded as IHT mitigation not avoidance. This is consistent with the rule that the GWR provision does not apply here.[55]

For transfers before 27 March 1974 it would be necessary to consider estate duty.

52.20 Transfer: Non res/dom Individual to offshore co

Suppose a non-resident non-dom individual transfers UK assets to a non-resident foreign incorporated company. In principle the individual enjoys two tax advantages:

(1) Obtaining IHT excluded property status
(2) Avoiding higher rates of income tax

Such transfers also give significant advantages which have nothing to do with tax. In particular, in the case of UK land, avoiding personal liabilities arising from direct ownership. In that case the transfer may be a commercial transaction, taking us to motive defence condition B.

Burns v HMRC held that this type of planning was avoidance. The judge started with examples of non-avoidance:[56]

> I would certainly accept that if a non-domiciled person arranged to hold foreign situs, rather than UK situs, assets, and then died, no tax advantage would have been sought.

The judge gives two examples:

> [1] Thus if a UK house was sold, and a French house purchased, that would simply be a case of genuinely changing the assets held, and were some [ToA] point to hinge on whether the change was effected for the purpose of avoiding UK tax, the answer would be that it was not.
> [2] And if UK bank deposits were withdrawn and deposits placed elsewhere, then again, that would be a pure investment switch, and not a step the purpose of which would involve the purpose of achieving a

his advisers, and the principal beneficiary was UK resident at the time; see [1999] STC (SCD) 134 at [145h] - [146].

[55] See 78.15 (Death: settled excluded property).

[56] [2009] UKSPC SPC00728 at [59].

> UK tax advantage.[57]

Example [1] is an easy one. Example [2] is less obvious, to say the least. However that may be, the judge considered that a transfer of UK land (here, farmland) to a UK company is different:

> Indirectly
> [1] retaining a UK real property, and
> [2] simply achieving the technical change in status by putting the property into a non-UK resident company
> in a case where one of the purposes is to achieve the potential Inheritance Tax advantage, implicit by effecting those steps, does seem to me to cross the border between mitigation and tax avoidance. This is because it has involved no real change of investment, as in the two previous examples, but the retention of the UK property, accompanied by a step to change the normal tax consequences of that. Thus where it is shown that the CTT or IHT considerations were one of the purposes of the transfer, or other where the appellants have not displaced the reasonable presumption that UK advantages were one of the purposes, I conclude that those purposes involve tax avoidance and not merely mitigation.[58]

Burns was a case of transferring a property already held to a company. Would the position be the same if the company was set up at the outset, the individual transferring cash to the company in order that the company purchases UK land from a third party? Discuss.

52.21 Transfer: Trust to underlying co

I use the term **"underlying company"** to mean a company wholly-owned by trustees, which holds beneficially what would in substance be regarded as trust assets, if one was allowed to pierce the corporate veil.

I assume that company is not UK resident.

[57] [Author's footnote] The purpose may well be to achieve a UK tax *advantage*; the correct point, and what the judge presumably meant to say, is that the purpose is mitigation not avoidance. The Commissioner has confused tax avoidance and tax advantage.

[58] [2009] UKSPC SPC00728 at [59]. See too *Estera Trust (Jersey) v Singh* [2019] EWHC 2039 (Ch), discussed at 2.5.5 (Practitioner/judicial views today), where a transfer to a Jersey holding company "could be regarded as aggressive tax avoidance, even though relatively unsophisticated in comparison with other notified avoidance schemes".

52.21.1 *Transfer: Commercial reasons*

Transfers to underlying companies arise in a wide variety of circumstances and may be made for the purpose of obtaining non-tax advantages:

(1) Advantages of trust administration:
   (a) Segregation of trust funds of trustee (or occasionally combining trust funds) for ease of management.
   (b) Avoiding conflict of law and other problems of trustees holding assets (especially land) in foreign jurisdictions. (The problem is most serious in civil law jurisdictions which may not understand or even recognise trusts, but problems could also arise in common law jurisdictions.)

(2) In the case of land (or other onerous property), avoiding personal liabilities of trustees arising from direct ownership.

(3) In the case of interest in possession trusts, to allow retention of income (to avoid distributing income to life tenant).

Purpose (1) is commercial: it arises in the ordinary course of managing investments. A transfer from trustees to a company is more often than not a commercial transaction, and for the motive defence one applies Condition B and not Condition A. Purpose (2) is rarer but certainly commercial when it occurs. Purpose (3) is not commercial. Where it is the policy of trustees that all its trust funds should be held in separate underlying companies,[59] the conclusion that the transfer has a commercial purpose seems factually likely. But if one is looking at New Condition B, the additional statutory requirements must be met, in particular, the trustees must carry on a business.

52.21.2 *Transfer for avoidance*

Transfer of UK assets[60] from trustees to an underlying company may offer significant tax advantages. It is a question of fact whether any of these advantages are purposes of the transfer and a question of law whether the

[59] The Edwards report suggests that 80–90% of Jersey trusts hold their assets through underlying companies: *Review of Financial Regulation in the Crown Dependencies* Cm 4109 (1998) para 12.5.2
http://www.archive.official-documents.co.uk/document/cm41/4109/4109-i.htm
Trusts managed in Switzerland generally use underlying companies for Swiss law reasons.

[60] Similar considerations apply to a transfer of foreign assets with a view to realisation and re-investment in UK assets.

purpose is avoidance or mitigation.

I begin with cases where s.624 ITTOIA does not apply. There are three possible tax advantages.

(1) Obtaining IHT excluded property status (non-dom settlor)

In *Rialas v HMRC*[61] a non-UK domiciled individual arranged a trust/underlying company structure, in 2005, to hold a company. This was said to be IHT avoidance:[62]

> 85. [The taxpayer] argued that even though Mr Rialas had sought to protect his estate from Inheritance Tax what Mr Rialas had done was not tax avoidance because he had merely taken advantage of an opportunity which had been intended by Parliament by inserting a non-resident trust[63] between himself and his UK assets.
> [The taxpayer] attempted to reinforce this argument by referring us to [the IHT residence-property code, inserted in 2017] ...
> 86. By this provision, he argued, Parliament had, by implication, intended that excluded property relief was available as long as the UK property in question was not UK residential property. In this way, what Mr Rialas had done was within an exemption intended by Parliament and was not therefore tax avoidance.
> 87. This was an interesting argument, but it does of course refer to a legislative change made in 2017, when the position regarding non-domiciled individuals had been changed dramatically as well as a number of other related changes.[64] We cannot therefore regard it as showing anything other than the fact that, in 2017, in the context of a very different tax environment for non-domiciled individuals, Parliament decided not to deny excluded property relief for UK property held via a non-resident trust other than where the property was UK residential property.
> 88. We therefore agree with [HMRC] that the interposition of a non-resident trust between Mr Rialas and UK property, did have a tax avoidance motive.

[61] [2019] UKFTT 520 (TC). The motive defence point was (rightly) not raised in the subsequent appeal.

[62] IT/CGT avoidance was more likely, as the company qualified for BPR; but the case does not mention that.

[63] Author's footnote: Slightly disconcertingly, the passage twice refers to a non-resident trust, though what gave the IHT advantage was the underlying trust company; but nothing turns on that.

[64] The "other related changes" are presumably the protected-trust regime.

It is correct that the intention of parliament in 2005 should not be ascertained by reference to tax reforms in 2017.[65] But what if the same transactions were carried out post-2017? Has the intention of parliament now changed?[66] The taxpayer has some good points to make:

(1) The principle that companies are not transparent for tax purposes is very deep in the tax system.[67]

(2) The planning is long-established in practice.

(3) The transfer to a company has likely CGT disadvantages,[68] and possible income tax disadvantages,[69] so any IHT saving may be regarded as part of a "package deal", with advantages and disadvantages. This does not savour of tax "avoidance".

(4) As noted in *Rialas* in the enactment of the IHT residential-property code, restricted to residential property, parliament chose to acquiesce to similar arrangements for non-residential property.[70]

The difficulty with the third argument, it seems to me, is that it assumes a level of coherence in UK tax law which does not exist (and never has, and never will). At some time the point may come to be judicially considered at a higher level, and in more depth, but *Burns* has now been unchallenged for so long that the outcome is likely to be the same.

(2) Avoid additional rate IT on UK source income of discretionary trust

In editions of this work up to 2020/21 I said:

> The striking thing about this tax is that there is generally[71] no effective method for HMRC to collect it and in practice no one expects it to be

[65] See 31.37 (Time to ascertain intention of parliament: Change in law).

[66] See 82.22 (IHT residence code: Critique).

[67] See App. 7.12 (Pierce corporate veil/facade).

[68] See 61.55 (Trust holding company).

[69] Loss of tax credits and double taxation relief; sometimes, possible charge under income tax benefit in kind rules.

[70] In *Mehjoo v Harben Barker* CGT planning involved converting UK registered shares to bearer shares and removing them from the UK, in order to make then non-UK situate. That was described (in a passing comment) as tax mitigation, not avoidance: see [2013] EWHC 1669 (QB) at [447] (the point was not considered on appeal). The subsequent decision to legislate on bearer shares for CGT but not for IHT also supports that view. But a stray comment in a case where the issue was not argued, or relevant, does not count for much.

[71] Except in the case of UK land.

> paid in cases where all the beneficiaries are outside the UK.[72] Perhaps this supports a conclusion of mitigation.

But the wide extent of mutual enforcement treaties now brings that into question.

(3) Avoid higher rate income tax on income of interest in possession trust
I suggest that a distinction should be drawn between UK resident life tenants (tax advantage is avoidance) and non-residents (tax advantage is mitigation). In many circumstances, however, non-residents do not pay income tax at the higher rate.

In *Burns v HMRC*:[73]

> I deal first with the feature of trying to cap the level of charge to income tax at the basic rate. This advantage seems to me to be in the category of tax avoidance. ... it seems to me to be difficult to argue that a transaction designed to reduce income tax by the mechanism of the transfer of UK property to a non-resident person (virtually a paraphrase of the [wording of s.720(1)]) is mere mitigation.

52.21.3 *Transfer by settlor-interested trust*

If the purpose of the transfer to an underlying company is to avoid a charge under s.624 ITTOIA, this is considered to be avoidance and not mitigation.

52.21.4 *Transfer of non-UK assets to underlying co*

When non-UK assets are transferred to an underlying company, the UK tax advantage may be less or nil or there may only be tax disadvantages in the loss of double taxation reliefs. In the absence of an intention to re-invest in the UK the purpose cannot as a matter of fact be a tax reduction purpose.

52.22 UK resident non-dom transfers to offshore co

Suppose a foreign domiciled UK resident individual transfers UK assets to a non-resident foreign incorporated company.

If a purpose was to reduce IHT, the transfer is considered to be IHT mitigation. A transfer to reduce income tax (because the company pays

[72] It is considered that non-payment is not in principle dishonest, and so not a fraud on HMRC, though this conclusion depends to some extent on the facts of the case.

[73] [2009] UKSPC SPC00728 at [58].

only basic rate income tax) is considered to be IT avoidance.

52.23 Transfer to UK resident foreign incorporated co

There are many reasons why assets may be transferred to UK resident foreign incorporated companies.

A foreign domiciliary starting a new UK resident company for trade or investment would prefer a non-UK incorporated company so as to own non-UK situate property. This is a commercial transaction and clearly satisfies Old Condition B. New Condition B is (almost) a dead letter,[74] but in an appropriate case there is a reasonable case that New Condition A (or A and B) is satisfied.

A foreign domiciliary (F) wishing to sell a UK unincorporated business may enter into an arrangement under which:

(1) F gives the business to a UK resident foreign incorporated company.
(2) F sells the company (not UK situate property).

If the purpose is to avoid CGT (by utilising CGT incorporation relief) then the claim for the motive defence is weak.

52.24 Transfer between trusts

There are many reasons why funds may be transferred between trusts. It is impossible to generalise as to whether such transfers are made for tax avoidance: one must look at the reason for the transfer.

One reason such transfers are made is where a single trust holds several sub-funds for different branches of a family. The transfer avoids the unfairness which arises under a single trust, that gains accruing to one share are taxable on a beneficiary of another share who receives a capital payment. It is considered that a transfer for this reason does not have the motive of CGT "avoidance".

52.25 Employee benefit trusts

Hoey v HMRC concerned a common-form contractor loan scheme:

> I ... regard the basic structure, of Contractors being employed by an umbrella company which then provides their services to the End Users, as being a perfectly reasonable commercial transaction. However, I regard the insertion of additional transactions, being the setting up of an umbrella company offshore, which makes payments to a trust, which

[74] See 52.6.3 (New Condition B).

> then makes interest free loans to the Contractors, with the expectation that those loans are never repaid, as constituting tax avoidance.[75]

That seems self-evident.

An offshore EBT set up by a UK resident employer is in principle a commercial transaction.[76] However it is more than incidentally designed for the purpose of avoiding taxation, and would not satisfy new condition B. A case of the kind which HMRC call "a normal commercial arrangement" should satisfy old condition B, on the grounds that it was not, *overall,* designed for the purpose of avoiding tax.

HMRC may not agree. Business Brief 18/11 floats the possibility of a s.731 charge on EBTs, without telling us much:

> **5.1.2 Benefit charge**
> Where the company, not the employee is the transferor the benefit charge may apply. The benefit charge matches any income arising within the Employee Benefit Trust with any benefits received by the employee. ... The benefit charge could, therefore, catch any income arising in the offshore Employee Benefit Trust if it is not caught by the income charge and there are actual distributions by the trustees which are not otherwise chargeable to Income Tax.

52.26 Associated operations: Introduction

The motive defence is relatively straightforward when there is a single transfer. It becomes more complicated if there are also associated operations to consider. It is necessary to consider the following cases:

Facts	**See para**
Transfer and associated operations all pre-2005	52.27
Transfer and associated operations all post-2005	52.28
Transfer is pre-2005 and the operation is post-2005	52.32

52.27 Pre-2005 associated operations

Section 739 ITA provides:

> (1) This section applies if all the relevant transactions are pre-5 December 2005 transactions.
> (2) An individual is not liable for income tax under this Chapter for the

[75] [2019] UKFTT 489 (TC) at [153]. HMRC might have cited *HMRC v Hyrax Resourcing Ltd* [2019] UKFTT 175 (TC) at [162] - [174] where (more or less) the same scheme was held to constitute avoidance.

[76] See 52.8.2 (Arm's length requirement).

> tax year by reference to the relevant transactions if the individual satisfies an officer of Revenue and Customs that condition A or B is met.
> (3) Condition A is that the purpose of avoiding liability to taxation was not the purpose, or one of the purposes, for which the relevant transactions or any of them were effected.
> (4) Condition B is that the transfer and any associated operations—
> (a) were genuine commercial transactions, and
> (b) were not designed for the purpose of avoiding liability to taxation.

Old Condition A refers to any "relevant transactions" and Old Condition B refers to "the transfer and any associated operations" (which comes to the same thing).[77] The transfer and associated operations in issue must each separately satisfy the motive test if the motive defence is to apply. One does not group the transfer and the associated operations together, and look for a single main purpose of the group.

52.27.1 *Operations subject to motive test: Critical operations*

The first task is to identify the associated operations to which the motive test must be applied. For pre-2005 transactions (which are not affected by the 2006 reforms) the statute refers to "*any* associated operations" but this is a reference only to associated operations as a result of which a charge arises under s.720 or s.731 ITA. That is, in other words, the associated operations which must be relied on in order to satisfy the conditions set out in those sections. That is, the transfer and operations as a result of which:

(1) (in any case) income accrues to the person abroad; and
(2) (a) (in a s.720 case) the transferor has power to enjoy; or
(b) (in a s.731 case) the individual receives a benefit, or income can be used to benefit them.

The INT Manual provides:

> **INTM602800 All relevant transactions post-4 December 2005 transactions** [Jul 2023]
> ...*Herdman* ... found that associated operations are in broad terms only

[77] Because the term "relevant transactions" is defined to mean the transfer and associated operations; see 48.12 (Why associated operations matter). The difference in the wording of old condition A and B is just a drafting quirk without difference in meaning.

taken into account in applying the purpose test if they involve avoidance and create either a new source of income or a new power to enjoy income.

I refer to an associated operation which meets these criteria as a "**critical operation**".

There may and generally will be other operations associated with the transfer, but unless they are critical operations they are irrelevant and should be ignored.

In *Herdman v IRC* 45 TC 394:

(1) T transferred shares to an Irish company (the person abroad) in consideration of an issue of new shares and a loan. This was an innocent transfer (the purpose was to avoid Irish tax).

(2) The company accumulated income. This was (arguably) an operation associated with the transfer, and the purpose was (then) regarded as UK tax avoidance.[78]

The motive defence was upheld. Lord Reid said:

> [1] It was admitted by Counsel that [what is now s.720] can only apply if [T] has "by means of" these operations "acquired any rights by virtue of which" he had "power to enjoy" this income during the relevant period. I think that Counsel was clearly right in making this admission.[79]
>
> [2] I cannot see how it can be said that [T] acquired any rights at all by means of these associated operations. By means of the transfer of the shares to the new company he acquired two rights. He acquired shares in the new company in the Republic and he became an unsecured creditor of that company for over £76,000. Neither right gave him any right in or to particular assets of the new company. The way in which that company dealt with its assets did not alter

[78] After *Willoughby* the purpose should be regarded as mitigation and not avoidance.

[79] Section 412 ITA 1952 then provided (so far as relevant):

"For the purpose of preventing the avoiding by individuals ordinarily resident in the UK of liability to income tax by means of transfers of assets by virtue or in consequence whereof, either alone or in conjunction with associated operations, income becomes payable to persons resident or domiciled out of the UK, it is hereby enacted as follows:- (1) Where *such an individual has by means of any such transfer, either alone or in conjunction with associated operations, acquired any rights by virtue of which he has ... power to enjoy ...* any income of a person resident or domiciled out of the UK ... that income shall, ... be deemed to be income of that individual ...."

> either of these rights. It may have made them more valuable and it may have made it easier for the company to pay its debts, but it did not change [T's] rights.[80]

Point [1] states the law (only critical operations need pass the motive test) and point [2] applies it to the facts of the case (the operations in that case were not critical).

The statement of law at [1] needs to be translated to reflect the revised statutory wording, which was recast in 1969, and rewritten in 2007, but the principle (that only critical operations need pass the motive test) survived the 1969 reforms.[81] Indeed, perhaps the principle was (slightly) more clearly stated under ITA than it was under ICTA, because of the words in s.739(2): An individual is not liable for income tax under this Chapter ... *by reference to the relevant transactions* if condition A or B is met. It is only the transactions *by reference to which the ToA provisions apply* which need to meet old condition A and B.

In *Carvill v IRC*:[82]

(1) T transferred assets to a Bermudian company (B Ltd) in exchange for its shares, so T was a majority shareholder in B Ltd ("the original transfer").
(2) T became a 100% shareholder in B Ltd by (a) purchasing shares from other shareholders and (b) B Ltd purchasing its own shares.
(3) B Ltd entered into arrangements to remunerate T via a personal services company and a brokerage sharing agreement.

Steps (2) and (3) were held not to be associated operations, but if they had been associated operations it would not have mattered as they were not critical operations. No income arose to B Ltd because of those operations and T did not acquire a power to enjoy because of them.[83]

HMRC accept this. RI 201 provides:

> The law was amended in 1969 following a decision of the Courts (in *IRC v Herdman* 45 TC 394) that only the transfer and any associated operations giving a power to enjoy at the outset were relevant for determining whether the terms of [the motive defence] were satisfied. The amendment to the legislation sought to bring all associated

[80] 45 TC 394 at p.413.
[81] See 52.28.1 (The 1969 reform).
[82] [2000] STC (SCD) 143 at [80]–[85], 75 TC 477 (Special Commissioners).
[83] See [81]-[83].

> operations into consideration when [the motive defence] was invoked. Because of doubts[84] expressed as to the effectiveness of this amendment, it has been the Revenue's practice in considering whether a defence under [the motive defence] is available to *consider only the transfer and any associated operations which directly establish a power to enjoy the income of the overseas person under any particular sub-head in [s 723 ITA].*

The last sentence goes too far and is not to be taken literally. Suppose:
(1) T transfers assets to a UK trust by an innocent transfer, and
(2) Foreign trustees are appointed (an associated operation)[85] for tax avoidance purposes.

It may be said that the associated operation does not establish a power to enjoy the income of the trust. But the associated operation is a critical one (since it causes income to accrue to the person abroad) so the motive defence does not apply.

Suppose:
(1) T transfers assets to a non-resident company in return for shares in that company ("the first transfer"). Suppose the first transfer is innocent (no tax avoidance purpose). Income accruing to the company is not caught by the ToA provisions as the motive defence applies.
(2) T transfers the shares in that non-resident company to a non-resident trust ("the second transfer"). The second transfer has a tax avoidance purpose.

The second transfer is an operation associated with the first. But that associated operation is not a critical operation. Income accrues to the non-resident company as a result of the first transfer. It does not accrue as a result of the first transfer in conjunction with associated operations.[86]

[84] "Doubts" seems a tendentious way to refer to a view based on a decision of the Special Commissioners from which the Revenue did not appeal; see 52.28.1 (The 1969 reform). But there it is.

[85] See 48.13.2 (Transfer to trust + trust migration pre-2006) and 48.13.4 (Transfer to co + co migration).

[86] Of course income arising to the trustees as a result of the second transfer is caught by the ToA provisions. The fact that the first transfer was innocent does not help. This is self-evident but if authority is needed see the decision of the Special Commissioners in *IRC v McGuckian* 69 TC 1. There was (wisely) no appeal on that point.

Take the same transactions, but assume that the first transfer (to the company) had a tax avoidance motive, and the second transfer (to the trust) was innocent. Income of the company is within the ToA provisions. The motive defence does not apply. It is not enough to find an innocent associated operation. Dividends from the company to its shareholders are caught since the income arises by virtue of the tainted transfer to the company and an associated operation (the dividends).

The INT Manual provides:

> **INTM602700 By reference to transactions** [Jul 2023]
> ...Taking each of the potential charges this can perhaps be summarised as shown below.
>
> **Income charge – power to enjoy**
> The transactions to be taken into account are
> [1] those that result in income becoming payable to a person abroad together with
> [2] those other associated operations, if different, which result in the individual having the power to enjoy the income.
>
> Income charge – receipt of/entitlement to capital sums
> The transactions to be taken into account are
> [1] those that result in income becoming payable to a person abroad, together with
> [2] those other associated operations, if different, which result in the individual receiving or being entitled to receive a capital sum.
>
> **Benefits charge**
> The transactions to be taken into account are
> [1] those that result in income becoming payable to a person abroad together with
> [2] those other associated operations, if different, which result in the individual receiving a benefit provided out of assets available for the purpose by reason of such transactions.
>
> From this it can be seen that in some instances the same transactions may result in income becoming payable and also give the power to enjoy the income, the entitlement to a capital sum, or result in receipt of a benefit. In other instances, there may be two sets of transactions, one leading to the income that becomes payable, the other to the power to enjoy, entitlement to capital sum or receipt of benefit. Whichever circumstance applies, the individual will need to have regard to all the transactions in showing how the particular test is met.
>
> In examining the actual conditions for exemption at INTM602760 onwards, it will be seen that there may also be further associated operations, apart from those described above, that fall to be taken into account in considering whether particular conditions are met. These further associated operations will need to be considered, for all transactions after 4 December 2005 following the changes introduced in the Finance Act 2006. Where that is the case, then the individual will need to satisfy HMRC in relation to all those transactions.

Although constructed differently, the pre-Finance Act 2006 legislation also took a transactional approach to the avoidance purpose exemption test. It required the individual to show that the conditions were met in relation to the transfer of assets, or associated operations, or any of them, or in relation to the transfer of assets and any associated operations. There is more about this at INTM602760 onwards, which consider the conditions for exemption.

Under the former legislation not every transaction will necessarily fall to be taken into account. Normally it will only be those that contribute to an outcome that falls within the conditions for a charge, such as those transactions which result in income becoming payable, or those which give the power to enjoy income, entitlement to capital sum or receipt of a benefit. For those that are within the provisions, the individual will be required to show that the conditions for exemption are met.

The principle that it is only transactions that lead to the particular outcomes which fall to be considered is demonstrated by the 1969 decision of the House of Lords in *Herdman v CIR* (45 TC 394). Although that case was on legislation (ITA 1952) constructed somewhat differently from that in ITA 2007 or ICTA 1988 the broad thrust of the principles demonstrated is the same as the approach set out in the bullets above.

In that case the Special Commissioner had found that a transaction which brought about income becoming payable to a person abroad, and which gave power to enjoy it, satisfied on the evidence available the conditions for exemption. There were however further transactions whose purpose would not have satisfied the test for exemption, but those transactions neither resulted in income becoming payable to a person abroad nor gave the individual any new or additional power to enjoy income. The House of Lords accepted the reasoning of the Court of Appeal in concluding that these additional transactions did not fall to be taken into account. Lord Chief Justice MacDermott in giving his decision, which was endorsed by the House of Lords, said (at pages 406/407) in commenting on and accepting the exposition given by counsel for the appellant:

> My reasons for this view may be enumerated as follows
>
> (I) The conditions which bring subsection (1) [ITA52/S412(1)] into force and make the income of the non-resident person chargeable as that of the individual concerned depend upon a true alternative, upon the effect of either (i) the transfer of assets alone or (ii) that transfer in conjunction with associated operations. If (i) applies (ii) does not.
>
> (II) If subsection (1) is brought into force by the transfer of assets alone, subsection (3) [the motive defence] must be applied accordingly and so that the taxpayer will escape from liability under subsection (1) on proving that the purpose of the transfer was not tax avoidance. In such a case any operation which is an "associated operation", in the sense of being within the definition in subsection (4), will fall outside subsection (1) and outside subsection (3) as well.

He went on to expand his reasoning into the facts of the particular case which indicated the extent of the transactions that resulted in income becoming payable and the individual having the power to enjoy that income. No other transactions fell to be considered.

> HMRC confirmed the use of this principle in a Tax Bulletin article in 1999 in relation to the 'power to enjoy', saying that, "it has been the Revenue's practice in considering whether a defence under section 741 [ICTA 1988] is available to consider only the transfer and any associated operations which directly establish a power to enjoy the income of the overseas person under any particular sub-head in section 742(2) [ICTA 1988]".
>
> But there are some instances within the specific conditions where a wider approach is required and individuals will need to take this into account in providing the information required about transactions in their tax returns.
>
> Specifically, FA 2006 introduced a new provision ITA07/S737(8) which will be considered further in the detailed conditions. This means that the individual may now have to disclose to HMRC additional associated operations which may not result in outcomes that meet the requirements for a charge. This is because the new provision reversed the principle in Herdman - for transactions taking place on or after 4 December 2005. It is important therefore that the individual, who is seeking to show that the conditions for exemption are met, properly identifies all the transactions that must be taken into account and provides the appropriate facts about each.

52.28 Post-2005 transfer + associated operations

It is quite common that a transfer is made by a foreign settlor for foreign beneficiaries, for unimpeachably non-UK tax reasons, and later some of the beneficiaries move to the UK. Then they will find the trust qualifies for the motive defence and is a useful vehicle for income tax purposes. There are three possibilities:

(1) The change of purpose may be accompanied by a new transfer of assets carried out for a tax avoidance purpose. In that case the transfer of asset provisions may apply in relation to the new transfer.

(2) There may be no further transfer of assets but there may be associated operations carried out for a tax avoidance purpose. The question then is whether this brings the transfer of asset rules into operation

(3) There may be a change of purpose without any new transfer or associated operation. In that case the motive defence remains available and the transfer of assets provisions do not bite at all.

52.28.1 *The 1969 reform*

To understand the current law, it is necessary to know its history. We start in1969, when the first attempt at reform was made. Harold Lever (then Financial Secretary to the Treasury) argued:

> If we are to have a section [720 ITA], it has to bite on all settlements abroad which at any time are used for avoidance of tax even though

> originally started for innocent purpose. Supposing a man has transferred money to set-up a Bible society in Bulowayo and his heir being more sophisticated and perhaps more materialistic, finds himself with a settlement set up for unimpeachable purposes and decides that it would make a useful vehicle for the avoidance of all income tax and surtax. The *Herdman* decision meant that section [720] would not prevent this. Clause 27 [FB 1969] therefore knocks out the *Herdman* decision and I think that the hon. and learned Gentleman would be fair enough to say that that is reasonable.[87]

The example is facetious (Lever was known for his wit). The common (if less exotic) example is that:

(1) a settlement is set up by a foreign settlor for foreign beneficiaries; and
(2) subsequently beneficiaries or settlor come to the UK.

If this was not envisaged at the time of the settlement, HMRC must concede that the original transfer satisfies the motive defence. Nothing that happened later would alter that defence. So, as Morritt LJ commented in *IRC v Willoughby* 70 TC at p.97:

> In the FA 1969, legislation was enacted, s.33, to nullify the [Herdman] decision ... on the point.

However, the Special Commissioners rejected this in an unreported decision.[88] Thus the 1969 Act failed to achieve its intention.

52.28.2 *The 2006 reform*

HMRC tried again in what I call **"the 2006 reform"** (it was introduced by FA 2006, though with effect from December 2005). Section 737(8) ITA provides:

> If—
> (a) apart from this subsection, an associated operation would not be taken into account for the purposes of this section, and
> (b) the conditions in subsections (2) to (4) [New Conditions A and B] are not met if it is taken into account, because of—
> (i) the associated operation, or
> (ii) the associated operation taken together with any other

[87] Hansard, 17 July 1969, cols 955–6.

[88] If any reader could supply a copy, it would be interesting to see it; though unreported Special Commissioner decisions cannot be cited as precedents: *Ardmore v HMRC* [2014] UKFTT 453 at [9] - [23].

> relevant transactions,
>
> it must be taken into account for those purposes.

The INT Manual provides:

> **INTM602800 All relevant transactions post-4 December 2005 transactions** [Jul 2023]
>
> ...The provisions reverse the effect of *Herdman* (INTM602640) which found that associated operations are in broad terms only taken into account in applying the purpose test if they involve avoidance and create either a new source of income or a new power to enjoy income. The new provision requires all associated operations with an avoidance purpose to be taken into account when applying the exemption test.
>
> In the past, structures such as family trusts were sometimes transformed into avoidance vehicles, with the associated operations carefully designed so that they could not be said to create new income flows or new power to enjoy income. The tax planners contended that HMRC could not apply the legislation against these structures even though they were clearly abusive.

The language is reminiscent of Harold Lever's comments in 1969.

EN Draft Clauses (2005) explained:

> certain associated operations that might potentially be disregarded when applying the [pre-2005 motive defence] have to be taken into account for the purposes of the new test. These are associated operations that have an avoidance purpose, but might not directly affect the application of the charging provisions.[89]

A post-4 December 2005 transfer which qualifies for the motive defence loses that defence if:

(1) there is an associated operation;

(2) that operation does not satisfy New Condition A or B.

Trusts and companies which qualify for the motive defence must ensure that from 5 December 2005 any acts by them meet Condition A (or Condition B if relevant). In short, they should not make associated operations which might be regarded as having a tax avoidance purpose.

[89] Para 62.The explanation in EN FB 2006 is more curtailed. The provision alters the former law. EN Draft Clauses (2005) claimed (outrageously) that this change was "clarifying and confirming the correct interpretation of the existing statute" but that was inconsistent with RI 201, and EN FB 2006 more or less abandoned that position; see App.1.2 (Clarify/modernise/reform).

It is important that new associated operations do meet the New Conditions. The effect of the rules may be harsh.

These conditions are extremely difficult to apply; this may be why almost 40 years passed before the second attempt to alter law established in 1969. The Blair/Brown administrations, it seems fair to say, were unaware or unconcerned about uncertainty and complexity in tax legislation, particularly anti-avoidance legislation.

52.28.3 *Clean break test*

The first task is to identify the associated operations to which the motive test must be applied. For post-2005 transactions the statute refers to "*an* associated operation" and it is clear that some operations which are not critical operations (under the old law) are now made subject to the motive test.

The task is to identify what counts as "an associated operation" for the purposes of s.737(8) ITA. The statutory definition of associated operation does not answer this as if it is read literally it is far too wide to be workable. Suppose in 1096 a Crusader transferred land to trustees to avoid feudal duties, and in 2000 the land is again transferred to trustees. The 1096 transfer is an operation historically associated with the 2000 transfer.[90] It cannot be that the Crusader's (arguable)[91] tax avoidance purpose would prevent the transfer in 2000 from qualifying for relief!

There must obviously be some connection between the associated operation and the transfer: mere historical association cannot be enough.

It is suggested that the courts ought to impose a clean break test.[92] One might refer to associated operations where there is no clean break as **"truly associated"**. In this terminology, truly associated operations must satisfy new conditions A and B, in order to qualify for the motive defence, and the effect of the 2006 reform is to extend the motive test from critical operations to truly associated operations. But the expression "associated operations" is sufficient because where there is a clean break the operations should not be regarded as associated for the purposes of the

[90] See 48.11 (Associated operation: definition).

[91] Feudal duties would be "taxation"; see 52.9 (Meaning of "taxation"). I forbear to consider the question whether it would be reasonable to assume that the 1096 transfer was avoidance, or mitigation, of feudal duties (and would that depend on attitudes to taxation in the Middle Ages or contemporary attitudes?).

[92] See 48.13.1 (A transfers to B + B to C: clean break test).

ToA rules.

52.29 Associated operations: Avoidance purpose

Note the extreme consequences of an associated operation motivated by tax avoidance. Even if the associated operation concerns only a small amount, the *entire* trust[93] may lose the benefit of the motive defence. This unfairness ought to colour the approach of the courts to construing the section.

52.29.1 *Investment transactions*

Buying and selling investments in the ordinary course of managing investments is not tax avoidance.

Suppose trustees wish to invest in UK equities, but do so via a UK unit trust or OEIC in order to hold property which is excluded property for IHT. The acquisition of a unit trust or OEIC is not tax avoidance. It is considered that the position is the same if the trustees acquire a non-UK unit trust or OEIC to avoid UK source income.

Suppose a trust, all of whose beneficiaries are abroad, wishes to invest in UK (non-residential) land. The trustees invest via an underlying company in order to avoid inheritance tax and reduce tax on the property income from the trust rate to the basic rate (pre 2020) or the CT rate (post 2020). It is suggested that this is mitigation rather than avoidance. If this is not the case, then the effect on the UK economy could be quite remarkable. Well-advised trustees would avoid investing in UK land in order to retain the motive defence. On the other hand, if land was purchased using an artificial SDLT avoidance scheme, that would be caught. The transfer of existing land to a company would be caught.

52.29.2 *Methods of distribution*

It is considered that retention of income within a company is not an "operation" but even if it is, it would not constitute tax avoidance.

It is considered that accumulation of income in a common form discretionary trust[94] is not an "operation" but even if it is, it would not be tax avoidance.

[93] More accurately, the entire transfer of assets abroad; but it will normally come to the same thing.

[94] A trust to accumulate income with power to distribute. Under a trust to distribute with power to accumulate, accumulation would constitute an "operation". But that is not the usual form.

Suppose a discretionary settlor-interested trust is within the motive defence, and the settlor is UK resident. The trustees retain trust income abroad (if it was remitted to the UK there could in some cases be a tax charge under the s.624 remittance basis). This is not tax avoidance.[95]

Suppose a discretionary trust is within the motive defence. A foreign domiciled beneficiary is UK resident. Trustees may in principle transfer funds to a beneficiary in the following ways:

(1) Outright distribution:
    (a) Distribution of trust capital
    (b) Distribution of trust income (which may be generated by a distribution from an underlying company)
(2) Loan (interest-free or on favourable or arm's length terms)

These options have different tax consequences but each of them are straightforward everyday methods of transferring funds from the trust to a beneficiary. None are tax avoidance which could cause the motive defence to be lost. There is no reason to say that any of them are "contrary to the intention of parliament".[96] This is so even if, for instance:

(1) A capital distribution is chosen in order to avoid an IT charge on an income distribution
(2) A loan on arm's length terms is chosen to avoid an IT/CGT charge on a capital payment
(3) A dividend is paid and accumulated by trustees, and the shares in the company (devalued by the dividend) are distributed to a beneficiary without a gain accruing on the disposal of the shares.

This is not to say that a loan or trust/company distributions cannot constitute avoidance. But they would have to be part of some wider arrangement. Examples are:

(1) Loans:
    (a) Trustees lend unsecured to a beneficiary in circumstances where the beneficiary is insolvent or so lacking in assets that the beneficiary is not likely to repay the sum lent.[97]

[95] See 18.55 (Remittance basis planning). The point is less likely to arise under the protected-trust regime, but it still matters for the past.

[96] Contrast the GAAR guidance that "trustees are entitled to organise distributions in a way that minimises tax for the beneficiaries within the range of normal tax planning"; see 61.57 (GAAR guidance).

[97] See 3.21.2 ("Artificial/devices"). Alternatively the loan in such a case may be categorised as an outright distribution.

(b) The borrower is told that a loan repayment is not going to happen in practice.[98]

(2) Trustees exercise a power to accumulate income, and then immediately exercise a power to distribute it as capital, in circumstances where the straightforward course would be to distribute as income.[99]

(3) A shareholder sells the right to a dividend to a non-resident for a capital sum.[100]

Suppose a non-resident company owned by a non-resident individual pays a large dividend the year before the individual becomes UK resident.[101] That is not tax avoidance. But if the individual lends the proceeds back to the company, interest free, that is a circular and artificial transaction, and the arrangement may be regarded as avoidance.[102]

52.29.3 *Inter-group transactions*

It is helpful to refer to the whitelist of transactions which HMRC accept

[98] Contractor loan schemes offer an example. In *HMRC v Hyrax Resourcing* [2019] UKFTT 175 (TC) scheme documentation was frank:

> "Do I have to repay the loan? In practice, extremely unlikely. Nearly 25,000 businessmen and contractors have used this mechanism and on-one has yet had to repay it. However, there needs to be the POSSIBILITY of repayment, otherwise it would not be a loan". See [162] - [178].

But many other facts in *Hyrex* also supported the conclusion of avoidance. See too 52.25 (Employee benefit trusts).

[99] Alternatively the distribution may in fact be categorised as income.

[100] *McGuckian v IRC* 69 TC 1 at p.81: "It is now necessary to consider how the composite transaction should be categorized. The declaration of the dividend was an ordinary commercial decision. But the other steps-the assignment [of the right to a dividend to the purchaser], the payment [of the dividend to the purchaser] and the payment [of the purchase price by the purchaser to the shareholder]—were not taken for any business or commercial reason. Those steps were taken in order to avoid tax. I would respectfully differ from the conclusion of Sir Brian Hutton LCJ and Carswell LJ. that the assignment was "the whole substance and raison d'etre of the transaction". Like Kelly LJ I am satisfied that the assignment was merely a means to an end, a step taken in an attempt to achieve the payment [to the shareholder] as capital. Tax avoidance was the only conceivable explanation for the assignment."

[101] It is assumed that the temporary non-resident rules do not apply.

[102] Transactions in securities would also need consideration; see 55.1 (Transactions in securities).

as outside the SDLT group relief TAAR.[103] SDLT Manual provides:

> **SDLTM23040 Para 2(4A) Sch 7 FA 2003** [Nov 2019]
> ... This guidance gives some examples of transactions where it is accepted that group relief is not denied by Para 2(4A) Schedule 7 FA 2003.
> It should be noted that the examples are intended only to give general guidance and do not use technical or statutory language, nor should they be interpreted as if they were a statute.
> They also assume that the transactions described do not form part of any larger scheme or arrangement which might have tax consequences....
> **Examples of transactions where group relief is not denied by Para 2(4A) Schedule 7 FA 2003[104]**
> (1)-(3): The transfer of a property to a group company having in mind:
> (1) the possibility that shares in that company might be sold more than three years after the date of transfer
> (2) the possibility that shares in that company might be sold within three years of the date of transfer, with a consequent claw-back of group relief, in order that any increase in value of the property after the intra-group transfer might be sheltered from SDLT
> (3) the possibility that either of the above might occur
> (4) The transfer of a property to a group company prior to the sale of shares in the transferor company, in order that the property should not pass to the purchaser of the shares
> (5)(6)(10) The transfer of property to a group company in order that:
> (5) commercially generated[105] rental income may be matched with commercially generated losses from a property income business
> (6) commercially generated[106] chargeable gains may be matched with commercially generated allowable losses
> (10) The transfer of property to a group company in order that interest payable on borrowings from a commercial lender on ordinary commercial terms may be set against commercially generated* rental income
> (7) The historic transfer of property to a non-resident group company in the

[103] Para 2(4A) Sch 7 FA 2003 provides:

> "Group relief is not available if the transaction—
> (a) is not effected for bona fide commercial reasons, or
> (b) forms part of arrangements of which the main purpose, or one of the main purposes, is the avoidance of liability to tax.
> "Tax" here means stamp duty, income tax, corporation tax, capital gains tax or [SDLT]."

[104] I have reformatted and amended slightly for greater clarity.

[105] Footnote original: Including income, gains and losses which are generated intra-group on transactions which would have been commercial had they been entered into by unconnected third parties.

[106] See above footnote.

anticipation that future appreciation or depreciation[107] in value would be outside the scope of UK tax on chargeable gains

(8) Transactions undertaken as part of a normal commercial securitisation

(9) The transfer of the freehold reversion in a property to a group lessee in order to merge the freehold and the lease, and thus prevent the lease being subject to the wasting assets rules as respects corporation tax on chargeable gains

(11) Borrowings on ordinary commercial terms

(a) from a commercial lender, or

(b) intra-group in circumstances which would have been commercial had they arisen between unconnected third parties

"Transfer" means the transfer of a freehold, in Scotland ownership of land, or the assignment, in Scotland assignation, of a lease.

Cases involving the grant of a lease will need to be considered on their facts.

The list provides examples of where, although a tax advantage might be obtained by the purchaser's group, SDLT group relief will not be denied subject to the warning that 'the transactions do not form part of any larger scheme or arrangement which might have tax consequences'

In determining whether the transaction forms part of arrangements of which the main purpose, or one of the main purposes, is the avoidance of tax, it is necessary to consider relevant case law.

Whether or not a sequence of steps constitutes avoidance is also informed by FA 2003 sections75A to 75C. HMRC Stamp Taxes acknowledge that deciding to sell shares rather than land so as to pay less tax or SDLT (see paragraph D2.2.1 of HMRC's General Anti-Abuse Rule Guidance as approved by the Advisory Panel with effect from 15 April 2013) represents a straightforward legislative choice and is not, of itself, objectionable.

HMRC approach

The HMRC aim is to give a consistent message to all taxpayers. Where it is possible to identify fact patterns that do not fall within the scope of the TAAR and therefore do not present a risk, HMRC are happy to make this clear. The current guidance including the list of transactions where group relief would not be denied continues to reflect HMRC position. However, there are, as always, a number of events involving a transaction for which group relief may be claimed and which HMRC may wish to raise an enquiry. In any case where an avoidance scheme is disclosed or there is evidence suggesting the implementation of an avoidance scheme, HMRC will raise an enquiry.

To promote greater certainty in HMRC Stamp Taxes approach in the application of FA 2003 Schedule 7 paragraph 2(4A)(b), HMRC Stamp Taxes confirmed the following, with the warning that the presence of steps in addition to those described below may indicate, when taken together, that there are arrangements of which the main purpose or one of the main purposes is avoidance of tax:

[107] Author's footnote: At first sight the reference to depreciation seems strange. Perhaps the point is that the transfer is part of a package, with tax advantages (in the appreciation in value not taxed) and disadvantages (no relief for depreciation).

> A business may choose to acquire a property-owning company as opposed to acquiring the property from that company.
>
> The purchaser may, after acquiring the company, transfer the property out of the company acquired and into a different company in the purchasing group. HMRC do not regard that of itself, and subject to the list of transactions above, as resulting in the avoidance of tax such that FA 2003 paragraph 2(4A)(b) would be in point, even if the acquisition of the property-owning company and the subsequent intra-group transfer of the property formed part of the same arrangements.
>
> The purchaser may, after acquiring the company and transferring the property intra-group, liquidate, wind-up or strike-off the company acquired. HMRC do not regard that of itself as resulting in, or being evidence of, the avoidance of tax such that FA 2003 paragraph 2(4A)(b) would be in point, even if the liquidation, winding-up or striking-off formed part of the same arrangements that also included the acquisition and the intra-group transfer.
>
> In the events described above, the FA 2003 paragraph 2(4A)(b) analysis would be the same even if the purchaser only became a member of a group for SDLT purposes as a result of the acquisition of the property-owning company.

It is difficult to take item (7) seriously, but even apart from that, it appears that HMRC do not strain to classify a group's ordinary tax planning as avoidance.

52.30 Income after tainted operation

Where there is a tainted operation associated with a transfer, all the income arising as a result of the transfer in principle comes within the scope of ss.720 and 731. If there is an innocent transfer of £10m, and a tainted operation of £10,000, all the income of the £10m comes into charge.

HMRC may not in fact take that view. The INT Manual provides:

> **INTM602800 All relevant transactions post-4 December 2005 transactions** [Jul 2023]
>
> Where a structure meets the requirements for exemption and an associated operation involves only a minor element of avoidance, if the associated operation producing 'tainted' income is only a small proportion of the income of the total structure, it may be appropriate to charge only the income from the 'tainted' source, thus applying the legislation in a proportionate way (see INTM602860).

52.30.1 *Partial exemption relief*

Section 741 ITA provides a very limited relief:

> (1) Section 742 (partial exemption where later associated operations fail

> conditions) applies if—
> (a) an individual is liable to tax[108] because of section 720 or 727 for a tax year (the "taxable year") because condition B in section 737(4) (genuine commercial transaction: post-4 December 2005 transactions) is not met, and
> (b) subsections (2) and (3) apply.

The relief only applies for s.720 (and 727) and not for s.731 ITA.

Section 741 continues:

> (2) This subsection applies if—
> (a) since the relevant transfer there has been at least one tax year for which the individual was not so liable by reference to the relevant transactions effected before the end of the year, and
> (b) the individual was not so liable for that year because—
> (i) condition B in section 737(4) was met, or
> (ii) condition B in section 739(4) (genuine commercial transaction: pre-5 December 2005 transactions) was met.

The relief only applies if Condition B is satisfied; not if Condition A is satisfied. In practice New Condition B is hardly ever satisfied.

Section 741 continues:

> (3) This subsection applies if the income by reference to which the individual is liable to tax for the taxable year is attributable—
> (a) partly to relevant transactions by reference to which one of those conditions was met for the last exempt tax year,[109] and
> (b) partly to associated operations not falling within para (a).

Assuming the conditions of s.741 are satisfied one moves on to the relief in s.742:

> (1) If this section applies, the individual is liable to tax under this

[108] "Liable to tax" is defined in s.741(5) ITA:
"References in this section to a person being liable to tax for a tax year because of section 720 or 727 include references to the individual being so liable had any income been treated as arising to the individual for that year under section 721 or 728."

[109] Defined in s.741(4) ITA:
For the purposes of this section a tax year is exempt if—
(a) it is one of the tax years mentioned in subsection (2), and
(b) there is no earlier tax year for which the individual was liable to tax because of section 720 or 727 by reference to the relevant transactions or any of them.
...

> Chapter only in respect of part of the income for which the individual would otherwise be liable.
> (2) That part is so much of the income as appears to an officer of Revenue and Customs to be justly and reasonably attributable to the operations mentioned in section 741(3)(b) in all the circumstances of the case.
> (3) Those circumstances include how far those operations or any of them directly or indirectly affect—
> (a) the nature or amount of any person's income, or
> (b) any person's power to enjoy any income.

The drafter has given up here. Draft ToA guidance INTM602880 has an example, not set out here, as it raises more questions than answers.

52.31 Income before tainted operation

This section considers how the ToA provisions apply where an innocent post 4-December 2005 transfer is followed by a tainted operation subsequently.

The position where a pre-5 December 2005 transfer is followed by a tainted operation on or after 5 December 2005 raises additional issues discussed at 52.32 (Pre-2005 transfer; post-2005 operation).

52.31.1 *Income pre-tainted op: s.720*

Suppose:

(1) an innocent transfer is made on or after 5 December 2005, and
(2) an associated operation made today fails the New Conditions ("the tainted operation").

At first sight *all* income back to the date of the transfer comes into charge under s.720 ITA.[110] HMRC say that only income of the year in the year of the tainted operation and subsequent years is charged:

> **Transitional arrangements, whether income charged retrospectively**
> Representation: It is suggested that the transitional arrangements of [s.740 ITA] have the effect that income could be brought into charge retrospectively. [Section740(4) ITA] could be interpreted as meaning that if an associated operation after 5 December 2005 fails the exemption test in [s.737 ITA], all of the income arising from 5 December 2005 could be charged (even where the subsequent associated

[110] In practice HMRC would be limited to a four year period.

operation takes place many years later).
Response: The legislation does not apply retrospectively in the manner suggested. [Section741C ICTA][111] provides the general rule that [s.720] applies in this type of case as it would apply apart from [s.736 to 742 ITA]. In those circumstances [s.720] would take the income arising in the relevant year of assessment.[112]

This is far from clear in the legislation, but it is a sensible result.

52.31.2 *Income pre-tainted op: s.731*

Suppose:
(1) An innocent transfer was made on or after 5 December 2005.
(2) A tainted associated operation is made subsequently.
(3) An individual receives a benefit in the same year as the associated operation or subsequently.

The individual is taxable under s.731 ITA by reference to all the income which has arisen backdated to the date of the transfer.

Suppose the order of transactions were reversed:
(1) An innocent transfer was made on or after 5 December 2005.
(2) An individual receives a benefit on or after 5 December 2005.
(3) A tainted associated operation is made in a tax year after the benefit is received.

That is, the benefit was received in the year before the tax motivated associated operation. Is the benefit retrospectively subject to tax? It is suggested that the answer is, no. This is consistent with how HMRC understand s.720 to work.

52.32 Pre-2005 transfer; post-2005 operation

Section 740 ITA provides:

> (1) This section applies if the relevant transactions include both pre-5 December transactions and post-4 December transactions.
> (2) An individual is not liable to tax under this Chapter for the tax year by reference to the relevant transactions if—
> (a) the condition in section 737(2) (exemption where all relevant transactions are post-4 December 2005 transactions) is met by

[111] Now s.740(3) ITA. The wording is not quite the same, but that has not altered the position.

[112] HMRC, Letter to representative bodies (7 April 2006).

reference to the post-4 December 2005 transactions, and

(b) the condition in section 739(2) (exemption where all relevant transactions are pre-5 December 2005 transactions) is met by reference to the pre-5 December transactions.

Thus in principle the New Conditions apply to post-4 December 2005 transactions and the Old Conditions to apply pre-5 December 2005 transactions.

An important question is whether the motive defence test must be met:

(1) by all truly associated operations; or

(2) only by critical operations (my terminology).

At first s.737(8) ITA appears to answer the question,[113] but it does not, because s.737(1) provides:

> This section applies if *all* the relevant transactions are post-4 December transactions.

It is suggested that the *Herdman* principle still applies to pre-5 December 2005 transfers even if the operation takes place subsequently. That is, even after 2005, only critical associated operations have to pass the motive test and other associated operations are ignored.

This view does not deprive s.740 ITA of meaning, for it governs the position where there are post-4 December 2005 critical operations. For instance, suppose:

(1) there was a transfer to a UK trust (an innocent transfer) before 5 December 2005;

(2) non-resident trustees are appointed (a critical association operation) post-4 December 2005.

In deciding whether the motive defence applies one asks whether the associated operation satisfies New Conditions A and B.

The position is not clear cut and HMRC could make the following points:

(1) Section 740(2)(b) incorporates s.737(2) the New Conditions A and B, but by doing so it necessarily incorporates s.737(3) to (7) which supplement s.737(2). So it is possible to say that s.740(2)(b) also incorporates s.737(8).

(2) The transitional rules in s.740, see below, arguably make better sense

[113] See 52.28.2 (The 2006 reform).

if s.727(8) is applied.

But the rules are so harsh that it is suggested that the taxpayer-favourable construction is to be preferred. ICAEW agree:

> 82. ... We appreciate that HMRC would like to interpret the FA 2006 legislation as reversing the decision in *IRC v Herdman* 45 TC 39 for both pre 5 December 2005 transactions and transactions on or after that date. This appears to be the line taken in the draft guidance.
> 83. We do not believe that it is correct technically as the FA 2006 modification to the legislation was only contained in the legislation for the new motive defence which should only be applied if the associated transfer is a relevant transfer and it is submitted that case law provides that where the original transfer occurred prior to 5 December 2005 it will be the *Herdman* principle that determines whether an associated transfer is a relevant transfer (that is whether the transfer has contributed to the charging provision conditions being met). In addition we view the HMRC interpretation as disproportionate and so there are EU law issues.[114]

52.32.1 *Transitional rule: s.731*

Section 740(3) ITA provides:

> If subsection (2)(b) applies but subsection (2)(a) does not, this Chapter applies with the modifications in subsections (4) to (6).

This brings in three transitional rules where:
(1) the pre-5 December 2005 transactions met the Old Conditions; but
(2) post-4 December 2005 transactions do not meet the New Conditions.

Section 740 ITA provides:

> (5) In determining the relevant income of an earlier tax year for the purposes of section 733(1) (see Step 4), it does not matter whether that year was a year for which the individual was not liable under section 731 because of section 739 or this section.
> (6) For the purposes of Step 1 in section 733(1), a benefit received by the individual in or before the tax year 2005–06 is to be left out of account.
> (7) But, in the case of a benefit received in the tax year 2005–06, subsection (6) applies only so far as, on a time apportionment basis, the

[114] Response to HMRC consultation "Transfer of assets abroad: draft guidance" (2013).

benefit fell to be enjoyed in any part of the year that fell before 5 December 2005.

HMRC supply a worked example, see 50.18.9 (Computation: Motive defence lost).

Suppose:

(1) An innocent transfer is made before 5 December 2005.
(2) A tainted associated operation is made on or after 5 December 2005.
(3) An individual receives a benefit in the same year as the associated operation or subsequently.[115]

The beneficiary is taxable under s.731 ITA by reference to all the relevant income from the date of the transfer (or from 1981, if later). This harsh rule was actually intended. EN FB 2006 para 33 provides:

> [The effect of s.740(5) ITA is:] for the purposes of [s.731 ITA] where the individual receives a benefit in a year of assessment ending after 5 December 2005, the process of determining relevant income under the general rule for years up to and including that year must take account of relevant income that arose in years of assessment ending before that date, as well as later years.

It will often be impossible for the quantum of relevant income to be ascertained exactly, as the records will not exist. But the issue may in practice be fudged by agreement with HMRC.

52.33 Tax return: Motive defence

52.33.1 *When disclosure required*

The motive defence does not require a formal claim. If there has been an innocent transfer, a taxpayer is entitled and indeed required to complete tax returns on the basis that the defence applies.[116]

However, individuals who complete a self assessment return need to indicate on that return if they have taken advantage of the defence. This is done by completing box 46 in form SA106 (Foreign pages, 2022/23). The rubric for this box (the "motive defence box") states:

> If you've omitted income from boxes 11, 13 and 42 because you're

[115] There is no charge if the benefit is received in a tax year before the operation: see 52.31.2 (Income pre-tainted op: s.731).

[116] See 52.36 (Motive defence: Disclaimer). See also 49.29 (Tax return: s.720 income) and 50.60 (Tax return: s.731 income).

> claiming an exemption in relation to a transfer of assets, enter the total amount omitted (and give full details in the 'Any other information' box on your tax return)

This relates to the two reliefs which the ITA describes as exemptions:[117] the motive defence, and the genuine transaction defence (now lapsed after Brexit).

It is only correct to put an entry in the box if the motive defence is needed. It is not correct to put an entry in the box if the ToA provisions do not apply to impose a charge for some other reason, such as s.720 protected-trust relief, or the s.720 remittance basis, because that is not an "exemption".[118]

It often happens that the motive defence box is left blank when it should be completed, as the need to do so in this "highly complex" area is overlooked. There is no penalty, provided the motive defence applies, as no additional tax is thereby due. It is suggested that an entry should be made in the box on the next tax return, with a note in the "Any other information" box to explain the position.

52.33.2 *What information is required*

Two items of information are required by the rubric to the motive defence box: the "amount omitted" and "full details". (The word "omitted" is somewhat tendentious*;* but perhaps it does not much matter.)

The "amount omitted" for a taxpayer within s.720 is the income of the person abroad, (ignoring unremitted foreign income if the remittance basis applies). For a taxpayer within s.731, the "amount omitted" is the lower

[117] Section 736(1) ITA provides: "Sections 737 to 742A deal with exemptions from liability under this Chapter."

[118] HMRC agree. SA106 Notes (2022/23) provides:

> "**Box 46 If you've omitted income from boxes 11, 13 and 42 because you're claiming an exemption in relation to a transfer of assets, enter the total amount omitted**
>
> Boxes 10 to 13 and box 42 do not apply as long as the purpose of the transfer and any associated operations was not to avoid tax. ... any income attributable to genuine transactions is exempt, where any liability imposed would constitute a restriction on the EU Treaty freedoms (for example, freedom of establishment or freedom of movement of capital).
>
> An exemption is only due if actual income would otherwise be chargeable."

HMRC practice (understandably) is not to investigate or provide a ruling on the motive defence, unless some tax turns on the issue.

of the value of benefits and relevant income (except so far as the s.731 remittance basis applies).

If it is difficult to ascertain the exact figure of "income omitted ", it seems to me reasonable to provide an estimate of s.720 income, or in a s.731 case, an estimate of the amount of the benefit but without quantifying the relevant income. The figure in box 46 is not a figure used in any tax computation. Its purpose is so that HMRC should know the amount at stake in the claim for the defence, and for this purpose a broad indication should be sufficient. If estimated figures are given, this should however be stated. If the person abroad is subject to CT or IT or foreign tax, that might be mentioned as it reduces the amount at stake.

SA106 Notes (2022/23) identifies the "full details" which are required:

> You must give details of
> [1] the assets transferred, and any associated operations,
> [2] the person abroad concerned,
> [3] the circumstances of the relevant transactions and
> [4] the basis of your claim
> in 'Any other information' on page TR 7 of your tax return or on a separate sheet.

On the occasion when the claim is first made, sufficient details should be given for HMRC to review the case, in that and in subsequent years until the motive defence claim is agreed. If and when the claim is agreed, I see no reason to give any details in subsequent tax returns (in the absence of further transfers or relevant associated operations). I suggest the words "n/r" be put in the motive defence box (or if the tax return software does not permit that, leave it blank) and note in the "Any other information" box that since the motive defence claim has been agreed, no figure need be provided in the return as it is irrelevant.

52.33.3 *HMRC response to claim*

RI 201 provides:

> Where such a disclosure has been made and the [motive defence] exemption claimed, the Revenue will make any necessary enquiries about that exemption in the statutory period allowed, and will not seek to reopen that year's return on discovery grounds if the [motive defence] exemption has to be reconsidered in later years.

International Manual explains HMRC's administrative arrangements for dealing with a claim:

> **INTM600050 Transfer of assets abroad: Mandatory referral to SPT Trusts & Estates Nottingham** [May 2020]
> Business Assets and International Technical and Valuation, Bootle is responsible for the operation of the legislation contained in Chapter 2 Part 13 ITA 2007, the provision of Technical Advice thereon and any litigation involving transfer of assets legislation.
> All enquiry work involving possible application of the transfer of assets legislation is undertaken by or in conjunction with the specialist team in WMBC Assets Edinburgh. Fraud Investigation Services and WMBC Wealthy Units also undertake review work in this area in relation to cases handled by them.
> The individual Self Assessment tax return will often be the first point of identification of cases where the legislation may apply, and as such those handling receipt of returns have a vital role to play in identifying potential application of this legislation. Offices should not however attempt to determine liability to the Income Charge or the Benefits Charge or discuss the application of the provisions with agents without first contacting Trusts Compliance, Edinburgh... who will arrange any necessary risk assessment of the case and advise on whether and how this aspect is to be taken forward.
> WMBC (Wealthy CCM teams) and Fraud Investigation Service offices do not have to make a referral of their own cases in accordance with the previous paragraph but should consult with BAI Technical and Valuation Team, Bootle for advice as necessary, and in every case where litigation may be a possibility.....
> **(This content has been withheld because of exemptions in the Freedom of Information Act 2000)**

On this basis, one should expect an enquiry, when a claim is first made; but in practice that does not always happen.

52.34 HMRC enquiry on claim

52.34.1 *"Satisfies an officer"*

Section 739(2) ITA provides:

> An individual is not liable for income tax under this Chapter for the tax year by reference to the relevant transactions if the individual *satisfies an officer of Revenue and Customs* that condition A or B is met.[119]

The motive defence applies if the individual *satisfies an officer* of HMRC

[119] The same wording is found in new conditions A and B: s.737(2) ITA.

that Condition A or B is met. This wording is language of subjectivity: it suggests that it is not sufficient that condition A or B is met, what matters is that the officer is satisfied in his or her own mind.

However the words have never been understood in that sense. They only impose the burden of proof on the taxpayer. That makes no difference as the burden of proof already rests on the taxpayer.[120] Thus all the words actually mean is:

> An individual is not liable for income tax under this Chapter for the tax year by reference to the relevant transactions if condition A or B is met.

The words "satisfy an officer that ..." add nothing.[121]

There is no advance ruling or clearance procedure on the application of the motive defence.[122]

52.34.2 *Evidence*

Contemporary correspondence and background documentation may be relevant to the factual issue of whether the transferor had the purpose of reducing tax. It will not shed much light on the issue of whether the purpose should be classified as avoidance or mitigation. Some factors such as confidentiality or tax related agreements may shed light on this, or at least, on whether the parties regarded the matter as tax avoidance.[123] In *IRC v Willoughby*[124] for instance, the Special Commissioner reviewed sales literature relating to the offshore bonds. In practice, expect HMRC to ask for contemporary documentation. The advisers should review it before making a claim. In the case of a transfer to a trust, this includes:

(1) Trust documentation and letters of wishes
(2) If not evident from the above, details of intended beneficiaries
(3) Details of assets transferred
(4) Contemporary correspondence between trustees, accountants and settlor (Legal advice should be privileged)

[120] See 6.36 (Residence: Burden of proof). And in any event, disputes are rarely decided by the burden of proof: see 4.7.4 (Who bears onus of proof).. But the burden of proof may have been a more important issue when the words were introduced in 1936.

[121] See App 2.24.5 ("It is shown that").

[122] As to the relevance of TiS clearance, see 55.11.3 (Transfer of value by 2 operations).

[123] See 3.20.8 (Other indicia of avoidance).

[124] 70 TC 57.

Often the issue arises many years after the transfer of assets, and the contemporary records have been lost. That should not matter, as secondary material and inferences from common sense should suffice, but efforts should be made to recover original documentation, if only to avoid the suspicion that damaging documents may have been suppressed.

Sometimes contemporary documents are relevant, and it should be borne in mind in their drafting that in the absence of privilege, they will be disclosed. In *Marwood Homes* a note of the meeting provided:

> [The senior tax manager] went through the draft clearance application ... The main change was to "beef up" the commercial justification for the transactions by referring to effect of the dividends being to offset the damage of the solvency of the *Marwood Homes Ltd* balance sheet due to the 1992 loss.[125]

The Tribunal inferred that it was only then that the commercial reason was seen as relevant by the parties (which from the terms of the note seems a possible inference, though not a necessary one).[126]

52.34.3 *Professional privilege*

INTM provides:

> **INTM602680 Individual satisfies an officer of HMRC** [Jan 2023]
> It is often the case that where transactions have taken place that result in a potential liability under the transfer of assets provisions, professional advice will have been taken in relation to the transactions. It is sometimes suggested that such advice cannot be disclosed to HMRC because of legal and professional privilege. More is said on this in the section on information powers from INTM603800 onwards, but there is no specific restriction on the information that an individual can provide to demonstrate that the exemption is due and they can be expected freely to provide it. Where an individual chooses to hold back particulars that may contain material evidence about transactions that would otherwise result in a charge to tax, it may well lead the officer of HMRC to conclude that the conditions for exemption are not met.

HMRC should not draw an adverse inference from a taxpayer's decision to exercise a right to privilege.[127] Privilege is a fundamental human right,

[125] [1999] STC (SCD) 44 at [42].

[126] At [75].

[127] This seems to be accepted in the HMRC Litigation & Settlement Strategy para 13: "HMRC would not normally expect legal professional privilege to be waived."

and it is HMRC's practice not to disclose their own privileged legal advice.

Care is needed before referring to legal advice or other privileged documents, in correspondence with HMRC, as this might amount to waiver of privilege.[128]

52.35 Appeals

Section 751 ITA provides:

> On any appeal that is notified to the tribunal, the jurisdiction of the tribunal includes jurisdiction to affirm or replace any decision taken by an officer of Revenue and Customs in exercise of the officer's functions under—[129]

ITA	*Topic*	*See para*
s.720A(4)/727A(4)	Shareholder-transferors	49.6.2
s.737	Motive defence: post-4 December 2005 transactions	
s.738	Meaning of "commercial transaction"	
s.739	Motive defence: pre-5 December 2005 transactions	
s.742	Later associated operations fail motive defence	
s.742A	Genuine transaction defence [lapsed after Brexit]	
s.743(2)	Double counting relief	51.10

The jurisdiction of the tribunal is appellate and not supervisory. The wording of New Conditions A and B ("... reasonable to draw the conclusion ...") does not impose a *Wednesbury* unreasonableness test on an appeal.

A decision in a tax appeal is, on ordinary principles, binding on the parties only in relation to the assessments under appeal. It does not bind the parties in other respects. In *Carvill v IRC*[130] a Special Commissioner allowed a motive defence appeal even though a previous appeal relating to earlier years had been decided against the taxpayers. The taxpayers then sought to recover from HMRC the tax paid under the earlier

That might depend on what nuance one gives to the word "normally", but the commentary provides:

> "HMRC should not interpret a decision by a customer not to waive LPP over legal advice as a sign of non-collaboration".

https://www.gov.uk/government/publications/litigation-and-settlement-strategy-lss

[128] *Conegate v HMRC* [2018] UKFTT 82 (TC).

[129] For clarity I have set this out in tabular form and with my own wording, rather than as in the statute.

[130] [2000] STC (SCD) 143.

assessments, but this rightly failed.[131] There must be some finality in tax, even when wrong decisions are reached by the courts. That issue will rarely, if ever, arise again in practice.

It may happen that tax has been paid under the ToA provisions for a number of years without consideration being given to the motive defence, and then it occurs to a taxpayer that a motive defence is applicable. It is considered that the principle in *Carvill (No. 2)* only applied where a motive defence had been litigated and decided by the tribunal, and in the absence of litigation on the point it should be possible to put in an error or mistake claim under usual principles.

An appeal will be made by the individual subject to tax (not the trustees or company within s.731 ITA who have no *locus standi*). If the trustees fund an appeal by the individual against assessment under s.731, will that funding constitute a benefit? If so that benefit would be subject to income tax under s.731, (except so far as costs are recovered by a successful appeal). The position depends on the facts. If the reason the trustees fund the appeal is in order to sort out their tax planning for the future, or in order to benefit the entire class of UK resident beneficiaries, then no taxable benefit is received by the appellant: any benefit is received by all UK beneficiaries and there is no rational means of apportionment. At the other extreme, if the trust fund is (more or less) wound up by a capital payment, and the appeal procedure is specifically to benefit one beneficiary, then the trustees financing the appeal would constitute a benefit.[132]

52.36 Motive defence: Disclaimer

There are circumstances where the application of the ToA provisions may reduce a tax charge. In particular, a UK resident transferor who receives a distribution from a non-resident company may be more lightly taxed under s.720: they are taxed on the company's income but has the benefit of tax and tax credits paid by the company, and the distribution is tax free.[133]

[131] See *Carvill v IRC (No. 2)* [2002] EWHC 1488 (Ch) and *Carvill (R, oao) v IRC* [2003] EWHC 1852 (Admin).

[132] Or else it may be subject to CGT as a capital payment.

[133] See 51.5 (Distribution relief).
Also, for completeness, a beneficiary who received a capital payment from an offshore trust before 2008/09 would prefer to be taxed under s.731 than under s.87

Is it possible for an individual to disclaim the motive defence? It seems arguable that the words "the individual satisfies an officer of HMRC" etc., suggest that the benefit of the motive defence can be disclaimed. The individual may choose not to satisfy an officer even though there was no tax avoidance purpose. If the motive defence is compulsory, we would have the surprising result that a transfer for tax avoidance may be less harshly taxed than one which was not.

However, this view would cause considerable difficulties. Suppose a non-resident trust has relevant income of £1m and trust gains of £1m, and capital payments of £1m are made in Year 1 to beneficiary A and in Year 2 to beneficiary B. A and B are both resident and domiciled in the UK. Suppose the trust is in principle within the motive defence because the transfer to it was not for tax avoidance purposes. Before 2008/09 A would probably wish to disclaim the motive defence, if A could, so the capital payment to A was subject to income tax, and they avoided the s.87 interest surcharge. However, it would be in the interest of B to argue that the motive defence did apply, so that the payment to A "washed" the capital gain and the payment to B was tax free. It is evident that the offshore trust rules simply do not work if the motive defence can be disclaimed by one beneficiary and claimed by another. Nor do they work fairly if it can be disclaimed by one beneficiary in a manner which binds all the others. So the better view is that the motive defence (if applicable on the facts) is compulsory and binds all parties.

The same applies where it suits HMRC to argue that the motive defence is satisfied, and the taxpayer argues that it is not. This in fact happened in one case[134] where HMRC successfully argued that the motive defence applied. In neither case did the taxpayer seek to argue that the motive defence could be disclaimed, so the point may now be regarded as settled law.

HMRC agree. The INT Manual provides:

> **INTM602660 Applying for exemption** [Jul 2023]
> ...The exemption applies automatically if the facts show that the conditions are met. It is not therefore the subject of a 'claim' under the

TCGA, because the IT rate under s.720 (then, 40%) was lower than the effective CGT rate under s.87 (then, 64%).

[134] *Anson v HMRC* [2012] UKUT 59 (TCC) reported at first instance under the name *Swift v HMRC* [2010] UKFTT 88 (TC) at [22] - [28]. The point was not considered in the subsequent appeals.

normal claims mechanism of the Tax Acts (TMA70/S42).

52.37 Abolish the 2006 rules

This topic was never easy, but the FA 2006 made it twice as complicated: it introduced wider and more obscurer rule which apply to transactions from 2005, while retaining the old rules for earlier transactions.[135]

The reader who studies this long and difficult chapter may well agree with the author that the 2006 reform was wrong headed in policy though (as so often) clumsy drafting adds its mite to the confusion. What should be done? One step forward would be to return to the (slightly) simpler pre-2006 position, though it would be helpful to have a statutory statement of what I take to be the pre-2006 rule, that the motive test must be satisfied by all critical associated operations. But there is no current prospect of that happening.

[135] EN FB 2006 stated:

> "The new provisions recast the test for exemption in cases not involving a tax avoidance purpose to make its meaning clearer."

But no-one was intended to take that seriously.

CHAPTER FIFTY THREE

PROFIT FRAGMENTATION

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53.1 Profit fragmentation: Introduction

Para 1(1) sch 4 FA 2019 provides:

> This Schedule contains provision about countering the tax effects of

> certain arrangements[1] ("profit fragmentation arrangements").

I refer to this as the **"PFA code"**.

Profit Fragmentation is a technical term which has nothing much to do with fragmentation. I write it with initial capitals, to reflect the technical nature of the expression.

The development of the PFA rules can be traced through:

- HMRC, "Tax Avoidance involving Profit Fragmentation Consultation document" (**"PFA condoc"**)[2]
- HMRC, "Tax Avoidance involving Profit Fragmentation Summary of Responses"[3] (**"PFA response doc")**

53.2 The target

PFA condoc provides:

> 2.5. A UK resident individual A has skills that would enable him or her to generate significant profits - for example, as an entertainer, an asset manager or a specialist producer of high value items.
> 2.6. A carries on business activity as a sole trader, in partnership, or as an employee or director of a company (in the last case it is likely that the company will be closely held). Some or all of the profits deriving, directly or indirectly, from A's earning capacity, are moved to an offshore vehicle, V Ltd, where nil or very little tax is paid. Commonly, this is an offshore company owned by an offshore trust. Typically A is not a settlor or trustee of that trust. In some cases, A is said to be excluded from benefitting from the trust assets, but there will often be some means by which those amounts will or may accrue to persons who have links to A, including non-lineal relatives of A.
> 2.7. It is claimed that the offshore entity is entitled to payment in respect of A's services for varied reasons. For example:
>
> - A service agreement that allows V Ltd to enter into agreements to supply A's services to clients - this may be in respect of all of A's activities, or only activities performed by A outside the UK. It is

[1] Para 11 sch 4 FA 2019 provides the standard (unnecessary) IT definition of "arrangements"; see App 2.2.3 (Definitions of "arrangement").

[2] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/698175/Tax_Avoidance_involving_Profit_Fragmentation_consultation_document.pdf* (April 2018)

[3] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/722457/Tax_Avoidance_involving_Profit_Fragmentation_summary_of_responses.pdf* (July 2018)

> likely that A will be paid a modest salary for these services but most of the receipts will be paid to the trustees via V Ltd, or
>
> - The offshore entity invests in a partnership through which A trades and is said to be entitled to an entrepreneurial return on that investment in priority to any profit allocation to A.
>
> Having regard to the activities carried on by V Ltd in the offshore jurisdiction, relative to those carried out by A elsewhere, it is clear that the entity is either overrewarded or designed to facilitate the avoidance of UK tax.
>
> It is asserted that V Ltd does not carry on any trade or profession in the UK and as it is at no time UK resident then no taxable profits arise.
>
> **Examples**
>
> In each of the examples below, it is asserted that existing anti-avoidance rules do not apply. In practice, all would be vulnerable to challenge, particularly under the Transfer of Assets Abroad legislation.

"Vulnerable to challenge" is something of an understatement.

53.2.1 *Example: Alienated receipts*

PFA condoc provides:

> 2.8. A management consultant is resident in the UK and provides professional services for both UK and overseas customers. A proportion of these services is attributed to the UK business, with those receipts reported by the UK business and taxed in the UK.
>
> 2.9. However, the remaining receipts are paid by customers directly to an offshore company in a tax haven, owned by a trust based in the tax haven. These are paid in return for consultancy services allegedly[4] provided by the offshore company, which has no assets apart from access to the skills and services of the management consultant himself, neither of which is exercised to any material extent in the tax haven.
>
> 2.10. The management consultant in the UK is expressly excluded from benefiting from the trust but relatives can benefit.
>
> 2.11. The underlying reality is that all income derives from a single underlying activity (namely the skills of the consultant, who is a UK resident), that no or negligible services are performed by that person in the low tax jurisdiction itself, and consequently the full profits should be taxed in the UK as profits of the consultant.

[4] The word "allegedly" is misconceived: there is no reason why the company may not provide consultancy services. If the offshore company had been UK resident, no-one would have questioned the point.

These are the facts of *Brackett v Chater*, which decided that the company should be taxed on the basis that it is carrying on a trade in the UK through a permanent establishment; or alternatively that the transfer of asset rules apply.[5]

53.2.2 *Example: Excess expenses*

PFA condoc provides:

> 2.12. A UK individual provides architectural services for clients in the UK. Customers pay the UK individual, but little profit is taxed in the UK, as the individual pays fees to an offshore company for "consultancy" which are deducted from profits and almost entirely cover the profits. The company receiving the fees is owned by an offshore trust which was settled many years ago by a distant relation of the UK individual. The company has no substance or assets.
> 2.13. The funds held in the company are then returned to the architect in various forms which are alleged to be non-taxable, for example, loans or payment of supposed business expenses...[6]
> 2.14. The reality again is that there is a single underlying source of income, namely the skills of the architect, who is a UK resident, that no or negligible services are performed by that person in the low tax jurisdiction itself, and so the full profits should be taxed in the UK as profits of the architect.

In this case the "commission" is not deductible as not incurred wholly and exclusively for the purposes of the business; or else the transfer pricing rules apply to remove the tax advantage.

> **Common features**
> 2.15. These arrangements differ in some of their details, but what they have in common is that UK profits are moved to offshore structures in low tax jurisdictions, to entities which are supposedly performing or providing services, but have little or no substance. The reality is that the business is carried on by an individual resident in the UK, with core services such as office space, IT and support staff located in the UK, and that the profit allocated offshore is excessive having regard to the services carried out in that territory.

[5] See 48.4 ("Transfer" of "assets"); 106.27.4 (Branch/agency distinctions).

[6] The example adds here: "The individual in the UK has a lifestyle which could not be supported on the small amount of net profit received and taxed in the UK." But that is irrelevant to the example.

53.2.3 *Existing legislation*

PFA condoc provides:

> 2.16. Existing legislation, in particular the transfer of assets abroad legislation, can tackle many of these arrangements. Challenges are also possible under the rules relating to transfer pricing, disguised remuneration, and other legislation. However, this legislation can be difficult to apply as it requires the gathering of large amounts of information, and the users or promoters of the arrangements may seek to delay matters by arguing that HMRC has no right to force the production of relevant information held offshore.
> 3.2. Some of the existing legislation which can be relevant to these arrangements, such as transfer pricing and Diverted Profits Tax, has specific exclusions for SMEs [Small and medium-sized enterprises].[7] The broad aim of any new legislation will be to target arrangements used by the types of business not covered by the existing rules.

Thus both the examples given to illustrate the need for the new law are wrong in the sense that they are clearly caught by existing legislation. That has happened before,[8] but it is a new development for HMRC to (more or less) concede that is the case.

53.3 Parties to PFA

53.3.1 *Resident party*

Para 1 sch 4 FA 2019 provides:

> (2) Profit fragmentation arrangements involve the following parties—
> (a) a person resident in the UK ("the resident party") ...

53.3.2 *Overseas party*

Para 1 sch 4 FA 2019 provides:

> (2) Profit fragmentation arrangements involve the following parties...
> (b) an overseas person or entity ("the overseas party") who is not resident in the UK ...

Para 1(3) sch 4 FA 2019 provides:

> An "overseas person or entity" means—

[7] This is not accurate statement: see 25.16 (Non-qualifying territory).

[8] The charity tainted donation rules are an example.

(a) a person abroad within the meaning given by section 718 of ITA 2007,[9] or

(b) a company, partnership, trust or other entity or arrangements established or having effect under the law of a country or territory outside the UK (regardless of whether it has legal personality as a body corporate).[10]

The INT Manual provides:

> **INTM610040: Parties** [May 2019]
> **Example 3 – Defining the Parties**
> C Ltd. is a UK resident company which carries out a trade in the UK as a management consultancy firm. D is an individual who is a 20% shareholder in C Ltd. and is responsible for all of the company's overseas business, which is performed from the UK. D is also involved in another business, O BVI Ltd. through which he performs some personal consultancy services. D arranges for C Ltd.'s overseas customers to make payments to O BVI Ltd. which is a British Virgin Islands resident company.
> In the above scenario when considering whether the Profit Fragmentation legislation is applicable C Ltd is the resident party, D is the related individual and O BVI Ltd is the overseas party.
> **INTM610050: Parties (Continued)** [May 2019]
> **Example 4 – The Overseas Party**
> O BVI Ltd. ("O") is a British Virgin Islands incorporated company. O is wholly owned by its director, A, who is UK resident. A carries out all the activities in relation to the entire business of O from his offices in the UK. Since O is centrally managed and controlled in the UK, and is therefore UK-resident, it cannot be the overseas party when considering the Profit Fragmentation legislation.
> In these circumstances, if value were transferred from A's UK business to O, and O subsequently transferred this value outside of the UK then, depending on the nature of the activities carried on by A and O, O could be treated as the resident party and the Profit Fragmentation legislation may be applicable to O's subsequent transfer of value outside of the UK.

53.3.3 *Related individual*

Para 1(2) sch 4 FA 2019 provides:

> Profit fragmentation arrangements involve the following parties ...

[9] See 48.5 ("Person abroad").

[10] The words in brackets are otiose, but they do no harm.

> (c) an individual (a "related individual") who is—
> (i) the resident party,
> (ii) a member of a partnership of which the resident party is a partner, or
> (iii) a participator in a company which is the resident party.

The drafting is clumsy. The resident party is a related individual, ie is related to himself/herself. There may not be any other related individual, and if there is, that individual may not be a party to the PF arrangements. But it does not matter.

The significance of the definition is that the PFA code applies if a related individual meets the enjoyment conditions.[11]

The definitions of resident/overseas/related party would apply only for the purposes of para 1, but para 11 extends them to the whole of sch 4.

53.4 Profit Fragmentation Arrangements

Para 2(1) sch 4 FA 2019 provides:

> Arrangements are "profit fragmentation arrangements" if-

A set of 4 conditions then follow which I call **"PFA conditions (a) to (d)"**.

The definition applies only for the purposes of para 2, but para 11 extends it to the whole of sch 4.

53.5 Condition a: Material provision

Para 2 sch 4 FA 2019 provides:

> (1) Arrangements are "profit fragmentation arrangements" if-
> (a) provision has been made or imposed as between
> [i] the resident party and
> [ii] the overseas party
> by means of the arrangements ("the material provision")

This is not so much a separate condition as a definition of "material provision".

The wording is based on the transfer pricing rules: see 25.7 ("The basic pre-condition").

Para 2(3) sch 4 FA 2019 provides:

[11] See 53.8 (Enjoyment conditions).

> For the purposes of sub-paragraph (1)(a) provision made or imposed as between
> [a] a partnership of which the resident party is a member and
> [b] the overseas party
> is to be regarded as provision made or imposed as between the resident party and the overseas party.

The INT Manual provides a straightforward example:

> **INTM610060 The Material Provision** [May 2019]
> **Example 5 – Provisions for Partnerships**
> A is a UK-resident individual who is carrying on a trade in partnership with a number of other individuals as P Associates. P Associates contracts with an overseas company O Ltd. for O Ltd. to provide services to P Associates in exchange for a fee. For the purpose of the Profit Fragmentation legislation the provision made between P Associates and O Ltd is treated as a provision made between A and O Ltd.

53.6 Condition b: Transfer of value

Para 2 sch 4 FA 2019 provides:

> (1) Arrangements are "profit fragmentation arrangements" if ...
> (b) as a result of the material provision, value is transferred from the resident party to the overseas party which derives directly or indirectly from the profits of a business chargeable to income tax or corporation tax (see paragraph 3)

Unpacking this paragraph, the requirements are:
(1) a business
(2) chargeable to IT/CT
(3) value transferred from a resident to an overseas party
(4) that value is derived from the business

The INT Manual provides 2 examples: assignment of a trading receipt, and excessive expenses:

> **INTM610080 Transfer of Value** [May 2019]
> **Example 6 – Transfer of Value Income Received Offshore**
> This example shows what is meant by a transfer of value where the resident party reduces the amount of income they take into account.
> As with other examples in this guidance, it is likely (?) that accounting principles, other legislation or case law would ensure the appropriate

amount of profits are charged to UK tax: the following example illustrates how Profit Fragmentation rules would apply if that were not the case.

F Ltd is a UK-resident company that provides consultancy services to UK and non-UK clients out of its offices in London. F Ltd arranges for its non-UK clients to make payments in return for these services to O Ltd which is an offshore company where none of the relevant business activity takes place.

F Ltd provides services with a value of £100,000 to a non-UK client. The non-UK client pays the £100,000 to O Ltd. rather than to F Ltd.

F Ltd has not made any direct payments out of the UK but there has been a transfer of value out of the UK. This is because F Ltd has provided services with a value of £100,000 but received £0 in return – this means there has been a transfer of £100,000 of value out of the UK.

Example 7 – Transfer of Value Expenses Paid from UK

This example illustrates what is meant by a transfer of value where excess expenses are paid by the resident party.

As with other examples in this guidance, it is likely (?) that accounting principles, other legislation or case law would ensure the appropriate amount of profits are charged to UK tax: the following example illustrates how Profit Fragmentation rules would apply if that were not the case.

G Ltd is a UK-resident company that provides consultancy services out of its offices in London. G Ltd carries out all its IT support functions in-house but makes a payment of £50,000 per year, described as IT costs, to O Ltd, an offshore company which lacks the capacity to fulfil the function such that no relevant activity takes place in O Ltd.

G Ltd has made a payment of £50,000 to an overseas party but has received no services, i.e. something with nil value, in return. This means there has been a transfer of £50,000 of value out of the UK.

53.6.1 *"Business"*

There must be a business. Para 11 sch 4 FA 2019 seeks to provide a definition:

> In this Schedule ...
> "business" includes any trade, profession or vocation.

This may be in some OPC handbook, as it crops up from time to time. But it is otiose, as a trade/profession/vocation is obviously a business.

This is an inclusive definition, so the PFA code could also apply to a property business.

53.6.2 *Link to business*

The requirement in PFA condition (b) is that the value transferred "derives directly or indirectly from the profits of the business". This cannot sensibly be defined, but that does not stop the drafter from trying. Para 3 sch 4 FA 2019 provides:

> (1) In determining whether value deriving directly or indirectly from a business is transferred from the resident party to the overseas party, account is to be taken of any method, however indirect, by which—
> (a) any property or right is transferred or transmitted, or
> (b) the value of any property or right is enhanced or diminished.
> (2) Sub-paragraph (1) applies in particular to—
> (a) sales, contracts and other transactions made otherwise than for full consideration or for more than full consideration,
> (b) any method by which any property or right, or the control of any property or right, is transferred or transmitted by assigning—
> (i) share capital or other rights in a company,
> (ii) rights in a partnership, or
> (iii) an interest in settled property,
> (c) the creation of an option affecting the disposition of any property or right and the giving of consideration for granting it,
> (d) the creation of a requirement for consent affecting such a disposition and the giving of consideration for granting it,
> (e) the creation of an embargo affecting such a disposition and the giving of consideration for releasing it, and
> (f) the disposal of any property or right on the winding up, dissolution or termination of a company, partnership or trust.
> (3) Value may be traced through any number of individuals, companies, partnerships, trusts and other entities or arrangements.
> (4) The property held by a company, partnership, trust or other entity or under any arrangements must be attributed to the shareholders, partners or members, beneficiaries or other participants at each stage on a just and reasonable basis.

The wording is derived from the transactions in land code.[12]
This does show, if it were necessary, that derivation is not to be narrowly understood.

[12] See 22.11.2 (Attributing value); 22.19 (Indirect arrangements). Also see App 2.9.8 (Derive/represent value).

53.6.3 *Remittance basis taxpayer*

The INT Manual provides:

> **INTM610080 Transfer of Value** [May 2019]
> **Example 8 – Deriving From the Profits of a Business** [Judy]
> This example illustrates how the concept of deriving from the profits of a business chargeable to income tax applies where an individual who is non-domiciled claims to use the remittance basis and has foreign source income.
> As with other examples in this guidance, it is likely (?) that accounting principles, other legislation or case law would ensure the appropriate amount of profits are charged to UK tax: the following example illustrates how Profit Fragmentation rules would apply if that were not the case.
> J is a UK-resident non-domiciled individual who claims the remittance basis.
> J is self-employed and carries on a trade in the UK as a pharmaceuticals consultant. J has offices in London and a small team of staff that she employs, all of who perform their duties in her London offices. J also occasionally travels to Geneva to perform pharmaceutical consulting for a Swiss company (A) in her capacity as a sole trader.
> J incorporates a 'brass plate' company (B) in Switzerland and asks A to make a contract with B when they seek to use her business's services, including the work of her UK staff. J does not change anything about her business activities except for arranging that consultancy payments from A are now paid to B instead of to her as a self-employed individual.
> We assume for the purpose of this example that no other provisions are applicable here (such as for example Central Management and Control).[13]
> J also spends every other weekend carrying out a trade in Switzerland through a further Swiss company (D) leading executive team building excursions in the Alps. This activity takes place solely in Switzerland and all the activities are carried out by J through her Swiss Company (D) in Switzerland.
> The Profit Fragmentation legislation would apply to the transfer of value arising from the diversion of income from J's UK business to the Swiss company, B. This is because these payments are properly attributable to the UK business and derive from the profits of a business chargeable to

[13] More analytically, it is assumed that the Swiss company is not UK resident.

income tax. These amounts are not eligible for the remittance basis as they are UK source income.

The Profit Fragmentation legislation will not apply to the income derived from her team building company, D, in Switzerland as this is foreign source income so is not derived from the profits of a business chargeable to income tax.

53.6.4 *Tracing example*

The INT Manual provides:

> **INTM610090 Tracing Value** [May 2019]
>
> **Example 9 – Tracing Value Through Transactions**
>
> In the following example UK1, UK2 and UK3 are UK resident companies, and OS1, OS2, and OS3 are non-UK resident companies. Each of these companies is party to arrangements whereby value is transferred for which nothing is received in return.
>
> As with other examples in this guidance, it is likely (?) that accounting principles, other legislation or case law would ensure the appropriate amount of profits are charged to UK tax: the following example illustrates how Profit Fragmentation rules would apply if that were not the case.
>
> The following series of transactions is carried out:
>
> - UK1 transfers £1,000 of value to OS1.
> - OS1 transfers £1,000 of value to UK2.
> - UK2 transfers £1,000 of value to OS2.
> - OS2 transfers £500 of value to UK3.
> - UK3 transfers £500 of value to OS3.
>
> In these circumstances the resident party could be any of UK1, UK2, UK3, or indeed any combination of UK1, UK2 and UK3 each with separate arrangements, as value has been transferred out of the UK by each of them. As described above this will depend on the specific facts and circumstances surrounding the arrangements. This will include the related individual's relationship with the companies and the nature of the activities that take place in each of these companies.

This is not exactly guidance, but no doubt we will muddle through.

53.7 Condition c: Arm's length

Para 2 sch 4 FA 2019 provides:

> (1) Arrangements are "profit fragmentation arrangements" if ...
>
> (c) the value transferred is greater than it would have been if it had resulted from provision made or imposed as between

> independent parties acting at arm's length

I would have said that if there were a transaction at arm's length, there would be no value transferred. So this paragraph is otiose. But it does not matter.

The INT Manual provides straightforward examples of (1) diverted receipts and (2) excessive expenditure, on non-arm's length terms. I set them out only for completeness:

> **INTM610100 Arm's Length Transfer** [May 2019]
> **Example 10 – Arm's Length Value – Reduction of Income Received**
> This example illustrates what is meant by a transfer of value being greater than it would have been if made between parties acting at arm's length in the context where the resident party reduces the amount of income they take into account. As with other examples in this guidance, it is likely (?) that accounting principles, other legislation or case law would ensure the appropriate amount of profits are charged to UK tax: the following example illustrates how Profit Fragmentation rules would apply if that were not the case.
> C Ltd. is a UK-resident company which provides consultancy services to UK and non-UK clients out of its offices in London. O Ltd. is an offshore company that provides limited ancillary services to consulting businesses. C Ltd. makes arrangements with O Ltd. whereby O Ltd. will provide limited ancillary services to C Ltd. if C Ltd. agrees to have its non-UK clients make payments in return for the services C Ltd. provides as follows:
>
> - 20% to C Ltd., and
> - 80% to O Ltd.
>
> C Ltd. provides services with a value of £1m to a non-UK client. In line with the above agreement, in return for these services the non-UK client pays £200,000 to C Ltd and £800,000 to O Ltd.
> C Ltd. has not made any direct payments out of the UK but there has been a transfer of value out of the UK. This is because C Ltd. has provided services with a value of £1m and only received £200,000 – this means there has been a transfer of £800,000 of value out of the UK. The services provided by O Ltd. do not warrant such an inflated return.
> A provision has been made between C Ltd. and O Ltd. for these arrangements to take place. Had this provision been made or imposed between independent parties acting at arm's length then O Ltd. would have received nothing. The value paid from the non-UK client to C Ltd. would have been the value of the services provided – so £1m. This means that there would be no transfer of value out of the UK as the amount paid into the UK (£1m) would be equivalent to the value of the services provided out of the UK (£1m).
> In these circumstances the value transferred out of the UK (£800,000) clearly exceeds the value that would have been transferred out of the UK had the provisions been made or imposed between independent parties acting at arm's length (£0). In these circumstances paragraph 2(1)(c) would be applicable.

Example 11 – Arm’s Length Value – Inflation of Expenses Paid
This example illustrates what is meant by a transfer of value taking place at greater than it would have been if made between parties acting at arm’s length where excess expenses are paid by the resident party.

As with other examples in this guidance, it is likely (?) that accounting principles, other legislation or case law would ensure the appropriate amount of profits are charged to UK tax: the following example illustrates how Profit Fragmentation rules would apply if that were not the case.

C Ltd. is a UK resident company which provides consultancy services out of its offices in London. C Ltd. carries out all its IT support functions in-house but makes a payment of £50,000 per year to O Ltd., an offshore company which provides limited services, which it describes as IT costs.

C Ltd. has made a payment of £50,000 to an overseas party but has received limited services, which for the purpose of this example have a value of £5,000, in return. This means there has been a transfer of £45,000 of value out of the UK.

Had the provision been made or imposed between independent parties acting at arm’s length the value paid from C Ltd. to O Ltd. would have been the arm’s length amount which in this case would be £5,000 as O Ltd. has only performed limited services. This means that there would be no transfer of value out of the UK as the amount paid out of the UK (£5,000) would be equivalent in value to the value of the services provided in to the UK (£5,000).

In these circumstances the value transferred out of the UK clearly exceeds the value that would have been transferred out of the UK had the provisions been made or imposed between independent parties acting at arm’s length. In these circumstances paragraph 2(1)(c) would be applicable.

53.8 Condition d: Enjoyment conditions

Para 2 sch 4 FA 2019 provides:

> (1) Arrangements are “profit fragmentation arrangements” if ...
> (d) any of the enjoyment conditions are met in relation to a related individual (see paragraph 4).

Para 4 sch 4 FA 2019 provides:

> (1) The enjoyment conditions are met in relation to a related individual if-

There follow two sets of conditions, in short:
(1) Link to individual; and
(2) (a) Enjoyment test; or
(b) Procurer test

It is difficult to see how the second condition could fail to be met.

The label “Enjoyment conditions” is not apt to describe the total set of conditions.

53.8.1 *Link to individual*

Para 4 sch 4 FA 2019 provides:

> (1) The enjoyment conditions are met in relation to a related individual if-
>
> (a) it is reasonable to conclude that some or all of the value transferred as a result of the material provision relates to something done by, or any property or purported right of, the individual

Will it ever happen that this condition is not satisfied?

53.8.2 *Power to enjoy*

Para 4(4) sch 4 FA 2019 provides:

> For the purposes of sub-paragraphs (2) and (3), references to an individual include a reference to any person connected with that individual...

I gloss this as "individual [including connected persons]".

Para 4 sch 4 FA 2019 provides:

> (1) The enjoyment conditions are met in relation to a related individual [including connected persons] if ...
>
> (b) either of the conditions in sub-paragraph (2) is met.
>
> (2) The conditions are that—
>
> (a) under the arrangements—
>
> (i) the value transferred, or part of it, is so dealt with by any person as to be calculated at some time to enure for the benefit of the individual [including connected persons],
>
> (ii) the value transferred, or part of it, operates to increase the value of any assets which the individual [including connected persons] holds or are held for the benefit of the individual [including connected persons],
>
> (iii) the individual [including connected persons] receives or is entitled to receive any benefit provided or to be provided out of the value transferred or part of it,
>
> (iv) the individual [including connected persons] may become entitled to the beneficial enjoyment of the value transferred, or part of it, if one or more powers are exercised or successively exercised (and for those purposes it does not matter who may exercise the powers or whether

> they are exercisable with or without the consent of another person), or
>
> (v) the individual [including connected persons] (whether acting alone or together with any other person) is able in any manner to control directly or indirectly the application of the value transferred or part of it,

Para 4(3) sch 4 FA 219 provides:

> (3) In determining whether the conditions in sub-paragraph (2)(a) are met in relation to an individual [including connected persons] and the value transferred as a result of the material provision, all benefits which may at any time accrue to a person as a result of the value being transferred must be taken into account, irrespective of—
>
> (a) the nature or form of the benefits, or
>
> (b) whether the person has legal or equitable rights in respect of the benefits.

The wording is based on the ToA rules.[14]

53.8.3 *Procurer test*

Para 4(2) sch 4 FA 2019 provides:

> The conditions are that ...
>
> (b) it is reasonable to conclude that the individual [including connected persons] (whether acting alone or with any other person) procured the transfer of value from the resident party to the overseas party in such a way as to avoid the conditions in paragraph (a) being met.

In this case the label "enjoyment conditions" is inapt, as the transferor will not have power to enjoy.

This reflects apparent HMRC frustration with the existing s.720 charge. PFA condoc provides:

> 4.12. In exceptional cases sums may accumulate for long periods with no access by A or immediate family members. In some cases the trust deeds contain conditions which provide that the UK individual does not have the power to enjoy the assets of the trust. In practice,
>
> [a] this condition may be ignored, or
>
> [b] the deeds may also give the trustees powers to make payments to

[14] See 49.15 ("Power to enjoy").

> anyone they choose, notwithstanding any specific prohibitions set out in the deeds.

In case [b] the individual actually has power to enjoy. Case [a] involves a sham.

The INT Manual provides:

> **INTM610130: Enjoyment Conditions: Procurer Test** [May 2019]
> **Example 12 – The Procurer Test**
> A is a UK resident individual who carries on a trade in the UK. A is seeking to reduce the tax they pay in the UK while still receiving the profits they make and seeks legal advice about how they can do this. A is given advice about how to set up a structure to divert profits out of the UK.
> The advice received by A sets out a number of steps which they can take to ensure that the enjoyment conditions set out in 4(2)(a) Schedule 4 Finance Act 2019 are not satisfied. This advice could involve arrangements for A or their legal advisers to procure a 'dummy' settlor to settle a trust, or for the beneficiaries of trusts to be specific named charitable causes. HMRC are not able to demonstrate that A or parties connected to A are able to benefit from these arrangements.
> In these circumstances A will have procured the transfer of value with a view to avoiding the conditions set out in paragraph 4(2)(a) and therefore the procurer test will be met.

53.8.4 *Connected persons*

Para 4 sch 4 FA 2019 provides:

> (4) ... for the purposes of this paragraph, section 993 of ITA 2007 (meaning of "connected") has effect but as if—
> (a) subsection (4) of that section were omitted, and

The deleted rule in s.993(4) provided that partners are connected with other partners and their relatives.

Para 4 sch 4 FA 2019 provides:

> (4) ... for the purposes of this paragraph, section 993 of ITA 2007 (meaning of "connected") has effect but as if...
> (b) members of a partnership in which the individual is also a member were not "associates" of the individual for the purposes of sections 450 and 451 of CTA 2010 ("control").

The rule that partners are not associates means that partners are not connected with a company held by their partnership.

Para 4(5) extends the scope of connected person in a novel way:

> For the purposes of sub-paragraph (4), an individual is treated as connected with a person or entity if—
>
> (a) the individual or a person connected with the individual (whether acting alone or with any other person)—
>
> (i) is able to secure that the person or entity acts in accordance with the wishes of the individual or any person connected with the individual,
>
> (ii) is able to acquire rights which would enable the individual or any person connected with the individual to secure that the person or entity acts in accordance with the wishes of the individual or any person connected with the individual, or
>
> (iii) is able to exercise significant influence over the person or entity (whether or not as a result of a legal entitlement of the individual or any person connected with the individual), or
>
> (b) the person or entity can reasonably be expected to act, or typically acts, in accordance with the wishes of the individual or a person connected with the individual.

PFA condoc explains the thinking here:

> 4.16. In some arrangements, persons may not be formally connected, yet it is apparent that transactions occur which would not occur in an arm's length situation. For example, profits made by a UK individual are paid away to a company owned by a trust, and the UK individual receives no services nor any other sort of return for those payments. HMRC is informed that there is no connection between the individual and the trust or company. In these circumstances it may be reasonable to believe that there is a form of connection between the UK individual and the trust.
> 4.17. The proposed legislation will therefore aim to address situations where individuals or companies effectively follow the instructions of another person, whether or not there is a strict legal arrangement providing that this is the case. It will involve looking at all the circumstances, and in particular whether the alienation of profits that occurs would happen in a genuine commercial arrangement.

This reverses the decisions on the ToA rule.[15]

[15] See 49.17.1 (Control over trust income).

53.9 Tax mismatch

Para 2(2) sch 4 FA 2019 provides:

> But arrangements are not "profit fragmentation arrangements" if—
> (a) the material provision does not result in a tax mismatch for a tax period of the resident party (see paragraphs 5 and 6)

53.9.1 *"Tax mismatch"*

Para 5 sch 4 FA 2019 provides:

> (1) The material provision results in a tax mismatch for a tax period of the resident party if—
> (a) in that period, in relation to a relevant tax, it results in one or both of—
> (i) an increase in the expenses of the resident party for which a deduction is taken into account in calculating the amount of the relevant tax payable by the resident party, or
> (ii) a reduction in the income of the resident party which would otherwise have been taken into account in calculating the amount of the relevant tax payable by the resident party,
> (b) it is reasonable to conclude that—
> (i) [A] the resulting reduction in the amount of the relevant tax which is payable by the resident party
> exceeds
> [B] the resulting increase in relevant taxes payable by the overseas party for the period corresponding to the tax period, and
> (ii) the overseas party does not meet the 80% payment test, and
> (c) the results described in paragraphs (a) and (b)(i) are not exempted by sub-paragraph (5).
> (2) In this Schedule references to "the tax reduction" are to the amount of the excess mentioned in sub-paragraph (1)(b)(i).
> (3) It does not matter whether the tax reduction results from the application of different rates of tax, the operation of a relief, the exclusion of any amount from a charge to tax, or otherwise.

"Tax mismatch" is not particularly apt. "Tax saving" is the more appropriate term. But it does not matter.

53.9.2 *The 80% payment test*

Para 5(4) sch 4 FA 2019 provides:

> "The 80% payment test" is met by the overseas party if the resulting increase in relevant taxes paid by that party as mentioned in sub-paragraph (1)(b)(i) is at least 80% of the amount of the resulting reduction in the amount of the relevant tax payable by the resident party.

53.9.3 *Tax period*

Para 5(7) sch 4 FA 2019 provides:

> "tax period", in relation to a resident party, means—
> (a) a tax year, or
> (b) if the resident party is a company, an accounting period of that party.

Para 5(6) sch 4 FA 2019 provides:

> In this paragraph and paragraph 6, where the overseas party does not have an actual period for the purposes of relevant taxes which coincides with the tax period of the resident party—
> (a) references to the corresponding period of the overseas party in relation to that tax period are to a notional period of that party for the purposes of relevant taxes that would coincide with that tax period, and
> (b) such apportionments as are just and reasonable are to be made to determine the income or tax liability of that party for that corresponding period.

53.9.4 *"Relevant tax"*

Para 5(7) sch 4 FA 2019 provides:

> In this paragraph—
> "relevant tax" means—
> (a) income tax,
> (b) corporation tax on income,
> (c) a sum chargeable under section 269DA of CTA 2010 (surcharge on banking companies) as if it were an amount of corporation tax,
> (d) a sum chargeable under section 330(1) of CTA 2010 (supplementary charge in respect of ring fence trades as if it were an amount of corporation tax), or
> (e) any non-UK tax on income

The definition is for para 5, but it is incorporated by reference in para 6.

53.9.5 *Resulting reduction*

Para 6 sch 4 FA 2019 provides:

> (1) For the purposes of paragraph 5, the resulting reduction in the resident party's liability to a relevant tax for a tax period is—
>
> $$A \times TR$$

A stands for **A**bsolute value; TR is **T**ax **R**ate:

> where—
>
> A is the sum of—
>
> (a) if there are expenses within paragraph 5(1)(a)(i) [deductible expenses], the lower of the amount of expenses and the amount of the deduction mentioned in that provision, and
>
> (b) any reduction in income mentioned in paragraph 5(1)(a)(ii), and
>
> TR is the rate at which, assuming the resident party has profits equal to A chargeable to the relevant tax for the tax period, those profits would be chargeable to that tax.
>
> For this purpose, the rate at which those profits would be chargeable to that tax for that period is the highest rate at which that tax would be chargeable for that period if those profits were added to the resident party's total income.

This may be comparing personal tax rates to corporation tax rates, which is not likely to pass the 80% payment test.

53.9.6 *Resulting increase*

Para 6 sch 4 FA 2019 provides:

> (2) For the purposes of paragraph 5(1)(b) and (4), the resulting increase in relevant taxes payable by the overseas party for the period corresponding to the tax period is any increase in the total amount of relevant taxes that would fall to be paid by that party (and not refunded) assuming that—
>
> (a) the overseas party's income for that period, in consequence of the material provision were an amount equal to A,
>
> (b) account were taken of any deduction or relief (other than any qualifying deduction or qualifying loss relief) taken into account by the overseas party in determining that party's actual liability to any relevant taxes in consequence of the material provision, and
>
> (c) all further reasonable steps were taken—
>
> (i) under the law of any part of the UK or any country or

territory outside the UK, and

(ii) under double taxation arrangements made in relation to any country or territory,

to minimise the amount of tax which would fall to be paid by the overseas party in the country or territory in question (other than steps to secure the benefit of any qualifying deduction or qualifying loss relief).

(3) The steps mentioned in sub-paragraph (2)(c) include—

(a) claiming, or otherwise securing the benefit of, reliefs, deductions, reductions or allowances, and

(b) making elections for tax purposes.

(4) For the purposes of this paragraph, any withholding tax which falls to be paid on payments made to the overseas party is (unless it is refunded) to be treated as tax which falls to be paid by that party (and not the person making the payment).

53.9.7 *80% payment test: Examples*

The INT Manual provides straightforward examples:

INTM610160 Quantifying the Resident Party's Tax Reduction [May 2019]

Example 14 – Determining the Relevant Taxes Payable

This example should be read alongside Example 15 below.

A is self-employed and liable to income tax at the 45% rate. A has expenses of £30,000 resulting from Profit Fragmentation Arrangements that have resulted in a deduction, and income of £50,000 which as a result of the arrangements has been omitted.

The reduction in A's liability to UK income tax would be computed as:

(£30,000 + £50,000) × 45% = £80,000 × 45% = £36,000

O is the overseas party to whom the value is transferred under Profit Fragmentation Arrangements. O pays tax at a rate of 10% on the value transferred and has no expenses.

The increase in the relevant taxes to be paid by the overseas party is:

(£30,000 + £50,000) × 10% = £80,000 × 10% = £8,000

Example 15 – The 80% Payment Test

This example illustrates the application of the 80% payment test which is described at INTM610150, and should be read alongside Example 14 above.

If we assume the facts are as above such that the reduction in A's liability to UK income tax was £36,000 ("X") and the increase in relevant taxes to be paid by the overseas party is £8,000 ("Y").

A comparison now needs to be made between these two figures to determine if the 80% payment test is met. This is done by dividing Y by X – to determine the percentage. In this case:

£8,000 / £36,000 = 22.2%

This means that the increase in the overseas party's tax liability is (22.2%) of the reduction in the resident party's liability to UK tax which is less than the required 80% meaning the 80% payment test is not met.

INTM610170 Qualifying Deduction and Qualifying Loss Relief [May 2019]

Example 16 – Qualifying Deduction

This example illustrates what is meant by a qualifying deduction.

As part of a material provision, the overseas party acquires IP from the resident party and then charges royalties to the resident party for its continued use. The overseas party amortises the amount paid for the IP, which is allowable as a deduction in computing the overseas party's liability. This is not a qualifying deduction because it arises from the making of the material provision.

Example 17 – Qualifying Deductions and Qualifying Losses

The effect of the rules on qualifying deductions and qualifying loss relief is to give a consistent comparison between the tax positions of the two parties.

If the resident party pays £100 to the overseas party for something that costs the overseas party £95 to provide then the comparison would not be expected to be between the tax effect on the resident party of its paying £100 and the tax payable by the overseas party on a net £5 (calculated as the amount they received for this thing (£100) less the amount it cost them to provide it (£95)). As long as the £95 costs of the overseas party meet the criteria of a qualifying deduction the comparison is between two amounts of £100.

However, if in another situation the overseas party was only taxed on £50 of the £100 because of some particular relief for £50 given in its country of residence that does not meet the qualifying deduction criteria then the comparison will be between the resident party's reduction of tax on expenditure of £100 and what would have been the overseas party's liability to relevant tax had its taxable income been £50.

Similarly, with loss relief, a reduction below £100 in the taxation of the receipt would not be taken into account to the extent that it relates to qualifying loss relief. But a loss is a qualifying one only if it corresponds to a loss for which the resident party could have obtained relief, so a loss that could be utilised under the law applicable to the overseas party but not to the resident party would not qualify.

If, for example, the resident party is a UK company making a payment to a non-UK resident group company that has no resulting increase in relevant taxes because it can set off brought forward losses of other group companies as well as its own against the relevant profits, only the element of loss relief that corresponds to what would be eligible under the UK rules would be qualifying loss relief.

53.9.8 *Tax refund*

Para 6(5) sch 4 FA 2019 provides:

> For the purposes of this paragraph, an amount of tax payable by the overseas party is refunded if and to the extent that—
> (a) any repayment of tax, or any payment in respect of a credit for tax, is made to any person, and
> (b) that repayment or payment is directly or indirectly in respect of the whole or part of the amount of tax payable by the overseas party,
>
> but an amount refunded is to be ignored if and to the extent that it results from qualifying loss relief obtained by that party.

53.9.9 *Overseas party transparent*

Para 6(6) sch 4 FA 2019 provides:

> Where some or all of the overseas party's income is treated for the purposes of a relevant tax charged under the law of a country or territory outside the UK as the income of a person or persons other than the overseas party, in paragraph 5 and this paragraph—
> (a) references to that party's liability to any tax (however expressed) include a reference to the liabilities of that person or those persons to the relevant tax,
> (b) references to any tax being payable by that party (however expressed) include a reference to the relevant tax being payable by that person or those persons, and
> (c) references to loss relief obtained by that party include a reference to loss relief obtained by that person or those persons, and sub-paragraph (4) applies to that person or any of those persons as it applies to that party.

The INT Manual provides:

> **INTM610180: Hybrid and Transparent Entities/ Reasonable to Conclude/ UK Resident Non-Domiciled Individuals** [May 2019]
> **Example 18 – Tax Transparent Entity**
> If the overseas party was a United States (US) limited liability company (LLC) it could be charged to tax in the US as if it was fiscally

transparent. However, for the purposes of UK tax, US LLCs are regarded as taxable entities and not fiscally transparent. In these circumstances paragraph 6(6) would apply to treat the US LLC as fiscally transparent for the purposes of applying the tax mismatch test, thus ensuring that account is taken of tax paid by the members of the overseas party.

For example, A is a UK resident company with Profit Fragmentation Arrangements under which it transfers £10,000 of value to O US LLC. O US LLC is owned by US resident individuals (B and C). O US LLC is a transparent entity for US tax purposes such that B and C pay tax on the profits generated by O.

B pays tax on £5,000 of the value transferred to O US LLC at 28% (£1,400). C also pays tax on £5,000 of value transferred to O US LLC at 39.6% (£1,980). In considering O US LLC's liability to tax account should be taken of the £1,400 and £1,980 paid by B and C. O US LLC is therefore treated as having paid £3,380 on the £10,000 transferred.

Thus when considering the tax mismatch condition the increase in relevant taxes to be paid by the overseas party would be £3,380 and not zero.

53.9.10 *Qualifying deduction/loss*

Para 6(7) sch 4 FA 2019 provides:

> In this paragraph—
>
> "qualifying deduction" means a deduction which—
>
> (a) is made in respect of actual expenditure of the overseas party,
>
> (b) does not arise directly from the arrangements,
>
> (c) is of a kind for which the resident party would have obtained a deduction in calculating that party's liability to any income tax or corporation tax had that party incurred the expenditure in respect of which the deduction is given, and
>
> (d) does not exceed the amount of the deduction that the resident party would have so obtained,
>
> "qualifying loss relief" means any means by which a loss might be used for tax purposes to reduce the amount in respect of which the overseas party is liable to tax on the profits of a business

53.9.11 *Reasonable to conclude*

The INT Manual provides:

> **INTM610180 Hybrid and Transparent Entities/ Reasonable to Conclude/ UK Resident Non-Domiciled Individuals** [May 2019]
>
> **Reasonable to Conclude**
>
> It will not always be possible for the resident party to obtain sufficient information about the overseas party to discern the increase in relevant taxes payable by the overseas party when carrying out the tax mismatch test.
>
> If it is reasonable to conclude that the reduction in relevant tax payable by the resident party does not exceed the increase in relevant tax payable by the overseas party, or that the 80% payment test is met then it is reasonable to conclude there is not a tax mismatch.
>
> The expression "reasonable to conclude" shows that this is an objective test, which is to be applied by taking into account all the relevant circumstances and asking what, in the light of those circumstances, a reasonable conclusion would be.

53.9.12 *Foreign domiciled taxpayer*

The INT Manual provides:

> **INTM610180 Hybrid and Transparent Entities/ Reasonable to Conclude/ UK Resident Non-Domiciled Individuals** [May 2019]
>
> **UK Resident Non-Domiciled Individuals**
>
> If the resident party is a non-domiciled individual with foreign source income that is not connected to a UK business activity, then, if that individual is chargeable on the remittance basis for a tax year the foreign source income is not chargeable to income tax or corporation tax. In such a case, any transfer of value from the foreign source will not derive from the profits of a business chargeable to UK tax, so any arrangements will not be Profit Fragmentation Arrangements.
>
> If the resident party is an individual who has settled an offshore trust, which has as a matter of fact protected foreign source income to which the trust protections described below apply and that is not connected to a UK business activity, then the income would not be an amount taken into account by the resident party in computing the amount of UK tax payable.
>
> The 'trust protections' are the changes made by Finance Act 2017 to remove overseas trusts settled by non-UK domiciled settlors from a charge under S624 Income Tax Trading and Other Income Act 2005 ("ITTOIA 05"), S720 ITA 2007 and S727 ITA 2007 in respect of certain trust income and the income of any underlying companies and instead bring them within the scope of S731 ITA 2007 or S643A ITTOIA 05 so that they are assessed on the benefits they receive from

the trust and its underlying entities.

This means that any genuine foreign source income will not be affected by the Profit Fragmentation legislation as the Tax Mismatch exception test will apply.

For more details regarding the interaction between the Profit Fragmentation legislation and the transfer of assets abroad rules see INTM610250 and INTM610260.

Example 19 – Remittance Basis – Foreign Source Income (Judy)

J is a UK resident non-domiciled individual who claims the remittance basis.

J spends every other weekend carrying out a trade in Switzerland through a Swiss company leading executive team building excursions in the Alps. This activity takes place solely in Switzerland and all the activities are carried out by J in Switzerland.

The Profit Fragmentation legislation will not apply to the income derived from her team building company in Switzerland as this is foreign source income not derived from the profits of a business chargeable to UK income tax.

53.10 Counteraction

Para 7 sch 4 FA 2019 provides:

> (1) Adjustments must be made so as to counteract the tax advantages that would (ignoring this Schedule) arise from profit fragmentation arrangements.
>
> (2) The adjustments—
>
> (a) must relate to the expenses, income, profits or losses of the resident party for the tax period in which value is transferred as a result of the material provision,
>
> (b) must be based on what the value transferred would have been if it had resulted from a provision made or imposed as between independent parties acting at arm's length, and
>
> (c) must be just and reasonable.
>
> (3) References in this paragraph to "the resident party" are references to the resident party at the time at which the material provision is made or imposed.

Since the requirements of PFA are so vague, and so many different arrangements may be caught, there seems little alternative to a wide HMRC discretion.

In the HMRC view, the taxpayer must make their own counteraction and self-assess accordingly.

The INT Manual provides:

> **INTM610280: Making Adjustment on the Tax Return: Individuals**
> [May 2019]
>
> Customers will be required to determine whether the Profit Fragmentation legislation applies to them. If they determine that the Profit Fragmentation legislation does apply to them, they will need to make the adjustments required by paragraph 7 of the legislation. These pages set out how different types of customers to whom the Profit Fragmentation legislation could apply should make the required adjustments on their tax return. Customers to whom the Profit Fragmentation legislation applies, and who currently do not make a self-assessment return, must make a self-assessment return in order to report taxable income arising from the adjustment made under the Profit Fragmentation legislation.
>
> Individuals operating as sole traders/ receiving UK property income required to make adjustments under the Profit Fragmentation legislation
>
> Individuals who are self-employed (completing SA103F or SA103S)
>
> Individuals required to adjust their self-employment income under paragraph 7 of the Profit Fragmentation legislation must record these adjustments on their SA return as follows.
>
> Individuals who complete form SA103F must:
>
> - If the required adjustment consists of reducing an expense, disallow the relevant expense that was previously included in the return by making the appropriate entry in one of boxes 32-45.
> - If the required adjustment consists of increasing their income, increase their income by inserting the additional income figure in box 60.
>
> Individuals who complete form SA103S must:
>
> - If the required adjustment consists of reducing an expense, take the relevant expense off the expense figure included in one of boxes 11-19 (and the total at box 20). If their annual turnover was such that they are only required to complete box 20, they should just take the relevant expense off the box 20 total figure.
> - If the required adjustment consist of increasing their income, increase their income by inserting the additional income figure at box 27.
>
> Individuals who have UK property income (completing SA105)
>
> Individuals required to adjust their UK property income under paragraph 7 of the Profit Fragmentation legislation must record these adjustments on their SA return (form SA105) as follows:
>
> - If the required adjustment consists of reducing an expense, take the

relevant expense off the expense figure/s included in boxes 24-29.

- If the required adjustment consists of increasing their income, increase their income by increasing the total income figure at box 20.

INTM610290: Members of a partnership required to make adjustments under the Profit Fragmentation legislation [May 2019]

Adjustments required on the Partnership Return (SA800)

If paragraph 7 of the Profit Fragmentation legislation requires adjustments relating to the income or expenses of a member of a partnership, adjustments must be first be made on the Partnership Return (form SA800).

- If the required adjustment consists of reducing an expense, disallow the relevant expense that was previously included in the return by making the appropriate entry in one of boxes 3.30-3.45.
- If the required adjustment consist of an increase in income, increase the income figure by inserting the additional income figure in box 3.67.
- The adjustments will be carried through to that member's allocation of profits and losses shown on the partnership statements prepared by the partnership as part of the partnership return.

Adjustments required by partners

The relevant partnership members must reflect the adjustments to the profit/loss shown on the partnership statement in their own returns. Therefore for partnership members who are individuals, the figure at box 8 (on form SA104F and SA104S) must be adjusted to reflect the change to their share of the partnership profit or loss as a result of the adjustments required under paragraph 7 of the Profit Fragmentation legislation. Corporate partners must make the necessary adjustment in their CT computation.

INTM610300 Companies required to make adjustments under the Profit Fragmentation legislation [May 2019]

If a company is required to make adjustments under paragraph 7 of the Profit Fragmentation legislation, it should make the necessary adjustments to expenses and/or income in its CT computation.

INTM610200: Profit Fragmentation Adjustments [May 2019]

Example 20 – Profit Fragmentation Adjustments

As with other examples in this guidance, it is likely (?) that accounting principles, other legislation or case law would ensure the appropriate amount of profits are charged to UK tax: the following example illustrates how Profit Fragmentation rules would apply if that were not the case.

A UK company (the resident party) makes arrangements with a

Bermudian company (the overseas party) to provide administrative services to the UK Company to support its UK business.

The UK Company pays the Bermudian company £100,000, however, the arm's length price of the services actually provided by the Bermudian company is only £10,000. The Bermudian company later makes a loan to a participator in the UK Company (the related individual) that is not taxable in the UK, meaning the enjoyment condition is met.

There is no commercial reason for the excessive payment and it is reasonable to conclude that the arrangements were entered into to obtain a tax advantage. The UK tax that would have been paid on the £90,000 diverted would have been £18,000 and the Bermudian tax paid on the £90,000 was £0, meaning the tax mismatch test was met.

These arrangements are Profit Fragmentation Arrangements so adjustments must be made to the amounts to be included in the UK Company's tax returns.

The Profit Fragmentation legislation ensures the amount of profit that should be taxable in the UK is fully taxed in the UK. In this case the amount relating to the arrangements that should be taxed in the UK but wasn't is £90,000. This is the difference between the value transferred and the arm's length price.

The UK Company should disallow £90,000 worth of their administrative services costs in their tax computation – increasing their taxable profits by £90,000.

The £10,000 that is still deducted represents the value that should have been transferred for tax purposes between independent parties acting at arm's length.

53.11 Exemptions

Para 5 sch 4 FA 2019 provides:

> (5) The results described in sub-paragraph (1)(a) and (b)(i) are exempted if they arise solely by reason of—
>
> (a) contributions paid by an employer under a registered pension scheme, or overseas pension scheme, in respect of any individual,
>
> (b) a payment to a charity,
>
> (c) a payment to a person who, on the ground of sovereign immunity, cannot be liable for any relevant tax...

53.12 Payment to fund

Para 5 sch 4 FA 2019 provides:

> (5) The results described in sub-paragraph (1)(a) and (b)(i) are exempted if they arise solely by reason of...
>
> (d) a payment to an offshore fund or authorised investment fund—
>
> (i) which meets the genuine diversity of ownership condition (whether or not a clearance has been given to that effect), or
>
> (ii) at least 75% of the investors in which are, throughout the accounting period, registered pension schemes, overseas pension schemes, charities or persons who cannot be liable for any relevant tax on the ground of sovereign immunity.

53.13 Diversity of ownership

Para 11 sch 4 FA 2019 provides:

> In this Schedule-
>
> "genuine diversity of ownership condition" means—
>
> (a) in the case of an offshore fund, the genuine diversity of ownership condition in regulation 75 of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/3001), and
>
> (b) in the case of an authorised investment fund,[16] the genuine diversity of ownership condition in regulation 9A of the Authorised Investment Fund (Tax) Regulations 2006 (S.I. 2006/964)

The two regulations are in similar terms: it is helpful to see them side by side:

Reg 75 OFTR	**Reg 9A AIFTR**
(1) The genuine diversity of ownership condition is met if the fund meets, or, in relation to a fund constituted by a class of interests in the main arrangements, the main arrangements meet, conditions A to C throughout the period of account.	(1) For the purposes of these Regulations, the genuine diversity of ownership condition is as follows. (2) The genuine diversity of ownership condition is that an authorised investment fund must— (a) meet conditions A to C throughout the accounting period; or (b) comply with paragraph (8).

[16] Defined para 11 sch 4 FA 2019: "authorised investment fund" means—
(a) an open-ended investment company within the meaning of section 613 of CTA 2010, or
(b) an authorised unit trust within the meaning of section 616 of that Act".

(2) Condition A is that the fund produces documents, available to investors and to HMRC, which contain— (a) a statement specifying the intended categories of investor, (b) an undertaking that interests in the fund will be widely available, and (c) an undertaking that interests in the fund will be marketed and made available in accordance with the requirements of paragraph (4)(a).	(3) Condition A is that the fund documents— (a) contain a statement that units in the fund will be widely available, (b) specify the intended categories of investor, and (c) specify that the manager of the fund must market and make available the units in the fund in accordance with paragraph 9A(6)(a).
(3) Condition B is— (a) that the specification of the intended categories of investor do not have a limiting or deterrent effect, and (b) that any other terms or conditions governing participation in the fund do not have a limiting or deterrent effect.	(4) Condition B is that neither— (a) the specification of the intended categories of investor, nor (b) any other terms or conditions governing participation in the fund, whether or not specified in the fund documents, have a limiting or deterring effect.
	(5) In paragraph (4) a limiting or deterring effect means an effect which— (a) limits investors to a limited number of specific persons or specific groups of connected persons, or (b) deters a reasonable investor within the intended categories of investor from investing in the fund.
(4) Condition C is— (a) that interests in the fund must be marketed and made available— (i) sufficiently widely to reach the intended categories of investors, and (ii) in a manner appropriate to attract those categories of investors, and (b) that a person who falls within one of the intended categories of investors can, upon request to the manager of this fund, obtain information about the fund and acquire units in it.	(6) Condition C is that— (a) units in the fund must be marketed and made available— (i) sufficiently widely to reach the intended categories of investors, and (ii) in a manner appropriate to attract those categories of investors; and (b) a person who is in an intended category of investor can, upon request to the manager of the fund, obtain information about that fund and acquire units in it. Condition C is subject to paragraph (7).

	(7) Condition C shall be treated as being met even if at the relevant time the fund has no capacity to receive additional investments, unless— (a) the capacity of the fund to receive investments in it is fixed by the fund documents (or otherwise), and (b) a pre-determined number of specific persons or specific groups of connected persons make investments in the fund which collectively exhausts all, or substantially all, of that capacity.
(5) A fund also meets the genuine diversity of ownership condition if— (a) an investor in the fund is an offshore fund, an open-ended investment company or an authorised unit trust scheme ("the feeder fund"), (b) conditions A to C are met in relation to the fund after taking into account— (i) the fund documents relating to the feeder fund, and (ii) the intended investors in the feeder fund, and (c) the fund and the feeder fund have the same manager (or proposed manager).	(8) An authorised investment fund also meets the genuine diversity of ownership condition if— (a) an investor in the fund is a unit trust scheme, an offshore fund or another authorised investment fund (a "feeder fund"); (b) conditions A to C are met in relation to the authorised investment fund after taking into account— (i) the fund documents relating to the feeder fund, and (ii) the intended investors in the feeder fund; and (c) the authorised investment fund and the feeder fund have the same manager (or proposed manager).

53.14 Double charge relief

Para 8 sch 4 FA 2019 provides:

> (1) This paragraph applies where—
> (a) the resident party has paid a relevant tax by virtue of the application of paragraph 7,
> (b) at any time, the resident party or another person pays—
> (i) a further amount of the relevant tax, or
> (ii) an amount of non-UK tax[17] corresponding to the relevant

[17] Defined by reference in para 11 sch 4 FA 2019: "non-UK tax" has the meaning given by section 187 of CTA 2010". Section 187 provides:
"(1) In this Part "non-UK tax" means a tax chargeable under the law of a territory outside the UK which—

tax, and

(c) the result is a double payment of tax calculated by reference to the same income or profits.

(2) In order to avoid the double payment of tax, the resident party may make a claim in writing for one or more consequential adjustments to be made in respect of the tax paid mentioned in sub-paragraph (1)(a).

(3) On a claim under this paragraph an officer of Revenue and Customs must make such of the consequential adjustments claimed (if any) as are just and reasonable.

(4) The amount of any consequential adjustments must not exceed the lesser of—

(a) the tax paid by the resident party as mentioned in sub-paragraph (1)(a), and

(b) the tax paid as mentioned in sub-paragraph (1)(b).

(5) Consequential adjustments may be made—

(a) in respect of any tax period,

(b) by way of an assessment, the modification of an assessment, the amendment of a claim or otherwise, and

(c) despite any time limit imposed by or under any enactment.

53.15 Reimbursement relief

Para 9 sch 4 FA 2019 provides:

> In calculating income, profits or losses for any tax purposes, no account is to be taken of any amount which is paid (directly or indirectly) by a person for the purposes of meeting or reimbursing the cost of tax charged on the resident party by virtue of the application of paragraph 7.

53.16 TAAR

Para 2(2) sch 4 FA 2019 provides:

> But arrangements are not "profit fragmentation arrangements" if...
>
> (b) it is not reasonable to conclude that the main purpose, or one of the main purposes, for which the arrangements were entered

(a) is charged on income and corresponds to UK income tax, or

(b) is charged on income or chargeable gains or both and corresponds to UK corporation tax.

(2) A tax is not outside the scope of subsection (1) by reason only that it—

(a) is chargeable under the law of a province, state or other part of a country, or

(b) is levied by or on behalf of a municipality or other local body."

> into was to obtain a tax advantage.

The double negative is non-standard wording, but I do not think that makes any difference.

Para 11 sch 4 FA 2019 sets out the GAAR definition of "tax advantage".[18] Tax here means income tax and corporation tax.

53.17 PFA: EU law

The PFA code is not EU-law compliant. Perhaps the drafter thought that no longer mattered. A case-law EU law defence must somehow be read it.

53.18 Partnerships

Para 10 sch 4 FA 2019 provides:

> (1) This paragraph applies where a person is a member of a partnership.
> (2) Any references in this Schedule to the expenses, income, profits or losses of, or to the adjustment of the expenses, income, profits or losses of, the person includes a reference to the person's share of the expenses, income, profits or losses of, or adjustment of the expenses, income, profits or losses of, the partnership.
> (3) For this purpose "the person's share" of an amount is determined by apportioning the amount between the members of the partnership on a just and reasonable basis.

53.19 "Partnership"/"Trust"

Para 11 sch 4 FA 2019 sets out foreign-entity definitions of partnership/ partner/trust/beneficiary; but these definitions are otiose; see 90.3.3 (Foreign-entity clauses).

53.20 Other anti-avoidance rules: Interaction

The INT Manual provides:

> **INTM610020: Introduction: Who do these rules apply to? / How will these rules be used?** [May 2019]
> The Profit Fragmentation legislation reinforces existing tax legislation. It will only apply after other existing provisions and only to the extent that the existing provisions have not fully counteracted any tax advantages arising from the arrangements. This means that if other tax

[18] See 3.19.1 (Tax advantage: Definitions).

legislation is being correctly applied such that the correct amount of UK tax is being paid by the resident party then the Profit Fragmentation legislation will not apply.

53.20.1 *PFA/transfer pricing/DPT*

The INT Manual provides:

> **INTM610210: Profit Fragmentation Adjustments: Hierarchy of Legislation [May 2019]**
> **Example 21 – Other Legislation Applying First** [Transfer pricing]
> A UK Company, the resident party, makes arrangements with a Bermudian company that meet all the conditions to be Profit Fragmentation Arrangements. The Bermudian company is owned by the same parent company as the UK Company.
> The UK Company makes a cash payment of £100,000 to the Bermudian company, however, the services the Bermudian company actually provide to the UK Company are only worth £10,000, this is the price that would be paid between independent parties acting at arm's length.
> The company makes transfer pricing adjustments to reduce the deduction claimed to £10,000 meaning there is no tax advantage gained from the arrangements.
> As the tax advantage has been fully counteracted by the transfer pricing adjustment it would not be just and reasonable to make further adjustments under the Profit Fragmentation legislation so not further adjustments should be made.
> **Diverted Profits Tax**
> DPT is a separate tax from income or corporation tax. If the Profit Fragmentation legislation leads to adjustments which bring any amount into charge, that amount will not be taxable diverted profits for the purposes of DPT. This is because S83(3), S84(2)(c), and S85(6)(b)(iii) FA 2015, remove any amount taken into account in an assessment to corporation tax from being considered diverted profits...

53.20.2 *PFA/s.720 interaction*

The INT Manual provides:

> **INTM610250: Interaction with Other Legislation: Income Chargeable to S720 or S727 ITA 2007** [May 2019]
> The pages describe the interaction between the Profit Fragmentation legislation, and the Transfer of Assets Abroad (TOAA) legislation which can be found at Chapter 2 Part 13 of The Income Tax Act 2007 (ITA 2007).

This guidance considers how the Profit Fragmentation legislation will apply to adjustments that are within the scope of both Paragraph 7 of the Profit Fragmentation legislation and S720 or S727 ITA 2007 of the TOAA legislation. In these circumstances S720 or S727 ITA 2007 should take precedence over the Profit Fragmentation legislation for the reasons that follow.

Paragraph 7 of the Profit Fragmentation legislation sets out the adjustments required in relation to the Profit Fragmentation arrangements. These adjustments are to be made in order to counteract any tax advantages arising from the Profit Fragmentation arrangements that remain after the application of other provisions.

Where S720 or S727 ITA 2007 has charged tax on the income such that any tax advantages arising from the Profit Fragmentation arrangements have been fully counteracted the Profit Fragmentation legislation will not apply. This is because if the individual did have Profit Fragmentation Arrangements as per the definition in paragraph 2, and S720 or 727 ITA 2007 are applied then no later adjustments will be required under paragraph 7 of the Profit Fragmentation legislation as the tax advantage will be counteracted.

If the tax advantage is only partially counteracted by the application of S720 or S727 ITA 2007 then adjustments should be made under paragraph 7 of the Profit Fragmentation legislation to counteract any remaining tax advantage. This could apply in circumstances where a resident party has incurred an expense reducing their taxable profits as a result of a payment to the overseas party. Part of the corresponding receipt is considered income in the accounts of the overseas party and is chargeable to S720 or 727 ITA 2007 on a UK resident individual, but part is treated for example as capital in the overseas party's accounts – Profit Fragmentation would still apply to correct the remaining tax advantage.

If the arrangements include a settlor interested trust and income arises to the settlement S624 Income Tax (Trading and Other income) Act 2005 (ITTOIA) may apply to counteract any tax advantage that arises under the Profit Fragmentation rules in the same way as S720 or S727 ITA 2007.

If an arrangement is covered by the Finance Act 2018 changes, such that there is relevant foreign income, this income is potentially caught by s731 ITA 2007. For information regarding the interaction of s731 ITA 2007 and the Profit Fragmentation arrangements please see 7.1.2 below.

For the purpose of these examples we refer solely to S720 ITA 2007, but if the capital sum conditions are in point this could be read as S727 ITA 2007, and the same conclusions would follow.

Example A - An individual makes a provision to transfer value via a UK resident company to an overseas company owned by an overseas trust in which the individual is settlor and beneficiary.

J, a UK resident and domiciled individual, owns all of the share capital in a UK resident company which makes a payment of £150,000 to an overseas company. The overseas company is owned by an overseas trust of which J is both the settlor and beneficiary. Following enquiries it transpires that the payment is made for services provided by the overseas company though the payments being made are inflated. The value of the services if they had been undertaken at arm's length are £100,000 not £150,000 though full amount of this receipt is treated as income in the overseas company's accounts. It is assumed for the purpose of this example that no other legislation applies.

The conditions for the application of TOAA are met and the profits of the overseas company will be assessable on J under S720 ITA 2007. The conditions to be Profit Fragmentation arrangements are also met. Assuming for the purpose of this example that the overseas company incurred no deductible expenditure the full amount of the £150,000 will be treated as income arising to J and they will be charged to tax on the full amount under S720 ITA 2007. This means that UK income tax has been paid on the full amount of the income and therefore there is no tax advantage as a result of the Profit Fragmentation arrangements.

Example B - An individual makes a provision to transfer value to an overseas company for the benefit of a connected person in circumstances when the conditions for s720 ITA 2007 are met.

A UK resident and domiciled individual (A) makes a payment of £150,000 to an overseas company which is owned by an overseas trust the settlor and beneficiary of which is another UK resident and domiciled individual (B). A and B are connected persons who pay income tax at the additional rate of income tax. The payment relates to services that are provided to him by the overseas company. The value that would have been transferred between independent parties acting at arm's length is £100,000 not £150,000 though full amount of this receipt is treated as income in the overseas company's accounts.

The conditions to be Profit Fragmentation arrangements are met, as we assume for the purpose of this example are the conditions for S720 ITA 2007 to apply.

The full amount of the £150,000 will be charged treated as income arising to B and they will be charged to tax on the full amount. This means that UK tax has been paid on the full amount of the income and therefore there is no tax advantage as a result of the Profit Fragmentation arrangements.

> **Example C- An individual makes a provision to transfer value directly to an overseas company owned by an overseas trust of which the individual is settlor and beneficiary.**
> A UK resident and domiciled individual makes a payment of £150,000 for services provided to him by an overseas company which is owned by an overseas trust of which he is the settlor and beneficiary. The services are provided by the overseas company though the payments being made are inflated. The value that would have been transferred between independent parties acting at arm's length is £100,000 not £150,000 though the full amount of this receipt is treated as income in the overseas company's accounts.
> The conditions to be Profit Fragmentation arrangements are met, as are the conditions for S720 ITA 2007 to apply.
> Assuming for the purposes of this example that the overseas company incurred no expenditure in respect of the services provided the full amount of the £150,000 will be charged treated as arising to the UK resident individual under S720 ITA 07 and they will be charged to tax on the full amount. This means that UK tax has been paid on the full amount of the income and therefore there is no tax advantage as a result of the Profit Fragmentation arrangements.

PFA	**ToA**
Applies to business income	Applies to any income
Transfer of assets	Value transferred
Individual transferor taxable	No transferor needed; anyone taxable
Distributed income not taxed again	No rule; maybe HMRC discretion
Motive defence: avoidance	Motive defence: Tax advantage

53.20.3 *PFA/s.731 interaction*

The INT Manual provides:

> **INTM610260: Interaction with Other Legislation: Income Chargeable to S731 ITA 2007** [May 2019]
> **Benefit Charge**
> If Profit Fragmentation legislation is applicable to arrangements under which a benefit charge under S731 ITA 2007 is later raised no relief will be available to set against the amount paid under S731 ITA 2007 to take account of the tax paid under the Profit Fragmentation legislation.
> There is no basis on which to give credit relief to the recipient of a benefit who is liable under S731 ITA 2007. Unlike the provisions of S720 and S727 ITA 2007, S731 does not deem particular income of the foreign person to be the income of the UK resident individual receiving the benefit but, rather, seeks to tax the value of a benefit actually

received by him, and then only if and to the extent that it can be matched by relevant income.

The relevant income itself is not being taxed as income of the UK resident individual, but the value of the benefit is. In arriving at the net figure for relevant income, deduction is made for any taxes, whether UK or foreign, and any expenses properly incurred against that income under S733(1) ITA 2007. This can include payments made by the overseas person to the resident party to cover the tax liability arising as a result of the Profit Fragmentation legislation.

The double taxation relief available under paragraph 8 of the Profit Fragmentation legislation will not be available in these circumstances as the charge under S731 ITA 2007 is on the benefit that arises and not on income attributed to the UK resident individual.

Example D-The application of the Profit Fragmentation rules when the benefit charge applies.

An overseas trust was settled by P, a UK resident and UK domiciled individual for the benefit of his two adult children. P is excluded from benefiting from the trust. A UK resident company makes a payment of £150,000 to an overseas company which is owned by the overseas trust. Services are provided by the overseas company though the payments being made are inflated. The value that would have been transferred between independent parties acting at arm's length is £100,000 not £150,000. Though full amount of this receipt is treated as income in the overseas company's accounts.

The conditions to be Profit Fragmentation arrangements are met so the UK resident company makes an adjustment to reduce their expenses by £50,000 under paragraph 7 of the Profit Fragmentation legislation.

The full amount of the £50,000 will be taxable on the UK resident company at 20% meaning the UK resident company pays £10,000 of tax. The overseas company makes a payment to the UK resident company for £10,000 to allow them to pay the tax due on the adjusted amount.

For the purposes of the transfer of assets legislation the remaining £140,000 will be relevant income under S733 ITA 07. For the purpose of this example it is assumed that there is no other relevant income in the structure. In the following tax year the overseas trustees make a capital distribution of £150,000 to one of P's children. The relevant income of £140,000 will be matched against the benefit under S733 ITA 07 resulting in a benefits charge on that individual under S731 ITA 2007of £140,000 assessable on the UK resident individual in this later year.

53.20.4 *PFA/Protected trusts interaction*

The INT Manual provides:

> **INTM610260: Interaction with Other Legislation: Income Chargeable to S731 ITA 2007** [May 2019]
>
> **Trust Protections**
>
> The 'trust protections' are the changes made by Finance Act 2017 and Finance Act 2018 to remove what is referred to as protected foreign source income arising in overseas trusts settled by non-UK domiciled settlors from a charge under S624 Income Tax Trading and Other Income Act 2005 ("ITTOIA 05"), S720 ITA 2007 and S727 ITA 2007 and the protected foreign source income of any underlying companies. Such income is instead brought within the scope of S731 ITA 2007 or S643A ITTOIA 05 so that the settlor and close family members are assessed on the benefits they receive from the trust and its underlying entities to the extent that this can be matched with the protected foreign source income arising within the structure.
>
> Protected foreign source income is defined at S628A ITTOIA 05, S721A and S729A ITA 2007. It is not affected by the Profit Fragmentation legislation for the reasons given below. This means that the trust protections will not be affected by the introduction of the Profit Fragmentation legislation.
>
> Paragraph 2 of the Profit Fragmentation legislation requires that there exists a material provision that results in a transfer of value from the resident party to the overseas party. The value transferred will be a transfer of value generated directly or indirectly from the profits of a business chargeable to UK income tax or corporation tax in the tax year or accounting period of the resident party.
>
> Protected foreign source income (PFSI) as defined at S721A ITA 2007, is foreign source income. As PFSI cannot represent value which derives directly or indirectly from the profits of a business chargeable to UK income tax or corporation tax, paragraph 2(1)(b) of the Profit Fragmentation legislation will not apply.
>
> PFSI cannot be income that the Profit Fragmentation legislation applies to, so there is no interaction between the Profit Fragmentation legislation and the TOAA legislation for this type of income.
>
> A "transfer of value" for the purpose of paragraph 2 of the Profit Fragmentation legislation will not therefore include genuine protected foreign source income chargeable in the UK under S731 ITA 2007.

53.20.5 *PFA/Carried interest/DIM interaction*

The INT Manual provides:

> **INTM610270: Interaction with Other Legislation: Carried Interest and Disguised Investment Management Fees** [May 2019]
> Remuneration for investment management services is typically divided between various parties to a fund arrangement. The fixed fee will show in the accounts of the investment management business as trading income, while the contingent fee element, typically referred to as carried interest, may be recognised in a special purpose vehicle and distributed. Where carried interest arises to individuals in respect of investment management services provided to a collective investment scheme, there are specific rules within Chapter 5, Part 4 of Taxation of Chargeable Gains Act 1992, that determine how this will be brought into account for tax purposes.
> It is expected that the value of the remuneration paid for the investment management services will be an arm's length value under a typical commercial arrangement. In circumstances where the contingent fee element of the remuneration includes 'disguised investment management fees', the existing legislation at Chapter 5E Part 13 ITA 07 applies in priority to the Profit Fragmentation rules and should result in the correct amount of UK tax being paid.

53.21 NICs

The INT Manual provides:

> **INTM610220: Profit Fragmentation Adjustments: NICs Consequences for Individuals** [May 2019]
> Section 15 and Schedule 2 to the Social Security Contributions and Benefits Act 1992 and the Social Security Contributions and Benefits (Northern Ireland) Act 1992 mean that profits adjusted under this Schedule are chargeable to Class 4 NICs where those profits are not from a trade, profession or vocation carried on wholly outside the UK.

53.22 Commencement

Para 12 sch 4 FA 2019 provides:

> This Schedule has effect—
> (a) for income tax purposes, in relation to any value transferred on or after 6 April 2019 as a result of a material provision, and
> (b) for corporation tax purposes, in relation to any value transferred on or after 1 April 2019 as a result of a material provision.

INTM provides:

INTM610030 Introduction: When Do These Rules Apply? [May 2019]

... **Example 1 –No Residual UK Business**

... In 2016 Company A, a UK resident research and development company, ("A Ltd") created a new type of high-tech micro-chip used in mobile phones. The technology was ahead of its time on creation and the company did not anticipate that it would need any technological maintenance for at least 4 years.

In 2018 the patent for the micro-chip was transferred to Company B ("B Ltd"). B Ltd is another group company, based in the British Virgin Islands (BVI), which holds all of the group's patents and exploits them all over the world. This transfer took place on arm's length terms: B Ltd paid a significant sum to A Ltd. in return for the patent

B Ltd. has a workforce based in the BVI responsible for exploiting the group's patents to customers. During the accounting period ending 31 December 2019 B Ltd. generated income of $1m from its customers relating to the patent.

The Profit Fragmentation legislation will not apply to the transfer of the patent in 2016 because the transfer took place in advance of the legislation applying. Furthermore, it will not apply to the income generated by B Ltd during the APE 31 December 2019 as this income is not properly attributable to the UK business.

Example 2 – Basic Post-Commencement Transfer

This example shows when the Profit Fragmentation legislation will apply to certain transfers occurring after 1 April 2019 (or 6 April 2019 for income tax purposes) in relation to transfers that have taken place before that date.

As with other examples in this guidance, it is likely (?) that accounting principles, other legislation or case law would ensure the appropriate amount of profits are charged to UK tax: the following example illustrates how Profit Fragmentation rules would apply if that were not the case.

The facts for this example are the same as those as set out in Example 1, but we are now considering the accounting period ended 31 December 2020.

In January 2020 it becomes apparent that the micro-chips will need updating to ensure the technology remains current. B Ltd. does not have the necessary expertise to update them, so A Ltd. updates the technology for B Ltd. but does not receive any remuneration for doing this. The service of updating the technology by A Ltd without receiving any remuneration results in a transfer of value to B Ltd.

The Profit Fragmentation legislation could apply to this transfer of value at the time this occurs (in this example this is during the accounting period ended 31 December 2020) provided the arrangements are Profit Fragmentation Arrangements and the exception conditions don't apply.

53.23 PFA impact

PFA condoc provides:

> This measure is expected to increase receipts by approximately up to £50 million per annum. The final costing will be subject to scrutiny by the Office for Budget Responsibility.
> This measure has no impact on compliant[19] businesses.
> It is likely to affect a small number of non-compliant businesses, estimated to be in the region of 4-5,000, which are currently involved in tax avoidance arrangements.

5,000 businesses, with a yield of £50m, suggests an average yield of £10k per business. That seems implausible, as one would not set up the arrangements at which PFA is targeted to gain an advantage of that amount. Perhaps the figure is not intended to be taken seriously.

Of course, if HMRC enforced the existing law, the yield should be nil.[20]

[19] For this tendentious use of the word "compliant" see App 1.4 ("Compliant").

[20] See 53.2 (The target).

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TAXATION OF NON-RESIDENTS AND FOREIGN DOMICILIARIES 2024-25

by

JAMES KESSLER KC

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TWENTY FOURTH EDITION

Key Haven Publications Ltd
P. O. Box 669, Oxford, OX3 3AU
Tel: 01865 352121
http://www.khpplc.co.uk

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54.1 Transfer of income streams

54.1.1 *Income-stream codes: Navigation*

This chapter considers the following topics:

Topic (my terminology)	**Legislation**	**Sections**
Income Tax income-stream codes	*Part 13 ITA*	
Main income-stream code	Chap 5A	809AZA-809AZG
Partnership income-stream code	Chapter 5AA	809AAZA-809AAZB
CGT: Disposal via partnership	Chapter 5D	809DZA-809DZB
CT income-stream code	*CTA*	
Company transferor	Chap 1 Part 6 CTA 2010	
Company transferee	Chap 2B Part 6 CTA 2009	

The background to the main income-stream code can be found in:

- HMRC, "Financial Products Avoidance: Consultation on Principles- Based Legislation" 2007
- HMRC, "Principles-based drafting: Transfers of Income Streams" 2009

I go beyond the themes of this book and address the topic as a whole.

54.1.2 *Section numbering system*

The ITA system of numbering sections is idiosyncratic. Section numbering begins with 809, followed by the Chapter letters, ie one of 809A/809AA/809D. The sections are then numbered ZA, ZB, etc. Hence:

- the 1st section of Chapter 5A is s.809AZA and the last is s.809AZG
- the 1st section of Chapter 5AA is s.809AAZA and the last is s.809AAZB

This is due to a misguided application of OPC drafting guidelines; see App.13.3 (Section numbering system).

54.2 Is income transferable?

It is helpful first to consider the position in the absence of the income-streams code or similar legislation.

54.2.1 *Income effectively transferable*

As a matter of property law, it is possible for a person:

(1) to transfer a right to a receipt which would constitute income (eg dividends/interest/royalties) if received by the transferor, and
(2) to do so without a transfer of the underlying asset (eg the shares/debt/ IP rights)

As a matter of tax law, in principle:

(1) The payment which the transferor receives for the transfer of the right to investment income is characterised as capital and not income.
(2) The receipt which the transferee receives is the income transferred (ie, specifically, the dividends/interest royalties).

It is helpful to coin a term for discussion here, and one may say that X **"tax-effectively transfers"** income if the transfer is effective for tax purposes as well as for property law purposes, ie:

(1) The payment which the transferor receives for the transfer is capital.
(2) The receipt of the transferee is regarded as the income transferred.

It may loosely (and pejoratively) be said that the transfer turns income into capital; but more accurately, it replaces what would have been the transferor's income receipt with a different receipt which is capital.

I say "in principle" as in two avoidance cases this analysis has been rejected, under *Ramsay* type arguments:

(1) *McGuckian v IRC*[1] concerned the sale of a right to dividends: the consideration received by the transferor for the sale was held to be income.

(2) *Hargreaves Property Holdings v HMRC*[2] concerned the sale of a right to interest: it was held that the transferee was not beneficially entitled to the interest (for the purpose of a relief from interest withholding tax). The reader may find that surprising, even in an avoidance case.

54.2.2 *Pre-2009 anti-avoidance rules*

Tax-effective transfers of income would allow scope for tax avoidance by the transferor.[3] This was countered by *ad hoc* anti-avoidance provisions, in particular:

ICTA 1988	**Topic**
s.730	Transfer of right to dividends
s.775A	Transfer of right to Annual Payments
s.785A	Transfer of chattel lease rent

EN FB 2009 provided:

> 48. These statutory rules are not comprehensive. There are also differences and inconsistencies in the way the various provisions work, and ... they have been the subject of attempts to avoid their operation.

These provisions were repealed on the introduction of the income-stream code in 2009.

54.2.3 *Earned income not transferrable*

On the other hand, certain types of income are not tax-effectively

[1] 69 TC 1.

[2] [2023] UKUT 120 (TCC); further consideration may be needed when the case is final. One might have thought that the transferor was caught by the income-stream code; this point was not raised; but why not?

[3] Of course the position of the transferee needed consideration, but I need not pursue that here.

transferable:

(1) Employment income is not tax-effectively transferable: ie if an employee assigns a right to earnings, the employee remains taxable, not the assignee.[4]

(2) Trading income is not in general tax-effectively transferable: ie if a trader sells a right to a trading receipt, the sale proceeds constitute a trading receipt, so the sale does not turn income into capital.[5] The disguised trading receipt rules need consideration; and the rules for appropriation from trading stock may also apply here.[6]

These rules are not affected by the income-stream code, because that code only applies if there would (but for the code) be a tax-effective transfer, ie:

(1) There is an effective transfer of income (a "relevant receipt")[7]

(2) The consideration for the transfer would not be subject to income tax[8]

In short, we are here considering transfers of an *investment* income stream.

[4] *RFC 2012 Plc v AG* [2017] UKSC 45 (the *Rangers* case).
Employment income of X is effectively transferable if:
(1) X ceases to be an employee and
(2) Y commences to be an employee.
But one might say that involves (in effect) a transfer of an underlying asset (the employment contract).

[5] Even consideration for an outright sale of royalties by an author carrying on a trade or profession is a receipt of the trade/profession.
Trading income of X is effectively transferable if:
(1) X ceases to trade and Y commences to trade, or
(2) X and Y commence to trade in partnership.
But that involves a transfer of the underlying asset (the trading business).

[6] On the other hand, partnership income is tax-effectively transferable, ie if a partner assigns a partnership share to a non-partner, the partner remains taxable on the partnership profits. This applies even where the partnership has no capital assets, and the income arises from the personal services of the partner. The position here has been clarified by *HMRC v BlueCrest Capital Management* [2023] EWCA Civ 1481. In a New Zealand case, a partner in a firm of accountants assigned a part of his partnership share to a non-partner. It was said that his partnership income arose from his personal services, not from the partnership agreement, and the assignment was held to be ineffective, in the sense that the income of the assigned share remained the income of the transferor for tax purposes: *Hadlee v CIR* [1993] AC 524. But *BlueCrest* decided that *Hadlee* is not applicable to UK partnership tax, which is different from that in New Zealand; see at [87].

[7] See 54.4 (Relevant receipts).

[8] See 54.8.1 (Amount otherwise taxed).

54.3 Application of IS code

EN FB 2009 provides a summary:

> 49.The new legislation sets out a general principle that a lump sum received for the sale or transfer of income stream is subject to tax in the transferor's hands in the same way that the income itself would have been (so there is no possibility of converting income into capital). The rule is subject to a number of exceptions.

Section 809AZA(1) ITA provides:

> This Chapter [Chap 5A, Income-streams code] applies where-
> (a) a person within the charge to income tax ("the transferor") makes a transfer to another person ("the transferee") of a right to relevant receipts (see subsection (2)), and
> (b) (subject to subsection (3)) the transfer of the right is not a consequence of the transfer to the transferee of an asset from which the right to relevant receipts arises.

I deal with these two conditions separately.

54.4 Relevant receipts

Section 809AZA ITA provides:

> (1) This Chapter [Chap 5A, Main income-stream code] applies where-
> (a) a person within the charge to income tax ("the transferor") makes a transfer to another person ("the transferee") of a right to relevant receipts

Section 809AZA(2) ITA provides:

> "Relevant receipts" means any income-
> (a) which (but for the transfer) would be charged to income tax as income of the transferor, or
> (b) which (but for the transfer) would be brought into account in calculating profits of the transferor for the purposes of income tax.

Relevant receipts is not a transparent term: I gloss it as relevant (income) receipts.

The CFM provides

CFM77050 Transfer Under Sale And Repurchase Agreement [Nov 2019]
Example 2 (Urban& Rural)
U Ltd sells securities to R plc under a sale and repurchase (or 'repo') agreement. Under the terms of the repo R will compensate U for not receiving the real income by the making of manufactured payments (CFM46010).
The manufactured payments represent consideration for the right to the income that U transfers as a result of the repo.
However, the income payments that are transferred are not relevant receipts. This is because relevant receipts are defined to be amounts that but for the transfer would be charged as income of the transferor. The transfer must therefore have the effect of causing the receipts not to be taxable income of the transferor. Where a sale is made under a standard repo this is not the case since the income is still treated as that of the seller - CTA09/S550. Accordingly, the transfers of income legislation will not apply.

54.5 Transfer of income, not asset

Section 809AZA ITA provides:

> (1) This Chapter applies where ...
> (b) (subject to subsection (3))[9] the transfer of the right is not a consequence of the transfer to the transferee of an asset from which the right to relevant [income] receipts arises.

The legislation distinguishes:
(1) A right to relevant (income) receipts
(2) An asset from which the right to relevant receipts arises

This is not always an easy distinction.

It is considered that a usufruct is an asset from which the right to relevant receipts arises, so the grant of a usufruct is not caught by the main income-stream code.

The CFM gives two straightforward examples: (1) sale of a business (not caught); (2) sale of a right to licence fees (caught).

CFM77030 Company Transferors [Nov 2019]
Example 1
A Ltd sells a picture-framing business to B. This includes assigning the

[9] See 54.5.1 (Annual Payments).

> lease for the premises and the sale of equipment and stock and the transfer of a number of income-producing assets.
>
> Although, there has, in a sense, been a transfer of an income stream from A Ltd to B (that is, the trading income), the transfer of income streams provisions will not apply. The underlying income-producing assets have been sold.
>
> **Example 2**
>
> C Ltd has a software development and consultancy business. In the course of the trade, the company develops a computer program in which there is commercial interest. C Ltd sets up a subsidiary company, D Ltd, to exploit and market the software.
>
> C Ltd enters into a licensing agreement granting D Ltd a 25-year licence on the source code and intellectual property rights in the software, in exchange for a licence fee paid quarterly. The agreement does not require C Ltd to further develop or maintain the software, or supply technical advice to users - this is all done by D Ltd.
>
> The licence fees are agreed to form part of C Ltd's trading income, and are reflected in the amount it returns as trading profits.
>
> C Ltd sells the right to the quarterly licence fees paid by D Ltd to an unconnected company, E Ltd.
>
> Depending on the facts of the case, the sale proceeds may be treated as trading income on first principles.

That is, D Ltd might be carrying on a trade.

> However, if they are not, then this is a sale of a right to relevant receipts without the transfer of the underlying asset and C Ltd should include the payment for the right to the income as trading income by virtue of S753(1).

54.5.1 *Annual Payments*

Section 809AZA(3) ITA provides:

> Despite paragraph (b) of subsection (1), this Chapter [Chap 5A, Main income-stream code] applies if the transfer of the right is a consequence of the transfer to the transferee of all rights under an agreement for annual payments ...

See 31.1 ("Annual Payment").

The CFM provides

> **CFM77040 Rights Under Agreement For Annual Payment** [Nov 2019]
>
> CTA10/S752(3) contains an exception to the requirement that the

> underlying asset is not transferred.

The CFM explains why:

> If the asset consists of all the rights under an agreement for annual payments then such an agreement is indistinguishable from a right to relevant receipts. So it is appropriate to treat the outright transfer of the agreement in the same way as a transfer of the right to relevant receipts. The transfer of all rights under an agreement for annual payments was previously taxed as income under ICTA88/S775A, which is repealed at FA09/SCH25/PARA9(1)(b).

The reader may doubt whether this policy argument is correct. The approach under the pre-2009 rules does not count for much, as the object of the income-stream code was said to be to rationalise inconsistent rules. But there it is. The point will not often arise.

> This rule applies only where the income that is transferred constitutes annual payments in the hands of the transferor. Where the transferor carries on a trade and the income stream would not have been pure income profit in his hands, S752(3) does not apply.
> **Example**
> Example 2 at CFM77030 describes the transfer of the right to licence fees from the holder of the licence, C Ltd, a trading company, to an unconnected company, E Ltd.
> If E Ltd does not carry on a trade then the fees are annual payments in its hands; they represent pure income profit.[10]
> If E Ltd then transfers the right to these annual payment to a third company, G Ltd, this may be the transfer of all rights under an agreement for annual payments.
> S752(3) makes it clear that, despite the fact that the underlying asset consists of all rights under an agreement for annual payments and this is what E Ltd transfers to G Ltd, the provisions of S753 apply.

54.5.2 *Sale & repurchase agreement*

Section 809AZA ITA provides:

> (3) ... for the purposes of that paragraph [s.809AZA(1)(b)[11]] the transfer of an asset under a sale and repurchase agreement is not to be regarded

[10] Whether or not the payments are Annual Payments is a complex issue, which depends on facts not supplied in the example; see 31.3.2 (Pure income profit).

[11] See 54.5 (Transfer of income, not asset).

> as a transfer of the asset.

The CFM provides

> **CFM77050 Transfer Under Sale And Repurchase Agreement** [Nov 2019]
> CTA10/S752(3) ensures that where a transfer of an asset is made under an agreement that provides for its repurchase, then for the purposes of S752(1) the asset is to be treated as not having been transferred.
> The legislation contains no definition of sale and repurchase agreement. HMRC considers that the expression covers not just agreements where there is a binding obligation to repurchase but to agreements that have the same practical effect (such as linked put and call options where it will always be a benefit for one party to exercise their option).

I think the last sentence is doubtful.

> It covers sale and repurchase of securities, but goes far wider.
> **Example 1**
> Town Ltd enters into a sale and repurchase agreement with Country Ltd under which an income generating asset is sold and repurchased. The income stream is retained by Country Ltd (and the consideration received by Town Ltd reflects that fact). Although the underlying asset is 'transferred', Town Ltd knows at all times that it will get it back and the effect of S752(3) is that the asset is treated as not having been transferred. So Town Ltd will be chargeable under S753 on the 'relevant amount' (see CFM77060).

54.6 "Transfer"

Section 809AZG ITA provides:

> (3) In this Chapter [Chap 5A, Main income-stream code]—
> (a) references to a transfer include
> [i] sale, exchange, gift and assignment (or assignation) and
> [ii] any other arrangement which equates in substance to a transfer, and

It is difficult to see the point of para [i], but it does no harm.

> (b) references to a transfer taking place are, in the case of an arrangement other than a sale, exchange, gift or assignment (or assignation), to the making of the arrangement.

I would have thought that was self-evident, but it does no harm.

A waiver of interest is not a transfer, or equivalent in substance to a transfer, so is not caught by the income-stream code. A waiver of a dividend might be equivalent in substance to a transfer if the consequence is that another shareholder receives a waiver-enhanced dividend.[12]

54.7 Charge on income-stream value

Section 809AZB(1) ITA provides:

> The relevant amount (see subsection (2)) is to be treated as income of the transferor chargeable to income tax in the same way and to the same extent as that in which the relevant [income] receipts-
> (a) would have been chargeable to income tax, or
> (b) would have been brought into account in calculating any profits for the purposes of income tax,
> but for the transfer of the right to relevant [income] receipts.

There is no purpose or motive defence.

54.7.1 *Relevant amount*

Section 809AZB(2) ITA provides:

> The relevant amount is-
> (a) (except where paragraph (b) applies) the amount of the consideration for the transfer of the right, or
> (b) where the amount of any such consideration is substantially less than the market value of the right at the time when the transfer takes place (or where there is no consideration for the transfer of the right), the market value of the right at that time.

Relevant amount is not a transparent term. I gloss it as relevant amount (consideration).

54.7.2 *Time income arises*

Section 809AZB(3) ITA provides:

> The income under subsection (1) is to be treated as arising in the chargeable period of the transferor in which the transfer takes place.

This differs from corporation tax where the default rule is that the income is to be allocated in accordance with accountancy practice.

[12] See 99.19 (Dividend-waiver settlement). Strictly speaking one might say that this is not a transfer of "a right"; but if "transfer" is widely defined, "right" should not be strictly construed.

The accountancy approach applies to trading/property income. Section 809AZB ITA provides:

> (4) But subsection (5) applies if (apart from the transfer) any of the relevant [income] receipts-
> (a) would have been brought into account in accordance with Part 2 or 3 of ITTOIA 2005 (trading income and property income) in calculating any profits for the purposes of income tax, and
> (b) in accordance with generally accepted accounting practice, would have been recognised otherwise than wholly in the chargeable period in which the transfer takes place.
>
> (5) If this subsection applies, the income under subsection (1) is to be treated as arising-
> (a) to the extent that it does not exceed the amount of the consideration for the transfer of the right, in the chargeable period or periods for which, in accordance with generally accepted accounting practice, the consideration for the transfer is recognised for accounting purposes in a profit and loss account or income statement of the transferor, and
> (b) otherwise, in the chargeable period or periods for which, in accordance with generally accepted accounting practice, the consideration for the transfer would be so recognised if it were of an amount equal to the market value of the right at the time when the transfer takes place.
>
> (6) But if in a case where the transferor is a company it at any time becomes reasonable to assume that the income (to any extent) is not, or would not be, treated by subsection (5) as arising in an accounting period of the transferor, the income is to that extent to be treated as arising immediately before that time.

54.8 Exceptions to charge

54.8.1 *Amount otherwise taxed*

Section 809AZC ITA provides:

> This Chapter [Chap 5A, Main income-stream code] does not apply if and to the extent that the income under section 809AZB(1) is (apart from this Chapter)-
> (a) charged to tax as income of the transferor,
> (b) brought into account in calculating the profits of the transferor, or
> (c) brought into account under CAA 2001.

The wording follows the definition of relevant receipt.[13] So settlor-interested trust rules have priority over the income-stream code.

54.8.2 *Pension/life annuity*

Section 809AZD provides:

> This Chapter [Chap 5A, Main income-stream code] does not apply to a transfer of a right to-
>
> (a) annual payments under a life annuity as defined in section 473(2) of ITTOIA 2005, or
>
> (b) annual payments under an annuity which is pension income within the meaning of Part 9 of ITEPA 2003 (see section 566(2) of that Act).

54.8.3 *Transfer by way of security*

Section 809AZE ITA provides:

> (1) This Chapter [Chap 5A, Main income-stream code] does not apply if-
>
> (a) the consideration for the transfer is the advance under a type 1 finance arrangement, and
>
> (b) the transferor is, or is a member of a partnership which is, the borrower in relation to the arrangement.
>
> (2) This Chapter does not apply if-
>
> (a) the consideration for the transfer is the advance under a type 2 finance arrangement or a type 3 finance arrangement, and
>
> (b) the transferor is a member of the partnership which receives that advance under the arrangement.
>
> (3) In this section-
>
> "type 1 finance arrangement" has the meaning given for the purposes of Chapter 5B by section 809BZA,
>
> "type 2 finance arrangement" has the meaning given for the purposes of Chapter 5B by section 809BZF, and
>
> "type 3 finance arrangement" has the meaning given for the purposes of Chapter 5B by section 809BZJ.

54.8.4 *Leases*

Section 809AZG(1) ITA provides:

> For the purposes of this Chapter [Chap 5A, Main income-stream

[13] See 54.4 (Relevant receipts).

> code]—
> (a) the grant or surrender of a lease of land is to be regarded as a transfer of the land, and
> (b) the disposal of an interest in an oil licence (within the meaning of section 809 of CTA 2009) is to be regarded as a transfer of the oil licence.

The CFM provides a straightforward example:

> **CFM77110 Transfers Of Certain Interests In Assets Regarded As Transfers Of Underlying Asset** [Nov 2019]
> Example
> Q Ltd is the tenant of property and the freehold is held by R Ltd. R grants a lease of the property to S Ltd, still subject to the sublease with Q Ltd. In this way R Ltd has transferred an income stream - the rentals from the sublease - to S Ltd.
> S757(1)(a) puts it beyond doubt that this is treated as a transfer of the asset from which the rental income from the sublease stems, so that the provisions of S753 do not therefore apply.

54.8.5 *Other exceptions*

Section 809AZG(2) ITA provides:

> The Treasury may by order make other provision for securing that other transactions are to be regarded as transfers of assets for those purposes.

No order has been made.

54.9 Transfer to partnership/trust

Section 809AZG(4) ITA provides:

> [a] A transfer to or by any partnership of which the transferor or transferee is a member, and
> [b] a transfer to the trustees of any trust of which the transferor is a beneficiary,
> counts as a transfer in relation to which this Chapter [Chap 5A, Main income-stream code] applies.

A gratuitous transfer to a trust of which the transferor is a beneficiary would in principle be caught by s.624 (settlor-interested trust code).
The income-stream rule can apply to a transfer for full consideration.

54.10 Position of transferee

Where the transferee is a company it is taxable only on its accounting profit from acquiring the income stream. This will generally be the difference between the cost of the income stream and the amount of income it actually receives. However, there is no similar relief or special treatment for a non-corporate transferee. The double taxation is presumably deliberate.

The reader may think that "principles-based" drafting is somewhat selective in its choice of principles.[14]

54.11 Income streams: Trusts

SAIM provides:

> **SAIM11040 Non-Corporate Transferors: Trust Issues** [Dec 2019]
> The transfers of income streams legislation applies only where the income which is transferred ceases to be taxable income of the transferor. The creation of an interest in possession by the trustees of a discretionary trust does not prevent the income being income of the trustees for the purposes of income tax.

The creation of an interest in possession - typically by deed of appointment - is not a transfer but it might, conceivably, be an arrangement which is in substance a transfer. Once one abandons legal concepts and looks for substance, anything becomes possible.[15]

> Similarly, a transfer by trustees of an existing interest in possession from one life tenant to another (?) does not prevent the income from being income of the trustees for income tax purposes. In both these cases the trustees remain taxable up to the basic rate as being in receipt of the income of the interest in possession part of the trust. This means that the transfers of income streams legislation will not apply to these transfers of income by trustees of a trust.
> If the beneficiary of a discretionary trust or an interest in possession trust sells their interest, they are transferring the asset from which the right to income arises. The underlying asset from which the right to relevant receipts arises is the interest in possession. Because the transfer of the income is the consequence of the transfer of an asset the transfers of income streams provisions will not apply.
> A discretionary beneficiary has no right to income, only a hope. Although he or she may be able to sell that interest to someone else (?) there is no transfer of a right to income. Even if there were such a

[14] See App 1.6 (Principles-based drafting).
[15] See App 7.6 (Real nature of transaction).

> transfer then the same reasoning as above would lead to the conclusion that the transfer is the consequence of the transfer of an asset from which the right arises.
>
> Where income to which a beneficiary is already beneficially entitled is mandated to him by the trustees then there is no transfer of a right since the beneficiary's right to the income already exists. Again the transfers of income streams legislation will not apply.

The author is this passage was not familiar with trust law or terminology. But clearly the income-stream code is not aimed at exercises of a power of appointment, and HMRC do not intend to apply it there.

The CFM provides:

> **CFM77030 Company Transferors** [Nov 2019]
>
> ... The transfer of income must be the consequence of the transfer of a right, and not simply an application of the transferor's income. So the legislation will not apply where, for example, trustees of a trust distribute trust income or apply trust income for the benefit of a beneficiary where the trustees remain liable to tax in respect of the income. ...

54.12 Territorial limitation

Section 809AZA ITA provides:

> (1) This Chapter [Chap 5A, Main income-stream code] applies where-
>
> (a) a person within the charge to income tax ("the transferor") makes a transfer

The transferor must be "within the charge to income tax".

A non-resident transferring a foreign income stream is not caught because:

(1) It is not "within the charge to IT".

(2) The foreign income stream would not be charged to income tax as income.

The same applies to a transfer during the overseas part of a split year.

The temporary non-residence rules do not apply.

A remittance basis taxpayer is within the charge to IT. The remittance basis applies, on the basis that the charge applies in the same way, and to the same extent, as the charge on relevant (income) receipts.[16]

[16] See 54.7 (Charge on income-stream value).

54.13 Partnership income stream/asset

Section 809AZF(1) ITA provides:

> For the purposes of this Chapter [Chap 5A, Main income-stream code] a transfer of a right to relevant receipts consisting of the reduction in a transferor's share in the profits or losses of a partnership is to be regarded as a consequence of a transfer of an asset from which the right arose (that is, the partnership property)

The result is (in short) to take partnerships outside the main income-stream code. Instead there is now a separate code.

The background can be found in consultation and response papers:[17]

- Partnerships: A review of two aspects of the tax rules (May 2013)
- Partnerships: A review of two aspects of the tax rules: Summary of Responses (Dec 2013)

These are now of historical interest only.

HMRC say:

> The legislation is designed to counter 'tax attribute' schemes involving the transfer of assets and income streams through or by partnerships. These schemes do not rely necessarily on the partnership comprising mixed membership [ie both a company and individuals], although mixed membership partnerships are within the scope of the rules. The transferor and transferee members may have different tax attributes if, for example:
>
> - the transferee is a company and the transferor is an individual
> - the transferee has losses to use whereas the transferor does not
> - the transferee and transferor are subject to different rate of tax
> - transferor and transferee are subject to differing tax computational rules in relation to the asset or income
>
> Where there is a disposal of an asset or income stream through or by a partnership and a main purpose is to secure an Income Tax or Corporation Tax advantage, the rules will impose a charge to tax on income on the person making the disposal.[18]

[17] *https://www.gov.uk/government/consultations/a-review-of-two-aspects-of-the-tax-rules-on-partnerships*

[18] *https://www.gov.uk/government/publications/mixed-membership-partnership-aifms-and-asset-disposal-rules-legislation-day-technical-note-and-guidance/partnerships-a-review-of-two-aspects-of-the-tax-rules#assets-income-streams*

It may be helpful to read the two Chapters on partnerships(5AA/5D) side by side.

In this area advisors also need to consider:

Topic	**See**
Settlor-interested trust code	99.21
Mixed partnership rules	86.3

54.14 Application conditions

s. 809AAZA(1) ITA	**s.809DZA ITA**
This Chapter [Chapter 5AA, partnership income streams] applies (subject to subsection (2)) if	(1) This Chapter [Chapter 5D, Asset disposed via partnership] applies if conditions A and B are met.
	(2) Condition A is (subject to subsection (3)) that
directly or indirectly in consequence of, or otherwise in connection with, arrangements[19] involving a person within the charge to income tax ("the transferor") and another person ("the transferee")—	directly or indirectly in consequence of, or otherwise in connection with, arrangements involving a person within the charge to income tax ("the transferor") and another person ("the transferee")—
(a) there is, or is in substance, a disposal of a right to relevant receipts[20] by the transferor to the transferee,	(a) there is, or is in substance, a disposal of an asset ("the transferred asset") by the transferor to the transferee,
(b) the disposal is effected (wholly or partly) by or through a	(b) [identical]

[19] Section 809AAZA(8)/809DZA(13) provide the standard (unnecessary) IT definition of "arrangements"; see App 2.2.3 (Definitions of "arrangement").

[20] Section 809AAZA(8) provides: "In this Chapter [Chapter 5AA, Partnership income-stream code]—

"relevant receipts" means any income—

(a) which (but for the disposal) would be charged to income tax as income of the transferor (whether directly or as a member of a partnership), or

(b) which (but for the disposal) would be brought into account as income in calculating profits of the transferor (whether directly or as a member of a partnership) for income tax purposes".

This is based on the Chapter 5A definition; see 54.4 (Relevant receipts).

partnership[21] (“the relevant partnership”),	
(c) at any time— (i) the transferor is a member of the relevant partnership or of a partnership associated with the relevant partnership, and (ii) the transferee is a member of the relevant partnership or of a partnership associated with the relevant partnership, and	(c) [identical]
(d) the main purpose, or one of the main purposes, of one or more steps taken in effecting the disposal is the obtaining of a tax advantage[22] for any person.	(d) [identical]

54.14.1 *Chap 5D: Condit^{n} B: Taxability*

Section 809DZA(9) ITA provides:

> Condition B is that it is reasonable to assume that, had the transferred asset instead been disposed of directly by the transferor to the transferee, the relevant amount [consideration] (or any part of it)—
> (a) would have been chargeable to income tax as income of the transferor, or
> (b) would have been brought into account as income in calculating profits of the transferor for income tax purposes.

There is no equivalent for Chapter 5AA (partnership income-stream code).

54.14.2 *Family partnership exemption*

s.809AAZA(2) ITA	**s.809DZA(3) ITA**
This Chapter [Chapter 5AA,	Condition A is not met if—

[21] Section 809AAZA(8)/809DZA(13) provide: “partnership” includes a limited liability partnership whether or not section 863(1) of ITTOIA 2005 applies in relation to it.

[22] Section 809AAZA(8)/809DZA(13) provide:
“tax advantage” means a tax advantage, as defined in section 1139 of CTA 2010, in relation to income tax or the charge to corporation tax on income.
See 3.19.1 (Tax advantage: Definitions).

Partnership income-stream code] does not apply if—	
(a) the transferor is the spouse or civil partner of the transferee and they are living together,[23] or (b) the transferor is a brother, sister, ancestor or lineal descendant of the transferee.	[identical]

Tax planning through close-family partnerships is unobjectionable.

54.14.3 *Disposal*

s.809AAZA ITA	**s.809DZA ITA**
(3) In subsection (1)(a)	(4) In subsection (2)(a)
the reference to a disposal of a right to relevant receipts includes anything constituting a disposal of such a right for the purposes of TCGA 1992.	the reference to a disposal of an asset includes anything constituting a disposal of an asset for the purposes of TCGA 1992.
(4) For the purposes of subsection (1)(b)	(5) For the purposes of subsection (2)(b)
the disposal might, in particular, be effected by an acquisition or disposal of, or an increase or decrease in, an interest in the relevant partnership (including a share of the profits or assets of the relevant partnership or an interest in such a share).	[identical]

54.14.4 *Associated partnership*

s.809AAZA ITA	**s.809DZA ITA**
(5) For the purposes of subsection (1)(c)	(6) For the purposes of subsection (2)(c)

[23] See App 3.4.3 (Living together: married couple).

it does not matter if the transferor and the transferee are not members of a partnership as mentioned at the same time.	[identical]
(6) For the purposes of subsection (1)(c)	(7) For the purposes of subsection (2)(c)
a partnership is "associated" with the relevant partnership if— (a) it is a member of the relevant partnership, or (b) it is a member of a partnership which is associated with the relevant partnership (whether by virtue of paragraph (a) or this paragraph).	[identical]

54.14.5 *Transferor/transferee*

s.809AAZA ITA	**s.809DZA ITA**
(7) In subsections (1)(c) and (5)	(8) In subsections (2)(c) and (6)
references to the transferor include a person connected with the transferor and references to the transferee include a person connected with the transferee.	[Identical]

54.15 Charge on partnership transfer

s.809AAZB ITA	**s.809DZB ITA**
(1) The relevant amount [consideration] is to be treated as income of the transferor chargeable to income tax in the same way and to the same extent as that in which the relevant receipts—	(1) The relevant amount [consideration] is to be treated as income of the transferor chargeable to income tax in the same way and to the same extent as that in which it—
(a) would have been chargeable to income tax as income of the transferor, or	(a) would have been chargeable to income tax as income of the transferor, or

(b) would have been brought into account as income in calculating profits of the transferor for income tax purposes,	(b) would have been brought into account as income in calculating profits of the transferor for income tax purposes,
but for the disposal.	as mentioned in section 809DZA(9).[24]

In the case of Chapter 5DD, one might have expected a CGT charge, as it is CGT which is avoided.

54.15.1 *Relevant amount: Chap 5AA*

Section 809AAZB ITA provides:

> (2) In subsection (1)
> [a] "the relevant amount" is to be read in accordance with section 809AZB(2)[25] and
> [b] section 809AZB(3) to (6) applies for the purpose of determining when income under subsection (1) is treated as arising.[26]
> (3) For this purpose, in section 809AZB(2) to (6) references to the transfer of the right are to be read as references to the disposal of the right.

Section 809DZB(2) ITA provides:

> Section 809AZB(3) to (6) applies for the purpose of determining when income under subsection (1) is treated as arising (reading references to the transfer of the right as references to the disposal of the transferred asset).

54.15.2 *Relevant amount: Chap 5D*

Section 809DZB provides:

> (10) In this Chapter [Chapter 5D, Asset disposed via partnership] "the relevant amount" means the amount of the consideration received by the transferor for the disposal.
> (11) If the transferor receives—
> (a) no consideration for the disposal, or
> (b) consideration which is substantially less than the market value

[24] See 54.14.1 (Chap 5D: Condit^{n} B: Taxability).

[25] See 54.7.1 (Relevant amount).

[26] See 54.7.2 (Time income arises).

of the transferred asset,

assume for the purposes of subsection (10) that the transferor receives consideration of an amount equal to the market value of the transferred asset.

(12) In subsection (11) references to the market value of the transferred asset are to that value at the time of the disposal.

54.16 Chap 5AA/5D interaction

s.809AAZB	**s.809DZB ITA**
(4) If, apart from this subsection and section 809DZB(3)—	(3) If, apart from this subsection and section 809AAZB(4)—
(a) both this Chapter [Chapter 5AA, Partnership income-stream code] and Chapter 5D [Asset disposed via partnership] would apply in relation to the disposal, and	(a) both this Chapter [Chapter 5D, Asset disposed via partnership] and Chapter 5AA [Partnership income-stream code] would apply in relation to the disposal, and
(b) Chapter 5D [Asset disposed via partnership] would give a greater amount of income of the transferor chargeable to income tax,	(b) Chapter 5AA [Partnership income-stream code] would give the same amount, or a greater amount, of income of the transferor chargeable to income tax,
this Chapter [Chapter 5AA] is not to apply in relation to the disposal.	this Chapter [Chapter 5D] is not to apply in relation to the disposal.

The larger of the two charges prevails. But this will not happen often.

54.17 DT relief

If the transferor is treaty-resident in a foreign state with a DTA in OECD Model form, DT relief will in principle be available under art 13 (Capital gains) or art 21 (Other Income).[27]

[27] See 33.20 (DT relief: "Other Income"); 56.23 (DT relief for capital gains).

CHAPTER FIFTY FIVE

TRANSACTIONS IN SECURITIES

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55.1 Transactions in securities

This chapter considers the "lengthy and complicated"[1] topic of transactions in securities.

There are two sets of rules:

Tax	Provisions	Term (my terminology)
IT	Chap 1 Part 13 ITA: s.682-713	IT TiS code
CT	Part 15 CTA 2010: s.731-751	CT TiS code

The two codes diverged in 2010.[2] They have some terminology in common, but are now essentially distinct. It would be accurate to refer to TiS code (in the singular) before 2010, and codes (in the plural) after that date. But perhaps that is pedantic.

On the CT code, the textbook *Taxation of Companies and Company Reconstructions* (TCCR) states:[3]

> The CT provisions have long fallen into what appears to be complete disuse. The only way in which these provisions could realistically be brought to bear would be if the avoidance of corporation tax on capital gains (as well as income) was within their scope, but it is not...[4]

In 2009 HMRC promised to publish guidance "which meets our customers' requirements for certainty and clarity" but that never materialised.[5]

[1] *IRC v Laird Group* [2003] UKHL 54 at [13]. By the standards of modern anti-avoidance provisions the TiS code is not lengthy, and no more than averagely complicated. But the case law is lengthy and complicated, as:
(1) There are more cases than any other anti-avoidance code.
(2) The cases often concern complicated schemes.
(3) The TiS code has had a complicated evolution, which makes it hard to identify which points discussed in old case law may be relevant to TiS now.
(4) In order to understand the cases one needs to know what the tax analysis would be in the absence of TiS; this is often complicated, and older cases require a knowledge of long-obsolete tax rules.

[2] This was preceded by a consultation paper: HMRC, "Simplifying Transactions in Securities Legislation" (2009) *https://www.taxation.co.uk/docs/default-source/file/TransactionsSecuritiesLegislation.pdf*

[3] Looseleaf para W6.1.2.

[4] See 55.11.2 (CT/CGT advantage).

[5] The 2009 consultation paper sets out the structure of proposed guidance, but not its contents, so there is no help to be found there.

The IT TiS code was rewritten (again) in 2016. The 2016 reforms were preceded by shallow HMRC consultation and response documents[6] but these shed little light on the provisions. I do not consider the pre-2016 version of the rules, but for some time yet, cases on pre-2016 transactions will continue to come to the Courts, and so will need to be reviewed to see their relevance to the present law. Such are the appalling delays in tax litigation.

I go beyond the themes of this book and address the IT code as a whole, if not in full detail. I consider the CT code only when it sheds light on the IT code or on other themes of this book.

55.1.1 *TiS definitions: Navigation*

Defined term	**See para**
Company/Close Company	55.2.1
Dividend/distribution	55.2.2
Associate	55.2.3
Security	55.3.1
Transaction in securities	55.3.2
Relevant person	55.5.1
Transfer of Company Assets (my term)	55.6.1
Consideration/Relevant Consideration	55.9

55.1.2 *Construction of TiS code*

The provisions are broad and the courts construe them broadly.[7] In *IRC v Parker*:[8]

> The Statute mounted a massive attack against tax avoidance in many forms. One type of tax avoidance transaction at which the Act is evidently aimed is that generically known as 'dividend stripping'… I do not find it possible to discern in this Act any indication that it was the purpose of the legislature to limit it to any specific form of tax avoidance… we must take the Act as we find it and endeavour to see

[6] HMRC, "Company distributions: consultation document" (2015) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483547/Company_distributions_-_consultation_document__7029_.pdf*
HMRC, "Company distributions: summary of responses" (2016) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/510263/Company_distributions_-_summary_of_responses.pdf*

[7] Contrast 48.2 (Construction of ToA provisions).

[8] 43 TC 396 at p.440.

> what it fairly covers.

Nowadays that would seem self-evident, though not in 1966, when *Parker* was decided. But the Courts have gone further. In *IRC v Joiner*:[9]

> ... the sections called for a different method of interpretation from that traditionally used in taxing Acts. For whereas it is generally the rule that clear words are required to impose a tax, so that the taxpayer has the benefit of doubts or ambiguities ... the scheme of the sections, introducing as they did a wide and general attack on tax avoidance, required that expressions which might otherwise have been cut down in the interest of precision were to be given the wide meaning evidently intended, even though they led to a conclusion short of which judges would normally desire to stop.

In *Greenberg v IRC*:[10]

> We seem to have travelled a long way from the general and salutary rule that the subject is not to be taxed except by plain words. But I must recognise that plain words are seldom adequate to anticipate and forestall the multiplicity of ingenious schemes which are constantly being devised to evade taxation. Parliament is very properly determined to prevent this kind of tax evasion[11] and, if the courts find it impossible to give very wide meanings to general phrases, the only alternative may be for Parliament to do as some other countries have done, and introduce legislation of a more sweeping character which will put the ordinary well-intentioned person at much greater risk than is created by a wide interpretation of such provisions as those which we are now considering.

What Lord Reid feared was a GAAR, which has now come to pass. Perhaps, but for his approach, it would have come sooner? or in a wider form which put the "ordinary well-intentioned person" at risk? or at greater risk? Discuss.

The TiS code may apply to:

(1) transactions which are not artificial or contrived; and
(2) transactions carried out on the open market.[12]

[9] 50 TC 449 at p. 480.

[10] 47 TC 240.

[11] Nowadays one would say "avoidance" not "evasion", see 2.2.2 (Avoidance/evasion distinction).

[12] This is self-evident but if authority is needed, see *Sema Group Pension Scheme v IRC* [2002] EWCA Civ 1857 at [91].

In *Grogan v HMRC:*[13]

> [The TiS code] should be construed purposively, to give effect to their self-evident objective of preventing disguised income receipts from being treated as capital (with or without the assistance of third parties).

Grogan rejected the argument that prescriptive tax codes by implication excluded the TiS code.[14] It is a matter of construction in each case, so it is theoretically possible that some codes might by implication exclude the TiS code, in some cases; but a strong case would be needed to justify that conclusion.

55.2 Minor definitions

It is helpful first to clear some minor definitions out of the way.

55.2.1 *"Close company"*

The TiS code is (broadly) restricted to close companies, because Circumstances A and B can only be met by transactions involving close companies.

Section 713(1) ITA provides:

> In this Chapter [Chapter 1 Part 13] ...
> "close company" includes a company that would be a close company if it were resident in the UK

This is a standard form.[15]

Section 713(1) continues:

> "company" includes any body corporate

This is not the standard definition of company. It is probably just for historical reasons.[16] It seems wider than the standard definition[17] because it does not have the exclusion for partnerships. Could a LLP fall within TiS? on the grounds that:

(1) it is a body corporate so

[13] [2010] UKUT 416 (TCC) at [79]:

[14] See at [114]. *Grogan* concerned the code for qualifying employee share ownership trusts.

[15] See 104.29.1 (Non-resident close company).

[16] This goes back to s.43 FA 1960, when there was no taxes-act wide definition of "company" (indeed there was no taxes act).

[17] See 90.8 (Definition of "company").

(2) it is a "company" for TiS purposes (or even a company in the general sense, the TiS definition being an inclusive one).

The answer must be no, for a variety of reasons any one of which would suffice:

(1) Although a LLP is a body corporate as a matter of general law, it is (generally) treated as a partnership, and so a non -body corporate, for IT purposes.
(2) Even if a LLP is a company for TiS purposes, it is not a close company
(3) Even if a LLP is a close company for TiS purposes, it is transparent for IT purposes, so it is not within the object of TiS, and cannot give rise to an IT advantage.

It would be a simplification to repeal the TiS definition and allow the standard tax definition of company to apply; but it does not much matter.

55.2.2 *Dividend/distribution*

The word dividend matters only for the definition of Relevant Consideration (which must, in short, represent the value of "assets which are available for distribution by way of dividend".

Section 713(1) ITA provides:

> In this Chapter [Chapter 1 Part 13]
> "dividends" includes references to other distributions and to interest...

Thus the word "distribution" is defined on two occasions, but only for the specific purposes of:

(1) The definition of dividend (above)
(2) The definition of IT Advantage

These definitions (slightly) modify the standard tax definition of distribution,[18] and are effectively identical:

s.713(2) ITA: defining dividend	**s.687(4) ITA: defining IT advantage**
In the definition of "dividends" given by subsection (1), "other distributions" does not include	In this section ... "distribution" does not include
a distribution which is a distribution	a distribution which is a distribution

[18] For the standard definition see 30.4 ("Distribution").

for the purposes of the Corporation Tax Acts only because it falls within paragraph C or D in section 1000(1) (redeemable share capital or security issued as bonus in respect of shares in, or securities of, the company).	for the purposes of the Corporation Tax Acts only because it falls within paragraph C or D in section 1000(1) of CTA 2010 (redeemable share capital or security issued as bonus in respect of shares in, or securities of, the company).

See 30.5.3 (Para C/D: Issue of securities).

Where the word distribution is used elsewhere, the standard tax definition applies.

55.2.3 *"Associate"*

"Associate" matters for:

(1) The exemption for fundamental change of ownership
(2) The definition of IT advantage, in the cap on consideration

Section 713(1) ITA provides:

> In this Chapter [Chapter 1 Part 13] ...
> "associate"[19]
> [a] is to be construed in accordance with section 681DL,
> [b] but as if subsection (4) of that section also included, as persons associated with each other, a person as trustee of a settlement and an individual, where one or more beneficiaries of the settlement are connected or associated with the individual

Amended as s.713(1) directs, s.681DL(2) ITA provides:

> Persons are associates if they are associated with each other.

Section 681DL(3) ITA deals with close family:

> The following are associated with each other—
> (a) an individual and the individual's spouse or civil partner or relative,
> (b) an individual and a spouse or civil partner of a relative of the individual,
> (c) an individual and a relative of the individual's spouse or civil

[19] The word "associate" is used in the definition of control/close company with a different meaning: see 104.6 (Associates). So strictly one should not use the term without a definition; but the context may provide the definition, and in this chapter the word is used in its TiS sense.

> partner,
> (d) an individual and a spouse or civil partner of a relative of the individual's spouse or civil partner.

Relative is defined in s.681DL(7) ITA:

> For the purposes of this section—
> (a) a relative is a brother, sister, ancestor or lineal descendant

Section 681DL(4) ITA (as amended by s.713(1) ITA) deals with trusts:

> The following are associated with each other—
> (a) a person as trustee of a settlement[20] and an individual who (in relation to the settlement) is a settlor, and
> (b) a person as trustee of a settlement and a person associated with an individual who (in relation to the settlement) is a settlor.
> [c] a person as trustee of a settlement and an individual, where one or more beneficiaries of the settlement are connected or associated with the individual.

Para [c] is wider than the definition of connected person, so an individual and a trustee may be associated without being connected persons.

Section 681DL(5) ITA deals with companies and partnerships:

> The following are associated with each other—
> (a) a person and a body of persons[21] of which the person has control,
> (b) a person and a body of persons of which persons associated with the person have control,
> (c) a person and a body of persons of which the person and persons associated with the person have control,
> (d) two or more bodies of persons associated with the same person under paragraphs (a) to (c).

"Control" is not defined here, so it has its strict sense.[22] I wonder if that

[20] Subsection (7) provides: "For the purposes of this section... (c) "settlement" and "settlor" have the meanings given by section 620 of ITTOIA 2005." In my terminology "settlement" means settlement-arrangement; see 87.4 (Settlement-arrangement definition).

[21] "Body of persons" is defined in ss.(7): "For the purposes of this section... (b) a body of persons includes a partnership". A partnership is a body of persons in the general sense, but probably not within the IT definition; see 9.22.1 (Partnership a treaty-person).

[22] The default definition of control applies "in relation to the control of a body corporate or a partnership"; see 104.2.3 (Default meaning of control). We are here looking at

is deliberate or accidental.

Section 681DL(6) ITA deals with joint ownership:

> In relation to a disposal by joint owners, the joint owners and any person associated with any of them are associated with each other.

55.3 Transaction in securities

55.3.1 *"Security"*

Section 713(1) ITA provides:

> In this Chapter [Chapter 1 Part 13] ...
> "securities"—
> (a) includes shares and stock, and
> (b) in relation to a company not limited by shares (whether or not it has a share capital) also includes a reference to the interest of a member of the company as such, whatever the form of that interest[23]

This represents the normal meaning of the word.[24]

"Securities" is not limited to securities in close companies, but the TiS code is (broadly) restricted to close companies, because Circumstances A and B (as they now stand) can only be met by transactions involving close companies.

For completeness: s.685(9) ITA provides two standard definitions taken from the distribution code:

> In this section—
> "security" includes securities not creating or evidencing a charge on assets;[25]
> "share" includes stock and any other interest of a member in a company.[26]

Williams v IRC[27] involved a loan secured on a gilt. Making the loan was

the control of a body of persons, but a body of persons is a body corporate or a partnership.

[23] This only matters in exceptional cases, such as a company limited by guarantee: see 103.2.1 (No share capital).

[24] See App 2.11 (Securities).

[25] This has no real effect: see App. 2.15.1 (Legal charge irrelevant).

[26] This is only a section-wide definition so it is repeated in s.700(4) ITA. It repeats the definition in s.713.

[27] 54 TC 257.

a transaction in securities, on the basis that:

(1) the gilt was a security; and the loan related to the gilt; or

(2) the loan was itself a security.

But it is not the case that every loan is a security.[28]

55.3.2 *"Transaction in" securities*

IT TiS code: s.684(2) ITA	**CT TiS code: s.751 CTA 2010**
In this Chapter [Chapter 1 Part 13] "transaction in securities" means	(1) In this Part [Part 15 CTA 2010] ... "transaction in securities" means
[A] a transaction, of whatever description, relating to securities,	[A] transactions, of whatever description, relating to securities,
[B] and includes in particular—	[B] and in particular—
(a) the purchase, sale or exchange of securities,	[identical]
(b) issuing or securing the issue of new securities,	[identical]
(c) applying or subscribing for new securities,	[identical]
(d) altering or securing the alteration of the rights attached to securities	[identical]
(e) a repayment of share capital or share premium, and	[no equivalent]
(f) a distribution in respect of securities in a winding up.	[no equivalent]

Thus the IT/CT codes use the same term (transaction in securities) but with a different definition. So strictly one should not use the term without a definition; but the context may provide the definition. Nowadays the IT TiS code, and so the IT definition, is what matters.

In *Parker v IRC*:[29]

> The particular instances given [now s.684(2)[B]] in my opinion do not

[28] See App 2.11 ("Security").

[29] 43 TC 396 at p.431. Similarly, *IRC v Joiner*: "we must continue to give to 'transactions in securities' the widest meaning: we can neither confine these expressions to the instances given in section 467(1) [the definition section], nor can we deduce from that enumeration any limitation upon their scope.".

> in any way restrict the meaning to be given to the general words which precede them. The redemption of the debentures was, in my opinion, a transaction relating to them and so a transaction in securities as defined.

And of course "relating to" is a wide expression:

> There could hardly be a wider net connecting transactions and securities.[30]

In *IRC v Joiner*[31] rights attached to a security were altered by a liquidation agreement; that was a transaction in securities.

A purchase of own shares is a transaction in securities.[32]

In *IRC v Laird Group*:[33]

> It would not be a normal use of language to describe the payment of a fixed dividend in respect of preference shares as a transaction relating to securities; and I would at least pause before attaching such a description to the payment of interest on a debt merely because it was secured by a debenture or unsecured loan note.[34] Neither the debt nor the rights attached to it, which include the right to receive interest payable in respect of it, is affected by the payment in any way. The debt merely provides the measure of the amount to be received by way of interest. The same applies to fixed dividends payable in respect of preference shares.

The reader may find this surprising, because "normal use of language" is not applicable: we have a wide definition. But there it is. The construction may be purposive: since a dividend or interest is income and taxable under basic principles, there is no need for the TiS code to apply.

Lairdn Group rejected the submission that there can be no transaction in or relating to securities where all that happens is that rights already inherent in the securities take effect.[35]

55.3.3 *Winding-up*

A distribution in a winding-up is a transaction in securities. In this context

[30] at p.409.

[31] 50 TC 499. See too 81.7.2 (Share alteration: Consequences).

[32] This is self-evident, but for an example, see *Sema Group Pension Scheme v IRC* [2002] EWCA Civ 1857.

[33] [2003] UKHL 54,at [29].

[34] Author's footnote: This suggests that a simple debt is not a "security".

[35] at [16].

the winding-up TAAR also needs consideration.[36]

CIOT say:

> All of the transactions that the [winding-up] TAAR considers are theoretically caught by the transactions in securities rules too, now that a transaction in securities includes a distribution in respect of securities on a winding up. What we think that this will mean is that any transaction where a taxpayer self-assesses that the TAAR does NOT apply is potentially open to counteraction under the transactions in securities rules. ...
>
> It is also extremely likely that, from now on, every liquidation is going to be the subject of a transactions in securities clearance application to HMRC...[37]

A transaction which falls within a straightforward exemption to the winding-up TAAR should not fall within the TiS code, but it does seem to do so.

The CTM comments on the interaction of the two codes:

> **CTM36350 Requests For Clearance** [Feb 2018]
>
> **... Transactions in Securities**
>
> ... Where S396B/404A [winding-up TAAR] applies to a distribution in a winding-up then Income Tax is payable on the distribution, and it follows that there can be no tax advantage for the purpose of the transactions in securities legislation. That means that the transactions in securities rules cannot apply where S396B/404A does, and a clearance under ITA07/S701 cannot extend to the application of S396B/404A. But clearance may still be relevant to the extent that S396B/404A does not apply.

This is correct as far as it goes. Of course, HMRC could if they wish give a clearance that neither set of provisions should apply to a proposed transaction. But there is no statutory duty to do that, and HMRC are not minded to assist their customers on the point, perhaps understandably.

55.4 TiS application conditions

Armed with these definitions, we turn to s.684 ITA which provides:

> (1) This section applies to a person ("the party") where—
>
> (a) the person is a party to a transaction in securities or two or more

[36] See 30.14 (Winding-up TAAR).

[37] CIOT, Letter to HMRC (June 2016).

> transactions in securities[38] ...
> (b) the circumstances are
> [i] covered by section 685 [TiS Circumstances] and
> [ii] not excluded by section 686 [substantial change of ownership],
> (c) the main purpose, or one of the main purposes, of the transaction in securities, or any of the transactions in securities, is to obtain an income tax advantage, and
> (d) the party or any other person obtains an income tax advantage in consequence of the transaction or the combined effect of the transactions.

This sets out four sets of conditions (**"TiS application conditions"**). In short:

(1) A transaction in securities
(2) TiS Circumstances
(3) No substantial change of ownership
(4) An IT Advantage:
    (a) Main purpose to obtain IT Advantage
    (b) Someone obtains an IT Advantage

55.5 TiS Circumstances

Section 685(1) ITA provides:

> The circumstances covered by this section are circumstances where condition A or condition B is met.

I refer to **"TiS Circumstances"**. Thus it appears there are two types of Circumstances, A and B; but there are 3 types of Circumstance A, which I call A(a), A(b) and A(c); it is easier to regard Circumstances A & B together as 4 distinct Circumstances.

Each Circumstance contains a set of four conditions. Two of these are common to all 4 Circumstances:

(1) a relevant person receives Relevant Consideration
(2) the relevant person does not pay income tax on the Consideration

55.5.1 *"Relevant person"*

"Relevant person" matters as all 4 Circumstances require that a relevant person receives Relevant Consideration. The definition is the same for all

[38] The words "or two or more transactions in securities" are otiose, but they do no harm.

Circumstances. Section 685(3A) ITA provides:

> In subsections (2) and (3) "relevant person" means-
> (a) the party, or
> (b) any person other than the party in relation to whom the condition in section 684(1)(d) is met.

Unpacking the definition, relevant person means:
(a) The parties to the transaction in securities and
(b) Any person within s.684(1)(d),[39] in short, a person who obtains an IT Advantage[40]

55.5.2 *No IT on Consideration*

All four Circumstances require that:

> the relevant person does not pay or bear[41] income tax on the consideration

If the relevant person did pay IT, there would usually be no IT Advantage. But there might be one, eg if the person was non-resident and
(1) paid IT but only at the dividend ordinary rate or
(2) qualified for non-resident relief

55.6 TiS Circumstances A(a)(b)(c)

Condition A has four sets of requirements. Section 685(2) ITA provides:

> Condition A is that,
> [1] as a result of the transaction in securities or any one or more of the transactions in securities,
> [2] a relevant person[42] receives relevant consideration
> [3] in connection with—
> (a) the distribution, transfer or realisation of assets of a close company,

[39] See 55.11.4 (IT advantage obtained).

[40] That is, para (b) should be read as if it had commas, thus:
"any person, other than the party, in relation to whom the condition in section 684(1)(d) is met".
In other words, the phrase *"in relation to whom the condition in section 684(1)(d) is met"* governs the words "any person"; not the words "other than the party".

[41] See App.2.3.2 (Bear tax by deduction or otherwise).

[42] See 55.5.1 ("Relevant person").

(b) the application of assets of a close company in discharge of liabilities, or[43]

(c) the direct or indirect transfer of assets of one close company to another close company,

[4] and the relevant person does not pay or bear income tax on the consideration (apart from this Chapter).

55.6.1 *Transfer of Company Assets*

It is necessary to have a label for dispositions (transfers, etc) within para [3](a)(b)(c). I describe these as **"Transfers of Company Assets"**, with initial capitals to indicate a technical term. Section 685[3] contains two requirements:

(1) There must be a Transfer of Company Assets
(2) There must be a connection[44] between :
  (a) the receipt of Relevant Consideration and
  (b) the Transfer of Company Assets

Transfer of Company Assets is very wide and includes making a loan, repaying a loan, and paying a purchase price.

55.7 TiS Circumstance B

Condition B also has 4 sets of requirements. Section 685(3) ITA provides:

> Condition B is that—
> (a) [i] a relevant person[45] receives relevant consideration
> [ii] in connection with[46] the transaction in securities or any one or more of the transactions in securities,
> (b) two or more close companies are concerned in the transaction or transactions in securities concerned, and
> (c) the relevant person does not pay or bear income tax on the consideration (apart from this Chapter).

55.7.1 *Irredeemable share capital*

For Circumstances A(c) and B, s.685(7) ITA provides a relief for

[43] An application in discharge of liabilities will normally fall within (a) as a transfer of assets; but it is just possible to conceive of examples where that is not the case. So para (b) is almost but not completely otiose.

[44] See App 2.4.2 (In connection with).

[45] See 55.5.1 ("Relevant person").

[46] See App 2.4.2 (In connection with).

irredeemable share capital:

> [a] So far as subsection (2)(c) or (3) [Circumstances A(c), B] relates to share capital other than redeemable share capital, it applies only so far as the share capital is repaid (on a winding up or otherwise);
> [b] and for this purpose any distribution made in respect of any shares on a winding up or dissolution of the company is to be treated as a repayment of share capital.

I refer to this as **"irredeemable share capital relief"** but the label is not entirely accurate, as the relief does not apply on a buy-back of own shares even if the shares are expressed to be "irredeemable". If irredeemable share capital is repaid:

(1) the relief does not apply; and
(2) the repayment of capital is itself a transaction in securities to which the TiS code may apply.

55.7.2 *Year of assessment*

For Circumstances A(c) and B, s.700 ITA provides a timing rule:

> (1) This section applies if section 684 (person liable to counteraction of income tax advantage) applies to a person because the person is in a position to obtain or has obtained an income tax advantage by falling within the circumstances mentioned in 685(2)(c) or (3) when share capital is repaid.[47]
> (2) An assessment to income tax made in accordance with a counteraction notice must be an assessment for the tax year in which the repayment occurs.

55.8 Circumstance A/B compared

Circumstances A(a)(b)(c)	**Circumstance B**
as a result of the transaction in securities or any one or more of the transactions in securities,	in connection with the transaction in securities or any one or more of the transactions in securities,[48]

[47] Section 700(3) ITA provides:
"The references in this section to the repayment of share capital include references to any distribution made in respect of any shares in a winding up or dissolution of the company."
This reflects the rule in s.685(7)[b] ITA.

[48] I have moved this phrase to facilitate the comparison.

a relevant person receives [type A] relevant consideration	a relevant person receives [type B] relevant consideration
in connection with— (a) the distribution, transfer or realisation of assets of a close company, (b) the application of assets of a close company in discharge of liabilities, or (c) the direct or indirect transfer of assets of one close company to another close company, [together, in my terminology, a Transfer of Company Assets]	[no equivalent]
the relevant person does not pay or bear income tax on the consideration (apart from this Chapter).	[identical]

55.9 "Relevant Consideration"

"Relevant Consideration" matters as:

(1) All 4 Circumstances require that a relevant person receives Relevant Consideration.

(2) The definition of IT Advantage asks (in short) whether income tax would be payable on the Relevant Consideration if it was a distribution.

Section 685 ITA provides two definitions and I coin terminology to describe them:

ITA	**Definition for**	**My terminology**	**See para**
s.685(4)	Circumstances A(a)(b)	Type A Relevant Consideration	55.9.1
s.685(5)	Circumstances A(c), B	Type B Relevant Consideration	55.9.1

This is not transparent terminology, but it is difficult to think of better. I use initial capitals, as befits complex defined terms.

The definitions apply for the purpose of the TiS Circumstances, but they are incorporated by reference elsewhere.[49]

[49] Section 687(4) ITA.

55.9.1 *Relevant Consideration*

Type A Consideration: s.685(4)ITA	**Type B Consideration: s.685(5)**
In a case within subsection (2)(a) or (b [ie, Circumstances A(a)(b)]	In a case within subsection (2)(c) or (3) [ie, Circumstances A(c), B]
"relevant consideration" [in my terminology, Type A Relevant Consideration] means consideration which—	"relevant consideration" [in my terminology, Type B Relevant Consideration] means consideration
[no equivalent]	[i] which consists of any share capital or any security issued by a close company and
(a) is or represents the value of—	[ii] which is or represents the value of assets which—
(i) assets which are available for distribution by way of dividend by the company, or	(a) are available for distribution by way of dividend by the company,
(ii) assets which would have been so available apart from anything done by the company,	(b) would have been so available apart from anything done by the company, or
(b) is received in respect of future receipts of the company, or	[no equivalent]
(c) is or represents the value of trading stock of the company.	(c) are trading stock of the company.

It is necessary to have a label for assets within paras (a)(b)(c). I describe these as **"Distributable Assets"** (with initial capitals to indicate a technical term). When it is necessary I distinguish:

Type A Distributable Assets: assets within s.685(4)(a)(b)(c)
Type B Distributable Assets: assets within s.685(5)(a)(b)(c)

Thus there are two steps to identifying Relevant Consideration:
(1) Identify the Distributable Assets
(2) Identify the asset which is or represents the value of Distributable Assets.

"Available" for distribution means distributable as a matter of company law, whether or not it is commercially possible to distribute.[50]

Cleary offers a straightforward illustration of para (a)(ii). A company purchased an asset.[51] The purchase price paid by the buyer was Distributable Assets because (but for the purchase) it would have been available for distribution.

"Trading stock" has the standard definition.[52] The point is that trading stock may represent unrealised (future) profits.

55.9.2 *"Consideration"*

Section 685(8) ITA provides an artificial definition:

> References in this section to the receipt of consideration include references to the receipt of any money or money's worth.

"Property" would be the more apt word. I write it with a capital letter.

55.9.3 *Foreign law rule*

Section 685(7A) ITA provides a rule about return of share capital by foreign companies, under the guise of a definition of "assets":

> The references in subsection (4)(a)(i) and (ii) to assets [available for distribution] do not include assets shown to represent return of sums paid by subscribers on the issue of securities merely because the law of the country in which the company is incorporated allows assets of that description to be available for distribution by way of dividend.

55.9.4 *Groups*

Section 685(7B) ITA deals with groups:

> The references in subsections (4)(a)(i) and (5)(a) to assets which are available for distribution by way of dividend by the company include assets which are available for distribution to the company by way of dividend by any other company it controls.

55.10 Fundamental change of ownership

Section 686(1) ITA provides:

[50] *Brown v IRC* 47 TC 217 at p.236.

[51] For this case, see 55.14.4 (Sale to close co for cash).

[52] Section 713 ITA provides a definition by reference: "trading stock" has the meaning given by section 174 of ITTOIA 2005.

> Circumstances are excluded by this section if—
> (a) immediately before the transaction in securities (or the first of the transactions in securities) the party holds shares or an interest in shares in the close company, and
> (b) there is a fundamental change of ownership of the close company.

55.10.1 *"Fundamental change"*

Section 686(2) ITA provides:

> There is a fundamental change of ownership of the close company if, as a result of the transaction or transactions in securities, the condition in subsection (3) is met.

So we turn to s.686(3) ITA:

> The condition in this subsection is that the original shareholder[53] or original shareholders taken together with any associate or associates[54]—
> (a) do not directly or indirectly hold more than 25% of the ordinary share capital of the close company,
> (b) do not directly or indirectly hold[55] shares in the close company carrying an entitlement to more than 25% of the distributions which may be made by the close company, and
> (c) do not directly or indirectly hold shares in the close company carrying more than 25% of the total voting rights in the close company.

I refer to this as the "sub-25% tests". Thus in order to apply this:

(1) One needs to identify:
 (a) The original shareholders, before the transaction in securities

[53] Section 686(4) ITA provides a commonsense definition: "In this section "original shareholder" means a person who, immediately before the transaction in securities (or the first of the transactions in securities), held any ordinary share capital of the close company."

[54] See 55.2.3 ("Associate").

[55] Section 686(5) ITA defines "holding" shares:
"For the purposes of this section, shares of or share capital in the close company which are held
[a] by a person controlled by an original shareholder, or
[b] by two or more original shareholders taken together,
count as shares or share capital held by that original shareholder or those original shareholders."
"Control" is not defined here, so it has its strict sense; see 104.2.3 (Default meaning of control).

    (b) The shares held by original shareholders (and associates) after the transaction in securities

(2) The total of the shares held by (b) must meet the sub-25% tests

(3) A causation test: The sub-25% tests must be met as a result of the transaction in securities. But I would have thought that would always be the case, if condition (2) is met.

55.11 TiS TAARs

IT TiS TAAR: s.684(1)(a) ITA	**CT TiS TAAR: s.734 CTA 2010**
(1) This section applies to a person where...	(1) Section 733 does not apply to a company in respect of a transaction in securities or two or more such transactions if the company shows that the transaction or transactions meet conditions A and B. .
[No equivalent]	(2) Condition A is that the transaction or transactions are effected— (a) for genuine commercial reasons, or (b) in the ordinary course of making or managing investments.
(c) the main purpose, or one of the main purposes, of the transaction in securities, or any of the transactions in securities, is to obtain an income tax advantage	(3) Condition B is that enabling corporation tax advantages to be obtained is not the main object or one of the main objects of the transaction or, as the case may be, any of the transactions

I refer to these provisions as the **"TiS TAARs"**.[56]

For discussion see 3.1 (TAAR/unallowable purpose test).

The CT TiS TAAR is important because there are many cases on this provision, starting with *Brebner*, which are relevant to other TAARs.

Old TiS TAAR cases often concern arrangements now caught by express provisions. For instance, the issue of redeemable shares in *Parker* would now be regarded as a distribution; TiS would not arise. That seems right:

[56] This was originally called the "escape clause", but I do not use that term here, and the many changes in the legislation have made it rather less apt.

where objective rules can be devised, it is good to avoid the difficulties and uncertainties which a TAAR entails.

Where an arrangement involves more than one transaction in securities, it is sufficient if only one of them has the purpose of obtaining of an Income Tax Advantage.[57] One tests all the relevant transactions in securities, ie those which lead to the TiS conditions being met. But one tests the purpose of each transaction in its wider context,[58] so the point is not likely to matter in practice.

55.11.1 *"Income Tax Advantage"*

"Income Tax Advantage" matters for two overlapping rules:

(1) The TiS TAAR
(2) s.684(1)(d) ITA, (in short) requiring that someone obtains an IT advantage

"Income Tax Advantage" is defined in s.687 ITA. Section 687(1) ITA provides:

> For the purposes of this Chapter [Chapter 1 Part 13] the person obtains an income tax advantage if—
> (a) [i] the amount of any income tax which would be payable by the person in respect of the relevant consideration[59] if it constituted a distribution[60] exceeds
> [ii] the amount of any capital gains tax payable in respect of it, or
> (b) [i] income tax would be payable by the person in respect of the relevant consideration if it constituted a distribution and
> [ii] no capital gains tax is payable in respect of it.[61]

This is not the standard definition of tax advantage[62] (which applied for the pre-2010 IT TiS rules and still applies for the CT TiS rules). The definition seems similar, but

(1) For the standard definition one must identify a possible comparator

[57] This is self-evident, but if authority is needed, see *Wroe v HMRC* [2022] UKFTT 143 (TC) at [115].

[58] See 3.4.2 (Test transaction in wider context).

[59] See 55.9 (Relevant Consideration).

[60] See 55.2.2 (Dividend/distribution).

[61] Para (b) adds nothing to para (a), so it is otiose, but that does not matter. The CT equivalent is in s.732 CTA 2010 but the definition is not identical.

[62] See 3.19.1 (Tax advantage: Definitions).

(2) in the TiS definition of IT Advantage, the comparator is specified.

It does not matter whether it is in fact possible for the Relevant Consideration to constitute a distribution.

Where Relevant Consideration is received by a UK individual or trust, it is (more or less) always the case that IT exceeds CGT, so there is (more or less) always an IT Advantage. I refer to this as "IT Advantage", with initial capitals to reflect the technical nature of the expression.

Where Relevant Consideration is received by a non-resident individual from a non-resident company the recipient does not obtain an IT Advantage as no income tax would be payable on a distribution. The same point sometimes applies to a non-resident trust.

There is in principle an IT Advantage if a company
- lends to a shareholder
- repays a debt to a shareholder

Section 687(2) ITA provides a cap:

> So much of the relevant consideration as exceeds the maximum amount that could in any circumstances have been paid to the person or an associate of the person by way of a distribution at the time when Condition A or B in section 685 is met is to be left out of account for the purposes of subsection (1)....

55.11.2 *CT/CGT advantage*

A CGT advantage does not count for the IT TiS rules: that is not an IT advantage. That is evident from the wording of the definition. This rule is deliberate. HMRC say:

> The proposed legislation, through the definition of tax advantage would make it clear that the TiS legislation does not apply to TiS where an advantage in relation to tax on chargeable gains is obtained. This would be more relevant for corporation tax where the position is not clear from the existing [pre 2010] legislation.[63]

HMRC accept that avoiding CT on chargeable gains does not amount to a CT advantage.[64]

[63] See HMRC , "Simplifying Transactions in Securities Legislation" (2009) para 3.3 *https://www.taxation.co.uk/docs/default-source/file/TransactionsSecuritiesLegislation.pdf*

[64] This appears from the passage cited above, and is confirmed by private correspondence mentioned in TCCR para W6.1.3.

55.11.3 *TiS/ToA motive defence compared*

In summary, the TIS TAAR and the ToA motive defence have the following real or apparent differences:

Transfer of Assets Abroad	**Transactions in securities**	**Which is stricter?**
Any purpose test	*Main* purpose test	Little difference
Avoidance of any tax	*IT* advantage needed	ToA stricter
Tax avoidance, not mitigation	"IT Advantage"	TiS stricter
"...reasonable to assume..."	no equivalent wording	No difference
Test associated operations	Test transactions in securities	ToA stricter
No clearance procedure	Clearance procedure	

It follows that TiS clearance does not entail that the ToA motive defence must also apply;[65] but TiS clearance will usually take one a long way there.

55.11.4 *IT advantage obtained*

Section 684 ITA provides:

> (1) This section applies to a person ("the party") where ...
>
> (d) the party or any other person obtains an income tax advantage in consequence of the transaction [in securities] or the combined effect of the transactions [in securities].

There are two requirements here:

(1) Someone obtains an IT Advantage

(2) A causation test: the Advantage must be obtained in consequence of the transaction(s) in securities

In *Grogan v HMRC*:[66]

(1) A company made a payment to a trust (not a transaction in securities)

(2) The trust used the money to purchase shares from an individual (the transaction in securities).

The taxpayer argued that the tax advantage was not obtained in consequence of transaction in securities (the sale) because it was obtained in consequence of two operations, one of which was not a transaction in securities. The argument was rejected. The causation test is not understood so strictly:

[65] For instance, if there is an non-IT avoidance purpose, say, IHT avoidance.

[66] [2010] UKUT 416 (TCC).

> [117] In *Williams*, Viscount Dilhorne referred to the scheme which produced the tax free gains. That scheme contained operations which did not fall within the definition of "transaction in securities"; but that did not result in the gains ceasing to be in consequence of such transactions. It is implicit in that analysis that the phrase 'in consequence of' does not mean 'in consequence only of' and, indeed, the Code would have almost no teeth at all if that were the case.
>
> [118] Further, I do not consider that such an operation has to be causally connected with the transaction in securities in the sense that it occurs as a result of that transaction. Thus, a complicated tax avoidance scheme may contain many operations which are not themselves transactions in securities but which take place after the first event which is a transaction in securities. Such operations may be a necessary ingredient of the scheme, without which the tax advantage would not be obtained. It may require active steps by a participant in the scheme to ensure that such an operation takes place. Such an operation takes place because there is a scheme, not because there has been a previous transaction in securities.
>
> [119] It can be seen therefore that a tax advantage can be obtained 'in consequence of' a transaction in securities notwithstanding
>
> (a) that another operation, which is not a transaction in securities, is a necessary ingredient and
>
> (b) that such other operation is not one which takes place 'in consequence of' the transaction in securities.
>
> I can see no reason in principle why the other operation has to take place after the transaction in securities itself. In my judgment, it is enough if the tax advantage is obtained as the result of an overall series of transactions which are linked together to form a scheme and where the relevant transaction in securities is part of that scheme.

55.11.5 *Amount of IT advantage*

The amount of IT Advantage has a commonsense definition in s.687(3) ITA:

> The amount of the income tax advantage is the amount of the excess or (if no capital gains tax is payable) the amount of the income tax which would be payable.

It is not clear what this is for, as the term "amount of the income tax advantage" is not used in the TiS code.

The amount of the IT advantage in general terms is relevant to:

(1) The terms of a counteraction notice

(2) The TiS TAAR (as a smaller advantage is less likely to be a main purpose)

But one does not need a definition for those purposes.

55.12 TiS issue list

To summarise the discussion so far. The best way to approach the TiS code is as follows:

Preparatory

(1) Identify the transaction(s) in securities
(2) Identify:
(a) the parties to the transaction in securities
(b) the persons who obtain an IT advantage
(together, "relevant persons")
(3) Identify the Consideration which the relevant person receives
(4) Identify the company with Distributable Assets
(5) Identify Relevant Consideration:

Type A Relevant Consideration	**Type B Relevant Consideration**
(5a) Identify assets representing Distributable Assets by the company	(5b) Identify share capital/security representing Distributable Assets by the company

(6) Consider the Circumstances:

Circumstances A(a)(b)(c)	**Circumstance B**
(6a) Identify Transfer of Company Assets	[not needed]
(6b) The necessary links: Is the Relevant Consideration received (i) as a result of the transaction(s) in securities and (ii) in connection with the Transfer of Company Assets	(6c) The necessary link: Is the Relevant Consideration received as a result of the transaction(s) in securities

Common to all cases

(7) Does the relevant person pay IT on the Relevant Consideration
(8) Identify the IT Advantage:
(a) Does anyone obtain an IT Advantage

(b) If so, do they obtain it in consequence of the transaction(s) in securities

(c) Is a main purpose of the transaction(s) to obtain IT Advantage

(9) Is there a substantial change of ownership

I refer to this as the **"TiS issue list"**. It needs to be applied:

- to each party to the transaction in securities if there is more than one within the scope of TiS[67]
- to each transaction in securities, if there is more than one

It will be apparent that a rigorous application of the issue list is a labourious exercise.

With this in mind I turn to consider some examples.

55.13 Examples

In the following examples when I say that arrangements in the example are "in principle" within TiS, I mean they fall within TiS assuming no TiS TAAR defence. That topic is not considered in the examples. I also leave out the question of what (if any) counteraction HMRC may choose to apply.

I first consider the position for UK companies and UK residents.

55.14 Individual sells shares to co

55.14.1 *Sale (not to close co) for cash*

Suppose:

(1) An individual (the seller) sells a company (T Ltd, for **T**arget co) for cash.

(2) The buyer is another individual, a trust or a non-close company.

(3) The buyer is an associate[68] of the seller

Applying the TiS issue list to the seller and buyer:

(1) The sale/purchase is a transaction in securities.

[67] We are concerned to parties to transactions in securities who are individuals, trusts or non-resident companies. A party to a transaction in securities which is a company subject to corporation tax is not subject to the IT TiS code, because the company is not subject to IT, and the CT TiS rules are (more or less) defunct.

[68] The example posits a sale to an associate because a sale to a non-associate would normally constitute a substantial change of ownership.

Position of seller	*Position of buyer*
(2)(a) The seller is party to the transaction in securities	(2)(a) The buyer is party to the transaction in securities
(b) The seller obtains an IT advantage	(b) Does the buyer obtain an IT advantage (as defined)?
so the seller is a relevant person.	so the buyer is a relevant person.
(3) The seller receives Consideration (the purchase price).	(3) The buyer receives Consideration (the purchase price).

(4) T Ltd (the company sold) has Distributable Assets (assume).
(5) The purchase price (the cash) is Type A Relevant Consideration.

But item (6) of the TiS issue list is not satisfied; the TiS Circumstances are not met:

(6)(a) Circumstance A is not met, because there is no Transfer of Company Assets
(b) Circumstance B is not met for two reasons (one would suffice):
(i) the Consideration is cash, not shares.
(ii) only one close company is concerned in the transaction

So TiS does not apply to the seller or buyer. It does not matter that most of the other requirements are met.

Of course, no-one would expect the buyer to be within TiS: the buyer does not obtain an IT Advantage in any meaningful sense. Whether the buyer obtains an IT Advantage within the definition might be debated, but the problem does not arise.

55.14.2 *Cash sale + extraction of cash*

If the arrangement consists of a cash sale and other transactions, then further thought is needed.

Suppose a cash sale (as above) followed by a further step (4):

(1) An individual (the seller) sells a company (T Ltd) for cash.
(2) The buyer is another individual, a trust or a non-close company.
(3) The buyer is an associate of the seller
Further step:
(4) (a) The buyer puts T Ltd (the company sold) into liquidation; or
(b) T Ltd (the company sold) purchases its own shares

Step (4) might be done, for instance, to raise funds to pay the purchase price, or to repay a short term loan used to pay the purchase price.

Step (4) is a transaction in securities and so there are two transactions in securities.

Starting with the TiS issue list for the seller, the first 5 items in the list are satisfied. Turning to item 6, the TiS Circumstances:

(6) Circumstance A is met as:
 (a) There is a Transfer of Company Assets (at step (4))
 (b) The necessary links are met: The Relevant Consideration is received:
  (i) as a result of the transaction(s) in securities and
  (ii) in connection with the Transfer of Company Assets (assume)

(7) The seller does not pay IT on the Relevant Consideration
(8) The IT Advantage:
 (a) The seller obtains an IT Advantage
 (b) The seller obtains it in consequence of the transaction in securities

So the seller is within TiS.

The buyer is also within TiS, as a result of step (4): see 55.15.2 (Purchase of own shares); 55.15.3 (Liquidation)

55.14.3 *Extraction of cash + sale*

Take the above example but reverse the order of events. Suppose the extraction of cash from the company occurs before the sale. In *Grogan v HMRC*:[69]

(1) A company made a payment to a qualifying employee share ownership trust (a Transfer of Company Assets).
(2) The trust used the cash to purchase shares from an individual (the transaction in securities).

Applying the TiS issue list for the seller, the first 5 items in the list are satisfied. Turning to item 6, the TiS Circumstances, TiS circumstance A is met because:

(a) There is a Transfer of Company Assets (at step (1))
(b) The necessary links are met: The Relevant Consideration is received:
 (i) as a result of the transaction(s) in securities and
 (ii) in connection with the Transfer of Company Assets

[69] [2010] UKUT 416 (TCC).

55.14.4 *Sale to close co for cash*

Suppose a sale as above, but the buyer is a close company:

(1) An individual (the seller) sells a company (T Ltd, for **T**arget co) to B Ltd (the buyer) for cash.
(2) The buyer (B Ltd) is a close company.
(3) B Ltd is an associate[70] of the seller.

Applying the TiS issue list to the seller:

(1) The sale is a transaction in securities.
(2) (a) The seller is a party to that transaction
 (b) The seller obtains an IT advantage
 so the seller is a relevant person.
(3) The seller receives Consideration (the purchase price).
(4) B Ltd has Distributable Assets (assume).
(5) The purchase price is Type A Relevant Consideration: the cash is (or represents the value of) an asset of B Ltd which would have been Available for Distribution by B Ltd (if not used for the purchase price).
(6) (a) The payment of the purchase price is a Transfer of Company Assets (assets of B Ltd) for two reasons (one would suffice):
 (i) it is a transfer of assets of B Ltd
 (ii) it is a payment in discharge of the liabilities of B Ltd.
(6) (b) Circumstance A is met.
(7) The relevant person does not pay IT on the Relevant Consideration.

So (subject to the substantial change of ownership/TiS TAAR defences) a sale of a company to another company is within TiS.

This has been discussed in a number of cases:

Cleary v IRC 44 TC 399
Brown v IRC 47 TC 217
Allam v HMRC [2021] UKUT 291 (TCC)

In *Cleary,* two joint shareholders sold their company to another company.

In *Brown*, the ownership of the purchaser (B Ltd) was not quite the same as the ownership of the target company (T Ltd); that made no difference.

In *Allam,* B Ltd (the purchaser) had sufficient Distributable Assets, so

[70] The example posits a sale to an associate because a sale to a non-associate would normally constitute a substantial change of ownership.

the purchase price it paid was Relevant Consideration. T Ltd (the company sold) did not have sufficient Distributable Assets, but that did not matter. That seems right, as a sale for cash effectively allows the extraction of cash from B Ltd, (perhaps also from T Ltd, the company sold), without the IT charge which would be payable on a dividend.

Although on the sale of T Ltd (the company sold) there is an income tax charge on the purchase price paid from B Ltd to the individual

(1) there is no reduction in the market value of the shares of B Ltd, and
(2) there is no increase in the base cost of those shares.

So there could be two charges to tax:

(1) A TiS IT charge on the sale of T Ltd
(2) A CGT charge on a future sale of B Ltd

But that seems right, because the same charges would arise if:

(1) Funds came from T Ltd (the company sold) by way of dividend (subject to IT); and
(2) B Ltd was sold (gain subject to CGT)

What if T Ltd (the company sold) has Distributable Assets, but B Ltd (the buyer) does not? Perhaps that will not often happen.

What if the asset sold to B Ltd was not shares in T Ltd, but securities, perhaps in a quoted non-close company? The TiS conditions are still met as the seller is party to a transaction in securities. But the TiS TAAR defence may be stronger.

It is suggested that the law would be simpler if a sale of a close company to another close company was deemed to be a distribution unless there is a substantial change of ownership. There should be no defence under the TiS TAAR. This would avoid the difficulties in the application of the TAAR illustrated by *Allam v HMRC*.[71]

55.14.5 *Sale for redeemable shares*

Suppose:

(1) An individual (the seller) sells a company (T Ltd, for **T**arget co) to B Ltd (the buyer)
(2) The buyer is an associate[72] of the seller

[71] See 3.12 (Consequence/purpose distinction).

[72] The example posits a sale to an associate because a sale to a non-associate would normally constitute a substantial change of ownership.

(3) The consideration is an issue of redeemable shares or loan notes by B Ltd.

Circumstance B is met and the transaction falls within TiS, just as for a cash sale. That seems right, as a sale for redeemable shares or loan notes is only a short step from a sale for cash; it amounts to a sale for cash, when the shares or loan notes are redeemed.[73]

55.14.6 *Sale for irredeemable shares*

Suppose:

(1) An individual (the seller) holds two companies (A Ltd and B Ltd)
(2) The individual transfers A Ltd to B Ltd, in consideration of an issue of irredeemable shares by B Ltd (new shares).

Applying the TiS issue list:

(1) The sale is a transaction in securities.
(2) The seller is a party to that transaction so a relevant person.
(3) The seller receives Consideration (the new shares)
(4) B Ltd has Distributable Assets
(5) The shares are Relevant Consideration Type A and Type B
(6) (a) The transfer of the A Ltd shares is a Transfer of Company Assets on the basis that it is an indirect transfer of assets of one close company to another close company,
 (b) Circumstance A(c) is therefore met.
 (c) Circumstance B is also met.
 However irredeemable share capital relief provides relief from Circumstances A(c) and B.[74]

So (in the absence of further steps) the TiS conditions do not apply.

HMRC do not object in principle to a simple sale for irredeemable shares. The CT Manual provides:

> **CTM36850: examples of common circumstances where clearance will be given** [Oct 2020]
> **Example 1**
> Mrs A and Mrs B jointly own all the share capital in companies C Ltd and D Ltd which operate similar trades. They decide to form a group

[73] See 55.14.4 (Sale to close co for cash).

[74] See 55.7.1 (Irredeemable share capital).

> for specified commercial reasons.[75] They form Newholdco Ltd which issues ordinary shares to Mrs A and Mrs B in exchange for their shares in C Ltd and D Ltd.

The difficulty comes if one adds a further step of a share buy-back:

(1) In my example, B Ltd might buy back its shares.
(2) In the HMRC example, Newholdco Ltd might buy back its shares.

That is not a distribution, ie not subject to IT, as the B shares were issued for consideration.[76] There is, in short, an uplift in the consideration of the shares for IT purposes. HMRC understandably do not like that:[77]

> 3.11 When a company repays part of the shareholders' capital, the payment is not treated as a distribution. This recognises that where the company is merely returning to the shareholder what the shareholder originally paid in, there should not be an income tax charge. The government is satisfied that this is the correct position.
> 3.12 However, where it is possible to increase the amount of 'capital' repaid to shareholders, the government is concerned that an opportunity to convert income to capital arises.
> *Example*
> S is the sole shareholder of SI Ltd, which was formed with £100 of share capital. After successfully trading for a number of years SI Ltd also has retained profits of £250,000 and no other assets.
> For a number of reasons, S is advised to create a new holding company, SI Holdings Ltd (SIH Ltd), which is achieved via a share for share exchange in which SIH Ltd issues £250,100 of share capital.
> S now holds all of the share capital in SIH Ltd, which holds all of the shares in SI Ltd. SIH can repay £250,000 of share capital to S. This

[75] Prior to Oct 2020, this read: "They decide to form a group to improve access to finance for expansion *and to benefit from group taxation provisions*." This is not an *Income* Tax Advantage, and not tax avoidance. (It is a CT advantage, but we are not concerned with CT TiS rules).
Does the new text reflect a change of practice, or is it simply that HMRC did not wish to give a hostage to fortune?
Under the post 2020 wording, the example is self-evident: since it seems to be posited that the sale is for commercial reasons only, it seems clear that the TiS TAAR provides a defence.

[76] See 30.5.2 (Para C/D: Issue of securities).

[77] HMRC, "Company distributions: consultation document" para 3.2.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/483547/Company_distributions_-_consultation_document__7029_.pdf
I have altered the text of the example for clarity

transaction is classed as a repayment of capital and is subject to CGT.

These were the facts of *Wroe v HMRC*.[78]

It is suggested that the answer is to extend the definition of distribution so that the seller does not get the IT uplift, for which there is no tax justification. Then HMRC need not rely on TiS and TiS TAAR problems do not arise.

55.15 Capital distributions

55.15.1 *Repayment of debt security*

A redemption (repayment) of a debt security is in principle within TiS.

55.15.2 *Purchase of own shares*

A purchase of own shares is a transaction in securities.

In the case of a UK company, the proceeds of sale may be income.[79] If so, TiS does not in principle apply, as the vendor will in principle pay IT on the income.[80]

If the proceeds of sale are a capital receipt, as in the case of a non-UK company, this is in principle within TiS. The TiS TAAR may be a defence.

55.15.3 *Liquidation*

A liquidation is in principle within TiS.

The textbook TCCR considers the following "familiar problem":[81]

(1) Oldco has two businesses, one of which is sold, so it has the remaining business, and cash.

(2) Of course Oldco could distribute the cash by way of dividend, ie taxably. But instead:
   (a) Oldco is put into liquidation.
   (b) The remaining business is transferred to Newco in consideration of shares which are issued to the Oldco shareholders.[82]
   (c) The cash is paid to the shareholders by the liquidator.

[78] See 55.18.2 (Disclosure for valid clearance).

[79] See 30.5 (Para B: Other distributions).

[80] See 55.5.2 (No IT on Consideration).

[81] *Taxation of Companies and Company Reorganisations* (looseleaf) para W6.2.3

[82] Section 110 Insolvency Act 1986 confers power to do this. CGT reorganisation relief should apply.

Prior to 2016, this was already in principle within TiS. But now that transaction in securities includes a distribution in a winding up, the analysis is more straightforward, because every liquidation falls within the scope TiS (even if, say, Oldco had sold both of its business and only held cash).

The significance of the pre-2016 history is that it suggests that this "familiar problem" is a type of transaction where HMRC are likely to issue a counteraction notice. The TiS TAAR is the only defence.

55.16 Examples with foreign company

So far we have been considering a UK resident company. I turn to consider some examples where the company is non-resident.

55.16.1 *Non-resident*

There is in principle no Income Tax Advantage if a non-resident receives a distribution from a non-resident company (without further steps). TiS cannot apply unless someone obtains a tax advantage.

55.16.2 *Remittance basis taxpayer*

There is no Income Tax Advantage if:

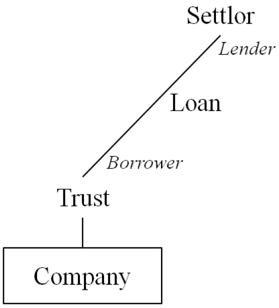
(1) the shareholder is a remittance basis taxpayer and

(2) the Consideration received by the individual from a non-resident company is not remitted to the UK

Even a dividend would not have been taxable.

55.16.3 *Foreign trust*

Suppose this common situation:



Assume the company and the trust are non-resident but the settlor is UK resident:

(1) The company buys back its own shares so the trust receives trust capital

(2) The trustees transfer the capital to the settlor[83]
  (a) by repayment of the loan
  (b) by making a new loan; or
  (c) by outright distribution

Applying the TiS issue list, to the trustee and to the settlor:

Position of trustee	**Position of settlor**
(1) The purchase of own shares is a transaction in securities.	
(2)(a) The trustee is a party to that transaction, so is a relevant person. (2)(b) The trustee does not obtain a tax advantage.	(2)(a) The settlor is not a party to that transaction. (2)(b) The settlor does obtain an IT Advantage, so is a relevant person.
(3) The trustee receives Consideration (cash from the company)	(3) The settlor receives Consideration (cash from the trustee)
(4) The company has Distributable Assets	
(5) The payment from the company is Type A Relevant Consideration	(5) The payment from the trust is Type A Relevant Consideration
(6) The payment of the cash from the company is a Transfer of Company Assets	
(7) The trustee (a relevant person) does not pay IT on the Relevant Consideration.	(7) The settlor (a relevant person) does not pay IT on the Relevant Consideration.

The settlor is not within TiS, as he/she is not a party to a transaction in securities. Could HMRC issue a counteraction notice on the trustees, who are not UK resident, in relation to a receipt from a non-resident company?[84] In practice it does not happen, or at least, has not happened. Would the TiS TAAR defence apply?

[83] The position is the same if the transfer is to any UK resident beneficiary.

[84] See 55.17.3 (Counteraction); 16.12 (Territorial principle: Application).

55.17 Counteraction

55.17.1 *TiS enquiry*

The TiS code is not within the standard IT/CT enquiry/discovery regimes. Section 695(1) ITA provides:

> An officer of Revenue and Customs may enquire into a transaction or transactions if—
> (a) the officer has reason to believe that section 684 (person liable to counteraction of income tax advantage) may apply to a person ("the taxpayer") in respect of the transaction or transactions, and
> (b) the officer notifies the taxpayer of his intention to do so.

I refer to this as a TiS enquiry.

Broadly speaking, the onus of proof lies on HMRC; but onus of proof does not matter much.[85]

55.17.2 *Time limits*

There is a time limit for starting a TiS enquiry. Section 695(2) ITA provides:

> The notification may be given at any time not more than 6 years after the end of the tax year to which the income tax advantage in question relates.

CIOT say:

> there are cases where HMRC have issued counteraction assessments under the transactions in securities rules for the year 2015/16, but done so only during the tax year 2021/22, mostly in the first three months of calendar year 2022. Under the rules that applied until 5 April 2016, it appears that the assessments had to be issued within four years of the end of the tax year in which the tax advantage arose, i.e. by 5 April 2020, in which case assessments raised by 5 April 2022 were two years too late.[86]

A test case is likely to follow.

55.17.3 *Counteraction*

Section 698(1) ITA provides:

[85] See 3.15 (Burden of proof).

[86] CIOT News, 24 Jan 2023.

> If on an enquiry under section 695 an officer of Revenue and Customs determines that section 684 [TiS] applies to the taxpayer, the income tax advantage in question is to be counteracted by adjustments, unless the officer is of the opinion that no counteraction is required.

The question is whether s.684 applies to the taxpayer. So we return to s.684, which provides:

> (1) This section applies to a person ("the party") where—
> (a) the person is a party to a transaction in securities ...

Thus the person who is within a counteraction notice must be a party to the transaction in securities.

Thus if a company lends to trustees, and trustees appoint the borrowed money to a beneficiary there can be no counteraction against the beneficiary, because the beneficiary is not a party to the transaction in securities.[87]

55.17.4 *Counteraction notice procedure*

Section 698 ITA provides:

> (2) The adjustments required to be made to counteract the income tax advantage and the basis on which they are to be made are to be specified in a notice served on the person by an officer of Revenue and Customs.
> (3) In this Chapter [Chapter 1 Part 13] such a notice is referred to as a "counteraction notice".
> (4) Any of the following adjustments may be specified—
> (a) an assessment,
> (b) the nullifying of a right to repayment,
> (c) the requiring of the return of a repayment already made, or
> (d) the calculation or recalculation of profits or gains or liability to income tax.

A counteraction notice generally leads to an assessment.

In the absence of a counteraction notice, there is no liability to tax. There is no duty to disclose to HMRC facts which might justify a counteraction notice.

Section 698 ITA provides:

> (5) An assessment may be made in accordance with a counteraction

[87] See 55.16.3 (Foreign trust).

> notice at any time (without regard to any time limit on making the assessment that would otherwise apply).
> (6) This section is subject to—
> [a] section 700 (timing of assessments),[88] and
> [b] section 702(2) (effect of clearance notification under s. 701).[89]
> (7) But no other provision in the Income Tax Acts is to be read as limiting the powers conferred by this section.

But while the assessment has no time limit, a taxpayer is protected by the 6 year TiS enquiry time limit.[90]

55.17.5 *No-counteraction notice*

Section 698A ITA provides:

> (1) If on an enquiry under section 695 an officer of Revenue and Customs is of the opinion that no counteraction is required, the officer must serve notice on the person (a "no-counteraction notice") stating that no counteraction is required and why.
> (2) The taxpayer may apply to the tribunal for a direction requiring an officer of Revenue and Customs to issue one of the following within a specified period—
> (a) a counteraction notice;
> (b) a no-counteraction notice.
> (3) Any such application is to be subject to the relevant provisions of Part 5 of TMA 1970 (see, in particular, section 48(2)(b) of that Act).
> (4) The tribunal must give the direction applied for unless satisfied that there are reasonable grounds for not serving either a counteraction notice or a no-counteraction notice within a specified period.

This is the equivalent of an application for a closure notice of a SA enquiry.[91]

55.17.6 *Appeals*

Section 705 ITA provides:

> (1) A person on whom a counteraction notice has been served may appeal on the grounds that—

[88] See 55.7.2 (Year of assessment).

[89] See 55.18.1 (Effect of clearance).

[90] The time limits for the pre-2016 rules are to be litigated in litigation at present reported only on preliminary issues: *Hunt v HMRC* [2024] UKFTT 78 (TC).

[91] See 121.21.1 (Application for closure notice).

> (a) section 684 (person liable to counteraction of income tax advantage) does not apply to the person in respect of the transaction or transactions in question, or
> (b) the adjustments directed to be made are inappropriate.
>
> (2) Such an appeal may be made only by giving notice to the Commissioners for HMRC within 30 days of the service of the counteraction notice.
>
> (3) On an appeal under this section that is notified to the tribunal, the tribunal may—
> (a) affirm, vary or cancel the counteraction notice, or
> (b) affirm, vary or quash an assessment made in accordance with the notice.
>
> (4) But the bringing of an appeal under this section does not affect—
> (a) the validity of the counteraction notice, or
> (b) the validity of any other thing done under or in accordance with section 698 (counteraction notices),
>
> pending the determination of the proceedings.

In *Allam v HMRC* the FTT held that s705(1)(b) ITA permits the Tribunal to hear a challenge to the validity of a counteraction notice on public law grounds, in short, acting wholly unreasonably.[92] But it remains to be seen if other tribunals will take the same view.

55.18 TiS clearance

Section 701 ITA provides:

> (1) A person may provide HMRC with particulars of a transaction or transactions effected or to be effected by the person in order to obtain a notification about them under this section...
>
> (4) The Commissioners must notify the person whether they are satisfied that the transaction or transactions, as described in the particulars, were or will be such that no counteraction notice ought to be served about the transaction or transactions.

The clearance application must be on behalf of all who may be within s.701, must include all relevant transactions, and must give full details.

The rest of s.701 deals with procedural matters relating to a clearance application:

> (2) If the Commissioners consider that the particulars, or any further

[92] [2020] UKFTT 216 (TC) at [225].

> information provided under this subsection, are insufficient for the purposes of this section, they must notify the person what further information they require for those purposes within 30 days of receiving the particulars or further information.
> (3) If any such further information is not provided within 30 days from the notification, or such further time as the Commissioners allow, they need not proceed further under this section...
> (5) The notification must be given within 30 days of receipt of the particulars, or, if subsection (2) applies, of all further information required.

The CT Manual provides:

> **CTM36840 transactions in securities: clearances** [Oct 2020]
> There is no obligation to seek clearance from HMRC in relation to transactions in securities and potential applicants may decide not to do so.
> A person may apply to the Commissioners for HMRC for clearance under ITA07/S701 or under CTA10/S748 that they will not be subject to counteraction. The application may be made before or after the transactions take place. It must be made by either a party to the transactions or an agent acting on their behalf.
> Applications may be made to reconstructions@hmrc.gov.uk or by post to: BAI Clearance, HMRC, BX9 1JL

SP 3/80 provides:

> **Reasons for Refusing Clearance**
> 1 Where the Commissioners for HMRC cannot give clearance under [s.701 ITA] they are not statutorily required to say why and at one time their practice was to decline to do so. With a view to removing misunderstanding in particular about the scope of [the TiS code] in relation to transactions with a commercial element, they later modified that practice.
> Where the applicant has given full reasons for his transactions and clearance has to be refused, the Commissioners for HMRC indicate, where possible, their main grounds for doing so. In appropriate cases where they do not think it right to give reasons the Commissioners for HMRC will invite the principals themselves as well as their advisers to an interview so that the Commissioners for HMRC can be certain they have fully appreciated the position.
> **Significance of Refusing Clearance**
> 2 The rules of the clearance procedure require the Commissioners for HMRC to say whether in their view [the TiS code] would not apply.

> They are not required to say whether in their view the section definitely would apply. It may not always be practicable to do so in advance of the transaction's actually being carried out, eg where the motive for it is a relevant factor. Nonetheless, it is not the practice of the Commissioners for HMRC to withhold consent under [s.701 ITA] unless they would, on the information available to them, expect to take counteraction under [the TiS code]. The then Financial Secretary to the Treasury stated this practice in the 1966 Finance Bill debates in the following words:
>
> > "The Revenue's approach is that it will not refuse a [s.701] clearance unless, having considered the transaction fully and all the circumstances of it, it would itself take action under the section if the transaction were completed."[93]

HMRC practice seems to have changed, and now in cases of doubt they refuse clearance and launch a TiS enquiry if the transaction goes ahead. It is safer and easier to refuse clearance than to give it.

There is no provision for appealing against a TiS clearance refusal. But it is possible to appeal against a refusal of a CGT clearance, which may determine (more or less) the same issues as a TiS clearance.[94]

55.18.1 *Effect of clearance*

Section 702 ITA provides:

> (1) This section applies if the Commissioners for Her Majesty's Revenue and Customs notify a person under section 701 that they are satisfied that a transaction or transactions, as described in the particulars provided under that section, were or will be such that no counteraction notice ought to be served about the transaction or transactions.
> (2) No such notice may be served on the person in respect of the transaction or transactions.
> (3) But the notification does not prevent such a notice being served on the person in respect of transactions including not only the ones to which the notification relates but also others.

55.18.2 *Disclosure for valid clearance*

Section 702(4) ITA provides:

> The notification is void if the particulars and any further information

[93] Hansard (13 July 1966) Vol 731 col 1566.

[94] See 58.6 (CGT reorganisation TAAR) and s.138(4) TCGA.

> given under section 701 about the transaction or transactions do not fully and accurately disclose all facts and considerations which are material for the purposes of that section.

In *Wroe v HMRC*:[95]

> In relation to non-statutory clearance applications ... "it is necessary that the taxpayer should have put all his cards face upwards on the table." I see no reason why a clearance application under section 701 should demand a lesser standard of disclosure from a taxpayer.

That is self-evident, but it is salutary to see it in black and white.

In *Wroe*[96] the accountants advised:

> We could apply for advanced clearance, prior to the redemption of any of the shares. However, to do so would simply flag the matter to HMRC

The taxpayer described this as mere "accountants' speak". Perhaps it was. But the judge inferred that the taxpayers and their advisers deliberately withheld information they considered material, and it supported the conclusion that the application did not fully disclose all material facts and considerations. Clearly, accountants need to be careful how they speak. One should bear in mind how notes of advice may be scrutinised unsympathetically a decade later. Though that is easier said than done.

The CT Manual provides:

> **CTM36845 Response To A Clearance Application** [Feb 2018]
> ... [The manual sets out s.702(4) and continues:]
> Clearance is given on the understanding that the person has come to HMRC with "all cards face up on the table". In particular an applicant should not consider that information previously supplied to another part

[95] [2022] UKFTT 143 (TC) citing *R v IRC ex p. MFK Underwriting Agencies Ltd* [1989] STC 873 at p.892.

[96] In *Wroe,* the arrangement consisted of two steps:

(1) A share for share exchange under which shareholders in company A acquired shares in company B.

(2) Company B purchased its own shares from the shareholders.

HMRC assessed income tax on the purchase under the TiS code.

The application for clearance did not mention the proposed purchase of own shares, and the clearance granted did not cover that. The clearance granted was invalid for lack of disclosure. But even if it were valid, it would not have covered step (2). The point is not mentioned in *Wroe*, perhaps because it did not arise.

of HMRC has been disclosed for the purposes of the clearance application.

There is no provision for “voiding” a clearance. Whether a clearance is, or is not, effective is ultimately a question of fact that would, ultimately, be determined by the Tribunal.

Where a clearance is void HMRC is free to apply, if appropriate, the relevant anti-avoidance provision.

CHAPTER FIFTY SIX

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56.27 Tax return: Gains

Cross references

The following topic is considered elsewhere:
43.13 (CGT rates)

This chapter is concerned with ordinary capital gains. Gains subject to income tax under special regimes (offshore funds, life policies, deeply discounted securities, etc) are considered separately in chapters on those topics.

56.1 2019 CGT rewrite: Navigation

FA 2019 rewrote the CGT legislation in Part 1 TCGA. It will take a decade before the CG Manual is (mostly) updated, and statutory instruments will not been updated at all; so readers will need to keep the old section numbers in mind:[1]

Topic	**Current TCGA**	**Pre-2019 TCGA**
Individuals/trusts	s.1A	s.1, 2
Branch/agency	s.1B	s.10
UK land	s.1C,1D	*new*
Losses	s.1E, 1F	s.2
Split year	s.1G	s.2
CGT rates	s.1H-1J	s.4-4BA
CGT annual exemption	s.1K, 1L	s.3
Temporary non-residence	s.1M, 1N	s.10A, 10AA
Companies	s.2-2G	s.8, 10B
Gains of non-resident company	s.3-3G	s.13-14A
CGT remittance basis	Sch 1	s.12

The rewrite was intended to restate the pre-rewrite law and not to change anything. Para 122 sch 1 FA 2019 provides for continuity of the law, as is standard form in rewrite legislation.[2]

56.2 Charge to CGT/CT on gains

56.2.1 *Charge to CGT*

Section 1(1) TCGA provides:

> Capital gains tax is charged for a tax year on chargeable gains accruing[3] in the year to a person on the disposal of assets.

Section 1(1) refers to a "person" so it applies to individuals, trustees, PRs, and, in theory, companies. But company gains within CT are taken out of

[1] For full tables of destinations/derivations see ICAEW Rep 105/18 Appendix 1 *https://www.icaew.com/-/media/corporate/files/technical/icaew-representations/2018/icaew-rep-105-18-chargeable-gains-accruing-to-non-residents-and-returns-for-disposals-of-land.ashx*
At the time of the rewrite I wrote: "Readers may doubt whether the benefit of the rewrite was worth the cost. One may also doubt whether the rewrite would have happened had there been a consultation." But practitioners have now become used to the new numbers, and the cost has been incurred, so this grumble is of historical interest only.

[2] This is discussed in more detail in the 2021/22 edition of this work para 53.1.2 (Pre-rewrite continuity) but I omit it now because no rewrite changes have been identified.

[3] See 15.2.4 (Accruing: Gains).

CGT, ie the CT charge where applicable has priority over CGT; see below.

IT is an annual tax, in the sense that the authority to levy it expires at the end of the tax year, and the tax is re-applied in each year's Finance Act.[4] This is not the case for CGT; but that does not make any difference. CGT is an annual tax, like IT, in the sense that assessments are made by reference to a tax year. In *Cooper v Billingham*:[5]

> an interest-free loan, even if repayable on demand, is a capital payment. It is therefore necessary ... to quantify the benefit conferred by it. In the ordinary course of events that process takes place at the end of a year of assessment, since it is only at the end of the year of assessment that the 'trust gains for the year' can be computed ... If that involves an element of retrospection it is implicit in the scheme of the legislation; capital gains tax, like income tax, is an annual tax.

56.2.2 *Charge to CT*

Section 2 CTA 2009 provides that CT is charged on profits of companies, defined to mean income and chargeable gains.[6]

Section 4 CTA 2009 provides:

> Capital gains tax is not charged on gains accruing to a company in respect of which the company is chargeable to corporation tax, or would be so chargeable but for an exemption.

This meshes with s.1(2) TCGA which provides:

> As a result of section 4 of CTA 2009, capital gains tax is not charged on gains accruing to a company, but corporation tax is chargeable instead in accordance with-
> (a) section 2 of CTA 2009,
> (b) Chapter 2 of this Part [Part 1 TCGA], and
> (c) other relevant provisions of the Corporation Tax Acts.

Thus companies are subject to CT on chargeable gains, and non-companies are subject to CGT.[7]

[4] See 14.3.4 (IT is an annual tax). CT is similar.

[5] [2001] EWCA Civ 1041 at [27].

[6] See 14.3.1 (Charge to IT/CT).

[7] A historical note: From 2013-2018 companies were subject to corporation tax on ordinary chargeable gains and to CGT on ATED and NRCGT gains. But we have now reverted to the straightforward pre-2013 rule.

56.3 “Disposal” and “assets”

56.3.1 *“Disposal”*

Disposal matters because CGT is charged on gains accruing on a disposal; in the absence of a disposal (normally) no gain accrues, or if it did, the gain is not charged under s.1 TCGA.

Section 24(1) TCGA provides:

> [a] Subject to the provisions of this Act and, in particular to sections 140A(1D), 140E(7) and 144,
> [b] the occasion of the entire loss, destruction, dissipation or extinction of an asset shall, for the purposes of this Act, constitute a disposal of the asset
> [c] whether or not any capital sum by way of compensation or otherwise is received in respect of the destruction, dissipation or extinction of the asset.

Section 21(2) TCGA deals with part disposals:

> For the purposes of this Act—
> (a) references to a disposal of an asset include, except where the context otherwise requires, references to a part disposal of an asset, and
> (b) there is a part disposal of an asset where an interest or right in or over the asset is created by the disposal, as well as where it subsists before the disposal, and generally, there is a part disposal of an asset where, on a person making a disposal, any description of property derived from the asset remains undisposed of.

See too 56.22.4 (“Disposal” of debt).

56.3.2 *“Assets”*

CGT is charged on gains accruing on a disposal of assets; in the absence of assets (normally) no disposal happens, and no gain accrues, or if it did, the gain is not charged under s.1 TCGA.

There is of course a wide definition. Section 21(1) TCGA provides:

> All forms of property shall be assets for the purposes of this Act, whether situated in the UK or not, including—
> (a) options, debts and incorporeal property generally, and
> (b) currency, with the exception (subject to express provision to the contrary) of sterling,
> (c) any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired.

Almost anything is an asset, if a gain can be derived from it.[8]

56.4 Computation of gain

56.4.1 *General principles*

In *Cooling v HMRC*:[9]

> The Act is ... (famously) silent as to how computation [of gains] should be performed, except that s 38 [TCGA] makes certain stipulations as to permitted deductions. However, the issue has been clarified by the courts over the years.

Cooling cites *Spectros v Madden*:[10]

> In calculating the chargeable gain arising on the taxpayer's disposal of the shares, the starting point is to find the consideration for the disposal: that is implicit in [what is now s.38 TCGA]. Where the consideration is not in money or not wholly in money, it is necessary, in order to calculate the gain, to value the consideration in monetary terms in pounds sterling.

56.4.2 *Deferred/contingent consideration*

Under a contract, consideration may be:

(1) Deferred: payable in the future, not immediately

(2) Contingent: payable in the future but subject a contingency, not definitely

There are two possible analyses for CGT:

(1) *Section 48 analysis:* Treat deferred/contingent consideration as if it were paid immediately

(2) *Chose in action analysis*:[11] Treat the right to deferred/contingent consideration as a separate asset for CGT

The dividing line is whether the consideration is ascertainable, or at least, capped at an ascertainable sum.

56.4.3 *Section 48 analysis*

Section 48(1) TCGA provides:

[8] *O'Brien v Benson's Hosiery* 53 TC 241 (employer's rights under employment contract held to be an asset).

[9] [2015] UKFTT 223 (TC) at [11].

[10] [1997] STC 114 at p.135.

[11] Sometimes called a *Marren v Ingles* analysis.

> [a] In the computation of the gain consideration for the disposal shall be brought into account
> [i] without any discount for postponement of the right to receive any part of it
> [ii] and, in the first instance, without regard
> [A] to a risk of any part of the consideration being irrecoverable or
> [B] to the right to receive any part of the consideration being contingent;

There are two rules here. In each case, the rule is "pay up front" which seems to be unfair. But the unfairness of rule [i] is mitigated to some extent by installment relief.[12] The unfairness of rule [ii] is mitigated by irrecoverable consideration relief.

56.4.4 *Irrecoverable consideration relief*

Section 48(1) TCGA continues:

> [b] and if any part of the consideration so brought into account subsequently proves to be irrecoverable, there shall be made, on a claim being made to that effect, such adjustment, whether by way of discharge or repayment of tax or otherwise, as is required in consequence.

I refer to this as "**irrecoverable consideration relief**".

56.4.5 *Deferred foreign currency consideration*

The CG Manual provides:

> **CG14930: consideration irrecoverable** [Jul 2019]
> The immediate effect of the decision [in *Goodbrand v Loffland Brothers North Sea* 71 TC 57] is that where consideration for a disposal is payable in foreign currency that currency is to be brought into account at its value at the date of disposal. If the value of the currency subsequently falls, so that its value on receipt is less than the value brought into the account, the shortfall is not irrecoverable consideration and no claim can be made under Section 48.
> More generally, where consideration for a disposal takes the form of money's worth, so that it has to be valued at the time of the disposal for the purpose of the computation, any shortfall in the value of that

[12] Section 280 TCGA.

> money's worth on receipt cannot give rise to a claim under Section 48. Section 48 applies only where some or all of the actual consideration due under the contract is irrecoverable.

56.4.6 *Chose in action analysis*

In *HMRC v Collins*:[13]

> section 48 applies only to future consideration of an amount which is ascertained or ascertainable at the time of the disposal.
> Where future consideration is wholly uncertain in amount, and not merely subject to contingencies,
> [1] the amount that has to be brought into account on the making of the disposal is the value of the right to receive the future consideration,
> [2] and the right itself is treated as a separate asset for CGT purposes which is the subject-matter of a separate disposal when the future consideration is paid, giving rise to a chargeable gain or an allowable loss as the case may be.

The separate asset is a contractual claim, known as a chose in action.

In *Marren v Ingles*[14] the taxpayer sold shares for a sum defined as £750 per share plus half of the profit on a subsequent flotation. The consideration for the share sale was a chose in action, the right to the unascertainable sum. There was a minimum but no cap on that amount. So when two years later, following the flotation, the taxpayer received the purchase price, there was a second disposal (of the chose in action) in consideration for the cash finally received.

In *Marson v Marriage*[15] the taxpayer sold land for "two alternative considerations depending on events". If planning permission was granted the price was specified; but if the land was nationalised, the price was half of the proceeds of nationalisation. The consideration for the sale was a chose in action: at the time of the disposal (in short, the date of the contract) the purchaser could not say what the consideration would be.

For the position where a non-resident sells land /a land-rich company for unascertainable consideration, see 57.36 (Unascertainable consideration).

56.4.7 *s.48/chose in action analyses: Border*

The CG Manual provides:

[13] [2009] EWHC 284 (Ch) at [5].

[14] 54 TC 76.

[15] 54 TC 59.

> **CG14881 - What Is Ascertainable** [Dec 2021]
>
> The amounts of the future payments are ascertainable if at the date of disposal they are
>
> - known, or
> - ascertainable by calculations, or
> - ascertainable by making up an account AND all of the events which establish the AMOUNT have occurred by the date of the disposal.
>
> If the future payments are unascertainable see CG14940+.
>
> Examples of ascertainable future payments are
>
> - the agreement for the disposal of the asset provides for a consideration of £300,000, of which £100,000 is payable on completion and £200,000 will be payable in four annual instalments of £50,000, or
> - the agreement for the disposal of a business provides for a consideration of £100,000 and a sum equal to half of the taxable profits of the business for the year ended on the date of disposal, payable nine months after the date of the contract.
>
> Where the amount of the future consideration is ascertainable the full amount is included in the disposal proceeds. There are no tax consequences when the future amounts are received.

The CG Manual provides:

> **CG14883 - Ascertainable But Contingent** [Jul 2019]
>
> Payments which are ascertainable but contingent are treated in the same way as all other ascertainable amounts.
>
> The wording of the agreement will link the liability to pay the future amount or amounts with the occurrence or non-occurrence of a particular event.
>
> Examples of ascertainable but contingent payments are
>
> - the agreement for the sale of a business provides for a consideration of £250,000, of which £200,000 is payable on completion and £50,000 is payable if the profits of the year following the date of disposal exceed £100,000, or
> - the agreement for the sale of a piece of land provides for a consideration of £75,000, of which £50,000 is payable on completion and £25,000 is payable if planning permission is granted within two years of the date of the disposal.
>
> The defining feature of ascertainable deferred consideration is that all of the events which affect the AMOUNT occur before the date of the disposal.

56.4.8 *Deferred consideration: Critique*

Goodbrand v Loffland Brothers North Sea Inc explained the reason for the deferred consideration rule:[16]

> The Judge described [s.48 TCGA] as a departure from economic or commercial reality, but in truth it is a necessary and proper provision for the protection of the revenue. Where payment of the whole or part of the consideration is deferred, the total amount of the consideration will normally be increased in order to compensate the seller for interest forgone on that part of the consideration. In economic terms the transaction is equivalent to a sale for a price payable immediately, but with a loan to the purchaser of the deferred part of the price at interest. Such interest would be taxable. To prevent the loss of tax which would otherwise occur by structuring the transaction as a sale for a greater but deferred consideration, the amount of the consideration is taken into account at its face value without any discount for deferred payment. There is, therefore, nothing paradoxical or contrary to economic reality in aggregating future instalments or disallowing a discount for deferment. Any hardship results from the liability to pay the tax before the consideration is received, but this may be alleviated by [installment relief]

Marson v Marriage was more concerned about hardship in the rule:[17]

> In construing [what is now s.48] I think it is of some importance to look at it in the light of the burden which it imposes on a person who has to deposit in advance large amounts of tax against a speculative right to receive purchase money. It is an onerous provision, and if it is to apply I think that it must be demonstrated clearly that the case falls within the provision.

But the chose in action analysis is in general harsher than the s.48 treatment, as:

(1) tax is paid on the first disposal without installment relief; and
(2) while a loss may arise on a subsequent disposal of the chose in action, it cannot be carried back to set against the gain on the first disposal.

There are other ways to tax unascertainable consideration. Why not align the chose in action treatment with s.48, ie allow an instalment relief, with

[16] 71 TC 57 at p.71.
[17] 54 TC 59 at p.75.

a further payment or refund when the correct amount is ascertained? The SDLT rule is that uncertain or unascertained consideration is taxed on the basis of a reasonable estimate, with provision for adjustment later if needed.[18] Is that not preferable? Discuss.

56.4.9 *Contingent liabilities*

The rule for contingent liabilities is "wait and see". Section 49(1) TCGA initially disallows contingent liabilities:

> In the first instance no allowance shall be made in the computation of the gain—
>
> (a) in the case of a disposal by way of assigning a lease of land or other property, for any liability remaining with, or assumed by, the person making the disposal by way of assigning the lease which is contingent on a default in respect of liabilities thereby or subsequently assumed by the assignee under the terms and conditions of the lease,
>
> (b) for any contingent liability of the person making the disposal in respect of any covenant for quiet enjoyment or other obligation assumed as vendor of land, or of any estate or interest in land, or as a lessor,
>
> (c) for any contingent liability in respect of a warranty or representation made on a disposal by way of sale or lease of any property other than land.

Section 49(2) TCGA then allows the liabilities if and when they actually fall due:

> If any such contingent liability subsequently becomes enforceable and is being or has been enforced, there shall be made, on a claim being made to that effect, such adjustment, whether by way of discharge or repayment of tax or otherwise, as is required in consequence.

The 4-year time limit commences from when the position occurs to make the claim.[19]

This does not apply to indemnities, which may instead qualify for relief under para 13 ESC D33.

[18] See s.51 FA 2003.

[19] See CG14805 for s.49, CG14933 for s.48; Minutes of Capital Taxes Liaison Group meeting, March 2023; *https://www.gov.uk/government/groups/capital-taxes-liaison-group*

56.4.10 *Consideration/loan relationship*

For completeness: s.48(2)(3) TCGA deal with loan relationships (not discussed here):

> (2) Subsection (1) above does not apply in relation to so much of any consideration as consists of rights under a creditor relationship to which a company becomes a party as a result of the disposal.
> (3) In the computation of the gain in a case where subsection (2) above has effect in relation to any consideration, the amount to be brought into account in respect of that consideration is the fair value of the creditor relationship.
> (4) In this section—
> (a) "creditor relationship", and
> (b) "fair value", in relation to a creditor relationship,
> each have the same meaning as in Part 5 of CTA 2009 (see sections 302(5) and 313(6)).

56.4.11 *Asset derived from asset*

Section 43 TCGA provides:

> If and so far as,
> [1] in a case where assets have been merged or divided or have changed their nature or rights or interests in or over assets have been created or extinguished,
> [2] the value of an asset is derived from any other asset in the same ownership,

If these conditions are met, without (it is assumed) a CGT disposal, one reads on to the rule:

> an appropriate proportion of the sums allowable as a deduction in the computation of a gain in respect of the other asset under paragraphs (a) and (b) of section 38(1) shall, both for the purpose of the computation of a gain accruing on the disposal of the first-mentioned asset and, if the other asset remains in existence, on a disposal of that other asset, be attributed to the first-mentioned asset.

Apart from corporate reorganisations, this will not be common. For an example, see 96.22 (Blockchain forks).

56.4.12 *Interaction of CGT/IT*

Section 37(1) TCGA deals with the relationship between CGT/IT:

> There shall be excluded from the consideration for a disposal of assets taken into account in the computation of the gain any money or money's worth
> [a] charged to income tax as income of, or
> [b] taken into account as a receipt in computing income or profits or gains or losses of,
> the person making the disposal for the purposes of the Income Tax Acts.

In short: IT has priority over CGT, and there is no double charge.

What is the position if foreign income of a remittance basis taxpayer is not remitted? Section 37(1) applies: the income is "charged to income tax" even if no tax is paid because of the remittance basis.[20] But this question will not often arise.[21]

For other aspects of s.37, see:

Topic	**See para**
Interaction of TiL/CGT	22.15.4
Interaction of disguised interest/CGT	26.25.4
Interaction of s.624/CGT	47.12

56.4.13 *Exceptions to s.37(1) rule*

For completeness: s.37(5) TCGA contains some exceptions to the general rule:

> This section shall not preclude the taking into account in a computation of the gain, as consideration for the disposal of an asset,
> [a] of the capitalised value of a rentcharge (as in a case where a rentcharge is exchanged for some other asset) or
> [b] of the capitalised value of a ground annual or feu duty, or
> [c] of a right of any other description to income or to payments in the nature of income over a period, or to a series of payments in the nature of income.

Rentcharges and ground/annual/feu duty (Scots law concepts) are obsolete.[22] That leaves para [c]. It is difficult to see the reason for it, but

[20] See App 2.3.1 (Unremitted RFI "chargeable").

[21] But it is possible to devise situations where the question could arise, for instance, if foreign source income arises to a remittance basis taxpayer from an asset which was UK situate for CGT purposes.

[22] Rentcharges cannot be created after 1977, and feu duty was abolished in 2004: s.3 Rentcharges Act 1977; s.7, 56(1) Abolition of Feudal Tenure etc (Scotland) Act 2000.

fortunately it rarely if ever arises in practice. The rule should be abolished, but the topic of Annual Payments is a dusty corner which needs review in its entirety.[23]

56.5 Amount charged to CGT/CT

The CGT/CT rules are in s.1(3)/2A(1) TCGA:

CGT: s.1(3) TCGA	**CT: s.2A(1) TCGA**
Capital gains tax is charged on the total amount of chargeable gains accruing to a person in a tax year after deducting-	The amount of chargeable gains to be included in a company's total profits for an accounting period is the total amount of chargeable gains accruing to the company in the period after deducting-
(a) any allowable losses accruing to the person in the tax year, and	(a) any allowable losses accruing to the company in the period, and
(b) so far as not previously deducted under this subsection, any allowable losses accruing to the person in any previous tax year.	(b) so far as not previously deducted under this subsection, any allowable losses previously accruing to the company while it was within the charge to corporation tax.

The rules are the same, except that companies are charged by reference to accounting periods and not tax years.

56.5.1 *CGT rules applied to CT*

Section 2D TCGA provides:

> (1) The total amount of chargeable gains to be included in a company's total profits for an accounting period is calculated for corporation tax purposes in accordance with capital gains tax principles.
> (2) All of the following questions are determined in accordance with the enactments relating to capital gains tax as if accounting periods were tax years-
> (a) any question as to the amounts to be, or not to be, taken into account as chargeable gains or allowable losses,
> (b) any question as to the amounts to be, or not to be, taken into

[23] See 31.13 (Annual Payments: Critique).

> account in calculating gains or losses,
> (c) any question as to the amounts charged to tax as a company's gains, and
> (d) any question as to the time when any amount is treated as accruing.
>
> (3) This section is subject to any provision made elsewhere by the Corporation Tax Acts.

I refer to CGT/CT (where CT refers specifically to the CT charge on chargeable gains). As the rules are (mostly) the same, the term CGT is sometimes used loosely (and conveniently, if strictly speaking, inaccurately) to include CT on chargeable gains.

56.5.2 *IT references in CT context*

Section 2E TCGA provides:

> (1) If the CGT enactments[24] contain any reference to-
> (a) income tax, or
> (b) the Income Tax Acts,
>
> the reference is, in relation to a company, to be read as a reference to corporation tax or the Corporation Tax Acts.
>
> (2) But-
> (a) this does not affect references to income tax in section 39(2), and
> (b) so far as the CGT enactments operate by reference to matters of any specified description, account is to be taken for corporation tax purposes of matters of that description confined to companies but not of any confined to individuals.

56.5.3 *Interaction of CT/CGT*

Section 2F TCGA provides:

> (1) This Act as it has effect in accordance with this Chapter is not to be affected in its operation by the fact that capital gains tax and corporation tax are distinct taxes.
>
> (2) But this Act is, so far as it is consistent with the Corporation Tax Acts, to apply in relation to capital gains tax and corporation tax on gains as if they were one tax.
>
> (3) Accordingly, a matter which in a case involving two individuals is

[24] Section 2E(3) TCGA provides a commonsense definition: "In this section "the CGT enactments" means the enactments relating to capital gains tax."

relevant to both of them in relation to capital gains tax is in a similar case involving an individual and a company-

(a) relevant to the individual in relation to capital gains tax, and
(b) relevant to the company in relation to corporation tax.

56.6 CGT/CT: Territorial scope

56.6.1 *"Chargeable" gain*

Section 15(2) TCGA provides:

> Every gain shall, except as otherwise expressly provided, be a chargeable gain.

The expression "chargeable" gain is a label which brings in an uncountable number of rules, for standard drafting to provide a CGT exemption is to direct that gains of a specified nature are not chargeable. However, the term "chargeable" gain does not bring in a territorial limitation: it does not mean gains on which CGT/CT is charged. Gains are in principle "chargeable" even if:

(1) The gains accrue to a non-resident or non-UK domiciled person; and
(2) The gains are not subject to CGT/CT.

56.6.2 *"Chargeable" asset*

The expression "chargeable asset" has at least 3 different definitions in the TCGA. This expression is found in:[25]

TCGA	**Topic**	**See para**
s.25	Asset ceases to be chargeable	56.8
s.159	Roll-over relief	*Not discussed*
s.139	Reconstructions	58.5
s.171	CG group relief	64.31
sch 4B para 10	Transfer linked with trustee borrowing	62.17
para 7 sch 7	Relief for gift of business asset	*Not discussed*

These definitions are as follows:

s.25/s.159	**s.171/s.139**	**para 10 sch 4B**
For the purposes of this section an asset is at any time a chargeable asset in relation to a person if,	For this purpose an asset is a "chargeable asset" in relation to a company at any time if, were the	For the purposes of sub-paragraph (1) an asset is a chargeable asset if

[25] This is not a complete list.

were it to be disposed of at that time,	asset to be disposed of by the company at that time,	
any chargeable gains accruing to him on the disposal would be chargeable to capital gains tax under section 1A(3)(a) or to corporation tax under section 2B(3).	any gain accruing to the company would be a chargeable gain chargeable to corporation tax as a result of section 2B(3) or (4).	a gain on a disposal of the asset by the trustees at the material time would be a chargeable gain.

Also note para 32 sch 7AC TCGA (substantial shareholding relief):

> Any exemption conferred by this Schedule shall be disregarded in determining whether shares are "chargeable shares", or an asset is a "chargeable asset", for the purposes of any enactment relating to corporation tax or capital gains tax.

One might use the expression "chargeable asset" loosely to mean an asset which gives rise to a gain within the territorial scope of CGT/CT. But given the different definitions, I prefer to avoid it as a general term, and I only use the expression in discussion of provisions where it is found, so it is clear which definition is applicable.

56.6.3 *Territorial scope: Summary*

There are four classes of the CGT/CT charge:

Taxpayer	**CGT**	**CT**	**See para**
UK resident	s.1A(1)	s.2B(1)	*See below*
Non-resident			
UK branch/agency/PE	s.1A(3)(a), s.1B	s.2B(3)	56.6.5
Interest in UK land	s.1A(3)(b), s.1C	s.2B(4)	57.6.3
Land-rich asset	s.1A(3)(c), s.1D	s.2B(4)	57.2

56.6.4 *CGT/CT charge: UK residents*

The CGT/CT rules for UK residents are in s.1A(1)/2B(1) TCGA:

CGT: s.1A(1) TCGA	**CT: s.2B(1) TCGA**
A person who is UK resident for a tax year is chargeable to capital gains tax on chargeable gains accruing to the person in the tax	A company which is resident in the UK in an accounting period is chargeable to corporation tax on chargeable gains accruing to the

year on the disposal of assets wherever situated.	company in the period on the disposal of assets wherever situated.[26]

Section 1A(4) TCGA provides:

> For the purposes of this Chapter [Chapter 1 Part 1 TCGA] a person is "UK resident" for a tax year if the person is resident in the UK during any part of the tax year.

Under the SRT, an individual is resident (or not) for an entire tax year and not during part of a year;[27] so for an individual, s.1A(4) restates the general rule.

The s.1A(4) rule matters for a trustee (a non-individual):

(1) For general tax purposes a trustee may be resident during part of a year;[28] but

(2) For the purposes of Chapter 1 Part 1 TCGA, ie for the purposes of the charge to CGT, trustees are resident for the whole tax year, and so chargeable on gains of a non-resident part of the year.[29] There is no split-year relief.

Thus one may not know until the end of the tax year whether a non-resident trust is subject to CGT. This might on occasion be helpful, in circumstances when tax on a UK trust is less than tax on a non-resident trust.[30]

56.6.5 *CGT/CT charge: non-residents*

A non-resident person is in general outside the scope of CGT. This is the case

– regardless of domicile and

[26] Section 2B(2) TCGA flags up an exemption which applies for CT and not for CGT: "This is subject to Chapter 3A of Part 2 of CTA 2009 (exemption from charge in respect of profits of foreign permanent establishments)."

[27] See 10.1 (Residence throughout tax year).

[28] See 10.17 (Split year of trustees and PRs).

[29] A historical note: the position was different pre-2019, though it makes no difference; see 9.9.3 (Trustee changes residence).

[30] This is (unsurprisingly) not common, but *Estera Trust (Jersey) v Singh* [2019] EWHC 2039 (Ch) offers an example: on a purchase of own shares, an appointment of UK trustees may reduce an IT charge to a CGT charge. And planning to obtain this tax advantage "is perfectly proper and no question of illegitimate tax avoidance arises"; see at [9].

– regardless of the situs of the asset disposed of (except for land/land rich assets).

(By contrast income tax is charged on UK source income, and IHT is charged on UK situate property, regardless of the residence or domicile of the individual.)

This general rule is subject to five exceptions. The first three are in s.1A/2B TCGA:

CGT: s.1A(3) TCGA	**CT: s.2B(3) TCGA**	**See para**
A person who is not UK resident for a tax year is chargeable to capital gains tax on chargeable gains accruing to the person in the tax year on the disposal of-	A company which is not resident in the UK is chargeable to corporation tax on chargeable gains that-	
[Branch/agency] (a) assets situated in the UK that [i] have a relevant connection to the person's UK branch or agency and [ii] are disposed of at a time when the person has that branch or agency (see section 1B),	*[Permanent Establishment]* (a) accrue to the company on the disposal of assets situated in the UK that have a relevant connection to the company's UK permanent establishment (see section 2C), (b) accrue at a time when it has that permanent establishment, and (c) are, in accordance with sections 20 to 32 of CTA 2009, attributable to that permanent establishment.	56.7
[UK land] (b) assets not within paragraph (a) that are interests in UK land (see section 1C), and	(4) In addition, a company which is not resident in the UK is chargeable to corporation tax on chargeable gains accruing to the company on the disposal of assets not within subsection (3) that are- (a) interests in UK land, or	57.2
[Land-rich asset] (c) assets (wherever situated)	(b) assets (wherever situated)	57.10

not within paragraph (a) or (b) that	not within paragraph (a) that
[i] derive at least 75% of their value from UK land [ii] where the person has a substantial indirect interest in that land (see section 1D and Schedule 1A).	[i] derive at least 75% of their value from UK land [ii] where the company has a substantial indirect interest in that land.

Other exceptions are:

Topic	**See para**
Temporary non-residents[31]	11.1
Exploration/exploitation assets on continental shelf	*Not discussed*

It follows that an individual (wherever domiciled) can in principle avoid CGT if they can arrange:
(1) to dispose of appropriate assets before they become UK resident or
(2) to postpone the disposal until they become non-resident.

A simple form of CGT planning for an individual whose stay in the UK is a short-term one is not to dispose of assets giving rise to chargeable gains while UK resident.

56.7 Trade through UK branch/PE

56.7.1 *"UK branch/PE"*

CGT: s.1B(1) TCGA	**CT: s.2C(1) TCGA**
For the purposes of section 1A(3)(a) a person has a UK branch or agency at any time if, at that time, the person carries on a trade, profession or vocation in the UK through a branch or agency there.	For the purposes of section 2B(3) a company has a UK permanent establishment at any time if, at that time, the company carries on a trade[32] in the UK through a permanent establishment there.

[31] This is not technically an exception to the general rule, as the legislation does not impose CGT on gains accruing to a non-resident. It deems the gains to accrue later, when the individual is resident. But it comes to the same thing.

[32] Section 2B(5) TCGA provides: "In this section references to a trade include an office and references to carrying on a trade include holding an office." But a company does not often hold an office, so this will not often arise.

56.7.2 *Relevant connection*

CGT: s.1B(2) TCGA	**CT: s.2C(2) TCGA**
For the purposes of section 1A(3)(a) an asset has a relevant connection to a person's UK branch or agency if-	For the purposes of section 2B(3) an asset has a relevant connection to a company's UK permanent establishment if-
(a) it is, or was, used in or for the purposes of the trade, profession or vocation at or before the time of the disposal,	(a) it is, or was, used in or for the purposes of the trade at or before the time of the disposal,
(b) it is, or was, used or held for the purposes of the branch or agency at or before that time, or	(b) it is, or was, used or held for the purposes of the permanent establishment at or before that time, or
(c) it is acquired for use by or for the purposes of the branch or agency.	(c) it is acquired for use by or for the purposes of the permanent establishment.

56.7.3 *Used in/for purposes of trade*

The expression "used in or for the purposes of a trade" is found in:

TCGA	**Topic**	**See para**
s.1B(2)/2C(2)	Territorial limits of CGT/CT on gains	*Discussed here*
s.80	Charge on emigration of trust	12.4
Sch 3ZAA	Exit charge payment by installments	12.7
Para 5 sch A1	Trading exemption for land-assets	57.8.5

This expression was discussed in *Marsh v HMRC*:[33]

> In a trade of property dealing in the UK by a non-resident the real property assets situated in the UK constitute the stock. Since stock is we think "used in … the trade" the assets disposed of are within [what is now s.1B(2)] TCGA.

That seems right. In *Marsh* this conclusion did not matter, because if the assets are trading stock then the chargeable gain would be nil.[34] The point

[33] [2017] UKFTT 320 (TC) at [77].

[34] at [78]. See 56.4.12 (Interaction of IT/CGT)

is however important for the application of the land-asset trading exemption to property trading/development companies.[35]

56.7.4 *1989 transitional relief*

For completeness: s.1B(4) TCGA provides:

> In the case of a profession or vocation carried on by a person, an asset does not have a relevant connection to the person's UK branch or agency if-
>
> (a) the asset was only used in or for the purposes of the profession or vocation before 14 March 1989, or
>
> (b) the asset was only used or held for the purposes of the branch or agency before that date.

It is difficult to imagine that this could now apply. It would be a simplification if it were repealed.

56.7.5 *DT relief*

s.1B(3)/2C(3) TCGA flag up DT relief for branch/agency and PE:

CGT: s.1B(3) TCGA	**CT: s.2C(3) TCGA**
Section 1A(3)(a) does not apply to a person who, as a result of Part 2 of TIOPA 2010 (double taxation arrangements), is exempt from income tax for the tax year in respect of the profits or gains of the branch or agency.	Section 2B(3) does not apply to a company which, as a result of Part 2 of TIOPA 2010 (double taxation arrangements), is exempt from corporation tax for the accounting period in respect of the profits of the permanent establishment.

56.8 Asset ceases to be chargeable

Section 25 TCGA supplements the charge on assets of a branch/agency:

> (1) Where an asset ceases by virtue of becoming situated outside the UK to be a chargeable asset in relation to a person, he shall be deemed for all purposes of this Act—
>
> (a) to have disposed of the asset immediately before the time when it became situated outside the UK, and
>
> (b) immediately to have reacquired it,
>
> at its market value at that time.
>
> (2) Subsection (1) above does not apply—

[35] See 57.8.5 (Property development company).

> (a) where the asset becomes situated outside the UK contemporaneously with the person there mentioned ceasing to carry on a trade[36] in the UK through a branch or agency, or
>
> (b) where the asset is an exploration or exploitation asset. [Not discussed in this work]
>
> (3) Where an asset ceases to be a chargeable asset in relation to a person by virtue of his ceasing to carry on a trade in the UK through a branch or agency, he shall be deemed for all purposes of this Act—
>
> (a) to have disposed of the asset immediately before the time when he ceased to carry on the trade in the UK through a branch or agency, and
>
> (b) immediately to have reacquired it, at its market value at that time.
>
> (3A) Subsection (3) above shall not apply if—
>
> (a) the person ceasing to carry on the trade is a company, and
>
> (b) on ceasing to carry on the trade the asset is disposed of in circumstances in which section 139 or 171 applies.
>
> (5) Subsection (3) above does not apply to an asset which is a chargeable asset in relation to the person there mentioned at any time after he ceases to carry on the trade in the UK through a branch or agency and before the end of the chargeable period in which he does so.
>
> ...

Section 25(7) TCGA provides the definition of chargeable asset:[37]

> For the purposes of this section an asset is at any time a chargeable asset in relation to a person if, were it to be disposed of at that time, any chargeable gains accruing to him on the disposal would be chargeable to capital gains tax under section 1A(3)(a) or to corporation tax under section 2B(3).

See too 12.7 (Payment by instalments).

56.8.1 *UK land within s.25*

Section 25ZA TCGA provides:

> (1) This section applies if an interest in UK land[38] is deemed to have

[36] Section 25(8) TCGA provides: "This section shall apply as if references to a trade included references to a profession or vocation."

[37] See 56.6.2 ("Chargeable" asset).

[38] Defined by reference in ss(8): "In this section "interest in UK land" has the meaning given by section 1C."

> been disposed of under section 25(3) by a person at any time.
> (2) The gain or loss that, but for this subsection, would have accrued to the person at that time is not to accrue at that time.
> (3) But, on a subsequent disposal by the person of the whole or part of the interest in UK land, the whole or a corresponding part of the gain or loss is treated as accruing on the subsequent disposal.
> (4) This gain or loss is in addition to any gain or loss that actually accrues on the subsequent disposal.
> (5) A disposal to which section 171 (transfers within a group) applies does not count as a subsequent disposal for the purposes of this section.
> (6) A person may elect for a disposal deemed to have been made under section 25(3) to be excluded from the operation of this section.
> (7) An election made by a company must be made within 2 years after the day on which the deemed disposal occurs.

56.9 Gain in split year

56.9.1 *Gain in split year: Individual*

Section 1G TCGA provides the usual split-year rule:

> (1) If, as respects any individual, a tax year is a split year, sections 1A(1)[39] and 1E[40] have effect subject to the modifications made by this section.
> (2) Gains accruing to the individual in the overseas part of the tax year are chargeable to capital gains tax only if they accrue on the disposal of assets within section 1A(3).[41]

Thus gains of the overseas part of a split year of an individual are in principle not subject to CGT.

56.9.2 *Gain in split year: Trust*

Trustees are subject to CGT on gains in the whole of a year in which they become non-resident or in which they become UK resident (unless DT relief applies).[42] There is no good reason for that rule and it gives rise to an anomaly:

(1) On emigration of a trust from the UK:

[39] See 56.6.4 (CGT/CT charge: UK residents).
[40] See 65.3 (Loss within scope of CGT).
[41] See 56.6.3 (Territorial scope: Summary).
[42] The position is different for IT: see 10.17 (Split year of trustees and PRs).

(a) If a UK trust becomes non-resident, gains of the entire year are in principle subject to CGT (DT relief might be available).
(b) If a UK trust transfers its assets to a non-resident trust, gains arising after the transfer are in principle not subject to CGT.

So a transfer could be better than appointment of non-resident trustees.[43]

(2) Similarly, on immigration of a trust to the UK:
(a) If a non-resident trust becomes UK resident, gains of the entire year are in principle subject to CGT (DT relief might be available).
(b) If a non-resident trust transfers its assets to a UK -resident trust, gains arising before the transfer are in principle not subject to CGT.

56.10 Date of disposal/acquisition

The date of disposal is fundamental for CGT as that is the date that the gain accrues. The acquisition date may also be important.

The CG Manual provides:

> **CG14250 date of disposal: introduction** [Jul 2019]
> You must establish the correct date of disposal of an asset. This will determine the correct period of assessment and the tax rules which apply. It may affect the rate of tax, relief for losses, valuation and so on.
> ..
> The date of disposal of the person who disposes of an asset will be the date of acquisition of the person who acquires it.

There is some scope to select the date of disposal, so this topic is also important for CGT planning.

56.10.1 *Unconditional contract*

Section 28(1) TCGA provides:

> Subject to section 22(2), and subsection (2) below, where an asset is disposed of and acquired under a contract the time at which the disposal and acquisition is made is the time the contract is made (and not, if different, the time at which the asset is conveyed or transferred).

The CG Manual provides:

[43] See too 12.4.1 (Trust emigration: Navigation).

> **CG14261 date of disposal: contracts for disposal** [Jul 2019]
> TCGA92/S28 comes into operation only if the contract is completed, or in other words, if the disposal actually takes place. It does not deem a disposal to take place. But when the disposal has taken place in accordance with the contract, it fixes the date of that disposal for capital gains purposes.
> This was confirmed in the House of Lords decision in *Jerome v Kelly*, 76 TC 147.

56.10.2 *Contract law background*

The question whether, and when, a contract is made is a matter of contract law. The CG Manual makes some comments:

> **CG14262 date of disposal: oral contracts** [Jul 2019]
> A contract, other than a contract in respect of land, need not necessarily be in writing....
> In considering whether an oral contract for sale existed, you will need to examine the facts of the case carefully, by reference to such documents and correspondence as exist, and in the light of the actions of the parties. The basic question will be whether the facts are consistent with an agreement which was binding on the parties.

56.10.3 *Oral contract: sale of land*

It is necessary to understand the land law background. In Scotland, and in England from 1989, an oral contract for the sale of land is not possible: a contract must be made in writing.

In England before 1989, the contract was valid but unenforceable. That made a difference. The CG Manual provides:

> **CG14262 date of disposal: oral contracts** [Jul 2019]
> A contract, other than a contract in respect of land, need not necessarily be in writing. An oral contract may not be enforceable, but this does not prevent it from being a contract of disposal for CGT purposes. There is authority for this in the case of *Thompson v Salah*, 47 TC 559: the principles of this case apply for CGT purposes although it concerned Case VII Schedule D (short term gains).
> *Thompson v Salah* involved an oral contract for the sale of land. It was possible for all contracts in respect of land to be oral up to 26 September 1989. With effect from 27 September 1989 onwards, however, the Law of Property (Miscellaneous Provisions) Act 1989 requires all contracts in respect of land in England and Wales to be in writing. ...

In England this is now of historical interest only. But in Northern Ireland, the land law remains as England was before 1989: an oral contact for the sale of land is unenforceable but not void.[44] So *Thompson v Salah* continues to be relevant there.

The CG Manual repeats these same points in CG25853 but it is not necessary to set that out here.

56.10.4 *Conditional contract*

Section 28(2) TCGA provides:

> If the contract is conditional (and in particular if it is conditional on the exercise of an option) the time at which the disposal and acquisition is made is the time when the condition is satisfied.

Eastham v Leigh London 46 TC 687 concerned a development lease, that is, the tenant undertook to put up a building on the land, in consideration for which the landlord promised to grant the lease. The language of the agreement was conditional in form:

> *If* the said building shall have been completely finished to the satisfaction of the said Surveyor ... and the Tenants shall have performed and observed all the stipulations and conditions on their part contained ... *then* the Landlords shall grant to the Tenants a Lease...

But this was not a conditional contract, in the s.28 sense, or in the ordinary sense (if different):

> Although clause 4 is couched in conditional language ... it amounts to no more than this: it provides that if the tenants perform their part of the contract then the landlords will perform their part of the contract; in other words, it is a recognition of the fact that the obligations of the parties are mutual and that the granting of the lease will in fact follow the completion of performance of the obligations of the tenants. That is not, in my judgment, a condition precedent to the contract at all; it is part of the terms of the contract. You may call it a condition if you please, but it does not make it a condition precedent to the existence of a contract, it merely indicates that it is part of the terms of the bargain, just as in all contracts for sale the terms of the bargain are customarily described as conditions of sale.

Similarly *Michaels v Harley House*:[45]

[44] See s.2 Statute of Frauds (Ireland) 1695; *Hamilton v Judge* [2010] NICA 49.

[45] [1998] Lexis Citation 3110.

> the important difference ... between a true condition precedent which it is not within a contracting party's power to bring about, even though he may undertake to use his best endeavours to bring it about, and a promissory condition which the party does have power to fulfil or to cause to be fulfilled. In this case the share sale agreement was said to be conditional on completion of the sale of the freehold to the company. But ... completion of the sale and purchase of the freehold was something that TWD had power to bring about, and which it undertook to bring about.

It seems to me that the terminology of condition precedent/subsequent, or true condition precedent/promissory condition, is not ideal for expressing this distinction. However that may be, at least the position is clear.

The CG Manual provides:

> **CG14270 date of disposal: conditional contracts** [Jul 2019]
> It can be difficult to recognise whether a contract is conditional. Many contracts contain conditions which are to be fulfilled. A contract is only conditional within the meaning of TCGA92/S28 if particular conditions have to be satisfied before the contract becomes a binding document. These are called 'conditions precedent'. When these conditions are met the contract becomes legally binding. At that point the contract has become unconditional. The date on which the conditions are met is the date of disposal.
>
> Other conditions in contracts are called 'conditions subsequent'. These may require the parties to do various things before completion or may establish how the contract is to be performed. But they do not prevent the contract from being binding with immediate effect. If they are not met the contract remains a binding contract but the vendor or purchaser may be able to sue for breach of contract.
>
> In *Lyon v Pettigrew* 58 TC 452, Walton J said
>
>> The words 'contract is conditional' have traditionally been used to cover really only two types of case. One is a 'subject to contract' contract, where there is clearly no contract at all ... and the other is where all the liabilities under the contract are conditional upon a certain event.
>
> He went on to give an example of a conditional contract:
>
>> It would, for example, be possible for a hotelier to make a booking with a tour operator conditionally upon the next Olympic Games being held in London. Then, until it had been decided that the next Olympic Games were going to be held in London, there would be no effective contract: the whole contract would be conditional, the

> whole liabilities and duties between the parties would only arise when the condition was fulfilled.

(There is a useful examination of the meaning of 'conditional' in *Eastham v Leigh London & Provincial Properties Ltd* 46 TC 687.)

56.10.5 *Options*

A full discussion of the CGT treatment of options requires a chapter. In short, options involve two disposals:

(1) A disposal of the option, when granted; and
(2) A disposal of the underlying property, when the option is exercised

The CG Manual provides:

> **CG14275 date of disposal: options** [Jul 2019]
> An option is not in itself a conditional contract but operates as an offer which is irrevocable during the option period. See CG12300+. The grant of an option, made either for good consideration or by deed, gives rise to a binding contract to keep the offer open.
> Where in the normal way the option agreement is unconditional, the date of the disposal of the option is given by TCGA92/S28 (1) as the date of that agreement.
> Where an option to buy is exercised, the offer is thereby accepted so that a separate unconditional contract is made in relation to the asset which is the subject of the offer. The date of the disposal of that asset is given by Section 28(1) as the date of exercise of the option.

56.10.6 *Postpone disposal date*

Obvious CGT planning for individuals is to postpone disposals until non-resident.[46] The CG Manual discussion is lengthy and pedestrian, but the practitioner needs to read it to see how HMRC may approach the issues. The CG Manual provides:

> **CG25800 avoidance risk on emigration** [Nov 2019]
> When an individual plans to emigrate from the UK they will often want to dispose of their assets located in the UK before departure. This is particularly true of privately run businesses carried on in the UK but it is often also true of other property located in the UK. For such assets it may be necessary, or at least convenient, for the individual to be in the UK to deal with negotiations for the sale. The individual may also need

[46] A pre-departure share for share/loan note exchange will not do; see 58.6.2 (CGT avoidance).

> to have a definite sale arranged in order to ensure he or she has funds for use in the country to which he or she is emigrating.
>
> The emigrating individual will have an expectation that their residence position may change and that this may affect their CGT liability.
>
> If the disposal occurs before the date of departure the individual will be liable to a charge to UK CGT in respect of the chargeable assets disposed of.
>
> But there is no form of capital gains ‘exit charge’ applying to individuals when they emigrate from the UK (see CG13400).
>
> ...For 2013-14 and later years an individual will either be resident or not resident in the UK for the year, however split year treatment may apply. If the disposal occurs in the non UK part of a split year the gain will normally be exempt because it is outside of the scope of TCGA92/S2 (unless the individual later resumes residence in the UK and the temporary non-residence rules in TCGA92/S2 or the other exceptions in CG10978 apply).
>
> So if the sale is genuinely postponed and the individuals residence position has changed by the date of disposal then there will be no charge to UK CGT. However, enquiries might reveal that despite appearances the disposal actually occurred on an earlier date ...
>
> **CG25805 establishing the correct time when a gain arises** [Nov 2019]
>
> An individual intending to emigrate from the UK and dispose of assets may arrange his or her affairs so that although they have certainty or near-certainty that the sale will occur before their UK residence position changes, it appears that the disposal for tax purposes takes place after that date.

The CG Manual then sets out three ways to attack this planning:

> There are a number of circumstances in which CGT liability may arise notwithstanding that the date of disposal appears to be after the date of emigration. These are where it can be shown that
>
> [1] there was a binding agreement or contract for sale on or before the date their residence position changes
>
> [2] a business was carried on in the UK through a branch or agency in the period from the date of emigration to the date of disposal...
>
> [3] The disposal falls in a period of temporary non residence see CG26100+.
>
> **CG25820 establishing the correct time when a gain arises: establishing basic facts** [Nov 2019]
>
> When an individual claims that a disposal is exempt because of the actual date of disposal (see CG12700+) you should firstly establish the

> facts concerning two basic points:
> - what is the date of disposal in a written contract? and
> - what is the individual's residence status on that date?
>
> In the case of a disposal under an unconditional contract the date of disposal is the date the contract is entered into not the date of completion .... However, it is not unknown for individuals and/or their agents to quote the date of completion as the disposal date.
>
> It can therefore be worth checking that the date quoted is not in fact the completion date.

Oh dear. Leaving aside unrepresented taxpayers, could that really happen very often?

> It can therefore be worth checking that the date quoted is not in fact the completion date.

56.10.7 *Binding contract pre-departure*

The CG Manual provides:

> **CG25850 delayed written contracts** [Nov 2019]
> The most common situation is for the individual to negotiate the terms for a disposal but to delay signing the written contract until after the date of departure from the UK. One indicator that this may have happened will be if there is a very short interval between the date their residence position changes and the date the contract is signed.
>
> Cases have been seen where the vendor leaves the UK with a copy of the contract in his possession and posts it from the foreign airport on arrival there. Alternatively, he gives his solicitor a power of attorney under which the solicitor can sign and exchange the contracts on behalf of the vendor once he is outside the UK. There are many other variations.

The author's apparent indignation seems to me to be misplaced; but it depends on whether one classifies the planning as "ordinary" or avoidance.

> In most straightforward cases, where there is no question of a continuing business ... it will not be possible to show there is liability to CGT. An agreement, oral or written, which remains 'subject to contract' is not a binding contract.
>
> Where a formal written contract is entered into after emigration, there is a presumption that the parties intend to leave the transfer unagreed until that time even if it is not explicitly 'subject to contract'. It may be possible to displace that presumption if evidence can be obtained ... that

> the disposal was not in fact conditional or 'subject to contract' at the time of emigration, see CG25805.
>
> **CG25860 binding contract pre-dating emigration** [Nov 2019]
>
> A disposal occurs at the earliest time at which there is a binding contract between the parties. Except where there is a statutory requirement for a contract to be in writing if it is to be valid (see CG25853 above), it does not matter whether the contract is oral or written. [The manual refers to *Thompson v Salah*, discussed 56.10.3 (Oral contract: sale of land), and continues:]
>
> Establishing the existence of a binding contract or agreement, oral or written, in advance of the formal contract presents considerable difficulty, see CG25850 above, and requires the facts of the case to be established in detail. Usually this will involve reviewing the correspondence, notes of meetings, telephone conversations, etc which have taken place between the vendor and purchaser (or more usually their professional representatives) prior to the date of signing the formal documents, to see whether there is evidence of a binding oral agreement or whether the correspondence itself constitutes a binding written agreement. It will not usually be worthwhile to undertake such a detailed review unless there are strong prima facie indications of a pre-emigration binding agreement.
>
> If a binding agreement prior to the date of formal documentation can be established, the date of the earlier agreement is the date of disposal for CGT purposes.

In circumstances like these, I would have thought a binding contract would be most unusual.

> ...**CG26020 splitting a single contract** [Nov 2019]
>
> In this type of case, what would normally have been included in a single contract for sale is split into two contracts. For example, a farmer owning a farmhouse and associated farmland emigrates; he claims to have sold the farmhouse prior to the date his residence position changes (possibly to give immediate access to capital) and the farmland after the date his residence position changes and this points to the fact that two separate contracts have been entered into. Relief under TCGA92/S222 is claimed on the disposal of the farmhouse. In such cases, it may be possible to sustain an argument that, in reality, there is only a single disposal for capital gains purposes, the date of disposal of the farmland and the farmhouse being the same: that is to say, the earlier of the two dates.

The argument seems far-fetched, though it depends on the facts.

> **CG26030 conditional contracts** [Nov 2019]
> Cases have been seen where it is claimed that the date of disposal for capital gains purposes does not occur until the satisfaction of a condition written into the terms of the agreement for sale. To decide whether a condition is such as to make a contract conditional within the terms of TCGA92/S28(2) can be difficult. You will need to consider the full facts of the case in the context of contract law. There is guidance on dates of disposal and conditional contracts at CG14250+ and CG14270+.
> **CG26040 options and cross-options** [Nov 2019]
> Sometimes the owner, before emigrating, grants an option to a potential purchaser to buy the asset, that option to be exercised during a specified period following the owner's emigration. ... With pure delay cases, however, there may be evidence to show that the option was a sham and that the vendor is assured of his sale before he leaves the UK.
> These are cases where the vendor and purchaser each grant an option to the other party to sell/buy the asset which is the subject of the agreements. Invariably in these cross-options cases, the options are granted before the vendor leaves the UK, but one of the options is exercised (usually by the purchaser) after the vendor's date of departure.
> ...

The sham argument seems very far-fetched, though it depends on the facts.

56.10.8 *Postpone disposal: GAAR*

The GAAR guidance provides:

> **D17 Unconditional contract**
> This example is intended to illustrate tax planning where arrangements are structured so that the disposal of an asset falls within a particular period.
> **D17.1 Background**
> D17.1.1 The Government announces at Autumn statement that, from 6 April 20XX, the rate at which chargeable gains are charged to tax will be reduced from the current level.
> **D17.2 The arrangements**
> D17.2.1 Taxpayer A has concluded negotiations to dispose of land and buildings to Taxpayer B with an intended completion date of 1 Jan 20XX. Taxpayer A having obtained tax advice renegotiates with Taxpayer B for the unconditional contract date and completion of the disposal to be after 6 April 20XX and to allow Taxpayer B exclusive occupation of the land and buildings rent free from 1 Jan 20XX.

D17.2.2 The sale is completed on 10 May which results in a substantial capital gain to Taxpayer A. The disposal takes place after 6 April 20XX for tax purposes.

D17.3 The relevant tax provisions

Sections 1, 2 and 28 TCGA 1992.

D17.4 The taxpayer's tax analysis

D17.4.1 The gain should be taxed according to the new rate of CGT in force from 6 April.

D17.5 What is the GAAR analysis under s207(2) of FA 2013

D17.5.1 Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?

The substantive results of the transactions are consistent with the principles on which the relevant provisions are based. The rate of capital gains tax has been reduced from 6 April and the disposal is charged according to the rule in s28 TCGA 1992 that a disposal by way of unconditional contract is treated as taking place at the time of the contract.

D17.5.2 Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?

Yes. The contract was delayed so as to take advantage of the reduced rate of tax applying after 5 April 20XX whilst the purchaser was given unusual rights of occupation from the originally agreed completion date.

D17.5.3 Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?

No. The gain is charged to tax at the rate of tax in force at the time.

D17.5.4 Does the arrangement include any of the indicators of abusiveness within s207(4) of FA 2013

No.

D17.5.5 Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?

Yes. Gains are charged at the rate of tax in force at the time of the contract for disposal.

D17.6 Conclusion

D17.6.1 On the facts the arrangements are not abusive and HMRC would not seek to apply the GAAR.[47]

As is common throughout the GAAR guidance, this example selects easy

[47] HMRC, "GAAR Guidance" (2017) Part D *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

facts, so the answer is straightforward and provides no help in borderline cases.

56.11 Pre-arrival rebasing

Unless the temporary non-resident rules apply, basic planning for someone coming to the UK is to realise gains when non-resident. I refer to this as **"pre-arrival rebasing"**. (Conversely, postpone realising losses until resident.)

56.12 Share pooling and matching

Davies v Hicks explains the background:[48]

> One matter on which [CGT has] always had detailed rules is the identification or matching of disposals of fungible assets (like shares of the same class) with acquisitions of assets of the same kind. If a taxpayer (1) acquires 100 ordinary shares in a company in year 1 for £x, (2) acquires another 100 shares of the same class in year 2 for £y, and (3) sells 100 shares in year 3 for £z, how is his CGT worked out? Which shares is he taken to have sold, and what is their base value for CGT? The legislation ... has always provided that the identification of shares disposed of with shares acquired (or the 'matching'... a more commonly used expression, though the statutes have used the word 'identify') is governed by specific rules laid down in the statutes from time to time, and is not determined by any specific matching which can be shown to have existed on the particular facts of any disposal.

This topic often arises in the context of non-residents/non-doms, so I consider it in the round. I refer to the rules as **"share pooling/matching"**, though the label is not wholly apt, as the rules apply to fungible assets, not just shares.

Sections 104-106A TCGA provide two approaches to the issue:

(1) Share pooling
(2) Arrangements of prompt acquisition/disposal, or prompt disposal/re-acquisition, informally known as bed-and-breakfasting. I refer to these as "**share-matching rules**".

A constant series of amendments over the years has resulted in scrappy drafting.

I do not consider:

[48] [2005] EWHC 847 (Ch) at [8].

- pre-2008 transitional rules
- reorganisations and stock dividends
- employee share rules
- CT rules

56.12.1 *Share pooling*

Section 104(1) TCGA provides for share pooling:

> Any number of securities of the same class acquired by the same person in the same capacity shall for the purposes of this Act (subject to express provision to the contrary) be regarded as
> [a] indistinguishable parts of a single asset
> [b] growing or diminishing on the occasions on which additional securities of the same class are acquired or some of the securities of that class are disposed of.

I refer to this single asset as the **"s.104 pool"**.

Share pooling is academic if all the pooled shares are disposed of in a single transaction, but it matters for a part-disposal of the pool.

The CG Manual provides:

> **CG51575 The Section 104 Holding In Detail** [May 2020]
> ...Because the Section 104 holding is treated as a single asset the part disposal rules of TCGA92/S42 apply on a disposal of less than all the shares in the holding. In strictness the apportionment should be made using the A/A+B formula where A equals disposal proceeds of sale and B the market value of the remaining asset. But in practice the apportionment may be made by reference to the number of shares sold.

The CG Manual gives examples:

CG51590 Share Identification Rules For Capital Gains Tax From 6.4.2008: Examples [May 2020]
In each example it should be assumed that all acquisitions and disposals are arm's length transactions in shares listed on the stock exchange. The shares are all of the same class in the same company and held by a UK taxpayer in the same capacity. Figures for disposal proceeds are net of incidental costs of disposal.

EXAMPLE 1 (Ms Davy)
D makes the following acquisitions and disposals[49]

[49] For clarity I have set this out in tabular form rather than the layout of the Manual.

Date	Transaction	No shares	Purchase/sale price
15 April 2006	buys	1,000	£1,300
4 August 2006	buys	1,000	£1,450
19 January 2007	buys	500	£950
16 March 2010	sells	2,000	£6,850
7 April 2010	buys	2,000	£6,790
10 December 2010	sells	2,200	£7,700

Some of D's purchases were made before 5 April 2008, but her disposals are made after that date so the pooling arrangements apply. Under TCGA92/S106A, see CG50464, her disposals must be identified with acquisitions in the following order

- disposal on 16 March 2010 - this is matched with the 2,000 shares acquired on 7 April 2010. A gain £60 (£6,850 − £6,790) arises. Because the shares bought on 7 April are identified under the "bed and breakfast" rule, they do not enter the pool.
- disposal on 10 December 2010 - this is a part disposal from the Section 104 holding.

Before the disposal, the Section 104 holding comprised the following -
Shares: 1,000 + 1,000 + 500 = 2,500
Cost: £1,300 + £1,450 + £950 = £3,700
D sold 2,200 out of 2,500 shares so on a simple apportionment the shares sold have a cost of £3,256. Her chargeable gain is therefore £7,700 − £3,256 = £4,444.
The Section 104 holding remaining after the disposal comprises 300 shares at a cost of £444.

EXAMPLE 2 (Mr Browne)
B makes the following acquisitions and disposals[50]

Date	Transaction	No shares	Purchase/sale price
17 August 2008	buys	10,000	£2,500
1 April 2009	buys	10,000	£2,600
8 October 2009	1 for 5 rights issue	4,000	£1060
10 December 2012	sells	7,500	£3,000

The 1 for 5 rights issue is a reorganisation of the company's share capital to which TCGA92/S127, see CG51700+, applies. The rights issue shares and their cost are simply added to the Section 104 holding.
Shares: 10,000 + 10,000 +4,000 = 24,000
Cost: £2,500 + £2,600 + £1060 = £6,160

[50] For clarity I have set this out in tabular form rather than the layout of the Manual.

B sold 7,500 out of 24,000 shares so on a simple apportionment the shares sold have a cost of £1,925. His chargeable gain is therefore £3,000 – £1,925 = £1,075.

The Section 104 holding remaining after the disposal comprises 16,500 shares at a cost of £4,236.

EXAMPLE 3 (Mrs Mountain)

M makes the following acquisitions and disposals[51]

Date	**Transaction**	**No shares**	**Purchase/sale price**
27 May 1979	buys	7,500	£18,750, worth £21,000 on 31/3/1982
6 February 1988	buys	4,000	£16,500
28 July 1993	buys	4,000	£17,000
31 March 2005	buys	6,000	£29,000
13 June 2013	sells	16,500	£114,675

Up to 5 April 2008, M’s 1979 purchase formed a 1982 holding, the 1988 and 1993 purchases together formed a Section 104 holding and the 1999 purchase were treated as a number of individual assets.

These distinctions are not relevant in calculating the chargeable gain on the disposal in 2013.

Before the disposal, the Section 104 holding comprised the following -

Shares: 7,500 + 4,000 + 4,000 + 6,000 = 21,500

Cost: £21,000 (market value at 31 March 1983 replaces cost for shares held on that date) + £16,,500 + £17,000 + £29,000 = £83,500

Note that the costs carried from the “old” Section 104 holding do not include indexation.

M sold 16,500 out of 21,500 shares so on a simple apportionment the shares sold have a cost of £64,081. Her chargeable gain is therefore £114,675 – £64,081 = £50,594.

The Section 104 holding remaining after the disposal comprises 5,000 shares at a cost of £19,419.

EXAMPLE 4

The trustees of the Peninsula Trust make the following acquisitions and disposals[52]

Date	**Transaction**	**No shares**	**Purchase/sale price**
24 September 1997	buy	15,000	£6,750
30 January 2001	3 for 5 rights issue	9,000	£3,600
14 June 2004	buy	12,000	£13,800

[51] For clarity I have set this out in tabular form rather than the layout of the Manual.

[52] For clarity I have set this out in tabular form rather than the layout of the Manual.

26 November 2005	1 for 4 rights issue	9,000	£9,450
23 February 2010	sell	20,000	£39,000

Up to 5 April 2008, the shares acquired on 24 September 1997 together with those acquired in the rights issue on 30 January 2001 and some of those acquired in the rights issue on 26 November 2005 formed a Section 104 holding. The shares acquired in June 2005 and the remaining shares acquired in the rights issue in November 2005 were treated as a number of individual assets.

These distinctions are not relevant in calculating the chargeable gain on the disposal in 2010. In particular, it is not necessary to break down the second rights issue to arrive at the trustees' chargeable gain on this disposal.

Before the disposal, the trustees' Section 104 holding comprised the following-

Shares: 15,000 + 9,000 + 12,000 + 9,000 = 45,000

Cost: £6,750 + £3,600 + £13,800 + £9,450 = £33,600

Note that the costs carried from the "old" Section 104 holding do not include indexation.

The trustees sold 20,000 out of 45,000 shares so on a simple apportionment the shares sold have a cost of £14,934. Their chargeable gain is therefore £39,000 – £14,934 = £24,066.

The Section 104 holding remaining after the disposal comprises 25,000 shares at a cost of £18,666.

56.12.2 *Share-matching*

On a disposal, the order of matching is:

(1) Assets acquired on the day of disposal (**"same-day rule"**)

(2) Assets acquired in 30 days from the date of disposal (**"30-day rule"**)[53]

(3) Assets in the s.104 pool

(4) Assets acquired following the disposal (and not already identified under stage (2) above), taking the earliest acquisition first: s.105(2) TCGA

The rules slightly restrict the scope for tax planning by prompt disposal and re-acquisition. This might be done:

(1) to obtain a tax advantage:

(a) to realise a capital loss

(b) to realise a gain within the annual exemption

(c) for pre-arrival rebasing

[53] HMRC describe this rule as the "bed and breakfast" rule. They do not refer to the same day rule as a bed and breakfast rule, which does have the connotation of an overnight stay.

but at the same time

(2) to effectively retain the asset, and minimise the commercial risk of holding cash and not the asset

The arrangement is known as bed-and breakfasting, and is said not to constitute tax avoidance.[54]

56.12.3 *Same-day rule*

Section 105(1) TCGA provides the same-day rule:

> Paragraphs (a) and (b) below shall apply where securities of the same class are acquired or disposed of by the same person on the same day and in the same capacity—
>
> (a) [i] all the securities so acquired shall be treated as acquired by a single transaction and
>
> [ii] all the securities so disposed of shall be treated as disposed of by a single transaction, and
>
> (b) all the securities so acquired shall, so far as their quantity does not exceed that of the securities so disposed of, be identified with those securities [ie, the securities acquired are identified with the securities disposed of].

56.12.4 *Analysis of identification rule*

The same-day/30-day rules both use the term identification. This is synonymous with "matching" which is the more commonly used word.[55]

Identification is a symmetrical relationship, ie if acquired securities are identified with disposed-of securities, then the disposed-of securities are identified with the acquired securities.

Davies v Hicks was a CGT avoidance scheme. In short:

(1) UK trustees sold shares and held cash

(2) Foreign trustees were appointed

(3) The foreign trustees reacquired the same shares within 30 days

The trustees made a disposal of shares at step (1). But under the 30-day rule, the disposed-of shares were identified with the re-acquired shares, and in computing the CGT computation on the disposal at step (1) the gain was computed as the sale price less the acquisition cost at step (3), and on

[54] See 3.20.9 (Established practice).

[55] That is self-evident, but if authority is needed, see the passage from *Davies v Hicks* set out above.

that basis no gain arose on that disposal.

The trustees also made a (deemed) disposal of the trust fund on the trust migration at step (2).[56] The trust fund was (actually) cash and no gain accrues on the disposal of cash. Here, HMRC argued that the effect of the 30-day rule was that the trustees were deemed to hold the shares not the cash, and so there was a deemed disposal of these deemed shares, on which a deemed gain accrued. So the Court had to consider the nature and effect of the share identification rule. HMRC's argument was rejected:

> 20.. In my view s.106A is a computational section, and I believe that that applies to s.106A(5)(a) just as much as to all the other detailed rules in the section. What triggers the operation of the section is a disposal of securities (see s.106A(1)), and the purpose of the section is to lay down rules as to how the chargeable gain or allowable loss on that disposal is to be computed. When that computation has been made the purpose of the section has been fulfilled.
> 21.. If there is not a disposal of securities the section does not begin to apply. Most disposals will be actual disposals. The section certainly can apply to deemed disposals, but the deemed disposal must be one provided for by some provision other than s.106A itself. Further, and even more importantly, for s.106A to apply the subject matter of the actual or deemed disposal must be securities... When there is a disposal, actual or deemed, of such assets ... , the shares disposed of are matched with shares acquired in accordance with the rules in s.106A . Once they have been so matched the gain or loss on the disposal is computed accordingly. When that process has been completed the application of s.106A to that particular disposal is at an end. The way in which the section operates on that disposal may affect the way in which it applies to future disposals by the same taxpayer of shares of the same class, but apart from that the section has no further statutory function to perform in consequence of the disposal of shares which caused it to apply in the first place. In particular it does not, in my judgment, operate additionally to cause the continuing settled property of the settlement to be treated for the purposes of different CGT provisions as consisting of assets different from those which actually are the continuing settled property.
> 23. ... So s.106A determined the CGT consequences of the actual disposal of AIT shares by the trustees on 24 October 2000, and the section could have had knock-on effects on the CGT consequences of future disposals of AIT shares by the same settlement. But in my firm

[56] See 12.4 (Charge on emigration of trust).

> opinion it could not and did not have the effect of changing the identity of other assets held by the trustees after they had sold the 100,000 shares, and causing those other assets to be regarded as shares in AIT when in fact they were not.

The reader may doubt whether a Court would make the same decision today. But the law is settled, at least below the level of the CoA, and if the same facts re-occurred, no doubt the GAAR would apply.

56.12.5 *Application of same-day rule*

Section 105(3) TCGA excludes share-pooling for securities acquired which fall within the same-day rule:

> None of the securities which, by virtue of this section, are identified with other securities shall be regarded as forming part of an existing section 104 holding or as constituting a section 104 holding.

Suppose T has a s.104 pool of securities. There are two possibilities:

(1) More securities are acquired and then disposed of on the same day. These are matched, they do not enter the s.104 pool, and there is no disposal from that pool.

(2) Existing securities are disposed of and then the same securities re-acquired on the same day. The securities acquired are identified with the securities disposed of, ie they are matched and so again, they do not enter the s.104 pool and there is no disposal from that pool.

The second case is more common. The identification here is fictional, in the sense that the disposed of securities would not (in the absence of the same-day rule) be identified with the acquired securities; because the disponor did not hold the acquired securities at the time of the disposal.

56.12.6 *30-day rule*

Section 106A TCGA provides:

> (1) This section has effect for the purposes of capital gains tax (but not corporation tax) where any securities are disposed of by any person.
> (2) The securities disposed of shall be identified in accordance with the following provisions of this section with securities of the same class that have been acquired by the person making the disposal.
> (3) The provisions of this section have effect in the case of any disposal notwithstanding that some or all of the securities disposed of are otherwise identified—

> (a) by the disposal, or
> (b) by a transfer or delivery giving effect to it;
>
> but where a person disposes of securities in one capacity, they shall not be identified under those provisions with any securities which he holds, or can dispose of, only in some other capacity.

Although s.106A(3) is expressed to apply for s.106A, the same principles would apply for s.105.

Section 106A(4) provides:

> Securities disposed of on an earlier date shall be identified before securities disposed of on a later date; and, accordingly, securities disposed of by a later disposal shall not be identified with securities already identified as disposed of by an earlier disposal.

Section 106A(5) TCGA provides the 30-day rule:

> Subject to subsection (4) above, if within the period of thirty days after the disposal the person making it acquires securities of the same class, the securities disposed of shall be identified—
> (a) with securities acquired by him within that period, rather than with other securities; and
> (b) with securities acquired at an earlier time within that period, rather than with securities acquired at a later time within that period.

Section 106A(5ZA) TCGA provides

> None of the securities which, by virtue of subsection (5) above, are identified with other securities shall be regarded as forming part of an existing section 104 holding or as constituting a section 104 holding.

This is the equivalent of s.105(3) TCGA.

Section 106A(9) TCGA provides:

> The identification rules set out in the preceding provisions of this section have effect subject to subsection (1) of section 105, and securities disposed of shall not be identified with securities acquired after the disposal except in accordance with that section or subsection (5) above.

So the same-day rule has priority over the 30 day rule.

The 30-day rule is disapplied for non-residents. Section 106(5A) TCGA provides:

> Subsection (5) above shall not require securities to be identified with

> securities which the person making the disposal acquires at a time when—
>
> (a) he is not resident in the UK, or
>
> (b) he is resident in the UK but is Treaty non-resident.

What matters is residence at the time of the acquisition, not at the time of disposal.

CG Manual offers some straightfoward examples:

> **CG51560 The "Same Day" And "Bed And Breakfast" Identification Rules** [May 2020]
>
> EXAMPLE 1
>
> Miss A has a Section 104 holding of 1,000 ordinary £1 shares in X plc.
>
> On 1 July 2011 she sells the whole 1,000 shares.
>
> She buys the same number of ordinary £1 shares in X plc on 31 July 2011.
>
> The acquisition is within the 30 day period after the disposal, so the disposal and later acquisition are matched in priority to identifying the disposal with the shares in the Section 104 holding.
>
> EXAMPLE 2
>
> Mr B has a Section 104 holding of 2,500 ordinary 10p shares in Y plc.
>
> On 27 March 2012 he sells 1,700 shares.
>
> On 30 March 2012 he buys another 500 10p shares in Y plc.
>
> The later acquisition of 500 shares does not become part of the Section 104 holding. They are identified with 500 of the shares disposed of on 27 March. The remaining 1,200 shares sold are identified with part of the Section 104 holding.
>
> EXAMPLE 3
>
> Mrs C has a Section 104 holding of 10,000 ordinary 25p shares in Z plc.
>
> On 28 February 2009 she sells 2,000 shares. On 31 March 2009 she buys another 3,000 of the same shares.
>
> Mrs C's acquisition is not within the 30 days after the disposal. So her disposal cannot be identified under the 30 day rule with 2,000 of the 3,000 shares bought on 31 March. The shares disposed of are therefore identified with part of the Section 104 holding.

56.12.7 *Disposal exceeds acquisitions*

Section 105(2) TCGA provides:

> Where the quantity of securities disposed of by any person exceeds the aggregate quantity of—
>
> (a) the securities (if any) which are required by subsection (1) above to be identified with securities acquired on the day of the

disposal [same-day rule],

(b) the securities (if any) which are required by section 106A(5) to be identified with securities acquired after the day of the disposal, [30 day rule] and

(c) the securities (if any) which are required by any of the provisions of sections 104, 106A or 107, or of Schedule 2, to be identified with securities acquired before the day of the disposal,

the disposal shall be treated as diminishing a quantity of securities subsequently acquired, and as so diminishing any quantity so acquired at an earlier date, rather than one so acquired at a later date.

This will not often arise.

56.12.8 *Share matching: Critique*

The main purpose of the share matching rules is to hinder bed-and-breakfasting, and the main purpose of bed-and-breakfasting was to use the CGT annual exemption. Now that the exemption is reduced to a trivial figure, the rules are not needed for that. The purposes remaining of bed-and-breakfasting are crystallization of losses and rebasing prior to becoming UK resident. It is suggested that the share matching rules should be repealed: that would be a significant simplification with little or no tax loss.

56.13 "Securities"

There are separate definitions for the same-day and 30-day rules.

56.13.1 *Relevant securities*

Both definitions use the term relevant securities. This term is defined twice, with the same meaning, though with trivial drafting differences:

s.108 TCGA	**s.106A(10) TCGA**
In this section "relevant securities" means —	In this section ..."relevant securities" means—
(a) securities, within the meaning of [Chapter 2 of Part 12 of ITA 2007 (accrued income profits);[57]	(a) [Identical
(aa) qualifying corporate bonds;	(b) qualifying corporate bonds, and

[57] See 28.2 (AIP securities),

(c) securities which are interests in a non-reporting fund, within the meaning of regulations [under section 354(1) of TIOPA 2010 (see Part 2 of [OFTR] 2009)	(c) securities which are interests in a non-reporting fund, within the meaning of [OFTR] 2009 (see regulation 4(2)).

Armed with this definition, we can turn to the two definitions of "securities"

Section 104(3) TCGA provides:

> For the purposes of this section [s.104] and sections 105, 107, 110 and 114 ...
> "securities" does not include relevant securities as defined in section 108 but, subject to that, means—
> (i) shares or securities of a company; and
> (ii) any other assets where they are of a nature to be dealt in without identifying the particular assets disposed of or acquired;...

The label "securities" is misleading as the rules apply to fungible assets which are not securities. But no short label could be entirely accurate, and I adopt the statutory term, as anything else is even more confusing.

Section 106A(10) TCGA provides:

> In this section ...
> "securities" means any securities within the meaning of section 104 or any relevant securities

I refer to "securities" within these definitions as "**s.104 Securities**" and **"s.106A Securities"** (the initial capital to signify the artificial nature of the definitions).

56.13.2 *Position of relevant securities*

Thus relevant securities are outside the same-day rule, and not subject to share pooling, but within the 30-day rule. That is significant for non-residents who are outside the 30-day rule. Is there any reason for treating relevant securities differently from other securities?

56.14 Pooling/matching: Cryptoassets

HMRC comment on the application of these rules in relation to cryptoassets:[58]

[58] See 96.2 (What cryptoassets are).

CRYPTO22200: Pooling [Feb 2022]

Pooling under TCGA92/S104 allows for simpler Capital Gains Tax calculations. Pooling applies to shares and securities of companies and also 'any other assets where they are of a nature to be dealt in without identifying the particular assets disposed of or acquired'.

Where the nature of the tokens means they are dealt in without identifying the particular tokens being disposed of or acquired then the tokens should be pooled as per TCGA92/S104(3)(ii) (CG11820). This is commonly referred to as a 'section 104 pool'. If TCGA92/S104(3)(ii) applies then the beneficial owner of the tokens will have a single pooled asset for Capital Gains Tax purposes that will increase or decrease with each acquisition, part disposal or disposal.

Non-Fungible Tokens (NFTs) are separately identifiable and so are not pooled.

Each type of token will need its own pool. For example, if a person owns bitcoin, ether and litecoin they would have three pools and each one would have its own 'pooled allowable cost' associated with it. This pooled allowable cost changes as more tokens of that particular type are acquired and disposed of.

Individuals must still keep a record of the amount spent on each type of token, as well as the pooled allowable cost of each pool.

Same day rule

TCGA1992/S105

Where an individual makes acquisitions and disposals of a particular type of tokens on the same day then the same day rules ensure that the maximum number of CGT computations the individual will need to produce for that token type is one per calendar day.

When tokens of the same type are acquired and disposed of by the same individual on the same day and in the same capacity then:

- all the tokens acquired shall be treated as acquired in a single transaction
- all the tokens disposed of shall be treated as disposed of in a single transaction

The tokens acquired will, as far as possible, be matched with the tokens disposed of so that those tokens don't go into the section 104 pool:

- if the quantity of tokens acquired exceeds the number disposed of then the excess tokens will then be considered for the 30 day rule (covered below) and if that doesn't apply then they will go into the section 104 pool
- if the quantity of tokens disposed of exceeds the number acquired then the excess tokens will then be considered for the 30 day rule (covered below) and if that doesn't apply then they will be treated as

a disposal from the section 104 pool.

Acquiring tokens within 30 days of selling TCGA1992/S106A

If an individual disposes of tokens and then acquires, in the same capacity, tokens of the same type within the next 30 days then:

- the same day rule (covered above) is applied first if applicable
- the tokens acquired to which the 30 day rule applies don't go into the section 104 pool but instead are matched to the earlier disposal (or disposals) of tokens
- the tokens acquired to which the 30 day rule applies are matched to disposals on the basis of earliest disposal first
- if the quantity of tokens so acquired exceeds the number of tokens disposed of in the preceding 30 days then the excess tokens will go into the section 104 pool.

Further guidance on these rules is at CG51560.

56.14.1 *Examples*

The Crypto Manual provides:

CRYPTO22251: Example 1 - basic section 104 pool disposal [Feb 2022]

This example provides a basic insight into how a section 104 pool operates.

Victoria bought 100 token A for £1,000. On 18 September 20XX Victoria bought a further 50 token A for £125,000. Victoria is treated as having a single section 104 pool of 150 of token A and total allowable costs of £126,000:

Date	**Quantity of token A**	**Pooled allowable costs**
Opening balance	100	£1,000
18/09/20XX	+50	+£125,000
Closing balance	150	£126,000

On 1 December 20XX Victoria sells 50 of her token A for £300,000. Victoria will be allowed to deduct a proportion of the pooled allowable costs when working out her gain:

Consideration		£300,000
Less allowable costs	£126,000 × (50 / 150)	(£42,000)
Gain		£258,000

Victoria will have a gain of £258,000 and she will need to pay Capital Gains Tax on this.

After the sale, Victoria will be treated as having a single section 104 pool of 100 token A and total allowable costs of £84,000:

Date	**Quantity of token A**	**Pooled allowable costs**
Opening balance	150	£126,000
01/12/20XX	(50)	(£42,000)
Closing balance	100	£84,000

If Victoria then sold all 100 of her remaining token A then she can deduct all £84,000 of the allowable costs when working out her gain/loss.

CRYPTO22252: Example 2 - application of the same day rule [Feb 2022]

This example shows how the same day rule operates, as well as showing what happens to any tokens that can't be matched to the disposal.

Martyn holds 5,000 token B in a section 104 pool. He spent a total of £500 acquiring them, which is his pooled allowable cost.

On 23 June 20XX Martyn enters into the following transactions:

- Morning – he disposes of 1,000 token B for £800.
- Afternoon – he acquires 1,600 token B for £1,000.
- Evening – he disposes of 500 token B for £600.

Martyn's disposals both take place on the same day, so they are treated as a single disposal of 1,500 token B for £1,400. Martyn's acquisition takes place on the same day, so the acquisition is matched with the disposal. Martyn will need to work out the gain on his disposal of 1,500 token B as follows:

Consideration	£800 + £600	£1,400
Less allowable costs	£1,000 × (1,500 / 1,600)	(£938)
Gain		£462

Martyn is unable to match the remaining 100 token B to disposals on the same day. Instead those100 token B and their associated cost of £62 (£1,000 × (100 / 1,600)) will go into the section 104 pool. The section 104 pool now contains 5,100 token B and total pooled costs of £562:

Date	**Quantity of token B**	**Pooled allowable costs**
Opening balance	5,000	£500
23/06/20XX	+100	+£62
Closing balance	5,100	£562

CRYPTO22253: Example 3 - application of the 30 day rule [Feb 2022]

This example shows how the 30 day rule operates, as well as showing what happens to any tokens that can't be matched to the disposal.

Rachel holds 2,000 token C in a section 104 pool. She spent a total of £1,000 to acquire them, which is her pooled allowable cost.

Rachel enters into the following series of transactions:

- On 31 March 20XX Rachel disposes of 1,000 token C for £400.
- On 20 April 20XX Rachel disposes of 500 token C for £150
- On 21 April 20XX Rachel acquires 700 token C for £175
- On 28 April 20XX Rachel acquires 500 token C for £100
- On 1 May 20XX Rachel acquires 500 token C for £150

Acquisitions within 30 days of a disposal are matched on the basis of the earliest acquisition being matched to a disposal. The acquisitions on 21 April 20XX and 28 April 20XX take place within 30 days of the disposal on 31 March 20XX. This means that the acquisitions are matched to the disposal on 31 March 20XX as far as is possible. The acquisitions on 28 April 20XX and 1 May 20XX take place within 30 days of the disposal on 1 May 20XX. This means that the acquisitions are matched to the disposal on 31 March 20XX as far as is possible.

Rachel will need to work out the gain on her two disposals as follows:

31 March 20XX

Consideration		£400
Less allowable costs – 30 day (21/04 – 700 token C)		(£175)
Less allowable costs – 30 day (28/04 – 300 token C)	£100 × (300 / 500)	(£60)
Gain		£165

20 April 20XX

Consideration		£150
Less allowable costs – 30 day (28/04 – 200 token C)	£100 × (200 / 500)	(£40)
Less allowable costs – 30 day (01/05 – 300 token C)	£150 × (300 / 500)	(£90)
Gain		£20

Rachel is unable to match the remaining 200 token C to acquisitions within 30 days of the disposal on 20 April 20XX. Instead those 200 token C and their associated cost of £60 (£150 × (200 / 500)) will go into the section 104 pool. The section 104 pool now contain 2,200 token C and total pooled costs of £1,060:

Date	**Quantity of token C**	**Pooled allowable costs**
Opening balance	2,000	£1,000
01/05/20XX	+200	+£60
Closing balance	2,200	£1,060

CRYPTO22254: Example 4 - interaction of same day rule with section 104 pool [Feb 2022]

This example shows how to the same day rule and a part disposal of the section 104 pool interact.

Daniel holds 8,000 token D in a section 104 pool. He spent a total of £1,000 acquiring them, which is his pooled allowable cost.

On 31 January 20XX Daniel enters into the following transactions:

- Disposal of 5,000 token D for £500.
- Acquisition of 4,000 token D for £320
- Acquisition of 1,000 token D for £75
- Acquisition of 1,000 token D for £70
- Disposal of 2,000 token D for £142
- Acquisition of 500 token D for £35

Daniel's disposals both take place on the same day, so they are treated as a single disposal of 7.000 token D for £642. Daniel's acquisitions all take place on the same day, so they are treated as a single acquisition of 6,500 token D for £500.

Daniel's acquisition and disposal take place on the same day, so the acquisition is matched with the disposal. The remaining 500 token D are treated as a part disposal of the section 104 pool. Daniel will need to work out the gain on his disposal as follows:

Consideration	£500 + £142	£642
Less allowable costs – same day (6,000 token D)	£320 + £75 + £70 + £35	(£500)
Less allowable costs – S104	£1,000 × (500 / 8,000)	(£63)
Gain		£79

Daniel will need to reduce his section 104 pool to 7,500 token D and total allowable costs of £937:

Date	**Quantity of token D**	**Pooled allowable costs**
Opening balance	8,000	£1,000
31/01/20XX	(500)	(£63)
Closing balance	7,500	£937

CRYPTO22255: Example 5 - interaction of 30 day rule with section 104 pool [Feb 2022]

This example shows how to the 30 day rule and a part disposal of the section 104 pool interact.

Melanie holds 14,000 token E in a section 104 pool. She spent a total of £200,000 acquiring them, which is her pooled allowable cost.

On 30 August 20XX Melanie sells 4,000 token E for £160,000.

Then on 11 September 20XX Melanie buys 500 token E for £17,500.

The 500 new tokens were bought within 30 days of the disposal, so they do not go into the section 104 pool. Instead, Melanie is treated as having disposed of:

- the 500 tokens she has just bought
- 3,500 of the tokens already in the section 104 pool

Melanie will need to work out her gain on the disposal of the 4,000 token E as follows:

Consideration		£160,000
Less allowable costs – 30 day		
(11/09 – 500 token E)		(£17,500)
Less allowable costs – S104		
(3,500 token E)	£200,000 × (3,500 / 14,000)	(£50,000)
Gain		£92,500

Melanie still holds a section 104 pool of 10,500 token E. The section 104 pool has allowable costs of £150,000 remaining:

Date	**Quantity of token E**	**Pooled allowable costs**
Opening balance	14,000	£200,000
30/08/20XX	(3,500)	(£60,000)
Closing balance	10,500	£140,000

CRYPTO22256: Example 6 - interaction of same day rule, 30 day rule and section 104 pool [Feb 2022]

This example shows how to the same day rule, 30 day rule and a part disposal of the section 104 pool interact.

Gulferaz holds 100,000 token F in a section 104 pool. He spent a total of £300,000 acquiring them, which is his pooled allowable cost.

Gulferaz enters into the following transactions:

- 31 July 20XX – acquisition of 10,000 token F for £45,000.
- 31 July 20XX – disposal of 30,000 token F for £150,000
- 5 August 20XX – disposal of 20,000 token F for £100,000
- 6 August 20XX – acquisition of 50,000 token F for £225,000
- 7 August 20XX – disposal of 100,000 token F for £150,000

Gulferaz's acquisition on 31 July 20XX takes place on the same day as a disposal so those transactions are matched as far as possible (that is 10,000 token F).

Gulferaz's acquisition on 6 August 20XX takes place within 30 days of the disposal on 31 July 20XX so that acquisition is matched with the disposal on 31 July 20XX as far as possible (that is 20,000 token F).

Gulferaz's acquisition on 6 August 20XX also takes place within 30 days of the disposal on 5 August 20XX so that acquisition is matched with the disposal on 5 August 20XX as far as possible (that is 20,000 token F).

The remaining 10,000 token F acquired on 6 August 20XX go into the section 104 pool as normal.

Gulferaz will need to work out his gains/losses on the three disposals as follows:

31 July 20XX

Consideration		£150,000
Less allowable costs – same day		
(10,000 token F)	£45,000	(£45,000)
Less allowable costs – 30 day		
(06/08 - 20,000 token F)	£225,000 × (20,000 / 50,000)	(£90,000)
Gain		£15,000

No token F go into or come out of the section 104 pool at this date.

5 August 20XX

Consideration		£100,000
Less allowable costs – 30 day		
(06/08 - 20,000 token F)	£225,000 × (20,000 / 50,000)	(£90,000)
Gain		£10,000

No token F go into or come out of the section 104 pool at this date.

6 August 20XX

The section 104 pool is changed as follows:

Date	**Quantity of token F**	**Pooled allowable costs**
Opening balance	100,000	£300,000
06/08/20XX	+10,000	+£45,000
Closing balance	110,000	£345,000

7 August 20XX

Consideration		£150,000
Less allowable costs – S104	£345,000 × (100,000 / 110,000)	(£313,637)
Loss		(£163,637)

The section 104 pool is changed as follows:

Date	**Quantity of token F**	**Pooled allowable costs**
Opening balance	110,000	£345,000
07/08/20XX	(100,000)	(£313,637)
Closing balance	10,000	£31,363

CRYPTO22257: Example 7 - disposal of tokens to acquire different tokens ('crypto-to-crypto' exchange) [Feb 2022]

Most types of tokens need to be purchased using another token. This means that a transaction may simultaneously affect two section 104 pools. This example illustrates how a transaction can affect two section 104 pools simultaneously.

Elina holds 100,000 token G in a section 104 pool. She spent a total of £300,000 acquiring them, which is her pooled allowable cost.

Elina enters into the following transactions:

- 31 August 20XX – acquisition of 10,000 token H (with a value of £3,200) for 1,000 token G (with a value of £3,200)
- 31 August 20XX – disposal of 5,000 token H (with a value of £1,700) for 600 token G (with a value of £1,920)
- 31 August 20XX – acquisition of 5,000 token H (with a value of £1,650) for 550 token G (with a value of £1,760)
- 4 September 20XX – disposal of 2,000 token H (with a value of £560) for 180 token G (with a value of £558)
- 16 September 20XX – acquisition of 4,000 token H (with a value of £1,080) for 400 token G (with a value of £1,080)

- 27 October 20XX – disposal of 12,000 token H (with a value of £2,400) for 900 token G (with a value of £2,430)

Elina entered into two acquisitions of token H on 31 August 20XX. These acquisitions are treated as a single acquisition of 15,000 token H on that date. That single acquisition is then matched as far as possible with the disposal of 5,000 token H on the same date. The remaining token H that were acquired go into a section 104 pool of token H.

Elina has also entered into two disposals of token G on 31 August 20XX. These two disposals are treated as a single disposal of 1,550 token G on that date. That single disposal is matched as far as possible with the acquisition of 600 token G on the same date. The disposal is then matched to the acquisition of 180 token G on 4 September 20XX. The remaining part of the disposal comes from the section 104 pool of token G.

Elina's disposal of 2,000 token H on 4 September 20XX is matched with the acquisition of 4,000 token H on 16 September 20XX as the acquisition takes place within 30 days of the disposal.

Elina's acquisition of 180 token G on 4 September 20XX goes into the section 104 pool for token G.

Elina's disposal of 400 token G on 16 September 20XX comes from the section 104 pool of token G.

Elina's disposal of 12,000 token H on 27 October 20XX comes from the section 104 pool for token H.

Elina's acquisition of 900 token G on 27 October 20XX goes into the section 104 pool for token G.

Elina will need to work out her gains/losses on the three disposals as follows:

31 August 20XX – disposal of token G

Consideration	Value of 15,000 token H acquired	£4,850
Less allowable costs – same day (600 token G)	Value of 5,000 token H disposed of on 31/08/20XX	(£1,700)
Less allowable costs – 30 day (04/09 – 180 token G)	Value of 2,000 token H disposed of on 04/09/20XX	(£560)
Less allowable costs – S104	£300,000 × 770 / 100,000 = £2,310	(£2,310)
Gain		£280

31 August 20XX – disposal of token H

Consideration	Value of token G acquired	£1,920
Less allowable costs – same day (5,000 token H)	(£3,200 + £1,760 = £4,960) × 5,000 / 15,000	(£1,653)
Gain		£267

4 September 20XX – disposal of token H

Consideration	Value of token G acquired	£558
Less allowable costs – 30 day (16/09 – 2,000 token H)	£1,080 × 2,000 / 4,000	(£540)
Gain		£18

16 September 20XX – disposal of token G

Consideration	Value of token H acquired	£1,080
Less allowable costs – S104	£297,690 × 400 / 99,230	(£1,200)
Loss		(£120)

27 October 20XX – disposal of token H

Consideration	Value of token G acquired	£2,430
Less allowable costs – S104		(£3,847)
Loss		(£1,417)

The section 104 pools are as follows:

Section 104 pool for token G

Date	**Quantity of token G**	**Pooled allowable costs**
Opening balance	100,000	£300,000
31/08/20XX - Disposal of 770 tokens	(770)	(£2,310)
Balance at 31/08/20XX	99,230	£297,690
16/09/20XX - Disposal of 400 tokens	(400)	(£1,200)
Balance at 16/09/20XX	98,830	£296,490
27/10/20XX - Acquisition of 900 tokens	+900	+£2,400
Balance at 27/10/20XX	99,730	£298,890

Section 104 pool for token H

Date	**Quantity of token H**	**Pooled allowable costs**
31/08/20XX - Acquisition of token H	+10,000	+£3,307
Balance at 31/08/20XX	10,000	£3,307
04/09/20XX - Acquisition of 2,000 tokens	+2,000	£540
Balance at 04/09/20XX	12,000	£3,847
27/10/20XX - Disposal of 12,000 tokens	(12,000)	(£3,847)
Pool ceases		£0

CIOT question the practicality of applying the rules to cryptoassets:[59]

> HMRC requires s.104 pooling and 30-day bed and breakfasting rules, as is used for shares for calculating the base cost for shares; yet over a given tax year it is possible for an individual to carry out thousands, hundreds of thousands or potentially even millions of micro transactions of tokens via automated trading routines, resulting in small portfolios with vast numbers of transactions unlike most 'standard' investment portfolios.

One hopes that HMRC will accept a reasonable estimate in appropriate circumstances.

56.15 Pooling/matching: ISAs

Reg 34 ISA regs 1998 provides:

> (1) For the purposes of capital gains tax on the occasion when the title to account investments is transferred from an account manager to an account investor there shall be deemed to be a disposal and reacquisition

[59] CIOT Response to the paper "Expanding the Investment Transactions List for the Investment Management Exemption and other fund tax regimes" (2022).

by the account investor of those investments for a consideration equal to their market value at the date of the transfer.

(2) Sections 104 to 114 of the Taxation of Chargeable Gains Act 1992 shall apply for the purposes of pooling and identifying account investments as if—

(a) in section 106A after subsection (11) there were added—

(12) This section and sections 104, 110, 110A and 114—

(a) shall apply separately in relation to any securities which are held by a person as account investments so long as they are so held, and

(b) shall apply in relation to any such securities which became account investments by being transferred or renounced to an account manager or to a nominee for an account manager in the circumstances specified in regulation 7(2)(h) and (10)(a), (b) or (ba) as if they had been account investments—

(i) in the case of securities acquired by that person in accordance with the provisions of a savings-related share option scheme, which were transferred in the circumstances specified in regulation 7(2)(h)(i) and (10)(a), from the date of their acquisition by him, or

(ii) in the case of securities appropriated to that person in accordance with the provisions of an approved profit sharing scheme, which were transferred in the circumstances specified in regulation 7(2)(h)(ii) and (10)(b), from the date when he directed the trustees to transfer the ownership of the securities to him or, if earlier, the release date in relation to those securities, or

(iii) in the case of securities which were plan shares of a Schedule 2 SIP before being transferred in the circumstances specified in regulation 7(2)(h)(iii) and (10)(ba), from the date when the securities ceased to be subject to the plan, and

(c) while applying separately to any such securities, shall have effect as if that person held them in a capacity other than that in which he holds any other securities of the same class whether under another such account or otherwise.

(13) In this section—

(a) "account", "account investment" and "account manager" have the same meanings as in the Individual Savings Account Regulations 1998 and "regulation" means a regulation of those Regulations;

(b) "approved profit sharing scheme" has the same meaning as in

Chapter IV of Part V of the Taxes Act and "savings-related share option scheme" has the meaning given by paragraph 1 of Schedule 9 to that Act.";

(c) "Schedule 2 SIP" and "ceased to be subject to the plan" shall be construed in accordance with the SIP code (see section 488(3) of ITEPA 2003); and

(d) "plan shares", in relation to a Schedule 2 SIP, shall be construed in accordance with the SIP code (see section 488(3) of ITEPA 2003) except that—

(i) paragraph 87(6) of Schedule 2 to ITEPA 2003 (meaning of the word "shares" in the context of company reconstructions) shall not apply, and

(ii) in paragraph 88(2) of that Schedule (treatment of shares acquired under rights issue) the words "or securities or rights" shall be treated as omitted.

(b) [This amended 110A, repealed 2008]

56.15.1 *Amendments to s.106A*

Reg 34 ISA regs 1998 provides:

> (3) Section 106A of the Taxation of Chargeable Gains Act 1992 shall apply for the purposes of identifying securities within the meaning of that section which are eligible to become account investments as if—
>
> (a) in subsection (4), there were added at the beginning the words "Subject to subsection (14) below";
>
> (b) in subsection (6), the words "subsections (4) and (5) above" were replaced with the words "subsections (4), (5) and (14)"; and

Amended as reg 34(3) directs, s.106A TCGA provides:

> (4) Subject to subsection (14) below securities disposed of on an earlier date shall be identified before securities disposed of on a later date; and, accordingly, securities disposed of by a later disposal shall not be identified with securities already identified as disposed of by an earlier disposal.
>
> ...
>
> (6) Subject to subsections ~~(4) and (5)~~ (4), (5) and (14) above, relevant securities disposed of shall be identified with relevant securities acquired at a later time, rather than with relevant securities acquired at an earlier time.

Reg 34 ISA regs 1998 provides:

> (3) Section 106A of the Taxation of Chargeable Gains Act 1992 shall apply for the purposes of identifying securities within the meaning of that section which are eligible to become account investments as if—
>
> (c) after subsections (12) and (13), as added by paragraph (2), there were added—
>
> "(14) Where a person disposes of securities and securities of the same class which were eligible for transfer to an account under regulation 7(2)(h) were—
>
> (a) held by him immediately before that disposal, or
>
> (b) acquired by him on the same day as that disposal, or
>
> (c) acquired by him within the period of thirty days after that disposal,
>
> and those securities were acquired in the circumstances specified in that regulation, he shall be treated as having first disposed of any securities of that class held or acquired by him which were not so eligible."

Reg 34(4) amends provisions relating to reorganisations, and is not discussed here.

56.16 2017 rebasing

56.16.1 *Rebasing reliefs*

This section discusses the relief in Para 41 sch 8 F(no.2)A 2017 which I call **"2017 rebasing"**. This is one of several rebasing reliefs:

Name of relief	**Provision**	**See para**
1982 rebasing	s.35 TCGA	*Not discussed*
2008 rebasing	para 126 Sch 7 FA 2008	61.46
2017 rebasing	para 41 sch 8 F(no.2)A 2017	*Discussed here*
UK land rebasing	sch 4AA TCGA	57.15
Rebasing on death	s.62(1) TCGA	88.5

Also see 20.13.14 (Rebasing/cleansing compared).

The professional bodies have published a set of Q&As with HMRC replies (**"Rebasing Q&As"**).[60] The edition history is:

[60] The full title is "Rebasing and Adjustment to the CGT Foreign Capital Losses Election Professional Bodies Q&A". See *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2019/taxguide-09-19-foreign-capital-losses.ashx* or *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99*

Version	Date	ICAEW label
1	March 2018	Taxguide 06/18
2	May 2019	Taxguide 09/19

56.16.2 *2017 rebasing conditions*

Para 41 sch 8 F(no.2)A 2017 provides:

> (1) This paragraph applies to the disposal of an asset by an individual ("P") where-

P stands for person. But 2017 rebasing applies only to assets of individuals: it discriminates against assets held through trusts and companies. In the current HMRC view, it seems, the only acceptable form of ownership is direct absolute ownership.

There follow four conditions, or sets of conditions, which I call **"rebasing conditions (a) - (d)"**.

56.16.3 *Acquisition/disposal date*

Para 41 sch 8 F(no.2)A 2017 provides:

> (1) This paragraph applies to the disposal of an asset by an individual ("P") where-
> (a) the asset was held by P on 5 April 2017

Para 41 sch 8 F(no.2)A 2017 provides:

> (1) This paragraph applies to the disposal of an asset by an individual ("P") where ...
> (b) the disposal is made on or after 6 April 2017

56.16.4 *Condition (c): Situs of asset*

Para 41 sch 8 F(no.2)A 2017 provides:

> (1) This paragraph applies to the disposal of an asset by an individual ("P") where...
> (c) the asset was not situated in the UK at any time in the relevant period

The relevant period matters as the asset must not be UK situate during that period. Para 41(2) sch 8 F(no.2)A 2017 provides:

> The relevant period is the period which-

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> (a) begins with 16 March 2016 or, if later, the date on which P acquired the asset, and
> (b) ends with 5 April 2017.

Perhaps this is an anti-forestalling rule.

56.16.5 *Qualifying individual*

Para 41 sch 8 F(no.2)A 2017 provides:

> (1) This paragraph applies to the disposal of an asset by an individual ("P") where...
> (d) P is a qualifying individual.

"Qualifying individual" is a label for a set of rules. Para 41 sch 8 F(no.2)A 2017 provides:

> (3) P is a qualifying individual if-

A set of four conditions then follow (**"qualifying individual conditions"**):

> (3) P is a qualifying individual if-
> (a) section 809H of ITA 2007 (claim for remittance basis by long-term UK resident: charge)[61] applied in relation to P for any tax year before the tax year 2017-18
> (b) P is not an individual who-
> (i) was born in the UK, and
> (ii) whose domicile of origin was in the UK

2017 rebasing does not apply to a formerly-domiciled resident.

> (3) P is a qualifying individual if ...
> (c) P was not domiciled in the UK at any time in a relevant tax year

A person who acquires a UK domicile of choice loses the relief.

> (3) P is a qualifying individual if ...
> (d) P met condition B in section 835BA of ITA 2007 [15-year rule][62] in relation to each relevant tax year.

It is difficult to see why qualifying individual condition (d) must be met for each relevant tax year (not just 2017/18); but it will be rare that the

[61] See 17.12.1 (7 & 12-year residence tests).

[62] See 5.4.3 (IT/CGT 15-year rule).

condition is met in 2017/18 and not subsequently (unless the individual leaves the UK and does not return, in which case 2017 rebasing ceases to be an issue).

56.16.6 *"Relevant tax year"*

"Relevant tax year" matters for two purposes:

Qualifying individual condition: Requirement
Condition (c): P must be non UK domiciled in each relevant tax year
Condition (d): P must meet the 15-year rule in each relevant tax year

Para 41(4) sch 8 F(no.2)A 2017 provides:

> The relevant tax years are-
> (a) the tax year 2017-18, and
> (b) if the disposal was made after that tax year, all subsequent tax years up to and including that in which the disposal was made.

"Relevant tax year" is distinct from the term "relevant period".[63]

56.16.7 *Effect of 2017 rebasing*

Assuming the rebasing conditions are satisfied, para 41(5) sch 8 F(no.2)A 2017 provides the relief:

> In computing, for the purpose of TCGA 1992, the gain or loss accruing on the disposal, it is to be assumed that P acquired the asset on 5 April 2017 for a consideration equal to its market value on that date.

I refer to this as **"2017 rebasing"** to distinguish it from rebasing under the 2008 rules, and other occasions of rebasing.
The wording is based on s.35 TCGA (1982 rebasing).
Para 41(8) sch 8 F(no.2)A 2017 provides:

> This Part of this Schedule has effect as if it were included in TCGA 1992.

The August 2016 consultation paper provides:

> [1] Rebasing will apply on an asset by asset basis and there will be no requirement that any part of the sales proceeds relating to the part of the gain which arose before April 2017 should be left outside the UK.
> [2] Where the asset was originally purchased with clean capital, the

[63] See 56.16.4 (Condition (c): Situs of asset).

> entire proceeds from the disposal can be brought to the UK without triggering a remittance. However, where it was purchased wholly or partly with foreign income and gains, an element of the disposal proceeds will still relate to[64] those income and gains and so will be subject to the remittance basis in the normal way when the proceeds are brought to the UK.

Point [2] is correct, because rebasing only applies "in computing... the gain or loss accruing on the disposal".

Offshore funds qualify for 2017 rebasing. The wording is designed to match reg 39(1) OFTR 2009 which provides that the starting point for calculating an offshore income gain is the amount which would be the gain on the disposal in question "for the purposes of TCGA 1992".[65] HMRC agree.[66]

Deeply discounted securities and life policy gains do not qualify for 2017 rebasing, since the chargeable amounts are not chargeable gains or computed on CGT principles.

Rebasing applies to assets held through partnerships.[67]

Taxpayers should keep evidence relating to value on 6 April 2017, and, in appropriate cases, instruct valuers to prepare valuations, as a contemporary valuation is easier, cheaper, and likely to be more accurate, than one made some years later.

56.16.8 *Inter-spouse transfer*

Para 41(6) sch 8 F(no.2)A 2017 provides:

> Sub-paragraph (5) applies notwithstanding section 58(1) of TCGA 1992 (disposals between spouses).

Where 2017 rebasing applies, an inter-spouse disposal does not cause it to be lost. Rebasing Q&As Q4 provides two straightforward examples, not set out here.

56.16.9 *Rebasing: share matching*

Rebasing Q&As Q7 (Kiki) provides:

[64] "Relate to" is an inaccurate paraphrase of the statutory wording, "derive from". But it does not matter.

[65] See 67.20.2 (Computation of OIG).

[66] Rebasing Q&As Q1; for Carried Interest, see 73.20 ("Permitted deductions").

[67] This is self-evident, but if authority is needed, see Rebasing Q&As Q2.

> K is deemed domiciled in 2017/18 and qualifies for rebasing. She has a mixed fund investment portfolio that contains a significant amount of clean capital which she wants to cleanse. K does not, however, want to be out of the market for long or acquire different investments. As such:
>
> - a new investment portfolio is opened for the clean capital;
> - all the investments are sold on 19 June 2018;
> - a cautious cleansing transfer (and nomination) to the new clean capital investment portfolio takes place;
> - on 20 June 2018 acquisitions are made such that, once all the acquisitions are made, across the two portfolios K is left with exactly the same investments and in the same quantities as she held on 19 June 2018.
>
> What is the tax analysis?
>
> *Suggested answer:*
>
> From a CGT perspective because there has been a re-acquisition within the period of 30 days after the disposal the base cost for the disposal is the acquisition cost of the new shares (that is the "bed and breakfasting rule"[68] applies).
>
> The base cost for the shares K has in her portfolios as at 20 June 2018 is the rebased 5 April 2017 amount...
>
> **HMRC Comment**
>
> The CG analysis is OK and looks to be another mechanism to convert an asset to cash that goes to an account that can then be cleansed. HMRC can agree the cleansing aspects of this.

56.16.10 *Rebasing: currency fluctuation*

Rebasing Q&As Q8 provides:

> HMRC's view ... is that if a taxpayer receives $1,000 of foreign income when it is worth £500 but brings it to the UK when it is worth £700 (due to forex movements) then he is considered to have made a taxable remittance of £700. (Equally if the funds are worth £300 when brought to the UK there is a taxable remittance of £300.)
>
> ... It should be noted that we think that the HMRC view is not the better technical interpretation ... [69]
>
> The issue is, however, thrown into sharp focus by rebasing since the HMRC view does not result in the results one would expect given the Chancellor's announcement
>
> Consider the following example:

[68] See 56.12.2 (Share-matching).

[69] The practitioners view is correct: see 95.6 (Remittance basis: Conversion date).

The taxpayer (who is deemed domiciled in 2017/18 and qualifies for rebasing) has $1 million of 2014/15 income which was worth £500,000 when received. It is then invested in an asset.

At 5 April 2017 it was worth $1.2 million (worth £900,000 at that date) and sold for that amount on 7 April 2017.

The taxpayer remits the $1.2 million (placed in a segregated account) to the UK immediately.

HMRC's interpretation is that the $1.2 million represents:

- the $1 million of original income, worth £750,000 at the date of remittance; and
- the £400,000 gain (that is £900,000 less £500,000) subject to rebasing relief.

Under this HMRC approach, since the entire mixed fund has been brought into the UK (so the remittance is not limited to the sterling value of the amount brought into the UK) the taxable remittance is £750,000 notwithstanding that the taxpayer has only remitted £900,000 of cash and expected to benefit from £400,000 rebasing relief.

In contrast, taking the alternative approach (as agreed by the professional bodies) with the same figures the $1.2 million represents:

- the $1 million of original income (£500,000); and
- the £400,000 gain (that is £900,000 less £500,000) subject to rebasing relief.

That is £900,000 is brought in per the mixed fund analysis, which agrees to the value of the sterling amount transferred. Only £500,000 is taxable meaning the taxpayer benefits in full from the £400,000 rebasing relief.

Given this issue what should be done in these circumstances?

Suggested Answer: Provided a consistent year on year approach is taken for each individual mixed fund bank account analysis the conversion of Remittance Basis foreign income to sterling can take place either on the date the income arises or when the income is remitted.

HMRC Comments

The gain is correct at £400k. HMRC's interpretation remains unchanged. The conversion of foreign currency into sterling is carried out using the spot rate on the date of remittance. HMRC does not agree the alternative approach suggested.

Rebasing Q&As Q9 provides:

Whilst HMRC in its manuals states that income in a foreign currency should be translated to sterling using the foreign exchange spot rate on remittance this is not the case for gains as there is clear case law to the contrary[70] ... As such, HMRC and practitioners agree on the position for gains.

How will rebasing work where just foreign chargeable gains were used wholly (or in part) to fund the acquisition?

Suggested Answer:

This is best explained by way of an example.

The taxpayer (who is deemed domiciled in 2017/18 and qualifies for rebasing) had $1 million within a bank account (this traced to the sale of an investment in 2009/10 and represented clean capital of £400,000 and Remittance Basis foreign chargeable gains of £200,000).

This $1 million was immediately re-invested in an asset such that the CGT base cost of the asset was £600,000 sterling.

At 5 April 2017 the new foreign asset was worth $1.2 million (worth £900,000 at that date) and sold for that amount on 7 April 2017.

The taxpayer remits the $1.2 million (placed in a segregated account) to the UK immediately.

The $1.2 million represents:

- the $1 million of original funds (£400,000 clean capital and £200,000 Remittance Basis foreign chargeable gains); and
- the £300,000 capital gain (that is £900,000 less £600,000).

That is £900,000 is brought to the UK per the mixed fund analysis, which agrees to the value of the sterling amount transferred.

HMRC Comments

I think the opening sentence is slightly confusing. Working out what gets remitted and how a gain is calculated are separate things.

On the example - I think it would be helpful if the example confirmed that the new asset was acquired straight after the sale of the investment, otherwise that raises questions on what the acquisition cost for CG would be. HMRC agrees the cleansing aspects of this.

Example adjusted in line with HMRC comments.

56.16.11 *Rebasing: Reorganisations*

Para 41(7) sch 8 F(no.2)A 2017 deals with reorganisations:

> Where under section 127 of TCGA 1992 (including that section as applied by sections 132, 135 and 136 of that Act) an original and a new holding of shares or other securities are treated as the same asset, the condition in sub-paragraph (1)(c) [non-UK situs][71] applies to both the original and the new holding.

[70] See 95.2 (CGT: Currency conversion date).

[71] See 56.16.4 (Condition (c): Situs of asset).

A reorganisation during the relevant period might convert a UK asset into a foreign asset which might arguably allow rebasing. A reorganisation after the relevant period should not matter.

One might have thought that the reorganisation TAAR would be sufficient to prevent abuse; but there it is.

56.16.12 *Rebasing: Remittance reliefs*

Para 42 sch 8 F(no.2)A 2017 deals with the interaction of 2017 rebasing and exempt property remittance relief:[72]

> (1) This paragraph applies for the purposes of paragraph 41(1)(c) [non-UK situs] in the case of an asset which, having been situated outside the UK, becomes situated in the UK before the end of the relevant period.
> (2) The asset is to be regarded as not situated in the UK at a time in the relevant period when—
> (a) it meets the condition in section 809Z(3)(a), (b) or (c) of ITA 2007 (public access),
> (b) it meets the condition in section 809Z3(3)(a), (b) or (c) of ITA 2007 (repairs),
> (c) the sole or principal purpose of its being situated in the UK is to sell it or put it up for sale, or
> (d) in the case of clothing, footwear, jewellery or a watch, it is for the personal use of—
> (i) P or a husband, wife or civil partner of P,[73] or
> (ii) a child or grandchild of a person within sub-paragraph (i), if the child or grandchild has not reached the age of 18.
> (3) The asset is to be regarded as not situated in the UK at any time in the relevant period if it is brought to, or received or used in, the UK in circumstances in which section 809L(2)(a) of ITA 2007 applies but—
> (a) by virtue of section 809X(5)(c) of ITA 2007 (notional remitted amount less than £1000) it is treated as not remitted to the UK, or
> (b) by the end of the relevant period it has not failed to meet the temporary importation rule in section 809Z4 of ITA 2007.

56.16.13 *Election out of 2017 rebasing*

Para 43(1) sch 8 F(no.2)A 2017 provides:

[72] See 19.29 (Exempt property).

[73] Para 41(4) provides: "Section 809M(3)(a) and (b) of ITA 2007 (persons living together) apply for the purposes of sub-paragraph (2)(d)(i)." See App.3.4.1 (Cohabitee treated as spouse).

> An individual may make an election for paragraph 41 not to apply to a disposal made by the individual.

This may be useful if a loss arises.
The standard claim procedure rules apply.[74]

Para 43 sch 8 F(no.2)A 2017 continues:

> (3) An election under this paragraph is irrevocable.
> (4) All such adjustments are to be made, whether by way of discharge or repayment of tax, the making of assessments or otherwise, as are required to give effect to an election under this paragraph.

56.16.14 *Rebasing: Critique*

2017 rebasing was an afterthought, first suggested in the 2016 Budget, and perhaps HMRC did not think very deeply about it. The August 2016 consultation paper provides:

> The government agrees that it would be punitive to require long-term resident non-doms to pay CGT on gains that have accrued on foreign assets held while the individual was a non-dom. To address these concerns, Budget 16 announced that those individuals who will become deemed-domiciled in April 2017 because they have been resident for 15 of the past 20 years will be able to rebase directly held foreign assets to their market value on 5 April 2017.

Rebasing is restricted to those who become deemed domiciled by clocking up 15 years residence by 2017/18. Someone who became UK resident in 2002/03 or before qualifies, and someone who became UK resident subsequently does not. What is the reason for that? It is a matter of speculation since no reason was ever given. Perhaps it is thought that those who do not become deemed domiciled in 2017/18:
(1) have more time in which to make disposals, taxed on the remittance basis, in anticipation of acquiring deemed domicile subsequently; or
(2) have more time in which to arrange to cease to be UK resident.

Or perhaps it was thought presentationally desirable to offer some relief, but the smaller the relief the better. As it stands, the largesse is significant but its application is random.

[74] See 123.2.5 (2017 rebasing election).

56.17 CGT remittance basis

Para 1 sch 1 TCGA provides:

> (1) This paragraph applies in the case of an individual to whom the remittance basis applies[75] for a tax year if—
>
> (a) in that year the individual disposes of foreign assets,[76]
>
> (b) chargeable gains accrue to the individual on the disposal of those assets, and
>
> (c) the gains are not taken outside the charge to capital gains tax as a result of section 1G (cases where tax year is a split year).
>
> (2) The gains are treated as accruing to the individual only so far as, and at the time when, they are remitted to the UK.
>
> (3) The amount treated as accruing is equal to the full amount remitted to the UK[77] at that time.

The use of the word "individual" means that trustees and personal representatives do not qualify for the remittance basis.

The CGT remittance basis applies to foreign *situate* assets.[78] By contrast, the RFI remittance basis applies to foreign *source* income, which is a different concept.[79]

See too 18.45 (Gain on disposal at undervalue).

56.17.1 *Disposal/accrual date*

The gain is treated as accruing at the date of the remittance. The gain is treated as not accruing on the date of the actual disposal, when it actually accrues. This is relevant for:

(1) Rate of CGT: rates depend on when gains accrue, so one applies the rate in the year of remittance, not the year of disposal.

[75] Para 5(2) sch 1 TCGA provides:
"For the purposes of this Schedule any reference to "the remittance basis" applying to an individual for a tax year is to section 809B, 809D or 809E of ITA 2007 applying to the individual for the year."

[76] Para 5(1) sch 1 TCGA provides a commonsense definition:
"For the purposes of this Schedule "foreign asset" means an asset situated outside the UK."

[77] Para 5(3) sch 1 TCGA provides:
"For the purposes of this Schedule any question as to whether, and when, amounts are "remitted to the UK" is determined in accordance with the rules in Chapter A1 of Part 14 of ITA 2007."

[78] See 103.1 (Situs of assets for CGT - Introduction).

[79] See 16.6 (No source/deemed source).

(2) EIS reinvestment relief: time limits for EIS relief depend on when gains accrue (not when the disposal takes place).[80]

Time limits for rollover relief depend on the date of disposal.[81] The drafter of the former para 16(4) schedule A1 TCGA clearly considered that the pre-2008 CGT remittance basis altered the date of disposal, ie the asset is regarded as disposed of at the time of remittance (not at the time of the actual disposal).[82] But for business asset disposal relief (formerly known as entrepreneurs' relief), HMRC regard the date of disposal as the date of the actual disposal, not the date of remittance.[83]

56.18 Remittance basis and taper/indexation

56.18.1 *Taper relief*

Para 56 sch 2 FA 2008 provides:

> (1) The amendments made by para 31(2) and (3) have effect where the intervening year is the tax year 2008-09 or any subsequent tax year.
> (2) The amendments made by paras 41 and 43 have effect where the eligible year is the tax year 2008-09 or any subsequent tax year.
> (3) The other amendments made by paras 23 to 55 have effect in relation to chargeable gains accruing or treated as accruing in the tax year 2008-09 or any subsequent tax year.

The important provision here is para 56(3).[84] This removes taper relief on gains on disposals before 2008/09 which are remitted after 2008/09. Computations of unremitted gains made before 2008 will need to be recomputed.

A different rule applies for s.1(3) amounts (trust gains).[85]

56.18.2 *Indexation relief*

Para 83 sch 2 FA 2008 provides:

> The amendments made by paragraphs 77 to 82 [which abolish the indexation allowance] have effect in computing gains on disposals made on or after 6 April 2008.

[80] Para 1 sch 5B TCGA.

[81] Section 152(3) TCGA

[82] See the 6th edition of this work, para 29.4.

[83] See 56.19.2 (Deadline for BADR claim).

[84] Para 56 (1)(2) relate to specialist topics, s.56A, 279A and 279B TCGA.

[85] See 61.42 (s.1(3) amount at 5/4/2008).

Assuming that this refers to the actual disposal, the effect is that indexation relief continues to apply to gains on pre-2008 disposals which are remitted after 6 April 2008. This is the HMRC view. The CG Manual provides:

> **CG25320 - Remittance basis: computing the foreign chargeable gain: indexation allowance and taper relief** [Nov 2019]
> When dealing with remittance basis cases the foreign chargeable gain should be computed as at the date of the disposal using all the normal computational rules.
> For disposals occurring after 5 April 1982 and before 6 April 1998 these rules will include an allowance for indexation up to the date of the disposal. No further allowance is due for indexation when the gain is remitted to the UK however long the interval is between the gain arising and the date of the remittance....

56.19 BAD relief: Remittance basis

The catchy name "business asset disposal relief" replaced "entrepreneurs' relief" in 2020. Presumably the old name had become an embarrassment. A full discussion of the relief needs a book to itself.

Taxguide 1/12 (Entrepreneurs' relief - practical points)[86] sets out the outcome of discussions with HMRC, and is discussed here. For other issues on BAD relief, see:

Topic	**See para**
TNR: BAD relief claim	11.9
BAD relief: Mixed fund	56.19.4
BAD relief: Trade group	64.35
s.86/87 and BAD relief interaction	60.17

56.19.1 *BADR and remittance basis*

Taxguide 1/12 provides:

> **EXAMPLE D1 – Foreign chargeable gains qualifying for ER fall within [what is now sch 1 TCGA, remittance basis]**
> 106 Section 169N(9) TCGA 1992 states that 'any gain or loss taken into account under subsection (1) is not to be taken account under this Act as a chargeable gain or an allowable loss.'
> 107 The Explanatory Notes published with the Finance Bill 2008

[86] *https://www.icaew.com/-/media/corporate/archive/files/technical/tax/taxguides/taxguide-1-12-er-final-at-25-jan-12.ashx*

indicate that the purpose of s 169N(9) is merely to ensure that where there is one ER disposal, and gains and losses are aggregated to determine the qualifying net ER gain, this cannot be segregated as gains and losses separately for CGT purposes. There have, however, been concerns about the interpretation of s 169N(9) and how it interacts with other provisions within TCGA 1992.

108 As can be seen from the responses to the following queries, HMRC considers that foreign chargeable gains qualifying for ER fall within [sch 1 TCGA] where such gains are realised by remittance basis users. The delay between the time the gains arises and when the remittance is made is no bar on the claiming of ER provided a valid ER claim is made within the specified time period (see Example D2).

56.19.2 *Deadline for BADR claim*

Taxguide 1/12 provides:

EXAMPLE D2 – The deadline for making an ER claim

109 The deadline for making an ER claim is linked to the tax year in which the qualifying business disposal is made, not to the tax year that the gain accrues to a taxpayer. Thus if a UK-resident foreign domiciliary wishes to make the claim for a qualifying business disposal of foreign property, it would seem that the following deadlines apply for disposals in the specified tax years, regardless of whether the chargeable gain has been remitted.

Tax year	**Claim deadline**
2008/09	31 January 2011
2009/10	31 January 2012
2010/11	31 January 2013
2011/12	31 January 2014

110 Does HMRC agree? How would it recommend that such a claim be made if it does not impact on the tax liability as there has been no remittance of the disposal proceeds?

HMRC response to Example D2

111 ER is only available on the making of a claim and such claim must be made within the statutory time limit which is set by reference to the date of the qualifying disposal (see s 169M(3) TCGA 1992). It is for the taxpayer to consider whether to submit a protective claim for ER within this time period.

Further note

112 This means that where a remittance basis user makes a qualifying gain in a tax year he or she has until the first anniversary of 31 January following the end of the tax year to decide whether or not to make the ER

> claim. The date that the proceeds are remitted is irrelevant.
> 113 For example: AB is a remittance basis user. He makes a £10m gain on a qualifying disposal in 2011/12 of shares in a foreign company (total proceeds £15m). He has not made any previous ER claims and so has the entire £10m ER allowance available. He does not expect to remit the proceeds from the gain for at least three years (having sufficient clean capital to supplement his UK income). If he wants to be able to benefit from ER on any eventual remittance of the proceeds he has until 31 January 2014 to make the ER claim. The fact that he will not have remitted the proceeds at that date is irrelevant to the claim deadline.
> 114 Where an ER claim is required prior to the gains being remitted there will be no gain shown on the tax return. The claim should be made by way of a note to the tax return, with the ER computation included.

56.19.3 *BAD relief limit*

There is a lifetime limit on BAD relief which has fluctuated wildly:

Date of disposal from	**Limit**
6 April 2008	£1 million.
6 April 2010	£2 million
23 June 2010	£5 million
6 April 2011	£10 million
11 March 2020	£1 million

Taxguide 1/12 provides:

> **EXAMPLE D3 – The raised ER limit**
> 115 It is understood that HMRC's settled view is that the ER limit to apply in respect of remittance basis gains is that which is in force when the gains arise.
> 116 For example, assuming there have been no other qualifying ER gains, where the disposal date for a qualifying ER gain of £5m (paid into a separate offshore bank account with interest being paid into a separate account) is 19 August 2008 and the proceeds are remitted on 25 October 2010, it is understood that HMRC believes that the £1m lifetime limit in force in 2008/09 applies, such that ER can only be claimed on £1m of the disposal. It would seem to follow from this that HMRC's view must be that the 4/9ths deduction applies to the gain rather than the special 10% tax rate. For a higher rate taxpayer this would mean that even the gain benefiting from ER will be subject to tax at 28% (meaning an effective 15.6% tax rate on the £1m gain benefiting from ER relief) with the £4m excess being taxed at 28%.
> 117 Can HMRC confirm that the above summarises its thoughts on the

issue?

HMRC response to Example D3

118 HMRC agree with the analysis. The ER limit to apply with respect to remittance basis gains is that which is in force when the qualifying disposal is made, not when any proceeds are remitted.

56.19.4 *BAD relief: Mixed fund*

Taxguide 1/12 provides:

EXAMPLE D4 – The ER provisions prior to 23 June 2010 and the mixed fund rules

119 The ER legislation at s 169N(4) TCGA 1992 states:

> The amount arrived at under subsections (1) to (3) is to be treated for the purposes of this Act as a chargeable gain accruing at the time of the disposal to the individual or trustees by whom the claim is made.

120 Does HMRC agree that this means that for the purposes of the mixed fund rules (s 809Q ITA 2007) the amount that will go into the foreign chargeable gains category is the amount of the gain after ER (ie after the 4/9ths reduction)?

HMRC response to Example D4

121 The amount to be included in a mixed fund under s 809Q(4) ITA 2007 is the gain as restricted by s 169N.

EXAMPLE D5 – How does ER relief work for remittance basis users given it is now a tax rate?

122 It is clear that without the 4/9ths discount provisions, which reduced the gain itself, the mixed fund rules work somewhat differently. It is unclear whether, in situations where the gain is in excess of the unused ER lifetime allowance, this means that:

- ER can be applied such that 10% tax is paid on the amount on which ER can be claimed (either the £10m lifetime limit or that limit less the aggregate of prior ER claims made) with future remittances being taxed at the full rates.
- Or, that a blended rate has to be used.

123 As an example: the capital gain on a disposal of shares by a UK-resident foreign domiciliary is, say, £13m. The individual has not made a prior ER claim and the first £10m is remitted over a number of years. Can you apply ER to this first £10m or do you have to use a blended rate because the actual gain exceeds £10m?

HMRC response to Example D5

124 Wherever there is a qualifying disposal and a chargeable gain that attracts the tax rate of 10% and there is a balance of that gain that is taxable at either 18% or 28% (and indeed where the individual may have other gains that do not qualify for ER), then the question arises of how

these elements are identified for the purposes of s 12 TCGA 1992.

86 HMRC considers that the mixed fund rules in ITA 2007 may be used to identify and quantify the remittance of the foreign chargeable gain. In the absence of a statutory rule for determining whether or not the gains brought into charge under s 12 are liable at the 10% rate, the onus is on the individual to nominate the 10% rate to apply to the maximum extent (by reference to the computational rules in ss (4)–(4B) of s 169N) in priority to other rates and the individual can do so as part of the normal self assessment process.

Further note

125 We have confirmed with HMRC that the above response means that in the example given the taxpayer would be able to claim on his or her self assessment return that the first £10m remitted is taxed at the special 10% rate.

127 For example: the disposal occurred in 2011/12 and pattern of remittance was as follows:

5m in 2011/12;
5m in 2012/13; and
3m in 2013/14.

Provided an ER claim is made the taxpayer can claim that the remittances in 2011/12 and 2012/13 are taxed at the 10% ER rate.

56.20 Winding-up offshore company

Suppose:

(1) F (a remittance basis taxpayer) owns non-UK situate shares.
(2) The company is put into liquidation and F receives a capital distribution from the liquidator.

F is treated as if F had disposed of the shares in consideration of the distribution.[87] The gain is taxable if the liquidator transfers to the shareholder money in the UK. So the liquidator should transfer the money to F’s account outside the UK.

The same applies if the liquidator transfers UK land to F, but this problem could only be avoided if the liquidator sold the land and transferred the proceeds to F outside of the UK.

56.21 Trust a taxable unit

The general scheme of CGT is that a trust is treated as a distinct taxable unit. A number of rules follow from or expand on this principle:

[87] Section 122 TCGA

Rule	**See para**	**Non-resident exception**
Gains taxed on trustees, not beneficiaries	56.21.1	60.1
Trust interest not a chargeable asset	56.21.2	56.21.3
Transfer to trust is a disposal	56.21.4	
Termination of trust is a disposal	56.21.5	
Trustees treated as distinct person	7.3	

The first two of these rules are modified for non-resident trusts, where they could be used for avoidance.

56.21.1 *CGT on UK resident trust*

A UK resident trust is in principle subject to CGT:

(1) the residence/domicile of settlor/beneficiaries is not relevant

(2) the situs of trust assets is not relevant.

The remittance basis does not apply as that only applies to individuals[88] and trustees are not individuals.

One might avoid this problem for gains accruing in the future by exporting the trust (appointing non-resident trustees) but there will in principle be a migration charge.[89]

One solution may be to transfer assets from the trust to UK resident foreign domiciled beneficiaries absolutely. Although this involves a disposal by the trustees, see below, it may be possible to claim CGT hold-over relief.[90] The relief applies on a disposal to a foreign domiciled beneficiary, even though that beneficiary may later be able to dispose of the asset without a CGT charge. This is confirmed, if confirmation is needed, in *McLaughlin v HMRC*.[91]

56.21.2 *Trust interest not chargeable asset*

Section 76(1) TCGA provides:

> Subject to subsection (1A) below
>
> [a] no chargeable gain shall accrue on the disposal of an interest created by or arising under a settlement (including, in particular, an annuity or life interest, and the reversion to an annuity or life interest)
>
> [b] [i] by the person for whose benefit the interest was created by the terms of the settlement or

[88] See 56.17 (CGT remittance basis).

[89] See 12.4 (Charge on emigration of trust).

[90] See 57.31 (Hold-over relief).

[91] [2012] UKFTT 174 (TC).

> [ii] by any other person except one who acquired, or derives his title from one who acquired, the interest for a consideration in money or money's worth, other than consideration consisting of another interest under the settlement.

A note on terminology. In English trust law, an interest created by or arising under a settlement is described as an "equitable interest". I prefer the expression "trust interest", which is also apt in trust jurisdictions without equity, such as Scotland and the Channel Islands.

56.21.3 *Non-resident trust interest*

Section 76 TCGA provides an exception to the relief for trust interests in s.76(1):

> (1A) Subject to subsection (3) below, subsection (1) above does not apply if—
> (a) the settlement falls within subsection (1B) below; or
> (b) the property comprised in the settlement is or includes property deriving directly or indirectly from a settlement falling within that subsection.
>
> (1B) A settlement falls within this subsection if there has been a time when the trustees of that settlement—
> (a) were not resident in the UK; or
> (b) fell to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the UK.

This could lead to double taxation. The problem is exacerbated by the rule that when a trust interest is conferred on a beneficiary, the base cost of the interest is nil: acquisition is not at market value.[92] Fortunately, interests in non-resident trusts are generally subject to powers of appointment. So a beneficiary does not normally dispose of the interest (the exercise of the power of appointment is not a disposal); and if there is a disposal, it does not matter as the market value of the interest is nil.

If a beneficiary disposes of an interest under a trust for actual consideration, it is necessary to consider sch 4A TCGA. I do not discuss this here as in practice this (almost) never happens.

56.21.4 *Disposal on transfer into trust*

Section 70 TCGA provides:

[92] See App.4.8.1 (Acquisition without disposal).

> A transfer into settlement, whether revocable or irrevocable, is a disposal of the entire property thereby becoming settled property
> [a] notwithstanding that the transferor has some interest as a beneficiary under the settlement and
> [b] notwithstanding that he is a trustee, or the sole trustee, of the settlement.

56.21.5 *Disposal on trust termination*

Section 71(1) TCGA provides:

> On the occasion when a person becomes absolutely entitled to any settled property as against the trustee[93] all the assets forming part of the settled property to which he becomes so entitled shall be deemed to have been
> [a] disposed of by the trustee, and
> [b] immediately reacquired by him in his capacity as a trustee within section 60(1) [ie, as bare trustee],
> for a consideration equal to their market value.

The CG Manual discusses valuation issues on this deemed disposal:

> **CG37300 occasions of absolute entitlement** [Nov 2023]
> Where two or more beneficiaries simultaneously become absolutely entitled to unquoted shares held as settled property (for example on the death of a life tenant or on the occurrence of a contingency), the number of shares to be valued, see CG59590, is the total number of shares which are deemed to have been disposed of by the trustees on that occasion, and not the proportionate number of shares to which each beneficiary has become absolutely entitled. If possible you should agree with the trustees what is to be valued before completing the form CG30.
> Where, therefore, the total number of shares deemed to have been disposed of by the trustees represents a majority holding, the shares must be valued on that basis even though each of the beneficiaries may have become absolutely entitled to shares representing only a minority holding. The valuation of unquoted shares is a matter for Shares and

[93] The standard CGT definition applies, see 87.7.3 (Entitled against trustee), but is extended by s.71(3) TCGA:

> "References in this section to the case where a person becomes absolutely entitled to settled property as against the trustee shall be taken to include references to the case where a person would become so entitled but for being an infant or other person under disability."

The extended wording (more or less) matches the definition of bare trust for CGT; see 87.7 (Bare trust/nomineeship).

> Assets Valuation, but it is the officer's responsibility to tell SAV what is to be valued. (As a general rule the value per share increases as the percentage holding increases.)
>
> Where however, on the exercise of a Power of Appointment etc. under a single or successive deeds, two or more beneficiaries each become absolutely entitled as against the trustees to a specified number of shares, the parcels of shares appointed to each beneficiary should be valued separately.
>
> For example, if 50 shares are appointed to A and under the same, or a separate, deed, 50 shares are appointed to B the valuation should be on the basis of two parcels each of 50 shares for the purpose of computing the chargeable gain on the trustees' deemed disposals of the shares.

If the trustees and the beneficiaries are connected persons, see CG14590+, then consideration should be given to the application of TCGA92/S19, see CG14650+.

Section 71(2)-(2D) TCGA deal with losses on the deemed disposal, not discussed here.

Section 76 TCGA provides:

> (2) Subject to subsection (1) above, where a person who has acquired an interest in settled property (including in particular the reversion to an annuity or life interest) becomes, as the holder of that interest, absolutely entitled as against the trustee to any settled property,[94] he shall be treated as disposing of the interest in consideration of obtaining that settled property (but without prejudice to any gain accruing to the trustee on the disposal of that property deemed to be effected by him under section 71(1)).
>
> (3) Subsection (1A) above shall not prevent subsection (1) above from applying where the disposal in question is a disposal in consideration of obtaining settled property that is treated as made under subsection (2) above.

Since transfers of trust interests are rare, it is not usually necessary to consider this.

56.22 CGT treatment of debts

The legislation is in s.251, 252 TCGA. The drafting is convoluted; but it works.

[94] The standard CGT definition applies, see 87.7.3 (Entitled against trustee).

56.22.1 *CGT debt exemption*

Section 251(1) TCGA provides:

> [a] Where a person incurs a debt to another, whether in sterling or in some other currency, no chargeable gain shall accrue to
> [i] that (that is the original) creditor
> [ii] or his personal representative
> [iii] or legatee
> on a disposal of the debt,
> [b] except in the case of the[95] debt on a security (as defined in section 132).

I refer to this as **"CGT debt exemption"**.

I call debts within the exemption **"first-hand debts"** and debts outside the exemption are **"second-hand debts"**. These are slightly inaccurate labels (because debts acquired from a trust or estate may be within the exemption) but no short label will encapsulate the complex rules.

I discuss the following aspects elsewhere:

Topic	**See para**
Debt on a security	App 2.11
Foreign currency bank account	95.10
CGT base cost of debt	App 4.8.1

The CGT debt exemption has been described as a provision "of notable obscurity, the purpose and philosophy of which it is difficult to detect".[96] But it seems straightforward. A first-hand debt (other than a debt on a security) could give rise to a gain,[97] but is more likely to give rise to a loss.[98] If the gain is chargeable, the loss should be allowable. The balance of advantage to HMRC lies in exemption. Exemption is a simple if rough and ready solution. The same thinking lies behind the CGT exemption for cars.

[95] '*The* debt' is just a slip for '*a* debt', though comity seems to have prevented the courts from saying so. Nothing turns on the definite article, but it has perhaps added to the section's reputation for obscurity.

[96] *Marren v Ingles* 54 TC 76 at p.96.

[97] Sterling loans may give rise to a gain, eg a fixed term fixed interest rate loan where commercial interest rates fall; foreign currency debts may give rise to a currency gain; but if one assumes currencies or interest rates may equally likely move in either direction, losses are still more likely than gains,

[98] Because of the risk that the debt may become irrecoverable.

56.22.2 *Meaning of "debt"*

The word "debt" has a variety of meanings.[99] Debt is a common word in tax, but the problem of its meaning has not often arisen, except in the context of the CGT debt exemption. In this context, a contingent obligation to pay an uncapped, unascertainable amount at an unknown date is not a "debt".[100] Tax practitioners generally have this at the back of their minds when they use the word debt. But in other contexts the word has a wider meaning.[101]

It follows that an asset which is not a debt (because the amount is unascertainable) may become a debt (when the amount is ascertained). But the CGT debt exemption "only applies to an obligation which has been a debt from the time it came into existence, or at least from the time when it was acquired by the taxpayer".[102]

56.22.3 *Debt exemption for beneficiaries*

Under s.251(1) the persons qualifying for CGT debt exemption are:

(1) the original creditor
(2) their personal representative
(3) legatees

Section 251(5) TCGA extends the exemption to beneficiaries who acquire the benefit of a debt from a trust:

> Where the trustees of a settlement are the original creditor, subsections (1) and (4) above shall apply as if for the references to the original creditor's personal representative or legatee there were substituted references to any person becoming absolutely entitled, as against the trustees,[103] to the debt on its ceasing to be settled property, and to that person's personal representative or legatee

Amended as directed, s.251(1) provides (in short) that where a person incurs a debt to a trust:

> [a] no chargeable gain shall accrue to

[99] See *Marren v Ingles* 54 TC 76 at p.89-91, where several cases are cited, in a passage approved by HL at p.97A; see too 80.1 (Liability/debt compared).

[100] See *Marren v Ingles* 54 TC 76.

[101] For an example, see 102.25 (Insurance policy).

[102] 54 TC 76 at p.100.

[103] The standard CGT definition applies; see 87.7.3 (Entitled against trustee).

> [i] any person becoming absolutely entitled, as against the trustees, to the debt on its ceasing to be settled property,
> [ii] that person's personal representative or legatee
> on a disposal of the debt,
> [b] except in the case of the debt on a security ...

So the CGT debt exemption is quite restricted. If a creditor gives the benefit of the debt to a donee, the donee does not qualify for relief on a subsequent disposal. Indeed, they may be taxable on a gain from the debt without relief for losses. This applies even to a gift to a spouse.

56.22.4 *"Disposal" of debt*

Section 251(2) TCGA provides:

> [1] Subject to the provisions of sections 132, 135 and 136 [reorganisations]
> [2] and subject to subsection (1) above [CGT debt exemption],
> [3] the satisfaction of a debt or part of it (including a debt on a security as defined in section 132) shall be treated as a disposal of the debt or of that part by the creditor made at the time when the debt or that part is satisfied.

I would have thought that satisfaction of a debt was a disposal in the general sense, and a disposal in the s.24 sense as the debt ceases to exist;[104] but it does not matter if s.251(2) is strictly unnecessary.

56.22.5 *Acquisition in satisfaction of debt*

Section 251(3) TCGA needs to be split up into parts to make sense of it:

> Where property is acquired by a creditor in satisfaction of his debt or part of it, then
> [1] [a] subject to the provisions of sections 132, 135 and 136 [reorganisations]
> [b] the property shall not be treated as disposed of by the debtor or acquired by the creditor for a consideration greater than its market value at the time of the creditor's acquisition of it;

So in an arm's length disposal, the property is treated as disposed of/acquired for the lower of:
(1) Market value

[104] See 56.3.1 ("Disposal").

(2) the value of the consideration given for the asset (the value of the debt)

Section 251(3) continues:

> [2] [a]but if under subsection (1) above (and in a case not falling within section 132, 135 or 136 [reorganisations]
> [i] no chargeable gain is to accrue on a disposal of the debt by the creditor (that is the original creditor), and
> [ii] a chargeable gain accrues to him on a disposal by him of the property,
> the amount of the chargeable gain shall (where necessary) be reduced so as not to exceed the chargeable gain which would have accrued if he had acquired the property for a consideration equal to the amount of the debt or that part of it.

I find that a bit surprising.

56.22.6 *Loss on disposal of debt*

A loss on a first-hand debt is not allowable as the gain is not chargeable.[105] Section 251(4) TCGA deals with attempts to avoid the inconvenience of that rule:

> A loss accruing on the disposal of a debt
> [a] acquired by the person making the disposal from the original creditor or his personal representative or legatee
> [b] at a time when the creditor or his personal representative or legatee is a person connected with the person making the disposal,
> [c] and so acquired either directly or by one or more purchases through persons all of whom are connected with the person making the disposal,
> shall not be an allowable loss.

This prevents arrangements which could give rise to an allowable loss; eg a gift of a debt to a spouse. The rule could work unfairly, as the owner of the second-hand debt is subject to tax on the gain and has no relief for the loss; but there it is.

56.22.7 *Interest in debt*

Section 251(5A) TCGA provides:

> References in this section to the disposal of a debt include the disposal

[105] See 65.6 (Allowable loss).

> of an interest in a debt (and, in the case of an interest in a debt, the reference in subsection (3) to the amount of the debt is to the amount of the person's interest in the debt).

56.23 DT relief for capital gains

Art13(5) OECD Model	**Art 13(5) US/UK DTA**
Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.	Gains from the alienation of any property other than property referred to in the preceding paragraphs of this Article shall be taxable only in the Contracting State of which the alienator is a resident.

The exceptions are:

OECD Model	**US DTA**	**Topic**	**See para**
Art.13(1)	13(1)(2)	Immovable property	56.24.1
Art.13(2)	13(3)	Permanent Establishment	56.24.2
Art.13(3)	13(4)	Ships/Aircraft	56.24.3
Art.13(4)	-	Land-rich company	56.24.4
-	13(6)	Former residents	

Subject to those exceptions, taxing rights are given to the residence State and not the source State.

For losses, see 65.24 (DT relief: gain + loss).

Article 9 BEPS MLI[106] makes provision for land-rich companies. The UK has opted out of this, so it will not be considered here, though it is found in some UK DTAs.

56.23.1 *"Gains"*

The text of art 13 refers to "gains" but the heading of the article is "capital gains".

OECD Commentary provides:

> 5. The Article does not give a detailed definition of capital gains. This is not necessary for the reasons mentioned above. ...
> 11. The Article does not distinguish as to the origin of the capital gain. Therefore all capital gains, those accruing over a long term, parallel to a steady improvement in economic conditions, as well as those accruing in a very short period (speculative gains) are covered. Also capital gains

[106] See 107.15 (BEPS multilateral instrument).

> which are due to depreciation of the national currency are covered. It is, of course, left to each State to decide whether or not such gains should be taxed.

In *Royal Bank of Canada v HMRC*:[107]

> As to what constitutes capital gains rather than income profits, the effect of Article 3(2) of the Treaty is that that question is determined by reference to the tax laws of the relevant Contracting State ... because the term is not defined in the Treaty.

56.23.2 *Gain subject to income tax*

OECD Commentary provides:

> 3.1 [a] ... The Article does not specify to what kind of tax it applies. It is understood that the Article must apply to all kinds of taxes levied by a Contracting State on capital gains.
>
> [b] The wording of Article 2 [Taxes Covered] is large enough to achieve this aim and to include also special taxes on capital gains.

The reference in para [b] is to art 2(1)(2) OECD Model. The difficulty in relying on those provisions as justification for the proposition at para [a] is that they are not usually included in UK DTAs.[108] But it is not necessary to rely on those provisions. In UK tax law the word "gain" is used to describe capital gains subject to income tax, such as chargeable-event gains, offshore income gains,[109] TiL gains,[110] and many other examples could be given. Income tax was once a tax on income, but it is not now.[111]

56.23.3 *Computation of gain*

The computation of gain does not matter if the gain is exempt under art 13(5) but it may matter if the gain is taxable but foreign tax credit relief applies.

OECD Commentary provides:

> 12. The Article does not specify how to compute a capital gain, this being left to the domestic law applicable. As a rule, capital gains are

[107] [2023] EWCA Civ 695 at [51].

[108] See 107.13 (Taxes Covered).

[109] See 67.25 (DT reliefs: OIG).

[110] See 22.12.4 (Capital gain).

[111] See 14.5 (Income Tax: a tax on income?)

calculated by deducting the cost from the selling price. To arrive at cost all expenses incidental to the purchase and all expenditure for improvements are added to the purchase price. In some cases the cost after deduction of the depreciation allowances already given is taken into account. Some tax laws prescribe another base instead of cost, e.g. the value previously reported by the alienator of the asset for capital tax purposes.

13. Special problems may arise when the basis for the taxation of capital gains is not uniform in the two Contracting States. The capital gain from the alienation of an asset computed in one State according to the rules mentioned in paragraph 12 above, may not necessarily coincide with the capital gain computed in the other State under the accounting rules used there. This may occur when one State has the right to tax capital gains because it is the State of situs while the other State has the right to tax because the enterprise is a resident of that other State.

14. The following example may illustrate this problem:

an enterprise of State A bought immovable property situated in State B. The enterprise may have entered depreciation allowances in the books kept in State A.

If such immovable property is sold at a price which is above cost, a capital gain may be realised and, in addition, the depreciation allowances granted earlier may be recovered.

State B, in which the immovable property is situated and where no books are kept, does not have to take into account, when taxing the income from the immovable property, the depreciation allowances booked in State A. Neither can State B substitute the value of the immovable property shown in the books kept in State A for the cost at the time of the alienation.

State B cannot, therefore, tax the depreciation allowances realised in addition to the capital gain as mentioned in paragraph 12 above.

15. On the other hand, State A of which the alienator is a resident, cannot be obliged in all cases to exempt such book profits fully from its taxes under paragraph 1 of the Article ... To the extent that such book profits are due to the realisation of the depreciation allowances previously claimed in State A and which had reduced the income or profits taxable in such State A, that State cannot be prevented from taxing such book profits.[112]

[112] The Commentary continues: “The situation corresponds to that dealt with in paragraph 44 of the Commentary on Article 23 A.” But as the UK does not adopt Article 23A, we need not pursue this here.

56.23.4 *Foreign currency gain*

OECD Commentary provides:

> 16. Further problems may arise in connection with profits due to changes of the rate of exchange between the currencies of State A and State B. After the devaluation of the currency of State A, enterprises of such State A may, or may have to, increase the book value of the assets situated outside the territory of State A. Apart from any devaluation of the currency of a State, the usual fluctuations of the rate of exchange may give rise to so-called currency gains or losses. Take for example an enterprise of State A having bought and sold immovable property situated in State B. If the cost and the selling price, both expressed in the currency of State B, are equal, there will be no capital gain in State B. When the value of the currency of State B has risen between the purchase and the sale of the asset in relation to the currency of State A, in the currency of that State a profit will accrue to such enterprise. If the value of the currency of State B has fallen in the meantime, the alienator will sustain a loss which will not be recognised in State B. Such currency gains or losses may also arise in connection with claims and debts contracted in a foreign currency. If the balance sheet of a permanent establishment situated in State B of an enterprise of State A shows claims and debts expressed in the currency of State B, the books of the permanent establishment do not show any gain or loss when repayments are made. Changes of the rate of exchange may be reflected, however, in the accounts of the head office. If the value of the currency of State B has risen (fallen) between the time the claim has originated and its repayment, the enterprise, as a whole, will realise a gain (sustain a loss). This is true also with respect to debts if between the time they have originated and their repayment, the currency of State B has fallen (risen) in value.
>
> 17. The provisions of the Article do not settle all questions regarding the taxation of such currency gains. Such gains are in most cases not connected with an alienation of the asset; they may often not even be determined in the State on which the right to tax capital gains is conferred by the Article. Accordingly, the question, as a rule, is not whether the State in which a permanent establishment is situated has a right to tax, but whether the State of which the taxpayer is a resident must, if applying the exemption method, refrain from taxing such currency gains which, in many cases, cannot be shown but in the books kept in the head office. The answer to that latter question depends not only on the Article but also on Article 7 and on Article 23 A. If in a given case differing opinions of two States should result in an actual

> double taxation, the case should be settled under the mutual agreement procedure provided for by Article 25.

56.23.5 *Sale for annuity*

OECD Commentary provides:

> 18. Moreover the question arises which Article should apply when there is paid for property sold an annuity during the lifetime of the alienator and not a fixed price. Are such annuity payments, as far as they exceed costs, to be dealt with as a gain from the alienation of the property or as "income not dealt with" according to Article 21? Both opinions may be supported by arguments of equivalent weight, and it seems difficult to give one rule on the matter. In addition such problems are rare in practice, so it therefore seems unnecessary to establish a rule for insertion in the Convention. It may be left to Contracting States who may be involved in such a question to adopt a solution in the mutual agreement procedure provided for by Article 25.

56.23.6 *Prizes*

OECD Commentary provides:

> 19. The Article is not intended to apply to prizes in a lottery or to premiums and prizes attaching to bonds or debentures.

56.23.7 *Share buy-back/liquidation*

The issue here is whether the proceeds of a purchase of own shares or liquidation are dividends (within art 10) or gains (within art 13).

OECD Commentary provides:

> 31. If shares are alienated by a shareholder in connection with the liquidation of the issuing company or the redemption of shares or reduction of paid-up capital of that company, the difference between the proceeds obtained by the shareholder and the par value of the shares may be treated in the State of which the company is a resident as a distribution of accumulated profits and not as a capital gain. The Article does not prevent the State of residence of the company from taxing such distributions at the rates provided for in Article 10: such taxation is permitted because such difference is covered by the definition of the term "dividends" contained in paragraph 3 of Article 10 and interpreted in paragraph 28 of the Commentary relating thereto, to the extent that the domestic law of that State treats that difference as income from shares. As explained in paragraphs 32.1 to 32.7 of the Commentary on Articles

> 23A and 23B, where the State of the issuing company treats the difference as a dividend, the State of residence of the shareholder is required to provide relief of double taxation even though such a difference constitutes a capital gain under its own domestic law. The same interpretation may apply if bonds or debentures are redeemed by the debtor at a price which is higher than the par value or the value at which the bonds or debentures have been issued; in such a case, the difference may represent interest and, therefore, be subjected to a limited tax in the State of source of the interest in accordance with Article 11 (see also paragraphs 20 and 21 of the Commentary on Article 11).
>
> 32. There is a need to distinguish the capital gain that may be derived from the alienation of shares acquired upon the exercise of a stock-option granted to an employee or member of a board of directors from the benefit derived from the stock-option that is covered by Article 15 or 16. The principles on which that distinction is based are discussed in paragraphs 12.2 to 12.5 of the Commentary on Article 15 and paragraph 3 of the Commentary on Article 16.

56.23.8 *"Alienation"*

OECD Commentary provides:

> 5. ...The words "alienation of property" are used to cover in particular capital gains resulting from the sale or exchange of property and also from
> [a] a partial alienation,
> [b] the expropriation,
> [c] the transfer to a company in exchange for stock,
> [d] the sale of a right,
> [e] the gift
> [f] and even the passing of property on death.
>
> 6. Most States taxing capital gains do so when an alienation of capital assets takes place. Some of them, however, tax only so-called realised[113] capital gains. Under certain circumstances, though there is an alienation no realised capital gain is recognised for tax purposes (e.g. when the alienation proceeds are used for acquiring new assets). Whether or not there is a realisation [in UK tax terms, whether a gain accrues on a disposal or whether it is a no gain/no loss disposal] has to be determined according to the applicable domestic tax law. No particular problems arise when the State which has the right to tax does not exercise it at the time the alienation takes place.

[113] UK tax lawyers do not use the word "realised" in this sense.

56.23.9 *Alienation: Deemed disposal*

The Supreme CoA of South Africa has held that "alienation" includes a deemed disposal:

> [24] Article 13 is widely cast. It includes within its ambit capital gains derived from the alienation of all property. It is reasonable to suppose that the parties to the DTA were aware of the provisions of the Eighth Schedule and must have intended Art 13 to apply to capital gains of the kind provided in the Schedule. It is of significance that no distinction is drawn in Art 13(4) between capital gains that arise from actual or deemed alienations of property. There is moreover no reason in principle why the parties to the DTA would have intended that Art 13 should apply only to taxes on actual capital gains resulting from actual alienations of property.
> [25] Having regard to the factors mentioned, I am of the view that the term 'alienation' as it is used in the DTA is not restricted to actual alienation. It is a neutral term having a broader meaning, comprehending both actual and deemed disposals of assets giving rise to taxable capital gains.[114]

The same point should apply in the UK, which is important because deemed disposals for CGT are very common.

OECD Commentary provides:

> 7. As a rule, appreciation in value not associated with the alienation of a capital asset is not taxed, since, as long as the owner still holds the asset in question, the capital gain exists only on paper. There are, however, tax laws under which capital appreciation and revaluation of business assets are taxed even if there is no alienation.
> 8. Special circumstances may lead to the taxation of the capital appreciation of an asset that has not been alienated. This may be the case if the value of a capital asset has increased in such a manner that the owner proceeds to the revaluation of this asset in his books. Such revaluation of assets in the books may also occur in the case of a depreciation of the national currency. A number of States levy special taxes on such book profits, amounts put into reserve, an increase in the paid-up capital and other revaluations resulting from the adjustment of the book-value to the intrinsic value of a capital asset. These taxes on capital appreciation (increment taxes) are covered by the Convention

[114] *Commissioner for the South African Revenue Service v Tradehold* [2012] ZASCA 61, 14 ITELR 967.

> according to Article 2 [Taxes Covered].[115]
>
> 9. Where capital appreciation and revaluation of business assets are taxed, the same principle should, as a rule, apply as in the case of the alienation of such assets. It has not been found necessary to mention such cases expressly in the Article or to lay down special rules. The provisions of the Article as well as those of Articles 6, 7 and 21 [immovable property/business profits/Other Income], seem to be sufficient. As a rule, the right to tax is conferred by the above-mentioned provisions on the State of which the alienator is a resident, except that in the cases of immovable property or of movable property forming part of the business property of a permanent establishment, the prior right to tax belongs to the State where such property is situated. Special attention must be drawn, however, to the cases dealt with in paragraphs 13 to 17 below.[116]
>
> 10. In some States the transfer of an asset from a permanent establishment situated in the territory of such State to a permanent establishment or the head office of the same enterprise situated in another State is assimilated to an alienation of property. The Article does not prevent these States from taxing profits or gains deemed to arise in connection with such a transfer, provided, however, that such taxation is in accordance with Article 7.

56.24 DT CGT relief: Exceptions

OECD Commentary provides:

> 4. It is normal to give the right to tax capital gains on a property of a given kind to the State which under the Convention is entitled to tax both the property and the income derived therefrom.

The OECD model has four exceptions to CG relief, and one further exception is quite commonly found. The exceptions are:

Topic	**Article**	**See para**
Immovable property	13(1)	56.24.1
Business property of a PE	13(2)	56.24.2
Ships/aircraft	13(3)	56.24.3
Land rich company	13(4)	56.24.4
Recently departed resident	-	56.24.5

[115] This should be so even in UK treaties which do not include art 2(1)(2) OECD Model. See 107.13 (Taxes Covered).

[116] See 56.23.3 (Computation of gain).

56.24.1 *Immovable property*

Article 13(1) OECD Model provides:

> Gains derived[117] by a resident of a Contracting State from the alienation of immovable property referred to in Article 6[118] and situated in the other Contracting State may be taxed in that other State.

56.24.2 *Business property of PE*

Article 13(2) OECD Model provides:

> Gains from the alienation of
> [a] movable property forming part of the business property of a permanent establishment[119] which an enterprise of a Contracting State has in the other Contracting State,
> [b] including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise),
> may be taxed in that other State.

OECD Commentary provides:

> 4. The right to tax a gain from the alienation of a business asset must be given to the same State without regard to the question whether such gain is a capital gain or a business profit. Accordingly, no distinction between capital gains and commercial profits is made nor is it necessary to have special provisions as to whether the Article on capital gains or Article 7 on the taxation of business profits[120] should apply. It is however left to the domestic law of the taxing State to decide whether a tax on capital gains or on ordinary income must be levied. The Convention does not prejudge this question.

In many countries, though not in the UK, gains on business property of a PE are taxed as business income.

56.24.3 *Ships and aircraft*

For completeness: art 13(3) OECD Model provides:

> Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property

[117] See 15.11.1 ("Deriving" income).

[118] This incorporates the definition in Article 9(2); see 24.7.1 ("Immovable property").

[119] See 107.14 (Effectively connected with PE).

[120] See 21.23 (DT relief: trading income).

> pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

56.24.4 *Land-rich company*

Article 13(4) OECD Model provides:

> Gains derived by a resident of a Contracting State from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the other Contracting State if, at any time during the 365 days preceding the alienation, these shares or comparable interests derived more than 50 per cent of their value directly or indirectly from immovable property, as defined in Article 6, situated in that other State.

This clause is not often found in UK treaties but about half a dozen recent treaties have some wording along these lines.[121]

Article 9 BEPS MLI provides alternative rules, but the UK has reserved the right for this not to apply to its Covered Tax Agreements, so it need not be considered here.

56.24.5 *Recently departed resident*

The CG article in some DTAs restricts CG relief for residents of one State who have recently left the other State. This is not in OECD Model, but about one third of UK treaties have a restriction of this kind. A variety of wordings are found, and I take Italy and USA as examples.

Treaties are easier to follow if one notes in the text which Contracting State is which. Article 13(5) Italy/UK DTA provides:

> The provisions of paragraph (4) of this Article [CG relief] shall not affect the right of a Contracting State [UK] to levy according to its law a tax on gains from the alienation of any property derived by an individual who:
> (a) is a resident of the other Contracting State [Italy]; and
> (b) has been a resident of the first-mentioned Contracting State [UK] at any time during the five years immediately preceding the alienation of the property; and
> (c) is not subject to tax on those gains in the other Contracting State [Italy].

Article 13(6) USA/UK DTA is similar, but specifies 6 years instead of 5, and lacks para (c):

[121] Including: Hungary, Libya, Zambia, Senegal, China, Morocco, Ethiopia.

> The provisions of paragraph 5 of this Article [CG relief] shall not affect the right of a Contracting State [UK] to levy according to its law a tax on gains from the alienation of any property derived by an individual who
> [a] is a resident of the other Contracting State [US] and
> [b] has been a resident of the first-mentioned Contracting State [UK] at any time during the six years immediately preceding the alienation of the property.

This does not impose a charge, but it means that the CGT charge on temporary non-residents who return to the UK is consistent with the treaty. It does not strictly matter, for UK tax, as if the clause is not there, there is a treaty override in any event.[122] But it may matter to treaty-partners (and others) who think the UK ought not to impose tax in breach its treaty obligations. The USA/UK DTA Technical Explanation provides:[123]

> Paragraph 6 allows each Contracting State to tax gains derived by certain non-residents who used to be residents of that Contracting State. The rule is included in the Convention in order to allow the UK to apply its domestic law regarding such sales. Under UK law, a former resident who re-establishes residence in the UK within five years will remain subject to tax in the UK on any gains realized during the period of nonresidence. The analogous US rules of section 877 are preserved by paragraph 6 of Article 1 (General Scope).
>
> Although the rules allow each of the Contracting States to apply their domestic anti-abuse rules, the foreign tax credit rules provided in paragraphs 2 and 4 of Article 24 (Relief from Double Taxation) ensure that the Contracting State applying an anti-abuse rule to a resident of the other Contracting State maintains only a residual right to tax. The primary right to tax remains with the country of residence. Accordingly, pursuant to subparagraph (b) of paragraph 2 of Article 24, if the gains subject to this rule are derived while the former UK resident was a resident of the United States, then such gains are considered to be gains from sources within the United States. Pursuant to paragraph 4 of Article 24, the UK will grant a foreign tax credit for US tax imposed upon those gains.
>
> Example. In year 1, UK resident A purchases stock in a Country X company for $1,000. A moves to the United States in year 2, when the fair market value of the stock is $2,000. In year 3, while A is still a US resident, A sells the Country X stock. In year 4, after the sale of the

[122] See 11.8 (DTA override: Gains).

[123] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> Country X stock, A moves back to the UK and re-establishes residence. Under Article 13 (6), both the United States and the UK may tax the gain on the sale of the property in year 3. Under Article 24, however, the gain from the sale of the Country X stock is deemed to be from sources within the United States because A was a US resident when the sale occurred and gains from the stock could be taxed by the UK only pursuant to paragraph 6 of Article 13 (that is, the stock could not be taxed under paragraph 1 or 3 of Article 13). Thus the UK is required to provide a foreign tax credit for US taxes paid with respect to gain on the disposition of the Country X stock.

56.24.6 *Foreign tax credit relief*

Where the full CG relief does not apply, foreign tax credit relief applies to avoid double taxation. For an example of the operation of FTCR in the USA/UK DTA, see 111.24 (Credit for TNR CGT).

56.25 DT relief: Remittance basis

Section 12 TCGA provides:

> (1) This section applies to foreign chargeable gains accruing to an individual in a tax year ("the foreign chargeable gains") if—
> (a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for that year, and
> (b) the individual is not domiciled in the UK in that year.
> (2) Chargeable gains are treated as accruing to the individual in any tax year in which any of the foreign chargeable gains are remitted to the UK.
> (3) The amount of chargeable gains treated as accruing is equal to the full amount of the foreign chargeable gains so remitted in that year.

Art.13(5) OECD Model provides (with immaterial exceptions):

> Gains from the alienation of any property ... shall be taxable only in the Contracting State of which the alienator is a [treaty-resident].

Suppose:

(1) A remittance basis taxpayer is UK-law UK resident and treaty-resident in a State with an OECD Model capital gains article.

(2) The taxpayer receives foreign gains which are in principle subject to CGT.

Can the individual claim DT relief? This raises a characterisation issue.[124]

[124] See para 107.22 (Characterisation).

Everyone agrees that DT exemption applies to gains taxable on the remittance basis. Section 12(2) TCGA imposes a deeming which changes timing, that is, the gains which actually accrue on disposal are deemed to accrue when remitted. Section 12(3) imposes a deeming which changes the amount. The character of the gains is not altered. That is, the chargeable gains which are "treated as accruing" are the actual gains which accrued to the individual, and not different (notional) gains.

DT relief requires in principle that the alienator is treaty-resident in the foreign State at the time the gain accrues.[125] What if the gain is a foreign gain of a remittance basis taxpayer? The gain is deemed to accrue at the time that the gain is remitted.[126] If that deeming applies for DT purposes, then odd consequences would follow. Suppose foreign gains accrue to a remittance basis taxpayer who is UK-law UK resident throughout. There are two possibilities:

	Treaty-resident in foreign State	
Case no.	*When gain actually arose*	*When gain remitted*
1	No	Yes
2	Yes	No

If the timing rule applies for DT purposes, DT relief applies in case 1 and not in case 2. That would be absurd: it would often lead to double taxation or double non-taxation. So it is considered that the timing rule does not apply for DT purposes, so DT relief can apply in case 2 but not in case 1.

56.26 Immigrant trust: DTR override

Section 83A TCGA blocks "Round the World" schemes.[127]

Section 83A(1) TCGA provides:

> This section applies if a chargeable gain accrues to the trustees of a settlement on the disposal by them of an asset in a year of assessment and the trustees—
>
> (a) are within the charge to capital gains tax[128] in that year of

[125] *Smallwood v HMRC* [2009] STC 1222.

[126] See 56.17.1 (Disposal/accrual dates).

[127] See 9.19.6 (Round the World schemes).

[128] Section 83A(3) gives this expression a commonsense definition:

"For the purposes of this section the trustees of a settlement are within the charge to capital gains tax in a year of assessment—

(a) if, during any part of that year of assessment, they are resident in the UK and

> assessment, but
> (b) are non-UK resident at the time of the disposal.

The expression "non-UK resident" in (b) is defined in s.83A(4) TCGA:

> For the purposes of this section the trustees of a settlement are non-UK resident at a particular time if, at that time,—
> (a) they are not resident in the UK, or
> (b) they are resident in the UK but are Treaty non-resident.

This is a slightly artificial definition, but it is difficult to think of a better label.

If these conditions are satisfied, s.83A(2) TCGA overrides DT relief:

> Where this section applies, nothing in any double taxation relief arrangements shall be read as preventing the trustees from being chargeable to capital gains tax (or as preventing a charge to tax arising, whether or not on the trustees) by virtue of the accrual of that gain.

EN FA 2005 explains the words in brackets:

> 4. Subsection (2) of section 83A has effect to provide that where section 83A applies, nothing in the terms of any Double Taxation Agreement (DTA) can be read as preventing the trustees being chargeable to capital gains tax, or of preventing a charge to tax arising (whether on the trustees or another person), by virtue of the accrual of the gain.
> 5. The reason for the reference to "another person" in paragraph 4 above is that, in certain circumstances where the trustees of a settlement are within the charge to capital gains tax in a tax year, the rules in section 77 TCGA provide that the trustees do not actually suffer a tax charge in respect of chargeable gains which arise to them on the disposal of settled property which originates from a UK resident or ordinarily resident settlor who has an interest in the settlement at any time in the year. Chargeable gains are instead treated as arising to the settlor, who is then chargeable to tax in respect of them.

Now that s.77 has been repealed, the words in brackets in s.83A(2) should be repealed, as they can never apply, but they do no harm. Section 83A is still needed in order to deal with the Round the World scheme.

Section 83A is somewhat wider than it needed to be in order to deal with round the world schemes, and care is needed where trustees become or

not Treaty non-resident".
(There is no para (b).)

cease to be treaty non-resident, but in practice difficulties are fairly rare.

56.27 Tax return: Gains

Gains are returned in Form SA108 (Capital Gains Tax summary).

SA108 Notes (2022/23) provides:

> Fill in the 'Capital Gains Tax summary' pages if:
>
> - you sold or disposed of chargeable assets which were worth more than £49,200
> - your chargeable gains before taking off any losses were more than £12,300 ('annual exempt amount')
> - you have gains in an earlier year taxable in this period
> - you want to claim an allowable capital loss or make a capital gains claim or election for the year
> - you were not domiciled in the UK and are claiming to pay tax on your foreign gains on the remittance basis
> - you're chargeable on the remittance basis and have remitted foreign chargeable gains of an earlier year
> - you made a direct or indirect disposal of the whole or part of an interest in UK property or land when either non-resident or UK resident and the disposal was in the overseas part of a split year

See 121.4.1 (Small gains).

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CHAPTER FIFTY SEVEN

UK PROPERTY HELD BY NON-RESIDENTS

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Cross references

The following topics are considered elsewhere:
121.23 (CT registration).

57.1 Introduction

This chapter considers gains accruing to non-UK residents from land/land-rich assets.

The development of the rules can be traced through:

- HMRC, "Taxing gains made by non-residents on UK immovable property: Consultation document" (Nov 2017)[1]
- HMC "Taxing gains made by non-residents on UK immovable property - Application of the anti-forestalling rule - Technical Note" (Nov 2017)[2]

[1] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/661467/Taxing_gains_made_by_non-residents_on_UK_immovable_property_-_consultation.pdf*

[2] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661470/Taxing_gains_made_by_non-residents_on_UK_immovab*

- HMRC "Taxing gains made by non-residents on UK immovable property Summary of Responses" (July 2018)[3] (**"Consultation Response Document"**)
- Draft clauses (July 2018)

HMRC guidance is in the CG Manual.[4]

I do not consider the topics of property-rich collective investment schemes,[5] compliance, and payment, though I hope to do so in a future edition.

The current rules were introduced from 2019/20.

From 2015/16 to 2018/19 there was a charge on non-residents gains from UK residential property, which was called NRCGT. That term is sometimes used as an informal label for the current rules, but I think it is best to use "NRCGT" as the name for the previous tax regime, and not to use the same term for the current rules. The CG manual uses the term "NRCG" for the current rules, which is marginally less confusing but perhaps the best that can be done. "Non residents CGT/CT" might be clearer, if more clumsy.

For an overview, see Lawrance & Coward, "Non-residents and UK real estate: the April 2019 changes" Tax Journal, 29 June 2019.

57.1.1 *Navigation*

The layout of the provisions is as follows:

TCGA	**Topic**
s.1A(3)(b)/2B(4)(b)	CGT/CT charge on UK land
s.1A(3)(c)/2B(4)(c)	CGT/CT charge on land-rich assets
s.1C	Definition of "interest in UK land"
sch 1A	Definition of land-rich assets
sch 2	Reporting and payment
sch 4AA	UK-land rebasing
sch 5AAA	Collective investment vehicles

le_property_-_technical_note.pdf Despite its name, this note does not contain material which a practitioner would call "technical"; see App.1.9 (Technical Notes).

[3] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/722418/Taxing_gains_made_by_non-residents_on_UK_immovable_property_summary_of_responses.pdf*

[4] This replaces draft guidance formerly in App 14 CG Manual.

[5] HMRC have issued draft guidance on this: App 15 CG Manual: collective investment schemes *https://www.gov.uk/hmrc-internal-manuals/capital-gains-manual/cg-app15*

57.2 Charge on land/land-rich assets

The CGT/CT charge is in s.1A(3)/2B(4) TCGA. I set these out elsewhere[6] but it is convenient to recap:

s.1A TCGA: CGT	**s.2B TCGA: CT**
(3) A person who is not UK resident for a tax year[7] is chargeable to capital gains tax on chargeable gains accruing to the person in the tax year on the disposal of ...	(4) In addition, a company which is not resident in the UK is chargeable to corporation tax on chargeable gains accruing to the company on the disposal of
(b) assets not within paragraph (a) that are interests in UK land (see section 1C), and	assets not within subsection (3) that are- (a) interests in UK land, or
(c) assets (wherever situated) not within paragraph (a) or (b) that [i] derive at least 75% of their value from UK land [ii] where the person has a substantial indirect interest in that land (see section 1D and Sch 1A).	(b) assets (wherever situated) not within paragraph (a) that [i] derive at least 75% of their value from UK land [ii] where the company has a substantial indirect interest in that land.

In this book a **"land-rich asset"** is an asset within s.1A(3)(c), in short >75% value from land.

Statute frequently refers to **"assets within s.1A(3)(b) or (c)"**. I gloss that as "UK land/land-rich asset". Occasionally it is helpful to abbreviate that to **"land-asset"**, and a gain on such an asset is a "**land-gain**".

In short, a non-resident individual/trust pays CGT, and a non-resident company pays CT, on gains from UK land/land-rich assets.

57.2.1 *Reliefs/exemptions*

The Consultation Response Document provides:[8]

> Existing reliefs and exemptions will apply to non-residents as they do for residents.

[6] See 56.6.5 (CGT/CT charge: non-residents).

[7] See 56.6.4 (CGT/CT charge: UK residents).

[8] Para 3.11.

The document refers specifically to 3 reliefs:

Relief	**See para**
CGT annual exemption	44.2
Substantial Shareholdings Exemption	*Not discussed*
Group relief	57.8.4

57.3 Land-rich asset

Para 1(1) sch 1A TCGA provides:

> This Schedule makes provision, for the purposes of section 1A(3)(c) or 2B(4)(b), for determining in the case of any disposal of any asset—
> (a) whether the asset derives at least 75% of its value from UK land (see Part 2 of this Schedule) ...

Para 3(1) sch 1A TCGA provides:

> An asset derives at least 75% of its value from UK land if—
> (a) the asset consists of a right or an interest in a company, and
> (b) at the time of the disposal, at least 75% of the total market value of the company's qualifying assets derives (directly or indirectly) from interests in UK land.[9]

I refer to this as the **"land-rich test"**.

It is possible to envisage a company with, say, A and B shares, where the A shares do not derive their value from UK land; but they still fall within para 3(1) because *the company* has sufficiently valuable UK land. Perhaps that was deliberate.

The land-rich test is a "cliff-edge" test and that is deliberate. The Consultation Response Paper provides:

> 3.51. In looking at the gross asset value of an entity, the 75% property richness test mirrors the provisions in international treaties.[10]
> A different domestic test would still need to be underpinned by consideration of the Treaty test, to see whether the UK has taxing rights, meaning it would only add complexity to deviate from this.[11]
> The government also considers that a quantitative test is easier than a qualitative one.

[9] See 57.6.3 ("Interest in UK land").

[10] But the author wisely does not seek to identify these treaties. Article 13(4) OECD Model in fact has a 50% test; but this is not normally included in UK treaties; see 56.24.4 (Land-rich company).

[11] But consideration of DTAs is required under the current rules.

> 3.52. The government believes that setting the bar at 75% or more of the gross asset value is sufficiently high so as to catch only cases where an entity is, in essence, an envelope for UK land.

The last paragraph does not bear serious examination.

57.3.1 *Computation of gain*

The chargeable gain is computed by reference to the value of the interest disposed of. Thus in the case of a company that was only 75% property-rich, the remaining assets would be indirectly charged to UK tax. But HMRC were probably right to conclude that the alternative was not workable.

57.3.2 *Standard of care*

The Consultation Response Paper provides:

> 3.53. Officials will produce guidance making it clear what level of due diligence is required to assess the property richness test. In many cases, it will be sufficient to look at a balance sheet or similar statement that represent recent valuations of the assets.

The qualification "in many cases" means that one cannot rely on this. In any case, I would expect some back-tracking.

57.4 Derivation of value

Para 3 sch 1A TCGA provides:

> (2) Market value
> [a] may be traced through any number of companies, partnerships, trusts and other entities or arrangements but
> [b] may not be traced through a normal commercial loan.[12]
> (3) It is irrelevant whether the law under which a company, partnership, trust or other entity or an arrangement is established or has effect is—
> (a) the law of any part of the UK, or
> (b) the law of any territory outside the UK.

This provision does two things:

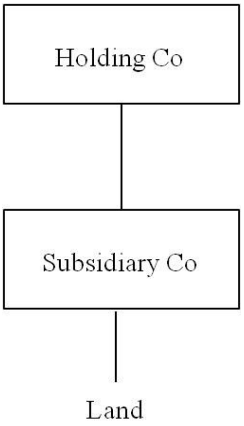
(1) It seeks to define derivation of value; the concept cannot sensibly be defined, but that did not stop the drafter from trying.[13]

[12] See 57.11 (Normal commercial loan).

[13] See App 2.9.8 (Derive/represent value).

(2) It also provides the exemption for normal commercial loans.

For example:



The subsidiary company is land-rich because it derives its value from UK land directly, and the holding company is land-rich as it derives its value from UK land indirectly.

Para 3(4) sch 1A TCGA discusses apportionment of value:

> The assets held by a company, partnership or trust or other entity or arrangement must be attributed to the shareholders, partners, beneficiaries or other participants at each stage in whatever way is appropriate in the circumstances.

Apart from the exception for a normal commercial loan, it comes down to a just and reasonable apportionment.

57.5 "Qualifying assets"

"Qualifying assets" matters because the land-rich test requires (in short) that at least 75% of the company's qualifying assets derives from UK land.

Para 3(5) sch 1A TCGA provides:

> For the purposes of this paragraph ...
> "qualifying assets" has the meaning given by paragraph 4.

Para 4(1) sch 1A TCGA provides:

> Subject as follows, all of the assets of the company are qualifying assets.

57.6 Chose in action disregard

The land-rich test disregards liabilities.

Para 4(2) sch 1A TCGA provides:

> An asset of the company is not a qualifying asset so far as it is matched to a related party liability...

I refer to this as the **"chose in action disregard"**.

57.6.1 *Chose in action*

Para 4 sch 1A TCGA provides:

> (4) An asset of the company is matched to a related party liability if—
> (a) the asset consists of a right under a transaction (for example, a right under a loan relationship or derivative contract),
> (b) the right entitles the company to require another person to meet a liability arising under the transaction...

I refer to an asset which meets this condition as a "chose in action" though the term is not completely apt. I refer to the other person as "the debtor."

57.6.2 *The debtor*

Para 4 sch 1A TCGA provides:

> (4) An asset of the company is matched to a related party liability if ...
> (c) the other person [the debtor]
> [i] is relevant to the paragraph 3 tracing exercise or
> [ii] is a related party of the company on the day of the disposal.

Para 4(5) sch 1A TCGA provides:

> For the purposes of this paragraph a person is relevant to the paragraph 3 tracing exercise if—
> (a) the person has assets that fall to be taken into account in the tracing exercise mentioned in paragraph 3, or
> (b) the person has obligations (whether as a trustee or otherwise) in relation to the holding of assets comprised in any trust or other arrangement that fall to be taken into account in that exercise.

57.6.3 *Interest in UK land*

The chose in action rule does not apply to an interest in UK land. Para 4(3) sch 1A TCGA provides:

> But an interest in UK land is a qualifying asset of the company even if it is matched to any extent to a related party liability.

Classifying non-land as non-qualifying assets makes it easier to pass the land-rich test.

57.6.4 *"Liability"*

Para 4(7) sch 1A TCGA provides a commonsense definition of liability:

> In this paragraph a liability includes a contingent liability (such as one arising as a result of the giving of a guarantee, indemnity or other form of financial assistance).

57.7 "Related party"

Para 4(6) sch 1A TCGA:

> [a] Whether, for the purposes of this paragraph, a person is a related party of the company on any day is determined in accordance with the rules in Part 8ZB of CTA 2010
>
> [b] but as if, in section 356OT(4) of that Act, the words ", within the period of 6 months beginning with that day" were omitted.

This adopts the transaction in land definition, with the tweak mentioned at para [b].

The definition is intricate. Section 356OT(1) CTA 2010 provides:

> For the purposes of this Part [Part 8ZB Transactions in UK Land] a person ("A") is related to another person ("B")—
>
> (a) throughout any period for which A and B are consolidated for accounting purposes,
>
> (b) on any day on which the participation condition is met in relation to them, or
>
> (c) on any day on which the 25% investment condition is met in relation to them.

57.7.1 *Consolidated accounts*

Section 356OT CTA 2010 provides:

> (2) A and B are consolidated for accounting purposes for a period if—
>
> (a) their financial results for a period are required to be comprised in group accounts,
>
> (b) their financial results for the period would be required to be comprised in group accounts but for the application of an exemption, or
>
> (c) their financial results for a period are in fact comprised in group accounts.

> (3) In subsection (2) "group accounts" means accounts prepared under—
>
> (a) section 399 of the Companies Act 2006, or
>
> (b) any corresponding provision of the law of a territory outside the UK.

57.7.2 *Participation condition*

Amended as para 4(6) sch 1A TCGA requires, s.356OT(4) CTA 2010 provides:

> The participation condition is met in relation to A and B ("the relevant parties") on a day if~~, within the period of 6 months beginning with that day—~~
>
> (a) one of the relevant parties directly or indirectly participates in the management, control or capital of the other, or
>
> (b) the same person or persons directly or indirectly participate in the management, control or capital of each of the relevant parties.

See 25.8 (Participation condition).

57.7.3 *25% investment condition*

Section 356OT(5) CTA 2010 provides:

> The 25% investment condition is met in relation to A and B if—
>
> (a) one of them has a 25% investment in the other, or
>
> (b) a third person has a 25% investment in each of them.

Section 356OT(6) CTA 2010 adopts the definition of "25% investment" in the hybrid entities code:

> Section 259NC of TIOPA 2010 applies for the purposes of determining whether a person has a "25% investment" in another person for the purposes of this section as it applies for the purposes of section 259NB(2) of that Act.

See 105.8 (% investment tests).

57.8 Trading exemption

Para 5(1) sch 1A(1) TCGA provides:

> A disposal of a right or interest in a company is not to be regarded as a disposal of an asset deriving at least 75% of its value from UK land if

> it is reasonable to conclude[14] that, so far as the market value of the company's qualifying assets derives (directly or indirectly) from interests in UK land[15]—
>
> (a) all of the interests in UK land are used for trading purposes ...

I refer to this as the **"trading exemption"**.

Trading companies must review their position. If they hold any non-trading land (more than insignificant) there is no relief. A group reorganisation may help.

A company which does not meet this trading exemption may still meet the trading requirement for the substantial shareholder exemption.

The trading exemption applies to a disposal of a company. If a trading company disposes of land, the disposal is taxable (though roll-over relief may apply).

57.8.1 *"Used for trading purposes"*

Para 5(2) sch 1A TCGA provides:

> An interest in UK land is "used for trading purposes" for the purposes of this paragraph if (and only if), at the time of the disposal—
>
> (a) it is being used in, or for the purposes of, a qualifying trade, or
>
> (b) it has been acquired for use in, or for the purposes of, a qualifying trade.

The CG Manual provides:

> **CG73946: Indirect disposals: The trading exception** [May 2020]
> Land can be counted as being used for trading where it is intended that it be so used. So a building that is under repair or being re-fitted can be considered - even if not occupied at the point of disposal - providing that the intention is to use it in the trade following the disposal.

57.8.2 *"Qualifying trade"*

Para 5(3) sch 1A TCGA provides:

> A trade is a "qualifying" trade for the purposes of this paragraph if—
>
> (a) [i] it has been carried on
>
> [A] by the company, or
>
> [B] by a person connected with the company,

[14] See App.2.24 (Reasonable-to-assume).

[15] The words "so far as the market value of the company's qualifying assets derives (directly or indirectly) from interests in UK land" are otiose; but it does not matter.

> [ii] throughout the period of one year ending with the time of the disposal
>
> [iii] on a commercial basis with a view to the realisation of profits,[16] and
>
> (b) it is reasonable to conclude[17] that the trade will continue to be carried on (for more than an insignificant period of time) on a commercial basis with a view to the realisation of profits.

The CG Manual provides:

> **CG73946: Indirect disposals: The trading exception** [May 2020]
> ... Whether a given trade continues is based on similar principles to those applied under Part 14 of CTA10 [change in company ownership]. It is necessary for the disponer to reasonably conclude that the trade is likely to continue for a 'more than insignificant' period of time – 'insignificant' in this context is a matter of degree, and should be taken in the context of these provisions to mean that the intention of the buyer is to continue to operate the trade. There may be circumstances where the trade is in distress and at risk of closing down after the sale; providing that there is a genuine understanding that the buyer is acquiring the land and trade with the intention of making the trade profitable this can meet the conditions.
> Letting out of property is not, in itself, a trade...

57.8.3 *Low-value non-trade interest*

Para 5(1) sch 1A(1) TCGA provides a de minimis test:

> A disposal of a right or interest in a company is not to be regarded as a disposal of an asset deriving at least 75% of its value from UK land if it is reasonable to conclude that, so far as the market value of the company's qualifying assets derives (directly or indirectly) from interests in UK land ...
>
> (b) all of the interests in UK land would be used for those [trading] purposes if low-value non-trade interests in UK land were left out of account.

Para 5(4) sch 1A TCGA provides:

> For the purposes of this paragraph, "low-value non-trade interests in UK land" means interests in UK land—

[16] See App 5.1 (Commercial basis/view to profit).

[17] See App.2.24 ("Reasonable-to-assume").

(a) which are not used for trading purposes, and
(b) the total market value of which is, at the time of the disposal, no more than 10% of the total market value at that time of the interests in UK land that are used for trading purposes.

The CG Manual provides:

> **CG73946: Indirect disposals: The trading exception** [May 2020]
> **... Land not being used in the trade**
> Either all of the UK land being disposed of must be used in a qualifying trade, or all but for low-value interests in UK land. This may be the case where, for example, a small amount of the value of UK land represents a dwelling for occupation by a member of staff (but not occupied for the purposes of the qualifying trade), or where there are derelict, low-value properties amongst otherwise occupied ones. This can include the letting out of surplus space by a trader. The scale of the portfolio of property being disposed of in the arrangement will be definitive in looking at the relative value of the amount of property not used in the trade.

57.8.4 *Inter-group transfer*

The CG Manual considers a pre-sale inter-group transfer:

> **CG73946: Indirect disposals: The trading exception** [May 2020]
> **... Transfers of UK land within a group ahead of a disposal**
> Under the NRCG rules UK land assets and shares in UK property rich companies are "chargeable assets". This means that intragroup transfers of these "chargeable assets" are undertaken on a tax neutral basis under TCGA 1992/s171...
> In a group context, it is common for properties used within the group to be held in a different company to the trading company. A group may have several different trades held via different subsidiaries (in different jurisdictions) and the group parent may be non-UK resident. In the year ahead of a disposal of one of the group's trades the properties used exclusively in that trade are transferred into a new property company. Where s171 applies the transfers involving UK land will be on a 'nil gain, nil loss' basis.
> If the relevant operating company and the property company are then sold together and the trade is expected to continue for the foreseeable future, then the conditions of the trading exception could be met. This would be a joint sale of the trading company and property-owning company as an ongoing trade.

> However, it is important to note that the trading exception applies only at the share asset tier. Depending on circumstances a degrouping charge could apply...

That seems straightforward.

57.8.5 *Property trading/development co*

The CG Manual provides:

> **CG73946: Indirect disposals: The trading exception** [May 2020]
> **... Application to Property Development Companies**
> Property Development Companies (PDC) can cover a range of activities associated with the development of UK land. This UK land is a principal asset such that they are likely to be UK property rich under Sch 1A.
> When considering the disposal of shares in a PDC consideration is first needed as to whether the disposal is charged under the 'Transactions in UK land' rules at [BIM60510+] which take priority. The 'Transaction in UK land' rules may apply to part or all of the gain.[18]
> If NRCG could apply to all or part of the gain then the trading exception can be considered, however it is unlikely the trading exception would apply. For example, it is unlikely
> [1] that the 'qualifying trade' will continue and
> [2] that the land being used in the 'qualifying trade' at the point of disposal would continue to be used in that 'qualifying trade'.
> Cases of doubt or difficulty should be referred to the CG Technical team using the submission template at CG99998.

But point [1] is a question of fact; and [2] is misconceived, as what matters is whether the trade continues, not whether the land continues to be used in the trade. The passage is perhaps considering the specific case of a SPV with one piece of land held as trading stock, selling to a purchaser who will use the land, so the trade will then cease and the trading exemption will not apply.

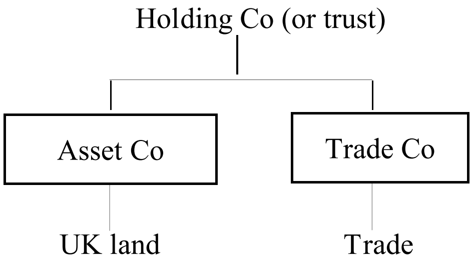
The Manual does accept, I think rightly, that land held as trading stock is "used in, or for the purposes of, a trade".[19] So the same point would apply to a property trading company, even if it is not carrying out development.

[18] See 22.5 (Transactions in land: Introduction).

[19] See 56.7.3 (Used in/for purposes of trade).

57.8.6 *Group structures*

In a typical structure, the land and the trade are held in two separate companies, thus:



Asset Co and Trade Co are connected persons. So a disposal of Asset Co by the shareholder is not subject to CGT/CT (though a direct disposal of the land by Asset Co would be subject to CT).

The very wide definition of connected person may be helpful here.

57.9 Linked disposals

Para 6 sch 1A TCGA provides:

> (1) This paragraph applies if—
> (a) there are two or more disposals of rights or interests in companies,
> (b) the disposals are linked with each other,
> (c) some but not all of the disposals would, apart from this paragraph, be disposals of assets deriving at least 75% of their value from UK land, and
> (d) if one of the companies included all of the assets of the others, a disposal of a right or interest in it would not be a disposal of an asset deriving at least 75% of its value from UK land...
>
> (3) In determining whether the condition in sub-paragraph (1)(d) is met in the case of a disposal of a right or interest in a company, it is to be assumed that, for the purposes of paragraph 4,[20] each of the other companies in which rights or interest are disposed of is (so far as this would not otherwise be the case) a related party of the company on the day of the disposal.

Assuming these conditions are met, the relief is in para 6(2) sch 1A TCGA:

[20] See 57.6 (Chose in action disregard).

> None of the disposals are to be regarded as disposals of assets deriving at least 75% of their value from UK land.

57.9.1 *"Linked"*

Para 6 sch 1A TCGA provides:

> (4) For the purposes of this paragraph a disposal of a right or interest in a company is linked with a disposal of a right or interest in another company if—
> (a) the disposals are made under the same arrangements,
> (b) the disposals are made by the same person or by persons connected with each other,
> (c) the disposals are made to the same person or to persons connected with each other, and
> (d) in the case of each disposal, the person making the disposal is connected with the company in which the right or interest is disposed of.
> (5) For the purposes of this paragraph, the question whether or not a person is connected with another is to be determined immediately before the arrangements are entered into.

Para 6(6) sch 1A TCGA extends the definition of connected person:

> Section 286 (connected persons: interpretation) has effect for the purposes of this paragraph as if, in subsection (4), the words "Except in relation to acquisitions or disposals of partnership assets pursuant to bona fide commercial arrangements," were omitted.

In short, partners and their spouses are all connected.[21]

Suppose a holding company has two subsidiaries of equal worth, one of which derived 100% of its value from UK property. The holding company is not property-rich, deriving only 50% of its value from UK property. If the holding company sells the subsidiaries separately, it would be chargeable on the disposal of the property-rich company. But if the disposals are "linked" this does not apply.

57.10 Substantial indirect interest

A disposal of a land-rich asset is only chargeable if the taxpayer has a "substantial indirect interest".[22]

Para 1 sch 1A TCGA provides:

[21] See 104.18 (Connected: Partners).

[22] See 57.2 (Charge on land/land-rich assets).

> This Schedule makes provision, for the purposes of section 1A(3)(c) or 2B(4)(b), for determining in the case of any disposal of any asset...
>
> (b) whether the person making the disposal has a substantial indirect interest in the UK land (see Part 3 of this Schedule).

Para 8(1) sch 1A TCGA provides:

> If—
>
> (a) a person disposes of an asset consisting of a right or an interest in a company, and
>
> (b) the asset derives at least 75% of its value from UK land,
>
> the person has a substantial indirect interest in UK land if, at any time in the period of 2 years ending with the time of the disposal, the person has a 25% investment in the company.

Para (a) is not a condition or requirement, but just a method of identifying the company referred to in the final paragraph.

Para (b) is otiose, as if the asset does not derived at least 75% of its value from UK land, the asset does not fall within s.1A(3)(c) TCGA, and the question whether the person has a substantial indirect interest does not arise. But it does not matter.

57.10.1 *Insignificant ownership period*

Para 8 sch 1A TCGA provides:

> (2) But a person is not to be regarded as having a 25% investment in the company at times falling in the person's qualifying ownership period if, having regard to the length of that period, the times (taken as whole) constitute an insignificant proportion of that period.
>
> (3) The "person's qualifying ownership period" means the period throughout which the person has held an asset consisting of a right or an interest in the company, but excluding times that fall before the beginning of the 2 year period mentioned in subparagraph (1).

57.10.2 *"Insignificant"*

This term is not defined. The CG Manual provides:

> **CG73936 Substantial indirect interest** [May 2020]
>
> As a general rule, HMRC will consider 'insignificant' to be 10% or less of the time (so 75[23] days or less for a full two year period). Where the total ownership period is very brief and the facts and circumstances

[23] Author's footnote: The correct figure is 73 (ignoring the complication of a leap year).

indicate that the person was never intended to hold a 25% or greater investment for any length of time, this may allow a greater leeway.

57.10.3 *"25% investment"*

For the definition see 105.8 (% investment tests).

57.10.4 *Partnership*

Para 9(11) sch 1A TCGA provides:

> Any reference in this paragraph, in the case of a person who is a member of a partnership, to the proceeds, amount or assets of the person includes the person's share of the proceeds, amount or assets of the partnership (apportioning those things between the partners on a just and reasonable basis).

57.11 Normal commercial loan

Normal commercial loan matters for:
(1) The derivation test in para 3 (Market value not traced through a NCL)
(2) The 25% test in para 9 (NCL does not count as equity)

The definition is intricate. It is taken from the CT group relief rules and illustrates how private client practitioners now have to extend their knowledge to matters which they could formerly have left to corporation tax practitioners.

Para 3(5) sch 1A TCGA provides:

> For the purposes of this paragraph-
> "normal commercial loan" means a loan which is a normal commercial loan for the purposes of section 158(1)(b) or 159(4)(b) of CTA 2010

That only applies for para 3, but the definition is repeated in para 9(5).

That takes us to s.162(1) CTA 2010 which provides:

> For the purposes of sections 158(1)(b) and 159(4)(b) "normal commercial loan" means a loan—
> (a) which is of or includes new consideration, and
> (b) in relation to which each of conditions A to D is met.

I refer to **"NCL conditions A-D"**.

57.11.1 *NCL cond. A: unconvertable*

Section 162(2) CTA 2010 provides:

> Condition A is that the loan does not carry any right to conversion into shares or securities other than a right to conversion into—
>
> (a) shares to which section 164(1) applies,
> (b) securities to which section 164(2) applies, or
> (c) shares or securities
>   [i] in a quoted unconnected company (see section 164(2A)) or
>   [ii] in the relevant company's quoted parent company (see section 164(3) to (7)).

Section 164 CTA 2010 provides:

> (1) This subsection applies to any shares—
> (a) in relation to which conditions A, C, D and E in section 160 are met, and
> (b) which do not carry any rights to conversion into shares or securities other than rights to conversion into shares or securities in the relevant company's quoted parent company (see subsections (3) to (6)).
>
> (2) This subsection applies to any securities—
> (a) which represent a loan of or including new consideration,
> (b) in relation to which conditions B, C and D in section 162 are met, and
> (c) which do not carry any rights to conversion into shares or securities other than rights to conversion into shares or securities in [a quoted unconnected company (see subsection (2A)) or in]1 the relevant company's quoted parent company.
>
> (2A) For the purposes of this section and section 162 a company is a quoted unconnected company if (and only if)—
> (a) its ordinary shares are listed on a recognised stock exchange,[24] and
> (b) it is not connected with the relevant company.
>
> (3) For the purposes of this section and sections 160 and 162 a company ("the candidate company") is the relevant company's quoted parent company if (and only if)—
> (a) the relevant company is a 75% subsidiary of the candidate company,
> (b) the candidate company is not a 75% subsidiary of any company, and
> (c) the candidate company's ordinary shares are listed on a recognised stock exchange.

[24] See App 2.18 (Listed/Recognised stock exchange).

> (4) In the case of a company whose]1 ordinary share capital is divided into two or more classes, subsections (2A)(a) and (3)(c) are met only if its ordinary shares of each class are listed on a recognised stock exchange.
> (5) In this section "ordinary shares" means shares forming part of ordinary share capital.
> (6) Subsection (7) applies if, in determining under subsection (3)(a) whether the relevant company is a 75% subsidiary of the candidate company, it is necessary to know, for the purposes of subsection (1)(b) or (2)(c) or section 160(4)(c) or 162(2)(c), whether the candidate company is the relevant company's quoted parent company.
> (7) It is to be assumed for those purposes that the candidate company is the relevant company's quoted parent company.

57.11.2 *Cond. B: no acquisition rights*

Section 162(3) CTA 2010 provides:

> Condition B is that the loan does not carry any right to the acquisition of shares or securities.

57.11.3 *NCL condition C: interest*

Section 162(4) CTA 2010 provides:

> Condition C is that the loan does not entitle the loan creditor to any amount by way of interest which—
> (a) depends to any extent on the results of the relevant company's business or on the results of any part of that business,
> (b) depends to any extent on the value of any of the relevant company's assets, or
> (c) exceeds a reasonable commercial return on the new consideration lent.
> This subsection needs to be read with section 163.

An interest-free loan satisfies condition C, and may therefore be a "normal commercial loan".

Section 163 CTA 2010 provides three exceptions:

> (1) Interest is not within section 162(4)(a) by reason only that the terms of the loan provide for the rate of interest—
> (a) to be reduced if the results of the relevant company's business or any part of the business improve, or
> (b) to be increased if such results worsen.
> (2) Interest is not within section 162(4)(b) by reason only that the terms

> of the loan provide for the rate of interest—
> (a) to be reduced if the value of any of the relevant company's assets increases, or
> (b) to be increased if the value of any such assets decreases.
>
> (3) Subsection (4) applies if—
> (a) a loan is made to the relevant company for the purpose of facilitating the acquisition of land,
> (b) the loan is made on the basis mentioned in subsection (5), and
> (c) none of the land that the loan is used to acquire is acquired with a view to resale at a profit.
>
> (4) Interest on the loan is not within section 162(4)(b) by reason only that the terms of the loan are such that the only way the loan creditor can enforce payment of an amount due is by exercising rights granted by way of security over the land that the loan is used to acquire.
>
> (5) The basis referred to in subsection (3)(b) is that—
> (a) the whole of the loan is to be applied in the acquisition of land by the relevant company or in meeting incidental costs incurred wholly and exclusively for the purpose of obtaining the loan or providing security for the loan,
> (b) the payment of any amount due in connection with the loan to the person making it is to be secured on the land that the loan is used to acquire, and
> (c) no other security is to be required for the payment of any such amount.
> (6) "Incidental costs" means expenditure on fees, commissions, advertising, printing or other incidental matters.

57.11.4 *NCL condition D: repayment*

Section 162(5) CTA 2010 provides:

> Condition D is that the loan is a loan in relation to which the loan creditor is entitled, on repayment, to an amount which—
> (a) does not exceed the new consideration lent, or
> (b) is reasonably comparable with the amount generally repayable (in relation to an equal amount of new consideration) under the terms of issue of securities listed on a recognised stock exchange.

57.12 Connected persons aggregated

Para 10(1) sch 1A TCGA provides:

> In determining for the purposes of paragraph 9 [definition of substantial

> indirect interest] the investment that a person ("P") has in a company, P is to be taken to have all of the rights and interests of any person connected with P.

I refer to this as the **"para 10 aggregation rule"**.

57.12.1 *"Connected"*

Para 10 sch 1A TCGA cuts down the standard definition of connected person, for the purposes of the para 10 aggregation rule:

> (2) A person is not to be regarded as connected with another person for the purposes of this paragraph merely as a result of their being parties to a loan that is a normal commercial loan for the purposes of paragraph 9.[25]
>
> (3) Section 286 (connected persons: interpretation)[26] has effect for the purposes of this paragraph—
>
> (a) as if, in subsection (2), for the words from ", or is a relative" to the end there were substituted "or is a lineal ancestor or lineal descendant of the individual or of the individual's spouse or civil partner", and
>
> (b) as if subsections (4) and (8) were omitted.

Section 286 TCGA as amended provides:

> (1) Any question whether a person is connected with another shall for the purposes of this Act be determined in accordance with the following subsections of this section (any provision that one person is connected with another being taken to mean that they are connected with one another).
>
> (2) A person is connected with an individual if that person is the individual's spouse or civil partner, ~~or is a relative, or the spouse or civil partner of a relative, of the individual or of the individual's spouse or civil partner~~ or is a lineal ancestor or lineal descendant of the individual or of the individual's spouse or civil partner.
>
> (3) A person, in his capacity as trustee of a settlement, is connected with—
>
> (a) any individual who in relation to the settlement is a settlor,
>
> (b) any person who is connected with such an individual,
>
> (c) any body corporate which is connected with that settlement,
>
> (d) if the settlement is the principal settlement in relation to one or more sub-fund settlements, the trustees of the sub-fund settlements, and
>
> (e) if the settlement is a sub-fund settlement in relation to a principal settlement, the trustees of any other sub-fund settlements in relation to the principal settlement.

[25] See 57.11 (Normal commercial loan).

[26] See 104.12 (Connected person).

> (3ZA) [definitions of "settlement" and "trustee"]
>
> (3A) For the purpose of subsection (3) above a body corporate is connected with a settlement if—
>
> (a) it is a close company (or only not a close company because it is not resident in the UK) and the participators include the trustees of the settlement; or
>
> (b) it is controlled (within the meaning of section 1124 of CTA 2010 [strict sense control]) by a company falling within paragraph (a) above.
>
> ~~(4) Except in relation to acquisitions or disposals of partnership assets pursuant to bona fide commercial arrangements, a person is connected with any person with whom he is in partnership, and with the spouse or civil partner or a relative of any individual with whom he is in partnership.~~
>
> (5) A company is connected with another company—
>
> (a) if the same person has control of both, or a person has control of one and persons connected with him, or he and persons connected with him, have control of the other, or
>
> (b) if a group of 2 or more persons has control of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by a person with whom he is connected.
>
> (6) A company is connected with another person, if that person has control of it or if that person and persons connected with him together have control of it.
>
> (7) Any 2 or more persons acting together to secure or exercise control of a company shall be treated in relation to that company as connected with one another and with any person acting on the directions of any of them to secure or exercise control of the company.
>
> ~~(8) In this section "relative" means brother, sister, ancestor or lineal descendant.~~

57.13 TAAR/Treaty override

Para 11 deals with two distinct topics: a TAAR and a treaty override.

57.13.1 *Land-rich TAAR*

Para 11 sch 1A TCGA provides an application-disregard TAAR:[27]

> (1) This paragraph applies if a person has entered into any arrangements[28] the main purpose, or one of the main purposes, of which is to obtain a tax advantage[29] for the person as a result (wholly or partly) of—

[27] See 3.2 (Types of TAAR).

[28] Para 11(6) sch 1A TCGA provides, with minor contextual modification, the standard (unnecessary) definition: see App 2.2.3 (Definitions of "arrangement").

[29] Para 11(6) sch 1A TCGA sets out the GAAR definition of "tax advantage"; see 3.19.1 (Tax advantage: Definitions).

> (a) a provision of this Schedule applying or not applying ...

This applies if the advantage arises as a result of a provision of sch 1A or a DTA. An advantage arising as a result of other provisions does not count. An advantage arising as a result of sch 1A together with other provisions would be caught.

It is easy to see that an arrangement to secure that sch 1A does not apply could have a tax advantage. It is less obvious how an arrangement to secure that sch 1A *does* apply could have a tax advantage; an example is an arrangement to obtain land-asset hold-over relief or rebasing relief.

Para 11(6) sch 1A TCGA provides:

> In this paragraph ... "tax" means capital gains tax or corporation tax

The CG Manual provides:

> **CG73950 Indirect disposals: TAAR** [May 2020]
> Some examples of where this could apply would be:
> [1] Manipulating the company's assets such that it was not UK property rich when a disposal was made.
> [2] Ordering transactions to ensure a UK land disposal occurred at a time when the company had ceased to be UK property rich.
> [3] Undertaking a disposal where the 'linked disposals' exemption[30] would apply with the intention to onward sell some or all of the non-UK land assets such that the exemption would not have been available had just the remaining interests been disposed of.
> [4] A disposal to which the 'trading exemption' was met and then UK land used in the trade was disposed of as part of planned arrangements although the trade continued.
> [5] The use of back to back arrangements to break related party rules applying.
> [6] Delaying completion of a transaction to ensure the disposer had ceased to hold a significant indirect interest including by fragmentation
> ...
> **Restructuring of pre-April 2019 holdings**
> The extension in scope of the non-resident capital gains rules may have prompted some non-resident investors to consider how their interests in UK land were held.
> For example, an exempt investor holding interests in UK land indirectly via a holding company where the holding company is not UK property

[30] See 57.9 (Linked disposal).

rich but one or more of its subsidiaries are. In such a case the disposal of a UK property rich subsidiary would be a taxable disposal by the holding company.

To avoid this outcome the exempt investor may have decided to concentrate their UK property rich companies under a new directly held holding company which could then make an exemption election under Para 12 Sch 5AAA.

Where the restructuring was solely undertaken to allow Sch 5AAA elections i.e. the transparency or exemption elections, to apply it is not expected that the TAAR would apply. Cases of doubt or difficulty should be referred to the CG Technical team using the submission template at CG99998.

57.13.2 *Treaty override*

Para 11 sch 1A TCGA provides:

> (1) This paragraph applies if a person has entered into any arrangements[31] the main purpose, or one of the main purposes, of which is to obtain a tax advantage[32] for the person as a result (wholly or partly) of ...
>
> (b) double taxation arrangements[33] having effect despite a provision of this Schedule in a case where the advantage is contrary to the object and purpose[34] of the double taxation arrangements.

Para 11(4) Sch 1A TCGA provides a treaty override:

> The counteraction has effect in a treaty shopping case[35] regardless of section 6(1) of TIOPA 2010.

The wording is based on the OECD principal purpose test.[36]

The CG Manual provides:

[31] Para 11(6) sch 1A TCGA provides (with minor contextual modification) the standard (unnecessary) definition: see App 2.2.3 (Definitions of “arrangement”).

[32] Para 11(6) sch 1A TCGA sets out the GAAR definition of “tax advantage”; see 3.19.1 (Tax advantage: Definitions).

[33] Para 11(6) sch 1A TCGA provides the standard commonsense definition: “In this paragraph ... “double taxation arrangements” means arrangements that have effect under section 2(1) of TIOPA 2010”.

[34] See 108.7 (OECD-concept abuse).

[35] Defined para 11(6) sch 1A TCGA: "treaty shopping case" means a case where this paragraph applies as a result of sub-paragraph (1)(b).

[36] See 108.8 (OECD principal purpose test).

> **CG73950 Indirect disposals: TAAR** [May 2020]
> [The treaty override] is rooted in the internationally agreed principles governing what the Commentary to the OECD Model calls "improper use of the Convention", and is explored at length in the Commentary to Article 1 of the OECD Model (paragraphs 54 to 80 in the 2017 version)[37]...
> A DTA will always provide a tax benefit in relation to a particular state in circumstances where the allocation of taxing rights and the relative rates of tax in the contracting states means a person pays less tax in that state than they would absent the DTA. However, under the guiding principle outlined above, abuse arises where arrangements have been entered into to create that effect, and not for commercial or substantive reasons.
> HMRC will consider each case on its merits, but for example would in particular consider the application of the TAAR where historically a person or group of persons had used structures for holding UK land that would become taxable in the UK under these rules, but after becoming aware of the indirect disposal rules began to structure so that DTAs would restrict the UK's right to tax.

See too OECD, "Taxation of Offshore Indirect Transfers (Draft Toolkit)".[38]

57.13.3 *Treaty/TAAR counteraction*

Para 11 sch 1A TCGA provides:

> (2) The tax advantage is to be counteracted by the making of such adjustments as are just and reasonable.
> (3) The adjustments may be made (whether by an officer of Revenue and Customs or the person) by way of an assessment, the modification of an assessment, amendment or disallowance of a claim, or otherwise.

This is a counteraction-style TAAR.[39].

The Consultation Response Document provides:

> 3.160. The government believes that in practice, given the motive test, customers will have certainty as to whether actions they undertake could trigger the [anti-avoidance] rule.

[37] See 108.7 (OECD-concept abuse).

[38] *https://www.oecd.org/tax/taxation-of-offshore-indirect-transfers.htm*

[39] See 3.2.3 (Consequences of TAAR).

The reader may doubt if that is intended to be taken seriously.

57.14 Grant of option

Section 1C TCGA provides:

> (4) The grant of an option by a person binding the person to dispose of an interest in UK land is (so far as it would not otherwise be the case) regarded as a disposal of an interest in UK land by the person for the purposes of section 1A(3)(b).
> (5) This does not affect the operation of section 144 in relation to the grant of the option (or otherwise).[40]

This is derived from the former NRCGT rule. Why is it needed?

57.15 UK-land rebasing: Introduction

The rebasing rules (**"UK-land rebasing"**) are in sch 4AA TCGA.

There are three types of UK-land rebasing. I coin the following terminology:

Type of rebasing	**Rebase to**	**sch 4AA**	**Applies to:**
2019 rebasing	2019	Part 2	(a) indirect disposal (b) direct disposal, no residential use (c) direct disposal by non-chargeable person
2015 rebasing	2015	Part 3	Direct disposal, fully residential
2015/19 rebasing	2015/2019	Part 4	Direct disposal, partly residential use

The elections out of these rebasing rules are:

Type of rebasing	**Elections**	**Sch 4AA para**
2019 rebasing	Historic cost[41]	4
	Time apportionment	*Not available*
2015 rebasing	Historic cost	8
	Time apportionment	9
2015/19 rebasing	Historic cost	14
	Time apportionment	*Not available*

57.16 General rebasing conditions

Para 1(1) sch 4AA TCGA provides:

> Part 2, 3 or 4 of this Schedule applies on the first occasion on which a

[40] Para 4(4)(5) sch 1B TCGA makes the same provision for the purposes of that schedule.

[41] Statute calls this the retrospective basis of calculation, but I think my term is clearer.

> person disposes of an asset that the person held on 5 April 2019 where—
> (a) the disposal is either a direct or indirect disposal of UK land, and
> (b) the disposal is made by a non-resident or a UK resident in the overseas part of a tax year.

These requirements apply to each of the 3 types of UK-land rebasing. I refer to this as the **"general rebasing conditions"**.

57.16.1 *Direct/indirect disposal*

Para 1(3) sch 4AA TCGA provides a (relatively) commonsense definition of direct/indirect disposal of UK land, which is the requirement in general rebasing condition (a):

> For the purposes of this Schedule—
> (a) a disposal is a "direct disposal of UK land" if it is a disposal of an interest in UK land, and
> (b) a disposal by a person is an "indirect disposal of UK land" if it is a disposal of an asset (other than an interest in UK land) deriving at least 75% of its value from UK land where the person has a substantial indirect interest in that land.

The wording mirrors s.1A(3)/2B(4) TCGA.[42]

57.16.2 *Disposal by non-resident*

Para 1(4) sch 4AA TCGA (in short) provides a definition of "non-resident", which is the requirement in general rebasing condition (b):

> For the purposes of this paragraph, the disposal is made by a non-resident or a UK resident in the overseas part of a tax year if it is—
> (a) a disposal on which a gain accrues that falls to be dealt with by section 1A(3) because the asset disposed of is within paragraph (b) or (c) of that subsection [land/land-rich asset],[43]
> (b) a disposal on which a gain accrues that falls to be dealt with by section 1A(1) in accordance with section 1G(2) [split year] because the asset disposed of is within section 1A(3)(b) or (c) [land/land-rich asset],
> (c) a disposal on which a gain accrues that falls to be dealt with by

[42] See 57.2 (Charge on land/land-rich assets).

[43] See 57.2 (Charge on land/land-rich assets).

> section 2B(4),[44] or
> (d) a disposal of an asset
> [i] on which a gain does not accrue
> [ii] but which, had a gain accrued, would fall to be dealt with as mentioned in any of the preceding paragraphs of this subparagraph.

This is convoluted drafting, but it works.

Land rebasing is therefore an unusual relief: it applies (in short) to non-residents but it does not generally apply to UK residents.[45] It follows that the relief does not apply for the purpose of computing s.3 gains[46] or s.1(3) amounts (trust gains)[47].

57.17 2019 rebasing

Para 2(1) sch 4AA TCGA provides:

> This Part [Part 2] of this Schedule applies to-
> (a) all indirect disposals of UK land,
> (b) direct disposals of UK land that were not fully residential before 6 April 2019, and
> (c) direct disposals of UK land by persons who were not chargeable before 6 April 2019.

I refer to this as **"2019 rebasing heads (a)-(c)"**.

57.17.1 *Not fully residential: Head (b)*

2019 rebasing applies (under head (b)) to direct disposals of UK land that were not fully residential before 2019. Para 2(2) sch 4AA TCGA provides the definition:

> For the purposes of this paragraph a direct disposal of UK land made by a person was "not fully residential before 6 April 2019" if in the period-
> (a) beginning with the day on which the person acquired the interest in land being disposed of or, if later, 6 April 2015, and
> (b) ending with 5 April 2019,
> there was no day on which the land to which the disposal relates consisted of or included a dwelling.

[44] See 56.6.5 (Charge on non-resident co).

[45] But see 57.26 (Rebasing: Company onshoring).

[46] See 64.4 (Computing gains: CT rules).

[47] See 61.6.3 (s.1(3) amount: Exemptions/reliefs).

"Not fully residential" seems an odd way to express this concept: Not residential (or not fully or partly residential) would be clearer.

57.17.2 *Contract to buy off-plan*

Para 2(3) sch 4AA TCGA provides:

> If the disposal is of an interest in land subsisting under a contract for the acquisition of land that, at any time before 6 April 2019, consisted of or included a building to be constructed or adapted for use as a dwelling, the disposal is taken to be fully residential before that date.

57.17.3 *Non-chargeable person: Head (c)*

2019 rebasing applies to direct disposals of UK land by non-chargeable persons. Para 2 sch 4AA TCGA provides the definition:

> (4) For the purposes of this paragraph, a disposal is made by a person who was not chargeable before 6 April 2019 if, immediately before that date, the person was-
>
> (a) a company which was not a closely-held company (see sub-paragraph (5)),
>
> (b) a widely-marketed scheme (see sub-paragraph (6)), or
>
> (c) a company carrying on life assurance business (as defined in section 56 of the Finance Act 2012) where the interest in UK land was, immediately before that date, held for the purpose of providing benefits to policyholders in the course of that business.
>
> (5) The question as to whether a company is "a closely-held company" is determined in accordance with Part 1 of Schedule C1; but if-
>
> (a) the company is a divided company within the meaning of section 14G, and
>
> (b) the company would not otherwise be regarded as a closely-held company,
>
> the company is to be so regarded if the conditions in subsection (3) of that section are met.
>
> (6) A person is a "widely-marketed scheme" if-
>
> (a) the person is a scheme within the meaning of section 14F, and
>
> (b) condition A or B in that section is met, reading the reference in subsection (8)(a) of that section to the non-resident CGT disposal as a reference to the disposal mentioned in paragraph 1(1).
>
> (7) In determining for the purposes of this paragraph whether or not-
>
> (a) a person is a closely-held company, or

> (b) a person is a widely-marketed scheme,
>
> arrangements are to be ignored if the main purpose of, or one of the main purposes of, them is to secure a tax advantage as a result of the person not being a closely-held company or the person being a widely-marketed scheme.[48]
>
> (8) In this paragraph ...
>
> (b) any reference to section 14F, 14G or Schedule C1 are to those provisions as they had effect on 5 April 2019 (before their repeal by Schedule 1 to the Finance Act 2019).

Thus the complex pre-2019 provisions continue to matter for 2019 rebasing head (c).

57.18 2019 Rebasing: The relief

Assuming the general rebasing conditions are met, and one of 2019 rebasing heads (a)-(c) apply, para 3(1) sch 4AA TCGA provides the relief:

> In calculating the gain or loss accruing on the disposal it is [to[49]] be assumed that the asset was on 5 April 2019 sold by the person, and immediately reacquired by the person, at its market value on that date.

The wording is based on s.35 TCGA (1982 rebasing).

57.19 Election out of 2019 rebasing

Para 3(2) sch 4AA TCGA

> This paragraph [2019 rebasing relief] has effect subject to any election made by the person under paragraph 4 (retrospective basis of calculation).

So we turn to para 4(1) sch 4AA TCGA which provides:

> The person may make an election under this paragraph for the assumption that the asset is sold and reacquired as mentioned in paragraph 3 not to apply.

Statute calls this the retrospective basis of calculation, but I think "historic cost" is clearer. There is no time apportionment, so the entire historic gain

[48] Para 2 incorporates the standard definitions, but for some reason does so indirectly: "(8) In this paragraph ... (a) "arrangements" and "tax advantage" have the same meaning as in section 16A".

[49] Typos in Acts of Parliament are exceptional. But on this occasion the word "to" has been erroneously omitted.

(if any) will come into charge. So an election will rarely be advantageous. The Consultation Response document provides:

> 3.21. The government recognises the burden on taxpayers in having to obtain valuations, but believes that offering the retrospective basis as an option means those unable to get a valuation can use original cost. Time apportionment is still available on purely residential property disposals, and for commercial and mixed-use property it is likely most taxpayers will obtain a valuation for rebasing to ensure they use the most tax effective calculation method.

57.19.1 *Para 4 election: Loss*

Para 4(2) sch 4AA TCGA provides:

> If, in the case of an indirect disposal of UK land-
> (a) a person makes an election under this paragraph, and
> (b) a loss accrues on the disposal,
> the loss is not an allowable loss.

The Consultation Response document provides:

> 3.22. The government recognises that in some circumstances on indirect disposals it will not be practical to obtain a valuation at April 2019, and so will allow the retrospective basis to be used. To prevent this creating significant losses arising from assets that were not in the UK tax base prior to commencement, where the retrospective basis is used on indirect disposals, it will not be able to produce an allowable loss. Not allowing losses that accrued pre- commencement is coherent with the overall policy, and aligns with the treatment of gains.
> 3.23. Hence in indirect disposal cases the retrospective basis would only be capable of producing a chargeable gain. Any loss would not be an allowable loss...

This does not apply to a direct disposal. Why is that?

57.19.2 *Para 4 election: Residential property*

Para 5 sch 4AA TCGA provides:

> (1) This paragraph applies if-
> (a) a person makes an election under paragraph 4 in respect of a disposal on which a gain accrues, and
> (b) it is necessary to determine, in accordance with Schedule 1B, how much of the gain is a residential property gain.
> (2) Paragraph 2 of Schedule 1B has effect as if-

> (a) sub-paragraphs (5) and (6) of that paragraph were omitted, and
> (b) in that paragraph, "the applicable period" had the definition given by the next sub-paragraph.
>
> (3) "The applicable period" means the period-
> (a) beginning with the day on which the person acquired the interest in land being disposed of or, if later, 31 March 1982, and
> (b) ending with the day before the day on which the disposal is made.

Amended as para 5 requires, the key parts of para 2 sch 1B TCGA provide:

> 2 (1) The proportion of a chargeable gain attributable to residential property is equal to—
> (a) the relevant fraction of the gain, and
> (b) if there has been mixed use of the land to which the disposal relates on one or more days in the applicable period, the relevant fraction of the gain as adjusted, on a just and reasonable basis, to take account of the mixed use on the day or days.
>
> (2) The relevant fraction is A/B where—
> A is the number of days in the applicable period on which the land to which the disposal relates consists of or includes a dwelling, and
> B is the total number of days in the applicable period.
>
> (3) [Definition of "mixed use of land"]
>
> (4) [Contract for the acquisition of dwelling]
>
> ~~(5) In this paragraph "the applicable period" means the period—~~
> ~~(a) beginning with the day on which the person making the disposal acquired the interest in land being disposed of or, if later, the day from which the interest in land became chargeable, and~~
> ~~(b) ending with the day before the day on which the disposal occurs.~~
>
> ~~(6) For the purposes of this paragraph an interest in land became "chargeable"—~~
> ~~(a) in any case where the disposal is of an interest in land in the UK—~~
> ~~(i) by a person in a tax year in which the person is not UK resident, or~~
> ~~(ii) by a person in the overseas part of a tax year which is, as respects the person, a split year, from 6 April 2015, and~~
> ~~(b) in any other case, from 31 March 1982.~~

> (7) [Interests in land acquired by the person at different times].
> (x) “The applicable period” means the period-
> (a) beginning with the day on which the person acquired the interest in land being disposed of or, if later, 31 March 1982, and
> (b) ending with the day before the day on which the disposal is made.

57.20 2015 rebasing conditions

Para 6(1) sch 4AA TCGA provides:

> This Part [Part 3, 2015 rebasing] of this Schedule applies to any direct disposal of UK land if-
> (a) the person held the interest in UK land being disposed of throughout the period beginning with 6 April 2015 and ending with the disposal, and
> (b) the disposal was fully residential before 6 April 2019.

I refer to this as **“2015 rebasing conditions”**.

57.20.1 *“Fully residential”*

Para 6 sch 4AA TCGA provides:

> (2) For this purpose a direct disposal of UK land made by a person is “fully residential before 6 April 2019” if in the period-
> (a) beginning with 6 April 2015, and
> (b) ending with 5 April 2019,
> every day on which the land to which the disposal relates consisted of a dwelling.
> (3) If the disposal is of an interest in land subsisting under a contract for the acquisition of land that, at any time in that period, did not consist of a building to be constructed or adapted for use as a dwelling, the disposal is taken to be not fully residential before 6 April 2019.

57.20.2 *Interaction with 2019 rebasing*

Para 6(4) sch 4AA TCGA provides:

> This Part [Part 3] of this Schedule does not apply to
> [a] a direct disposal of UK land
> [b] made by a person who was not chargeable before 6 April 2019, as determined for the purposes of paragraph 2.[50]

[50] See 57.17.3 (Non-chargeable person).

Thus 2019 rebasing relief has priority, if the relevant conditions are met.

57.21 2015 rebasing relief

Para 7(1) sch 4AA TCGA provides:

> In calculating the gain or loss accruing on the disposal it is [to[51]] be assumed that the asset was on 5 April 2015 sold by the person, and immediately reacquired by the person, at its market value on that date.

The wording is based on s.35 TCGA (1982 rebasing).

57.22 Elections out of 2015 rebasing

Para 7(2) sch 4AA TCGA provides:

> This paragraph has effect subject to any election made by the person under either-
> (a) paragraph 8 (retrospective basis of calculation), or
> (b) paragraph 9 (straight-line time apportionment),
> (and an election may be made under only one of those paragraphs).

57.22.1 *Historic-cost election*

Para 8 sch 4AA TCGA provides:

> The person may make an election under this paragraph for the assumption that the asset is sold and reacquired as mentioned in paragraph 7 not to apply.

I call this a para 8 historic-cost election.

57.22.2 *Time-apportionment election*

Para 9 sch 4AA TCGA provides:

> (1) The person may make an election under this paragraph-
> (a) for the assumption that the asset is sold and reacquired as mentioned in paragraph 7 not to apply, and
> (b) for the gain or loss accruing on the disposal to be apportioned so that only the post-5 April 2015 proportion of it is treated as accruing on the disposal.
>
> (2) The "post-5 April 2015 proportion" is the proportion that the days in the post-5 April 2015 period bear to the days in the ownership period.

[51] Typos in Acts of Parliament are exceptional. But on this occasion the word "to" has been erroneously omitted.

> (3) For this purpose-
> "the post-5 April 2015 period" means the day beginning with 6 April 2015 and ending with the day on which the disposal is made, and
> "the ownership period" means the period beginning with the day on which the person acquired the interest disposed of or, if later, 31 March 1982 and ending with the day on which the disposal is made.

I call this a para 9 time-apportionment election.

The CG Manual gives a straightforward example:

> **CG73972 Direct disposals of pre-April 2015 assets fully chargeable before 6 April 2019** [Dec 2021]
> Disposal made in May 2019 (1500 days after 5 April 2015) and acquisition February 2011 (1500 days before in 6 April 2015).
> Gain before any apportionment £1,000.
> The post 5 April 2015 proportion of the gain would be £500
> i.e. 1,000 × (1,500/(1,500 + 1,500))

57.22.3 *Para 8/9 elections: Residential property gain*

Para 9 and 10 sch 4AA TCGA are best read side by side:

Para 9 sch 4AA: historic cost	**Para 10 sch 4AA: time apportion**
(1) This paragraph applies if-	(1) This paragraph applies if-
(a) a person makes an election under paragraph 8 in respect of a disposal on which a gain accrues, and	(a) a person makes an election under paragraph 9 in respect of a disposal on which a gain accrues, and
(b) it is necessary to determine, in accordance with Schedule 1B, how much of the gain is a residential property gain.	[identical]
(2) Paragraph 2 of Schedule 1B has effect as if-	[identical]
(a) sub-paragraphs (5) and (6) of that paragraph were omitted, and	[identical]
(b) in that paragraph, "the applicable period" had the definition given by the next sub-paragraph.	[identical]
(3) "The applicable period" means the period-	(3) "The applicable period" means the period-

(a) beginning with the day on which the person acquired the interest in land being disposed of or, if later, 31 March 1982, and	(a) beginning with 6 April 2015, and
(b) ending with the day before the day on which the disposal is made.	[identical]

These are the equivalents to para 5 sch 4AA TCGA but with different applicable periods; see 57.19.2 (Para 4 election: residential property).

57.23 2015/2019 rebasing conditions

Para 12 sch 4AA TCGA provides:

> (1) This Part [Part 4, 2015/2019 rebasing] of this Schedule applies to any direct disposal of UK land if-
> (a) neither Part 2 [2019 rebasing] nor Part 3 [2015 rebasing] of this Schedule applies to the disposal, and
> (b) the interest in UK land being disposed of was not a post-April 2015 asset that was fully residential before 6 April 2019.
>
> (2) For this purpose-
> (a) the interest in UK land being disposed of is a "post-April 2015 asset" if it was acquired by the person after 5 April 2015, and
> (b) the asset "was fully residential before 6 April 2019" if, in the period beginning with the day on which it was acquired and ending with 5 April 2019, every day on which the land to which the disposal relates consisted of a dwelling.
>
> (3) If the disposal is of an interest in land subsisting under a contract for the acquisition of land that, at any time in that period, did not consist of a building to be constructed or adapted for use as a dwelling, the disposal is taken to be not fully residential before 6 April 2019.

I refer to this as **"2015/2019 rebasing conditions"**.

57.24 2015/2019 rebasing: the relief

Assuming the general rebasing conditions and the 2015/2019 rebasing conditions are met, para 13 sch 4AA TCGA provides:

> (1) In calculating the gain or loss accruing on the disposal ("the actual disposal") it is [to[52]] be assumed that-

[52] Typos in Acts of Parliament are exceptional. But on this occasion the word "to" has been erroneously omitted.

> (a) the asset was on 5 April 2015 sold by the person, and immediately reacquired by the person, at its market value on that date (but see sub-paragraph (3)), and
> (b) in addition, the asset was on 5 April 2019 sold by the person, and immediately reacquired by the person, at its market value on that date.
>
> (2) In the case of the assumed sale on 5 April 2019, the gain or loss accruing on that sale is treated as accruing on the actual disposal (in addition to the gain or loss that actually accrues on the actual disposal).
>
> (3) If the asset was acquired by the person after 5 April 2015, the assumption that it is sold, and immediately reacquired, on 5 April 2015 is not to apply.

57.25 Election out of 2015/2019 rebasing

Para 13(4) sch 4AA TCGA provides:

> This paragraph has effect subject to any election made by the person under paragraph 14 (retrospective basis of calculation).

So we turn to para 14 sch 4AA TCGA which provides:

> The person may make an election under this paragraph for the assumptions that the asset is sold and reacquired as mentioned in paragraph 13 not to apply.

57.25.1 *Para 14 election: Residential property gain*

Para 15 sch 4AA TCGA provides:

> (1) This paragraph applies if-
> (a) a person makes an election under paragraph 14 in respect of a disposal on which a gain accrues, and
> (b) it is necessary to determine, in accordance with Schedule 1B, how much of the gain is a residential property gain.
>
> (2) Paragraph 2 of Schedule 1B has effect as if-
> (a) sub-paragraphs (5) and (6) of that paragraph were omitted, and
> (b) in that paragraph, "the applicable period" had the definition given by the next sub-paragraph.
>
> (3) "The applicable period" means the period-
> (a) beginning with the day on which the person acquired the interest in land being disposed of or, if later, 31 March 1982, and
> (b) ending with the day before the day on which the disposal is made.

This is the equivalent to para 5 sch 4AA TCGA but with a different applicable period; see 57.19.2 (Para 4 election: residential property).

57.26 Rebasing: Company onshoring

It is a general requirement of land-rebasing that the disposal is made by a non-resident (or in the overseas part of a split year): para 1(1)(b) sch 4AA TCGA.

Para 16 sch 4AA TCGA provides an exception:

> (1) This paragraph applies in any case where-
> (a) a company becomes resident in the UK after 5 April 2019,
> (b) the company makes a direct or indirect disposal of UK land after that date, and
> (c) (ignoring this paragraph) Part 2, 3 or 4 of this Schedule would have applied to the disposal but for the fact that it is made at a time when the company is resident in the UK.
> (2) In that case, Part 2, 3 or 4 of this Schedule applies in relation to the disposal (regardless of paragraph 1(1)(b)).

This only applies to companies, so individuals and trustees who become UK resident after 5 April 2019 do not qualify for rebasing. This anomoly is deliberate. The consultation response paper provides:

> 3.31. In order not to dis-incentivise on-shoring, the government is content to allow for companies who become UK resident to retain the ability to calculate their gains or losses using rebasing to April 2019.

The policy to facilitate onshoring companies, but discourage onshoring of trusts and individuals seems a strange one; but there it is.

57.27 Company/trust leaves UK

Similar rules apply to companies and trusts, and it is easiest to follow if the text is set out side by side:

Para 17 sch 4AA TCGA (trust)	**Para 18 sch 4AA TCGA (company)**
(1) This paragraph applies in any case where-	(1) This paragraph applies in any case where-
(a) the trustees of a settlement cease to be resident in the UK after 5 April 2019, and	(a) a company ceases to be resident in the UK after 5 April 2019, and
(b) the trustees make a direct or indirect disposal of UK land after that date.	(b) the company makes a direct or indirect disposal of UK land after that date.

(2) Nothing in Part 2, 3 or 4 of this Schedule applies to the disposal.	*Identical*
(3) The asset that is disposed of is excepted from the application of section 80(2) (deemed disposal of assets on trustees ceasing to be resident in UK).[53]	(3) The asset that is disposed of is excepted from the application of section 185(2) and (3) (deemed disposal of assets on company ceasing to be resident in UK).

In short, companies and trusts which cease to UK resident do not qualify for rebasing. But individuals who cease to be UK resident do qualify for rebasing.

57.28 Rebasing: Wasting asset

Para 19 sch 4AA TCGA provides:

> (1) This paragraph applies if, in calculating a gain or loss accruing to a person in a case where paragraph 3, 7 or 13 is applicable, it is necessary to make a wasting asset determination in relation to the asset disposed of.
> (2) The assumption that the asset was acquired on a date mentioned in paragraph 3, 7 or 13 (as the case may be) is to be ignored in making that determination.
> (3) In this paragraph "a wasting asset determination" means a determination whether or not an asset is a wasting asset, as defined for the purposes of Chapter 2 of Part 2 of this Act. Capital allowances

Para 20 sch 4AA TCGA provides:

> (1) This paragraph applies if, in calculating a gain or loss accruing to a person in a case where paragraph 3, 7 or 13 is applicable, it is to be assumed that the asset disposed of was acquired on a particular date for a consideration equal to its market value on that date.
> (2) For the purposes of that calculation-
> (a) section 41 (restriction of losses by reference to capital allowances and renewals allowances), and
> (b) section 47 (wasting assets qualifying for capital allowances),
> are to apply in relation to any allowance made in respect of the expenditure actually incurred in acquiring or providing the asset as if it were made in respect of the expenditure assumed to have been incurred.

[53] See 12.4.7 (Exit charge: UK land)

> (3) In this paragraph "allowance" means any capital allowance or renewals allowance.

57.29 Rebasing election procedure

Para 21 sch 4AA TCGA provides:

> (1) An election under any provision of this Schedule must (regardless of section 42(2) of the Management Act)[54] be made by being included in a relevant return relating to the disposal.
>
> (2) For the purposes of this paragraph a "relevant return" means—
>
> (a) an ordinary tax return, or
>
> (b) a return under Schedule 2 to the Finance Act 2019.
>
> (3) An election under any provision of this Schedule which is made by being included in a return under Schedule 2 to the Finance Act 2019 may be subsequently revoked by provision included in an ordinary tax return which is delivered on or before the filing date for the ordinary tax return.
>
> (4) Subject to that, an election under any provision of this Schedule is irrevocable.
>
> (5) All such adjustments are to be made, whether by way of discharge or repayment of tax, the making of assessments or otherwise, as are required to give effect to an election under any provision of this Schedule.
>
> (6) For the purposes of this paragraph, in the case of a person other than a company—
>
> "ordinary tax return" means a return under section 8 or 8A of the Management Act,[55] and
>
> "the filing date", in relation to that return, has the meaning given by section 9A(6) of that Act.
>
> (7) For the purposes of this paragraph, in the case of a company—
>
> "ordinary tax return" means a company tax return under Schedule 18 to the Finance Act 1998, and
>
> "the filing date", in relation to that return, has the meaning given by paragraph 14 of that Schedule.
>
> (8) For the purposes of this paragraph—
>
> (a) the reference to an election being included in a relevant return includes its being included as a result of an amendment of the return, and
>
> (b) the reference to the revocation of an election being included in

[54] See 123.5 (Tax return claims).

[55] See 121.4 (Notice to make return).

an ordinary tax return includes its being included as a result of an amendment of the return.

57.30 Interaction with anti-avoidance

57.30.1 *UK-land gain outside s.3*

Section 3(1) TCGA provides:

> (1) This section applies if ...
>
> (d) apart from this section, some or all of the gain would not be chargeable to corporation tax on the company.

A non-resident company is subject to CT directly, on gains from UK land/land-rich assets, so this takes the gains outside s.3, and avoids a double charge.

57.30.2 *UK-land gain outside s.86/87*

The wording follows a template, so it is helpful to read the provisions side by side:

s.86(4ZA) TCGA	**s.87(5A) TCGA**
Where (apart from this subsection) the amount mentioned in subsection (1)(e)[56] would include a chargeable gain or allowable loss to which section 1A(3)(b) or (c) applies (disposals by non-UK residents within the charge to capital gains tax [disposal of UK land/land-rich asset]),	Where (apart from this subsection) the amount mentioned in subsection (4)(a)[57] would include a chargeable gain or allowable loss to which section 1A(3)(b) or (c) applies (disposals by non-UK residents within the charge to capital gains tax),
so much of the gain or loss as would be so included is to be disregarded for the purposes of subsection (1)(e).	so much of the gain or loss as would be so included is to be disregarded for the purposes of determining the section 1(3) amount.

A non-resident trust is subject to CGT directly, on gains from UK land/land-rich assets, so this takes the gains outside s.86 and s.87 TCGA, and avoids a double charge.

[56] See 60.11 (Section 86 gains condition).

[57] See 61.6 (Section 1(3) amount).

57.31 Hold-over relief

CGT has two sets of hold-over reliefs, which (in short) may avoid the charge otherwise arising on gifts[58]:

(1) s.165 TCGA (business/agricultural property):

s.165 amended by	***Gift by***	***Asset***
(a) *unamended*	individual	business property
(b) para 1 sch 7	individual	agricultural property
(c) para 2 sch 7	trustee	business property
(d) para 3 sch 7	trustee	agricultural property

(2) s.260 TCGA: gift by individual/trustee:

(a) a chargeable transfer[59]

Both sets of reliefs apply in an amended way for land-gains. One might refer to them as **"land-asset s.165/s.260"**.

There are *four* versions of each set of reliefs:

Version		**Transferor**	**Transferee**
Standard (non land-assets)		Does not matter	Resident
Land-assets			
s.165(7A)-(7C)	s.260(6ZA)-(6ZC)	Non-resident	Resident
s.167A(2)	s.261ZA(2)	Resident	Non-resident
s.167(3)	s.261ZA(3)	Non-resident	Non-resident

Simplicity was not a consideration here; a full discussion would need a book to itself. [60]

57.32 Hold-over relief: Standard version

57.32.1 *s.165/260 application conditions*

s.165(1) TCGA	**s.260(1) TCGA:**
If—	If—
(a) an individual ("the transferor") makes a disposal otherwise than under a bargain at arm's length of an asset within subsection (2) below, and	(a) an individual or the trustees of a settlement ("the transferor") make a disposal within subsection (2) below of an asset

[58] I refer for simplicity to gifts, though the relief applies to all disposals at an undervalue.

[59] There are a further 9 categories of disposal within s.260 which are not discussed here.

[60] See Gunn, "Hold-over relief for land: did someone lose the plot" Tax Planning Review (2020) Vol 7 p.233.

	(b) the asset is acquired by an individual or the trustees of a settlement (“the transferee”), and
(b) a claim for relief under this section is made by the transferor and the person who acquires the asset ("the transferee") or, where the trustees of a settlement are the transferee, by the transferor alone,	(c) a claim for relief under this section is made by the transferor and the transferee or, where the trustees of a settlement are the transferee, by the transferor alone,
then, subject to subsection (3) and sections 166, 167, 167A, 169, 169B and 169C, subsection (4) below shall apply in relation to the disposal.	then, subject to subsection (6) below and sections 169, 169B, 169C, 261 and 261ZA, subsection (3) below shall apply in relation to the disposal.

I refer to the conditions in s.165(1)/s.260(1) as **“s.165/s.260 application conditions”** .

The last paragraph of s.165(1)/260(1) refers to some of the exceptions to hold-over relief; but it is more helpful to set out a complete list:

TCGA	**Topic**	**See para**
Hold-over relief disapplied		
s.166/261	Gift to non-resident	
s.167	Gift to foreign-controlled company	
s.167A/261ZA	Gift of land-asset to non-resident	
s.169	Gift to dual resident trust	
s.169B	Gift to settlor-interested trust	
Hold-over relief clawed back		
s.168	Gift to individual who becomes non-resident	8.2
s.169A	Gift to LLP which ceases business (this will rarely if ever happen)	
s.169C	Gift to trust which becomes settlor-interested	

The exceptions in the above table are effectively the same for s.165 and s.260.[61] The next requirement is what distinguishes s.165/260 reliefs:

[61] The drafting is erratic, in that on 2 occasions there are separate provisions for s.165/s.260 reliefs; on other occasions there is one single provision which applies to both reliefs. But it does not matter.

s.165(2) TCGA	**s.260(2) TCGA**
(2) An asset is within this subsection if— (a) it is, or is an interest in, an asset used for the purposes of a trade, profession or vocation carried on by— (i) the transferor, or (ii) his personal company, or (iii) a member of a trading group of which the holding company is his personal company, or	(2) A disposal is within this subsection if it is made otherwise than under a bargain at arm's length and—
(b) it consists of shares or securities of a trading company, or of the holding company of a trading group, where— (i) the shares or securities are not listed on a recognised stock exchange, or (ii) the trading company or holding company is the transferor's personal company.	(a) is a chargeable transfer within the meaning of the Inheritance Tax Act 1984 (or would be but for section 19 of that Act) and is not a potentially exempt transfer (within the meaning of that Act)...

Section 226A TCGA restricts private residence relief following a claim for hold-over relief under s.260; this is not discussed here.

57.32.2 *Restrictions on s.165 relief*

Section 165(3) TCGA provides 3 restrictions on s.165 hold-over relief, one of which has an equivalent in s.260(6) TCGA

s.165(3) TCGA	**s.260(6) TCGA:**
Subsection (4) below does not apply in relation to a disposal if—	
(ba) in the case of a disposal of shares or securities, the transferee is a company,	
(c) in the case of a disposal of qualifying corporate bonds, a gain is deemed to accrue by virtue of section 116(10)(b), or	Subsection (3) above does not apply in relation to a disposal of assets within section 115(1) on which a gain is deemed to accrue by virtue

	of section 116(10)(b) [QCBs].
(d) subsection (3) of section 260 applies in relation to the disposal (or would apply if a claim for relief were duly made under that section).	

The effect of para (d) is that s.260 has priority over s.165, if both apply. The point may be to avoid the apportionment which may apply under s.165 for a trading company with non-trading assets.

57.32.3 *Standard hold-over relief*

Assuming these conditions are satisfied, the standard relief is in s.165(4)/s.260(3) TCGA:

s.165(4) TCGA	**s.260(3) TCGA:**
(4) Where a claim for relief is made under this section in respect of a disposal—	Where this subsection applies in relation to a disposal—
(a) the amount of any chargeable gain which, apart from this section, would accrue to the transferor on the disposal, and (b) the amount of the consideration for which, apart from this section, the transferee would be regarded for the purposes of capital gains tax as having acquired the asset in question, shall each be reduced by an amount equal to the held-over gain on the disposal.	[identical]

57.32.4 *Held-over gain*

s.165(6) TCGA	**s.260(4) TCGA:**
(6) Subject to Part II of Schedule 7 and subsection (7) below,	(4) Subject to subsection (5) below,
the reference in subsection (4) above to the held-over gain on a disposal is a reference to the	the reference in subsection (3) above to the held-over gain on a disposal is a reference to the

chargeable gain which would have accrued on that disposal apart from subsection (4) above,

and in subsection (7) below that chargeable gain is referred to as the unrelieved gain on the disposal.

chargeable gain which would have accrued on that disposal apart from this section.

57.32.5 *Actual consideration*

Section 165(7)/s.260(5) TCGA provide:

> In any case where—
> (a) there is actual consideration[62] (as opposed to the consideration equal to the market value which is deemed to be given by virtue of any provision of this Act) for a disposal in respect of which a claim for relief is made under this section, and
> (b) that actual consideration exceeds the sums allowable as a deduction under section 38,
> the held-over gain on the disposal shall be reduced by the excess referred to in paragraph (b) above.

Section 260(9) TCGA provides:

> Where subsection (3) above applies in relation to a disposal which is deemed to occur by virtue of section 71(1) or 72(1), subsection (5) above shall not apply.

Why is that needed?

57.32.6 *IHT added to base cost*

Section 260 TCGA provides:

> (7) In the case of a disposal within subsection (2)(a) above [(whether or not subsection (3) above applies in relation to it)]6 there shall be allowed as a deduction in computing the chargeable gain accruing to the transferee on the disposal of the asset in question an amount equal to whichever is the lesser of—
> (a) the inheritance tax attributable to the value of the asset; and
> (b) the amount of the chargeable gain as computed apart from this subsection.
> (8) Where an amount of inheritance tax is varied after it has been taken

[62] See App.4.2 (Consideration) and in particular App.4.4.3 (Transfer on divorce).

> into account under subsection (7) above, all necessary adjustments shall be made, whether by the making of an assessment to capital gains tax or by the discharge or repayment of such tax.

57.32.7 *Partial relief*

Section 260(10) TCGA provides:

> Where a disposal is partly within subsection (2) above, or is a disposal within paragraph (f) of that subsection on which there is a reduced charge such as is mentioned in that paragraph, the preceding provisions of this section shall have effect in relation to an appropriate part of the disposal.

57.32.8 *Making the claim*

As the claim is usually made by transferor and transferee, it is a freestanding claim, not made in the transferor's tax return.[63] There is an official form.[64] It seems that this form is also intended for use when the claim is made by the transferor alone.

57.33 Land-asset hold-over relief

The drafting is dense, and some readers may think, obtuse. The drafter was particularly fond of referential definitions, and of incorporating provisions with amendments. I expand the latter, thus setting the provision out in full, for the benefit of readers who do not possess instant recall of all the relevant provisions.

57.33.1 *"Land-asset"*

The statute frequently refers to assets "within s.1A(3)(b) or (c) TCGA". That means UK land or land-rich assets. I refer to that as a **"land-asset"**, and the gain on the disposal of a land-asset is a **"land-gain"**.

57.33.2 *Land disposal: non-residence condition*

The statute uses the clumsy expression "direct or indirect disposal of UK land which meets the non-residence condition." Section 165(7D)/260(6ZD) TCGA provide a clumsy referential definition of this term:

> For the purposes of subsections [subsections (7A) to (7C)/(6ZA) to

[63] See 123.6 (Free-standing claims).

[64] *https://www.gov.uk/government/publications/relief-for-gifts-and-similar-transactions-hs295-self-assessment-helpsheet*

> (6ZC)] a disposal is a "direct or indirect disposal of UK land which meets the non-residence condition" if it is—
>
> (a) a disposal on which a gain accrues that falls to be dealt with by section 1A(3) because the asset disposed of is within paragraph (b) or (c) of that subsection [land/land-rich asset], or
>
> (b) a disposal on which a gain accrues that falls to be dealt with by section 1A(1) in accordance with section 1G(2) [split years] because the asset disposed of is within section 1A(3)(b) or (c) [land/land-rich asset].

In short, this applies to a disposal of a land-asset by a non-resident.

The definition only applies for s.165/s.260, so it has to be repeated verbatim in s.261ZA(6) TCGA.

57.34 Land-asset: Resident transferee

s.165 TCGA	**s.260 TCGA**
(7A) Subsections (7B) and (7C) apply in any case where	(6ZA) Subsections (6ZB) and (6ZC) apply in any case where—
(a) the disposal is a direct or indirect disposal of UK land which meets the non-residence condition [disposal of land/land-rich asset by non-resident], and (b) the transferee is resident in the UK.	[identical]

If these conditions are met, the provisions of s.165/260 are amended as follows:

s.165 TCGA	**s.260 TCGA**
(7B) Subsections (4) and (6) have effect in relation to the disposal as if the references to "chargeable gain" were references to "so much of any gain accruing on the disposal as falls to be dealt with as mentioned in subsection (7D)(a) or (b)"	(6ZB) Subsections (3) and (4) have effect in relation to the disposal as if the reference to "chargeable gain" were a reference to "so much of any gain accruing on the disposal as falls to be dealt with as mentioned in subsection (6ZD)(a) or (b)".
(7C) Subsection (7) has effect in relation to the disposal as if the	(6ZC) Subsection (5) has effect in relation to the disposal as if the

reference to “the excess referred to in paragraph (b) above” were a reference to [“so much of the gain mentioned in subsection (7B)]10 which, ignoring this section and section 17(1), would accrue to the transferor on the disposal”.	reference to “the excess referred to in paragraph (b) above” were a reference to “so much of the gain mentioned in subsection (6ZB) which, ignoring this section and section 17(1), would accrue to the transferor on the disposal”.

Amended as ss 7B/6ZB require, s.165(4)/s.260(3) TCGA provide:

s.165 TCGA	**s.260 TCGA**
(4) Where a claim for relief is made under this section in respect of a disposal—	(3) Where this subsection applies in relation to a disposal—
(a) the amount of ~~any chargeable gain~~ so much of any gain accruing on the disposal as falls to be dealt with as mentioned in subsection (7D)(a) or (b) which, apart from this section, would accrue to the transferor on the disposal, and	(a) the amount of ~~any chargeable gain~~ so much of any gain accruing on the disposal as falls to be dealt with as mentioned in subsection (6ZD)(a) or (b) which, apart from this section, would accrue to the transferor on the disposal, and
(b) the amount of the consideration for which, apart from this section, the transferee would be regarded for the purposes of capital gains tax as having acquired the asset in question,	[identical]
shall each be reduced by an amount equal to the held-over gain on the disposal.	[identical]

Amended as ss 7B/6ZB require, s.165(6)/s.260(4) TCGA provide:

s.165 TCGA	**s.260 TCGA**
Subject to Part II of Schedule 7 and subsection (7) below,	(4) Subject to subsection (5) below,
the reference in subsection (4) above to the held-over gain on a disposal is a reference to	the reference in subsection (3) above to the held-over gain on a disposal is a reference to
~~the chargeable gain~~ so much of any gain accruing on the disposal as falls to be dealt with as mentioned in subsection (7D)(a) or (b) which would have	~~the chargeable gain~~ so much of any gain accruing on the disposal as falls to be dealt with as mentioned in subsection (6ZD)(a) or (b) which would have

accrued on that disposal apart from subsection (4) above and (in appropriate cases) Schedule 6, and in subsection (7) below that chargeable gain is referred to as the unrelieved gain on the disposal.	accrued on that disposal apart from this section.

We therefore need to ascertain what is the "gain accruing on the disposal as falls to be dealt with as mentioned in subsection [(7D)(a) or (b)/(6ZD)(a) or (b)]". That is, in short, the gain on a land-asset disposed of by a non-resident.

In short, hold-over relief is reduced to the taxable, land-gain.

57.34.1 *Actual consideration*

Amended as s.165(7C)/s.260(6ZC) TCGA require, s.165(7)/s.260(5) provide:

> In any case where—
>
> (a) there is actual consideration (as opposed to the consideration equal to the market value which is deemed to be given by virtue of any provision of this Act) for a disposal in respect of which a claim for relief is made under this section, and
>
> (b) that actual consideration exceeds the sums allowable as a deduction under section 38,
>
> the held-over gain on the disposal shall be reduced by ~~the excess referred to in paragraph (b) above~~ so much of the gain mentioned in subsection [(7B)/(6ZB)] which, ignoring this section and section 17(1), would accrue to the transferor on the disposal.

57.35 Non-resident transferee

Section 166(1)/s.261(1) TCGA disallow standard hold-over relief on a gift to a non-resident transferee:

s.166 TCGA	**s.261 TCGA**
(1) Subject to section 167A, section 165(4) shall not apply where the transferee is not resident in the UK.	Subject to section 261ZA, section 260(3) shall not apply where the transferee is not resident in the UK.

That makes sense because a non-resident transferee would not be generally subject to CGT on the held-over gain, in the event of a later disposal. But UK land is different, so s.167A/s.261ZA TCGA provide different rules.

57.35.1 *Relevant gain*

For the definition, one needs to read together s.167A(6)(7)/s.261ZA(6)(7)

TCGA:

> (6) For the purposes of this section, a disposal is a "direct or indirect disposal of UK land which meets the non-residence condition" if it is—
> (a) a disposal on which a gain accrues that falls to be dealt with by section 1A(3) because the asset disposed of is within paragraph (b) or (c) of that subsection [land/land-rich asset], or
> (b) a disposal on which a gain accrues that falls to be dealt with by section 1A(1) in accordance with section 1G(2) [split year] because the asset disposed of is within section 1A(3)(b) or (c) [land/land-rich asset].
> (7) For the purposes of this section, a "relevant gain" means so much of any chargeable gain accruing on a disposal as falls to be dealt with as mentioned in subsection (6)(a) or (b).

In my terminology, the relevant gain is the land-gain.

57.35.2 *Disposal by UK resident to non-resident*

s.167A(1) TCGA	**s.261ZA(1) TCGA**
(1) This section applies where [A] the disposal in relation to which a claim could be made under section 165 is [i] a disposal of an asset within section 1A(3)(b) or (c)[land/land-rich asset] [ii] to a transferee who is not resident in the UK and,	(1) This section applies where [A] the disposal in relation to which a claim could be made under section 260 is [i] a disposal of an asset within section 1A(3)(b) or (c) [land/land-rich asset] [ii] to a transferee who is not resident in the UK and,
[B] ignoring section 165— (a) a gain would accrue to the transferor on the disposal, and (b) on the assumption that the disposal is a direct or indirect disposal of UK land which meets the non-residence condition (whether or not that is the case),	[B] ignoring section 260— (a) a gain would accrue to the transferor on the disposal, and (b) on the assumption that the disposal is a direct or indirect disposal of UK land which meets the non-residence condition (whether or not that is the case),
that gain would be a relevant gain (see subsections (6) and (7)).	that gain would be a relevant gain (see subsections (6) and (7)).

In these circumstances, s.167A(2)/s.261ZA(2) modify the standard hold-over relief:

Section 165(4) has effect in relation to the disposal as if it read—	(2) Section 260(3) has effect in relation to the disposal as if it read—

It may be helpful to contrast the standard reliefs and the land-asset reliefs:

Standard s.165 relief: s.165(4)	**Land-asset s.165 relief: s.167A(4)**
(4) Where a claim for relief is made under this section in respect of a disposal—	(4) Where a claim for relief is made under this section in respect of the disposal,
(a) the amount of any chargeable gain which, apart from this section, would accrue to the transferor on the disposal, and (b) the amount of the consideration for which, apart from this section, the transferee would be regarded for the purposes of capital gains tax as having acquired the asset in question, shall each be reduced by an amount equal to the held-over gain on the disposal.	the amount of any chargeable gain which, apart from this section, would accrue to the transferor on the disposal, shall be reduced by an amount equal to the held-over gain on the disposal.
Standard s.260 relief: s.260(3)	**Land-asset s.260 relief: s.261ZA(2)**
Where this subsection applies in relation to a disposal—	Where this subsection applies in relation to a disposal,
(a) the amount of any chargeable gain which, apart from this section, would accrue to the transferor on the disposal, and	the amount of any chargeable gain which, apart from this section, would accrue to the transferor on the disposal,
(b) the amount of the consideration for which, apart from this section, the transferee would be regarded for the purposes of capital gains tax as having acquired the asset in question,	

shall each be reduced by an amount equal to the held-over gain on the disposal.	shall be reduced by an amount equal to the held-over gain on the disposal.

57.35.3 *Disposal by non-resident to non-resident*

s.167A(3)	**s.261ZA(3)**
Where the disposal is a direct or indirect disposal of UK land which meets the non-residence condition—	[identical]
(a) section 165(4), as modified by subsection (2) of this section, has effect in relation to the disposal as if the reference to "chargeable gain" were a reference to "relevant gain", (b) section 165(6) has effect in relation to the disposal as if the references to "chargeable gain" were references to "relevant gain", and	(a) section 260(3), as modified by subsection (2) of this section, and section 260(4) have effect in relation to the disposal as if the references to "chargeable gain" were references to "relevant gain", and
(c) section 165(7) has effect in relation to the disposal as if the reference to "the excess referred to in paragraph (b) above" were a reference to "the relevant gain which, ignoring this section and section 17(1), would accrue to the transferor on the disposal".	(b) section 260(5) has effect in relation to the disposal as if the reference to "the excess referred to in paragraph (b) above" were a reference to "the relevant gain which, ignoring this section and section 17(1), would accrue to the transferor on the disposal".

Amended as these provisions require:

s.165(4) TCGA	**s.260(3) TCGA:**
(4) Where a claim for relief is made under this section in respect of a disposal—	Where this subsection applies in relation to a disposal—
the amount of any ~~chargeable gain~~ relevant gain which, apart from this	[identical]
section, would accrue to the transferor	

on the disposal, and	
(b) the amount of the consideration for which, apart from this section, the transferee would be regarded for the purposes of capital gains tax as having acquired the asset in question, shall each be reduced by an amount equal to the held-over gain on the disposal.	[identical]
(6) Subject to Part II of Schedule 7 and subsection (7) below, the reference in subsection (4) above to the held-over gain on a disposal is a reference to the ~~chargeable gain~~ relevant gain which would have accrued on that disposal apart from subsection (4) above and (in appropriate cases) Schedule 63, and in subsection (7) below that ~~chargeable gain~~ relevant gain is referred to as the unrelieved gain on the disposal.	[No equivalent]
(7) In any case where— (a) there is actual consideration (as opposed to the consideration equal to the market value which is deemed to be given by virtue of section 17(1)) for a disposal in respect of which a claim for relief is made under this section, and (b) that actual consideration exceeds the sums allowable as a deduction under section 38, the held-over gain on the disposal shall be the amount by which the unrelieved gain on the disposal exceeds ~~the excess referred to in paragraph (b) above~~ the relevant gain which, ignoring this section and section 17(1), would accrue to the transferor on the disposal.	(5) In any case where— (a) there is actual consideration (as opposed to the consideration equal to the market value which is deemed to be given by virtue of any provision of this Act) for a disposal in respect of which a claim for relief is made under this section, and (b) that actual consideration exceeds the sums allowable as a deduction under section 38, the held-over gain on the disposal shall be reduced by ~~the excess referred to in paragraph (b) above~~ the relevant gain which, ignoring this section and section 17(1), would accrue to the transferor on the disposal.

57.35.4 *Disposal by transferee*

Section 167A(4)/261ZA(4) TCGA deals with the position where:

(1) A gives a land-asset to B and claims s.260 hold-over relief

(2) B later disposes of the asset.

s.167A(4) TCGA	**s.261ZA(4) TCGA**
(4) Where a claim for relief is made under section 165 in relation to the disposal mentioned in subsection (1), on a subsequent disposal by the transferee of the whole or part of the asset within section 1A(3)(b) or (c) [land/land-rich asset] which is the subject of the disposal mentioned in subsection (1), the whole or a corresponding part of the held-over gain (see section 165(6))—	Where a claim for relief is made under section 260 in relation to the disposal mentioned in subsection (1), on a subsequent disposal by the transferee of the whole or part of the asset within section 1A(3)(b) or (c) [land/land-rich asset] which is the subject of the disposal mentioned in subsection (1), the whole or a corresponding part of the held-over gain (see section 260(4))—
(a) is deemed to accrue to the transferee (in addition to any gain or loss that actually accrues on that subsequent disposal), and (b) (if that would not otherwise be the case) is to be treated as a relevant gain.	(a) is deemed to accrue to the transferee (in addition to any gain or loss that actually accrues on that subsequent disposal), and (b) (if that would not otherwise be the case) is to be treated as a relevant gain accruing on a direct or indirect disposal of UK land which meets the non-residence condition.

57.35.5 *Subsequent disposal chargeable transfer*

s.167A(5) TCGA	**s.261ZA(5) TCGA**
(5) Where the subsequent disposal mentioned in subsection (4) is (or proves to be) a chargeable transfer for inheritance tax purposes, section 165(10) has effect in relation to the disposal as if—	Where the subsequent disposal mentioned in subsection (4) is a disposal within section 260(2)(a), subsection (7) of that section has effect in relation to the disposal as if—
(a) the reference to "the chargeable gain accruing to the transferee on the disposal of the asset" were a reference to the chargeable gain accruing on the disposal as computed apart from subsection (4), and	(a) the reference to "the chargeable gain accruing to the transferee on the disposal of the asset" were a reference to the chargeable gain accruing on the disposal as computed apart from subsection (4), and

(b) the reference in section 165(10)(b) to “the chargeable gain” were a reference to— (i) the chargeable gain chargeable to capital gains tax by virtue of any provision of this Act accruing on the disposal, and	(b) the reference in section 260(7)(b) to “the chargeable gain” were a reference to— (i) the chargeable gain (or, where the disposal is a a direct or indirect disposal of UK land which meets the non-residence condition, the relevant gain) accruing on the disposal, and
(ii) the held-over gain deemed to accrue under subsection (4).	(ii) the held-over gain deemed to accrue under subsection (4).

Amended as s.167A(5)/s.261ZA(5) TCGA direct:

s.165(10) TCGA	**s.260(7) TCGA**
Where a disposal [in relation to which subsection (4) above applies]7 is (or proves to be) a chargeable transfer for inheritance tax purposes, there shall be allowed as a deduction in computing (for capital gains tax purposes) ~~the chargeable gain accruing to the transferee on the disposal of the asset~~ the chargeable gain accruing on the disposal as computed apart from subsection (4) in question an amount equal to whichever is the lesser of—	In the case of a disposal within subsection (2)(a) above (whether or not subsection (3) above applies in relation to it) there shall be allowed as a deduction in computing ~~the chargeable gain accruing to the transferee on the disposal of the asset~~ the chargeable gain accruing on the disposal as computed apart from subsection (4) in question an amount equal to whichever is the lesser of—
(a) the inheritance tax attributable to the value of the asset, and (b) the amount of ~~the chargeable gain~~ (i) the chargeable gain chargeable to capital gains tax by virtue of any provision of this Act accruing on the disposal, and (ii) the held-over gain deemed to accrue under subsection (4) as computed apart from this subsection, and, in the case of a disposal which, being a potentially exempt transfer, proves to be a chargeable transfer, all necessary adjustments shall be made, whether by the discharge or repayment of capital gains tax or otherwise.	(a) the inheritance tax attributable to the value of the asset; and (b) the amount of ~~the chargeable gain~~ (i) the chargeable gain (or, where the disposal is a a direct or indirect disposal of UK land which meets the non-residence condition, the relevant gain) accruing on the disposal, and (ii) the held-over gain deemed to accrue under subsection (4) as computed apart from this subsection.

57.36 Unascertainable consideration

Section 48A TCGA deals with a disposal of UK land/land rich asset for unascertainable consideration.

Section 48A(1) TCGA provides:

> This section applies where—
>
> (a) a person ("P") has made a disposal ("the original disposal") on which a relevant non-resident gain or relevant non-resident loss accrued
>
> (b) P acquired a right as the whole or part of the consideration for that disposal,
>
> (c) on P's acquisition of the right, there was no corresponding disposal of it, and
>
> (d) the right is a right to unascertainable consideration (see subsections (4) to (6)).

If these conditions are met, we move on towards the rule in s.48A(2) TCGA:

> If
>
> [a] P subsequently receives consideration ("the ascertained consideration") representing the whole or part of the [unascertained] consideration referred to in subsection (1)(d) and
>
> [b] P is not UK resident for the tax year in which the ascertained consideration is received (as determined for the purposes of Chapter 1 of Part 1)—

We then turn to the rules where these conditions are met:

> (a) the ascertained consideration is treated as not accruing on the disposal of the right,
>
> (b) the costs of P's acquisition of the right (or, in the case of a part disposal of the right, those costs so far as referable to the part disposed of) are taken to be nil, and
>
> (c) the following steps are taken.
>
> *Step 1*
>
> Any amount by which
>
> [i] the ascertained consideration exceeds
>
> [ii] the relevant original consideration[65]

[65] Section 48A(3) TCGA provides: "In step 1 in subsection (2), "the relevant original consideration" means the consideration accruing on the original disposal, so far as

> is treated as consideration (or further consideration) accruing on the original disposal.
>
> If the relevant original consideration exceeds the ascertained consideration, the consideration accruing on the original disposal is treated as reduced by the amount of the excess.
>
> *Step 2*
>
> Compute the difference that the adjustment under step 1 makes to what (if any) relevant non-resident gain or relevant non-resident loss or loss or other gain or loss accrues on the original disposal (computing this separately for each type of gain or loss).
>
> The difference is "positive" if a loss is decreased (to nil or otherwise) or a gain created or increased.
>
> The difference is "negative" if a gain is reduced (to nil or otherwise) or a loss created or increased.
>
> *Step 3*
>
> Any positive amount computed under step 2 is treated for the purposes of this Act and the Management Act [TMA] as a gain (of the type appropriate to the computation) accruing to P at the time of the receipt of the ascertained consideration.
>
> Any negative amount computed under step 2 is treated for the purposes of this Act and the Management Act as a loss (of the type appropriate to the computation) accruing to P at the time of the receipt of the ascertained consideration.

Could the gain on the disposal of the right to unascertainable consideration qualify for DT relief, on the grounds that it is not a gain derived from the alienation of UK land?

57.36.1 *Unascertainable*

Section 48A(4) TCGA provides:

> A right is a right to unascertainable consideration if, and only if—
>
> (a) it is a right to consideration the amount or value of which is unascertainable at the time when the right is conferred, and
>
> (b) that amount or value is unascertainable at that time on account of its being referable, in whole or in part, to matters which are uncertain at that time because they have not yet occurred. This subsection is subject to subsections (5) and (6).

referable to the right mentioned in subsection (1)(b) (or, in the case of a part disposal of the right, referable to the part disposed of)."

Section 48A(5) TCGA provides:

> The amount or value of any consideration is not to be regarded as being unascertainable by reason only—
>
> (a) that the right to receive the whole or any part of the consideration is postponed or contingent, if the consideration or, as the case may be, that part of it is, in accordance with section 48, brought into account in the computation of the gain accruing to a person on the disposal of an asset, or
>
> (b) in a case where the right to receive the whole or any part of the consideration is postponed and is to be, or may be, to any extent satisfied by the receipt of property of one description or property of some other description, that some person has a right to select the property, or the description of property, that is to be received.

In these circumstances s.48 TCGA applies; it has priority over s.48A. See 56.4.3 (Section 48 analysis).

Section 48A(6) TCGA provides:

> A right is not to be taken to be a right to unascertainable consideration by reason only that either the amount or the value of the consideration has not been fixed, if—
>
> (a) the amount will be fixed by reference to the value, and the value is ascertainable, or
>
> (b) the value will be fixed by reference to the amount, and the amount is ascertainable.

57.36.2 *"Relevant gain/loss"*

Section 48A(7) TCGA provides:

> In this section—
>
> "relevant non-resident gain" means—
>
> (a) a gain that falls to be dealt with by section 1A(3) because the asset disposed of is within paragraph (b) or (c) of that subsection [land/land-rich asset], or
>
> (b) a gain that falls to be dealt with by section 1A(1) in accordance with section 1G(2) [split year] because the asset disposed of is within section 1A(3)(b) or (c) [land/land-rich asset], and
>
> "relevant non-resident loss" means an allowable loss accruing on a disposal which, had a gain accrued instead, would have been a relevant non-resident gain.

57.36.3 *Application to corporation tax*

CIOT say:[66]

> it is unclear whether s.48A applies only for the purposes of CGT (ie not corporation tax) on the basis that s.48A(7)(a) refers only to s.1A(3).[67]

It is difficult to see why the rules for CGT and CT should differ.[68] On the other hand, it may seem difficult to construe the reference to s.1A(3) to include other provisions. But a purposive construction will take us there, and the better view is that s.48A applies for CT. Perhaps in due course s.48A will be amended.

57.36.4 *Pre-2019 disposal*

The text set out above includes the amendments made by para 27 sch 1 FA 2019. Para 27 provides:

> (5) The amendments made by this paragraph have effect where the ascertained consideration is received on or after 6 April 2019, but, subject to the following modifications, in a case where the original disposal was made before that date.
> (6) In that case, section 48A of TCGA 1992—
> (a) has effect without the amendments made by sub-paragraphs (2) and (3)(b), and
> (b) has effect as if, in step 3 in subsection (2)(c) of that section, for "(of the type appropriate to the computation)" (in both places) there were substituted "(of a kind most closely corresponding to that accruing on the original disposal)".

This will not often apply now.

57.37 Residential property gain

57.37.1 *Residential property gain: outline*

This term matters for:

Topic	**See para**
UK-land rebasing	57.15

[66] CIOT, letter to HMRC 31 Oct 2023 re the UK/Luxembourg DTA *https://www.tax.org.uk/ref1240*

[67] See 57.2 (Charge on land/land-rich assets); for treaty relief, see 107.25.1 (Disposal for unascertained consideration).

[68] See 56.5.1 (CGT rules applied to CT).

Rates of CGT	43.13
Private residence relief	59.1

The definition is in:

(1) sch 1B TCGA

(2) sch 4AA TCGA (which amends the sch 1B rules where there is an election out of UK-land rebasing)

Para 1(1) sch 1B TCGA provides:

> For the purposes of Chapter 1 of Part 1 "residential property gain" means so much of a chargeable gain accruing to a person on a disposal of residential property as, in accordance with paragraph 2, is attributable to that property.

This definition is for the purposes of Chapter 1 Part 1, which contain s.1-1O TCGA, which includes the provisions governing rates of CGT. The definition is incorporated by reference where needed elsewhere.

The requirements are, in short:

(1) Disposal of a residence

(2) Gain attributable to the residence

A s.3 gain attributed to a UK resident will be a residential property gain where the company disposes of residential property; but a s.87 gain is not a residential property gain, even if matched to a gain on the disposal of residential property.

57.37.2 *Gain attributed to residence*

Para 2(1) sch 1B TCGA provides:

> The proportion of a chargeable gain attributable to residential property is equal to—
>
> (a) the relevant fraction of the gain ...

Para 2(2) sch 1B TCGA provides for time apportionment:

> The relevant fraction is A/B where—
>
> A is the number of days in the applicable period on which the land to which the disposal relates consists of or includes a dwelling, and
>
> B is the total number of days in the applicable period.

57.37.3 *Mixed use of land*

Para 2(1) sch 1B TCGA provides:

> The proportion of a chargeable gain attributable to residential property is equal to ...
>
> (b) if there has been mixed use of the land to which the disposal relates on one or more days in the applicable period, the relevant fraction of the gain as adjusted, on a just and reasonable basis, to take account of the mixed use on the day or days.

Para 2(3) sch 1B TCGA provides:

> There is mixed use of land on any day on which the land consists of—
>
> (a) one or more dwellings, and
>
> (b) other land.

57.37.4 *Disposal of contract*

Para 2(4) sch 1B TCGA provides:

> If the disposal is of an interest in land subsisting under a contract for the acquisition of land consisting of or including a building that is to be constructed or adapted for use as a dwelling, that land is taken to consist of or include a dwelling throughout the applicable period.

57.37.5 *Applicable period*

Para 2(5) sch 1B TCGA provides:

> In this paragraph "the applicable period" means the period—
>
> (a) beginning with
>
> [i] the day on which the person making the disposal acquired the interest in land being disposed of
>
> [ii] or, if later, the day from which the interest in land became chargeable, and
>
> (b) ending with the day before the day on which the disposal occurs.

Para 2(6) sch 1B TCGA provides:

> For the purposes of this paragraph an interest in land became "chargeable"—
>
> (a) in any case where the disposal is of an interest in land in the UK—
>
> (i) by a person in a tax year in which the person is not UK resident, or
>
> (ii) by a person in the overseas part of a tax year which is, as respects the person, a split year,

> from 6 April 2015, and
> (b) in any other case, from 31 March 1982.

57.37.6 *2 or more acquisitions*

Para 2(7) sch 1B TCGA provides:

> If the interest in land disposed of by the person results from interests in land acquired by the person at different times, the person is regarded for the purposes of this paragraph as having acquired the interest disposed of at the time of the first acquisition.

57.38 Residential property

A residential property gain requires a disposal of residential property.

Para 1(2) sch 1B TCGA provides:

> The question whether or not a person disposes of residential property is determined in accordance with paragraphs 3 to 7.

Para 3 sch 1B TCGA provides:

> (1) For the purposes of this Schedule a person "disposes of residential property" if the person disposes of an interest in land in a case where—
> (a) the land consisted of or included a dwelling at any time falling on or after the date on which the applicable period begins,
> (b) the interest in land subsisted for the benefit of land that consisted of or included a dwelling at any time falling on or after that date, or
> (c) the interest in land subsists under a contract for the acquisition of land consisting of or including a building that is to be constructed or adapted for use as a dwelling.
> (2) No account is to be taken for the purposes of this paragraph of any time falling on (or after) the day on which the disposal is made.

This is actually a definition of "residential property" (not a definition of "disposes" as the wording might suggest).

There are two conditions or sets of conditions:

(1) Interest in land; see App 2.21 (Interest in land/chargeable interest).
(2) Conditions (a) to (c), in short, a dwelling; see App 2.22 (Dwelling/residential property).

The term "residential property gain" includes gains from a foreign residence.

57.39 Commencement

Para 120 sch 1 FA 2019 provides:

> (1) The amendments made by this Schedule have effect-
> (a) for the purposes of capital gains tax, for the tax year 2019-20 and subsequent tax years, and
> (b) for the purposes of corporation tax, for accounting periods beginning on or after 6 April 2019.
>
> (2) The amendments made by this Schedule also have effect for the purposes of corporation tax in relation to disposals made on or after 6 April 2019 (whether in their application to accounting periods beginning on, and ending on or after, that date or to later accounting periods).

57.39.1 *Pre-2019 losses*

Para 121 sch 1 FA 2019 provides:

> 121 (1) This paragraph applies to—
> (a) allowable NRCGT losses accruing to a person before 6 April 2019, and
> (b) ring-fenced ATED-related allowable losses accruing to a person before that date,
>
> so far as they have not been deducted under section 2B, 8(1)(b)(ii), 14D or 188D of TCGA 1992 (as those provisions have effect before the amendments made by this Schedule) from chargeable gains accruing before that date.
>
> (2) If losses to which this paragraph applies accrued to a company, they are deductible in accordance with section 2A(1) of TCGA 1992 as if they had accrued to the company while it was within the charge to corporation tax.
>
> (3) If losses to which this paragraph applies accrued to any other person, they—
> (a) are deductible in accordance with section 1(3) of TCGA 1992, and
> (b) are to be treated for the purposes of section 1E of TCGA 1992 as if they accrued on a disposal of assets that were within section 1A(3) of that Act.
>
> (4) In this paragraph—
> (a) the reference to allowable NRCGT losses is to be read in accordance with Schedule 4ZZB to TCGA 1992 (as that Schedule has effect before its repeal by this Schedule), and
> (b) the reference to ring-fenced ATED-related allowable losses is to be read in accordance with section 2B of that Act (as that

section has effect before its repeal by this Schedule).

57.40 Non-residents CG/CT: History

From the inception of CGT until 2013, a non-resident did not pay CGT on disposals of UK land (except in the case of a non-resident trader with a UK PE/branch).

From 2013/14 there was a charge (ATED-CGT) on companies within ATED.

From 2015/16 there was a charge (NRCGT) on non-residents, but restricted to residential property.

In the 2017/18 edition of this work, I said:

> HMRC say:
>
> > "The government believes that it is right that CGT should apply to disposals of interests in UK residential property. **The government does not intend to broaden the scope of the charge and apply CGT to disposals of interests in non-residential property.** This change is focussed on rectifying the unfairness in the system that currently allows non-residents to escape UK CGT on disposals of UK property that are or could be used as a dwellinghouse."[69]
>
> The bold font is in the original. The author rightly considered the issue an important one. But no reason is given. The claim that this rectifies "unfairness" (and is "right") is a rhetorical device which avoids answering the question while appearing to do so.
>
> There is no need to justify the taxation of non-residents on gains accruing on UK land (or indeed other UK assets). That is consistent with the general principles of international tax law.[70] Many countries with CGT (perhaps a majority) impose tax in this situation. The question is why there should be a tax on *residential* property but not on non-residential; and why an exemption for widely held companies?...
>
> Is there any other country in the world which charges non-residents on gains from residential property, but not from non-residential property? ... The fact that the rest of the world is out of step does not prove that UK policy is wrong, but it might have given pause for thought - had there been time for thought. The legislation was published in draft in

[69] NRCGT response paper para 3.9. The same point was made in the NRCGT consultation paper para 2.3: "The government does not intend to change the tax treatment for property, such as office and industrial buildings, which cannot be used as and are not in the course of being converted to a place to live."

[70] OECD Model recognises this: see 56.24.1 (Immovable property in source state).

> December 2014, and completely recast in the Finance Bill. Because of the 2015 election, the Finance Bill was published on 24 March 2015 and enacted on 26 March, without consideration or amendment. Does anyone think that law enacted in this way is likely to be stable?

Does it now matter? Readers may think it pointless to cry "foul" in a game which has no referee, and whose result is now declared. But I think the story deserves to be recorded, as a lesson in how not to legislate, and as a warning to those minded to rely on HMRC promises about future tax reform.

57.41 Non-residents CGT/IT: Critique

The 2019 extension of CGT to non-residents holding UK land and land-rich assets is in line with the policy of many, perhaps most countries.

Policy considerations in favour of the reform are fairness and additional revenue.

Policy considerations in favour of the position as it was from the inception of CGT in 1965 to 2019 are: encouragement of inward foreign investment, avoiding the lock-in effect of CGT, and simplicity.[71]

Needless to say, there has been no informed debate on the challenge of finding a balance between the conflicting policy considerations.

This is illustrative of a wider problem: CGT as a whole is

> ... a highly unsatisfactory tax. Possibly more than any other tax, it has been subject to frequent, dramatic, and often controversial changes...[72]

[71] An indication of HMRC unease concerning the complication of the land-asset rules is that the consultation response document contains no less than six claims that its proposals constitute simplification.

[72] Mirrlees Review, "Tax by Design" (2011) p.326.

CHAPTER FIFTY EIGHT

REORGANISATIONS

58.1 Reorganisations: Introduction
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58.1 Reorganisations: Introduction

Corporate restructuring is a topic of "immense complexity"[1]. This chapter considers the CGT issues in the round, though with special consideration to residence aspects, and the reorganisation TAAR, because cases on that TAAR shed light on other TAARs.

We should start with an index of the statutory provisions, for the purposes of navigation:

TCGA	**Topic**
Definitions	
s.126	Reorganisation
s.126	Original shares/new holding
sch 5AA	Scheme of reconstruction
Reliefs	
s.116	Reorganisation involving qualifying corporate bonds
s.127	Reorganisation
s.135	Exchange of shares[2] for shares
s.136	Reconstruction + shares issued/cancelled

[1] The words are from *Taxation of Companies & Company Reconstructions* (looseleaf) para W1.1.1.

[2] References to shares here include debentures.

s.139	Reconstruction + transfer of business
TAARs restricting reliefs	
s.137	TAAR restricting s.135/136 reliefs
s.139(5)	TAAR restricting s.139 relief
s.138	Clearance procedure (for both TAARs)

The following topics are discussed elsewhere:

Topic	**See para**
Reorganisation & remittance investment relief	19.13.2
CGT group relief	64.24
QCB of non-resident co	64.33

Other taxes also need consideration; IHT[3] and Stamp duty/SDRT (not considered here).

58.2 Reorganisation relief

Section 127 TCGA provides:

> [1] Subject to sections 128 to 130,
> [2] a reorganisation shall not be treated as involving
> [a] any disposal of the original shares or
> [b] any acquisition of the new holding or any part of it,
> [3] but the original shares (taken as a single asset) and the new holding (taken as a single asset) shall be treated as the same asset acquired as the original shares were acquired.

58.2.1 *"Reorganisation"*

Section 126 TCGA provides:

> (1) For the purposes of this section and sections 127 to 131 "reorganisation" means a reorganisation or reduction of a company's share capital ...

58.2.2 *Original shares/new holding*

Section 126 TCGA continues:

> and in relation to the reorganisation—
> (a) "original shares" means shares held before and concerned in the reorganisation,
> (b) "new holding" means, in relation to any original shares, the shares in and debentures of the company which as a result of the

[3] See 81.7 (Change in share capital/rights).

> reorganisation represent the original shares (including such, if any, of the original shares as remain).

58.2.3 *Allotment*

Section 126(2) TCGA provides:

> The reference in subsection (1) above to the reorganisation of a company's share capital includes—
>
> (a) any case where persons are, whether for payment or not, allotted shares in or debentures of the company in respect of and in proportion to (or as nearly as may be in proportion to) their holdings of shares in the company or of any class of shares in the company...

58.2.4 *Share alteration*

Section 126(2) TCGA provides:

> The reference in subsection (1) above to the reorganisation of a company's share capital includes ...
>
> (b) any case where there are more than one class of share and the rights attached to shares of any class are altered.

58.2.5 *Reduction of share capital*

Section 126(3) TCGA provides:

> [a] The reference in subsection (1) above to a reduction of share capital does not include the paying off of redeemable share capital, and
>
> [b] where shares in a company are redeemed by the company
>
> [i] otherwise than by the issue of shares or debentures (with or without other consideration) and
>
> [ii] otherwise than in a liquidation,
>
> the shareholder shall be treated as disposing of the shares at the time of the redemption.

58.3 Share-for-share relief

Section 135(1) TCGA provides:

> This section applies in the following circumstances where a company ("company B") issues shares or debentures to a person in exchange for shares in or debentures of another company ("company A").

I refer to this as a **"share-for-share exchange"**. Thus there are three *dramatis personae*:

Company A (whose shares are transferred to company B)
Company B (who issues its shares to the person)
The person ("X") (to whom company B shares are issued)

The circumstances are in short:

Case	**Circumstance**
1	B acquires more than 25% ordinary share capital
2	General offer
3	B acquires more than half of the votes

In full detail, s.135(2) TCGA provides:

> The circumstances are:
> *Case 1*
> Where company B holds, or in consequence of the exchange will hold, more than 25% of the ordinary share capital[4] of company A.
> *Case 2*
> Where company B issues the shares or debentures in exchange for shares as the result of a general offer—
> (a) made to members of company A or any class of them (with or without exceptions for persons connected with company B), and
> (b) made in the first instance on a condition such that if it were satisfied company B would have control of company A.
> *Case 3*
> Where company B holds, or in consequence of the exchange will hold, the greater part of the voting power in company A.

On the question of to whom shares in the form of depositary receipts are issued, see 71.5 (Other CGT issues).

If these conditions are met, we move on to the relief. Section 135(3) TCGA provides:

> Where this section applies, sections 127 to 131 (share reorganisations etc) apply with the necessary adaptations as if company A and company B were the same company and the exchange were a reorganisation of its share capital.

[4] Defined s.135(4) TCGA: "In this section "ordinary share capital" has the meaning given by section 1119 of CTA 2010 and also includes—
(a) in relation to a unit trust scheme, any rights that are treated by section 99(1)(b) of this Act (application of Act to unit trust schemes) as shares in a company, and
(b) in relation to a company that has no share capital, any interests in the company possessed by members of the company."

I refer to this as **"share-for-share relief"**.

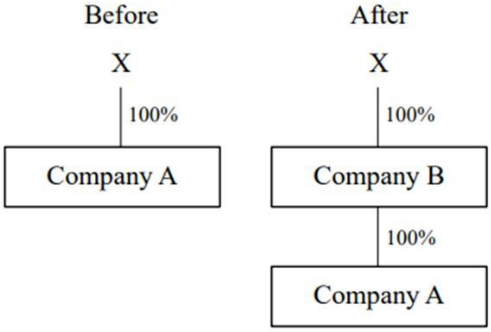
There are two important features of a share-for-share exchange:

(1) The base cost of the shares in company A (in the hands of company B, which acquires them) is their market value at the time of the acquisition, so CGT on a subsequent disposal is limited to any future increase in value. One might describe that CGT rebasing. This was the rule which offered (or seemed to offer) a tax advantage in *Furniss v Dawson*. But the CGT reorganisation TAAR restricts the CGT advantage.

(2) The new shares in company B are issued for full consideration and so IT on a purchase of own shares is limited to any future increase in value. One might describe that as rebasing for IT. But the TiS rules restrict the IT advantage.[5]

The paradigm example of a share-for-share exchange is a transaction (a hive-down) where X (who holds all the shares in company A) transfers them to a new company (company B) in exchange for an issue of shares in company B:

Hive-down



Note that companies A and B need not be incorporated in the UK, and X need not be UK resident.

58.4 Share issue/cancellation relief

Section 136(1) TCGA provides share issue/cancellation relief:

[5] See 55.14.5 (Sale for irredeemable shares).

This section applies where—

Three conditions, or sets of conditions, then follow:

(a) an arrangement between a company ("company A") and—
   (i) the persons holding shares in or debentures of the company, or
   (ii) where there are different classes of shares in or debentures of the company, the persons holding any class of those shares or debentures,

   is entered into for the purposes of, or in connection with, a scheme of reconstruction, and

(b) under the arrangement—
   (i) another company ("company B") issues shares or debentures to those persons in respect of and in proportion to (or as nearly as may be in proportion to) their relevant holdings in company A, and
   (ii) the shares in or debentures of company A comprised in relevant holdings are retained by those persons or are cancelled or otherwise extinguished.

If these conditions are met, we move on to the relief. Section 136 TCGA provides:

(2) Where this section applies—
   (a) those persons are treated as exchanging their relevant holdings in company A for the shares or debentures held by them in consequence of the arrangement, and
   (b) sections 127 to 131 (share reorganisations etc) apply with the necessary adaptations as if company A and company B were the same company and the exchange were a reorganisation of its share capital.

For this purpose shares in or debentures of company A comprised in relevant holdings[6] that are retained[7] are treated as if they had been

[6] Defined in s.136(4)(b): "In this section ...
(b) references to "relevant holdings" of shares in or debentures of company A are—
   (i) where there is only one class of shares in or debentures of the company, to holdings of shares in or debentures of the company, and
   (ii) where there are different classes of shares in or debentures of the company, to holdings of a class of shares or debentures that is involved in the scheme of reconstruction (within the meaning of paragraph 2 of Schedule 5AA);

[7] Defined in s.136(4)(c): "In this section ...
(c) references to shares or debentures being retained include their being retained with altered rights or in an altered form, whether as the result of reduction,

> cancelled and replaced by a new issue.
> (3) Where a reorganisation of the share capital of company A is carried out for the purposes of the scheme of reconstruction, the provisions of subsections (1) and (2) apply in relation to the position after the reorganisation.

58.5 Transfer of business relief

Section 139(1) TCGA provides transfer of business relief:

> Subject to the provisions of this section, where—

Three conditions, or sets of conditions, then follow:

> (a) any scheme of reconstruction involves the transfer of the whole or part of a company's business to another company, and
> (b) the conditions in subsection (1A) below are met in relation to the assets included in the transfer, and
> (c) the first-mentioned company receives no part of the consideration for the transfer (otherwise than by the other company taking over the whole or part of the liabilities of the business),

If these conditions are met, we move on to the relief:

> then, so far as relates to corporation tax on chargeable gains,
> [i] the 2 companies shall be treated as if any assets included in the transfer were acquired by the one company from the other company for a consideration of such amount as would secure that on the disposal by way of transfer neither a gain nor a loss would accrue to the company making the disposal,
> [ii] and for the purposes of Schedule 2 the acquiring company shall be treated as if the respective acquisitions of the assets by the other company had been the acquiring company's acquisition of them.

The second condition relates to residence/chargeability. Section 139(1A) TCGA provides:

> The conditions referred to in subsection (1)(b) above are—
> (a) that the company acquiring the assets is resident in the UK at the time of the acquisition, or the assets are chargeable assets in relation to that company immediately after that time, and
> (b) that the company from which the assets are acquired is resident

consolidation, division or otherwise".

> in the UK at the time of the acquisition, or the assets are chargeable assets in relation to that company immediately before that time.

Section 139(1A) TCGA then provides a definition of chargeable asset:[8]

> For this purpose an asset is a "chargeable asset" in relation to a company at any time if, were the asset to be disposed of by the company at that time, any gain accruing to the company would be a chargeable gain chargeable to corporation tax as a result of section 2B(3) or (4).

It is difficult to see the point of s.139(1A)(b). The consequence seems to be that s.139 relief is not available for a non-resident company within the scope of s.3 TCGA (except for its chargeable assets). Could that have been intended?

For completeness, s.139 TCGA continues:

> (1B) Nothing in section 179(3D) prevents the two companies being treated as mentioned in subsection (1).
> (2) This section does not apply in relation to an asset which, until the transfer, formed part of trading stock of a trade carried on by the company making the disposal, or in relation to an asset which is acquired as trading stock for the purposes of a trade carried on by the company acquiring the asset.
> Section 170(1) applies for the purposes of this subsection.
> (4) This section does not apply in the case of a transfer of the whole or part of a company's business to a unit trust scheme to which section 100(2) applies or which is an authorised unit trust or to an investment trust or a venture capital trust.

58.6 CGT reorganisation TAAR

The principal reorganisation reliefs are restricted by a TAAR:

s.137(1) TCGA	**s.139(5) TCGA**
[1] Subject to subsection (2) below [de minimis exemption], and section 138 [clearance],	This section does not apply
[2] neither section 135 nor section 136 shall apply to any issue by a company of shares in or debentures	

[8] See 56.6.2 ("Chargeable" asset).

of that company in exchange for or in respect of shares in or debentures of another company	
unless the exchange or scheme of reconstruction in question	unless the reconstruction
[a] is effected for bona fide commercial reasons and	[a] is effected for bona fide commercial reasons and
[b] does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax or corporation tax.	[b] does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to corporation tax, capital gains tax or income tax;

I refer to these together as the **"CGT reorganisation TAAR"**.

Section 137(2) TCGA provides a 5% *de minimis* exemption to the s.137 TAAR:

> Subsection (1) above shall not affect the operation of section 135 or 136 in any case where the person to whom the shares or debentures are issued does not hold[9] more than 5 per cent of, or of any class of, the shares in or debentures of the second company mentioned in subsection (1) above.

Section 137(4) TCGA provides an extended power of assessment, not discussed here. Sections 138/139(5) TCGA provide a clearance procedure, not discussed here; but see 55.18.2 (Disclosure for valid clearance).

58.6.1 *Commercial reasons*

In *Snell v HMRC*[10] the facts were simple:

(1) a UK resident shareholder exchanged shares for loan notes
(2) the shareholder's intention was to leave the UK in the following tax

[9] Section 137(3) TCGA provides an anti-fragmentation rule: "For the purposes of subsection (2) above shares or debentures held by persons connected with the person there mentioned shall be treated as held by him."

[10] [2006] EWHC 3350 (Ch). For completeness, the same issue arose in *Coll v HMRC* [2010] UKUT 114 (TCC) but this case primarily concerns the factual issue of what whether the taxpayer actually intended to leave the UK at the time of the reorganisation

> year and then to dispose of the loan notes free of CGT.

The share exchange passed the commercial reasons test:

> [The taxpayer] concentrated on the reason for the issue of the loan stock, and [HMRC] on the reason for the appellant choosing loan stock rather than cash. We are not convinced that one should make a comparison with a different transaction, a sale for cash, and ask if the exchange for loan stock, rather than cash, was effected for bona fide commercial reasons. Such a comparison that can fairly easily be made for an exchange of shares for short-term loan stock but much less easily for a share for share exchange or a reconstruction (which implies continuity of ownership) or amalgamation. We consider that one should take the actual transactions carried out, here the sale of shares to a third party in exchange for three different types of loan stock, and ask whether that was carried out for bona fide commercial reasons.

This was upheld on appeal:

> The question is whether ‘the exchange in question is effected for bona fide commercial reasons’. If the answer is in the affirmative it is irrelevant to consider the reasons why the parties chose to structure their transaction in that way.[11]

In *Delinian v HMRC*:[12]

> ... one can enter into a share exchange transaction for bona fide commercial reasons even if that transaction is wholly or partly tax driven. The “tax purpose” is the subject of inquiry under the second limb, not the first.

If the main purpose of the exchange is avoidance of foreign tax, or, say, IHT, it should pass the TAAR, on the basis that:

(1) the exchange is for bona fide commercial reasons, and
(2) it does not does not form part of a scheme or arrangements of which the main purpose is avoidance of liability to CGT/CT (or IT if relevant).

On the other hand, if the main purpose of the exchange is the avoidance of (say) CGT, it will still be a bona fide commercial transaction, but fail

[11] at [12].

[12] [2023] EWCA Civ 1281 at [43]; for the facts of *Delinian*, see 3.4.1 (Test whole arrangement). This case was reported under the name *Euromoney* in the FTT and UT, because Euromoney changed its name to Delian in 2023, following a takeover.

on the second limb of the TAAR.

58.6.2 *CGT avoidance*

Snell v HMRC illustrates that point. The taxpayer's success on the commercial reasons point did not help, as the taxpayer lost on the next part of the TAAR: the purpose was tax avoidance, not mitigation:[13]

> [The taxpayer] contended that the structure of capital gains tax was not to charge tax on disposals by non-residents and so it could not be contrary to the evident intention of Parliament if a person did not pay tax by reason of non-residence. In addition, the Appellant genuinely suffered the economic consequences of becoming non-resident. [HMRC] ... contends that but for s 135 capital gains tax would be payable on the contract of sale; Parliament's purpose in enacting s 135 is to allow a person to defer paying tax until he receives cash but not to create an exemption from tax.
>
> We agree with [HMRC]. We consider that [the taxpayer's] analysis considers the absence of liability to tax of non-residents in the abstract and ignores that tax avoidance is part of a purpose test aimed at the circumstances of the particular exchange. It is one thing for a person to enter into an exchange knowing that the consequence may be that as a result of a relief (on death, setting the gain against losses or annual exemptions, becoming non-resident or non-domiciled) no tax will ultimately be paid. It is another for a person to enter into the exchange with the main purpose that no tax should be paid as a result of obtaining a particular relief in a later year. It must be within the evident intention of Parliament that reliefs may result in no tax being paid in the future. But it does not follow that it is within the evident intention of Parliament that that one can enter into an exchange with the specific purpose of deferring tax so as to obtain a particular relief in a subsequent year... In principle, if one of the Appellant's main purposes of effecting the Arrangements is that capital gains tax should not be paid because the loan stocks will be redeemed while he is non-resident, that is avoidance of liability to capital gains tax within [the CGT reorganisation TAAR].

58.7 Redomiciled (ex-UK) securities

The legislation is slotted in after s.138 and before s.138A TCGA, so the

[13] [2006] UKSPC SPC00532 at [5]-[6], approved on appeal: [2006] EWHC 3350 (Ch) at [36].

sections are numbered s.138ZA to s.138ZC.[14]

Section 138ZA(1) TCGA provides:

> Section 138ZB applies where—
> (a) section 135 or 136 applies to an issue by a company ("company B") of shares in or debentures of that company ("the exchanged shares or debentures") in exchange for or in respect of shares in or debentures of another company ("company A"),
> (b) immediately before the issue is made, company A is a close company which is incorporated in the UK (whether or not it is resident in the UK),
> (c) immediately after the issue is made, company B is a close company which is not incorporated in the UK (whether or not it is resident in the UK), and
> (d) the person to whom the exchanged shares or debentures are issued ("P") is an individual who meets the conditions in subsection (2).

One might refer to this as "redomiciliation".[15]

Section 138ZA(2) TCGA provides:

> Those conditions are that—
> (a) immediately before the issue is made, P—
> (i) has a material interest in company A, and
> (ii) is a participator in company A, and
> (b) immediately after the issue is made, P—
> (i) has a material interest in company B, and
> (ii) is a participator in company B.

The rules only apply to individuals, so does not affect shares held in a trust or company.

58.7.1 *Material interest*

Section 138ZA TCGA provides the definition. It is very similar to the definition in s.457 CTA 2010, which I discuss in 11.12.3 (Material interest), and so I do not repeat the discussion here.

Section 138ZA(3) TCGA provides

> A person has a material interest in a company for the purposes of this section if condition A or B is met.

[14] See App.13.3 (Section numbering system).

[15] See 90.59 (Redomiciliation).

From this point the wording differs from s.457. As the wording of conditions A and B is not quite identical, it may be helpful to set them side by side:

s.1338ZA(4) TCGA	**s.457(2) CTA 2010**
Condition A is that	Condition A is that
[i] the person, an associate of the person, or [ii] the person or an associate of the person together with one or more associates	[i] the person (with or without one or more associates) or [ii] any associate of that person (with or without one or more other such associates)
is— (a) the beneficial owner of, or (b) directly or indirectly able to control, more than 5% of the ordinary share capital of the company.	is— (a) the beneficial owner of, or (b) directly or indirectly able to control, more than 5% of the ordinary share capital of the company.
s.1338ZA(5) TCGA	**s.457(3) CTA 2010**
Condition B is that	Condition B is that, in the case of a close company,
[i] the person, an associate of the person, or [ii] the person or an associate of the person together with one or more associates	[i] the person (with or without one or more associates) or [ii] any associate of that person (with or without one or more other such associates)
possesses or is entitled to acquire such rights as would— (a) in the event of the winding up of the company, or (b) in any other circumstances, give an entitlement to receive more than 5% of the assets which would then be available for distribution among the participators.	possesses or is entitled to acquire such rights as would— (a) in the event of the winding up of the company, or (b) in any other circumstances, give an entitlement to receive more than 5% of the assets which would then be available for distribution among the participators.

58.7.2 *Minor definitions*

Section 138ZA TCGA provides:

> (6) Chapter 2 of Part 10 of CTA 2010 (meaning of "close company" and related terms) applies for the purposes of this section but with the omission of section 442(a) (exclusion of non-UK resident companies).
> (7) In relation to a company that has no share capital, this section applies as if—
> (a) references to shares in, or debentures of, the company included any interests of the company possessed by members of the company, and
> (b) the reference in subsection (4) to the ordinary share capital of the company were to all such interests.
> (8) In this section "ordinary share capital" has the meaning it has in the Corporation Tax Acts (see section 1119 of CTA 2010).

58.7.3 *Deemed UK situs for CGT*

Section 138ZB TCGA provides:

> (1) Where this section applies (see section 138ZA), a security falling within subsection (2) is to be treated for the purposes of this Act as situated in the UK (whether or not it would otherwise be so treated) if—
> (a) it is held by P, other than as a result of a disposal of the security by P's spouse or civil partner ("S") to P to which section 58 (no loss or gain on disposals between spouses or civil partners) did not apply, or
> (b) is held by S, other than as a result of a disposal of the security by P to S to which that section did not apply.

I refer to securities within ss(2) as **"redomiciled (ex-UK) securities"**. Section 138ZB(2) TCGA provides:

> Those securities are as follows—
> (a) the exchanged shares or debentures;
> (b) a security of company B acquired by P on or after the day on which the exchanged shares or debentures are issued;
> (c) where—
> (i) there is a repo (within the meaning of section 263A) in respect of a security, and
> (ii) that security falls within any of the paragraphs of this subsection (including this paragraph), any similar security (see section 263AA(5) and (6)) that P, or a person connected with P, buys back under the repo;
> (d) where—
> (i) P transfers a security to another person under a stock lending arrangement (within the meaning of section 263B),

and

(ii) that security falls within any of the paragraphs of this subsection (including this paragraph),

any security of a similar description (see section 263B(6)) transferred back to P under the arrangement;

(e) a security of a company issued to P where—

(i) the security is issued in exchange for, or in respect of, another security,

(ii) section 135 or 136 applies to that issue,

(iii) the other security falls within any of the paragraphs of this subsection (including this paragraph), and

(iv) P has a material interest in the company (within the meaning of section 138ZA(3));

(f) where a security of a company, other than company B, falls within paragraph (e), a security of that company acquired by P on or after the first day on which a security of that company fell within that paragraph.

(3) For the purposes of paragraphs (b), (f) and (e) of subsection (2), it does not matter whether or not—

(a) consideration was given for the security acquired by P, or

(b) the security acquired by P is of a different class from the exchanged shares or debentures.

(4) If S acquires a security falling within subsection (2) as a result of a disposal by P to which section 58 applies, subsections (2) and (3) have effect, from the time of its acquisition by S (whether or not S continues to hold it), as if every reference to "P" were to "P or S".

(5) In this section—

"company B", "P", and "the exchanged shares or debentures" are to be construed in accordance with section 138ZA;

"security" means—

(a) shares in, or debentures of, a company, or

(b) interests of a company that has no share capital that are possessed by members of the company.

58.7.4 *Election to disapply s.135/136*

Section 138ZC TCGA provides:

(1) This section applies where section 138ZB would, but for an election under this section, apply in relation to the issue by a company of shares in or debentures of that company in exchange for, or in respect of, shares in or debentures of another company.

(2) The person to whom the shares or debentures are issued may elect

for section 135 or 136 not to apply to the issue, and accordingly—

(a) the exchange or scheme of reconstruction in question will not be treated as a reorganisation within the meaning of section 126, and

(b) section 138ZB will not apply in relation to the issue. (3) An election under this section must be made on or before the first anniversary of the 31 January following the tax year in which the shares or debentures are issued.

58.7.5 *Deemed non RFI*

Section 830(3A) ITTOIA provides:

> "Relevant foreign income" does not include income paid in respect of a security, within the meaning of section 138ZB of TCGA 1992, if—
>
> (a) the security is treated, for the purposes of that Act, as situated in the UK as a result of section 138ZB of that Act, and
>
> (b) that section applies in respect of the security as a result of an issue of shares in or debentures of a company in exchange for, or in respect of, shares in or debentures of another company that is incorporated, and is resident, in the UK.

The significance is that income of redomiciled (ex-UK) securities in the hands of the individual holder of the securities does not qualify for the remittance basis.

58.7.6 *Commencement*

Section 36 F(no.2) A 2023 provides:

> (4) The amendments made by subsections (2) and (3) [inserting s.138ZA - 138ZC) have effect in relation to an issue of shares or debentures made on or after 17 November 2022.
>
> (6) The amendment made by subsection (5) [inserting s.830(3A)] is treated as having come into force on 17 November 2022.

However where a redomiciliation took place before 17 November 2022, it is likely to be within the reorganisation TAAR, so reorganisation relief would not apply.

CHAPTER FIFTY NINE

RESIDENTIAL PROPERTY: CGT

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Cross references

The following topics are considered elsewhere:

Topic	**See**
CGT rates on residential property gains	43.13
UK land rebasing	57.15
Offshore company holds residence: s.3 TCGA issues:	
s.3 motive defence	64.16.3
Private residence relief n/a for s.3 gain	64.34

59.1 Private residence relief

A full discussion of private residence relief ("PRR") requires a book to itself, and indeed such books have been written. This chapter focuses on matters closest to the themes of this book, but it is necessary to look wider to see the matter in its context.

I do not consider the topics of:

- job-related accommodation
- relief where part of the residence has been let: s.223B TCGA
- disposals by disabled persons or persons in care homes: s.225E TCGA
- relief where delay in moving into property: s.223ZA TCGA
- restriction on relief following a holdover claim: s.226A TCGA
- date of payment of residential property gains

FA 2020 made the following changes:

- Reducing final period exemption from 18 months to 9 months
- Amending lettings relief so that relief is only available where the owner remains in shared occupancy with the tenant.
- Extending job related accommodation relief for the armed forces
- Legislating extra-statutory concessions D21 and D49
- Amending rules for inter spouse transfer of residential property interests

For the background to these changes, see HMRC policy paper, “Changes to ancillary reliefs in Capital Gains Tax Private Residence Relief”.[1]

59.2 “Residence”

Section 222(1) TCGA provides:

> This section applies to a gain accruing to an individual so far as attributable to the disposal of, or of an interest in—
> (a) a dwelling-house or part of a dwelling-house which is, or has at any time in his period of ownership been, his only or main residence, or
> (b) land which he has for his own occupation and enjoyment with that residence as its garden or grounds up to the permitted area.

Residence (in the sense of private-residence[2]) is a key term for PRR.

The meaning is the same as “home” and so discussion on the meaning of “home” may be relevant here.[3]

[1] *https://www.gov.uk/government/publications/changes-to-ancillary-reliefs-in-capital-gains-tax-private-residence-relief/changes-to-ancillary-reliefs-in-capital-gains-tax-private-residence-relief* (July 2019).

[2] See 6.1 (Concepts of residence).

[3] See 6.21.3 (Home/residence compared).

59.2.1 *Private residence/territory-residence*

The CG Manual provides:

> **CG64455 Meaning of residence in a wider context** [Jul 2019]
> Outside the field of taxation there are many circumstances in which the identification of an individual's residence is important. Whilst the word must be construed by reference to its particular context, the use of the word in a similar context to that with which we are concerned assists in the interpretation to be used for private residence relief.
>
> One such example is the identification of the constituency in which an individual is resident for the purpose of voting. Under the Representation of the People Act 1948, entitlement to vote was given to persons resident in a constituency on a qualifying date. In the case of *Fox v Stirk, Ricketts v Registration Officer for the City of Cambridge* [1970] 3 All ER 7 the Court of Appeal considered whether students should be resident in the constituency of the University that they attended. In his judgment, Lord Denning M.R. cited a passage from the speech of Viscount Cave L.C. in *Levene v IRC* [1928] AC 217
>
> > "... the word 'reside' is a familiar English word and is defined in the Oxford English Dictionary as meaning 'to dwell permanently or for a considerable time, to have one's settled or usual abode, to live in or at a particular place'."
>
> Lord Denning went on to say
>
> > "I derive three principles. The first is that a man can have two residences. He can have a flat in London and a house in the country. He is resident in both. The second principle is that temporary presence at an address does not make a man resident there. A guest who comes for the weekend is not resident. A short stay visitor is not resident. The third principle is that temporary absence does not deprive a person of his residence. If he happens to be away for a holiday or away for the weekend or in hospital, he does not lose his residence on that account."
>
> Further to this Lord Widgery commented,
>
> > "This conception of residence is of a place where a man is based or where he continues to live, the place where he sleeps and shelters and has his home. It is imperative to remember in this context that 'residence' implies a degree of permanence. In the words of the Oxford English Dictionary, it is concerned with something which will go on for a considerable time. Consequently a person is not entitled to claim to be a resident at a given town merely because he pays a short, temporary visit. Some assumption of permanence, some degree of continuity, some expectation of continuity, is a vital factor which turns

> simple occupation into residence."
>
> These comments are regarded as equally applicable to private residence relief and were relied on in the case of *Goodwin v Curtis*, see CG64460.

Now, *Fox* and *Levine* are territory-residence cases. It seems to me one should not segue so lightly from the concepts of territory-residence (or tax residence) to private residence; the word is identical but the concepts are different.[4] But no doubt just as one has to live in a country for it to become one's territory-residence, one also has to live in a dwelling in order for it to become one's private residence. The same conclusion would have been reached even without referring to authority.

The reader may ask whether the reasoning matters, as the conclusion is clear. Perhaps not much. But it is good to know what one is talking about.

59.2.2 *Period of occupation*

If a residence is "a place where somebody lives", the question arises how long they have to live there for it to qualify as their residence.

The CG Manual provides:

> **CG64435 Meaning of residence: judicial interpretation** [Jul 2019]
>
> There is no minimum period of occupation that would enable an individual to establish a residence. This was confirmed by Millet J in *Moore v Thompson* (61 TC 15) where he stated,
>
> "It is clear that the Commissioners were alive to the fact that even occasional and short residence in a place can make that a residence; but the question was one of fact and degree for the Commissioners."
>
> Every case must be decided upon its own particular facts.

59.2.3 *Mere temporary accommodation*

The CG Manual provides:

> **CG64460 Meaning of residence: Goodwin v Curtis** [Jul 2019]
>
> The meaning of the word 'residence' was considered further in the case of *Goodwin v Curtis* (70 TC 478).
>
> In 1983 Mr Goodwin set up a company to acquire Hazleton Manor Farmhouse. At that time he was buying it with a view to making it a home for himself and his family. On 1 April 1985 Mr Goodwin

[4] See 6.1 (Concepts of residence).

acquired the farmhouse from the company, but prior to the completion of his purchase he had instructed agents to sell the farmhouse. At the time of his acquisition he had separated from his wife and he took up temporary residence in the farmhouse until 3 May 1985 when the farmhouse was sold. Mr Goodwin contended that the farmhouse was his only or main residence.

In the High Court, Sir John Vinelott drew heavily on the observations of Lord Denning and Widgery L.J. in *Fox v Stirk, Ricketts v Registration Officer for the City of Cambridge* [1970] 3 All ER 7, and he also quoted with approval the line taken by Brightman J in *Sansom v Peay* (52 TC 1).

Sir John said,

> "Amongst the factors to be weighed by the Commissioners are the degree of permanence, continuity and the expectation of continuity. ... in my judgment, they were fully entitled to take the view that the farmhouse was used not as a residence but as mere temporary accommodation for a period that the taxpayer hoped would be brief and which in fact lasted some 32 days between completion of the sale to him and the completion of the sale by him."

The Court of Appeal upheld the decision of the Commissioners and the High Court that Mr Goodwin had not established a residence in the farmhouse; it had merely provided temporary accommodation. Millett L J stated in the Court of Appeal,

> "What I derive from Viscount Cave's speech is that the word 'reside' is an ordinary word of the English language and is eminently suitable for a lay tribunal such as the General Commissioners to apply."

He went on,

> "they (the Commissioners) must be taken to have accepted the Revenue's submission that the quality of the taxpayer's occupation of the farmhouse did not have a sufficient degree of permanence, continuity or expectation of continuity to justify its description as residence."

And later,

> "Temporary occupation at an address does not make a man resident there. The question whether the occupation is sufficient to make him resident is one of fact and degree for the Commissioners to decide."

He went on to say,

> "The substance of the Commissioners' finding taken as a whole, in my judgment, is that the nature, quality, length and circumstances of the taxpayer's occupation of the Farmhouse did not make his occupation qualify as residence."

Schiemann LJ added,

> I agree with the judgment that has just been delivered. I accept, as did the Commissioners, the Crown's contention that in order to qualify for the relief a taxpayer must provide some evidence that his residence in the property showed some degree of permanence, some degree of continuity or some expectation of continuity.

59.2.4 *Physical occupation*

The CG Manual provides:

> **CG64465 Occupation is a requirement** [Jul 2019]
> Except in those cases where the legislation deems a dwelling house to be the residence of an individual which are summarised at CG64477, a dwelling house must have been physically occupied as a residence of the individual at some time during their period of ownership in order to qualify for relief.
> It is sometimes argued that private residence relief is due where an individual has acquired a dwelling house with the intention of making it their home, but for reasons outside their control they were forced to sell it without ever having occupied it. In these circumstances relief is not available; an intention to occupy is not enough.
> The requirement to physically occupy the dwelling house as a residence is made clear in the judicial comments set out at CG64455 and also in the legislation itself. For example,
>
> - TCGA1992/S222 (8) allows an individual currently living in job related accommodation relief in respect of a dwelling house which they intend to occupy as a residence in due course. See CG64555+. If occupation was not a pre-requisite to relief, this provision would not be necessary.
> - TCGA92/223 (3) allows relief during certain periods of absence from the dwelling house, see CG65030+. If occupation was not a pre-requisite to relief, absence from the dwelling house would not prevent relief from being available and this provision would be unnecessary.
> - TCGA92/224 (2) allows relief to be adjusted where there has been a change in what has been occupied as an individual's residence, see CG67460+. If occupation was not a pre-requisite to relief, a change in what is occupied as the residence would not affect the amount of relief due.

59.2.5 *Interest in dwelling*

The CG Manual provides:

> **CG64470 An interest in a dwelling house is a requirement** [Jul 2019]
>
> An individual must have an interest in a dwelling house used as his residence for it to be a residence within the meaning of TCGA92/S222. This is because relief is available on the disposal of, or of an interest in a dwelling house or part of a dwelling house. References to a residence in Section 222 should be interpreted on this basis. Therefore, when considering which of an individual's residences is their main residence for the purpose of private residence relief, it is only necessary to consider those in which that individual has an interest.
>
> An interest in a dwelling house means a legal or equitable interest. It includes all possible forms of ownership from owning the freehold to being the co-owner of a minimal tenancy. In most cases, where a residence is rented a tenancy exists, and such residences therefore remain within Section 222.
>
> The only circumstance in which an individual can reside in a dwelling house in which he or she has no legal or equitable interest is where the property is occupied under licence. A licence is a permission to reside in a property which may be contractual or gratuitous. For instance, staying in a hotel or in lodgings are examples of residence under contractual licence. And staying with family or friends is an example of residence under gratuitous licence.
>
> An individual's only or main residence may be in a home in which they have no interest. Where it is the case that their main home is occupied under licence but they also reside in another dwelling house in which they have an interest, the residence in which they have an interest will be the only or main residence within S222 because the word residence within Section 222 only refers to residences in which the individual owns an interest...

If this is right, then the meaning of the word "residence" for PRR differs from the ordinary meaning, at least in this one respect.

59.2.6 *Garden or grounds*

The CG Manual provides:

CG64360 Garden And Grounds: Definitions [Jan 2020]

Whether you can regard a particular piece of land as garden or grounds of a residence is a question which must be decided on the facts. The phrase 'garden or grounds' is not defined in the statute and neither has its meaning been considered in case law. Therefore the words must take their everyday meaning.

A useful dictionary definition of the word garden is,

'a piece of ground, usually partly grassed and adjoining a private house, used for growing flowers, fruit or vegetables, and as a place of recreation.'

The word 'grounds' infers a larger area than 'garden'. A useful dictionary definition of the word grounds is,

'Enclosed land surrounding or attached to a dwelling house or other building serving chiefly for ornament or recreation.'

Generally speaking you should accept that land surrounding a residence which is in the same ownership, is the grounds of the residence, unless it is in use for some other purpose.

Land which at the date of disposal is in use for some other purpose for example agricultural land, commercial woodlands, land under development or land in use for a trade or business should not be regarded as part of the garden or grounds.

The following land should not necessarily be excluded from the garden and grounds:

- Land which has traditionally been the garden and grounds of the residence but at the date of sale is unused or overgrown.
- Paddocks or orchards providing there is no significant business use.
- Land which has a building on it, see CG64200, unless that building is in use for a business or is let.

Where the land in question was acquired on a different date to the residence, it should also be accepted as garden or grounds providing it was subsequently brought into use as the garden or grounds of the residence and remains as garden or grounds at the date of disposal.

Mixed Use

To qualify for relief land does not have to be exclusively in use for recreational purposes. For example, the owner of a guest house may allow guests to use the garden. In these circumstances the garden will still qualify for relief if the other tests are satisfied.

CG64367 Garden And Grounds: Land Physically Separated [Jul 2019]

You may come across the argument that land which is some distance from the residence should qualify for relief because it is in the same ownership as the residence and is used as a garden. Generally speaking this argument should be resisted.

TCGA92/222 (1) (b) provides relief for land which the owner "has for his own occupation and enjoyment with the residence as its garden or grounds". Therefore the land which qualifies for relief must be the garden and grounds of the residence, not land which simply happens to be in the same ownership as the residence. Usually the garden and grounds will be the land which surrounds the residence and is enclosed with it. Land which is separated from the residence by other land which is not in the same ownership will not normally be part of the garden and grounds of the residence.

However if the facts show that land which is physically separated from the residence is naturally and traditionally the garden of the dwelling house and it would normally be passed on as such on conveyance, relief should be allowed. For example, in some villages it is common for the garden to be across the street from the dwelling house. This separation should not be regarded as a reason for denying relief if it can be shown that the land was naturally and traditionally the garden and grounds of that house.

Conversely, a keen gardener may buy a plot of land some distance from their dwelling house because the dwelling house itself may have an inadequate garden. Even though the plot of land may be fully cultivated and regarded as part of the garden by the owner, it will not qualify for relief.

CG64391 Garden And Grounds: Caravans And Boats [Jan 2020]
You may conclude that a caravan or a boat can be regarded as a dwelling house and so may qualify for relief under TCGA92/S222(1)(a), see CG64325 and CG64328. Where this is the case, land which can be regarded as the garden or grounds of the caravan or boat can also qualify for relief under TCGA92/S222 (1) (b).
This view was confirmed in *Moore v Thompson* (61 TC 15) in which the Judge stated, "Perhaps somewhat generously the Revenue have taken the view that if the caravan was a dwelling house, and it was at any time during the taxpayers period of ownership her only or main residence, then the land of the farm was in her occupation and enjoyment with that residence as its garden and grounds up to the permitted area."
A similar line was also taken in the earlier case of *Makins v Elson* (51 TC 437) and this remains the line that you should take.
You will often find that the reason for suggesting that a caravan or boat is a dwelling house is in order to obtain relief on the land on which it stands or is surrounded. This is because the land is often far more valuable that the caravan or boat itself. However if the other conditions for relief are fulfilled and there is land which is identifiably used as the garden and grounds of the caravan or boat, you should allow relief on the disposal of that land.

See App.2.22.1 (Garden or grounds).

59.2.7 *Period of ownership*

Section 222(7) TCGA provides:

> In this section and sections 222A to 226, "the period of ownership" where the individual has had different interests at different times shall be taken to begin from the first acquisition taken into account in arriving at the expenditure which under Chapter III of Part II is allowable as a deduction in the computation of the gain to which this section applies ...

59.2.8 *Inter-spouse transfer*

Section 222(7) TCGA provides:

> and in the case of an individual living with his spouse or civil partner living with him—
> (a) if the one disposes of, or of his or her interest in, a dwelling-house or part of a dwelling-house to the other, and in particular if it passes on death to the other as legatee, the other's period of ownership shall begin with the beginning of the period of ownership of the one making the disposal, and
> (b) if paragraph (a) above applies, but the dwelling-house or part of a dwelling-house was not the only or main residence of both throughout the period of ownership of the one making the disposal, account shall be taken of any part of that period during

which it was his only or main residence as if it was also that of the other.

59.3 Non-residents PRR disallowance

59.3.1 *Introduction*

PRR was curtailed in 2015, on the introduction of the short-lived charge on residential property of non-residents, known as NRCGT. The NRCGT consultation paper provided:

> Bringing non-residents into CGT without any changes could mean that non-residents invariably chose to nominate their UK residence as their main residence and obtain tax relief on gains made on that property, even where it was not in fact their main residence, yet not pay any UK CGT on gains relating to their other residences outside of the UK. This would undermine the extension of CGT to non-residents.[5]

The problem could not be avoided by restricting PRR to UK residents. The NRCGT consultation paper provided:

> 6.18 The government has sought legal advice and considers it would not be possible to restrict claims for PRR to EU or EEA residents.

No reason is given (readers may infer that a general object of the paper was to close discussion rather than to inform it). But the reason was that there would be a restriction on free movement of capital, which applies to non-EU states as well as within the EU.

The wording has been amended in consequence of the extension of CGT to non-residents in 2019, but there has been no change of substance.

59.3.2 *Outline*

In summary: a residence is treated as not being occupied as a residence (so it does not qualify for PRR) unless:

[5] (1) HMRC & HM Treasury, "Implementing a capital gains tax charge on non-residents: consultation" (March 2014) para 3.3. *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/298759/CGT_non-residents_condoc.pdf*
(2) HMRC & HM Treasury, "Implementing a capital gains tax charge on non-residents: summary of responses" (November 2014) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/380397/Implementing_a_capital_gains_tax_charge_on_non_residents_disposing_of_UK_residential_property-_summary_of_responses_FINAL.pdf*

(1) The person is resident in the same territory as the residence; or
(2) The person is present in the residence for at least 90 days per annum. The statutory term for this is the **"day count test"**.

This is most important for non-residents who wish to claim PRR on a UK home; but it can also affect UK residents who wish to claim PRR on a non-UK home.

59.3.3 *The disallowance*

In order to follow the legislation, one needs to read s.222(1) TCGA and s.222B(1) TCGA together:

> **222(1)** This section applies to a gain accruing to an individual so far as attributable to the disposal of, or of an interest in—
> (a) a dwelling-house or part of a dwelling-house which is, or has at any time in his period of ownership been, his only or main residence...
> **222B(1)** For the purposes of sections 222 to 226 the dwelling-house or part of a dwelling-house mentioned in section 222(1) is treated as not being occupied as a residence by the individual so mentioned ("P") at any time in P's period of ownership which falls within—
> (a) a non-qualifying tax year, or
> (b) a non-qualifying partial tax year.
> In the remainder of this section the dwelling-house or part of a dwelling-house is referred to as "the dwelling-house".

This feeds into the rule that PRR relief is restricted where a property is not the residence throughout the period of ownership. Section 223 TCGA provides:

> *(*1) No part of a gain to which section 222 applies shall be a chargeable gain if the dwelling-house or part of a dwelling-house has been the individual's only or main residence throughout the period of ownership, or throughout the period of ownership except for all or any part of the last 9 months of that period.
> (2) Where subsection (1) above does not apply, a fraction of the gain shall not be a chargeable gain, and that fraction shall be—
> (a) the length of the part or parts of the period of ownership during which the dwelling-house or the part of the dwelling-house was the individual's only or main residence, but inclusive of the last 9 months of the period of ownership in any event, divided by
> (b) the length of the period of ownership.

So s.222B works to disallow PPR either wholly or in part. Section 223

TCGA defines the key term "period of ownership":

> (7) In this section "period of ownership"—
>
> (a) does not include any period before 31 March 1982, and
>
> (b) where
>
> [i] the whole or part of the gain to which section 222 applies is a residential property gain (as defined by Schedule 1B)[6]
>
> [ii] which is chargeable to capital gains tax because of section 1A(3)(b),[7]
>
> does not include any period before 6 April 2015 (but see subsection (7A)).
>
> (7A) Paragraph (b) of the definition of "period of ownership" does not apply in a case where paragraph 8 or 14 of Schedule 4AA applies (the individual has made an [historic-cost] election for the retrospective basis of computation to apply).

59.3.4 *"Non-qualifying tax year"*

Section 222B(3) TCGA provides:

> A tax year the whole of which falls within P's period of ownership is "a non-qualifying tax year" in relation to the dwelling-house if—
>
> (a) neither P nor P's spouse or civil partner was resident for that tax year in the territory in which the dwelling-house is situated, and
>
> (b) the day count test was not met by P with respect to the dwelling-house for that tax year (see section 222C).

59.3.5 *Partial tax years*

Section 222B(5) TCGA defines "partial tax year":

> Where part only of a tax year falls within P's period of ownership, that part is a "partial tax year" for the purposes of this section.

Section 222B(4) TCGA provides the rule:

> A partial tax year is "a non-qualifying partial tax year" in relation to the dwelling-house if—
>
> (a) neither P nor P's spouse or civil partner was resident for the tax year in question in the territory in which the dwelling-house is situated, and

[6] See 57.37 (Residential property gain).

[7] See 56.6.5 (CGT/CT charge: non-residents).

> (b) the day count test was not met by P with respect to the dwelling-house for that partial tax year.

59.4 Residence in territory of house

Section 222B(3) TCGA provides:

> A tax year the whole of which falls within P's period of ownership is "a non-qualifying tax year" in relation to the dwelling-house if—
> (a) neither P nor P's spouse or civil partner was resident for that tax year in the territory in which the dwelling-house is situated

A person who is not so resident will still be entitled to PRR if they meet the day count test.

The question whether an individual is resident in the UK is decided by the SRT.

Section 222B TCGA provides rules to identify when an individual is resident in a foreign state (**"overseas-residence")**. Section 222B(6) provides:

> For the purposes of this section an individual is resident in a territory outside the UK ("the overseas territory") for a tax year ("year X") in relation to which condition A or B is met.

I refer to **"foreign residence conditions A and B"**

59.4.1 *Residence condition A*

Section 222B(7) TCGA provides:

> Condition A is that the individual is, in respect of a period or periods making up more than half of year X, liable to tax in the overseas territory under the law of that territory by reason of the individual's domicile or residence.

The wording is loosely based on OECD Model definition of treaty-residence.[8]

"Tax" is not defined and it is considered that any residence-based tax[9] will count.

This deals with split years in the foreign state in a sensibly rough and ready manner.

[8] See 9.3 (Residence under art 4(1)).

[9] Or domicile-based tax, though I doubt if there are any.

59.4.2 *Residence condition B*

Where an individual is resident (in a normal sense of the word) in a country which does not impose residence-based tax, that individual will not meet foreign residence condition A. That may include states with no direct tax at all, such as Saudi Arabia, and states which only tax income from sources in that state, such as Singapore and Hong Kong. Such persons may still fall within foreign residence condition B. Section 222B TCGA provides:

> (8) Condition B is that the individual would be resident in the overseas territory for year X in accordance with the statutory residence test in Part 1 of Schedule 45 to the FA 2013, if in Parts 1 and 2 of that Schedule—
>
> (a) any reference to the UK (however expressed) were read as a reference to the overseas territory,
>
> (b) "overseas" meant anywhere outside that territory, and
>
> (c) in paragraph 26 (meaning of "work"), sub-paragraphs (2) to (4), (6) and (7) were disregarded.[10]
>
> (9) In applying the statutory residence test in accordance with subsection (8), any determination of whether—
>
> (a) the individual was resident in the overseas territory for a tax year preceding year X, or
>
> (b) another individual is resident in the overseas territory for year X,
>
> is to be made in accordance with the statutory residence test, as modified by subsection (8).

59.5 Day count test

Section 222B(3) TCGA provides:

> A tax year the whole of which falls within P's period of ownership is "a non-qualifying tax year" in relation to the dwelling-house if...
>
> (b) the day count test was not met by P with respect to the dwelling-house for that tax year (see section 222C).

Section 222C(1) TCGA provides:

> This section explains how P meets the day count test (see section 222B) with respect to the dwelling-house or part of a dwelling-house mentioned in section 222(1) for a full or partial tax year.

[10] These provisions deal with matters such as travelling and training: see 6.22 (Work).

> In the remainder of this section the dwelling-house or part of a dwelling-house is referred to as "the dwelling-house".

After this proem we move on:

> (2) P meets that test for a tax year with respect to the dwelling-house if, during that year, P spends at least 90 days in one or more qualifying houses.

Section 222C(6) TCGA explains how to count to 90:

> For the purposes of subsections (2) and (3) the days need not be consecutive...

59.5.1 *Ownership in part of year*

Where the property is owned for part of a year the 90 day requirement is reduced proportionately. Section 222C TCGA provides:

> (3) P meets that test for a partial tax year[11] with respect to the dwelling-house if, during that partial tax year, P spends at least the relevant number of days in one or more qualifying houses.
> (4) To find the relevant number of days for the purposes of subsection (3), multiply 90 days by the relevant fraction and round up the result to the nearest whole number of days if necessary.
> (5) The relevant fraction is (X ÷ Y)
> where—
> "X" is the number of days in the partial tax year;
> "Y" is the number of days in the tax year.

59.5.2 *Days spent*

Section 222C(8) TCGA provides:

> For the purposes of this section, a day counts as a day spent by an individual in a qualifying house if—
> (a) the individual is present at the house at the end of the day, or
> (b) the individual—
> (i) is present in the house for some period during the day, and
> (ii) the next day, has stayed overnight in the house.

The wording of (8)(a) is taken from the SRT[12] but is not appropriate here

[11] Section 222C(10) incorporates the definition by reference: In this section "partial tax year" has the meaning given by section 222B(5).

[12] See 6.15.1 (Ascertaining days spent in UK).

because under the SRT the question is whether the individual is present in the country, and here the question is whether the individual is present in the residence. The problem will often be solved by para (b). It is easy to envisage circumstances where, like Cinderella, P will need to leave the party before midnight in order to qualify for PRR. But fortunately that will not often be the case.

The rules are unnecessarily complicated. It would be sensible to use the SRT test (present in the dwelling-house on a day for at least some of the time, no matter how short a time).[13]

59.5.3 *Qualifying house*

Where more than one residence is owned in the same territory during the year, the day count test applies across the properties.

Section 222C(6) TCGA provides:

> For the purposes of subsections (2) and (3) ... days spent in different qualifying houses may be aggregated.

Section 222C(9) TCGA provides:

> For the purposes of this section—
> (a) the dwelling-house is a qualifying house in relation to P, and
> (b) any other dwelling-house or part of a dwelling-house which is situated in the same territory as the dwelling-house is a qualifying house in relation to P at any particular time if at that time any of the following has an interest in it—
> (i) P,
> (ii) an individual who is P's spouse or civil partner at that time, and
> (iii) an individual who is P's spouse or civil partner at the time of disposal of the dwelling-house.

59.6 MPR notice

59.6.1 *Power to make MPR notice*

Section 222(5) TCGA provides:

> So far as it is necessary for the purposes of this section to determine which of 2 or more residences is an individual's main residence for any period—

[13] See 6.11.3 (Sufficient time in UK home).

(a) the individual may conclude that question by notice to an officer of the Board given

[i] within 2 years from the beginning of that period

[ii] but subject to a right to vary that notice by a further notice to an officer of the Board as respects any period beginning not earlier than 2 years before the giving of the further notice.

I refer to this as **"a MPR notice"**.

59.6.2 *Time limit for notice*

The deadline for making the MPR notice is short, easy to overlook, and if remembered, it has to be made at a time when it may not be clear which is the best property to elect to be the main residence.

The CG Manual provides:

> **CG64495 two or more residences: time limit for nominating** [Nov 2019]
>
> TCGA92/222 (5) sets out that a notice nominating which of two or more residences is to be treated as the main residence must be given within two years from the date on which the individual has a particular combination of residences. Each time there is a change in the individual's combination of residences a new period begins and there is a new opportunity to make a nomination. This interpretation of the legislation was confirmed in the case of *Griffin v Craig Harvey*[14] ...
>
> Where a dwelling house is acquired, the date on which there is a new combination of residences will not necessarily be the date of acquisition, it will be the date on which the dwelling house was first used as a residence. Similarly, where an individual ceases to use a dwelling house as a residence, the date on which there is a new combination of residences will be the date on which the dwelling house is no longer used as a residence, it will not necessarily be the date on which that dwelling house is disposed of.
>
> *Example:*
>
> An individual has a single residence until 1 April 2015. On that date she acquired a dwelling house and immediately began to use it as a second residence. She has until 31 March 2017 to nominate which of these residences is to be treated as her main residence.
>
> On 23 November 2015 she acquired another dwelling house and began to use it as a third residence on 1 June 2016. A new period for

[14] 66 TC 396.

> nominating begins on 1 June 2016 giving her until 31 May 2018 to nominate which of her three residences is to be treated as her main residence.
>
> On 30 September 2016 she ceased to use one of her dwelling houses as a residence and subsequently disposed of it on 30 November 2016. A new period for nominating therefore begins on 30 September 2016; she has until 29 September 2018 to nominate which of her two remaining residences is to be treated as the main residence.

Section 222(5A) TCGA provides:

> But a notice or further notice under subsection (5)(a) determining which of 2 or more residences is an individual's main residence for any period may be given more than 2 years from the beginning of the period if during the period the individual has not held an interest of more than a negligible market value in more than one of the residences.

59.6.3 *Period notice applies*

The CG Manual provides:

> **CG64497 two or more residences: date from which a nomination applies** [Jul 2019]
>
> A nomination will apply from the beginning of a period to which it relates, i.e. the date on which the individual had that particular combination of residences giving rise to the need to determine which is the main residence.
>
> The nomination will have continuing effect until the earlier of,
>
> - The date on which the individual's combination of residences changes, or
> - The date from which a variation of the original notice is to apply.
>
> A variation of a notice will apply from the date specified in the notice of variation which may be up to two years before the giving of the notice.

59.6.4 *Variation of MPR notice*

The CG Manual provides:

> **CG64510 two or more residences: variation of a notice** [Jul 2019]
>
> A notice given under TCGA92/222 (5) can be varied by a further notice at any time. The further notice can be backdated to be effective from up to two years from the date that it was given.
>
> A variation will often be made when a disposal of a residence is in prospect or the disposal has already been made and the individual

> making the disposal wishes to secure the final period exemption. See CG64985+.
>
> For example, where an individual with two residences validly nominates house A, they may vary that nomination to house B at any time. The variation can then be varied back to house A within a short space of time. This will enable the individual to obtain the benefit of the final period exemption on house B with a loss of only a small proportion of relief of on house A.

59.6.5 *Form of MPR notice*

The CG Manual provides:

> **CG64520 two or more residences: form of notice** [Jul 2019]
>
> There is no statutory form for a notice under TCGA92/S222 (5) or for a variation of such a notice. However the following conditions must be fulfilled,
>
> - A nomination by an individual must be made to an officer of the Board and must be signed by the individual. TCGA92/S222 (5).
> - Spouses or civil partners who are living together[15] can only have one main residence between them for the purpose of private residence relief. If a nomination affects both of them it must be made by notice in writing to an officer of the Board and must be signed by both of them. TCGA92/S222 (5). See also CG64525 regarding elections on marriage or on registering as civil partners.
> - Where one of more of the residences is occupied by a person entitled to occupy it under the terms of a settlement, the notice must be writing to an officer of the Board and should be signed by both the trustees of the settlement and the person entitled to occupy the residence. TCGA92/S225 (b).
> - The signature of an agent is not sufficient.

59.6.6 *Procedure on receipt of notice*

The CG Manual provides:

> **CG64530 two or more residences: treatment of notice** [Jul 2019]
>
> If a notice or a variation of a notice is received, it should be acknowledged without any comment on its validity, and filed. On acknowledging the notice great care should be taken to avoid giving the impression that the notice is valid where the full facts are not available. In certain circumstances it may be appropriate to ask the taxpayer or

[15] See App 3.4.3 (Living together: married couple).

their agent for further information with regard to a notice. For example,

- It may be apparent that the notice has been given more than two years after the acquisition of a further dwelling house. This doesn't necessarily mean that the notice is late; the house may not have been occupied as a residence immediately on acquisition. So you should consider asking for more information to establish if the notice has been made after the expiry of the time limit.
- It may be apparent that the nominated dwelling house has not been a residence of the person giving the notice.
- If it appears that the nominated dwelling house is occupied under licence, see CG64536, or that the notice takes account of such a residence, you should consider asking the taxpayer or their agent for further information in order to confirm its validity.

Any enquiries that you do make should be to the extent of satisfying yourself, on the facts available, that the notice is valid or invalid. And, where it is invalid, explaining why to the person who has given the notice, or to their agent.

However until a dwelling house is sold any dispute over the validity of a notice will have no tax consequences. Therefore you should not take your enquiries beyond the stage at which, on the facts made available, you believe the notice to be invalid.

59.6.7 *MPR notice under regime*

The CGT charge on non-residents has a more generous rule for when it is possible to make or change a MPR notice. It is convenient to have different terms for the different types of notice, and in the following discussion I coin the following terms:

(1) **"a UK MPR notice"** is a an ordinary notice under s.222 TCGA.

(2) **"a overseas MPR notice"** is a notice under s.222A(2).

Section 222A(1) TCGA provides:

> This section applies where—
>
> (a) an individual ("P") makes a disposal of, or of an interest in—
>
> (i) a dwelling-house, or part of a dwelling-house, which was at any time in P's period of ownership occupied by P as a residence, or
>
> (ii) land (as mentioned in section 222(1)(b)) which P had for P's own occupation and enjoyment with that residence as its garden or grounds, and
>
> (b) the disposal is—
>
> (i) a disposal on which a residential property gain (as defined

> by Schedule 1B)[16] accrues which is chargeable to capital gains tax because of section 1A(3)(b), or
>
> (ii) a disposal on which a loss accrues but is one which, had a gain accrued, would be within sub-paragraph (i).
>
> In the remainder of this section the residence concerned is referred to as "the dwelling-house".

Section 222A(2) TCGA provides:

> So far as it is necessary for the purposes of section 222, P may determine, by a notice under this section, which of 2 or more residences (of which one is the dwelling-house) was P's main residence for any period within P's period of ownership of the dwelling-house.

The important point is that the time limits for a UK MPR notice do not apply to an overseas notice. Section 222A(3) provides:

> A notice under this section may vary, as respects any period within P's period of ownership of the dwelling-house, a notice previously given under section 222(5)(a)....

In principle a notice may be given at any time. Section 222A(4) imposes one limit:

> (4) A notice under this section may not vary a notice previously given under section 222(5)(a) as respects any period for which the previous notice had the effect of determining whether or not a disposed of residence was P's main residence.
>
> (5) In subsection (4) "disposed of residence" means one of P's residences which was disposed of (in whole or in part) before the date of the disposal mentioned in subsection (1)(a).

The expression "disposed of residence" is slovenly, verging on ungrammatical, but at least one drafter in the office of parliamentary counsel is fond of it. However clumsy, it is easier to follow the statutory usage.

The new notice can be backdated almost indefinitely.

Section 222A(6) TCGA then deals with procedure:

> A notice under this section—
>
> (a) must be given in the return under Schedule 2 to the Finance Act 2019 in respect of the disposal mentioned in subsection (1)(a),

[16] See 57.37 (Residential property gain).

and

(b) may not subsequently be varied, whether by a notice under this section or section 222(5)(a).

It will be necessary to consider the position at the time of a sale.

In short, the ability to elect operates more favourably as the determination is made at the time of the disposal in the sch 2 return. By contrast, the regime for UK residents remain restricted to a two-year time limit.

Having different time periods for notice (or determination) by residents and by non-residents raises issues for non-residents who become UK resident. A non-resident (with a house still in the UK) would be able to sell the house while away and make an notice at the time of sale. However, if individual became UK resident and then sold the house they could not elect.

To add to the confusion, the individual may not know whether they are UK resident until late in the tax year or some time after the year.

CIOT rightly observed that it would be better to align the provisions for UK and for offshore MPR notices.[17] But no-one took any notice of that.

59.7 Which is main residence

The question of identifying the "main" private residence arises in various tax contexts. It is not possible to give a full list, but they include:

(1) PRR, where there is no MPR notice
(2) Definition of Scottish/Welsh taxpayer[18]
(3) Council tax[19]

A similar question is which is the chief territory-residence for domicile purposes.[20]

How does one ascertain which of two competing private residences is the main residence? The test is multifactorial: no single factor is decisive. The question is one of fact and degree.[21]

The issue arose in *Frost v Feltham* where the taxpayer spent two or three

[17] CIOT "Draft FB15 Clauses on Disposals of UK residential interest by non-residents" (2015).

[18] See 6.43.6 (Two UK residences).

[19] Council tax cases offer further examples, but without, I think, taking the matter much further. See eg *Bennett (R oao) v Copeland Borough Council* [2004] EWCA Civ 672.

[20] See 3.9.3 (Which is chief residence).

[21] *Frost v Feltham* 55 TC 10 at p.14.

days a month at his property "Mount Severn". He spent the rest of the time in a pub, "The White Horse", where he was licensee. The judge noted that "viewed in isolation those are not long periods of time to spend at a house which can properly be described as the principal or more important residence of the persons concerned". Nevertheless, Mount Severn was his main residence:

> If someone lives in two houses the question, which does he use as the principal or more important one, cannot be determined solely by reference to the way in which he divides his time between the two. I can test that by reference to an example far removed from the facts of this case and the conditions of our own times. In his "Lives of the Lord Chancellors" Lord Campbell tells how Lord Eldon was often prevented by the burdens of his office from visiting his estate at Encombe in Dorset for long periods at a time. Sometimes he was only able to get down there for three weeks or so in the year, for the partridge shooting in September. True it was that Lord Eldon also had a good house in Hamilton Place, but it could not really have been suggested that he did not use Encombe as his principal or more important residence.[22]

The CG Manual provides:

> **CG64545 two or more residences: no valid notice made** [Jul 2019]
> Where an individual has two or more residences within the meaning of Section 222 it is not mandatory for that individual to make a notice nominating which is to be treated as the only or main residence.
> However where a notice is not made, or an invalid notice is made, the residence which attracts relief is the dwelling house which is the main residence as a matter of fact.

The Manual then turns to the question of which is the main residence as a matter of fact:

> All of the facts and circumstances of the particular case must be considered in order to conclude which the residence is the main residence.
> In practice the main residence is not necessarily the residence where the individual spends the majority of their time, although it commonly will be. [The Manual considers *Frost v Feltham* discussed above, and continues:]
> The following list of points to consider, although not exhaustive, may

[22] 55 TC 10 at p.13.

> be useful in establishing which is the main residence,
> - If the individual is married or in a civil partnership, where does the family spend its time?
> - If the individual has children, where do they go to school?
> - At which residence is the individual registered to vote?
> - Where is the individual's place of work?
> - How is each residence furnished?
> - Which address is used for correspondence?
>   - Banks & Building Societies
>   - Credit cards
>   - HMRC
> - Where is the individual registered with a doctor / dentist?
> - At which address is the individual's car registered and insured?
>
> Which address is the main residence for council tax?

Scottish Taxpayer Technical Guidance Manual adds to the list:

> **STTG3700: meaning of 'main place of residence'** [Jun 2016]
> - Location of social/non-work activity i.e. club membership/ participation, hobbies, etc
> - Where are the majority of the individual's possessions kept

59.8 Spouses

Section 222(6) TCGA provides:

> In the case of an individual living with his spouse or civil partner—
>
> (a) [i] there can only be one residence or main residence for both, so long as living together and,
> [ii] where a notice under subsection (5)(a) above affects both the individual and his spouse or civil partner, it must be given by both.

In short, spouses can only have one residence which qualifies for PRR. That made sense when the rule was introduced, in 1965, when spouses formed one taxable unit. But it is strange that this policy, which entails a significant discrimination against marriage, has survived independent taxation without more comment.[23] In a case where unmarried cohabitees each own a residence, on which each could claim PRR, marriage brings a significant CGT cost. Those who argue that the tax system should

[23] See Loutzenhiser, "Transferable Personal Allowances: A Small Step in the Wrong Direction" [2015] BTR 110.

support marriage, and those who argue it should be neutral, should be in favour of repeal of this rule, or its extension to cohabitees.

The principle that spouses form one taxable unit runs through to the overseas PPR provisions. Section 222C(7) TCGA provides:

> A day spent by P's spouse or civil partner in a dwelling-house or part of a dwelling-house which is a qualifying house in relation to P counts as a day spent by P in the qualifying house (but no day is to be counted twice as a result of this subsection).

59.9 MPR notice on marriage

The CG Manual provides:

> **CG64525 two or more residences: nominations on marriage or on registering as civil partners** [Jul 2019]
> TCGA92/S222 (6) sets out that spouses or civil partners who are living together can only have one main residence between them for the purpose of private residence relief. If when they marry or register as civil partners they each own a residence and they continue to use both as residences, they can jointly nominate which is to be treated as the main residence. The two year period for making the nomination commences on the date of marriage or the date of registration.
>
> Where one spouse or civil partner owns more than one residence, but the other spouse or civil partner does not own a residence and there is no change in this on marriage or registration as civil partners, then a fresh period for making a nomination does not begin. This is because neither spouse nor civil partner has had a change in their combination of residences, and neither of them needs to become a party to an existing nomination to which they were not already a party. A notice under TCGA92/S222 (5) only has to be made jointly where it affects both spouses or civil partners.
>
> Where the spouses or civil partners jointly own more than one residence at the date of marriage or on registering as civil partners, and neither separately owns any other residence, a new two year period for making a nomination begins. Even though both spouses or civil partners own the same residences as before, and even if they have both previously nominated the same residence, they now have to make a joint nomination in order for it to be valid from the date of marriage or from the date that they were registered as civil partners.

59.9.1 *MPR notice by spouses*

Section 222A(7) TCGA provides:

> Where a notice under this section affects both P and an individual ("X") who was, in the period to which the notice relates ("the relevant period"), P's spouse or civil partner living with P—
>
> (a) in a case where each of P and X is required to make a return under Schedule 2 to the Finance Act 2019 in respect of the disposal of an interest in the dwelling-house, notice given by P under this section is effective as respects any part of the relevant period when P and X were living together as spouses or civil partners only if notice to the same effect is also given under this section by X in respect of that period;
>
> (b) in any other case, notice given by P under this section is effective as respects any part of the relevant period when P and X were living together as spouses or civil partners only if it is accompanied by written notification from X agreeing to the terms of the notice in respect of that period.

In short, spouses must act jointly in giving a notice.

59.10 Periods of absence relief

59.10.1 *Permitted periods of absence*

Section 223(3) TCGA provides relief for certain periods of absence:

> For the purposes of sections 222(5) and 222A and subsections (1) and (2) above—
>
> (a) a period of absence not exceeding 3 years (or periods of absence which together did not exceed 3 years), and in addition
>
> (b) any period of absence throughout which the individual
>
> [i] worked in an employment or office all the duties of which were performed outside the UK or
>
> [ii] lived with a spouse or civil partner who worked in such an employment or office, and in addition
>
> (c) any period of absence not exceeding 4 years (or periods of absence which together did not exceed 4 years) throughout which the individual was prevented from residing in the dwelling-house or part of the dwelling-house
>
> [i] in consequence of the situation of his place of work or
>
> [ii] in consequence of any condition imposed by his employer requiring him to reside elsewhere, being a condition reasonably imposed to secure the effective performance by the employee of his duties, and in addition,
>
> (d) any period of absence not exceeding 4 years (or periods of

> absence which together did not exceed 4 years) throughout which the individual lived with a spouse or civil partner in respect of whom paragraph (c) applied in respect of that period (or periods),
>
> shall be treated as if in that period of absence the dwelling-house or the part of the dwelling-house were occupied by the individual as a residence if conditions A and B are met.

In short, conditions A and B require a period of residence before and after the period of absence. In full detail:

> (3A) Condition A is that before the period there was a time when the dwelling-house was the individual's only or main residence.
>
> (3B) Condition B is that after the period—
>
> (a) in a case falling within paragraph (a), (b), (c) or (d) of subsection (3), there was a time when the dwelling-house was the individual's only or main residence,
>
> (b) in a case falling within paragraph (b), (c) or (d) of that subsection, the individual was prevented from resuming residence in the dwelling-house in consequence of the situation of the individual's place of work or a condition imposed by the terms of the individual's employment requiring the individual to reside elsewhere, being a condition reasonably imposed to secure the effective performance by the employee of his duties, or
>
> (c) in a case falling within paragraph (b), (c) or (d) of that subsection, the individual lived with a spouse or civil partner to whom paragraph (b) of this subsection applied.

Section 222B TCGA provides:

> (11) Subsection (1) is subject to—
>
> (a) section 222(8) (job-related accommodation), and
>
> (b) section 223(3) (absence reliefs).

If these reliefs apply, a non-resident period is not disqualified from PRR. HMRC say:

> **Q11 I lived in the property for 20 years before leaving the UK in 2010 and had met all the conditions for PRR up to that date. Does this mean if I sell the property by 5 October 2016 there will be no CGT liability?**
>
> A11 Yes. If you can identify a time prior to 6 April 2015 that the property qualified for PRR then final period relief will be available i.e.

the last 18 months of ownership will be eligible for relief.[24]

59.11 2015 transitional rules

Draft clauses EN provides a summary:

> ... where a non-UK resident person disposes of a dwelling-house, the use of the property prior to 6 April 2015 is ignored in determining eligibility to private residence relief unless the person otherwise elects and specifies the date as to when, prior to then, the property was the person's only or main residence. Any absence from that date to 5 April 2015 is deducted from the amount of absence available for relief for periods after 5 April 2015.

Section 222B(2) TCGA provides:

> Except where the disposal mentioned in section 222(1) is a disposal falling within section 222A(1)(b) (non-resident disposals), subsection (1) does not have effect in respect of any tax year or partial tax year before the tax year 2015-16.

Section 223A TCGA provides:

> (1) This section applies where—
> (a) the individual mentioned in section 223(1) ("P") acquired the asset to which the gain mentioned in section 222(1) is attributable before 6 April 2015, and
> (b) P's period of ownership for the purposes of section 223 begins on that date because of section 223(7)(b).
> (2) Times before 6 April 2015 are to be ignored in determining whether or not condition A in section 223 is met in relation to a period of absence, unless P elects that this subsection is not to apply in relation to the period.
> (3) An election under subsection (2)—
> (a) must specify which day before 6 April 2015 P relies on in relation to the period of absence for the purpose of meeting condition A in section 223, and
> (b) must be made in the return under Schedule 2 to the Finance Act 2019 in respect of the disposal.

[24] HMRC, "Capital Gains Tax for non-UK residents: sales and disposals of UK residential property: Frequently Asked Questions" (March 2015). *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/413988/capital-gains-tax-non-uk-res.pdf*

> (4) Where P has made an election under subsection (2), section 223 applies as if relevant prior periods of absence counted against the maximum periods (and maximum aggregate periods) specified in subsection (3)(a), (c) and (d) of that section.
>
> (5) In relation to a maximum period (or maximum aggregate period) specified in paragraph (a), (c) or (d) of section 223(3), "relevant prior period of absence" means a period of absence which would have counted against that maximum period (or maximum aggregate period) if the bridge period were included in the period of ownership.
>
> (6) In subsection (5) "the bridge period" means the period beginning with the day specified in the election and ending with 5 April 2015.
>
> (7) In this section "period of absence" has the same meaning as in section 223.

59.12 Residence held by trust or PRs

Section 225 TCGA provides PRR for trusts. FA 2015 makes (relatively) straightforward amendments to bring this into line with the relief for individuals:

> (1) Sections 222 to 224 shall also apply in relation to a gain accruing to the trustees of a settlement on a disposal of settled property being an asset within section 222(1) where, during the period of ownership of the trustees, the dwelling-house or part of the dwelling-house mentioned in that subsection has been the only or main residence of a person ("B") entitled to occupy it under the terms of the settlement, and in those sections as so applied—
>
> (a) references to the individual shall be taken as references to the trustees except in relation to ~~the occupation of the dwelling-house or part of the dwelling-house~~ the matters dealt with in subsection (2), and
>
> (b) the notice which may be given to an officer of the Board under section 222(5)(a) shall be a joint notice by the trustees and ~~the person entitled to occupy the dwelling-house or part of the dwelling-house~~ B, and;
>
> (c) the notice which may be given by the trustees under section 222A is effective only if it is accompanied by written notification from B agreeing to the terms of the notice;
>
> but section 223 (as so applied) shall apply only on the making of a claim by the trustees.
>
> (2) In sections 222 to 224, as applied by subsection (1), references to the individual, in relation to-
>
> (a) the occupation of the dwelling-house or part of the

> dwellinghouse,
> (b) residence in a territory, or
> (c) meeting the day count test,
> are to be taken as references to B.

Trustees sometimes have a choice of who should be entitled to occupy a property, and that choice may confer (or deny) PRR.

Section 225A TCGA (not discussed here) provides PRR for personal representatives. The FA 2015 makes the corresponding amendments to bring this into line with the relief for individuals

59.13 Commencement of PRR rules

Para 10 sch 9 F(no.1)A 2015 provides:

> The amendments made by this Schedule have effect in relation to disposals made on or after 6 April 2015.

59.13.1 *Pre-2015/16 years*

Section 222B(2) TCGA provides:

> Except where the disposal mentioned in section 222(1) is a disposal falling within section 222A(1)(b) (non-resident disposals), subsection (1) does not have effect in respect of any tax year or partial tax year before the tax year 2015-16.

CHAPTER SIXTY

GAINS OF NON-RESIDENT SETTLOR-INTERESTED TRUSTS: s.86

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60.19 DT relief: s.86 gains
60.19.1 Trust treaty-resident outside UK
60.19.2 Settlor treaty-resident outside UK
60.19.3 Trust co treaty-resident outside UK

Cross references

The following topics are considered elsewhere:

Topic	See
DT relief: trust formerly within s.86	60.19
UK-land gain outside s.86/87	57.30.2
s.86 gain deducted	61.6.7
Non-resident trust: CGT planning	61.54
Distribution relief/s.87/86: Interaction	64.20.5

Loss of non-resident trust	65.13
Personal loss and s.86 gain	65.15
Two settlors: CGT	100.1.4
Statutory tax indemnity	101.1

60.1 CGT on non-resident trusts

The scheme of the TCGA is that a trust is generally treated as a taxable unit.[1] If the trustees are UK resident, they are subject to CGT, even if the beneficiaries have no connection with the UK. Non-resident trustees are in principle not subject to CGT, even if beneficiaries are resident in the UK.[2] This rule presents an obvious means of CGT avoidance. HMRC's first answer to this is the anti-avoidance rules in ss.86, 87 TCGA.

In outline:

(1) A settlor is subject to CGT on gains accruing to a non-resident trust if:

(a) The settlor is UK resident and UK domiciled.

(b) The settlor has an "interest" in the settlement. (This is widely and artificially defined.)

I refer to this as the **"s.86 charge"** and the gains treated as accruing to the settlor under this section are **"s.86 gains"**.

(2) A beneficiary is subject to CGT if:

(a) The beneficiary is UK resident.

(b) The beneficiary receives a capital payment from the trust.

(c) The trust realises gains.

I refer to this as the **"s.87 charge"** or the **"s.87 capital payments basis"** and the gains treated as accruing to a beneficiary under this section are **"s.87 gains"**. This topic is discussed in the next chapter.

60.2 Section 86 charge

The s.86 charge is the subject of this chapter.

The charge was extended in 1991 and 1998 with transitional relief for:

(1) trusts made before 19 March 1991 ("**pre-1991 trusts**")

(2) trusts made before 17th March 1998 ("**pre-1998 trusts**")

I refer to trusts which qualify for these reliefs as "**pre-1991 protected trusts" and "pre-1998 protected trusts**".

[1] See 56.21 (Trust a taxable unit).

[2] See 56.6 (Territorial scope of CGT).

The charge does not apply to a deemed domiciled settlor if the trust is a protected trust.[3]

Section 86 may not have been EU-law compliant, but post-Brexit the point is not likely to arise.

Sloppy and repetitive drafting adds to the difficulties.

60.3 s.86 application conditions

Section 86(1) provides:

> This section applies where the following conditions are fulfilled as regards a settlement in a particular year of assessment ...

There follow eight conditions, or sets of conditions. I refer to these as the "**s.86 application conditions**". In their statutory order they are:

(1) Qualifying settlement
(2) Trustee residence condition
(3) Settlor residence and domicile conditions
(4) Settlor-interested condition
(5)-(8) Death/divorce of settlor or certain beneficiares

Where these conditions are satisfied, I describe the trust as **"within s.86"**.

60.4 Minor definitions

It is helpful first of all to clear out some (relatively) minor definitions. They are repeated up to five times, verbatim: the repetition is because on each occasion the definitions are expressed to be for the purposes of the paragraph and not for the purposes of the schedule or the Act. I set out the para 9 version and give the references for the others.

60.4.1 *"Settlement" and "settlor"*

"Settlement" is not expressly defined so the standard IT/CGT definition applies.[4] Contrast the IT settlor-interested trust rules, and the s.87 rules, where the settlement-arrangement definition applies. It would be bold to plan on the assumption that this will not change.

For "settlor" see 99.2.11 (Settlor: CGT s.86 definition).

60.4.2 *"Control" and "participator"*

Para 9(9) sch 5 TCGA provides a slightly cut down form of the ultra-wide

[3] See 92.3 (s.86 protected-trust relief).

[4] See 87.3 (Settlement: Standard IT/CGT definition).

sense of control:[5]

> [a] For the purposes of sub-paragraph (7) above the question whether a company is controlled by a person or persons shall be construed in accordance with sections 450 and 451 of CTA 2010;
> [b] but in deciding that question for those purposes no rights or powers of (or attributed to) an associate or associates of a person shall be attributed to him under section 451(4) to (6) of CTA 2010 if he is not a participator in the company.

Paras 2(8), 2A(8) and 8(8) sch 5 TCGA and s 96(10) TCGA each repeat this definition.

Participator is relevant to this definition of control. Para 9(11) sch 5 TCGA provides the standard definition:

> In this paragraph ... "participator" has the meaning given by section 454 of CTA 2010.

Paras 2(10), 8(9) sch 5 TCGA and s.96(10) TCGA each repeat this definition verbatim.

Para 2A(10) also repeats the definition, but para 2A(9A) sch 5 TCGA cuts it down:

> For the purposes of sub-paragraphs (8) and (9) above a person is not to be regarded as a participator in a company controlled by the trustees of a settlement where the person has a share or interest in the capital or income of the company solely by virtue of an interest which the person has under the settlement.

There are (more or less) identical provisions in para 8(8A) and para 9 (10ZA) sch 5 TCGA.

60.4.3 *"Associated company"*

Para 9(10) sch 5 TCGA provides a slightly cut down form of the close-co definition:[6]

> [a] For the purposes of sub-paragraph (7) above the question whether one company is associated with another shall be construed in accordance with section 449 of CTA 2010;
> [b] but where in deciding that question for those purposes it falls to be

[5] For the ultra-wide sense of control, see 104.2.2 (Definitions of "control").

[6] See 104.17.1 ("Associated company").

> decided whether a company is controlled by a person or persons, no rights or powers of (or attributed to) an associate or associates of a person shall be attributed to him under section 451(4) to (6) of CTA 2010 if he is not a participator in the company.

Paras 2(9) and 2A(9) sch 5 TCGA repeat this definition.

60.4.4 *"Child" and "grandchild"*

Para 9(11) sch 5 TCGA provides:

> In this paragraph—
> "child" includes a step-child;
> "grandchild" means a child of a child;

This is repeated verbatim in para 2A(10) sch 5 TCGA.

60.4.5 *"Relevant property/income"*

Para 2(2) sch 5 TCGA provides:

> (a) relevant property is property originating from the settlor,
> (b) relevant income is income originating from the settlor.

This is repeated (more or less) verbatim in para 9(10D) sch 5 TCGA.

60.5 Settlor-interested condition

Section 86 TCGA provides:

> (1) This section applies where the following conditions are fulfilled as regards a settlement in a particular year of assessment ...
>
> (d) at any time during the year the settlor has an interest in the settlement;

If a settlement becomes (or ceases to be) settlor-interested during a tax year, s.86 TCGA applies for the whole tax year. Perhaps there is a good reason for this, because the s.86 charge is on gains less losses for the entire year, and splitting the year would involve some trouble. The rule does however mean that CGT planning by excluding the settlor needs to be carried out some time in advance. (A similar rule applies for s.720, though not for s.624: If a settlor is excluded s.624 ITTOIA ceases to apply from the date of the exclusion, but s.720 continues to apply for the rest of the tax year.[7])

[7] See 47.6.6 (Settlor-interest ceases); 49.14 (Condition A: Power to enjoy).

60.5.1 *"Settlor-interested"*

The term "settlor-interested" in a s.86 context[8] is a label for a complex set of rules.

Para 2 sch 5 TCGA provides:

> (1) For the purposes of section 86(1)(d) a settlor has an interest in a settlement if—
>
> (a) any relevant property[9] which is or may at any time be comprised in the settlement is, or will or may become, applicable for the benefit of or payable to a defined person in any circumstances whatever,
>
> (b) any relevant income which arises or may arise under the settlement is, or will or may become, applicable for the benefit of or payable to a defined person in any circumstances whatever, or
>
> (c) any defined person enjoys a benefit directly or indirectly from any relevant property which is comprised in the settlement or any relevant income arising under the settlement;
>
> but this sub-paragraph is subject to sub-paragraphs (4) to (6) and paragraph 2A below.

The key term is "defined person". Para 2(3) sch 5 TCGA provides:

> For the purposes of sub-paragraph (1) above each of the following is a defined person—
>
> (a) the settlor,
>
> (b) the settlor's spouse or civil partner;
>
> (c) any child of the settlor or of the settlor's spouse or civil partner;
>
> (d) the spouse or civil partner of any such child;
>
> (da) any grandchild of the settlor or of the settlor's spouse or civil partner;
>
> (db) the spouse or civil partner of any such grandchild;
>
> (e) a company controlled by a person or persons falling within paragraphs (a) to (db) above;
>
> (f) a company associated with a company falling within paragraph (e) above.

The history has been one of gradual expansion, with the reference to children added in 1991 and paras (da) and (db) - dealing with

[8] The same term is used in an IT context with a different meaning: see 47.6.1 (Concepts of "settlor-interested").

[9] See 60.4.5 ("Relevant property/income").

grandchildren - added in 1998. Thus the definition of settlor-interested is wider than the IT equivalent in s.624, eg the settlor is chargeable on gains accruing to a trust from which their children or grandchildren could benefit even though there is no actual benefit to the settlor.

Para 2(4) sch 5 TCGA provides exceptions copied from the precedent of the IT settlor-interested trust rules; they have no significant application in practice.

The IT settlor-interested rules have a provision that references to spouses do not include separated or potential future spouses.[10] Unfortunately, the CGT settlor-interested rules do not have that rule. The omission raises a number of difficulties.

60.5.2 *Civil partner\same-sex spouse*

The Civil Partnership Act took effect on 5 December 2005. Before then, civil partners of the settlor were not expressly excluded in trust drafting, so a trust which merely excluded spouses might become settlor-interested from 2005! HMRC tactfully overlook that:

> For settlements made before 5 December 2005, the settlor may not have been considered to have retained an interest in the settlement for Income Tax purposes, as both the settlor and his spouse were specifically excluded from benefit under the particular terms of the settlement deed. Although such an 'exclusion clause' would not have included a 'civil partner', HMRC will not regard the settlor as retaining an interest unless and until a beneficiary becomes the civil partner of the settlor.[11]
>
> With regards to the provisions of Section 86 TCGA 1992, whereby the gains of a non-resident trust or dual resident trust are chargeable on the settlor. If such provisions did not apply in relation to a settlement made prior to 5 December 2005, and the deed was drafted in such an obvious way as to exclude spouses or future spouses without particular definition of those terms, that exclusion might reasonably be regarded in the context as covering civil partners and those treated as such under CPA who stand in the same position as spouses under the law from 5 December 2005. In such circumstances it will not be HMRC's intention to apply those provisions to a settlement only as a result of the coming into effect of the CPA. For settlements made on or after 5 December 2005, it is expected that the drafting of the settlement deed excludes the full list of 'defined persons' (Schedule 5, Para 2(3) TCGA 1992),

[10] See App 3.2 ("Spouse"); App 3.3 ("Civil partner").

[11] For IT, this rule is statutory; see App 3.2 ("Spouse"); App 3.3 ("Civil partner").

> including 'civil partners', from benefiting in any circumstances under the settlement, if it is intended for the settlement not to be caught by the provisions.[12]

This is just a concession and it may be in the interest of beneficiaries to argue that a pre-2005 settlement under which a future civil partner may benefit should be treated as settlor-interested for CGT purposes.

A similar problem arises with same-sex spouses, for trusts made before the Marriage (Same Sex Couples) Act 2013 came into force. A pre-Act exclusion clause which excludes "spouses" will not exclude a same-sex spouse: see para 1 sch 4 Marriage (Same Sex Couples) Act 2013. But I expect HMRC will operate a similar concession.

60.5.3 *Potential defined persons*

ICAEW guidance note on non-resident settlements (TAX 20/92) 14 December 1992 provides:

> 24 ... TCGA 1992 Sch 5 specifies the test as to whether the settlor has an interest. Each of sub-paragraphs 2(1)(a) and(b) uses the words "may…in any circumstances whatever". Interpreted literally, it appears virtually impossible to define a trust where the settlor does not have an interest, because any beneficiary may become a relative of the settlor as a result of subsequent marriages (or indeed subsequent births if necessary to imagine all conceivable possibilities). ...
> *Revenue response*: If the terms of a settlement are so framed that a clearly defined person can benefit, eg the class of beneficiaries includes "any spouse of the settlor" or "spouses of the settlor's children", or such persons could be added to the class of beneficiaries, then the settlor will be treated as having an "interest" in the trust. However, where there is no prima facie possibility of a defined person benefiting, the Revenue will not treat the settlor as having an "interest", unless the terms of the settlement and the circumstances of the case indicate an intention to benefit a person who is likely to become a defined person in the future, eg a settlement in favour of the fiancé of the settlor or of the settlor's child.

60.5.4 *Separated spouse*

ICAEW guidance note on non-resident settlements (TAX 20/92) 14 December 1992 provides:

[12] "HMRC Residency: Non-resident trusts" *https://www.gov.uk/non-resident-trusts*

> 25 Also on the question of whether a settlor has an interest in a trust, it would be helpful if the statement of practice could confirm that a separated spouse would not be regarded as the settlor's spouse for this purpose.
> *Revenue response*: A separated spouse would be regarded as a spouse for the purposes of these provisions unless, in accordance with existing practice (see para 13(a) Appendix B of the Resident trusts consultative document 19 March 1991)[13] on other provisions having a bearing on "settlor interest" trusts, the separation is permanent.

60.6 Pre-1998 protected trusts

Para 2A(1) sch 5 TCGA provides:

> [A] In determining for the purposes of section 86(1)(d) whether the settlor has an interest at any time during any year of assessment in a settlement created before 17th March 1998, paragraphs (da) and (db) of paragraph 2(3) above, and the reference to those paragraphs in paragraph 2(3)(e), shall be disregarded
> [B] unless—
> (a) that year is a year in which one of the four conditions set out in the following provisions of this paragraph becomes fulfilled as regards the settlement; or
> (b) one of those conditions became fulfilled as regards that settlement in any previous year of assessment ending on or after 5th April 1998.

In the following discussion:

(1) A trust qualifying for this relief is a "**pre-1998 protected trust**"

[13] The reference is to the former SP A30 which provided:
"The settlement legislation [now s.624 ITTOIA] includes provisions which may be applied to any settlement where the spouse or any possible future spouse of a settlor may be able to benefit from the income or capital of the settlement in any circumstances whatsoever. In relation to the concept of "possible future spouse" the Board of Inland Revenue have considered the scope of the decision reached in the case of *IRC v Tennant* (24 TC 215) and they take the view that that decision applies -
(a) where, although a settlor is not at the material time a party to a subsisting marriage, the terms of the settlement are such that a benefit may be conferred on substantially any person who may become the wife or husband of the settlor in future, or
(b) where, whether or not the settlor is married, the terms of the settlement are such as to indicate a specific intention that a future wife or husband of the settlor may be enabled to benefit."

(2) The conditions in para [B] are the "**s.86 trigger conditions**". Their effect is that the trust becomes settlor-interested, with the consequence that s.86 begins to apply.

In short, the relief is that a pre-1998 protected trust is allowed to benefit the settlor's grandchildren without becoming "settlor-interested".

60.6.1 *Trigger 1: Provide property*

Para 2A(2) sch 5 TCGA provides:

> The first condition is (subject to sub-paragraph (3) below) that on or after 17th March 1998 property or income is provided directly or indirectly for the purposes of the settlement—

Providing property is discussed in the chapter "who is the settlor": see 99.6 (Tainting).

There are three exceptions where provision of property is allowed. The first two are in Para 2A(2), which requires that the property is provided:

> (a) otherwise than under a transaction entered into at arm's length,
> (b) otherwise than in pursuance of a liability incurred by any person before that date.

Thirdly, para 2A(3) sch 5 TCGA provides:

> For the purposes of the first condition, where the settlement's expenses relating to administration and taxation for a year of assessment exceed its income for the year, property or income provided towards meeting those expenses shall be ignored if the value of the property or income so provided does not exceed the difference between the amount of those expenses and the amount of the settlement's income for the year.

I discuss these exceptions in the context of the 2017 protected trust rules, as that is where these issues now arise; see 88.4.4 (Gratuitous intent: Disregards (a)(b)); 88.4.7 (Expenses: Disregard (g)).

60.6.2 *Trigger 2: Emigrating trust*

Para 2A(4) sch 5 TCGA provides:

> The second condition is that—
> (a) the trustees cease on or after 17 March 1998 to be resident in the UK, or
> (b) the trustees, while continuing to be resident in the UK, become on or after 17th March 1998 trustees who fall to be regarded for

> the purposes of any double taxation relief arrangements as resident in a territory outside the UK.

60.6.3 *Trigger 3: Variation of trust*

Para 2A(5) sch 5 TCGA provides:

> The third condition is that on or after 17th March 1998 the terms of the settlement are varied so that any person falling within sub-paragraph (7) below becomes for the first time a person who will or might benefit from the settlement.

SP 5/92 provides:

> 36 This provision is concerned with situations where the terms of the settlement are varied by the beneficiaries or a court to admit new beneficiaries within the class of persons defined at TCGA 1992 Sch 5 para 9(7) without thereby bringing the settlement to an end and creating a new one. For example, where the terms of the trust include a power to appoint anyone within a specified range to be a beneficiary, exercise of that power after 19 March 1991 will not be regarded as a variation of the settlement...

60.6.4 *Trigger 4: Unexpected beneficiary*

Para 2A sch 5 TCGA provides:

> (6) The fourth condition is that—
> (a) on or after 17th March 1998 a person falling within sub-paragraph (7) below enjoys a benefit from the settlement for the first time, and
> (b) the person concerned is not one who (looking only at the terms of the settlement immediately before 17th March 1998) would be capable of enjoying a benefit from the settlement on or after that date.
>
> (7) Each of the following persons falls within this sub-paragraph—
> (a) any grandchild of the settlor or of the settlor's spouse or civil partner;
> (b) the spouse of or civil partner any such grandchild;
> (c) a company controlled by a person or persons falling within paragraph (a) or (b) above;
> (d) a company controlled by any such person or persons together with any person or persons (not so falling) each of whom is for the purposes of paragraph 2(1) above a defined person in relation to the settlement;

> (e) a company associated with a company falling within paragraph (c) or (d) above.

SP 5/92 provides:

> 37 For the purposes of clarification, this condition deals with "ultra vires" payments, ie cases where one of the persons defined at TCGA 1992 Sch 5 para 9(7) receives a benefit from the trust for the first time and that person is not a beneficiary under the terms of the trust deed. It may also apply where such a person benefits from a transaction with the settlement carried out, for example, under the trustees' investment powers.

This trigger condition may apply in the case of an ultra vires payment (ie a payment in breach of trust), but only if the payment is in fact a benefit.[14] A transaction under the trustees investment powers is not in principle a benefit, unless perhaps the transaction is a breach of trust, in which case it is not really "under the trustees investment powers".

60.7 Qualifying settlement

Section 86(1) provides:

> This section applies where the following conditions are fulfilled as regards a settlement in a particular year of assessment—
> (a) the settlement is a qualifying settlement in the year;

"Qualifying" settlement is a label for a set of transitional rules.

60.7.1 *Post-1991 trust*

This is straightforward. Para 9(1) sch 5 TCGA provides:

> A settlement created on or after 19th March 1991 is a qualifying settlement for the purposes of section 86 and this Schedule in—
> (a) the year of assessment in which it is created, and
> (b) subsequent years of assessment.

60.8 Pre-1991 protected trusts

Para 9 continues with a complex transitional relief for what statute calls "protected settlements"; although it is generally better to adopt statutory terminology, I refer to these as "**pre-1991 protected trusts**". That terminology avoids confusion with pre-1998 protected trusts.

[14] See 50.4.11 ("Benefit" in breach of trust).

Para 9 (1A) sch 5 TCGA provides:

> Subject to sub-paragraph (1B) below, a settlement created before 19th March 1991 is a qualifying settlement for the purposes of section 86 and this Schedule in—
> (a) the year 1999–00, and
> (b) subsequent years of assessment.

The relief is in para 1B. Para 9(1B) sch 5 TCGA provides:

> Where a settlement created before 19th March 1991 is a protected settlement immediately after the beginning of 6th April 1999, that settlement shall be treated as a qualifying settlement for the purposes of section 86 and this Schedule in a year of assessment mentioned in sub-paragraph (1A)(a) or (b) above only if—
> (a) any of the five conditions set out in subsections (3) to (6A) below becomes fulfilled as regards the settlement in that year; or
> (b) any of those five conditions became so fulfilled in any previous year of assessment ending after 19th March 1991.

In the following discussion:

(1) A trust qualifying for this relief is a **" pre-1991 protected trust"**

(2) The conditions in para (a) are the "**s.86 trigger conditions**". Their effect is that the trust becomes a qualifying settlement, with the consequence that s.86 begins to apply. The drafting technique is different from that used for pre-1998 settlements but the end result is essentially the same.

60.8.1 *"Protected settlements"*

Para 9 sch 5 TCGA provides:

> (10A) Subject to sub-paragraph (10B) below, a settlement is a protected settlement at any time in a year of assessment if at that time the beneficiaries[15] of that settlement are confined to persons falling within

[15] Para 9(10C) defines beneficiary: "For the purposes of sub-paragraph (10A) above a person is a beneficiary of a settlement if—
(a) there are any circumstances whatever in which relevant property which is or may become comprised in the settlement is or will or may become applicable for his benefit or payable to him;
(b) there are any circumstances whatever in which relevant income which arises or may arise under the settlement is or will or may become applicable for his benefit or payable to him;
(c) he enjoys a benefit directly or indirectly from any relevant property comprised in

> some or all of the following descriptions, that is to say—
>
> (a) children of a settlor or of a spouse or civil partner of a settlor who are under the age of eighteen at that time or who were under that age at the end of the immediately preceding year of assessment;
>
> (b) unborn children of a settlor, of a spouse or civil partner of a settlor, or of a future spouse or civil partner of a settlor;
>
> (c) future spouses or civil partners of any children or future children of a settlor, a spouse or civil partner of a settlor or any future spouse or civil partner of a settlor;
>
> (d) a future spouse or civil partner of a settlor;
>
> (e) persons outside the defined categories.
>
> (10B) For the purposes of sub-paragraph (10A) above a person is outside the defined categories at any time if, and only if, there is no settlor by reference to whom he is at that time a defined person in relation to the settlement for the purposes of paragraph 2(1) above.

The point is that a pre-1991 protected trust may have minor children of the settlor as beneficiaries, but if it is to remain protected, it must exclude them before they become 18.

The trigger conditions are set out at length in para 9.

The relief for pre-1991 trusts was important in its day, and HMRC issued extensive guidance in SP 5/92. The guidance has ceased to be directly important (because there are now few pre-1991 protected trusts left) but it is still relevant where similar wording is used elsewhere.

60.8.2 *Trigger 1: Providing property*

Para 9(3) sch 5 TCGA provides:

> The first condition is that on or after 19th March 1991 property or income is provided directly or indirectly for the purposes of the settlement—
>
> (a) otherwise than under a transaction entered into at arm's length, and
>
> (b) otherwise than in pursuance of a liability incurred by any person before that date;
>
> but if the settlement's expenses relating to administration and taxation for a year of assessment exceed its income for the year, property or income provided towards meeting those expenses shall be ignored for the purposes of this condition if the value of the property or income so

the settlement or any relevant income arising under the settlement."

> provided does not exceed the difference between the amount of those expenses and the amount of the settlement's income for the year.

I discuss these conditions in the context of the 2017 protected trust rules, as that is where these issues now arise.[16]

60.8.3 *Trigger conditions 2-4*

Trigger condition 2 is the same as the s.86 trigger conditions which apply to pre-1998 protected trusts; it need not be separately set out here.[17]

The third and fourth conditions are based on the s.86 trigger conditions which apply to pre-1998 protected trusts with corresponding amendments in the wording. Para 9 sch 5 TCGA provides:

> (5) The third condition is that on or after 19th March 1991 the terms of the settlement are varied so that any person falling within sub-paragraph (7) below becomes for the first time a person who will or might benefit from the settlement.
> (6) The fourth condition is that—
> (a) on or after 19th March 1991 a person falling within sub-paragraph (7) below enjoys a benefit from the settlement for the first time, and
> (b) the person concerned is not one who (looking only at the terms of the settlement immediately before 19th March 1991) would be capable of enjoying a benefit from the settlement on or after that date.

Para 9(7) sch 5 TCGA provides:

> Each of the following persons falls within this sub-paragraph—
> (a) a settlor;
> (b) the spouse or civil partner of a settlor;
> (c) any child of a settlor or of a settlor's spouse or civil partner;
> (d) the spouse or civil partner of any such child;
> (da) any grandchild of a settlor or of a settlor's spouse or civil partner;
> (db) the spouse or civil partner of any such grandchild;
> (e) a company controlled by a person or persons falling within paragraphs (a) to (db) above;

[16] See 88.5.1 (Gratuitous intent: Disregards (a)(b)); 88.5.3 (Pre-2017 liability: Disregard (f)); 88.5.4 (Expenses: Disregard (g)).
Para 9(3) is the same as para 2A(2)(3); see 60.6.1 (Trigger 1: Providing property).

[17] Para 9(4) = para 2A(4); see 60.6.2 (Trigger 2: Emigrating trust).

> (f) a company associated with a company falling within paragraph (e) above.

See 60.6.3 (Trigger 3: Variation of trust); 60.6.4 (Trigger 4: Unexpected beneficiary).

60.8.4 *Trigger 5: Cease to be protected*

Para 9(6A) sch 5 TCGA provides:

> The fifth condition is that the settlement ceases to be a protected settlement at any time on or after 6th April 1999.

60.8.5 *Pre-1991 trusts: Critique*

These rules have been in place since 1991. Children then living (or born in the following decade) have reached 18. It is possible to envisage circumstances in which pre-1991 protected trusts could still exist but I suspect that there are no pre-1991 protected trusts now in existence. It is suggested in the interests of simplification that the transitional relief for pre-1991 protected trusts should now be withdrawn.

60.9 Trust residence condition

Section 86 TCGA provides:

> (1) This section applies where the following conditions are fulfilled as regards a settlement in a particular year of assessment ...
> (b) the trustees of the settlement fulfil the condition as to residence specified in subsection (2) below;

This takes us to s.86(2) TCGA which provides:

> The condition as to residence is that—
> (a) there is no time in the year when the trustees are resident in the UK, or
> (b) there is such a time but, whenever the trustees are resident in the UK during the year, they fall to be regarded for the purposes of any double taxation relief arrangements[18] as resident in a territory outside the UK.

Condition (a) is that the trustees are non-resident; condition (b) is that the trustees are UK tax-resident but treaty-resident in a foreign state with a capital gains article (under the tie-breaker).[19]

[18] For the meaning of this term, see 12.6.1 ("DTR arrangements" for CGT).

[19] For treaty aspects, see 60.19 (DT reliefs: s.86 TCGA).

60.10 Settlor residence/domicile conditions

Section 86 TCGA provides:

> (1) This section applies where the following conditions are fulfilled as regards a settlement in a particular year of assessment ...
>
> (c) a person who is a settlor in relation to the settlement ("the settlor")
>
> [i] is domiciled[20] in the UK at some time in the year and
>
> [ii] is resident in the UK for the year;

Section 86 does not apply to a foreign domiciled settlor, whether or not they claim the remittance basis. At first sight this seems a surprising inconsistency with the general scheme of taxation of foreign domiciliaries, introduced in 2008. It was however a deliberate decision.[21] No reason was given for it so it is tempting to speculate. Probably it reflects an understanding, which most readers would accept, that it is not appropriate to apply the rules to settlors and trustees from outside the UK because:

(1) the definition of "settlor-interested" for s.86 purposes is too wide, and

(2) the trigger conditions are too harsh and too complicated,

One must bear in mind that foreign settlors and trustees may not have had the same opportunities to consider UK legislation when making or administering their settlements.

That is actually quite a good reason, though one should not assume that rules of tax law, even important rules, are necessarily enacted for good reasons. Perhaps it was just a concession thrown without much rationalisation, to placate the lobby opposing the 2008 reforms, that is, the explanation may be located in tax politics rather than tax policy.

Although no claim is needed, the matter should be disclosed on a tax return, if one is completed: see 60.18.1 (Non-domiciled settlor).

60.11 Section 86 gains condition

Section 86 TCGA provides:

> (1) This section applies where the following conditions are fulfilled as regards a settlement in a particular year of assessment ...

[20] Section 86(3A) TCGA provides: "Section 835BA (deemed domicile) applies for the purposes of subsection (1)(c)." This is the standard wording to apply the deemed domicile rules.

[21] Draft Finance Bill clauses which would have amended s.86 were withdrawn.

> (e) by virtue of disposals of any of the settled property originating from the settlor, there is an amount on which the trustees would be chargeable to tax for the year under section 1(3) if the assumption as to residence specified in subsection (3) below were made.

I refer to this as the "**s.86 gains condition**".

60.11.1 *Residence assumption*

The assumption as to residence is set out in s.86(3) TCGA but in order to follow it one must read it with s.86(2):

> (2) The condition as to residence is that—
> (a) there is no time in the year when the trustees are resident in the UK, or
> (b) [i] there is such a time but,
> [ii] whenever the trustees are resident in the UK during the year, they fall to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the UK
> (3) [a] Where subsection (2)(a) above applies, the assumption as to residence is that the trustees are resident in the UK throughout the year; and
> [b] where subsection (2)(b) above applies, the assumption as to residence is that the double taxation relief arrangements do not apply.

I refer to the assumption as to residence in s.86(3)[a] as "the s.86 residence assumption".[22] The statutory residence assumption may be regarded as a deeming provision, or at least, like a deeming provision, it is construed purposively.[23]

In para (3)[b] the assumption is not in fact an assumption "as to residence": the assumption is a disapplication of treaty relief, but the meaning is clear, no short label could accurately summarise the position, and this point does not often arise. See 61.6.1 (s.87 residence assumption).

60.11.2 *Ascertaining s.86 gains*

The condition in s.86(1)(e) is that there is an amount, which I call the

[22] For statutory residence assumptions, see 61.6.1 (s.87 residence assumption).

[23] See App 8.1.2 (Statutory assumptions).

"**s.86 gains**". The quantum of the s.86 gains matters because the amount of the charge depends on that.

All the usual CGT reliefs are in principle applicable in computing the s.86 gains. For instance, hold-over relief is available on a transfer to a UK resident beneficiary, if the usual conditions are satisfied.[24]

Para 1(1) sch 5 TCGA provides:

> In construing section 86(1)(e) as regards a particular year of assessment, the effect of section 1K shall be ignored.

This disapplies the trust annual CGT exemption[25] (which is fair, because the settlor has their own annual exemption).

60.12 Death of settlor

Section 86 TCGA provides:

> (1) This section applies where the following conditions are fulfilled as regards a settlement in a particular year of assessment ...
>
> (f) paragraph 3, 4 or 5 of schedule 5 does not prevent this section applying.

This sets out three conditions which are best considered separately.

Para 3 sch 5 TCGA provides:

> Section 86 does not apply if the settlor dies in the year.

What is the reason for this rule? Presumably it was thought unfair to tax the settlor's estate on post-death gains, and too much trouble to split the year into disposals before/after the death.

60.13 Death/divorce of beneficiaries

The last two s.86 conditions are set out in paras 4 and 5 sch 5 TCGA:

> 4(1) This paragraph applies where for the purposes of section 86(1)(d) the settlor has no interest in the settlement at any time in the year except for one of the following reasons, namely, that—
>
> (a) property is, or will or may become, applicable for the benefit of or payable to one of the persons falling within para 2(3)(b) to (db) above,
>
> (b) income is, or will or may become, applicable for the benefit of or payable to one of those persons, or
>
> (c) one of those persons enjoys a benefit from property or income.

[24] See HMRC Helpsheet 295 quoted at 61.6.3 (s.1(3) amount: Exemptions/reliefs).

[25] See 44.2.4 (Annual exemptions: Trusts).

> (2) This paragraph also applies where sub-para (1) above is fulfilled by virtue of 2 or all of paras (a) to (c) being satisfied by reference to the same person.
> (3) Where this paragraph applies, section 86 does not apply if the person concerned dies in the year.
> (4) In a case where—
> (a) this paragraph applies, and
> (b) the person concerned falls within para 2(3)(b), (d) or (db) above,
> section 86 does not apply if during the year the person concerned ceases to be married to, or a civil partner of, the settlor, child or grandchild concerned (as the case may be).
> 5 (1) This paragraph applies where for the purposes of section 86(1)(d) the settlor has no interest in the settlement at any time in the year except for the reason that there are 2 or more persons, each of whom—
> (a) falls within para 2(3)(b) to (db) above, and
> (b) stands to gain for the reason stated in sub-para (2) below.
> (2) The reason is that—
> (a) property is, or will or may become, applicable for his benefit or payable to him,
> (b) income is, or will or may become, applicable for his benefit or payable to him,
> (c) he enjoys a benefit from property or income, or
> (d) 2 or all of paras (a) to (c) above apply in his case.
> (3) Where this paragraph applies, section 86 does not apply if each of the persons concerned dies in the year.

I cannot see the point of this, though it does offer a kind of symmetry with para 3. I doubt if it ever has or ever will apply.

60.14 s.86 gains attributed to settlor

Assuming all eight s.86 application conditions are satisfied, we proceed to s.86(4) TCGA which provides:

> Where this section applies—
> (a) chargeable gains of an amount equal to that referred to in subsection (1)(e) above shall be treated as accruing to the settlor
> [i] in the year
> [ii] or if, as respects the settlor, the year is a split year, in the UK part of that year ...

The point of para [ii] is that there is no split-year relief.[26] The entire gains of the year are taxable, even if the settlor has a split year and the gains accrue during the offshore part of the year.

[26] See 10.3.3 (When no split-year relief).

60.14.1 *Residential property: CGT rate*

Suppose a gain accrues to a trust within s.86 on a disposal of residential property.

The gain is not within s.86 to the extent that it is charged on the trustees.[27] However, residential property gains may accrue to trustees on which they are not subject to CGT. This could occur where the gain accrues on a disposal of non-UK residential property, or where the trustees' gain subject to CGT is reduced by 2015 rebasing. Gains charged on the settlor under s.86 could therefore represent residential property gains.

What is the rate of tax on such gains? HMRC say that s.86 gains of the settlor are not the same as the actual gains of the trustees.[28] At first sight, therefore, the s.86 gains do not have the nature of residential property gains. On that basis the settlor would be subject to CGT on the gains at the normal CGT rates of 10% and 20%, not the higher CGT rates of 18% and 24% which apply to residential property gains.[29] But the definition of "residential property gains" is "a chargeable gain accruing to a person on a disposal of residential property".[30] That seems wide enough to include a s.86 gain which accrues to a person (the settlor) and does so on a disposal of residential property (it does not matter that the disposal is made by a trust or underlying company). The fact that the s.86 gains are not the same as the trustees gains does not stop them from both being residential property gains. This view fits the purpose of s.86, which is to put the settlor in the same position as if they had not made the settlement.

60.15 Interaction of s.86/s.3 TCGA

Suppose a settlor-interested trust within s.86 TCGA owns a non-resident company within s.3 TCGA, and a gain accrues to the company. The gain is treated as accruing to the trustees. In the absence of express provision, this gain would not fall within s.86 because the s.86 gains condition would not be satisfied: the gain does not accrue "by virtue of disposals of any of the settled property".[31] The company property is not settled property.

[27] See 57.30.2 (UK-land gain outside s.86/87).

[28] See 60.19.1 (Trust treaty-resident outside UK).

[29] See 43.14.1 (Residential property gain).

[30] See 57.37 (Residential property gain).

[31] See 60.11 (Section 86 gains condition).

Para 1(3) sch 5 TCGA deals with this:

> In a case where—
>
> (a) the trustees are participators in a company in respect of property which originates from the settlor, and
>
> (b) under section 3 gains or losses would be treated as accruing to the trustees in a particular year of assessment by virtue of so much of their interest as participators as arises from that property if the assumption as to residence specified in section 86(3) were made,
>
> the gains or losses shall be taken into account in construing section 86(1)(e) as regards that year as if they had accrued by virtue of disposals of settled property originating from the settlor.
>
> Section 3B(1) to (3) shall apply for the purposes of this sub-paragraph as they apply for the purposes of that section.

60.16 Corporate settlor

Section 86 TCGA will not apply to a company which creates a settlor-interested settlement, for the following reasons (any one would suffice):

(1) In the case of a commercial trust, the company is not a settlor.[32]

(2) Even assuming a trust made with bounty/gratuitous intent:

  (a) In the case of a close company, those who control it will usually be settlors, and the company will not be a settlor.[33]

  (b) Even if the company is a settlor:

    (i) Section 86 only applies if the company settlor is resident and domiciled (ie incorporated) in the UK, which is not likely to be the case.

    (ii) The context suggests that only individual settlors are intended to be caught.

60.17 s.86/87 & BAD relief interaction

This section considers whether business asset disposal relief[34] (formerly called “entrepreneurs’ relief) is available on a disposal by a non-resident trust, within s.86, assuming all the relevant conditions are satisfied (so that a disposal by a UK resident trust would qualify for the relief).

Section 169N TCGA provides (so far as relevant):

[32] See 99.39 (Pension/employee benefit trust).

[33] See 99.40.1 (Co settlor: s.86 definition).

[34] See 56.19 (BAD relief: Remittance basis).

> (1) Where a claim is made in respect of a qualifying business disposal—
>
> (a) the relevant gains (see subsection (5))[35] are to be aggregated, and
>
> (b) any relevant losses (see subsection (6)) are to be aggregated and deducted from the aggregate arrived at under paragraph (a).
>
> (2) The resulting amount is to be treated for the purposes of this Act as a chargeable gain accruing at the time of the disposal to the individual or trustees by whom the claim is made.
>
> (3) The rate of capital gains tax in respect of that gain is 10%, but this is subject to subsections (4) to (4B)...[36]
>
> (9) Any gain or loss taken into account under subsection (1) is not to be taken into account under this Act as a chargeable gain or an allowable loss.

The technical question is whether the gains which are treated as accruing to the settlor are the same gains as the gains accruing to the trustees. It is considered that one should apply a purposive construction so that the relief is available.[37] If that were wrong, UK law would not be EU-law compliant, which would give a further defence if the trustees were resident in a MS.

However if it is possible to make the trust UK resident in the year of the disposal, that would be better, as the issue would not arise.

On the other hand, BAD relief is probably not available if the trust is within s.87, as the s.87 gain accruing to a beneficiary is not the same gain.[38]

60.18 Tax return: s.86 gains

60.18.1 *Non-domiciled settlor*

This section considers the position where gains accrue to a settlor-interested trust, but s.86 does not apply because the settlor is not UK domiciled.

[35] Section 169N(5) TCGA provides: "In subsection (1)(a) "relevant gains" means—
(a) if the qualifying business disposal is of (or of interests in) shares in or securities of a company (or both), the gains accruing on the disposal (computed in accordance with the provisions of this Act fixing the amount of chargeable gains), and
(b) otherwise, the gains accruing on the disposal of any relevant business assets comprised in the qualifying business disposal (so computed)."

[36] Subsections (4) to (4B) impose a £10m cap which need not be considered here.

[37] A similar issue arises for DTAs; see 60.19.1 (Trustees treaty-resident outside UK).

[38] See 61.60.1 (Trustees treaty-resident outside UK).

If the settlor claims the remittance basis, and submits a tax return, they will have completed the relevant boxes in SA109 and no further return or disclosure is necessary.[39]

If the settlor does not claim the remittance basis, but does submit a tax return, then:

(1) It is necessary to tick box 23 in form SA109 (2022/23). The caption by this box states: *If you are domiciled outside the UK and it is relevant to your Income Tax or Capital Gains Tax liability for 2022–23, put 'X' in the box. Please explain in box 40 how your domicile is relevant to your Income Tax or Capital Gains Tax liability*. (There are further relevant boxes if this is the first domicile claim).

(2) It is not necessary to tick box 8 in form SA100 (2022/23). The caption by this box reads: *Residence, remittance basis etc. Were you, for all or part of the year to 5 April 2023, one or more of the following – not resident, not domiciled in the UK and claiming the remittance basis, dual resident in the UK and another country?*

If the settlor does not submit a tax return (because HMRC have not sent a notice to submit the return, and there are no income/gains requiring a return) then no claim or notification is needed.

60.18.2 *UK domiciled settlor*

Helpsheet HS299 (Non-resident trust and CGT) 2021 provides:

> If you're liable to tax when gains arise to one or both of the non-resident trustees of your trust and to relevant overseas private companies in which they invest, the trustees' net chargeable gains are attributed to you. You should include them in the overall figure in box 17 on your Capital Gains Tax summary pages. You should include details of these gains in your computations accompanying these pages.

60.19 DT relief: s.86 gains

60.19.1 *Trust treaty-resident outside UK*

Suppose:

(1) A trust within s.86.

(2) The trustees are treaty-resident in a foreign state whose DTA has a standard form CGT article.

[39] See 123.4 (Claim made in return).

(3) The settlor is UK tax-resident and not treaty-resident in a foreign state.

The question is whether the settlor qualifies for third-party DTA relief.[40] Where a Savings Clause applies, the answer is no.

What if the treaty does not have a Savings Clause? Section 86(4) TCGA provides:

> Where this section applies—
>
> (a) chargeable gains of an amount equal to that referred to in subsection (1)(e) above shall be treated as accruing to the settlor in the year ...

In the HMRC view, the fact that the trustees are treaty-resident in a foreign state with standard form DTA CGT relief does not allow the settlor to claim third-party relief from s.86.

HMRC raise two arguments in the Manuals. The first is a categorisation, *Bricom*-type argument. The CG Manual provides:

> **CG38545: Double taxation relief** - TCGA92/S86 [Dec 2021]
> Articles in double taxation agreements which give sole taxing rights to the alienator's country of residence do not apply to the gain chargeable on the settlor under TCGA92/S86. That is because the person making the disposal is the trustees and not the settlor. Section 86 does not deem the trustees' gain to accrue to the settlor. Instead section 86(4) treats the settlor as accruing a gain equal to the gain that accrues to the trustees. This is a particular issue if the country of residence does not tax capital gains, for example, Mauritius or New Zealand. Some Double Taxation agreements, including Mauritius and New Zealand, have been amended to make it clear that the UK has the right to charge attributed gains.

I think this argument is debatable, but the Courts have accepted it in other avoidance contexts and so it would likely be accepted here.[41]

If needed, HMRC have a further argument, on which the CG Manual provides a hint, in a section (now withdrawn) discussing s.77 TCGA (long ago repealed). The Manual first explains why third–party DT relief did apply to s.77 TCGA[42] when trustees were treaty-resident in a foreign state

[40] See 107.21 (Third-party DT relief).

[41] See 109.4 (Characterisation: Same income?).

[42] Section 77(1) TCGA (now repealed) provided, so far as relevant:

> Where in a year of assessment—
>
> (a) chargeable gains accrue to the trustees of a settlement from the disposal of

with a capital gains article:

> ***CG34912. Double taxation relief*** *[Jul 2019]*
> *A settlor may be able to claim exemption [from s.77 TCGA] on some or all of the attributed trust gains, but this depends on the terms of the particular double taxation agreement. The gain which is chargeable on the settlor is not the same as the gain which accrues to the trustees. Therefore Articles which exempt trustees from UK tax on gains accruing on the disposal of particular property do not necessarily operate to exempt the settlor from liability under Section 77. However section 77(1)(b) requires there to be an amount on which the trustees would have been chargeable for the year in respect of the gains in question. So if the correct interpretation of the Double Taxation Agreement by reference to the relevant acts is that the trustees would be exempt if they were chargeable then there is no liability.*

HMRC say this argument does not run for s.86 because the legislation is differently worded:

> *This is by way of contrast with section 86 where there is a hypothesis in subsections (1)(e)(i) and (3) that the trustees are in fact resident in determining whether the section applies*[43] *and therefore one cannot take into account the actual non-residence. Compare Bricom Holdings v CIR 70 TC 272.*

This is not necessarily right[44] but the question is not likely to arise.

Another argument, if needed, is that s.86(3) envisages a charge in a case where trustees are dual resident in the sense of being UK tax-resident but treaty-resident in a foreign state. In that case the treaty is intended to be overridden. By implication the same should apply where the trustees are treaty-resident in a foreign state and not UK resident at all.

any or all of the settled property,

(b) after making any deduction provided for by section 2(2) in respect of disposals of the settled property there remains an amount [now, s.1(3)] on which the trustees would be chargeable to tax for the year in respect of those gains ... and

(c) at any time during the year the settlor has an interest in the settlement,

[i] the trustees shall not be chargeable to tax in respect of those gains but

[ii] instead chargeable gains of an amount equal to that referred to in para (b) shall be treated as accruing to the settlor in that year.

[43] See 60.11 (Section 86 gains condition).

[44] See 61.60.1 (Trustees treaty-resident outside UK) for the discussion on the point in the context of s.87.

In practice one should plan on the basis that the settlor will not qualify for third party DTA relief.

HMRC do accept that the settlor does qualify for third-party foreign tax credit relief, ie foreign tax paid by the trustees may be set against the s.86 charge. This is fair though not consistent with the HMRC argument on characterisation discussed above. The CG Manual provides:

> **CG38545: Double taxation relief - TCGA92/S86** [Dec 2021]
> Credit relief may be given for any foreign tax paid on the gains. This is because the gain chargeable on the settlor is calculated by reference to the gain that accrues to the trustees. Foreign tax credit is allowed either under the credit Article in a double taxation article by TIOPA10/S18(1) or unilaterally by TIOPA10/S9(2).

60.19.2 *Settlor treaty-resident outside UK*

Suppose:

(1) A trust within s.86.
(2) The settlor is UK tax-resident but treaty-resident in a foreign state.

Can the settlor claim direct relief? The point is the same as for s.3 gains. Art.13(5) OECD Model provides (with immaterial exceptions):

> Gains from the alienation of any property ... shall be taxable only in the Contracting State of which the *alienator* is [treaty-resident].

On a literal reading, the settlor does not qualify for treaty relief because (though treaty non-resident) the settlor is not the alienator. The trustees are the alienator but (on the facts of this example) the trustees are not treaty non-resident. So the terms of art.13(5) are not satisfied. The US treaty is wider and DT exemption applies to a settlor who is treaty-resident in the US.[45] Even under OECD Model, the same result is arguable on the grounds that the gain is treated as accruing to the settlor, they should be deemed to be the alienator; or the word "alienator" does not require that one must alienate property, only that the gain on the alienation accrues to the person.

60.19.3 *Trust co treaty-resident outside UK*

If a non-resident trust within s.86 owns a treaty non-resident company

[45] See 91.7.8 (s.624/720 income; s.3/86 gain).

which realises a gain, DT relief is disallowed and the settlor is taxable; see 64.41 (Trust participator: No DT relief).

CHAPTER SIXTY ONE

CAPITAL PAYMENTS FROM NON-RESIDENT TRUSTS: s.87 CODE

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Cross references

The following topics are considered elsewhere:

Topic	**See para**
BAD relief & s.86/87 interaction	60.17
s.3 distribution relief and s.86/87 interaction	64.20.5
Loss of non-resident trustees	65.13
Personal loss of beneficiary not set against s.87 gain	65.14

For s.87 gains accruing to charity,See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*.[1]

61.1 s.87 code: Introduction

This chapter considers CGT charges on beneficiaries who receive capital payments from non-resident trusts. I call this the **“s.87 code**”. This is set out in s.86A - s.97 and Sch 4C TCGA.

[1] (14th ed., 2024-25), Chapter 32 (Payments to Charity from Non-Resident Trusts) online version *http://www.taxationofcharities.co.uk*

There are *four* versions of the s.87 code:

Version	**Applies**	**See para**
Standard s.87 code	Generally	*Discussed here*
Sch4C s.87 code	After sch4B-transfer	62.19
Modified codes for offshore income gains		
Modified standard code for OIGs		67.13
Modified sch4C code for OIGs		62.32

The result is so intricate that no written description could do justice to its complexities.

The rules were introduced in 1981, extended in 1998, extended and rewritten in 2008, and extended again in 2017.

In the following discussion:

The **"pre-2008 s.87"** means s.87 as it was before the 2008 amendments.

The **"s.87 guidance note"** means HMRC's 54-page guidance note entitled "FA 2008 changes to the CGT charge on beneficiaries of non-resident settlements".[2]

61.2 "Settlement"/"settled property"

Section 97(7) TCGA provides:

> In sections 86A to 96 and Schedule 4C and in this section—
> "settlement" has the meaning given by section 620 of ITTOIA 2005, and
> "settled property" and references (however expressed) to property comprised in a settlement shall be construed accordingly.

"Settlement" here means settlement-arrangement.[3]

The estate of a deceased person is not a "settlement" in this sense.[4]

61.3 Non-classic trust

In practice, s.87 is normally concerned with trusts in the classic sense. But a settlement-arrangement need not be a classic trust. I refer to that here as a "settlement" with scare quotation marks.

Section 97(7A) TCGA provides the standard deemed-trustee rule to deal

[2] First published May 2009, 2nd version October 2009, *http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/cnr/beneficiaries-non-resident.pdf*

[3] See 87.4 (Settlement-arrangement definition of settlement).

[4] See 88.8.1 (Is estate a "settlement" for s.87).

with the situation where the settlement-arrangement is not a classic trust, and so does not have trust-law trustees.[5] It continues:

> (and a person who is treated as a trustee of the settlement by virtue of this subsection shall be treated as a trustee of the settlement for the purposes of section 69).

Thus for s.87 purposes the distinct-person rule,[6] and the standard IT/CGT test of trust residence, apply to the deemed trustee.

61.3.1 *Outright transfer: s.87*

Suppose P gives an asset[7] outright to C. There is no classic trust, but there is a "settlement".[8]

No-one thinks s.87 would apply to this "settlement", but it is helpful to ask why not, as the answer is relevant for analysis of other cases.

The "settlement" has no trust-law trustees. There will be a deemed trustee, namely, C, on the basis that the property is vested in C and the management, generally, is also vested in C.[9]

Section 87 does not apply here because:

(1) There are no s.1(3) amounts (trust gains): no gains accrue to the deemed trustee in their capacity as trustee. On a disposal of the asset, gains accrue to C in C's private capacity.

(2) There can be no capital payments (benefits) from the deemed trustees.

This fits the scheme of the legislation. There is no need for the s.87 rules: a disposal of the asset constitutes a disposal by C, on which gains accrue to C. The purpose of s.87 is to deal with cases where gains (trust gains) do not accrue to beneficial owners.

61.3.2 *Usufruct: s.87*

A usufruct[10] is not a classic trust but it is a "settlement" within the

[5] See 87.8.2 (Non-classic trust: Deemed trustee).

[6] See 7.3 (Trustees a distinct person).

[7] Further complications arise if the asset is a non-resident company, see 61.3.4 (s.87/s.3 relationship).

[8] See 87.4 (Settlement-arrangement definition). The main significance is that if C is a child of P, and under 18, P will be taxed on the income arising under the "settlement".

[9] It makes no difference if the property is vested in a nominee for C, because of the CGT bare trust disregard; see 87.7 (Bare trust/nomineeship).

[10] See 90.25 (Usufructs).

settlement-arrangement definition.

The "settlement" has no trust-law trustees.

Section 87 TCGA does not apply to this "settlement", for the following reasons:

(1) There is no settled property. There are two items of property, one belonging to the usufructuary and the other belonging to the encumbered owner.

(2) There is arguably no deemed trustee as there is no one person in whom the property or its management is vested.

If (contrary to the above) there was a deemed trustee, the analysis of an outright transfer becomes applicable:

(3) No gains accrue to the deemed trustees: on a disposal of the usufruct property, gains accrue to the usufructuary and the encumbered owner in their private capacities. So there are no s.1(3) amounts (trust gains).

(4) There are no capital payments from the deemed trustees.[11]

This fits the scheme of the legislation. There is no need for the s.87 rules: a disposal of the usufruct property constitutes disposals by the usufructuary/encumbered owner of their respective interests, on which gains accrue to them.

Points (1) and (2) also support the view that a usufruct is not a settlement in the IHT sense. While the concept of IHT-settlement includes non-trust arrangements which are equivalent in effect to a trust, IHT assumes that a settlement has a trustee and settled property, and if an entity does not, then it should not be regarded as a settlement for IHT purposes.

61.3.3 *s.87/s.3 relationship*

Suppose P gives a non-resident company to C outright. There is no classic trust, but there is a "settlement" (in the settlement-arrangement sense). No-one thinks s.87 would apply to this "settlement", but it is helpful to ask why not, as the answer is relevant for analysis of other cases.

The "settlement" has no trust-law trustees. Who is the deemed trustee?

(1) Perhaps C is the deemed trustee, on the basis that the property here should be taken to be the shares. In that case the analysis is like any other

[11] In particular, the termination of the usufruct is not a capital payment.

gift to C.[12]

(2) Perhaps the company is the deemed trustee, on the basis that the company's property and its management is vested in the company. In that case, the answer may be that there can be no capital payments (benefits) from the deemed trustee.

More fundamentally, the non-resident company falls within s.3 TCGA. As a general principle, one cannot apply s.3 *and* s.87 rules, because of the presumption against double taxation.

61.3.4 *Foundations: s.87*

After some vacillation, the analysis adopted in this book is that:

(1) A Foundation is in principle a settlement within the standard IT/CGT definition and a settlement-arrangement.

(2) A Foundation is not a company.[13]

It may be said that the "settlement" has no trust-law trustees. If so, there will be a deemed trustee, namely, the Foundation itself, on the basis that the property and its management is vested in the Foundation.[14]

On this analysis, the s.87/s.3 overlap or border issue does not arise.

However another possible view is that:

(1) A Foundation is not a settlement, in the standard IT/CGT sense, and

(2) A Foundation *is* a company.

As a Foundation is in principle a "settlement" (it is an arrangement) the question would then arise whether one would apply s.87 or s.3.

In order to apply s.87, one needs to identify the s.1(3) amount, ie the amount on which the deemed trustees would be chargeable under s.1(3) if they were UK resident. The Foundation (if UK resident) would be subject to CT, on the basis that it is a company and not a settlement. So at first sight, the amount chargeable under s.1(3) would be nil! But there are two answers to this:

[12] See 61.3.1 (Outright transfer: s.87).

[13] See 90.14 (Stiftung/Foundation). Different considerations apply to a Foundation with Founder's Rights.

[14] I have considered whether the members of the board of the Foundation may be a deemed trustee on the basis that the management of the property is vested in them; but the board is simply an organ of the Foundation itself. Where a company is a trustee, no-one says that its directors are trustees. Also no gains can be said to accrue to the directors.

(1) Section 97(7A) applies the distinct-person rule, so the deemed trustees are a separate person which is not a company.
(2) One does not apply the deeming to that extent.[15]

So s.87 can apply to a Foundation even if (contrary to the view taken here) it were held to be a company.

It is considered that the context shows that s.87 should apply in priority to s.3. This fits the scheme of the legislation, as apportioning trust gains to participators would be difficult.

Different considerations apply to a Foundation with Founder's Rights. That is a company within s.3, and not a settlement. Gains accruing to the Foundation would be attributable to the founder and no-one else.[16]

Note incidentally that this analysis will sometimes favour HMRC and sometimes not; this is not a case where one analysis will benefit HMRC and the other the taxpayer.

61.4 Non-resident trust condition

Section 87(1) TCGA sets out the fundamental condition for the application of s.87:

> This section applies to a settlement for a tax year ("the relevant tax year") if there is no time in that year when the trustees are resident in the UK.

Statute often refers to a settlement "to which s.87 applies"; this means (in short) a non-resident settlement. In full, it means:
(1) a non-resident settlement; or
(2) a dual-resident settlement (more accurately, UK tax-resident, but treaty non-resident under the tie-breaker).[17]

It is not necessary for the settlement to be in existence at the time when a capital payment is received.[18]

61.5 The s.87 charge

Section 87(2) TCGA provides:

> [a] Chargeable gains are treated as accruing in the relevant tax year to

[15] See App 8.2 (Deeming provisions: Construction).
[16] See 90.14.10 (Founder's Rights: a company).
[17] See 61.38 (Dual-Resident trust: s.88 TCGA).
[18] *Bowring v HMRC* [2015] UKUT 550 (TCC) at [65] - [71].

a beneficiary of the settlement

[b] who has received a capital payment from the trustees in the relevant tax year or any earlier tax year

[c] if all or part of the capital payment is matched (under s.87A as it applies for the relevant tax year) with the s.1(3) amount for the relevant tax year or any earlier tax year.

The key requirements are "capital payment" "s.1(3) amount" and "matching".

I refer to gains treated as accruing as "**s.87 gains**". The term "deemed gains" is sometimes used, but my terminology is clearer.

A s.87 gain accrues in the year that a capital payment is matched with a s.1(3) amount. That may be later than the year that the capital payment is made.

Section 87 is not strictly a charging section, it feeds into s.2 TCGA which imposes the charge. But I use the expression "s.87 charge" as a convenient shorthand.

61.6 Section 1(3) amount

Section 87(4) TCGA provides:

> The s.1(3) amount for a settlement for a tax year for which this section applies to the settlement is—
>
> (a) the amount upon which the trustees of the settlement would be chargeable to tax under s.1(3) for that year if they were resident in the UK in that year ...[19]

The terminology has changed over time:

Date	**Term**
1981-2008	Trust gains
2008-2018	s.2(2) amount
2018 -	s.1(3) amount

"s.1(3) amount" has more or less the same meaning as the term "trust gains" in the pre-2008 s.87. The old terminology was clearer, and EN FB 2008 itself used the term "trust gains". It is usually better to adopt statutory terminology, rather than using a different term with the same meaning but the term "s.1(3) amount" is opaque, so I use the phrase "s.1(3) amounts (trust gains)" or just "trust gains".

[19] For s.87(4)(b) see 61.6.7 (s.86 gain deducted).

Some practitioners use the term "stockpiled gains" or describe a trust as having a pool of s.1(3) amounts.

Strictly one should not use the term "s.1(3) amount" in the abstract. A s.1(3) amount can exist only in relation to a particular trust, and for a particular tax year. That is, each s.1(3) amount is linked to a specific trust and a specific tax year. But where the context is clear it is permissible to refer to a s.1(3) amount in isolation (leaving the words "for a settlement and tax year" to be inferred). The expression "s.1(3) amounts" (in the plural) is appropriate where there are s.1(3) amounts for more than one tax year.

61.6.1 *s.87 residence assumption*

The definition of s.1(3) amount refers to the amount on which the trustees would be chargeable to tax "if they were resident in the UK in that year". This is a statutory assumption, which may be regarded as a deeming provision, or at least, like a deeming provision, it is construed purposively.[20]

Statutory residence assumptions are quite common. I list them here as discussion in one context can be relevant to the others:

Assumption (my term)	**Provision**	**See para**
s.87 residence assumption	s.87(4) TCGA	*Discussed here*
s.86 residence assumption	s.86(1)(3) TCGA	60.11
s.3 residence assumption	s.3G(3) TCGA	64.4; 11.6.2
CFC residence assumption	-	61.60.1
RFI residence assumption	*various*	16.9.3

61.6.2 *Trust outside s.87*

Section 87(5) TCGA provides:

> The s.1(3) amount for a settlement for a tax year for which this section does not apply to the settlement is nil.

This makes sense, of course, since if s.87 does not apply the trustees must be UK resident and within the scope of CGT.

The s.87 guidance note provides:

> 10. Section 87(5) ... In particular this is needed to deal with transfer between settlements. The transferee settlement may have a [s.1(3)]

[20] See App 8.1.2 (Statutory assumptions).

> amount for a year in which the trustees were resident in the UK. Section 87(5) ensures no account is taken of that amount. But it can still be treated as having a [s.1(3)] amount for that year from the transferor settlement.

61.6.3 *s.1(3) amount: Exemptions/reliefs*

All the usual CGT reliefs are in principle available for computing the s.1(3) amount.

For instance, hold-over relief is available on a transfer to a UK resident beneficiary, if the usual conditions are satisfied. HMRC accept this. Helpsheet 295 (Relief for gifts and similar transactions, 2021) provides:

> There's no need for the transferor to be resident in the UK. Therefore the relief is available for trustees of non-resident settlements where the chargeable gain would, or might otherwise be, charged on UK residents.[21]

For 1981/1988/2008 transitional rules, see 61.40 (Pre-1981 gain/capital payment) ff.

61.6.4 *Claims for relief*

What is the position where a claim is needed for a relief or exemption?[22] A common example is relief for capital losses. Other examples include an election under reg 48 OFTR where a non-reporting fund owned by the trust converts into a reporting fund,[23] and claims for DT relief. There are too many to give a full list.

One needs to review the wording of the provision requiring a claim but these tend to take a standard form. For loss relief, the relevant provision requires that a claim is made by the person to whom the loss accrues, so a claim could be made by the trustees.[24] It is considered that the s.87 residence assumption requires one to assume that the trustees would have made any claims which are beneficial, even though no claim is made. So the trustees do not actually need to make a claim. This raises the old question of how far to carry the deeming.[25] My construction gives the most sensible result, as a claim makes no difference to the trustees own

[21] For instance, the gain might be charged under s.86 or s.87 TCGA.

[22] I am grateful to John Barnett of Burges Salmon for his comments on this issue.

[23] See 67.26 (Fund becomes reporting fund).

[24] See 123.2.3 (Capital loss claims).

[25] See App 8.2 (Deeming provisions: Construction).

tax position, and losses may arise at a time when the trustees have no UK beneficiaries and cannot possibly be expected to consider UK tax issues. It is supported by *Bricom v IRC*, a case on the CFC residence assumption:[26]

> The computation of the profits on which corporation tax is chargeable... involves ascertaining ... the amount which would have represented the amount of such profits if the controlled foreign company had been resident in the UK and had made all necessary claims for relief.

Of course, if the trustees do make a claim then this issue does not arise. A claim could be made by submitting form 50(FS) with a computation attached detailing the losses. But I wonder how often that is done in practice.

However that may be, the beneficiary who receives the capital payment does not make the loss claim. That avoids the problem of different beneficiaries making different claims.

Similarly, an election under reg 48 OFTR is made by the "participant in the fund". Unlike capital losses, it may not be obvious whether it is better to elect. So the *Bricom* deeming of all necessary (or beneficial) claims may not apply, and the trustees should make the election.

61.6.5 *CGT annual exemption*

What about the CGT annual exemption?[27] The CG Manual provides:

> **CG38610: Trustees' gains - section [1(3)] amount** [Nov 2019]
> The trustees do not have an annual exempt amount which is deducted in calculating the section [1(3)] amount.

And again:

> 9. ... [The s.1(3) amount] is defined in section 87(4). It is the amount on which the trustees would be liable to CGT if they had been resident and ordinarily resident in the UK during the year. As in the original section 87 this is the amount of the gains after deducting losses and without giving any annual exempt amount.[28]

The underlined words are wrong as s.1K(1) TCGA (extended to trustees by sch 1C TCGA) provides: "the annual exempt amount for the year is to

[26] See 61.60 (DT relief: s.87 gain).

[27] See 44.2 (CGT annual exemption).

[28] Section 87 guidance note, para 9.

be deducted from" trustees gains.[29] So "the amount upon which the trustees would be chargeable to tax under s.1(3) for that year if they were resident" is reduced by the exempt amount.

The courts might disapply the plain words if the result were absurd, but it is not. There may be an element of double relief as beneficiaries may have their own annual exemption. This rule is nevertheless sensible because it saves trustees from having to keep track of small gains (and it avoids non-compliance so far as one could not reasonably expect trustees to actually do so). Perhaps the author confused the position for s.86, where the trustee annual exemption is disapplied.[30]

The trust is deemed UK resident and so grouped with any other UK trusts for the purpose of ascertaining the annual exemption.[31] But the trust is not grouped with any other non-resident trusts. That might allow scope for fragmentation, but costs (and the GAAR) prevent abuse.

Of course, there is not much tax at stake here, especially after the reductions in the CGT annual exemption in 2023 and 2024.

61.6.6 *UK land/land-rich asset*

UK-land rebasing does not apply in computing s.1(3) amounts (trust gain) because:

(1) it must be assumed that the trust is UK resident;[32] and
(2) rebasing does not apply to UK resident trusts[33]

So the gain on a disposal of UK land/land-rich asset is a s.1(3) amount. However the part of the gain which is actually chargeable to CGT (ie the gain post-rebasing) is not a s.1(3) amount.[34]

61.6.7 *s.86 gain deducted*

In the absence of relief, a gain accruing to a trust may be:

(1) a s.86 gain taxed on the settlor and
(2) a s.1(3) amount (trust gain)

Section 87(4)(b) TCGA provides relief for s.87 and so prevents double

[29] See 44.2.4 (Annual exemption: Trusts).
[30] See 60.11 (Section 86 gains condition).
[31] See 44.2.5 (Grouped trusts).
[32] See 61.6.1 (S.87 residence assumption).
[33] See 57.16 (General rebasing conditions).
[34] See 57.30.2 (UK-land gain outside s.86/87)

taxation. It is necessary to read the whole of s.87(4) in order to follow the sense:

> The section 1(3) amount for a settlement for a tax year for which this section applies to the settlement is—
> (a) the amount upon which the trustees of the settlement would be chargeable to tax under section 1(3) for that year if they were resident in the UK in that year, or
> (b) if section 86 applies to the settlement for that year, the amount mentioned in paragraph (a) minus the total amount of chargeable gains treated under that section as accruing in that year.

In short, s.86 in principle has priority over s.87. This applies even if the settlor does not pay the tax which is due under s.86. That rule seems generous at first sight. But it makes sense, as it is not practical for beneficiaries to check whether or not the settlor is tax compliant.

61.7 Capital payment

61.7.1 *"Capital payment"*

"Capital payment" is defined in s.97(1) TCGA:

> In sections 86A to 96 and Schedule 4C and this section "capital payment" —
> (a) means any payment which is neither—
> (i) chargeable to income tax on the recipient, nor
> (ii) chargeable to income tax on another person under any of sections 643A, 643J and 643L of ITTOIA 2005 and sections 733A, 733C and 733E of ITA 2007,
> or, in the case of a recipient who is not resident in the UK, any payment received otherwise than as income...

Section 731 ITA has similar rules. For the interaction with s.731, see 50.17 (s.731/s.87 interaction).

61.7.2 *"Payment"*

Section 97(2) TCGA provides:

> In subsection (1) above references to a payment include references to
> [a] the transfer of an asset and
> [b] the conferring of any other benefit, and to
> [c] any occasion on which settled property becomes property to

which s.60 applies [nominee property][35].

For the meaning of benefit, see 50.4 (Benefit).

61.7.3 *Termination of settlement*

The termination of a settlement constitutes a capital payment, so any s.1(3) amounts at that time will be attributed to the beneficiaries who become entitled to the trust property: s.97(2)[c] TCGA.

This rule should not, in practice, affect well drafted settlements, whose life may extend for a century or more. If action is taken in time it will generally be possible to extend the life of a settlement by appropriate exercise of trustees' powers. Trustees should if appropriate diarise the date when the settlement may come to an end so as to take action beforehand.

61.7.4 *Benefit chargeable to IT*

A payment is not in general a capital payment if it is chargeable to income tax.

The CG Manual provides:

> **CG38625: Capital payments** [Jul 2019]
> The exclusion for amounts chargeable to Income Tax includes both actual income receipts and amounts deemed to be income for tax purposes. For example:
> [1] [a] Trust income payable to a life tenant
> [b] including distributions of accumulated income.[36]
> [2] Distributions of income treated as income of the settlor when it arises, ITTOIA05/S624(1).

What is the position if a trust makes an income distribution[37] to a remittance basis taxpayer, which is not remitted? This is not a capital payment. The payment is "chargeable" to income tax even if no tax is paid because of the remittance basis.[38] If that were wrong:

(1) There would be double taxation, a s.87 gain and an IT charge, if the

[35] See 87.7 (Bare trust/nomineeship).

[36] I guess para [b] is referring to income of a life tenant retained in a trust and paid to the life tenant after some delay, though a trusts lawyer would call that retaining income, not accumulating income. But it does not matter.

[37] For what is an income distribution, see 41.8 (Trust payment: Income/capital).

[38] See 2.3.1 (Unremitted RFI "chargeable").

payment were remitted.

(2) The payment would be matched with s.1(3) amounts which would reduce tax on subsequent capital payments with odd results and some scope for tax planning.

Similarly a benefit which is within s.731, or within s.731 subject to the s.731 remittance basis, is not a capital payment.[39]

The same applies if a settlor-interested discretionary trust within s.624 makes a distribution out of its income to the settlor: that is not a capital payment. In this case there does seem at first sight to be a problem, as there is no income tax charge on receipt of the payment.[40] However the sum is treated for all purposes of income tax to be the income of the settlor and that deeming should be applied in order to determine whether the payment is chargeable to income tax for the purposes of the definition of capital payment.

The same applies if the settlor is within the s.624 remittance basis.

The same applies if a person abroad makes a distribution out of its income to a transferor within s.720, or a transferor within the s.720 remittance basis: that is not a capital payment. (This issue arises in the exceptional case of a trust within s.720 and not within s.624, and in the more common case of a payment from a company held by a trust.)

61.7.5 *Payment from unremitted income*

Suppose:

(1) A remittance basis taxpayer ("S") receives foreign income ("old income") which is not remitted to the UK and so not taxed.

(2) S transfers the old income to a non-resident trust.

(3) The trustees invest and realise gains ("trust gains") in a subsequent tax year. For simplicity, assume that no income accrues to the trustees, or any income which arises to them is paid out to the settlor.

(4) The trustees make a distribution to the settlor which is received in the UK and which is derived from the old income.[41]

It is considered that the distribution is not a capital payment as it is

[39] See 50.17 (s.731/s.87 interaction).

[40] See 47.10.3 (Relief for settlor).

[41] On the mixed fund rules which apply in this case, see 20.10.3 (Unremitted income given to trust).

chargeable to income tax. Otherwise there would appear to be double taxation on the distribution, an income tax charge and a s.87 charge.

61.7.6 *Payment from unremitted gains*

Suppose:

(1) A remittance basis taxpayer ("S") receives foreign gains ("old gains") which are not remitted to the UK and so not taxed.
(2) S transfers the old gains to a non-resident trust.
(3) The trustees invest and realise gains ("trust gains") in a subsequent tax year.
(4) The trustees make a capital payment to the settlor which is received in the UK and which is derived from the old gains.[42]

At first sight there is a double charge, CGT on the old gains on the remittance basis, and a s.87 charge. That can hardly be right.

The RDR Manual gives an example where the old gains arise on a disposal to a trust (but that makes no difference to the analysis):

> **RDRM31180. Foreign chargeable gains accruing on disposal made otherwise than for full consideration** [Jan 2019]
> Example 2 (Ahmeda)
> A transfers his property in Dubai to a [non-resident[43]] trust receiving no consideration in return.[44] The deemed gain computed using the market value of the property at date of transfer is £400,000.
> The trustees subsequently sell the property for £550,000.
> The trustees then make a capital payment of £300,000 to a UK close company in which A's spouse is a participator.[45]

I refer to the £400k gain accruing to A as A's old gain.

The HMRC analysis is as follows:

> [1] £300,000 of A's foreign chargeable gain [ie of A's old gain] has been

[42] On the mixed fund rules which apply in this case, see 20.10.3 (Unremitted income given to trust).

[43] The example does not specify that the trust is non-resident, but that is, I think, assumed. I do not consider the position if the trust is UK resident, which is not likely in practice.

[44] The analysis is much more complex if the sale is for consideration but the consideration is less than market value. But in practice that will not often happen.

[45] A capital payment to a UK company of which A's spouse is a participator seems somewhat implausible: one would expect a capital payment to A. The example is framed this way in order to illustrate the extent of the definition of relevant person.

> remitted to the UK. This is because
> [a] the property is treated as deriving from his gain (Section 809T ITA 2007)[46] and
> [b] the proceeds from the sale of the property therefore also derive from the [old] gain.

The position is more complicated than that. The analysis depends on the value of the property at the time of the transfer into the trust, which is not specified.

If the property is worth £550k when transferred into the trust, the trustees do not realise a gain when they sell it, and the HMRC analysis is correct.

Suppose however the property is worth £400k when transferred into the trust. The £550k proceeds of sale received by the trustees is a mixed fund, consisting of:

Item	**Amount**	**Mixed fund category: Note**
A's old gain	£400,000	(e): Or category (h) if gain subject to foreign tax
Trustees' gain	£150,000	(i): Or could it be category (e) or (h)?
Total	£550,000	

Applying the mixed fund rules, the capital payment out of the mixed fund is treated as coming first from the trustees gain (at least, if it accrues in a later year, let us assume that is so). So only £150k of the old gain is remitted.

The HMRC analysis continues:

> [2] The company is a relevant person (Section 809M(2)(f) ITA 2007)

This is correct.

> [3] and property (that is, money) which derives from A's gain has therefore been received in the UK by or for the benefit of a relevant person (Section 809L ITA 2007).

The example did not in fact specify that the money was received in the UK, only that it was received by a UK company (which is not the same); but let us take that as implicit in the example.

The HMRC analysis continues:

> [4] The gain which accrues to the trust on the actual sale of the property will be subject to normal rules.

[46] See 18.45.2 (Remittance of deemed gain).

What are the normal rules? The author of the example has given up here. The answer is that the capital payment is matched to the trust gain (if there is one). Eg if the trust gain is £150k, the recipient of the benefit (in the example, the UK company) is subject to a s.87 charge on £150k.

This analysis leads to a fair result:

(1) If there is no trust gain, then £300k of the old gain is remitted

(2) If there is a trust gain of £150k, then £150k of the old gain is remitted and there is a s.87 charge on the £150k matched to the trust gain

Possibly HMRC assume that there is a s.87 charge on the gain *and* a remittance of £300,000 of the old gain, leading to double taxation; if so they but tactfully refrain from saying so. The effective rate of CGT on a capital payment could be:

Tax	**Rate**	**Comment**
CGT on the old gain	20%	Can be 28% (upper rate gains)
CGT on capital payment	32%	Including full interest surcharge
Total tax	52%	

But on the above analysis there is no double charge. The problem could arise on more complex facts, eg if the trustees make a capital payment to a non-resident beneficiary and then make a payment to a UK beneficiary. In such a case, it is suggested that one should construe the legislation to avoid a double charge; the question is how best to reach that conclusion. Possibilities include:

(1) So far as the s.87 charge applies, the capital payment is not to be regarded as derived from the old chargeable gains.

(2) The reference to income tax in the definition of capital payment could be read purposively as extending to CGT so the payment is not a capital payment.[47] Or the old gains exclude the deeming under s.87.

These solutions would be consistent with the position where old income is settled.[48]

Another possibility is to say that the value of the benefit is reduced to reflect the fact that remittance gives rise to a charge on the old gains.

[47] Contrast the ToA rules where a reference to income tax was construed to include corporation tax in order to avoid double taxation; see 51.3.3 (HMRC counterarguments).
I have also considered s.809P(12) ITA and s.32 TMA but these do not easily help.

[48] See 61.7.5 (Payment from unremitted income).

The position is simpler where the payment is made to the settlor, and not to a third party (as in the HMRC example). But even then, none of these solutions are straightforward. Legislation enacted in the slapdash manner of the FA 2008 is bound to leave rough edges, and the courts should seek to find a construction which avoids double taxation and produces a workable result.

61.7.7 *Payment to non-resident*

Section 97(1) TCGA provides:

> ... "capital payment" —
> (a) means any payment ... in the case of a recipient who is not resident in the UK, any payment received otherwise than as income...

As to when a payment is received as income, see 41.8 (Trust payment: Income/ capital). But it does not usually matter if a payment to a non-resident is a capital payment, because of the non-resident disregard.[49]

61.7.8 *Arm's length relief*

Section 97(1) TCGA provides:

> In sections 86A to 96 and Schedule 4C and this section "capital payment"...
> (b) does not include a payment under a transaction entered into at arm's length if it is received on or after 19th March 1991.

I refer to this as **"s.87 arm's length transaction relief"** and use the following terminology:

Term	**Meaning**
Arm's length transaction	Transaction entered into at arm's length
Full consideration transaction	Transaction on market value terms
Connected person transaction	Transaction between connected persons

An arm's length transaction is usually for full consideration, and such a transaction is not a benefit, and so not a capital payment (or it is was, the amount of the capital payment would be nil).[50] In this case s.87 arm's length transaction rule is not needed.

An arm's length transaction might be for less than full consideration,

[49] See 61.21 (Non-resident disregard).

[50] See 50.9.1 ("Benefit" for full consideration).

because the parties made some valuation mistake. In such a case there is no capital payment, either because of s.87 arm's length transaction relief or because of the fair bargain rule, with which the s.87 relief overlaps.[51]

Section 87 arm's length transaction relief does apply when there is an arm's length loan, or lease, even though the consideration for the transaction (ie market interest or rent) may (and often will) be less than the value of the benefit under the statutory valuation rules.[52]

One might have thought that a connected person transaction does not qualify for s.87 arm's length transaction relief because:

(1) it is treated for CGT as not "a *bargain* made at arm's length"[53] and so
(2) it should be treated as not a *"transaction* entered into at arm's length".

One might say that proposition (2) follows from (1) under the principles of construction which apply to deeming provisions.[54] But really there is no meaningful difference between the two propositions: they are two ways of saying the same thing. However HMRC do not agree. The CG Manual provides:

> **CG38625: Capital payments** [Jul 2019]
> The exclusion for arm's length payments covers commercial transactions.
> It also allows the trustees to enter into commercial transactions with connected persons such as the settlor. This is because 'a transaction at arm's length', the term used in TCGA92/S97(1), is not the same as 'a bargain made at arm's length', the term used in TCGA92/S18(2).
> Section 18 treats an acquisition and disposal between connected persons as a bargain not made at arm's length and imposes the market value rule

[51] See 39.35.4 (Fair bargain rule). When s.87 arm's length transaction relief was introduced, in 1991, the overlap would not have been so clear, as the fair bargain cases came later.

[52] See 50.9 (Statutory valuation rules). The CG Manual appears to accept this:

> **CG38625: Capital payments [**Jul 2019]
> The exclusion for payments under arm's length transactions is also relevant to the provision of benefits, see CG38640. Trust property occupied by a beneficiary at a commercial rent or a loan on commercial terms would not be a capital payment.

But this passage was written in 2015, before the enactment of the statutory valuation rules in 2017. Although the text has not changed, it is not likely that HMRC have considered the issues of the 2017 reforms. So the taxpayer should not draw much comfort from these sentences.

[53] See App 4.10.9 (Deemed non-arm's length).

[54] See App 8.2 (Deeming provisions: Construction).

> in TCGA92/S17. So if the trustees buy an asset from the settlor sections 17 and 18 will treat the acquisition as taking place at market value whatever the terms of the contract. But if the trustees pay a commercial price for the asset the payment is not a capital payment for the purposes of section 87. If the trustees pay more than the market value that may be a capital payment.

The HMRC view is long-standing.[55] So it seems that a connected person transaction can qualify for arm's length transaction relief.

The point will not often arise, as transactions between trustees and beneficiaries are not generally entered into at arm's length: the fact that the transaction is on arm's length terms is not by itself enough to make it an arm's length transaction.[56]

61.8 Receipt from trustees

The s.87 charge applies where a beneficiary has received a capital payment from the trustees. There are two requirements here: a *receipt by a beneficiary*, and a receipt *from trustees*.

On the general meaning of "receipt by a beneficiary" see 50.5 (Who receives the benefit?).

Section 97(5) TCGA expands on these concepts:

> For the purposes of sections 86A to 90 and Schedule 4C a capital payment shall be regarded as received by a beneficiary from the trustees of a settlement if—
>
> (a) he receives it from them directly or indirectly, or
> (b) it is directly or indirectly applied by them in payment of any debt of his or is otherwise paid or applied for his benefit, or
> (c) it is received by a third person at the beneficiary's direction.

This does not extend the meaning of capital payment. It assumes that there is a capital payment (as defined) and addresses the questions of who is the recipient and whether the receipt is from the trustees.[57]

The explanation for s.97(5) is to be found in *Potts' Executors v IRC* 32 TC 211. This concerned (what is now) s.641 ITTOIA which (then) applied

[55] See SP 5/92 cited at 92.5.1 (Gratuitous intent: Disregards (a)(b)).

[56] See App 4.10 (Arm's length).

[57] This is clear from the wording, but if authority is needed, see *Burton v HMRC* [2009] SFTD 682 at [43]: "Section 97(5)(b) does not ... require that the benefit be received by the beneficiary but rather extends the circumstances in which a capital payment is treated 'as received' from the trustees."

to:

> Any capital sum paid directly or indirectly ... to the settlor.

In *Potts*, at the request of the settlor, a company connected with a settlement paid tax liabilities of the settlor.[58] The settlor did not actually receive the funds. The House of Lords (in the era of literal, perhaps over-literal, interpretation) held that this was not a payment to the settlor directly or indirectly, so (what is now) s.641 ITTOIA did not apply.
Lord Simonds said:

> It is sufficient to say that [the word 'indirectly'] cannot so enlarge the meaning of the words 'paid to the settlor' as to include payment to some other person than the settlor for his own use and benefit. I do not feel called upon to determine positively what transactions it might be apt to cover. It may be that it is not apt to cover any that are not already covered by the normal meaning of the words 'paid to the settlor'.

Lords Normand and Oaksey said:

> ...it was obviously necessary to provide for the case when persons accountable to the settlor are interposed between the payer and the settlor for the purpose of disguising the transaction. That is a satisfactory explanation of the use of the words "directly or indirectly".
> I think the words "paid directly or indirectly to the settlor" should be held to mean paid into the settlor's hands or into the hands of someone accountable to him.

Lord MacDermott said:

> [The payments] made to Mr. Potts' agents or in some circuitous way designed to put the money under his control eventually. Had they been, the word "indirectly" might have had a part to play, for in that case the issue would be whether, as a matter of fact, payment had been made one way or another to the settlor. In short, as it appears to me, the words "directly or indirectly" bear only on the mechanics of payment in fact.

It seems to me that there are three distinct views here:
(1)The word "indirectly" adds nothing or nothing much (Lord Simonds).
(2) The word "indirectly" applies to payments to X via someone accountable to X (Lords Normand and Oaksey).

[58] The trust also made other payments, such as payments to charities at the request of the settlor.

(3) The word “indirectly” applies to payments “in some circuitous way designed to put the money under his control eventually” (Lord MacDermott).

The second of these views was adopted in *Piratin v IRC* 54 TC 730. Here a payment was made from A to B on terms which obliged B to pay an equivalent sum to C. This was held not to amount to an indirect payment to C, because B was not “accountable” for the sum received. The Judge considered the comments of Lords Simonds, Normand and Oaksey set out above and continued:

> One thus finds both Lord Normand and Lord Oaksey expressing the opinion in the *Potts* case that a sum cannot be said to be “paid indirectly” to the settlor within the section, unless it is paid into the hands of someone accountable to him.

“Accountable” was understood strictly (I would have thought, excessively so):

> It is common ground that the word “accountable” in an English law sense is not apt to describe the position of a person who is under a mere contractual obligation, such as that owed by [B] to the two settlors. [Counsel for the Revenue] suggested that Lord Normand may have intended to use the word according to a broader meaning attributed to it by Scottish lawyers, but I can see no sufficient justification for that inference. I think that Lord Normand referred to strict accountability in English law, and Goff J. took the same view in *IRC v Wachtel* 46 TC 543 at page 555F....

He rejected the view that the word “indirectly” adds nothing but also rejected Lord MacDermott’s wide approach:

> The phrase “or indirectly” in the context of s 451(1) undeniably gives rise to problems of interpretation. If, however, a broader meaning is attributed to it than that attributed to it by Lord Normand and Lord Oaksey, so that it is capable of including payments to persons who are not accountable to the settlor, it is difficult to see where the line should be drawn.

In 1981 parliament reversed these decisions by adding a new subsection to (what was then) s.451 ICTA 1970:

> (9) For the purposes of this section there shall be treated as a capital sum paid to the settlor by the trustees of the settlement any sum which—
>
> (a) is paid by them to a third party at the settlor’s direction or by virtue of the assignment by him of his right to receive it; or

> (b) is otherwise paid or applied by them for the benefit of the settlor...

The 1981 Act also introduced s.87 code including the provision which is now s.97(5) TCGA:[59]

> ... a capital payment shall be regarded as received by a beneficiary from the trustees of a settlement if—
> (a) he receives it from them directly or indirectly, or
> (b) [i] it is directly or indirectly applied by them in payment of any debt of his or
> [ii] is otherwise paid or applied for his benefit, or
> (c) it is received by a third person at the beneficiary's direction.

The wording of (b) and (c) has its equivalents in s.451(9). In practice these paragraphs are not so important. However, the *Potts* and *Piratin* cases set out above are relevant to discussion of the meaning of "directly or indirectly" in paragraph (a), which is important, and to which I can now turn.

61.8.1 *Indirect receipt from trust*

Section 97(5) TCGA provides:

> ... a capital payment shall be regarded as received by a beneficiary from the trustees of a settlement if—
> (a) he receives it from them directly or indirectly...

What is the meaning of "receives *indirectly*"? It is some sort of anti-conduit rule.

Broadly speaking, there are two possible views:

(1) The word "indirectly" applies to payments to X via someone accountable to X (following the approach of Lords Normand and Oaksey in *Potts*). I refer to this as the "**narrow view**".

(2) The word "indirectly" applies to payments "in some circuitous way designed to put the money under his control eventually" (following the approach of Lord MacDermott in *Potts*). I refer to this as the "**wide view**".

There are two difficulties with the wide view. The first is raised in *Piratin*:

> If, however, a broader meaning is attributed to [indirectly] than that

[59] Then s.83(5) FA 1981.

> attributed to it by Lord Normand and Lord Oaksey, so that it is capable of including payments to persons who are not accountable to the settlor, it is difficult to see where the line should be drawn.

The reader may think that vagueness is such a common feature of contemporary anti-avoidance legislation that this objection may not have the weight it carried when *Piratin* was decided, in 1981.

Secondly, if it is possible for one person to receive a payment directly, and another to receive the same payment indirectly, there is the problem of double taxation, as each may be taxed on the payment. The double taxation problem arises (inter alia) if there is held to be an indirect payment to B in two cases:

Case (1):

(a) Trust 1 makes a payment to A; and
(b) A makes a payment to B.

Case (2):

(a) Trust 1 makes a payment to trust 2; and
(b) Trust 2 makes a payment to B.

In case (1) there is in principle double taxation in the form of tax on both A and B.[60] In case (2) there is in principle double taxation on B.[61] In some cases there is no double taxation,[62] but one cannot say that the question whether there is an indirect payment depends on whether there is double taxation.[63]

These considerations support the narrow view. After some vacillation, the courts upheld that view in *Bowring v HMRC*.[64] The facts were those of case (2) above.[65] The judge said:

> 55. In my view the natural meaning and effect of indirect receipt in ss.97(5)(a) is that a beneficiary is still to be taken to have received a payment from a settlement even if it is paid to him through an

[60] Assuming the payments to A and to B can be matched with a s.1(3) amounts (trust gains).

[61] Assuming the payment can be matched with a s.1(3) amounts in trust 1 and trust 2.

[62] Eg in case (1) if A is non-resident; or in case (2) if trust 1 has no trust gains.

[63] If the temporary non-resident rules are in point, ie if in case (1) A is temporarily non resident, it may not be determined for some years whether there is double taxation.

[64] [2015] UKUT 550 (TCC) reversing *Herman v HMRC* [2007] STC (SCD) 571, and adopting criticism of *Herman* set out in the 14th edition of this work.

[65] For case (1) (payment from trust to A, and from A to B) see 50.13.1 (Benefit to B1, used by B1 to benefit B2).

> intermediary. It is conceivable that a separate settlement could, depending on the circumstances, constitute such an intermediary, but the payment would not in those circumstances fall to be treated as "made by" and "received from" that intermediary for the purposes of the legislation....

When is a payment received "through an intermediary"?

> 89. I do not believe that assessment of the facts in a case such as this, in order to determine whether a capital distribution was received from/made by a particular settlement, is susceptible to the application of some more or less formulaic "test", whether by reference to the existence of a plan or otherwise. In my view the issue raised here requires all relevant factors to be considered, and each case will depend on its own facts. Relevant factors will no doubt include whether what is done is pursuant to a plan or understanding or agreement.

So far we are none the wiser. One might have thought that a trust was a clear case of an intermediary, on the basis that trustees merely "fill in the blanks" left by the settlor.[66] But in *Bowring* the payment was *not* through an intermediary:

> I note in particular that the trustee of [trust 1] made an outright, unconditional transfer of its settled property to [trust 2]. There was no agreement between the trustee of [trust 1] and the trustees of [trust 2], and the former admittedly had no say whatsoever in what the latter did with the transferred property, whether by way of distributions to the beneficiaries or otherwise. It is true that
> [1] there was a plan to enable capital payments to be made free of CGT,
> [2] that the plan envisaged virtually all the transferred property being paid to the beneficiaries of [trust 2] (who were also beneficiaries of [trust 1]), and
> [3] that both sets of trustees knowingly played a part in the realisation of the plan.
> However, the existence of the plan did not affect the fact that [trust 1]'s settled property was transferred to [trust 2] and was held on the terms of the latter settlement, and that when [trust 2] decided to make (and made) the capital payments, they did so entirely in the exercise of their own discretion - they alone decided on the amounts and dates of the payments, and they made those decisions after the trust assets had been transferred to them. This independence of decision-making is

[66] See 87.5.7 (Trust appointment: Filling blanks)

> underscored by the fact that *they decided to leave a substantial part of the trust assets undistributed, notwithstanding that the plan had envisaged otherwise*.
> ... the capital distributions in the present case were clearly received from/made by [trust 2], for the purposes of the legislation. ... I do not consider it possible, taking a realistic view of the facts here, to regard [trust 2] as a mere intermediary in the sense that would be necessary if the distributions were to be treated as received from/made by [trust 1] indirectly.[67]

The outcome would have been different if trust 2 had followed the original plan. If that is right, the facts of *Bowring* are quite unusual, for plans are usually followed through; and that might explain why there was no appeal.

The FTT reached the same conclusion on another aspect of this case where the facts were more striking:

(1) A trust made a payment of £400k to a beneficiary ("B"). This was on the non-binding understanding he would pay it on to two of his cousins (who were also beneficiaries).
(2) B gave the sum to his two cousins accordingly.

The reason was that B wished to pay the s.87 charge (if any) so the cousins took free of the s.87 charge. HMRC assessed B who then argued, unmeritoriously, that they should have assessed the cousins.

The question was whether the cousins received the sum from the trust "indirectly".[68]

> [The beneficiary] was not in law bound to pay the money on to his two cousins. Nor did he hold it on trusts which were essentially the same as the 1969 trusts. 'Tracing' does not apply because while the source of the money could be traced, it no longer was imprinted with a trust. Causation was broken.[69]

On the basis of the informal understanding, this is surprising, and I think it would not and should not be followed. It would be easy for another court to ignore it, either as turning on its own facts, or (better) on the grounds that the subsequent appeal restated the test for providing a benefit "indirectly". The reader may wonder whether the result would have been

[67] [2016] STC 816 at [90] (emphasis added).

[68] See 61.8.1 (Indirect receipt from trust).

[69] *Bowring v HMRC* [2014] SFTD 347 at [192]. This point was not considered on the appeal.

the same if HMRC had chosen to assess the cousins rather than B.

The onward-gift rules also need to be considered.[70]

61.9 Capital payment to/from company

61.9.1 *Terminology*

Section 96 TCGA contains two rules:

Rule (my terminology)	**Topic**	**See para**
s.96(1) rule	Capital payment received *from* close co	61.10
s.96(2) rule	Capital payment made *to* close co	61.11

These labels are not transparent, but it is difficult to think of better.

The rules are distinct, but they share some common definitions and concepts which I consider first.

61.9.2 *Control: s.96 sense*

"Control" in s.96 matters:

(1) For the s.96(1) rule, which (in short) applies where a capital payment is received from a company controlled by trustees

(2) For the s.96(2) rule, which deems a capital payment received by a non-resident company to accrue to those who control the company

"Control" is defined in s.96(10) TCGA:

> For the purposes of this section—
>
> (a) [i] the question whether a company is controlled by a person or persons shall be construed in accordance with sections 450 and 451 of CTA 2010,
>
> [ii] but in deciding that question for those purposes no rights or powers of (or attributed to) an associate or associates of a person shall be attributed to him under section 451(4) to (6) of CTA 2010] if he is not a participator in the company;

This is a slightly cut down form of the ultra-wide sense of control.[71]

There is also a slightly cut down form of the standard definition of participator. Section 96(10) TCGA provides:

> (aa) a person is not to be regarded as a participator in a company controlled by the trustees of a settlement where the person has a

[70] See 61.30 (Onward-gifts: Introduction).

[71] See 104.3 (Control: Ultra-wide sense).

> share or interest in the capital or income of the company solely by virtue of an interest which the person has under the settlement; ...
> (b) "participator" has the meaning given by section 454 of CTA 2010[72]

The same definitions are used in the context of s.86; for a discussion see 60.4.2 ("Control" and "participator").

61.9.3 *Capital payment to/from co*

A capital payment *from* a close company matters for the s.96(1) rule, which (in short) applies where a capital payment is received from a company controlled by trustees.[73]

A capital payment *to* a close company matters:

(1) For the s.96(2) rule, which deems a capital payment received by a non-resident company to accrue to those who control the company

(2) If the company is UK resident: the s.96(2) rule will not apply, but the company will in principle receive s.87 gains.

61.10 Payment *from* close co: s.96(1) rule

Section 96(1) TCGA provides:

> Where a capital payment is received from a qualifying company which is controlled by the trustees of a settlement at the time it is received, for the purposes of sections 87 to 90 and Schedule 4C it shall be treated as received from the trustees.

I refer to this as the "**s.96(1) rule**".

See too 88.10 (Capital payment from co in estate).

61.10.1 *"Qualifying company"*

Section 96(6) TCGA provides:

> For the purposes of subsection (1) above a qualifying company is
> [a] a close company[74] or
> [b] a company which would be a close company if it were resident in the UK.

[72] This is the standard definition, see 104.22 (Definitions of participator).

[73] See 30.13 (Distribution to non-shareholder) for a discussion as to whether a payment from a company held by a trust, to a beneficiary, is a capital or income payment.

[74] In practice it would be rare for s.96(1) to apply in relation to a (UK resident) close company, as a payment from a (UK resident) close company is not likely to be a capital payment.

On this terminology see 104.29.1 (Non-resident close company).

61.10.2 *"Controlled by the trustees"*

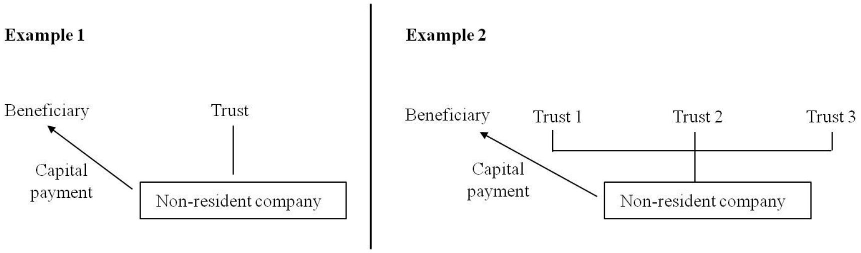
Section 96 TCGA provides:

> (7) For the purposes of subsection (1) above a company is controlled by the trustees of a settlement if it is controlled
> [a] by the trustees alone or
> [b] by the trustees together with a person who (or persons each of whom) falls within subsection (8) below.
>
> (8) A person falls within this subsection if—
> (a) he is a settlor in relation to the settlement, or
> (b) he is connected with a person falling within paragraph (a) above.

61.10.3 *s.96(1) rule: Examples*

The s.96(1) rule is needed because s.87 only applies if a beneficiary receives a capital payment from *the trustees*. A capital payment from a *company* which was not (directly or indirectly) from the trustees would not be caught.

In the following discussion it is important to distinguish between:
(1) Control in the s.96 sense[75]
(2) Control in the natural sense of the word



In example 1, the trustees control the company in the natural sense of control. The beneficiary receives the capital payment from the company directly, but from the trustees indirectly. The s.96(1) rule is not needed in this case, though it does no harm.

In example 2, the company is held in equal shares by three separate trusts. Assume they have the same settlor. No one trust has control in the natural

[75] See 61.9.2 (Control: s.96 sense).

sense of control. In the absence of s.96(1), it might perhaps be argued that a capital payment from the company is tax free, on the grounds that it is not received even indirectly from the trustees of any of the trusts. So the s.96(1) rule might perhaps be needed in a case where trustees "control" a company (in the s.96 sense) but do not control the company in the natural sense of control.

Where a capital payment is received from a company "controlled" (in the s.96 sense) by several persons, there is no apportionment provision (unlike the s.96(2) rule on a capital payment *to* a company). It is suggested that s.96(1) is a deeming provision which deems the payment to be received from the trustees, but the amount of the capital payment is not affected by the deeming. In example 2, the amount of the capital payment from each trust is not the amount received from the company but the amount actually attributable to the trust:

(1) If each trust holds a third of the company, and they act together to procure the payment, each makes a third of the capital payment.

(2) If:
(a) one trust has control (in the natural sense), and
(b) that trust is in a position to procure the capital payment
the capital payment is from that trust alone, and not from any other trust with some other interest in the company.[76]

61.11 Payment *to* close co: s.96(2) rule

Section 96(2) TCGA provides:

> Where
> [1][a] a capital payment is received from the trustees of a settlement
> [b] (or treated as so received by virtue of subsection (1) above)[77] and
> [2] it is received by a non-resident qualifying company,
> the rules in subsections (3) to (6) below shall apply for the purposes of sections 87 to 90 and Schedule 4C.

I refer to this as the "**s.96(2) rule**", and the company is the **"recipient company"**.

61.11.1 *"Non-resident qualifying co"*

Section 96(9) TCGA provides:

[76] Bur in practice, condition (2)(b) is not likely to be satisfied.

[77] See 61.10 (Payment from close co: s.96(1) rule).

For the purposes of subsection (2) above a non-resident qualifying company[78] is a company which is not resident in the UK and would be a close company if it were so resident.

61.11.2 *Consequence of payment to co*

The s.96(2) rule depends on whether the recipient company is controlled:
(1) by one person alone
(2) by 2 or more persons (taking each one separately)
(3) by 2 or more persons (taking them together)

Section 96(3)-(5) are conveniently read side by side:

s.96(3)	**s.96(4)**	**s.96(5)**
Control by: 1 person	**persons separately**	**persons together**
If the company is controlled by one person alone at the time the payment is received, and	If the company is controlled by 2 or more persons (taking each one separately) at the time the payment is received, then—	If the company is controlled by 2 or more persons (taking them together) at the time the payment is received-
that person is then resident in the UK, it shall be treated as a capital payment received by that person.	(a) if one of them is then resident in the UK, it shall be treated as a capital payment received by that person;	
	(b) if 2 or more of them are then resident in the UK ("the residents")	
	[i] it shall be treated as being as many equal capital payments as there are residents and	(a) it shall be treated as being as many capital payments as there are participators in the company at the time it is received, and
	[ii] each of them shall be treated as receiving one of the payments.	(b) each such participator (whatever his residence) shall be treated as receiving one of the payments, quantified on

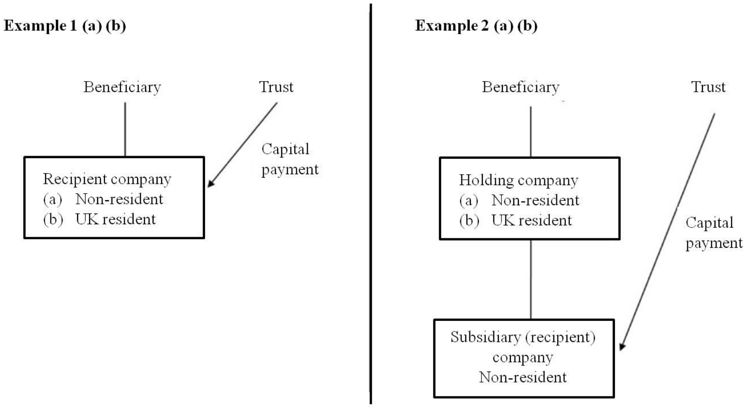
[78] For a note on this terminology, see 104.29.1 (Non-resident close company).

the basis of a just and reasonable apportionment,

but where (by virtue of the preceding provisions of this subsection and apart from this provision) a participator would be treated as receiving less than one-twentieth of the payment actually received by the company, he shall not be treated as receiving anything by virtue of this subsection.

For the meaning of "control" see 61.9.2 (Control: s.96 sense).

61.11.3 *Capital payment to co: Examples*


Example 1 (a) (b)
Beneficiary
Trust
Capital payment
Recipient company
(a) Non-resident
(b) UK resident
Example 2 (a) (b)
Beneficiary
Trust
Holding company
(a) Non-resident
(b) UK resident
Capital payment
Subsidiary (recipient) company
Non-resident

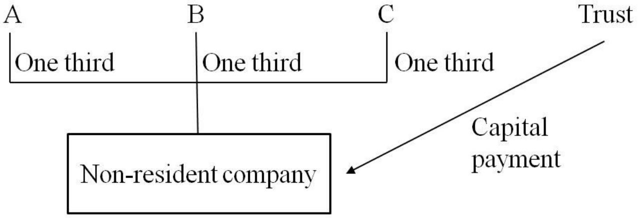
In example 1(a), a non-resident company receives a benefit directly from the trust. The company is a non-resident qualifying company, so under s96(2) the beneficiary (if UK resident) is treated as receiving the capital payment. In the absence of s.96(2) the position would have been less clear, but it is not necessary to consider that.

In example 1(b), a *UK resident* company receives a benefit directly from the trust. The company is not a non-resident qualifying company, so the s.96(2) rule does not apply. It is not needed, because the capital payment to a UK resident company gives rise to a s.87 gain which is subject to corporation tax. It might be said that the beneficiary receives a benefit indirectly, because the value of his company is increased. But that would lead to double taxation, so the better view is that would not count for the purposes of s.87: the benefit is too indirect.

In example 2(a), the non-resident subsidiary of a non-resident holding company receives a capital payment. Under s96(2) the beneficiary (if UK resident) is treated as receiving the capital payment.

In example 2(b), the non-resident subsidiary of a *UK resident* holding company receives a capital payment. One would expect the charge to lie with the UK company, though it needs a somewhat purposive construction to reach that result.

Example 3

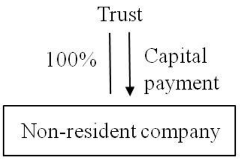

A
B
C
Trust
One third
One third
One third
Capital payment
Non-resident company

In example 3, if A, B and C are not associates, then s.96(5) applies and each is treated as receiving one third of the capital payment.

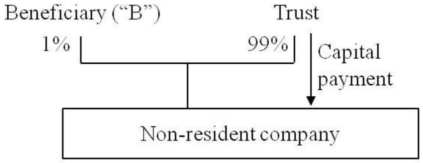
If A, B and C are associates, then each "controls" the company and s.96(4) applies. It is suggested that the outcome is the same. The capital payment which is treated received by each of them is of an amount equal to one third of the capital payment received by the company.

What if A held two thirds of the company and B and C had only one sixth each? It appears that the capital payment is still shared equally.

Example 4 (a)


Trust
100%
Capital payment
Non-resident company

Example 4 (b)


Beneficiary ("B")
Trust
1%
99%
Capital payment
Non-resident company

In example 4(a), the settlor "controls" NR Co in the ultra-wide sense, but does not "control" the company in the s.96 sense. If there were a capital payment from the trust to the company, it would not be treated as accruing to the settlor. But the trust/company group disregard[79] means that a capital payment from the trust to the company is not normally possible.

In example 4(b), the beneficiary ("B") is a participator. If B is the settlor, or a relative of the settlor, B has "control" of the company in the s.96 sense. If there were a capital payment from the trust to the company, it would be treated as accruing to B. It is suggested that the amount of the capital payment is only 1% of the value of the benefit to the company.

Suppose a trust subscribes for shares in a company which is not wholly owned by the trust.

(1) If the share subscription is on arm's length terms, that is not a benefit to anyone.

(2) If the terms are unfavourable to the trust (ie the shares which the trust acquires are worth less than the subscription price), it is suggested that:
   (a) There is still no benefit to the company, so the s.96(2) rule does not apply.
   (b) A benefit accrues to the other shareholders, if the value of their shareholdings is increased, and the amount of the benefit is the amount of that increase.

61.11.4 *Disregard of payment to co: s.87C*

Section 87C TCGA provides:

> (1) For the purposes of sections 87 and 87A as they apply in relation to a settlement, no account is to be taken of a capital payment (or a part of a capital payment) within subsection (2).
> (2) A capital payment is within this subsection if (and to the extent that) it is received (or treated as received) in a tax year from the trustees of the settlement by a company that—
> (a) is not resident in the UK in that year, and
> (b) would be a close company if it were resident in the UK,
> (and is not treated under any of subsections (3) to (5) of section 96 as received by another person).

This is one of a number of capital payment disregards:

TCGA	Scope	See para
s.87C	Cap payment received by non-resident co w/i s.96(1)	*Discussed here*
s.87D	Cap payment received by any non-resident	61.21
-	Trust/company group disregard	61.12

[79] See 61.12 (Trust/company group disregard).

It is useful to have labels for these rules. I refer to the first as the **"s.87C disregard"**. I generally refer to the second as the **"non-resident disregard"**, but where it is necessary to distinguish it from the s.87C disregard, I call it the **"general (s.87D) disregard"**.

The s.87C disregard is (more or less) overtaken by the general (s.87D) disregard; though it is possible to envisage circumstances where s.87C may apply and s.87D does not (eg a capital payment in the final trust year).

Presumably the purpose of the s.87C disregard was to prevent tax avoidance by capital payments to non-resident companies intended to "wash" trust gains. It is not easy to see how that could have been achieved. But it does not much matter.

61.11.5 *Temporary non-resident beneficiary*

Section 96(9A) TCGA provides:

> For the purposes of this section an individual shall be deemed to have been resident in the UK at any time in any year of assessment for which he or she was not so resident if—
>
> (a) section 1M[80] applies to him or her, and
>
> (b) the year falls within the temporary period of non-residence.

Section 96(9B) TCGA deals with assessment time limits:

> If—
>
> (a) it appears after the end of any year of assessment that any individual is to be treated by virtue of subsection (9A) above as having been resident in the UK at any time in that year, and
>
> (b) as a consequence, any adjustments fall to be made to the amounts of tax taken to have been chargeable by virtue of this section on any person,
>
> nothing in any enactment limiting the time for the making of any claim or assessment shall prevent the making of those adjustments (whether by means of an assessment, an amendment of an assessment, a repayment of tax or otherwise).

61.11.6 *EU-law compliance*

The section 96(2) rule does not apply to a capital payment made to a UK resident company. That makes sense as the UK company would receive a s.87 gain on which it would be taxable. Perhaps the discrimination might not have been EU-law compliant? But if that were right, then perhaps the

[80] See 11.6 (TNR gain/loss).

entire s.87 code was not EU-law compliant, which seems far-fetched. Post-Brexit, the point may not arise.

61.12 Trust/company group disregard

SP 5/92 para 18 provides:

> In general, transactions between trustees and companies which they, directly or indirectly, wholly own, or between such companies, are … not treated as capital payments within TCGA 1992 s 97.[81]

The paragraph sets out a commonsense definition of "wholly owned"[82], and includes a qualification in case of avoidance.[83]

I coin the following terminology. A trust and its wholly owned companies is a **"trust/company group structure"**. The rule set out above is the **"trust/company group disregard"**.

61.12.1 *Trust benefits wholly owned co*

Thus (say) an interest-free loan from trustees to a wholly owned company is not a capital payment. This fits the scheme of the Act, and no-one has ever suggested otherwise. But why not? This view can be justified on the basis that:

(1) An interest-free loan to a company wholly owned by the lender is a commercial transaction with no gratuitous intent.
(2) Whether such a transaction constitutes a "benefit" depends on the context, and the context shows that is not the case here.

In the normal case, no-one other than the trustees would "control" the wholly owned company, in the s.96 sense, so for the purposes of s.96(2) it would not matter if the loan were a capital payment. But it would matter if the company had a participator in the form of a loan creditor.

61.12.2 *Wholly owned co benefits trust*

What about an interest-free loan *from* a wholly owned company *to* the trust

[81] For settlor/tainting aspect of transactions within a trust/company group structure, see 99.24.1 (Transfer within trust/co group).

[82] "A company is treated as indirectly wholly owned by the trustees where the whole of its issued share capital is directly and beneficially owned by a company which is directly wholly owned by the trustees or it is the 100% subsidiary of such a company, or a chain of companies, which is indirectly wholly owned by the trustees."

[83] "This approach may not, however, be taken where, on the facts of a particular case, it appears that the transaction has been entered into solely or mainly for the purposes of obtaining a UK tax advantage."

which owns it? That would also come within the trust/company group disregard, ie HMRC say it is not treated as a capital payment. Once again, this fits the scheme of the Act, and no-one has ever suggested otherwise. But why not? It seems hard to say that the loan is not a benefit and so a capital payment. The reason must be that the trust cannot be deemed to make a capital payment to itself.

SP 5/92 provides two examples of inter-group transactions:

> Intragroup payments which are not capital payments, for example
> [1] a capital distribution on winding up which represents merely a repayment of capital on shares, or
> [2] a distribution chargeable to corporation tax,
> do not fall within the ambit of TCGA 1992 s 96.

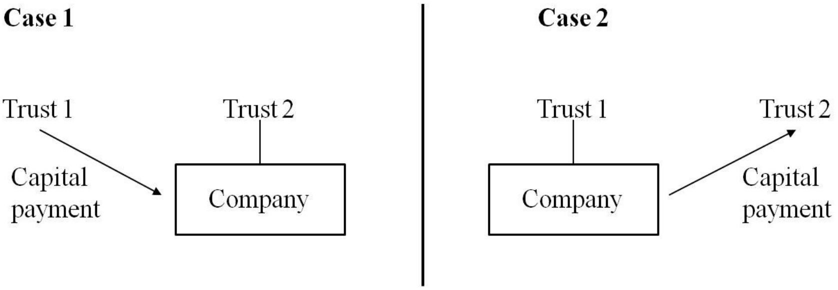
I think example [1] is misconceived, because a distribution on winding up is not a capital payment (it is not a benefit) and whether it represents merely a repayment of capital on shares is irrelevant. But if it were a benefit, it would fall within the trust/company group disregard.

Turning to example [2]: a capital payment is defined as a benefit which is not chargeable to *income* tax (or in the case of a non-resident, not received as income). The SP is considering a distribution chargeable to corporation tax. I am not sure how that could happen, in a case where the distribution is received by a non-resident company. However, a distribution is probably not a benefit, and if it were a benefit, it would fall within the trust/company group disregard.

61.13 Payment to/from co across trusts

The position is more complicated if two trusts are involved.

I here consider the s.96 issues: for a list of other issues on transfers to/from companies across trusts, see 79.14 (Transfers to/from underlying co).



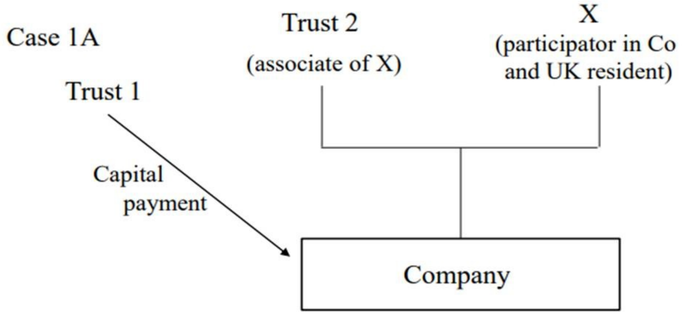
In both cases, the capital payment is not an inter-group transaction, and so the inter-group disregard does not apply.

In case 1, trust 1 makes a capital payment to a company held by trust 2, a separate non-resident trust. There is a capital payment from trust 1 to the company but:

(1) This capital payment is not treated as received by the settlor of trust 2, under the s.96(2) rule, because the settlor does not have "control" of the company.
(2) This capital payment is not treated as received by the trustees of trust 2, under s.96(3), as they are non-resident.
(3) This capital payment is not treated as received by any other person, under s.96(3)-(5), so it has to be disregarded under the s.87C disregard.[84]

Alternatively, it might be said that the trustees of trust 1 make a (separate) capital payment to trust 2, as they increase the value of the assets of trust 2, which is a benefit. But that would normally be disregarded under the general (s.87D) disregard.

The position would be different if there were a UK resident individual who was (1) a participator and (2) an associate of the trustees:



In this case the capital payment is treated as received by X! The rule would apply, for instance, if:

(1) X is a loan creditor, or a shareholder, (and so a participator); and
(2) X is either the settlor or a relative of the settlor (and so has "control" in the s.96 sense, because the trustees are associates of X).

[84] For completeness: The payment might also be disregarded under the general (s.87D) disregard. But that adds nothing to s.87C, so it does not matter.

This is so even if X's loan or shareholding is only a small one. The rule might be described as penal.

Turning to case 2: In this case a company held by trust 1 makes a capital payment to trust 2, a separate non-resident trust

There is a capital payment to trust 2 from the company, which is treated as received from trust 1, under the s.96(1) rule. Alternatively, it might be said that the trustees of trust 1 make a separate capital payment to trust 2, by procuring the company to make the payment.

The s.96(2) rule does not apply, and the s.87C disregard does not apply, because these only apply to a receipt *by* a company. But the capital payment is normally disregarded under the general (s.87D) disregard.

In short, the end result is that neither of the s.96 rules have a role to play in payments to/from companies across trusts (unless the company has a UK resident participator).

61.14 Payment to non-beneficiary

Section 87 gains are treated as accruing to *a beneficiary of the settlement* who has received a capital payment from the trustees.[85]

At first sight the charge only applies to beneficiaries, so if a capital payment is received by a non-beneficiary there is no charge. However, s.97(8) TCGA provides:

> In a case where—
> (a) at any time on or after 19th March 1991
> [i] a capital payment is received from the trustees of a settlement
> [ii] or is treated as so received by virtue of section 96(1),[86]
> (b) [i] it is received by a person,
> [ii] or treated as received by a person by virtue of section 96(2) to (5),[87]
> (c) at the time it is received or treated as received, the person is not (apart from this subsection) a beneficiary of the settlement, and
> (d) subsection (9) or (10) below does not prevent this subsection applying,
>
> for the purposes of sections 86A to 90 and Schedule 4C the person shall be treated as a beneficiary of the settlement as regards events occurring

[85] Section 87(2) TCGA.

[86] See 61.10 (Payment from close co: s.96(1) rule).

[87] See 61.10 (Payment to close co: s.96(2) rule).

at or after that time.

The drafting is clumsy. The s.87 charge applies to a "beneficiary" who receives a capital payment, but any person who receives a capital payment is treated as a beneficiary. It would have been simpler to say that the charge applies to a "person" who receives a capital payment, and drop the (notional) requirement that recipient has to be a beneficiary! But it comes to the same thing.

The reader may wonder how a capital payment could be received by a non-beneficiary. In general, trustees may only confer benefits on beneficiaries. However, there are cases where it could happen:

(1) An exercise of a power to apply capital for the benefit of B (a beneficiary) may take the form of a payment to a third person, X (not a beneficiary). This is not a capital payment received by B[88] but it is a capital payment received by X.

(2) Beneficiaries may authorise trustees to make a payment to a non-beneficiary.[89]

On the other hand if B (a beneficiary) *directs* trustees to make a payment to a third person, X, the benefit is treated as received by B (not X).[90]

If a payment is made in breach of trust, to a non-beneficiary (or indeed to a beneficiary) there is no capital payment (or the value of the benefit is nil).[91]

It is possible that a person may be a beneficiary at the time of a capital payment but not when the s.87 gain accrues (if the trust gain is matched in a later year and the person has then ceased to be a beneficiary). Section 97(8) TCGA does not apply in such a case, because the condition in s.97(8)(c) is not met. It is considered that s.87(2) can and should be construed so as to apply in this case; otherwise there would be a strange anomaly in the legislation. That is, when it states that s.87 gains accrue to "a beneficiary of the settlement who has received a capital payment" it is sufficient that the recipient is a beneficiary at the time they receive the

[88] See 50.4.8 (Moral/sentimental/hard to value benefit).

[89] Another case: suppose trustees make a capital payment to a non-resident close company which is treated as received by the persons who control it; see 61.11 (Payment to close co: s.96(2) rule). Perhaps those persons might not be beneficiaries. But it would be a rare case where trustees could properly make a payment to a company controlled by non-beneficiaries.

[90] See 61.8 (Receipt from trustees).

[91] See 50.4.11 ("Benefit" in breach of trust).

capital payment, it is not required that the recipient is also a beneficiary at the time that the s.87 gain accrues.

61.14.1 *Receipt by non-resident co*

Section 97(8)(d) signposts two exceptions to the rule in s.97(8). One concerns transfers between trusts and is discussed elsewhere.[92]

The other is s.97(9) TCGA which provides:

> Subsection (8) above shall not apply where a payment mentioned in para (a) is made in circumstances where it is treated (otherwise than by subsection (8) above) as received by a beneficiary.

This would apply where:

(1) Trustees make a capital payment to a non-resident company, which is not a beneficiary and

(2) The trustees are treated as making the payment to beneficiaries who control the company.[93]

The point of ss.(9) is that the company is not to be treated as a beneficiary.[94] But would it matter if it were? Perhaps it might have mattered before the enactment of the s.87C disregard, in 2008.

61.15 Matching

61.15.1 *Why matching matters*

The matching of capital payments with s.1(3) amounts is important for many reasons:

(1) *Time of charge:* The s.87 gains accrue in the year that a capital payment is matched with a s.1(3) amount.

[92] See 61.39.1 (Trust transfer: s.87 disapplied).

[93] See 61.11 (Payment to close co: s.96(2) rule).

[94] For completeness. Could ss(8) also apply in a case where a capital payment is received by two persons, one a beneficiary and the other a non-beneficiary? Suppose an arrangement where X receives property directly and Y later receives it indirectly. (The onward gift rules would also need consideration here.)

(1) Assume one of X or Y is a beneficiary but not both. Perhaps in this case the non-beneficiary is not charged, because the capital payment is "treated as received by a beneficiary". However, this is a case where the payment is *actually* received by the beneficiary (directly or indirectly), not a case where it is *treated* as received.

(2) Assume neither X nor Y are a beneficiary. In that case, X is treated as a beneficiary, but not Y. But this scenario is very far fetched.

(2) *Amount of charge:* The amount of the s.87 gain is the amount of the capital payment or the amount matched, if less.

(3) *Which beneficiaries come into charge:* if
   (a) more than one beneficiary receives capital payments, and
   (b) there are not enough s.1(3) amounts to match all the capital payments

   the question which capital payment is matched with a s.1(3) amount makes all the difference as to which beneficiary receives s.87 gains.

(4) *Which capital payments come into charge:* if
   (a) one beneficiary receives more than one capital payment, some in and some outside the UK; and
   (b) there are not enough s.1(3) amounts to match all the capital payments

   the question which capital payment is matched with a s.1(3) amount matters for the remittance basis. If a UK benefit is matched, there is a charge; if a non-UK benefit is matched, the s.87 remittance basis offers a defence to the charge.

(5) *The interest surcharge,* which depends on the time gap between a s.1(3) amount and the capital payment with which it is matched.

(6) *2008 transitional relief*, which applies where post-2008 capital payments are matched with pre-2008 s.1(3) amounts.

Matching is carried out on a LIFO (last in first out) basis. EN FB 2008 provides a summary:

> 452. Where the s.2(2) amount is equal to or greater than the capital payments then all the capital payments are matched:
> [1] any surplus s.2(2) amount is carried back to the year preceding the current tax year and any unmatched capital payments of that earlier year are matched to the surplus s.2(2) amount;
> [2] any surplus s.2(2) amount is carried back to the preceding year and matched with unmatched capital payments of that year, and so on, until the s.2(2) amount has been reduced to nil or there are no unmatched capital payments left in any earlier year; and
> [3] any surplus s.2(2) amount left after matching to previous years is available to match against future capital payments.
>
> 453. Where the amount of capital payments for the latest relevant tax year is greater than the s.2(2) amount for that year, then the surplus capital payments are carried back in the same way as surplus s.2(2) amounts, matching the surplus capital payments against the unmatched trust gains of each earlier year, starting with the latest year first and only

> moving back to an earlier year where there are no unmatched trust gains left in the later year. Any capital payments that remain unmatched are carried forward from the current tax year to be matched against the s.2(2) amounts of future years. ...
> 455. Note that:
> [1] the matching rules are modified by new subs.(4) of s.762 ICTA in relation to offshore income gains; and
> [2] capital payments are matched to trust gains within a given tax year on a pro rata basis, not on a daily basis.

The s.87 guidance note provides:

> 14. A key element of the FA 2008 changes is the introduction of rules for matching capital payments to section 2(2) amounts from 6 April 2008. The basic rules are set out in section 87A TCGA in a series of steps. Capital payments are matched against section 2(2) amounts in the following order:
> 15. First against section 2(2) amounts of the same year.
> 16. Second against unmatched section 2(2) amounts of earlier years taking the most recent year first.
> 17. Third against section 2(2) amounts of later years. In this case priority is given first to any capital payments received in that year and then to any capital payments brought forward. If capital payments are brought forward from more than one year the capital payment received in the latest year is matched first.

The rules changed from a FIFO to a LIFO basis in 2008. HMRC did not state why they made this change. I surmise that it was done to minimise the benefit of 2008 transitional relief, which applies if post-2008 capital payments are matched with pre-2008 s.1(3) amounts. The old rule would have maximised the benefit of the relief, so that trusts with substantial s.1(3) amounts may have been free of CGT for a substantial period of time. Had the reason been given, there might have been some debate about whether the benefit justified the change, but as it was, there was none. But there it is.

A note on terminology: the statutory language is to match s.1(3) amounts (trust gains) *with* capital payments; HMRC guidance tends to say: match *to* or *against* capital payments. It is better to use the statutory terminology rather than a paraphrase; though nothing actually turns on the preposition.

61.15.2 *The statute*

Section 87A TCGA provides:

> (1) This section supplements s.87.
>
> (2) The following steps are to be taken for the purposes of matching capital payments with s.1(3) amounts.
>
> *Step 1*
>
> Find the s.1(3) amount for the relevant tax year.
>
> *Step 2*
>
> Find the total amount of capital payments received by the beneficiaries from the trustees in the relevant tax year.

Armed with these figures we proceed to the matching rule:

> *Step 3*
>
> The s.1(3) amount for the relevant tax year is matched with—
>
> (a) if the total amount of capital payments received in the relevant tax year does not exceed the s.1(3) amount for the relevant tax year, each capital payment so received, and
>
> (b) otherwise, the relevant proportion of each of those capital payments.
>
> "The relevant proportion" is the s.1(3) amount for the relevant tax year divided by the total amount of capital payments received in the relevant tax year.

I refer to a case within (a) as a "**surplus s.1(3) amount**" and a case within (b) as a "**surplus capital payment**".

The next step is a recomputation of the s.1(3) amount and of the amount of capital payments

> *Step 4*
>
> [1] If para (a) of Step 3 applies—

That is, if there is a surplus s.1(3) amount—

> (a) reduce the s.1(3) amount for the relevant tax year by the total amount of capital payments referred to there, and
>
> (b) reduce the amount of those capital payments to nil.

I refer to the s.1(3) amount after this reduction as the "**unmatched s.1(3) amount**".

> [2] If para (b) of that Step applies—

That is the case of a surplus capital payment—

> (a) reduce the s.1(3) amount for the relevant tax year to nil,
> and

(b) reduce the amount of each of the capital payments referred to there by the relevant proportion of that capital payment.

I refer to the amount of the capital payments after this deduction as the "**unmatched capital payments**".

Then one starts again at the beginning, but with modifications:

Step 5
[1] Start again at Step 1 (unless subs.(3) applies).
[2] If the s.1(3) amount for the relevant tax year (as reduced under Step 4) is not nil, read references to capital payments received in the relevant tax year as references to capital payments received in the latest tax year which—
(a) is before the last tax year for which Steps 1 to 4 have been undertaken, and
(b) is a tax year in which capital payments (the amounts of which have not been reduced to nil) were received by beneficiaries.

I again refer to a case within step 5[2] (where there is an unmatched s.1(3) amount) as a "**surplus s.1(3) amount**".

Amended as step 5[2] directs, Steps 1-4 become:

Step 1
Find the s.1(3) amount for the relevant tax year [ie the unmatched s.1(3) amount].
Step 2
Find the total amount of capital payments received by the beneficiaries from the trustees ~~in the relevant tax year~~ *in the latest tax year which—*
(a) is before the last tax year for which Steps 1 to 4 have been undertaken, and
(b) is a tax year in which capital payments (the amounts of which have not been reduced to nil) were received by beneficiaries.
Step 3
The s.1(3) amount for the relevant tax year is matched with—
(a) if the total amount of capital payments received ~~in the relevant tax year~~ *in the latest tax year which—*
(a) is before the last tax year for which Steps 1 to 4 have been undertaken, and
(b) is a tax year in which capital payments (the amounts of which have not been reduced to nil) were received by beneficiaries.
does not exceed the [unmatched] s.1(3) amount for the relevant tax year, each capital payment so received, and
(b) otherwise, the relevant proportion of each of those capital payments.
"The relevant proportion" is the [remaining] s.1(3) amount for the relevant tax year divided by the total amount of capital payments received ~~in the relevant tax year~~ *in the latest tax year which—*
(a) is before the last tax year for which Steps 1 to 4 have been

> *undertaken, and*
>
> *(b) is a tax year in which capital payments (the amounts of which have not been reduced to nil) were received by beneficiaries.*
>
> *Step 4*
>
> If para (a) of Step 3 applies—
>
> (a) reduce the [unmatched] s.1(3) amount for the relevant tax year by the total amount of capital payments referred to there, and
>
> (b) reduce the amount of those capital payments to nil.
>
> If para (b) of that Step applies—
>
> (a) reduce the [unmatched] s.1(3) amount for the relevant tax year to nil, and
>
> (b) reduce the [unmatched] amount of each of the capital payments referred to there by the relevant proportion of that capital payment.

Eventually the unmatched s.1(3) amount is reduced to nil (ie all the s.1(3) amount is matched). Then step 5[2] ceases to apply. Our journey then takes us to step 5[3]:

> *Step 5*
>
> [3] If the s.1(3) amount for the relevant tax year (as so reduced) is nil, read references to the s.1(3) amount for the relevant tax year as the s.1(3) amount for the latest tax year—
>
> (a) which is before the last tax year for which Steps 1 to 4 have been undertaken, and
>
> (b) for which the s.1(3) amount is not nil.

I refer to a case within step 5[3] as a "**surplus capital payment**". This is a case where:

(1) there is no unmatched s.1(3) amount for the relevant year;

(2) there is a s.1(3) amount for an earlier year.

Amended as step 5[3] directs, steps 1-4 become:

> *Step 1*
>
> Find the s.1(3) amount ~~for the relevant tax year~~ *for the latest tax year* —
>
> *(a) which is before the last tax year for which Steps 1 to 4 have been undertaken, and*
>
> *(b) for which the s.1(3) amount is not nil.*
>
> *Step 2*
>
> Find the total amount of capital payments received by the beneficiaries from the trustees in the relevant tax year.
>
> *Step 3*
>
> The s.1(3) amount ~~for the relevant tax year~~ *for the latest tax year*—
>
> *(a) which is before the last tax year for which Steps 1 to 4 have been undertaken, and*
>
> *(b) for which the s.1(3) amount is not nil*
>
> is matched with—
>
> (a) if the total amount of capital payments received in the relevant tax year does

> not exceed the s.1(3) amount ~~for the relevant tax year~~, *for the latest tax year—*
>
> *(a) which is before the last tax year for which Steps 1 to 4 have been undertaken, and*
>
> *(b) for which the s.1(3) amount is not nil.*
>
> each capital payment so received, and
>
> (b) otherwise, the relevant proportion of each of those capital payments.
>
> "The relevant proportion" is the s.1(3) amount ~~for the relevant tax year~~ *for the latest tax year—*
>
> *(a) which is before the last tax year for which Steps 1 to 4 have been undertaken, and*
>
> *(b) for which the s.1(3) amount is not nil.*
>
> divided by the total amount of capital payments received in the relevant tax year.
>
> *Step 4*
>
> If para (a) of Step 3 applies—
>
> (a) reduce the s.1(3) amount ~~for the relevant tax year~~ *for the latest tax year—*
>
> *(a) which is before the last tax year for which Steps 1 to 4 have been undertaken, and*
>
> *(b) for which the s.1(3) amount is not nil.*
>
> by the total amount of capital payments referred to there, and
>
> (b) reduce the amount of those capital payments to nil.
>
> If para (b) of that Step applies—
>
> (a) reduce the s.1(3) amount ~~for the relevant tax year~~ *for the latest tax year—*
>
> *(a) which is before the last tax year for which Steps 1 to 4 have been undertaken, and*
>
> *(b) for which the s.1(3) amount is not nil.*
>
> to nil, and
>
> (b) reduce the amount of each of the capital payments referred to there by the relevant proportion of that capital payment.

61.15.3 *When to stop*

Section 87A(3) TCGA (incorporated at step 5[1]) states when one can stop repeating these steps:

> This subsection applies if—
>
> (a) all of the capital payments received by beneficiaries from the trustees in the relevant tax year or any earlier tax year have been reduced to nil, or
>
> (b) the s.1(3) amounts for the relevant tax year and all earlier tax years have been reduced to nil.

That is, one stops when there are no unmatched capital payments or s.1(3) amounts.

Section 87A(4) TCGA provides:

> The effect of any reduction under Step 4 of subsection (2) is to be taken into account in any subsequent application of this section.

That seems self-evident.

61.15.4 *Example: Surplus trust gains*

EN FB 2008 provides some examples. *Text in italics represents HMRC comments*:

> ***56. Section 87A: Example 1: section 2(2) amount is greater than the total amount of capital payments for latest tax year:***
> The facts assumed in the example are as follows:
> *2008-09: no surplus trust gains or surplus capital payments*

Year	***Capital payment***	***s.2(2) amount***
2009-10:	*£100k*	*nil*
2010-11:	*£200k*	*nil*
2011-12:	*£500k*	*nil*
2012-13:	*£500k*	*£2m*

I set out the text of the relevant steps in the analysis.

> *Step 1*
> Find the s.2(2) amount for the relevant tax year.
> *Step 2*
> Find the total amount of capital payments received by the beneficiaries from the trustees in the relevant tax year.

The relevant tax year is 2012/13 and we can take the figures from the table.

We move on to step 3. There is (in my terminology) a surplus s.1(3) amount, because "the total amount of capital payments received in the relevant tax year" (£500k) does not exceed "the s.1(3) amount for the relevant year" (£2m). Accordingly:

> *Step 3*
> The s.1(3) amount for the relevant tax year is matched with—
> (a) ... each capital payment so received,

Thus step 3 states that £2m (the s.1(3) amount for 2012/13) is matched with the £500k capital payment. There are two difficulties with this. First, the charge in s.87(2) requires us to ask whether the *capital payment* is matched with the s.1(3) amount, and step 3 tells us that the *s.1(3) amount* is matched with the capital payment. The answer is that matching is by implication a symmetrical relationship, ie if A is matched with B, then B is matched with A.

Secondly, applying step 3 literally, the capital payment (£500k) is matched with the *entire* s.1(3) amount (£2m). This does not matter because s.87(3) TCGA restricts the charge to the amount of the capital payment. In order to follow s.87(3) one needs to read it together with s.87(2):

> (2) Chargeable gains are treated as accruing in the relevant tax year to a beneficiary of the settlement who has received a capital payment from the trustees in the relevant tax year or any earlier tax year if all or part of the capital payment is matched (under s.87A as it applies for the relevant tax year) with the s.1(3) amount for the relevant tax year or any earlier tax year.
> (3) The amount of chargeable gains treated as accruing is equal to—
> (a) the amount of the capital payment, or
> (b) if only part of the capital payment is matched, the amount of that part.

But the HMRC analysis is as follows:

> *Match as follows:*
> *a. 2012-13 capital payments £500,000 match to £500,000 gains.*

The HMRC analysis (wisely) does not try to refer to the statutory steps which authorise this conclusion. (Indeed, there is no reason to think that the author of the HMRC example read the legislation.) But the end result is the same.

We move on to step 4. Ours is a surplus capital payment case, so step 4 provides:

> *Step 4*
> If para (a) of Step 3 applies—
> (a) reduce the s.1(3) amount for the relevant tax year by the total amount of capital payments referred to there, and
> (b) reduce the amount of those capital payments to nil.

So our revised table becomes:

Year	***Capital payment***	***s.1(3) amount***
2009-10:	*£100k*	*nil*
2010-11:	*£200k*	*nil*
2011-12:	*£500k*	*nil*
2012-13:	*£0 ~~£500k~~*	*£1.5 ~~£2m~~*

The HMRC analysis is as follows:

> *[1] 2012-13 capital payments reduced to nil.*
> *[2] Unmatched 2012-13 trust gains reduced to £1.5 million.*

> *[3] Refer unmatched trust gains to preceding year.*

Point [1] is correct. Points [2] and [3] are a fair paraphrase.

Our journey takes us to step 5:

> *Step 5*
> [1] Start again at Step 1 (unless subsection (3) applies).
> [2] If the s.1(3) amount for the relevant tax year (as reduced under Step 4) is not nil, read references to capital payments received in the relevant tax year as references to capital payments received in the latest tax year which—
> (a) is before the last tax year for which Steps 1 to 4 have been undertaken, and
> (b) is a tax year in which capital payments (the amounts of which have not been reduced to nil) were received by beneficiaries.

There is still a surplus s.1(3) amount (the s.1(3) amount for the relevant tax year is not nil, it is now £1.5m).

We revert to step 2 which now reads:

> *Step 2*
> Find the total amount of capital payments received by the beneficiaries from the trustees ~~in the relevant tax year~~ *in the latest tax year which—*
> *(a) is before the last tax year for which Steps 1 to 4 have been undertaken, and*
> *(b) is a tax year in which capital payments (the amounts of which have not been reduced to nil) were received by beneficiaries*

The "latest tax year" is now 2011-12 and we can take the figures from the revised table.

We move on to step 3. This is a surplus s.1(3) amount case, because "the total amount of capital payments received in the latest tax year" (£500k) does not exceed "the s.1(3) amount for the relevant year" (£1.5m). Accordingly:

> *Step 3*
> The s.1(3) amount for the relevant tax year is matched with—
> (a) ... each capital payment so received,

Thus step 3 states that £1.5m (the unmatched s.1(3) amount) is matched with the £500k capital payment. But the HMRC analysis is as follows:

> *b. 2011-12 unmatched capital payments £500,000 match to £500,000 gains.*

As noted, this is a loose paraphrase of step 3, but it does not matter.

We move on to step 4. Ours is a step 3(a) case, so step 4 provides:

> *Step 4*
> If para (a) of Step 3 applies—
> (a) reduce the s.1(3) amount for the relevant tax year by the total amount of capital payments referred to there, and
> (b) reduce the amount of those capital payments to nil.

So:
(a): reduce the s.1(3) amount for the relevant year thus: £1.5m −£500k = £1m.
(b): reduce the capital payment for the latest year [2011-12] to nil.
The HMRC analysis is as follows:

> *2011-12 capital payments reduced to nil.*
> *Unmatched 2012-13 trust gains reduced to £1 million.*
> *Refer unmatched trust gains to preceding year.*

The process repeats once again, but "the latest tax year" now becomes 2009-10. It is not necessary to set out the steps. The reader will by now have the idea. The HMRC analysis (or paraphrase) is as follows:

> *2010-11 unmatched capital payments £200,000 match to £200,000 gains.*
> *2010-11 capital payments reduced to nil.*
> *Unmatched 2012-13 trust gains reduced to £800,000.*
> *Refer unmatched trust gains to preceding year.*

The process repeats once again, but "the latest tax year" now becomes 2009-10. It is not necessary to set out the steps. The HMRC analysis (or paraphrase) is as follows:

> *d. 2009-10 unmatched capital payments £100,000 match to £100,000 gains.*
> *2010-11 capital payments reduced to nil.*
> *Unmatched 2012-13 trust gains reduced to £700,000.*
> *Refer unmatched trust gains to preceding year.*

At this point s.87A(3) TCGA applies because "all of the capital payments received by beneficiaries from the trustees in the relevant tax year or any earlier tax year have been reduced to nil". Accordingly the steps come to an end. The HMRC analysis is:

> *e. No unmatched capital payments in 2008-09 or earlier years.*

Lastly, the HMRC analysis provides:

> *Carry forward unmatched trust gains of 2012-13 of £700,000 to be matched against capital payments of 2013-14 and subsequent years.*

This is a reference to step 1 as amended by step 5[3] but the point does not actually arise under the facts of the HMRC example.

It is noteworthy that in order to deal with the HMRC example (which is a simplication of a typical real life case, for there is only one s.1(3) amount) one has to carry out 15 steps.

The s.87 guidance note provides:

> **Example 3: New section 87A - Section 2(2) amounts greater than capital payments in latest year**
>
> At the start of 2008-09 there are no unmatched capital payments or section 2(2) amounts.
>
> | Year | Capital payments | S.2(2) amount |
> |---|---|---|
> | 2008-09 | £10,000 | Nil |
> | 2009-10 | £15,000 | Nil |
> | 2010-11 | £2,000 | £24,000 |
>
> When the years 2008-09 and 2009-10 are considered immediately after the end of those years no chargeable gains accrue.
>
> In 2010-11 the capital payment of £2,000 is matched against the section 2(2) amount. A chargeable gain of £2,000 accrues in the year 2010-11. The capital payments for 2010-11 are reduced to nil. The section 2(2) amount is reduced to £22,000 (£24,000 – £2,000).
>
> The £22,000 section 2(2) amount for 2010-11 is matched against the capital payments of £15,000 in 2009-10. A chargeable gain of £15,000 accrues in the year 2010-11.
>
> The section 2(2) amount for 2010-11 is reduced to £7,000 (£24,000 – £2,000 – £15,000)
>
> The capital payments for 2009-10 are reduced to nil.
>
> The £7,000 section 2(2) amount for 2010-11 is matched against the capital payments of £10,000 for 2008-09. A chargeable gain of £7,000 accrues in the year 2010-11.
>
> The section 2(2) amount for 2010-11 is reduced to nil (£24,000 – £2,000 – £15,000 – £7,000). The capital payments for 2008-09 are reduced to £3,000 (£10,000 – £7,000). These capital payments will be set against future section 2(2) amounts.
>
> The chargeable gains for 2010-11 total £24,000 (£2,000 + £15,000 + £7,000).

61.15.5 *Example: Surplus capital payment*

HMRC's second example is as follows

> ***57. Section 87A: Example 2: capital payments are greater than section 2(2) amount for latest tax year: The facts assumed in the example are as follows:***
>
> *2008-09: no surplus trust gains or surplus capital payments*

Year	***Capital payment***	***s.2(2) amount***
2009-10:	*nil*	*£100k*
2010-11:	*nil*	*£200k*
2011-12:	*nil*	*£500k*
2012-13:	*£2m*	*£500k*

I set out the text of the relevant steps in the analysis.

> *Step 1*
> Find the s.2(2) amount for the relevant tax year.
> *Step 2*
> Find the total amount of capital payments received by the beneficiaries from the trustees in the relevant tax year.

The relevant tax year is 2012/13 and we can take the figures from the table.

We move on to step 3. There is (in my terminology) a surplus capital payment because "the total amount of capital payments received in the relevant tax year" (£2m) does exceed "the s.1(3) amount for the relevant year" (£500k). Accordingly:

> *Step 3*
> The s.1(3) amount for the relevant tax year is matched with—
> (b) ... the relevant proportion of each of those capital payments.

The relevant proportion" is the s.1(3) amount for the relevant tax year (£500k) divided by the total amount of capital payments received in the relevant tax year (£2m) = 0.25.

Thus step 3 states that £500k (the s.1(3) amount) is matched with one quarter of the capital payment = £500k. As noted, the charge in s.87(2) requires us to ask whether the *capital payment* is matched with the s.1(3) amount, and step 3 tells us that the *s.1(3) amount* is matched with the capital payment. The solution is that matching is a symmetrical relationship, ie if A is matched with B, then B is matched with A.

The HMRC analysis is as follows:

> *Match as follows:*
>
> *a. 2012-13 capital payments £500,000 match to £500,000 gains.*

We move on to step 4. Ours is a surplus capital payment case, so step 4 provides:

> *Step 4*
>
> [2] If para (b) of that Step [step 3] applies—
>
> (a) reduce the s.1(3) amount for the relevant tax year to nil, and
>
> (b) reduce the amount of each of the capital payments referred to there by the relevant proportion of that capital payment.

So our revised table becomes:

Year	**Capital payment**	**s.1(3) amount**
2009-10:	nil	£100k
2010-11:	nil	£200k
2011-12:	nil	£500k
2012-13:	£1.5 ~~£2m~~	£0 ~~£500k~~

The HMRC analysis is as follows:

Unmatched 2012-13 capital payments reduced to £1.5 million.
Refer unmatched capital payments to preceding year.

Our journey takes us to step 5.

> *Step 5*
>
> [1] Start again at Step 1 (unless subs.(3) applies)....
>
> [3] If the s.1(3) amount for the relevant tax year (as so reduced) is nil, read references to the s.1(3) amount for the relevant tax year as the s.1(3) amount for the latest tax year—
>
> (a) which is before the last tax year for which Steps 1 to 4 have been undertaken, and
>
> (b) for which the s.1(3) amount is not nil.

This is a surplus capital payment case, (the s.1(3) amount for 2012–13 is now nil).

We revert to step 3 which now reads:

> *Step 3*
>
> The s.1(3) amount ~~for the relevant tax year~~ *for the latest tax year—*
>
> *(a) which is before the last tax year for which Steps 1 to 4 have been undertaken, and*
>
> *(b) for which the s.1(3) amount is not nil*
>
> is matched with—
>
> (a) if the total amount of capital payments received in the relevant tax year does

> not exceed the s.1(3) amount ~~for the relevant tax year~~, *for the latest tax year—*
>
> *(a) which is before the last tax year for which Steps 1 to 4 have been undertaken,*
>
> *(b) for which the s.1(3) amount is not nil.*
>
> each capital payment so received, and
>
> (b) otherwise, the relevant proportion of each of those capital payments.
>
> "The relevant proportion" is the s.1(3) amount ~~for the relevant tax year~~ *for the latest tax year*
>
> *(a) which is before the last tax year for which Steps 1 to 4 have been undertaken,*
>
> *(b) for which the s.1(3) amount is not nil*
>
> divided by the total amount of capital payments received in the relevant tax year.

The "latest tax year" is now 2011-12. This is a surplus capital payment case because "the total amount of capital payments received in the relevant tax year" (now £1.5m) does exceed "the s.1(3) amount for the latest year" (£500k). Accordingly:

> *Step 3*
>
> The s.1(3) amount for the latest tax year is matched with—
>
> (b) ... the relevant proportion of each of those capital payments.

The relevant proportion is one third.

The process repeats again and again. It is not necessary to set out the steps. The reader will by now have the idea. The HMRC analysis (or paraphrase) is as follows:

> *2012-13 trust gains reduced to nil.*
>
> *b. 2011-12: match 2012-13 capital payments £1.5 million to £500,000 gains.*
>
> *2011-12 trust gains reduced to nil.*
>
> *Unmatched 2012-13 capital payments reduced to £1 million.*
>
> *Refer unmatched capital payments to preceding year.*
>
> *c. 2010-11: match 2012-13 capital payments £200,000 to £200,000 gains.*
>
> *2010-11 trust gains reduced to nil.*
>
> *Unmatched 2012-13 capital payments reduced to £800,000.*
>
> *Refer unmatched capital payments to preceding year.*
>
> *d. 2009-10: match 2012-13 capital payments £100,000 to £100,000 gains.*
>
> *2010-11 trust gains reduced to nil.*
>
> *Unmatched 2012-13 capital payments reduced to £700.000.*
>
> *Refer unmatched capital payments to preceding year.*
>
> *e. No unmatched trust gains in 2008-09 or earlier years.*

> *Carry forward unmatched capital payments of 2012- 13 of £700,000 to be matched against trust gains of 2013-14 and subsequent years.*

It is noteworthy that in order to deal with the HMRC example (which is a simplication of a typical real life case, for there is only one capital payment in five years) one has to carry out 15 steps.

61.15.6 *Year of death of beneficiary*

If a beneficiary dies in a tax year, all gains accruing to the trustees in that year are s.1(3) amounts, which can be matched with capital payments made to the beneficiary, even post-death gains. However gains of a subsequent tax year cannot be matched. Section 87 does not say so expressly but the beneficiary could not be subject to CGT on s.87 gains, as the charge is limited to UK residents (s.2 TCGA) and a deceased person is not resident in the UK. That has to be the rule: otherwise it could happen that an estate of a beneficiary who received capital payments could not be completely administered, as there might be a possibility of gains accruing at any time in the future.

HMRC agree. The CG Manual provides:

> **CG38605: Beneficiary** [Nov 2019]
> If a beneficiary dies having received unmatched capital payments those payments cannot be matched against trustees' section [1(3)] amounts for years after the year of death. They can be matched section [1(3)] amounts for the year of death even if the trustees' disposal is after the date of death.

Contrast the rule for s.86 which does not apply to gains accruing to the trustees in the year that the settlor dies, even pre-death gains.[95] Perhaps the reason for the s.87 rule is that it works (slightly) more fairly when two beneficiaries receive capital payments in a tax year and one of them dies during that year.

61.15.7 *Method statements: Critique*

The pre-2008 s.87 provided:

> *(4) Subject to the following provisions of this section, the trust gains for a year of assessment shall be treated as chargeable gains accruing in that year to beneficiaries of the settlement who receive capital payments*

[95] See 60.12 (Death of settlor).

> *from the trustees in that year or have received such payments in any earlier year.*
> *(5) The attribution of chargeable gains to beneficiaries under subsection (4) above shall be made in proportion to, but shall not exceed, the amounts of the capital payments received by them.*
> *(6) A capital payment shall be left out of account for the purposes of subsections (4) and (5) above to the extent that chargeable gains have by reason of the payment been treated as accruing to the recipient in an earlier year.*

No reader who labouriously works through the almost endless iterative steps of s.87A will consider the new style of wording is an improvement on the old. I first speculated whether the legislation was drafted by someone who trained to write computer programs rather than legislation. The correct explanation seems to be that "method statements" (ie step-based drafting) was an innovation of the Tax Law Rewrite project in the search for new and clearer methods of drafting; the drafter of the FA 2008 adopted the technique, but in more clumsy hands the technique delivered obscurity rather than clarity.

This does not necessarily mean that step-based drafting is a bad technique, but it certainly demonstrates how it can be used to bad effect. Finance Bills are generally drafted in a hurry (the FA 2008 was a mad panic) and clarity was a victim of the process.

The fundamental problem however is not the drafting, but the need to match capital payments with trust gains for a year.

61.16 Planning by matching

Matching is a rough and ready rule and trustees need to plan carefully to avoid unfairness.

61.16.1 *Planning: Remittance basis*

Suppose:

(1) Years 1–10: A beneficiary ("B") occupies a UK house held by a trust. This is a capital payment.

(2) Year 11: The house is sold for £1m gain and a s.1(3) amount arises.

In principle the s.1(3) amount in year 11 is matched with the capital payments in years 1–10. The s.87 gain is taxed on an arising basis of the benefit received in the UK. If B is UK resident in year 11, this is an expensive matter. Suppose:

(3) Year 11: The trustees make a capital payment of £1m to B outside the

UK.

The s.1(3) amount is matched with the £1m capital payment and the s.87 gain is taxed on the remittance basis.

61.16.2 *Planning: Interest surcharge*

Since the surcharge matches on a LIFO basis, the charge can be avoided by realising gains in the year that any capital payment is made, so as to frank any capital payment with current year gains. If gains are not actually realised, the rules in schedule 4B TCGA make it fairly easy to realise deemed gains which may do just as well.[96]

61.17 Interest surcharge

Section 91(1) TCGA provides:

> This section applies if—
> (a) chargeable gains are treated under s.87 or 89(2) as accruing to an individual directly or indirectly by virtue of the matching (under s.87A) of all or part of a capital payment with the s.1(3) amount for a tax year ("the relevant tax year"),
> (b) the individual is charged to tax by virtue of that matching, and
> (c) the capital payment was made more than one year after the end of the relevant tax year.

It is not enough that chargeable gains to accrue to a beneficiary, and that the beneficiary is charged to tax; this must be "by virtue of the matching". But since gains do not accrue unless there is matching, and the beneficiary is not charged unless there is matching, the words appear to be otiose.

Section 91(1A) deals with part matching:

> Where part of a capital payment is matched, references in subsections (2) and (3) to the capital payment are to the part matched.

We then turn to the tax increase:

> (2) [a] The tax payable by the individual in respect of the payment shall be increased by the amount found under subsection (3) below,
> [b] except that it shall not be increased beyond the amount of the payment;
> [c] and an assessment may charge tax accordingly.

[96] See 62.1 (Borrowing by non-resident trust).

Para 2[b] stops the Treasury increasing the tax rate above 100%. One would hope it is not necessary. Para 2[c] is otiose.

s91(1) and (2) were amended by FA 2018 schedule 10. Prior to these changes references to "the individual" above were to "the beneficiary". The change was presumably because the extended definition of beneficiary in s97(8) does not apply for the purposes of s91. But the change now suggests that if a (UK) company were a beneficiary that the interest surcharge would now not apply. A capital payment to a UK company is not likely to happen in practice.

Section 91(3) specifies the amount of the increase:

> The amount is one equal to the interest that would be yielded if an amount equal to the tax which would be payable by the beneficiary in respect of the payment (apart from this section) carried interest for the chargeable period at the rate of 10 per cent per annum.

Thus we have a notional 10% interest – the rate bears no relation to commercial interest rates – for a period called a chargeable period.

> (4) The chargeable period is the period which—
> (a) begins with the later of the 2 days specified in subsection (5) below, and
> (b) ends with 30th November in the year of assessment following that in which the capital payment is made.
> (5) The 2 days are—
> (a) 1st December in the tax year immediately after the relevant tax year, and
> (b) 1st December falling 6 years before 1st December in the year of assessment following that in which the capital payment is made.

I call this the "**interest surcharge.**" It is not interest in the true sense of the word, but the wording is designed to give the some of the appearance of interest.

The effect of s.91(1)(c) is that there is a one year grace period, the tax year after the gain accrued to the trustees, during which there may be a capital payment without a surcharge. On a payment after the one year grace period, the surcharge applies, backdated to 1 December in the "grace year". Odd; but there it is.

As the chargeable period cannot exceed 6 years, the maximum surcharge is 60% of the tax. As the top CGT rate is 20%, the maximum rate of tax on a capital payment is 32%. The top CGT rate is lower than top IT rates (though this has not always been the case).[97]

For completeness, the Treasury may alter the rules;[98] but they have never done so.

61.17.1 *HMRC example*

The s.87 guidance note gives an example:

> **Example 13: New section 91 - tax increase under section 91 TCGA**
> As at [the start of] 2008-09 there are no unmatched capital payments or section 2(2) amounts.

Year	**Capital payments**	**s.2(2) amount**
2008-09	£ 3,000	£17,000
2009-10	£ 5,000	£ 6,000
2010-11	£37,000	£16,000
Total	£45,000	£39,000

In summary, the capital payments for each year are matched with the section 1(3) amounts for each year as follows:

	Capital payment	s.1(3) amount	s.87 gain	Unmatched s1(3) amount	Unmatched capital payment
2008-09	3,000	17,000	3,000	14,000	
2009-10	5,000	6,000	5,000	1,000	
2010-11	37,000	16,000	16,000	nil	21,000

> In 2010-11 it is necessary to match the unmatched capital payments for that year against the unmatched section 2(2) amounts of earlier years. On a last in-first out basis £1000 is matched against the unmatched amount section 2(2) for 2009-10 and £14,000 against the unmatched section 2(2) amount for 2008-09.
> Total gains of £31,000 arise as a result of the capital payment in 2010-11 matched as follows:

2010-11	£16,000
2009-10	£1,000
2008-09	£14,000

> At the time of writing the annual exempt amount and rate of CGT are not known for 2010-11. This example assumes they are £10,200 and 18% respectively.
> The tax due for 2010-11 is £3744 ([£31,000 - £10,200] @ 18%).

[97] Up to 2015/16, where the full surcharge applied, there was not much difference between IT and the top CGT rate.

[98] Section 91(6)(7) TCGA.

> Section 91 TCGA will apply to increase the tax due on the gain £14,000. The taxpayer's annual exempt amount can be set against that part of the gain. The tax due on £14,000 – £10,200 is £3800 @ 18% = £684. This amount of tax is increased by 20% ie £136 making the total tax payable £3880 (£3,744 + £136).

In the terminology of s.91, so far as the s.87 gain is matched with the £14k s.1(3) amount for 2008/09:
The relevant tax year is 2008/09
The chargeable period begins 1 December 2009.
The chargeable period ends 30 November 2011.
Hence the rate of the interest surcharge is 20%.
There is no interest surcharge so far as the s.87 gain is matched with the s.1(3) amount for 2009/10 as the condition in s.91(1)(c) is not met. In short, the interest surcharge rule does not apply if only one year has passed since the s.1(3) amount (trust gain).

61.17.2 *Surcharge/remittance basis interaction*

What is the position if the s.87 remittance basis applies? Para 1(2) sch 1 TCGA provides:

> The [s.87] gains are treated as accruing to the individual only so far as, and at the time when, they are remitted to the UK.

One might argue that there is no interest surcharge, because the gains are not charged to tax by virtue of matching; they are charged by virtue of the remittance. But the better view is the surcharge applies (by reference to the year of capital payment, not by reference to the year of remittance). HMRC agree.[99]

There is a small planning point here for remittance basis taxpayers. One could avoid the interest surcharge if the trustees make capital payments in the year that s.1(3) amounts (trust gains) accrue, with a view to remittance in later years; whereas if the capital payment is made in the later year, followed by prompt remittance, there is an interest surcharge.

61.17.3 *Interest surcharge planning*

Realise gains later: It would be worthwhile where practical to realise gains, in order to match a capital payment to those later gains, rather than

[99] See 61.19.1 (HMRC examples).

matching to earlier gains which incurs the supplement.

Make capital payments sooner: If it is not possible to realise later gains, it would generally be better to make capital payments sooner, and pay the CGT sooner but without the surcharge, than to make the capital payments later and pay the surcharge.

61.17.4 *Interest surcharge: Critique*

What is the reason for the interest surcharge? It is to counter the perceived advantage that UK trusts pay CGT on an arising basis, but non-resident trusts (outside s.86) pay CGT on a capital payments basis, which is more favourable. But it works very oddly, particularly after the extension of s.87 to foreign domiciled settlors and beneficiaries in 2008. For instance, consider a trust set up some years ago by an Australian for Australian beneficiaries; one beneficiary comes to the UK and receives a capital payment here. Why should there be a surcharge?

As the rate is penal, the surcharge when it applies may be a late distribution penalty; or an incentive to distribute promptly. That might be regarded as a reason for the surcharge, if the policy object were to encourage prompt distributions. But the incentive only operates when a trust realises a single gain, and does not realise subsequent gains, so it seems unlikely that consideration was a reason for the surcharge.

The surcharge is not likely to bring in sufficient tax to justify the complications and unfairness that it causes. That makes a good case for repeal of the surcharge. But there is no reason to expect that. Anyway, what is needed is a review of s.87 more generally; and there is no likelihood at all of that.

61.18 s.87 gains of split year

Section 87(2A) TCGA provides:

> If the relevant tax year is a split year as respects the beneficiary, the gains are treated as accruing in the UK part of that year.

So all s.87 gains of a split year come into charge.

61.18.1 *s.87 split year: Critique*

At first sight, s.87 ought to operate the same split-year rule as ordinary gains: s.87 gains accruing in the overseas part of a split year should not be taxed. That would however require one to determine when in the split year s.87 gains accrue (or at least, whether gains accrue in the overseas part or the UK part of a split year).

In the following discussion, a **"split-year benefit"** is a benefit conferred during a split year.

In a simple case where trust gains of earlier years will exceed any split-year benefits, it is easy to see that s.87 gains accrue when the benefit is conferred. But where there are (or may be) insufficient trust gains of earlier years to match the split-year benefit, the question of when s.87 gains accrue is less clear. The amount of the s.87 gains depends on factors which are not determined until the end of the tax year:

(1) the total amount of trust gains (less losses) of the entire tax year and
(2) the total amount of capital payments to all beneficiaries in the entire tax year.

This was, I expect, the reason for the pre-2018 rule that s.87 gains accruing in a split year were time-apportioned across the year.

A fair and practical rule would be that benefits conferred on a beneficiary during the overseas part of their split year treated like benefits of a year of non-residence, ie (in short) disregarded.

The unfairness of the current rule is exacerbated by the uncertainty as to whether s.87 DT relief applies where a beneficiary is treaty-resident in an foreign state with a treaty in OECD model form.[100]

61.19 s.87 remittance basis

Section 87B TCGA provides what I call the "**s.87 remittance basis**".

Section 87B(1) provides:

> This section applies if—
> (a) chargeable gains are treated under s.87 as accruing to an individual in a tax year, and
> (b) s.809B, 809D or 809E (remittance basis) applies to the individual for that year.

In short, the relief applies to remittance basis taxpayers.

In order to understand the law one must carefully distinguish:

(1) trust gains (gains accruing to the trustees)
(2) s.87 gains (treated under s.87 as accruing to the beneficiary)

Section 87B(2) TCGA provides the relief:

[100] See 61.60.2 (Beneficiary treaty-resident outside UK).

> The chargeable gains [s.87 gains] are chargeable gains accruing on the disposal of an asset situated outside the UK.[101]

This incorporates the remittance basis.[102] It would not work by itself as s.87 gains (being fictional) do not exist and cannot be remitted. So s.87B(3) TCGA provides:

> For the purposes of Chapter A1 of part 14 of ITA 2007 (remittance basis) treat relevant property or benefits as deriving from the chargeable gains [the s.87 gains].

The definition of "relevant property or benefits" is convoluted, but ultimately what one would expect. Section 87B(4) TCGA provides:

> For the purposes of subsection (3) property or a benefit is "relevant" if the capital payment by reason of which the chargeable gains [the s.87 gains] are treated as accruing consists of—
> (a) [i] the payment or transfer of the property or
> [ii] its becoming property to which s.60 applies, or
> (b) the conferring of the benefit.[103]

I refer to this as the "**derivation fiction**".

Thus we have three fictions:

(1) We pretend the beneficiary receives s.87 gains: this is the basic s.87 fiction.
(2) We pretend the s.87 gains arise on the disposal of foreign situate assets.
(3) We pretend the capital payments derive from those s.87 gains (the derivation fiction).

The derivation fiction feeds into remittance condition B. There is a taxable remittance if (in short):

(1) *Property*[104] is brought/received/used in the UK (remittance condition A) and

[101] It would be more apt to say that the s.87 gains "are *treated as* chargeable gains accruing on the disposal of an asset situated outside the UK." But nothing turns on that.

[102] See 56.17 (CGT remittance basis).

[103] The wording follows the wording of the definition of capital payment: see 61.7.2 ("Payment").

[104] Or services, but for clarity I refer only to property. I also assume that the property is brought/received/used by a relevant person.

(2) That property is derived (indirectly) from foreign gains (remittance condition B).

Section 731 adopts a similar rule; for a fuller discussion see 50.39 (s.731 remittances: Operation).

A capital payment still reduces the s.1(3) amount (trust gains) even though the payment is (un)taxed under the s.87 remittance basis. This is sensible because other beneficiaries (and the trustees) could not know what the position was.

It does not matter whether the s.1(3) amounts (trust gains) accrue on disposals of UK or foreign assets. All that matters is whether the capital payment is remitted to the UK. HMRC agree. The s.87 guidance note provides:

> 43. The remittance basis applies to the s.87 gain not the gain that created the s.2(2) amount. For example,
> trustees dispose of an asset held outside the UK creating a s.2(2) amount.
> In the same year they make a capital payment outside the UK to a non-domiciled beneficiary.
> The capital payment is matched against the s.2(2) amount.
> A s. 87 gain accrues to the beneficiary who has claimed the remittance basis for that year.
> The trustees apply the proceeds of the disposal in buying investments in the UK.

The HMRC analysis is as follows:

> This remittance of the gain which created the s. 2(2) amount [the trust gain] is not treated as a remittance of the s.87 gain by the beneficiary.[105]

Relevant property/benefits may be received in the UK in a year before the s.87 gains accrue, due to the quirky matching rules. Suppose:

(1) Year 1: a beneficiary receives a benefit; there are no s.1(3) amounts (trust gains) so the benefit is not matched and no s.87 gain accrues.

(2) Year 2: the beneficiary remits the benefit to the UK. There is still no s.87 gain.

[105] Similarly, FAQ Residence & Domicile – NR trusts provides:
"**Does it make any difference if the assets in the non-resident trust or underlying non-resident company owned by the trust are UK situated?**
There is no difference in the CGT treatment of UK situated vs foreign situated assets when these are owned by a non-resident trust or underlying non-resident company."

(3) Year 3: trust gains accrue to the trustees and a s.87 gain accrues to the beneficiary.

The s.87 gain is deemed to be remitted in the year it arises (year 3) and not before.[106]

61.19.1 *Example: Outright payment*

The s.87 guidance note provides:

> **Example 8 – New section 87B - remittance of capital payment: payment**
> A is a UK resident and domiciled beneficiary of a non-UK resident settlement. B is a UK resident but non-UK domiciled beneficiary of the same settlement. The settlement owns shares in X Inc. X Inc is an American company registered on the New York Stock Exchange.[107]
> In 2008-09 the trustees sell shares in X Inc for $120,000 when the spot rate is £1 = $1.50. The acquisition cost of the shares was $20,000 when spot was also £1 = $1.50. This creates a section 2(2) amount of £66,666 for 2008-09, ie $100,000 @ 1.50.
> In 2010-11 the trustees make capital payments of $40,000 into the US bank accounts of each beneficiary. The spot rate of the US dollar at the date of the payment is £1 = $1.75. Chargeable gains of £22,857 accrue to each beneficiary under section 87 in 2010-11 in respect of these capital payments. $40,000 @ $1.75 = £22,857.
> At the time of writing the annual exempt amount and rate of CGT are not known for 2010-11 and 2012-13. This example assumes the rate of CGT is 18% for both years and the annual exempt amount was £10,000 in 2010-11 and £11,000 in 2012-13.

The example first deals with the position of A, the UK domiciled beneficiary:

> Beneficiary A has other gains in 2010-11. The overall position is as follows.
> - Section 87 gains £22,857
> - Other personal gains £40,000
> - Other personal losses £20,000
> - Annual exempt amount £10,000
>
> The amount on which CGT is chargeable is £32,857. The personal losses can be set only against the other personal gains but the annual exempt amount is allocated first to the section 87 gain leaving £12,857 of that part of the gain chargeable at 18%. The tax due on £12,857 is £2,314 (£12,857 @ 18%). This is increased by £462 (£2,314 @ 20%) because there is a delay of over one year in making the capital payment.

[106] See 18.48 (Remittance before income/gains arise).

[107] This sentence is irrelevant, as the situs of the trust asset does not matter for s.87 purposes.

The example then deals with the position of B, the remittance basis taxpayer:

> Beneficiary B claims the remittance basis for 2010-11 and leaves the $40,000 in the US bank account. B also has other gains in 2010-11. These gains and losses arise on the disposal of assets situated in the UK. The overall position is as follows.
>
> - Section 87 gains £22,857
> - Other personal gains on UK assets £40,000
> - Other personal losses on UK assets £20,000
>
> B does not have an annual exempt amount in 2010-11 because they have claimed the remittance basis. B is not liable to CGT on the section 87 gain of £22,857 because of section 87B. B is liable to CGT at 18% on the full amount of the other net personal gains £20,000.
>
> Because B has claimed the remittance basis they also have to decide whether or not to make an election under section 16ZA TCGA. The effect of that election is allow losses on the disposal of assets situated outside the UK to be set-off against gains, either foreign chargeable gains or gains on the disposal of assets situated in the UK. Unless the election is made the foreign losses will be lost. An effect of the election is that the annual exempt amount cannot be set foreign chargeable gains remitted to the UK, section 16ZB(4). B makes a valid election within the time limit, 31 January 2017.
>
> In 2012-13 B remits $30,000 of the $40,000 from the US bank to their UK bank where it is converted to sterling at a rate of £1 = $2.00 ie £15,000. B is not a remittance basis user in 2012-13. The rate of CGT is 18%. The annual exempt amount is £11,000. The remittance is a disposal of foreign currency in the US bank account giving a loss of £2,142 [$30,000 @ $2.00 = £15,000 – $30,000 @ 1.75 = £17,142].
>
> B is liable to CGT in 2012-13 on the following elements.
>
> The section 87 gain is a foreign chargeable gain. Section 12(2) and (3) TCGA provides this chargeable gain is treated as accruing in 2012-13 equal to the full amount of the gains remitted in 2012-13. B has remitted 75% of the £22,857 chargeable gain (30,000/40,000×£22,857) = £17,142. Section 2(4) TCGA prevents the personal losses, £2,142, being set against this gain. Because of the election under s16ZA neither can the annual exempt amount be set against this part of the gain. Tax is due at 18% on £17,142 = £3,085. This tax is subject to the increase in section 91 TCGA. This is calculated by reference to the year the gain was matched ie 2010-11 not the year the gain was remitted. The rate charged, 20%, will be the same that applied to beneficiary A. The total tax charged on this part of the gain is £3,085 + £617 = £3,702.
>
> If B had not made the election under s16ZA the annual exempt amount could be set against the remitted gains reducing the amount liable to the increase under s91. But they would lose the benefit of losses on any assets situated the UK.
>
> Additionally for 2012-13 B has other personal gains on UK assets of £18,000. Because of the election under s16ZA the personal losses £2,142 can be set against these gains as can the annual exempt amount £11,000. With a tax rate of 18% the total tax charged on the net gains of £4,858 is £971. The total CGT

payable for 2012-13 is £4,673 (£3,702 + £971).

61.19.2 *Example: Use of property*

The next HMRC example concerns capital payments which take the form use of accommodation, rather than an outright transfer. Omitting irrelevant detail, the example is as follows:[108]

> *Example 9 - New section 87B - Remittance of capital payment: benefit*
> C is a UK resident but non-UK domiciled beneficiary of a non-UK resident settlement. C claims the remittance basis. The settlement has s.2(2) amounts.
> The trustees (or underlying companies) allow C to use rent-free:
> (1) a property outside the UK and
> (2) a property in the UK.

The HMRC analysis is as follows:

> The use of both properties by C gives rise to a capital payment equal to the value of the benefit. These capital payments are matched against the section 2(2) amount and a s.87 chargeable gain accrues to C. Section 87B(2) TCGA provides this is a foreign chargeable s.87 gain.
> The use of the UK property meets remittance condition A in section 809L.
> Because section 87B(3) TCGA provides the benefits derive from the [s.87] chargeable gains the use of that property also meets remittance condition B in section 809L(3)(b) ITA 2007.
> C is treated as remitting the capital payment created [by] the use of the Devon property to the UK and C is liable to CGT on that [capital] payment.
> The use of the property outside the UK is not treated as a remittance to the UK and C is not liable to CGT on that payment.

Remittance conditions A and B are (so far as relevant):

[108] The example in full, including its irrelevant detail, is as follows:
"C is a UK resident but non-UK domiciled beneficiary of a non-UK resident settlement. C claims the remittance basis. The settlement owns 100% of the issued share capital of a Gibraltarian holding company which in turn owns 100% of the issued share capital of a Gibraltarian company. That company owns a property in Spain. Both companies are non-UK resident.
The company sells the property in Spain creating a section 2(2) amount of £120,000 through section 13 TCGA. The company invests some of the proceeds in the purchase of a smaller property in Spain. C is allowed to use the property rent-free. C is also allowed rent-free use of a cottage in Devon owned by the settlement."

> (2) Condition A is that—
>
> (a) money or other property is brought to, or received or used in, the UK by or for the benefit of a relevant person ...
>
> (3) Condition B is that ...
>
> (b) the property, [ie the property within (2)(a)]—
>
> (i) derives (wholly or in part, and directly or indirectly) from the ... chargeable gains, and
>
> (ii) ... is property of ... a relevant person...

Remittance condition A is satisfied on the basis that property (the Devon cottage) is used in the UK. Clarke questions whether remittance condition B is satisfied.[109] There is a relevant benefit: the rent free use of the cottage. That benefit is deemed to be derived from the s.87 gain. It does not follow from that deeming that the property (the Devon cottage) derives from the s.87 gain.

The correct analysis, it is suggested, is that:

(1) Condition A is satisfied because the right to use the cottage is itself property received or used in the UK; and

(2) That right is the benefit which is deemed to derive from the s.87 gain.

Clarke argues that "the issue stems from the fact that Conditions A and B in ITA 2007, s 809L require the money or other property used in the UK to be or be derived from the foreign income or gains in order for such income or gains to be remitted. But s 87B(3) deems the capital payment constituted by the use of the asset to be derived from the s 87 gain, not the asset itself. Similarly, it is the benefit, not the property over which the benefit is conferred, which is treated by s 735(4) as derived from the s 732 income." But if the benefit is derived from the s.87 gains, then the proprietary interest conferred by the benefit is also derived (indirectly) from the s.87 gains.[110]

61.20 Non-resident disregards: Outline

HM Treasury say:

> **2.3.1 Treatment of capital gains in trusts**
>
> ... where a beneficiary is not UK resident, no tax is due. Making a capital

[109] Woodward, *Clarke's Offshore Tax Planning — Trusts and Companies* (2023-24), para 63.18 (Benefits in kind: land and chattels).

[110] See too 50.40.2 (Beneficial loan).
For a similar argument in another context, see 18.17 (Property is the income or gains).

> payment to such a beneficiary has the effect of reducing the gains in the pool and the amounts available to match against any subsequent payments to UK resident beneficiaries. For tax purposes, the pool of gains has been depleted by the payments to non-residents – even though the non-residents did not pay tax on the gain.
> ... under the new [2018] regime capital payments to a non-resident beneficiary ... will ... not be matched against the pool of trust gains. This is regardless of the domicile status of the settlor and whether or not the recipient of the payment is the settlor or another beneficiary of the trust. This will ensure that the pool of gains against which payments to UK beneficiaries are matched will not be depleted because of payments made to non-residents.[111]

As usual, the policy can be stated in a few lines but its implementation requires a chapter to discuss.

61.20.1 *Navigation*

The following table may assist:

TCGA	**Topic**	**See para**
s.87D	Non-resident disregard	61.21
s.87E	Temporary non-resident	61.22
s.87F	Final trust year	61.24
s.87G-M	s.87 settlor-attribution	61.29
s.87N	Migrant disregard	61.23
s.87P	Temporary migrant	61.23.1

61.21 Non-resident disregard

Section 87D(1) TCGA provides:

> [a] For the purposes of sections 87 and 87A as they apply in relation to a settlement,[112] no account is to be taken of a capital payment (or a part of a capital payment) within subsection (2) ...

The section then signposts some exceptions:

> [b] but this—

[111] Reforms to the taxation of non-domiciles: response to further consultation (2016) para 2.3.5. *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574450/non_doms_consultation_response_final.pdf*

[112] Section 87D(1) refers to s.87/87A "as they apply in relation to a settlement" but the sections do not apply to anything else. The phrase is otiose, though it does no harm.

> (a) is subject to
> [i] subsection (3) [settlor-attribution rule] and
> [ii] section 87E [temporary non-residence], and
> (b) does not affect the operation of sections 87I to 87L [onward gifts] (see, in particular, sections 87K(2) and 87L(2) which apply sections 87 and 87A by reference to the payment mentioned in section 87I(1)(a)).

Section 87D(2) TCGA then identifies the disregarded payments:

> [a] A capital payment is within this subsection if (and to the extent that[113]) it is in a tax year received from the trustees of the settlement by a beneficiary who at all times in that year is not resident in the UK,
> [b] but this is subject to section 87F [final trust year].

I refer to this rule as the **"non-resident disregard"**. That is not a neat label, but it is difficult to think of a better one. The rule is one of a number of capital payment disregards.[114]

It follows that the non-resident beneficiary will not be taxed, even if the capital payment is matched at a later time when they have become UK resident.

There are five exceptions to the non-resident disregard; for some reason, 4 are mentioned in s.87D(1) and the fifth is mentioned in s.87D(2). They are:

TCGA section	**Topic**	**See para**
87D(3)	s.87 settlor attribution	61.21.2
87E	Temporary non-resident	61.22
87F	Final trust year	61.24
87K(2), 87L(2)	Onward gifts	61.33

What about a capital payment to a non-resident company which is treated as made to a UK resident participator, under the s.96(2) rule?[115] Context show that should not be disregarded.

61.21.1 *EU-law compliance*

Is the non-resident disregard EU-law compliant? The rule is particularly

[113] The words in brackets assume that one capital payment could be made partly to a non-resident; that seems a somewhat laboured view, but it does not matter.

[114] See 61.11.4 (Disregard of payment to co: s.87C).

[115] See 61.11 (Payment to close co: s.96(2) rule).

odd for charities, as a capital payment to a UK resident charity is not disregarded, but a capital payment to a non-resident charity is disregarded. That is likely a breach of EU law. But that point may not often arise.

61.21.2 *Preservation of s.87 settlor-attribution*

The non-resident disregard in s.87D(2) would apply where:

(1) There is a capital payment to a non-resident who is close-family of the settlor
(2) The settlor is UK resident and within the s.87 settlor-attribution rule[116]

In this case the non-resident disregard would help the taxpayer as it would disapply the s.87 settlor-attribution rule. Section 87D(3) TCGA prevents this:

> Subsection (1) does not apply in relation to a capital payment (or a part of a capital payment) if-
> (a) the recipient beneficiary is a close member of the settlor's family (see section 87H)[117] when the beneficiary receives (or is treated as receiving) the payment (or part),
> (b) the payment (or part) is received on or after 6 April 2018, and
> (c) the settlor is resident in the UK in the tax year in which the payment (or part) is received.

In short, the s.87 settlor-attribution rule has priority over the non-resident disregard.

61.21.3 *Planning*

Separate settlements (for UK and non-UK beneficiaries) are better than one settlement for both.

Where a single settlement currently exists, a transfer to separate settlements for separate branches of the family is likely to be advantageous.

61.21.4 *Pre-2018 payment to non-resident*

Para 1(12) sch 10 FA 2018 provides:

> The new sections 87D and 87E have effect—
> (a) except as provided by the new section 87D(3) [preservation of settlor-attribution rule], in relation to payments received in the tax

[116] See 61.26 (Settlor-attribution rules).
[117] See 61.27.2 ("Close-family").

year 2018-19 or a later tax year, and

(b) in the tax year 2018-19 and later tax years, also in relation to payments received before the tax year 2018-19 that have not been matched under section 87A of TCGA 1992 as it applies for tax years before the tax year 2018-19.

Pre-2018 payments to non-residents that are matched pre-2018 are unaffected.

Pre-2018 payments to non-residents that are unmatched pre-2018 are disregarded. Thus there is an element of retrospectivity in the rule.

61.22 Payment to temporary non-resident

The non-resident disregard in s.87D(2) would apply where:

(1) There is a capital payment to a non-resident who is temporarily non-resident

(2) The beneficiary becomes UK resident

In this case the non-resident disregard would help the taxpayer by taking the capital payment out of the s.87 TNR charge.[118]

Section 87E(1) TCGA prevents this:

> If-
>
> (a) as a result of section 87D, no account is taken of a capital payment (or a part of a capital payment) for the purposes of sections 87 and 87A,
>
> (b) the recipient beneficiary is an individual who is temporarily non-resident,[119] and
>
> (c) the payment (or part) is received in the beneficiary's temporary period of non-residence,
>
> the payment (or part) is treated for the purposes of sections 87 and 87A as received (by the beneficiary) in the beneficiary's period of return, and account is to be taken of it accordingly for those purposes.

The payment is disregarded in the year of payment, but taken into account in the year of return. For instance: Suppose a trust had trust gains of £3m

[118] See 11.6 (TNR gains/losses).

[119] Section 87E(2) TCGA incorporates the usual TNR definitions: "Part 4 of Schedule 45 to FA 2013 explains—

(a) when an individual is to be regarded as "temporarily non-resident", and

(b) what "the temporary period of residence" and "the period of return" mean."

This is repeated in s.87P(2) TCGA and para 2(4) sch 10 FA 2018.

(1) Year 1: Payment of £2m to X (temporarily non-resident). Payment is disregarded.
(2) Year 2: Payment of £2m to Y (UK resident). Payment is matched with trust gains and £2m s.87 gains accrue to Y.
(3) Year 3: X becomes UK resident. The year 1 payment is matched with the outstanding £1m trust gains, and £1m s.87 gains accrue to X.

By contrast, if X had returned in year 2, then £1.5m s.87 gains would accrue to each of X and Y.

61.22.1 *Pre-2015 migration*

Para 2 sch 10 FA 2018 provides:

> (1) Sub-paragraph (2) applies in a case where-
> (a) section 10A of TCGA 1992 (temporary non-residents) as substituted by paragraph 119 of Schedule 45 to FA 2013 applies in relation to an individual,

That is, a post-2013 migration.

> (b) the period of temporary non-residence[120] began before 8 July 2015, and
> (c) a capital payment (or part of a capital payment) is treated by
> [i] section 87E [payment to temporary non-resident] or
> [ii] 87P [payment to temporary migrant] of TCGA 1992
> as received by the individual in the period of return.
>
> (2) For the purposes of capital gains tax in respect of any chargeable gain treated by section 87 of TCGA 1992 as accruing to the individual as a result of matching of the payment (or part), section 809B(1A) of ITA 2007 does not have effect in relation to the tax year which consists of or includes the period of return.

Section 809B(1A) applies deemed domicile rules to s.809B (claim for remittance basis).[121] So the effect is to disapply deemed domicile.
Para 2(3) sch 10 FA 2018 provides:

> Where by virtue of sub-paragraph (2) the individual makes a claim under section 809B of ITA 2007 for any of the tax years 2018-19 to 2020-21 inclusive, sections 809C, 809G and 809H of ITA 2007 do not

[120] Para 2(4) incorporates the usual TNR definitions.
[121] Section 809B(1A) provides: "Section 835BA (deemed domicile) applies for the purposes of subsection (1)(b)."

apply to the individual for that tax year.

This disapplies the remittance basis charge, which seems generous, though it will not often arise.

61.23 Migrant disregard

The non-resident disregard in s.87D(2) would not apply where:

(1) There is a capital payment to a UK resident
(2) There are no trust gains, so there is no s.87 charge at that time
(3) The individual becomes non-resident
(4) Trust gains then accrue, which are matched with the earlier capital payment

Section 87N TCGA deals with this:

> (1) [a] For the purposes of sections 87 and 87A as they apply in relation to a settlement for a particular tax year, no account is to be taken of a capital payment (or part of a capital payment) within subsection (2),
> [b] but this is subject to section 87P [temporary migrant].

The wording is the same as the 87D disregard.

> (2) A capital payment is within this subsection—
> (a) if it is received by a beneficiary of the settlement before the particular tax year,
> (b) if the relevant person is resident in the UK in the tax year in which it is received,
> (c) if the relevant person is not resident in the UK in the particular tax year, and
> (d) so far as it has not been matched (under section 87A as it applies for tax years before the particular tax year) with—
> (i) the section 1(3) amount for any tax year before the particular tax year, but not earlier than the tax year 2018-19, in which the relevant person is resident in the UK, or
> (ii) the section 1(3) amount for any tax year earlier than the tax year 2018-19.
> (3) For the purposes of subsection (2), the beneficiary is "the relevant person" unless section 87G(2) applies in relation to the capital payment in which event the settlor is "the relevant person".

I refer to the beneficiary as the **"migrating beneficiary"**, and the rule is the **"migrant disregard"**.

61.23.1 *Temporary migrant*

Section 87P TCGA is the equivalent of s.87E TCGA.[122] The migrant disregard in s.87N(2) would apply where:

(1) There is a capital payment to a UK resident
(2) There are no trust gains, so there is no s.87 charge
(3) The beneficiary becomes temporarily non-resident
(4) Trust gains then arise

In this case the migrant disregard would help the taxpayer by taking the capital payment out of the normal TNR charge.[123]

Section 87P(1) TCGA prevents this:

> If—
> (a) as a result of section 87N, no account is taken of a capital payment (or a part of a capital payment) for the purposes of sections 87 and 87A as they apply in relation to a settlement for a particular tax year,
> (b) the recipient beneficiary (where section 87G(2) does not apply in relation to the capital payment), or the settlor (where section 87G(2) does apply in relation to the capital payment), is an individual who is temporarily non-resident,[124]
> (c) the whole or part of the particular tax year constitutes, or forms part of, that individual's temporary period of non-residence,
> (d) either—
> (i) that individual's temporary period of non-residence begins with the start of a tax year and the payment (or part) is received before that tax year, or
> (ii) that individual's temporary period of non-residence begins otherwise than at the start of a tax year and the payment (or part) is received before, or at any time in, the tax year in which that individual's temporary period of non-residence begins, and
> (e) the payment (or part) has not been matched (under section 87A as it applies for tax years before the particular tax year) with—
> (i) the section 1(3) amount for any tax year before the particular tax year, but not earlier than the tax year 2018-19, in which that individual is resident in the UK, or

[122] See 61.22 (Temporary non-resident: Payment postponed until return).
[123] See 11.6 (TNR gains/losses).
[124] Section 87P(2) incorporates the standard TNR definitions.

> (ii) the section 1(3) amount for any tax year earlier than the tax year 2018-19,
>
> the payment (or part) is treated for the purposes of sections 87 and 87A as received (by that individual) in that individual's period of return, and account is to be taken of it accordingly for those purposes.

The payment is disregarded in the year of payment, but taken into account in the year of return.

61.23.2 *Commencement*

Para 1(15) sch 10 FA 2018 provides:

> The new sections 87N and 87P have effect where the particular tax year is the tax year 2018-19 or a later tax year.

61.24 Final trust year

The policy seems to be that prompt termination of a trust is a public good; and in such a case there is a limited exception to the non-resident disregard.

Section 87F TCGA provides:

> (1) This section applies in relation to a settlement if-
> (a) in a particular tax year, the settlement ceases to exist,
> (b) two or more beneficiaries ("the recipients") in the year receive capital payments from the trustees, and
> (c) at least one of the recipients is, and at least one is not, a non-resident beneficiary.[125]
>
> (2) Those capital payments, so far as received by such of the recipients as are non-resident beneficiaries, are not within section 87D(2).

If capital payments are made to UK and non-UK beneficiaries the capital payment is apportioned between them.

This has important planning implications. Suppose a trust has £4m trust gains, £8m assets, and a UK and a non-resident beneficiary.

(1) Suppose there is a £4m capital payment to the non-resident beneficiary in year one, and the balance is paid to the UK resident in year 2. The £4m is taxable.

(2) Suppose the two payments are made in the same year. The UK tax charge is on £2m.

[125] Section 87F(3) provides: "In this section "non-resident beneficiary" means a beneficiary who at all times in the year is not resident in the UK."

There may be scope for planning by transferring funds to another settlement, and so terminating an existing settlement.

61.24.1 *Commencement*

Para 1(13) sch 10 FA 2018 provides:

> The new sections 87F [final trust year] ... and the amendments made by subparagraphs (4) and (10), have effect in relation to payments received in the tax year 2018-19 or a later tax year

61.25 Non-resident disregard: Critique

The pre-2018 matching rules were a rough and ready solution to the intractable problem of attributing trust gains to beneficiaries; but they were a solution of a kind. The 2018 rules attribute (more or less) all trust gains to UK residents. For multi-jurisdiction families, ie where family members are resident in different jurisdictions, they will lead to double or multiple taxation, as beneficiaries resident in non-UK jurisdictions (other than tax havens) will also be subject to tax on benefits. The tax may exceed the gains.

One might regard the disregard as an illustration of Brexit parochialism, but that is perhaps to over-intellectualise.

HMRC presented the disregard as a consequence of introducing the deemed domicile changes;[126] but that was the occasion and not the cause of the change.

61.26 Settlor-attribution: Introduction

Settlor-attribution rules apply where benefits within the scope of s.87, s.643A, or s.731 are received by close family of the settlor. If the relevant conditions (which I call attribution conditions) are satisfied, the s.87 gain

[126] Reforms to the taxation of non-domiciles: response to further consultation (2016) para 2.3.5: "The government is concerned that there will be an increased opportunity and incentive for those who are deemed domiciled and therefore benefit from the trust arrangements, to benefit further from existing rules that allow the "pool" of taxable gains in overseas trusts to be reduced when capital payments are made to non-resident beneficiaries. In order to address this opportunity for tax avoidance under the new regime capital payments to a non-resident beneficiary ... will therefore not be matched against the pool of trust gains."
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574450/non_doms_consultation_response_final.pdf

or s.643A/731 income is attributed to the settlor; that is, treated as arising to the settlor rather than the individual (close-family) receiving the benefit.[127]

These attribution rules are written out 3 times:

Section	**Topic**	**Supplement**	**See para**
s.87G TCGA	s.87 settlor-attribution rule	s.87H	61.29
s.643A(3)(4) ITTOIA	s.643A settlor-attribution rule	s.643E	47.28
s.733A(2)(3) ITA	s.731 settlor-attribution rule	s.733B	50.49

I refer to these together as **"settlor-attribution rules"**.

There is a further set of attribution rules which apply where:

(1) Benefits within the scope of s.87, s.643A or s.731 are received by a recipient who is not close-family of the settlor.

(2) The recipient gives the benefits to close family of the settlor.

Again, the s.87 gain or s.643A/s.731 income is in some cases attributed to the settlor, that is, treated as arising to the settlor rather than the individual (close-family) receiving the gift.

These attribution rules are also written out 3 times:

Section	**Name (my terminology)**	**See para**
s.87L TCGA	OG s.87 settlor-attribution rule	61.34
s.643L ITTOIA	OG s.643A settlor-attribution rule	47.36
s.733E ITA	OG s.731 settlor-attribution rule	50.57

I refer to these together as **"OG settlor-attribution rules"** (and they may be contrasted with the **"basic"** settlor-attribution rules mentioned above).

These uniform labels conveniently indicate a common template behind the rules, though they also conceal significant differences in the scope of the rules. It would have been neater if the attribution rules had been better aligned, but there it is.

The repetition does make it harder to write a comprehensible exposition. The reader does not want to read the same discussion three times or more. But cross referencing is also inconvenient. There is no solution to this. Sometimes I repeat material, and sometimes I cross reference to where

[127] The background can be traced in HMRC, "Reforms to the taxation of non-domiciles: response to further consultation" (2016) para 2.3.5. *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574450/non_doms_consultation_response_final.pdf* But this is now of historical interest only.

equivalent provisions are discussed in more detail.

61.27 "Close-family"

61.27.1 *Position from 2018/19*

A common definition of close-family applies for:
(1) The settlor-attribution rules
(2) The close-family s.643A/s.731 benefit charges

The definition is written out three times, but it suffices to set out s.87H(1) TCGA which provides:

> For the purposes of sections 87D, 87G and 87L as they apply in relation to a settlement, a person is a close member of the settlor's family at any time if the settlor is living at that time and—
> (a) the person is the settlor's spouse or civil partner at that time, or
> (b) the person—
> (i) is a child of the settlor, or of a person who at that time is the settlor's spouse or civil partner, and
> (ii) at that time has not reached the age of 18.[128]

Section 87H(2) TCGA extends this to cohabitees, using the standard formula.[129]

As the word "close" suggests, this is a narrow definition. In short, close-family means spouse/cohabitee and minor children. Minor grandchildren are not included.

Although not the statutory usage, I prefer to write "close-family" with a hyphen, to highlight the artificially defined nature of the term.

61.27.2 *2017/18: "Close-family"*

Section 731(1B)(b) ITA provides a fourth definition:

> a person is a close member of the family of the settlor of a settlement if the person is—

[128] The s.643A/s.731 equivalent definitions are in s.643H ITTOIA/s.733A(7) ITA. (For completeness: The original drafting of s.733A(7) was different, but it was amended in 2018 with retrospective effect from 2017/18 to bring it into line. This sort of mess is to be expected from the decision to bring the s.731 provisions into effect a year before the s.624A and CGT provisions. But this is now of historical interest only.)

[129] See App 3.4.1 (Cohabitee treated as spouse).

(i) the settlor's spouse or civil partner,[130] or
(ii) a child of the settlor, or of a person within sub-paragraph (i), if the child has not reached the age of 18;

That has not been amended so it remains in its original form. What a mess!

61.28 Settlor-attribution indemnity

Section 87G(3) TCGA provides:

> Where any tax is chargeable on the settlor as a result of subsection (2) and is paid, the settlor is entitled to recover the full amount of the tax from the original recipient.[131]

This is a common feature of all 3 close-family rules, and I refer to it as the **"settlor-attribution indemnity"**.

Tax charge under	**Indemnity**
s.643A settlor-attribution	s.643E ITTOIA
s.87 settlor-attribution	s.87G(4) TCGA
s.87 settlor-attribution	s.87L(5) TCGA
s.731 settlor-attribution	s.733A(5) ITA
s.731 settlor-attribution	s.733E(5) ITA

For a general discussion see 101.1 (Statutory tax indemnities).

The indemnity is from the beneficiary to the settlor (not from the trustees). That is right, as an indemnity from the trustees would not have been convenient.

Bearing in mind the limited scope of the settlor-attribution rules, the settlor-attribution indemnity is not important, except in cases of divorce or separation.

The settlor indemnity under the settlor-interested trust code is more sophisticated, dealing with the issues of (1) repayment of tax and (2) the quantum of tax.[132] It is suggested that similar rules ought to be implied for the settlor-attribution indemnities.

[130] The concluding words of s.731(1B(b) ITA are: "and section 733A(7) (persons living together) applies also for the purposes of paragraph (b)." That is a slip for s.733A(8), which extends para (a) to cohabitees, using the standard formula: see App 3.4.1 (Cohabitee treated as spouse).

[131] Section 87G(4) TCGA provides for HMRC to certify the amount of tax paid, in the standard form. See 101.2.1 (Certificate of tax paid).

[132] See 101.1 (Statutory tax indemnities).

61.29 s.87 settlor-attribution rule

61.29.1 *s.87 attribution rule: Outline*

Section 87G TCGA introduces what I call the **"s.87 settlor-attribution rule"**. This is one of a set of three rules which I call s.731/s.643A/s.87 settlor-attribution rules; see 50.4.11 (Settlor-attribution rules: Introduction).

In outline, a capital payment to close-family of the settlor is attributed to the settlor (if UK resident).

This will generally apply where the settlor and close-family beneficiary are both UK resident, but then the only effect is likely to be loss of the CGT annual exemption, and lower rate of CGT, which is not that significant.

This will also apply where the close-family beneficiary is non-resident, but the settlor is resident. Then what would be a non-chargeable benefit becomes chargeable, which could be important. However it will be rare to have a UK resident settlor and non-resident close-family, and even then, the remittance basis will often avoid the charge.

61.29.2 *s.87 attribution conditions*

Section 87G(1) TCGA provides:

> Subsection (2) applies if in the case of a settlement-

A set of three straightforward conditions then follow, which I call **"s.87 attribution conditions"**:

> (a) a beneficiary of the settlement receives a capital payment from the trustees in a tax year,
> (b) the settlor is resident in[133] the UK at any time in that year, and
> (c) the beneficiary ("the original recipient") is a close member of the settlor's family (see section 87H) at the time of receipt.

61.29.3 *s.87 settor-attribution rule*

Assuming the s.87 attribution conditions are met, we move on to the rule. Section 87G(2) TCGA provides:

> Sections 87 and 87A have effect as if the capital payment-
> (a) was received from the trustees by the settlor-

[133] The correct expression for residence of individuals is resident *for* the year; but it does not matter.

(i) as a beneficiary of the settlement (whether or not the settlor is otherwise a beneficiary of the settlement),[134] and

(ii) at the time it was received by the original recipient, and

(b) was not received by the original recipient.

I refer to this as the **"s.87 settlor-attribution rule"**.

The remittance basis will apply to a settlor who is a remittance basis taxpayer.

61.29.4 *Settlor-attribution/start date*

Para 1(13) sch 10 FA 2018 provides:

> The new sections ... 87G [s.87 settlor-attribution rule], and the amendments made by subparagraphs (4) and (11), have effect in relation to payments received in the tax year 2018-19 or a later tax year

A pre-2018 capital payment is not caught, even if matched with a post-2018 trust gain.

61.29.5 *s.87/IT attribution compared*

The s.87 attribution rule is unlike the s.643A/s.731 attribution rules in two important respects:

(1) The CGT rule applies to all trust gains; the s.643A/s.731 rules only apply in relation to protected income

(2) The s.87 settlor-attribution rule applies even if the close-family individual who received the benefit is UK resident and so could have been chargeable. The s.643A/s.731 settlor-attribution rule applies only if the beneficiary is not UK resident, or non-dom, and so not chargeable. In other words, for s.643A/s.731, the settlor is the fall-back taxpayer if the beneficiary is not taxable.

61.30 Onward-gifts: Introduction

The onward-gift rules[135] were introduced in 2018.

HM Treasury say:

> The government is aware that if payments are made from a trust
>
> [1] to a beneficiary who is not a close family member [ie not close-family of the settlor] and who is not UK-resident, or

[134] Para (i) is otiose; see 61.14 (Payment to non-beneficiary); but it does no harm.

[135] A note on terminology: The statutory term is "onward gifts". Consultation documents used the term "recycling" but the statutory term is better.

> [2] to a beneficiary who is a remittance basis user,
> the recipient could agree to hold the money for a period of time before giving or lending it back to a beneficiary in the UK. This would allow the UK-resident beneficiary to receive payments from the trust without paying any UK tax on the distribution.
> The government is concerned that this relatively straightforward tax planning could increase significantly once the new non-dom rules have been implemented...
> The government will take steps to ensure that, where payments are made from a trust to a nonresident or to a remittance basis user who gives or lends it back to a beneficiary in the UK ... the payment from the trust will be taxed on the UK-resident beneficiary.[136]

In fact this planning was not straightforward. Even before 2018 there were anti-conduit rules. For s.87, the arrangement could be caught as an indirect receipt;[137] for s.731 it could be caught as an associated operation.[138] Those provisions will still need to be considered in cases where the onward-gift rules do not apply. The overlap of those rules and the onward-gift rules may also be problematic, but perhaps no-one will worry about that.

Onward gifts also raise trust law issues which I only mention briefly. Trustees must exercise their powers in the interests of beneficiaries, not with a view to benefiting non-beneficiaries. If there is an arrangement under which:

(1) Trustees make a distribution to a beneficiary
(2) The beneficiary gives the distribution to a donee who is a non-beneficiary

then the distribution is in principle void under the proper purpose rule. But if the donee is also a beneficiary, this difficulty does not arise.

It is melancholic to compare the concept expressed in a few lines with the pages of dense legislation which implement it. Clumsy drafting adds to the complexity.

[136] Reforms to the taxation of non-domiciles: response to further consultation (2016) para 2.3.5.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574450/non_doms_consultation_response_final.pdf
Draft clauses were published Sept 2017, but that is now of historical interest only; *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/644270/settlements_draft_legislation.pdf*

[137] See 61.8.1 (Indirect receipt from trust).

[138] See 50.13.1 (B1 gives benefit to B2).

There are three sets of onward-gift rules, as follows:

Sections	**Name of rule (my term)**	**(Name sometimes used)**
s.87I -87M TCGA	s.87 onward-gift rule	(CGT onward-gift rule)
s.643I - 643N ITTOIA	s.643A onward-gift rule	
s.733B- 733E ITA	s.731 onward-gift rule	(ToA onward-gift rule)

These uniform labels conveniently indicate a common template, but they also conceal significant differences in the scope of the rules. It would have been better if the wording of the onward-gift rules had been more closely aligned, but there it is.

The repetition does make it harder to write a comprehensible exposition. The reader does not want to read the same discussion three times or more. But cross referencing is also inconvenient. There is no solution to this. Sometimes I repeat material, and sometimes I cross reference to where an identically worded provision is discussed in more detail.

Similar issues arise for IHT, where the arrangement is called "channelling"; this is addressed by the IHT associated operation rule.[139]

61.30.1 *Navigation*

There is a rough template which s.643A/s.731 mostly follow, and CGT sometimes follows:

Topic	**ITTOIA**	**ITA**	**TCGA**
Onward gift conditions	643I	733B	87I
s.643A/731 chargeable income arising to donee	643J	733C	-
s.643A/731 non-chargeable income arising to donee	643K	733D	-
[CGT] Relevant parts of payment from which onward gift derived	-	-	87J
[CGT] Attribution of s.87 gains/capital payments to donee	-	-	87K
Beneficiary exempt, settlor chargeable	643L	733E	87L
Onward gift to settlor/close-family	643M	-	-
Onward-gift remittance basis	643N	-	87M

The gateway requirements for the onward-gift rules ("onward-gift conditions") are in subsection (1) of s.87I/s.643I/s.733B. They can be tabulated as follows:

s.87 onward-gift	**s.643A/s.731 onward-gift**
s.87I(1) TCGA	*s.643I(1)/s.733B(1)*
(a) Payment to donor	(a) s.643A/s.731 income
	(b) Matched with benefit/to protected income

[139] See 74.16.1 (Channelling).

(b) Intention to give	(c) Intention to give
(c) Gift & time limit	(d) Gift & time limit
(d) Gift from cap. payment	(e) Gift from benefit
(e) Donee UK resident	
(f) Donor s.87-exempt	(f)(g) Donor outside close-family rule/ s.731
	643I(1)(h) Donee settlor/close family

61.30.2 *Onward-gift terminology*

The 3 onward-gift rules share some common terminology. Although it is normally best to adopt statutory terminology, I add a gloss for clarity:

Statutory term	***Term in this book***
Original beneficiary	Original beneficiary [donor]
Subsequent recipient	Subsequent recipient [donee]
Otherwise-liable person	Otherwise-liable person [donor/settlor]
Original payment	Original [capital] payment
Onward payment	Onward payment [gift]
Payment year	[Capital] payment year

61.30.3 *Compliance*

If a donor benefits a UK resident, the donee needs to consider if the donor derived the property from which the benefit is provided from an offshore trust, within the last 3 years.

The donee may not be a beneficiary of the trust, and so not entitled to the information needed to complete their tax return, which will largely (not entirely) be in the knowledge of the trustees. But if HMRC assess, the onus would be on the donee to show that the assessment is wrong.

61.31 s.87 onward-gift conditions

Section 87I(1) TCGA provides:

> Sections 87J and 87K apply if in the case of a settlement...

A set of 6 conditions then follow, which I call **"s.87 onward-gift conditions"**.

61.31.1 *Cond. (a): Payment to donor*

Section 87I(1) TCGA provides:

> Sections 87J and 87K apply if in the case of a settlement...
> (a) a capital payment ("the original [capital] payment") is received in a tax year ("the [capital] payment year") by a person ("the

original beneficiary" [donor]) from the trustees of the settlement

61.31.2 *Cond. (b): Intention to give*

Section 87I(1) TCGA provides:

> Sections 87J and 87K apply if in the case of a settlement...
> (b) at the time of receipt—
> (i) there are arrangements,[140] or there is an intention, as regards the (direct or indirect) passing-on of the whole or part of the original [capital] payment, and
> (ii) it is reasonable to expect[141] that, in the event of the whole or part of the original [capital] payment being passed on to another person as envisaged by the arrangements or intention, that other person will be resident in the UK when they receive at least part of what is passed on to them

The intention must be the intention of the donor, as no-one else is capable of making the onward payment (gift).

"Arrangement or intention" is a novel expression. It is difficult to envisage an arrangement without the intention, or an intention without the arrangement, since "arrangement" itself has an element of volition; it requires some sort of plan.[142] The reader may think this is slovenly drafting; but it does not matter.

It is suggested that making a will does not count as intention or arrangements, unless made specifically in order to deal with the capital payment.

Section 87I(8) TCGA provides a presumption as to intention:

> Where subsection (1)(c) and (d) are met in any case [gift made out of capital payment], it is to be presumed (unless the contrary is shown) that subsection (1)(b) [intention to give] is also met in that case.[143]

But this presumption is of little if any significance, as in a tax appeal the onus of proof is already on the taxpayer.[144]

[140] There is the standard (unnecessary) definition in s.87I(7) TCGA, s.643(7) ITTOIA, and s.733B(7) ITA; see App 2.2.3 (Definitions of "arrangement").

[141] See App 2.24 (Reasonable-to-assume).

[142] See App.2.2 (Arrangement).

[143] The IT equivalents are: s.643I(6), s.643M(5) ITTOIA/s.733B(6) ITA.

[144] See 6.36 (Residence: Burden of proof). And in any event, disputes are rarely decided by the burden of proof: see 4.7.3 (Standard of proof).

"Pass on" is layman's language. The professional bodies say:[145]

> **Example 5 "passing on"**
> The trustees of a settlement, established for primarily IHT planning reasons, de-envelope a valuable UK residential property and bring the settlement to an end by distributing the assets to the non UK resident and domiciled settlor.
> There is no income in the structure.[146]
> The settlement is brought to an end because the initial advice to envelope and settle is no longer considered appropriate...[147]
> At the time of the distribution of the UK property the settlor planned to retain the property and use it as a base when in the UK.
> However, he also intended to allow his two UK resident adult daughters to occupy the property.
> [1] He grants them a licence (non-exclusive, so the father can still occupy as before) when both were studying at UK universities.
> [2] Subsequently one daughter returned home [ie, ceased to occupy the property] and the other was given an assured shorthold tenancy in the property at a low rent.[148]
> The licence is gratuitous, non-exclusive and revocable at any time.
> The tenancy is exclusive and may run on from year to year.
> Both the licence and the tenancy are granted less than three years after the distribution.

The professional bodies' analysis is as follows:

> There has to be an arrangement or intention as regards the passing on of the whole or part of original property (i.e. something contained in the bundle of rights that father obtained when he replaced the trustees as the absolute owner of the land) in order for the onward gift rules to apply...
> [1] In the case of the licence the father has nothing less than he originally had, namely the same bundle of rights in relation to the same property and this should not, therefore, be seen as coming within the legislation as no part of the original trust distribution has

[145] I have slightly altered the text of the example, for clarity.

[146] This fact is not relevant to the example, though it may make the benefit subject to IT rather than CGT.

[147] This fact is not relevant to the example.

[148] This seems odd for the father to grant his daughter a lease; but that does not spoil the fact of the example. The example has to specify that rent is under market rent, otherwise there is no passing-on, no benefit and no charge. If the rent is low enough, the tenancy is not an assured shorthold tenancy but nothing turns on that.

been "passed on".

[2] In the case of the tenancy given to the daughter she is given an interest in the property. The father's rights have diminished (to what extent depends on the length of the tenancy). As such there has been a "passing-on" of part of the distribution received by the father and the onward gift rules would be engaged.[149]

Point [1] is a somewhat literal reading.

A similar question may arise with loans. Suppose:

(1) A trust has lent money interest free, repayable on demand to a UK beneficiary (B1).
(2) The trust transfers the debt to a non-resident beneficiary (B2)
(3) B2 leaves the loan outstanding.

Has B2 passed on part of the original capital payment? The professional bodies would say nothing has been passed on. But the reader may think the section should be construed less literally, particularly bearing in mind that "gift" is widely defined, to include any benefit.

61.31.3 *Condition (c): Gift*

Section 87I(1) TCGA provides:

> Sections 87J and 87K apply if in the case of a settlement...
> (c) the original beneficiary [donor] makes, directly or indirectly, a gift ("the onward payment") to a person ("the subsequent recipient" [donee])-
> (i) [A] at the time the original [capital] payment is received,
> [B] or at any later time in the 3 years beginning with the day containing the start time, or
> (ii) at any time before the original [capital] payment is received and, it is reasonable to assume, in anticipation of receipt of the original [capital] payment

There are two rules here:
(1) the original beneficiary (donor) makes a gift directly or indirectly to a subsequent recipient (donee); and
(2) a time limit for that gift.

[149] "Finance Act 2018 Section 35 and sch 10 Settlements: Anti-avoidance Notes on practical points and areas of uncertainty" (Mar 2019) *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2019/taxguide-03-19-fa-2018-section-35.ashx*

Statute frequently refers to an onward payment (gift) "made as mentioned in s.87I(1)(c)(ii)". I refer to such a gift as a **"pre-capital payment gift"**. Section 87I(7) TCGA provides a wide definition of making a gift:

> In this section[150] ...
> "gift" includes any benefit, and
> "make", in relation to a gift that is a benefit, means confer.[151]

An arm's length transaction is not an onward payment (gift).

61.31.4 *Gift via trust*

Suppose:

(1) A capital payment to B1, a non-resident /remittance basis taxpayer.
(2) B1 transfers the benefit to a trust.
(3) The trustees benefit B2, a UK resident, within the 3 year time limit.

This raises two issues:

(1) Is s.87 onward-gift condition (b) met: in short, is there an arrangement/intention for passing on the benefit to a UK resident? It is a question of fact, but note that arrangement is a wide word, and includes arrangements which develop or take place over a period of time, as long as they have "sufficient unity".[152]
(2) Is s.87 onward-gift condition (c) met: in short, does B1 make a gift indirectly to B2? Similar wording is used elsewhere in s.87, and the question (in short) is whether there is a plan which is fulfilled.[153] So it overlaps with point (1) and is again a question of fact; but if in practice payments were made in and out of a trust, within a relatively short time, it may not be easy to convince a tribunal that there was no plan. But unless the trust is UK resident, the series of gifts rule will deem condition (c) to be satisfied in any event.[154]

61.31.5 *Onward gift time limit*

There is no time limit for the period between a pre-capital payment gift and the capital payment.

[150] This is only a section-wide definition, but it is incorporated by reference in s.87M(6) TCGA.
[151] The IT equivalents are: s.643I(7), 641M(8) ITTOIA; s.733B(7) ITA.
[152] See App 2.2.4 (Identifying the arrangement).
[153] See 61.8.1 (Indirect receipt from trust).
[154] See 61.36 (Series of gifts: A to B to C).

Otherwise, the requirement is that the original beneficiary (donor) must make the gift to the subsequent recipient (donee) within 3 years of the "start time".

In outline, there are 2 possible start times:

Para	***Circumstances***	***Start time***
87I(3)(a)	Direct gift	When benefit provided to donor
87I(3)(b)	Chain of gifts	Time of first gift

The start times are best read side by side; s.87I(3) TCGA provides:

> For the purposes of subsections (1)(c)(i) and (2)(b)(i)[155]—

(a) if the original [capital] payment is a capital payment other than one that is treated as received by section 87M, [For s.87M, see 61.35 (Donee remittance basis user)]	(b) if the original payment is a capital payment that is treated as received by [i] section 87M in connection with the operation of this section, and [ii] sections 87J and 87K, on a previous occasion,
"the start time" is the time the original payment is received	"the start time" is the time given by this subsection as the start time on that occasion

I do not understand para (b).

61.31.6 *Cond. (d): Gift from capital payment*

Section 87I(1) TCGA provides:

> Sections 87J and 87K apply if in the case of a settlement...
>
> (d) the gift is of or includes-
>
> (i) the whole or part of the original [capital] payment,
>
> (ii) anything that (wholly or in part, and directly or indirectly) derives from, or represents,[156] the whole or part of the original [capital] payment, or
>
> (iii) any other property, but only if the original [capital] payment is made with a view to enabling or facilitating,[157] or

[155] See 61.36 (Series of gifts: A to B to C).

[156] See App.2.9 ('Representing' assets).

[157] The wording draws on s.103 FA 1986; see 80.12.6 (s.103(2) exceptions to s.103(1)(b)); but the drafter sought to widen it with the addition of "otherwise in connection with".

> otherwise in connection with, the making of the gift of the property to the subsequent recipient [donee]

If a capital payment is made to a company held by the donor, the shares are not derived from the capital payment but they might represent the capital payment.[158]

The donor may wish to segregate the original [capital] payment, in order to avoid making gifts out of it for 3 years. (If the capital payment is mixed with other funds, it would be necessary to apply the non-statutory mixed fund rules.[159])

That prevents a gift falling within (i)(ii), but para (iii) would still need consideration.

61.31.7 *Cond. (e): Donee UK resident*

Section 87I(1) TCGA provides:

> Sections 87J and 87K apply if in the case of a settlement...
> (e) the subsequent recipient [donee] is resident in the UK in the tax year in which the onward payment [gift] is received by the subsequent recipient ...[160]

61.31.8 *Cond. (f): Donor s.87-exempt*

Section 87I(1) TCGA provides:

> Sections 87J and 87K apply if in the case of a settlement...
> (f) in the period beginning with the start of the [capital] payment year and ending with the end of the gift year[161], there is at least one tax year-
> (i) for which the otherwise-liable person [donor/settlor] is not resident in the UK, or
> (ii) for which section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the otherwise-liable person [donor/settlor].

Section 87I(7) TCGA provides:

> In this section[162] ...

[158] See App 2.9.6 (Do shares represent co assets).

[159] See App 2.10 (Withdrawal from mixed fund).

[160] The words omitted here define “gift year”; see 61.32.3 (“Gift” year).

[161] See 61.32.3 (“Gift” year).

[162] This is only a section-wide definition, but it is incorporated by reference elsewhere: s.87M(6) TCGA.

> "the otherwise-liable person"
> [i] means the original beneficiary [donor]
> [ii] unless section 87G(2)[163] applies in relation to the original [capital] payment in which event the settlor is "the otherwise-liable person".

"Otherwise-liable person" is a clumsy expression, but it is transparent, and difficult to think of better.

61.31.9 *Time of pre-cap. payment gift*

Section 87I(4) TCGA provides:

> Where the onward payment [gift] is made as mentioned in subsection (1)(c)(ii) [pre-capital payment gift], the onward payment is to be treated—
> (a) for the purposes of the provisions of this section following subsection (1)(c), and
> (b) for the purposes of sections 87K to 87M,
> as made and received immediately after the original [capital] payment is received (and in the [capital] payment year).

The point is repeated (unnecessarily) in s.87M(6) TCGA:

> Section 87I(4) and (7) (interpretation of references to gifts and their making) apply also for the purposes of subsections (3) and (4) of this section.

61.31.10 *Several gifts in gift year*

Section 87I(5) TCGA provides:

> Where this section provides for section 87K to apply in relation to two or more gifts received from the original beneficiary [donor] in the gift year[164] by reference to the original [capital] payment—
> (a) treat that section as applying in relation to a single gift equal in amount to the total of the amount or value of each of the gifts (and as not applying in relation to each gift separately), and
> (b) apportion between the gifts (in proportion to their amounts or values)—
> (i) any capital payments given by section 87K(2),[165] and

[163] See 61.29 (s.87 settlor-attribution rule).

[164] See 61.32.3 ("Gift" year).

[165] See 61.33.1 (OG deemed capital payment).

> (ii) any gains given by section 87K(3),[166]
>
> as a result of applying section 87K in accordance with paragraph (a).

This would apply in the (somewhat contrived) case where a donor makes pre- and post-capital payment gifts.[167]

61.31.11 *Gift from pre-2018 original payment*

Para 1(14) sch 10 FA 2018 provides:

> The new sections 87I to 87M have effect in relation to onward payments [gifts] made on or after 6 April 2018, and do so even in cases where the original [capital] payment is received before that date.

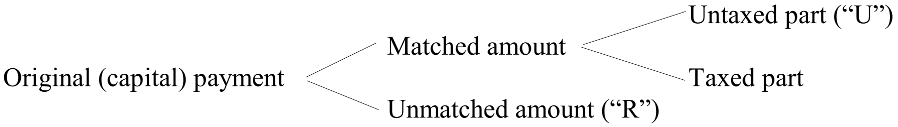
This rule will effectively cease to matter in April 2021.

61.32 s.87 onward-gift definitions

Assuming the s.87 onward-gift conditions are met, we move on. First it is helpful to set out some definitions.

61.32.1 *U, R, G*

The original (capital) payment is divided into two amounts (matched and unmatched) and the matched amount is divided into two parts, taxed and untaxed. Diagrammatically:



In full detail, s.87J(1) TCGA provides:

> Where this section applies (see section 87I) [s.87 onward-gift conditions are met], for the purposes of section 87K treat the original [capital] payment as divided into slices as follows-
>
> (a) a slice consisting of the taxed part (if any) of each matched amount (if any),
>
> (b) a slice ("U") consisting of the untaxed part (if any) of each matched amount (if any), and
>
> (c) a slice ("R") consisting of the rest (if any) of the original [capital] payment.

U stands for the **U**ntaxed part. R is presumably the **R**emaining amount (ie

[166] See 61.33.2 (OG deemed s.87 gain).

[167] See 61.31.3 (Condition (c): Gift).

the unmatched amount, but the abbreviation U had already been taken).

G is the **G**ift. Section 87K(1) TCGA provides:

> Where this section applies (see section 87I) [s.87 onward-gift conditions are met], G is—
>
> (a) the amount or value of so much of the original [capital] payment as is within any of sub-paragraphs (i) to (iii) of section 87I(1)(d) [gifted capital payment], or
>
> (b) if lower, the amount of the original [capital] payment.

61.32.2 *"Matching year"*

The "matching year" is the year in which the original (capital) payment is matched. The relevant part of s.87J(2) provides:

> if all or part of the original [capital] payment is, in a tax year ("the matching year") ... matched under section 87A with the section 1(3) amount for the matching year or any earlier tax year ...[168]

61.32.3 *"Gift year"*

The "gift year" is (in general) the tax year in which the onward payment [gift] is made. The relevant part of s.87I(1)(e) provides:

> the tax year in which the onward payment [gift] is received by the subsequent recipient ("the gift year", but see subsection (4))[169]

61.32.4 *"Matched amount"*

Section 87J(2) TCGA provides:

> For the purposes of this section, if all or part of the original [capital] payment is, in a tax year ("the matching year") not later than the gift year, matched under section 87A with the section 1(3) amount for the matching year or any earlier tax year, so much of the original [capital] payment as is so matched is a "matched amount".

61.32.5 *Taxed/untaxed parts of matched amount*

It is easier to follow if the two parts of the definition are read side by side. Section 87J(3)(4) TCGA provides:

[168] For the full text of this para, see 61.32.4 ("Matched amount").

[169] For the full text of this para, see 61.31.7 (Condition (e): Donee UK resident). For subsection (4), see 61.31.9 (Time of pre-cap. payment gift).

Donor/settlor on arising basis	**Donor/settlor on remittance basis**
(3) For the purposes of subsection (1), if—	(4) For the purposes of subsection (1), if—
(a) as a result of there being a matched amount, gains are treated by section 87 as accruing to the otherwise-liable person [donor/settlor], (b) the otherwise-liable person [donor/settlor] is resident in the UK for the matching year, and	(a) [identical]
(c) none of sections 809B, 809D and 809E of ITA 2007 applies to the otherwise-liable person	(b) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the otherwise-liable person
[donor/settlor] for the matching year	[donor/settlor] for the matching year, and (c) the whole or part of those gains is remitted to the UK in a tax year— (i) that is not later than the gift year[170], and (ii) in which the otherwise-liable person [donor/settlor] is resident in the UK,
[I] the whole of the matched amount is its "taxed part"	[I] so much of the matched amount as is equal to so much of the gains as is remitted as mentioned in paragraph (c) is the matched amount's "taxed part",
[II] (and it has no "untaxed part").	[II] and the rest of the matched amount is its "untaxed part".

Section 87J(5) TCGA deals with the specialist case of sch 4C pools:

> For the purposes of subsection (1), if all or part of the original [capital] payment is in a tax year ("the pool-matching year") not later than the gift year matched, under section 87A as applied by paragraph 8 of

[170] See 61.32.3 ("Gift" year).

> Schedule 4C, with the section 1(3) amount in the Schedule 4C pool for the pool-matching year or any earlier tax year—
> (a) so much of the original [capital] payment as is so matched is a "matched amount", and
> (b) the whole of the matched amount is its "taxed part" (and it has no "untaxed part").

61.32.6 *s.87K application in later year*

Section 87I(6) TCGA provides:

> Where this section provides for sections 87J and 87K to apply in relation to a gift received in a tax year—
> (a) take the steps required by section 87J before applying section 87K in relation to the gift, but
> (b) in taking the steps required by section 87J, have regard to the application of section 87K in relation to gifts made in earlier tax years.

61.33 s.87 onward-gift rule

Armed with these definitions, and assuming the s.87 onward-gift conditions are satisfied, we turn to the rules in s.87K TCGA. In short:

Condition	**Consequence**	**Amount**	**Provision**
R>0 (unmatched amount)	Deemed cap payment	Smaller of R and G	s.87K(2)
U>0 (untaxed matched amount)	Deemed s.87 gain	Smaller of U and (G-R)	s.87K(3)

61.33.1 *OG deemed capital payment*

Section 87K(2) TCGA provides:

> If R is greater than nil, sections 87 and 87A have effect for the gift year[171] and later tax years-
> (a) as if a capital payment was received from the trustees by the subsequent recipient [donee]-
> (i) as a beneficiary of the settlement (whether or not the subsequent recipient is otherwise a beneficiary of the settlement),[172] and
> (ii) at the time the subsequent recipient received the onward payment [gift],

[171] See 61.32.3 ("Gift" year).

[172] The wording at para (a) matches s.87D(2) TCGA. It is otiose but it does no harm: see 61.29 (s.87 settlor-attribution rule).

> (b) as if that capital payment consisted of-
> (i) R, if G is greater than R, or
> (ii) so much of R as is equal to G, if G is not greater than R, and

I refer to this as a **"OG deemed capital payment"**.

Para (c) provides relief for the donor:

> (c) as if so much of the original [capital] payment as is equal to that capital payment was not received by the otherwise-liable person [donor/settlor].

61.33.2 *OG deemed s.87 gain*

Section 87K(3) TCGA provides:

> If G is greater than R, and if U is greater than nil-
> (a) chargeable gains are treated as accruing to the subsequent recipient [donee] in the gift year[173] (but see section 87L(3) and (4)),
> (b) the amount of those gains is-
> (i) U, if (G – R) is greater than U, or
> (ii) so much of U as is equal to (G – R) , if (G – R) is not greater than U

I refer to this as a **"OG deemed s.87 gain"**.

Para (c) provides relief for the donor:

> (c) the chargeable gains treated by section 87 as accruing to the otherwise-liable person [donor/settlor] by reason of the original [capital] payment are treated as from the end of the gift year[174] as reduced by that amount, with that reduction being made from so much of those gains as has not by then been remitted to the UK in a tax year in which the otherwise-liable person [donor] is resident in the UK.

61.33.3 *Pre-capital payment gift: R/U*

Section 87K(4) TCGA provides:

> If this section applies [s.87 onward-gift conditions are met] by reference to the original [capital] payment also in relation to a gift received from the original beneficiary [donor] in a tax year earlier than the gift year, this section applies in relation to the onward [capital] payment as if—

[173] See 61.32.3 ("Gift" year).

[174] See 61.32.3 ("Gift" year).

(a) the amount given by section 87J for R were reduced by the amount of any capital payment given by subsection (2) in relation to that earlier year, and

(b) the amount given by section 87J for U were reduced by the amount of any gains given by subsection (3) in relation to that earlier year.

61.34 Onward-gift to close-family: s.87 settlor-attribution rule

Suppose:

(1) A capital payment is made to a beneficiary (not close-family)

(2) The beneficiary makes an onward gift to close-family of the settlor

A direct capital payment to close-family is treated as made to the settlor, under the s.87 settlor-attribution rule.[175] Section 87L TCGA ensures that the same applies in the case of an onward gift to close-family. I refer to this as the **"s.87 OG settlor-attribution rule"**.

Section 87L TCGA provides distinct rules for:

(1) OG deemed capital payment[176]

(2) OG deemed s.87 gain[177]

The layout is: s.87L(1)(3) set out application conditions; s.87L(2)(4) set out the rules where those conditions are satisfied. It is easier to follow if the s.87L application conditions are read side by side. Section 87L(1)(3) TCGA provide:

OG deemed capital payment	**OG deemed s.87 gain**
(1) Subsection (2) applies where-	(3) Subsection (4) applies where-
(a) ignoring this section and section 87M [Donee remittance basis user], a person is treated by section 87K(2) as receiving a capital payment from the trustees of a settlement at a time ("the time of receipt") in a tax year,	(a) in the case of a settlement, chargeable gains are (ignoring this section and section 87M [Donee remittance basis user]) treated by section 87K(3) as accruing to a person in a tax year ("the subsequent recipient" [donee]),
(b) the settlor is resident in the UK at any time in that year, and	(b) [identical]

[175] See 61.26 (Settlor-attribution rules: Introduction).

[176] See 61.33.1 (OG deemed capital payment).

[177] See 61.33.2 (OG deemed s.87 gain).

(c) the person mentioned in paragraph (a) [the donee] is a close member of the settlor's family (see section 87H) at the time of receipt.	(c) the subsequent recipient [donee] is a close member of the settlor's family when the subsequent recipient receives the onward payment (see section 87I(1)(c)) by reference to which the chargeable gains are treated as accruing.

Assuming these conditions are satisfied, we move on to the rules.

Section 87L(2) TCGA provides the rule for an OG deemed capital payment:

> Sections 87 and 87A have effect for that year, and later tax years, as if the capital payment-
> (a) was received from the trustees by the settlor-
> (i) as a beneficiary of the settlement (whether or not the settlor is otherwise a beneficiary of the settlement),[178] and
> (ii) at the time of receipt, and
> (b) was not received by the person mentioned in subsection (1)(a) [the donee].

Section 87L(4) TCGA provides the rule for an OG deemed s.87 gain:

> [a] Section 87K(3)(a)[179] has effect as if its reference to the subsequent recipient were a reference to the settlor, and
> [b] references (however expressed) to chargeable gains treated as accruing by this section are to chargeable gains treated by section 87K(3)(a) as accruing to the settlor as a result of the operation of this subsection.

Amended as s.87L(4) directs, s.87K(3)(a) provides:

> (a) chargeable gains are treated as accruing to the ~~subsequent recipient~~ settlor in the gift year...

Section 87L(5) TCGA provides the settlor with the standard settlor-attribution indemnity.[180]

[178] The wording at para (a) matches s.87D(2) TCGA. It is otiose but it does no harm: see 61.29.3 (s.87 settor-attribution rule).

[179] See 61.33.2 (OG deemed s.87 gain).

[180] See 61.28 (Settlor-attribution indemnity).

61.35 Donee remittance basis user

Section 87M TCGA provides distinct rules for:

(1) OG deemed capital payment (s.87K(2) applies[181])

(2) OG deemed s.87 gain (s.87K(3) applies[182])

The layout is: s.87M(1)(3) set out application conditions; s.87M(2)(4) set out the rules where those conditions is satisfied.

It is easier to follow if the s.87M application conditions are read side by side. Section 87M(1)(3) TCGA provides:

OG deemed capital payment	**OG deemed s.87 gain**
(1) Subsection (2) applies where— (a) ignoring this section, a person is treated by section 87K(2) as receiving a capital payment from the trustees of a settlement at a time ("the time of receipt") in a tax year,	(3) The rules in subsection (4) apply where— (a) in the case of a settlement, chargeable gains are (ignoring this section) treated by section 87K(3), but not as a result of the operation of section 87L(4), as accruing to a person in a tax year by reference to a gift within section 87I(1)(d) made to the person,
(b) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the person for that tax year, and	(b) [identical]
(c) the payment is not treated by section 87L(2) [onward-gift to close-family] as received by the settlor.	(c) none, or part only, of the gains is remitted to the UK in that tax year.

Section 87M(2) TCGA provides the rule for an OG deemed capital payment:

> Section 87I(1)(a) has effect as if
>
> [a] the capital payment were received from the trustees by the person at the time of receipt, and
>
> [b] section 87K(2)(a) and (b) do not have effect for the purposes of

[181] See 61.33.1 (OG deemed capital payment).

[182] See 61.33.2 (OG deemed s.87 gain).

> sections 87 and 87A in the case of the payment.

Section 87M(4) TCGA provides the rule for an OG deemed s.87 gain.

> The rules are—
>
> (a) section 87I(1)(a) has effect—
>
> (i) as if a capital payment were received from the trustees by the person at the time the gift is made, and
>
> (ii) as if the capital payment were equal in amount to so much of the gains as is not remitted in the tax year mentioned in subsection (3)(a) of this section,
>
> (b) for the purposes of section 87J—
>
> (i) the whole of the capital payment is a "matched amount", and
>
> (ii) the whole of the matched amount is its "untaxed part" (and the matched amount has no "taxed part"), and
>
> (c) the amount of the gains treated by section 87K(3)(a) and (b) as accruing to the person by reference to the gift[183] is reduced by the amount of the capital payment.

The professional bodies say:

> **Subsequent recipient a remittance basis user**
>
> The capital gains tax onward gift rule applies in an odd way where the subsequent recipient is a remittance basis user.
>
> Where the payment to the original beneficiary is not matched against gains the subsequent recipient is treated under section 87K as having received a capital payment. The effect of section 87M(1) and (2) is that the subsequent recipient is not taxable on that capital payment, even if it is remitted to the UK. The only consequence is that the subsequent recipient is treated as having received a capital payment for the purposes of the conduit rules and would therefore be within the scope of the conduit rules if he or she makes a further onward gift.
>
> The position is slightly different where the subsequent recipient is treated as if chargeable gains had accrued to him or her (as a result of the payment to the original beneficiary being matched against gains but not having been taxed). In these circumstances the effect of section 87M(3) and (4) is that the subsequent recipient is taxable if the onward payment is remitted in the year of receipt but is not taxed if it is remitted to the UK in a subsequent year. Instead, the subsequent recipient is again treated as having received a capital payment for the purposes of the rules and so will be within the scope of the onward gift rules if a

[183] See 61.33.2 (OG deemed s.87 gain).

further onward payment is made.

Whether or not a subsequent recipient who is a remittance basis user is taxable therefore depends on whether he or she is treated as receiving a capital payment or whether he or she is treated as if chargeable gains have accrued to them. In the former case, he or she will not be taxable but will be capable of making a further gift within the scope of the onward gift rules. In the latter case, he or she will be taxable to the extent that the onward payment is remitted in the year it is received but not if it is remitted in a later year.

The position is similar under the transfer of assets benefits charge. If the onward gift is not remitted to the UK in the charging year, the subsequent recipient is not taxable even if he or she remits the onward payment in a later year. The subsequent recipient is however, in these circumstances, treated as the recipient of a benefit for the purposes of the onward gift rule and so any further gift he or she makes may be taxable on the ultimate recipient.

Where the original beneficiary is a remittance basis user, remittance by the subsequent recipient only leads to him being taxed if the subsequent recipient is a relevant person (as defined by ITA 2007, s 809M(2)).[184]

61.35.1 *Previous onward gift*

Section 87M(5) TCGA provides:

> Where the capital payment mentioned in section 87I(1)(a) is one treated as received by subsection (2) or (4) of this section in connection with the operation of sections 87I to 87K on a previous occasion, section 87I(1) has effect—
>
> (a) with the omission of its paragraph (b),
>
> (b) as if the reference in its paragraph (c) to the original [capital] payment were, instead, to what was the original [capital] payment on that previous occasion, and
>
> (c) as if the references in its paragraph (d) to the original [capital] payment were, instead, to so much of that original [capital] payment as was on that previous occasion within any of subparagraphs (i) to (iii) of that paragraph.

Amended as s.87M(5) directs, s.87I(1) provides:

[184] "Finance Act 2018 Section 35 and sch 10 Settlements: Anti-avoidance Notes on practical points and areas of uncertainty" (Mar 2019) *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2019/taxguide-03-19-fa-2018-section-35.ashx*

Sections 87J and 87K apply if in the case of a settlement—

(a) a capital payment ("the original payment") is received in a tax year ("the payment year") by a person ("the original beneficiary") from the trustees of the settlement,

~~(b) at the time of receipt—~~

~~(i) there are arrangements, or there is an intention, as regards the (direct or indirect) passing-on of the whole or part of the original payment, and~~

~~(ii) it is reasonable to expect that, in the event of the whole or part of the original payment being passed on to another person as envisaged by the arrangements or intention, that other person will be resident in the UK when they receive at least part of what is passed on to them,~~

(c) the original beneficiary [donor] makes, directly or indirectly, a gift ("the onward payment") to a person ("the subsequent recipient")—

(i) at the time what was the original payment on the previous occasion is received, or at any later time in the 3 years beginning with the day containing the start time, or

(ii) at any time before the original payment is received and, it is reasonable to assume, in anticipation of receipt of the original payment,

(d) the gift is of or includes—

(i) the whole or part of ~~the original payment~~, so much of that original [capital] payment as was on that previous occasion within any of subparagraphs (i) to (iii) of this paragraph

(ii) anything that (wholly or in part, and directly or indirectly) derives from, or represents, the whole or part of ~~the original payment~~, so much of that original [capital] payment as was on that previous occasion within any of subparagraphs (i) to (iii) of this paragraph or

(iii) any other property, but only if ~~the original payment~~ so much of that original [capital] payment as was on that previous occasion within any of subparagraphs (i) to (iii) of this paragraph is made with a view to enabling or facilitating, or otherwise in connection with, the making of the gift of the property to the subsequent recipient,

(e) the subsequent recipient is resident in the UK in the tax year in which the onward payment is received by the subsequent recipient ("the gift year", but see subsection (4)), and

(f) in the period beginning with the start of the payment year and

> ending with the end of the gift year, there is at least one tax year—
> (i) for which the otherwise-liable person is not resident in the UK, or
> (ii) for which section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the otherwise-liable person.

61.36 Series of gifts: A to B to C

Section 87I(2) TCGA provides:

> Where-

A set of six conditions then follow, which I call **"gift-series conditions"**:

> (a) there is a series of two or more gifts,[185]
> (b) the first gift in the series is made, directly or indirectly, by the original beneficiary [donor]—
> (i)[A] at the time the original [capital] payment is received,
> [B] or at any later time in the 3 years beginning with the day containing the start time, or
> (ii) at any time before the original payment is received and, it is reasonable to assume, in anticipation of receipt of the original payment,

That is, s.87 onward-gift condition (c) is met.[186]

> (c) the recipient of a gift in the series is the person who makes, directly or indirectly, the next gift in the series,
> (d) the recipient of the last gift in the series is resident in the UK in the tax year in which that gift is received,
> (e) as regards each earlier gift in the series, its recipient is not resident in the UK at any time in the tax year in which it is received, and
> (f) the condition in subsection (1)(d) is met in relation to each gift in the series,[187]

Assuming the gift-series conditions are met, we turn to the rule:

> the last gift in the series is treated for the purposes of subsection (1)(c)[188] as if its maker were the original beneficiary [donor] (and not its actual

[185] "Gift" includes any benefit; see 61.31.3 (Condition (c): Gift).

[186] See 61.31.3 (Condition (c): Gift).

[187] See 61.31.6 (Condition (d): Gift from capital payment).

[188] See 61.31.3 (Condition (c): Gift).

maker).

Section 87I(1)(c) provides:

> Sections 87J and 87K apply if in the case of a settlement...
> (c) the original beneficiary [donor] makes, directly or indirectly, a gift ("the onward payment") to a person ("the subsequent recipient" [donee])-
> (i) [A] at the time the original [capital] payment is received, or
> [B] at any later time in the 3 years beginning with the day containing the start time, or
> (ii) at any time before the original [capital] payment is received and, it is reasonable to assume, in anticipation of receipt of the original [capital] payment

The requirement is therefore that the last gift in the series is made within 3 years of the original (capital) payment; (or is a pre-capital payment gift within para (ii)).[189]

Also see 61.31.4 (Gift via trust).

61.37 Migrant settlement

61.37.1 *UK trust becomes non-resident*

Section 89(1) TCGA provides:

> Where
> [a] a period of one or more years of assessment for which s.87 applies to a settlement ("a non-resident period") succeeds
> [b] a period of one or more years of assessment for each of which s.87 does not apply to the settlement ("a resident period"),
> a capital payment received by a beneficiary in the resident period shall be disregarded for the purposes of sections 87 and 87A if it was not made in anticipation of a disposal made by the trustees in the non-resident period.

61.37.2 *Offshore trust comes to UK*

Section 89 TCGA provides:

[189] The professional bodies agree: see "Finance Act 2018 Section 35 and sch 10 Settlements: Anti-avoidance Notes on practical points and areas of uncertainty" (Mar 2019) *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2019/taxguide-03-19-fa-2018-section-35.ashx*

> (1A) Subsection (2) applies to a settlement if—
>
> (a) a non-resident period is succeeded by a resident period, and
>
> (b) in relation to the last tax year in the non-resident period ("the last non-resident tax year"), s.87A(3) applied by virtue of para (a) of that provision (exhaustion of capital payments).[190]
>
> (2) Chargeable gains are treated as accruing in a tax year (in the resident period) to a beneficiary of the settlement who receives a capital payment from the trustees in that year if all or part of the capital payment is matched (under s.87A as it applies for that year) with the s.1(3) amount for the last non-resident tax year or any earlier tax year.
>
> (3) Section 87(3) and (4) and ss.87A to 87C apply for the purposes of subsection (2) as if the relevant tax year were the tax year mentioned in subsection (2).
>
> (4) Section 87B (remittance basis) applies in relation to chargeable gains treated under subsection (2) as accruing as it applies in relation to chargeable gains treated under s.87 as accruing.

61.38 Dual-Resident trust: s.88 TCGA

Section 88 TCGA applies to a trust where:

(1) The trust is:
   (a) UK tax-resident (ie UK resident under UK law); and
   (b) Treaty-resident in a foreign State (under the tie-breaker)

(2) The relevant DTA has an article conferring CGT relief

The heading to s.88 is "dual resident" trusts, and it is convenient to use that term to describe trusts which fall within s.88, though I use initial capitals as it is an artificial use of the term which would naturally be used with a somewhat wider meaning;[191]

A Dual-Resident trust is not subject to CGT (so far as the DTA provides exemption) but would not be within s.87.[192] This gap is filled by s.88(1) TCGA:

> Section 87 also applies to a settlement for any year of assessment beginning on or after 6th April 1991 if—
>
> (a) the trustees are resident in the UK during any part of the year, and
>
> (b) at any time of such residence they fall to be regarded for the

[190] See 61.15.3 (When to stop).

[191] On the terminology see 107.7 (Types of residence).

[192] See 61.4 (Non-resident settlement condition).

> purposes of any double taxation relief arrangements[193] as resident in a territory outside the UK.

There is also a special exit charge for Dual-Resident trusts; see 12.6 (Treaty-emigration of trust).

61.38.1 *Revised s.1(3) amount*

The usual definition of s.1(3) amount (trust gains) would not work for a Dual-Resident trust, so s.88(2) TCGA amends it:

> The section 1(3) amount for a tax year for which section 87 applies by virtue of this section is what it would be if the amount mentioned in section 87(4)(a) were the assumed chargeable amount.

Amended as s.88(2) directs, s.87(4) provides:

> The section 1(3) amount for a settlement for a tax year for which this section applies to the settlement is—
> (a) ~~the amount upon which the trustees of the settlement would be chargeable to tax under section 1(3) for that year if they were resident and ordinarily resident in the UK in that year~~ the assumed chargeable amount, or
> (b) if section 86 applies to the settlement for that year, the amount mentioned in paragraph (a) minus the total amount of chargeable gains treated under that section as accruing in that year.

The term "assumed chargeable amount" is defined in s.88(3) TCGA:

> For the purposes of subsection (2) above the assumed chargeable amount in respect of a year of assessment is the lesser of the following 2 amounts—

It may be helpful to read the two amounts side by side:

s.88(3)(a) TCGA	**s.88(3)(b) TCGA**
(a) the amount on which the trustees would be chargeable to tax for the year under section 1(3) on the assumption that the double taxation relief arrangements did not apply;	(b) the amount on which, by virtue of disposals of protected assets, the trustees would be chargeable to tax for the year under section 1(3) on the assumption that those arrangements did not apply.

Amount (b) will normally be smaller than amount (a) but it may be

[193] For the meaning of this term, see 12.6.1 ("DTR arrangements" for CGT).

different if there were losses.

61.38.2 *Protected assets*

Section 88 TCGA provides the definition:

> (4) For the purposes of subsection (3)(b) above assets are protected assets if—
> (a) they are of a description specified in the double taxation relief arrangements, and
> (b) were the trustees to dispose of them at any relevant time, the trustees would fall to be regarded for the purposes of the arrangements as not liable in the UK to tax on gains accruing to them on the disposal.
> (5) For the purposes of subsection (4) above—
> (a) the assumption specified in subsection (3)(b) above [that no DT relief applies] shall be ignored [ie assume DT relief does apply];
> (b) a relevant time is any time, in the year of assessment concerned, when the trustees fall to be regarded for the purposes of the arrangements as resident in a territory outside the UK;
> (c) if different assets are identified by reference to different relevant times, all of them are protected assets.

In short, "protected" assets are those whose gains are protected by a DTA. Most trust assets of a Dual-Resident trust are "protected assets;" the main exceptions being UK land and land-rich assets.[194]

61.38.3 *Underlying company of dual resident trust*

Suppose:

(1) A Dual-Resident trust (UK tax-resident, treaty non-resident) holds a company within s.3 TCGA
(2) A gain accrues to the company ("the company's gain") which is apportioned to the trustees under s.3

The company's gain is not within s.88 as it is not an assumed chargeable amount, and so not a s.1(3) amount (trust gain), and so not caught by s.88. But the trustees are subject to tax on the company's gain directly on the grounds that:

(1) The gain is attributed to the trustees under s.3
(2) The trustees (being UK resident) are taxable on the gain. They cannot

[194] See 56.23 (DT relief for capital gains).

claim DT relief for the company's gain (even if the company is resident in a jurisdiction with a UK treaty).

So it seems right that s.88 does not apply: there is no scope for avoidance here. That prevents a double charge.

61.38.4 *Planning: Avoid Dual Residence*

It is generally best to avoid Dual-Resident (ie, UK tax-resident, treaty non-resident) trusts because the tax treatment is more involved than UK resident or simple non-resident trusts:

(1) The trustees in principle pay:
    (a) CGT in the UK (so far as the treaty does not provide relief) *and*
    (b) tax in the treaty jurisdiction
(2) UK beneficiaries pay tax under s.87.

In practice such trusts mainly arise by accident.

61.39 Transfer between trusts

For trust transfers generally, see 79.1 (Inter-trust transfers: Navigation).

61.39.1 *Trust transfer: s.87 disapplied*

Suppose a trust (trust 1) transfers funds to another trust (trust 2). Section 87(2) TCGA does not apply, and trust 2 does not receive s.87 gains. No-one has ever suggested that it does. But why not, assuming of course that trust 2 is UK resident? The reason is that the trustees of trust 2 are not regarded as a beneficiary of trust 1. The word beneficiary may or may not include a trustee who has an interest under a trust which is not a beneficial interest.[195] The context must determine the issue and the context here (especially s.90 TCGA) shows that it does not.[196]

[195] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), paras 5.17 (Definition of "Beneficiaries").

[196] The drafter of s.97(8)(10) TCGA considered this to be the correct analysis, as they took special care to preserve it.

Section 97(8) TCGA provides that a non-beneficiary is treated as a beneficiary:

> "In a case where—
> (a) ... a capital payment is received from the trustees of a settlement...
> (b) it is received by a person ...
> (c) at the time it is received ... the person is not ... a beneficiary of the settlement...
> for the purposes of sections 86A to 90 ... the person shall be treated as a beneficiary of the settlement as regards events occurring at or after that time."

This might apply s.87 to an inter-trust transfer, but that is excluded by s.97(10):

61.39.2 *Trust gain transferred*

Section 90(1) TCGA provides:

> This section applies if the trustees of a settlement ("the transferor settlement") transfer all or part of the settled property to the trustees of another settlement ("the transferee settlement").

Section 90 applies on a transfer between settlements (ie between settlement-arrangements). But it has generally been accepted that two separate trusts constitute two separate arrangements, so in short, s.90 applies on a transfer between trusts.

The section only applies on a transfer of trust capital: if trustees of a discretionary trust distribute trust *income* to another trust, it is suggested that s.90 does not apply, because trust income is not "settled property".[197] There is no scope for avoidance in this view, since the transferee trust receives income which is within the scope of all the income tax anti-avoidance provisions.

Section 90(3) TCGA provides:

> Treat the s.1(3) amount for the transferee settlement for any tax year (not later than the year of transfer)[198] as increased by—
> (a) the s.1(3) amount for the transferor settlement for that year (as reduced under s.87A as it applies in relation to that settlement for the year of transfer and all earlier tax years), or
> (b) if part only of the settled property is transferred, the relevant proportion of the amount mentioned in para (a).

Section 90(5) TCGA provides corresponding relief for the transferor trust:

> Treat the s.1(3) amount for the transferor settlement for any tax year as

---

> "Subsection (8) above shall not apply so as to treat—
> (a) the trustees of the settlement referred to in that subsection, or
> (b) the trustees of any other settlement,
> as beneficiaries of the settlement referred to in that subsection."

It might alternatively be said that s.87(2) does not apply as there is no capital payment, on a transfer between trusts; but that seems a less attractive solution..

[197] This is consistent with the rule that undistributed discretionary trust income is not settled property for IHT purposes; see 87.6 (Definition of "IHT-settlement"). Though the CGT definition is not the same; see 87.3 (Settlement: Standard IT/CGT definition).

[198] Section 90(2) TCGA provides a commonsense definition: "In this section 'the year of transfer' means the tax year in which the transfer occurs."

> reduced by the amount by which the s.1(3) amount for the transferee settlement for that year is increased under subs.(3).

Section 90(7)(8) TCGA deal with timing issues:

> (7) The increase under subs.(3) has effect for the year of transfer and subsequent tax years.
> (8) The reduction under subs.(5) has effect for tax years after the year of transfer.

A loss accruing to the transferee trust cannot be set against the s.1(3) amount transferred from the transferor trust.

61.39.3 *Amount transferred*

Section 90(4) TCGA provides:

> "The relevant proportion" is—
> (a) the market value of the property transferred, divided by
> (b) the market value of the property comprised in the transferor settlement immediately before the transfer.

Gains are transferred on a proportionate basis, not LIFO or FIFO.

Section 90(9) TCGA deals with trust debts:

> When calculating the market value of property for the purposes of this section or s.90A in a case where the property is subject to a debt, reduce the market value by the amount of the debt.

61.39.4 *Transfer to UK trust*

Section 90(6) TCGA deals with a transfer to a UK resident settlement:

> If neither s.87 nor s.89(2) would otherwise apply to the transferee settlement for the year of transfer—
> (a) s.89(2) to (4) apply to the settlement for that year (and subsequent tax years), and
> (b) for this purpose, references there to the last non-resident tax year are to be read as the year of transfer.

Amended as s.90(6) directs, s.89(2) TCGA provides:

> Chargeable gains are treated as accruing in a tax year (in the resident period) to a beneficiary of the settlement who receives a capital payment from the trustees in that year if all or part of the capital payment is matched (under section 87A as it applies for that year) with the section 1(3) amount for the ~~last non-resident tax year~~ *year of transfer* or any earlier tax year.

See 61.37.2 (Offshore trust comes to UK).

61.39.5 *Transfer for consideration*

Section 90A TCGA provides:

> (1) Section 90 does not apply to a transfer of settled property made for consideration in money or money's worth if the amount (or value) of that consideration is equal to or exceeds the market value of the property transferred.
> (2) The following provisions apply if—
> (a) s.90 applies to a transfer of settled property made for consideration in money or money's worth, and
> (b) the amount (or value) of that consideration is less than the market value of the property transferred.
> (3) If the transfer is of all of the settled property, for the purposes of s.90 treat the transfer as being of part only of the settled property.
> (4) Deduct the amount (or value) of the consideration from the amount of the market value referred to in s.90(4)(a).

Section 90 does not apply to a loan from trust 1 to trust 2 on commercial terms. It does not apply to an interest-free loan repayable on demand, because the promise to repay is full consideration. For the same reason s.90 does not apply to repayment of a loan.

61.39.6 *Interaction with sch 4B*

Section 90(10) TCGA provides:

> This section does not apply to—
> (a) a transfer to which Schedule 4B applies, or
> (b) any s.1(3) amount that is in a Schedule 4C pool (see para 1 of Schedule 4C).

See 62.19 (Schedule 4C: The key condition).

61.39.7 *HMRC examples*

The s.87 guidance note provides some straightforward examples:

Example	**Transfer**	**Consideration for transfer**
14	Entire fund	None
15	Part fund	None
16	Entire fund	Market value
17	Entire fund	Less than market value
18	Part fund	Less than market value

19	Transferee trust has unmatched gains (not matched)
20	Gains of transferor trust matched first

The first example is a transfer of an entire trust fund:

Example 14 – New section 90 – All settled property transferred between settlements for nil consideration

All the settled property of the transferor settlement is transferred to the transferee settlement for nil consideration in 2008-09.

No capital payments have been made out of the transferor settlement.

The transferor settlement had the following gains made by the trustees:

2005-06	Trustees' gains (section 2(2) amount)	£20,000
2008-09	Section 2(2) amount on transfer of all settled property	£75,000

The transferee settlement acquires these unmatched section 2(2) amounts. They are added to any unmatched section 2(2) amounts it already has for the years 2005-06 and 2008-09. This applies whatever the residence status of the transferee settlement.

The unmatched section 2(2) amounts in the transferor settlement are now reduced to Nil.[199]

The next example is a transfer of part of a trust fund:

Example 15 – New section 90 – Part of settled property transferred between settlements for nil consideration

The transferor settlement's assets consist of shares with a market value of £400,000 and cash of £100,000. The shares are transferred to the transferee settlement for nil consideration in 2008-09. The cash remains in the transferor settlement.

No capital payments have been made out of the transferor settlement.

The transferor settlement has the following gains made by the trustees:

2005-06	Trustees' gains (section 2(2) amount)	£20,000
2008-09	Section 2(2) amount on transfer of shares	£75,000

It is only the 'relevant proportion' of these unmatched section 2(2) amounts that is transferred to the transferee settlement.

The relevant proportion is 4/5 (£400,000 / [£400,000 + £100,000]).

Transferee settlement

The transferee settlement acquires the following unmatched section 2(2) amounts:

2005-06	£16,000	(£20,000 × 4/5)
2008-09	£60,000	(£75,000 × 4/5)

They are added to any unmatched section 2(2) amounts it already has and can be matched with capital payments made from the transferee settlement in 2008-09 or a later year. This applies whatever the residence status of the transferee settlement.

Transferor settlement

The unmatched section 2(2) amounts of the transferor settlement are reduced by the section 2(2) amounts that have been treated as transferred to the transferee settlement. The unmatched section 2(2) amounts become:

[199] Author's footnote: But the transferor settlement has ceased to exist.

2005-06	£4,000	(£20,000 − £16,000)
2008-09	£15,000	(£75,000 − £60,000)

This reduction has effect for matching in the year after the year of transfer (2009-10) and subsequent years.

The next example is a transfer for full consideration:

Example 16 – New section 90A – All settled property transferred between settlements for consideration of market value

All the settled property of the transferor settlement is transferred to the transferee settlement in 2008-09. The transferee settlement pays market value to the transferor settlement for these assets.

No capital payments have been made out of the transferor settlement.

The transferor settlement has the following gains made by the trustees:

2005-06	Trustees' gains (section 2(2) amount)	£20,000
2008-09	Section 2(2) amount on transfer of all settled property	£75,000

These unmatched section 2(2) amounts remain in the transferor settlement and can be matched with future capital payments from that settlement. None of the unmatched section 2(2) amounts are transferred to the transferee settlement.

The next example is a transfer at an undervalue:

Example 17 – New section 90A – All settled property transferred between settlements for consideration less than market value

The transferor settlement's assets consist of shares with a market value of £400,000 and cash of £100,000. All these assets are transferred to the transferee settlement in 2008-09. The transferee settlement pays £300,000 to the transferor settlement for these assets.

No capital payments have been made out of the transferor settlement.

The transferor settlement has the following gains made by the trustees:

2005-06	Trustees' gains (section 2(2) amount)	£20,000
2008-09	Section 2(2) amount on transfer of all settled property	£75,000

The transfer is treated as if it was a transfer of part only of the settled property. This is to bring in the 'relevant proportion' rules in section 90(3) and (4) TCGA in deciding how much of the unmatched section 2(2) amounts are transferred to the transferee settlement. In calculating the 'relevant proportion' you deduct the amount paid by the transferee settlement from the 'market value of the property transferred'. The relevant proportion is 2/5 ([£400,000 + £100,000 − £300,000] / [£400,000 + £100,000]).

Transferee settlement

The transferee settlement acquires the following unmatched section 2(2) amounts:

2005-06	£8,000	(£20,000 × 2/5)
2008-09	£30,000	(£75,000 × 2/5)

They are added to any unmatched section 2(2) amounts it already has and can be matched with capital payments made from the transferee settlement in 2008-09 or a later year. This applies whatever the residence status of the transferee settlement.

Transferor settlement

The unmatched section 2(2) amounts of the transferor settlement are reduced by the section 2(2) amounts that have been treated as transferred to the transferee settlement. The unmatched section 2(2) amounts become:

2005-06	£12,000	(£20,000 – £8,000)
2008-09	£45,000	(£75,000 – £30,000)

This reduction has effect for matching in the year after the year of transfer (2009-10) and subsequent years.

Example 18 – New section 90A – Part of settled property transferred between settlements for consideration less than market value

The transferor settlement's assets consist of shares with a market value of £400,000 and cash of £100,000. The shares are transferred to the transferee settlement in 2008-09. The cash remains in the transferor settlement. The transferee settlement pays £300,000 to the transferor settlement for the shares.

No capital payments have been made out of the transferor settlement.

The transferor settlement has the following gains made by the trustees:

2005-06	Trustees' gains (section 2(2) amount)	£20,000
2008-09	Section 2(2) amount on transfer of shares	£75,000

This transfer of part of the settled property brings in the 'relevant proportion' rules in section 90(3) and (4) TCGA in deciding how much of the unmatched section 2(2) amounts are transferred to the transferee settlement. In calculating the 'relevant proportion' you deduct the amount paid by the transferee settlement from the 'market value of the property transferred'.

The relevant proportion is 1/5 ([£400,000 – £300,000] / [£400,000 + £100,000]).

Transferee settlement

The transferee settlement acquires the following unmatched section 2(2) amounts:

2005-06	£4,000	(£20,000 × 1/5)
2008-09	£15,000	(£75,000 × 1/5)

They are added to any unmatched section 2(2) amounts it already has and can be matched with capital payments made from the transferee settlement in 2008-09 or a later year. This applies whatever the residence status of the transferee settlement.

Transferor settlement

The unmatched section 2(2) amounts of the transferor settlement are reduced by the section 2(2) amounts that have been treated as transferred to the transferee settlement. The unmatched section 2(2) amounts become:

2005-06	£16,000	(£20,000 – £4,000)
2008-09	£60,000	(£75,000 – £15,000)

This reduction has effect for matching in the year after the year of transfer (2009-10) and subsequent years.

Example 19 – New section 90(7) – Unmatched section 2(2) amounts transferred on a transfer between settlements do not affect matching in earlier years in transferee settlement

All the settled property of the transferor settlement is transferred to the transferee settlement for nil consideration in 2008-09.

No capital payments have been made out of the transferor settlement.

The transferor settlement has the following gains made by the trustees:

2005-06	Trustees' gains (section 2(2) amount)	£20,000
2008-09	Section 2(2) amount on transfer of all settled property	£75,000

The transferee settlement acquires these unmatched section 2(2) amounts. They are added to any unmatched section 2(2) amounts it already has. This applies whatever the residence status of the transferee settlement.

The unmatched section 2(2) amounts in the transferor settlement are now reduced to Nil.

In its own right the transferee settlement had:

2001-02	Trustees' gains (section 2(2) amount)	£10,000
2004-05	Capital payments	£30,000
2006-07	Trustees' gains (section 2(2) amount)	£50,000

This has resulted in chargeable gains treated as accruing to the beneficiary of:

2004-05	£10,000	(Also possible increase in tax charged under section 91)
2006-07	£20,000	

There is no reworking of this matching when section 2(2) amounts are transferred from the transferor settlement. So the 2005-06 section 2(2) amount transferred in is not matched with any of the 2004-05 capital payments. The transferee settlement has unmatched section 2(2) amounts to carry forward of:

2005-06	£20,000	From transferor settlement
2006-07	£30,000	In its own right
2008-09	£75,000	From transferor settlement

Example 20 – New section 90(3) – Capital payments out of transferor settlement in year of transfer matched with section 2(2) amounts of transferor settlement for that and earlier years before calculating section 2(2) amounts transferred

The transferor settlement's assets consist of shares with a market value of £400,000 and cash of £100,000. The shares are transferred to the transferee settlement for nil consideration in 2008-09. The cash remains in the transferor settlement.

The transferor settlement has the following gains made by the trustees:

2005-06	Trustees' gains (section 2(2) amount)	£20,000
2008-09	Section 2(2) amount on transfer of shares	£75,000

The first capital payment made out of the transferor settlement is made in 2008-09. It does not matter whether the capital payment is made before or after the transfer of the shares between settlements. The capital payment is £50,000 to a beneficiary. That £50,000 capital payment is matched with £50,000 of the 2008-09 section 2(2) amount and a chargeable gain of £50,000 is treated as accruing to the beneficiary under section 87 for 2008-09. The remaining unmatched section 2(2) amount for 2008-09 is reduced to £25,000 (£75,000 − £50,000).

It is only the 'relevant proportion' of the remaining unmatched section 2(2) amounts that is transferred to the transferee settlement.

The relevant proportion is 4/5 (£400,000 / [£400,000 + £100,000]).

Transferee settlement

The transferee settlement acquires the following unmatched section 2(2) amounts:

2005-06	£16,000	(£20,000 × 4/5)
2008-09	£20,000	(£25,000 × 4/5)

They are added to any unmatched section 2(2) amounts it already has and can be matched with capital payments made from the transferee settlement in 2008-09 or a later year. This applies whatever the residence status of the transferee settlement.

Transferor settlement

The unmatched section 2(2) amounts of the transferor settlement are reduced by the section 2(2) amounts that have been treated as transferred to the transferee settlement. The unmatched section 2(2) amounts become:

2005-06	£4,000	(£20,000 – £16,000)
2008-09	£5,000	(£25,000 – £20,000)

This reduction has effect for matching in the year after the year of transfer (2009-10) and subsequent years.

61.39.8 *Trust transfers: s.87 planning*

It is interesting to compare the technique of s.81 IHTA (deeming transferred property to remain in the original trust).[200] While that is not without its problems, it is a more effective anti-avoidance rule. The reason may be that s.90 is not (or not just) an anti-avoidance provision. It is intended to facilitate inter-trust transfers. Such transfers may be desirable:

(1) for non-tax reasons, to separate the interests of different branches of a family
(2) to avoid unfairness which otherwise follows from the operation of s.87.

To illustrate the fairness point. Suppose:

(1) Trustees hold a trust fund worth £2m with s.1(3) amounts of £1m
(2) Principal beneficiaries are B1/B2, both UK resident/domiciled
(3) The trustees wish to make a capital payment of £1m to B1

If they do so directly, then a subsequent distribution to B2 would be tax free. That would not be fair as between B1 and B2.

Instead:

(1) The trustees transfer half of the trust fund to a new trust.
(2) Either the old or the new trust makes the £1m capital payment to B1.

This in principle solves this unfairness: B1 pays tax on one half of the s.1(3) amount and B2 in due course will in principle pay tax on the other half, when that fund is transferred to B2.

Take the same facts but assume that B1 or B2 is non-resident. Prior to the introduction of the non-resident disregard, HMRC were content for payments to be timed so that B1 received his or her payment first and

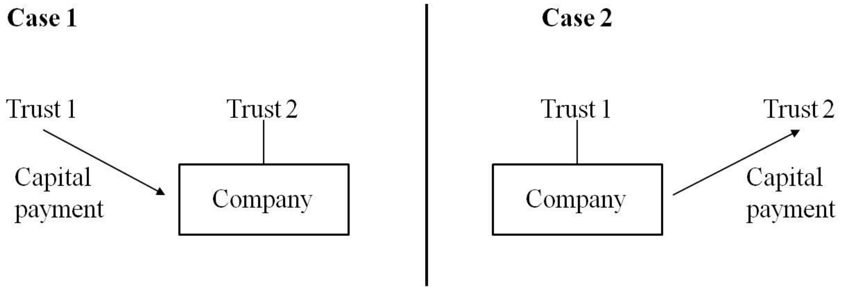
[200] See 79.10 (Same settlement fiction: s.81).

"washed" the trust gains.[201] The planning now would be to transfer a fund to a separate trust. Then make the payment to B1. A payment to the UK resident beneficiary only pays tax on half the gains. That seems a fair result. Could planning to obtain such a fair result constitute avoidance? It might be wise, at least, to arrange that the new trust is not wound up immediately after being created.

61.39.9 *Trust transfer via company*

The position is more complicated if an inter-trust transfer involves a payment from or to an underlying company.

I here consider the s.90 issues: for a list of other issues on transfers to/from companies across trusts, see 79.14 (Transfers to/from underlying co).



In case 1, there is a transfer from trust 1 to a company held by trust 2. At first sight, s.90 does not apply because it is not the case that the trustees of a trust 1 transfer *settled property* to the trustees of trust 2.

In case 2, there is a transfer from a company held by trust 1 to trust 2. At first sight, s.90 does not apply because it is not the case that the trustees of a trust 1 transfer settled property *to the trustees of trust 2*.

There might be a transfer from a company held by trust 1 to a company held by trust 2; in that case there are two independent reasons why s.90 does not apply. In these cases there is (in general) a *value shift* between trusts, but no *transfer of property* between trusts.

There is in principle a capital payment from trust 1 to trust 2. But it is difficult to say that a capital payment entails that there is deemed to be a transfer of settled property, even on a purposive construction, because the s.87C disregard and/or the general (s.87D) disregard apply.[202]

[201] See 61.57.1(Capital payment timing).

[202] See 61.13 (Payment to/from co across trusts).

Note however that there is (in general) a disposal of assets, by trust 1 (in case 1) or by the company (in case 2), on which a gain may accrue to the trust or company concerned.

Does this offer a means to avoid the application of s.90? If the issue arises in the context of a tax avoidance scheme, there is more to be said:

(1) One argument is that the trust/company structure constitutes one arrangement, and so one "settlement" for s.87 purposes. There is a transfer from one such arrangement to another.
(2) Alternatively, of course, the GAAR might apply.

Neither of those two arguments are straightforward, and both are fact sensitive; but we are fishing in murky waters.

61.40 Pre-1981 gain/capital payment

Para 116 sch 7 FA 2008 provides:

> For the purposes of sections 87 and 87A of TCGA 1992, no account is to be taken of—
> (a) any capital payment received before 10 March 1981, or
> (b) any capital payment received on or after that date but before 6 April 1984, so far as it represents a chargeable gain which accrued to the trustees before 6 April 1981.

Capital payments before 10 March 1981 are disregarded.

Capital payments before 6 April 1984 are disregarded if they represent a chargeable gain which accrued to the trustees before 6 April 1981. How does one decide whether a capital payment represents a pre-1981 gain? Presumably that is so if the capital payment is matched with a pre-1981 gain. But this question will not often arise now.

No account is taken of gains/losses before 1981/82 when the legislation was introduced.

61.41 Pre-1998 gain/capital payment

Para 118 sch 7 FA 2008 provides:

> (1) This paragraph applies if—
> (a) s.87 of TCGA 1992 applies to a settlement for the tax year 2008-09 or any subsequent tax year ("the tax year"),
> (b) the settlement was made before 17 March 1998,
> (c) none of the settlors fulfilled the residence requirements when the settlement was made, and
> (d) none of the settlors fulfils the residence requirements in the tax

> year.
> (2) For the purposes of that section as it applies to the settlement for the tax year, no account is to be taken of—
> (a) any gains or losses accruing to the trustees of the settlement before 17 March 1998, or
> (b) any capital payments received before that date.
> (3) A settlor "fulfils the residence requirements" when the settlor is—
> (a) resident or ordinarily resident in the UK, and
> (b) domiciled[203] in any part of the UK.

In principle, (inter alia) for foreign domiciled settlor settlements, one disregards gains and capital payments before 17 March 1998. But if in any year there is a UK resident and domiciled settlor, even only one of several, the relief is lost in that year. Thus, a "tainting" principle applies.[204] A small, even nominal contribution from a UK resident and domiciled settlor will forfeit the transitional relief for all years that that settlor is UK resident and domiciled.

One can envisage a case where it is better that this relief does not apply, in which case it would be possible to arrange to forfeit the relief, but this will not be common.

61.42 s.1(3) amount at 5/4/2008

The concept of s.1(3) amount[205] was introduced in the FA 2008 with effect from 2008/09. However it is necessary to compute the s.1(3) amount for earlier years in order to know what s.1(3) amount is carried forward to 2008/09 and subsequently.

Para 120 sch 7 FA 2008 provides:

> (1) This paragraph applies to a settlement if s.87 or s.89(2) of TCGA 1992 applied to it for the tax year 2007–08 or any earlier tax year.
> (2) The following steps are to be taken for the purposes of calculating the s.2(2) amount for the settlement for the tax year 2007-08 and earlier tax years.
> *Step 1*
> Calculate (in accordance with s.87 and, where appropriate, s.88) the s.2(2) amount for the settlement for the tax year 2007-08 and earlier tax years.

[203] See 61.53 (UK dom/Formerly-dom resident).

[204] See 99.6 (Tainting).

[205] It was then called a s.2(2) amount, but I use the modern reference for convenience.

> For this purpose, references in s.87(4) and (5) of TCGA 1992 (as substituted) to s.87 of that Act applying to a settlement for a tax year are to be read as references to s.87 of that Act (as it had effect before that substitution) applying to a settlement for a tax year.
>
> *Step 2*
>
> Find the total amount of chargeable gains treated under s.87 or 89(2) as accruing to beneficiaries of the settlement in the tax year 2007-08 or any earlier tax year ("the total deemed gains").

I prefer the label "pre-2008 s.87 gains".

> *Step 3*
>
> Find the earliest tax year for which the s.2(2) amount is not nil.
>
> If the s.2(2) amount for that year is less than or equal to the total deemed gains [pre-2008 s.87 gains], reduce that s.2(2) amount to nil.
>
> Otherwise, reduce that s.2(2) amount by the amount of the total deemed gains.
>
> *Step 4*
>
> Reduce the total deemed gains [pre-2008 s.87 gains] by the amount by which the s.2(2) amount was reduced under Step 3.
>
> *Step 5*
>
> If the total deemed gains [pre-2008 s.87 gains] is not nil, start again at Step 3.
>
> For this purpose, read references to the earliest tax year for which the s.2(2) amount is not nil as references to the earliest tax year—
>
> (a) which is after the last tax year for which Steps 3 and 4 have been undertaken, and
>
> (b) for which the s.2(2) amount is not nil.

EN FB 2008 provides an example:

> 60. Example: determining the s.2(2) amount for years preceding 2008-09:
>
> The s.2(2) amounts of a settlement were:
>
> 2004-05: £100,000
> 2005-06: £50,000
> 2006-07: £200,000
> 2007-08: £200,000
>
> Total deemed gains [pre-2008 s.87 gains] were £450,000.
>
> a. Subtract the s.2(2) (£100,000) amount for the earliest year from the total deemed gains. Section 2(2) amount for 2004-05 reduces to nil. Total deemed gains reduced to £350,000.
>
> b. Subtract the s.2(2) (£50,000) amount for the next earliest year from the total deemed gains carried forward. Section 2(2) amount for 2005-06

> reduces to nil. Total deemed gains reduced to £300,000.
> c. Subtract the s.2(2) (£200,000) amount for the next earliest year from the total deemed gains carried forward. Section 2(2) amount for 2006-07 reduces to nil. Total deemed gains reduced to £100,000.
> d. Subtract the s.2(2) (£200,000) amount for the next earliest year from the total deemed gains carried forward. Section 2(2) amount for 2007-08 reduces to £100,000. Total deemed gains reduced to nil.
> The s.2(2) amount for the settlement for 2007-08 is therefore £100,000.

In short, pre-2008 s.87 gains are deducted from pre-2008 s.1(3) amounts on a FIFO basis (first in first out). It is expressed in just about the most obscure way possible.[206]

The s.87 guidance note provides:

> **Identifying unmatched s.2(2) amount for years before 2008-09: para 120 Sch 7**
> 30. Although the new matching rules in section 87A take effect from 2008-09 they will apply to match capital payments received in 2008-09 and later against unmatched section 2(2) amounts of 2007-08 and earlier. This means it is necessary to calculate what those section 2(2) amounts are. Paragraph 120 of Schedule 7 explains how to do this in a series of steps. Capital payments matched with these section 2(2) amounts may be subject to the increased tax charge under section 91 TCGA.
> 31. First you calculate what the section 2(2) amount would be for each earlier year using the definition in the new section 87(4) but applying the CGT rules for the earlier year. So you give taper relief and indexation allowance as appropriate. These section 2(2) amounts include gains made by the trustees which have been matched with capital payments.
> 32. Second you identify the total chargeable gains that have accrued to beneficiaries under section 87 in the years up to and including 2007-08. This includes chargeable gains that have not been charged to tax – for example because of the non-UK residence or domicile status of the beneficiary. This figure is called the "total deemed capital gains".
> 33. Third you allocate the total deemed capital gains to years in which there is a section 2(2) amount taking the earliest year first. You reduce the section 2(2) amount by the amount of the total deemed gains [pre-2008 s.87 gains]. If the total deemed gains are greater than the section 2(2) amount the section 2(2) for the year is reduced to nil. A corresponding reduction is made in the total deemed gains. When all the total deemed gains have been allocated you are left with the unmatched

[206] For discussion of the drafting technique, see 61.15.7 (Method statements: Critique).

section 2(2) amounts for 2007-08 and earlier years. See example 5.

Example 5: Identifying unmatched s.2(2) amounts for years before 2008-09: para 120 Sch 7

The section 2(2) amounts for a settlement are:-

2005-06	£50,000
2006-07	£75,000
2007-08	£60,000

Up to and including 2007-08 capital payments of £90,000 have been received by beneficiaries and the total deemed gains [pre-2008 s.87 gains] are £90,000. None of the capital payments were received in the period 12 March to 5 April 2008. See example 12 for an example of payments received in this period by a non-UK domiciled beneficiary.

The total deemed gains are allocated against the section 2(2) amounts using the FIFO rules in paragraph 120 of Schedule 7 that apply to matching for 2007-08 and earlier years. They are allocated as follows:

	Original s2(2) amount	Total deemed gains	Deemed s2(2) amount
2005-06	£50,000	£50,000	Nil
2006-07	£75,000	£40,000	£35,000
2007-08	£60,000	Nil	£60,000

Suppose capital payments of £70,000 were received by beneficiaries in 2009-10 and there is no section 2(2) amount for that year or 2008-09. The £70,000 capital payments are matched under the LIFO rules in the new section 87A TCGA that apply for matching in 2008-09 and later years. £60,000 of those payments are matched against the section 2(2) amount for 2007-08 and £10,000 of those payments are matched against the section 2(2) amount for 2006-07. The total deemed gains are £70,000 (£60,000 + £10,000) treated as accruing in 2009-10. This leaves unmatched a deemed section 2(2) amount for 2006-07 of £25,000 (£35,000 – £10,000) available to match against capital payments made in 2010-11 or later years.

Assuming all the beneficiaries were resident in the UK in 2009-10 their liability to CGT on the section 87 gains accruing to them will depend on their domicile in 2009-10. If any of the beneficiaries are non-UK domiciled individuals paragraph 124(2)(b) of Schedule 7 will prevent them being charged to CGT. This applies whether or not they have claimed to use the remittance basis for 2009-10. If any of the beneficiaries are UK domiciled they will be charged to CGT on the section 87 gains. Any tax due on these gains will be increased by section 91 TCGA.

Assume the entire capital payment is received by a UK resident and domiciled beneficiary who has no other capital gains and losses in 2009-10. At the time of writing the annual exempt amount and rate of CGT are

> not known for 2009-10. This example assumes they are the same as for 2008-09 at £9,600 and 18% respectively. The annual exempt amount is set first against the gain accruing from the 2006-07 capital payment. Ie £10,000 – £9,800 = £200. The tax due on the gain accruing from the 2006-07 capital payment is £36 (£200 @ 18%). This tax is increased by £10 (£36 @ 30% = £10). The tax due on the gain accruing from the 2007-08 amount is £10,800 (£60,000 @ 18%). This tax is increased by £2,160 (£10,800 @ 20%). The total CGT payable for 2009-10 is £13006 (£36 + £10 + £10,800 + £2,160).

Para 120(3) provides for schedule 4B cases, though the drafter does not try very hard:

> If, before 6 April 2008, the trustees of the settlement made a transfer of value to which Schedule 4B to TCGA 1992 applied, sub-para (2) has effect subject to such modifications as are just and reasonable on account of Schedule 4C to that Act having applied in relation to the settlement.

61.42.1 *Pre-2008 OIG amounts*

Para 99 sch 7 FA 2008 applies the same rule to OIG amounts:

> Paragraphs 120 and 121 apply in relation to offshore income gains as if—
> (a) references to section 2(2) amounts were to OIG amounts,
> (b) references to chargeable gains were to offshore income gains, and
> (c) Step 1 of paragraph 120(2) provided that OIG amounts are to be calculated in accordance with—
> (i) section 762(2) of ICTA (the reference in the second sentence of that Step to section 87(4) of TCGA 1992 being read as a reference to section 762(2) of ICTA), or
> (ii) section 87(5) of TCGA 1992 as applied by section 762(3) of ICTA.

Section 762 ICTA is now repealed. The OFTR should have updated the references but (somewhat negligently) failed to do so. It is considered that the slip can be corrected by construction, ie references to the new provisions should be implied.

61.43 Pre-2008 capital payments

In order to follow the present legislation, one needs to have in mind the original terms of s.87(6) TCGA, and in order to follow that, one needs to read all of the pre-2008 s.87(4)-(6) TCGA:

> *(4) Subject to the following provisions of this section, the trust gains for a year of assessment shall be treated as chargeable gains accruing in that year to beneficiaries of the settlement who receive capital payments from the trustees in that year or have received such payments in any earlier year.*
> *(5) The attribution of chargeable gains to beneficiaries under subsection (4) above shall be made in proportion to, but shall not exceed, the amounts of the capital payments received by them.*
> *(6) A capital payment shall be left out of account for the purposes of subsections (4) and (5) above to the extent that chargeable gains have by reason of the payment been treated as accruing to the recipient in an earlier year.*

Para 122 sch 7 FA 2008 provides:

> (1) If all of a capital payment would (in the tax year 2008-09) have been left out of account by virtue of s.87(6) of TCGA 1992 as originally enacted, the amount of that capital payment is reduced to nil.
> (2) If part of a capital payment would (in the tax year 2008-09) have been left out of account by virtue of s.87(6) of TCGA 1992 as originally enacted, the amount of that capital payment is reduced by the amount of that part.
> (3) If—
> (a) chargeable gains were treated under s.87 or 89(2) of, or para 8 of Schedule 4C to, TCGA 1992 as accruing in the tax year 2007-08 or any earlier tax year to a beneficiary,
> (b) more than one capital payment that the beneficiary had received was taken into account for the purposes of determining the amount of chargeable gains treated as accruing to the beneficiary, and
> (c) the amount of those chargeable gains was less than the total amount of capital payments taken into account,
>
> for the purposes of this paragraph treat s.87(6) of TCGA 1992 as originally enacted as having effect in relation to earlier capital payments before later ones.

The point of this (I think) is to prevent double counting of a capital payment: it is set against s.1(3) amounts under para 120 and not a second time.

The s.87 guidance note provides:

> 34. In the same way that it is necessary to deal with unmatched section 2(2) amounts for a year before 2008-09 it is also necessary to deal with unmatched capital payments received before 2008-09. You have to identify the year in which

> an unmatched capital payment was received. This is dealt with in paragraph 122 of Schedule 7.
>
> 35. First you apply the rule in the original section 87(6) to determine if all or any of a capital payment would be left out of account. A payment would be left out of account to the extent that chargeable gains accrued to a beneficiary as a result of making the payment. In other words if the payment is matched against gains made by the trustees. See example 6.
>
> 36. If more than one capital payment is matched against the trustees' gains for a year and the total of the payments is greater than the chargeable gain that accrues the rule in paragraph 122(3) applies. You identify the year the unmatched payment was received by matching the payments received in the earliest years first. See example 7.
>
> **Example 6: Identifying unmatched capital payments received before 2008-09: para 122(1) & (2) Sch 7**

2005-06	Capital payments received	Beneficiary A	£15,000
		Beneficiary B	£12,000
	Trustees' gains (s.2(2) amount)		£37,000
2007-08	Capital payments received	Beneficiary A	£8,000
		Beneficiary B	£9,000

> In 2005-06 the capital payments £15,000 and £12,000 are matched against £37,000 trustees' gains and chargeable gains of £15,000 and £12,000 accrue to A and B. In 2008-09 and later years paragraph 122(1) of schedule 7 applies and the capital payments are reduced to nil. The unmatched trustees' gains of £10,000 are carried forward under the old section 87(2) to later years.
>
> In 2007-08 £10,000 trustees' gains are matched against the £17,000 capital payments received. Gains of £4,705 (£10,000 × 8,000/17,000) accrue to A and gains of £5,295 (£10,000 × 9,000/17,000) accrue to B. Their respective unmatched capital payments are reduced to £3,295 (£8,000 – £4,705) and £3,705 (£9,000 – £5,295). Paragraph 122(2) of Schedule 7 ensures only those unmatched parts of the capital payments are carried forward for use in 2008-09 or later years.

The s.87 guidance note provides:

> 36. If more than one capital payment is matched against the trustees' gains for a year and the total of the payments is greater than the chargeable gain that accrues the rule in paragraph 122(3) applies. You identify the year the unmatched payment was received by matching the payments received in the earliest years first. See example 7.

The s.87 guidance note provides:

> **Example 7: Identifying unmatched capital payments received before 2008-09: Para 122(3) Sch 7**

2005-06	Capital payments received	Beneficiary A	£16,000
		Beneficiary B	£14,000
	Trustees' gains (s.2(2) amount)		£ 5,000
2007-08	Capital payments received	Beneficiary A	£10,000
		Beneficiary B	£ 8,000

	Trustees' gains (s.2(2) amount)	£13,000
2008-09	Section 2(2) amount	£20,000

In 2005-06 gains of £2,667 (£5,000 × 16,000/30,000) would accrue to beneficiary A and the unmatched capital payment would be reduced to £13,333 (£16,000 – £2,667). Gains of £2,333 (£5,000 × 14,000/30,000) would accrue to beneficiary B and the unmatched capital payment would be reduced to £11,667 (£14,000 – £2,333).

In 2007-08 A receives a further capital payment of £10,000 giving them total unmatched capital payments of £23,333. B receives a further capital payment of £8,000 giving them total unmatched capital payments of £19,667. Gains of £7,054 (£13,000 × 23,333/43,000) accrue to A. Gains of £5946 (£13,000 × 19,657/43,000) accrue to B. A's unmatched capital payments to carry forward to 2008-09 are £16,279 (£23,333 – £7,054). B's unmatched capital payments are £13,721 (£19,667 – £5,946).

In 2008-09 the conditions for paragraph 122(3) of Schedule 7 are satisfied:

(a) Chargeable gains have accrued to both beneficiaries in 2007-08.

(b) Capital payments from 2005-06 and 2007-08 have been used for the purposes of determining those gains.

(c) The amount of the chargeable gains £13,000 is less than the total of the capital payments £43,000.

Paragraph 122(3) matches the £13,000 gains first against the capital payments received in 2005-06. In 2005-06 A's unmatched capital payments were £13,333. The 2007-08 gains of £7,054 are matched first against those payments reducing the unmatched capital payments to £6,279. B's unmatched capital payments were £11,667. The 2007-08 gains of £5,496 are matched first against those payments reducing the unmatched capital payments to £5,721. The total unmatched capital payments to carry forward to 2008-09 are then:

- To A £16,279 consisting of £6,279 from 2005-06 and £10,000 from 2007-08
- To B £13,721 consisting of £5,721 from 2005-06 and £8,000 from 2007-08

The ordinary rules of section 87A then apply for the purpose of matching the £20,000 2008-09 section 2(2) amount with the earlier years' capital payments. Gains of £10,000 accrue to A and gains of £8,000 accrue to B as a result of matching the section 2(2) amount against the capital payments received in 2007-08. That leaves £2,000 of the section 2(2) amount to match with capital payments from 2005-06. A gain of £1,046 (£2,000 × 6279/12,000) accrues to A and a gain of £954 (£2,000 × 5721/12,000) accrues to B as a result of matching that £2,000 of the section 2(2) amount. The total gains attributed under section 87 for 2008-09 are:

- To A £11,046 (£10,000 + £1,046)
- To B £8,954 (£8,000 + £954)

The total unmatched capital payments to carry forward to 2009-10 are then:

- To A £5,233 (£6,279 – £1,046) all from 2005-06
- To B £4,767 (£5,721 – £954) all from 2005-06.

Para 122 then imposes the same rules for OIGs:

> (4) References in this paragraph to s.87(6) of TCGA 1992 include that provision as it would (but for the amendments made by this Schedule) have applied by virtue of s.762(3) of ICTA (offshore income gains).
> (5) References in this paragraph to chargeable gains include offshore income gains.

Section 762 ICTA is now repealed. The OFTR should have updated the reference but (perhaps carelessly) failed to do so. It is considered that the slip can be corrected by construction, ie references to the new provisions should be implied.

61.44 Pre-2008 capital payment/trust gain, matched post 2008

Para 124 sch 7 FA 2008 provides:

> (1) This paragraph applies if—
> (a) chargeable gains are treated under s.87 or 89(2) of TCGA 1992 as accruing to an individual in the tax year 2008-09 or any subsequent tax year, and
> (b) the individual is not domiciled[207] in the UK in that year.
> (2) The individual is not charged to capital gains tax on the chargeable gains if and to the extent that they are treated as accruing by reason of—
> (a) a capital payment received (or treated as received) by the individual before 6 April 2008, or
> (b) the matching of any capital payment with the s.2(2) amount for the tax year 2007-08 or any earlier tax year.

There are two reliefs here:

(1) Para (2)(a) provides relief for pre-2008 capital payments to foreign domiciliaries which are matched with post-2008 s.1(3) amounts.

(2) Para (2)(b) provides relief for post 2008 capital payments which are matched with pre-2008 s.1(3) amounts.

EN FB 2008 summarises the matter this way:

> 440. The overall effect of these new rules is that: ...
> [1] there will be no charge to tax in respect of capital payments made to non-UK domiciled beneficiaries who:
> [a] receive capital payments before 6 April 2008 that are matched to trust gains accruing on or after 6 April 2008; or
> [b] receive capital payments on or after 6 April 2008 that are matched to trust gains accruing before 6 April 2008.

[207] See 61.53 (UK dom/Formerly-dom resident).

This will be so irrespective of whether the non-UK domiciled beneficiary is a remittance basis user

The s.87 guidance note provides:

Example 10: Capital payments received by non-UK domiciled beneficiary before 6 April 2008 matched with s.2(2) amount for 2008-09 or later: para 124 Sch 7

2005-06	Capital payments received	£10,000
2008-09	Capital payments received	£16,000
	Section 2(2) amount	24,000

The capital payments are received by a beneficiary who is UK resident but non-UK domiciled in 2008-09. A chargeable gain of £24,000 accrues to the beneficiary in 2008-09. On the LIFO basis the capital payments received are matched £16,000 2008-09 and £8,000 2005-06. The beneficiary is liable to CGT on the £16,000 only. The beneficiary is not liable on the £8,000 because the section 2(2) amount realised in 2008-09 is matched to a capital payment received in 2005-06 by a person who is not domiciled in the UK. This applies whether or not the beneficiary is a remittance basis user.

The CGT due on the £16,000 will depend on whether the beneficiary is a remittance basis user and on whether the trustees had made an election under paragraph 126 of Schedule 7. If the trustees have made the election the gain will be restricted to the amount that relates to the growth in the value of the asset since 5 April 2008. If the beneficiary is a remittance basis user the gain will not be charged until it is remitted.

In any circumstances the settlement's section 2(2) amount for 2008-09 is reduced to nil. There are unmatched capital payments from 2005-06 of £2,000 (£10,000 − £8,000) to carry forward.

If the beneficiary was non-UK domiciled in 2005-06 but became UK domiciled sometime before the capital payment was received the condition in paragraph 124(1)(b) is not satisfied. The beneficiary is liable to CGT on the entire gain of £24,000. It is irrelevant whether the domicile status changed before or after 6 April 2008.

Example 11: Gain accruing in respect of s.2(2) amount for a year before 2008-09 when beneficiary non-UK domiciled: para 124 Schedule 7

2005-06	Capital payments received	Nil
	Section 2(2) amount	£ 7,000
2006-07	Capital payments received	Nil
	Section 2(2) amount	£ 5,000
2008-09	Capital payment received	£30,000
	Section 2(2) amount	£16,000

The capital payment in 2008-09 was received by a UK resident but non-UK domiciled beneficiary. A chargeable gain of £28,000 accrues in 2008-09. Using the last-in first-out basis of matching the capital payment £30,000 is matched against the section 2(2) amounts as follows.

2008-09	£16,000
2006-07	£ 5,000

2005-06	£ 7,000
	£28,000

The beneficiary is liable to CGT only on the £16,000 matched with the section 2(2) amount for the year 2008-09. The beneficiary is not liable to CGT on the section 87 gains that accrue as a result of matching the capital payment against section 2(2) amounts for 2006-07 and 2005-06. This is because the beneficiary was not domiciled in the UK in 2008-09 when the capital payment was received and the section 2(2) amounts are for years before 2008-09.

The CGT due on the £16,000 will depend on whether the beneficiary is a remittance basis user and on whether the trustees had made an election under paragraph 126 of Schedule 7. If the trustees have made the election the gain will be restricted to the amount that relates to the growth in the value of the asset since 5 April 2008. If the beneficiary is a remittance basis user the gain will not be charged until it is remitted.

In any circumstances the settlement's section 2(2) amounts for 2008-09, 2006-07 and 2005-06 are reduced to nil. The unmatched capital payments for 2008-09 are reduced to £2,000 (£30,000 – £28,000).

Suppose the beneficiary was non-UK domiciled in 2005-06 and 2006-07 but became UK domiciled in 2007-08 or 2008-09. They would be liable to CGT on the whole chargeable gain £28,000. The fact that they were non-UK domiciled in the years before 2008-09 when the section 2(2) amounts were realised is not relevant. The test in paragraph 124(1)(b) of Schedule 7 is the domicile status for the year in which the gain accrues as a result of matching those amounts with a capital payment.

61.44.1 *Pre-2008 capital payment and pre-2008 OIG amount*

Para 100 sch 7 FA 2008 provides the same rules for OIG amounts:

> (1) This paragraph applies if—
>
> (a) by virtue of section 87 or 89(2) of, or Schedule 4C to, TCGA 1992 as applied by regulation 20 of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/3001), income is treated under such regulations (regulation 17 of those Regulations[)] as arising to an individual in the tax year 2008–09 or any subsequent tax year, and
>
> (b) the individual is not domiciled[208] in the UK in that year.
>
> (2) The individual is not charged to income tax on the income if and to the extent that it is treated as arising by reason of—
>
> (a) a capital payment received (or treated as received) by the individual before 6 April 2008, or
>
> (b) the matching of any capital payment with the OIG amount for the tax year 2007–08 or any earlier tax year.

[208] See 61.53 (UK dom/Formerly-dom resident).

61.44.2 *Payment 12 Mar - 5 Apr 2008*

Para 125 sch 7 FA 2008 provides a special rule for these capital payments:

> (1) This paragraph applies in relation to a settlement for the tax year 2008-09 or any subsequent tax year ("the relevant tax year") if—
>
> (a) an individual who was resident or ordinarily resident, but not domiciled, in the UK in the tax year 2007-08 received a capital payment from the trustees of the settlement on or after 12 March 2008 but before 6 April 2008, and
>
> (b) the individual is resident or ordinarily resident, but not domiciled, in the UK in the relevant tax year.
>
> (2) For the purposes of sections 87 to 89 of TCGA 1992 as they apply in relation to the settlement for the relevant tax year, no account is to be taken of the capital payment.

One might refer to capital payments made between 12 March and 5 April 2008 as post-budget 2008 capital payments. There is no matching for post-budget 2008 capital payments, so such payments do not reduce s.1(3) amounts.

January 2009 Qs & As provides some background explanation:

> **Q4**: Paragraph 125(2) appears to disregard payments between 12 March and 5 April altogether, which is different to the treatment proposed in the Budget documentation published on 12 March.
>
> **A**: The original intention set out in the Budget documentation of 12 March and legislation was to allow the matching of capital payments between 12 March 2008 and 5 April 2008 with any gains relating to the period up to 5 April 2008 arising to the trustees after 5 April 2008. However, this proposal was dropped because it would have introduced additional and unnecessary complexity to the legislation.

This rule is not extended to offshore income gains. It is not clear if that was deliberate or an oversight.

The s.87 guidance note provides:

> **Non-UK domiciled beneficiaries: capital payments received 12 March to 5 April 2008: para 125 Sch 7**
>
> 50. Paragraph 125 of Schedule 7 is an anti-avoidance measure. Its purpose was to discourage trustees making large capital payments to non-UK domiciled beneficiaries immediately before the beginning of 2008-09. These would then be matched against section 2(2) amounts for 2008-09 or later and, unless they had become UK domiciled, the beneficiaries would not be liable to CGT on any gains accruing to them.

51. The paragraph provides that any capital payment received by a UK resident or ordinary resident beneficiary is ignored if it was received on or after 12 March and before 6 April 2008 by a non-UK domiciled beneficiary. The payment is ignored only if the chargeable gain accrues in 2008-09 or later and the beneficiary is still non-domiciled when the gain accrues. See example 12.

Example 12: Non-UK domiciled beneficiary: capital payment received 12 March to 5 April 2008: para 125 Sch 7

Year	**Capital payments**	**S.2(2) amount**
2007-08	£200,000	£ 50,000
2010-11	Nil	£ 80,000

The 2007-08 capital payment was made on 4 April 2008 to a UK resident but non-UK domiciled beneficiary.

A chargeable gain of £50,000 accrues to the beneficiary in 2007-08 but they are not liable to CGT on this gain. The settlement's section 2(2) amount for 2007-08 is reduced to nil. The unmatched capital payment for 2007-08 is reduced to £150,000.

If the beneficiary is non-UK domiciled in 2010-11 the unmatched capital payment £150,000 for 2007-08 is not matched against the section 2(2) amount £80,000 for 2010-11 and no section 87 gain accrues for that year. This is because the capital payment was received in the period 12 March 2008 to 5 April 2008 inclusive by a beneficiary who was not domiciled in the UK when they received the payment.

The settlement's unmatched section 2(2) amount for 2010-11 remains at £80,000.

The capital payment will remain unmatched against section 2(2) amounts for future years provided the beneficiary remains non-domiciled. If the taxpayer has become UK domiciled by the time a section 2(2) amount is realised in a future year the payment can be matched against that amount and a section 87 gain will accrue to the beneficiary in that year.

In the example suppose a section 2(2) amount of £20,000 is realised in 2011-12. There are no capital payments in that year. The beneficiary is still non-UK domiciled. The unmatched capital payment £150,000 from 2007-08 is not matched against this section 2(2) amount.

The beneficiary becomes UK domiciled in 2012-13 and stays UK domiciled in later years.

In 2014-15 a section 2(2) amount of £80,000 is realised. No capital payments are made in that year. Paragraph 125 of Schedule 7 does not apply to year 2014-15 because the taxpayer is UK domiciled in that year. The rules in section 87A match the section 2(2) amount for 2014-15 with the unmatched capital payment £150,000 2007-08. A chargeable gain of £80000 accrues to the beneficiary in 2014-15. At the time of writing the annual exempt amount and rate of CGT are not known for 2014-15. This example assumes they are £15,000 and 18% respectively. Assuming that the annual exempt amount is £15,000 and the rate of CGT 18% the beneficiary will be liable to £11,700 CGT on this gain.

The section 2(2) amount for 2014-15 is reduced to nil and the unmatched capital payment for 2007-08 is reduced to £70,000 (£150,000 – £80,000). This capital payment will be matched against section 2(2) amounts realised in later years. Applying the matching rules in section 87A TCGA to a section 2(2) amount for 2014-15 does not result in a capital payment received in 2007-08 being matched against section 2(2) amounts for years 2010-11 and 2011-12. The section 2(2) amounts for those years will be matched against capital payments received in years after 2014-15. The remaining unmatched capital payments for 2007-08 £70,000 will be matched against section 2(2) amounts for years after 2014-15.

61.45 Pre-2008 inter-trust transfer

Para 120(4) sch 7 FA 2008 disapplies the rules in para 120 where there was an inter-trust transfer before 2008/09[209] and para 121 sch 7 FA 2008 sets out its own set of rules:

> (1) If s.90 of TCGA 1992 (as originally enacted) applied to a transfer of settled property made before 6 April 2008, this paragraph applies in relation to the transferor settlement and the transferee settlement.
> (2) In this paragraph "the year of transfer" means the tax year in which the transfer occurred.
> (3) The following steps are to be taken for the purpose of calculating the s.2(2) amount for the transferor and transferee settlements for the tax year 2007-08 and earlier tax years.
> *Step 1*
> Take the steps in para 120(2) for the purpose of calculating the s.2(2) amount (at the end of the year of transfer) for the transferor settlement for the year of transfer and earlier tax years.
> For this purpose, read references there to the tax year 2007-08 as references to the year of transfer.
> *Step 2*
> Take the steps in para 120(2) for the purpose of calculating the s.2(2) amount (before the year of transfer) for the transferee settlement for the tax year before the year of transfer and earlier tax years.
> For this purpose, read references there to the tax year 2007-08 as references to the tax year before the year of transfer.
> *Step 3*
> Calculate the s.2(2) amount for the transferee settlement for the year of transfer.
> *Step 4*
> Treat the s.2(2) amount for the transferee settlement for the year of transfer or any earlier tax year (as calculated under Step 2 or 3) as increased by—
> (a) the s.2(2) amount for the transferor settlement for that year (as calculated under Step 1), or
> (b) if part only of the settled property was transferred, the relevant proportion of the amount mentioned in para (a).
> "The relevant proportion" here has the same meaning as in s.90(4) of TCGA 1992

[209] Para 120(4) provides:
This paragraph does not apply if s.90 of TCGA 1992 applied to a transfer of settled property by or to the trustees of the settlement that was made before 6 April 2008 (see para 121).

> (as substituted by this Schedule).
> *Step 5*
> Treat the s.2(2) amount for the transferor settlement for any tax year as reduced by the amount by which the s.2(2) amount for the transferee settlement for that year is increased under Step 4.
> *Step 6*
> Take the steps in para 120(2) for the purpose of calculating the s.2(2) amount for the transferor settlement for the tax year 2007-08 and earlier tax years.
> For this purpose—
> (a) treat the s.2(2) amount for the year of transfer or any earlier tax year as the amount calculated by taking Steps 1 and 5 above, and
> (b) reduce the total deemed gains by the amount of the total deemed gains calculated by taking Step 1 above.
> *Step 7*
> Take the steps in para 120(2) for the purpose of calculating the s.2(2) amount for the transferee settlement for the tax year 2007-08 and earlier tax years.
> For this purpose—
> (a) treat the s.2(2) amount for the year of transfer or any earlier tax year as the amount calculated by taking Steps 2 to 4 above, and
> (b) reduce the total deemed gains by the amount of the total deemed gains calculated by taking Step 2 above.

The drafter felt something should be done about multiple transfers, and sch 4B, but did not know what:

> (4) This paragraph applies with any necessary modifications in relation to a settlement as respects which more than one relevant transfer was made.
> (5) In sub-para (4) "relevant transfer" means a transfer—
> (a) made before 6 April 2008, and
> (b) to which s.90 of TCGA 1992 applied.
> (6) If, before 6 April 2008, the trustees of the transferor or transferee settlement made a transfer of value to which Schedule 4B to TCGA 1992 applied, this paragraph has effect subject to such modifications as are just and reasonable on account of Schedule 4C to that Act having applied in relation to the settlement.

Para 99 sch 7 FA 2008[210] applies the same rules for OIG amounts.

61.46 Pre-2008 trust immigration

In order to follow the present legislation, one needs to have in mind the original terms of s.89(2) TCGA, and in order to follow that it needs to be read with s.89(1):

> *(1) Where a period of one or more years of assessment for which section 87 applies to a settlement ("a non-resident period") succeeds a period of*

[210] Set out at 61.42.1 (Pre-2008 OIG amounts).

> *one or more years of assessment for each of which section 87 does not apply to the settlement ("a resident period"), a capital payment received by a beneficiary in the resident period shall be disregarded for the purposes of section 87 if it was not made in anticipation of a disposal made by the trustees in the non-resident period.*
>
> *(2) Where*
>
> *(a) a non-resident period is succeeded by a resident period, and*
>
> *(b) the trust gains for the last year of the non-resident period are not (or not wholly) treated as chargeable gains accruing in that year to beneficiaries,*
>
> *then, subject to subsection (3) below, those trust gains (or the outstanding part of them) shall be treated as chargeable gains accruing in the first year of the resident period to beneficiaries of the settlement who receive capital payments from the trustees in that year; and so on for the second and subsequent years until the amount treated as accruing to beneficiaries is equal to the amount of the trust gains for the last year of the non-resident period.*

Para 123 sch 7 FA 2008 provides:

> Section 89(2) of TCGA 1992 as substituted applies to a settlement for the tax year 2008-09 (and subsequent tax years) if s.89(2) of that Act as originally enacted would (but for the amendments made by this Schedule) have applied to the settlement for the tax year 2008-09.

61.47 2008 rebasing election

61.47.1 *Need for rebasing election*

Para 126 sch 7 FA 2008 provides a relief which I call **"2008 rebasing relief".** This is one of several rebasing reliefs.[211]

Para 126 sch 7 FA 2008 provides:

> (1) The following provisions apply to a settlement if—
>
> (a) s.87 applies to the settlement for the tax year 2008-09, and
>
> (b) the trustees of the settlement have made an election under this subparagraph. ...
>
> (5) An election under sub-para (1) is irrevocable.

EN FB 2008 provides:

> 63. The provisions of para [126] are subject to an election rather than being mandatory because:

[211] See 56.16.1 (Rebasing reliefs).

> [1] depending on the assets comprised in the settlement as at 6 April 2008 it may not be advantageous for the paragraph to apply; and
>
> [2] the trustees will be required to provide additional information to HMRC about trust assets. Trustees of non-resident settlements have been assured in a letter from the Acting Chairman of HMRC, Dave Hartnett, dated 12 February 2008 that in applying the provisions set out in this Schedule, HMRC will not require any additional disclosure.[212]

As far as [1] is concerned, it can never be disadvantageous for para 126 to apply (the election cannot in any circumstances increase the tax liability). The s.87 guidance note provides:

> 79. The election ... cannot increase the tax payable by a beneficiary. Whether it improves the position of the beneficiary depends on the history of the assets disposed of.

Subject to point [2] (confidentiality) an election should be made in every case where it might be useful, which is generally the case where there are or might be UK resident foreign domiciled beneficiaries. I understand however that an election in relation to a trust unknown to HMRC will generally lead to enquiries.

61.47.2 *Election: Requirements*

The s.87 guidance note provides:

> 82. The election can be made only if the settlement was non-UK resident throughout 2008-09.

This follows from para 126(1)(a). The guidance note continues:

> Paragraph 126(1) requires that the election be made by the trustees of the settlement. It must be made by all the trustees or by a majority of them if they are permitted to act through a majority. It cannot be made by a beneficiary. If the beneficiary's Self Assessment tax return is taken up for enquiry an election may require additional disclosure to HMRC about assets held by the trustees in order to agree the valuation.

Para 126(6) sch 7 FA 2008 provides:

> An election under that sub-paragraph must be made in the way and form

[212] *http://webarchive.nationalarchives.gov.uk/20080305134412/http:/www.hmrc.gov.uk/news/residence-domicile.pdf*

> specified by the Commissioners for HMRC.

The s.87 guidance note provides:

> 89. ... HMRC have provided a form RBE1 to satisfy this requirement and all elections must be made on that form. The form asks for the name of the settlement and the date it was created. The date is used to distinguish between settlements with similar names in particular those created by settlors with a prevalent surname. The form also asks the trustees to identify if and when a trigger event has occurred. The RBE1 can be downloaded from the HMRC website[213]....
> 90. Some trustees may have made the election by writing to CAR Residency before the form was available. That election remains valid and there is no need to make a further election on the form.

61.47.3 *Election: Time limit*

Para 126(2) sch 7 FA 2008 provides:

> An election under sub-para (1) may only be made on or before the first 31 January to occur after the end of the first tax year (beginning with the tax year 2008-09) in which an event within either of the following paragraphs occurs—
> (a) a capital payment is received (or treated as received) by a beneficiary of the settlement,[214] and the beneficiary is resident in the UK in the tax year in which it is received, and
> (b) the trustees transfer all or part of the settled property to the trustees of another settlement, and s.90 of TCGA 1992 applies in relation to the transfer.

The time limit is crucial. The s.87 guidance note provides:

> 83. The relief is given only to individuals, paragraph 126(7), but the time limit is triggered if a capital payment is received by any UK resident

[213] *https://www.gov.uk/government/publications/non-resident-capital-gains-tax-rebasing-election-assets-held-in-non-uk-resident-settlement-at-5-april-2008-rbe1*

[214] Para 126 expands on this in sch 4C cases:
"(3) For a tax year as respects which the settlement has a Schedule 4C pool, the reference in sub-para (2)(a) above to a capital payment received (or treated as received) by a beneficiary of the settlement is to be read as a capital payment received (or treated as received) by a beneficiary of a relevant settlement from the trustees of a relevant settlement.
(4) Para 8A of that Schedule (relevant settlements) applies for the purposes of sub-para (3) above."

> beneficiary.

"Capital payment" is not defined in sch 7. The standard definition, in s.97 TCGA, is only "for the purposes of s.86A to 97 (and sch 4C)". Strictly that definition does not apply for the purposes of sch 7. It is considered however that the context shows that the usual definition is intended to apply, notwithstanding the absent-minded omission of a provision to that effect. If that is right, a benefit within s.731 is not a capital payment so does not trigger the deadline for an election. It is well arguable that a benefit within the scope of OIG s.87 (which is chargeable to income tax) is not a "capital payment" for the purposes of para 126,[215] but it would be best not to rely on that point and to make the election in good time.

The s.87 guidance note provides:

> 87. An election may be made before a triggering event happens.

This is important as it is convenient and (in cases of offshore income gains, may be necessary) to make the election before there is any capital payment. The s.87 guidance note continues:

> There is no requirement that the beneficiary receiving the payment was a beneficiary of the settlement as at 6 April 2008. The recipient may become a beneficiary at some later time. The time limit in paragraph 126(2) of Schedule 7 runs from the time the trustees first make a capital payment to a UK resident beneficiary. If the trustees make such a payment and do not make the election they may be out of time for making the election if they make a payment to a UK-resident but non-domiciled beneficiary at a later time. The election can be made even if there are no non-UK domiciled beneficiaries when the payment is made.
> 88. Any election made late will be considered in accordance with the guidance in paragraph 13801 onwards in HMRC's Capital Gains Tax Manual [*recte* Capital Gains Manual].[216]

61.48 2008 Rebasing: The relief

Assuming an election has been made, we can move on to consider the relief.

The s.87 guidance note provides:

> 80. The election is commonly known as a "rebasing" election ... But it is not rebasing as that term applies to section 35 TCGA and assets held at

[215] See 67.13.3 ("Capital payment").

[216] The reference is now CG13810.

> 31 March 1982. There is no across the board revaluation of the assets in the trust fund as at 6 April 2008.

Para 126(7) sch 7 FA 2008 provides:

> Sub-para (8) applies if—
> (a) by virtue of the matching of
> [i] a capital payment with
> [ii] the s.2(2) amount for the settlement for the tax year 2008-09 or any subsequent tax year ("the relevant tax year"),
> chargeable gains are treated under s.87 or 89(2) of, or para 8 Schedule 4C to, TCGA 1992 as accruing to an individual in a tax year, and
> (b) the individual is resident, but not domiciled,[217] in the UK in that year.

That is, in short, the relief applies if s.87 gains accrue to a foreign domiciliary. If that condition is satisfied, we turn to the relief in para 126(8):

> The individual is not charged to capital gains tax on so much of the chargeable gains as exceeds the relevant proportion of those gains.

EN FB 2008 provides:

> 64. It should be noted that para [126] does not affect the computation of the s.2(2) amount under s.87 for a year. It simply provides a mechanism for identifying an amount of the chargeable gain treated as accruing to a non-UK domiciled beneficiary that is not chargeable to tax because an element of the underlying s.2(2) amounts are attributable to the period before 6 April 2008, when non-UK domiciled beneficiaries were not chargeable to tax in respect of chargeable gains attributed to them under s.87.

But that generally comes to the same thing.

> 65. Para [126] applies to all non-UK domiciled beneficiaries of a settlement, the trustees of which have made a valid election. The non-UK domiciled beneficiary does not need to be a remittance basis user. Only once the provisions of para [126] have been applied is it necessary to see whether the amount of tax that is left in charge is chargeable on the arising basis, in the year in which the gains are treated as having accrued to the beneficiary, or on the remittance basis where one of s.809B, [809D

[217] See 61.53 (Formerly-domiciled resident).

> or 809E] applies.
> 66. ... Although there is only one s.87 pool for each tax year, where an election has been made under para [126](1) trustees will need to keep track of the separate elements of gains attributed to the period before and after 6 April 2008 within the pool.
> 67. There are no special rules to deal with assets where the market value as at 6 April 2008 was either higher or lower than both the cost of acquisition of the asset and the disposal proceeds....
> 81. The election has no effect on the matching of capital payments to section 2(2) amounts or the reduction of capital payments and section 2(2) amounts. It has no effect on gains accruing to UK domiciled beneficiaries.

61.48.1 *"Relevant proportion"*

Para 126(9) sch 7 FA 2008 provides:

> The relevant proportion is A ÷ B where—
> A is what would be the s.2(2) amount for the settlement for the relevant tax year, if immediately before 6 April 2008 every relevant asset had been sold by the trustees (or the company concerned) and immediately re-acquired by them (or it) at the market value at that time, and
> B is the s.2(2) amount for the settlement for the relevant tax year.

In short, rebasing relief applies to relevant assets;
A = gain after rebasing
B = the historic gain (gain without rebasing)

61.48.2 *"Relevant asset"*

Para 126(10) sch 7 FA 2008 provides:

> For the purposes of sub-para (9) an asset is a "relevant asset" if—
> (a) by reason of the asset, a chargeable gain or allowable loss accrues to the trustees in the relevant tax year,[218] and
> (b) the asset has been comprised in the settlement from the beginning of 6 April 2008 until the time of the event giving rise to the chargeable gain or allowable loss.

The s.87 guidance note provides:

> 79. ... It is not possible to make the election only in respect of assets which have increased in value since 6 April 2008...

[218] The relevant tax year is the year that the trust gain (s.1(3) amount) accrues to the trustees.

> 97. You consider only the assets whose disposal gave rise to the section 2(2) amount. Any assets held at 6 April 2008 which are not disposed of are not included in the comparison. This means that assets held at 6 April 2008 need be valued only when they are disposed of.

61.48.3 *Asset in underlying company*

Para 126(11) extends rebasing relief to assets held by companies held by trusts:

> For those purposes, an asset is also a "relevant asset" if—
> (a) by reason of the asset, chargeable gains are treated under s.13[219] of TCGA 1992 as accruing to the trustees in the relevant tax year,
> (b) the company to whom the chargeable gains actually accrue has owned the asset from the beginning of 6 April 2008 until the time of the event giving rise to those chargeable gains, and
> (c) had the company disposed of the asset at any time in the relevant period,[220] part[221] of the chargeable gains (if any) accruing on the disposal would have been treated under s.13 of TCGA 1992 as accruing to the trustees.

Para 11(a)(b) are the equivalent of para 10(a)(b) for directly held trust assets. Para (c) is new. A company's asset is not a relevant asset if a loss accrues on the disposal. But a trust asset can be a relevant asset even if a loss accrues on the disposal. It follows that one can envisage cases where the fraction A/B is greater than 1 (because an asset which gives rise to a loss on an actual disposal may be such that a gain would arise if the asset had been disposed of on 6/4/2008). However it does not matter if this is so. The relief is that:

> The individual is not charged to capital gains tax on so much of the chargeable gains as exceeds the relevant proportion of those gains.

So if the relevant proportion is greater than 1, no relief applies but the tax charge is not increased.

[219] Now s.3 TCGA.

[220] Para 126(12) provides: "In sub-para (11)(c) "the relevant period" means the period beginning at the beginning of 6 April 2008 and ending immediately before the event giving rise to the chargeable gains."

[221] The context shows that this must mean: *all or* part.

61.49 2008 rebasing: HMRC examples

EN FB 2008 provides some examples. Example 1 is relatively straightforward:

> 68. *Example 1: basic mechanism of para [126(8)(9)]*:
> The trustees of a settlement make an election under para [126](1).
> In 2009-10 the trustees dispose of a property for £10 million. The chargeable gain accruing to the trustees is £8 million.
> The chargeable gain that would have accrued to the trustees if the gain had been computed using the market value of the property as at 6 April 2008 as the cost of acquisition is £1 million.
> The trustees make a capital payment to beneficiaries X and Y of £4 million each. X and Y are both resident in the UK but X is also domiciled in the UK whereas Y is not.
> There are no unmatched capital payments or trust gains relating to earlier years.

It is easier to follow in a table:

Gains		**A**	**B**	**A/B**	**Capital payment**	
Pre-08	*Post-08*				*to X*	*to Y (nondom)*
£7m	£1m	£1m	£8m	1/8	£4m	£4m

The HMRC analysis is as follows:

> a. Match the capital payments to the s.2(2) amount for the year. Capital payments total £8 million and match to the s.2(2) amount of £8 million. Chargeable gains of £4 million are treated as accruing to X and Y for 2009-10.
> X is chargeable to CGT in 2009-10 under s.87 on the gains of £4 million. Y is non-UK domiciled so para [126](1) applies to determine how much of the chargeable gains of £4 million is chargeable to tax.
> b. The s.2(2) amount for 2009-10 is £8 million ("B" in para [126(9)].
> c. The s.2(2) amount that would have applied if the trustees had sold the property and reacquired it immediately before 6 April 2008 is £1 million ("A" in para [126(9)].
> d. A/B is ⅛.
> e. Apply A/B to the chargeable gains of £4 million accruing to Y: the amount of the gains that is chargeable to tax under para [126(8)] is
> £4 million/8, i.e. Y is chargeable to CGT on £500,000.
> If Y is a remittance basis user there will be no charge to tax until Y remits gain to the UK.
> There are no surplus capital payments or trust gains for 2009-10.

Example 2 is more challenging.

> 69. *Example 2: matching capital payments across years and s.13 gains*
> The trustees of a settlement make an election under para [126](1)].
> The beneficiaries of the settlement are X, who is UK domiciled, and Y, who is not. Both X and Y are resident in the UK.
> There are no unmatched trust gains or capital payments relating to earlier years.
> In 2010-11 the trustees dispose of two assets:
> a. the chargeable gains are £8 million: the pre 6 April 2008 gains are £7 million and the post 5 April 2008 gains are £1 million;
> b. the overall loss is £5 million: the pre 6 April 2008 gain is £1 million and the post 5 April 2008 loss is £6 million.
> A capital payment of £5 million is made to beneficiary Y.
> In 2011-12 the trustees dispose of an asset. The chargeable gain is £5 million: the pre 6 April 2008 gain is £4 million and the post 5 April 2008 gain is £1 million.
> Capital payments are made to beneficiaries X and Y of £2 million each.
> In 2012-13 an underlying company within s.13 wholly owned by the trustees disposes of an asset.[222] The loss on the asset is £2 million.[223] But substituting the market value as at 6 April 2008 creates a post 5 April gain of £1 million. The trustees also dispose of an asset. The chargeable gain is £3 million: the pre 6 April 2008 gain is £2 million and the post 5 April 2008 gain is £1 million.
> Capital payments are made to beneficiaries X and Y of £2 million each.

The EN sets out a table to summarise these facts which for ease of reference I set out here slightly expanded. It is easier to follow the example with the fuller spreadsheet available online.[224]

	Gain (loss)		**A**	**B**	**A/B**	**Capital payment**	
	Pre-08	*Post-08*				**to X**	**to Y**
2010-11	£8m	(£5m)	£0	£3m	0	-	£5m
2011-12	£4m	£1m	£1m	£5m	⅕	£2m	£2m
2012-13	£2m	£2m	£2m(?)	£3m	⅔(?)	£2m	£2m

[222] The example confusingly adds that the disposal is for £5m. But that is irrelevant, as what matters for tax is the gain or loss on the disposal, not the amount of the sale proceeds.

[223] Author's footnote: This loss is not allowable; careful planning might have avoided that result.

[224] *http://www.kessler.co.uk/wp-content/uploads/2012/05/TFD_rebasing_computation.pdf* (not set out here because it requires an A4 sheet to fit in all the data).

The HMRC analysis is as follows:

2010-11

The s.2(2) amount is £3 million. Match capital payment of £5 million against trust gains of £3 million: chargeable gains of £3 million treated as accruing to Y. But Y is not UK domiciled so para [126] applies.

Only £3 million×(A÷B) of the matched capital payment is chargeable to tax. However, the s.2(2) amount based on the market value of the assets as at 6 April 2008 is £0. Therefore A÷B is zero and none of the chargeable gains treated as accruing to Y is chargeable to tax.

2010-11: £2 million unmatched capital payments to Y.

2011-12

The s.2(2) amount is £5 million. Match capital payments of £4 million in the year against trust gains of £5 million; chargeable gains of £2 million treated as accruing to each of X and Y.

There are £1 million trust gains of 2011-12 unmatched. Step 5 of s.87A(2) applies.

Match 2011-12 £1 million trust gains to unmatched capital payments of £2 million to Y of 2010-11.

Chargeable gains of £1 million treated as accruing to Y. Unmatched capital payment to Y of 2010-11 reduced to £1 million.

X is chargeable to tax on £2 million in respect of 2012-13.

Y has chargeable gains of £3 million in respect of 2012-13. But Y is not UK domiciled so para [126] applies.

Under para [126(8)(9)]£3 million×(A÷B) of the matched capital payment is chargeable to tax.

A÷B is 1/5 so £600,000 of the chargeable gains treated as accruing to Y in 2011-12 are taxable.

£1 million unmatched capital payments to Y originating from 2010-11 to carry forward.

2012-13

The s.2(2) amount is £3 million. The disposal of the asset by the underlying company does not form part of the s.2(2) amount because only s.13 gains are brought into s.87. However, by applying the market values to the assets as at 6 April 2008 there is a gain attributable to the disposal of the asset by the company.

Match the capital payments of £4 million to the s.2(2) amount. Chargeable gains are treated as accruing to X and Y of £1.5 million each under part (b) of Step 3 of s.87A(2).

X is chargeable to tax on £1.5 million in respect of 2012-13.

Y has chargeable gains of £1.5 million in respect of 2012-13. But Y is not UK domiciled so para [126] applies.

Under para [126(8)(9)], £1.5 million×(A÷B) of the matched capital payment is chargeable to tax. A÷B is ⅔ so £1 million of the chargeable gains treated as accruing to Y in 2012-13 are taxable. While the kink in the value of the company's asset has increased the proportion of gains on which Y is chargeable to tax, Y is still better off than if no election had been made.

This assumes that the company's asset is a "relevant asset". However it is not a relevant asset, as it is not the case that "by reason of the asset, chargeable gains are treated under s.13 TCGA as accruing to the trustees in the relevant tax year." The correct figure for A/B is ⅓ and not ⅔ and the taxable gain after rebasing relief is £0.5m and not £1m.

> There are £1.5m unmatched capital payments to Y to carry forward - £1m from 2010-11 and £0.5m from 2012-13.
> There are £0.5m unmatched capital payments to X to carry forward all originating from 2012-13.
>
> 70. *Example 3: keeping track of pre 6 April and post 5 April gains and losses.*
> The trustees of a settlement make an election under para [126](1). The beneficiaries of the settlement are X, who is UK domiciled, and Y, who is not. Both X and Y are resident in the UK. There are no unmatched trust gains or capital payments relating to earlier years.
> In 2010-11 the trustees dispose of an asset. The chargeable gain is £8 million: the pre 6 April gain is £7 million and the post 5 April 2008 gain is £1 million.
> A capital payment of £2 million is made to each of beneficiaries X and Y.
> In 2011-12 the trustees make a further capital payment to X and Y of £2 million each.

The example is easier to follow if the facts are set out in a table:

	Gain	**Gain**	**A**	**B**	**A/B**	**Capital payment**	
	Pre 6/4/08	*Post 5/4/08*				**to X**	**to Y**
2010-11	£7m	£1m	£1m	£8m	⅛	£2m	£2m
2011-12	0	0	n/r	£5m	n/r	£2m	£2m

The HMRC analysis is as follows:

> ***2010-11***
> The s.2(2) amount is £8 million.
> Match capital payments of £4 million in the year against trust gains of £8 million: chargeable gains of £2 million treated as accruing to each of X and Y. X is chargeable to tax on £2 million in respect of 2010-11.
> Y has chargeable gains of £2 million in respect of 2010-11. But Y is not UK domiciled so para [126] applies.
> Under para [126(8)(9)] £2 million×(A÷B) of the matched capital payment is chargeable to tax.
> A÷B is ⅛ so £250,000 of the chargeable gains treated as accruing to Y in 2010-11 are taxable.
> The reduced s.2(2) amount for 2010-11 for the purposes of matching with future capital payments is £4m.
>
> ***2011-12***
> There is no s.2(2) amount for the year. Apply s.87A matching rules to earlier year.
> Match capital payments of £4 million in 2011-12 to s.2(2) amount (as reduced)

for 2010-11 of £4m:
chargeable gains of £2 million treated as accruing to each of X and Y.
X is chargeable to tax on £2m in respect of 2011-12.
Y has chargeable gains of £2 million in respect of 2011-12. But Y is not UK domiciled so para [126] applies.
Under para [126(7)(8)] £2 million×(A÷B) of the matched capital payment is chargeable to tax.
A÷B is 0.5/4 so £250,000 of the chargeable gains treated as accruing to Y in 2011-12 are taxable.
The table below shows how the s.2(2) amount for the year and the underlying gains (or losses) relating to the period before and after 6 April 2008 are matched.

2010-11 matching of capital payments	**Pre 6 April gain/loss**	**Post 5 April gain/loss**	**Total trust gains (s.2(2) amount)**
2010-2011	£7m	£1m	£8m
Less matched to capital payment in 2010-11	£3.5m	£500,000	£4m
Unmatched in 2010-11	£3.5m	£500,000	£4m
Less matched to capital payments in 2011-12	£3.5m	£500,000	£4m
Unmatched in 2011-12	£0	£0	£0

The s.87 guidance note provides:

Example 22: Rebasing: basic operation: para 126 Sch 7
Settlement X is a non-UK resident settlement created in September 2000. The trust fund consists of a number of quoted investments. Some of these have been held since September 2000. Others have been acquired since 6 April 2008. The settlement has two UK resident beneficiaries. A is domiciled in the UK. B is not domiciled in the UK.
As at 6 April 2008 there are no unmatched capital payments and section 2(2) amounts.
2008-09
In 2008-09 a section 2(2) amount of £180,000 accrues to the trustees and capital payments of £50,000 are made to A and B. The capital payments are matched to the section 2(2) amount as shown below.

	2008-09	**Matched**	c/f
Section 2(2) amount	£180,000	£100,000	£80,000
Capital payments A	£50,000	£50,000	nil
Capital payments B	£50,000	£50,000	nil

A chargeable gain of £50,000 accrues to each beneficiary. Beneficiary A is liable to CGT on the full amount of £50,000. The trustees make a valid election under paragraph 126(1) of Schedule 7 before 31 January 2010. The effect of the election is to reduce the gains chargeable on beneficiary B in accordance with paragraph 126(8) of Schedule 7.
You calculate the section 2(2) amount that the trustees would have made if the gain were calculated by reference to the 6 April 2008 value of assets held at that date and included in the disposal.

	Held 6/4/08	**Acquired after 6/4/08**	**Total**
Disposal Proceeds	£180,000	£170,000	£350,000
Acquisition cost	– £10,000	– £160,000	– £170,000
Gain	£170,000	£10,000	£180,000

Disposal Proceeds	£180,000
6/4/08 value	– £165,000
Gain	£15,000

Relevant proportion of s87 gain £50,000 =

$$£50,000 \times \frac{15,000 + 10,000}{180,000} = £6944$$

Beneficiary B is liable to CGT on £6944 of the £50,000 capital payment. If beneficiary B is a remittance basis user the gain will be taxed only when the gain is remitted to the UK.

2009-10

The trustees dispose of assets creating a £20,000 section 2(2) amount. They make capital payments of £15,000 to each beneficiary. £10,000 of each capital payment is matched to the 2009-10 section 2(2) amount. Section 87 gains of £10,000 accrue to each beneficiary in respect of the 2009-10 section 2(2) amount. The £5,000 balance of each capital payment is matched to the £80,000 2008-09 section 2(2) amount. Section 87 gains of £5,000 accrue to each beneficiary in respect of the 2008-09 section 2(2) amount giving total chargeable gains of £15,000 for 2009-10 for each beneficiary. The capital payments for that year are reduced to nil. The section 2(2) amount for 2008-09 is reduced to £70,000.

	Amount/payment	**Matched**	**Year**	**c/f**
2009-10 s.2(2) amount	£20,000	£20,000	2009-10	Nil
Capital payments A	£15,000	£10,000	2009-10	Nil
		£5,000	2008-09	
Capital payments B	£15,000	£10,000	2009-10	Nil
		£5,000	2008-09	
2008-09 s.2(2) amount	£80,000	£10,000	2009-10	£70,000

Beneficiary A will be liable to CGT on the full £15,000 section 87 gain. Beneficiary B's liability will be reduced in accordance with paragraph 126(8) of Schedule 7. This has to be calculated separately for the £10,000 payment matched to the 2009-10 amount and the £5,000 payment matched to the 2008-09 amount. For 2009-10 the figures are:

	Held 6/4/08	**Acquired after 6/4/08**	**Total**
Disposal proceeds	£70,000	£100,000	£170,000
Acquisition cost	–£65,000	– £85,000	– £150,000
Gain	£5,000	£15,000	£20,000

Disposal proceeds	£70,000
6/4/08 value	£80,000
Loss	(£5,000)

The section 2(2) amount calculated using 6 April 2008 values is £10,000 ie

£15,000 – £5,000. The relevant proportion of the £10,000 section 87 gain is:

$$\pounds 10{,}000 \times \frac{10{,}000}{20{,}000} = \pounds 5{,}000$$

The CGT liability on the £5,000 section 87 gain relating to the 2008-09 section 2(2) amount is limited to:

$$\pounds 5{,}000 \times \frac{25{,}000}{180{,}000} = \pounds 694$$

B's total liability to CGT in 2009-10 is on gains of £5,694 (£5,000 + £694). If beneficiary B is a remittance basis user the gain will be taxed only when the gain is remitted to the UK.

Example 23: Rebasing: relevant proportion is 0: para 126 Sch 7
The facts are the same as that in example 22 year 2009-10 except for the 6 April 2008 value of the assets sold. This is £120,000.
The calculation is now:

	Held 6/4/08	**Acquired after 6/4/08**	**Total**
Gain	**£5,000**	**£15,000**	**£20,000**
Disposal proceeds	£70,000		
6/4/08 value	– £120,000		
Loss	£50,000		

The section 2(2) amount calculated using 6 April 2008 values is £15,000 – £50,000. This is restricted to 0 as a section 2(2) amount cannot be negative. Beneficiary B is not liable to CGT on any of the £10,000 2009-10 gain ie £10,000 × 0 = 0. B remains liable to CGT on the section 87 gain matched to the 2008-09 section 2(2) amount. As in example 22 this is £694.
B's capital payments for 2009-10 are still reduced to nil.

61.50 2008 rebasing: Minor rules

61.50.1 *Asset derived from asset*

Para 126(13) sch 7 FA 2008 extends the relief where one asset is derived from another asset without a disposal, ie a case where s.43 applies.[225] This will not be very common. Para 126(13) provides:

> If—
> (a) by reason of an asset which would not otherwise be a relevant asset ("the new asset"), chargeable gains or allowable losses accrue, or are treated under s.13 as accruing, to the trustees in the relevant tax year,
> (b) the value of the new asset derives wholly or in part from another asset ("the original asset"), and
> (c) s.43 of TCGA 1992 applies in relation to the calculation of the

[225] See 56.4.10 (Asset derived from asset).

chargeable gains or allowable losses,

the new asset (or part of that asset) is a "relevant asset" if the condition in sub-para (10)(b) or the conditions in sub-para (11)(b) and (c) would be met were the references there to the asset to be read as references to the new asset or the original asset.

61.50.2 *Inter-group transfer*

Para 126(14)(15) sch 7 FA 2008 extends rebasing relief where there is an inter-group transfer:

> (14) If—
>
> (a) on or after 6 April 2008, a company ("company A") disposes of an asset to another company ("company B"), and
>
> (b) s.171 of TCGA (transfers within groups) (as applied by s.14(2) of that Act) applies in relation to the disposal,
>
> for the purposes of sub-para (11) (and this sub-paragraph) treat company B as having owned the asset throughout the period when company A owned it.
>
> (15) If an asset is a relevant asset by virtue of sub-para (14), for the purposes of sub-para (9)—
>
> (a) treat the chargeable gains as having accrued to the company which owned the asset at the beginning of 6 April 2008, and
>
> (b) treat the proportion of those chargeable gains attributable under s.13 of TCGA 1992 to the trustees as being the proportion of the chargeable gains actually accruing that are so attributable.

Para 126(16) to (18) deals with the situation where an asset is held by a company, and the trustees have held different interests in the company at different times:

> (16) If—
>
> (a) an asset would otherwise be a "relevant asset" within sub-para (11), and
>
> (b) the proportion of chargeable gains treated under s.13 of TCGA 1992 as accruing to the trustees by reason of the asset ("the relevant proportion") is greater than the minimum proportion,
>
> for the purposes of sub-para (9) treat the appropriate proportion of the asset as a relevant asset and the rest of the asset as if it were not a relevant asset.
>
> (17) "The minimum proportion" is the smallest proportion of chargeable gains (if any) that would have been attributable to the trustees on a disposal of the asset at any time in the relevant period (as defined by sub-para (12)).

> (18) "The appropriate proportion" is the minimum proportion divided by the relevant proportion.

This does not work. Suppose for example a trust held 50% of the shares in a non resident company, T Ltd before 2008, and later acquired all the shares. T Ltd realises a gain of £100 on an asset (the company's asset) held before 2008. The gain is deemed to accrue to the trust under s.13.
The terms of subpara 16 are met:

> (a) the company's asset would otherwise be a "relevant asset" within sub-para (11), and
> (b) the proportion of chargeable gains treated under s.13 of TCGA 1992 as accruing to the trustees by reason of the asset ("the relevant proportion" - 100%) is greater than the minimum proportion (which under the definition in 126(17) is 50%.

So subpara 16 directs:

> for the purposes of sub-para (9) treat the appropriate proportion of the asset as a relevant asset and the rest of the asset as if it were not a relevant asset.

We need to ascertain the appropriate proportion. That is one half divided by the relevant proportion. So we need to know the relevant proportion. That is:

> A÷B where—
> A is what would be the s.2(2) amount for the settlement for the relevant tax year, if immediately before 6 April 2008 every relevant asset had been sold by the trustees (or the company concerned) and immediately re-acquired by them (or it) at the market value at that time, and
> B is the s.2(2) amount for the settlement for the relevant tax year.

B is £100. In order to work out A we need to know what is the relevant asset, but we do not know what is a relevant asset until we have applied subpara 16. Presumably we are to ignore the subpara 16 reduction, in which case the company asset is the relevant asset. Assume that the company asset was worth £50 on 6 April 2008, so the relevant proportion is one half. Then the appropriate proportion is one-half divided by one-half, = one. I suspect that the drafter has confused "divided" with "multiplied". What a shambles! Fortunately the problem may not often arise.

61.51 2008 rebasing: OIG amounts

Para 101 sch 7 FA 2008 provides equivalent rebasing relief for OIGs:

> (1) This paragraph applies if—
>
> (a) the trustees of a settlement have made an election under paragraph 126(1) (re-basing election),
>
> (b) income is treated under regulation 17 of the Offshore Funds (Tax) Regulations 2009 as arising to an individual in the tax year 2008–09 or any subsequent tax year ("the relevant tax year") by reason of the matching, under section 87A of TCGA 1992 as applied by regulation 20 of those Regulations, of an OIG amount with a capital payment received by the individual from the trustees, and
>
> (c) the individual is resident or ordinarily resident, but not domiciled,[226] in the UK in the relevant tax year.
>
> (2) The individual is not charged to income tax on so much of the income as exceeds the relevant proportion of that income.
>
> (3) Sub-paragraphs (9) to (18) of paragraph 126 (meaning of "the relevant proportion") apply for the purposes of sub-paragraph (2) above as if—
>
> (a) references to section 2(2) amounts were to OIG amounts,
>
> (b) references to chargeable gains were to offshore income gains,
>
> (c) references to allowable losses were omitted, and
>
> (d) references to anything accruing were to it arising (and similar references were read accordingly).

Amended as para 101(3) requires, para 126(9) to (12) provide:

> (9) The relevant proportion is A÷B where—
>
> A is what would be the ~~section 2(2) amount~~ OIG amount for the settlement for the relevant tax year, if immediately before 6 April 2008 every relevant asset had been sold by the trustees (or the company concerned) and immediately re-acquired by them (or it) at the market value at that time, and
>
> B is the ~~section 2(2) amount~~ OIG amount for the settlement for the relevant tax year.
>
> (10) For the purposes of sub-paragraph (9) an asset is a "relevant asset" if—
>
> (a) by reason of the asset, ~~a chargeable gain or allowable loss accrues~~ an offshore income gain arises to the trustees in the

[226] See 61.53 (Formerly-domiciled resident).

relevant tax year, and

(b) the asset has been comprised in the settlement from the beginning of 6 April 2008 until the time of the event giving rise to the chargeable gain or allowable loss.

(11) For those purposes, an asset is also a "relevant asset" if—

(a) by reason of the asset, ~~chargeable gains~~ offshore income gains are treated under section 13[227] of TCGA 1992 as ~~accruing~~ arising to the trustees in the relevant tax year,

(b) the company to whom the ~~chargeable gains~~ offshore income gains actually accrue has owned the asset from the beginning of 6 April 2008 until the time of the event giving rise to those ~~chargeable gains~~ offshore income gains, and

(c) had the company disposed of the asset at any time in the relevant period, part of the ~~chargeable gains~~ offshore income gains (if any) accruing on the disposal would have been treated under section 13 of TCGA 1992 as ~~accruing~~ arising to the trustees.

(12) In sub-paragraph (11)(c) "the relevant period" means the period beginning at the beginning of 6 April 2008 and ending immediately before the event giving rise to the ~~chargeable gains~~ offshore income gains.

(It is not necessary to set out the rest of para 126, as amended).

61.52 Rebasing: Transfer between trusts

Para 127(1) schedule 7 FA 2008 provides:

This paragraph applies if—

(a) in the tax year 2008-09 or any subsequent tax year, the trustees of a settlement ("the transferor settlement") transfer all or part of the settled property to the trustees of another settlement ("the transferee settlement"),

(b) s.90 of TCGA 1992 applies in relation to the transfer,

(c) the trustees of the transferor settlement have made an election under para 126(1),

(d) by virtue of the matching of a capital payment with the s.2(2) amount for the transferee settlement for the tax year 2008-09 or any subsequent tax year ("the relevant tax year"), chargeable gains are treated under s.87 or 89(2) of, or para 8 of Schedule 4C to, TCGA 1992 as accruing to an individual in a tax year, and

(e) the individual is resident, but not domiciled,[228] in the UK in that

[227] Now s.3 TCGA.

[228] See 61.53 (Formerly-domiciled resident).

year.

61.52.1 *Election to rebase*

Para 127(2) sch 7 FA 2008 provides:

> If the trustees of the transferee settlement have made an election under para 126(1), para 126(7) to (9) have effect in relation to the transferee settlement for that year as if the reference in para 126(9) to relevant assets included relevant assets within the meaning of this paragraph.

61.52.2 *No election to rebase*

Para 127 sch 7 FA 2008 provides:

> (3) If the trustees of the transferee settlement have not made an election under para 126(1), the individual is not charged to capital gains tax on so much of the chargeable gains mentioned in sub-para (1)(d) above as exceeds the relevant proportion of those gains.
>
> (4) The relevant proportion is A ÷ B where—
>
> A is what would be the s.2(2) amount for the transferee settlement for the relevant tax year, if immediately before 6 April 2008 every relevant asset had been sold by the company concerned and immediately re-acquired by it at the market value at that time, and
>
> B is the s.2(2) amount for the transferee settlement for the relevant tax year.
>
> (5) For the purposes of this paragraph an asset is a "relevant asset" if—
>
> (a) by reason of the asset, chargeable gains are treated under s.13 of TCGA 1992 as accruing to the trustees of the transferee settlement in the relevant tax year,
>
> (b) the company to whom the chargeable gains actually accrue has owned the asset from the beginning of 6 April 2008 until the time of the event giving rise to those chargeable gains,
>
> (c) had the company disposed of the asset at any time in the relevant period, part of the chargeable gains (if any) accruing on the disposal would have been treated under s.13 of TCGA 1992 as accruing to—
>
> (i) the trustees of the transferor settlement (if the disposal had been made before the transfer), or
>
> (ii) the trustees of the transferee settlement (if it had not).
>
> (6) In sub-para (5)(c) "the relevant period" means the period beginning at the beginning of 6 April 2008 and ending immediately before the event giving rise to the chargeable gains.
>
> (7) Sub-paras (13) to (18) of para 126 apply for the purposes of this paragraph (with such modifications as are necessary) as they apply for the

purposes of that paragraph.

January 2009 Qs & As provides:

> **Q7** In applying the allocation rules to transfers between settlements, the transferor trust gains carried across will be treated as having accrued to the transferee trust in the year in which they in fact accrued to the transferor trust. Those gains that have been matched with capital payments out of transferor trust in the year of transfer or previous years will be left out of account. Gains carried across will be allocated to a capital payment from the transferee trust on a 'last in first out' (LIFO) basis. Gains on such assets will be governed by whether or not the transferor trust has made a rebasing election under paragraph 126 sch 7 FA 2008.
>
> If the transferor settlement has made a rebasing election by the time of the transfer of the transferee settlement, then pre and post April 2008 gains which are deemed to have accrued on the actual disposal of an asset go across *pro rata*.
>
> If the transferor settlement has not made a rebasing election by the 31 January following the year of the transfer, then even if no capital payment has yet been made, the right to rebase is lost in relation to the transferred assets and any assets retained in the transferor trust.
>
> However, it should be noted that any transfers between settlements made prior to 6 April 2008 will not trigger a time limit on rebasing and any assets moving over to the transferee settlement as a result of a transfer made prior to 6 April 2008 will not be affected by any subsequent election for rebasing made by the transferor trust. If the asset appointed over to the transferee settlement before 6 April 2008 includes shares in a company within s.13 TCGA 1992, then the transferee settlement may wish to elect for rebasing in its own right. An election made by the transferee settlement may cover gains made by such a company – see para 127 Sch 7 FA 2008. Transferee settlements which receive property on or after 6 April 2008 cannot elect for rebasing in relation to the transferred assets – the decision is solely that of the transferor settlement.

The s.87 guidance note provides:

> **Rebasing and transfers between settlements**
>
> 110. A rebasing election made by the transferor settlement can cover gains made by that settlement after 5 April 2008 even if they are not brought into charge until they are matched with capital payments made by the transferee settlement. Transferee settlements receiving property on or after 6 April 2008 cannot elect for rebasing in relation to the transferred assets – the decision is solely that of the transferor settlement. See example 26.

111. An election made by the transferee settlement can cover gains made by that settlement after 5 April 2008 including those on assets received, prior to 6 April 2008, from another settlement.

Example 26 Effect of 'rebasing election' made by transferor settlement on gains made by transferor settlement treated as accruing when matched with capital payments made by transferee settlement: para 126 Sch 7

All the settled property of the transferor settlement is transferred to the transferee settlement for nil consideration in 2009-10. No capital payments have been made out of the transferor settlement. The transferor settlement had no gains made by the trustees prior to the transfer.

Gains arise on the transfer of £100,000. These are on the disposal of an asset which had been held by the trustees since 2001. The post 5 April 2008 element of the gain is £15,000 based on the difference between the value at 6 April 2008 and the value at the time it is transferred.

The transferee settlement has no unmatched section 2(2) amounts of its own. Its only unmatched section 2(2) amount is the £100,000 for 2009-10 it is treated as receiving on the transfer.

In 2010-11 the transferee settlement makes a capital payment of £300,000 to a UK resident but non-UK domiciled beneficiary. Under section 87 £100,000 of the capital payment is matched with the section 2(2) amount and a £100,000 chargeable gain is treated as accruing to the beneficiary.

If a valid election under paragraph 126 Schedule 7 has been made by the trustees of the transferor settlement then only the post 5 April 2008 element of the gain (£15,000) is chargeable to tax on the beneficiary. And that is subject to the remittance basis if the beneficiary is a remittance basis user.

If no valid election has been made by the trustees of the transferor settlement then the full £100,000 is chargeable to tax on the beneficiary. Again this is subject to the remittance basis if the beneficiary is a remittance basis user.

An election made by the trustees of the transferee settlement has no effect on this gain.

Rebasing and transfers between settlements owning non-UK resident companies: para 127 Sch 7

The transfer of settled property between settlements does not result in a disposal of the assets held in the underlying non-UK resident company. Where the transfer takes place after 5 April 2008 a disposal may subsequently be made by the underlying company of assets it acquired prior to 6 April 2008. In such a case the rules in paragraph 126 do not apply to any gains made by the underlying company as it has not been part of the transferee settlement structure since 5 April 2008 – paragraph 126(11)(c)

There are special rules in paragraph 127 to give 'rebasing election' relief in such cases.

113. For any relief to be available the trustees of the transferor settlement must have made a 'rebasing election'. How any relief is calculated depends on whether, or not, the trustees of the transferee settlement have also made a 'rebasing election'.

114. If the trustees of the transferee settlement have made a rebasing election then the assets disposed of by the underlying company are treated in the same way as

any assets the transferee settlement has owned from before 6 April 2008 – paragraph 127(2).

115. If the trustees of the transferee settlement have not made a rebasing election then you have to calculate a fraction 'A/B' called the 'relevant proportion' where (A) is defined as the section 2(2) amount for the transferee settlement for the year a gain is treated as accruing to the non-UK domiciled beneficiary on the assumption the underlying company had sold and immediately re-acquired all its relevant assets at market value immediately before 6 April 2008, divided by (B) is defined as the actual section 2(2) amount for the transferee settlement for the relevant tax year

116. The non-UK domiciled beneficiary is not charged to tax on so much of the gains treated as accruing to him that exceeds the 'relevant proportion' of those gains – paragraph 127(3) & (4). See example 27.

Example 27 Effect of 'rebasing election' made by transferor settlement on gains made by underlying non-UK resident close company after company has been transferred to another settlement: Para 127 Sch 7

All the settled property of the transferor settlement is transferred to the transferee settlement for nil consideration in 2009-10. No capital payments have been made out of the transferor settlement. The transferor settlement had no gains made by the trustees prior to the transfer.

The transferor settlement's only assets at the time of transfer are shares in a wholly owned non-UK resident company which it has owned since 2001. A gain arises on the transfer of £100,000. The post 5 April 2008 element of the gain is £15,000 based on the difference between the value at 6 April 2008 and the value at the time it is transferred.

The underlying non-UK resident company continues to own an asset which it acquired in 2002. That asset is sold in 2011-12 and produces an overall gain of £150,000. The post 5 April 2008 element of the gain is £20,000 based on the difference between the value at 6 April 2008 and the value at the time of its disposal.

The transferee settlement has no unmatched section 2(2) amounts of its own. Its only unmatched section 2(2) amount is the £100,000 for 2009-10 it is treated as receiving on the transfer.

In 2011-12 the transferee settlement makes a capital payment of £250,000 to a UK resident but non-UK domiciled beneficiary. Under section 87 £150,000 of the capital payment is matched with the £150,000 gain made by the underlying non-UK resident company in 2011-12. A £150,000 chargeable gain is treated as accruing to the beneficiary in 2011-12.

Under section 87 a further £100,000 of the capital payment is matched with the section 2(2) amount for 2009-10 and a £100,000 chargeable gain is treated as accruing to the beneficiary in 2011-12.

If no valid election has been made by the trustees of the transferor settlement then the full amount of the gains (£150,000 and £100,000 respectively) are chargeable to tax on the beneficiary in 2011-12. This is subject to the remittance basis if the beneficiary is a remittance basis user. The tax due on the gain relating to the 2009-10 section 2(2) amount will be increased by section 91.

If a valid election under paragraph 126 of Schedule 7 has been made by the trustees of both settlements only the post 5 April 2008 element of both of the gains (£20,000 for the 2011-12 section 2(2) amount and £15,000 for the 2009-10 section 2(2) amount) are chargeable to tax on the beneficiary in 2011-12. This is subject to the remittance basis if the beneficiary is a remittance basis user. The time limit for making the election is 31 January 2011 for the transferor settlement and 31 January 2013 for the trustees of the transferee settlement. The tax due on the gain relating to the 2009-10 section 2(2) amount will be increased by section 91.

If a valid election has been made by the trustees of the transferor settlement but not the trustees of the transferee settlement the formula in paragraph 127(4) applies to determine the relevant proportion of the gain on which the beneficiary is taxed. Suppose the facts are the same as the example but there is further section 2(2) amount for 2011-12 when the trustees dispose of an asset they have held since before 6 April 2008. The gain on this asset is £80,000. £80,000 of the capital payment made in 2011-12 is matched against this section 2(2) amount. The total amount matched against the 2011-12 section 2(2) amount is £230,000 leaving only £20,000 to be matched against the 2009-10 section 2(2) amount.

A in the formula in paragraph 127(4) is the transferee settlement's section 2(2) amount for 2011-12 if all the relevant assets had been sold and reacquired at their value immediately before 6 April 2008. These are the assets in the underlying company. This part of the section 2(2) amount is £20,000 to which you have to add the £80,000.

B in paragraph 127(4) is the full section 2(2) amount of the transferee settlement for 2011-12 of £230,000 (£150,000 + £80,000).

The UK resident but non-UK domiciled beneficiary is charged on £230,000 × £100,000/£230,000 = £100,000 of the gains matched to the 2011-12 section 2(2) amount. The gain on the payments matched against the section 2(2) amount on the transfer in 2009-10 is covered by the paragraph 126 election made the trustees of the transferor settlement. The amount of that gain charged to CGT on the UK resident but non-UK domiciled beneficiary is limited to £3000 (£20,000 × 15,000/100,000). The total gains chargeable in 2011-12 are £103,000. This is subject to the remittance basis if the beneficiary is a remittance basis user. The tax due on the gain relating to the 2009-10 section 2(2) amount will be increased by section 91.

61.52.3 *Transfer between trusts: OIG*

Para 102 sch 7 FA 2008 provides equivalent rules for OIG amounts:

> (1) This paragraph applies if—
> (a) in the tax year 2008–09 or any subsequent tax year, the trustees of a settlement ("the transferor settlement") transfer all or part of the settled property to the trustees of another settlement ("the transferee settlement"),
> (b) section 90 of TCGA 1992 applies in relation to the transfer,
> (c) the trustees of the transferor settlement have made an election

under paragraph 126(1),

(d) by virtue of the matching (under section 87A of TCGA 1992 as applied by regulation 20 of the Offshore Funds (Tax) Regulations 2009 (S.I. 2009/3001)) of a capital payment with an OIG amount of the transferee settlement, income is treated under such regulations (regulation 17 of those Regulations [)] as arising to an individual in a tax year ("the relevant tax year"), and

(e) the individual is resident or ordinarily resident, but not domiciled,[229] in the UK in the relevant tax year.

(2) If paragraph 101 applies in relation to the transferee settlement, paragraph 126(9) as applied by paragraph 101(3) has effect as if the reference there to relevant assets included relevant assets within the meaning of paragraph 127(4) (as modified by sub-paragraph (4)(b) below).

(3) If paragraph 101 does not apply in relation to the transferee settlement, the individual is not charged to income tax on so much of the income mentioned in sub-paragraph (1)(d) above as exceeds the relevant proportion of that income.

(4) Sub-paragraphs (4) to (7) of paragraph 127 (meaning of "the relevant proportion") apply for the purposes of sub-paragraph (3) above as if—

(a) references section 2(2) amounts were to OIG amounts,

(b) references to chargeable gains were to offshore income gains, and

(c) references to anything accruing were to it arising.

61.53 UK dom/formerly-dom resident

The 2008 transitional reliefs cease to apply to a non-dom who acquires an actual UK domicile.

The reliefs continue to apply to those who become deemed domiciled under the 15-year rule, but para 172 sch 7 FA 2008 removes the reliefs for formerly-domiciled residents. Para 172(1) provides:

> Sub-paragraph (2) has effect for the purposes of—[230]

Sch 7 para	**Topic**	**See**
100(1)(b)	OIG	61.44.1
101(1)(c)	OIG	61.51
102(1)(e)	OIG amounts	61.52.3
118(3)(b)[231]	Pre-1998 gain/capital payment	61.41

[229] See 61.53 (Formerly-domiciled resident).

[230] For clarity I have set this out in tabular form rather than the layout of the statute.

[231] so far as having effect for purposes of para 118(1)(d).

124(1)(b)	Pre-2008 gain/cap payment, matched post 2008	61.44
126(7)(b)	2008 rebasing relief	61.47
127(1)(e)	Rebasing: Transfer between trusts	61.52
151(1)(b)	Payment received 12 Mar 08 - 5 Apr 08	-

Assuming one of these transitional reliefs is in point, we read on:

> (2) An individual not domiciled in the UK at a time in the tax year 2017-18, or a later tax year, is to be regarded as domiciled in the UK at that time if—
>
> (a) the individual was born in the UK,
>
> (b) the individual's domicile of origin was in the UK, and
>
> (c) the individual is resident in the UK for the tax year concerned.

61.54 Non-resident trust: CGT planning

When are non-resident trusts advantageous for CGT?

One situation is to maximise use of losses: losses of remittance basis taxpayers are generally unallowable,[232] but losses of non-resident trusts can be set against s.1(3) amounts (trust gains). However no-one *plans* to realise losses so that is not generally a planning point.

61.54.1 *s.87 basis v. arising basis*

For taxpayers who are not UK domiciled (or deemed domiciled), non-resident trusts are direct ownership for property within the scope of UK CGT, ie

(1) For a remittance basis taxpayer: UK situate property and land-rich assets are within the scope of CGT

(2) For a taxpayer who does not claim the remittance basis: all assets. So even where an individual is not so wealthy that it is worth paying the remittance basis charge, it may still be worthwhile setting up a non-resident trust.

Also trusts are worthwhile for a taxpayer in anticipation of becoming deemed domiciled.

The CGT advantage of the trust is that that gains are taxed on a s.87 capital payment basis and not on the arising basis. That is, if property is held by the settlor directly, gains would be chargeable on an arising basis; if the same property is held on a trust, the gains are taxable on a capital payments basis.

[232] See 65.16 (Loss of remittance basis taxpayer).

61.54.2 *s. 87 basis v. remittance basis*

Non-resident trusts may be better than absolute ownership of foreign situate property by remittance basis taxpayers, as they may avoid the application of the mixed fund rule.

Example 1 (trust better than absolute ownership)
Suppose a foreign situate asset is acquired for £1m, sold for £2m, giving a gain of £1m.

If the asset is held by a remittance basis taxpayer (T) who remits £1m, there is a CGT charge on £1m as the remitted sum is all gain. By contrast, suppose:

(1) the asset is held in a non-resident trust.
(2) the trust makes a capital payment of £1m to T offshore.
(3) in the following year, the trust makes a capital payment of £1m to T onshore.

The offshore payment has reduced the s.1(3) amount to nil, so the second payment is free of CGT.

However to take advantage of this requires careful timing of gains and payments that is often not practical. Often, the remittance basis will be better than the capital payments basis.

Example 2 (trust worse than absolute ownership)
Suppose 3 foreign situate assets are each acquired for £1m, sold for £2m, giving a gain of £1m each.

If the assets are held by a remittance basis taxpayer (T) who remits the £2m proceeds of one of the assets, there is a CGT charge on £1m only. (Assume the proceeds are not paid into a singe account, ie are not mixed.)

By contrast, suppose:

(1) the assets are held in a non-resident trust.
(2) the trust makes a capital payment of £2m in the UK.

There is then a CGT charge on £2m.

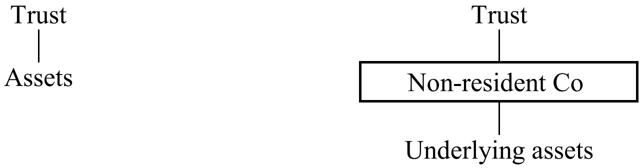
The solution may be to have three separate trusts, one for each asset.

61.54.3 *When non-resident trust not desirable*

Non-resident trusts are not desirable where the settlor is non-UK resident, since trust gains are s.1(3) amounts and gains accruing to the settlor are in principle CGT free.

61.55 Trust holding company

Trustees may hold trust assets directly or through a wholly-owned non-resident company (here called **“an underlying company”**).



Which is better? This is a very large question, raising many issues, for many taxes, and the following is more of a checklist.

61.55.1 *Holding co: Advantages*

The trustees have the option to sell the company rather than the underlying assets, potentially avoiding SDLT and, (subject to the land-rich asset rules) CGT which would otherwise arise on a disposal of UK assets.

There may be IT advantages, particularly for UK source income: depending on the type of income, the company only pays tax at the basic rate, or corporation tax rate.

For dividend income receipt by the company is tax free because the company qualifies for a tax credit. But if the income is distributed, or within the scope of s.731, UK beneficiaries will pay tax at their marginal rates, and the use of the company may increase effective tax rates.

There may be of course IHT advantages (the company being non-UK situate).[233]

A UK resident holding company may be advantageous if the income of the non-resident company falls within s.720, as it allows the income to be accumulated.

It is harder to utilise capital losses which accrue to the company.

61.55.2 *Asset extraction problem*

The extraction of assets from the company will generally give rise to a double charge:

(1) An extraction involves a disposal by the underlying company. Gains accruing to the company on that disposal may be attributed to the trustees under s.3 and so constitute trust gains (s.1(3) amounts).[234]

[233] See too 52.21 (Transfer: Trust to underlying co).

[234] See 64.1 (Section 3 TCGA: Introduction). But the motive defence may apply.

(2) In addition, there may be a further charge on extraction of an asset from the company:

(a) If the asset is extracted on a liquidation, the offshore trustees dispose of the company's shares and so further trust gains accrue.

(b) If asset is extracted by dividend, the dividend is income for tax purposes, raising IT issues.

There is normally no relief for that double charge.[235]

Other problems, usually less significant, are:

(1) Losses of the underlying company are restricted and easily lost altogether.

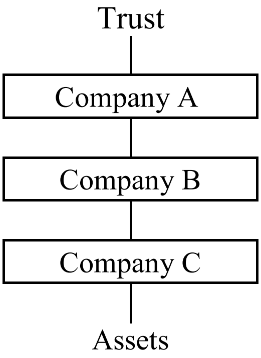
(2) If the property is a residence, CGT private residence relief (if otherwise available) is lost by use of a company.[236]

In short: an underlying company should not be used unless there is some good reason to justify the extraction of asset problem.

If the trustees need limited liability, a LLP (which is transparent for CGT) is an alternative which avoids the problems.

61.55.3 *Chain of cos: Disadvantages*

Suppose a chain of companies thus:



The asset extraction problem is now exacerbated.

(1) The asset may be extracted by a series of liquidations: C Ltd is liquidated and its asset transferred to B Ltd; B Ltd is liquidated and its

[235] There are some reliefs, eg s.3 distribution relief; but these only help the person who pays tax under s.3, so would only be relevant to a settlor-interested trust within s.86.

[236] See 64.34 (Private residence relief).

asset is transferred to A Ltd; A Ltd is liquidated and its asset is transferred to the trustees. This involves 6 disposals (3 disposals of the asset and disposals of the shares of A, B and C Ltd). The three disposals of the asset give rise to one chargeable gain (the first two disposals qualify for group relief) but the three disposals of the shares give rise to 3 sets of chargeable gain, with no group relief.[237] The position is worse than where there is no chain of companies.

(2) The asset may be extracted by a series of dividends: C Ltd transfers the asset in specie to B Ltd by way of dividend, B Ltd transfers the asset in specie to A Ltd by way of dividend, and A Ltd transfers the asset to the trustees by way of dividend. In this case there is again only one chargeable gain from the disposal of the asset. There is also only one set of income for s.720 or s.731 purposes.[238]

In short: chains of companies should in principle be avoided where possible.

61.56 Basic planning for s.87

In outline the position is as follows:

61.56.1 *Indefinite deferral*

Beneficiaries are only liable to the s.87 charge if they receive a capital payment. But there may be no need for a capital payment to be made. Instead, the capital of the trust fund may be retained. The beneficiaries of the settlement would enjoy a trust fund unreduced by the burden of CGT. In this way the charge may be postponed indefinitely.

61.56.2 *Non-resident beneficiary*

Section 1(3) amounts are treated as chargeable gains accruing to a beneficiary who receives capital payments. But a beneficiary who is not resident in the UK (and not temporarily non-resident[239]) is not subject to CGT on those gains. Such a beneficiary may therefore receive capital payments from the trust tax free, just as they can realise capital gains of their own without incurring a tax charge.

[237] See 64.24 (CG group reliefs).

[238] See 51.12 (Section 720 trust/co/and co/subsidiary structure); see 50.32 (Company income distributed).

[239] See 11.1 (Temporary non-residence).

61.56.3 *UK/nondom beneficiaries: Capital payment timing*

Section 1(3) amounts which have been matched with a capital payment to a beneficiary in an earlier tax year cease to be available for the purpose of the s.87 charge in the following year. This principle applies when the beneficiary is a remittance basis taxpayer. Suppose that s.1(3) amounts are matched with capital payments to a remittance basis beneficiary and the capital payments equal the total s.1(3) amounts. In subsequent tax years these are not taken into account and a capital payment may be made to a UK arising basis beneficiary without incurring any tax charge under s.87. Careful timing is needed. The payment to the remittance basis beneficiary must be made in one tax year and the payment to arising basis beneficiary must be postponed until the following tax year. Section 1(3) amounts accruing in a subsequent tax year may be taxed on that beneficiary.

In *McLaughlin v HMRC*[240]a marketed tax avoidance scheme involved bringing in a nondom beneficiary artificially. This survived a technical challenge; and (on its facts rather surprisingly) a *Ramsay*/realistic view challenge.

61.57 GAAR guidance

GAAR guidance provides two s.87 examples.

61.57.1 *Capital payment timing*

The first example is straightforward timing planning, which no-one would have thought was within the GAAR:

D20 Offshore trust and washing[241] out gains - example 1
This example illustrates that where the legislation sets precise boundaries the GAAR will not be in point where taxpayers satisfy the statutory conditions.
D20.2 The arrangements
D20.2.1 A discretionary trust resident outside the UK was set up by a now deceased foreign domiciled settlor.[242] The trust is worth £4m, has a pool of trust gains of £2.5m and no accumulated income or offshore income gains. There are

[240] [2012] UKFTT 174 (TC). The artificial planning in this case would now be caught by the GAAR.

[241] I would hesitate to use the term "wash", but the GAAR guidance uses it in an apparently neutral, non-pejorative sense.

[242] The example posits that the settlor is deceased:
(1) in order to avoid s.86 complications; and,
(2) perhaps, to establish the genuineness or long term nature of the trust.

no Sch 4C gains.

D20.2.2 There are four beneficiaries,

– two of whom are resident and domiciled in the UK and

– two of whom live permanently outside the UK [more analytically, are non-resident].

The trustees have made no capital distributions in recent years and it has been decided to end the trust.

The trustees have three options and the taxpayer's analysis on each is as follows:

Option 1 [Payment to all beneficiaries at once]

End the trust in Year 1 paying £1m to each beneficiary.

The UK resident beneficiaries will each pay UK tax on one quarter of the trust gains i.e. £625,000, at the appropriate rate, since the gains are allocated pro rata to the beneficiaries. The non-resident beneficiaries will pay no UK tax although half the trust gains are allocated to them.

Option 2 [Payment to UK beneficiaries first]

Pay the UK resident beneficiaries £2m in Year 1 and the non-resident beneficiaries £2m in Year 2.

The UK resident beneficiaries will each pay UK tax on £1m of gains since all the gains are allocated to them on a LIFO basis. The non-UK resident beneficiaries pay no UK tax and no gains are allocated to them.

Option 3 [Payment to foreign beneficiaries first]

Pay the non-UK resident beneficiaries £2m in Year 1 and the UK resident beneficiaries £2m in Year 2.

The non-UK resident beneficiaries pay no UK tax but the pool of trust gains that can be allocated to payments in the following year is reduced to £500,000. £2m of gains have been "washed out". The UK resident beneficiaries each pay CGT on £250,000.

D20.2.3 The trustees therefore choose option 3 resulting in the least amount of tax for the beneficiaries. The UK resident beneficiaries receive their payment later but with less tax payable.

D20.4 The taxpayer's tax analysis

D20.4.1 The taxpayer's analysis is as set out above. The taxpayer contends that LIFO should be applied.

D20.5 What is the GAAR analysis under s.207(2) FA 2013?

D20.6 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether expressed or implied) and the policy objectives of those provisions?*

The trustees are entitled to organise distributions in a way that minimises tax for the beneficiaries within the range of normal tax planning.

In relation to option 3 the substantive results of the transactions are consistent with the principles on which the relevant provisions are based. The trustees have three different ways of achieving the same result viz to end the trust and distribute property equally to the beneficiaries. They are not compelled to choose the one that raises the most tax or the "middle" option. Provided the payments to the non-resident beneficiaries in Year 1 are genuinely intended to benefit them (and the cash will not simply be passed back to the UK residents later) HMRC would not seek to invoke the GAAR.[243] It is clear that the policy of the capital gains tax legislation in relation to capital payments to beneficiaries is to operate a LIFO policy and in some cases this will result in greater tax on UK residents and in some cases less.

D20.6.1 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The trustees of the discretionary trust making payment to the UK resident beneficiaries in the later year would not be regarded as a contrived or abnormal step.

D20.6.2 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

The anomalies that may arise under the LIFO rules are not seen as shortcomings in themselves but just a necessary result of having a system that allocates gains to capital payments in a certain order.

D20.6.3 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

The arrangements accord with established practice and HMRC has indicated acceptance of the practice.[244]

D20.7 Conclusion

D20.7.1 This is not regarded as an abusive tax arrangement and HMRC would not seek to invoke the GAAR.[245]

From 2018, this example is overtaken by the non-resident disregard.[246] But the same principle applies if:

(1) There were four beneficiaries of which two were domiciled in the UK, and two were resident non-domiciled remittance basis taxpayers, who received the payment first and did not remit.

(2) There were two non-resident beneficiaries, and the trustees adopted

[243] An arrangement under which the benefits non-resident beneficiaries will pass the benefit on to UK resident beneficiaries is caught without invoking the GAAR: see 61.8.1 (Indirect receipt from trust).

[244] The author is not aware of any publication where HMRC have accepted the practice (other than the GAAR guidance itself). But it does not matter.

[245] HMRC, "GAAR Guidance" Part D (Examples) (2017) *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

[246] See 61.21 (Non-resident disregard).

option 1 which may become the favoured option.

61.57.2 *Self-cancelling payment*

The second GAAR example concerns a scheme which no-one would have thought falls outside the GAAR (except that it would fail on traditional *Ramsay* grounds of circular, self cancelling arrangement/inserted steps):

D21 Offshore trusts and washing out gains - Example 2
This example illustrates that the inclusion of abnormal steps may cause the arrangement to become abusive in its own context.
D21.2 The arrangements
Mrs X is non-UK resident and domiciled.
Her son Y is UK resident but foreign domiciled and occupies a house owned by a non-UK resident company that is held within a trust.
The trustees own no other assets. The property is worth £10m. Gains that have accrued[247] post April 2008 are £4m (£2m on property and £2m on company).[248] The property has not increased in value since April 2013.[249]
The trustees do not want to pay ATED and decide to end the trust by liquidating the company [and then distributing the trust property]. The intention of the trustees and family is that the son should own the property.
There is no accumulated income or offshore income gains.
The trustees are advised on two options and the taxpayer's analysis on each is as follows:
Option 1 - Trustees pay [more correctly, transfer] the property to the son. He receives a capital payment of £10m in the UK to which gains of £4m are attributed [more correctly, matched]. He will pay tax on all the trust gains at 28%. The remittance basis does not apply. There is also a small inheritance tax exit charge.
Option 2 - The settlor[250] adds £4m cash to the trust in year 1.
In the same year the trust liquidates the company and holds the property direct thus realising the £4m gain.
It then pays the £4m cash back to the settlor in the same year.
Year 2 - the property is distributed to the son with a small amount of inheritance

[247] I think the reference is to unrealised gains.

[248] In fact the £2m gain accruing to the company is likely to qualify for the s.3 motive defence. But this does not spoil the point of the example.

[249] This is factually implausible, but it simplifies matters by avoiding the complication of CGT on the disposal, and does not affect the point of the example.

[250] It is, I think, implied that Mrs X is the settlor of the trust. But it does not matter whether the £4m is added by the settlor or some other non-resident, non-domiciled person.

tax. The £4m cash payment made in Year 1 washes out the trust gains and so on the distribution of the property to the son there is no CGT.
The trustees therefore choose option 2.

In this example the motive for the capital payment to the son is to avoid ATED. But that background is irrelevant: The same planning could arise whenever it was desired to make a capital payment to a UK beneficiary within the scope of s.87.

If one accepts that the trust must be unwound, there are better options. But those alternatives do not spoil the point of the example.

D21.4 The taxpayer's tax analysis

D21.4.1 The taxpayer's analysis is as set out above. The taxpayer contends that LIFO should be applied.

D21.5 What is the GAAR analysis under s207(2) FA 2013

D21.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether expressed or implied) and the policy objectives of those provisions?*

The trustees are entitled to organise distributions in a way that minimizes tax for the beneficiaries within the range of normal tax planning.[251]

However, option 2 is not consistent with the principles on which the relevant tax provisions are based. LIFO was intended to operate on distributions of capital to beneficiaries by matching gains in a certain order. In this case the settlor has added the cash to the trust as part of a pre-arranged scheme to wash out the gains that she knows will be realised and on the basis that she will receive the cash back again. HMRC would seek to invoke the GAAR. The legislation was not intended to allow settlors to add cash to trusts on a short term basis only to receive it back again shortly thereafter and simply as an exercise to wash out gains.

D21.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*

The addition of cash followed by the payment out is an abnormal step that is contrived.

D21.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*

This does intend to exploit a shortcoming in the legislation in a manner where the transactions are intended to have no economic consequences. The settlor has made the gift in the full expectation of receiving the monies back shortly and therefore not losing out.

The position would be different if the settlor had made the gift of cash and the

[251] This is a slightly loose paraphrase of the statutory rules, but I think unobjectionable in the context of the example.

trustees later independently decided in the exercise of their discretion to pay that cash out to other beneficiaries rather than as part of a pre-arranged circular scheme to pass the cash back to the settlor. Then the same issues would not arise.

D21.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*

HMRC has never accepted such practice.

D21.6 Conclusion

D21.6.1 HMRC would seek to apply the GAAR to such arrangements.

D21.7 Proposed counteraction

D21.7.1 The likely counteraction would be that the addition to the trust and payment of cash to the settlor would be ignored and the son will pay tax as under option 1.[252]

This seems right. The unfairness should be noted of imposing ATED on a company set up in accordance with standard practice, without a de-enveloping relief;[253] but that unfairness is one of the "principles on which the relevant tax provisions are based".

In practice, it is not actually worth paying CGT on £4m, or even £2m, just to avoid ATED, so the better option may be to leave the structure as it is (though IHT also need consideration). But that does not spoil the point of the example. Perhaps that is the point of the example.

As with most of the GAAR guidance, the answer to the posited example is easy and uncontroversial. What would the position be if the settlor made the payment to the trust, acknowledging the possibility (with a varied range of probabilities) of a capital payment to a non-resident beneficiary (not necessarily the settlor) in a few years time? The reader will not expect GAAR guidance to answer that.

From 2018, the example has been superseded by the non-resident disregard,[254] but the issue could arise in other circumstances, such as a UK resident remittance basis taxpayer beneficiary.

61.58 Record keeping for s.87/s.731

In cases where it is anticipated that s.87 charges are likely to arise, trustees (most likely using UK agents) should make an annual computation of s.1(3) amounts (trust gains). Likewise if it is anticipated that s.731 charges are

[252] HMRC, "GAAR Guidance" Part D (Examples) (2017) *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

[253] See 98.37 (De-enveloping).

[254] See 61.21 (Non-resident disregard).

likely to arise, trustees (most likely using UK agents) should make an annual computation of relevant income. It should be less work to do this annually than to wait until it matters and review back years after the event.

61.58.1 *Form 50(FS)*

A computation of relevant income, and s.1(3) amounts (trust gains), could be sent annually to HMRC in the voluntary form 50(FS). The TSE Manual provides:

> **TSEM10130 Non-resident trusts: issue of form 50FS** [Aug 2019]
> Although the trustees of a trust which has been non-resident throughout a tax year are not chargeable to Capital Gains Tax on the trust gains, the trust gains may be attributable to the settlor and/or beneficiaries who will be chargeable on the attributed gains in the year the gains arise or in a later year.
> SPT Personal Tax International issue forms 50FS to non-resident trusts that are notified to HMRC. The form is a non-statutory form requesting information on trust income and gains. It also asks for details of capital payments made by the trustees to enable HMRC to monitor liabilities arising to UK resident settlors and beneficiaries of non-resident trusts. Completion of the form is voluntary, but by completing the form and providing information which can be used to reconcile entries made on the settlors' and/or beneficiaries' tax returns, the trustees may prevent enquiries being made into those aspects of the settlors' and beneficiaries' tax returns.
> The forms can be issued to any person (including trustees, settlor or beneficiary) and are also available on the HMRC website for customers.

In the absence of immediate or closely anticipated tax charges, I wonder if it is worthwhile for trustees to complete the form.

What if no records are available? HMRC practice is pragmatic. The INT Manual provides:

> **INTM601700 Relevant income** [Jul 2023]
> For the purposes of calculating the liability of a UK resident beneficiary who receives a capital distribution or benefit it is important that the trustees of non-resident trusts maintain records of the income and gains that arise in the structure. They should maintain historical records for the purpose of matching the income and gains with the capital distributions and benefits they make. Sometimes, for various reasons, no historic record of the amounts of capital, income and gains arising in the funds under management are available. This presents trustees with specific difficulties

in notifying UK resident beneficiaries, who have received capital distributions or benefits from the trustees, of the income and gains against which such distributions can be matched which would give rise to a UK tax liability. Where this occurs, it may be necessary to estimate the capital, income and gains elements contained within funds under management for each year based upon the known facts.

Based upon the known facts available, any reasonable agreed basis may be adopted although no estimate should be applied if the actual information required to decide the matter can be obtained from third parties. In such cases the actual information should be sought and used.

Where it is necessary to estimate, either the Retail Prices Index (RPI), or the Consumer Prices Index (CPI) may be applied to an agreed year and scaled forward or backward as agreed to reach an agreed apportionment of the investment fund. Any known fact, such as the value of the opening capital settled, should also be factored into the analysis.

Alternatively, reference may be made to using investment performance information for each relevant year that may have been compiled by professional trust associations specifically for this purpose. This may provide an acceptable alternative to using an estimated calculation in situations where the original records are not held or cannot be obtained.

Where HMRC are advised that no records of historic funds under management have been maintained - or that estimated or investment performance tables have been used to reconstitute the capital, income or gain elements of such funds - a risk assessment of the tax impact should be undertaken. Where the suggested adjustment is considered to be material then the matter should be investigated further.

If technical advice is required by HMRC staff in these circumstances, they should contact Personal Tax International (see INTM604440).

61.58.2 *Pre-2008 records*

The s.87 guidance note provides:

> 133. Before 6 April 2008 trustees of non-UK resident settlements that have no UK domiciled beneficiaries, or beneficiaries who may become UK domiciled, will not have had to consider the possible UK CGT liabilities of the beneficiaries. From 6 April 2008 they will have to consider the possibility that a charge under section 87 or Schedule 4C TCGA may accrue to UK resident but non-UK domiciled beneficiaries.
>
> 134. In relation to pre 6 April 2008 transactions HMRC recognise that in such cases trustees
>
> - May not have kept sufficient records to calculate precisely the post 5 April 2008 CGT liabilities that may accrue on UK resident but

> non-UK domiciled beneficiaries, or
>
> - May not want to incur the expense of searching through old records to obtain all the necessary information to calculate precise CGT liabilities.
>
> 135. In such cases HMRC will consider any reasonable solution suggested to them. Usually proposed solutions will have to be considered on a case by case basis.

The guidance note concludes:

> One solution that HMRC will accept generally is that all assets held by trustees or underlying companies at midnight on 5 April 2008 are treated as having a zero acquisition cost. Provided the trustees make a valid election under paragraph 126 of Schedule 7 there will be no disadvantage to the beneficiaries. This is because the chargeable gain is restricted to the growth in the value of asset since 6 April 2008.

If a rebasing election is made, pre-2008 gains do not often matter, but there are situations in which it does matter.

61.59 Tax return: s.87 gain

Section 87 gains are returned in Box 18 in the Capital Gains Tax summary pages (form SA108) 2022/23. The note beside this box reads:

> Attributed gains where personal losses cannot be set off.

Form SA108 (notes) 2022/23 provides:

> Only fill in this box if you've received any gains, capital payments or benefits, as a beneficiary from a non-UK resident trust.

Helpsheet HS299 (Non-resident trust and CGT) 2023 provides:

> If you're liable to Capital Gains Tax as a beneficiary (whether or not you are also the settlor), because you directly or indirectly receive capital or some other benefit from the trust, then, details of such gains should be set out in a computation accompanying the Capital Gains Tax summary pages and the amount included in box 18.

61.60 DT relief: s.87 gain

61.60.1 *Trustee treaty-resident outside UK*

Suppose:

(1) Gains ("trust gains") accrue to a trust which is:

(a) not tax-resident but

(b) treaty-resident in a foreign state with a DTA with a CG article in standard OECD Model form.

(2) The beneficiary receives a capital payment so a s.87 gain accrues to them.

(3) The beneficiary is UK tax-resident and not treaty-resident in the foreign State.

The question is whether the beneficiary qualifies for third party DTA relief.[255] Where a Savings Clause applies, the answer is no.

What if the treaty does not have a Savings Clause? At first sight, the DTA offers no defence to the charge on the beneficiary. The trust gains accruing to trustees meet the requirements for DTR but the s.87 gain accruing to the beneficiary under s.87 TCGA is not the same gain as the trust gains accruing to the trustees.[256] Section 87 may be regarded as a charge on the capital payment, or a charge on fictional gains, but it is not a charge on the trust gains accruing to the trustees. That seems reasonably clear for several reasons:

(1) The wording of s.87(2) suggests that the s.87 gains and the trust gains are distinct.

(2) If the trust gains exceed the capital payment, it would not be clear which trusts gains were charged. Although there are matching rules, these rules only match capital payments to trust gains of a year; they do not match capital payments to specific gains within the year.

(3) For the purposes of the CGT remittance basis, the s.87 gain is treated as accruing on the disposal of a foreign situate asset, even if trust gains of the trustees accrue on the disposal of a UK situate asset.[257]

The absence of DT relief in this situation was always unjust, but following the extension of s.87 to foreign domiciliaries in 2008 it became a more significant injustice.

There is however an argument that the gains accruing to the trustees are not s.1(3) amounts (trust gains). The definition is:

> the amount upon which the trustees of the settlement would be chargeable to tax under s.1(3) for that year if they were resident in the UK in that year.

[255] See 109.2 (Third-party DT relief).

[256] See 107.22 (Characterisation).

[257] See 61.19 (s.87 remittance basis).

Applying this rule (the s.87 residence assumption), ie assuming the trustees were UK resident, they should still be treaty non-resident, so "the amount on which they would be chargeable to tax" would be nil![258] I refer to this as the **"DT argument"**. It is the old question of how far to carry the deeming.[259] The argument is supported by the fact that the s.86 residence assumption expressly deals with the treaty point.[260]

Unfortunately an argument of this kind was put in a similar context in *Bricom v IRC* where it was rejected. That was a case on the CFC residence assumption. The issue was to ascertain the chargeable profits of the CFC. The relevant legislation then provided:

> **Section 747(6) ICTA:** In relation to a company resident outside the UK—
> (a) any reference in this Chapter to its chargeable profits for an accounting period is a reference to the amount which, on the assumptions in Schedule 24, would be the amount of the total profits of the company for that period on which ... corporation tax would be chargeable.
>
> **Para 1(1) sch 24 ICTA:** The company shall be assumed to be resident in the UK.

The CFC was resident in the foreign state, and treaty-resident there, and it argued that although it was deemed to be UK resident, the deeming did not undo the fact of treaty non-residence. Accordingly, the CFC's chargeable profits should be ascertained on the assumption that the CFC was dual resident and entitled to DTA relief.

The CoA rejected the argument:

> ... para 1(1) of Sch 24 is a statutory assumption, and is ambiguous. The question is: what is the nature of the assumption?...
>
> In the present case the purpose for which the assumptions are required is self-evident (!). A controlled foreign company is ex hypothesis resident outside the UK. As a non-resident, it will not normally be subject to UK corporation tax and will have made no claim to relief from such tax. The computation of the profits on which corporation tax is chargeable, therefore, involves ascertaining a hypothetical amount, that is to say the amount which would have represented the amount of such profits if the

[258] This assumes that the trustees would claim treaty relief, see 61.6.4.
The position is different for gains accruing to underlying companies which are deemed to accrue to the trustees under s.3. See 61.6.1 (s.87 residence assumption).

[259] See See App 8.2 (Deeming provisions: Construction).

[260] See 60.11.1 (Residence assumption).

> controlled foreign company had been resident in the UK and had made all necessary claims for relief. The assumptions which Sch 24 requires are not additional assumptions to be made in combination with the actual facts. In relation to the matters which they cover they are substituted for the actual facts. [The CFC] was resident outside the UK; this means that it had no profits actually chargeable to corporation tax; accordingly its chargeable profits are to be ascertained on the footing that it was resident in the UK instead.

So far so good. The judgment continues:

> It is as simple as that. There is no question of dual residence.
> ... The chargeable profits referred to in s 747(4)(a) must be ascertained without reference to the double taxation agreement ....[261]

The reader may think that the Court has ignored, rather than answered the point, or may have thought that treaty-residence and UK tax residence were the same thing. Or perhaps this a particularly blatant case of assuming the answer and then construing the statute to yield that answer.

However that may be, *Bricom* is not a general rule for the construction of all statutory residence assumptions, but a case on the construction of the CFC residence assumption. The point in the s.87 code should be considered independently.

If the DT argument were correct, there would be an anomaly between:

(1) trusts which were UK-law non-resident and treaty non-resident, ie within the scope of a DTA; and
(2) trusts which were UK tax-resident and treaty non-resident, for these are caught by s.88 TCGA.[262]

The CG Manual provides:

> **CG38610 Trustees' gains - section [1(3)] amount** [Nov 2019]
> Foreign tax paid by the trustees may be deductible in calculating the trustees' section [1(3)] amount, TIOPA10/S113.

See 111.27 (CGT/IT computation deduction).

If third-party DT relief is not available, a CGT computation deduction is available so foreign tax paid by the trustee is deducted in computing the s.1(3) amount. This is because:

(1) The s.1(3) amount is the amount on which trustees would have been

[261] *Bricom v IRC* 70 TC 272 at p.289.
[262] See 61.38 (Dual-Resident trust: s.88 TCGA).

chargeable to tax if UK resident; and

(2) UK resident trustees would qualify for a CGT computation deduction, which reduces the amount on which trustees would be chargeable to tax.

61.60.2 *Beneficiary treaty-resident outside UK*

Suppose:

(1) Gains ("trust gains") accrue to a trust which is:
    (a) not tax-resident and not
    (b) treaty-resident in a foreign State.
(2) The beneficiary receives a capital payment so a s.87 gain accrues to them.
(3) The beneficiary is UK tax-resident and treaty-resident in a foreign State with a standard form CGT article.

Can the beneficiary claim treaty relief directly? Art.13(5) OECD Model provides (with immaterial exceptions):

> Gains from the alienation of any property ... shall be taxable only in the Contracting State of which the alienator is a [treaty-resident].

In 2018, I said:

> It is suggested that the beneficiary cannot claim DT relief because:
> (1) The beneficiary is not the alienator.[263]
> (2) The gain is not "from the alienation of any property".
> The contrary is arguable, but does require a very loose reading of the provision.

The position is however changed by the 2019 CGT rewrite, as s.87B(2) now reads:

> The chargeable gains [s.87 gains] are chargeable gains accruing on the disposal of an asset situated outside the UK.

So DT relief should apply, from 2019/20, at least if the beneficiary claims the remittance basis.

[263] See 64.40.1 (Individual treaty non-resident; company simple non-resident).

CHAPTER SIXTY TWO

BORROWING BY NON-RESIDENT TRUSTS: SCH 4B

62.1 Borrowing by non-resident trust
62.1.1 Loan issues: Navigation
62.2 Flip-flop schemes
62.2.1 Income tax flip-flop scheme
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62.1 Borrowing by non-resident trust

This chapter considers schedules 4B and 4C TCGA, which are designed to counter a set of tax avoidance schemes informally known as flip-flop schemes.

62.1.1 *Loan issues: Navigation*

Trust loans can raise countless issues in addition to sch 4B/4C: if a full list could be written, it would include most chapters in this work. The following may serve as a starting point:

General loan issues	**See para**
General law loan issues	App 2.5
Taxation of interest (including situs of source)	26.1
Situs of benefit of debt	102.1
Trust borrower under loan	
Loan from individual lender to trust	
Remittances: are trustees relevant persons in relation to lender	18.6
s.624: is lender a settlor/is the loan an interest in the trust	47.6.4; 99.26
Could loan cause a POA intangible property charge	83.8
Repayment of trust borrowing to individual lender	
s.633/s.727: charge on repaying loan to settlor/transferor	47.14; 49.23
All loans to trusts	
IHT deduction for trust debt	80.1; 80.15
Tainting protected trusts	92.7
Trust lender under loan	
s.731/s.87 benefit	50.10
Loans to/from companies held by trusts	61.11

62.2 Flip-flop schemes

In order to understand the law it is helpful to review these schemes. They were designed avoid ss.86, 77 and 87 TCGA and I refer to them as "**s.86, 77, and 87 schemes**". (The catchy title "flip-flop" schemes seems inapt, though it is, perhaps, useful to have as a label.)

The s.86 scheme was as follows. Suppose a non-resident settlor-interested trust ("trust 1") wished to dispose of an asset. The gain on the disposal would in principle be taxed on the settlor under s.86 TCGA. The following steps could be taken:

(1) The trustees of trust 1 borrow money up to the value of the asset.
(2) They transfer the borrowed money to a second trust ("trust 2").
(3) The trustees exclude the settlor and designated persons from trust 1 so that s.86 ceases to apply to it.[1]
(4) In the following tax year, the trustees of trust 1 may sell the asset and realise a gain to which s.86 does not apply. They may then repay the loan.

This scheme was in principle successful.[2]

The s.77 scheme was designed to avoid s.77 TCGA. It involved (more or less) the same steps as the s.86 scheme. In this case however the legislation was (slightly) differently worded. It was litigated in *West v Trennery*[3], where the result (appropriately) flip-flopped: the first instance decision was reversed in the High Court, which was reversed in the Court of Appeal, which was reversed in the House of Lords. When the roulette wheel stopped spinning, the s.77 scheme turned out to be unsuccessful. Section 77 has long been repealed, so this is now of historical interest only, but the background explains one or two features which survive in the present legislation.

The s.87 TCGA schemes came in two versions. The first version was as follows. Suppose a non-resident trust ("trust 1") without any s.1(3) amount (trust gains) wished:

(1) to dispose of an asset on which trust gains would accrue, and
(2) to make a capital payment to UK beneficiaries.

[1] See 60.5 (Settlor-interested condition).

[2] *Burton v HMRC* [2009] UKFTT 203 (TC). At that time I said "It was striking that the transactions took place in 2000 but the appeal was not heard until a decade later." But nowadays such delay is so common that it does not excite comment.

[3] [2005] UKHL 5.

The beneficiaries would in principle be chargeable under s.87. The following steps could be taken:

(1) The trustees of trust 1 borrow money up to the value of the asset.
(2) They transfer the borrowed money to a second trust ("trust 2").
(3) The trustees of trust 2 made a capital payment to the beneficiary.
(4) In the following tax year, the trustees of trust 1 sell the asset and realise a gain. The capital payment from trust 2 is not matched with the gain in trust 1.
(5) The trustees may then repay the loan.

A second (and more common) version of the s.87 scheme could be used for a trust which did have trust gains. Suppose the trust wished to make a capital payment to UK beneficiaries. The beneficiaries would in principle be chargeable under s.87. The following steps could be taken:

(1) The trustees of trust 1 borrow money.
(2) They transfer the borrowed money to trust 2.
(3) The trustees of trust 2 make a capital payment to the beneficiary. The capital payment from trust 2 is not matched with the trust gains of trust 1. Section 90 TCGA would have stopped this scheme (it carried the trust gain across to trust 2, where the gain would be matched to the capital payment from trust 2). However this section was absentmindedly disapplied by sch 4B TCGA in 2000, which lead to a flurry of tax avoidance until the mistake was corrected in 2003.[4]
(4) In due course, the trustees of trust 1 may repay the loan.

In the 2015/16 edition of this work I said:

> The s.87 schemes were held to be unsuccessful in *Herman v HMRC*. It is striking that most of these expensive and widely marketed schemes failed, contrary (I think) to the general expectation of the profession. The reader may think that the taxpayer had the better argument, in *Trennary* and in *Herman*. What lessons should be learned from the debacle? I leave readers to ponder over that.

The courts subsequently reversed the decision in *Herman*,[5] so the s.87 schemes succeeded after all, or at least those of them which held out to the end of the battle. There is still food for thought in this eventful history, but perhaps less cause for gloom.

[4] See 61.39.6 (Interaction with sch 4B).

[5] See 61.8.1 (Indirect receipt from trust).

Be that as it may, the key features of the schemes were trustee borrowing and a transfer of trust property in year 1, followed by a disposal in a subsequent year. Schedule 4B produces a deemed disposal in year 1, which counteracts the s.86 (and s.77) schemes and the first version of the s.87 scheme. Schedule 4C contains a modified version of the s.87 regime, which allows gains of trust 1 to be matched with capital payments from trust 2; this counteracts the second version of the s.87 scheme.

62.2.1 *Income tax flip-flop scheme*

Since schedules 4B/4C only apply for CGT purposes, the reader may wonder if something similar to the s.86 scheme could work for IT. Suppose a non-resident settlor-interested discretionary trust ("trust 1") wished to receive income (for instance by receiving dividends) which would fall within s.624 or s.720. Could the following steps be taken:

(1) The trustees borrow money up to the anticipated income.
(2) They transfer the borrowed money to a second trust ("trust 2").
(3) The trustees use their powers to exclude the settlor (etc) from trust 1 so that trust ceases to be settlor-interested.
(4) In the following tax year, the trustees of trust 1 receive the income and repay the borrowing.

The answer is that income tax capital payment provisions, s.633 ITTOIA and s.727 ITA, fill that gap, not to mention the GAAR; but perhaps there may be occasions where planning of that kind is possible.

Similarly, since sch 4C only applies for CGT and OIG purposes, the reader may wonder if something similar to the s.87 schemes would work for s.731; the answer is no, as transfers between trusts do not isolate relevant income.[6] In this respect, s.731 operates rather like schedule 4C.

62.3 The key conditions

Para 1 sch 4B TCGA provides:

> (1) This Schedule applies where trustees of a settlement—
> (a) [i] make a transfer of value (see paragraph 2)
> [ii] in a year of assessment in which the settlement is within section 86 or 87 (see paragraph 3), and
> (b) in accordance with this Schedule the transfer of value is treated as linked with trustee borrowing (see paragraphs 4 to 9).

[6] See 50.13.2 (Transfer between trusts).

Thus there are three key conditions, or sets of conditions:

Condition	**See para**
Transfer of value (in my terminology, a " **sch4B-transfer**")	62.4
Trustee borrowing	62.10
The sch4B-transfer is "linked" with trustee borrowing	62.12

If these conditions are satisfied, there is what I call "**a sch4B-disposal**".[7]

62.4 Sch4B-transfer

The statutory term "transfer of value" is unfortunate. Firstly the term is usually used with its IHT meaning. Secondly, the term is artificially defined to include loans and other transactions which do not constitute a transfer of value in any normal sense of the term. Although it is usually better to adopt statutory terminology, in this case I think it is clearer to use the term "**sch4B-transfer**".

The fact that there is a sch4B-transfer does not necessarily mean that there is a sch4B-disposal: the transfer is only the first of the three conditions that must be met for a sch4B-disposal.

There are three types of sch4B-transfer. Para 2(1) sch 4B TCGA provides:

> For the purposes of this Schedule trustees of a settlement make a [sch4B] transfer of value if they—
> (a) lend money or any other asset to any person,
> (b) transfer an asset to any person and receive either no consideration or a consideration whose amount or value is less than the market value of the asset transferred, or
> (c) issue a security of any description to any person and receive either no consideration or a consideration whose amount or value is less than the value of the security.

Trustees do not make a sch4B-transfer:

(1) If an underlying company held by trustees lends, transfers, or issues a security.

(2) If trustees repay a loan.

I comment on the 3 types of sch4B-transfer in the order set out in the statute.

[7] See 62.17 (Sch4B-disposal).

62.5 Sch4B-transfer: Loan

Para 2(1) sch 4B TCGA provides:

> For the purposes of this Schedule trustees of a settlement make a [sch4B] transfer of value if they—
>
> (a) lend money or any other asset to any person...

The CG Manual provides:

> **CG35124. Transfer of value** [Jan 2015]
> Under TCGA 1992, SCH 4B, para 2(1) trustees make a transfer of value if they
>
> (a) lend money or any other asset, regardless of whether a commercial rate of interest or hire is charged...

The flip-flop schemes[8] used in practice involved a transfer of an asset, not a loan. But (were it not for this provision) there could be a s.87 scheme under which:

(1) trust 1 lent to trust 2, and
(2) trust 2 lent to a beneficiary (or acquired property used rent free by the beneficiary).

So the legislation needed to deal with loans as well as transfers of assets.

62.5.1 *Occupation of property*

RI 259 provides:

> **B2 Paragraph 2(1)(a)—beneficiary exercising rights under [TOLATA][9] 1996 s 12**
> In certain circumstances a beneficiary's occupation of property, instead of being the consequence of the volition of the trustees, may result from personal rights under Trusts of Land and Appointment of Trustees Act 1996 s 12. Our view is that if the rights of the beneficiary arise as a consequence of the wording of the deed or will, then the occupation does not give rise to a transfer of value. It may be otherwise where the rights have arisen as a consequence of the exercise by the trustees of a power of appointment or advancement.

But it is considered that a beneficiary's occupation of property is not a loan of an asset, and (unless the trustees grant a lease) it is not a part-

[8] See 62.2 (Flip-flop schemes).

[9] The original refers erroneously to the "Trustee etc Act".

disposal of the property, so it is not a sch4B-transfer, and the application or otherwise of TOLATA is not relevant.

RI 259 provides:

> **B7 What happens when trustees put money into a conventional current or deposit account at a bank or building society?**
> Although in general law this is regarded as a loan from the customer to the bank, in the context of this legislation we do not consider that this comes within the meaning of "lend" for the purposes of para 2(1)(a). The currency in which the deposit is made is immaterial.

This is purposive, bordering on wishful, thinking; but since it usually suits the taxpayer, it will not usually be challenged.

62.6 Sch4B-transfer: Asset

Para 2(1) sch 4B TCGA provides:

> For the purposes of this Schedule trustees of a settlement make a [sch4B] transfer of value if they...
> (b) transfer an asset to any person and receive either no consideration or a consideration whose amount or value is less than the market value of the asset transferred...

This is the most important type of sch 4B-transfer.

Para 13(1) sch 4B TCGA provides a commonsense definition of "asset":

> In this Schedule any reference to an asset includes money expressed in sterling.
> References to the value or market value of such an asset are to its amount.

This is needed as sterling is not usually regarded as an asset for CGT purposes.[10]

Para 13(2) sch 4B TCGA provides a wide definition of "transfer":

> Subject to sub-paragraph (3), references in this Schedule to the transfer of an asset include
> [a] anything that is or is treated as a disposal of the asset for the purposes of this Act,
> [b] or would be if sub-paragraph (1) above ["asset" includes £ sterling] applied generally for the purposes of this Act.

[10] See 56.3.2 ("Assets").

The CG Manual provides:

> **CG35125. Transfer of value** [Jan 2015]
> References to transfers of value include everything that is or is treated as a disposal under TCGA 1992, and also include transfers or loans of money, and loans of other assets. Note that this includes disposals of assets such as government stock or a dwelling house occupied as a beneficiary's principal private residence, even though there would be no chargeable gain on the disposal. It also includes the occasion of a beneficiary becoming absolutely entitled as against the trustee but in this context see CG35128...
> CG35124(b) above makes it clear that a sale of an asset, whether to an unconnected person or a beneficiary, is not a transfer of value provided it is for full consideration.

RI 259 provides:

> **B1 Paragraph 2(1)(b)—cash distributions which are income**
> Where trustees of a discretionary trust make a distribution which is income of the recipient for UK tax purposes, this is not a [sch4B] "transfer of value" within para 2, which is concerned with capital transactions.

This interpretation is not obviously what the legislation says. But it is a sensible view of the overall scheme of the legislation and, as it benefits the taxpayer, is unlikely to be challenged.

62.6.1 *Grant of lease*

Para 13(3) sch 4B TCGA provides:

> References in this Schedule to a transfer of an asset do not include a transfer of an asset that is created by the part disposal of another asset.

The CG Manual provides:

> **CG35125. Transfer of value** [Jan 2015]
> ... Some part disposals involve the creation of a new asset. In this situation any reference in the legislation to the transfer of an asset refers to the (part) disposal of the old asset.

RI 259 provides:

> **B8** ... Under paragraph 13(2) references to the transfer of an asset include references to anything that is a disposal, and under section 21(2) TCGA references to a disposal include references to a part

> disposal. [The manual sets out para 13(3) and continues:] The grant of a lease is a part disposal of the freehold interest and therefore the grant of a lease is a transfer of the freehold interest for the purposes of paragraph 2(1)(b) and is not regarded as the transfer simply of the lease.

62.7 Sch4B transfer: Security

Para 2(1) sch 4B TCGA provides:

> For the purposes of this Schedule trustees of a settlement make a [sch4B] transfer of value if they ...
>
> (c) issue a security of any description to any person and receive either no consideration or a consideration whose amount or value is less than the value of the security.

It is normally companies rather than trusts which issue securities, so this is of somewhat theoretical interest. RI 259 provides:

> **B3 Paragraph 2(1)(c)— "issue a security"**
> We have been asked what the expression "issue a security" covers. It caters for those exceptional circumstances where trustees issue to a beneficiary or to the trustees of another trust a document acknowledging liability. Schedule 4B para 13(2) provides that references to the transfer of an asset include everything that is or is treated as a disposal of an asset. The issue of a security is not in itself the disposal or part disposal of an asset. Therefore para 2(1)(b) does not apply to it, and it was necessary to have a specific provision to cover this possibility.

In practice, as far as I am aware, flip-flop schemes were not carried out by issuing a security but it would be possible: issuing the security at an undervalue is a capital payment. A neater solution would have been to define transfer to include the creation of an asset (as for the ToA provisions); but it works.

62.8 Amount of value transferred

Para 2 sch 4B TCGA provides:

> (3) In the case of a loan, the amount of value transferred is taken to be the market value of the asset.
> (4) In the case of a transfer, the amount of value transferred is taken to be—
>
> (a) if any part of the value of the asset is attributable to trustee borrowing, the market value of the asset;
>
> (b) if no part of the value of the asset is attributable to trustee

> borrowing, the market value of the asset reduced by the amount or value of any consideration received for it...
>
> (5) In the case of the issue of a security, the amount of value transferred shall be taken to be the value of the security reduced by the amount or value of any consideration received by the trustees for it.
>
> (6) References in this paragraph to the value of an asset are to its value immediately before the material time, unless the asset does not exist before that time in which case its value immediately after that time shall be taken.

The grant of a lease out of a freehold is treated as a sch4B-transfer of value of the freehold interest, and the amount of the value transferred is therefore the value of the freehold, not the value of the lease.

> **B8 What happens when money is borrowed to purchase the freehold interest of a property which is then rented on a commercial basis?**
>
> ... Under para 13(2) references to the transfer of an asset include references to anything that is a disposal, and under TCGA 1992 s 21(2) references to a disposal include references to a part disposal. Paragraph 13(3) provides that references to a transfer of an asset do not include the transfer of an asset which is created by the part disposal of another asset. The grant of a lease is a part disposal of the freehold interest and therefore the grant of a lease is a transfer of the freehold interest for the purposes of para 2(1)(b) and is not regarded as the transfer simply of the lease. If the freehold interest was bought with borrowed money it meets the test in para 2(4)(a), and the amount of value transferred equals the market value of the freehold.

62.9 Settlement within section 86/87

Para 3 sch 4B TCGA provides (more or less) commonsense definitions.

62.9.1 *Within s.86*

Para 3 sch 4B TCGA provides:

> (1) This paragraph explains what is meant in this Schedule by a settlement being "within section 86 or 87" in a year of assessment.
>
> (3) A settlement is "within section 86" in a year of assessment if, assuming—
>
> (a) that there were chargeable gains accruing to the trustees by virtue of disposals of any of the settled property originating from the settlor, and

> (b) that the other elements of[11] the condition in subsection (1)(e) of that section were met,
>
> chargeable gains would, under that section, be treated as accruing to the settlor in that year.
>
> Expressions used in this sub-paragraph have the same meaning as in section 86.

62.9.2 *Within s.87*

Para 3 sch 4B TCGA, as inserted by s.92(2) FA 2000, used to provide:

> *(4) A settlement is "within section 87" in a year of assessment if, assuming—*
>
> *(a) there were trust gains for the year within the meaning of subsection (2) of that section, and*
>
> *(b) that beneficiaries of the settlement received capital payments from the trustees in that year or had received such payments in an earlier year,*
>
> *chargeable gains would, under that section or section 89(2), be treated as accruing to the beneficiaries in that year.*
>
> *Expressions used in this sub-paragraph have the same meaning as in section 87.*

This para was rewritten by para 130 sch 7 FA 2008:

> In paragraph 3 of Schedule 4B (transfers of value by trustees linked with trustee borrowing: settlements), for sub-paragraph (4) substitute—
>
> "(4) A settlement is "within section 87" for a tax year if—
>
> (a) section 87 applies to the settlement for that year,[12] or
>
> (b) chargeable gains would be treated under section 89(2) as accruing in that year to a beneficiary who received a capital payment from the trustees of the settlement in that year.
>
> (5) The reference in subsection (4)(b) to chargeable gains treated as accruing includes offshore income gains treated as arising."

The drafter absentmindedly repealed the final sentence of para 4, "Expressions used in this sub-paragraph have the same meaning as in section 87".[13] However, that the context shows that the expressions in

[11] The words "the other elements of" are otiose: para 3(3)b) requires one to assume that the condition in s.86(1)(e) is met, in other words, the condition need not be met. That makes sense. For this condition, see 60.11 (Section 86 gains condition).

[12] See 61.4 (Non-resident settlement condition).

[13] Some databases failed to notice this (accidental) repeal and still include this sentence in para 3 sch 4B TCGA.

para 3(4) are nevertheless to be construed with their s.87 meanings.

62.10 Trustee borrowing

Para 4(1) sch 4B TCGA provides a wide definition of borrowing:

> For the purposes of this Schedule trustees of a settlement are treated as borrowing if—
> (a) money or any other asset is lent to them, or
> (b) an asset is transferred to them and in connection with the transfer the trustees assume a contractual obligation (whether absolute or conditional) to restore or transfer to any person that or any other asset.
>
> In the following provisions of this Schedule "loan obligation" includes any such obligation as is mentioned in paragraph (b).

RI 259 provides:

> **B4** ... The fact that money was borrowed before 21 March 2000 does not prevent it from being outstanding trust borrowing.
>
> Where trustees are presented with a bill, for example for repairs to trust property, bona fide delay in payment would not convert this into a borrowing for the purposes of paragraph 4.

The second paragraph is wrong, since a debt on a bill for *repairs* cannot constitute borrowing within para 4; para 4(1)(b) only applies on a loan or transfer of *assets*.

62.10.1 *Amount borrowed*

Para 4(2) sch 4B TCGA provides:

> The amount borrowed (the "proceeds" of the borrowing) is taken to be—
> (a) in the case of a loan, the market value[14] of the asset;
> (b) in the case of a transfer [ie a transaction within para 4(1)(b)], the market value of the asset reduced by the amount or value of any

[14] Defined para 4(3):
"References in this paragraph to the market value of an asset are to its market value immediately before the loan is made, or the transfer is effectively completed, unless the asset does not exist before that time in which case its market value immediately after that time shall be taken.
The effective completion of a transfer means the point at which the person acquiring the asset becomes for practical purposes unconditionally entitled to the whole of the intended subject matter of the transfer."

consideration received for it.

62.11 Loan to/from underlying co

In the following discussion, a company wholly owned by a trust is called an "**underlying company**".

Where an underlying company lends to a trust, there is "trustee borrowing" for the purposes of sch 4B TCGA. RI 259 states that HMRC take this point:

> **B4 Paragraph 4(1): meaning of "borrowing"**
> It is not unusual for the trustees of a non-resident trust to borrow money from a non-resident company which they control. In this situation, if the company were resident in the UK, [s.455 CTA 2010 (loans to participators)] might well be applicable. It has been suggested that in this situation the trustees are effectively "borrowing" from themselves and therefore outside para 4(1). We consider this incorrect, particularly in the light of *Chamberlain v IRC*.[15] It does not matter whether the borrowing is from a company controlled by the trustees or their associates, or from an entirely unconnected company.

At first sight this rule seems unnecessary. If a trust borrows from an underlying company, rather than a third party, and makes a sch4B-transfer, it seems odd that there should be a sch4B-disposal and that sch 4C should apply. But in fact a flip-flop scheme could be carried out if trustees borrow from an underlying company, just when they borrow from a third party.

Where a trust lends to an underlying company, there is a sch4B-transfer.

One could in principle avoid the issue by making other arrangements, eg a capital payment from the company to a beneficiary, rather than a loan to trustees who make the capital payment.

Where mistakes have been made, sympathetic courts have set aside loans made in (understandable) ignorance of these counterintuitive rules.[16]

[15] 25 TC 317. But *Chamberlain* does not seem relevant here. For this case, see App. 2.2.7 (Pre-arrangement steps).

[16] *Re Leumi Overseas Trust* [2007] JRC 248; *Barclays Private Bank v Chamberlain* 9 ITELR 304. The Supreme Court in *Pitt v Holt* [2013] UKSC 26 (more or less) abolished the rule in *Hastings-Bass,* on which these decisions were based; but offshore jurisdictions continue regardless. See eg art 47B ff Trusts (Jersey) Law 1984; Smellie, "Dealing with Mistakes of Trustees or Settlors: the Outlook from the Offshore Bench" (2013) *http://judicial.ky/wp-content/uploads/publications/speeches/2013-11-19-Speech-*

62.12 Transfer linked with borrowing

62.12.1 *Terminology*

The expression "linked with trustee borrowing" is defined in para 5-8 sch 4B. These paragraphs employ the following terms:

Term	**See para**
Linked with trustee borrowing	62.12.2
Outstanding trustee borrowing	62.12.4
Normal trust purposes	62.13
Ordinary trust assets	62.14.1

These expressions are best regarded as labels for complex sets of rules. The labels are not particularly apt and the definitions can be described as artificial; the labels taken literally would be misleading. The cosy expressions conceal the complex and arbitrary nature of the rules to which they refer. However it is difficult to think of better terms, and for the purposes of discussion it is best to adopt the statutory terminology *faute de mieux*.

62.12.2 *"Linked" with trustee borrowing*

Para 5(1) sch 4B TCGA provides:

> For the purposes of this Schedule a [sch4B] transfer of value by trustees is treated as linked with trustee borrowing if at the material time there is outstanding trustee borrowing.

62.12.3 *"Outstanding" trustee borrowing*

Para 5(2) sch 4B TCGA provides:

> For the purposes of this Schedule there is outstanding trustee borrowing at any time to the extent that—
> (a) any loan obligation[17] is outstanding, and
> (b) there are proceeds of trustee borrowing that have not been either—
> (i) applied for normal trust purposes, or
> (ii) taken into account[18] under this Schedule in relation to an

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[17] Defined in para 4(1): see 62.10 (Trustee borrowing).

[18] Para 5(3) sch 4B TCGA provides a commonsense definition:
"An amount of trustee borrowing is "taken into account" under this Schedule in

> earlier [sch4B] transfer of value.

62.12.4 *The material time*

Para 2(2) sch 4B TCGA provides:

> References in this Schedule to "the material time", in relation to a [sch4B] transfer of value, are to the time when the loan is made, the transfer is effectively completed or the security is issued.
> The effective completion of a transfer means the point at which the person acquiring the asset becomes for practical purposes unconditionally entitled to the whole of the intended subject matter of the transfer.

The CG Manual provides:

> **CG35128. The material time** [Jan 2015]
> The expression 'the material time' is important for two reasons.
> The first is that the test whether the transfer of value is linked with trust borrowing is applied at the material time.
> The second is that the deemed disposal by the trustees occurs at the material time.
> [The Manual sets out para 2(2) and continues] So if say trustees appoint a cash sum to a beneficiary, he would become unconditionally entitled when the money had been transferred to his bank account, not when the cheque was handed to him, for at that stage the trustees might have no funds to meet the cheque.[19]

62.13 Normal trust purposes

Para 6(1) sch 4B TCGA provides:

> For the purposes of this Schedule the proceeds of trustee borrowing are applied for normal trust purposes in the following circumstances, and not otherwise.

relation to a transfer of value if the transfer of value is in accordance with this Schedule treated as linked with trustee borrowing.
The amount so taken into account is—
(a) the amount of the value transferred by that transfer of value, or
(b) if less, the amount of outstanding trustee borrowing at the material time in relation to that transfer of value."

[19] It would be unusual for trustees to write a cheque if they are not in funds: the point is that a cheque is revocable until payment is made.

There are three types of "normal trust purposes":

Category	**See para**
Payment for ordinary trust asset	62.14
Repayment of loan	62.15
Payment of expenses	62.16

Para 9 sch 4B TCGA provides power to amend paras 6-8 by regulation. Presumably HMRC were worried that they might have left some loophole for future tax avoiders. In practice no regulations have been made.

62.14 Payment for ordinary trust asset

Para 6(2) sch 4B TCGA provides:

> They are applied for normal trust purposes if they are applied by the trustees in making a payment in respect of an ordinary trust asset and the following conditions are met—
> (a) the payment is made under a transaction at arm's length or is not more than the payment that would be made if the transaction were at arm's length;
> (b) [i] the asset forms part of the settled property immediately after the material time
> [ii] or, if it does not do so, the alternative condition in paragraph 8 below[20] is met; and
> (c) the sum paid is (or but for section 17 or 39 would be) allowable under section 38 as a deduction in computing a gain accruing to the trustees on a disposal of the asset.

62.14.1 *Ordinary trust asset*

The label "ordinary trust asset" is not apt and many common trust assets do not count as "ordinary". Para 7 sch 4B TCGA provides:

> (1) The following are "ordinary trust assets" for the purposes of this Schedule—
> (a) shares or securities;[21]
> (b) tangible property, whether movable or immovable, or a lease of such property;
> (c) property not within paragraph (a) or (b) which is used for the

[20] See 62.14.3 (Asset becomes valueless).

[21] Defined (after a fashion) in para 7(2): "In sub-paragraph (1)(a) "securities" has the same meaning as in section 132." See App 2.14 (s.132 TCGA definition). In this section I use the word "securities" to include shares.

> purposes of a trade, profession or vocation carried on—
> (i) by the trustees, or
> (ii) by a beneficiary who has an interest in possession in the settled property;
>
> (d) any right in or over, or any interest in, property of a description within paragraph (b) or (c).

Thus securities are ordinary trust assets but interests in securities are not. The distinction between securities and interests in securities raises some deep questions, though there is no reason to think that the drafter gave any thought to this.

If trustees lend to an underlying company they have not incurred normal trust expenditure.

If trustees subscribe for redeemable shares they have incurred normal trust expenditure (though redeemable shares may be commercially equivalent to a loan, and the TiS rules need consideration). The same would be the case if the trustees subscribe for a security issued by an underlying company.

RI 259 provides:

> We have been asked to say whether a futures contract relating to commodities is an "ordinary trust asset". Such a contract is not a tangible asset nor does it give the holder an interest in such an asset. Therefore, it is not an "ordinary trust asset".

62.14.2 *Grant of lease*

RI 259 provides:

> **B8 What happens when money is borrowed to purchase the freehold interest of a property which is then rented on a commercial basis?**
> ... Assuming that there is outstanding trustee borrowing at "the material time", which is defined in para 2(2) as the time the transfer is effectively completed, it is then necessary to consider whether the transfer of value is linked with trustee borrowing. Under para 7 tangible property, and any interest in such property falls within the expression "ordinary trust assets". However the property concerned must under para 6(2)(b) either form part of the settled property immediately after the material time, or meet the alternative condition in para 8(1)(b) that it is represented by ordinary trust assets which form part of the settled property immediately after the material time. Paragraph 6(2)(b) and para 8(1)(b) may be looked at together. In this situation we say that the reversion to the lease is still part of the settled property, and the lease itself is represented by

> the right to the rental stream.
>
> Therefore where trustees borrow money to acquire the freehold interest in a property which is then let commercially and, at the material time, there are no outstanding trustee borrowings other than those which have been applied for normal trust purposes, Sch 4B does not apply. But the position will be different if at that moment there are outstanding trustee borrowings applied for other purposes.
>
> The same considerations apply where trustees acquire a long lease which is sublet, and where the asset in question is a chattel rather than land or buildings.

62.14.3 *Asset becomes valueless*

Para 8 sch 4B TCGA provides:

> (1) The alternative condition referred to in paragraph 6(2)(b) in relation to an asset which no longer forms part of the settled property is that—
> - (a) the asset is treated as having been disposed of by virtue of section 24(1), or
> - (b) one or more ordinary trust assets which taken together directly or indirectly represent the asset—
>   - (i) form part of the settled property immediately after the material time, or
>   - (ii) are treated as having been disposed of by virtue of section 24(1).
>
> (2) Where there has been a part disposal of the asset, the condition in paragraph 6(2)(b) and the provisions of sub-paragraph (1) above may be applied in any combination in relation to the subject matter of the part disposal and what remains.
>
> (3) References in this paragraph to an asset include part of an asset.

62.15 Repayment of loan

Para 6(3) sch 4B TCGA provides:

> They are applied for normal trust purposes if—
> - (a) they are applied by the trustees in wholly or partly discharging a loan obligation of the trustees, and
> - (b) the whole of the proceeds of the borrowing connected with that obligation (or all but an insignificant amount) have been applied by the trustees for normal trust purposes.

62.16 Payment of expenses

Para 6(4) sch 4B TCGA provides:

> They are applied for normal trust purposes if they are applied by the trustees in making payments to meet bona fide current expenses incurred by them in administering the settlement or any of the settled property.

RI 259 provides:

> **B5 Paragraph 6(4)—application of proceeds to meet current expenses**
>
> We have been asked whether trustee borrowings to meet payments on account or provision for future or past expenses are covered by the expression "current expenses". One circumstance in which borrowings are applied for "normal trust purposes" (para 6) is where they are applied by the trustees in making payments to meet bona fide current expenses incurred by them.
>
> One may note that there are three tests to be met—
>
> – The borrowings have been applied by the moment of the transfer of value (para 5(2)(b)(i)).
> – They have been applied to meet bona fide "current expenses".
> – The expenses are expenses of "administering" the settlement or any of the settled property.
>
> In the case of borrowing to meet future expenses it is hard to see how the borrowings can be said to have been applied. But the time for making the test is not when the money is borrowed, but the time of the transfer of value (this is "the material time", as defined in para 2(2)). In the case of payments on account there would be the requisite application and the liability to pay would have been incurred.
>
> We do not regard "current" as restricting qualification to expenditure which for accounting purposes must fall in the year of borrowing, but we should regard it as excluding borrowing to make a provision for future expenditure or to meet expenditure that was incurred long before but left unpaid. In general where contracts for repairs of an ordinary kind have been entered into, we should regard the expenditure anticipated under those contracts to be current expenses at the moment of borrowing. Where trustees as the owner or tenant of a flat are obliged by contract or under the terms of the lease to make payments into a common fund to meet future maintenance or repair expenditure this would be regarded as a current expense.
>
> The expression "administering the settlement or any of the settled property" should be construed widely to cover not only those expenses properly chargeable to income, or which would be so chargeable but for express provisions of the trust deed, but also capital expenditure such as capital taxes in the UK or elsewhere, or legal costs of a reorganisation, in particular the costs of an application under the Variation of Trusts

> Act. Other capital expenditure would often be expenditure on the asset itself, and therefore qualify under para 6(2). Contributions to the day-to-day running costs of a nominee company controlled by the trustees would also qualify.

62.16.1 *Unproductive expenditure*

RI 259 provides:

> **B9 What happens when money is spent unproductively, for example on a planning application that fails?**
> Under para 6(2) there are three conditions that must be met by a payment in respect of "an ordinary trust asset" if it is to be regarded as applied for normal trust purposes. The third, in para 6(2)(c), is that the sum is allowable under TCGA 1992 s 38 (or would be but for s 17 or 39) as a deduction in computing a gain accruing to the trustees on a disposal of the asset. If an application for planning permission fails, then when the land is actually sold the costs relating to the application are generally not allowable; this is because they are not "reflected in the state or nature of the asset at the time of the disposal". Paragraph 6(2)(c) however must be referring to a notional disposal not to a real one. In the context of para 6 we consider that the reference can only be to a notional disposal taking place at the time when the expenditure is incurred.
> Although one could not lay down as a universal rule that the expenditure would always qualify, the test is whether the existence of the current application for planning permission is reflected in the state or nature of the asset at the time of the notional disposal.

62.17 Sch4B-disposal

Para 1(2) sch 4B TCGA provides an outline:

> Where this Schedule applies the trustees are treated as disposing of and immediately reacquiring the whole or a proportion of each of the chargeable assets that continue to form part of the settled property (see paragraphs 10 to 13).

I refer to this as a **"Sch4B-disposal"**. Para 10 sch 4B TCGA provides the details:

> (1) Where in accordance with this Schedule a [sch4B] transfer of value by trustees is treated as linked with trustee borrowing, the trustees are treated for all purposes of this Act—
>
> (a) as having at the material time[22] disposed of, and

[22] See 62.12.4 (The material time).

> (b) as having immediately reacquired,
>
> the whole or a proportion (see paragraph 11) of each of the chargeable assets that form part of the settled property immediately after the material time ("the remaining chargeable assets").
>
> (2) The deemed disposal and reacquisition shall be taken—
>
> (a) to be for a consideration equal to the whole or, as the case may be, a proportion of the market value of each of those assets, and
>
> (b) to be under a bargain at arm's length.[23]

62.17.1 *Chargeable asset*

The key term here is "chargeable asset". Para 10(3) sch 4B provides:

> For the purposes of sub-paragraph (1) an asset is a chargeable asset if a gain on a disposal of the asset by the trustees at the material time would be a chargeable gain.

An offshore fund (within the OIG regime) is not a chargeable asset as no chargeable gain can arise on a disposal.[24]

62.17.2 *Extent of disposal*

Para 11 sch 4B TCGA provides:

> (1) This paragraph provides for determining whether the deemed disposal and reacquisition is of the whole or a proportion of each of the remaining chargeable assets.
>
> (2) If the amount of value transferred—
>
> (a) is less than the amount of outstanding trustee borrowing, and
>
> (b) is also less than the effective value of the remaining chargeable assets,
>
> the deemed disposal and reacquisition is of the proportion of each of the remaining chargeable assets given by:
>
> VT÷EV
>
> where—
>
> VT is the amount of value transferred, and
>
> EV is the effective value of the remaining chargeable assets.
>
> (3) If the amount of value transferred—
>
> (a) is not less than the amount of outstanding trustee borrowing, but
>
> (b) is less than the effective value of the remaining chargeable assets,

[23] This deeming prevents hold-over relief (which might otherwise apply to a UK resident trust).

[24] See 56.6.2 ("Chargeable" asset).

> the deemed disposal and reacquisition is of the proportion of each of the remaining chargeable assets given by:
> TB÷EV
> where—
> TB is the amount of outstanding trustee borrowing, and
> EV is the effective value of the remaining chargeable assets.
> (4) In any other case the deemed disposal and reacquisition is of the whole of each of the remaining chargeable assets.
> (5) For the purposes of this paragraph the effective value of the remaining chargeable assets means the aggregate market value of those assets reduced by so much of that value as is attributable to trustee borrowing.
> (6) References in this paragraph to amounts or values, except in relation to the amount of value transferred, are to amounts or values immediately after the material time.

62.17.3 *Example: Part-disposal*

RI 259 provides an example:

> **B10 How should we compute the base cost of assets for future disposals?**
> ... Suppose that an asset cost £600,
> the trustees are treated as disposing of two thirds of the asset at the material time (paragraph 10(1)), and
> the respective values of two thirds and one third immediately after that time are £900 and £450.

HMRC compute the gain on the sch4B-disposal:[25]

Deemed Proceeds	900
Cost [two thirds of 600]	-400
Gain	500

HMRC compute the base cost for a future disposal:

Remaining original cost	600 - 400	200
Deemed Acquisition		900
Revised base cost		1100

62.18 Gain/loss on sch4B-disposal

62.18.1 *Gain on sch4B-disposal*

If a gain arises to a trust within s.86, on sch4B-disposal, the position is

[25] I have slightly amended the layout for clarity.

straightforward: the settlor is taxable on the gain.

If the trust is within s.87, the sch 4C rules apply as discussed below.

62.18.2 *Loss on sch4B-disposal*

If a loss arises on a sch4B-disposal, it can in principle be set against other gains of the trustees.

In the HMRC view, if a sch4B-disposal is deliberately made to realise a loss, the loss is disallowed under the capital loss TAAR.[26] CG Manual Appendix 9 provides:

> **Example 18 - trustees make a deliberate transfer of value** [Jun 2016]
> 1. A body of trustees who fall within the terms of Schedule 4B have outstanding borrowing which has not been used for trust purposes (Schedule 4B is a measure introduced to discourage trustees avoiding capital gains tax by incurring debt and advancing funds from the settlement). The trustees intentionally make a transfer of value which triggers off a charge under Schedule 4B, and as they expect this transaction results in a capital loss. The trustees have realised chargeable gains in the same year, and claim to set the loss against those gains.
> 2. It is necessary to look at the arrangements which have been entered into by the trustees to determine whether these have been entered into with a main purpose of securing a tax advantage. There are arrangements in this case, so the question is whether or not those arrangements were entered into with a main purpose of securing a tax advantage, and to decide this it is necessary to take account of all the circumstances surrounding the transactions. It will be relevant to consider what the trustees' overall economic objective was, and whether that objective is being fulfilled in a straightforward way, or whether additional, complex or costly steps have been inserted. It is significant that Schedule 4B is itself anti-avoidance legislation, intended to counter avoidance of tax on gains by contrived arrangements between settlements. The fact that the trustees have deliberately triggered the operation of the schedule is an indicator that one of their main purposes was to secure the advantage of the capital loss. In such a case, the TAAR [s.16A TCGA] will apply and the loss will not be an allowable loss.

62.19 Schedule 4C: Introduction

A sch4B-disposal takes a trust from the standard s.87 regime to the (even) more complicated rules which I call the **"sch 4C s.87 regime"**.

[26] See 65.21 (Capital loss TAAR).

Section 85A(1) TCGA provides:

> (1) Schedule 4C to this Act has effect with respect to the attribution of gains to beneficiaries where there has been a transfer of value to which Schedule 4B applies.
> (2) Sections 86A to 95 have effect subject to the provisions of Schedule 4C.

Para 1(1) sch 4C TCGA makes the same point:

> This Schedule applies where the trustees of a settlement ("the transferor settlement") make a transfer of value to which Schedule 4B applies ("the original transfer")....

Thus, the sch 4C s.87 regime applies if trustees make a sch4B-transfer which is linked to trustee borrowing.[27]

For completeness, para 1(1) sch 4C TCGA provides:

> References in this Schedule to a transfer to which Schedule 4B applies include any such transfer, whether or not any chargeable gain or allowable loss accrues under that Schedule by virtue of the transfer.

We need some terminology to deal with this, and so in this chapter:

The "**transferor trust"** is the trust which makes the sch 4B-transfer (I adopt the statutory term).

In the statute, the sch4B-transfer is called "the original transfer". I refer to it as the **"sch4B-transfer"** or if there is more than one, the "**original sch4B-transfer**".

The **"sch4B-transfer year"** is the year in which the sch4B-transfer is made.

62.20 Sch4C pool

The key to understanding sch 4C is to appreciate that following a sch4B-transfer, there are *two* pools of gains:

(1) *"Standard s.87 pool"*: The transferor trust may have a pool of s.1(3) amounts (trust gains) governed by the standard s.87 regime

(2) *"Sch 4C pool"*: The transferor trust may have a sch4C pool, governed by the sch4C s.87 regime

Para 1(2) sch 4C TCGA provides:

[27] See 62.3 (The key conditions).

> The transferor settlement is regarded for the purposes of this Schedule as having a "Schedule 4C pool".

I abbreviate this to "**Sch4C pool**". Para 1(3) sch 4C TCGA provides:

> The Schedule 4C pool contains the section 1(3) amounts for the settlement that are outstanding at the end of the tax year in which the original [Sch 4B-]transfer is made (see paragraph 1A).

Trust gains accruing in years after the sch4B-transfer year do not go into the sch4C pool (unless there is another sch4B-transfer). They go into the standard s.87 pool.

62.20.1 *"Outstanding s.1(3) amounts"*

We need to ascertain "the section 1(3) amounts for the settlement that are outstanding" at the end of the tax year when the sch4B-transfer is made. Para 1A(1) sch 4C TCGA provides:

> The following steps are to be taken for the purpose of calculating the section 1(3) amounts for a settlement that are outstanding at the end of a tax year ("the relevant tax year").

Step 1 provides a commonsense starting point:

> *Step 1* Find the section 1(3) amount[28] for the settlement for the relevant tax year and earlier tax years, as reduced under section 87A [matching] as it applies for the relevant tax year and earlier tax years....

So far the rules are the same as for standard s.87 trust gains, ie all the standard s.87 trust gains as at the end of the sch4B-transfer year go into the sch4C pool.

62.20.2 *Trust transfer in/before sch4B-transfer year*

Para 1A(2) sch4C TCGA deals with the special case of transfers between settlements:

> For the purposes of Step 1 of sub-paragraph (1) take into account the effect of section 90 in relation to any transfer of settled property from or to the trustees of the settlement made in or before the relevant tax year.

Section 90 TCGA does not apply to a sch4B-transfer, but it would apply

[28] See 61.6 (Section 1(3) amount).

if there had been an earlier transfer between trusts which was not a sch4B-transfer.[29]

So far the rules are still the same as for the s.87 trust gain pool.

62.20.3 *Payment to non-resident*

Para 1A(1) sch 4C TCGA provides:

> *Step 2* This Step applies if directly or indirectly, by virtue of the matching of the section 1(3) amount for the settlement for a tax year ("the applicable year") with a capital payment, chargeable gains are treated under section 87, 87K,[30] 87L[31] or 89(2) as accruing in the relevant tax year to an individual who is not chargeable to tax for that year.
> Increase the section 1(3) amount for the applicable year (found under Step 1) by the amount of the chargeable gains.
> ...
> (3) For the purposes of this Schedule an individual is "chargeable to tax" for a tax year if, as respects that year, the individual is UK resident for the tax year (as determined in accordance with Chapter 1 of Part 1 of this Act).

Thus capital payments to non-residents which (before 2017/18) reduced the standard s.87 pool are added to the sch4C pool. Effectively such payments do not take trust gains out of the sch4C pool. The same rule applies to capital payment to non-residents after the sch4B-transfer is made: see 62.24.3 (Sch4C matching rules).

The capital payments which are disregarded are those which are matched to s.87 gains accruing in the "relevant tax year".

62.21 Sch4B trust gains

62.21.1 *Sch4B gains added to Sch4C pool*

Section 85A(3) TCGA provides:

> [a] When calculating the section 1(3) amount for a settlement for a tax year (within the meaning of section 87), no account is to be taken of any chargeable gains or allowable losses accruing by virtue of Schedule 4B.

[29] See 61.39.6 (Interaction with sch 4B).

[30] See 61.33 (s.87 onward-gift rule).

[31] See 61.34 (Onward-gift to close-family: s.87 settlor-attribution rule).

> [b] Nothing in this subsection affects any increase in a section 1(3) amount by virtue of paragraph 1(3A) or 7B(2)(b)[32] of Schedule 4C.

Gains on the sch4B-disposal do not enter the standard s.87 pool. Instead para 1A(3A) sch 4C TCGA puts them in the sch4C pool:

> The section 1(3) amount for that tax year is increased by—
> (a) the amount of Schedule 4B trust gains accruing by virtue of the original [Sch 4B-]transfer (see paragraphs 3 to 7), and
> (b) the total amount of any further Schedule 4B trust gains accruing by virtue of any further transfers of value to which that Schedule applies that are made by the trustees in that tax year.

The key term here is "sch4B trust gains". This term is artificially defined: it does not mean the gains accruing on the sch4B-disposal. For clarity, I write the expression with scare quotation marks.

62.21.2 *"Sch4B trust gains"*

Para 3 sch 4C TCGA provides:

> (1) This paragraph explains what is meant for the purposes of this Schedule by "Schedule 4B trust gains".
> (2) The Schedule 4B trust gains are computed in relation to each transfer of value to which that Schedule applies.
> (3) In relation to a transfer of value the amount of the Schedule 4B trust gains for the purposes of this Schedule is given by—
> CA – SG – AL ...

In short:
CA is **C**hargeable **A**mount
SG is the **S**ettlor **G**ains
AL is **A**llowable **L**osses

Each of these terms is elaborately defined. Para 3(3) continues with an outline:

> CA is the chargeable amount computed under paragraph 4 or 5 below,
> SG is the amount of any gains attributed to the settlor that fall to be deducted under paragraph 6 below, and
> AL is the amount of any allowable losses that may be deducted under paragraph 7 below.

[32] See 62.23 (Second sch4B-disposal).

62.21.3 *Ch. amount: Non-resident trust*

Para 4 sch 4C TCGA provides:

> (1) If the [sch4B] transfer of value is made in a year of assessment during which the trustees of the transferor settlement are at no time resident in the UK the chargeable amount is computed under this paragraph.
> (2) Where this paragraph applies the chargeable amount is the amount on which the trustees would have been chargeable to tax under section 1(3) by virtue of Schedule 4B if they had been resident in the UK in the year (and had made the disposals which Schedule 4B treats them as having made).

Para 4(3) sch 4C TCGA deals with the special case of a disposal of land by a non-resident:

> Where (apart from this sub-paragraph) the chargeable amount mentioned in sub-paragraph (2) would include a chargeable gain or allowable loss to which section 1A(3)(b) or (c) applies (disposals by non-UK residents within the charge to capital gains tax), so much of the gain or loss as would be so included is to be disregarded for the purposes of determining the chargeable amount.

The wording is based on the s.87 definition of s.1(3) amount.[33]

62.21.4 *Ch. amount: Dual-resident trust*

Para 5 sch 4C TCGA provides:

> (1) If the [sch4B] transfer of value is made in a year of assessment where—
> (a) the trustees of the transferor settlement are resident in the UK during any part of the year, and
> (b) at any time of such residence they fall to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the UK,
>
> the chargeable amount is computed under this paragraph.
> (2) Where this paragraph applies the chargeable amount is the lesser of—
> (a) the amount on which the trustees would be chargeable to tax under section 2(2) by virtue of Schedule 4B on the assumption that the double taxation relief arrangements did not apply (and the disposals which Schedule 4B treats them as having made

[33] See 61.6 (Section 1(3) amount).

> were made), and
> (b) the amount on which the trustees would be so chargeable to tax by virtue of disposals of protected assets.
>
> (3) For this purpose "protected assets" has the meaning given by section 88(4).

The wording is based on the s.87 rules for dual-resident trusts.[34]

62.21.5 *Settlor gains*

Para 6(1) sch 4C TCGA provides:

> For the purposes of this Schedule the chargeable amount in relation to a [sch4B] transfer of value shall be reduced by the amount of any chargeable gains arising by virtue of that transfer of value that—
> (a) are by virtue of section 86(4) treated as accruing to the settlor,

The wording is based on the s.87 rules.[35]

Para 6(1)(b) deals with a temporary non-resident settlor:

> or
> (b) where section 1M applies, are treated by virtue of that section (as it has effect subject to paragraph 12 below) as accruing to the settlor in the period of return.

For the s.87 equivalent rules, see 62.28.1 (Trust within s.86 TCGA).

62.21.6 *Loss set against s.86 gain*

Para 6(2) sch 4C TCGA provides:

> In determining for the purposes of sub-paragraph (1)(a) the amount of chargeable gains arising by virtue of a [sch4B] transfer of value that are treated as accruing to the settlor, there shall be disregarded any losses which arise otherwise than by virtue of Schedule 4B.

This applies where a trust within s.86 has losses and then realises gains on a sch4B-disposal. The losses are set against the gains, so net gains are treated as accruing to the settlor. This provision is needed to ensure that those gains are not added to the sch4C pool.

62.21.7 *Loss on sch4B-disposal*

Para 7 sch 4C TCGA provides:

[34] See 61.38 (Dual resident trust: s.88 TCGA).

[35] See 61.6 (Section 1(3) amount).

> (1) An allowable loss arising under Schedule 4B in relation to a [sch4B] transfer of value by the trustees of a settlement may be taken into account in accordance with this paragraph to reduce for the purposes of this Schedule the chargeable amount in relation to another transfer of value by those trustees.
> (2) Any such allowable loss goes first to reduce chargeable amounts arising from other transfers of value made in the same year of assessment.
> If there is more than one chargeable amount and the aggregate amount of the allowable losses is less than the aggregate of the chargeable amounts, each of the chargeable amounts is reduced proportionately.
> (3) If in any year of assessment the aggregate amount of the allowable losses exceeds the aggregate of the chargeable amounts, the excess shall be carried forward to the next year of assessment and treated for the purposes of this paragraph as if it were an allowable loss arising in relation to a [sch4B] transfer of value made in that year.
> (4) Any reduction of a chargeable amount under this paragraph is made after any deduction under paragraph 6.

62.22 Restriction on losses

It is necessary to distinguish between losses accruing on a sch4B-disposal and other losses accruing to trustees.

Section 85A(3) TCGA provides:

> When calculating the section 1(3) amount for a settlement for a tax year (within the meaning of section 87), no account is to be taken of any chargeable gains or allowable losses accruing by virtue of Schedule 4B....

Thus losses on a sch4B-disposal cannot be set against gains in computing the s.1(3) amount for s.87 purposes.

Section 85A(4) TCGA provides:

> No account shall be taken of any chargeable gains or allowable losses to which sections 87 to 89 apply in computing the gains or losses accruing by virtue of Schedule 4B.

Thus losses on a non-sch4B-disposal cannot be set against gains accruing on a sch4B-disposal, in computing the sch4C pool.

I cannot see the reason for these rules, but complication was not of concern to the drafter of sch4C, who seems to have regarded loss relief with suspicion.

62.23 Second sch4B-disposal

Para 7B sch 4C TCGA provides:

> (1) This paragraph applies if the trustees of the transferor settlement make a further transfer of value to which Schedule 4B applies in a tax year ("the year of the transfer") after the tax year mentioned in paragraph 1(3).[36]
> (2) If the settlement has a Schedule 4C pool at the beginning of the year of the transfer—
> (a) the section 1(3) amounts in the Schedule 4C pool are increased by the section 1(3) amounts for the settlement that are outstanding at the end of the year of the transfer, and
> (b) the section 1(3) amount in the pool for the year of transfer is increased (or further increased) by the amount of Schedule 4B trust gains accruing by virtue of the further transfer.
> (3) If the settlement does not have a Schedule 4C pool at the beginning of the year of the transfer, this Schedule applies in relation to the further transfer as it applied in relation to the original [Sch 4B-]transfer.
> (4) For the purposes of this paragraph a settlement has a Schedule 4C pool until the end of the tax year in which all section 1(3) amounts in the pool have been reduced to nil.

For a transitional rule for pre-2008 sch4C pools, see 62.36 (Pre-2008 sch 4C pool).

62.24 Sch4C s.87 regime

62.24.1 *Standard s.87 regime excluded*

Section 85A(2A) TCGA provides:

> For the purposes of sections 87 to 89, no account is to be taken of any section 1(3) amount in a Schedule 4C pool (see paragraph 1 of Schedule 4C).

I refer to the s.1(3) amounts in a sch 4C pool as **"Sch4C pool gains"**. This provision takes sch4C pool gains out of the standard s.87 regime. Instead they fall within what I call the "**Sch4C s.87 regime**".

Trustees therefore need to keep two sets of computations:

(1) s.1(3) amounts (trust gains) for the standard s.87 regime

[36] "The tax year mentioned in para 1(3)" (sch 4C TCGA) is the tax year in which the original sch 4B-transfer is made; see 62.20 (Schedule 4C pool).

(2) Sch4C pool gains

62.24.2 *Schedule 4C s.87 charge*

This is best understood if set side by side with the usual s.87 rule and highlighting the changes:

Para 8(1) sch 4C TCGA	**s.87(2) TCGA**
Chargeable gains are treated as accruing in a tax year ("the relevant tax year") to a beneficiary who has received[37] a capital payment from the trustees of a relevant settlement in the relevant tax year or any earlier tax year if all or part of the capital payment is matched (under section 87A as it applies for the relevant tax year) with the section 1(3) amount in the Schedule 4C pool for the relevant tax year or any earlier tax year.	Chargeable gains are treated as accruing in the relevant tax year to a beneficiary of the settlement who has received a capital payment from the trustees in the relevant tax year or any earlier tax year if all or part of the capital payment is matched (under section 87A as it applies for the relevant tax year) with the section 1(3) amount for the relevant tax year or any earlier tax year.

Para 8(2) sch 4C TCGA provides:

> The amount of chargeable gains treated as accruing is equal to—
> (a) the amount of the capital payment, or
> (b) if only part of the payment is matched, the amount of that part.

This is the sch 4C equivalent of s.87(3) TCGA.

62.24.3 *Sch4C matching rules*

Para 8(3) sch 4C TCGA provides:

> Section 87A [matching rules] applies for a tax year for the purposes of matching capital payments received from the trustees of a relevant settlement with section 1(3) amounts in the Schedule 4C pool as if—
> (a) references to section 1(3) amounts were to section 1(3) amounts in the Schedule 4C pool,

[37] Para 8(6) sch 4C TCGA provides: "Sections 87G(2), 87K(2) and 87L(2) (capital payment treated for purposes of sections 87 and 87A as received by someone other than actual recipient) apply also for the purposes of this paragraph, but this is subject to paragraph 9." This incorporates the close-family rules: see 61.29.3 (s.87 settor-attribution rule); 61.33 (s.87 onward-gift rule); 61.34 (Onward-gift to close-family: s.87 settlor-attribution rule).

(b) references to a capital payment received from the trustees by a beneficiary were to a capital payment received from the trustees of a relevant settlement by a beneficiary who is chargeable to tax for that year, and

(c) for section 87A(3)(b) there were substituted—

“(b) all section 1(3) amounts in the Schedule 4C pool have been reduced to nil.”

Amended as para 8(3) directs, s.87A TCGA provides:

(1) This section supplements s.87.

(2) The following steps are to be taken for the purposes of matching capital payments with s.1(3) amounts in the Schedule 4C pool.

Step 1

Find the s.1(3) amount in the Schedule 4C pool for the relevant tax year.

Step 2

Find the total amount of capital payments received by the beneficiaries who are chargeable to tax for that year from the trustees of a relevant settlement in the relevant tax year.

Step 3

The s.1(3) amount in the Schedule 4C pool for the relevant tax year is matched with—

(a) if the total amount of capital payments received in the relevant tax year does not exceed the s.1(3) amount in the Schedule 4C pool for the relevant tax year, each capital payment so received by the beneficiaries who are chargeable to tax for that year from the trustees of a relevant settlement, and

(b) otherwise, the relevant proportion of each of those capital payments.

“The relevant proportion” is the s.1(3) amount in the Schedule 4C pool for the relevant tax year divided by the total amount of capital payments received in the relevant tax year.

Step 4

[1] If para (a) of Step 3 applies—

(a) reduce the s.1(3) amount in the Schedule 4C pool for the relevant tax year by the total amount of capital payments referred to there, and

(b) reduce the amount of those capital payments to nil.

[2] If para (b) of that Step applies—

(a) reduce the s.1(3) amount in the Schedule 4C pool for the relevant tax year to nil, and

(b) reduce the amount of each of the capital payments referred to there by the relevant proportion of that capital payment.

Step 5

[1] Start again at Step 1 (unless subs.(3) applies).

[2] If the s.1(3) amount in the Schedule 4C pool for the relevant tax year (as reduced under Step 4) is not nil, read references to capital payments received

> in the relevant tax year as references to capital payments received in the latest tax year which—
>
> (a) is before the last tax year for which Steps 1 to 4 have been undertaken, and
>
> (b) is a tax year in which capital payments (the amounts of which have not been reduced to nil) were received by beneficiaries.
>
> (3) This subsection applies if—
>
> (a) all of the capital payments received by beneficiaries who are chargeable to tax for that year from the trustees of a relevant settlement in the relevant tax year or any earlier tax year have been reduced to nil, or
>
> (b) all section 1(3) amounts in the Schedule 4C pool have been reduced to nil. ~~the section 1(3) amounts for the relevant tax year and all earlier tax years have been reduced to nil~~.
>
> (4) The effect of any reduction under Step 4 of subsection (2) is to be taken into account in any subsequent application of this section.

Para 1A(3) sch 4C TCGA defines “chargeable to tax”:

> For the purposes of this Schedule a beneficiary is “chargeable to tax” for a tax year if, as respects that year, the beneficiary is UK resident for the tax year (as determined in accordance with Chapter 1 of Part 1 of this Act).

Para 8(3)(b) is wider than the non-resident disregard in s.87D TCGA which applies to the standard s.87 regime, as there is no exemption for the final tax year, and it applies in tax years before s.87D took effect.

62.24.4 *Sch 4C/standard s.87: Priority*

Para 8(4) sch 4C provides:

> Section 87A applies for a tax year by virtue of this paragraph before it applies for that year otherwise than by virtue of this paragraph; but this is subject to sub-paragraph (5).

Thus the sch4C regime has priority over the standard s.87 regime where a trust has:

(1) a sch4C pool of gains within sch 4C, and

(2) standard s.1(3) amounts (trust gains) within s.87

62.24.5 *Sch 4C/standard s.87 OIG: Priority*

Para 8(5) sch 4C provides:

> If section 87A applies for a tax year by virtue of section 762(3) of the

> Taxes Act[38] (offshore income gains), it applies for that year by virtue of that provision before it applies for that year by virtue of this paragraph.

Thus the standard OIG s. 87 regime has priority over the sch4C regime where a trust has:
(1) a sch4C pool of gains within sch 4C, and
(2) OIG amounts within OIG s.87.

62.25 "Relevant settlement"

"Relevant settlement" matters because a capital payment from any relevant settlement is matched to the sch 4C pool.

Para 8A(1) sch 4C TCGA provides:

> This paragraph specifies what settlements are relevant settlements in relation to a Schedule 4C pool.

62.25.1 *Transferor/transferee settlements*

Para 8A(2) sch 4C TCGA provides:

> The transferor and transferee settlements in relation to the original [Sch 4B-]transfer of value are relevant settlements.

Para 14(2) sch 4C TCGA defines "transferor" and "transferee settlement":

> In this Schedule, in relation to a [sch4B] transfer of value—
> (a) references to the transferor settlement are to the settlement the trustees of which made the [sch4B] transfer of value; and
> (b) references to a transferee settlement are to any settlement of which the settled property includes property representing, directly or indirectly, the proceeds of the [sch4B] transfer of value.

62.25.2 *Subsequent transfer*

Para 8A sch 4C TCGA provides:

> (3) If the trustees of any settlement that is a relevant settlement in relation to a Schedule 4C pool—
> (a) make a transfer of value to which Schedule 4B applies, or
> (b) make a transfer of settled property to which section 90 applies,

[38] The reference to ICTA is obsolete. However the legislation still works, because the continuity of law provisions in (for example) para 5 sch 2 CTA 2010 require old references to take effect as references to the rewritten provisions.

> any settlement that is a transferee settlement in relation to that transfer is also a relevant settlement in relation to that pool.
> (4) If the trustees of a settlement that is a relevant settlement in relation to a Schedule 4C pool make a transfer of value to which Schedule 4B applies, any other settlement that is a relevant settlement in relation to that pool is also a relevant settlement in relation to the Schedule 4C pool arising from the further transfer.

62.26 Capital payment disregards

Para 9(1) sch 4C TCGA provides:

> For the purposes of
> [i] paragraph 8 [sch 4C s.87 charge]
> [ii] (and section 87A as it applies for the purposes of that paragraph),
> no account is to be taken of a capital payment to which any of sub-paragraphs (2) to (4) applies (or a part of a capital payment to which sub-paragraph (4) applies).

There are three disregards:

Para	**Disregard**
9(2)	Capital payment made before a sch4B-transfer
9(3)	Capital payment from UK resident trust
9(4)	Capital payment to non-resident close company

62.26.1 *Payment pre-4B-transfer*

Para 9(2) sch 4C TCGA provides:

> This sub-paragraph applies to a capital payment received before the tax year preceding the tax year in which the original [Sch 4B-]transfer is made.

That is relatively straightforward.

For a transitional rule for pre-2008 sch4C pools, see 62.36 (Pre-2008 sch 4C pool).

62.26.2 *Payment from UK resident trust*

Para 9(3) sch 4C TCGA provides:

> This sub-paragraph applies to a capital payment that—
> (a) is received by a beneficiary of a settlement from the trustees in a tax year during the whole of which the trustees—
> (i) are resident in the UK, and
> (ii) are not Treaty non-resident,

> (b) was made before any transfer of value to which Schedule 4B applies was made, and
> (c) was not made in anticipation of the making of any such [sch4B] transfer of value or of chargeable gains accruing under that Schedule.

This is a rare case but it can happen.

62.26.3 *Payment to non-resident co*

Para 9(4) sch 4C TCGA provides:

> This sub-paragraph applies to a capital payment if (and to the extent that) it is received (or treated as received) in a tax year from the trustees by a company that—
> (a) is not resident in the UK in that year, and
> (b) would be a close company if it were resident in the UK,
> (and is not treated under any of subsections (3) to (5) of section 96 as received by another person).

This is the sch4C equivalent of s.87C TCGA.[39]

62.27 Remittance basis

Para 8AA sch 4C TCGA provides:

> Section 87B (remittance basis) applies in relation to chargeable gains treated under paragraph 8 as accruing as it applies in relation to chargeable gains treated under section 87 as accruing.

This incorporates the s.87 remittance basis.[40]

62.28 Temporary non-resident

62.28.1 *Trust within s.86 TCGA*

Para 12 sch 4C TCGA provides:

> (1) This paragraph applies if—
> (a) by virtue of section 1M,[41] an amount of chargeable gains within section 86(1)(e) that accrued in a tax year ("year A") to the trustees of a settlement would be treated as accruing to a person ("the settlor") in the period of return, and

[39] See 61.11.4 (Disregard of payment to co: s.87C).

[40] See 61.19 (s.87 remittance basis).

[41] See 11.6 (TNR gain/loss).

> (b) after paragraph 8 has applied for the year of return, the section 1(3) amount for year A that is in the Schedule 4C pool for the settlement is less than the amount mentioned in paragraph (a).
>
> (2) The amount of chargeable gains treated as mentioned in sub-paragraph (1)(a) as accruing to the settlor in the period of return is limited to the section 1(3) amount referred to in sub-paragraph (1)(b).
>
> (4) Where the property comprised in the transferor settlement has at any time included property not originating from the settlor, only so much (if any) of any capital payment taken into account for the purposes of paragraph 8 above as, on a just and reasonable apportionment, is properly referable to property originating from the settlor shall be taken into account in computing the amount charged to beneficiaries.
>
> (5) Expressions used in this paragraph and section 1M have the same meanings in this paragraph as in that section; and paragraph 8 of Schedule 5 shall apply for the construction of the references in sub-paragraph (4) above to property originating from the settlor as it applies for the purposes of that Schedule.

62.28.2 *Trust within s.87*

Para 12A sch 4C TCGA provides:

> (1) This paragraph applies where by virtue of section 1M[42] an amount of gains would (apart from this Schedule) be treated under section 87 as accruing to a person ("the beneficiary") in the period of return by virtue of a capital payment made to him in the temporary period of non-residence.
>
> (2) Where this paragraph applies, a capital payment equal to so much of that capital payment as exceeds the amount otherwise charged shall be deemed for the purposes of this Schedule to be made to the beneficiary in the year of return.
>
> (3) The "amount otherwise charged" means the total of any chargeable gains attributed to the beneficiary under section 87(2) or 89(2) by virtue of the capital payment.
>
> (4) For the purposes of paragraph 13(5)(b) a deemed capital payment under this paragraph shall be treated as made when the actual capital payment mentioned in sub-paragraph (1) above was made.
>
> (5) Expressions used in this paragraph and section 1M have the same meanings in this paragraph as in that section.

[42] See 11.6 (TNR gains/loss).

62.29 Interest surcharge

Para 13 sch 4C TCGA provides:

> (1) This paragraph applies if—
> (a) chargeable gains are treated under paragraph 8 as accruing to a beneficiary by virtue of the matching (under section 87A) of all or part of a capital payment with the section 1(3) amount for a tax year ("the relevant tax year"), and
> (b) the beneficiary is charged to tax by virtue of the matching.
> (1A) Where part of a capital payment is matched, references in sub-paragraphs (2) and (3) to the capital payment are to the part matched.
> (2) The tax payable by the beneficiary in respect of the payment shall be increased by the amount found under sub-paragraph (3) below, except that it shall not be increased beyond the amount of the payment; and an assessment may charge tax accordingly.
> (3) The amount is one equal to the interest that would be yielded if an amount equal to the tax which would be payable by the beneficiary in respect of the payment (apart from this paragraph) carried interest for the chargeable period at the specified rate.
> The "specified rate" means the rate for the time being specified in section 91(3).
> (4) The chargeable period is the period which—
> (a) begins with the later of the 2 days specified in sub-paragraph (5) below, and
> (b) ends with 30th November in the year of assessment following that in which the capital payment is made.
> (5) The 2 days are—
> (a) 1st December in the tax year immediately after the relevant tax year, and
> (b) 1st December falling 6 years before 1st December in the year of assessment following that in which the capital payment is made.

This is the sch4C equivalent of the s.87 interest surcharge: see 61.17 (Interest surcharge).

62.30 Residence of trustees

Para 10(1) sch 4C TCGA provides:

> Subject to paragraph 9(3),[43] it is immaterial for the purposes of

[43] See 58.21.2 (Payment from UK resident trust).

> paragraph 8 that the trustees of any relevant settlement are or have at any time been resident in the UK.

Why is this needed?

62.31 Trust ends after sch4B-disposal

Para 13A sch 4C TCGA provides:

> Where a settlement ceases to exist after the trustees have made a transfer of value to which Schedule 4B applies, this Schedule has effect as if a year of assessment had ended immediately before the settlement ceased to exist.

Why is this needed?

62.32 OIG sch 4C

Regulation 20(3) OFTR incorporates sch 4C TCGA rules. So far as relevant, this provides:

> ... Schedule 4C to, TCGA 1992 apply in relation to OIG amounts as if—
> (a) references to section 1(3) amounts (except those in paragraph 7B(2)(b) and (4) of Schedule 4C) were to OIG amounts,
> (b) references to chargeable gains (except the one in paragraph 1(5) of Schedule 4C) were to offshore income gains,
> (c) references to anything accruing were to it arising[44] (and similar references, except the one in paragraph 1(5) of Schedule 4C, were read accordingly),
> (d) ... paragraphs 1(3A), 3 to 7 and 12 of Schedule 4C were omitted ...

For the application of s.87-98 TCGA to OIGs, see 67.13 (OIG s.87 charge).

It is necessary to distinguish the CGT sch 4C rules and the OIG sch 4C rules because the rules are not identical. It might be helpful to use the following terminology:

(1) "**CGT sch 4C**", the provisions of sch 4C TCGA.
(2) "**OIG sch 4C**", the provisions of sch4C as amended, which apply when the trust has "**OIG amounts**".

[44] The terminology of the Taxes Acts is that CGT chargeable gains *accrue;* but OIGs *arise.* There is no difference in meaning so it seems somewhat pedantic to make the change of terminology when incorporating sch 4C for OIGs; but it does no harm.

The omission of para 1(3A) and paras 3-7 sch 4C makes sense as sch 4B does not apply to OIGs. It would have been logical to omit para 7B; instead the drafter neutralises it by not amending references to it.

The omission of para 12 sch 4C makes sense, as s.86 TCGA does not apply to OIGs.

62.33 Definitions

There are different sets of definitions for sch 4B and sch 4C.

62.33.1 *"Settlement" and "trustee"*

"Settlement" in sch 4C means settlement-arrangement (and "trustee" has a similarly extended meaning).[45] Whereas "settlement" in sch 4B has the standard CGT/IT definition. This reflects the difference between s.87 and s.86.[46] But sch 4C only applies if the trustees make a sch4B-disposal,[47] so sch 4C can only apply where there is a settlement within the standard CGT/IT meaning.

62.33.2 *Misc sch 4C definitions*

Para 14(1) sch 4C TCGA provides:

> In this Schedule—
> (a) "transfer of value" has the same meaning as in Schedule 4B; and
> (b) references to the time at which a transfer of value was made are to the time which is the material time for the purposes of that Schedule.

62.33.3 *"Beneficiaries"*

Para 14(3) sch 4C TCGA provides:

> References in this Schedule to beneficiaries of a settlement include—
> (a) persons who have ceased to be beneficiaries by the time the chargeable gains accrue, and
> (b) persons who were beneficiaries of the settlement before it ceased to exist,
>
> but who were beneficiaries of the settlement at a time in a previous year of assessment when a capital payment was made to them.

[45] See 61.2 ("Settlement"/"settled property").

[46] See 60.4.1 ("Settlement" and "settlor").

[47] See 62.19 (Schedule 4C: Introduction).

62.34 Schedule 4B/4C: Examples

Suppose:
(1) The settlor lends to a trust.
(2) The trust repays the loan.

The trust does not make a sch4B-transfer, so it does not make a sch4B-disposal, and sch 4C does not apply.

Suppose:
(1) The settlor lends to a trust ("trust 1").
(2) The settlor assigns the debt to another trust ("trust 2").
(3) Trust 1 repays the loan to trust 2.
(4) Trust 2 makes a payment to the settlor or another beneficiary.

Trust 1 does not make a sch4B-transfer, so it does not make a sch4B-disposal.
Trust 2 does not borrow, so it also does not make a sch4B-disposal.

Suppose:
(1) The settlor lends to a trust.
(2) The trustees lend to an underlying company.

Schedule 4B and 4C apply.

Suppose:
(1) The settlor gives to a trust ("trust 1").
(2) Trust 1 lends to trust 2.
(3) Trust 2 transfers an asset to the settlor.

Trust 1 does not borrow, so it does not make a sch4B-disposal.
Trust 2 does make a sch4B-disposal. But trust 1 is not a relevant settlement.

62.35 Transitional rules

Sch 4B and 4C were introduced in 2000 and revised in 2003 and 2008. I refer to the sch 4B/4C regime in the form they took before 2008 as the **"pre-2008 sch 4B/4C regimes"**. There are about a dozen transitional rules. Two of these are considered elsewhere:
61.42 (computing s.1(3) amount at 6/4/2007)
61.45 (Pre-2008 inter-trust transfer)

62.35.1 *Pre-2008 sch4B-disposal*

Para 147 sch 7 FA 2008 provides:

> The amendments made by paragraphs 128 to 146 have effect in relation to transfers of value to which Schedule 4B to TCGA 1992 applies that are made on or after 6 April 2008.

Pre-2008 transfers of value are governed by the pre-2008 sch4B rules.

62.35.2 *Pre-21 Mar 2000 capital payment*

Para 148 sch 7 FA 2008 provides:

> For the purposes of
> [i] paragraph 8 of Schedule 4C to TCGA 1992 [sch 4C s.87 charge][48]
> [ii] (and section 87A of that Act [matching rules] as it applies for the purposes of that paragraph),
> no account is to be taken of any capital payment received before 21 March 2000.

62.35.3 *Pre-2008 payment to company*

Para 149 FA 2008 provides:

> A capital payment received before 6 April 2008 is not within paragraph 9(4) of Schedule 4C to TCGA 1992 (if it otherwise would be).

This concerns a capital payment to a non-resident close company: see 62.26.3 (Payment to non-resident co).

62.35.4 *Pre-2008 cap. payment/trust gain matched post 2008*

Para 150 sch 7 FA 2008 provides:

> Paragraph 124 applies in relation to chargeable gains treated under paragraph 8 of Schedule 4C to TCGA 1992 as accruing as it applies in relation to chargeable gains treated under section 87 as accruing.

In other words, para 124 applies for the sch 4C s.87 charge as it applies for the standard s.87 charge. See 61.44 (Pre-2008 capital payment/trust gain, matched post 2008). So there is no charge on non-UK domiciled beneficiaries who:

(1) receive pre-2008 capital payments that are matched to a sch4C pool

[48] See 62.24 (Sch4C s.87 regime).

after 6 April 2008; or

(2) receive post-2008 capital payments that are matched to a pre-2008 sch4C pool.

62.35.5 *Payment 12 Mar-5 Apr 2008*

Para 151 sch 7 FA 2008 provides:

> (1) This paragraph applies for the tax year 2008–09 or any subsequent tax year ("the relevant tax year") if—
>
> (a) an individual who was resident or ordinarily resident, but not domiciled, in the UK in the tax year 2007–08 received a capital payment from the trustees of a settlement on or after 12 March 2008 but before 6 April 2008, and
>
> (b) the individual is resident or ordinarily resident, but not domiciled, in the UK in the relevant tax year.
>
> (2) For the purposes of
>
> [i] paragraph 8 of Schedule 4C to TCGA 1992 [sch 4C s.87 charge] as it applies for the relevant tax year
>
> [ii] (and section 87A of that Act [matching rules] as it applies for those purposes),
>
> no account is to be taken of the capital payment.

This is the equivalent of para 125 sch 7 FA 2008: see 61.44.2 (Payment 12 Mar - 5 Apr 2008).

62.36 Pre-2008 sch 4C pool

Para 152 FA 2008 provides:

> [1] Schedule 4C to TCGA 1992 (as it has effect without the amendments made by paragraphs 128 to 146)
>
> [2] applies for the tax year 2008–09 and subsequent tax years in relation to Schedule 4C pools created before 6 April 2008 ("existing Schedule 4C pools")
>
> [3] as if paragraphs 7B and 9(2) were omitted.

The pre FA 2008 sch 4C regime applies when matching post 5 April 2008 capital payments to gains in the pre 6 April 2008 schedule 4C TCGA pool.

The omitted paragraphs listed at [3] are provisions in the pre-2008 sch 4C replaced by provisions in the post-2008 sch 4C:

Para	**Topic**	**See now**
7B	Gains on 2nd sch4C-disposal	62.23 (2nd sch4B-disposal)
9(2)	When capital payment is available	62.36.2 (Matched capital payment)

62.36.1 *Pre-2008 sch 4C regime*

An important feature of the pre-2008 sch4C regime was that capital payments to UK resident non-doms did not reduce the sch4C pool. That rule changed in 2008 for post-2008 sch4C pools. From 2003-2008, para 8 sch 4C provided:

> *(1) The gains in a settlement's Schedule 4C pool at the end of any year of assessment are treated as chargeable gains accruing in that year to beneficiaries who receive in that year, or have received in an earlier year, capital payments from the trustees of any settlement that is a relevant settlement in relation to the pool.*
>
> *Paragraph 8A defines "relevant settlement" for this purpose.*
>
> *(2) The attribution of chargeable gains to beneficiaries under this paragraph shall be made in proportion to, but shall not exceed, the amounts of the capital payments made to them.*
>
> *Paragraphs 8B and 8C provide for the matching of gains with available capital payments.*
>
> *(3) A chargeable gain shall not be treated as accruing to a beneficiary under this Schedule unless he is chargeable to tax for that year of assessment.*
>
> *(4) For the purposes of this Schedule a beneficiary is "chargeable to tax" for a year of assessment if, and only if—*
>
> *(a) he is resident in the United Kingdom for any part of that year or is ordinarily resident in the United Kingdom for that year, and*
>
> *(b) he is domiciled in the United Kingdom for any part of that year.*[49]
>
> *(5) Any gains in a settlement's Schedule 4C pool that are not attributed to beneficiaries in a year of assessment are carried forward to the following year of assessment, when this paragraph applies again.*

The former para 8B sch 4C TCGA provided:

> *(1) The following rules apply as regards the attribution of the gains in a settlement's Schedule 4C pool to beneficiaries of relevant settlements. This paragraph has effect subject to paragraph 8C (order of attribution as between gains in Schedule 4C pool and other trust gains).*
>
> *(2) Gains of earlier years are attributed to beneficiaries before gains of later years.*

[49] A non-domiciled beneficiary was not within the scope of the s.87 or sch4C charge before 2008.

> *(3) For the purposes of this Schedule the year of a gain is determined as follows—*
>
> *(a) a Schedule 4B trust gain is a gain of the year of assessment in which the transfer of value in question takes place;*
>
> *(b) a section 87/89 gain is a gain of the year of assessment in which it first forms part of a settlement's trust gains in accordance with section 87(2).*
>
> *(4) Gains of the same year are matched with available capital payments made at any time by trustees of any relevant settlement.*
>
> *(5) If gains of one year are wholly matched, gains of the next year are then matched, and so on.*
>
> *(6) The gains are attributed to beneficiaries in proportion to, but not so as to exceed, the amount of available capital payments received by them.*

The former para 8C sch 4C TCGA dealt with the priority of the pre-2008 sch 4C charge and the standard s.87 charge:

> *(1) Where in a year of assessment—*
>
> *(a) gains in a settlement's Schedule 4C pool fall to be attributed to beneficiaries of relevant settlements, and*
>
> *(b) one or more of those settlements also have gains that fall to be attributed to beneficiaries under section 87(4) or 89(2),*
>
> *the provisions of paragraph 8B have effect as follows.*
>
> *(2) The rules in that paragraph apply in relation to all the gains falling to be so attributed.*
>
> *(3) As between gains of the same year, Schedule 4C gains are attributed to beneficiaries before other gains.*

Thus sch 4C has priority over the standard s.87 charge.

62.36.2 *Matched capital payment*

Para 153 sch 7 FA 2008 provides:

> Any reduction in the amount of a capital payment has effect for the purposes of Schedule 4C to TCGA 1992 as it applies in relation to existing Schedule 4C pools (as well as for other purposes).

"Existing sch 4C pool" means a pre-2008 sch4C pool.[50]

Para 154 sch 7 FA 2008 provides:

[50] See 62.36 (Pre-2008 sch 4C pool).

> (1) If all of a capital payment ceases (in the tax year 2008–09 or any subsequent tax year) to be available, the amount of the capital payment is reduced to nil.
>
> (2) If part of a capital payment ceases (in the tax year 2008–09 or any subsequent tax year) to be available, the amount of the capital payment is reduced by the amount of that part.
>
> (3) A capital payment "ceases to be available" in a tax year if and to the extent that, by reason of the capital payment, chargeable gains are treated under paragraph 8 of Schedule 4C to TCGA 1992 (as it has effect in relation to existing Schedule 4C pools) as accruing in that year to the recipient.
>
> (4) If—
>
> (a) chargeable gains are treated under paragraph 8 of Schedule 4C to TCGA 1992 (as it has effect in relation to existing Schedule 4C pools) as accruing in a tax year,
>
> (b) more than one capital payment that the beneficiary has received is taken into account for the purposes of determining the amount of chargeable gains treated as accruing to the beneficiary, and
>
> (c) the amount of the chargeable gains is less than the total amount of capital payments taken into account,
>
> sub-paragraph (3) applies in relation to earlier capital payments before later ones.

62.36.3 *Pre/post-2008 sch 4C regimes: priority*

Para 155 sch 7 FA 2008 provides:

> In any tax year—
>
> (a) Schedule 4C to TCGA 1992 (as amended by paragraphs 128 to 146) applies in relation to a settlement before that Schedule (as it has effect without those amendments) applies in relation to the settlement, and
>
> (b) that Schedule (as it has effect without those amendments) applies in relation to the settlement before section 87 or 89(2) of that Act applies in relation to the settlement.

Thus the post-2008 sch4C regime has priority over the pre-2008 sch 4C regime where a trust has:

(1) a pre-2008 sch4C pool, and

(2) a post -2008 sch4C pool

62.36.4 *Example: post 2008 sch4C pool*

Example 30 HMRC s.87 guidance illustrates:

(1) The disregard for a capital payment to a non-resident beneficiary

(2) Transitional relief for pre-2008 gains matched to a post-2008 capital payment

Example 30[51]

New last in first out (LIFO) rules for allocating capital payments against gains in post 5 April 2008 Schedule 4C pools.

Application of remittance basis to gains treated as accruing to beneficiaries who are non-UK domiciled remittance basis users.

A Schedule 4C TCGA pool of gains was created in 2008-09 as a result of a transfer of value linked with trustee borrowing. The transfer was between two non-UK resident settlements. The Schedule 4C TCGA pool consists of the following gains:

2004-05	Trustees' gains (section 2(2) amount)	£20,000
2005-06	Trustees' gains (section 2(2) amount)	£30,000
2008-09	Trustees' gains (section 2(2) amount) on transfer	£35,000
Total schedule 4C pool		£85,000

No capital payments have been made out of either settlement prior to 2009-10. The following capital payments are made subsequently out of the transferee settlement:

2009-10 Payment to non-UK resident and non-UK domiciled beneficiary[52]	£90,000
2010-11 Payment to UK resident but non-UK domiciled beneficiary	£21,000
2010-11 Payment to UK resident and domiciled beneficiary	£42,000

The HMRC analysis is as follows.

2009/10 [Payment to non-resident]

The 2009-10 £90,000 capital payment to a non-UK resident and non-UK domiciled beneficiary is not matched with any of the gains (section 2(2) amounts) in the post 6 April 2008 Schedule 4C TCGA pool. This comes from the wording of the new paragraph 8(3)(b) Schedule 4C TCGA.[53]

The capital payment is still available to carry forward to be matched with future gains under section 87 or 89(2) TCGA.

2010/11 [Payment to UK resident dom/non-dom]

The 2010-11 capital payments total £63,000 (£21,000 + £42,000). As this is less than the £85,000 gains in the post 6 April 2008 Schedule 4C TCGA pool then all the capital payments can be matched. The restriction [in the pre-2008 sch 4C regime] that does not allow capital payments to a UK resident but non-UK domiciled beneficiary to be matched with gains in a pre 6 April 2008 Schedule 4C TCGA pool does not apply to a post 5 April

[51] I altered the layout slightly for added clarity.

[52] Author's footnote: The domicile of the non-resident beneficiary is irrelevant.

[53] See 62.24.3 (Sch4C matching rules).

2008 Schedule 4C TCGA pool.

The new last in first out (LIFO) rules for matching capital payments with gains in the post 5 April 2008 Schedule 4C TCGA pool apply. These are applied by paragraph 138 Schedule 7 which introduces a new paragraph 8 Schedule 4C TCGA which applies the LIFO rules in section 87A TCGA.

So we look first at the latest gain (section 2(2) amount) in the post 5 April 2008 Schedule 4C TCGA pool. That is the 2008-09 gain of £35,000. This is all matched with capital payments. Gains of £11,667 (£35,000 × £21,000 / [£21,000 + £42,000]) are attributed to the UK resident but non-UK domiciled beneficiary in 2010-11. Gains of £23,333 (£35,000 × £42,000 / [£21,000 + £42,000]) are attributed to the UK resident and domiciled beneficiary in 2010-11.

Next we look at the 2005-06 gain (section 2(2) amount) of £30,000. There are only capital payments left of £28,000 (£63,000 − £35,000) to match with this. Gains of £9,333 (£28,000 × £21,000 / [£21,000 + £42,000]) are attributed to the UK resident but non-UK domiciled beneficiary in 2010-11. Gains of £18,667 (£28,000 × £42,000 / [£21,000 + £42,000]) are attributed to the UK resident and domiciled beneficiary in 2010-11.

What remains in the post 5 April 2008 Schedule 4C TCGA pool are

2004-05	Trustees' gains (section 2(2) amount)	£20,000
2005-06	Trustees' gains (section 2(2) amount)	£2,000

The UK resident and domiciled beneficiary has attributed to them gains of £42,000 (£23,333 + £18,667). These are all chargeable to tax on the beneficiary for 2010-11.

The UK resident but non-UK domiciled beneficiary has attributed to them gains of £21,000 (£11,667 + £9,333). £9,333 of these are not chargeable to tax because they result from a matching with trustees' gains (section 2(2) amount) of a year before 2008-09 – paragraph 150 Schedule 7.[54]

The remaining £11,667 are chargeable to tax on the beneficiary in 2010-11 subject to the remittance basis. Paragraph 139 Schedule 7 introduces a new paragraph 8AA Schedule 4C TCGA which applies the section 87B remittance basis rules.

62.37 Example: pre-2008 Sch 4C pool

HMRC s.87 guidance provides:

123. Schedule 4C pools created before 6 April 2008 are dealt with differently from those created after 5 April 2008. In broad terms Schedule 4C pools created before 6 April 2008 continue to be dealt with under Schedule 4C as it applied before Schedule 7 changes – paragraph 152 of Schedule 7. See example 28. It is not possible for post 5 April 2008 trust gains to be added to a pre 6 April 2008 Schedule 4C pool.

124. There are ordering rules for matching capital payments made after 5 April 2008. They are matched in the following order under paragraph 155 of Schedule 7: See example 29.

- First against gains in a Schedule 4C pool created after 5 April 2008
- Second against gains in a Schedule 4C pool created before 6 April 2008
- Third against gains not in a Schedule 4C pool

[54] See 62.35.4 (Pre-2008 cap. payment/trust gain matched post 2008).

125. Where capital payments are matched against gains in a Schedule 4C pool created before 6 April 2008 earlier gains continue to be matched with earlier capital payments. In other words FIFO (first in, first out) rules continue to apply rather than the general new LIFO (last in, first out) rules. This is relevant for calculating the "increase in tax" charge under paragraph 13 of Schedule 4C.

HMRC example 28 illustrates the treatment of a pre-2008 sch4C pool:

Example 28[55]
Pre 6 April 2008 Schedule 4C TCGA pool
Capital payments made post 5 April 2008 to UK domiciled and non-UK domiciled beneficiaries

A Schedule 4C TCGA pool of gains was created in 2006-07 as a result of a transfer of value linked with trustee borrowing. The transfer was between two non-UK resident settlements. The Schedule 4C TCGA pool consists of the following gains:

2004-05	Trustees' gains (section 2(2) amount)	£20,000
2005-06	Trustees' gains (section 2(2) amount)	£30,000
2006-07	Trustees' gains (section 2(2) amount) on transfer	£70,000
Total sch4C pool		£120,000

No capital payments have been made out of either settlement prior to 2008-09. The following capital payments are made subsequently out of the transferee settlement:

2008-09	Payment to non-UK domiciled beneficiary	£90,000
2009-10	Payment to UK resident and domiciled beneficiary	£60,000

The HMRC analysis is as follows.

Paragraph 152 Schedule 7 confirms that you apply the pre FA 2008 version of Schedule 4C TCGA when matching post 5 April 2008 capital payments to gains in the pre 6 April 2008 Schedule 4C TCGA pool.

2008/09 [Payment to non-dom]

The 2008-09 £90,000 capital payment to a non-UK domiciled beneficiary is not matched with any of the gains (section 2(2) amounts) in the pre 6 April 2008 Schedule 4C TCGA pool. This comes from the pre FA 2008 wording of paragraph 8(3) Schedule 4C TCGA.[56] The capital payment is still available to carry forward to be matched with future gains under section 87 or 89(2) TCGA or gains in a post 5 April 2008 Schedule 4C TCGA pool.[57]

2009/10 [Payment to UK dom]

The 2009-10 £60,000 capital payment to a UK resident and domiciled beneficiary is matched with £60,000 of the gains (section 2(2) amounts) in the pre 6 April 2008

[55] I altered the layout slightly for added clarity.

[56] See 62.36.1 (Pre-2008 sch 4C regime).

[57] Author's footnote: the capital payment is however not matched to the pre-2008 gains, so it is taxable on the non-dom beneficiary.

Schedule 4C TCGA pool. This results in £60,000 gains being treated as accruing to the beneficiary in 2009-10. The capital payment is matched against gains (section 2(2) amounts) on a first in first out (FIFO) basis. This comes from the pre FA 2008 wording of paragraph 8B(2) Schedule 4C TCGA.[58] So for the purpose of the "increase in tax" charge under paragraph 13 Schedule 4C TCGA the £60,000 capital payment is matched against gains (section 2(2) amounts) in the following order:

- First against the 2004-05 £20,000 gains (section 2(2) amounts)
- Second against the 2005-06 £30,000 gains (section 2(2) amounts)
- Third the remaining £10,000 (£60,000 −[£20,000 + £30,000]) of the capital payment against £10,000 of the 2006-07 gains (section 2(2) amounts)

This leaves £60,000 gains in the Schedule 4C TCGA pool which are all gains (section 2(2) amounts) from 2006-07.

HMRC example 29 concerns a trust with pre- and post-2008 sch4C pools:

Example 29
Ordering rules for allocating capital payments between different Schedule 4C pools and gains dealt with under section 87 or 89(2)

A pre 6 April 2008 Schedule 4C TCGA pool of gains was created in 2006-07 as a result of a transfer of value linked with trustee borrowing.

A post 5 April 2008 Schedule 4C TCGA pool of gains was created in 2008-09 as a result of a further transfer of value linked with trustee borrowing.

Paragraph 152 of Schedule 7 applies to keep the Schedule 4C TCGA pools separate. Both transfers were between the same two non-UK resident settlements. Additionally there are unmatched gains (section 2(2) amounts) in the transferee settlement. In summary the gains are:

2004-05	Trustees' gains (section 2(2) amount) in transferee settlement	£10,000
2006-07	Pre 6 April 2008 Schedule 4C pool - gains	£50,000
2008-09	Post 6 April 2008 Schedule 4C pool - gains	£30,000
2009-10	Trustees' gains (section 2(2) amount) in transferee settlement	£20,000

In 2010-11 a capital payment of £95,000 is made from the transferee settlement to a UK resident and domiciled beneficiary.

The HMRC analysis is as follows.

The rules in paragraph 155 Schedule 7[59] say that the capital payment is allocated against gains in the following order:

- First against the £30,000 gains in the post 5 April 2008 Schedule 4C TCGA pool
- Second against the £50,000 gains in the pre 6 April 2008 Schedule 4C TCGA pool
- Third the remaining £15,000 (£95,000 − [£30,000 + £50,000]) of the capital payment against £15,000 trustees' gains (section 2(2) amount) in the transferee settlement.

Next you go to the new section 87A TCGA matching rules to decide which trustees' gains these £15,000 capital payments are matched with. The last in first out (LIFO) rule there

[58] See 62.36.1 (Pre-2008 sch 4C regime).

[59] See 62.36.3 (Priority of post-2008 sch 4C regime).

matches it all with £15,000 of the 2009-10 £20,000 trustees' gains (section 2(2) amount). This leaves unmatched trustees' gains (section 2(2) amount) of:

2004-05	Trustees' gains (section 2(2) amount) in transferee settlement	£10,000
2009-10	Trustees' gains (section 2(2) amount) in transferee settlement	£5,000

62.38 Critique

In accordance with the usual policy, there was no consultation or discussion on the enactment, or multiple amendments, of sch 4B /4C, but it is worth looking back now to assess them.

HMRC would regard sch 4B and 4C (in their current form) as successful, as they successfully stopped the schemes at which they are addressed.

Measured by any other criteria they are a failure. They are too wide (applying to arrangements where there is no avoidance). They are so complicated and counterintuitive that one could not expect even conscientious trustees to comply, except some of the largest trusts with a large budget for UK professional advice. A full analysis - which would be several times the length of this long chapter - will never be written.

I expect that the drafter only expected HMRC, and taxpayers, to look at the rules in cases of "abuse"; an attitude HMRC have expressed in relation to other unworkable anti-avoidance legislation.[60] They are in practice generally ignored, by HMRC and by taxpayers. They remain like unexploded ammunition from a forgotten war: exceptionally careful taxpayers avoid it; others disregard it, generally with impunity as HMRC will rarely know and may not care. While never satisfactory, the problems were made much worse by the extension of the scope of the s.87 charge in 2008. In all these respects, of course, schedules 4B and 4C are not very different from other anti-avoidance legislation of their time.

If a serious attempt is ever made to rationalise the UK taxation of offshore trusts, something much better can be devised. The easiest course would be to restrict the rules with a focussed motive test, ie they only apply where there is a purpose specifically to avoid s.87 or s.86. The schemes at which they are aimed are complex and artificial ones where the avoidance intention is hardly to be denied. The 2013 amendments to (what is now) s.3 TCGA offer a precedent.[61]

The professional bodies raised a similar proposal, with a more ambitious

[60] The former substantial donor rules are an example, see Kessler & Marre, *Taxation of Charities and Nonprofit Organisations* (9th ed., 2013), para 3.15 (Can bona fide charities safely ignore the substantial donor rules?) (The rules are now repealed).

[61] See 64.16 (s.3 motive defence).

ambit:

> **Schedules 4B and 4C should be removed**
> This should be accompanied by (panel approved) GAAR guidance saying that any arrangements designed along flip-flop lines would be considered to be caught by the GAAR.[62]

One of the selling points of the GAAR was said to be that some anti-avoidance provisions would become unnecessary.[63] If this is not suitable then what is?

No-one took any notice of that, but lobbying continues.[64]b

[62] Taxrep 59/15 Reforms to the Taxation of Non Domiciles *https://icaew.access.preservica.com/index.php/IO_92e162f4-7550-4854-9986-c44f874c466c*

[63] See 1.12.3 (Alternatives to Framework).

[64] STEP consultation response "OTS review of its approach to simplification and its aims, approach and priorities" (Apr 2022): "There are highly complicated rules for creating new pools of gains on certain transfers by offshore trusts. In some cases, they can be manipulated to the advantage of beneficiaries to avoid the supplemental charge or by using personal losses. Given recent case law, there is no particular need for these provisions in the majority of cases anyway. Alternatively, they could be much simplified without the need to keep separate pools of gains." *https://www.step.org/sites/default/files/2022-04/step-response-to-ots-review-of-simplification.pdf*

CHAPTER SIXTY THREE

SUB-FUNDS

63.1 Position outside sub-fund regime
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63.11 Sub-Funds: Critique

Cross references

The following topics are considered elsewhere:

Topic	**See para**
Sub-fund trustees relevant persons for remittance basis	18.7
Sub-fund rebasing on death	88.6.2
Sub-fund trustees connected persons	104.14.1

63.1 Position outside sub-fund regime

It is common for one trust to hold separate funds ("sub-funds") on distinct terms.[1]

The existence of sub-funds within one trust causes various difficulties, because the trustees of the trust are one person for CGT and IT: the sub-funds constitute one taxable unit. In particular:

Rule	**See para**
There is one tax return, and one assessment to CGT/IT	
Any trustee could be liable for all the tax	63.1.1
Allowable losses accrue to the trust as a whole	
The trust has one residence for tax purposes	7.10
Non-resident trust sub-funds share s.1(3) amounts (one trust gain pool)	

[1] For the distinction between (1) separate trusts and (2) sub-funds of one trust, see 99.22.2 (Variation or resettlement?).

The trust has one registration under TRS	130.23.5
CGT share pooling/matching rules apply to the trust as a whole	56.12

There are also advantages:

The creation of a sub-fund, or a transfer between sub-funds, is:

(a) not a disposal for CGT, so no gain arises
(b) not a transfer between trusts (which raises IHT and CGT issues)
(c) not a disposition for IHT purposes

A payment between sub-funds cannot constitute income for IT purposes

These points could matter for resident and non-resident trusts.

63.1.1 *Separate sub-fund trustees*

It is possible (though not common) for sub-funds to have separate trustees. Section 474(2)(3) ITA and s.69(3) TCGA address this. They are effectively identical, and are conveniently read side by side:

s.474(2)(3) ITA	**s.69(3) TCGA**
	For the purposes of this section, [*Note 3*] and of sections 71(1) and 72(1), where
(2) If different parts of the settled property in relation to a settlement are vested in different bodies of trustees, [*Note 1*]	[a] part of the property comprised in a settlement is vested in one trustee or set of trustees and part in another
subsection (1) and sections 475 and 476 [*Note 2*] apply in relation to the different bodies as if they were all one body.	
(3) The cases covered by subsection (2) include cases where	[b] (and in particular where
[a] settled land (within the meaning of the Settled Land Act 1925) is vested in the tenant for life and [b] investments representing capital money are vested in the trustees of the settlement.	[i] settled land within the meaning of the Settled Land Act 1925 is vested in the tenant for life and [ii] investments representing capital money are vested in the trustees of the settlement),
	they shall be treated as together constituting and, in so far as they act separately, as acting on behalf of a single body of trustees.

Note 1 The drafter has here retained the expression "body of trustees" which has elsewhere been deleted from the legislation, but it does not matter.

Note 2 As s.474(1) applies for the purposes of ITA, so does the rule in s.474(2); the references to ss.475, 476 are not actually necessary, but they do no harm.

Note 3 As s.69(1) applies for the purposes of TCGA, so does the rule in s.69(3); the references to ss.72, 72 are not actually necessary, but they do no harm.

Thus trustees of one sub-fund may be subject to tax on income or gains of the other.[2] On the appointment of separate trustees, an indemnity is required to deal with this (and to deal with the issue of capital losses). In *Roome v Edwards*:[3]

> Persons, whether professional men or not, who accept appointment as trustees of settlements such as these, are clearly at risk under the [TCGA] and have only themselves to blame if they accept the obligations of trustees in these circumstances without ensuring that they are sufficiently and effectively protected whether by their beneficiaries or otherwise for fiscal or other liabilities which may fall upon them personally as a result of the obligations which they had felt able to assume.

63.2 Sub-Fund regime

FA 2006 introduced a regime for sub-funds which applies where there has been a sub-fund election. I refer to this as the **"Sub-Fund regime"** (with initial capitals to distinguish it from sub-funds outside the regime). The legislation is written out twice, once in TCGA and again in ITA.

Para 1 sch 4ZA TCGA	**s.477 ITA**
The trustees of a settlement (the "principal settlement") may elect that a fund or other specified portion of the settled property (the "sub-fund") be treated, unless the context otherwise requires, as a separate settlement (the "sub-fund settlement") for the purposes of this Act, and the election shall have effect.	(1) This section applies for the purposes of the Income Tax Acts (except so far as, in those Acts, the context otherwise requires) if the trustees of a settlement have made a sub-fund election under paragraph 1 of Schedule 4ZA to TCGA 1992. (2) The sub-fund settlement is treated as a settlement that is created at the relevant time.

The requirements of an election are set out in TCGA, but making the election also has IT consequences.

[2] This was confirmed in *Roome v Edwards* 54 TC 359.

[3] 54 TC 359 at p.395.

Section 477(7) ITA incorporates some definitions by reference:

> In this section—
> "principal settlement" has the meaning given by paragraph 1 of Schedule 4ZA to TCGA 1992,
> "the relevant time" means the time when the sub-fund election is treated as having taken effect under paragraph 2 of that Schedule,
> "sub-fund election" has the meaning given by paragraph 2 of that Schedule, and
> "sub-fund settlement" has the meaning given by paragraph 1 of that Schedule.

The TSE provides:

> **TSEM3510: Sub-fund elections - conditions for making an election** [Mar 2017]
> ... Where the reality before the election is made is that there are two separate funds which together contain all the property in the settlement the trustees must decide which is to be the sub-fund settlement and which the principal settlement. The principal settlement is for Income Tax and CGT purposes a continuation of the settlement before the election. In appropriate cases a further sub-fund settlement election could be made in respect of the principal settlement.

The TSE Manual provides:

> **TSEM3515 Sub-Fund Elections - Time Limits** [Mar 2017]
> The time limit for making an election is the first anniversary of 31 January following the tax year in which the specified date falls. So, for an election to be treated as having taken effect on a date falling in the year 2006-07 it must be made no later than 31 January 2009.
> Sub-Fund Elections

63.2.1 *Date election takes effect*

Para 2 sch 4ZA TCGA provides:

> (1) An election under paragraph 1 (a "sub-fund election") must specify the date on which it is to be treated as having taken effect, which must not be later than the date on which it is made.
> (2) The election shall be treated as having taken effect—
> (a) at the beginning of the specified date, or
> (b) if there is a deemed disposal of an asset by the trustees of the principal settlement under section 71(1) (by virtue of

> paragraph 19) or section 80(2) (by virtue of paragraph 18(2)), on the specified date immediately after the deemed disposal.

63.3 Sub-Fund election: Conditions

Para 3 sch 4ZA TCGA provides:

> Trustees may make a sub-fund election only if—
>
> (a) Conditions 1 to 4 are satisfied when the election is made, and
>
> (b) Conditions 2 to 4 were satisfied throughout the period beginning with the time when the election is to be treated as having taken effect and ending immediately before the election is made.

63.4 Condition 1: No sub-subfund

Para 4 sch 4ZA TCGA provides:

> Condition 1 is that the principal settlement is not itself a sub-fund settlement.

63.5 Condition 2: At least 2 Sub-Funds

Para 5 sch 4ZA TCGA provides:

> Condition 2 is that the sub-fund is not the whole of the property comprised in the principal settlement.

This did not need to be said, but it does no harm.

63.6 Condition 3: No co-ownership

Para 6 sch 4ZA TCGA provides:

> Condition 3 is that, if the sub-fund election had taken effect, the sub-fund settlement would not consist of or include an interest in an asset any other interest in which would be comprised in the principal settlement.

Para 7 sch 4ZA TCGA provides:

> For the purpose of Condition 3—
>
> (a) section 104(1) shall not have effect, and
>
> (b) "interest", in relation to any asset, means an interest as a co-owner of the asset (whether the asset is owned jointly or in common and whether or not the interests of the co- owners are equal).

63.7 Cond. 4: Distinct beneficiaries

Para 8 sch 4ZA TCGA provides:

> Condition 4 is that, if the sub-fund election had taken effect, no person would be a beneficiary under both the sub-fund settlement and the principal settlement.

Para 9(1) sch 4ZA TCGA provides a commonsense definition of "beneficiary":

> For the purpose of Condition 4 a person is a beneficiary under a settlement—
>
> (a) if—
>
> (i) any property which is or may at any time be comprised in the settlement, or
>
> (ii) any derived property,
>
> is, or will or may become, payable to him or applicable for his benefit in any circumstances whatsoever, or
>
> (b) if he enjoys a benefit deriving directly or indirectly from—
>
> (i) any property which is comprised in the settlement, or
>
> (ii) any derived property.

Para 9(2) sch 4ZA TCGA provides some limited exceptions to the rule that there must be no common beneficiaries. It does this by the clumsy but effective technique of limiting the definition of "beneficiary":

> But for the purpose of Condition 4 a person is not to be regarded as a beneficiary under a settlement if property comprised in the settlement, or any derived property,[4] will or may become payable to him or applicable for his benefit by reason only of—
>
> (a) his marrying, or entering into a civil partnership with, a beneficiary under the settlement,
>
> (b) the death of a beneficiary under the settlement,
>
> (c) the exercise by the trustees of the settlement of—
>
> (i) a power conferred by section 32 of the Trustee Act 1925 or

[4] Defined para 9(3): In this paragraph "derived property", in relation to any property, means—
(a) income from that property,
(b) property directly or indirectly representing—
(i) proceeds of that property, or
(ii) proceeds of income from that property, or
(c) income from property which is derived property by virtue of paragraph (b)."

> section 33 of the Trustee Act (Northern Ireland) 1958 (powers of advancement),
>
> (ii) a power conferred by the law of a jurisdiction other than England and Wales or Northern Ireland which makes provision similar to the provisions specified in sub-paragraph (i), or
>
> (iii) a power of advancement which is conferred by the instrument creating the principal settlement, or by another instrument made in accordance with the terms of the principal settlement, and which is subject to the same restrictions as those specified in section 32(1)(a) and (c) of the Trustee Act 1925, or
>
> (d) the failure or determination of trusts of the kind described in section 33 of the Trustee Act 1925 (protective trusts).

There are some puzzles here, but the points are not worth pursuing.

63.8 Procedure for election

Para 10 sch 4ZA TCGA provides:

> A sub-fund election must be made—
>
> (a) by notice to an officer of Revenue and Customs, and
>
> (b) in such form as the Commissioners for Her Majesty's Revenue and Customs may require.

Para 11 sch 4ZA TCGA provides:

> A sub-fund election may not be made after the second 31st January after the year of assessment in which the date on which the election is to be treated as having taken effect falls.

Para 12 sch 4ZA TCGA provides

> A sub-fund election must contain—
>
> (a) a declaration by each trustee of the principal settlement that he consents to the election,
>
> (b) a statement by the trustees of the principal settlement that the requirement in paragraph 3 is satisfied, [in short, that all sub-fund conditions are satisfied][5]
>
> (c) such information as the Commissioners for Her Majesty's Revenue and Customs may require in relation to the principal settlement (which may, in particular, include information

[5] See 63.3 (Sub-Fund election: Conditions).

relating to the trustees, the trusts, property which is or has been comprised in the settlement, the settlors or the beneficiaries),

(d) a declaration by the trustees of the principal settlement that the information given in the election is correct, to the best of their knowledge and belief, and

(e) such other declarations as the Commissioners for Her Majesty's Revenue and Customs may require.

Para 13 sch 4ZA TCGA provides:

> A sub-fund election may not be revoked.

63.9 Effect of sub-fund election

63.9.1 *Separate settlement*

Para 1, 17 sch 4ZA TCGA	s.477(2) ITA
Para 1 The trustees of a settlement (the "principal settlement") may elect that a fund or other specified portion of the settled property (the "sub-fund") be treated, unless the context otherwise requires, as a separate settlement (the "sub-fund settlement") for the purposes of this Act, and the election shall have effect. **Para 17** The sub-fund settlement shall be treated, for the purposes of this Act, as having been created at the time when the sub-fund election is treated as having taken effect.	The sub-fund settlement is treated as a settlement that is created at the relevant time.

So the Sub-Fund is treated as a separate settlement for CGT/IT.

The phrase "unless the context otherwise requires" echoes the phrase in the in the standard IT/CGT definition of "settlement" and makes room for cases where the settlement-arrangement definition of settlement applies.[6] But in general a Sub-Fund and the principal settlement should constitute two separate settlement-arrangements.

[6] See 87.3 (Settlement: Standard IT/CGT definition); 87.4 (Settlement-arrangement definition of settlement).

The CG Manual provides:

> **CG33331 Sub-Fund Settlements: Basic Effects For CGT: Deemed Disposal** [Jul 2019]
> Except for the purposes of the annual exempt amount (see CG18115) the sub-fund becomes a new separate settlement on "the specified date" (see the end of TSEM3510). Otherwise the basic principle is that the tax consequences should be the same as those which would apply if the trustees had exercised their powers to transfer assets to the trustees of a separate settlement. The legislation provides the same possibilities in the case where such powers are not available to them. ...

63.9.2 *Trustees of Sub-Funds*

Para 18 sch 4ZA TCGA	**Section 477 ITA**
(1) Each trustee of the trusts on which the property comprised in the sub-fund settlement is held shall be treated as a trustee of the sub-fund settlement for the purposes of this Act.	(3) Each trustee of the trusts on which property comprised in the sub-fund settlement is held is treated as a trustee of the sub-fund settlement.
(2) A person who is a trustee of the sub-fund settlement shall be treated for the purposes of this Act, from the time when the election is treated as having taken effect, as having ceased to be a trustee of the principal settlement unless he is also a trustee of trusts on which property comprised in the principal settlement is held.	(4) A person ("T") who is a trustee of the sub-fund settlement is treated, from the relevant time, as having ceased to be a trustee of the principal settlement unless T is also a trustee of trusts on which property comprised in the principal settlement is held.
(3) A person who is a trustee of the principal settlement shall not be treated for the purposes of this Act as a trustee of the sub-fund settlement unless he is also a trustee of trusts on which property comprised in the sub-fund settlement is held.	(5) A person ("T") who is a trustee of the principal settlement is not to be treated as a trustee of the sub-fund settlement unless T is also a trustee of trusts on which property comprised in the sub-fund settlement is held.

63.9.3 *Disposal and acquisition*

Para 19 sch 4ZA TCGA

The trustees of the sub-fund settlement shall be treated for the purposes of this Act as having become absolutely entitled, at the time when the sub-fund election is treated as having taken effect, to the property comprised in that settlement as against the trustees of the principal settlement.

s.477(6) ITA

The trustees of the sub-fund settlement are treated as having become, at the relevant time, absolutely entitled to the property comprised in that settlement as against the trustees of the principal settlement.

The point of this deeming is to trigger the CGT charge on termination of a settlement.[7] Thus an election may have a significant CGT cost, unless the trust fund does not give rise to a gain, or is in the form of cash on which no gain can arise. A good time to consider an election may be when trust property has been or is about to be sold. There is no disposal of property in the principal fund, so careful selection of what property goes into the Sub-Fund may make a difference.

Para 20 sch 4ZA TCGA provides:

> (1) A deemed disposal by the trustees of the principal settlement of an asset under
>
> [a] section 71(1) (by virtue of paragraph 19) or
>
> [b] section 80(2) (by virtue of paragraph 18(2))[8]
>
> shall be treated as having been made at the beginning of the date on which the sub-fund election is treated as having taken effect.
>
> (2) If the trustees of the sub-fund settlement have acquired an asset of which the trustees of the principal settlement are deemed to have disposed under section 71(1) (by virtue of paragraph 19), they shall be deemed to have acquired it at the time when the election is treated as having taken effect.
>
> (3) The trustees of the principal settlement shall not be treated as having disposed of an asset under section 80(2) by virtue of paragraph 18(2) if they are treated as having disposed of the same asset under section 71(1) by virtue of paragraph 19.

The CG Manual provides:

[7] See 56.21.5 (Disposal on trust termination).

[8] See 12.4 (Charge on emigration of trust).

> **CG33331 Sub-Fund Settlements: Basic Effects For CGT: Deemed Disposal** [Jul 2019]
> If however a particular asset meets the business asset test or agricultural property test "gifts hold-over relief" may be available under TCGA section 165 or TCGA Schedule 7 paragraphs 1 to 4. See CG66940+. It is also accepted that if the transaction creating the sub-fund settlement is a chargeable transfer for Inheritance Tax, and the specified date is the same day, the conditions of TCGA92/S260(2)(a) can be met. For example one might have a will trust where currently there is an immediate post-death interest for A, the son of the testator, see CG36542. The trustees exercise a power to declare discretionary trusts for A's children, B,C and D, in respect of part of the settled property. This is a chargeable transfer for IHT. Assuming the property held on discretionary trusts meets the conditions for there to be a sub-fund, an election might be made under which the specified date is the date of the exercise of the power. In this situation section 260(2)(a) could apply unless any of B,C and D are under 18.

Para 21 sch 4ZA TCGA provides:

> If the trustees of the sub-fund settlement are treated by virtue of paragraph 19 as having become absolutely entitled to money expressed in sterling, for the purposes of this Act—
> (a) the trustees of the principal settlement shall be treated as having disposed of the money at the beginning of the day on which the sub-fund election is treated as having taken effect, and
> (b) the trustees of the sub-fund settlement shall be treated as having acquired the money at the time when the election is treated as having taken effect.

Why is this needed? The CG Manual provides:

> **CG33332 Sub-Fund Settlements: Basic Effects For CGT: Other Effects** [Jul 2019]
> This would be relevant for the purposes of identifying the settlor of the sub-fund settlement, which is determined by section 68B, see CG33247.

63.9.4 *Transfer to Sub-Fund*

Para 22 sch 4ZA TCGA provides:

> (1) If the trustees of the principal settlement are deemed to have disposed of an asset under section 71(1) (by virtue of paragraph 19), the

> trustees of the principal settlement shall be treated for the purposes of sections 90 and 94[9] as having transferred the asset to the trustees of the sub-fund settlement.
>
> (2) Sub-paragraph (1) also applies where the trustees of the principal settlement would be deemed to have disposed of money expressed in sterling under subsection (1) of section 71 if in that subsection—
>
> (a) the reference to "assets" were a reference to "property", and
>
> (b) for "their" there were substituted "its".

This brings into effect the rules on transfers between settlements.

63.9.5 *Sub-Funds connected persons*

s.268(3) TCGA	**s.993(3)(g) ITA/s.1112(3)(g) CTA 2010**
A person who is the trustee of a settlement is connected with ...	A person, in the capacity as trustee of a settlement, is connected with...
(e) if the settlement is a sub-fund settlement in relation to a principal settlement, a person in the capacity as trustee of any other sub-fund settlements in relation to the principal settlement.	(g) [identical to s.268(3)(e) TCGA]

63.10 Planning

If it is not desired to have one settlement with sub-funds governed by the general rules, the choice usually lies between:

(1) A Sub-Fund election
(2) To create separate settlements

The latter is usually better, as:

(1) It is simpler.
(2) It is not necessary to comply with the Sub-Fund election conditions (in particular, condition 4 (no common beneficiaries) may be inconvenient).

It is possible to think of cases where a Sub-Fund election will be useful, but they are rare. Examples are:

(1) To create separate settlements for CGT purposes but to preserve an

[9] Section 94 TCGA has been repealed, but the need to amend the provision here seems to have been overlooked.

pre-2006 estate IIP for IHT purposes.

(2) If trustees do not have power to create separate settlements (and do not want to go to court to obtain that power). But modern trusts generally confer the necessary power.

The HMRC Manual (correctly) warns against giving advice:

> **CG33334 Giving Advice** [Jul 2019]
> It is important that HMRC officers should avoid giving specific guidance to trustees on the question whether an election should be made. Advice should be limited to telling them what is actually said in CGM and TSEM and the legislation. This is because although the long-term consequences, in particular the removal of the four points in the bullets in CG33330, are greater fairness between different funds, and considerably greater convenience where there are discrete trustees, the short-term tax effects may be very complicated. In particular one has to consider the effects of there being a deemed disposal for CGT purposes on the prescribed date, in particular on the base costs of various assets (if appropriate after hold-over relief) and the position for CGT taper relief.

63.11 Sub-Funds: Critique

The Sub-Fund regime illustrates a general problem, that sensible tax reforms are often enacted so hedged with anti-avoidance provisions as to become unworkable. The lengthy and complex provisions are dead letter tax law. In the first year of the Sub-Fund regime, only *eight* Sub-Fund elections were made.[10]

The best course would be to abolish the Sub-Fund regime altogether - we do not need it - which would be a simplification. There would need to be protection for existing Sub-Funds, until the last of them is wound up.

[10] Private correspondence. In 2019 HMRC informed the author that they were unable to ascertain the number of Sub-Fund elections, but the author's experience continues to be that they are not made.

CHAPTER SIXTY FOUR

GAINS OF NON-RESIDENT COMPANIES

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Cross references

The following topics are considered elsewhere:

Topic	**See**
TNR s.3 gains	11.6.2
Trust holding company	61.55
Gain accruing to unit trust	69.8
Carried interest	73.25.1

For s.3 gains accruing to charities, see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 5.6 (Section 3 TCGA) online version *https://www.taxationofcharities.co.uk*

64.1 Section 3 TCGA: Introduction

Non-resident companies generally pay no UK tax on chargeable gains. This presents an obvious means of CGT avoidance. HMRC's first answer to this is s.3 TCGA.

The same problems arise for income of non-resident companies and for income/gains of non-resident trusts, but the statutory solutions are entirely different.

I refer to gains treated as accruing to a participator under s.3 TCGA as "**s.3 gains**".

64.1.1 *Pre-2019 rewrite provisions*

Until the 2019 CGT rewrite,[1] the rule was in s.13 TCGA. It will take a

[1] See 56.1 (2019 CGT rewrite: Navigation).

decade before the CG Manual is (mostly) updated, and statutory instruments will not be updated at all; so readers will need to keep the old section numbers in mind:

TCGA	**Topic**	**Formerly**
s.3	Charge	s.13(1) - (3A), (5)(b)(c)(cb)(d), (8) , (9), (10)
s.3A	Motive defences	s.13(5)(b), (ca)(cb), s13A
s.3B	Participators	s.13(10B), (12), (13), (14)
s.3C	Double charge reliefs	s.13(5A), (5B), (7), (7A)
s.3D	Remittance basis	s.14A
s.3E	Temporary non-residents	s.10A(3), (4), (10); s10AA(4); s13(5); s13(3A)
s.3F	Group relief	s.14
s.3G	Supplemental	s.13(11), (11A)

64.1.2 *2013 changes*

FA 2013 made four changes (retrospective to 2012):

Change	**See**
Minimum holding requirement: increased from 10% to 25%	64.13
Motive defence	64.16
Defence for foreign trading companies - holiday accommodation	64.17.1
Defence for economically significant activities	64.18

This was done for EU-law compliance reasons. As the 2013 rules are statutory, they are not directly affected by Brexit, though it would now be possible for Parliament to reverse them. The background is discussed in the 2022/23 edition of this work para 63.13 (EU-law compliance), but I omit that now, as it is mainly of historical interest.

64.2 Non-resident close company

Section 3(1) TCGA provides:

> This section applies if—

A set of four conditions then follow:

> (a) a chargeable gain accrues at any time to a non-UK resident close company,[2]

[2] Section 3(11) TCGA provides the standard definition:
"In this section "a non-UK resident close company" means a company-
(a) which is not resident in the UK, and
(b) which would be a close company if it were resident in the UK."

In this chapter I assume the company to which the gain accrues is a non-UK resident close company.

Next, s.3(1) TCGA provides:

> This section applies if ...
> (b) the gain is connected to avoidance (see section 3A),
> (c) the gain is not connected to
> [i] a foreign trade or
> [ii] other economically significant foreign activities...

This signposts 3 exceptions considered below.

Lastly, s3(1) TCGA provides:

> This section applies if ...
> (d) apart from this section, some or all of the gain would not be chargeable to corporation tax on the company.

Thus the CT charge payable by non-resident companies has priority over the s.3 charge.

64.3 s.3 gain attributed to participator

Section 3(2) TCGA provides:

> So much of the gain as would not otherwise be so chargeable is apportioned among participators, or indirect participators, in the company—
> (a) who are resident in the UK at that time, or
> (b) who are trustees of a settlement and are not resident in the UK at that time.

Section 3(4) TCGA provides:

> The amount apportioned to each person is treated as a chargeable gain accruing to the person.

The sidenote to s.3 calls this *attribution* of gains.[3] Section 3 TCGA refers to gains *apportioned* to participators. Elsewhere the company's gain is said to be *treated as accruing* to a person under s.3.[4] These expressions are interchangeable.

For the definition of close company see 104.26 (Close company: Introduction).

[3] The sidenote reads: "Gains attributed to UK resident individuals etc".

[4] See 19.37.8 (Relief for gain on sale).

64.4 Computing gains: CT rules

It is necessary to ascertain the amount of chargeable gains accruing to the non-resident company.

Section 3 applies to chargeable gains, so reliefs which prevent a gain from being a chargeable gain apply for the purposes of s.3.

Section 3G(3) TCGA provides:

> For the purposes of section 3 the amount of a gain or loss accruing to a company is calculated as if the company were a company resident in the UK chargeable to corporation tax on the gain.

There are two distinct statutory assumptions here:

(1) Corporation tax principles apply to compute the gain ("**s.3 CT principles assumption**")

(2) Assume the company is UK resident ("**s.3 residence assumption**")[5]

The statutory assumptions may be regarded as deeming provisions, or at least, like deeming provisions, they are construed purposively.[6]

Applying these assumptions, in computing s.3 gains:

(1) indexation relief is applicable (though the amount is now frozen), because a company within the charge to CT qualifies for that relief when computing its gains.

(2) The substantial shareholding exemption can apply. Although it is a requirement of that relief that the gain accrues to a UK resident company,[7] that requirement is deemed to be met because of the s.3 residence assumption.

(3) UK land rebasing does not apply, because it is a requirement of that relief that the company is non-resident, and that condition is deemed not to be met, because of the s.3 residence assumption.[8]

64.5 Gain from loan relationship

Section 295(1) CTA 2009 provides:

> The general rule for corporation tax purposes is that all profits arising to a company from its loan relationships are chargeable to tax as income in accordance with this Part.

[5] For statutory residence assumptions, see 61.6.1 (s.87 residence assumption).

[6] See App 8.1.2 (Statutory assumptions).

[7] See para 3 sch 7AC TCGA.

[8] See 57.16 (General rebasing conditions).

Gains on debts and other loan relationships (including life policies and foreign exchange gains) are not within s.3. Applying the s.3 CT principles assumption, these gains are chargeable to tax as income, so no chargeable gain accrues on the disposal.[9]

For a participator who is an individual or a trust, this seems too good to be true, which raises the question whether a court should construe the statutory assumption purposively so as to avoid that result.[10] However, s.3 also applies to a participator which is a company. It would be anomalous if a corporate participator did *not* obtain indexation relief, and somewhat surprising if loan relationship (etc) gains were treated as chargeable gains. The battle of the anomalies does not give a clear result, and the provision should be given its natural meaning.

HMRC accept this reasoning:

> As a consequence of the application of the loan relationship rules, a gain which accrues to a non-UK resident company on disposal of a debt represented by a balance in a non-sterling bank account will not be a chargeable gain. If the company has no chargeable gain, section 13 is not engaged, and therefore UK resident participators cannot be liable to tax in respect of such disposals. This difference in treatment between non-sterling bank accounts held directly and those held indirectly via a non-UK resident company is long standing ....[11]

The foreign currency CGT reform which followed in 2012 was enacted on the basis of this view of the law.[12]

Debts and policies often qualify for other CGT reliefs, so the question whether such gains could fall within s.3 may not often arise.

64.5.1 *"Loan relationship"*

The definition is intricate and a full discussion would need a chapter to itself.

[9] See s.37 TCGA, discussed at 56.4.12 (Interaction of IT/CGT).

[10] See App 8.1 (Deeming/statutory assumptions).

[11] HMRC, "The remittance basis and foreign currency bank accounts" (2009) *https://www.gov.uk/government/publications/the-remittance-basis-and-foreign-currency-bank-accounts* The website records that "This publication was withdrawn on 29 May 2015" but there is no reason to think that HMRC practice has changed on this point.

[12] The relief on disposals of foreign currency bank accounts applies to individuals, trustees and PRs but not to companies, because companies do not need the relief: see 95.10 (Foreign currency bank account: CGT).

The starting point is s.302(1) CTA 2009:

> For the purposes of the Corporation Tax Acts a company has a loan relationship if—
>
> (a) the company stands in the position of a creditor or debtor as respects any money debt (whether by reference to a security or otherwise), and
>
> (b) the debt arises from a transaction for the lending of money.[13]

In short, the requirements are:

(1) money debt and

(2) lending of money.

64.5.2 *Money debt*

Section 303 CTA 2009 defines "money debt":

> (1) For the purposes of this Part a money debt is a debt which—
>
> (a) falls to be settled—
>
> (i) by the payment of money,
>
> (ii) by the transfer of a right to settlement under a debt which is itself a money debt, or
>
> (iii) by the issue or transfer of any share in any company,
>
> (b) has at any time fallen to be so settled, or
>
> (c) may at the option of the debtor or the creditor fall to be so settled.
>
> (2) For the purposes of subsection (1) any option exercisable by either party to settle the debt in any other way than is mentioned in subsection (1)(a) is ignored.

64.5.3 *Transaction of lending money*

Section 303(3) CTA 2009 defines "transaction for the lending of money":

> A money debt is a debt arising from a transaction for the lending of money for the purposes of this Part if an instrument is issued by any person for the purpose of representing—
>
> (a) security for the debt, or
>
> (b) the rights of a creditor in respect of the debt.

Section 303(4) CTA 2009 excludes shares:

> A debt does not arise from a transaction for the lending of money for the

[13] In the case of a money debt which does not arise from a loan relationship, the provisions apply but only as respects *interest* payable to or by a company.

> purposes of this Part so far as it arises from rights conferred by shares in a company.

Why is this needed?

64.5.4 *Deemed loan relationships*

Section 302(4) signposts 8 sets of special rules in part 6 CTA 2009 (not considered here) which may be treated as loan relationships, so that gains likewise fall out of s.3:

Chapter	**Topic**
3	OEICs, unit trusts and offshore funds
4	Building societies
5	Registered societies
6	Alternative finance arrangements
7	Shares with guaranteed returns
8	Returns from partnerships
9	Manufactured interest
10	Repos
11	Investment life insurance contracts

64.5.5 *Derivatives and intangibles*

The same applies to gains on:

(1) Derivative contracts, charged to CT as income: Part 7 CTA 2009
(2) Intangible fixed assets, charged to CT as income: Part 8 CTA 2009

These gains are likewise taken out of the scope of s.3.

64.6 Amount attributed to participator

Once one has identified the participators, one asks how much of the company's gain is attributed to each of them.

Section 3(3) TCGA provides:

> The proportion of the amount of the gain to be apportioned to each person corresponds to the extent of the person's interest in the company as a participator or indirect participator.

Section 3B(2) TCGA provides:

> Any reference to a person's interest as a participator in a company is to the interest in it represented by all the factors by reference to which the person is a participator.

That is, "interest" in s.3 is not construed in a narrow or technical manner.

Section 3B(3) TCGA provides:

> Any reference to the extent of a person's interest as a participator in a company is to such proportion of the interests as participators of all of the company's participators as, on a just and reasonable basis, is represented by that interest.

What is just and reasonable? The CG Manual starts with general comments:

> **CG57260 participators' fractional interests** [Nov 2019]
> ...
> **The just and reasonable requirement**
> It is quite possible for the different criteria by which persons are participators to produce different percentages for one person's interest in a company. So
> [1] under one test, for example entitlement to income, A may have 60% and B have 40% and
> [2] under another test, for example entitlement to capital, A have 36%, B have 54% and C have 10%.
> This can happen even with relatively simple company structures, for example where there are preference shares, or loans. The total amount of gains apportioned cannot exceed the chargeable gain of the non-resident company. In this situation the gain has to be apportioned as is just and reasonable. This includes taking into account the interests of non-residents.
> In considering a just and reasonable apportionment you should take into account all relevant factors, and not simply make an arithmetical adjustment. It would not usually be correct merely to average out the interests using the different factors. The aim of the provisions is to ensure that the gain is attributed to the participators who have the real economic interest in the non-resident company and who will derive the benefit of the gain however indirectly. The just and reasonable apportionment prevents an inappropriate part of the gain being attributed to persons without real economic interests, for example commercial loan creditors, see below.

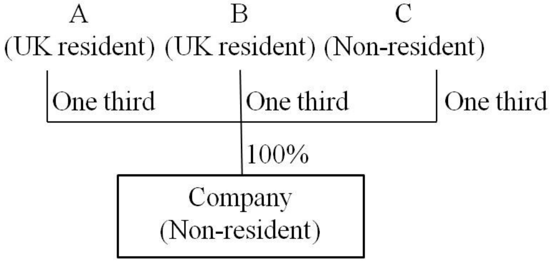
64.6.1 *Resident/non-resident shareholders*

The CG Manual starts with a very simple example:

> **CG57275 amount assessable** [Nov 2019]
> **Example 1**
> • a non-resident company has issued share capital of 150 Ordinary

shares

- A, B and C own 50 shares
- A and B are all resident in the UK. C has never been resident in the UK
- the non-resident company realises a gain of 300,000.



You compute the gains to attribute as follows.

Step 1

Calculate the gain that would have arisen if the non-resident company had been resident in the UK. This is 300,000.

Step 2

Determine the interests of all participators, including any who are not resident in the UK, by applying the tests of participation appropriate to the circumstances. In this case each of the three participators has a 33⅓ per cent interest.

Step 3

Calculate the proportion of the gain apportionable to the interests of each participator. Calculate the interests of all participators, including any who are not resident in the UK. In this case the proportion for each participator is 33⅓% of 300,000 = 100,000.

Step 4

Consider whether the gains calculated in Step 3 represent a just and reasonable apportionment. In this case the apportionment is just and reasonable. Gains of 100,000 are attributed to each of A and B and treated as gains accruing to them on the date on which the gain actually accrued to the company.

C is not liable to UK taxation. But it would not be just and reasonable to reapportion C's gain of 100,000 to A and B as C has a real economic interest in the non-resident company.

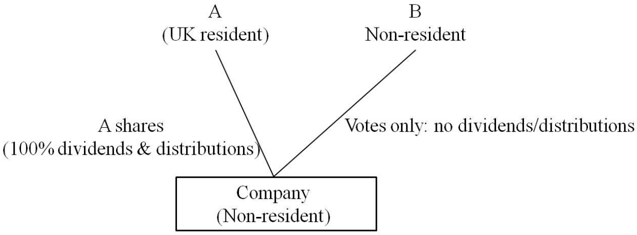
64.6.2 *Two share classes*

The CG Manual's next example concerns a company with two classes of shares:

CG57275 amount assessable [Nov 2019]

Example 4

- a non-resident company has issued share capital of 100 A shares and 100 B shares.
- both classes of shares carry equal voting rights but the B shares carry no entitlement to dividends or distributions in a winding-up.
- the A shares are owned by X who is resident in the UK
- the B shares are owned by Y who has never been resident in the UK
- the non-resident company realises a gain of 200,000.


A
(UK resident)
B
Non-resident
A shares
(100% dividends & distributions)
Votes only: no dividends/distributions
Company
(Non-resident)

You compute the gains to be attributed charge as follows.

Step 1

Calculate the gain that would have arisen if the non-resident company had been resident in the UK. This is 200,000.

Step 2

Determine the interests of all participators, including any who are not resident in the UK, by applying the tests of participation appropriate to the circumstances.

Participator	Voting rights	Distributions
X	50%	100%
Y	50%	0%

X is a 50% participator by reference to voting rights attached to the shareholding in A shares.

Y is a 50% participator by reference to voting rights attached to the shareholding in B shares.

X is a 100% participator by reference to rights to dividends and distributions attached to the shareholding in A shares.

Step 3

Calculate the proportion of the gain apportionable to the interests of each participator.

X (rights to income and capital)	200,000 × 100% = 200,000
Y (voting rights)	200,000 × 50% = 100,000

Step 4

Consider whether the gains calculated in Step 3 represent a just and reasonable apportionment. In this case the apportionment is not just and

> reasonable as the total of the gains under the initial apportionment exceeds the actual gain. A full review of all of the circumstances would be necessary. It appears that the true economic interest in the non-resident company is held solely by X. Y's entitlement should be ignored, and the whole of the gain apportioned to X.

64.7 Participators overlap

It is necessary to identify the participators in the non-resident company. Section 3B(1) TCGA incorporates the standard definition.[14] That was not drafted with s.3 in mind. One company can have too many participators for s.3 to cope with easily. I refer to this as the problem of "**overlapping participators**".

The problem may arise in the context of trusts,[15] loan creditors[16] and chains of companies.[17] The problem is solved in different ways in each case.

64.8 Participators overlap: Loan creditors

This section considers the position where a company has participators who are loan creditors. To whom are the company's gains apportioned, the loan creditors, or the shareholders (or partly one and partly the other)? What, in these circumstances, is the just and reasonable apportionment?

The CG Manual provides:

> **CG57260 participators' fractional interests** [Nov 2019]
> **Loan creditors**
> ... There will be cases where a loan creditor will be a person or institution (such as a bank[18] or similar financial institution) which has loaned money to the non-resident company as a matter of business on commercial terms. The interest of such a loan creditor acting at arms length will be limited to an expectation of repayment of the amount loaned together with payments of interest at a commercial rate. There will be no expectation that the loan creditor can or will benefit from the profits or gains of the non-resident company. In such a case it would not

[14] Section 3B(1) TCGA provides: ""Participator" has the meaning given by section 454 of CTA 2010." See 104.22 (Definitions of participator).

[15] See 64.9 (Participators overlap: Trustees/beneficiaries).

[16] See 64.8 (Participators overlap: Loan creditors).

[17] See 64.10 (Co chain: Indirect participator).

[18] Author's footnote: the author has overlooked that a bank is not a loan creditor: see 104.25.11 (Bank creditor). But this does not affect the point made here.

> be just and reasonable to apportion any of the gain to a loan creditor of this type. The attribution should be made to those participators who have a real economic interest in the capital gains.
>
> Where there are participators who are loan creditors it will be necessary to review all of the circumstances to satisfy yourself that the interests of the loan creditors can be excluded for the reasons in the preceding paragraph.
>
> In some cases the persons with the real economic interest in the non-resident company will be loan creditors whether or not they are participators under one or more of the other tests. In such cases, where there is participation in more than one way, it may be appropriate, depending on the facts of the case, to aggregate the interests of those persons in reaching an apportionment that is just and reasonable.
>
> In other cases the persons with the real economic interest in the non-resident company may be providing the funds which the loan creditor has loaned to the company, and may be persons who are entitled to secure that income or assets (whether present or future) of the company will be applied directly or indirectly for their benefit, and may be participators in their own right by virtue of that test.

If a creditor does not have an economic interest in the company's gains, that is, if the gains do not benefit the creditor, then the gains should not be apportioned to the creditor. I refer to that as the "economic-interest test." One asks: At the time the gain accrued, and on the assumption that the asset which realised a gain had been disposed of at base cost, giving rise to no gain or loss, could the company have repaid the debt? If so then no gain should be apportioned to the loan creditor. That seems relatively clear.

The position is less clear when the economic-interest test is not satisfied. For instance, suppose:

(1) An unconnected, commercial lender (not a bank) lent £100 on commercial terms to a company with assets worth £200

(2) The assets of the company fell to £50

(3) The asset value rose and company realised a gain which left the company with £100

Under the economic-interest test, the lender does have an economic interest in the gain. But it is suggested that one should still not apportion the gain to the commercial lender. Otherwise no well informed UK resident, (other than a bank), and no non-resident trust, would lend to a non-resident close company.

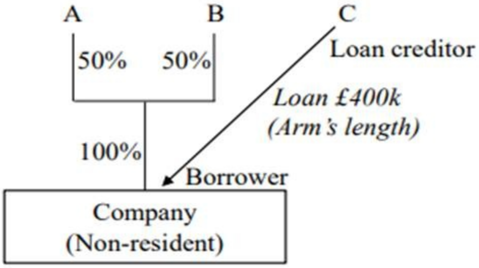
It is suggested that the position is the same with a lender who is a connected person, provided the loan is on commercial terms.

In principle, apportionment to the loan creditor would only seem appropriate if the loan was not on commercial terms and the economic-interest test was met. However, in the context of a tax avoidance scheme, an apportionment which prevents the tax advantages would be just and reasonable.

64.8.1 *HMRC examples: loan creditors*

The CG Manual gives two examples involving loan creditors. The first involves a loan on commercial terms:

> **CG57275 amount assessable** [Nov 2019]
>
> **Example 2**
>
> - A and B each own 50 shares
> - A and B are both resident in the UK
> - C is a loan creditor for 400,000. The loan is an arm's length commercial transaction and interest is payable at a fully commercial rate on the loan
> - the non-resident company realises a gain of 500,000
> - the total capital[19] of the non-resident company after the gain is 1,000,000.



The solution is to disregard the loan creditor, and attribute only to the shareholders; though the Manual takes many lines to reach this conclusion:

> You compute the gains to attribute as follows.
>
> *Step 1*
>
> Calculate the gain that would have arisen if the non-resident company had been resident in the UK. This is 500,000.

[19] Author's footnote: "Total capital" here means net asset value, not share capital.

> *Step 2*
> Determine the interests of all participators, including any who are not resident in the UK, by applying the tests of participation appropriate to the circumstances.
> A is a 50% participator by reference to the shareholding of 50 shares
> B is a 50% participator by reference to the shareholding of 50 shares
> C is a participator as a loan creditor, being entitled to an amount of 400,000 out of the total capital of 1,000,000
> *Step 3*
> Calculate the proportion of the gain apportionable to the interests of each participator. In this case the proportion for each participator is
> A (as shareholder) 500,000 × 50% = 250,000
> B (as shareholder) 500,000 × 50% = 250,000
> C (as loan creditor) 500,000 × 40% = 200,000
> *Step 4*
> Consider whether the gains calculated in Step 3 represent a just and reasonable apportionment. In this case the apportionment is not just and reasonable as the total of the gains under the initial apportionment exceeds the actual gain.

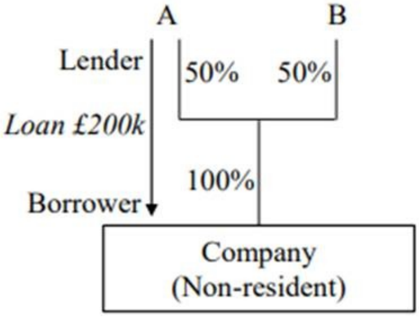
I would have thought that was not an apportionment at all, as one cannot apportion more than the amount of the gain. But whatever the reason, this is not the method used.

> C is a participator only by virtue of being a commercial loan creditor, see CG57220. C's entitlement as loan creditor should be ignored, subject to a review of the circumstances to establish that C is indeed merely a commercial loan creditor and has no entitlement to a share of profits or gains, and that there are no other arrangements. In this example it is assumed that there are no other arrangements and therefore the whole of the gain should be apportioned by reference to the interests in shares. The final apportionment becomes
> A (as shareholder) 500,000 × 50% = 250,000
> B (as shareholder) 500,000 × 50% = 250,000

The second example is the same but the loan is interest-free and from a shareholder:

> **CG57275 amount assessable** [Nov 2019]
> **Example 3**
>
> - a non-resident company has issued share capital of 100 Ordinary shares
> - A and B each own 50 shares
> - A and B are both resident in the UK

- A is a loan creditor for 200,000. No interest is payable on the loan
- the non-resident company realises a gain of 500,000.
- the total capital[20] of the non-resident company after the gain is 1,000,000.



The solution is *still* to disregard A's interest as loan creditor, though the Manual is not so confident in its answer:

> You compute the gains to be attributed as follows.
> *Step 1*
> Calculate the gain that would have arisen if the non-resident company had been resident in the UK. This is 500,000.
> *Step 2*
> Determine the interests of all participators, including any who are not resident in the UK, by applying the tests of participation appropriate to the circumstances.
> A is a 50% participator by reference to the shareholding of 50 shares
> B is a 50% participator by reference to the shareholding of 50 shares
> A is also a participator as a loan creditor, being entitled to an amount of 200,000 out of the total capital of 1,000,000. If all of the assets of the company were to be distributed immediately after the accrual of the gain the entitlements of A and B would be:
> A: 200,000 (as loan creditor) plus 50% of the balance of 800,000 (as shareholder), a total of 600,000 or 60% of the assets.
> B: 400,000, 50% of the balance of 800,000 (as shareholder), or 40 % of the assets.
> *Step 3*
> Calculate the proportion of the gain apportionable to the interests of each participator. In this case there are two possible apportionments.

[20] Author's footnote: "Total capital" here means net asset value, not share capital.

> A: 500,000 × 50% = 250,000
> B: 500,000 × 50% = 250,000
> or
> A: 500,000 × 60% = 300,000
> B: 500,000 × 40% = 200,000
>
> *Step 4*
>
> Consider whether the gains calculated in Step 3 represent a just and reasonable apportionment. As there are at least two possible apportionments we must consider all of the facts relating to the arrangements under which A's loan was made and the arrangements regarding profits and gains of the company. For instance:
>
> - Does the loan agreement give A any preferential rights to profits or gains, or simply to a repayment of the capital?
> - Is B entitled to an equal share of profits or gains?
>
> In such cases there is no easy answer and a full consideration of all of the relevant circumstances is necessary. On the bare facts of this example A has no preferential rights and consequently an apportionment by reference to the shareholdings, effectively excluding A's participation as loan creditor, may be just and reasonable. If so, the gain would be attributed
> A: 500,000 × 50% = 250,000
> B: 500,000 × 50% = 250,000

This is a case where the company could have repaid the debt even if there had been no gain. So the gain did not significantly increase the value of the debt. The loan creditor does not have an economic interest in the gain. The outcome would be different if that were not the case.

64.9 Participators overlap: Trustees/beneficiaries

Suppose a company is owned by a trust. The trustees are participators. The beneficiaries are in general participators since in general they have an interest in trust property.[21]

The difficulty this would cause for s.3 TCGA was recognised, and beneficiaries are taken out of s.3. Section 3B(4) TCGA provides:

> If-
>
> (a) the interest of a person in a company is wholly or partly represented by an interest under a settlement ("the beneficial interest"), and

[21] See 104.23.4 (Trustees and beneficiaries).

> (b) the beneficial interest is the factor (or one of them) by reference to which the person would, apart from this subsection, have an interest as a participator in the company,
>
> that interest as a participator is, so far as represented by the beneficial interest, to be treated instead as the interest of the trustees of the settlement.

The CG Manual provides:

> **CG57220 basic conditions for [s.3 TCGA]: the company** [Nov 2023]
> **Beneficiaries**
> Where the trustees of a settlement, whether resident in the UK or not, are participators in a non-resident company then in certain circumstances a beneficiary of the settlement will also be within the definition of participator. The effect of [s.3B(4)] is that once you reach shares or other interests held by trustees, except in the case of a bare trust, see CG34300, you stop there. In deciding how the chargeable gain of the company should be apportioned, you treat the trustees as if they were the beneficial owners of their shares or other interests and apportion the gain to them as appropriate, ignoring the interests of the beneficiaries. If the trustees are resident then their share of the gain is assessed on them. If the trustees are non-resident then the gain is subject to TCGA92/S86 and TCGA92/S87, see CG57395. Any interest as a participator in the non-resident company which the beneficiary holds in their own right, for example by a personal holding of shares in the non-resident company, will remain within [s.3].

64.10 Co chain: Indirect participator

Section 3(7) TCGA provides:

> A person ("P") is an "indirect participator" in a company ("A") if-
>
> (a) another company ("B") which is a non-UK resident close company is a participator in A, and
>
> (b) P is a participator in B or P is a participator in a third non-UK resident close company which is participator in B,
>
> and so on through any number of non-UK resident close companies that are participators in other non-UK resident close companies.

Section 3(8) TCGA provides:

> P's interest as an indirect participator in A in the case of any gain is determined by-

(a) apportioning the gain among the participators in A according to the extent of their respective interests as participators, and

(b) then further apportioning the gain apportioned to B among the participators in B according to the extent of their respective interests as participators, and so on through other companies.

The CG Manual provides:

> **CG57290 indirect interests: introduction** [Nov 2019]
> Without special rules UK resident shareholders or participators could avoid the [s.3 CGA] charge by placing another non-resident company between themselves and the company making the gain. TCGA92/S13(9) prevents this by allowing us to look through a chain of non-resident companies. The gain is apportioned to the first tier of UK residents or non-resident trusts in the chain of interests. For TCGA92/S13(9)to apply each company in the chain must itself satisfy the basic conditions outlined in CG57220.
> Therefore each company must be
> • a company that is not resident in the UK
> and
> • a company that would be a close company if it was resident in the UK.

The CG Manual begins with a straightforward example:

> Example 1[22]
> Mr A UK resident shareholder owns 100% of
> B Ltd non-resident close company which owns 100% of
> C Ltd non-resident close company which owns 100% of
> D Ltd non-resident close company.

Gains accruing to D Ltd are not attributed to C under s.3 because C is not UK resident. But the CG Manual correctly notes:

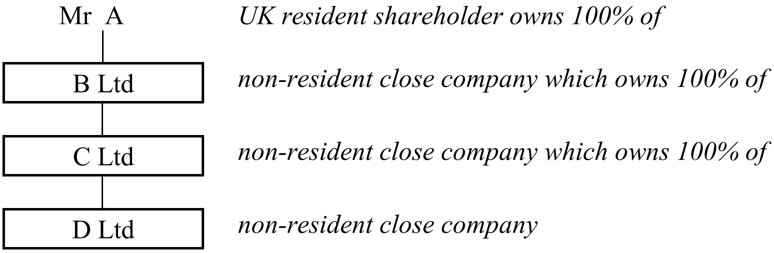
> Any gains of D Ltd can be apportioned to Mr A because TCGA92/S13(9) allows you to look through the chain of non-resident closely controlled[23] companies.

Diagrammatically:

[22] I have added the diagrams to increase clarity.

[23] The Manual (somewhat unhelpfully) uses the expression “closely controlled” as a synonym of “close”.

Example 1


Mr A
UK resident shareholder owns 100% of
B Ltd
non-resident close company which owns 100% of
C Ltd
non-resident close company which owns 100% of
D Ltd
non-resident close company

The next example concerns a chain including a resident company:

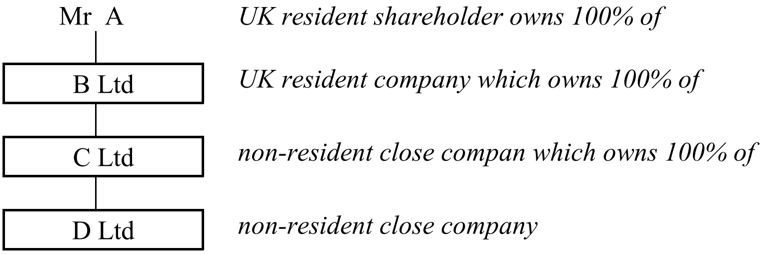
> Example 2
> Mr A UK resident shareholder owns 100% of
> B Ltd UK resident company which owns 100% of
> C Ltd non-resident close company which owns 100% of
> D Ltd non-resident close company.

The Manual analyses this as follows:

> Any gains of D Ltd can be apportioned to B Ltd but not Mr A. This is because B Ltd is the first UK resident shareholder in the chain.

Diagrammatically:

Example 2

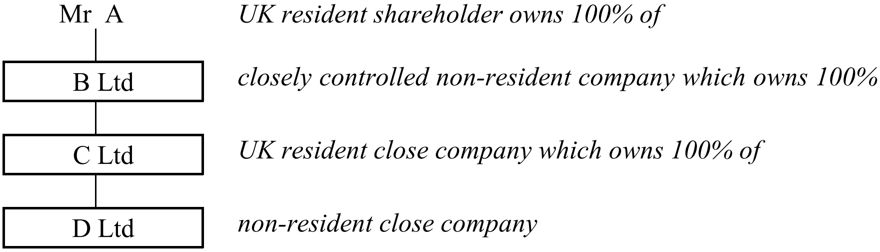

Mr A
UK resident shareholder owns 100% of
B Ltd
UK resident company which owns 100% of
C Ltd
non-resident close compan which owns 100% of
D Ltd
non-resident close company

This was correct before 1995, when the former s.13(2) and (9) TCGA only apportioned gains to a *shareholder* in a non-resident company. A is not a shareholder of D Ltd. But why can't A be assessed now? A *is* a participator in D Ltd. Perhaps this rule is implied by s.3(7) TCGA. Or perhaps it would be just and reasonable to apportion under s.3B(3) to company B and to no-one else. One way or the other, the problem of overlapping participators in chains of companies is solved by stopping at the first UK resident company.

> Example 3
> Mr A UK resident shareholder owns 100% of
> B Ltd closely controlled non-resident company which owns 100% of
> C Ltd UK resident close company which owns 100% of
> D Ltd non-resident close company.
> Any gains of D Ltd can be apportioned to C Ltd but not Mr A even though Mr A owns shares in B Ltd which is a closely controlled non-resident company. (Gains which accrue to B Ltd in its own right on disposal of its own assets can be apportioned to Mr A.)

Diagrammatically:

Example 3


Mr A
UK resident shareholder owns 100% of
B Ltd
closely controlled non-resident company which owns 100%
C Ltd
UK resident close company which owns 100% of
D Ltd
non-resident close company

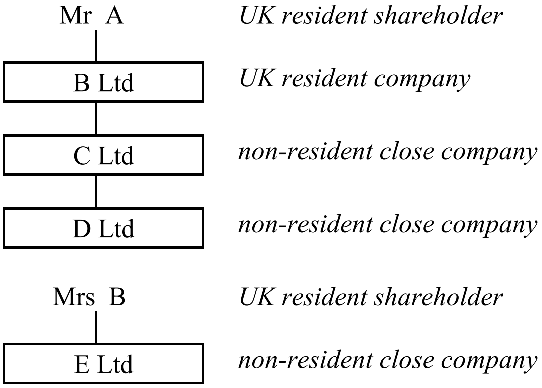
The next Manual example is a straightforward variation on the above:

> Example 4
> Mr and Mrs A are both UK resident. Mr A holds shares in B Limited, a UK resident close company. B Ltd holds shares in C, a non-UK resident close company, which holds shares in D, also a non-UK resident close company. Mrs A holds shares in E, a non-UK resident close company which also holds shares in D.
> The gains of D Ltd can be apportioned to Mrs A because she is the first UK resident shareholder in the chain of shareholdings which runs from E to her. The gains of D Ltd [E Ltd][24] cannot be apportioned to Mr A because B Ltd is the first UK resident shareholder in his chain of shareholdings.
> You calculate the extent of a person's indirect interest on a particular test of participation by multiplying the proportional interest in the assets of each company in the chain.

Diagrammatically:

[24] The original reads "D Ltd" which must be a slip for "E Ltd", if the diagram is correct.

Example 4


Mr A
UK resident shareholder
B Ltd
UK resident company
C Ltd
non-resident close company
D Ltd
non-resident close company
Mrs B
UK resident shareholder
E Ltd
non-resident close company

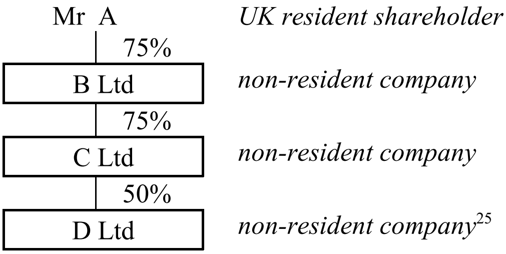
64.11 Co chain not wholly-owned

We have so far considered simple chains of wholly-owned companies. The CG Manual continues with an example of a less than 100% chain:

> **CG57290 indirect interests: introduction** [Nov 2019]
> ... You calculate the extent of a person's indirect interest on a particular test of participation by multiplying the proportional interest in the assets of each company in the chain.
> Example 5
> Mr A is a UK resident. He is a 75% participator in B, which is a 75% participator in C, which is a 50% participator in D. B, C and D are non-UK resident close companies.
> If D Ltd makes gains of 100,000 the [s.3 TCGA] the gain attributed to Mr A is £100,000 × 50% × 75% × 75% = £28,125.

Diagrammatically:

Example 5


Mr A
UK resident shareholder
75%
B Ltd
non-resident company
75%
C Ltd
non-resident company
50%
D Ltd
non-resident company[25]

[25] It is assumed in the example that D Ltd is close, which is not necessarily the case; that depends on the other shareholdings, which are not specified in the example.

Mr A is not a participator in D Ltd but that does not matter because:
(1) Mr A is a participator in B Ltd
(2) B Ltd is a participator in C Ltd
(3) C Ltd is a participator in D Ltd

So gains of D Ltd are attributed to Mr A.

64.12 s.3 gains of split year

64.12.1 *Split year: Individual*

Section 3(5) TCGA provides the standard split-year rule:

> No apportionment of any part of a gain is made to an individual if-
> (a) the gain accrues in a tax year which, as respects the individual, is a split year, and
> (b) the gain accrues in the overseas part of the year.

64.12.2 *Split year: trustee*

Section 3 TCGA provides (so far as relevant):

> (1) This section applies if—
> (a) a chargeable gain accrues at any time to a non-UK resident close company ...
> (2) So much of the gain as would not otherwise be so chargeable is apportioned among participators ... in the company—
> (a) who are resident in the UK at that time, or
> (b) who are trustees of a settlement and are not resident in the UK at that time.

Trustees may become UK resident (or cease to be UK resident) during a tax year, eg if a non-resident trustee retires in favour of a UK trustee, or a UK trustee retires in favour of a non-resident trustee. All the s.3 gains of the year are treated as accruing to the trustee, and therefore are within the charge to tax. Thus there is no split year rule.

64.13 25% minimum holding

Section 3(6) TCGA provides:

> No apportionment of any part of a gain is made to a person if the total amount that would, apart from this subsection, be apportioned to-
> (a) the person, and

(b) persons connected to[26] the person,

is 25% or less of the amount of the gain falling to be apportioned.

I refer to this as the **“25% minimum condition”** and para (b) is the **“aggregation rule”**.

In order know whether a participator (“A”) in a non-resident company (“OC”) meets the 25% minimum condition, it is necessary to identify and aggregate the interests of other persons if two conditions are satisfied:

(1) The other person (“C”) is connected with A

(2) Gains are apportioned to C

One does not aggregate the interests in OC of

(1) A and

(2) *all* persons connected with A

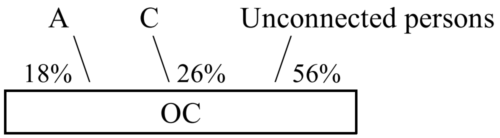
One only counts connected persons to whom gains are apportioned. One ignores connected persons if gains are not apportioned to them (apart from s.3(6)).

For example, assume OC is a non-resident company and:

(1) A owns 18% of the shares in OC. (Unless the aggregation rule applies, A does not meet the 25% minimum condition.)

(2) C (the only participator in OC who is connected with A) owns 26% of the shares in OC. (So if the aggregation rule applies, the interest of C is aggregated with the interest of A, and A does meet the 25% minimum condition.)

Diagrammatically:



The aggregation rule applies if C is:

(1) a UK resident[27]

(2) a non-resident trust[28]

[26] The correct expression is connected *with* (not connected *to*); see 104.12 (Connected person). But it does not matter.

[27] Further consideration would be needed if C were a remittance basis taxpayer who did not remit the s.3 gain.

[28] Prior to 2019/20 the aggregation rule probably did not apply to a non-resident trust.

In all these cases the gains of OC do fall to be apportioned to C under s.3.

The aggregation rule does not apply if C is a *non-resident individual*. In this case, gains cannot be apportioned to C under s.3. This is the case even if C is within the temporary non-residence rules.

The aggregation rule does not apply if C is a non-resident *company*. In this case, gains of OC may be apportioned to participators in C, but that does not cause A to meet the 25% minimum condition unless those participators are themselves connected with A.

It will always not be possible for a participator to know whether the 25% minimum condition is satisfied, but one must do the best one can.

Interests held by pension funds are not aggregated for the 25% minimum condition.[29]

The figure was raised from 10% to 25% as one of the 2013 changes.[30]

64.14 Loss accruing to non-resident co

A participator may deduct losses which accrue to them personally against s.3 gains, in accordance with the usual rules.

Different rules apply to losses accruing to the non-resident company which I call "**s.3 losses**".

64.14.1 *Arising basis participator*

Section 3 TCGA only attributes the company's gains (not losses) to a participator, so in the absence of further provision a participator would have no relief for losses accruing to the company. Section 3 TCGA provides some relief for these losses:

> (9) So far as it would go to reduce or extinguish chargeable gains accruing, as a result of this section, to a person in a chargeable period, this section applies to a loss accruing to the company on the disposal of an asset in that period as it would apply if there had been a gain.
> (10) But-
> (a) this only applies in relation to that person,[31] and

[29] See 64.37 (Pension scheme).

[30] See 64.1.2 (2013 changes).

[31] What is the purpose of the rule that loss relief shall only so apply in relation to that person? Perhaps it is intended to cover the situation where:
(1) A owns a company.
(2) The company disposes of asset 1 and realises a loss.
(3) A transfers the company to B.

> (b) this section does not otherwise apply in relation to losses accruing to the company.

The CG Manual correctly provides:

> **CG57295 losses: - general** [Nov 2019]
> [s.3 TCGA] is concerned with the apportionment of gains not losses. If the disposal by the non-resident company gives rise to a loss then that loss cannot be apportioned to UK residents for them to set it off against their other gains. However, the loss can be set-off
> - against gains made by the same company in the same year of assessment
> - against gains made by other non-resident companies which have been apportioned to the taxpayer in the same year of assessment.
>
> The term year of assessment means the year of assessment for a UK resident individual. Where the participator is a UK resident company the references to year of assessment are references to accounting periods of the participator.
> Losses of the same company (TCGA92/S13(8))
> If the non-resident company makes gains and losses in the same year of assessment the losses can be set off against the gains. Any surplus losses cannot be carried forward or back to set-off against gains arising in a different year of assessment.
> **Losses of different companies**
> If the UK resident is a participator in more than one non-resident company the proportion of the gains and losses of those companies apportioned to the UK resident can be set off against each other in the same year of assessment. Any surplus loss cannot be carried forward or back to set against the gains arising in different years of assessment.

Careful timing of disposals is needed to ensure that the loss relief is used: s.3 losses should not exceed s.3 gains in any year.

64.14.2 *Remittance basis participator*

Section 3D TCGA provides:

(4) The company disposes of asset 2 and realises a gain (in the same year).
Perhaps the intention is that the loss is not available to B. But that would have been clear in any case.
Perhaps it was intended to disapply the former rule that losses of one spouse could be deducted against gains of the other, in which case the provision has been otiose since the introduction of independent taxation in 1988.

> (4) The apportioned amount may not be reduced or extinguished by a loss under section 3 if-
> (a) the apportioned amount is regarded for the purposes of paragraph 1 of Schedule 1 as accruing on a disposal of a foreign asset,
> (b) the remittance basis applies to the individual for the tax year in question, and
> (c) any of the apportioned amount is remitted to the UK in a subsequent tax year.

This is analogous to the general rule that there is no carry-back of losses, and it echoes the rule which applies where there is a loss election.

Careful planning is needed to ensure that relief is available for s.3 losses of remittance basis taxpayers.

It is considered that the code of restrictions which apply to personal losses of remittance basis taxpayers[32] do not apply to s.3 losses. If a remittance basis taxpayer has made a loss election, personal losses are set against gains in a particular order, but those rules do not easily fit with the s.3 loss rules. If a remittance basis taxpayer has not made a loss election, personal foreign losses are not allowable; but foreign s.3 losses should remain allowable under the s.3 loss rules.

64.14.3 *Non resident trust participator*

The position is similar as for a UK participator. The aim should be that s.3 losses should not exceed s.3 gains in any year, so that the losses can be set against the gains in computing trust gains (s.1(3) amounts).

64.14.4 *s.3 losses: Policy and reform*

At first sight the rules for s.3 losses are unfair and anomalous compared to other losses:

(1) s.3 losses can only be set against s.3 gains.
(2) s.3 losses can only be set against current year s.3 gains and cannot be carried forward.

However there is a good reason not to apportion s.3 losses in the same way as gains, as there may be scope for acquisition of companies in order to acquire their losses; CT has rules for pre-acquisition losses, but no-one would want to introduce that complexity into CGT.

There is a better case for carry forward of s.3 losses, to set against other

[32] See 65.16 (Loss of remittance basis taxpayer).

s.3 gains, but even here the possibility of buying in losses prevents reform. Section 16A TCGA prevents obvious abuse, but is not a substitute for properly targeted rules.

A reasonable reform would be to allow s.3 losses to be set only against s.3 gains but to be carried forward for a limited period, say 4 or 6 years Indeed it would be reasonable to restrict all losses from being carried forward for more than that period.

64.15 Negligible value claim

Section 24 TCGA provides:

> (1A) A negligible value claim may be made by the owner of an asset ("P") if condition A or B is met.

The usual case is condition A:

> (1B) Condition A is that the asset has become of negligible value while owned by P.[33]

The negligible value claim should be made by the non-resident company, though in practice HMRC have accepted claims by UK resident participators.[34] It is possible that the non-resident company might authorise a person to make claims on its behalf, especially if that person is the direct or indirect owner and subject to tax under s.3 on the company's gains.

Section 24(2)(a) TCGA provides the relief:

> Where a negligible value claim is made:
> (a) this Act shall apply as if the claimant had sold, and immediately reacquired, the asset
> [i] at the time of the claim or
> [ii] (subject to paragraphs (b) and (c) below) at any earlier time specified in the claim,
> for a consideration of an amount equal to the value specified in the claim.

Section 24(2)(b) TCGA specifies the limit of the carry-back:

> (b) An earlier time may be specified in the claim if:
> (i) the claimant owned the asset at the earlier time; and

[33] Condition B (not discussed) arises when the disposal by which P acquired the asset was a no gain/no loss disposal.

[34] Private correspondence.

> (ii) the asset had become of negligible value at the earlier time; and either
>
> (iii) for capital gains tax purposes the earlier time is not more than two years before the beginning of the year of assessment in which the claim is made; or
>
> (iv) for corporation tax purposes the earlier time is on or after the first day of the earliest accounting period ending not more than two years before the time of the claim.

The time limit here is that in (iv), on or after the first day of the earliest accounting period of the non-resident company ending not more than two years before the time of the claim, since s.3 gains are calculated by CT rules.[35]

64.16 s.3 motive defence

Section 3(1) TCGA provides:

> This section applies if ...
>
> (b) the gain is connected to avoidance (see section 3A)

Section 3A(1) TCGA provides:

> A gain accruing to a company on the disposal of an asset is taken to be "connected to avoidance" unless it is shown[36] that neither-
>
> (a) the disposal of the asset by the company, nor
>
> (b) the acquisition or holding of the asset by the company,
>
> formed part of a scheme or arrangements of which the main purpose, or one of the main purposes, was avoidance of liability to capital gains tax or corporation tax.

I refer to this as the "**s.3 motive defence**".[37]

CGT/CT means the UK taxes, and does not include corresponding foreign taxes.[38] Only CGT/CT avoidance matters; eg an intention to avoid IHT/IT would not disqualify the s.3 motive defence. For convenience I refer below only to CGT and leave CT to be understood.

It is best to approach the s.3 motive defence in 2 stages:

[35] See 64.4 (Computing gains: CT rules).

[36] See App 2.24.5 ("It is shown that").

[37] See 3.1 (TAAR/unallowable purpose test).

[38] See 52.9 (Meaning of "taxation"). The context suggests that corporation tax here means corporation tax on chargeable gains.

(1) Identify the arrangement, of which the disposal, acquisition or holding form part
(2) Does this arrangement have a CGT avoidance purpose?

64.16.1 *Identify the arrangement*

It is difficult to envisage that there could be no arrangement, but it is necessary to identify what the arrangement is in order to ascertain its purpose.[39]

Acquisition, holding and disposal themselves will normally constitute one arrangement. Arguably the wording requires a wider arrangement, of which these steps form part, but not much more is needed, so it does not matter. In practice the company will often be part of a trust/corporate structure, and that will constitute the arrangement. A company held directly (without a trust) may also constitute an arrangement.

It is possible that (1) an acquisition constitutes (or is part of) one arrangement and (2) a disposal constitutes (or is part of) another arrangement. Eg suppose:
Step 1: In year 1, X transfers an asset to a company owned by X
Step 2: In year 5, X sells the company to a 3rd party, P
Step 3: In year 10, the company sells the asset

Step 1 and Step 3 should constitute 2 separate arrangements, not one single arrangement.
Arrangement 1 involves the acquisition and holding of an asset.
Arrangement 2 involves the holding and disposal of an asset.

The motive defence is lost if the purpose of arrangement 2 was CGT avoidance, ie if the purpose of holding the asset in years 5-10, or the purpose of the disposal, was CGT avoidance. One is looking at the purpose of P. It does not matter what was the purpose of X in years 1-5.

64.16.2 *Purpose of arrangement*

CGT and CT were introduced in 1965. Where a structure was set up before the introduction of CGT, and not in anticipation of the introduction of CGT, it cannot have had a CGT avoidance purpose.

The CG Manual provides:

[39] See App.2.2 (Arrangement). I use the singular (arrangement); there is no difference between arrangement (singular) and arrangements (plural).

> **CG57319 disposal of assets where the arrangements did not involve a tax avoidance motive - for 2012-13 and later years** [Nov 2019]
> ... There may be a number of genuine[40] reasons why a non-resident company is used as an investment vehicle.
> For example if an individual wanted to acquire a property in another country but was prevented from doing so under the prevailing law in that country because they are non-resident there, this difficulty might be overcome by setting up a company in that territory. The company could then acquire the property as a resident.
> To determine if the exemption applies a clear understanding of why the asset was acquired, held and disposed of by the company is needed....

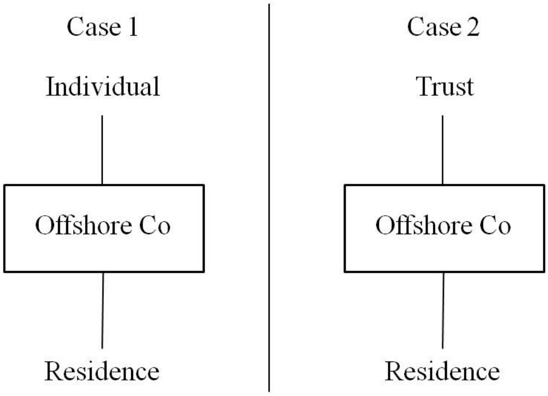
64.16.3 *Offshore co holds residence*

Suppose:

(1)(a) *Case (1):* an individual owns an offshore company which holds a residence

(1)(b) *Case (2):* a trust owns the company which holds the residence; and

(2) In either case, the residence which would have been expected to qualify for private residence relief if held directly:



This was typically done before 2017 for IHT reasons.

Applying the two-stage approach:

(1) In case 1, the arrangement is the use of the company. This cannot have a CGT avoidance purpose: no CGT would be payable if the property had been held in a trust or by the occupier. That continued to be the

[40] "Genuine" reasons here means non-tax-avoidance reasons: see 3.21.3 ("Genuine"). But of course the focus ought to be specifically on CGT avoidance.

case after the introduction of NRCGT in 2015,[41] though the circumstances in which a property can be expected to qualify for private residence relief are narrower than before. What matters is the expectation at the time of the acquisition by the company.

(2) In case (2) the arrangement is the creation of the trust and company. Was CGT avoidance one of the purposes of the creation of the trust? This requires further investigation of the facts. Was the trust a part of a CGT avoidance scheme?[42] Was the use of the company envisaged when the trust was created? and does it matter if it was not?

64.16.4 *Motive defence claim*

The s.3 motive defence does not require a formal claim. If there is no CGT avoidance purpose, a taxpayer is entitled and indeed required to submit tax returns on the basis that the motive defence applies; one is not required to show the motive defence applies before completing the tax return on that basis.

If an individual completes a self assessment return, it is necessary to indicate that they have taken advantage of the ToA motive defence by an entry in the relevant box.[43] There is no comparable box for the s.3 motive defence, so usual disclosure principles apply.[44]

64.16.5 *Pre-2012 gains*

The CGT motive defence is one of the 2013 changes[45] and applies to gains from 2012/13.[46] Older trusts may have substantial s.1(3) amounts (trust gains) even if the motive defence applies. It is arguable that the pre-2012 rules were not EU-law compliant and earlier gains should have qualified for exemption. But the position would need to be reviewed post-Brexit.

It is possible to envisage circumstances where the taxpayer will be better off if the motive defence does not apply, because matching to pre-2012 trust gains to a greater interest surcharge than if a capital payment is matched to post-2012 gains.[47] That will not happen often, but might

[41] Now replaced by CGT payable by non-residents; see 56.6.5 (CGT/CT charge: non-residents).

[42] See 52.12.4 (Avoidance of beneficiary CGT).

[43] See 52.33 (Tax return: Motive defence).

[44] See chapter 116.1 (Tax return filing position).

[45] See 64.1.2 (2013 changes).

[46] See s.62(5) FA 2013.

[47] See 61.17 (Interest surcharge).

perhaps explain why the relief was not backdated before 2012.[48]

64.16.6 *ToA/s.3 motive defence compared*

In summary, the two motive defences have the following real or apparent differences:

Transfer of Assets Abroad	**s.3 TCGA**	**Which is stricter?**
Any purpose test	*Main* purpose test	Little difference
Avoidance of *any* tax	*CGT* avoidance needed	ToA stricter
"...reasonable to assume..."	no equivalent wording	No difference[49]
Test operations individually	Test arrangement	ToA stricter
Applies to all historic income	Post-2012 gains only	CGT stricter (EU law may help)

64.17 Foreign trade exemption

Section 3(1) TCGA provides relief for a non-resident trading company:

> This section applies if ...
> (c) the gain is not connected to a foreign trade ...

Section 3A(2) TCGA provides:

> A gain is "connected to a foreign trade" if it accrues on the disposal of an asset used only-
> (a) for the purposes of a trade carried on by the company wholly outside the UK, or
> (b) for the purposes of the foreign part of a trade carried on by the company partly within, and partly outside, the UK,
> and the reference here to the foreign part of a trade is to the part of the trade carried on outside the UK.

A company within the foreign trade exemption will normally also qualify for the economically significant activity exemption; but it is just about possible to imagine a foreign trade which is not economically significant.

64.17.1 *Furnished holiday letting*

Section 3A(3) TCGA extends the foreign trade exemption to include furnished holiday letting. Spring Budget 2024 announced the abolition of the Furnished Holiday Lettings tax regime from 2025/26, so presumably this will then cease to be the case. The legislation was not in the Finance (no.2) Bill 2024, but is promised to follow in due course.

[48] Note that pre-2008 s.1(3) amounts may not count; see 61.44 (Pre-2008 capital payment/trust gain, matched post 2008).

[49] See App.2.24 (Reasonable-to-assume).

64.18 Economically significant activity

Section 3(1) TCGA provides exemption for a company carrying on an economically significant activity:

> This section applies if ...
> (c) the gain is not connected to ... other economically significant foreign activities (see section 3A)

Section 3A(6) TCGA provides:

> A gain accruing on the disposal of an asset is "connected to other economically significant foreign activities" if-
> (a) the asset is used only for the purposes of activities carried on by the company wholly or mainly outside the UK,
> (b) the activities consist of the provision of goods or services on a commercial basis, and
> (c) the activities also satisfy the staff, premises and economic value test.

I refer to this as the "**economic activity defence**". It is one of the 2013 changes.[50]

64.18.1 *Staff/premises/economic value*

Section 3A(7) TCGA provides:

> Activities satisfy the staff, premises and economic value test if they involve-
> (a) the use of employees, agents or contractors of the company in numbers, and with competence and authority, commensurate with the size and nature of the activities,
> (b) the use of premises and equipment commensurate with the size and nature of the activities, and
> (c) the addition of economic value by the company to the persons to whom the goods or services are provided commensurate with the size and nature of the activities.

The CG Manual provides:

> **CG57314: Economically Significant Activities** [Dec 2021]
> The purpose of the requirement in [s.3(1)(c) TCGA] is to ensure that only arrangements that are wholly artificial arrangements are caught by the charge under [s.3]. The test distinguishes between commercial arrangements, where an

[50] See 64.1.2 (2013 changes).

asset is held by a non UK resident company for reasons of genuine commercial activity outside the UK, and artificial arrangements put in place for the circumvention of UK tax rules through the holding of an asset in a non UK resident company without genuine commercial use in the UK. An asset will be outside of the scope of [s.3] if it is used only for the purposes of economically significant activities carried on by the company wholly or mainly outside the UK. (If the activities are wholly or mainly carried on in the UK see CG57315).

Based on the approach of both the Court and Advocate General in Case C-196/04 *Cadbury Schweppes*, the legislation seeks to differentiate between companies carrying on legitimate economic activities (which reflect economic reality) and those operating wholly artificial arrangements in the host (other) country.

In applying [s.3] activities carried on by a company which are 'economically significant activities' are to be regarded as legitimate economic activities and excluded from the [s.3] charge. Such activities are so characterised if they consist of the provision of goods or services to others on a commercial basis and involve:

- the use of staff (employees, agents or contractors of the company) in numbers and with competence and authority
- the use of premises and equipment
- the addition of economic value by the company to those to whom the goods or services are provided
- which are commensurate with the size and nature of the activities of the company.

Applying these criteria as indicators of legitimate (as opposed to wholly artificial) arrangements enables an assessment to be made of the genuine nature of the business, activities. For example that:

1. the non-resident company is genuinely established in another country, which is informed by the number of staff in use, whether they are directly employed or contractors. Also whether the premises they are working from and the equipment available to them is consistent with what would reasonably be expected for a legitimate (genuine) commercial operator, bearing in mind the size and nature of the services offered;

2. the genuine nature of the services provided by the company - that where the services offered require a level of decision making the staff employed reasonably have the level of competence necessary for a genuine company to operate; and

3, the company is providing genuine value added contribution on a sound commercial basis - that reasonable consideration is being provided in return for any payment by the UK parent company. For example if the non-resident company is providing services which have no economic substance in relation to the parent company's activity, then it would indicate that there is a wholly artificial arrangement.

To determine if this exemption applies a clear understanding of the activities of the company and how the asset is used by the company is needed. The features described are indicators of genuine behaviour and should be assessed on that basis. If the arrangements appear genuine time should not be spent on a detailed analysis of scale and proportion - see CG57315.

If the economically significant test is satisfied, no charge is generated under [s.3].

CG57315: Economically Significant Activities practical considerations [Dec 2021]

The term economically significant activities should be straightforward to apply in practice provided a clear understanding of the nature of the company's activities is held. If a company is carrying on genuine commercial activity then the test would be met. For example a joint property venture in a genuine commercial business would satisfy this test. Difficult areas that may need to be considered include investments, holding companies and cases where the asset was used wholly or mainly in activities carried on wholly or mainly in the UK:

Asset used in activities wholly or mainly in the UK

Following the approach of the Advocate General in Case C-196/04 *Cadbury Schweppes* the question of the genuineness or otherwise of the company's activities focuses on the activities of the company in the host country (Member State or third country other than the UK). However, although the specific exclusion in [s.3(1)(c)] is not available for an asset used for the purposes of 'economically significant activities' carried on by the company wholly or mainly in the UK, consideration must still be given to how the asset has been used. If it has been used by the company in carrying on legitimate economic activities which reflect economic reality then the disposal of the asset will be outside the scope of [s.3].

Investment companies

Investments comes within the meaning of "goods and services to others on a commercial basis" for the purposes of [s.3A(6)(b)]. So an investment business may provide a service to investors on a commercial basis, for example a financial service company providing investments to the general public would be providing a service on a commercial basis.

However a company holding or making investments solely for its participants is unlikely to meet the test - it may just be a private money box.

A distinction needs to be drawn between a business that uses the asset within its business of asset management and for which it would expect reward from the management activity itself and merely seeking to benefit from the actual or anticipated increase in the value of the asset.

Holding companies

It is possible for a holding company to undertake economically significant activities, for example providing management services to other companies in a group.

A holding company may undertake no economically significant activities within the holding company itself. For the purposes of applying the economically significant activities test HMRC will look at the wider business structure in assessing the business of the holding company.

64.18.2 *Activities "outside UK"*

The defence requires one to identify where the company's activities are carried on, or at least, whether they are wholly or mainly carried on outside the UK. If the activities are in the UK, or partly in the UK, this defence does not apply.

64.19 Partnership holds non-resident co

Suppose a partnership holds a non-resident company to which a gain accrues. Section 59(1) TCGA provides:

> Where 2 or more persons carry on a trade or business in partnership—
> (a) tax in respect of chargeable gains accruing to them on the disposal of any partnership assets shall, in Scotland as well as elsewhere in the UK, be assessed and charged on them separately, and
> (b) any partnership dealings shall be treated as dealings by the partners and not by the firm as such.

This does not apply to a s.3 gain, which is not a gain on the disposal of a partnership asset. But the partners are participators in the company, and it is just and reasonable (because it fits the scheme of the TCGA) to attribute the s.3 gain to the partners. That is, HMRC do not need s.59 TCGA to tax the partners.

64.20 s.3 distribution relief

Section 3C(1) TCGA provides:

> If-
> (a) an amount of tax [s.3 tax] is paid by a person as a result of section 3 in respect of a gain, and
> (b) there is a distribution[51] of an amount in respect of the gain before the end of the relevant period,
>
> the amount of tax [s.3 tax] is applied so as to reduce or extinguish any liability of the person to tax[52] in respect of the distribution.

In the following discussion:
This relief is "**s.3 distribution relief**".
The amount of tax in (a) - paid as a result of s.3 - is "**s.3 tax**".
The amount of the liability on the distribution in (b) - in respect of the distribution - is "**distribution tax**".

In short, the s.3 tax is set against the distribution tax.

[51] Section 3C(2) TCGA provides: "For the purposes of subsection (1)-
(a) the distribution is one made by way of dividend or distribution of capital or on the dissolution of the company,"

[52] Section 3C(2) TCGA provides: "For the purposes of subsection (1) ...
(b) the tax in respect of the distribution is income tax, corporation tax or capital gains tax."

The CG Manual provides:

> **CG57351 outline of tax credit relief** [Oct 2019]
> [The Manual summarises the provision and continues]
> [1] It is important to note that relief under TCGA92/S13(5A) is only due where a charge arises under section 13 in respect of a gain and a further charge arises in respect of a distribution of an amount in respect of the same gain, and that both charges arise on the same person.
> [2] Where a gain is attributed to participator A and the distribution is made to participator B no relief can be given to B as B has not paid tax under section 13. ...

Point [1] is a rough paraphrase. Point [2] is correct, but will not arise much in practice.

> **CG57360 quantifying tax set-off available following capital dividends or distributions** [Nov 2019]
> ... Once capital gains tax has been paid under TCGA92/S13(2), then the whole of that tax is available for set-off against any tax liability on a subsequent distribution where the conditions for relief are met. Should only half of the gain be distributed this does not mean that only half of the section 13 capital gains tax can be set off. The section 13 tax represents a pool of tax credit to be used up against tax liability arising from appropriate distributions in respect of the same gain. Thus if only half of the gain is distributed but the tax liability on the distribution is at a higher rate than the tax on the section 13 gain, the tax credit relief will be more than half of the Section 13 tax.
> It is a condition of TCGA92/S13(5A) relief that the tax arising on the gain attributed under TCGA92/S13 must have been paid. In some cases the liability on the section 13 gain and on the distribution will arise in the same year of assessment or accounting period, and in other cases the tax on the section 13 gain will not have been paid.
> In practice relief may be given by set off providing that the only reason preventing relief being given is that tax on the section 13 gain is unpaid.
> ...

Income distributions by a non-resident company are generally exempt in the hands of a corporate participator, so they do not benefit from s.3 distribution relief.

64.20.1 *Amount of distribution tax*

For the purpose of s.3 distribution relief, it is necessary to ascertain:

(1) The amount of distribution tax, which may be
 (a) Income tax or

(b) CGT[53]

(2) The amount of s.3 tax

Where the distribution is subject to income tax, the amount of distribution tax is straightforward. The position is governed by s.3C(2) TCGA:

> For the purposes of subsection (1) ...
>
> (c) in determining the liability to tax of any individual in respect of any distribution for a tax year it is to be assumed that the distribution is the highest part of the individual's income for the year.

Where the distribution is subject to CGT, the amount of distribution tax is less straightforward.

Before 2008:

(1) the former s.13(7A)(b)(c) TCGA determined the amount of distribution tax when the distribution was subject to CGT;

(2) the former s.13(7A)(d) TCGA determined the amount of s.3 tax.

The former s.13(7A) TCGA provided:

> *In ascertaining for the purposes of subsection (5A) or (7) above the amount of CGT or income tax chargeable on any person for any year on or in respect of any chargeable gain or distribution...*
>
> *(b) any gain accruing in that year on the disposal by that person of any asset representing his interest as a participator in the company shall be regarded as forming the highest part of the gains on which he is chargeable to tax for that year;*
>
> *(c) where any such distribution as is mentioned in subsection (5A)(b) above falls to be treated as a disposal on which a gain accrues on which that person is so chargeable, that gain shall be regarded as forming the next highest part of the gains on which he is so chargeable, after any gains falling within para (b) above; and*
>
> *(d) any gain treated as accruing to that person in that year by virtue of subsection (2) above shall be regarded as the next highest part of the gains on which he is so chargeable, after any gains falling within para (c) above.*

The CG Manual explains:

[53] Or corporation tax, but that is not considered here.

> **CG57375 tax adjustment and reliefs: tax relief ordering rules** [Nov 2019]
>
> Where the events which could give rise to relief under TCGA92/S13(5A) and (7) occurred within a single tax year, there could, in certain circumstances, be computational problems. To prevent this subsection (7A) set out the order of priority to be given to each tax charge. In ascertaining for the purposes of subsections (5A) and (7) the amount of CGT or IT which is chargeable on a person for a year, the order was
>
> 1. any distribution which is chargeable as income is treated as the top slice of income for that year
> 2. any gain accruing on the disposal of any asset representing the participator's interest in the non-resident company is treated as the top slice of gains for that year
> 3. any gain accruing on a capital distribution is treated as the second slice of gains for that year
> 4. the gain attributed to the participator under Section 13 is treated as the third slice of gains for that year. ...

Paragraphs (b) - (d) were repealed in 2008. The CG Manual explained why:

> In 2008-09 and later years Capital Gains Tax is charged at a fixed rate regardless of an individual's income and so these priority rules are not necessary.[54]

This was correct in 2008. But in 2010/11, CGT rates changed and there were (once again) two rates of CGT, then 18%/28%, and now there are five rates.[55] Unfortunately, the need to re-enact subsections (b)-(d) was overlooked! So there is no current statutory guidance. It is considered the pre-2008 rules should continue to be applied, on the basis that they provide an indication of the intention of parliament, and the failure to re-enact them must have been an oversight. The HMRC examples below adopt that view.

It would of course be easy to tidy up this muddle by re-enacting the old provisions. Mistakes like this are inevitable, and will become more

[54] See CG57375: Non-resident companies: tax adjustment and reliefs: tax relief ordering rules. The passage was deleted in Apr 2019, presumably the point was thought to be of historical interest only.
In fact, even in 2008 the provision might have been retained to deal with the CGT annual exemption; but that might have been regarded as trivial.

[55] See 43.13 (CGT rates).

frequent as the complexity of the UK tax system spirals each year, and the part which a single person can keep in mind becomes ever smaller. It is a pity that the rewrite did not take the opportunity to put this right.

64.20.2 *HMRC examples*

The CG Manual tries to provide two straightforward worked examples. The first sets s.3 tax against tax on a dividend. The second sets s.3 tax against tax on a capital distribution. There are problems with the worked examples, which have been altered, not always successfully, in a series of amendments to the Manual. I hope to consider this in a future edition.

64.20.3 *Relevant period*

Section 3C TCGA provides:

> (3) For the purposes of subsection (1) "the relevant period" means the period of 3 years from the end of whichever of the following periods is earlier-
> (a) the period of account of the company in which the gain accrued, and
> (b) the period of 12 months beginning with the date on which the gain accrued.

The drafting is convoluted, but in plain English the time limit is the earlier of:

(1) three years from the end of the accounting period; or
(2) four years from the date of the gain.

CIOT have argued that this time limit should be removed.[56] But no-one has taken any notice. There is something to be said for the current rule. A time limit offers some administrative simplification, as it prevents the need to examine very distant years. Indeed there is something to be said for a similar time limit on other carry forward reliefs, such as loss relief, which currently applies without any time limit on the gap between when the loss accrues, and when the gain accrues against which the loss is set.

64.20.4 *Remittance basis taxpayer*

Section 3 distribution relief applies to foreign s.3 gains which are taxed on

[56] CIOT, "Reform of two anti-avoidance provisions" (2012) *https://www.kessler.co.uk/wp-content/uploads/2018/12/121002-s13-and-transfer-of-assets-CIOT-comments.pdf*

a remittance basis. However the relief only sets tax on the s.3 gain against tax on the distribution. So the relief does not apply unless:

(1) the s.3 gain is remitted (so tax is paid on it), and
(2) the distribution is remitted (so tax actually paid on the distribution qualifies for relief).

Thus suppose:

(1) Year 1: A company realises a gain deemed to accrue to a remittance basis taxpayer under s.3 but not taxed as it is not remitted.
(2) Year 3: The company declares a dividend in respect of the gain. The dividend is RFI but not taxable as it is not remitted.
(3) Year 10: the gain and the dividend are remitted.

The relief applies. The time limit is met as the distribution was within 3 years of the relevant time, the time that the gain accrued to the company. The date of the remittance is not relevant.

64.20.5 *Distribution relief/s.87/86: Interaction*

Suppose non-resident trustees hold a company, and:

(1) A gain accrues to the company; this gain (the "s.3 gain") is a trust gain.
(2) The company is wound up, and a gain accrues to the trustees; this gain ("the distribution gain") is a further trust gain.
(3) The two trust gains are matched to a capital payment resulting in a charge under s.87.

Does s.3 distribution relief apply? The taxpayer has to argue:

(1) CGT paid by the beneficiary, so far as the capital payment is matched to the s.3 gain, is paid "as a result of section 3".
(2) CGT paid by the beneficiary, so far as the capital payment is matched to the distribution gain, is tax "in respect of the distribution".

The s.87 gain matched to the s.3 gain arises as a result of the combination of s.3 and s.87. The s.87 gain matched to the distribution gain arises in respect of the combination of the distribution and the capital payment.

"As a result of" and "in respect of" are vague phrases. They can be interpreted more widely, or more loosely, and should take their meaning from the context. The context here is the avoidance of a double charge to tax, which suggests that the words should be construed more widely, so that s.3 distribution relief is available in this case.

A solution may be to make the trust UK resident (the company remaining non-resident); then s.3 distribution relief clearly applies.

By contrast, the application of s.3 distribution relief where s.86 applies seems relatively straightforward.

64.21 Deduction relief

Section 3C TCGA provides:

> (4) The amount of tax paid by a person as a result of section 3 is allowable as a deduction in calculating a chargeable gain accruing on the disposal by the person of any asset representing the person's interest as a participator in the company.
>
> (5) An amount of tax-
>
> (a) is not to be used more than once under this section (whether to reduce or extinguish a liability or as a deduction or a combination of those things)...

I refer to this as "**s.3 deduction relief**".

This relief sets s.3 tax against the gain, so it is not generous. The CG Manual provides:

> **CG57370 tax adjustment and reliefs: disposal of interest by UK resident participator** [Nov 2019]
>
> [The Manual summarises s.13(7) and continues]
>
> No deduction is due if the tax was paid by the non-resident company, see CG57390.
>
> Example:
>
> Facts
>
> - June 2016 a taxpayer buys 500 out of the 750 issued shares in X Ltd, a non- resident close company, at a cost of £100,000.
> - March 2017 X Ltd realises a gain of £6,000. 500/750 × £6,000 = £4,000 is apportioned to the taxpayer. The amount is included in the 2016-17 Self Assessment return. The taxpayer was liable at 20% and tax of £800 was due.
> - August 2017 the taxpayer sells the shares for £130,000.

Chargeable Gain		
Disposal proceeds		£130,000
Less Cost	£100,000	
Less s.13(7) deduction	£ 800	−£100,800
Chargeable gain		£ 29,200

64.22 Reimbursement by non-resident co

Tax on the s.3 gain is due from the UK resident participator and not from the company. The participator has no statutory right of indemnity against the company. But it is possible that the company might pay the tax on the s.3 gain voluntarily, or perhaps a participator might anticipate the problem and enter into a contract requiring the company to pay the tax.

Section 3G TCGA provides:

> (1) If tax payable by a person ("P") as a result of section 3 is paid by-
> (a) the company ("C") to which the gain accrues, or
> (b) a company by reference to which P is regarded as an indirect participator in C, the amount paid is not a payment to P for tax purposes.
>
> (2) The reference here to tax purposes is to the purposes of income tax, capital gains tax or corporation tax.

I refer to this as "**reimbursement relief**".

The CG Manual provides a précis:

> CG**57390 Payment of UK tax by NR company** [Nov 2019]
> The non-resident company may pay the UK tax due from a UK resident when gains have been apportioned to him under [s.3 TCGA]. If so, TCGA92/S13 (11) provides that the payment of the tax on behalf of the UK resident does not give rise to any further liability in the hands of the UK resident. You do not treat the payment as income of the resident or as a capital distribution in respect of the shares in the non-resident company. TCGA92/S13 (11) will also apply if the liability arises because a UK resident has an indirect shareholding in the non-resident company. The liability can be paid by any of the non-resident close companies in the chain.

Reimbursement is better than an income distribution in respect of the gain as the reimbursement is tax free, whereas an income distribution is subject to income tax (at income tax rates) with the benefit of CGT relief (at CGT rates). Of course, the non-resident company will need to consider whether it would be proper to make the reimbursement as a matter of company law (eg are there other shareholders who may be prejudiced?).

Section 3C TCGA provides:

> (5) An amount of tax ...
> (b) is not to be applied[57] if it is reimbursed by the company.

64.23 Section 3 remittance basis

Section 3D TCGA provides a relief which I call the "**s.3 remittance basis**".

[57] That is, the amount is not to be applied so as to reduce or extinguish any liability of the person to tax, see s.3C(1).

Section 3D provides:

> (1) This section applies if, as a result of section 3, an amount in respect of a gain accruing to a company in a tax year is apportioned to an individual who is not domiciled in the UK in that year.
> (2) The apportioned amount is regarded for the purposes of paragraph 1 of Schedule 1 as accruing on a disposal of a foreign asset if the asset disposed of by the company is a foreign asset[58] (but not otherwise).

This brings sch 1 TCGA into effect, and so provides the remittance basis.[59]

Section 3D(3) TCGA provides:

> For the purposes of Chapter A1 of Part 14 of ITA 2007 (remittance basis)-
> (a) treat any consideration obtained by the company on the disposal of the asset as deriving from the apportioned amount, and
> (b) if that consideration is less than the market value of the asset, treat the asset as deriving from the apportioned amount.

In the absence of express provision, it might be argued that a s.3 gain could not be remitted as it does not exist. Section 3D(3)(a) deals with that problem.[60] I refer to the amount treated as derived from the s.3 gain (under s.3D(3)) as "**s.3 derived property**".

Suppose:

(1) A non resident company ("OC") disposes of a foreign situate asset and realises a gain.
(2) A s.3 gain is deemed to accrue to T (a remittance basis taxpayer).

T is subject to tax on the s.3 gain if:

(1) OC brings/receives/uses the s.3 derived property in the UK and
(2) OC is a relevant person in relation to T. (This requirement will in principle be met, as a company within s.3 will in principle be a relevant person in relation to T.)

[58] Section 3D(5) TCGA provides:
> Paragraph 5 of Schedule 1 applies for the purposes of this section as it applies for the purposes of that Schedule.

This is a somewhat roundabout way of applying the definition of "foreign asset" in para 5(1) sch 1 TCGA; see 56.17 (CGT remittance basis).

[59] See 56.17 (CGT remittance basis).

[60] Section 3D(3)(b) is necessary since the equivalent rule in s.809T ITA only applies to gains accruing on a disposal by an individual: see 18.45.2 (Remittance of deemed gain).

Suppose OC distributes the s.3 derived property by way of dividend and T brings/receives/uses the sum in the UK. Then T is arguably subject to two charges:
(1) CGT on the s.3 gain and
(2) IT on the distribution

Likewise if OC is wound up and the liquidator distributes the s.3 derived property by way of capital distribution, and T brings/receives/uses the sum in the UK. Then T is arguably subject to two charges:
(1) CGT on the s.3 gain and
(2) CGT on the disposal of the shares in OC

If there are two charges, s.3 distribution relief may apply. But the better view is that there is only a single charge to tax in these cases. One receipt cannot give rise to two charges under the remittance basis.[61]

64.24 CG group reliefs

Group reliefs prevent a gain accruing when an asset is transferred between group companies. We need labels for these reliefs, and I coin the following terminology:

Type of relief	**TCGA section**	**See para**
UK-group relief	s.170-181	64.27
Non-resident group relief	s.3F	64.31

Where it is necessary to distinguish these from other group reliefs, I call them CG group reliefs.

A full discussion needs a long chapter to itself. The private client practitioner might think that this is a topic of interest only to corporate tax practitioners; but no: non-resident group relief is important for offshore company structures, and so for offshore trust tax, and one cannot understand non-resident group relief without understanding UK-group relief on which it is based.

For other aspects of group reliefs, see 85.24 (Partnerships: Group reliefs); 61.55.3 (Chain of cos: Disadvantages).

64.25 Group/principal co of group

Section 170(2) TCGA provides:

> Except as otherwise provided—

[61] See 18.18.15 (Income from income/gains).

> (b) subsections (3) to (6) below apply to determine
> [i] whether companies form a group
> [ii] and, where they do, which is the principal company of the group.

So we turn to s.170(3) TCGA:

> Subject to subsections (4) to (6) below—
> (a) [i] a company (referred to below and in sections 171 to 181 as the "principal company of the group") and all its 75% subsidiaries form a group and,
> [ii] if any of those subsidiaries have 75% subsidiaries, the group includes them and their 75% subsidiaries, and so on

Under this definition both resident and non-resident companies may form a group. For partnerships in group structures, see 85.24 (Partnerships: Group reliefs).

64.26 "51/75/90 % subsidiary"

Section 1154 CTA 2010 defines 51/75/90 % subsidiary. The definitions also apply for IT purposes.[62] Section 1154 CTA 2010 provides:

> (1) Subsections (2) to (4) define, for the purposes of the Corporation Tax Acts,[63] the circumstances in which a body corporate ("B") is a 51% subsidiary, a 75% subsidiary or a 90% subsidiary of another body corporate ("A").
> (2) B is a 51% subsidiary of A if more than 50% of B's ordinary share capital is owned directly or indirectly by A.
> (3) B is a 75% subsidiary of A if at least 75% of B's ordinary share capital is owned directly or indirectly by A.
> (4) B is a 90% subsidiary of A if at least 90% of B's ordinary share capital is owned directly by A.
> (5) For the purposes of subsections (2) and (3) ordinary share capital is owned "directly or indirectly" by a body corporate if it is owned by it—
> (a) directly,
> (b) indirectly, or
> (c) partly directly and partly indirectly.

[62] Section 989 ITA provides:
'51% subsidiary', in relation to bodies corporate, has the same meaning as in the Corporation Tax Acts (see Chapter 3 of Part 24 of CTA 2010).
'75% subsidiary', in relation to bodies corporate, has the same meaning as in the Corporation Tax Acts (see Chapter 3 of Part 24 of CTA 2010).

[63] CT principles apply for s.3 purposes, see 64.4 (Computing gains: CT rules).

The term used here is body corporate, not company; the difference occasionally matters.

For the definition of ordinary share capital, see 90.55 (Ordinary share capital).

The term "51% subsidiary" is not wholly accurate (because any shareholding over 50% will suffice); but the label is convenient, and one should not expect complete accuracy in short labels.

CTM provides:

> **CG45110 what is a group?** [Jul 2019]
> ...The question of whether a particular entity has ordinary share capital may be important when considering capital gains groups. A company that has no ordinary share capital cannot be a subsidiary. The question arises most often when considering entities created under foreign law. There is also the possibility that a foreign entity may be considered to be transparent for UK tax purposes. Of course, a company that has no ordinary share capital may be the principal company of a group. ...

64.26.1 *Ownership*

Section 1154(6) CTA 2010 provides:

> In this Chapter references to ownership are to be read as references to beneficial ownership.

Beneficial ownership is not defined; it has its English law meaning.[64]

64.26.2 *Indirect ownership*

Section 1155 CTA 2010 provides:

> (1) For the purposes of this Chapter ordinary share capital is owned indirectly by a body corporate if it is owned through another body corporate or other bodies corporate.
> (2) References in this Chapter to ownership through a body corporate are to be read in accordance with subsections (3) and (4).
> (3) Suppose that 3 or more bodies corporate are ordered in a series such that each body in the series (other than the last) owns ordinary share capital of the body immediately below it in the series.
> (4) If B is a body that is below, but not immediately below, A in the series, A is said to own ordinary share capital of B through each body corporate that is between A and B in the series.

[64] See App. 6.2 (English-law beneficial ownership).

So indirect ownership means ownership through another body corporate. Section 1155(5) CTA 2010 provides:

> Sections 1156 and 1157 contain rules for calculating, for the purposes of this Chapter, the amount of a body corporate's ordinary share capital that another body corporate owns-
> (a) indirectly, or
> (b) partly directly and partly indirectly.

These rules are straightforward but not discussed here.

64.26.3 *Effective subsidiary rule*

Section 170(3) TCGA provides:

> (b) a group does not include any company (other than the principal company of the group) that is not an effective 51% subsidiary of the principal company of the group.

I refer to this as the **"effective subsidiary rule".** Section 170(7) TCGA provides:

> For the purposes of this section and sections 171 to 181, a company ("the subsidiary") is an effective 51% subsidiary of another company ("the parent") at any time if and only if—
> (a) the parent is beneficially entitled to more than 50% of any profits available for distribution to equity holders of the subsidiary; and
> (b) the parent would be beneficially entitled to more than 50% of any assets of the subsidiary available for distribution to its equity holders on a winding-up.

These terms are defined by reference:

> (8) Chapter 6 of Part 5 of CTA 2010 (group relief: equity holders and profits or assets available for distribution) applies for the purposes of subsections (6) and (7) as if—
> (a) references to section 151(4)(a) and (b) of that Act were references to subsections (6) and (7) above, . . .
> (aa) in section 158 of that Act after subsection (2) there were inserted—
>> (2A) But for those purposes a person carrying on a business of banking is not treated as a loan creditor of a company in respect of any loan capital or debt issued or incurred by the company for money lent by the person to the company in the

ordinary course of that business.”,[65] and

(b) sections 171(1)(b) and (3), 173, 174 and 176 to 178 of that Act were omitted.

The definitions are as follows:

Term	**Definition in CTA 2010**
Equity holder	s.157-164
Available for distribution	
Proportion of profits	s.165
Proportion of assets available on winding up	s.166
Supplementary	s.167-182

These definition are highly elaborate, and a full discussion would need a long chapter. In short, the parent’s beneficial ownership must confer a corresponding economic interest in the subsidiary, both when its profits are distributed and when it is wound up.

64.26.4 *Principal company*

Section 170(4) TCGA provides:

> A company cannot be the principal company of a group if it is itself a 75% subsidiary of another company.

Section 170(5) TCGA provides:

> [a] Where
> [i] a company (“the subsidiary”) is a 75% subsidiary of another company but
> [ii] those companies are prevented from being members of the same group by subsection (3)(b) above [effective 51% subsidiary rule],
> the subsidiary may, where the requirements of subsection (3) above are satisfied, itself be the principal company of another group notwithstanding subsection (4) above
> [b] unless this subsection enables a further company to be the principal company of a group of which the subsidiary would be a member.

64.26.5 *Which group?*

Section 170(6) TCGA provides:

> [A] A company cannot be a member of more than one group;
> [B] but where, apart from this subsection, a company would be a member

[65] See 104.25.11 (Bank creditor).

> of 2 or more groups (the principal company of each group being referred to below as the "head of a group"), it is a member only of that group, if any, of which it would be a member under one of the following tests (applying earlier tests in preference to later tests)—
>
> (a) it is a member of the group it would be a member of if, in applying subsection (3)(b) above [effective 51% subsidiary rule], there were left out of account any amount to which a head of a group is or would be beneficially entitled of any profits available for distribution to equity holders of a head of another group or of any assets of a head of another group available for distribution to its equity holders on a winding-up,
>
> (b) it is a member of the group the head of which is beneficially entitled to a percentage of profits available for distribution to equity holders of the company that is greater than the percentage of those profits to which any other head of a group is so entitled,
>
> (c) it is a member of the group the head of which would be beneficially entitled to a percentage of any assets of the company available for distribution to its equity holders on a winding-up that is greater than the percentage of those assets to which any other head of a group would be so entitled,
>
> (d) it is a member of the group the head of which owns directly or indirectly a percentage of the company's ordinary share capital that is greater than the percentage of that capital owned directly or indirectly by any other head of a group (interpreting this paragraph as if it were included in section 1154(2) of CTA 2010).

64.26.6 *Change of principal company*

Section 170(10) TCGA provides:

> For the purposes of this section and sections 171 to 181, a group remains the same group so long as the same company remains the principal company of the group, and if at any time the principal company of a group becomes a member of another group, the first group and the other group shall be regarded as the same, and the question whether or not a company has ceased to be a member of a group shall be determined accordingly.

Section 170(10A) deals with a company becoming a Societas Europaea, which I need not consider here.

64.26.7 *Winding up*

Section 170(11) TCGA provides:

> For the purposes of this section and sections 171 to 181, the passing of a resolution or the making of an order, or any other act, for the winding-up of a member of a group of companies shall not be regarded as the occasion of that or any other company ceasing to be a member of the group.

64.26.8 *"Company"*

Section 170(9) TCGA provides a non-standard definition of "company":

> For the purposes of this section and sections 171 to 181, references to a company apply only to—
> (a) a company as defined in section 1(1) of the Companies Act 2006,[66] and
> (b) a company (other than a limited liability partnership) which
> [i] is constituted under any other Act or a Royal Charter or letters patent or
> [ii] is formed under the law of a country or territory outside the UK, and
> (c) a registered society (see section 1119 of CTA 2010) [Co-operative and Community Benefit Societies, etc];[67] and
> (cc) an incorporated friendly society within the meaning of the Friendly Societies Act 1992; and
> (d) a building society.

A company without ordinary share capital (eg a company limited by guarantee) may only be a member of a group as its principal company.

A group of companies can include companies that are not resident in the UK.

An unincorporated association does not count as a company and so cannot be a member of a group. Perhaps that is the main point of this definition.

[66] Section 1(1) Companies Act 2006 provides:
In the Companies Acts, unless the context otherwise requires—
"company" means a company formed and registered under this Act, that is—
(a) a company so formed and registered after the commencement of this Part, or
(b) a company that immediately before the commencement of this Part—
(i) was formed and registered under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986, or
(ii) was an existing company for the purposes of that Act or that Order,
(which is to be treated on commencement as if formed and registered under this Act).

[67] Section 170(2) TCGA provides: "Except as otherwise provided ...
(c) in applying section 1154(3) of CTA 2010 (meaning of "75% subsidiary") any share capital of a registered society (see section 1119 of that Act) shall be treated as ordinary share capital".

Section 170(2) TCGA extends the definition to foreign incorporated companies:

> Except as otherwise provided ...
>
> (d) "group" and "subsidiary" shall be construed with any necessary modifications where applied to a company incorporated under the law of a country outside the UK.

64.27 UK-group relief

Section 171 TCGA provides UK-group relief:

> (1) Where—
>
> (a) a company ("company A") disposes of an asset to another company ("company B") at a time when both companies are members of the same group, and
>
> (b) the conditions in subsection (1A) below are met,
>
> company A and company B are treated for the purposes of corporation tax on chargeable gains as if the asset were acquired by company B for a consideration of such amount as would secure that neither a gain nor a loss would accrue to company A on the disposal.

Section 171(1A) TCGA restricts this relief to UK resident companies (or non-resident companies within the scope of CT). It is helpful to set out the two conditions side by side:

> The conditions referred to in subsection (1)(b) above are—

Company A (transferor)	***Company B (transferee)***
(a) that company A is resident in the UK at the time of the disposal, or	(b) that company B is resident in the UK at the time of the disposal, or
the asset is a chargeable asset[68] in relation to that company immediately before that time, and	the asset is a chargeable asset in relation to that company immediately after that time.

[68] "Chargeable asset" is defined in the final sentence of s.171(1A) TCGA:

> "For this purpose an asset is a "chargeable asset" in relation to a company at any time if, were the asset to be disposed of by the company at that time, any gain accruing to the company would be a chargeable gain chargeable to corporation tax as a result of section 2B(3) or (4)."

This extends UK-group relief to:

(1) Non-resident companies with a UK permanent establishment

(2) Disposals of UK land/land-rich assets

See 56.6.2 ("Chargeable" asset).

I refer to this as "**UK-group relief**".

Group relief is compulsory but it should be possible to arrange that companies are not part of a group, by issuing shares or arranging some other breach of the definition of a group, and so exclude the relief. That is not likely to arise for UK-group relief, but it may for non-resident group relief.

Section 171(6) TCGA dots some *I*'s and crosses some *T*'s:

> Subsection (1) above applies notwithstanding any provision in this Act fixing the amount of the consideration deemed to be received on a disposal or given on an acquisition.
>
> But where it is assumed for any purpose that a member of a group of companies has sold or acquired an asset, it shall be assumed also that it was not a sale or acquisition to which this section applies.

64.28 Dividend in specie

The CG Manual provides:

> **CG45315: groups: dividends in kind** [Jul 2019]
>
> The transfer of the asset may be effected by the subsidiary company declaring a dividend in kind also known as a dividend in specie. The Corporation Tax consequences are described at CTM15250. Such a dividend will normally be declared in a given amount, to be satisfied by the transfer of the asset, and any dividend within CTA10/S1000(1)A will be equal to that specified amount. If the dividend is declared in an amount equal to the market value of the asset, then that is the measure of the dividend. If the dividend is declared in an amount equal to the book value of the asset, any excess of market value of that asset over the specified amount will be a distribution within CTA10/S1020, but CTA10/S1021 will disapply section 1020 in a group case.
>
> The receipt of the dividend will not give rise to a chargeable gain. The disposal of the asset by the subsidiary will be covered by TCGA92/S171, provided, for dividends on or after 1 April 2000, the asset remains within the UK tax net (CG45301). Neither the specified amount of the dividend nor any amount that would be a distribution for CTA10/Part 23 purposes but for CTA10/S1021 will be a capital distribution in respect of shares as defined in TCGA92/S122. Nor will there be any charge under TCGA92/S22. If a dividend paid on or after 1 April 2000 results in the asset ceasing to be within the scope of UK corporation tax on chargeable gains, the disposal is not within section 171, and will be at market value under TCGA92/S18...

EXAMPLE
B Ltd is a wholly owned UK resident subsidiary of A Ltd, a UK resident company. B Ltd owns an asset X book value £100,000 market value £1M. B Ltd declares a dividend of £100,000 to be satisfied by the transfer of X to A Ltd.
For chargeable gains purposes there are potentially two disposals

- the disposal of X by B Ltd. This is protected by TCGA92/S171
- the receipt of a capital distribution by A Ltd in respect of its shareholding in B Ltd. Neither the dividend of £100,000 nor the £900,000 difference between the market value of X and the specified amount of the dividend represents a capital distribution.

If A Ltd was not resident in the UK, and did not take the asset into use for the purposes of the trade of a UK permanent establishment, the transfer of the asset will be a disposal by B Ltd which could give rise to a chargeable gain or allowable loss. The disposal proceeds to B for the purposes of computing any gain or loss will be the market value of £1M. As A Ltd is not within the charge to corporation tax, it will have no chargeable gain on any capital distribution received.

64.29 Disposal + acquisition needed

The CG Manual provides:

CG45320 Exceptions [Jul 2019]
The no gain/no loss rule in TCGA92/S171(1) only applies where a member of a group of companies disposes of an asset to another member of the same group. The general requirement is therefore that there should be both
[1] a disposal by a group company and
[2] an acquisition by a group company.
The no gain/no loss rule does not apply where a group company makes a deemed disposal of an asset for consideration received from another group company, if the group company paying the consideration does not itself acquire an asset.

64.29.1 *Disposal without acquisition*

Disposal without a corresponding acquisition happens on the destruction of an asset. The CG Manual continues:

Examples would be
[1] intra-group transactions involving capital sums derived from assets within TCGA92/S22, or
[2] capital distributions in respect of shares within TCGA92/S122, see CG45315.

Suppose A Ltd owns B Ltd, B Ltd is put into liquidation, and its asset is transferred to A Ltd. There are two disposals:

(1) B Ltd disposes of the asset which is transferred to A Ltd: this disposal qualifies for group relief.

(2) A Ltd disposes of its shares in B Ltd.[69]

There are two reasons why disposal 2 does not qualify for group relief. Firstly there is no corresponding acquisition. Secondly, s.171(2) TCGA provides:

> the reference in subsection (1) above to company A disposing of an asset shall not apply to anything which under section 122 is to be treated as a disposal of an interest in shares in a company in consideration for a capital distribution (as defined in that section) from that company, whether or not involving a reduction of capital.

It seems strange that the relief does not apply, but the rule is clearly deliberate.

Another example is a purchase of own shares:

> **CG45320 Exceptions** [Jul 2019]
> If group company A owns shares in group company B, and company B purchases its own shares from A under Section 690 Companies Act 2006, there is a disposal by A of the shares in B but no corresponding acquisition of those shares by B. TCGA92/S171(1) accordingly does not apply. Further instructions on company own share purchases are at CG58600+.

64.29.2 *Acquisition without disposal*

Acquisition without corresponding disposal happens on the creation of an asset. The CG Manual gives an example of an issue of shares or securities:

> **CG45320 Exceptions** [Jul 2019]
> If group company B issues shares to group company A, there is an acquisition of the shares by A but no disposal of the shares by B. This is in accordance with the general rule that a company issuing shares does not make any disposal of those shares. The no gain/no loss rule [group relief] accordingly does not apply when one group company issues shares to another. The same considerations apply when one group company issues securities to another.

See too App 4.8.1 (Acquisition without disposal).

[69] Section 122 TCGA.

64.30 Exceptions to group relief

64.30.1 *Charge on branch/agency asset*

Section 171(1B) TCGA provides:

> If—
> (a) company A is deemed under section 25(3) to have previously disposed of the asset, but
> (b) no gain or loss accrued on that deemed disposal as a result of section 25ZA(2),
>
> that deemed disposal is to be ignored in applying subsection (1) of this section in relation to company B.

See 56.8 (Asset ceases to be chargeable).

64.30.2 *Debts*

Section 171(2) TCGA provides:

> (2) Subsection (1) above shall not apply where the disposal is—
> (a) a disposal of a debt due from company B effected by satisfying the debt or part of it

> **CG45320 Exceptions** [Jul 2019]
> The no gain/no loss rule does not apply to a disposal of a debt due from a member of a group of companies where the disposal is effected by satisfying the debt or part of it. This specific exception puts the matter beyond doubt as for such a disposal there is no corresponding acquisition, so the general rule in TCGA92/S171(1) would not in any event apply.
> The exclusion of debts from the no gain/no loss rule only applies to the disposal of the debt itself at the time it is wholly or partly repaid. If one group company transfers an asset to another in satisfaction of a debt, the no gain/no loss rule may apply separately to the asset transferred.
> EXAMPLE
> Company A lends money to company B in the same group. In satisfaction of the debt company B transfers an asset (land) to company A. If none of the specific exclusions from Section 171(1) applies, B disposes of the land to A at no gain/no loss, so that A effectively takes over the capital gains cost of the land to B. The no gain/no loss rule does not apply to A's disposal of the debt.

64.30.3 *Redeemable shares*

Section 171(2) TCGA provides:

> (2) Subsection (1) above shall not apply where the disposal is...

> (b) a disposal of redeemable shares in a company on the occasion of their redemption

This exception also overlaps with the exclusion of cases where there is a disposal but no corresponding acquisition.

64.30.4 *Exempt transferee company*

Section 171(2) TCGA provides:

> (2) Subsection (1) above shall not apply where the disposal is...
> (c) a disposal by or to an investment trust; or
> (cc) a disposal by or to a venture capital trust; or
> (cd) a disposal by or to a qualifying friendly society[70]; or
> (d) a disposal to a dual resident investing company; or
> (da) a disposal by or to a company which is, or is a member of, a UK REIT within the meaning of Part 12 of CTA 2010

64.30.5 *Options*

Section 171(2) TCGA provides:

> (2) Subsection (1) above shall not apply where the disposal is...
> (db) a disposal by company A in fulfilment of its obligations under an option granted to company B at a time when those companies were not members of the same group

64.30.6 *Reorganisations*

Section 171(3) TCGA provides:

> Subsection (1) above shall not apply to a transaction treated by section 127 as it applies by virtue of section 135 as not involving a disposal by company A.

64.31 Non-resident group relief

64.31.1 *"Non-resident group"*

Section 3F(3) TCGA provides:

> In this section-
> "non-resident company" means a company which is not resident in the UK,
> "non-resident group of companies"-

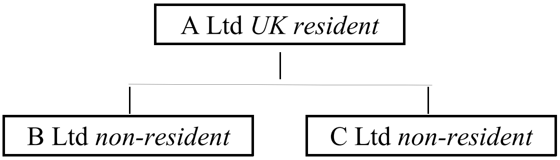
[70] Defined in subsection (5).

(a) in the case of a group none of whose members are resident in the UK, means that group, and

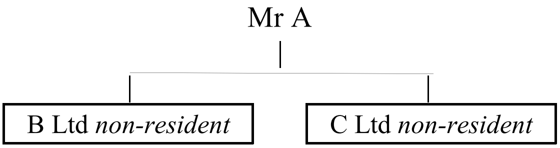
(b) in the case of a group some of whose members are not resident in the UK, means the members which are not resident in the UK, and "group" is to be read in accordance with section 170.

The CG Manual provides 3 examples:

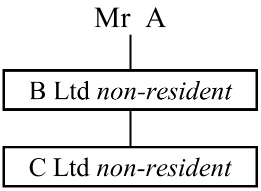
> CG**57400 non-resident group** [Nov 2019]
>
> ...[71]
>
> *Example 1*


A Ltd *UK resident*
B Ltd *non-resident*
C Ltd *non-resident*

> B Ltd and C Ltd form a non-resident group.
> A Ltd is not a member of the non-resident group but it does have the effect of 'grouping' B Ltd and C Ltd.
>
> *Example 2*


Mr A
B Ltd *non-resident*
C Ltd *non-resident*

> B Ltd and C Ltd do not form a non-resident group because they are not members of any group.
>
> *Example 3*


Mr A
B Ltd *non-resident*
C Ltd *non-resident*

> B Ltd and C Ltd form a non-resident group because all of the companies in the group are not resident.

64.31.2 *s.3 group relief*

Section 3F TCGA provides:

[71] I have created the diagrams to increase clarity.

> (1) This section applies, for the purposes of section 3, certain provisions of this Act (modified as mentioned below) in relation to non-resident companies which are members of a non-resident group of companies.
> (2) The applied provisions are-
> (a) section 41(8) [capital allowances],
> (b) section 171 but as if subsections (1)(b) and (1A) were omitted,
> (c) section 173 but as if "to which this section applies" in subsections (1)(a) and (2)(a) were omitted, as if "such" in subsections (1)(c) and (2)(c) were omitted and as if subsection (3) were omitted,
> (d) section 174(4) but as if "at a time when both were members of the group" were substituted for "in a transfer to which section 171(1) applied",
> (e) section 175(1) but as if "to which this section applies" were omitted...

Thus the rules for UK-group relief are applied to a transfer from a non-resident group company to another non-resident group company. I refer to this as **"non-resident group relief"**.

What about a disposal from a non-resident group company to a UK resident group company? Non-resident group relief does not apply because the companies are not both members of a non-resident group; UK-group relief does not apply as the condition in s.171(1A) TCGA is not met. In practice this problem may not arise, as a transfer from a non-resident company (within the scope of s.3) to a UK company in the same group would be unusual.

For the position before 2019, see the 2018/19 edition of this work para 62.29.7 (Scope of s.3 group relief).

64.32 De-grouping charge

Section 3F TCGA provides:

> (1) This section applies, for the purposes of section 3, certain provisions of this Act (modified as mentioned below) in relation to non-resident companies which are members of a non-resident group of companies.
> (2) The applied provisions are ...
> (f) section 179 but as if subsections (1)(b) and (1A) were omitted, as if for any reference to a group of companies there were substituted a reference to a non-resident group of companies and as if for any reference to a company there were substituted a reference to a non-resident company.

So the clawback rules for which apply to UK-group relief are incorporated into non-resident group relief. Amended as s.3F directs, s.179(1) TCGA (in outline) provides:

> This section applies where—
> (a) [i] a company not resident in the UK ("company A") acquires an asset from another company not resident in the UK ("company B")
> [ii] at a time when company A and company B are members of the same non-resident group
> (b) [disapplied for non-resident group relief purposes]
> (c) company A ceases to be a member of that group within the period of six years after the time of the acquisition.
>
> References in this section to a company ceasing to be a member of a group of companies do not apply to cases where a company ceases to be a member of a non-resident group in consequence of another member of the non-resident group ceasing to exist.

Amended as s.3F directs, s.179(3) TCGA provides the charge:

> If, when company A ceases to be a member of the non-resident group, company A, or an associated non-resident company also leaving the group, owns, otherwise than as trading stock—
> (a) the asset, or
> (b) property to which a chargeable gain has been carried forward from the asset on a replacement of business assets,
>
> then, subject to subsection (4) below, company A shall be treated for all the purposes of this Act as if immediately after its acquisition of the asset it had sold, and immediately reacquired, the asset at market value at that time.

Section 179(4) TCGA deals with timing:

> Any chargeable gain or allowable loss accruing to company A on the sale referred to in subsection (3) above shall be treated as accruing to company A at whichever is the later of the following, that is to say—
> (a) the time immediately after the beginning of the accounting period of that company in which or, as the case may be, at the end of which the company ceases to be a member of the group; and
> (b) the time when under subsection (3) above it is treated as having reacquired the asset; and sections 138 to 142 of CTA 2010 have effect accordingly as if the actual circumstances were as they are treated as having been.

Section 179(13) TCGA dots some *i*’s and crosses some *t*’s:

> Where under this section company A is to be treated as having disposed of, and reacquired, an asset, all such recomputations of liability in respect of other disposals, and all such adjustments of tax, whether by way of assessment or by way of discharge or repayment of tax, as may be required in consequence of the provisions of this section shall be carried out.

64.32.1 *Associated cos leave together*

Amended as s.3F directs, s.179(2) TCGA provides:

> Where two non-resident companies cease to be members of the non-resident group at the same time, subsection (1) does not have effect as respects the acquisition of an asset by one of the companies from the other if condition A or B is met.

I refer to “**de-grouping exemptions A and B**”.
Section 179(2ZA) sets out degrouping exemption A:

> Condition A is that the non-resident companies—
> (a) are both 75% subsidiaries and effective 51% subsidiaries of another non-resident company on the date of the acquisition, and
> (b) remain both 75% subsidiaries and effective 51% subsidiaries of that other non-resident company until immediately after they cease to be members of the non-resident group.

Section 179(2ZB) sets out degrouping exemption B:

> Condition B is that one of the non-resident companies—
> (a) is both a 75% subsidiary and an effective 51% subsidiary of the other on the date of the acquisition, and
> (b) remains both a 75% subsidiary and an effective 51% subsidiary of the other until immediately after the non-resident companies cease to be members of the non-resident group.

Section 171 then deals with the case where company A leaves the second non-resident group:

> (2A) Subsection (2AA) applies where—
> (a) a non-resident company ("company A") acquired an asset from another non-resident company ("company B") at a time when both company A and company B were members of the same non-resident group ("the first non-resident group"),
> (aa) company A has ceased to be a member of the first non-resident group,
> (b) subsection (2) above applies in the case of company A’s ceasing to be a member of the first non-resident group so that subsection (1) above does not have effect as respects the acquisition of that asset,

(c) at the time company A ceases to be a member of the first non-resident group there is a connection between that group and the group of companies of which company A becomes a member on leaving the first group ("the second group"), and

(d) subsequently—

(i) company A ceases to be a member of the second non-resident group, or

(ii) (before sub-paragraph (i) applies) there ceases to be a connection between the two groups.

(2AA) Where this subsection applies—

(a) in a case within subsection (2A)(d)(ii), for the purposes of this section (other than subsection (2A)) as it applies as respects the acquisition, company A and any associated non-resident company are to be treated as having ceased to be members of the second non-resident group at the time the connection between the two groups ceases,

(b) subsection (1) has effect in relation to company A's ceasing to be a member of the second non-resident group as if it had been the second non-resident group of which both companies had been members at the time of the acquisition, and

(c) subsection (2) may operate to prevent subsection (1) applying by virtue of paragraph (b), unless subsection (2AB) applies.

(2AB) This subsection applies if company A's ceasing to be a member of the first non-resident group at the same time as one or more associated non-resident companies forms part of arrangements the main purpose, or one of the main purposes, of which is the avoidance of a liability to corporation tax.

(2B) For the purposes of subsection (2A) above there is a connection between the first group and the second group at a particular time if, at that time, the company which is the principal company of that group is under the control[72] of—

(a) the non-resident company which is the principal company of the first non-resident group or, if that group no longer exists, which was the principal company of that group when company A ceased to be a member of it;

(b) any person or persons who control the non-resident company mentioned in paragraph (a) above or who have had it under their control at any time in the period since company A ceased to be a member of the first non-resident group; or

(c) any person or persons who have, at any time in that period, had under their control either—

(i) a non-resident company which would have been a person falling within paragraph (b) above if it had continued to exist, or

(ii) a company which would have been a person falling within this paragraph (whether by reference to a company which would have been a person falling

[72] Section 179(9A) TCGA provides: "Sections 450 and 451 of CTA 2010 (meaning of control) shall have effect for the purposes of subsection (2B) above as they have effect for the purposes of Part 10 of CTA 2010; but a person carrying on a business of banking shall not for the purposes of that subsection be regarded as having control of any company by reason only of having, or of the consequences of having exercised, any rights of that person in respect of loan capital or debt issued or incurred by the company for money lent by that person to the company in the ordinary course of that business."

within that paragraph or to a company or series of companies falling within this subparagraph).

(2C) This section shall not have effect as respects any asset if, before the time when company A ceases to be a member of the group or, as the case may be, the second group, an event has already occurred by virtue of which the company falls by virtue of section 101A(3) to be treated as having sold and immediately reacquired the asset at the time specified in subsection (3) below.

(2D) This section shall not have effect as respects any asset if, before the time when company A ceases to be a member of the non-resident group or, as the case may be, the second non-resident group, an event has already occurred by virtue of which the company falls by virtue of section 101C(3) to be treated as having sold and immediately reacquired the asset at the time specified in subsection (3) below.

64.32.2 *Exceptions: Chargeable assets*

*S*ection 179 TCGA goes on to set out some exceptions to the charge:

(3A) Any chargeable gain or allowable loss which would otherwise accrue to company A on the sale referred to in subsection (3) does not so accrue if—

(a) company A ceases to be a member of the non-resident group in consequence of—

(i) a disposal of shares in company A or another member of the group made by a member of the group, or

(ii) two or more such disposals,

(b) either—

(i) subsection (3B) applies to the disposal or, if there is more than one disposal, to at least one of them, or

(ii) sub-paragraph (i) does not apply but had subsection (3B) applied to the disposal or, if there is more than one disposal, to each of them, any gain arising on the disposal or disposals would not have been a chargeable gain by virtue of Schedule 7AC, and

(c) in the absence of this subsection, section 535 of CTA 2010 (UK REITS: exemption of gains) would not apply to the chargeable gain or allowable loss which would accrue to company A on the sale.

(3B) This subsection applies to a disposal of shares if—

(a) the company making the disposal is resident in the UK at the time of the disposal,

(b) the shares are chargeable assets[73] in relation to that company immediately before that time, or

(c) any part of the chargeable gain or allowable loss accruing on the disposal is treated as a gain or loss accruing to a person by virtue of section 3 (attribution of gains to

[73] Section 179(10A) TCGA provides: "For the purposes of this section an asset is a "chargeable asset" in relation to a company at any time if any gain accruing to the company on a disposal of the asset by the company at that time—

(a) would be a chargeable gain and would by virtue of section 10B form part of its chargeable profits for corporation tax purposes, or

(b) would, but for Schedule 7AC (exemptions for disposals by companies with substantial shareholdings), be within paragraph (a)."

members of non-resident companies).

In this section “group disposal” means a disposal within subsection (3A)(a) to which this subsection applies and the company making the disposal is referred to as “the transferor company”.

(3C) For the purposes of subsections (3A) and (3B), the question whether there is a disposal is to be determined ignoring section 127 (share reorganisations etc treated as not involving disposal).

(3D) If subsection (3A) applies, any chargeable gain or allowable loss accruing to the transferor company on a group disposal (other than a group disposal to which section 127 applies) is to be calculated—

(a) where a chargeable gain would accrue to company A in the absence of subsection (3A), as if the amount of the consideration for the group disposal were increased by the amount of the gain, and

(b) where an allowable loss would accrue to company A in the absence of subsection (3A), as if an amount equal to the amount of the loss were a sum allowable under section 38 as a deduction in the computation of the gain or loss accruing on the group disposal.

(3E) If subsection (3A) applies, and section 127 applies to a group disposal, any chargeable gain or allowable loss accruing to the transferor company on a disposal of the new holding arising from the group disposal (or any part of that holding) is to be calculated—

(a) where a chargeable gain would accrue to company A in the absence of subsection (3A)—

(i) as if an amount equal to the amount of the gain were excluded from the expenditure allowable as a deduction under section 38 in the computation of the gain or loss accruing on the disposal (but not so as to reduce that expenditure below nil), and

(ii) where (ignoring sub-paragraph (i)) the amount of the gain exceeds the expenditure allowable as such a deduction, as if a gain equal to that excess accrued on the disposal of the new holding (or, if the disposal is of a part of the new holding, a gain equal to the corresponding part of that excess accrued on that disposal), in addition to any gain or loss that actually accrues on the disposal of the new holding or part, and

(b) where an allowable loss would accrue to company A in the absence of subsection (3A), as if an amount equal to the amount of the loss were a sum allowable under section 38 as a deduction in the computation of the gain or loss accruing on the disposal.

In this subsection “new holding” has the meaning given by section 126.

(3F) If there is more than one group disposal, the references in subsections (3D) and (3E) to the amount of the gain or loss which would accrue to company A in the absence of subsection (3A) are to be read, in relation to each disposal, as references to—

(a) such proportion of that amount as the transferor companies in relation to the group disposals jointly elect as the appropriate proportion in relation to the disposal in question, or

(b) where no election is made, the proportion of that amount attributable to that disposal if that amount is divided equally between the group disposals.

(3G) An election under subsection (3F) must—

(a) specify the appropriate proportion in relation to each group disposal, and
(b) be made, by notice to an officer of Revenue and Customs, no later than 2 years after the end of the first accounting period of a company in which any chargeable gain or allowable loss on a group disposal accrues.

(3H) If a group disposal by a company consists of shares of more than one class, then, for the purposes of subsections (3D) and (3E), the company may apportion any increase or deduction to be made between the classes of shares in such manner as it considers appropriate.

64.32.3 *Principal co joins other group*

Amended as s.3F directs, s.179 TCGA (in outline) provides:

(5) Subsections (6) to (8) apply where—
(a) in the absence of subsection (6), company A would be treated by virtue of subsection (3) as selling an asset at any time, by reason of ceasing to be a member of the group, and
(b) company A ceases to be a member of the group by reason only of the fact that the principal company of that group becomes a member of another group.

(6) Subsection (3) does not apply to treat company A as selling the asset at that time; but if—
(a) within 6 years of that time company A ceases at any time ("the relevant time") to satisfy the following conditions, and
(b) at the relevant time, company A, or a company in the same group as that company, owns otherwise than as trading stock the asset or property to which a chargeable gain has been carried forward from the asset on a replacement of business assets, company A shall be treated for all the purposes of this Act as if, immediately after its acquisition of the asset, it had sold and immediately reacquired the asset at the value that, at the time of acquisition, was its market value.

(7) Those conditions are—
(a) that company A is a 75% subsidiary of one or more members of the other group referred to in subsection (5) above, and
(b) that company A is an effective 51% subsidiary of one or more of those members.

(7A) Any chargeable gain or allowable loss which would otherwise accrue to company A on the sale referred to in subsection (6) does not so accrue if—
(a) company A ceases at the relevant time to satisfy the conditions in subsection (7) in consequence of—
(i) a disposal of shares in company A, or another member of the other group mentioned in subsection (5)(b), made by a member of that other group, or
(ii) two or more such disposals,
(b) either—
(i) subsection (3B) applies to the disposal or, if there is more than one disposal, to at least one of them, or
(ii) sub-paragraph (i) does not apply but had subsection (3B) applied to the disposal or, if there is more than one disposal, to each of them, any gain arising on the disposal or disposals would not have been a chargeable gain by virtue of Schedule 7AC, and
(c) in the absence of this subsection, section 535 of CTA 2010 (UK REITS: exemption

of gains) would not apply to the chargeable gain or allowable loss which would accrue to company A on the sale.

(7B) Where subsection (7A) applies, subsections (3C) to (3H) apply to the calculation of any chargeable gain or allowable loss accruing on a disposal within subsection (7A)(a) to which subsection (3B) applies (a "relevant disposal") with the following modifications—

(a) in subsections (3C) to (3H) for the references to a group disposal substitute references to a relevant disposal, and

(b) in subsections (3C), (3D) and (3E) for the references to subsection (3A) substitute references to subsection (7A).

(8) Any chargeable gain or allowable loss accruing to company A on the sale referred to in subsection (6) is to be treated as accruing immediately before the relevant time.

(9) Where—

(a) by virtue of this section a company is treated as having sold an asset at any time, and

(b) if at that time the company had in fact sold the asset at market value at that time, then, by virtue of section 30 or 31, any allowable loss or chargeable gain accruing on the disposal would have been calculated as if the consideration for the disposal were increased by an amount, subsections (3) and (6) above shall have effect as if the market value at that time had been that amount greater.

64.32.4 *"Associated"*

Section 179(10) TCGA provides:

> For the purposes of this section—
>
> (a) two companies are associated with each other if one is a 75% subsidiary of the other or both are 75% subsidiaries of another company.
>
> (b) a chargeable gain is carried forward from an asset to other property on a replacement of business assets if, by one or more claims under sections 152 to 158, the chargeable gain accruing on a disposal of the asset is reduced, and as a result an amount falls to be deducted from the expenditure allowable in computing a gain accruing on the disposal of the other property,
>
> (c) an asset acquired by company A shall be treated as the same as an asset owned at a later time by that company or an associated company if the value of the second asset is derived in whole or in part from the first asset, and in particular where the second asset is a freehold, and the first asset was a leasehold and the lessee has acquired the reversion.

64.33 QCB: Non-resident co

For this topic see 58.1 (Reorganisations: Introduction). I focus here on one particular point which arises where a reorganisation is carried out by a non-resident company within s.3.

For individuals and trustees, the TCGA distinguishes between:

(1) a qualifying corporate bond ("QCB")
(2) a non-qualifying corporate bond ("NQCB")

A bond which would otherwise be a QCB may be drafted so as not to meet the requirements of a QCB, eg by a provision allowing the holder to redeem in a currency other than sterling. So on a reorganisation, individual or trustee shareholders can opt out of the QCB regime into the NQCB regime.
However, s.117(A1) TCGA provides:

> For the purposes of corporation tax "qualifying corporate bond" means any asset representing a loan relationship of a company

This rule applies for s.3 purposes. A corporate bond is in principle a loan relationship of a company. Suppose:
(1) A non-resident company within s.3 ("H") holds a subsidiary ("S").
(2) H sells S to a purchaser ("P") in consideration of loan notes of P.

The loan notes may be drafted so as to constitute a NQCB in the hands of individual or trustee shareholders, but for s.3 purposes gains are computed as if the loan note were a QCB.

64.34 Private residence relief

Suppose T owns a non-resident company, which holds residential property that is T's main residence ("the residence"). If the company disposes of the residence, and a gain accrues to T, could private residence relief apply? Section 222(1) TCGA provides:

> This section applies to a gain accruing to an individual so far as attributable to the disposal of, or of an interest in—
> (a) a dwelling-house or part of a dwelling-house which is, or has at any time in *his* period of ownership been, his only or main residence, or
> (b) land *which he has* for his own occupation and enjoyment with that residence as its garden or grounds up to the permitted area.
>
> (emphasis added)

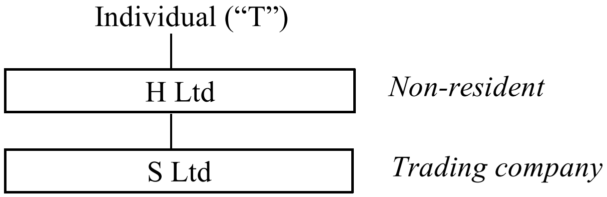
The gain may accrue to an individual, and it is attributable to the disposal of the residence. However, the relief cannot apply because:
(1) the condition in (b) is not met: there is no land which T *has*;
(2) the condition in (a) is not met: the company's period of ownership is not *his* period of ownership.

T might argue that the section should be read non-literally, but it is not absurd to deny private residence relief when a residence is held through a company. The policy is consistent with the rule that gain are computed as if the company were within the charge to CT, and no-one suggests a UK resident company qualifies for private residence relief.

Likewise if the company is held by a non-resident trust, no relief applies to the trustees and the gain on a disposal of the property by the company is a s.1(3) amount (s.87 trust gain) or a s.86 trust gain.

64.35 BAD relief: Trade group

Suppose an individual holds a non-resident company which holds a trading company, thus:



If T owned the shares in S personally, T can in principle qualify for business asset disposal relief (formerly called entrepreneurs' relief) on a disposal of S, assuming the necessary conditions are satisfied.[74]

Suppose H disposes of S. The s.3 gain which will accrue to T on that disposal does not qualify for BAD relief, because it is not a material disposal of business assets (as defined in s169I TCGA).

Suppose H is wound up after the disposal of S. The gain accruing to T on the disposal of H can qualify for BAD relief and so in principle qualifies for the 10% rate.

T will also be able to claim s.3 distribution relief[75] so that tax charged under s.3 on the disposal of S will be set against tax on the gain from disposal of H. However the s.3 gain will be charged at 20% and the gain on the disposal of H will be charged at 10%. The former is likely to eliminate the latter so the benefit of BAD relief will be lost.

64.36 Foundations

A Foundation is not within s.3 TCGA for the following reasons:

(1) A Foundation is a trust in the standard IT/CGT sense.

(2) Even if a Foundation is not a trust, it is still not a company in the

[74] See 56.19 (BAD relief: Remittance basis).

[75] See 64.20 (s.3 distribution relief).

standard tax sense.[76]

(3) A Foundation is in principle a settlement for the purposes of s.87, so even if it were a company in the standard tax sense, it would fall within s.87.[77] The presumption against double taxation applies. The s.87/s.3 regimes must be alternatives. So even if a Foundation is a company in the s.3 sense, it should be regarded as within the protection of 3B(4) TCGA.[78]

However some commentators take the view that a Foundation is a company, and for completeness I outline here the s.3 issues which would arise if that view were correct.

If a Foundation is a company for the purposes of s.3, the Foundation may be a close company[79] and so within s.3. If that is right, two questions arise:

(1) Are foundation-beneficiaries participators?[80]
(2) If they are participators, what is the extent of their interest for the purpose of s.3?

These questions raise imponderable and unexplored sub-issues: what are the rights of the beneficiaries under the relevant foreign law;[81] and do those rights amount to "interests" for this purpose (a matter of UK law)?

In practice the HMRC view, and my view, is that foundations are trusts, in the standard IT/CGT sense, and not companies, so these problems should not arise.[82]

Different considerations apply to a Foundation with Founder's Rights. That is a company within s.3, and Foundation gains would be attributable to the founder.[83]

64.37 Pension scheme

Pension schemes qualify for CGT relief under s.271(1)(c) and (1A) TCGA:

[76] See 90.14.4 (Foundation: IT/CGT trust).
[77] See 61.3.4 (Foundations).
[78] See 64.9 (Participators overlap: Trustees/beneficiaries).
[79] A Foundation may be a close company on the basis that:
(1) The members of the board are directors.
(2) The members of the board are participators.
(3) The Foundation is under the control of directors who are participators.
However this depends on the constitution of the Foundation.
[80] See 104.23.4 (Trustees and beneficiaries).
[81] See 90.13 (Beneficiary rights).
[82] See 90.14.11 (HMRC view).
[83] See 90.14.10 (Founder's Rights: a company).

> (1) The following gains shall not be chargeable gains ...
>
> (c) any gain accruing to a person from his acquisition and disposal of assets held by him as part of a fund—
>
> (i) mentioned in section 614(2) of the Taxes Act,
>
> (ii) to which section 615(3) of the Taxes Act applies, or
>
> (iii) mentioned in section 648, 649, 650, 651 or 653 of ITEPA 2003;
>
> ...
>
> (1A) A gain accruing to a person on a disposal of investments held for the purposes of a registered pension scheme or an overseas pension scheme is not a chargeable gain.

This does not confer relief from s.3 gains but s.3B(5) TCGA provides relief:

> If-
>
> (a) exempt assets of a pension scheme[84] are taken into account in ascertaining a person's interest as a participator in a company, and
>
> (b) if those assets were ignored, an amount in respect of a gain accruing to the company would not be apportioned to the person as a result of section 3,
>
> no amount in the respect of the gain is to be apportioned to the person as a result of that section.
>
> (6) For this purpose-
>
> (a) "assets of a pension scheme" means assets held for the purposes of a fund or scheme to which section 271(1)(c) or (1A) applies, and
>
> (b) those assets are "exempt" if, at the time when the gain accrues, a disposal of those assets would be exempt from tax as a result of either of those provisions.

A beneficiary of a pension scheme might be a participator in a non-resident company held by the scheme, but they are protected by the exclusion for beneficiaries.[85]

Section 3B(5) also prevents aggregation of a pension scheme's interest

[84] Defined s.3B(6): "For this purpose-
(a) "assets of a pension scheme" means assets held for the purposes of a fund or scheme to which section 271(1)(c) or (1A) applies, and
(b) those assets are "exempt" if, at the time when the gain accrues, a disposal of those assets would be exempt from tax as a result of either of those provisions."

[85] See 64.9 (Participators overlap: Trustees/beneficiaries).

with the interest of a person connected with the trustees of the pension scheme, for the purposes of the 25% minimum condition. That will not normally arise, as trustees of a pension scheme are not usually connected with other persons, but it could happen, eg if the trustees were partners in an investment partnership.

64.38 Administration and appeals

The CG Manual provides:

> **CG57213 Non-resident companies: reports and liaison** [Nov 2019]
> Any case within the scope of [s.3 TCGA] involving individuals should be sent to WMBC Assets using the WMBC, Assets Disclosures (Specialist PT) mailbox whether there is any Capital Gains Tax liability or not. That Group will also consider any Income Tax liability under ITA07/s720.
> Mail items that should be sent to this mailbox include:
>
> - any disclosures (Inheritance Tax, Trusts, Periods of Administration)
> - intel reports (Inheritance Tax, Trusts, Periods of Administration)
> - information that may lead to a discovery assessment for Inheritance Tax, Trusts or Periods of Administration
>
> If you are required to make an apportionment that is just and reasonable by reference to the interests of all of the participators (see CG57260), you will need to liaise with other officers dealing with participators in the non-resident company.

64.39 Tax return: s.3 gain

There is no box in form SA108 (Capital Gains Tax summary, 2022/23) for s.3 gains of individuals or trustees, so s.3 gains must be entered into the same boxes as if they accrued directly to the participator.

For disclosure of the motive defence, see 64.16.4 (Motive defence claim).

Non-resident trustees are not taxable on s.3 gains, so there is no obligation to put in any return. If the trustees choose to submit the voluntary form 50(FS) (Trust gains and capital payments, 2022/23) details of s.3 gains are disclosed:

> Box 9: Did the trustees or any underlying non-UK resident company make any offshore income gains in the year ended 5 April 2023? If Yes, enter the amount.
> Box 10: Did the trustees or any underlying non-UK resident company make any capital gains in the year ended 5 April 2023? If Yes, enter the amount.

64.40 DT relief: s.3 gain

In the following discussion I use the following terms to distinguish between 3 types[86] of company residence:

Type of residence	UK-law resident	Treaty-resident in State with CG article
Treaty non-resident	No	Yes
Simple non-resident	No	No
UK resident	Yes	No

In this terminology, for instance, a company in Belize is *simple* non-resident (the Belize/UK DTA has no CG article) but a company in Luxembourg is *treaty* non-resident (the Luxembourg/UK DTA does have CG article).

I consider the following permutations:

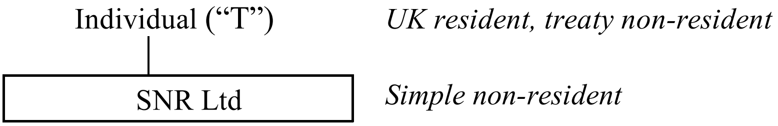
Case no	**Individual (**UK-law resident**)**	Company
1	Treaty non-resident	Simple non-resident
2	Treaty non-resident	Treaty non-resident
3	Treaty resident	Treaty non-resident

64.40.1 *Individual treaty non-resident; company simple non-resident*

Suppose

(1) An individual ("T") is UK-law resident but treaty non-resident

(2) T owns a simple non-resident company which realises a gain:



The gain treated as received by T is the same gain as the gain received by SNR Ltd. But art.13(5) OECD Model provides (with immaterial exceptions):

> Gains from the alienation of any property ... shall be taxable only in the Contracting State of which the *alienator* is [treaty-resident].

On a literal reading, T does not qualify for treaty relief on a gain accruing to SNR Ltd. T (though treaty non-resident) is not the alienator. SNR Ltd is the alienator but (on the facts of this example) NR Ltd is not treaty

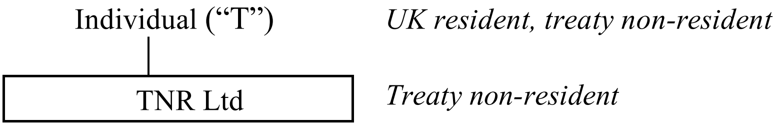
[86] A company which is treaty non-resident must also be domestic law non-UK resident, see 8.19 (DTA residence rule). So it is not necessary to consider the position of a company which is UK resident but treaty-resident outside the UK.

resident in the foreign state which confers DT reliefs. So the terms of art.13(5) are not satisfied.

The US treaty is wider and DT relief applies to an individual who is treaty-resident in the US.[87]

Even under OECD Model, it is suggested that the result is the same, on the grounds that the gain is treated as accruing to T, so T should be deemed to be the alienator; or the word "alienator" does not require that one must dispose of property, only that the gain on the alienation accrues to the person.

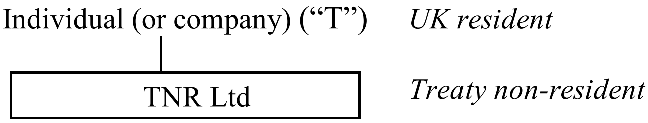
Take the same facts except that the company is also treaty non-resident:



In this case DT relief will apply.

64.40.2 *Company treaty non-resident*

Suppose an individual (or a company) owns a treaty non-resident company which realises a gain:



Section 3(4) TCGA provides:

> The amount apportioned to each person is treated as a chargeable gain accruing to the person.

The sidenote to s.3 calls this "attribution" of gains. The expressions *attribute/apportion/treat as* all come to the same thing. This is a deeming which changes the recipient, but the s.3 gain treated as received by T is the same gain as the gain actually received by TNR Ltd. Subject to the OECD Savings Clause, T can in principle claim DT relief (in my terminology, third-party DT relief)[88] for gains accruing to TNR Ltd (deemed to accrue to T) under s.3 TCGA.[89]

[87] See 91.7.8 (s.624/720 income; s.3/86 gain).

[88] See 109.1 (Third-party DT relief).

[89] The same point is also made (no doubt it was common ground of the parties) in C-112/14 *EC v UK* (the s.3 case) at [5].

HMRC agree. The CG Manual provides:

> **CG57380 double taxation agreements** [May 2020]
> You should always check whether there is a double taxation agreement between the UK and the country in which the company making the gain is resident. If there is no double taxation agreement any [s.3 TCGA][90] charge is unaffected. Similarly if the agreement does not refer to capital gains or Capital Gains Tax the charge under [s.3 TCGA]is unaffected. But, if the agreement provides that gains of the type realised by the non-resident company are only taxable in that company's country of residence [s.3 TCGA] cannot apply. For example, Article 15(4) of the Kenya/UK Double Taxation Agreement would prevent [s.3 TCGA] applying to the disposal of stocks and shares by a company resident in Kenya. Agreements will often treat gains on the disposal of particular types of asset differently.[91]

However the Savings Clause (if applicable) overrides DT relief.[92] so 3rd party DT relief applies only:

(1) In jurisdictions where the OECD Savings Clause does not apply (because the foreign State has opted out of this clause). Luxembourg is an example.

(2) In the (rare) case where the individual is treaty non-resident (and so

[90] I have updated references to the former s.13 TCGA.

[91] Likewise INT Manual provides:

> **INTM169060 Resident shareholders in non-resident companies - Section 13 TCGA 1992** [Jun 2016]
> ... the Capital Gains Articles in double taxation agreements may override [s.3 TCGA].
> If the non-resident company disposes of immovable property; for example, land, buildings etc, in the UK, double taxation agreements normally provide that any gain can be taxed in UK. Although UK domestic law may prevent a capital gains tax charge on the non-resident company (see s.10 TCGA 1992), s.13 TCGA 1992 can be applied to tax the UK resident shareholder.
> If the asset disposed of is not immovable property in the UK; for example, immovable property situated outside the UK, shares etc, then the Capital Gains Article will normally prevent a charge to tax under s.13 TCGA 1992 being made on the shareholder..."

Of course, the text of the CG article in the relevant DTA agreement with the country concerned would need to be examined to see whether it has any variations from the OECD model form, as some did. This is discussed in the 2018/19 edition of this work para 66.40.2 (DTAs excluding s.3 relief); the material is now omitted as the OECD Savings Clause makes it less important.

[92] See 109.5 (Savings Clause).

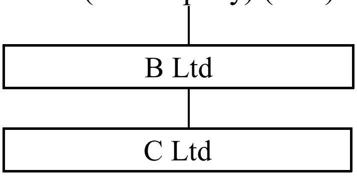
outside the Savings Clause).

If the policy is to exclude s.3 gains from treaty relief, this seems misguided. It is illogical for a treaty to provide CGT exemption but not s.3 exemption. If the foreign state does not tax chargeable gains, there should be no CG exemption at all. If it does, exemption should extend to s.3. But there it is.

64.40.3 *Chain of companies*

Suppose there is a chain of companies:

Individual (or company) ("A") - *UK resident*



Suppose a gain accrues to C ("C's gain"). We have the following possibilities:

	Case 1	**Case 2**	**Case 3**
B Ltd	UK resident	simple non-resident	treaty non-resident
C Ltd	treaty non-resident	treaty non-resident	simple non-resident

Case 1: If B Ltd is UK resident, and C Ltd is treaty non-resident:

(1) C's gain is deemed to accrue to B Ltd; B Ltd may claim DT relief, as noted above, but subject to the Savings Clause.

(2) A does not need to claim relief, as C's gain is not deemed to accrue to A.

Case 2: If B Ltd is simple non-resident and C Ltd is treaty non-resident, C's gain in principle accrues to A. A can claim DT relief, but subject to the Savings Clause.

Case 3: If C Ltd is simple non-resident, but B Ltd is treaty non-resident, C's gain is deemed to accrue to A, but A cannot claim DT relief.

64.41 Trust participator: No DT relief

Section 79B(1) TCGA provides:

> This section applies where the trustees of a settlement are participators[93]—

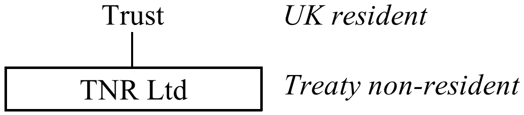
[93] The second sentence in s.79B(1) TCGA provides: "For this purpose "participator" has the same meaning as in section 3 (see section 3B)". That incorporates the

> (a) in a close company,[94] or
> (b) in a company that is not resident in the UK but would be a close company if it were resident in the UK...

Assuming this condition is met, we move on to the rule. Section 79B(2) TCGA provides:

> Where this section applies, nothing in any double taxation relief arrangements[95] shall be read as preventing a charge to tax arising by virtue of the attribution to the trustees under s.3, by reason of their participation in the company mentioned in subsection (1) above, of any part of a chargeable gain accruing to a company that is not resident in the UK.

Suppose a UK trust owns a treaty non-resident company which realises a gain:



DT relief is disallowed under s.79B(1)(b) and the trustees are taxable.

Similarly if a non-resident trust within s.86 owns a treaty non-resident company which realises a gain: DT relief is disallowed under s.79B(1)(b) and the settlor is taxable.

Section 79B(3) TCGA provides:

> Where this section applies and—
> (a) a chargeable gain accrues to a company that is not resident in the UK but would be a close company if it were resident in the UK, and
> (b) all or part of the chargeable gain is treated under section 3 as accruing to a close company which is not chargeable to corporation tax in respect of the gain by reason of double taxation arrangements, and
> (c) had the company mentioned in para (b) (and any other relevant[96]

standard definition; see 64.6.2 (Overlapping participators).

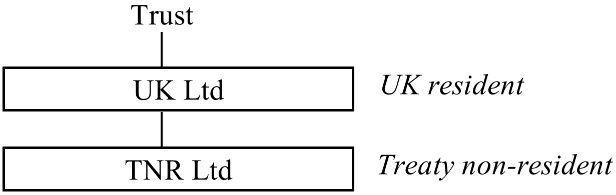
[94] I am unable to see the point of s.79B(1)(a). If trustees are participators in a close company, gains accrue to that company and are not attributed to the trustees. Probably the drafter followed other statutory precedents using this form, and did not realise the wording is unsuitable here. See 104.29.1 (Non-resident close company).

[95] For the meaning of this term, see 12.6.1 ("DTR arrangements" for CGT).

[96] Section 79B(4) TCGA provides:
"The references in subsection (3) above to 'any other relevant company' are to any

> company) not been resident in the UK, all or part of the chargeable gain would have been attributed to the trustees by reason of their participation in the company mentioned in subsection (1) above,
>
> section 3(7)[97] shall apply as if the company mentioned in para (b) above (and any other relevant company) were not resident in the UK.

Section 79B(3) addresses the more challenging case where:
(1) a trust owns a UK holding company ("UK Ltd")
(2) UK Ltd holds a treaty non-resident subsidiary ("TNR Ltd"):



UK Ltd is not taxed under s.3 on TNR's gain as UK Ltd can claim DT relief. In the absence of s.79B(3), TNR's gain apparently cannot be apportioned to the trust. The trust does not need DT relief. Section 79B(3) treats UK Ltd as non-resident, so that the gain accruing to TNR can be attributed to the trust.

64.41.1 *Critique of s.79B*

There are two objections to s.79B.

One is the constitutional point that the UK is in breach of DTAs with a standard form CG article. It might pragmatically be said that if the foreign state does not complain, that does not matter.

It is anomalous that s.79B adversely singles out trustee participators, ignoring individual and company participators.[98] Section 79B could have no part to play in a coherent and logical system of taxing offshore company gains.

other company which if it were not resident in the UK would be a company in relation to which section 3(7) applied with the result that all or part of the chargeable gain was attributed to the trustees as mentioned in that subsection."

[97] See 64.10 (Co chain: Indirect participator).

[98] CIOT make this point: "Reform of two anti-avoidance provisions" (2012) *https://www.kessler.co.uk/wp-content/uploads/2018/12/121002-s13-and-transfer-of-assets-CIOT-comments.pdf*
But the anomaly is reduced by the introduction of the Savings Clause.

64.42 Foreign tax credit relief: s.3

SP D23 provides:

> [1] Where a UK participator in a non-resident company which would be a close company if resident in the UK is chargeable to CGT on a proportion of a capital gain accruing to that company, tax credit relief may be given against UK CGT for the appropriate proportion of any overseas tax payable by the company in the country where it is resident in respect of its gain [s.9(2) TIOPA[99]];
> [2] alternatively, under [s.113 TIOPA[100]], the appropriate proportion of the overseas tax may be deductible in computing the shareholder's gains to the extent that the overseas tax has not qualified for relief under [s.9(2) TIOPA].

This relates to two reliefs:
(1) Foreign tax credit relief
(2) CGT computation deduction
The CG Manual summarises these two reliefs and gives a worked example:

> **CG57381 overseas tax payable by non-resident company** [Nov 2019]
> The non-resident company may have to pay tax on the gain in its country of residence. UK residents to whom the gain is apportioned will get relief for this tax. The two methods of giving relief are:
>
> - Either the UK resident can claim tax credit relief, or
> - a proportionate part of the tax can be claimed in computing the apportioned gain.
>
> Relief is given on a proportion of the foreign tax equal to the proportion of the total gain attributable to the UK resident. This amount is set-off against the charge to Capital Gains Tax or Corporation Tax on the relevant chargeable gains.
> If tax credit relief is allowed no deduction can be allowed in computing the chargeable gain.
> If the UK resident does not want to claim tax credit relief, the tax can be deducted in computing the gain, see INTM169010+. The foreign tax paid does not qualify for indexation allowance. Although it is an allowable deduction in computing the gain it is not a deduction within TCGA92/S38 (1)(a) or TCGA92/S38 (1)(b). This means it is not relevant allowable expenditure for indexation allowance purposes, see CG17240. In all other respects you compute and apportion the gain in the usual way

[99] See 111.1 (Credit for foreign tax).
[100] See 111.27 (CGT/IT computation deduction).

allowing the foreign tax paid as a deduction.

The Manual gives a worked example:

> The following example illustrates the differences between allowing any foreign tax paid by the non-resident company as tax credit relief or as a deduction in computing the gain.
>
> Facts
>
> - The non-resident company realises a gain of £20,000 computed under the normal Capital Gains Tax rules.
> - It has to pay £5,000 tax on this gain in its country of residence.
> - 75% of the gain is attributable to a UK resident.
>
> *Capital Gains Tax treatment*
>
> A [s.3 TCGA] charge of £20,000 @ 75% = £15,000 is apportioned to the UK resident. Relief for the tax paid can be claimed in two ways.
>
> • TAX CREDIT RELIEF
>
> Suppose the UK resident is liable to Capital Gains Tax at 40%. The tax payable would be £6,000. The UK resident can claim tax credit relief on the foreign tax of £5,000 paid by the company in the same proportion as the gain is apportioned. £5,000 @ 75% = £3,750. The total tax payable by the UK resident becomes £2,250.
>
> • DEDUCTION IN COMPUTING THE GAIN
>
> The foreign tax paid of £5,000 can be deducted in computing the gain. No indexation allowance is due on this deduction. The gain to be apportioned becomes £20,000 - £5,000 = £15,000. The taxpayer's share is £15,000 @ 75% = £11,250. At a rate of 40% the tax payable would be £11,250 @ 40% = £4,500.
>
> In this example you would expect the taxpayer to claim tax credit relief.

CHAPTER SIXTY FIVE

CAPITAL LOSSES

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65.2 Relief for losses
65.3 Loss within scope of CGT
65.4 Corporation tax losses
65.5 Computation of loss
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65.23 Loss-TAAR: Critique
65.24 DT relief on gain + loss

Cross references

The following topics are considered elsewhere:
20.15 (Loss in mixed fund)
56.22.6 (Loss on disposal of debt)
67.22 (Losses from offshore funds)
64.14 (Loss of non-resident co) - s.3 loss

65.1 Capital losses: Introduction

This chapter considers CGT relief for losses.

In this chapter:
"**Personal losses**" means losses accruing to individuals
"**Trust losses**" means losses accruing to trustees

I concentrate on the themes of this book, but the subject can only be understood in the context of the provisions as a whole.

65.2 Relief for losses

The rules are in s.1(3) TCGA for non-companies and s.2A(1) for companies. It is easier to follow if the provisions are read side by side:

s.1(3) TCGA	**s.2A(1) TCGA**
Capital gains tax is charged on the total amount of chargeable gains accruing to a person[1] in a tax year after deducting—	The amount of chargeable gains to be included in a company's total profits for an accounting period is the total amount of chargeable gains accruing to the company in the period after deducting—
(a) any allowable losses accruing to the person in the tax year, and	(a) any allowable losses accruing to the company in the period, and
(b) so far as not previously deducted under this subsection, any allowable losses accruing to the person in any previous tax year.	(b) so far as not previously deducted under this subsection, any allowable losses previously accruing to the company while it was within the charge to corporation tax

Para (a) deducts current year losses and para (b) deducts brought forward losses.

65.3 Loss within scope of CGT

The rule is in s.1E(1) TCGA for non-companies and s.2A(2) for companies. It is easier to follow if the provisions are read side by side:

[1] Section 1(3) refers to a "person", so it applies to individuals, trustees and PRs.

Section 1E TCGA

A loss is not an allowable loss if it accrues in a tax year at a time when, had a gain accrued instead, the gain would not have been chargeable to capital gains tax under this Act for the tax year (and see also sections 16(2) and 16A).

Section 2A(2) TCGA

For the purposes of corporation tax on gains "allowable loss" does not include a loss accruing to a company if, had a gain accrued, the company would not have been chargeable to corporation tax on the gain.

65.4 Corporation tax losses

Other rules specifically relating to capital losses for corporation tax are not discussed here.

65.5 Computation of loss

Section 16(1) TCGA provides a fairly commonsense rule to compute the amount of a loss:

> [a] Subject to sections 261B, 261D and 263ZA and except as otherwise expressly provided
> [b] the amount of a loss accruing on a disposal of an asset shall be computed in the same way as the amount of a gain accruing on a disposal is computed.

The exceptions listed in [a] are specialist topics not discussed here:

Section	**Topic**
s.261B	Trading loss treated as CGT allowable loss
s.261D	Post-cessation trade loss treated as CGT allowable loss
s.263ZA	Former employees: employment-related liabilities

65.6 Allowable loss

The legislation refers to "allowable" losses. Section 16(2) TCGA defines "allowable" loss:

> [a] Except as otherwise expressly provided, all the provisions of this Act which distinguish gains which are chargeable gains from those which are not, or which make part of a gain a chargeable gain, and part not, shall apply also
> [i] to distinguish losses which are allowable losses from those which are not, and
> [ii] to make part of a loss an allowable loss, and part not;
> [b] and references in this Act to an allowable loss shall be construed accordingly.

Thus there are two drafting techniques to disallow losses. The drafter may direct that a certain type of gain is not chargeable, from which it follows that a loss is not allowable. Or the drafter may direct that a loss is not allowable (in which case a gain from the same asset might be chargeable).

An allowable loss requires a notice or claim.[2] The notice must be given, and any dispute about the loss resolved, at the time the loss accrues, not when the loss is used, which may be at any subsequent time.

65.7 Loss of non-resident

Section 16(3) TCGA formerly provided:

> *A loss accruing to a person in a year of assessment where the residence condition is not met (see section 2(1A)) shall not be an allowable loss for the purposes of this Act unless, under section 2B, 10, 10B, 14D or 188D,[3] he would be chargeable to tax in respect of a chargeable gain if there had been a gain instead of a loss on that occasion.*

Section 16(3) was repealed in the 2019 CGT rewrite (saving the need to update the five cross references). I wonder if that was intended. There does not seem to be an express replacement. Perhaps the drafter thought that the general rule about losses sufficed.[4]

Applying the presumption of continuity, if needed, it continues to be the case that a loss accruing to a non-resident is not in general an allowable loss. This gives a symmetry with the rule that a gain accruing to a non-resident is not in principle subject to CGT.

There is also some relief for losses of non-resident trusts within s.86, 87 TCGA,[5] and non-resident companies within s.3 TCGA.[6]

65.7.1 *Non-resident UK land gains*

Section 1E TCGA provides:

[2] See 123.2.3 (Capital loss claims).

[3] The exceptions referred to are:

Old	**Now**	**Topic**
s.2B	-	ATED-related gains
s.10	s.1B	Non-resident trading through UK branch/agency
s.10B	s.2C	Non-resident company trading through UK PE
s.14D	s.1A(3)/s.2B(3)	NRCGT, now non-residents CGT/CT
s.188D	-	NRCGT group

[4] See 65.3 (Loss within scope of CGT).

[5] See 65.13 (Loss of non-resident trustees).

[6] See 64.14 (Loss accruing to non-resident co).

> (2) In addition, the only allowable losses that qualify for deduction from chargeable gains under section 1A(3) (non-UK residents) are those accruing to the person on disposals of assets within that subsection.
> (3) An allowable loss counts for the purposes of subsection (2) even if it accrues in a tax year in which the person was UK resident.

65.8 Loss in split year

A split year does not fall within non-residence condition A, as it is a year for which the individual is UK resident. Section 16(3A) TCGA provides:

> If the person is an individual and the year is a split year as respects that individual, subsection (3) also applies to a loss accruing to the individual in the overseas part of that year.

This still refers to s.16(3) which set out the rule which disallowed losses of non-residents but was (perhaps accidentally?) repealed. Applying the presumption of continuity, if needed, s.16(3A) continues to apply or extend this rule to disallow a loss accruing in the overseas part of a split year.

65.9 Loss on connected person disposal

Section 18 TCGA provides:

> (1) This section shall apply where a person acquires an asset and the person making the disposal is connected with him.
> (2) [See App.4.10.9 (Deemed non-arm's length)]
> (3) Subject to subsection (4) below, if on the disposal a loss accrues to the person making the disposal, it shall not be deductible except from a chargeable gain accruing to him on some other disposal of an asset to the person acquiring the asset mentioned in subsection (1) above, being a disposal made at a time when they are connected persons.[7]

Losses within s.18(3) are referred to as **"clogged"** losses.

The purpose of this rule is not obvious. Perhaps the thinking is that connected person disposals are unlike unconnected person disposals as an asset transferred to a connected person may continue to be available to the

[7] For completeness: s.18(4) TCGA contains an exemption for gifts for educational, cultural or recreational purposes, which (more or less) never has effect and ought to be repealed; s.18(5) TCGA deals with options, not discussed here.

transferor. The rule restricts a taxpayer's ability to accrue losses without the practical consequences that a sale to an unconnected person would entail.

Where there is a clogged loss, a person may make a disposal to the connected person on which a gain accrues, to set the loss against the gain. That should be regarded as acceptable, at least in principle. The drafter could have directed that the loss is not allowable but has expressly recognised that it could be set against some gains.

65.10 Chattels

65.10.1 *Gain on disposal of chattel*

Section 262 TCGA provides:

> (1) Subject to this section a gain accruing on a disposal of an asset which is tangible movable property shall not be a chargeable gain if the amount or value of the consideration for the disposal does not exceed £6,000.
> (2) Where the amount or value of the consideration for the disposal of an asset which is tangible movable property exceeds £6,000, there shall be excluded from any chargeable gain accruing on the disposal so much of it as exceeds five-thirds of the difference between—
> (a) the amount or value of the consideration, and
> (b) £6,000.

65.10.2 *Loss on disposal of chattel*

Section 262(3) TCGA provides:

> Subsections (1) and (2) above shall not affect the amount of an allowable loss accruing on the disposal of an asset, but for the purposes of computing under this Act the amount of a loss accruing on the disposal of tangible movable property the consideration for the disposal shall, if less than £6,000, be deemed to be £6,000 and the losses which are allowable losses shall be restricted accordingly.

The CG Manual gives a worked example:

> **CG76613 - Chattels: examples: losses** [Jul 2019]
> Mr C sells his son a painting for £5,000. It had originally cost him £8,000. He claims a loss of £3,000.
> As this is a transaction between connected persons, see CG14580+, the market value of the asset is used as the disposal consideration. The painting has a market value of £4,000.

However, as this is less than £6,000, the loss is restricted to:

Deemed consideration	£6,000
Less cost	-£8,000
Restricted loss	£2,000

It would be simpler just to disallow losses on disposals of assets for less than £6k, and it seems anomalous to allow a loss in circumstances when a gain would not be allowable.

The figure of £6,000 was fixed in 1989, so this relief has been substantially eroded by inflation. But it may not actually be a relief, as it is more likely to disallow a loss than to exempt a gain.

65.11 Losses used in best way

Section 1F TCGA provides:

> (1) Allowable losses may (subject to express provision to the contrary) be deducted from gains in whichever way is most beneficial to a person chargeable to capital gains tax.
> (2) Accordingly, an allowable loss may be deducted from a chargeable gain irrespective of the rate of tax at which the gain would otherwise have been charged.
> (3) Allowable losses that are deducted from gains may not be deducted any further than is necessary to eliminate the gains.
> (4) No part of an allowable loss may be relieved under this Act more than once.
> (5) So far as an amount has been relieved under the Income Tax Acts, it may not be further relieved under this Act.

It may be advantageous to set losses against:

(1) Residential/carried interest gains (in priority to ordinary gains)
(2) Ordinary gains (in priority to gains which qualify for DT relief)[8]

65.12 Losses on death

65.12.1 *Loss accruing before death*

Losses accruing before death are not carried forward to PRs.

Section 62(2) TCGA provides for carry-back of losses accruing in the year of death:

> Allowable losses sustained by an individual in the year of assessment in which he dies may, so far as they cannot be deducted from

[8] See 111.21.2 (FTC: Capital losses).

> chargeable gains accruing in that year, be deducted from chargeable gains accruing to the deceased in the 3 years of assessment preceding the year of assessment in which the death occurs, taking chargeable gains accruing in a later year before those accruing in an earlier year.

Section 62(2AA) TCGA provides the same rule for non-resident losses:

> Where relevant non-resident losses (see subsection (11)) are sustained by an individual in the year of assessment in which the individual dies, the losses may, so far as they cannot be deducted from chargeable gains accruing to the individual in that year, be deducted from any gains such as are mentioned in subsection (2A)(b) that accrued to the deceased in the 3 years of assessment preceding the year of assessment in which the death occurs, taking chargeable gains accruing in a later year before those accruing in an earlier year.

Section 62(11) provides the definition:

> "relevant non-resident loss" means an allowable loss accruing on a disposal which, had a gain accrued instead, would have been a relevant non-resident gain.

Carry-back on death seems unnecessary; its repeal would be a small but useful simplification.[9]

Section 62(2A) TCGA provides:

> Amounts deductible from chargeable gains for any year in accordance with subsection (2) above shall not be so deductible from any such gains so far as they are—
>
> (a) gains that are treated as accruing by virtue of section 87 or 89(2) (read, where appropriate, with section 1M), or
>
> (b) relevant non-resident gains (see subsection (11)).[10]

Thus the disallowance of personal losses against s.87 gains, and the disallowance of ordinary losses against relevant non-resident gains,

[9] This rule perhaps made more sense when introduced in 1965, in the context of the CGT charge on death. If so, the rule lost its rationale following the introduction of rebasing on death in 1971.

[10] Section 62(11) provides: "In this section "relevant non-resident gain" means—
(a) a gain that falls to be dealt with by section 1A(3) because the asset disposed of is within paragraph (b) or (c) of that subsection, or
(b) a gain that falls to be dealt with by section 1A(1) in accordance with section 1G(2) because the asset disposed of is within section 1A(3)(b) or (c)".

continues to apply on death. That is consistent with the general rule.[11]

65.12.2 *Unrealised loss at death*

If a person dies holds assets standing at a loss, the effect of CGT rebasing on death is to nullify the loss.[12] Losses could be preserved by a lifetime gift (or sale) to the spouse.[13]

Alternatively, if appropriate, the individual may realise the losses in the year of death (but before death) in order to carry them back against gains in the preceding three years.[14]

65.13 Loss of non-resident trust

65.13.1 *s.87 and trust loss*

Section 87(4) TCGA provides:

> The section 1(3) amount for a tax year for which this section applies to the settlement is—
>
> (a) the amount upon which the trustees would be chargeable to tax under section 1(3) for that year if they were resident in the UK in that year ...

Under this provision, trust losses in a tax year could be set against trust gains in the same year, in computing s.1(3) amounts (trust gains). But trust losses of an earlier year in which the trustees were not resident could not be carried forward and set against trust gains of a later year, because losses of nonresidents are disallowed.[15] However s.97(6) TCGA allows losses to be carried forward:

> Section 16(3)[16] shall not prevent losses accruing to trustees in a year of assessment for which section 87 of this Act or section 17 of the 1979 Act applied to the settlement from being allowed as a deduction from chargeable gains accruing in any later year (so far as they have not previously been set against gains for the purposes of a computation under either of those sections or otherwise).

[11] See 65.14 (Personal loss and s.87 gain).

[12] See 88.5 (Acquisition by PRs).

[13] See 65.22 (Spouse-transfer loss).

[14] See 65.12.1 (Loss accruing before death); 65.22 (Inter-spouse transfer).

[15] See 65.7 (Loss accruing to non-resident).

[16] The 2019 CGT rewrite (accidentally?) repealed s.16(3) but see 65.7 (Loss of non-resident).

Carried-forward trust losses will usually be used to reduce s.1(3) amounts (trust gains) of a subsequent year. If the trust became UK resident they could be set against gains to reduce the trust's own liability.

A trust is in this respect better than absolute ownership by a remittance basis taxpayer, whose personal losses may be disallowed.[17]

65.13.2 *s.86 and trust loss*

Under s.86 TCGA the settlor is taxed on what I call "**s.86 gains**", which is the amount on which trustees would be charged to tax if UK resident.[18] Under this provision trust losses in a tax year could be set against trust gains in the same year, in computing the s.86 gains. But trust losses of an earlier year in which the trustees were not resident could not be carried forward and set against trust gains of a latter year because non-residents losses are disallowed. However para 1(2) sch 5 TCGA provides:

> In construing section 86(1)(e) as regards a particular year of assessment [that is, in order to ascertain the s.86 gains] —
> (a) any deductions provided for by section 2(2) shall be made in respect of disposals of any of the settled property originating from the settlor, and
> (b) section 16(3)[19] shall be assumed not to prevent losses accruing to trustees in one year of assessment from being allowed as a deduction from chargeable gains accruing in a later year of assessment (so far as not previously set against gains).

For losses and sch 4B TCGA, see 62.21.6 (Loss set against s.86 gain).

65.13.3 *Loss: s.86 conditions not met*

A settlor who is not within s.86 may later come within the section.

Para 1(6) sch 5 TCGA provides:

> The following rules shall apply in construing section 86(1)(e) as regards a particular year of assessment ("the year concerned") in a case where the trustees fall within section 86(2)(a)—
> (a) if the conditions mentioned in section 86(1) are not fulfilled as regards the settlement in any year of assessment falling before the year concerned, no deductions shall be made in respect of

[17] See 65.16 (Loss of remittance basis taxpayer).

[18] See 60.11 (Section 86 gains condition).

[19] The 2019 CGT rewrite (accidentally?) repealed s.16(3) but see 65.7 (Loss of non-resident).

> losses accruing before the year concerned;
>
> (b) if the conditions mentioned in section 86(1) are fulfilled as regards the settlement in any year or years of assessment falling before the year concerned, no deductions shall be made in respect of losses accruing before that year (or the first of those years) so falling,
>
> but nothing in the preceding provisions of this sub-paragraph shall prevent deductions being made in respect of losses accruing in a year of assessment in which the conditions mentioned in section 86(1)(a) to (d) and (f) are fulfilled as regards the settlement.

65.13.4 *Loss on pre-1991 disposal*

For completeness, para 1(7) Sch 5 TCGA provides:

> In construing section 86(1)(e) as regards a particular year of assessment and in relation to a settlement created before 19th March 1991, no account shall be taken of disposals made before 19th March 1991 (whether for the purpose of arriving at gains or for the purpose of arriving at losses).

65.14 Personal loss and s.87 gain

Section 1E(4) TCGA provides:

> No allowable losses may be deducted from chargeable gains treated as accruing to an individual as a result of section 87, 87K, 87L or 89(2) (read, where appropriate, with section 1M).

The effect is that personal losses may not be set against s.87 gains accruing to the individual.

65.14.1 *Personal loss & s.87: Critique*

The disallowance of personal losses against s.87 gains was introduced in 1998 because of difficulties of interaction with taper relief.[20] The repeal of taper in 2008 should have allowed personal losses to be set once again against s.87 gains. Presumably this point was overlooked; or perhaps a deliberate decision was made to discourage the use of trusts. It is

[20] The CG Manual formerly provided: "**CG34272 Personal losses** [June 2005]
... For 1998–99 onwards the beneficiary's personal allowable losses are not available to reduce these attributed gains. It is not possible to identify any particular gain with a capital payment and so the changes introduced for Section 77 and Section 86 gains, see CG34865+, for 2003–04 onwards could not be extended to Section 87 gains."

suggested that the rule disallowing personal losses against s.87 gains should be repealed.

65.15 Personal loss and s.86 gain

The settlor can set their personal losses against s.86 gains, under s.1(3) TCGA.

For completeness, s.1E(5) TCGA deals with the situation where a settlor has made two or more settlements:

> If—
> (a) amounts (or elements of amounts) treated as accruing to an individual as a result of section 86 relate to different settlements, and
> (b) the deduction of allowable losses does not reduce the amounts or elements to nil,
>
> the deduction applicable to each amount is the proportion that the amount concerned bears to the total of the amounts.

This is only necessary to ascertain the amount which can be recovered under the settlor's indemnity against each settlement.

65.16 Loss of remittance basis taxpayer

65.16.1 *"Foreign/UK loss/gain"*

The legislation distinguishes between foreign losses and other losses. Section 16ZA(6) TCGA gives "**foreign loss**" a commonsense meaning:

> In this section "foreign loss" means a loss accruing from the disposal of an asset situated outside the UK.

In this chapter:
"**UK loss**" means a loss which is not a foreign loss, ie a loss on a disposal of a UK situate asset
"**Foreign gain**" means a gain accruing on a disposal of an asset situated outside the UK.
"**UK gain**" means a gain which is not a foreign gain, ie a gain on a disposal of a UK situate asset

65.16.2 *Background*

The complex rules can be better understood if one understands the constraints faced by the drafter.

It is difficult to think of a satisfactory rule for losses of a remittance basis taxpayer. Relief for all losses is too generous when only some gains are taxable. Relief for foreign losses remitted to the UK is not satisfactory, as it would usually be easy to remit the losses to the UK, so that amounts to a relief for (almost) all losses, at least for a well-advised taxpayer. Moreover in the case of the extinction of an asset there may be nothing to remit.

The pre-2008 solution was to disallow relief on foreign losses on foreign domiciliaries (to whom the remittance basis applied compulsorily – there was no claim procedure). The CGT remittance basis was a package with advantages and this disadvantage. This was a rough and ready solution, but simple and workable. However the introduction of the claim for the CGT remittance basis in 2008 changed the situation. If foreign losses of a foreign domiciliary were disallowed only in years that the individual claimed the remittance basis, then an individual might claim the remittance basis in the year that they realise gains and not in the year that they realise losses. On the other hand, the failure to claim would often be expensive in other ways, and as a simple and pragmatic solution it has much to commend it.

The FD draft clauses 2007 proposed to disallow all foreign losses of foreign domiciliaries, but that was not EU-law compliant (not to mention unfair). HMRC presumably agreed, and a new solution had to be devised in the rushed weeks between publication of the FD draft clauses and the Finance Bill, allowing insufficient time for HMRC to consider the issues, and none at all for consultation.

65.16.3 *Summary*

EN FB 2008 provides a summary:

> 355. The overall effect of these new rules is that:
> [1] on the first occasion when a non-UK domiciled individual claims remittance basis for a tax year, the individual may make an election in relation to their foreign losses;
> [2] if the individual does not make an election, foreign losses of that tax year and all future tax years will not be allowable losses; and
> [3] if the individual makes an election, special rules apply to the deduction of allowable losses where there are foreign chargeable gains.
> 356. The effect of the special rules is that:
> [1] where foreign chargeable gains are remitted to the UK in a tax year later than that in which the asset was disposed of:
>
> [a] no losses of that later year, or of any year later than that in which

they arose, are deductible from those gains, and

[b] [those gains] may not be covered by the [CGT annual exemption] of the year in which they are remitted; and

[2] if remittance basis is claimed for the tax year in which foreign chargeable gains arise, the allowable losses available for deduction from gains of that year are deducted

[a] first from foreign chargeable gains that both arise and are remitted in that year,

[b] then against foreign chargeable gains arising but not remitted in that year, and

[c] only then from any other (non-foreign) chargeable gains arising in that year.

The CG Manual provides:

> **CG25330 - Remittance basis: losses: introduction** [Nov 2019]
> ... For tax year 2008-09 onwards an individual may elect that such "foreign losses" which arise in the year of election or subsequent years are allowable, subject to certain special rules, against chargeable gains (TCGA92/S16ZA). The election is irrevocable and has effect in the year it is made and all subsequent years.
> The special rules for giving relief in respect of foreign losses have two main effects:
>
> - They prevent any loss (not just a foreign loss) of a later year being allowed against a foreign chargeable gain which arose in an earlier year but which is not remitted (and so not taxed) until the year of the loss or later (TCGA92/S16ZB). This is analogous to the "no carry back" rule where the remittance basis is not in point.
> - They limit the amount of losses available for relief against chargeable gains in a year by imposing a strict order in which they are matched with gains of various classes, including unremitted foreign chargeable gains (TCGA1992/S16ZC). Correct operation of these rules is likely to demand careful record-keeping by the taxpayer. ...

The CG Manual provides:

> **CG25330C - Remittance basis: matching rules for relieving losses: TCGA92/S16ZC** [Nov 2019]
> If an election has been made for foreign losses to remain allowable losses (see CG2530A) then, in a tax year in which the remittance basis applies and the individual is not domiciled in the UK, special rules apply to determine how gains are to be relieved by losses. In summary, the allowable losses deductable under TCGA92/S2 are matched:

> - Firstly, against foreign chargeable gains accruing in the tax year to the extent that they are remitted to the UK in that year
> - Secondly, against foreign chargeable gains accruing in that year to the extent that they are not so remitted and
> - Thirdly, against chargeable gains accruing in that year other than foreign chargeable gains (this does not include chargeable gains treated as accruing under TCGA92/S12 ie on the remittance basis).
>
> And then the amount on which Capital Gains Tax is charged in the year is the total amount of chargeable gains accruing in the year less the losses matched against gains in the first and third categories only.
>
> This means in effect that allowable losses which are matched with unremitted foreign chargeable gains are not available for relief against gains on UK assets, which therefore remain chargeable. The unremitted foreign chargeable gains are reduced by the losses matched with them, and so will not give rise to any tax charge if or when they are remitted (TCGA92/S16ZD(3))...
>
> A taxpayer will need to keep records to allow the correct operation of these provisions to be verified.

The F(no.2)A 2017 tweaked these rules by making provision for the possibility that a (deemed) domiciled individual may cease to be deemed domiciled, and later become UK resident again; but that is of limited importance.

65.16.4 *Foreign-loss election*

Section 16ZA(1) TCGA provides:

> An individual may make an election under this section in respect of—
> (a) the first tax year in which section 809B of ITA 2007 (claim for remittance basis) applies to the individual, or
> (b) the first tax year in which that section applies to the individual following a period in which the individual has been domiciled[21] in the UK.

I refer to para (a) as the **"first RB-claim year"**.

One can put off the first RB-claim year by not making a s.809B remittance basis claim, but that is not generally going to be worthwhile. In straightforward cases the first RB claim year will be 2008/09 or the first year of UK residence if later.

[21] Section 16ZA(7) ITA provides: "Section 835BA (deemed domicile) applies for the purposes of this section." This is the standard wording to apply the deemed domicile rules.

Para (b) will not be common: it will apply where (in short):

(1) An individual becomes deemed domiciled in the UK.
(2) The individual leaves the UK for 5 years.
(3) The individual becomes UK resident again, but not deemed domiciled, as time starts running again for the 15-year rule.

An individual within s.809D or 809E (sub-£2k taxpayer or non-taxpayer) is not within s.809B so all losses are allowable in the usual way.

65.16.5 *Permanent effect of election*

Section 16ZA TCGA provides:

> (2) Where an individual makes an election under this section in respect of a tax year, the election has effect in relation to the individual for—
> (a) that tax year, and
> (b) all subsequent tax years.
> ...
> (5) An election under this section is irrevocable.

Thus a taxpayer on claiming the remittance basis has a (more or less) once in a lifetime opportunity to make an election under s.16ZA (which I call a **"foreign-loss election**") and this election (if made) applies for the rest of their life. It is impossible to know what will be the best choice and the taxpayer will have to guess. This is almost unprecedented in tax legislation.

65.16.6 *Individual becomes UK dom*

A foreign-loss election lapses if and when the individual becomes UK domiciled. Section 16ZA TCGA provides:

> (2A) But if after making an election under this section an individual becomes domiciled[22] in the UK at any time in a tax year, the election does not have effect in relation to the individual for—
> (a) that tax year, or
> (b) any subsequent tax year.
> (2B) Where an election made by an individual under this section in respect of a tax year ceases to have effect by virtue of subsection (2A), the fact that it has ceased to have effect does not prevent the individual from making another election under this section in respect of a later tax year.

[22] See above footnote.

The professional bodies have published a set of Q&As[23] which includes two questions on this topic. Question 10 provides:

> Do surplus losses which arise while a capital loss election is in force remain available to offset gains accruing once deemed domiciled?
>
> **Suggested answer put to HMRC**
>
> Section 16ZA TCGA provides for an election, the consequence of which is to confirm foreign losses as allowable losses. While the election has effect, s16ZB, s16ZC and s16ZD also have effect (subject to other specific criteria) and provide for special ordering rules on how to offset foreign losses.
>
> Once an individual becomes deemed domiciled, s16ZA(2A) disapplies the election for that, and subsequent, tax years and consequently s16ZB, s16ZC and s16ZD are also turned off. Surplus foreign losses which arose while the election was in place remain as allowable losses under s16 once the individual becomes deemed domiciled. And since the special ordering rules at s16ZB, s16ZC and s16ZD no longer apply, the surplus losses may be offset against both UK and foreign gains which arise (subject to any normal restrictions that might apply eg, to a foreign loss that is also a clogged loss) once the individual is deemed domiciled.
>
> For individuals who did not make the foreign capital loss election, any losses which accrued prior to becoming deemed domiciled are not allowable losses and remain so.
>
> **HMRC Comments**
>
> Agreed.

Question 11 provides:

> Can capital losses which are realised while deemed domiciled be offset against Remittance Basis foreign chargeable gains that are remitted to the UK during the deemed domiciled period?
>
> *Suggested answer*
>
> S16ZB operates to stop allowable losses being offset against earlier foreign chargeable gains remitted at a later date (i.e. to prevent the effective carry back of losses). Loss relief is instead provided by the special ordering rules in s16ZC.

[23] The full title is "Rebasing and Adjustment to the CGT Foreign Capital Losses Election Professional Bodies Q&A". See *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2019/taxguide-09-19-foreign-capital-losses.ashx* or *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/225a7316-5841-4f2e-9a4b-cd789906664a/RebasingAdjustments.pdf*

> However, once an individual becomes deemed domiciled, s16ZA(2A) disapplies the election under s16ZA for that, and subsequent, tax years and consequently s16ZB, s16ZC and s16ZD are also turned off. Thus, allowable losses which are realised while the individual is deemed domiciled can be offset against Remittance Basis foreign chargeable gains remitted while the individual is deemed domiciled.
>
> It should be noted that the same result applies where the individual did not make the foreign capital losses election (that is a loss realised after an individual is deemed UK domiciled can be set against a gain that: (i) was realised when an individual was not deemed UK domiciled; and (ii) is remitted when the individual is deemed UK domiciled).
>
> **HMRC Comment**
>
> Agreed

65.16.7 *Making election/time limit*

RDR Manual provides:

> **RDRM32060 - Foreign chargeable gains loss election** [Jan 2019]
>
> The election should be made for the first year for which the remittance basis is claimed, irrespective of whether the individual has any foreign chargeable gains or overseas losses in that year. The election will usually be expected to be made within the white space in the Capital Gains supplementary pages of the same SA Return as the first remittance basis claim is made. ...

The election is made in form SA108 (2022/23) box 54 (Any other information). HMRC, “Capital gains summary notes” (2022/23) provides:

> if you’re making a claim or an election for losses on foreign assets to be allowable losses, write in the box ‘I elect for my foreign losses to be allowable losses’

The usual time limits apply.[24] The best approach may be to wait until the time limit approaches and make the decision then to elect or not, with the benefit of four year’s hindsight.

65.17 Foreign loss disallowed if no election

Section 16ZA(3) TCGA provides:

> If an individual does not make an election under this section in respect of a year referred to in subsection (1)(a) or (b), foreign losses accruing

[24] See 123.2.3 (Capital loss claims).

to the individual in—

(a) that tax year, or

(b) any subsequent tax year except one in which the individual is domiciled[25] in the UK,

are not allowable losses.

In short, if no election is made, foreign losses accruing to a foreign domiciliary are not allowable:

(1) in the year that a s.809B remittance basis claim is made; or
(2) in any subsequent year (even if no remittance basis claim is made in that year) up to the acquisition of UK domicile

There are therefore four or five distinct periods for a UK resident foreign domiciled individual, assuming no foreign-loss election is made:

(1) Before 2008/09: foreign losses are disallowed[26]
(2) From 2008/09:
    (a) Period when UK resident but before making a s.809B remittance basis claim: foreign losses are allowable
    (b) The first RB-claim year, and subsequently while non-domiciled: foreign losses are disallowed
    (c) After becoming UK domiciled: foreign losses are allowable
(3) If individual ceases to be UK deemed domiciled and returns to UK, the para (2) cycle begins again.

If a foreign-loss election is not made, UK losses are allowable in the normal way, and so:

(1) Set against
    (a) UK gains and
    (b) foreign gains (whenever realised) in the year that they are remitted to the UK; or

[25] Section 16ZA(7) ITA provides: "Section 835BA (deemed domicile) applies for the purposes of this section." This is the standard wording to apply the deemed domicile rules.

[26] Section 16(4) TCGA as it had effect before 2008/09 provided:

> "In accordance with section 12(1), losses accruing on the disposal of assets situated outside the UK to an individual resident or ordinarily resident but not domiciled in the UK shall not be allowable losses."

This wording is confusing. It means that losses accruing to a foreign domiciliary on a disposal by the foreign domiciliary of foreign situated assets are not allowable. It does not mean that losses are not allowable on a disposal (by any person) to a foreign domiciliary.

(2) Carried forward.

Para 3(5) sch 8 F(no.2)A 2017 provides a transitional rule:

> Where—
> (a) an individual makes an election under section 16ZA of TCGA 1992 as originally enacted for a tax year before the tax year 2017-18, but
> (b) after making the election the individual becomes domiciled in the UK at any time in a tax year,
>
> sections 16ZB and 16ZC of that Act do not have effect in relation to the individual by virtue of that election for that tax year or any subsequent tax year.

65.17.1 *Planning*

Consider the position before disposing of an asset on which an (otherwise) non-allowable loss will accrue. Possibilities are:
(1) making assets UK situate prior to disposal[27]
(2) an inter-spouse transfer[28]

A foreign domiciliary who claims the remittance basis may be worse off than if they had not made the claim, if (1) they fail to make a foreign-loss election (2) they realise disallowed foreign losses; and (3) they remit sufficient gains to the UK.

An individual who comes to the UK may consider:
(1) realising historic foreign losses in the first year of residence (or in the UK part of a split year); and
(2) not making a s.809B remittance basis claim until after the first year of residence.

65.18 Effect of loss foreign-election

For the purposes of the following discussion it is necessary to distinguish:
(1) the year in which a gain actually accrues and
(2) the year in which a gain is remitted (the year of remittance)

A remittance basis taxpayer has three types of foreign gains:
"**Promptly-remitted gains**" means gains remitted in the year that the gains actually accrue.

[27] Contrast 103.24 (Planning: Changing situs).
[28] See 65.22 (Inter-spouse transfer).

"**Subsequently-remitted gains**" means gains which are remitted in a year after the gains actually accrue.
"**Unremitted gains**" means gains which are not remitted and so remittance basis exempt.

Para 2 sch 1 TCGA provides:

> (1) This paragraph applies if—
> (a) gains are treated as accruing to an individual in a tax year as a result of paragraph 1 [remittance basis],[29]
> (b) the tax year is later than the one ("the actual year of accrual") in which those gains actually accrued to the individual, and
> (c) an election under section 16ZA (election for foreign losses to be allowable losses) has effect for both the tax year and the actual year of accrual.
> (2) No allowable losses may be deducted under section 1 from the gains.
> (3) This prohibition—
> (a) applies regardless of whether or not the allowable losses accrue on disposals of foreign assets, but
> (b) does not prevent the prior application of paragraph 3(3) in relation to the gains (which contains a rule for reducing the amount of the gains by reference to losses).

In short, para 2 applies to subsequently-remitted gains accruing in or after the RB-claim year. The rules do not apply to gains which accrued before that year. In particular, the rules do not apply to pre-2008 gains, since no s.809B claim or foreign-loss election was made in those years.
The CG Manual provides:

> **CG25330B: no effective carry back of foreign allowable losses: TCGA92/S16ZB*** [May 2020]
> If an election has been made for foreign losses to remain allowable losses (see CG25330A) then a loss may not be set against chargeable gains taxable on the remittance basis in a tax year -known as the applicable tax year[30] - after the foreign chargeable gains which are being remitted arose, if the foreign chargeable gain arose in a year before the loss. This means that a loss cannot be "carried back" and set against a foreign chargeable gain of an earlier year, even if that gain is not taxed until the year of loss because of the remittance basis.

[29] See 17.14 (Charge on remitted gains).
[30] The Manual is using the terminology of the pre-2017 legislation.

> **Example:** (Henri)
> H elects to use the remittance basis in 2014-15 and has an unremitted foreign chargeable gain of £1m in that year. He also elects for his foreign losses to remain allowable losses. In 2016-17 he remits the gain to the UK and has a foreign loss of £500,000. He does not elect to use the remittance basis in 2016-17. The relevant tax year[31] is 2014-15 and the applicable tax year is 2016-17. Foreign chargeable gains accrued in or after the relevant tax year but before the applicable tax year and a chargeable gain is treated as accruing in the applicable tax year when those gains are remitted. The conditions of TCGA92/S16ZB(1)* are therefore satisfied. The remitted gains are known as relevant gains and are excluded from the total amount of chargeable gains from which losses are deducted under TCGA92/S2*. The relevant gains are nonetheless included in the amount on which Capital Gains Tax is charged for the applicable tax year (TCGA92/S16ZB(2)-(3)*). So the £500,000 loss may not be set against the chargeable gain of £1m treated as accruing to Henri in 2016-17.
> *These provisions were re-written for disposals from 6 April 2019 see CG10150.
> Note that this prohibition of carry-back applies to all losses, not just to foreign losses.
> Note also that this prohibition applies whether or not the remittance basis applies in the applicable year, ie the year in which the foreign chargeable gain is remitted.

65.18.1 *Setting losses against gains*

Para 3 sch 1 TCGA directs that losses are to be used in a manner which is not the most favourable to the taxpayer:

> (1) This paragraph applies in the case of an individual for a tax year if—
> (a) the remittance basis applies to the individual for the tax year, and
> (b) an election under section 16ZA has effect for the tax year.
> (2) Allowable losses accruing to the individual must be matched to chargeable gains accruing to the individual in accordance with paragraph 4.
> (3) If allowable losses are matched to chargeable gains accruing on disposals of foreign assets—
> (a) which actually accrue in the tax year, but
> (b) which are, as a result of paragraph 1, treated as not accruing in

[31] The Manual is using the terminology of the pre-2017 legislation.

> the tax year,
>
> the amount of those gains is reduced by the matched amount (and the allowable losses are reduced accordingly).
>
> (4) So far as allowable losses are matched to other chargeable gains, they are deducted from chargeable gains accruing to the individual in the tax year.
>
> (5) This is subject to—
>
> (a) paragraph 2 (no use of allowable losses against foreign gains remitted in later year), and
>
> (b) section 1E(4) (prohibition of deduction of losses from gains treated as accruing under section 87, 87K, 87L or 89(2)).

So in my terminology, losses are set against gains in this order:

(a) promptly-remitted gains;
(b) unremitted foreign gains;
(c) UK gains.

Losses set against (b) may not be wasted but they are not used until the unremitted gains are remitted.

Para 4 sch 1 TCGA provides:

> (1) This paragraph explains how, for the purposes of paragraph 3, allowable losses are matched to chargeable gains in the case of an individual to whom that paragraph applies for a tax year.
>
> (2) The losses are matched to the gains in the following order—
>
> *first*, gains actually accruing to the individual in the tax year on the disposal of foreign assets so far as they are remitted to the United Kingdom in the tax year;
>
> *second*, gains actually accruing to the individual in the tax year on the disposal of foreign assets so far as they are not remitted to the United Kingdom in the tax year;
>
> *third*, any other gains accruing to the individual in the tax year.
>
> (3) If the tax year is a split year, the matching under the first and second steps is to be done by reference to the extent to which the gains are, or are not, remitted in the UK part of the year.
>
> (4) If there are losses to be matched to gains under the second step but the losses are insufficient to eliminate the gains—
>
> (a) the losses are to be matched against gains accruing on the most recent day first (and then the next most recent day and so on until none of the losses remain), and
>
> (b) if losses cannot be matched fully against gains accruing on a particular day, the appropriate portion of the losses is matched against each of the gains.

(5) "The appropriate portion" means the amount of each gain accruing on the day divided by the total amount of all of the gains accruing on the day.

65.18.2 *HMRC example*

The CG Manual provides:

> **CG25330D - Remittance basis: matching rules for relieving losses: example: Section S16ZC TCGA 1992** [Nov 2019]
>
> *Example (Johann)*
>
> J is a remittance basis user in all years. He has made an election under Section 16ZA TCGA 1992 so his foreign losses are allowable, subject to the rules in Section 16ZB TCGA 1992 and Section 16ZC TCGA 1992. His history of gains and losses is as follows:

	UK gains	UK losses	Foreign gains	Cash brought to UK	Foreign losses
2008-09	100,000	25,000	30,000	0	0
2009-10	17,000	5,000	50,000	60,000[32]	30,000
2010-11	0	0	12,000	20,000[33]	25,000

The HMRC analysis is as follows:

2008-09

Relevant allowable losses are £25,000 (Section 16ZC(7) TCGA 1992)

Chargeable gains classified and ordered according to Section 16ZC(3) TCGA 1992:

a) 2008-09 foreign chargeable gains remitted	Nil
b) 2008-09 foreign chargeable gains not remitted	30,000
c) 2008-09 other chargeable gains [UK gains]	100,000

Step 1 deduct relevant allowable losses from the gains so ordered. The net gains are therefore:

a) 2008-09 foreign chargeable gains remitted	Nil
b) 2008-09 foreign chargeable gains not remitted	5,000
c) 2008-09 other chargeable gains	100,000

Step 2 the total amount of chargeable gains on which tax is charged by Section 2(2) TCGA 1992 is equal to the amount it would be if there were no relevant allowable losses (i.e. £100,000 UK gains) LESS the total amount deducted at step 1 from gains in classes (a) and (c) (i.e. £Nil).

So in 2008-09 Capital Gains Tax is charged on £100,000. The effect of the rules is to use allowable losses to frank unremitted foreign chargeable gains even though that leaves UK gains in charge.

[32] [HMRC's note] accepted after enquiry to establish facts and application of mixed fund rules ... as being £30,000 from 2008-09 plus £30,000 from 2009-10

[33] [HMRC's note] accepted after enquiry to establish facts and application of mixed fund rules ... as being all from 2009-10

The foreign chargeable gain not remitted is reduced by the allowable UK loss deducted from it at step 1 so going forward it becomes £5,000 (Section 16ZD (3) TCGA 1992). This is important to remember if it is remitted in a later year (see below).

2009-10

Relevant allowable losses are £35,000 (Section 16ZC(7) TCGA 1992)

Chargeable gains classified and ordered according to Section 16ZC(3) TCGA 1992:

a) 2009-10 foreign chargeable gains remitted	30,000
b) 2009-10 foreign chargeable gains not remitted	20,000
c) 2009-10 other chargeable gains	17,000

Step 1 deduct relevant allowable losses from the gains so ordered. The net gains are therefore:

a) 2009-10 foreign chargeable gains remitted	Nil
b) 2009-10 foreign chargeable gains not remitted	15,000
c) 2009-10 other chargeable gains	17,000

Step 2 the total amount of chargeable gains on which tax is charged by Section 2(2) TCGA 1992 is equal to the amount it would be if there were no relevant allowable losses(i.e.

£35,000 remitted gains[34]
£17,000 UK gains
£52,000

LESS the total amount deducted at step 1 from gains in classes (a) and (c) (i.e. £30,000).

So in 2009-10 Capital Gains Tax is charged on £22,000 (52,000 - 30,000). The effect of the rules is to use allowable losses to frank unremitted foreign chargeable gains even though that leaves UK gains in charge.

The foreign chargeable gain not remitted (category (b)) is reduced by the loss deducted from it at step 1, so it becomes £15,000 (Section 16ZD(3) TCGA 1992). This will be significant if it is remitted in a later year (see below).

2010-11

Relevant allowable losses are £25,000 (Section 16ZC(7) TCGA 1992)

Chargeable gains classified and ordered according to Section 16ZC(3) TCGA 1992:

a) 2010-11 foreign chargeable gains remitted	Nil
b) 2010-11 foreign chargeable gains not remitted	12,000
c) 2010-11 other chargeable gains	Nil

Step 1 deduct relevant allowable losses from the gains so ordered. The net gains are therefore:

a) 2010-11 foreign chargeable gains remitted	Nil
b) 2010-11 foreign chargeable gains not remitted	Nil
c) 2010-11 other chargeable gains	Nil

Step 2 the total amount of chargeable gains on which tax is charged by Section 2(2) TCGA 1992 is equal to the amount it would be if there were no relevant

[34] £5,000 from 2008-09 (after set-off of 2008-09 losses) plus £30,000 from 2009-10

allowable losses (i.e.
£15,000, the adjusted residue of the 2009-10 gain; see above)
LESS the total amount deducted at step 1 from gains in classes (a) and (c) (i.e. £Nil).
So in 2010-2011 Capital Gains Tax is charged on £15,000. Note that none of the foreign loss arising in 2010-2011 can be relieved against the chargeable gain which accrued in the earlier year, even though that gain was not remitted until the year of loss. This is consistent with the fact that UK losses cannot be carried back to set against gains of earlier years.
The foreign chargeable gain not remitted (category (b)) is reduced by the loss deducted from it at step 1, so it becomes £Nil (Section 16ZD (3) TCGA 1992). It has been franked by the loss of the period and will not give rise to a taxable remittance if cash etc representing it is brought to the UK in a later year.
The unused balance of allowable losses (£25,000 − 12,000 = £13,000) is carried forward and may be used to relieve chargeable gains of later years. (Section 16ZD(2) TCGA 1992).

65.18.3 *Record-keeping*

Record-keeping from 2008 is onerous. Before 2008 a taxpayer had only to keep a total of brought forward losses and remitted gains. But now (if a taxpayer makes a foreign-loss election) they need to keep track of which year losses accrue, and which day and year subsequently-remitted gains accrue, in order to apply these loss rules.

65.19 When is loss election worthwhile

Careful timing of realisation of losses and of remittances is necessary in order to maximise loss relief if a foreign-loss election is made. A few general points can be made.

A person who will realise UK losses and not foreign losses should not make a foreign-loss election.

A person who will realise UK losses and foreign losses, but can use inter-spouse transfers to avoid disallowable foreign losses should not make an election.

A person who will realise foreign losses and not UK losses should make an election.

In other cases it is a matter of guesswork.

65.20 Basic planning for losses

The restriction on carry-back of losses means that careful timing of disposals may be needed to match losses to gains.

The realisation of losses by non-residents is wasteful. Unless the temporary non-residence rules apply:

(1) An individual leaving the UK may consider realising losses before they become non-resident.

(2) An individual coming to the UK may postpone the disposal of assets with unrealised losses until they become UK resident.

65.21 Capital-loss TAAR

Capital loss relief is restricted by a TAAR.[35] Section 16A(1) TCGA provides:

> For the purposes of this Act, "allowable loss" does not include a loss accruing to a person if—
>
> (a) it accrues to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements, and
>
> (b) the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage.

I refer to this as the **"capital-loss TAAR"**.

HMRC have issued guidance which I call the "**loss-TAAR guidance**".[36]

There are two stages to the application of s.16A:

(a) *Loss-arrangement analysis*: To identify the arrangement[37] within (a): I refer to such arrangements as a "**loss-arrangement**".

(b) *Main-purpose analysis* To ascertain whether the (or a) main purpose of the loss-arrangement is to secure a tax advantage **("a tax-advantage purpose"**).

65.21.1 *Loss-arrangement*

Section 16A(1)(a) TCGA provides:

> For the purposes of this Act, "allowable loss" does not include a loss accruing to a person if—
>
> (a) it accrues to the person directly or indirectly in consequence of, or otherwise in connection with, any arrangements...

At first glance s.16A(1) contains two conditions, but para (a) in isolation

[35] See 3.1 (TAAR/unallowable purpose test).

[36] CG Manual Appendix 9 CGT: avoidance through the creation and use of capital losses [Jul 2019].

[37] I do not distinguish between plural *arrangements* and the singular *arrangement*.

does not amount to anything: a loss will (more or less) never accrue without an arrangement.[38] The purpose of para (a) is to *identify* "the arrangements" referred to in para (b), that is, the arrangements whose main purpose must be ascertained. One cannot ascertain the purpose of an arrangement until one knows what the arrangement is.

"The arrangements" are those:

(1) in consequence of which (directly or indirectly) the loss accrues to the person,[39] or

(2) in connection with which, the loss accrues to the person.

65.21.2 *Gain-transfer arrangement*

Correct identification of the arrangement may make a crucial difference to the outcome. Suppose:

(1) H realised a loss.

(2) Some time later there is an arrangement (a "gain-transfer arrangement") under which:

   (a) W transfers an asset to H (by gift or sale).

   (b) H disposes of the asset and realises a gain.

   (c) Possibly, H transfers the proceeds of sale back to W (by gift or payment of the purchase price).[40]

The main purpose of the gain-transfer arrangement is to secure that a gain is set against H's loss. However it is considered that there is no loss-arrangement (so the TAAR does not apply), because:

(a) the loss did not arise in consequence of the gain-transfer arrangement; and

(b) the loss did not accrue in connection with the gain-transfer arrangement. The loss accrued entirely independently of that arrangement, indeed (let us assume) before that arrangement was ever contemplated.

[38] A disposal on which a loss accrues is a single step, but probably constitutes "arrangements" as the plural includes the singular. If that is right then a loss can never accrue without an arrangement. But that does not matter, as a single step arrangement is not likely to have a tax-advantage purpose.

[39] The statutory words "directly or indirectly in consequence of" are otiose, as if the loss accrues *in consequence of* the arrangements it must accrue *in connection with* the arrangements.

[40] In practice step (c) is not necessary, and it may be wise not to do it; but it is included for the purpose of the example.

Steps (1) and (2) do not constitute a single arrangement.[41]

Section 16A(3) TCGA provides:

> For the purposes of subsection (1) it does not matter—
> (a) whether the loss accrues at a time when there are no chargeable gains from which it could otherwise have been deducted, or
> (b) whether the tax advantage is secured for the person to whom the loss accrues or for any other person.[42]

That does not add anything, or anything much. One would not expect an anti-avoidance rule to be narrowly construed. Section 16A(3)(a) does not alter the analysis of the gain-transfer arrangement: the reason that the arrangement is not a loss-arrangement is not *because* the loss accrues at a time when there are no chargeable gains (although it does accrue at such a time).

A similar point arises with clogged losses. Suppose:

(1) T transfers an asset to C (a connected person, perhaps a trust made by T) by gift or by sale. A loss accrues which is a clogged loss.[43]

(2) Some time later:
  (a) T transfers another asset to C, by gift or sale, on which a gain accrues. The clogged loss can be set against the gain.
  (b) C sells the asset.
  (c) Possibly, C transfers the proceeds of sale back to T (by gift or payment of the purchase price).[44]

Step 2 constitutes a gain-transfer arrangement with a tax-advantage purpose. However it is considered that there is no loss-arrangement (so the TAAR does not apply), because:

(a) the loss did not arise in consequence of the gain-transfer arrangement; and

(b) the loss did not accrue in connection with the gain-transfer arrangement. The loss accrued entirely independently of that

arrangement, indeed (let us assume) before that arrangement was ever

[41] The GAAR might need separate consideration.

[42] What is the point of s.16A(3)(b) TCGA? How can a tax advantage be secured for a person *other* than the person to whom the loss accrues? The answer is if the loss accrues to a non-resident trust or company, for the tax advantage might be enjoyed by a settlor (under s.86) or a beneficiary (under s.87) or a participator (under s.3).

[43] See 65.9 (Loss on connected person disposal).

[44] In practice step (c) is not necessary, and it would be wise not to do it; but it is included for the purpose of the example.

contemplated.

65.21.3 *"Tax advantage"*

Section 16A(2) TCGA provides the standard definition of "tax advantage".[45]

65.21.4 *Tax-advantage purpose*

Section 16A(1) TCGA provides:

> For the purposes of this Act, "allowable loss" does not include a loss accruing to a person if...
>
> (b) the main purpose, or one of the main purposes, of the arrangements is to secure a tax advantage.

Where the (or a) main purpose is to secure a tax advantage, I refer to it as **"a tax-advantage purpose"**.

65.21.5 *"Genuine" loss and the TAAR*

The loss-TAAR guidance provides:

> The [TAAR] does not apply to a simple sale at arm's length of an investment standing at a loss and the setting of that loss against gains, utilising the statutory relief for losses. Such a transaction does not constitute arrangements whose main purpose is to secure a tax advantage, as the main purpose is the disposal of the unprofitable investment.

And again:

> Nor will the [TAAR] ordinarily[46] prevent a genuine loss on a real disposal of an asset from being set off against a person's own gains, including the case where, before the real disposal that gives rise to the genuine loss, the person acquires the relevant asset from a spouse or civil partner at no gain/no loss under section 58 [TCGA].

According to this, s.16A does not (in short) apply to genuine losses, and a loss following an inter-spouse transfer ("a spouse-transfer loss") is an example of a genuine loss.

[45] See 3.19.1 (Tax advantage: Definitions).

[46] The word "ordinarily" seems unnecessary, given that the sentence is already qualified by the requirements of a "genuine" loss and a "real" disposal; but the author did not want to give any hostage to fortune.

What is meant by genuine loss? At first the unlawyerlike term "genuine" seems almost impossible to pin down, but I think that the concept intended here is the tax avoidance/mitigation distinction.[47] A loss is genuine (in the intended sense) if it is in accordance with the intention of parliament, which may be inferred from indicia such as its economic consequences.

The loss-TAAR guidance provides:

> The straightforward use of a statutory relief does not of itself bring arrangements within the TAAR.

The straightforward use of a statutory relief (almost) always involves an arrangement, and often, perhaps usually, there is a tax-advantage purpose; but it is not tax avoidance.

The loss-TAAR guidance gives 18 examples:

Example	**Facts**	**Result**
1	Avoidance scheme: loss on second-hand policy	Caught
2	Avoidance scheme manipulating co value	Caught
3	Avoidance scheme: matched options	Caught
4	H sells to realise loss; W buys unbeknown to H (!)	OK
5	Inter-spouse transfer to transfer loss to spouse	OK
6	H sells, W buys same shares & transfers to H	Caught
7	As eg 6, but W buys different no. shares	"less likely" caught
8	As eg 6, but W waits 30 days	OK
9	Share sale to realise loss + repurchase after 30 days	OK
10	Sale to realise loss + option to repurchase	Caught
11	Trustees sell to realise loss	OK
12	As eg 11, + trustees fund beneficiary who buys asset	OK
13	As eg 11	OK
14	Trustees distribute asset to beneficiary to realise loss	OK
15	Disposal to purchase EIS shares & obtain EIS relief	OK
16	Disposal of EIS shares	OK
17	Liquidation of company	OK
18	Trustees make deliberate sch4B transfer of value	Caught

Examples 15 and 16, concerning EIS relief, illustrate the "genuineness" point. Example 15 is a sale (realising a loss) in order to raise funds to purchase EIS shares:

> An individual, J, invests in shares under the Enterprise Investment Scheme (EIS), with a view to securing income tax relief.

[47] See 3.21.3 ("Genuine").

> In order to fund the purchase of the shares J sells a capital asset which is standing at a loss to a third party.
>
> To decide whether or not the TAAR applies, it is necessary to consider whether there have been arrangements, and whether a main purpose of those arrangements was the securing of a tax advantage.
>
> In this case it is clear that there have been arrangements within the meaning of the legislation, as J has disposed of the capital asset and used the proceeds to fund the purchase of the EIS shares.

That is correct.

> To decide what J's main purpose was in entering into these arrangements, it is necessary to consider the overall economic objective of the arrangements, and whether that objective is being fulfilled in a straightforward way, or whether additional, complex or costly steps have been inserted.
>
> J has made a real disposal of a capital asset in a straightforward way, and has incurred a genuine economic loss. There have been no additional, costly or complex steps inserted into the transactions. The fact that the disposal has been made with a view to using the proceeds to invest in shares which fall within the EIS tax regime does not mean that the arrangements have been entered into with a main purpose of securing a tax advantage, because the straightforward use of a statutory relief does not of itself bring arrangements within the TAAR. Hence the TAAR does not apply.

Example 16 is the disposal of EIS shares at a loss:

> Y has disposed of a capital asset and realised a chargeable gain, but the gain is deferred because he invests a sufficient amount in shares issued under the Enterprise Investment Scheme (EIS).
>
> Unfortunately the EIS company in which Y has invested does not succeed, and the shares later become worthless.
>
> Y makes a negligible value claim under section 24(2) and the resulting loss on the shares is set against
>
> [a] the original gain that is brought back into charge under the EIS rules,
>
> [b] or possibly against Y's income under [s.131 ITA].
>
> To determine whether or not the TAAR applies so that the losses Y has realised on the shares in the EIS company are not allowable, it is necessary to decide whether or not arrangements have been entered into with a main purpose of realising a tax advantage. It is clear that there have been arrangements...

More analytically, the question is not *whether* there are arrangements, but *what* are the arrangements. HMRC assume that the arrangement is (1) the acquisition of the EIS shares and (2) the negligible value claim. I doubt if these unconnected steps constitute one set of arrangements. However it does not matter:

> ... and to decide whether securing a tax advantage was a main purpose of those arrangements it is necessary to take account of all the circumstances in which the arrangements were entered into, including the participants' overall economic objective, and whether that objective is being fulfilled in a straightforward way, or whether additional, complex or costly steps have been inserted.
>
> In this case, Y has made a real investment in an EIS company, and there is nothing to suggest that the EIS company was other than a genuine investment opportunity from Y's perspective. The negligible value claim only creates a disposal for capital gains purposes. No additional, costly or complex steps have been inserted as part of the arrangements; Y is taking advantage of the tax reliefs offered in respect of EIS investments in a straightforward manner. The loss Y suffers on the shares in the company is a real economic loss. Taken together, these factors suggest (?) that there was no main purpose of securing a tax advantage and so Y's loss is allowable. It makes no difference that a gain on the EIS shares may have been exempt. The [capital-loss TAAR] does not have any effect on the normal operation of the relief.

The difficulty is to reconcile the loss-TAAR guidance with the words of the statute. One might simply give up at this point:

> We think that the words "**tax avoidance**" should be substituted for "**tax advantage**" ... the guidance contradicts the legislation. Some transactions (such as transfers between spouses) are stated in the guidance not to be caught by the TAAR, when it is strongly arguable that they are caught.[48]

[48] CIOT consultation response (8 February 2007). An earlier version of the loss-TAAR guidance (27 March 2007) stated this expressly:

> "5. The effect of the legislation will be to restrict the use of capital losses resulting from the arrangements where *tax avoidance* is the main purpose or one of the main purposes of the arrangements."

But presumably HMRC noticed the inconsistency, and the guidance was amended on 19 July 2007 to read:

> "The legislation is intended to have effect where a person enters deliberately and knowingly into arrangements to gain a tax advantage."

If that is right, then the HMRC guidance is wrong. That is CIOT view.[49] The decision whether or not to apply the legislation to inter-spouse transfers (and many other cases) would then made by HMRC with no appeal by the taxpayer (outside judicial review). However, our tools of construction are not so weak as that. There are at least two possible routes to reach the HMRC view:[50]

(1) A genuine transaction does not give rise a tax advantage. That is, the reference to "tax advantage" should be construed to mean tax avoidance in the strict sense.
(2) In the case of a genuine transaction, a tax-advantage purpose is not a main purpose.

In either case, the statutory words are construed restrictively. Perhaps it does not matter which analysis is chosen. HMRC rely on the concept of main purpose:

> 38. The rule does not apply to a simple sale at arm's length of an investment standing at a loss and the setting of that loss against gains, utilising the statutory relief for losses. Such a transaction does not constitute arrangements whose main purpose is to secure a tax advantage, as the main purpose is the disposal of the unprofitable investment.

In the normal sense of the expression, a disposal of an asset standing at a loss could have the main purpose of obtaining loss relief. In March,

[49] "2.1 CIOT disagrees strongly with the majority of HMRC's Guidance, believing it to be in contradiction to the clear wording of section 16A. While it would be tempting to rely on HMRC's leniency, CIOT believe that it may be dangerous to do so.
2.2 CIOT agrees HMRC's *conclusions* in examples 1, 2, 3, 6, 7, 10 and 18 of HMRC Guidance. CIOT also agree that, depending upon the exact fact pattern, HMRC's conclusions in examples 12, 13 and 17 may also be correct.
2.3 However, CIOT disagrees with HMRC's *reasoning* in all bar the first example. In some cases (examples 2, 3, 10 and 17) this is because HMRC's reasoning does not go far enough. In the remaining cases, CIOT believes HMRC's reasoning is incorrect.
2.4 CIOT disagrees with both HMRC's *conclusions* and their *reasoning* in examples, 4, 5, 8, 9, 11, 14, 15 and 16 believing that it is unduly lenient and does not accord with the wording of section 16A TCGA. CIOT believes that HMRC's reasoning and conclusions may also be lenient in examples 12, 13 and 17, although this will depend upon the exact factual situation."
CIOT, "TAAR guidance: Comments" (2007)
HMRC did not respond.

[50] A third route is to say that a genuine transaction does not constitute an arrangement.

before the tax-year end, all competent fund managers review their client portfolios and arrange disposals to accrue losses to set against gains. It may be - indeed I think it will often be - the case that but for CGT, these disposals would not take place.

The fact that the investment was unprofitable in the past might constitute the reason for the disposal, but not necessarily. The asset might become profitable in the future. "Past performance is not a guide to future performance" is an investment mantra.

I suggest, therefore, that context shows that the expression "main purpose" should be given a restricted meaning. Whatever the subjective frame of mind of the taxpayer, and regardless of the result of a but-for test, it is only the main purpose to obtain a tax advantage, in cases of tax avoidance, or (which comes to the same thing) in non-genuine transactions. That is not, admittedly, the most natural meaning of "main purpose", but it is a possible meaning, and if necessary supportable on *Pepper v Hart* grounds. In other words, purpose is a subjective question of fact, but *main* purpose is a legal concept.

The reader may wonder whether this discussion matters, given that HMRC have stated that they will not normally challenge, say, a spouse-transfer loss. On a constitutional level it matters to those who believe that tax should be based on law and not concession and discretion. On a practical level it matters if HMRC decide to change their practice (which the IR20 debacle shows is not a theoretical possibility) or if they apply it inconsistently.

65.21.6 *Sale and repurchase*

Loss-TAAR guidance example 9 is a straightforward sale and repurchase after 30 days:

> An individual, R, who has realised a chargeable gain in a particular tax year, sells shares in a company, X plc., which are standing at a loss, to an unconnected third party.[51] R wishes to offset the resulting capital loss against the other chargeable gain.
>
> 31 days later R buys back the same number of shares in X plc., again from an unconnected third party.[52]
>
> To decide whether or not the TAAR applies, it is necessary to consider whether there have been arrangements, and as for example 8, this seems

[51] If the sale is to a connected person, the loss is restricted.

[52] It should not matter that the purchase is from a connected person.

> to be the case here.

More analytically, the question is not *whether* there are arrangements, but *what* are the arrangements. The loss-arrangement is (1) the sale and (2) the repurchase.

> The next question, therefore, is whether the arrangements have a main purpose of securing a tax advantage. As for previous examples, this entails examining all the circumstances surrounding the arrangements, considering their overall economic objective, whether that objective is one that the participants might be expected to have, and which is genuinely being sought, and whether that objective is being fulfilled in a straightforward way, or additional, complex or costly steps have been inserted. In this case, the shares were bought back after the 30 day time limit in section 106A(5) TCGA, so the transaction is not within those "bed and breakfasting" rules.[53]
> In disposing of the shares in X plc, R has incurred a real economic loss on a genuine disposal to a third party.

This is not quite right. In disposing of the shares, R did not *incur* a loss. R *accrued* or *realised* the loss which had already been incurred as the asset had fallen in value.

The main-purpose analysis can then begin:

> Provided that R has not entered into some form of contract or agreement to ensure that he is not exposed to a genuine economic risk in respect of the shares during the period they were not in his ownership, this suggests that he has not entered into arrangements with a main purpose of securing a tax advantage. The transactions therefore fall outside the scope of the TAAR.

I suggest the better analysis is that since the statute sets out a 30 day limit, a purchase thereafter is not avoidance, and so not a main purpose.

65.21.7 *Liquidation*

The loss-TAAR guidance provides:

> **Example 17 - capital loss following disposal of company assets**
> M and K are married and between them own all the shares in a property investment company, B Ltd. The shares are standing at a loss but B Ltd owns a valuable property.
> M and K jointly buy the property from B Ltd. for cash at its open market

[53] See 56.12 (Share pooling).

> value and the company distributes its remaining assets, the cash, during its winding up.
>
> M and K realise losses on their shares.

The HMRC analysis is as follows:

> To decide whether or not the TAAR applies, it is necessary to consider whether there have been arrangements, and whether a main purpose of those arrangements was the securing of a tax advantage. In this case, it seems clear that there have been arrangements, so it is necessary to look at what M and K's main purpose in entering into these arrangements was. This can be determined only by looking at all the circumstances surrounding the arrangements.

The author assumes that M and K have the same purpose. That is not necessarily the case, though the fact that they are married suggests that is likely. (The fact that M and K are married is otherwise irrelevant.) Otherwise, so far, this is not contentious.

> In the present example, M and K wanted to wind up B Ltd, but also to retain ownership of the valuable property they controlled via the company. The property was purchased by them from the company at market value, and paid for with real consideration, so there was no artificial reduction in the value of the company.[54] The winding-up of the company allowed the shareholders to realise the economic value of their investment in it in a straightforward way. B Ltd. has simply converted value represented by property into the same value represented by cash, and M and K now own the property directly. This, coupled with the fact that the tax effect of the transactions reflects the economic outcome suggests that there was no main purpose of realising a tax advantage, and so the TAAR will not apply.

It is difficult to take this seriously, but what does emerge is that HMRC do not seek to apply the loss-TAAR to a straightforward liquidation. The same must logically apply if the company were put into liquidation without a prior purchase of its property.

[54] Author's footnote: HMRC suggest that if the sale was at an undervalue, there would have been an artificial reduction in the value of the company, so the loss-TAAR would apply. Normally the sale at an undervalue would be a distribution subject to IT, and the cost of the IT charge on the distribution would exceed the benefit of the loss relief, so the issue is not likely to arise. But if one could devise circumstances where that were not the case (DT relief for the distribution, but not for the chargeable gain, perhaps?) then the point may be valid.

65.22 Spouse-transfer loss

65.22.1 *Tax reasons for spouse transfer*

Suppose an individual ("H") owns an asset which stands at a loss. It will sometimes happen that the position would be improved if the loss accrued to H's spouse ("W") rather than to H. That would be the case if:

(1) W has realised a gain which could be set against the loss.
(2) W expects to realise a gain which could be set against the loss.[55]
(3) W is UK resident and H is non-resident, so his loss is not allowable.
(4) H is a remittance basis taxpayer, and has made a foreign-loss election, so that his loss would be set against foreign gains and so wasted.
(5) H is expected to die and his loss will then cease to be available, but W has a better life expectancy.

Inter-spouse transfers are on a no-gain no-loss basis for CGT.[56] This relief offers possible tax planning:

(1) H gives the asset to W.
(2) W disposes of the asset, and so the loss accrues to her.

65.22.2 *Spouse transfer and the TAAR*

The planning is accepted in loss-TAAR guidance example 5:[57]

> H has shares in S plc which are standing at a loss.
> W has shares in a separate company, T plc, standing at a gain.
> H transfers his shares to W under the no-gain, no-loss rule in section 58 TCGA, and she then sells both holdings of shares.
> The loss on the shares in S plc covers the gain arising from the shares in T plc, and so no CGT is payable by W.

The HMRC analysis is as follows:

> Taking the spouses together, H and W each have shares which they want to sell. What happens in fact is that they do sell their shares, and the economic consequence is that they realise a gain on one set of shares and a loss on the other set. To decide whether or not the TAAR applies, it is necessary to consider whether there have been arrangements, and

[55] An alternative here may be for W to transfer the asset with the gain to H, so H realises the gain and the loss.

[56] See 93.11 (CGT spouse exemption),

[57] The guidance refers to Mr H and Mrs H; I have changed that to H and W, which I find slightly easier to follow.

> whether a main purpose of those arrangements was the securing of a tax advantage. In this case, it seems clear that there have been arrangements, namely the transfer of the shares from H to W.

More analytically, the question is not *whether* there are arrangements, but *what* are the arrangements. Here, the loss-arrangement consists of (1) the transfer to W and (2) the sale by W; not the transfer alone. But it does not matter.

We turn to the main-purpose analysis:

> It is then necessary to look at what the main purpose of H and W in entering into these arrangements was. This can be determined only by looking at all the circumstances surrounding the arrangements. In the present example, H and W wanted to dispose of their shareholdings, and they did this in a straightforward way.

"Straightforward" is not, er, straightforward. It is evaluative, subjective, and a matter of degree. The *most* straightforward way would be for H to sell, not to give the shares to W who then sells.

> They made use of the provisions of section 58 TCGA, which provides the opportunity for spouses (or civil partners) to bring together gains and losses, but again the straightforward use of a statutory relief in this way does not (of itself) bring arrangements within the TAAR.

The same point arises.

> Moreover, the tax outcome of the transactions reflects the economic reality of H and W's situation.

"Economic reality" is vague, evaluative, subjective and often debatable.[58] But in this case the position is clear: in economic reality, W does not realise a loss. The *family unit* (H and W) realises a loss but husband and wife are not now[59] regarded as one person, or one unit, in society generally or for (most) tax purposes (apart from anti-avoidance). That is why the inter-spouse transfer is needed.

> In all the circumstances, this suggests that there was no main purpose of achieving a tax advantage, and where there is no such main purpose the rule does not apply.

[58] See App.7.7 (Economic reality etc).

[59] It is relevant to note that from the inception of CGT until 1988, spouses were one taxable unit, and losses of one spouse were set against gains of the other: s.4(2) Capital Gains Tax Act 1979 (repealed).

A main purpose is to obtain the benefit of the loss on a simple but-for test, the inter-spouse transfer would not otherwise have taken place. Any other view is highly implausible. However the purpose is not to achieve a *tax advantage* in the relevant sense, so it does not count as a main purpose within the sense of the section.

Contrast HMRC example 6:

> As in example 4, H sells shares in a company, in order to crystallise a loss which can then be set against his chargeable gains arising in the year.
> H makes arrangements for his wife W to purchase the same number and class of shares.
> W then transfers the shares back to H on the following day. By virtue of section 58 TCGA this is a no-gain, no-loss transaction.

The author's CGT analysis (leaving the loss-TAAR aside for a moment) is defective. Section 58 is not likely to be relevant, as W acquires the shares at market value so she would not realise a gain on the disposal the next day to H. More importantly, the author overlooks the effect of s.106A TCGA on the acquisition by H.[60] But on the assumption that s.106A does not apply, the passage continues:

> To decide whether or not the TAAR applies, it is necessary to consider whether there have been arrangements, and whether a main purpose of those arrangements was the securing of a tax advantage. In this case it is clear that there have been arrangements, as H has arranged for his wife to purchase the same number and class of shares.

More analytically, the question is not *whether* there are arrangements, but *what* are the arrangements. The arrangements are the sale by H, the purchase by W, and the transfer from W to H.

The main-purpose analysis can then begin:

> It is then necessary to look at what the main purpose of H and W in entering into these arrangements was, and to do so it is necessary to consider the overall economic objective of the arrangements, and whether that objective is being fulfilled in a straightforward way, or whether additional, complex or costly steps have been inserted. Clearly the real economic ownership of the shares has remained with H, which suggests that the disposal of the shares was incidental to some other

[60] See 56.12.2 (Share-matching rules).

> main purpose of the arrangements. The only substantive change here is that a tax loss has been obtained. Since H & W have the same effective holding of shares and no less cash at the end of the arrangements as at the beginning, they have not suffered any corresponding economic loss, which suggests that a main purpose of the arrangements was the securing of that tax advantage. The TAAR will therefore apply and the capital losses claimed by H will not be allowable losses.

There has in fact been a substantive change: W has transferred assets to H so she owns less and he owns more. The difference would be crucial if H became insolvent.

> On a subsequent sale by H any chargeable gain would be greater (or any allowable loss would be smaller) than would have been the case if the arrangements had not been entered into. This does not affect the operation of the TAAR in relation to the losses generated under the arrangements.

Example 7 tweaks two facts: (1) the number of shares purchased by W and (2) W wisely does not transfer the shares to H:

> The situation may arise where variants on the arrangements in example 6 occur. For example, instead of making arrangements for W to buy back the same number of shares as had been sold by H, the couple might arrange for a slightly different number of shares to be bought. Or she might purchase the shares and retain them as part of her own portfolio, not transferring them back to H at all.
>
> To decide whether or not the TAAR applies in such cases, it is still necessary to consider whether there have been arrangements, and whether a main purpose of those arrangements was the securing of a tax advantage. In each case it is clear that there have been arrangements, and so it is necessary to look at what the main purposes of these arrangements were.

The main-purpose analysis can then begin:

> All the circumstances surrounding the arrangements have to be taken into account, and to do so it is necessary to consider the overall economic objective of the arrangements, whether that objective is one that the participants might ordinarily be expected to have, whether that objective is genuinely being sought, and whether it is being fulfilled in a straightforward way, or additional, complex or costly steps have been inserted.
>
> In a case where a slightly different number of shares has been bought

> back by W, but those shares are immediately transferred back to H, it is likely that the securing of a tax advantage would still be one of the main purposes, in which case the TAAR would still apply. But if only a very small proportion of the shares sold by H were then purchased by W and transferred back to H, or if W bought the shares and retained them as part of her own share portfolio, it is less likely that the securing of a tax advantage was one of the main purposes of the arrangements, in which case the TAAR would not apply.

"It is less likely" is not exactly guidance. But the author of the guidance did not want to give a hostage to fortune by venturing into the realm of "unlikely".

Example 7 also raised the intriguing question which arises if W does not transfer the shares to H; but the author forgot to address that.

Example 8 tweaks the facts relating to timing:

> A further variant on the situation in example 6 is that W could buy back the same number and class of shares that had been sold by H, but that she does not do so until, say, 31 days after H has sold the shares.
>
> Again, it seems clear that there have been arrangements, and so it is necessary to look at what the main purpose of H and W in entering into these arrangements was.
>
> So to determine whether or not the TAAR applies all the circumstances surrounding the arrangements have to be taken into account, considering:
>
> - the overall economic objective of the arrangements,
> - whether that objective is one that the participants might be expected to have, and which is genuinely being sought, and
> - whether that objective is being fulfilled in a straightforward way, or additional, complex or costly steps have been inserted.
>
> If W bought back the same number and class of shares which had been sold by H, but did not do so until some weeks after his disposal, it is less likely that the securing of a tax advantage will have been a main purpose of the arrangements, because there will have been a degree of exposure to market fluctuations and therefore a genuine economic risk. As a general rule of thumb HMRC considers that the TAAR will not apply in any case where a sale of shares is followed by their re-purchase after a period exceeding 30 days, provided that the exposure to market fluctuations in that period is real and there are, for example, no additional contracts or arrangements in place that significantly limit any economic risk. This 30 day rule of thumb is derived from the time limit in section 106A(5) TCGA 1992, the rule which operates to counteract

> so-called “bed and breakfasting” transactions.

This is consistent with example 9.[61]

65.23 Loss-TAAR: Critique

IFS say:

> 7.4 ... the width of this relatively simple provision [s.16A TCGA] meant that HMRC needed to publish 17 pages of detailed Explanatory Notes to explain how the legislation would be applied. So, considering the example of the person who sells shares standing at a loss in order to set the loss against a gain on another disposal, the Explanatory Notes explain that this transaction will not be prevented, albeit that the legislation could be used to prevent this.
> 7.5 There are several problems with this approach. First, the Explanatory Notes are not themselves subject to the scrutiny and care in drafting given to legislation. By their nature, Explanatory Notes are not drafted in the precise (?) way required for legislation.
> 7.6 Second, HMRC does not have the power to legislate: taxation can only be imposed by the legislature and while HMRC may decide upon its own interpretation of the legislation, that interpretation is not binding on taxpayers.
> 7.7 Third, the ability of taxpayers to rely on the guidance depends upon the type of transaction involved: if it is a single transaction entered into in reliance on specific guidance, the taxpayer can rely on the guidance (although enforcement may be cumbersome, for the reasons explained below). In contrast, if the taxpayer is seeking to rely on guidance in relation to a continuing state of affairs, the taxpayer is exposed to changes in that guidance. ... [62]

IFS then discussed the important issue of whether the loss-TAAR guidance is enforceable.[63] But the loss-TAAR guidance is intended to give HMRC maximum freedom to disregard their guidance (or at least to give freedom to decide when it should or should not apply, which comes to the same thing):

[61] See 65.21.6 (Sale and repurchase),

[62] TLRC discussion paper 7, “Countering Tax Avoidance in the UK” (2009*)* *https://ifs.org.uk/sites/default/files/output_url_files/dp7.pdf (*Footnotes omitted).

[63] The material, updated, is now in IFS, “HMRC’s Discretion: The Application of the Ultra Vires Rule and the Legitimate Expectation Doctrine” (2014) *http://www.ifs.org.uk/publications/7475* But this is a developing area, and the starting point should now be *Samarkand v HMRC* [2017] EWCA Civ 77.

> Examples of how the legislation will apply in particular circumstances are set out below. These examples are intended to show how different factors will be taken into consideration in deciding whether or not the TAAR applies in a given set of circumstances. They are not designed as templates[64] for deciding whether a loss is or is not caught by the TAAR in any particular case.

Thus unless my view on the meaning of "tax advantage" in s.16A TCGA is adopted, the loss-TAAR guidance is (more or less) unjusticiable: there is no law, only discretion.

In the 8th and subsequent editions of this work, I said:

> The uncertainty caused by provisions such as s.16A (which apply for corporation tax as well as CGT) is a factor which encourages companies... to leave the UK for Ireland, Switzerland or elsewhere.[65] Nevertheless, HMRC regard the provision as "successful"[66] (which in the sense of preventing avoidance it no doubt is). So the current position will continue until HMRC change their view that preventing tax avoidance is a priority that trumps other policy considerations such as the need for certainty and the rule of law.

When lobbying against or critiquing what was (in 2007) perceived as the striking vagueness and uncertainty of the capital loss-TAAR, practitioners did not foresee that this would become a standard form, routinely included in countless new TAARs.[67] But there it is.

[64] "Template" is a metaphor which may mean little or much. It might mean that the examples cannot be relied on for deciding whether a loss is caught by the TAAR. (In that case one might wonder what is their purpose.) Or it might mean that special circumstances may alter the position so the example is not directly applicable; that seems unobjectionable, indeed self-evident.

[65] Freedman et al, "Alternative Approaches to Tax Risk and Tax Avoidance: analysis of a face-to-face corporate survey" (2008) *ideas.repec.org/p/btx/wpaper/0814.html:* "A majority of ... respondents expressed exasperation with the complexity and unpredictability of current anti-avoidance rules, all but one asserting that this was a phenomenon hindering the competitiveness of the UK economy." Brexit issues are likely to put the loss-TAAR uncertainty issue, with countless others, onto the back shelf, because of its higher salience and importance.

[66] OECD "Engaging with High Net Worth Individuals on Tax Compliance" (2009) para 135; see: *https://read.oecd-ilibrary.org/taxation/engaging-with-high-net-worth-individuals-on-tax-compliance_9789264068872-en#page1*

[67] See 3.2.1 (Types of unallowable purpose).

65.24 DT relief on gain + loss

The International Manual provides:

> **INTM153150 - Description of double taxation agreements: Capital gains** [Jul 2018]
> ...CSTD Business, Assets & International, Tax Treaty Team would like to see any case where an individual claims relief for capital losses in circumstances where a corresponding gain would be exempt from UK tax under the terms of a double taxation agreement. In the case of companies such losses are not allowable by virtue of TCGA92/S8(2).[68]

It is easy to think of cases where losses would be allowable but gains exempt; however in practice it will not often matter.

[68] See 65.3 (Loss within scope of CGT).

CHAPTER SIXTY SIX

FUNDS: TERMS & CONCEPTS

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66.1 Fund terminology

This chapter considers terminology relating to funds:

Term	**FSMA definition**		**Tax definition(s)**	
	Section	**See**	**Section**	**See**
FSMA terms				
CIS	s.235 FSMA	*This chapter*	Various, based on FSMA	66.1.3
OEIC	s.236 FSMA	*This chapter*	Various, based on FSMA	66.1.2
Unit trust	s.237 FSMA	69.2	Various, based on FSMA	69.2
TIOPA terms				
Mutual fund	*Not used in FSMA*		s.356, 357 TIOPA	*This chapter*
Offshore fund	*Not used in FSMA*		s.355 TIOPA	*This chapter*

The definitions of CIS/OEIC interact, in that:

- an OEIC must meet the requirements of a CIS and certain further requirements, but
- certain OEICs (bodies corporate) do not count as a CIS

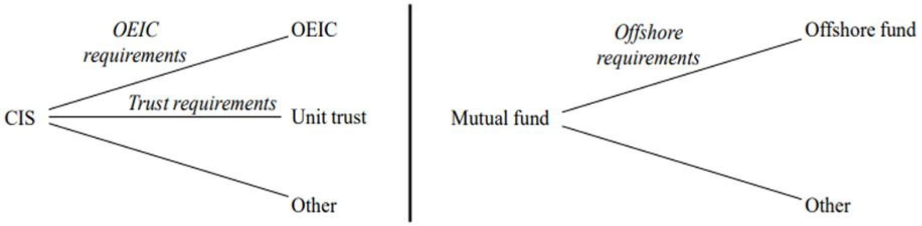
Thus an entity may have the status of:
- CIS but not OEIC
- OEIC but not CIS
- both CIS and OEIC (though in practice perhaps that is rare)

The definitions of mutual fund/CIS overlap as the TIOPA definition of mutual fund derives from the FSMA definition of CIS. In practice a CIS or OEIC is usually a mutual fund, and vice versa.

Unit trust/offshore fund are secondary terms in the sense that they are defined as a CIS/mutual fund meeting further requirements:
- Unit trust is a CIS where the property is held on trust
- Offshore fund is a mutual fund meeting "offshore" requirements

FCA guidance[1] on the FSMA terms CIS/OEIC is relevant to mutual/ offshore funds, so far as the wording is comparable. I do not discuss all the guidance here. A full discussion would need a long chapter.

It may be helpful to summarise the terminology with a diagram. In short:



66.1.1 *FSMA terms: Tax definitions*

When FSMA terms (CIS, OEIC, unit trust) are used in a tax context, a definition is provided. Sometimes the tax definition simply incorporates the FSMA definition. I refer to that as the **"standard FSMA definition"**. Sometimes the tax definition tweaks the FSMA definition, and occasionally there are more significant changes. Strictly one should not use these terms without indicating which definition applies: the FSMA

[1] See PERG 9 (Meaning of open-ended investment company) *https://www.handbook.fca.org.uk/handbook/PERG.pdf*

definition or a specific tax definition; but the context may supply the definition.

66.1.2 *OEIC: Tax definitions*

There are two definitions, a standard definition (adopting FSMA) and (what I call) a “domestic OIEC definition” (tweaking the FSMA definition):

Standard definition **s.613 CTA 2010**	**Domestic OEIC definition** **s.272 IHTA**
In this Chapter ‘open-ended investment company’ means a company incorporated in the UK to which section 236 of FISMA 2000 applies.	‘open-ended investment company’ means an open-ended investment company within the meaning given by section 236 of the Financial Services and Markets Act 2000 which is incorporated in the UK.

These definitions only apply for the purposes of Chapter 2 Part 13 CTA 2010/IHTA; but the definitions are often incorporated or repeated elsewhere.

A foreign incorporated OEIC is within the FSMA definition but not the domestic OEIC definition.

66.1.3 *CIS: Tax definitions*

Section 288(1) TCGA provides:

> In this Act, unless the context otherwise requires ...
> "collective investment scheme" has the meaning given by section 235 of the Financial Services and Markets Act 2000 (subject to section 99A)

For the s.99A exemption see 66.17 (One fund or more).

In other places the standard definition of CIS may be tweaked:

Topic	**See para**
Disguised investment management fees	73.11.1
TRS/International Tax Compliance Regs 2015	131.28.2

66.2 Participant/participate

The term “participant” is used in the definitions of mutual fund and CIS, and throughout OFTR and FSMA. The term has a commonsense definition in TIOPA and in FSMA. These use different drafting techniques, but the meaning is the same:

s.362 TIOPA (tax definition)	**s.235 FSMA (FSMA definition)**
(1) In this Part [Part 8, Offshore Funds] references to “participant”, in relation to arrangements (or a fund), are to a person taking part in the arrangements (or the arrangements constituting the fund), whether by becoming the owner of, or of any part of, the property that is the subject of the arrangements or otherwise.	(1) In this Part “collective investment scheme” means any arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from ... the property ... (2) The arrangements must be such that the persons who are to participate (“participants”) do not have day-to-day control over the management of the property ...
(2) In this Part references (however expressed) to participation, in relation to arrangements (or a fund), are to be read in accordance with subsection (1).	

These definitions only apply for the provisions specified, but they are incorporated by reference when the same term is used elsewhere.[2]

66.2.1 *“Participant” for CGT*

Section 288(1) TCGA provides:

> In this Act, unless the context otherwise requires ...
> "participant", in relation to a collective investment scheme, has the meaning given by section 103C(10)

So we turn to s.103C(10) TCGA which provides:

> "participant", in relation to a collective investment scheme, is to be read in accordance with section 235 of the Financial Services and Markets Act 2000.

So the FSMA definition applies for CGT, in relation to a CIS.

A mutual fund may not be a CIS in which case the FSMA definition does not apply. With this in mind, s.103D(10) TCGA tweaks the definition:

> In this section—
> “participant”—

[2] See 66.2.1 (“Participant”).

(a) in relation to a collective investment scheme, is to be read in accordance with section 235 of the Financial Services and Markets Act 2000, and

(b) in relation to an offshore fund (which is not a collective investment scheme), has the meaning given in section 362(1) of TIOPA 2010

But the two meanings are the same.

66.3 Mutual fund/CIS/OIEC

66.3.1 *Why it matters*

"CIS" matters as the term is used in the definitions of OEIC and unit trust, and is common in taxation.
"OEIC" matters as the term is used in the definitionof CIS, and OEICs have a dedicated tax regime.
"Mutual fund" matters as the term is used in the definition of offshore fund, and offshore funds have a dedicated tax regime.

66.3.2 *The definitions compared*

It is helpful to see the definitions side by side, so far as possible:

Mutual fund: s356 TIOPA	**CIS: s.235 FSMA**	**OEIC: s236 FSMA**
(1) In section 355 "mutual fund" means arrangements with respect to property of any description (including money) that meet conditions A, B and C.	(1) In this Part "collective investment scheme" means any arrangements with respect to property of any description, including money,	(1) In this Part "an open-ended investment company" means a collective investment scheme which satisfies both the property condition and the investment condition.
(2) [Signposts winding-up exemption]		(2) The property condition is that the property belongs beneficially to, and is managed by or on behalf of, a body corporate[3] ("BC")

Mutuality conditions:

Mutual fund: s356(3) TIOPA	**CIS: s.235(1) FSMA**	**OEIC: s236(2) FSMA**
(3) Condition A is that the purpose or effect of the	the purpose or effect of which is to enable persons	having as its purpose the investment of its funds with

[3] For completeness: s.417 FSMA provides: "body corporate" includes a body corporate constituted under the law of a country or territory outside the United Kingdom. But no-one would have thought otherwise.

arrangements is to enable the participants—	taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise)	the aim of—
(a) to participate in the acquisition, holding, management or disposal of the property, or (b) to receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.	to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.	(a) spreading investment risk; and (b) giving its members the benefit of the results of the management of those funds by or on behalf of that body.

Management conditions:

Mutual fund: s356(3) TIOPA	**CIS: s.235(1) FSMA**	**OEIC**
(4) Condition B is that the participants do not have day-to-day control of the management of the property.	(2) The arrangements must be such that the persons who are to participate ("participants") do not have day-to-day control over the management of the property,	
(5) For the purposes of condition B a participant does not have day-to-day control of the management of property by virtue of having a right to be consulted or to give directions.	whether or not they have the right to be consulted or to give directions.	

Realisation conditions:

Mutual fund: s356(6) TIOPA	**CIS: s.235 FSMA**	**OEIC: s236(3) FSMA**
Condition C is that, under the terms of the arrangements, a reasonable investor participating in the arrangements would	[No realisation requirement]	The investment condition is that, in relation to BC, a reasonable investor would, if he were to participate in the scheme—
expect to be able to realise all or part of an investment in the		(a) expect that he would be able to realize, within a period

arrangements	appearing to him to be reasonable, his investment in the scheme (represented, at any given time, by the value of shares in, or securities of, BC held by him as a participant in the scheme); and
on a basis calculated entirely, or almost entirely, by reference to— (a) the net asset value of the property that is the subject of the arrangements, or (b) an index of any description.	(b) be satisfied that his investment would be realized on a basis calculated wholly or mainly by reference to the value of property in respect of which the scheme makes arrangements.

66.3.3 *Summary*

In outline, there are three broad requirements, or sets of requirements. OEIC and mutual fund use different terms, and CIS does not have any terms at all. But in order to discuss the conditions, it is convenient to use transparent terms, common to all the various entities, so I coin the following:

My term	**Statutory terms**		
	Mutual Fund	***OEIC***	***CIS***
Mutuality	Condition A	Property condition	*No statutory term*
Control	Condition B	*No extra requirement*	*No statutory term*
Realisation	Condition C	Investment condition	*Not required*

Requirement	**Mutual fund**	**CIS**	**OEIC**	**See**
	TIOPA	**FSMA**	**FSMA**	
Mutuality	s.356(3)	s.235(1)/(4)(a)	s.236(2)	66.4
Control	s.235(4)	s.235(2)/(4)(b)	No extra requirement	66.5
Realisation	s.235(6)	Not required	s.236(3)	66.6

So the starting point is:

- a mutual fund must meet 3 conditions: Mutuality, Control and Realisation
- a CIS need only meet the first two of those conditions
- An OEIC is a CIS which meets further conditions relating to Mutuality and Realisation

The wording of these conditions varies between the 3 terms, but they are best considered together.

CIS has a further requirement which has no equivalent in the definition of mutual fund. Section 235(3) FSMA provides:

> The arrangements must also have either or both of the following characteristics—
> (a) the contributions of the participants and the profits or income out of which payments are to be made to them are pooled;
> (b) the property is managed as a whole by or on behalf of the operator of the scheme.

Here, para (a) is a Mutuality requirement and para (b) is a Management requirement, but only one of these needs to be met.

66.3.4 *Body corporate status*

Reg 3(1) Open-Ended Investment Companies Regulations 2001 provides:

> If the Authority makes an authorisation order then, immediately upon the coming into effect of the order, the body to which the authorisation order relates is to be incorporated as an open-ended investment company (notwithstanding that, at the point of its incorporation by virtue of this paragraph, the body will not have any shareholders or property).

In *HMRC v Hargreaves Lansdown Asset Management:*[4]

> An OEIC is a body corporate. That is clear from Regulation 3 (1) of the Open-Ended Investment Companies Regulations 2001 which provides that if the FCA makes an authorisation order permitting an OEIC to be marketed to the public then immediately upon the coming into effect of the order, the body to which the authorisation order relates is to be incorporated as an open-ended investment company.

This is also clear from the Property Condition of an OEIC, which requires that OEIC property belongs beneficially to a body corporate.

A CIS and an offshore fund may take the form of a body corporate but need not do so (eg a unit trust).

66.4 Mutuality conditions

Mutual fund: s356(3) TIOPA	**CIS: s.235(1) FSMA**	**OEIC: s236(2) FSMA**
Condition A is that the purpose or effect of the	the purpose or effect of [the arrangements] is to enable	The property condition is that the property belongs

[4] [2019] UKUT 246 (TCC) at [68].

arrangements is to enable the participants—	persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise)	beneficially to, and is managed by or on behalf of, a body corporate ("BC") having as its purpose the investment of its funds with the aim of—
(a) to participate in the acquisition, holding, management or disposal of the property, or (b) to receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.	to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.	(a) spreading investment risk; and (b) giving its members the benefit of the results of the management of those funds by or on behalf of that body.

There must be more than one participant.[5]

66.5 Control conditions

Mutual fund: s356 TIOPA	**CIS: s.235(2) FSMA**
(4) Condition B is that the participants do not have day-to-day control of the management of the property.	The arrangements must be such that the persons who are to participate ("participants") do not have day-to-day control over the management of the property
(5) For the purposes of condition B a participant does not have day-to-day control of the management of property by virtue of having a right to be consulted or to give directions.	whether or not they have the right to be consulted or to give directions.

The IF Manual provides:

[5] This is self-evident but if authority is needed, see *Barker v Baxendale Walker Solicitors* [2016] EWHC 664 (Ch) at [207]:

> "[The statutory conditions of a CIS] require, albeit by necessary implication, that there is more than one participator taking part in the [collective investment] scheme: indeed, that is the essence of the investment being "collective"."

The case floats the possibility that additional participators with "only an illusory or purely nominal share" might not suffice to meet the requirement, but the point is not pursued at first instance, and was not mentioned on the appeal.

> **IFM12233 Meaning of 'mutual fund': condition 'B'** [Apr 2020]
> Condition B is that the participants do not have day-to-day control of the management of the property. In this context, 'participants' means persons acting in the capacity of investors in a particular scheme. Control would therefore mean having control by way of rights as an investor. So, if the scheme manager held units or shares in the fund managed, that would not prevent condition B from being satisfied.
> In the case of a fund with an advisory committee, which would typically comprise either a few key investors or independent investment experts, again nothing prevents Condition B from being satisfied (particularly so in this case, as it would not be expected that the role of the investment manager would be usurped by such a committee).

The IF Manual continues:

> Merely having a right to be consulted or to give directions does not result in a participant having day-to-day control. So, for example, the right to a vote at annual general meetings would not be considered to amount to day-to-day control.

PERG 11 provides:

> In order for the arrangements not to be a collective investment scheme, all individual participants, regardless of their contribution or stated preferences, must have day-to-day control. So, if one participant does not have day-to-day control then the whole scheme could amount to a collective investment scheme.

PERG 11 provides:

> **Q6.** What is the purpose of the 'day-to-day control' test and the nature of day-to-day control?
> The purpose of the 'day-to-day control' test is to try to draw an important distinction about the nature of the investment that each investor is making. If the substance is that each investor is investing in a property whose management will be under his control, the arrangements should not be regarded as a collective investment scheme. On the other hand, if the substance is that each investor is getting rights under a scheme that provides for someone else to manage the property, the arrangements would be regarded as a collective investment scheme. Day-to-day control is not defined and so must be given its ordinary meaning. In our view, this means you have the power, from day-to-day, to decide how the property is managed. You can delegate actual management so long as you still

have day-to-day control over it.

Q7. The participants in my property investment club do not get involved in every single management decision, but appoint agents to take decisions for them in accordance with criteria agreed between them. Have the participants lost day-to-day control?

We do not consider that day-to-day control means that each participant would themselves need to be involved in each and every decision taken, so long as they retain day-to-day control over the management. For example, delegating rent collection, cleaning and management services in relation to a property, by appointing agents to carry out these tasks would not necessarily mean that the participants lose day-to-day control, so long as the participants retain day-to-day control over the management of the agency contracts.

Q8. Must each participant individually have day-to-day control for my property investment club not to be a collective investment scheme?

Yes, though this does not prevent two or more individuals having day-to-day control together. (This may happen, for example, where business partners buy several flats in a block and manage them jointly.) But the more distant any individual participant is from controlling the management of the property himself, the less likely it is that the individual participants can be said to have control which is 'day-to-day'.

Q9. I run a property investment club where the participants have a right to be consulted on management decisions or at least give directions. Do they have day-to-day control?

Not by virtue of those rights alone. Simply having the right to be consulted or give directions is not enough to give a participant day-to-day control. Also, if all management decisions are taken by the operator (or a person appointed by him) using generic mandates (for example, a power of attorney) from participants, then it is unlikely to be the case that the participants have day-to-day control. It is more likely in this case that the scheme is effectively one where management is devolved entirely to the operator, with participants only retaining a notional control over the decision-making of the operator - in essence amounting to a right to be consulted or give directions, rather than day-to-day control.

66.6 Realisation conditions

Mutual fund: s356(6) TIOPA	**OEIC: s236(3) FSMA**
(6) Condition C is that, under the terms of the arrangements, a reasonable investor participating in the	(3) The investment condition is that, in relation to BC, a reasonable investor would, if he were to participate in the

arrangements would expect to be able to realise all or part of an investment in the arrangements	scheme— (a) expect that he would be able to realize, within a period appearing to him to be reasonable, his investment in the scheme (represented, at any given time, by the value of shares in, or securities of, BC held by him as a participant in the scheme); and
on a basis calculated entirely, or almost entirely, by reference to— (a) the net asset value of the property that is the subject of the arrangements, or (b) an index of any description.	(b) be satisfied that his investment would be realized on a basis calculated wholly or mainly by reference to the value of property in respect of which the scheme makes arrangements.

A realisation condition (my term), (or "investment condition", the FSMA OEIC term), is one of the requirements to be a Mutual Fund /OEIC. It is not part of the definition of CIS (except indirectly, because of the rule that a closed-ended company is not a CIS).

PERG 9 has extensive guidance.

66.6.1 *Realisation at NAV*

The IF Manual provides:

> **IFM12235 Condition 'C': introduction** [Dec 2021]
> [The Manual sets out mutual fund condition C and continues:]
> To 'expect', in this context, does not necessarily mean that an enforceable right exists, but it does mean that an investor could reasonably expect to rely on realisation as described.
> "Realisation" of an investment has a wide meaning, and so may be by redemption, by sale to a third party, or by distribution of assets on the termination of a fund. So, if a fund has a limited life, it would not matter that an investor may not be able to sell his or her shares or units on the open market for a sum representing NAV or close to NAV, as there would be an expectation that the investment could be realised at or close to NAV when the fund terminated...
> **IFM12236: Condition 'C': meaning of 'reasonable investor'** [Apr 2020]
> A 'reasonable investor' is not defined in the legislation. It is assumed that such an investor (whether an individual, corporate investor, or otherwise) would have read the documentation and taken account of all additional material and communications of any nature whatsoever provided by the fund prior to investing.
> Where the scheme documentation is not written in a language that the investor can understand then it is assumed that the investor will have obtained a translation of the prospectus and any other relevant scheme documents or

material.

IFM12237 realisation of investment by reference to NAV or an index [Dec 2021]

... There is no definition within the legislation of 'almost entirely'. Any stated percentage limit of variation from NAV could be susceptible to arrangements seeking to avoid the intention of the offshore funds rules. It depends on what the arrangements are intended to provide. For example, buy-back arrangements normally take effect when there is a large discount to NAV, but may also be used in very exceptional circumstances to buy back at a very small discount or at NAV which, on its own, may not mean that the arrangements constitute a mutual fund...

Realisation of investment on a basis calculated at or close to NAV

It is not necessary that the investor obtains NAV directly from the fund. Where a reasonable investor could expect to receive NAV on selling their interest on a secondary market the fund will be an offshore fund if all other conditions are satisfied. For example, Exchange Traded Funds (ETFs) are usually operated in such a way that the quoted prices are at NAV or very close to NAV because market makers are able to create or redeem units. In that sense, such funds are open-ended and ETFs would be expected to qualify as mutual funds. On the other hand, arrangements where a fund offered to buy back shares to keep a discount on the share price within a reasonable limit would not make the fund a mutual fund unless it was clear to a reasonable investor, at the time that they invested (or on alteration of the terms of an investment), that there were such arrangements and that they were intended to ensure that such purchases were at, or almost at, NAV...

Shares trading close to NAV

The mere fact that shares in a closed-ended arrangement sometimes trade at or close to NAV does not mean that condition C is satisfied unless that is as a result of arrangements being in place, such that a reasonable investor could expect to receive NAV or close to NAV on selling their interest.

Warrants and options

Warrants or options that give an investor the right to sell shares back to an issuer for a particular price will not cause condition C to be satisfied unless the price is determined by reference to NAV so that the investment can be realised at or close to NAV. Similarly, rights that carry the option to convert to other classes of interest would only satisfy condition C if the new rights themselves permitted an investor to realise their investment at or close to NAV

The IF Manual provides:

IFM12224 corporate entities - s355(1)(a) TIOPA 2010 [Apr 2020]

... It is expected that relatively few fixed share capital companies will fall within the new [2009] definition of an offshore fund. For example, an investment in a trading or investment company or group with fixed share capital and that was not limited life (even if local law provides for continuation votes) would not come within the definition. But under the characteristics-based approach, entities that have fixed share capital and that are structured in such a way that they share characteristics of open-ended share capital arrangements will be within the definition. So, fixed share capital companies that are predicated on the basis that investors will get a net asset value return or a return which is very close to net asset value may fall within the new definition of an offshore fund. That will also be the case where there are no redemption rights but where the arrangements have a limited life and a reasonable investor could expect to get a net asset value return on winding up (unless one of the exceptions in S357 TIOPA 2010 applies).

IFM12238: disposals of underlying fund assets [Dec 2021]
A reasonable investor could expect to realise their investment at or close to NAV as a result of the intention of a fund to dispose of its assets in tranches followed by a final distribution of any remaining assets, instead of a liquidation of all of the fund's assets on a winding-up. For example, a fund may be set up in order to acquire distressed debt assets with an intention to realise those assets as they mature and to distribute the proceeds to investors in the following way-
Step 1: debt assets are acquired with 1, 2 and 3 year lives;
Step 2: the assets are realised, without reinvesting the proceeds, at the various maturity dates;
Step 3: the sums realised on the occasion of each realisation are distributed to investors, and;
Step 4: the fund is formally wound up and any remaining assets distributed.
There would be an expectation of realising an investment in such an arrangement at or close to NAV ('at NAV' on the final distribution or perhaps 'close to NAV' if remaining negligible assets are not in fact distributed). In those circumstances condition C would be satisfied and the fund would be a mutual fund, so long as conditions A and B were also satisfied and none of the exceptions at S357 TIOPA 2010 applied. It would therefore be an offshore fund as defined at S355 TIOPA 2010.
In the example above, condition E (not limited life) is not satisfied as the nature of the fund's assets and the intention not to reinvest them mean that there is a determinable latest termination date- see IFM12244).
Note that in the example above, a UK investor would be treated as making a part-disposal of his or her interest (see S42 TCGA 1992). If the fund was within the definition of an offshore fund then the treatment of that part-disposal would depend on whether regulation 17 of the Offshore Funds (Tax) Regulations 2009 applied. If regulation 17 did apply then an offshore income gain would arise on any gain or, if it did not apply, then any gain would be subject to capital gains tax or corporation tax on capital gains.

66.6.2 *Realisation at indexed value*

The IF Manual provides:

IFM12237 realisation by reference to index [Dec 2021]
... Realisation of investment by reference to an index
In some cases, an investor may have a right to redeem an investment at an amount not representing the assets directly invested in, but which

> is expressed in terms of an index. The fund manager may then invest the assets to produce a return as nearly as possible matching the index that is offered. In such a case condition C will also be met. Again, this is subject to exceptions where conditions E or F apply.
>
> In many cases investments designed to produce an indexed return are likely to be non-income producing (that is, they reflect capital growth only) in which case the exception provided by S357(5) - condition F - may apply.
>
> Where an investment is by reference to an index that reflects both capital growth and income returns then S357(5) would not apply, but condition F may still apply due to S357(7) - see IFM12249.
>
> Realisation by reference only to a fixed return does not constitute realisation by reference to an index (although it does not exclude it being by reference to NAV).

66.6.3 *CIS: Realisation time limit*

The mutual fund realisation condition (unlike the OEIC definition) does not require that the realisation must be within a reasonable period.[6]

The OEIC realisation condition requires realisation within a reasonable period.

PERG 9.11 (FAQs) provides:

> **Q8:** Would a body corporate holding out redemption or repurchase of its shares or securities every six months be an OEIC?
>
> **A:** In the FSA's view a period of six months would generally be too long to be a reasonable period for a liquid securities fund. A shorter period affording more scope for an investor to take advantage of any profits caused by fluctuations in the market would be more likely to be a reasonable period for the purpose of the realisation of the investment (in the context of the 'expectation' test, see PERG 9.8 and, in particular, PERG 9.8.9 G which sets out the kind of factors that may need to be considered in applying the test).

This does not introduce an upper limit of six months on the length of period which is reasonable to decide if any investment company is open-ended. The reply to FAQ8 is in the context of liquid securities funds that are offering redemption or repurchase of securities.

PERG 9.8.9 G provides:

> As indicated in PERG 9.3.5 G (The definition), the potential for

[6] See 66.3 (Mutual fund/CIS/OIEC).

variation in the form and operation of a body corporate is considerable. So, it is only possible in general guidance to give examples of the factors that the FSA considers may affect any particular judgment. These should be read bearing in mind any specific points considered elsewhere in the guidance. Such factors include:

(1) the terms of the body corporate's constitution;
(2) the applicable law;
(3) any public representations that have been made by or on behalf of the body corporate;
(4) the actual behaviour of the body corporate or of a person acting on its behalf in relation to investors seeking to realise their investment in it;
(5) whether investors in the body corporate are in a position to take advantage of fluctuations in property value in the particular market in which the body corporate invests;
(6) the existence of a guarantee, which may mean that a longer period may appear reasonable than would be the case without the guarantee;
(7) where the underlying property in which the body corporate invests is relatively illiquid; in this case, the period within which realisation of an investment may be regarded as reasonable may be longer than it would be for property which has greater liquidity;
(8) the levels of disclosure of the terms on which investment is made;
(9) the nature of the investment objectives or policy of the body corporate; and
(10) the appropriateness of the name of the body corporate.

66.7 OEIC: Purchase of own shares

Section 236(4) FSMA provides:

> In determining whether the investment condition is satisfied, no account is to be taken of any actual or potential redemption or repurchase of shares or securities under—
> (a) Chapters 3 to 7 of Part 18 of the Companies Act 2006;
> (d)[7] provisions in force in a country or territory which the Treasury have, by order, designated as corresponding provisions.

Chapters 3-7 relate to redeemable shares, purchase of own shares, and treasury shares. Mutual funds have no close equivalent of this, but the

[7] There is no para (b)(c).

mutual fund winding-up exemption is comparable in some respects.

66.8 Mutual fund: winding-up exemption

Section 357(1) TIOPA provides:

> Arrangements are not a mutual fund for the purposes of section 355 if—
> (a) condition D is met, and
> (b) condition E or F is met.

The conditions are as follows:

Condition	**TIOPA**	**Topic**	**See**
D	s.357(2)	Realisation only on winding up	66.9
E	s.357(4)	Fixed end date	66.10
F	s.357(5)-(7)	Rules relating to fund income	66.11

I refer to them together as **"winding-up conditions D to F"**.

66.9 Condition D: Realisation on winding up

Section 357(2) TIOPA provides:

> Condition D is that, under the terms of the arrangements, a reasonable investor participating in the arrangements would expect to be able to realise all or part of an investment in the arrangements on a basis mentioned in section 356(6)[8] only in the event of the winding up, dissolution or termination of the arrangements.

The IF Manual provides:

> **IFM12242 exceptions to the meaning of mutual fund: introduction** [Dec 2021]
> ...Arrangements meet the criteria of condition D where the only occasion on which a reasonable investor would expect to be able to realise an investment based entirely or almost entirely by reference to the net asset value ('NAV') of the property or an index of any description is on a winding-up, dissolution or termination of the arrangements. An example is a case where there is a final redemption of a class of interest (s357 (2)).
> Section 357(2) has the effect that 'open-ended' arrangements (i.e. those that enable investors to realise NAV by disposing of their interest) cannot come within the exceptions provided by s357.
> The conditions E or F do, however, except certain types of closed-ended arrangements from the meaning of a 'mutual fund'.
> The exceptions can also apply to arrangements where a reasonable investor

[8] See 66.6 (Condition C: realisation value).

> could expect to realise their investment at or close to NAV as a result of the intention of a fund to dispose of its assets in tranches followed by a final distribution of any remaining assets, as opposed to a liquidation of all of the fund's assets on a winding-up.

The IF Manual provides:

> **IFM12235: Condition 'C': introduction** [Dec 2021]
> Condition C requires that a 'reasonable investor' (see IFM12236) would, as participant in the arrangements, expect to be able to realise all or part of an investment in the arrangements on a basis calculated entirely or almost entirely by reference to either
> • the net asset value (NAV) of the scheme property, or
> • an index of any description.
> To 'expect', in this context, does not necessarily mean that an enforceable right exists, but it does mean that an investor could reasonably expect to rely on realisation as described.
> "Realisation" of an investment has a wide meaning, and so may be by redemption, by sale to a third party, or by distribution of assets on the termination of a fund. So, if a fund has a limited life, it would not matter that an investor may not be able to sell his or her shares or units on the open market for a sum representing NAV or close to NAV, as there would be an expectation that the investment could be realised at or close to NAV when the fund terminated.
> See IFM12236 for guidance on the meaning of a 'reasonable investor', and IFM12237 regarding realising an investment on a basis calculated entirely, or almost entirely, by reference to NAV or an index of any description.
> The exceptions to the meaning of the term 'mutual fund' relate directly to condition C, and so condition C must be read in conjunction with section S357 TIOPA 2010 (which provides the exceptions) for the purposes of determining whether or not arrangements come within the meaning of a mutual fund, and hence an offshore fund- see IFM12240 onwards.

66.10 Condition E: Fixed end date

Section 357(3) TIOPA provides:

> Condition E is that the arrangements are not designed to wind up, dissolve or terminate on a date stated in or determinable under the arrangements.

Section 357(8) TIOPA provides:

> For the purposes of this section the fact that arrangements provide for a vote or other action that may lead to the winding up, dissolution or termination of the arrangements does not, by itself, mean that the arrangements are designed to wind up, dissolve or terminate on a date stated in or determinable under the arrangements.

The IF Manual provides:

> **IFM12244 condition 'E'** Apr 2020]
>
> [The Manual summarises condition E and continues:]
>
> This condition means, for example, that ordinary shares in any company with defined share capital (that is, not an open-ended company with variable share capital) and which does not have a limited life, will not be an offshore fund.
>
> ... As elsewhere "arrangements" has a wide meaning and is not limited to the documents establishing the fund, so can include all agreements and understandings. Similarly, "determinable" has a wide meaning. For example, if a fund prospectus stated that it was intended to wind-up the fund after it had realised all of its assets, but those assets consisted of debt instruments none of which was longer dated than 5 years, then the termination date would be determinable (unless, of course, it was clear that the fund would reinvest the proceeds of asset realisations and was not 'limited life' in any other regard).
>
> **Asset realisations**
>
> It will not be sufficient to satisfy condition E, for a fund to state that an intention to dispose of its assets on or by a certain date is subject to market conditions or some similar caveat. Where it is clear that a long-stop date exists, or where there is no specific and realistic possibility that would lead a reasonable investor to conclude that the fund would not be able to dispose of its assets by the date stated, condition E is not met. For example, if a fund's assets consist of short-dated debt instruments, or commercial leases with a life of 20 years then, unless the fund was reasonably likely to re-invest funds from disposals, condition E could not be satisfied. Where there is no such long-stop date implicit in the nature of the assets themselves then condition E may still not be satisfied if a fund stated an intention to dispose of its assets in, say, four years' time 'subject to market conditions' or some other broad statement.
>
> HMRC will consider particular cases where a fund manager or its advisers believe that there are tangible and specific reasons why such a statement should lead to condition E being satisfied, but this is expected only to apply in exceptional circumstances. An example of the circumstances when a broad statement relating to whether assets could be realised on or by a given date may be sufficient to satisfy condition E would be if a fund held significant assets in a country about which there were real and significant concerns regarding any future government's policy in respect of the assets in question (such as public declarations of an intention to nationalise particular industries or companies in which the fund holds significant investments).

> **Continuation votes**
> Where arrangements provide for a continuation vote, or similar action, to determine whether they will persist beyond a given date that will not, in itself, mean that condition E is not met. So, if a reasonable investor, considering all of the facts, could not have any expectation that a continuation vote would fail then, provided the continuation vote was not for a determinable period and absent any other factors, the arrangements could not be said to have a determinable life and condition E could then be satisfied. HMRC accept that it could usually be expected that condition E would be satisfied where continuation votes are provided for, because continuation resolutions may well be passed if a fund is performing well, and a reasonable investor would be expected to invest on the basis that a fund would be successful. However, if arrangements or understandings are in place, so that it could be expected that a continuation vote would not be passed, then there would be a determinable date...

66.11 Condition F: Fund income

Condition F is in fact a set of conditions. Section 357(4) TIOPA provides:

> Condition F is that—
> (a) the arrangements are designed to wind up, dissolve or terminate on a date stated in or determinable under the arrangements,
> (b) subsection (5), (6) or (7) applies, and
> (c) the arrangements are not designed to produce a return for participants that equates, in substance, to the return on an investment of money at interest.

66.11.1 *No income-producing assets*

Section 357(5) TIOPA provides:

> This subsection applies if none of the assets that are the subject of the arrangements is a relevant income-producing asset (see section 358).

Section 358 TIOPA provides the definition:

> (1) This section has effect for the purposes of section 357.
> (2) An asset is a relevant income-producing asset if it produces income on which, if it were held directly by an individual resident in the UK, the individual would be charged to income tax (but see subsections (3) and (4)).
> (3) An asset is not a relevant income-producing asset if the asset is hedged, provided that no income is expected to arise from—

> (a) the asset (taking account of the hedging), or
> (b) any product of the hedging arrangements.
>
> (4) Cash awaiting investment is not a relevant income-producing asset, provided that the cash, and any income that it produces while awaiting investment, is invested as soon as reasonably practicable in assets that are not relevant income-producing assets (as defined by this section).

This is designed to exclude funds which invest in assets intended to give a purely capital growth based return.

The IF Manual provides:

> **IFM12237: meaning of realisation of investment by reference to NAV (net asset value) or an index** [Dec 2021]
>
> ... In many cases investments designed to produce an indexed return are likely to be non-income producing (that is, they reflect capital growth only) in which case the exception provided by S357(5) - condition F - may apply (see IFM12247 onwards).
>
> Where an investment is by reference to an index that reflects both capital growth and income returns then S357(5) would not apply, but condition F may still apply due to S357(7) - see IFM12249.
>
> Realisation by reference only to a fixed return does not constitute realisation by reference to an index (although it does not exclude it being by reference to NAV).

66.11.2 *Entitlement to income*

Section 357(6) TIOPA provides:

> This subsection applies if, under the terms of the arrangements, the participants in the arrangements are not entitled to the income from the assets that are the subject of the arrangements or any benefit arising from such income.

The IF Manual provides:

> **IFM12248 condition 'F': no entitlement to income or any benefit arising from income** [Apr 2020]
>
> An example of an arrangement satisfying this condition might be the capital shares or units in an arrangement which splits the rights to capital and income between the holders of different classes of interest, where the holders of capital shares or units are not entitled to any of the income or any benefit arising from the income.

66.11.3 *Income distributed*

Section 357(7) TIOPA provides:

This subsection applies if—

(a) under the terms of the arrangements, after deductions for reasonable expenses, any income produced by the assets that are the subject of the arrangements is required to be paid or credited to the participants, and

(b) a participant who is an individual resident in the UK would be charged to income tax on the amounts paid or credited.

66.12 Share buy-back and share issue

The IF Manual provides:

> **IFM12285 share buy-backs and share issuance** [Apr 2020]
> The price or value of shares in fixed share capital companies may reflect either a discount or a premium to the net asset value of the underlying assets. It may also be the case in some circumstances that there is either directors' or investors' discretion to allow or require the buy-back of shares if there is a discount of a certain level between the net asset value of the arrangements and the share price.
>
> Provided the share buy-back arrangements are made to prevent the discount becoming too large by reference to net asset value, and provided a reasonable investor cannot expect to realise their investment either entirely or almost entirely by reference to net asset value (or by reference to an index), and there is no determinable termination date, then such arrangements will be outside the definition of an offshore fund for UK tax purposes (as condition C at s356 TIOPA2010 will not be satisfied). Similar considerations apply where the shares trade at a premium.
>
> For example, if a foreign equivalent of an investment trust was trading at a discount of 15% to NAV and bought its own shares on the open market to reduce the discount then, absent any factors that could lead to an investor being able to expect to redeem their investment at or close to NAV, this would not cause condition C at s356(6) TIOPA2010 to be satisfied: it is clear that before the company commenced to buy its own shares that some investors would not have been able to redeem their interest at NAV and that any subsequent reduction in the discount would be due to normal operation of the market. Without any factors indicating that the company would act to reduce the discount, either having been in place prior to this market activity or at some point in the future, a reasonable investor could not expect to realise their investment at or close to NAV.
>
> However, share buy-back arrangements that are specifically designed to provide tracking to net asset value will cause the company or share class to come within the definition of an offshore fund. This would include any arrangements introduced as a result of changes to the constitution of a scheme. See IFM13251, IFM13270 and IFM13370 for further guidance.
>
> When considering an investor's rights, account should be taken of all scheme documents, promotional documentation or communications to determine what guarantees or undertakings may have been given to the investor.
>
> An undertaking or guarantee etc. to buy back or redeem only a part of an

> investor's holding, entirely or almost entirely by reference to the net asset value of the property or an index of any description, can still constitute an expectation. For example, if the fund manager undertook to redeem or buy back an investor's shares in tranches the arrangements could still be within the definition of an offshore fund.
>
> Warrants or options that give an investor the right to sell shares back to an issuer for a particular price will not cause condition C to be satisfied unless the price is determined by reference to NAV, so that the investment can be realised at or close to NAV. Similarly, rights that carry the option to convert to other classes of interest would only satisfy condition C if the new rights themselves permitted an investor to realise their investment at or close to NAV.

66.13 Company in liquidation

The IF Manual provides:

> **IFM12289 limited life companies: company liquidations** [Apr 2020]
>
> An investor may have invested in a company or other arrangement which subsequently goes into liquidation, at which point the investor might reasonably expect to realise their investment at net asset value. However, if a company or other arrangement is outside the definition of an offshore fund before it goes into liquidation, then being in liquidation will not by itself bring that company or arrangement into the definition of an offshore fund. This also applies in the case of self-managed wind-downs with the subsequent appointment of a liquidator to complete the liquidation.
>
> This treatment would also extend to the purchase of shares in a company after it has entered a self-managed wind-down or liquidation. This may not be the case, though, for wind-downs and liquidations that are intentionally extended or contrived.
>
> Some overseas companies can be liquidated or reconstructed at any time. If there is a decision to do so, at the point of the approval of the reconstruction or liquidation the investors may obtain net asset value. However, the relevant point is whether a reasonable investor can expect the company to be liquidated or reconstructed in order to deliver net asset value. It is necessary to consider the reasonable investor's expectation to realise their investment either entirely or almost entirely by reference to net asset value (or by reference to an index) when the company was established (or when there was a change in the investor's rights).

66.14 CIS exemptions

The definition of CIS is very wide. However, there are very wide exceptions set out in the Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 which I call **"CISO 2001"**. This sets out 21 categories of exceptions. Many of them are of somewhat specialist interest but the following are relevant to the themes of this book.

66.14.1 *Operated by way of business*

Para 4 Sch CISO 2001 provides:

> Arrangements do not amount to a collective investment scheme if they are operated otherwise than by way of business.

This is further elaborated in Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001. In particular, reg 3 provides:

> (1) A person is not to be regarded as carrying on by way of business an activity to which [paragraph (2) applies], unless he carries on the business of engaging in one or more such activities.
> (2) This paragraph applies to an activity of the kind specified by any of the following provisions of the Regulated Activities Order, namely—
> (a) article 14 (dealing in investments as principal);
> (b) article 21 (dealing in investments as agent);

Art 14(1) Regulated Activities Order 2001[9] provides (so far as relevant):

> Buying, selling, subscribing for or underwriting securities or contractually based investments ... as principal is a specified kind of activity.

Art 21(1) Regulated Activities Order 2001[10] provides:

> Buying, selling, subscribing for or underwriting securities, structured deposits or relevant investments as agent is a specified kind of activity.

66.14.2 *Contract of insurance*

Para 17 Sch CISO 2001 provides:

> A contract of insurance does not amount to a collective investment scheme.

[9] The full title is: Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

[10] The full title is: Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

Contracts of insurance are excluded as they are governed by different regulatory and tax regimes.

66.14.3 *Exemption for non-OEICs*

Most companies would be meet the requirements of a CIS set out in s.235 FSMA. But para 21 Sch CISO 2001 provides:

> (1) Subject to sub-paragraph (2),
> [a] no body
> [i] incorporated under the law of, or any part of, the UK relating to building societies or [registered societies] or
> [ii] registered under any such law relating to friendly societies, and
> [b] no other body corporate other than an open-ended investment company,
> amounts to a collective investment scheme.
> (2) Sub-paragraph (1) does not apply to any body incorporated as a limited liability partnership.

This is clumsy drafting, but if one ignores the specialist topics of building/registered/friendly societies, the rule is that a body corporate is not a CIS, unless it is an OEIC or a LLP (ie, a UK LLP).

One might refer to a body corporate which is not an OEIC or LLP as a "closed-ended" company. So in short, the rule is that a closed-ended company is not a CIS.

The reference to LLPs makes sense as a LLP is (generally) treated like a partnership for tax purposes, it is not treated like a body corporate.

The definition of OEIC is crucial for this purpose. CISO fails to supply a definition but the context shows that the FSMA definition applies.

66.15 Offshore fund: Definition

Armed with the definition of mutual fund, we can turn to the definition of offshore fund.

Section 355(1) TIOPA provides:

> In section 354 "offshore fund" means—
> (a) a mutual fund constituted by a body corporate resident outside the UK,
> (b) a mutual fund under which property is held on trust for the participants where the trustees of the property are not resident in the UK, or
> (c) a mutual fund constituted by other arrangements that create

rights in the nature of co-ownership[11] where the arrangements take effect by virtue of the law of a territory outside the UK.

In short, an offshore fund is a non-resident mutual fund.

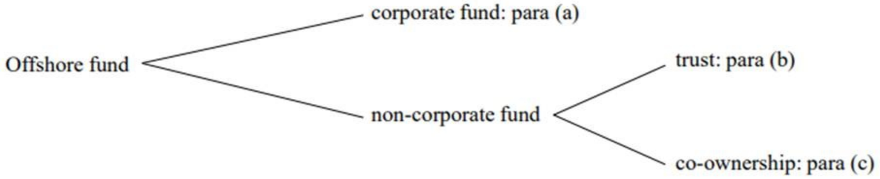
This definition applies only for s.354,[12] so it needs to be incorporated when the expression "offshore fund" is used elsewhere.[13]

66.15.1 *Types of offshore fund*

Offshore funds may be categorised as follows:

Type of offshore fund	**Definition**
Corporate fund	Fund within s.355(1)(a): a company
Non-corporate fund	Fund within s.355(1)(b)/(c): unit trust/co-ownership

Diagrammatically:



IFM12214 gives examples of typical offshore funds:

Corporate funds:
Belgian SICAV
Cayman registered company with a limited life

Non-corporate funds:
Luxembourg Fonds Commun de Placement
Jersey property unit trust

Offshore funds may also be categorised as follows:

Type of offshore fund	**See para**
Bond fund	68.2

[11] Section 355(3) TIOPA provides:

> "In this section ... "co-ownership" is not restricted to the meaning of that term in the law of any part of the UK."

[12] Section 354 TIOPA, headed "Power to make regulations about tax treatment of participants", is the authority for the OFTR.

[13] So reg.3(1) OFTR provides:

> "In these Regulations "offshore fund" has the meaning given by section 40A(2) of FA 2008 [now s.355(1) TIOPA] (read with the provisions of the relevant group of sections)."

The definition is similarly incorporated in s.378A(7) ITTOIA.

Reporting/non-reporting fund	67.2.2
Transparent fund	67.24.1

66.15.2 *Residence of fund*

Residence of a body corporate matters, because a body corporate must be non-resident to count as an offshore fund. Section 363A TIOPA provides a special residence rule for the benefit of EU offshore funds (in short, deeming such funds to be non-UK resident and thus disapplying the usual residence tests.) EN FB 2011 provides:

> The UCITS IV directive provides that an investment fund authorised under the provisions of Article 5 of that directive may have a manager which is not resident in the same State as that in which the fund is established and regulated.
> 6. [Section 363A] ensures that the affected offshore funds and their investors will not be subject to any tax consequences in the UK as a result of having a UK resident management company.

For unit trusts, see 69.7.3 (Residence of unit trust).

66.16 Partnerships

One would not expect partnerships to be offshore funds, because partnership income and gains accrue to the partners: there is no scope or need for offshore fund rules.

66.16.1 *General/limited partnership*

A partnership might[14] fall within limb (c) of the definition of mutual fund; but if it did, s.355(2) TIOPA takes it out:

> Subsection (1)(c) does not include a mutual fund constituted by two or more persons carrying on a trade or business in partnership.

A partnership does not fall within limb (b) of the definition of mutual fund, because property is not (generally) held on trust for the participants, or because if it is, it is just for conveyancing reasons, and not a trust within the meaning of s.354.

A general or limited partnership does not fall within limb (a) of the

[14] Though it is not self-evident that a partnership constitutes "rights in the nature of co-ownership".

definition of mutual fund as it is not a body corporate.

66.16.2 *UK LLP*

A non-resident UK incorporated LLP would within limb (a) of the definition of mutual fund, as it is a body corporate,[15] but s.355(3) TIOPA takes it out:

> In this section—
> "body corporate" does not include a limited liability partnership.

The IF Manual provides:

> **IFM12216 ... Limited liability partnerships** [Apr 2020]
> Limited liability partnerships ('LLPs') incorporated under the Limited Liability Partnerships Act 2000 but that are tax resident outside the UK are excluded from the definition even if they are otherwise treated as being a "body corporate" (S355(3) TIOPA 2010).
> This exclusion does not apply to LLPs formed under the law of any other territory. If such an LLP is a body corporate (and opaque for capital gains purposes) and a mutual fund, then it will come within the definition of an offshore fund at S355(1)(a) TIOPA 2010.

66.17 One fund or more?

66.17.1 *"Umbrella arrangement"*

Section 235(4) FSMA provides:

> If arrangements provide for such pooling as is mentioned in subsection (3)(a) in relation to separate parts of the property, the arrangements are not to be regarded as constituting a single collective investment scheme unless the participants are entitled to exchange rights in one part for rights in another.

Section 363 TIOPA provides:

> (1) In this Part [Part 8, Offshore Funds] "umbrella arrangements" means arrangements which provide for separate pooling of the contributions of the participants and the profits or income out of which payments are made to them.
> (2) In this Part references to a part of umbrella arrangements are to the arrangements relating to a separate pool.

[15] See 85.21.1 (Definition and nature of LLP).

66.17.2 *Umbrella/class: Separate funds*

s.360 TIOPA

(1) This section has effect for the purposes of this Part [Part 8, Offshore Funds].

(2) In the case of umbrella arrangements (see section 363)—

(a) each part of the umbrella arrangements is to be treated as separate arrangements, and

(b) the umbrella arrangements are to be disregarded.

(3) Subsection (2)(a) is subject to section 361 [More than 1 class of interest].

s.361 TIOPA

(1) This section has effect for the purposes of this Part.

(2) Where there is more than one class of interest in arrangements (the "main arrangements")—

(a) the arrangements relating to each class of interest are to be treated as separate arrangements, and

(b) the main arrangements are to be disregarded.

(3) In relation to umbrella arrangements, "class of interest" does not include a part of the umbrella arrangements (but there may be more than one class of interest in a part of umbrella arrangements).

The significance of being separate arrangements is that each part of the umbrella or class of interest is treated as separate, so the test of whether it is a mutual/offshore fund must be applied to each part/class separately.[16]

Reg 5 OFTR

In these Regulations, in relation to an offshore fund constituted by a part of umbrella arrangements (within the meaning of [s.363 TIOPA])—

(a) a reference to the assets of an offshore fund is to such of the assets of the umbrella arrangements

Reg 6 OFTR

In these Regulations, in relation to an offshore fund constituted by a class of interest in the main arrangements (within the meaning of section [361 TIOPA])—

(a) a reference to the assets of an offshore fund is to the assets of the main arrangements;

[16] See 66.3 (Mutual fund). See too 66.17(One fund or more?).

as under the arrangements form part of the separate pool to which that part of the umbrella arrangements relates;	
(b) a reference to the income of an offshore fund is to the income arising from those assets; and	(b) a reference to the income of an offshore fund is to such of the income of the main fund as is attributable to interests of that class under the arrangements constituting the main arrangements; and
(c) a reference to a participant in an offshore fund is to a person for the time being owning an interest in that separate pool.	(c) a reference to a participant in an offshore fund is to a person for the time being owning an interest of that class.

The IF Manual discusses umbrellas:

> **IFM12260 umbrella funds and protected cell companies** [Apr 2020]
> References to part of an umbrella arrangement are to the arrangements relating to a separate pool (or 'sub-fund'). Umbrella arrangements will not themselves be treated as an offshore fund. Instead -
>
> - each sub-fund and each class of interest is treated as an offshore fund in its own right,
> - the umbrella fund is not treated as an offshore fund,
> - the overall arrangements are disregarded.
>
> The same approach applies to an individual cell of a protected cell company.

The former OFM discussed residence of umbrellas/parts:

> **OFM08000 umbrella funds & protected cell companies** [Jun 2016]
> [The Manual sets out the definition in s.363 and continues:]
> ... For umbrella arrangements and protected cell companies, it would usually follow that each sub-fund has the same residence status as the overall arrangement. In the case of a non-resident company it would be expected that each sub-fund would also be non-resident if it was under the "central management and control" of the directors of the company which constitutes the overall arrangement. In the case of a unit trust scheme, the trustees of the overall trust arrangements will usually also be the trustees of each separate arrangement, and so their residence status determines the residence of the fund, but where there are different

> trustees for each sub-fund then each must be considered separately. The "central management and control" test is also applicable to unit trusts.

This does not seem to be in the current manual.

The IF Manual discusses classes of interest:

> **IFM12270 classes of interest** [Apr 2020]
> [The Manual summarises s.361 and continues:]
> "Class of interest" is not limited to share classes. There may be other forms of interest which entitle an investor to realise their investment on a basis calculated entirely or almost entirely by reference to the net asset value (NAV) of the scheme property or an index. For example, certain types of loan may provide a return which tracks NAV or is based on an index. A class of interest may also be created as a result of new issues or conversions of existing rights.
> It is possible for an entity, particularly a company, to have a class of interest such as ordinary shares which does not constitute a mutual fund and another class of interest which does constitute such a mutual fund.
> However, a particular class of shares can only constitute a single class of interest, even if different types of holders of those shares enjoy different rights. For example, in the case of an exchange traded fund, only the creation unit holders who act as market makers typically have the right to redeem or issue shares directly. Shares acquired by another investor on the secondary market would still form part of the same class of interest and satisfy condition C (s356 TIOPA 2010) because, as a consequence of the market makers' ability to redeem or create units, all other investors would expect to be able dispose of their interest at or close to NAV. (See also IFM12282 regarding exchange traded funds).
> ... Funds may issue units in 'series' on a monthly basis as a method of equalising the charging of performance fees. These units will have different names (2016 - M1, 2016 - M2, 2016 - M3 etc) depending on the month in which they are issued. Each monthly series will be charged performance fees based on different issue prices and to that extent each monthly series may have a different reportable income per unit for the reporting period of issue. In most cases in later years all 2016 units will typically carry exactly the same rights to reportable income per unit.
> Strictly each different unit class should be a treated as a separate fund, but HMRC are prepared to reduce the administrative burden placed on fund managers by treating the funds as if they are a single fund in certain circumstances.
> HMRC will agree to treat such funds as a single fund where the units of each different class are identical in all respects except in respect of rights to income and expenditure in the first reporting period. Where this is the case the fund should include in its application for reporting fund status (see IFM12423):
>
> - details of the different share classes that it intends to issue in the period along with details of how the rights of unit holders vary from other share classes issued in the reporting period.
> - a statement confirming that the income of all share classes of the fund will

derive from a single pool of assets in current and future reporting periods.

- a statement confirming that all such share classes will collapse into one reporting fund at the end of the reporting period to the effect that in the next reporting period the same units will hold identical rights.

Example: Vanilla Fund (UK investors)

If a reporting offshore fund issues 1 class of share per month to UK investors only, where in reporting period 1 the units hold different rights, and where going forward all units will collapse into one class the fund may apply to the Collective Investments Scheme Centre to treat all such share classes as one reporting fund. But note that separate reports of reportable income will be required for each new series in the first period in which that series is issued.

Example: UK/ Worldwide investors

If a reporting offshore fund issues some classes of shares to UK investors, and issues other general classes of shares to other investors, where in reporting period 1 the units hold different rights, but at the end of reporting period 1 all units of a share class will collapse into a single class of shares, and the fund wishes to apply for reporting fund status in respect of the share classes relating to UK investors but not for the share classes issued to general investors, the fund may apply to the Collective Investment Schemes Centre for reporting fund status for those share classes relating to UK investors.

However, if the fund later wishes to merge all share classes there could be tax consequences for any UK investors who invested in non-reporting share classes. This is because an offshore income gain may accrue when the units held in the non-reporting fund are merged into a reporting offshore fund (See IFM13380).

These rules are not found in the definitions of CIS/OEIC. There are comparable rules for co-ownership schemes.

See too s.99A TCGA and s.619 CTA 2010.

66.18 Offshore fund: Clearance

The IF Manual provides:

IFM12210 Introduction [Apr 2020]

... HMRC is not able to provide an up-front clearance service confirming whether or not a particular set of arrangements comes within the definition of an offshore fund. It will often be clear that a particular set of arrangements either does or does not come within the definition, but HMRC recognise that will not always be the case. If, after having considered the guidance in this manual in relation to all of the facts, there is material uncertainty as to whether particular arrangements are within the definition, then HMRC will provide an opinion, unless it is considered that the request does not come within published guidelines. Although this is not a formal clearance service, enquirers should consider the guidance concerning clearance requests available on gov.uk, including the circumstances in which HMRC will

> and will not provide an opinion. Queries should be sent at least 28 days in advance if the matter is material to whether or not to proceed with marketing to UK investors, and should be addressed to HMRC's Collective Investment Schemes Centre.

The INT Manual provides:

> **INTM180060 Contacts and clearances** [Dec 2023]
> If you need HMRC's view on whether particular entities constitute collective investment schemes, you should contact *cisc.sheffield@hmrc.gov.uk*

CHAPTER SIXTY SEVEN

OFFSHORE INCOME GAINS

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Cross references

For OIG of temporary non-residents, see 11.19 (TNR: Offshore funds)
For OIG of charities, see Kessler, Wong & Borlace, *Taxation of Charities & Nonprofit Organisations* (13th ed., 2022-23), para 4.15 (Offshore Funds) online version *https://www.taxationofcharities.co.uk*

67.1 Taxation of offshore funds

This chapter considers offshore income gains ("OIG") arising on the disposal of an offshore fund (it is assumed that the relevant conditions are met, in short, that the fund is a non-reporting fund). The next chapter considers income distributions from offshore funds.

The tax legislation is in the Offshore Funds (Tax) Regs ("OFTR"). The OFTR naturally referred to the then current provisions in FA 2008, now in TIOPA. The Tax Law Rewrite did not update secondary legislation so those references remain in the regulations. The obsolete references take effect as references to the corresponding TIOPA provisions[1] but readers

[1] Para 5(1) sch 9 TIOPA provides:
"Any reference (express or implied) in any enactment, instrument or document to a superseded enactment in its application for relevant tax purposes is to be read, so far as is required for those relevant tax purposes, as including, in relation to times, circumstances or purposes in relation to which any corresponding rewritten provision has effect, a reference to the rewritten provision."
Para 9(1) sch 9 TIOPA provides: "In this Part—
"enactment" includes subordinate legislation (within the meaning of the Interpretation Act 1978),
"relevant tax purposes" means, in relation to a superseded enactment, tax purposes for which the enactment has been rewritten by this Act, and
"superseded enactment" means an earlier enactment which has been rewritten by this Act for certain tax purposes (whether it applied only for those purposes or for those and other tax purposes)."

were left to work out what those are.

Term	**Definition**	**Formerly**	**See**
Offshore fund	s.355 TIOPA	s.40A FA 2008	66.15
Mutual fund	s.356, s.357 TIOPA	s.40B - 40E FA 2008	66.3

The reader may think it unfortunate that such an important matter was left to regulations, since the drafting and opportunity for consideration are of lower quality, and regulations are not updated with current statutory references. But there it is.

I do not consider in full the position of offshore funds held by UK resident companies subject to corporation tax.

67.2 Definitions

The following definitions are considered elsewhere:

Term	**Para**
Participant	66.2
Offshore fund	66.15
Main arrangements	66.17.2

67.2.1 *"Interest in an offshore fund"*

Regulation 8(1) OFTR provides a commonsense definition:

> For the purposes of these Regulations the interest of a participant in an offshore fund is the investment held by a participant taking part in arrangements (or arrangements constituting a fund) to which the relevant group of sections applies.

67.2.2 *Reporting/non-reporting fund*

Regulation 4 OFTR provides:

> (1) Offshore funds consist of—
> (a) non-reporting funds (see Part 2 of these Regulations), and
> (b) reporting funds (see Part 3 of these Regulations).
> (2) In a period of account, an offshore fund is a non-reporting fund unless it is a fund to which Part 3 of these Regulations applies.

Regulation 50 OFTR provides:

> In these Regulations a "reporting fund" means an offshore fund to which this Part [Part 3] applies for a period of account.

The requirements to qualify as a reporting fund are not discussed here, though I hope to cover it in a future edition.

The terminology is not to be confused with the CRS concept of reporting/non-reporting financial institutions.

HMRC publish a list of reporting funds.[2]

67.3 Charge to tax on OIG

The legislation distinguishes:

(1) Offshore income gains ("**OIG**"), which arise on a disposal of a non-reporting offshore fund and fall within the offshore funds rules.

(2) Chargeable gains, within the scope of CGT. I refer to this for clarity as "**CGT chargeable gains**" though strictly the term "chargeable gains" is only applicable to CGT. HMRC Manuals sometimes use the term "capital gains". I do not use that expression as capital gains are not necessarily chargeable gains; but in context the meaning may be clear.

Regulation 17(1) OFTR provides the charge to tax:

> There is a charge to tax if—
> (a) a person disposes of an asset,
> (b) either condition A or condition B is met, and
> (c) as a result of the disposal, an offshore income gain arises to the person making the disposal.

I refer to **"OIG conditions A and B"**.

This provision refers to a "person" so it applies to individuals, trustees, companies and PRs.

67.3.1 *Condition A: Non-reporting fund*

Regulation 17(2) OFTR provides:

> Condition A is that the asset is an interest in a non-reporting fund at the time of the disposal.

67.3.2 *Condition B: former non-reporting fund*

Condition B concerns funds changing from non-reporting to reporting fund status. Regulation 17(3) OFTR provides:

> Condition B is that—
> (a) the asset is an interest in a reporting fund at the time of the disposal,
> (b) the reporting fund was previously a non-reporting fund

[2] *https://www.gov.uk/government/publications/offshore-funds-list-of-reporting-funds*

(becoming a reporting fund as the result of an application under regulation 52),

(c) the interest was an interest in a non-reporting fund during some or all of the material period,[3]

(d) an election under regulation 48[4] was not prevented by paragraph (5) of that regulation, and

(e) no election has been made under regulation 48(2).

67.3.3 *OIG treated as income*

Regulation 18(1) OFTR provides:

> The offshore income gain arising is treated for all the purposes of the Tax Acts as income which arises at the time of the disposal to the person making the disposal (or treated as making the disposal).

OIG are not income for trust law purposes; so for instance, proceeds of sale of an offshore fund represent OIG but are not payable to a life tenant.

In accordance with the principles of plain English drafting, reg.18(5) signposts the exceptions:

Regulation	**Topic**
19	Remittance basis
20(1)	Non-resident trusts: OIG not income of settlor
20(5)	Non-resident trusts
24(6)	s.3 TCGA

67.3.4 *Person liable*

Regulation 18(2) OFTR provides:

> The tax is charged on the person making the disposal (or treated as making the disposal).

67.3.5 *Charge as misc income*

Reg 18(3) OFTR: Income tax	**Reg.18(4) OFTR: Corporation tax**
In the case of a person chargeable to income tax, tax is charged under	In the case of a person chargeable to corporation tax, tax is charged

[3] Defined reg. 17(4) OFTR:
"For the purposes of paragraph (3)(c) the "material period" means a period
[a] beginning with the day on which consideration was given for the acquisition of the asset or on 1st January 1984 (whichever is the later) and
[b] ending with the day on which the fund became a reporting fund."

[4] See 67.26 (Fund becomes reporting fund).

Chapter 8 of Part 5 of ITTOIA 2005 (miscellaneous income: income not otherwise charged) for the year of assessment in which the disposal is made ...	under Chapter 8 of Part 10 of CTA 2009 (miscellaneous income: income not otherwise charged) for the accounting period in which the disposal is made.

Thus the charge is under the Misc Sweep-up Income charge.[5]

Regulation 18(3) continues:

> but sections 688(1) and 689 of ITTOIA 2005 (income charged and person liable) do not apply.

These sections are disapplied because OFTR cover the points or covers them differently.

Under s.689, the person liable is the person liable is the person receiving/ entitled to the income. Under reg 18(2) tax is charged on the person making (or treated as making) the disposal. I would have thought that was the same thing.

Under s.688(1) the charge is on the income arising in the tax year. But OIG is the same. Perhaps s.688(1) is disapplied in order to disapply the exceptions in s.688(2).

It would have been simpler to impose a separate charge, rather than to incorporate the charging provision from the misc income sweep-up provisions, and then to exclude other rules of those provisions; but it does not matter. I think the drafting is for historical reasons as the earlier provisions imposed a charge under sch D case VI.

67.4 Meaning of "disposal"

It will be recalled that there is a charge to tax if a person disposes of an offshore fund. "Disposal" is defined in Chapter 4 Part 2 OFTR. Regulation 32 provides:

> This Chapter [Chap 4 Part 2] applies if a participant disposes of an asset and at the time of the disposal—
> (a) the asset is an interest in a non-reporting fund, or
> (b) [i] the asset is an interest in a reporting fund and
> [ii] the requirements specified in paragraph (3) of regulation 17 (read, as appropriate, with paragraphs (4) and (5) of that regulation)[6] are met.

[5] See 33.1 (Misc Sweep-up Income).

[6] See 67.3.2 (Condition B: former non-reporting fund).

I cannot see the point of this, as if a participant disposes of an asset which is not within (a) or (b) then there is no charge under the OFTR and the question of whether there is a disposal for the purposes of the OFTR does not arise. I would be grateful to any reader who could explain. However that may be, reg.32 does no harm.

We can move on to reg.33(1) which defines disposal:

> There is a disposal of an asset for the purposes of these Regulations if there would be a disposal of an asset for the purposes of TCGA 1992.

It is considered that this incorporates the CGT rules on the timing of disposals, as well as the CGT definition of disposal.

OIG differs from CGT in two respects:

Issue	**See para**
Charge on death	67.5
Reorganisations	67.27

67.5 OIG charge on death

For CGT purposes, there is no disposal on death. Section 62(1) TCGA provides:

> For the purposes of this Act the assets of which a deceased person was competent to dispose—
> (a) shall be deemed to be acquired on his death by the personal representatives or other person on whom they devolve for a consideration equal to their market value at the date of the death, but
> (b) shall not be deemed to be disposed of by him on his death (whether or not they were the subject of a testamentary disposition).[7]

Regulation 34(1) OFTR undoes this and provides for a deemed disposal on death:

> Notwithstanding anything in paragraph (b) of subsection (1) of section 62 of TCGA 1992 (general provisions applicable on death: no deemed disposal by the deceased), where a person dies and the assets of which the deceased was competent to dispose[8] at the time of death include an

[7] See 88.5 (Acquisition by PRs).

[8] Regulation 34(2) defines this expression by reference:

"... the reference in that paragraph to the assets of which a deceased person was

> interest in a non-reporting fund, then, for the purposes of these Regulations—
>
> (a) immediately before the acquisition referred to in paragraph (a) of that subsection, that interest shall be deemed to be disposed of by the deceased for such a consideration as is mentioned in that subsection; ...

For completeness, reg.34(1) concludes:

> but (b) nothing in this regulation affects the determination, in accordance with regulation 32, of the question whether that deemed disposal is one to which this Chapter applies.

I cannot see the point of that, but it does no harm.

Regulation 34(2) incorporates other rules of s.62 TCGA:

> Subject to paragraph (1), section 62 of TCGA 1992 applies for the purposes of these Regulations as it applies for the purposes of that Act...,

The following provisions of s.62 therefore apply for OIG; I set out the section highlighting the amendments that the context requires when applying the section to OIG:

> [(2) and (2A) deal with losses and are not relevant to OIG.]
>
> (3) In relation to property forming part of the estate of a deceased person the personal representatives shall for the purposes of this Act be treated as being a single and continuing body of persons (distinct from the persons who may from time to time be the personal representatives), and that body shall be treated as having the deceased's residence and domicile at the date of death.
>
> (4) On a person acquiring any asset as legatee (as defined in section 64)—
>
> (a) no ~~chargeable~~ offshore income gain shall accrue to the personal representatives, and
>
> (b) the legatee shall be treated as if the personal representatives' acquisition of the asset had been his acquisition of it.
>
> (5) Notwithstanding section 17(1) no ~~chargeable~~ offshore income gain shall accrue to any person on his making a disposal by way of donatio mortis causa.
>
> [Subsections (6) to (9) deal with IoVs and need not be set out here.]

competent to dispose are to be construed in accordance with [s.62(10) TCGA]." Section 62(10) provides a commonsense definition; see 88.5 (Acquisition by PRs).

The IF Manual deals with the interaction of the OIG charge on death and IHT:

> **IFM13383: Offshore Funds: participants in offshore funds: participants within the charge to income tax: disposals: non-reporting funds: death of participant** [Apr 2020]
> ...An offshore income gain arises and resulting tax becomes payable before the estate of the deceased person is valued for inheritance tax purposes.

There is scope for deathbed planning: a lifetime gift to charity or to a spouse avoids the OIG charge on death, because no OIG arises on the disposal (applying CGT rules which brings into effect the CGT spouse exemption and the CGT charity exemption). By contrast if there is a gift by will to charity or to a spouse the OIG comes into charge on the death. It seems that a gift by way of *donatio mortis causa* [gift in anticipation of death] also avoids the OIG charge on death.[9]

67.6 OIG arising to partnership

Partnerships are transparent for IT and CGT, in the sense that income/gains arise to the partners not the partnership, The same applies to OIG. HMRC agree. SAI Manual provides:

> **6370 Offshore income gains: The tax charge** [Feb 2020]
> Where an offshore income gain is realised by a partnership, each partner should be separately assessed in respect of his share of the ... income.

67.7 OIG remittance basis

Regulation 19 OFTR provides:

> (1) This regulation applies to income treated as arising under regulation 17 to an individual in a tax year if—
> (a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for that year, and
> (b) the individual is not [actually] domiciled[10] in the UK in that year.
> (2) The income is treated as relevant foreign income of the individual.

The significance of treating the income as RFI is that the income can

[9] See 88.7.3 (Gift in anticipation of death).

[10] The deemed domicile rules do not apply to para 19(1)(b): see 5.3.1 (Scope of IT/CGT deemed-dom). But that does not matter, as the deemed domiciled rules do apply for s.8090B (remittance basis claim), and for s.809E; so a deemed domiciled individual cannot usually meet the requirement in reg 19(1)(a).

qualify for the remittance basis. I refer to this as the "**OIG remittance basis**".

The remittance basis applies even if the offshore fund is a UK situate asset (the CGT situs rules are not relevant) but in practice that is not likely to happen.

So long as the gain is not remitted, a remittance basis taxpayer will not care if the gain is a chargeable gain or an OIG, ie they will not care whether the asset disposed of is an offshore fund.

Regulation 19(3) OFTR contains two rules:

> For the purposes of Chapter A1 of Part 14 of ITA 2007 (remittance basis)—
>
> (a) any consideration obtained on the disposal of the asset[11] is treated as deriving from the income, and
>
> (b) unless the consideration so obtained is of an amount equal to or exceeding the market value of the asset, the asset is treated as deriving from the income.

At first sight it is not clear why reg.19(3)(a) is needed. It seems self-evident. There is no equivalent in the CGT charge on gains accruing to individuals. But a reason will emerge.[12]

Regulation 19(3)(b) is the equivalent of the CGT rule for deemed gains.[13]

67.8 OIG arising to UK trust

67.8.1 *UK trust (not settlor-interested)*

A UK resident trust is in principle subject to income tax on its OIG.[14] Tax is charged at the trust rate, 45%: it falls within s.482 type 3.[15]

67.8.2 *UK settlor-interested trust*

An OIG arising to UK trustees is not "income" in the general sense and in

[11] Reg 19(4) provides two somewhat unnecessary definitions:

"In paragraph (3)—

(a) "the asset" means the asset the disposal of which causes the income to be treated as arising, and

(b) "the disposal" means the disposal mentioned in sub-paragraph (a) of that paragraph."

[12] See 67.13.7 (OIG s.87 TCGA remittance basis).

[13] See 18.45 (Gain on disposal at undervalue).

[14] See 67.3 (Charge to tax on OIG).

[15] See 41.2.3 (Trust-rate income).

the absence of express provision it would not fall within s.624 ITTOIA which only applies to income. However reg.18 OFTR directs that the OIG is "treated for all the purposes of the Tax Acts as income" so it does fall within s.624 ITTOIA.

If the settlor is a remittance basis taxpayer the s.624 remittance basis applies, ie an unremitted OIG is not taxed on the settlor but on the trustees.[16]

The rate of tax in the absence of s.624 is the trust rate, which is the top rate, so s.624 can only reduce the tax rate (or make no difference).

67.9 OIG non-residence defence

Regulation 22(1) OFTR provides a territorial limitation for non-residents:

> The following enactments have effect in relation to income tax or corporation tax in respect of offshore income gains as they have effect in relation to capital gains tax or corporation tax in respect of chargeable gains—
>
> (a) section 2(1) of TCGA 1992 (persons chargeable to capital gains tax) ...

This incorporates the CGT territorial limitations by reference.[17]

[16] See 47.8 (s.624 remittance basis).

[17] See 56.6.3 (Territorial scope: Summary). For completeness: reg 22 OFTR also incorporates s.10 TCGA (now s.1B TCGA) which would apply if a non-resident carried on a trade through a branch or agency and used the offshore funds for the purposes of the trade. This gives a neat symmetry with the CGT rules but it is hard to imagine that this will ever apply in practice. Regulation 22 provides:

> "(1) The following enactments have effect in relation to income tax or corporation tax in respect of offshore income gains as they have effect in relation to capital gains tax or corporation tax in respect of chargeable gains—
>
> ...
>
> (b) section 10 of TCGA 1992 (non-resident with a UK branch or agency);
>
> (c) section 10B of TCGA 1992 (non-resident company with UK permanent establishment).
>
> (2) Paragraph (1) is subject to paragraphs (3) and (4).
>
> (3) In the application of section 10 of TCGA 1992 in accordance with paragraph (1), paragraphs (a) and (b) of subsection (1) (assets on the disposal of which chargeable gains are taxable) have effect with the omission of the words "situated in the UK and".
>
> (4) In the application of section 10B of TCGA 1992 in accordance with paragraph (1), paragraphs (a) and (b) of subsection (1) (assets on the disposal of which chargeable profits arise for the purposes of corporation tax) have effect with the

After the 2019 rewrite, the reference to s.2(1) takes effect as a reference to the CGT/CT rules in s.1A(1)/2B(1) TCGA. It is helpful to read these side by side, amended as reg. 22(1) directs:

IT: s.1A(1) TCGA	**CT: s.2B(1) TCGA**
A person who is UK resident for a tax year is chargeable to ~~capital gains tax~~ income tax on ~~chargeable gains~~ offshore income gains accruing to the person in the tax year on the disposal of assets wherever situated.	A company which is resident in the UK in an accounting period is chargeable to corporation tax on ~~chargeable gains~~ offshore income gains accruing to the company in the period on the disposal of assets wherever situated.

By implication, a person is not chargeable to IT on offshore income gains if they do not meet the residence condition, that is, if they are not UK resident.

67.10 OIG arising to non-resident trust

Where an OIG arises to a non-resident trust, the trustees are not subject to tax on the gain because they are non-UK resident.

67.10.1 *Non-res. settlor-interested trust*

An OIG arising to a non-resident settlor-interested trust is not within s.624 ITTOIA, unlike a UK resident trust. Regulation 20(1) OFTR provides:

> If
> [a] an offshore income gain arises to a settlement in a tax year and
> [b] the trustees of the settlement are not resident in the UK in the tax year,
> the gain is not regarded as income for the purposes of Chapter 5 of Part 5 of ITTOIA 2005 (settlements: amounts treated as income of settlor).

It follows that a settlor (if liable under s.720) does not have an indemnity against the trust for the tax. One wonders if this has been thought through.

The whole of Chapter 5 is disapplied, so where a capital payment is made to a minor child of the settlor, the settlor is not taxable under s.629 ITTOIA (instead the child would be taxable at the appropriate rate. This could lead to a significant saving).

omission of the words “situated in the UK and”.”

Section 1015 ITA could also restrict the territorial scope of the OIG charge, but the rules discussed here leave it no room to operate.

67.11 OIG anti-avoidance: Outline

The rule that non-resident trusts and companies are not subject to tax on OIG presents an obvious means of tax avoidance. HMRC might have applied either ToA or CGT anti-avoidance provisions to deal with this. In fact they have applied both:
(1) The ToA provisions apply: reg.21
(2) The CGT provisions apply (with amendments):
 (a) Regulation 20 applies s.87 TCGA.
 (b) Regulation 24 applies s.3 TCGA.

Further rules are needed to deal with the many possible ways in which the anti-avoidance provisions may interact:
(1) Interaction between these IT and CGT anti-avoidance provisions potentially applying to the same OIG; and
(2) Interaction between:
 (a) the applicable anti-avoidance provision relating to an OIG and
 (b) s.731 or CGT s.87 (where a beneficiary receives a benefit and there is also relevant income or a CGT s.1(3) amount).

67.11.1 *OIG avoidance rules: Critique*

The result of applying two sets of overlapping anti-avoidance provisions is so complicated that no-one could expect the rules which I seek to explain below to be applied in practice, except by the largest trusts with a large budget for UK professional advice. It also introduces a full set of anomalies and some scope for tax planning.

Although it was the case before 2008 that both ToA and CGT anti-avoidance provisions applied, the 2008 reforms made both sets of provisions more complicated, so that the dual application presents much more complexity than before.

The drafting of the OIG provisions was even more rushed than the rest of the 2008 legislation, leaving no time even for HMRC to properly consider the issues, let alone for consultation.[18] It seems to me that there can be no better criticism of the rules than an attempt to explain them. The reader who labours through this chapter is likely to agree that the law ought to be simplified by applying either the ToA or the CGT anti-avoidance rules – CGT would be the better of the two, as OIG are more

[18] The 2009 regulations might have offered an opportunity to rethink, but it was not taken up.

like capital gains – but not both.

67.12 OIG ToA provisions

An OIG arising to a non-resident is not "income"; so in the absence of express provision it would not fall within the ToA provisions even if it arose to a person abroad within s.720 or s.731.[19] Regulation 21(1) OFTR deals with this and thus applies the ToA provisions to OIG:

> Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) applies in relation to an offshore income gain arising to a person resident or domiciled outside the UK as if the offshore income gain were income becoming payable to the person.

It is helpful to distinguish the ordinary transfer of asset rules and the rules as they apply to OIG. I use the following terminology:

(1) **"OIG s.720"**: the provisions of s.720 ITA which apply when:
   (a) a person abroad receives OIG, treated as income for the purposes of s.720, and
   (b) the transferor is deemed to receive income ("**OIG s.720 income**").

(2) "**OIG s.731**": the provisions of s.731 ITA which apply when:
   (a) a person abroad receives OIG, treated as relevant income for the purposes of s.731, and
   (b)a beneficiary is deemed to receive income ("**OIG s.731 income**").

There are only limited differences between the way that s.720/ 731 work for OIG/ordinary income.

67.12.1 *s.720/s.371 remittance basis*

Regulation 21(2) OFTR provides:

> Income treated as arising under that Chapter [Chapter 2 Part 13 ITA, transfer of assets abroad] by virtue of paragraph (1) is regarded as "foreign" for the purposes of section 726, 730 or 735 of that Act.

This feeds into s.726 ITA which provide a remittance basis for s.720 income.[20] So the s.720 remittance basis applies for OIG s.720 income. The s.731 remittance basis applies similarly for OIG s.731 income.

The motive and EU-law defences may also apply.

[19] See 48.15 (Income of person abroad).

[20] See 49.26 (s.720 remittance basis).

67.12.2 *OIG: Protected s.720 income?*

The question arises whether offshore income gains of a person abroad constitute protected foreign-source income (in my terminology, "protected s.720 income").[21] This matters because protected s.720 income qualifies for (what I call) s.720 protected-trust relief. One would expect the answer to be, yes, whether or not the transferor was a remittance basis taxpayer; because that is the case for other foreign source income, and one would expect OIG to be treated in the same way.

The definition of protected s.720 income is in s.721A ITA. The difficulty is the RFI condition, that:

> it [in this case, the OIG which arises to the person abroad] would be relevant foreign income if it were the individual's[22]

Income is RFI if there is a provision which specifically says so.[23]

There are three provisions which might be called on to show that the requirement in s.721A(3)(a) is met.

The first contender is reg. 21(2) OFTR, combined with s.726 ITA. But that does not help for two reasons (either one would suffice):

(1) it concerns the s.720 OIG income which arises to the transferor. We are concerned with the OIG income which arises to the person abroad. The two are distinct.

(2) s.726 only applies to remittance basis taxpayers (like reg 19).

The second contender is reg. 19 OFTR. This provides:

> (1) This regulation applies to income treated as arising under regulation 17 to an individual in a tax year if—
>
> (a) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to the individual for that year, and
>
> (b) the individual is not domiciled in the UK in that year.
>
> (2) The income is treated as relevant foreign income of the individual.

For the purpose of the RFI condition, we must imagine that the OIG arising to the person abroad arises to the individual. It should follow, applying the deeming, that there is income treated as arising under

[21] See 60.9 (Protected s.720 income).

[22] Where the person abroad is a trust the applicable provision is s.721A(3)(a) ITA. Where the person abroad is a company, the applicable provision is s.721A(4)(a) ITA. But the wording is the same in each case, so it makes no difference.

[23] See 16.9.2 ("Relevant foreign income").

regulation 17 to the individual.[24] However reg 19 only applies if the individual is a remittance basis user.

That suggests that the position is as follows:

(1) If the transferor is a remittance basis taxpayer, the OIG is protected s.720 income, and qualifies for s.720 protected-trust relief.

(2) If the transferor is not a remittance basis taxpayer (typically because they are deemed domiciled and cannot claim the remittance basis; or because they chose not to do so) then the OIG is not protected s.720 income; so it is taxable on the transferor on an arising basis.

That would be a strange and no doubt unintended result.

67.12.3 *Deemed source argument*

A third argument is based on s.830(1) ITTOIA:

> ... "relevant foreign income" means income which
> (a) arises from a source outside the UK, and
> (b) is chargeable under any of the provisions specified in subs.(2)

OIGs are chargeable under one of the provisions specified in s.830(2), namely, Chapter 8 Part 5 ITTOIA, which is specified in s.830(2)(o).

The professional bodies have flagged up this argument in a series of papers ("OIG papers"). For completeness, these are:

Title	**ICAEW name**	**Date**
Summary Technical Analysis		Jan 2019
HMRC Response		Nov 2020
Trust Protections and Offshore Income Gains	TAXguide 03/21	Feb 2021[25]

The 2021 OIG paper sets out the text of the earlier papers verbatim, so it is not now necessary to read the earlier papers..

The 2019 OIG paper started with a disclaimer in fortissimo:

> THE ANALYSIS BELOW DOES NOT REFLECT THE VIEWS OF ANY OF THE PROFESSIONAL BODIES. IT IS PUBLISHED SO THAT PROFESSIONAL ADVISERS CAN CONSIDER THE ANALYSIS FOR THEMSELVES USING THEIR OWN PROFESSIONAL JUDGMENT AND

[24] Reg.17 requires a disposal, and there is no provision expressly deeming a disposal; contrast 67.13.5 (Deemed disposal for s.87). But this can be implied.

[25] *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2021/taxguide-03-21-deemed-domicile-changes---note-on-the-trust-protections-and-offshore-income-gains.ashx*

> CONSTITUTES NEITHER ADVICE NOR GUIDANCE ...

The 2021 paper has a similar disclaimer, though no longer in block capitals.

The "summary technical analysis" is as follows:

> 4) ... the question put is whether the income would meet the definition of RFI at section 830 ITTOIA 2005 if received by the transferor directly. There are 2 conditions to be RFI.
>
> *Condition 1: Is the OIG foreign income?*
>
> All income must have a source (various case law can be cited in support of this contention), so if one carries through the deeming in line with *Marshall v Kerr* ... then the deemed income must too have a source.
>
> [The analysis cites the well-known passage from *Marshall v Kerr*,[26] and continues]
>
> In the case of offshore income gains the source should be the foreign fund (it is argued that nothing else is plausible (as stated at the beginning readers must make their own evaluation on this and the other issues).

But an OIG does not arise from a source, as it is a capital gain.[27] It is not the case that "All income must have a source". The CIOT argument fails at this point. HMRC agree.

I set out the rest for completeness:

> *Condition 2: Is the OIG chargeable under one of the provisions listed in s830(2), one of which is Chapter 8 of Part 5 (income not otherwise charged)?*
>
> The analysis postulates that under section 721A(3) the income is received by the transferor (see point 3 above). The analysis goes on to say that Regulation 18 would then be the relevant charging provision in this case (charging individuals under Chapter 8 of Part 5 ITTOIA 2005).
>
> Taking all of the above into account, the analysis concludes that both conditions 1 and 2 are met.
>
> Having gone through the above, the analysis concludes that:
>
> - the OIG does meet the definition of RFI at section 830 ITTOIA 2005; and
> - the corollary of this conclusion is that the OIG falls within the trust protections on first principles.

CIOT then seek to explain the purpose of reg 19(2) and s.830(4)(aa)

[26] See App. 4.4 (Deeming provisions: Construction).

[27] See 16.6 (No source/deemed source).

ITTOIA (which refers to reg 19(2)):

> Various arguments have been put forward. The first is that regulation 19(2) was included by the draftsman to put the matter beyond any doubt. [CIOT cite a well-known comment on the argument from redundancy[28]]. Alternative arguments are that:
>
> - regulation 19 deals only with remittance basis users but is not exclusive; or
> - in 2009 regulation 19 unnecessarily re-enacted section 762ZB ICTA 1988 without appreciating that the 2008 reforms had already brought OIGs within Chapter 8 Part 5 ITTOIA.
>
> Whichever argument is correct the analysis states that the existence of regulation 19(2) and section 830(4)(aa) ITTOIA 2005 does not preclude the technical argument made that OIGs should fall within the trust protections on first principles.

But reg 19(2) is needed on the basis that an OIG has no source.

CIOT say:

> Note that there is a similar issue for accrued income profits with a similar technical argument being available for why the income should come within the trust protections.

It is arguable that a purposive construction should apply, so that OIG can be protected s.720 income even if the transferor does not claim the remittance basis. As tax statutes become more complex, and the standard of statutory drafting does not (and realistically, cannot) meet the challenge, the Courts should become more willing to correct obvious slips by construction. But that requires moving the line which distinguishes construction from rewriting the legislation.

CIOT asked to change the law, but it was too much trouble.[29] Perhaps

[28] See App.2.1.2 (Argument from redundancy).

[29] HMRC say (2018): "A decision has been made not to amend the current legislation to include income arising in offshore non-reporting funds in the foreign trust exemptions at this time. The current demands placed on parliamentary resource make it difficult for the government to justify returning to the legislation at this time to add to the generous package of protections which the government has already legislated for in the extensive reform of the non-dom rules last year. Going forward, HMRC will continue to monitor this situation and engage with stakeholders."
https://www.tax.org.uk/non-dom-reforms-protected-trusts-and-non-reporting-funds-a-survey-for-completion-by-offshore-trustees
The reason (if it can be called that) will not satisfy HMRC's customers, and perhaps

the hope of the CIOT argument was to give HMRC the opportunity to allow the relief under the easier guise of interpretation. But HMRC declined to do so, with an analysis which is technically correct, though lacking an acknowledgement of the unfairness of the consequences:

> Having considered the analysis HMRC CANNOT AGREE THAT IT IS A CORRECT INTERPRETATION for the OIG situation and we would make the following observations:
> 1) Whilst we appreciate that Regulation 18 of the Offshore Funds (Tax) Regulations 2009 (the Offshore Funds Regulations) treats OIGs arising to participants in non-reporting funds as income which arises at the time of the disposal to the person making the disposal "for all the purposes of the Tax Acts" we do not agree that it follows that OIG income is relevant foreign income as defined in s 830(1)ITTOIA.
> 2) For the purposes of s 830(1) ITTOIA relevant foreign income means income which:
>
> a) arises from a source outside the UK; and
> b) is chargeable under any of the provisions listed in s 830(2)
>
> We do not consider that OIG income treated as arising under Regulation 18(2) of the Offshore Fund Regulations can be said to be income which arises from a source outside the UK. Whilst Regulation 18(2) treats the OIGs as income which arises at the time of the disposal to the person making the disposal it does not treat it as income arising from a source outside the UK. To do so would be to take the deeming provision too far.

It is not even a matter of taking the deeming "too far": the deeming simply does not entail that the offshore fund has a source.

> Therefore it is our view that while it may (?) be correct to say that such deemed income is chargeable under Chapter 8 of Part 5 ITTOIA and thus falls within s 830(2)(o), it does not fall within the definition of relevant foreign income.
> 3) S 830(4) ITTOIA refers to the treatment of "other income" as relevant foreign income. The wording of this provision makes it clear that it was intended to deal with the treatment of income which had not already been covered in the preceding subsections. It refers to the "treatment" of these categories of income as relevant foreign income rather than stating that they will fall within the definition of relevant foreign income. This is because only some of the statutory provisions listed treat the income in question as relevant foreign income for all

the decision will come to be reviewed.

purposes. Others such as the provision relating to OIG income limit this treatment.

4) We do not believe that it is correct to say that the provision in Regulation 19(2) of the Offshore Funds Regulations simply restates the position which already existed as a result of applying the definition of relevant foreign income set out in section 830(1) and (2) ITTOIA (on the assumption that OIG income fell within it). If OIG income was correctly categorised as relevant foreign income under s 830(1) and (2) ITTOIA, that would have enabled an individual who was a non-domiciled remittance basis user access to the remittance basis in respect of that income. However there are also other consequences of income being categorized as relevant foreign income which apply to those other than non-domiciled remittance basis users. For example, Part 8 Chapter 3 ITTOIA contains provisions about deductions and reliefs available where relevant foreign income is charged on the arising basis.[30]

Therefore, if it was correct to say that OIG income falls within s 830(1) ITTOIA, the effect would be not only that non-domiciled remittance basis users would be able to claim remittance basis in respect of that income, but that those individuals in receipt of OIG income who are not non-domiciled remittance basis users would be entitled to those deductions and reliefs. When the Offshore Fund Regulations were made, Regulation 19(2) could have stated that OIG income treated as arising under Regulation 17 was treated as relevant foreign income of the individual. However it did not do so – it specifically limited treatment of OIG income as relevant foreign income to those cases where the individual was a non-domiciled remittance basis user.

5) If HMRC were to accept that OIG income already falls within the definition of relevant foreign income in s 830(1) and (2) ITTOIA, the effect would be wider than simply enabling OIG income treated as arising to offshore trustees to be within the definition of protected foreign source income for the purposes of section 721A Income Tax Act 2007. It would also mean that individuals not entitled to claim remittance basis could treat their OIG income as relevant foreign income for the purposes of the rules about expenses and deductions in Part 8 Chapter 3 ITTOIA both before and after the 6 April 2017 date. This would appear to frustrate the intentions of Parliament in enacting section 830 ITTOIA, which clearly indicates that it is s 830(4)(aa) and the provisions of the Offshore Funds Regulations which are to determine the treatment of OIG income as relevant foreign income.

[30] See 16.10 (RFI collection costs).

> ... The intention behind Regulations 18 and 19 of the Offshore Funds Regulations is clear, in that those provisions, rather than s 830(1), are to determine the relevant foreign income treatment of such deemed income and this is confirmed by the wording of s 830(4)(aa) ITTOIA. Here we have a provision which deems an OIG to be income arising at the time of the disposal to the person making the disposal but does not go on to deem it to be income arising from a foreign source. There is nothing in the deeming provision which is irreconcilable with the conclusion that the OIG income, being deemed rather than actual income, does not have a source.

An action group was formed with a view to taking a test case, but no test case has been forthcoming.[31]

67.12.4 *Tax return disclosure*

CIOT say:

> **2017/18 Tax Returns**
> For those completing 2017/18 returns now, where this issue is in point, consideration will need to be given as to what filing position to take. The professional bodies cannot provide advice or guidance; however, professional advisers may want to take the following into account.
> HMRC expect: (i) tax returns to be filed on the basis that the trust protections do not apply to OIGs; and (ii) for tax to be paid accordingly.
> Notwithstanding HMRC's response, an adviser might consider that the better technical position is that the trust protections DO apply. This could be on the basis of the [CIOT analysis] ... or as a result of a different technical analysis. Appropriate white space disclosure of the technical position should be considered (this would include a reference to the view taken being contrary to that of HMRC) bearing in mind the fundamental principles and standards set out in PCRT with particular reference to paragraph 2.29 et seq.[32]
> If the tax return is filed on the basis that the trust protections do not apply, the client will have to 31 January 2020 to file an amended return.
> In the light of the HMRC response, tax advisers may want to consider: (i) whether to amend returns already submitted on the basis that the trust protections do apply; or (ii) whether they feel that the HMRC response is incorrect (in such cases the adequacy of the initial white space disclosure may be something to review).

[31] For details, contact Jennifer.Smithson@Macfarlanes.com

[32] See 122.3 (Tax return filing position); 122.8 (Disclosing doubt/further information).

The 2021 OIG paper upgrades this advice (if one may use the term, having regard to the disclaimer?):

> full disclosure is essential (this would include a reference to the view taken being contrary to that of HMRC).

The PCRT has not changed in the interim, but it seems that its "fundamental principles and standards" are susceptible to more than one interpretation. But in this case, disclosure would be advisable.

67.13 OIG s.87 charge

An OIG is not a chargeable gain, and so in the absence of express provision an OIG arising to a non-resident trust would not be a s.1(3) amount (trust gain), and would not give rise to a charge under s.87 TCGA. Regulation 20(3) OFTR deals with this and applies the s.87 rules with modifications. Because there are modifications, there are significant differences between OIG s.87 and CGT s.87.

67.13.1 *OIG s.87 charge*

Regulation 20(3) OFTR incorporates the s.87 TCGA rules in this manner:

> Sections 12,[33] 87 to 90A and 96 to 98 of, and Schedule 4C to, TCGA 1992 apply in relation to OIG amounts[34] as if—
> (a) references to section 2(2) amounts[35] (except those in paragraph 7B(2)(b) and (4) of Schedule 4C) were to OIG amounts,
> (b) references to chargeable gains (except the one in paragraph 1(5) of Schedule 4C) were to offshore income gains,
> (c) references to anything accruing were to it arising[36] (and similar references, except the one in paragraph 1(5) of Schedule 4C, were read accordingly),
> (d) sections 87(4), 88(2) to (5) and 97(6) and paragraphs 1(3A), 3 to 7 and 12 of Schedule 4C were omitted, and

[33] The reference to s.12 TCGA in regulation 20(3) (which became sch 1 TCGA under the 2019 CGT rewrite) makes no sense, and must be a drafting error. However no great harm is done by the error. What matters is the incorporation of s.87 ff TCGA.

[34] See 67.13.2 ("OIG amount"),

[35] Section 2(2) amounts (trust gains) are now called s.1(3) amounts; but the 2019 CGT rewrite did not rewrite statutory instruments.

[36] The terminology of the Taxes Acts is that CGT chargeable gains *accrue;* but OIG *arise.* There is no difference in meaning so it seems slightly pedantic to make the change of terminology when incorporating the CGT s.87 provisions for OIG; but it does no harm.

(e) regulation 21[37] did not apply.

In this section I consider the application of s.87-98 TCGA to OIG.

I do not set out all of s.87-98 TCGA, as amended, because the text would be too long for the exercise to be useful. The key provision is s.87(2)(3) TCGA which (amended as reg.20(3) directs) provides:

> (2)[a] *Offshore income gains* are treated as *arising* in the relevant tax year to a beneficiary of the settlement
> [b] who has received a capital payment from the trustees in the relevant tax year or any earlier tax year
> [c] if all or part of the capital payment is matched (under s.87A as it applies for the relevant tax year) with the *OIG amount* for the relevant tax year or any earlier tax year.
>
> (3) The amount of *offshore income gains* treated as *arising* is equal to—
> (a) the amount of the capital payment, or
> (b) if only part of the capital payment is matched, the amount of that part.

It is necessary to distinguish CGT s.87 and OIG s.87 because the rules are not identical. I use the following terminology:

(1) "**CGT s.87**", the provisions of s.87 TCGA which apply when:
  (a) a trust has a "**CGT s.1(3) amount**" (trust gains) and
  (b) a beneficiary is deemed to receive a CGT chargeable gain ("**s.87 CGT gain"**).

(2) "**OIG s.87**", the provisions of s.87 as amended, which apply when:
  (a) a trust has an "**OIG amount**"; and
  (b) a beneficiary is deemed to receive an OIG ("**s.87 OIG**").

For a discussion of CGT s.87, see 61.1 (s.87 code: Introduction). I concentrate here on points where OIG s.87 is different from CGT s.87.

67.13.2 *"OIG amount"*

Regulation 20(2) OFTR defines the term "OIG amount":

> If—
> (a) offshore income gains arise to the trustees of a settlement in a tax year, and
> (b) section 87 of TCGA 1992 (gains of non-resident settlements) applies to the settlement for that year,

[37] See 67.12 (OIT ToA provisions).

> the OIG amount for the settlement for that year is the amount of the offshore income gains.

"OIG amount" is the OIG equivalent of the CGT concept "s.1(3) amount" (formerly called trust gains).

The definition is not identically worded. It is necessary to have a different definition, since the definition of s.1(3) amounts (trust gains) caters for losses, and for CGT chargeable gains within s.86 TCGA; the definition of OIG amounts does not do this because there is no relief for OIG losses and s.86 does not apply to OIG.

67.13.3 *"Capital payment"*

"Capital payment" is defined in s.97(1) TCGA. The OFTR does not amend this. Section 97(1) provides:

> In sections 86A to 96 and Schedule 4C and this section "capital payment"—
> (a) means any payment which is neither—
> (i) chargeable to income tax on the recipient, nor
> (ii) chargeable to income tax on another person under any of sections 643A, 643J and 643L of ITTOIA 2005 and sections 733A, 733C and 733E of ITA 2007,
> or, in the case of a recipient who is not resident in the UK, any payment received otherwise than as income...

Suppose a trust within OIG s.87 makes a capital payment (or what appears to be a capital payment) to a UK resident beneficiary. The definition does not actually work for OIG s.87, since what would otherwise be a capital payment falling within OIG s.87 *is* chargeable to IT under OIG s.87! But for the purposes of OIG s.87 the definition must be taken to read that "capital payment" means:

> [i] any payment which is not chargeable to income tax ... *[apart from OIG s.87]*
> [ii] or, in the case of a recipient who is not resident in the UK, any payment received otherwise than as income...

I refer to a capital payment which is subject to income tax under OIG s.87 as an **"OIG capital payment"**.

67.13.4 *Disapplied provisions*

Regulation 20(3) OFTR provides:

> Sections 12,[38] 87 to 90A and 96 to 98 of, and Schedule 4C to, TCGA 1992 apply in relation to OIG amounts[39] as if ...
>
> (d) sections 87(4), 88(2) to (5) and 97(6) and paragraphs 1(3A), 3 to 7 and 12 of Schedule 4C were omitted, and
>
> (e) regulation 21[40] did not apply.

The provisions disapplied in this way are:

Provision	**Topic**	**Comment**	**See**
TCGA			
s.87(4)	"s.1(3) amount"	not needed	61.6
s.88(2)	"s.1(3) amount" for s.88	not needed	61.38.1
s.88(3)	"assumed chargeable amount"	not needed	61.38.1
s.88(4)(5)	"protected assets"	not needed	61.38.2
s.97(6)	losses	not appropriate	65.13.1
Sch 4C TCGA			
para 1(3A)			
para 3 to 7			
para 12			
Reg 21 OFTR			

67.13.5 *Deemed disposal for s.87*

If OIG s.87 applies, a beneficiary receives a s.87 OIG. OIG s.87 does not directly impose a charge on the s.87 OIG: the deeming feeds into reg.17 which imposes the charge when an OIG arises to the person making the disposal of an offshore fund.[41] A further deeming is needed, because the beneficiary who receives the s.87 OIG does not make a disposal. Therefore reg.20(5) OFTR provides for a deemed disposal, to bring the s.87 OIG into charge under reg.17:

> If this regulation applies, the person to whom the offshore income gain arises is treated as the person making the disposal.

The same rule applies for s.3 OIG.[42]

[38] The reference to s.12 TCGA in regulation 20(3) (which became sch 1 TCGA under the 2019 CGT rewrite) makes no sense, and must be a drafting error. However no great harm is done by the error. What matters is the incorporation of s.87 ff TCGA.

[39] See 67.13.2 ("OIG amount"),

[40] See 67.12 (OIG ToA provisions).

[41] See 67.3 (Charge to tax on OIG).

[42] See 67.14.1 (Deemed disposal for s.3).

67.13.6 *OIG s.87 : Misc points*

The deemed disposal rules of sch 4B TCGA do not apply to OIG,[43] but sch 4C TCGA may apply.

The interest surcharge rule in s.91 TCGA applies only to CGT s.87 and not to OIG s.87.

A capital payment from a trust with OIG amounts does not give rise to an IHT exit charge as the exit charge income exemption applies.[44]

I deal with the 2008 transitional rules elsewhere because they are best considered together with the CGT s.87 transitional rules.[45]

For sch 4C, see 62.32 (OIG sch 4C).

67.13.7 *OIG s.87 Remittance basis*

If a remittance basis taxpayer receives a s.87 OIG, s.87B TCGA applies to bring in a remittance basis just like the CGT s.87 remittance basis.

Reg.19(5) OFTR provides:

> This regulation does not apply for the purposes of regulation 20.

That disapplies the ordinary OIG remittance basis.[46] That is needed because the OIG s.87B remittance basis applies instead.

67.13.8 *HMRC views*

HMRC agree with the above. The IF Manual provides:

> **IFM13430: Effect of residence / domicile of beneficiary on offshore income gains arising in non-resident settlement structures that are attributed under section 87 TCGA rules - regulation 20** [Apr 2020]
>
> **Beneficiary is UK resident and domiciled**
>
> Where attributions are made to a beneficiary who is UK resident or ordinarily resident and is domiciled in the UK, then the full amount of the offshore income gain attributed is liable to tax on the beneficiary as income.
>
> **Beneficiary is UK resident but non-UK domiciled**
>
> Where attributions are made to a beneficiary who is UK resident or ordinarily resident but non-UK domiciled then, under section 87 TCGA

[43] See 62.17.1 (Chargeable asset).

[44] See 76.9.3 (Income-receipt relief).

[45] See 61.42.1 (Pre-2008 OIG amounts); 61.45 (Pre-2008 inter-trust transfer); 61.51 (Rebasing - OIG amounts).

[46] See 67.7 (OIG remittance basis).

rules, the full amount attributed may not be chargeable to income tax. Special rules may apply where the offshore income gains or capital payment were prior to 6 April 2008 – see the Capital Gains Manual from CG38730.

From 6 April 2017 a person may become deemed domiciled under s835BA ITA 2007. This document gives an introduction to the rules.

The full amount of the offshore income gain attributed to the individual reduces the OIG amount of the non-resident settlement structure that is available to match with future capital payments. That is so even though less than the full amount may be chargeable to income tax on the individual.

Beneficiary is non-UK resident

Offshore income gains can still be attributed to a beneficiary who is not resident or ordinarily resident in the UK using the section 87 TCGA attribution rules. This applies even though they may not be chargeable to tax on such an individual. Any such attribution reduces the OIG amount of the non-resident settlement structure that is available to match with future capital payments. Detail on the rules for matching capital payments can be found in the Capital Gains Manual from CG38700.

67.14 OIG s.3 charge

An OIG is not a chargeable gain, so in the absence of express provision an OIG arising to a non-resident company would not fall within s.3 TCGA. Regulation 24 OFTR deals with this and applies s.3 TCGA to OIG, with some modification:

> (1) Section 13 of TCGA 1992 (chargeable gains accruing to certain non-resident companies) applies for the purposes of this Part with the following modifications.
>
> (2) The section applies as if—
>
> (a) for any reference to a chargeable gain there were substituted a reference to an offshore income gain; and
>
> (b) for any reference to anything accruing there were substituted a reference to it arising[47] (with similar references being read accordingly).
>
> (3) The section applies as if, in subsection (5), paragraphs (b) and (c)

[47] The terminology of the Taxes Acts is that CGT chargeable gains *accrue;* but OIG *arise.* There is no difference in meaning, so it seems slightly pedantic to make the change of terminology when incorporating the CGT s.3 code for OIG; but it does no harm.

> were omitted.
>
> (4) The section applies as if, in subsection (7), for the reference to capital gains tax there were substituted a reference to income tax or corporation tax.
>
> (5) The section applies as if subsection (8) were omitted. ...

The references are to the pre-2019 legislation; the OFTR ought to be rewritten for the 2019 CGT rewrite, but the policy is not to update statutory instruments; we will have to cope as best we can.

I refer to this as the **"OIG s.3 charge"**. It is necessary to distinguish the CGT s.3 rules and the OIG s.3 rules because the rules (though similar) are not identical. I refer below to:

(1) "**CGT s.3**", the provisions of s.3 TCGA which apply when:
  (a) a non-resident close company receives CGT chargeable gains, and
  (b) a participator is deemed to receive the gain (the "**s.3 CGT gain"**).

(2) "**OIG s.3**", the provisions of s.3 as amended, which apply when:
  (a) a non-resident close company receives OIG, and
  (b) a participator is deemed to receive the OIG (the "**s.3 OIG**".)

Amended as reg.24 directs, the former s.13 TCGA provided:

> (1) This section applies as respects *offshore income gains arising* to a company—
>
> (a) which is not resident in the UK, and
>
> (b) which would be a close company if it were resident in the UK.
>
> (1A) [Interaction with ATED-CGT and NRCGT; not now applicable]
>
> (2) Subject to this section, every person who at the time when the *offshore income gain arises* to the company is resident in the UK, and who is a participator in the company, shall be treated for the purposes of this Act as if a part of the *offshore income gain* had *arisen* to him.
>
> (3) That part shall be equal to the proportion of the gain that corresponds to the extent of the participator's interest as a participator in the company.
>
> (3A) Subsection (2) does not apply in the case of a participator who is an individual if—
>
> (a) the tax year in which the *offshore income gain arises* to the company is a split year as respects the participator, and
>
> (b) the *offshore income gain arises* to the company in the overseas part of that year.
>
> (4) Subsection (2) above shall not apply in the case of any participator in the company to which the *offshore income gain arises* where the aggregate amount falling under that subsection to be apportioned to him and to persons connected with him does not exceed one quarter of the gain.
>
> (5) This section shall not apply in relation to—
>
> ~~(b) *an offshore income gain* accruing on the disposal of an asset used, and used only—~~

~~(i) for the purposes of a trade carried on by the company wholly outside the UK, or~~

~~(ii) for the purposes of the part carried on outside the UK of a trade carried on by the company partly within and partly outside the UK, or~~

(ca) *an offshore income gain arising* on the disposal of an asset used, and used only, for the purposes of economically significant activities carried on by the company wholly or mainly outside the UK, or

(cb) *an offshore income gain arising* to the company on a disposal of an asset where it is shown that neither—

(i) the disposal of the asset by the company, nor

(ii) the acquisition or holding of the asset by the company,

formed part of a scheme or arrangements of which the main purpose, or one of the main purposes, was avoidance of liability to capital gains tax[48] or corporation tax, or

(d) to *an offshore income gain* in respect of which the company is chargeable to tax by virtue of section 10B.

[*Subsections 5A to 7A relate to company distribution relief and company disposal relief and need not be set out here.*]

~~(8) So far as it would go to reduce or extinguish chargeable gains accruing by virtue of this section to a person in a year of assessment this section shall apply in relation to a loss accruing to the company on the disposal of an asset in that year of assessment as it would apply if a gain instead of a loss had accrued to the company on the disposal, but shall only so apply in relation to that person; and subject to the preceding provisions of this subsection this section shall not apply in relation to a loss accruing to the company.~~

(9) If a person who is a participator in the company at the time when the *offshore income gain arises* to the company is itself a company which is not resident in the UK but which would be a close company if it were resident in the UK, an amount equal to the amount apportioned under subsection (3) above out of the *offshore income gain* to the participating company's interest as a participator in the company to which the gain *arises* shall be further apportioned among the participators in the participating company according to the extent of their respective interests as participators, and subsection (2) above shall apply to them accordingly in relation to the amounts further apportioned, and so on through any number of companies.

(10) The persons treated by this section as if a part of an *offshore income gain arising* to a company had *arisen* to them shall include the trustees of a settlement who are participators in the company, or in any company amongst the participators in which the gain is apportioned under subsection (9) above, if when the gain *arises* to the company the trustees are not resident in the UK.

[48] In the context of offshore income gains, CGT should be read as a reference to Income Tax. When para (cb) was added to s.13, the drafter overlooked the need to make a corresponding amendment to reg.24 OFTR in order to make the words fit to OIG. This slip should be corrected by construction as the intended meaning is clear.

> (10B) [*This relates to pension schemes and need not be set out here*]
> (11) [*This confers relief where tax is paid by the non-resident close company and need not be set out here*]
> (11A) For the purposes of this section the amount of the gain or loss[49] *arising* at any time to a company that is not resident in the UK shall be computed (where it is not the case) as if that company were within the charge to corporation tax on *offshore income gains*.
> [*Section 13(12) to (14) contain definition and administrative provisions which need not be set out here*]

For a discussion of CGT s.3, see 64.1 (Section 3 TCGA: Introduction). I discuss here only the areas where OIG s.3 is different from CGT s.3.

The most important difference is that a s.3 CGT gain is subject to CGT at CGT rates; a s.3 OIG is subject to IT at IT rates.

The deletions in the former s.13(5)(8) make sense as those CGT rules would not be appropriate for OIG s.3.

DT relief may apply where a UK resident trustee holds a treaty non-resident company to which an OIG applies: s.79B TCGA disapplies the relief for CGT[50] but not for OIG.

Non-resident group relief does not apply to OIG s.3 because reg.24 does not incorporate the group relief rules (formerly s.14 TCGA, now s.3F TCGA).

67.14.1 *Deemed disposal for s.3*

If OIG s.3 applies, a participator receives a s.3 OIG. OIG s.3 does not directly impose a charge on the s.3 OIG: the deeming feeds into reg.17 which imposes the charge when an OIG arises to the person making the disposal of an offshore fund.[51] A further deeming is needed, because the participator who receives the s.3 OIG does not make a disposal. Therefore reg.24(6) OFTR provides for a deemed disposal, to bring the s.3 OIG into charge under reg.17:

> If this regulation applies, the person to whom the offshore income gain arises is treated as the person making the disposal.

The same rule applies for OIG s.87.[52]

[49] The words "or loss" are otiose here. Presumably the drafter overlooked the need to delete them as the legislation takes the trouble to delete them elsewhere. But nothing turns on that.

[50] See 64.41(Trust participator: No DT relief).

[51] See 67.3 (Charge to tax on OIG).

[52] See 67.13.5 (Deemed disposal for s.87).

67.14.2 *OIG s.3 remittance basis*

Section 3D TCGA provides the CGT s.3 remittance basis,[53] but that section does not apply for the purposes of OIG s.3. Instead the ordinary OIG remittance basis in reg.19 applies,[54] but the end result is the same. This explains reg.19(3)(a) which provides:

> (3) For the purposes of Chapter A1 of Part 14 of ITA 2007(10) (remittance basis)—
>
> (a) any consideration obtained on the disposal of the asset is treated as deriving from the income. ...

This is the equivalent of s.3D(3) TCGA; see 64.23 (Section 3 remittance basis).

67.15 OIG and s.86

An OIG is not a chargeable gain so it does not fall within s.86 even if it arises to a non-resident trust. There is no provision which extends s.86 to apply. So a settlor of a non-resident trust is not subject to tax on trust OIG under s.86 TCGA; but s.720 may apply where the settlor has power to enjoy.

67.15.1 *Planning: Exclude settlor not children*

Suppose a non-resident trust where:
(1) the settlor and spouse are excluded, but
(2) s.86 applies (because the settlor is UK domiciled and the settlor's children are beneficiaries)

It may be attractive for a trust to invest in offshore funds (which give rise to OIG outside s.86) rather than other assets (which give rise to CGT chargeable gains within s.86). Similarly, the trustees may invest for income and not capital growth. It may however be a balancing exercise, as to do so does increase the rate of tax on capital payments from CGT rates to IT rates.

67.16 OIG s.87/CGT s.87: Priority

Suppose a capital payment is made to a UK beneficiary from a trust with OIG amounts and CGT s.1(3) amounts. This would in principle give rise

[53] See 64.23 (Section 3 remittance basis).
[54] See 67.7 (OIG remittance basis).

to a charge under OIG s.87 and CGT s.87, or at least it might not be clear which of the two applied.

It matters which applies because in one case the OIG is taxed at income tax rates and in the other the CGT chargeable gain is taxed at CGT rates.

Regulation 20(4) OFTR deals with this:

> Section 87A of TCGA 1992 applies for a tax year by virtue of paragraph (3) before it applies for that year otherwise than by virtue of that paragraph.

In short, OIG s.87 has priority to CGT s.87. Where OIG s.87 applies to a capital payment, there is no "capital payment" for the purposes of CGT s.87 as the payment is subject to income tax.

The IF Manual offers the following example:

> **IFM13432: Allocating capital payments between offshore income gains and chargeable gains arising in non-resident settlements - regulation 20(4)** [Apr 2020]
> Example where both offshore income gains and capital gains received
> A settlement with non-UK resident trustees has never been settlor interested and has never received any income.

This simplifies matters as it is not necessary to consider the ToA rules or s.86 TCGA. In real life, the position would generally be more complicated.

> The following OIG amounts and capital gains have been received by the settlement:

	OIG amount	Chargeable gains
2008-09	£30,000	
2009-10		£40,000
2010-11	£50,000	£60,000
Total	£80,000	£100,000

> The first capital payment out of the settlement is made in 2019-20. That is a capital payment of £70,000 to a UK resident and domiciled beneficiary.

The HMRC analysis for 2019/20 is as follows:

> Regulation 20(4) tells you that you match any capital payments with OIG amounts arising in the non-resident settlement before matching with chargeable gains. This applies even if the OIG amount arose in an earlier year than the capital gain.
> Using the section 87A TCGA attribution rules the capital payment is

> matched first with the entire £50,000 OIG amount arising in 2019-20. Then the remaining £20,000 (£70,000 - £50,000) is matched with £20,000 of the £30,000 OIG amount arising in 2017-18.
> The beneficiary is treated as receiving £70,000 offshore income gains chargeable to income tax in 2019-20.

HMRC note that the £70k capital payment is matched with (1) the £50k OIG in 2010/11 and (2) £20k of the OIG in 2008/09. But it does not matter, as on the facts of the example, it makes no difference to which OIG the capital payment is matched. It matters for CGT chargeable gains, because of the interest surcharge, but that does not apply for OIG.

HMRC do not seek to argue that s.731 OIG applies.

HMRC then turn to consider the position going forward:

> There are unmatched OIG amounts and chargeable gains in the settlement to carry forward at 5 April 2020 of:
> 2017-18 OIG amount £10,000 (£30,000 less £20,000 matched with capital payment)
> 2018-19 Capital gains £40,000
> 2019-20 Capital gains £60,000.

The HMRC example is an easier case as there was one capital payment which was less than the total OIG. Suppose there was more than one capital payment, and the total amount exceeded the OIG. For instance, on the facts of the above example, suppose in the same year but on different days:
Capital payment 1: £80k
Capital payment 2: £20k

Does one say:
(a) Capital payment 1 is matched with the OIG and capital payment 2 is matched with the CGT chargeable gains? or
(b) Each capital payment is matched with 80% of the OIG and 20% of the CGT chargeable gains?

It is considered that solution (b) is correct. That is consistent with the rule for s.1(3) amounts (trust gains).

67.17 OIG s.3/ToA priority: Company structure

Suppose an OIG arises to a non-resident company (the company not being held by a trust). This could give rise to a charge
(1) under OIG s.720 (on the transferor) and

(2) under OIG s.3 (on the participators)

or at least it might not be clear which of the two charges applies.

It may not matter which applies, as the OIG is taxed at income tax rates in either event, but it could matter eg if the transferor is not the sole participator.

Regulation 21(3) OFTR deals with this but it needs to be read with reg.21(1) to follow the sense:

> (1) Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) applies in relation to an offshore income gain arising to a person resident or domiciled outside the UK as if the offshore income gain were income becoming payable to the person...
> (3) Paragraph (1) does not apply in relation to an offshore income gain if (and to the extent that) it is treated, by virtue of regulation 24 [OIG s.3], as arising to a person resident in the UK.

In short, a s.3 OIG charge has priority over the OIG ToA provisions. Regulation 24(7) OFTR provides:

> To the extent that an offshore income gain is treated, by virtue of this regulation [reg 24 = OIG s.3], as having accrued[55] to any person resident in the UK, that gain shall not be deemed to be the income of any individual for the purposes of Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad).

67.18 OIG s.87/ToA: priority

Suppose:

(1) An OIG arises to a non-resident trust

(2) The trust makes a capital payment to a beneficiary.

This could give rise to a charge under OIG s.87 and the ToA provisions, or at least it might not be clear which of the two applies.

It may matter which applies because:

(1) OIG s.87 qualifies for:

(a) 2008 rebasing relief

(b) 2008 transitional relief.

(2) Different remittance basis rules apply.

[55] The terminology of the Taxes Acts is generally that CGT chargeable gains *accrue;* but OIG *arise*. There is no difference in meaning so it does not matter that the wrong word is used here.

Regulation 21(5) deals with this but one first needs to read reg.21(4) OFTR which provides:

> The following provisions apply if regulation 20 [OIG s.87] applies in relation to an offshore income gain (the "relevant offshore income gain").

In short, the two provisions which follow – reg.21(5)(6) – apply where an OIG arises to a non-resident trust.

Regulation 21(5) needs to be read with reg.21(1) to follow the sense:

> (1) Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) applies in relation to an offshore income gain arising to a person resident or domiciled outside the UK as if the offshore income gain were income becoming payable to the person...
> (5) If—
> (a) by virtue of regulation 20 [OIG s.87] an offshore income gain is treated as arising in a tax year to a person resident in the UK, and
> (b) it is so treated by reason of the relevant offshore income gain (or part of it),
> for that and subsequent tax years paragraph (1) does not apply in relation to the relevant offshore income gain (or that part).

In short, the OIG s.87 charge has priority over the ToA provisions if the OIG amount is matched to a capital payment to a *UK resident*. I refer to this provision as the "**OIG s.87 priority rule**". This applies even if the s.87 OIG is matched to a remittance basis taxpayer and (un)taxed on the s.87 OIG remittance basis, because an OIG is nevertheless treated as arising to a UK resident.

The OIG s.87 priority rule applies for Chapter 2 of Part 13 of ITA 2007 but it is necessary to consider s.720 and s.731 separately.

67.18.1 *OIG s.720/s.87 priority*

The following examples are based on this situation:

(1) A non-resident settlor-interested trust is within s.720. The transferor/settlor (for the purposes of these examples the terms are interchangeable) is UK resident. The motive defence does not apply.

(2) The trust has realised an OIG in year 1 of £1m.

(3) The trust has no relevant income. (It would be unusual for a trust within s.720 to have relevant income.)

Example 1: no capital payment
The trustees make no capital payment to any beneficiary in the year that the OIG arises.
The settlor as transferor is taxed on the OIG under OIG s.720 (subject to the s.720 remittance basis if applicable).

Regulation 21(6) OFTR prevents a double charge to tax under OIG s.87, if there is a capital payment in a subsequent tax year. It provides:

> If, by virtue of paragraph (1) [OIG s.720] as it applies in relation to the relevant offshore income gain, income is treated under Chapter 2 of Part 13 of ITA 2007 as arising in a tax year, the OIG amount in question must be reduced (with effect from the following tax year) by the amount of the income.

Example 2: capital payment to settlor
The trustees make a capital payment of £1m to the settlor in year 1.
The settlor is taxed on the capital payment under OIG s.87 (subject to the s.87 OIG remittance basis).
The ToA provisions are disapplied for OIG because the OIG s.87 priority rule applies.
It may make no difference whether it is OIG s.720 or OIG s.87 which is used to tax the settlor but it may matter for the following reasons:
(1) 2008 rebasing relief
(2) 2008 transitional relief
(3) mixed fund rules.

Example 2a: capital payment of part of OIG to settlor
The trustees make a capital payment of £0.5m to the settlor in year 1.
The settlor is taxed on the £0.5m capital payment under OIG s.87 (subject to the s.87 OIG remittance basis).
The settlor is taxed on £0.5m under OIG s.720.

Example 3: capital payment to UK beneficiary
The trustees make a capital payment of £1m to a UK resident beneficiary (not the settlor) in year 1.
The beneficiary is taxed on the capital payment under OIG s.87 (subject to the s.87 OIG remittance basis if applicable).
The ToA provisions are disapplied because the OIG s.87 priority rule applies.
So the result of the capital payment is to shift the tax charge from the settlor to the beneficiary. This would be particularly important if the

beneficiary was a remittance basis taxpayer and the settlor was not. In such a case a capital payment to the beneficiary would save tax. The capital payment also affects the quantum of the charge if 2008 rebasing relief or 2008 transitional relief applies.
If the capital payment had been to a non-UK resident beneficiary, the settlor would be taxed on £1m under OIG s.720.

Example 3a: capital payment of part of OIG to beneficiary
The trustees make a capital payment of £0.5m to a UK resident beneficiary (not the settlor) in year 1.
The beneficiary is taxed on the capital payment under OIG s.87 (subject to the s.87 OIG remittance basis if applicable).
The settlor is taxed on £0.5m under OIG s.720.

Planning for trust within s.720 which realises an OIG
In short, where an OIG arises to a trust within s.720, it is advantageous for the trustees to make a capital payment equal to the OIG amount to a UK beneficiary, if:

(1) the settlor is not a remittance basis taxpayer and the beneficiary is a remittance basis taxpayer; or
(2) 2008 rebasing relief or 2008 transitional relief applies.

This planning point will often require a distribution to be made in the year that the OIG arises. The sum distributed need not be the proceeds representing the OIG. Other capital payments (eg the use of living accommodation) may suffice as that capital payment may be matched with the OIG.

If there is no time to make a payment in the form of a bank transfer, a resolution of the trustees to exercise their power to make a distribution will suffice. If the figures are not available, a resolution to distribute an amount equal to the offshore income gains will suffice. In order to make a distribution, it may be necessary to make a deed of appointment, or obtain consent of a protector: that depends of course on the terms of the trust.

67.18.2 *OIG s.731/s.87 priority: same OIG*

I turn to consider whether OIG s.87 takes precedence over OIG s.731.

The effect of the OIG s.87 priority rule is that if the OIG amount is matched to a capital payment to a UK resident then:

(1) an OIG is treated as arising in the year to that beneficiary and

(2) this disapplies OIG s.731.

In this situation, the OIG s.87 charge has priority over OIG s.731. This applies even if the OIG s.87 charge is (un)taxed on the s.87 OIG remittance basis because the s.87 OIG is nevertheless treated as arising.

Examples

The following examples are based on this situation:

(1) A non-resident trust is within s.731 (UK resident beneficiaries) but not within s.720 (transferor has no power to enjoy or is not UK resident). The motive defence does not apply.
(2) The trust has realised an OIG in year 1 of £1m.
(3) The trust has no relevant income (leaving aside the OIG).

Example 1: *capital payment to UK beneficiary in year 1*
The trustees make a capital payment of £1m to a UK resident beneficiary in year 1.
The beneficiary is taxed on the capital payment under OIG s.87 (subject to the s.87 OIG remittance basis).
The ToA provisions are disapplied, ie, the OIG does not count as relevant income for s.731.

Example 1a: *capital payment of part to UK beneficiary*
The trustees make a capital payment of £0.5m to a UK resident beneficiary in year 1.
It is considered that the beneficiary is taxed on the capital payment under OIG s.87 (subject to the s.87 OIG remittance basis). HMRC agree: see the HMRC example set out in para 67.16 (Priority between OIG s.87 and CGT s.87), where a trust with an OIG amount of £80k made a capital payment of £70k and the capital payment was said to fall within OIG s.87. It is not entirely clear from the wording of the OIG s.87 priority rule that this is the case. That provides:

> (5) If—
> (a) by virtue of regulation 20 [OIG s.87] an offshore income gain is treated as arising in a tax year to a person resident in the UK, and
> (b) it is so treated by reason of the relevant offshore income gain (or part of it),
>
> for that and subsequent tax years paragraph (1) [applying the ToA rules] does not apply in relation to the relevant offshore income gain (or that

part).

Now, the position is clear if a capital payment is equal to the entire OIG amount (as in example 1). But if the capital payment is equal to half the OIG amount, one might say that half the OIG remains to count as relevant income so the capital payment falls within s.731 OIG. But that would be an anomalous inconsistency with the position which applies when the capital payment equals the entire OIG. It would be particularly difficult to apply if the capital payment is more than half the OIG. So the better view is that OIG s.87 applies. If that is correct, then OIG s.731 will never apply.

Example 2: *capital payment to UK beneficiary in year 2*
(1) The trustees make no capital payment in year 1.
No-one is subject to tax in year 1 as:
(a) OIG s.87 only applies if there is a capital payment.
(b) OIG s.731 only applies if there is a benefit (which means (more or less) the same as a capital payment).
(2) *The trustees make a capital payment of £1m to a UK resident beneficiary in year 2.*

The beneficiary is taxed on the capital payment under OIG s.87 (subject to the s.87 OIG remittance basis). The beneficiary is not taxed under OIG s.731 as the OIG s.87 priority rule applies.

I have considered whether reg. 21(6) OFTR overrides this rule. Reg 21(6) OFTR provides:

> If, by virtue of paragraph (1) as it applies in relation to the relevant offshore income gain, income is treated under Chapter 2 of Part 13 of ITA 2007 as arising in a tax year, the OIG amount in question must be reduced (with effect from the following tax year) by the amount of the income.

Does this apply in year 1? Only if *income is treated under Chapter 2 of Part 13 of ITA as arising* in year 1. Chapter 2 Part 13 uses the expression *income is treated as arising* in s.731 (income treated as arising to an individual who receives a benefit) and in s.720 (income treated as arising to a transferor). However these sections do not apply in year 1. So reg.21(6) does not apply.

I have considered the argument that income is treated as arising in year 1 to the *person abroad* (the OIG) because of reg.21(1). But this is not correct, for such income is not treated as arising under Chapter 2 Part 13.

This is confirmed, I think, by reg. 21(2) OFTR which uses the expression "treated as arising" where the reference is clearly to income treated as arising to the transferor under s.720 or to a beneficiary under s.731.

It follows that if capital payments are made only to UK resident beneficiaries, they are all taxed under OIG s.87 and not OIG s.731.

Example 2a: *capital payment of part of OIG to UK beneficiary in year 2*
The facts are the same as example 2, but the trustees make a capital payment of only £0.5m to a UK resident beneficiary in year 2.
It is considered that the beneficiary is taxed on the capital payment under OIG s.87 (subject to the s.87 OIG remittance basis). The beneficiary is not taxed under OIG s.731 as the OIG s.87 priority rule applies.

Example 3
(1) Year 1: The trustees make a capital payment of £1m (ie an amount equal to the OIG) to a non-resident beneficiary
No-one is subject to tax in year 1 as OIG s.87 TCGA and OIG s.731 only apply if there is a capital payment or benefit to a UK resident beneficiary.
(2) *Year 2: The trustees make a capital payment of £1m to a UK resident beneficiary.*

(a) The UK beneficiary is taxed on the capital payment under OIG s.87. The trust's capital payment in year 1 is in principle disregarded under the non-resident disregard.
(b) The UK beneficiary is therefore not subject to tax under OIG s.731.

67.18.3 *Trust/company structure*

Suppose:

(1) An OIG arises to a company held by a settlor-interested trust. Suppose the company is within s.720.
(2) The trustees make a capital payment to a UK resident beneficiary.

This could give rise to charges:

(1) under OIG s.720 on the transferor and
(2) under OIG s.87 on the beneficiary, on the basis that the OIG arise to the trustees and constitute OIG amounts which are matched to the capital payments.

Is relief available under reg. 24(7) OFTR? That provides:

> To the extent that an offshore income gain is treated, by virtue of this regulation [reg 24 = OIG s.3], as having accrued to any person resident in the UK, that gain shall not be deemed to be the income of any

> individual for the purposes of Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad).

One would have to argue that the gain accruing to the individual is the same gain as that accruing to the company. It is suggested that this is the case, since otherwise there would be a strange anomaly between this case and the simple case where the OIG arises to the trust directly (without a company). The purpose of s.3 is to put the taxpayer in the same position as if there were no company.

67.18.4 *Example: OIG s.87/2008 transitional relief*

The IF Manual provides:

> **IFM13434: Example showing how a UK resident but non-UK domiciled beneficiary may not be chargeable to tax on an offshore income gain arising in a non-resident settlement prior to 6 April 2008 - paragraph 100 Schedule 7 FA 2008** [Apr 2020]
> **Example of effect of paragraph 100 Schedule 7 FA 2008**
> A settlement with non-UK resident trustees has never been settlor interested. The trustees own all the share capital of a non-UK resident company. Neither the trustees nor the company has received any income nor made any chargeable gains.
> The non-resident company held a material interest in an offshore fund. When that was disposed of in 2005-06 an OIG amount of £60,000 arose.
> The first capital payments to beneficiaries were made in 2010-11 which were:
>
> - £40,000 to a UK resident and domiciled beneficiary
> - £40,000 to a UK resident but non-UK domiciled beneficiary
> - £40,000 to a non-UK resident beneficiary.

What is the position for OIG s.731? Para 21(5) OFTR (the OIG s.87 priority rule) provides:

> If—
>
> (a) by virtue of regulation 20 [OIG s.87] an offshore income gain is treated as arising in a tax year to a person *resident in the UK*, and
>
> (b) it is so treated by reason of the relevant offshore income gain (or part of it),
>
> for that and subsequent tax years paragraph (1) does not apply in relation to the relevant offshore income gain (or that part).

Of the £60k OIG, only £40k is treated as arising to persons resident in the

UK, so one might think that £20k remained as relevant income, taxable on the UK resident beneficiaries. That is a surprising result, for contrast the situation where the same payments are made to the UK beneficiaries and no payment to the non resident. The UK domiciled resident is taxed on £30k and the foreign domiciled resident is not taxed. It seems strange if the tax should be more because of the payment to the non-resident. The author of the IF Manual presumably thought so. Presumably the reason is that the payment to the non-resident is regarded as distributing the relevant income.

The same point applies to the next example.

67.18.5 *Example: Settlor excluded OIG s.87 rebasing relief*

The IF Manual provides:

> **IFM13436: Example showing how a UK resident but non-UK domiciled beneficiary may benefit from a 'rebasing' election - paragraph 101 Schedule 7 FA 2008** [Apr 2020]
>
> Example of effect of 'rebasing' election - paragraph 101 Schedule 7 FA 2008
>
> A settlement with non-UK resident trustees is settlor interested because the settlor can benefit. The trustees own all the share capital of a non-UK resident company. Neither the trustees nor the company has received any income nor made any chargeable gains. The trustees have made a 'rebasing' election under paragraph 126 Schedule 7 FA 2008.
>
> The non-resident company purchased a material interest in an offshore fund in 2000-01. This is disposed of in 2010-11 resulting in an OIG amount of £60,000. The post 5 April 2008 element of that OIG amount is £15,000.
>
> The first capital payments made to beneficiaries were made in 2010-11. They were:
>
> - £40,000 to a UK resident and domiciled beneficiary
> - £40,000 to a UK resident but non-UK domiciled beneficiary
> - £40,000 to a non-UK resident beneficiary.

The HMRC analysis is as follows:

> There is a matching of £20,000 of each of these capital payments with the 2010-11 OIG amount. Each beneficiary has £20,000 of offshore income gain attributed to them via section 87 TCGA rules. There are no unmatched OIG amounts to carry forward within the non-resident settlement structure.
>
> The UK resident and domiciled beneficiary is chargeable to income tax

in 2010-11 on the £20,000 offshore income gain attributed to them.

The UK resident but non-UK domiciled beneficiary (where the remittance basis is used) is only chargeable to income tax on £5,000 (£20,000 x £15,000/£60,000) of the £20,000 offshore income gain attributed to them.

That is the post 5 April 2008 element of the £20,000 offshore income gain attributed to them. This is by virtue of paragraph 101 Schedule 7 FA 2008.

The non-UK resident beneficiary is not chargeable to income tax on any of the £20,000 offshore income gain attributed to them.

There are unmatched capital payments of £20,000 to each beneficiary to carry forward at 5 April 2011.

67.18.6 *Example: OIG s.720: Loss of rebasing relief*

The IF Manual provides:

IFM13438: Example showing how a UK resident but non-UK domiciled beneficiary may not benefit from a 'rebasing' election - paragraph 101 Schedule 7 FA 2008 [Apr 2020]

Example of 'rebasing' election having no effect - paragraph 101 Schedule 7 FA 2008

This example has similar facts as that in OFM15650 with the exception that capital payments are not made to beneficiaries until a year after that in which the OIG amount arises in the offshore trust structure. In such a case there may be no benefits of a 'rebasing' election to a non-UK domiciled beneficiary in respect of any offshore income gain attributed to them.

A settlement with non-UK resident trustees is settlor interested because the UK resident and ordinarily resident, but non-domiciled, settlor can benefit. The trustees own all the share capital of a non-UK resident company. Neither the trustees nor the company has received any income nor made any capital gains. The trustees have made a 'rebasing' election under paragraph 126 Schedule 7 FA 2008.

The non-resident company purchased a material interest in an offshore fund in 2000-01. This is disposed of in 2010-11 resulting in an OIG amount of £60,000. The post 5 April 2008 element of that OIG amount is £15,000.

The first capital payments made to beneficiaries were made in 2011-12. They were:

- £40,000 to a UK resident and domiciled beneficiary
- £40,000 to a UK resident but non-UK domiciled beneficiary (who was also the settlor)

> - £40,000 to a non-UK resident beneficiary.
>
> In 2010-11 there have been no capital payments in that year, or earlier years, to beneficiaries. So there can be no attribution of the OIG amount to beneficiaries under the section 87 attribution rules in regulation 20. We then have to consider if there can be an attribution under the transfer of assets rules in regulation 21 for 2010-11. The entire £60,000 OIG amount can be attributed to the settlor as an offshore income gain for that year. The non-UK domiciled settlor is chargeable to income tax in 2010-11 on the £60,000 offshore income gains attributed to them, subject to any remittance basis considerations. The 'rebasing' election has no effect on the amount chargeable to income tax as the attribution has not been made via the section 87 attribution rules.
>
> The OIG amount is reduced to Nil (regulation 21(6)). There are no unmatched OIG amounts to carry forward to 2011-12. There is nothing to match with the capital payments made in 2011-12 so the full amount of those payments are unmatched capital payments to carry forward at 5 April 2012.

Was this result intended in 2008? Since HMRC gave no indication of their thinking, it is hard to tell.

67.19 OIG s.87/ToA motive defence

EN FB 2008 provides:

> 46. Offshore income gains that are not matched in that year [the year they arise] will be chargeable to tax by reason of the provisions relating to the transfer of assets abroad legislation in Chapter 2 of Part 13 of the Income Tax Act 2007. *There is an exception to this rule where the motive or purpose defence in sections 736 to 742 applies to the gain.*

Has the legislation achieved this result? Regulation 21(6) disapplies OIG s.87:

> If, by virtue of paragraph (1) as it applies in relation to the relevant offshore income gain, income is treated under Chapter 2 of Part 13 of ITA 2007 as arising in a tax year,...

We must ask whether "income is treated under Chapter 2 of Part 13 of ITA 2007 as arising" if the motive defence applies. In fact even where the motive defence does apply, income is treated as arising *to the person abroad.* Regulation 21(1) OFTR provides:

> Chapter 2 of Part 13 of ITA 2007 (transfer of assets abroad) applies in relation to an offshore income gain arising to a person resident or

> domiciled outside the UK as if the offshore income gain were income becoming payable to the person.

But reg.21(6) is intending us to ask if income is treated as arising *to the transferor or to an individual who receives a benefit* under s.720 or s.731. Section 739(2) ITA provides the relief where the motive defence applies to pre-2006 transactions:

> An individual is not liable for income tax under this Chapter for the tax year by reference to the relevant transactions if the individual satisfies an officer of Revenue and Customs that condition A or B is met.

Section 737(2) ITA is identically worded for post-2006 transactions. Now, even though the individual is not liable for IT, the terms of reg.21(6) are still satisfied: "income is treated under Chapter 2 of Part 13 of ITA 2007 as arising in a tax year" even if the individual is not liable for income tax on that income. But a court is likely to find this too literal an approach. While the author's view has wavered, it is considered that if ToA is disapplied by the motive defence, s.87 OIG continues to apply.

67.20 Computation of OIG

Regulation 38 OFTR provides:

> (1) An offshore income gain arises to a person on the disposal of an asset if a basic gain arises on the disposal.
> (2) The disposal gives rise to an offshore income gain of an amount equal to the basic gain on the disposal.
> (3) The following provisions of this Chapter explain how the basic gain is computed.

67.20.1 *"Basic gain"*

So we move on to reg 39(1) OFTR:

> In the case of a participant chargeable to income tax,[56] the basic gain is a gain of the amount which would be the gain on that disposal for the purposes of TCGA 1992 if the gain were computed without regard to any charge to income tax arising under this Part.

The amount of the "basic gain" is the same as the amount of a CGT chargeable gain would be had the asset not been an offshore fund.

There is no relief for tax credits or foreign tax paid by the offshore fund

[56] Also see 67.20.2 (OIG of company within CT).

(except that such tax reduces the value of the fund and so reduces the OIG). But this is also the case for CGT.

Regulation 39(3) signposts eight special cases:

> The computation of the basic gain is subject to—
>
> (a) regulation 34 (provisions applicable on death);[57]
> (aa) regulation 36A (exchanges and schemes of reconstruction);
> (d) regulation 37 (exchange of interests of different classes);
> (e) regulation 40 (earlier disposal to which the no gain/no loss basis applies);
> (f) regulation 41 (modifications of TCGA 1992);
> (g) regulation 42 (losses);
> (h) regulation 43 (special rules for certain existing holdings).

In these cases the amount of the OIG may exceed the basic gain.

I do not discuss regulations 36A-37.

Regulation 41(1) disapplies roll-over relief:

> If the disposal forms part of a transfer to which section 162 of TCGA 1992 (roll-over relief on transfer of business) applies, the basic gain arising on the disposal is computed without regard to any deduction which falls to be made under that section in computing a chargeable gain.

It would be a rare case where roll-over relief would be in point.

Regulation 41(2) OFTR disapplies hold-over relief:

> If the disposal is made otherwise than under a bargain at arm's length and a claim for relief is made in respect of that disposal under section 165 or 260 of TCGA 1992 (relief for gifts), the claim does not affect the computation of the basic gain arising on the disposal.

67.20.2 *OIG of company within CT*

For completeness: reg.39(2) OFTR provides:

> In the case of a participant chargeable to corporation tax, the basic gain is a gain of the amount which would be the gain on that disposal for the purposes of TCGA 1992 if the gain were computed—
>
> (a) without regard to any charge to corporation tax arising under this Part, and
> (b) without regard to any indexation allowance on the disposal under TCGA 1992.

[57] See 67.5 (OIG charge on death).

Separate provision is needed to disapply the indexation allowance (which is available to companies but not to individuals).

Regulation 40 OFTR prevents indexation relief creeping in by the back door:

> (1) This regulation applies if—
>
> (a) a participant is chargeable to corporation tax, and
>
> (b) the amount of any chargeable gain or allowable loss which would arise on the disposal would fall to be computed in a way which, in whole or in part, would take account of the indexation allowance on an earlier disposal to which section 56(2) of TCGA 1992 (disposals on a no gain/no loss basis) applies.
>
> (2) The basic gain on the disposal is computed as if—
>
> (a) no indexation allowance had been available on any such earlier disposal, and
>
> (b) subject to that, neither a gain nor a loss had arisen to the person making such an earlier disposal.

67.21 CGT gain from offshore fund

A disposal for the purposes of the offshore funds rules is generally also a disposal for CGT.[58] The OFTR provides relief against a double charge. Regulation 44 sets the scene and provides terminology:

> (1) This Chapter applies if—
>
> (a) a material disposal[59] gives rise to an offshore income gain, and
>
> (b) that disposal also constitutes the disposal of the interest concerned for the purposes of TCGA 1992.
>
> (2) In this Chapter the disposal specified in paragraph (1)(b) is called the "TCGA disposal".

Regulation 45 OFTR provides:

> (1) This regulation applies for the purposes of the computation of the chargeable gain arising on the TCGA disposal.
>
> (2) The provisions of this regulation have effect in relation to the TCGA disposal in substitution for section 37(1) of TCGA 1992 (deduction of consideration chargeable to tax on income).
>
> (3) In the computation of the gain arising on the TCGA disposal, a sum equal to the offshore income gain shall be deducted from the sum which

[58] See 67.4 (Meaning of "disposal"),

[59] Defined in reg.15 OFTR: "In these Regulations a 'material disposal' means a disposal to which this Part applies." Since the expression "material disposal" is only used once in reg.44, it could have been more concisely expressed, but the meaning is clear.

> would otherwise constitute the amount or value of the consideration for the disposal.

Regulation 45(2) disapplies s.37(1) TCGA which normally avoids a double charge of IT and CGT. In its place, reg 45(3) introduces its own rules. I am not sure why, because s.37 would seem to have had the same effect.[60] I would be grateful to any reader who could explain.

67.21.1 *Part-disposal*

Regulation 45(5)(6) OFTR deals with part-disposals:

> (5) Paragraph (6) applies if the TCGA disposal is of such a nature that, by virtue of section 42 of TCGA 1992 (part disposals), an apportionment falls to be made of certain expenditure.
> (6) No deduction is to be made by virtue of paragraph (3) in determining the amount or value of the consideration for the purposes of the fraction in section 42(2) of TCGA 1992.

The IF Manual provides:

> **IFM13615: Offshore Funds: deduction of offshore income gains in computing capital gains: treatment of the disposal - general** [Apr 2020]
> **Regulation 45 of SI 2009/3001**
> ... Where there is a part-disposal so that section 42 TCGA applies to determine the apportionment of acquisition costs to the disposal, the full amount of disposal consideration is taken into account for the purposes of the calculation of the fraction required by that section. In other words, the offshore income gain is not deducted from the disposal consideration for the purposes of calculating the part-disposal fraction at section 42(2) - for further details relating to part-disposals see the Capital Gains Manual.

Why is that?

67.22 Losses from offshore funds

Regulation 42 OFTR provides:

[60] Section 37(1) TCGA provides: "There shall be excluded from the consideration for a disposal of assets taken into account in the computation of the gain any money or money's worth charged to income tax as income of, or taken into account as a receipt in computing income or profits or gains or losses of, the person making the disposal for the purposes of the Income Tax Acts."

> (1) If the effect of any computation under regulations 39 to 41 would be to produce a loss, the basic gain on the disposal is nil.
> (2) Paragraph (1) applies notwithstanding section 16 of TCGA 1992 (losses determined in like manner as gains).
> (3) Accordingly, for the purposes of these Regulations, no loss is to be treated as arising on the disposal.

An offshore income gain is charged to IT but where a loss arises on the disposal, there is no income tax relief.[61] The loss will be allowable for CGT if ordinary CGT principles permit. HMRC agree. The IF Manual provides:

> **IFM13410: Offshore Funds: participants in offshore funds: the charge to tax on disposal of an interest in a non-reporting fund: overview** [Apr 2020]
> ...Where there is a loss on disposal then the gain for the purposes of tax on an offshore income gain is nil; that is there is no recognition of losses for the purposes of these regulations (regulation 42). Accordingly, in a case where there is also a disposal for the purposes of TCGA, any loss made (calculated in accordance with that Act) may be treated as a capital loss for the purposes of TCGA.

This means that remittance basis taxpayers and non-residents will generally have no loss relief.[62]

The allowable loss (if there is one) is computed on CGT principles (not the OIG computation rules) but the result is the same.

67.23 Tax regimes priority to OIG

67.23.1 *Loan relationships/derivatives/intangible fixed assets*

Regulation 25 OFTR provides:

> (1) No liability to tax arises under regulation 17 if any of conditions A to E is met.
> (2) Condition A is that the participant is required to treat the interest in the fund as a loan relationship under Chapter 3 of Part 6 of CTA 2009.
> (3) Condition B is that the participant is required to treat the interest in the fund as a derivative contract to which the provisions of Part 7 of CTA 2009 apply.
> (4) Condition C is that the asset is an intangible fixed asset to which the provisions of Part 8 of CTA 2009 apply.

[61] Section 152(8) ITA prevents miscellaneous losses being set against OIG.

[62] See 65.1 (Capital losses).

These exemptions concern UK companies within corporation tax.

67.23.2 *Excluded indexed securities*

Regulation 25 OFTR provides:

> (1) No liability to tax arises under regulation 17 if any of conditions A to E is met...
> (5) Condition D is that the asset consists of excluded indexed securities as defined in section 433 of ITTOIA 2005.[63]

67.23.3 *Insurance policies*

Regulation 25 OFTR provides:

> (1) No liability to tax arises under regulation 17 if any of conditions A to E is met...
> (6) Condition E is that the asset is a right arising under a policy of insurance.

67.24 Transparent fund exemption

Regulation 29(1) OFTR provides:

> No liability to tax arises under regulation 17 if—
> (a) the disposal is the disposal of an interest in an offshore fund falling within paragraph (b) or (c) of section 40A(2) of FA 2008 [now s.355 TIOPA, non-corporate mutual funds],[64] and
> (b) the fund is a transparent fund.
> This is subject to paragraphs (2) and (3).

The exceptions are:

Para	**Exception**
(2)	Fund holding other funds
(3)	Provision of information

67.24.1 *"Transparent fund"*

Regulation 11 OFTR provides the definition:

> For the purposes of these Regulations a fund is a "transparent fund" if,

[63] See 29.7 (Excluded indexed security).

[64] See App. 66.3 (Mutual fund/CIS/OIEC). The wording makes sense, as a fund within para (a) of the section cannot be a transparent fund, but it could have been more simply drafted.

> in the case of holders of interests in the fund who are individuals resident in the UK, any sums which form part of the income of the fund are of such a nature that those holders—
>
> (a) are chargeable to tax under a provision specified in section 830(2) of ITTOIA 2005[65] in respect of such of those sums as are referable to their interests, or
>
> (b) if any of that income is derived from assets within the UK, would be so chargeable had the assets been outside the UK.

I am not sure why the definition is expressed in such a convoluted fashion. But in practice this comes down to the usual tax sense of the word "transparent".[66]

67.24.2 *Fund of funds*

Regulation 29(2) OFTR provides:

> But there is a charge to tax under regulation 17 if—
>
> (a) there is a disposal of an interest in a transparent fund, and
>
> (b) during a period beginning with the date the interest (or any part of it) was acquired and ending with the date of the disposal, the offshore fund has at any time held interests in other non-reporting funds which amounted in total to more than 5% by value of the offshore fund's assets.

The IF Manual provides:

> **IFM13470: interests in certain transparent funds** [Apr 2020]
> Arrangements that fall within the definition of an offshore fund and are transparent for income purposes but not transparent for capital gains purposes include, for example, so called 'Baker' unit trusts (following the case of *Archer-Shee v. Baker*, 11 TC 749) and certain foreign contractual arrangements (such as Fonds Commun de Placement ('FCPs')).
> They are subject to the Offshore Funds (Tax) Regulations 2009 (SI2009/3001) generally, with certain modifications as described below.
> The purpose of the offshore funds regime is to ensure that income cannot be rolled up with any subsequent gain on disposal being charged only as a capital gain. If a fund is transparent for income, such as would be the case for certain unit trusts and contractual funds, then any income

[65] Section 830(2) ITTOIA lists the 24 categories of RFI; see 16.9.2 (Relevant foreign income).

[66] See 90.6 (Transparency issues).

arising to the fund is treated as arising to an investor in proportion to their rights. This means that income is charged to tax as it arises.

However, it might be the case that an income transparent fund that came within paragraph (b) or (c) of S355(1) of TIOPA 2010 has itself invested in an opaque non-reporting fund, and if that were the case then income could be rolled up in the underlying fund, because income would only be credited to the investing fund if it was actually distributed.

To prevent unnecessary administrative burdens for transparent arrangements that come within the definition of an offshore fund and for their investors, any gain on disposal of an interest in an income-transparent offshore fund will not be taxed as an offshore income gain unless -

- during a period beginning on the date the interest (or any part of it) was acquired and ending on the date of the disposal, the offshore fund at any time held interests in other non-reporting funds (except for certain other transparent funds - see below) which amounted in total to more than 5% by value of the offshore fund's assets (regulation 29(2)), or
- the transparent fund is a non-reporting fund, and the fund fails to make sufficient information available to participants in the fund to enable those participants to meet their tax obligations in the United Kingdom with respect to their shares of the income of the fund (regulation 29(3)).

Whilst this means that such funds will have to monitor their underlying investments, it allows them to avoid the need to apply for reporting fund status. UK investors will be charged capital gains tax or corporation tax on a capital gain arising, rather than incurring an offshore income gain, provided the fund has complied with regulation 29(2)).

It follows that, if a transparent offshore fund is invested more than 5% by value of its total investments in non-reporting non-transparent funds, it may apply for reporting fund status in order to allow UK investors to be charged to tax on capital gains on disposal rather than on an offshore income gain. If reporting fund status is granted then the fund will be subject to the requirements of the regulations, including those relating to the calculation of income from non-reporting funds (see regulations 69 to 71).

67.24.3 *Transparent fund holds another*

Regulation 29(4) OFTR provides:

If, on the disposal by an offshore fund of an interest in another non-

> reporting fund, no liability would arise under regulation 17 by virtue of this regulation, that interest is not taken into account for the purposes of paragraph (2)(b).

The IF Manual provides:

> **IFM13470: Offshore Funds: investors in non-reporting funds: exceptions to the charge to tax: interests in certain transparent funds** [Apr 2020
> Investments by transparent non-reporting funds in other transparent non-reporting funds - Regulation 29(4)
> There is one important relaxation of the requirements of regulation 29(2). That is, if a transparent non-reporting fund ('TNRF1') invests in another TNRF (TNRF2). Then, where a disposal of an interest in TNRF2 would not itself give rise to an offshore income gain (under regulation 17) for a UK investor, the interest held by TNRF1 in TNRF2 is ignored in determining whether TNRF1 is invested in non-reporting funds by more than 5% of the value of its assets in total. This is because, in such circumstances, there can be no significant roll-up of income in the underlying fund(s).
> This means that a TNRF's investments could, for example, consist wholly of interests in other underlying TNRFs that may only hold UK property or a TNRF could be the top-layer fund in a fund of funds structure, with multiple layers of other TNRFs below the top fund, provided that each of those underlying TNRFs themselves did not hold more than 5% by value of their total assets in other non-transparent, non-reporting funds.
> In deciding whether the investee fund qualifies under this regulation, this rule may be applied to the investee fund and to any funds in which it, in turn, holds investments.

67.24.4 *Provision of information*

Regulation 29(3) OFTR provides:

> And there is a charge to tax under regulation 17 if—
> (a) there is a disposal of an interest in a transparent fund,
> (b) the fund is a non-reporting fund, and
> (c) the fund fails to make sufficient information available to participants in the fund to enable those participants to meet their tax obligations in the UK with respect to their shares of the income of the fund.

The IF Manual provides:

> **IFM13470: Offshore Funds: investors in non-reporting funds: exceptions to the charge to tax: interests in certain transparent funds** [Apr 2020]
>
> **Provision of 'sufficient information' to participants - Regulation 29(3)**
>
> If a fund is unable to provide sufficient information to its UK investors to enable them to meet their UK tax obligations then an offshore income gain will be charged on any gains realised on subsequent disposals of relevant interests. The provision of 'sufficient information' would include details of an investor's proportionate share of both income arising to the fund and reported income or offshore income gains arising to it, as well as confirmation as to whether or not the fund has invested more than 5% by value of its assets in non-reporting funds.
>
> In practice, many existing income-transparent funds with UK investors already provide vouchers to those clients detailing income arising to the fund, for example interest income, and foreign or UK dividends.
>
> HMRC consider that, for the purposes of regulations 29 and 92D only, sufficient information will have been provided by the fund to a UK investor if the information would enable the UK investor to compute their final UK tax liability (arising from their interest in the offshore fund) correctly. The required level of detail will depend upon the complexity of the fund and/or its investments.
>
> UK investors will still be required to complete their tax returns in the required format under self-assessment. For example, a unit holder would need to know whether the source of their income is land and property income, trading income, interest, UK dividends, foreign dividends and so on. Where transparent funds have complex structures and a number of sources of income, this can lead to complex tax issues arising for an individual completing their tax return.

67.25 DT reliefs: OIG

Suppose an individual who is UK resident and treaty-resident in a foreign state disposes of offshore funds so that OIG arise directly to them.

Article 13(5) OECD Model provides (with immaterial exceptions):

> Gains from the alienation of any property ... shall be taxable only in the Contracting State of which the alienator is a [treaty-resident].

Article 21(1) OECD Model provides:

> Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

It is an interesting question whether the individual claims relief under Art.13 or Art.21. At first sight OIG are "gains" which arise from the alienation of property, even though not chargeable gains and even though subject to income tax rather than CGT.[67] But OIG are also "income" if that word is given its UK tax meaning. Of course it does not normally matter which of the articles apply, if the treaty has both. But if a particular treaty has an equivalent of art.21 (Other Income) but no capital gains article, then it is considered that treaty relief is in principle available.

67.25.1 *s.3 OIG: Company treaty-resident outside UK*

Suppose OIG arise to a company which is treaty-resident in a foreign state and so are deemed to accrue to a UK resident participator under s.3 TCGA. In principle, DT reliefs apply to OIG deemed to accrue under OIG s.3 just as they do for chargeable gains deemed to accrue under CGT s.3.[68] I have considered reg. 24(6) OFTR which provides:

> If this regulation applies, the person to whom the offshore income gain arises is treated as the person making the disposal.

This does not disapply treaty relief, either because it has no application for the purposes of the treaty or because (while deeming the participator to be the disponor) it does not say that the non-resident company is not the alienator.[69]

67.25.2 *s.3 OIG: Participator treaty-resident outside UK*

In the case of CGT s.3 gains, the participator has a difficulty in obtaining relief under a CG article, in that they are not at first sight the "alienator".[70] However it is considered that the Other Income article[71] provides relief, in the case of OIG. If the capital gains article is in point, it is arguable that reg. 24(6) OFTR deems the participator to be the alienator.

67.25.3 *s.87 OIG: Beneficiary treaty-resident outside UK*

In the case of CGT s.87 gains, the beneficiary has a difficulty in obtaining relief, in that they are not at first sight the "alienator" and the gain is not

[67] See 56.23.2 (Gain subject to income tax).

[68] For this terminology, see 67.14 (OIG s.3 charge).

[69] For the reason for this provision, see 67.13.5 (Deemed disposal for s.87).

[70] See 64.40.1 (Participator treaty non-resident).

[71] See 33.20 (DT relief: "Other Income").

"from the alienation of any property".[72] However in the case of OIG it is considered that the Other Income article[73] provides relief. If the capital gains article were in point, it is arguable that reg.20(5) OFTR deems the beneficiary to be the alienator but the problem remains that the gain is not "from the alienation of any property".

67.25.4 *DT relief: OIG of trust/co*

If OIG arises to a trust, the position is similar to s.624; see 47.18 (DT relief: s.624 income). If the OIG arises to a company within s.720, s.720 issues arise: see 49.30 (DT relief: s.720 income).

67.26 Fund becomes reporting fund

Reg 48 OFTR provides:

> (1) This regulation applies if an offshore fund ceases to be a non-reporting fund and becomes a reporting fund.
> (2) A participant in the fund may make an election to be treated—
> (a) as disposing of the interest owned by the participant in the non-reporting fund at its market value on the disposal date,[74] and
> (b) as acquiring a holding in the reporting fund at the beginning of the reporting fund's first period of account.
> This is subject to paragraphs (5) and (5A).
> (3) Chapter 5 of this Part applies to determine the offshore income gain arising on the deemed disposal referred to in paragraph (2)(a).
> (4) The deemed acquisition referred to in paragraph (2)(b) is treated as made for the same amount as the deemed disposal referred to in paragraph (2)(a).
> (5) An election may not be made under paragraph (2) unless the offshore income gain arising on the deemed disposal referred to in paragraph (2)(a) (determined in accordance with paragraph (3)) is greater than zero.
> (5A) [This deals with allocation of profit to the AIFM firm under section 863I ITTOIA,]
> (6) If the participant is chargeable to income tax, the election mentioned in paragraph (2) must be made by being included in a return made for the tax year which includes the disposal date.

[72] See 61.60.2 (Beneficiary treaty-resident outside UK).

[73] See 33.20 (DT relief: "Other Income").

[74] Reg 48(8) OFTR provides: "In this regulation ... the "disposal date" means the final day of the last period of account before the fund becomes a reporting fund."

(7) If the participant is chargeable to corporation tax, the election mentioned in paragraph (2) must be made by being included in the participant's company tax return[75] for the accounting period which includes the disposal date.

67.27 Reorganisations: navigation

There are 5 sets of provisions to consider:

Provisions	**Topic**
s.126-138A TCGA	The **"usual reorganisation rules"**
Chapter 4 Part 3 TCGA	Collective Investment Scheme reorganisations
Reg 36A, 37 OFTR	Amendments to above rules for offshore funds
Sch 5AA TCGA	Definition of "reconstruction" for usual rules
Sch 5AZA TCGA	Definition of "reconstruction" for CI Scheme

Usual reorganisations		**Collective Investment Scheme reorganisation**	
TCGA section	***Topic***	***TCGA***	***See para***
	Reorganisation/reduction of share capital		
126	Application of ss. 127 to 131	s.103E	67.28, 67.29
127	Equation of original shares/new holding		
128	Consideration given/received by holder		
129	Part disposal of new holding	s.103F	67.30
130	Composite new holding		
131	Indexation allowance		
	Conversion of securities		
132	Equation of converted securities/new holding		
133	Premiums on conversion of securities		
133A	Cash payments: euroconversion of securities		
134	Compensation stock		
	Company reconstructions		
135	Exchange of securities for those in another company	s.103G	67.31
136	Reconstruction involving issue of securities	s.103H	67.32
137	Reorganisation TAAR	s.103K	67.35
138	Clearance in advance		
138A	Earn out rights		

As the reader interested in this area is likely to be familiar with the usual reorganisation rules, I set out the rules side by side to highlight the differences.

[75] Reg 48(8) OFTR provides: "In this regulation "company tax return" has the same meaning as in Schedule 18 to the Finance Act 1998".

67.28 "Collective investment scheme"

Section 103E TCGA provides:

> (1) In this Chapter (except this section) references to a collective investment scheme are to a collective investment scheme falling within any of the following paragraphs--
> (a) an authorised contractual scheme which is a co-ownership scheme,
> (b) a unit trust scheme, or
> (c) an offshore fund.
> (5) In this Chapter, "units" includes shares in a company.

67.29 Usual reorganisation rules disapplied

Section 103E TCGA provides:

> (2) Sections 126 to 138A (reorganisation of share capital, conversion of securities etc) do not apply for the purposes of the treatment of participants in collective investment schemes falling within subsection (1)(a) to (c) except as applied by this Chapter.
> (3) But sections 135 to 138A (company reconstructions) may apply for those purposes where either company A or company B is not a collective investment scheme falling within subsection (1)(a) to (c).
> (4) In subsection (3), "company A" and "company B" have the meaning given by section 135 or 136 as the case may be.

67.30 Exchange within same scheme

Section 103F TCGA provides:

> (1) This section applies in the following cases.
> Case 1
> Where--
> (a) a participant in a collective investment scheme exchanges units in the scheme for other units in the scheme ("new units") of substantially the same value, and
> (b) the property subject to the scheme and the rights of participants to share in the capital and income in relation to that property are the same immediately before and immediately after the event (ignoring any changes as a result of a variation in management charges[76]).

[76] Defined s.103F(3): "In subsection (1), "management charges" mean the costs charged to the property subject to the scheme in respect of remunerating the parties operating

Case 2
Where there is a reorganisation of the units in a collective investment scheme in which
[i] all the participants holding units in the scheme
[ii] or, where there are different classes of unit in the scheme, all the participants holding units in the same class,
exchange all their units for other units ("new units") in the scheme.

(2) Where this section applies--
(a) sections 127 to 131 (share reorganisations etc) apply with the necessary adaptations as if the collective investment scheme were a company and the event mentioned in subsection (1) were a reorganisation of its share capital, and
(b) any distribution in relation to any new units is to be treated for the purposes of capital gains tax, corporation tax or income tax on the basis set out in section 127 (as adapted).

67.31 Exchange: other scheme units

Section 103G TCGA is the equivalent of the usual s.135 rule:

Section 135	**Section 103G**
(1) This section applies in the following circumstances where a company ("company B") issues shares or debentures to a person in exchange for shares in or debentures of another company ("company A").	(1) This section applies in the following cases where units in a collective investment scheme ("collective investment scheme B") are issued to a person in exchange for units in another collective investment scheme ("collective investment scheme A").
(2) The circumstances are: Case 2 Where company B issues the shares or debentures in exchange for shares as the result of a general offer (a) made to members of company A or any class of them (with or without exceptions for persons connected with company B), and (b) made in the first instance on a condition such that if it were	(2) The cases are-- Case 1 Where units in collective investment scheme B are issued in exchange for units as the result of a general offer-- (a) made to participants in collective investment scheme A or any class of them, and (b) made in the first instance on a condition such that if it were satisfied the property subject to collective investment scheme B would include units in collective investment

the scheme, administrating the scheme or investing or safeguarding the property subject to the scheme."

satisfied company B would have control of company A.	scheme A giving rights to more than 50% of the capital, and more than 50% of the income, of collective investment scheme A.
Case 1 Where company B holds, or in consequence of the exchange will hold, more than 25% of the ordinary share capital of company A.	Case 2 Where-- (a) under an arrangement, participants in collective investment scheme A exchange units in that scheme for units of substantially the same value in collective investment scheme B, and (b) in consequence of the exchanges under the arrangement, 85% or more of the property subject to collective investment scheme B is constituted by units in collective investment scheme A.
Case 3 Where company B holds, or in consequence of the exchange will hold, the greater part of the voting power in company A.	
(3) Where this section applies, sections 127 to 131 (share reorganisations etc) apply with the necessary adaptations as if company A and company B were the same company and the exchange were a reorganisation of its share capital.	(3) Where this section applies, sections 127 to 131 (share reorganisations etc) apply with the necessary adaptations as if collective investment scheme A and collective investment scheme B were the same company and the exchange were a reorganisation of its share capital.
(6) This section has effect subject to section 137(1) (exchange must be for bona fide commercial reasons and not part of tax avoidance scheme).	(4) This section has effect subject to section 103K(1) (exchange must be for bona fide commercial reasons and not part of tax avoidance scheme).

67.32 Reconstruction: issue of units

Section 103H TCGA is the equivalent of the usual s.136 rule:

Section 136 TCGA	**Section 103H**
(1) This section applies where (a) an arrangement between a company ("company A") and (i) the persons holding shares in or	(1) This section applies where-- (a) for the purposes of, or in connection with, a scheme of reconstruction an arrangement is entered into by

debentures of the company, or
(ii) where there are different classes of shares in or debentures of the company, the persons holding any class of those shares or debentures,
is entered into for the purposes of, or in connection with, a scheme of reconstruction, and

(b) under the arrangement
(i) another company ("company B") issues shares or debentures to those persons in respect of and in proportion to (or as nearly as may be in proportion to) their relevant holdings in company A, and
(ii) the shares in or debentures of company A comprised in relevant holdings are retained by those persons or are cancelled or otherwise extinguished.

(2) Where this section applies
(a) those persons are treated as exchanging their relevant holdings in company A for the shares or debentures held by them in consequence of the arrangement, and
(b) sections 127 to 131 (share reorganisations etc) apply with the necessary adaptations as if company A and company B were the same company and the exchange were a reorganisation of its share capital.
For this purpose shares in or debentures of company A comprised in relevant holdings that are retained are treated as if they had been cancelled and replaced by a new issue.

(3) Where a reorganisation of the share capital of company A is carried out for the purposes of the scheme of reconstruction, the provisions of subsections (1) and (2) apply in relation to the position after the reorganisation.

[i] all the participants holding units in an original collective investment scheme ("scheme A"), or
[ii] where there are different classes of units in the scheme, all the participants holding any class of those units, and

(b) under the arrangement--
(i) units in a successor collective investment scheme or feeder fund ("scheme B") are issued to those participants in respect of and in proportion to (or as nearly as may be in proportion to) their relevant holdings in scheme A, and
(ii) the units in scheme A comprised in relevant holdings are retained by those participants or are cancelled or otherwise extinguished.

(2) Where this section applies--
(a) those participants are treated as exchanging their relevant holdings in scheme A for the units held by them in consequence of the arrangement, and
(b) sections 127 to 131 (share reorganisations etc) apply with the necessary adaptations as if scheme A and scheme B were the same company and the exchange were a reorganisation of its share capital.
For this purpose units in scheme A comprised in relevant holdings that are retained are treated as if they had been cancelled and replaced by a new issue.

(3) Where a reorganisation within case 2 of section 103F(1) of the units in scheme A is carried out for the purposes of the scheme of reconstruction, the provisions of subsections (1) and (2) apply in relation to the position after the reorganisation.

(4) In this section (a) "scheme of reconstruction" has the meaning given by Schedule 5AA to this Act;	[See s.103J]
(b) references to "relevant holdings" of shares in or debentures of company A are (i) where there is only one class of shares in or debentures of the company, to holdings of shares in or debentures of the company, and (ii) where there are different classes of shares in or debentures of the company, to holdings of a class of shares or debentures that is involved in the scheme of reconstruction (within the meaning of paragraph 2 of Schedule 5AA);	(4) In this section, references to "relevant holdings" of units are-- (a) where there is only one class of units in scheme A, to holdings of units in the scheme, and (b) where there are different classes of units in scheme A, to holdings of a class of units that is involved in the scheme of reconstruction (within the meaning of paragraph 3 of Schedule 5AZA).
(c) references to shares or debentures being retained include their being retained with altered rights or in an altered form, whether as the result of reduction, consolidation, division or otherwise; and (d) any reference to a reorganisation of a company's share capital is to a reorganisation within the meaning of section 126.	[See s.103J]
(6) This section has effect subject to section 137(1) (scheme of reconstruction must be for bona fide commercial reasons and not part of tax avoidance scheme).	(5) This section has effect subject to section 103K(1) (scheme of reconstruction must be for bona fide commercial reasons and not part of tax avoidance scheme).

67.33 Reconstruction with conversion

Section 103I TCGA provides:

> (1) This section applies where--
>
> (a) a scheme of reconstruction is entered into and given effect to, and
>
> (b) for the purposes of, or in connection with, the scheme of reconstruction, units in a collective investment scheme ("the conversion scheme") are issued to participants in another

collective investment scheme ("scheme C") in exchange for and in proportion to (or as nearly as may be in proportion to) their conversion holdings in accordance with regulation 12(1)(b) of the Undertakings for Collective Investment in Transferable Securities Regulations 2011.[77]

(2) Where this section applies sections 127 to 131 apply with the necessary adaptations as if scheme C and the conversion scheme were the same company and the exchange were a reorganisation of its share capital.

(3) In this section "conversion holdings" means the units in scheme C to be converted in accordance with regulation 12(1)(b) of the Undertakings for Collective Investment in Transferable Securities Regulations 2011 into units in the conversion scheme for the purposes of, or in connection with, the scheme of reconstruction.

(4) This section has effect subject to section 103K(1) (scheme of reconstruction must be for bona fide commercial reasons and not part of tax avoidance scheme).

67.34 Supplementary provisions

Section 103J TCGA provides:

In sections 103H and 103I--

(a) "feeder fund" has the meaning given by paragraph 3(2) of Schedule 5AZA to this Act;

(b) "scheme of reconstruction" has the meaning given by paragraph 1 of Schedule 5AZA;

(c) "original collective investment scheme" and "successor collective investment scheme" must be construed in accordance with paragraph 2(2) of Schedule 5AZA; and

(d) references to units being retained include their being retained with altered rights or in an altered form, whether as the result of

[77] Reg 12(1) provides: "The unit-holders of the merging and the receiving UCITS may require their UCITS—

(a) to purchase or redeem any units they hold in either the merging or the receiving UCITS; or

(b) to convert any units they hold in either the merging or receiving UCITS into units of another UCITS which—

(i) has similar investment policies to those of the merging or receiving UCITS; and

(ii) is managed by the same manager or by a manager which is associated with that manager within the meaning of section 256 of the Companies Act 2006."

reduction, consolidation, division or otherwise.

67.35 Reorganisation TAAR

Section 103K TCGA is the equivalent of the usual s.137 rule:

s.135 TCGA	**s.103K TCGA**
(1) Subject to subsection (2) below, and section 138, neither section 135 nor section 136 shall apply to any issue by a company of shares in or debentures of that company in exchange for or in respect of shares in or debentures of another company unless the exchange or scheme of reconstruction in question is effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax or corporation tax.	(1) Subject to subsection (2) below, and section 138, section 103G, 103H or 103I shall not apply to any issue of units in a collective investment scheme in exchange for or in respect of units in another scheme unless the exchange or scheme of reconstruction in question is effected for bona fide commercial reasons and does not form part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax, corporation tax or income tax.
(2) Subsection (1) above shall not affect the operation of section 135 or 136 in any case where the person to whom the shares or debentures are issued does not hold more than 5 per cent of, or of any class of, the shares in or debentures of the second company mentioned in subsection (1) above.	(2) Subsection (1) above shall not affect the operation of section 103G, 103H or 103I in any case where the participant to whom the units are issued does not hold more than 5 per cent of, or of any class of, the units in the second scheme mentioned in subsection (1) above.
(3) For the purposes of subsection (2) above shares or debentures held by persons connected with the person there mentioned shall be treated as held by him.	(3) For the purposes of subsection (2) above units held by participants connected with the participant there mentioned shall be treated as held by that participant
(4) If any tax assessed on a person (the chargeable person) by virtue of subsection (1) above is not paid within 6 months from the date determined under subsection (4A) below, any other person who (a) holds all or any part of the shares or debentures that were issued to the chargeable person, and (b) has acquired them without there	(4) If any tax assessed on a participant ("the chargeable participant") by virtue of subsection (1) above is not paid within 6 months from the date determined under subsection (5) below, any other participant who-- (a) holds all or any part of the units that were issued to the chargeable participant, and (b) has acquired them without there

having been, since their acquisition by the chargeable person, any disposal of them not falling within section 58(1) or 171, may, at any time within 2 years from that date, be assessed and charged (in the name of the chargeable person) to all or, as the case may be, a corresponding part of the unpaid tax; and a person paying any amount of tax under this subsection shall be entitled to recover from the chargeable person a sum equal to that amount together with any interest paid by him under section 87A of the Management Act on that amount.	having been, since their acquisition by the chargeable participant, any disposal of them not falling within section 58(1) or 171, may, at any time within 2 years from that date, be assessed and charged (in the name of the chargeable participant) to all or, as the case may be, a corresponding part of the unpaid tax; and a participant paying any amount of tax under this subsection shall be entitled to recover from the chargeable participant a sum equal to that amount together with any interest paid by him under section 87A of the Management Act on that amount.
(4A) The date referred to in subsection (4) above is whichever is the later of (a) the date when the tax becomes due and payable by the chargeable person; and (b) the date when the assessment was made on the chargeable person.	(5) The date referred to in subsection (4) above is whichever is the later of-- (a) the date when the tax becomes due and payable by the chargeable participant; and (b) the date when the assessment was made on the chargeable participant.
	(6) Section 138 (procedure for clearance in advance) applies to this section as it applies to section 137 (with any necessary modifications).

67.36 Reorganisations: Offshore funds

The above rules apply to collective investment schemes. OFTR further tweaks these reorganisation rules in relation to offshore funds. Reg 36A OFTR provides:

> (1) The following sections of TCGA 1992 do not apply to the extent that an interest in a non-reporting fund is exchanged or treated as exchanged for an asset which is not an interest in a non-reporting fund.
> (2) The sections are—
> (a) section 103G (exchange of units for those in another collective investment scheme),
> (b) section 103H (scheme of reconstruction involving issue of units),
> (c) section 135 (exchange of securities for those in another company), and

> (d) section 136 (scheme of reconstruction involving issue of securities).
>
> (3) In a case where one of those sections would apply apart from paragraph (1), the exchange or deemed exchange shall for the purposes of this Part constitute a disposal of interests in the non-reporting fund for a consideration equal to their market value at the time of the exchange or deemed exchange.

Reg 37 OFTR provides:

> (1) If conditions A to D are met, section 127 of TCGA 1992 (equation of original shares and new holding) does not prevent an exchange from constituting a disposal for the purposes of these Regulations.
>
> (2) Condition A is that an offshore fund is constituted by a class of interest ("class A") in main arrangements.[78]
>
> (3) Condition B is that a participant exchanges an interest of class A for an interest in another offshore fund constituted by a different class of interest ("class B") in those main arrangements.
>
> (4) Condition C is that the interest of class A is at the time of the exchange an interest in a non-reporting fund.
>
> (5) Condition D is that the interest of class B is at the time of the exchange an interest which is not an interest in a non-reporting fund.
>
> (6) Any disposal to which this regulation applies is to be treated as a disposal for a consideration equal to the market value of the rights at the time of the exchange.

The object is to prevent fundholders reorganising their way out of OIG status, and so out of OIG charges.

[78] See App.66.17.2 (Different classes of interest).

CHAPTER SIXTY EIGHT

INCOME FROM OFFSHORE FUNDS

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68.1 Introduction

This chapter considers the taxation of income arising from offshore funds. The taxation of offshore income gains (which arise on the disposal of a fund) is considered in the previous chapter.

68.2 Bond fund

Section 378A ITTOIA reclassifies some dividends as interest:

> (1) This section applies where—
> (a) a dividend[1] is paid by an offshore fund, and
> (b) the offshore fund fails to meet the qualifying investments test at any time in the relevant period.[2]

[1] Defined in s378A(7): "In this section ... "dividend" includes any distribution that (but for this section) would be treated as a dividend for income tax purposes". What is this referring to?

[2] Defined in s.378A(4)(5):
(4) "The relevant period" means—
(a) the relevant period of account of the offshore fund, or
(b) if longer, the period of 12 months ending on the last day of that period.
(5) "The relevant period of account" means—
(a) the last period of account ending before the dividend is paid, in a case in which the profits available for distribution at the end of that period (and not

(2) The dividend is treated as interest for income tax purposes.

I refer to offshore funds within s.378A as **"bond funds"**, and s.378A is **"the bond-fund rule"**. In short, the rule re-categorises dividends as interest.

EN FA 2009 explains:

> Certain distributions from offshore funds are economically similar to payments of yearly interest. [Section 378A ITTOIA] charges distributions of this type to tax as if they were yearly interest.
> ... The test in subsection (3) is similar to that which applies to corporate investors for the purposes of the loan relationships legislation. (See sections 490 and 493 CTA 2009). A distribution is treated as interest if the offshore fund, at any time during the 'relevant period', holds more than 60 per cent of its assets in the form of qualifying investments. The definition of a qualifying investment is set out in section 494 CTA 2009 and, in summary, refers to interest bearing and economically similar investments.
> ... The purpose of the clause is to prevent a tax advantage being gained by holding interest bearing assets within an offshore fund structure....
> ... where a distribution from an offshore fund takes the form of a dividend the rate will be the dividend tax rate after taking into account the dividend tax credit. However, where the offshore fund is substantially invested in interest bearing, or economically similar, assets as described in paragraph 4 above then any distribution will be treated as interest for income tax purposes.

The bond-fund rule applies to reporting and non-reporting funds.

One might have thought that the bond-fund rule only applies to a corporate fund, as a non-corporate fund does not pay "dividends". But reg 96 OFTR[3] assumes s.378A (the bond-fund rule) may also apply to a non-corporate non-transparent fund. However, the only effect of the bond-fund rule, if it does apply to a non-corporate non-transparent fund, would be to categorise as interest what would otherwise be Misc Sweep-up Income or Annual Payment income: that will rarely if ever make any difference.[4]

used since then by distribution or otherwise) equal or exceed the amount of the dividend (aggregated with any other distribution made by the offshore fund at the same time), and

(b) the period of account in which the dividend is paid, in any other case.

[3] See 68.4 (Taxation of reporting fund income).

[4] It could make a difference if there were miscellaneous income losses.

The bond-fund rule does not apply to transparent funds, because a distribution from (or through) a transparent fund is not a "dividend".

68.2.1 *60% qualifying investments test*

Section 378A(3) ITTOIA defines the qualifying investments test:

> For the purposes of this section, an offshore fund fails to meet the qualifying investments test if the market value of the fund's qualifying investments exceeds 60% of the market value of all of the assets of the fund (excluding cash awaiting investment)...
> "qualifying investments" has the meaning given in section 494 of CTA 2009.

68.2.2 *Qualifying investments*

Section 494(1) CTA 2009 provides:

> In section 493 "qualifying investments", in relation to an open-ended investment company, a unit trust scheme or an offshore fund, means investments of the company, scheme or fund of any of the following descriptions—
> (a) money placed at interest,
> (b) securities,[5]
> (c) shares in a building society,
> (d) qualifying holdings in an open-ended investment company, a unit trust scheme or an offshore fund,
> (e) alternative finance arrangements,
> (f) derivative contracts whose underlying subject matter consists wholly of any one or more of—
> (i) the matters referred to in paragraphs (a) to (e) (other than diminishing shared ownership arrangements), and
> (ii) currency,
> (g) contracts for differences whose underlying subject matter consists wholly of any one or more of—
> (i) interest rates,
> (ii) creditworthiness, and
> (iii) currency, and
> (h) derivative contracts not within paragraph (f) or (g) where there is a hedging relationship between the contract and an asset within paragraphs (a) to (d).

[5] Section 494(2) CTA 2009 provides: "In this section ... "security" does not include shares in a company".

I do not consider the definitions of the terms used above for which s.494(2) CTA 2009 incorporates definitions by reference:

Term	**Definition in CTA 2009**
Contract for differences	s.582
Diminishing shared ownership arrangements	s.504
Hedging relationship	s.496
Qualifying holding	s.495(1)
Underlying subject matter	s.583

68.3 Deemed reporting-fund income

In the absence of express provision, undistributed income of offshore funds would not be subject to tax. Regulation 94(1)(2) OFTR deal with non-transparent/transparent funds;[6] it is helpful to read them side by side:

Reg 94(1): Non-transparent fund	**Reg 94(2): transparent fund**
In the case of a reporting fund which is not a transparent fund,	In the case of a reporting fund which is a transparent fund,
the Tax Acts have effect as if the excess (if any) of [a] the reported income of the fund in respect of a reporting period over [b] the distributions made by the fund in respect of the reporting period	the Tax Acts have effect as if the excess (if any) of [a] the reported income of the fund in respect of a reporting period over [b] the income of the fund for the reporting period
were additional distributions made to the participants in the fund in proportion to their rights.	were additional income of the participants in the fund in proportion to their rights.

I refer to this as "**deemed reporting-fund income**".

Reg.94(3) OFTR identifies the date and recipient of deemed reporting-fund income:

> The excess specified in paragraphs (1) and (2) is treated as made, on the fund distribution date,[7] or on such earlier date as the reported income in respect of that reporting period is recognised in the participant's

[6] See 67.24.1 ("Transparent fund").

[7] This term is defined in reg.94(4) OFTR: In these Regulations the "fund distribution date" for a reporting period of a reporting fund means the date six months following the last day of the reporting period.

> accounts, to participants holding an interest in the fund at the end of the reporting period.

Deemed reporting-fund income is notional income, distinct from the actual income of the offshore fund. For instance, tax credits on the fund would not be available to the participant.

For completeness: reg 94(3A) deals with the interaction with the share-matching 30-day rule:[8]

> If—
>
> (a) a participant disposes of an interest in a reporting fund in a reporting period ("the earlier period"), and
>
> (b) section 106A of TCGA 1992 (identification of securities: capital gains tax) applies to identify the whole or any part of that interest with an interest acquired in the next reporting period,
>
> then, for the purposes of paragraph (3), the disposal of the interest so identified shall be ignored and the participant shall be treated as holding that interest at the end of the earlier period.

68.4 Taxation of reporting-fund income

Regulations 95/96/97 OFTR deal with reporting-fund income as follows:

Reg	**Type of reporting fund**
95	Corporate fund
96	Non-corporate non-transparent fund
97	Transparent fund

It may be convenient to read them side by side:

Reg 95: corporate fund	**Reg 96: non-corp. non-transp.**	**Reg 97: transparent**
(1) This regulation applies if—	(1) This regulation applies if—	(1) This regulation applies if—
(a) a reporting fund makes a distribution to a participant chargeable to income tax in respect of a reporting period, and	[identical to 95(1)(a)]	
(b) the fund falls within section 40A(2)(a) of FA	(b) the fund falls within paragraph (b) or (c) of	

[8] See 56.12.2 (Share-matching rules).

2008 [now s.355(1)(a) TIOPA: corporate fund[9]].	section 40A(2) of FA 2008 [now s.355(1)(b)(c) TIOPA: non-corporate fund[10]], and	
	(c) the fund is not a transparent fund.	(a) a reporting fund is a transparent fund, and
(2) This regulation also applies if some or all of the excess specified in regulation 94(1) is treated as made by such a fund to such a participant.	[identical to 95(2)]	(b) some or all of the excess specified in regulation 94(2) is treated as income of a participant by virtue of that provision.
(3) If section 378A of ITTOIA 2005 (offshore fund distributions)[11] applies to any amount falling within paragraph (1) or (2), the amount is charged to income tax in accordance with that section.	(3) Any amount to which paragraph (1) or (2) applies is charged to income tax—	(2) Any amount to which paragraph (1) applies is charged to income tax
	(a) under section 378A of ITTOIA 2005 (offshore fund distributions), or	
	(b) (if that section does not apply) under Chapter 8 of Part 5 of ITTOIA 2005 (miscellaneous income: income not otherwise charged) for the year of assessment in which the distribution is made,	under Chapter 8 of Part 5 of ITTOIA 2005 as relevant foreign income within the meaning given by section 830 of ITTOIA 2005 for the year of assessment in which the distribution is made,
	but sections 688(1) and 689 of ITTOIA 2005 (income charged and	but sections 688(1) and 689 of ITTOIA 2005 do not apply.

[9] See App. 66.3 (Mutual fund/CIS/OIEC).

[10] See App. 66.3 (Mutual fund/CIS/OIEC).

[11] See 68.2 (Bond fund).

person liable) do not apply.[12]

In short:

(1) Deemed reporting-fund income of bond funds is "treated as interest for income tax purposes."

(2) Corporate non-bond fund: deemed reporting-fund income is treated as a distribution.

(3) Non-corporate non-bond fund: deemed reporting-fund income is treated as miscellaneous sweep-up income.

68.4.1 *Non-resident participant*

Actual distributions from a non-transparent fund: the income is non-UK source, so a non-resident is not subject to tax.

Deemed reporting-fund income from a non-transparent fund: A non-resident is not subject to tax as reg 95/96 only apply if the participant is "chargeable to income tax".

Deemed reporting fund income from a transparent fund: The deeming in reg 92(2) OFTR is that the deemed income arises from the fund, so the income is foreign source and so a non-resident is not subject to tax.[13]

Actual distributions of a transparent fund: UK source income of the transparent fund would be chargeable, subject to non-resident IT relief;[14] but a charge would rarely if ever happen in practice.

It is considered that deemed reporting-fund income counts as income of the person abroad, for the purposes of the ToA provisions, even though it is not chargeable on the person abroad.

68.4.2 *Remittance basis participant*

Actual distributions from a non-transparent fund: the income is RFI and qualifies for the remittance basis.

Deemed reporting-fund income from a non-transparent fund: The deeming in reg 92(1) OFTR is that the deemed income arises from the fund, so the income is RFI and qualifies for the remittance basis.

Deemed reporting fund income from a transparent fund: Reg 97(2) states

[12] The disapplied sections are the rules for quantum of charge/ remittance basis and liability for s.687 misc sweep-up income. This follows the precedent of the OIG provisions; see 67.3.5 (Charge on OIG).

[13] See 16.2 (Source: IT territorial limit).

[14] See 45.1 (Non-residents IT relief: Introduction),

that the income is RFI, so it qualifies for the remittance basis.

Actual distributions of a transparent fund: UK source income of the transparent fund would be chargeable on an arising basis; but that would rarely if ever happen in practice.

Can deemed reporting-fund income be remitted? Legislation frequently deems an individual to receive income/gains (eg deemed s.624/s.720 income, deemed s.3 gains). In these cases the legislation almost always has a provision which deems some actual property to be derived from the individual's deemed income/gain.[15] So if that property is received by the individual (or a relevant person) there is a taxable remittance. In this case however there is no such provision. So it appears at first sight that the deemed reporting-fund income cannot be remitted. While the actual income in the hands of the offshore fund could be received in the UK, those funds do not derive from the deemed reporting-fund income. The deemed reporting-fund income perhaps derives from those funds.

This does lead to a result that might be thought too good to be true. So it is more than possible that a court might read in an implied provision that the actual income of the offshore fund is derived from the deemed reporting-fund income, though that verges on legislation rather than construction.

HMRC may not agree. The IF Manual provides:

> **IFM13338: Offshore Funds: participants in offshore funds: participants within the charge to income tax: non-UK domicile: remittance basis** [Apr 2020]
>
> Where individuals not domiciled in the United Kingdom are taxed on the remittance basis, then the normal remittance basis rules will apply to income arising from the holding in the offshore fund (for detailed guidance see the Residence, Domicile and Remittance basis Manual from RDRM3000.
>
> In the case of income that is reported by a reporting fund, but is not distributed, then that income has not been remitted to the UK.
>
> **Transparent Funds**
>
> In a case where the offshore fund is transparent for UK tax purposes then the income will arise from the underlying assets and not from the fund. In such a case, the income may sometimes arise in the UK (even though the fund itself is domiciled offshore). Where the income arises in the UK the remittance basis does not apply – the income is charged

[15] See for instance 64.23 (Section 3 remittance basis).

to tax on the UK resident individual as it arises. Where the income arises offshore then the remittance rules will apply.

The IF Manual provides:

> **IFM13372: Offshore Funds: participants in offshore funds: participants within the charge to income tax: disposals: reporting funds** [Apr 2020] to w/e 5 Mar 2021)
> ...**Remittance basis users**
> The proceeds of a disposal of a reporting fund will normally constitute a 'mixed fund' for the purposes of the remittance basis rules, applicable to UK resident investors subject to income tax. This is because the proceeds may have been funded by undistributed (and therefore unremitted) reported income as well as by the original investment and any capital growth.

68.4.3 *Tax credit on distribution*

For completeness: reg 95(4) OFTR dealt with tax credits:

> If
> [a] paragraph (3) does not apply to any amount falling within paragraph (1) or (2), but
> [b] the participant is entitled to a tax credit on receiving a distribution falling within paragraph (1),
> section 397A of ITTOIA 2005 (savings and investment income: dividends from non-UK resident companies) also applies to the excess falling within paragraph (2).

But tax credits were abolished in 2016, and s.397A was repealed, so reg 95(4) cannot apply. The failure to repeal it was an oversight or, perhaps, a decision was made not to bother to bring statutory instruments up to date.

68.5 Non-reporting fund income

Non-reporting funds may not make any income distributions to participants. But if they do, then subject to the bond-fund rule, normal principles apply:

(1) Distributions from corporate funds are taxed as dividend income.
(2) Distributions from non-transparent non-corporate funds (eg non-transparent unit trusts) would be taxed as Annual Payments.
(3) Net income of transparent funds would be taxed as the income of the underlying assets.

In each case the income will in principle be RFI and so can qualify for the remittance basis.

68.6 Summary

Type of fund		**Type of distribution**	**Categorisation/Reference**	
Corporate	Bond fund	Dividend	Interest	s.378A
		Distribution	Interest	reg 95(3)(a)
		Deemed R-F income	Interest	reg 95(3)(a)
	Non-bond fund	Dividend/distribution	Div/distribution	Ord principles
		Deemed R-F income	Distribution	reg 92(1)
Non corporate Non transparent	Bond fund	Distribution	Interest	s.378A
		Deemed R-F income	Interest	reg 96(3)(a)
	Non-bond fund	Distribution	Misc income	reg 96(3)(b)
		Deemed R-F income	Misc income	reg 96(3)(b)

68.7 Non-reporting fund holds reporting fund

Regulation 16 OFTR provides:

> (1) This regulation applies if a non-reporting fund which is a transparent fund has an interest in a reporting fund.

Transparent	Actual income	As act income	Gen principles
	Deemed R-F income	Misc income	reg 97

> (2) In the case of any **excess** specified in regulation 94(1) or (2) which is treated, under that regulation, as made to the non-reporting fund, the Tax Acts have effect as if the excess were additional income of the participants in the non-reporting fund in proportion to their rights.
> (3) The additional income is treated as arising on the same date as the excess is treated as made to the non-reporting fund.
> (4) If a participant in the non-reporting fund is chargeable to income tax, the additional income is charged as relevant foreign income within the meaning given by section 830 of ITTOIA 2005.

68.8 Fund treated as non-trading

This topic is dealt with in chapter 6 part 3 OFTR. A full discussion needs a long chapter to itself. In short, reg.80 OFTR provides:

> (1) This regulation applies if a diversely owned fund carries out an investment transaction in an accounting period.
> (2) The investment transaction is treated as a non-trading transaction.

The consequence of non-trading status is that the profit of the transaction is not income and need not be distributed by reporting funds.

The definitions of diversely owned and investment transaction are not considered here. HMRC argue that reg.80 is not to be taken to mean what it says:

> HMRC is aware that there has been recent industry speculation as to whether regulations contained within Chapter 6 of Part 3 of The Offshore Funds (Tax) Regulations 2009 (the 'regulations'), setting out when transactions by certain offshore 'reporting' funds are not treated as trading transactions for the purposes of computing 'reportable income', has any relevance to matters relating to the taxation of such funds potentially trading in the UK through a permanent establishment or agent. HMRC is therefore confirming that there is no such relevance.
>
> Regulation 80(2) of the regulations, which confirms that certain transactions are treated as non-trading transactions, applies only for the purposes of Chapter 5 of the regulations; that is for the purposes of computing an offshore fund's reportable income in order to establish the UK tax position of participants in the fund.
>
> The regulations are made under powers enabling provision to be made about the tax treatment of participants in an offshore fund (section 41 FA 2008) and they should be read in that context. Specifically, the regulations do not make or purport to make rules that affect the taxation of any of the funds referred to therein as 'offshore funds'; only to regulate the taxation of the returns from those funds to persons taxable under UK legislation. Funds that are taxable in the UK are dealt with by other legislation.
>
> It is a question of fact whether or not, for the purposes of that other legislation, a non-resident fund is carrying on a trade in the UK. Where such a fund is carrying on a trade in the UK through an investment manager operating here, the protection of the Investment Manager Exemption may be available in relation to any 'investment transaction' specified in the Investment Manager (Specified Transaction) Regulations 2009.[16]

68.9 Non-reporting becomes reporting fund

Regulation 48 OFTR provides:

> (1) This regulation applies if an offshore fund ceases to be a

[16] *http://webarchive.nationalarchives.gov.uk/20140109143644/http://www.hmrc.gov.uk/ctsa/invest-man-exempt.htm* (Feb 2010).

non-reporting fund and becomes a reporting fund.

(2) A participant in the fund may make an election to be treated—

(a) as disposing of the interest owned by the participant in the non-reporting fund at its market value on the disposal date, and

(b) as acquiring a holding in the reporting fund at the beginning of the reporting fund's first period of account.

This is subject to paragraph (5).

(3) Chapter 5 of this Part applies to determine the offshore income gain arising on the deemed disposal referred to in paragraph (2)(a).

(4) The deemed acquisition referred to in paragraph (2)(b) is treated as made for the same amount as the deemed disposal referred to in paragraph (2)(a).

(5) An election may not be made under paragraph (2) unless the offshore income gain arising on the deemed disposal referred to in paragraph (2)(a) (determined in accordance with paragraph (3)) is greater than zero.

(6) If the participant is chargeable to income tax, the election mentioned in paragraph (2) must be made by being included in a return made for the tax year which includes the disposal date.

(7) If the participant is chargeable to corporation tax, the election mentioned in paragraph (2) must be made by being included in the participant's company tax return for the accounting period which includes the disposal date.

(8) In this regulation—

"company tax return" has the same meaning as in Schedule 18 to the FA 1998;

the "disposal date" means the final day of the last period of account before the fund becomes a reporting fund.

68.10 2009 transitional rules

I do not attempt to discuss transitional rules in detail.[17]

[17] Note also the following HMRC statement: "HMRC regrets that ... the Statutory Instrument (SI 2009/3139) ... contained an error with respect to long periods of account.

The intention was that the transitional rules, which provide for an existing fund to apply for distributing status for periods ended on or after 1 December 2009, would not apply to any period ending after 31 May 2012 (not 2011 as provided for in the instrument).

The government intends to amend the cut-off date given in sub-paragraph 3(3B) of Schedule 1 to The Offshore Funds (Tax) Regulations (SI 2009/3001 as amended by SI 2009/3139) to read 31 May 2012.

This announcement therefore gives notice of the intended amendment, which will be

Reg.30 OFTR provides:

> (1) No liability to tax arises under regulation 17 in respect of any rights in an offshore fund to which this regulation applies if the rights are acquired by a person—
>
> (a) before 1st December 2009, or
>
> (b) in accordance with paragraph (2).
>
> (2) Rights are acquired in accordance with this paragraph if—
>
> (a) the rights are acquired by the participant in accordance with a legally enforceable agreement in writing that was entered into by the participant before 30th April 2009,
>
> (b) in the case of an agreement which was conditional, the conditions are met before that date, and
>
> (c) the agreement is not varied on or after that date.
>
> (3) Rights of a person in a fund are rights in an offshore fund to which this regulation applies if, on the date on which the person acquired the rights, those rights did not constitute a material interest in an offshore fund within the meaning of that expression given by section 759 of ICTA.

Reg.43 OFTR provides for the case where a person holds an offshore fund before 2009 and purchases more of the same fund:

> (1) This regulation applies if—
>
> (a) a person acquired rights (the "protected rights") in an offshore fund—
>
> (i) before 1st December 2009, or
>
> (ii) in accordance with paragraph (2),
>
> (b) immediately before 1st December 2009 those rights did not constitute a material interest in an offshore fund within the meaning of that expression given by section 759 of ICTA, and
>
> (c) on or after 1st December 2009 the person acquires additional rights in the offshore fund (the "non-protected rights").
>
> (2) Rights are acquired in accordance with this paragraph if—
>
> (a) the rights are acquired by the participant in accordance with a legally enforceable agreement in writing that was entered into by the participant before 30th April 2009,
>
> (b) in the case of an agreement which was conditional, the conditions are met before that date, and
>
> (c) the agreement is not varied on or after that date.
>
> (3) For the purposes of tax in respect of chargeable gains—

made at the first convenient opportunity."

(a) section 104 of TCGA 1992 (share pooling: general interpretative provisions) applies as if the protected rights were assets of a different class from the non-protected rights, and

(b) all the protected rights must be treated as disposed of before any of the non-protected rights may be so treated.

CHAPTER SIXTY NINE

UNIT TRUSTS

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69.13 Irish Common Contractual Fund

Cross references

The following topics are considered elsewhere:

Remittances: Is unit trust a relevant person	18.6.1
Connected persons	104.19
TRS	131.28

69.1 Unit trusts: Introduction

This chapter considers:

(1) Unit trusts

(2) Contractual funds (which are treated in a similar way):

(a) Fonds commun de placement

(b) Irish common contractual funds

The taxation of unit trusts needs a book to itself. This chapter focuses on the matters closest to the themes of this book.

69.2 Definition of "unit trust"

The definition is (more or less) standard:

s.1007(1) ITA	**s.99(2) TCGA**	**s.1119 CTA 2010**
In the Income Tax Acts "unit trust scheme" has the meaning given by section 237 of FSMA 2000. This is subject to subsection (2)[1]	Subject to subsection (3) and sections 99A and 151W(a) below,[2] in this Act— (a) "unit trust scheme" has the meaning given by section 237(1) of the Financial Services and Markets Act 2000	[for the purposes of the Corporation Tax Acts] "unit trust scheme" has the meaning given by section 237 of FISMA 2000

So we turn to s.237(1) FSMA, which provides:

> In this Part "unit trust scheme" means a collective investment scheme[3] under which the property is held on trust for the participants,[4] except that it does not include a contractual scheme.

In this work I abbreviate "unit trust scheme" to **"unit trust"**.

Strictly one should not use the term without indicating which definition applies, but the context may supply the definition.

A unit trust (except where it is deemed to be a company) is not a body corporate.[5]

69.2.1 *"On trust for participants"*

It is not sufficient that property is held on trust for the participants. It must be so held under the collective investment scheme. That depends of course on identifying what is the scheme.

Partnership property of partnership with legal personality, such as a Scots partnership, may be, and I expect usually is, held by the partnership and not on trust. But even if property is held on trust for a partnership with

[1] See 69.2.2 (Limited partnership exemption).

[2] These exceptions are as follows:

TCGA	**Topic**	**See para**
s.99(3)	Limited partnerships	69.2.2
s.99A	Umbrella schemes	App.66.17
s.151W(a)	Investment bond arrangements	*Not discussed*

[3] See App 66.3 (Mutual fund/CIS/OIEC).

[4] See App 66.2 (Participant/participate).

[5] This is self-evident, because a unit trust is a trust, and a trust is not a body corporate; see 90.9.3 (What is a body corporate?). But if authority is needed, see *HMRC v Hargreaves Lansdown Asset Management* [2019] UKUT 246 (TCC) at [74].

legal personality, the property is not held on trust for the participants.

Partnership property of an English partnership cannot be held by the partnership. It may sometimes be held by the partners, without a trust, but in practice it will often need to be held by a nominee on trust for the partnership. Land in England is held on trust in all cases of co-ownership. Shares may be held on trust if there are more than four co-owners, as shares cannot usually be registered in the names of more than four shareholders. But this may not constitute a unit trust, on the grounds that the trust is a mere conveyancing device, and not part of the scheme.[6]

What if some but not all scheme property is held on trust for the participants? It is suggested that the definition of unit trust requires that all (or at least substantially all) the property is held on trust.

69.2.2 *Limited partnership exemption*

There is some power to alter the definition by regulation. The drafting is not quite uniform between the taxes, which makes an exposition more difficult to follow, but there it is:

s.1007(2) ITA	**s.99(3) TCGA**
The Treasury may, in relation to a unit trust scheme within the meaning given by section 237 of FISMA 2000 whose trustees are UK resident, by regulations provide that the scheme is not to be a unit trust scheme for the purposes of the definition in section 989 of "unauthorised unit trust" if it is within a specified description.	The Treasury may by regulations provide that any scheme of a description specified in the regulations shall be treated as not being a unit trust scheme for the purposes of this Act...

The regulations are:
Capital Gains Tax (Definition of Unit Trust Scheme) Regulations 1988
Income Tax (Definition of Unit Trust Scheme) Regulations 1988

IT regs	**CGT regs**
3 Subject to the provisions of these Regulations, a unit trust scheme which is ...	**3** A unit trust scheme which is— (a) a limited partnership

[6] In *Samarkand Film Partnership No 3 v HMRC* [2011] UKFTT 610 (TC) at [42] Jersey partnerships (which are like English partnerships) were collective investment schemes, but it was not contended that their assets were held on trust so as to constitute a unit trust. This point was not discussed on appeal.

(c) a limited partnership scheme ... [7] shall be treated as not being a unit trust scheme for the purposes of section 354A [ICTA 1970, now s.504 ITA and s.621 CTA 2010].	scheme ...[8] shall be treated as not being a unit trust scheme for the purposes of the principal Act.[9]
8 A unit trust scheme is a limited partnership scheme when the scheme property is held on trust for the general partners and the limited partners in a limited partnership.[10]	**4** [identical]

I refer to this as the **"LP exemption"**.

An Inland Revenue press release explained the background:

> The wide Financial Services Act definition of unit trust scheme (which was introduced for tax purposes in 1987) may cover some schemes for which there is already a satisfactory tax treatment different from the unit trust tax treatment. Limited partnerships come into this category. It appears that a limited partnership can technically constitute a unit trust scheme within the meaning of the FSA 1986. Consequently, in the absence of regulations, limited partnerships would be subject to taxation as unit trusts. Ministers have decided that this would not be appropriate. Regulations are therefore proposed to leave limited partnerships to be taxed as they always have been, the partners bearing tax on their share of partnership income and gains.[11]

69.2.3 *Partnership outside LP exemption*

The LP exemption only applies to a LP registered under the Limited Partnerships Act 1907 so it does not apply to a foreign law LP. But in a

[7] The omitted words relate to enterprise zone property schemes, charitable unit trust schemes, approved profit sharing schemes and approved employee share ownership plans; these are not discussed here.

[8] The omitted words relate to approved profit sharing schemes and employee share ownership plans; these are not discussed here.

[9] Reg 2 provides that "the principal Act" means the Capital Gains Tax Act 1979; this now takes effect as a reference to the TCGA.

[10] Regulation 2 provides some necessary (and some unnecessary) definitions. In particular, "limited partnership" means a limited partnership registered under the Limited Partnerships Act 1907 and "general partner" and "limited partner" have the same meanings as in that Act. The CGT regs are identical.

[11] [1987] STI 784.

civil law jurisdiction, partnership property is not likely to be held on trust, so the LP would not fall within the definition of unit trust, and the exemption is not needed. So the issue is not likely to arise, except, perhaps, in relation to an LP governed by the law of the Republic of Ireland (which is a common law jurisdiction).

The LP exemption does not apply to a general partnership (because that is not a LP). It was perhaps considered that the exemption is not needed for that, as the partners should have day-to-day control, so the partnership is not a collective investment scheme, so it should not be a unit trust.

Of course, even if the LP exemption is not applicable, a partnership is only a unit trust if it satisfies all the other parts of the definition, and that will not happen very often.

The rule is not likely to have been UE-law compliant, but that is not likely to matter post-Brexit.

69.2.4 *"Units"*

Section 103D(10) TCGA provides a commonsense definition:

> In this section ...
> "units", in relation to a tax transparent fund, means the rights or interests (however described) of the participants in the fund.

69.3 Categories of unit trust

There are (at least) five categories of unit trust for tax purposes:

Type of unit trust	**See**
Authorised unit trust	69.4
Unauthorised unit trusts:	69.5
Exempt unauthorised unit trust	69.5
Non-exempt unauthorised unit trust	
NE UUT with UK trustees	69.6
NE UUT with non-UK trustees	69.7
Tax transparent funds 69.9	

69.4 Authorised unit trust

I discuss authorised unit trusts in outline only.

69.4.1 *AUT: Definition*

s.99(2) TCGA	**s.616 CTA 2010**	**s.272 IHTA**
Subject to subsection (3) and sections 99A and 151W(a) below,		

in this Act ...	In this Chapter[12]	
(b) "authorised unit trust" means, as respects an accounting period, a unit trust scheme in the case of which an order under section 243 of the Financial Services and Markets Act 2000 is in force during the whole or part of that period.	"authorised unit trust" means, in relation to an accounting period, a unit trust scheme in respect of which an order under section 243 of FISMA 2000 is in force during the whole or part of the period.	'authorised unit trust' means a scheme which is a unit trust scheme for the purposes of the Income Tax Acts (see section 1007 of the ITA 2007) and in the case of which an order under section 243 of the Financial Services and Markets Act 2000 is in force.

ITA adopts the CTA definition by reference.[13]

Section 243 FSMA (in short) gives the FCA power to make an order if the relevant requirements are satisfied. That takes us to the topic of financial regulation which strays too far from the themes of this work.

69.4.2 *Income arising to AUT*

Section 617(1) CTA 2010 provides:

> In respect of income arising to the trustees of an authorised unit trust, and for the purposes of the provisions relating to relief for capital expenditure, the Tax Acts shall have effect as if—
> (a) the trustees were a UK resident company; and
> (b) the rights of the unit holders were shares in the company.

So authorised unit trusts are not transparent for IT purposes.

69.4.3 *Distributions of AUT*

EN ITTOIA Vol II discusses the location of the source of AUT income distributions:

> 51. It is possible for the FSA to recognise a non-UK unit trust scheme for marketing into the UK. However, only those UK tax resident unit trusts that are "authorised" by the FSA come within [what is now s.617 CTA 2010]. Section [617(1) CTA 2010] provides that the Tax Acts apply to UK authorised unit trusts and shall have effect as if the trustees

[12] "This Chapter" is Chapter 2 Part 13, but s.119 CTA 2010 applies the definition for the Corporation Tax Acts.

[13] Section 989 ITA provides: "authorised unit trust" is to be read in accordance with sections 616 and 619 of CTA 2010.

> of the authorised unit trust were a company resident in the UK. Although the application of [s.617 CTA 2010] is by reference to the trustees' income (and relief for capital expenditure), the treatment of the trustees as a UK resident company carries through for the purposes of taxing interest distributions treated as made to unit holders. That is because [what is now s.373 ITTOIA] provides that the Tax Acts shall have effect as if such interest distributions were made "by the company referred to in section 468(1)". As these distributions are treated as made by such a company, that is a UK resident company, they can only be UK source income.

The wording has changed but the point is still valid.

69.4.4 *Gains of AUT*

Section 100 TCGA provides a CGT exemption.

69.5 Unauthorised unit trusts

The law is in the Unauthorised Unit Trusts (Tax) Regulations 2013 (UUTT Regs 2013).

Unauthorised unit trusts are divided into two categories:

(1) Exempt unauthorised unit trusts
(2) Non-exempt unauthorised unit trusts (NE UUTs)

An unauthorised unit trust is exempt if, in short, the unit holders are tax-exempt bodies and the trust has been approved by HMRC.[14]

This type of unit trust is not discussed here.

69.6 NE UUT: UK trustees

Reg 28 Unauthorised Unit Trusts (Tax) Regulations 2013 provides:

> (1) In respect of income arising and chargeable gains accruing to UK resident trustees of a non-exempt unauthorised unit trust, and for the purposes of the provisions relating to relief for capital expenditure, the Tax Acts have effect as if—
>
> (a) the trustees were a UK resident company, and
> (b) the rights of the unit holders were shares in the company.
>
> (2) References in the Corporation Tax Acts to a body corporate are to be read in accordance with paragraph (1); and sections 1104 and 1107 of CTA 2010 (companies and nominees required to provide tax certificates) apply with any necessary modifications.

[14] Reg 3 UUTT Regs 2013.

So non-exempt unauthorised unit trusts with UK resident trustees, like authorised unit trusts, are not transparent for IT purposes. The taxation of these unit trusts is not discussed further here. But I wonder if unit trusts of this kind are in fact found in practice.

69.7 NE UUT: Foreign trustees

This leaves the question of non-exempt unauthorised unit trusts with non-resident trustees. There is no statutory provision so we are thrown back to first principles, and ordinary trust rules apply. For IT purposes, depending on the drafting and proper law, a unit trust may be a transparent, *Baker* style trust or non-transparent.[15]

HMRC agree. The IF provides:

> **IFM13324 tax transparent funds** [Apr 2020]
> **Regulation 97 – transparent offshore funds of SI 2009/3001**
> Arrangements that fall within the definition of an offshore fund and are transparent for income purposes but not transparent for capital gains purposes include, for example, so called 'Baker' unit trusts (following the case of *Archer-Shee v. Baker*, 11 TC 749) and certain foreign contractual arrangements (such as Fonds Commun de Placement ('FCPs')).
> Income: UK tax treatment of investors
> No matter what the legal form of a transparent reporting fund, for UK tax purposes the income of an income-transparent fund is treated as arising directly to its investors (UK investors are charged to tax on income arising net of a deduction for proper expenses of the management of the fund in question, and this is the case for both unit trusts and contractual arrangements).

The IF Manual also discusses *Garland* unit trusts:

> **IFM13322 other non-corporate offshore funds** [Apr 2020]
> **Regulation 96 – other non-corporate offshore funds of SI 2009/3001**
> Arrangements that are non-transparent for income purposes and that come within the definition of an offshore fund under section S355(1) TIOPA 2010 (that is, funds that do not take corporate form) will be

[15] See 42.1 (IIP trusts: income tax). This view is supported by *Minister of National Revenue v Trans-Canada Investment Co* [1956] SCC 49 *https://www.kessler.co.uk/wp-content/uploads/2012/04/Minister-of-National-RevenuevTrans-Canada.pdf* where the Canadian Supreme Court applied *Baker* to a unit trust.

> foreign unit trusts. Foreign unit trusts that are not transparent for income purposes are sometimes referred to as 'Garland' unit trusts.
>
> UK investors in foreign unit trusts that are non-transparent for income purposes are taxable on their proportionate share of income (as ascertained after the trustees have met the expenses of administering the trust) when it is indefeasibly allocated to them, regardless of whether the income is paid to them or is accumulated. Unlike the position for transparent unit trusts, that income is taxable as miscellaneous foreign income (under Chapter 8 of Part 5 of ITTOIA 2005) and the tax rates applying will be those applying to such income.
>
> If there is an excess of reported income over the amount allocated (for example if the unit trust has invested in another reporting fund and has itself received reports of income which was not actually distributed to it) then the excess must be treated by the participant in the same way as the allocated income (that is as miscellaneous foreign income (under Chapter 8 of Part 5 of ITTOIA 2005).

A Garland trust may be a reporting or a non-reporting fund.

Whether a fund is a Baker trust or a Garland trust depends on the applicable law[16] and the drafting. Appropriate drafting may create a *Garland*-style non-transparent unit trust even in a *Baker* jurisdiction.

69.7.1 *Australian unit trusts*

The HMRC transparent/opaque list classifies Australian unit trusts as transparent for IT.[17] That is an oversimplification.

In Australia, most unit trusts are drafted to be transparent. But there are some where the unit holder's entitlement depends on the exercise of a discretionary power by the trustee so they are UK-law opaque; they may be treated as Australia-law transparent if the trustee exercises the power by the end of the tax year (in which case the unit trust is a hybrid entity). Australian law also has an anti-avoidance measure designed to prevent listed companies reorganising as unit trusts. A public trading trust /corporate unit trust[18] is a unit trust that carries on a business and has more than a threshold number of unit holders. These are Australian-law opaque, but may be UK-law transparent, so may be hybrid entities.[19]

[16] See 42.12 (Baker or Garland trust?).

[17] See 90.54 (HMRC transparent/opaque list).

[18] A public trading trust is one which was set up as a unit trust; a corporate unit trust – is one which started life as a company whose business was transferred to a unit trust.

[19] I am grateful to Michael Flynn SC for his comments on this point.

69.7.2 *Irish unit trusts*

The HMRC transparent/opaque list classifies Irish unit trusts as opaque.[20] But again, the position will depend on the drafting of the particular unit trust.

69.7.3 *Residence of unit trust trustees*

As a matter of trust law, and tax law, trustees of a unit trust are persons, but a unit trust is not a person. So it is more accurate to refer to trustee residence, not unit trust residence.

The residence of trustees of a unit trust is important for purposes, because the rules depend on whether or not the trustees are UK resident. However, there is no definition of residence for this purpose. The standard IT/CGT definition of residence of "trustees of a settlement"[21] does not apply, because a unit trust is not a "settlement".[22] Ordinary rules of residence apply to determine the residence of the trustees in their private capacities.

The residence of the trustees of a unit trust is also important for determining whether a unit trust is an offshore fund, and (more or less)[23] the same principles apply.

69.7.4 *Equalisation*

The CG Manual provides:

> **CG57705: Unit trusts: dividend equalisation payments** [Dec 2021]
> A unit holder may receive an equalisation payment at the end of the first distribution period in which they buy new units. New investors are not entitled to any share of the unit trust's income which arose before they bought their units. However, at the end of each distribution period the manager allocates the same amount from the income of the fund to each unit. To compensate for this an equalisation payment is added to the cost of new units. This is the amount of in-come that has arisen up to the date of purchase. Because these payments are included in the amount available for distribution they are effectively repaid to the purchaser.

[20] See 90.54 (HMRC transparent/opaque list).

[21] See 7.1 (Residence of trusts).

[22] The term "settlement" in this context is not expressly defined, but property in a unit trust is not "settled property" for the purposes of IT: s.466 ITA. It is considered that "settlement", in this context, requires settled property (as defined).

[23] For an exceptional case, see 66.15.2 (Residence of fund).

> The purchaser's dividend voucher at the end of the first distribution period should show the amount of the returned equalisation payment. This payment is not income. It should not be treated as a capital distribution, see CG57800+. It is a return of the initial price paid and it should therefore be deducted from the price paid when computing the chargeable gain on eventual disposal.

69.8 CGT: Deemed-company fiction

Section 99(1) TCGA provides:

> This Act shall apply in relation to any unit trust scheme as if—
> (a) the scheme were a company,
> (b) the rights of the unit holders were shares in the company, and
> (c) in the case of an authorised unit trust, the company were resident in the UK,
>
> except that nothing in this section shall be taken to bring a unit trust scheme within the charge to corporation tax on chargeable gains.

I refer to this as the **"deemed-company fiction"**.

Residence of the deemed company is important for CGT. Statute states that authorised unit trusts are UK resident but does not define the test of residence for unauthorised unit trusts. Since a unit trust is treated as a company, it is considered that the test of residence for CGT is the corporate test, ie, central management and control.[24]

Gains accruing to a non-resident "close" unit trust fall in principle within the scope of s.3 TCGA, and may be attributed to UK resident unit holders.[25]

A unit trust is (generally) a bare trust, but by implication the deemed-company fiction overrides the general principle of the CGT bare trust disregard.[26]

69.9 Tax transparent funds

69.9.1 *"Tax transparent fund*"

Section 103D(1) TCGA provides:

> For the purposes of this section—
> "tax transparent fund" means—

[24] There is some relevant discussion at 9.19.4 (POEM/CMC compared).

[25] Ghosh agrees: "When is a company not a company?" PTPR Vol 7 p.241 *http://www.khpplc.co.uk/reviews*

[26] See 87.7 (Bare trust/nomineeship).

> (a) an authorised contractual scheme which is a co-ownership scheme,[27] or
> (b) an offshore fund that is a transparent fund within the meaning given by regulation 11 of the Offshore Funds (Tax) Regulations 2009 and
>
> "fund property", in relation to a tax transparent fund, means the property subject to the fund.

69.9.2 *Deemed-company fiction disapplied*

Section 99(1A) TCGA provides an exception to the deemed-company fiction:

> Subsection (1) does not apply to an offshore fund that is a transparent fund within the meaning given by regulation 11 of the Offshore Funds (Tax) Regulations 2009[28] (see instead section 103D).

So we turn to s.103D(3) TCGA which provides:

> [a] A unit in a tax transparent fund is treated as an asset for the purposes of this Act,
> [b] and, accordingly, a participant's interest in the fund property is disregarded for those purposes.

A tax transparent fund is (notwithstanding its terminology) opaque for CGT in the sense that gains accrue to the fund, not to the participants.

69.9.3 *Gain on disposal of unit*

Section 103D TCGA provides:

> (4) In computing the gain accruing on a disposal by a participant of units in a tax transparent fund, an amount which—
> (a) represents income from the fund property, and
> (b) is taken into account as a receipt or other credit of the participant in calculating an amount chargeable to income tax,
>
> is treated as expenditure falling within section 38(1)(b).
>
> (5) In computing the gain accruing on a disposal by a participant of units in a tax transparent fund—
> (a) the sums that would otherwise be allowable under section 38(1) as a deduction from the consideration in the

[27] Defined s.103D(2) TCGA: "For the purposes of this Act—
"authorised contractual scheme" has the meaning given by section 237(3) of the Financial Services and Markets Act 2000, and
"co-ownership scheme" has the meaning given by section 235A of that Act."

[28] For reg 11OFTR, see 67.24.1 ("Transparent fund").

> computation of the gain are reduced (but not below nil) by the amounts within subsection (7), and
>
> (b) if those amounts exceed the sums that would otherwise be so allowable, the consideration is treated as increased by the amount of the excess.
>
> (6) So far as an amount within subsection (7) is dealt with under subsection (5)(a), it is not also dealt with under section 39.
>
> (7) An amount is within this subsection if it is—
>
> (a) any amount arising to the participant from the fund property which is taken into account as an expense or other debit of the participant in calculating an amount chargeable to income tax, or
>
> (b) anything paid or transferred to the participant, or anything else of value received by the participant, which is referable to the holding of the units (whenever paid, transferred or received) unless section 22 applies to whatever is paid, transferred or received.
>
> (8) In the case of any asset transferred as mentioned in subsection (7)(b), the value of the asset on the date of the transfer is taken to be its market value on that date.
>
> (9) If a participant has incurred expenditure in relation to any fund property in respect of which a capital allowance or renewals allowance (as defined by section 41(4) or (5)) has been or may be made, that expenditure is excluded from the sums allowable as a deduction in computing the amount of a loss accruing to the participant on a disposal of the units in the fund.

Lastly, for completeness, 103DA TCGA deals with share pooling for transparent funds:

> A unit in a transparent fund is to be regarded as a security for the purposes of sections 104, 105, 107, 110 and 114 (share pooling, identification of securities and indexation).

I would have thought that was the case anyway, so the provision only for the avoidance of doubt.

69.10 Situs of unit

69.10.1 *Situs of unit for IHT*

The situs of a unit in an authorised unit trust is not normally relevant for IHT[29] but it may matter for the ITA remittance basis. The situs of a unit

[29] See 75.3 (Non-settled UK funds).

in an unauthorised unit trust is important for IHT.

A unit is unlike an equitable interest under a conventional trust. The rights of a unit holder arise from contract as well as trust, and a unit is in many ways analogous to a share in a company.[30] One should not apply rules governing other kinds of equitable interests without considering this.

It is considered that share/security situs rules should normally be applied, so that the place of the register is normally the determining factor. HMRC accept this.[31]

Another possible view is that situs depends on the residence of the trustees. In practice a situation where the place of residence of the trustees is different from the place of the register would be rare so the priority between the two tests may never need to be decided. Trustee residence determines whether a unit trust is treated as a company or offshore fund for IT and CGT purposes.[32] It might therefore be said to be consistent with the tax legislation if situs of a unit for IHT depends upon the residence of the trustees. However, situs for IHT is based on private international law, not tax law, so the relevance of unit trust tax provisions is very marginal.

Situs of a unit does not depend on the situs of the underlying assets of the unit trust. The idea that one looks at the underlying assets, at first sight seems sensible, as it is consistent with the usual test for situs of a bare trust. But it is unsound for two reasons:

(1) If the underlying assets are spread across different jurisdictions it would be impossible to ascertain the situs of the unit (if a unit is regarded as a single asset). The unit should not be regarded as several separate interests in as many assets as are held by the unit trust, looking through the unit trust like a bare trust, as this is to ignore the

[30] Thomas & Hudson, *The Law of Trusts* (2nd ed., 2010), para 53.28, says that the rights are *primarily* contractual, but to classify overlapping rights as "primary" and "secondary" seems to me somewhat arbitrary.

[31] Press Release 16 October 2002 (OEICs and AUTs) para 9 stated (before the introduction of IHT relief for AUTs):

> "[OEICs and units in Authorised Unit Trusts] are treated as situated in the UK in the same way as other UK registered shares. That is so even if the 'underlying' assets of the collective investment fund are non-UK assets."

See too [1998] PCB 172. This conclusion is supported by *CPT Custodian Pty v Commissioners of State Revenue* (2005) 221 ALR 196 *http://www.austlii.com* (unit holders not joint "owner" of land for purposes of Australian rating laws).

[32] See 69.6 (Unauthorised UT: UK trustees); App. 66.3 (Mutual fund/CIS/OIEC).

nature of the unit.[33]

(2) The proposal to look to the situs of the underlying assets is unworkable because the unit holder will not normally be able to ascertain what the underlying assets are at any particular moment. (Accounts of the unit trust may disclose the position at the end of an accounting period but that will not help as underlying assets may be bought and sold frequently by the trustees of the unit trust. The unit holder normally has no further right to information.)

Although the consequence is that one can alter situs by interposition of a unit trust, that is not surprising: one can do the same with an OEIC or a company.

69.10.2 *Situs of unit for CGT*

Since a unit trust is treated as a company, the test of situs for CGT should be that which applies for companies.

The applicable rule is that registered shares are situated where they are registered.[34] As units are treated as shares, and are (in practice) registered, units in a unit trust are situate where they are registered. The situs of the underlying assets is not relevant. This rule is the same as the private international law rule.

There are three other CGT situs rules which I should mention for completeness:

(1) Under the UK-law rule, intangible property governed by UK law is UK situate, unless the situs is otherwise determined.[35] This rule does not apply, even if the unit trust is governed by UK law, because its situs is "otherwise determined": it is determined by the rule which applies to registered shares.

(2) Shares of a company "incorporated in the UK" are UK situate for CGT purposes.[36] It is considered that this rule does not apply, even if the unit trust is governed by UK law, because although a unit trust is treated as a company, and units are treated as shares, there is nothing to say that the deemed company is "incorporated in the UK".

However, a UK law unit trust will in practice have a register here, so these

[33] A similar argument applies in relation to the situs of an equitable interest under a substantive trust.

[34] See 103.6 (Registered security: Non-UK co).

[35] See 103.13.4 (UK-law rule).

[36] See 103.5 (Securities of UK company).

two questions will not arise.

(3) Lastly, under the co-ownership rule, the situs of co-owned assets is determined on the assumption that the asset is wholly-owned by the person holding the interest in the asset.[37] As a matter of general law, unit holders are co-owners of the underlying assets of the unit trust. But the co-ownership rule does not apply to a person holding a unit because the unit is deemed to be a share, so it is not an interest in an asset. (The co-ownership rule would apply if a unit were co-owned by two or more persons.)

69.10.3 *Residence of trustees and situs*

The residence of the trustees is not relevant for situs, though non-resident trustees are required if it is desired that the units are not to be chargeable securities for SDRT purposes.[38]

69.11 Gain on disposal of unit

An offshore unit trust will be an offshore fund. It may qualify as a reporting fund. If it does not, a gain accruing on a disposal of a unit will be an offshore income gain.[39]

69.12 Fonds commun de placement

Fonds commun de placement may be translated as "mutual funds", or "common funds" but it is better to use the French term, (abbreviated as FCP).

The UCITS directive provides:

> Les organismes visés au paragraphe 2 [organismes de placement collectif en valeurs mobilières (OPCVM)] peuvent revêtir la forme contractuelle (fonds communs de placement gérés par une société de gestion) ou de trust (unit trust) ou la forme statutaire (société d'investissement).

> The undertakings referred to in paragraph 2 [undertakings for collective investment in transferable securities (UCITS)] may be constituted in accordance with contract law (as common funds [FCPs] managed by management companies), trust law (as unit trusts), or statute (as investment companies).

[37] See 103.3 (Co-owned assets).

[38] See s.99(5A) FA 1986.

[39] See 66.15 ("Offshore fund").

Luxembourg law offers two definitions of the term in different statutes, but the differences do not matter for present purposes:

> Est réputée fonds commun de placement pour l'application de la présente partie toute masse indivise de valeurs mobilières et/ou d'autres actifs financiers liquides mentionnés à l'article 41, paragraphe (1), composée et gérée selon le principe de la répartition des risques pour le compte de propriétaires indivis qui ne sont engagés que jusqu'à concurrence de leur mise et dont les droits sont représentés par des parts destinées au placement dans le public par une offre publique ou privée.[40]

> Fonds commun de placement for the purposes of this Part means a fund of transferable securities and/or other liquid financial assets mentioned in article 41(1), established and managed, on the basis of spread risk, on behalf of joint owners who are liable for no more than their investment, and whose rights are represented by shares to be issued to the public under a public or private offer.

> Est réputée fonds commun de placement pour l'application de la présente loi toute masse indivise de valeurs composée et gérée selon le principe de la répartition des risques pour le compte de propriétaires indivis qui ne sont engagés que jusqu'à concurrence de leur mise et dont les droits sont représentés par des parts réservées à un ou plusieurs investisseurs avertis.[41]

> Fonds commun de placement for the purposes of this law means a fund of securities, established and managed, on the basis of spread risk, on behalf of joint owners who are liable for no more than their investment, and whose rights are represented by units intended for one or more informed investors.

In France:

> Sous réserve des dispositions de l'article L. 214-8-7, le fonds commun de placement, qui n'a pas

> Subject to the provisions of article L. 214-8-7, a fonds commun de placement, which does not have

[40] Loi du 17 décembre 2010 concernant les organismes de placement collectif (Law of 17 December 2010 concerning undertakings for collective investment) Art 5 *http://legilux.public.lu/eli/etat/leg/loi/2010/12/17/n9/jo*

[41] Loi du 13 février 2007 relative aux fonds d'investissement spécialisés (Law of 13 February 2007 relating to specialized investment funds) Art 4 *http://legilux.public.lu/eli/etat/leg/loi/2007/02/13/n1/jo*

la personnalité morale, est une copropriété d'instruments financiers et de dépôts dont les parts sont émises et rachetées à la demande, selon le cas, des souscripteurs ou des porteurs et à la valeur liquidative majorée ou diminuée, selon les cas, des frais et commissions.[42]

legal personality, is a joint ownership of financial instruments and deposits, the shares of which are issued and redeemed at the requests, as the case may be, from subscribers or holders and at the increased or decreased net asset value, as the case may be, of fees and commissions.

69.12.1 *IT position of FCP*

The HMRC transparent/opaque list refers to Luxembourg fonds commun de placement, and French fonds commun de placement à risques, and classifies them as transparent.[43]

69.12.2 *CGT position of FCP*

An FCP is not a unit trust, on the basis that FCP assets are not held on trust. This is addressed by s.103D TCGA (and assumed in the drafting of the definition of offshore fund[44]).

But if it mattered, the question whether an FCP is a trust (or more accurately, whether references to a trust in any particular provision include an FCP) would benefit from further examination. The Australian Taxation Office classify an FCP as a trust for tax purposes:

> **Overview of the Umbrella Fund**
> 19. The Umbrella Fund is an open-ended unincorporated mutual investment fund in the form of a 'fonds commun de placement'. It is governed by Luxembourg law and qualifies as an Undertakings for Collective Investment in Transferable Securities (UCITS) ...
> 20. As a pooled investment vehicle and form of collective investment fund, the Umbrella Fund receives cash or assets from Unitholder subscriptions and invests its cash/assets in various assets comprising Transferable Securities, Money Market Instruments and some non-transferable securities. Investments are made within permitted

[42] Article L214-8 Code monétaire et financier. *https://www.legifrance.gouv.fr/affichCode.do;jsessionid=86E31C071F2CC1F64CB6CCA5D49016CE.tplgfr21s_3?idSectionTA=LEGISCTA000027786850&cidTexte=LEGITEXT000006072026&dateTexte=20200106*

[43] See 90.54 (HMRC transparent/opaque list).

[44] See 66.15 ("Offshore fund").

parameters as set out in the Management Regulations and Prospectus, and in accordance with the requirements applicable to UCITS under Luxembourg laws and regulations.

21. Subscription for Units in the Umbrella Fund is made by completing required documentation (including an Account Opening Agreement) and submitting that, together with payment of the full purchase price of the Units subscribed for, for acceptance by the Management Company. The issue price of a particular Unit class in the Umbrella Fund or a Fund is based on the net asset value of that Unit class (subject to adjustments for swing pricing) at the Valuation Point on the relevant Dealing Day (that is the time of subscription).

22. The key features of the Umbrella Fund are that:

- it is managed by the Management Company, the sole and exclusive objective in respect of which is the management of the Umbrella Fund (and its assets) on behalf, and in the interests, of its Unitholders
- its assets are kept separate from the Management Company which entrusts the Depositary with the custody of its assets in separate accounts or deposits on behalf of the Unitholders
- the Umbrella Fund is divided into separate sub-funds referred to as Funds
- Units issued with respect to each Fund may be divided into separate classes with each such class representing an interest in the underlying net assets of the Fund but with different characteristics as are established specifically with respect to such class
- the Unitholders legally own Units in the Umbrella Fund (or Fund), as evidenced by mention in the Register of Unitholders
- a Unitholder’s acquisition of Units in the Umbrella Fund implies their acceptance of the Management Regulations of the Umbrella Fund which govern the legal relationship between the Unitholders, the Management Company and the Depositary
- the entire assets of the Umbrella Fund are the joint property of all Unitholders, who have equal rights in proportion to the number of Units of each class they hold in individual Funds
- each Unit confers an equal and undivided interest in the assets of the Umbrella Fund as a whole or the relevant Fund, and does not confer an interest in any particular asset
- the Unitholders of Distributing Unit Classes (as beneficiaries of the Umbrella Fund) are beneficially entitled to the income of a Fund as it is earned by the Fund
- the extent to which distributions are made with respect to any Fund will be determined by the Management Company with consideration to net investment income and net realised capital gains, and the net asset value of the Umbrella Fund not falling below the minimum

capital amount prescribed by law, and

- distributions to the Unitholders of Distributing Unit Classes of the Funds will generally be declared and paid at least annually within one month following the end of the financial year of the Umbrella Fund.

23. Distributions to the Unitholders of Distributing Unit Classes in a Fund may represent both dividends and capital gains received by the Umbrella Fund as a result of holding and/or disposing its assets, and on-paying these income streams to the Unitholders in the form of a fund distribution, net of taxes, fees and other expenses.

24. Depending on the domestic tax laws of the jurisdiction that the Umbrella Fund has invested in, withholding tax is likely to be incurred by the Umbrella Fund when income and/or capital proceeds are remitted from that jurisdiction to the Umbrella Fund. The amount of dividend income and/or capital proceeds that is then on-paid by the Umbrella Fund to the Unitholders, in the form of a fund distribution, will effectively be net of withholding tax.

25. Unitholders may request redemption of their Units from a Fund at the redemption price. The redemption price is based on the net asset value of the relevant Unit class in the Umbrella Fund or a Fund (subject to adjustments for swing pricing) at the Valuation Point on the relevant Dealing Day (that is the time of redemption).

26. Legal or beneficial ownership of Units cannot be transferred other than by redemption in accordance with the Management Regulations.

The Management Company

27. Amongst other things, the Management Company:

- is entitled to buy, sell, subscribe for, exchange and receive any assets and to exercise all the rights directly or indirectly connected with the Umbrella Fund's assets
- shall determine the investment policy of the Umbrella Fund, but may avail itself of services of Investment Managers
- is authorised to file any tax elections and tax certifications with tax authorities outside of Luxembourg as it deems necessary, and is responsible for making Units available to Unitholders.

The Depositary

28. Amongst other things, the Depositary:

- holds the legal title to all of the Umbrella Fund's assets for the benefit of all Unitholders
- is the administrative, registrar, transfer and paying agent for the Umbrella Fund
- may only draw on the Umbrella Fund's assets or make payments to third parties for the Umbrella Fund by order of the Management

Company within the scope of the Management Regulations

- shall ensure that the sale, issue, redemption, conversion and cancellation of Units effected for the account of the Umbrella Fund or by the Management Company are carried out in accordance with the law and the Management Regulations
- shall ensure that the value of Units is calculated in accordance with the law and the Management Regulations, and
- shall ensure that the Umbrella Fund's proceeds/earnings are employed in accordance with the Management Regulations...

Explanation

The Umbrella Fund constitutes a trust

30. The term 'trust' is not defined in the ITAA 1936 or ITAA 1997. Whether a trust relationship between the Management Company (or the Depositary) and a Unitholder exists upon the Unitholder's acquisition of Units in the Umbrella Fund should therefore be determined in accordance with guidance provided by the Courts.

31. Gaudron, McHugh, Gummow, Kirby and Hayne JJ in *Associated Alloys Pty Limited v. ACN 001 452 106 Pty Limited* [2000] HCA 25, at paragraph 29, endorsed the joint judgment of Dixon CJ, Williams and Fullagar JJ, in *Kauter v. Hilton* (1953) 90 CLR 86 who, at page 97, identified:

> ...the established rule that in order to constitute a trust the intention to do so must be clear and that it must also be clear what property is subject to the trust and reasonably certain who are the beneficiaries.

32. [The ruling refers to the definition of "trust" in *Harmer v. FCT*; see 90.14.6 (Trust concept in Australian law), and continues:]

33. All four essential elements of a trust are present so as to give rise to a trust relationship between the Management Company, the Depositary and the Unitholders. This is held because:

- legal title to the assets of the Umbrella Fund vests with the Depositary (or a member of the Depositary's sub-custody network).
- the assets of the Umbrella Fund (being Transferable Securities, non-transferable securities and Money Market Instruments) are capable of being held on trust and, pursuant to the terms of the Management Regulations, are dealt with by the Management Company and the Depositary acting in a trustee capacity on behalf of, in the interests and for the benefit of, the Unitholders, and
- Unitholders (who are clearly intended to be beneficiaries of the Umbrella Fund) are beneficially entitled to a proportion of the underlying assets of the Umbrella Fund (or a relevant Fund) in accordance with their Unit holding and receive income from the investment of the Umbrella Fund assets by the Management

Company and/or the Depositary as it arises.[45]

69.13 Irish Common Contractual Fund

The [Ireland] European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 2011 provides a definition:

> 3(1) In these Regulations—
> "common contractual fund" means a collective investment undertaking, being an unincorporated body established by a management company under which the participants by contractual arrangement participate and share in the property of the undertaking as co-owners

This appears to be a statutory equivalent of a FCP.
The HMRC transparebnt/opaque list classifies a CCF as transparent.[46]

[45] ATO, Product Ruling PR 2016/8 Income tax: tax consequences of investing in Wellington Management Funds (Luxembourg)
https://www.ato.gov.au/law/view/document?DocID=PRR/PR20168/NAT/ATO/00001

[46] See 90.54 (HMRC transparent/opaque list). See too 90.40.3 (Stichting holds CCF).

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TAXATION OF NON-RESIDENTS AND FOREIGN DOMICILIARIES 2024-25

by

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Cross references

The following topics are considered elsewhere:
11.18 (TNR: life policies)
101.1 (Statutory tax indemnity)
102.25 (Insurance policy)
103.15 (Insurance policy)
131.26 (TRS: UK trust holding Irish bond)

The taxation of policies held by UK resident companies is not discussed.

70.1 Policies: Introduction

This chapter considers:
(1) life insurance policies
(2) life annuity contracts
(3) capital redemption policies

ITTOIA refers to these as “policies and contracts”. I abbreviate that to **“policies”**. In the insurance industry the asset is often described as an investment bond, or just a bond; statute adopts that term in the expressions “personal portfolio bond” and “guaranteed income bond”. I prefer not to use the word “bond” since it is also used to describe debentures and indeed strictly includes any obligation undertaken by deed; but no difficulty arises as long as the meaning is clear.

Policies fall within Chapter 9 Part 4 ITTOIA, sometimes called the “chargeable event” regime. This contains almost 100 sections: it is the longest chapter in ITTOIA. The reader will not be surprised if I say that a full discussion needs a long book to itself. This chapter focuses on matters closest to the themes of this work.

One can effectively opt into the chargeable event regime by framing an investment as a capital redemption policy, or a life policy (which need have only a nominal element of life insurance); and this is common practice.

70.1.1 *Navigation*

The layout of the provisions is as follows:

Topic	**ITTOIA sections**
Charge to tax	461 - 463
Person liable	464 - 472
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70.2 Definitions

70.2.1 *"Policy"*

The IPT Manual provides:

> **IPTM1115 Fundamental Concepts: what is a life policy** [Jun 2016]
> The word policy in connection with insurance has a long history. It is the formal document in which an insurer (that is, insurance company or friendly society) sets out the terms of its obligations in consideration of the stipulated premiums. For an insurance contract to be made, or varied, between an insurer and policyholder requires the completion of the standard contract law offer and acceptance. There is no practical distinction between contract and policy; the latter simply evidences the former. Lord Donaldson confirmed this in the judgment referred to at IPTM1110 [*Scher v Policyholders Protection Bond* [1994] 2 AC 57.]

70.2.2 *"Life insurance"*

The definition of life insurance[1] needs a chapter to itself. IPT Manual provides:

[1] A note on terminology. The General Insurance Manual provides:
"**GIM1060. Legal basis of insurance: Indemnity** [Jun 2016]
It used to be said that there was a distinction between
[1] insurance, meaning insurance against a financial loss, and
[2] assurance, meaning the assurance of a fixed or minimum sum upon the occurrence of a specified event that is bound to occur.
The text of the [Policies of Assurance] Act 1601, however, shows that the term "assurance" was applied to what is manifestly indemnity insurance. More recently the distinction has faded further under the influence of the EU, where the official English texts of the relevant Directives consistently use the term "life insurance". For most practical purposes therefore insurance and assurance can be treated as interchangeable terms. In tax legislation, however, the term "assurance" is usually confined to life business.

> **IPTM1115. What is a life policy?** [Jun 2016]
> According to the 1774 Life Assurance Act, a policy of life insurance is an insurance policy on life. There is no further definition in the Taxes Acts. If a policy pays benefits on the death of an individual, either whenever it happens, or within a specified term, then it is potentially within the scope of the chargeable event legislation.
> It is not relevant for tax purposes that such a policy may also provide insurance against other risks, such as disability and critical illness, although that might affect its regulatory or accounting treatment.
> Funeral plan contracts where a customer pays a sum to a funeral provider to provide a funeral in due course are not contracts of insurance, although similar arrangements if made with an insurer as a whole of life policy are, according to the regulatory rules of the Financial Services Authority.[2]

70.2.3 *"Capital redemption policy"*

Section 473(2) ITTOIA provides:

> In this Chapter—
> "capital redemption policy" means a contract made in the course of a capital redemption business, within the meaning given by section 56(3) of FA 2012.

The definition is only for the purpose of Chapter 9 Part 4 ITTOIA (the "chargeable event" regime) but it is applied by reference elsewhere.[3] That takes us to s.56(3) FA 2012 which provides:

> Business is "capital redemption business" if it consists of
> [a] the effecting on the basis of actuarial calculations, and the carrying out, of contracts
> [b] under which, in return for one or more fixed payments, a sum of a specified amount (or a series of sums of a specified amount) become payable at a future time or over a period.

IPT Manual provides:

> **IPTM1120. What is a capital redemption policy?** [Nov 2018]
> Capital redemption policies, though issued by insurance companies, are not strictly speaking insurance products. They were once known as investment bond

[2] There is also an interesting discussion in:
General Insurance Manual GIM1010 (Legal and economic basis of insurance)
Part 7 of the Law Commission paper "Insurable Interest" (2008)
PERG 6 (Guidance on the Identification of Contracts of Insurance)
https://www.handbook.fca.org.uk/handbook/PERG.pdf

[3] Eg s.432(3) ITTOIA (DDS code).

contracts, which is more descriptive but needs to be distinguished from the type of life policy investment bond described at IPTM1100. Under capital redemption policies, one or more fixed sums is paid to an insurer under a contract pursuant to which one or more specified amounts is paid out at some later time or times, on the basis of an actuarial calculation. Typically the contracts take the form of

- an annuity certain, where a capital sum is used to buy an annuity for a fixed term not contingent on life, see IPTM4200,[4] or
- a sinking fund where regular sums are paid in to secure a capital sum at some later date, for example against the need to find a premium payment to renew a lease.

The statutory definition of capital redemption business is at [s.56 FA 2012]. Contracts within such business are long term insurance business but not life business. A capital redemption policy that creates a debtor/creditor relationship, with an agreement to return the sum advanced, is known as a capital redemption bond and is similar in nature to a relevant or deeply discounted security, see SAIM3000. However, such bonds, which may only be sold by an insurer, are removed from the scope of the deeply discounted securities income tax charge of Section 427 ITTOIA onwards.[5] ...

70.2.4 *"Life annuity"*

Section 473(2) ITTOIA provides:

> In this Chapter... "life annuity" means—
> (a) an annuity that—
> (i) is a purchased life annuity for the purposes of Chapter 7 of this Part (see section 423),[6] and
> (ii) is not specified in section 718 (annuities excluded from the exemption for part of purchased life annuity payments

[4] See 38.17.3 ("Annuity certain").

[5] See too the explanatory notes to the draft legislation published in the Pre-Budget Report, 5 December 2005:

> 15. A capital redemption policy is a contract, issued by an insurer, which is made in the course of capital redemption business. Under a capital redemption policy, for consideration of a sum or sums of money, the issuer of the policy guarantees to pay out a larger sum on a specified future date or to make a series of payments. Payment is independent of any contingency linked to human life.
>
> Examples of such contracts include—
>
> - an annuity certain - an annuity payable for a set period not contingent upon the survival of a life,
> - a leasehold redemption policy - which builds up a fund to be used in some way on the expiry of a lease, and
> - a sinking fund policy - this accumulates a fund for the eventual replacement of a wasting asset.

[6] See 38.17.2 ("Purchased life annuity").

under section 717)

Section 718 ITTOIA provides the list of exceptions:

> (2) The annuities are—
> (a) an annuity the whole or part of the consideration for which consisted of sums satisfying the conditions for relief under section 266 of ICTA (life assurance premiums),
> (b) an annuity purchased following a direction in a will, and
> (c) an annuity purchased to provide for an annuity payable as a result of a will or settlement out of income of property disposed of by the will or settlement.
> (3) For the purposes of subsection (2)(c), it does not matter whether or not capital could also be used to pay the annuity.

70.2.5 *"Surrender"*

In this chapter:

"A full surrender" is a surrender of all the rights under the policy.

"A part-surrender" is a surrender of part of the rights under the policy.

Section 500 ITTOIA provides:

> The following events are treated for the purposes of this Chapter as a surrender of a part of the rights under the policy or contract in question—
> (a) the falling due of a sum payable as a result of a right under a policy or contract to participate in profits where further rights remain under it,
> (b) in the case of a contract for a life annuity which provides for a capital sum to be taken as an alternative in part to the annuity payments, taking the capital sum,
> (c) the making of a loan to which section 501 applies, and
> (d) the making of a payment to which section 504 applies (payments by insurers under guaranteed income bonds etc.).

Para (c)(d) (loans and guaranteed income bonds) are specialist topics and not discussed here.

70.2.6 *"Insurance year"*

Section 499(1) ITTOIA provides:

> In this Chapter "insurance year", in relation to a policy or contract, means the 12 months beginning with—
> (a) the date on which the insurance or contract is made, or

> (b) any anniversary of that date.

Special rules apply on the termination of a policy:

> (3) An event referred to in section 484(1)(a)(i) or (iii) or (b) to (e)[7] ... is treated as ending the insurance year in which it occurs.
> (4) In this Chapter "final insurance year" means an insurance year that is ended as a result of subsection (3).
> (5) But if, as a result of subsection (3), an insurance year would begin and end in the same tax year—
> (a) that insurance year and the previous insurance year are treated as one insurance year, and
> (b) "final insurance year" needs to be read accordingly.

The IPT Manual provides:

> **IPTM3505 Chargeable events: calculating gains: 'insurance year'** [Jun 2016]
> 'Insurance year' - sometimes called policy year - begins on the day a policy is taken out and on the same date in subsequent years. It ends on the day before the anniversary of the start date and each subsequent year.
> For example, a policy taken out on 1 June 2004 has an 'insurance year' ending on 31 May 2005. A part surrender giving rise to an 'excess event' taking place on 1 April 2005 would fall in tax year 2004-05. But the gain on the 'excess event' would be treated as arising at the end of the 'insurance year', on 31 May 2005, and consequently would be assessable for tax year 2005-6.
> If an event brings a policy or contract to an end - full surrender of rights, death, maturity or taking a capital sum as a complete alternative to annuity payments - the 'insurance year' is treated as ended on that date. It is then referred to as the 'final insurance year'.
> If that rule would result in an 'insurance year' beginning and ending within the same tax year, then the 'final insurance year' is extended to include the previous 'insurance year'.
> For example, if there is an 'insurance year' running from 1 June 2004 to 31 May 2005 and the policy is fully surrendered on 30 June 2005, the 'final insurance year' runs from 1 June 2004 to 30 June 2005.
> The extended period of a 'final insurance year', coupled with the requirement on the insurer to issue a chargeable event certificate broadly within three months of the event, may result in the issue of a certificate

[7] This is a terminal event: see 70.3.3 (Types of chargeable event).

> for an event that turns out not to be chargeable. This may happen where the event is swept up in a calculation for a terminal event that brings the 'final insurance year' to an end, see IPTM3570. In this case the insurer should notify the policyholder that the earlier certificate should be disregarded - see IPTM7210.

70.2.7 *Rights, parts and shares*

Section 464(3) ITTOIA provides:

> If there has been a surrender or assignment of only a part of or share in rights under the policy or contract, the references in this section and those sections to the rights are references to that part or share.[8]

EN ITTOIA comments:

> 417. *Subsection (3)* provides that references in sections 464 to 467 to a surrender or assignment of rights refer, where appropriate, to a surrender or assignment of a part of, or share of, the rights. A *part* of the rights means one or more discrete rights provided by the policy or contract. A *share* in the rights means part of the ownership, where there are multiple owners, of such a discrete right or rights or of all the rights in the policy or contract.

70.3 The charge

The charge is in s.461(1) ITTOIA:

> Income tax is charged on gains treated as arising[9] from policies and contracts to which this Chapter applies.

Section 463(1) ITTOIA provides:

> Tax is charged under this Chapter on the amount of the gains arising in the tax year.

70.3.1 *Policies within charge*

This takes us to s.473(1) ITTOIA:

[8] This is repeated in s.468(6) ITTOIA. (If s.464(3) had ITTOIA-wide application this would have been unnecessary.)

[9] The general usage of tax legislation is that chargeable gains "accrue" but income "arises". In the chargeable events legislation, gains are regarded as income and so the word used is "arise". There is no difference in meaning.
In the chargeable events legislation, gains are sometimes said to "arise" and sometimes "treated as arising". Again, there is no difference in meaning.

> This Chapter applies to—
> (a) policies of life insurance,
> (b) contracts for life annuities, and
> (c) capital redemption policies.

Sections 478–483 ITTOIA (not discussed here) specify various types of policies to which the provisions do not apply.

70.3.2 *When gains arise*

The time that the gain arises is particularly important for a beneficiary who becomes or ceases to be UK resident, as a gain arising to a non-resident (or in the overseas part of a split year) is not taxable.

Section 462(1) ITTOIA provides:

> For the purposes of this Chapter, a gain from a policy or contract arises when a chargeable event occurs in relation to the policy or contract (see section 484).

For full surrenders the chargeable event occurs, and the gain arises, at the time of the surrender.

For part-surrenders the event occurs, and the gain arises, at the end of the insurance year[10] for the policy concerned. The reason is perhaps so that only one chargeable event computation is needed, even if there are several part-surrenders during the year.

70.3.3 *Types of chargeable event*

"Chargeable event" is a label which brings in a complex set of rules. Section 484(1) ITTOIA sets out the starting point:

Chargeable event: text of s.484	**Type**
The following are chargeable events—	
(a) in the case of any kind of policy or contract—	Terminal Event
(i) the surrender of all rights under the policy or contract,	
(ii) the assignment of all those rights for money or money's worth,	
(iii) the falling due of a sum payable as a result of a right under a policy or contract to participate in profits, if there are no remaining rights under it	

[10] See 70.2.6 ("Insurance year").

(iv) a chargeable event treated as occurring under section 509(1) (chargeable events in certain cases where periodic calculations show gains),	
(v) a surrender or assignment treated as a chargeable event under section 514(1) (chargeable events where transaction-related calculations show gains), and	Calculation Event
(vi) a chargeable event treated as occurring under section 525(2) (chargeable events where annual personal portfolio bond calculations show gains)	
(b) in the case of a policy of life insurance, a death giving rise to benefits under it,	
(c) in the case of a policy of life insurance or a capital redemption policy, its maturity,	
(d) in the case of a contract for a life annuity which provides for the payment of a capital sum on death, the death, and	Terminal Event
(e) in the case of a contract for a life annuity which provides for a capital sum to be taken as a complete alternative to the annuity payments (or any further annuity payments), taking the capital sum.	

Thus there are ten types of chargeable event. They fall into two categories:

(1) **Calculation events:** s.491(4) ITTOIA provides the terminology:

> In this Chapter—
> "calculation event" means
> [a] an excess event,
> [b] a part surrender or assignment event or
> [c] a personal portfolio bond event

Thus there are three types of calculation event: Section 491(4) then defines these three types:

> [a] "excess event" means a chargeable event within section 509(1),
> [b] "part surrender or assignment event" means a chargeable event within section 514(1), and
> [c] "personal portfolio bond event" means a chargeable event within section 525(2).

The terminology of [a] is opaque, and [b] is misleading, but it is hard to think of better labels for the tortuous statutory rules. Calculation events are therefore within s.484(1)(a)(iv), (v) or (vi).

(2) Other events: that is, chargeable events other than calculation events. Statute calls these "**terminal events**".[11] Terminal events are those within s.484(1)(a)(i)-(iii) and (b)-(e), in short:
(a)(i) full surrender
(a)(ii) full assignment
(a)(iii), (e) final payment
(b)(d) death giving rise to benefits
(c) maturity

Logically there should be two stages, first to ascertain whether there is a chargeable event and secondly to compute the gain. But in the three calculation event cases the two stages overlap, because the question of whether there is a chargeable event depends on whether there is a gain.

It should be noted that an assignment for no consideration is not a chargeable event. This is the opposite of the CGT position.

Sections 484-489 ITTOIA contain exemptions. These are not discussed here, but s.487 is important because it contains an exemption for inter-spouse transfers (based on the CGT spouse exemption).

70.3.4 *Computation of gains*

The computation of gains is complex and artificial, and sometimes bears no relation to the commercial gain. *Mayes v HMRC* noted:

> This is legislation which does not seek to tax real or commercial gains.[12]

The rules are not the same as the computation of gains for CGT purposes, so one must take care not to confuse:
(1) chargeable gains (the CGT term) and
(2) gains under the chargeable events legislation

It is confusing that the legislation calls them both "gains". The term "**chargeable-event gains**" is used when one needs to distinguish the two types of gains.[13]

There are five different methods of computation for different types of chargeable event. The computation rules are not discussed here.

SA904(Notes) (Notes on Trust and Estate Foreign, 2022/23) comments

[11] This convenient term was introduced in s.465B ITTOIA.

[12] *Mayes v HMRC* [2011] STC 1267 at [60].

[13] The tern is occasionally used in statute, eg in a heading in sch 45 FA 2013 ("New special rule: chargeable event gains").

on how to compute foreign currency gains:

> Calculate gains on foreign life insurance policies, life annuities and capital redemption policies in the currency in which the policy or life annuity is denominated. Then convert the gain into sterling at the rate of exchange applicable at the time of the chargeable event (which may not be at the time the transaction occurred).[14]

This is different from method of computation of chargeable gains. In cases where the CGT method suits the taxpayer, it might well be questioned.

70.3.5 *Partial surrender trap*

The provisions are sometimes very crude and partial surrender is a particular trap.

In practice, properly advised taxpayers avoid the problem by taking out a cluster of separate policies, instead of one single policy, and making a full surrender of some of them when they want. So the problem tends to affect those who come to the UK, who have taken out a policy when non-UK resident and without considering the tax issues.

[14] Similarly, the IPT Manual provides:

> **IPTM9220 Calculation of gains and other amounts for policies in foreign currencies** [Jun 2016]
>
> Where a tax representative or insurer reports a gain in sterling, it should compute the gain by calculating the amount of the chargeable event gain in the currency in which the policy is denominated and then convert it into sterling at the conversion rate on the date of the event. This method ensures that currency fluctuations during the life of the policy are disregarded.
>
> Where a tax representative or insurer reports other amounts in sterling, for instance the premiums paid where there has been an assignment, they should be translated at the rate applying on the date of the chargeable event.

Similarly, IPT Manual:

> **IPTM3700 Foreign policies: differences in treatment** [Dec 2017]
>
> ... Some policies are denominated in a foreign currency. In such cases, any chargeable event gain should be computed in the foreign currency and then converted to sterling at the rate that applies at the date of the chargeable event. This method should be adopted rather than any other method such as converting each transaction to sterling at the rate applying on the date the transaction occurred.
>
> For instance, if premium of €10,000 was paid into a policy on 10 May 2002 and the policy was surrendered for €12,500 on 3 January 2005, the chargeable event gain on the surrender is €2,500. This should then be converted to sterling at the conversion rate applying on 3 January 2005 to arrive at the amount of taxable gain.

HMRC now have a discretion to recalculate the gain where the statutory computation gives a figure which is wholly disproportionate,[15] though well advised taxpayers would not want to rely on that.

70.4 Individuals and settlors

Once one has identified a chargeable event, and computed the chargeable-event gain, the next stage is to ascertain the person liable for the charge.

Section 464 ITTOIA provides an introduction:

> (1) The person liable for any tax charged under this Chapter is the person indicated by—
> section 465 (person liable: individuals),
> section 466 (person liable: personal representatives), and
> section 467 (person liable: UK resident trustees),
> according to how the rights under the policy or contract are owned or held immediately before the chargeable event in question occurs.
> (2) References in those sections to the ownership or holding of those rights are references to their ownership or holding at that time.

Section 465(1) ITTOIA provides:

> An individual is liable for tax under this Chapter if
> [a] the individual is UK resident for the tax year in which the gain arises and
> [b] condition A, B or C is met.

I call these conditions "**individual bond conditions A to C**".

70.4.1 *Individual beneficial owner*

Section 465(2) ITTOIA provides:

> Condition A is that the individual beneficially owns the rights under the policy or contract in question.

Individual bond condition A – gain charged on individual if they are beneficial owner – is natural and sensible.

Sections 469–471 ITTOIA deal with joint ownership.

70.4.2 *Individual is settlor*

Section 465(3) ITTOIA provides:

[15] See s. 507A, 512A, ITTOIA, enacted after the *cause célèbre* of *Lobler v HMRC* [2013] UKFTT 141 (TC) which is discussed at 2.5 (Attitudes to tax avoidance).

> Condition B is that those rights are held on non-charitable trusts which the individual created.

There are two strange features about individual bond condition B, where a policy or contract is held in trust. First, it does not refer to the "settlor", which is the normal tax and trust term, but to trusts "created" by a person. In practice, the settlor will usually be the creator.[16] I use the term "creator (settlor)".

Secondly the creator (settlor) is charged on the chargeable-event gain arising to their trust regardless of the identity of the beneficiaries. The individual has an indemnity against the trustees[17] so ultimately it is the beneficiaries who bear the burden of the charge, but they do so at the creator (settlor)'s marginal rates. At first sight this seems surprising: the approach more commonly adopted in taxation is only to charge the settlor in the case of settlor-interested trusts, ie if the settlor or (more or less) closely connected persons are beneficiaries. However:

(1) One approach is not necessarily better than the other.[18]
(2) The approach adopted for policies may favour the taxpayer, because chargeable-event gains may otherwise be taxed at the trust rate, ie the top rate; so in a very rough and ready way the rule can mitigate the unfairness of taxing trusts at the trust rate, whose beneficiaries may be lower taxpayers.

Section 545 ITTOIA provides a commonsense definition of a "trust":

> "non-charitable trust" means a trust other than a charitable trust.

What if X creates a bare trust for the benefit of Y, and the trust holds a policy on which a gain arises? Condition A is satisfied, so Y is taxed on the gain: condition A refers to beneficial ownership. At first sight, condition B is also satisfied! "Trust" is not defined; the usual tax term is

[16] The reason for the non-standard term was, possibly, (1) to avoid the rule that a "settlor" must have provided an element of bounty or (2) a concern that a company may not be a "settlor"; see 99.39 (Pension/employee benefit trust), or (most likely) (3) a rough and ready way to deal with the two-settlor situation. That is, if A created a trust and B added property, A alone was the creator and was formerly subject to tax on the whole of the gain. But s.472 ITTOIA now provides a more sensible rule in this case.

[17] See 101.1 (Statutory tax indemnity).

[18] See App 14.10.2 (Definitions of settlor-interested).

"settlement" or "settled property" (which excludes a bare trust). However the two conditions cannot both be satisfied, and the context shows that condition B is not intended to be satisfied. Bare trusts are invariably transparent for tax purposes. So a bare trust does not count as a trust for this purpose and "trust" has the same meaning as the usual tax term "settlement". HMRC agree. The IPT Manual provides:

> **IPTM3250 Person liable to charge: summary of the position in relation to trusts** [Jun 2016]
> **... Rights held on a bare trust - beneficiary chargeable**
> Here the beneficiary is absolutely entitled as against the trustee and the rights are vested in the beneficiary as beneficial owner. The bare trust is ignored and the beneficiary is chargeable by virtue of ITTOIA05/S465 (2). This applies equally where the beneficiary is a minor...

Section 472 ITTOIA deals with trusts with two or more settlors.

The IPT Manual discusses the meaning of "creator":

> **IPTM3250 Person liable to charge: summary of the position in relation to trusts** [Jun 2016]
> ... 'Settlor' or 'creator' of a trust has a wide meaning and includes any person who settles property on the trust. So, for instance, where a person pays sums to the trustees to use as current or future premiums for a policy held in the trust, that person is a creator of the trust.
>
> **IPTM3290 Person chargeable: multiple interests: trusts created by more than one person** [Jun 2016]
> ... If property is contributed by different persons at different times, for instance where property is added to an existing settlement, each is treated as a creator in relation to the trust and consequently as a sole settlor.
> The share is taken to be the same as the proportion of property contributed by the creator to the trust as it stands immediately before the chargeable event. Property is contributed for this purpose if it originates from the creator, meaning provided directly or indirectly by that person, unless under reciprocal arrangements with another person. A just and reasonable apportionment may be made where necessary.

I would have said that if A creates a trust, and B adds property to it, A alone is the "creator";[19] but the issue will not often arise.

[19] See too 79.3 (One IHT-settlement or more).

70.4.3 *Debt charged on policy*

Section 465(4) ITTOIA provides:

> Condition C is that those rights are held as security for the individual's debt.

Individual bond condition C – gain charged on individual if held as security for the individual's debt – is a rough and ready solution to the problem of imposing the tax charge where the economic ownership lies. CGT has the opposite rule: s.26 TCGA.

70.4.4 *Gains of non-resident*

The charge only applies "if the individual is UK resident for the tax year in which the gain arises": s.465(1) ITTOIA.

70.4.5 *Gains of split year*

Section 465(1A) ITTOIA provides the usual split-year rule:

> But if the tax year is a split year as respects the individual, the individual is not liable for tax under this Chapter in respect of gains arising in the overseas part of that year (subject to section 465B).[20]

70.5 No remittance basis

Section 465(5) ITTOIA provides:

> For the purposes of calculating the total income of an individual liable for tax under this Chapter, the amount charged is treated as income.

The drafting technique is that the gain is added to the individual's "total income". The gain is taxed on an arising basis. The remittance basis does not apply even if the individual is a remittance basis taxpayer and the gain arises from an offshore policy.

It follows that a policy or contract which will give rise to a gain under the chargeable event provisions is not a suitable form of investment for:

(1) an individual who is a remittance basis taxpayer or

(2) a trust whose creator (settlor) is a remittance basis taxpayer[21]

unless the individual expects to be non-resident in the year that the chargeable-event gain arises. If the individual has no short or medium

[20] The exception in brackets refers to the TNR rules: see 11.18 (TNR: life policies).

[21] But it may be suitable if held by a non-resident company held by the trust: see below.

term intention of realising a gain (ie the policy is a long term investment) then the tax disadvantage may be set against the practical convenience of the policy.

The RDR Manual correctly provides:

> **RDRM33540 Identifying Remittances: Chargeable Event gains** [Jan 2019]
> ... Gains arising on a chargeable event, for example, the surrender of all rights under a policy of life insurance are chargeable to tax on the arising basis regardless of whether the policyholder is domiciled in the UK or not. The remittance basis does not apply.
>
> ...
>
> **Withdrawals in excess of 5% or full surrenders**
> If the individual withdraws more than 5% of accumulated premiums then, the amount in excess of 5% or the actual gain if a full surrender, will be chargeable to income tax under the chargeable event legislation. It is charged on the arising basis whether it is remitted or not.

70.5.1 *Remittance basis: Critique*

This is at first sight a surprising inconsistency with the general scheme of taxation for foreign domiciliaries.

For completeness: some might suggest the following justification for taxing chargeable-event gains on an arising basis. A remittance basis taxpayer may take out a foreign policy, whose value is linked to a UK asset held by the life insurance company.[22] If the chargeable-event gain was taxed on the remittance basis, then use of a policy "wrapper" would allow what is in economic terms UK source income or gains to be taxed on a remittance basis. I doubt if that is the historical reason for the rule, which is probably due to oversight. However that may be, this possibility does not justify the rule. It is suggested that gains on foreign policies should be taxed on the remittance basis. The problem does not even call for a targeted anti-avoidance, for the planning which only amounts to deferral, and turns capital into income should be regarded as unobjectionable; deferral is in any case available in a number of different ways.

Long-term residents who pay the remittance basis charge and who have acquired foreign policies may well feel short-changed, though if the figures are large enough, there may be some scope for planning. As with

[22] For an example, see *Foulser v MacDougall* [2007] STC 973.

most anomalies, the rule should not affect the well-advised.

70.5.2 *Premium unremitted income/gain*

The RDR Manual provides:

> **RDRM33540 Chargeable Event gains** [Jan 2019]
> ...Under a special rule (ITTOIA05/s507) policyholders are able to make partial surrenders or assignments of broadly up to 5% of accumulated premiums with any tax charge postponed until maturity or other later realisation. This is known as the '5% deferral rule' or the 'excess rule'. When the policy comes to an end any earlier withdrawals are taken into account in calculating the end gain.
> However when considering the position of a remittance basis user you will need to consider what income or gains they used to pay the premium due under the contract or policy. Where an individual purchases an overseas life insurance, or other income-generating, policy and subsequently part of that policy is surrendered for a cash payment and that money is brought to the UK, such payments will be treated as taxable remittances to the extent that the purchase of the original premium was made with the individual's untaxed foreign income and gains that would have been taxed on the remittance basis if remitted to the UK.
> So if the premium was paid using the individual's foreign income or foreign gains that were untaxed when they arose, because the individual was a remittance basis user in that year, then any of the 5% withdrawal will be a taxable remittance if the money is brought to, or received or used in, the UK. The amount attributable to the '5% withdrawal' indirectly derives from the original premium paid, so Conditions A and B of s809L apply. ...

For mixed fund issues where a policy is bought out of foreign income/gains, see 20.4.7 (Finding income/capital for year).

70.6 Non-UK period relief

Section 528 ITTOIA provides relief for the individual who is UK resident in the year that the gain arises (so they are within the charge) but who has formerly been non-resident. I refer to this as "**non-UK period relief**".

The development of the current law can be traced from a Consultation document Life Insurance - Time Apportioned Reductions (2012).

EN FB 2013 summarises the 2013 changes:

> Current [pre-2013] rules only provide for time apportioned reductions where a life insurance policy has been issued by a foreign insurer. Time

apportioned reductions will be extended to life insurance policies issued by UK insurers.
Time apportioned reductions will be calculated by reference to the residence history of the person liable to income tax on the gains and not by reference to the residence history of the legal owner of the policy.

70.6.1 *Pre/post-2013 rules*

FA 2013 contains 2 sets of amendments:

(1) Para 3 sch 8:
  (a) deleted the former s.528, 529 ITTOIA ("pre-2013 provisions") and
  (b) inserted new s.528, 528A ITTOIA ("post-2013 provisions")

(2) Confusingly, para 87 sch 45 then amended the new s.528, 528A which the same act had just introduced. The significance of that, I think, is to preserve the pre-SLT residence rules where it is necessary to ascertain residence in years before the SLT.

Para 7 sch 8 FA 2013 deals with the transitional rules. Para 7(1) provides:

> (1) The amendments made by this Schedule have effect in relation to—
>   (a) any policy of life insurance issued in respect of an insurance made on or after 6 April 2013, or
>   (b) any contract constituting a capital redemption policy made on or after that date.

The starting point is that:

(1) The post-2013 provisions apply to post-2013 policies
(2) The pre-2013 provisions will continue to be relevant for a generation.

Para 7 sch 8 FA 2013 provides:

> (2) The amendment made by paragraph 3 above has effect in relation to any insurance or contract made[23] before 6 April 2013 if on or after that date—
>   (a) the policy or contract is varied with the result that there is an

[23] Para 7(4) sch 8 FA 2013 provides: "In the case of a policy or contract treated under section 473A of ITTOIA 2005 as a single policy or contract, for the purposes of sub-paragraphs (1) and (2) the date on which the insurance or contract is made is the date on which, as the case may be—
(a) the first insurance is made in respect of which the connected policies are issued, or
(b) the first of the connected contracts is made."

> increase in the benefits secured,
> (b) there is or was an assignment (or assignation) of rights, or a share of the rights, conferred by the policy or contract (whether or not for money's worth) to the individual or deceased, or
> (c) some or all of the rights conferred by the policy or contract become or became held as a security for a debt of the individual or deceased,
>
> and the other amendments made by this Schedule have effect in relation to the insurance or contract accordingly.
>
> (3) For the purposes of sub-paragraph (2)(a) an exercise of rights conferred by a policy or contract is to count as a variation of the policy or contract.

If the post-2013 regime is advantageous, it is possible to bring a pre-2013 policy within its scope. But if the pre-2013 regime is better, it is necessary to take some care to preserve it.

70.6.2 *Non-UK period relief: New law*

Post-2013(1) s.528 ITTOIA provides:

> Subsection (2) applies if—
> (a) an individual is liable for tax charged on a gain from a policy of life insurance or a capital redemption policy, and
> (b) there are one or more days in the material interest period that are foreign days.

70.6.3 *Relief for appropriate fraction*

Post-2013 s.528 ITTOIA provides:

> (2) In determining the individual's liability for tax, the gain[24] on which the tax is charged in the case of the individual is to be reduced by the appropriate fraction.
>
> (3) The appropriate fraction is A / B
>
> where—
>
> A is the number of days in the material interest period which are foreign days, and
>
> B is the number of days in the material interest period.

The key terms are "foreign days" and "material interest period".

[24] Section 528(4) ITTOIA provides: "In subsection (2) the reference to the gain is to be read in accordance with section 463A(4), 463D(4) or 463E(3) (which relates to restricted relief qualifying policies) if applicable."

70.6.4 *"Foreign days"*

Post-2013 s.528(1A) ITTOIA provides:

> "Foreign days" are—
> (a) days falling within any tax year for which the individual is not UK resident, and
> (b) days falling within the overseas part of any tax year that is a split year as respects the individual.

70.6.5 *"Material interest period"*

Post-2013(5) s.528 ITTOIA provides:

> In this section "the material interest period" means so much of the policy period as during which the individual meets condition A, B or C in section 465 in relation to the policy (subject to subsection (7)).

That is, in short, the individual is beneficial owner, settlor or mortgagee.[25]

70.6.6 *Inter-spouse transfer*

Post-2013 s.528 ITTOIA provides:

> (6) Subsections (7) and (8) apply if, before the chargeable event, there is an assignment falling within section 487(c) [inter-spouse transfer] in relation to the policy where the individual is the assignee.
> (7) There is to be added to the material interest period any part of the policy period falling before the assignment—
> (a) during which the assignor meets condition A, B or C in section 465 in relation to the policy, and
> (b) which is not included in the material interest period under subsection (5).
> (8) In relation to any period added to the material interest period under subsection (7), in subsection (1A)(a) and (b) the reference to the individual is to be read as a reference to the assignor.

70.6.7 *Minor provisions*

Post-2013 s.528 ITTOIA provides:

> (9) For the purposes of subsections (5) and (7), in section 465(2) to (4) references to the rights under the policy are to be read as including references to a share of those rights.

[25] See 70.4 Individuals and settlors).

(10) In this section "the policy period" means the period for which the policy has run before the chargeable event occurs.

(11) If the policy is a policy of life insurance which is a new policy in relation to another policy, for the purposes of subsection (10) the new policy is to be taken to have run—

(a) from the issue of the other policy, or

(b) if it also was a new policy in relation to an earlier policy, from the issue of the earlier policy,

and so on; and in subsections (5) to (9) references to the policy are to be read accordingly as including any relevant earlier policy.

(12) In subsection (11) "new policy" has the meaning given in paragraph 17 of Schedule 15 to ICTA.

70.7 Non-UK period relief: PRs/trustees

Section 528A ITTOIA provides equivalent relief for PRs:

(1) Subsection (3) applies if—

(a) personal representatives are liable for tax charged on a gain from a policy of life insurance or a capital redemption policy under section 466, and

(b) there were one or more days in the material interest period that were foreign days.

Section 528A ITTOIA provides equivalent relief for trustees:

(2) Subsection (3) also applies if—

(a) trustees are liable for tax charged on a gain from a policy of life insurance or a capital redemption policy under section 467 where—

(i) of conditions A to D in that section, only condition B is met, and

(ii) the absent settlor condition which is met is the one in subsection (4)(b) of that section (deceased settlor),

(b) there were one or more days in the material interest period that were foreign days, and

(c) the deceased died—

(i) in a tax year for which the deceased was UK resident but not one that was a split year as respects the deceased, or

(ii) in the UK part of a tax year that was a split year as respects the deceased.

(2A) "Foreign days" are—

(a) days falling within any tax year for which the deceased was not UK resident, and

> (b) days falling within the overseas part of any tax year that was a split year as respects the deceased.
>
> (3) In determining the liability for tax of the personal representatives or trustees, the gain on which the tax is charged in the case of the personal representatives or trustees is to be reduced by the appropriate fraction.
>
> (4) The appropriate fraction is—
>
> A / B
>
> where—
>
> A is the number of days in the material interest period which [were foreign days, and
>
> B is the number of days in the material interest period.
>
> (5) In subsection (3) the reference to the gain is to be read in accordance with section 463C(8) (which relates to restricted relief qualifying policies) if applicable.
>
> (6) In this section "the material interest period" means so much of the policy period falling before the deceased's death as during which the deceased met condition A, B or C in section 465 in relation to the policy (subject to subsection (8)).
>
> (7) Subsections (8) and (9) apply if, before the deceased's death, there was an assignment falling within section 487(c) in relation to the policy where the deceased was the assignee.
>
> (8) There is to be added to the material interest period any part of the policy period falling before the assignment—
>
> (a) during which the assignor met condition A, B or C in section 465 in relation to the policy, and
>
> (b) which is not included in the material interest period under subsection (6).
>
> (9) In relation to any period added to the material interest period under subsection (8), in subsection (2A)(a) and (b) the reference to the deceased is to be read as a reference to the assignor.

Section 528A(10)-(13) is the equivalent of s.528 (9)-(12), and need not be set out again here.

70.8 Pre-2013 non-UK period relief

For pre-2013 policies the legislation is as follows. Pre-2013 s.528 ITTOIA provides:

> (1) The gain from a foreign policy of life insurance or foreign capital redemption policy is reduced for the purposes of this Chapter if the policy holder was not UK resident throughout the policy period.
>
> (2) The amount of the reduction is the appropriate fraction of the gain.

> (3) The appropriate fraction is A/B
> where—
> A is the number of days on which the policy holder was not UK resident in the policy period, and
> B is the number of days in that period.
> [(4)(5)(6) are the equivalent of 528(10)(11)(12) in the post-2013 law]
> (7) This section is subject to section 529.

Pre-2013 s.529 ITTOIA provides:

> (1) Section 528 does not apply if, when the chargeable event occurs or at any time during the policy period, the policy is or was held—
> (a) by a non-UK resident trustee,
> (b) by non-UK resident trustees,[26] or
> (c) by a foreign institution.

70.9 Liability of UK trust

If the creator (settlor) of the trust is alive and UK resident, they will be taxed on the gain.[27] Section 467 ITTOIA provides for the situations where the creator (settlor) is not taxable:

> (1) Trustees are liable for tax under this Chapter if immediately before the chargeable event in question occurs they are UK resident and condition A, B, C or D is met.

I refer to **"trust policy conditions A, B, C or D"**. It is considered that these conditions must be satisfied immediately before the event, ie "immediately before" governs the phrase"they are UK resident" and "condition A, B, C or D is met".

> (1A) If trustees are liable for tax under this Chapter, the gain is treated for income tax purposes as income of the trustees.

The rate of tax is in principle 45%.[28]

An appointment to UK resident beneficiaries before the chargeable event may reduce the rate of tax and an appointment to non-resident

[26] Para (b) is otiose, but it does not matter. Section 529(2) deals with a detail of trustee residence:"section 110 of FA 1989 (residence of trustees) applies for the purposes of subsection (1)(b) despite section 110(6) of that Act (which provides that it only applies for 1989-90 and subsequent tax years)."

[27] See 70.4 (Individuals and settlors).

[28] Section 482 ITA type 7: see 41.2.3 (Trust-rate incomes).

beneficiaries may avoid tax altogether.

A trust migration may be effective if done before the chargeable event; it is not necessary to wait until the following tax year.

70.9.1 *Condition A: Charitable trust*

Section 467(2) ITTOIA provides

> Condition A is that the rights under the policy or contract are held by the trustees on charitable trusts.

See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 4.14 (Life policies/annuities) online version *https://www.taxationofcharities.co.uk*

70.9.2 *Condition B: Absent settlor*

Section 467 ITTOIA provides

> (3) Condition B is that—
> (a) those rights are held by the trustees on non-charitable trusts, and
> (b) one or more of the absent settlor conditions is met.
> (4) The absent settlor conditions are that the person who created the trusts—
> (a) is non-UK resident,
> (aa) is UK resident but the gain arises in the overseas part of a tax year that is, as respects the person who created the trusts, a split year,
> (b) has died, or
> (c) in the case of a company or foreign institution (see section 468(5)), has been dissolved or wound up or has otherwise come to an end.

70.9.3 *Conditions C and D*

Section 467 ITTOIA provides:

> (5) Condition C is that—
> (a) the rights under the policy or contract are held by the trustees on non-charitable trusts,
> (b) condition B does not apply, and
> (c) neither section 465 nor section 466 applies.
> (6) Condition D is that the rights under the policy or contract are held as security for a debt owed by the trustees.

70.10 ToA: Chargeable-event gains

Non-resident trustees are outside the scope of the charge on a chargeable event because s.467(1) ITTOIA (which imposes the charge on trustees) applies only to UK-resident trustees.

A non-resident company is outside the scope of the charge under ITTOIA (which does not apply to companies). It is outside the scope of the charges in CTA 2009 (which only apply to corporation tax).[29]

In the absence of express provision, the chargeable-event gain would not fall within the ToA provisions because the receipt by the person abroad (assuming they are non-resident) is capital and not income or (more accurately) the chargeable-event gain is not income.[30] However, s.468 ITTOIA deals with this. It is helpful to consider trusts and companies separately.

70.10.1 *Non-resident trust*

Section 468 ITTOIA provides:

> (1) This section applies if a gain is treated as arising under this Chapter and ...
>
> (a) trustees who are non-UK resident would be liable for tax in respect of the gain as a result of section 467 if the trustees were UK resident immediately before the chargeable event in question occurs, ...
>
> (2) Chapter 2 of Part 13 of ITA 2007 (which prevents avoidance of tax where a UK resident individual benefits from a transfer of assets) applies with the modifications specified in subsection (3) or (4).
>
> (3) In a case within subsection (1)(a), Chapter 2 of Part 13 of ITA 2007 applies as if—
>
> (a) the gain were income becoming payable to the trustees, and
>
> (b) that income arose to the trustees in the tax year in which the gain arises. ...

This incorporates ss.720[31] and 731 ITA.

[29] This continues the position formerly governed by ESC C33.

[30] See 48.15 (Income of person abroad).

[31] Section 720 ITA is not needed here because a transferor within s.720 would normally be taxed as the creator of the settlement, but the overlap does not matter. It is similar to the overlap of s.624 ITTOIA and s.720 ITA.

70.10.2 *Non-resident co/institution*

Section 468 ITTOIA provides (so far as relevant):

> (1) This section applies if a gain is treated as arising under this Chapter and ...
> (b) immediately before that event occurs—
> (i) a foreign institution[32] beneficially owns *a share* in the rights,
> (ii) the rights are held for the purposes of a foreign institution, or
> (iii) *a share* in them is held as security for a foreign institution's debt.
>
> (Emphasis added)

It is curious that (i) and (iii) refer to *shares* in rights. Contrast ss.465(2) and 467(2) ITTOIA.[33] On a traditional approach to statutory construction the (i) and (iii) do not apply if the foreign institution beneficially owns the *entire* policy. The gap is more or less filled by s.468(1)(b)(ii), as if a foreign company owns a policy, the rights are held for its purposes. If necessary a court might decide there was a slip in the drafting, which on a modern approach to construction could be corrected. Perhaps the drafting will be corrected some time.

Assuming s.468(1)(b) ITTOIA is satisfied, we read on:

> (2) Chapter 2 of Part 13 of ITA 2007 (which prevents avoidance of tax where a UK resident individual benefits from a transfer of assets) applies with the modifications specified in subsection (3) or (4). ...
> (4) In a case within subsection (1)(b), Chapter 2 of Part 13 of ITA 2007 applies as if—
> (a) the gain were income becoming payable to the institution, and
> (b) that income arose to the institution in the tax year in which the gain arises.

Section 720 ITA is needed here, as the transferor would not otherwise be taxed on the gain.

[32] "Foreign" is defined in s.468(5) ITTOIA: "In this Chapter 'foreign institution' means a company or other institution resident or domiciled outside the UK." "Institution" is not defined.

[33] See 70.4 Individuals and settlors) and 70.9 (Liability of UK trust).

70.10.3 *Transferors: Pre-2005 gain*

Suppose:

(1) gains arose before 5 December 2005 to a foreign company or trust within s.731; the transferor was not subject to tax on those gains as they arose;[34] and

(2) the *transferor* receives a benefit.

A transferor is outside the scope of s.731.[35] Under the pre-5 December 2005 law, I suggested that the transferor's s.731 defence would not apply when s.720 did not apply. Now that s.720 does apply, the transferor's defence should apply even to pre-5 December 2005 gains. This could be something of a windfall for transferors; but since unrealised gains were brought within the s.720 charge from 5 December 2005, HMRC can hardly complain that realised gains now fall within the transferor's defence.

Following the restriction of the taxable-transferor defence in 2017, it is still possible to devise circumstances where this point arises, but in practice it would be very unusual.

70.10.4 *s.720 remittance basis/protected-trust relief*

A chargeable-event gain does not qualify for the s.720 remittance basis, and does not qualify for s.720 protected-trust relief, because the gain does not meet the requirement that the income of the person abroad "would be relevant foreign income if it were the individual's".[36]

For the same reason, a benefit which relates to the gain does not qualify for the s.731 remittance basis.[37]

70.10.5 *Income of life company*

So far we have considered the taxation of chargeable-event gains arising to non-resident trusts or companies which hold policies.

The payment to a non-resident life company (or a subsidiary of such a company) is in principle a transfer of assets within the ToA provisions. The ToA provisions would in principle apply if:

(1) Income arising as a result of the payment can be identified (ie if the

[34] See the 4th edition of this work, para 20.5.
[35] See 50.15 (Taxable-transferor defence).
[36] See 49.26 (s.720 remittance basis).
[37] See 50.39 (s.731 remittance basis).

premium paid is segregated)[38]; and

(2) the motive defence does not apply.

In a straightforward case, the application of the motive defence is well established: *IRC v Willoughby*.[39] If there were a tax avoidance purpose, however, the ToA provisions would in principle apply: the fact that a policy is taken out does not preclude the possibility of tax avoidance. As to whether this could lead to double taxation, see 51.18 (Life policies).

70.11 s.624: Chargeable-event gains

Section 624 ITTOIA never applies to a chargeable-event gain. To see why, it is helpful to distinguish:

(1) UK resident settlor

(2) Non-UK resident settlor:

  (a) non-resident trustees

  (b) UK resident trustees

Where the settlor is UK resident they are taxed on the gain under basic principles as a creator. Section 624 does not apply because the gain is not income of the trustees.

Where the settlor is non-resident and the trustees are non-resident, section 624 does not apply because the gain is not "income" and so it is not "income arising under a settlement".

Where the trustees are UK resident, but the settlor is not resident, the gain is deemed to be income of the trustees. In these circumstances the s.624 non-resident settlor defence will apply.[40]

70.12 Personal representatives

Section 466 ITTOIA provides:

> (1) Personal representatives are liable for tax under this Chapter if
>
> [a] the rights under the policy or contract are held by them and
>
> [b] the condition in subsection (2) is met
>
> (and accordingly the gain is treated for income tax purposes as income of the personal representatives in that capacity).

[38] See 48.9.5 (Transfer for issue of life policy).

[39] 70 TC 57.

[40] That is, the gain is such that if the settlor were actually entitled thereto, they would not be chargeable to income tax by reason of being non-resident: see 47.9 (Non-resident settlor).

> (2) The condition is that if an individual were liable for tax on a gain in respect of the policy or contract, section 530(1) (individual treated as having paid tax at the basic rate) would be disapplied as a result of—
>
> (a) section 531(1) (exceptions from section 530 for policies and contracts specified in section 531(3)), or
>
> (b) para 109(2) of Schedule 2 (contracts in accounting periods beginning before 1st January 1992).
>
> (3) For cases where the condition in subsection (2) is not met, see section 664 of this Act and [section 947 of CTA 2009] (under which the gain is treated as part of the aggregate income of the estate for the purposes of Chapter 6 of Part 5 of this Act and [Chapter 3 of Part 10 of CTA 2009] respectively).

The condition in subsection (2)(b) is a transitional rule now of limited scope.

In order to understand the condition in subsection (2)(a) one needs to follow a trail of statutory provisions. First, ss.530 and 531 ITTOIA:

> **530 Income tax treated as paid etc.**
>
> (1) An individual or trustees who are liable for tax on an amount under this Chapter are treated as having paid income tax at the basic rate on that amount.
>
> ...

I refer to this as a "**s.530 tax credit**".

> **531 Exceptions to section 530**
>
> (1) Section 530 does not apply to gains from the kinds of policies and contracts specified in subsection (3), except for the purposes of calculating relief under section 535 (top slicing relief).
>
> (2) Subsection (1) is subject to—
>
> section 532 (relief for policies and contracts with European Economic Area insurers), and
>
> section 534 (regulations providing for relief in other cases where foreign tax chargeable).
>
> (3) The policies and contracts are—
>
> (a) a policy of life insurance issued or a contract for a life annuity made by a friendly society in the course of tax exempt life or endowment business[41],
>
> (b) a foreign policy of life insurance that does not meet conditions A and B,

[41] Terms defined in subsection (4); the definitions need not be considered here.

> (ba) a contract the effecting or carrying out of which constitutes protection business within the meaning of section 62 of FA 2012,
> (bb) a contract which is not within paragraph (ba) but which, as a result of subsection (4) of that section, is treated for the purposes of that section as being made at any time,
> (c) a contract for a life annuity (other than one within para (a)) which has at any time not formed part of any insurance company's or friendly society's basic life assurance and general annuity business the income and gains of which are subject to corporation tax, and
> (d) a foreign capital redemption policy.

If we focus on foreign life policies, the relevant provision is (3)(b). The question is whether the foreign policy does not meet conditions A and B (which I will call "**foreign policy conditions A and B**"). Section 531(5) provides:

> Condition A is that the policy falls within para (a) of the definition of "foreign policy of life insurance" in section 476(3) (policy issued by a non-UK resident company).

So we turn to s.476(3) ITTOIA:

> In this Chapter—
> "foreign policy of life insurance" means—
> (a) a policy of life insurance issued by a non-UK resident company, and
> (b) a policy of life insurance which forms part of the overseas life assurance business of an insurance company or friendly society ...

A foreign policy will typically fall within that definition, so it will meet the condition in s.476(3)(a). The meaning of "overseas life assurance business" can be found in s.431D(1) ICTA:

> **431D Meaning of "overseas life assurance business"**
> (1) In this Chapter "overseas life assurance business" means so much of a company's relevant life assurance business as is with a policy holder or annuitant not residing in the UK (but not including the reinsurance of such business).

I think we conclude that most foreign policies will satisfy foreign policy condition A. That takes us to foreign policy condition B. Section 531(6)

ITTOIA provides:

> Condition B is that the conditions in para 24(3) of Schedule 15 to ICTA (conditions that are required to be met for certain policies issued by non-UK resident companies to be qualifying policies) are met throughout the period between—
> (a) the date on which the policy was issued, and
> (b) the date on which the gain arises.

It is easy to become tangled in the double double negatives, but I think the chain of reasoning goes as follows:

(1) Foreign policies will not (usually) satisfy condition B.
(2) So they fall within s.531(3)(b) ("a foreign policy of life insurance that does not meet conditions A and B").
(3) So they do not qualify for a s.530 tax credit.
(4) So they do meet the condition in s.466(2).
(5) So that PRs are liable for the chargeable-event gain.

This could be avoided by an assent to a beneficiary.

Section 466 ITTOIA is not expressed to be limited to UK resident PRs. However s.368 ITTOIA provides:

> (1) Income arising to a UK resident is chargeable to tax under this Part whether or not it is from a source in the UK.
> (2) Income arising to a non-UK resident is chargeable to tax under this Part only if it is from a source in the UK....
> (3) References in this section to income which is from a source in the UK include, in the case of any income which does not have a source, references to income which has a comparable connection to the UK.
> (4) This section is subject to any express or implied provision to the contrary in this Part (or elsewhere in the Income Tax Acts).

Thus non-resident PRs are not chargeable. EN ITTOIA confirms that this is intended:

> 421. Chapter 1 of Part 4 of this Act provides a general territorial limitation on the scope of the Part. As regards income arising outside the UK, it limits the charge to such income arising to a UK resident. See section 368 (territorial scope of Part 4 charges) and the related commentary on that Chapter. [Section 465 ITTOIA] overlaps and supplements that Chapter to ensure that a non-UK resident individual is not liable to tax under this Chapter on any gains, whether arising in the UK or elsewhere.

70.13 Planning for immigrant to UK

70.13.1 *Post-immigration planning*

The advisers of a foreign domiciled person who has recently come to the UK should check whether they or any trust they have created has a policy or contract. If so, the position needs to be reviewed.

An assignment of the policy or contract from an individual to a trust (resident or not) does not help, since the individual remains liable as creator.

One simple form of planning is to arrange there is no chargeable event in a year when the individual is UK resident. The part-surrender of up to 5% of the premium paid for the policy or contract per year is not a chargeable event. The surrender, assignment for money or money's worth and maturity of the policy or contract is normally a chargeable event but this can be anticipated and perhaps postponed to a year when the individual is non-resident. A death giving rise to benefits under the policy is also a chargeable event unless the policy is a qualifying policy. In such a case the individual may be at risk as death while UK resident may give rise to a tax charge.

Another course is for the individual to surrender their policy shortly after becoming UK resident; most of the gain will qualify for non-UK period relief.[42]

If a chargeable event is anticipated, the policy or contract could be assigned to a non-resident company, perhaps held by a trust. An assignment for no consideration is not a chargeable event. But the ToA rules will need consideration.

70.13.2 *Pre-immigration planning*

There are further possibilities if the individual acts before the tax year in which they become UK resident or in the overseas part of a split year. One possibility is to surrender the policy. A part-surrender may also be a possible option.

70.14 Personal portfolio bonds

A UK resident is not likely to acquire a personal portfolio bond (**"PPB"**), at least knowingly; but a non-resident who holds one may come to the UK.

Section 515 ITTOIA provides:

[42] See 70.6 (Non-UK period relief).

> (1) This section applies if a policy or contract to which this Chapter applies is a personal portfolio bond at the end of an insurance year.

In short, the charge arises if the bond is a PPB at the end of the insurance year.[43] The status of the bond at any other time does not matter.

Section 515(3) ITTOIA provides:

> A calculation is to be made in accordance with section 522 in relation to the policy or contract as at the end of the insurance year to determine—
>
> (a) whether a gain has arisen on the policy or contract in relation to that year, and
>
> (b) if so, the amount of the gain.

The computation of the PPB charge under s.522 is not discussed here. In short, the computation is penal. The tax regime designed not to tax PPBs, but to prevent them being used by UK residents.

I do not discuss the transitional rules for pre-1998 policies.

70.14.1 *Final insurance year*

Section 515(2) ITTOIA provides:

> But this section does not apply if the insurance year is the final insurance year.

70.14.2 *PPB: Critique*

The IPTM explains the rationale for the PPB regime:

> **IPTM7705 - Personal portfolio bonds: introduction** [Aug 2016]
> In law, it is the insurer not the policyholder that owns the property that determines the benefits under a life policy. Where the policyholder has the ability to select the property that determines the policy benefits, the policyholder retains nearly all the advantages of direct personal ownership of that property. But because the property is held in the 'envelope' of a life insurance policy, the policyholder does not have to pay income tax on dividend and interest income arising from the investments nor capital gains tax on disposals when the investments underlying the policy are altered. Tax on any gains on the policy can also be deferred until the policy comes to an end.
>
> **Personal portfolio bond legislation**
> The personal portfolio bond (PPB) legislation is an anti-avoidance

[43] See 70.2.6 ("Insurance year").

> measure which imposes a yearly charge to tax on life insurance and capital redemption policies and life annuity contracts in some circumstances where the property that determines the benefits is able to be selected by the policyholder...

This rationale of the PPB regime calls for critical examination. The tax advantage of deferral is more than compensated by other features of the regime, in particular, the IT charge on capital gains when the policy is realised, and the lack of a tax free uplift on death. The issue should be considered in the context of more fundamental questions on the basis of the taxation of savings, on which the Mirrlees review have done good work. The proposition that "the policyholder retains nearly all the advantages of direct personal ownership of that property" is highly debatable.

In short, it is doubtful whether there is a real problem; and the problem, so far as it exists, does not need a cure of this complexity. The professional bodies made the points when the PPB regime was introduced. The Tax Faculty described it as a "disproportionate response to a perceived problem"[44] and the reader may well agree. But no-one took any notice.

70.15 Definition of PPB

I discuss the definition in some detail; a full discussion would need a chapter to itself.

Section 516(1) ITTOIA provides:

> In this Chapter "personal portfolio bond" means a policy of life insurance, contract for a life annuity or capital redemption policy which meets conditions A and B.

I refer to **"PPB conditions A and B"**.

70.15.1 *Wrapper-type policy*

Section 516(2) ITTOIA provides:

> Condition A is that, under the terms of the policy or contract, some or all of the benefits are determined by reference to—
>
> (a) fluctuations in, or in an index of, the value of property of any description, or

[44] Tax Journal, 26 Oct 1998 (Issue 473), p.3.

> (b) the value of, or the income from, property of any description.

Where the value of the policy is linked to specific property, this is informally called a life insurance **"wrapper"**, though "wrapper" is not a legal or technical term with a fixed or precise meaning.[45] I refer to the property as the **"underlying property"**. It is sometimes said that the underlying property is "held in the bond"; that is not the strict legal analysis but (although the point has been contested[46]) it seems to me that is not so far from the commercial position.

Section 516(3) ITTOIA provides:

> For this purpose it does not matter whether or not the index or property is specified in the policy or contract.

Where policies are acquired by way of investment, PPB Condition A will be commonly be met. What matters then is condition B.

70.15.2 *Power to select*

Section 516(4) ITTOIA provides:

> Condition B is that the terms of the policy or contract permit the selection of the index or some or all of the property by—
> (a) the holder of the policy or contract,
> (b) a person connected with the holder,
> (c) the holder and such a connected person acting together,
> (d) a person acting on behalf of the holder,
> (e) a person acting on behalf of a person connected with the holder, or
> (f) a person acting on behalf of the holder and such a connected person acting together.

Section 516(5) ITTOIA deals with jointly held policies:

> In subsection (4) "holder", in the case of a policy or contract held by two or more persons, means any of them.

In the following discussion, I use the term **"policyholder"** to include any person within s.516(4), ie the actual policyholder, connected persons, etc.

[45] As far as I am aware, the 2011 Swiss Tax Agreement represents the first use of the word in tax legislation: see art (2)(i)(f) (the text is set out in the 2016/17 edition of this work at 97.3.3).

[46] See 3.20.7 (Economic consequences).

So the question is (in short) whether the terms of the contract permit the policyholder to select the underlying property.

The IPT Manual provides:

> **IPTM7715 Ability to select property: meaning** [Jun 2016]
> **Meaning of 'ability to select' is wide**
> [1] Under the PPB legislation, a policyholder's ability to select property or an index is defined to have a wide scope. It extends to circumstances where a policyholder has any say, even indirectly, in the selection of the property or index.
> [2] In particular, a policyholder will be treated as having the ability to select property or an index if under the terms of the policy or contract, the index or property in question may be selected by any of the following: [the Manual summarises the list in s.516(4)].
> [3] Where there is more than one policyholder, there will be an 'ability to select' if any of the policyholders have the ability to select property or an index.
> [4] Where the policyholder genuinely does not have the ability to select property or an index, even if that property or index is not within any of the permitted categories, the policy or contract will not be a PPB, although the presence of personal assets would test this analysis.
> [5] If, for instance, the insurer has complete discretion over the selection of the property or index determining the benefits then the policy would not be a PPB. But if the policyholder does have influence over the selection then the 'ability to select' lies with the policyholder.

The expression "ability to select" is a convenient paraphrase of the statutory wording of PPB condition B, and I adopt it here. On that basis, paragraphs [2] - [4] are correct. But paras [1] and [5] go too far. A policyholder has ability to select if they can choose an underlying investment, out of various possible underlying investments, and having chosen, their choice will be adopted. That might be extended to say that a policyholder has ability to select if their choice can be expected to be adopted, disregarding some exceptional cases. But a person does not have ability to select merely because they have "any say" or "influence". Influence, in its normal sense, is a matter of degree (one speaks of weak and strong influences). At the far end of the spectrum, strong influence shades imperceptibly into an ability to select. The word influence in its normal sense is not restricted to that end of the spectrum.[47]

[47] See 49.17 (Enjoyment condition E: Control).

The IPT Manual provides:

> **IPTM7715 Ability to select property: meaning** [Jun 2016]
> **...Options in a policy to select property**
> If a policyholder is entitled to exercise an option to select property or an index determining the benefits under the policy then the policyholder does have the 'ability to select' even if the option is not exercised. But if the insurer has discretion to offer the policyholder the right to select the property or index, the policyholder will have no ability to select until this discretion has been exercised by the insurer.
> Similarly, if the terms of the policy allow the policyholder to request a change in its terms to permit selection of property outside the scope of the permitted property, but subject to the agreement of the insurer, the policyholder lacks the ability to select until the insurer has agreed.
> A link to personal assets to determine policy benefits will indicate the existence of an ability to select.
>
> **IPTM7720 selection of property by insurers but level of risk selected by policyholder** [Jun 2016]
> It is common for policyholders to be able to adjust their level of risk in relation to policy investments by selecting one or more of the insurer's internal linked funds. Such ability does not, on its own, amount to a power to select property to determine the policy benefits. It is the insurer or its appointed manager that manages the investments in its internal linked funds and selects the property that determines the policy benefits. Units in an insurer's internal linked fund are not property for the purposes of the PPB legislation.
> There may be some cases where the ability to select property is shared between the insurer and the policyholder. Property that may be selected by the insurer alone is of no relevance in determining whether or not a policy is a PPB. The PPB legislation is only concerned with property that may be selected by the policyholder.
>
> **IPTM7725 circumstances where policy is not a PPB**
> **Broker-managed funds ('broker bonds')** [Jun 2016]
> Many companies offer policyholders the opportunity to invest in broker-managed funds. An intermediary or adviser chosen by the policyholder selects the assets in this sort of fund. The intermediary or adviser has an arrangement with the insurer to manage one of the insurer's internal funds and for this fund to be open to any client of the broker.
> The broker is regarded as an agent of the policyholder when advising on whether the client should take out the policy or 'broker bond' in the first

place. However, once the broker bond has been taken out, the broker manages the fund as an agent for the insurer and is remunerated by the insurer for doing so. The broker is not an agent of the policyholder when acting in the capacity of an investment adviser for the insurer.

Policyholders who have a policy under whose terms they are able to select a broker-managed fund to determine the value of benefits under the policy would not therefore normally be regarded as having a PPB. Exceptionally, arrangements may result in a policy described as a broker bond being a PPB because the policyholder retains the ability to select - see IPTM7730.

Investment advisers

Where the policyholder is unable under the terms of the policy to select the property to determine the policy benefits, there may nonetheless be an option to require the insurer to appoint an investment adviser. The insurer may offer the policyholder a menu of possible advisers it is willing to appoint. There will usually be a separate agreement in these cases between the insurer and the investment adviser.

A policy written in these terms would not in general be a PPB. In such a case, the adviser would be acting as an agent of the insurer under the agreement between them. That agreement is separate from the insurance contract between the insurer and the policyholder, and from any agreement between the policyholder and the investment adviser. The adviser would not therefore be acting on behalf of the policyholder. The position would be the same as with broker- managed funds, as described in the previous section.

However, as with broker bonds, in exceptional circumstances the arrangements may be such that the policyholder does retain an ability to select - see IPTM7730.

IPTM7730 circumstances where policy may be a PPB [Jun 2016]

Exceptionally, a policy may be a PPB even where there is a broker or investment adviser involved. The arrangements between the insurer and the adviser or broker, or between the adviser or broker and the policyholder, or in the case of a tripartite agreement among all three of them, could prove material.

The investment objectives of the policyholder in accordance with which the adviser or broker has to act may be so restricted that it is effectively the policyholder that is selecting the property held in the policy. In this case, the adviser or broker is no more than a conduit or agent through whom the policyholder gives the insurer its instructions. These may be instructions as to what new investments may be selected and, with a continuing policy, the scope and freedom for replacing investments by other investments.

> The terms of the legislation cannot be avoided simply by interposing an investment adviser or broker between the policyholder and the insurer. An insurer may, however, not be aware of an arrangement between a policyholder and an investment adviser or broker. It is not the responsibility of the insurer, when deciding whether a particular policy is a PPB, to review anything other than the contracts to which it is a party.

70.16 Whitelisted property

Section 517 ITTOIA provides exceptions to the general rule, where a policyholder may have power to select underlying property. The rules are set out twice, first for index linked bonds, and then for bonds linked to underlying property. I consider them in reverse order, as I think the underlying property rules are more important in practice.

Section 517(2) ITTOIA provides:

> A policy or contract is not a personal portfolio bond merely because its terms permit the selection of property as described in section 516(4) if all of the property which may be so selected—
>
> (a) falls within one or more of the categories listed in section 520, and
>
> (b) meets one or both of the property selection conditions (see section 521).

I refer to property within s.520 as **"whitelisted property"**. The ITPM refers to "permitted property".

Section 520 ITTOIA sets out 7 categories of whitelisted property. These are, in short, mutual funds:

> (1) The table in subsection (2) sets out the categories of property referred to in section 517(2).
>
> (2) This is the table—

Category	**Property**
1	property which the insurance company has appropriated to an internal linked fund[48]

[48] Defined s.520(4): "In this section ... "internal linked fund" has the meaning given by—

(a) the Interim Prudential Sourcebook for Insurers made by the Prudential Regulation Authority under FISMA 2000, or

(b) rules made by the Prudential Regulation Authority under FISMA 2000 and having effect for the time being in place of the Sourcebook".

2	units in an authorised unit trust
3	shares in an investment trust[49]
4	shares in an open-ended investment company[50]
5	cash[51]
6	a policy or contract to which this Chapter applies, other than an excluded policy or contract (see subsection (3))[52]
7	an interest in a collective investment scheme[53] constituted by— (a) a company which is resident outside the UK (other than an open-ended investment company), (b) a unit trust scheme the trustees of which are non-UK resident, or (c) any other arrangement which takes effect by virtue of the law of a territory outside the UK, and which under that law creates rights in the nature of co-ownership (without restricting that term to its legal meaning in any part of the UK)

HMRC have published a shallow consultation paper considering some

[49] Section 50(4) provides the standard definition.

[50] Section 50(4) provides the standard definition.

[51] Defined s.520(4): "In this section ... "cash"—
(a) includes any sum which is deposited—
(i) in a building society account (including a share account) or similar account, or
(ii) in a bank account or similar account, but
(b) does not include cash which is acquired wholly or partly for the purpose of realising a gain from its disposal".

[52] Defined s.520(3): "A policy or contract is "excluded" if—
(a) the policy or contract is itself a personal portfolio bond,
(b) the value of any benefits under the policy or contract is or has at any time been capable of being determined directly or indirectly by reference to a personal portfolio bond, or
(c) a personal portfolio bond is related property in relation to the policy or contract."

"Related property" is defined by reference in s.520(4): "In this section ... "related property" has the same meaning as in section 625 (see subsection (5))." That takes us to s.625(5) ITTOIA which provides: "In this section "related property", in relation to any property, means income from that property or any other property directly or indirectly representing proceeds of, or of income from, that property or income from it."

[53] Section 520(4) provides the standard definition.

extensions to these categories, but without considering wider issues.[54]

Section 521 ITTOIA sets out the property selection conditions. The IPTM has some relevant guidance, but it is too far from the themes of this book to discuss here.

70.16.1 *General selection condition*

Section 521 ITTOIA provides:

> (1) The property selection conditions are—
> (a) the general selection condition (see subsection (2)), and
> (b) the class selection condition (see subsection (3)).
>
> (2) Property meets the general selection condition if, at the time when it may be selected, the opportunity to select property falling within the same category is available to—
> (a) all policy holders of the insurance company, or
> (b) persons acting on behalf of those policy holders.

70.16.2 *Class selection condition*

Section 521 ITTOIA provides:

> (3) Property meets the class selection condition if, at the time when it may be selected, the opportunity to select property falling within the same category is available to—
> (a) a particular class or classes of policy holders of the insurance company, or
> (b) persons acting on behalf of the members of that class or those classes.
>
> (4) A group of policy holders to whom the opportunity to select property falling within a particular category is available is a "class" for the purposes of subsection (3) if—
> (a) neither membership of the class nor the opportunity are limited to connected persons,
> (b) the question whether a policy holder is a member of a class, or has the opportunity, is determined solely by the insurance company, and
> (c) the opportunity is clearly identified in marketing or other promotional material published by the insurance company to

[54] HMRC, "Personal Portfolio Bonds - Reviewing the Property Categories" (August 2016) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/544513/Personal_portfolio_bonds-reviewing_the_property_categories.pdf*

> members of the public, or members of the public who are intending investors, as available generally to any person falling within its terms.

The IPTM provides:

> **IPTM7715 Ability to select property: meaning** [Jun 2016]
> Where the policyholder is also an employee of a permitted fund such as a collective investment scheme or investment trust company – see IPTM7745 and IPTM7750 – and selects units or shares in that fund, that in itself would not cause the policy to be a PPB.
> However, the property selection conditions would still need to be met – see IPTM7780 onwards.

70.17 Whitelisted indices

Section 517(1) ITTOIA provides:

> A policy or contract is not a personal portfolio bond merely because its terms permit the selection of an index as described in section 516(4) if that index—
> (a) falls within one of the categories listed in section 518, and
> (b) meets one of the index selection conditions (see section 519).

I refer to indices within s.518 as **"whitelisted indices"**.
Section 518 sets out the whitelisted indices:

> (1) This section sets out the categories of index referred to in section 517(1).
> (2) Category 1 is the retail prices index.
> (3) Category 2 is any general index which—
> (a) is similar to the retail prices index, and
> (b) is published by the government of any foreign state or an agent of such a government.
> (4) Category 3 is any published index of prices of shares listed on a recognised stock exchange.[55]

70.17.1 *General selection*

Section 519(1) ITTOIA identifies the two index selection conditions:

> The index selection conditions are—
> (a) the general selection condition (see subsection (2)), and

[55] See App 2.18 (Listed/Recognised stock exchange).

(b) the class selection condition (see subsection (3)).

The conditions are the same as the property selection conditions set out above; the same wording is used (more or less) verbatim, just replacing *property* with *index* as appropriate.

Section 519(2) ITTOIA provides:

> An index meets the general selection condition if, at the time when it may be selected, the opportunity to select the same index is available to—
>
> (a) all policy holders of the insurance company, or
>
> (b) persons acting on behalf of those policy holders.

70.17.2 *Class selection*

Section 519(3) ITTOIA provides:

> An index meets the class selection condition if, at the time when it may be selected, the opportunity to select the same index is available to—
>
> (a) a particular class or classes of policy holders of the insurance company, or
>
> (b) persons acting on behalf of the members of that class or those classes.
>
> (4) A group of policy holders to whom the opportunity to select an index is available is a "class" for the purposes of subsection (3) if—
>
> (a) neither membership of the class nor the opportunity are limited to connected persons,
>
> (b) the question whether a policy holder is a member of the class, or has the opportunity, is determined solely by the insurance company, and
>
> (c) the opportunity is clearly identified in marketing or other promotional material published by the insurance company to members of the public, or members of the public who are intending investors, as available generally to any person falling within its terms.

70.18 Variation of policy

70.18.1 *Novation/variation distinction*

The starting point is to note that a policy is a contract, and like any contract, the parties to a policy can change its terms or to revoke it. A change of the terms of a policy may constitute:

(1) The termination (rescission) of the old policy in consideration for which the life insurance company enter into a new policy; the contract

law term for this is "**novation**." The IPT Manual uses the expression "fundamental reconstruction".

(2) A variation of the terms of a continuing policy (**"a variation"**).

The IPT Manual discusses the contract law/insurance law background:

> **IPTM8145 Significant variation: how and when variations occur** [Aug 2016]
> **Variation of a policy**
> The terms of a policy can normally only be varied by explicit agreement between the insurer and the policyholder or a person acting on behalf of the policyholder and the insurer should get written acceptance of the variation from the policyholder. It cannot in general be assumed that the variation is accepted simply because the policyholder does not respond.
> ... whether there has been a variation in the terms of a policy is a question of contract law.
>
> **IPTM8150 Significant variations: examples** [Jun 2016]
> ... **Date of a variation**
> The date of a variation follows the principles of contract law and will normally be the date that the party receiving the offer of a variation accepts that offer.
>
> **IPTM7335 Surrenders: fundamental reconstruction of the policy** [Aug 2016]
> ... **Surrender date of old policy and insurance year of new policy**
> In line with the general advice given in IPTM7325, the date of the surrender on a reconstruction is the date on which the insurer agrees to make the fundamental change.
> The new policy comes into existence on the same date and starts a new insurance year, see IPTM3505. So, following a reconstruction the insurance year will in future end on the day before the anniversary of the date on which the reconstruction happened, not the day before the anniversary of the date on which the original policy was taken out.

A *novation* has important consequences under the chargeable event regime; in particular:

(1) It constitutes a chargeable event (the surrender of all rights under the policy), on which a gain will in principle arise.

(2) The new policy may qualify for less, or no, non-residence period relief; will have a different insurance year end date; etc.

A *variation* is not in principle a chargeable event, but it may have important consequences under the chargeable event regime. In particular, a policy may become a PPB, or cease to be a PPB. The IPTM provides:

> **IPTM7710 Scope and outline of the PPB legislation** [Aug 2016]
> ...The test of whether a policy is a PPB is not limited to the terms of the policy at inception but is an ongoing test. Even if a policy was not a PPB when it was taken out, it could subsequently become a PPB through a change in its terms. The reverse situation could also apply if the policy was originally a PPB but its terms were varied so that it ceased to be a PPB.
>
> **IPTM7715 Ability to select property: meaning** [Jun 2016]
> **Variation of the terms of the policy**
> Even if the original terms of the policy provide only for the selection of property within the permitted categories, if the policyholder subsequently selects other property then that will indicate that the terms of the policy have been varied to allow selection of property wider than the permitted categories. Then the policy will be a PPB.

The annual PPB charge only arises if a policy or contract is a PPB on the last day of the insurance year.

The novation/variation distinction is a matter of contract law/insurance law, not tax law.[56] From a commercial (non-tax) point of view it usually makes no difference, and the courts avoid making the distinction if possible.[57] So the contract law cases are mostly antique. But in this and some other tax contexts, the distinction remains important, so more recent cases tend to be tax cases.[58]

The general principle is well established, that there is a novation if:

(1) The parties choose it, ie they expressly extinguish the old contract and substitute a new agreement; or

(2) The parties enter into a contract entirely inconsistent with the old contract, or, if not entirely inconsistent with it, inconsistent with it to an extent that goes to the very root of it.[59]

[56] See Clarke, *The Law of Insurance Contracts* (looseleaf ed) para 23-4B ff (Modification or Extension of Existing Insurance); *Chitty on Contracts* (34th ed., 2021), chapter 25 (Discharge by Agreement, Variation and Waiver).

[57] *Samuel v Wadlow* [2007] EWCA Civ 155 at [34].

[58] For instance: *Magnavox Electronics Co v Hall* 59 TC 610; *Indofood International Finance v JP Morgan Chase Bank* [2006] EWCA Civ 158 at [60-63] (for other aspects of this case, see 108.10.7 (Indofood); *Cobalt Data Centre 2 LLP v HMRC* [2022] EWCA Civ 1422.

[59] *British and Benningtons v NW Cachar Tea Co* [1923] AC 48 at p.62, 67.

The IPTM provides:

> **IPTM7335 - Surrenders: fundamental reconstruction of the policy** [Aug 2016]
>
> Where the terms of a policy are changed, those changes may be so fundamental as to constitute a reconstruction bringing to an end the old contract and bringing into existence a new policy in substitution. If so, then the ending of the old policy is treated as a full surrender of the rights under the policy, with all the chargeable event consequences that might follow...
>
> **What is a fundamental reconstruction?**
>
> Whether a change to a policy is fundamental is a question of contract law and can only be answered by reference to the particular facts and circumstances. But it is possible to give some general principles - see IPTM8110....Although the guidance in IPTM8110 specifically applies to qualifying policies, advice about the distinction between changes which are merely variations and those which are fundamental reconstructions has application to non-qualifying policies also.
>
> A variation of a policy, whether significant within the meaning of the qualifying policy rules, or not, has no chargeable event implications for non-qualifying policies.
>
> The main changes which are regarded as fundamental are:
>
> - addition or removal of a life assured under the policy
> - switch from an endowment policy to a whole of life policy or vice versa
> - change of contingency, for instance addition or removal of disability benefit and critical illness cover, or a change to the cover under a joint policy from first-to-die basis to last-to-die, or vice versa.
>
> A change in the way benefits are calculated, extending the term of the policy or making a regular premium policy paid up are not in most cases fundamental reconstructions ....
>
> A transfer of business from one insurer to another under the Part 7 FSMA2000 process sanctioned by the Court will not normally result in the fundamental reconstruction of the policies transferred but each case would need to be carefully considered on its own facts.
>
> **IPTM8110 - Substitutions: circumstances in which they arise** [Jun 2016]
>
> Where the change to a policy goes to the root of the original contract such that there is a fundamental reconstruction of it, the original policy is treated as surrendered and substituted by a new policy on the date of

> the change. Such a change may be by agreement between the policyholder and the insurer or by the exercise of an option in the original policy.
>
> A change in the contingency on which the policy pays out a capital sum would always give rise to a fundamental reconstruction but this is not the only example.
>
> **Changes of contingency**
>
> Examples of changes of contingency that give rise to a substitution are
>
> - adding a life assured to a single life policy or removing a life from a joint policy
> - changing the contingency on a joint policy so that death benefits are paid on the death of the last survivor rather than on the first death, or vice versa
> - adding to a policy that previously lacked it, disability or critical illness cover that would bring the policy to an end if paid, or removing such cover completely from a policy
> - converting a whole life policy to an endowment policy or vice versa
> - converting a term assurance policy to a whole life or endowment policy.
>
> **Other fundamental changes**
>
> - reducing the premium to a nominal amount, so-called 'peppercorn premiums'
> - making a number of changes simultaneously which separately may not be fundamental but together make a substantial difference to the contract
> - the addition or removal of an option, which if exercised would end the policy and bring into existence a substitute policy...

I would not agree that these changes necessarily constitute a novation; it depends on the facts. But in practice it should be possible to avoid changes of this kind and the issue will not arise.

The qualifying policy rules (not discussed here) distinguish between a significant variation and an insignificant variation. The distinction does not matter for PPBs, but the IPT Manual material is set out here, as anything which is classified as a variation (significant or not) does not constitute a novation.

> **IPTM8150 - Significant variations: examples** [Jun 2016]
>
> Examples of changes to a policy that are significant variations falling short of a reconstruction are
>
> - an extension or shortening of the term or premium spreading term
> - an increase or decrease in the premium

- an increase or decrease in the amount of death benefit assured
- the addition or removal of critical illnesses from the list of illnesses
  - covered under the policy where the insured person is charged in any way for that benefit: but note that
  - if there is no charge for the benefit then the change is an insignificant variation, see IPTM8160
- the addition of critical illness cover to a policy that did not have it before or the complete removal of critical illness cover is a fundamental reconstruction, see IPTM8110
- the addition, removal or significant alteration of an extra benefit for death by accident or of any other permitted benefit
- the addition or removal of a waiver of premium condition
- permitting the policyholder to take a premium holiday
- permitting the policyholder to make a part surrender of rights under the policy
- the addition or removal of an option to the policy, the exercise of which would itself be a significant variation in the terms of the policy.

A change in the way the benefits secured under the policy are determined, as for example between with-profits, without profits and unit-linked (or 'investment linked') was a significant variation before 7 October 2005. However, since that date, such a change is no longer treated as a significant variation - see IPTM8155.

Note that switches between different unit-linked funds are regarded in any event as insignificant variations ...

IPTM8155 - certain variations not treated as significant [Aug 2016]

There are some circumstances where a significant variation is disregarded for the purposes of the qualifying policy rules either by statute or by concession.

Changes in the way benefits secured under a policy are determined

Legislation was introduced for changes effected on or after 7 October 2005 that ensure that a change in the method for calculating the benefits under the policy, whilst still a variation in contract law, will be disregarded for the purposes of the qualifying policy rules. This encompasses, for instance, a change from with-profits to non-profit unit linked, which would otherwise be treated on first principles as a significant variation, as described in the penultimate paragraph of IPTM8150.

This will mean that changes of this kind can be made with no consequences for the qualifying status of the policies.

However, the new legislation does not extend, for instance, to changes in the premiums payable or the sum assured, as these are not changes to the method for calculating benefits.

Variations connected with an exceptional risk of death or disability
Certain variations of a policy are not treated as a variation for the purpose of the qualifying policy rules when there is an exceptional risk of death or disability - see IPTM8075 - even if they are significant. These are where

- a premium loading for the exceptional risk is added or removed from the policy (although this will require consideration of the annual premium limit for variations which increase the premiums payable from 21 March 2012)
- a provision is added, removed or altered because of an exceptional risk giving rise to a sum chargeable as a debt against the capital sum guaranteed by the policy on death or disability.

IPTM8160: Insignificant variations [June 2016]
Examples of insignificant variations are

- a one-off change in the payment of premiums if it relates only to a change in the frequency of the premiums, including for instance where annual premiums are changed to monthly premiums that, when annualised, are slightly higher to reflect the increased frequency
- a change in ownership of the policy
- a change to the names and addresses on the policy of the policyholder or lives insured, but not changes to the lives insured themselves
- any changes to the premium, sum assured or policy term because of a mis-statement of age on the proposal form
- addition or removal of a critical illness to the list of critical illnesses covered, where the cover on that illness is provided free by the insurer
- a switch between different unit-linked or investment linked funds
- the addition or removal of an option where if the option is exercised the policy is not regarded as having been significantly varied...

70.19 Converting PPB into non-PPB

There are two main ways to convert a PPB into a non-PPB:

(1) Vary the terms of the policy to restrict the underlying assets to whitelisted assets. It would be usual for the life company to dispose of underlying assets which were not on the whitelist.

(2) Vary the terms of the policy so that the policyholder has no power to select underlying property. Instead, selection would normally be made by an unconnected fund manager acting on behalf of the life

company, not on behalf of the policyholder. It may be necessary for the life company to dispose of underlying assets on the basis that the policyholder has selected them and may be said to retain the power to select until they are disposed of. But that depends on the circumstances.

It is possible to combine the approaches so:

(1) the policyholder has power to select whitelisted assets and

(2) other underlying property could be selected but by an unconnected fund manager, not the policyholder.

Drafting is crucial and the documentation needs to be reviewed by someone familiar with the tax background.

70.20 CGT exemption for policies

Sections 204 and 210 TCGA provide exemptions for policies. In outline, policies are exempt unless assigned for consideration (known as secondhand policies).

70.21 Tax return: Chargeable event

SA100 (notes) (2022/23) provides:

> You should fill in the 'Additional information' pages if you have any chargeable event gains.

70.22 DT relief: Chargeable-event gain

Suppose an individual who is UK resident and treaty-resident in a foreign state disposes of a policy so that chargeable-event gains arise directly to them. The position is similar to OIGs: see 67.25 (DT reliefs: OIG). It is an interesting question whether the individual claims relief under art.13 or art. 21 OECD Model Convention. At first sight chargeable-event gains are "gains" which arise from the alienation of property, even though not chargeable gains (in the CGT sense) and even though subject to income tax rather than CGT. But the gain is also "income" if that word is given its UK tax meaning. Of course it does not normally matter which of the articles apply, if the treaty has both. But if a particular treaty has an equivalent of art.21 (other income) but no capital gains article, then it is considered that treaty relief is still in principle available.

If a chargeable-event gain arises without an alienation, relief is not available under art 13 OECD Model, but should still be available under art 21.

70.23 Policy held by non-dom: IHT

Section 11 Revenue Act 1884 provides:

> ... where a policy of life assurance has been effected with any insurance company by a person who shall die domiciled[60] elsewhere than in the UK, the production of a grant of representation from a court in the UK shall not be necessary to establish the right to receive the money payable in respect of such policy.

The IHT Manual provides:

> **IHTM30039 - Policies effected by a person who dies domiciled outside the UK** [Sep 2018]
> [The Manual summarises s.11 Revenue Act[61] 1884 s.11 and continues:]
> For the purposes of this section, any policy under which a sum of money becomes payable on a death may be treated as a policy of life assurance, and any association of persons which issued policies in the ordinary course of its business, whether incorporated or not, may be treated as an insurance company.
> These provisions do **not** confer any exemption from IHT. Where policy moneys are situate in the UK, tax is nonetheless payable though the moneys may be receivable without the production of a UK grant of representation.
> The insurance company can however be liable for the tax where
> [1] it retains policy moneys for the benefit of the beneficiary for investment purposes, outside the terms of the life assurance contract, in which case IHTA s.200(1)(c) may apply to the company as a vestee, or
> [2] it received prior notice that the policy in question is subject to a statutory charge for tax under s.237 IHTA.[62]
> Where there is other estate in the UK in respect of which a UK grant is necessary, but the UK representatives are only administrators acting under a power of attorney and in point of fact have not intermeddled with the policy moneys and, without knowledge of the claim for tax in respect of such moneys, have parted with the assets collected by them to their principal (the foreign executor), the claim in respect of the policy moneys should not be pursued against the UK administrators.
> Similar conditions apply in Scotland to a Factor or Attorney authorised

[60] Deemed domicile does not apply for this purpose.

[61] The Manual wrongly refers to the Customs & Inland Revenue Act.

[62] Author's footnote: In practice it is unlikely that either [1] or [2] will be the case.

> by executors abroad to give up an Inventory (in such cases it is the executors who are confirmed, not the Factor or Attorney).
>
> Refer to Technical for consideration
>
> - all enquiries on this topic
> - any case where it is apparent that policy moneys have been paid out without a grant being produced.

The withheld text may well state that IHT in many cases is uncollectable and set out the circumstances in which no attempt should be made to collect it. In practice a well-advised foreign domiciliary (not deemed domiciled) will not acquire or retain a UK situate policy. However a person who is deemed UK domiciled may find this useful, as the executors can fund IHT more easily if they can first recover the money due under the policy and then pay the IHT and obtain a grant.

CHAPTER SEVENTY ONE

INTERMEDIATED SECURITIES

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71.15 Intermediated securities: IHT BPR

71.1 Securities law background

There is a substantial literature on this topic. I refer to two Law Commission papers:

"Law Commission 2008 paper": The UNIDROIT Convention on Substantive Rules regarding Intermediated Securities Further Updated Advice to HM Treasury[1]
"Law Commission 2020 paper": Intermediated securities: who owns your shares?[2]
"Law Commission, Digital Assets Final Report" (2023)[3]

[1] *https://www.lawcom.gov.uk/project/property-interests-in-intermediated-securities*

[2] *https://www.lawcom.gov.uk/project/intermediated-securities*

[3] *https://lawcom.gov.uk/project/digital-assets/* See chapter 7 (Intermediated holding arrangements)

The 2008 paper addresses situs issues which are not considered in the 2020 paper, so I refer to both. The position has not materially changed since 2008. .

71.1.1 *What is intermediation*

The Law Commission 2008 paper provides:

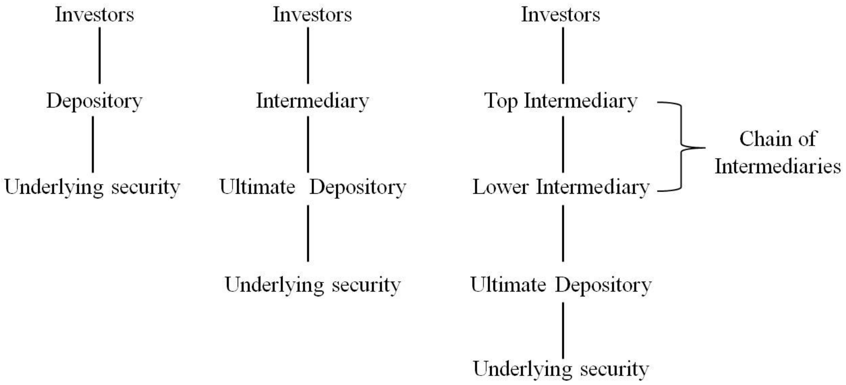
> 2.7 ...immobilisation entails depositing securities in paper form with a depository linked to a settlement system so that they are held indirectly. Where a new issue of securities is immobilised from the outset, the entire issue will be typically constituted by a single 'global' or 'jumbo' certificate which remains in the vaults of the depository.[4] The depository (or its nominee) becomes the owner of the securities either by registering the securities in its name with the issuer (in the case of registered securities) or by physical possession of the global certificate (in the case of bearer securities).
>
> 2.8 Participants in the settlement system keep interests in the immobilised securities by holding an account with the securities depository. These account holders are able to transfer and pledge their interests in the securities through book entries on the depository's books rather than by re-registration or by delivery of the underlying securities. Following the computerisation of settlement systems in the late twentieth century, the depository's 'books' that record ownership are now electronic records....
>
> **Pooled Accounts**
>
> 2.17 ... Where an intermediary holds fungible securities for more than one investor it will typically pool these securities in a single client account. To do so, the intermediary opens an account with the issuer or intermediary above it in its own name and records in its own books each individual investor's allocation in the pooled account. In most legal systems, the only reference to an investor's specific allocation is made in its intermediary's accounts and not in the accounts of any higher-tier intermediary or in the register of the issuer...

There is no agreed terminology:

[4] Footnote original: Interests in the global note may be exchangeable for definitive certificates, so that the investor can acquire a direct relationship with the issuer. Usually, however, the global note is intended to be permanently immobilised and cannot be split into definitive certificates other than in extreme circumstances, such as the failure of a bond trustee to act on the instructions of the investors upon a default.

My term (*term also used)*	**Meaning**
Ultimate depository *(Holder)*	Holder of legal title to security for intermediary or investor
Intermediary *(Account keeper)*	Holder of security for intermediary/investor[5]
Underlying security	Asset held by the ultimate depository
Immobilised *or*	Ultimate depository holds a certificate *or*
Dematerialised	Where there is no certificate
Investor *(Ultimate account holder)*	Holder of securities through intermediaries, not intermediary for another person

Diagrammatically:


Investors
Depository
Underlying security
Investors
Intermediary
Ultimate Depository
Underlying security
Investors
Top Intermediary
Lower Intermediary
Chain of Intermediaries
Ultimate Depository
Underlying security

I refer in this chapter to securities but similar points apply to other fungible assets, such as cryptoassets, or a bank account, if the cryptoassets or money in the account is pooled and held through intermediaries.

71.1.2 *Reason for intermediation*

The Law Commission 2008 paper provides:

> 2.11 Recording investors' interests in securities as electronic bytes of information enables these interests to be transferred with ease from one account holder to another simply by a credit and debit in the computerised accounts of an intermediary. As long as the legal system recognises this as a valid transfer of an interest in securities, traditional formalities associated with the transfer of underlying securities (for example, the execution of stock transfer forms and the issuance of new certificates) can be avoided. Greater transferability of securities

[5] The "depository" is in a sense also an "intermediary" as they come between the asset and the investor.

enhances liquidity and consequently their value.

71.1.3 *Depositary receipts*

Benjamin, *Interests in Securities* (1st ed, 2008) provides:

> 11.05 ... DRs were originally developed by US banks in order to facilitate cross border investment, by repackaging foreign securities as US law interests in securities. DRs permit local investors to acquire an interest in foreign securities in circumstances where direct investment would not have been possible or attractive, for example because of investment restrictions, the inconvenience of local settlement and/or receipt of dividends in local currency. ...
>
> 11.06 In a DR programme, the underlying foreign shares are acquired by a financial institutions (usually a bank) acting as depositary, and (usually) registered in its name (or that of its nominee) in the register of the issuer of the shares. A share certificate representing the depositary's holding is held for the depositary by the custodian, which is responsible for administering the shareholding locally. As registered shareholder, the depositary holds legal title to the underlying shares.
>
> The depositary issues new securities in the form of DRs. DRs are registered securities, and the depositary maintains a register of DR holders and issues DR certificates. The depositary holds its title to the underlying shares on trust for DR holders.[6] The deposit agreement specifies the arrangements whereby the depositary passes on benefits associated with the shares such as dividends and (possibly) voting rights. The beneficiaries of the trust are DR holders from time to time; where a DR holder transfers its DRs, the depositary ceases to hold the relevant proportion of underlying shares for the transferor, and instead holds it for the transferee. Thus, a DR constitutes a beneficial interest in the underlying shares. DRs are governed by the law of the jurisdiction in which the depositary operates (in many cases, New York law or English law) and are settled through the major electronic settlement systems. ...
>
> 11.08 In many DR programmes, the number of DRs in issue varies from time to time. Investors are permitted (subject to local law ownership restrictions affecting the issuer of the shares) to have shares transferred out of the name of the depositary into their name or as they direct. At the same time, the corresponding number of DRs are cancelled. Conversely, in some cases investors are permitted to arrange for new shares to be transferred into the name of the depositary, and for new DRs to be issued to them or as they direct. ...
>
> 11.10 DRs were originally developed in the early part of the twentieth century by US banks as American Depositary Receipts or ADRs. ADRs are issued into the US markets. A later development was the Global Depositary Receipt or GDR. GDRs are issued both into the US and European markets. The term European Depositary Receipts, or EDRs, is sometimes used for DRs issued into Europe only. ...
>
> 1.13 An important legal advantage of repackaging securities in a DR programme is that it changes the governing law of the asset which investors hold. Where the investment powers of institutional investors restricts their ability to hold foreign assets, the use of a

[6] Footnote original: In English law arrangements the depositary holds the underlying shares as trustee. In New York law arrangements, the depositary holds as bailee.

local law DRs programme enables them to acquire or increase an exposure to foreign markets. Other institutions have other reasons to wish to convert foreign assets into local law assets in this way. ...
11.14 A second significant legal result of a DR programme is to change the situs of the asset ... DRs are a form of registered security. The situs of registered securities is (broadly) the place where the relevant register is maintained. ... One technique for avoiding the requirements of an unhelpful jurisdiction in relation to local shares which are used as collateral, is to establish a DR programme and place the DR register in a robust jurisdiction. ...
11.16 The first point is of course that, as against the depositary, this interest is proprietary. DR holders acquire the beneficial interests in the underlying shares, which the depositary holds on trust for them, under the terms of the deposit agreement. ...
11.17 The interest of DR holders in the underlying shares is beneficial and not legal, arising under a trust. As discuss in Chapter 2, the interest of a beneficiary in trust assets is indirect, in the sense that in the normal course there is no direct recourse against the underlying assets. Where the trust assets consist of shares, the trustee (in this case the depositary) is the shareholder and, in the normal course, the beneficiary (in this case the DR holder) has no direct right of action against the issuer.
11.19 As an indirect property interest, the interest of the DR holder equates with that of the client of a global custodian or a participant in an electronic settlement system.

Unallocated

11.20 A further point of similarity between the interests of clients of electronic custody and settlement arrangements and those of DR holders, is that both are unallocated. There is no allocation between any particular DR holder and any particular underlying share.

The CG Manual also discusses the nature of depository receipts:

> **CG50240 Depository receipts** [May 2020]
> You may come across assets referred to as Depository Receipts (DRs). The commonest are American Depository Receipts (ADRs).
> DRs are used as substitute instruments indicating ownership of securities such as shares. Although DRs may be owned by anyone, they are designed primarily to enable investors to hold and deal in shares of companies located in countries other than their own. Such activities might otherwise be inhibited by difficulties in transferring original share certificates from one country to another. The investors hold or trade the DRs rather than the share certificates themselves.
> A person holding shares for which DRs are available can convert them into DR form by depositing the share certificates with a local branch of a depository (a financial institution such as a bank). The depository issues a DR. This document certifies that the depository, or an appointed custodian in the country of the underlying shares, holds the share certificates and that the owner of the DR is entitled to the share certificates on surrender of the DR. The precise detail of the arrangements may vary, but the holder of a DR will generally have

> many of the benefits associated with share ownership. In particular:
>
> - the DR can be exchanged for the underlying shares on demand by the DR holder
> - any dividends, subject to a handling fee, flow through to the DR holder.
> - the holder of shares in DR form may at any time cancel the arrangement by asking for delivery of the share certificates in respect of their underlying shares, and surrendering the DRs at a local branch of the depository.
>
> This guidance applies to DRs that display such characteristics.

A difference between depositary receipts and intermediated securities as described by the Law Commission is that the purpose of intermediation is to facilitate transfers; the main purpose of depositary receipts may be to create a US law asset from a foreign law asset. Benjamin calls this "repackaging". But the differences are not material for UK tax purposes, and depository receipts should for present purposes be regarded as a type of intermediated securities.[7]

71.1.4 *Central securities depositories*

The Law Commission 2008 paper provides:

> 2.19 The efficiencies generated by intermediation led the Group of Thirty to recommend in 1989 that each domestic market should establish a central securities depository (CSD) to hold both physical and dematerialised securities in the relevant market. Immobilisation of securities is therefore centralised in a single depository (or through a nominee of the CSD). An indirect holding system based on the immobilisation of securities in a domestic CSD is the most common model in advanced countries and there are about thirty systems operating in this manner in Europe alone.

CREST may be regarded as the UK CSD. But securities registered on CREST are registered in the name of the legal owner (ie not registered in the name of CREST).[8] So CREST is not a depository, and the securities are not intermediated securities unless the legal owner is itself an intermediary.

National CSDs do not usually raise issues for situs, as the situs of the

[7] See Benjamin, *Interests in Securities,* (1st ed 2008) para 11.02 ("the legal result in both cases is the same").

[8] See 102.10 (CREST).

register of the CSD is usually the same as the situs of the underlying securities. However the issue does arise for international CSDs and other intermediaries.

> 2.20 In addition to national CSDs, Euroclear in Brussels and Clearstream in Luxembourg operate as international central securities depositories (ICSDs). ICSDs were originally established to manage clearing and settlement of Eurobonds for which there was no supporting market infrastructure. Since their creation over thirty years ago, the business of ICSDs has expanded to also cover most domestic and internationally traded securities....

71.2 Transparent/contract-based securities

In order to determine tax treatment of an asset one must identify the asset and its legal nature.

There are in principle two types of intermediated security:

(1) The intermediary may hold the underlying security in such a manner that the investors have a proprietary interest in it. In a common law jurisdiction, that will involve the depository holding the underlying security on trust for the investor. In a civil law jurisdiction the relationship will not be described as a trust, but the investors may have a proprietary interest and the end result is the same. I refer to that as a **"proprietary"** intermediated security,.

(2) The intermediary may hold the underlying security beneficially, and have a merely contractual obligation to transfer money or assets to the investor. I refer to that as a "**contract-based**" intermediated security.

The Law Commission Digital Asset Report uses different terminology:[9]

> **"Intermediated holding"** by a **"holding intermediary"**: arrangements for the holding of crypto-tokens or crypto-token entitlements by an intermediary on behalf of or for the account of others. These are further divided between the following two sub-types of intermediated holding arrangement
>
> (1) **Custodial intermediated holding** by a **custodial holding intermediary**: arrangements under which users retain superior legal title or equitable title to the crypto-tokens or crypto-token entitlements held on their behalf or for their account. In the event of the custodial holding intermediary entering an insolvency process, these entitlements

[9] Para 7.17, 7.26 (footnotes omitted).

> would ordinarily not form part of the holding intermediary's estate and would not be available to meet the claims of its general creditors. In practice, we anticipate that such arrangements under the current law of England and Wales will likely and most commonly be structured as trusts....
>
> (2) **Non-custodial intermediated holding** by a **non-custodial holding intermediary**: arrangements under which the holding intermediary acquires (or retains) superior legal title to the crypto-tokens or crypto-token entitlements that they hold (or acquire) on behalf of or for the account of users. Under this model, users have primarily personal contractual claims to the return of assets equivalent to those held. In the event of a non-custodial holding intermediary entering insolvency proceedings these claims would consequently rank as unsecured claims only and would give rise to no priority right of recourse to any specific crypto-tokens or token entitlements.

I do not adopt this terminology here, but it may catch on.

Where there is a chain of intermediaries, each may hold their interest on a proprietary or contract-based obligations in favour of the next in the chain, or some may hold on one basis and others on another.

Whether an intermediated security is transparent or contract-based depends on the documentation and the law which governs it. This subject is made more complicated by the variety of jurisdictions which may be involved. Also the relevant documentation is not generally available to the investors. But in practice intermediated securities usually are, and may be assumed to be, proprietary.

71.2.1 *English law*

The Law Commission 2020 paper provides:[10]

> 2.63 Under the law of England and Wales, it is now "reasonably well settled" that the arrangements between parties in an intermediated securities chain are characterised as a "series of trusts and sub-trusts"[11]. This may be agreed expressly by the parties or implied. As Mr Justice Briggs (as he then was) said in *Re Lehman Brothers*:[12]

[10] I omit most of the footnote references in this quote.

[11] Footnote original: *Re Lehman Brothers International (Europe) (in administration)* [2012] EWHC 2997 (Ch) at [163].

[12] Footnote original: *Re Lehman Brothers International (Europe) (in administration)* [2010] EWHC 2914 (Ch) at [226] and *Re Lehman Brothers International (Europe) (in administration)* [2012] EWHC 2997 (Ch) at [163]. See also *SL Claimants v Tesco plc* [2019] EWHC 2858 (Ch), at [6].

> It is common ground that a trust may exist not merely between legal owner and ultimate beneficial owner, but at each stage of a chain between them, so that, for example, A may hold on trust for X, X on trust for Y and Y on trust for B. The only true trust of the property itself (ie of the legal rights) is that of A for X. At each lower stage in the chain, the intermediate trustee holds on trust only his interest in the property held on trust for him. That is how the holding of intermediated securities works under English law, wherever a proprietary interest is to be conferred on the ultimate investor. In practice, especially in relation to dematerialised securities, there may be several links in that chain.

2.64 In our simple example above, the company issues shares, which are purchased by the custodian bank, a CREST member. According to the trusts law analysis, the custodian bank is the legal owner of the shares and, as trustee, holds the shares on trust for its account holders, including the broker. The broker is both the beneficiary of the trust with the custodian bank, and a sub-trustee, holding an interest in the shares on trust for the ultimate investor.

2.65 As well as trusts and sub-trusts between the parties, the relationships in the chain are regulated by individual contracts entered into between the relevant parties at each stage in the chain...

2.66 ... For debt securities, the top of the chain differs, although the general structure, from the company to the holder of debt securities, is similar. Where there is a bond or note issue, it is usual for there to be only one global bearer note, which represents the entire issue.[13] That note is physically held by a custodian bank permanently on behalf of an international central securities depositary (this process is referred to as "immobilisation"). The chain then proceeds as above, with intermediaries between the custodian bank and the ultimate investors.

An ultimate investor has both proprietary and personal rights in relation to the securities

2.67 As we have seen, the relationships between the parties in an intermediated securities chain are characterised as trusts, overlaid with contracts agreed between parties at each level of the chain. This analysis has two effects. The first effect is that an ultimate investor does not own securities. Instead, they hold a beneficial interest in securities.

2.68 The second effect is that an ultimate investor has a combination of both proprietary and personal rights in relation to intermediated securities. By "proprietary" rights, we mean that an ultimate investor has a right of ownership in the property held on trust (in this case, the beneficial interest in the securities held by the intermediary, rather than the securities themselves). Proprietary rights are enforceable against third parties.

2.69 For example ... if an intermediary becomes insolvent, the interest in the securities will not form part of the insolvent intermediary's estate. Beneficial ownership of the property remains with the ultimate investor...

[13] Footnote original but abbreviated: Most bonds are now held through these global custodian arrangements: J Payne, *Intermediation and Beyond* (2019) p 177. R Goode and L Gullifer, *Goode and Gullifer on Legal Problems of Credit and Security* (6th ed 2017) para 6-08.

2.70 Where an intermediary uses an omnibus account, which may contain millions of intermediated securities, the ultimate investor does not have a proprietary right in respect of specific intermediated securities in that account. Rather, the ultimate investor has a proprietary right in the form of beneficial co-ownership in the pool of intermediated securities. This means that the ultimate investor cannot point to certain intermediated securities which they own. Instead, they own a proportion of the intermediated securities in the account.[14]

2.71 Along with proprietary rights, an ultimate investor has personal rights. By "personal" rights, we mean that an ultimate investor would be able to claim compensation from an intermediary for breach of their duties under contract or the trust. For example, the intermediary, as trustee, may have a duty to transfer the intermediated securities upon instruction or perform other duties.[15] If the intermediary fails to carry out these duties, the ultimate investor may have a claim against the intermediary. However, unlike proprietary rights, personal rights are not enforceable against third parties. Therefore, an ultimate investor's claim against an intermediary may be worth little or nothing if the intermediary has become insolvent.

71.2.2 *Foreign law*

So far as the topic raises issues of foreign law I necessarily rely on limited material available to an English lawyer. I would be interested to hear from readers with expertise on entities discussed in this chapter.

For Scots law, see the Law Commission 2020 paper para 2.72. But perhaps in practice intermediation is not governed by Scots law.

71.2.3 *US law*

Section 8 [US] Uniform Commercial Code[16] sets out a code for intermediated securities. It has a vocabulary and concepts of its own. The right of the investor ("entitlement holder") is a "security entitlement". This confers personal rights against the "securities intermediary" and an interest in the financial asset held by the intermediary. Section 8-503 Uniform Commercial Code provides:

(a) To the extent necessary[17] for a securities intermediary to satisfy all

[14] The Law Commission give references, including *Goode and Gullifer on Legal Problems of Credit and Security* (6th ed 2017) para 6-15.

[15] Footnote original: R Goode and L Gullifer, *Goode and Gullifer on Legal Problems of Credit and Security* (6th ed 2017) para 6-18.

[16] *https://www.law.cornell.edu/ucc*

[17] This formulation reflects the fact that US intermediaries do not generally segregate securities so one cannot identify particular securities as the ones held for customers; Official Comment 1 to §8-503.

> security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary...
>
> (b) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) is a pro rata property interest in all interests in that financial asset held by the securities intermediary, without regard to the time the entitlement holder acquired the security entitlement or the time the securities intermediary acquired the interest in that financial asset.
>
> (c) An entitlement holder's property interest with respect to a particular financial asset under subsection (a) may be enforced against the securities intermediary only by exercise of the entitlement holder's rights under Sections 8-505 through 8-508.

This is not a common law trust, or at least, it does not use trust law vocabulary, but I think it comes to the same thing.

However, a security representing other securities does not create a security entitlement, so depository receipts (or units in a fund) are not governed by article 8. Instead the holder's rights are determined by the relevant document.[18]

71.2.4 *American depositary receipts*

The CG Manual provides:

> **CG50240 Depository receipts** [May 2020]
>
> ... **DRs issued outside UK**
>
> Where a DR is issued outside the UK the question of whether the holder of the DR is the beneficial owner of the underlying shares will be determined by reference to the law of the territory in which the DR is issued. ...

More accurately, whether the holder of the DR is the beneficial owner of the underlying securities will depend on the terms of the deposit agreement construed in accordance with the law governing the agreement.

The CG Manual rather optimistically provides:

[18] Financial Markets Law Committee, "Report on research into the 1994 revisions to Article 8 of the Uniform Commercial Code" para 2. *http://fmlc.org/wp-content/uploads/2018/02/Issue-3-Background-paper-on-Article-8-of-the-Uniform-Commercial-Code.pdf*

> Information on beneficial ownership may be provided to investors by the depository.

It seems unlikely that a foreign depository would give UK tax advice, or sufficient information to determine the UK tax issues.

In *Chembulk Management Pte Ltd v Vedanta Ltd*:[19]

> an American Depositary Receipt ("ADR") or ADS program[20] divides the ownership of a foreign stock between the depositary and/or custodian, which act as the title owner, and the ADS holder, who holds a beneficial interest, the exact parameters of which are delineated in the governing ADR agreement, in the stock.

In *Carver v Bank of New York Mellon*:[21]

> A careful reading of the Deposit Agreement confirms that BNYM, as *title* owner, holds the Deposited Securities for the Plans, which in turn have a beneficial ownership interest in the underlying Deposited Securities. ... With the exception of the obligation to hold the Deposited Securities, the [Deposit Agreement] seems to allocate all other relevant rights with respect to the Deposited Securities to the Plans. These include the right to redeem ADRs by exchanging them for the underlying Deposited Securities; the right to receive cash distributions in USD; and the right to instruct BNYM regarding the voting of shares. The Court concludes that these equitable rights give rise to, at least, a beneficial ownership interest in the Deposited Securities by the Plans.

These American depositary receipts would be IT/CGT transparent, and there is no reason to think that they were untypical, so unless the documentation was non-standard, that would be the UK tax position. Until 2012 that was, I think, generally accepted, and this was the view expressed in the CG Manual.

HSBC Holdings v HMRC[22] concerned ADRs governed by the law of New York. It suited HMRC to argue that HSBC depository receipts were contract-based. The tribunal heard expert evidence and preferred the view that the ADRs, which were "fairly typical",[23] were contract-based, though

[19] Nos. 16 CV 9827-LTS-KHP, 16 CV 9799-LTS-KHP United States District Court (2018)

[20] Footnote original: ADSs [American Depositary Shares] are also referred to as ADRs.

[21] United States District Court , New York (2017).

[22] [2012] UKFTT 163 (TC)

[23] at [97].

the conclusion is tentatively expressed:

> 148. Overall our conclusion is that we are not satisfied as a matter of fact that under the law of the State of New York the holder of an HSBC ADR has a beneficial interest in the underlying fund of HSBC shares.

In the HSBC litigation it suited HMRC to argue for contract-based ADRs, but that conclusion would sometimes favour the taxpayer. Accordingly HMRC now seek to return to what was formerly understood to be the position:

> Where beneficial ownership of the underlying shares cannot conclusively be determined by reference to the law governing the arrangements relating to the issue of the DRs, for tax purposes HMRC will continue to determine beneficial ownership according to its understanding of the principles of UK law.[24] This means that HMRC will continue to apply its longstanding practice of regarding the holder of a DR as holding the beneficial interest in the underlying shares and the treatment will be the same for UK issued DRs.
> The ADRs referred to in the HSBC decision fall into this category.

Thus HMRC first disregarded their longstanding practice, and now disregard the tribunal's decision which was based on HMRC's expert evidence. The reader may think this a not very impressive display of administration. Now it is done, the genie is not so easily returned to the bottle. If it suits them, taxpayers may properly proceed on the basis of HMRC's view that the HSBC ADRs, and others in standard form, are contract-based. Though taxpayers may also properly proceed on the basis that the HMRC statement is correct, the ADRs are proprietary, and I expect that is the usual practice.[25]

71.2.5 *Belgium and Luxembourg*

Belgium and Luxembourg are important as they are the homes of Euroclear and Clearstream. The Law Commission 2008 paper provides:

[24] Author's footnote: The UK has three legal systems. Scots trust law is quite different from English law, though whether these differences lead to a different outcome is less clear.

[25] See Cooklin, "UK companies listing in the US", Tax Journal 14 March 2014: "Many US lawyers expressed surprise at the expert witness evidence on the effects of the underlying New York law documentation on which the FTT's finding of facts was based."

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2.31 Belgium[26] and Luxembourg[27] are each home to major ICSDs (Euroclear and Clearstream respectively) ... Investors that hold securities through an intermediary in an omnibus account are treated as having a co-ownership right in the pool of fungible securities, exercisable only against the intermediary. Should the intermediary fall insolvent, the investor is given a right of revendication, that is to say, a claim for the return of property enforceable against the intermediary and its creditors...

Direct enforcement versus indirect enforcement

2.35 In all common law jurisdictions (such as the UK and the US) and a number of civil law countries (for example Belgium and Luxembourg), an investor that holds through an intermediary is unable to exercise the rights it may have in the underlying securities directly against the issuer of those securities.[28] The investor can only enjoy the fruits of its investment by enforcing its rights against its intermediary. Furthermore, the investor will be generally prohibited from making a claim against securities held in the account of a higher tier intermediary but must rely on the contractual and fiduciary obligations of its own intermediary to pursue such claims....

2.49 The effect of commingling securities in a pooled account is generally to preclude the continuing existence of direct property rights of individual owners in the specific securities held prior to commingling...

LEGAL PROTECTION BASED ON CO-OWNERSHIP

2.51 In a number of EU Member States, account holders are given proprietary rights (or the equivalent protection) by treating their interests in a commingled account as co-ownership (or co-proprietary) interests in a fungible pool.

2.52 In Belgium[29] and Luxembourg,[30] statute converts what would otherwise be

[26] Footnote original: Belgian Royal Decree No. 62, as co-ordinated by Royal Decree of 27 January 2004.

[27] Footnote original: Luxembourg Law of 1 August 2001 on the circulation of securities and other fungible instruments, Articles 6.7 and 15.

[28] Footnote original: Unless the issuer permits otherwise by contract or provisions in a deed poll or trust deed.

[29] The footnote refers to Belgium Royal Decree No 62, which is headed: Coordonné relatif au dépôt d'instruments financiers fongibles et à la liquidation d'opérations sur ces instruments. [Facilitating the Circulation of Securities], Article 2.
http://eur-lex.europa.eu/n-lex/legis_nl/overheid_form_en.htm or
http://justice.belgium.be/fr/

[30] Article 3(1) [Luxembourg] Securities Act 2001 *http://www.cssf.lu* provides:

Le titulaire de compte bénéficie, à concurrence du nombre de titres inscrit s en son compte titres, d'un droit réel de nature incorporelle sur l'ensemble des titres de même genre, tenus en compte par son teneur de compte pertinent, des	The account holder benefits - up to the amount of securities held on its securities account - from an intangible interest in all the securities of the same description held on an account by the relevant account keeper, from the rights

> a mere contractual claim against the intermediary into an intangible co-ownership right in a pool of fungible book-entry securities held by the intermediary.[31]

This is not called a trust, but it comes to the same thing. So intermediated securities held by Euroclear and Clearstream are transparent, not contract based.

71.2.6 *Denmark, Germany, Netherlands, Switzerland*

The Law Commission 2008 paper provides:[32]

> An investor may be granted a right to enforce its claim against an upper tier intermediary in circumstances where its own intermediary has acted in breach of duty or is insolvent. This is the case in Denmark and Germany[33] and possibly also in the Netherlands.[34]

Thus it seems that intermediated securities in these jurisdictions are also transparent.

For Switzerland, see the Loi fédérale sur les titres intermédiés (Federal Act on Intermediated Securities).[35]

71.3 Situs of transparent intermediated security for IHT & IT

There are no relevant statutory provisions, so the common law rules apply

droits attachés aux titres et des droits prévus par la présente loi. Sous réserve de dispositions légales contraires, it ne peut faire valoir ses droits qu'á l'égard du teneur de comptes pertinent.	attached to the securities and from the rights provided for in this law. Unless otherwise provided by law, the account holder may only exercise its rights against the relevant account keeper

[31] Law Com. *The UNIDROIT Convention on Substantive Rules regarding Intermediated Securities Further Updated Advice to HM Treasury* (May 2008).

[32] Law Commission, "Issues Affecting Account Holders and Intermediaries" para 1.239 (June 2006) *http://www.lawcom.gov.uk/wp-content/uploads/2015/03/Intermediated_securities_seminar_2.pdf*

[33] Footnote original: If an intermediary refuses to enforce a claim against the intermediary above for the return of securities, German law permits the investor to bring a direct action for return against the upper tier intermediary under the Securities Deposit Act, sections 7-8.

[34] Footnote original: Sections 7:420 and 421 of the Netherlands Civil Code which relate to agency contracts could give the investor a right against an upper tier intermediary in the event of a breach of duty or insolvency of its own intermediary.
The Netherlands Civil Code is available in English on *http://www.dutchcivillaw.com*

[35] *https://www.admin.ch/opc/en/classified-compilation/20061735/index.html*

for IHT.

The relevant principle is that a security is situate where it can be dealt with, which is where the security register is kept.[36] An intermediated security is dealt with (ie transferred) where the intermediary's register is kept. That is the jurisdiction where litigation over the transfer of the intermediated security would normally take place. So that is the situs of the intermediated security; the situs of the underlying security is irrelevant.

It might be argued that in the case of a transparent intermediated security, the situs of the investor's asset (the intermediated security) must be that of the underlying security, on the basis that:

(1) intermediation constitutes a bare trust (or more accurately, a series of bare trusts) over the underlying security, and
(2) the situs rule for bare trusts is always that the bare trust should be disregarded.[37]

However the trust (if any) is unlike a straightforward bare trust since (inter alia):

(1) Ultimate investors can only make claims against their immediate intermediary, not against the company which issues the securities, or against another intermediary (the "no look-through principle").
(2) The interests of the ultimate investors are pooled.
(3) Change of title is effected by registration.

In fact intermediation is not properly described as a bare trust in the older sense of that expression.[38] If it is described as a bare trust, then the expression is being used widely, and there is no reason that all bare trusts (if the term is used so widely) should be governed by the same situs rule.

Dicey agrees:[39]

> ... the *situs* of immobilised securities should be regarded as the place where the depository is established and where it keeps the database in which the entitlements of the depositors are recorded.

Re Bloom concerned intermediated securities, where:

(1) Securities were registered in the name of a nominee for Canadian

[36] See 102.4 (Situs of shares: General principle) ff.

[37] See 102.32 (Bare trust or nomineeship).

[38] See 87.7.1 ("Bare trust" and related terms).

[39] Dicey, Morris & Collins, Conflict of Laws (16th ed., 2022), para 23-041 (Immobilised securities). This view is enthusiastically supported by Benjamin, *Interests in Securities* (2000), Chap 7 and 11.14.

Depository for Securities Ltd (the ultimate depositary).[40]

(2) The ultimate depository held the securities on trust for Bank of Nova Scotia Trust Co (the intermediary).

(3) The intermediary held the securities on trust for the deceased.

> In a multi-tiered holding system, the account would be situated at the financial investment intermediary on whose books the interest of the debtor [ie ultimate owner] appears. This is the place where the record that determines title is to be found...
> Applying that test, the Applicant submits that the situs of the deceased's securities is "the financial investment intermediary on whose books the interest of the deceased is recorded and where her personal representative must go to effect the transmission, and that is the Securities Department of The Bank of Nova Scotia Trust Company in Toronto, Ontario." I agree with that submission.[41]

The Law Commission agree. The Law Commission 2008 paper provides:

> 21.6 The concentration of the investor's interests into one account *with a single situs* can also greatly simplify conflicts of laws issues. This is of particular benefit to lenders wishing to take security over a portfolio of securities. Provided that the choice of law rules applied to the different intermediated securities are clear, the lender need only concern itself with the perfection requirements of the jurisdiction in which the account is located rather than the requirements of each of the jurisdictions applicable to the various underlying securities.[42]

[40] [2004] BCSC 70 *http://www.canlii.org*

[41] [2004] BCSC 70 at [61] to [63]. In *Secure Capital v Credit Suisse* [2015] EWHC 388 (Comm) at [43] the interest of Secure Capital (the ultimate investor) in a bearer security (the underlying asset) was said to be situate in Luxembourg, on the basis that:
(1) The top intermediary (RBS) was situate there; or alternatively
(2) The ultimate depositary (Clearstream) was situate there
In the event, the situs of the interest was held to be irrelevant to the Secure Capital's claim, so the test of situs did not have to be determined, and was not discussed. So the case does tell us much about the test of situs; but it is noteworthy that no-one suggested that the situs of the interest of the ultimate investor was the same as the situs of the underlying security. The point was not discussed in the appeal.

[42] Similarly, Law Commission, refers to "PRIMA" principle which states that "certain issues governing intermediated securities should be governed by the "place of the relevant intermediated account". Its main attraction is the reduction in transaction costs. An exchange would not have to enquire where its customers are habitually resident. Instead, it could be assured that one system of law governed all its dealings.

Thus the situs of the intermediated security (the asset held by the investor) may be different from the situs of the underlying security.

It may seem surprising that situs of an intermediated security is different from the situs of the underlying security. However, situs is not (or not just) a matter of common sense, and that view cannot stand against the authorities set out above. The common law situs rules looks to the situs of the intermediated security, not the underlying security.

More fundamentally, differences between intermediated securities and directly held securities are not surprising. As the Law Commission 2020 paper observes:

> Holding investments through an intermediated securities chain can have a profound effect on the ability of ultimate investors to exercise rights... ultimate investors can generally only make a contractual or trusts claim against their immediate intermediary, and not against the company which issues the securities, nor against another intermediary (the "no look through principle").[43]

Investors may for practical purposes ignore the difference between intermediated and underlying securities, and may indeed ignore the even more fundamental question whether their interests are proprietary or contract-based; but the differences will emerge on the insolvency of an intermediary, as happened in the case of Lehman Brothers, and in any cases where the investor needed to exercise rights in relation to the securities.

71.3.1 *HMRC view*

HMRC may take a different view. They may regard intermediated securities which are transparent for income tax as transparent for situs; what matters is the situs of the underlying security. In 1994 HMRC said:

> ... where a financial institution or other intermediary has purchased Eurobonds or similar fungibles through Euroclear or Cedel [now Clearstream] on behalf of a client-investor, the Revenue will treat the financial institution or intermediary as the nominee or agent of the

See "Digital assets and ETDs in private international law: which court, which law? Call for evidence" at p.232

[43] Law Commission 2020 paper, para 1.23 -1.24. Likewise the 2008 paper: "2.24 Intermediation has had a substantial effect in transforming the legal nature of investor's rights in securities."

> client-investor, unless the terms of the particular issue prescribed otherwise. So, save in the excepted circumstances, the Revenue will look through the intermediary and treat the beneficiary-investor as owning the underlying Eurobonds or similar fungibles.[44]

The IHT Manual is obscure:

> **IHTM27077 Eurobonds and American depository receipts** [May 2020]
> We regard the situs of securities dealt with through computerised clearing systems (for example, Euroclear; CEDEL [which became Clearstream in 2002]) as determined by the terms of issue of the particular security. ...

This passage might perhaps be intended to say that HMRC look through the intermediary, but it does not say that. It actually says very little. It does not explain what constitute "the terms of issue": does that include intermediation? It does not explain how situs is decided once one knows what are the terms of issue. To say that "situs is determined by the terms of issue" is not a very accurate statement, or at least, not a very helpful statement, of the rules which apply to directly held (non-intermediated) securities. So it impossible to say from this passage what HMRC's position may be.

It must be frustrating for HMRC to see a significant part of the economy taken out of the scope of IHT by means of clearing systems and intermediated securities. But in practice the loss of tax should be (more or less) nil, because:

(1) UK resident foreign domiciliaries (if properly advised) will not usually hold investments in listed UK companies (for IT and CGT reasons as well as possible IHT).
(2) For non-residents, IHT on such assets is largely uncollectable.

Indeed the current law could aid the UK economy by encouraging foreign investment in UK incorporated companies, or at least it could if HMRC acknowledged it.

71.4 Proprietary intermediated security: Situs for CGT

In the absence of a statutory provision, the IHT situs rule will apply for CGT. Six statutory provisions need consideration: the co-ownership situs

[44] [1994] PCB 139. But it is open to question whether an obscure article of that age can be taken as a guide to current HMRC practice.

rules, the bare trust disregard, the UK-law rule, and the rules dealing with securities in s.275(1)(d)(da)(e).

71.4.1 *Intermediated securities of non-UK company*

Section 275(1)(e) TCGA provides:

> subject to paras (d) [government securities] and (da) [UK incorporated companies] above, registered shares or debentures are situated where they are registered and, if registered in more than one register, where the principal register is situated.[45]

In this paragraph I assume we are not concerned with government securities or UK incorporated companies within paras (d) or (da).

I first consider debentures and then shares.

As far as debentures are concerned, there are two questions:

(1) are intermediated debentures (the interests held by investors) properly described as "debentures" within the meaning of s.275(1)(e)?

(2) if so are intermediated debentures "registered" debentures?

Since debenture stock count as "debentures"[46] it seems reasonably clear that the intermediated debentures are properly described as "debentures".

Intermediated debentures are registered in the sense that the investors interests are recorded on the intermediary's register.[47] At first sight one might think that the register referred to in s.275(1)(e) must be a register kept by the company which issued the debentures. However a company does not have to keep a register of its debenture holders (unlike a shareholder register). The distinguishing feature of a register is that it determines or provides evidence of ownership.[48] So it is considered that intermediated debentures are "registered" on the intermediary's register. It follows that:

(1) If the underlying debenture is not registered, the intermediary's register is the only register, and the investors interests are situate

[45] See 103.6 (Registered security: non-UK co).

[46] See 103.2.4 ("Debenture").

[47] Benjamin, *Interests in Securities* (2000) para 2.91: "Interests in securities [Intermediated securities] may properly be characterised as a form of registered securities, even where the underlying securities are in bearer form."

[48] The intermediary's register is not open to inspection, unlike a register under s.744 Companies Act 2006, but open access is not an essential feature of a register, and there is no reason to expect foreign law to apply English company rule principles.

where the intermediary's register is situated.

(2) If the underlying debenture is registered, there are two registers:
   (a) The company's register of the underlying debenture (which will record the intermediary as the registered holder).
   (b) The intermediary's register of the intermediated debenture (which will record the investor as the registered holder).

It is considered that the company's register does not come into the picture, since the asset which the investor owns is the intermediated debenture and not the underlying debenture. But even if that is not correct, the intermediary's register should be regarded as the principal register so that is the one which governs situs.

For these reasons, an intermediated debenture of a non-UK incorporated company is situate where the intermediary keeps its register.

In practice it does not often matter whether the situs of an intermediated debenture (of a non-UK incorporated company) is in the place of the intermediary's register or the situs of the underlying debenture. Either way, the asset will not usually be UK situate. But it could matter, for instance, if the debenture is a bearer debenture and the document is in the UK. In such a case it is sensible to look to the intermediary's register rather than to the place of the document of the underlying debenture, since an investor could not be expected to know where the document of the underlying debenture is situated.

The same applies when the underlying security is shares in a non-UK incorporated company, rather than debentures.

71.4.2 *Securities of UK incorporated co*

It is considered that intermediated securities of UK incorporated companies are properly described as shares or debentures and so fall within the rules in s.275(1)(da) TCGA. If that is correct, the registered securities rule in 275(1)(e) does not apply: it does not matter whether the securities are regarded as registered. Intermediated securities of UK incorporated companies are UK situate for CGT purposes.

71.4.3 *Municipal/government securities*

For the same reason, intermediated securities of government or municipal authorities are situated in the authority concerned: s.275(1)(d) TCGA.

71.4.4 *Another view*

In the case of co-ownership interests the co-ownership situs rules[49] in s.275C TCGA provide:

> (2) The situation of the interest in the asset shall be taken to be the same as the situation of the asset, as determined in accordance with subsection (3) below.
> (3) The situation of the asset for the purposes of subsection (2) above shall be determined on the assumption that the asset is wholly-owned by the person holding the interest in the asset.

Do investors hold interests in the underlying securities as co-owners (within the meaning of the co-ownership rule)? That depends on the terms of the agreement with the intermediary but it is likely to be the case.[50] If so, it appears at first sight that these rules override the common law situs rule, so the situs of the investor's interest for CGT is that of the underlying security.

The CGT bare trust disregard[51] provides another route to the same destination. Does the intermediary hold for the investors as bare trustee (within the statutory sense of that expression)? That depends on the terms of the agreement with the intermediary but it is likely to be the case. If so, it appears at first sight that the effect of s.60 TCGA is to treat the investors as co-owners of the underlying security, so the situs of the investor's interest is that of the underlying security.

It is arguable however that these deeming provisions do not alter the fact that the investor's intermediated securities are "registered" so that s.275(1)(e) continues to apply. This also overrides the UK-law rule[52] even if the underlying security was subject to UK law, or if the intermediary arrangement was subject to UK law.

71.4.5 *Conclusion*

The CG Manual formerly stated that the situs of an intermediated security for CGT purposes is that of the underlying security rather than that of the intermediary's register.[53] That is correct for securities of UK incorporated

[49] See 103.3 (Co-owned assets).

[50] See 71.1 (Securities law background).

[51] See 87.7 (Bare trust/nomineeship).

[52] See 103.13.1 ("Intangible asset").

[53] See 71.3.1 (HMRC view). Curiously, the CG Manual in 2012 deleted the passage which formerly stated that the situs of the DR is the situs of the underlying security.

companies. It is considered that situs of securities of non-UK companies depends on the place of the intermediary's register. That could be different from the situs of the underlying security, though circumstances in which the difference matters will be rare.

71.5 Other CGT issues

The CG Manual discusses a number of CGT issues. The comments are in the context of depositary receipts, but the same will apply to other intermediated securities.

> **CG50240 Depository receipts** [May 2020]
> ... We have been asked to clarify how holding shares via DRs will affect liability to Capital Gains Tax or Corporation Tax on chargeable gains following the decision of the First Tier Tribunal in the Stamp Duty Reserve Tax case of *HSBC v Commissioners for HMRC*, [2012] UKFTT 163 (TC).

The CG Manual sets out some tax implications of the two types of depositary receipts, and it may be helpful to see this side by side:

UK-issued DRs	**Beneficial ownership determined by overseas law**	**See**
Where a DR is issued in the UK the HMRC view is that the holder of a DR is the beneficial owner of the underlying shares...[54] The practical implications include that:	Where the relevant law means that the holder of a DR is not the beneficial owner of the underlying shares the practical implications include that:	
[1] a transfer of shares by a shareholder to a depository in exchange for an issue of DRs is not a disposal of the shares for capital gains purposes because the shareholder retains beneficial ownership of the shares	[1] a transfer of shares by a shareholder to a depository in exchange for an issue of DRs is a disposal of the shares for capital gains purposes because the shareholder loses beneficial ownership of the shares	
[2] a disposal of the DRs is a disposal of both the DRs	[2] a disposal of the DRs is not a disposal of the underlying shares	

That might reflect a hesitant change of view or just an accident. But as far as I know, HMRC practice has not changed.

[54] Author's footnote: More accurately, whether a trust is created would depend on the terms of the deposit agreement construed in accordance with the law governing the agreement. But in the UK there will in practice be a trust.

themselves and a disposal of the underlying shares.[55] In practice the value of a DR will track the value of the underlying shares very closely and to that extent the consideration for the disposal of the DRs should be regarded as consideration for the disposal of the shares		
[3] in a share exchange or company reconstruction in which shareholders have an option to receive DRs instead of being issued with shares we accept that the shares are to be treated for the purposes of TCGA92/S135 as being issued to the shareholders, see CG52500+.	[3] in a share exchange or company reconstruction in which shareholders have an option to receive DRs instead of being issued with shares the conditions of TCGA92/S135 will not be met by shareholders who take DRs as they have not been issued with shares.	58.3
[4] if the holder of DRs converts them back into the underlying shares there is no change of ownership of those shares and so no disposal of the shares. There will have been a disposal of the DRs and the usual computational rules will apply. If no consideration is received for the disposal of the DRs there will be no chargeable gain.	[4] where a holder of DRs converts them into the underlying shares there will be a disposal of the DRs and an acquisition of shares. The usual computational rules will apply.	
[5] where a person holds the same class of shares directly and through DRs then they may be		56.12

[55] Author's footnote: This assumes that the investor holds two distinct assets, (1) "the DRs themselves", and (2) the underlying securities (or at least an interest in them). It is suggested that a DR should be regarded as a matter of general law as one asset and not two. Admittedly a DR confers a bundle of different rights, namely an interest in the underlying security and contractual rights; but many types of property, such as a share, a unit in a unit trust, an equitable interest, confer a bundle of rights, and are nevertheless regarded as single items of property and not as two or more distinct items. However, it does not matter as the Manual goes on to effectively ignore the two-asset analysis. In the view of the Manual, the beneficial interest in the underlying share is effectively the only asset.

> regarded as constituting a single
> holding for share identification
> purposes, see CG51500.

This passage does not address situs or source of income.

71.6 Manufactured payments: Introduction

The legislation is in part 11ZA ITA, sections 614ZA-614ZD.
I do not discuss REITs (s.918 ITA).
The CFM provides:

> **CFM46010 - Deemed loan relationships: manufactured interest and repos: overview** [Aug 2018]
> Manufactured payments normally arise under repos and stock lending arrangements where the transaction crosses an interest or dividend date, so that the temporary owner, instead of the original owner, receives the interest or dividend as the registered owner of the security.
> Where interest is received by the temporary owner in respect of a security and is paid to the original owner in the form of a manufactured payment ('manufactured interest'), the manufactured interest is taxed in the same way as if the original owner had received the actual interest. CTA09/PT6/CH9 brings manufactured interest within the loan relationships provisions. Further details are at CFM46050.
> Other legislation dealing with manufactured payments is in ITA07/PT11/CH2, ITA07/PT15/CH9 and CTA10/Part 17. The legislation aims to tax and relieve manufactured payments as far as possible in the same way as the underlying 'real' interest or dividends, and imposes a requirement to deduct tax from certain payments...

71.7 Manufactured payment relationship

This is the key term. Section 614ZB ITA provides:

> (1) For the purposes of the Income Tax Acts a person has a manufactured payment relationship if conditions A to C are met.
> (2) Condition A is that under any arrangements-
> (a) an amount is payable by or to the person, or
> (b) any other benefit is given by or to the person (including the release of the whole or part of any liability to pay an amount).
> (3) Condition B is that the arrangements relate to the transfer of securities.
> (4) Condition C is that the amount or value of the other benefit-
> (a) is representative of a dividend or interest on the securities, or

> (b) will fall to be treated as representative of such a dividend or interest when it is paid or given.
>
> (5) In subsection (2) the reference to an amount being payable, or other benefit being given, by the person includes a reference to an amount being payable, or other benefit being given, by another person on behalf of the person in question.

71.7.1 *Manufactured payment*

Section 614ZB ITA provides:

> (6) In this Part-
>
> "manufactured payment", in relation to a manufactured payment relationship, means an amount, or the value of a benefit, within subsection (2), and

71.7.2 *Securities*

Section 614ZB(6) ITA provides a commonsense definition:

> "securities" means-
>
> (a) shares in a company, and
>
> (b) loan stock or any similar security (whether the security is of the government of the United Kingdom, any other government, any public or local authority in the United Kingdom or elsewhere, or any other company or body).

71.8 Manufactured payment: Payor

Section 614ZC ITA provides:

> (1) This section applies where a person has a manufactured payment relationship under which a manufactured payment is paid by or on behalf of the person.
>
> (2) No deduction is allowed in respect of the manufactured payment in calculating any profits or other income of the person for income tax purposes (subject to subsection (3)).
>
> (3) Subsection (2) does not apply in relation to the person so far as the manufactured payment is brought into account under Part 2 of ITTOIA 2005 in calculating the profits of a trade carried on by the person.
>
> (4) But nothing in subsection (3) affects the question whether (apart from that provision) a deduction in calculating the profits of a trade carried on by the person is allowed.

71.9 Manufactured payment: Payee

Section 614ZD ITA provides:

> (1) Subsection (2) applies if a person has a manufactured payment relationship under which a manufactured payment is payable to the person.
> (2) For the purposes of the charge to income tax on the person's income, the Income Tax Acts apply to the person as if the manufactured payment were a dividend or interest on the securities (as the case may require).
> (3) Subsection (2) is subject to subsections (4) and (5).

The exceptions relate to trading income and to DTR. Section 614ZD ITA provides:

> (4) Subsection (2) does not apply in relation to the person so far as the manufactured payment is brought into account under Part 2 of ITTOIA 2005 in calculating the profits of a trade carried on by the person.
> (5) Subsection (2) does not apply in relation to the person for the purposes of determining entitlement to double taxation relief[56] in respect of any dividend or interest.

71.10 Manufactured interest: UK payor

Section 919 ITA provides:

> (1) This section applies if—
> (a) a person pays a manufactured payment as mentioned in section 614ZC(1),
> (b) the amount payable is representative of interest on UK securities ("manufactured interest"), and
> (c) the person—
> (i) is UK resident, or
> (ii) pays the manufactured interest in the course of a trade carried on in the UK through a branch or agency.
> (1A) But this section does not apply if—
> (a) the manufactured interest is paid by a UK resident company in the course of a trade carried on through a permanent establishment in a territory outside the UK, and
> (b) section 18A of CTA 2009 has effect in relation to the company for the accounting period in which it is paid.

Assuming these conditions are met, deduction at source rules apply. Section 919 ITA provides:

[56] Section 614ZD(7) ITA provides a commonsense definition: "For the purposes of this section "double taxation relief" means any relief given under or as a result of Part 2 of TIOPA 2010."

> (2) The payer of the manufactured interest must, on making the payment, deduct from the gross amount of the manufactured interest a sum representing income tax on it at the basic rate in force for the tax year in which the payment is made.
> (3) The "gross amount" of manufactured interest is equal to the gross amount of the interest of which it is representative.
> ...
> (6) In subsection (1) "UK securities" means securities of—
> (a) the government of the UK,
> (b) a local authority in the UK,
> (c) another public authority in the UK, or
> (d) a UK resident company or other UK resident body.
> (7) But "UK securities" does not include shares in a UK resident company.
> (8) In this section "securities" includes loan stock or any similar security.

71.11 Creditor repos

Section 925A ITA provides:

> (1) Subsection (2) applies if a company ("the lender") has a creditor repo for the purposes of Chapter 10 of Part 6 of CTA 2009 (see section 543 of that Act).
> (2) Sections 918, 919 and 921 have effect in relation to the lender while the arrangement is in force as if—
> (a) the lender paid the borrower amounts which are representative of the income payable on the securities that are initially sold,
> (b) the payments were made under requirements of the arrangement, and
> (c) the payments were made on the dates on which the income is payable.
> (3) For the purposes of subsection (2), an arrangement is in force from the time when the securities are initially sold until the earlier of—
> (a) the time when the subsequent sale of the securities, or similar securities, takes place, and
> (b) the time when it becomes apparent that that sale will not take place.

71.12 Company payor

CFM46050 - Deemed loan relationships: manufactured interest
Manufactured interest treated as interest on a loan relationship [Aug 2018]
Where a company pays or receives manufactured interest (either on UK or

overseas securities), CTA09/S540 applies to

- treat the company as being a party to a loan relationship
- treat the manufactured interest as interest under a loan relationship (and, in the case of the recipient, as though it were under the loan relationship under which the real interest is payable)

Because the company is treated as being party to a loan relationship, other loan relationship provisions also apply, such as late interest (CFM35800) and the unallowable purposes rules (CFM38100).

Provisions such as CTA10/S812 deem manufactured payments to be made in certain circumstances. Where the deemed payment constitutes interest, it is also brought within the loan relationships provisions by virtue of CTA09/S541(1). However, this does not override the rule in CTA10/S812 disallowing a deduction for deemed manufactured payments. The equivalent rule for income tax purposes is now in ITA07/S596.

Whether receipts and payments of manufactured interest (either real or deemed) are loan relationships credits or debits depends generally on their accounting treatment. See CFM46060 and CFM46070.

Example

LY Ltd borrows loan stock from TW Ltd for 2 months to enable it to settle a short sale. During that period interest of £500 arises on the security. LY Ltd does not receive the real interest because it does not hold the security, but still has to pay manufactured interest of £500 to TW Ltd as compensation for the fact that TW Ltd did not receive the real interest.

If LY Ltd debits the manufactured interest payment of £500 to its profit and loss account in accordance with GAAP, it will be a loan relationship debit. For TW Ltd, the manufactured interest receipt is treated as though it were the real interest on the loan stock that it has lent to LY Ltd.

For repos, the treatment of manufactured interest is dealt with under the issue of income arising on securities during the period of the repo. See CFM46260 and CFM46380.

71.13 DCC Holdings

The CFM provides:

CFM46060 - Deemed loan relationships: manufactured interest: DCC Holdings [Aug 2017]

In a 'net-paying' repo, the transaction crosses a coupon or dividend date and the purchaser does not pass on any income it receives by means of a manufactured payment. Instead the repurchase price is reduced to reflect the fact that the seller has, in effect, repaid part of the loan. The purchaser in a net-paying repo is deemed to make a manufactured payment: manufactured interest where the securities are loan relationships.

In a transaction predating the FA 2007 rules (see CFM46200), DCC Holdings purchased and resold gilts in a number of net-paying repos in which it received gilt interest of £28.8m. It made an economic profit of £1.8m (the 'interest' under the repo), but claimed that the transactions resulted in a loan relationships debit of £27m, on the basis that the gilt interest received was not taxable and that it was entitled to a 'freestanding' deduction for full amount of the deemed manufactured interest payment.

The Supreme Court found in HMRC's favour in December 2010 ([2010] UKSC 58). There was no freestanding deduction for the deemed payment of manufactured interest; instead there must be symmetry between the credit for the interest received and the debit for the manufactured interest deemed to be paid. Both should be £2.9m, the amount of the coupon that accrued during the period of the repo. As a consequence, DCC was taxed on its economic profit of £1.8m.

CFM46070 - Deemed loan relationships: manufactured interest: DCC Holdings: FA 2009 changes [Aug 2018]

DCC Holdings: FA 2009 changes

The High Court in the DCC Holdings case had earlier found (in October 2008) that the company was entitled to a freestanding deduction for the deemed payment of manufactured interest. In response, CTA09/S540(3) and FA96/S97(2) were amended by paragraph 5 Schedule 30 FA 2009 to ensure that the tax treatment of manufactured interest (both real and deemed) accords with its economic effect. Only amounts that are recognised in determining a company's profit or loss in accordance with GAAP are brought into account as loan relationships debits and credits.

The changes applied to real payments of manufactured interest whenever made, and to payments of manufactured interest deemed to be made on or after 27 January 2009. The Supreme Court judgment in the DCC Holdings case means that for such payments and deemed payments, the 2009 changes restate the existing law that their tax treatment accords with their economic effect. For payments of manufactured interest deemed to be made before 27 January 2009 (which were not covered by the 2009 changes), the DCC judgment upholds HMRC's view that the law means that their tax treatment accords with their economic effect.

CTA09/S545 means that there is no general relief for manufactured interest under repos entered into on or after 1 October 2007 (CFM46260), and relief for deemed manufactured payments (including manufactured interest) in stock loans is statutorily prohibited under CTA10/S812 (CFM46050).

71.14 Voting on intermediated securities

The holder of intermediated securities may or may not have the voting rights attached to the shares: that depends on the documentation. Normally it makes no difference for tax purposes, but occasionally that matters.

Section 169S(3) TCGA defines "personal company" for the purposes of business asset disposal relief:

> For the purposes of this Chapter "personal company", in relation to an individual, means a company—
> (a) at least 5% of the ordinary share capital of which is held by the individual, and
> (b) at least 5% of the voting rights in which are exercisable by the individual by virtue of that holding.

So where BAD relief may be applicable, care needs to be taken or the relief may be lost.

71.15 Intermediated securities: IHT BPR

The IHT Manual provides:

> **IHTM25193 American Depositary Receipts** [Apr 2023]
> [The manual outlines the nature of ADR/ADS and continues:] ADSs are usually listed on major US exchanges such as the New York Stock Exchange or the Nasdaq. Shares and securities listed on these markets are regarded as 'listed' for HMRC purposes, including Inheritance Tax (IHT) (IHTM18061). These shares and securities are 'quoted' for IHT purposes and only qualify for business relief at 50% if they give the transferor control of the company immediately before the transfer, IHTA84/S105(1)(cc) (IHTM25202).
> Shares in unquoted companies (IHTM25192) may sometimes be exchanged for Depositary Receipts, most commonly ADRs. When this happens, it is necessary to consider whether the property held is the ADSs, as evidenced by the ADRs, or the underlying shares in the company they ultimately represent.
> If the law of the territory or state where the ADRs are issued conclusively determines that the holder of the ADRs is the beneficial owner of the underlying shares, then IHT relief will be available under IHTA84/S104(1)(a).
> If it does not, our approach is that the owner of the ADRs is not the beneficial owner of the underlying shares for IHT. The asset in their estate is the ADSs, evidenced by the ADRs, and business relief is not available unless they gave the owner control of the company as mentioned above.
> This approach follows the decision of the First-Tier Tax Tribunal in the Stamp Duty Reserve Tax case of *HSBC v Commissioners for HMRC* [2012] UKFTT 163 where the tribunal concluded that it was not satisfied that under the law of the State of New York, the holder of an

> HSBC ADR had a beneficial interest in the underlying fund of HSBC shares.

Section 104(1) IHTA provides business property relief:

> Where the whole or part of the value transferred by a transfer of value is attributable to the value of any relevant business property, the whole or that part of the value transferred shall be treated as reduced—
>
> (a) in the case of property falling within section 105(1)(a) [(b) or (bb) below, by 100 per cent;
>
> (b) in the case of other relevant business property, by 50 per cent;

Section 104-105 IHTA defines relevant business property, and (so far as relevant) provides:

> (1) ... "relevant business property" means, in relation to any transfer of value ...
>
> (bb) any unquoted shares in a company;
>
> (cc) shares in or securities of a company which are quoted and which (either by themselves or together with other such shares or securities owned by the transferor) gave the transferor control of the company immediately before the transfer;

There are three points here.

(1) If the ADR is listed, HMRC regard the shares as listed. Whatever the technical analysis, that seems right on a purposive construction.

(2) If the holder of the ADR has a beneficial interest in the securities, the ADR is disregarded for the purposes of BPR; and that is not contentious.

(3) If the holder of the ADR does not have a beneficial interest in the securities, HMRC say that BPR is not available. I doubt if that is consistent with *HMRC v Nelson Dance Family Settlement*[57] but the point will not often arise.

[57] [2009] EWHC 71 (Ch).

CHAPTER SEVENTY TWO

INVESTMENT MANAGER EXEMPTIONS

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72.1 Investment manager exemptions

This chapter considers three related exemptions where an investment manager or broker ("**broker/IM**") acts for a non-resident client.

In order to understand the exemptions, it is helpful first to note the tax issues which a non-resident person would face (in the absence of relief) if it carried on a trade in the UK through a broker/IM. It is necessary to consider separately (1) a non-resident company and (2) a non-resident individual or trust.

In the absence of these exemptions, if a non-resident *company* carried on a trade in the UK through a UK broker/IM, the non-resident company would face a UK tax charge arising from the fact that it might be trading in the UK through a permanent establishment (ie the broker/IM might be an agency PE). If so:

(1) The non-resident company would (in short) be subject to corporation tax on its profits.[1]
(2) The broker/IM would be a "UK representative" and that tax could be collected from it.[2]

Similarly, in the absence of these exemptions, if a non-resident *individual or trust* carried on a trade in the UK through a UK broker/IM, the non-resident would face a UK tax charge arising from the fact that it might be trading in the UK through a branch or agency (ie the broker/IM might be a branch or agency). If so:

(1) The non-resident individual or trust would (in short) be subject to income tax and CGT[3] on its profits.
(2) The broker/IM would be a "UK representative" and that tax could be collected from it.[4]

Alternatively the position might be that the broker/IM was not a branch or agency or PE of the non-resident, but nevertheless the non-resident was trading in the UK. In that case (whether a company or an individual or trust) the non-resident person would in principle[5] be subject to income tax on its trading profits.

Clearly, if there were no relief, non-residents would not use a UK broker/IM (at least if there were a risk that their activities might be characterised as trading). The investment management exemptions override these tax charges. Assuming the various requirements are met the exemptions are as follows:

(1) *IME PE relief:* A broker/IM is not a permanent establishment of a non-resident company. The main significance of this is:
    (a) to disapply the corporation tax charge which applies when a non-resident company trades through a UK PE.

[1] See 21.6 (CT territorial limit: Trading).

[2] See 124.3 (UK representative).

[3] See 56.7 (Trade through UK branch/PE).

[4] See 106.26 (Why branch/agency matters).

[5] In practice a DTA would often provide relief.

(b) to disapply the provisions allowing collection of tax from a PE (as its "UK representative").

(2) *IME UK-representative relief:* A broker/IM is not a UK representative for IT and CGT. The main significance of this is to disapply the rules allowing the collection of IT/CGT from UK representatives of non-residents. This exemption is in chapter 2B part 14 ITA and chapter 7A TCGA.

(3) *IME non-resident IT relief :* UK source income generated through a broker/IM is one of the classes of income which qualifies for non-resident IT relief.[6] This exemption is part of the code of non-resident IT relief set out in Chapter 1 Part 14 ITA. I refer to it as "**IME non-resident IT relief**".

Relief	**Section**
IME PE relief	ss.1145-1151 CTA 2010
IME UK-representative relief	835H-835S ITA
IME non-resident IT relief	816-828 ITA

I refer to the exemptions together as the "**investment manager exemptions**" abbreviated to "**IME**" . (References to investment managers in this label include brokers.) The term used in the HMRC Manuals is "investment management exemption", in the singular. But they are best regarded as three separate (though linked) exemptions.

The rules are written out *four* times in four different places.[7] The rules for brokers are similar to investment managers, but are set out separately each time, so there are eight sets of rules. This does make a coherent exposition rather difficult. Where the rules repeat or overlap, I set out the text of IME non-resident IT relief, citing the statutory equivalents for the other rules in footnotes, unless there are material differences.

It would be simpler and shorter if branch/agency were abolished and the PE rules applied to non-companies just as to companies.[8]

72.1.1 *Policy background*

SP 1/01 explains the policy considerations behind the investment management exemptions:

[6] See 45.1 (Non-residents IT relief: Introduction).

[7] The fourth iteration of the IME is in part 8B CTA 2010 (Northern Ireland Rate), not discussed here.

[8] See 106.28 (Branch/agency: Critique).

> 1. There are two policy objectives underlying the Investment Managers Exemption. These objectives are
> [a] firstly, that an overseas investor should not be brought into UK tax in relation to investment transactions simply because they are conducted on their behalf by a UK resident investment manager, and
> [b] secondly, that any fees earned by a UK resident investment manager for services performed for the non-resident investors should be fully chargeable to UK tax.

The first objective rests on tax competition considerations.[9]

> 2. The UK tax system seeks to achieve these objectives by granting what is termed the Investment Manager Exemption. The exemption enables non-residents to appoint UK based investment managers without the risk of UK taxation and is one of the key components of the UKs continuing attraction for investment managers. HMRC is committed to maintaining this environment by improving the exemption to meet developments in the investment management industry through providing greater flexibility and better explanations for investment managers and expanding the scope of exempt activities.

Other countries adopt the same approach:

> The highly mobile nature of the funds management business suggests that income from portfolio foreign investments flowing to non resident investors should not be taxed in Australia. Even modest amounts of Australian tax on these investors is likely to impede the growth of this business. Only the income of the Australian funds manager should be subject to Australian tax.[10]

72.2 IME PE relief

I discuss IME PE relief in this chapter, though to see the topic in the round one needs to be familiar with the meanings and functions of PE, for which see 106.2 (PE: UK-law/OECD Model meanings).

The key points to bear in mind for present purposes are as follows. Firstly, the term "permanent establishment" is used in different places with different definitions. It is strictly necessary to distinguish between:

(1) "**UK-law PE**" defined in s.1141 CTA 2010.

[9] See 1.3 (Other tax competition).

[10] See "A Platform for Consultation" (Australia, 2010) para 30.61.

(2) "**OECD-model PE**" defined in OECD Model.

Secondly, an independent agent is not a PE (the "**independent agent exemption**"). The wording of the independent agent exemption differs slightly between UK-law PE and OECD-model PE so it is strictly necessary to distinguish between:

(1) "**UK-law independent agent exemption"** defined in s.1142 CTA 2010.

(2) "**OECD Model independent agent exemption**" defined in OECD Model.

Section 1142 CTA 2010 provides:

> (1) A company is not regarded as having a permanent establishment in a territory by reason of the fact that it carries on business there through an agent of independent status acting in the ordinary course of the agent's business.
> (2) Sections 1145 to 1151 apply for the purpose of supplementing subsection (1) in relation to transactions carried out on behalf of a non-UK resident company by a person in the UK acting as—
> (a) a broker (section 1145),
> (b) an investment manager (sections 1146 to 1150)...

Section 1145 CTA 2010 provides IME PE relief for a broker:

> (1) This section applies if a transaction is carried out on behalf of a non-UK resident company in the course of the company's trade by a person in the UK acting as a broker.
> (2) In relation to the transaction, the broker is regarded for the purposes of section 1142(1) as an agent of independent status acting in the ordinary course of the broker's business if (and only if) each of conditions A to D is met. ...

Section 1146 CTA 2010 provides IME PE relief for an investment manager:

> (1) This section applies if an investment transaction is carried out on behalf of a non-UK resident company in the course of the company's trade by a person in the UK acting as an investment manager.
> (2) In relation to the investment transaction, the investment manager is regarded for the purposes of section 1142(1) as an agent of independent status acting in the ordinary course of the investment manager's business if (and only if) each of conditions A to E is met ("the independent investment manager conditions"). ...

If the conditions for IME PE relief are met:
(1) The broker/IM is not a UK-law PE.
(2) It will not normally matter whether the broker/IM is an OECD-model PE.[11]

If the conditions for IME PE relief are *not* met, the broker/IM is not "an agent of independent status acting in the ordinary course of the investment manager's business" and does not qualify for the UK-law independent agent exemption. Thus the broker/IM may be a UK-law PE – if the general requirements of a PE are met, that is, if the broker/IM is "an agent acting on behalf of the non-resident company and has and habitually exercises there authority to do business on behalf of the company". In other words, failure to meet the conditions for IME PE relief disapplies the independent agent exemption, but it does not necessarily follow that the broker/IM is a UK-law PE:
(1) If the broker/IM is not a UK-law PE, it will not normally matter whether the broker/IM is an OECD-model PE.
(2) If the broker/IM is a UK-law PE, it is possible that it is not an OECD-model PE, in which case treaty relief may apply.

These are the complications which arise from having two definitions of PE.

In short, IME PE relief offers a safe harbour, in which a company can be reasonably sure it does not have a PE. SP 1/01 explains:

> 10. The Investment Manager Exemption legislation now only has relevance for corporation tax by providing greater clarity about what constitutes independence of investment managers in relation to the non-residents for which they act.

72.3 IME non-resident IT relief

I discuss the IME aspects of non-resident IT relief in this chapter, though to follow it one needs to be familiar with the background rules of non-resident IT relief, for which see 45.1 (Non-residents income tax relief: Introduction).

SP 1/01 explains:

[11] For completeness: where the conditions for IME PE relief are met, (1) it is likely that the broker/IM is an independent agent, and so not an OECD-model PE; (2) It is not likely that HMRC would seek to argue to the contrary.

> 10. ... For income tax it raises the threshold for chargeability so that the same criteria apply when there is no treaty protection in the form of a permanent establishment article.[12]

For individuals and trustees, non-resident IT relief applies to "disregarded income".[13] This term includes "disregarded transaction income". This is where IME non-resident IT relief comes into play. For individuals and trusts, s.814(1)(2) ITA provides relief for a broker:

> (1) Subsection (2) applies if a non-UK resident carries on (alone or in partnership) a business through a broker in the UK.
> (2) Income is "disregarded transaction income", subject to subsection (6), if—
> (a) it is transaction income, and
> (b) the independent broker conditions are met in relation to the transaction in question.

For individuals and trusts, s.814(3)(4) ITA provides relief for an investment manager:

> (3) Subsection (4) applies if a non-UK resident carries on (alone or in partnership) a business through an investment manager in the UK.
> (4) Income is "disregarded transaction income", subject to subsection (6), if—
> (a) it is transaction income, and
> (b) the independent investment manager conditions are met in relation to the transaction in question.

For non-resident companies the drafting is similar and the result is the same. Non-resident IT relief applies to "disregarded company income". Section 816 ITA provides:

> (1) For the purposes of this Chapter income arising to a non-UK resident company is "disregarded company income" if it is ...
> (c) income arising from a transaction carried out through a broker in the UK acting as an agent of independent status in the ordinary course of the broker's business,
> (d) income arising from a transaction carried out through an

[12] That is, IME non-resident IT relief provides roughly the same relief as article 7 OECD Model: "The profits of an enterprise carried on by a resident of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein."

[13] See 45.5 (Disregarded income).

> investment manager in the UK acting as an agent of independent status in the ordinary course of the investment manager's business, ...

72.4 IME UK-representative relief

I discuss IME UK-representative relief in this chapter, though to see it in the round one needs to be familiar with the UK representative rules, for which see 124.2 (Tax collected from UK representative).

Section 835H ITA provides relief for brokers:

> (1) This section applies if a non-UK resident carries on (alone or in partnership) a business through a broker in the UK.
> (2) The broker is not the UK representative of the non-UK resident in relation to an amount within section 835E(2) if—
> (a) the amount is transaction income in relation to a transaction carried out through the broker in the UK on behalf of the non-UK resident, and
> (b) the independent broker conditions are met in relation to the transaction (see section 835L).

Section 835I ITA provides relief for investment managers:

> (1) This section applies if a non-UK resident carries on (alone or in partnership) a business through an investment manager in the UK.
> (2) The investment manager is not the UK representative of the non-UK resident in relation to an amount within section 835E(2) if—
> (a) the amount is transaction income in relation to an investment transaction carried out through the investment manager in the UK on behalf of the non-UK resident, and
> (b) the independent investment manager conditions are met in relation to the investment transaction (see section 835M).

72.5 IME definitions

72.5.1 *"Investment manager"*

Section 827(1) ITA provides a commonsense definition:

> In this Chapter "investment manager" means a person who provides investment management services.[14]

An investment manager who merely gives advice would not be a PE. However an investment manager with discretionary management powers

[14] The equivalent for IME PE relief is s.1150(1) CTA 2010.

would be a PE, at least if the principal was carrying on a trade.

72.5.2 *"Broker"*

There is no statutory definition. The former International Tax Handbook provided:

> **926. NRs: Machinery of assessment: commodity markets: broker**
> A few words are called for about an important market operator, the broker. London has been a great market for centuries. Until a few decades ago vast amounts of produce were landed in, or trans-shipped in London docks and it was here and in other ports that the markets grew. They are run by Trade Associations which lay down rules designed to secure a fair, orderly and open market; to provide for membership, and to consider things like rates of brokerage. The actual constitution of the different markets varies but one would normally find as members some big producers, some major users, both of whom may have a seat in the market ring, the place of business. But the central character is the broker. A broker is a negotiator for commission, who will sell or buy for clients. Brokers have a long history, but, in modern usage, Bowstead, the writer of the standard work on agency, describes the broker in this way–
>
> > "A broker is an agent whose ordinary course of business is to negotiate and make contracts for the sale and purchase of goods and other property of which he is not entrusted with the possession or control."[15]
>
> Payne, a writer on British Commercial Institutions, says this of an import broker–
>
> > "The function of a broker is to bring two parties together for the purpose of concluding a contract. Brokers are generally produce brokers with whose aid very large transactions take place at the chief importing ports. They are often specialists who, through long experience of markets ... are able to buy and sell to better advantage than could the general import merchant ... he (the broker) is not associated with the physical movement of the goods, nor with clearing them through Customs. After selling a consignment by auction, or by private treaty, the broker is paid a commission or fee (brokerage) which, with the other expenses of sale is deducted from the gross selling price."
>
> Brokers are thus associated with the great commodity markets and exchanges, professional negotiators who will act for buyers and sellers and have nothing to do with the work-a-day business of handling or insuring the goods. They constitute an essential link in the market mechanism, in making the function of the market-place in determining price, available to their clients. Another odd quality of brokers is that the same broker can, by the custom of certain markets, act both for buyer and seller.
>
> This means in practice that if A has asked a broker to sell something and B has asked the same broker to buy the same thing, the broker can match the two. The market rules would require that the broker does this business in the open (so that

[15] Bowstead and Reynolds on Agency, (19th ed., 2013), 1.035.

> any other broker can step in if he wishes) and that preserves the idea of open market dealing and the natural protection which it gives to buyer and seller. Although the broker has acted for both parties the open nature of the market mechanism ensures that the price is a fair market price. ...
>
> **939 NRs: when to accept the TMA 70 s.82 broker exemption - General**
>
> Brokers and general commission agents take a very limited part in the marketing process. They are there to make the advantages of the market-place available to their clients. Whatever the terms mean, we do not accept as a broker or as a general commission agent a man who does everything the client himself would do in running the business were he himself here to do it, even if the agent acts for more than one client. Both expressions are primarily to do with commodity markets and that is what they were really intended for.
>
> But over the years the application of the broker and general commission agent exemption has been extended. Stockbrokers, for example, will generally fall within Section 82(1) [TMA].[16] We have certainly accepted that there can be general commission agents and brokers in the field of shipping and that the exemption is sometimes appropriate. In insurance, on the other hand, we resist the suggestion that an underwriting agent can be a general commission agent. Insurance brokers will not normally be carrying on a non-resident's trade. If it seems that they do then they will arguably be acting in the capacity of underwriting agents and we would deny the exemption. If, in Districts, there are cases outside the usual commodity markets, where exemption under Section 82(1) appears to have been given but this treatment has not definitely and fairly recently, say within the last twenty years, been approved or condoned by International Division, it would be sensible to consider asking for advice on the next convenient occasion.

72.5.3 *"Transaction income"*

Section 814(5) ITA provides the definition:

> In this Chapter "transaction income", in relation to a transaction carried out through a broker or investment manager in the UK on behalf of a non-UK resident, means income which arises to the non-UK resident from—
>
> (a) so much of the non-UK resident's business carried on (alone or in partnership) through the broker or investment manager as relates to the transaction, or
>
> (b) property or rights which, as a result of the transaction, are used by, or held by or for, the broker or investment manager on behalf of the non-UK resident.

[16] Section 82 (now repealed) provided: "Nothing in this Part of this Act shall render a non-resident person chargeable in the name of a broker ...In this subsection, 'broker' includes a general commission agent."

72.6 Investment transaction list

The law is in the following regulations:[17]

Investment Manager (Investment Transaction) Regs 2014 ("IMITR 2014")
Investment Transactions (Tax) Reg 2014 ("ITTR 2014")

The definition of investment transaction comes in two versions:

Definition (my term)	**Regs**	**Applies to**
Funds definition	ITRR	UK tax regimes for funds[18]
IME definition	ITTR & IMITR	IME

HMRC refer to the definition as the "investment transaction list".

72.6.1 *Scope of funds definition*

Reg 2(1) ITTR provides:

> These Regulations specify certain kinds of transactions as investment transactions for the purposes of-
> (a) the Authorised Investment Funds (Tax) Regulations 2006,
> (b) the Offshore Funds (Tax) Regulations 2009,
> (c) the Investment Trust (Approved Company) (Tax) Regulations 2011, and
> (d) the Unauthorised Unit Trusts (Tax) Regulations 2013.

72.6.2 *Scope of IME definition*

Section 827(2) ITA provides:

> In this section "investment transaction" means any transaction of a description specified for the purposes of this section in regulations made by HMRC.[19]

Reg 2 IMITR 2014 provides:

[17] The background can be traced in consultation and response papers "Investment Management Exemption and Collective Investment Schemes - expanding the 'white list'" (2013). A consultation paper proposes to add cryptoassets to this list: HMRC, "Expanding the Investment Transactions List for the Investment Management Exemption and other fund tax regimes" (2022) *https://www.gov.uk/government/consultations/expanding-the-investment-transactions-list-for-the-investment-management-exemption-and-other-fund-tax-regimes*

[18] The regimes are not discussed here. They are: (1) diversely owned authorised investment funds; (2) exempt unauthorised unit trusts; (3) diversely owned reporting offshore funds; (4) approved investment trusts;

[19] IME PE relief equivalent is s.1150(1) CTA 2010.

> (1) Any transaction which falls within the meaning of investment transaction in the Investment Transactions (Tax) Regulations 2014 is specified for the purposes of-
>
> (a) section 827 of the Income Tax Act 2007,
> (b) section 835S of the Income Tax Act 2007, and
> (c) section 1150 of the Corporation Tax Act 2010.
>
> This is subject to paragraphs (2) to (5).

The sections referred to are:

Section	**Topic**
s.827 ITA	IME non-resident IT relief
s.835S ITA	IME UK-representative relief
s.1150 CTA 2010	IME PE relief

Para (2)-(5) lightly amend ITR:

> (2) References in the Investment Transactions (Tax) Regulations 2014 to "fund" are to be treated as references to "non-UK resident" (and the definition of "fund" in regulation 2(3) of those Regulations is to be ignored).
> (3) References in the Investment Transactions (Tax) Regulations 2014 to "manager" are to be treated as references to "investment manager".

72.6.3 *The definitions*

Reg 2 ITTR : Funds definition	**ITTR as amended: IME definition**
(2) An investment transaction means-	[identical]
(a) any transaction in stocks and shares,	[identical]
(b) any transaction in a relevant contract,	[identical]
(c) any transaction which results in a fund[20] becoming a party to a loan relationship or a related transaction in respect of a loan relationship	(c) any transaction which results in a non-UK resident[21] becoming a party to a loan relationship or a related

[20] Reg 2(3) ITTR provides: "For the purposes of these Regulations, "fund" means an authorised investment fund, an offshore fund, an investment trust or an exempt unauthorised unit trust, as the case may be."

[21] Reg 2(4) IMITR provides: ""Non-UK resident" has the meaning given in section 989 of the Income Tax Act 2007 or section 1119 of the Corporation Tax Act 2010, as the case may be."

	transaction in respect of a loan relationship,
(d) any transaction in units in a collective investment scheme,	[identical]
(e) any transaction in securities of any description not falling within paragraphs (a) to (d),	[identical]
(f) any transaction consisting in the buying or selling of any foreign currency,	[identical]
(g) any transaction in a carbon emission trading product,	[identical]
(h) any transaction in rights under a life insurance policy.	[identical]

The definition(s) of investment transaction are identical, with amendments only to fit the different contexts.

The label "*investment* transaction" is not strictly appropriate: the transaction will be a *trading* transaction and the so-called investment will be trading stock.[22] But it does not matter, and perhaps the objection is pedantic.

Terms used in the definition(s) are in turn defined as follows:

Term	**ITTR reg**	**Amended IMITR**
Relevant Contract	3	-
Loan relationship[23] & related transaction	4	-
Units in CIS	5	2(5)
Carbon emission trading product	6	-

I do not consider these definitions here.

72.7 Investment manager conditions

For IME non-resident IT relief, s.818(1) ITA provides:

> The independent investment manager conditions are met in relation to an investment transaction carried out on behalf of a non-UK resident by an investment manager in the UK if conditions A to E are met.

[22] See 72.15.1 ("Investment": Terminology).

[23] See 64.5.1 ("Loan relationship").

For IME PE relief, s.1146 CTA 2010 provides:

> (1) This section applies if an investment transaction is carried out on behalf of a non-UK resident company in the course of the company's trade by a person in the UK acting as an investment manager.
> (2) In relation to the investment transaction, the investment manager is regarded for the purposes of section 1142(1) as an agent of independent status acting in the ordinary course of the investment manager's business if (and only if) each of conditions A to E is met ("the independent investment manager conditions").

I refer to these as "**investment manager conditions A to E**".

72.8 Cond. A/B: Investment manager

Section 818 ITA provides:

> (2) Condition A is that at the time of the transaction the investment manager is carrying on a business of providing investment management services.
> (3) Condition B is that the transaction is carried out in the ordinary course of that business.[24]

These are the equivalent of broker conditions A and B.

72.9 Cond. C: Independence test

Section 818(4) ITA provides:

> Condition C is that, when the investment manager acts on behalf of the non-UK resident in relation to the transaction, the relationship between them, having regard to its legal, financial and commercial characteristics, is a relationship between persons carrying on independent businesses dealing with each other at arm's length.[25]

SP 1/01 calls this the independent capacity test.

The requirement is equivalent to the rule that an independent agent is not a PE. According to the INTM, an agent's "legal financial and commercial characteristics" is relevant to determine whether the agent has "independent status" (so as to qualify for the independent agent exemption to the PE rule). So guidance on what is an independent agent for PE is relevant to condition C.[26]

[24] The equivalent for IME PE relief is s.1146(3)(4) CTA 2010.

[25] The equivalent for IME PE relief is s.1146(5) CTA 2010.

[26] See 106.16 (Independent agent exemption).

This is imprecise, so the SP offers two (relatively) bright line tests which may offer a safe harbour for collective funds:

(1) widely held funds
(2) 70% test

If neither bright line test is satisfied, one is back to the vagueness of the law. SP 1/01 provides:

> 41. If none of the above tests are satisfied HMRC will have regard to the overall circumstances of the relationship between the non-resident and the investment manager in determining whether they are carrying on independent businesses that deal with each other on arms length terms. It is not possible to describe every scenario in which the relationship may still meet this test but the guidance in this Statement of Practice should provide certainty to the vast majority of non-residents trading in the UK through an investment manager and HMRC will also continue to provide advice for any other circumstances.

72.9.1 *Widely held fund*

SP 1/01 provides:

> 36. The relationship will be considered to be independent if the non-resident has the following characteristics:
> (a) the non-resident is a widely held collective fund or, if not,
> (b) the non-resident is not a widely held collective fund but is either being actively marketed with the intention that it become one or is being wound up or dissolved.
>
> 37. A fund will be regarded as widely held if
> [a] either no majority interest in the fund is ultimately held by five or fewer persons and persons connected with them, or
> [b] no interest of more than 20% is held by a single person and persons connected with that person.
>
> A fund may need to establish a track record before new investors are obtained and will therefore have 18 months from the commencement of trading in the UK to meet the widely held test.
>
> Where investment management services are provided to a collective investment scheme constituted as a partnership, participants in the scheme will not be regarded as connected persons for this purpose if their only connection is membership of the partnership. This means that if the investment manager is a partner in the fund it will not be treated as connected with the other partners in the fund for the purpose only of the Independent Capacity Test, although there may still otherwise be connection under s 993 ITA 2007 between the participants, for example

as partners in another capacity.

38. Actively marketed means there must be evidence of ongoing genuine attempts to obtain third party investment into the fund in order to meet the widely held test and that the terms on which interests in the fund are offered are not prohibitive or discriminatory for that class of business.

39. If the fund has one of the above two characteristics the independent capacity test will be met without the need to refer to any other factors.

72.9.2 *70% test*

SP 1/01 provides:

> 40. In other cases the independent capacity test will be met:
>
> (a) where the provision of services to the non-resident and persons connected with the non-resident is not a substantial part of the investment management business. Where that part does not exceed 70% of the investment managers business, either by reference to fees or to some other measure (where that would be more appropriate), it will not be regarded as substantial.

There is special provision for start-ups. SP 1/01 provides:

> 40. In other cases the independent capacity test will be met ...
>
> (a) ... Further, if in the first 18 months from the start of a new investment management business the services provided to the non-resident exceed 70% of the business, they will not be treated as a substantial part of the business provided that they are consistently below 70% in subsequent periods.
>
> (b) where the provision of services to the non-resident represents more than 70% of the investment managers business 18 months after the start of a new investment management business but
>
> [i] that was for reasons outside the managers control and
>
> [ii] the manager had taken all reasonable steps to bring it below 70%.
>
> The investment manager will be expected to provide all relevant information to support a contention that the services are a substantial part of the manager's business for reasons beyond the managers control and to demonstrate what steps have been taken to rectify that position.

72.9.3 *Feeder funds and sub-funds*

SP 1/01 provides:

> 42. Some funds adopt a master/feeder structure. Where the investment

> manager manages an opaque master fund, such as a company, which has feeder funds then the independence test will be applied as if the master fund were transparent by looking at the beneficial ownership of each feeder fund (and applying the provisions of this Section A to the aggregate interests in the feeder funds) to determine whether the master fund is independent.
>
> 43. Similarly, if the investment manager acts for one or more sub-funds of an umbrella fund it is the beneficial ownership of the latter (applying the provisions of this section A to the interests in the umbrella fund) that will determine whether the independence test is met.

72.9.4 *Parent/subsidiary*

SP 1/01 provides:

> 44. It should be noted that a subsidiary may be considered independent of its parent company for the purposes of the test, notwithstanding the parents ownership of the share capital.

See 106.17.1 (Control by principal).

72.10 The 20% rule

Section 818(5) ITA provides:

> Condition D is that the requirements of the 20% rule are met (see s.819).[27]

SP 1/01 calls this "the 20% test". A clearer label would be the 20% beneficial owner rule; but it is best to use the wording of the statute. Section 819(1) ITA provides:

> The requirements of the 20% rule are met if conditions A and B are met.[28]

I refer to these as "**20% rule conditions A and B**". Section 819(2) ITA defines condition A:

> Condition A is that in relation to a qualifying period[29] it has been or is

[27] The equivalent for IME PE relief is s.1146(6) CTA 2010.

[28] The equivalent for IME PE relief is s.1147(1) CTA 2010.

[29] Section 820 ITA provides:

> "(1) This section applies for the purposes of this Chapter.
>
> (2) If section 819 applies for the purposes of section 813, a "qualifying period" means—
>
> (a) the tax year in which the transaction income is chargeable to income tax, or

> the intention of the investment manager and the persons connected with the investment manager that at least 80% of the non-UK resident's relevant disregarded income should consist of amounts to which none of them has a beneficial entitlement.

Section 819(3) ITA defines condition B:

> Condition B is that, so far as there is a failure to fulfil that intention, that failure—
>
> (a) is attributable (directly or indirectly) to matters outside the control of the investment manager and persons connected with the investment manager, and
>
> (b) does not result from a failure by any of them to take such steps as may be reasonable for mitigating the effect of those matters in relation to the fulfilment of that intention.[30]

SP 1/01 provides:

> 48. The 20% test is treated as satisfied throughout any period, not exceeding five years, for which it is met in respect of the total taxable income of the period arising from transactions carried out through the investment manager. It is also treated as satisfied if the manager intended to meet that test but failed to do so, wholly or partly, for reasons outside the managers control, having taken any reasonable steps to fulfil that intention. This means that the manager must fulfil the intention to keep its beneficial entitlement within 20% of the total taxable income for the period insofar as it is reasonable to do so, but is not required to get within that figure at any cost, for instance where there are good commercial reasons for not achieving.

72.10.1 *"Relevant disregarded income"*

For IME non-resident IT relief, s.821 ITA provides:

> (1) This section applies for the purposes of this Chapter.

(b) a period of not more than 5 years comprising two or more tax years including that one.

(3) If section 819 applies for the purposes of section 816, a "qualifying period" means—

(a) the accounting period of the non-UK resident company in which the transaction in question is carried out, or

(b) a period of not more than 5 years comprising two or more complete accounting periods including that one."

[30] The equivalent for IME PE relief is s.1147(2)(3) CTA 2010.

There are two definitions, one for individuals/trusts and another for companies. It is easier to follow if they are read side by side:

s.821(2)(4): trusts/individuals	**s.821(3)(5): companies**
(2) If section 819 applies for the purposes of section 813,[31]	(3) If section 819 applies for the purposes of section 816,[32]
the "relevant disregarded income" of the non-UK resident for the qualifying period is the total of the non-UK resident's income for the tax years comprised in the qualifying period which derives from the transactions mentioned in subsection (4).	the "relevant disregarded income" of the non-UK resident company for the qualifying period is the total of the non-UK resident company's income for the accounting periods comprised in the qualifying period which derives from the transactions mentioned in subsection (5).
(4) The transactions referred to in subsection (2) are investment transactions—	(5) The transactions referred to in subsection (3) are transactions—
(a) carried out by the investment manager on the non-UK resident's behalf, and	(a) [identical]
(b) in relation to which the independent investment manager conditions are met, ignoring the requirements of the 20% rule.	(b) in relation to which the investment manager does not fall to be treated as a permanent establishment of the non-UK resident company, ignoring the requirements of the 20% rule.

Section 1148(4)(5) CTA 2010 provides the equivalent for IME PE relief in identical wording.

72.10.2 *"Beneficial entitlement"*

For IME non-resident IT relief, s.822(1) ITA provides:

> This section applies for the purposes of this Chapter.

In fact the expression "beneficial entitlement" only appears in 20% rule

[31] This applies to individuals and trusts: see 45.5 (Disregarded income).

[32] This applies to companies: see 45.5 (Disregarded income).

condition A, so the definition is only needed for that purpose.

> (2) A person has a "beneficial entitlement" to relevant disregarded income if the person has or may acquire a beneficial entitlement that is, or would be, attributable to the relevant disregarded income as a result of having an interest or other rights mentioned in subsection (3).
> (3) The interests and rights referred to in subsection (2) are—
> (a) an interest (whether or not an interest giving a right to an immediate payment of a share in the profits or gains) in property in which the whole or any part of the relevant disregarded income is represented, or
> (b) an interest in, or other rights in relation to, the non-UK resident.

Section 1148 CTA 2010 provides the equivalent for IME PE relief.

72.10.3 *20% rule: HMRC practice*

SP 1/01 provides:

> 45. In essence the requirement is that the investment manager and persons connected with it, including connected charities, must not have a beneficial entitlement to more than 20% of the non-residents chargeable profit arising from transactions carried out through the investment manager. The definition of connected persons is that in s 993 ITA 2007.
> 46. Management fees paid to the investment manager and persons connected with it are not included in the chargeable profit provided they would be allowable in computing the profit of the non-resident were it chargeable to UK tax. This applies equally to incentive fees, performance fees or incentive allocations which are calculated by reference to any increase in the net asset value or profits of the relevant non-resident. This treatment of incentive allocations is explained further below...
> 49. This is an example of how the test may be met throughout a period of five years:

Years	**1**	**2**	**3**	**4**	**5**
Taxable income of non-resident	£100	£200	£200	£250	£250
Entitlement of manager to above	£32	£58	£40	£35	£5
Expressed as % for each year	32%	29%	20%	14%	2%
Average % over qualifying period	32%	30%	26%	22%	17%

> It may be assumed that the test is satisfied for year one because (a) in this example it was the managers intention to have a beneficial entitlement to an average of 20% or less in aggregate over a five year

period and (b) that intention was fulfilled. Had the 20% beneficial entitlement been achieved before the five years were up, then that shorter period would have been the qualifying period. A second qualifying period of up to five years could include years 2, 3, 4, 5 and 6 and so on.

50. As with any other tests for the exemption, unless specified otherwise, the UK tax rules regard companies, including LLCs, as opaque and the CTA 2010 rules apply. Partnerships (including LLPs to which s 863 ITTOIA/1273 CTA 2009 apply) are transparent for income and corporation tax purposes: CTA 2010 rules will apply to partners within the charge to CT and ITA 2007 to partners within the charge to IT. In addition, the rule for non-resident companies at s1149 CTA 2010 treats partnership collective investment schemes in which they invest as assumed companies for the purposes of the 20% test.

51. Non-UK resident investors in a fund which is structured as a partnership will be partners and participants in the fund. Where a non-resident is connected to the investment manager the 20% test would be automatically broken since all the non-resident participants would be connected to the investment manager under s 993(4) ITA 2007 by virtue of their being partners in the same partnership. The investment manager and connected persons would then be entitled to all the income of that non-resident. Accordingly, where the investment management services are provided to a collective investment scheme (as defined in the Financial Services and Markets Act 2000) the 20% test is applied by looking at the scheme as a whole rather than at the individual participators. It is not then relevant that the investment manager may be connected to the non-resident as partner (s.835Q ITA 2007 and s.1149 CTA 2010) or that the non-resident participants themselves carry on a financial trade as the availability of the exemption is instead tested solely by reference to the nature of the activities of the notional company represented by the scheme.

52. In certain circumstances the investment manager may be connected with the participants because both are partners in one or more partnerships which have an interest in the fund in question. Where the 20% test is failed as a consequence of aggregating the managers income with that of certain partners who are not connected persons otherwise than as a result of s 993(4) ITA 2007, ie by being partners in a partnership, the failure will be regarded as a failure under s.835N ITA 2007 and s.1147 CTA 2010 to fulfil an intention to satisfy the test. But in certain situations that failure will be considered as:

(a) attributable to matters outside the control of the manager and persons connected with it; and

(b) as not being the result of a failure to take reasonable steps to

> mitigate the effect of those matters in relation to the fulfilment of that intention.
>
> In those situations the 20% test will be met. The legislation will be applied in this way where:
>
> – the connected persons are partners other than solely in a fund under consideration; and
>
> – partnership is the only reason that the manager is connected with them.

This is a fudge to avoid undesirable consequences of the ultra-wide definition of connected person.[33]

> 53. Where overseas pension funds are set up under trust the trustees do not have beneficial ownership of the pension fund income although they may be the legal owners. The 20% test will not therefore apply where the trustee is connected to the UK investment manager. In practice it would be unusual for an overseas pension fund to be carrying on a financial trade.
>
> ...[34]
>
> 55. Some non-residents remunerate investment managers with profit or incentive allocations and in consultations HMRC, investment managers and advisors reached a consensus that these are performance fees in substance. As such, these are income in nature and where they are recognised by the UK manager as fee income the allocations may be treated as fees payable by the non-resident when computing the chargeable profit. Furthermore, where HMRC is satisfied that some of the allocations are due to an overseas service provider as remuneration for those services at the arms length rate those allocations will have the same treatment in computing relevant excluded income.
>
> 56. Deferred fees, or securities or interests provided as reward, may in turn generate some form of return. The legislation draws no distinction between the forms in which the profits of the fund are attributed to deferred fees or other investments as the test is based on beneficial entitlement to the chargeable profits of the non-resident and if the managers beneficial entitlement to those profits, including the return on the securities, interests or deferred fees, exceeds 20% the test will not have been met.
>
> 57. Options to acquire any securities or interests in the non-resident, within the meanings at s 420 ITEPA 2003, need only be considered in the context of the 20% test when the options are exercised.

[33] See 104.8 (Width of definition).

[34] The paragraph omitted here discusses “control”; see 104.3.3 General control).

> 58. Some investments in a non-resident may be linked to structured products issued to customers which provide a return based on the performance of the non-resident, an example of which would be a bank investing in a non-resident fund and selling a product to a customer on which the return is linked to the performance of the fund. In such circumstances the beneficial entitlement to the income of the non-resident remains with the investor in the non-resident, in this example the bank, and not the holder of the structured product, such as the customer.

72.10.4 *Position if 20% rule not met*

Section 823 ITA provides:

> (1) This section applies in the case of an investment transaction in relation to which the independent investment manager conditions are met, except for the requirements of the 20% rule.
>
> (2) This Chapter has effect as if the requirements of that rule were met in relation to the transaction but only in relation to—
>
> (a) so much of the transaction income of the non-UK resident as falls within subsection (3), if this section applies for the purposes of section 813, or
>
> (b) so much of the income of the non-UK resident company deriving from the transaction as falls within subsection (3), if this section applies for the purposes of section 816.
>
> (3) Income falls within this subsection if it does not represent income—
>
> (a) which is relevant disregarded income of the non-UK resident, and
>
> (b) to which the investment manager or a person connected with the investment manager has or has had any beneficial entitlement.

SP 1/01 provides:

> 47. Where the 20% threshold is exceeded, the part of the income of the non-resident to which the investment manager and connected persons are beneficially entitled is excluded from the limitation of charge. The limitation of charge will apply to the part to which they are not beneficially entitled provided the other tests in the investment manager provisions are met.

72.10.5 *20% rule: mutual funds*

Section 824 ITA provides:

(1) This section applies if amounts arise or accrue to the non-UK resident as a participant in a collective investment scheme.[35]

(2) It applies for the purposes of determining whether the requirements of the 20% rule are met in relation to a transaction carried out for the purposes of the scheme [(so far as the transaction is one in respect of which such amounts so arise or accrue)]1.

(3) In applying this section make the following assumptions—

(a) that all the transactions carried out for the purposes of the scheme are carried out on behalf of a company ("the assumed company") which is—

(i) constituted for the purposes of the scheme, and

(ii) non-UK resident, and

(b) that the participants do not have any rights in respect of the amounts arising or accruing in respect of those transactions, other than the rights which, if they held shares in the assumed company, would be their rights as shareholders.

(4) If the scheme is such that the assumed company would not be regarded for tax purposes as carrying on a trade in the United Kingdom in relation to the appropriate relevant period,[36] the requirements of the 20% rule are treated as met in relation to a transaction carried out for the purposes of the scheme.

(5) If the scheme is such that the assumed company would be so regarded for tax purposes, sections 819 to 823 have effect in relation to a transaction carried out for the purposes of the scheme with the modifications in subsection (6).

(6) The modifications are—

(a) for references to the non-UK resident substitute references to the assumed company, and

(b) for references to the non-UK resident's relevant disregarded income for a qualifying period substitute references to the sum of the amounts that would, for relevant periods[37] comprised in

[35] Section 824(7) incorporates the FSMA definitions of participant and CIS; see 66.2 (Participant/participate); 66.3 (Mutual fund/CIS/OIEC).

[36] Section 824(7) provides: "In this section—
"the appropriate relevant period" is—
(a) the tax year in which the transaction income is chargeable to income tax, if this section applies for the purposes of section 813, or
(b) the accounting period in which the transaction is carried out, if this section applies for the purposes of section 816,"

[37] Section 824(7) provides: "In this section—
"relevant period" means—

> the qualifying period, be chargeable to tax on the assumed company as profits deriving from the transactions—
> (i) carried out by the investment manager, and
> (ii) assumed to be carried out on behalf of the company.

72.10.6 *20%/independence test interaction*

SP 1/01 provides:

> 59. The independence test and the 20% test apply quite separately. For example, a UK investment manager acts for an overseas trading fund constituted as a company. If the investment manager is not acting in an independent capacity in relation to the fund company then the whole of the income of the fund is liable to assessment. If the independence test is satisfied, then the 20% test must be separately addressed. If the investment managers interest in the fund company is 25% then that share of the funds trading income is liable to assessment.

72.11 Cond. E: Customary remuneration

Section 818 ITA(6) provides:

> Condition E is that the remuneration which the investment manager receives in respect of the transaction for the provision of investment management services to the non-UK resident is not less than is customary for that class of business.

SP 1/01 calls this "the customary rate test"

This is the equivalent of broker condition C. It overlaps with investment manager condition C since an arm's length relationship would normally involve customary remuneration.

SP 1/01 explains the meaning of "customary remuneration":

> 60. The UK investment manager must receive remuneration at a rate that is not less than customary for the services. The legislation does not define what is customary nor does it specify from whom remuneration must be received although, as already explained, HMRC will not regard a UK investment manager as acting in an independent capacity on behalf of the non-resident unless the relationship between them is that of persons carrying on independent businesses and dealing with each other at arms length.
> 61. HMRC will be guided by the OECD Transfer Pricing Guidelines for

(a) a tax year, if this section applies for the purposes of section 813, or
(b) an accounting period, if this section applies for the purposes of section 816.

Multinational Enterprises and Tax Administrations when determining whether a pricing structure applies the customary rate and will look at whether the net effect of any provision made or imposed by means of a transaction or series of transactions provides the UK investment manager with a level of remuneration which would have been achieved at arms length. All circumstances will be taken into consideration, including whether that remuneration has been reduced below the arms length rate in any way either before or after payment to the UK investment manager.

62. HMRC recognises that remuneration structures through which the non-resident pays fees in a particular class of investment management take numerous forms, with variations including, for example, investment terms intended to attract certain investors or to lock in an investment. The arms length definition of customary rate for the independent investment manager means that such arrangements between unconnected parties would not jeopardise this test. Transactions made at arms length may include directly or indirectly reduced or rebated fees for unconnected investors in the non-resident. Similarly, rebated, reduced or zero fee arrangements which are made between the manager and the unconnected non-resident for genuine commercial reasons, such as where the manager is receiving a separate fee in respect of the assets in which the non resident is investing, would be regarded as transactions made at arms length.

63. In determining whether remuneration has been reduced below the arms length rate in any way HMRC will consider both the remuneration received by the UK investment manager and any amounts payable to any person:

- for services provided to the non-resident, or
- in connection with the non-resident, or
- that relate to the performance of the non-resident.

These amounts, which may be payable by either the non-resident or the UK investment manager, will be treated as reducing the remuneration received in the UK below the customary rate unless they can be shown to be at an arms length rate.

64. HMRC consider that in order to meet the customary rate test fees payable to a UK investment manager should be recognised for UK tax purposes when earned. A cash payment may be deferred or reinvested in the fund but this should not affect the recognition of the fee income. As a result, the UK manager would pay tax on the fee for the period when earned and no difficulty with the customary rate test is envisaged in these circumstances. If cash settlement of management fees is deferred the manager may have effectively made a loan to, or investment in, the non-resident, as a result of which the return on that loan or investment

> would be attributable to the manager and may need to be taken into account for the 20% test.

Paras 64 onwards do not stand up to much examination.

> 65. Where a UK investment manager, a partner, LLP member, director or employee of that manager, or a person connected with any of these, acquires a security or an interest of some other kind, in the non-resident or in another entity, for services provided by the manager:
> – to the non-resident
> – in connection with the non-resident
> the customary rate test will only be met if it can be shown that the manager, partner or LLP member brings the security or other interest into charge to UK tax at its market value or, in the case of a director or employee, that the security or other interest is taxed as employment income in accordance with Part 7 ITEPA 2003. The definition of security here will be that found in s420 ITEPA 2003. An interest is intended to apply to an interest in a security or securities and any other interest not within the s420 ITEPA definition.
> 66. Where an option is brought into UK tax charge at full market value at the time it is exercised HMRC will not regard this remuneration as less than the arms length rate for the purposes of the customary rate test.
> 67. Preferential investment terms involving reduced or rebated fees for directors or staff of the investment manager may be a benefit provided by reason of employment and thus may give rise to an employee income tax charge under ITEPA 2003. Similarly, where the investment manager is a partnership, preferential fee terms may be offered to partners who acquire interests in the non-resident, in which case the ensuing personal tax consequences will apply. HMRC will not ordinarily regard these terms as reducing the investment managers fees for services below the arms length amount unless significant UK tax avoidance or evasion is suspected, in which case all the facts and circumstances will be considered to determine whether the rate of remuneration is below the arms length amount.
> 68. The vast majority of non-residents easily meet the customary rate test. However, HMRC has occasionally encountered structures in which offshore arrangements have been used to evade or avoid UK tax. Commonly, such structures involve arrangements whereby fees charged to the non-resident are diverted to an offshore vehicle at a non-arms length rate. Such arrangements represent an abuse of the exemption, place compliant[38] UK managers at a competitive disadvantage and may

[38] For this contested use of the word “compliant” see App 1.4 (“Compliant”).

> result in a non-resident failing to meet the terms of the exemption unless remedial action is taken.

The SP then turns to consider what evidence may be required:

> 69. HMRC has published guidance in its International Manual on what documentation and evidence is required to demonstrate an arms length reward. At the time of publication of this Statement that guidance appears at INTM483030 and it is advisable to check that the most up to date advice is being followed.
>
> 70. The legislation considers the obligations and liabilities of the non-resident and whether the non-resident is exempt from UK tax on its UK trading profits. A non-resident may be a taxable person and in considering whether that is the case, and whether the UK agent has been rewarded with an arms length rate, it may be appropriate in some circumstances for HMRC to ask for information such as statutory financial statements of the non-resident and its agents and a full and factual functional analysis of all services provided to the non-resident.
>
> 71. In circumstances where such information is requested to ascertain whether the remuneration has been at the customary rate HMRC would normally ask the UK investment manager, but in some circumstances may ask the non-resident, to provide such information as may reasonably be considered necessary. The information powers available to HMRC would include those relevant to the tax liabilities of the non-resident but where reasonable co-operation is provided by the UK investment manager and/or, where appropriate, the non-resident it is intended that a reasonable opportunity will be given to supply the information voluntarily before the use of information powers is considered.
>
> 72. Where appropriate documentation, including a factual functional analysis and an acceptable transfer pricing methodology, is in place to support a tax return, the investment manager will have an opportunity to agree an adjustment to the return to meet the customary rate test or for any other reason, or to have adjustments determined through litigation where such an agreement has not been reached, without the non-resident having thereby failed the customary rate test.
>
> 73. However, where the investment manager does not have the appropriate documentation and methodology in place at the time of making a return and the remuneration for that period is less than the arms length rate, it is possible that the customary rate test has not been met. HMRC would expect the non-resident and the investment manager to ensure that adequate measures are taken to prevent the fund or its investors being exposed to UK tax and will give reasonable notice of possible action, and the reasons for it, to both the non-resident and its

> agents if it discovers any circumstances in which the non-resident may not have met the Investment Manager Exemption tests.
> 74. Each case will be considered on its own facts and it is possible that appropriate corrective action through adjustment to the customary rate will still enable the test to be met. It is not possible to describe every scenario but this general approach is intended to provide certainty on what the legislation requires and to reassure non-residents that a disproportionate outcome will not arise from a corrected failure to meet the test.

72.12 Independent broker conditions

Section 817 ITA provides:

> (1) The independent broker conditions are met in relation to a transaction carried out on behalf of a non-UK resident by a broker in the UK if—
> (a) conditions A to D are met, if this section applies for the purposes of section 813 [individuals/trustees], or
> (b) conditions A to C and E are met, if this section applies for the purposes of section 816 [companies].

I refer to these as "**broker conditions A to E**".

72.12.1 *Cond. A/B: Broker business*

Section 817 ITA provides:

> (2) Condition A is that at the time of the transaction the broker is carrying on the business of a broker.
> (3) Condition B is that the transaction is carried out in the ordinary course of that business.

The former International Tax Handbook provided:

> **940. NRs: accepting TMA 70 s82 broker exemption: in course of business**
> The exemption in Section 82(1) applies only to transactions which the broker carries out (on behalf of the non-resident) "in the ordinary course of his business as such". In modern times it has become common for brokers to extend their business beyond mere "broking" but it does not follow that, just because what they do is now customarily done by brokers, they do it in the ordinary course of their business as brokers. Thus stockbrokers and commodity brokers often provide investment management schemes for clients. But investment management does not thereby become an ordinary function of a broker. However, there are

> special provisions for investment managers which are considered in ITH951.

72.12.2 *Condition C: Remuneration*

Section 817(4) ITA provides:

> Condition C is that the remuneration which the broker receives in respect of the transaction for the provision of the services of a broker to the non-UK resident is not less than is customary for that class of business.

72.12.3 *Cond. D: UK representative*

Section 817(5) ITA provides:

> Condition D is that the broker does not fall for the purposes of Chapter 2B of this Part, or of Chapter 1 of Part 7A of TCGA, to be treated as a UK representative of the non-UK resident in relation to
> [1] any other income which is chargeable to income tax, or
> [2] amounts which are chargeable to capital gains tax,
> for the same tax year as the transaction income.

This condition applies to individuals/trustees and not to companies.

72.12.4 *Cond. E: Permanent establishment*

Section 817(6) ITA provides:

> Condition E is that the broker does not fall to be treated as a permanent establishment of the non-UK resident company in relation to any other transaction of any kind carried out in the same accounting period of the non-UK resident company as the transaction in question.

The wording is the equivalent of broker condition D for companies (using the company tax concept of PE rather than the individual/trustee concept of branch/agency).

72.13 Transactions through broker

Section 828 ITA provides:

> (1) For the purposes of this Chapter a person is regarded as carrying out a transaction on behalf of another if the person—
> (a) undertakes the transaction, whether on behalf of or to the account of the other, or
> (b) gives instructions for it to be so carried out by another.

> (2) In the case of a person who acts as a broker or investment manager as part only of a business, this Chapter has effect as if that part were a separate business.

72.14 Relevance of trading to IME

The question whether the non-resident client is trading is crucial for the IME. Unless the non-resident client is trading, the three IME exemptions are not needed:

(1) In the absence of a trade, a non-resident company is not subject to CT even if it has a permanent establishment and so the company does not have to rely on IME PE relief.

(2) In the absence of a trade, there can be no UK representative and the non-resident does not need to rely on IME UK-representative relief.

(3) In the absence of a trade, non-residents may qualify for non-resident IT relief and do not have to rely on IME non-resident IT relief.

SP 1/01 acknowledges this:

> 14. The Investment Manager Exemption legislation has no relevance unless the non-resident is trading in the UK.
> 15. If the transactions carried out through the investment manager are part of the trade carried on by the non-resident then, unless the [IME] tests ... are satisfied ... the income from that trade, including any profit from the realisation of securities, for example, is taxable. ...

72.15 What is a financial trade?

For general discussion of the concept of trade, see App.2.23 (Trade). I consider here when there is a trade of dealing in securities, options and futures (which I abbreviate to securities, "financial assets" or "financial transactions"); and the related question of when gambling is a trade.

The trading/non-trading distinction is important here, for non-resident individuals, trusts and companies; but it is elusive.

72.15.1 *"Investment": Terminology*

"Investment" or "investing" is a word with several meanings.[39]

[39] For discussion of this terminology in a commercial context see Graham & Dodd, *Security Analysis* (6th ed., 2009), chap 4 (distinctions between investment and speculation). For discussion in a UK tax context, see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 6.8 (Investment) online version *https://www.taxationofcharities.co.uk*

In one sense all securities are "investments". We have investment managers, investment brokers and investment companies or trusts. This is convenient and common usage. However two distinctions are sometimes drawn which narrow the meaning of "investment":

Investment/gambling distinction: A distinction is sometimes drawn between:
(1) investing in securities and
(2) gambling or speculating.

I discuss the meaning of "gambling" and "speculating" below. The point here is that gambling or speculating (whatever that means) is not (in some sense of the word) investing.

Investment/trading distinction: For tax purposes a distinction is drawn between:
(1) investing in securities and
(2) *trading* in securities. (In tax terminology "dealing" is an informal synonym of trading, but I think it is clearer to use the statutory term.)

The point here is that trading (whatever that means) is not investing (in some sense of the word). In this sense, which is strictly correct tax terminology, a trader is not "investing" and holds securities as trading stock and not as "investments". I stress this because one often finds the word "investment" used in a trading context.[40] HMRC agree. The Crypto Manual provides:

> **CRYPTO20250: What is trading** [Apr 2021]
> It's often the case that individuals and companies entering into transactions consisting of buying and selling tokens will describe them as 'trades'. However, the use of the term 'trade' in this context is not sufficient to be regarded as a financial trade for tax purposes.

This is not surprising because in the finance industry, the terms "investing", "trading" and "dealing" are all used as synonyms: brokers and investment managers do not draw the tax distinction.

In the absence of trade, a financial transaction is usually investment, and the trading/non-trading tax distinction can be described as a trading/investment distinction. This has been doubted:

> [Counsel for HMRC] mildly criticised para 11 for having posed the

[40] See 72.6 (Investment transaction list).

> question 'trade or no trade?' but then, having treated that as equivalent to 'trade or investment?' I think there is some force in that criticism, since the word 'investment' has many shades of meaning, both in taxing statutes and elsewhere ....[41]

This is strictly correct. Non-financial transactions may easily be non-trade and non-investment. The purchase of a lunch-time sandwich, for instance, is neither trade nor investment. Financial transactions may also be non-trading and non-investment. There may be a gap. (In particular, financial transactions have sometimes been described as "gambling" and classified as neither trading nor investment.) However, for most practical purposes that can be disregarded, and in the context of financial transactions, the trade/non-trade distinction can be regarded as equivalent to trade/ investment distinction.

This discussion of terminology does not identify the dividing line between trading and investment, but it is a necessary start if we are to know what we are talking about.

72.15.2 *Principles*

The principles are summarised in *Cooper v C & J Clark*:

> [1] First, marketable securities, being income-yielding assets usually capable of appreciating in value, are prima facie purchased and sold by way of investment and not by way of trade.
> [2] Secondly, a series of purchases and sales may sometimes, if carried out pursuant to a deliberate and organised scheme of profit-making, amount to a trade.
> [3] Thirdly, it is easier to characterise a series of purchases and sales as a trade in a case where they are made by a trading entity[42] as opposed to an individual.
> [4] Fourthly, in the case of a trading entity that characterisation is more easily made where the purchases and sales are substantial in relation to

[41] *Wannell v Rothwell* 68 TC 719 at p.730.

[42] By "trading entity" it is not entirely clear whether the judge had in mind:
(1) an entity carrying on a trade apart from any financial transactions (such as the taxpayer company in *C&J Clark*, which manufactured shoes); or
(2) any company entitled to carry on a trade, whether or not it carries on any activity apart financial transactions.
The general rule is that it is easier to characterise a series of purchases and sales as a trade in any case where they are made by a company entitled to carry on a trade. See 72.15.4 ("Gambling").

> its other activities, all the more so where they are of frequent occurrence and extend over a long period of time.[43]

This is uncontentious and helpful as far as it goes.

72.15.3 *"Speculative" transactions*

Cooper v C & J Clark continues:

> Fifthly, it is sometimes helpful, although not decisive, to ask whether a series of sales and purchases is speculative or not. The reason why the question is sometimes helpful is that the answer may throw light in one direction or the other, but it is not decisive because according to the circumstances either a trade or a course of investment may be speculative.[44]

What does speculative mean? Graham & Dodd canvas various possible definitions, and suggest the following "as in harmony with the popular understanding of the term and the requirements of reasonable precision":

> An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative.[45]

[43] 54 TC 670 at p.676.

[44] 54 TC 670 at p.676.

[45] Graham & Dodd, *Security Analysis* (6th ed., 2009), p.106.
Fred Schwed Jr gives a similar explanation of this slippery word in *Where are the Customers' Yachts?* (1940) Chapter 8:

> "Investment and speculation are said to be two different things, and the prudent man is advised to engage in the one and avoid the other. This is something like explaining to the troubled adolescent that Love and Passion are two different things. He perceives that they are different, but they don't seem quite different enough to clear up his problems.
>
> Investment and speculation have been so often defined that a couple more faulty definitions should do no harm, the science of economics having reached a point where further confusion is impossible. Thus,
>
> - Speculation is an effort, probably unsuccessful, to turn a little money into a lot.
> - Investment is an effort, which should be successful, to prevent a lot of money from becoming a little.
>
> If you take a thousand dollars down to Wall Street and attempt to run it up to $25,000 in the course of a year, you are speculating. If you take $25,000 down there and attempt to earn a thousand dollars a year with it (by buying twenty-five four per cent bonds) you are investing. ..."

Sometimes the word "speculative" is used to describe a transaction made with a view to profit (as opposed to a transaction intended to hedge a financial risk). In that sense

In short, a financial transaction is described as "speculative" if it is risky and especially if the purchaser stands to make or lose money depending on how the market moves in the short term. I use the expression "speculative (high-risk)".

In that sense, financial transactions are often if not mostly speculative (high-risk) though it is a question of degree and some transactions are more speculative (high-risk) than others.

The passage from *C&J Clark*, while describing the issue of whether a transaction is speculative as "sometimes helpful" does not inform us whether a positive answer supports a conclusion of trading or non-trading. I think the inference is that speculative (high-risk) transactions are more likely to be trading. But it is considered that to ask whether a transaction is speculative (high-risk) is rarely if ever going to be helpful. See *Lewis Emanuel v White*:

> The word 'speculation' is not, I think, as a matter of language, an accurate antithesis either to the word 'trade' or to the word 'investment': either a trade or investment may be speculative.[46]

But *Eclipse Film Partners No. 35 v HMRC* took a different view:

> [Counsel for the taxpayer] criticised the FTT's statement ... that the transactions entered into by Eclipse did not have the speculative aspect which the FTT would expect to see in trading transactions. He submitted that they were wrong to view speculation as a critical ingredient of trade. ... We agree that carrying on a trade does not necessarily require that there must be risk. It is apparent, however ... that the FTT's view was that speculation is an indication of trade, not that it is essential. That is a perfectly legitimate approach.[47]

But the question in *Eclipse* was not trade or investment. It was trade or non-trade/non-investment, and in that context the element of speculation is perhaps more relevant.

it is relevant to ask whether a transaction is speculative, in hedging transactions the important question is the tax treatment of the liability which is hedged. However hedging is a special case, and I do not think that is what the judge had in mind in *C&J Clark* when he said that it is relevant to ask whether a series of sales and purchases is speculative.

[46] 42 TC 369 at p.377; this passage was cited with approval in *Wannell v Rothwell* 68 TC 719 at p.730.

[47] [2015] STC 1429 at [143].

72.15.4 *"Gambling"*

In order to avoid confusion, it is essential to bear in mind that the word "gambling" may be used in two senses.

In the strict sense:

(1) Gambling[48] contracts were formerly unenforceable
(2) Gambling transactions are not a trade

I refer to this as the "**gaming/wagering sense"**. The Gambling Act 2005 abolished the former contract law rule that gaming/wagering contracts were unenforceable in English law.[49] However the rule remains that the activity of gaming/wagering is not a trade, and the profits (if any) are not subject to income tax;[50] or CGT.[51]

[48] Also called gaming, wagering and betting.

[49] Section 63 Financial Services Act 1986 had already restricted the rule that bets on stock market movements were unenforceable.

[50] *Hakki v Secretary of State for Work and Pensions* [2014] EWCA Civ 530 (professional poker player not carrying on trade). BIM provides:

> **BIM22015 Meaning of trade: betting and gambling - introduction** [Jan 2019]
> The basic position is that betting and gambling, as such, do not constitute trading. Rowlatt J said in *Graham v Green* [1925] 9 TC 309:
> 'A bet is merely an irrational agreement that one person should pay another person on the happening of an event.'
> This decision has stood the test of time. In an Australian case, *Evans v FCT* [1989] 20 ATR 922, 89 ATC 4540 Hill J said:
> 'There has been no decision of a court in Australia nor, so far as I am aware, in the UK where it has been held that a mere punter was carrying on a business.'
> However, an organised activity to make profits out of the gambling public will normally amount to trading.
> Although over time new forms of games of chance have evolved, these principles remain the same. The taxpayer placing a spread bet is not normally carrying on a trade (see BIM22020 for exceptions). They are not taxable on the profits, nor do they receive relief for their losses. The bookmaker organising the spread bet is taxable on their profits."

In Northern Ireland, gaming was legalised more recently: the Betting, Gaming, Lotteries and Amusements (Amendment) Act (Northern Ireland) Act 2022. It seems right that changes to gaming law in individual countries of the UK should not affect the issue of whether gaming constitutes a trade, which should be the same across the whole of the UK.

On the policy issues, see Royal Commission on the Taxation of Profits and Income, Final Report (1953) Cmd 9474 chapter 13.

[51] Section 51(1) TCGA. The reason for IT/CGT exemption is (1) that losses are generally more likely than profits, and one could not tax profits without allowing

In a loose sense, "gambling" means (more or less) the same as speculative, in the sense discussed above: that is, high-risk. I refer to this as the **"loose (high-risk) sense"**. Thus the purchase of a future or option, or bitcoin, say, may constitute gambling in the loose (high-risk) sense, but it is not gambling in the strict (gaming/wagering) sense.[52]

In *Lewis Emanuel v White* the court said:

> ... it is certainly true, at any rate in the case of an individual, that he may carry out a whole range of financial activities which do not amount to a trade but which could equally not be described as an investment, even upon a short-term basis. These activities include betting and gambling in the narrow sense. They also include, it seems to me, all sorts of Stock Exchange transactions. For want of a better phrase, I will describe this class of activities as gambling transactions.

It seems a little strange to describe "all sorts of stock exchange transactions" as gambling, but the passage makes sense if one bears in mind that it was written in 1965, when the cult of the equity had only just begun, and before it had received judicial notice.[53] Before then, the only assets recognised as investments were gilts and mortgages, and equities would not be regarded as investments: they were felt to be too risky. They would not naturally be regarded as trading, so they were put into the category of non-trading non-investments.

some relief for losses; (2) betting duty may apply instead.

In relation to financial bets (as opposed to betting such as sports betting) the commercial effect of a bet is (more or less) the same as a cash settled option or future, so the existence of two distinct tax regimes is somewhat odd; but there it is. For spread betting, see 18.18.18 (Betting).

[52] HMRC agreed:

CRYPTO10450: Why HMRC does not consider buying and selling cryptoassets to be gambling [Apr 2021]

HMRC does not consider the buying and selling of cryptoassets to be the same as gambling. The term 'gambling' is not defined in the Income Tax or Corporation Tax Acts, or in the Taxation of Chargeable Gains Act 1992. Whether a transaction can be characterised as betting or gambling is a question of fact. It will be down to the caseworker to consider the particular facts of any transaction involving cryptoassets and conclude whether that transaction had the character of betting or gambling. Where a customer considers that their transactions involving cryptoassets amounted to gambling please make a referral following the process at CRYPTO100500.

[53] *Sinclair v Lee* [1993] Ch 497 at p.512: "The cult of the equity ... did not really begin until the mid or late 1950s."

It is considered that to ask whether or not transactions are gambling (in the loose (high-risk) sense) is the same as to ask whether or not transactions are speculative (high-risk): it is not helpful in determining whether or not transactions are to be classified as trading.[54]

72.15.5 *Trading: companies/individuals*

It is well established that the test for whether a company is trading in financial assets is different from the test of whether an individual is trading, and that companies are more likely to be trading than individuals. The reason is said to be that companies (unlike individuals) are usually entitled only to trade or to invest. They cannot carry on non-trading non-investment activities of the kind categorised as "gambling" (in the loose (high-risk) sense). The passage cited above continues:

> It seems to me, however, that in general it is much more difficult to bring the activities of a company within this class of gambling transactions. An individual may do as he pleases: a corporation must act within the limitations of its memorandum of association. All companies have power to invest; many companies have power to deal [ie trade] in securities; few companies can have power to enter into gambling transactions - i.e., by [the judge's] definition, transactions otherwise than by way of investment or trade. Where a transaction can be brought within the scope of an authorised object - e.g., investment or dealing - one would not readily treat the transaction as having been carried out ultra vires in pursuit of an unauthorised object - e.g., gambling. In other words, one expects a trading company's activities, apart from capital investment, to be by way of trade.

The reasoning is now invalid:

(1) Nowadays one would not readily describe normal equity investment as "gambling" even in the loose (high-risk) sense.

(2) Companies powers have increased.

The BI Manual notes point (2). It cites *Lewis Emanuel v White* and comments:

[54] Of course (in the absence of trade) it does not matter for individuals whether one describes financial transactions as investment or as gambling (in the loose high-risk sense), since the tax consequence is the same: the profits are subject to CGT and not IT.

> **BIM56870 Financial traders - instruments and shares: case law and companies** [Jun 2016]
>
> ... **Recent developments**
>
> Since the *Lewis Emanuel* case was heard, company law has been amended. S39 Companies Act 2006 now says:
>
> > 'The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution.'
>
> Furthermore, there is judicial approval for the right of a company to engage in speculative transactions. In *Hazell v Hammersmith & Fulham London Borough Council* [1991] 2 WLR 372 at p.372, Lord Templeman said:
>
> > '... Individual trading corporations and others may speculate as much as they please or consider prudent.'
>
> Although it is unlikely that a company would ever enter into a gambling transaction, there is no reason why its activities could not include speculative transactions which, while not being investments, might also not amount to trading.

It is considered that the rule continues to be valid that companies (assuming their articles authorise trading) are more easily held to be trading than individuals.[55] However the basis of that rule cannot now be the reason given in *Lewis Emanuel* (that financial transactions carried out by individuals should generally be classified as non-trading non-investment transactions but companies, unlike individuals, must either trade or invest, so they are more likely to be trading). One could simply say that the rule is now established and continues to hold even if its reasons have ceased to be sound. However, if needed the rule has another, sounder basis. This is that one badge or indication of trade is "trading structure" and companies (if their articles authorise trading) have that element of "trading structure" which individuals do not.[56]

Business Income Manual provides:

> **BIM56850 Financial traders - instruments and shares: case law and individuals** [Jan 2019]
>
> In the past, the approach taken in deciding whether a company is

[55] See 72.15.2 (Principles) item [3].

[56] Similarly, what may constitute a business if carried on by a company may not be a business if carried on by an individual: *American Leaf Blending Co v DG of Inland Revenue* [1978] UKPC 18, [1979] AC 676.

> carrying on a trade of buying and selling shares and other financial instruments has been different from that adopted for individuals....

Despite the words "in the past" I do not think the author intends to suggest the position is any different today.

Since different tests apply to determine whether companies and individuals are trading, I consider the cases for individuals and for companies separately.

72.15.6 *Trading by individual*

There have been five UK cases discussing whether individuals are trading in financial assets. The first is *Salt v Chamberlain* 53 TC 143 where Oliver J said:

> Where the question is whether an individual engaged in speculative dealings in securities is carrying on a trade, the prima facie presumption would be ... that he is not. It is for the fact-finding tribunal to say whether the circumstances proved in evidence or admitted take the case out of the norm.

In *Salt v Chamberlain* the individual relied on the following matters to justify a conclusion of trading. There were about 50 sale/purchase transactions per annum, over a four-year period. A substantial proportion of the transactions concerned options (rather than securities yielding income). One-third of purchases and sales were within the settlement period, and many others were within a short period thereafter. The purchases were financed in part by borrowing. On these facts the General Commissioners found that the taxpayer was not trading, and on appeal the court held that the Commissioners were entitled to reach that conclusion.

A similar approach was applied in Hong Kong Inland Revenue Board of Review Decision *Case No. D 42/90*. The following aspects of the matter might have justified a conclusion of trading. The individual's transactions were in Hang Seng Index futures contracts which had a short lifespan and produced no income. The individual ran an "active" account (the number of transactions is not recorded). The Board found that the taxpayer was not trading.[57]

The next UK case is *Wannell v Rothwell* 68 TC 719. In this case there were about 60 sale/purchase transactions per annum. The assets traded

[57] *https://www.info.gov.hk/bor/en/decisions/docs/d4290.pdf*

were shares and commodities. Some of the money used was borrowed. The taxpayer was aiming at quick profits and had no intention of taking possession of the commodities or (with rare exceptions) of holding shares. The Special Commissioner did not decide whether the taxpayer was trading, but the Judge found that the Special Commissioner would have been "almost bound" to reach the conclusion that the taxpayer was trading. I think it was significant that the assets traded included commodities as well as securities.

In assessing the significance of turnover of assets, one should take into account that active portfolio management is more common now than in the past. In *Manzur v HMRC*[58] transactions numbered between 240 and 300 per annum, which was described as "not numerous". Shares were sometimes held for as long as six months. This was held to be investment, not trade.

The most recent case is *Ali v HMRC*.[59] The facts were extreme. The individual conducted about 1000-2000 transactions each year. Shares were held for a few hours, or for a day or two. He worked a 40-hour week on his share dealing activities. Even that was held to fall within the no-man's land of fact and degree, but unsurprisingly the tribunal found it was trading.

The BI Manual provides:

> **BIM56860 Financial traders - instruments and shares: three cases involving individuals** [Jun 2016]
>
> An activity of buying and selling shares and other financial instruments undertaken by an individual will normally amount to investment or speculation falling short of trading unless there are factors which take the case 'out of the norm' (see BIM56850). ...
>
> **Salt v Chamberlain**
>
> The Commissioners in this case found that Mr Salt was not trading, and Oliver J held in the High Court that the facts entitled the Commissioners to come to this conclusion.
>
> Mr Salt was a mathematics graduate who used his knowledge of computers to forecast the movements in share prices. In the period 11

[58] [2010] UKFTT 580 (TC). However little weight should be given to this brief first tier tribunal decision, in which the taxpayer was not represented by counsel and the taxpayer's best case *Wannell v Rothwell* was not cited.

[59] [2016] SFTD 335. A disturbing feature of this case was that HMRC had sought penalties, contending that the Taxpayer's view was not merely incorrect but negligent. But neither side was represented by counsel.

December 1968 - 31 March 1973 he entered into approximately 200 transactions for the purchase and sale of securities, which included put and call options and settlements at the end of an account for balances only. He used his own funds as well as borrowings from the bank and against life assurance policies.

Wannell v Rothwell

Mr Wannell had previously worked for a commodity futures dealer as a trader prior to the commencement of his activity. His duties had included advising clients on long-term investments and short-term trading opportunities in commodity futures and options. He had obtained qualifications relevant to his duties and, in the course of his own activity, had access to market reports and analysis but not a full screen service. All the transactions were placed with a broker. There were 11 purchases and sales of commodities between May and October 1986 and 46 purchases and 49 sales of shares between October 1985 and August 1987. He dealt on his own account and there were no customers.

The Deputy Special Commissioner said:

> 'The essential point in the present case is that of organisation. Was the Appellant, doing two or three deals a month from home through brokers, but doing them with the benefit of experience, training and contacts which he had, organised in a way that a trader could be said to be organised? The case is very close to the borderline, and if the only question I had to decide were whether the Appellant was trading, I might be inclined to give him the benefit of the doubt and find that he fell, by a hair's breadth, on the trading side of the dividing line.'

This case considered not only the question of whether Mr Wannell was trading but whether he was trading commercially for the purposes of relief for losses (see BIM85705), and the Deputy Special Commissioner concluded that:

> 'a case which is so close to the trading borderline because of its lack of commercial organisation is bound to be on the wrong side of the [loss relief] borderline.'

When this case came before the High Court, Robert Walker J found that the Deputy Special Commissioner must be taken to have found that Mr Wannell was trading, but also that he had had sufficient evidence before him to come to the conclusion that the activity was not carried on commercially, so the losses could not be set off against general income...

Manzur

Mr Manzur was a retired surgeon. He used his own savings to begin acquiring stocks and shares. He made between 240 and 300 trades in a year using an online stockbroker. Some of the shares were turned over very quickly but others were retained for six months or more.

The tribunal held that Mr Manzur's buying and selling amounted to the management of a portfolio of investments rather than trading. They upheld the view in *Salt v Chamberlain* that the badges of trade were of limited value and said there was no definitive checklist which could be used to say whether someone was trading or not. The number and frequency of transactions, and the short-term nature of the holdings alone did not establish trading. Other factors taken into account were:

- the time spent on the activity (about two hours a day);
- the fact that Mr Manzur did not entirely rely on his own expertise but used the advice of brokers;
- that the activities were not characteristic of established share dealers, for example Mr Manzur had no customers and was dependent on market movements alone to make a profit.

Conclusion

The cases discussed above show that no one factor can determine whether an activity has been taken 'out of the norm'. Some factors may be more relevant in some cases than in others. You have to take a view after considering the relevant circumstances as a whole.

72.15.7 *Trading by trust*

There are no tax cases on whether trustees of a private trust are trading, but it is considered that their position is in principle similar to individuals.

In *Smith v Anderson* (a non-tax case discussing an early unit trust) James LJ said:

> In my opinion, nothing that is to be done under this deed by the trustees comes within the ordinary meaning of "business", any more than what is done by the trustees of a marriage settlement who have large properties vested in them, and who have very extensive powers of disposing of the investments, changing the investments, and selling them and reinvesting in other investments, according to their discretion and judgment ... That is not a business. No doubt there is power ... to dispose of the investments and reinvest in some similar securities ... This appears to me to be no more than the power of varying investments which you would find in an ordinary trust deed ...[60]

SP1/01 states that "In practice it would be unusual for an overseas pension fund to be carrying on a financial trade."

[60] 15 Ch D 247 at p.276.

72.15.8 *Trading by company*

There have been two cases discussing whether companies are trading in financial assets. Each concerned a trading company using spare cash to carry out stock exchange transactions.

In *Lewis Emanuel v White* 42 TC 369 the company carried out over 100 transactions per annum (described as "a very large number"). The majority were sold in the same year, often within a matter of weeks. It was held that the only possible conclusion was trading.

In *Cooper v C & J Clark* 54 TC 670 the company made only 13 transactions over nine months. The commissioners findings of trade were upheld, though only just (the judge would not have found there was a trade). So I think we can say that is an example of a non-trade.

It is considered the company's own classification of its activity as trading/non-trading (in the company's constitution, board resolutions and accounts) is a matter which in an otherwise marginal case ought to be decisive.

An activity may constitute a trade even it the activity is ultra vires the company. *Lewis Emanuel* was such a case: 42 TC at p.377. But in the light of subsequent changes to company law, this issue is not now likely to arise.

UK resident companies also need to consider the derivative contract rules in part 7 CTA 2009, which are not discussed here.

72.15.9 *Trading by partnership*

The same principles apply to partnerships as to companies.

The CT Manual provides:

> **CTM36580 BVCA statement and guidelines** [Feb 2018]
> ... Where the general partner provides management assistance to the companies in which investments are held by the partnership, such assistance would not, of itself, cause the limited partnership to be treated as trading.

That seems self-evident.

72.15.10 *SP 1/01*

SP 1/01 provides some heavily guarded generalities, and anyone who tries to use this guidance will find that it does not take them very far.[61] For

[61] There is similar (qualified) guidance in SP 3/02.

what it is worth, the material is set out here:

> 16. Whether or not a taxpayer is trading is a question to be determined by reference to all the facts and circumstances of the particular case. This applies as much to financial transactions as to other activities.
> 17. In determining the question of trading, any transactions carried out through an investment manager are to be considered in the context of the status and world-wide activities of the non-resident. It is not possible in this statement to consider every possible set of circumstances but, for example, an individual is unlikely to be regarded as trading as a result of purely speculative transactions.[62]
> 18. For a company, a transaction will generally be either trading or capital in nature (this may also be the case for non-corporate collective investment vehicles whether open-ended or closed-ended.)

The point of para 18 is that the transaction will not give rise to misc sweep-up income; see 33.12 (Futures and Options).

> If the main business of a non-resident company is a trade outside the financial area, or an investment holding business, the activities in the UK would normally amount to trading only if they constituted or were part of a separate financial trade. But if, exceptionally, activities which are an integral part of the profit earning activities of a non-financial trade are carried out through a UK investment manager (for example, hedging on the London terminal markets by a non-resident dealer in physical commodities) then that might amount to trading here. The view to be taken on a particular case will depend on all the facts of that case.
> 19. The active management of an investment portfolio of shares, bonds and money market instruments such as bills, certificates of deposit, floating rate notes and commercial paper does not constitute a trade.

The use of the term "investment" (if it carries its normal tax meaning) makes para 19 tautologous. Presumably the word is used in the wider sense, in which case the sentence makes an important point. But the author adds a qualification to neutralise that:

> But every case must be considered in the light of its own facts.
> 20. HMRC view short positions as conceptually the same as long positions and synthetic positions as conceptually the same as the equivalent real positions. Neither going short nor taking synthetic positions using derivatives are in themselves indicative of trading. Furthermore, synthetic positions that give exposure to part of an asset

[62] Likewise SP 3/02 para 8.

> are conceptually the same as synthetic positions that give exposure to the whole of an asset. Thus a synthetic position that gives exposure only to a bonds credit risk is no more or less likely to be a trading transaction than a synthetic or real position that gives exposure to the bonds coupon, liquidity, credit and currency risks. These techniques may constitute investment in themselves or may form part of an investment activity.
>
> 21. Where futures and options are used by non-residents who are collective investment vehicles (whether open-ended or closed-ended), pension funds and other bodies which either do not trade or whose principal trade is outside the financial area, Statement of Practice 03/02 Tax Treatment of Derivative Transactions will be applied.
>
> 22. ... [63] The criteria for deciding whether a non-resident financial company is an investment company or a trading company are the same as those which apply to a resident company.

BI Manual expands on this:

> **BIM20250 - Trade: badges of trade: income producing assets** [Mar 2022]
>
> ... *Financial assets*
>
> Normally transactions by individuals and companies in financial assets, such as shares, options and futures, do not amount to trading for tax purposes. Shares are generally held for investment, either to gain from income or capital growth. Short-term transactions, which cannot be classed as investments, usually fall short of trading, being in a class of transaction analogous to gambling or speculation.
>
> Whether an activity of buying and selling shares, securities and other financial instruments amounts to a trade is considered further at BIM56800 onwards.
>
> **BIM56910. Financial traders - instruments and shares: synthetic positions** [Jun 2016]
>
> Financial transactions include the acquisition, holding, dealing with, and disposal of financial assets such as shares and bonds. They also include taking synthetic positions in relation to such assets or corresponding indices, or discrete components of them. In our view, using synthetics is not itself indicative of trading. There is no conceptual difference between a 'real' and a synthetic financial transaction (for example, buying a share or entering into a derivative contract that replicates the risks and rewards of ownership). All of these approaches may form part of an investment strategy and some of them may constitute investment in themselves.
>
> ***Short positions are conceptually the same as long positions***
>
> Buying a share because you take the view that its price will rise and shorting a share because you think its price will fall are conceptually the same. In simple

[63] The omitted text discusses whether the financial trade is carried on in the UK; see 21.13.3 (Buying/selling through agent). This is distinct from the question of whether there is a trade.

terms, a view is merely being taken on the direction of movement. It follows that synthetic long and short positions are conceptually the same as one another and the equivalent real transactions.

Derivatives that give exposure to part of an asset are conceptually the same as derivatives that give exposure to the whole asset

A view may be expressed on a bundle of components embedded in an instrument, for example the coupon, liquidity, credit risk and currency of a bond, or alternatively a view may be expressed on one or a combination of these components. There is no conceptual difference between taking a view on all components by buying the instrument or entering a derivative contract that replicates ownership, or taking a view on one or a combination of the components via derivatives. There is no conceptual difference between taking a view on the direction of movement (as with simply long and short positions) or taking a view on the magnitude or timing of movements, or other components. Multi-derivative or hybrid strategies should not be unbundled.

Given the wide range of situations this principle can apply to, three examples are set out below. These are intended to be illustrative and not a definitive list.

In all cases involving any such 'bundling' we would expect there to be evidence that the transactions were executed in pursuit of a clear prior strategy.

Two or more derivatives

Where, for example, the view is that the price will increase but only within a certain band, and the most efficient way to express that single view is via a series of derivative transactions, those transactions should be considered as a whole and not each in isolation.

A derivative and another financial asset (for example shares)

Where the view is that an asset would not be acquired at current value but would be at a set lower value, a put option is written at that lower value, i.e. as a cost efficient method of acquisition. The writing of the option and the potential acquisition of the asset should be considered as a whole and not each in isolation.

A sequential series of similar derivative strategies

A derivative that is close to maturity generally has greater liquidity than a derivative identical in every way, other than having a longer period to maturity. 'Rolling' short dated derivative strategies such that there is a sequential series of similar derivatives should be viewed as a whole and not each in isolation.

72.15.11 *Critique*

The trading/non-trading distinction in financial assets raises three difficulties:

(1) *Uncertainty*: The leading cases are old and investment practice has since changed. The cases do not address the many varieties of transaction carried out by hedge funds and other sophisticated investors/traders, and even in the case of straightforward transactions, it is often unclear whether or not there is a trade.

(2) *Complexity*: There are some complex and narrow exemptions which

recognise and address this problem and (more or less) treat financial transactions as non-trading:

(a) The IME discussed in this chapter
(b) An exemption for authorised investment funds (introduced in an attempt to stop funds relocating to Ireland or Luxembourg)[64]
(c) Chapter 6 part 3 OFTR[65]

(3) *Irrationality*: The line drawn between trading/non-trading in transactions in financial assets (so far as it is discernible) is arbitrary.

These three difficulties follow from one underlying problem: there is no clear *economic* line to be drawn between trading and non-trading, in the context of financial transactions. The distinction is not drawn for accountancy purposes. Financial reporting standards require the use of fair value for investments in shares which are publicly traded or where the fair value can be measured reliably.[66] Movements in this fair value are recognised in profit or loss, whether the person concerned is trading or not. It is of course possible that tax and accountancy standards may define profit in different ways. But in this case the accountancy standards are right not to draw the distinction. There is an economic distinction between buying for short term and buying for long term holding[67] and to the extent that this intuition underlies the trading/non-trading distinction it is not irrational. However this economic distinction is nowhere close to the tax trading/non-trading distinction; and there is no reason why the two activities should be taxed differently. As far as I am aware, most other jurisdictions sensibly do not attempt to draw a comparable distinction.

It is suggested that all transactions in financial assets, defined along the lines of the IME, should in principle be deemed non-trading for tax purposes.[68] The IME, AIF and offshore fund exemptions can be repealed. That would be a simplification with little if any tax loss.

[64] Authorised Investment Funds (Tax) (Amendment) Regulations, SI 2009/2036 (31 pages of regulations accompanied by 107 pages of draft guidance).

[65] See 68.8 (Fund treated as non-trading).

[66] *https://www.frc.org.uk/Our-Work/Publications/Accounting-and-Reporting-Policy/FRS-102-The-Financial-Reporting-Standard-applicab.pdf* Para 2.47

[67] "We believe that according the name investors to institutions that trade actively is like calling someone who repeatedly engages in one-night stands a romantic." (Attributed to Warren Buffet - I would be grateful to any reader who could supply the reference).

[68] There would be some limited exceptions, eg if a company elects for trading treatment, and the hedging of trading risks.

CHAPTER SEVENTY THREE

INVESTMENT MANAGEMENT FEES & CARRIED INTEREST

73.1 Investment management fees & carried interest
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73.1 Investment management fees & carried interest

The topics of this chapter are:

(1) Disguised investment management fees (**“DIMF”**)[1]
(2) Carried interest

The layout of the chapter is as follows:

(1) Major definitions
(2) DIMF code
(3) Carried interest code
(4) Income-based carried interest

A full discussion requires a book to itself. I go beyond the themes of this book and address the topic as a whole.

73.1.1 *Navigation*

The legislation is as follows:

Chap	Part	Sections	Act	Topic
5E	13	809EZA-809EZH	ITA	Disguised investment management fees
5F	13	809FZA-809FZZ	ITA	Definition of “Income-based carried interest”
1	1	1H	TCGA	Rate of CGT on carried interest gain
5	3	103KA-103KH	TCGA	Carried interest code

The definitions are mainly in Chapter 5E and incorporated by reference elsewhere.

The system of numbering sections is idiosyncratic. In the ITA, section numbering begins with 809, followed by the Chapter letter, ie one of 809E/809F. The sections are then numbered ZA, ZB, etc. Hence:

- the 1st section of Chapter 5E is s.809EZA and the last is s.809EZH
- the 1st section of Chapter 5F is s.809FZA and the last is s.809FZZ

[1] HMRC sometimes use the abbreviation “DMF”.

Subsequent sections are slotted in, such as s.809EZDA and s.809EZDB.

In the TCGA, the sections begin 103K, and are numbered starting from A, so the first section is s.103KA and the last is s.103KH.

This is due to a misguided application of OPC drafting guidelines; see App.13.3 (Section numbering system).

73.2 DIMF: history and guidance

The legislation was introduced in 2015, amended in 2016 and 2017.

The development of the current rules can be traced through:

- HMRC Guidance "Investment managers: CGT treatment of carried interest (2015)[2]
- HMRC Technical Note "Investment Managers: Disguised Fee Income" (2015)[3]
- Draft guidance informally circulated (2016) (**"DIMF draft guidance"**)[4]

73.2.1 *Outline of industry practice*

The IF Manual outlines industry practice:

> **IFM36120: Overview: Introduction** [Oct 2020]
> **Introduction**
> ... Many investment management businesses only charge a management fee for the services they provide. However, those who provide services to private equity funds and other funds with alternative strategies typically negotiate:
>
> - a 'management fee' based on funds (or assets) under management generally at a rate of 1.5-2%; and
> - a share of the funds' profits once the investments have grown by an agreed percentage (hurdle) which is commonly referred to as 'carried interest' (IFM36500).
>
> In a typical model, management fees are due irrespective of how well an investment fund performs. They can be paid monthly, quarterly or annually.

[2] *https://www.gov.uk/government/publications/investment-managers-capital-gains-tax-treatment-of-carried-interest-july-2015/investment-managers-capital-gains-tax-treatment-of-carried-interest-july-2015*

[3] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/417049/Disguised_Investment_Management_Fees_Guidance.pdf*

[4] Investment Managers: Disguised Fee Income, CGT Treatment of Carried Interest *https://www.bvca.co.uk/LinkClick.aspx?fileticket=n5CPCclpPFo%3d&portalid=0&timestamp=1524063247595*

> Carried interest is only paid when the fund performs to a pre-agreed standard. It is performance-related payment typically paid indirectly, through a special purpose vehicle to the individuals who provided investment management services to a fund. Meeting the 'hurdle' (or 'preferred return') typically means that those involved in managing the fund share 20% profits above a hurdle rate equivalent to an annualised rate of approximately 8%. These amounts vary depending on the agreement entered into with the investors.
>
> Other funds that are not partnerships may agree to pay a performance fee in addition to a management fee. These sums should also be considered under the DIMF rules.

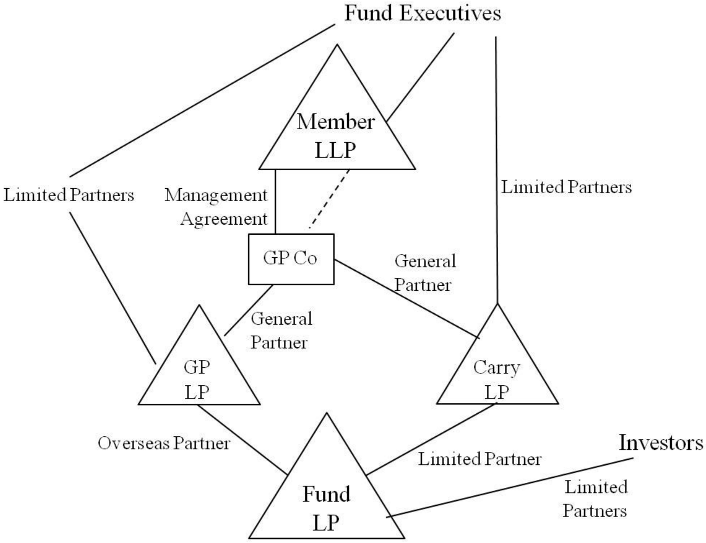
73.2.2 *Outline of DIMF code*

The IF Manual then outlines the DIMF code:

> The tax treatment of an investment management fee is covered by the DIMF rules. The main aim of these rules is to ensure that management fees received for managing an investment scheme (and which are not calculated by reference to the performance of the underlying investments) are charged to income tax where they arise to individuals. This is because the amounts in question are in substance income paid in return for the provision of investment management services.
>
> Broadly, the DIMF rules ensure that where sums arise from a fund to an individual providing investment management services, those sums are charged to income tax where they are not:
>
> - carried interest; or
> - a return of capital; or
> - a return on sums invested
>
> The tax treatment of the first management fee described above (generally 1.5-2% of funds under management), as detailed throughout this guidance applies to any fund which is an investment scheme (IFM36230) irrespective of its structure.
>
> New rules for the tax treatment of carried interest took effect from 8 July 2015. Carried interest is subject to taxation under specific capital gains tax (CGT) rules which are covered in separate guidance, starting at IFM37100. Carried interest is defined in ITA07/S809EZC, which is in Chapter 5E, and sums meeting this definition are excluded from DIMF rules unless the amounts are Income Based Carried Interest (IBCI). Income Based Carried Interest is explained in detail in separate guidance, starting at IFM38000. (reference currently not active - manual awaiting completion)

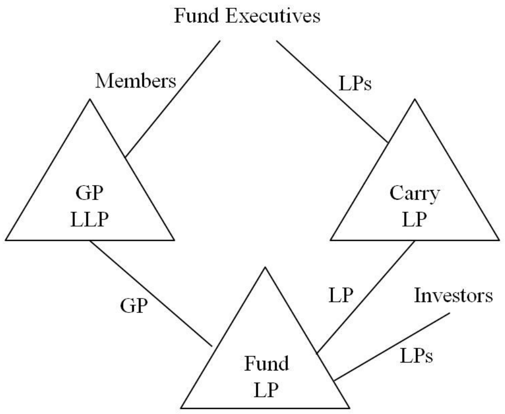
DIMF draft guidance provides:

> **GP LP and GP LLP planning**
> 5. The effects of the measure are not limited to any one avoidance structure or category of asset manager. However the types of planning at which they were initially aimed are sometimes described as GP LP and GP LLP planning.
> 6. In both cases, the investments of the fund are held in a limited partnership (LP), the fund partnership. In GP LP planning, the general partner of this LP is itself a limited partnership (GP LP) (See Fig 1).


Fund Executives
Member LLP
Limited Partners
Management Agreement
Limited Partners
GP Co
General Partner
General Partner
GP LP
Carry LP
Overseas Partner
Investors
Limited Partner
Fund LP
Limited Partners

> 7. The annual fee[5] is paid as a priority profit share by the fund LP to the GP LP.
> Some of the fee may be paid on to a management company or limited liability partnership, i.e. the traditional structure. However the individual partners in the GP LP may allocate some of the annual fee to themselves without passing it via the management company. GP LLP planning (Fig 2) is broadly similar.

[5] Footnote original: The fee based on assets under management is referred to for convenience in this document as the annual fee, although in practice the fee may be paid at different intervals, for example quarterly or semi-annually. In most private equity funds the fee will strictly be calculated by reference to the sums committed by investors to the fund, even before those sums have been drawn down.



8. The effect of this planning is that annual fees for investment management are not being taxed in full. Since the annual fees are clearly a return for services provided, they should be charged to income tax. Chapter 5E has therefore been introduced to ensure that these fees are charged to income tax.

73.3 "Disguised fee"

Section 809EZA(3) ITA provides:

> For the purposes of this Chapter [Chapter 5E] a "disguised fee" arises to an individual in a tax year from an investment scheme if-

A set of three conditions then follows which I call **"disguised-fee conditions (a) to (d)"**. In outline:

Para	**Requirement**
(a)	Investment management services
(c)[6]	Management fee from investment scheme
(d)	Management fee untaxed

73.4 Disguised-fee c^n (a): IM services

Section 809EZA(3) ITA provides:

> For the purposes of this Chapter [Chapter 5E] a "disguised fee" arises to an individual in a tax year from an investment scheme if-
> (a) the individual at any time performs or is to perform investment management services directly or indirectly in respect of the scheme

[6] There is no para (b).

under any arrangements[7]

I refer to these arrangements as **"investment-services arrangements"**.

73.4.1 *Timing*

The IF Manual provides:

> **IFM36310: Performs investment management services** [Oct 2020]
> **Timing of the services performed**
> The investment management services do not necessarily have to be provided in the year in which the fee arose to meet this condition. Where an individual has performed investment management services in the past or will perform such services in the future this also meets the requirements of condition 1.

The Manual provides a straightforward example:

> *Example (Amelia)*
> A is a recently retired fund manager. She received a disguised fee for investment management services provided in the run up to her retirement. This fee was received in the year after which A retired and no longer provides investment management services.
> Despite the investment management services relating to the fee being undertaken in a previous year, the fee is still received in relation to the performance of investment management services, and condition 1 would be met...

73.4.2 *In respect of an investment scheme*

The IF Manual continues:

> The scope of ITA07/S809EZA(3)(a) is intentionally wide but, if it can be demonstrated that shares or an interest in an asset manager firm have been granted solely to incentivise executives and the award is not in relation to the performance of the fund, then the DIMF rules may not apply. If however, the award has been made as part of a wider remuneration scheme to avoid the application of the DIMF rules, then the amount may still be charged as income. All facts and circumstances must therefore be taken into consideration in order to evaluate whether the DIMF rules apply.

[7] Section 809EZE ITA provides the standard (unnecessary) IT definition of "arrangements"; see App 2.2.3 (Definitions of "arrangement"). The definition is applied to CGT by s.103KH(1) TCGA.

> *Example 1 (Frances)*
> An individual fund manager, F, works for a US headquartered group, whose shares are listed on the US stock exchange.
> F is a member of a UK LLP (controlled by a corporate member owned by the group) which acts as the UK sub-advisor in relation to some of the funds managed by the group. The UK LLP has appropriate commercial substance (staff, contracts and other assets) and receives an arm's length fee for the services it provides to other group companies.
> F receives a profit share from the LLP in line with market expectations and holds rights to receive carried interest in the funds she is involved with.
> Separately, F receives an award of shares in the listed US parent under a global share plan designed to incentivise and reward staff (including employees and members of LLPs) across the worldwide group in growing the business.

The HMRC analysis is as follows:

> If F and the group are able to demonstrate that the share award in the listed US parent is not part of a wider scheme to deliver a disguised fee (IFM36300) to her, then neither the DIMF rules nor the carried interest rules (IFM37100) will apply to the holding of the shares or any resultant dividends received in respect of those shares.
>
> *Example 2 (Sam)*
> An individual fund manager, S, works for a UK based fund management group with full commercial substance in the UK (staff, contracts and other assets). S is one of four founders of the business and holds a 25% stake in the parent company of the group. S receives an arm's length remuneration (salary, bonus and other benefits) for his work, which is taxed as employment income, and has a carried interest in the funds operated by the group in line with industry standards. The shares S owns in the business carry an entitlement to a 25% share in the residual profits of the business. The group receives priority profit shares, management fees and a small amount of carried interest from the funds it operates as per the contractual arrangements with the investors.

The HMRC analysis is as follows:

> Dividends paid to S in respect of his shareholding in the parent company do not constitute a disguised fee (IFM36300). Later, when S disposes of his shareholding, the disposal proceeds will not constitute a disguised fee.
> The DIMF rules may apply however if S's equity participation is part of

a wider arrangement designed to deliver a disguised fee.

73.5 Disguised-fee c^{n} (c): from investment scheme

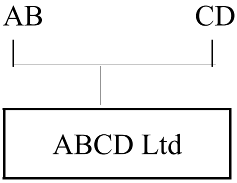
Section 809EZA(3) ITA provides:

> For the purposes of this Chapter [Chapter 5E] a “disguised fee” arises to an individual in a tax year from an investment scheme if ...
> (c) under the arrangements, a management fee arises[8] to the individual from an investment scheme in the tax year (see section 809EZB)

Chapter 3 DIMF draft guidance (Examples) provides:

> *Example 4 - [accountancy company]*
> AB is a director and 50% shareholder in ABCD Limited, an accountancy firm.

Diagrammatically:



> AB provides corporate finance advice on a potential acquisition by RS LP, an unconnected private equity fund [ie an investment scheme]. ABCD receives a fee for doing so and this increases ABCD’s profits. ABCD’s profits are subject to corporation tax. AB receives a dividend from ABCD. CD has not provided any services to RS LP and also receives a 50% dividend.

The HMRC analysis is as follows:

> Corporate finance services fall within the “investment management services” definition.
> The fee is included in the calculation of the profits of ABCD and not AB and so is “untaxed”.
> However the dividend is not regarded as arising from the collective investment scheme, and so does not fall within the scope of [the DIMF] charge.

More analytically, the dividend does not meet disguised-fee condition (c).

[8] See 73.15 (To whom DIMF arises);15.5.9 (Disguised investment management fees).

73.6 Disguised-fee c^n (d): Untaxed

Section 809EZA(3) ITA provides:

> For the purposes of this Chapter [Chapter 5E] a "disguised fee" arises to an individual in a tax year from an investment scheme if...
> (d) some or all of the management fee is untaxed;
> and the amount of the disguised fee is so much of the management fee as is untaxed.

Section 809EZA(4) ITA provides an artificial definition of "untaxed":

> For the purposes of subsection (3) the management fee is "untaxed" if and to the extent that the fee would not (apart from this section)-
> (a) be charged to tax under ITEPA 2003 as employment income of the individual for any tax year, or
> (b) be brought into account in calculating the profits of a trade[9] of the individual for the purposes of income tax for any tax year.

In short, "untaxed" means not taxed as trading/employment income in the hands of the individual. A fee is "untaxed" even if it is subject to tax in the hands of the actual recipient (but not the individual); or if is a dividend subject to tax in the hands of the individual at the dividend rates. It would be appropriate to write "untaxed" with an initial capital or scare quotation marks.

DIMF draft guidance provides:

> 72. The effect of the definition is that sums arising to employees which are taxed as benefits or under the employment related securities legislation will not be untaxed for the purposes of Chapter 5E.
> 74. Section 809EZA(4) makes clear that the charge to tax as employment or trading income does not need to occur in the same year as the charge that would otherwise arise under Chapter 5E. This means that the charge under Chapter 5E could occur in a later or earlier tax year than the other tax liability. For example, an individual performing investment management services could be engaged as an employee and receive a deferred bonus which does not fall within the definition of carried interest. Under the statutory definition of arise which applies from 22 October 2015, this amount is likely to have arisen to the individual. When the amount is released from the deferral structure however, it will

[9] s.809EZA(5) ITA provides: "In subsection (4) "trade" includes profession or vocation."

> be charged to income tax and National Insurance contributions in full as employment income. It will not, therefore, be treated as "untaxed". However, where an individual is or expects to be outside the charge to UK tax when the sum would otherwise be liable to income tax in respect of the sum, this treatment will not apply: section 809EZA requires that the sum is charged to tax as employment income under ITEPA 2003 or that it is brought into account when calculating the profits or a trade for the purposes of UK income tax.

The IF Manual provides a straightforward example:

> **IFM36325 The sum arising must be untaxed** [Oct 2020]
> ...Example 1 - accountancy partnership (Ali)
> A is a partner in CD LLP, a large accountancy firm. A carries out due diligence on a potential acquisition by RS LP, an unconnected private equity fund. CD LLP received a fee from the fund for doing so and this increases CD LLP's profits. A receives a share of those profits.

The HMRC analysis is as follows:

> Due diligence falls within (b) of the "investment management services" definition found at ITA07/S809EZE(1).
> The fee is included in the profits of CD LLP, ITA07/S809EZA(4)(b) advises that a sum will not be considered as 'untaxed' if it has been brought into account in calculating the profits of an individual and, as A has received a share of those profits, which will be chargeable to income tax, the sum will not be considered as 'untaxed' in her hands.

As the fee is not "untaxed" it is not a disguised investment management fee, because disguised-fee condition (d) is not met.

73.7 "Management fee"

This term is used in the definition of "disguised fee": disguised-fee condition (d).

Section 809EZB(1) ITA provides:

> Subject as follows, for the purposes of section 809EZA "management fee" means any sum (including a sum in the form of a loan or advance or an allocation of profits) except so far as the sum constitutes-
> (a) a repayment (in whole or part) of an investment made directly or indirectly by the individual in the scheme,
> (b) an arm's length return on an investment made directly or indirectly by the individual in the scheme, or
> (c) carried interest which is not income-based carried interest (see

> sections 809EZC and 809EZD for carried interest, and Chapter 5F for income-based carried interest).

If a management fee is "any sum", almost anything is a management fee. The price paid for this book is a management fee, if the definition is taken literally.[10] The concept is brought down to size by disguised-fee condition (d) which requires links between the "management fee" and the fund: the sum must in short arise from an investment scheme.

The significance of the definition of management fee is in paras (a)-(c) I refer to this as **"management-fee exclusions (a) to (c)"**:

Exclusion	**Topic**	**See para**
(a)	Scheme investment: Repayment	73.12.4
(b)	Scheme investment: Arm's length return	73.7.1
(c)	Carried interest	73.8

73.7.1 *Management-fee exclusion (b): "Arm's length return"*

Section 809EZB(1) ITA provides that "management fee" means any sum

> ... except so far as the sum constitutes...
> (b) an arm's length return on an investment made directly or indirectly by the individual in the scheme

Section 809EZB(2) ITA provides an artificial definition:

> For the purposes of subsection (1)(b) a return on an investment is "an arm's length return" if-
> (a) the return is on an investment which is of the same kind as investments in the scheme made by external investors,[11]
> (b) the return on the investment is reasonably comparable to the return to external investors[12] on those investments, and
> (c) the terms governing the return on the investment are reasonably comparable to the terms governing the return to external investors on those investments.

DIMF draft guidance provides:

> 88. For example, arrangements could be made for the managers' capital to receive an excessive return, and to pay the annual fee in that way.

[10] Though if needed, one might argue that the label "disguised fee" itself imposes some implied restriction on the concept.

[11] See 73.12.6 ("External investor").

[12] See 73.12.6 ("External investor").

> Please note this could be a purely commercial arrangement with external investors negotiated at arm's length. The test does not require an "arm's length return" to be paid in a subjective sense as would be tested, for example, under the transfer pricing rules. The term is a term of art for these purposes and subject to the comments below on "reasonably comparable", that return must be the same as the return paid to external investors. An agreement, for example, which gives the management team enhanced upside and enhanced downside exposure would take the return on that co-investment outside the exclusion even if this was agreed between the managers and unconnected investors at arm's length as part of their genuine commercial bargain.
>
> 89. If the return does not meet the arm's length test, then sums arising will be treated entirely as disguised fees, and subject to income tax.
>
> 90. It is accepted that the return to internal and external investors will not be identical. In particular, where a private equity fund manager invests in a fund on the same terms as external investors but is not liable to the management fee or carried interest in respect of that investment, HMRC accept that it will still meet the reasonably comparable tests above

73.7.2 *"Reasonably comparable"*

This term is used in the definition of an arm's length return. It is not definable, but that does not deter the drafter. Section 809EZB(2A) ITA provides:

> For the purposes of subsection (2)(b), the return on the investment is reasonably comparable to the return to external investors on the investments referred to in subsection (2)(a) if (and only if)-
>
> (a) the rate of return on the investment is reasonably comparable to the rate of return to external investors on those investments, and
>
> (b) any other factors relevant to determining the size of the return on the investment are reasonably comparable to the factors determining the size of the return to external investors on those investments.

DIMF draft guidance provides:

> 91. The wording "reasonably comparable" is intended to allow for this sort of difference, i.e. where there are genuine commercial reasons for the difference and they do not materially affect, in substance, the return received by managers compared to that accruing to external investors. For example, the "fee and carry free" terms referred to above prevent capital provided by the fund management team "going in a circle" and returning to them in the form of management fee chargeable to tax as

income.

92. While it is not set out as such in the legislation, HMRC would accept that where an individual invests capital in a scheme which has been lent to the individual on arm's length terms, it can still meet the above requirements.

93. HMRC also accept that a management team may take out debt to fund their co-investment commitment indirectly via another vehicle. For example, debt may be advanced by a bank to a company owned by, or partnership comprised of, the management team. This entity would then meet the co-investment commitment required from the management team with the third party debt subsequently being repaid, with an appropriate return, from the sums allocated in respect of that investment at fund level. Such a structure will not preclude the investment made by managers giving rise to a return which is within the exception provided that return is still, having regard to all the circumstances, reasonably comparable to the return received by external investors (i.e. the return is the same as it would have been if the managers had taken out the debt directly on arm's length terms as described in paragraph 92).

94. However, where the investment has been made through a leveraged co-investment vehicle which gives the fund manager(s) an effective deduction for the interest costs on any debt, this would not meet the above requirements. For example, this could involve a partnership with third party borrowing where the financing cost reduces profits on which the managers would otherwise be chargeable. The return from such a structure would no longer be comparable with the return to external investors.

95. Where a co-investment is awarded to an employee at a discount and that discount is fully charged to income tax and National Insurance contributions as employment income, then the return on that investment (for the purposes of applying section 809EZB(2)) should be determined by reference to the amount brought into charge to tax plus any amounts actually paid by the individual. This would be the same where the co-investment is awarded to an employee in return for no monetary consideration.

96. For example, if an individual receives a co-investment interest of £100, but only pays £20, with the remaining £80 being funded from sums taxed as employment income of the individual, the co-investment treated as made by the individual when applying section 809EZB(2) and determining the return on that co-investment is one of £100. In the round this employee is in the same financial position as another employee who funded their co-investment of £100 out of taxed employment income. HMRC do not believe, in the absence of attempts to avoid or reduce an

individual's total tax liability, section 809EZB(2) should be interpreted strictly so as to treat these two employees differently.

...

98. In some situations a fund manager will not make a personal contribution to the fund in question as their co-investment. Instead they will acquire their co-investment from another person. This could arise where a fund manager joins a pre-existing team, or where the entire team managing a fund changes (for example, because of poor performance or due a wider business take-over).

99. The repayment of, and return on, such a co-investment is capable of coming within the exclusions from the definition of disguised fee contained in section 809EZB(1)(a) and (b). In HMRC's view, having regard to the purpose of this legislation, the specific reference to an investment made directly or indirectly includes such acquired co-invest. In the context of investment schemes constituted as a limited company section 809EZE(3) makes specific reference to secondary acquisitions. This should not be read as restricting the meaning of section 809EZE(2) which applies more generally in determining what amounts to an investment in investment scheme. Section 809EZE does not include specific reference to the secondary acquisition of such an interest because it is aimed at partnership situations where the investment, in effect and very broadly, takes the form of a proportionate direct interest in the underlying assets for most direct tax purposes in the UK. It is therefore possible to "step into the shoes" of another in respect of a contribution to the property held by the scheme. The wording "whether by way of capital, loan *or otherwise*" (emphasis added) shows that section 809EZE(2) is not to be read in an overly narrow manner. Section 809EZE(3) puts beyond doubt in the situation where the investment scheme is constituted as a limited company (which will be beneficially owner of the underlying assets and where investors acquire shares in that company) the same treatment is available as regards acquired co-invest. It is designed to make sure that the same rules apply regardless of how a scheme is constituted, rather than applying specifically relaxed rules to corporate schemes over other types of investment vehicle.

100. However, while the repayment of and return on an acquired co-investment can fall within section 809EZB(1)(a) and (b), the analysis of whether the conditions for an arm's length return in sections 809EZB(2) and (2A) can be more difficult. In particular the value of drawn co-investment is likely to have moved since the original investment was drawn down from the person now selling their interest in the fund. If the fund has performed poorly, the co-investment may be worth less than the vendor originally contributed to the scheme. If the

fund has performed well, however, the value may have increased. In both situations regard must be had to the strict formulation of sections 809EZB(2) and (2A) described in more detail above.

a. Where the co-investment has declined in value, if the fund manager purchases the investment for an amount equal to its market value, the fund manager will then receive a return which exceeds that paid to external investors (whose return will, in effect, be calculated of the original amount contributed to the fund). In this case it is therefore necessary for the fund manager to pay at least the "par value" of the co-investment, even if this exceeds the market value.

b. Where the fund has performed well and the co-investment has appreciated in value, if the fund manager acquires the co-investment for the amount originally contributed to the fund, it will receive a return which exceeds that flowing to external investors and which therefore falls outside section 809EZB(2) and (2A). For the entire return to fall within the exclusion, the fund manager will need to pay a price which equals the increase in value of the investment in the fund. Generally where the fund manager pays the unrestricted market value of the co-investment at the point of acquisition as part of a genuine commercial arrangement negotiated at arm's length, HMRC will accept that the return arising on that co-investment is capable of falling within sections 809EZB(2) and (2A) provided the return otherwise meets the conditions set out in those provisions.

No comparable funds

101. Where an investment fund is entirely "in house" it may have no external investors. In these situations, the comparison to be made for the purposes of s809EZB (2) is with a fund of a similar nature which does have external investors, taking all factors into account.

73.7.3 *"Sum"*

Section 809EZB(3) ITA provides:

> In this Chapter [Chapter 5E] "sum" includes any money or money's worth (and other expressions are to be construed accordingly).

73.7.4 *Payment for scheme asset*

Section 809EZB(4) ITA provides:

> Where-
>
> (a) a sum in the form of money's worth arises to the individual from the scheme in the ordinary course of the scheme's business, and
>
> (b) the individual gives the scheme money in exchange for the sum,
>
> the sum constitutes a "management fee" only to the extent that its

market value at the time it arises exceeds the amount of the money given by the individual.

73.8 "Carried interest"

73.8.1 *Why carried interest matters*

Carried interest matters because:

(1) It is in principle not a management fee, under management-fee exclusion (c),[13] and so not subject to IT as DIMF

(2) Special CGT rules apply[14]

73.8.2 *Carried interest: definition(s)*

Broadly, "carried interest" refers to a share of the profits which arise to managers of the fund where the investments in a fund perform above a certain level.

Prior to the introduction of the DIMF rules, there was no statutory definition. However the term, and the typical structures used, were explained in two statements:

Statement (my term)	Structure explained in:
BVCA Statement 1987[15]	Para 2 schedule A
BVCA MOU 2003[16]	Para 7, 8

I do not think there is any significant difference in the explanations in these two statements.

The definition of carried interest is now in two sections:

ITA	Content	See para
s.809EZC	General definition	73.9
s.809EZD	BVCA statements: Subordinated interest	73.10

[13] See 73.7 ("Management fee").

[14] See 73.19 (Carried interest: CGT); 43.13 (CGT rates: Introduction).

[15] The full title is: "British Venture Capital Association: Statement approved by the Inland Revenue and the Department of Trade and Industry on the use of limited partnerships as venture capital investment funds" *https://www.bvca.co.uk/Portals/0/library/Files/StandardIndustryDocuments/UseofLPsasPEVCfunds.pdf*

[16] The full title is: Memorandum of Understanding between the BVCA and Inland Revenue on the income tax treatment of Venture Capital and Private Equity Limited Partnerships and Carried Interest (2003) *https://www.bvca.co.uk/Portals/0/library/Files/StandardIndustryDocuments/PDF_2.pdf?ver=2013-06-14-112836-650*

I prefer to think of this as a single (if complex) definition, though one might regard the sections as two distinct definitions. DIMF draft guidance explains why the legislation takes this form.

> 103... Section 809EZD sets out the definition of carried interest which follows the description of typical carried interest arrangements in [the BVCA MOU 2003 and BVCA Statement 1987].
> 104. However, some investment funds use models of carried interest which do not fit within the description in the MOU. For example, venture capital funds may have a lower hurdle rate, and some funds will pay carried interest out of unrealised profits.
> 105. Since genuine carried interest is intended to be exempted from the [DIMF] charge, an alternative definition of carried interest is also used in the legislation.
> 106. The legislation is set out in this way so that funds which are using the model set out in the MOU can be satisfied that the carried interest will be exempt without needing to study the broader definition in s809EZC. (This model of carried interest is defined as meeting the requirements of s809EZC).
> 107. The wider definition of carried interest used in s809EZC should not be taken as an indication that any particular arrangement necessarily falls within the definition of carried interest in the Memorandum of Understanding; that is a separate issue which must be considered on the facts of the case.

Section 103KH TCGA applies the definition(s) for CGT:

> In this Chapter ... "carried interest", in relation to arrangements referred to in section 103KA(1)(a), has the same meaning as in section 809EZB of ITA 2007 (see sections 809EZC and 809EZD of that Act).

73.9 Carried interest: general definition

Section 809EZC(1) ITA provides:

> For the purposes of section 809EZB "carried interest" means a sum which arises to the individual
> [a] under the [investment-services] arrangements
> [b] by way of profit-related return.[17]

[17] The second sentence signposts exceptions: "This is subject to subsections (3) to (8) (sums where no significant risk of not arising); and see also section 809EZD (sums treated as carried interest)."

73.9.1 *"Profit-related return"*

This is the key element in the definition of carried interest. Section 809EZC(2) ITA provides:

> A sum which arises to the individual under the [investment-services] arrangements does so by way of "profit-related return" if under the arrangements-

There follows a set of 3 requirements, each of which must be satisfied:

> (a) the sum is to, or may, arise only if-
>   (i) there are profits for a period on the investments, or on particular investments, made for the purposes of the scheme, or
>   (ii) there are profits arising from a disposal of the investments, or of particular investments, made for those purposes,
>
> (b) the amount of the sum which is to, or may, arise is variable, to a substantial extent, by reference to those profits, and
>
> (c) returns to external investors[18] are also determined by reference to those profits;
>
> but where any part of the sum does not meet these conditions, that part is not to be regarded as arising by way of "profit-related return".

73.9.2 *"Profits"*

Section 809EZE(1) ITA provides:

> In this Chapter [Chapter 5E] ... "profits", in relation to an investment made for the purposes of an investment scheme, means profits (including unrealised profits) arising from the acquisition, holding, management or disposal of the investment (taking into account items of a revenue nature and items of a capital nature).

The IF Manual provides:

> **IFM36520: Meaning of carried interest** [Dec 2021]
> ... The profits to be considered are the profits based on the period set out in the arrangements. For example, if a fund draws up annual accounts, and a decision on whether to pay carry is based on those accounts, (for example by comparing the net asset value with the net asset value at the start of the accounts period), then the period in question would be the

[18] See 73.12.6 ("External investor").

> year that this condition is tested against.
>
> Condition 1 may still be met in some circumstances where a fund has made a loss.
>
> **Example**
>
> A fund is arranged over a 2 year period, it has made a loss in the second year. However, due to substantial profits in the previous year the fund has made a sufficiently high profit over a two-year period.
>
> As the specified period is 2 years, the above situation would meet the first condition despite making a loss in one of the years.

73.9.3 *Vary by reference to profits*

The IF Manual provides:

> **IFM36520 Meaning of carried interest** [Dec 2021]
>
> ... **Example**
>
> A fund manager is entitled to a fixed fee which will equate to 2% of the value of a fund, payment will be deferred until the fund has positive profits or a capital return.
>
> Just because the fee is conditional (on profits) does not mean that the fee would be carried interest. The amount in this case may be conditional but it does not vary in relation to profits, the value is determined only by the value of the fund - condition 2 is therefore not met.

73.9.4 *Risk-free return*

In short, a risk-free return is not carried interest.

Section 809EZC(3) ITA provides:

> Where-
>
> (a) one or more sums ("actual sums") arise to the individual under the [investment-services] arrangements by way of profit-related return in a tax year, and
>
> (b) there was no significant risk that a sum of at least a certain amount ("the minimum amount") would not arise to the individual,
>
> so much of the actual sum, or of the aggregate of the actual sums, as is equal to the minimum amount is not "carried interest".[19]

The IF Manual provides:

[19] The following sentence flags ss(7)(8): "(See subsections (7) and (8) as to how the minimum amount is to be apportioned between the actual sums where more than one actual sum arises in the tax year.)"`

IFM36531 The "no significant risk" test: Overview [Dec 2021]

... 'Significant risk' is not defined in legislation, but the intention is to only capture disguised fees; that is, sums which are highly likely to arise. Passing the 'no significant risk' test means that there must be significant risk that the sum will not arise. The intention is that, any attempt to make a fee appear as if it is linked to profits while actually being fixed in substance, will be ineffective.

Purpose of the 'no significant risk' test

The intention of the "no significant risk" test is to ensure that sums awarded to individuals, which in reality are highly likely to arise, are not categorised as carried interest. Instead such sums should be caught by the DIMF rules and charged to income tax. Whether the sum is likely to arise will depend on the facts and circumstances of each case.

Example (Ayo)

A, an individual providing investment management services is due to be paid £1m, or £1m plus 10% of profits if the fund profits exceed a certain level.

The £1m is not carried interest as it does not vary by reference to profits and there is not a significant risk that it will not arise. The 10% of profits above a certain profit level could be carried interest as the amount appears to vary. We still have to be mindful that the three profit-related return conditions of ITA07/S809EZC(2) (IFM36300) are met and the requirements of the "no-significant risk" test are fulfilled. For instance, the profit level may have been set at an unrealistically low level where there is no significant risk that it would arise, this could mean that the "no significant risk" test would not be met. Whether the amount meets the profit-related return conditions or the "no significant risk" test will depend on the facts and circumstances at the time.

In practice it should be clear to fund managers, through management agreements entered into whether sums arising to them represent their fixed management fee as opposed to carried interest. This test is intended to catch all amounts which, viewed realistically, represent a largely fixed entitlement based on the amount of assets under management. HMRC may challenge any attempt made to circumvent this test or any of the profit related conditions of ITA07/S809EZC(2) (IFM36300).

Where arrangements do not meet the "no significant risk" test, the sum arising to the fund manager is not carried interest even if the three-profit-related conditions are met.

Application of the "no significant risk" test to the arrangements

The no significant risk test applies to sums arising to an individual under arrangements by way of a profit related return, not to the investments made by the fund.

Example

Fund A invests in risky investments but puts arrangements in place which provide a certain payment every year to the fund managers. Fund B invests in relatively safe investments but set a high hurdle rate that must be exceeded before any carried interest was paid.

Despite the nature of the investments, Fund A may not meet the significant risk test, and therefore the fees would be caught by the DIMF rules. Should it be the case that in Fund B it was by no means guaranteed that a manager would ever receive carried interest this may pass the significant risk test despite the less risky investments held.

A history of good performance (e.g. 5 out of 6 previous funds have delivered high returns) does not in itself mean there is no significant risk attached to the sums arising to the fund manager. If funds have to deliver a high enough performance to repay loans to external investors and meet the hurdle rate before any carried interest is paid, it is likely that at the outset there would be a significant risk that carried interest would not be paid. This is not an automatic qualification however and whether the "no significant" risk test has been met would have to be based on the facts and circumstances at the time.

73.9.5 *Time to assess risk*

Section 809EZC(5) ITA provides:

> For the purposes of subsection (3)(b) assess the risk as at the latest of-
> (a) the time when the individual becomes party to the [investment-services] arrangements,
> (b) the time when the individual begins to perform investment management services directly or indirectly in respect of the scheme under the [investment-services] arrangements, and
> (c) the time when a material change is made to the [investment-services] arrangements so far as relating to the sums which are to, or may, arise to the individual.

The IF Manual provides:

> **IFM36534 Timing of significant risk tests** [Dec 2021]
> ... In practice, where there is more than one sum paid in a year each sum should be considered individually then consider all the sums together. It is expected that where sums are taken together, there would only be a different outcome in circumstances where a fund had invested in a series of investments which when taken together, deliver a certain return

to the managers.

Generally, this means that for a fund with a defined lifespan (closed ended fund) the test is likely to be applied at an early stage in the life of the fund. Later in the life of a fund that has been successful, it may be certain that sums will arise to the managers under the arrangements. This does not mean that a sum does not qualify as carried interest, so long as there was significant risk that the sum would arise when the arrangements were entered into.

Where an individual leaves a management team and that individual's entitlement to a sum is wholly or partly reallocated between the remaining managers, this will generally not be considered a material change, provided that:

- the individuals receiving the allocation were previously entitled to a portion of the carried interest in respect of the scheme; and
- the reallocation does not materially distort the proportions in which those individuals will share the carried interest between themselves.

If an individual receives a re-allocated award of carried interest that is greater than the pro-rata amount, then a material change will generally not be considered to have occurred in relation to the original carried interest amount as long as the new carried interest addition has no bearing on the calculation, right to receive or previous arrangement. If the new carried interest addition does have any bearing on the previous arrangement then a material change will have deemed to have occurred for all of the individual's carried interest balance.

There is no legislative definition for material change. Whether a "material change" has occurred or not will depend on the facts.

73.9.6 *Insolvency risk*

Section 809EZC(6) ITA provides:

> For the purposes of subsection (3)(b) ignore any risk that a sum is prevented from arising to the individual (by reason of insolvency or otherwise).

The IF Manual provides:

> **IFM36536 Prevention of a sum arising** [Dec 2021]
> ... The intention of this sub-section is to prevent individuals claiming that the scheme that they provide services to is taking risks and therefore there is significant risk that sums will not arise to them as individuals.

DIMF draft guidance provides:

> 147. It does not mean that a risk of insolvency in the underlying

investments of the fund must be ignored; rather this is one of the elements which is taken into account in assessing whether a payment is carried interest or not. It is understood that investment funds may invest in risky ventures where insolvency of an investee company is a real[20] risk.

73.9.7 *Tests of risk*

Section 809EZC(4) ITA provides:

> For the purposes of subsection (3)(b) assess the risk both-
> (a) in relation to each actual sum (and the investments to which it relates) individually, taking into account also any other sums that might have arisen to the individual under the [investment-services] arrangements instead of that sum, and
> (b) in relation to the actual sum or sums and any other sums that might have arisen to the individual under the [investment-services] arrangements by way of profit-related return in the tax year (and the investments to which all those sums relate) taken as a whole;
>
> (so that, in a particular case, some of the minimum amount may arise by assessing the risk in accordance with paragraph (a) and some by assessing it in accordance with paragraph (b)).

DIMF draft guidance provides:

> 140. ... the key point is to look at the arrangements as a whole. As explained above, it would be possible for arrangements using safe investments nonetheless not to give a certain return to managers, if the managers had to meet a high hurdle rate before getting any return. The essential is that these clauses are intended to target arrangements to get round the rules by delivering a certain return.
> 141. HMRC would accept any reasonable qualitative assessment of the risk attached to the carried interest; there is no requirement for a quantitative (e.g. Black Scholes or Monte Carlo method) to be used.

The IF Manual provides:

> **IFM36531 The "no significant risk" test: Overview** [Dec 2021]
> *Example* (Dipti)
> D, an individual providing investment management services is to

[20] Note how "real" is used here as a synonym of the statutory term significant; see App 7.4 (Real used as intensifier).

receive £1m if there are no profits, and 20% of any profits above £50m. There is a 30% chance that profits will exceed £50m.
If profits are £60m, D receives £3m. There is no risk attached to the £1m fee but there was a risk that the extra £2m may not have arisen. £2m is considered carried interest and the £1m fee is a disguised fee charged to income tax.
If the profits were instead £45m, then no additional sum arises. The carried interest is nil and the disguised fee is £1m.
The consideration of the sums together is not intended to catch normal diversification arrangements by funds as it is not unusual for funds to spread investments to give a safer return overall. Sums taken together would only be applicable if avoidance arrangements are in place to give investment managers disguised fees where there was no significant risk.

73.9.8 *Apportionment*

Section 809EZC ITA provides:

> (7) Where more than one actual sum arises in the tax year, the minimum amount is to be apportioned between the actual sums as follows for the purposes of subsection (3)-
> (a) so much of the minimum amount as is attributable to a particular actual sum is to be apportioned to that actual sum, and
> (b) so much of the minimum amount as is not attributable to any particular actual sum is to be apportioned between the actual sums on a just and reasonable basis.
>
> (8) For the purpose of subsection (7) any part of the minimum amount is attributable to a particular actual sum to the extent that there was no significant risk that that part would not arise to the individual in relation to that actual sum, assessing the risk in accordance with subsection (4)(a).

73.10 Subordinated carried interest

In short, a subordinated interest is treated as carried interest.

Section 809EZD ITA provides:

> (1) A sum falling within subsection (2) or (3)-
> (a) is to be assumed to meet the requirements of section 809EZC [definition of carried interest], and
> (b) accordingly, is to be treated as constituting "carried interest" for the purposes of section 809EZB.[21]

[21] Is para (a) otiose or does it add anything to the meaning?

It is helpful to read ss (2)(3) side by side:

s.809EZD(2) ITA	**s.809EZD(3) ITA**
A sum falls within this subsection if, under the [investment-services] arrangements, it is to, or may, arise to the individual out of profits on the investments made for the purposes of the scheme, but only after-	A sum falls within this subsection if, under the [investment-services] arrangements, it is to, or may, arise to the individual out of profits on a particular investment made for the purposes of the scheme, but only after-
(a) all, or substantially all, of the investments in the scheme made by the participants have been repaid to the participants, and	(a) all, or substantially all, of the relevant investments made by participants have been repaid to those participants, and
(b) each external investor[22] has received a preferred return on all, or substantially all, of the investor's investments in the scheme.	(b) each of those participants who is an external investor has received a preferred return on all, or substantially all, of the investor's relevant investments;
	and for this purpose "relevant investments" means those investments in the scheme to which the particular investment made for the purposes of the scheme is attributable.

The IF Manual provides:

> **IFM36540 Sums treated as carried interest** [Dec 2021]
> ... The reference to "substantially all" of the investments being repaid acknowledges that capital contributions to the investment scheme (rather than loan commitments to the investment scheme, which will comprise the vast majority of the investment made by managers and third party investors) will rarely be repaid until the investment scheme is wound up. Therefore the carried interest may be paid when the capital investment is still outstanding.

[22] See 73.12.6 ("External investor").

73.11 "Investment scheme"

This term is used in the definitions of "disguised fee"[23] and "carried interest".

Section 809EZA(6) ITA provides:

> In this Chapter [Chapter 5E] "investment scheme" means-
> (a) a collective investment scheme, or
> (b) an investment trust.

73.11.1 *Collective investment scheme*

Section 809EZE ITA incorporates the FSMA definition:[24]

> In this Chapter [Chapter 5E]
> ... "collective investment scheme" has the meaning given by section 235 of FISMA 2000.

However, s.809EZA(7) ITA extends this definition to deal with (a) managed funds and (b) parallel structures. It may be helpful to read them side by side:

> The reference in subsection (6)(a) to a collective investment scheme includes-

[ss(7)(a): Managed funds]	*[ss(7)(b): Parallel structures]*
(a) arrangements which permit an external investor[25] to participate in investments acquired by the collective investment scheme without participating in the scheme itself,	(b) arrangements under which sums arise to an individual performing investment management services [i] in respect of the collective investment scheme [ii] without those sums arising from the scheme itself.

The IF Manual discusses managed funds:

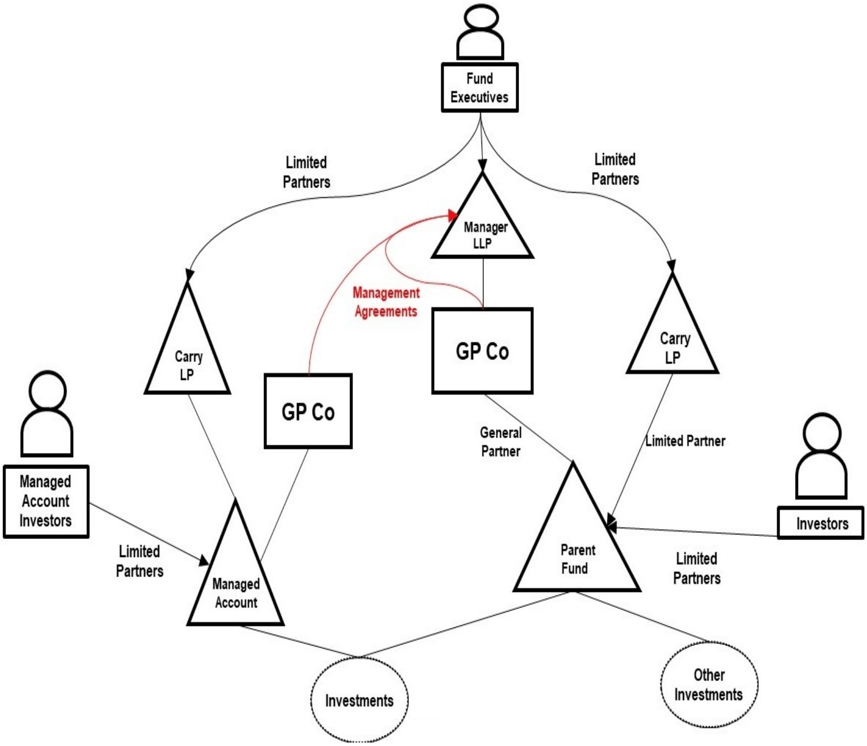
> **IFM36367: Managed accounts** [Dec 2021]
> Managed accounts in their simplest form can be thought of as a fund comprising one investor, usually known as the 'managed account

[23] See 73.3 ("Disguised fee").

[24] See 66.3 (Mutual fund/CIS/OIEC).

[25] See 73.12.6 ("External investor").

investor' providing the capital which is managed by the fund management team. These managed accounts may operate and invest alongside a more mainstream fund vehicle, typically referred to as the 'parent fund' which is managed by the same team. See the diagram below for a simplified example. A managed account may resemble a smaller version of the parent fund and may have the same carried interest structure. However, a variety of vehicles can be used to implement such an arrangement.


Fund Executives
Limited Partners
Limited Partners
Manager LLP
Management Agreements
GP Co
Carry LP
Carry LP
GP Co
General Partner
Limited Partner
Managed Account Investors
Investors
Limited Partners
Managed Account
Parent Fund
Limited Partners
Investments
Other Investments

A common reason for this approach is where an investor has particular requirements which cannot be catered for if it invests in the parent fund vehicle alongside a range of other investors. Such an example would be an institutional investor which may not want to invest in certain industries such as tobacco or alcohol.

Investing through a managed account allows such an investor to decline participation in any investments which fall outside their requirements. This is why on the above diagram most of the fund's investments are also investments made by the managed account, but there is likely to be disconnected investments where the managed account declines to

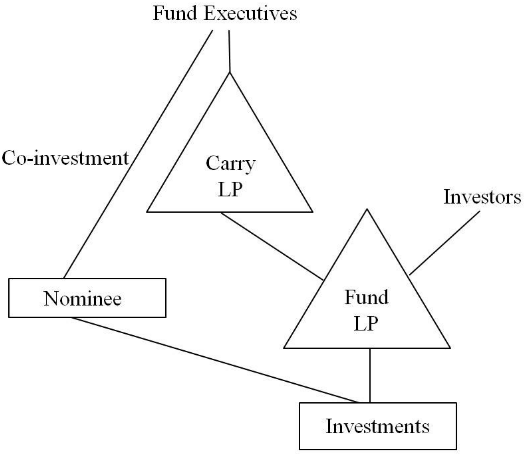
> participate.
>
> There may be other reasons for a managed account. It allows the managed account investor to negotiate a separate deal with the fund management team, potentially around carried interest and management fees, which is kept private from other investors. Some managed account investors may also want more control over the investments made, perhaps retaining the right to refuse certain opportunities even if they do not violate any ethical guidelines or, conversely, to take a disproportionately bigger stake in an investment it feels particularly positive about.

The IF Manual provides a straightforward example of a parallel structure:

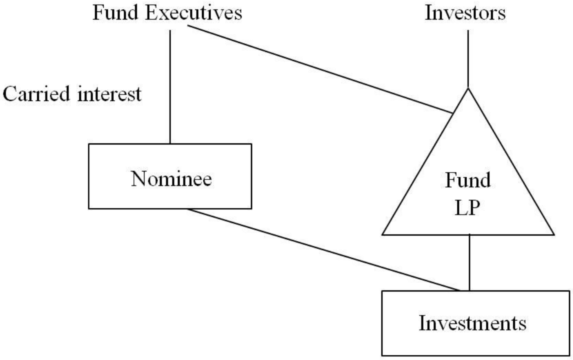
> **IFM37220: Carried interest from other funds and retired funds managers** [Oct 2020]
>
> *Example (Kofi)*
>
> A fund management house provides investment management services to three separate collective investment schemes known as A Fund, B Fund and C Fund.
>
> K, a fund manager who works for the fund house has provided investment management services for A Fund. The carried interest hurdle for A Fund has been met. However, the proceeds have not been released to the carried interest holders.
>
> Arrangements are put in place within the fund management business so that carried interest from B Fund which is ready to pay out is passed to K.
>
> Even though K has not provided investment management services for B Fund, the carried interest rules may still apply as the fund manager has received carried interest under arrangements where they have provided investment management services to a collective investment scheme.

DIMF draft guidance provides:

> 82. It is possible that the managers of a particular fund will not make their co-investment (i.e. the amounts they are required to put into the scheme of their own money on the same terms as investors to give them "skin in the game") in the fund vehicle itself, but through a parallel structure. This structure could simply be a nominee that acquires the agreed proportion of any underlying investment made by the fund using the fund managers' own resources. A simplified example is illustrated below.


Fund Executives
Co-investment
Carry LP
Investors
Nominee
Fund LP
Investments

83. HMRC is also aware that such a structure could be used for less benign ends. For example, the fund managers' "carried interest" could be achieved not by a special class of interest in the fund limited partnership as has historically been the case, but through a direct interest in the underlying investments which replicates the same economic terms. Again, a simple diagram to illustrate this issue is shown below.


Fund Executives
Investors
Carried interest
Nominee
Fund LP
Investments

84. To avoid any doubt that the rules apply to these structures as they would to a more conventional fund set-up, a new sub-section 809EZA(7)(b) was inserted by Finance Act 2016 which provides that "Collective Investment Scheme" for the purposes of the DMF Rules, includes arrangements under which sums arise to a fund manager in respect of a collective investment scheme without the sums arising from

> the collective investment scheme itself. Please note that the wording "in respect of" is intentionally wide and could catch any arrangement (including one seeking to avoid these rules) where sums are in any sense structured so that they do not arises from a collective investment scheme...

73.11.2 *Investment trust*

"Investment trust" matters as it is used in the definition of investment scheme.

Section 809EZE(1) ITA provides a definition by reference:

> In this Chapter [Chapter 5E] ... "investment trust" means a company[26] in relation to which conditions A to C in section 1158 of CTA 2010 are met (or treated as met).

That takes us to s.1158 CTA 2010:

> (2) Condition A is that all, or substantially all, of the business of the company is investing its funds in shares, land or other assets with the aim of spreading investment risk and giving members of the company the benefit of the results of the management of its funds.
> (3) Condition B is that the shares making up the company's ordinary share capital (or, if there are such shares of more than one class, those of each class) are admitted to trading on a regulated market.[27]
> (5) Condition C is that the company is not—
> (a) a venture capital trust (within the meaning of Part 6 of ITA 2007), or
> (b) a company UK REIT (within the meaning of Part 12 of this Act).

Section 1158(6) CTA 2010 provides for further rules:

> The Treasury may by regulations provide—

[26] Section 809EZE(1) ITA provides: "for this purpose "company" has the meaning given by section 1121 of CTA 2010." That incorporates the standard CT definition of company; see 90.8.1 (Company: Standard tax sense).

[27] Defined in ss(4): "For this purpose "regulated market" means—
(a) a UK regulated market within the meaning given by Article 2.1(13A) of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments,
(b) an EU regulated market within the meaning given by Article 2.1(13B) of that Regulation, and
(c) a Gibraltar regulated market within the meaning given by Article 26(11)(b)(i) of that Regulation."

> (a) for one or both of conditions A and B to be treated as met in the cases, and subject to any conditions, specified in the regulations, and
> (b) for the period for which the condition or conditions are treated as met.

See the Investment Trust (Approved Company) (Tax) Regulations 2011 Chapter 2 (Cases Where Eligibility Conditions Treated As Being Met). This concerns relatively minor points:
(1) Delay in admission of shares to trading on a regulated market and
(2) Winding up of company approved as investment trust.

I do not consider these topics here.

73.12 Misc definitions

73.12.1 *Investment management services*

This term is used in the definition of "disguised fee"[28] and carried interest. Section 809EZE(1) ITA provides a wide definition:

> In this Chapter [Chapter 5E] ...
> investment management services", in relation to an investment scheme, includes-
> (a) seeking funds for the purposes of the scheme from participants or potential participants,
> (b) researching potential investments to be made for the purposes of the scheme,
> (c) acquiring, managing or disposing of property for the purposes of the scheme, and
> (d) acting for the purposes of the scheme with a view to assisting a body in which the scheme has made an investment to raise funds.[29]

DIMF draft guidance provides:

> 54. ... HMRC's starting position will always be that a person in receipt of disguised fees (or carried interest) is performing investment management services. Apart from in extremely unusual situations, HMRC would always seek to argue that if investors/the management team have agreed to share part of the remuneration for managing the

[28] See 73.3 ("Disguised fee").

[29] The definition is applied to CGT by s.103KH(1) TCGA.

> fund with an individual the reason for that arrangement must be that the individual is performing investment management services in respect of that fund. Otherwise HMRC struggles to see the commercial rationale for the individual receiving either a disguised management fee or carried interest. If an individual works in a business which involves performing investment management services and receives a disguised fee or carried interest, HMRC would say that fact is compelling evidence in and of itself that the individual him or herself performs investment management services directly or indirectly. HMRC would expect the only persons who are not within this category to be remunerated purely through salary and bonus rather than a direct interest in the performance of the underlying fund vehicles.

73.12.2 *"Market value"*

Section 809EZE(1) ITA incorporates the CGT rules:

> In this Chapter [Chapter 5E] ... "market value" has the same meaning as in TCGA 1992 (see sections 272 and 273 of that Act).

73.12.3 *"Participant"*

Section 809EZE(1) ITA provides:

> In this Chapter [Chapter 5E] ...
> "participant"-
> (a) in relation to a collective investment scheme, is construed in accordance with section 235 of FISMA 2000;[30]
> (b) in relation to an investment trust, means a member of the investment trust;

73.12.4 *"Investment in scheme"*

Section 809EZE ITA provides:

> (2) In this Chapter [Chapter 5E] a reference to an investment made by a person in an investment scheme is a reference to a contribution by the person (whether by way of capital, loan or otherwise) towards the property subject to the scheme (but does not include a sum committed but not yet invested).
> (3) For the purposes of subsection (2) a person who holds a share in an investment scheme which is a company limited by shares and who acquired the share from a person other than the scheme is to be taken to have made a contribution towards the property subject to the scheme

[30] See App 7.2 (Participant/participate).

> equal to-
> (a) the consideration given by the person for the acquisition of the share, or
> (b) if less, the market value of the share at the time of the acquisition.

73.12.5 *"Repayment or return"*

Section 809EZE(4) ITA provides:

> In this Chapter [Chapter 5E], in relation to an investment scheme which is a company limited by shares-
> (a) references to a repayment of, or a return on, an investment in the scheme include a repayment of, or a return on, an investment represented by a share in the scheme resulting from-
> (i) the purchase of the share by the scheme,
> (ii) the redemption of the share by the scheme,
> (iii) the distribution of assets in respect of the share on the winding up of the scheme, or
> (iv) any similar process;
> (b) references to a return on an investment in the scheme include a dividend or similar distribution in respect of a share in the scheme representing the investment.

73.12.6 *"External investor"*

This term is used in various places, including the definition of arm's length return, profit-related return, and subordinated carried interest.

Section 809EZE(1) ITA provides:

> In this Chapter [Chapter 5E] ...
> "external investor", in relation to an investment scheme and any arrangements, means a participant in the scheme other than-
> (a) an individual who at any time performs or is to perform investment management services directly or indirectly in respect of the scheme, or
> (b) a person through whom sums are to, or may, arise directly or indirectly to such an individual from the scheme under the [investment-services] arrangements.[31]

73.13 DIMF: Deemed trade

Armed with the definition of disguised fees, we turn to the rules which

[31] The definition is applied to CGT by s.103KH(1) TCGA.

govern them.

Section 809EZA(1) ITA provides:

> Where one or more disguised fees arise to an individual in a tax year from one or more investment schemes (whether or not by virtue of the same arrangements), the individual is liable for income tax for the tax year in respect of the disguised fee or fees as if–
>
> (a) the individual were carrying on a trade for the tax year,
>
> (b) the disguised fee or fees were the profits of the trade of the tax year, and
>
> (c) the individual were the person receiving or entitled to those profits.[32]

The IF Manual provides:

> **IFM36210: Deemed trade: Introduction** [Oct 2020]
>
> **Consequence of a disguised fee arising**
>
> ... the disguised fees are brought into account for the purposes of both income tax and Class 4 National Insurance Contributions (NICs).
>
> As disguised fees are treated as the profits of the deemed trade and not as receipts, no losses or expenses can be set against the disguised fees. For this reason the deemed trade cannot give rise to a loss, as it only applies to fees arising.
>
> However the DIMF rules only re-characterise the nature of the receipt arising to an individual. They do not alter, for tax purposes, the nature of the underlying activities carried out by the individual which give rise to the disguised fee. Nor do the DIMF rules alter the nature of the activities of any entity or arrangement by virtue of which the disguised fee arises.
>
> For example, where a disguised fee arises from a typical General Partner Limited Partner (GP-LP) structure (IFM36132), although the individual receiving the fee is treated as carrying on a deemed trade, the rules do not re-classify that partnership as carrying on a trade (as may be relevant, for example, to entrepreneurs' relief and interest relief). The GP LP is carrying on an investment business; sums received by the GP LP are not therefore reclassified as trade income.

DIMF draft guidance provides:

> 28. Please note that as amounts of disguised fee are treated as the profits

[32] Para (c) reflects the standard ITTOIA rule that the person liable is the person receiving/entitled to income; see 15.2.1 (Receipt/entitlement basis of liability).

of a trade (which then come into charge under Part 2 of ITTOIA 2005 without more) they also comprise "relevant UK earnings" for the purposes of determining relief for contributions to registered pension schemes.

73.14 DIMF: Territorial limitation

Section 809EZA(2) ITA provides:

> For the purposes of subsection (1) the trade is treated as carried on-
> (a) in the UK, to the extent that the individual performs the relevant services in the UK;
> (b) outside the UK, to the extent that the individual performs the relevant services outside the UK;
> and for this purpose "the relevant services" means the investment management services by virtue of which the disguised fee or fees arise to the individual in the tax year.

The IF Manual provides:

> **IFM36220: Territorial scope of the deemed trade** [Oct 2020]
> ... Where an individual who is resident in the UK for tax purposes performs services both within and outside the UK, the entirety of the profits from the deemed trade are chargeable to UK tax in accordance with ITTOIA05/S6.[33]
> For an individual who is non-resident in the UK for tax purposes, the trade is regarded as carried on in the UK when the services are performed in the UK and carried on outside the UK where the services are performed outside the UK.
> Even where an individual only performs very limited services in the UK, for example coming to the UK for a small number of business meetings during the course of the year, the legislation provides that a deemed trade exists for that individual.

73.14.1 *DT relief*

The IF Manul provides:

> **FM36220: Deemed Trade: Territorial scope of the deemed trade** [Oct 2020]
> **Territorial scope of the deemed trade**
> **Location of the deemed trade**
> ... This means that the business profits article of most double taxation

[33] See 21.4 (IT territorial limit: Trading).

> treaties could apply, and so a tax charge will only arise if a permanent establishment (PE) exists (INTM264050).[34]
>
> *Example (Thomas and Sam)*
>
> ABC LLP is a US limited liability partnership. T is one of three partners who live and work in the US and has not been to the UK in the tax year. S is a fourth partner who lives and works in the US but has visited the UK for three days in relation to the acquisition of a UK business by a collective investment scheme (IFM36900) to which ABC LLP provides investment services. Neither T nor S is UK resident for tax purposes. Each of the four partners received £10,000 that would, if the individuals had lived and worked in the UK, be treated as a disguised fee.

The HMRC analysis is as follows:

> T has not performed any services in the UK, so is not brought into charge under the DIMF rules. S has performed services in the UK, so is potentially within the charge. It is unlikely that a few days in the UK will have the effect of creating a UK PE but S will have to consider this carefully and make a decision based on the facts. If there is no PE, then a charge will not arise under the DIMF rules.

"Unlikely" seems an understatement - but HMRC did not wish to give any hostage to fortune. The Manual continues:

> Many asset manager firms are international businesses with operations in more than one financial centre. Where an individual performs any investment management services in the UK they are potentially within the scope of the DIMF rules. Therefore, this may cause concern to non-resident individuals who come to the UK very rarely and do not perform any significant investment management activity whilst in the UK.
>
> Each case will be a question of fact. However, where individuals have little or no presence in the UK it is not expected that a situation will be created in which they will be subject to the DIMF rules. This is the case even where the wider business or group they work for does have a substantial UK operation. For example:
>
> A fund management business headquartered outside the UK has a UK operation and an individual from the headquarters occasionally visits the UK; or
>
> A fund management business that is UK headquartered has fund management divisions based in other jurisdictions and an individual

[34] See 21.23 (DT relief: Trading income).

involved in such offshore operations occasionally comes to the UK.

Where an individual is resident in a country with a double taxation agreement with the UK, even where they perform some investment management services in the UK, it does not follow that they will automatically be charged under the DIMF legislation. The general approach and practices followed in relation to double taxation treaties applying to the taxation of trade profits also apply to the individual's deemed trade.

In the context of DIMF, the deemed trade concerned is a trade of the individual rather than being the same trade as carried on by the entity which engages the individual. In considering whether the individual has a PE for the purposes of a relevant double taxation treaty you must consider the individual's deemed trade, not that of the entity that engages them.

Whether the engaging entity itself or its wider group already has a UK PE is therefore a separate question entirely. This means it is possible for the entity which engages the individual to have a UK PE while the individual fund manager will not be treated as having a personal PE for the purposes of the relevant treaty. An individual may therefore be able to rely on that treaty to be out of scope of liability under the DIMF rules.

Further advice on permanent establishments and double taxation treaties is available in the International Manual (INTM260000).

Where the activities of an individual do amount to a PE such that a double taxation treaty does not preclude liability from UK tax, it will be necessary to determine the amount of profit attributable to that PE. Establishing the extent to which the individual is performing investment management services in the UK will be a fact specific question which needs to be determined, given reference to all the facts and circumstances.

73.15 To whom DIMF arises

The rules are in the appallingly numbered s.809EZDA and s.809EZDB:

ITA	Applies to	Enjoyment conditions	See para
s.809EZDA	Connected non-co	No	73.16
s.809EZBB	Connected co/unconnected person	Yes	73.17

73.16 809EZDA: Connected non-company

Section 809EZDA ITA provides:

> (1) This section applies in relation to an individual ("A") if-
>
> (a) a sum arises to a person ("B") who is connected with A,

> (b) B is not a company,
> (c) income tax is not charged on B in respect of the sum by virtue of this Chapter [Chapter 5E, DIMF],
> (d) capital gains tax is not charged on B in respect of the sum by virtue of Chapter 5 of Part 3 of TCGA 1992 [carried interest], and
> (e) the sum does not arise to A apart from this section.
>
> (2) The sum referred to in subsection (1)(a) arises to A for the purposes of this Chapter [Chapter 5E].
>
> (3) Where a sum arises to A by virtue of this section, it arises to A at the time the sum referred to in subsection (1)(a) arises to B.

73.16.1 *"Connected person"*

Section 809EZDA(4) ITA tweaks the standard definition:

> Section 993 (meaning of "connected") applies for the purposes of this section, but as if-
> (a) subsection (4) of that section were omitted, and
> (b) partners in a partnership in which A is also a partner were not "associates" of A for the purposes of sections 450 and 451 of CTA 2010 ("control").[35]

Thus:

(a) Partners are not connected persons.[36]

(b) A partner is not connected with a company held by the partnership.[37]

This is only a section-wide definition, but it is repeated elsewhere: s.809EZDB(10) ITA, s.103KG(15) TCGA so it applies for the whole DIMF code.

73.17 809EZDB: Company/unconnected person

Section 809EZDB(1) ITA provides:

> This section applies in relation to an individual ("A") if-
> (a) a sum arises to-
> (i) a company connected with A, or

[35] See 104.15.3 (Person controls company).

[36] See 104.18 (Connected: Partners).

[37] Please note, if any individual partner does have direct or indirect control of a company through a partnership, that company will still be a connected person to that individual for these purposes, it is only the aggregation of interests when judging control which is modified.

> (ii) a person not connected with A,
>
> (b) any of the enjoyment conditions is met, and
>
> (c) the sum does not arise to A apart from this section.

73.17.1 *"Enjoyment conditions"*

Section 809EZDB(2) ITA provides:

> The enjoyment conditions are-
>
> (a) the sum, or part of the sum, is in fact so dealt with by any person as to be calculated at some time to enure for the benefit of A or a person connected with A;
>
> (b) the arising of the sum operates to increase the value to A or a person connected with A of any assets which-
>
> (i) A or the connected person holds, or
>
> (ii) are held for the benefit of A or the connected person;
>
> (c) A or a person connected with A receives or is entitled to receive at any time any benefit provided or to be provided out of the sum or part of the sum;
>
> (d) A or a person connected with A may become entitled to the beneficial enjoyment of the sum or part of the sum if one or more powers are exercised or successively exercised (and for these purposes it does not matter who may exercise the powers or whether they are exercisable with or without the consent of another person);
>
> (e) A or a person connected with A is able in any manner to control directly or indirectly the application of the sum or part of the sum.

The drafting is based on the ToA enjoyment conditions.[38] But the ToA rules apply where the individual transferor has a *personal* power to enjoy; the rules here apply if A *or a person connected with A* has power to enjoy.

[38] See 49.15 ("Power to enjoy"). Section 809EZDB(5) ITA adds: "In determining whether any of the enjoyment conditions is met in relation to a sum or part of a sum-
(a) regard must be had to the substantial result and effect of all the relevant circumstances, and
(b) all benefits which may at any time accrue to a person as a result of the sum arising as specified in subsection (1)(a) must be taken into account, irrespective of-
(i) the nature or form of the benefits, or
(ii) whether the person has legal or equitable rights in respect of the benefits."
This is also based on the ToA provision; see 49.15.1 (Substance).

That is of course much wider.[39]

The last paragraph of s.809EZDB(1) tweaks the definition of connected person in the context of Power to Enjoy:

> In this subsection, in a case where the sum referred to in subsection (1)(a) arises to a company connected with A, references to a person connected with A do not include that company.

Assuming the conditions in s.809EZDB(1) are met, we move on. Section 809EZDB ITA provides:

> (3) There arises to A for the purposes of this Chapter [Chapter 5E] -
> (a) the sum referred to in subsection (1)(a), or
> (b) if the enjoyment condition in subsection (2)(a), (c), (d) or (e) is met in relation to part of the sum, that part of that sum, or
> (c) if the enjoyment condition in subsection (2)(b) is met, such part of that sum as is equal to the amount by which the value of the assets referred to in that condition is increased.
>
> (4) Where a sum (or part of a sum) arises to A by virtue of this section, it arises to A at the time it arises to the person referred to in subsection (1)(a)(i) or (ii) (whether the enjoyment condition was met at that time or at a later date).

73.17.2 *Relief for taxable company*

Section 809EZDB(6) ITA provides:

> The enjoyment condition in subsection (2)(b), (c) or (d) is to be treated as not met if it would be met only by reason of A holding shares or an interest in shares in a company.

What matters then is whether enjoyment conditions (a) and (e) are met. Section 809EZDB(7) ITA provides:

> The enjoyment condition in subsection (2)(a) or (e) is to be treated as not met if the sum referred to in subsection (1)(a) arises to a company connected with A and-
> (a) the company is liable to pay corporation tax in respect of its profits and the sum is included in the computation of those profits.

The IF Manual provides:

[39] In this respect the DIMF code follows the approach of the mixed partnership code: see 86.10.1 (PtoE condition (c): Enjoyment conditions).

> **IFM36335 special provisions for companies** [Sep 2021]
> Special provision is made in relation to companies. This is because a fund management business could be set up as a wholly onshore corporate structure, with the fees and any carried interest arising from the underlying funds being charged in full to corporation tax. If, for example, an individual owned more than 50% of that business they would be connected (IFM36330) with the company and charged in full on amounts arising to that company but for this rule.
> This would be the case even if the company was a genuine vehicle of substance carrying on the entire investment management trade, the profits of which are charged fully to corporation tax.

Section 809EZDB(7) ITA provides:

> The enjoyment condition in subsection (2)(a) or (e) is to be treated as not met if the sum referred to in subsection (1)(a) arises to a company connected with A and ...
> (b) paragraph (a) does not apply but-
> (i) the company is a CFC[40] and the exemption in Chapter 14 of Part 9A of TIOPA 2010 [foreign tax at least 75% of corresponding UK tax] applies for the accounting period in which the sum arises, or
> (ii) the company is not a CFC but, if it were, that exemption would apply for that period.

The IF Manual provides:

> **IFM36335: special provisions for companies** [Sep 2021]
> ... In effect this means that the CFC is liable to pay an amount of tax in its country of residence equal to at least 75% of the amount that would have been due if it had been chargeable to the tax in the UK. The tax exemption contains detailed rules as to how the comparison is to be undertaken. These rules are designed to prevent manipulation of the tax due in the country of residence. Guidance on these rules can be found at INTM226000+.
> Furthermore if the company is not a CFC (for example because it is controlled by persons outside the UK), the exclusion can still apply if the conditions for the tax exemption in the CFC rules are otherwise met (for example, if the company were a CFC it would qualify for exemption because the tax it pays is equal to at least 75% of the amount that would have been due if it had been chargeable to UK tax).

[40] Section 809EZDB(7) ITA incorporates a definition by reference: “In this subsection “CFC” has the same meaning as in Part 9A of TIOPA 2010.”

Section 809EZDB ITA then restricts the exceptions with a TAAR, which takes somewhat non-standard form:

> (8) But subsections (6) and (7) do not apply if the sum referred to in subsection (1)(a) arises to
> [i] the company referred to in subsection (1)(a)(i) or
> [ii] the person referred to in subsection (1)(a)(ii)
> as part of arrangements where-
> (a) it is reasonable to assume[41] that in the absence of the arrangements the sum or part of the sum would have arisen to A or an individual connected with A, and
> (b) it is reasonable to assume that the [investment-services] arrangements have as their main purpose, or one of their main purposes, the avoidance of a liability to pay income tax, capital gains tax, inheritance tax or corporation tax.

The IF Manual provides:

> **IFM36335: special provisions for companies** [Sep 2021]
> ... Where a UK based manager has a very small shareholding in the ultimate (often quoted) parent vehicle of a large multi-national corporate asset management group, it will generally be obvious that the sums which represent the management fee would not arise to them in the absence of those arrangements.
> On the other hand, an individual manager or small management team interposing a corporate entity with no substance will be caught.
> In between the two extremes it is harder to define a clear line where it will become reasonable to assume that in the absence of those arrangements, the sum would have arisen to A or an individual connected with A. The factors below, which are non-exhaustive, may help in considering what is reasonable:
>
> - What structures were used by the fund management house in relation to prior funds (this may not just be their immediately preceding fund);
> - Whether the company was put in place in response to advice to minimise a tax burden or achieve tax efficient co-investing funding;
> - Whether the fund management business operates (and has always operated) as a wholly corporate group;
> - Whether a company in the corporate group carries on a trade of providing investment management or advisory services on a commercial basis with a view to profit and the individual receives an

[41] See App 2.24 (Reasonable-to-assume).

> arm's length rate of remuneration from his or her employment by that company. That company has sufficient substance to carry on the management activity and actually does so i.e. with its own employees, contracts and other assets;
>
> - The size of the management team;
> - The international spread of the management team;
> - What happens when an individual joins or leaves the management team – both in terms of prior agreements and understandings, as well as legal agreements (if the expectation is that the manager will receive a reward which in any sense reflects or is calculated by reference to amounts which have arisen or profits which have accrued to the corporate).
>
> The above list contains suggestions of what could be considered when deciding if it is reasonable to assume that a sum would have arisen to A in the absence of the arrangements. No factor is deemed to be decisive; the analysis depends on the facts and circumstances.
>
> (b) It is reasonable to assume that the arrangements have as their main purpose, or one of their main purposes, the avoidance of a liability to pay income tax, capital gains tax, inheritance tax, or corporation tax.
>
> This test does not require the purpose of the arrangements to involve the avoidance of the DIMF rules. Seeking to avoid any income tax, capital gains tax, inheritance tax or corporation tax advantage will be sufficient. In particular, HMRC understands that some of the structures set up historically by nom-domiciled fund managers were designed to manage their liability to inheritance tax rather than secure any income tax advantage and this will be sufficient to fail this test.
>
> This test will be deemed to be met where the management fee is used (whether directly or indirectly) to make an investment in a collective investment scheme (ITA07/S809EZB(9)). This will be the case even if there is, in fact, no tax avoidance motive to the arrangements in any sense.

Section 809EZDB(9) ITA provides:

> The condition in subsection (8)(b) is to be regarded as met in a case where the sum is applied directly or indirectly as an investment in a collective investment scheme.

The IF Manual provides:

> **IFM36335: special provisions for companies** [Sep 2021]
>
> ... This responds to structures which were common before the DIMF rules were introduced which sought to meet fund manager's co-investment commitments in a tax efficient way. Many of these

structures sought to apply management fees which would otherwise arise to a fund manager to pay up his or her co-investment commitment. While this provision (ITA07/S809EZDB(9)) is targeted at co-invest funding structures, please note this can include investments in any collective investment scheme, not just those managed by the individual in question. If taxpayers argue that the sums are not arising from a collective investment scheme in a way which undermines the clear policy rationale behind this legislation, HMRC will consider making a challenge, this includes applying the targeted anti-avoidance rules (ITA07/S809EZF) (IFM36600).

73.18 DIMF double taxation

DIMF could give rise to multiple charges on the same income. Section 809EZG ITA provides relief in two situations:

s.809EZG(1)	**s.809EZG(2)**
This section applies where-	This section also applies where-
(a) income tax is charged on an individual by virtue of section 809EZA in respect of a disguised fee, and	(a) income tax is charged on an individual by virtue of section 809EZA in respect of a disguised fee which arises to the individual under the [investment-services] arrangements by way of a loan or advance,
(b) at any time, a tax (whether income tax or another tax) is charged on the individual or another person otherwise than by virtue of section 809EZA in relation to the disguised fee.	(b) at any time, a tax (whether income tax or another tax) is charged on the individual in relation to another sum which arises to the individual under the arrangements, and
	(c) some or all of the loan or advance has to be repaid as a result of the other sum having arisen to the individual.

Where these conditions are satisfied, we move on to the relief:

> (3) In order to avoid a double charge to tax, the individual may make a claim for one or more consequential adjustments to be made in respect of the tax charged as mentioned in subsection (1)(b) or (2)(b).
> (4) On a claim under this section an officer of Revenue and Customs

> must make such of the consequential adjustments claimed (if any) as are just and reasonable.
>
> (5) The value of any consequential adjustments must not exceed the lesser of the income tax charged on the individual as mentioned in subsection (1)(a) or (2)(a) and-
>
> (a) where subsection (1) applies, the tax charged as mentioned in subsection (1)(b);
>
> (b) where subsection (2) applies, the tax charged as mentioned in subsection (2)(b) in relation to so much of the other sum as does not exceed the amount of the loan or advance that has to be repaid as mentioned in subsection (2)(c).
>
> (6) Consequential adjustments may be made-
>
> (a) in respect of any period,
>
> (b) by way of an assessment, the modification of an assessment, the amendment of a claim, or otherwise, and
>
> (c) despite any time limit imposed by or under any enactment.

The IF Manual provides:

> **IFM36730: Avoidance of double taxation: Claim under the first provision** [Oct 2020]
>
> ...
>
> *Example: Fund disposal of an investee company*
>
> A fund disposes of an investee company. The proceeds from the disposal are, as a matter of fact, allocated to the individual at the level of a General Partner Limited Partner (GP-LP) entity and used to meet an annual fee. This gives rise to a charge under the DIMF rules. The individual's share of the proceeds are £2m. The individual is also liable to capital gains tax on the share disposal.
>
> The individual has been taxed twice as a result of the DIMF rules and the CG charge on disposal. The individual may therefore be able to make a claim for a consequential adjustment to the CGT charge.
>
> Example: Following the change in the definition of fees 'arising' from 22 October 2015
>
> Following the changes made to the definition of arise with effect from 22 October 2015 (discussed below) a disguised fee arises to a fund manager's husband (the fund manager having procured that part of the interest in the GP-LP to which she was entitled was instead issued to her husband). The gains and income which the husband is allocated at the level of GP-LP are taxable in his hands in accordance with their original characteristic for tax purposes, for example as a capital gain or dividend income. However, the sum is also treated as arising to the fund manager by virtue of the DIMF rules and is charged in her hands as a disguised

fee to trading income.

The provision gives relief in respect of the ‘other tax’ which is the tax paid by the fund manager’s husband in this example. In order to facilitate a just and reasonable claim an officer of HMRC may deem the fund manager’s DIMF charge to have been paid by her husband as an administrative easement. This easement, however, is only for administrative purposes and in no way should the application of the easement provide a tax advantage for either party. If a tax advantage is achieved then this may lead to penalties.

In both examples, if the claim is allowed, then the adjustment will be limited by ITA07/S809EZG(5) to the lower of:

- the tax charge under the DIMF rules; and
- the other tax involved.

IFM36740: Avoidance of double taxation: Claim under the second provision [Oct 2020]

Claim under the second provision

ITA07/S809EZG(2)

ITA07/S809EZG(5)

This provision applies where income tax is charged to an individual in respect of a disguised fee under the disguised investment management fees (DIMF) rules and this fee has been paid by way of a loan or advance. If this loan or advance is then discharged by using some of the profits of the fund then there may be a further DIMF charge.

Example: Loan advance paid to manager

An individual investment manager gets a loan from an investment scheme. Three years later, profits arise in a way that means the profits are not included as profits of a trade and this profit is used to discharge the outstanding loan. The DIMF rules determine that an untaxed management fee arises both at the time the loan is made and again when the profits are used to repay the individual’s loan.

The individual has been taxed twice despite the latter profits offsetting the amount that would have at some point been repayable under the individual’s loan. Relief can be given against the DIMF charge which is due in respect of the latter profit payment.

73.18.1 *Expenses*

The IF Manual provides:

IFM36720: Avoidance of double taxation: Consequential adjustment [Oct 2020]

...Expenses

In circumstances where the General Partner Limited Partner (GP-LP) or

> the General Partner Limited Liability Partner (GP-LLP) structures are in place in a limited partnership fund (LP Fund) some of the monies flowing through the GP-LP or GP-LLP may be applied in meeting genuine commercial expenses of the LP Fund. The amount applied to these expenses will not be treated as arising to the individuals managing the fund, provided they would be deductible when calculating the profits of a trade of the GP-LP or GP-LLP under normal UK tax principles.
>
> However, in most cases it is unlikely that such expenses would be deductible from investment income and gains arising to members of the GP-LP or GP-LLP from the LP Fund.
>
> The fund manager may therefore be charged to capital gains tax, for example, on the gross gain treated as arising under Statement of Practice D12. Only the net amount actually arising after genuine expenses have been paid is charged under DIMF rules.
>
> HMRC accept that the CGT charged on the gross gain can be reduced under ITA07/S809EZG (up to the amount of tax charged under the DIMF rules in the unlikely situation that the CGT charge exceeds the former). This is the case even though the charge under the DIMF rules will be on the net sum arising.
>
> This treatment will only be permitted as just and reasonable in relation to genuine commercial expenses where those expenses would have been deductible in calculating the profits of a trade of providing investment management expenses in line with the clear purpose of the DIMF rules. It cannot be used to access relief on expenses which would not have been deductible when calculating trading profits.

73.19 Carried interest: CGT

Armed with the definition of carried interest,[42] we can turn to the CGT rules for carried interest. The drafting draws on the definition of disguised fee, and it is helpful to see them side by side:

Carried interest: s.103KA(1) TCGA	**Disguised fee: s.809EZA(3) ITA**
This section applies where–	For the purposes of this Chapter a "disguised fee" arises to an individual in a tax year from an investment scheme if—
(a) an individual ("A") performs	(a) the individual at any time performs or is to perform

[42] See 73.8 ("Carried interest").

investment management services directly or indirectly in respect of an investment scheme	investment management services directly or indirectly in respect of the scheme under any arrangements,
involving at least one partnership, and	[No equivalent]
(b) carried interest arises to A under the arrangements.	(c) under the arrangements, a management fee arises to the individual from an investment scheme in the tax year (see section 809EZB), and
[No equivalent]	(d) some or all of the management fee is untaxed;

Thus some of the discussion on s.809EZA(3) is relevant here.[43]

I refer to the arrangement as as an “investment-services arrangement”.

DIMF draft guidance provides:

> 15. ... section 103KA(1)(a) does not refer to carried interest arising from any particular investment scheme. Section 103KA therefore applies to any carried interest which arises to an investment manager, even if it arises from another investment scheme in relation to which no investment management services are in fact provided. The only condition is that the carried interest arises to the fund management under the arrangements by which he or she provides investment management services to a collective investment scheme ...
>
> 16. In virtually all situations, HMRC considers that carried interest (given its commercial rationale) will only arise to individuals where this condition is met. To give an example, a fund manager may manage Fund X at an asset management house. The fund manager may also be given carried interest in another fund managed by a different team (Fund Y). This is part of the remuneration structure at the business where the fund managers are given cross-exposure to the performance of each other’ funds.
>
> Here, the carried interest is arising to the fund manager from Fund Y because he or she is performing investment management services to Fund X and so the carried interest arising from both funds falls within section 103KA.
>
> 17. Section 103KA also applies where a fund manager has retired or has

[43] See 73.3 (“Disguised fee”).

ceased to perform investment management services and is still in receipt of carried interest. Section 103KA(1) does not include any requirement that the individual is still performing investment management services when the carried interest arises provided the fund manager is performing, or has previously performed, investment management services. If the fund manager has at some point performed investment management services in respect of a collective investment scheme and the carried interest arises under those arrangements, it comes within the scope of these rules.

73.19.1 *Carried-interest charges*

There are two charging provisions which I call **"partnership CI charge"** and the **"general CI charge"**; and the two charges together are the **"carried-interest charges"**.

s.103KA(2): partnership CI charge	**s.103KA(3): general CI charge**
If the carried interest arises to A	If the carried interest arises to A
in connection with the disposal of one or more assets of the partnership or partnerships–	in circumstances other than those specified in subsection (2),
(a) a chargeable gain equal to the amount of the carried interest less any permitted deductions (and no other chargeable gain or loss) is to be treated as accruing to A on the disposal, and	a chargeable gain of an amount equal to the amount of the carried interest less any permitted deductions is to be treated as accruing to A
(b) the chargeable gain is to be treated as accruing to A at the time the carried interest arises.	at the time the carried interest arises.

Comparing the two charges:

Partnership CI charge	**General CI charge**
Disposal of partnership asset	No disposal of partnership asset
CI gain accrues to A	*Same*
No other gain/loss accrues to A	No equivalent rule

The partnership CI charge typically arises when a partnership sells assets and a distribution is made to the partners including carried interest holders. The gain which is treated as arising is the **"carried interest gain"**. This is a notional (fictional) gain. It is computed according to carried interest rules, and not on CGT principles. It is distinct from the gain (if any) on any actual disposal. A carried interest gain arises even though the asset actually disposed of:

(1) is not a chargeable asset (eg it may be a qualifying corporate bond) or
(2) is a foreign asset (otherwise qualifying for the CGT remittance basis)
(3) is sold at a loss (applying CGT computation principles)

DIMF draft guidance provides:

> *Section 103KA(2) – disposals property of a partnership*
> 20. ... HMRC expect that section 103KA(2) will apply to most carried interest arising from most "classic" fund structures, where the fund is structured as limited partnership and the carried interest awarded to fund managers is held through another limited partnership (which is a limited partner in the fund limited partnership as shown in the diagram at paragraph 6 of section 1 above.) Section 103KA(2) is therefore also the primary means by which the legislation counters "base cost shift" and "cherry picking" as these both required carried interest to arise through partnership structures.
> 21. As outlined above, where carried interest arose to an individual from the disposal of assets held in a partnership (such as the disposal of an investment held by a fund limited partnership) the quantum of the gain treated as arising to the individual was previously calculated in accordance with SoP D12.[44] Section 103KA(2) supersedes SoP D12 where it applies and substitutes a new, statutory, method to determine the quantum of the gain treated as arising. Section 103KA(2)(a) provides that a gain equal to the amount of carried interest arising less any permitted deductions will arise. As noted below, "permitted deductions"are narrowly defined and section 103KA(2) will charge a fund manager on their true economic gain from the carried interest rather than the amounts calculated under SoP D12.
> 22. Please note, that section 103KA(2)(a) provides that the gain treated as arising under this section is the only chargeable gain (or loss) treated as arising in respect of that disposal of partnership property, and section 103KA(2)(b) also potentially alters the timing of when the gain accrues to the point at which the carried interest arises to the fund manager. Section 103KA(2) therefore acts to adjust both the timing and quantum of any gain arising to a fund manager which comprises carried interest.
> 23. In some circumstances a gain may accrue to an individual under SoP

[44] See 85.20 (Partnership transparency: CGT).

> D12 before section 103KA is invoked. This is because section 103KA is triggered by a sum arising to a fund manager, whereas a gain can be treated as accruing under the general scheme of CGT and SoP D12 when a partnership asset is disposed of, even if the proceeds are retained and no sum arises to the relevant individual. This is most likely to occur where a partnership asset is disposed of necessitating the calculation of a gain under SoP D12 but where the carried interest is placed into escrow (as discussed below at paragraphs 37-44) such that no sum "rises"to the fund manager at that time. There is nothing at this stage to prevent the gain calculated in accordance with SoP D12 accruing to the fund manager and he or she will be taxed on that gain in accordance with his or her own circumstances. However, once the sum is released from escrow and a sum "rises"to the fund manager, the chargeable gain accruing under section 103KA(2) vacates and supersedes the earlier gain at that point –section 103KA(2) putting beyond doubt that the gain calculated under that section is the only gain treated as arising to the fund manager.
>
> 24. Please note the exclusivity of section 103KA(2) also applies in respect of any loss that would otherwise accrue to a fund manager under SoP D12 (for example, where the hurdle has been hit and the fund manager is receiving carry which is paid out of the disposal of an asset at a loss). Here a gain accrues to the fund manager equal to the sum received, less any permitted deductions, and no loss is treated as accruing to the individual. Where there is the timing difference referred to above (i.e. an asset is disposed of at a loss some time before the proceeds are distributed in a way which prevents a sum "rising"to the fund manager until that later point) it may be prudent for a taxpayer not to claim that loss under section 16(2A), TCGA 1992. If the loss has been claimed as an allowable loss and section 103KA(2) is later invoked such that the loss is vacated and treated as never having arisen, the fund manager may find that his previous tax return(s) are incorrect and that tax has been underpaid.

DIMF draft guidance provides:

> 26. Please note, in common with other references in the TCGA, "asset" in section 103KA(2) refers to an asset the disposal of which could give rise to a chargeable gain. Where an asset is effectively exempt from capital gains tax under general principles, the carried interest will be charged under section 103KA(3) rather than section 103KA(2). This is most likely to arise in respect of qualifying corporate bonds (or QCBs) within section 116, TCGA 1992 which do not give rise to chargeable gains. The loan notes issued to funds to represent shareholder debt are

> often QCBs and so carried interest satisfied out of their repayment will come within section 103KA(3) rather than section 103KA(2).

Sections 103KFA - 103 KFE TCGA provide an elective accruals basis of taxation for carried interest. The object is to allow UK resident investment managers to accelerate their tax liabilities in order to align their timing with the position in other jurisdictions, where they may obtain double taxation relief. I do not discuss these provisions here.

73.19.2 *Who receives carried interest*

Section 103KG(1) TCGA provides:

> For the purposes of this Chapter [Chapter 5 Part 3], carried interest "arises" to an individual ("A") if, and only if, it arises to him or her for the purposes of Chapter 5E of Part 13 of ITA 2007.

See 73.15 (To whom DIMF arises).

The usual terminology is that income *arises* and gains *accrue*. Consistently with that, a carried interest gain is said to accrue, and carried interest is said to arise. The carried interest code adopts the DIMF code, which concerns income rather than gains, and so used the word "arises". But "arise" and "accrue" amount to the same thing.

The IF Manual provides:

> **IFM37268: Sums released from escrow** [Oct 2020]
> ... The deferred carried interest rules modify the application of the enjoyment conditions in relation to companies through TCGA92/S103KG(8)-(11). This mirrors the modification as part of the Disguised Investment Management Fees (DIMF) rules seen at ITA07/S809EZDB (6)-(9) (IFM36335).

73.19.3 *Carried interest trade receipt*

Section 103KA(4) TCGA provides:

> Subsections (2) and (3) [carried-interest charges] do not apply in relation to carried interest to the extent that–
> (a) it is brought into account in calculating the profits of a trade[45] of A for the purposes of income tax for any tax year

DIMF draft guidance provides:

[45] Section 103KA(8) TCGA provides: "In this section ... "trade" includes profession or vocation."

> This ensures that fund managers who receive a performance fee which is brought into account when calculating their trading profits do not need to claim relief from the CGT charge under this legislation to avoid double taxation.

73.19.4 *"Carried interest gain"*

The term "carried interest gain" matters because such gains are (in short) subject to tax at the higher, 28% CGT rate.[46] This is a convenient place to consider the definition, as it refers to provisions and wording discussed here.

Section 1H TCGA provides:

> (9) For the purposes of this section chargeable gains are "carried interest gains" if they accrue to an individual ("X")—
> (a) under section 103KA(2) or (3) (investment management services),
> (aa) under section 103KFA(3) (gains on deemed carried interest where election made), or
> (b) as a result of carried interest arising to X under arrangements
> [i] not involving a partnership
> [ii] under which X performs investment management services directly or indirectly in respect of an investment scheme.
> (10) A gain is not a carried interest gain under subsection (9)(b) if the carried interest constitutes a co-investment repayment or return.[47]

73.19.5 *Relevance of partnership*

The s.103KA charges only apply if the arrangement involves a partnership. A partnership is not needed for DIMF or for a carried interest gain (taxable at 28%). But in practice there usually is a partnership involved somewhere in the structure.

73.20 "Permitted deductions"

This term is used in the computation of carried-interest gains.

Section 103KA(5) TCGA provides:

> For the purpose of subsections (2) and (3) "permitted deductions" in relation to A means such parts of the amounts specified in subsection (6) as is just and reasonable.

[46] See 43.15.1(Residential/carried interest gain).

[47] Section 1H(11) TCGA provides referential definitions: "Expressions used in subsection (9) or (10) have the same meaning as they have in Chapter 5 of Part 3."

Permitted deductions are more narrowly defined than the usual rule for CGT deductions (in s.38 TCGA). There are three categories of permitted deduction. Section 103KA(6) TCGA provides:

> The amounts referred to in subsection (5) are–
>
> (a) the amount of any consideration in money given to the scheme by or on behalf of A wholly and exclusively for entering into the [investment-services] arrangements referred to in subsection (1)(a) (but not consideration in respect of co-investments),

The other two deductions deal with the overlap with employment income:

> (b) any amount that constituted earnings of A under Chapter 1 of Part 3 of ITEPA 2003 (earnings) in respect of A's entering into those arrangements (but not any earnings in respect of co-investments or any amount of exempt income within the meaning of section 8 of that Act), and
>
> (c) any amount which, by reason of events occurring no later than the time the carried interest arises, counts as income of A under the enactments referred to in section 119A(3) [employment-related securities] in respect of A's participation in the [investment-services] arrangements referred to in subsection (1)(a) (but not an amount counting as income of A in respect of co-investments); (and section 119A(5) applies for the purposes of this paragraph as it applies for the purposes of section 119A(4)).
>
> For the purposes of this Act no other deduction may be made from the amount of the carried interest referred to in subsection (2) or (3).

Section 103KA(7) TCGA allows a deduction where carried interest is acquired for consideration:

> Where the carried interest arises to A by virtue of his or her acquisition of a right to it from another person for consideration given in money by or on behalf of A, the amount of the chargeable gain accruing to A under subsection (2) or (3) is, on the making of a claim by A under this subsection, to be regarded as reduced by the amount of the consideration.

The IF Manual provides:

> **IFM37236: Permitted deductions** [Oct 2020]
>
> ... Deductions are not permitted for base cost contributed by other members of the partnership, or attributable to revaluations of the

> partnership assets, as was previously possible under Statement of Practice D12 (the "base cost shift", explained in IFM37160).

2017 Rebasing does not apply, because although there is a deemed disposal and re-acquisition, it is not deemed to be for money. HMRC agree.[48]

73.21 Co-investment

In short, co-investment is an amount of their own money that fund managers are required to put into the investment scheme, on the same terms as external investors, to give them "skin in the game".

Section 103KA(4) TCGA provides:

> Subsections (2) and (3) [carried-interest charges] do not apply in relation to carried interest to the extent that...
>
> (b) it constitutes a co-investment repayment or return.

Section 103KA(8) TCGA defines co-investment:

> In this section-
>
> "co-investment", in relation to A, means
>
> [a] an investment made directly or indirectly by A in the scheme,
>
> [b] where there is no return on the investment which is not an arm's length return within the meaning of section 809EZB(2) of ITA 2007;

Section 103KA(8) TCGA defines repayment or return:

> "co-investment repayment or return" means a repayment in whole or in part of, or a return on, a co-investment;

73.22 Disposal of carried interest

Section 103KB TCGA provides:

> (1) For the purposes of section 103KA [carried-interest charges], consideration received or receivable by an individual for the disposal, variation, loss or cancellation of a right to carried interest is to be treated as carried interest arising to that individual at the time of the disposal, variation, loss or cancellation.
>
> (2) But subsection (1) does not apply if and to the extent that the consideration is a disguised fee arising to the individual for the purposes of section 809EZA of ITA 2007.

[48] See 56.16.7 (Effect of 2017 rebasing), and Rebasing Q&As Question 1.

The IF Manual provides:

> **IFM37232: Operation of the charge: Disposals** [Oct 2020]
> **Disposal of partnership assets**
> ... The general rules in TCGA92, which determine whether a disposal has taken place and for what consideration, will also apply to this section. In particular, TCGA92/S17 will apply to treat an individual as having received market value for a right to carried interest when it is disposed of otherwise than at arm's length. In circumstances where an individual is forced to dispose of their right to receive carried interest, TGCA92/S17(1)(b) will not apply to the individual making the disposal, where the disposal is sufficiently disassociated to services rendered.

DIMF draft guidance provides:

> 54. When initially published, the draft Finance Bill contained provisions which would have disregarded restrictions which reduced the value of a right to carried interest for the purposes of section 17. The government was persuaded that this approach was not appropriate and with the expanded definition of "arise" no longer necessary. Such restrictions are not, therefore, disregarded on disposals of carried interest which come within section 17 under Finance (No.2) Act as enacted.
> 55. So if an individual disposed of their right to carried interest in favour of their child or to an unconnected entity but on non-arm's length terms (for example, as a gift to a trust structure from which only their adult children could benefit in an attempt to mitigate the impact of the new rules), the amount charged as a capital gain under this measure will equal the market value of the right to carried interest at that time taking into account any restrictions.

73.23 Carried-interest remittance basis

Section 103KC TCGA provides:

> In a case where section 103KA [carried-interest charges] applies, a chargeable gain accruing or treated as accruing to an individual in respect of carried interest is a chargeable gain accruing on the disposal of an asset situated outside the UK only to the extent that the individual performs the services referred to in section 103KA(1)(a) [investment management services[49]] outside the UK.

This restricts the remittance basis so far as the services are performed in

[49] See 73.19 (Carried interest: CGT).

the UK.[50]

Where possible, it is advantageous for investment activity to be performed abroad.

The approach to apportionment should be the same as for employment income.[51]

DIMF draft guidance provides:

> 59. This replaces the normal rule ... that defines a foreign chargeable gain by reference to the location of the assets disposed of. Given that carried interest arises in relation to the performance of investment management services, looking to the location where these are performed rather than the location of the assets used to satisfy the carried interest is more appropriate and reflects the "hybrid" nature of the receipt as having some characteristics of an investment return and others of a reward for services.
>
> ...
>
> 61. For some individuals' circumstances, a simple apportionment of their gain based on day-count may produce an acceptable result but in other cases, where more significant management duties are consistently performed in one territory than are performed in another, a simple time-apportionment will tend to under- or over-state the foreign chargeable gain which accrues. Please note that generally the focus will be on the services performed by the individual fund manager – a fund manager who performs the vast majority of their investment management services outside the UK would not be prejudiced by the activities of his or her UK focused colleagues.
>
> 62. For example, a UK-based German national may work for a UK headquartered fund. Her office is based in London where she and her family are based. However, her role in the fund is very much focused on Germany and Austria and she leads the teams responsible for investment in those jurisdictions. She spends, on average, 2-3 days a week in Germany but this misrepresents her input. In relation to most transactions on which she works, the fund manager spends an extended period of time setting up and negotiating the original acquisition and subsequently stays in Germany for, say, one week a month to support the management team before staying for a further extended period to negotiate the disposal. Here a day-count may not be appropriate and it is likely that a greater proportion than the c.25% produced by looking at

[50] Conversely, it extends the remittance basis to UK situate carried interest. In practice carried interest is usually non-UK situate, so the issue does not arise.

[51] See 34.31 (Earnings "in respect of" UK duties).

> one week out of four is the correct proportion treated as a foreign chargeable gain under the new section 103KC.
>
> 63. Similarly HMRC are aware that, for some types of closed-ended funds, carried interest will arise in one year which, in truth, reflects services performed by an individual over a longer period. In such a situation, it may be correct to look at where services have been performed over prior years although, again, this will depend on individual facts and circumstances. For example, an individual involved in fund-raising for a fund may spend the first few years of a fund's life travelling seeking to raise funds from investors outside the UK, only returning to the UK at irregular intervals and generally because it presents their personal home. Once the fund raising process is finished there may be a period where the individual is effectively based in the UK full-time, maintaining relations with investors. Subsequently, before the first fund has even begin to pay carried interest, the fund raiser may recommence travelling seeking to raise commitments for the next fund. Here, those early years largely spent overseas will probably carry more weight when determining what proportion of the carried interest represents a foreign chargeable gain. An additional example of such a situation is provided in Chapter 3.
>
> 64. These two examples are intended to be helpful and to show when HMRC will potentially accept a more generous split under section 103KC in favour of a foreign chargeable gain. However, section 103KC is a double-edged sword and will also operate to increase the proportion of carried interest taxable on a remittance basis user on the arising basis. As a general observation HMRC will be prepared to give weight to activities performed in the underlying jurisdictions where a fund invests.

The IF Manual provides:

> **IFM37330: Foreign chargeable gains: Low tax jurisdictions** [Oct 2020]
>
> The successful performance of a fund which generates carried interest does not arise from tax efficient holding structures but the management of genuine underlying business operations. This is especially true where services based in low tax jurisdictions are labelled as marketing services, investor relations or other vague descriptions which seek to disguise the real contribution of value by the management team in the offshore financial centres where they are normally based.
>
> The correct proportion of carried interest applicable to UK taxation will not be affected by the attempt to disguise the legitimate underlying investment management services.

73.23.1 *Record keeping*

The IF Manual provides:

> **IFM37340: Foreign chargeable gains: Record keeping requirements** [Oct 2020]
> HMRC recognises that carried interest may arise in relation to services performed prior to the introduction of the carried interest rules in Finance (No. 2) Act 2015 (IFM37150) and therefore individuals would not have been aware of the need to keep the relevant records.
> HMRC will adopt a pragmatic approach to record keeping and the evidence used to identify a just and reasonable split for foreign chargeable gains.
> For remittance basis users, HMRC would expect the customer to have already recorded the information required to determine their residency position and accurately return the income and gains eligible for taxation under the remittance basis.
> Additional information may be required to evidence specific duties performed, their location or duties performed over certain periods of time.

Records should be kept to show where the work was done. For periods before the legislation was introduced, taxpayers would not have expected to need this, and records may be difficult to recover; the rules operate with an element of retrospectivity. But there it is.

73.23.2 *Carried interest: Mixed funds*

The IF Manual provides:

> **IFM37350: Foreign chargeable gains: Mixed funds** [Oct 2020]
> In general where a remittance of a sum is made to the UK which comprises various items for tax purposes, the mixed funds rules determine the order in which sums are treated as remitted to the UK. Core mixed funds rules can be found at ITA07/S809Q.
> Carried interest may comprise foreign chargeable gains and "UK chargeable gains" (taxable on the arising basis when arising to a remittance basis tax payer). If a sum of carried interest was to be considered from a mixed fund, the foreign chargeable gain would be treated as remitted in priority to the UK chargeable gain being taxed under the arising basis. The individual would therefore be required to pay tax on that foreign chargeable gain when making a remittance, in addition to paying tax due on the chargeable gain being taxed under the arising basis. This is in line with ITA07/S809Q.

> In circumstances where a non-domiciled individual performs services that give rise to carried interest in the UK and one or more jurisdictions, the carried interest rules produce two separate gains, one relating to UK services and one relating to non-UK services. As two gains are brought into existence at the same time there is no mixed fund from the perspective of the individual in the account of the payor. It is therefore possible to split a sum of carried interest into two separate payments, with one being the foreign chargeable gain. If these two funds are never comingled, a mixed fund will not come into existence.
>
> This does not alter the application of the mixed funds rules to the extent that each of the two carried interest gains may represent a mixed fund of different items determined on general principles. It only applies to the joint effect of TCGA92/S103KA and TCGA92/S103KC with the result that the gains those sections give rise to will not constitute elements of a single mixed fund unless they are actually paid into a single account, thus making that account a mixed fund.
>
> This analysis derives from the terms of TCGA92/S103KC. HMRC do not consider it justifiable in respect of any other situation or potential mixed fund.

73.24 Non-residents

Non-residents are not in general subject to CGT, and this rule applies to carried interest. This is deliberate.[52]

73.25 Other anti-avoidance rules

The usual CGT anti-avoidance rules are not needed because of the rules as to who receives carried interest.[53] This was overlooked at the time of the introduction of the carried interest code, and so the following provisions were inserted with retrospective effect in 2017.

73.25.1 *Carried interest outside s.3*

Section 13(1A) TCGA formerly provided:

> *But this section does not apply if the gain is ...*
>
> *(c) a chargeable gain treated as accruing under section 103KA(2) or (3) (carried interest gains).*

This took carried-interest gains outside s.13 TCGA, now s.3 TCGA.

[52] 2015 carried-interest guidance para 41.

[53] See 73.19.2 (Who receives carried interest).

Where is the equivalent in the 2019 CGT rewrite?

73.25.2 *Carried interest outside s.86*

Section 86(4B) TCGA provides:

> Where (apart from this subsection) the amount mentioned in subsection (1)(e) would include an amount of chargeable gains treated as accruing under section 103KA(2) or (3) (carried interest gains), the amount of the gains is to be disregarded for the purposes of subsection (1)(e).

This takes carried-interest gains outside s.86 TCGA.

73.25.3 *Carried interest outside s.87*

Section 87(5B) TCGA provides:

> Where (apart from this subsection) the amount mentioned in subsection (4)(a) would include an amount of chargeable gains treated as accruing under section 103KA(2) or (3) (carried interest gains), the amount of the gains is to be disregarded for the purposes of determining the section 1(3) amount.

In short, carried-interest gains are not s.1(3) amounts (trust gains) and so are outside s.87 TCGA.

73.26 DIMF/Carried interest TAARs

The DIMF and carried interest codes are protected (or one might say, extended) with a TAAR:

s.809EZF ITA	**s.103KD TCGA**
In determining whether section 809EZA [DIMF code][54] applies in relation to an individual,	In determining whether section 103KA [carried-interest code] applies in relation to an individual,
no regard is to be had to any arrangements the main purpose, or one of the main purposes, of which is to secure that that section does not apply in relation to- (a) the individual, or (b) the individual and one or more	no regard is to be had to any arrangements the main purpose, or one of the main purposes, of which is to secure that that section does not to any extent apply in relation to- (a) the individual, or

[54] See 73.13 (DIMF: Deemed trade).

other individuals.	(b) the individual and one or more other individuals.

In my terminology, these are arrangement-disregard TAARs.[55]

The IF Manual provides:

> **IFM36600: Anti-avoidance clause: Anti-avoidance** [Oct 2020]
> ... Where steps are taken to ensure that arrangements fall within the definition of carried interest this will not in itself mean that the anti-avoidance clause will be invoked. For example, if the hurdle rate for a fund was increased from 5% to 6% to adhere with the condition for carried interest detailed at ITA07/S809EZD(4)(b), this would not necessarily be a reason for the anti-avoidance provision to be applied.

Is that law or concession?

73.27 Carried interest double taxation

73.27.1 *Conditions for relief*

Section 103KE TCGA provides:

> (1) This section applies where-
> (a) capital gains tax is charged on an individual by virtue of section 103KA in respect of any carried interest, and
> (b) Condition A or Condition B is met.
> (2) Condition A is that-
> (a) at any time, tax (whether income tax or another tax) charged on the individual in relation to the carried interest has been paid by the individual (and has not been repaid), and
> (b) the amount on which tax is charged as specified in subsection (1)(a) is not a permissible deduction under section 103KA(6)(b) or (c).[56]
> (3) Condition B is that at any time tax (whether income tax or another tax) charged on another person in relation to the carried interest has been paid by that other person (and has not been repaid).

It will almost always be the case that one or other of these conditions is satisfied.

The IF Manual provides:

[55] See 3.1 (TAAR/unallowable purpose test).

[56] Para (2)(b)(c) apply where the carried interest is earnings or employment-related security income: see 73.20 ("Permitted deductions").

IFM37240: Interaction with other taxes [Oct 2020

A charge under TCGA92/S103KA does not displace any charge to tax other than CGT that arises by reference to the carried interest. If carried interest represents an amount of income, for example dividends or interest, the fund manager will have two liabilities to tax. Firstly, a liability to income tax on the amount determined in accordance with the appropriate rules (e.g. dividend treatment). Secondly, a chargeable gain calculated in accordance with TCGA92/S103KA(2) or (3) as appropriate. Relief may be claimed for that other tax against the CGT charged under the carried interest rules (IFM37400). This is only applicable to taxes charged under the UK Taxes Acts.

IFM37420: Double taxation adjustment [Sep 2021]

The value of adjustments made will not exceed the lesser of:

- The capital gains tax charge in respect of the carried interest under the new legislation; and
- The other tax paid.

Note that, when considering an adjustment, the other tax must have been paid.

Subject to the next paragraph, an adjustment will not be made if the sum may become chargeable to another tax or if the other tax has only been charged and not paid. Where the other tax has been paid, the individual should file their tax return for the year in which the carried interest arises and claim under these rules for an adjustment to be made in that tax return. If another tax is paid after the capital gain tax (CGT) has been paid, the individual will be able to make a claim to avoid double taxation by amending their tax return or by other means in line with normal rules and time limits rather they relying on TCGA/ 103KE(7).

Where a sum of carried interest is charged to both CGT under these rules and also income tax in the same year (for example, where the sum represents interest or dividend income), resulting in two charges in respect of the carried interest, a claim can be made in the appropriate tax return so that the appropriate liability is paid and double taxation does not arise. HMRC will treat the income tax as paid by the payment made with the tax return for the year in question. In this particular scenario, it is therefore not required to have first paid the income tax before being able to claim relief. In all other instances, the other tax must have been paid before relief can be claimed.

Each component of the carried interest arising should be considered separately when determining relief due under TCGA92/S103KE. When a sum comprises a series of items, double taxation relief will be given on an item by item basis and not on a sum as whole. It will therefore only be possible to set the other tax due on a particular component of the sum arising against the CGT due on that component, rather than the CGT due on the sum as a whole. This is considered to be a just and reasonable approach, in accordance with TCGA92/S103KE(5).

Example 1

A sum comprises Item X, Item Y and Item Z. These will be dealt with as three individual items and not as one whole item. This would mean any other tax paid on Item X can only be set against the CGT due on Item X and not on the combined sum of CGT due on Item X, Item Y and Item Z.

Example 2

A sum of carried interest totals £2,000 and comprises debt principal of £1,000 and £1,000 of interest on that debt. Relief under TCGA92/S103KE would be given as follows:

The £1,000 of principal is "carried interest" and is charged to CGT at 28% under the carried interest rules amounting to £280.

The £1,000 of interest is also "carried interest" and so charged to CGT at 28% amounting to £280. Income tax charged at 45% will need to be paid and this amounts to £450.

Relief under TCGA92/S103KE allows full relief against the £280 of CGT due on the interest; the income tax payable of £450 effectively discharges the CGT liability due.

The income tax payable cannot also be set off against the CGT due on the principal. Income tax arises only in respect of the interest and not against the CGT of any other item within the £2,000 (£1,000 principal plus £1,000 interest) carried interest sum.

The net tax charge will therefore be £730:

CGT paid on principal:	280
CGT paid on interest:	280
Income tax paid on interest:	450
Total tax paid:	1,010
Double taxation relief:	-280
Net tax payable:	730

73.27.2 *Foreign tax*

DIMF draft guidance provides:

72. Please note that in contrast to the DMF Rules, section 103KE adjusts the CGT charge under section 103KA to eliminate double taxation (the DMF Rules preserve the charge under section 809EZA by contrast and adjust the "other tax"). As "tax" is not defined for the purposes of the TCGA, it is therefore possible for HMRC to make an adjustment to the charge under section 103KA in respect of non-UK tax to avoid double

> taxation. To give a very simple example, a US citizen fund manager will be chargeable to US tax on their worldwide income. That fund manager is resident in the UK for tax purposes however and receives carried interest through a partnership structure which is charged to tax under section 103KA(2). For US tax purposes however, the entities in that structure have made "check the box" elections such that it is treated as transparent for US tax purposes. The fund manager is therefore treated as receiving underlying dividend income for US tax purposes and this is charged to US Federal Income tax at a rate in excess of 28%. Here HMRC would accept that the US tax is suffered "in relation to" the carried interest and given the drafting of section 103KE, would be able to adjust down the UK charge under section 103KA to avoid tax. Please note that in situations where the UK has a primary taxing right over the carried interest (as would be likely on the above example) it will only be just and reasonable to grant relief where it is not possible to obtain a tax credit in the other relevant jurisdiction. Section 103KE only operates as a credit of the "last resort" in these cases.
>
> 73. If tax has been paid on amounts which are then treated as permitted deductions in computing the chargeable gain then no relief is available against CGT in respect of that tax under this provision.
>
> 74. The value of the adjustments made will not exceed the lesser of: a. the capitals gains tax charge in respect of the carried interest under the new legislation; and b. the other tax paid.

73.27.3 *"Paid"*

DIMF draft guidance provides:

> 75. The other tax in respect of which an adjustment is sought must have been paid by the individual. It is not sufficient that the sum is charged or may be chargeable to another tax. Often, this other tax will have been paid by the time the individual files his or her tax return for the year in which the carried interest arises: a claim under these rules for an adjustment should then be made in that tax return. Please note that, where a sum of carried interest is charged to capital gains tax under this measure but is also charged to income tax in the same tax year (for example, where the sums represent interest or dividend income to the underlying partnership), such that there are two charges in respect of that carried interest, a claim can be made in the appropriate tax return without the need to discharge both tax liabilities. HMRC will treat the income tax as having been "paid" by the payment made alongside the tax return for the year in question. It would not be necessary to pay both the income tax due and capital gains tax charged under this measure at the same time before requesting a repayment.

> 76. Where, however, another tax is paid after the CGT charged under the new rules has been paid, the individual will be able to make a claim to avoid double taxation through an amendment to their tax return (where possible) or by other means in accordance with the normal rules and time limits.
>
> 77. As explained above in paragraph 46, this legislation establishes a minimum level of tax on carried interest rather than a new regime which disregards the underlying receipts to the fund partnership. This means each component of the sum arising is looked at separately when determining what relief should be given under section 103KE. Where a sum comprises a series of items, double taxation relief will be given on an item by item basis (i.e. it will only be possible to set the other tax due on a particularly component of the sum arising against the CGT due on that component, rather than the CGT due on the sum as a whole). This is the only approach which will be considered "just and reasonable" in accordance with section 103KE(3) by HMRC.
>
> 78. Using the same figures as the example in paragraph 47, section 103KE would work as follows.
>
> - The £1000 of principal is "carried interest" and so is charged to capital gains tax at 28% under this measure (£280).
> - The £000 of interest is also "carried interest" and so charged to capital gains tax at 28% (£80). Income tax at 45% (£50) must still be paid.
>
> Section 103KE will allow full relief against the £80 of CGT technically due on the interest income under these rules. The income tax payable on the interest would effectively discharge CGT liability on the same sum. However, the income tax due on the interest income cannot also be set off against the capital gains tax due on the principal. The income tax arises in relation to the interest and so can only be relieved against the capital gains tax due on that interest, and not against the CGT due on any other item which is represented in the sum of carried interest.

73.27.4 *Double taxation adjustment*

Assuming these conditions are satisfied, we move on to the relief. Section 103KE TCGA provides:

> (4) In order to avoid a double charge to tax, the individual may make a claim for one or more consequential adjustments to be made in respect of the capital gains tax charged as mentioned in subsection (1)(a).
>
> (5) On a claim under this section an officer of Revenue and Customs must make such of the consequential adjustments claimed (if any) as are just and reasonable.

> (6) The value of any consequential adjustments made must not exceed the lesser of-
>
> (a) the capital gains tax charged as mentioned in subsection (1)(a), and
>
> (b) the tax charged as mentioned in subsection (2)(a) or (3).

This seems an unnecessarily complicated way to express the cap on the relief, but there it is.

> (7) Consequential adjustments may be made-
>
> (a) in respect of any period,
>
> (b) by way of an assessment, the modification of an assessment, the amendment of a claim, or otherwise, and
>
> (c) despite any time limit imposed by or under an enactment.

This is the equivalent of the DIMF rule: see 73.18 (DIMF double taxation).

73.27.5 *Claim to disregard losses*

Section 103KE(8) TCGA provides:

> Where-
>
> (a) an individual makes a claim under this section in respect of a year of assessment, and
>
> (b) apart from this subsection, an amount falls to be deducted under section 1(3)(b) [carried-forward losses[57]] from the total amount of chargeable gains accruing to the individual in that year,
>
> the individual may elect that the amount to be so deducted be reduced by any amount not exceeding the amount on which tax is charged as specified in subsection (2)(a) or (3).

This may be relevant where an individual receives a sum which is both income and carried-interest gain. Setting carried-forward capital losses against the carried-interest gain would be wasteful, because the gain qualifies for double taxation adjustment relief.

73.28 External investors

Section 103KF TCGA provides:

> (1) If-
>
> (a) a chargeable gain accrues to an external investor[58] in an

[57] See 65.2 (Relief for losses).

[58] See 73.12.6 ("External investor").

> investment scheme on the disposal of one or more partnership assets, and
>
> (b) the external investor makes a claim for relief under this section,
>
> then subsection (2) applies in relation to the disposal.
>
> (2) The amount of the chargeable gain is to be reduced by an amount equal to-
>
> I – C
>
> where-
>
> (a) I is an amount equal to such part of the sum invested in the fund by the external investor which on a just and reasonable basis is referable to the asset or assets disposed of, and
>
> (b) C is the amount deducted under section 38(1)(a) in respect of consideration given wholly and exclusively for the acquisition of the asset or assets.

This sets aside the base cost shift in favour of the external investors.

73.29 Deferred carried interest

Section 103KG(2) TCGA provides:

> But section 809EZDB of ITA 2007 (sums arising to connected company or unconnected person) does not apply in relation to a sum of carried interest arising to-
>
> (a) a company connected with A, or
>
> (b) a person not connected with A,
>
> where the sum is deferred carried interest in relation to A.

Section 103KG(3) TCGA provides:

> In this section, "deferred carried interest", in relation to A-
>
> (a) means a sum of carried interest where the provision of the sum to A or a person connected with A is deferred (whether pending the meeting of any conditions (including conditions which may never be met) or otherwise), and
>
> (b) includes A's share (as determined on a just and reasonable basis) of any carried interest the provision of which to A and one or more other persons, taken together, has been deferred (whether pending the meeting of any conditions (including conditions which may never be met) or otherwise).
>
> In this subsection, in a case where the sum referred to in subsection (2) arises to a company connected with A, the reference to a person connected with A does not include that company.

73.30 Interest ceases to be deferred

Section 103KG TCGA provides:

> (4) Where-
> (a) section 809EZDB of ITA 2007 has been disapplied in relation to a sum of deferred carried interest by virtue of subsection (2),
> (b) the sum ceases to be deferred carried interest in relation to A, and
> (c) the sum does not in any event arise to A apart from this subsection,
>
> the sum is to be regarded as arising to A at the time it ceases to be deferred carried interest.
>
> (5) But subsection (4) does not apply if-
> (a) none of the enjoyment conditions is met in relation to the sum when it ceases to be deferred carried interest, and
> (b) there is no reasonable likelihood that any of those conditions will ever be met in relation to the sum.

73.30.1 *"Enjoyment conditions"*

Section 103KG TCGA duplicates the definition in the DIMF legislation; see 73.17.1 ("Enjoyment conditions").

> (6) The enjoyment conditions are-
> (a) the sum, or part of the sum, is in fact so dealt with by any person as to be calculated at some time to enure for the benefit of A or a person connected with A;
> (b) the sum's ceasing to be deferred carried interest in relation to A operates to increase the value to A or a person connected with A of any assets which-
> (i) A or the connected person holds, or
> (ii) are held for the benefit of A or the connected person;
> (c) A or a person connected with A receives or is entitled to receive at any time any benefit provided or to be provided out of the sum or part of the sum;
> (d) A or a person connected with A may become entitled to the beneficial enjoyment of the sum or part of the sum if one or more powers are exercised or successively exercised (and for these purposes it does not matter who may exercise the powers or whether they are exercisable with or without the consent of another person);
> (e) A or a person connected with A is able in any manner to control directly or indirectly the application of the sum or part of the

> sum.
>
> In this subsection, in a case where the sum referred to in subsection (2) arises to a company connected with A, references to a person connected with A do not include that company.
>
> (7) In determining whether any of the enjoyment conditions is met in relation to a sum or part of a sum-
>
> (a) regard must be had to the substantial result and effect of all the relevant circumstances, and
>
> (b) all benefits which may at any time accrue to a person as a result of the sum ceasing to be deferred carried interest in relation to A must be taken into account, irrespective of-
>
> (i) the nature or form of the benefits, or
>
> (ii) whether the person has legal or equitable rights in respect of the benefits.

DIMF draft guidance provides:

> 44. ... the deferred carried interest rules also modify the application of the enjoyment conditions in the context of corporate structures. The relevant provisions at section 103KG(8)-(11) mirror subsections 809EZDB(6)-(9), ITA 2007 here.

Section 103KG TCGA provides:

> (8) The enjoyment condition in subsection (6)(b), (c) or (d) is to be treated as not met if it would be met only by reason of A holding shares or an interest in shares in a company.
>
> (9) The enjoyment condition in subsection (6)(a) or (e) is to be treated as not met if the sum referred to in subsection (2) arises to a company connected with A and-
>
> (a) the company is liable to pay corporation tax in respect of its profits and the sum is included in the computation of those profits, or
>
> (b) paragraph (a) does not apply but-
>
> (i) the company is a CFC and the exemption in Chapter 14 of Part 9A of TIOPA 2010 applies for the accounting period in which the sum arises, or
>
> (ii) the company is not a CFC but, if it were, that exemption would apply for that period.
>
> In this subsection "CFC" has the same meaning as in Part 9A of TIOPA 2010.
>
> (10) But subsections (8) and (9) do not apply if the sum referred to in subsection (2) arises to the company referred to in subsection (2)(a) or the person referred to in subsection (2)(b) as part of arrangements

where-

(a) it is reasonable to assume that in the absence of the [investment-services] arrangements the sum or part of the sum would have arisen to A or an individual connected with A, and

(b) it is reasonable to assume that the [investment-services] arrangements have as their main purpose, or one of their main purposes, the avoidance of a liability to pay income tax, capital gains tax, inheritance tax or corporation tax.

(11) The condition in subsection (10)(b) is to be regarded as met in a case where the sum is applied directly or indirectly as an investment in a collective investment scheme.

(12) Subsection (2) does not apply in relation to any sum in relation to which the condition in subsection (8)(b) of section 809EZDB is met by virtue of subsection (9) of that section.

(13) Subsection (2) also does not apply if-

(a) it is reasonable to assume that the deferral referred to in subsection (3)(a) or (b) is not the effect of genuine commercial arrangements, or

(b) that deferral is the effect of such arrangements but it is reasonable to assume that the [investment-services] arrangements have as their main purpose, or one of their main purposes, the avoidance of a liability to pay income tax, capital gains tax, corporation tax or inheritance tax.

(14) In subsection (13), "genuine commercial arrangements" means arrangements involving A (alone or jointly with others performing investment management services) and external investors in the investment scheme.

73.31 Income-based carried interest

The term "income-based" carried interest ("IBCI") is used in:

(1) Temporary non-resident rules

(2) The definition of "management fee"

The general rule is that IBCI, which would otherwise be taxed as capital, is taxed as income.

Section 809EZB(1) ITA provides (so far as relevant)

> ... "management fee" means any sum (including a sum in the form of a loan or advance or an allocation of profits) except so far as the sum constitutes ...
>
> c) carried interest which is not income-based carried interest.

The definition is in Chapter 5F Section 809FZA - 809FZY ITA, ie spread over 25 sections of ITA. So it cannot be covered here. Section 809FZA ITA provides an outline:

> (1) This Chapter [Chapter 5F] determines when carried interest arising to an individual from an investment scheme is "income-based carried interest" for the purposes of Chapter 5E (and, in particular, section 809EZB(1)(c)).
> (2) Section 809FZB contains the general rule, under which the extent to which carried interest is income-based carried interest depends on the average holding period of the investment scheme.
> (3) Sections 809FZC to 809FZP contain further provision relating to average holding periods.
> (4) Sections 809FZQ and 809FZR contain a particular rule for direct lending funds.
> (5) Sections 809FZS and 809FZT contain an exception to the general rule for carried interest which is conditionally exempt from income tax.
> (6) Sections 809FZU to 809FZZ contain supplementary and interpretative provision.
> (7) Nothing in this Chapter [Chapter 5F] affects the liability to any tax of-
> (a) the investment scheme, or
> (b) external investors in the investment scheme.

Section 809FZB ITA provides:

> (1) "Income-based carried interest" is the relevant proportion of a sum of carried interest arising to an individual from an investment scheme.
> (2) The relevant proportion is determined by reference to the investment scheme's average holding period as follows.

Average holding period	**Relevant proportion**
Less than 36 months	100%
At least 36 months but less than 37 months	80%
At least 37 months but less than 38 months	60%
At least 38 months but less than 39 months	40%
At least 39 months but less than 40 months	20%
40 months or more	0%

> (3) This section is subject to the following provisions of this Chapter.

We leave the reader to journey on, unaccompanied, to the end of the definition.

73.32 IBCI: Returning non-resident

Section 809EZA(2A) ITA provides:

> Subsection (2B) applies instead of subsections (1)[59] and (2)[60] where-
> (a) one or more disguised fees arise to an individual in a tax year ("the relevant tax year") from one or more investment schemes (whether or not by virtue of the same arrangements),
> (b) the disguised fees consist of carried interest which is income-based carried interest,
> (c) the individual is UK resident in the relevant tax year,
> (d) before the relevant tax year, the individual was not UK resident for a period of at least five consecutive tax years ("the period of non-residence"), and
> (e) either-
> (i) the relevant tax year is the first tax year immediately after the end of the period of non-residence, or
> (ii) the relevant tax year is the second, third, or fourth tax year after the end of that period and the individual has been UK resident in all the intervening tax years.

If these conditions are met, we move on.

Section 809EZA(2A) ITA provides:

> To the extent that the income-based carried interest arises by virtue of pre-arrival services, the individual is liable for income tax for the relevant tax year in respect of it as if-

The rules are in para (a) and (b): it is convenient to read them side by side:

(a) in relation to pre-arrival services[61] performed in the UK-	(b) in relation to pre-arrival services performed outside the UK-
(i) the individual were carrying on a trade for the relevant year consisting of the performance of those services,	[identical]
(ii) the income-based carried interest, so far as arising by virtue of those services, were profits of that trade, and	[identical]

[59] See 73.13 (DMIF: Deemed trade).

[60] See 73.14 (Territorial limitation).

[61] Section 809EZA(2C) ITA provides: "In subsection (2B) "pre-arrival services" means investment management services performed before the end of the period of non-residence."

(iii) the individual were the person receiving or entitled to those profits,	[identical]

Thus there are two deemed trades. I think the point is that the profits of the second may qualify for the remittance basis. But this relief does not apply if the individual is away for less than 5 years.

73.33 Returns and compliance

IFM provides

> **IFM36800: Returning sums chargeable under the disguised investment management fees (DIMF) rules** [Oct 2020]
> **Reporting period**
> Sums that arise and are subject to the disguised investment management fees (DIMF) rules should be reported in reference to the tax year. Calendar year reporting is not acceptable unless the disguised fee arises from a profit allocation from a partnership. In these circumstances, this can be returned on the same basis period as that partnership see (IFM36160).
> If a sum has been reviewed and DIMF is not believed to be applicable then a note should be included within the white space section that adequately explains why DIMF is not applicable in this case.
> For example, if accounts for a partnership are drawn up to the 31 December 2016, and it has been agreed that the profits shown in those accounts are taxed as profits of 2016/17, then the same basis can be applied to the deemed trade.
> **How to return sums chargeable under these provisions**
> Sums that arise and are subject to the DIMF rules should be entered on a separate Self-Employment page and returned within the Self-Assessment return.
> On the return, the following fields should be completed, with the individual entering:
> "Description of business" field: "sums arising under Chapter 5E of Part 13 ITA 2007".
> "Net profit or loss" field: The net profits under the DIMF rules.
> "Total taxable profits or net business loss" field: The net profits under the DIMF rules.
> "White space": Details of each sum of the fund in relation to the individual and structure from which the sum arises should be noted in the computations or as a 'white space' disclosure.
> In most cases HMRC expect that the sum will arise from a fund limited partnership potentially via a General Partner Limited Partner (GP-LP)

or similar. The exact wording of the necessary disclosure will depend on the structure and the number of entities through which the sum has passed.

Where disguised fees arise from more than one fund or partnership then an analysis should be provided showing the sums arising from each.

Example of a return of DIMF profits

Greg is a partner in CD LLP, Greg pays income tax and class 4 NICs on his share of CD LLP's profits. In addition £20,516 is treated as a disguised fee under the DIMF legislation.

Greg will need to report the fees as a separate trade on his tax return. He would enter the following on a separate Self-Employment page within his Self-Assessment:

Description of business field: sums arising under Chapter 5E of Part 13 ITA2007.

Net profit or loss field: £20,516.

Total taxable profits or net business loss field: £20,516.

White space: Disguised investment management fee arising from X Capital Fund LP via X Capital Fund GP LP.

CHAPTER SEVENTY FOUR

IHT TERMS & CONCEPTS

74.1 IHT terminology
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74.17 Gift followed by sale: APR/BPR

74.1 IHT terminology

IHT has a technical vocabulary. It is impossible to discuss any aspect of IHT without constantly using these terms, or at least, most of them, so it is necessary to consider them first.

This chapter considers:

Term	**See para**
General IHT terminology	
Estate	74.2
Property	74.2.1
Transfer of value	74.3
Value transferred	74.3
Disposition	74.4
Chargeable/exempt transfer	74.6
Associated operation	74.11
IHT trust terminology	
Qualifying interest in possession (IIP)	74.7

Relevant property	74.8
Settlement power	74.10

This chapter considers only the definitions of these terms, except for associated operations, where there is also a discussion of provisions where the expression is used.

The following IHT terms are considered elsewhere:

Term	**See para**
Excluded property	75.1
Settlement (for IHT purposes)	87.6

74.1.1 *"CTT" now refers to IHT*

Section 100(1) FA 1986 provides:

> On and after the passing of this Act, the tax charged under the Capital Transfer Tax Act 1984 (in this Part of this Act referred to as "the 1984 Act") shall be known as inheritance tax and, accordingly, on and after that passing,—
> (a) the 1984 Act may be cited as the Inheritance Tax Act 1984; and
> (b) subject to subsection (2) below,[1] any reference to capital transfer tax
> [i] in the 1984 Act,
> [ii] in any other enactment passed before or in the same Session as this Act or
> [iii] in any document executed, made, served or issued on or before the passing of this Act or at any time thereafter
> shall have effect as a reference to inheritance tax.

74.2 Estate

The word "estate" matters for the definition of "transfer of value".

Section 272 IHTA provides:

> In this Act, except where the context otherwise requires ... "estate" shall be construed in accordance with sections 5, 55 and 151(4) above.

The sections referred to are:

IHTA	**Topic**	**See**
s.5	Definition of estate	*Discussed here*

[1] Section 100(2) FA 1986 is a transitional provision now spent: "Subsection (1)(b) above does not apply where the reference to capital transfer tax relates to a liability to tax arising before the passing of this Act."

s.55	Reversionary interest acquired by beneficiary	*Not discussed*[2]
s.151(4)	IHT-exempt pension schemes	82.13.1

So the definition is in s.5 IHTA, and the other sections mentioned concern niche topics.

Section 5 IHTA provides:

> (1) For the purposes of this Act a person's estate is the aggregate of all the property to which he is beneficially entitled, except that ...

There follows a set of four exceptions, of which the most important is:

> (b) the estate of a person immediately before his death does not include excluded property...

"Estate" in IHT is a technical term. Outside IHT, the term is only used in discrete contexts (eg bankrupt's estate, deceased's estate) and in each case with a well understood meaning. In practice no confusion arises.

74.2.1 *"Property"*

There is of course a wide definition. Section 272 IHTA provides:

> "property"
> [a] includes rights and interests of any description but
> [b] does not include a settlement power

For settlement powers, see 74.10 (Settlement power).

74.3 Transfer of value/value transferred

Section 1 IHTA provides:

> Capital transfer tax [now IHT][3] shall be charged on the value transferred by a chargeable transfer.

The terms transfer of value/value transferred matter because:
(1) A transfer of value is required for a chargeable transfer
(2) The charge is on the value transferred

Section 3(1) IHTA provides (so far as relevant):

[2] For a discussion, see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 24.22 (Acquisition of reversionary interest/settlement power from charity).

[3] See 74.1.1 ("CTT" now refers to IHT).

> [a] ... a transfer of value is
>
> [i] a disposition[4] made by a person (the transferor)
>
> [ii] as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition; and
>
> [b] the amount by which it [the estate] is less is the value transferred by the transfer.

The estate of a person does include excluded property except for the moment immediately before death. So if a person uses chargeable (non-excluded property) to purchase excluded property, for full value, the value of the estate is not reduced, and there is no transfer of value.

74.3.1 *Transfer of value: Extended definitions*

When the drafter wishes to impose a charge to IHT on an event which is not a transfer of value, as defined, two techniques may be used:

(1) a deemed transfer of value

(2) a freestanding charge to IHT

Section 3(4) IHTA extends the meaning of "transfer of value" to include case 1, deemed transfers of value:

> [a] Except as otherwise provided, references in this Act to a transfer of value made, or made by any person, include references to events on the happening of which tax is chargeable as if a transfer of value had been made, or, as the case may be, had been made by that person;
>
> [b] and "transferor" shall be construed accordingly.

Occasionally, the meaning is further extended to include cases 1 and 2 (deemed transfers and freestanding charges):

s.221(6) IHTA: Notice of determination	**s.239 IHTA: Certificate of discharge**
References in this section to transfers of value or to the values transferred by them shall be construed as including references to—	References in this section to a transfer of value, or to the value transferred by a transfer of value, shall be construed as including references to
(a) chargeable events by reference to which tax is chargeable under section 32 or 32A of this Act,	
(b) occasions on which tax is chargeable under Chapter III of Part III of this Act,	an occasion on which tax is chargeable under Chapter III of Part III of this Act (apart from section 79)

[4] See 74.4 (Disposition).

(c) disposals on which tax is chargeable under section 126 of this Act,	
or to the amounts on which tax is then chargeable.	or to the amount on which tax is then chargeable.

The provisions referred to here are:

Provision	**Topic**
s.32/32A IHTA	Conditional exemption/historic property
Chap III Part III IHTA	Relevant property trust tax
s.126 IHTA	Trees/Woodland

That is a little clumsy, perhaps, but it works.

74.4 Disposition

"Disposition" matters in particular because a disposition is a requirement of:

Concept	**See para**
Transfer of value	74.3
Exit charge	76.8
Settlement	79.3

Newlon Housing Trust v Alsulaimen discusses the natural meaning of the word:[5]

> "Disposition" is a familiar enough word in the law of property and ordinarily means an act by which someone ceases to be the owner of that property in law or in equity... In some contexts it may include the case in which the property ceases to exist... I feel sure that "disposition" was intended to include the surrender of a subsisting proprietary interest, such as a tenancy for years or for life, so as to merge in the reversion or remainder... But, be that all as it may, I think it is essential to the notion of a disposition of property in this context that there is property of which the disponor disposes, whether to someone else or not.

The IHT Manual provides:

> **IHTM04023: what is a disposition?** [Sep 2018]
> The word disposition has its wide natural meaning and we regard it as
> - including all forms of disposals and transfers of cash and other

[5] [1999] 1 AC 313 at p.317. I omit the references cited.
A disclaimer is not a disposition: see 99.18.1 (Disclaimer law background).

property, and

- including both the creation and the release or other extinguishment of any debt or other right enforceable against a person or his estate...

IHT tinkers with the natural meaning in various ways. Firstly, a disposition may be deemed to occur in the following cases:

Topic	**See para**
Omission to exercise right	74.5
Alteration of close company share/loan capital	81.7
Payment more than 1 year after transfer at undervalue[6]	*Not discussed*

Secondly, a disposition may be effected by associated operations; I discuss this below in the context of associated operations; see 74.15 (Disposition by associated ops).

74.5 Omission: Deemed disposition

An omission is not a disposition, in the normal sense of the word, and so would not be a transfer of value. Section 3(3) IHTA provides a limited exception to this rule:

> Where
> [A] the value of a person's estate is diminished, and
> [B] the value—
> (a) of another person's estate, or
> (b) of any settled property, other than settled property treated by section 49(1) below as property to which a person is beneficially entitled,[7]
> is increased
> [C] by the first-mentioned person's omission to exercise a right,
> [D] he shall be treated for the purposes of this section as
> [i] having made a disposition
> [ii] at the time (or latest time) when he could have exercised the right,
> [E] unless it is shown[8] that the omission was not deliberate.

This rule only applies for the purposes of s.3, but it is repeated or

[6] Section 262 IHTA.

[7] In the discussion below, for the sake of brevity, cases within (a) or (b) might both be referred to as "increases in a person's estate".

[8] The onus of proof is on the taxpayer. That is self-evident, though if authority is needed, see *Fryer v HMRC* [2010] UKFTT 87 (TC) at [37]; see too App 2.24.5 ("It is shown that").

incorporated in a few other places.[9]

I use the following terminology:

Term	**Meaning**
Diminution condition	Condition in s.3(3)[A]
Increased estate condition	Condition in s.3(3)[B]
Causation condition	Condition in s.3(3)[C]
Omittor	Person who omits to exercise right
Third party's estate	Other estate or trust whose value is increased

An omission may also be an associated operation.[10]

Several s.3(3) issues were discussed in *Fryer v HMRC*,[11] where the deceased omitted to take her pension rights at retirement date, when she was terminally ill. All the s.3(3) conditions were met, so the omission was treated as a disposition and was a chargeable transfer.

74.5.1 *Diminution condition*

The requirement is:

> the value of a person's estate [the omittor's estate] is diminished

In *Fryer v HMRC*:[12]

> Is it correct to describe a person's estate as being "diminished" by the omission to exercise a right where the result of the omission is that value which might potentially have been added to the estate is not, after all, so added? [The deceased]'s estate included the right to opt for retirement benefits under the pension plan. It did not include the benefits themselves.
>
> My conclusion is that the "loss" of a potential addition of value to the estate does not, as such, diminish it. However, that is not a complete answer to the "diminution" argument. [the deceased] had a valuable right; by not exercising it, she allowed the whole of its value to disappear from her estate. Her estate was therefore diminished by her omission to exercise that right, and therefore that condition for the application of s 3(3) IHTA 1984 is fulfilled.

If the pension scheme has the form of a trust, it is suggested that the right

[9] See 76.8.2 (Reducing value of trust property): exit charge; 74.13 (Arm's length disposal relief).

[10] See 74.11.1 ("Operation").

[11] [2010] UKFTT 87 (TC). See 84.11.3 (Omission to exercise rights).

[12] at [41], [42].

should be disregarded as a settlement power.[13] The point did not arise in *Fryer* where the pension scheme took the form of a contract with a Life Office.

74.5.2 *Increased estate condition*

The requirement is:

> [B] the value—
> (a) of another person's estate, or
> (b) of any settled property, other than settled property treated by section 49(1) below as property to which a person is beneficially entitled,[14]
>
> is increased

In *Fryer v HMRC:*

> The next question is whether the value of settled property ... was increased by [the deceased]'s omission to exercise her rights under clause 4.1. ... Clause 4.2 of the Scheme Rules provided that if the policyholder died before the "pension date" [which is what happened], NPI would pay to the trustees the death benefits specified in the Schedule. If instead of taking no action [the deceased] had exercised her right to take the pension benefits, the whole of the contract value would have been used to provide pension benefits... and the trust would have received nothing.
> It follows that [the deceased]'s omission to exercise the rights did increase the value of the settled property, as the omission resulted in the death benefits payable under the policy being paid to the trustees.

That must be right.

The increase condition may be satisfied after the diminution condition. In *HMRC v Parry*:[15]

> There is a correlation of substance between the reduction and the increase, in that one results from the other, but they need not occur at precisely the same time.

In *HMRC v Parry*:[16]

[13] See 74.10 (Settlement power).

[14] In the discussion below, for the sake of brevity, cases within (a) or (b) might both be referred to as "increases in a person's estate".

[15] [2020] UKSC 35 at [92].

[16] at [95].

> section 3(3) requires only that "another person's estate" is increased. It is not concerned with the identity of the other person. The benefits that were generated by Mrs Staveley's omission to draw her lifetime pension were undoubtedly going to increase "another person's estate", even if the scheme administrator had not exercised its discretion in favour of the sons, but instead chosen others from the list within the scheme rules. To my mind, this adds weight to an interpretation of the subsection which results in the omission in this case being deemed to be a disposition, and it deals also with the practical problem which the appellants suggested arose. The persons liable for tax might not have been identifiable, but it would have been clear from the date of Mrs Staveley's death that a charge to tax would arise by virtue of the omission.

I find it difficult to see the point of the diminution requirement. A charge should arise if the omission reduces the value of the omittor's estate, whether or not the estate of another is increased. That would be consistent with the basic rule that a transfer of value is disposition which reduces a person's estate, whether or not the estate of another is increased. But at present the IHT charge on omissions is slightly narrower than the IHT charge on dispositions. Though normally, if one estate is reduced, another will be increased, so the issue will not often arise.

74.5.3 *Causation condition*

The word "by" in s.3(3)[C] brings in a causation requirement: the decrease in the value of the omittor's estate, and the increase in the value of some other person's estate, must both be *by reason of* the omission.

This issue arose in *HMRC v Parry*[17] where:

(1) T (deliberately) omitted to claim a pension benefit.
(2) The pension scheme administrators later conferred benefits on T's children.

The children's estates were increased. T argued that this was not by reason of T's omission to claim the pension benefit. It was by reason of the scheme administrators' decision! That was clearly[18] wrong:

[17] [2020] UKSC 35. For another aspect of this case, see 74.13.1 (Operation confers benefit).

[18] I would have said untenable, but the argument actually succeeded in the Upper Tribunal. It might have helped if HMRC had cited the principle that a trust appointment merely fills in blanks left by the settlor; see 87.5.7 (Trust appointment:

> ... the omission yielded the death benefits that, in fact, increased the sons' estates and I do not see the limited discretion of the scheme administrator as breaking the chain connecting the two events. ... Putting it another way, the omission was the operative cause of the increase. ... it may be that the increase in the sons' estates could also be said to be brought about "by" the exercise of the administrator's discretion, but that does not preclude a finding that they were increased "by" the omission.[19]

Quite so.

74.5.4 *Time of deemed disposition*

The time of the deemed disposition is "the time (or latest time) when he could have exercised the right".

In *Fryer v HMRC* the latest time the right could be exercised was the moment before the death of the taxpayer.

In *Fryer v HMRC*:

> The fact that [the increase in the trust's value] occurred after her death does not prevent this condition in s.3(3) IHTA 1984 from being fulfilled, as there is no reference in the sub-section to the time at which the value of the settled property is increased.

But the increase did *not* occur after the death. Immediately from the moment of death, the trust had the valuable right to the pension payment; the fact that it was actually paid later did not matter.

Fryer suggests that if the increase condition is met at a later time, the deemed disposition is retrospectively regarded as taking place at the time specified. What if the transferor has died? How long do the executors remain at risk of a back-dated tax charge? Perhaps there could be a charge even before any estate is increased, on the basis that it is bound to happen sooner or later.

74.6 Chargeable/exempt transfer

Section 2(1) IHTA defines chargeable transfer. So far as relevant, this provides:

> A chargeable transfer is
> [a] a transfer of value

Filling blanks). But I think the point is self-evident.

[19] [2020] UKSC 35 at [94].

> [b] which is made by an individual
> [c] but is not (by virtue of Part II of this Act or any other enactment) an exempt transfer.

74.7 Qualifying interest in possession

The term "interest in possession" (IIP) is not defined (except in Scotland).[20] It has its trust law meaning. A full discussion of the expression requires a chapter to itself. I omit that here as I have considered it elsewhere.[21]

Qualifying IIP is defined in s.59(1) IHTA:

> In this Chapter [Chapter 3 Part 3 IHTA] "qualifying interest in possession" means—
> (a) an interest in possession—
> (i) to which an individual is beneficially entitled, and
> (ii) which, if the individual became beneficially entitled to the interest in possession on or after 22nd March 2006, is
> [A] an immediate post-death interest,
> [B] a disabled person's interest or
> [C] a transitional serial interest, or
> (b) an interest in possession to which, where subsection (2) below applies, a company is beneficially entitled.[22]

Qualifying IIP is an opaque term; for clarity I gloss it as "qualifying (estate) IIP, or just estate IIP, as the key feature of a qualifying IIP is that the individual entitled to the IIP is treated as entitled to the trust property, ie the trust property is treated as being in the individual's estate.

Although the definition is expressed to apply only for Chapter 3 Part 3 IHTA, it is incorporated by reference elsewhere, so it applies throughout the IHT legislation. On other occasions the wording of (i)(ii) is set out in full, rather than using the definition, which is somewhat clumsy drafting, but it works.

74.8 Relevant property

"Relevant property" is a key term for the Inheritance Taxation of trusts, because 10 year charges and exit charges are (in short) charges on

[20] See 90.11.1 (IIP in Garland trust).

[21] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), Chapter 16 (Provisions Inconsistent with IP and IHT Special Trusts).

[22] The esoteric topic of company IIPs is not considered here.

"relevant property".

Section 58(1) IHTA provides:

> In this Chapter [Chapter 3 Part 3 IHTA] "relevant property" means settled property in which no qualifying interest in possession subsists, other than ...

When the drafter wishes to exempt specified property from these charges, they direct that it is not relevant property. So "relevant property" is a label which brings in a large number of rules. There are 8 exceptions altogether, of which the most important for this book is the last:

> (f) excluded property

"Relevant property" is an opaque term. "Chargeable trust property" might perhaps be better, but it is better to adopt the statutory term. For clarity I sometimes expand it to "**relevant (non-excluded) trust property**".

The term **"relevant property trust"** is often used to describe a trust with no qualifying IIP, and so which falls, or may fall, within the relevant property regime. Thus before 2006, relevant property trusts were, broadly, discretionary trusts; but post-2006, the term also includes non-estate IIP trusts.

74.9 Settlement commencement date

Section 48A IHTA provides:

> In this Act any reference to the commencement of a settlement is to the time when property first becomes comprised in it.

An English law trust does not exist until property is held in trust. A Scots law trust may exist before a transfer of property to it.[23] But that entity is not an IHT-settlement, which requires that *property* is held in trust for persons in succession (etc). So s.48A IHTA is otiose, but it does no harm. It serves as a reminder that the date a trust deed is executed, as recorded on the trust deed, may be before the date when property is first transferred to the trust; and it is the latter date which matters for IHT.

[23] Scottish Law Commission *Discussion Paper on the Nature and the Constitution of Trusts* (2006) para 3.1ff
https://www.scotlawcom.gov.uk/files/1312/7892/7069/dp133_trusts.pdf
Scottish Law Commission *Report on Trust Law* (2014) para 3.6
https://www.scotlawcom.gov.uk/files/4014/0904/0426/Report_on_Trust_Law_SLC_239.pdf

74.10 Settlement power

"Settlement power" is a defined term for IHT. Section 47A IHTA provides a wide definition:

> In this Act "settlement power" means any power over, or exercisable (whether directly or indirectly) in relation to, settled property or a settlement.

That includes a right of revocation. It includes a power arising:
(1) Under the terms of a settlement
(2) Under common law principles, eg when a settlement is voidable under rules relating to capacity of the settlor, mistake, undue influence
(3) Under foreign law forced heirship rules, eg legitime and Sharia, where family of the testator may have power to set aside a testamentary or lifetime gift to a settlement[24]

It does not include a contractual right (eg repayment of a loan) or a right of reimbursement from trustees (statutory indemnities). This is for two reasons (either would suffice):
(1) The right is not a "power".
(2) The right is a right against the trustees not arising under the settlement, and (in the relevant sense) it is not exercisable "in relation to"[25] the settlement or settled property.

The term "settlement power" matters because it is not property for IHT purposes.[26] I refer to this rule as **"settlement-power relief"**. It follows that for IHT purposes:
(1) A settlement power is not an asset in the estate of the powerholder
(2) The non-exercise or release of the power is not a transfer of value

74.11 Associated operation

The definition is very wide,[27] as one might expect. Section 268(1) IHTA provides:

[24] See 77.7 (Forced heirship/legitime/Sharia).

[25] See App 2.4.3 (Relating to).

[26] See 74.2.1 ("Property").

[27] This is self-evident, but if authority is needed see *IRC v Macpherson* [1989] AC 159 at p.175: "extremely wide and ... capable of covering a multitude of events affecting the same property which might have little or no apparent connection between them".

> [1] In this Act "associated operations" means, subject to subsection (2) below, any two or more operations of any kind, being—
>
> (a) [i] operations which affect the same property, or
>
> [ii] one of which affects some property and the other or others of which affect property which represents,[28] whether directly or indirectly,
>
> [A] that property, or
>
> [B] income arising from that property, or
>
> [C] any property representing accumulations of any such income, or
>
> (b) any two operations of which
>
> [i] one is effected with reference to the other, or
>
> [ii] with a view to enabling the other to be effected or
>
> [iii] facilitating its being effected,
>
> and any further operation having a like relation to any of those two, and so on,
>
> [2] whether those operations are effected by the same person or different persons, and whether or not they are simultaneous; ...

The IHT Manual describes paragraphs (a)/(b) of the definition as objective/subjective:

> **IHTM14822 Definition** [June 2016]
>
> ...You must specifically consider two alternative tests to determine whether separate events are associated operations. One of these tests must be satisfied if the associated operations provisions are to apply.
>
> - The (first) objective test looks at the relationship between items of property affected by the events - IHTA84/S268(1)(a).
> - The (second) subjective test looks at the relationship or connection between the events concerned - IHTA84/S268(1)(b).

Rysaffe v IRC concerned an arrangement under which an individual transferred 5 parcels of shares to 5 newly created settlements. So there were 5 operations, but they were not associated as:

(a) they did not relate to the same property; and

(b) they were not (in short) effected with reference to each other.[29]

74.11.1 *"Operation"*

Section 268(1) IHTA provides:

[28] See App.2.9 ('Representing' assets).

[29] [2002] EWHC 1114 (Ch) at [36]. For other aspects of this case see 79.3.2 (*Rysaffe*).

> ... "operation" includes an omission.

The IHT Manual provides:

> **IHTM14826 Definition Of Terms** [Sep 2018]
> **Operation**
> Under IHTA84/S268(1) the term 'operation' expressly includes an omission but is otherwise undefined. It applies to all forms of dispositions (IHTM04023), for example a gift, a sale, a purchase or an exchange.
> You can also consider the term to extend to wider activities such as making of a will or the exercise of votes as a controlling shareholder at a company meeting. However it does not cover automatic events like birth, death or the attainment of any specific age.

See too 48.11.1 ("Operation").

An omission may also constitute a disposition and so a transfer of value.[30]

There is a transitional relief for pre-1974 operations[31] but that is not now likely to arise.

74.11.2 *ToA/IHT assoc ops compared*

The term "associated operations" is also used in ToA.[32] The definition is similar in part. Clearly the drafter of the IHT definition in 1940 had in mind the ToA definition from 1936:

ToA definition	**IHT definition**
"associated operation", in relation to a transfer of assets, means an operation of any kind effected by any person in relation to—	"associated operations" means, ... any two or more operations of any kind, being—
(a) any of the assets transferred,	(a)[i] operations which affect the same property, or
(b) any assets directly or indirectly representing[33] any of the assets transferred,	[ii] one of which affects some property and the other or others of which affect property which represents, whether directly or indirectly, that property, or
(c) the income arising from any assets	income arising from that property, or

[30] See 74.5 (Omission: Deemed disposition).

[31] Section 268(2) IHTA.

[32] See 48.11 (Associated operation: Definition)

[33] "Representing" is elaborately defined in s.717(b) ITA.

within para (a) or (b), or (d) any assets directly or indirectly representing the accumulations of income arising from any assets within para (a) or (b).	any property representing accumulations of any such income ...

Strictly, one should not use the term "associated operations" without specifying which definition applies, but context will generally make that clear.

Cases on one definition will sometimes be helpful for the other; thus the IHT case *Macpherson* refers to the ToA case *Herdman.*

74.12 Why associated operations matter

It is not enough to establish that there are associated operations. This is just a first step. One must then go on to ask what (if anything) follows.[34]

Associated operations matter for various IHT purposes. The list includes:

Topic	**See para**
Definition of disposition, relevant for	
Definition of transfer of value	74.16
Definition of settlement	79.3
Arm's length transaction relief	74.13
Restriction on freedom to dispose:	*Not discussed;* see s.163 IHTA
Reservation of benefit	78.6.6
s.103 disallowance of debts	80.12.10
Pre-owned assets: excluded liability	83.17.1

So it is necessary to address associated operations as a discrete topic.

74.13 Arm's length transaction

Section 10(1) IHTA provides (so far as relevant):

[34] This is self-evident, but if authority is needed, see *Rysaffe v IRC* [2002] EWHC 1114 (Ch) at [28]:

> "s 268 [IHTA] is not an operative provision which of itself imposes inheritance tax liabilities. It is a definition of an expression (associated operations) which is used elsewhere. The definition only comes into effect in so far as the expression 'associated operations' is used elsewhere, and then only if the expression in another provision is relevant to the way in which that other provision applies to the facts of the particular case."

This decision was approved on appeal.

> A disposition[35] is not a transfer of value if
> [A] it is shown that it
> [i] was not intended, and
> [ii] was not made in a transaction intended,
> to confer any gratuitous benefit on any person and
> [B] either—
> (a) that it was made in a transaction at arm's length between persons not connected with each other, or
> (b) that it was such as might be expected to be made in a transaction at arm's length between persons not connected with each other ...

I refer to this as **"arm's length transaction relief"**.

Section 10(1)[A] IHTA is otiose, because if there is an intention to confer a gratuitous benefit, the disposition will not satisfy the condition in [B]; but it does not matter.

IRC v Spencer-Nairn[36] considers *s.*10(1)[B](b). In this case an asset worth £200k was sold for £100k to a connected person. One might think the undervalue alone is enough to say this transaction was not "such as might be expected to be made in a transaction at arm's length". But that is not so:

> It is plain from an examination of these two subsections that [IHT arm's length relief] has no function in cases where the disposition takes place at full value, with the result that immediately after it there is no diminution in the value of the transferor's estate. Its only purpose is to deal with cases where the value of his estate is less than it was before the transfer because the disposition was for a price less than the open market value of the property ... That being its purpose, it is also plain that transactions which are gratuitous or which were for less than the open market value of the property may nevertheless be taken out of charge if they satisfy the tests which it lays down. The fact that the transaction was for less than the open market value cannot be conclusive of the issue at this stage, otherwise the subsection would be deprived of its content. The gratuitous element in the transaction becomes therefore no more than a factor, which must be weighed in the balance with all the other facts and circumstances to see whether the onus which is on the

[35] Section 10(3) IHTA provides: " In this section "disposition" includes anything treated as a disposition by virtue of section 3(3) above"; see 74.5 (Omission: Deemed disposition).

[36] [1991] STC 60.

> transferor has been discharged

There are circumstances where a transaction at arm's length may be expected to be an undervalue. This was the case in *Spencer-Nairn,* but the facts were unusual.[37]

74.13.1 *Operation confers benefit*

Associated operations enter the picture through the definition of "transaction". Section 10(3) IHTA provides:

> In this section ... "transaction" includes a series of transactions[38] and any associated operations.

If the extended meaning of 'transaction' is read into the opening words of s.10, the wording becomes:

> a disposition is not a transfer of value if it is shown that it
> [a] was not intended, and
> [b] was not made in a transaction including a series of transactions and any associated operations intended,
> to confer any gratuitous benefit ...

In *Macpherson v IRC*:[39]

> ... the intention to confer gratuitous benefit qualifies both transactions and associated operations.

That does seem clear. But which associated operations must meet this requirement? Not all of them, but only some:

> If an associated operation is not intended to confer such a benefit it is not relevant for the purpose of the subsection. That is not to say that it must necessarily per se confer a benefit but it must form a part of and contribute to a scheme which does confer such a benefit.

Macpherson concerned a series of two operations:
Step 1: Trustees granted an arm's length chattel lease[40] to B1
Step 2: Trustees appointed the chattels to B2, subject to that lease

Step 1 reduced the value of the chattels, so it was a transfer of value unless

[37] See App 4.10.4 (Bad bargain).

[38] "Series of transactions" does not add anything to "associated operations".

[39] [1989] AC 159 at p.175.

[40] For another aspect of this case, see App.4.9.2 (Market value/full consideration).

arm's length transaction relief applied. It was found as a fact not to be intended to confer any gratuitous benefit on B1[41] so requirement [a] was met. But arm's length transaction relief did not apply at step 1 because requirement [b] was not met:

(1) Step 2 was an associated operation and
(2) Step 2 *was* intended to confer gratuitous benefit on B2.

> the appointment would not have been made if the [chattel lease] had not been [made]. It follows that the [chattel lease] was not only effected with reference to the appointment but was a contributory part of the scheme to confer a benefit on [B2]. So viewed there can be no doubt that the [chattel lease]... was made in a transaction, consisting of the [lease] and the appointment, intended to confer a gratuitous benefit on [B2].

Suppose the two steps had been made in the opposite order, that is:

Step 1: Trustees appointed the chattels to B2 (intending to confer a benefit)

Step 2: B2 granted the chattel lease to B1 (reducing the value of the chattels but not intending to confer a benefit)

Arm's length transaction relief would have applied at step 2:

> The [chattel lease] would undoubtedly have been associated with the appointment within the definition ... but it would not have been a relevant associated operation since it would have contributed nothing to the conferment of the gratuitous benefit which had already been effected by the appointment. It could alternatively be said that the transaction intended to confer gratuitous benefit had already been completed before the [chattel lease] had been entered into, therefore although it was an associated operation it could not be said to have been made in that transaction.

One might today call that a purposive construction. On these facts, IHT is charged on full value at step 1, not on depreciated value. So there is no need for a further charge at step 2.

The issue arose again in *HMRC v Parry*[42] which concerned a set of 2 operations:

[41] That seems implausible, but it was a question of fact and could not be challenged on appeal.

[42] [2020] UKSC 35. For another (rather more important) aspect of this case, see 74.5 (Omission: Deemed disposition).

Step 1: T transferred funds from one pension fund to another, reducing the value of her estate.

Step 2: T omitted to take pension benefits, thus increasing the funds distributed in due course to her children.

Step 1 was found not to have the intention to confer a gratuitous benefit.[43] The Supreme Court somehow found that step 2 did not form part of a scheme with step 1.[44] So arm's length transaction relief did apply at step 1. But the facts were unusual.

Suppose A sells an asset to B and leaves the purchase price outstanding. Arm's length transaction relief does not apply because the omission to call in the purchase price is an associated operation with gratuitous intent. But if the sale is at market value, the disposition is not a transfer of value and arm's length transaction relief is not needed.

74.14 Relevant operation

The IHT Manual provides:

> **IHTM14828 Restrictions On Association** [Sep 2018]
> Several operations may be associated under the definition in IHTA84/S268. However, as the decision of the House of Lords in *Macpherson v IRC* [1989] AC 159 made clear, it may not be possible to take all of those operations into account.
> The decision in *Macpherson* established that only operations which together are relevant to the tax charge being considered are to be taken into account as associated operations.
> As a result, when applying the associated operations rules you may only take account of operations
> - which are 'associated' within the statutory definition, and
> - which are relevant for the purposes of the tax charge that you are considering.
>
> Whether any given associated operation is also a relevant operation will depend on the statutory context in which it is being considered. However an operation will usually be a relevant operation if
> - it forms part of and
> - contributes to
>
> a scheme or plan which gives rise to the tax charge under consideration for IHT purposes.

[43] That seems implausible, but it was a question of fact, and the issue is not likely to arise very often.

[44] A 3:2 decision. The reader may find the minority view more persuasive.

In short, the definition of associated operation is so wide that the Courts have had to restrict its operation. A similar issue arises with association operations for ToA.[45]

74.15 Disposition by associated ops

Section 272 IHTA provides:

> In this Act, except where the context otherwise requires ...
> "disposition" includes a disposition effected by associated operations

Associated operations are therefore relevant where the word disposition is used, which is quite common, in particular:

Concept	**See para**
Transfer of value made by associated operations	74.16
Settlement made by associated operations	79.3

74.16 Transfer of value by 2 operations

Associated operations enter the picture through the definition of "disposition". If the extended meaning of 'disposition' is read into the definition of transfer of value in s.3(1) IHTA,[46] the wording becomes:

> ... a transfer of value is a disposition including a disposition effected by associated operations made by a person ... as a result of which the value of his estate immediately after the disposition including a disposition effected by associated operations is less than it would be but for the disposition

Section 268(3) IHTA addresses issues of timing and quantification of the value transferred by a transfer effected by associated operations:

> [1] Where a transfer of value is made[47] by associated operations carried out at different times it shall be treated as made at the time of the last of them;
> [2] but
> [a] where any one or more of the earlier operations also constitute a transfer of value made by the same transferor, the value

[45] See 48.11.5 (Mere historical association).

[46] See 74.3 (Transfer of value/value transferred).

[47] Section 268(3) uses the expression "made by associated operations" and s.272 uses the expression "effected by associated operations". It would have been better drafting to use the same word, but there is no difference between *made* and *effected*.

> transferred by the earlier operations shall be treated as reducing the value transferred by all the operations taken together,
>
> [b] except to the extent that the transfer constituted by the earlier operations but not that made by all the operations taken together is exempt under section 18 above [spouse exemption[48]].

The IHT Manual provides:

> **IHTM14828 Restrictions On Association** [Sep 2018]
> **Relevant operations**
> In the case of a transfer of value under IHTA84/S3 (1), every associated operation which contributes to the loss to the transferor's estate is a relevant operation. Any other operation, although it may be 'associated', is not relevant for the purpose of that provision.
> **Example** *(Angus and Brodie)*
> So if
> [1] A grants a lease to B and
> [2] then later gives him the freehold reversion, after which
> [3] B pays to have an extension built,
> all three operations are associated. They all affect the same property. But the only the first two operations are relevant to the transfer of value under IHTA84/S3(1), since the building of the extension by B does not give rise to any further loss to A's estate.

The rule that a disposition (and so a transfer of value) may be made by associated operations can arise in many contexts, see in particular:

Topic	**See para**
Channelling	74.16.1
Asset splitting	74.16.2
Alteration of share capital	81.7
Joint accounts	94.3.5

74.16.1 *Channelling*

In *Rysaffe*:[49]

> ... a disposition which is effectively by A to C is channelled through B with a view to picking up a saving of inheritance tax in the process. Instead of A transferring the property to C he transfers it to B, and B, pursuant to the scheme, makes an onward transfer to C. One can readily imagine cases where inheritance tax might, the associated operations

[48] See 93.9 (Spouse gift: Associated operations).

[49] *Rysaffe Trustee Co v IRC* [2002] EWHC 1114 (Ch) at [30].

provision apart, be avoided by an exercise of that nature. For example,
[a] an A to B transfer might have benefited from an exemption, such as that for transfers between a husband and wife,
[b] and for some reason[50] there may be a lower liability on a transfer by B to C than there would have been on a direct transfer from A to C.

In practice HMRC do not take that point, at least for straightforward inter-spouse transfers.[51]

In an IT/CGT context, channelling of this kind is addressed by the onward-gift rules.[52]

74.16.2 *Asset splitting*

In *Rysaffe*:[53]

> ... a case where an asset, instead of being transferred to a transferee by a single transfer of the whole asset, is fragmented and transferred in stages, with a view to achieving an overall reduction in the value transferred. For example, X wants to give a valuable freehold to Y, but a simple transfer of the freehold would give rise to a large transfer of value for inheritance tax purposes. Instead
> [1] he first gives a medium length lease of the property to Y, and
> [2] later he gives to Y the freehold reversion.
> If that was a case of two independent dispositions one can readily imagine arguments that the aggregate of their separate values would be considerably lower than the value of a simple one step transfer of the freehold. ... the possibility of manoeuvres like those two examples would have been obvious to the draftsman ... and that the probability is that it was for that purpose ... that 'disposition' was defined to include a disposition by associated operations.

The IHT Manual offers 3 examples of asset splitting. The first is the lease example:

> **IHTM14827 Transfer Of Value Made By Associated Operations** [Aug 2016]
> ... **Example** *(Angus and Brodie)*
> A has a house with vacant possession worth £260,000.

[50] The most common reason is that B has unused nil-rate band and A does not; though there could be other reasons.

[51] See 93.9 (Spouse gift: Associated operations).

[52] See 61.30 (Onward gifts: Introduction).

[53] *Rysaffe Trustee Co v IRC* [2002] EWHC 1114 (Ch) at [30].

> A grants a controlled tenancy of it to B at full rent.

The HMRC analysis of the first operation is as follows:

> At this point the value is reduced to £182,000 but no claim for IHT then arises because of IHTA84/S10. A has incurred a loss to his estate from £260,000 to £182,000, but he has not made a transfer of value because of IHTA84/S10.[54] It is nevertheless a relevant operation.

Then comes the second operation:

> Two years later, the house is worth £300,000 with vacant possession. A gives B the freehold reversion so that B now effectively owns the house with the right to vacant possession.

The HMRC analysis of the second operation is as follows:

> The two operations, the granting of a tenancy and then the gift of the freehold reversion, affect the same property. A has transferred the house with vacant possession, but he has done it by splitting the transfer into two separate operations. Through the associated operations rule these two operations are combined together. Consequently, tax can be charged on the full vacant possession value of £300,000 at the time of the last operation, the gift of the freehold reversion.

Section 268(2) IHTA supports this view by providing a narrow exemption:

> The granting of a lease for full consideration in money or money's worth shall not be taken to be associated with any operation effected more than three years after the grant

The second example is a release of a loan by instalments. The IHT Manual provides:

> **IHTM14834 Sale without immediate payment of the purchase price** [Sep 2018]
> In this situation, property (typically a house) is sold with the purchase price being treated as a loan. Subsequently, the loan is released in stages (normally in order to utilise the annual exemptions). Also see IHTM14152. You need to
> - consider whether the sale price represents the full open market value of the property at the date of the sale,
> - consider whether the purported releases are legally effective (IHTM19100), and

[54] Author's footnote: This is possible but factually implausible.

> - establish by whom and on what basis the property was occupied between the sale and the death (so that the application of the Gift With Reservation (IHTM14301) provisions can be considered). ...

The third example is the transfer of an asset by instalments. The IHT Manual provides:

> **IHTM14835 Transfer In Stages** [June 2016]
> A transfer may be effected in a series of stages. Typically successive portions of a property may be transferred, often annually. The portion may be calculated in a variety of ways: often it is a share equivalent in value to the amount of the annual exemption.[55]

Whether the instalment examples are actually caught by the associated operations rule is doubtful.

74.17 Gift followed by sale: APR/BPR

The topics of APR/BPR are outside the scope of this book, and would need long chapters to themselves. However they do provide another example of the associated operations issue. *Reynaud v IRC* concerned an arrangement with two steps:

(1) A gift of shares qualifying for BPR
(2) A sale of the shares by the donee

The Special Commissioners said:[56]

> 16. There is no doubt that the two operations of the transfer of shares to the discretionary trusts and the purchase of own shares are associated within the meaning of s 268. They affect the same property, the shares. However, the question is not whether they are associated, but whether there is a disposition effected by associated operations. ...
> 17. An associated operation is relevant only if it is part of the scheme contributing to the reduction of the estate...
> Here the value of the estates of the brothers were diminished as a result of the gift into settlement alone. The purchase of own shares contributed nothing to the diminution which had already occurred and was not therefore a relevant associated operation.

[55] The Manual adds: This is sometimes referred to colloquially as 'salami slicing'. But I do not think this expression has become established, even in the specialist dialect of IHT-practitioners.

[56] [1999] STC (SCD) 185, approved in *Rysaffe v IRC* [2002] STC at 872 at [29]. That HC decision was itself approved on appeal.

> 19. Accordingly, we decide that the disposition reducing the value of their estates was achieved solely as a result of the transfer of the shares into the settlement. The purchase of own shares is not an operation which is part of the disposition reducing the value of the estate. It is not therefore a case of a disposition being effected by associated operations, but a single disposition. It follows that the disposition cannot be treated as taking place later than it actually did, with the result that business relief is available.

The IHT Manual provides:

> **IHTM14832 Transfers Involving Relievable Property** [Sep 2018]
> A transfer of property that qualifies for agricultural or business relief may be followed by an event which, if it had occurred before the transfer, would have prevented the relief being available.
> **Examples**
> - Property which is entitled to agricultural relief is transferred and then sold by the transferee.
> - A transfer of unquoted shares/securities which are eligible for business relief is followed by the shares becoming quoted on a recognised stock exchange (IHTM18061).
>
> A point to consider in these situations is whether relief, which is otherwise available, should be challenged by reference to the associated operations provisions. ...

So the Manual has been out of date since 1999.[57] Is this a record?

[57] The law also altered with s.113A IHTA.

CHAPTER SEVENTY FIVE

EXCLUDED PROPERTY: DEFINITION

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75.16.4 FAs 2010 and 2012

Cross references

The following topics are considered elsewhere:
79.2 (Addition/transfer to trust)
82.1 (IHT residential-property code)

75.1 Excluded property: Introduction

Excluded property is (more or less) outside the scope of inheritance tax. There are 11 classes of excluded property:

(1) Non-settled property:[1]
   (a) Foreign situate property
   (b) UK funds (unit trusts and OEICs)
   (c) FOTRA securities
(2) Settled property:
   (a) Foreign situate property
   (b) UK funds (unit trusts and OEICs)
   (c) FOTRA securities
(3) Qualifying certificates of IoM/Channel Islands doms
(4) Property of visiting forces[2]
(5) Reversionary interests in settled property
(6) Decorations and awards[3]
(7) Property subject to clearance under the 2011 Swiss Tax Agreement[4]

Thus, with an economy of language, exemptions for excluded property serve several purposes:
(1) Territorial exemption
(2) Limiting the scope of IHT:
   (a) To encourage UK investment by foreigners (FOTRA securities, UK funds)
   (b) To fit the scheme of the Act, avoid double taxation (relief for reversionary property)
   (c) Other meritorious cases (visiting forces, etc)

This chapter considers the definition of excluded property. The reliefs for excluded property are considered in the next chapter.

Excluded property and foreign situate property are distinct concepts. Foreign situate property is the most common category of excluded property but:
(1) UK situate property may be excluded property (eg FOTRA securities).
(2) Foreign situate property may be non-excluded property (eg shares in a foreign company holding a UK residence).

[1] A note on terminology. I use the term “non-settled property” to describe property which is not held in a settlement for IHT purposes. The term used in the IHT Manual is “unsettled property”.

[2] See App 11.4.1 (Excluded property).

[3] Section 6(1B) IHTA; this is too specialist a topic to discuss here.

[4] See para 22(1) sch 36 FA 2012. I discuss this in para 97.20 of the 2016/17 edition of this work.

75.2 Non-settled foreign property

Section 6(1) IHTA provides:

> Property situated outside the UK is excluded property if the person beneficially entitled to it is an individual domiciled outside the UK.

Excluded property status depends on the domicile of the individual at the time the disposition is made. Likewise, excluded property status depends on the location of assets at that time only. It is irrelevant that the assets may previously have been situate in the UK.

On the situs of assets, see 102.1 (Concepts of situs).

75.3 Non-settled UK funds

Section 6(1A) IHTA provides:

> [a] A holding in an authorised unit trust[5] and
> [b] a share in an open-ended investment company[6]
> is excluded property if the person beneficially entitled to it is an individual domiciled outside the UK.

AUTs and OEICs will generally be UK situate assets. I refer to them together as "**UK funds**". These are excluded property for all IHT purposes.

The relief only applies to a *holding* in an AUT or a *share* in an OEIC so other interests in AUTs and OEICs (for instance, options) are not excluded property. Perhaps that does not arise in practice.

The definition for UK funds uses the expression "beneficially entitled" and the definition for FOTRA securities uses the expression "beneficial ownership" but it is considered that the meaning is the same.[7]

This exemption is due to tax competition.[8] HMRC explain:

> Overseas investors are in theory liable to inheritance tax on their OEIC and AUT holdings, because they are regarded as being situated in the UK for tax purposes on the investors' death. Competing centres do not charge tax in parallel circumstances. Removing the potential inheritance tax charge will help UK managers compete on an equal footing with

[5] For the definition see 69.4 (Authorised unit trust).
[6] For the definition see 66.1.2 (Open-ended investment co).
[7] See App. 6.2 (English-law beneficial ownership).
[8] See 1.3 (Other tax competition).

overseas fund providers.[9]

75.4 Non-settled FOTRA securities

The next category of excluded property consists of FOTRA securities[10] (certain UK government securities, sometimes called exempt gilts). FOTRA securities are UK situate assets. Section 6(2) IHTA provides:

> Where securities have been issued by the Treasury subject to a condition authorised by section 22 of the F(No.2)A 1931 (or section 47 of the F(No. 2)A 1915) for exemption from taxation so long as the securities are in the beneficial ownership of persons of a description specified in the condition, the securities are excluded property if they are in the beneficial ownership of such a person.

FOTRA securities issued from 1 April 2005 are titled "Treasury Gilts". Earlier securities have one of the following names:

- Treasury Loan/Stock
- Conversion Loan/Stock
- Exchequer Loan/Stock
- Consolidated Loan/Stock
- War Loan

These names have only historical significance.

Products issued by National Savings and Investments are not FOTRA securities.

75.4.1 *Interest on FOTRA security*

The IHT Manual provides:

> **IHTM27260 Exclusion of interest on exempt securities** [Jul 2016]
> The exclusion for exempt securities can also apply to certain payments of interest on the securities. Payments that qualify for the exclusion are:
> [1] warrants or coupons for interest already received but not encashed at

[9] Press Release 16 October 2002 (OEICs and AUTs) para 6 [2002] STI 24 October 2002. The text continued (inaccurately):

> "This very rarely generates any significant yield, because UK assets still have to exceed the inheritance tax threshold ... before any tax is due. But it is a deterrent in marketing terms".

I suspect that the true reason that the former IHT charge on UK funds raised little IHT was different, namely that no-one (if properly advised and wishing to comply with UK tax rules) would invest more than the IHT threshold in AUTs or OEICs. Undetectable non-compliance must also be reckoned with.

[10] "Free of Tax to Residents Abroad".

> the date of the relevant chargeable event
>
> [2] apportionment of interest due up to, but receivable after, the date of the chargeable event
>
> [3] in the case of a trust, any interest payments already encashed but held, at the date of the chargeable event, by the trustees, before distribution in the administration of the trust. These payments will be excluded even if no separate money can be identified as relating directly to interest on exempt securities.
>
> The **exclusion for interest does not apply** to any warrants or coupons already encashed, or payments of interest already received by the beneficiary in their lifetime, in connection with a chargeable event that happened after they were encashed or received. This is the case whether the beneficiary is the absolute owner of the exempt securities or a beneficiary under a trust.

[1] and [2] are correct, but point [3] seems generous.[11]

75.4.2 *EU state securities*

The EC say:

> The underlying [EU law] principles could equally prohibit, inter alia, inheritance tax treatment that ...
>
> (c) is less favourable in the case of public debt securities issued by other Member States than in the case of similar securities issued by the taxing Member State.[12]

[11] For completeness, the Manual continues:

> **"IHTM27261 Exclusion of repayment of IT on exempt securities** [Jul 2016]
>
> A repayment of Income Tax relating to interest on exempt securities is also excluded from the charge to Inheritance Tax on exempt securities:
>
> - if an existing warrant for repayment has not been cashed at the date of the relevant chargeable event
> - if the proceeds of an encashed warrant are held – at the date of the chargeable event – by the trustees pending distribution in the administration of the trust or
> - if the repayment due up to the date of the chargeable event is received after the date.
>
> A repayment that is cashed before a chargeable event, by the person beneficially entitled to the repayment, is not excluded on that event."

Before 1998 interest was generally paid subject to deduction of tax. But now interest is paid without deduction of tax (unless the owner asks for tax to be deducted) so this point will not arise.

[12] Commission Staff Working Paper "Non-discriminatory inheritance tax systems: principles drawn from EU case-law" (December 2011) para 3

The EC took action over similar rules in Spain:

> The European Commission has officially requested Spain to amend the provisions of the Inheritance and Gift Tax legislation of the *Territorios Históricos de Alava y Bizkaia* as these do not respect the free movement of capital.
> Under these tax provisions public debt issued by the local administrations (*la Comunidad Autónoma del País Vasco, the Diputaciones Forales or the Entidades Locales Territoriales de los tres Territorios Históricos*) benefits from a preferential tax treatment. This means that titles of public debt from these administrations are less taxed than other similar titles after inheritance. This tax treatment discriminates against investments in public debt issued by other EU Member States or EEA States.[13]

Spain subsequently amended its law.[14]

The exemption for UK gilts may not have been EU-law compliant, but post-Brexit the point is not likely to arise.

75.5 FOTRA exemption conditions

FOTRA securities were first issued under s.47 F(No 2)A 1915. This was a temporary measure:

> The Treasury may, if they think fit, during the continuance of the present war and a period of twelve months thereafter, issue any securities which they have power to issue for the purpose of raising any money or any loan with a condition that neither the capital nor the interest thereof shall be liable to any taxation, present or future, so long as ... the securities are in the beneficial ownership of persons who are neither domiciled nor ordinarily resident in the UK...

This section was repealed in 1927, but the repeal did not affect tax exemptions for securities previously issued and one such security (War Loan 1952 Or After) is still in existence.

Section 22(1) F(No.2)A 1931 provides:

> Any securities issued by the Treasury under any Act may be issued with the condition that -

https://taxation-customs.ec.europa.eu/system/files/2016-09/working_paper_en.pdf

[13] MEMO/13/122 Event Date: 21/02/2013 *http://europa.eu/rapid/press-release_MEMO-13-122_en.htm*

[14] C-127/12.

> (a) so long as the securities are in the beneficial ownership of persons who are not [ordinarily][15] resident in the UK, the interest thereon shall be exempt from income tax; and
>
> (b) so long as the securities are in the beneficial ownership of persons who are neither domiciled nor [ordinarily] resident in the UK, neither the capital thereof nor the interest thereon shall be liable to any taxation present or future.

Subsequent statutory provisions do not specify the condition for exemption: they give the Treasury a discretion to specify the condition in the terms of the issue. Section 60 FA 1940 provides:

> The power of the Treasury under s.22 F(No.2)A 1931 to issue securities with the condition as to exemption from taxation specified in that section shall extend to the issuing of securities with that condition so modified, whether as to the extent of the exemption or the cases in which the exemption is to operate, as the Treasury may specify in the terms of the issue.

So the details must be found in the prospectus for each gilt concerned.[16] Section 154(1) FA 1996 provides:

> The modifications which, under s.60 of the FA 1940, may be made for the purposes of any issue of securities to the conditions about tax exemption specified in s.22 of the F(No.2)A 1931 shall include a modification by virtue of which the tax exemption contained in any condition of the issue applies, as respects capital, irrespective of where the person with the beneficial ownership of the securities is domiciled.

It is hard to see the need for this, but it does no harm.

Before 6 April 1998 some gilts were issued without FOTRA conditions. These have now been given the benefit of FOTRA conditions by s.161 FA 1998:

> (1) Subject to the following provisions of this section, any gilt-edged security[17] issued before 6 April 1998 without FOTRA conditions shall be treated in relation to times on or after that date as if—
>
> (a) it were a security issued with the post-1996 Act conditions; and
>
> (b) those conditions had been authorised in relation to the issue of that security by virtue of s.22 of the F(No. 2)A 1931...

[15] See 75.5.2 (Abolition of ordinary residence).

[16] Prospectuses can be found on *https://www.dmo.gov.uk/search/?q=prospectuses*

[17] “Gilt-edged securities” has the CGT definition: see s.161(6) FA 1998.

> (4) In this section "FOTRA conditions" means any such conditions about exemption from taxation as are authorised in relation to the issue of a gilt-edged security by virtue of section 22 of the Finance (No 2) Act 1931...
> (5) In this section "the post-1996 Act conditions" means the FOTRA conditions with which 7.25% Treasury Stock 2007 was first issued by virtue of s.22 of the F(No. 2)A 1931.[18]
> (7) This section does not apply to any 3½% War Loan 1952 Or After which was issued with a condition authorised by virtue of s.47 of the F(No. 2)A 1915.

So all UK government securities have FOTRA status, irrespective of the original terms of issue but there are two classes of FOTRA securities with different conditions attached. The IHT Manual provides:

> **IHTM04291 Government securities in foreign ownership: introduction** [Sep 2018]
> ...Before 6 April 1998, FOTRA securities or gilts were issued with the additional requirement that the beneficial owner had to be domiciled (IHTM13000) as well as ordinarily resident outside the UK. The domicile requirement still applies to FOTRA securities that were issued before 29 April 1996.
> Under FA40/S60 (1), the Treasury has powers to modify the terms of issue of a Government security so as to change the scope of the exemption. These powers were exercised so that with effect from 6 April 1998 all gilts were deemed to be FOTRA gilts. So, for deaths and other chargeable events on or after 6 April 1998, all government securities are excluded property (IHTM04251) for Inheritance Tax purposes if the beneficial owner was ordinarily resident outside the UK (or, for securities acquired after 6 April 2013, simply resident outside the UK).
> The only exception is 3½% War Loan, where the additional domicile condition still applies to deaths or other chargeable events on or after 6 April 1998.
> So, in summary,
>
> - FOTRA securities issued before 29 April 1996 will be exempt if the beneficial owner is both domiciled and ordinarily resident outside the UK;
> - 3½% War Loan 1952 or after will be only be exempt if the beneficial

[18] This was one of the first gilts issued in 1996/97. The condition provided: "the Stock will be exempt from all UK taxation, present or future, so long as it is shown that the Stock is in the beneficial ownership of persons who are not [ordinarily] resident in the UK".

owner is both domiciled and ordinarily resident outside the UK, even if the chargeable event is after 6 April 1998;
- all government securities issued without FOTRA conditions before 6 April 1998 will be exempt from that date provided the beneficial owner is ordinarily resident outside the UK. Domicile is relevant only for 3½% War Loan;
- all government securities issued between 29 April 1996 and 5 April 2013 will be exempt provided the beneficial owner is ordinarily resident outside the UK. Domicile is relevant only for 3½% War Loan;
- all government securities acquired on or after 6 April 2013 will be exempt provided the beneficial owner is resident outside the UK. Domicile will be relevant only for any future issue of 3½% War Loan.

> The main factors for determining the exclusion (or otherwise) of Government securities are
> - the type and ownership (IHTM04294) of the security which is deducted as excluded property,
> - the ordinary residence (IHTM04295) of the beneficial owner of the relevant security or, where the security is settled property, that of the beneficiary or beneficiaries concerned, but
> - for deaths and chargeable events prior to 6 April 1998, the domicile (IHTM04296) of the person(s) mentioned above must also be outside the UK.

It would be simpler if all gilts could be governed by the same rules.

75.5.1 *Deemed domicile disapplied*

Section 267(2) IHTA provides:

> Subsection (1) above [deemed domicile for IHT] shall not apply for the purposes of section 6(2) or (3) or 48(4) above ...

Similarly, s.267ZA(5) IHTA provides:

> An election under this section does not affect a person’s domicile for the purposes of section 6(2) or (3) or 48(4).

That is, the IHT deemed domicile rules do not apply for the purposes of the exemptions conferring excluded property status on:
(1) FOTRA securities
(2) Qualifying certificates of IoM/Channel Island doms.[19]

[19] See 75.7 (Channel Islands/IoM domicile).

The reason is historical. The concept of deemed domicile was introduced with CTT in 1974. At that time gilts had been issued with a promise that they would be free from taxation (including estate duty, now IHT) if the owner was not (actually) UK domiciled. The deemed domicile rule could not have been applied to those gilts. All that the drafter needed to do was to disapply the deemed domicile rule to FOTRA securities in issue at the time of the introduction of CTT (now IHT). It was not necessary to disapply the deemed domicile rule to gilts issued later. But that is the rule. Presumably the intention was to avoid having two classes of FOTRA securities governed by different rules; or to encourage foreigners to continue to invest in FOTRA securities issued after 1974.

No doubt the same reasoning applied to Qualifying certificates of IoM/Channel Island domiciliaries.

The practical importance of this rule is diminished by the fact that it is only relevant to those FOTRA securities where IHT FOTRA exemption requires the owner to be domiciled outside the UK; in (I think) almost all cases, except 3½% War Loan 1952 Or After, the exemption only requires the owner to be non resident, and domicile (deemed or actual) is irrelevant.

75.5.2 *Abolition of ordinary residence*

Para 114 sch 46 FA 2013 provides:

> (4) Sub-paragraph (5) applies to a person who becomes the beneficial owner of a pre-commencement security (or an interest in such a security) on or after 6 April 2013.
> (5) If obtaining the relevant exemption is conditional on being not ordinarily resident in the UK, any enactment conferring the exemption is to have effect (in relation to a person to whom this sub-paragraph applies) as if obtaining the exemption were conditional instead on being not resident in the UK.
> (6) In this paragraph—
> "pre-commencement security" means a FOTRA security (as defined in section 713 of ITTOIA 2005) issued before the day on which this Act is passed [17 July 2013];
> "the relevant exemption", in relation to a pre-commencement security, means the exemption for which provision is made in the exemption condition (as defined in that section).

Para 114(1) sch 46 FA 2013 deletes the word "ordinarily" in s.22 F(No.2)A 1931 and para 114(3) provides a similar rule:

> (3) Subject to sub-paragraph (5), the amendment made by sub-paragraph (1) does not affect a pre-commencement security (nor the availability of the relevant exemption).

75.6 Ownership & Registration

The gilts must be in the "beneficial ownership" of the individual. Beneficial ownership has various meanings,[20] but the meaning here is (in my terminology) English-law beneficial ownership, ie the English property law/trust law meaning.

The IHT Manual provides:

> **IHTM04294 type of security and ownership** [Sept 2018]
> If a government security is a FOTRA gilt (IHTM04291) you will have to consider who is beneficially entitled (IHTM04031) to that security to work out whether it is excluded property for IHT purposes.
> If a worthwhile amount of tax is at stake you should investigate the possibility of a last-minute purchase. Except where the available information reasonably rules out that possibility - for instance, if the amount of interest returned suggests long-term ownership - you should seek specific confirmation that the gilts concerned were in fact registered in the transferor's, or the trustee's, name(s) at the date of the relevant transfer.
> Technical can give you advice if you discover a last-minute purchase of gilts.

I do not think that the IHT Manual means to say that relief only applies if the securities are registered in the name of the individual or the trustees. The point is that no relief applies if the securities are purchased but not paid for. The purchaser is not the beneficial owner until payment, or even if they were, securities not paid for have no value because of the vendor's lien. So if the gilts are not registered in the name of the individual, further evidence may be needed to show that the individual actually is the beneficial owner.

In practice, register the gilts in the name of the individual or the trustees to avoid possible dispute. Perhaps the withheld text instructs Inspectors how to identify false claims for relief, or perhaps it identifies what is a "worthwhile amount" to investigate.

[20] See App.6.1 (Beneficial ownership: Meanings).

75.7 Channel Islands/IoM domicile

Section 6(3) IHTA provides:

> Where the person beneficially entitled to the rights conferred by any of the following, namely—
>
> (a) war savings certificates;
> (b) national savings certificates (including Ulster savings certificates);
> (c) premium savings bonds;
> (d) deposits with the National Savings Bank or with a trustee savings bank;
> (e) a certified SAYE savings arrangement within the meaning of section 703(1) ITTOIA;
>
> is domiciled in the Channel Islands or the Isle of Man, the rights are excluded property.

In the following discussion:

(1) "**Qualifying certificates**" are investments within (a) to (e).
(2) "**Islanders**" are persons domiciled in the Channel Islands or the Isle of Man.

The IHT 3-year and 15-year deemed domicile rules do not apply for the purposes of this section: see s.267(2) IHTA.

The IHT Manual para 27270 [July 2016] correctly states:

> Other points to note are:
>
> [1] the exclusion applies not only to securities that are owned absolutely but also to any settled securities in which the owner has a beneficial interest in possession[21]
> [2] the exclusion does not extend to settled securities in which there is no interest in possession, (held on discretionary trusts
> [3] the relevant domicile is that of the transferor (and not the transferee) of the securities, at the time of the transfer
> [4] the deemed domicile provisions of IHTA84/S267 (2) do not apply. So the transferor's domicile has to be determined under general law.

Points [2] to [4] are straightforward, but point [1] is important.

The exemption could be particularly useful for an individual who is:

(1) domiciled in the Channel Islands or the Isle of Man, and
(2) deemed UK domiciled (so in principle within the scope of IHT), and

[21] Author's footnote: From 2006 this will only apply to an estate IIP.

(3) resident in the UK (so the FOTRA securities exemption is not available).

The exemption is also useful for an estate IIP trust with an Islander life tenant.

The exemption dates back to 1931[22] and was presumably an attempt to market the securities to Islanders, who would otherwise not find them an attractive choice. It seems surprising that the exemption is limited to Islanders; perhaps there were exchange control reasons?

75.8 Trusts: Foreign property

This section sets out the position for transfers made on or after 22 July 2020.

Section 48(3) IHTA provides:

> Where property comprised in a settlement is situated outside the UK—
> (a) [i] the property (but not a reversionary interest in the property) is excluded property unless the settlor was domiciled in the UK at the time property became comprised in the settlement
> [ii] (but see also subsection (3F))[23]

This is the main category of settled excluded property, roughly corresponding to the rule that non-settled foreign situate property is excluded property.

A trust made by a foreign domiciled settlor is sometimes referred to as an "**excluded property trust**". This label is not wholly accurate, as property in a (so-called) excluded property trust may or may not be excluded property, depending on its situs and nature; but it is a convenient shorthand.

The residence and domicile of the beneficiaries is irrelevant for this purpose. The residence of the trustees is similarly irrelevant.

Excluded property status depends on the domicile of the settlor at the time the property became comprised in the settlement, which is typically, though not necessarily, the time the settlement was made. Domicile at the time of the chargeable event is generally ignored.[24] Contrast the IT/CGT

[22] Section 41 FA 1931. The exemption for FOTRA securities was revived in the same year.

[23] For s.48(3F), see 75.8.1 (Accumulated income).

[24] There are two exceptions:
(1) If the settlor/spouse has an initial IIP in the settled property: see 75.13 (Initial

position. The identity of the settlor is obviously crucial.[25]

The post-2020 law adopts a date of addition test, as opposed to the old law where the test was the date that the settlement was made.[26] It may therefore be necessary to determine the domicile of the settlor on repeated occasions, and to trace funds added to a trust which may become mixed with funds added previously.

There are times where it is unclear when property is added, such as interest-free loans;[27] or what property is added, eg on payment of trust expenses or liabilities.

The situs of the trust assets matters only at the moment a charge arises; provided the assets are then situated abroad, it is irrelevant that they may previously have been situated in the UK.

HMRC accept this. IHT Manual provides:

> **IHTM04274 Identifying settled property** [July 2020]
> The expression 'property comprised in a settlement' in IHTA84/S48 (3) means the items of property (IHTM04030) held in the settlement (IHTM16042) at the time of the chargeable event you are considering.
> In determining the locality (IHTM27071) of any particular property you should consider the property in its current form and not its previous history.
> *Example* [Stella, Xavier and Yolanda]
> In 2004 S, when domiciled in Germany, transfers a house in Germany and some UK securities into a settlement for X for his life with remainder to Y.
> On X's death - the potentially chargeable event - the settled fund consists of
>
> - Option 1: a villa in Spain.
> - Option 2: land in the UK.
> - Option 3: a house in Spain and some UK securities.
>
> With Option 1 the villa is excluded property even though it partly represents the proceeds of what was previously UK property (the securities).
> The land in Option 2 is not excluded property although it is partly derived from the proceeds of sale of the German house.

interest settlor/spouse).
(2) Formerly domiciled residents

[25] See 99.2.10 (Settlor: IHT definition).

[26] See 75.15 (Adding property).

[27] See 99.26 (Loans).

> In Option 3 the house in Spain is excluded property but the UK securities are not.

75.8.1 *Accumulated income*

As a matter of general law, accumulated income becomes comprised in a settlement at the time that it is accumulated.[28] However s.48(3F) IHTA provides:

> If—
> (a) an amount is payable in respect of property ("the existing property") comprised in a settlement, and
> (b) the amount represents an accumulation of income which (once accumulated) becomes comprised in the settlement,
>
> subsections (3)(a), (3A)(a) and (3E) have effect, in the case of the amount, as if any reference to the time it became comprised in the settlement were to the time the existing property became comprised in the settlement.

This only applies for the provisions mentioned, but the provision is repeated verbatim elsewhere where needed: s.64(1BA) and s.65(8A) IHTA.

75.8.2 *Formerly-dom resident settlor*

Section 48(3E) IHTA overrides the usual rule for a settlor who is a formerly-domiciled resident:[29]

> In a case where the settlor of property comprised in a settlement is not domiciled in the UK at the time the property became comprised in the settlement (but see also subsection (3F)),[30] the property is not excluded property by virtue of subsection (3) or (3A) above at any time in a tax year if the settlor was a formerly domiciled resident for that tax year.

If the formerly-domiciled resident ceases to be resident, or dies, the trust property becomes excluded property again.

The HMRC consultation paper "Reforms to the taxation of non-domiciles" (2015) provides:

> [Formerly domiciled residents] will be treated as having a UK domicile for tax purposes. This means there will be no protection for offshore

[28] See 87.6.1 (Undistributed trust income).

[29] See 5.5 (IHT Formerly-domiciled resident rule.

[30] For subsection (3F), see 75.8.1 (Accumulated income).

> trusts, either in terms of the tax on income/gains in the trusts or for IHT purposes.
>
> The excluded property trust rules for IHT will be changed so that they do not apply in these circumstances. This will be the case even for trusts that are set up offshore while the individual was not domiciled or resident in the UK (and would therefore be excluded property for IHT purposes under the current rules). So if an individual caught by this test acquires an overseas domicile and then sets up an offshore trust while non-UK domiciled, once that individual becomes UK resident the assets in that trust will cease to qualify as excluded property and would be liable to inheritance tax charges. ...
>
> Since the residence criteria will be based on the statutory residence test where individuals are either resident or non-resident for the whole year, it will create situations in which property will switch from being excluded property to being liable to IHT under the "relevant property" regime for periods of one or more tax years. If someone is frequently coming and going from the UK, the property in the trust will be excluded property one year and relevant property in the next year. The government accepts this position as it would allow individuals flexibility to move in and out of the UK as and when necessary.[31] However, trustees will need to consider whether a ten year anniversary charge arises at any point during each period the settlor is UK resident.[32]

The rule operates in an arbitrary way. Eg, if an formerly-domiciled resident who has created a trust comes to the UK for 5 years, a 10 year charge depends on the accident of whether the 10 year anniversary falls within any of those 5 years. Planning is possible:

(1) Winding up the trust before the settlor becomes deemed domiciled for IHT would avoid the trust charges.

(2) Excluding the settlor before the settlor becomes deemed domiciled for IHT would avoid a GWR charge which may otherwise arise on the death of the settlor while UK resident.

The rule is particularly harsh for foreign charitable trusts (not charities for UK tax purposes).[33] It may be possible for such charities to convert into

[31] A restriction on "individuals flexibility to move in and out of the UK" would not be EU-law compliant.

[32] *https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles/reforms-to-the-taxation-of-non-domiciles*

[33] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), Chapter 3 (Definitions of "Charity"), online version

a form which qualifies as a charity for UK tax. But the issue will rarely arise.

75.9 Income unpaid on life tenant death

Suppose:

(1) A trust for A for life remainder to B.
(2) On the death of A, income has accrued but not yet been paid ("the accrued income").
(3) After the death of A, the trustees receive that income.

75.9.1 *Trust law background*

The default trust law rule is that the trustees apportion the income they receive, and a part equal to the accrued income is paid to the executors of A.[34] I refer to this as the "**apportionment rule**".

For instance, suppose A dies on 30 April 2012. In 2013 the trustees receive interest which accrued in the calendar year 2012:

(1) One-third of the income will be apportioned to the period before A's death (and so paid to A's estate).
(2) The remaining two-thirds is apportioned to the period after A's death and so paid to B.

There are however two exceptions so wide that the apportionment rule does not often apply:

(1) The rule may be reversed by the terms of the trust, and it usually is.[35]
(2) The Trusts (Capital and Income) Act 2013 abolished this rule for trusts created after 1 October 2013, when the Act took effect, including a trust created under a power conferred by an old trust. Any entitlement to income under a new trust is an entitlement to income as it arises.

The amounts involved are usually small, in which case no-one takes any notice of the apportionment rule even if it does apply; but that is not always the case.

75.9.2 *IHT position*

Dymond states:

https://www.taxationofcharities.co.uk

[34] Apportionment Act 1870.

[35] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 21.65 (Statutory and equitable apportionment rules).

> [1] When a life-tenant dies, any apportionment of dividends or interest payable to his personal representatives may be excluded from the account of the property passing under the settlement and should be included in the Inland Revenue account of his free estate.
> [2] If any dividend or apportionment does not come within the charge to Inheritance Tax because, for instance, the life-tenant had a foreign domicile and the apportionment is payable by foreign trustees, it seems that in strictness deduction of the dividend could be refused on the ground that the value for tax is the market price of the security at the date of death, but in practice the deduction is permitted.[36]

Point [1] is looking at the position where:

(1) Trust property is held on trust for A for life, remainder to B.
(2) A dies and there is income (dividends or interest) which accrued during the lifetime of A ("the accrued income").
(3) The apportionment rule applies, so the accrued income is payable to the executors of A.

Dymond states that the accrued income is subject to IHT as part of A's free estate. The accrued income is not subject to IHT as part of the trust fund. In such a case, clearly, one would not expect the accrued income to be subject to IHT twice, once as part of A's free estate and also as part of the trust fund. It should be one or the other. Of the two, it can be said to make sense to treat it as part of A's free estate and not as part of the trust fund because that is where it belongs, and then IHT is paid by the executors, and borne by the residuary beneficiaries of A's free estate who receive it; the burden of IHT should not be paid by the trustees of the trust who do not receive it.

Point [2] is looking at the same position but the accrued income is not subject to IHT in A's free estate. The example is where the accrued income is excluded property (on the basis that A is not UK domiciled and the accrued interest is not UK situate property). Dymond says that in practice in such cases the trustees are still not subject to IHT on the accrued income. Here it is suggested that the trustees have a deduction for the accrued income.

The practice is long standing, as the same point is made in Dymond's Death Duties[37] in a passage from which the current text of Dymond is

[36] Dymond's Capital Taxes (looseleaf) para 23.673.
[37] (15th ed., 1973), p.819.

derived.

There are two possible bases for this practice. It might be said that the trust holds two assets, the loan and the accrued income; but that seems difficult to sustain (even more so if the trust asset is shares and the accrued income is an unpaid dividend). The correct basis is that the trustees have a liability in respect of the accrued income, which is deductible in computing the value of the trust fund for IHT purposes, just like any other trustee liability.

Sometimes the practice will favour HMRC. For instance, if A is UK domiciled but the settlor of the trust was not UK domiciled when the trust was made then the trust property (including the accrued income) would be excluded property but the right to the A's free estate is chargeable property.

Does the same practice apply where the apportionment rule is excluded? If the practice is that the liability to pay accrued income is a deductible trustee liability, it should be deductible in this case also. The liability remains; the exclusion of the apportionment rule only alters the person to whom the liability is due.

For the special case of accrued income on FOTRA securities, see 75.4.1 (Interest on FOTRA security).

75.10 Trusts: UK funds

Section 48(3A) IHTA provides:

> Where property comprised in a settlement is a holding in an authorised unit trust or a share in an open-ended investment company—
> (a) [i] the property (but not a reversionary interest in the property) is excluded property unless the settlor was domiciled in the UK at the time the property became comprised in the settlement
> [ii] (but see also subsection (3F)),[38] and
> (b) section 6(1A) above applies to a reversionary interest in the property but does not otherwise apply in relation to the property;[39]
> but this subsection is subject to subsection (3B) below[40] and to Schedule A1.

This is the settled property equivalent of the relief discussed at 75.3 (Non-

[38] For subsection (3F), see 75.8.1 (Accumulated income).

[39] For a discussion of s.48(3A)(b), see 75.12.2 (Foreign prop/UK funds).

[40] For the subsection 3B exception, see 75.16.3 (Purchased equitable interest).

settled UK funds).

The relief does not apply if the settlor is a formerly-domiciled resident: see 75.8.2 (Formerly-dom resident settlor).

75.11 Trusts: FOTRA securities

FOTRA securities held by trustees may be excluded property. Under this exemption the domicile of the settlor is irrelevant; one must look at the residence of the relevant beneficiary or beneficiaries and, if appropriate, their domicile.

For the interaction with s.44(2) IHTA, see 79.5.3 (When fiction applies).

75.11.1 *Estate IIP trust*

Section 48(4) IHTA provides:

> Where securities issued by the Treasury subject to a condition of the kind mentioned in subsection (2) of section 6 above are comprised in a settlement, that subsection shall not apply to them; but the securities are excluded property if—
>
> (a) a person of a description specified in the condition in question is entitled to a qualifying interest in possession[41] in them...

75.11.2 *Other trusts*

Section 48(4) IHTA provides:

> Where securities issued by the Treasury subject to a condition of the kind mentioned in subsection (2) of section 6 above are comprised in a settlement, that subsection shall not apply to them; but the securities are excluded property if ...
>
> (b) no qualifying interest in possession[42] subsists in them but it is shown that all known persons
>
> [i] for whose benefit the settled property or income from it has been or might be applied, or
>
> [ii] who are or might become beneficially entitled to an interest in possession in it,
>
> are persons of a description specified in the condition in question.
>
> This subsection is subject to Schedule A1.

The IHT Manual provides:

[41] See 74.7 (Qualifying interest in possession).

[42] See 74.7 (Qualifying interest in possession).

> **IHTM04298 Relevant Property Trusts & FOTRA Gilts** [Sep 2018]
>
> ... • ‘all known persons’. Accordingly, when considering the question of ordinary residence (and domicile) you should disregard the possibility that some (currently) unknown person, for example, an unborn child or future spouse or civil partner (IHTM11032) of an existing beneficiary might become a beneficiary in the future.

The expression “known persons” is to be contrasted with “any person whether ascertained or not”.[43]

> - ‘the settled property’. So the application of the settled property and its income relate to all the property comprised in the particular settlement and not just to the exempt securities.
> - ‘has been or might be applied’. This means that you will need to consider both past and future or potential application of the property and its income.
>
> However, in the case of *Von Ernst and Cie SA v IRC* [1980] 1 WLR 468 the Court ruled that any payment or potential payment from the settled property to an incorporated UK charity - to be used by the charity for its charitable purposes - would not be an application for the ‘benefit’ of the charity. Accordingly you should not deny the exclusion for exempt securities merely because a qualifying charity (whether incorporated or not) has received or might receive any of the settled property or income from it.

The possibility that non-resident beneficiaries may later come to the UK does not preclude the relief - or else it would never apply.

For relief for the exit charge on acquisition of FOTRA securities, see 76.8 (Exit charge).

75.12 Estate IIP trust

75.12.1 *The question*

As we have seen, there are two sets of definitions of excluded property:

(1) Section 6 IHTA defines categories of excluded property for non-settled property to which a person is beneficially entitled.

(2) Section 48 IHTA defines corresponding categories of excluded property for trust property.

Property is either settled or not, so at first sight the definitions appear to be mutually exclusive. However, a settlement under which a beneficiary has

[43] Section 1(b) VTA 1958.

an estate interest in possession raises a doubt. Property held in a settlement with an estate IIP is certainly settled property (so *prima facie* the s.48 rules apply). However, s.49(1) IHTA provides (for an estate IIP):

> A person beneficially entitled to an interest in possession in settled property shall be treated for the purposes of this Act as beneficially entitled to the property in which the interest subsists.

Since the person is treated as beneficially entitled, should the s.6 IHTA rules apply to settled property?

75.12.2 *Foreign prop/UK funds*

The answer is provided by s.48(3)(b) IHTA:

> Where property comprised in a settlement is situated outside the UK ...
> (b) section 6(1) above applies to a reversionary interest in the property *but does not otherwise apply in relation to the property*;

Thus for settled foreign-situate property the s.48 definition applies and the s.6(1) definition is disapplied. The operation of these rules can be illustrated by two examples:

(1) Suppose a foreign domiciled beneficiary has an estate IIP in a settlement made by a UK domiciled settlor. The trust property is situated outside the UK.

The trust property is not excluded property as it does not meet the requirements of s.45(3)(a). It would meet the requirements of s.6(1) but s.48(3)(b) disapplies s.6(1).

(2) Suppose the reverse situation – a UK domiciled beneficiary has an estate IIP in a settlement created by a foreign domiciled settlor. The trust property is again situated outside the UK.

The tax position is now reversed. The trust property would not qualify as excluded property under s.6(1) but it does qualify under s.48(3)(a). Section 48(3)(b) disapplies s.6(1) but that is irrelevant: the trust property is excluded property.

For UK funds, the same answer is provided by s.48(3A)(b) IHTA:

> Where property comprised in a settlement is a holding in an authorised unit trust or a share in an open-ended investment company ...
> (b) section 6(1A) above applies to a reversionary interest in the property *but does not otherwise apply in relation to the property*;

Thus for settled AUTs and OEICs, the s.48 definition applies and the s.6(3A) definition is disapplied.

75.12.3 *FOTRA securities in trust*

Section 48(4) IHTA provides:

> Where securities issued by the Treasury subject to a condition of the kind mentioned in subsection (2) of section 6 above are comprised in a settlement, that subsection shall not apply to them; ...

Again, the s.48(4) definition of excluded property applies and the s.6(2) definition is disapplied. This is not actually necessary because s.6(2) and s.48(4)(a) lead to the same result, but it does no harm.

75.12.4 *Qualifying certificates in trust*

Qualifying certificates of an individual domiciled in the Channel Islands or the Isle of Man ("**an Islander**") are excluded property.[44] If an Islander is entitled to an estate IIP in qualifying certificates, the certificates are not excluded property under s.48(3) or s.48(4). But it is considered that the property does qualify as excluded property under s.6(3) since the individual is to be treated as if they were beneficially entitled. In this case there is no express provision that s.48 overrides s.6. Section 48 and s.6 do not contradict each other: they offer two alternative routes to attain excluded property status. Such settled property is therefore excluded property. HMRC agree with this view.

75.13 Initial interest settlor/spouse

75.13.1 *Section 80 fictions*

Special rules apply where the settlor or spouse have an estate interest in possession in a trust when it is made ("**an initial IIP**").

The basic rule is set out in s.80(1) IHTA:

> Where a settlor or his spouse or civil partner is beneficially entitled to a qualifying interest in possession[45] in property immediately after it becomes comprised in the settlement,
>
> [a] the property shall for the purposes of this Chapter [Chapter 3 Part 3 IHTA, relevant property] be treated as not having become comprised in the settlement on that occasion;
>
> [b] but when the property or any part of it becomes held on trusts under which neither of those persons is beneficially entitled to a qualifying

[44] See 75.7 (Individual domiciled in Channel Islands or Isle of Man).

[45] See 74.7 (Qualifying interest in possession). I use the term "estate IIP".

interest in possession, the property or part shall for those purposes be treated as
[i] becoming comprised in a separate settlement
[ii] made by that one of them who ceased (or last ceased) to be beneficially entitled to a qualifying interest in possession in it.

Thus where the settlor or spouse has an initial estate IIP, s.80 imposes three fictions the ("**s.80 fictions**"):

(1) Property which is actually held in one settlement (the "**actual settlement**"):
(a) is treated as non-settled property (so long as the settlor/spouse have an estate IIP); and subsequently:
(b) is treated as being held in a separate settlement (the "**s.80 notional settlement**").
(2) The s.80 notional settlement is treated as having the following qualities:
 (a) The person who is treated as the settlor of the s.80 notional settlement may be the spouse, ie different from the real settlor of the actual settlement.
 (b) The time at which trust property is treated as becoming held in the s.80 notional settlement is when the settlor/spouse IIP ceases, which is later than the time that property actually became held in the actual settlement.

For other tax issues, see 78.18.1 (Termination of IIP: Navigation).

75.13.2 *Anniversary date: s.80*

The date of trust 10-year anniversaries matters because:
(1) There is a 10-year charge on the 10 year anniversary
(2) The rate of an exit charge depends on the 10-year anniversary (if any) which preceded it.

The date is normally ascertained in a straightforward manner. Section 61(1) IHTA provides:

> In this Chapter "ten-year anniversary" in relation to a settlement means the tenth anniversary of the date on which the settlement commenced[46] and subsequent anniversaries at ten-yearly intervals, but subject to subsections (2) to (4) below.

[46] See 74.9 (Settlement commencement date).

However, s.61(2) IHTA provides a special rule for the s.80 notional settlement:

> The ten-year anniversaries of a settlement treated as made under section 80 below shall be the dates that are (or would but for that section be) the ten-year anniversaries of the settlement first mentioned in that section.

The section 80 fictions do not apply for the purposes of ascertaining the ten-year anniversary date of the notional trust: that is fixed by reference to the date of the actual settlement. I cannot see the reason for that rule and would be grateful to any reader who could suggest one.

75.13.3 *Trust partly within s.80*

It is possible that one trust may hold property which is within the scope of s.80 and property which is not. This could happen in various ways, but the common example will be a trust conferring an IIP on the settlor where:
(1) Property ("pre-2006 property") was settled before 22 March 2006
(2) Other property ("post-2006 property") was added after 22 March 2006.

In that case:
(1) The pre-2006 property is treated as held in a s.80 notional settlement governed by the s.80 fictions.
(2) The post-2006 property is treated as held in the actual settlement.

The actual commencement date of the actual settlement is the date that property was first comprised in it. However pre-2006 property is "treated as not having become comprised in the settlement" at that date. The first time that property that is held by the actual settlement is when post-2006 property is added. That date is treated as its commencement date, and anniversaries of that date are treated as its 10-year anniversaries.

75.13.4 *IIP spouse: Excluded property*

Suppose:
(1) In Year 1, H creates a trust under which W has an initial IIP.
(2) In Year 2, W dies (so her IIP comes to an end). H does not become entitled to an estate IIP at the time that W dies.

In this example H is the settlor of the actual trust and Year 1 is the date of commencement of the actual trust. However, applying the s.80 fictions, the property is treated as held in a notional trust, which is treated as made in Year 2 and W is treated as the settlor.

If that were all, it would follow that the trust property could be treated as excluded property if W was foreign domiciled at the time of her death in Year 2. The domicile of H would be irrelevant. This could benefit the taxpayer if (for instance) H was UK domiciled and W was not, and could sometimes be used for tax avoidance.

Therefore where s.80 applies, s.81B IHTA imposes a further condition relating to excluded property.[47] This provides:

> (1) This section applies to property to which section 80 (initial interest of settlor etc) applies.
> (2) If the property would apart from this section be excluded property by virtue of section 48(3)(a) or (3A)(a),[48] the property is at any time in a tax year to be regarded as excluded property for the purposes of this Chapter, [Chapter 3 Part 3 IHTA, relevant property] except sections 78 and 79,[49] only if Conditions A and B are met.
> (3) Section 65(8) has effect in relation to the property only if Condition A is met (in addition to any condition mentioned in that provision).
> (4) Condition A is that the actual settlor was not domiciled in the UK at the time of the occasion first referred to in section 80(1).
> (5) Condition B is that the actual settlor is not a formerly domiciled resident for the tax year.
> (6) In this section "the actual settlor" means the person who is the settlor of the property in relation to the settlement first mentioned in section 80(1).

I refer to this rule as "**s.80 retesting**".

In relation to foreign situate trust property, s.81B prevents the s.80 fictions from benefiting the taxpayer. The fictions may however benefit HMRC. Suppose:

(1) H is the settlor.
(2) W has an initial IIP.
(3) Subsequently the settled property is held on trusts where neither H nor W has an interest in possession.[50]

In order to determine whether foreign situate trust property (in the s.80

[47] Similar rules apply on transfers between trusts; see 79.11 (Trust-transfer retesting).

[48] See 75.10 (Trusts: UK funds).

[49] Sections 78, 79 IHTA concern conditional exemption for historic property, which is not discussed here.

[50] Whether an estate IIP or not. This is anomalous, but the drafter of the 2006 rules did not think through the consequences for s.80.

notional settlement) is excluded property it is necessary to look at

(1) the domicile of H at the time when the actual settlement was actually made *and*

(2) the domicile of W at the time her interest in possession came to an end.

H and W must both be domiciled outside the UK (at the right time) in order for foreign situate property to qualify securely for excluded property status.

75.13.5 *IIP settlor: Excluded property*

In practice, in lifetime trusts it is rare for the settlor's spouse to have an initial IIP but it is common for the settlor to have an initial IIP. Suppose first that:

(1) Year 1: H has an initial IIP; and

(2) Year 2: that IIP comes to an end (without W becoming entitled to an estate IIP).

In this example H is the settlor of the actual trust and Year 1 is the date of commencement of the actual trust. However, applying the s.80 fictions, the property is treated as held in a notional trust, which is treated as made in Year 2 though H is still treated as the settlor.

If that were all, it would follow that the trust property could be treated as excluded property if H was foreign domiciled in Year 2. The domicile of H at the time the trust was made would be irrelevant. This could not be used for tax avoidance, but s.81B IHTA nonetheless imposes its further condition relating to excluded property. In order to determine whether foreign situate trust property (in the s.80 notional settlement) is excluded property it is necessary to look at the domicile of H

(1) at the time when the actual settlement was actually made *and*

(2) at the time the interest in possession came to an end.

H must be domiciled outside the UK at both times in order for foreign situate property to qualify securely for excluded property status.

Suppose:

(1) In Year 1, H creates a trust under which H has an estate IIP.

(2) In Year 2, H dies and W becomes entitled to an estate IIP.

(3) In year 3, W's interest comes to an end (H not at that time becoming entitled to an estate IIP).

In this example H is the settlor of the actual trust and Year 1 is the date of commencement of the actual trust. However, applying the s.80 fictions, the property is treated as held in a notional trust, which is treated as made in Year 3 and W is treated as the settlor.

If that were all, it would follow that the trust property could be treated as excluded property if W was foreign domiciled at the time of her death in Year 3. The domicile of H would be irrelevant. Once again, s.81B IHTA imposes a further condition relating to excluded property. In relation to foreign situate trust property, s.81B prevents the s.80 fictions from benefiting the taxpayer. It may however benefit HMRC. In order to determine whether foreign situate trust property (in the s.80 notional settlement) is excluded property it is necessary to look at

(1) the domicile of H at the time when the actual settlement was actually made *and*
(2) the domicile of W at the time her interest in possession came to an end

H and W must both be domiciled outside the UK (at the right time) in order for foreign situate property to qualify for excluded property status.

75.13.6 *Partly excluded property trust*

I use the term **"partly excluded property trust"** to refer to a trust where:

(1) the trust property in the actual settlement is excluded property on ordinary principles; but
(2) it is not excluded property in the s.80 notional settlement under s.80/81B rules.

The s.80/81B rules apply only for the purposes of "this chapter": the relevant property trust regime. They have no wider application. So foreign property of a partly excluded property trust:

(1) is not excluded property for the purposes of the relevant property trust taxation; but
(2) is excluded property for all other IHT purposes (eg GWR and the estate IIP trust regime).

Before 2006, s.80 did not much matter as a partly excluded property trust could remain IIP in form throughout its life. So in practice it qualified as excluded property. Now it cannot do so. So the tax position of these trusts has been seriously affected as an accidental result of the 2006 reforms.

75.13.7 *s.80 retesting: Post-2006 trust*

No difficulty arises for lifetime trusts from 22 March 2006, unless the trust confers a disabled person's interest (which will be rare).

Section 80 still poses a trap for will trusts, where the testator is not UK domiciled and the spouse is (or later becomes) UK domiciled. One needs to avoid an IPDI.

A simple solution is to arrange that the will trust is discretionary at the outset, ie the widow does not have an initial interest in possession. A two-year discretionary period will in principle be needed to avoid s.144 IHTA. This is easy to arrange if the property given to the will trust is not UK situate.

75.13.8 *s.80 retesting: Pre-2006 trust*

In cases where an existing trust conferred an initial IIP on the settlor/spouse, it would be desirable to revoke the IIP before the settlor becomes deemed UK domiciled. It does not matter that the settlor/spouse may have an initial IIP provided that when it comes to an end[51] the life tenant is not UK domiciled or IHT deemed domiciled.

75.13.9 *s.80 retesting: FOTRA/UK funds*

Section 81B(2) provides:

> If the property would apart from this section be excluded property by virtue of section 48(3)(a) or (3A)(a), the property is at any time in a tax year to be regarded as excluded property for the purposes of this Chapter [Chapter 3 Part 3 IHTA, relevant property] .. only if Conditions A and B are met.

So s.80 retesting rule does not apply to FOTRA securities.

Until 2020, the s.80 retesting rule did not apply to UK funds. Now it does, but s.81B(7) IHTA provides a generous transitional relief:

> Where the occasion first referred to in section 80(1) occurred before the day on which the Finance Act 2020 was passed [22 July 2020], this section has effect as if, in subsection (2), "or (3A)(a)" were omitted."

So (in short) in the case of a pre-2020 settlement , the s.80 retesting rule does not apply to UK funds.

75.13.10 *s.80 fictions: Critique*

What is the purpose of the three s.80 fictions? The standard IHT trust regime would not work well where the settlor or their spouse has an initial

[51] Not being followed by another IIP for the settlor/spouse.

estate interest in possession under a settlement commencing after 26 March 1974. Dymond explains:

> In such a case there will be no chargeable transfer when the settlement was made and so no occasion to value the settled property for CTT or IHT at that time. If an exit charge arose nearly 10 years later, it might be difficult to ascertain the value at the commencement of the settlement, as required by s.68(5)(a) IHTA, because important evidence might have been lost or destroyed. It might also not be easy to ascertain the settlor's cumulative total at that time as required by s.68(4)(b) IHTA. The same difficulty with the settlor's cumulative total might occur at the time of the 10 yearly charge, because of s.66(5)(a).[52]

Section 80 solves this administrative problem but the reader may think that even before 2006 the cure was worse than the disease. This does explain why the s.80 fictions only apply for the purposes of the standard IHT trust regime.

Since 2006 the operation of the rules is bizarre, but (as is generally the case with bizarre law) careful planning can mitigate much of the unfairness.

It is suggested that the rules should be repealed.

75.14 s.80 transitional rules

75.14.1 *"Occasion first referred to*"

The transitional rules use the cumbersome expression "The occasion first referred to" in s.80(1). This is the date that the property becomes held in the actual settlement, ie the date that the actual settlement is made.

75.14.2 *Pre-1974 trust*

Section 80(3) IHTA provides:

> This section shall not apply if the occasion first referred to in subsection (1) above occurred before 27 March 1974.

So s.80 does not apply to property settled before 27 March 1974.

75.14.3 *Post-2006 trust*

The position is complicated by botched implementation of the 2006 IHT trust reforms.

[52] *Dymond's Capital Taxes* (looseleaf), para 19.700.

Section 80(4) IHTA provides:

> Where the occasion first referred to in subsection (1) above [date actual settlement made] occurs on or after 22 March 2006, this section applies—
>
> (a) as though for "a qualifying interest in possession" in each place where that appears in subsection (1) above there were substituted "a postponing interest", and
>
> (b) as though, for the purposes of that subsection, each of the following were a "postponing interest"—
>
> (i) an immediate post-death interest;
>
> (ii) a disabled person's interest.

Amended as s.80(4) IHTA directs, s.80(1) provides for settlements made from 22 March 2006:

> Where a settlor or his spouse or civil partner is beneficially entitled to ~~a qualifying interest in possession~~
>
> (i) an immediate post-death interest; [or]
>
> (ii) a disabled person's interest
>
> in property immediately after it becomes comprised in the settlement,
>
> [a] the property shall for the purposes of this Chapter [Chapter 3 Part 3, relevant property] be treated as not having become comprised in the settlement on that occasion;
>
> [b] but when the property or any part of it becomes held on trusts under which neither of those persons is beneficially entitled to ~~a qualifying interest in possession~~
>
> (i) an immediate post-death interest; [or]
>
> (ii) a disabled person's interest
>
> the property or part shall for those purposes be treated as
>
> [i] becoming comprised in a separate settlement
>
> [ii] made by that one of them who ceased (or last ceased) to be beneficially entitled to ~~a qualifying interest in possession~~
>
> (i) an immediate post-death interest; [or]
>
> (ii) a disabled person's interest
>
> in it.

Section 80 can apply to trusts from 22 March 2006 if the trust confers:

(1) an IPDI (which applies to will trusts) or

(2) a disabled person's interest (which will be rare).

Why is a transitional serial interest not included?

75.14.4 *Pre-2006; IIP ceases post-2006*

The word "qualifying" which should have been inserted into s.80 in 2006, was finally added in 2015. Section 13(1) F(no.2)A 2015 provides:

> In section 80 of IHTA 1984 (initial interest of settlor or spouse or civil partner), for "an interest in possession", in each place it appears, substitute "a qualifying interest in possession".[53]
> (2)The amendments made by this section come into force on the day after the day on which this Act is passed[54] subject to the saving provision in subsections (3) to (7).

I refer to this as the 2015 qualifying IP amendment.

What is the position if:

(1) A trust is made before 22 March 2006 and confers an initial IIP on the settlor ("H").
(2) That IIP comes to an end
 [i] during the lifetime of H
 [ii] the 2015 qualifying IP amendment was not in effect.
(3) The spouse ("W") then acquired an IIP which is not a qualifying IIP ("W's non-estate IIP").

In the 2014/15 edition of this work, I said:

> A purposive construction is called for, or the provisions are nonsensical. It is suggested that the reference to an "interest in possession" in s.80 means an interest in possession to which s.49 IHTA applies. The non-estate IIP of W does not count as an interest in possession. So the trust property is treated as becoming comprised in a s.80 notional settlement on the death of H.

It seems that HMRC did not agree with that view and preferred the literal construction. EN F(no.2)B 2015 provides:

> This measure [Clause 13 set out below] fixes an unintended effect of the legislation that allowed a (non-qualifying) interest in possession to escape all IHT charges, because the settled property was neither part of the beneficiary's estate, nor was it comprised in a relevant property trust.

The transitional provisions for the 2015 qualifying IP amendment are therefore important. Section 13 provides:

[53] See 74.7 (Qualifying interest in possession).

[54] The Act was passed on 18 Nov 2015, so the amendment took effect on 19 Nov 2015.

(3) Subsections (4) to (7) apply where—

(a) the occasion first referred to in subsection (1) of section 80 of IHTA 1984 occurred before 22 March 2006,

(b) on that occasion the settlor, or the settlor's spouse or civil partner, became beneficially entitled to an interest in possession in property which, as a result of that subsection, was treated as not becoming comprised in a settlement for the purposes of Chapter 3 of Part 3 of IHTA 1984 on that occasion, and

(c) at all times in the relevant period that property, or some particular part of it, has been property in which the settlor, or the settlor's spouse or civil partner, has been beneficially entitled to an interest in possession,

and in subsections (4) to (7) "the protected property" means that property or, as the case may be, that particular part of it.

(4) The amendments made by subsection (1) do not have effect in relation to any particular part of the protected property for so long as the subsisting interest in possession continues to subsist in that part (but see subsections (5) and (6) for what happens afterwards).

(5) As from immediately before the time when the subsisting interest in possession comes to an end so far as subsisting in any particular part of the protected property (whether or not it also comes to an end at the same time so far as subsisting in some or all of the rest of the protected property), section 80(1) of IHTA 1984 has effect in relation to that part as if the second appearance of "an interest in possession" were "a qualifying interest in possession".

(6) If (ignoring this subsection), subsection (5) would have the consequence that a particular part of the protected property is treated as becoming comprised in a separate settlement at a time earlier than the time at which the subsisting interest in possession comes to an end so far as subsisting in that part, that part is to be treated as becoming comprised in a separate settlement at that later time.

(7) In this section—

(a) "the relevant period" means the period beginning with the occasion first mentioned in section 80(1) of IHTA 1984 and ending with the day on which this Act is passed [18 Nov 2015],

(b) "qualifying interest in possession" has the same meaning as in section 80(1) of IHTA 1984,

(c) "subsisting interest in possession", in relation to a part of the protected property, means the interest in possession which subsisted in that part immediately before the end of the relevant period, and

(d) the reference in subsection (3)(c) to the spouse or civil partner of a settlor includes a reference to the widow or widower or surviving civil partner of the settlor.

75.15 Adding property

Suppose:

(1) A settlor creates a trust when not UK domiciled.
(2) The settlor[55] later adds property to the trust when UK domiciled.

Can the added property be excluded property? The answer for chargeable transfers after the FA 2020 is, no. Before then, there were two views.

(1) "**The addition-date view**": the excluded property status of the added property depends on the domicile of the settlor at the date the property is added to the trust.
(2) "**The settlement-date view**": the status of added property depends on the domicile of the settlor at the date the settlement was made.

HMRC took the addition-date view, but the settlement-date view was the better. I discussed this in earlier editions of this work, but omit the material now as it is of historical interest only.[56]

Budget 2018 provided:

> **2.21. Inheritance tax - trusts settlement definition**
> ... the government will introduce legislation in Finance Bill 2019-20 to reflect HMRC's established legal position in relation to the IHT treatment of additions to existing trusts. The legislation will confirm that additions of assets by UK-domiciled (or deemed domiciled) individuals to trusts made when they were non-domiciled are not excluded property. The legislation will apply to IHT charges arising on or after the date on which Finance Bill 2019-20 receives Royal Assent, whether or not the additions were made prior to this date.

Note the chutzpah of the reference to "HMRC's established legal position" which legislation is to "confirm" or "clarify".[57] But there is a long tradition of misdescribing substantial tax changes as clarification.[58]

Suppose a settlor created a trust when UK domiciled and added property to it when foreign domiciled. The added property is now clearly excluded property, and in this case the taxpayer benefits from the 2020 reform. Of course, a well-advised settlor would not be in this situation, but it does arise from time to time by accident.

[55] This section considers the position where the original settlor adds to a trust. For the position where others add to a trust, see 79.6 (B adds property to A's trust).

[56] See the 2019/20 ed. of this work para 74.15 (Added property: change of domicile).

[57] The word "clarify" is used in EN FB 2020 background note on clause 72.

[58] See App 1.2 (Clarify/modernise/reform).

75.15.1 *Change of domicile: Gift to underlying co*

Suppose:

(1) A settlor creates a trust while domiciled outside the UK;
(2) The settlor becomes UK domiciled; and
(3) The settlor gives property to a company owned by the trust.

The shares in the company (if not UK situate) must be and remain excluded property. But scope for avoidance is limited by the fact that the gift may be a gift with reservation, and a chargeable transfer for IHT, and the GAAR may also need consideration.

75.16 Interest in trust property

An interest in trust property (an equitable interest) is itself an item of property which may be subject to IHT. That would lead to double taxation, eg in a trust for A for life, remainder to B, there might be:

(1) tax on the death of A (if A has an estate IIP) or 10-year charges; and
(2) tax on the death of B (if the reversionary interest is an asset of B's estate).

75.16.1 *Reversionary interest*

Section 48(1) IHTA deals with this problem by providing that a reversionary interest is generally excluded property:

> A reversionary interest is excluded property unless—
> (a) it has at any time been acquired (whether by the person entitled to it or by a person previously entitled to it) for a consideration in money or money's worth, or
> (b) it is one to which either the settlor or his spouse [or civil partner] is or has been beneficially entitled, or
> (c) it is the interest expectant on the determination of a lease treated as a settlement by virtue of section 43(3) above.

What about a reversionary interest within (a) to (c)? Section 48(3) IHTA provides:

> Where property comprised in a settlement is situated outside the UK—
> (a) the property (but not a reversionary interest in the property) is excluded property unless the settlor was domiciled in the UK at the time the settlement was made, and
> (b) section 6(1) above applies to a reversionary interest in the property *but does not otherwise apply in relation to the property*
> ...

The words in italics make it clear that the non-settled property rules apply. An equitable interest which is a reversionary interest may be excluded property if it meets the conditions of s.48(1) or if it is not UK situate and owned by a foreign domiciliary.

75.16.2 *Interest in possession*

An equitable interest which is an estate IIP is excluded properly only if it is owned by a foreign domiciliary and is not UK situate. However, the disposal of the interest is not a transfer of value; s.51 IHTA. Tax is charged under s.52 only if the settled property is not excluded property.

75.16.3 *Purchased equitable interest*

Section 48(3) and (3A) IHTA both provide:

> but this subsection is subject to subsection (3B) below ...

Section 48(3B) IHTA is an anti-avoidance provision which applies to two categories of settled excluded property: foreign situate property and UK funds. It provides:

> Property is not excluded property by virtue of subsection (3) or (3A) above if—
> (a) a person is, or has been, beneficially entitled to an interest in possession in the property at any time,
> (b) the person is, or was, at that time an individual domiciled in the UK, and
> (c) the entitlement arose directly or indirectly as a result of a disposition made on or after 5th December 2005 for a consideration in money or money's worth.

EN FB 2006 explains:

> 8. ... By purchasing interests in existing trusts originally settled by a person domiciled outside the UK, UK-domiciled individuals have increasingly exploited this exemption to convert their wealth into IHT-free form.
> 9. This clause is aimed at blocking such avoidance by providing that property is not excluded property by virtue of section 48(3) or section 48(3A) IHTA if, at any time, a person domiciled in the UK has had an interest in possession in it, and their interest arose from a disposition for a consideration in money or money's worth. This applies whoever paid the money, and if the interest was acquired indirectly (for example, under a will or by intestacy) or has been passed on to someone else.

Section 48(3C) IHTA expands on this:

> For the purposes of subsection (3B) above—
>
> (a) it is immaterial whether the consideration was given by the person or by anyone else, and
>
> (b) the cases in which an entitlement arose indirectly as a result of a disposition include any case where the entitlement arose under a will or the law relating to intestacy.

Section 48(3C)(a) confirms (what would have been clear) that the provision can apply if an interest is purchased by A and then given by A to B. I am unable to see the point of s.48(3C)(b).

75.16.4 *FAs 2010 and 2012*

Consideration is also needed for the anti-avoidance rules introduced in 2010 and 2012: ss.52, 53 F(No.1)A 2010; s.48(3D), s.74A, 74B IHTA. This topic will require many pages to discuss. It is some way from the themes of this book but I hope to address it in a future edition.

CHAPTER SEVENTY SIX

EXCLUDED PROPERTY EXEMPTIONS

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76.1 Excluded property exemptions

This chapter considers:

(1) IHT exemptions for excluded property

(2) Reliefs for:

(a) works of art
(b) foreign currency bank accounts
(c) foreign pensions
These are not excluded property, but qualify for similar exemptions.

(3) Related planning issues (except will drafting, which is considered in the next chapter)

In order to understand the IHT exemptions one must consider the relevant charging provisions.

76.2 Lifetime IHT charge

We begin with the main charge to IHT. Section 1 IHTA provides:

> Capital transfer tax shall be charged on the value transferred by a chargeable transfer.

76.2.1 *Methods of exemption*

Statute uses a variety of ways to confer IHT exemption:

(1) Sometimes a disposition is not a transfer of value.
(2) Sometimes a transfer of value is exempt (eg the IHT spouse exemption).
(3) Sometimes property is not in the individual's estate.

The excluded property exemptions work in a variety of ways. Each exemption needs to be seen in the context of the charging provision concerned.

76.3 Lifetime IHT charge: Exemption

The excluded property exemption for the lifetime charge slots into the definition of transfer of value.[1] Section 3(2) IHTA provides:

> For the purposes of subsection (1) above no account shall be taken of the value of excluded property which ceases to form part of a person's estate as a result of a disposition.

"Ceases to form part of a person's estate" is not to be construed too literally. Suppose an individual makes a disposition which reduces the value of excluded property but the property itself is retained. That must come within the exemption in s.3(2).

[1] See 74.3 (Transfer of value/value transferred).

Excluded property status is determined at the time of the disposition. It does not matter if the individual subsequently becomes UK domiciled or deemed domiciled. HMRC agree:

> ... where an individual transfers a property that is situated abroad while they are non-UK domiciled and then dies after having become deemed-UK domiciled, the transfer should be outside the charge to inheritance tax. This is in line with the current treatment of transfers made by non-domiciled individuals who die after having become UK domiciled. The government does not intend to change this treatment.[2]

76.3.1 *Gift to UK bank account*

What is the position if a foreign domiciled donor makes a gift from their foreign bank account (ie, not a UK situate asset) to a *UK situate* bank account of the donee? The gift is not a transfer of value for IHT purposes. When funds are held in the donor's account, the donor has an asset (a debt). When funds are transferred to the donee's account, the donor's asset comes to an end and the donee acquires a new asset (a debt). The donor is at no time entitled to the funds in the UK account.[3]

As a matter of banking law, the donor's cheque or other instruction to the bank to transfer funds from the donor's account to another account is in principle revocable until it is carried out[4] but that does not alter the analysis, because when the donee receives the credit to his account, the instructions have been carried out and the instruction has become irrevocable.

I stress this because the contrary has been suggested, but the position is perfectly clear.

76.4 Death: IHT charge & exemption

The occasion of death would not be a transfer of value as defined in s.3(1) IHTA, as death does not involve a disposition. Section 4(1) IHTA deals with this:

[2] "Reforms to the taxation of non-domiciles: further consultation" (2016) *https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles-further-consultation*

[3] For the banking law background, see 18.14.6 (Gift to non-relevant person).

[4] For completeness: in any particular case it would be relevant to consider the documentation and proper law concerned; but that will not affect the IHT analysis because it makes no difference if the instruction to the bank is revocable or not.

> On the death of any person tax shall be charged as if, immediately before his death, he had made a transfer of value and the value transferred by it had been equal to the value of his estate immediately before his death.

The excluded property exemption for the IHT charge on death slots into the definition of estate.[5]

76.5 IHT spouse exemption and excluded property

76.5.1 *Spouse exemption: Introduction*

I begin with an introduction to the IHT spouse[6] exemption.

Section 18(1) IHTA provides:

> A transfer of value is an exempt transfer to the extent that the value transferred is
> [a] attributable to property which becomes comprised in the estate of the transferor's spouse or civil partner or,
> [b] so far as the value transferred is not so attributable, to the extent that the estate is increased.

I refer to this as the "**IHT spouse exemption**".

The exemption applies to lifetime transfers and on death.

A full discussion of the IHT spouse exemption needs a book to itself. Section 18(3) IHTA and s.56 IHTA contain anti-avoidance provisions which are not discussed because they are too far from the themes of this work, and I have discussed them elsewhere.[7]

A striking feature of the exemption is that it applies even if the spouses are not living together. It is suggested that the exemption would be better targeted if it was restricted in that way, which would also be consistent with the CGT spouse exemption. But separated spouses will not complain.

This section considers the interrelation of the IHT spouse exemption and excluded property rules. I deal with other spouse exemption issues as they arise in the context of other topics:

[5] See 74.2 ("Estate").

[6] References to spouse include a civil partner; see App 3.2 ("Spouse") and App 3.3 ("Civil partner").

[7] There is a full discussion on the (almost) identical charity provisions in Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), online version *http://www.taxationofcharities.co.uk*

Topic	**Para**
GWR spouse exemption	78.10
GWR on death: Spouse exemption	78.19
Interaction with spouse exemption	80.29.1
Restricted IHT spouse exemption	93.2
Spouse exemption on death of account holder	94.3.4

76.5.2 *Spouse exemption/excluded property interaction*

The issues arise most often on the death of a spouse. Suppose:

(1) H (not UK domiciled) dies leaving an estate which consists of:
  (a) excluded property and
  (b) chargeable (ie, non-excluded) property
(2) Part of H's estate passes[8] to H's spouse ("W").

This raises the interesting question of the interaction of the excluded property rules and the IHT spouse exemption.

Sections 4 and 5 IHTA provide (so far as relevant):

> **4 Transfers on death**
> (1) On the death of any person tax shall be charged as if, immediately before his death, he had made a transfer of value and the value transferred by it had been equal to the value of his estate immediately before his death. ...
> **5 Meaning of estate**
> (1) For the purposes of this Act a person's estate is the aggregate of all the property to which he is beneficially entitled, except that ...
> (b) the estate of a person immediately before his death does not include excluded property...

The following propositions are clear:

(1) IHT is charged as if H made a transfer of value ("the deemed transfer of value").
(2) The estate of H immediately before H's death does not include H's excluded property.
(3) The value transferred by the deemed transfer of value is equal to the value of H's estate (which is the value of the chargeable property).

76.5.3 *Gift of excluded property to spouse*

Suppose that on the death of H, only H's excluded property passes to W.

[8] By will, by survivorship or by the relevant succession law; this makes no difference.

Does the spouse exemption apply? Section 18(1) IHTA provides:

> A transfer of value is an exempt transfer to the extent that the value transferred is
> [a] attributable to property which becomes comprised in the estate of the transferor's spouse or civil partner or,
> [b] so far as the value transferred is not so attributable, to the extent that the estate is increased.[9]

The deemed transfer of value is not exempt under s.18(1)[a]. There is "property which becomes comprised in the estate of the spouse". However, the value transferred is not attributable to that property.

That leaves the exemption in s.18(1)[b]. A transfer of value is an exempt transfer to the extent that the estate of the spouse is increased. The estate of W is increased on the death of H.[10] It is therefore considered that the spouse exemption does apply, on a plain reading of the words.[11] Is this result so absurd that the courts should not adopt a plain reading? I do not see why it should be regarded as absurd. If W is UK domiciled the application of the spouse exemption on the death of H is reasonable, because W's estate is increased and the property W receives will be subject to tax on the death of W. [12] If the contrary view were adopted, then the practical consequence should not be to raise more funds for HMRC, but only to pose a trap for taxpayers and their advisers.

76.5.4 *Pecuniary legacy to spouse*

Suppose H leaves W a pecuniary legacy. The IHT Manual provides:

[9] In the case considered here the restriction in s.18(2) does not apply since H (the transferor) is not domiciled in the UK.

[10] This is the case even if the property is excluded property in the estate of W (which will be the case if W was not UK domiciled). Excluded property is "property" for IHT and (except immediately before death) a person's estate includes their excluded property.

[11] Exemption is given to the extent of the value of the property given to W.

[12] It might be said to be anomalous because a simple lifetime gift of excluded property by H to H's spouse would not be a transfer of value, so it would not qualify as an exempt transfer under the IHT spouse exemption. But of course in such a case the spouse exemption is not needed.
The end result is consistent with the exemption for funeral expenses, which are set against UK property alone; see 80.45 (Funeral expenses).

> **IHTM11013 Quantifying the exemption** [Jan 2020]
> ... *Example* ...
> Where the will of a person domiciled (IHTM13000) abroad disposes of their UK estate and some or all of their world estate, exemption for pecuniary legacies (IHTM12082) should be given against the UK estate in the proportion it bears to the worldwide estate, and not against the UK estate alone. Any case where you have difficulty obtaining details of the world estate, or where our official practice meets resistance, should be referred to Technical.

This is correct in relation to charities. The IHT charity exemption is more narrowly worded. But for spouses, it is not consistent with the words of s.18(1)[b]. It is suggested that the spouse exemption applies to the full extent of the pecuniary legacy. It makes no difference whether the pecuniary legacy is subsequently paid out of UK or foreign situate property.

76.6 Allocation of exemption

The reader might think that answers may be found in Chapter 3 Part 2 IHTA (Allocation of Exemptions). In order to focus on the main issue, I do not consider the provisions dealing with abatement and the burden of IHT.

76.6.1 *Definitions*

Before turning to the rules, it is helpful to consider the meaning of the term "specific gift". Section 42(1) IHTA first defines "gift":

> In this Chapter [Chapter 3 Part 2 IHTA]—
> "gift", in relation to any transfer of value, means the benefit of any disposition or rule of law by which, on the making of the transfer, any property becomes ... the property of any person or applicable for any purpose;
> "given" shall be construed accordingly;

Section 42(1) IHTA then defines "specific gift":

> "specific gift" means any gift other than a gift of residue or of a share in residue.

76.6.2 *Application of allocation rule*

Section 36 IHTA provides:

> Where
> [i] any one or more of sections 18, 23 to 27 and 30 above apply in relation to a transfer of value but
> [ii] the transfer is not wholly exempt—
> (a) any question as to
> [A] the extent to which it is exempt or,
> [B] where it is exempt up to a limit, how an excess over the limit is to be attributed to the gifts concerned
>
> shall be determined in accordance with sections 37 to 40 below...

We are considering the estate of a testator ("T") who by will makes gifts to a spouse ("S") and a chargeable beneficiary (say, a child) ("X"). The estate is as follows:

> Chargeable assets ("C"), value £C
> Excluded property ("E"), value £E
> Transfer of value on death = value of chargeable assets = £C
> Property given to S has value £S

Condition [i] is satisfied.
Condition [ii] is satisfied if £S < £C. But if £S > £C (the value of what is given to S equals or exceeds the value of the chargeable property) then the estate is wholly exempt, condition [ii] is not satisfied, and the allocation of exemption rules do not apply.

76.6.3 *Allocation of exemption rule*

Section 38(1) IHTA provides (so far as relevant):

> Such part of the value transferred shall be attributable to specific gifts as corresponds to the value of the gifts …

Consider just a few of the possible permutations:

	Specific Gifts			
Case	Gift of C	Gift of E	Pecuniary	Residue
1	S	X	-	-
2	X	S	-	-
3	S	-	-	X
4	X	-	-	S
5	-	S	-	X
6	-	X	-	S

Assume £S (value given to the spouse) is less than £C (the value of the chargeable property) so the transfer is not wholly exempt. It is plain that the allocation of exemption rule has absurd results:

In cases 1 and 2, the transfer of value is attributed to both gifts. Quite apart from the fact that the value of the gifts exceeds the value transferred, it makes no difference whether the gift to S is of excluded or chargeable property. In cases 3 to 6, the transfer of value is attributed to the gift of C.

It is suggested that the allocation of exemption rules are intended to solve problems arising on:

(1) gifts of business property, and
(2) gifts which bear their own tax.

The allocation of exemption rules have no application to allocation of exemptions for estates holding excluded property.

76.7 10-year charge

IHT operates a system of 10-year and exit charges on relevant property trusts. A full discussion needs a book to itself. I focus on the reliefs for excluded property, but as usual, it is necessary to review the charging provisions to see the reliefs in context.

The 10-year charge on trusts is in 64(1) IHTA:

> Where immediately before a ten-year anniversary all or any part of the property comprised in a settlement is relevant property, tax shall be charged
> [a] at the rate applicable under sections 66 and 67 below
> [b] on the value of the property or part at that time.

The excluded property exemption for the 10-year charge comes in the definition of relevant property. If trust property is excluded property on the 10-year anniversary, it is not relevant property so there is no charge.

76.7.1 *Property formerly excluded*

It may happen that:

(1) Relevant (non-excluded) trust property was formerly excluded property; and
(2) The property is not excluded at the time of the 10-year anniversary.

In this case, s.66(2) IHTA provides a time-apportioned relief:

> [a] Where the whole or part of the value mentioned in section 64 above is attributable to property which
> [i] was not relevant property, or
> [ii] was not comprised in the settlement,

> throughout the period of ten years ending immediately before the ten-year anniversary concerned,
>
> [b] the rate at which tax is charged on that value or part shall be reduced by one-fortieth for each of the successive quarters in that period which expired before the property became, or last became, relevant property comprised in the settlement.

This will apply in particular:

(1) If a trust disposes of excluded property and acquires non-excluded property which is held at the time of the 10-year anniversary.

(2) If a trust holds a company which holds a UK residence: the shares ceased to be excluded property in 2017 under the IHT residential-property code.

76.7.2 *Undistributed trust income*

Section 64(1A) IHTA provides:

> For the purposes of subsection (1) above, property held by the trustees of a settlement immediately before a ten-year anniversary is to be regarded as relevant property comprised in the settlement at that time if—
>
> (a) it is income of the settlement,
>
> (b) the income arose before the start of the five years ending immediately before the ten-year anniversary,
>
> (c) the income arose (directly or indirectly) from property comprised in the settlement that, when the income arose, was relevant property, and
>
> (d) when the income arose, no person was beneficially entitled to an interest in possession in the property from which the income arose.

I refer to income within s.64(1A) as **"undistributed trust income"**.

This deals with the problem that undistributed trust income is not settled property for IHT purposes, unless and until it is accumulated (at which point it becomes settled property).[13] It will be very rare that trustees retain trust income unaccumulated and undistributed for more than 5 years; but it could happen if there was a tax incentive to do so.

Five years seems a generous period for this rule, but it does not much matter.

[13] See 87.6.1 (Undistributed trust income).

In these (somewhat unlikely) circumstances, s.64 IHTA goes on to confer relief for the undistributed trust income, in accordance with the rules for excluded property:

> (1B) Where the settlor of property comprised in a settlement was not domiciled in the UK at the time the property became comprised in the settlement (but see also subsection (1BA)) and is not a formerly domiciled resident for the tax year in which the ten-year anniversary falls, income of the settlement is not to be regarded as relevant property comprised in the settlement as a result of subsection (1A) above so far as the income—
>
> (a) is situated outside the UK, or
>
> (b) is represented by a holding in an authorised unit trust or a share in an open-ended investment company.
>
> (1BA) [Section 64(1BA) deals with accumulated income, see 75.8.1 (Accumulated income).]
>
> (1C) Income of the settlement is not to be regarded as relevant property comprised in the settlement as a result of subsection (1A) above so far as the income—
>
> (a) is represented by securities issued by the Treasury subject to a condition of the kind mentioned in subsection (2) of section 6 above, and
>
> (b) it is shown that all known persons for whose benefit the settled property or income from it has been or might be applied, or who are or might become beneficially entitled to an interest in possession in it, are persons of a description specified in the condition in question.

Note that undistributed trust income does not fall within the definition of “excluded property”. So the IHTA residential-property code, in sch A1 IHTA, which de-excludes property which would otherwise be excluded property by virtue of s.6 or s.48 IHTA,[14] does not apply here.

76.8 Exit charge

The on trusts in s.65 IHTA is known as the exit charge. It applies in two circumstances, or sets of circumstances:

Circumstance	**s.65**	**See para**
Ceasing to be excluded property	(1)(a)	76.8.1
Reducing value of trust property	(1)(b)	76.8.2

[14] See 82.2 (De-exclusion of sch A1 property).

Perhaps one should refer to exit charges, in the plural, but it is usual to use the singular.

I do not discuss the computation of the amount of the exit charge, though I hope to cover this in a future edition.

76.8.1 *Cease to be relevant property*

Section 65 IHTA provides:

> (1) There shall be a charge to tax under this section—
>
> (a) where the property comprised in a settlement or any part of that property ceases to be relevant property (whether because it ceases to be comprised in the settlement or otherwise);

This applies in principal where:

(1) Relevant (non-excluded) trust property ceases to be trust property (ie, a beneficiary becomes absolutely entitled); or

(2) Relevant (non-excluded) trust property remains trust property, but ceases to be relevant property, typically because it becomes excluded property. That may happen if:

(a) the situs changes (eg a chattel is moved outside the UK)

(b) non-excluded property is sold and excluded property is acquired[15]

If a beneficiary becomes absolutely entitled to excluded property, there is no exit charge because excluded property is not relevant property, so it does not "cease to be relevant property" when it ceases to be comprised in a settlement.

There is no exit charge if an excluded property trust makes a distribution in the form of a payment from an offshore bank account of the trustees to a UK bank account of a beneficiary, as no property ceases to be relevant (non-excluded) property.[16]

76.8.2 *Depreciatory transaction*

Section 65 IHTA continues:

> (1) There shall be a charge to tax under this section ...
>
> (b) in a case in which paragraph (a) above does not apply, where

[15] Settled property is regarded for IHT as a fund with a continuing identity, not as a set of distinct assets.

[16] Contrast 76.3.1 (Gift to UK bank account).

> the trustees of the settlement make a disposition[17] as a result of which the value of relevant property comprised in the settlement is less than it would be but for the disposition.

The drafting is based on the definition of transfer of value.[18]

The charge might apply even if the result of the disposition is to increase the value of property in other relevant property trusts. But this issue will not often arise.

See too 81.5.2 (IHT close-company code/Non-IIP trust).

76.8.3 *10-year/exit charge: Planning*

IHT DOTAS guidance considers this topic:[19]

> **Example 13:** Immediately before a ten-year anniversary a distribution is made from a relevant property settlement to reduce the charge on the subsequent ten-year anniversary

The guidance considers whether the two IHT DOTAS conditions are met. Condition 1, so far as relevant, is that:

> one of the main purposes of the arrangements is to enable a person to obtain one or more of the following advantages in relation to inheritance tax ...
>
> (b) the avoidance or reduction of a charge to inheritance tax under section 64, 65, 72 or 94 of IHTA 1984;

On the facts as posited ("a distribution ... made... to reduce the 10 year charge) this condition is met.[20]

The important point is HMRC's discussion of DOTAS condition 2. This provides, so far as relevant:

[17] Section 65(9) IHTA extends the meaning of disposition to include an omission:
"For the purposes of this section trustees shall be treated as making a disposition if they omit to exercise a right (unless it is shown that the omission was not deliberate) and the disposition shall be treated as made at the time or latest time when they could have exercised the right."
The drafting is based on s.3(3) IHTA; see 74.5 (Omission: Deemed disposition).

[18] See 74.3 (Transfer of value/value transferred).

[19] HMRC, "Guidance: Disclosure of tax avoidance schemes" (April 2018) *https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance*

[20] But whether an actual distribution would have that purpose is a question of fact in each case.

> Condition 2 is that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained.[21]

HMRC say:

> The inheritance tax legislation applies a tax charge in respect of the distribution and another tax charge at the ten-year anniversary. The choice of making the distribution before the ten-year anniversary may be to achieve a lower overall inheritance tax bill, but the trustees choosing to exercise their powers to make a distribution is, on its own, neither contrived nor abnormal. It would not therefore be reasonable to expect an informed observer to conclude that condition 2 was met.

The author does not explain why the distribution before the ten-year anniversary achieves a lower overall IHT bill, but it often happens that the exit charge (if any) is lower than the 10-year charge. In particular, the exit charge on a distribution within the first 10 years of a trust may be £nil.

An income distribution to a non-resident or remittance basis taxpayer may avoid the exit charge, so that both charges are avoided. But that too is not "contrived or abnormal".

76.9 Exit charge reliefs

In this section I discuss two reliefs, or sets of reliefs, from the exit charge:

(1) excluded property reliefs
(2) income-receipt relief

The residence-property code has two further exemptions to the IHT exit charge.[22]

76.9.1 *Property becomes excluded*

Under s.65(1)(a) IHTA there would be a charge if relevant (non-excluded) trust property becomes excluded property (as it then ceases to be relevant property). There are four exemptions which usually prevent this charge.

Section 65(7) IHTA provides relief if relevant (non-excluded) trust property becomes non-UK situate excluded property:

> Tax shall not be charged under this section by reason only that property comprised in a settlement

[21] Reg 4(3) Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2017.

[22] See 82.14 (Residence exit-charge reliefs).

> [a] ceases to be situated in the UK
> [b] and thereby becomes excluded property by virtue of section 48(3)(a) above.[23]

Section 65(7A) IHTA provides relief if relevant (non-excluded) trust property becomes UK-fund excluded property:

> Tax shall not be charged under this section by reason only that property comprised in a settlement becomes excluded property by virtue of section 48(3A)(a) (holding in an authorised unit trust or a share in an open-ended investment company is excluded property unless settlor domiciled in UK when property became comprised in settlement).[24]

Section 65(7B) IHTA provides relief if relevant (non-excluded) trust property becomes excluded property because a formerly-domiciled resident settlor ceases to be UK resident or dies:

> Tax shall not be charged under this section by reason only that property comprised in a settlement becomes excluded property by virtue of section 48(3E) ceasing to apply in relation to it.[25]

Section 65(8) IHTA provides some relief if relevant (non-excluded) trust property becomes FOTRA-security excluded property:

> If the settlor of property comprised in a settlement was not domiciled in the UK when property became comprised in the settlement (but see also subsection (8A)),[26] tax shall not be charged under this section by reason only that
> [a] the property is invested in securities issued by the Treasury subject to a condition of the kind mentioned in section 6(2) above and
> [b] thereby becomes excluded property by virtue of section 48(4)(b) above.

This is not a complete FOTRA exemption: there is still an exit charge if trust property becomes FOTRA-security excluded property under
(1) s.48(4)(a), non-resident entitled to estate IIP; or
(2) s.48(4)(b), if the settlor was UK domiciled.[27]

[23] For s.43(3)(a), see 75.8 (Trusts: Foreign situate property).
[24] For s.43(3A)(a), see 75.10 (Trusts: UK funds).
[25] See 75.8.2 (Formerly-dom resident settlor).
[26] Section 65(8A) deals with accumulated income, see 75.8.1(Accumulated income).
[27] See 75.11 (Trusts: FOTRA securities).

There could be an exit charge if relevant (non excluded) trust property becomes excluded property under other categories of excluded property, see s.58(a) - (eb); but in practice that would be rare.

76.9.2 *Property previously excluded*

There is an exit charge if relevant (non-excluded) trust property ceases to be trust property, ie a beneficiary becomes absolutely entitled.

It may happen that:

(1) Relevant (non-excluded) trust property was formerly excluded property; and
(2) The property ceases to be trust property (eg a beneficiary becomes absolutely entitled).

In this case there is a time-apportioned relief. Section 68(3) IHTA provides the relief before the first 10-year anniversary:

> [A] Where the whole or part of the amount on which tax is charged is attributable to property which
> [i] was not relevant property, or
> [ii] was not comprised in the settlement,
> throughout the period referred to in subsection (2) above,
> [B] then in determining the appropriate fraction in relation to that amount or part—
> (a) no quarter which expired before the day on which the property became, or last became, relevant property comprised in the settlement shall be counted, but
> (b) if that day fell in the same quarter as that in which the period ends, that quarter shall be counted whether complete or not.

This is the exit charge equivalent of s.66(2) IHTA (relief for 10-year charge).[28]

The relief is incorporated by reference for an exit charge after the first 10-year anniversary. Section 69(4) IHTA provides:

> [a] For the purposes of this section the appropriate fraction is so many fortieths as there are complete successive quarters in the period beginning with the most recent ten-year anniversary and ending with the day before the occasion of the charge;
> [b] but subsection (3) of section 68 above shall have effect for the

[28] See 76.7.1 (Property formerly excluded).

> purposes of this subsection as it has effect for the purposes of subsection (2) of that section.

76.9.3 *Income-receipt relief*

Section 65(5) IHTA provides:

> Tax shall not be charged under this section in respect of[29]—
>
> (b) a payment[30] which
>
> [i] is (or will be) income of any person for any of the purposes of income tax or
>
> [ii] would for any of those purposes be income of a person not resident in the UK if he were so resident
>
> or in respect of a liability to make such a payment.[31]

I refer to this as exit-charge **"income-receipt relief"**.

There is a similar relief in the IHT close-company code.[32]

Suppose trustees receive income and distribute it. There is no exit charge, because unaccumulated income is not settled property, and so not relevant property, so s.65(1) does not apply. Income-receipt relief is not needed here. But it can happen that trustees distribute trust capital in a manner which constitutes income of the recipient, and then income-receipt relief will apply.

Suppose a discretionary trust holds a company and procures the company to make a dividend. The value of the settled property (the shares) is reduced, because the income received is not settled property. At first sight there is nevertheless no exit charge, because the trustees have not made a disposition (even by omission). However the IHT close-company code needs consideration.[33]

If a UK resident beneficiary receives a benefit which is taxable in the year of receipt under s.731, it is considered that income-receipt relief applies. The benefit is income of the recipient.

Suppose:

(1) at the time the benefit is received there is no relevant income; but

[29] See App 2.4.1 (In respect of).

[30] Section 63 IHTA provides a wide definition: "In this Chapter [Chapter 3 Part 3], unless the context otherwise requires ... "payment" includes a transfer of assets other than money".

[31] It is difficult to see how an exit charge could arise in relation to a liability to make a payment; but it does not matter.

[32] See 81.4.6 (Income-receipt relief).

[33] See 81.6 (Dividend: Close-co code analysis).

(2) the person abroad receives relevant income later in the same tax year.

It is considered that the relief still applies: the benefit is still taxable. This explains why s.65(5) refers to a payment which is *or will be* income.

Similarly, if a UK resident beneficiary receives a capital payment which is subject to income tax under OIG s.87, the capital payment is subject to income tax, and exit-charge income-receipt relief applies.

This is consistent with the object of the relief, which is to prevent a double charge to IT and IHT.

What if the beneficiary is non-resident? The relief applies because the payment "would for IT purposes be income of a person not resident in the UK if he were so resident".

Suppose a series of payments to a non-resident, thus:

(1) A discretionary trust with a UK domiciled settlor had funds of £2m and relevant income of £1m.
(2) Year 1: the trust made a capital payment to a non-resident of £1m.
(3) Year 2: the trust made another payment to the non-resident of £1m.

There is no exit charge in year 1 as income-receipt relief applies. But there is an exit charge in year 2. The question is whether the payment "would ... be income of a person not resident in the UK if he were so resident." The hypothesis should be that the person is UK resident in year 1 as well as year 2. The payment in year 1 would match the relevant income, and the payment in year 2 would not be subject to IT. The relevant income is not counted twice.

76.10 Termination of estate IIP

Section 52(1) IHTA provides:

> Where at any time during the life of a person beneficially entitled to an interest in possession in settled property his interest comes to an end, tax shall be charged, subject to section 53 below, as if at that time
> [1] he had made a transfer of value and
> [2] the value transferred had been equal to the value of the property in which his interest subsisted.

76.10.1 *Disposal for consideration*

Section 52(2) IHTA provides:

> If
> [a] the interest comes to an end by being disposed of by the person

> beneficially entitled to it and
> [b] the disposal is for a consideration in money or money's worth,
> tax shall be chargeable under this section as if the value of the property in which the interest subsisted were reduced by the amount of the consideration; but in determining that amount the value of a reversionary interest in the property or of any interest in other property comprised in the same settlement shall be left out of account.

76.10.2 *IIP: Depreciatory transaction*

Section 52(3) IHTA provides:

> [A] Where
> [i] a transaction is made between the trustees of the settlement and a person who is, or is connected with,—
> (a) the person beneficially entitled to an interest in the property, or
> (b) a person beneficially entitled to any other interest in that property or to any interest in any other property comprised in the settlement, or
> (c) a person for whose benefit any of the settled property may be applied,
> [ii] and, as a result of the transaction, the value of the first-mentioned property is less than it would be but for the transaction,
> [B] a corresponding part of the interest shall be deemed for the purposes of this section to come to an end,
> [C] unless the transaction is such that, were the trustees beneficially entitled to the settled property, it would not be a transfer of value.

This roughly corresponds to depreciatory transaction exit charge.[34] But the wording is not entirely aligned:

(1) In the IIP case the trustees must make a "transaction". In the exit charge case, the trustees must make a "disposition". Transaction has its ordinary meaning; disposition has a more extended definition, in particular, it may include an omission.[35]

(2) In the IIP case the transaction must meet be between the persons identified at para [i]. In the exit charge case, the parties to the disposition do not matter. But this point may not often arise, as

[34] See 76.8.2 (Depreciatory transaction). See too 81.10 (Alterations: Estate IP trust).

[35] See 74.4 (Disposition).

depreciatory transactions will normally be between those persons.

76.10.3 *Charges only on qualifying IIP*

Section 52(2A)(3A) IHTA are conveniently read side by side:

52(2A) IHTA	**52(3A) IHTA**
Where the interest mentioned in subsection (1) or (2) above is one to which the person became beneficially entitled on or after 22nd March 2006, that subsection applies in relation to the coming to an end of the interest only if the interest is—	Where the interest mentioned in paragraph (a) of subsection (3) above is one to which the person mentioned in that paragraph became beneficially entitled on or after 22nd March 2006, that subsection applies in relation to the transaction only if the interest is—
(a) an immediate post-death interest,	[identical]
(b) a disabled person's interest, or	[identical]
(c) a transitional serial interest	[identical]
or falls within section 5(1B) above.	[identical]

76.10.4 *Interests in part*

Section 52(4) IHTA provides:

> References in this section or section 53 below to any property or to an interest in any property include references to part of any property or interest; and—
>
> (a) the tax chargeable under this section on the coming to an end of part of an interest shall be charged as if the value of the property (or part) in which the interest subsisted were a corresponding part of the whole; and
>
> (b) if the value of the property (or part) to which or to an interest in which a person becomes entitled as mentioned in subsection (2) of section 53 below is less than the value on which tax would be chargeable apart from that subsection, tax shall be chargeable on a value equal to the difference.

76.11 Termination of IP: Reliefs

Section 53 IHTA contains a set of reliefs for the charge under s.52, the first of which is relevant here. Section 53(1) IHTA provides:

> Tax shall not be chargeable under section 52 above if the settled property is excluded property.

76.12 When excluded property matters

RI 166 states:

> ... an "excluded" asset is not always completely irrelevant for the purposes of IHT.

The RI gives two examples. The first concerns marriage value between excluded and non-excluded property:

> an "excluded" asset in a person's estate may still affect the valuation of another asset in the estate, for example, an "excluded" holding of shares in an unquoted company may affect the value of a similar holding in the estate which is not "excluded";

One could just about imagine circumstances where this could happen, but it will so rarely (if ever) happen in practice that it is not worth investigating here.

The second example concerns IHT exit charges on relevant property trusts:

> the value of an "excluded" asset at the time the asset becomes comprised in a settlement may be relevant in determining the rate of any tax charge arising in respect of the settlement under the IHT rules concerning trusts without [estate] interests in possession.[36]

This arises where a trust holds (or has held) excluded and non-excluded (chargeable) property. Before 2017 this was unusual, but it might now happen under the IHT residential-property code.

76.13 Foreign currency account

76.13.1 *Individual account*

Section 157(1)(a) IHTA provides a limited relief for non-residents foreign currency bank accounts:

> In determining for the purposes of this Act the value of the estate

[36] RI 166 refers to:
(1) Exit charges: s.68(5), and 69(3) IHTA;
(2) 10-year charge: s.66(4) IHTA, but following reforms in 2015, this is not now a case where excluded property affects the IHT charge.

> immediately before his death of a person to whom this section applies there shall be left out of account the balance on—
>
> (a) any qualifying foreign currency account of his ...

Section 157(5) IHTA defines "qualifying foreign currency account":

> In this section "qualifying foreign currency account" means a foreign currency account with a bank[37]; and for this purpose—
>
> (a) "foreign currency account" means any account other than one denominated in sterling.

Section 157(2) IHTA explains who qualifies for the relief:

> This section applies to a person who is not domiciled and not resident[38] in the UK immediately before his death.

76.13.2 *Trust account*

Section 157(1)(b) IHTA provides a similar but more restricted relief for a foreign currency trust bank account of an IIP trust:

> (1) In determining for the purposes of this Act the value of the estate immediately before his death of a person to whom this section applies there shall be left out of account the balance on ...
>
> (b) subject to subsection (3) below, any qualifying foreign currency account of the trustees of settled property in which he is beneficially entitled to an interest in possession.
>
> ...
>
> (3) Subsection (1)(b) above does not apply in relation to settled property
>
> [a] if the settlor was domiciled in the UK when the settled property became comprised in the settlement, or
>
> [b] if the trustees are domiciled or resident[39] in the UK immediately before the beneficiary's death.

Domicile presumably depends on the domicile of the trustees in their personal capacity. The rule that trustee's domicile should be relevant is

[37] Section 157(6) IHTA provides: "In this section 'bank' has the meaning given by section 991 of the Income Tax Act 2007."

[38] Section 157(4) IHTA applies the income tax definition of residence:

"For the purposes of this section—

(a) the question whether a person is resident in the UK shall, subject to para (b) below, be determined as for the purposes of income tax".

Para (b) deals with trustee residence, discussed below.

[39] For the definition of trust residence see 7.19 (Trust residence for IHT).

odd, and inconsistent with the general scheme of trust IHT or the taxation of trusts generally.

This relief has not been amended in line with the 2006 changes in inheritance taxation of trusts. There is no relief for discretionary trusts or income accumulated in the account after a change of domicile of the settlor;[40] but the relief does apply to non estate interests in possession.

The relief is not important, so these oddities do not much matter.

76.13.3 *Overdrawn account*

The IHT Manual provides:

> **IHTM04380 foreign currency bank accounts** [Sep 2018]
> ... Where the conditions are met, the balance on the account, whether in credit or in debit should be left out of account. You should refer any case of difficulty, especially if you are seeking to disallow a debit balance, to Technical. ...

The last sentence suggests, perhaps, that HMRC are not entirely confident in this interpretation. It seems literally correct on a first reading, and provides an apparent symmetry of treatment with accounts with a positive balance; on the other hand it is a daft rule, a petty trap easily avoided by the well advised, and inconsistent with the general approach of deduction for debts.[41] I do not think it could have been the intention of parliament.

See too 80.26 (Debt attributable to foreign account).

76.13.4 *Foreign currency: Critique*

This is a limited relief. The bank account is *not* excluded property for IHT purposes. It is only disregarded on the death of the owner or life tenant, so it is taken into account for lifetime gifts of individuals, and 10-year charges on trusts. The conditions for the relief are also stricter than for excluded property. It would in almost all cases be better to use a foreign bank account (which will be excluded property) rather than to rely on this relief.

The purpose of the relief is, I think, to encourage foreign domiciliaries to deposit funds with UK banks. If that is right, these restrictions make no sense. It is suggested that foreign currency accounts (indeed all accounts) ought simply to qualify as excluded property in the same way as non-UK

[40] See 75.8.1 (Accumulated income).

[41] See 80.5 (Allocation of debt).

accounts. That change would:

(1) ensure that the relief serves its purpose
(2) align the deductibility of overdrawn accounts with the usual deductibility rules
(3) simplify the law[42]

Alternatively, the relief is just clutter in the system and if (as I expect) it is not much used it would be better to repeal it.

76.14 Works of art

The IHTA provides a pragmatic relief for works of art. Section 5(1) IHTA provides relief on death:

> For the purposes of this Act a person's estate is the aggregate of all the property to which he is beneficially entitled, except that ...
>
> (b) the estate of a person immediately before his death does not include ... a foreign-owned work of art which is situated in the UK for one or more of the purposes of public display, cleaning and restoration (and for no other purpose).

Section 64(2) IHTA provides relief from 10-year charges:

> For the purposes of subsection (1) above, a foreign-owned work of art which is situated in the UK for one or more of the purposes of public display, cleaning and restoration (and for no other purpose) is not to be regarded as relevant property.

Section 272 IHTA defines these terms:

> "foreign-owned", in relation to property, means property in the case of which the person beneficially entitled to it is domiciled outside the UK or, if the property is comprised in a settlement, in the case of which the settlor was domiciled outside the UK when the property became comprised in the settlement;
>
> "public display" means display to which the public are admitted, on payment or not, but does not include display with a view to sale;

The reason is tax competition. Dawn Primarolo (then Financial Secretary to the Treasury) explained:

[42] The current position further complicates anti-avoidance provision withdrawing relief for excluded property, as they need to refer to both excluded property and to foreign currency bank accounts; eg see 80.26 (Debt attributable to foreign account).

> the public interest would not be served if foreign owners of works of art were unwilling to send them to the UK for [purposes of public display, cleaning or restoration] for fear of a potential inheritance tax charge.[43]

This relief falls short of a complete exemption but in practice it is sufficient, and the gaps are not sufficiently important to discuss further here. See too 19.31 (Public access rule).

76.15 Residence nil-rate band

A discussion of the residence nil-rate band needs a long chapter to itself.[44] This takes us too far from the themes of this book, but the IHT Manual has one comment which is relevant to note here:

> **IHTM46032 Residence outside the UK** [Nov 2018]
> There is no requirement that the residence (dwelling-house) has to be in the UK but it does have to be within the scope of IHT and it has to be included in a person's estate. Whether the residence is within the scope of IHT may depend on the domicile status of the deceased and the location of the property.
> For UK domiciled individuals, who are subject to IHT on their worldwide assets, it does not matter where the residence (dwelling-house) which is left to direct descendants is located. For non-UK domiciled individuals, who are subject to IHT only on their assets in the UK, the residence which is to be left to direct descendants must be situated in the UK in order to be within their estate for IHT purposes and hence to be able to qualify for the RNRB.

76.16 Overseas pensions

A full discussion of the IHT treatment of pensions needs a book to itself. This section focusses on the issues closest to the themes of this book. See too 102.36 (Situs of pension and death benefits).

Section 153 IHTA provides a narrow relief:

> (1) In determining for the purposes of this Act the value of a person's estate immediately before his death there shall be left out of account any pension payable under the regulations or rules relating to
> [a] any fund vested in Commissioners under section 273 of the Government of India Act 1935 or

[43] Ministerial Statement 25 February 2003 [2003] STI 303.

[44] See Kessler & Ashley, "Residence Nil-rate Band".

> [b] to any fund administered under a scheme made under section 2 of the Overseas Pensions Act 1973 which is certified by the Secretary of State for the purpose of this section to correspond to an Order in Council under subsection (1) of the said section 273....
>
> (3) Subsection (1) above shall be construed as if contained in section 273 of the Government of India Act 1935 ...
>
> (4) If, by reason of Her Majesty's Government in the UK having assumed responsibility for a pension, allowance or gratuity within the meaning of section 1 of the Overseas Pensions Act 1973 payments in respect of it are made under that section, this section shall apply in relation to the pension, allowance or gratuity, exclusive of so much (if any) of it as is paid by virtue of the application to it of any provisions of the Pensions (Increase) Act 1971 or any enactment repealed by that Act, as if it continued to be paid by the Government or other body or fund which had responsibility for it before that responsibility was assumed by Her Majesty's Government in the UK.

76.17 Excluded property planning

In the following discussion it is assumed the property concerned is not a UK residence, so it is not necessary to consider the IHT residential-property code.

76.17.1 *Planning for individual*

A foreign domiciliary should arrange, as far as possible, that their assets are situated outside the UK so that they qualify as excluded property and fall outside inheritance tax. The question is: how is the individual's property to be transferred abroad?

The transfer abroad of funds from a UK bank account poses no problem. The transfer of bearer instruments abroad raises no problem. Chattels could be physically moved abroad but that may not be practical.

It is possible to turn UK situate shares and securities into non-UK situate assets for IHT.[45]

Any UK asset could be sold and the proceeds remitted abroad. This is simple and satisfactory for inheritance tax; however, a sale raises CGT and commercial considerations.

If the individual is in good health, there is a lot to be said for doing nothing and ignoring IHT planning. The only inheritance tax risk in this approach is that the individual might die so suddenly that no steps to save

[45] See 102.9 (Bearer and negotiable instruments).

tax can be taken. This risk is reduced (but not eliminated) if the spouse exemption is available. It might be possible to take out insurance.

76.17.2 *Anticipation of UK domicile*

The standard course for the foreign domiciliary is to transfer their assets to a trust. If the settlor has a foreign domicile when at the time the trust is made, settled property can be excluded property and will retain that status indefinitely, even if the settlor later become domiciled here. This has been common practice since at least 1975 and (in the case of deemed domicile) parliament has endorsed it with protected-trust relief.

HMRC accept this. DOTAS guidance provides:

> **13.4 Examples of arrangements which aren't notifiable**
> As set out above, the hallmark does not catch straightforward inheritance tax planning...
> **Example 12:** A non-UK domiciled individual transfers non-UK situs property into a trust just before they become deemed domiciled in the UK. The individual can benefit from the trust
> *Condition 1*: The transfer reduces the value of the person's estate, but this reduction does not give rise to a chargeable transfer or potentially exempt transfer due to section 3(2) IHTA 1984. It is likely that an informed observer would conclude that obtaining the inheritance tax advantage was the main reason, or one of the main reasons for the arrangements, so condition 1(d) is met.
> *Condition 2*:[46] A transfer into a discretionary trust, on its own, is not contrived or abnormal. Although this arrangement is entered into to obtain an inheritance tax advantage, it is making use of the excluded property provisions. The transfer is not within condition 2 and is not a notifiable arrangement under this hallmark.[47]

The opportunity, once missed, cannot be regained so it is desirable to ascertain the exact moment when a UK domicile is acquired. There are three possibilities:

(1) The individual who has decided to make a permanent home in the UK

[46] Reg 4(3) Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2017 provides: "Condition 2 is that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained."

[47] HMRC, "Guidance: Disclosure of tax avoidance schemes" (April 2018) *https://www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-guidance*

will acquire a UK domicile as soon as they arrive here. Such an individual needs to carry out the tax planning before setting foot in this country.

(2) The individual who arrives here to take up residence without such an intention will acquire a UK domicile if and when they later form the intention to live here permanently. They need to carry out the tax planning before their mind is made up, ie while their long-term intentions remain unclear.

(3) The individual who arrives and remains residing in the UK without deciding to live here permanently will acquire a deemed UK domicile after 15 years' UK residence. This is the effective deadline for the IHT planning, although limited planning opportunities remain available for the deemed domiciliary.[48]

A life interest trust will normally be suitable, ie:

(1) income is to be paid to the settlor for life;

(2) subject thereto the trust fund held on discretionary trusts for the benefit of the family of the settlor.

Trust income will belong to the life tenant but (if not UK domiciled) they may mandate the trustees to retain the income and add it to capital. This may be useful to avoid relevant income.[49]

A common form discretionary settlement is a possible alternative.

76.17.3 *Planning for non-resident UK dom*

A non-resident individual who is UK domiciled or deemed domiciled by purchasing FOTRA securities. This may be important for deathbed planning.

In the case of an individual who is deemed domiciled but actually domiciled in the Isle of Man or in the Channel Islands there is similar scope for acquiring excluded property in the form of exempt saving certificates.[50]

Reg 4 Inheritance Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2017 provides:

> (1) Arrangements fall within the description in this regulation if it

[48] See below.

[49] See 50.22 (Income of life tenant: Relevant income).

[50] See 75.7 (Channel Islands/IoM domicile).

> would be reasonable to expect an informed observer (having studied the arrangements and having regard to all relevant circumstances) to conclude that condition 1 and condition 2 are met.
> (2) Condition 1 is that the main purpose, or one of the main purposes, of the arrangements is to enable a person to obtain one or more of the following advantages in relation to inheritance tax (the "tax advantage")
> ...
> (d) a reduction in the value of a person's estate without giving rise to a chargeable transfer or potentially exempt transfer.
> (3) Condition 2 is that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained.

HMRC discuss DOTAS:[51]

> **Question:** Suppose a non-resident UK domiciled person is diagnosed with a terminal illness and uses all his cash to buy gilts which he gives away to his children. Is this a disclosable transaction? Does the age or the person's health make any difference?
> **Answer:** Arrangements need to be tested against the hallmark conditions. In this example it seems clear that condition 1(d) would be met as there is a reduction in the transferor's estate without giving rise to a chargeable transfer or PET.

That is right. HMRC continue:

> Whether Condition 2 is met depends on the particular circumstances and whether the arrangements involve one or more contrived or abnormal steps to achieve the tax advantage. It seems likely that, in the circumstances described, Condition 2 would be met.

Is that right? Discuss.

Note that if the individual retains the gilts until his death, rather than giving them away, the condition in para 1(d) is not met.

76.17.4 *Excluded property trust*

This section considers the position of a trust made by a person who is not UK domiciled (or deemed domiciled) when the trust is made.

The trustees should avoid UK situate property, at least at the times when it matters.

Trust property in an excluded property trust can remain effectively free

[51] Letter from HMRC to STEP dated 05/08/2019 .

of IHT so long as the trust continues to exist. The trustees should be reluctant to appoint trust capital to a beneficiary who is or may become UK domiciled; that property may cease to be excluded property. If necessary, steps should be taken to extend its life by exercising powers of appointment or advancement.

If a UK domiciled beneficiary has substantial assets in their own estate then it may be worth adopting a policy of gradually spending their own assets while allowing their trust fund to accumulate or invest for capital growth. It may be attractive for the beneficiary to acquire a purchased life annuity.[52]

76.17.5 *Companies: Situs planning*

If an individual or trustees do not wish UK assets to be sold to a third party, they might sell or give them to a company (typically, non-resident) owned wholly by them. In principle the shares in the company would not be UK situate.[53]

In the case of an individual, the transfer would not be a transfer of value for IHT because the individual's estate would not be reduced in value. It is considered that it is not a disposal by way of gift, as there is no gratuitous intent.

The transfer would be a disposal for CGT purposes and hold-over relief would not normally be available. In some cases BAD or CGT incorporation relief may be available. A gift from an individual to the company by way of *donatio mortis causa* [gift in anticipation of death] may solve the CGT problem.[54]

Property becomes excluded property the moment that it becomes non-UK situate; there is no qualifying period such as is required for agricultural/ business property reliefs. Trustees could transfer the settled property out of the UK the moment before the death of a life tenant, or the occasion of a ten-year charge, and obtain the benefit of excluded property status.

In *Kwok Chi Leung Karl v Commissioner of Estate Duty*[55] the individual transferred his property to a company at 8:45 pm and died on the following day. This last minute planning was successful. The Privy

[52] See 38.17.3 ("Annuity certain").

[53] See 102.5 (Situs of registered shares); 102.9 (Bearer and negotiable instruments).

[54] See 88.7.3 (Gift in anticipation of death).

[55] [1988] STC 728.

Council were not pleased with the outcome of their decision:

> A series of transactions so unusual and so close to the death of the testator almost inevitably suggests that there might have been grounds for attacking the transactions as a sham or as lacking bona fides or as ineffective under the principles enunciated by the House of Lords in *Ramsay...*
>
> As has already been stated, no challenge has been raised to the bona fides of the transaction, so that their Lordships have been compelled ... to treat it in the same way as an arm's length transaction. Lest, however, it should be thought that the door has been opened to making estate duty in Hong Kong a voluntary imposition, their Lordships would add that it would be unwise to assume that the genuineness of similar transactions in the future will necessarily be beyond challenge.

This was a shot from the hip. It is obvious that no serious thought was given to this passage, and it would be a mistake to construe it as if there was; that is not how case law works. So it is not surprising that in *Shiu Wing v Commissioner of Estate Duty*[56] the Hong Kong Court of Final Appeal held that the *Ramsay* principle did not apply to arrangements made by the taxpayer to create property situated abroad (in this case situated outside Hong Kong). The jurisprudence has of course moved on since *Shiu Wing* was decided in 2000. The *Ramsay* principle has "reached a state of well-settled maturity"[57] somewhat different from its 1981 formulation in *Ramsay*. Just how well-settled remains to be seen. However that may be, the outcome should be the same in this context. The IHT residential-property code assumes that (other than for residential property) the planning still works. Still, it would no doubt be wise to avoid the provocative timescale found in *Kwok.*

76.18 UK dom settlor becomes non-dom

What is the best form of tax planning where a settlor has made a settlement while UK domiciled and later acquires a foreign domicile? If nothing is done the trust property cannot be excluded property.

A solution may be to transfer the trust property back to the settlor. That may be impractical. eg if the settlor is not a beneficiary and commercial or foreign tax or UK CGT considerations make this course unattractive.

[56] 2 ITLR 794. See too App.7.12 (Pierce corporate veil/facade).

[57] *Hurstwood Properties v Rossendale BC* [2021] UKSC 16 at [9]; and see the comments on piercing the corporate veil at [63].

In some circumstances, a solution may be:

(1) the settlor creates a new trust; and

(2) the trustees of the old trust transfer the trust property to the new trust.[58]

76.19 Planning for non-estate IIP trust

A discretionary trust (and a non-estate IIP trust) is subject to IHT on its ten- year anniversaries. If the settlor is not UK domiciled when they made the trust, all that matters for IHT is the situs of the trust fund on that date.[59] The trustees may safely invest in the UK for a number of years, provided that, by the deadline, they hold foreign situate assets.

In principle this short-term planning may be extended indefinitely:

(1) As each 10-year anniversary approaches the trustees could sell the UK trust property and invest in excluded property.

(2) Immediately after the anniversary they might sell and revert to UK investments.

In practice such a course might be subject to the GAAR but it depends on how it is done. Ideally the trustees should look for a different approach such as holding UK assets in a foreign registered company.

76.20 Planning: Trust with UK dom settlor

If the settlor is UK domiciled when the settlement was made/funded, trust property is not normally excluded property even if the beneficiary is foreign domiciled.

76.20.1 *Non-resident beneficiaries*

If the life tenant of an estate IIP trust is not resident in the UK, the trustees might invest in FOTRA securities. The trust property would then be excluded property. See 75.11 (Trusts: FOTRA securities).

Likewise if all the known beneficiaries of a discretionary trust are resident abroad. This option is not available if any beneficiaries are domiciled or resident in the UK. A deed of appointment might be needed to satisfy these conditions. This would give rise to an exit charge unless

[58] See 79.9 (Transfer: A's trust to A's trust).

[59] Note also the possible tax charge on the death of the settlor, under the gift with reservation rules, if the property is UK situate: see 78.15 (GWR on death: Settled excluded property) and following.

the settlor is foreign domiciled when the settlement was made/funded. However, the amount of the charge may be moderate or small.

76.20.2 *Non-dom beneficiary*

The best option – if circumstances allow – may be to bring the present settlement to an end by appointment to the foreign domiciled beneficiary absolutely. CGT needs consideration. The beneficiary may after an appropriate period re-settle.[60] This may also be appropriate where the settlor has become foreign domiciled after making/funding the settlement.

An alternative course may be to confer a general testamentary power on the foreign domiciled beneficiary. The beneficiary may on their death create a new trust with excluded property.

76.21 UK funds *v* foreign funds

As far as tax is concerned, which is better for the foreign domiciliary: UK funds or foreign funds?

(1) A remittance basis taxpayer will prefer a foreign fund to a UK one, so that income and gains from the fund will be taxed on the remittance basis.[61] Likewise a settlor-interested trust whose settlor is a remittance basis taxpayer will prefer a foreign fund to a UK one; similarly if the transfer of asset rules may apply, as UK source income from the fund will be taxed on an arising basis and foreign source income will qualify for the remittance basis.

(2) A non-resident non-domiciled individual will not mind (for IHT, CGT or IT) whether they purchase a UK or a foreign fund. However, taxation at fund level is another matter, and the additional burden on UK funds, particularly SDRT, has encouraged fund managers to set up new funds offshore.[62]

Thus the IHT exemption for UK funds represents a pragmatic decision by the Government, but, like so much in the tax system, falls short of

[60] See 99.41 (Planning to create excluded property trust).

[61] If the individual intends to remit income from the fund, it would be better to have a UK fund because higher rates of tax apply to remitted dividends. But that is a special case.

[62] See "Taxation and the Competitiveness of UK Funds" (2006) *https://www.theia.org/sites/default/files/2019-05/20061009-jointkpmgimataxreport.pdf* The report also notes that the uncertainty and instability of the UK tax regime is regarded as making the UK an unsuitable location.

consistency (AKA "joined-up thinking").[63]

76.22 FOTRA securities: Planning

The FOTRA exemption is useful for individuals who are:

(1) UK domiciled or deemed domiciled, (so foreign property is not excluded property) but

(2) not resident in the UK (so they can satisfy the conditions for exemption).

76.23 Channel Islands/IoM domicile

The exemption for Islanders[64] could be useful for an individual who is:

(1) domiciled in the Channel Islands or the Isle of Man

(2) deemed UK domiciled (so in principle within the scope of IHT), and

(3) resident in the UK (so the FOTRA securities exemption is not available)

The exemption is also useful for a trust with such a person as life tenant.

[63] See 1.3 (Other tax competition).

[64] See 75.7 (Channel Islands/IoM domicile).

CHAPTER SEVENTY SEVEN

WILLS AND IOVs

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77.1 IHT on death: Introduction

The topics of this chapter are:

(1) Will drafting for foreign domiciled testators or beneficiaries
(2) Variation of wills
(3) Forced heirship (légitime, Sharia)

I do not discuss the general or residence nil-rate bands.

There has always been scope for tax saving through an appropriately drafted will.

77.2 UK-dom testator: Non-dom beneficiaries

Here the testator should in principle give their estate to beneficiaries absolutely so that the property may qualify as excluded property in their hands. A short-term discretionary will trust within s.144 IHTA is just as good from a tax viewpoint, and allows additional flexibility.

77.3 Non-dom testator: UK-dom beneficiaries

From an IHT viewpoint, the will should in principle provide that the estate is held on trust for the beneficiaries so that trust property situated outside the UK will remain excluded property.

Do not add property to an existing trust, if the trust may have a pool of trust gains or relevant income.

In addition to creating a trust, the testator should consider making some gifts directly to UK beneficiaries. The advantage is that benefits received by UK beneficiaries from the will trust will come into charge, when matched to trust gains or (subject to the motive defence) relevant income; but direct gifts under a will are tax free. So some absolute gifts may be appropriate, leaving the trust to provide further (though taxable) benefits in the more distant future and accumulate its funds in the meantime.

77.4 Gifts to spouse by will

77.4.1 *Non-dom testator, non-dom spouse*

Suppose:

(1) A foreign domiciled testator has:
  (a) excluded property and
  (b) chargeable (non-excluded) property

(2) The spouse is foreign domiciled so the IHT spouse exemption is fully available.

The safe course will be:

(1) Give the chargeable property to:
  (a) the spouse; or
  (b) a trust where the spouse has an interest in possession (better where the spouse is UK domiciled).

(2) Give excluded property to other persons.

A pecuniary legacy to the spouse should be secured on chargeable property. Watch the drafting.

This course should avoid a dispute with HMRC. However, it is not strictly necessary.[1]

77.4.2 *UK-dom testator, non-dom spouse*

Suppose:

(1) A foreign domiciled testator has
  (a) excluded property and
  (b) chargeable (non-excluded) property

[1] See 76.5.2 (Spouse exemption/excluded property interaction).

(2) The spouse is UK domiciled so the IHT spouse exemption so the full IHT spouse exemption will only apply if the spouse makes the spouse election. That may or may not be desirable, depending on the position of the spouse.[2]

The choice for the will lies between a discretionary will trust or an absolute gift to the foreign domiciled spouse. Which is better? If the property is given to the spouse, it is outside the scope of IHT thereafter, so long as it is excluded property. If the property is given to a will trust, it remains within the scope of IHT, it is not excluded property, as the will trust has a UK domiciled settlor. So at first sight, the absolute gift seems better. Having said that, if property goes into the discretionary will trust and out to the spouse again within two years, the IHT position is (more or less) the same as a direct gift: s.144 IHTA 1984. And it may be desired to pass the property to others, perhaps giving it to the next generation (particularly if not UK domiciled). Also when the testator makes the will, one would not usually know the domicile position at the time of the death. If the spouse lives long enough, she may become deemed UK domiciled for IHT purposes. All things considered, the discretionary will trust seems the more flexible and safer course for the will, in a routine case. In most cases, the will trust is likely to be wound up within two years. But the only cost is the deed of appointment.

77.5 Charitable gift by will

Suppose a foreign domiciled testator has:
(1) excluded property and
(2) chargeable (non-excluded) property

The best course in principle will be:
(1) Give the chargeable property to UK charities or EU charities which qualify for UK tax relief.[3]
(2) Give excluded property to other persons.

A pecuniary legacy to charity should be secured on chargeable property.

77.6 Instrument of variation (IOV)

Books have been written on this topic. I restrict discussion to the statutory

[2] See 5.14 (Spouse-election domicile).

[3] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), online version *https://www.taxationofcharities.co.uk*

provisions and some non-dom issues.

77.6.1 *IHT/CGT IoV reliefs*

The relief for IoVs is in s.142 IHTA/62 TCGA:

s.142(1) IHTA	**s.62(6) TCGA**
	(6) Subject to subsections (7) and (8) below,
(1) Where within the period of two years after a person's death—	where within the period of 2 years after a person's death
(a) any of the dispositions (whether effected by will, under the law relating to intestacy or otherwise) of the property comprised in his estate immediately before his death are varied, or	any of the dispositions (whether effected by will, under the law relating to intestacy or otherwise) of the property of which he was competent to dispose are varied, or
(b) the benefit conferred by any of those dispositions is disclaimed,	the benefit conferred by any of those dispositions is disclaimed,
by an instrument in writing made by the persons or any of the persons who benefit or would benefit under the dispositions,	by an instrument in writing made by the persons or any of the persons who benefit or would benefit under the dispositions—
	(a) the variation or disclaimer shall not constitute a disposal for the purposes of this Act, and
this Act shall apply as if the variation had been effected by the deceased or, as the case may be, the disclaimed benefit had never been conferred.	(b) this section shall apply as if the variation had been effected by the deceased or, as the case may be, the disclaimed benefit had never been conferred.

77.6.2 *Statements required*

s.142(2) IHTA	**s.62(7) TCGA**
(2) Subsection (1) above shall not apply to a variation unless the instrument contains a statement,	(7) Subsection (6) above does not apply to a variation unless the instrument contains a statement by

made by all the relevant persons,[4] to the effect that they intend the subsection to apply to the variation.	the persons making the instrument to the effect that they intend the subsection to apply to the variation.

77.6.3 *Variation for consideration*

s.142(3) IHTA	**s.62(8) TCGA**
(3) Subsection (1) above shall not apply to a variation or disclaimer made for any consideration in money or money's worth other than consideration consisting of the making, in respect of another of the dispositions, of a variation or disclaimer to which that subsection applies.	(8) Subsection (6) above does not apply to a variation or disclaimer made for any consideration in money or money's worth other than consideration consisting of the making of a variation or disclaimer in respect of another of the dispositions.

77.6.4 *Completion of administration*

s.142(6) IHTA	**s.62(9) TCGA**
(6) Subsection (1) above applies whether or not the administration of the estate is complete or the property concerned has been distributed in accordance with the original dispositions.	(9) Subsection (6) above applies whether or not the administration of the estate is complete or the property has been distributed in accordance with the original dispositions.

77.6.5 *IoV for charity*

For completeness: s.142(3A) IHTA provides:

> Subsection (1) does not apply to a variation by virtue of which any property comprised in the estate immediately before the person's death becomes property in relation to which section 23(1) applies unless it is

[4] Defined in s.142(2A) IHTA: "(2A) For the purposes of subsection (2) above the relevant persons are—
(a) the person or persons making the instrument, and
(b) where the variation results in additional tax being payable, the personal representatives.
Personal representatives may decline to make a statement under subsection (2) above only if no, or no sufficient, assets are held by them in that capacity for discharging the additional tax."

shown that the appropriate person[5] has been notified of the existence of the instrument of variation.

77.6.6 *IHT 2 year interest rule*

Section 142(4) IHTA provides:

> Where a variation to which subsection (1) above applies results in property being held in trust[6] for a person for a period which ends not more than two years after the death, this Act shall apply as if the disposition of the property that takes effect at the end of the period had had effect from the beginning of the period; but this subsection shall not affect the application of this Act in relation to any distribution or application of property occurring before that disposition takes effect.

77.6.7 *IoV and excluded property*

Section 142(5) IHTA provides:

> For the purposes of subsection (1) above the property comprised in a person's estate includes any excluded property but not any property to which he is treated as entitled by virtue of section 49(1) above or section 102 of the Finance Act 1986.

The IHT Manual provides:

> **IHTM35094 Redirection of excluded property** [Sep 2018]
> Another scheme (see also IHTM35093) where the taxpayers seek to take advantage of the provisions of IHTA84/S142 without there being a bona fide variation is where the estate contains excluded property (IHTM04251) such as government securities.
> The deceased, domiciled (IHTM13000) outside the UK, may leave property in this country to chargeable beneficiaries and excluded property to the spouse or civil partner (IHTM11032). An instrument of variation may then be used for the spouse's or civil partner's entitlement to be switched from excluded property to the ordinary UK estate without any change in the amount the spouse or civil partner receives.

[5] Section 142(3B) IHTA provides:
"For the purposes of subsection (3A) "the appropriate person" is—
(a) the charity or registered club to which the property is given, or
(b) if the property is to be held on trust for charitable purposes or for the purposes of registered clubs, the trustees in question."

[6] Section 142(7) IHTA provides:
"In the application of subsection (4) above to Scotland, property which is subject to a proper liferent shall be deemed to be held in trust for the liferenter."

> You should refer cases of this type immediately above to Technical without making any preliminary enquiries provided the basic facts are clear.

I do not understand in what sense it could be said that this is not a "bona fide variation".[7] Section 142(5) IHTA expressly envisages an IOV relating to excluded property.

A variation of this kind cannot sensibly be challenged if properly carried out. If the author's view of the spouse exemption is right, however, an IOV would not be necessary.[8] It may nevertheless be desirable as a useful precaution where a will has not been drafted in the manner recommended above.

77.7 Forced heirship/légitime/Sharia

77.7.1 *Heirship law background*

This section considers forced heirship. That includes:

(1) *Légitime* in civil law jurisdictions (in Scotland, *legitim*) (children's inheritance rights)
(2) Spouses' inheritance rights (in Scotland the technical term "legal rights" is used to refer to spouse rights and legitim[9])
(3) Sharia law inheritance rights

The holder of forced heirship rights is here called "the beneficiary".

The beneficiary may be entitled after the death of the testator:

(1) to override[10] dispositions in the will of the testator

[7] It would be different if there was an arrangement under which the spouse later swapped the UK property for the excluded property.

[8] See 76.5.2 (Spouse exemption/excluded property interaction).

[9] Section 36 Succession (Scotland) Act 1964 ("legal rights" means jus relicti, jus relictae, and legitim).

[10] The position could be different depending on the applicable law
(1) The effect of a forced heirship right may allow the beneficiary to set aside a provision in a will
(2) The effect of a forced heirship right may be that the beneficiary acquires the asset (ie the will is void ab initio).

But English law concepts such as void/voidable (which are themselves far from precise) would not easily be translatable into foreign legal systems. Forced heirship rules vary greatly between different jurisdictions, but in most if not all cases the beneficiary has to take some action to vindicate the right, so a provision in the will in breach of forced heirship rights is not void in the sense of being wholly ineffective. Certainly that was thought to be the case in *AG v Jewish Colonization Association*, discussed below, though that case concerned a lifetime gift, not a will.

(2) to set aside gifts made by the testator during his life

77.7.2 *Position in testator's lifetime*

It is well established that under English law,[11] a beneficiary under the will of a living person has no interest in the property of the testator. The interest of the beneficiary is described as a "mere expectancy". An assignment or disclaimer of a mere expectancy is not valid in English law.[12]

It follows that during the lifetime of the testator the beneficiary's expectancy is not an asset capable of giving rise to a gain for CGT, and is not property for the purpose of IHT.

A contract or undertaking to assign or disclaim during the lifetime of the testator may be valid, but the drafting would require some thought.

77.7.3 *Légitime and trust proper law*

AG v Jewish Colonization Association briefly discussed the proper law of a lifetime trust made by a settlor domiciled in a forced heirship jurisdiction. The settlor, Baron de Hirsch, domiciled in Austria, created a trust for himself for life, with remainder to charity. The issue was whether the trust property was subject to succession duty[13] on the settlor's death. The tax applied if the trust was governed by English law, which was held to be the case.[14] In this context:

> [Counsel for the taxpayer] argued that, if there had been children of the Baron's, inasmuch as by Austrian law an Austrian father cannot divest himself of property so as to impair the rights of his children to "legitim," and any alienation at any time having that effect may on the death of the father be set aside, to the extent to which it has that effect, Austrian and not English law governed the case.

The argument was that a trust made by an Austrian domiciliary must be governed by Austrian law, because of the impact, or theoretical impact,[15]

[11] Although a question of foreign law, the same must apply to a beneficiary who expects to acquire forced heirship rights on the death of a testator.

[12] *Smith v Smith* [2001] 1WLR 1937. Although strictly a question of foreign law, the same would apply *a fortiori* in the forced heirship jurisdiction.

[13] This interesting tax was repealed in 1949.

[14] The moral is that tax advice should have been taken before the trust was made.

[15] It would have been interesting if expert evidence had been provided as to the application of Austrian law in the case of a settlor who was domiciled in Austria but (though not stated in the decision) a German national. But it would have made no

of a légitime claim. That seems hopeless now (perhaps it was less clear in 1901):

> I do not agree. The trust and the administration of the trust can only be enforced or the trust got rid of by having resort to English law - i.e., to an English Court of justice. Till that has been done the English company [trustee] is entitled to hold the £7,000,000, subject, of course, to the [charitable trusts]. In any proceedings to set aside the trust evidence of what is the Austrian law as regards the father's rights might, I think, be given to shew that the trust was non-effective; but this question would have to be decided by an English Court before the company [the trustee] could be deprived of its money.[16]

I mention this for completeness, as it is the only tax case I know involving forced heirship; but proper law rarely matters for tax, now, except for the four surviving estate duty/IHT DTAs.[17] I do not think the case has much wider application.

77.7.4 *Forced heirship right: CGT*

After the death of the testator, a forced heirship right may be an asset for CGT purposes. So disclaimer or other disposal of the right may give rise to a chargeable gain. A remittance basis taxpayer may not be concerned as the asset, if it is one, is not (or at least is not likely to be) UK situate. If a gain is deemed to accrue on a disclaimer of the forced heirship right, the gain cannot be remitted to the UK.

Otherwise, a safe course (if practical) may be that the beneficiary disclaims the forced heirship right or enters into an instrument of variation, in writing, within two years of the death. The forced heirship right will then be ignored for CGT.[18] But the better view that the right is not an asset for CGT. This is part of the wider conundrum of the CGT analysis of beneficiary's rights in a deceased's estate. A beneficiary who exercises forced heirship rights acquires as legatee.

77.7.5 *Forced heirship right: IHT*

There are express IHT provisions, not discussed here, for legitim in

difference to the outcome.

[16] [1901] 1 QB 123 at p.133 approved in *Akers v Samba Financial Group* [2017] UKSC 6 at [23].

[17] See 115.6 (Proper-Law Rule).

[18] See 77.6.1 (IHT/CGT IoV reliefs).

Scotland.[19] This does not in terms apply to foreign forced heirship. The discrimination might not have been EU-law compliant, but post-Brexit the point may not arise.

If forced heirship relates to settled property (eg the property is settled by the will) the right may be a settlement power, ignored for IHT.[20]

Where a will makes a outright (non-settled) gift, subject to forced heirship rights, the beneficiary's forced heirship right (after the death of the testator) might be property for IHT purposes. A foreign domiciled beneficiary may not be concerned as the asset is not (or at least, is not likely to be) UK situate. Otherwise, a safe course (if possible) may be that the beneficiary disclaims the forced heirship right or enters into an instrument of variation, in writing, within two years of the death. The right will then be ignored for IHT.[21] But the better view is that a disclaimer is not a transfer of value,[22] and, perhaps, that the right is not property for IHT.

77.7.6 *Forced heirship right: IT*

HMRC appear to accept that disclaimer or non-exercise of the right does not make the beneficiary a settlor.[23] It does not constitute a transfer of assets for ToA purposes. It may be an associated operation, but the significance of that would need further consideration.

77.8 Family Provision Act claim

This section considers claims under family provision legislation, such as the Inheritance (Provision for Family and Dependents) Act 1975 and its foreign equivalents.

There are express provisions, not discussed here, for UK family provision legislation.[24] This does not in terms apply to foreign family provision legislation, though the discrimination might not be EU-law compliant.

Since the power of the Court under family provision legislation is

[19] Section 147 IHTA, supplemented by s.17(d) IHTA. See Kessler & Grant, *Drafting Trusts and Will Trusts in Scotland* (2nd ed., 2017), para 17.9 ("Legal rights" and NRBs).

[20] See 74.10 (Settlement powers).

[21] See 77.6.1 (IHT/CGT IoV reliefs).

[22] See 99.18.4 (Disclaimer: Tax consequences).

[23] See 99.18.5 (Person disclaiming: a settlor?).

[24] Section 146 IHTA.

discretionary, it is considered that the beneficiary’s right under the legislation is not an asset for CGT or property for IHT. The IT position is the same as for forced heirship, see above.

CHAPTER SEVENTY EIGHT

RESERVATION OF BENEFIT

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78.23 1986 transitional relief
78.23.1 Pre-1986 insurance policy

Cross references
The following topics are considered elsewhere:

Topic	**See para**
GWR property subject to debt	80.6
Pre-owned assets: GWR exemptions	83.19
Liability for GWR	125.3.5

78.1 GWR: Introduction

Here is a rendezvous of questions and question marks! A full discussion needs a book to itself. I focus on matters closest to the themes of this book, but it is necessary to consider the provisions generally in order to see the issues in their context.

I do not consider the special rules for:

Topic	**Reference**
Land	s.102A-102C FA 1986
Insurance policies	Para 7 sch 20 FA 1986
Agricultural/business property relief	Para 8 sch 20 FA 1986
Double charges	IHT (Double Charges Relief) Regs 1987

The IHT Manual contains much fascinating material which cannot be set out here.

78.2 Purpose of GWR

In *Ingram v IRC*:[1]

> I should say something about the more general considerations involved in the application of s.102. Its policy has puzzled people for a long time. For one thing, it is in one sense a penal section. Not only may you not have your cake and eat it, but if you eat more than a few de minimis crumbs of what was given, you are deemed for tax purposes to have eaten the lot. Secondly, a superficial reading of phrases like 'beneficial enjoyment of the property' and enjoyment of property 'to the entire exclusion . . . of the donor' has led to numerous occasions in the past century in which the Revenue has put forward the proposition that, as a matter of practical common sense, it simply must be contrary to the policy of the statute for a donor to be able to give away property such as a house and go on enjoying the benefit of the property by continuing to live there. This is the premise upon which the Revenue claim the high ground of substance and reality. [Counsel for the Revenue] said that for Lady Ingram to have made a PET and retained the right to stay in the house was simply too good to be true ... But this approach ignores the fact that 'property' in s.102 is not something which has physical existence like a house but a specific interest in that property, a legal construct, which can co-exist with other interests in the same physical object. Section 102 does not therefore prevent people from deriving benefit from the object in which they have given away an interest. It

[1] *Ingram v IRC* [1999] STC 37 at p.41; for other aspects of this case see 83.2.2 (*Ingram* schemes). On identifying statutory purpose, see App 9.1 (Purpose of a statute).

> applies only when they derive the benefit from that interest.
>
> If Lady Ingram had been dealing with a fund of investments instead of a house, she would have had no difficulty in achieving the same result, in economic terms, as the transaction in this case. She could have used part of the fund to purchase an annuity which would have guaranteed her exactly the same income as she had been receiving from the fund and given away the rest. Unless she needed to resort to capital, her outward circumstances would have continued unchanged. Why should it make a difference that her asset happened to consist of land? ...
>
> What, then, is the policy of s.102? It requires people to define precisely the interests which they are giving away and the interests, if any, which they are retaining. Once they have given away an interest they may not receive back any benefits from that interest. In *Lang v Webb*[2] Isaacs J suggested that the policy was to avoid the 'delay, expense and uncertainty' of requiring the Revenue to investigate whether a gift was genuine or pretended. It laid down a rule that if the donor continued to derive any benefit from the property in which an interest had been given, it would be treated as a pretended gift unless the benefit could be shown to be referable to a specific proprietary interest which he had retained. This is probably the most plausible explanation ...

78.2.1 *GWR and the GAAR*

HMRC draft GAAR guidance provided:[3]

> ***4.1.2 The scheme***
>
> *J grants a long lease over his home to S for no consideration, to take effect in 20 years time. ... J is able to continue to occupy the property for the next 20 years as he continues to own the freehold.*
>
> *The result of the scheme is that J has divided his home into two different interests: the lease and the freehold.*
>
> *J has gifted the lease of his home to S. J has also retained the freehold, which diminishes in value over the following 20 years.*

This is a slight variant of the *Ingram* arrangement[4] but the conveyancing details do not matter here.

> ***4.1.4 The taxpayer's tax analysis***
>
> *The interest given away (the lease to take effect in 20 years time) is a potentially exempt transfer under section 3A, IHTA 1984 and will be exempt from IHT provided J survives*

[2] (1912) 13 CLR 503.

[3] HMRC, "GAAR Guidance- Consultation Draft Part B Examples of How the GAAR Applies to Tax Arrangements" (December 2012).

[4] See 83.2.2 (*Ingram* schemes).

for 7 years after the gift.

The interest retained (the freehold subject to the lease) is reducing in value as the time for the lease to take effect approaches, so reducing the value of J's estate that will be subject to IHT on death.

As the time for the lease to take effect approaches, the value of the asset transferred to S increases, but without giving rise to a charge to IHT.

4.1.5 What is the GAAR analysis under clause 2(2)?

4.1.5.1 Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based and the policy objectives of those provisions?

In 1975 Capital Transfer Tax ("CTT") replaced Estate Duty with the aim of reducing avoidance[5] *through giving property away before death. Under CTT, all disposals of property, whether to individuals or into trust were immediately subject to tax. By 1986, CTT was seen as an inhibitor to the transfer of wealth, so transfers between individuals and to certain favoured*[6] *trusts were exempted from charge (provided the donor survived 7 years). Provisions were introduced to prevent the avoidance of the charge on death by gifts where the donor continues to benefit from the gift. And the tax was renamed. The purpose of these provisions was published in the Budget Press Release in March 1986. The scheme allows the taxpayer to 'have their cake and eat it' since an interest in J's home is given away and will be free from IHT provided J survives 7 years; yet J is still able to live in and enjoy his home; the value of which is reducing as the commencement of the lease draws ever closer. This is not consistent with the principles or policy objectives of the reservation of benefit provisions.*

4.1.5.2 Does the means of achieving the substantive tax results involve one or more contrived or abnormal steps?

Absent the arrangements, had J given his home to S and continued to live there rent-free, there would have been a clear reservation of benefit in the property. The property would have formed part of J's estate on death and the full value of the property at that time would have been subject to IHT. Simply making a gift of his home to S whilst continuing to live there might be considered a 'normal' step for J to take, as opposed to the "abnormal steps" which J did take.

The intermediate step taken by J in granting a long lease for no consideration, the commencement of which is deferred for a period of time, is contrived and is inserted purely to gain a tax advantage.

4.1.5.3 Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?

The gifts with reservation rules in section 102, FA 1986 cover a situation where an individual disposes of property by way of gift, but does not fully give away the ability to enjoy that property. The rules do not cover a situation where an individual creates two different interests in that property, and gives one interest away and retains the other.

In both situations the non-tax result for the individual may be the same. However, in the first situation the reservation with benefit rules apply. In the second situation, the rules

[5] This is tendentious: see 3.22 (Intention: parliament\government).

[6] This adjective is tendentious; but that does not affect the policy issues discussed here, and any one-paragraph summary of CTT must oversimplify.

do not apply.
The failure of the rules to cover a situation where an individual creates two different interests in a property is a shortcoming that the scheme is intended to exploit.
4.1.5.4 Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?
HMRC has not indicated that these arrangements give rise to the claimed tax result.[7]
4.1.6 Conclusion
On the facts given, the arrangements are abusive arrangements to which HMRC would seek to apply the GAAR.

In an early test of the GAAR advisory panel, this passage was deleted from the GAAR guidance. The guidance now provides:

> D27.5.1 ... In [*Ingram*], the House of Lords held that the policy of the legislation was to identify precisely what property had been given away by the donor and what (if anything) was retained. They noted that there is nothing in principle behind the 'gifts with reservation' provisions that stops the donor carefully dividing up his cake, giving away a slice and retaining the remaining cake. Continued enjoyment of the latter does not amount to a reservation in the former. Arrangements of the type adopted are known as 'shearing' operations.
> Ss102A–102C FA 1986 were introduced to stop 'shearing' arrangements in relation to certain 'carve out' schemes over land. Therefore the policy on such arrangements has clearly been altered by legislation and the effect of the GAAR in relation to such tax schemes must be considered in this light. However, this does not mean that all 'carve out' arrangements have been stopped. The House of Lords has indicated that such arrangements are not necessarily[8] against the principles behind the legislation and no legislative action has been taken in relation to other types of assets to stop such arrangements. The discounted gift scheme can be seen as a classic shearing operation on property other than land.[9]

78.3 Basic GWR conditions

Section 102(1) FA 1986 provides:

[7] I wonder about that. *Ingram* arrangements (*avant la lettre*) were used in the 1960's and never challenged. But that does not affect the policy issue discussed here.

[8] This is a somewhat tendentious summary of the view expressed in *Ingram*; but perhaps it does not matter.

[9] HMRC, "GAAR Guidance" Part D (2017)
https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules

> Subject to subsections (5) and (6) below,[10] this section applies where, on or after 18 March 1986, an individual disposes of any property by way of gift and either—
>
> (a) possession and enjoyment of the property is not bona fide assumed by the donee at or before the beginning of the relevant period;[11] or
>
> (b) at any time in the relevant period the property is not enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise ...

There are two sets of conditions:

(1) An individual (in this chapter the "**donor**") makes a disposal of property by way of gift. There are three separate elements here: a *disposal*, of *property*, which must be *by way of gift.*

(2) Condition (a) or (b) above must be satisfied (a reservation of benefit).

78.4 GWR terminology

Section 102(2) FA 1986 defines "**property subject to a reservation**":

> If and so long as—
>
> (a) possession and enjoyment of any property is not bona fide assumed as mentioned in subsection (1)(a) above, or
>
> (b) any property is not enjoyed as mentioned in subsection (1)(b) above,
>
> the property is referred to (in relation to the gift and the donor) as property subject to a reservation.

I coin the following terminology:

My term	Meaning
GWR property	Property subject to a reservation
Settled GWR property	GWR property (gift to a trust)
Non-settled GWR property	GWR property (gift not to a trust)

[10] These exemptions are as follows:

Section	Topic	See
s.102(5)(a)	GWR spouse exemption	78.10
s.102(5)(b)ff	Misc minor reliefs	78.11
s.102(6)	Pre-1986 insurance policy	78.23.1

[11] Section 102(1) provides:

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

GWR death charge	Charge imposed by s.102(3) FA 1986
GWR PET charge	Charge imposed by s.102(4) FA 1986

78.5 Disposal by way of gift

There is no definition of "disposal by way of gift".

The surrender of a lease or life interest is arguably not a disposal.

It is considered that giving consent to an exercise of a power of advancement or appointment is not a disposal.

It is considered that a transfer to a settlement in which the settlor has an estate interest in possession is a disposal by way of gift, but from 2006 this issue will not usually arise.

GWR only applies if an *individual* makes a disposal by way of gift. If a company makes a gift, the shareholder or shareholders do not make a disposal by way of gift.[12]

A sale at market value, where the purchase price is left outstanding as an interest-free loan, repayable on demand, is not a disposal by way of gift. A sale at an undervalue may not be a disposal "by way of gift".[13]

An interest-free loan is not a disposal by way of gift.[14]

78.6 Reservation of benefit

When (re)introduced in 1986, the wording of s.102(1)(a)(b) was regarded as exceptionally, even scandalously, vague. But it does not seem exceptional by the standards of contemporary anti-avoidance legislation.

While in most cases the matter will be clear enough there are significant areas of uncertainty. HMRC guidance helps in some cases.

78.6.1 *Gift to settlor-interested trust*

IHT Manual provides:

> **IHTM14393 Settlement on discretionary trusts** [Aug 2016]
> If a donor makes a settlement and is one of the members of the discretionary class of beneficiaries, this is a GWR.

[12] This seems clear from first principles but for completeness, this view is supported by the fact that the shareholders are not transferors for the purposes of s.720; see 49.6 (Shareholders not transferors).

[13] This view is supported by the drafting of para 2(4) sch 20 FA 1986: see 78.21.1 (Gift by donee). See too *AG v Rosenlund* [2016] JRC 062 at [38]-[39].

[14] This view is supported by the drafting of para 5(4) sch 20 FA 1986: see 78.22.3 (Loan to trust).

- The donor's position as a member of the discretionary class of beneficiaries is not an equitable interest retained by them (and so not included in the gift) and
- as the donor is a member of the class, they have not been excluded (IHTM14333), or virtually excluded, from enjoyment. The fact that they do not receive any tangible benefit during the relevant period is immaterial.

This is correct.[15]

It is considered that the same in principle applies where an individual makes a gift to a discretionary trust under which:

(1) the settlor is not included in the class of beneficiaries; but
(2) the trustees have an unrestricted power to add the settlor to the class of beneficiaries.

After some vacillation, HMRC agree.[16] The IHT Manual continues:

> **Discretionary class**
> If a donor settles property on discretionary trusts and is one of the discretionary class of beneficiaries, the gift is a GWR. However, a donor who is not named as a member of the discretionary class may
> - become one if the trustees have power to extend the class of beneficiaries, or
> - benefit if their spouse or civil partner is a beneficiary.
>
> **Example 1** (Anthony)
> A transfers assets into a discretionary settlement under which he is not included in the class of beneficiaries. There is however power to the trustees to add beneficiaries including A to the class at some future date. That A can be considered as a potential beneficiary is sufficient to say that the trust fund is not enjoyed to the entire or virtually to the entire exclusion of benefit to him under the settlement and the gift will be a GWR (*IRC v Eversden* [2003] STC 822). Only if the trust irrevocably excludes A from being a beneficiary under the trust will a GWR not arise.

The position however depends on the proper law and the terms of the trust. For instance, s.9(9) [Malta] Trusts and Trustees Act 1989 provides:

> A person who may be added as a beneficiary in terms of a power

[15] *IRC v Eversden (Greenstock's Executors)* [2002] EWHC 1360 (Ch) at [17]; on the appeal, CoA did not consider this point. *Lyon v HMRC* [2007] UKSPC SPC616.

[16] The text of the Manual changed materially in 2014.

> granted to the trustee
> [a] shall not enjoy any rights in relation to the trust property or against the trustee and
> [b] shall not be considered a beneficiary in any manner until appointed as a beneficiary by the trustee.

It is arguable there is no gift with reservation of benefit in a case where:

(1) the trustees have power to add beneficiaries but
(2) the donor does not "enjoy any rights in relation to the trust property or against the trustee" (whether as a result of the proper law or the drafting of the specific trust).[17]

But it would be better not to plan on that basis.

78.6.2 *Benefit to spouse*

A benefit to a spouse does not count. The Manual passage continues:

> **Example 2** (Anthony)
> A makes a discretionary settlement. The class of beneficiaries includes A's wife, but not himself.
> This does not constitute a reservation but if A shares any benefit (IHTM14339) taken by A's wife, this can be a GWR. You should consider whether a GWR claim is appropriate.

78.6.3 *A gives to B + B gives to trust*

The position is different where:

(1) A makes a gift to B.
(2) Later, by an independent transaction, B creates a discretionary trust under which A is a beneficiary (or where A can be added as a beneficiary).

In these circumstances A is *not* the settlor. It is considered that there is no reservation merely because A is a discretionary beneficiary. There will be a gift with reservation if A actually receives a benefit.

78.6.4 *"Virtually" excluded*

This concept matters for several purposes:

(1) GWR
(2) Remittance conditions C and D[18]

[17] It is assumed that the donor does not enjoy any other benefits from the trust.
[18] See 18.29.4 (Enjoyment disregards).

(3) With an economy of concepts, HMRC apply their guidance to the conceptually distinct issue of whether a person "occupies" land, ie a person "virtually" excluded from land is not an occupier[19]

So the topic often arises.

RI 55 provides:

> The word "virtually" in the de minimis rule in FA 1986 s 102(1)(b) is not defined and the statute does not give any express guidance about its meaning. However, the shorter Oxford English Dictionary defines it as, amongst other things, "to all intents" and "as good as". Our interpretation of "virtually to the entire exclusion" is that it covers cases in which the benefit to the donor is insignificant in relation to the gifted property.
>
> It is not possible to reduce this test to a single crisp proposition. Each case turns on its own unique circumstances and the questions are likely to be ones of fact and degree. We do not operate s 102(1)(b) in such a way that donors are unreasonably prevented from having limited access to property they have given away and a measure of flexibility is adopted in applying the test.

These generalities do not take us far. RI 55 goes on to give more concrete examples:

> Some examples of situations in which we consider that FA 1986 s 102(1)(b) permits limited benefit to the donor without bringing the GWR provisions into play are given below to illustrate how we apply the de minimis test—
>
> [1] a house which becomes the donee's residence but where the donor subsequently—
>
> – stays, in the absence of the donee, for not more than two weeks each year, or
> – stays with the donee for less than one month each year;
>
> [2] social visits, excluding overnight stays made by a donor as a guest of the donee, to a house which he had given away. The extent of the social visits should be no greater than the visits which the donor might be expected to make to the donee's house in the absence of any gift by the donor;
>
> [3] a temporary stay for some short term purpose in a house the donor had previously given away, for example—

[19] "Occupy" is a concept which matters for many tax purposes; see 83.3.1 ("Occupation").

> – while the donor convalesces after medical treatment;
> – while the donor looks after a donee convalescing after medical treatment;
> – while the donor's own home is being redecorated;
> – visits to a house for domestic reasons, for example baby-sitting by the donor for the donee's children;
>
> [4] a house together with a library of books which the donor visits less than five times in any year to consult or borrow a book;
> [5] a motor car which the donee uses to give occasional (ie less than three times a month) lifts to the donor;
> [6] land which the donor uses to walk his dogs or for horse riding provided this does not restrict the donee's use of the land.

There follow some examples of where there is a benefit:

> It follows, of course, that if the benefit to the donor is, or becomes, more significant, the GWR provisions are likely to apply. Examples of this include gifts of—
> [1] a house in which the donor then stays most weekends, or for a month or more each year;
> [2] a second home or holiday home which the donor and the donee both then use on an occasional basis;
> [3] a house with a library in which the donor continues to keep his own books, or which the donor uses on a regular basis, for example because it is necessary for his work;
> [4] a motor car which the donee uses every day to take the donor to work.[20]

The RDR Manual gives an example of a car, in the context of remittance condition C:[21]

> **RDRM33270 Condition C -enjoyment by a relevant person ignored**
> [Jan 2019]
> *[James ("B") and Julia ("S")]*
> B, a remittance basis user, gives his sister S £10,000 of his foreign income. This money is qualifying property of a gift recipient. The following year S brings the money to the UK to purchase a car for £10,000.
> B visits S two or three times a year and while there he occasionally uses

[20] The same passage is found in IHTM14333 (modernised in 2010 to gender inclusive language).

[21] See 18.29.4 (Enjoyment disregards).

her car to run errands. Otherwise the car is used only by S. Although there is enjoyment by a relevant person (B) of qualifying property (the car acquired with the foreign income), the enjoyment is marginal and may be disregarded.

Although the car is registered in S's name, S gives B the car to use every weekend and also for a long-distance journey every second month. B's enjoyment of the car is not 'marginal'.

78.6.5 *Exclusion from part*

Suppose S makes a gift to a settlor-interested trust, and later a separate subfund ("the excluded fund") is created and S is wholly excluded from that fund. Does the excluded fund cease to be property subject to a reservation? Is the position better if the excluded fund (or the non-excluded fund) is transferred to a separate settlement? Discuss.

78.6.6 *Benefit: associated operations*

Para 6(1)(c) sch 20 FA 1986 provides:

> a benefit which the donor obtained by virtue of any associated operations (as defined in section 268 of the 1984 Act) of which the disposal by way of gift is one shall be treated as a benefit to him by contract or otherwise.

See 74.11 (Associated operation). I am not sure this makes much difference in practice, but it shows that the concept of "benefit by contract or otherwise" is to be widely understood.

78.7 Full consideration exemption

Para 6(1) sch 20 FA 1986 provides:

> In determining whether any property which is disposed of by way of gift is enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise—
>
> (a) in the case of property which is an interest in land or a chattel, retention or assumption by the donor of actual occupation of the land or actual enjoyment of an incorporeal right over the land, or actual possession of the chattel shall be disregarded if it is for full consideration in money or money's worth;

RI 55 provides:

> ... we take the view that full consideration [for the GWR rule] is required throughout the relevant period—and therefore consider that

the rent paid should be reviewed at appropriate intervals to reflect market changes.

See App 4.9 (Market value/full consideration).

78.8 IHT on disposal by way of gift

A gift which is a chargeable transfer will give rise to a charge to IHT (assuming it exceeds the nil rate threshold) whether or not it is a gift with reservation.[22] The reservation of benefit does not affect the lifetime charge; it just imposes a further charge on the death of the donor. The Inheritance Tax (Double Charges Relief) Regulations 1987 mitigate a double charge. This chapter does not consider the IHT which might arise on a disposal by way of gift; it considers only the GWR aspects.

78.9 Gift of excluded property

GWR applies when an individual disposes of property by way of gift. A foreign domiciliary is "an individual". A gift of UK situate property by a foreign domiciliary is clearly within the GWR rule.

What is the position where a foreign domiciliary disposes of excluded property by way of gift? That is not a transfer of value.[23] The question is

[22] The IHT Manual seems to make this somewhat elementary error:

"**IHTM14316 Sales for less than full consideration** [Sep 2018]

Example 1 (Robert and James)

In 2011 R sold a house, then worth £100,000, to his son, J, for £25,000. This is a disposition partly by way of sale and partly by way of gift. R dies in 2013.

If R has been excluded from enjoyment of the property throughout the period, the gift is a PET chargeable on his death. The loss to his estate is the value of the entirety of the property less the consideration received (£100,000 less £25,000 = £75,000).

[The correct view is that the sale is a PET whether or not the donor is excluded]

If R was not excluded from enjoyment of the property, for instance because he resided at the property following the disposition, the disposal by way of gift is a GWR. The value of the property disposed of by way of gift is 75% of the value of the whole property. Thus, if the property is still subject to a reservation immediately before R's death, 75% of its death value is treated as property to which R was beneficially entitled."

[This is very doubtful; no property is disposed of by way of gift]

[23] Section 3 IHTA provides:

(1) ... a transfer of value is a disposition made by a person (the transferor) as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition...

(2) For the purposes of subsection (1) above no account shall be taken of the value

whether disposal "by way of gift" here means: by way of a disposition which is a transfer of value.

I mention some preliminary points to clear them out of the way:

(1) Section 3(2) IHTA does not in its terms support the view that a gift of excluded property is not a gift for the purposes of GWR. The subsection is expressed to apply "for the purposes of s.3(1)." It is not expressed to apply for other purposes. We are looking for a purposive (non-literal) construction.

(2) The operation of ten year/exit charges and gift with reservation on death of the settlor is harsh. But the effect of the GWR rule is always to double the potential IHT charges, as property subject to a reservation is taxed in the estate of the donee and the donor. Moreover the severity is in part attributable to the 10 year/exit charge regime, which in general taxes settled property more severely than non-settled property.

It is possible for the Courts to imply a territorial limitation beyond that set out in the statute, but it needs a strong case to do that.[24] Is that case made out here? If GWR applies on a gift of excluded property, there would be a charge to IHT in circumstances where:

(1) a foreign domiciliary with no UK connection makes a gift of excluded (foreign) property to another person with no UK connection, and enjoys some benefit; and

(2) the donor dies many years later at a time when the gifted property, or property representing it, is not excluded property (eg situate in the UK or within IHTA sch A1).

It is not easy for the foreign domiciled donor or their executors to comply with an obligation to pay IHT in such circumstances. But if GWR does not apply in these circumstances, there is some scope for what may be regarded as avoidance. There is at least some UK connection in the IHT charge, in that the property must be UK situate or non-excluded property at the time the charge arises.

Suppose a foreign domiciled individual makes a gift of excluded property to their spouse. On the literal construction, the gift will fall within GWR. A gift of excluded property is not a transfer of value, so not

of excluded property which ceases to form part of a person's estate as a result of a disposition.

[24] See 16.11 (General territorial principle).

an exempt transfer, so it is outside the scope of the GWR spouse exemption. [25] That is anomalous. This consideration does support the argument that gifts of excluded property are not "by way of gift" (and the same argument might apply to any gifts which are not transfers of value, though we need not go that far). But:

(1) Taxpayer arguments based on anomalies are not the most powerful of arguments.
(2) Assuming, by a purposive (non-literal) construction, inter-spouse gifts of excluded property must be taken to fall within the relief in s.102(5), a Court may say that it does not follow that all gifts of excluded property are outside the GWR rule.

In s.3A IHTA gift is defined to mean "transfer of value". Section 3A was introduced by s.101 FA 1986. It might be argued that it would be strange for gift to have a different meaning in the next section, s.102. I do not find this a strong argument, as the wording is different and because inferences from inconsistency in drafting are based on the doubtful assumption that tax legislation is always drafted with consistent wording.

The use of the label "excluded property" suggests the property is regarded as excluded from IHT. But labels used in definitions are only brief descriptions, so the argument is not very strong. In addition, exempt transfers under s.19 IHTA are clearly within GWR (they are omitted from the list of reliefs in s.102(5) FA 1986) even though described as "exempt".

Earlier editions of this work took a more optimistic view. But reviewing the arguments above, it is considered that the better view is that a gift of excluded property is within GWR. HMRC take that view.

This view will sometimes favour the taxpayer, as it means that the POA GWR exemption would be available.[26] But it is not necessary to pursue that here.

78.10 GWR spouse exemption

This section considers the GWR position on inter-spouse gifts.

Section 102(5) FA 1986 provides a set of 10 reliefs. The first is:

> This section does not apply if or, as the case may be, to the extent that the disposal of property by way of gift is an exempt transfer by virtue of any of the following provisions of Part II of the [IHTA],–

[25] See 78.10.1 (H gives excluded property to W).

[26] See 83.19 (GWR exemptions).

> (a) section 18 (transfers between spouses or civil partners);

In the following discussion:
"General IHT spouse exemption" is the IHT exemption on inter-spouse transfers in s.18 IHTA.[27]
"**GWR spouse exemption**" is the GWR exemption in s.102(5)(a).

In short, the GWR rules do not apply on gifts between spouses if the general IHT spouse exemption applies.

Where a UK domiciled individual makes a gift to a foreign domiciled spouse, the IHT spouse exemption is restricted[28] and a gift over the limit will be within the scope of GWR, unless some other exemption[29] is in point. One solution to this problem is to sell assets at market value, so there is no disposal by way of gift. Watch the SDRT/SDLT implications.

One common situation is where one spouse gives an interest in the family home to the other spouse, but as long as the property is jointly occupied, there is in principle no GWR: see s.102B FA 1986.

78.10.1 *H gives excluded property to W*

What is the position when a foreign domiciled individual makes a gift of excluded property to their spouse? On a literal construction, the gift will fall within the GWR rules. A gift of excluded property is not a transfer of value, so not an exempt transfer, so it is outside the scope of the GWR spouse exemption! But that is absurd and cannot be the correct construction, even if words must be strained to reach this result. [30]

78.10.2 *Spouse exemption restricted*

Section 102 FA 1986 provides:

> (5A) Subsection (5)(a) above does not prevent this section from applying if or, as the case may be, to the extent that—

[27] For the IHT spouse exemption generally see 76.5.1 (Spouse exemption: Introduction); see too 78.19 (GWR on death: Spouse exemption).

[28] See 93.2 (Restriction on IHT spouse exemption for foreign domiciled spouse).

[29] Such as the family maintenance exemption: see 93.4 (Disposition for maintenance of spouse and other exemptions).

[30] If this view were wrong the further anomaly would arise that gifts of qualifying investments to charity would fall within the scope of GWR because such gifts fall within s.12 IHTA and not s.102(5)(d) FA 1986; but it is not necessary to pursue that here.

> (a) the property becomes settled property by virtue of the gift,
> (b) by reason of the donor's spouse or civil partner ("the relevant beneficiary") becoming beneficially entitled to an interest in possession in the settled property, the disposal is or, as the case may be, is to any extent an exempt transfer by virtue of section 18 of the 1984 Act in consequence of the operation of section 49 of that Act (treatment of interests in possession),
> (c) at some time after the disposal, but before the death of the donor, the relevant beneficiary's interest in possession comes to an end, and
> (d) on the occasion on which that interest comes to an end, the relevant beneficiary does not become beneficially entitled to the settled property or to another interest in possession in the settled property.
>
> (5B) If or, as the case may be, to the extent that this section applies by virtue of subsection (5A) above, it has effect as if the disposal by way of gift had been made immediately after the relevant beneficiary's interest in possession came to an end.
>
> (5C) For the purposes of subsections (5A) and (5B) above—
> (a) section 51(1)(b) of the 1984 Act (disposal of interest in possession treated as coming to end of interest) applies as it applies for the purposes of Chapter 2 of Part 3 of that Act; and
> (b) references to any property or to an interest in any property include references to part of any property or interest.

This stopped *Eversden* schemes;[31] it is now unnecessary, because of s.102ZA, the POA rules, and the 2006 IHT trust tax reforms; it should be repealed.

78.11 GWR exempt transfer reliefs

In addition to the GWR spouse exemption, s.102(5) FA 1986 provides 9 further minor reliefs, numbered semi-alphabetically:

> This section does not apply if or, as the case may be, to the extent that the disposal of property by way of gift is an exempt transfer by virtue of any of the following provisions of Part II of the 1984 Act- [32]

Para	IHTA	Topic
(a)	s.18	transfers between spouses
(b)	s.20	small gifts

[31] See 83.2.1 (Eversden schemes).

[32] For clarity I have set this out in tabular form rather than the layout of the statute.

(c)	s.22	gifts in consideration of marriage or civil partnership
(d)	s.23	gifts to charities
(e)	s.24	gifts to political parties
(ee)	s.24A	gifts to housing associations
(f)[33]	s.25	gifts for national purposes, etc
(h)	s.27	maintenance funds for historic buildings
(i)	s.28	employee trusts and
(j)	s.28A	employee-ownership trusts

Thus most types of exempt transfer are outside GWR, though the annual exemption (s.19 IHTA) is omitted from this list, no doubt deliberately.

78.12 GWR death charge

Section 102(3) FA 1986 provides:

> If, immediately before the death of the donor, there is any property which, in relation to him, is property subject to a reservation then ... that property shall be treated for the purposes of the [IHTA] as property to which he was beneficially entitled immediately before his death.

I refer to this as the "**GWR death charge**".

CGT rebasing on death does not apply.[34] That might be an accident, an absence of joined-up thinking, or it might be a deliberate decision to penalise or discourage reservations of benefit.

Section 102(3) is a deeming provision; the donor is not in fact beneficially entitled to the property subject to the reservation but the property is treated as if they were so entitled. To understand the significance of this, it is necessary to set out the short series of sections that impose an inheritance tax charge on property to which a person is beneficially entitled at death.

Section 4(1) IHTA imposes the IHT charge on death:

> On the death of any person tax shall be charged as if, immediately before his death, he had made a transfer of value and the value transferred by it had been equal to the value of his estate immediately before his death.

The key word here is "estate". Section 5(1) IHTA defines estate by

[33] There is no para (g).

[34] See 88.5.1 (Rebasing on death).

reference to beneficial entitlement:

> .... a person's estate is the aggregate of all the property to which he is beneficially entitled, except that ...
>
> (b) the estate of a person immediately before his death does not include excluded property ...

So if there is a GWR until death and the property is *not* excluded property:
(1) the property is treated as property to which the donor was beneficially entitled (in all cases);
(2) the property is part of their estate.

If there is a GWR until death and the property *is* excluded property:
(1) the property is treated as property to which the donor was beneficially entitled (in all cases);
(2) the property is not part of their estate.

78.13 GWR over debt owed by deceased

Suppose:
(1) S creates a discretionary settlement under which S is a beneficiary.
(2) The trustees lend to S.
(3) S dies.
The debt ("the GWR debt") is treated as being in the estate of S. However a person cannot owe a debt to himself or herself. If the GWR debt is treated as property beneficially owned by the debtor, it must be treated as if it ceased to exist. For this reason there is no IHT charge on the debt under the GWR rules, on the death of S, even if the GWR debt is UK situate.[35]

78.14 Death: Non-settled excluded prop

Suppose:
(1) A gives property to B, an individual, outright.
(2) There is a reservation of benefit: A enjoys benefits at the time of A's death.
(3) The property is not UK situate at the time of A's death.

A is treated as if A were beneficially entitled to the property at the time of

[35] If the debt is non-UK situate it may also be outside the scope of IHT because of the excluded property rules. On the question of a deduction for the GWR debt, see 80.13.3 (Settlor debt to settlor-interested discretionary trust).

A's death. It forms part of their estate unless it is excluded property at that time. How do the excluded property rules work in these circumstances?

Here we are concerned with non-settled property. The relevant rule is that:

> Property situated outside the UK is excluded property if the person beneficially entitled to it is an individual domiciled outside the UK.[36]

In the example above, B is *in fact* beneficially entitled to the property. A is *treated* as beneficially entitled. Who is "beneficially entitled" for the purpose of applying the excluded property rule; is it A or is it B? This does not matter if A and B are both foreign domiciled, but it does if one is and the other is not. One common case is in a gift from a UK domiciled donor to their foreign domiciled spouse.[37] The answer is to be found by applying the general rule of construction which applies to deeming provisions.[38] Applying this principle it follows that the domicile of the donor A is what matters for excluded property status. Thus if A has a foreign domicile, the property (if not UK situated) is excluded property. The domicile of the donee B is irrelevant. This conclusion is confirmed by the context. It would be absurd if the taxation of A depended on the domicile of B. The taxation of A should depend on A's own domicile position.

For the purposes of the excluded property rule, therefore:

(1) The domicile of the donor at the time of gift is irrelevant (contrast the position where the gift is made in trust).[39]

(2) The situs of the property at the time of the gift is irrelevant to the operation of the excluded property rules on the death of the donor.

HMRC agree. The IHT Manual provides:

> **IHTM14318 The gift: exempt transfers which cannot be GWRs** [Aug 2016]
>
> ...
>
> *Excluded property*
>
> Under the charging provisions (IHTM04072), excluded property (IHTM04251) cannot be the subject of a GWR...

[36] Section 6(1) IHTA.

[37] See 78.10 (GWR spouse exemption).

[38] See App 8.2 (Deeming provisions: Construction).

[39] See 78.15 (GWR death charge: excluded property rules for settled property) below.

> *Example*[40]
> Example 3 (George)
> G is originally domiciled in the UK, but moves to New Zealand and acquires a domicile of choice there. He gives some New Zealand shares to his son, R, but continues to enjoy the dividends until his death ten years later. He dies domiciled in New Zealand.
> The property is subject to a reservation and is therefore deemed to be part of G's estate on death. However, the property is situated outside the UK and the donor, who is treated as beneficially entitled to it, was domiciled outside the UK at his death. The property is therefore excluded property within IHTA84/S6 (1) and escapes the GWR charge.

This is correct; but the fact that G had a domicile of origin in the UK, and was not UK domiciled at the time of the gift, is not relevant: All that matters is domicile at the time of death.

The Manual continues with a variant of these facts:

> However, if G had returned to the UK and his domicile of origin had revived, there will be a GWR claim on his death, or if the reservation had ceased in his lifetime and within 7 years of his death, the ending of the reservation will be treated as a deemed PET. This is because at the time the GWR charge arises, G is domiciled in the UK so IHTA84/S6(1) does not apply...

While it is correct that s.6(1) does not apply on the facts of this version of the example, it is arguable that there is no GWR for other reasons.[41]

The same applies to gifts to companies, including companies held by trusts.

78.15 Death: Settled excluded property

Suppose:

(1) S (not UK domiciled) gives property to a settlement.
(2) There is a reservation of benefit, eg S is a beneficiary.
(3) The property is not UK situate[42] at the time of the death of S.

S is treated as if S were beneficially entitled to the property at the time of S's death. It forms part of S's estate unless it is excluded property at that time. How do the excluded property rules work in these circumstances?

[40] This example was reworded and improved in 2010, probably in response to criticisms of the former wording in the 2010/11 edition of this book.

[41] See 78.9 (Gift of excluded property).

[42] The position is the same if the property consists of UK AUTs or OEICs, but for convenience I refer to non-UK situate property only.

78.15.1 *Rival solutions*

There are two sets of excluded property rules, relating to settled and non-settled property. Which does one apply?

The Settled Property Solution The property subject to a reservation is in fact settled property, so on this view one applies the settled property rules set out in s.48(3) IHTA:

> Where property comprised in a settlement is situated outside the UK–
> (a) The property ... is excluded property unless the settlor was domiciled in the UK at the time the property became comprised in the settlement. ...

So on this view, where an individual makes a gift to a settlement with reservation of benefit, and dies, the property is excluded property for the GWR rules if:

(1) the donor is domiciled outside the UK at the time the property was transferred to the trust. (The domicile of the donor at the time of death is irrelevant); and
(2) the property is not situated in the UK at the time of death.

I call this the "**Settled Property Solution**".

The Non-settled Property Solution The settled property GWR is to be treated as property to which the donor is "beneficially entitled". On this view one applies the deeming provision to its logical conclusion: if a person is beneficially entitled to property, it is not settled property. So on this view, where an individual makes a gift to a settlement with reservation of benefit, and dies, the property is excluded property for the GWR rules if:

(1) the donor was domiciled outside the UK at the time of their death. (The domicile of the donor at the time the property was transferred to the trust is irrelevant for GWR, though it is relevant for other purposes); and
(2) the property is not situated in the UK at the time of death.

I call this the "**Non-settled Property Solution**".

78.15.2 *Correct solution*

The Non-settled Property Solution has had supporters.[43] Nevertheless it

[43] Venables, "Excluded Property Trusts and GROBs" [2003] OITR Vol 11 p.75 *http://www.khpplc.co.uk/reviews* Akin, *GITC Review*, Vol 1 Issue 2, p.1 (no longer

is generally regarded as wrong. What about the deeming provision that the property is to be treated as if the donor were beneficially entitled to it? The answer is that the property must still be regarded as "settled property" for the application of the excluded property rules. One does not carry the implications of the deeming provisions as far as the Non-settled Property Solution suggests. One way to reach this conclusion is to note that the deeming provision does not deem the donor to be beneficially and *absolutely* entitled to the settled property. One can be beneficially entitled to property which is settled property. (Bear in mind that "settlement" has a wide definition for IHT. It includes property held subject to a contingency, property charged with the payment of an annuity, and a lease for life. A person entitled to such property may nevertheless be said to be "beneficially" entitled.)

This view is supported by s.49(1) IHTA which provides:

> A person beneficially entitled to an interest in possession in settled property shall be treated for the purposes of this Act as *beneficially entitled* to the property in which the interest subsists.
> [Emphasis added]

No-one suggests that property to which s.49(1) applies is to be treated as non-settled property for the purposes of the GWR rules. The wording of the deeming provision in s.102(3) is materially the same.

Under the Non-settled Property Solution, the property is simultaneously excluded property (for general IHT purposes) and non-excluded property (for GWR purposes). While that is not impossible, it would be remarkable, even in as convoluted an area as this, and for this reason too the Settled Property Solution is to be preferred.

It has been said that a purposive construction favours the Non-settled Property Solution: the purpose of the GWR rules is to put the donor in the same position as if they had not made the gift. This is the general purpose in the case of gifts by UK domiciliaries. However, arguments on purposive construction only run when one knows the general purpose and is confident that the general purpose applies in the particular circumstances of the case. This argument *assumes* that that purpose necessarily extends to the foreign domiciliary – which begs the question. Perhaps parliament intended there to be a difference between the two cases. One cannot apply a purposive construction unless the purpose is

online).

clear.[44]

Even adopting the Settled Property Solution, there will arguably[45] be a charge to IHT on the death of a settlor who enjoys a benefit over trust property if at the time of their death the trust property is UK situated (and not UK AUTs or OEICs). Though I doubt if much notice is taken of that in practice.

In short, if the settlor is a beneficiary it is safer not to invest directly in UK situate property during their life.

Note that the Non-settled Property Solution favours the taxpayer if a UK domiciliary makes a GWR settlement, and becomes non-UK domiciled before their death. However that won't often happen.

78.15.3 *HMRC view*

After a decade of dithering[46] HMRC agreed with the Settled Property Solution. The IHT Manual provides:[47]

> **IHTM14396 Settled property: Settlement created when the settlor is domiciled outside the UK** [Sep 2018]
> Where the settlor was domiciled outside the UK at the time a settlement was made, any foreign property in the settlement is excluded property and is not brought into charge for IHT purposes (IHTM27220). This rule applies where property is subject to a reservation of benefit even though the settlor may have acquired a domicile of choice in the UK, or be deemed to be domiciled in the UK, at the time the GWR charge arises (IHTM04071).
> *Reservation ceasing on death*
> At the material date FA86/S102(3) deems the donor to be beneficially

[44] In the battle of the anomalies HMRC might instance the case where a foreign domiciliary made a settlement shortly before becoming UK domiciled, and say that it is absurd that a settlement made in such circumstances should avoid IHT on the death of the settlor. But (1) this is certainly the case where the foreign domiciliary enjoys no benefit from the settlement; and (2) this was the case under estate duty; and (3) this was the case under HMRC practice in the first 15 years or so of IHT; in the circumstances it is wrong (if not absurd) to describe that result as absurd.

[45] See 78.9 (Gift of excluded property).

[46] See the 2010/11 edition of this work para 51.12.3.

[47] The point is also made in HMRC "Technical note: Changes to the taxation of non-UK domiciled individuals";

> "Excluded property will not be brought into charge on the settlor's death even if the settlor retains a benefit in the trust assets."

See A1.7.3 (Pre-2025 settlements).

> entitled to property that is, at that time, settled property. As the property in which the reservation subsisted is ‘property comprised in a settlement’, it is the provisions of IHTA84/S48(3) that are in point. It is the domicile of the settlor at the time the settlement was made that is relevant in deciding whether foreign property in which the reservation subsisted is excluded property.
>
> *Example* (Henry)
>
> H, who is domiciled in New Zealand, puts foreign property into a discretionary trust under which he is a potential beneficiary (IHTM14393). He dies five years later having acquired a domicile of choice in the UK and without having released the reservation. The property is subject to a reservation on death but it remains excluded property and is outside the IHT charge.

The Manual continues by noting three exceptions:

> *Exceptions to the rule*
>
> There are, however, circumstances where this rule does not apply:
>
> [1] If the trustees had sold the foreign assets so that at the date of death the settled property was invested in UK assets, the exclusion would not apply as the property comprised in the settlement was not situated outside the UK, so IHTA84/S48(3) cannot apply.
>
> [2] If
>
> [a] the donor has acquired a domicile of choice (or is deemed domiciled) in the UK and
>
> [b] adds other property to the settlement (irrespective of the situs (IHTM27071) of the property),
>
> we regard the donor as creating a separate settlement (IHTM04272). All the trust assets will be property subject to a reservation, but the foreign assets settled when the donor was domiciled outside the UK will be excluded property, whereas the assets settled when the donor was domiciled in the UK will be subject to IHT
>
> [3] And in the reverse situation, if a donor who is domiciled (or deemed domiciled) in the UK creates a settlement with foreign assets and the settled property remains subject to a reservation at death, the trust assets will be subject to IHT under FA86/S102(3) even if the settlor dies domiciled outside the UK as IHTA84/S48(3) does not apply - as well as being subject to relevant property trust charges (IHTM42000).

Point [1] is correct that s.48(3) does not apply but it is arguable that there is no GWR for other reasons.[48] As to point [2], see 75.15 (Adding

[48] See 78.9 (Gift of excluded property).

property). Point [3] is correct, assuming the settled property solution is correct. The unfairness of the double charge (which does not seem to trouble HMRC) may be avoidable by winding up the trust.

78.16 Gift to non-dom who creates trust

Suppose:

(1) A gives property outright to B.
(2) B gives that property to a settlement.
(3) A is a beneficiary of that settlement and enjoys benefits so that there is a reservation of a benefit in relation to A's gift.
(4) B (and not A) is the settlor of the settlement.[49]

Now which set of excluded property rules is applied? It is suggested that one must apply the rules applicable to settled property for the reasons given in 78.15 (Death: Settled excluded property). FA 1986 sch. 20 para 5 needs to be considered but, properly understood, nothing there deems A to be the settlor of the settlement. If that is right, there is no reservation of benefit problem if:

(a) B (the settlor) was not domiciled in the UK when the settlement was made/funded; and
(b) the property is not situated in the UK at the time of the death of A.

Conversely, on this view, there is a GWR problem if B (the settlor) is UK domiciled (regardless of the domicile of A).

78.17 GWR lifetime charge

So far we have considered the position where the benefit continues until the death of the donor. In the absence of any provision, the cessation of a reservation of benefit during the individual's lifetime would not be a transfer of value. Section 102(4) FA 1986 deals with this:

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

I refer to this as the "**GWR lifetime charge**".

Section 102(4) is a deeming provision; it is a different deeming from

[49] See 99.7 (A gives to B, B gives to trust).

s.102(3), the GWR death charge. In s.102(3) the donor is deemed to be beneficially entitled. Here, the donor is deemed to have made a PET. To understand the significance of this, it is necessary to set out the definition of a PET. A PET is a particular kind of transfer of value (s.3A IHTA) and s.3 IHTA provides:

> (1) [a] ... a transfer of value is a disposition made by a person (the transferor) as a result of which the value of his estate immediately after the disposition is less than it would be but for the disposition;
> [b] and the amount by which it is less is the value transferred by the transfer.
> (2) For the purposes of subsection (1) above no account shall be taken of the value of excluded property which ceases to form part of a person's estate as a result of a disposition.

Note that s.3(1) contains two definitions: s.3(1)[a] defines "transfer of value" and s.3(1)[b] defines "value transferred". For both purposes s.3(2) states that excluded property is (in short) disregarded.

78.17.1 *Non-settled GWR PET charge*

Suppose:
(1) a non-UK domiciliary makes a non-settled GWR of non-UK situate property; and
(2) the property ceases to be subject to a reservation (while the donor is still non-UK domiciled).

No-one could sensibly suggest that there is a possible IHT charge. The reason is in s.3(2): the donor is deemed to have made a disposition of excluded property. While one can (just) call that a PET, the value transferred is ignored and no charge to IHT can arise. Nothing in the deeming provision requires one to ignore the application of s.3(2) to s.3(1)[b]. What matters is the domicile of the donor (and the situs of the GWR property) at the time the reservation ceases. There would be a deemed PET if:
(1) F (a foreign domiciliary) makes a GWR.
(2) F becomes UK domiciled.
(3) The GWR is released.[50]

[50] There is a hint of this in IHTM 14318, but the point is not addressed clearly.

78.17.2 *Settled GWR PET charge*

Suppose settled property ceases to be subject to a reservation; eg a settlor/donor ceases to be a beneficiary of a trust they have created, and becomes excluded from benefit. The issues are similar to the case of the GWR death charge: how far do you carry the implications of the deemed PET? Do you deem the GWR property which is actually settled property to be non-settled property? Although the deeming is marginally different, the context is the same as for GWR on death.

The answer must be decided consistently with the answer to the related issue for GWR on death. If (as concluded above) the Settled Property Solution is correct on death then there is also no charge on a lifetime cessation of GWR. HMRC agree, and (having eventually come down in favour of the Settled Property Solution) accept the view that there is no charge. The IHT Manual provides:

> **IHTM14396 - Settled property: Settlement created when the settlor is domiciled outside the UK** [Sep 2018]
> ... *Reservation ceasing during lifetime*
> Where the reservation is released during the donor's lifetime, FA86/S102(4) treats the donor as making a disposition of the property by a disposition which is a potentially exempt transfer (PET) (IHTM04072). This is different to the basis of the charge arising on death, but as property in which the reservation ceases is 'property comprised in a settlement' the provisions of IHTA84/S48(3) are again in point to decide whether any foreign property is excluded property.
> As FA86/S102(4) treats the donor as making a disposition, it is the treatment of excluded property when a disposition is made that is relevant. IHTA84/S3(2) states that no account shall be taken of the value of excluded property which ceases to form part of a person's estate as a result of a disposition.
> So as the donor is treated as making a disposition, property is treated as ceasing to form part of their estate. Provided that property is excluded property, IHTA84/S3(2) applies to exclude the assets in which the reservation ceased from charge.

This vindicates the view taken in the pre-2011 editions of this work.[51]

The Manual continues with three exceptions:

[51] "The taxpayer should conduct their affairs on the basis of the Settled Property Solution. .. One should not be deterred by the ghost of an argument rattling its chains in the IHT Manual."

The same exceptions to the above will apply as regards

[1] foreign property which is replaced by UK situs property (IHTM27071),

[2] property added to the settlement when the donor is domiciled in the UK, and

[3] in the reverse situation outlined above, a charge will arise under FA86/S102(4) if the reservation ceases before the donor's death.

Refer any case where you consider that there is such a charge, or any enquiries about the possibilities of a charge, to Technical.

For these exceptions, see 78.15.3 (HMRC view).

78.18 Termination of estate IIP

78.18.1 *Termination of IIP: Navigation*

Termination of an estate IIP raises a variety of tax issues:

Topic	See para
Termination in lifetime of life tenant	
IHT charge	76.10 (s.52 IHTA)
GWR	*Considered here*
Termination on death of life tenant	
IHT charge	76.4 (s.4 IHTA)
CGT rebasing	88.6
Termination at any time	
Settlor/spouse initial IIP	75.13

78.18.2 *Termination of IIP: GWR*

Before 2006, GWR did not normally apply on the termination of an interest in possession, because the termination did not normally involve a disposal by way of gift. Section 102ZA FA 1986 now provides:

> (1) Subsection (2) below applies where—
>
> (a) an individual is beneficially entitled to an interest in possession in settled property,
>
> (b) either—
>
> (i) the individual became beneficially entitled to the interest in possession before 22nd March 2006, or
>
> (ii) [A] the individual became beneficially entitled to the interest in possession on or after 22nd March 2006 and
>
> [B] the interest is an immediate post-death interest, a disabled person's interest or a transitional serial

> interest, or falls within section 5(1B) of the 1984 Act
>
> and
>
> (c) the interest in possession comes to an end during the individual's life.
>
> (2) For the purposes of—
>
> (a) section 102 above, and
>
> (b) Schedule 20 to this Act,
>
> the individual shall be taken (if, or so far as, he would not otherwise be) to dispose, on the coming to an end of the interest in possession, of the no-longer-possessed property[52] by way of gift.

On the termination of an interest in possession, the (former) life tenant is in the same position as the settlor. See 78.15 (Death: Settled excluded property).

If the life tenant does not enjoy a benefit, no problem arises.

If the former life tenant does enjoy a benefit the position is as follows:

(1) The GWR rules do not apply if the GWR property is excluded property.

(2) The GWR property is excluded property if (in short):

  (a) the settlor was not UK domiciled when the settlement was made/funded; and

  (b) the trust property is not UK situate (or is UK funds excluded property) at the time of the GWR charge (the death of the former life tenant or the time of cessation of benefit).

The domicile of the life tenant at the time that the interest came to an end is not relevant (except where the settlor/spouse has an initial estate interest in possession).

78.19 GWR on death: Spouse exemption

This section considers whether the IHT spouse exemption can apply on the death of the donor so as to override the GWR death charge.[53]

[52] "The no-longer-possessed property" is defined in s.102ZA(3) IHTA:

> "In subsection (2) above 'the no-longer-possessed property' means the property in which the interest in possession subsisted immediately before it came to an end, other than any of it to which the individual becomes absolutely and beneficially entitled in possession on the coming to an end of the interest in possession."

I refer to this as **"GWR property"**.

[53] For the IHT spouse exemption generally see 76.5.1 (Spouse exemption: Introduction); see too 78.10 (GWR spouse exemption).

Suppose:

(1) H makes a gift to S which is a GWR so the gifted property is GWR property.
(2) H dies and leaves H's entire estate to his spouse W (and the IHT spouse exemption applies to H's estate).

On the death of H the position for the GWR property is governed by s.102(3) FA 1986:

> ...that property shall be treated for the purposes of the [IHTA] as property to which [H] was beneficially entitled immediately before his death.

The GWR property is not excluded property (even if S is foreign domiciled).[54] So H will in principle be subject to inheritance tax on the GWR property on H's death.

The spouse exemption is not available on the death of H to avoid this GWR charge. The IHT spouse exemption provides that the transfer of value deemed to be made on the death of H:

> ... is an exempt transfer to the extent that the value transferred is
> [a] attributable to property which becomes comprised in the estate of the transferor's spouse or civil partner or,
> [b] so far as the value transferred is not so attributable, to the extent that the estate is increased.

This exemption does not apply to the GWR property since it does not become comprised in the estate of W.

Suppose:

(1) H (UK domiciled) makes a gift to W (foreign domiciled at the time of the gift).[55]
(2) The gift does not qualify for the IHT spouse (or any other) exemption and H continues to enjoy benefits from the property until H's death so the gifted property is GWR property.
(3) W still owns the GWR property at the time of the death of H.
(4) W has become UK domiciled (or IHT deemed domiciled) at the time of the death of H.

At first glance it might seem that the IHT spouse exemption does not

[54] See 78.14 (Death: Non-settled excluded prop).

[55] The gift is a PET (but assume H survives seven years so no tax charge arises on the PET).

apply. On the facts of this example the conditions of the relief are not in reality satisfied. The GWR property does not "become" comprised in the estate of the spouse; and on the occasion of the death of H, the estate of the spouse has not "increased". However, one must remember that s.102(3) FA 1986 is a deeming provision. It is the old question of how far one carries the deeming.[56] If one deems, as s.102(3) requires, the GWR property to be property to which H was beneficially entitled, it would follow that one must deem the estate of W to be increased by reason of the death of H. The conclusion is supported by considering the object of the GWR rules. The object is to put the donor in the same position as if they had not made the gift. If H had not made H's gift then (on the facts of the above example) H would qualify for the spouse exemption.

The IHT spouse exemption would also apply to defeat a GWR death charge if H made a gift to a trust under which H's spouse acquired an estate interest in possession on H's death.

The same would apply if A made a GWR gift to B and A was not married to B at the time of the gift but was married at the time of A's death.

After some vacillation, HMRC now agree. The IHT Manual provides:

> **IHTM14303 devolution of GWR property** [Mar 2021]
> The gift with reservation provisions provide that the gifted property is deemed to be treated as part of the donor's estate immediately before death.
> Although the property does not pass on death under the will or intestacy, exemptions that are available on death such as spouse exemption (IHTM11031) and charity exemption (IHTM11101) may be applicable to the transfer deemed to be made on death if, on death, the property passes to an exempt beneficiary. However, if the reservation ceases during the lifetime of the donor, since the donor is deemed to have made a disposition which is a potentially exempt transfer (IHTM04064), no exemptions can apply.
> Annual exemptions (IHTM14141) will not apply to the transfer deemed to be made on death or deemed to be made when the reservation ceases.[57]

[56] See App 8.2 (Deeming provisions: Construction).

[57] This change was anticipated in a STEP Briefing Note "IHT- Gift with reservation and spouse exemption" (Feb 2021.

78.19.1 *Remedial planning after GWR*

Where H has made a gift, and a reservation of benefit problem arises, the following solutions may be considered:

(1) H ceases to enjoy any benefit.
(2) The donee gives the property back to H.
(3) Arrange that the IHT spouse exemption applies on the death of H.
(4) The donee settles the property: see 93.10.2 (Gift to spouse + gift to trust).

78.20 Tracing gifted property

The identity of the property disposed of by way of gift matters for several reasons:

(1) To determine whether the donor has reserved a benefit over it
(2) To apply the excluded property rules
(3) To identify the property subject to the GWR charge

Sch 20 FA 1986 contains three sets of tracing rules:

Tracing rules for	**Sch 20 para**
Non-settled property	2 - 4
Termination of estate IIP	4A
Settled property	5

The drafter in 1986 took the wording from the old estate duty provision in FA 1957. The legislation could have simply used the concepts of "derived from" or "representing", and the whole of paras 2-5 would not have been necessary. But there it is.

78.20.1 *"The material date"*

All three codes use the term "material date" which is (in short) the date when the GWR charge arises. Para 1 sch 20 FA 1986 provides:

> "the material date", in relation to any property means,
> [a] in the case of property falling within [s.102(3)], the date of the donor's death and,
> [b] in the case of property falling within [s.102(4)], the date on which the property ceases to be property subject to a reservation;

https://www.step.org/system/files/media/files/2021-02/step-iht-gift-with-reservation-and-spouse-exemption-briefing-note_0.pdf

78.21 Tracing non-settled property

Para 2(1) sch 20 FA 1986 provides the general rule:

> Where
> [a] there is a disposal by way of gift and,
> [b] at any time before the material date, the donee ceases to have the possession and enjoyment of any of the property comprised in the gift,
>
> then on and after that time the principal section [s.102] and the following provisions of this Schedule shall apply as if the property, if any, received by the donee in substitution for that property had been comprised in the gift instead of that property (but in addition to any other property comprised in the gift).

Para 2(3) sch 20 FA 1986 provides a commonsense definition of "in substitution":

> In sub-paragraph (1) above the reference to property received by the donee in substitution for property comprised in the gift includes in particular—
> (a) in relation to property sold, exchanged or otherwise disposed of by the donee, any benefit received by him by way of consideration for the sale, exchange or other disposition; and
> (b) in relation to a debt or security, any benefit received by the donee in or towards the satisfaction or redemption thereof; and
> (c) in relation to any right to acquire property, any property acquired in pursuance of that right.

This is a straightforward tracing or derivation rule. Para 2(2) sch 20 FA 1986 provides two exceptions. The first relates to settled property, which has a separate code.[58] The second is a surprise:

> This paragraph does not apply if the property disposed of by the gift ...
> (b) is a sum of money in sterling or any other currency.

Suppose:

(1) A gives money to B.
(2) B uses the money to buy an asset.
(3) A enjoys a benefit over the asset.

There is no GWR over the money: which no longer exists, or else belongs

[58] See 78.22 (Tracing settled property).

to the vendor of the asset. Does it follow that there is no GWR at all? Taken at face value, this suggests that if there is a non-settled gift of money which is then invested, GWR ceases to apply. Could that really be correct? HMRC say that it is.[59]

78.21.1 *Gift by donee*

Para 2(4) sch 20 FA 1986 provides:

> Where, at a time before the material date, the donee
> [a] makes a gift of property comprised in the gift to him,
> [b] or otherwise voluntarily divests himself of any such property otherwise than for a consideration in money or money's worth not less than the value of the property at that time,[60]
>
> then, unless he does so in favour of the donor, he shall be treated for the purposes of the principal section [s.102] and sub-paragraph (1) above as continuing to have the possession and enjoyment of that property.

Para 2(5) sch 20 FA 1986 defines "voluntarily":

> For the purposes of sub-paragraph (4) above—
> (a) a disposition made by the donee by agreement shall not be deemed to be made voluntarily if it is made to any authority who, when the agreement is made, is authorised by, or is or can be authorised under, any enactment to acquire the property and
> (b) a donee shall be treated as divesting himself, voluntarily and without consideration, of any interest in property which merges or is extinguished in another interest held or acquired by him in the same property.

78.21.2 *Tracing shares*

Para 2(6) sch 20 FA 1986 provides:

> Where
> [a] any shares in or debentures of a body corporate are comprised in a gift and
> [b] the donee is, as the holder of those shares or debentures, issued with shares in or debentures of the same or any other body corporate, or granted any right to acquire any such shares or debentures,
>
> then, unless the issue or grant is made by way of exchange for the

[59] See 83.19.3 (Tracing rules).

[60] The words at [b] are needed as a sale at an undervalue is not a disposal by way of gift.

> first-mentioned shares or debentures, the shares or debentures so issued, or the right granted, shall be treated for the purposes of the principal section [s.102] and this Schedule as having been comprised in the gift in addition to any other property so comprised.
> (7) In sub-paragraph (6) above the reference to an issue being made or right being granted to the donee as the holder of shares or debentures shall be taken to include any case in which an issue or grant is made to him as having been the holder of those shares or debentures, or is made to him in pursuance of an offer or invitation made to him as being or having been the holder of those shares or debentures, or of an offer or invitation in connection with which any preference is given to him as being or having been the holder thereof.

This is needed because a bonus issue is not "in substitution" and so not within para 2(1).

78.21.3 *New consideration: Deduction*

Para 3 sch 20 FA 1986 provides:

> (1) Where either sub-paragraph (3)(c) or sub-paragraph (6) of paragraph 2 above applies to determine, for the purposes of the principal section [s.102], the property comprised in a gift made by a donor—
> (a) the value of any consideration in money or money's worth given by the donee for the acquisition in pursuance of the right referred to in the said sub-paragraph (3)(c) or for the issue or grant referred to in and said sub-paragraph (6), as the case may be, shall be allowed as a deduction in valuing the property comprised in the gift at any time after the consideration is given, but
> (b) if any part (not being a sum of money) of that consideration consists of property comprised in the same or another gift from the donor and treated for the purposes of the 1984 Act as forming part of the donor's estate immediately before his death or as being attributable to the value transferred by a potentially exempt transfer made by him, no deduction shall be made in respect of it under this sub-paragraph.
>
> (2) For the purposes of sub-paragraph (1) above, there shall be left out of account so much (if any) of the consideration for any shares in or debentures of a body corporate, or for the grant of any right to be issued with any such shares or debentures, as consists in the capitalisation of reserves of that body corporate, or in the retention by that body corporate, by way of set-off or otherwise, of any property distributable by it, or is otherwise provided directly or indirectly out of the assets or

> at the expense of that or any associated body corporate.
> (3) For the purposes of sub-paragraph (2) above, two bodies corporate shall be deemed to be associated if one has control of the other or if another person has control of both

78.21.4 *Donee dies before material date*

Para 4 sch 20 FA 1986 provides:

> Where there is a disposal by way of gift and the donee dies before the date which is the material date in relation to any property comprised in the gift, paragraphs 2 and 3 above shall apply as if—
> (a) he had not died and the acts of his personal representatives were his acts; and
> (b) property taken by any person under his testamentary dispositions or his intestacy (or partial intestacy) were taken under a gift made by him at the time of his death.

78.22 Tracing settled property

Para 5 sch 20 FA 1986 contains the tracing rules for a gift to a trust, and para 4A contains the rules on the termination of an estate IIP. It is convenient to consider these together, as para 4A adopts the para 5 rules, with a nod to plain English drafting (describing the donor as "D").

Para 5(1) sch 20 FA 1986 ***After gift to trust***	**Para 4A(1)(2) sch 20 FA 1986** ***After termination of estate IIP***
Where there is a disposal by way of gift and the property comprised in the gift becomes settled property by virtue of the gift,	(1) This paragraph applies where— (a) under section 102ZA of this Act, an individual ("D") is taken to dispose of property by way of gift, and (b) the property continues to be settled property immediately after the disposal.
[a] paragraphs 2 to 4 above shall not apply[61]	(2)[a] Identical

[61] In addition, para 2(2) sch 20 FA 1986 provides: "This paragraph does not apply if the property disposed of by the gift ... (a) becomes settled property by virtue of the gift". But that is otiose as para 5(1)[a] has the same effect.

[b] but, subject to the following provisions of this paragraph, the principal section [s.102] and the following provisions of this Schedule shall apply as if the property comprised in the gift consisted of the property comprised in the settlement on the material date,	Identical
[c] except in so far as that property neither is, nor represents,[62] nor is derived from, property originally comprised in the gift.	Identical

This is the same in effect as the tracing rule for non-settled property, except that it also applies to money.

Para 5 does not apply to a gift to a company held by a trust.

78.22.1 *Trust comes to end*

Para 5(2) sch 20 FA 1986 ***After gift to trust***	**Para 4A(4) sch 20 FA 1986** ***After termination of estate IIP***
If the settlement comes to an end at some time before the material date as respects all or any of the property which, if the donor had died immediately before that time would be treated as comprised in the gift,—	If the settlement comes to an end at some time before the material date as respects all or any of the property which, if D had died immediately before that time, would be treated as comprised in the gift,—
(a) the property in question, other than property to which the donor then becomes absolutely and beneficially entitled in possession, and	(a) the property in question, other than property to which D then becomes absolutely and beneficially entitled in possession, and
(b) any consideration (not consisting of rights under the settlement) given by the donor for	(b) any consideration (not consisting of rights under the settlement) given by D for any of

[62] See App 2.9 ('Representing' assets).

any of the property to which he so becomes entitled,	the property to which D so becomes entitled,
shall be treated as comprised in the gift (in addition to any other property so comprised).	Identical

This would also apply on a transfer between trusts.

78.22.2 *Donee creates trust*

Para 5(3) sch 20 FA 1986 provides:

> Where
> [a] property comprised in a gift does not become settled property by virtue of the gift,
> [b] but is before the material date settled by the donee,
> sub-paragraphs (1) and (2) above shall apply in relation to property comprised in the settlement as if the settlement had been made by the gift; and for this purpose property which becomes settled property under any testamentary disposition of the donee or on his intestacy (or partial intestacy) shall be treated as settled by him.

78.22.3 *Loan to trust*

Para 5(4) sch 20 FA 1986	**Para 4A(3) sch 20 FA 1986**
Where property comprised in a gift becomes settled property either by virtue of the gift or as mentioned in sub-paragraph (3) above, any property which—	Any property which—
(a) on the material date is comprised in the settlement, and	[identical]
(b) is derived, directly or indirectly, from a loan made by the donor to the trustees of the settlement,	(b) is derived, directly or indirectly, from a loan made by D to the trustees of the settlement,
shall be treated for the purposes of sub-paragraph (1) above as derived from property originally comprised in the gift.	shall be treated for the purposes of sub-paragraph (2) above as derived from property originally comprised in the gift.

The drafter presumably considered that a loan is not a disposal by way of gift.

78.22.4 *Accumulated trust income*

Para 5(5) sch 20 FA 1986	**Para 4A(5) sch 20 FA 1986**
Where, under any trust or power relating to settled property, income arising from that property after the material date is accumulated, the accumulations shall not be treated for the purposes of sub-paragraph (1) above as derived from that property.	Where, under any trust or power relating to settled property, income arising from that property after the material date is accumulated, the accumulations shall not be treated for the purposes of sub-paragraph (2) above as derived from that property.

This seems generous, but there it is.

78.23 1986 transitional relief

The GWR rules only apply to disposals on or after 18 March 1986. The IHT Manual states correctly:

> **IHTM14311 GWRs: the gift: initial requirements** [Sep 2018]
> ... Gifts made before 18 March 1986 cannot be the subject of a GWR claim.
> *Settled property*
> A pre-18 March 1986 settlement which would have been caught by the GWR provisions had it been made after 17 March 1986 will therefore escape the GWR charge unless further gifts into settlement are made after that date. The GWR provisions will apply to the property settled by those further gifts....

The Manual gives a straightforward example:

> *Example* (Frederick)
> On 1 January 1985 F settled £100,000 on discretionary trusts under which he was a potential beneficiary. On 1 January 1989 he added a further £50,000 to the settlement. Frederick died on 1 April 1992, having remained a potential beneficiary throughout.
> The GWR provisions apply to the 1989 addition but not to the property originally settled. The GWR claim extends to the assets in the settled fund at 1 April 1992 representing that £50,000. The Double Charges Regulations (IHTM14711) will be in point.

GWR does apply to pre-1986 settlements on a post-1986 termination of an estate IIP.[63]

78.23.1 *Pre-1986 insurance policy*

For completeness: s.102(6)(7) FA 1986 provide a transitional relief for pre-1986 policies of insurance:

> (6) This section does not apply if the disposal of property by way of gift is made under the terms of a policy issued in respect of an insurance made before 18th March 1986 unless the policy is varied on or after that date so as to increase the benefits secured or to extend the term of the insurance; and, for this purpose, any change in the terms of the policy which is made in pursuance of an option or other power conferred by the policy shall be deemed to be a variation of the policy.
> (7) If a policy issued as mentioned in subsection (6) above confers an option or other power under which benefits and premiums may be increased to take account of increases in the retail prices index (as defined in section 8(3) of the 1984 Act) or any similar index specified in the policy, then, to the extent that the right to exercise that option or power would have been lost if it had not been exercised on or before 1st August 1986, the exercise of that option or power before that date shall be disregarded for the purposes of subsection (6) above.

A gift might be made under the terms of a policy if a person covenanted to pay the premiums of a policy held by another. That would not have been usual and I doubt if the issue ever arises now.

[63] See 78.18.1 (Termination of IIP: GWR)

CHAPTER SEVENTY NINE

INTER-TRUST TRANSFERS: IHT

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79.1 Inter-trust transfers: Navigation

This chapter discusses IHT issues on transfers between trusts. Transfers between trusts raise many other tax issues:

Topic	**See para**
Trust law background	99.10
IHT Transfer of value	*Not discussed; see s.52 IHTA*
IHT loss of estate IIP status	*Not discussed*
Gift with reservation of benefit	78.2.1
CGT disposal by transferor	56.21.5
s.731	50.13.2
ToA motive defence	52.24

s.87 trust gains transferred	61.39
2008 rebasing	61.47.3; 61.52
sch 4B (Flip-flop schemes)	62.2
Tainting protected trusts	92.4
Addition to pre-2006 settlor IIP trust	75.13.3
Who is settlor	99.11 - 99.14; 100.1
CRS	130.25

I also discuss the IHT consequences of individuals adding property to trusts.

79.2 Addition/transfer to trust

There are four tiers of rules:

(1) General rules of trust law

(2) General rules of IHT law:

   (a) The IHT definition of settlement: this applies for all IHT purposes

   (b) An IHT provision for trusts with two settlors: this applies for (more or less) all IHT purposes[1]

   I refer to this as "**general IHT law**"

(3) IHT provisions for transfers between trusts: these apply only for the taxation of relevant property[2] which I call "**relevant property taxation**"

(4) Further rules apply to the specialist (but important) topics of employee trusts[3] and pension trusts[4]

The main significance of these rules relates to excluded property status, where there has been a change of domicile of the settlor. The rules can affect other matters, such as date and computation of a 10-year charge.

79.3 One IHT-settlement or more

In order to decide whether there has been a transfer between trusts (or settlements, I use the terms synonymously) it is first necessary to identify what is (or are) the settlement(s) for IHT purposes. A transfer can only take place if there are two (or more) distinct settlements.

[1] See 79.5 (Separate-settlement fiction).

[2] For this important but opaque term, see 74.8 ("Relevant property").

[3] See s.86(4)(5) IHTA (not discussed here).

[4] See 84.14 (Transfer between schemes).

There are trust law rules which determine for trust law purposes whether one trust exists, or whether two (or more) distinct or separate trusts exist.[5] Subject to context, and specific tax rules, these rules apply for tax purposes. That is, in the absence of specific context or rules, the word trust has its normal trust law meaning. So the question is: when do these trust law rules apply, and when do specific IHT rules override them.

Section 43 IHTA provides:

> (1) The following provisions of this section apply for determining
> [a] what is to be taken for the purposes of this Act to be a settlement, and
> [b] what property is, accordingly, referred to as property comprised in a settlement or as settled property.
> (2) "Settlement" means any disposition or dispositions of property, whether effected by instrument, by parol [ie, orally] or by operation of law, or partly in one way and partly in another, whereby[6] the property is for the time being held in trust...[7]

There are two distinct concepts here:

(1) The entity, created by a disposition (or dispositions), which has an ongoing existence. I refer to this entity, if within the IHT definition, as an **"IHT-settlement"**.

(2) The disposition (or dispositions) which create an IHT-settlement, which take place at a particular moment (or moments).

The following points seem clear:

(1) 2 (or more) dispositions may create 2 (or more) separate IHT-settlements.

(2) On the other hand:
    (a) 2 (or more) dispositions may create one IHT-settlement.
    (b) 2 (or more) associated operations may create one IHT-settlement (as 1 disposition can be made by 2 (or more) operations).[8]

I refer to a case within (2) as a **"compound IHT-settlement"**.

[5] See 99.10 (Inter-trust transfer: Trust law background).

[6] "Whereby" means "by virtue of which". That is self-evident, but if authority is needed, see *Rysaffe v IRC* [2002] STC 872 at [34].

[7] For the text which follows these words, see 87.6.3 (Definition of "IHT-settlement").

[8] See 74.15 (Disposition by associated ops).

The IHT definition derives from s.1 SLA 1925,[9] which also has a concept of compound settlements.[10]

When do dispositions or operations create only one (compound) IHT-settlement and when do they create more than one? There are two cases where this question has been discussed.

79.3.1 *Hatton*

In *Hatton v IRC*[11] there was an arrangement under which:

(1) A made a settlement ("the first disposition") conferring a valuable equitable interest on B.

(2) B transferred her interest to a new settlement ("the second disposition").

The Judge said:

> the first settlement was made with a view to enabling or facilitating the making of the second settlement. Accordingly, the two settlements are associated operations

That is straightforward. What follows? The 2 dispositions (operations) created one IHT-settlement (in my terminology, a compound IHT-settlement):

> they are, therefore, to be regarded as effecting together a single disposition for the purposes of [IHT]. On that basis, the two settlements together constitute a single disposition of property, namely the property assigned ... to the trustees of the first settlement... That single disposition is a "settlement" within the [IHT] definition.[12]

79.3.2 *Rysaffe*

In *Rysaffe v IRC* the settlor transferred 5 parcels of shares to five settlements. As a matter of trust law, there were 5 separate settlements.

[9] The SLA reference to "any… instrument, or any number of instruments" has become "any disposition or dispositions" in s.43 IHTA (in order to include settlements made orally).

[10] A note on terminology: the SLA 1925 was the first statute to use the term compound settlement, but the terminology was in use before 1925: see *Re Coull* [1905] 1 Ch 712.

[11] 67 TC 759 at p.788.

[12] That was one IHT-settlement with two settlors. For the consequences, see 79.7 (Direct and indirect settlors).
For another aspect of *Hatton,* see 99.33 (Purpose: Adviser/agent of settlor).

HMRC argued that there was only one IHT-settlement. HMRC's first argument relied on the words "disposition or dispositions" in the definition of IHT-settlement. Thus it was argued that 5 dispositions[13] created one IHT-settlement.

This was rejected:

> [20] [s.43(1) IHTA] begins by saying that the provisions of the section 'apply for determining what is to be taken for the purposes of this Act to be a settlement'. Notwithstanding those words of the statute, my opinion is that s 43 gives little or no guidance to answering the question of whether ... there is one settlement or more than one. In my judgment the draftsman has for the most part left those questions to be answered in accordance with general [trust law] principles...

The judge then explains why:

> [21] ...the use of the plural ['dispositions'] is merely a recognition that in a case where there is a settlement (ie only one settlement) it is possible for there to have been more dispositions to the trustees than one. A typical case is where a settlor creates his settlement with one disposition, and later adds more property to it by one or more other dispositions. ... One of the hypothetical examples which I gave earlier was of a case where a wife made an addition to the trust fund of an existing settlement previously made by her husband. I do not accept that the use of the plural means any more than that it is possible to have more than one disposition to the trustees of a single settlement. In particular, the use of the plural is not a positive enactment that, where there are two or more dispositions to different settlements, they are to constitute one settlement for inheritance tax purposes even if they would constitute two or more settlements under the general law.[14]

This proposition was justified by considering the easy case of two unconnected persons creating separate settlements:

> [22] Indeed, if it was all a matter of the wording of s 43, it would be impossible to discriminate between cases of two dispositions to different settlements which count as one settlement for inheritance tax, and cases of two dispositions to different settlements which do not count as one settlement for inheritance tax.

[13] In fact there were 10 dispositions, as the settlor first transferred £10 to each settlement, but nothing turned on that.

[14] *Rysaffe v IRC* [2002] STC 872, approved in *Barclays Wealth v HMRC* [2017] EWCA Civ 1512 at [52]. Also see 75.15 (Added property: Change of domicile).

> Assume that settlor A has made a disposition of property to trustee X whereby some property is currently held on a discretionary trust, and that settlor B has made a disposition of other property to trustee Y whereby the other property is also currently held on a discretionary trust. Assume also that there is no connection between A and B or between X and Y: they have never even heard of one another. Assume yet further that there is no connection or overlap between the two discretionary classes. The only things which the two settlements have in common is that they are both discretionary and that they are both structures under which some property is 'for the time being' held in trust. Could it be argued that the two settlements rank as one settlement for inheritance tax purposes because of the definition in s 43(2)? Of course not. The argument would be ridiculous. But if one looks only at the words of the statute there have been 'dispositions of property … whereby the property is for the time being … held by trustees' on discretionary trusts. The obvious proposition that each is a separate settlement for inheritance tax purposes as well as for other purposes cannot, in my opinion, be found spelt out in the small print of s 43. The proposition follows because it is the position in the general law, and s 43 assumes that that position will apply for inheritance tax as for other purposes of the law—unless, as sometimes is so but not in this case, there is a detailed provision requiring a departure from the position in the general law.

HMRC's second argument was based on associated operations. The 5 dispositions to the trusts were operations. These operations were in fact not associated,[15] but the judge considered the position if they had been (that does make the discussion somewhat unrealistic). HMRC relied on the rule that a disposition includes a disposition effected by associated operations; they argued that the 5 associated operations constituted a single disposition effected by associated operations. Hence there was one IHT-settlement. This was also rejected:

> The starting point should have been to consider whether the property which the case was about was 'property comprised in a settlement' within the meaning of s 64 [IHTA] (the charging section) read with s 43 [IHTA] (the section which explains the concepts of settlement and of property being comprised in a settlement). If it was property comprised in a settlement anyway without the need to rely on the extension of 'disposition' to cover also a disposition by associated operations, the associated operations provision was not relevant. Sections 43 [definition

[15] See 74.11 ("Associated operation").

> of IHT-settlement] and 64 [10-year charge] applied, and there was no need to invoke the definition of associated operations in order to make them apply. Nor was there any need to consider whether, if the definition had been potentially relevant, the facts of this case would have come within it...
>
> [34] Let me begin with the parcel of shares held by [the] first settlement (settlement no 1) ... I find it clearest to begin in para (b) of sub-s (2). Were the shares 'held by trustees on trust' as described in the paragraph? To paraphrase, were they held by trustees on discretionary trusts? The answer is: yes. ... [s.43(2)] requires me to ask whether the shares were held by trustees on discretionary trusts by virtue of 'a disposition or dispositions of property'. My answer is: yes. They were held by the trustee on discretionary trusts by virtue of the transfer of them which [the settlor] made to the trustee ... That transfer was a disposition of property. Having given that obvious answer I go on to say that it is the answer on the ordinary meaning of 'disposition', without recourse to the extended definition under which the term includes a disposition by associated operations. It is wrong to say that the parcel of 6,900 shares held by the trustee of settlement no 1 on discretionary trusts was so held by the trustee by virtue of a disposition effected by associated operations. The parcel of shares was held by the trustee on the discretionary trusts by virtue of a disposition of it effected by a single operation, not by virtue of a disposition of it effected by multiple operations. It is neither necessary nor appropriate to invoke or to apply the extended statutory definition in order to conclude that the parcel of shares was property comprised in a settlement at the time when the ten-yearly charge fell to be applied.

The comments in *Rysaffe* should be seen in the context of the issue in the case, which was whether simple and discrete dispositions to separate trusts could be combined to create one compound IHT-settlement. It is now settled that the answer is, no.[16]

Rysaffe is not authority for the proposition that one can *never* combine dispositions (or associated operations) so as to constitute one compound IHT-settlement. That is not consistent with *Hatton* (which was not cited in *Rysaffe,* but should not be regarded as overruled).

[16] The reader may wonder whether the same answer would have been reached today, when a different attitude to avoidance prevails; but the issue does not arise: the doctrine of precedent (more or less) prevents the issue from being re-litigated, and the legislation has also now changed.

79.3.3 *GAAR guidance: Pilot trusts*

GAAR guidance discusses the issue. It is not relevant to the current law, and the more focussed reader should skip to the next section, but I digress to set it out here, as it illustrates the weakness of the GAAR guidance, which is a point of general importance:

> **D26 Pilot trusts**
> This example shows a long-established practice approved by the Courts in an area where the law provides deliberately precise boundaries.
> The Inheritance Tax legislation described below has been amended since the original publication of this guidance: this example is included to demonstrate the underlying principles.[17]
> **D26.1 Background**
> D26.1.1 [The guidance summarises the relevant property regime and notes:] In determining the rate at which tax is charged on settled property, the value of all the property in settlements established by the same settlor on the same day – 'related settlements' – is taken into account.
> **D26.2 The arrangements**
> D26.2.1 C wishes to leave his estate in trust for his 7 grandchildren. He wants to ensure that these settlements are not subject to Inheritance Tax after his death.
> C establishes one settlement per day over a period of 7 days, settling £100 on each.[18] He revises his Will so that he leaves a specific legacy of £250,000 free of tax to each settlement.
> Following his death, his executors pay the legacies to each of the trustees...

I refer to this as a **"pilot trust scheme"**.

> **D26.4 The taxpayer's tax analysis**
> D26.4.1 On C's death, his estate will be subject to Inheritance Tax and

[17] Author's footnote: See s.62B IHTA, enacted in 2015. Perhaps it was thought too much trouble to find an example to make the point which operated under the current law. It is not easy to find examples of contrived and artificial transactions which are not caught by the GAAR.

[18] Author's footnote: The position should be the same if the sum have been £10, which was the sum used in *Rysaffe*. Perhaps HMRC wanted to be free to argue that £10 (worth less now than it was worth at the time of *Rysaffe*) could be ignored as *de minimis*? But if so what happened to the "deliberately precise boundaries"? Probably that is reading the text with more care than was intended.

> the tax will be borne by the residuary estate. But going forward, each settlement will benefit from its own nil-rate band and the funds added to each of the other settlements will not be taken into account in arriving at the rate of tax as the settlements are not related settlements. Provided that the value of the settled property remains below the Inheritance Tax nil-rate band, the trusts will not pay any [Inheritance] tax.
>
> **D26.5 What is the GAAR analysis under s207(2) of FA 2013**
>
> D26.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*
>
> ...Settlements that are established on the same day are related settlements and the value of property, immediately after they commenced, in related settlements is taken into account in determining the rate of tax that is charged on each settlement. Because the settlements were created on consecutive days, they are not related settlements and so the rate of tax is calculated without reference to the other settlements, even though the substantial addition of funds came about as a result of a single event - C's death.

This does not answer the question set out at D26.5.1. But it suggests that the answer is yes, the pilot trust scheme is consistent with tax principles, on the grounds that " the law provides deliberately precise boundaries".

> D26.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*
>
> Had C's Will established a single settlement for the benefit of all of his grandchildren that trust would have been subject to Inheritance Tax. And if seven separate settlements had been established by his Will, they would have been related settlements so each would have been taken into account with the other to establish the rate of tax. Establishing the 'pilot' trusts on separate days before death had no purpose other than to put the trusts in a tax-advantaged position.

This does not answer the question set out at D26.5.2, but it suggests that the answer is yes: the pilot trust scheme is contrived and abnormal; which seems fairly clear.

This seems to be a rare example of a scheme which is contrived and abnormal but consistent with tax principles.

> **D26.5.3 Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?**
>
> The practice was litigated in the case of *Rysaffe Trustee v IRC* [2003]

> STC 536.[19] HMRC lost the case and having chosen not to change the legislation [from 2003 to 2015] must be taken to have accepted the practice.

There was no HMRC statement to that effect. The inference is from silence. Pilot trust schemes were rarely used in practice, as far as I am aware.[20] If that is right, the inference from silence is a weak one.

The reader may also wonder *when* HMRC should be taken to have accepted the efficacy of pilot trust schemes. Presumably HMRC's acceptance took effect after they had a reasonable opportunity to change the law, perhaps a year or two after the *Rysaffe* decision was final. If the GAAR had been in effect in 2003, it would have applied. What if the law changed in 2004, or a few years later? Discuss.

> **D26.6 Conclusion**
> D26.6.1 The arrangements accord with established practice accepted by HMRC and are accordingly not regarded as abusive.

HMRC's customers may regard this guidance as somewhat unimpressive. But there it is.

79.4 Inter-trust transfer: IHT effect

After that digression, and with the definition of IHT-settlement and its case law in mind, I return to ask: What is the position where there is an appointment between trusts, that is:

(1) S creates a trust ("trust 1")
(2) The trustees exercise a trustee power to transfer the trust property to what is (for trust law purposes) a separate and distinct trust ("trust 2").

I refer to that as an **"inter-trust transfer"**.

The two steps constitute 2 dispositions (and also 2 associated operations).

Before 2018, there was a good argument that:

(1) The 2 dispositions (or operations) should be regarded as a constituting a single compound IHT-settlement.
(2) That trust is the same as trust 1. That is, for IHT purposes the

[19] Author's footnote: The facts of *Rysaffe* were different and did not involve a gift by will to long-dormant pilot trusts. But it seems HMRC did not consider the differences were significant.

[20] Particularly since even if pilot trusts were made, the arrangement only took effect on the death of the testator.

property is regarded as remaining in trust 1.

In short, the inter-trust transfer has no effect for IHT purposes. The exercise of the power has the same effect as if the trustee of trust 1 appointed the trust fund to be held upon trusts identical with the trusts of trust 2 but set out in full in the appointment, without reference to trust 2. This avoids the problems and anomalies which arise if an inter-trust transfer is regarded as a transfer to a separate IHT-settlement. I refer to that as the **"no-transfer approach"**.

The no-transfer approach is not now open. It is inconsistent with *Barclays Wealth v HMRC*.[21] In this case, trustees held property in an excluded property trust. They transferred the trust fund to another trust. The settlor was (deemed) UK domiciled when the second trust was made. The CoA said:

> There can be no doubt that, when the [trust's] shares were appointed by the Trustee ... from the 2001 Settlement to the DBJT, they ceased to be comprised in the former settlement and became comprised in the latter. ... Accordingly, section 81(1) applied with the consequence that, for the purposes of Chapter III, the shares had to be treated as remaining comprised in the 2001 Settlement for so long as they (or, after the sale, their proceeds) were in fact comprised in the DBJT...
>
> It is also clear that, while the shares and their proceeds remained in the DBJT, they were not excluded property. ... the settlor ... was UK-domiciled when the DBJT was made, so the [retesting] condition in section 82(3) could not be satisfied.[22]

In *Barclays Wealth* this was in fact common ground. The no-transfer approach was not put to the court. Strictly speaking, a case is not binding authority for a proposition which was not argued. But where the CoA have expressed themselves in such strong terms, and the parties were represented by leading counsel, there is little prospect that a Court below the Supreme Court would refuse to follow the CoA lead on this point. In short, for practical purposes, the law on this point is now settled at all levels below the Supreme Court.

An inter-trust transfer should not be within the scope of s.81 retesting. That would avoid many anomalies and issues discussed below. As the Supreme Court are not likely to have an opportunity to put this right,

[21] [2017] EWCA Civ 1512.

[22] para [41], [44].

statutory law reform is needed to provide that a transfer between trusts is ignored for all IHT purposes.[23]

79.5 Separate-settlement fiction

Section 44(2) IHTA provides:

> Where more than one person is a settlor in relation to a settlement and the circumstances so require, this Part of this Act (except s.48(4) to (6)) shall have effect in relation to it as if the settled property were comprised in separate settlements.

I refer to this as the "**separate-settlement fiction**".

79.5.1 *Analysis of fiction*

When the separate-settlement fiction applies, the settled property is treated as being in separate settlements (which I call "**notional trusts**").

Each notional trust must (for IHT purposes) be regarded as possessing three features: (1) notional trust property (2) a notional settlor and (3) a notional date on which it was made. These features are as notional (or fictional) as the notional trust itself. The statute does not expressly tell us what they are: context and common sense must fill that gap.

One might say that the notional trusts do not exist, in the sense that the trust with several settlors exists, and one might describe the latter as "the real trust". But more analytically, the trust with several settlors exists for the purposes of trust law (and other purposes which adopt trust law principles) and the notional trusts exist for IHT purposes.[24]

As to tracing when some of the trust fund is taken from a settlement with two settlors, see App.2.10 (Withdrawal from mixed fund).

79.5.2 *Purpose of fiction*

The separate-settlement fiction is needed because inheritance taxation of trusts depends on:

(1) the domicile of the settlor

(2) the transfers made by the settlor in the 7 years before commencement of the trust (which affect the trust's nil-rate band for trust taxation).

The rules are drafted on the basis that every trust has one settlor and only

[23] There is a loose precedent in the IT/CGT appointment rules; see 99.11 (Inter-trust transfer: appointment).

[24] See App 7.1 (What do we mean by real).

properly work on that basis; instead of making provision for a trust with multiple settlors, the scheme is to regard such trusts as multiple trusts.

IHT Manual provides:

> **IHTM42253. More than one settlor** [Jun 2016]
> ... This separation has 3 main effects
> [1] Where more than one trust exists each will have its own nil-rate band for rate purposes.
> [2] The value of property may be affected. For example, holdings of unquoted shares in a single trust might amount to a control holding whereas the same parcels of shares would be minority holdings if taken separately.
> [3] The separate trust made by the second person will have its own starting date. (IHTM42221)

This is correct as far as it goes, but it ignores the settlor domicile aspect of the rule, which is in practice the most important.

79.5.3 *When fiction applies*

The separate-settlement fiction is expressed to apply for the purposes of Part 3 IHTA (not generally), but all the important provisions which govern trust IHT are in Part 3 (which is headed: Settled Property).[25]

There are two cases where the separate-settlement fiction does not apply.

Firstly, the fiction does not apply unless "the circumstances so require". Normally the circumstances do so require. Most likely the drafter could not identify any cases where the fiction should not be applied but thought there might be some such cases; another possibility is that the drafter identified some cases but thought they were too difficult or insufficiently important to set out in the statute. So that has been left to the courts to sort out.

Secondly, the separate-settlement fiction does not apply for the purposes of s.48(4) to (6), ie for the FOTRA securities exemption. The reason was that FOTRA exemption does not depend on the identity of the settlor, it depends on the identity of the beneficiaries.[26] It was therefore unnecessary to apply the separate-settlement fiction. As far as I can see the fiction would not have done any harm, but it would not have had any effect:

[25] The separate-settlement fiction has to be repeated in s.201(4) IHTA in order to apply it to s.201 (because that is not in Part 3).

[26] See 75.11 (Trusts: FOTRA securities).

presumably the drafter thought it safer or simpler not to have to bother with the separate-settlement fiction.

79.6 B adds property to A's trust

Suppose:
(1) an individual ("A") creates a trust ("the real trust"), and
(2) another[27] individual ("B") adds property to it.[28]

The real trust has two settlors, A and B. The separate-settlement fiction applies, and one must imagine that the trust fund of the real trust is comprised in two notional trusts, "notional trust A" and "notional trust B". Common sense suggests:
(1) Notional trust A is regarded as if:
    (a) It holds the property given by A.
    (b) A is its sole settlor.
    (c) It was made at the time A made the real trust.
(2) Notional trust B is regarded as if:
    (a) It holds the property given by B.
    (b) B is its sole settlor.
    (c) It was made at the time B added property to the real trust.

This seems clear, but if authority is needed, see *Hatton v IRC*:

> Circumstances in which [the separate-settlement fiction] is commonly found to apply include those in which two or more persons have separately provided funds from their own independent resources to be held upon the trust of the same settlement. In such a case the effect of [the separate-settlement fiction] is, I suspect, generally thought to be that the settled property is treated as if a proportionate or identifiable part were held in other, separate settlements; each notionally separate settlement having its own single settlor.[29]

79.6.1 *More than 1 addition to trust*

Suppose:
(1) An individual ("A") creates a trust ("the real trust").

[27] For the position where the settlor adds to their *own* trust, see 75.15 (Added property: Change of domicile).

[28] The same analysis applies if A and B together transfer funds to a new jointly made trust.

[29] 67 TC 759 at p.789.

(2) Another individual ("B") adds property to it ("the first addition").
(3) B later adds more property to the trust ("the second addition").

It is considered that there are still two notional trusts. Notional Trust A is as before. Notional trust B is regarded as if:

(a) It holds the property given by B.
(b) B is its sole settlor.
(c) It was made at the time of the first addition
(d) B added property to the notional trust at the time of the second addition.

It follows that trust property added by the second addition may be excluded property if B was not UK domiciled at the time of the first addition.[30]

79.6.2 *Adding value indirectly*

It is suggested that the same applies if B adds value indirectly to the real trust (eg by a gift to a company held by the real trust). The real trust has two settlors, A and B.[31] The circumstances require the real trust to be regarded as two separate notional trusts. A division of the trust property of the real trust into two parts representing the value given by A and the value given by B is still possible. It may not be easy but it is no harder than many apportionments required for tax.[32]

79.7 Direct and indirect settlors

Suppose there is an arrangement under which:

(1) A gives property to B, and
(2) B gives the property to a trust ("the real trust").

It appears at first sight that there are then two settlors: an indirect settlor (A) and a direct settlor (B).[33] Both have provided the *same* property. A similar issue may arise if A owns a company and procures the company to make a settlement. The company is a direct settlor and A is an indirect settlor.

[30] But see 75.15 (Added property: Change of domicile).

[31] See 99.24 (Providing property to co in a trust).

[32] For instance, apportionment of gains of non-resident companies to participators.

[33] See 99.7 (A gives to B, B gives to trust). This issue may arise in the context of failed tax planning of the kind discussed at 99.41 (Planning to create excluded property trust).

What is the IHT analysis? On one view the separate-settlement fiction applies so that the settled property in the real trust is treated as being comprised in separate trusts (which I call "notional trust A" and "notional trust B"). On this view the consequence is said to be that:

(1) Notional trust A:
   (a) holds *all* the trust property of the real trust;
   (b) A is its sole settlor;
   (c) I do not know when proponents of this view would say that notional trust A was made. It would either be at the time A gave the property to B or the time that B settled it, and this poses perhaps another difficulty with this view.

(2) Notional trust B:
   (a) also holds *all* the trust property of the real trust;
   (b) B is its sole settlor;
   (c) was made at the time B created the real trust.

The difficulty with this view is that it leads to double taxation[34] and the separate-settlement fiction which only applies "if the circumstances so require" should not be used to give that result. So the better view is that the circumstances do not "so require" and the separate-settlement fiction does not apply.

We have therefore one real settlement with two settlors. What is the position for excluded property if A is foreign domiciled and B is not? It will be recalled that settled property is (in short) excluded property "unless *the settlor* was domiciled in the UK at the time the settlement was made". There are two possible solutions:

(1) One cannot say that "the settlor" was domiciled in the UK unless both settlors were domiciled here. In that case the trust property may be excluded property if either A or B are foreign domiciled.
(2) To read the word "the settlor" in this context as meaning "the settlor or one of the settlors".[35] In that case the trust property is only excluded property if A and B are both foreign domiciled.

[34] This view is supported by comments in *Hatton v IRC* 67 TC 759 at pp.789–790. But (1) the comments were not a necessary part of the decision, and so are not binding (2) the judge did not have the benefit of counsel's arguments on the issue (3) the judge did not appreciate the double taxation difficulties which arise on his view; in the circumstances it is considered that these comments do not represent the law.

[35] Applying (perhaps extending) the rule of construction that the singular includes the plural.

Both solutions have anomalous results, though in one case the anomaly favours the taxpayer and in the other it favours HMRC.

The best solution to this conundrum is that one should identify A as the "real" settlor and infer that B should not be regarded as a settlor.[36] Then the anomalies do not arise.

79.7.1 *HMRC view*

RI 166 provides:

> **Several persons contribute to a single settlement** [February 1997]
> ...
> [Section 44(2)] is similar in terms[37] to FA 1975 Sch 5 para 1(8), which was considered by Chadwick J in *Hatton v IRC* [1992] STC 140. In the light of the decision in that case [HMRC] take the view
> [1] that the determination of the extent to which overseas assets in a settlement are excluded property by reason of the settlor's domicile is a relevant "required circumstance"; and that
> [2] where a clear, or reasonably sensible, attribution of settled property between the contributions made by several settlors is possible, there will be a separate settlement, with its own attributed assets, for each contributor for IHT purposes;
> [3] if such an attribution is not feasible, each separate settlement will comprise all the assets of the single, actual settlement.[38]
>
> **Trust records**
>
> It follows from the comments above that the trustees of a settlement should keep adequate records to enable any necessary attribution of the settled property to be made if ... two or more persons have contributed funds for the purposes of the settlement.

[36] See 99.7.2 (Is B also a settlor?).

[37] Author's footnote: Although the RI uses the word "similar", there are in fact no material differences.

[38] In similar vein, IHT Manual provides:

> "**IHTM42253. More than one settlor** [Jun 2016]
> ... In practice, you can take the phrase 'and the circumstances so require' to mean, 'in a simple and straightforward case'.
> [1] You can accept the separateness of direct additions made by the settlor's favourite aunt,
> [2] but if for instance the added property is situate in Liechtenstein and transferred by a nominee in Liberia to a trust company in Jersey you would need to satisfy yourself as to what the circumstances were and whether they require treatment as separate trusts."

Para [2] unhelpfully ducks the issue.

Points [1] and [2] are correct.

A discussion of point [3] first requires consideration of when attribution is "feasible", I suggest it should always be feasible where two or more persons have contributed distinct funds, even if the funds are later merged.[39] I understand point [3] to refer to the *Hatton* situation, gift from A to B and gift from B to a trust, in which case the HMRC view is subject to the objections considered above.[40]

In practice it is perhaps better to avoid joint settlors (or for one person to add property to a settlement made by another). This avoids the complication of the separate-settlement fiction. But in a straightforward case there should not be any difficulty as long as:

(1) all settlors are foreign domiciled or all are UK domiciled; or
(2) the settlors include both UK and foreign domiciliaries, but trust record keeping is adequate. (Ordinary trust accounts should suffice.)

It is likewise best to avoid indirect additions to a trust fund (eg a beneficiary using their own funds to improve trust property), where the original settlor is foreign domiciled and another person adding property is UK domiciled.[41]

79.8 Transfer: A's trust to B's trust

Suppose:

(1) A gives property ("A's fund") to trust A ("real trust A")
(2) B gives property ("B's fund") to trust B ("real trust B")
(3) The trustees of real trust A transfer A's fund to real trust B[42] ("the inter-trust transfer")

In this paragraph I consider the general IHT position, ie the position on the assumption that s.81 does not apply (or at least before the application of s.81). That is the case if we are concerned with the taxation of estate IIP trusts (though this will be rare).

Real trust B has two settlors, A and B. The separate-settlement fiction applies and one imagines that the settled property is comprised in two

[39] This is assumed in s.471 ITA; see 99.11.3 (IT/CGT appointment rule).

[40] See 79.7 (Direct and indirect settlors).

[41] If the settlor adds property to a trust of which they are the settlor, see 75.15 (Added property: Change of domicile).

[42] The same analysis applies if the trustees of real trusts A and B each transfer their trust funds to a third real trust C.

notional trusts ("notional trust A" and "notional trust B").

Notional trust A is regarded as if:

(1) it holds the property provided by A; and
(2) A is its sole settlor.

The important question is: at what time is notional trust A regarded as being made? The choice is:

(a) at the time that real trust A was made;
(b) at the time of the transfer to real trust B.

The latter view cannot be right, for various anomalies would then arise.

(1) Suppose A died before the transfer to real trust B. One cannot then apply the rule that the excluded property status of the trust depends on the domicile of the settlor "at the time the settlement was made".[43]
(2) Suppose a transfer from trust A to trust B and A changes domicile after the date of trust A but before the transfer:
    (a) If A is UK domiciled when A made real trust A and foreign domiciled at the time of the transfer to real trust B, A's fund would become excluded property after the transfer. One would not expect HMRC to agree with that.
    (b) Conversely, if A is foreign domiciled when A made real trust A and UK domiciled at the time of the transfer to real trust B, the trust fund would cease to be excluded property.

    These are not equivalent or self cancelling anomalies, for in case (a) no transfers would usually take place, whereas in case (b) transfers would take place every time.

[43] It has been argued that if A is UK domiciled when A made real trust A and dead at the time of the transfer to real trust B, A's fund can be excluded property after the transfer. The argument is:
(1) Notional trust A is regarded as made at the time of the transfer to real trust B.
(2) A is regarded as not "domiciled in the UK" at that time (because a dead person has no domicile).
The view that notional trust A is regarded as made at the time real trust A was made avoids obvious anomalies and is to be preferred.
If (contrary to my view) notional trust A is regarded as made at the time of the transfer to real trust B, after the death of A, one might regard A as having at that time the domicile A had:
(1) at the time of A's death; or
(2) at the time A made real trust A.
Another view is that s.44(2) only applies if the circumstances so require, and they do not so require. However adopting my approach, s.44(2) gives a sensible result.

Under this analysis, there is (subject to s.81, if applicable) no IHT advantage or disadvantage from a transfer to another trust, regardless of changes in the settlor's domicile, or the settlor's death, which is logical and sensible. I see no difficulty in a rule that the notional trust is regarded as made before the transfer, for once one accepts that the notional trust is fictional, it can logically be regarded as being made on any date.[44]

79.9 Transfer: A's trust to A's trust

Suppose:

(1) A creates two separate trusts, trust A1 and A2.

(2) The trustees of trust A1 transfer property ("the transferred property") to trust A2.

In this paragraph I consider the general IHT position, ie the position on the assumption that s.81 does not apply (or at least before the application of s.81). That is the case if are concerned with two estate IIP trusts (though this will be rare).

Trust A2 has only one settlor, A, and the separate-settlement fiction does not apply to it.

The possibilities are as follows:

A is UK domiciled when A made trust A1; but not when A made trust A2. It is suggested that the transferred property in trust A2 may in principle qualify as excluded property. Trust A2 *does* satisfy the condition that the settlor was foreign domiciled at the time that *this* settlement was made.

A is foreign domiciled when A made trust A1; and UK domiciled when A made trust A2. The result is reversed. The transferred property in trust A2 is not excluded property. Trust A2 does not satisfy the condition that the settlor was foreign domiciled when this settlement was made.

Thus there is a distinction between:

(1) transfer from trust made by A to a trust made by B (change of A's domicile irrelevant); and

(2) transfer from trust made by A to another trust made by A (change of A's domicile significant).

This is anomalous but the anomaly naturally follows from the fact that the separate-settlement fiction applies in case (1) and not in case (2).

[44] See 87.5.7 (Trust appointment: Filling blanks).

79.9.1 *Transfer to new trust*

It is tentatively suggested that the same applies where trustees of trust A1 transfer the trust fund to new trustees who hold on the terms of a new declaration of trust which is an "empty trust", there being no trust property before the transfer ("trust A2"). In this case too the separate-settlement fiction does not apply.

The view that trust A2 is regarded as made at the time trust A1 was made, the principle that a trust appointment merely fills in blanks left by the settlor,[45] gives a sensible result but is hard to reconcile with s.48A IHTA which provides:

> In this Act any reference to the commencement of a settlement is to the time when property first becomes comprised in it.[46]

It is considered that the transferred property may in principle be excluded property if A is living and foreign domiciled at the time of the transfer, even though A was UK domiciled when A made trust A1.

What if A is dead at the time of the transfer? On a literal reading, one might argue that (regardless of the domicile of A during A's life) the settlor, A, was not UK domiciled when trust A2 was made, since a deceased person has no domicile. The scope for tax avoidance would make that result unacceptable to a court in a case where A was UK domiciled at the time A made trust A1 and at the time of A's death. A court is likely to regard A as retaining after A's death the domicile A had during A's life. This is not as much of a stretch as first appears. If a company can be regarded as having a domicile (by analogy to the domicile rules of a living individual) why not a deceased person? However, it is suggested that the trust property in trust A2 may be excluded property if A was not UK domiciled at the time of A death.

79.10 Same-settlement fiction: s.81

Section 81(1) IHTA provides:

> [1] Where property which ceases to be comprised in one settlement becomes comprised in another
> [2] then, unless in the meantime any person becomes beneficially

[45] See 87.5.7 (Trust appointment: Filling blanks).

[46] See 74.9 (Settlement commencement date).

entitled to the property (and not merely to an interest in possession in the property),

[3] it shall for the purposes of this Chapter [Chapter 3 Part 3 IHTA, relevant property] be treated as remaining comprised in the first settlement.

I call this the "**same-settlement fiction**".

79.10.1 *Purpose of fiction*

As with any deeming provision, in order to understand the same-settlement fiction one must understand its purpose.[47]

It must be intended to counter avoidance of the IHT 10-year charge, based on moving property between settlements. Suppose a trust ("the old trust") is approaching its 10-year anniversary (on which a 10-year charge would arise). In the absence of s.81, the trustees might perhaps avoid the charge by the following:

(1) The trustees transfer trust property to another trust whose 10-year anniversary is some way off.

Or

(2) (a) The trustees appoint a reversionary interest to a beneficiary.
(b) The beneficiary transfers that interest to a new trust.
(c) The new trust becomes entitled to the trust property before the ten year anniversary of the old trust.[48]

Section 81 effectively counteracts these schemes by deeming the trust property to remain in the old trust. This explains why the same-settlement fiction applies only for the purpose of relevant property taxation.

79.10.2 *Application of fiction*

IHT regards trust property as a continuing fund,[49] so s.81 does not apply

[47] See App 8.2 (Deeming provisions: Construction).

[48] Under the scheme (2), the beneficiary would be the settlor of the new trust, which might also be advantageous. For completeness: this scheme might also be advantageous if the settlor had made chargeable transfers in the 7 years before the creation of the old trust, as the second trust might have a better nil-rate band in the computation of its ten-year charges.

[49] Contrast SP E9: "Property is regarded ... as becoming comprised in a settlement when it, *or other property which it represents,* is introduced by the settlor." See Dymond's Death Duties (15th ed, 1973) p.75 ("the term "property" in the Finance Acts embraces, not merely the specific investments at a particular, time, but the corpus which is the subject-matter of the disposition..."). See App. 2.9 ('Representing' assets).

on a sale between trusts at full value, for no property moves between settlements.

Section 81 does not apply to a loan from trust 1 to trust 2 on commercial terms. It does not apply to an interest free loan repayable on demand, because the promise to repay is full consideration.

Section 81 only applies on a transfer of trust capital: if trustees distribute trust income to another trust, s.81 does not apply, because the income is not "settled property" within the IHT definition.[50]

What if property is transferred from trust A to trust B and the terms of the trusts are different? Although the property transferred is deemed to be held in trust A, it is not deemed to be held on the terms of trust A: it is regarded as held on the terms of trust B as if they had been incorporated in trust A. For instance, on a transfer from an estate IIP trust to a discretionary trust:

(1) the property is deemed to remain held in the first trust but
(2) it is regarded as held on the terms of the second trust.

So the interest in possession in the property transferred comes to an end, giving rise to an IHT charge: the deeming does not affect that.

What about a transfer to an insolvent trust? Suppose:

(1) Trust B is insolvent: its assets are worth 100 and it has debts of 200.
(2) Trust A transfers an asset worth 100 to trust B.

The asset is deemed to be in trust A. But if the debt is deductible against the asset there is an exit charge on the basis that trust property has reduced in value. If the debt is not deductible against the asset, there is an exit charge when the debt is satisfied.

79.11 Trust-transfer retesting

Where s.81 applies, s.82/82A IHTA impose additional requirements for trust property to qualify as excluded property.[51] I coin the following terminology:

Term	**Meaning**
Trust-transfer retesting	s.82/82A rules together
Pre-2020 trust-transfer retesting	s.82 rule
Post-2020 trust-transfer retesting	s.82A rule

[50] See 87.6 (Definition of "IHT-settlement").

[51] Similar rules apply where the settlor/spouse have an initial IIP: see 75.13 (Initial interest settlor/spouse).

Section 82 IHTA provides:

> (1) [a] In a case where, apart from this section, property to which section 81 applies would be excluded property by virtue of section 48(3)(a) above,
>
> [b] that property shall not be taken to be excluded property at any time ("the relevant time") for the purposes of this Chapter [Chapter 3 Part 3 IHTA, relevant property] (except sections 78 and 79)[52] unless Conditions A and B are satisfied.
>
> (2) [This is a transitional rule: see 79.13 (s.81 transitional rules)].

It is convenient to read conditions A and B side by side:

Condition A: s.82(3)	**Condition B: s.82(4)**
Condition A referred to in subsections (1) and (2) above is	Condition B referred to in subsection (1) above is
(b)[53] in the case of property to which subsection (1) or (2) of section 81 above applies,	(b) in the case of property to which subsection (1) or (2) of section 81 above applies,
that the person who is the settlor in relation to the second of the settlements mentioned in the subsection concerned,	that the person who is the settlor in relation to the first or second of the settlements mentioned in that subsection,
was not domiciled in the UK when that settlement was made.	was not a formerly domiciled resident[54] for the tax year in which the relevant time falls.

Section 82(5) IHTA provides:

> This section does not apply in relation to a case to which section 82A applies.

The following discussion focusses on condition A, as condition B (formerly-domiciled resident) will be uncommon.

Pre-2020 retesting only applies for determining whether property is excluded property "by virtue of s.48(3)(a)", ie for determining whether

[52] Sections 78, 79 IHTA concern conditional exemption for historic property, which is not discussed here.

[53] Para (a) has been deleted in s.82(3) and (4).

[54] This has its normal IHT meaning: see 5.5 (IHT Formerly-domiciled resident rule).

foreign situate property is excluded property. So it does not apply for AUTs and OEICs.[55]

Retesting only applies for the purposes of relevant property taxation, so one must distinguish:

(1) excluded property for the purposes of relevant property taxation ("**RP excluded property**"); and
(2) excluded property for other IHT purposes (but the scope of this has been greatly reduced since the trust IHT reforms introduced in 2006)

The consequences of retesting depend on the circumstances of the inter-trust transfer.

79.11.1 *A's trust to A's other trust*

Suppose:

(1) A creates two separate trusts, trust A1 and trust A2.
(2) The trustees of trust A1 transfer property ("the transferred property") to trust A2.

The possibilities are as follows:

A is not UK domiciled when A made trust A1 but UK domiciled when A made trust A2. The transferred property in trust A2 is not excluded property under general IHT principles.[56]

A is UK domiciled when A made trust A1 but not UK domiciled when A made trust A2. The transferred property may be excluded property under general IHT principles. However, s.82 retesting prevents transferred property in trust A2 from qualifying as RP excluded property. (This is probably an accidental consequence of the wording, because if the drafter had had this point in mind they would have made s.82 IHTA apply for all IHT purposes and not only for the purposes of relevant property taxation.)

In short, for foreign situate transferred property to qualify as RP excluded property, A must be domiciled outside the UK at the time A made trust A1 and trust A2.

79.11.2 *Transfer to 3rd or to 1st trust*

Suppose:

(1) A creates three separate trusts, A1, A2 and A3.

[55] See 75.10 (Trusts: UK funds).

[56] See 79.11.4 (Transfer of equitable interest).

(2) The trustees of trust A1 transfer property ("the transferred property") to trust A2.
(3) The trustees of trust A2 transfer the transferred property to trust A3.

The transferred property is treated as remaining in trust A1. It is only excluded property if A was not UK domiciled when A made "the second of the settlements mentioned" in s.81(1), but that refers (it is considered) to trust 3. The domicile of A at the time A made trust A2 is not relevant.

Thus if trustees of an excluded property trust transfer property to a non-excluded property trust made by the same settlor, they have fallen into a trap: foreign situate transferred property ceases to be excluded property. They can extricate themselves from the trap if the trustees of trust A2 transfer the property back to trust A1: *Barclays Wealth v HMRC*.[57] But there will be an exit charge if the property ceases to be excluded property on the transfer. That is anomalous, because if the trust property was UK situate at the time of the transfer there would be no exit charge, even it it later became foreign situate. But this is an area full of anomalies, and only law reform, or the Supreme Court, can put that right.

79.11.3 *From A's trust to B's trust*

Suppose:
(1) A gives property ("A's fund") to a settlement ("real trust A").
(2) B gives property ("B's fund") to a separate settlement ("trust B").
(3) The trustees of real trust A transfer A's fund to trust B.

For general IHT purposes, A's fund is regarded as in a notional trust and may be excluded property if A was not UK domiciled when real trust A was made.

At first sight the position for the purposes of RP trust tax seems to be different:
(1) A's fund is treated as remaining comprised in real trust A (applying the same-settlement fiction); and
(2) foreign situate property in A's fund can only be excluded property if:
  (a) A is foreign domiciled at the time real trust A was made; and
  (b) B is foreign domiciled at the time trust B was made
(applying trust-transfer retesting).

There is a better view. On these facts the separate-settlement fiction of

[57] See 75.15 (Added property: Change of domicile).

s.44(2) applies. A's fund is treated for IHT as if it were transferred to a separate notional trust. The same-settlement fiction applies as if there is a transfer from real trust A to the separate notional trust deemed to be made by A at the time (I think) of real trust A. So, for RP trust tax purposes, A's fund may be excluded property if A is not UK domiciled at the time A made trust A. That is, trust-transfer retesting does not add anything to the general excluded property rule. The domicile of B is irrelevant. That gives a fair result and is consistent with what I take to be the purpose of s.82; see below.

A similar result applies if the trustees of trust A transfer A's fund to a company held by trust B.

79.11.4 *Transfer of equitable interest*

The position is different if:

(1) A gives property ("A's fund") to a settlement ("trust A").
(2) B has an equitable interest under trust A (perhaps a reversionary or contingent right to trust capital).
(3) B assigns B's equitable interest to a separate settlement ("trust B").
(4) Trust B becomes entitled to A's fund (perhaps because the reversionary interest falls into possession or the contingency is satisfied).

B is in principle the settlor of trust B for general tax purposes. The position for the purposes of RP trust taxation is that:

(1) A's fund is treated as remaining in trust A (applying the same-settlement fiction); and
(2) A's fund can only be RP excluded property if:
    (a) A is foreign domiciled at the time that trust A was made, and
    (b) B is foreign domiciled at the time trust B was made
    (applying trust-transfer retesting).

It would be possible to avoid these consequences if the trustees of trust B sell the equitable interest before it falls into possession, or if they transfer it to a company.

79.11.5 *Pre-2020 test: FOTRA security*

Section 82(2) IHTA provides:

> Section 65(8) above shall not have effect in relation to property to which section 80 or 81 above applies unless Condition A is satisfied (in addition to the condition in section 65(8) that the settlor was not

domiciled in the UK when the settlement was made).

This relates to the specialist topic of IHT exemption for FOTRA securities.[58] IHT Manual provides:

> **IHTM27251 exempt securities: anti-avoidance rules** [Sep 2018]
> ... The rules are designed to deter people from avoiding tax by transferring property from one settlement where the beneficiaries are resident or domiciled in the UK, into a sub-settlement where the beneficiaries are all abroad. ...

79.11.6 *Trust-transfer retesting: Purpose*

What is the purpose of trust-transfer retesting? It often happens that an artificial deeming rule which closes one avoidance scheme can be exploited for another. The same-settlement fiction is an example. Suppose:

(1) A, who is domiciled outside the UK, settles foreign property on discretionary trusts for a short period with remainder to A absolutely.
(2) B, who is UK domiciled, buys A's reversion and settles it on discretionary trusts.[59]

Under general IHT law, B would in principle be the settlor of trust B, which would be within the scope of IHT in the ususal way. However applying the same-settlement fiction, in the absence of retesting, A would be the settlor and (because of A's domicile) B's trust would be an excluded property trust!

Section 82 counteracts this scheme. If my analysis is right,[60] then s.82 works, though it does not produce the fair result in every case. Suppose the facts were reversed:

(1) A, who is domiciled in the UK, settles foreign property on discretionary trusts for a short period with remainder to A absolutely.
(2) B, who is foreign domiciled, buys A's reversion and settles it on discretionary trusts.

There is no obvious fairness here in the rule that B's trust should be within the scope of IHT. But the example is somewhat contrived and perhaps it does not much matter.

[58] See 76.9.1 (Property becomes excluded).
[59] These are the facts considered in 79.11.4 (Transfer of equitable interest).
[60] See 79.11.3 (Transfer: A's trust to B's trust).

An incidental result is to restrict or prevent tax advantages on a transfer from trust A1 to A2, where A was UK domiciled when A made trust A1 but foreign domiciled at the time A made trust A2.[61]

79.12 Post-2020 transfer retesting

79.12.1 *Application conditions*

Section 82A(1) IHTA provides:

> This section—
> (a) applies where, at any time on or after the day on which the Finance Act 2020 is passed [22 July 2020],
> [i] property ceases to be comprised in a settlement ("the first settlement") but
> [ii] is treated as a result of section 81 as remaining comprised in that settlement for the purposes of this Chapter [Chapter 3 Part 3 IHTA, relevant property], and
> (b) applies whether or not at any subsequent time the property is comprised in the first settlement without regard to that section.

79.12.2 *Retesting rule*

Section 82A(2) IHTA provides:

> If the property would apart from this section be excluded property by virtue of section 48(3)(a) or (3A)(a), the property is to be regarded as excluded property for the purposes of this Chapter [Chapter 3 Part 3 IHTA, relevant property], except sections 78 and 79, at any time only if the non-domicile condition is met in relation to each qualifying transfer occurring on or before that time.

79.12.3 *Qualifying transfer*

This term matters as each qualifying transfer must satisfy the "non-domicile condition".

Section 82A IHTA provides:

> (4) For the purposes of this section each of the following is a "qualifying transfer"—
> (a) the occasion on which section 81 applies to the property; and
> (b) any subsequent occasion on which the property would, if the effect of section 81 were ignored, become comprised in a

[61] See 79.11.1 (Transfer: A's trust to A's trust).

> settlement to which this Chapter applies (including the first settlement).
>
> (5) But a qualifying transfer does not occur as a result of—
>
> (a) an assignment[62] by a beneficiary of an interest in a settlement, or
>
> (b) an exercise of a general power of appointment,[63]
>
> unless the time of the assignment or exercise of the power falls on or after the day on which the Finance Act 2020 is passed [22nd July 2020].

79.12.4 *Non-domicile condition*

Section 82A(6) IHTA provides:

> For the purposes of this section "the non-domicile condition" is—
>
> (a) in a case where a qualifying transfer occurs as a result of[64] an assignment by a beneficiary of an interest in a settlement or an exercise of a general power of appointment,[65] that the beneficiary or the person exercising the power—
>
> (i) was not domiciled in the United Kingdom at the time of the assignment or exercise of the power, and
>
> (ii) is not a formerly domiciled resident for the tax year in which the time mentioned in subsection (2) falls;
>
> (b) in a case in which section 81 applies which is not within paragraph (a), that the person who was the settlor of the property in relation to the first settlement was not domiciled in the UK immediately before the time when the property ceased to be comprised in the first settlement;
>
> (c) in any other case, that the person who was the settlor of the property in relation to the first settlement was not domiciled in the UK immediately before the time of the subsequent occasion.

79.12.5 *Transfer after death of settlor*

Section 82A(7) IHTA provides:

[62] Section 82A(9) acknowledges Scots law terminology: "In this section any reference to an assignment includes an assignation."

[63] See 87.10.1 (General power: Terminology).

[64] Section 82A(8) provides: "In this section any reference to a qualifying transfer occurring as a result of—
(a) an assignment by a beneficiary of an interest in a settlement, or
(b) an exercise of a general power of appointment,
includes the transfer occurring partly as a result of the assignment or exercise of the power."

[65] See 87.10.1 (General power: Terminology).

> If—
>
> (a) the settlor mentioned in subsection (6)(b) or (c) has died before the time mentioned there, and
>
> (b) the death does not give rise to a qualifying transfer,
>
> the non-domicile condition is treated as met.

79.12.6 *Post 2020-retest: FOTRA security*

Section 82A(3) IHTA provides:

> Section 65(8) has effect in relation to the property at any time only if (in addition to the condition mentioned there) the non-domicile condition is met in relation to each qualifying transfer occurring on or before that time; but, for the purposes of this subsection, the non-domicile condition has effect with the omission of subsection (6)(a)(ii).

79.12.7 *2020 retesting: Critique*

In the 2019/20 edition of this work I said:

> What is needed is a review and rethinking the rules as a whole, not tinkering; but there is not much chance of that.

HMRC say:

> HMRC met with stakeholders [in 2020] to discuss questions and requests for clarification around the recent legislative changes concerning trust settlements definition and application of excluded property tests. HMRC agreed that more could be done to provide certainty and clarity to affected customers, and to work collaboratively with stakeholders to improve customer understanding of how HMRC interprets legislation in what are often complex individual scenarios. To that end it was agreed to take forward work across three areas;
>
> - HMRC to clarify in guidance, working with stakeholders, their interpretation of how the legislation applies in certain more straightforward scenarios. Clarifying any misunderstandings on how they interpret the legislation operating.
> - HMRC and stakeholders to work together to update the available customer guidance on the treatment of loans in regards to settlements, and consequential application of the tax code. It was acknowledged there are some longstanding areas of uncertainty for customers in this area, which predate the recent changes. This is especially true given the range of complex scenarios which may arise.
> - HMRC and stakeholders to continue discussions to best understand if and how improvements could be made to ensure the interaction of

> settlements[66] between trusts and the gifts with reservation of benefits rules are operating as intended.[67]

The reader may think that the time for these discussions was before the provisions were enacted - not after. But the philosophy of "ready, fire, aim" prevails.[68] The hope that the problems of ill thought out provisions (such as 2020 retesting) will be solved by guidance appears to be ineradicable - despite all experience and case law to the contrary.

79.13 s.81 transitional rules

The current provisions have evolved over time.

From 1975 to 1981, the position was governed by para 11(4) sch 5 FA 1975:

> *Where, by the same disposition, property ceases to be comprised in one settlement and becomes comprised in another settlement, the property shall be treated as remaining comprised in the first settlement.*

This was narrower than the current s.81 rule, which applies to an inter-trust transfer "unless in the meantime any person becomes beneficially entitled to the property" rather than one made "by the same disposition".

In particular, the 1975 rule would not apply where an individual was entitled to a reversionary interest, and transferred that interest to a settlement, and subsequently the interest fell into possession.

FA 1982 introduced the current rule but preserved the former rule for earlier transfers. Section 81(2) IHTA preserves that status quo:

> (2) [a] Subsection (1) above shall not apply where the property ceased to be comprised in the first settlement before 10 December 1981;
>
> [b] but where property ceased to be comprised in one settlement before 10 December 1981 and after 26 March 1974 and, by the same disposition, became comprised in another settlement, it shall for the purposes of this Chapter [Chapter 3 Part 3 IHTA, relevant property] be treated as remaining comprised in the first settlement.

There was an afterthought in 1984, now in s.81(3) IHTA which provides:

[66] Presumably the meaning is, transfers between trusts.

[67] Informally circulated email, Sep 2020.

[68] See 1.12 (State of UK tax reform).

> Subsection (1) above shall not apply where a reversionary interest in the property expectant on the termination of a qualifying interest in possession subsisting under the first settlement was settled on the trusts of the other settlement before 10 December 1981.

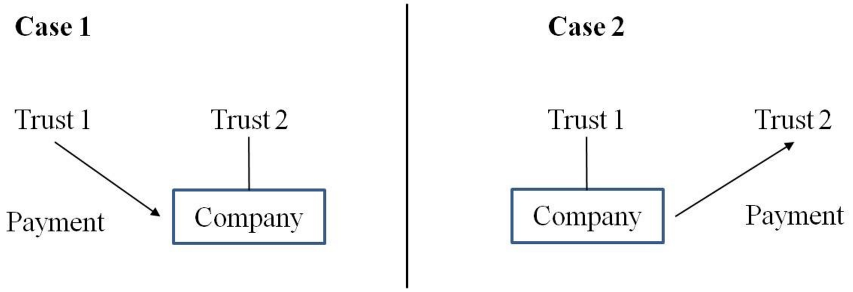
That would apply in a case where the reversionary interest fell into possession (ie where the inter-trust transfer took effect) even after the date of change of 10 December 1981.

A reversionary interest settled before 1981 is likely to have fallen into possession, but the point is still relevant as settlements affected by the transitional rules may still be in existence.

By today's standards, s.81(3) seems a generous transitional provision: the principle that amendments should not have retrospective effect was more strictly observed a generation ago than it is today.

79.14 Transfers to/from underlying co

Section 81 only applies on a transfer from one trust to another trust. It does not apply on a transfer from a company held by a trust, or on a transfer to a company held by a trust.



In case 1, there is a transfer from trust 1 to the company held by trust 2. In case 2, there is a transfer from the company held by trust 1 to trust 2. Section 81 does not apply in either case.

Section 81 is not needed, because a variety of other IHT provisions fill the gap. A full analysis would be a lengthy exercise, as there are a number of permutations, depending on whether we are considering case 1 or 2, and whether the payment is income or capital. But in outline:

(1) In case 2, there is in principle a charge under the IHT close-company code.

(2) (a) If trust 1 is a discretionary trust, there will in principle be an exit charge:

(i) in case 1, as property ceases to be relevant property
(ii) in case 2, on the diminution of the value of trust property[69]

(b) If trust 1 is an estate IIP trust, there may be a chargeable transfer:
(i) in case 1, as an interest in possession comes to an end
(ii) in case 2, perhaps, on diminution of value of trust property[70]

(3) If the payment is income, then s.731 and other income tax anti-avoidance provisions need consideration.

79.14.1 *Transfers across trust/co structures: Navigation*

Transfers across trust/company structures raise other issues; see:

Topic	**See para**
Capital payments	
s.96 TCGA	61.13
s.90 TCGA	61.39.9
Capital payment from co in estate	88.10
Case 2: Whether income receipt of trust 2	30.13
Chargeable gain on disposal of	
Transferor co	s.30 TCGA (value shifting)
Transferee co	Increase in value without increase in base cost
Who is (are) the settlor(s) of trust 2: Case 1	
Is settlor of trust 1 a settlor of trust 2	99.12; 99.24
Who is (are) the settlor(s) of trust 2: Case 2	
Is settlor of trust 1 a settlor of trust 2	99.12
Is transferor co a settlor of trust 2	99.40
Is trustee of trust 1 a settlor of trust 2	99.40.3
If transferor co is settlor of trust 2	
Application of s.624	47.16
Application of s.86	60.16

[69] See 76.8.2 (Reducing value of trust property).

[70] See 76.8.2 (Reducing value of trust property).

CHAPTER EIGHTY

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Cross references

The following topics relating to IHT deduction of debts are considered elsewhere:
75.9 (Income unpaid on life tenant death)
114.9 (Deductions for IHT DTAs)
83.17 (Pre-owned assets - Excluded liability rule)
82.6 IHT residential-property code: Liabilities of residence-company
82.9 IHT residential-property code: Deductibility of relevant loan

Debts raise many other tax issues: see 62.1.1 (Loan tax issues: Navigation).

80.1 IHT deduction for debts: Introduction

This chapter is concerned with IHT deductions for debts or liabilities.[1] I go beyond the themes of this book and address the topic as a whole.

I also consider the IHT position of the creditor, and IHT deductions on death for funeral expenses and costs of estate administration.

This chapter needs to be reviewed in the light of the recent cases on home loan schemes;[2] but that must wait until the cases are final.

80.2 Position of creditor

A creditor owns an asset (the benefit of the debt) which is part of their estate.

80.2.1 *Value of debt-asset for IHT*

Section 166 IHTA provides:

> [1] In determining the value of a right to receive a sum due under any

[1] A note on terminology: "Debt" and "liability" are used (more or less) synonymously. There is a distinction in that:
(1) "Liability" is only apt to describe the burden of the debt.
(2) "Debt" may be used to describe (a) the burden of the debt (the obligation of the debtor) *or* (b) the benefit of the debt (the asset of the creditor). The context should make it clear which meaning of "debt" is intended. For instance, in s.251 TCGA, the word is first used with one meaning and then with the other; see 56.22.1 (CGT debt exemption). It might sometimes assist clarity to refer to the benefit/burden of the debt, or to refer to a debt-asset/debt-liability; or to use the word "liability" for the burden of the debt and "receivable" for the benefit of the debt.

In this chapter the word debt is generally used, perhaps loosely, as equivalent to liability. I prefer *debt* as the shorter word. See too 56.22.2 (Meaning of "debt").

[2] *Pride v HMRC* [2023] UKFTT 316 (TC); *Elborne (Executors of) v HMRC* [2023] UKFTT 626 (TC) (14 July 2023).

obligation it shall be assumed that the obligation will be duly discharged,

[2] except if or to the extent that recovery of the sum

[a] is impossible or not reasonably practicable and

[b] has not become so by any act or omission of the person to whom the sum is due.

I refer to this as the "s.166 statutory valuation rule".

It is necessary to distinguish:

(1) Market value of a debt-asset

(2) Statutory IHT value: value for IHT purposes under s.166

(3) Face value: the amount due under the terms of the debt

In the following discussion:

(1) An **"impaired debt"** is one which will not (or may not) be repaid in full, because the debtor has insufficient assets

(2) A debt is **"deliberately"** impaired if it has become so by an act or omission of the creditor

(3) A **"time-barred debt"** is one which cannot be enforced under the English law Limitation Act 1980 or similar legislation[3]

80.2.2 *Impaired debt*

The market value of an impaired debt is less than face value. But if a creditor ("C") deliberately allows a debt to become impaired, by omitting to take some step, such as calling in the debt, the value of the debt for IHT purposes in C's estate is (for IHT purposes) regarded as if the obligation will be fully discharged. The statutory IHT value is higher than the market value.

Suppose the relationship between creditor and debtor is arm's length. It could still happen that:

(1) C has an opportunity to call in the debt but for commercial reasons does not do so.

(2) The debt later becomes impaired or worthless.

No-one would suggest that the s.166 statutory valuation rule applies. One might say that context shows that the act or omission must be one where C intends to confer a gratuitous benefit on the debtor. Or one might rely on a causation argument and say that in this commercial case, the reason

[3] Different considerations apply in Scotland; see 80.8.3 (Limitation in Scots law).

that the debt becomes impaired is not the omission to call it in, it is the failure of the creditor. Causation is a context-dependent concept. These are two routes to the same destination.

The s.166 statutory valuation rule may favour HMRC because the value of C's estate is higher, which may increase IHT due on the death of C; or if C is a trust, the value of the trust property is higher, which may increase trust IHT charges. But the rule may favour C, because C does not make a transfer of value by allowing a debt to become impaired, even if the omission is deliberate; ie if C could have called for payment, but gratuitously and deliberately left it outstanding to become impaired in order to benefit the debtor.

This makes sense, because the market value of an impaired debt fluctuates over time. There is no specific occasion or point of time when an IHT charge could arise.

80.2.3 *Time-barred debt*

Similar points arise for a time-barred debt. The market value of a time-barred debt is nil. But if a creditor ("C") allows a debt to become time-barred, the value of the debt in C's estate is (for IHT purposes) regarded as if the obligation will be fully discharged. So C does not make a transfer of value by allowing a debt to become time-barred: the value of C's estate is not reduced. Likewise there is no IHT exit charge if trustees allow a debt to become time-barred. This applies even if the omission is deliberate, ie the creditor could have called for payment but deliberately left it outstanding to become time-barred.

This makes sense, if it is seen in the context of HMRC practice that a time-barred debt is deductible in the estate of the debtor.[4]

80.2.4 *Gift/waiver/disposal of debt*

If C gives a deliberately impaired, or time-barred, debt to a 3rd party, C makes a transfer of value equal to the statutory IHT value.

The value of the debt for IHT purposes in the hands of the assignee is its market value. The s.166 valuation rule does not then apply as the condition in s.166[2][b] is not met.

If C waives the debt, the same point arises.

If C calls in the debt in part, the value of the outstanding debt remains

[4] See 80.2.1 (Value of debt-asset for IHT).

its face value, if the impairment is due to C.

If C releases a deliberately impaired debt for consideration less than its IHT value, there is a reduction in C's estate of the difference.

If the debtor becomes bankrupt, the debt may cease to exist, but C does not make a disposition or transaction, so there is no occasion of charge to IHT.

80.3 Basis of deduction for debts

The IHTA distinguishes between:

(1) A debt which is an incumbrance[5] on an asset. I refer to this as an "**incumbrance-debt**" and I refer to the asset as the "**incumbered property**".

(2) Other debts ("**unsecured debts**").

80.3.1 *Incumbrance-debt*

IHT is charged by reference to the market value of assets. In the case of incumbrance-debts, there are in principle two possible ways to approach the deduction for debts:

(1) *A net-value approach*: One might identify the asset as the asset subject to the incumbrance; the market value of the asset is the value taking the incumbrance into account.

(2) *A deduction approach*: One might identify the asset as the asset free of the incumbrance; the market value is the value of the asset ignoring the debt and then a deduction is made as a separate step.

The two approaches generally reach the same result. However occasionally the paths diverge. The question arose in a procedural context in *Alexander v IRC*, because a question about the value of land is (in some cases) referred to the Lands Tribunal but other questions are not.[6] In *Alexander* the asset was a lease acquired at a discount under "right to buy" legislation. Under the lease the tenant covenanted to repay the discount if he sold the property within five years. The CoA adopted the net-value approach:

> The liability to repay the discount, being charged on the leasehold premises, was in my judgment, an incumbrance on the property and

[5] A note on spelling: the IHTA refers to *incumbrance*. Outside UK statutory drafting, the word is generally spelt *encumbrance* but I adopt the IHTA spelling here.

[6] Section 222(4A) IHTA.

> should be taken into account in ascertaining the value of that property. I therefore agree that ... the question as to the value of the flat, taking into account the liability to repay discount, was a question as to the value of land for the Lands Tribunal ... . the issue as to the value of the property of the deceased in the flat was not correctly described by the Lands Tribunal, as a question of 'deciding liabilities between the vendor and a third party'. It was, in my judgment, a question of the value of the property in the hands of the deceased.[7]

80.3.2 *Unsecured debt*

In the case of unsecured debts, the net-value approach is not possible, and the only approach is the deduction approach: one must value the assets of the estate, and make a deduction as a separate step. In this case s.5(3) IHTA authorises, or at least confirms,[8] the deduction for the debt:

> In determining the value of a person's estate at any time his liabilities at that time shall be taken into account, except as otherwise provided by this Act.

80.4 Amount of deduction for debt

Section 162(2) IHTA provides:

[7] [1991] STC 112 at p.122. If further authority is needed, see *Henty v The Queen* [1896] AC 567 at p.573: "In any question as to probate duty, [an incumbrance-debt] is a burden which adheres to and tends to diminish, or it may be to extinguish, the value of the asset upon which it is charged."

[8] *Green v IRC* [2005] EWHC 14 (Ch) at [12] regarded s.5(3) IHTA as merely confirming a deduction, not authorising it:

> "... the property of the deceased ... is his personal estate net of his liabilities. In other words, it is at that stage that the liabilities are dealt with. It is not necessary for section 5(3) to provide for a second time that the debts are to be deducted in arriving at the value of the deceased's property (or estate) and in my view it is not really doing that. It is in part confirmatory, but in the main it is intended to provide a qualification or qualifications to the principle that debts are deductible– the meat of the subsection is in the closing words 'except as otherwise provided by this Act'. One finds provisions in the Act which qualify that right in sections 5(4), 5(5) and 162. Its confirmatory nature is supported by the use of the phrase 'taken into account', which is more general than 'shall be deducted'. I accept that the nature of section 5(3) would be clearer without the comma, but nevertheless it seems to me to be clear enough."

In relation to incumbrance-debts, that is right; in relation to unsecured debts, it seems an odd construction of the words; but it does not matter.

> Subject to subsection (3) below,[9] where a liability falls to be discharged after the time at which it is to be taken into account it shall be valued as at the time at which it is to be taken into account.

This only states what one would have expected. Suppose, say, T dies in year 1, owing a debt for 100 payable in year 2, interest free. The valuation of the debt is less than 100, as there is a discount for the delayed payment. But the point may not often arise.

80.5 Allocation of debt

80.5.1 *Why allocation matters*

Suppose an individual dies and is liable to certain debts immediately before death. The debt is deducted in computing the value of the estate. If on the death all the estate is subject to IHT at the same rate, it does not matter for IHT whether the debt is regarded as a deduction from any particular item of property. However it often happens that an estate includes chargeable and exempt property. In particular:

(1) An individual may own excluded property and non-excluded (chargeable) property
(2) An individual may own property which qualifies for an IHT relief, eg:
  (a) APR or BPR
  (b) DT relief
  (c) Instalment relief
(3) Property may be given to a spouse or charity and so qualify for the IHT spouse or charity exemption

In these cases one must ask whether the debt is deducted from the value of the chargeable or the exempt property.

80.5.2 *Incumbrance-debt*

Section 162(4) IHTA provides:

> A liability which is an incumbrance on any property shall,
> [a] so far as possible and
> [b] to the extent that it is not taken to reduce value in accordance with section 162B [debt attributable to agricultural/business property],
> be taken to reduce the value of that property.

[9] The exception (not discussed here) relates to a liability to pay IHT; this is taken into account without making an allowance for the fact that payment of the tax is not due immediately.

That adopts or confirms what I call the net-value approach.[10] The term sometimes used is "economic alliance" principle.

It is considered that "incumbrance" here means a security interest, ie a mortgage, charge, lien or pledge.[11]

If the amount of the debt exceeds the value of the property, the value of the property is taken as nil and the excess is deductible from the estate like an unsecured debt.

If a debt is an incumbrance on several assets there must be an apportionment. HMRC agree. The IHT Manual provides:

> **IHTM28210 Investigating liabilities: mortgages** [Sep 2018]
> ... when a debt is charged on several properties it should be apportioned between them.

If the incumbrance on some asset has priority, then the deduction should be against that asset first.

If it is desired to secure a debt on non-UK property (but to keep the IHT deduction against UK property), a back-to-back guarantee may be a solution. That is:

(1) T borrows from a third party ("the primary debt").
(2) T's primary debt is guaranteed by a bank.
(3) Under the terms of the guarantee, T is required to reimburse the bank if the guarantee is called upon ("the second debt"). This second debt is secured on foreign assets.

Section 162(4) will not apply to the primary debt, which can in principle be deducted from UK property. But the GAAR may need consideration.

Conversely, if on those facts the second debt is secured on UK property, but the primary debt is not secured on that property and the deduction is not set against that property.

Note the need to comply with the Bills of Sale Acts if securing loans on chattels.

80.5.3 *Unsecured debt*

Section 162(5) IHTA provides:

> Where a liability taken into account is a liability to a person resident outside the UK which neither—

[10] See 80.3 (Basis of deduction for debts).

[11] See 82.10.1 (Security/collateral).

> (a) falls to be discharged in the UK, nor
> (b) is an incumbrance on property in the UK,
>
> it shall,
>
> [i] so far as possible and
> [ii] to the extent that it is not taken to reduce value in accordance with section 162B [debt attributable to agricultural/business property],
>
> be taken to reduce the value of property outside the UK.

This identifies three connecting factors. Where a debt is not an incumbrance on any property, there are two connecting factors and four permutations:

Case No.	**1**	**2**	**3**	**4**
Debt to UK resident	No	No	Yes	Yes
Discharge in the UK	No	Yes	No	Yes

Section 162(5) tells us the answer to Case 1: the debt is set against non-UK property. Which non-UK property, if there is more than one item of property? IHT Manual provides:

> **IHTM28394 deducting foreign debts** [Sep 2018]
>
> [1] Debts that are owed to a person resident outside the UK and:
>
> - not charged on UK property, or
> - not contracted to be paid in the UK
>
> should be deducted primarily against foreign property, IHTA84/S162 (5).
>
> [2] If there are debts in more than one country the debts in any one country should be set against the assets in that country, and any excess set proportionately against the assets in other foreign countries.
>
> [3] This instruction does not apply to funeral expenses (IHTM10371).

I do not see any good reason for point [2]: an unsecured debt should be set against foreign property pro rata; but it will not often matter.

Suppose an individual holds shares in a foreign company which holds a UK residence. The shares are non-excluded property, but they remain foreign situate property, so that an unsecured debt may be set against the shares under s.162(5).

There is nothing about Cases 2 to 4. However, the implication is that in Cases 2 to 4 the debt reduces the value of the property in the UK.

What is the priority between s.162(4) and (5)? It is considered that (4) is applied first. An incumbrance-debt is taken so far as possible to reduce the value of the property. Only if the debt is not an incumbrance on any property, or if the amount of the debt exceeds the value of the property, does one apply the rules in s.162(5). HMRC agree. The IHT Manual provides:

> **IHTM28395 Deducting liabilities where there is excluded property** [Sep 2018]
> You will see cases where there is excluded property in the estate and deductions may be properly payable out of both excluded and other property. In this situation, provided the debts are to UK creditors, you may allow a deduction in full against the non-excluded property.
> But, in view of IHTA84/S162 (4) this does not apply to debts that are charged on excluded property.
>
> **IHTM28396 Deducting UK debts when there is both UK and foreign property in the estate** [Sep 2018]
> If the deceased's estate includes both UK and foreign assets you should first deduct any UK debts against the UK assets and set the deficit, if any, against the foreign assets. Debts are UK debts if one of the following applies:
> - they are owed to creditors who are resident solely in the UK
> - they are charged on property in the UK, or
> - they are contracted to be paid in the UK.
>
> This practice should be applied, despite the decision in *Re Kloebe*, *Kannreuther v Geiselbrecht* [1884] 28 Ch D 175. This was that in the administration of the English estate of a deceased person domiciled abroad, foreign creditors are entitled to be paid, along with those who are resident in the UK, in shares proportionate to their respective claims.
> If our official practice is challenged you should refer the case to Technical.

The practice seems right; though I do not see why the probate case cited should have any relevance to IHT.

80.5.4 *Where debt falls to be discharged*

In outline, the place where a debt falls to be discharged is that specified in the contract, or (if not specified) the residence of the creditor.[12] HMRC broadly agree. The IHT Manual provides:

[12] See *Chitty on Contracts* (34th ed., 2021), para 24-053 (Place of payment). Further consideration is needed for a contract not governed by English law.

> **IHTM28396 Deducting UK debts when there is both UK and foreign property in the estate** [Sep 2018]
> If the deceased's estate includes both UK and foreign assets you should first deduct any UK debts against the UK assets and set the deficit, if any, against the foreign assets. Debts are UK debts if one of the following applies
> - *they are owed to creditors who are resident solely in the UK*
> - they are charged on property in the UK, or
> - *they are contracted to be paid in the UK. ...*
>
> (Emphasis added)

A debt which is set against UK property (but which is not charged on specific property) will be set against UK property rateably. Some of the deduction will be wasted if the individual owns UK property outside the scope of IHT, in particular:

(1) Property qualifying for APR or BPR
(2) For a foreign domiciliary: UK AUTs or OEICs
(3) For a non-resident: FOTRA securities

80.6 GWR property subject to debt

A debt secured on an asset is in principle deductible in computing a GWR charge on the asset.[13]

If the GROB property is held in trust, trust debts are similarly deductible. HMRC agree. IHT Manual provides:

> **IHTM14401. The property comprised in the gift** [Sep 2018]
> ... *Example* (Vineet)
> In 2000 V settles £1 on discretionary trusts of which he is, and remains until his death in 2005, an object. Shortly after the creation of the settlement he advances £50,000 to the trustees by way of loan, interest free and repayable on demand.
> At the time of V's death, the settled property comprises £1 cash (representing the original £1 gift into settlement) and the proceeds of an insurance policy (purchased with the borrowed monies) on V's life amounting to £250,000.
> The loan of £50,000 has been repaid at the rate of £2,500 per annum by the trustees and £25,000 is outstanding at the date of death.

The HMRC analysis is as follows:

[13] See 80.3.1 (Incumbrance-debt).

> The proceeds of £250,000, *less the loan of £25,000*, are derived from the original loan, and you can treat them as part of the death estate. (The balance outstanding under the loan less £25,000 forms part of the free estate).

80.7 Invalid claim

In principle a deduction is only allowed for a valid and enforceable debt. In general an invalid or unenforceable claim (such as a debt of honour) is not a debt at all, in the true sense:[14] it is not classified as a debt which is disallowed for IHT. But it comes to the same thing.

The IHT Manual provides:

> **IHTM28383 Debts must be legally enforceable** [Sep 2018]
> The general position is that no deductions can be allowed for debts that are not legally enforceable or capable of being legally enforced...
> Debts that may be disallowed because they are not legally enforceable include
> - debts paid under a moral obligation (these are likely to be debts that have either been incurred for no consideration or for past consideration)
> - liabilities that are unenforceable because there is no written evidence (for example, oral agreements for the sale of an interest in land)

80.8 Time-barred debt

80.8.1 *Limitation law background*

In outline: s.5 Limitation Act 1980 provides:

> An action founded on simple contract shall not be brought after the expiration of six years from the date on which the cause of action accrued.[15]

A debt which under the LA 1980 cannot be enforced is called "time-barred" (or "statute-barred", but "time-barred" is the better term).

There was formerly held to be a moral obligation to pay a time-barred debt. In *Re Rownson*:

[14] It would not matter if an unforceable claim were said to be a "debt", as its value would be nil; see 80.4 (Amount of deduction for debt).

[15] In the case of a specialty (deed) the period is 12 years: s.8 Limitation Act 1980. The same applies in Northern Ireland law: Art 4 Limitation (Northern Ireland) Order 1989

> We know that there are some people, both Judges and other persons, who think that to plead the Statute of Limitations is unconscionable.[16]

Norton v Frecker (not a tax case) shows how strong the moral obligation was perceived to be in the 18th century:[17]

> no executor was compellable, either in law or equity, to take advantage of the statute of limitations against a demand otherwise well formed.

I think attitudes to this moral issue have changed.[18] But it depends on the circumstances. A time-barred debt to a friend in need is one thing, and refusal to pay may still be regarded as unconscionable. A debt to a trust of which the debtor is settlor, or principal beneficiary, may be quite different.

Time-barred debts - unenforceable but retaining a spectral existence - occupy a strange space between validity and invalidity.

80.8.2 *Time-barred debt: Deduction*

The IHT Manual provides:

> **IHTM28384 Statute-barred debts** [Dec 2021]
> [The Manual summarises the rules in the Limitation Act (wrongly called the Limitations Act) and continues:]
> Even though the lender may be barred from pursuing recovery, a debtor may decide to pay the debt after the expiry of the time limits. Because of this you should allow a debt which is otherwise statute-barred if the personal representatives pay the debt and you receive evidence that the payment has been made.

This practice is at first sight surprising, though taxpayers who qualify for an IHT deduction will not complain. But on reflection it makes sense. It would not be right that a debt, incurred for full consideration, and paid under an accepted moral obligation, should be disallowed for IHT; and the practice established under estate duty, or earlier, has continued unaltered for IHT.

It logically follows that HMRC should in practice accept that a debor

[16] (1885) 29 Ch D 358 at p.362. Kocourek, "A Comment on Moral Consideration and the Statute of Limitations" (1923) 18 Ill LR 538.

[17] (1737) 1 Atk. 524. It seems to me that in an appropriate case this antique comment should be reconsidered. But the question will not often arise.

[18] See 121.13.2 (Time limits: Policy).

who pays a time-barred debt is not a transfer of value; though that is not said expressly in the Manual.

If contemporary morality has changed, the practice has lost its original *raison d'être*; but sometimes a moral obligation still obtains; see above.

80.8.3 *Limitation in Scots law*

A different rule applies to a debt governed by Scots law. The IHT Manual provides:

> **IHTM28384 Statute-barred debts** [Sep 2018]
> ... These instructions do not apply to debts in Scotland. Under Scottish law, if a lender allows time to pass without receiving any payment an action for recovery may become barred under the Prescription and Limitation (Scotland) Act 1973 (For details of this Act see Gloag and Henderson's *The Law of Scotland* 12th edition[19] at Chapter 4.) These debts are completely extinguished and cannot be enforced. Once the prescriptive period expires the debt cannot be allowed as a deduction.

For a debt governed by a foreign law one would have to consider whether the limitation law followed the English or the Scots model.

80.8.4 *Time-barred debts: Critique*

If recovery of a valuable debt is made impossible due to the creditor consciously allowing the debt to become time-barred, the omission should logically be a transfer of value. One should not treat an unenforceable debt as if it were enforceable. (The position is different for an impaired debt).

By the same logic, the rule (or practice) that a time–barred debt should be deductible for IHT should be abolished.

In short, normal IHT principles should apply in this area. This would bring the law into line with reality. It would align the law in England/Northern Ireland with Scotland. It would seem to be a simplification.[20] But the issue arises so rarely that the change seems more trouble than it is worth.

[19] Author's footnote: Now 14th ed., 2017.

[20] We would need transitional rules for debts which are time-barred at the time of the law reform, so there would be different rules for new and for old time-barred debts, until all the old time-barred debts ceased to exist, which would take a generation. So the reform is more like a complication than a simplification.

80.9 Disallowed debts: Introduction

There are 12 cases[21] where IHT deduction for a debt is disallowed:

Circumstance	**See para**
Right to reimbursement	80.10
Debt incurred for less than full consideration	80.11
Section 103 FA 1986	80.12
Estate IIP: Life tenant's personal debt not set against trust fund	80.15.2
Debt owed to trust in which the debtor has an estate IIP	80.16
Non-residents overdrawn foreign currency bank account	76.13.3
Debt attributable to:	
(a) excluded property (excluded property disallowance)	80.18
(b) business/agricultural/woodland property	80.29
(c) non-residents foreign currency bank account	80.26
Debt unpaid after death	80.36
Debt which the debtor is treated as entitled to under GWR rules	80.44.5
Debt in connection with a life policy[22]	*not discussed*

The drafting technique of most of the disallowance provisions is to state that the debt is not "taken into account". The s.103 disallowance provides that the debt is "subject to abatement", but that means the same.

80.9.1 *Position of creditor*

The disallowances could lead to insolvency, as debts disallowed for IHT purposes nevertheless remain payable. Unsecured creditors may need to ask for security in order to have priority over HMRC IHT claims.

80.9.2 *Debt of company*

The debt disallowance rules set out above are aimed at disallowing debts of individuals and trustees, who are liable for IHT. Companies are not subject to IHT. In valuing shares for IHT purposes, it is considered that company debts, like assets, should be taken into account in all circumstances.

In most cases the wording of the disallowances makes this clear (though if it did not, that might easily be inferred). The rules clearly do not apply to companies so far as they are expressed to apply:

[21] The GAAR is another exception; but the GAAR is an exception to every rule of tax law.

[22] See s.103(7) FA 1986.

- to a liability "incurred by a transferor" (the company is not the transferor)
- "in determining the value of a person's estate immediately before his death"

A company is not (usually) a transferor, so the disallowance cannot apply. The excluded property disallowance does not apply because company property is not excluded property.

80.10 Right to reimbursement

Section 162(1) IHTA provides:

> A liability in respect of which there is a right to reimbursement shall be taken into account only to the extent (if any) that reimbursement cannot reasonably be expected to be obtained.

Although this rule is expressed as a disallowance, it does not usually make much difference, as the right to reimbursement would either reduce the value of the debt or constitute an asset of the estate. (There could be a difference if the right to reimbusement was excluded property.)

The IHT Manual provides:

> **IHTM28354: reimbursement of guarantee debt** [Sep 2018]
> If you have accepted that there was consideration you need to consider the possibility of the deceased being reimbursed. This is because IHTA84/S162 (1) provides that the liability is to be restricted to the extent that reimbursement cannot reasonably be expected.
> If the tax at stake is worthwhile, you should look at the borrower's financial position at the date of death. This may involve valuing the deceased's assets such as unlisted shares or land. If the borrower was an unlisted company you should ask for advice from Shares and Assets Valuation (SAV).
> If the deceased was not the only person to guarantee the debt you will need to take into account the combined resources of the debtor and other creditor to calculate the deceased's liability on death. To do this you will need to consider the financial position of the other guarantor at the time of the deceased's death, as well as that of the borrower. The deceased's liability will be restricted to that part of the debt that cannot be met by the combined resources of the borrower and the other guarantor.
> When the financial position of the other liable people is known you can calculate the allowable deduction (IHTM28355) in the deceased's estate.

> **IHTM28355: calculating the allowable deduction for a guarantee debt** [Sep 2018]
>
> As long as the debt was for consideration (IHTM28353) you should allow a deduction in the deceased's estate for the part of the outstanding loan that cannot be met by the borrower. The basic scenarios are as follows
>
> **Borrower has no resources**
>
> If the borrower has no financial resources the whole of the outstanding liability will be deductible but the guarantee may be a lifetime transfer (IHTM28356).
>
> **Borrower has resources**
>
> If the borrower has enough financial resources to repay the loan in full the debt is not allowable. There is no lifetime transfer.
>
> **Borrower can repay part of the outstanding loan**
>
> If the borrower can only repay part of the loan the deduction is limited to that part of the loan that cannot be met by the borrower and which will have to be met by the deceased. You will need to negotiate the size of the deduction with the taxpayers. The guarantee may be a lifetime transfer (IHTM28356).
>
> The deduction allowed will not necessarily be the same as the amount, if any, ultimately paid out of the estate. This is because the liability is considered as at the date of death for Inheritance Tax purposes.

80.11 Debt not for full consideration

Section 5(5) IHTA provides:

> Except in the case of a liability imposed by law, a liability incurred by a transferor shall be taken into account only to the extent that it was incurred for a consideration in money or money's worth.

80.11.1 *Consideration*

This disallowance does not often apply, because debts are normally incurred for full consideration.[23] In particular, if an individual borrows money, the liability to repay the lender is in principle outside the scope of s.5(5), because the debt is incurred for full consideration.

What about interest accruing on a disallowed debt? Strictly, interest is incurred for full consideration, namely, not repaying the principal sum due, but it may be said that one should look back to the original

[23] For the meaning of "consideration" see App 4.2 (Consideration).

consideration (or lack of it) for the debt of the principal; and it would be safer to adopt the more cautious view.

The IHT Manual provides:

> **IHTM28353 Consideration For A Guarantee Debt** [Sep 2018]
> Before you can allow a deduction you must be sure that consideration was given in money or money's worth, IHTA84/S5 (5).
> This will usually be the case. For example, in the normal commercial situation where a bank will not extend credit to A without a guarantee from B the 'consideration' for the debt will be the granting of credit on the strength of the guarantee. In cases where a company's overdraft is guaranteed by one of the principal shareholders, you should assume that the requirements of IHTA84/S5 (5) are satisfied.
> An example of the sort of situation where there may be no consideration is where a parent agrees to guarantee a child's bank borrowings without the bank itself having given any undertaking in connection with the debt. The fact that the bank has made no undertaking means there has been no consideration. In this case the main purpose of the guarantee is to benefit the child, perhaps simply as an assurance that the parent will meet any debts incurred by the child from the bank. If a guarantee was given without any consideration you should not allow a deduction and you should also consider the possibility that lifetime transfers (IHTM28356) were made.

80.11.2 *Payment of disallowed debt*

If an individual gratuitously covenants to pay money to a person, the liability to pay under that covenant is disallowed. It follows that

(1) There is no transfer of value when the covenant is made.

(2) There is a transfer of value when a payment is made under the covenant.[24]

The payment of a disallowed debt may be a PET. The IHT Manual provides:

> **IHTM28356: lifetime transfers on guarantee debt** [Sep 2018]
> If no consideration was given in exchange for the guarantee (IHTM28353) any payments made by the deceased before the death should be treated as lifetime transfers to the borrower.
> In other cases, where you have allowed a deduction for the deceased's

[24] In this case, s.10 IHTA will not provide relief.

> liability you will need to consider whether the giving of the guarantee was a lifetime transfer. For example, if at the time the deceased gave the guarantee there was little prospect that the borrower would be able to pay the debts then there may be a lifetime transfer approximately equal to the full amount of the liability. If it was likely that at least some of the debt would be repaid then there may still be a transfer of value equivalent to the value of the guarantee less what the borrower could have been expected to repay. In both these cases any lifetime payments by the guarantor are not treated as lifetime transfers.
>
> When considering lifetime transfers you will need to look closely at the circumstances when the agreement was entered into. This usually means that you will need to see details of the borrower's financial position at that time.
>
> You should refer any case involving guarantee debts where you think that a lifetime transfer might be involved to Technical.
>
> **IHTM28357 lifetime transfers on guarantee debts called in and fully paid before death** [June 2016]
>
> Lifetime transfers might have arisen if the deceased entered into an agreement to guarantee a debt within the 7 years before they died and payments under the guarantee were required and made before death.
>
> You should consider the borrower's financial position at the date that the guarantee was given in the same way as on the previous page (IHTM28356) even though there is no outstanding liability at the date of death.
>
> This information will not be shown on form IHT419. In strictness any lifetime transfer should be shown on form IHT403. But in many cases this will only come to light in the course of other enquiries or if other information is received. Although you should be alert to possible omissions, particularly in where unlisted companies are involved, you should not raise any enquiries unless you have evidence to suggest that a lifetime transfer has not been returned.

There is no guidance on the consequences of part payment of a debt which is partly disallowed by s.5(5). We only have the words "to the extent that". I expect that the issue does not often arise. It is considered that the position should be as follows:

(1) In the absence of contrary intent, a part repayment of a partly disallowed debt should be regarded as
    (a) in part in consideration of allowable debt, and so not a transfer of value
    (b) in part in consideration of disallowable debt, and so a transfer of value

in the same proportions as the original principal of the debt.

(2) It should be possible for a debtor to specify whether part repayment should be regarded as relating to allowable or disallowable parts of the debt. This is consistent with the well-established principle that a debtor can in principle specify whether a part repayment of a debt is attributed to outstanding interest or to principal.[25]

80.11.3 *Debt imposed by law*

A debt imposed by law is allowable, even though not incurred for consideration. IHTM28381 [May 2020] gives examples: taxes, fines and penalties.

80.12 Section 103 FA 1986

80.12.1 *Section 103: Introduction*

A debt is in principle deductible even if it is owed to a connected person. But in this case s.103 FA 1986 needs consideration. This applies (in short) where an individual owes a debt to a person to whom they have previously made a gift.

The section was described in *McDougal v IRC* 31 ATC 153 as "intricate and involved in expression". The reader who studies this section will agree! But if one works patiently through it a few times the meaning becomes clearer; contrast the less convoluted but hopelessly vague wording of s.102 (GWR). Thus there has been little litigation on s.103, and a vast amount on s.102.

GAAR guidance describes s.103 as concerned with "self-generated liabilities" but that label is not very apt, and is best avoided as it may cause confusion.

80.12.2 *Section 103 disallowance*

Section 103(1) must be split up into separate parts in order to distil the sense:

> Subject to subsection (2) below, if, in determining the value of a person's estate immediately before his death, account would be taken, apart from this subsection, of a liability consisting of
>
> [i] a debt incurred by him or
>
> [ii] an incumbrance created by a disposition made by him,

[25] See 26.7 (Part payment: interest or principal).

> that liability shall be subject to abatement to an extent ...

Thus, subject to certain defences, s.103(1) disallows the deduction for the debt to a certain extent. The section then goes on to specify the extent of the disallowance:

> ... to an extent proportionate to the value of any of the consideration given for the debt or incumbrance which consisted of—
> (a) property derived from the deceased; or
> (b) consideration (not being property derived from the deceased) given by any person
> [A] who was at any time entitled to, or
> [B] amongst whose resources there was at any time included,
> any property derived from the deceased.

Thus s.103(1) works like this:

(1) One needs to identify the consideration given for the debt.
(2) One asks to what extent the consideration consists of the type of consideration described in s.103(1)(a) and (b).
(3) To that extent, the debt is in principle disallowed. (There are defences; I come to those later.)

80.12.3 *Property derived from deceased*

This expression "property derived from the deceased" is defined in s.103(3):

> In subsections (1) and (2) above "property derived from the deceased" means, subject to subsection (4) below, any property
> [a] which was the subject matter of a disposition made by the deceased,
> [i] either by himself alone
> [ii] or in concert or by arrangement with any other person
> or
> [b] which represented any of the subject matter of such a disposition, whether directly or indirectly, and whether by virtue of one or more intermediate dispositions.

What if an individual owns a company and procures it to make a disposition? There is no disposition made by the deceased, and s.103 does not apply.

The words at s.103(3)[a][ii] cover reciprocal arrangements.

The IHT Manual comments on "property derived from the deceased":

> **IHTM28367 Definition of 'property derived from the deceased' for s.103 FA 1986 purposes** [Sep 2018]
> ... In practice, income from property given absolutely by the deceased is treated as falling outside this definition. But where the deceased settled the property, the definition includes income payable under the disposition.
> You should treat money raised by the sale or mortgage of property derived from the deceased as though it was property derived from the deceased.

As to mortgages, see App.2.9.5 (Borrowing charged on asset).

80.12.4 *s.103(1)(a) disallowance*

One needs first of all to ascertain whether the consideration for the debt was "property derived from the deceased". If so, the debt is disallowed under s.103(1)(a). The debt is wholly disallowed if all the consideration is "property derived from the deceased" or partly disallowed if the consideration is partly "property derived from the deceased".

The IHT Manual gives this simple example:

> **IHTM28365 How s.103 FA 1986 applies when the consideration is 'property derived from the deceased'?** [Aug 2016]
> *Example*
> On 19 March 1987 A gives his brother B £25,000.
> On 25 April 1987 A borrows back £25,000 from B.[26]
> On 7 April 1994 A dies.
> Without the legislation A's estate includes the original £25,000. But if the money was still owed when A died the debt might [?] be claimed as a deduction against his estate. And the PET in 1987 is exempt as more than 7 years have elapsed.
> The legislation disallows the deduction for IHT purposes ...

80.12.5 *s.103(1)(b) disallowance*

Assuming one passes unscathed past the s.103(1)(a) disallowance, the journey takes us to s.103(1)(b). One must identify the person who gave the consideration for the debt. One then asks whether this is a person:

> who was at any time entitled to, or amongst whose resources there was at any time included, any property derived from the deceased.

[26] Author's footnote: It is assumed that this £25,000 is, or represents, the £25,000 given to B.

If so, the debt is disallowed under s.103(1)(b). In principle the debt is wholly disallowed.[27] The IHT Manual gives this simple example:

> **IHTM28366 How s.103 FA 1986 applies when there is 'consideration given by any person whose resources at any time included property derived from the deceased'?** [Sep 2018]
> ... *Example*
> On 19 March 1987 A gives his brother B a parcel of land worth £25,000.
> On 27 April 1987 A borrows £25,000 from B.
> On 7 April 1994 A dies, at which time B retains the land which is non-income producing.[28]

The HMRC analysis is as follows:

> The PET was made more than seven years before the death so that no claim arises on the death.
> As the consideration for the debt is not derived from the deceased s.103(1)(a) FA 1986 would not apply.[29]
> But this arrangement is caught by s.103(1)(b) FA 1986 and the liability is not an allowable deduction for Inheritance Tax purposes.

80.12.6 *s.103(2) exceptions to s.103(1)(b)*

Section 103(2) provides exceptions to the s.103(1)(b) disallowance.[30] This provides:

> If, in a case where the whole or a part of the consideration given for a debt or incumbrance consisted of such consideration as is mentioned in subsection (1)(b) above, it is shown that
> [a] the value of the consideration given, or of that part thereof, as the case may be, exceeded
> [b] that which could have been rendered available by application of all the property derived from the deceased,
> [c] other than such (if any) of that property—
> (a) as is included in the consideration given, or

[27] Unless the consideration for the debt is given by more than one person (very unusual); but see below on defences to the s.103(1)(b) disallowance.

[28] But whether the land is income producing is not directly relevant.

[29] Author's footnote: It is assumed that the £25,000 which B lends to A does not represent the land.

[30] Section 103(2) does not override the s.103(1)(a) disallowance.

> (b) as to which it is shown that the disposition of which it, or the property which it represented, was the subject matter was not made with reference to, or with a view to enabling or facilitating, the giving of the consideration or the recoupment in any manner of the cost thereof,
>
> no abatement shall be made under subsection (1) above in respect of the excess.

It is helpful to consider this as three distinct exceptions.

80.12.7 *s.103(2)[b] exception*

The "s.103(2)[b] exception" is my term for the exception given by the words of s.103(2) down to the end of s.103(2)[b], ie ignoring s.103(2)[c]. The IHT Manual gives a simple example:

> **IHTM28369 Allowing part of a debt under s.103(2) FA 1986** [Aug 2016]
> Even if an arrangement (IHTM28366) is caught by FA86/S103 (1) (b), a deduction may still be allowed for part of the debt. If the value of the consideration given by the [lender][31] exceeded the amount that would have been available if the lender had applied all the property derived from the deceased, then the debt is reduced only to the extent of that lower amount.
> *Example*
> A gives his son B shares worth £20,000.
> B lends A £25,000, out of his separate resources, at a time when the shares were worth £17,000.
> A dies and a deduction of £25,000 is claimed.
> The amount of the deduction is the realisable value at the time the debt was created. So the liability is reduced by £17,000 - leaving £8,000 as a valid deduction.

The s.103(2)[b] exception allows a deduction (overriding the s.103(1)(b) disallowance) to the extent that the debt exceeds the value of the property derived from the deceased. That is obviously fair.

80.12.8 *s.103(2)[c](a) exception*

The next exception is the extension of s.103(2)[b] by s.103(2)[c](a). This prevents double counting with the s.103(1)(a) disallowance. The IHT Manual gives an example:

[31] The IHT Manual erroneously reads: "deceased".

> **IHTM28369 Allowing part of a debt under s.103(2) FA 1986** [Aug 2016]
> ... *Example*
> A gives shares worth £15,000 to B
> 18 months later B sells half the shares back to A for £7,500 – which is not paid but left as a debt repayable on demand.
> B lends A £12,000 entirely from his own resources.
> A dies owing B £19,500 [ie both debts remain outstanding].

The £7,500 debt is disallowed under s.103(1)(a). The reason is that the consideration for the £7,500 debt (the shares) is property derived from the deceased. The Manual correctly makes this point:

> The debt of £7,500 is clearly derived from the earlier gift of shares – and falls within s.103(1)(a) FA 1986. This liability is not deductible.

The Manual then turns to the £12,000 debt:

> If it was not for the provisions of FA86/S103 (2)(a) it would be possible to take that £7,500 into account in considering the debt of £12,000. The result would be that the entire debt of £12,000 would be non-deductible, so the whole of the claimed £19,500 would be disallowed. But because under FA86/S103 (1)(b) half the value of the shares is included in the consideration given for the debt there remains an excess of £4,500. This figure of £4,500 for the allowable debt is arrived at by calculating the resources available to B against the second loan of £12,000 as £7,500, being the original gift of shares less the £7,500 disallowed. So the balance of £4,500 is deductible without restriction because under IHTA84/S103 (2)(a) this amount is the excess consideration.

80.12.9 *s.103(2)[c](b) exception*

The next exception is the extension of s.103(2)[b] by sub-para [c](b). The Manual does not give an example of a case within s.103(2)[c](b); though this is perhaps the most important of the three. The result in the s.103(1)(b) examples in the IHT Manual would be different if the gift from A to B was not made (in short) with a view to enabling B to lend to A.

80.12.10 *s.103(4) exception*

Section 103(4) provides an important exception to the s.103(1)(a) and (b) disallowances:

> If
> [a] the disposition first-mentioned in subsection (3) above[32] was not a transfer of value and
> [b] it is shown that the disposition was not part of associated operations which included—
> (a) a disposition
> [i] by the deceased, either alone or in concert or by arrangement with any other person,
> [ii] otherwise than for full consideration in money or money's worth paid to the deceased for his own use or benefit; or
> (b) a disposition by any other person operating to reduce the value of the property of the deceased,
>
> that first-mentioned disposition shall be left out of account for the purposes of subsections (1) to (3) above.

Associated operation has its IHT meaning[33] as s.103 is to be construed as one with the IHTA.

Suppose:

(1) S (not UK domiciled) transfers excluded property (ie non-UK situate property) to a trust.
(2) S borrows from the trustees and invests or spends the sum borrowed.

At first sight, the debt is disallowed as the consideration is property derived from the deceased, S. However, the s.103(4) exception applies. The disposition to the trust is disregarded, because it is the disposition first-mentioned in s.103(3)[a] and:

[a] the disposition is not a transfer of value;
[b] the disposition is a simple gift. It is not part of associated operations within s.103(4)[b](a) or (b).

Using the sum borrowed is an associated operation and it may be said that the disposition to the trust is "part of associated operations". But the requirement of s.103(3)[b] is still met:

> [b] ... the disposition was not part of associated operations which included—
> (a) *a disposition*
> [i] by the deceased, either alone or in concert or by

[32] That is, the disposition made by the deceased. See 80.12.4 (s.103(1)(a) disallowance).

[33] See 74.11 ("Associated operation").

> arrangement with any other person,
> [ii] otherwise than for full consideration in money or money's worth paid to the deceased for his own use or benefit; or
> (b) a disposition by any other person operating to reduce the value of the property of the deceased,

The trust disposition is not for full consideration. But the disposition mentioned in the third line must be a *different* disposition from the trust disposition.

Thus a debt to an excluded property trust is not in principle disallowed under s.103. It may be said that the intention of section 103 FA 1986 is to prevent self-generated debts from being deductible for inheritance tax purposes, so a purposive construction should be applied. But s.103(4) can be explained as a rational policy-based exemption for foreign domiciliaries, so it should be given its natural meaning.

The same applies if the gift is to a trust where the settlor has a estate IIP (eg a gift to a pre-2006 IIP trust) because such a gift is not a transfer of value.

Suppose an arrangement under which:

(1) Trustees lend to the settlor, S.
(2) S gives the borrowed money to another person.

The debt is disallowed. The s.103(4) exception does not apply. Condition [a] is satisfied but condition [b] is not, because the gift at stage (2) is an associated operation otherwise than for full consideration.

80.12.11 *Payment of debt: deemed PET*

In the absence of any provision, repayment of a disallowed debt would not be a transfer of value.[34] Section 103(5) FA 1986 deals with this:

> If, before a person's death but on or after 18 March 1986, money or money's worth, is paid or applied by him—
> (a) in or towards the satisfaction or discharge of a debt or incumbrance in the case of which subsection (1) above would have effect on his death if the debt or incumbrance had not been satisfied or discharged, or
> (b) in reduction of a debt or incumbrance in the case of which that subsection has effect on his death,

[34] Because s.103 only disallows the debt on death; s.10 IHTA may also provide relief, but it is not necessary to rely on that.

> the [IHTA] shall have effect as if, at the time of the payment or application, the person concerned had made a transfer of value equal to the money or money's worth and that transfer were a potentially exempt transfer.

I refer to this as a "**s.103(5) deemed PET**".

There is no express provision for a foreign domiciliary. Taken literally, there would be a deemed PET where, say, an individual domiciled in Australia:

(1) made a gift to a child
(2) later borrowed from the child
(3) later repaid the debt

The debt could fall within s.103(5) as the debt is one "in the case of which s.103(1) would have effect on his death if the debt had not been satisfied."[35]

However, the principle of territorial limitation requires that some exemption is implied. The best solution is that the deemed PET should be regarded as not only "equal to the money or money's worth" but made out of the money or money's worth. Thus no tax charge arises if:

(1) The individual is not UK domiciled at the time they discharge the debt, and
(2) The debt is discharged out of excluded property.

This would be broadly consistent with the comparable GWR provision.[36]

80.12.12 *Assignment of debt*

Suppose:

(1) A borrows from a bank ("A's debt").
(2) B purchases the benefit of the debt from the bank for its market value.

It is suggested that the purchase price paid by B to the bank is "consideration given for the debt". So A's debt is disallowed if the purchase price which B pays to the bank is property derived from A. Otherwise the section is easy to avoid.

[35] From 2013, the debt might be disallowed under the excluded property disallowance, in which case there would be no s.103(5) deemed PET; but that is not necessarily the case.

[36] See 78.17 (GWR lifetime charge).

Conversely if A's debt is disallowed because it is made in consideration of property derived from A, it continues to be disallowed even if the debt is sold to a third party. In other words, "consideration for the debt" means the consideration for the creation of the debt but also includes consideration for the assignment of the debt.

80.12.13 *1986 transitional rules*

For completeness: s.103(6) FA 1986 provides:

> Any reference in this section to a debt incurred is a reference to a debt incurred on or after 18 March 1986 and any reference to an incumbrance created by a disposition is a reference to an incumbrance created by a disposition made on or after that date …

This will rarely if ever now apply. But it illustrates how attitudes to retrospective effect in commencement provisions have changed since 1986.[37]

80.13 Debt owed by individual to trust

80.13.1 *Non-settlor life tenant debt to estate IIP trust*

Suppose the life tenant (not the settlor) owes a debt to trustees of an estate IIP trust (as happens when a pre-2006 IIP trust lends money to the life tenant). At first sight, the position seems to be:

(1) The life tenant has a deduction for the burden of the debt on their death.

(2) The benefit of the debt is an asset of the trust fund, and therefore part of the estate of the life tenant.

These two factors, the deduction and the asset, normally cancel each other out and the position ends up at neutral.

There is however one exceptional case. If the benefit of the debt is excluded property (in short, foreign domiciled settlor and debt not UK situate) then at first sight the result is a mismatch which benefits the taxpayer:

(1) a deduction for the burden of the debt in the estate of the life tenant; and

(2) no IHT on the benefit of the debt, being excluded property.

[37] See 2.9 (Retrospective tax legislation).

Robert Venables KC takes the view that there is no deduction for the debt. He cites Lord Asquith's well-known comment on deeming provisions[38] and continues:

> If one applies Lord Asquith's dictum, what is deemed to happen when the settlor[39] in fact borrows money from the trustees? As he is deemed to own the money before it is borrowed [s.49 IHTA], he cannot borrow it from himself. The transfer of the money to himself is a non-event for inheritance tax purposes. His estate is subject to no debt, as a man cannot owe a debt to himself. The question of any such debt being treated as non-deductible in computing the value of his estate for inheritance tax purposes therefore does not arise. Conversely, however, the settled property does not include the right to sue the settlor for the money borrowed, as a man cannot have a right against himself.[40]

I agree. The effect of s.49(1) IHTA is therefore to disallow the deduction for the debt.

A practical solution may be to arrange that the debt is not due to the trustees, but to a company owned by the trustees. Alternatively, perhaps, arrange that the debtor beneficiary ceases to be life tenant.

80.13.2 *Settlor life tenant debt to estate IIP trust*

Suppose a settlor life tenant owes a debt to trustees of an estate IIP trust (as happens when a pre-2006 IIP trust lends money to the settlor life tenant). At first sight, the general position seems to be:

(1) The settlor can claim a deduction for the burden of the debt on their death.

(2) The benefit of the debt is an asset of the trust fund, and therefore part of the estate of the life tenant.

These two factors, the deduction and the asset, normally cancel each other out and the position ends up at neutral. There are however two special cases.

If the benefit of the debt is excluded property, at first glance the result is a mismatch which favours the settlor (deduction for the burden of the debt,

[38] See App 8.2 (Deeming provisions: Construction).

[39] Venables is considering the position of a settlor life tenant, but the same applies to a non-settlor life tenant.

[40] Venables, "An IHT Trap for Settlors of Non-UK Resident Trusts", OTPR, vol 4, issue 3, p.165 *http://www.khpplc.co.uk/reviews*

no charge on the benefit of the debt).[41]

If the deduction for the debt is disallowed (eg under s.103[42]) the result is a mismatch which favours HMRC (no deduction for the burden of the debt, but a charge on the benefit of the debt, unless it is excluded property).

However on the view set out in para 80.13.1 (Debt owed by non-settlor life tenant to trust), the burden of the debt and the asset of the trust cancel each other out and both are ignored for IHT purposes. This is a sensible result, which fits the purpose of the legislation. In practice HMRC appear to accept this.

80.13.3 *Settlor debt to settlor-interested discretionary trust*

Suppose:

(1) The settlor ("S") owes a debt to trustees of a discretionary trust (as happens when a discretionary trust lends money to the settlor).

(2) The trust is within the scope of the GWR rules.

At first sight, the position seems to be:

(1) The settlor can claim a deduction for the burden of the debt on their death.

(2) The benefit of the debt is an asset of the trust fund, and therefore part of the estate of the settlor under the GWR rules.

These two factors, the deduction and the asset, normally cancel each other out and the position ends up at neutral.

There is however one exceptional case. Where the benefit of the debt is excluded property (in short, foreign domiciled settlor and debt not UK situate) then at first sight the result is a mismatch which benefits the taxpayer:

(1) a deduction for the burden of the debt in the estate of the settlor;[43] and

(2) no IHT on the benefit of the debt, being excluded property.

It is considered that the debt is disallowed under s.102(3) FA 1986. Under this section the benefit of the debt is treated as property to which the settlor was beneficially entitled on their death. The analysis is therefore

[41] This might happen if the settlor was not UK domiciled, but needed the deduction for the debt as their property was UK situate.

[42] But this would not often apply to excluded property trusts or to trusts where the settlor has an initial estate IIP: see 80.12.10 (Section 103(4) exception).

[43] Since s.103 does not usually apply: see 80.12.10 (Section 103(4) exception).

the same as where the settlor is a life tenant, see above. This is so whether the GWR debt is UK situate or foreign situate.[44]

80.14 Debts to and from trusts

Do not confuse two situations:

(1) Where an individual owes money to trustees (eg the trustees have lent money to the individual). Here:
   (a) The individual may be entitled to an IHT deduction for the burden of the debt in their estate.
   (b) The trustees have an asset, the benefit of the debt (which may or may not be excluded property).

(2) The reverse, where trustees owe money to another person (eg an individual has lent to the trustees). Here:
   (a) The individual owns an asset in their estate, the benefit of the debt (which may or may not be excluded property).
   (b) The trustees or life tenant may be entitled to an IHT deduction for the burden of the debt on the trust property.

The issue of deduction for debts of trustees raises entirely different questions to which we now turn.

80.15 Deduction for trust debt

The position for a trust debt[45] which is an incumbrance on a specific trust asset is straightforward: under the net-value approach, the asset is valued for IHT purposes at the net value (less the incumbrance)[46]; that rule applies for the Inheritance Taxation of trusts as for individuals.

It is clear that unsecured trust debts are also in principle deductible for IHT purposes, although there is no provision which states this expressly.[47] This apparent gap has caused some confusion.

Let us consider first the position where the trustees have borrowed funds and an estate interest in possession terminates during the lifetime of the life tenant. There is a transfer of value and the value transferred is:

[44] As to whether the GWR debt is subject to IHT under the GWR rules, see 78.13 (GWR over debt owed by the deceased).

[45] Strictly one should refer to a trustee debt rather than a trust debt, but in practice the two terms may be used synonymously.

[46] See 80.3.1 (Incumbrance-debt).

[47] In particular, s.5(3) IHTA does not apply here as trustees do not have an estate. See 80.3.2 (Unsecured debt).

> equal to the value of the property *in which his interest subsisted*.[48]

What is "the property in which the interest subsists"? In my view it is not the settled property; it is the property subject to the trustee lien.[49] For the trustee lien takes priority over the interest of the life tenant. The trustee lien is a lien over both income and capital of the trust fund. The value of property is its market value. Market value of property subject to a lien will be the net value, the value after deducting the value of the lien. In this valuation exercise we are not strictly claiming a "deduction" for the lien. We are simply ascertaining what property will fetch in the open market.

For the same reason, trust debts are deductible when an estate IIP terminates on the death of the life tenant and in computing 10-year and exit charges.[50]

This is the correct reason why unsecured trust debts are deductible.[51]

Some provisions which disallow debts of individuals do not apply to trust debts. Section 103(1) FA 1986 provides:

> ... if, in determining the value of a person's estate immediately before his death, account would be taken, apart from this subsection, of a liability consisting of a debt *incurred by him* or an incumbrance created by a disposition *made by him*, that liability shall be subject to abatement.

This does not apply to debts of trustees as we are not concerned with a debt or disposition made by the individual.

Section 5(5) IHTA provides:

[48] Section 52(1) IHTA, emphasis added. See 76.10 (Termination of estate IIP).

[49] Where a trustee has incurred a liability as trustee, they may in principle reimburse themselves out of the trust fund. For this purpose the trustee has a lien over the trust fund. One exception is where the trustee has committed a breach of trust. In the discussion here, it is assumed that is not the case.

[50] Section 65(5) IHTA assumes debts are deductible for the IHT exit charge, though it is not necessary to rely on this.

[51] In *Green v IRC* [2005] EWHC 14 (Ch) at [12] the judge took a short cut to reach the same destination:

> "... s.49 IHTA [deems] the deceased to be beneficially entitled to 'the property' in which his life interest subsists. It does not say 'net property' (i.e. the value of the property net of trust liabilities) but that is what it must mean, and the parties to this appeal both agree that in practice that is the effect the Revenue gives to the section."

The point is discussed in detail in the 3rd ed of this book para 27.9, but it is not necessary to set this out now that *Green* has confirmed the principle that trust debts are deductible for IHT.

On HMRC practice see for instance IHT Manual 10541 [Jun 2014] (deductions).

> Except in the case of a liability imposed by law, a liability incurred by a transferor shall be taken into account only to the extent that it was incurred for a consideration in money or money's worth.

This does not apply to trustees because they are not the transferor.

However the disallowance in s.162A IHTA (liability attributable to financing excluded property) can apply to trustees.

80.15.1 *Debt set against what property*

It matters in various cases whether a deduction for a trust debt is set against one item of trust property or another.[52] In particular, it matters where a trust with a foreign domiciled settlor has UK and excluded property.

The principles are as follows:

(1) If the debt is an incumbrance on specific trust property, the deduction is set against that property. This follows from the net-value approach and is confirmed by s.162(4) IHTA.[53]

(2) If the debt is not an incumbrance on specific trust property, it is under general trust law principles an incumbrance on the trust fund as a whole and deducted from the trust assets *pro rata*. The place of payment and residence of creditor are not relevant, and s.162(5) IHTA does not apply.

80.15.2 *Debt of life tenant not set against trust fund*

The IHT Manual provides:

> **IHTM28397 Liabilities: dealing with deficits** [June 2016]
> We take the view that a liability at any title may only be deducted against the assets at that title. This means that if there is an overall deficit on the free estate you cannot set this against the value of settled property. This is derived from the judgements of Lawrence J and the Court of Appeal in *Re Barnes (deceased)* [1938] 2 KB 684 in the first instance and [1939] 1 KB 316 CA. It is considered that these decisions, based on the relevant estate duty provisions in the 1894 Finance Act apply equally to the corresponding provisions in the Inheritance Tax legislation. But a contrary view is possible in view of IHTA84/S5(1) and IHTA84/S49(1). If the official view is contested and the tax

[52] See 80.5.1 (Why allocation matters).

[53] If under the terms of the trust a debt is payable out of certain property it is for this purpose a incumbrance on that property.

> involved is substantial you should refer the matter to Technical. **(This content has been withheld because of exemptions in the Freedom of Information Act 2000)**[54]

It is in fact clear that a personal debt of the life tenant cannot be set against property in which the life tenant has an estate interest in possession.[55]

80.16 Estate IIP trust debt to life tenant

Suppose trustees of an estate IIP trust owe a debt to the life tenant (as happens when a life tenant lends to a pre-2006 IIP trust). At first sight, the position seems to be:

(1) The trust can claim a deduction for the burden of the debt on the death.
(2) The benefit of the debt is part of the estate of the life tenant.

These two factors, the deduction and the asset, normally cancel each other out and the position ends up at neutral.

There is however one exceptional case. Where the benefit of the debt is excluded property (ie foreign domiciled life tenant and the debt not UK situate) then at first sight the result is a mismatch which benefits the taxpayer:

(1) a deduction for the burden of the debt in the trust;[56] and
(2) no IHT on the benefit of the debt, being excluded property.

[54] For completeness: The Manual continues:

> You should treat a deficit on joint survivorship property in a similar way. The deficit cannot be set against the assets at another title. But a deficit on joint property that passes under the Will can be set against free estate assets.
>
> You may generally allow a deficit in the deceased's estate that does not qualify for the instalment option to be set against the property that qualifies for the instalment option. If the value of the instalment option assets is insufficient to cover the liabilities, then the balance can be carried forward and set against any foreign property that the deceased owns. You may also allow any excess liabilities on the instalment option property against the non-instalment option property with any balance being carried forward against any foreign property, if any.

I am unable what point is being made here. Possibly the text would make sense if read together with the preceding passage which was omitted because of supposed exemptions in the FOIA 2000 (it is also difficult to understand what the FOA point may be, but there it is).

[55] *Green v IRC* [2005] EWHC 14 (Ch).

[56] Of course in most cases the trust property is excluded property so there is no need for the deduction, but that is not necessarily the case: the trust may hold UK property.

It is considered that s.49 IHTA does not disallow the debt.

80.17 Deduction for foreign taxes

80.17.1 *IHT on death*

Foreign inheritance taxes and similar taxes may be available as a credit to set against IHT: see 120.1 (Credit for Foreign IHT). Such taxes are not deductible for IHT purposes on general principles as they arise on the death and IHT is charged immediately before the death.

80.17.2 *Lifetime taxes*

Unpaid foreign taxes, and penalties, which accrue during a person's lifetime are in principle deductible. They are liabilities imposed by law. The IHT Manual provides:

> **IHTM28100 Overseas taxes** [Sep 2018]
> Special rules (IHTM27181) apply to overseas taxes that are similar in nature to Inheritance Tax (IHT). These may in some cases be set against the IHT liability.
> For other types of overseas taxes the general rule is that they can normally only be deducted from the value of property in the country that imposes the tax. This is because the taxes are unenforceable in other countries, *Government of India v Taylor* [1955] AC 491.
> There are three exceptions to this rule:
> - tax debts in the Republic of Ireland (IHTM28101)
> - Canadian income tax on a deemed disposal on death (IHTM28102)
> - foreign tax on shares situated in the UK (IHTM27201).

The proposition that foreign taxes are unenforceable in other countries now needs to be qualified. Enforceability of foreign taxes is a large topic, and may need investigation in the circumstances of the case; but under international treaties, foreign taxes are generally enforceable in other countries, and there may be other methods of enforcement (eg arrest of the executors if they enter the jurisdiction concerned.)

So far as foreign taxes are unenforceable and unpaid it seems right in principle that there should be no deduction and a court would be expected to reach that conclusion even in the absence of express provision to that effect.[57]

It is difficult to see why the deduction should be against property in the

[57] See too 80.36 (Debt unpaid after death).

country concerned: it should be against non UK property generally, under s.162(5) IHTA, unless the foreign tax legislation imposes an incumbrance (which does not seem likely).

80.17.3 *Irish tax*

The IHT Manual provides:

> **IHTM28101 Deduction for tax debts in the Republic of Ireland** [Sep 2018]
> If the deceased died owing tax in the Republic of Ireland, you should allow a deduction against the free estate for any tax that has actually been paid to the Irish authorities provided the deceased
> - was domiciled in the United Kingdom, and
> - had no assets in the Republic of Ireland.
>
> Where, in these circumstances, the deceased also has assets in a third country, you should apportion the tax debts.
> If a deduction is claimed for any 'Probate Tax' paid in the Republic of Ireland, you must refer the matter to Technical for advice. This tax, which is paid by the executors or administrators of an estate, is not covered by our Double Taxation Convention with the Republic of Ireland.

80.17.4 *Canadian income tax*

The IHT Manual explains the Canadian tax background:

> **IHTM28102. Canadian income tax** [Jul 2016]
> Under Canadian law, the estate of an individual is deemed to have been disposed of immediately before their death. Income tax is charged on any resulting gains. If, under the (Income Tax) Double Taxation Agreement the deceased was resident in Canada, the charge applies to all property wherever it is situated. But if the deceased was resident in the UK the charge applies only to immovable property in Canadia and to certain business property.

There was a similar charge to CGT in the UK between 1965 and 1971. The UK abolished the CGT charge on death; Canada abolished its estate duty instead, a wiser decision.[58] The Manual continues:

> In a press release dated 1 August 1978, the Board announced that, by concession
> - IHTA84/S5 (3) will be treated as applying to income tax in Canada

[58] See 88.5.6 (Rebasing on death: Critique).

> imposed on a deemed disposal immediately before death even though the liability may not in strictness have arisen until the person had died
>
> - where Inheritance Tax (IHT) is chargeable on a person's world-wide estate, and income tax in Canada is charged on deemed gains which are attributable to property forming part of that estate, the Canadian tax will be allowed as a deduction in arriving at the value of the estate for IHT purposes, and
> - Canadian tax will normally be treated as reducing the value of property situated outside the UK whether that property is liable to IHT or not. But if the Canadian tax is more than the value of that property the excess will be set off against the value of the UK property.
>
> Any case in which IHT is not chargeable on the deceased's world-wide estate (for example, because the deceased was not domiciled in the UK) but a deduction is claimed for Canadian income tax on a deemed disposal immediately before death should be referred to Technical.

The matter was formerly covered by ESC F18, but HMRC withdrew that as they decided that the practice was correct as a matter of law, not concession.[59]

80.17.5 *Foreign tax on UK shares*

The IHT Manual provides:

> **IHTM27201. Procedure for relief by concession on shares** [Jul 2016]
> Occasionally shares in a company situated in some part of the UK by UK law, are also treated as liable to tax in a foreign country on the grounds, for example, that the company carries on business there. In this circumstance, by concession, the amount of foreign tax is allowed as a deduction against the value of the shares. This concession operates whether the company is incorporated in the UK or elsewhere.
>
> The concession applies in the same way where the obligation to pay foreign tax on death falls upon the company and the company has the right to be reimbursed by the personal representatives of the deceased shareholder before it registers a transfer of the shares.
>
> The concession does not apply to cases covered by the statutory reliefs provided for by s.158 IHTA 1984 and s.159 IHTA 1984. Nor does it apply to shares that become liable to the foreign tax by reason of the

[59] HMRC, "Withdrawal of extra statutory concessions: Technical note and call for evidence" (January 2014).

> operation of a double taxation convention to which the UK is not a party.

I would have thought in this situation s.158 or 159 relief would normally apply, and in other cases relief would be available by law and not by concession. I would be interested if any reader can identify the foreign taxes to which this paragraph is applicable.

80.18 Excluded property disallowance

Section 162A(1) IHTA provides:

> To the extent that a liability is attributable to financing (directly or indirectly)—
> (a) the acquisition of any excluded property, or
> (b) the maintenance, or an enhancement, of the value of any such property,
> it may only be taken into account so far as permitted by subsections (2) to (4).

I refer to this as the "**excluded property disallowance**".

The disallowance applies to individuals and trustees, on death and on other occasions of charge.

80.18.1 *Commencement: Pre-2013 debt*

Para 5(1) sch 36 FA 2013 provides:

> Subject to sub-paragraph (2),[60] the amendments made by this Schedule have effect in relation to transfers of value made, or treated as made, on or after the day on which this Act is passed [17th July 2013].

So the excluded property disallowance applies to pre-2013 debts, if the transfer of value is after enactment. This was an unfair commencement rule as in many cases, including those without tax avoidance, existing liabilities will have been incurred in reliance of the pre-2013 rules. The norm requiring commencement rules to avoid retrospective effect has weakened.[61] But there it is.

80.19 "Financing" an acquisition

What is meant by the expression "financing" an acquisition of excluded

[60] This relates to the business/agricultural property disallowance: see 80.30.2 (BPR/APR disallowance: Commencement).

[61] Contrast 80.12.13; and see 2.8.2 (Retrospective legislation: Extent).

property? It is considered that it should be widely construed.

Suppose T enters into a contract to purchase excluded property and the purchase price remains outstanding on completion. The debt is attributable to financing the acquisition of the excluded property.

What about borrowing to pay incidental costs of acquiring excluded property, such as foreign stamp duty or agents commission? It is suggested that this is not disallowed.

If a person borrows to pay for services, the debt is not disallowed (unless the services relate to maintenance/improvement of excluded property).

Suppose:

(1) T borrows to acquire excluded property ("debt 1").
(2) T borrows to pay interest on debt 1 ("debt 2").

It is considered that debt 2 is not incurred in financing the acquisition, and so is not disallowed.

More commonly, the interest will be added to the acquisition debt, ie there will be one single debt; it is arguable that the debt is disallowed to the extent it reflects the acquisition cost, but not to the extent it reflects interest. However the drafter seems to have assumed that an increase in the debt due to interest is in principle caught.[62]

80.20 Maintenance/enhancement of value

The IHT Manual provides:

> **IHTM28012 meaning of 'maintain' and 'enhance'** [Sep 2018]
> The words 'maintain' and 'enhance' extend the scope of the provisions beyond simply buying either excluded property (IHTM28014) or assets that qualify for relief (IHTM28019).
> Both words have their normal meaning. 'Maintain' means to keep in good or proper order, and 'enhance' means to improve or augment. These words are most likely to apply in connection with borrowing money to maintain or enhance buildings.
> Where a person borrows money instead of using their own money to acquire assets, it could be said that they have 'maintained' the value of their other assets. So if they were not domiciled in the UK and held most of their assets abroad, borrowing against UK assets could be said to be 'maintaining' the value of excluded property. Individuals are free to choose how to use and invest their assets and whether to borrow

[62] See 80.25.5 (Disallowable reason 2: increase in liability).

> money. So you should not normally disallow the deduction of a liability in these circumstances.
>
> But, any case where the borrowing against UK assets appears to be part of arrangements that are primarily designed to avoid these provisions and obtain a tax advantage should be referred to Technical.

80.21 "Indirectly" financing

The IHT Manual provides:

> **IHTM28013 meaning of "indirectly"** [Dec 2021]
>
> The word 'indirectly' at s.162A(1) IHTA84, s.162B(1)(b), (3)(b) & (5)(c) IHTA84 significantly broadens the scope of the provisions. It reduces the possibility of avoiding the restrictions by inserting a step or steps in the process of acquiring excluded or relievable property with the borrowed funds.
>
> As with the pre-owned assets charge (IHTM44005),[63] it is not necessary to show any intention that the funds should eventually be converted into excluded or relievable property when a loan was taken out. Inserting steps in an attempt to disguise the true nature of a transaction will be a strong indicator of indirect financing. And the acquisition of assets of any nature as part of a sequence of transactions that ends with the acquisition of excluded or relievable property will not necessarily be sufficient to prevent the deduction being disallowed.

"Not necessarily" is not exactly guidance. HMRC go on to cite a case:

> In *IRC v Stype Investments (Jersey) Ltd*[64] Vinelott J observed that the word 'indirectly' was used to make it clear that the (Inland Revenue) charge extended not only to the proceeds of sale of property subject to the charge and to property purchased with those proceeds (which may be said to represent that property 'directly') but also to any property into which the property subject to the charge or the proceeds of sale can be traced. Whilst this view may (?) have been expressed in connection with

[63] This relates to different wording: "the chargeable person has directly or indirectly provided ... any of the consideration given by another person for the acquisition of ... an interest in the relevant land"; see 83.6 ("Provide"). That does not shed much light on the issue discussed here.

[64] For the *Stype* case, see App 2.9.6 (Do co shares represent co assets). But I do not think that a comment on the meaning of "directly or indirectly representing" in the context of the Inland Revenue charge sheds much light on the meaning of "indirectly financing" in the present context; "directly or indirectly" is a phrase which is very context dependent.

> an administrative process, it shows the potentially broad scope of the word. There is no number of steps or a timescale beyond which borrowing money can be regarded as safe from being attributed to the acquisition of excluded or relievable property. And there is no statutory let-out where the taxpayer can show that at the time the loan was taken out; there was no intention to convert the borrowed funds into excluded or relievable property. But although the word 'indirectly' has a broad meaning, in the context of this provision, it must be possible to reasonably attribute the acquisition of the excluded or relievable property to the borrowed funds before the deduction of the loan is disallowed. Each case will turn on its own facts. You can find some examples of situations where property is acquired indirectly at IHTM28025.

This is an important question. Suppose:

(1) T borrows to acquire an asset ("asset 1").

(2) T sells asset 1 and uses the proceeds to acquire another asset ("asset 2").

Is it the case that the debt is "attributable to financing indirectly the acquisition of asset 2? That is the case if the steps formed part of an arrangement, but perhaps not otherwise.[65]

80.21.1 *Borrowed money in mixed account*

HMRC's first set of examples concern borrowed money mixed in an account with other money:

> **IHTM28025 examples where money has been borrowed to 'indirectly' acquire excluded or relievable property** [Sep 2018]
> *Example 1* (Marianne)
> M, who is domiciled outside the UK, owns a property in the UK.
> She borrows some money which she charges against her property and puts the money in her UK bank account.
> Some time later, she use some of the money in the account to buy some UK listed shares and some foreign shares.
> On her death, the liability is still charged against her property. The extent to which the liability may be disallowed will depend on the facts.

This particular scenario seems far-fetched, as one normally draws down a loan facility when the funds are needed, not before. But mixed fund

[65] In the IHT residential-property code, there is a provision to deal with this case: see 82.8.6 (Finance indirectly).

issues will arise in various circumstances.

HMRC consider three permutations of facts.

> [*Example 1(a)*]
> If
> [1] M had borrowed £100,000 and added that to her UK account which already contained £50,000 (that had not been borrowed) and
> [2] had then used that money to buy £75,000 worth of UK shares and £75,000 worth of foreign shares,
> it might be reasonable to say that one half of the liability was attributable to acquiring excluded property and disallow £50,000.

The author of the passage seems unsure. "It might be reasonable" is not guidance.

In my view one should apply the rule in *Clayton's case*: M has power to chose, and in the absence of an express choice, first in first out.[66] If the UK shares were purchased first, then (1) the UK shares were purchased with the UK money and £25k borrowed money; (2) the foreign shares were purchased with £75k borrowed money and £75k borrowing is disallowed. If the foreign shares were purchased first, then vice versa, and £25k is disallowed. If the shares were purchased at the same time, then as HMRC suggest, half the liability is disallowed.

The moral is that M should not mix borrowed money and other money. She should:

(1) use her existing £50k to purchase foreign shares, and
(2) borrowed £100k to purchase £75k UK shares and £25k foreign shares.

Then only £25k would be disallowed. But of course before 2013, M could not have known that.

In the next example the bank account holds (more or less) only the borrowed money:

> [*Example 1(b)*]
> Had the account contained very little other money and £100,000 of foreign shares had been acquired, the whole liability should be disallowed.

That seems straightforward.

The next example is similar to example 1a, but the HMRC analysis is unknown:

[66] See App. 2.10 (Withdrawal from mixed fund).

> [*Example 1(c)*]
> On the other hand, had the account contained, say, £400,000 and £100,000 of foreign shares had been acquired the position will depend on circumstances. You should obtain details of the amount in the account before the borrowed funds were added and details of how the funds in the account were used afterwards.
> Where the funds were borrowed specifically to acquire the excluded property, then they should be treated as being used wholly for that purpose and the liability disallowed. But if the facts indicate that the funds in the account were mixed, it might be more appropriate to apportion the amounts used to purchase the excluded property. If the position is unclear, or if the taxpayer or agent disagrees with your apportionment of the liability, refer the case to Technical.

This is not exactly "guidance".

80.21.2 *Tracing borrowed money through purchases and sales*

It is convenient to coin some terminology. In the following discussion:
"**A debt-financed asset**" is one purchased out of borrowed funds.
"**A partly debt-financed asset**" is one purchased partly out of borrowed funds and partly out of other funds.
"**Chargeable property**" is property which is not excluded property within the IHT definition.

The IHT Manual provides:

> **IHTM28025 examples where money has been borrowed to 'indirectly' acquire excluded or relievable property** [Sep 2018]
> ... *Example 3*
> The trustees[67] of an excluded property trust borrow £1m which is charged against existing UK property worth £1.5m (property 1).
> They use the borrowed funds to purchase a second UK property for £1m (property 2).
> At this point, if the liability were to be taken into account in arriving at the value subject to tax, the £1m liability would be allowed as a deduction because the money has been used to acquire UK property. IHTA84/S162A does not apply, so the chargeable value would be £1.5m (£2.5m chargeable UK assets less £1m allowable liability).

[67] This set of examples concern trustees whereas the first set concerned an individual. Do HMRC intend to suggest that there is a difference between trustees and individuals? Trustees are more likely to keep good accounts and a trust has more of a unity of purpose.

> Property 2 is later sold for £1m and all the proceeds are transferred offshore to become excluded property.

This is therefore a case where:
(1) A debt-financed asset is chargeable property.
(2) The chargeable property is sold.
(3) Excluded property is purchased with the proceeds.

The HMRC analysis is as follows:

> The liability would now be disallowed by IHTA84/S162A. This is because the liability has been incurred to indirectly acquire excluded property - the funds now held offshore. The chargeable value is still £1.5m (£1.5m of UK assets and no deduction for the liability).

In the next example:
(1) A debt-financed asset is chargeable property.
(2) The chargeable property is sold.
(3) Excluded property is purchased with part of the proceeds.

> *Example 4*
> The trustees of an excluded property trust borrow £1m which is charged against existing UK property worth £1.5m (property 1).
> They use the borrowed funds to purchase a second UK property for £1m (property 2).
> Property 2 is later sold for £1m,

So far the facts are the same as example 3, but the proceeds of sale are used in a different manner.

> £400,000 of which is used to acquire UK listed shares and the £600,000 to acquire foreign shares.

The HMRC analysis is as follows:

> £600,000 of the liability is disallowed by IHTA84/S162A(1) having been used to acquire indirectly the foreign shares which are excluded property, with the result that only £400,000 of the liability is allowed as a deduction.
> The value of the UK assets is £1.9m (£1.5m, plus the additional £400,000 in shares) from which can be deducted the allowable part of the liability of £400,000, leaving £1.5m chargeable.

In the next example:
(1) A *partly* debt-financed asset is chargeable property.
(2) The chargeable property is sold

(3) All the proceeds are used to purchase excluded property.

> *Example 5*
> The trustees of an excluded property trust own £1.5m of UK listed shares.
> They borrow £1m and use a further £600,000 from sale of some of the shares to purchase a UK property for £1.6m.
> The property is subsequently sold for £2.5m and all the sale proceeds are invested in foreign shares.
> The whole of the £1m liability has been used indirectly to acquire excluded property, so it is disallowed by IHTA84/S162A(1).
> The chargeable value is £900,000 (the original £1.5m less the £600,000 worth of the shares used to purchase the property).

In the next example:

(1) A partly debt-financed asset is chargeable property.
(2) The chargeable property is sold.
(3) Part of the proceeds are used to purchase excluded property.

> *Example 6*
> The trustees of an excluded property trust own £1.5m of UK quoted shares.
> They borrow £1m and use a further £600,000 from sale of some of the shares to purchase a UK property for £1.6m.
> The property is subsequently sold for £2.5m.

So far the facts are as in example 5.

> This time £750,000 of the sale proceeds are used to reinvest in UK quoted shares and £1.75m is used to acquire foreign shares.
> IHTA84/S162A(1) disallows the liability to the extent that it has been used indirectly to acquire excluded property.
> Part of the £1.75m of excluded property has been acquired indirectly from the £1m borrowed at the outset; this part is established as follows.
> The £1m borrowed made up 62.5% of the purchase price of the £1.6m UK property purchased by the trustees.
> When this property was sold, 70% of the sale proceeds (£1.75m out of £2.5m) were used to acquire the foreign shares. Of the original £1m borrowed therefore, £437,500 (£1m × 70% × 62.5%) is attributable indirectly to financing the acquisition of excluded property.
> Only the remaining £562,500 of the liability can be taken into account.
> The value of the UK assets is £1.65m (the original £1.5m less £600,000 used to buy the property plus the additional £750,000 reinvested in UK shares) from which can be deducted the allowable part of the liability of

£562,500, leaving £1,087,500 chargeable.

80.21.3 *Borrowing to repay debt*

Suppose:
(1) T borrows to purchase excluded property ("debt 1").
(2) T borrows to repay debt 1 ("debt 2").

Is debt 2 indirectly attributable to financing the acquisition of excluded property? What if T borrows to purchase non-excluded property but later sells that property and uses the proceeds to repay debt 1? It is suggested that debt 2 is attributable to financing excluded property if the steps form part of an arrangement, but not otherwise.

80.21.4 *Acquisition by third party*

The position becomes more complex if a second person is involved. Suppose:
(1) A (an individual) borrows.
(2) A gives the borrowed funds to B.

If A borrows and acquires *excluded* property, and gives it to B the debt is forever disallowed.

A may borrow and acquire *chargeable* property and give it to B; in the hands of B the property may (a) be excluded or (b) later become excluded. A's gift may be a PET or qualify for the IHT spouse exemption or it may be a chargeable transfer.

In the expression "attributable to financing (directly or indirectly) the acquisition of any excluded property" does "acquisition" mean acquisition by the person who has the liability? or does it mean acquisition by anyone? It is tentatively suggested that A's debt is attributable to financing the acquisition by B, if the steps form part of an arrangement, but not if they are independent.

Similar issues arise if trustees borrow and appoint the borrowed funds to B.

80.22 Excluded property disallowance reliefs

Statute provides the following reliefs (exceptions to excluded property disallowance):
(1) Disposal of debt-financed excluded property (disposal relief)
(2) Debt-financed asset ceases to be excluded property
(3) Debt exceeds debt-financed asset

80.23 Disposal of debt-financed asset

Section 162A(2) IHTA provides:

> [1] Where the property mentioned in subsection (1) has been disposed of, in whole or in part, for full consideration in money or money's worth, the liability may be taken into account
> [2] up to an amount equal to so much of that consideration as—
> (a) is not excluded property, and
> (b) has not been used—
> (i) to finance (directly or indirectly) the acquisition of excluded property or the maintenance, or an enhancement, of the value of such property, or
> (ii) to discharge (directly or indirectly) any other liability that, by virtue of this section, would not be taken into account.

I refer to this as "**disposal relief**".

"Dispose" is not defined so will bear its normal meaning, not the extended CGT meaning.

The liquidation of a company does not give rise to a disposal for consideration, in the strict sense;[68] but it appears that HMRC do not take this point. The IHT Manual provides:

> **IHTM28015 disposal of acquired assets where money has been borrowed to acquire excluded property** [Sep 2018]
> ... Example 2 (Axel)
> A, who is not domiciled in the UK, owns shares in an overseas company, which owns a UK property.
> A acquired the company by borrowing £1m.
> The company is liquidated and the UK property is transferred to A.
> IHTA84/S162A(2) refers to the disposal of excluded property for consideration in money or money's worth. You may accept that liquidating the company and transferring the property to A meets that requirement so the liability may[69] be allowed as a deduction against the UK property, although the allowable liability cannot exceed the value of the UK property that was transferred to the A.

[68] See App 4.5 (Transfer on liquidation).

[69] The example states *may* rather than *will* to allow for the possibility of other disallowable deduction rules, and that the deduction (if allowable) is not set specifically against the UK property (unless it is charged on the property, which the author of the example has perhaps assumed to be the case).

Suppose:
(1) T borrows to acquire excluded property ("asset 1").
(2) Asset 1 is sold and other excluded property is purchased ("asset 2").
(3) Asset 2 is sold and chargeable property is purchased.

Disposal relief can apply, as the debt is attributable to financing the acquisition of asset 2. HMRC agree. The IHT Manual provides:

> **IHTM28015 disposal of acquired assets where money has been borrowed to acquire excluded property** [Sep 2018]
> Example 3 (Basha)
> B, who is not domiciled in the UK, borrows £1m which she uses to invest in an overseas company (Company A).
> Company A in turn owns another overseas company (Company B) which owns a UK property.
> Company A is liquidated so B receives the shares in Company B. Company B is then liquidated and B becomes the owner of the UK property.
> Here the liability is attributable to indirectly financing the acquisition of the shares in Company B that owned the UK property. So excluded property was disposed of for full consideration in money's worth and as the consideration (the UK property) is not excluded, the liability may be allowed as a deduction against it.

80.24 Debt-financed asset becomes non-excluded property

An item of property may be excluded property at one time and subsequently become chargeable property, for instance, because:
(1) The owner of property may become UK domiciled.
(2) Foreign situate property (such as a chattel) may be brought to the UK.
(3) The law may change (as with the introduction of the 2017 IHT residence-property rules).

Section 162A(3) IHTA provides:

> The liability may be taken into account up to an amount equal to the value of such of the property mentioned in subsection (1) as—
> (a) has not been disposed of, and
> (b) is no longer excluded property.

If T borrows to acquire excluded property but the property becomes chargeable, the debt becomes allowable under 162A(3) up to the value of the property.

The IHT Manual gives this example:

> **IHTM28016 property is no longer excluded where money has been borrowed to acquire excluded property** [Aug 2016]
> ... Example (Chandra)
> C, who is not domiciled in the UK borrows £750,000 and buys a property abroad for £1m.
> The interest due on the loan is allowed to accumulate instead of being repaid.
> C subsequently becomes deemed domiciled in the UK (IHTM13024) so the property is now subject to tax.

More analytically, it is no longer excluded property.

> On C's death, the property is worth £1.2m and the sum owed under the liability is £1.3m.
> As the property is now subject to tax, the liability may be allowed; but only up to the value of £1.2m. The remaining £100,000 may not be deducted.

Had C bought property in the UK, the remaining £100k would be allowable. This seems a clear restriction on free movement of capital; so as long as EU law continues to apply, the law is not EU-law compliant.

It is open to question whether the interest part of the debt is disallowed.

80.25 Debt exceeds excluded property

80.25.1 *"Remaining liability"*

Statute uses the term "remaining liability" which is defined in s.162A(8) IHTA:

> "remaining liability" means the liability mentioned in subsection (1) so far as subsections (2) and (3) do not permit it to be taken into account;

The label is not entirely apt: "disallowed liability" might have been clearer.

80.25.2 *Debt exceeds original excluded property*

Section 162A(4) IHTA provides:

> To the extent that any remaining liability is greater than the value of such of the property mentioned in subsection (1) as—
> (a) has not been disposed of, and
> (b) is still excluded property,

> it may be taken into account, but only so far as the remaining liability is not greater than that value for any of the reasons mentioned in subsection (7).

The IHT Manual gives a straightforward example:

> **IHTM28017 Excess liability over value of excluded property where money has been borrowed to acquire excluded property** [Sep 2018]
> **Example 1** (Dominique)
> D, who is not domiciled in the UK, borrows £800,000 which is charged on UK assets worth £1.5m.
> She uses the £800,000 to acquire a villa in Spain, which is excluded property.
> The open market value of the Spanish villa falls to £500,000 by the date of her death.
> The £800,000 liability has been incurred to directly acquire excluded property, so would normally be disallowed by IHTA84/S162A(1). However, the reason for the liability being greater than the value of the excluded asset is not due to:
>
> - it being part of an arrangement to secure a tax advantage, or
> - an increase in the value of the liability, or
> - a disposal of the whole or part of the excluded asset.
>
> So £300,000 of the liability (£800,000 liability less the £500,000 value of the excluded asset) is allowed and reduces the chargeable value of the UK assets to £1.2m.
> **Example 2**
> If, in the example above:
>
> - the money had been borrowed from abroad,
> - it had not been charged on UK property, and
> - the deceased had also owned assets in France,
>
> the £300,000 should first be set against the French assets[70] before any balance is then set against UK assets.

80.25.3 *Debt exceeds property which becomes excluded*

Section 162A IHTA provides:

> (5) Subsection (6) applies where—
> (a) a liability or any part of a liability is attributable to financing (directly or indirectly)—
> (i) the acquisition of property that was not excluded property,

[70] More accurately, the deduction is against D's *foreign* assets; but the author has perhaps assumed that D's French assets are her only foreign assets.

> or
>
> (ii) the maintenance, or an enhancement, of the value of such property, and
>
> (b) the property or part of the property—
>
> (i) has not been disposed of, and
>
> (ii) has become excluded property.
>
> (6) The liability or (as the case may be) the part may only be taken into account to the extent that it exceeds the value of the property, or the part of the property, that has become excluded property, but only so far as it does not exceed that value for any of the reasons mentioned in subsection (7).

The IHT Manual provides a straightforward example:

> **IHTM28018 excess liability over property that has become excluded where money has been borrowed to acquire excluded property** [Sep 2018]
>
> ... Example (Roberto)
>
> R who is not domiciled in the UK borrows £500,000 which he uses to buy two paintings which he keeps in his London house.
>
> He subsequently takes one of the paintings, worth £300,000, to keep in his house in Florida. This painting is now excluded property.

The HMRC analysis is as follows:

> The £300,000 painting has not been disposed of but has become excluded property. The liability of £500,000 is therefore allowed to the extent that it exceeds the value of that painting. In other words, £200,000 of the liability is an allowable deduction (£500,000 less £300,000).

It was not necessary to have a separate relief for this case. Relief should have been available under s.162A(4).[71] But it does no harm.

80.25.4 *Disallowable reason: Avoidance*

Section 162A(7) IHTA sets out three disallowable reasons. They override the reliefs in:

Section	**Topic**	**See para**
s.162A(4)	Liability exceeds value of original excluded property	80.25.2
s.162A(5)(6)	Liability exceeds value of property which becomes excluded	80.25.3

[71] See 80.25.2 (Liability exceeds value of original excluded property).

The first disallowable reason is set out in s.162A(7)(a) IHTA:

> The reasons are—
>
> (a) arrangements[72] the main purpose, or one of the main purposes, of which is to secure a tax advantage ...

Section 162A(8) provides the standard IHT definition of "tax advantage".[73] "Tax" is not defined here, so it means IHT: see s.272 IHTA.

80.25.5 *Disallowable reason 2: Increase in debt*

The second disallowable reason is set out in s.162A(7)(b):

> The reasons are...
>
> (b) an increase in the amount of the liability (whether due to the accrual of interest or otherwise)...

An increase in the debt due to interest or index-linking is disallowed. So inflation will whittle away the value of the allowable debt over time.

The IHT Manual provides a straightforward example:

> **IHTM28018 meaning of 'indirectly' where money has been borrowed to acquire excluded property** [Sep 2018]
>
> ...
>
> *Example 2* (Emilio)
>
> E, who is domiciled outside the UK, borrows £800,000 and invests it in diamonds, which he keeps in the UK.
>
> He moves the diamonds abroad just before he dies.
>
> On his death, the diamonds are still worth the same amount but interest has accumulated on the loan so that Emilio now owes £850,000.

The HMRC analysis is as follows:

> As the assets acquired with the loan have not been disposed of but have become excluded property, only the excess value of the loan over the asset can be allowed as a deduction against any chargeable estate. However, as the liability has increased due to accrued interest, none of the liability may be allowed as a deduction.

Clearly E should have been advised to keep the diamonds in the UK. What if he took them outside and returned them before his death?

[72] Section 162A(8) IHTA Section 404A(8) ITTOIA provides the standard (unnecessary) IHT definition : see App 2.2.3 (Definitions of "arrangement").

[73] See 3.19.1 (Tax advantage: Definitions).

In the case of a foreign currency debt the debt is valued at the time it is taken out and an increase in the value of the debt due to currency fluctuation is disallowed.

80.25.6 *Disallowable reason 3: Disposal*

The third disallowable reason is set out in s.162A(7)(c):

> The reasons are...
>
> (c) a disposal, in whole or in part, of the property.

I do not understand the purpose of (c): how can a liability be attributable to a disposal? Is this a reference to disallow borrowing to cover the incidental costs of disposal?

80.26 Debt attributable to foreign account

A foreign currency bank account of a foreign domiciled non-resident qualifies for IHT relief, but it is not classified as excluded property.[74] It follows that a debt attributable to such an account is not disallowed under the excluded property disallowance. This was overlooked in 2013, but a provision was introduced to deal with the matter in 2014. Section 162AA IHTA provides a set of rules based on the excluded property disallowance:

> (1) This section applies if—
>
> (a) in determining the value of a person's estate immediately before death, a balance on any qualifying foreign currency account ("the relevant balance") is to be left out of account under section 157 (non-residents' bank accounts), and
>
> (b) the person has a liability which is attributable, in whole or in part, to financing (directly or indirectly) the relevant balance.
>
> (2) To the extent that the liability is attributable as mentioned in subsection (1)(b), it may only be taken into account in determining the value of the person's estate immediately before death so far as permitted by subsection (3).
>
> (3) If the amount of the liability that is attributable as mentioned in subsection (1)(b) exceeds the value of the relevant balance, the excess may be taken into account, but only so far as the excess does not arise for either of the reasons mentioned in subsection (4).
>
> (4) The reasons are—

[74] See 76.13 (Foreign currency account).

(a) arrangements[75] the main purpose, or one of the main purposes, of which is to secure a tax advantage,[76] or
(b) an increase in the amount of the liability (whether due to the accrual of interest or otherwise).

The better course would have been to classify foreign currency bank accounts as excluded property; or else to repeal FCBA relief altogether.[77] Does it matter? It is just one more page of legislation, one more straw on the camel's back.

80.27 Excluded property disallowance: planning

Planning is needed at the time of the acquisition of UK property. Suppose T owns £1m foreign property and wishes to purchase a UK home worth £1m:
(1) If T borrows to purchase the UK home, the debt is deductible.
(2) If T sells the foreign property to purchase the home, and subsequently borrows £1m to purchase foreign property, T is (more or less) in the same economic position. But in this case the debt is disallowed.

80.28 Business/agricultural property debt

Section 162B IHTA effectively disallows three classes of debt, attributable to:
(1) business property
(2) agricultural property
(3) woodland

I do not consider the provisions relating to woodland. The IHT Manual uses the terms "relievable property" or "relievable assets"; but I think it is clearer to refer to business /agricultural property. This takes us some way from the themes of this book, but s.162A-s.162C form part of a single code, and HMRC guidance on s.162B is relevant to 162A.

80.29 Business property debt

Section 162B(1) IHTA provides:

[75] Subsection (5) provides the standard (unnecessary) IHT definition: see App 2.2.3 (Definitions of "arrangement").
[76] Subsection (5) provides the standard IHT definition of "tax advantage"; see App 3.19.1 (IHT definition of "tax advantage").
[77] See 76.13.4 (Foreign account: Critique).

> (1) Subsection (2) applies if—
>
> (a) the whole or part of any value transferred by a transfer of value[78] is to be treated as reduced, under section 104, by virtue of it being attributable to the value of relevant business property, and
>
> (b) the transferor has a liability which is attributable, in whole or in part, to financing (directly or indirectly)—
>
> (i) the acquisition of that property, or
>
> (ii) the maintenance, or an enhancement, of its value.

The words in (b) are the same as the excluded property disallowance.[79]

Section 162B(2) IHTA provides:

> [a] The liability is, so far as possible, to be taken to reduce the value attributable to the value of the relevant business property, before it is treated as reduced under section 104 [BPR],
>
> [b] but only to the extent that the liability—
>
> (a) is attributable as mentioned in subsection (1)(b), and
>
> (b) does not reduce the value of the relevant business property by virtue of section 110(b).

This is not strictly a disallowance of the debt; but in the (usual) case of property qualifying for 100% relief, it comes to the same thing. I refer to this as "**the BPR disallowance**". The wording is different from the excluded property disallowance as business property may not qualify for 100% relief.

The disallowance can apply to individuals and to trustees, on death and on other occasions of charge.

The IHT Manual gives a straightforward examples of a debt used to purchase shares qualifying for BPR:

> **IHTM28020 borrowed money used to acquire assets that qualify for business relief** [Feb 2020]
>
> ...
>
> *Example 2* (Habibah)
>
> H borrows £450,000, which is charged on her house, and uses the funds to acquire AIM shares. At the date of H's death the AIM shares are worth £575,000 and qualify for business relief. The rest of her estate is

[78] Section 162B(9) IHTA provides a standard definition of "transfer of value" (repeating s.103(1) IHTA).

[79] See 80.19 ("Financing" an acquisition).

> worth £1.5m.
> At the date of death the liability is taken to reduce the value of the AIM shares that can qualify for business relief under IHTA84/S162B(2) from £575,000 to £125,000. Business relief applies to that value.
> The total estate, including the AIM shares is £2,075,000 (£1.5m plus £575,000).
> This is reduced by business relief of £125,000 and, subject to it meeting the provisions of IHTA84/S175A, the liability of £450,000.
> The value of the chargeable estate is £1.5m.
> As the liability has been taken into account to reduce the value of the AIM shares under IHTA84/S162B, the liability cannot be deducted against the value of the house under IHTA84/S162(4).

80.29.1 *Spouse exemption: Interaction*

The Manual then considers a more complex case:

> *Example 3* (Ian)
> I borrows £600,000, which is charged on his house and uses the money to buy shares in his son's company.
> At I's date of death,
> - the shares are worth £800,000,
> - the house £1m and
> - his personal estate is worth £500,000.
>
> Under his Will, I leaves his house to his spouse with the residue to his son.
> Assuming the liability meets the conditions of IHTA84/S175A, it is taken to reduce the value of the company shares before business relief is applied. As the liability has been taken into account under IHTA84/S162B, it cannot be taken against the value of the house under IHTA84/S162(4).
> The value of shares is reduced to nil through a combination of deducting the liability (£600,000) and business relief (£200,000).
> The liability has been taken into account against the shares, so the house passes to the spouse, free of the liability and qualifies for spouse or civil partner exemption.
> This leaves a chargeable estate of £500,000 that passes to the son.

The house does *not* pass to the spouse free of the debt as a matter of succession law.[80] The author means that the spouse exemption applies as if the house were free of the debt. The value transferred on the death for

[80] Unless I's will so provides; see s.35 AEA 1925.

IHT purposes is £1.5m, of which £1m is exempt under the IHT spouse exemption.

The IHT Manual does not address the more interesting question of whether the debt is disallowed on the death of I's spouse.

80.30 Agricultural property debt

Section 162B IHTA provides:

> (3) Subsection (4) applies if—
> (a) the whole or part of any value transferred by a transfer of value is to be treated as reduced, under section 116, by virtue of it being attributable to the agricultural value of agricultural property, and
> (b) the transferor has a liability which is attributable, in whole or in part, to financing (directly or indirectly)—
> (i) the acquisition of that property, or
> (ii) the maintenance, or an enhancement, of its agricultural value.
>
> (4) To the extent that the liability is attributable as mentioned in subsection (3)(b), it is, so far as possible, to be taken to reduce the value attributable to the agricultural value of the agricultural property, before it is treated as reduced under section 116.

I refer to this as the "**APR disallowance**". The wording echoes the BPR disallowance.

The IHT Manual gives some examples. The first example is a straightforward loan to improve agricultural property:

> **IHTM28021 borrowed money used to acquire assets that qualify for agricultural relief** [Sep 2018]
> ... *Example 1* (Ken)
> K borrows £200,000 which he uses to repair buildings on his farm which qualify for agricultural relief. The value of K's estate on death is £2m, of which £1,200,000 is agricultural property qualifying for relief at the date of death.
> The £200,000 liability reduces the agricultural value of the agricultural property to £1,000,000 under IHTA84/S162B(4).
> This £1,000,000 of agricultural value qualifies for agricultural relief.
> The value of the estate is reduced by agricultural relief of £1,000,000 and, subject to it meeting the provisions of IHTA84/S175A, the liability of £200,000, leaving a chargeable estate on death of £800,000.

80.30.1 *Debt partly attributable to agricultural property*

The next example involves a loan to acquire agricultural and non-agricultural property. It is also relevant to a loan to acquire excluded and non-excluded property:

> **IHTM28021 borrowed money used to acquire assets that qualify for agricultural relief** [Sep 2018]
> *Example 2* (Jan)
> J borrows £1m and invests it in a house and some adjoining farmland.[81] The house is worth £700,000 and the land £300,000.
> The farmland is let out to a neighbouring farmer.[82]
> At J's date of death, the value of the combined property has increased in value to £2m of which £1.2m is attributable to the house and £800,000 to the land.

In tabular form:

	House	**Land**	**Total**
Purchase date	£700k (70%)	£300k (30%)	£1m (100%)
Death date	£1.2m (60%)	£800k (40%)	£2m (100%)

The HMRC analysis is as follows:

> The liability is to be taken against the agricultural property to the extent to which it can be attributed to paying for that property, IHTA84/S162B(4).
> When J acquired the property, £300,000 was attributable to the farmland and this is the amount of the liability to be taken against the agricultural value on death.
> So, subject to the liability meeting the provisions of IHTA84/S175A, the chargeable value of the house will be £500,000 (£1.2m less the £700,000 portion of the liability used to buy the house). The value of the land (£800,000) will be reduced to nil by a combination of the liability (£300,000) and agricultural relief (£500,000). ...

Apportionment is by reference to values at the date of acquisition. The text goes on to consider the alternative of apportionment by reference to values at the date of death:

> An alternative approach would be to apportion the liability by reference to the values at the date of death. The effect, in this example, would be that only £600,000 of the liability would have been attributable to the house (£1,200,000 ÷ £2,000,000 × £1,000,000) giving a chargeable value for the house of £600,000 and increasing the liability to tax.
> If the combined value had been split differently between the house and the farmland, or if their values had increased in different proportions, apportioning

[81] It is assumed (1) the house does not qualify for APR and (2) the land qualifies for 100% APR.

[82] The point of stating this is that the land qualifies for APR but not BPR.

> the liability by reference to, say, date of death values may give a different result. But a consistent approach is necessary, and the liability should be apportioned using the values at the date of acquisition, even if an alternative approach would give rise to more tax.
>
> As well as being consistent, using the values at the date of acquisition avoids difficulties that might arise if either
>
> [1] part of the property is sold but the liability retained (how should the remaining liability then be apportioned?), or
>
> [2] if there were a sale and part of the liability was repaid, which would trigger the provisions of IHTA84/S162C, (IHTM28026).[83]
>
> Fixing the liability attributable to the different parts of the assets at the time they were acquired provides a certain basis going forward.

It would be better to take out two separate loans, one for the agricultural property and one for other property.

80.30.2 *BPR/APR disallowance: Commencement*

Para 5 sch 36 FA 2013 provides:

> (2) Section 162B of IHTA 1984 (inserted by paragraph 3) only has effect in relation to liabilities incurred on or after 6 April 2013.
>
> (3) For the purposes of sub-paragraph (2), where a liability is incurred under an agreement–
>
> (a) if the agreement was varied so that the liability could be incurred under it, the liability is to be treated as having been incurred on the date of the variation, and
>
> (b) in any other case, the liability is to be treated as having been incurred on the date the agreement was made.

This is different from the commencement of the other 2013 debt disallowances.

Care must be taken over refinancing pre-2013 loans relating to agricultural/business property, as that will have the effect of disallowing the debt.

Suppose:

(1) A pre-2013 debt is attributable to the acquisition of BPR/APR property which is not UK situate.

(2) The property is excluded property as it is owned by a foreign domiciliary or an excluded property trust.

The debt is not disallowed under the BPR/APR disallowance. However

[83] See 80.34 (Part payment of mixed debt).

it is disallowed under the excluded property disallowance!

One solution if possible is to make the property UK situate.

This seems a clear restriction on free movement of capital, so as long as EU law continues to apply, the disallowance is not EU law compliant.

80.30.3 *Effect on wills*

The rules may have an effect on pre-2013 wills using formulae relating to valuation, or relating to agricultural or business property relief.

80.31 Debt of unincorporated business

Section 110 IHTA provides:

> For the purposes of this Chapter—
> (a) the value of a business or of an interest in a business shall be taken to be its net value;
> (b) the net value of a business is the value of the assets used in the business (including goodwill) reduced by the aggregate amount of any liabilities incurred for the purposes of the business;
> (c) in ascertaining the net value of an interest in a business, no regard shall be had to assets or liabilities other than those by reference to which the net value of the entire business would fall to be ascertained.

In the following discussion, "**business debt**" means a debt incurred for the purposes of an unincorporated business.

The IHT Manual gives an example involving an unsecured business debt:

> **IHTM28020 borrowed money used to acquire assets that qualify for business relief** [Feb 2020]
> ...
> *Example 1* (Gareth)
> G, who runs his own sole trader business, borrows £250,000 to buy property that is to be used in his business. The loan is unsecured and is shown in the accounts as a liability of the business. IHTA84/S162B(1)(b) applies as the liability has been incurred to acquire relevant business assets. Under IHTA84/S162B(2) the liability should be taken to reduce the value of the relevant business assets before that value is reduced by business relief. However in this case the liability has already been reflected in the net value of the business under IHTA84/S110(b), so IHTA84/S162B(2)(b) prevents the liability being deducted twice.

Charging a business debt on non-business assets did not reduce the IHT liability even before 2013. Now the position is reinforced by s.162B. The IHT Manual provides:

> **IHTM25250 Partnership interests** [Feb 2017]
> ... One example of the operation of [s.110(c)] concerns a partner's Income Tax liability on their share of the partnership profits. As the partner's tax is not a liability incurred for the purposes of the business, it should not be taken into account in determining the net value of the partnership for the purposes of business relief.

80.32 Property qualifying for BPR/APR

The IHT Manual provides:

> **IHTM28022 borrowed money used to acquire assets that qualify for both agricultural and business relief** [Sep 2018]
> Where an asset qualifies for both agricultural and business relief, IHTA84/S114 (IHTM24151) directs that agricultural relief applies to the agricultural value first, with business relief applying to any excess value over the agricultural value of the asset. So, where the liability exceeds the agricultural value of the asset, there will be no agricultural relief to be deducted against the estate. The balance of the liability should then be set against the non-agricultural value of the asset to arrive at the value of the asset which may qualify for business relief.
> If the liability is more than the open market value of the asset, any excess can be set against any other chargeable assets. If the other chargeable assets qualify for business relief, the balance of the liability must be set against those assets that qualify for business relief before being set against any other assets that are chargeable to tax, subject to the liability meeting the provisions of IHTA84/S175A (IHTM28027).
> *Example* (Leon)
> L borrows £800,000 which he uses to buy a farm which he then farms himself. On L's death the estate is worth £2m, of which the farm is worth £1m with an agricultural value of £750,000.
> The liability of £800,000 was incurred to finance the acquisition of assets that are both relevant business assets and agricultural assets. IHTA84/S114 provides that where both agricultural relief and business relief can apply to the same asset agricultural relief is given in priority to business relief.
> Under IHTA84/S162B(4) the agricultural value of the agricultural property is reduced from £750,000 to nil, leaving no value qualifying for agricultural relief.
> The remaining £50,000 liability is deducted from the £250,000 value of the relevant business property, leaving £200,000 which can qualify for

> business relief.
> So the value of the estate of £2m is reduced by business relief of £200,000 and, subject to it meeting the provisions of IHTA84/S175A, the liability of £800,000, leaving a chargeable value on death of £1m.

Why does it matter which relief applies?

80.33 Gift of debt-financed business/agricultural property

The IHT Manual provides:

> **IHTM28024 transfer of relievable assets where borrowed money is used to acquire assets that qualify for relief** [Sep 2018]
> Where assets that qualify for relief have been acquired using borrowed funds and the liability has been secured against other chargeable assets, it would still be possible to obtain full relief and the deduction of the liability by:
> - giving away the relievable assets before death, but
> - retaining the liability within the estate.
>
> IHTA84/S162B requires that the liability is set against the transfer of relievable assets at the time of the lifetime transfer, and any excess value over the value of the liability would qualify for relief. But at death, the estate would no longer include any relievable assets, so the provisions of IHTA84/S162B would not apply and the liability could still be deducted against estate on death under IHTA84/S162(4).

Section 162B(7) IHTA deals with this problem:

> Subject to subsection (8), to the extent that a liability is, in accordance with this section, taken to reduce value in determining the value transferred by a chargeable transfer, that liability is not then to be taken into account in determining the value transferred by any subsequent transfer of value by the same transferor.

The IHT Manual provides:

> To prevent this, IHTA/S162B(7) stipulates that where a liability has already been taken into account to reduce the value transferred by a chargeable transfer, the liability cannot then be taken into account to reduce a subsequent transfer of value made by the same transferor.
> The wording used is important. The liability must reduce the value transferred by a chargeable transfer (a transfer that is immediately chargeable or a failed PET). If the lifetime transfer was a PET and the transferor survives 7 years, the transfer is an exempt transfer; so the liability may still be deducted from the estate on death as it will not have

> taken into account by an earlier chargeable transfer.
> ...
> *Example* (John)
> J, who has an estate of £3m, borrows £1m and uses this to purchase farmland which he then farms for 3 years.
> He then gives the farmland, now worth £1.2m to his daughter who farms the land herself, but he retains the liability.
> The individual has made a transfer of value when he gives the farmland to his daughter. The value transferred is the loss to J's estate of £1.2m. IHTA84/S162B(4) has the effect of reducing the £1.2m agricultural value by the amount of the liability to £200,000. This £200,000 value then qualifies for agricultural relief, reducing the value transferred to nil.
> When J dies 2 years later, the £1m liability cannot be taken into account again due to IHTA84/S162B(7). Instead of the chargeable transfer on death being £2m (£3m less the £1m liability), it is £3m with no deduction for the liability.

Care is needed if a parent wishes to give different property to different children.

80.33.1 *Relevant property trusts*

Section 162B(8) IHTA deals with this problem:

> Subsection (7) does not prevent a liability from being taken into account by reason only that the liability has previously been taken into account in determining the amount on which tax is chargeable under section 64.

The IHT Manual provides:

> **IHTM28024 transfer of relievable assets where borrowed money is used to acquire assets that qualify for relief** [Sep 2018]
> ...
> But this limitation does not apply to ten-year charges in view of IHTA84/S162B(8). So, whilst the assets acquired with the liability remain in the trust, the liability can be taken into account at each ten year charge. But once the assets cease to be relevant property, so that the liability is taken in account at the time of the exit charge, then if the liability remains in the trust, IHTA84/S162B(7) will prevent it from being taken into account against any further charges.

80.34 Part payment of mixed debt

A single debt may be used to finance the acquisition of:
(1) excluded property

(2) UK business/agricultural property
(3) chargeable property

I refer to this as a "**mixed debt**".

What if the debt is repaid in part? Is the part repaid:
(1) the allowable part (attributable to the chargeable property) or
(2) the disallowable part (attributable to APR/BPR/excluded property)?

Section 162C IHTA provides the answer in the manner most favourable to HMRC:

> (1) This section applies for the purposes of determining the extent to which a liability is attributable as mentioned in
> [a] section 162A(1) or (5) [excluded property disallowance]
> [b] 162AA(1) [foreign currency bank account disallowance] or
> [c] 162B(1)(b), (3)(b) or (5)(c) [BPR/APR disallowances]
>
> (1A) In a case in which the value of a person's estate immediately before death is to be determined, where a liability was discharged in part before that time—
> (a) any part of the liability that, at the time of discharge, was not attributable as mentioned in subsection (1) is, so far as possible, to be taken to have been discharged first,
> (b) any part of the liability that, at the time of discharge, was attributable as mentioned in section 162B(1)(b), (3)(b) or (5)(c) is, so far as possible, only to be taken to have been discharged after any part of the liability within paragraph (a) was discharged,
> (c) any part of the liability that, at the time of discharge, was attributable as mentioned in section 162AA(1) is, so far as possible, only to be taken to have been discharged after any parts of the liability within paragraph (a) or (b) were discharged, and
> (d) any part of the liability that, at the time of discharge, was attributable as mentioned in section 162A(1) or (5) is, so far as possible, only to be taken to have been discharged after any parts of the liability within paragraphs (a) to (c) were discharged.
>
> (2) In any other case, where a liability was discharged in part before the time in relation to which the question as to whether or how to take it into account arises—
> (a) any part of the liability that, at the time of discharge, was not attributable as mentioned in section 162A(1) or (5) or 162B(1)(b), (3)(b) or (5)(c) is, so far as possible, to be taken to

have been discharged first,

(b) any part of the liability that, at the time of discharge, was attributable as mentioned in section 162B(1)(b), (3)(b) or (6)(c) is, so far as possible, only to be taken to have been discharged after any part of the liability within paragraph (a) was discharged, and

(c) any part of the liability that, at the time of discharge, was attributable as mentioned in section 162A(1) or (5) is, so far as possible, only to be taken to have been discharged after any parts of the liability within paragraph (a) or (b) were discharged.[84]

The IHT Manual provides:

> **IHTM28026 partial repayment of loan before tax charge arises** [Sep 2018]
> Where borrowed money has been used to acquire:
> - excluded property (IHTM28014), or
> - finance the balance of a qualifying foreign currency bank account (IHTM28033), or
> - assets that have become excluded property (IHTM28018) or
> - relievable assets (IHTM28019)
>
> and the loan has been partially repaid before a charge to tax arises only the balance of the loan will be affected by the provisions of IHTA84/S162A, S162AA or S162B, subject to the liability meeting the conditions of IHTA84/S175A (IHTM28027).
> Where borrowed money has been used to acquire a mixture of:
> - excluded property (IHTM28014), or
> - assets that have become excluded property (IHTM28018) and
> - finance the balance of a qualifying foreign currency bank account (IHTM28033),
> - relievable assets (IHTM28019)
>
> and the liability has been partially repaid before a charge to tax arises, IHTA84/S162C contains rules that set out the order in which the liability is treated as having been discharged. The provisions cover the situation where a single loan has been used to acquire other assets that would be subject to tax as well.
> IHTA84/S162C(1A) only applies when considering the estate on death and only applies where the death is on or after 17 July 2014.
> Any part of the liability that is attributable to assets that are neither

[84] I set out the section as amended by the FA 2014 with effect from royal assent.

excluded nor relievable, nor used to finance a foreign currency bank account is treated as having been repaid first, IHTA84/S162C(1A)(a). If the partial repayment was greater than that part of the liability, the part of the liability that is attributable to relievable assets is treated as having been repaid next, IHTA84/S162C(1A)(b).

If the partial repayment was greater than the part of the liability attributable to both of those two categories of asset, the part of the liability that is attributable to financing the foreign currency account is treated as having been repaid next, IHTA84/S162C(1A)(c).

And, if the partial repayment was greater than the part of the liability attributable to all of the above categories, the remainder of the liability must be attributable to excluded property, or assets that have become excluded property, and is treated as being repaid last, IHTA84/S162C(1A)(d). So if the balance of the liability outstanding on death can only be attributable to excluded property then, subject to the provisions of IHTA84/S162A (IHTM28014), any deduction for the balance of the loan is disallowed.

IHTA84/S162C(2) applies in all other cases (and for events on or after 17 July 2013) in the same order as above, but ignoring the references to foreign currency bank accounts.

Example 1

The trustees of an excluded property trust which contains a UK house worth £2m borrow £1.5m which is charged against the property.

£800,000 is used to acquire unlisted UK shares which qualify for business relief and

£700,000 is used to acquire excluded property.

£300,000 of the liability is repaid before the ten year anniversary leaving a liability of £1.2m. At that time the unlisted UK shares are valued at £900,000 and the excluded property is valued at £1m.

Under IHTA84/S162C(2) the liability is treated as having been repaid first on the part of the liability incurred to acquire the unlisted UK shares. As £800,000 of the loan was used for this purpose, the £300,000 that was repaid is treated as having partially discharged this part of the liability - leaving £500,000 as a loan used to acquire the UK shares.

Under IHTA84/S162B(2) the value of the unlisted UK shares that can qualify for business relief is reduced by £500,000 from £900,000 to £400,000. The remaining £700,000 liability that was used to acquire excluded property is disallowed by IHTA84/S162A.

So the value of the UK assets in the trust of £2.9m (the UK house and the unlisted UK shares) is reduced by the part of the debt that was used to acquire the UK shares, £500,000, and business relief of £400,000 to £2m – or the same as the value of the UK assets before any transactions took place. Business relief is allowed against the increase in the value of the UK unlisted shares.

Example 2

The trustees of an excluded property trust which contains a UK house worth £2m borrow £1.5m which is charged against the property. This time the trustees use the £1.5m to acquire

- £900,000 of excluded property,
- £350,000 of assets qualifying for agricultural relief and
- £250,000 of UK listed shares.

£700,000 of the liability is repaid before the ten year anniversary leaving a liability of £800,000. At that time the excluded property is worth £1m, the agricultural assets are worth £400,000 and the UK shares, £300,000.

In tabular form:

	Excluded Prop	**Ag. Land**	**Shares**	**Total**
Purchase date	£900k (60%)	£350k (23%)	£250k (17%)	£1.5m (100%)
TYA date	£1m (59%)	£400k (24%)	£300k (18%)	£1.7m (100%)

The HMRC analysis is as follows:

Under IHTA84/S162C(2) the liability is treated as having been repaid first on the part used to acquire the UK shares. As £250,000 of the liability was used for this purpose, the first £250,000 of the amount discharged reduces the liability which can be deducted from the UK shares to nil.

Of the remaining £450,000 that was repaid, £350,000 was used to acquire agricultural assets which are worth £400,000 at the date of the ten year anniversary. So, the next £350,000 of the amount repaid reduces the liability which can be taken against the agricultural assets under IHTA84/S162C(2)(b) to nil. As none of the remaining liability can be attributed to acquiring the agricultural assets, the full value of the agricultural assets may qualify for agricultural relief with no restriction under IHTA84/S162B.

The last £100,000 of the liability which has been discharged (£700,000 - (£250,000 + £350,000) = £100,000) is treated as reducing the liability incurred to acquire the excluded property under IHTA84/S162C(2)(c). This reduces that part of liability from £900,000 to £800,000. So the balance of the liability that was not repaid, £800,000 is attributed to the acquisition of excluded property and is disallowed by virtue of IHTA84/S162A.

The value of the UK assets in trust of £2.7m (the UK house, agricultural assets and quoted shares) is reduced by the agricultural relief to £2.3m and none of the liability is allowable.

> In effect, the original £2m in the trust, plus the UK shares are now liable to tax. Although this may seem a harsh result given that the shares were acquired through borrowing, without a priority rule, it would be possible to manipulate assets and values to obtain an advantage.

80.35 Payment of disallowed debt

The payment of a disallowed debt is in principle a transfer of value, because it reduces the value of the estate. However, relief will in principle be available under s.10 IHTA (Dispositions not intended to confer gratuitous benefit). There is no equivalent of a s.103(5) deemed PET.[85] A simple course if possible is to repay the borrowing at any time before the death. Repayment reduces the value of the estate, but will in principle for relief under s.10. So "deathbed" planning may be possible.

If s.10 does not apply, however, repayment would be a chargeable transfer. It would not fall within the definition of a PET.

80.36 Debt unpaid after death

Section 175A IHTA provides:

> (1) In determining the value of a person's estate immediately before death, a liability may be taken into account to the extent that—
> (a) it is discharged on or after death,
> [i] out of the estate or from excluded property owned by the person immediately before death,
> [ii] in money or money's worth, and
> (b) it is not otherwise prevented, under any provision of this Act, from being taken into account.
>
> (2) Where the whole or any part of a liability is not discharged in accordance with paragraph (a) of subsection (1), the liability or (as the case may be) the part may only be taken into account for the purpose mentioned in that subsection to the extent that [the commercial reason defence applies].

Subsection (1) is worded as an *allowance* for debts which are paid: in order to identify the disallowance of undischarged debts, one needs to read subsections (1) and (2) together. The wording is convoluted, but it works.

I refer to this rule as the **"s.175A disallowance"**. That is not a transparent label, but I cannot think of a better one.

This disallowance only applies on death. It does not apply to lifetime

[85] See 80.12.11 (Payment of debt: deemed PET).

transfers (failed PETs or chargeable transfers) or to 10 year and exit charges on trusts.

A deduction is not allowed if the creditor waives (releases) the debt as that is not a discharge out of the estate. But a deduction is allowed if:
(1) The debt is paid, and
(2) The creditor makes a gift back to the debtor.

This is commercially equivalent to a waiver by the creditor. That arrangement is not avoidance: it makes the practical difference that interest accruing on the debt becomes taxable.

80.36.1 *To extent discharged*

If a debt for (say) 100 is discharged as to 50%, by a payment of 50, then 50% of the debt is allowable.

If the debt is wholly discharged by the transfer of money's worth valued 50, then it would be sensible if only 50% of the debt is allowable; though it requires a purposive reading to reach that result.

80.36.2 *s.175A disallowance: Commencement*

Para 5 sch 36 FA 2013 provides:

> (1) Subject to sub-paragraph (2),[86] the amendments made by this Schedule have effect in relation to transfers of value made, or treated as made, on or after the day on which this Act is passed.

So the s.175A disallowance applies to pre-2013 debts, if the transfer of value (ie the death) is after 17 July 2013. This is an unfair commencement rule as in many cases, including those without any element of tax avoidance, existing debts will have been incurred in reliance of the pre-2013 rules.[87] But there it is.

80.37 Discharge "out of the estate"

80.37.1 *Payment from "estate"*

Section 175A(1) IHTA provides:

> In determining the value of a person's estate immediately before death,

[86] This relates to the business/agricultural property disallowance: see 80.30.2 (BPR/APR disallowance: Commencement).

[87] Note the change in attitude to commencement provisions with retrospective effect, see 80.18.1 (Commencement: Pre-2013 debt).

> a liability may be taken into account to the extent that—
> (a) it is discharged on or after death,[88]
> [i] out of the estate or
> [ii] from excluded property owned by the person immediately before death ...

"The estate" in (1)(a)[i] refers back to the "person's estate immediately before death" in the opening words in (1): the deceased's estate.

A debt is paid out of the estate if it is paid out of:

(1) property which was in the estate immediately before death, or
(2) property representing that property: IHT adopts the concept of a continuing fund.

"Estate" has its usual IHT meaning.[89] It includes in particular:

(1) Settled property in which the deceased had an estate interest in possession
(2) GWR property

Such property is treated as part of the deceased's estate immediately before death, and following the individual's death the property is no longer be treated as part of his or her estate. It is considered that does not matter: following the death the deceased has no estate at all. So the discharge of a debt on GWR property out of that property (or property representing such property) will satisfy the requirement.

80.37.2 *Payment from excluded property*

Section 175A(1)(a) needs to refer to excluded property, because that is not part of the estate immediately before death.[90]

The IHT Manual provides:

> **IHTM28028 meaning of 'out of estate'** [Aug 2016]
> In determining whether the loan has been discharged out of the estate, the word 'estate' has its normal meaning for Inheritance Tax (IHTM28027); but IHTA84/S175A(1)(a), extends this meaning for the purpose of this provision only to include any excluded property owned by the deceased.[91] It is important here that the excluded property was

[88] The words "on or after the death" are otiose.

[89] See 74.2 ("Estate").

[90] See 74.2 ("Estate").

[91] This is not strictly correct. Section 175A does not extend the meaning of "estate": it provides that debts may be allowed if paid out of the estate or out of excluded

> 'owned' by the deceased, taking the natural meaning of the word 'owned'. Excluded property that is also settled property in which the deceased had an interest is not property 'owned' by the deceased.
>
> Although the meaning of estate is extended in this way, the normal rule that a liability can only be deducted against assets at the same title applies (IHTM28397). Other than in exceptional circumstances, in reality, assets in the Free Estate are not available to trustees to settle trusts debts.

What if there is a GWR of settled property which is excluded property? The deceased is treated as beneficially entitled to such property, and so should be treated as owning it for s.175A purposes.

80.37.3 *Payment out of loan to PRs*

Suppose:
(1) An estate has a debt ("the pre-death debt").
(2) The PRs borrow, so the estate has a second debt ("the post-death debt").
(3) The PRs use the borrowed funds to pay the pre-death debt.

This is a matter of refinancing. The deduction is allowed even if the post-death debt is not discharged, or is discharged, but not out of the estate. That arrangement is not avoidance: it makes the practical difference that interest accruing on the pre-death debt becomes taxable.

This is important where:
(1) The estate had a pre-death debt.
(2) The deceased took out a life policy to fund repayment, and settled the policy.

If the trustees of the policy repay the pre-death debt (as would have been envisaged when the trust was made) the pre-death debt is not deductible. The solution is that:
(1) The trustees lend to the PRs.
(2) The PRs repay the debt out of the estate.
(3) The trustees may then waive the post-death debt.

HMRC agree. The IHT Manual provides:

property. But it comes to the same thing.

> **IHTM28028 meaning of 'out of estate'** [Aug 2016]
>
> ...
>
> There may be circumstances where the estate has very little in the way of liquid assets from which to repay a liability so the personal representatives may need to borrow money to actually repay the debts. Where this happens, with the result that the estate is charged with repaying that new debt, you can accept that the liability owed by the deceased has been repaid 'out of' the estate.
>
> *Example* (Kevin)
>
> K's estate is valued at £750,000, £700,000 of which is attributable to his home.
>
> A mortgage of £100,000 is secured against the house.
>
> The executors borrow £100,000 to repay the mortgage and secure the new loan on the house, so that the beneficiary receives the property charged with the new debt.

The HMRC analysis is as follows:

> You may accept that the liability has been discharged out of the estate. There is no need to raise any enquiries into the source of funds lent to the executors, including whether or not the beneficiary is the creditor for the new loan. Provided the mortgage has actually been repaid from funds charged against the estate, the deduction may be allowed as this has the same effect as the liability being discharged out of the estate had there been sufficient liquid assets.
>
> It is possible that the beneficiary[92] may be able to make a loan to the estate from the proceeds of an insurance policy held in trust outside the estate for the purposes of repaying the mortgage. Again, the source of the funds does not matter.

Although this passage refers to an illiquid estate, where the trustees "need" to borrow, the same would apply to a liquid estate (if it mattered).

80.38 Commercial reason defence

Section 175A(2) IHTA provides a TAAR, in slightly non-standard form:

> Where the whole or any part of a liability is not discharged in accordance with paragraph (a) of subsection (1), [ie the liability is not paid out of the estate] the liability or (as the case may be) the part may only be taken into account for the purpose mentioned in that subsection to the extent that—

[92] "The beneficiary" is presumably a slip for the trustees of the insurance policy trust.

> (a) there is a real commercial reason for the liability or the part not being discharged,
> (b) securing a tax advantage is not the main purpose, or one of the main purposes, of leaving the liability or part undischarged, and
> (c) the liability or the part is not otherwise prevented, under any provision of this Act, from being taken into account.

Paras (a)-(c) contain an exception to the s.175A disallowance. I refer to this as the "**commercial reason defence**". The label is not entirely apt to cover all the requirements of (a) - (c) but no short label could do that.

There is no relief if the debt is discharged, but not out of the estate (even if that is done for commercial reasons).

80.38.1 *Commercial reason*

Section 175A(3) IHTA provides:

> For the purposes of subsection (2)(a) there is a real commercial reason for a liability, or part of a liability, not being discharged where it is shown that—
> (a) the liability is to a person dealing at arm's length, or
> (b) if the liability were to a person dealing at arm's length, that person would not require the liability to be discharged.

I abbreviate "real commercial reason" to "commercial reason" because "real" does not add anything to the meaning.[93] I refer to the requirements in (a) and (b) as "**commercial reason requirements (a) and (b)**".

Section 175A(3) is not expressed to be a comprehensive definition of commercial reason. It is suggested that there could be a commercial reason even if commercial reason requirements (a) and (b) are not met; but that would be rare, as those conditions more or less encapsulate the meaning of "commercial" in this context.[94]

At what time does one ask whether commercial requirement (a) is met? A person may be dealing at arm's length at one time and not at another time. At what time does one ask whether commercial requirement (b) is met? It may be that a person (hypothetically) dealing at arm's length would require the debt to be discharged at one time but not at another time.

Clearly, one cannot look at the position at the date of the death. It is

[93] See 3.21.3 ("Genuine").

[94] See App.5.2 (Commercial).

suggested that one looks at the position at the time that the IHT is due and payable. The due date is normally when probate is applied for. If the commercial reason defence applies at that time, the debt is deductible. Since there is no provision for the possibility that IHT may subsequently fall due, it is suggested that it does not matter what happens later. This view increases the scope of the commercial reason requirements (a) and (b) but that does not matter as the commercial reason defence is still effectively policed by the tax motive rule.

HMRC say:

> 8.8 The 'commercial reason' test will apply at the time the decision is made not to repay the loan.[95]

However it may not be possible to identify that time.

80.38.2 *Tax motive rule*

The second requirement of the commercial reason defence is that:

> (b) securing a tax advantage is not the main purpose, or one of the main purposes, of leaving the liability or part undischarged ...

I refer to this as the **"tax motive rule"**.

Section 175A(5) IHTA provides the standard definition of "tax advantage"[96] rather than the usual IHT definition (as in the excluded property disallowance).[97] That makes sense because of the wider definition of "tax" applies here. Section 175A IHTA(6) provides:

> In subsection (5) "tax" includes income tax and capital gains tax.

What matters is the purpose for leaving the debt undischarged, not the purpose for creating it. Leaving a debt undischarged is not usually going to avoid IHT. It could avoid IT or CGT.

Again, the legislation is silent as to the time when the main purpose(s) are ascertained. Purpose may vary over time. It is suggested that one looks at the time the IHT is due. But since avoidance need only be one of the purposes, this problem may not often arise.

If one meets all the requirements of the commercial reason defence, then

[95] HMRC, "Treatment of liabilities for inheritance tax: HMRC response to comments on schedule 36 FA 2013" (September 2013).

[96] See App 3.19.1 (Tax advantage: Definitions).

[97] See 80.25.4 (Disallowable reason 1: Avoidance).

it does not matter if the debt is later waived.

The IHT Manual provides 3 examples.

80.38.3 *HMRC eg 1: NRB debt scheme*

Example 1 is a (more or less) standard nil-rate band debt scheme.[98]

> **IHTM28029 non-repayment of liabilities deducted against the estate on death** [Sep 2018]
>
> ...
>
> *Example 1* (Harvey and Wendy)
>
> H dies leaving a nil-rate band (NRB) discretionary trust under his Will with the residue of the estate passing to his wife, W.
>
> The trustees of the NRB trust exercise their powers and pass the whole of the H's estate to W in return for her agreeing to repay an amount equal to the NRB (£325,000). Interest is charged on the debt at 3% per annum, compounded annually.[99]
>
> On W's death four years later, interest has increased the liability from £325,000 to £365,790. The liability is not disallowed by any other part of the IHTA, so it can be taken into account to the extent that it is actually repaid out of the estate in money or money's worth under IHTA84/S175A(1)(a).

The HMRC analysis is as follows:

> Provided the whole £365,790 is repaid out of W's estate, the full sum can be deducted from her estate. The interest received by the NRB trustees will be income of the trust and should be declared for Income Tax purposes.
>
> If, instead, only £325,000 is discharged from W's estate, that sum can still be deducted from her estate under IHTA84/S175A(1)(a). But there is unlikely to be any commercial purpose to the interest not being repaid as, had the creditor been at arm's length, they would have wanted the interest repaid as well. As a result, the £40,790 of the liability that is not repaid from the estate is not allowed as a deduction against the estate – but equally, the trustees will have no Income Tax liability.

HMRC argue that the commercial reason defence does not apply. They

[98] On these schemes, see Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 18.3 (Residence NRB).

[99] Under the NRB schemes in practice, the debt is usually index-linked, and index-linking is not interest: see Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para Appendix 4 (NRB Interest).

accept if is possible (if unlikely) that commercial requirements (a) or (b) may be met, if that is the case, the tax motive rule disallows the relief:

> Even if it could be shown that the liability incurred by the wife to the NRB trustees was incurred in an arm's length transaction, the provisions of IHTA84/S175A(2)(b) must be considered.

Does the author mean to suggest that the time to assess commercial reason requirement (a) is when the debt is incurred?

> The part of the liability not discharged may not be taken into account if the main purpose, or one of the main purposes, for not repaying the liability was to secure a tax advantage. If the trustees have waived the interest, it would result in the trust receiving less income than it otherwise would. This in turn would lead to a reduced Income Tax liability. A reduction of a charge to Income Tax falls within the definition of a tax advantage in IHTA84/S175A(45), so £40,790 of the liability that is not repaid from the estate is not allowed as a deduction against the estate.

I wonder about that. For basic rate taxpayer beneficiaries, the maximum tax advantage may be saving IT on the interest at 20% or less (allowing for the repayment of the trustees tax credit on a distribution to beneficiaries): is the saving of £8k likely to be a main purpose? Not if the estate is illiquid. The purpose of waiving the loan is to avoid the cost of borrowing.

80.38.4 *HMRC eg 2: Family trust lends*

The next example concerns a loan from a family trust. The IHT Manual provides:

> **IHTM28029** [Sep 2018]
> *Example 2* (David)
> D's estate includes a house valued at £800,000. There is a commercial mortgage of £200,000 from a family trust charged against the property. D leaves his house to his son, Roger. The trustees[100] are content that the house can be transferred to Roger provided that Roger takes over the mortgage and continues to make the repayments.
> Although the liability has not been repaid, the arrangements are commercial and there is no tax advantage arising from Roger taking over the mortgage, so the liability may be allowed as a deduction against the

[100] More accurately, PRs or executors; but nothing turns on the terminology.

> estate.

How does D "take over" the mortgage? The passage is not drafted by a lawyer. The usual way would be a tripartide agreement between (1) the PRs, (2) the lender, (3) D, under which:

(1) The lender discharges/releases the debt due from the PRs in consideration for which
(2) D promises to pay a like sum to the lender.

That would not strictly qualify for the commercial reason defence as that only applies if the debt is not discharged. HMRC may not take the point. The safe way to deal with the matter is for D to borrow, lend to the PRs who then repay the lender.

80.38.5 *HMRC eg 3: Family loan repayable on 2^nd^ death*

The IHT Manual provides:

> **IHTM28029** [Sep 2018]
> *Example 3* (Adrian)
> A makes of loan of £25,000 to his father to help with living expenses, which is secured on his parent's house.
> A normal rate of interest is charged, but they agree to allow the interest to be added to capital sum owing.
> The liability is not to be repaid until after the death of both parents, so when A's father dies, two years later the loan is not repaid.

Of course s.103 FA 1986 may disallow the debt on the death of the father, but we must assume it does not.

The HMRC analysis is as follows:

> Since the loan was not due to be repaid until the death of the survivor, an arm's length creditor would not have any cause to seek repayment, so the liability may be allowed as a deduction against the estate.

More analytically, the commercial reason defence applies.

> On the mother's subsequent death, the liability must be repaid from the estate before it can be allowed as a deduction against the estate. If the accrued interest was not repaid, no deduction should be allowed for that sum.

It may be different if there is a break clause in the agreement.

> The position may be different if the loan agreement contains a 'break' clause that allows for early repayment. If a favourable rate of interest, or

> no interest, was charged and the repayment could be demanded after the first death, an arm's length creditor might reasonably be expected to call in the loan to gain a better return from the money. In these circumstances, if the loan is not repaid on the first death, the terms of IHTA84/S175A(2)(a) are unlikely to be met and the liability should be disallowed unless it is repaid, although this may be of limited impact if most of the estate passes to the surviving spouse.

The disallowance for debts not paid after death is irrelevant if the spouse exemption applies. The example may be more important for cohabitees.

80.39 Part payment of mixed debt after death

A single debt may be used to finance the acquisition of:
(1) excluded property
(2) business/agricultural property
(3) chargeable property

If the debt is not repaid after death, it will be wholly disallowed. If the debt is wholly repaid after death, it will be (effectively) disallowed to the extent was used to finance excluded or business/agricultural property and allowable to the balance. What if the debt is repaid in part after death? Is the part repaid the allowable or the disallowable part? Section 175A(7) IHTA provides the answer in the way most favourable to HMRC:

> Where the liability is discharged as mentioned in subsection (1)(a) only in part—
> (a) any part of the liability that is attributable as mentioned in section 162A(1) or (5) is, so far possible, taken to be discharged first,
> (aa) any part of the liability that is attributable as mentioned in section 162AA(1) is, so far as possible, taken to be discharged only after any part of the liability within paragraph (a) is discharged,
> (b) any part of the liability that is attributable as mentioned in section 162B(1)(b), (3)(b) or (5)(c) is, so far as possible, taken to be discharged only after any parts of the liability within paragraph (a) or (aa) are is discharged, and
> (c) the liability so far as it is not attributable as mentioned in paragraph any of paragraphs (a) to (b) is, so far as possible, taken to be discharged only after any parts of the liability within any of those paragraphs are discharged.

This follows the pattern of the rules for excluded property/APR/BPR.[101] The IHT Manual provides:

> **IHTM28032 partial repayment of liabilities after death** [Nov 2016]
> Where a liability is partially repaid after death only the part of the loan that has been repaid will be allowed as a deduction, unless the balance that has not been repaid meets the conditions of IHTA84/S175A(2), (IHTM28029).
> Where borrowed money has been used to acquire a mixture of excluded property (IHTM28014), finance a foreign currency bank account (IHTM28033) and/or relievable assets (IHTM28019) and the loan has been partially repaid, IHTA84/S175A(7) sets out the priority in which the partial repayment should be allocated against the assets of the estate. The provisions cover the situation where the single loan has been used to acquire other chargeable assets as well...
> Any part of the liability that is attributable to excluded property is treated as being repaid first, IHTA84/S175A(7)(a), with the result that although this part of the liability has been repaid, the deduction is still disallowed under IHTA84/S162A (IHTM28014), unless one of the exceptions is satisfied. If the partial repayment was greater than that part of the liability, the part of the liability that is attributable to a foreign currency bank account is treated as being repaid next, IHTA84/S175A(7)(aa), so the deduction is still disallowed under IHTA84/S162AA (IHTM28033). If the partial repayment was greater than that part of the liability, the part of the liability that is attributable to relievable property is treated as being repaid next IHTA84/S175C(7)(b), so that this part of the loan is a valid deduction against the estate, but it will reduce the value of the property that can qualify for relief; ultimately reducing the relief to nil.
> And if the partial repayment was greater than the part of the liability attributable to all the above categories of asset, the remainder of the liability can then be allowed as a deduction against the chargeable estate, IHTA84/S175A(7)(c).

The HMRC example has 3 parts:[102]

> *Example* [1] (Neville)
> N, who is non-UK domiciled, borrows £1.5m from an excluded property trust. He charges the liability against his existing UK chargeable property worth £2m.

[101] See 80.34 (Part payment of mixed debt).

[102] I have slightly altered the layout for enhanced clarity.

He uses the £1.5m to acquire:

excluded property	£600,000
property qualifying for agricultural relief	£500,000
chargeable UK property	£400,000
	£1,500,000

When he dies the whole £1.5m remains outstanding.
The values of the assets have not changed; none of the exceptions to the general rules apply.

The Manual first considers the position if the debt is wholly repaid after death:

Under IHTA84/S162A the £600,000 used to acquire excluded property is disallowed. Under IHTA84/S162B the agricultural value of the agricultural property which can qualify for relief is reduced from £500,000 to nil.
If the liability is discharged in full from the estate after the date of death, the UK assets of £2.9m (UK property, agricultural land and other chargeable property) is reduced by

- the £500,000 liability set against the agricultural property and
- the £400,000 liability used to acquire chargeable UK assets,

leaving £2m in charge.

Example [2]: partial repayment after death

Assume however, that only £750,000 of the liability is discharged from the estate after death.
Under IHTA84/S175A(7)(a) the first £600,000 discharged is taken to have discharged the liability incurred to acquire excluded property. This part of the liability remains disallowed by IHTA84/S162A(1)(a).
Under IHTA84/S175A(7)(b) the next £150,000 is taken to have discharged part of the £500,000 liability incurred to acquire agricultural property. As only £150,000 of this liability is treated as having been discharged, only £150,000 is an allowed as a deduction from the value of the estate on death. This reduces the value of the property that can qualify for agricultural relief to £350,000, and assuming that relief is available, the chargeable value of the property is reduced to nil.
Under IHTA84/S175A, the agricultural property that makes up part of the UK assets of £2.9m is reduced to nil by a mixture of the liability (£150,000) and agricultural relief (£350,000) leaving a chargeable estate of £2.4m

Example [3]: partial repayment after death

Assume now that £1.3m of the liability is discharged from the estate after death.
Under IHTA84/S175A(7)(a) the first £600,000 repaid is taken to have discharged the liability incurred to acquire excluded property. Under

> IHTA84/S175A(7)(b) the next £500,000 is taken to have discharged the liability incurred to acquire agricultural property.
> As the value of the agricultural property is reduced to nil by deducting the liability, there is no agricultural relief. Under IHTA84/S175A(7)(c) the remaining £200,000 of the liability which has been discharged can be taken into account to reduce the value of the chargeable estate.
> The deduction allowable under IHTA84/S175A is therefore £700,000 (£500,000 + £200,000) so the chargeable estate is reduced from £2.9m to £2.2m.

The attribution rule is unfair but it will not bring in any additional revenue to HMRC. In practice, if the issue arose, the PRs would repay the whole debt. If it is anticipated that may not happen, it would be better to take out separate loans, one for each class of property, so the PRs could decide which debt to repay.

80.40 Interaction of s.175A disallowance/spouse exemption

Section 175A(4) IHTA provides:

> Where, by virtue of this section, a liability is not taken into account in determining the value of a person's estate immediately before death, the liability is also not to be taken into account in determining the extent to which the estate of any spouse or civil partner of the person is increased for the purposes of section 18.

The IHT Manual provides:

> **IHTM28030 interaction with spouse or civil partner exemption where liabilities are deducted against the estate on death** [Sep 2018]
> Where a liability is secured on a property that passes to the spouse or civil partner, the value by which the spouse or civil partner's estate is increased (being the net value of the property) could result in a charge arising against property that passes to the spouse or civil partner. This is because if the liability is not repaid, no deduction is allowed against the estate, but the spouse or civil partner's estate is only increased by the net value of the property.
> To be clear that spouse or civil partner exemption should continue to apply to the full value of the property that the spouse or civil partner receives, IHTA84/S175A(4) provides that where a liability is not taken into account in determining the value of a person's estate, the liability is also not to be taken into account in determining the extent to which the spouse or civil partner's estate is increased.

That seems misconceived. Section 18(1) IHTA provides:

> A transfer of value is an exempt transfer to the extent that the value

> transferred
> [a] is attributable to property which becomes comprised in the estate of the transferor's spouse or civil partner
> [b] or, so far as the value transferred is not so attributable, to the extent that that estate is increased.

It is correct that the spouse's estate is only increased by the net value of the property, which restricts the exemption under [b]. But the IHT spouse exemption would still apply under [a]. If that is right, s.175A(4) is unnecessary, though it does no harm.

> *Example* (James)
> J makes of loan of £25,000 to his father to help with living expenses, secured on his parent's £500,000 house. The loan is interest-free and repayable on demand. On the father's death, the loan is not repaid as the son is content for it to remain outstanding until his mother's death. The property passes to his mother under his father's Will.
> An arm's length creditor would not leave the loan outstanding so the liability cannot be taken into account by virtue of IHTA84/S175A(2)(a). The liability is disallowed as a deduction against the estate so the chargeable value of the house is £500,000 rather than £475,000. But the liability is also not taken into account when considering spouse exemption. So even though the spouse actually receives the £500,000 subject to the £25,000 liability, spouse exemption applies to the full £500,000 value of the property.

If on the same facts the father had left the estate to charity, the debt would be disallowed; would the charity exemption be restricted to the net value? J should have purchased a share in the father's house. Then the debt would not be disallowed.

80.41 When must debt be discharged?

80.41.1 *The strict position*

A debt may be discharged after the time that an IHT account is delivered or after IHT is paid. The strict position is that:

(1) If at the time of payment of the IHT the debt has not been discharged, it is disallowed in computing the amount of IHT due.
(2) If the debt is subsequently discharged, IHT is recomputed if a claim is made under s.241 IHTA; note the 4 year time limit.

PRs cannot obtain probate until tax is paid but often cannot pay liabilities until they have probate. I doubt if the commercial reason defence was specifically designed to cover this (it is more likely that HMRC overlooked the problem) but it seems to me entirely apt to cover it. So the debt will be deductible as long as there is no tax avoidance purpose.

80.41.2 *HMRC practice*

The IHT Manual provides:

> **IHTM28031 investigation of liabilities deducted against the estate on death** [Sep 2018]
> As the majority of liabilities taken as deductions against an estate will be at arm's length, the starting assumption is that all liabilities will be repaid. So, unless the personal representatives are aware beforehand that a liability is not going to be repaid and it is not otherwise allowable as a deduction, the IHT400 Notes allow the personal representatives to include all the deceased's liabilities when filling in the IHT400. There is no need to make any enquiries to establish that liabilities which are clearly commercial and at arm's length have been repaid, as it is more than likely that the creditor will want to recover the money owed to them. Examples here would be:
>
> - utility bills,
> - credit card bills,
> - council tax,
> - payments due to HMRC,
> - outstanding care fees,
> - professional fees (to the date of death),
> - overpaid pension,
> - payments for goods and services.
>
> If an arm's length liability for which a deduction is included is not actually repaid, form IHT400 would then be incorrect and the taxpayer is obliged to tell us about the adjustment to be made under IHTA84/S217.

Presumably this should be done when it becomes clear that the debt will not be repaid.

> Where, however, liabilities have been deducted which are not due to arm's length creditors, such as family members, family trusts or companies or liabilities deducted in connection with avoidance schemes, you should ask the taxpayer or agent to provide evidence that the money has been repaid. This might be a copy of the letter enclosing a cheque to the creditor or confirmation of receipt of the payment by the creditor. You should also obtain evidence that the liability has been repaid out of the estate; remembering the extended meaning of estate for this purpose

> (IHTM28027). This might be a copy of the bank statement from the personal representatives' bank account, or a ledger entry from the appropriate solicitor's client account.
> Where the personal representatives do not repay a liability during the normal administration of the estate and the exception at IHTM28029 does not apply, you should disallow the deduction and ask for the tax to be paid. If the liability is subsequently repaid, the deduction may then be allowed and the tax repaid, provided the claim for repayment is made within the 4 year period set out in IHTA84/S241. But you do not need to keep the file open to wait to see if the liability is repaid...

80.42 The 2013 disallowances: Critique

FA 2013 made 3 reforms, the excluded property disallowance; the BRP/APR disallowance; and the s.175A disallowance. They raise distinct issues and need to be considered separately.

80.42.1 *s.175A disallowance: purpose*

One purpose (perhaps the only purpose) of the s.175A disallowance is to counter arrangements under which:

(1) an inheritance tax deduction is increased, by making a debt subject to interest; but
(2) the interest is not in fact paid, so there is no liability to income tax on it.

The most common cases will be:

(1) NRB discretionary trusts[103] funded by debt or charge arrangements.
(2) Home loan schemes.[104]

NRB trusts have not (usually) been created since 2007, and home loan schemes have not been created since 2004, but many made before then are still in existence.

The disallowance could apply in relation to other loans from family or family trusts, but I think that would be rather less common.

Taxpayers now have the choice between:

(1) IHT (due if the debt is not repaid) or
(2) income tax on interest, (if the interest is paid).

[103] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 19.13 (Winding up NRB trust after death of surviving spouse).

[104] See 83.2.3 (Home loan schemes).

That this is the purpose (or at least one purpose) of the disallowance is supported by the definition of "tax" which includes:

(1) IT (the target here is IT avoidance) and
(2) CGT (the target is CGT avoidance, on the basis that the debts may be a secondhand debt, or a debt on a security, within the charge to CGT).[105]

It is possible that HMRC were concerned that their recent change of view (taking the position that home loan schemes do not work) was not sustainable; and s.175A was partly motivated (or maybe primarily motivated) by the desire to find an effective means of attacking pre-2004 home loan schemes.[106] Such schemes were avoidance, but the POAT regime offered taxpayers the option of keeping the home loan arrangement in exchange for paying POAT: HMRC have withdrawn from their side of the bargain.

There is a case for disallowing a deduction for interest not paid after the death, but it is difficult to see the case for disallowing other debts ("non-interest debts"). HMRC assert that there is scope for avoidance but I cannot see it. It might perhaps be said that if estate debts are not paid the beneficiaries of the estate have a windfall which may fairly be taxed. The way that the HMRC press release expresses it is that if debts are not repaid there is no "real reduction" in the value of the estate. But if debts are not repaid, there is a gift from the *creditor* to the debtor. That is not a gift which passes on death, so should not be subject to IHT.

Even if there were a case for disallowing non-interest debts (and I cannot see what it could be) there is no case for disallowing debts unless paid *out of the estate*. If I am right that the purpose of the rules is to ensure that IT (or CGT) on pre-death debts is not avoided by non-payment, all that matters is that the interest is paid. It does not matter whether it is paid out of the estate or not.

80.42.2 *Excluded property disallowance: purpose*

HMRC say:

> 5.1 The principle behind disallowing any deduction for a liability which has been incurred to acquire excluded property is that a deduction

[105] See 80.38.2 (Tax motive rule).

[106] The law in this area is now a mess, following *Shelford v HMRC* [2020] UKFTT 53 (TC)

should only be allowed if the acquired asset is chargeable to IHT. If the acquired asset is excluded property, there is already in effect a deduction for that asset from the value of the estate subject to IHT so HMRC does not believe that any further deduction should be made for the liability.[107]

80.42.3 *BPR/APR disallowance: purpose*

HMRC say:

> 2.4 If a liability is incurred to acquire certain business assets or agricultural property and the loan is secured against those assets, the liability is deducted from the value of those assets and only the net value qualifies for relief. However, if the loan is secured on other assets in the estate, the liability is deducted from the value of the estate and relief is also given on the full value of the assets. The resulting tax advantage creates an incentive for loans to be secured against non-business assets, provides a basis for certain types of avoidance schemes, and discriminates against those businesses that borrow and secure the liability against their business assets.
>
> 2.5 The new provisions remove that tax advantage and ensure that all liabilities incurred to acquire property that qualifies for a relief are treated in the same way regardless of the nature of the property or how the loan has been secured. This consistent treatment eliminates the current discrimination, the basis for avoidance, the incentive to structure borrowing in a certain way, and the resulting distortion to borrowing arrangements.
>
> 7.2 The intention of the new proposals is not to prevent or deter individuals from starting a business or investing in one, but to remove the current difference in treatment for different types of qualifying assets and to close avoidance opportunities. HMRC does not believe that the changes will disrupt business activity or that they will prevent a business from securing a loan. The majority of business loans and overdrafts are unsecured or are secured against business assets, and are repaid before death, so most estates that have business liabilities and claim reliefs will be unaffected by the changes. Estates will continue to get a deduction for liabilities provided they are not used to acquire assets which are not chargeable to IHT and they are repaid after death (unless there are commercial reasons for the non-repayment and the non-repayment does not give rise to a tax advantage).
>
> 7.3 Reliefs such as APR and BPR are available so that farms and

[107] HMRC, “Treatment of liabilities for inheritance tax: HMRC response to comments on schedule 36 FA 2013” (September 2013).

> businesses do not have to be sold or broken up, thereby undermining their economic potential, to meet IHT bills. They are not intended to incentivise loans to be structured or secured in a certain way, so that those arrangements obtain a further tax advantage in addition to the relief. The Government understands that investment decisions are made on the basis of a variety of factors, and believes that the inheritance tax system should neither penalise nor favour particular borrowing arrangements. The changes introduced by FA2013 are in line with this key principle and remove the current difference in treatment.[108]

80.42.4 *Non-debt financing: comparison*

HMRC say:

> 7.4 Stakeholders also commented that the new provisions will give a different result for those who borrow funds to acquire relievable property compared to those that realise their existing assets, and therefore the new rules will discourage borrowing. If two people invest the same amount in business assets but one sells some of their existing assets to fund the investment and the other borrows the necessary funds, the borrower's taxable estate will be greater than the seller's by the amount of the loan even though both of them have the same investment in the business, net wealth and net equity.
>
> 7.5 Although their overall position appears to be very similar at first glance, it is unlikely to be case in practice. The seller will have had to sell some of their assets to fund the investment, which would constitute an equity investment. They will no longer have access to those assets as they will no longer be in their estate; they will have incurred costs and possibly paid other tax charges as well, such as capital gains tax and/or stamp duty. On the other hand, the borrower can keep and continue to benefit from and enjoy all their assets whilst also investing in the business through securing loan finance. The two have quite different circumstances. HMRC acknowledges that the IHT position will be different for the seller and the borrower as a result of the new provisions, with the equity investment by the seller now more advantageous than a debt financed investment by the borrower from an IHT perspective. However, there is also an inconsistency in the current rules in how liabilities are treated for IHT purposes, which the new provisions address, as explained in paragraphs 2.4 and 7.3. The Government considers that it is more important to ensure that the tax

[108] HMRC, "Treatment of liabilities for inheritance tax: HMRC response to comments on schedule 36 FA 2013" (September 2013).

system neither penalises nor encourages particular borrowing arrangements than continuing the previous position of treating investments by borrowers and sellers the same. [109]

80.42.5 *How it seemed to HMRC*

I quote the press release announcing the 2013 changes at some length as:

(1) It illustrates the state of UK tax policy formation, at least as at 2013.

(2) It illustrates the difficulties which may arise if one looks to a press release to identify the policy of tax provisions.

The FA 2013 introduced 3 reforms, but the press release treats all three as a single item of reform.

I insert question marks at the more startling half-truths: no further elaboration is needed.

> **Inheritance tax: limiting the deduction for liabilities**
> **Who is likely to be affected?**
> Users and promoters of avoidance schemes and participators in arrangements which take advantage of the current IHT treatment of liabilities to reduce the value of an estate. (?)
> **General description of the measure**
> For most estates, liabilities owed by the deceased in the normal course of events where the debt has been repaid after death will continue to be deducted as they are now. (?)
> **Policy objective**
> The measure will remove the tax advantage that these schemes and arrangements seek to achieve, and ensure that the value of an estate subject to IHT reflects the normal economic consequences of incurring a liability. (?)
> **Background to the measure**
> The measure is a response to avoidance schemes and arrangements which exploit the current rules that allow a deduction for liabilities owed by the deceased against the value of an estate regardless of whether or not the debt is paid after death. Some arrangements involve contrived debts which are subsequently not repaid so there is no real reduction in the value of the estate; others involve loans used to acquire assets which are not chargeable to IHT, or which qualify for a relief, so that the value of the estate is doubly reduced.

[109] HMRC, "Treatment of liabilities for inheritance tax: HMRC response to comments on schedule 36 FA 2013" (September 2013).

> The measure has not been previously announced. There has been no consultation on the measure.
>
> **Summary of impacts**[110]
>
> | 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 |
> |---|---|---|---|---|
> | +5 | +20 | +15 | +15 | +15 |
>
> **Impact on individuals and households**
>
> This measure will only (?) affect individuals entering into avoidance schemes involving debts to artificially reduce the value of an estate.
>
> The administrative impact of this measure is not on the deceased individual but rather on those acting as executors or administrators of the estate. (?) Personal representatives will need to ensure that any outstanding loans are repaid in order to claim the deduction against the value of the estate.
>
> This measure will affect only a small number of individuals and households (?) as the base of estates that fall within the charge to IHT is fairly small (it is estimated for 2010-11 that there will have been approximately 17,000 estates left on death paying IHT, representing less than 4 per cent of the total). Of the estates left on death a few hundred are likely to be using one of these schemes. (?)
>
> **Impact on business including civil society organisations**
>
> There is unlikely to be any impact on most businesses because normal commercial debts will be unaffected. (?)[111]

No doubt the press release does not fully represent HMRC's thinking and motivation; every law reform proposal has to be "sold" to its target audience(s). Subject to that, Hanlon's razor suggests it should be taken at face value. If this press release is taken as typical, the court's policy of not having regard to press releases in the construction of statutes, or in the ascertainment of the policy of tax provisions, is a wise one.

80.42.6 *Critique*

HMRC are wrong to classify the arrangements caught by the provisions as avoidance, or principally avoidance, except in the debased sense that anything one dislikes in tax involves avoidance.

[110] Author's footnote: These figures seem to me to be a significant underestimate; but that is a matter of impression rather than knowledge or research.

[111] HMRC & HM Treasury budget announcement, "Overview of Tax Legislation and Rates" (2013) *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/207419/022_fb20013_ootlar.pdf*

The idea of a disallowance of (effectively) a double deduction is an understandable policy; though so far as the provisions go beyond preventing a double deduction they are difficult to justify; and it is open to question whether the problem justifies the complication of the provisions. The cure is worse than the disease.

These issues should have been debated before enactment; but in the UK provisions brought in under a tax avoidance banner are exempt from the Tax Consultation Framework; the tax avoidance siren drowns out the sound of reasoned argument, and we are faced with the more familiar process of legislate first and think later. Had the matter been dealt with in accordance with the Tax Consultation Framework, it seems safe to say that different rules would have resulted.

In the 2014/15 edition of this work, I said: "I expect another round of amendments will follow eventually". But that now seems less likely to happen.

80.43 GAAR: Debt reduces 10 year charge

The GAAR guidance is confused; but it is worth studying as the confusion is itself revealing.

> **D28 Excluded property trust and debt**
> D28.2 ***The arrangements***
> D28.2.1 The trustees of an excluded property settlement buy a property in the UK and hold it directly. At the ten year anniversary, the UK property (in the absence of any other arrangements) will be subject to inheritance tax at a maximum of 6%.

The tax problem anticipated by the trustees is the 10-year charge. What do the trustees do?

> Shortly before the ten-year anniversary, the trustees borrow funds from a bank and secure the debt on the property.

At this stage - while the borrowed funds are still held by the trustees - there is no IHT saving, though the exact IHT analysis depends on whether the borrowed funds are excluded property or relevant (ie chargeable) property.

If the borrowed funds are UK situate at the time of the 10-year charge, the debt is deductible but the borrowed funds are chargeable property: the IHT ten year charge is unchanged by the borrowing, as the net value of the trust fund is the same.

Before 2013, the trustees could have carried out the following arrangements:

(1) The trustees borrow charged on the property.
(2) The trustees hold the borrowed funds offshore on the ten year anniversary (so the funds would be excluded property),
(3) The trustees repaid the debt later.

This worked as the debt was then deductible but the borrowed funds were not chargeable. I refer to this as "**pre-2013 debt planning**". But of course this planning no longer works from 2013 because of the excluded property disallowance.

My guess is that this is the scheme which the author of the example had in mind. But they realised that pre-2013 debt planning no longer worked, so they proposed a further step:

> The cash is paid out to the settlor[112] on the understanding[113] that the money will be returned.

The guidance does not specify the timing here, but it is envisaged that the payment to the settlor is made before the 10-year anniversary and the payment back from the settlor is made afterwards.[114] I refer to this as "**post-2013 debt planning**".

The post-2013 debt planning does not save any IHT:

(1) If the trustees held the borrowed funds in the UK at the time the borrowed cash is paid to the settlor, there would be an IHT exit charge.
(2) If the borrowed cash was not UK situate at that time, the there would be no exit charge, but the trust debt would be disallowed under the excluded property disallowance; so there is a 10-year charge.

> Shortly after the ten-year anniversary, the settlor adds the funds back to the trust and the trustees use it to repay the loan, freeing the UK

[112] Author's footnote: Although the example specifies that funds are paid to the settlor, it does not matter for present purposes whether it is paid to the settlor or any other beneficiary.

[113] Author's footnote: It is envisaged that this is a non-binding understanding. If the arrangement involved a legally binding promise by the settlor to return the funds, then the promise is trust property

[114] This is clear on first principles, but for completeness, it is confirmed later in the guidance ("... it is always intended to use the cash borrowed to repay the debt as soon as the anniversary has passed ...").

> property from its charge...

The payment from the settlor to the trust has many tax consequences, of which IHT in principle due on the payment is the most obvious.[115]

The guidance next considers the taxpayer's tax analysis. It does so in a paragraph of 3 sentences; it is convenient to consider the middle sentence first, as it makes a distinct point:

> D28.4 ***The taxpayer's tax analysis***
> D28.4.1 ...
> [2] The cash borrowed by the trustees is excluded property at the time of the ten-year charge and not subject to tax.

Sentence [2] is inconsistent with the given facts, which are that the borrowed cash has been paid out to the settlor before the 10-year anniversary. The borrowed cash is outside the scope of the 10 year charge because once it has been paid out to the settlor it is no longer settled property (in the statutory terminology, it is not relevant property). It is wrong to describe it as excluded property. I guess that what has gone wrong is that the author of the guidance here has in mind the pre-2013 planning (which does not involve any payment to the settlor) and has forgotten that the given example was altogether different.

The rest of the section "taxpayer's tax analysis" concerns deduction for the trustees debt:

> [1] The value of the UK property that will be subject to tax on the ten-year anniversary is reduced to nil as a result of the debt secured against it, so no tax will be payable in respect of the UK property...
> [3] The taxpayer claims that he has effected the scheme in such a way that the new anti-avoidance legislation in Sch 36 FA 2013 introducing the excluded property disallowance does not apply.

We move on to the HMRC analysis:

> D28.5 ***What is the GAAR analysis under s207(2) FA 2013?***
> D28.5.1 Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?

[115] One can avoid this IHT problem if one is allowed to hypothesise that the settlor is not UK domiciled at the time of the transfer and the funds are not UK situate at that time, so the property is excluded property. The example does not specify that, but it not inconsistent with the given facts.

> The relevant property regime applies to excluded property settlements only if UK property is owned by the trustees directly on the relevant date such as on the ten year anniversary.
>
> By charging the UK property with debt and paying the cash out to the settlor abroad, the trustees have tried to avoid the ten-year charge.
>
> Even if the taxpayer has found a way to circumvent the specific provisions of FA 2013 [the excluded property disallowance] it is clear that the policy intent expressed there is to prevent a deduction against UK property except where the loan was taken out to acquire the UK property. Using contrived borrowing that is not genuinely used to acquire UK property is clearly against the intent of the legislation.

Sentence [3] of the taxpayer's analysis, and the last paragraph of HMRC's analysis is lazy and inadequate. It is not satisfactory to say "*even if* the taxpayer has found a way to circumvent" the excluded property disallowance then the GAAR applies:

(1) If the taxpayer has *not* found a way to circumvent the excluded property disallowance, there is no tax saving and the GAAR does not apply.

(2) If the taxpayer *has* found a way to circumvent the excluded property disallowance, it is necessary to know how and why. One cannot carry out a GAAR analysis unless one knows what is the technical tax analysis in the absence of the GAAR.

The drafter of the guidance has not taken the trouble to identify and to answer these questions. It seems a safe inference that they reached the answer first, and the analysis (such as it is) came later. That is of course always a risk, particularly in policy-based adjudication such as the GAAR.

> D28.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*
>
> Borrowing with the intention of removing the cash from charge and then repaying the loan shortly thereafter is not a normal transaction. Borrowing taken out simply to avoid tax may in this context be regarded as a contrived step.
>
> D28.5.3 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*
>
> The ten-year charge is based on a 'snapshot' of the assets and liabilities of the settlement at the time of the charge. Until FA 2013 there was no specific provision dealing with the deduction of liabilities against settled property, nor could regard be had to the reasons behind borrowing the money. FA 2013 makes it clear that the general intention of the

> legislation is to grant inheritance tax deductions only in respect of borrowing taken out to acquire the particular property, with only limited exceptions, for example, where the value of the property acquired with the borrowings at the relevant time of charge is less than the amount borrowed (and not artificially devalued) in which case the excess may be set against other property.
>
> If the UK property was sold just before the ten year anniversary, HMRC accepts that the sale proceeds (if retained abroad) would not be subject to inheritance tax. Similarly, if the trustees had borrowed and lost the money on a poor investment the liability could be deducted against the house.
>
> However in this case the UK property continues to be owned before and after the ten year anniversary and one would therefore expect inheritance tax to be due on its value. The real economic value of the UK property has not been reduced; it is always intended to use the cash borrowed to repay the debt as soon as the anniversary has passed and the cash has been paid out of the trust in an attempt to circumvent the provisions but with the parties agreeing in advance that the monies will be resettled shortly thereafter. FA 2013 makes the regime for deduction of liabilities clear and attempts to circumvent this through insertion of more abnormal steps will be caught by the GAAR. In looking at the application of the GAAR it is appropriate to look at the wider context of the transaction before and after the ten year anniversary and in the light of FA 2013 to consider the context in which liabilities have been incurred.
>
> D28.5.4 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*
>
> HMRC has not indicated its acceptance of this practice and in the light of FA 2013 it is clear that liabilities may be deducted only if certain principles are satisfied.
>
> D28.6 ***Conclusion***
>
> D28.6.1 On the facts given, the arrangements are abusive arrangements to which HMRC would seek to apply the GAAR.
>
> D28.7 ***Proposed counteraction***
>
> D28.7.1 The liabilities would be ignored in calculating the tax due on the house and the transaction counteracted on this basis.[116]

Assuming for a moment that the post-2013 scheme could have worked,

[116] HMRC GAAR Guidance Part D (Examples) (2015) *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

that is, ignoring the actual IHT legislation, a similar result could have been defended on *Ramsay* grounds even without the GAAR. Though one point of the GAAR, I think, is that HMRC should no longer have to rely on the *Ramsay* principle, which is (to say the least) a tool of uncertain application.

Perhaps a moral to draw is that HMRC dislike circular arrangements involving short term borrowing and repayment; the borrower should not return the borrowed money back to the trust to allow the trustees to repay the loan very shortly after the ten year anniversary.

It seems safe to predict that GAAR guidance example D28 will be withdrawn in due course.

80.44 GAAR: Debt against UK residence

This section considers GAAR guidance para D31 (Lending to fund UK real estate by foreign domiciliary).

GAAR guidance provides:

> *This example illustrates how standard tax planning may have increasing levels of abnormality attached to it. A number of the alternatives are, nonetheless, clearly on the non-abusive side of the GAAR boundary. However, the example aims to illustrate at approximately what point that boundary is crossed, although – given the condensed nature of the illustration – this will always be highly fact dependent. The example also aims to demonstrate a situation (option 7) where the arrangements might fail a single reasonableness test, but be saved by the double reasonableness test. ...*

Para D31 is not one example, but a set of nine examples.

80.44.1 *Nine options*

> **D31.2 The arrangements**
>
> D31.2.1 R is domiciled abroad and wishes to buy a valuable house in the UK for his occupation. He has a number of options:

Example	**GAAR: HMRC view**
1. [*Individual purchase*] R buys the house in his own name, using his own cash resources to fund the purchase.	Not caught
2. [*Trust purchase*] R settles cash from his own resources into a trust that purchases the house. R is a beneficiary of the trust...	Not caught

3. [*Individual borrows 70%from bank*] R even if he could have funded the purchase from his existing resources, chooses to borrow from a bank to fund a large part, say 70%, of the purchase price.[117]	Not caught
4. [*Trust borrows 70% from bank*] R (as in 2. above) partially funds the trust. The trustees (as in 3. above) then borrow the remainder of the purchase price from a bank.[118]	Not caught
5. [*Individual borrows 95% from bank*] R deposits foreign investments with a bank thereby enabling the bank to lend a greater amount (say 95%) to fund the purchase of the property. The borrowing is again secured on the property.	Not caught
6. [*Trust borrows 95%from bank*] R having funded a trust to the value of, say, 5%, of the purchase price of the house, agrees to guarantee the trustees' borrowing. This enables R's trust to borrow the remainder of the purchase price from a bank. The borrowing is again secured on the property.	Not caught
7. [*Existing trust borrows 100%from family offshore company*] R has an existing substantive[119] discretionary trust which he settled many years ago. R is a beneficiary of the trust, but his adult children are also beneficiaries and they have all benefited from the trust over the years. The trustees previously owned a UK house, but sold it a couple of years ago.[120] The trustees previously owned a UK house, but sold it a couple of years ago.[121] The trustees have been looking around for a new UK property suitable for R and his children to use as each of them visit the UK for a few weeks a year.[122]	Not caught

[117] It is assumed that R charges the debt on the property.

[118] It is assumed that the trustees charge the debt on the property.

[119] Author's footnote: The term "substantive" is here used in a non-technical, layman's sense; see below.

[120] Author's footnote: The ownership of a previous house should be irrelevant, but it does illustrate the existence of the trust over an earlier period.

[121] Author's footnote: The ownership of a previous house should be irrelevant, but it does illustrate the existence of the trust over an earlier period.

[122] Author's footnote: I think the facts in this sentence are irrelevant to the example.

The trustees could afford to buy the new house using existing resources but instead they accept an offer from R to lend them the purchase price via an offshore company that is wholly owned by R. The loan is interest free and repayable on demand. The company owned by R secures the loan on the house.	
8. [*Gift to trust and loan back to settlor*] R settles cash from his overseas resources into a newly established trust which then lends it back to him via an underlying company for the purchase of the house in his own name.	Caught
9. [*Loan trust lends to property trust*] R adds cash from his overseas resources to a trust, known as the Loan Trust, where he is settlor and beneficiary. His spouse or other relative sets up another trust, known as the Property Trust, which is funded with, say, £1000 cash. R adds no funds to the Property Trust. The Loan Trust forms an overseas company into which the cash is transferred and the company lends the cash to the Property Trustees who acquire the UK property that R wishes to occupy. The loan is repayable on demand and may be interest-free, interest-bearing or index-linked. The Property Trustees incur no personal liability as the lender may have recourse to the house only...[123]	Caught

Examples 7-9 are now affected by the 2017 IHT residence-property rules. Those rules represent a more satisfactory way of dealing with the IHT issues, and may reflect an HMRC understanding that the guidance is not in all respects correct or beyond challenge. The guidance has not yet been updated[124] and I set it out here for the light it may shed on the GAAR, and the GAAR guidance.

80.44.2 *GAAR sub-issues*

The GAAR raises two distinct sub-issues. In short:

(1) Tax advantage purpose issue: Is obtaining a tax advantage one of the main purposes of the arrangement.

[123] It is not clear whether HMRC regard this fact as significant to the outcome; it seems to me irrelevant.

[124] Of course the GAAR guidance should be kept up to date. But that is a formidable task, given the pace of change, and some readers may doubt whether that will happen.

(2) Abuse issue: can the arrangement reasonably be regarded as a reasonable course of action.

80.44.3 *Options 1 and 2*

Options 1 and 2 are straightforward. GAAR guidance provides:

> D31.4.1 In options 1 and 2 [individual purchase and trust purchase] above there is no tax advantage and indeed additional ten year charges arise in relation to option 2. These options are included to illustrate the range of alternatives which R has and by way of contrast with the following options.

More analytically, to identify a tax advantage requires a comparator, and options 1 and 2 are the comparators for the options which follow.

In fact option 2 (trust purchase) may have an IHT advantage of a settlement created by a foreign domiciled settlor. That would be important if the individual was about to become deemed domiciled. If it did not have that advantage, then it is unlikely that a well advised person would create a trust. Elsewhere HMRC do suggest that option 2 may be tax motivated:

> The reasons for using a trust may be *partially* non-tax related and may include a desire for confidentiality, to avoid complex probate procedures, or to provide an automatic succession plan on R's death.

80.44.4 *IHT debt deduction advantage*

GAAR guidance provides:

> **D31.4 *The taxpayer's tax analysis***
> D31.4.2 In options 3 and 4 [70% bank borrowing] the borrowing provides a clear inheritance tax advantage compared to options 1 and 2. As R is not domiciled in the UK the cash he retains personally abroad is not subject to inheritance tax and the UK property is devalued by commercial borrowing.
> D31.4.3 The same tax advantage, albeit to a greater extent, is claimed to apply in options 5 to 9.

80.44.5 *GWR*

GAAR guidance provides:

> D31.4.4 The reservation of benefit rules do not apply to options 1, 3, 5 and 8 because R owns the property.

More analytically, GWR does not apply in options 1 [individual purchase], or 3 and 5 [individual purchase with 70% or 95% borrowing], because R does not make a disposal by way of gift. GWR does not apply in option 8 [gift to trust and loan back to settlor] because the property in R's trust is excluded property.

> There is a reservation of benefit in options 2, 4, 6 and 7, but the taxpayer argues that [in cases 4, 6, & 7 where the trust borrows] this is only on the net value of the property...

HMRC do not agree:

> D31.4.9 HMRC does not accept R's analysis of the legislation and in particular the deductibility of loans against UK property in which he reserves a benefit under options
> 2 [trust purchase],[125]
> 4 and 6 [trust borrows 70%/95% from bank], and
> 7 [trust borrows from family offshore company].
> The GAAR analysis below should be read with this point in mind.

The reader may think it unsatisfactory that HMRC do not state what their analysis is, or why the taxpayer's analysis is wrong. The GAAR analysis should only be carried out after one knows the general tax analysis.

Of course the tax analysis raises complex issues, but HMRC are primarily responsible for that complexity.

If HMRC were right about non-deductibility, the point would be of general importance. I cannot myself see a basis of an argument, and suspect HMRC wanted to avoid giving a hostage to fortune by saying anything at all. HMRC say the same later, in relation to examples 7-9:

> D31.6.5 With all the options (but particularly options 7, 8 and 9) HMRC would consider whether other legislative means at their disposal should be used to challenge the claimed tax treatment.[126]

Turning to option 9:

> D31.4.6 In option 9, there is no [GWR] charge on the death of R because he has not gifted any property to the Property Trust (so the

[125] The reference to option 2 is mistaken here, because that option did not involve a loan.

[126] A reference to *Lear* seems apposite: ("I will do such things – What they are, yet I know not...").

> reservation of benefit provisions do not apply) and he is a beneficiary only of the Loan Trust that holds excluded property. As he has made no gift to the Property Trust, s102 and para 5(4) Sch 20 FA 1986 are not in point.
>
> If he has made such a gift then it is argued that the UK property is devalued by the loan taken out to acquire it.

80.44.6 *s.103 disallowance*

GAAR guidance provides:

> D31.4.5 In option 8, the liability is not, it is claimed, caught by s103 FA 1986 as a self-generated liability due to it being funded with excluded property (see s103(4) FA 1986).[127]

80.44.7 *Pre-owned assets*

GAAR guidance provides:

> D31.4.7 Pre-owned assets charge does not apply to options 1, 3, 5 and 8 since R has made no disposal of the property and does not satisfy the contribution condition since the property has been acquired by him and not a third person.
>
> It does not apply to the other options on the basis that even if the contribution condition is satisfied, the loan in which R reserves a benefit (or in the case of option 2 the house itself) derives its value from the house and therefore protection under para 11(3) Sch 15 is available.[128]

80.44.8 *Excluded property disallowance*

GAAR guidance provides:

> D31.4.8 The liabilities are incurred to buy the UK property and therefore on the face of it are not disallowed by Sch 36 FA 2013.

That seems straightforward.

80.44.9 *Other tax issues*

GAAR guidance section headed “taxpayers analysis” is limited to IHT. But in the cases involving a trust (assuming the trust is non-resident) it is necessary to consider s.87 and (in example 7, where the children occupy, s.731). It is also necessary to consider sch 4B. In short, there is a capital

[127] The taxpayers analysis is correct: See 80.12.10 (Section 103(4) exception).

[128] HMRC seem to accept here the views set out in 83.16.2 (Derived property: Loan).

payment which would come into charge in the event of trust gains. All this may impact on whether the GAAR applies.

80.44.10 *GAAR analysis: tax advantage purpose*

GAAR guidance provides:

> D31.5 ***What is the GAAR analysis under s.207(2) FA 2013?***
> D31.5.1 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*
> D31.5.2 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*
> It is reasonable to conclude that the obtaining of a tax advantage was the main purpose or one of the main purposes of options 7 to 9.

This is correct for options 8 (Gift to trust and loan back to settlor) and 9 (Loan trust lends to property trust).

It is not correct for option 7 (Existing trust borrows 100% from family offshore company); this is in fact recognised in a passage which follows ("In the above example the loan may not be mainly tax motivated anyway...").

> This may not be so in relation to options 3 to 6. R might prefer to borrow from a bank to allow him more flexibility to make other investments with his cash or to preserve his liquidity.
> The intention behind the inheritance tax legislation is to tax UK assets and UK domiciliaries. The foreign assets of foreign domiciliaries are excluded property being outside the territorial scope of inheritance tax in the first place, whereas any UK assets they own are subject to tax.
> Options 3 and 4 [70% bank borrowing] are an application of the rules whereby IHT is chargeable on the net value of UK assets. The fact that R or his trustees could have funded the purchase using foreign investments is irrelevant: R is not compelled to turn assets which are outside the territorial scope of the tax into assets which are subject to tax, whatever his motivation for the borrowing. R's or the trustees' borrowing is a normal commercial transaction and is not contrived or abnormal. While reservation of benefit may be in point in relation to option 4 the GAAR is not thought to apply to option 3 or option 4.
> Options 5 and 6, [95% bank borrowing] similarly, represent a commercial decision by R or his trustees. R or his trustees take the commercial risks associated with the additional borrowing and R takes the economic downsides of depositing funds in support of the

> borrowing/guarantee. Choosing to borrow a higher amount is similarly neither contrived nor abnormal. R takes the economic consequences of borrowing commercially. He may lose the cash he has chosen to place elsewhere. It can reasonably be regarded as a reasonable course of action.

More analytically, the arrangement is not abusive.

80.44.11 *Option 7: loan from family co*

> In option 7 [existing trust borrows 100% from family offshore company] loans to trusts do occur for all sorts of non-tax reasons and therefore cannot be considered in themselves to be necessarily abnormal or contrived. Even though the loan is tax-motivated and (in some senses) self-generated, it involves a single straightforward step.

The passage then goes on to consider variants of example 7:

> The position might well be different, however, if
> [1] the trust were not established for some time already or
> [2] [if the trust were not] substantive; for instance if R were the sole or principal beneficiary or able to direct the trustees or revoke the trust.[129]
> A loan to such a newly created trust might be considered a contrivance.

This is not clearly expressed, but I think the guidance is that the GAAR might apply if the trust is both newly created *and* settlor-interested. I do not see why it matters that the trust is settlor-interested.[130] But the conclusion, that the position "may well" be different because the arrangement "might be" considered a contrivance, is so vague that the passage is not worth much scrutiny: it is scarcely to be called guidance.

> In the above example the loan may not be mainly tax motivated anyway e.g. the trustees may wish to preserve cash for liquidity purposes, but even if it were the arrangement is still not necessarily abusive.

[129] A note on terminology: We need a term to describe a trust where the settlor is principal beneficiary, or which is revocable. I use the term "settlor-interested"; a trust lawyer would not use the expression "not substantive". I have wondered whether the author was thinking (perhaps confusedly) of sham or illusory trusts, but those would not be settlements for IHT purposes.

[130] I suspect that the author disapproved of settlor-interested trusts generally, and regarded any use of them as an indicative of contrivance. If that is right, there is a wide gap between HMRC's perception and that of most private client practitioners.

Another set of questions arises if the loan is from an individual rather from a family company. Does it make a difference if the trust owns the family company? The guidance does not consider those possibilities.

The 2017 IHT residence-property rules would now need consideration.

80.44.12 *Option 8: Gift to trust & loan back*

The guidance then turns to option 8 (Gift to trust and loan back to settlor):

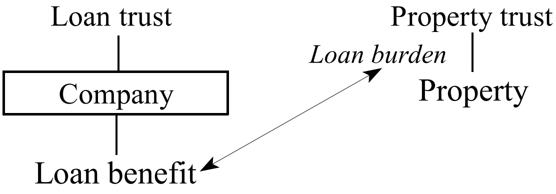
> In option 8, the cash goes in a circle back to the settlor via a trust and loan arrangement. The position might be different under the GAAR if the trust had been in existence for some time so the gift was not made in contemplation of a loan back. The settlor sets up a trust as a vehicle to lend to himself. The setting up of the trust and company is done simply to enable a loan to be made back to the settlor and this is a contrived step. S103 FA 1986 was designed to stop assets being given away that are then lent back by the donee and it may be thought that option 8 is using a possible loophole in s103 to circumvent the intended policy.

"It may be thought" is not much guidance but I suspect it is intended to represent the HMRC/GAAR panel view. It is just as arguable that s.103(4) is a rational policy-based exemption for foreign domiciliaries. The circularity of example 8 is no doubt avoidance; whether it passes the stricter test of abuse is more arguable. HMRC's example gives a more objectionable version of the facts as the trust is specified as "newly-established." If it were established some time previously, there would be no abuse and indeed no avoidance.

The 2017 IHT residence-property rules would now need consideration.

80.44.13 *Option 9: loan between trusts*

The guidance then turns to option 9 (Loan trust lends to property trust):



> In option 9 the combination of a nominal-value settlement specifically set up to own the property coupled with the establishment of a separate

> loan trust and a corporate vehicle underlying it which is then used to make a loan which is on a non-recourse basis is on these facts set up only to achieve an artificial tax deduction. And, while taken individually, the steps may be considered normal, when taken in combination they may be considered abnormal.

The guidance then considers some variants of option 9:

> However, each case would be taken on its own facts and a situation where, for instance,
> [1] both trusts were substantial and existing trusts or
> [2] where the loan was on fully commercial terms or
> [3] where the property trust was established for a different beneficiary apart from the settlor
> might be considered differently (see option 7 above).

"Might be" is not much guidance.

> D31.5.3 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*
> Neither of the last two options accord with established practice and HMRC has not indicated acceptance of the interpretation that foreign domiciliaries are not caught by s103 as a matter of principle.

Section 207(5) FA 2013 provides:

> The fact that tax arrangements accord with established practice, and HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice, is an example of something which might indicate that the arrangements are not abusive.

This refers to "the fact" (in the singular) but it goes on to refer to *two* facts, namely (1) the fact that tax arrangements accord with established practice, and (2) the fact that HMRC indicated its acceptance of that practice.

If *both* facts are present, then that is obviously "something which might indicate that the arrangements are not abusive." (At first sight, that seems over-tentative. It is difficult to imagine anything that HMRC publically accept, but which is not reasonable tax planning: that could only arise if HMRC's acceptance of the planning is unreasonable. Perhaps HMRC were concerned at the possibility of a maverick inspector, whose views HMRC later wanted to disavow.)

Contrary to the statement in the GAAR guidance, in option 9, my experience is that *one* of the facts is present, namely, the arrangement has been an established practice for a few years now. However it is not an arrangement about which HMRC has indicated a view. Is that solitary fact "something which might indicate that the arrangements are not abusive"? It is suggested that it should be taken as an indication to that effect (though not of course decisive).

> D31.6 ***Conclusion***
>
> ...
>
> D31.6.2 Options 3 and 4 are straightforward applications of the legislation and would not be caught by the GAAR. Similarly, options 5 and 6 involve commercial arrangements which are neither contrived nor abnormal and HMRC would not seek to invoke the GAAR against them.
>
> D31.6.3 With option 7, while economically the liability appears to be self-generated, the trust is of substance and the arrangements are not necessarily contrived or abnormal.
>
> Thus, although some observers might consider this to be unreasonable, it is possible to see that other reasonable observers might reach a different view. As such these particular facts may well not be caught by the GAAR. However, it is important to realise that this is a borderline case and one where, for the purposes of illustration, the facts are inevitably condensed. Each case would have to be considered on its own facts and a subtly different set of facts might result in a different conclusion.
>
> D31.6.4 Options 8 and 9, on these particular facts, would be caught by GAAR. The liabilities would be ignored in calculating the tax due on the house and the transaction counteracted on this basis. However, as with option 7, each case would have to be considered on its full facts and it is not impossible that different scenarios might potentially be saved from the GAAR by the double-reasonableness test.

The passage is no doubt correct to say "it is not impossible that different scenarios might potentially be saved from the GAAR by the double-reasonableness test." But the reader may doubt whether a statement which is so qualified should be called "guidance".

One might of course set up the option 9 loan trust/property trust structure with a view to replacing the internal loan with bank borrowing at a later date.

If the loan is disallowed for IHT, the property trust will be insolvent after IHT falls due. If the trust loan is secured on the property, there will be no value left in the trust for IHT to be paid.

The IHT residential-property code would now need consideration.

80.45 Funeral expenses

Funeral expenses are not, in principle, a debt of the deceased, but there is a relief as if they were. Section 172 IHTA provides:

> In determining the value of a person's estate immediately before his death, allowance shall be made for reasonable funeral expenses.

The IHT Manual provides:

> **IHTM10376 Overseas funerals of non-domiciled deceased** [Jun 2016]
> You should allow overseas funeral expenses as a deduction against the UK estate, even if the deceased was not domiciled in the UK for IHT purposes.
> Although s.162(5) IHTA 1984 might seem to justify the deduction of such expenses from the non-UK estate, that sub-section cannot apply as funeral expenses are not a liability for the purposes of s.5 IHTA 1984 or s.162 IHTA 1984.

80.46 Foreign administration expenses

There is in general no IHT deduction on death for the cost of the subsequent administration of the deceased's estate.[131]

Section 173 IHTA provides a limited exception:

> In determining the value of a person's estate immediately before his death, an allowance against the value of property situated outside the UK shall be made for any expense incurred in administering or realising the property which is shown to be attributable to the situation of the property, but the allowance shall not exceed 5 per cent of the value of the property.

The IHT Manual provides:

> **IHTM27050: deduction for administration of non-UK assets** [Sep 2018]
> ... The allowance is for additional expenses only. So it is only allowed on the excess of the expenditure over and above which it would have cost to deal with the property in the UK. The cost of obtaining a foreign

[131] Unless the residuary estate is given to charity. That can be important for estates giving substantial amounts to charity; see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 26.13 (Cost of administration).

> grant is allowed but not the cost of reporting the death of a deceased shareholder with a foreign company.
>
> If worthwhile you must ask for details of the expenses and point out, if necessary, that the allowance is for additional expenses only and restricted to 5 per cent of the value. When the deduction is agreed, calculate the net value of the asset. If the value is shown in non-Sterling currency use one of the many currency conversion websites available on the internet to convert it to Sterling.

The deduction is not the additional expense "over and above which it would have cost to deal with the property in the UK"; it is for the expense "attributable to the situation of the property" but that arguably comes to the same thing.

Non-deductibility of administration expenses may be regarded as unfair, but it is consistent with the principle that IHT is a tax on estates, not donees, and (perhaps more importantly) it is simpler, because only on completion of administration of an estate is it clear what the expenses will be. On the basis of simplicity and consistency it is suggested that s.173 should be repealed.

CHAPTER EIGHTY ONE

IHT CLOSE-COMPANY CODE

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81.1 Close-co code: Introduction

This chapter considers the IHT consequences of:

(1) Transfers of value by close companies
(2) Alteration of share capital of close companies

The provisions are in Part 4 IHTA, which I call the **"IHT close-company code"**. I go beyond the themes of this book and address the topic as a whole, except for the specialist topic of a company holding an interest in possession in settled property.

81.1.1 *"Close company"*

Section 102(1) IHTA provides the definition one would expect:[1]

[1] See 104.29.1 (Non-resident close company).

> In this Part of this Act [Part 4 Close Companies] "close company" means a company within the meaning of the Corporation Tax Acts which is (or would be if resident in the UK) a close company for the purposes of those Acts.

81.2 Transfer of value by close co

A company has an estate, and may make a transfer of value.[2] That transfer of value is not a chargeable transfer, as that expression means a transfer of value made by an individual.[3] However, a transfer of value made by a close company is attributed to participators, who may be taxable.

The IHT close-company code does not apply to a company in liquidation, as it is not beneficial owner of its assets[4] and so does not have an estate and cannot make a transfer of value. But the point is not likely to arise.

81.3 Close company terminology

81.3.1 *"Participator"*

Section 102(1) IHTA provides a slightly cut down version of the standard definition of "participator":

> [a] "participator", in relation to any company, means any person who is (or would be if the company were resident in the UK) a participator in relation to that company within the meaning given by section 454 of the Corporation Tax Act 2010,[5]
>
> [b] other than a person who would be such a participator by reason only of being a loan creditor

The point of para [b] may be to avoid the problem of overlapping participators which arises in the context of apportioning s.3 gains to participators.[6]

81.3.2 *Right/interest in company*

Section 102(2) IHTA provides:

> References in this Part of this Act to a person's rights and interests in

[2] See 74.2 ("Estate"); 74.3 (Transfer of value/value transferred).

[3] See 74.6 ("Chargeable transfer").

[4] See 98.5.2 (Co in liquidation not beneficial owner).

[5] See 104.22 (Definitions of participator).

[6] See 64.8 (Participators overlap: Loan creditors).

> a company include references to rights and interests in the assets of the company available for distribution among the participators in the event of a winding-up or in any other circumstances.

For discussion, see 82.3.3 (Residence-company Interest).

81.3.3 *Foundations*

The analysis adopted in this book is that in principle:

(1) A Foundation is an IHT-settlement.
(2) A Foundation is not a company.[7]

On this analysis, the IHT close-company code does not apply to a Foundation. However some commentators take the view that a Foundation is a company. In that case a Foundation is a hybrid settlement/company, in the sense that it is both an IHT settlement and a company. For completeness I consider here the IHT issues which would arise if that view were correct.

As a general principle, one cannot apply *both* the IHT charges on settlements *and* the IHT close-company code, because of the presumption against double taxation. Either one or the other must apply. Note incidentally that the choice between the two will sometimes favour HMRC and sometimes not; this is not a case where one analysis benefits HMRC and the other the taxpayer. The close-company issues are briefly discussed in the context of s.3 gains; see 64.36 (Foundations). But even if, which is doubtful, the conditions of the IHT close-company code are satisfied, it is suggested that the context shows that the IHT settlement charges should apply, and the IHT close-company code should not apply.

Different considerations apply to a Foundation with Founder's Rights. That is a company and not an IHT-settlement. The IHT close-company code will apply.[8]

81.4 Individual participators

81.4.1 *Charge on individuals*

Section 94(1) IHTA provides:

> [a] Subject to the following provisions of this Part of this Act [Part 4 Close Companies], where a close company makes a transfer of value,

[7] See 90.14 (Stiftung/Foundation). A Dutch stichting needs further consideration.

[8] See 90.14.10 (Founder's Rights: a company).

> tax shall be charged as if each individual to whom an amount is apportioned under this section had made a transfer of value ...

There are three types of transfer of value which may arise here:

(1) The close company makes a transfer of value. This is not a chargeable transfer, but it is the trigger for a s.94 transfer.

(2) Participators are treated as if they had made a transfer of value. I refer to this as a **"s.94 transfer"**.

(3) Participators may make an actual transfer of value (typically, an omission which reduces the value of their estate).

HMRC rely on the s.94 transfer, and do not pursue the possibility of a double charge under heads (2) and (3).[9]

81.4.2 *s.94 amount*

Section 94(1) goes on to specify the amount of the s.94 transfer:

> [b] ... of such amount as after deduction of tax (if any) would be equal to
>
> [i] the amount so apportioned, less
>
> [ii] [A] the amount (if any) by which the value of his estate is more than it would be but for[10] the company's transfer;
>
> [B] but for this purpose his estate shall be treated as not including any rights or interests in the company.

I refer to that as the **"s.94 amount"**.

81.4.3 *Apportionment of s.94 transfer*

Section 94(2) IHTA explains how the s.94 amount is apportioned among the participators:

> For the purposes of subsection (1) above
>
> [a] the value transferred by the company's transfer of value shall be apportioned among the participators according to their respective

[9] See 81.4.4 (No double charge).

[10] "but for" is a slip for "as a result of". (Or alternatively, *more* is a slip for *less*!). The same slip is found in:
- s.95(1) IHTA where the wording is "but for"
- s.93(3) IHTA where the wording is "apart from" (which means the same)

HMRC agree: see the Manual passage cited at 81.5.3 (s.99 amount).
If s.94(1) had been written today, it would have been split into two or three subsections, and that might have exposed the drafting error; but we muddle through.

rights and interests[11] in the company immediately before the transfer, and

[b] any amount so apportioned to a close company shall be further apportioned among its participators, and so on...

Apportionment is on a just and reasonable basis, like s.3 gains.[12]

The IHT Manual gives an example:

> **IHTM16247 Close companies and settled property: example** [Jul 2016]
> Calculating the chargeable value of the property (or part):
> A close company has assets in excess of £3million.
> It transfers cash of £1million to A and B [in equal shares] absolutely.[13]
> The company has 1000 shares in issue.
> The 'participators' are identified under IHTA84/S94 (2). They are:

Person	**Shares**[14]
A (individual)	500
B (individual)	250
C (trustee)	250
Total	1000

The HMRC analysis for the individuals A and B, is as follows:

> The transferred amount of £1,000,000 is apportioned so that A is deemed to have made a transfer of value of (500 ÷ 1,000) × £1,000,000 = £500,000.
> From this figure we must deduct the amount of the transfer remaining in A's estate ('the amount by which his estate is more than it would be apart for[15] the company's transfer' - S94(1)(a)). In this case he has accepted the money. His estate is 'more' by £500,000. So the taxable amount is £500,000 less £500,000 = nil.
> As B is also an individual and has taken the money personally, his calculation follows the same lines.

Presumably A and B are beneficiaries of the trust; otherwise C is in breach

[11] See 81.3.2 (Rights/interest in company).

[12] See 64.6 (Amount attributed to participator).

[13] Author's footnote: It is assumed, perhaps doubtfully, that the transfer is not an income distribution (which would qualify for close co income-receipt relief).

[14] I set this out in tabular form for clarity.

[15] Author's footnote: the statutory wording is "but for" but this is a slip for "as a result of".

of trust. I return to consider the position of C, the trustee, below.

81.4.4 *No double charge*

The IHT Manual continues:

> also, if a company worth £3million gives away £1million as above, the thought might reasonably occur that the value of shares held by the shareholders personally has possibly dropped by about ⅓. You might then wonder about 'loss to the transferor'. You must put such thoughts out of your mind because such a claim does not exist.

Could there be a double charge? Presumably not, because of a presumption against double taxation.

81.4.5 *Non-PET trap*

Section 3A(6) IHTA provides:

> Where, under any provision of this Act, tax is in any circumstances to be charged as if a transfer of value had been made, that transfer shall be taken to be a transfer which is not a potentially exempt transfer.

So a s.94 transfer is immediately chargeable, not a PET. The reason for this rule is unclear, and s.3A(6) ought to be repealed. But IHT is not a rational tax, and fortunately this problem does not often arise.

81.4.6 *Income-receipt relief*

Section 94(2) IHTA sets out two reliefs. Section 94(2)(a) provides:

> so much of that value as is attributable to any payment or transfer of assets to any person which
> [i] falls to be taken into account in computing that person's profits or gains[16] or losses for the purposes of income tax or corporation tax
> [ii] (or would fall to be so taken into account but for section 1285 of the Corporation Tax Act 2009 (exemption for UK company distributions)
> shall not be apportioned...

I refer to this as close-company **"income-receipt relief"**.

This relief might be considered as one of a number of broadly similar income-receipt reliefs:

[16] "Profits or gains" here means income: see14.2 (Income/gains/profits).

Relief (my term)	**IHTA**	**See para**
Close co income-receipt relief	s.94(a)	*Discussed here*
Exit charge income-receipt relief	s.65(5)(b)	76.9.3
Disposition allowable in computing IT	s.12[17]	*Not discussed*

What these reliefs have in common is that they deal with the interaction of IHT and IT: in short, IT has priority and there is no double charge. There are however differences in the wording. Exit charge income-receipt relief is more widely expressed, and s.12 relief is narrower.

81.4.7 *Relief for non-dom individual*

Foreign property of a company is not excluded property, since excluded property means foreign property of an *individual.*[18] Hence there is express exemption for foreign domiciled individuals, which covers the point. Section 94(2)(b) IHTA provides:

> if any amount which would otherwise be apportioned to an individual who is domiciled outside the UK is attributable to the value of any property outside the UK, that amount shall not be apportioned.

Suppose:

(1) The participator is a non-domiciled individual.
(2) (a) *Case 2(a):* The company shares are not UK situate; or
(2) (b) *Case 2(b):* The company shares are UK situate
(3) The company does not hold an interest in UK residential property, so the rules in schA1 IHTA are not relevant.

In case 2(a) the shares are excluded property. It is strange that a gift of the UK assets by the company should give rise to an IHT charge under the IHT close-company code, when a gift of the shares by the shareholder does not. But there it is.

(I address case 2(b) for completeness. In this case, the anomaly works the other way. The shares are not excluded property. It is strange that a gift of foreign assets by the company should not give rise to an IHT charge

[17] The inclusion of s.12 relief in this list might be questioned. This relief requires a payment which is deductible in the hands of the transferor. That is not exactly the same as a requirement that the payment is income of the recipient. But there is a general rule of symmetry under which deductibility for the payor, and taxability for the payee, normally go together.

[18] See 75.2 (Non-settled foreign property).

under the IHT close-company code when a gift of the shares by the shareholder would do so. But the facts of case 2(b) are not likely to happen in practice.)

Property within sch A1 IHTA (where the company asset is a relevant loan or a subsidiary holding UK a residence) may fall within this exemption, as the company property is in general situate outside the UK, even though it is not excluded property).[19]

FOTRA securities of a non-resident company are excluded property since excluded property means FOTRA securities of a non-resident *person*.[20] So if a non-resident company makes a disposition of FOTRA securities, it does not make a transfer of value and there is no s.94 deemed transfer. Section 94(2)(b) is not needed here.

However, in all the above cases, where the close-company IHT charge does not apply, the participator might make a transfer of value (perhaps by omission) which is potentially chargeable under general principles.

UK situate AUTs or OEICs fall into a gap. They are not excluded property, if held by a company, and do not fall within the exemption in s.94(2)(b) IHTA. An HMRC concession would be sensible, and it might be worth asking HMRC in an appropriate case. The issue will not often arise.

81.4.8 *De minimis exemptions*

Section 94(4) IHTA provides a limited exemption:

> Where the amount apportioned to a person under this section is 5 per cent or less of the value transferred by the company's transfer of value then, notwithstanding section 3(4) above,[21] tax chargeable under subsection (1) above shall be left out of account in determining, with respect to any time after the company's transfer, what previous transfers of value he has made.

This provides exemption up to the amount of the available nil rate band.

Section 96 IHTA provides a de minimis relief for preference shares:

> Where
>
> [a] part of a close company's share capital consists of preference shares (within the meaning of section 1023(5) of the Corporation Tax Act

[19] See 82.2.1 (Effect of de-exclusion).

[20] See 75.4 (Non-settled FOTRA securities).

[21] See 74.3.1 (Transfer of value: Extended definitions).

> 2010) and
> [b] a transfer of value made by that or any other close company has only a small effect on the value of those shares, compared with its effect on the value of other parts of the company's share capital,
>
> the preference shares shall be left out of account in determining the respective rights and interests of the participators for the purposes of sections 94 and 95 above.

Section 97 IHTA provides a de minimis group relief, not discussed here.

81.4.9 *Charity and other reliefs*

HMRC say:

> So far as the company's transfer of value relates to property given
> [1] to charity or
> [2] to the national institutions or bodies mentioned above,[22]
>
> then the exemptions for gifts to those bodies extend to the amounts apportioned to the individual participators.[23]

The same would apply to the IHT spouse exemption, business property relief, and other exemptions.

81.4.10 *Inter-company transfer*

Section 95(1) IHTA provides:

> Where—
> (a) the value of the estate of a company ("the transferee company") is increased as the result of a transfer of value made by a close company ("the transferor company"), and
> (b) an individual to whom part of the value transferred is apportioned under section 94 above has an interest in the

[22] I expect this is a reference to bodies within s.25 & sch 3 IHTA (gifts for national purposes).

[23] "The Arts are your Business" (1980) issued by the Association for Business Sponsorship of the Arts in conjunction with the Inland Revenue, referred to in Hansard HC Deb 09 March 1981 vol 1000 cc260-1W
https://api.parliament.uk/historic-hansard/written-answers/1981/mar/09/arts-sponsorship-tax-benefits
The passage is printed in Butterworths Yellow Tax Handbook 2015/16; it is not in later editions, but there is no reason to think that HMRC practice has changed.
The textbook *Taxation of Companies and Company Reconstructions* (looseleaf) formerly took the opposite view, criticised in the 2017/18 ed of this work para 71.13.7, but the passage has been deleted.

> transferee company (or in a company which is a participator of the transferee company or any of its participators, and so on),
>
> subsection (2) below shall apply to the computation, for the purposes of section 94 above, of the amount to be offset, that is to say, the amount by which the value of his estate is more than it would be but for[24] the transfer.

So we move to s.95(2) for the quantum of the relief:

> Where this subsection applies—
>
> (a) the increase in the value of the transferee company's estate shall be taken to be such part of the value transferred as accounts for the increase, and
>
> (b) the increase so computed shall be apportioned among the transferee company's participators according to their respective rights and interests in the company immediately before the transfer (and, where necessary, further apportioned among their participators, and so on),
>
> and the amount so apportioned to the individual shall be taken to be the amount to be offset.

81.5 Trustee participators

Section 94(1) IHTA only applies to individuals. Section 99(1) IHTA confirms that it does not apply to trusts:

> Subsection (1) of section 94 above shall not apply in relation to a person who is a participator in his capacity as trustee of a settlement...

Section 99(1) then makes express provision for trusts:

> but—
>
> (a) the reference in subsection (2) of that section to subsection (1) shall have effect as including a reference to subsection (2) of this section...

Amended as s.99 directs, s.94(2) provides:

> [a] For the purposes of ~~subsection (1) above~~ s.99(2) IHTA the value transferred by the company's transfer of value shall be apportioned among the participators according to their respective rights and interests in the company immediately before the transfer,
>
> [b] and any amount so apportioned to a close company shall be further

[24] "but for" is a slip for "as a result of"; see 81.4.2 (s.94 amount).

> apportioned among its participators, and so on; ...

This takes us to s.99(2) IHTA which slots the close-company charge into the code of rules for (a) estate IIP and (b) non-estate IIP trusts. I refer to this as a **"s.99 trust transfer"**.

81.5.1 *Estate IIP trust*

Section 99(2) IHTA provides:

> Where any part of the value transferred by a close company's transfer of value is apportioned to a trustee of a settlement under section 94 above, then—
>
> (a) if a qualifying [estate] interest in possession[25] subsists in the settled property, a part of that interest corresponding to such part of the property as is of a value equal to

Section 99 goes on to specify the amount of that value (**"the s.99 amount"**):

> [i] the part so apportioned less
> [ii] the amount specified in subsection (3) below
> shall be treated for the purposes of Chapter II of Part III of this Act as having come to an end on the making of the transfer

This activates the rules which apply on a termination of an IIP.[26]

The IHT Manual provides:

> **IHTM16243 Close companies and settled property: the taxable amount** [Sep 2018]
> ... The provisions of IHTA84/Part IV do not provide any special charging section where settled property is concerned. Instead, the system for settled property provides a 'special' framework and then directs the notional transfers to their own existing taxing and rate sections, with the result that the claims produced by this legislation are the familiar IHTA84/S52 (1) for interests in possession ceasing. This basis of claim is artificial because in reality the interest does not cease. As a result such an event, occurring after 16 March 1987, can be a PET (IHTM04057) if it would have been so under a plain IHTA84/S52 (1) claim [i.e. if it was not then becoming held on non-interest in possession trusts]. This contrasts with the treatment of absolute gifts by close

[25] See 74.7 (Qualifying IIP).

[26] See 76.10 (Termination of estate IIP).

companies which, under IHTA84/S98 (3), are never PETs.
In similar vein, annual and other exemptions (IHTM16082) available on a claim under IHTA84/S52 (1) are allowable.

81.5.2 *Non-IIP trust*

Section 99(2) IHTA provides:

> Where any part of the value transferred by a close company's transfer of value is apportioned to a trustee of a settlement under section 94 above, then...
>
> (b) if no qualifying interest in possession [estate IIP] subsists in the settled property, Chapter III of Part III of this Act shall have effect as if on the making of the transfer the trustee had made a disposition as a result of which the value of the settled property had been reduced by

Section 99(2)(b) goes on to specify the amount in the same way as in s.99(2)(a) (**"the s.99 amount"**):

> an amount equal to
> [i] the part so apportioned less
> [ii] the amount specified in subsection (3) below;
> and where a qualifying interest in possession subsists in part only of the settled property paragraphs (a) and (b) above shall apply with the necessary adjustments of the values and amounts referred to there.

This activates the exit charge in s.65 IHTA,[27] which can have some quirky results.

81.5.3 *s.99 amount*

The s.99 amount is computed by reference to the amount apportioned less "the amount specified in subsection (3)".
Section 99(3) IHTA provides:

> The amount referred to in paragraphs (a) and (b) of subsection (2) above is
> [a] the amount (if any) by which the value of the settled property is more than it would be apart from[28] the company's transfer,
> [b] leaving out of account the value of any rights or interests in the

[27] See 76.8.2 (Reduce value of trust property).

[28] "Apart from" is a slip for "as a result of"; see 81.4.2 (s.94 amount).

company.

The IHT Manual gives an example; for the facts of the example see 81.4.3 (Apportionment of s.94 transfer). The HMRC analysis for the trust is as follows:

> But C is also a participator, and (250/1,000) × £1m is apportioned to him under S99 (1)(a) i.e. £250,000.
> The amount to be taxed in relation to C under S99 (2) is £250,000 less the amount by which the settlement in question is 'more' as a result of the company's transfer - S99 (3).
> Thus, as C and his settlement received nothing, the calculation is £250,000 less nil = £250,000 chargeable under S99 (2) above.
> The last part of S99 (3) 'leaving out of account the value of any rights or interests in the company' means that the calculation stops here. S99 (3) prohibits the taking into account of the effects of these transactions by the company on the value of the shares (rights or interests).
> E.g. the value of rights and interests still held by the shareholders as such could nullify the effect of all these provisions if that value were allowed into the above equation

81.5.4 *Excluded property trust exemption*

Section 94(2)(b) IHTA provides exemption from the close company apportionment for a foreign domiciled participator who is an individual.[29] That provision only applies to individuals, so it does not apply to a trustee. But if the trust property is excluded property, there is no charge to IHT so the exemption in s.94(2)(b) is not needed.

Thus there is an interesting distinction between settled and non-settled companies. Where a close company makes a transfer of value:

(1) If a foreign domiciled *individual* is the participator:
  (a) There is no IHT charge if the company property (the property to which the company's transfer of value is attributable) is foreign situate.
  (b) The situs of the company shares does not matter.

(2) If an excluded property *trust* is the participator:
  (a) There is no IHT charge if the company shares are excluded property.
  (b) The situs of the company property does not matter.

[29] See 81.4.7 (Relief for non-dom individual).

The rule for trusts is the sensible rule, and the rule for individuals is anomalous. But there it is.

The IHT Manual provides:

> **IHTM16244 Close companies and settled property: foreign element** [Sep 2018]
> Bearing in mind that claims on settled property in the 'close company' (IHTM14851) regime under IHTA84/Part IV cases arise in their normal context and under normal charging sections it would seem that if the trusts identified above (IHTM16243) would in their own right, satisfy IHTA84/S48 (3), and the close company in question, being 'the property', is incorporated (and therefore situate[30]) outside the UK, then an apportionment will not be made.
> So the trust property takes the benefit of excluded property treatment. IHTA84/S94 (2)(b) achieves this result for lifetime transfers.
> Where a company has the interest in possession as above, the position is more explicit -S48(4). If the trust property is invested in FOTRA securities (IHTM04306), and on looking through the company to the real beneficiaries, it can be seen that those individuals qualify under S48 (4), then exemption will be given.

81.5.5 *Other exemptions*

Of the two exemptions in s.94(2), para (a) still applies (close company income-receipt relief).[31]

Section 99(1)(b) IHTA incorporates two other minor exemptions by reference:

> in relation to tax chargeable by virtue of subsection (2) of this section, sections 94(4)[32] and 95[33] above shall apply with the necessary modifications.

81.6 Dividend: Close-co code analysis

Suppose a company pays a dividend. No-one expects or suggests that would give rise to an IHT charge under the IHT close company code. But the analysis may be helpful when considering other problems of the close-company code. The analysis is not entirely straightforward.

[30] The original erroneously reads: domiciled.

[31] See 81.4.6 (Income-receipt relief).

[32] See 81.4.8 (De minimis exemptions).

[33] See 81.4.10 (Inter-company transfer).

The starting point is that the company's estate is reduced. So in principle, the company makes a transfer of value.[34]

81.6.1 *Dividend to individual*

Suppose a close company pays a dividend to a shareholder who is an individual.

The estate of the shareholder remains (broadly) the same. Apart from tax on the dividend, the sum received by the individual shareholder (broadly) matches the reduction in the value of their shares.[35] So the s.94 amount would be nil.

However the individual may pay tax on the dividend in which case the s.94 amount is not nil.[36] Then close co income-receipt relief prevents a charge.[37] This relief also applies in the case of an alphabet share arrangement,[38] if a controlling shareholder procures dividends are paid to another shareholder.

The shareholder may pay CGT on the dividend. Then s.165 IHTA provides relief.

The shareholder may pay foreign tax on the dividend. In this case one may fall back on the argument that the tax charge on the dividend is too remote and should not be taken into account in computing the s.94 amount.

81.6.2 *Dividend to trust*

Suppose a close company pays a dividend to a shareholder who is a trustee of a discretionary trust.

One might think that the analysis is the same as for an individual. At first glance, the value of the settled property remains broadly the same. The he

[34] A straightforward dividend might qualify for IHT arm's length transaction relief; see 74.13 (Arm's length disposal relief). But if the analysis here is correct it is not necessary to rely on that.

[35] That is not necessarily the case, but in the absence of special circumstances, it is not likely to be necessary to pursue the valuation issues.

[36] Unless one says that a tax charge on the dividend is too remote and should not be taken into account in computing the s.94 amount.

[37] See 81.4.6 (Income-receipt relief). That assumes that the dividend is subject to UK income tax, However that relief would not protect against:

(1) Foreign income tax, or

(2) CGT payable on the dividend, as might happen for a capital dividend of a non-resident company (but see s.165 IHTA).

[38] See 99.20 (Alphabet share arrangement).

sum received by the trustee shareholder matches the reduction in the value of the shares. So applying the computation in s.99(2), the amount of the s.99 trust transfer is nil.

The difficulty with that analysis is that trust income is not settled property until it is accumulated. Even assuming that the trustees have power to accumulate the income, and that they exercise that power, their decision to accumulate may be made after the time of payment. At the time of payment the value of the settled property is reduced. This is why undistributed income is not subject to a 10-year anniversary charge.[39]

The answer is that there is a s.99 transfer, but no exit charge arises because in most cases close company income-receipt relief applies, and where it does not, *exit charge* income-receipt relief applies (the latter relief is somewhat wider).[40] This analysis allows one to reach the intuitively correct result.

For where a company makes a transfer of a UK residence, see 82.15 (Company dividend in specie).

81.7 Change in share capital/rights

81.7.1 *s.98 application conditions*

Section 98(1) IHTA provides:

> Where there is at any time—
> (a) an alteration in so much of a close company's share or loan capital as does not consist of quoted shares or quoted securities
> (b) an alteration in any rights attaching to unquoted shares in or unquoted debentures of a close company,

I refer to this as the **"s.98 application conditions"**.

"Alteration" has an inclusive definition.[41]

References to altering share rights are also found in the context of reorganisations and transactions in securities,[42] so case law/guidance in that area may be relevant here too.

81.7.2 *Share alteration: Consequences*

Assuming either of the s.98 application conditions are met, we move on:

[39] See 76.7.2 (Undistributed trust income).

[40] See 81.4.6 (Income-receipt relief).

[41] Section 98(2) IHTA provides: "In this section "alteration" includes extinguishment."

[42] See 55.3.2 ("Transaction in" securities); 58.1 (Reorganisations: Introduction).

the alteration

[A] shall be treated as having been made by a disposition made at that time by the participators, whether or not it would fall to be so treated apart from this section, and

[B] shall not be taken to have affected the value immediately before that time of the unquoted shares or unquoted debentures.

An alteration of share capital/rights does not cause a loss to the company's estate, so does not give rise to a s.94 transfer or a s.99 trust transfer. If the conditions in para (a) or (b) are met, there are two consequences, in short:

- Para [A]: alteration is a (deemed) disposition
- Para [B]: s.98 valuation rule

I consider these separately below.

Alterations in share capital/rights may raise many other tax issues:

Topic	**See**
Transactions in securities	55.3.2
Reorganisations	58.1
CGT value shifting	s.29-31 TCGA
Identity of settlor	99.40.2
Transfer of assets abroad	49.5
Employment-related shares	Part 7 ITEPA

81.7.3 *Alteration deemed disposition*

Section 98(1) IHTA provides:

> [a] the alteration shall be treated as having been made by a disposition made at that time by the participators,
>
> [b] whether or not it would fall to be so treated apart from this section

This is needed because an alteration is not a disposition in the normal sense of the word.[43]

The significance of the (deemed) disposition is that the alteration:

(1) May constitute a transfer of value, if the participator is an individual

(2) May give rise to an exit charge, if the participator is a trust

This would not be the case if there were no disposition.[44]

I say the alteration *may* constitute a transfer of value/exit charge because

[43] Though an alteration might involve an omission, which is a deemed disposition; this may be what the drafter had in mind in s.98(1)[b].

[44] See 74.4 (Disposition).

there are other requirements to be met. An alteration does not constitute a transfer of value/exit charge if

(1) it does not reduce the value of a shareholding, or

(2) it qualifies for IHT arm's length transaction relief[45]

I refer to a transfer of value within s.98 as a **"s.98 transfer"**.

Section 98(3) IHTA provides:

> The disposition referred to in subsection (1) above shall be taken to be one which is not a potentially exempt transfer.

This is the "non-PET" trap. There is no good reason for the rule, and it ought to be repealed, along with the equivalent s.94 trap.[46]

81.7.4 *Share issue: HMRC example*

Shares & Assets Valuation Manual provides:

> **SVM108280 Alterations in Share Capital** [Nov 2018]
> Section 98 serves to stop avoidance by the alteration of a company's capital or the rights attaching to it. It achieves this by treating the alterations as if they had been effected by dispositions made by the participators (normally the shareholders). To give rise to a liability one is looking for a situation where, after the company has altered its capital or varied share rights, the value of an individual's holding after the event is less than it was before. A common case involves the creation of new classes of shares which are not issued pro rata to existing shareholders.

The Manual gives an example:[47]

> **Example 1 [issue of preference & deferred shares]**
> A company has issued shared capital of 100 Ordinary Shares:[48]

Shareholder	**Ordinary Shares**
A	60
B	20
C	20
Total	100

[45] See 74.13 (Arm's length transaction).

[46] See 81.4.5 (Non-PET trap).

[47] The same example is found in IHTM14855 Transfers By Close Companies: Alterations In Share Capital, Loan Capital Or Rights [Mar 2021], where A, B and C are named Fernando, Filipe & Kimi.

[48] I have altered the layout of the example for clarity.

The company issues two further classes of shares:

- 20 Deferred shares (acquiring rights to votes and to 50% of the income and capital after 5 years) to C.
- 80 20% Preference shares (absorbing much of the current income) to C.

So the position becomes:

Shareholder	Ordinary	Deferred	Preference	Total
A	60			60
B	20			20
C	20	20	80	120
				200

The HMRC analysis is as follows:

> Although control remains with A the value of his holding is substantially diminished and s.98 is in point.

More analytically, the alteration is a deemed disposition and a chargeable transfer. The shareholders have fallen into the non-PET trap. (They might, perhaps, be able to set aside the alteration for mistake.)

Fortunately, the non-PET trap only arises if (as in the example) shares are issued in different proportions to how the exiting shares are held. Suppose:

(1) The new shares were issued to existing shareholders *pari passu*; and
(2) A and B gave their newly acquired shares to C.

In that case the analysis is:

(1) The share issue is not a s.94 transfer.
(2) The gift is a PET, not a chargeable transfer.

As often happens, careful planning can avoid the trap.

The Manual gives 3 further examples, but these do not add much.[49]

[49] For completeness, these examples are:
Example 2 [Rights issue taken up in part]
A company has issued share capital of 100 shares owned as to 70% by X and 30% by Y.
The company makes a 2 for 1 rights issue which is not wholly taken up by the controlling shareholder.
[This is not as clear-cut as example 1 because X's new holding may range from 70% if he takes up almost all his rights to 43% is he takes up none. In addition, when a rights issue is involved there may be an absence of gratuitous intent (which it will be for the taxpayer to prove) so that s.10 may be in point.]

The creation of alphabet shares[50] will give rise to a s.98 charge if the participator's shares are worth less after the alteration than before. Alphabet shares which do not carry control are (more or less) worthless. Everything depends here on how the alteration creating the alphabet shares is carried out.

81.8 s.98 transfer: Value transferred

If the participators are individuals, the value transferred by a s.98 transfer is in principle the reduction in the value of the shareholding as a result of the alteration.

81.8.1 *s.98 valuation rule*

Section 98(1) IHTA provides that the alteration:

> shall not be taken to have affected the value immediately before that time of the unquoted shares or unquoted debentures.

I refer to this as the **"s.98 valuation rule"**

81.8.2 *Death value transferred rule*

On death, IHT is charged on the value of the estate "immediately before" the death.[51] I refer to that as a **"death transfer"**. (One might call it a "s.4 transfer".) This also has a valuation rule. Section 171 IHTA provides:

> (1) In determining the value of a person's estate immediately before his death changes in the value of his estate which
> [a] have occurred by reason of the death and

Example 3 [Related property rules]
A company has issued capital of 100 shares, 60 of which are owned by A, 30 by Mrs A and 10 by B.
100 further shares are issued to B at a nominal price well below market value.
It should be noted that for the purpose of looking at close company transfers, the related property provisions are not in point.
Example 4 [Loss of control]
A company has issued capital of 100 shares, of which W owns 60 and X 40.
30 shares are issued to Y and 30 to Z.
W now has 60 out of 160 issued shares and has lost control.
X now has 40 shares as a 25% holding compared to his former 40 shares as a 40% holding.

[50] See 99.20 (Alphabet share arrangement).

[51] See 76.4 (Death: IHT charge & exemption).

> [b] fall within subsection (2) below
> shall be taken into account as if they had occurred before the death.
> (2) A change falls within this subsection
> [a] if it is an addition to the property comprised in the estate or
> [b] [i] an increase or decrease of the value of any property so comprised,
> [ii] other than a decrease resulting from such an alteration as is mentioned in section 98(1) above;
> [c] but
> [i] the termination on the death of any interest or
> [ii] the passing of any interest by survivorship
> does not fall within this subsection.

I refer to a change within s.171(2) as a **"death-value change"**. Section 171 applies on any death transfer, but I consider it here because it mentions s.98.

The IHT Manual gives four examples where s.171 applies.

> **IHTM04046 changes in value by reason of the death** [Sep 2018]
> ... **Examples**
> [1] Damages payable to the personal representatives under the Law Reform (Miscellaneous Provisions) Act 1934 are included in the death estate.

The 1934 Act provides that (most) claims vested in a living person survive on their death for the benefit of their estate. So this is not an example of an addition to the property comprised in the estate by reason of death, within s.171(2)[a]; though in some cases the value of the claim might be said to change by reason of the death, in which case the claim might be property falling within s.171(2)[b].

There are claims which (as an exception to the 1934 Act) do not survive death of the claimant (such as a claim for defamation). No-one suggests that such a claim should be subject to IHT, and it might perhaps be said that the claim falls within s.171(2)[b], on the grounds that its value reduces (to zero).

The next 3 examples relate to a change in valuation, within s.171(2)[b]:

> [2] A life assurance policy maturing on the death is valued as a sum immediately payable.
> [3] Property that becomes vacant on the death is valued with vacant possession.
> [4] If the deceased's death causes a fall in the value of shares, this is

taken into account.

Death can obviously affect values. It is less clear that the change occurs at the moment of death and not before. Would it not be known immediately before death that the deceased was about to die, and the market value determined accordingly? For instance, in the case of £100 policy maturing on death, is the value any less than £100 immediately before death? Death should be factored into the pre-death valuation. In other words, what matters for valuation is the immanence of death and not the occasion of death. It would be the same as if a policy matured on a fixed date, and the owner gifted it immediately before that date.

If that is right, what is the role of s.171? The answer may be that market value depends on what would be paid by the hypothetical purchaser on a hypothetical sale; and that price depends on what the purchaser hypothetically knows. The concern is an argument that the hypothetical purchaser will not anticipate the immanent death of the deceased, or would not circumstances of sudden, unexpected death; so the policy is valued on the basis of hypothetical life expectancy of a person with the age of the deceased but not with other characteristics. The argument seems tenuous, though it has its supporters. But it is not necessary to pursue that here because if there were anything in the point, s.171 overrides it.

The proviso in s.171(2)[c] suggests that the following would or might otherwise count as a death-value change, within s.171(2):

(1) the termination on the death of any interest or
(2) the passing of any interest by survivorship

Point (1) makes sense on the drafter's assumption that death may not be fully factored into a valuation. Point (2) makes no sense to me; for prior to a death, the value of a joint interest, which passes by survivorship, does not seem to be affected by a subsequent death.

81.8.3 *s.171/s.98 valuation rule: Interaction*

Section 171 does not apply to a decrease in value which:

(1) arises as a result of the death, and
(2) results from "such an alteration as is mentioned in s.98(1)", ie an alteration in share capital/rights of a close company

Thus a death-value change of this kind is not within the rule that it is computed "as if it had occurred before the death". Instead the s.98 valuation rule applies.

Suppose company articles provide that the deceased's shares carry rights to dividends during his or her life and not subsequently. Perhaps the drafter assumed that:

(1) There is an alteration of share rights on the death; and
(2) The alteration decreases the value.

If so, the s.98 valuation rule applies. But are these assumptions correct?

81.9 Deferred shares

HMRC comment on the deferred shares in the example discussed above:[52]

> A further claim under IHTA84/S98 will arise when the deferred shares actually acquire voting and other rights in 5 years' time.

The HMRC's view is that there is an occasion of charge under s.98 when deferred shares come to rank equally with other shares. This view is long standing:

> Following recent legal advice, the Revenue's interpretation of IHTA s.98 has changed.
> Until now the Capital Taxes Offices have taken the view that when deferred shares came to rank equally with another class of shares there would be no alteration in the rights of the shares within the meaning of IHTA s.98(1)(b). But there would be an alteration in the company's share capital within the meaning of IHTA s.98(1)(a).
> The Board of Inland Revenue has now been advised that an alteration of rights, within the meaning of IHTA s.98(1)(b), occurs when deferred shares come to rank equally[53] with another class of shares.
> Accordingly, claims for inheritance tax will be raised where deferred shares, issued after 5 August 1991,[54] subsequently come to rank equally, or become merged, with shares of another class.[55]

The HMRC view rests on the proposition that the occasion where deferred shares come to rank equally is an "alteration" in the company share capital

[52] See 81.7.4 (Share issue: HMRC example).

[53] HMRC are considering a case where deferred shares come to rank equally with other shares, but the same point would apply when deferred share rights change, whether or not they rank equally with other shares.

[54] So there appears to be a concession for pre-1991 share issues. The concession seems illogical, as under HMRC's pre-1991 view, there should still have been an IHT charge under para (a). But the point may not now arise.

[55] *Law Society's Gazette*, 11 September 1991.

or rights. Is that right? It is not an alteration in the strict sense of the word.[56] Time has altered but the share rights have not. They are what they have always been. Thus at first sight it seems that HMRC's position is not correct. However:

(1) It is then difficult to see the purpose of the s.98 valuation rule. That rule assumes that there could be an alteration which affects the value of shares immediately before the time of the alteration. That seems to be referring to a prospective alteration such as deferred shares. That supports the HMRC view.[57]
(2) Alternatively HMRC may say that the occasion when the rights of deferred shares change is an operation, which may be associated with a prior gift or issue of the deferred shares, so there is a transfer of value, at the time the deferred shares come to rank equally, and the value transferred is computed by reference to the value of the shares at that time.[58]

In practice it would be wise to plan on the basis that the HMRC view is correct, because to do otherwise is to invite litigation.

Unfortunately the HMRC example does not consider the application of the s.98 valuation rule, ie how does one approach the valuations required to compute the value transferred? If one ignores the alteration, there would seem to be a double charge to tax, for there was already one charge on issue of the deferred shares.

The s.98 transfer (assuming HMRC are right to say there is one) might be avoided in various ways, for instance:

(1) Draft share rights so that there is no occasion where deferred shares come to rank equally.
(2) Give non-deferred shares to charity before the deferred shares come to rank equally.[59]

81.10 Alteration: Estate IIP trust

Section 100(1) IHTA provides:

[56] See *Unilever (UK) Holdings v Smith* [2002] EWCA Civ 1787.

[57] It is relevant to note that deferred shares were used in pre 1974 Estate Duty planning, so the drafter of the current provisions may be taken to have them in mind.

[58] See 74.16 (Transfer of value by 2 operations).

[59] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 24.34 (Deferred shares) online version *https://www.taxationofcharities.co.uk*

> This section applies where, by virtue of section 98 above, an alteration in a close company's share or loan capital or of any rights attaching to shares in or debentures of a close company is treated as a disposition made by the participators, and—
>
> (a) a person is a participator in his capacity as trustee of a settlement, and
>
> (b) the disposition would, if the trustee were beneficially entitled to the settled property, be a transfer of value made by him, and
>
> (c) at the time of the alteration an individual is beneficially entitled to an interest in possession[60] in the whole or part of so much of the settled property as consists of unquoted shares in or unquoted securities of the close company.

Assuming these conditions are satisfied, we move on to the rule in s.100(2) IHTA:

> Where this section applies, such part of the individual's interest shall be treated for the purposes of Chapter II of Part III of this Act as having come to an end at the time of the alteration as corresponds to the relevant decrease of the value of the property in which the interest subsists, that is to say the decrease caused by the alteration.

This echoes the position for a s.94 transfer.[61]

What about a relevant property trust? The deemed disposition may give rise to an exit charge as a depreciatory transaction.

The relief for excluded property will work in the same way as for a s.94 transfer.

81.11 Close-co IHT: Liability

Section 202 IHTA provides:

> (1) The persons liable for tax chargeable by virtue of section 94(1) or section 99(2) above are—

[60] Section 100(1A) IHTA restricts the rule to an estate IIP:

"Where the interest in possession is one to which the individual became beneficially entitled on or after 22nd March 2006, this section applies only if the interest in possession is—

(a) an immediate post-death interest,

(b) a disabled person's interest, or

(c) a transitional serial interest

or falls within section 5(1B) above."

[61] See 81.5.1 (Estate IIP trust).

(a) the company making the transfer of value concerned, and
(b) so far as the tax remains unpaid after it ought to have been paid,
  [i] the persons to whom any amounts have been apportioned under section 94 above and
  [ii] any individual (whether such a person or not) the value of whose estate is increased by the company's transfer.

(2) A person to whom not more than 5 per cent of the value transferred by the company's transfer is apportioned shall not as such be liable for any of the tax; and each of the other persons to whom any part of that value has been apportioned shall be so liable only for such part of the tax as corresponds to that part of that value.

(3) A person the value of whose estate is increased by the company's transfer shall not as such be liable for a greater amount than the amount of the increase.

(4) No person other than those liable under this section shall be liable for any tax chargeable by virtue of section 94(1) or section 99(2) above.

CHAPTER EIGHTY TWO

IHT RESIDENTIAL-PROPERTY CODE

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Cross references

The following topics are considered elsewhere:
131.10.1 (Underlying co has UK residence) - trust registration
125.18.1 (IHT residential-property code) - Inland Revenue charge

82.1 IHT residential-property code

This chapter considers:

(1) The IHT rules for residential property, which I call the **"residential-property code"**.

(2) A general discussion of some planning issues for the family home, in the light of this and previous chapters.

The development of the residential-property code can be traced through consultation papers, but these are now of historical interest only:

- Technical Briefing on Non Dom/IHT Residential property changes ("**the 2015 residential-property paper**")[1]
- Reforms to the taxation of non-domiciles: further consultation ("**the 2016 consultation paper**")[2]
- Reforms to the taxation of non-domiciles: response to further consultation[3]
- Finance Bill March 2017
- Draft clauses and EN July 2017

The IHT Manual has a short entry-level discussion of the topic.

HMRC have answered a set of questions from the professional bodies

[1] HMRC, "Technical Briefing on Non-Dom changes announced at Summer Budget 2015" (2015).

[2] *https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles-further-consultation* (August 2016)

[3] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/574450/non_doms_consultation_response_final.pdf* (December 2016)

("Sch A1 Q&As").[4]

82.2 De-exclusion of sch A1 property

Para 1 sch A1 IHTA provides:

> Property is not excluded property by virtue of section 6(1) or 48(3)(a) [non-UK situate property][5] if and to the extent that paragraph 2 or 3 applies to it.

The property (which I call sch A1 property) is chargeable (non-excluded) property, even if not UK situate. Adopting HMRC's neologism, para 1 sch A1 IHTA *de-excludes* the property.

Paragraphs 2 and 3 apply to four categories of property:

Para	My term	Typical case	See para
2	Residence-company	Interest (shares/loan) in close co holding UK residence	82.3
2	Residence-partnership	Interest in partnership holding UK residence	82.4
3(a)	Relevant loan	Loan to individual/trust to purchase UK residence	82.7
3(b)	Residence-security	Property charged as security for relevant loan	82.9

I refer to these together as **"Sch A1 property"**.

These are not transparent labels, but there are no short labels which neatly encapsulate these four categories of property.

Until 2017, property was either excluded or chargeable (not excluded). Sch A1 property may be excluded to an extent. If property is excluded to an extent, can one make a gift of the excluded part separately from the de-excluded part? Presumably not. But one could divide a company into A and B shares, in such a manner that the A shares are excluded property and B shares are chargeable. Likewise for a relevant loan.

[4] *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/fd698038-572f-4043-a0c2-c0d192dc0757/NonDomsQnA.pdf*
This comes with the following disclaimer:
"The Q&As do not constitute advice and are not a substitute for professional consideration of the issues by the professional adviser in each client's specific context. Furthermore, these Q&As should be read in conjunction with HMRC's comments and advisers should consider the position to take for themselves."
There is also advice for those who disagree with HMRC views:
"Where an adviser adopts a position contrary to that of HMRC the fundamental principles and standards set out in PCRT (with particular reference to paragraph 2.21 et seq) should be considered in terms of communication with the client and any reporting and disclosure required." See 122.9.2 (Disclosure that HMRC disagree).

[5] See 75.2 (Non-settled foreign property); 75.8 (Trusts: Foreign situate property).

82.2.1 *Effect of de-exclusion*

If sch A1 applies, the de-excluded property becomes subject to IHT, not the land to which that property relates. To put it another way, schA1 does not disregard the company or make it transparent for IHT purposes. This sometimes matters, eg for valuation.[6] The property is not deemed to be UK situate.

82.3 Residence-company

Para 2(1) sch A1 IHTA provides:

> This paragraph applies to an interest in a close company or in a partnership, if and to the extent that the interest meets the condition in sub-paragraph (2).

Para 2 deals with companies and partnerships together, but it is convenient to consider them separately.

I refer to a company within para 2(1) as a **"Residence-company"**.

82.3.1 *Attribution condition*

Para 2(2) sch A1 IHTA provides:

> The condition is that the value of the interest is—
> (a) directly attributable to a UK residential property interest,[7] or
> (b) attributable to a UK residential property interest by virtue only of one or more of the following—
> (i) an interest in a close company;
> (ii) an interest in a partnership;
> (iii) property to which paragraph 3 (loans) applies[8].

I refer to this as the **"attribution condition"**. There are 4 ways that the attribution condition may be satisfied. I refer to attribution condition **"limb (a) and limb (b)(i), (ii) and (iii)"**.

Attribution condition limb (a) is straightforward. It applies where the company owns the residential property interest.

Attribution condition limb (b) is more complicated. The value of the interest in the company must be:

[6] See too 131.10.1 (Underlying co has UK residence).

[7] See 82.17 ("Residential property interest").

[8] See 82.7 (Relevant loan: Definition); 82.9 (Residence-security).

(1) Not directly attributable to a UK residential property interest (because the company does not own UK residential property directly)
(2) Indirectly attributable to a UK residential property interest by virtue of the company owning items (i) to (iii)

It is possible that the value of an interest in a company may be:
(1) indirectly attributable to a UK residential property interest, but
(2) not by virtue of items (i) to (iii).

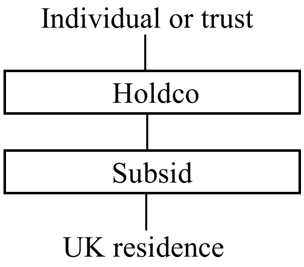
An example is if the company owns the benefit of a loan, secured on UK residential property, which is not a relevant loan. This does not fall witin limb (b) and the interest in the company is not sch A1 (de-excluded) property.

82.3.2 *Chain of companies*

Attribution condition limb (b)(i) applies where:

> the value of the interest [in a close company] is—
> (b) attributable to a UK residential property interest by virtue ... of ...
> (i) an interest in a close company

Suppose a chain of companies, thus:

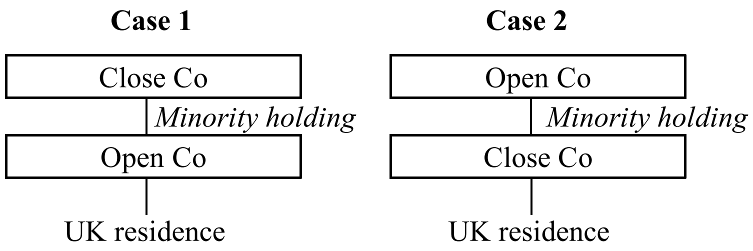


Attribution condition (b)(i) is met, and so the Holdco shares are chargeable (de-excluded) property, because their value is attributable to the residence, by virtue of Holdco's interest in Subsid (a close company).

The shares in Subsid are also chargeable property, but that does not matter.[9]

Suppose:

[9] Unless Holdco makes a transfer of value, see 81.2 (Transfer of value by close co), but that is not likely to happen.



In case 1, a close company holds an interest in an open company. Some of the value of the close co is attributable to the residence. But it is not attributable by virtue of an interest in a close company, so the attribution condition is not satisfied.

In case 2, an open (non-close) company holds land through a subsidiary. The *open* company is not within para 2, even if its value is attributable to the residence by virtue of its interest in the close company.

82.3.3 *Residence-company Interest*

Para 9 sch A1 IHTA provides the expected definition of close company; the term includes a non-resident close company.[10]

Para 9 provides a wide definition of "interest in a company":

> (1) In this Schedule ...
> references to an interest in a close company are to the rights and interests that a participator[11] in a close company has in that company.
> (2) In this paragraph...
> references to rights and interests in a close company include references to rights and interests in the assets of the company available for distribution among the participators in the event of a winding-up or in any other circumstances.

[10] Para 9(1) sch A1 IHTA provides:

> "In this Schedule "close company" means a company within the meaning of the Corporation Tax Acts which is (or would be if resident in the UK) a close company for the purposes of those Acts".

See 104.29.1 (Non-resident close company).

[11] Para 9(2) sch A1 IHTA incorporates the standard definition, though by slightly non-standard wording:

> "In this paragraph "participator", in relation to a close company, means any person who is (or would be if the company were resident in the UK) a participator in relation to that company within the meaning given by section 454 of the Corporation Tax Act 2010."

This will include a loan to the company, if the lender is a loan creditor (and so a participator).[12] A creditor does not have an interest in a company, in the normal sense: they have a claim against the company. But in the event of a winding-up, a creditor has an interest in the assets of the company.[13]

I refer to an interest in a residence-company, in this wide sense, as **"Residence-company Interest"** with initial capitals to reflect the technical nature of the expression. (Note this term is different from the statutory term "*residential-property* interest" which means an interest in UK land.)

82.3.4 *Company owns relevant loan*

Attribution condition limb (b)(iii) applies where:

> the value of the interest [in a close company] is ... attributable to a UK residential property interest by virtue ... of ... (iii) property to which paragraph 3 (loans) applies.

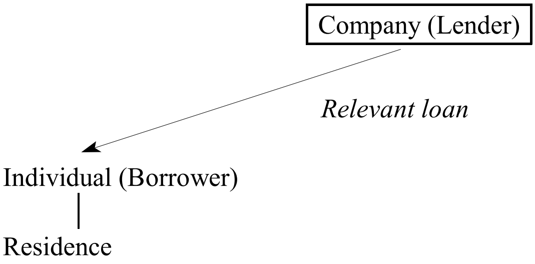
Para 3 applies to (1) relevant loans and (2) residence-security.[14] It is helpful to consider these separately.

One might have expected the legislation to say:

> *the value of the interest [in a close company] is ... attributable to property to which paragraph 3 (loans) applies [ie value is attributable to a relevant loan or residence-security]*

But that is not what it says.

Suppose a company has lent to an individual to finance acquisition of a UK residence. The company holds the benefit of the loan (a relevant loan, ie a loan to which para 3 applies):



The value of the company is attributable to the relevant loan. But is the value attributable to a *UK residential property interest* (ie the UK

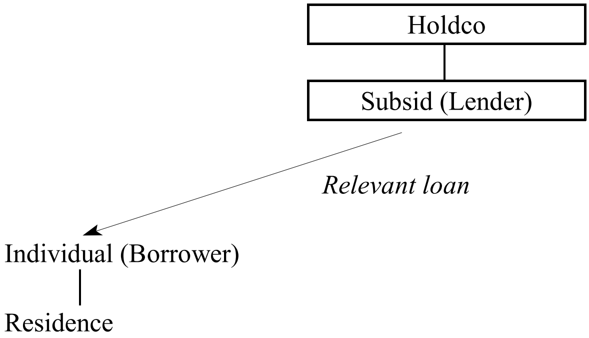
[12] See 104.25.2 ("Loan creditor").

[13] I think that is clear on first principles, but if further authority is needed, see 104.28 (Close co winding-up test).

[14] See 82.7 (Relevant loan: Definition); 82.9 (Residence-security).

residence[15])? That will depend on the facts.[16]

Similarly, suppose a company subsidiary has lent to an individual to finance acquisition of a UK residence:


Holdco
Subsid (Lender)
Relevant loan
Individual (Borrower)
Residence

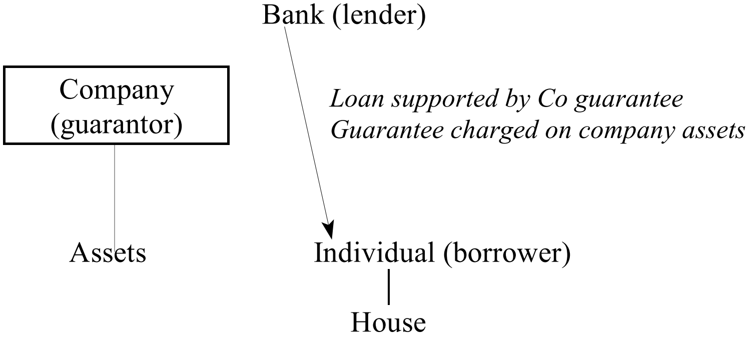
The value of Subsid is attributable to the relevant loan. The value of Holdco is also attributable to the relevant loan, by virtue of its interest in Subsid. But the question is whether the value of Holdco is attributable to the *UK residential property interest*. As in the previous example, that will depend on the facts.

82.3.5 *Company owns residence-security*

Attribution condition limb (b)(iii) applies where:

> the value of the interest [in a close company] is ... attributable to a UK residential property interest by virtue ... of ... (iii) property to which paragraph 3 (loans) applies.

Suppose a company has guaranteed a relevant loan and secured that guarantee by a charge on its assets. Diagrammatically:


Bank (lender)
Company (guarantor)
Loan supported by Co guarantee
Guarantee charged on company assets
Assets
Individual (borrower)
House

[15] See 82.17 ("Residential property interest").

[16] See 83.16.2 (Derived property: Loan).

The assets of the company are a residence-security, and not excluded property. The value of the company is attributable to the value of the assets. But the value of the company is not attributable to a UK residential property interest, so the attribution condition is not met, and the company shares are not sch A1 (de-excluded) property.

82.4 Residence-partnership

Para 2(1) sch A1 IHTA provides:

> This paragraph applies to an interest ... in a partnership, if and to the extent that the interest meets the condition in sub-paragraph (2).

The attribution condition is the same as for a Residence-company.[17]

I refer to this as a **"Residence-partnership"**.

An interest in a partnership set up specifically to hold a UK home is likely to be UK situate property on general principles.[18] Perhaps HMRC took a different view; or perhaps they just wanted to put it beyond doubt. The issue is not now likely to be tested.

I do not consider partnerships in detail, as partnerships do not commonly hold residential property.

82.4.1 *"Partnership": Definition*

Para 10 sch A1 IHTA provides the definition:

> In this Schedule "partnership" means—
> (a) a partnership within the Partnership Act 1890,
> (b) a limited partnership registered under the Limited Partnerships Act 1907,
> (c) a limited liability partnership formed under the Limited Liability Partnerships Act 2000 or the Limited Liability Partnerships Act (Northern Ireland) 2002, or
> (d) a firm or entity of a similar character to either of those mentioned in paragraph (a) or (b) formed under the law of a country or territory outside the UK.

This definition is similar to the SDLT/ATED definition,[19] but not identical: a foreign LLP is an SDLT/ATED-partnership, but it is classified as a company, not a partnership for the purposes of the IHT residential-

[17] See 82.3.1 (Attribution condition).

[18] See 102.35.2 (Partnership holding land).

[19] See 98.2.1 ("Partnership" for SDLT/ATED).

property code. That is sensible, and presumably deliberate. A general or limited partnership would be within the IHT residential-property code, even if the partnership is large and would not be a close company if it were corporate. But in practice large investment partnerships are usually structured as foreign LLPs, which do not count as partnerships for the purpose of the IHT residential-property code, they count as companies. They will be classified as open companies and so fall outside the IHT residential-property code.

82.5 5% exemption

Para 2(3) sch A1 IHTA provides:

> For the purposes of sub-paragraphs (1) and (2) disregard—
>
> (a) an interest in a close company, if the value of the interest is less than 5% of the total value of all the interests in the close company...

I refer to this as the **"5% exemption"**.

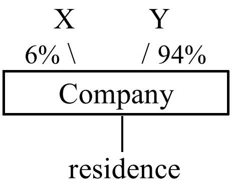
82.5.1 *The 5% test*

The test is whether "the *value* of the interest is less than 5% of the *total value* of all the interests in the close company"; not whether the interest is less than 5% of the shares.

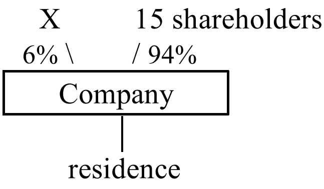
The total value of all the interests in the company includes the value of the interest which may qualify under the 5% test. The section refers to *all* the interests in the company, not all the other interests.

It is not clear whether one values the interests separately, or brings them together and values them as one item. It is suggested that one values them separately.[20]

Case 1



Case 2



[20] That is consistent with the connected person aggregation rule in para 2(4) which directs the value of a person's interest to be increased by the value of connected person interests (ie it requires separate valuations of each interest); see 82.5.3 (Connected persons). A similar issue arose in *Short v Treasury Commissioners* [1948] AC 534 and received the same answer.

In case 1:

(1) X has a 6% shareholding

(2) Y (not connected) has the rest of the shares.

X's holding is likely to satisfy the 5% test. Even a 10% holding is likely to do so because the discount for a 10% holding is likely to reduce its value to less than 5% of the value of all the interests (the 94% and the 6% interests, valued separately or even if valued together).

In case 2:

(1) X has a 6% shareholding.

(2) 15 other shareholders (not connected with X) have an equal share in the rest (approximately 6% each).[21]

What is "total value of all the interests in the company"? Is it the value of the 16 minority holdings, valued separately? Or the value of a 100% shareholding? The application of the 5% test depends on the answer to this question. It is suggested that the former is the case, so the 5% test is not met.

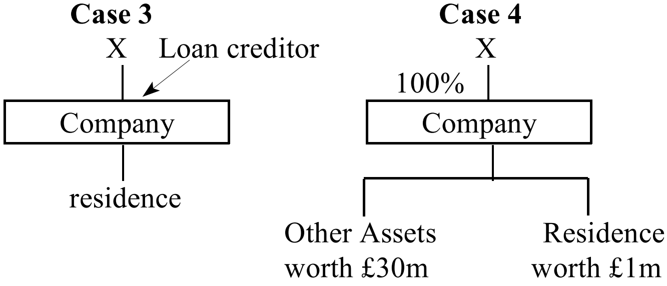
Sch A1 Q&As provide:

> **Question 3: Para 2(3): de minimis provisions**
> ... Curiously this de minimis provision does not value the minority shareholding and then compare it with the value of the company as a whole or look at how much value in the company is derived from residential property. Instead it compares the value of each participator's interest with the value of total participators' interests in the company. Does HMRC agree that this will lead to different results depending on whether the shareholder interests in a company comprise one majority shareholding or many small shareholdings and the extent to which the company is funded by borrowings?
> *Example 1*
> Newco is owned by two unconnected people, one of whom holds 80 per cent and the other 20 per cent. That 20 per cent interest might well be worth less than 5 per cent of the aggregate value of the 20% interest and the 80% interest.
> If on the other hand five unconnected people own 20 per cent each then it is unlikely the de minimis exemption will apply.
> If Newco is funded with a loan from an unconnected third party of, say,

[21] It is assumed that some of the 15 shareholders are associates, so the company is close.

> 70% of the value of the property, the de minimis exemption is likely to apply to a 20% shareholding in both of the above patterns of shareholdings.
>
> *Suggested answer*
>
> We broadly agree with the above analysis. The alternative option that the draftsperson could have adopted is to compare the value of the relevant person's interest with the value of 100% of the share capital but that is not the approach here.

HMRC agree.



The "interests in the company" include the interest of a loan creditor.[22] So in case 3, even a 100% shareholding may meet the 5% test, if the loan to the loan creditor is sufficiently large. But the loan is a Residence-company Interest, and so not excluded property.

In case 4, the value of the residence is less than 5% of the value of the company assets. But the test depends on the value of the *interests* in the company, not the value of the *assets* of the company; so the 5% test is not met.[23]

82.5.2 *One person holds 2 interests*

One person may have 2 interests in a company, eg shares and a loan. If the loan is small, the value of the loan may be less than 5% of the combined value of shares and loan. If the loan is large, the value of the shares may be less than 5% of the combined value of the shares and loan. Contexts suggests that one values the two assets together, so they do not qualify for the 5% exemption. But that is not a literal reading.

[22] See 82.3.3 (Residence-company Interest).

[23] Sch A1 Q&As agrees: "Note that there is no de minimis exemption just because the company only owns a very small amount of residential property."

82.5.3 *Connected persons*

Connected persons interests are aggregated. Para 2(4) sch A1 IHTA provides:

> In determining under sub-paragraph (3) whether to disregard a person's interest in a close company or partnership, treat the value of the person's interest as increased by the value of any connected person's[24] interest in the close company or partnership.

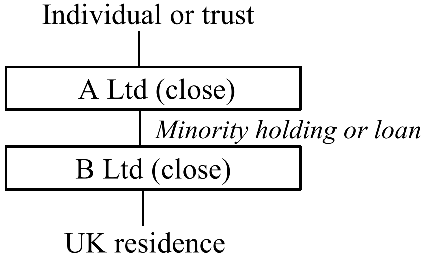
Sch A1 Q&As provide:

> **Question 4: Connected party interests and de minimis provisions**
> ... Para 2(4) says that one is to treat the value of the person's interest as increased by the value of any connected person's interest in the close company or partnership. This seems to differ from valuing the aggregate of the interests of the relevant person and all those connected with him.
> *Example 2*
> Adam and his son and daughter each has a 3% shareholding in a close company where each 3% is only worth 1.5% of the total value of all the interests in the company. As worded do HMRC agree that the value of Adam's interest is increased by the value of his children's interests - to 4.5% of the total value of all the interests in the company. If instead one valued the aggregate of the interests of Adam and his children, Adam's enlarged interest might then be worth 5% or more of the total value of all the interests in the company.
> *Suggested answer*: The first approach should be taken so that Adam's interest is increased to 4.5% of the total value of all interests in the company.

HMRC agree. No other answer is possible.

82.5.4 *Chain of companies*

Suppose:



[24] See 104.12.2 (Connected: IHT definition).

In the absence of para 2(2), the attribution condition would be met. But if the minority holding or loan is valued at less than 5%, it is in principle disregarded for the purposes of para 2.

Sch A1 Q&As provides:

> It should also be borne in mind that if a shareholder owns a company X Ltd which in turn owns a small interest of Y Ltd which holds the residential property, the de minimis provisions must be applied through all levels upwards. The value of the interest of X Ltd may be less than 5% of the total value of all the interests in Y Ltd.

82.5.5 *Partnership 5% exemption*

Para 2(3) sch A1 IHTA provides:

> For the purposes of sub-paragraphs (1) and (2) disregard—
> (b) an interest in a partnership, if the value of the interest is less than 5% of the total value of all the interests in the partnership.

Since partners are in general connected persons,[25] members of a partnership holding a Residence-company will not qualify for the 5% exemption, even if the partner holds less than 5% of the partnership. But the issue will not often arise.

82.6 Liabilities of Residence-company

Para 2(5) sch A1 IHTA provides:

> [a] In determining whether or to what extent the value of an interest in a close company or in a partnership is attributable to a UK residential property interest for the purposes of sub-paragraph (1),
> [b] liabilities of a close company or partnership are to be attributed rateably to all of its property, whether or not they would otherwise be attributed to any particular property.

This is relevant if (in short) the company
(1) holds UK residential property and other property and
(2) has a liability

So it will not arise very often. It could be avoided by using separate companies for the two classes of asset.

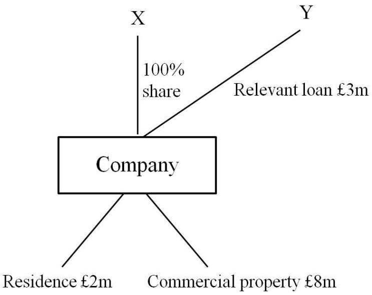
It is not entirely clear how para 2(5) applies to liabilities which are also

[25] See 104.18 (Connected: Partners).

an interest (loan-participation) in a residence-company. For instance suppose:

(1) A company owns £2m residential property and £8m non-residential property.

(2) The company was funded with £7m of shares (owned by X) and £3m of loan-notes (owned by Y). Diagrammatically:



If Y dies, how much of the value of Y's loan is attributable to residential property? The obvious answer is 20% of £3m = £600k. But para 2(5) suggests that one first attributes the £3m liability rateably against the residential and commercial property - reducing the value of the residential property from £2m to £1.4m.

Is the answer then that value of Y's loan-notes are only 30% of £1.4m = £420k? Value has been lost in this process (and in a company highly-geared with shareholder loan it would then seem, on this logic, to be possible to eliminate a large proportion of value for IHT purposes).

The fallacy in the above argument seems to be in confusing the value, post attribution of liabilities, of the company's assets, with the value of the participations in that company. The rateable attribution of liabilities under para 2(5) is there merely to establish the proportions (where they would otherwise actually fall differently). But para 2(5) does not reduce the value of the participations - unlike a third-party loan which would. On the above example the 20/80 proportions are preserved both before and after the para 2(5) exercise and Y must therefore apply 20% × £3m = £600k.[26]

82.6.1 *Liability: Residence-partnership*

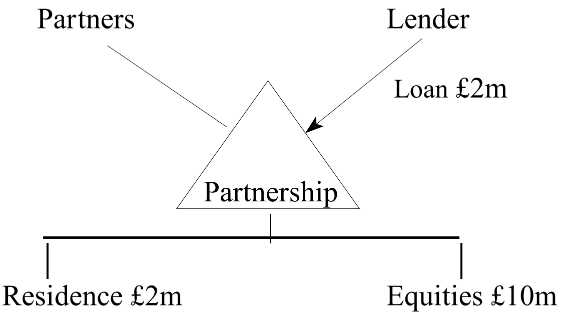
A liability of a Residence-partnership raises the question of the interaction of this debt allocation rule and relevant loan rules. Sch A1 Q&As

[26] I am grateful to John Barnett for this observation.

discusses this:

> **Question 6: Corporate liabilities**
> The position is reasonably clear for companies as loans to companies cannot be relevant loans and the purpose for which the loan is taken out is irrelevant. However, a loan to a partnership can be a relevant loan within para 4 if used to finance the acquisition of UK residential property.
> **Example 3**
> A partnership holds a UK residential property worth £2 million and borrows £10 million from X (a foreign dom) to invest in equities.

Diagrammatically:



The Q&A analysis is as follows:

> This is not a relevant loan.
> However, the loan reduces the value of the UK residential property pro rata.
> The same is true if a company borrows to buy equities. The loan is still in part deductible against the value of the residential property.

More analytically:

(1) The loan reduces the value of the partnership interest.
(2) The partnership interest is chargeable (de-excluded) property to the extent that the value of the partnership interest is attributable to the residence.
(3) In making that attribution, the partnership liability is attributed across the partnership property as a whole.

But it comes to the same thing.

In the above example, the loan was made for the purchase of the equities. Consider the same structure but suppose the loan was made for the purchase of the property:

> If the partnership borrows £2m to purchase residential property but also owns other assets of £10m,
> [1] only one sixth of the borrowing reduces the value of the residential property for the purposes of calculating tax on the partnership interest but
> [2] the entire loan is a relevant loan and therefore a non-excluded asset and fully chargeable to IHT...

There is potentially double taxation here.

> By contrast if the loan is to a company
> [1] that [the loan] is a para 2 participator interest [in my terminology, a Residence-company Interest] not a relevant loan and
> [2] only a proportion of it will be [chargeable property under para 2] as only a proportion will be attributable to residential property.

HMRC agree.

In practice, partnerships do not usually hold a UK residence, so this issue will not often arise.

82.7 Why relevant loans matter

Para 3 sch A1 IHTA provides:

> This paragraph applies to—
> (a) the rights of a creditor in respect of a loan which is a relevant loan (see paragraph 4) and
> (b) money or money's worth held or otherwise made available as security, collateral or guarantee for a loan which is a relevant loan, to the extent that it does not exceed the value of the relevant loan.

In short, the significance of a relevant loan is that:
(a) the benefit of the loan and
(b) security for the loan
are chargeable (de-excluded) property even if not UK situate.[27]

82.8 Relevant loan: Definition

82.8.1 *"Loan"*

Para 6(6) sch A1 IHTA provides a wide definition:

[27] See 82.2 (De-exclusion of sch A1 property).

> [a] In this Schedule, references to a loan include
> [i] an acknowledgment of debt by a person or
> [ii] any other arrangement under which a debt arises;
> [b] and in such a case references to money or money's worth made available under the loan are to the amount of the debt.

This includes a sale at market value where the purchase price is left outstanding.

Why did the drafter not just say that "loan" includes a debt?

82.8.2 *Relevant loan*

Para 4(1) sch A1 IHTA provides:

> For the purposes of this Schedule a loan is a relevant loan if and to the extent that money or money's worth made available under the loan is used to finance, directly or indirectly—
> (a) the acquisition by an individual, a partnership or the trustees of a settlement of—
> (i) a UK residential property interest, or
> (ii) property to which paragraph 2 to any extent applies [Residence-company/partnership]

I have considered referring to a relevant loan as a **"residence-loan"**, which would be a more transparent term, but it is better to adopt the statutory terminology. It may sometimes be helpful to gloss the term and say "relevant (de-excluded) loan".

It does not matter who makes the loan: a relevant loan may be made by an individual, partnership, trust or company.

The concept of "relevant loan" here must not be confused with "relevant debt" as defined for the purposes of remittances.

It does not matter whether the loan is on commercial terms or made at arm's length.

82.8.3 *Loan to company*

If a person lends to a *company* for the company to acquire a UK residence, the loan not a relevant loan: the requirement of para (a) is not met. But the benefit of the loan is in principle a Residence-company Interest and chargeable (de-excluded) property under para 2 sch A1 IHTA.[28]

If a close company (A Ltd) lends to another close company (B Ltd), the

[28] See 82.3.3 (Residence-company Interest).

benefit of the loan may be a Residence-company Interest (being an interest in B Ltd). So the shares of A Ltd may not be excluded property so far as their value was attributable to a UK residential property interest, by virtue of the loan.

If T (an individual or trust) borrows from an outside lender, and lends on to a company, there are two loans:

(1) The loan from the outside lender to T: This is a relevant loan as it is used to finance the acquisition of the Residence-company Interest.

(2) The loan from T to the company: This is not a relevant loan, but it is a Residence-company Interest.

82.8.4 *Bank loan*

A loan from a bank to a company is not a relevant loan; and the benefit of the loan is not a Residence-company Interest, because the bank is not a loan creditor[29].

A loan from a bank to an individual/partnership/trust for the purpose of acquiring a UK residence is a relevant loan. That does not matter if the lender is an open company. But it could affect a bank which is a close company as (subject to the 5% exemption) its shares could be chargeable (de-excluded) property.[30] Fortunately BPR would normally be available.[31]

82.8.5 *Acquisition by intermediary*

Para 4(1) sch A1 IHTA continues:

> For the purposes of this Schedule a loan is a relevant loan if and to the extent that money or money's worth made available under the loan is used to finance, directly or indirectly ...
>
> (b) [i] the acquisition by an individual, a partnership or the trustees of a settlement of an interest in a close company or a partnership ("the intermediary") and
>
> [ii] the acquisition by the intermediary of property within paragraph (a)(i) or (ii) [UK residential property interest/ Residence-company/partnership]

I refer to this as the **"intermediary rule"**.

[29] See 104.25.11 (Bank creditor).

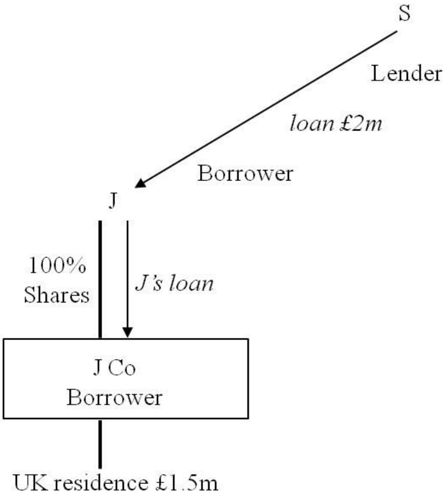
[30] To the extent that the value of the shares is attributable to a UK residence; but this may not be the case, it depends on the facts; see 82.3.4 (Company owns relevant loan).

[31] See 82.16.1 (APR/BPR).

The IHT Manual provides this example:

> **IHTM04313 Relevant Loans** [Jan 2020]
> Example 7 (John and Seamus)
> J is domiciled in the Republic of Ireland. He owns all of the shares in a Jersey Company (J Co) that owns foreign assets worth £10m.
> J's brother S, who is also domiciled in the Republic of Ireland lends J £2m in order to fund J Co (by way of loan)
> and then J Co purchases UK residential properties worth £12m.

Diagrammatically:



The HMRC analysis is as follows:

> J's interest in J Co is no longer excluded property because the value of J's stake in that company is now attributable to UKRPI [a UK residential property interest].
> S has made a relevant loan, which is not excluded property. While his loan did not fund the acquisition of a UKRPI by an individual, partnership or trustee it was used by J to acquire an interest (as a loan creditor) in J Co and J Co as an intermediary has acquired a UKRPI.

But one does not need the intermediary rule (para 4(1)(b) IHTA) to reach the conclusion that S's loan is a relevant loan. The loan falls within para 4(1)(a)(ii).[32] So it is not clear what the intermediary rule is for. It seems

[32] See 82.8.3 (Loan to company).

to be otiose.

> Note that if the loan to J Co was made by another close company K Co then that loan would not be a relevant loan. Instead the participators in K Co would have an interest in J Co. and therefore an indirect interest in the UKRPI, subject to the de minimis rule (IHTM04312).

82.8.6 *Finance indirectly*

The wording is based on s.162A/162B IHTA, on which there is extensive HMRC guidance.[33]

Para 4(2) sch A1 IHTA provides an inclusive definition:

> [A] In this paragraph references to
> [i] money or money's worth made available under a loan or
> [ii] sale proceeds[34]
> being used "indirectly" to finance the acquisition of something include
> [B] the money or money's worth or sale proceeds being used to finance—
> (a) the acquisition of any property the proceeds of sale of which are used directly or indirectly to finance the acquisition of that thing, or
> (b) the making, or repayment, of a loan to finance the acquisition of that thing.

Para (a) would cover the case where:
(1) T borrows to acquire an asset.
(2) T sells the asset.
(3) T uses the sale proceeds to acquire a residence.

Para (b) would cover the case where:
(1) T borrows to purchase an residence ("debt 1").
(2) T borrows to repay debt 1 ("debt 2").

That might not be caught otherwise.[35]

Suppose:
(1) Year 1: A loan is made to an individual/trust.
(2) The individual/trust uses the proceeds to subscribe for shares in a

[33] See 80.18 (Excluded property disallowance).

[34] The expression sale proceeds (or rather, proceeds of sale) is in fact used only in para 4(2)[B](a).

[35] See 80.21 ("Indirectly" financing).

close company.

(3) Year 3: The company acquires a residence.

The loan becomes a relevant loan in year 3.

Sch A1 Q&As provides:

> **Question 18: Meaning of "indirectly finances"**
> ... Clearly ... there must be some limits to the meaning of "indirect". If A lends to B who buys a car, which he sells 4 years later; and then gives the proceeds of sale to his children; and those children 3 years after that unexpectedly buy a UK residential property, then it would be difficult to argue that A has indirectly financed the acquisition of a UK residential property interest.
> However, it is unclear whether what breaks the chain is (a) the purpose of the loan (b) the intention of the borrower (c) the proximate use of the proceeds (d) the unexpectedness of the residential property purchase (e) the passage of time (f) a new actor in the chain (g) some other factor or (h) some combination of the above.
> *Suggested answer*
> The use of the verb "to finance" is important here. In relation to similar language in s162A IHTA 1984, HMRC has confirmed (for instance) that a person borrowing to buy a UK house (and thereby not using non-UK monies which they would otherwise have used to effect that purchase) cannot be said to be "financing" the maintenance of the non-UK monies; rather they are "financing" the purchase of the UK house.[36]
> It is not possible to give hard and fast guidance covering every case. However, in interpreting whether a loan "indirectly finances", one needs to examine - using a realistic assessment of the facts and a credible view of the parties' intentions - what the purpose of the loan was and what it was contemplated would be done with the proceeds.
> Para 4(2) makes it plain that one cannot get out of the relevant loan provisions simply by inserting an intervening asset or an intervening person in the chain. But if the loan is intended for one purpose which is fulfilled then an unexpected subsequent use of the monies, such as in the example above, would not constitute the indirect financing of a UK residential property interest.

I suggest the matter should depend on what is the arrangement. HMRC say:

[36] Author's footnote: Is this a good analogy?

> We agree that there could be cases where a factual link between a loan and an acquisition is too remote for it to be a relevant loan.

This is no doubt correct, but it is not exactly guidance.

82.8.7 *Lender unaware of use of loan*

The lender may not know what money lent is indirectly used for. Sch A1 Q&As provides:

> **Question 19: Lender unsure what a borrower has done with the proceeds of a loan**
> Lenders may not always know what a borrower has done with the proceeds of a loan. How, in such a case, are lenders to assess whether some or all of their loan is a relevant loan?
> **Example 11**
> Mr J is a wealthy individual with many different investments and interests worth hundreds of millions. Many of these investments are illiquid and, from time to time Mr J has cash-flow difficulties. At such times he borrows from a family trust set up, many years ago, by his (non-domiciled and non-resident) mother. Mr J is clearly good for the money and the trustees do not impose any particular restrictions on the use to which he puts the borrowed-monies: they are simply for his general lifestyle needs.
> Mr J spends the money on a variety of things including school fees, holidays, living expenses and (potentially) in maintaining one or more of his homes around the world (including the UK). Mr J also uses the monies to make payments to his ex-wife under their divorce settlement. His ex-wife spends those payments on a similar range of things which may include enhancing or maintaining her UK property.
> The family trust, which until now has been an excluded property trust, has a 10 year anniversary approaching and needs to know what proportion of the loans to Mr J may be "relevant loans". However, the loans all predate the 2017 provisions (in some cases by up to 20 years), and it is impossible for either the trustees or Mr J to reconstruct what Mr J did with the loans.
> *Suggested answer*
> As in the previous question the use of the verb "to finance" is important here. The trustees and Mr J should make as detailed enquiries as they can and if it is clear that a particular residential property interest - for instance a new purchase or a major refurbishment or extension of an existing property - was clearly what the loan was spent on, then they should report accordingly. However, where it is clear that the purpose

> of the loan was to "finance" general living expenses, then the fact that some of those living expenses might have included everyday repairs and other low-level property expenses would not be what the loan "financed".
> Similarly, on these particular facts, a loan used to finance a divorce settlement which the ex-wife unexpectedly spends on UK property may be thought to be sufficiently distant not to be caught (the position might be different if the divorce settlement specifically contemplated the purchase of a UK house, for instance).
> HMRC will take a pragmatic view.
> Lenders should make appropriate enquiries and report obvious use of loan-funding, but low-level use which cannot be quantified and more distant use by third parties will not be caught by these provisions.

An "arrangement" analysis makes the position clearer for the lender.

HMRC say:

> We agree that there is a practical issue here and that HMRC will take a pragmatic view.

This is not exactly guidance, but the reader may infer tacit agreement with the Q&A view.

The question also considers the position of a close-company bank lender:

> The position is even more difficult in relation to a closely controlled foreign bank which may have made many 100s of loans without inquiring in all cases how such borrowings are used. On the death of a shareholder or partner how can the executors proceed?

HMRC comment on this:

> The position for the bank may be more difficult but BPR may often assist on the death of a shareholder.

82.8.8 *Acquisition*

Para 4(3) sch A1 IHTA provides an artificial definition:

> [A] In this paragraph references to the acquisition of a UK residential property interest by an individual, a partnership, the trustees of a settlement or a close company[37] include

[37] The words "or close company" relate to the reference to the acquisition by an intermediary, in para 4(1).

[B] the maintenance, or an enhancement, of the value of a UK residential property interest which is (as the case may be) the property of the individual, property comprised in the settlement or property of the partnership or close company.

82.8.9 *Loan to pay rent*

Sch A1 Q&As provide:

> **Question 10: scope of relevant loans (3)**
> Where funds are borrowed, so an individual can pay his or her rent in relation to a UK residential property does this create a "relevant loan"?
> *Suggested answer*
> Such a loan would be a relevant loan as a tenancy agreement is sufficient to create an interest in residential property.[38]

HMRC agree.

82.8.10 *Incidental acquisition costs*

Sch A1 Q&As provides:

> **Question 8: scope of relevant loans (1)**
> Where funds are borrowed to pay the SDLT or other related legal and other expenses (not being expenses relating to the enhancement or maintenance of the value of the UK residential property interest) on the acquisition of UK residential property interest, would this be a "relevant loan"?
> *Suggested answer:* [The definition of relevant loan] is not intended to include borrowed funds which are used to pay
> [1] SDLT, and
> [2] other incidental costs of acquisition within the meaning of s38(2) TCGA 1992[39]

[38] The example continues: "The exception to this would be where the specific legislation (paragraph 8) defining "UK residential property interest" excludes the interest from the definition. For example, purpose built student accommodation meeting the conditions set down at [what is now para 5(4) sch 1B TCGA] does not come within the definition of "UK residential property interest" and so a loan to allow an individual to pay their rent on qualifying purpose built student accommodation would not be a "relevant loan"."

[39] Section 38(2) TCGA refers to:
"[1] fees, commission or remuneration paid for the professional services of any surveyor or valuer, or auctioneer, or accountant, or agent or legal adviser and

> provided such expenses do not relate to the enhancement or maintenance of the value of the UK residential property interest.

That seems right, and HMRC agree. It is an important point, given current rates of SDLT.

82.8.11 *Interest on loan*

Suppose a lender has lent to an individual to finance the purchase of a residence. I refer to this as the first loan, and it is a relevant loan.

As far as interest is concerned, there are three possibilities:

(1) **An additional loan**: the borrower borrows, by a separate loan, to pay interest on the first loan

(2) **Simple unpaid interest:** Interest on the first loan rolls up unpaid

(3) **Capitalised interest:** Interest on the first loan is capitalised

One would expect the IHT position to be the same in each case.

Sch A1 Q&As considers the position of an additional loan:

> **Question 9: scope of relevant loans**
> Where funds are borrowed to service [ie to pay] the interest on a "relevant loan" is this additional borrowing also a "relevant loan"?
> *Suggested answer*
> Servicing the interest on a relevant loan does not result in the acquisition of a UK residential property interest and neither does the expense relate to the enhancement or maintenance of the value of the UK residential property interest. As such, there is no "relevant loan".

HMRC say:

> We do not agree. If the interest is part and parcel of financing the purchase price of the UK residential property then the making of an additional loan to service that interest will be a relevant loan, whether directly or indirectly.

When is interest "part and parcel" of financing the purchase price? That is layman's language. Interest is always part and parcel of financing. So HMRC seem to be saying that if there is a relevant loan (eg to purchase a

[2] costs of transfer or conveyance (including stamp duty or stamp duty land tax)
[3] together... in the case of the acquisition of an asset, with costs of advertising to find a seller".

UK property), then the additional loan to pay interest on the first loan is also a relevant loan.

The question here is whether the additional loan could be described as "indirectly financing" the acquisition; if so it is also a relevant loan. "Indirectly" is wide enough to cover this, unless the context suggests otherwise.

Turning to unpaid interest: Suppose a loan of £100 and £2 interest has accrued but is unpaid. The lender owns a single debt, I think, and so a "loan", of £102. The question here is to what extent the money or money's worth made available under the loan is used to finance the acquisition. It can be argued that the £2 is"money's worth made available under the loan" and not so used; so to the extent of the £2, the simple unpaid interest, the loan is not a relevant loan. But HMRC will argue that it is so used, at least indirectly; or else that the £2 is not "money or money's worth made available under the loan".[40] On either analysis, the loan of £102 is entirely a relevant loan.

It is difficult to see that capitalisation of the interest can alter the IHT position.

These points are untested, but it is suggested the HMRC view is to be preferred. It seems strange that the first loan is de-excluded property, subject to IHT, but the additional loan, or interest (unpaid or capitalised), is not.

82.8.12 *Disposal of residence*

Para 4(4) sch A1 IHTA provides:

> Where the UK residential property interest by virtue of which a loan is a relevant loan is disposed of, the loan ceases to be a relevant loan.

Sch A1 Q&As provides:

> **Question 20: Relevant loan not repaid but company sold**
> Consider an individual, partnership or trust borrowing to fund[41] a close company which uses the funds to acquire UK residential property.

[40] I am grateful to John Barnett for his comments on this point.

[41] "Funding" a company may mean subscribing for shares or making a loan to the company. In the diagram I assume a share subscription. Similar points arise if there is a loan to the company instead, but the position is slightly more complex to follow.

Diagram 1 (Q20)

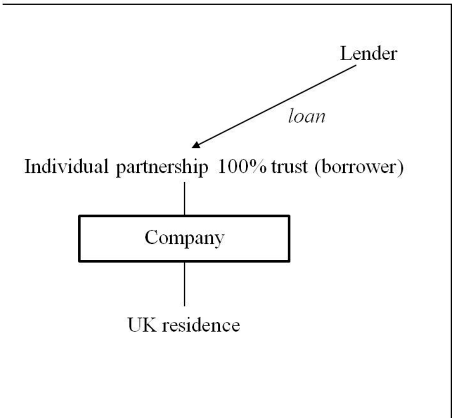
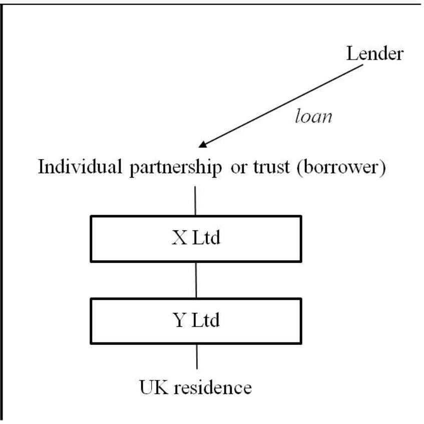


Diagram 2 (Q21)



> The relevant loan remains outstanding but the individual, partnership or trust borrower disposes of the company holding the UK residential property rather than selling the house itself and the loan is not repaid? Does the loan remain a relevant loan indefinitely even though no house is in the structure? There seems no provision in the legislation to remove the relevant loan from schedule A1. Para 5 only has a two year rule if the loan is repaid.
>
> *Suggested answer*: We would take the view that the loan remains a relevant loan and only when repaid does the two year rule apply.

HMRC agree.

> **Question 21: Loan to company (non-relevant loan) remains outstanding or is repaid where property or subsidiary holding property is sold**
>
> If there is a loan by an individual or trust to a company X Limited which has acquired another company Y Limited which holds residential property and that Y Limited subsidiary is sold, even if the loan to X Limited remains outstanding, as X Limited is no longer schedule A1 property the loan ceases to be chargeable property immediately and repayment is irrelevant. [See diagram 2]. Do HMRC agree?

HMRC agree. But is this view correct? It is true that X Ltd is not sch A1 property, after the sale of Y Ltd; but one might have thought that it was sufficient if the loan was used to finance the acquisition of property which was sch A1 property at the time of acquisition or subsequently. If Q21 is correct then the same reasoning should apply in Q20.

Maybe this situation will not happen much.

Para 4(5) sch A1 IHTA deals with part-disposals:

> Where a proportion of the UK residential property interest by virtue of which a loan is a relevant loan is disposed of, the loan ceases to be a relevant loan by the same proportion.

82.9 Deductibility of relevant loan

In simple cases, borrowing is neutral for IHT. If A lends £100 to B:

(1) The value of the estate of A is unaffected, as before the transaction A held the £100, and after the loan is made, A holds the benefit of the debt worth £100

(2) The value of the estate of B is unaffected, as after the loan is made, B has the £100 and a liability of £100 deductible from the estate of B.

This section considers problems which arise where:

(1) The benefit of a debt is within the charge to IHT, ie
   (a) it is chargeable (non excluded) property; or
   (b) it is held by a company whose shares are chargeable (non excluded property) and

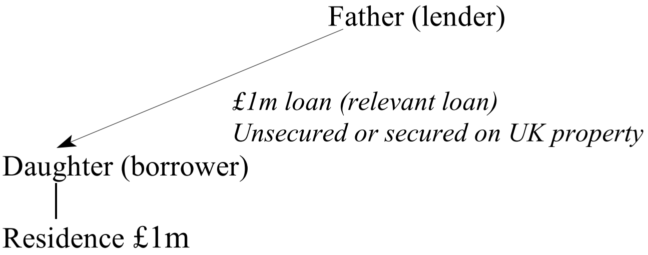
(2) The burden of the debt (the liability) is not deductible in the estate of the borrower, ie
   (a) it is disallowed under one of the many rules which disallow deduction for liabilities; or
   (b) it is notionally deductible but set against excluded property, not chargeable property, so the deduction is wasted.

In these circumstances there is (effectively) a double charge to IHT. This has always been a possible consequence of disallowed debts. However the scope of the problem has increased as a result of the IHT residential-property code, since relevant loans, which were in general excluded property under the pre-2017 rules, have now become chargeable. In other words, there is an element of unfairness or overkill in the legislation, as is common in anti-avoidance rules.

Sch A1 Q&As provides a simple example:

> **Example 4**
> Father and daughter are both domiciled in France.
> Daughter lives in the UK and father lends her £1m to buy a London flat.
> He takes as security her Paris property or maybe makes the loan unsecured.

Diagrammatically:



Father (lender)

£1m loan (relevant loan)
Unsecured or secured on UK property

Daughter (borrower)

Residence £1m

The Q&A analysis is as follows:

> a. Father has made a "relevant loan" which is not excluded property. It will therefore be subject to IHT on his death.
> Indeed as daughter is UK resident the loan is likely to be a UK situated asset anyway unless made a specialty debt or secured on non-UK property;
> b. Daughter owns a UK situs asset (worth £1m) and the debt that she owes her father is owed to a non resident and will be discharged in France "so far as possible" thus reducing the value of daughter's property outside the UK (see IHTA 1984 s162(5)).
> c. The result is that both the loan (which will be set against daughter's non-UK assets) and the full value of the London property are brought within the IHT net.
> If father releases the loan he will make a PET.

The suggested answer recommends tax planning to ensure the debt is deductible:

> We agree with the above analysis although double tax treaty relief in both cases should be considered.[42]
> Otherwise the loan should expressly be charged on the UK property so that it comes within the terms of s162(4).

HMRC agree:

> We agree with your analysis of SchA1 and we also agree that the liability will have to be deducted from foreign assets to the extent that IHTA/s162(5) applies.

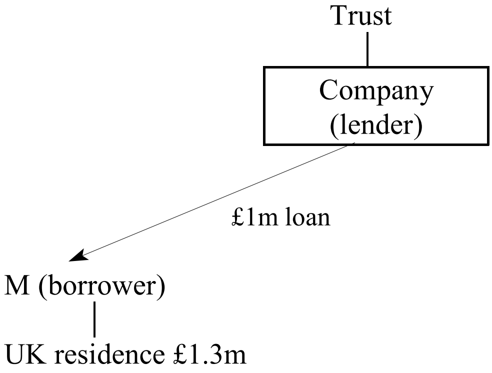
[42] Author's footnote: On the facts of the example, the France IHT DTA should provide relief for IHT on the father's asset (the debt) on the death of the father (even if the debt is UK situate): see 115.10.2 (Treaty-situs: France/ Italy).
DTA relief would not apply to IHT on the daughter's assets (the residence) on the death of the daughter.

> However, the eventual outcome may be mitigated by the effect of a double taxation convention or IHTA/s159 [foreign IHT credit relief].

Sch A1 Q&As provides another example, where the lender is a family trust rather than the father:

> **Question 14: ROB and s103 - borrowing issues**
> *Example 8* (M)
> M is resident but not domiciled (or deemed domiciled) in the UK. She has established a non-UK settlement which holds its assets through a non-UK company owned by the trustees. M is a beneficiary of the trust.
> In order to purchase a property in the UK for £1 million, M borrows £1 million from the company paying an arm's length rate of interest.[43]
> On M's death, the property is worth £1.3 million.

Diagrammatically:



> The debt may be deductible from the value of the property assuming the loan is repaid leaving a net value subject to inheritance tax of £300,000. It is however possible as a result of sections 162(5)/175A IHTA or (in some circumstances), section 103 Finance Act 1986 that the debt will not be deductible in which case the full £1.3 million value of the property will be within the scope of UK inheritance tax.[44]
> In addition, as the property held by the trust is subject to a reservation of benefit (as M is a beneficiary), the value of the shares in the company owned by the trust will, to the extent that their value is attributable to the loan[45] to M (£1 million) be subject to inheritance tax on M's death

[43] Author's footnote: But interest is not relevant for the IHT analysis.

[44] But section 162(5)/175A will not apply if the advisers are paying attention.

[45] This is not correct. It should read: to the extent that their value is attributable to the *house*. See 82.3.4 (Company owns relevant loan).

> as non-excluded property.
>
> The total amount on which inheritance tax is payable will therefore either be £1.3 million or £2.3 million. This takes no account of ten yearly charges to which the trustees will be subject by virtue of holding a company within para 2.
>
> *Suggested answer* We agree that, depending on the circumstances, the total amount subject to inheritance tax on M's death could be £2.3 million.

HMRC agree.

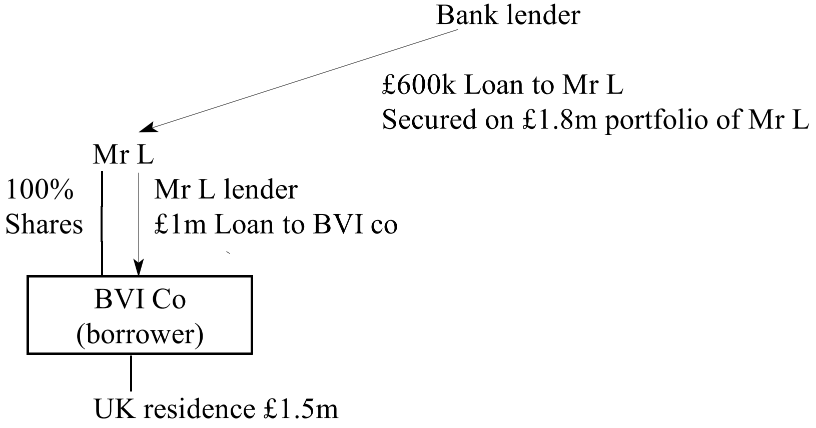
Perhaps the point of the example is to shame HMRC into seeing how unfair the law can be. But double taxation frequently arises when a debt is disallowed for IHT purposes, and double taxation is always an issue if a trust is within GWR and 10 year charges.

82.9.1 *Debt set against collateral*

Sch A1 Q&As provides:

> **Example 5**
>
> Mr L, who is resident and domiciled in Malaysia, purchases a buy to let flat in Battersea for £1 million through a wholly owned BVI company. The BVI company owns no other assets. He borrows £600,000 of the purchase price from his bank in Malaysia which he then lends to the company together with £400,000 from his own money. The bank loan is formally secured on a portfolio of investments belonging to Mr L and held by the Malaysian bank worth £1.8 million.

Diagrammatically:



> On Mr L's death, the UK property is worth £1.5 million.

Mr L's interests in the BVI company include the loans of £1 million and the equity in the company which is now worth £500,000. These interests will be subject to inheritance tax on his death. (£1.5m). This is comprised of his interest as a participator by reason of being a loan creditor, and the equity in the property [ie in the company].

In addition, the loan from the bank is a relevant loan as it is a loan to an individual which has been used to acquire an interest (in this case the onward loan to the company) in a close company which in turn uses the money to acquire a UK residential property interest. Inheritance tax will therefore potentially also be payable on the value of the collateral up to the amount of the loan (£600,000). The total potential value subject to inheritance tax on Mr L's death is therefore £2.1m (£1.5m plus £600k).

The loan from the bank of £600,000 is in principle deductible from the collateral. However, is it deductible in its entirety only from the value of the collateral which is within the scope of inheritance tax or might the deduction be taken pro rata against the whole of the £1.8 million of collateral? If the latter, only

£200,000 (£600,000 × £600,000/1,800,000)

of the loan would be deducted from the £600,000 of collateral which is taxable. S162(5) IHTA offers no express answer to this point.

The position would be different if the bank lent direct to the BVI company and Mr L offered personal investments as collateral for this loan. In that case as the collateral is not to secure a relevant loan the personal investments are not chargeable. See example 9 later for further details.

Suggested answer

In practice we will accept that the loan is deductible only from the collateral that is within the scope to IHT. Therefore, all the £600,000 is deducted from £600,000 of the £1.8m collateral which is chargeable. The total amount subject to inheritance tax on Mr L's death will be £1.5m and for this purpose the collateral is effectively ignored. This is because the collateral is only chargeable up to the value of the amount lent and therefore the loan should be deductible against that part of the collateral. The policy intention is not to impose a double charge but simply ensure that the full value of the house is chargeable to IHT when the loan has been secured by means of other collateral.

HMRC original answer was in sch A1 Q&As version 2:

We disagree. There is no relevant loan in this scenario. The (de-excluded) property within the scope of IHT on Mr L's death is the interest in the BVI Company consisting of his interest as a loan

> *creditor and the balance of the equity. Here, that is broadly equivalent to the value of the UK RPI.*

The professional bodies noted tactfully that they were unclear as to the basis of the HMRC analysis that there is no relevant loan. Version 3 now provides:

> **HMRC:** We agree that the value of the property in Mr L's estate would be £2.1m and the question is how to take account of an allowable liability (of £600,000) which is an incumbrance on property (£1,800,000) that it partly chargeable (£600,000) and partly excluded (£1,200,000). Like you, we take the view that for the purposes of SchA1 the liability should be set off against the value in the UK estate so that the value chargeable to IHT is £1,500,000. This view is confined to SchA1 and should not be taken as applying to other similar situations that may be covered elsewhere in the IHTA 1984.

82.10 Residence-security

Para 3 sch A1 IHTA provides:

> This paragraph applies to ...
> (b) [i] money or money's worth
> [ii] held or otherwise made available as security, collateral or guarantee
> [iii] for a loan which is a relevant loan,
> [iv] to the extent that it does not exceed the value of the relevant loan.

I refer to property within para (b) as a **"Residence-security"**. That is not an ideal label, but there is no short term which summarises this paragraph.

The significance is that the property is chargeable (de-excluded) property.

The wording is novel.

"Money or money's worth" is usually used in the phrase "consideration in money or money's worth" where it has a technical meaning.[46] Here it is just a long-winded way to say "property".

[46] A security over the property is said to be "collateral" to the personal obligation. Hence the property is itself (elliptically) referred to as "collateral". The word "collateral" in this sense is possibly more common in America, but it is also established in UK legal English, eg s.263C TCGA (from 2009) and it can be traced back at least to FA 1995.

82.10.1 *Security/collateral*

Snell explains the legal meaning of “security”:[47]

> In a technical sense, a security interest gives the interest holder a right in respect of the property of another person which can be used to satisfy ... the payment of a debt or other obligation owed to the holder of the security interest. In this technical sense there are only four kinds of consensual security known to English law: (i) pledge (ii) contractual lien; (iii) equitable charge and (iv) mortgage.

It is considered that the word is used with this meaning here.

“Security” can refer to:

(1) the security interest held by the security holder, or
(2) the underlying property subject to that interest (usually held by the debtor)

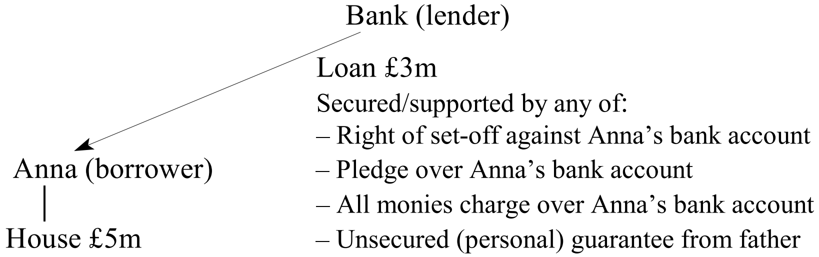
Here we are concerned with property “held or otherwise made available as security” ie the underlying property.

“Collateral” is just a synonym of security,[48] so I refer below to security rather than “security or collateral”.

The meaning of security is debated in a STEP[49] submission to HMRC. Its comments are based on this straightforward example:

> Anna, who is not resident[50] or domiciled (and not deemed domiciled) in the UK, purchases a house in London for £5 million.
> She takes a £3 million loan from her bank in Jersey to help purchase the property. The loan is secured over the property …

Diagrammatically:



Secured/supported by any of:
– Right of set-off against Anna’s bank account
– Pledge over Anna’s bank account
– All monies charge over Anna’s bank account
– Unsecured (personal) guarantee from father

[47] Snell's Equity (34th ed., 2020) para. 36-001.

[48] See 18.24.3 (HMRC pre–2014 view).

[49] together with TACT and BBA, but for brevity I refer only to STEP.

[50] A’s residence is not relevant for IHT purposes, but perhaps it is stated in order that the separate topic of remittances does not arise.

The starting point is that the debt is deductible for IHT, so that A's UK situate property is valued at £2m.

82.10.2 *Is set-off right "security"*

STEP say:

> Under English law, a bank in certain circumstances has the right to apply credit balances held by a customer in satisfying liabilities due to the bank. There are similar rules in many other countries.
> In most cases, any common law or statutory rights of set off are supplemented by specific contractual rights of set off contained in the bank's standard terms and conditions.
> In our example, assume A held £1 million of cash in an account with the same bank. As a result of the bank's right of set off, the bank could use this cash to satisfy A's liability under the loan.
> If the £1 million of cash is treated as "money or money's worth held or otherwise made available as security, collateral or guarantee" for the loan, the £1 million will be subject to inheritance tax as well as the net £2 million value of the UK residential property. …
> We do not however think that this is the correct interpretation of the draft legislation.

That is correct, because a right of set-off is not a security interest[51] (and, obviously, it is not a guarantee).

HMRC did not reply to STEP, and sch A1 Q&As repeats the question:

> **Question 7: Paragraph 3 - collateral and relevant loans**
> The wording of paragraph 3(b) of Schedule A1 is not entirely clear but presumably includes only
> [1] assets pledged or charged in support of a relevant loan or
> [2] money made available as support for a guarantee for a relevant loan.
> It is not entirely clear whether the asset in question has to be formally pledged or charged or needs simply to be available by way of set-off for the lender. We assume the former is required. i.e. that the assets must be put in a position that they cannot be withdrawn by the guarantor

[51] See Law Commission Consultation Paper, "Registration of Security Interests: Company Charges and Property Other Than Land" (2002) para 6.48: "A contractual set-off is not a security interest as it gives no right over the debtor's property, merely an entitlement to set-off one personal obligation against another".
http://www.lawcom.gov.uk/app/uploads/2015/03/cp164_Company_Security_Interests_Consultation.pdf

> without the consent of the lender and are in that sense formally held by the bank or made available as security.
>
> Do HMRC agree?
>
> *Suggested answer*
>
> [1] We agree that
>
> [a] general rights of set off in a bank's standard terms and conditions or arising under general law or
>
> [b] a general pledge (for example arising under the bank's standard terms and conditions)
>
> will not be caught by the collateral rules. The assets are not "held or otherwise made available" as security for the relevant loan.

HMRC appear to disagree:

> If the lender has the power to set off credits from another financial account to secure the loan then the lender can properly be said to have hold such funds and that it has been made available by the collateral provider in accordance with the contractual arrangements.

More analytically, the question is whether property subject to a right of set-off constitutes property "held or otherwise made available as security or collateral", and I think it does not, because the right of set off is not a security interest, and not, in the true sense, a security.

STEP reaches the same conclusion, but by a different and, I think, less convincing, argument:

> In order to be caught by paragraph 3(b), the property has to be "held or otherwise made available" as security for the loan. This implies that there must be some connection between the asset in question (in this case the £1 million deposit) and the loan taken out to purchase the property.
>
> This might, for example, be the case if specific security is given over the asset or if the terms of the loan make some reference to the asset such as an ability to demand repayment of the loan if the asset is no longer held by the bank.
>
> On the other hand, it is difficult to see that the mere existence of a right of set off (whether arising under general law or under the bank's terms and conditions) can be said to result in the property being held or otherwise made available as security or collateral for the loan.

HMRC returned to the question in version 3 of the sch A1 Q&As, where the question has been rephrased. I think it is necessary to consider a right of set-off and a pledge separately, as they are different types of right. A pledge is a security interest and a right of set-off is not. But the Q&As address them together:

> **Question 7 – Sch A1 para 3 – Collateral and Relevant Loans**
> 1. There are a number of different approaches to determining whether assets are "held or otherwise made available as security, collateral or guarantee" for a relevant loan within the meaning of paragraph 3(b) of schedule A1.
> 2. The policy was to secure that property given as security for a loan is, in appropriate circumstances, brought within the scope of inheritance tax.
> 3. Bearing this in mind, it would normally be expected that property given as security will fall within paragraph 3(b) of schedule A1, unless (what would otherwise be) the security, collateral or (property standing behind a) guarantee is too remote from the relevant loan.
> 4. What would otherwise be the security may well be too remote where the lender has some sort of generic security over assets held by a lender on behalf of the borrower. This would include, for example,
> [a1] a right of set-off or a general pledge contained in a bank's standard terms and conditions or
> [b] a right of set-off which arises under common law or the law of the jurisdiction in which the lender is based.
> A right of set-off or general pledge does not "incumber" the assets over which it subsists provided that the customer is free (in the absence of a default) to withdraw those assets at any time. In that sense the lender can only "be secure" (in the sense of having confidence) that those assets are available to it once a default has happened. Until such a default the position is inchoate: the security can be thought of as not yet formed.
> 5. Such an interpretation also provides symmetry with the phrase "incumbrance on any property" in s162(4) IHTA.[52]
> 6. There may be other situations where it can be shown that assets which are held as security by the lender have no connection with the relevant loan (for example they may be security for a different liability) but this would need to be considered on a case by case basis taking into

[52] See 79.5.2 (Incumbrance-debt). The argument here is:
(1) "Incumbrance" in s.162(4) has the same meaning as security in the present context: the two words are synonymous.
(2) "Incumbrance" in s.162(4) does not include a right of set-off or pledge.
But I think the argument fails at point (2) as while "incumbrance" does not include a right of set-off, it does include a pledge, which is a security-interest.

> account all of the relevant facts.
>
> **HMRC:** HMRC agrees that the legislation was not intended to interfere with normal banking arrangements. Therefore, HMRC agrees with the analysis set out above subject to the following comments.
> One point to bear in mind however is that there is a cap on the security which can be taken into account for the purpose of paragraph 3(b) so HMRC would expect that the distinctions above would only be of relevance if the value of the non – UK property held as security – that was specifically given in relation to the loan and that was therefore clearly within the definition – was less than the value of the loan.
> Para 4: In some instances, the examples given may fall within paragraph 3(b) depending on the facts of a particular case.

That is not exactly guidance.

82.10.3 *Is a pledge "security"*

STEP say:

> The standard terms and conditions of some banks contain not only rights of set off but also a specific pledge over any of the customer's assets held by the bank so that those assets can be used by the bank to meet any liability the customer may have to the bank at any time during the relationship. In the case of some international banks, the pledge is wide enough to enable assets held by one group company to be used to satisfy a customer's liability to another group company. ...
> In our example, there could therefore be a problem if A had a £10 million portfolio with the bank's sister company in Switzerland. If the portfolio is treated as being "held or otherwise made available" as security for the loan from the Jersey bank as a result of the general pledge in the standard terms and conditions, £3 million of the portfolio would be within the scope of inheritance tax ...
> For the same reasons as described above in relation to rights of set off, we do not think that assets are "held or otherwise made available" as security for a loan as a result of a general pledge which has nothing to do with the loan in question.

This is an implausible construction even if one can assume that the security "has nothing to do with the loan" (which is far from self-evident). A pledge confers a security-interest on the lender, so if an asset is pledged for a debt, it is made available as security, whether a general pledge or not.

It appears that HMRC would agree: see 82.10.2 (Is set-off right security).

82.10.4 *Is all-monies charge "security"*

STEP say:

> An all monies charge may arise where the customer has entered into a completely unconnected transaction with the bank under which the bank has been given security over specific assets but where the security documentation provides that the assets can be used to meet not only the obligation in question but also any other liability which the customer may have to the bank.
>
> In this case, the position is very similar to general rights of set off or general pledges in that, although the bank has security over the assets, there is no connection between the granting of the security and the making of the loan which is used to purchase the property. On this basis, the analysis should be the same - i.e. that the assets in question are not held or otherwise made available as security for the loan to purchase the property as there has been no positive act to link the security with the loan.

I would agree that the analysis should be the same: there is no difference between a pledge and an all-monies charge. An all-monies charge confers a security-interest on the lender, so if an asset is subject to such a charge, it is made available as security, whether a charge of specific property or an all-monies charge.

82.10.5 *Guarantees*

Para 3 sch A1 IHTA provides (so far as relevant):

> This paragraph applies to ...
>
> (b) money or money's worth held or otherwise made available as ... guarantee for a loan which is a relevant loan,

A guarantee is a promise by one person to meet the debt of another person, if the other person is in default. In principle no property need be "held" or "made available" as a guarantee, that is, a guarantee may simply be an unsecured promise to make a payment; but the promise may be secured on property, so that the lender has a security interest in the property; and the reference is to security of that kind.

STEP say:

> Where a loan is made by a bank to an entity (for example a trust or a company), it is standard practice for a bank to require a related

> individual to give a personal guarantee in respect of the liability in question. Typically, such a guarantee would be unsecured ...
> It might be argued that, as a result of the guarantee, all of the assets of the guarantor are available as "guarantee" for the loan which the bank has made to enable the related entity to purchase the property. However, we do not think that this is how paragraph 3(b) should be interpreted.

That is correct, because (unless the guarantee is secured) no money or money's worth is held or otherwise made available as guarantee.

STEP reaches the same conclusion, but by its different argument:

> What is caught is property which is "made available as security, collateral or guarantee" for the loan. This suggests to us that property held by a guarantor would only fall within the relevant paragraph if it has been given [the legal term is charged] specifically as security for the guarantee in question.

HMRC did not reply to STEP, but provide an answer in sch A1 Q&As version 3. HMRC (grudgingly) agree:

> **Question 7 – Sch A1 para 3 – Collateral and Relevant Loans**
> 7. As far as guarantees are concerned, it must be borne in mind that the way in which schedule A1 operates is to "de-exclude" property which is in some way supporting the relevant loan. A guarantee is not itself property of the guarantor. This means that where a guarantee is completely unsecured (in the sense above) and so is not connected with any particular property of the guarantor, the guarantor's assets remains excluded property. On the other hand, if the guarantor has provided some form of security or collateral for their obligations under the guarantee, the assets in question will fall within paragraph 3(b) of schedule A1.
> **HMRC reply**
> Para 7: Again, as to what extent the funds of the guarantor are made available, would be viewed by HMRC as a question of degree and fact. If the creditor's only recourse to the guarantor for the failure of the primary debtor to repay is the guarantee and there is not an additional connection to any particular property of the guarantor then we would be inclined to agree.

"Be inclined to agree" is not exactly guidance, but at least HMRC appear to accept that an unsecured guarantee is not caught.

82.10.6 *Multiple security*

One debt may be secured on more than one asset. Suppose a relevant loan (say £10m) is secured on:
(a) a house in Spain (worth £11m) and
(b) a floating charge over a portfolio (worth say £20m).

CIOT say:

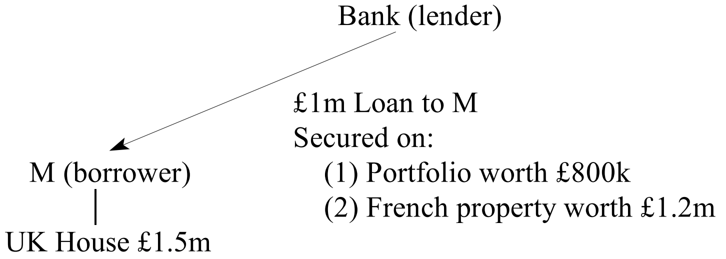
> it is unclear whether the additional wording at the end of paragraph 3(b)
> [1] restricts the overall collateral to £10m (but if so how does one apportion this?) or
> [2] whether it simply restricts each item of collateral to £10m.

I would have thought the answer was [1], with an apportionment by value (in the absence of express priority in the charge or charges).

Sch A1 Q&As provides:

> **Question 12: Collateral or security exceeding amount of borrowing: s162**
> *Example 6* (Mrs M)
> M, a French resident, borrows £1m from a French bank to buy a house in the UK worth £1.5m. Her personal investment is £0.5m. She offers a portfolio of non-UK shares worth £800,000 and a property in France worth £1.2m. i.e. total non-UK security charged is £2m for a property worth £1.5m and a loan of £1m.

Diagrammatically:



> Could HMRC confirm the following:
> 1.That the reference to the "extent to which it does not exceed the relevant loan" in para 3 refers to the totality of the collateral. i.e. that only £1.0m of the combined collateral will fail to be excluded property rather than the whole of the value of the shares (being less than the £1 million loan) and £1 million of the value of the French house (i.e. £1.8 million in total) being within the charge to IHT?
> *Suggested answer:* This is confirmed

That is clearly correct, and HMRC agree.

> 2. What would the position be if the bank could only enforce against the foreign assets once the UK house was found to be insufficient to meet the borrowing and there was a formal charge against the UK house? In that event under s162(4) the borrowing reduces the value of the house for IHT purposes. Does this mean £500K of the equity in the house is chargeable and £1m of the overseas collateral? i.e total of £1.5m.
> *Suggested Answer*: We agree a total of £1.5m is charged to IHT on death even though the loan is deductible under s162 against the value of the house (the net £500K value of the UK house and £1 million of the non-UK collateral).

HMRC agree.

> 3. The position will be particularly important to resolve as M might leave the UK property and the shares and French property subject to IHT but to different people under her Will. Matters get more complicated where perhaps some collateral is provided by the borrower and other collateral is provided by another person such as the parent of the borrower.

82.10.7 *Security for non-relevant loan*

Sch A1 Q&As provides:

> **Question 16: Collateral and loans to companies**
> Do HMRC agree that collateral provided for a loan to a close company is not caught as it is only collateral made to support relevant loans that is within the scope of the charge.
> So, for example, if a company borrows from a bank to purchase residential property and that is backed by collateral from the shareholder, such collateral is not subject to IHT. The bank loan is not a relevant loan as it is not taken out to purchase UK residential property by an individual, trust or partnership and the bank is a loan participator but outside the scope of inheritance tax (if not close).

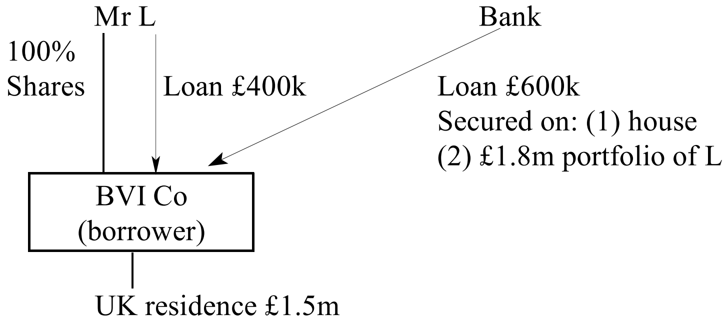
This is self-evident, and HMRC agree. The Q&As provide an example to hammer the point home:

> **Example 9**
> The facts are the same as in Example 5 above[53] except that the bank has

[53] See 82.9.1 (Debt set against collateral).

> made the loan direct to the BVI company (but still secured on Mr L's portfolio).

Diagrammatically:



The Q&A analysis is as follows:

> The loan to the BVI company is not a relevant loan as it is not made to an individual, a partnership or the trustees of the settlement. Mr L's collateral is not therefore subject to inheritance tax on his death. In addition, the loan is deductible from the value of the property in calculating the value of Mr L's interest in the BVI company. The value of his interest in the BVI company is therefore £900,000 (£1.5 million minus £600,000). The total amount on which inheritance tax is payable on Mr L's death is £900,000.
> *Suggested answer*: We agree that, in this situation, the only liability to inheritance tax on Mr L's death is on the net value of Mr L's interest in the BVI company which will be £900,000. This assumes the BVI company holds no other assets.

HMRC agree.

82.11 Residence-security: Double IHT issues

I discussed above the problem of double inheritance taxation where:

(1) the benefit of a debt was a chargeable asset in the hands of the creditor and

(2) the burden of the debt (the liability) was not deductible in the hands of the debtor.[54]

The same issue arises where residence-security is made a chargeable asset under the residence-security rules.

Suppose:

[54] See 82.9 (Deductibility of relevant loan),

(1) T (an individual or trust) borrows from a 3rd party (non-close) bank to buy a residence. The loan (owned by the bank) is a relevant loan, and so not excluded property, but that raises no IHT problem. The bank shares are not sch A1 property because that is an open company.

(2) T charges property as security for the loan. This property is chargeable (de-excluded) property up to the value of the loan.

The purpose of the residence-security rule is presumably to fill this gap, or perceived gap. That leads to the same double taxation as for relevant loans. But if the loan is from an individual, trust or close company, then there is potentially triple taxation: on the property, the debt and the security.

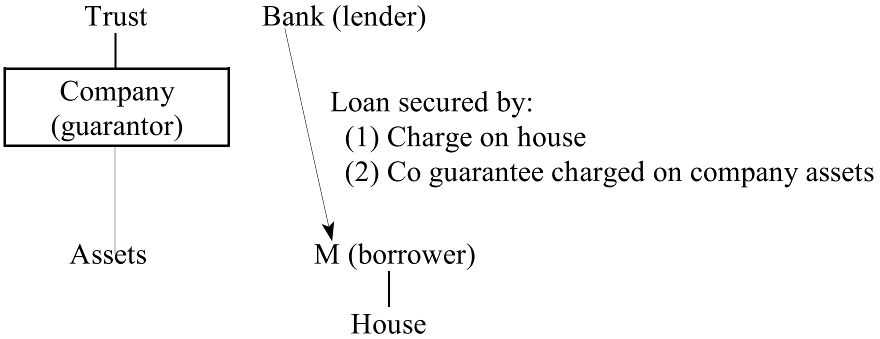
Depending on the facts, the liability for the loan may be disallowed, or it may be deducted from the residence or from the security (but since both are chargeable (de-excluded) property, that may not make any difference as far as the total IHT liability is concerned).

Careful tax planning is needed here to avoid unfairness.

Sch A1 Q&As provides:

> **Question 15: ROB - further queries**
> Instead of M borrowing from the company, she borrows from a UK bank which takes security over the house but also is given a guarantee by the company secured over its assets.

Diagrammatically:



> [1] In these circumstances, the debt to the bank is deductible (subject to section 175A IHTA).[55]

[55] But s.175A will not apply in practice, assuming the advisers of M's PRs are reasonably alert.

> [2] However, the value of the shares in the company owned by the trust will be within the scope of inheritance tax but capped at the amount of the loan.

Point [2] is very doubtful.[56]

> The likelihood therefore is that the total amount subject to inheritance tax on M's death will be the £300,000 net value of the house and the value of the shares in the company owned by the trust up to £1 million - i.e. £1.3 million in total.
> *Suggested answer*: We agree that the tax charge in this situation will be on £1.3 million as long as a deduction for the debt is not denied by section 175A.

HMRC agree.

82.12 Residence-tail

82.12.1 *Residence-tail rule*

Para 5(2) sch A1 IHTA provides the rule:

> If and to the extent that this paragraph applies to any property—
> (a) for the two-year period it is not excluded property by virtue of
> [i] section 6(1), (1A) or (2) or
> [ii] 48(3)(a), (3A) or (4),[57] and
> (b) if it is held in a qualifying foreign currency account within the meaning of section 157 (non-residents' bank accounts),[58] that section does not apply to it for the two-year period.

The property (which I call residence-tail property) is chargeable (non-excluded) property, even if not UK situate. In the same manner as para 1, para 5(2) sch A1 IHTA *de-excludes* the property.

82.12.2 *The two-year period*

Para 5(3) sch A1 IHTA defines the two-year period:

> The two-year period is the period of two years beginning with the date of—
> (a) the disposal referred to in sub-paragraph (1)(a), or

[56] See 82.3.5 (Company owns residence-security).

[57] For s.43(3)(a), see 75.8 (Trusts: Foreign situate property); for s.43(3A)(a), see 75.10 (Trusts: UK funds).

[58] See 76.13 (Foreign currency account).

> (b) the payment referred to in sub-paragraph (1)(b).

In short, residence-tail property has a two year "tail" during which it remains chargeable (de-excluded) property. This is intended to prevent planning shortly before death or other occasion of charge.

Sch A1 Q&As provides:

> **Question 26: Two year rule and contract/completion**
> It is assumed that the two years runs from the date of the completed disposal or loan repayment not from contract. The CGT rule that the date of contract is the date of disposal is not in point. This raises similar issues to questions 1 and 2.[59]
> *Suggested answer* The two years runs from actual receipt of sale proceeds - whether this is from exchange or completion does not matter.

That must be right. HMRC agree.

82.13 Residence-tail Property

Para 5(1) sch A1 IHTA provides:

> This paragraph applies to—

There follows 3 or 4 categories of property. I refer to property within para 5(1) as **"Residence-tail Property"**. That is not a transparent label, but there is no short term which can summarise this paragraph.

82.13.1 *Residence-tail: Share proceeds*

The first category of Residence-tail Property is:

> (a) property which constitutes consideration in money or money's worth for the disposal of property to which paragraph 2 [Residence-company/partnership] ... applies;

The paradigm case is the proceeds of sale of a residence-company.

82.13.2 *Residence-tail: Loan proceeds*

The next category of Residence-tail Property is:

> (a) property which constitutes consideration in money or money's worth for the disposal of property to which ... paragraph 3(a) [relevant loan] applies;

[59] See 82.19.2 (Contract of sale).

> (b) any money or money's worth paid in respect of a creditor's rights falling within paragraph 3(a) [relevant loan] ...

The paradigm case is the proceeds of repayment or sale of a relevant loan.

82.13.3 *Residence-tail: Derived property*

The next category of Residence-tail Property is:

> (c) any property directly or indirectly representing[60] property within paragraph (a) or (b).

I refer to that as **"derived Residence-tail Property"**.

82.13.4 *Proceeds of sale of land*

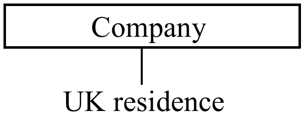
The definition of Residence-tail Property does not include proceeds of sale of UK land. Where a UK residence held directly, there is no two-year tail, so IHT can be avoided by a sale shortly before death or other occasion of charge. That is deliberate:

> Disposal of shares is caught under the two-year rule quite deliberately because it avoids other taxes such as SDLT and nonresidents CGT.[61] A sale of shares cannot therefore be done as a deathbed measure. Disposal of property itself does not avoid other taxes and therefore the two-year run off does not apply.[62]

The definition of Residence-tail Property does not include proceeds of a liquidation of a company holding UK land.[63]

82.13.5 *Examples*

Suppose a company owns a UK residence:



The company is within para 2. The proceeds of sale of the company are Residence-tail Property under para (a).

[60] See App 2.9 ("Representing" assets).

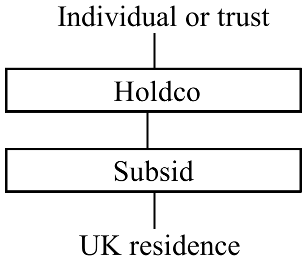
[61] The CGT position changed after the date of this statement.

[62] *https://www.step.org/system/files/media/files/2020-03/Briefing_note_non_doms_and_offshore_trusts.pdf*

[63] See App 4.5 (Transfer on liquidation).

Suppose the company sells the residence. The proceeds of sale are not Residence-tail Property, and the company is not Residence-tail Property.

Suppose a chain of companies, thus:

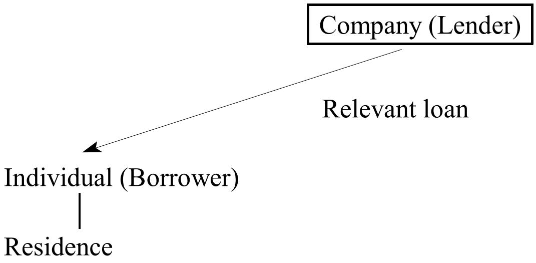


Holdco and Subsid are both within para 2.

Suppose the individual or trust sells Holdco. The proceeds of sale are residence-tail property under para (a).

Suppose Holdco sells Subsid. The proceeds of sale are Residence-tail Property in the hands of Holdco, but that does not matter.[64] Are the shares in Holdco Residence-tail Property? The strict answer is no.[65] But a purposive construction suggests the opposite conclusion. A Court may well feel that there ought to be a charge on these facts. The residence-tail rule would apply on a sale of Holdco, so why should it be different on a sale of the subsidiary? And what would the position be if Holdco was wound up, so that the trustees received the transaction proceeds?

Suppose a company has lent to an individual to finance acquisition of a UK residence. The company holds the benefit of the loan:



The loan is within para 3 (a relevant loan). The shares in the company may be within para 2, though that depends on the facts.[66]

[64] Unless Holdco makes a transfer of value, see 81.2 (Transfer of value by close co), but that is not likely to happen.

[65] See App.2.9.6 (Do shares represent co assets).

[66] See 82.3.4 (Company owns relevant loan).

Suppose the loan is repaid. The proceeds of the loan are Residence-tail Property, but that does not matter. Are the shares in Holdco Residence-tail Property? This raises the same question as when Holdco sells Subsid, discussed above.

82.13.6 *Residence-tail Property in mixed fund*

Sch A1 Q&As provides:

> **Question 24: Para 5 - disposals and repayments: sales of shares**
> ... paragraph 5 does not deal very comprehensively with what happens in the event that the sale proceeds are mixed with other funds.

That is something of an understatement.

> *Example 12*
> A father sells his company shares (the company's only asset being a UK residential property) to his son[67] and puts the proceeds of £1m on deposit in a separate bank account. He then spends the money buying a house in Hong Kong.
> The Hong Kong house is not excluded property for two years. If the house increases in value only the original sale price is taxed. If the HK property falls in value the lower value is taken.

That is straightforward. The Hong Kong house is derived Residence-tail Property. HMRC agree. The point is to introduce the question which follows:

> **Question 25: Mixing of funds from sale caught by para 5**
> What would be the position if the funds are mixed with other funds and then some funds are withdrawn and spent. For example, £1m represents the sale proceeds in example 12 above and the balance of the bank account represents £500K which is from an art sale. A withdrawal of £500K occurs. Do HMRC consider that the withdrawal removes the funds pro rata one third from the account so that the £1m is reduced by £333,333 or would HMRC accept that the rule in *Devaynes v Noble* 1816 35 ER 781 better known as the rule in *Clayton's Case* applies such that the withdrawal is on a first in first out basis?
> *Suggested answer*: Our preference is that a FIFO basis is used. However, pro rata is acceptable if a FIFO basis is not possible due (for example) to lack of records.

HMRC say:

[67] The identity of the purchaser is not relevant to the residence-tail rule.

> If there is no evidence to the contrary[68] then the FIFO basis is acceptable (so that the withdrawal, here, is not property representing the proceeds).

It would be better not to mix residence-tail property and other funds.

82.13.7 *Proceeds of UK situate relevant loan*

Para 2/3 sch A1 apply to property whether UK situate or not. So the proceeds of a UK situate relevant loan are Residence-tail Property.[69]

A UK situate relevant loan is not excluded property, and so not affected by the de-exclusion rule in para 1. But the residence-tail rule may still apply to it, which could matter if (say) a UK situate relevant loan was repaid and the proceeds held abroad.

82.13.8 *Loan repaid then property sold*

Sch A1 Q&As provides:

> **Question 13: What is the position where loans are refinanced and then the property is sold?**
> *Example 7*
> A lends to B who purchases a UK property. A has a relevant loan but then B repays A and borrows from a bank. The repayment of the loan received by A is within the IHT net for two years under para 5.
> Shortly after refinancing and within the two years B sells the property. HMRC seem to assume at IHTM 04314 Example 3 that the repayment proceeds received by A will then be excluded property.[70] However, para 5 does not treat the repayment proceeds as a relevant loan and so para 4(4) is inapplicable. The two years continues to run even though if B had sold the property and only then repaid A no two year rule would operate.
> We assume also it is right that if B had sold the property and not repaid A but left the loan outstanding it would cease to be a relevant loan and the two year rule in para 5 does not apply.
> *Suggested answer*: We agree with the above analysis.

HMRC agree. That must be right.

[68] Author's footnote: It is clear from *Clayton's Case* that the customer and banker may agree some other basis: FIFO is the presumed position subject to any agreement to the contrary. See App.2.10 (Withdrawing from mixed funds).

[69] The proceeds of a UK situate Residence-company are also residence-tail property (though that is less likely to happen in practice).

[70] I cannot see that in the HMRC example.

82.13.9 *Residence-securities*

Para 5(1) does not apply to residence-securities: in my terminology, residence-securities are not Residence-tail Property.

Sch A1 Q&As provides:

> **Question 17: Collateral and the two year rule**
> Please confirm that the two year rule does not apply to collateral, whether or not such collateral is provided in respect of relevant loans or loans to companies
> *Example 10*
> Father provides collateral for bank borrowings taken out by his son to purchase residential property; if that collateral is released the father is immediately outside the scope of IHT.

HMRC agree. That is the only possible answer.

82.13.10 *Cap on residence-tail*

Para 5 sch A1 IHTA provides:

> (4) The value of any property within sub-paragraph (1)(c) [derived property] is to be treated as not exceeding the relevant amount.
> (5) The relevant amount is—
> (a) where the property within sub-paragraph (1)(c) directly or indirectly represents property within sub-paragraph (1)(a) ("the consideration"), the value of the consideration at the time of the disposal referred to in that sub-paragraph, and
> (b) where the property within sub-paragraph (1)(c) directly or indirectly represents property within sub-paragraph (1)(b), the amount of the money or money's worth paid as mentioned in that sub-paragraph.

82.14 Residence exit-charge reliefs

The residential-property code provides two exemptions to the IHT exit charge.[71]

Section 65(7C) IHTA provides:

> Tax shall not be charged under this section by reason only that property comprised in a settlement
> [a] ceases to any extent to be property to which paragraph 2 or 3 of Schedule A1 applies [Sch A1 property]
> [b] and thereby becomes excluded property by virtue of section

[71] See 76.8 (Exit charge).

48(3)(a) above.

This would apply if:

(1) A trust owns a company which holds a UK residence (the shares are non- excluded property).
(2) The company sells the property and acquires other property (not a UK residence) so the shares become excluded property and cease to be relevant property.

There is no exit charge at step (2). SDLT on the sale is considered to be sufficient tax.

Section 65(7D) IHTA provides:

> Tax shall not be charged under this section where property comprised in a settlement or any part of that property—
> (a) is, by virtue of paragraph 5(2)(a) of Schedule A1 [residence-tail], not excluded property for the two year period referred to in that paragraph, but
> (b) becomes excluded property at the end of that period.

This would apply if:

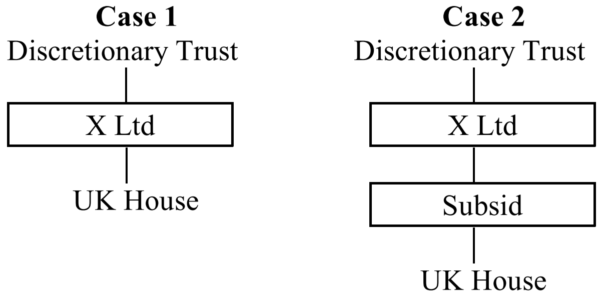
(1) A trust owns a company which holds a UK residence (the shares are non- excluded property).
(2) The trust sells the shares and acquires other property (not UK situate); for two years the property remains chargeable (de-excluded) property.
(3) After two years the property becomes excluded property and ceases to be relevant property.

There is no exit charge at stage (3).

Planning is needed more than 2 years before the date of a 10-year anniversary or exit charge.

82.15 Company dividend in specie

Suppose:


Case 1

Case 2

Suppose:

(1) X Ltd declares a dividend in specie (in case 1, a dividend of the house; in case 2, a dividend of the shares in Subsid).

(2) s.624/720 do not apply (this may be because settlor is non-resident, deceased, excluded, or because the trust is a protected trust).

The dividend is income of the trustees but no IT charge arises.

X Ltd makes a transfer of value and this transfer is apportioned to the trustees.[72]

As the dividend is trust income, it is not settled property.[73] So the amount apportioned to the trustees is equal to the amount of the dividend.

The trustees are deemed to have made a disposition as a result of which the value of the settled property is reduced.[74]

The trust fund, ie the shares in X Ltd, is not excluded property. *Close-company* income-receipt relief does not apply, unless the trust is UK resident.[75] At first sight, there is therefore an exit charge on the distribution by the company. But it is considered that *exit-charge* income-receipt relief applies: the IHT charge would be "in respect of" a payment which would be income of the person if he were UK resident.[76]

Suppose instead of a dividend, X Ltd makes a gift to a third party which is a capital receipt of the recipient. Exit-charge income receipt relief would not apply. Would the residence exit charge relief in s.65(7C) IHTA apply? It is suggested that this relief would not apply. It is the case that:

(a) the shares in X Ltd cease to Sch A1 property; and

(b) the shares become excluded property by virtue of s.48(3)(a).

However it is not the case that the exit charge arises *by reason only* of those facts. It arises because the shares reduce in value. That view better fits the scheme of the Act.

82.16 Spouse and other exemptions

Apart from the excluded property rules, all the usual IHT exemptions still apply for sch A1 property and residence-tail property. The 2015

[72] See 81.2 (Transfer of value by close co); 81.5 (Trustee participators).

[73] Unless immediately accumulated by the trustees and so turned into settled property. See 87.6.1 (Undistributed trust income).

[74] See 81.5.2 (IHT close-company code/Non-IIP trust).

[75] See 81.4.6 (Income-receipt relief).

[76] See 81.6 (Dividend: Close-co code analysis); 76.9.3 (Income-receipt relief).

residential-property paper provides:

> 16. It is intended that the same reliefs and charges will apply as if the property was held directly by the owner of the company. Hence a deceased individual who owned the company shares directly will have the benefit of spouse exemption if the company shares are left to a spouse.

Pre-2017 wills need to be reviewed in the light of the residence–property code. But everything needs to be reviewed in the light of the rules.

82.16.1 *BPR/APR*

Sch A1 property may qualify for business or agricultural property relief, if the relevant conditions are satisfied. Pre-2017 arrangements may require review, and in some cases reorganisation, because where property was formerly excluded property, no attention will have been given to the requirements of these reliefs.

Sch A1 Q&As provides:

> **Question 22: Banks and BPR (1)**
> It has been pointed out that private closely controlled banks (whether companies or partnerships) that lend to investors in UK residential property can inadvertently be caught by schedule A1. Such loans will often be relevant loans or the bank will be loan participators in the borrowing company. In these circumstances the [foreign] shareholders of / partners in the bank may only be able to rely on business property relief (BPR) to prevent an IHT charge.
> We assume that if the bank is carrying on a trade of money lending HMRC will accept that in the normal course of events BPR will be available on any value attributable to relevant loans and that HMRC will apply the relief by looking at the bank's operations as a whole first in determining whether the shareholder is eligible for relief on the transfer of value attributable to non-excluded property.
> *Suggested answer*
> We confirm that banks with a banking licence (or sufficient authorisation to act under its governing law) taking deposits and lending will generally qualify for BPR although of course each case must be looked at on its facts.
> There will be no special provisions here so new shareholders and partners will have a UK inheritance tax exposure until the two year holding requirement has been met.

HMRC agree. That is the only possible answer. The usual BPR rules will apply.

82.16.2 *Excepted assets*

Suppose a company qualifies for BPR and its assets are:

Asset	**Value**
UK residential property (a business asset)	30
Non-residential property (business assets)	65
Non-residential property not used for business (excepted asset)	5

The relevant provisions are:
Section 104(1) IHTA:

> Where the whole or part of the value transferred by a transfer of value is attributable to the value of any relevant business property, the whole or that part of the value transferred shall be treated as reduced ... by 100%; but subject to the following provisions of this Chapter.

Section 112 IHTA:

> In determining for the purposes of this Chapter what part of the value transferred by a transfer of value is attributable to the value of any relevant business property so much of the last-mentioned value as is attributable to any excepted assets within the meaning of subsection (2) below shall be left out of account.

Sch A1 para 1 & 2:

> Property is not excluded property ... if and to the extent that ... the value of the interest is... attributable to a UK residential property interest

Let us assume a tax charge on death of the shareholder, in which case s.5IHTA provides that the estate of the individual does not include excluded property.

The deceased's estate is therefore 30 as is the transfer of value he makes on death under s4 as is the value transferred by that transfer of value.

The value transferred (30) is reduced by s104 to the extent that it is attributable to the value of business property. The value of the business property, having by s.112 left out of account 5, is therefore 95.

Does one in this case say that the 30 is attributable solely to the 95 and therefore entirely exempted by BPR? Or does one say that 95% of the 30 is attributable to the value of relevant business property? It is suggested that the former view is the better one, viewing the legislation purposively. Obviously the opposite would apply if the excepted asset were itself residential property.[77]

82.16.3 *Excepted subsidiary*

Similar questions arise if there is an excepted subsidiary in the group under s111 IHTA 1984.

> **Question 23: Banks and BPR (2)**
> A foreign bank may be closely controlled and hold (usually through subsidiaries) relevant loans to third parties to facilitate the latter's purchase of UK residential properties. If the bank would otherwise qualify for BPR on such lending activities, is full relief given even though the bank may separately own an investment subsidiary holding foreign investment property on which BPR would normally not be available by virtue of s111 IHTA. In other words does BPR have to be tested only by reference to the holding company and the value attributable to the relevant loans or more generally throughout the whole group?
> *Suggested answer*: We would first ascertain whether the holding company qualifies for relief looked at in the round taking into account s105(3) and then only look at the offending subsidiary in applying BPR rather than examine each separate subsidiary or group activity.

HMRC agree.

82.17 Sch A1 TAAR

Para 6(1) sch A1 IHTA provides:

> In determining whether or to what extent property situated outside the UK is excluded property, no regard is to be had to any arrangements[78] the purpose or one of the main purposes of which is to secure a tax advantage[79] by avoiding or minimising the effect of paragraph 1 or 5.

I refer to that as the **"Sch A1 TAAR"**. In my terminology, this is a disregard-style TAAR; see 3.2.3 (Consequence of TAAR).

This must be approached in 3 stages:

[77] I am grateful to John Barnett for this observation.

[78] Para 6(2) provides the standard (unnecessary) IHT definition: see App 2.2.3 (Definitions of "arrangement"). I use the singular as there is no difference between arrangement and arrangements.

[79] Para 6(2) incorporates the GAAR definition of tax advantage by reference: "In this paragraph ... "tax advantage" has the meaning given in section 208 of the Finance Act 2013". See 3.19.1 (Tax advantage: Definitions).

(1) Identify the arrangement.
(2) Ascertain whether a main purpose of the arrangement is to secure a tax advantage by avoiding/minimising the effect of para 1 or 5 ("avoiding para 1 or 5").
(3) If caught, ascertain the effect of disregarding the arrangement ("the TAAR disregard").

I refer to that as the **"TAAR analysis"**.

82.17.1 *Setup arrangements*

Suppose:
(1) A close company was minded to acquire UK residential property.
(2) The company was told of the IHT consequences (the effect of para 1 is that the shares become chargeable property).
(3) In order to avoid that, the company decided to buy non-residential property or foreign residential property.

One would not expect this to be caught. Applying the TAAR analysis:

Identify the arrangement: That is the purchase of non-residential property.

Is a main purpose to avoid para 1? I would say not. In the old (but valid) cliché, the tax tail would be wagging the commercial dog. A diluted concept of tax avoidance infiltrates into this kind of TAAR, in order to reach the intuitively right result.

If caught, what is the effect of the disregard? One disregards the purchase of the non-UK property. But fiction does not require one to go so far as to deem a purchase of UK residential property (which property? what values would it reach?).

So the TAAR will not apply.

A similar analysis should apply if:
(1) An individual or trust was minded to borrow from a close company or family trust to acquire UK residential property
(2) The person was told of the IHT consequences (the effect of para 1 is that a trust loan is chargeable trust property or in the case of a company loan, the shares may become chargeable property)
(3) In order to avoid that, the person decided to borrow from a 3rd party open company.

Applying the TAAR analysis:

Identify the arrangement: That is the loan from the 3rd party.

Is a main purpose to avoid para 1? I would say not. That is less evident if the terms of the 3rd party loan would be the same as the terms of the trust or close company loan. But a diluted concept of tax avoidance infiltrates into this kind of TAAR, in order to reach the intuitively right result.

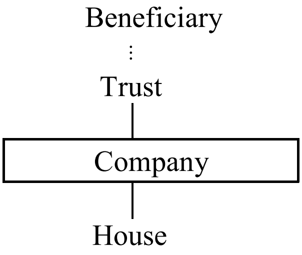
If caught, what is the effect of the disregard? One disregards the 3rd party loan. But the disregard does not require one to go so far as to deem a UK loan (which does not exist, and could not be taxed).

I have considered whether the effect of the TAAR could be that the shares in the open company may be chargeable (de-excluded) property. That would surprise the third party lender.[80] But that is not done by disregarding the arrangement, but by disregarding one of the effects of the arrangement.

82.17.2 *Unwinding arrangements*

Suppose:

(1) An existing trust holds a company which holds a residence, thus:



(2) The trust was told of the IHT consequences (the effect of para 1 is that the company is chargeable trust property within the scope of 10-year charges[81]).

(3) The trust appoints the company to a beneficiary and pays a small exit charge.

Applying the TAAR analysis:

Identify the arrangement: That is the appointment.

Is a main purpose to avoid para 1? One would expect not. That is less than self-evident. But a diluted concept of tax avoidance infiltrates into this kind of TAAR, in order to reach the intuitively right result.

[80] The 5% exemption does not help, as that applies to close companies; see 82.5 (5% exemption).

[81] And, potentially, within GWR on death of the settlor (in the case of a settlor-interested trust).

If caught, what is the effect of the disregard? One disregards the appointment. But that only applies "In determining whether or to what extent property situated outside the UK is excluded property". The trust has no property. So nothing is taxable. It would be remarkable to seek to tax on trustees who had made an absolute appointment and had no assets.

Suppose steps (1)(2) were the same, but a different step (3):

(3) The trust sells the company to a beneficiary. The trust keeps the proceeds as excluded property (once the 2 year tail expires).

Applying the TAAR analysis:

Identify the arrangement: That is the sale.

Is a main purpose to avoid para 1? One would expect not. That is less than self-evident. But a diluted concept of tax avoidance infiltrates into this kind of TAAR, in order to reach the intuitively right result.

If caught, what is the effect of the disregard? One disregards the sale. But that only applies "In determining whether or to what extent property situated outside the UK is excluded property". Does one say the trust property (the proceeds of sale) is then treated as chargeable property? That is not consistent with disregarding the sale, as if one disregards the sale the trust does not hold the proceeds of sale. Does one say that the trust is treated as holding shares which it does not hold? But as it does not hold shares, it is not necessary to "determine whether or to what extent the shares (property situated outside the UK) are excluded property".

Suppose:

(1) A person has borrowed from a family company or trust to acquire UK residential property
(2) Having regard to the IHT consequences, the person repaid the loan and replaced it by a loan from a 3rd party open company.

The same approach should apply.

What about a gift to a spouse or to charity, made with the purpose of qualifying for IHT spouse or charity relief? That is not affected, as the TAAR only applies "in determining whether or to what extent property situated outside the UK is excluded property".

Sch A1 Q&As provides:

> **Question 27: Tax avoidance arrangements (TAAR)**
> ... It is assumed this would not catch "ordinary" arrangements such as an individual choosing to borrow from a bank to purchase UK property rather than using their own cash resources.
> *Suggested answer*: Confirmed

It is correct that this arrangement is not within the scope of the TAAR. But the reason is not that it is an "ordinary" arrangement (whatever that may mean); but because there is no excluded property to which the disregard might apply.

HMRC say:

> ...without more we would say that in your example the liability is deductible depending upon IHTA s162(5) and the lender has made a relevant loan

82.18 DTA override

Sch A1 property is chargeable (de-excluded) property. However the property is normally movable rather than immovable property, and it can in principle qualify for IHT DTA relief.

Para 7(1) sch A1 IHTA provides a treaty override:

> [A] Nothing in any double taxation relief arrangements[82] made with the government of a territory outside the UK is to be read as preventing a person from being liable for any amount of inheritance tax by virtue of paragraph 1 [Sch A1 property] or 5 [residence-tail] in relation to any chargeable transfer
>
> [B] if under the law of that territory—
>
> (a) no tax of a character similar to inheritance tax is charged on that chargeable transfer, or
>
> (b) a tax of a character similar to inheritance tax is charged in relation to that chargeable transfer at an effective rate[83] of 0% (otherwise than by virtue of a relief or exemption).

I refer to this as **"treaty-override"**. It is a breach of the IHT treaties. But parliament is supreme and can breach treaties. But the section should be narrowly construed, to minimise the breach.

The provision distinguishes between cases where:

(a) No tax is charged

(b) Tax is charged but at a rate of 0%.

I would have thought that if tax is charged at 0% then no tax is charged. But it does not matter.

[82] Para (2) provides the standard IHT definition: "In this paragraph "double taxation relief arrangements" means arrangements having effect under section 158(1)".

[83] Para 7 (2) sch A1 IHTA provides a commonsense definition: "In this paragraph "effective rate" means the rate found by expressing the tax chargeable as a percentage of the amount by reference to which it is charged."

82.18.1 *>0% rate or relief*

Sch A1 Q&As provides:

> **Question 30: Zero rate and DTT**
> Where a DTT is applicable but the rate of tax is nil because of say spouse exemption (as with the USA on transfers between US citizens) we assume that para 7 is not intended to disapply relief. IHT is not as such charged at all in these circumstances rather than at an effective rate of zero. The words in para 7(1)(b) could be taken to mean that unless IHT is actually charged but at zero percent DTT does not apply where a chargeable transfer is (say) spouse exempt. In many cases there will just be an exemption and no IHT.
> *Suggested answer*: We agree that para 7 does not disapply relief in these circumstances.

HMRC agree. No other answer is possible.

If property falls within a foreign equivalent of the nil-rate band, the effective rate will be nil, but that does not matter if the band is a relief or exemption. IHT Manual provides:

> **IHTM04315 Double Taxation Arrangements** [Sep 2018]
> ***...Example 2*** (Nadine)
> N is a farmer and is domiciled in Iowa. She is not a UK national. Her £1m house in the Scottish highlands is held via an offshore company. She dies in the USA.
> The USA has taxing rights but the value of her estate is below the threshold and there is no tax paid in the USA. The UK charges IHT on the full £1m value attributable to the UK property.
> However, if her estate were charged to US Federal Estate Tax then the UK's charge to IHT is denied by the UK/US Convention. This would also be the case where there was no US tax payable because of a specific relief, such as the special land use valuation for farm assets

HMRC assume that the nil-rate threshold is not a relief or exemption, but is that right?

Sometimes planning may be possible to arrange that a foreign inheritance tax is paid at a rate which is above nil, but less than the IHT rate.

82.18.2 *Scope of treaty override*

Suppose there is UK situate sch A1 property. Some DTAs provide relief for these assets even though UK situate. In such a case DT relief continues to apply. The treaty override does not apply, because there is no liability "by virtue of paragraph 1 or 5".

Suppose a deemed domiciled individual holds sch A1 property. The treaty override does not apply as the shares are not excluded property and so there is no liability "by virtue of paragraph 1 or 5". Bizarrely, the treaty override does apply before the individual became deemed domiciled, since the non-UK situs shares would be excluded property at that time, but the treaty override ceases to apply on the deemed domicile start date.

Sch A1 Q&As agrees:

> **Question 29: Double tax treaty override and deemed domiciliary**
> The double tax treaty override in para 7 only applies to the extent a person is liable to IHT by virtue of para 1 or para 5. We assume ... that in relation to a person who is already deemed domiciled here and whose interests in foreign companies are not excluded property irrespective of schedule A1, that para 7 has no relevance. The excluded property rules are not disapplied by virtue of paras 1 or 5 but simply do not apply in the first place.
>
> *Example 14*
> Two brothers Jeremy and John are both foreign domiciled. John is deemed domiciled for UK tax purposes. Both are domiciled in India under common law. Both hold UK residential properties through offshore companies. They are killed in an accident and their non-UK estates are dealt with under Indian Wills. In these circumstances:
>
> - on the death of John (who is deemed domiciled) treaty relief is available to exempt the company shares from IHT because the treaty override in para 7 is not effective for a deemed domiciliary as his interests in foreign companies are not excluded property so Sch A1 is not applicable;
> - in the case of Jeremy (who is not deemed domiciled) nothing in the treaty prevents Sch A1 from applying to his interests in the offshore companies since for UK inheritance tax purposes the shares are otherwise excluded property.
>
> Please confirm that HMRC agrees with the above analysis.
> *Suggested answer*: Confirmed.

That is the only possible answer. HMRC agree.

82.19 "Residential property interest"

The IHT residential-property code is aimed at residential property. We therefore need a definition of the residential property to which it applies.

Para 8 sch A1 IHTA provides:

> (1) In this Schedule "UK residential property interest" means an interest in UK land[84]—
>
> (a) where the land consists of a dwelling,[85]
>
> (b) where and to the extent that the land includes a dwelling, or
>
> (c) where the interest subsists under a contract for an off-plan purchase.[86]
>
> (2) For the purposes of sub-paragraph (1)(b), the extent to which land includes a dwelling is to be determined on a just and reasonable basis.

IHT adopts CGT definitions of "interest in UK land" and "dwelling".

What matters is the state of the land and other facts as at the time of the IHT charge.

82.19.1 *Easement/restrictive covenant*

Para 8(3) sch A1 IHTA provides:

> In this paragraph... "the land", in relation to an interest in UK land which is an interest subsisting for the benefit of land, is a reference to the land for the benefit of which the interest subsists".

This refers to easements (such as a right of way) or covenants (eg a promise not to build on land): these are interests in land which subsist for the benefit of other land.

Expanded as para 8(3) requires, para 8(1) sch A1 IHTA provides, in relation to easements etc, "UK residential property interest" includes an interest in UK land:

> (a) where the land for the benefit of which the interest subsists consists of a dwelling,
>
> (b) where and to the extent that the land for the benefit of which the

[84] Para 8(3) sch A1 IHTA provides:
"In this paragraph "interest in UK land" has the same meaning as it has for the purposes of section 1A(3)(b) of the 1992 Act (see section 1C of that Act)".
See App 2.21 (Interest in land/chargeable interest).

[85] Para 8(3) sch A1 IHTA provides:
"In this paragraph ... "dwelling" has the same meaning as it has for the purposes of Schedule 1B to the 1992 Act".
See App 2.22 (Dwelling/residential property).

[86] Para 8(3) sch A1 IHTA provides:
"In this paragraph ... "contract for an off-plan purchase" means a contract for the acquisition of land consisting of, or including, a building, or part of a building, that is to be constructed or adapted for use as a dwelling."

interest subsists includes a dwelling, or

(c) where the interest subsists under a contract for an off-plan purchase.

82.19.2 *Contract to buy/sell asset*

In English law, buyer and seller both hold interests in land, between contract and completion.[87] Both interests are therefore within the scope of the IHT residential-property code. The same applies to a sale of shares or of a relevant loan.

Assuming a sale at market value, and assuming values do not change during the life of the contract, the value of the buyer's interest is equal to the deposit paid; and the value of the seller's interest is equal to the market value less the value of the deposit received.

HMRC agree. The answer to sch A1 Q&As Question 1 provides:

> HMRC: We agree that the value of the purchaser's right would be subject to the obligation to pay the consideration.

A loan to an individual/trust buyer, which funds the payment of the deposit, is a relevant loan.

A loan to an individual/trust seller, which was used to fund the purchase of the property, remains a relevant loan between contract and completion; though if a deposit is received, it is considered that part disposal relief applies, so the loan ceases to be a relevant loan to that extent.[88]

It appears that HMRC agree. The answer to sch A1 Q&As Question 2 provides:

> There must be a loan and that would occur when it is drawn down and that loan becomes a relevant loan when the interest in UK land is acquired.

If that is right, the analysis in sch A1 Q&As Questions 1 and 2 (not set out here) may be slightly imprecise, but its conclusions are broadly correct.

82.20 Residence co: Share value

What is taxed, and valued, is the sch A1 property, not the land.

The 2016 consultation paper provides an example:

[87] Further thought would be required for land in Scotland/Northern Ireland. See too 102.31 (Land subject to contract of sale).

[88] See 82.8.12 (Disposal of residence).

> ... a non-dom is the sole shareholder of an overseas company whose sole assets consist of a UK residential property. The company has no liabilities.
> At the individual's death, their estate will consist of the overseas shares which have an open market value of £950,000.
> At the same time, the UK property has an open market value of £1 million.

The HMRC analysis is as follows:

> In such a situation, the value of the estate is £950,000, and this is derived wholly from the UK residential property. This would mean that IHT would be charged on the entire estate which has an open market value of £950,000. This is broadly the treatment which would apply in the case of an individual who is domiciled in the UK.

Valuation of a company holding a residence is not straightforward. From a purchaser's viewpoint:

(1) There should be a discount on net asset value to reflect liabilities for:
  (a) CT on the gain (contingent on a disposal)
  (b) ATED
  (c) Administration costs
  (d) The risk of undisclosed corporate liabilities/due diligence cost
  (e) The risk of future tax changes

(2) There should be a premium to reflect SDLT advantages achievable by a sale of the shares rather than the company

A purchaser who will be within ATED (in short, intending to use the property as a home) would prefer to purchase the property, not the company; and may want a discount to reflect the disadvantages of holding through a company. But the purchaser may still save SDLT by purchasing the company and then promptly winding it up.

On the other hand, a purchaser for long term investment, who can qualify for ATED rental relief,[89] and who is prepared to undertake corporate due diligence, is likely to prefer to purchase the company. But that purchaser will bear in mind the difficulties and costs when selling the shares in the future.

Perhaps HMRC will adopt a pragmatic practice of allowing a 5% discount from net asset value, which accords with the approach of the

[89] See 98.18 (ATED rental relief).

example.[90] But if supported by valuation evidence, taxpayers may argue for a greater discount. Valuation is a question of fact, on which a share valuer would be needed to advise (though the valuer would need to be aware of the tax background, ie the current advantages and disadvantages of holding a property through a company, and would probably need to be briefed on that). While comparables of earlier company sales may be relevant, the tax background has constantly changed,[91] and earlier data would need to be reviewed in the light of that.

82.21 Home of non-dom: Planning

The starting point is that an individual may own the property directly. This is the benchmark against which other proposals may be assessed.

The property is in the individual's estate and in principle within the scope of IHT on his death. An individual who is married may provide by will that the property should pass to the individual's surviving spouse, or to a trust under which the spouse has an interest in possession. That in principle postpones IHT until the occasion of the death of the survivor of the individual and spouse.[92]

The risk of IHT may quite cheaply be covered by insurance. Watch that the insurance policy is not subject to IHT on the death of the individual:

(1) Arrange that the policy is not UK situate[93] (so the policy is excluded property); or

(2) transfer the policy to a trust (under which the individual is excluded) but possible IHT charges on the trust make this unattractive for a UK situate policy.

The amount to be insured will need to be reviewed from time to time in line with house inflation and possible changes in the rate of IHT.

It would be possible to take steps to avoid IHT even at short notice, if the death of a non-domiciled owner became imminent, by a sale.[94]

[90] Though the example was looking at the position in 2016, before the introduction of CGT on shares in land-rich companies; that change should increase the discount.

[91] In particular, company sales at an earlier time would have had additional advantages over property sales, relating to CGT and IHT. So whatever discounts may have existed in the past ought to increase. For this purpose what matters is not the date of implementation of the changes, but the date of the announcement of the changes.

[92] See 78.19 (GWR on death: Spouse exemption).

[93] See 102.25 (Insurance policy).

[94] The sale must be completed: an uncompleted contract of sale is not sufficient.

So in practice tax exposure should be limited to:

(1) SDLT, not insubstantial, of course, and CGT (if any); and
(2) the risk of IHT in the event of the sudden death of the individual (or sudden joint deaths of individual and spouse).

There will be no CGT on the sale of property if main private residence relief applies. If the individual has another residence inside or outside the UK, it may be appropriate to make a MPR election.

There is in principle a taxable remittance, if the purchase price is paid out of foreign income or chargeable gains within the scope of the remittance basis.

Loans from open companies may be used to reduce the IHT exposure.[95] That needs to be considered when the property is purchased, not later.

Similar points apply to chattels in the home except there is no CGT exemption (apart from the exemption for chattels under £6,000),[96] no SDLT, and the IHT residential-property code does not apply.

82.21.1 *Ownership: Non-tax aspects*

The property may be held by a nominee for the individual. This may give an element of confidentiality, as it avoids the name of the beneficial owner being published on the land registry, though the bare trust would need to be registered under TRS. In addition an English grant of probate would still be needed in the event of the death of the individual.

Trust or company ownership avoids the need for an English grant of probate after the death of the individual.

Personal ownership may be necessary, or at least desirable, in order to secure that the owner of a long lease acquires the right to enfranchisement.

Further consideration will be needed for property in Scotland and Northern Ireland.

82.21.2 *Home in estate IIP trust*

This option only arises if there is a suitable estate IIP trust in existence, which will not now be so common.

The IHT position is broadly the same as absolute ownership by the life tenant.

This course is more attractive for estate IIP trusts where:

[95] See 80.44 (GAAR: Debt against UK residence).

[96] See 65.10 (Chattels).

(1) the life tenant is the settlor;
(2) the settlor is dead;
(3) the settlor is, or can be, excluded from the trust (or from a sub-fund which will hold the UK home); or
(4) the settlement was made before 18 March 1986.

Otherwise there is potentially a charge on the death of the settlor under the GWR rules.[97]

In the case of a non-resident trust, the occupation of the property is a capital payment received in the UK, giving a possible s.87 charge if chargeable gains accrue to the trust. Chargeable gains may accrue on a disposal of the house, if the private residence exemption is not fully available, for instance if:
(1) the grounds exceed the "permitted area"
(2) there is another private residence which qualifies for the relief
(3) in relation to chattels which do not qualify for exemption

82.21.3 *Home in discretionary trust*

In principle a discretionary trust or non-estate IIP trust could hold the UK home between ten year anniversaries. This might be a convenient short or medium term way to hold a family home. This course is more attractive where:
(1) the settlor is dead;
(2) the settlor is, or can be, excluded from the trust (or from a sub-fund which will hold the UK home); or
(3) the settlement was made before 18 March 1986.

Otherwise there is a risk of a charge on the death of the settlor, under the GWR rules.[98]

82.21.4 *Home in non-resident company*

Holding the UK home of a foreign domiciliary in a non-resident company, formerly the standard course, is not usually attractive.

For inheritance tax, the shares in the company are chargeable (de-excluded) property, and the proceeds of sale of the shares are also caught for two years under the residence-tail rule.

[97] See 78.9 (Gift of excluded property).
[98] See 78.9 (Gift of excluded property).

The company will be subject to CT if it sells the property. A non-resident shareholder will also in principle be subject to CGT.

Purchase by a company has the advantages of SDLT saving on a sale of the company. However, the general rule will be not to purchase by a company because of ATED and ATED-SDLT. A corporate purchase may however still be attractive where ATED rental relief will apply (property let to an unconnected person), for SDLT and for IT reasons. But the company will need to register under the Register of Overseas Entities[99]

A corporate purchase of a property worth under £500k is outside ATED, but it does not seem worthwhile, bearing in mind:

(1) The possibility that the property will sooner or later become worth more than £500k and fall within ATED; or that the ATED bands may be lowered again

(2) Administrative costs

82.22 IHT residence code: Critique

82.22.1 *Restriction to residential property & stability*

Why is the IHT residential-property code limited to residential property? This is speculation as the policy reasons have never been discussed publically, and may never have been considered, even privately; but various possible justifications come to mind:

(1) Perhaps the rules reflect an unexamined assumption that tax planning involving residential property is more objectionable than other tax planning.

(2) Perhaps the aim is an economic one: not to affect the commercial property market, while accepting, or perhaps welcoming, a dampening effect on residential property. It seems to me questionable whether IHT has a significant effect on the residential property market, though I am not aware of any serious studies on the topic. To disentangle IHT from other tax factors, such as SDLT and broader economic considerations of supply and demand, would be difficult and perhaps impossible. But that does not mean that IHT has no effect. There may be an effect at the top end of the market if not elsewhere.

(3) Perhaps the aim is a social or political one, to discourage foreign investment in residential property, or to tax it more heavily, or at least

[99] See 130.1 (CRS & other information sources).

to ensure that it is not taxed any less heavily.

There may of course be more than one of these reasons in play.

This may be seen in the context of other rules which tax non-residents more heavily on UK residential property.[100]

Is the law stable? The 2015 residential-property paper provides:

> 9. The government does not intend to change the IHT position for non doms or excluded property trusts in relation to UK assets other than residential property, or for non-UK assets.[101]

Experience shows that statements like this cannot be relied on. So (even without a change of government) it is possible that the rules may be extended to non-residential property; this happened with the former NRCGT, a CGT charge on residential property introduced in 2015 and extended to non-residential property in 2019.[102]

The drafting of the provisions is in some respects inadequate. Resources permitting, amendment on points of detail seems likely if and when that is appreciated.

But these changes may not happen soon, or at all.

82.22.2 *Replace residence-code with ATED*

Will the IHT residential-property code produce a significant yield, proportionate to its complexity, which is enormous? That seems unlikely. But simple repeal would face the objection to rules under which UK property was chargeable but the charge could quite simply be avoided by use of a company (The fact that this was the law from the inception of CTT/IHT in 1975 until 2017 is not a full answer).

There is a relatively simple solution. This is to abolish the IHT residential-property code, and replace it with an ATED charge, ie ATED rates should reflect the IHT lost by holding UK residential property in companies. Adopting the approach of the IHT relevant property regime,

[100] See 59.3 (Non-residents PRR disallowance), and the SDLT non-UK resident surcharge to be introduced in the FA 2021. This is an international trend in taxation: see Ti, "Politics and Policy: Chinese money and its impact on the Regulation of Residential Property in the West" [2019] The Conveyancer 371.

[101] The paper continues: "Nor will these reforms affect people who are domiciled in the UK." That is incorrect, as the reforms affect settlements made by foreign domiciled settlors who have later become UK domiciled.

[102] See 57.1 (UK property held by non-residents: Introduction).

that would equate to roughly 0.6% p/a for more valuable property (say above £1m).

This could be criticised as:

(1) It is a rough and ready solution, in that the same rate is payable regardless of the IHT exposure of a direct owner; and
(2) It is harsh by some comparison to the IHT cost of direct ownership.

But the same is true of the IHT relevant property trust regime generally; and individuals may chose not to hold UK residential property via companies if they wish.

The reader may think it a pity that the manner in which UK tax reform is conducted precluded serious policy discussion of this kind when the rules were introduced.

CHAPTER EIGHTY THREE

PRE-OWNED ASSETS

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83.1 Pre-owned assets: Introduction

This chapter considers the provisions in schedule 15 FA 2004 ("**POA provisions**"). A full discussion of this topic needs a book to itself. This chapter focuses on the matters closest to the themes of this book, but it is necessary to review the general rules to understand these matters in their context.

The supplementary regulations (whose title is so long it cannot sensibly be used)[1] are referred to as the "**POA Regulations 2005**".

"**CIOT Statement**" gives HMRC answers to a number of questions raised by tax practitioner bodies.[2]

The label "pre-owned assets" is inaccurate since the charge may apply to property not previously owned by the taxpayer; but no short label could do justice to the complexities.

The provisions impose three charges to income tax which I call:

(1) "**POA land charge**"
(2) "**POA chattel charge**"
(3) "**POA intangible property charge**"

[1] The Charge to Income Tax by Reference to Enjoyment of Property Previously Owned Regulations 2005.

[2] *https://www.kessler.co.uk/wp-content/uploads/2018/12/CIOT-Statement-Matters-on-which-HMRC-view-is-sought-in-relation-to-pre-owned-assets-income.pdf* The current version of the statement is dated 31 August 2006; earlier versions were dated October 2005 and March 2006.

Land, chattel and intangible property are given commonsense definitions.[3]

83.2 Purpose of POA rules

The POA rules were designed to counter three distinct IHT avoidance schemes:

(1) Eversden schemes
(2) Ingram schemes
(3) Home loan schemes

In order to understand the provisions it is necessary to understand the schemes at which they were addressed.

83.2.1 *Eversden schemes*

There was only one scheme, but the analysis now depends on whether the asset involved was land or not.

In relation to land, the IHT Manual explains:

> **IHTM44101 land - settlement on IIP trusts** [Jun 2016]
> This scheme, known as an 'Eversden' scheme, involved a spouse putting their marital home into a trust under which the other spouse had a life interest. ... The transaction is exempt from Inheritance Tax and excluded from the reservation of benefit provisions.
> The life interest(s) are then terminated in most of the fund so that each spouse is treated as making a transfer at that later time. The termination of the life interest meant that the spouse(s) make a PET; but it was not a gift so that it was not caught by the reservation of benefit provisions. The spouses continued to occupy the property through their life interests in the parts of the property retained by the trustees.
> HMRC challenged the scheme and lost in the case of *Eversden v IRC.*[4]
> Consequently, legislation was introduced with effect from 20 June 2003 to reverse the decision (IHTM14318). ...

The HMRC analysis is as follows:

> - where the scheme was effected on or after 20 June 2003:
>
> the property will be subject to a reservation of benefit for Inheritance Tax purposes by reason of FA86/S102(5A).[5]
> As a result the [POA GWR] exemption under FA04/Sch15/Para11(3)

[3] Para 1 sch 15 FA 2004.

[4] *IRC v Eversden (Greenstock's Executors)* 75 TC 340 [2003] STC 822.

[5] See 78.10.2 (Spouse exemption restricted).

> will apply to the settlor.[6]
>
> There may be a separate reservation of benefit when the spouse's interest in possession terminates and which is treated as a gift under FA86/S102ZA.[7]

This is all somewhat theoretical since the scheme would not be done after 20 June 2003.

> - where the scheme was effected before 20 June 2003, the arrangement succeeds in avoiding the reservation of benefit provisions. However, provided the spouse's life interest continues until their death, there will be no POA charge because the transaction is an excluded transaction under FA04/Sch15/Para(10)(1)[8]
> - if, however, the spouse's life interest comes to an end during their lifetime, the transaction will not longer be an excluded transaction by virtue of FA04/Sch15/Para10(3) so the POA charge will arise from that point on the settlor, assuming the settlor occupies of the property.
>
> If the spouse's qualifying interest in possession ends after 18 March 2006, she may also be subject to a separate inheritance tax charge on her death under FA86/S102ZA if she still benefits from the property. But as she did not, herself, dispose of this interest in the property, she is not subject to the POA charge.

The scheme could also be used for property other than a dwelling house:

> **IHTM44110 intangibles - settlement on interest in possession trusts**
> [Jun 2016]
> Intangible property may also be settled using an Eversden scheme, where the chargeable person settles cash on interest in possession trusts for their spouse or civil partner, which the trustees then invest in, say, a bond. If the terms of the settlement fall within the definition in FA04/Sch15/Para8 similar results to the scheme involving land apply. For example, if the spouse or civil partner's interest in possession ends during their lifetime and the property is now held on discretionary trusts of which the settlor is one of the potential beneficiaries, the POA charge will apply where the settlement was effected before 20 June 2003.
>
> However, the excluded transaction provisions have no application with regard to intangible property so FA04/Sch15/Para10(1)(c), which may have a bearing in respect of schemes involving land, has no relevance.

[6] See 83.19 (GWR exemptions).

[7] See 78.18.1 (Termination of IIP: GWR).

[8] See 83.10.4 (Trust where spouse has IIP).

> If the settlement was effected on or after 20 June 2003 the property is subject to a reservation of benefit by virtue of FA86/S102(5A) and the POA charge will not apply.

83.2.2 *Ingram schemes*

There were two varieties of these schemes; I describe both as "**Ingram schemes**". The IHT Manual explains:

> **IHTM44100 land - lease carve-out scheme** [Jun 2016]
> This scheme, known as an 'Ingram' scheme, involved a nominee structure where an individual gives their home to nominees who then grant the individual a lease to occupy the house. The lease is usually for 21 years or less at a peppercorn rent. The nominee then gives the property, subject to the lease, away to (usually) the individual's children. The individual continues to occupy the property under the lease.

The HMRC analysis is as follows:

> There is no loss to the transferor's estate when the property is given to the nominees and the individual does not reserve a benefit in the property that was given away - the freehold reversion - although they continue to occupy the property.
> HMRC challenged the scheme and lost in the case of *Ingram v IRC* [1999] STC 37. Consequently, legislation was introduced with effect from 8 March 1999 to reverse the decision (IHTM14360). The impact of this legislation on the POA charge is as follows
>
> - where the scheme was effected on or after 9 March 1999, the property will be subject to a reservation of benefit for Inheritance Tax purposes by reason of FA86/S102A. As a result the exemption under FA04/Sch15/Para11(3) will apply,
> - where the scheme was effected before 9 March 1999, the arrangement succeeds in avoiding the reservation of benefit provisions and will be subject to the POA charge under FA04/Sch15/Para3(2).
>
> ...
>
> **IHTM44102 land - reversionary leases** [Jan 2020]
> This scheme is an arrangement where a donor grants a long lease of their property for say 999 years to the proposed donee, and the lease does not take effect until some future date.
> *Example (Victor)*
> V, who has owned his house since 1990, grants a 999-year lease to his daughter ... in 1998 but it is not to take effect until 2018. V continues to occupy the property.

The HMRC analysis is as follows:

> The effect of this transaction is that
>
> - Victor has made a PET (IHTM04057) of the lease. The loss to his estate (IHTM04054) will be the difference between the unencumbered freehold and the freehold subject to the lease,
> - Victor continues to occupy the property as the freeholder, and
> - the value of the freehold interest remaining in Victor's estate will decline as the time for the lease to commence approaches.
>
> Where the scheme is subject to the POA charge, the value subject to the charge will be calculated in accordance with FA04/Sch15/Para4(2) (IHTM44010). You will need to obtain three values to correctly assess the POA charge
>
> - the rental value (R), say, £25,000,
> - the value at the valuation date (IHTM44011) of the interest that was disposed of (DV); in this case, the value of the lease (that is to take effect in 20 years), say, £100,000, and
> - the value of the property at the valuation date (V), say, £800,000.
>
> Following the formula at IHTM44010, the amount subject to the POA charge is
>
> 25,000 × 100,000 ÷ 800,000 = £3,125 - which would be covered by the de minimis rule (IHTM44056).
>
> But note that as the date for the lease to start gets nearer, so the value of the interest that was disposed of (DV) will increase. The initial value will apply for the first five years of the POA charge, but on revaluation (IHTM44011) the portion of the rental value that is subject to the POA charge is likely to be higher.
>
> Reservation of Benefit Provisions
>
> The gift of the reversionary lease will be property subject to a reservation of benefit under FA86/S102 where there are covenants within the terms of the lease that are beneficial to the donor, such as covenants by the lessee to, say, maintain the property and keep it in repair. This was confirmed at the Court of Appeal in *Viscount Hood (executor of Lady Hood v HMRC* [2018] EWCA Civ 2405.
>
> If there are no covenants within the terms of the lease then the reservation of benefit provisions are still capable of applying where the scheme was established on or after 9 March 1999. FA86/S102A(5) is capable of applying where the freehold interest was acquired less than 7 years before the gift (this is the significance of the date Victor acquired his house in the example above). If the freehold was acquired within 7 years the continued occupation of the property by the donor would be a significant right in relation to the land in view of FA86/S102A(5) dependent upon how the remaining provisions of the

section apply – for example, if the donor pays full consideration for the right to occupy or enjoy the land, that would not a significant right in view of FA86/S102(3).

An exemption from the POA charge will be available under FA04/Sch15/Para 11 where the gifted lease is subject to a reservation of benefit. Where the gifted reversionary lease is not property subject to a reservation of benefit, the POA charge would then arise instead.

IHTM44108 chattels - lease carve-out scheme [Jun 2016]

Although the use of a lease to carve out an interest in property is more commonly used with land (IHTM44100) it can also apply to chattels. In effect, the owner of the chattels carves out a lease for themselves and then makes a gift of the chattels. Although FA86/S102A is aimed at ensuring such a transaction with land is now subject to the reservation of benefit provisions, that section only applies to interests in land and so does not apply to similar transactions involving chattels.

The transaction is a disposal by the chargeable person and they will be liable to the POA charge under FA04/Sch15/Para6(2)....

83.2.3 *Home loan schemes*

The IHT Manual explains:

IHTM44103 land - home loan or double trust scheme [Sep 2018]

This is a scheme whereby the individual seeks to put the value of their home outside their estate and avoid the reservation of benefit provisions, whilst still continuing to occupy the property. The steps in a typical scheme were:

- the individual creates an interest in possession trust under which they are the life tenant; the trustees have the power to allow the life tenant to use the trust property,
- the individual then sells their house to the trust, usually at the open market value; but because the trustees have no funds, they agree to leave the purchase price outstanding by way of loan,
- the individual creates a second interest in possession trust under which (usually) their children are the life tenants and excludes the taxpayer from any benefit,
- the individual transfers the benefit of the loan to the trustees of the second trust.

The HMRC analysis is as follows:

The Inheritance Tax consequences are intended to be as follows

- there is no loss to the estate on the sale of the property to the first trust as the individual enjoys a life interest in the trust property. On their

> death, the trust fund forms part of their estate, but the value of the property is largely or wholly covered by the debt now owed to the trustees,
>
> - the transfer of the debt to the second trust is a PET (since the taxpayer is wholly excluded from benefiting under this trust), so that on survival for 7 years, the value of their home is not charged to Inheritance Tax.
>
> [The Manual comments on SDLT aspects and continues] The requirements of FA04/Sch15/Para3 are met in that the individual is occupying land which they owned and has now disposed of, so the POA charge applies. However, the property still forms part of their estate as the life tenant of an interest in possession trust, and so the exemption in FA04/Sch15/Para11(1) applies. To bring this scheme within the POA charge, the concept of excluded liabilities is contained in FA04/Sch15/Para11(6) which states that only the value of the property in excess of an excluded liability is treated as forming part of the individual's estate and therefore qualifies for the exemption under FA04/Sch15/Para11(1).
>
> ...
>
> But, this assumes that the scheme succeeds in avoiding the reservation of benefit provisions. HMRC does not accept that the scheme succeeds and is litigating the point. A brief analysis of HMRC's view and the consequences for the POA charge are at IHTM44104 onwards.

The GWR aspect of home loan schemes is an interesting story, but is not discussed here. The position here will need to be reviewed *Shelford v HMRC* [2020] UKFTT 53 (TC) is final.

83.2.4 *Width of POA provisions*

The POA provisions are widely drafted. This may be because they are aimed at three distinct schemes with nothing in common. Alternatively, with hindsight, one might see the provisions as adopting a style of anti-avoidance provisions under which:

(1) The gateway conditions for the operation of the rules are extremely wide and it is only a slight exaggeration to say that they potentially catch (more or less) everything.

(2) There are a large number of exemptions to the provisions some of which are also very wide.[9]

[9] A good example of this style of drafting is the disguised remuneration rules (not discussed in this book, but I hope to do so in a future edition).

So the POA provisions apply in situations which have nothing to do with the three schemes at which they were targeted. They need consideration whenever one person provides funds to another to purchase a home, which includes any case where a home is held by a trust or a company. This will often be the case for the home of foreign domiciliaries; my guess is that any effect on foreign domiciliaries is entirely accidental; no-one had worked it out as the provisions were frantically amended and re-amended in the short time available as the FA 2004 passed through parliament.

83.3 POA land charge

Para 3(1) sch 15 FA 2004 provides:

> This paragraph applies where—
> (a) an individual ("the chargeable person") occupies any land ("the relevant land"), whether alone or together with other persons, and
> (b) the disposal condition or the contribution condition is met as respects the land.

In the discussion below the "chargeable person" is called "T" and the land T occupies is called "land occupied by T" (rather than "the relevant land").

83.3.1 *"Occupation"*

"Occupation" is a technical legal concept extensively discussed in rating cases. The IHT Manual provides:

> **IHTM44003 property in charge: land** [Aug 2016]
> ...
> The meaning of the word 'occupies' should be taken quite widely. It goes wider than the chargeable person being physically present at the property concerned. Case law suggests that the word 'occupy' requires some element of control. So a visitor may not be in occupation (even someone who stays for an extended period of time due to illness) but someone who has a key and can freely enter and leave premises as they please is more likely to be in occupation; even if they are absent for significant periods. It does not necessarily mean the place you reside which implies a greater level of permanence so a lower threshold is required to satisfy the occupation condition.
> A person may be in occupation if they are storing possessions in a property - but only if they also had the right of access to the property to use it as they wished - or if they were the only person with the means of access and used the property from time to time. Storing possessions on its own is not occupation, but may be evidence of occupation. The

> chargeable person would not be regarded as occupying a property from which they were receiving rental payments from the person(s) actually in occupation.
>
> If the chargeable person's use of the property is only very limited in its nature or duration, they may not be in 'occupation' for the purposes of the POA charge. Each case should be decided on the facts and circumstances relating to it. The guidance at IHTM14333 contains some examples where limited use or occupation of land does not gives rise to a reservation of benefit and are unlikely, on their own, to be 'occupation' for the POA charge.
>
> Where the chargeable person was occupying part of their former property and was entitled to, and did, use the rest of the property from time to time, you should regard them as being in occupation of the whole of the property for the POA charge. On the other hand, if the chargeable person occupies a self-contained part of their former property and has no access to the remainder which is occupied by others, you should regard the relevant land as limited to the self-contained part. You should consider occasional visits to the remainder of the property in the same manner as social visits mentioned in example 2 at IHTM14333.[10]

83.4 Disposal conditions

Para 3(2) sch 15 FA 2004 provides:

> The disposal condition is that—
>
> (a) at any time after 17 March 1986 the chargeable person owned an interest—
>
> (i) in the relevant land, or
>
> (ii) in other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of an interest in the relevant land, and
>
> (b) the chargeable person has disposed[11] of all, or part of, his interest in the relevant land or the other property, otherwise than by an excluded transaction.

This is best regarded as two conditions depending on whether (a) (i) or (ii) applies. I call them "**disposal conditions (i) and (ii)**". Only one of them needs to be satisfied for the "disposal condition" to be met.

83.4.1 *Disposal condition (i)*

The essence of disposal condition (i) is that:

[10] See 78.6.4 ("Virtually" to the entire exclusion).

[11] "Disposal" is defined in para 3(4) sch 15 FA 2004.

> (a) T owned an interest in the land occupied by him.... and
> (b) T has disposed of all, or part of, his interest in the land ...

What if T enters into a contract to purchase land and then assigns that contract to a trust or company? The contract is an interest in land. However, on completion the contract ceases to exist. That will normally be before the valuation date. Since the asset cannot be valued on the valuation date, it is tentatively suggested that disposal condition (i) does not apply in this situation.

The disposal condition is satisfied by a disposal of land for full consideration. However, in such a case the exclusion for arm's length transactions may apply.

83.4.2 *Disposal condition (ii)*

The essence of disposal condition (ii) is that:

> (a) T owned ... other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of an interest in the land occupied by T, and
> (b) T has disposed of all, or part of, his interest in the ... other property ...

Disposal condition (ii) is probably intended to deal with the situation where:

(1) T disposes of land to A.
(2) A sells the land and uses the proceeds to purchase other land occupied by T.

However, it may apply where:

(1) T disposes of any property (not land or cash) to A; and
(2) A disposes of that property and uses the proceeds to purchase land occupied by T.

This overlaps with the contribution conditions. The overlap matters because the excluded transaction defences to the contribution and disposal conditions are not the same.

The IHT Manual provides:

> **IHTM44004 the disposal condition - land** [Aug 2016]
> ...
> **Example** (Trevor and Paul)
> T gives The Paddocks to P. P then sells The Paddocks and buys Whiteacre with the proceeds. T then occupies Whiteacre. The disposal

> condition is met.
>
> So the disposal condition will apply to the chargeable person's occupation or use of the property even if that property was never actually owned by them. If they give away other property (it does not have to be land, but see the contribution condition IHTM44005) if the gift is of cash) to another person who then sells such property and uses the proceeds to buy the relevant land, the disposal condition is satisfied, unless it qualifies as an excluded transaction.
>
> A disposition that creates a new interest in land out of an existing interest is taken to be a disposal of part of the existing interest, FA04/Sch15/Para 3(4).
>
> The disposal condition will be met whether the sale or gift is of the whole or part of land and whether or not the sale is at less than the full market value. See IHTM44031 where the disposal is of the whole of the land for full consideration.
>
> FA04/Sch15/Para 3(2)(a)(ii) applies where the proceeds of sale are used to acquire land that is subsequently occupied by the chargeable person. So, in the example above, if P exchanged The Paddocks for Whiteacre, on the face of it the disposal condition is not met; but see IHTM44005

83.5 Contribution conditions

Para 3(3) sch 15 FA 2004 provides:

> The contribution condition is that at any time after 17 March 1986 the chargeable person has directly or indirectly provided, otherwise than by an excluded transaction, any of the consideration given by another person for the acquisition of—
>
> (a) an interest in the relevant land, or
>
> (b) an interest in any other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of an interest in the relevant land.

This is best regarded as two conditions, depending on whether (a) or (b) applies. I call them "**contribution conditions (a) and (b)**". Only one of them need be satisfied for the "contribution condition" to be met.

83.5.1 *Contribution condition (a)*

The essence of contribution condition (a) is that:

> T has directly or indirectly provided…any of the consideration given by another person for the acquisition of ... the land occupied by T …

This envisages that:

(1) "another person" (which may be a company or trust) acquires for consideration land occupied by T; and
(2) T has provided that consideration directly or indirectly.

83.5.2 *Contribution condition (b)*

The essence of contribution condition (b) is that:

> T has directly or indirectly provided … any of the consideration given by another person for the acquisition of … any other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of ... the land occupied by T.

This applies where:
(1) "another person" ("A") acquires "other property" for consideration.
(2) T has provided that consideration directly or indirectly.
(3) A disposes of the other property.
(4) The proceeds are (directly or indirectly) applied by "another person" (presumably either A or another person, "B") towards the acquisition of the land occupied by T.

The drafter may be considering a situation where:
(a) T transfers funds to A, who purchases a property; and
(b) A sells that property and uses the proceeds to buy another property occupied by T.

or

(a) T transfers funds to A (eg a trust);
(b) A transfers the funds to B (eg a company held by A);
(c) B uses the funds to purchase a property occupied by T.

In both those cases I would have said that T had indirectly provided consideration given for the land and contribution condition (a) was already satisfied. I cannot think of a situation which falls within condition (b) and which does not fall within condition (a). But it does not much matter.

83.5.3 *Provision of funds for acquisition*

What is the position if T provides funds, but not for the purpose of the acquisition of the land? Suppose:
(1) In 1987 T created a trust. At the time T had no plans to move to the UK.
(2) In 2005 the trustees make an interest-free loan to a company which purchases a property which T occupies.

The foreign domiciled individual has directly provided the property for the purposes of the trust. They are probably to be regarded as having indirectly provided the consideration given for the acquisition of the land under the principle that a trust appointment merely fills in blanks left by the settlor.[12] So contribution condition (a) is satisfied.

But if T gives funds to A, an individual, and A later uses those funds to buy a property, it is suggested that T has not provided the consideration, unless the two steps form a single arrangement.

The IHT Manual provides:

> **IHTM44005 the contribution condition - land** [Aug 2016]
> ...
> **Example** (Trevor and Paul)
> T gives P the funds to buy Blackacre.
> P then sells Blackacre and buys The Paddocks with the proceeds.
> T then occupies The Paddocks.

The HMRC analysis is as follows:

> The contribution condition is met.
> You do not need to show that when the contribution was made, the individual intended to occupy the land purchased by another; if the chargeable person occupies land that they have, as a matter of fact, indirectly contributed to the purchase of, the contribution condition is met.
> The contribution condition does not only apply to cash contributions. So in the example at IHTM44004, where P exchanges The Paddocks for Whiteacre, the gift of The Paddocks from T to P is a contribution to the acquisition of the property that T subsequently occupied and so the contribution condition is met.

83.5.4 *Width of contribution conditions*

The contributions conditions apply whenever one person gives funds to another for the purchase of a home. For instance, if H gives funds to W so H and W can purchase a home jointly; but if H and W are spouses, the POA spouse exemption may apply;[13] if H and W jointly occupy the property, the GWR exemption may apply.[14]

[12] See 87.5.7 (Trust appointment: Filling blanks).

[13] See 83.10.3 (Inter-spouse transfer).

[14] See 83.19 (GWR exemptions).

83.5.5 *Purpose of contribution conditions*

It is hard to see the purpose of the contribution conditions. *Ingram*, *Eversden* and home loan schemes would be caught by the disposal conditions. Perhaps it was meant to catch schemes set up on the occasion of purchase of a new property where the settlor would provide cash to a trust. But this was never done in the past; it would have been better to frame more targeted anti-avoidance provisions than this blunderbuss approach.

83.6 "Provide"

"Providing" is the fundamental concept in the contribution conditions and it is not an easy one. Some guidance can be found in cases on the meaning of "settlor" where the statutory language is similar.[15]

It is considered that "provide" implies an element of bounty. So if T lends money on arm's length terms to A, who uses the money lent to buy the property, T has not "provided" the consideration and the contribution condition is not satisfied.

What if T lends interest-free to A, who uses the money lent to buy the property? At first sight T has provided the consideration. But it might be argued that A provides the consideration (by A's promise to repay T) and that T provides nothing.[16] In practice HMRC now[17] accept this. The IHT

[15] Some guidance ought to be found from comparable wording in Stamp Duty and SDLT group relief: s.27 FA 1967; para 2(2) sch 7 FA 2003. Unfortunately the SD/SDLT position is even more obscure than the POA: SP 3/98; Tax Bulletin 70.

[16] One might say that T has provided the interest foregone on the loan, but (1) interest foregone does not exist, and it is difficult to see how one could provide something which does not exist; see 99.26 (Loans); (2) the interest foregone is not the consideration given for the acquisition of the land.

[17] This reverses the view taken in CIOT Statement:

> "6.2 The meaning of the 'provision' of 'consideration' in the context of the contribution condition needs to be clarified. On the basis of the case law the word provided suggests some element of bounty.
>
> On this basis our view is that if there is a transfer of Whiteacre by A (or another asset) to his son at full market value which is then sold by son and the sale proceeds used to purchase Blackacre for A to occupy this is a breach of the disposal but not the contribution condition because it lacks the necessary element of bounty.
>
> Similarly the provision of a loan on commercial terms by A to his son to enable son to purchase a house which A then occupies in our view does not fall within the contribution condition.

Manual provides:

> **IHTM44005 the contribution condition - land** [Aug 2016]
> ... However, the contribution condition is not met where the chargeable person resides in property purchased by another with money loaned by the chargeable person. This is because the outstanding debt will form part of the lender's estate for Inheritance Tax purposes, and the lender cannot be said to have provided a contribution to the purchase of that property when that money has to be repaid to them, even if the loan was interest free. It follows that the 'lender', in such an arrangement, is not subject to a POA charge.

What if:

(1) T lends interest-free to A,
(2) A purchases the property, and
(3) T later releases the loan (or makes a gift to A which A uses to repay

---

Question 32
Do HMRC agree with this analysis?
HMRC answer to question 32
In our view, it is arguable that the contribution condition does not depend on a degree of bounty for its application. If, on the contrary, a degree of bounty was necessary, might not the operation of the contribution condition provisions in paras 3(3) and 6(3) of Schedule 15 be circumvented by the relatively simple expedient of A, in your example, providing the wherewithal for the purchase of a house by his son by way of a loan, ostensibly on commercial terms, which is then left outstanding indefinitely?
Having said that, we have considered further the sort of case where a loan is made **and operated** on commercial terms eg a commercial rate of interest is specified and paid and there are provisions for repayment of the loan over the sort of period one would expect to find in a truly commercial loan. Having regard to paras 4(2)(c) or 7(2)(c) of Schedule 15, the chargeable amount would depend on the value of DV in R (or N)×DV/V: that's to say on 'such part of the value of the land/chattel as can reasonably be attributed to the consideration provided by the chargeable person'. In the case where the loan is on truly commercial terms and conducted in a truly commercial way, we would accept that the attributable amount is nil or de minimis.
In determining 'reasonable attribution' for the purposes of para 4(2)(c), it is the terms on which the loan is made and operated that are relevant, as indicated above. In that context, the period over which the loan is repaid as well as whether a commercial rate of interest is charged is relevant.
Thus, where an interest-free loan is repaid over a typical 'commercial' period, it would be reasonable to regard the interest foregone as attributable to the consideration provided by the chargeable person. In cases where the principal of the loan was left outstanding indefinitely, such principal could reasonably be regarded as attributable to the consideration provided."

the loan, which comes to the same thing)?

Alternatively, more simply, what if:
(1) A purchases the property
(2) T makes a gift to A, or reimburses A for the expense (without being obliged to do so).

If T has not provided the consideration at the time that A purchases the property, T cannot provide it later. However if the steps form part of a single arrangement, it can probably be said that A has provided the consideration indirectly, even if belatedly.

What if T subscribes for shares on arm's length terms? Probably T has provided funds to the company

83.6.1 *Arrangement with 3rd parties*

The position becomes more complex where more than two persons are involved.

Suppose:
(1) T provides funds to A, an individual
(2) A gives them to B, an individual
(3) B purchases the property.

It is suggested that T has not provided the consideration if the "clean break" test is satisfied.[18]

Suppose:
(1) T provides funds to a trust
(2) The trust lends them to a company owned by the trust
(3) The company purchases the property.

It is suggested that T has provided the consideration because the "clean break" test is not satisfied.

What if T gives funds to A, and A borrows from a third party on the security of those funds, and uses the borrowed funds to buy the property? It is considered that T has not provided the consideration.

If T provides fund X to a company or trust, which borrows fund Y from a third party, and the company or trust uses both funds to acquire the property, then T has provided fund X but not fund Y.

Commonplace arrangements for a foreign domiciliary's residence will often satisfy the contribution condition, for instance where:

[18] See 99.7.1 (Is A an indirect settlor?).

(1) an individual gives to a trust which purchases the home (without a company); or
(2) a foreign domiciliary gifts funds to a trust which lends interest-free to the company which acquires the home.

In most cases one exemption or another will apply but it is possible to fall between the gaps.

83.6.2 *Guarantees*

Para 17 sch 15 FA 2004 provides:

> Where a person ("A") acts as guarantor in respect of a loan made to another person ("B") by a third party in connection with B's acquisition of any property, the mere giving of the guarantee is not to be regarded as the provision by A of consideration for B's acquisition of the property.

It is suggested that this applies even if A provides security for A's guarantee or deposits funds with a bank as a back-to-back loan.

What if:
(1) B borrows to purchase property (perhaps with a guarantee by T); and
(2) T later gives funds to B who repays?

If the steps are independent, it is considered that T has not provided the consideration. If, however, the steps form part of a single arrangement, it is suggested that T can be said to have provided the consideration indirectly.

83.6.3 *Secondhand company*

The contribution condition will not be satisfied where:
(1) A has provided funds to a company to purchase a house.
(2) A sells the company to B who occupies the house.

B has not provided the funds for the purchase (unless the two steps form a single arrangement).[19]

83.7 POA chattel charge

Para 6 sch 15 FA 2004 provides:

> (1) This paragraph applies where—

[19] See 48.10.1 (Individual purchases secondhand co).

(a) an individual ("the chargeable person") is in possession of, or has the use of, a chattel, whether alone or together with other persons, and

(b) the disposal condition or the contribution condition is met as respects the chattel.

(2) The disposal condition is that—

(a) at any time after 17 March 1986 the chargeable person had (whether alone or jointly with others) owned—

(i) the chattel, or

(ii) any other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of the chattel, and

(b) the chargeable person disposed[20] of all or part of his interest in the chattel or other property otherwise than by an excluded transaction.

(3) The contribution condition is that at any time after 17 March 1986 the chargeable person had directly or indirectly provided, otherwise than by an excluded transaction, any of the consideration given by another person for the acquisition of—

(a) the chattel, or

(b) any other property the proceeds of the disposal of which were (directly or indirectly) applied by another person towards the acquisition of the chattel.

This follows the form of the POA land charge.

The IHT Manual provides:

> **IHTM44007 the disposal condition- chattels** [Aug 2016]
>
> ...
>
> **Example** (Trevor and Paul)
>
> T gives a painting to P. P then sells the painting and buys a violin with the proceeds, which T then plays. The disposal condition is met.
>
> So the disposal condition will apply to the chargeable person's enjoyment or use of a chattel even if it was never actually owned by them. If they give away another asset (it does not have to be another chattel, but see the contribution condition (IHTM44008) if the gift is of cash) to another person who sells the asset and uses the proceeds to purchase the chattel concerned, the disposal condition is satisfied, unless it qualifies as an excluded transaction.
>
> A disposition that creates a new interest in a chattel out of an existing

[20] "Disposal" is further defined in para 6(4) sch 15 FA 2004.

interest is taken to be a disposal of part of the existing interest, FA04/Sch15/Para 6(4).

The disposal condition will be met whether the sale or gift is of the whole or part of the chattel and whether or not the sale is at less than the market price. See IHTM44031 where the disposal is of the whole of the chattel for full consideration.

FA04/Sch15/Para 6(2)(a)(ii) applies where the proceeds of sale are used to acquire a chattel that is subsequently used or enjoyed by the chargeable person. So, in the example above, if P exchanged the painting for the violin, on the face of it, the disposal condition is not met; but see IHTM44008.

IHTM44008 the contribution condition - chattels [/Aug 2016]

...

The contribution condition applies not only where the contribution provided by the chargeable person is directly used to purchase the chattel but also where the contribution is indirect. If the chargeable person provided all or part of the consideration for the purchase of an asset by another person, who then sold that asset and used the proceeds to purchase the chattel used or enjoyed by the chargeable person, the contribution condition is satisfied.

Example (Trevor and Paul)

T gives P the funds to buy a painting. P then sells the painting and buys a violin with the sale proceeds which T then plays. The contribution condition is met.

You do not need to show that when the contribution was made, the individual intended to use or enjoy the chattel purchased by another; if the chargeable person uses or enjoys a chattel that they have, as a matter of fact, indirectly contributed to the purchase of, the contribution condition is met.

The contribution condition does not only apply to cash contributions. So in the example at IHTM44007, where P exchanges a painting for a violin, the gift of the painting from T to P is a contribution to the acquisition of the chattel that T subsequently used or enjoyed and so the contribution condition is met.

However, the contribution condition is not met where the chargeable person uses or enjoys a chattel purchased by another with money loaned by the chargeable person. This is because the outstanding debt will form part of the lender's estate for Inheritance Tax purposes, and the lender cannot be said to have provided a contribution to the purchase of the chattel when that money has to be repaid to them, even if the loan was interest free. It follows that the 'lender', in such an arrangement, is not subject to a POA charge.

83.8 POA intangible property charge

Para 8 sch 15 FA 2004 provides:

> (1) This paragraph applies where—
>
> (a) the terms of a settlement, as they affect any property comprised in the settlement, are such that any income arising from the property would be treated by virtue of section 624 of ITTOIA (income arising under settlement where settlor retains an interest) as income of a person ("the chargeable person") who is for the purposes of Chapter 5 of Part 5 of that Act the settlor,
>
> (b) any such income would be so treated even if section 625(1) of ITTOIA (settlor's retained interest) did not include any reference to the spouse or civil partner of the settlor, and
>
> (c) that property includes any property as respects which the condition in sub-para (2) is met ("the relevant property").
>
> (2) The condition mentioned in sub-para (1)(c) is that the property is intangible property which is or represents property which the chargeable person settled, or added to the settlement, after 17 March 1986.

In common form settlor-interested discretionary trusts the GWR exemption will apply.

If S lends on favourable terms to a trust from which S is excluded, s.624 applies[21] but para 8 does not apply.[22]

In common form trusts where the settlor has an IIP, the GWR exemption (or for an estate IIP, the estate exemption) will apply.

Accordingly, the POA intangible property charge will not usually affect foreign domiciliaries.

The charge does not apply to intangible property held by a company held by a trust, since that is not property comprised in a settlement, and not caught by s.624, but the shares in the company will be intangible property.

The charge is intended to catch *Eversden* schemes (which will not normally have been carried out by foreign domiciliaries). But it is much wider than that. It applies (in short) to (almost) any settlor-interested trust unless GWR also applies. If A creates a trust to A for life remainder to B absolutely, or to B for life remainder to A absolutely, the charge applies. However, if there is a power of appointment in favour of A, the charge

[21] See 47.6.2 ("Settlor-interested" for s.624).

[22] Because s.624 only applies because of the loan, and not because of the terms of the settlement (in the IHT sense).

does not apply as in this case there is a GWR. There is no sense in this and in practice HMRC do not take the point. Since s.102ZA FA 1986 stops the *Eversden* schemes, the intangible property charge is an anti-avoidance provision that has lost its purpose[23] and only remains as clutter in the tax system which will occasionally trap the unwary (if anyone notices or cares). It should be repealed (except for pre-2003 disposals).

The IHT Manual provides:

> **IHTM44009 intangible property** [Aug 2016]
>
> ...
>
> Note that under FA04/Sch15/Para 8(1)(a), income arising from the assets concerned (and not the settlement generally) must be treated as income of the chargeable person. So, if the settled property is partitioned so that the settlor cannot benefit from one part of the fund, the POA charge will only apply to the part of the fund that the settlor can benefit from. If the part the settlor can benefit from contains land - but the settlor does not occupy it - the POA charge on land IHTM44004) cannot apply, and will not apply to the part the settlor cannot benefit from, even if that part contains intangibles.
>
> You should also note the fact that the settled property may not actually produce any income does not matter, as long as any income that might arise would be treated as income of the settlor, a charge under FA04/Sch15/Para 8 will arise.
>
> ...
>
> Note that the intangibles charge does not apply to intangible property which is owned by a company which is in turn owned by a trust since the property owned by the company is not settled property. On the other hand, the shares of the company itself will be settled property and potentially caught by the POA charge subject to any exclusions (IHTM44030).
>
> **Example** (Andrew and Joan)
>
> A sets up a trust for his wife J on their marriage in 2005 and as he is excluded from all benefit there is no possibility of a charge under FA04/Sch15/Para 8 arising.
>
> If, however, he sets up a trust where J receives the income but he can benefit under, say, an overriding power of appointment or perhaps a remainder interest (although see IHTM44112 in this regard), then a charge under FA04/Sch15/Para 8 arises subject to any relevant exemptions IHTM44040), even though the property forms part of J's estate (being a pre-March 2006 interest in possession).

[23] Except for *Eversden* schemes carried out before 2003.

83.8.1 *"Settlement"*

"Settlement" here has the IHT meaning, not the settlement-arrangement meaning: para 1 sch 15 FA 2004. See 87.1 (Definitions of "settlement").

The IHT Manual provides:

> **IHTM44009 property in charge: intangible property** [Aug 2016]
>
> ...
>
> In this context 'settlement' has the same meaning as it does for Inheritance Tax purposes. The definition of 'settlement' is in IHTA84/S43(2) (IHTM16042). Unlike the requirement for Income Tax, the fact that there is no element of bounty does not prevent a trust being a 'settlement' for Inheritance Tax - although the legislation does still require the chargeable person to have 'settled' or 'added' property to the settlement. So an arms length sale at full market value to the trust would not be a settlement or addition by the vendor.
>
> ...
>
> **IHTM44112 insurance based products: discounted gift trust** [Jun 2016]
>
> A discounted gift trust or plan is where the settlor makes a gift into settlement with certain 'rights' being retained by them. The retained rights may, for example, be a series of single premium policies maturing (usually) on successive anniversaries of the initial investment or on survival, reverting to the settlor, if they are alive on the maturity date; or the settlor carves out the right to receive future capital payments if they are alive at each prospective payment date. The gift with reservation provisions do not apply.
>
> In the straightforward case where the settlor has retained a right to an annual income or to a reversion under arrangements, that right is not property within FA04/Sch15/Para8 as the trustees hold it on bare trust for the settlor. A bare trust is not a settlement for inheritance tax purposes (IHTM16030). The settlor is excluded from other benefits under the policy and so the POA charge does not apply.
>
> There may be more complex cases where the settlor's retained rights or interests are themselves held on trust. But that would normally be construed as being a separate trust of those benefits in which the settlor had an interest in possession. No POA charge will arise where the interest in possession arose before 22 March 2006 by virtue of FA04/Sch15/Para11(1) (IHTM44041).
>
> Where, however, the POA charge does arise, it will be by reference to the value of the rights held on trust for the settlor, not by reference to the value of the underlying life policy. An open market value of those rights will need to be obtained in order to calculate the charge (IHTM44025).

83.8.2 *POA/protected trusts interaction*

Para 8(4) sch 15 FA 2004 provides:

> For the purpose of deciding whether the condition in subparagraph (1)(a) is met, ignore section 628A of ITTOIA 2005 (which provides for section 624 of that Act not to apply to certain foreign income arising under a settlement).

In short, the 2017 protected trust regime[24] does not affect the operation of POAT.

83.9 Excluded transactions

A disposal of property by an excluded transaction is ignored for the disposal conditions; and the provision of property by an excluded transaction is ignored for the contribution conditions. Para 10(1) sch 15 FA 2004 defines "excluded transaction" for the disposal conditions and para 10(2) sch 15 FA 2004 defines it for the contribution conditions. Each sub-paragraph contains five categories of excluded transaction, making 10 in all. Simplicity was evidently not an important consideration to the drafter of the POA rules.

Excluded transactions are not a defence to the POA intangible property charge.

83.10 Excluded transactions: Disposals

The concept of excluded transaction matters because the disposal conditions do not apply if the disposal is "by an excluded transaction".[25]

83.10.1 *Arm's length disposal of whole*

Para 10(1) sch 15 FA 2004 provides:

> For the purposes of ... [the disposal condition], the disposal of any property is an "excluded transaction" in relation to any person ("the chargeable person") if—
>
> (a) it was a disposal of his whole interest in the property, except for any right expressly reserved by him over the property, either—
>
> (i) by a transaction made at arm's length with a person not connected with him, or
>
> (ii) by a transaction such as might be expected to be made at

[24] See 92.10 (Protected trust: s.624 relief).

[25] See 83.4 (Disposal conditions).

> arm's length between persons not connected with each other.

There are two requirements here:

(1) A disposal of the whole interest (except for any rights expressly reserved).

(2) The disposal[26] falls within para (i) or (ii), ie it is (in short) on arm's length terms.

There is no equivalent of this category of excluded transaction for the purposes of the contribution conditions. The reason is that a disposal at arm's length is not likely to amount to "providing" consideration.

The IHT Manual provides two examples. The first concerns a sale:

> **IHTM44031 excluded transactions: the disposal condition - sale of entire interest** [Aug 2016]
> **Example** (George and Robert)
> G sells his house to his son R for full consideration, but continues to live in the property.

The HMRC analysis is as follows:

> As he has not made a gift, there is no reservation of benefit (IHTM14301)

That is correct.

> and provided the sale falls within FA04/Sch15/Para 10(1)(a)(ii), [ie provided it is on arm's length terms] there will be no POA charge either.

That is correct.

> The position would be different if G had given R money in the past (IHTM44005).

This is not correct. HMRC should say, the position would be different if G had provided the consideration for the purchase, directly or indirectly, but perhaps that is what is meant.

The second example concerns an *Ingram* scheme:

> **IHTM44031 excluded transactions: the disposal condition - sale of entire interest** [Aug 2016]
> **Example** (Robert and James)
> R executes an 'Ingram' (IHTM44100) scheme and sells the freehold

[26] Not the reservation of rights.

reversion to J.

That is:
(1) R grants a lease to a nominee
(2) R sells the property to J subject to the lease

The HMRC analysis is as follows:

> This would be an excluded transaction, provided that the sale was at arm's length or such as might be expected to be made at arm's length between persons not connected with each other. The reversion is a distinct item of property and R has sold his entire interest in it; he continues to occupy the property by virtue of his leasehold interest which is a separate item of property.

HMRC go on to comment on what may constitute arm's length terms in this case:

> There will be a 'marriage' value for the two interests and a truly arm's length transaction must reflect this. In practice, this is likely to be difficult for the taxpayer to show since an independent purchaser would not normally want to pay for marriage value unless he was certain of getting the leasehold interest.

That is not right. If an independent purchaser would not want to pay anything, or anything much, for marriage value, then arm's length terms would simply reflect that. But what constitutes arm's length terms is a question of fact.

83.10.2 *Arm's length part-disposal*

Reg. 5(1) POA Regulations 2005 provide a further relief for part-disposals:

> Para 3 (land) and para 6 (chattels) do not apply to a person in relation to a disposal of part of an interest in any property if—
> (a) the disposal was by a transaction made at arm's length with a person not connected with him;
> (b) the disposal was by a transaction such as might be expected to be made at arm's length between persons not connected with each other, and
> (i) the disposal was for a consideration not in money or in the form of readily convertible assets[27], or

[27] Defined in reg.5(2).

(ii) the disposal was made before 7 March 2005.

This is wider than Para 10(1) sch 15 FA 2004 in that it provides relief from the POA land and chattel charges, not just relief where the disposal conditions apply. But it is narrower in that its requirements are more restrictive.

In particular, one might think the word "not" is included accidentally in reg.5(1)(b)(i) but it was deliberate. A written ministerial statement of Hansard 7 March 2005 provides:

> We do not in general think it is appropriate to provide exemption for sales of a part interest which are made otherwise than at arm's length. If one member of a family needs to raise cash, and another member of the family is willing and able to provide it, there are other and more straightforward ways of structuring this than adopting the form of an equity release transaction.

Very few readers will find that satisfactory. But there it is. The statement continues:

> The point was however made in consultation that some intra-family part disposals can arise from patterns of behaviour adopted for good family or business reasons, for example where a child moves in to care for an aged parent and acquires an equitable interest in their shared home as a corollary of that, or where younger members of a family take over the active role in a family partnership, and in doing so acquire an interest from the partners who preceded them.

What is notable is that the drafter seems to have assumed that these are "transactions such as might be expected to be made at arm's length between persons not connected with each other".

The IHT Manual provides:

> **IHTM44059. Sale of part share** [Jun 2016]
> Regulation 5(1)(b)(i))... may also apply where someone acquires their interest in a property by way of an equitable arrangement, rather than for cash, for example where the person has given up work to care for the owner of the property on the understanding that they will acquire a share of the property in return.

The guidance formerly published on the HMRC website was more helpful:

> If Miss B acquired her interest in the property by way of an equitable arrangement rather than for cash – for example, she had given up work to care for Mr A on the understanding that she would receive a share of

> the property in return – the income tax charge will not apply: Regulation 5
>
> In considering whether the conditions were satisfied, we would need information about how the essential elements of the transaction had been arrived at. We do recognise that there is a substantial body of case law dealing with the circumstances in which an interest in a house is acquired in consequence of a person acting to his detriment. The Ministerial Statement had these sorts of situations in mind and we would interpret Regulation 5 accordingly. In particular, we accept that the requirement that "the disposal was by a transaction such as might be expected to be made at arm's length between persons not connected with each other" would be interpreted with such cases in mind. Where the parties had sought separate advice and acted upon it or had obtained a court order confirming the property entitlement, that would reinforce the claim that the conditions were satisfied. But we would not expect parties to such an arrangement to have done this. We recognise that detriment that the acquirer can demonstrate he has suffered can provide consideration for the acquisition of the interest and prevent the transaction from being gratuitous.

It is straining credulity to describe this as a transaction that may have been expected to have been made at arm's length. But the legislation was not intended to catch this, and HMRC avoid the problem by informal concession dressed up as a statement of practice.

83.10.3 *Inter-spouse transfer*

The second category of excluded transaction is in para 10(1)(b) sch 15 FA 2004:

> Para 3 (land) and para 6 (chattels) do not apply to a person in relation to a disposal of part of an interest in any property if ...
>
> (b) the property was transferred to his spouse or civil partner (or where the transfer has been ordered by a court, to his former spouse or civil partner),

This applies whether or not the IHT spouse exemption applies on the transfer. The transfer to the spouse need not be by way of gift.

83.10.4 *Trust where spouse has IIP*

The third category of excluded transaction is in para 10(1)(c) sch 15 FA 2004:

> Para 3 (land) and para 6 (chattels) do not apply to a person in relation to

> a disposal of part of an interest in any property if ...
>
> (c) it was a disposal by way of gift (or, where the transfer is for the benefit of his former spouse or civil partner, in accordance with a court order), by virtue of which the property became settled property in which his spouse or civil partner or former spouse or civil partner is beneficially entitled to an interest in possession.[28]

This applies whether or not the IHT spouse exemption applies on the transfer. The disposal to a trust under which a spouse has an interest in possession must be by way of gift if the disposal is to be an excluded transaction. Perhaps the reason is to stop some variants of the home loan scheme, which involves a sale of a house to an interest in possession trust for consideration.

This seems to apply even after 2006, when the interest in possession may not be an estate interest.

The IHT Manual provides:

> **IHTM44032 excluded transactions: the disposal condition - transfer to spouse or civil partner** [Aug 2016]
>
> ...
>
> The spouse or civil partner must take an interest in possession from the outset, but note that this does not have to be a qualifying interest in possession under IHTA84/S49(1A). The transaction will remain an excluded transaction provided the interest in possession remains in place until the death of the spouse or civil partner. If the interest in possession ends during their lifetime, the transaction ceases to be an excluded transaction, FA04/Sch15/Para 10(3), so the POA charge will arise in the normal way from that point onwards. However, if the spouse or civil partner (or former spouse or civil partner) has become absolutely entitled to the property, you can accept that the benefit of the exclusion is not lost.

[28] This is restricted by para 10(3) sch 15 FA 2004:

> "A disposal is not an excluded transaction by virtue of sub-para (1)(c) or (2)(b), if the interest in possession of the spouse or civil partner or former spouse or civil partner has come to an end otherwise than on the death of the spouse or civil partner or former spouse or civil partner."

The former HMRC Website Guidance provided at 1.3.1:

> "In cases where the spouse or civil partner or former spouse or civil partner has become absolutely entitled to the property, we would accept that the benefit of the exclusion is not lost."

> **Example** (Paul and Susan)
> In 2005, P settles his house on qualifying interest in possession trusts for himself for life, then to his wife S with remainders to their children. Both occupy the property. In 2009, the trustees terminate P's life interest; so that S now has a non-qualifying interest in possession, but P continues to occupy the property.
> Initially there would have been no POA charge as the transaction would have been exempt from the charge (IHTM44041). On the termination of the P's life interest, S's interest in possession is **not** an excluded transaction because there is no disposal by way of gift by virtue of which the property becomes settled property in which S has a life interest. So the exclusion under FA04/Sch15/Para 10(1)(c) does not apply and as the exemption no longer applies either, a POA charge arises.
> However, as P continues to occupy the property and the termination of his qualifying life interest is deemed to be a gift by the life tenant, FA86/S102ZA IHTM14391), the exclusion under FA04/Sch15/Para 11(3) applies and no POA charge arises.

83.10.5 *Family maintenance*

The fourth category of excluded transaction is in para 10(1)(d) sch 15 FA 2004:

> Para 3 (land) and para 6 (chattels) do not apply to a person in relation to a disposal of part of an interest in any property if ...
> (d) the disposal was a disposition falling within section 11 of IHTA (dispositions for maintenance of family).

83.10.6 *Annual exemption/small gifts*

The fifth category of excluded transaction is in para 10(1)(e) sch 15 FA 2004:

> Para 3 (land) and para 6 (chattels) do not apply to a person in relation to a disposal of part of an interest in any property if ...
> (e) the disposal is an outright gift[29] to an individual and is for the purposes of IHTA a transfer of value that is wholly exempt by virtue of section 19 (annual exemption) or section 20 (small gifts).

This will include substantial gifts which qualify for 100% BPR or APR.

[29] See 83.12 ("Outright gift").

83.11 Excluded transaction: Contributions

The concept of excluded transaction matters because the contribution conditions do not apply if the consideration for the acquisition is provided "by an excluded transaction".[30]

83.11.1 *Four exclusions*

Para 10(2) sch 15 FA 2004 provides:

> For the purposes of ... (the contribution condition) the provision by a person ("the chargeable person") of consideration for another's acquisition of any property is an "excluded transaction" in relation to the chargeable person if—
>
> (a) the other person was his spouse or civil partner (or, where the transfer has been ordered by the court, his former spouse or civil partner),
>
> (b) on its acquisition the property became settled property in which his spouse or civil partner or former spouse or civil partner is beneficially entitled to an interest in possession.

These are the equivalent of the exclusions discussed above, see 83.10.3 (Inter-spouse transfer). The spouse trust exclusion here is wider than the spouse trust exclusion for the disposal condition, as the words "by way of gift" do not appear.

The last two exclusions in para 10(2) sch 15 FA 2004 are:

> (d) the provision of the consideration is a disposition falling within section 11 of IHTA (dispositions for maintenance of family), or
>
> (e) the provision of the consideration is an outright gift to an individual and is for the purposes of IHTA a transfer of value that is wholly exempt by virtue of section 19 (annual exemption) or section 20 (small gifts).

These are the equivalent of 83.10.5 (Family maintenance) and 83.10.6 (Annual exemption/small gifts).

The IHT Manual provides:

> **IHTM44035 excluded transactions: the contribution condition - transfer to spouse or civil partner** [Aug 2016]
>
> ...
>
> The spouse or civil partner must take an interest in possession from the

[30] See 83.5 (Contribution conditions).

outset, but note that this does not have to be a qualifying interest in possession under IHTA84/S49(1A). The transaction will remain an excluded transaction provided the interest in possession remains in place until the death of the spouse or civil partner. If the interest in possession ends during their lifetime, the transaction ceases to be an excluded transaction, FA04/Sch15/Para 10(3), so the POA charge will arise in the normal way from that point onwards. However, if the spouse or civil partner (or former spouse or civil partner) has become absolutely entitled to the property, you can accept that the benefit of the exclusion is not lost.

Example (Jane and Edward)

J has an interest in possession in a trust with remainders to her children. In 2003 her husband E adds £300,000 to the trust. The transfer is exempt from IHT, although it will initially be subject to the POA intangibles charge if E is a beneficiary (IHTM44009). The trustees purchase a house that J and E occupy. Since, on its acquisition, the property becomes settled property and would otherwise meet the conditions of FA04/Sch15/Para 3(3), the POA charge is excluded by FA04/Sch15/Para 10(2)(b).

If J's interest is terminated during her lifetime, then FA04/Sch15/Para 10(3) prevents the exclusion under FA04/Sch15/Para 10(2)(b) from applying, so the POA charge will arise in the normal way, unless J becomes absolutely entitled to the property, when you can accept that the benefit of the exclusion is not lost. In the event that J's interest comes to an end with her death and E continues to occupy the property, the exclusion will continue to apply.

The timing of such transactions can give rise to very complicated outcomes due to the interaction of FA86/S.102(5A)-(5C) (IHTM14318); FA86/S102ZA (IHTM14391) and changes to the treatment of interest in possession trusts from 18 March 2006 (IHTM16061). Any cases where this mix of circumstances arises should be referred to Technical for advice.

83.11.2 *Outright gift of money*

The remaining exclusion is in para 10(2)(c) sch 15 FA 2004 where:

(c) the provision of the consideration constituted an outright gift[31] of money (in sterling or any other currency) by the chargeable person to the other person and was made at least seven years before the earliest date on which the chargeable person met the condition in

[31] See 83.12 ("Outright gift").

para 3(1)(a)[32] or, as the case may be, 6(1)(a).[33]

Para (c) applies only to the contribution conditions.

The exemption only applies to gifts of money. I am unable to see the reason for that.

The IHT Manual provides:

> **IHTM44049 cash gifts and exclusion of reservation of benefit provisions** [Aug 2016]
> **Example** (Andrew)
> A gives his daughter £150,000 in 2006.
> In 2008, they decide to buy a property together worth £300,000.

For the HMRC analysis, see 83.19.3 (Tracing rules). HMRC add:

> If the daughter had purchased the property in her own name and A had given his daughter the money before 6 April 1998, or if he had not moved into the property within 7 years of the gift being made, the exclusion for outright gifts of money (IHTM44036) will apply.

83.12 "Outright gift"

The expression "outright gift" is used in three of the ten categories of excluded transaction:

(1) Outright gifts to individuals within s.19 (annual exemption) or s.20 (small gifts) are excluded transactions for the disposal and contribution conditions.[34]

(2) Outright gifts of money (whether or not to an individual) are excluded for the disposal condition.[35]

"Outright gift" is not defined.[36] Clearly a loan and a subscription for shares is not an outright gift. It is suggested that a gift to a trust from which the settlor is excluded is in principle an outright gift.

It is tentatively suggested that a gift to an irrevocable discretionary trust of which the donor is merely a discretionary beneficiary is an outright gift. It must be envisaged that the donor occupies the land given or the

[32] ie, T occupies the relevant land.

[33] ie, T has possession of the chattels.

[34] See 83.10.6 (Annual exemption/small gifts); 83.11.1 (Four exclusions).

[35] See 83.11.2 (Outright gift of money).

[36] The term "outright gift" is partially defined in s.626 ITTOIA; see 93.14 (Marriage of dom/non-dom or resident/non-resident: IT planning), but that definition does not apply here.

exclusion will not apply.

83.13 POA exemptions

Para 11 sch 15 FA 2004 provides a set of exemptions from the POA charges which (in my terminology) are as follows:

(1) Estate exemptions
(2) GWR exemptions
(3) Para 11(5)(b) sch 15 FA 2004 exemptions (charities and other specialist areas) not discussed here
(4) Para 11(5)(c) sch 15 FA 2004 exemption (jointly occupied property) not discussed here
(5) Full consideration exemption

83.14 "Relevant property"

A key concept in the POA exemptions is "relevant property" defined in para 11(9) sch 15 FA 2004. The expression has three possible meanings.

In relation to the POA land and chattel charges, "relevant property" means:

> (i) where the disposal condition ... is met, the property disposed of,
> (ii) where the contribution condition ... is met, the property representing the consideration directly or indirectly provided.

In a contribution condition case, the relevant property is the property representing the consideration directly or indirectly provided. Since "provided" is a difficult concept,[37] this is also difficult.

If T gives money to A, who uses it to buy a house, the house represents the consideration provided.

What if T subscribes for shares in A Ltd which purchases the house. Is it the shares or the house which represent the property provided? It is suggested that the relevant property is the house, but the shares may be derived property.[38]

What if T lends money to A interest-free, who purchases a house? Is it the house or the benefit of the loan which represents the consideration provided? In this case HMRC accept that T does not provide the consideration so the contribution condition is not satisfied; but if it mattered, it is suggested that the relevant property is the house and the

[37] See 83.6 ("Provide").

[38] See 83.16.1 (Derived property: Shares).

loan may be derived property.

In relation to the POA intangible property charge, "relevant property" has the meaning given in para 8 sch 15 FA 2004 (in short, the settled property).[39]

83.15 Estate exemptions

83.15.1 *Full estate exemption*

Para 11(1) sch 15 FA 2004 provides that the POA charges:

> do not apply to a person at a time when his estate for the purposes of IHTA includes—
> (a) the relevant property, or
> (b) other property—
> (i) which derives its value from the relevant property, and
> (ii) whose value, so far as attributable to the relevant property, is not substantially less than the value of the relevant property.

I refer to this as the "**estate exemption**" (or "**full** estate exemption" if necessary to distinguish it from the partial exemption discussed below).

If T transfers funds to a trust under which T has an estate interest in possession, the estate exemption will apply. Transfers after 2006 will not normally give rise to an estate IIP, so the exemption is of less importance to post-2006 trusts.

The IHT Manual provides:

> **IHTM44042 examples where relevant property remains part of the Inheritance Tax estate** [Aug 2016]
> **Example** (Brian and Julie)
> In 2005, B transfers his house to an interest in possession trust with a life interest for himself and then for his wife, J, with remainders to his children. B continues to occupy the house.
> The disposal condition (IHTM44004) is met and none of the exclusions (IHTM44030) apply.
> The property continues to form part of B's estate under IHTA84/S5(1) and so is exempt from the POA charge under FA04/Sch15/Para11(1) whilst his interest in possession exists.
> Note that exemption still applies even though on B's death, the property is exempt from Inheritance Tax as the life interest passes to J. However,

[39] See 83.8 (POA intangible property charge).

should the trustees bring B's life interest to an end during his lifetime, the charge under FA04/Sch15/Para3(2) will apply unless B ceases to occupy the property, another exemption applies or he becomes absolutely entitled to the property.

If the trustees brought B's life interest to an end after 22 March 2006, he will be treated as making a PET under IHTA84/S52(1); but - assuming he continues to occupy the property - he will also be treated as reserving a benefit (IHTM14391) in the property in which his life interest ceased by virtue of FA86/S102ZA(2). Because B is treated as reserving a benefit in the property, he continues to be exempt from the POA charge, but under a different exemption (IHTM44044).

Example

If, in the example above, B had made the transfer in 2009, the position would have been quite different, as outlined below.

The transfer into the trust is an immediately chargeable transfer (IHTM04067) and tax would be payable at 20% if the value transferred exceeded the nil-rate band. The trust will also be subject to the normal relevant property trust charges (IHTM42070). B's interest in possession is not part of his estate, so the exemption under FA04/Sch15/Para11(1) (IHTM44041) does not apply. The POA charge will therefore apply, unless B reserves a benefit in the property when a different exemption will apply.

B has made a gift of land to the trust, so the provisions of FA86/S102A (IHTM14360) must be considered. If B has retained a significant right or interest that entitles him to occupy the land, he will be treated as reserving a benefit in the property, FA86/S102A(2). Although the property does not form part of B's estate for Inheritance Tax purposes, his interest under the trust does entitle him to occupy the property and so he will be exempt from the POA charge under FA04/Sch15/Para11(5) (IHTM44044).

83.15.2 *Partial estate exemption*

Para 11(2) sch 15 FA 2004 provides:

Where the estate for the purposes of IHTA of a person to whom para 3, 6 or 8 applies includes property—

(a) which derives its value from the relevant property, and

(b) whose value, so far as attributable to the relevant property, is substantially less than the value of the relevant property,

the appropriate rental value in para 4, the appropriate amount in para 7 or the chargeable amount in para 9 (as the case may be) is to be reduced by such proportion as is reasonable to take account of the inclusion of the property in his estate.

I refer to this as the "**partial estate exemption**".

The concluding words "such proportion as is reasonable to take into account of the inclusion of the property in his estate" are somewhat incoherent. One can speak of "a proportion of a property", but not "a proportion of an inclusion". Presumably it means: "such proportion as is reasonable to take into account of the property which is included in his estate".

83.16 Derived property

In the following discussion:

(1) "**Fully-derived property**" is property falling within para 11(1)(b) sch 15 FA 2004.[40] That is property:

- (i) which derives its value from the relevant property, and
- (ii) whose value, so far as attributable to the relevant property, is not substantially less than the value of the relevant property.

(2) "**Partly-derived property**" is property falling within para 11(2) sch 15 FA 2004. That is property:

- (a) which derives its value from the relevant property, and
- (b) whose value, so far as attributable to the relevant property, is substantially less than the value of the relevant property.

Thus there are three steps to decide whether property is "derived property":

(1) Is its value derived from the relevant property (the house)? If so:
(2) Ascertain how far its value is attributable to the house.
(3) Is that value (the value attributable to the house) "substantially[41] less" than the value of the house?

83.16.1 *Derived property: Shares*

Suppose T subscribes for shares in a company which buys a house and has

[40] In para 11 sch 15 FA 2004 this is simply called "derived property".

[41] "Substantially" is, obviously, not a precise word. The IHT Manual provides:

> **"IHTM44043. Property in a person's estate that derives its value from the relevant property** [Aug 2016]
>
> ... You should normally regard the value of the derivative property as being 'substantially less' than that of the relevant property where the difference in value is more than 20%. Any case where you consider the exemption should apply (or not apply) in full and there is a reduction of more (or less) than 20% should be referred to Technical."

no other assets. The shares are fully-derived property since:
(1) the shares derive their value from the house (the relevant property); and
(2) the value of the shares is attributable to the house; and
(3) that value is not substantially less than the value of the house.

Suppose the company owns a house and other assets. The context shows that the shares are still to be regarded as fully-derived property since:
(1) they derive their value from the house;
(2) their value is to some extent attributable to the house;
(3) their value to that extent is not substantially less than the value of the house.

One might question whether it is the case that the shares derive their value from the house. They derive their value in part from the house and in part from other assets. However, the context shows that that satisfies the condition of para 11(1)(b)(i) sch 15 FA 2004. Otherwise the condition in para 11(1)(b)(ii) sch 15 FA 2004 is never satisfied.

Suppose the company owns only the house and is subject to a substantial liability. The shares are not fully-derived property as their value is substantially less than the house. The shares are partly-derived property.

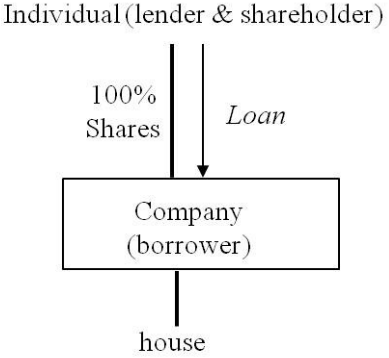
Suppose the company owns the house and other assets, and is subject to a debt. It is suggested that the shares are fully-derived property so long as the amount of the debt is less than the value of the other assets.

The estate exemption applies so long as T retains the shares in T's estate. If T gifts half the shares to T's spouse the estate exemption ceases to apply and POA land charge is due (but with some relief under the partial estate exemption). HMRC agree. The IHT Manual provides:

> **IHTM44043 - Property in a person's estate that derives its value from the relevant property** [Aug 2016]
>
> *Example (Bruce)*
>
> B transfers his house to a company wholly owned by him. The value of the shares in the company which are included in B's estate is fully derived from the value of the house and so the exemption in FA04/Sch15/Para 11(1) applies.
>
> But if B gave the house to a company which was owned 25% by his civil partner then the value of the 75% shares he holds would be 'substantially less' than the value of the house, so although the POA charge would apply, the appropriate rental value should be reduced by a reasonable proportion, perhaps 75%, to reflect the value of the shares in B's estate.

83.16.2 *Derived property: Loan*

Suppose T lends interest-free to a company which purchases the house and has no other assets.



Initially the loan is fully-derived property as the shares have no value. The loan derives its value from the house because, if the loan is called in, it could only be paid by the company:

(1) selling the house and using the proceeds of sale, or
(2) borrowing on the strength of the house (in the sense that no lender would lend if the company did not hold the house) and repaying out of that loan.

Can HMRC argue that:

(1) the loan derives its value from the contractual undertaking that obliges the company to repay; and so
(2) the loan does not derive its value from the underlying property (the house).

Point (1) is correct but point (2) does not follow and is not correct. It is the existence of the house which gives value to the contractual obligation to repay.

If the value of the house increases substantially, the shares and loan (taken together) are fully-derived property and taken separately they are partly-derived property.

Unfortunately HMRC may disagree. CIOT Statement provides:

> 6.3 Clarification is requested on the position where a house is owned by a company but the company is funded by way of loan. The concern is over paras 11(1)(b) and 11(3)(b).

> **Example 9**
>
> [1] B owns 100 £1 shares in X Limited and otherwise funds it by shareholder loan.
>
> [2] (Or the house is owned by a company held within an interest in possession trust for B and again the funding for the purchase comes by way of loan from trustees to company.)
>
> X Limited buys the house in which B lives. B *prima facie* falls within the para 3 charge.

In fact HMRC accept that case [1] does not fall within the POA land charge because the interest-free loan is not providing consideration.[42] CIOT Statement continues:

> It would appear that para 11(1) protects him. The shares are not themselves property which derive much value from the house because they are worth substantially less than the house (see para 11(1)(b)(ii)) but the shares and the loan together are comprised in B's estate and between them indirectly derive their value from the house. On that basis para 11(1) does offer full protection.
>
> **Question 33**
>
> Do HMRC agree with this analysis or do they consider that the loan derives its value from the contractual undertakings that oblige the borrowing company to repay?
>
> It would be odd if there is a POA problem when the company is funded by way of loan but not if it is funded by way of share capital.
>
> *HMRC*
>
> In our view, the loan, albeit an asset of B's estate, is not property that derives its value from the relevant property. However, our response to Q32 above[43] would no doubt be applicable here in appropriate circumstances.

This is plainly wrong and I would be surprised if HMRC try to defend it if challenged.[44] It is also inconsistent with GAAR guidance.[45] But in the context of the IHT residential-property code it may suit the taxpayer to argue that this view is correct.[46]

[42] See 83.6 ("Provide").

[43] See 83.6 ("Provide").

[44] But one could avoid the issue by avoiding loans, eg subscribe for redeemable shares, which are commercially equivalent to loans.

[45] See 80.44 (GAAR: Debt against UK residence).

[46] See 82.3.4 (Company owns relevant loan).

The position is more complicated if T lends to a company which purchases the house and has other assets. Suppose, for example, the company's assets and liabilities consist of a house worth £1m, investments of £1m, and a debt of £1m. It is still plainly the case that the benefit of the debt and the shares taken together are fully-derived property. It is suggested that if the debt is charged on the house it derives its value from the house, and if it is not charged then it does not do so (but the shares do derive their value from the house).

What if T lends to a trust which purchases a house? If the loan is on limited recourse terms[47] the loan is fully-derived property. It is suggested that the same applies even if the trustees are personally liable for the loan.

83.16.3 *Equitable interest*

If T transfers property to a trust for A for life, remainder to T, T has a reversionary interest which is derived property. The interest is part of T's estate so the full (or partial) estate exemptions apply (depending on whether the value of the reversionary interest is equal to 80% or more of the value of the trust fund).

If T transfers property to a trust for T for life, remainder to A, T's life interest is derived property but it does not form part of T's estate (after 2006) so the estate exemption does not apply.

83.17 Excluded liability rule

Para 11(6) sch 15 FA 2004 provides a restriction on the estate exemptions:

> Where at any time the value of a person's estate for the purposes of IHTA is reduced by an excluded liability affecting any property...

I call this the "**excluded liability rule**". The effect of the rule if it applies is:

> ... that property is not to be treated for the purposes of sub-para (1) or (2) as comprised in his estate except to the extent that the value of the property exceeds the amount of the excluded liability.

The excluded liability rule disallows the estate and partial estate exemptions. It does not disallow the GWR exemption even if the debt reduces the GWR charge.[48]

[47] ie the trustees' liability to repay is restricted to the trust assets or their value.

[48] See 80.6 (GWR property subject to debt).

83.17.1 *"Excluded liability"*

The term "excluded liability" is defined in para 11(7) sch 15 FA 2004:

> For the purposes of sub-para (6) a liability is an excluded liability if—
> (a) the creation of the liability, and
> (b) any transaction
> [i] by virtue of which the person's estate came to include
> [A] the relevant property or
> [B] property which derives its value from the relevant property or
> [ii] by virtue of which the value of property in his estate came to be derived from the relevant property,
> were associated operations, as defined by section 268 of IHTA.[49]

This is odd. The liability within (a) must relate to the acquisition of the property within (b). It appears at first sight that every liability is an excluded liability. It is suggested that a liability is an excluded liability only if the creation of the liability and the acquisition of the property form part of a single scheme or arrangement.[50]

83.17.2 *"Affecting" property*

The rule only applies to a liability which "affects" property. It is suggested that a liability of an individual or company does not affect property of the individual or company unless secured on that property. A liability of a company does not affect the shares of the company (even if it may reduce their value). A liability of a trust does affect the trust property since the trustees have a lien over the trust fund to meet the liability.

83.18 Estate "reduced" by liability

The excluded liability rule only applies if the value of a person's estate is "reduced" by the liability. In what circumstances does a liability reduce the value of an estate? Plainly it does not do so if it is disallowed for IHT.[51]

83.18.1 *Trustees borrow from trust co*

Suppose:

[49] See 74.12 ("Associated operation").
[50] See *Reynaud v IRC* [1999] STC (SCD) 185.
[51] See 80.9 (Disallowed debts: Introduction).

(1) T is the life tenant of an estate IIP trust.
(2) The trustees borrow from a company held by the trust and purchase land occupied by T.

It is considered that the debt does not reduce the life tenant's estate since the benefit of the debt increases the value of the company's shares: the two cancel each other out. So the debt is not an excluded liability. (In addition, if T is the settlor, the GWR exemption will usually apply.)

83.18.2 *Bank borrowing*

Suppose:
(1) T is the life tenant of an estate IIP trust.
(2) The trustees borrow from a bank or third party, and purchase land occupied by T.

It is considered that T's estate is not "reduced" by the liability, since T's estate is not reduced by the transaction: the liability is matched by the receipt of the borrowed money.[52]

Otherwise the excluded liability rule would apply whenever anyone borrows on the security of T's house, which would be absurd.

CIOT Statement provides:

> 2.5 A common scenario (both for foreign and UK domiciliaries) is where cash is settled into an interest in possession trust for the donor life tenant. The trustees then buy a house for the donor to live in using the gifted cash plus third party barrowings. Although not a home loan scheme, the legislation appears to affect such arrangements.
> **Example 4**
> E settles cash of £200,000 into an interest in possession trust for himself in 2003. The trustees purchase a property worth £500,000, borrowing £300,000 from a bank. There are other assets in the trust which can fund the interest but the borrowing is secured on the house which E then occupies.
> In these circumstances, one would not expect a POA charge. There is no inheritance tax scheme since the property is part of E's estate and the borrowing is not internal. One would argue that E's estate still includes the house and therefore protection is available under para 11(1). The difficulty is that on one view the loan is an excluded liability within para

[52] Admittedly s.162(5) IHTA applies and uses the word "reduced" in connection with the same liability. But the question is not whether the value of an *asset* is reduced, but whether the value of the *estate* is reduced.

> 11(7) reducing E's estate, albeit it is a loan on commercial terms with a bank.
>
> We would argue that the relevant property for the purposes of para 11 is simply the value of the property net of the commercial borrowing. As this is part of E's estate there is no POA charge.
>
> **Question 13**
>
> Is the above analysis correct?
>
> **HMRC**
>
> We agree with your analysis in para 2.5.

It is correct that one would not expect a POA charge, as there is no IHT saving. However, what is the correct analysis of the provisions in this situation? It is wrong to say that the *property* for the purposes of para 11 sch 15 FA 2004 is its *value* net of the liability, because that confuses two different things: property and the value of property. It is also wrong to say that the asset for the purposes of para 11 sch 15 FA 2004 is the asset net of the liability; if one said that, the legislation would not work at all. The solution is to say that the liability does not reduce the estate of the individual, E, because E's estate is increased by the proceeds of the loan (as well as being reduced by the liability; the two cancel each other out). So the loan is not an excluded liability.

83.18.3 *Co borrows from individual*

Suppose:

(1) T lends to a company (owned by T).

(2) The company purchases a property occupied by T.

The liability is an excluded liability as defined, but so long as T retains the benefit of the debt the excluded liability rule does not apply because the debt does not reduce T's estate. What if T gives away the debt? The excluded liability rule does not apply unless the debt is secured because the debt does not affect the property.

83.18.4 *Home loan schemes*

The excluded liability rule was intended to catch home loan schemes. Suppose:

(1) T sells T's home to a trust under which T has an interest in possession in return for a debt.

At this point the excluded liability rule does not apply. The liability is an excluded liability as defined.[53] However, the benefit of the debt is in T's estate. It is considered that the value of T's estate is not "reduced" by the liability.

(2) T gives the benefit of the debt to T's children or to a trust for their benefit.

Is the value of T's estate is now reduced by the liability? One can argue that it is reduced by the gift of the debt, not by the liability. But a purposive construction suggests that this cannot be right.

The provision works as intended.

The IHT Manual provides:

> **IHTM44051 relevant property remains part of the Inheritance Tax estate: excluded liabilities** [Aug 2016]
>
> ...
>
> **Example** (Duncan)
>
> D sets up a home loan scheme in 2004 where the property is sold to the trust for £500,000. In April 2005, the property is worth £650,000 and the amount of the loan, together with interest accrued at the same date is £550,000. Exemption under FA04/Sch15/Para11(5)(a) applies to the excess of £100,000 and the proportion of the annual rental value that is referable to £550,000 is subject to the POA charge. If the annual rental value was £20,000, the POA charge is 20,000 × (550,000 ÷ 650,000) = £16,923
>
> At the next revaluation date (IHTM44011), the loan should be quantified at that time, taking into account the interest/indexation that has accrued to that date and adding it to the amount of the loan. In the event that part of the loan has been repaid (this is unlikely with a home loan scheme), the reduced amount of the loan - plus accrued interest/indexation - may be taken into account when it occurs and the POA liability recalculated for the tax year in question and subsequently.
>
> It is possible that the property concerned may be sold, some of the proceeds reinvested in a smaller replacement property and the balance retained in the trust as intangibles. This then raises the question of how the loan, which is a general debt of the trust, should be treated. For the sake of simplicity, you should apportion the amount of the loan, at the date the trust assets change, between the two categories of asset and then work out the POA charges in the normal way - although it may now be

[53] The transaction by which the person's estate included the house was its purchase not the sale to the trust. The creation of the liability is an associated operation because it affects the same property even if the purchase was many years earlier.

the case, with a smaller property and smaller annual rental that the amount of the POA charge is below the de minimis limit (IHTM44056).

83.19 GWR exemptions

83.19.1 *Full GWR exemption*

Para 11(3) sch 15 FA 2004 provides:

> Paras 3, 6 and 8 do not apply to a person at a time when—
> (a) the relevant property, or
> (b) any other property—
> (i) which derives its value from the relevant property, and
> (ii) whose value, so far as attributable to the relevant property, is not substantially less than the value of the relevant property,
>
> falls within sub-para (5) in relation to him.
>
> ...

There are four circumstances, or sets of circumstances, where property falls within sub-para (5). The first, and most important, is GWR property. Para 11(5) sch 15 FA 2004 provides:

> Property falls within this sub-paragraph in relation to a person at a time when it—
> (a) would fall to be treated by virtue of any provision of Part 5 of the 1986 Act (inheritance tax) as property which in relation to him is property subject to a reservation

In short, the POA charges do not apply to property subject to a reservation. ("**GWR property**"). I refer to this as the "**full GWR exemption**".

Thus in this context it is in the taxpayer's interest to argue that property *is* GWR property, and HMRC's interest is to argue that it is not! The question of whether property is GWR property (subject to a reservation) is considered at 78.4 (GWR terminology).

Note that property may be GWR property even though it is excluded property. Suppose:

(1) T transfers funds to a discretionary trust under which T is a beneficiary (a GWR).[54]

(2) The trustees lend the funds to a company which purchases a house occupied by T.

[54] The position is the same for a non-estate IIP trust, if T is the object of a power of appointment (so there is a GWR).

The shares and the benefit of the loan are derived property, and are subject to a reservation. This is so even if they are excluded property. So the GWR exemption applies.

A complication arises if T becomes UK domiciled: see 83.25 (Former non-dom).

The other sub-para (5) cases arise where property would be GWR property but for one of nine sets of exemptions. Para 11(5) sch 15 FA 2004 provides:

> Property falls within this sub-paragraph in relation to a person at a time when it ...
>
> (b) would fall to be so treated but for any of paras (d) to (i) of subsection (5) of section 102 of the 1986 Act (certain cases where disposal by way of gift is an exempt transfer for purposes of inheritance tax),
>
> (c) would fall to be so treated but for subsection (4) of section 102B of the 1986 Act (gifts with reservation: share of interest in land), or would have fallen to be so treated but for that subsection if the disposal by way of gift of an undivided share of an interest in land had been made on or after 9 March 1999, or
>
> (d) would fall to be so treated but for section 102C(3) of, and para 6 of Schedule 20 to, the 1986 Act (exclusion of benefit).

83.19.2 *Partial GWR exemption*

Para 11(4) sch 15 FA 2004 provides:

> Where any property which falls within sub-para (5) in relation to a person includes property—
>
> (a) which derives its value from the relevant property, and
>
> (b) whose value, so far as attributable to the relevant property, is substantially less than the value of the relevant property,
>
> the appropriate rental value in para 4, the appropriate amount in para 7 or the chargeable amount in para 9 (as the case may be) is to be reduced by such proportion as is reasonable to take account of that fact.

I refer to this as the "**partial GWR exemption**". It is the equivalent of the partial estate exemption discussed above (except that the words at the end of the subsection are grammatical).

83.19.3 *Tracing rules*

For this purpose para 11(8) sch 15 FA 2004 tinkers with the GWR tracing rules:

> In determining whether any property falls within sub-para (5)(b), (c) or (d) in a case where the contribution condition in para 3(3) or 6(3) is met, para 2(2)(b) of Schedule 20 [FA 1986] (exclusion of gifts of money) is to be disregarded.

This extends the GWR tracing rules[55] and so extends the scope of the POA GWR exemption.

The IHT Manual provides:

> **IHTM44049 cash gifts and exclusion of reservation of benefit provisions** [Aug 2016]
> **Example** (Andrew)
> A gives his daughter £150,000 in 2006.
> In 2008, they decide to buy a property together worth £300,000.

The HMRC analysis is as follows:

> The contribution condition (IHTM44005) will be met[56] and A has not made a gift with reservation as the gift was of cash.
> A has not made a gift of an undivided share of land, so the exemption at IHTM44047 does not apply.
> So on the face of it, A is subject to the POA charge.
> However, the effect of FA04/Sch15/Para 11(8) is to allow the normal tracing rules that apply to substitutions for the reservation of benefit provisions to apply. Therefore the property the donee acquired with cash is treated as being comprised in the original gift. So, as the original gift is treated as a gift of an undivided share of land, the exemption from the POA charge for such gifts (IHTM44047) does apply.
> One consequence of this will be that if the donee ceases to occupy the property, the exemption from the POA charge will cease.
> If the daughter had purchased the property in her own name and A had given his daughter the money before 6 April 1998, or if he had not moved into the property within 7 years of the gift being made, the exclusion for outright gifts of money (IHTM44036) will apply.

83.20 Reverter to settlor restriction

83.20.1 *Purpose of rule*

Para 11(11)(12) sch 15 FA 2004 set out a restriction to the estate and

[55] See 78.21 (Substitution of gifted property).

[56] It is assumed that the daughter used the £150k to purchase the property.

GWR exemptions which I call the “**reverter to settlor restriction**”. It is helpful first to explain the problem which the reverter to settlor restriction is intended to address.

EN FB 2006 explains:

> 17. [The POA] income tax charge was designed to discourage disposals done in a contrived way to avoid IHT. The income tax charge does not therefore apply
> [a] when the original owner has the property back in their estate for IHT purposes (para 11(1) Schedule 15 – for example, because it has been given back to them), or
> [b] when it is treated as back in their estate (para 11(5) – for example, because the original transaction is caught by the IHT “gift with reservation” rules).

This explanation of the estate exemption is correct.

The explanation of the GWR exemption is in essence correct, though strictly speaking, GWR property is not in the individual’s estate; it is however taxed as though it is. I stress this point as it will be relevant in the discussion below. The EN continues:

> 18. There is a mismatch between this relief and an existing IHT exemption for the settled property in “reverter-to-settlor” trusts. The property in such a trust is treated as part of the trust beneficiary’s [ie life tenant’s] estate for IHT purposes, but it is not actually charged when their interest ends.
> 19. In particular, section 54(1) IHTA provides that, when a person who is beneficially entitled to an interest in possession in settled property dies while the settlor is still living, and the property reverts to the settlor, its value is left out of account in determining the value of the person’s estate. [The EN summarises ss.53 and 54 IHTA and continues:]
> 20. This can be used to side-step both IHT and the pre-owned asset income tax charge. For example:
> - B owns an asset, say a house, which he wants to carry on using. B gives it to S, who would otherwise inherit on B’s death;
> - S then settles an interest in possession in the house back on B for life, with the condition that it reverts to S on B’s death [ie S settles the property on B for life with remainder to S];[57]
> - for IHT purposes, B is therefore treated as owning the house by virtue of section 49 IHTA and so para 11(1) Schedule 15 disapplies the “pre-

[57] Author’s footnote: This is not generally possible after 2006.

owned asset" charge;

- however, although the house is part of B's estate for IHT purposes, there is no IHT charge on B's death by virtue of the exemption in section 54(1) IHTA.

Avoidance of this kind was in fact quite common between 2004 and 2006, and clearly something had to be done.

> 21. This clause is aimed at blocking such avoidance by ensuring that the income tax exemption [POA estate and GWR exemptions] does not apply where the property in question (or any derived property) is back in the chargeable person's estate for IHT purposes by virtue of their being beneficially entitled to an interest in possession in it.
> 22. However, the clause also provides that, if the chargeable person does not wish to be subject to the income tax charge, they can elect (like other former owners otherwise liable to the "pre-owned asset" charge) that the property should fall back into their estate for IHT purposes. Thus the clause ensures an effective IHT charge in these circumstances by providing that the [reverter to settlor] exemptions in sections 53(3), 53(4) and 54 IHTA will not apply.

83.20.2 *Reverter to settlor restriction*

Para 11(11) sch 15 FA 2004 sets out the circumstances in which the reverter to settlor restriction applies:

> Sub-para (12) applies where at any time—
> [i] (a) the relevant property has ceased to be comprised in a person's estate ... , or
> (b) he has directly or indirectly provided any consideration for the acquisition of the relevant property,
>
> and
>
> [ii] at any subsequent time the relevant property or any derived[58] property is comprised in his estate ... as a result of section 49(1) IHTA.

In these circumstances, para 11(12) sch 15 FA 2004 disapplies the estate exemptions and the GWR exemptions:

> Where this sub-paragraph applies, the relevant property and any derived property—
> (a) are not to be treated for the purposes of sub-paras (1) and (2) as

[58] Para 11(13) sch 15 FA 2004 defines "derived property" in terms which repeat the wording of para 11(1)(b) sch 15 FA 2004 verbatim.

comprised in his estate at that subsequent time, and

(b) are not to be treated as falling within sub-para (5) in relation to him at that subsequent time.

83.20.3 *IIP trust for settlor from outset*

The condition in para 11[i](b) is a paraphrase of the contribution condition. At first sight, wherever the contribution condition applies, the estate exemption is disapplied. For instance, suppose:

(1) T transfers cash to an estate IIP trust; and
(2) the trustees acquire a UK residence.

The condition in para 11(12)[i](b) is met. At first sight the condition in para 11(12)[ii]) is also met: one might think that at *any subsequent time ... derived property is comprised in his estate ... as a result of section 49(1) IHTA*. So the reverter to settlor restriction applies (even though the reverter to settlor exemption does not apply). So it appears that the POA charge applies. But HMRC do not agree. They say that the condition in para 11(12)[ii] is not met. Published correspondence between STEP and HMRC provides:

> **STEP letter**
> Are the following cases caught by POAT ...
> 1. In 1987, A sets up an interest in possession trust for himself into which he gifts his house. If the house is still held by the trustees now there is no POAT charge because nothing has left his estate.

More accurately, there is no POAT charge as the conditions of para 11(11) are not satisfied.

> However assume that the house has since been sold but he retains an interest in possession. The trust holds a mixture of investments and another house that A occupies. Is para 11(11)(b) satisfied on the basis that A has provided consideration for the acquisition of the land which land has subsequently become comprised in his estate. ...
> 3. In June 2006, C, a disabled person, sets up a trust for himself that qualifies as a disabled person's interest within s89B IHTA. C puts in cash and the trustees invest in equities or a house that C occupies. C will pay POAT. ...

These two examples raise the same point: they are both estate IIP trusts (though after 2006 a trust of that kind can only be made for a disabled beneficiary). But HMRC say that the reverter to settlor restriction does not apply, as the condition in para 11(11)[ii] is not met. That provides:

> [ii] at any subsequent time the relevant property or any derived property is comprised in his estate ... as a result of section 49(1) IHTA.

The HMRC response is as follows:

> As I understand your concern, it is that the new para 11(11)(b) in Schedule 15 FA 2004 will catch someone who has settled, say, cash on interest in possession trusts for themselves (either before 22 March 2006, or afterwards if it is a "disabled person's interest") and subsequently occupies property bought by the trustees; or where the property they settled initially has been sold and replaced by other property, while the settlor has retained their interest in possession.
> ... In our view, the words "at any subsequent time" should be read as meaning that a POA charge will arise where
> [1] the consideration leaves the donor's estate, as a result of which that estate is reduced, and
> [2] later property acquired with such consideration becomes comprised in it again because of their interest in possession. This is consistent with the reasons for Schedule 15.
> We do not, therefore, consider that there will be a charge in the scenarios numbered 1 and 3 in your letters, because the assets transferred into trust and any derived assets have always been in the settlor's estate for IHT purposes. We believe that also applies if, in your second scenario,[59] B set up an interest in possession trust from the outset before Budget Day [2006]. The taxpayer should self-assess on the basis that no POAT is due and there is therefore no need to put anything about POAT on the tax return or for him to make the election where the settlor has retained an interest in possession throughout and settled the cash or property directly into trust himself (rather than through any other funding vehicle such as another trust). This is because no POAT charge arises under s80 FA 2006 [which inserted para 11(11) - (13) Sch 15 FA 2004].
> In summary we do not consider that s.80 FA 2006 has any implications for:
>
> - a settlement of cash on interest in possession trusts for onself made before 22 March 2006, or made by a disabled person on or after that date, after which the trustees purchase a property in which the settlor resides; or
> - the settlement of a house in the same way, which is subsequently sold by the trustees and replaced by other investments or another property.

[59] See 83.20.4 (Trust becomes settlor - IIP).

> That remains our view, on the basis that the words "at any subsequent time" mean that new para 11(11)(b) Schedule 15 FA 2004 will only be relevant where:
>
> - the consideration in question leaves the donor's estate, as a result of which that estate is reduced; and
> - later, property acquired with such consideration becomes comprised in the estate once more by virtue of an interest in possession.
>
> We do not agree that this interpretation makes para 11(11)(a) redundant,[60] since that relates to cases where the disposal condition is met and para 11(11)(b) to cases where the contribution condition is met.

This is a purposive construction, but taxpayers will not object.

83.20.4 *Trust becomes settlor - IIP*

The STEP letter sets out one other example:

> Are the following cases caught by POAT ...
>
> 2. B is a foreign domiciliary who before 22 March 2006 set up a discretionary trust into which he transferred cash. He remains a beneficiary of the trust. The trust then funds a company which buys a house or possibly holds UK investments (and B will pay income tax under [s720 ITA] in respect of any UK income). The trust was before 22 March 2006 converted into an interest in possession trust. If there are any UK intangibles or UK property occupied by A which are held by the trustees within the interest in possession structure he is now subject to POAT. Even if one reads "subsequent time" to mean some time must elapse between the date when the gift is made and the date the property comes back into B's estate this would still not protect B in this example because the trust was originally discretionary.

[60] This paragraph addresses a point made in the STEP letter in these words: "The potential difficulty with paras 11(11) and 11(12) is that they do not distinguish between reverter to settlor trusts and any trust set up between March 1986 and 22 March 2006 where the settlor has a qualifying interest in possession and would in that event be subject to inheritance tax on his death.
These difficulties arise because paras 11(11) and 11(12) catch not only those transactions where land has been given away and ceased to be comprised in the settlor's estate and then comes back into his estate (condition a above). They also catch transactions where a settlor contributed funds or property to a trust and the trust (or an underlying company) has then used those funds or property representing them to buy the relevant property i.e. the land now occupied (condition b above). There is nothing in the words about "any subsequent time" which suggests that under (b) the property had first to cease to be comprised in his estate before being caught by this provision. Indeed if that was the case the words in (a) would be redundant."

HMRC comment on this:

> We accept that a POA charge may arise where someone set up a discretionary trust that has subsequently been converted into an interest in possession trust for the benefit of the settlor. (Scenario 2 in your example). However, it remains possible in those circumstances to elect out of the charge. So, take the following example:[61]
>
> - H settles a property on discretionary trusts before 22 March 2006;
> - also before that date, the trust is converted into an interest in possession trust for H's benefit, with remainder to his wife, W;
> - A POA charge therefore arises because of s.80 FA 2006 but H elects.
>
> As we see it, the effects of the election are:
>
> - the chargeable proportion of the property will be treated as subject to a reservation, but only so far as H is not beneficially entitled to an interest in possession in the property (*para 21(2)(b)(i), Schedule 15 FA 2004*) – i.e. not at all;
> - section 102(3) and (4) FA 1986 will apply, but only so far as H is not beneficially entitled to an interest in possession in the property (*para 21(2)(b)(ii)*) – i.e. not at all; and
> - the reverter-to-settlor exemptions in s.53(3) and (4) and s.54 IHTA will not apply to the actual interest in possession (*para 21(2)(b)(iii)*).
>
> We do not, therefore, consider that the election affects the availability of spouse exemption on H's interest in possession on his death – or on its termination during his lifetime. That is because, as we have just noted, the election will not cause s.102(3) and (4) FA 86 to apply because of H's interest in possession, so there will be no deemed PET.

It is absurd to expect taxpayers to make an election in this case. It is considered that the condition in para 11(12)[ii] is not satisfied, just as it is not satisfied in STEP examples 1 and 3. The property is in the estate of the settlor as soon as the settlement was made. (The settlor did not have an interest in possession, but it is property subject to a reservation, and one may (loosely) regard such property as being in the estate of an individual. That was the view of the drafter of the provisions.[62]) The statutory words *at any subsequent time the relevant property or any derived property is comprised in his estate* require that the property becomes comprised in the individual's estate by means of a disposition other than the original transfer to the trust by the individual.

[61] Author's footnote: The HMRC reply simplifies the facts of STEP example 2 by omitting the company: that allows HMRC to ignore various additional complications.

[62] See 83.20.1 (Purpose of rule).

In short, the reverter to settlor restriction can and should be construed purposively, so it only applies in cases where the reverter to settlor restriction is actually in point, because that, unquestionably, was the intention when it was enacted.

The IHT Manual provides:

> **IHTM44050 relevant property remains part of the Inheritance Tax estate: restriction for subsequent ownership** [Aug 2016]
>
> ...
>
> **Example** (Abel and Eve)
>
> In 1990 A gave his widowed mother E the money so that she could buy her council house. E died in 2005 leaving her house in trust to A for life with remainder to her grandson. A lives in the house as life tenant, so does not pay any rent. Despite the house being treated as part of A's estate, A is not exempt under FA04/Sch15/Para11(1) - unless the de minimis (IHTM44056) applies.
>
> **Example** (Adam)
>
> A settled a holiday cottage in trust in 2000 giving his wife an interest in possession only while they are married, with a defeasible life interest for himself thereafter and remainders on discretionary trust for his children. He shares the occupation of the cottage with his wife. The initial transfer is an excluded transaction (IHTM44032) and also exempt from reservation of benefit (IHTM14318).
>
> In May 2008 they divorce and A's former wife's interest ends. The initial exclusion comes to an end, but A's subsequent qualifying life interest (a TSI under IHTA/S49C (IHTM16061)) is not exempt under FA04/Sch15/Para11(1).

83.21 Full consideration exemption

Para 11(5)(d) sch 15 FA 2004 provides a POA exemption where (in my paraphrase) the relevant property or derived property:

> would fall to be treated as property subject to a reservation but for s.102C(3) and Schedule 20 para 6 FA 1986.

There is a set of exemptions here:[63]

(1) Where the GWR rule would apply but for s.102C(3) FA 1986 (this

[63] Another possible reading is that the exemption only applies if s.102C(3) and sch 20 para 6 both apply, ie it is not enough that sch 20 para 6 applies if s.102C(3) does not. But a close reading of s.102C shows that s.102C(3) and para 6 sch 15 FA 2004 are alternatives. They cannot both apply. *Hansard* confirms this (if it were necessary): HC 7 July 2004 col.881, 900 and the IHT Manual set out below takes the same view.

section is not discussed here).

(2) Where the GWR rule would apply but for para 6 sch 20 FA 1986.

Para 6(1) sch 20 FA 1986 provides two exemptions to the GWR rule. The first is:

> In determining whether any property which is disposed of by way of gift is enjoyed to the entire exclusion, or virtually to the entire exclusion, of the donor and of any benefit to him by contract or otherwise—
>
> (a) in the case of property which is an interest in land or a chattel, retention or assumption by the donor of actual occupation of the land or actual enjoyment of an incorporeal right over the land, or actual possession of the chattel shall be disregarded if it is for full consideration in money or money's worth ...

I call this the "**full consideration exemption**". This is particularly important in relation to chattels because full consideration would be much less than the deemed income charge.

For the concept of "full consideration", see App 4.9 (Market value/full consideration).

The full consideration exemption only applies if there would otherwise be a GWR. If an individual has carried out an *Eversden* scheme, they will not qualify for the full consideration exemption even if they pay full consideration for use of the land (though the rent paid will reduce the quantum of the POA charge).

The second exemption in para 6(1)(b) sch 20 is less likely to be important in practice.

The IHT Manual provides:

> **IHTM44048 exclusion of reservation of benefit under FA86/Sch20/Para6** [Aug 2016]
>
> Where the chargeable person makes a gift that is not subject to a reservation of benefit because the benefit is excluded under FA86/Sch20/Para6(a) & (b), it is also exempt from the POA charge under FA04/Sch15/Para11(5)(d). This covers two situations.
>
> **Full consideration**
>
> Where the donor gives away land and continues to occupy it, or gives away a chattel and continues to use and enjoy it, but pays full consideration in money or money's worth, there is no reservation of benefit (IHTM14341) nor is there a POA charge. What is full consideration and the way the parties should go about the transaction to avoid being subject to a charge as a reservation of benefit applies

equally to the exemption from the POA charge.

If the consideration paid is less than full consideration, or if they initially pay full consideration but, over time, this falls below market rates, a reservation of benefit will arise at the time they ceased to pay full consideration. There will be no POA charge in view of FA04/Sch15/Para11(5)(a).

Change in donor's circumstances

Where the donor makes a gift of property that is not subject to a reservation of benefit, but they subsequently have to return to the property due to an unforeseen change in their circumstances and are unable to look after themselves because of age or infirmity, there is no reservation of benefit (IHTM14342) nor is there a POA charge.

83.22 Partnerships

The guidance formerly published on the HMRC website provided:

> The treatment of a share of a partnership interest for Schedule 15 purposes follows that applied for IHT purposes. In other words, we do not regard the partnership interest as transparent, and the disposal of a share is unlikely to give rise to a Schedule 15 charge in any circumstances.

This is not a view which bears much examination. If a partnership holds land, a partnership interest is an interest in land, and a disposal of that interest meets the disposal condition.[64] But the legislation was not intended to catch partnerships and HMRC avoid the problem by informal concession dressed up as a statement of practice. The passage is not in the IHT Manual but there is no reason to think that HMRC practice has changed.

83.23 Non-resident individual

Para 12(1) sch 15 FA 2004 provides:

> This Schedule does not apply in relation to any person for any year of assessment during which he is not resident in the UK.

This is straightforward.

[64] Contrast the original HMRC guidance (called "Technical Guidance", 2004) which took the correct (if worrying) line that the POA rules in principle apply "if C, an existing partner, brings his son D into partnership"; see the 6th edition of this work, para 43.10.1.

83.24 UK resident non-dom

Para 12(2) sch 15 FA 2004 provides:

> Where in any year of assessment a person is resident in the UK but is domiciled[65] outside the UK, this Schedule does not apply to him unless the property falling within para 3(1)(a), 6(1)(a) or 8(1)(c) is situated in the UK.

This provides exemptions to:
(1) POA land charge, where T occupies non-UK situate land
(2) POA chattel charge, where T uses non-UK situate chattels
(3) POA intangible property charge, where intangible property is not UK situate.[66]

Para 12(2) does not provide exemption where T transfers assets to a non-UK company which holds UK land occupied by T. But the GWR or estate exemption will usually apply.

83.25 Former non-dom

Para 12(3) sch 15 FA 2004 provides:

> In the application of this Schedule to a person who was at any time domiciled[67] outside the UK, no regard is to be had to any property which is for the purposes of IHTA excluded property in relation to him[68] by virtue of section 48(3)(a) of that Act.[69]

The words "was at any time domiciled outside the UK" refer to a person who was formerly foreign domiciled but who has become UK domiciled. The words do not refer to a person who was and remains foreign domiciled. (The words in isolation could, taken literally, apply in such a

[65] "Domiciled" is defined in para 12(4) sch 15 FA 2004:
"For the purposes of this paragraph, a person is to be treated as domiciled in the UK at any time only if he would be so treated for the purposes of IHTA."

[66] This exemption (anomalously) does not apply to FOTRA securities, AUTs or OEICs which may be excluded property but which are UK situate. But the intangible property charge is not likely to affect non-dom settlors, so it may not matter.

[67] This includes deemed domicile: see above footnote.

[68] The words "in relation to him" are misconceived. Property is excluded property or not excluded; but it cannot be excluded property "in relation to" any particular beneficiary. It is considered that these words should simply be disregarded.

[69] The exemption (anomalously) does not apply to FOTRA securities, AUTs or OEICs which may be excluded property, but not under s.48(3)(a) IHTA.

case, but the word *was* in para 12(3) is to be contrasted with *is* in para 12(2).)

Suppose:

(1) T (not UK domiciled) creates a discretionary trust of which T is a beneficiary;

(2) The trust holds:

    (a) Non-UK investments.

    (b) A company holding UK property occupied by T.

At this point, the conditions for the POA intangible property charge and the POA land charge are satisfied but the GWR exemption provides relief in both cases.

(3) Suppose T becomes IHT deemed domiciled (or actually UK domiciled).

At first sight T ceases to enjoy the benefit of the GWR and estate exemptions as the trust property is excluded property, so "no regard" is to be had to it.

(1) In relation to the investments, there is still no POA intangible property charge, since the investments are excluded property, so no regard is to be had to them either.

(2) However, the land is not excluded property, so the POA land charge seems to apply.[70] This was certainly not foreseen at the time the legislation was passed. It is suggested that para 12(3) sch 15 FA 2004 is, like a deeming provision, to be construed to have effect so far as intended but it was not intended to disapply the GWR and estate exemptions. The purposive approach to construction of tax statutes may on this occasion assist the taxpayer. The 17 March 1986 POA start date supports this view. That date shows that the object of the rules is to prevent GWR avoidance, not other kinds of IHT mitigation.

HMRC agree. CIOT Statement provides at para 7:

> Para 12(3) states that no regard is to be had to excluded property. In a case where a trust settled by a foreign domiciliary owns a UK house through a foreign registered company the shares in the company (and any loan to the company) are excluded property. Concern has been expressed that since para 12(3) says that no regard is to be had to these

[70] A further tax charge would arise if (as some have argued) T is also caught by the GWR rules on his death; see 78.15 (Death: settled excluded property).

> assets, this in turn means that the shares and loan have to be ignored in applying para 11 and in particular cannot be taken into account in determining whether there is derived property which is in the taxpayer's estate or GWR property in relation to him (which the shares and loans otherwise are). We think that this argument is misconceived but it has been advanced.
>
> **Question 42**
>
> Can HMRC confirm that they agree para 12(3) does not operate in this way and that para 11 can still work to protect the UK house or underlying assets owned by the offshore company in these circumstances?
>
> *HMRC*
>
> We agree with what you say in para 7.1 about the interaction between paras 12(3) and 11.

The guidance formerly published on the HMRC website provided at 4.1:

> Para 12(3) of the schedule provides that if any property situated outside the UK became comprised in a settlement when the person settling the property was domiciled outside the UK it will not be subject to the charge. Even if that person becomes domiciled in the UK at a later date this property will remain excluded from the charge.
>
> Para 12(3) provides that a charge under this Schedule shall not arise in relation to property regarded as excluded by virtue of section 48(3) IHTA'84. We do not regard this provision as having an impact on para 11 in determining whether there is derived property in the taxpayer's estate, or GWR property in relation to him (see foreign domiciliary example in appendix).

The passage is not in the present IHT Manual, but HMRC practice may not have changed.

The IHT Manual provides:

> **IHTM44054 exemptions: foreign element - foreign domiciliaries**
> [Aug 2016]
>
> Example (Gregor)
>
> G, who is non-UK domiciled but resident in the UK, gives his French house to an offshore company which is 100% owned by him and continues to live there. This is a disposal of land, but there is no POA charge because of the exemption under FA04/Sch15/Para12(2). However G owns the company shares that derive their value from the house, so he is also exempt under FA04/Sch15/Para11(1). If, after a period of time, G becomes deemed domiciled in the UK, this exemption under FA04/Sch15 /Para12(2) will be lost. However, exemption under

FA04/Sch15/Para11(1) (IHTM44041) is still available as G's estate includes property (the company shares) which derives its value from the relevant property.

If G had given his UK house to the offshore company and continued to live there, a POA charge potentially arises. The exemption under FA04/Sch15/Para12(2) does not apply because the property is situated in the UK. However, exemption under FA04/Sch15/Para11(1) is still available as G's estate includes property (the company shares) which derives its value from the relevant property.

Note that in the second scenario above, the exemption still applies even though should G die non-UK domiciled the property will not be liable to Inheritance Tax because the shares in the offshore company will be excluded property (IHTM04260).

IHTM44055 exemptions: foreign element - foreign domiciliaries: settled property exemption [June 2016]

Where a person who is domiciled outside the UK creates a settlement that contains overseas property, that settlement is an excluded property settlement for Inheritance Tax purposes (IHTM27220). No regard is to be had to any such property for the purposes of the POA charge, FA04/Sch15/Para12(3). This provision provides an exemption for individuals who subsequently become domiciled in the UK and continue to benefit from the settled property and who would therefore no longer be able to rely on the foreign domiciliary exemption (IHTM44054).

If, having become domiciled in the UK the person adds property, wherever it may be situated, to the settlement, the added property may be subject to the POA charge in the normal way. If available, the exemptions and exclusions would apply as they would for any person domiciled in the UK.

The definition for excluded property for inheritance purposes includes interests in UK unit trusts, OEICs and gilts, but this is not extended to the POA charge.

83.26 Loan to trust

The IHT Manual provides

IHTM44113 insurance based products: gift and loan trust [Jun 2016]

A gift and loan trust is where the settlor makes a small gift into trust, possibly by way of an insurance policy and settles it on trusts for the benefit of others and from which the settlor is entirely excluded. They then make a substantial interest free loan to the trustees, repayable on demand. The trustees use the loan to purchase more policies, and make partial surrenders each year to pay off part of the loan.

> This arrangement is not a gift with reservation for inheritance tax. The settlor is not a beneficiary of the trust itself and the making of the loan does not constitute a settlement for the purposes of Inheritance Tax. No POA charge arises as the benefit to the settlor arises as a creditor and not under the trust.

83.27 Quantum of charge: Land

We find the usual cascade of definitions. Para 3(5) sch 15 FA 2004 provides:

> Where this paragraph applies to a person in respect of the whole or part of a year of assessment, an amount equal to the chargeable amount determined under para 4 is to be treated as income of his chargeable to income tax.

83.27.1 *Chargeable amount/deductions*

One therefore turns to para 4 sch 15 FA 2004 to find the quantum of the charge. Para 4(1) sch 15 FA 2004 provides:

> For any taxable period[71] the chargeable amount in relation to the relevant land is
> [a] the appropriate rental value ... less
> [b] the amount of any payments which, in pursuance of any legal obligation, are made by the chargeable person during the period to the owner of the relevant land in respect of the occupation of the land by the chargeable person.

To obtain a deduction requires good paperwork:
(1) a legal obligation; and
(2) payment to the owner of the relevant land.
This is straightforward in an *Eversden* scheme, but who is the "owner" of the land in an *Ingram* scheme (where there is a lease owned by T and a reversion owned by others)? Who is owner of the land in a home loan scheme (where the land is held by trustees)?

83.27.2 *"Appropriate rental value"*

This is defined in para 4(2) sch 15 FA 2004. This provides:

[71] "Taxable period" has common sense definition in para 4(6) sch 15 FA 2004:
"In this paragraph—
'the taxable period' means the year of assessment, or part of a year of assessment, during which para 3 applies to the chargeable person."

The appropriate rental value is R × (DV ÷ V)

In short, R is the **R**ental value; V is the capital **V**alue. DV ÷ V is (in a sense) the chargeable part of that value. **DV** stands, perhaps, for Disposal Value.

83.27.3 *"Rental value"*

R is the rental value of the relevant land for the taxable period. "Rental value" is defined in the same manner as the income tax benefit in kind rule: it means the "annual value".

"Annual value" is in turn defined in para 5 sch 15 FA 2004. That is copied from s.110 ITEPA, except that s.110(3), (4) are omitted. It is here called **"POA Annual Value"**. POA Annual Value is defined as the rent which will be payable *on the assumption that the landlord (rather than the tenant) pays for all repairs and insurance*. The normal market rent will be lower than the POA Annual Value, because market practice is that the *tenant* pays the cost of repairs and insurance. The difference between POA annual value and normal market rent will vary from one property to another. The difference would be greater with large properties which are expensive to maintain and insure. In relation to other benefits in kind provisions, such as s.87 and s.731, beneficiaries have sometimes been given the benefit of living accommodation on terms that they are responsible for maintenance and insurance. If the maintenance and insurance cost is substantial, they argue that the value of the benefit is small or sometimes even nil. It was perhaps to avoid these arguments that the legislation was framed in this way. It seems extraordinary if one thinks that the legislation is intended to charge income tax on a benefit in kind. However, the object of the legislation is really to penalise taxpayers who have carried out some IHT planning schemes and so it does make sense.

The wording is derived from rating legislation. There is a substantial amount of case law, and to research this the reader should refer to rating law textbooks.

Annual value for benefit in kind purposes is by concession taken to be the rateable value.[72] There is no reason to think that this concession will be applied for POA Annual Value.

POA Annual Value is therefore slightly above market rental value.

[72] See 39.18.1 ("Rental value").

83.27.4 *The proportion (DV ÷ V)*

The key expression is DV. Para 4(2) sch 15 FA 2004 provides:

> DV is—
>
> (a) in a case falling within para 3(2)(a)(i),[73]
>
> [i] the value as at the valuation date of the interest in the relevant land that was disposed of as mentioned in para 3(2)(b) by the chargeable person or,
>
> [ii] where the disposal was a non-exempt sale, the appropriate proportion of that value,
>
> (b) in a case falling within para 3(2)(a)(ii),[74]
>
> [i] such part of the value of the relevant land at the valuation date as can reasonably be attributed to the property originally disposed of by the chargeable person or,
>
> [ii] where the original disposal was a non-exempt sale, to the appropriate proportion of that property, and
>
> (c) in a case falling within para 3(3),[75] such part of the value of the relevant land at the valuation date as can reasonably be attributed to the consideration provided by the chargeable person, and
>
> V is the value of the relevant land at the valuation date.

The drafter does not deal with a case falling within the disposal and the contribution condition, eg if the individual disposes of an interest in a contract to purchase land to another person and also provides the purchase price.

83.27.5 *(DV÷V) and valuation date*

The valuation date is determined by the POA Regulations 2005. The Consultation Document "Taxation of Pre-Owned Assets: Further Consultation" 16 August 2004 explains:

> 5. In the case of land, the "cash equivalent" of enjoyment in a particular tax year is derived from market rental that would be paid for use of the land over the "taxable period" (that is, the tax year or any shorter period for which the asset is "caught" by Schedule 15). This figure is then scaled down, in cases where the taxpayer's "stake" in the caught asset is less than 100 per cent, in the proportion DV/V, where V is the value of the whole asset on the "valuation date" for the year, and

[73] ie disposal condition (i), see 83.4.1 (Disposal condition (i)).

[74] ie disposal condition (ii), see 83.4.2 (Disposal condition (ii)).

[75] ie the contribution condition, see 83.5 (Contribution conditions).

> DV is the value reasonably attributable to the taxpayer on that date. In many cases, however, we would expect that taxpayers and their advisors will be able to establish the ratio DV/V from the surrounding circumstances without necessarily establishing the absolute amount of V or DV.

83.27.6 *Non-exempt sale*

Para 4(4) sch 15 FA 2004 provides a relief for a "non-exempt" sale. Para 4(4) sch 15 FA 2004 begins with the definition of this term:

> The disposal by the chargeable person of an interest in land is a "non-exempt sale" if (although not an excluded transaction) it was a sale of his whole interest in the property for a consideration paid in money in sterling or any other currency;

The label ("non-exempt sale") is chosen, presumably, because the sale is not an excluded transaction. (Perhaps "non-excluded sale" would have been clearer.)

The relief is given by the method of re-defining "the appropriate proportion" to a smaller amount. Para 4(4) sch 15 FA 2004 continues:

> and, in relation to a non-exempt sale, "the appropriate proportion" is
> $(MV–P) \div MV$
> where—
> MV is the value of the interest in land at the time of the sale;
> P is the amount paid.

This will not often apply as a sale for full value will usually be an excluded transaction and a sale at an undervalue will probably qualify for the GWR exemption.

83.28 Quantum of charge: Chattels

Para 6(5) sch 15 FA 2004 provides:

> Where this paragraph applies to a person in respect of the whole or part of a year of assessment, an amount equal to the chargeable amount determined under para 7 is to be treated as income of his chargeable to income tax.

83.28.1 *Chargeable amount*

Para 7(1) sch 15 FA 2004 provides:

> For any taxable period the chargeable amount in relation to any chattel is

> [a] the appropriate amount (as determined under sub-para (2)),
> [b] less the amount of any payments which, in pursuance of any legal obligation, are made by the chargeable person during the period to the owner of the chattel in respect of the possession or use of the chattel by the chargeable person.

This follows the format of the POA land charge.

83.28.2 *Appropriate amount*

Para 7(2) sch 15 FA 2004 provides:

> The appropriate amount is N×(DV ÷ V)

In short, N is **N**otional interest. DV and V are similar to the POA land charge. In detail:

> N is the amount of the interest that would be payable for the taxable period[76] if interest were payable at the prescribed rate on an amount equal to the value of the chattel [at][77] the valuation date,
> DV is—
> (a) in a case falling within para 6(2)(a)(i),
> [i] the value as at the valuation date of the interest in the chattel that was disposed of as mentioned in para 6(2)(b) by the chargeable person or,
> [ii] where the disposal was a non-exempt sale,[78] the appropriate proportion of that value,
> (b) in a case falling within para 6(2)(a)(ii),
> [i] such part of the value of the chattel at the valuation date as can reasonably be attributed to the property originally disposed of by the chargeable person or,
> [ii] where the original disposal was a non-exempt sale, to the appropriate proportion of that property, and
> (c) in a case falling within para 6(3), such part of the value of the chattel at the valuation date as can reasonably be attributed to the consideration provided by the chargeable person, and
> V is the value of the chattel at the valuation date.

[76] Para 7(5) sch 15 FA 2004 provides that "the taxable period" means the year of assessment, or part of a year of assessment, during which para 6 sch 15 FA 2004 applies to the chargeable person.

[77] The statute erroneously reads "as".

[78] Non-exempt sale is defined in para 7(3) sch 15 FA 2004 following the form of the POA land charge: see 83.27.6 (Non-exempt sale).

83.29 Quantum: Intangible property

Para 8(3) sch 15 FA 2004 provides:

> Where this paragraph applies in respect of the whole or part of a year of assessment, an amount equal to the chargeable amount determined under para 9 is to be treated as income of the chargeable person chargeable to income tax.

83.29.1 *Chargeable amount*

Para 9(1) sch 15 FA 2004 provides:

> For any taxable period the chargeable amount in relation to the relevant property is N minus T

In short, **N** is **N**otional income; **T** is **T**ax payable. In more detail:

> N is the amount of the interest that would be payable for the taxable period[79] if interest were payable at the prescribed rate on an amount equal to the value of the relevant property at the valuation date, and
>
> T is the amount of any income tax or capital gains tax payable by the chargeable person in respect of the taxable period by virtue of any of the following provisions—
> (a) section 461 [ITTOIA],
> (b) section 624 [ITTOIA],
> (c) sections 720 to 730 [ITA],
> (d) section 77 [TCGA], and
> (e) section 86 [TCGA],
> so far as the tax is attributable to the relevant property.

Setting notional income against tax is penal and bizarre, but then, the POA regime is bizarre and intended to be penal.

There is no provision for carry forward or back if T exceeds N (but that will be rare).

If foreign income is unremitted and no tax is paid because of the s.624 remittance basis, it is considered that the amount of T is nil.

83.29.2 *Valuation date*

Para 9 sch 15 FA 2004 continues:

[79] Para 9(3) sch 15 FA 2004 provides:
"'the taxable period' means the year of assessment, or part of a year of assessment, during which para 8 applies to the chargeable person".

> (2) Regulations may, in relation to any valuation date, provide for a valuation of the relevant property by reference to an earlier valuation date to apply subject to any prescribed adjustments.
> (3) In this paragraph—
>
> ...
>
> "the valuation date", in relation to a year of assessment, means such date as may be prescribed.

The date is prescribed in the POA Regulations 2005.

83.30 Land/intangibles charge overlap

Para 18 sch 15 FA 2004 provides:

> *Persons chargeable under different provisions by reference to same property*
> (1) Where, in any year of assessment, a person ("the chargeable person") is (apart from this paragraph) chargeable to income tax both—
> (a) under para 3 (land) or para 6 (chattels) by reason of his occupation of any land or his possession or use of any chattel, and
> (b) under para 8 (intangible property) by reference to any intangible property which derives its value (whether in whole or part) from the land or the chattel,
>
> he is to be charged to income tax under whichever provision produces the higher chargeable amount in relation to him.
> (2) Where sub-para (1) applies, only the amount under the paragraph under which he is chargeable is to be taken into account in relation to the chargeable person for the purposes of para 13(2).

83.31 Interaction with benefits in kind

Para 19 sch 15 FA 2004 provides:

> Where, in any year of assessment, a person is (apart from this paragraph) chargeable, in respect of his occupation of any land or his possession or use of any chattel, to income tax both—
> (a) under this Schedule, and
> (b) under Part 3 of ITEPA,
>
> the provisions of that Part shall have priority and he shall not be chargeable to income tax under this Schedule, except to the extent that the amount chargeable under this Schedule exceeds the amount to be treated as earnings under that Part.

83.32 *De minimis* exemption

The Press Release announcing the POA regime promised "a substantial *de minimis* exemption" (*sic*). This turned out to be £5,000 per annum. As this book predicted, the "substantial" £5,000 figure has not been raised in line with inflation.

Para 13 sch 15 FA 2004 provides:

> (1) This paragraph applies where, in relation to any person who would (apart from this para) be chargeable under this Schedule for any year of assessment, the aggregate of the amounts specified in sub-para (2) in respect of that year does not exceed £5,000.
>
> (2) Those amounts are—
>
> (a) in relation to any land to which para 3 applies in respect of him, the appropriate rental value as determined under para 4(2),
>
> (b) in relation to any chattel to which para 6 applies in respect of him, the appropriate amount as determined under para 7(2), and
>
> (c) in relation to any intangible property to which para 8 applies in respect of him, the chargeable amount determined under para 9.
>
> (3) Where this para applies, the person is not chargeable for that year of assessment under any of the following provisions—
>
> (a) para 3(5) (land),
>
> (b) para 6(5) (chattels), or
>
> (c) para 8(3) (intangible property).

This is significant if annual value is (contrary to my expectation) construed by concession to mean rateable value. It could also be significant where husband and wife entered into IHT planning arrangements jointly, since each have their own separate allowance. The exception applies to the "appropriate rental value", so deductible expenses are not relevant. Another problem here is that the £5,000 limit must be satisfied every year.

The *de minimis* limit is not time apportioned so the full £5,000 can be set against a much shorter period of deemed income.

It is therefore necessary to ascertain "the appropriate rental value". That takes us to para 4(2) sch 15 FA 2004:

> The appropriate rental value is R×(DV/V) where
>
> R is the rental value of the relevant land *for the taxable period*

The "taxable period" is defined in para 4(6) sch 15 FA 2004:

> "the taxable period" means the year of assessment, or part of a year of

assessment, during which para 3 applies to the chargeable person.

Thus it seems clear that if para 3 sch 15 FA 2004 only applies for part of the year, the taxable period is reduced, so R is reduced, so the "appropriate rental value" is reduced and so (carrying the chain to the end) the *de minimis* exemption may apply. Note that the estate exemption in para 11(1) sch 15 FA 2004 disapplies para 3 sch 15 FA 2004: see para 11(1) sch 15 FA 2004.

83.33 POA election

One can elect out of the POA regime at an IHT cost. Para 21 sch 15 FA 2004 deals with the POA land and chattels charges. Para 22 sch 15 FA 2004 deals with intangible property. They are not quite the same but for reasons of space I only cover the former.

83.33.1 *Conditions for election*

Para 21(1) sch 15 FA 2004 provides

> This paragraph applies where—
> (a) a person ("the chargeable person") would (apart from this paragraph) be chargeable under para 3 (land) or para 6 (chattels) for any year of assessment ("the initial year") by reference to his enjoyment[80] of any property ("the relevant property"), and
> (b) he has not been chargeable under the paragraph in question in respect of any previous year of assessment by reference to his enjoyment
> [i] of the relevant property, or
> [ii] of any other property for which the relevant property has been substituted.

If an election is made by mistake (because the POA regime does not in fact apply) it has no effect.

83.33.2 *Effect of election*

Para 21(2) sch 15 FA 2004 provides:

[80] "Enjoyment" is defined in para 21(4) sch 15 FA 2004:
"For the purposes of this paragraph a person 'enjoys' property if—
(a) in the case of an interest in land, he occupies the land, and
(b) in the case of an interest in a chattel, he is in possession of, or has the use of, the chattel."

> The chargeable person may elect in accordance with para 23 that—
> (a) the preceding provisions of this Schedule shall not apply to him during the initial year and subsequent years of assessment by reference to his enjoyment of the relevant property or of any property which may be substituted for the relevant property ...

This disapplies schedule 15. The price is in sub-para (b):

> ..., but
> (b) so long as the chargeable person continues to enjoy the relevant property or any property which is substituted for the relevant property—
> (i) the chargeable proportion of the property is to be treated for the purposes of Part 5 of FA 1986 (in relation to the chargeable person) as property subject to a reservation, but only so far as the chargeable person is not beneficially entitled to an interest in possession in the property,
> (ii) section 102(3) and (4) of that Act shall apply, but only so far as the chargeable person is not beneficially entitled to an interest in possession in the property, and
> (iii) if the chargeable person is beneficially entitled to an interest in possession in the property, sections 53(3) and (4) and 54 of IHTA 1984 (which deal with cases of property reverting to the settlor etc) shall not apply in relation to the chargeable proportion of the property.

Suppose a former foreign domiciliary makes an election in relation to a discretionary trust of which they are a beneficiary and the property is excluded property. How does s.102(3) apply? See 78.15 (Death: settled excluded property).

83.33.3 *Chargeable proportion*

This takes us to the definition of "chargeable proportion" in para 21(3) sch 15 FA 2004:

> In this paragraph, "the chargeable proportion", in relation to any property, means DV ÷ V
> where DV and V are to be read in accordance with para 4(2) or 7(2), as the case requires, but as if—
> (a) any reference in para 4(2) or 7(2) to the valuation date were a reference—
> (i) in the case of property falling within subsection (3) of section 102 of the FA 1986, to the date of the death of the

> chargeable person, and
> (ii) in the case of property falling within subsection (4) of that section, to the date on which the property ceases to be treated as property subject to a reservation, and
> (iii) in the case of property in which the chargeable person is beneficially entitled to an interest in possession, to the date of his death or if his interest comes to an end on an earlier date) that earlier date, and
>
> (b) the transactions to be taken into account in calculating DV included transactions after the time when the election takes effect as well as transactions before that time.

I do not see the purpose or effect of para 21(3)(b) sch 15 FA 2004. How does this work in the case of an *Ingram* scheme?

83.33.4 *Time limit for election*

Para 23(3) sch 15 FA 2004 provides:

> The election must be made on or before—
> (a) the relevant filing date, or
> (b) such later date as an officer of Revenue and Customs may, in a particular case, allow..

The key expression is "relevant filing date" which is defined in para 23(1) sch 15 FA 2004:

> "the relevant filing date" means 31 January in the year of assessment that immediately follows the initial year within the meaning of para 21 or (as the case requires) para 22.

Time runs from when the schedule begins to apply. Normally that will be 6 April 2005,[81] because in the future no-one will deliberately enter into arrangements caught by the schedule. But where a person is non-resident or domiciled, the schedule may not begin to apply until a later time when they become UK resident or domiciled, and in such a case time for the election starts at that later time; a sensible rule.

83.33.5 *Revocation of election*

Para 23(5) sch 15 FA 2004 provides:

[81] Or 6 April 2007 for those caught by the reverter to settlor restriction in the FA 2006; see 83.20 (Reverter to settlor restriction).

> The election may be withdrawn or amended, during the life of the chargeable person, at any time on or before the relevant filing date.

This will only be useful in very exceptional circumstances.

83.33.6 *Retrospective effect of election*

Para 23(6) sch 15 FA 2004 provides:

> Subject to sub-para (5), the election takes effect for the purposes of inheritance tax from the beginning of the initial year within the meaning of para 21 or (as the case requires) para 22 or, if later, the date on which the chargeable person would (but for the election) have first become chargeable under this Schedule by reference to the property to which the election relates.

83.34 Election: *Eversden* scheme

If a client has lost their appetite for IHT planning, it would be better to unwind an *Eversden* scheme than to elect. Unwinding an *Eversden* scheme is straightforward.

By contrast, unwinding home loan schemes needs considerable care. Watch out for the proper purpose rule.

83.35 Election: Home loan scheme

Suppose:

(1) The client ("H") has entered into a home loan plan: H has sold H's home to a trust (before 22 March 2006) ("the property settlement") in return for a debt, and given away the debt.

(2) Under the terms of the property settlement, income is paid to H for life, and then for H's widow ("W") after H's death.

(3) Suppose first of all that the home has not increased in value, so that the net value of the trust fund of the property settlement is nil.

(4) A POA election has been made.

(5) H is survived by W.

83.35.1 *Effect of election*

The chargeable proportion (here = the whole) of the property:

> is to be treated for the purposes of Part 5 of FA 1986 (in relation to the chargeable person) as property subject to a reservation.

So it is treated as property to which H is beneficially entitled.

However, H is already entitled to the property as H has an interest in possession in it. The property is subject to the debt. Is this taken into account in valuing the estate of H on H's death? If so the debt scheme still works! In *IRC v Ayrshire Employers Mutual Insurance Association* 27 TC 331 the House of Lords notoriously said that the legislation had "misfired". But the modern approach of the courts is to make sure that legislation does not "misfire" if they can. Indeed this approach is not so modern, and in 1965 Lord Diplock criticised the *Ayrshire* decision:

> If the Courts can identify the target of Parliamentary legislation their proper function is to see that it is hit: not merely to record that it has been missed.

83.35.2 *Spouse exemption*

The IHT spouse exemption provides that the transfer of value deemed to be made on the death of H:

> ... is an exempt transfer to the extent that the value transferred is
> [a] attributable to property which becomes comprised in the estate of the transferor's spouse or civil partner; or
> [b] so far as the value transferred is not so attributable, to the extent that the estate is increased.

See s.18(1) IHTA 1984.

H does not qualify for exemption within [b]. We have to argue that the value transferred is "attributable to property" (the home) "which becomes comprised in the estate of the spouse or civil partner".

Does it? Only subject to the debt. The Revenue may reply that "property" in s.49(1) IHTA means net property and this is supported by *St Barbe Green v IRC*:

> Section 49(1) IHTA 1984 [deems] the deceased to be beneficially entitled to "the property" in which his life interest subsists. It does not say "net property" (i.e. the value of the property net of trust liabilities) but that is what it must mean, and the parties to this appeal both agree that in practice that is the effect the Revenue gives to the section.[82]

On the facts of the above example, no net property becomes comprised in the estate of the spouse. A purposive construction supports that view. It does not make sense for the spouse exemption to apply there.

The spouse exemption would apply to the extent that the value of the

[82] [2005] STC 288.

property exceeds the debt.

If the debt were released, the problem disappears and it is clear that the spouse exemption would apply.

83.36 Unwinding existing structures

What is to be done when an existing structure falls within the POA land charge?

Do nothing and pay the POA tax? A suitable option where the client has a short life expectancy. Mitigate the charge by arranging that maintenance costs are deductible: see 83.27.1 (Chargeable amount and deductible expenses).

Elect out of the POA regime? Generally unattractive: you have the IHT charge on death usually without CGT uplift or spouse exemption on death.[83] Consider it if IHT is a long term problem (middle-aged clients). Perhaps a future government will scrap these rules in a decade or so's time.

It may be sensible to elect and retain the structure where:

(1) IHT is not a problem (eg insurance is inexpensive);
(2) Shadow directorship is not a problem (expect an investigation to follow the election); and
(3) A sale of the company is envisaged in the short or medium term. See 83.6.3 (Secondhand company).

In most cases shadow directorship may be a problem; it will usually be better to liquidate the company if IHT, CGT and SDLT issues permit.

The best solution is usually unwinding, or reorganising so as to fall within the estate exemption.

83.37 Is existing scheme validly created

In *Wolff v Wolff* [2004] STC 1633, a husband and wife entered into a reversionary lease of the property in favour of their daughters for 125 years starting from 2017. Subsequently, they became aware that from 2017 they had no right to stay in the property and were at the mercy of the owners of the lease! The lease was set aside for mistake.

83.38 Human rights

The Parliamentary Joint Committee on Human Rights considered the

[83] See 78.19 (GWR on death charge: Spouse exemption).

POA provisions to be HR compliant[84] – except (intriguingly) in relation to the spouse exemptions (which deny relief to cohabitees) but no-one took any notice of that. The prospect of a successful human rights challenge now seems slender.

83.39 Critique

83.39.1 *Nature of POA charge*

What is the nature of the POA charge? Although the charge is imposed under the Income Tax Acts, it is not an income tax (in the sense that it is not a tax on income or in any way relating to income). To put it another way, the provisions impose an income tax charge on income which does not exist. Once it is accepted that income tax is not in general charged on an individual who occupies their own property[85] then it is anomalous to charge income tax on the benefit of occupation through a trust or company. And since the POA intangible property charge applies even if the property also produces income subject to income tax, it is obviously not income which Schedule 15 is seeking to tax.

The POA charge might be seen as an *ersatz* annual IHT charge on property which has slipped through the IHT net.[86] However, the quantum of the charge is penal (compared to IHT rates).

The true nature of the POA charge is therefore that it is a penalty for carrying out (and not unwinding) certain IHT planning. Hardly anyone is seriously expected to pay it. The object is to force taxpayers (by electing or unwinding) to bring themselves back into the IHT net.[87] The POA charge takes the clothes or label of income tax, but – looking beyond the label to the content – it is not income tax; indeed, it is not a "tax" at all, as that word is properly understood. It is well established that a fee, levy or toll may in fact be a tax despite its name.[88] Likewise provisions carrying the label of a tax do not necessarily constitute a tax.

This point may be relevant to construction, because the principle of construction that penalty provisions are to be strictly construed may have more force than the principle that clear words are required to impose a

[84] *http://www.publications.parliament.uk/pa/jt200304/jtselect/jtrights/93/9305.htm*

[85] See Kay and King, *The British Tax System* (5th ed., 1990), p.80.

[86] It is significant that the pre-owned asset charge is dealt with in IHT textbooks and in the HMRC IHT Manual.

[87] And to stop similar arrangements being made in the future.

[88] *Re a By-law of the Auckland City Council* [1924] NZLR 907 at p.911.

tax.

83.39.2 *Retrospectivity*

One controversial aspect of the POA regime is that it is retrospective in effect. (One should avoid semantic – indeed Orwellian – debate about the meaning of "retrospective" and look at the effect.) Retrospective legislation is pernicious when it entails liability for conduct which would have been different if the agent had known of the terms of the retrospective law. The POA rules are unashamedly targeted at taxpayers who carried out *Eversden*, *Ingram* and home loan schemes before these were stopped by anti-avoidance legislation.

Those that carried out *Ingram* schemes were particularly unfairly treated. They entered into a package with an IHT advantage (generally) at a significant CGT cost. Parliament removed the benefit and left them with the cost. In 2004 I said:

> This is unprecedented in the UK tax system, which has traditionally allowed taxpayers to plan their affairs more securely on the basis of the law of the day. One may approve of this as an attack on tax avoidance, or disapprove as contrary to the rule of law. Views may divide on party political lines.

Since 2004, however, retrospective tax legislation has become a matter of routine.[89]

83.39.3 *Assessment*

No doubt the POA rules bring some revenue for the Government, though how much is a matter of speculation. Set against the tax raised (whatever it is) and the blow against tax avoidance (however one values or regards that) there are some entries to make on the debit side: the POA rules impose significant costs of compliance and tax planning (for they require taxpayers to incur professional fees in order to rearrange their affairs). They impose the unquantifiable burden of complexity and uncertainty which (combined with unfairness) will lead to an equally unquantifiable loss of taxpayer goodwill. One cannot put a value on that goodwill, but it is essential to successful tax administration.

Back in 2004, I think everyone who understood and cared about the UK tax system was aghast at the conception, enactment process and

[89] See 2.9 (Retrospective tax legislation).

administration of the POA provisions.[90] Looking back with hindsight it can be seen that the provisions were not an aberration. They are the natural result of a fiscal policy with one and only one priority, the attack on tax avoidance, set against which any other *desiderata* of a tax system count for very little and views of practitioners count for nothing at all.

The House of Commons Treasury Committee cite Pre-owned Assets as a paradigm of bad anti-avoidance legislation:

> 53. The charge on non-domiciled individuals is only one example of a tax whose imposition may have had unforeseen consequences. For example, the Finance Act 2004 introduced rules intended to clamp down on the avoidance of inheritance tax. Someone who gave away an asset but who later benefits from that asset may now be subject to an income tax charge. The intention was to close a loophole relating to inheritance tax; imposing a potential charge which can affect a wider population leads to unwelcome complexity. The likelihood is that many people do not realise they are caught, still less that they should be paying income tax in consequence. **Tax policy must be clearly targeted, so that taxpayers can have certainty about which rules apply to them.**[91]

OTS discussed the topic in two sentences, and called for a review,[92] but no-one took any notice of that.

The HMRC change of view that home loan schemes are caught by the GWR rules is icing on the cake of poor administration.

It is suggested that:

(1) The POA intangible property charge should be repealed except for transactions carried out before the anti-Eversden legislation enacted in 2003. That would be more or less a repeal.

(2) The POA land and intangible property should be repealed and replaced by an IHT charge on the death of the person who carried out

[90] "The anti-avoidance Pre-Owned Assets regime ... is: retrospective in its effect, disproportionate to the mischief at which it is purportedly aimed, contrary to taxpayers' legitimate expectations, and arbitrary ... ."
CIOT and ICAEW Tax Faculty (October 2004).

[91] House of Commons Treasury Committee, "Principles of tax policy" (2011)
http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/753/753.pdf

[92] OTS, "Inheritance Tax Review – second report: Simplifying the design of Inheritance Tax (July 2019) para 7.15.
https://www.gov.uk/government/publications/ots-inheritance-tax-review-simplifying-the-design-of-the-tax

Ingram or Home Loan arrangements (with credit for POA charges if paid). If this was restricted to death after the new rules comes in, it should not be regarded as offensively retrospective.

That would be a valuable simplification.

CHAPTER EIGHTY FOUR

PENSION SCHEMES AND IHT

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84.1 Scope of chapter

This chapter considers IHT aspects of pension schemes. I consider the matter in the round but do not attempt to be comprehensive.

84.2 Pension scheme history

Hosking comments on the early history of pensions:[1]

[1] Hosking, *Pension Schemes and Retirement Benefits* (1956) which is a second edition of Hosking & Lane, *Superannuation Schemes* (1948).

> Although pension schemes for employees existed in this country in the latter part of the 19th century, it was the raising of the level of taxation during World War 1 which brought home to many employers the desirability of taking out of their business assets money representing the accruing liability, moral or legal, for pensions for their employees and setting it aside as a separate entity in the form of a trust or under a contract with a Life Office. ... The FA 1956 has opened up a new era in pension provision. Until it was passed it was only those in pensionable employment for whom pension provision could be made economically. Now controlling directors, those who are self-employed and also employees in non-pensionable employment can save for their old age.

And he continues with a comment with contemporary resonance:

> While in essence the principles involved are simple, the provisions of the Act are complicated and several chapters are devoted to their elucidation...

There was another major change in 2006, when a single set of rules was introduced to replace the previous eight different regimes.

84.3 Types of pension scheme

There are countless types of pension scheme. The following is not a full list:

Type of scheme: current law	**Abbreviation**	**Definition**	**See para**
IHT-exempt schemes			
Registered pension scheme	RPS	Pt 4 FA 2004	84.4
Overseas pension scheme		s.150(7) FA 2004	
Qualifying non-UK pension scheme	QNUP	s.171A IHTA	84.5
Section 615(3) scheme	-	s.615(3) ICTA	84.7
Employer-financed retirement benefits scheme	EFURBS	s.393A ITEPA	84.8
Type of scheme: pre-2006 law	**Abbreviation**	**Definition**	**See para**
Sponsored superannuation scheme	SSS	s.624 ICTA	84.9
Retirement benefits scheme		s.611 ICTA	
Non-approved retirement benefits scheme		s.387 ITEPA	
Approved scheme		s.612(1) ICTA	
Relevant statutory scheme		s.611A ICTA	

FURBS (funded unapproved retirement benefit scheme) is not a statutory term (unlike EFURBS with the initial *E*). FURBS is used to describe an unapproved pension scheme funded with employer contributions, typically, I think, a SSS funded pre-2006.

Statute frequently refers to 3 types of scheme:

(1) a registered pension scheme
(2) a qualifying non-UK pension scheme
(3) a s.615(3) scheme

I refer to these together as **"IHT-exempt schemes"**. (This term, as I use it, does not include other types of scheme which can qualify for some IHT relief, such as an SSS).

Funded schemes may be **"trust-based"**, ie the funds are held in trust; or **"contract-based"** ie the scheme takes the form of a contract with a Life Office.

84.4 Registered pension scheme

84.4.1 *Pension scheme*

Section 150 FA 2004 provides:

> (1) In this Part [Part 4 FA 2004] "pension scheme" means a scheme or other arrangements, comprised in one or more instruments or agreements, having or capable of having effect so as to provide benefits to or in respect of persons—
> (a) on retirement,
> (b) on death,
> (c) on having reached a particular age,
> (d) on the onset of serious ill-health or incapacity, or
> (e) in similar circumstances.

84.4.2 *Registered pension scheme*

Section 272 IHTA provides the definition by reference:

> registered pension scheme" has the same meaning as in Part 4 of the Finance Act 2004;

Section 150(2) FA 2004 provides:

> A pension scheme is a registered pension scheme for the purposes of this Part at any time if it is at that time registered under Chapter 2.

Schemes that were approved before then were automatically registered on that date.

84.5 Qualifying non-UK pension scheme

Section 271A IHTA provides the definition for QNUP:

> (1) For the purposes of this Act "qualifying non-UK pension scheme" means a pension scheme (other than a registered pension scheme) which—
> (a) is established in a country or territory outside the UK, and
> (b) satisfies any requirements prescribed for the purposes of this section by regulations made by the Commissioners for Her Majesty's Revenue and Customs.
>
> (2) "Pension scheme" has the same meaning as in Part 4 of the Finance Act 2004 (see section 150 of that Act).

The regulations are Inheritance Tax (Qualifying Non-UK Pension Schemes) Regulations 2010 ("QNUPR"). Reg 3 QNUPR provides:

> These Regulations apply to pension schemes which are established in a country or territory outside the UK.

84.6 QNUP: Schemes recognised abroad

Regulation 4 QNUPR provides:

> (1) For the purposes of section 271A of the Inheritance Tax Act 1984 (qualifying non-UK pension scheme) a pension scheme must-
> (a) be recognised for tax purposes under the tax legislation of the country or territory in which it is established (see regulation 5) and satisfy regulation 6 ...

Reg 5 QNUPR provides:

> (1) A scheme is recognised for tax purposes under the tax legislation of a country or territory in which it is established if it meets both Primary Condition 1 and Primary Condition 2 and either Condition A or Condition B.

84.6.1 *Primary Conditions*

Reg 5(1) QNUPR continues:

> Primary Condition 1
> The scheme is open to persons resident in the country or territory in which it is established.
> Primary Condition 2
> The scheme is established in a country or territory where there is a system of taxation of personal income under which tax relief is available in respect of pensions and-
> (a) tax relief is not available to the member on contributions made to the scheme by the member or, if the member is an employee,

> by their employer, in respect of earnings to which benefits under the scheme relate;
>
> (b) the scheme is liable to taxation on its income and gains and is of a kind specified in the Schedule to these Regulations; or
>
> (c) all or most of the benefits paid by the scheme to members who are not in serious ill-health are subject to taxation.
>
> For the purposes of this condition "tax relief" includes the grant of an exemption from tax.

84.6.2 *Conditions A & B*

Reg 5 QNUPR provides:

> Condition A
>
> (2) The scheme is approved or recognised by, or registered with, the relevant tax authorities as a pension scheme in the country or territory in which it is established.
>
> Condition B
>
> (3) If no system applies for the approval or recognition by, or registration with, relevant tax authorities of pension schemes in the country or territory in which it is established-
>
> (a) the scheme must be resident there;
>
> (b) the scheme rules must provide that at least 70% of a member's relevant scheme funds[2] will be designated by the scheme manager for the purpose of providing the member with an income for life, or, in the case of a member who has died, so provided immediately before the member's death; and
>
> (c) the pension benefits payable to the member under the scheme (and any lump sum associated with those benefits) must be payable no earlier than they would be if pension rule 1 applied.[3]

84.6.3 *Recognition*

Reg 6 QNUPR provides:

> (1) This regulation is satisfied if paragraph (2), (3) or (4) applies.

[2] Defined in reg 2: "relevant scheme funds" means any sums and assets held under a pension scheme-

(a) to which these Regulations apply, and

(b) which would be subject to inheritance tax if the scheme did not meet the requirements for a qualifying non-UK pension scheme.

[3] Defined reg 2: "pension rule 1" means pension rule 1 in section 165 of the Finance Act 2004.

> (2) This paragraph applies if the scheme is an occupational pension scheme and there is a body in the country or territory in which it is established-
>
> (a) which regulates occupational pension schemes; and
>
> (b) which regulates the scheme in question.
>
> (3) This paragraph applies if the scheme is not an occupational scheme and there is a body in the country or territory in which it is established-
>
> (a) which regulates pension schemes other than occupational pension schemes; and
>
> (b) which regulates the scheme in question.
>
> (4) This paragraph applies if neither paragraph (2) nor (3) applies by reason only that no such regulatory body exists in the country or territory and-
>
> (a) the scheme is established in a member State, Norway, Iceland or Liechtenstein; or
>
> (b) the scheme is one where-
>
> (i) the scheme rules provide that at least 70% of a member's relevant scheme funds will be designated by the scheme manager for the purpose of providing the member with an income for life, or, in the case of a member who has died, so provided immediately before the member's death, and
>
> (ii) the pension benefits payable to the member under the scheme (and any lump sum associated with those benefits) are payable no earlier than they would be if pension rule 1 applied.
>
> (5) In this regulation "occupational pension scheme" has the meaning given by section 150(5) of the Finance Act 2004.

84.6.4 QNUP: International organisations

Regulation 4 QNUPR provides:

> (1) For the purposes of section 271A of the Inheritance Tax Act 1984 (qualifying non-UK pension scheme) a pension scheme must ...
>
> (b) be established by an international organisation for the purpose of providing benefits for, or in respect of, past service as an employee of the organisation and satisfy regulation 7.
>
> (2) In this regulation "international organisation" means an organisation to which section 1 of the International Organisations Act 1968 applies by virtue of an Order in Council under subsection (1) of that section.

Reg 7 QNUPR provides:

> This regulation is satisfied if-
> (a) the scheme rules provide that at least 70% of a member's relevant scheme funds will be designated by the scheme manager for the purpose of providing the member with an income for life, or, in the case of a member who has died, so provided immediately before the member's death, and
> (b) the pension benefits payable to the member under the scheme (and any lump sum associated with those benefits) are payable no earlier than they would be if pension rule 1 applied.

84.7 Section 615(3) scheme

Section 272 IHTA provides the definition by reference:

> section 615(3) scheme" means a superannuation fund to which section 615(3) of the Taxes Act 1988 applies;

So we turn to s.615 ICTA, which still survives in the 1988 Act. Section 615(3) is an exemption from withholding tax on pension payments. Section 615(6) ICTA provides:

> (6) Subsection (3) above applies to any superannuation fund which—
> (a) is bona fide established under irrevocable trusts in connection with some trade or undertaking carried on wholly or partly outside the UK;
> (b) has for its sole purpose (subject to any enactment or Northern Ireland legislation requiring or allowing provision for the value of any rights to be transferred between schemes or between members of the same scheme) the provision of superannuation benefits in respect of persons' employment in the trade or undertaking wholly outside the UK;
> (c) is recognised by the employer and employed persons in the trade or undertaking; and
> (d) meets the benefit accrual condition (see subsection (6A)).

In short, s.613(3) schemes are pension schemes for undertakings outside the UK. This overlaps with QNUPs. I leave the reader to follow the trail from there unaccompanied.

84.8 EFURBS

Section 393A ITEPA provides:

> (1) In this Chapter "employer-financed retirement benefits scheme"

means a scheme[4] for the provision of benefits consisting of or including relevant benefits to or in respect of employees or former employees of an employer.

(2) But neither—

(a) a registered pension scheme, nor

(b) a section 615(3) scheme,

is an employer-financed retirement benefits scheme.

84.9 Sponsored superannuation scheme

This type of scheme ("SSS") was introduced in 1956. The definition was most recently found in s.624 ICTA 1988. This was repealed by FA 2004 with effect from 6 April 2006, but the term is relevant for 2006-SSS reliefs.[5]

Section 624 ICTA provided:

> *(1) ... "a sponsored superannuation scheme" means a scheme or arrangement—*
>
> *(a) relating to service in particular offices or employments, and*
>
> *(b) having for its objects or one of its objects to make provision in respect of persons serving in those offices or employments*
>
> *[i] against future retirement or partial retirement,*
>
> *[ii] against future termination of service through death or disability, or*
>
> *[iii] against similar matters,*
>
> *[c] being a scheme or arrangement under which any part of the cost of the provision so made is or has been borne[6] otherwise than by those persons by reason of their service*
>
> *[d] (whether it is the cost or part of the cost*
>
> *[i] of the benefits provided, or*

[4] Section 393A(4) ITEPA provides an (unnecessary) definition:
"Scheme" includes a deed, agreement, series of agreements, or other arrangements.
See App 2.2.2 (Scheme or arrangement).

[5] See 84.17 (2006-SSS reliefs).

[6] Bearing the cost was defined in s.624(2) ICTA:
For the purposes of subsection (1) above a person shall be treated as bearing by reason of his service the cost of any payment made or agreed to be made in respect of his service, if
[a] that payment or the agreement to make it is treated under the Income Tax Acts as increasing his income, or
[b] would be so treated if he were chargeable to tax under section 15 of ITEPA 2003 in respect of his general earnings from that service.

> *[ii] of paying premiums or other sums in order to provide those benefits, or*
> *[iii] of administering or instituting the scheme or arrangement).*

The IHT Manual provides:

> **IHTM17039 Sponsored Superannuation Schemes**
> The provision of the benefits does not need to be the main object of the scheme.
> Some employee benefit trusts (IHTM42900) set up before 6 April 2006 will also be sponsored superannuation schemes, even though the only superannuation benefit they provide is a death or disability in service payment.

84.10 IHT-exempt pension schemes: reliefs

As there are many charges to IHT, there are a number of distinct reliefs, which are scattered across the IHT legislation.

84.10.1 *Contribution to exempt scheme*

A contribution to a scheme is not a transfer of value for various reasons:
(1) A contribution by a member would not normally reduce their estate
(2) A contribution by an employer would qualify for relief under s.12(1) IHTA.

But if there are any gaps, s.12(2) IHTA fills them:

> Without prejudice to subsection (1) above, a disposition made by any person is not a transfer of value if it is a contribution under
> [a] a registered pension scheme,
> [b] a qualifying non-UK pension scheme or
> [c] a s.615(3) scheme in respect of an employee of the person making the disposition.

84.10.2 *Relief for 10-year/exit charges*

Section 58 IHTA provides:

> (1) In this Chapter [Chapter 3 Part 3 IHTA] "relevant property" means settled property in which no qualifying interest in possession subsists, other than ...
> (d) property which is held for the purposes of
> [i] a registered pension scheme,
> [ii] a qualifying non-UK pension scheme or

> [iii] a (3) scheme;[7]

The effect is that IHT-exempt schemes are outside the scope of IHT 10-year and exit charges.[8]

84.10.3 *Limited relief for pension rights*

Section 151(2) IHTA provides a relief for pension or annuity rights:

> [A] An interest in or under
> [i] a registered pension scheme,
> [ii] a qualifying non-UK pension scheme or
> [iii] a section 615(3) scheme which comes to an end on the death of the person entitled to it ...

That is, in my terminology, an interest in/under an IHT-exempt scheme...

> ... shall be left out of account in determining for the purposes of this Act the value of his estate immediately before his death,
> [B] if the interest—
> (a) is, or is a right to, a pension or annuity, and
> (b) is not an interest resulting (whether by virtue of the instrument establishing the scheme or otherwise) from the application of any benefit provided under the scheme otherwise than by way of a pension or annuity.

That is a limited exception, so if a member has other rights under a scheme, these are in principle assets of their estate and subject to IHT on a lifetime gift or on death.

The ABI guidance note provides:

> 5.8 A claim might arise under section 3(1) of the Act where the death benefit is assigned whilst the member is in ill health. Although the death benefit and the pension rights are mutually exclusive, at the date of assignment both remain potentially available. The section 3(1) claim is on the loss to the estate, i.e:
> - the open market value of the whole plan, i.e. the death benefits, less
> - the value of the pension rights retained at that date,
> i.e. the maximum commutable lump sum plus the value of the 10 year guaranteed annuity payable monthly in advance which the remainder of

[7] Defined in s.272 IHTA: "section 615(3) scheme" means a superannuation fund to which section 615(3)of the Taxes Act 1988 applies".

[8] See 74.8 (Relevant property).

> the fund would purchase.
> 5.9 Where any existing bolt-on term assurance exists (e.g. under IHTA84/S226A) and is assigned in similar circumstances a claim may also arise. The claim would be based on the open market value of the term assurance, which would be dependant inter alia on the individuals state of health.

84.10.4 *Relief for omission to exercise right*

Section 12A IHTA provides a relief for IHT-exempt schemes:

> (1) Where a person has a drawdown fund, section 3(3) above[9] does not apply in relation to any omission that results in the fund not being used up in the person's lifetime.
> (2) For the purposes of subsection (1) above, a person has a drawdown fund if the person has—
> (a) a member's drawdown pension fund,
> (b) a member's flexi-access drawdown fund,
> (c) a dependant's drawdown pension fund,
> (d) a dependant's flexi-access drawdown fund,
> (e) a nominee's flexi-access drawdown fund, or
> (f) a successor's flexi-access drawdown fund, and
> in respect of a money purchase arrangement under a registered pension scheme.

These terms are defined by reference in s.12A(4) IHTA:

> (4) In this section ...
> "money purchase arrangement" has the same meaning as in Part 4 of the Finance Act 2004 (see section 152 of that Act);
> "member's drawdown pension fund", "member's flexi-access drawdown fund", "dependant's drawdown pension fund", "dependant's flexi-access drawdown fund", "nominee's flexi-access drawdown fund" and "successor's flexi-access drawdown fund" have the meaning given, respectively, by paragraphs 8, 8A, 22, 22A, 27E and 27K of Schedule 28 to that Act.

Section 12A(3) IHTA extends this relief to corresponding foreign schemes:

> (3) For the purposes of subsection (1) above, a person also has a drawdown fund if sums or assets held for the purposes of a money

[9] See 74.5 (Omission: Deemed disposition).

> purchase arrangement under a corresponding scheme[10] would, if that scheme were a registered pension scheme, be the person's—
> (a) member's drawdown pension fund,
> (b) member's flexi-access drawdown fund,
> (c) dependant's drawdown pension fund,
> (d) dependant's flexi-access drawdown fund,
> (e) nominee's flexi-access drawdown fund, or
> (f) successor's flexi-access drawdown fund,
> in respect of the arrangement.

Section 12 (2ZA) IHTA provides:

> Where a person who is a member of
> [1] a registered pension scheme,
> [2] a qualifying non-UK pension scheme or
> [3] a section 615(3) scheme ...

That is, in my terminology, a member of an IHT-exempt scheme...

> ... omits to exercise pension rights under the pension scheme, section 3(3) above does not apply in relation to the omission.

Section 12 IHTA provides:

> (2F) For the purposes of this section—
> (a) a person omits to exercise pension rights under a pension scheme if he does not become entitled to the whole or any part of a pension or lump sum (or both) under the pension scheme at a time when he was eligible to become so entitled (whether or not he does become entitled to any other benefits under the pension scheme)
> (2G) In this section—
> “entitled”, in relation to a pension or lump sum, shall be construed in accordance with section 165(3) or 167(1A), or section 166(2), of the Finance Act 2004;
> “pension” has the same meaning as in Part 4 of that Act (see section 165(2) of that Act);

84.10.5 *Relief for IIP trust charges*

Section 151(3) IHTA provides:

[10] Defined s.12A(4): In this section ... "corresponding scheme" means—
(a) a qualifying non-UK pension scheme (see section 271A below), or
(b) a section 615(3) scheme that is not a registered pension scheme”.

> (3) Sections 49 to 53 above shall not apply in relation to an interest satisfying the conditions of paragraphs (a) and (b) of subsection (2) above.

84.11 Non-exempt schemes

I turn to consider schemes which are not IHT-exempt schemes.

84.11.1 *Contribution to scheme*

A contribution to a scheme is not normally a transfer of value for various reasons:

(1) A contribution by a member would not normally reduce their estate

(2) A contribution by an employer would qualify for relief under s.12(1) IHTA.

There might be cases where a contribution is chargeable. The IHT Manual provides:

> **IHTM17043 IHT charges: contributions made whilst in ill-health**
> Contributions made into a persons own pension scheme may be transfers of value if they are made at a time when the person is unlikely to survive to take some or all of the retirement benefits and the death benefits will be paid outside the estate. Any transfer of value depends on the health of the scheme member at the time the contributions were made. In general, where contributions are made more than 2 years before a death you can assume that the member was in normal health, unless there is evidence that suggests they were not. If the member is in normal health there is no transfer of value.
> Where contributions have been made to a pension scheme within 2 years of death the relevant section of form IHT409 should have been completed. If the contributions are substantial and unusual (where they are not made under regular arrangements that have been in existence for more than 2 years) you should establish the full facts and refer to Technical for advice on any transfer of value.

This only applies to non-exempt schemes, as IHT-exempt schemes have a statutory relief.

84.11.2 *10-year and exit charges*

Non-exempt trust-based schemes are within the scope of 10-year and exit charges, unless within

(1) 2006-SSS relief; see 84.17;

or

(2) s.86 IHTA (not discussed here)

84.11.3 *Omission to exercise right*

Tax Bulletin 2 (Feb 1992) provides:

> **Retirement Benefits Under Private Pension Contracts - s.3(3) IHTA**
> BACKGROUND
> Many pension scheme benefits are written under trust on terms which provide that
> [1] the retirement benefit (that is, the pension) continues to be for the policyholder and
> [2] the death benefit is assigned, normally to members of the family.
> The two benefits are mutually exclusive: once the retirement benefit is taken, the death benefit lapses.
> A common feature of these schemes is that from a specified age – from fifty upwards depending on the type of scheme – the policyholder can elect to take the retirement benefit. There are cases where policyholders do not elect to take the benefit at the specified age and have still not done so when they die (so that the death benefit becomes payable). In such cases the Capital Taxes Offices (CTO) take the view that, in certain circumstances, the failure to exercise the right to take the retirement benefit before death can give rise to a lifetime charge to inheritance tax under Section 3(3).
> The Association of British Insurers asked the CTO to clarify the circumstances in which a Section 3(3) claim might arise with these pension arrangements. The CTO set out their view in correspondence with the Association. It is summarised here.
> **The Scope for a s.3(3) Claim**
> In practice, the overwhelming majority of pension arrangements are not affected. The CTO expect to see very few cases where a claim would even be considered. This is because
> [1] the vast majority of policyholders exercise their right to take retirement benefits during their lifetime or survive to the age beyond which they cannot defer taking the retirement benefit. All these cases fall outside the scope of a potential claim
> [2] the chargeable estate of many policyholders will be below the inheritance tax threshold. If no tax is actually payable CTO would naturally not pursue a claim
> [3] any claims that do arise are likely to be limited to retirement annuity contracts or personal pension schemes. Only exceptionally would claims involve occupational pension schemes
> [4] there is no question of a claim being raised in cases of genuine

> pension arrangements, that is, where it is clear that the policyholder's primary intention is to provide for his or her own retirement benefit.
>
> CTO would consider raising a claim in such cases as remain only where there was evidence that the policyholder's intention in failing to take up retirement benefits was to increase the estate of someone else (the beneficiaries of the death benefit) rather than to benefit himself or herself.
>
> To this end, CTO will look closely at certain pension arrangements where the policyholder became aware that he or she was suffering from a terminal illness, or was in such poor health that his or her life was uninsurable, and at or after that time the policyholder
>
> [1] took out a new policy and assigned the death benefit on trust, or
>
> [2] assigned on trust the death benefit of an existing policy, or
>
> [3] paid further contributions to a single premium policy or enhanced contributions to a regular premium policy where the death benefit had been previously assigned on trust, or
>
> [4] deferred the date for taking retirement benefits.
>
> In these circumstances it would be difficult to argue that the actions of the policyholder were intended to make provision for his or her own retirement given the prospect of an early death. Even then CTO would not pursue the claim where the death benefit was paid to the policyholder's spouse and/or dependents (that is, any individuals financially dependent on the policyholder). In addition, a claim would not normally be pursued where the policyholder survived for two years or more after making any of these arrangements but the CTO reserve the right to examine each case individually.
>
> For the avoidance of doubt, CTO would adopt a similar approach in cases involving
>
> – personal pension schemes set up under deed poll under the Superannuation Funds Office or
>
> – Integrated Model rules, or buy-out policies under trust, approved under ICTA 1988, Section 591(2)(g) (commonly known as 'Section 32 policies' after the original legislation).

The s.3(3) charge on omissions has ceased to apply to IHT-exempt schemes[11] but the statement remains relevant for other schemes.

The IHTM provides:

> **IHTM17102 income drawdown**
>
> Income drawdown is the situation where the deceased has reached

[11] See 84.10.4 (Relief for omission to exercise right).

pension age but has chosen not to buy an annuity that will provide their pension. Instead they decide to draw a certain level of income from their pension fund with a view to buying an annuity at a later date.

The option to defer purchase of an annuity was introduced by FA95 at a time when annuity rates were relatively poor. This allowed the member to defer taking their whole retirement benefits. They would take a part lump sum and a certain level of income drawdown (between 35% - 100% of what the fund produced) and then at some later date (but no later than age 75) when annuity rates had hopefully improved the member could go back and purchase an annuity with the balance of the fund.

For Inheritance Tax (IHT) purposes the member is effectively taking less than their full entitlement when they retire so there is a possibility of an IHT lifetime transfer (IHTM14000) for a failure to exercise a right under IHTA84/S3 (3)...

IHTM17103 ABI guidance note

In June 1999 the Association of British insurers (ABI) (after discussion with HMRC Inheritance Tax) issued a guidance note setting out the basis on which a claim to Inheritance Tax might arise. The text of the guidance note is as follows:

1. **Introduction**

1.1 This paper sets out the conclusions reached in discussions and correspondence between ABI and the Capital Taxes Office on the Inheritance Tax position regarding the deferral of annuity purchase/income withdrawal facility under personal pensions.

1.2 While there will be cases where there is an Inheritance Tax liability, these are likely to be relatively few...

2. **Background**

[The statement summarises the s.5(2) and 3(3) IHTA charges and continues:]

2.4 During the recent discussions ABI argued that income withdrawal was a direct alternative to annuity purchase and so electing the income withdrawal option should not carry any Inheritance Tax implications which do not apply where an annuity has been bought. We do not accept this argument. They point out that after the death of a member who had elected for income withdrawal, the lump sum is paid subject to a 35% tax charge. That is therefore an indication that at that time the money has ceased to be what was previously a tax approved pension scheme. The protection under IHTA84/S151 of the Act would not apply and there is therefore nothing to prevent an Inheritance Tax liability arising where this is appropriate. (Section 151 provides, broadly, that an interest

> in a pension or annuity under an exempt approved occupational scheme, an approved personal pension or an approved retirement annuity contract will not be taken into account in determining the value of an individuals estate immediately before his death.) ...
>
> **The application of Section 3(3) to income withdrawal**
>
> 3.1 The circumstances in which an Inheritance Tax charge might be considered under section 3(3) are where decisions have been made prima facie with the aim of benefiting others on death rather than to make provision for the members retirement. If having elected to take income withdrawal it can be shown that the member (or survivor, where applicable) was in normal health and that the option was elected for commercial and retirement planning reasons, a section 3(3) claim would not arise. As a rule of thumb, if the member makes a decision, unless it was known the member is in ill health, and lives for two years, that is evidence that he was not suffering from ill-health when he made the decision (ill-health in this context means terminal ill-health or such ill health that the members life is uninsurable). We acknowledge that income withdrawal will usually be elected for commercial and retirement planning rather than donative reasons.
>
> **Valuation of a Section 3(3) Claim**
>
> 3.2 When a section 3(3) claim does arise the claim is on the failure to take up the retirement benefits available to the member at the instant before death, i.e. on the loss to the estate at that date. At that point the member had the right to use the whole remaining fund for the purchase of an annuity.
>
> 3.3 The section 3(3) claim is therefore based on the value of an annuity guaranteed for 10 years payable monthly in advance calculated by HMRC, which the balance of the whole fund would have purchased. The annuity value for this purpose will be based upon the drawdown providers single life rates, without increases or provision for dependants except to the extent that this is specified in the scheme rules. (Any lump sum payment would have to have been taken at the outset of drawdown and so would not feature in the calculation.)

Fryer v HMRC has a discussion, not considered here, on valuation of the value transferred in these circumstances.[12]

[12] See too **IHTM17306 omission to exercise a right: calculation of the charge**

> When there is an omission to exercise a right to take pension benefits, the amount of the deemed disposition derives from the loss to the estate resulting from the failure to take up the available benefits at the latest time these benefits could be taken, which is immediately before the members death.

> 3.4 We stress that no claim under section 3(3) will normally arise where there is no change in the established pattern of income withdrawal i.e. where what was clearly initially a commercial transaction or plan continues without change despite intervening ill health. In addition the concessions given in the Tax Bulletin of February 1992 will continue to apply and the result should be that very few claims will arise.
>
> **The importance of planning within the advice process: the implications for Inheritance Tax**
>
> 3.5 It is essential that, as part of the advice process, an adviser discusses death during income withdrawal and the Inheritance Tax position. General advice about death and Inheritance Tax on the plan will not prejudice the position as regards a claim. However, this would not be the case if the advice dealt with, say, a scenario whereby the holder became ill and the drawdown was altered because of the ill-health of the holder.
>
> 3.6 If a clear commercial plan of action is agreed and documented while the individual is in good health, and is then acted upon, much greater certainty then exists regarding Inheritance Tax. The plan would set out the level of income to be taken for each year and might include other parameters, such as when an annuity is to be bought. If this member later becomes terminally ill, or so ill as to be uninsurable, this does not of itself give rise to an Inheritance Tax charge. If he then decides to reduce any payments received under drawdown this will give rise to a potential Inheritance Tax charge as this is a decision driven by being ill. The charge will arise on the annuity capable of being produced by the whole of the remaining residual fund...

In the case of a trust-based scheme, a right under the scheme is a settlement power and should be disregarded.[13] This would not apply to a contract-based scheme. That may seem anomalous, but it is not, as a trust-based scheme is potentially within 10-year and exit charges, which a contract-based scheme is not. The point did not arise in *Parry* or *Fryer*, which were contract-based schemes.

The calculation is based on the value of an annuity guaranteed for 10 years, payable monthly in advance, which the balance of the whole fund would have purchased. The annuity value for this purpose will be based on the drawdown providers single life rates, without increases or provision for dependants except to the extent that this is specified in the scheme rules.

Technical and the Boards Actuarial Officer can advise on any potential liability to IHT under ITA84/S3 (3).

[13] See 74.10 (Settlement power).

84.12 General powers

84.12.1 *General power: IHT-exempt scheme*

Section 151(4) IHTA provides:

> In relation to an interest in or under
> [a] a registered pension scheme,
> [b] a qualifying non-UK pension scheme or
> [c] a section 615(3) scheme,

That is, in my terminology, an interest in/under an IHT-exempt scheme.

> section 5(2) above shall apply as if the words "other than settled property" were omitted (in both places).

Amended as directed, s.5(2) IHTA provides:

> [A] A person who has a general power which enables him, or would if he were sui juris enable him,
> [a] to dispose of any property ~~other than settled property~~, or
> [b] to charge money on any property ~~other than settled property~~,
> shall be treated as beneficially entitled to the property or money;
> [B] and for this purpose "general power" means a power or authority enabling the person by whom it is exercisable to appoint or dispose of property as he thinks fit.

In practice, general powers under exempt pension schemes are not common. This provision effectively discourages them: perhaps that was the point of it. Death benefits are payable at the discretion of the scheme trustees, or held on the terms of a trust, so they are not within the estate.

This provision applies to IHT-exempt schemes, but not to other types of scheme. That makes sense where schemes are within the scope of IHT. It might seem rather favourable to an SSS which qualifies for 2006-SSS relief, but it fits the wider pattern of continuing transitional exemptions for these schemes.

84.12.2 *What is a general power*

The ABI guidance note provides:

> **4. The application of Section 5(2) to income withdrawal**
> 4.1 ... An example of a general power is the option of the survivor to take a lump sum within two years of the members death during income withdrawal. If the survivor dies within those two years the value of the lump sum would form part of the survivors estate for Inheritance Tax

> purposes unless the survivor gives up the right to take the lump sum, at a time when he/she could reasonably have expected to live to enjoy the benefits, by effecting an irrevocable disclaimer of that right.
> 4.2 ... a potential Inheritance Tax liability is unlikely where the member had a power of nomination in relation to a lump sum death benefit, revocable in life but binding on death, to select from a limited class of survivors. There would be a claim, of course, if the effect of a revocation is that the lump sum is paid to the legal personal representatives as of right.

The IHT Manual provides:

> **IHTM17052 general power over death benefits**
> The issue of a general power over property arose in the case of *Kempe v IRC* [2004] STC (SCD) 467. This case involved a term life policy where the policyholder could designate the beneficiaries who would receive the sum assured when he died. After the policyholder's death the sum assured was paid to his sisters as the designated beneficiaries. It was held that the deceased did have a general power to dispose of the property, so it fell into his estate.

See 87.10 (General power). See too 87.10.1 (General power: Terminology)

84.12.3 *Relief for spouse/dependent*

Section 152 IHTA provides:

> Where on a person's death an annuity becomes payable under
> [a] a registered pension scheme,
> [b] a qualifying non-UK pension scheme or
> [c] a section 615(3) scheme
> to a widow, widower, surviving civil partner, dependant or nominee of that person and under the terms of the scheme a sum of money might at his option have become payable instead to his personal representatives, he shall not, by virtue of section 5(2) above, be treated as having been beneficially entitled to that sum.

84.13 Transfer of death benefit

The IHT Manual provides:

> **IHTM17070 lifetime transfers of death benefits**
> Lifetime transfers of death benefits can occur when a pension scheme member changes or transfers pension rights at a time when they are in ill-health, whatever their reason is for doing so. This can happen when:

- a member assigns their death benefits to a trust (IHTM17071)
- a member transfers their pension fund from one scheme to another (IHTM17072)

Where the transferor is in good health and is likely to take their pension benefits at some later date, then the death benefits have only a nominal value. In general, where transfers are made more than 2 years before a death you can assume that the member was in normal health, unless there is evidence to the contrary. In that case there is no transfer of value.

There may be lifetime transfers to consider even where an estate is spouse or civil partner exempt...

IHTM17071 assignment of death benefits

The right to a death benefit from a pension scheme is often transferred irrevocably to a discretionary trust. Many pension providers have standard documents to put this into effect. This type of transfer or assignment is a lifetime transfer at the date of transfer and can result in a lifetime transfer of value if the scheme member is in ill-health at the time.

Not all cases though involve irrevocable transfers. Where a trust is:

- only one of the potential beneficiaries, even if nominated in a letter of wishes, and
- the pension provider retains the right to make a payment at its discretion

there is no lifetime transfer.

It is also possible that an irrevocable nomination could be made in favour of other beneficiaries. However, this is unlikely because a beneficiary who is an individual may unexpectedly pre-decease the pension scheme member.

Details of any assignment of death benefits within the 2 years before a death should be included on form IHT409 (IHTM17015).

84.14 Transfer between schemes

A transfer between schemes may reduce the member's estate, if their rights under the new scheme are less valuable. So to procure a transfer, or omit to prevent one, may be a transfer of value.

Alternatively a transfer between schemes may increase the member's estate, if their rights under the new scheme are more valuable. In that case an omission to procure a transfer may be a transfer of value.

IHTM17072: transfers between pension schemes [Mar 2021]

A pension scheme member has a statutory right to transfer their pension

> fund from one scheme to another. When this type of transfer is made, the member surrenders their rights under the first scheme in return for rights under the second. A person can do this regardless of their rights to benefits under the first scheme. This includes the situation where there is an existing irrevocable nomination in relation to death benefits, for example where the death benefits have been assigned on discretionary trusts. The second scheme is not subject to directions given in relation to the first scheme.
>
> The funds do not rejoin the member's estate during transit. What is in the estate at this point is the right to determine the terms of payment of death benefits in the second scheme. This right has value because the member could direct the payment to their own estate. If payment is not directed to the estate then there may be a loss to the estate depending on the member's health at the time.
>
> If a person is in normal health at the date of the transfer then the loss to the estate is nominal. If they are in ill-health at the date of the transfer then the loss may be significant.
>
> Details of any transfers made within the 2 years before the death should be reported on the IHT409 (IHTM17014)

This issue arose in *HMRC v Parry*[14] where the taxpayer (somehow) qualified for IHT arm's length transaction relief. But the facts were unusual.

84.15 Lump sum benefit: position before payment

The IHT Manual provides:

> **IHTM17083 Status of funds after death but before payment**
>
> When a person dies and the rules of a trust-based pension scheme mean that a lump sum death benefit becomes payable, this sum is held by the pension scheme trustees on trust before the payment to beneficiaries. But, it is no longer being held for the purposes of the pension scheme.

This seems odd, as there is not normally an identifiably distinct sum held by trustees, and if there was, it is still held for the purposes of the scheme, as it the payment to a trust is one of the purposes of the scheme. The benefit is typically a death benefit (payable on the death of the member) but the same applies to other benefits.

A statutory rule governs the position before payment from an IHT-exempt scheme. Section 58(2A) IHTA provides a relief for IHT-exempt

[14] [2020] UKSC 35. See 74.13.1 (Operation confers benefit).

schemes:

> For the purposes of subsection (1)(d) above [relief for 10-year/exit charges[15]]—
>
> (a) property applied to pay lump sum death benefits within section 168(1) of the Finance Act 2004 in respect of a member of a registered pension scheme is to be taken to be held for the purposes of the scheme from the time of the member's death until the payment is made, and
>
> (b) property applied to pay lump sum death benefits in respect of a member of
>
> [i] a qualifying non-UK pension scheme or
>
> [ii] a section 615(3) scheme
>
> is to be taken to be so held if the benefits are paid within the period of two years beginning with the earlier of the day on which the member's death was first known to the trustees or other persons having the control of the fund and the day on which they could first reasonably be expected to have known of it.

84.16 Scheme-benefit trust

A pension scheme benefit may be paid to a trust (**"a scheme-benefit trust"**). The starting point is that a scheme-benefit trust is not a pension scheme, it does not qualify for pension scheme reliefs, and it is taxed like any other trust.

The IHTM provides:

> **IHTM17084 settlement of death benefits**
> When a payment is made by a pension scheme into a trust set up to receive death benefits, the property is no longer held for the purposes of a pension scheme. It is treated in the same way as any other relevant property and is liable to the ten-year anniversary charge and exit charges (IHTM04096).

It is necessary to consider separately:

(1) a trust of a benefit from an IHT-exempt scheme

(2) a trust of a benefit from a non-exempt scheme

84.16.1 *Trust of benefit from IHT-exempt scheme*

Section 151(5) IHTA provides:

[15] See 84.10.2 (Relief for 10-year/exit charges).

> Where
> [a] Where a benefit has become payable under
> [i] a registered pension scheme,
> [ii] a qualifying non-UK pension scheme or
> [iii] a section 615(3) scheme ...

That is, in my terminology, under an IHT-exempt scheme ...

> [b] and the benefit becomes comprised in a settlement made by a person other than the person entitled to the benefit,
>
> the settlement shall for the purposes of this Act be treated as made by the person so entitled.

The IHT Manual provides:

> **IHMT17085. The identity of the settlor** [Mar 2021]
> The settlor of a discretionary trust created to receive death benefits paid from a pension scheme is the pension scheme member.

This is correct, for IHT purposes, and assuming that the pension scheme is an IHT-exempt scheme, because of s.151(5), and that is presumably what HMRC have in mind. For the position for other taxes, or where the pension scheme is not an IHT-exempt scheme, see below.

The IHTM provides:

> **IHTM17084 settlement of death benefits**
> Where the pension scheme is itself not trust based (for example it is a retirement annuity contract, and the death benefits are paid into a relevant property trust) the ten-year anniversary is based on the date the trust was set up by the member, either during their lifetime or by their Will.
>
> Where the pension scheme paying the death benefits is a trust based scheme, the funds are moving from one settlement to another and IHTA1984/S81 will apply to determine the date of the 10-year anniversary. In this case, the date for the ten-year anniversary in the receiving trust is based on the date the member first joined the original pension scheme.

The Manual provides a straightforward example.[16]

[16] For completeness, the example (Hilary) is as follows:

- H became a member of a trust based pension scheme on 15 May 1974
- She set up a new discretionary trust on 2 September 2007 with 100 and completed a letter of wishes nominating the trust to receive any death benefits from the

84.16.2 *Trust of benefit from EFRBS*

IHMT17085 continues:

> Property settled on the trusts of an employer-financed retirement benefit scheme (EFRBS) (IHTM17027) on or after 6 April 2006 is treated in the same way as settled property in any other discretionary trust. So it is liable to the ten-year anniversary charge and exit charges (IHTM04096).

This is correct. The Manual then becomes more contentious:

> In this case the scheme member is a settlor for Inheritance Tax (IHT) purposes. This applies to:
>
> - contributions made by the member as an individual, and
> - contributions made by their employer (even where this is non-contributory for the employee (member) and is wholly financed by the employer). This is because pension rights and benefits are derived from payments by the employer as deferred or delayed remuneration for the employee's current work. This principle was established in *Parry v Cleaver* and *The Halcyon Skies.*[17]
>
> In this way, the scheme member has provided funds directly or indirectly and is the settlor for IHT purposes.

I think the context suggests that this is not discussing the question of who is the settlor of an EFURBS[18]: it is discussing the question of who is the settlor of a trust to which an EFURBS makes a payment (**"EFURBS-benefit trust"**).

A member is clearly the settlor of an EFRBS-benefit trust if:

(1) They are actually entitled to the benefit and assign it to the trust; or

(2) They have a general power of appointment over the benefit and

pension scheme

- H died on 3 January 2012
- The death benefit is paid at the discretion of the pension scheme trustees to the new trust on 4 August 2012.

The lump sum death benefit is relevant property from the date of payment on 4 August 2012. However, the ten year anniversary is based on the date H joined the pension scheme on 15 May 1974, so will first apply to these funds on 15 May 2014. The ten-year anniversary charge relating to the initial 100 used to set up the trust is based on the date the trust was set up, so it will first apply on 2 September 2017

Author's comment: The last sentence is of theoretical interest, as no-one will bother about the IHT on the initial nominal £100.

[17] *Parry v Cleaver* [1970] AC 1; *The Halcyon Skies* [1977] QB 14.

[18] As to who is the settlor of an EFIRBS, see 99.39 (Pension/employee benefit trust).

creates the trust by exercise of that power.

In other cases the position is different. The two cases cited in the Manual are authority for the well-settled rule that:

> ... pensionable employment is more valuable to a man than the mere amount of his weekly wage. It is more valuable because by reason of the terms of his employment money is being regularly set aside to swell his ultimate pension rights whether on retirement or disablement. His earnings are greater than his weekly wage. [Where the wage is £20 with total contributions to the pension fund of £4 per week] his employer is willing to pay £24 per week to obtain his services, and it seems to me that he ought to be regarded as having earned that sum per week. The products of the sums paid into the pension fund are in fact delayed remuneration for his current work. That is why pensions are regarded as earned income.[19]

The non-tax cases cited in the IHT Manual do not address the issue of who is the settlor for tax purposes. The fact that a pension is delayed remuneration does not answer the tax issue. The member is not generally the settlor of the EFRBS before the transfer of a benefit to the EFURBS-benefit trust.[20] How can they become the settlor? The transfer from one trust (EFURBS) to another (the EFURBS-benefit trust) should not alter the identity of the settlor.[21] It may be said that the EFURBS represents earning of many members but the EFURBS-benefit trust isolates or

[19] *Parry v Cleaver* [1970] AC 1 at p.l6. Similarly, *Imperial Group Pension Trust v Imperial Tobacco* [1991] 1 WLR 589 at p.579:

> "Pension scheme trusts are of quite a different nature to traditional trusts. The traditional trust is one under which the settlor, by way of bounty, transfers property to trustees to be administered for the beneficiaries as objects of his bounty. Normally, there is no legal relationship between the parties apart from the trust. The beneficiaries have given no consideration for what they receive. The settlor, as donor, can impose such limits on his bounty as he chooses ... a pension scheme is quite different. Pension benefits are part of the consideration which an employee receives in return for the rendering of his services. In many cases, ... membership of the pension scheme is a requirement of employment. In contributory schemes ... the employee is himself bound to pay for his or her contributions. Beneficiaries of the scheme, the members, far from being volunteers have been given valuable consideration. The company employer is not conferring a bounty."

[20] See 99.39 (Pension/employee benefit trust).

[21] See 99.12.1 (Transfer: A's trust to B's trust).

represents earnings of one particular member. But even so, the required element of bounty is missing. That is why s.155(5) IHTA is needed.

84.17 2006-SSS reliefs

Para 56 sch 36 FA 2004 provides a set of reliefs which I call **"2006-SSS reliefs"**.

84.17.1 *2006-SSS reliefs: Requirements*

> (1) This paragraph applies in relation to a fund or scheme—
> (a) which is not
> [i] a registered pension scheme,
> [ii] a qualifying non-UK pension scheme[22] or
> [iii] a superannuation fund to which section 615(3) of ICTA applies, but
> (b) to which section 151 of the Inheritance Tax Act 1984 (treatment of pension rights) applied immediately before 6th April 2006.

Schemes within (a) are IHT-exempt schemes, they are excluded from s.151 transitional relief because they do not need it. We need to identify the other schemes to which s.151 formerly applied.

Our journey takes us to the pre-2006 s.151 IHTA. This provided as follows:

> **151 Treatment of pension rights, etc**
> *(1) This section applies*
> *[a] to any fund to which section 615(3) of the Taxes Act 1988 applies,*
> *[b] to any scheme approved under section 620 or 621 of that Act,*
> *[c] to any exempt approved scheme or statutory scheme as defined in Chapter I of Part XIV of that Act and*
> *[d] to any other sponsored superannuation scheme as defined in section 624 of that Act.*
> *(1A) This section also applies to approved personal pension arrangements within the meaning of Chapter IV of Part XIV of the Taxes Act 1988;*

Thus pre-2006 s.151 applied to 5 categories of scheme. Four of these are

[22] Defined by reference: Para 56(4) sch 36 FA 2004 provides:
In this paragraph "qualifying non-UK pension scheme" has the same meaning as in the Inheritance Tax Act 1984 (see section 271A of that Act).

still IHT-exempt schemes, and so do not need 2006-SSS relief.

Para [d] is not on the post-2006 IHT-exempt scheme list, and this is where 2006-SSS reliefs are needed. In short, 2004-transitional relief applies to a sponsored superannuation scheme ("SSS").

Why could the section not say this more directly? Perhaps the object is to include other schemes which were approved pre-2006, but later lost approval?

84.17.2 *SSS: no post-2006 contribution*

Para 56 sch 36 FA 2004 provides 2 reliefs:

> (2) If no contributions are made under the fund or scheme on or after that date—
> (a) section 151 of the Inheritance Tax Act 1984 continues to apply to the fund or scheme on and after that date for all purposes of that Act, and
> (b) property which is part of or held for the purposes of the fund or scheme does not constitute relevant property for the purposes of Chapter 3 of Part 3 of that Act (settlements without interest in possession).

This confers the reliefs which apply to IHT exempt pension schemes: see 84.10 (IHT-exempt pension schemes).

There is no transitional relief comparable to s.12A/12(2ZA) IHTA. so an omission to exercise a right under a SSS may be chargeable on basic principles.[23] I wonder if that is deliberate.

84.17.3 *SSS: post-2006 contribution*

If there are post-2006 contributions, there is a proportionate relief. In practice this may not be so common.

Para 56 sch 36 FA 2004 provides:

> (3) In any other case, paragraphs 57 and 58 apply to the fund or scheme on and after that date.

Para 57 sch 36 FA 2004 provides:

> (1) The percentage of the assets of the fund or scheme which at any time is the protected percentage of those assets does not at that time constitute relevant property for the purposes of Chapter 3 of Part 3 of

[23] See 74.5 Omission: Deemed disposition.

the Inheritance Tax Act 1984 (settlements without interest in possession).

(2) "The protected percentage" of the assets of the fund or scheme at a time is—

(ACV / V) × 100

where—

V is the market value of the assets of the fund or scheme at that time, and

ACV is the adjusted commencement value, that is an amount equal to the market value of the assets of the fund or scheme on 5th April 2006, but subject to the adjustments provided by sub-paragraph (3).

(3) The adjustments are—

(a) an increase by the percentage by which the retail prices index for the month of September immediately preceding the time in question is greater than that for April 2006, and

(b) a reduction by the amount of any relevant payments made under the fund or scheme on or after 6th April 2006 and before that time.

(4) "Relevant payments" are payments other than—

(a) payments of costs or expenses, or

(b) payments which are (or will be) income of any person for any of the purposes of income tax.

Para 58 sch 36 FA 2004 provides:

(1) Section 151 of the Inheritance Tax Act 1984 (treatment of pension rights) continues to apply to so much of the assets of the fund or scheme at any time as does not exceed the amount that is the protected amount at that time.

(2) But sub-paragraph (1) does not affect the operation of subsection (1)(d) of section 58 of that Act (because paragraph 57 makes provision about the extent to which the assets of the fund or scheme constitute relevant property within the meaning given by that section).

(3) If inheritance tax has not previously been chargeable (otherwise than only because of this paragraph) by reference to the value of the assets of the fund or scheme on or after 6th April 2006, the protected amount is an amount equal to the amount of the market value of the assets of the fund or scheme on 5th April 2006, but subject to the adjustments provided by sub-paragraph (4).

(4) The adjustments are—

(a) an increase by the percentage by which the retail prices index for the month of September immediately preceding the time in question is greater than that for April 2006, and

> (b) a reduction by the amount of any relevant payments made under the fund or scheme on or after 6th April 2006 and before that time.
>
> (5) If inheritance tax would (apart from this paragraph) have previously been chargeable by reference to the value of the assets of the fund or scheme on one or more occasions on or after 6th April 2006, the protected amount is what it was immediately before the occasion, or (where there has been more than one) the last occasion, on which inheritance tax would have been so chargeable ("the relevant tax occasion"), but—
>
> (a) reduced by the value of the property on which inheritance tax would have been chargeable on the relevant tax occasion, and
>
> (b) subject to the adjustments provided by sub-paragraph (6).
>
> (6) The adjustments are—
>
> (a) an increase by the percentage by which the retail prices index for the month of September immediately preceding the time in question is greater than that for the month in which the relevant tax occasion fell, and
>
> (b) a reduction by the amount of any relevant payments made under the fund or scheme since the relevant tax occasion.
>
> (7) "Relevant payments" are payments other than—
>
> (a) payments of costs or expenses, or
>
> (b) payments which are (or will be) income of any person for any of the purposes of income tax.

IHTM17039 provides that "A transfer from one pension scheme to another is not treated as a new contribution, so the funds in one protected scheme may be transferred to another protected scheme without the exclusion being lost."

84.18 Reservation of benefit

GWR does not apply on a corporate employer making a contribution, as this only applies where an individual makes a disposal by way of gift.

GWR would not normally apply on an individual making a contribution, as that would not normally be "by way of gift".

GWR might apply on a disposal of a pension benefit (typically, a disposal of a death benefit by a member).

84.18.1 *GWR: IHT-exempt pension scheme*

SP 10/86 provides an GWR exemption for IHT-exempt schemes:

> The Board confirm that their previous practice of not charging capital

> transfer tax on death benefits that are payable from tax approved occupational and retirement annuity schemes under discretionary trusts also applies to Inheritance Tax
> The practice extends to tax under the gift with reservation rules as well as to tax under the ordinary inheritance rules.

84.18.2 *GWR: Non-exempt pension scheme*

There may be a GWR if a member disposes of a benefit (typically a death benefit) under a non-exempt scheme and reserves a benefit. The IHT Manual provides :

> **IHTM17074 unregistered schemes and gifts with reservation**
> Where a member of an employer-financed retirement benefits scheme (EFRBS) (IHTM17027) makes (or is deemed to make) a disposition in connection with the EFRBS, the disposition may constitute a gift with reservation, where the class of discretionary beneficiaries includes the members personal representatives. In these circumstances:
>
> - the scheme member will be the settlor (IHTM17073) because they have provided funds, either directly or indirectly, and
> - the inclusion of their legal personal representatives amongst the class of beneficiaries is not consistent with their exclusion or virtual exclusion from the potential conferment of substantial benefit on them.
>
> The rationale for this is as follows:
>
> - the EFRBS is a settlement for Inheritance Tax purposes
> - an unregistered scheme is not within the protection afforded by Statement of Practice 10/86, so the gift with reservation provisions may in principle apply to an EFRBS
> - the death benefits provision under an EFRBS is an item of property for IHT purposes IHTA84/S272. As such it can be the subject of a disposition by the scheme member either on joining the scheme or at any time during their lifetime before they retire. Accordingly it is capable of being the subject matter of a gift. While it is usually of no more than nominal value, its value at any given time will depend on the age and state of health of the scheme member.
> - the member or their estate is not excluded from enjoyment and benefit of the death benefits FA86/S102(1)(b) where the objects of the discretionary trust include the members legal personal representatives...

CHAPTER EIGHTY FIVE

PARTNERSHIPS

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Cross references

This chapter considers aspects of partnerships which are more conveniently addressed in isolation. I have generally preferred to deal with partnership issues as they arise in the context of other topics:

Topic	**See para**
Offshore funds	66.16
Remittances	18.49
Partnership income stream/asset	54.13
NIC	46.21
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Pre-owned assets	83.22
Foreign law partnerships	90.26 - 90.37
Foreign law LLP	90.37
ATED	98.15
Situs of partnership debt	102.14.5
Situs of partnership share	102.35
UK representative	124.4

85.1 Partnerships: Introduction

A full discussion of partnership taxation would require at least two volumes. In this chapter I focus on aspects relevant to the themes of this book but it is necessary to review the topic more generally to understand these matters in their context.

I do not consider losses.

For the general law of partnerships, see *Lindley & Banks on Partnerships* ("Lindley & Banks").

85.2 "Partnership" and "Firm"

85.2.1 *Definitions of "partnership"*

Section 1(1) PA 1890 provides:

> **Definition of partnership**
> Partnership is the relation[1] which subsists between persons carrying on

[1] I think in contemporary English one would use the word relationship rather than relation, but nothing turns on that.

a business in common with a view of profit.

I refer to this as the general (partnership law) meaning.

Both general partnerships and limited partnerships are partnerships within this definition and I refer to them together as **"ordinary partnerships"**.

For IT/CGT/CT purposes the word partnership is (generally) extended to include LLPs[2] but apart from that it is not usually defined.

There are different definitions for:

Topic	**See para**
SDLT/ATED	98.2.1
IHT residential-property code	82.4.1

85.2.2 *Definition of "firm"*

s.4 PA 1890	**s.847(1) ITTOIA/s.1257 CTA 2009**
Persons who have entered into partnership with one another are for the purposes of this Act called collectively a firm ...	In this Act [ITTOIA/CTA 2009] persons carrying on a trade [including business] in partnership are referred to collectively as a "firm".

The definitions are the same, though differently worded.

The ITTOIA/CTA definition is only for the purposes of ITTOIA/CTA 2009. It is incorporated by reference in some parts of ITA,[3] but it does not apply in ITA as a whole. However the ITTOIA/CTA definitions set out the normal meaning of the word, so (subject to context) the same meaning would apply even where the definition is not formally applied. It would be simpler if there were one single taxes-act wide definition, but it does not matter.

In this terminology,"firm" means the *persons* carrying on the business and "partnership" means the *relationship* between them; but in practice the terms are used interchangeably.[4]

There is a different definition in the Companies Act,[5] where the word

[2] See 85.21 (Limited liability partnership).

[3] For the details see the table in sch 4 ITA (Index of Defined Expressions).

[4] The PA 1890 itself is not consistent and sometimes uses "partnership" where, according to its own scheme, "firm" would be more appropriate.
The Law Commission report on Partnership Law proposed to modernise the definition, but nothing came of that.

[5] Section 1193 Companies Act 2006 provides: "firm" means any entity, whether or not a legal person, that is not an individual and includes a body corporate, a corporation

"firm" includes both a partnership and a company. I am not sure that lawyers would use the word firm to mean a company, unless speaking colloquially or informally.

I generally prefer not to use the word "firm", and use the word partnership (or company, as appropriate). But of course the word can be used where the context is clear, and when discussing particular statutory provisions, it is usually best to follow the statutory terminology.

85.3 Nature of partnership share

In order to understand partnership tax, one needs to understand the nature of a partner's interest in a partnership (also known as a partnership share).

I consider English law, then Scots law, and consider LLP's separately below.[6]

85.3.1 *English partnership: 2 analyses*

This section considers the position of partnerships governed by English law, or by a foreign law which adopts common law principles. That includes for instance a Northern Ireland partnership.

Everyone agrees that a partner has an interest in partnership property; but what is the nature of that interest?

Gower doubts whether this question has an answer:

> ... the exact nature of this equitable interest is not crystal clear ... no very satisfactory solution to this problem has been found, and the most one can say is that the partners have an equitable interest... which floats over the partnership assets throughout the duration of the firm, although it crystallises only on dissolution. Still, there is admittedly some sort of proprietary nexus (however vague and ill-defined) between the partnership assets and the partners.[7]

The answer (which explains apparently inconsistent case law) is that a partnership share has a twofold nature:[8]

> [1] As between themselves, partners are not entitled individually to exercise proprietary rights over any of the partnership assets. This is because they have subjected their proprietary interests to the terms of

sole and a partnership or other unincorporated association.

[6] See 85.21 (Limited liability partnership).

[7] Gower, *Principles of Modern Company Law*, 10th ed., para 23.1 (Legal nature of shares).

[8] *IRC v Gray* [1994] STC 360 at p.377.

> the partnership deed which provides that the assets shall be employed in the partnership business, and on dissolution realised for the purposes of paying debts and distributing any surplus.
> [2] As regards the outside world, however, the partnership deed is irrelevant. The partners are collectively entitled to each and every asset of the partnership, in which each of them therefore has an undivided share.

Lindley & Banks refers to the two parts of this dual nature as internal and external perspectives;[9] but for present purposes it is clearer to describe them as a *chose in action* analysis and a *co-ownership* analysis of a partnership share. One might also use the terms *transparent* (for the co-ownership analysis) and *opaque* (for the chose in action analysis).[10]

85.3.2 *Is one analysis correct and the other wrong?*

At first sight the chose in action/co-ownership analyses of a partnership share are inconsistent and one might think that one ought to be right and the other wrong.

Of the two rival analyses, I think the chose in action (opaque) analysis might be described as the dominant or default analysis, as more sources can be cited in its favour. For instance the Stamp Taxes on Shares Manual:

> **STSM091040 nature of a partnership interest** [Sep 2017]
> A partnership interest or share is, in law, a separate item of 'property' in its own right. A partner cannot claim to be the owner of any particular partnership asset, nor of any specific share of a partnership asset. Rather, a partnership interest represents a right to control the partnership assets and affairs for as long as the partnership lasts and, upon dissolution, a right to have the assets liquidated, the liabilities

[9] *Lindley & Banks* (21st ed., 2022), para 19-04; Law Com, *Partnership Law*, Report no 283 (2003), para 9.66 (Nature of a partner's interest) *http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc283_Partnership_Law.pdf*

[10] A note on terminology. Under the chose in action (opaque) analysis, a partner's interest is sometimes called a *"future interest"*. Televantos in [2023] LQR 26. refers to it as the *"remainderman model"*. A partner's interest is future, or in remainder, in the sense that the partners receive the partnership capital only after the dissolution of the partnership, and after partnership creditors have been paid. But of course it is not a future interest, or an interest in remainder, in the sense that the partners are in principle entitled to partnership income as it arises. So I prefer to use the term "chose in action (opaque)"; but it does not ultimately matter what label is used.

> discharged and a division of any surplus.[11]

Likewise *Bayonet Ventures LLP v HMRC:*[12]

> Property which belongs to a partnership ... is no more the property of the individual partners than the property of a body corporate is the property of its shareholders. Such property might become the property of members and/or shareholders upon winding up or dissolution once debts and liabilities have been paid, but until that time it is the property of the partnership ... In our judgement it was and is fundamentally wrong for the respondents to proceed on the basis that because a loan was made ... to the first appellant [a LLP] , it follows that that same sum of money was lent to the second appellant [a member of the LLP].

On the other hand one can cite authorities for the co-ownershiop (transparent) analysis:

> A partner ... is, with his partners, an owner of the undertaking in which he is engaged and he is entitled, with his partners, to an undivided share in all the assets of the undertaking.[13]

Televantos argues from first principles that the co-ownership analysis is the correct one as a matter of partnership law.[14] But it seems to me, on the basis of *Gray*, that for tax purposes, at least, this is not a case of either/or. Which analysis is adopted can make a difference for tax purposes, but there is no general answer: the decision is made according to the context of the provisions concerned, and there are plenty of examples of each of them:[15]

[11] Likewise the BI Manual:

> **BIM82058 Partnerships - general notes: property** [Jun 2016]
> ... In commercial law in England and Wales the partner's interest in partnership property is not a proportionate interest in each asset but rather an undivided interest in the totality of the partnership property... The quantum of that interest cannot be finally determined until the partnership is finally wound up (or perhaps earlier should all the assets be sold and the net proceeds after paying liabilities distributed).

These passages were probably written before *Gray*.

[12] [2018] UKFTT 262 at [47]; but HMRC were not represented by Counsel.

[13] *Mackinlay v Arthur Young Mcclelland Moores* [1990] 2 AC 239 at p.249.

[14] Televantos "The Nature of Partnership Property and Equitable Interests" [2023] LQR 26.

[15] The Law Commission refers to "the courts' flip-flopping from one theory to another when they attempt to justify results with reference to the nature of partnership:" Law Com 283, *Partnership Law* (2003) para 3.51.

Topic	**See para**
Co-ownership (transparent) analysis adopted:	
Partnership income arises to partners, not partnership	85.16
Valuation	85.4
Cases where ownership through partnership does not block relief:	
Group reliefs	85.24
IHT relief on FOTRA securities	App 6.5
DT relief for direct investor	30.15.6
Chose in action (opaque) analysis adopted:	
Situs of partnership share for IHT not situs of partnership assets	102.35
Remittance by partnership not remittance by partners	18.49
Pension fund charge: loan to partnership not a loan to partners	[16]

In my view the co-ownership (transparent) analysis applies in the context of BPR, so that ownership of a company through a partnership does not block BPR;[17] but that is controversial.

Sometimes statute addresses the issue and directs that a partnership should be treated as transparent for some purpose (assuming that in the absence of the provision it would or might not be):

Topic	**Expression**	**See**
Withholding tax	Partnership beneficially entitled to income	26.24.3
Incorporation relief	Ownership by partnership	s.162A(8) TCGA

85.3.3 *Scots partnership: 2 analyses*

Just as in England, inconsistent views have been expressed about the nature of a share in a Scottish partnership.

Anson v HMRC adopts (what I call) a chose in action (opaque) analysis:[18]

> Although taxed in the same way as an English partnership,[19] and having many points of similarity to an English partnership, a Scottish partnership differs in possessing separate legal personality. The partners do not, therefore, have any direct proprietary interest in any of the

http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc283_Partnership_Law.pdf

[16] *Bayonet Ventures LLP v HMRC* [2018] UKFTT 262 (TC).

[17] See Kessler & Marre, "A Merry Dance" Taxation Magazine, 20 March 2014. The BPR controversy is too far from the themes of this book to pursue here, but it illustrates how in tax everything is connected.

[18] [2015] UKSC 44 at [39]. The judgment is given by a Scottish judge, Lord Reed. References cited are omitted here.

[19] See 85.16 (Partnership transparency: IT/CT).

> partnership assets (unless they happen to hold assets as trustees for the partnership). They have no title to sue for damage to partnership property, and they have no insurable interest in partnership property. What the partners do own is a share of the partnership. That share is an incorporeal moveable right or *ius crediti*: the right is a debt or demand against the partnership. As long as the partnership continues, a partner is entitled under statute to require that the partnership's assets be applied for partnership purposes, and to his share of the profits of the partnership business. On a winding up, a partner is entitled to claim his portion of the net proceeds of sale of partnership assets.

Memec v IRC adopts (what I call) a co-ownership (transparent) analysis. A partner's interest was described as:

> a pro indiviso [joint ownership] right in the stock or common fund vested in the partners, firstly for payment of the company debts and then for the partners themselves[20]

And according to CoA in *Anson v HMRC*:[21]

> a Scottish partner has an (indirect) interest in the profits of the partnership as they accrue as well as in the assets of the partnership. In a real sense the profits and assets are the profits and assets of the partners, the firm, their collective alter ego, merely receiving those profits and holding those assets for the partners who are the firm.[22]

[20] 71 TC 77 citing Bell's Commentaries on the Law of Scotland

[21] *Anson v HMRC* [2013] EWCA Civ 63 at [44]. But as the decision was reversed on appeal, this passage might be questioned.

[22] The IHT Manual provides some support for both views:

> **IHTM25102 Partnership Share Scotland** [May 2020]
>
> In the absence of express provision in the partnership agreement, all the partners have an interest in the entirety of the partnership property but no partner has the right to any particular asset or assets comprised within the partnership property to the exclusion of the other partners. "What is meant by the share of a partner is his proportion of the partnership assets after they have all been realised and converted into money, and all the partnership debts and liabilities have been paid and discharged."

HMRC cite this quote from *Lindley & Banks* (21st ed., 2022), para 19 -08 (The classic definition). But it is not safe to rely on an English law textbook for an analysis of Scots partnerships. The Manual also refers to the Scottish textbook *Miller on Partnership* (2nd ed., 1994) p.199; there has not been a subsequent edition.

The Manual passage continues:

> One consequence of this is, that notwithstanding that the partnership assets may include heritable property, nevertheless the partner's share in the partnership is

As in England, one might say that these are inconsistent views and only one can be right. However I prefer the view that both may be right: a Scots partnership may also have a dual nature, like an English partnership, as a matter of Scots partnership law. Or even if that is not a correct statement of Scots partnership law, it is considered that a dual nature analyses does at least apply for tax purposes, if the context so requires. In this way, and only in this way, the tax treatment of English and Scots partnerships can be aligned.

85.3.4 *Scots partnership: Legal personality*

Section 4(2) PA 1890 provides:

> In Scotland a firm is a legal person distinct from the partners of whom it is composed...

There is, at first sight, some tension between:

(1) The rule that a Scots partnership has legal personality.
(2) Other rules, to the effect that:
  (a) the partners carry on the business of a Scots partnership
  (b) income accrues to the partners
  (c) the partners may be said to "own" the business[23]

Underlying this point is some vagueness or ambiguity in what the concept of legal personality means or entails.[24] Scots partnership legal personality does not mean much more than that it can enter into contracts and be registered as owner of assets.

Avery Jones says:[25]

> Although normally in the common law system a partnership is not a legal person, and hence cannot have any legal capacity, because the common law equates the two, a Delaware RUPA [Revised Uniform

moveable for the purposes of succession. It is a mere right to a debt rather than an undivided right." It is also the case in English law that a partnership share is regarded as personalty, not real property.

[23] For instance for the purposes of IHT BPR. Section 106 IHTA provides: "Property is not relevant business property in relation to a transfer of value unless it was owned by the transferor throughout the two years immediately preceding the transfer." But no-one suggests that partners of a Scots partnership cannot meet this requirement.

[24] See App 2.6 (Person/legal personality).

[25] 'Characterisation of Other States' Partnerships for Income Tax' [2002] BTR 375. Some footnotes are omitted or abbreviated.

> Partnership Act] partnership and a Scots partnership are legal persons and accordingly have the capacity to carry on business themselves, although it is still the partners that carry on the business because that is the definition of partnership...
> In civil law, a partnership's capacity and name is more important than whether it is a legal person... This difference in legal capacity between civil law and common law is more a feature of the difference in the laws dealing with agency, than any real difference.

HMRC agree. The Partnership Manual provides:

> **PM131700** [Jul 2019]
> **Scottish partnerships**
> ... Unlike its English, Welsh or Northern Irish counterpart, a Scottish partnership is a legal person. This has very few consequences for tax purposes.
> Where the differing legal systems would produce different results as between Scotland and the rest of the UK, specific legislation has been enacted to preserve equality of treatment; for example assessment of partnership profits (see PM141000) and capital gains (see CG27000).[26]
> Where the tax legislation itself would produce different results, the courts have directed that:
>
> > '…it is desirable to adopt a construction of statutory words which avoids differences of interpretation of a technical character such as are calculated to produce inequalities in taxation as between citizens of the two countries.'[27]

85.3.5 *Who carries on partnership business?*

In the case of an English partnership, it is obvious that the *partners* carry on the partnership business. If one refers to the *partnership* carrying on the business, it might be objected that the expression is inaccurate, or at

[26] Author's footnote: It may be doubted whether these are good examples, but it is not necessary to pursue that here.

[27] *R v General Commissioners ex p. Gibbs* 24 TC 221 at p.244. *BPP Holdings v HMRC* [2017] UKSC 55 at [23] expressed same sentiment in procedural matters: "it is highly desirable, particularly in a field where the law is the same throughout the United Kingdom (as in tax), that tribunals, or at any rate tribunals in the same field, apply the same, or (at least in some cases) even similar, rules in the same way throughout the UK. In these circumstances, all tribunals and appellate courts above the level of the UT should be wary of applying or relying on the procedural jurisprudence of the English and Welsh courts without also taking into account that of the Scottish and Northern Irish courts.

least loose, as only a person can carry on a business and an English partnership is not a person. But I think the objection would be pedantic, and in practice the expression is often found.

In the case of a Scots partnership, it is also the case that the partners carry on the partnership business, though one could also say that the partnership carries on the partnership business: both statements are true.[28]

85.3.6 *English/Scots partnership tax aligned*

The legal personality of a Scots partnership is not therefore as important for tax as might appear at first sight. On top of that, there is a strong presumption of parity and the courts have consistently preferred an analysis under which English/Scots partnerships are treated alike.

> I think it right to lay aside any preconceptions derived either from the law of England or from the law of Scotland as to the technical legal nature of a partnership. In Scotland a firm is "a legal person distinct from the partners of whom it is composed", but this is not so under English law. For the present purpose[29] this distinction should, in my opinion, be disregarded. The Income Tax Acts are ... equally applicable on both sides of the border and the language which they employ ought to be construed so as to have, as far as possible, uniform effect in England and in Scotland alike.[30]

85.4 Valuation of partnership share

A full discussion of valuation of a partnership share would need a chapter, and only some points of principle are addressed here.

After the introduction of 100% BPR, in 1992, valuation of partnership shares only arises occasionally, so it is a somewhat unexplored topic. But the question may arise if BPR does not apply, most commonly, for an investment partnership.

In *IRC v Gray,* Lady Fox was a partner with a 92.5% interest in a partnership which held a valuable tenancy:[31]

> It is this outside view [the co-ownership (transparent) analysis] which

[28] See 83.8 (Tiered partnership).

[29] The question was whether a partnership constituted "a person charged" within the meaning of Rule 9 of schedule D cases I and II, ITA 1918. There is no equivalent in current legislation, but that does not affect the point being made.

[30] *R v General Commissioners ex p. Gibbs* 24 TC 221 at p.247.

[31] *IRC v Gray* [1994] STC 360 at p.377.

> identifies the nature of the property falling to be valued for the purpose of capital transfer tax [now IHT], although in accordance with the *Crossman* principle[32] the restrictions imposed by the partnership deed must be taken into account in assessing its value ... In my judgment, therefore, Lady Fox had for the purposes of [what is now s.160 IHTA[33]] a 92·5% interest in the tenancy which the Lands Tribunal had jurisdiction to value as an interest in land.

So one adopts the co-ownership (transparent) analysis, not the chose in action (opaque) analysis, for the purposes of:
(1) valuation generally and
(2) tribunal jurisdiction in particular[34]

The first of these is obviously the important point, though *Gray* actually concerned the somewhat niche jurisdiction issue. The IHT Manual provides:

> **IHTM25102 Valuing The Partnership Interest: Partnership Share**
> [May 2020]
> Following the judgement of Hoffmann LJ in the case of *Gray v IRC* [1994] STC 360, at p.377c, the valuation of an interest in a business carried on as a partnership should be by reference to the value of the appropriate share of each asset. The previous practice of allowing a discount for the costs of sale is effectively overturned by this decision. That earlier treatment had been based on the general law definition of a partnership share as a proportionate interest in the partnership assets after they have been converted into money, and all the partnership debts and liabilities have been paid and discharged.
> In the valuation of an interest in an agricultural tenancy held for the benefit of a farming partnership, the Lands Tribunal made no allowance or discount in calculating the value of a deceased partner's interest - *Walton v IRC* [1996] STC 68.

While there is no reduction in the valuation for notional costs of sale, what is valued is the partnership share. A one half share in a partnership is not worth one half of the partnership assets: where A and B own, say, land in

[32] As to which, further thought is needed, if there are restrictions on transfer of a partnership share, or if the partner receives, or is entitled to receive, a lump sum.

[33] This provides (so far as relevant): "the value ... of any property shall for the purposes of this Act be the price which the property might reasonably be expected to fetch if sold in the open market ...".

[34] Questions as to the value of land go to a different tribunal, not the FTT; s.222 IHTA.

equal shares, as co-owners but not as partners, everyone agrees that the valuation of the share is in principle less than half the value of the whole.

The same approach is applied in Scotland.

85.5 Partnership law primer

The Partnership Manual contains a general introduction to partnership law. This is broadly sound, though it has the defect that the cases cited are mostly tax cases. Insofar as the aim is to set out a primer of partnership law, this is a myopic approach, like trying to write a book without using the letter *e.* To be fair, it is inevitable that tax lawyers will focus on tax cases, which are their everyday reading, and the fact that it is possible at all does illustrate how often tax turns on issues of general (non-tax) law, in this case, partnership law. But one needs to be aware of the shortcomings of this approach.

Of course it is only a basic outline of a large topic. In this book I do not include a primer of trust or company law, but it may be useful to survey partnership law, as the questions often arise in a tax context, and the topic is not on the undergraduate law syllabus.

85.5.1 *"Business"*

The definition of partnership uses the word business.

Section 45 PA 1890 provides:

> In this Act, unless the contrary intention appears ...
> The expression "business" includes every trade, occupation, or profession.

This does not add much, if anything; everyone agrees that business is a wide word. Perhaps that was less clear in 1890.

The Partnership Manual cites the definition and continues:

> **PM120100 What is a partnership?** [Jul 2019]
> ... So 'business' is a very wide term, embracing almost every commercial activity, and is much wider than trade or profession alone.

Making and managing investments may constitute a business.[35] It follows that "business" for partnership law purposes has a different meaning from "business" (or "economic activity") for VAT purposes. It is not inconsistent to say that a partnership is carrying on a partnership business,

[35] See 85.12 (Investment partnership).

and so is a valid partnership, but is not carrying on a VAT business, and so is not subject to VAT.

85.5.2 *"View of profit"*

I discuss this phrase elsewhere.[36]

85.5.3 *Formation of partnership*

The Partnership Manual provides:

> **PM120100 What is a partnership?** [Jul 2019]
> ... Partnership is a relationship resulting from a contract or agreement, oral or written. The implementation of that agreement creates the partnership relationship. If it is not implemented, it is not effective (*Dickenson v Gross* [1927] 11 TC 614)...

The Partnership Manual provides:

> **PM134100 Partnerships - formation** [Jul 2019]
> A partnership may exist without a written agreement, on the basis that a later written agreement gives formal expression to an oral agreement already existing. The date of the formation of the partnership remains the date on which the terms of the oral agreement were implemented...

The Partnership Manual provides:

> **PM133000 Does a Partnership exist?** [Jul 2019]
> S2(3) Partnership Act 1890
> ...It is important that you establish all of the facts to determine the true relationship between the parties. This will include finding out what the intentions of the parties were. No single factor is likely to be conclusive on its own. You will need to form an overall view, based on all the facts and evidence.
> A declaration that a deed is to create a partnership relation, or is not to do so, is not conclusive on its own, though it may cast some light on the parties' intentions - see *Morden Rigg & Co v Monks* (1923) 8 TC 450. In that case, two companies purchased and sold cotton and shared profits. The agreement disclaimed that their relationship was one of partnership but it was nevertheless held to be one. In *Fenston v Johnstone* [1940) 23 TC 29 an agreement for joint purchase and development of land stated that it did not constitute a partnership but it was nevertheless held to be one.

[36] See App.5.3 (A view to profit).

A mere assertion that a partnership exists is not conclusive if there is no supporting evidence. In *CIR v Williamson* (1928) 14 TC 335 a father and sons worked a farm. There was no partnership deed, no evidence that profits were shared and the father conducted all financial arrangements. The court decided that there was not a partnership.

The fact that the parties did not intend to create the relationship of partnership is a factor to be taken into account in deciding whether a partnership exists but again is not conclusive - see *Horner v Hasted* (1995) 67 TC 439. A senior manager in an accountancy practice was given the status of partner within the firm and argued that he was a partner. The manager was paid as an employee though the salary was a share of profits. The intention of the firm was that he should not be a partner as this would be contrary to professional and statutory rules. The court decided that he was not a partner.

The receipt of a share of net profits is prima facie but not conclusive evidence of partnership. An agreement to share net losses in the sense of being obliged to make good those losses is an even stronger indication.

A partnership whose income is above the VAT registration limits is required to register on Form VAT 2 with HMRC. If a partnership fails to register that of itself does not mean that there is no partnership but it is a factor to be taken into account in deciding whether a partnership exists.

For a review of other factors which might be evidence of partnership, and earlier cases, see *Saywell (trading as Eaton Tractor Co) v Pope* (1979) 53 TC 40 (in which a partnership deed was held not to have retrospective effect) and *Alexander Bulloch & Co v CIR* (1976) 51 TC 563 (where it was held that persons claimed to be partners who were minors were not partners - see BIM82065).

85.5.4 *How work & profit shared*

Lineker v HMRC summarised the principles:[37]

> While a fixed remuneration does not preclude a finding of a partnership, it is in most cases a strongly negative indication of one.
>
> Although s 1(1) of the Partnership Act 1890 refers to the aim of making a profit, it ... abstains from reference to any necessity that it be shared. The partners are free to arrange for their remuneration in any manner they choose including by agreement that one partner should receive specific sums irrespective of profits.

[37] [2023] UKFTT 340 (TC) at [80].

> It is not necessary for all partners to make a profit earning contribution for there to be a partnership.
> It is not a prerequisite for a relationship of partnership to exist that one of the partners should be involved in the management of the partnership. It is well-established that a sleeping partner can be a partner.

85.5.5 *Date of commencement*

The Partnership Manual provides:

> **PM134100 Partnerships - formation** [Jul 2019]
> Partnership agreements were held not to have retrospective effect in *Ayrshire Pullman Motor Services & Ritchie v CIR* (1929) 14 TC 754, *Waddington v O'Callaghan* (1931) 16 TC 187, and *Saywell (trading as Eaton Tractor Co) v Pope* (1979) 53 TC 40.

85.5.6 *Partnership v joint venture*

The BI Manual provides:

> **BIM82010 Joint Venture** [Jun 2016]
> The contention is sometimes advanced that an association between persons for a business purpose falls short of partnership in some way. Such an association is often called a 'joint venture'.

"Joint venture" is an imprecise term, covering a wide variety of arrangements; but it is here used to mean some form of co-operation that falls short of a partnership.

> On close examination many of these associations prove to be partnerships, despite the name applied to them. A joint venture which is not a partnership is most likely to be found where parties already carrying on businesses of their own agree to co-operate in a single project but they do not agree to share net profits or losses. Where they do agree to share net profits or losses, it is likely that a partnership will result even where the parties are already engaged in their own businesses - see *Morden Rigg & Co v Monks* (1923) 8 TC 450 in which two companies purchased and sold cotton and shared profits. The agreement between them disclaimed that their relationship was one of partnership but the court decided that there was one. In *John Gardner & Bowring, Hardy & Co Ltd v CIR* (1930) 15 TC 602 coal merchants entered into temporary and informal arrangements during a strike for the purchase and sale of coal. Profits were divided equally and the court decided that the arrangements were partnerships. In *George Hall & Son*

> *v Platt* (1954) 35 TC 440 a farmer and an agricultural merchant entered into an agreement to grow carrots. Expenses were met out of gross proceeds and the balance of profit was divided equally. The arrangements were held to be a partnership.
> But for a partnership to exist there must be a business. And that business must be a business that is separate and distinct from any other business that the joint venturers may conduct on their own account. Such a situation occurs in a genuine share farming agreement where a landowner and farmer combine, sharing their resources, with each party meeting their own expenses and taking a share of the produce. In these circumstances the relationship will fall short of partnership.

85.5.7 *Dissolution*

The Partnership Manual provides:

> **PM134200 Dissolution** [Jul 2019]
> A partnership is the relationship between a particular combination of persons. Any change in those persons terminates that partnership and may result in the creation of another partnership, but in some circumstances could also terminate the partnership and not create a new one. Whether a new partnership is created depends on the facts and is different in every instance.

85.5.8 *Assignment of share*

The Partnership Manual provides:

> **PM134300 Death Or Retirement Of Partner** [Jul 2019]
> Partners may assign their interest in a partnership, or they may confer it on death or retirement to another person, but that does not automatically make the assignee a partner. A deliberate decision by the assignee and the surviving partners for the assignee to be made a partner is required.

85.5.9 *Death of partner*

The Partnership Manual provides:

> **PM134300 Death Or Retirement Of Partner** [Jul 2019]
> ... On the death of a partner, the estate of the deceased person is entitled, in the absence of any other agreement, at the option of their personal representatives, to the share of the profits made since death attributable to the use of their share of the partnership assets, or to interest at 5% per annum on their share, until their share of the partnership is paid out.

> Depending on the precise terms of the agreement between the surviving partners and the personal representatives, the sums payable in these circumstances may be interest or annual payments deductible in arriving at the trade profits of the partnership and chargeable as savings income on the recipients.

85.6 Partners

"Partners" in formal legal English means members of a partnership, not the colloquial meaning (cohabitees).

The Partnership Manual provides:

> **PM120100 Partnerships General Notes: Definition** [Jul 2019]
> The word 'persons' in this definition includes artificial as well as natural persons, so an individual, a body corporate or the trustee of a settlement may all be partners. This includes companies and Limited Liability Partnerships ...
> There is no limit on the number of partners a partnership may have.

The BI Manual provides:

> **BIM82005 Existence Of Partnership** [Jun 2016]
> *... Who is a Partner?*
> [The Manual refers to s.1(1) PA 1890 and continues:]
> In the case of *Tiffin v Lester Aldridge LLP* [2012] EWCA Civ 35 the Court of Appeal said that in looking at whether someone was a partner, it was important to look at the intention of the parties.
> Although some factors are seen as being indications that someone is, or is not a partner, their importance will vary depending on the facts of the case. In the case of *Williamson & Soden v JJ Briars* [2011] UKEAT 0611/10/DM, Briars received a share of the profits: although this is often an indication of being a partner, in this case it was outweighed by other facts and he was held to be an employee.
> In applying the test of whether someone is carrying on a business in common:
>
> - You have to look at all the facts of that case.
> - No single factor will be determinative.
> - The weighting of any factors depend on the facts of that case.
> - The intention of the parties is important.
> - Is the person really a principal; that is, someone who is part of the business or someone who is its servant?

85.6.1 *Capacity of partner*

The BI Manual provides:

> **BIM82020 Capacity Of Partners** [Jun 2016]
>
> It is not a requirement of partnership that each member is capable of performing the full range of the activities of the partnership business, but each must be capable of performing a part of the activities. The differing abilities of the parties may have made partnership desirable in the first place; see, for example, *Fenston v Johnstone* (1940) 23 TC 29. In that case arrangements for the joint purchase and development of land, with one party providing expertise and the other finance, were held to be a partnership. See also *Newstead v Frost* (1980) 53 TC 525 in which an entertainer entered into an agreement with a company to exploit his artistic talents and the court decided that there was a valid partnership.
>
> Some professions may only be carried on by qualified persons (for example solicitors, dentists, and patent agents) so a non-qualified person may not become a partner. Some professional bodies permit partnership between qualified and non-qualified persons but will not allow such partnerships to describe themselves as 'chartered' for example accountants and surveyors. Others permit such partnerships provided the non-qualified members do not lay claim to qualifications they do not have or perform services they are not qualified to do, for example insurance brokers and general practitioners.

The Partnership Manual provides:

> **PM132100 Types Of Partner** [Jul 2019]
>
> *General partner*
>
> An ordinary member of a general partnership within the meaning of the Partnership Act 1890 or a limited partnership regulated by the Limited Partnerships[38] Act 1907, who bears joint liability without limit for debts of the partnership.
>
> *Limited partner*
>
> A limited member of a limited partnership whose rights and liabilities to creditors are restricted - see PM131310.
>
> *Salaried partner*
>
> Either
>
> - an employee, not a partner at all, who is given the title for prestige and who may be remunerated in part by reference to the firm's profits. The employee's name may even appear on the firm's notepaper. But, if it does, the employee bears liability only to those who have advanced credit to the firm in the belief that they were a partner (S12 Partnership Act 1890), or

[38] The original erroneously reads "Limited Partnership Act 1907".

> - a partner who is entitled to a first share of profits, and who is in all other respects an ordinary partner
>
> You should determine the true status of the person concerned by a detailed examination of the facts. In deciding which side of the line a person falls, it is important to consider whether or not they are entitled to participate as principal in the general management and conduct of the business. That is not to say that the day to day management of the business might not be delegated to others. This is often the case, particularly in relation to partnerships with large numbers of partners. But it is inherent in the contract of partnership that a true partner (as opposed to an employee) is permitted, indeed has the right, to participate in the general management and administration of the firm. If you require further guidance on this issue please contact CTISA (Technical)...

85.6.2 *Spouse as partner*

The BI Manual provides:

> **BIM82065 Husbands, Wives, Civil Partners And Minor Children**
> [Jun 2016]
>
> A spouse or civil partner is sometimes taken into partnership wholly or mainly to maximise the benefit of the tax reliefs that are available.
>
> You cannot challenge the apportionment of profits, as you can a wage, by reference to the value of the partners' contribution to the firm's activity. It may be possible in these cases to challenge the spouse or civil partner's status as a partner, but such a challenge is often very difficult to sustain. It is sometimes overlooked that there is no need for the spouse or civil partner to contribute capital; or to participate in management; or, in a trading context at least, to be capable of performing the main activity of the business. Indeed to be a partner one need not take an active part in the business at all. Where the spouse or civil partner has signed a deed declaring an intention to carry on the business and the deed gives a right to share in the profits, and subsequently accounts of the business show that that person has been allocated a share of the profits, there will not usually be much chance of mounting a successful challenge.
>
> It is worth emphasising that a partnership is not a sham merely because it is set up to save tax, as indeed the spouse or civil partner who is deserted by a partner leaving them to meet the firm's liabilities may find to their cost. There will always of course be some cases which will be worth investigating and challenging, but these are more likely to be found among those where there is no current partnership deed, and

particularly where there is a clear attempt to antedate the setting up of a partnership by more than a few months. CTISA (Technical) will be happy to advise on worthwhile cases.

Difficult problems are posed where a taxpayer who is carrying on a profession or vocation (as opposed to a trade), which is dependent on their personal skills or qualifications, purports to take a spouse or civil partner (who does not possess a like skill or qualification) into partnership. Some professions have internal rules that preclude this; but this is not always the case. You could argue that in such a case a partnership between the spouses or civil partners to carry on the profession or vocation in question would not be possible, but in the light of the judgments in the case of *Newstead v Frost* (1980) 53 TC 525 (in which an entertainer entered into an agreement with a company to exploit his artistic talents and the court held that there was a valid partnership) that still leaves open the possibility that there might be a partnership between them to exploit the spouse or civil partner's talents for the benefit of both. The Frost case involved a partnership with a company, but the principle is the same.

Settlements legislation

However, even if it is considered that challenging the existence of a partnership would not be successful, it does not necessarily mean that this is the end of the matter. In certain circumstances the settlements legislation may apply - see TSEM4215.

85.6.3 *Minor child as partner*

The BI Manual provides:

BIM82065 Husbands, Wives, Civil Partners And Minor Children [Jun 2016]

... *Minor children*

Partnerships involving minor children appear to be comparatively rare and where found, for example, in farming cases, may not have been set up primarily for Income Tax purposes. Minors are not, by reason of minority alone, incapable of entering into partnership, although in general while under age they are not personally responsible for the debts of the firm. On the other hand it is much more likely in these cases that a partnership deed is not in practice being acted upon. See, for example, *Dickenson v Gross* (1927) 11 TC 614 in which a farmer entered into partnership agreement with sons but the court held that it was not acted upon and therefore there was no partnership. A common-sense approach is suggested. Given the nature of the business and the age of the child is it reasonable to assume that the child is capable of carrying on the business in common with the other partners? Is it likely that the relationship of agency exists between the child and the others, or that third parties look on the child as a principal? Indeed in the case of a young child is it likely that the child was capable of sufficient understanding to have entered into the relationship at all?

In the case of *Alexander Bulloch & Co v CIR* (1976) 51 TC 563 two schoolgirls aged 15 and 16 were claimed to be partners in the family off-licence business. The Court of Session held that the Commissioners were entitled to hold that for the relevant year (during which in any case there was no partnership deed) the essential proof of the existence of a partnership was lacking. It is clear from the stated case that the Commissioners based their decision in part on the immaturity of the children and it is probable that they were also influenced by the nature of the business. On the other hand in the case, for example, of a farming partnership, Commissioners might well be prepared to accept that a 15 or 16 years old person was capable of acting as a partner. CTISA (Technical) will be happy to advise on worthwhile cases. Again if it is considered that a partnership involving a minor (that is aged under 18 and unmarried) is artificial and its existence cannot be challenged you must refer it to HMRC Trusts and Estates to determine whether the Settlements legislation can be applied.

Settlements legislation

Where the child's share of the partnership was transferred from a parent, the settlements legislation applies to treat the income as that of the donor parent until the child reaches the age of 18, marries or enters into a civil partnership - see TSEM4300 onwards.

85.7 Nominee partner

85.7.1 *Terminology*

We begin as so often with terminology:

An **agent** (in the sense used here) is someone who (as a matter of contract law) has power to enter into a contract which binds his **principal**. As agent has a variety of meanings, one might describe the agent as a **contract-law agent**.

A **nominee** is someone who (as a matter of trust law) holds property as nominee (or bare trustee) for a **beneficial owner**.

A person may be:

(1) a nominee but not a contract-law agent

(2) a contract-law agent but not a nominee

(3) both contract-law agent and nominee; I refer to that as a **"nominee-agent"**

A nominee-agent is acting for the **beneficiary-principal** in two distinct capacities, or at least, a nominee-agent has two distinct sets of powers and duties.

85.7.2 *Partnership law background*

There are two possibilities:

(1) A contract-law agent may enter into a partnership agreement under which the principal becomes a partner of the partnership

(2) A nominee may enter into a partnership agreement under which:
(a) The beneficial owner is not a partner of the partnership
(b) The nominee is a partner, and holds its partnership interest on trust as nominee/bare trustee for the beneficial owner

The first question is to decide which of (1) or (2) is the case. This depends on what has been agreed. If the documentation is well drafted the answer will be clear. The drafter ought to consider who the partners are, and a partnership ought to know who its partners are! But documentation is not always well drafted, and then it is a matter of construing the documentation, in the light of the relevant facts and principles of partnership/contract law.[39]

85.7.3 *Nominee partner: Tax analysis*

If we have a nominee-partner, as a matter of partnership law, the next question is the tax analysis. We need to consider the position of the nominee and the beneficial owner. I first consider the simpler case where the beneficial owner is an individual or a company; the position where the nominee holds on trust for a partnership is considered separately below.

The PM discusses ordinary partnerships and LLPs separately, but its analysis is the same:

PM132200 [True partnerships, May 2022]	**PM131420** [LLPs, May 2022]
... Where a person admitted as partner is a nominee, acting under the instructions of a principal [beneficial owner], it is necessary to decide who is taxable on the profit share.	Where a person admitted as member is a nominee, acting under the instructions of a principal. It is necessary to decide who is taxable on the LLP profit share.

[39] For these principles, see *Lindley & Banks* (21st ed., 2022) para 4-37 to 4-41.

The person taxable on the profit share is the person who was admitted as a partner, whatever the context in which they have become a partner. [*Case 1*] If the other partners admitted the principal to the partnership ... the principal is taxable on the profit share. [*Case 2*] In other cases the nominee is taxable, as the nominee is the person admitted to the partnership.	The person taxable on the profit share is the LLP member, whatever the context in which they have become a member. The LLP member is the person who has entered into an agreement with the other members, either to form the LLP or to be admitted as a member and whom the LLP is required to register as a member of the LLP.

We are here considering case [2], ie where the nominee is the partner and the beneficial owner is not. HMRC say that *"the nominee is taxable, as the nominee is the person admitted to the partnership"*. HMRC do not expressly say that the beneficial owner is not taxable, but perhaps that should be implied. I refer to that as the HMRC Manual view.

For chargeable gains accruing to the partnership, the person taxable must be the beneficial owner, not the nominee. This follows from the bare-trust disregard[40] and applies for CGT and for CT on chargeable gains. It is not clear whether the Manual means to express the contrary view, but if it does it is wrong.

For income accruing to the partnership, one must consider IT and CGT separately.

(1) For IT on partnership income, ie assuming that the nominee is an individual, the Manual view is at least a very considerable simplification. An individual nominee could only be taxed at the basic rate, and even then not if the nominee mandates the income to the beneficial owner. The nominee could not be taxed as if it were the beneficial owner.[41]

(2) For CT on partnership income, ie assuming that the nominee is a company, the Manual view is supported by *BCM*, discussed below, but the decision is doubtful and not yet final.

[40] See 87.7.2 (Bare trust terminology).

[41] Further consideration is needed if the nominee acts as UK representative for a non-resident beneficial owner, but I ignore that here; see 124.2 (Tax collected from UK representative).

These Manual passages[42] were written before the enactment of s.848A ITTOIA/s.1258A CTA 2009. This provides:

> (1) This section applies if—
> (a) a partner in a firm is partner as trustee for a beneficiary who is absolutely entitled[43] to the partner's share of the profits of the firm, and
> (b) the beneficiary is chargeable to tax on those profits.
> (2) References in this Part [Part 9 ITTOIA/Part 17 CTA 2009] to a partner or member of the firm include references to the beneficiary.

I refer to this as the **"nominee-partner disregard"**.

Thus even if it were formerly the case that *"the nominee is taxable, as the nominee is the person admitted to the partnership"*, which I doubt, it is not the case now. Indeed, the purpose of the nominee-partner disregard is to reverse the HMRC Manual view.[44]

The drafting of the disregard is not ideal. It states that the beneficial owner is to be regarded as a partner or member; it does not say that the nominee is to be regarded as not being a partner; but I think that is implied. It assumes that (even in the absence of the provision) the beneficial owner would be chargeable, which is right, but I wonder if that is consistent with the HMRC Manual view.

So in the author's view, the nominee-partner disregard only states what was the position before, and it was not actually needed, except for the avoidance of doubt. As at present there would be doubts, it is a useful provision.

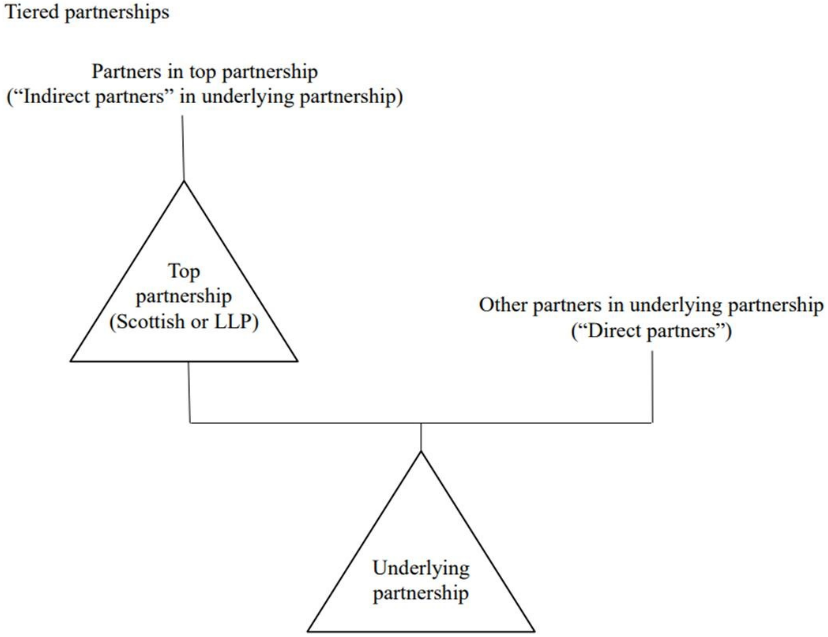
[42] PM132200 was formerly in BIM 82005.

[43] "Absolutely entitled" is not defined. But it is suggested that the standard CGT definition (at least, in general) represents the ordinary meaning, and so should be the starting point here; see 87.7.3 (Entitled against trustee).

[44] The background can be traced through shallow consultation and response papers. See HMRC, "Partnership taxation: proposals to clarify tax treatment" *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/544520/Partnership_taxation-proposals_to_clarify_tax_treatment.pdf* (2016)
HMRC, "Partnership taxation: proposals to clarify tax treatment Summary of Responses (2017)
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/601175/Partnership_taxation-proposals_to_clarify_tax_treatment_-_summary_of_responses.pdf
The papers are discussed in the 2017/18 edition of this work para 47.6 (Nominee partner).

85.8 Tiered partnership

I coin the term “tiered partnership” to describe the position where one partnership (“the top partnership”) is a direct member of another partnership (“the underlying partnership”). Diagrammatically:


Tiered partnerships
Partners in top partnership
(“Indirect partners” in underlying partnership)
Top partnership (Scottish or LLP)
Other partners in underlying partnership
(“Direct partners”)
Underlying partnership

85.8.1 *Tiers: Partnership law background*

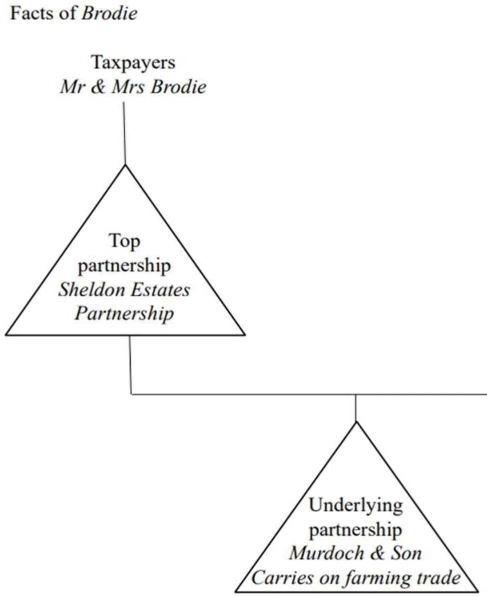
A note on the partnership law background: if the (purported) top partnership is an English law partnership, the situation in the diagram cannot happen. For the definition of partnership is that *persons* carry on business in common, and an English law partnership is not a person.[45] In short, English partnerships cannot tier. But Scottish partnerships and LLPs do have legal personality and so can be members of the underlying

[45] Well drafted documentation would recognise this and would not state that an English law partnership is to be a partner in another partnership.
If a document does state that an English law partnership is to be a partner in another partnership, *Lindley & Banks* (21st ed., 2022), para 4-42 states that the result would be to “constitute each of the members of that firm as a partner in his own right.” That is, what results is just a single partnership, whose partners are all the partners of the (purported) underlying partnership and the (purported) top partnership. The tax analysis then follows in a straightforward manner.

partnership.[46] So the structure set out above can exist as long as the top partnership is Scottish, or a LLP, or a foreign law partnership with legal personality.

85.8.2 *Tiers: Tax analysis*

If we have a tiered partnership structure, as a matter of partnership law, we need to consider the position of the partners in the top partnership. The analysis was discussed in *Major v Brodie*, which involved exactly this structure. The top partnership was a partner in an underlying partnership which carried on a farming trade. Both were Scots partnerships:


Facts of *Brodie*
Taxpayers
Mr & Mrs Brodie
Top
partnership
Sheldon Estates
Partnership
Direct partner
Henry Murdoch
Underlying
partnership
Murdoch & Son
Carries on farming trade

The taxpayers borrowed money and contributed it to the top partnership. They were entitled to interest relief if the *top* partnership carried on the farming trade which was carried on by the *underlying* partnership.[47] This

[46] This is self-evident, but if authority is needed, see *Lindley & Banks*, para 4-44 which continues:

> "The position is otherwise in Scotland, where the firm is a separate legal person and its ability to enter into the partnership relation is well recognised."

[47] The law is unchanged but now in s.398 ITA, which provides (so far as relevant):

> "(1) This section applies to a loan to an individual that is used in one or more of the ways specified in subsection (2).
> (2) The ways are ... (b) contributing money to a partnership ... that is used wholly

condition was met:[48]

> Leaving aside for a moment the special feature that a Scottish partnership has a legal personality of its own, a trade carried on by a partnership is a trade carried on by its members and by each of them.[49]
> ... The following two statements are not inconsistent with each other; on the contrary, they are two separate ways, each correct, of saying the same thing.
> (1) the top partnership carries on the trade of farming as a member of the underlying partnership.
> (2) the underlying partnership, a firm of which a member is top partnership, carries on the trade of farming.

The Scots law rule that a partnership has legal personality makes no difference:

> The argument ... was that the trade of farming carried on by the underlying partnership was not also carried on by the members of the underlying partnership, because the underlying partnership was a separate legal person distinct from its members and, therefore, only it could carry on its trade. [But] although s 4(2) [PA 1890] ascribes separate legal personality to a Scottish partnership, it remains the case that by virtue of ss 1(1) and 4(1) PA 1890 there are still persons carrying on business in common with a view of profit, and those persons are the partners.

All the judge had to decide was that the *top partnership* (the partner in the underlying partnership) was carrying on the trade of the underlying partnership. But further points can be made:

(1) the *partners* of the top partnership were carrying on the trade of the underlying partnership. In this respect, the partners in the top partnership are treated as partners in the underlying partnership.

(2) As the partners of the top partnership are also carrying on the business of the top partnership, they are carrying on two businesses:
(a) the business of the top partnership;[50] and

for the purposes of the trade ... carried on by the partnership,"

[48] 70 TC 576 at p.597. For clarity, I have replace the partnership names with my preferred labels.

[49] The judge referred to s 1(1) PA 1890 Act: "Partnership is the relation which subsists between persons carrying on business in common with a view of profit".

[50] The business of the top partnership is in principle (or will include) the business of holding an interest in the underlying partnership (an investment business).

(b) the business of the underlying partnership

The outcome would be the same had these been English law partnerships, though the partnership-law analysis would be somewhat different.[51]

A note on terminology. Section 847(4) ITTOIA describes a partner in the top partnership as an "indirect partner" in the underlying partnership.[52] This term is only used in s.852A and s.855A ITTOIA, dealing with basis periods for trading partnerships. Basis periods are not considered here, though I hope to in a future edition. But the terminology might be used more generally.

Also see 86.15 (Associated partnership).

85.9 Tiered partnership through nominee

I use the expression **"tiered partnership through a nominee"** to describe the position where:

(1) There are two partnerships in existence:
  (a) an "underlying partnership" and
  (b) a "top partnership"

(2) A person (the "nominee") is a partner in the underlying partnership, and so holds a partnership share in that partnership

(3) The partnership property of the top partnership is the nominee's partnership share in the underlying partnership. The nominee may typically be
  (a) a partner in the top partnership, and
  (b) the general partner, if the top partnership is a limited partnership
  But that is not necessary.

This structure may be considered as a combination of (1) the nominee structure, and (2) the tiered partnership structure considered above. It differs from the nominee structure considered above, as here the nominee holds for a partnership and not an individual or a company. It differs from the tiered partnership structure considered above, as here the

[51] at p.599.

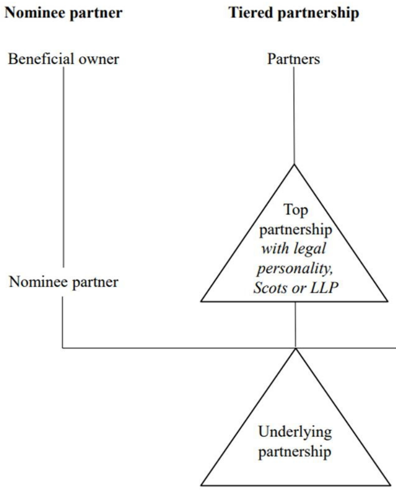
[52] This provides:

> "For the purposes of this Part [Part 9, partnerships], a person is an indirect partner in a partnership ("the underlying partnership") if the person is a partner in—
> (a) a partnership which is a partner in the underlying partnership, or
> (b) any partnership which is an indirect partner in the underlying partnership by virtue of the preceding application of this subsection."

There is no CT equivalent.

member of the underlying partnership is a nominee and not the top partnership itself.[53] Where the top partnership does not have legal personality, this is the way that a tier of partnerships has to be structured, as a partnership without legal personality cannot be a member of another partnership.

Diagrammatically:


Nominee partner
Tiered partnership
Tiered partnership through nominee
Beneficial owner
Partners
Partners
Top partnership
Top partnership *with legal personality, Scots or LLP*
Nominee partner
Nominee partner
Underlying partnership

[53] *Lindley & Banks* (21st Ed.) Section 8 (Sub-partnerships) uses the term "sub-partnership":

> An agreement to share profits only constitutes a partnership between the parties to the agreement. If, therefore,
> [1] several persons are partners and
> [2] one of them agrees to share the profits derived by him with a stranger,
> this agreement does not make the stranger a partner in the original firm. The result of such an agreement is to constitute what is called a sub-partnership, that is to say,
> [1] it makes the parties to it partners inter se; but
> [2] it in no way affects the other members of the principal firm.
> Thus, a sub-partnership is, conventionally, a partnership in a share of another partnership ...

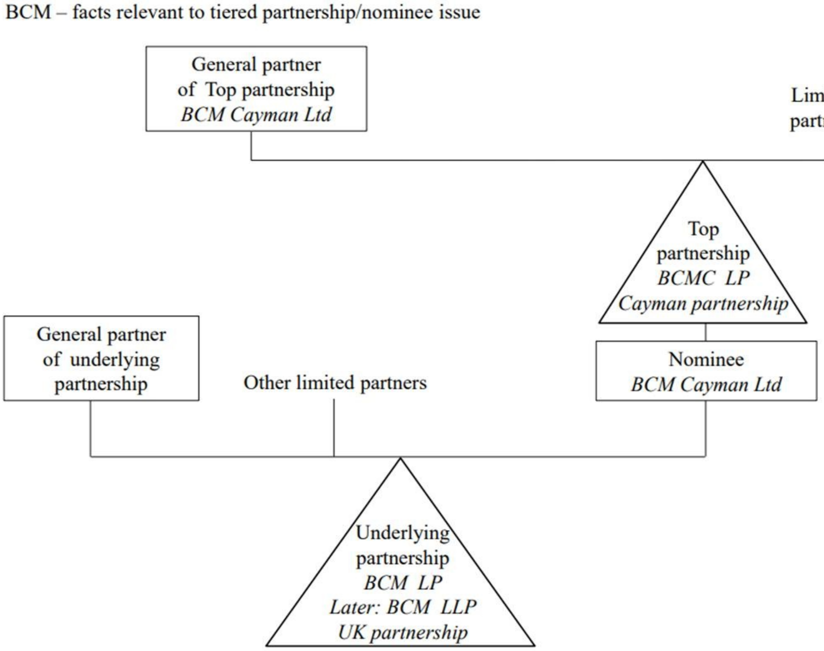
Lindley & Banks notes the commercial (partnership law) consequences of the structure:

> “It follows from the fact that a sub-partner will not become a partner in the head partnership that he will not be liable to the creditors of that firm; his indirect participation in the profits of the head partnership is naturally not sufficient to found any such liability. Moreover, the sub-partnership and the head partnership will, in the current editor's view, be distinct entities for the purposes of the insolvency legislation.”

But we are here considering the tax position.

85.9.1 *Tax analysis*

Assuming we have this structure, the next question is the tax analysis. The question arose in *BCM Cayman LP v HMRC* (*"BCM"*).[54] *BCM* raised many interesting issues, and quite complicated facts. But for present purposes it sufficient to say that there was a "tiered partnership through nominee" structure:


BCM – facts relevant to tiered partnership/nominee issue
General partner of Top partnership *BCM Cayman Ltd*
Limited partners
Top partnership *BCMC LP* *Cayman partnership*
General partner of underlying partnership
Other limited partners
Nominee *BCM Cayman Ltd*
Underlying partnership *BCM LP* *Later: BCM LLP* *UK partnership*

The nominee was carrying on a trade in the UK through a PE, because it was a partner in the underlying partnership. So it was subject to CT on the profits it received beneficially. But the UT held that the nominee was subject to CT on all the profits of its share in the underlying partnership, even though it held them on trust for the limited partners, and even though s.6(1) CTA 2009 states that a company is *not* chargeable to corporation tax on profits accruing to it in a fiduciary or representative capacity! This is an astonishing outcome. In the author's view it is wrong technically, wrong on the merits (tax ought to be paid by beneficial owners and not nominees[55]) and wrong administratively, raising difficulties as to the

[54] [2023] EWCA Civ 1179.

[55] This is the case everywhere else; see 15.8 (Receipt by nominee/trustee).

position of the other partners in the top partnership, which the judgment did not consider. CA decided the case on other grounds. But from 2018 the nominee-partner disregard ought to restore common sense to this area of law.[56]

85.10 Service company

The BI Manual provides:

> **BIM82070 Service Companies** [Jan 2019]
> Partnerships may use a company, owned by the partners, to provide services to the partnership. In such cases, the main issue is likely to be whether fees paid by the partnership to the company are allowable deductions in calculating profits of the partnership trade.
> Relevant factors to consider are:
> - what services the company provides to the partnership
> - the basis on which the company is remunerated for the services it provides
> - whether the company and partnership are connected persons.

The BI Manual provides:

> **BIM82070 Service Companies** [Jan 2019]
> ... In some cases the company providing services is also a partner in the partnership and receives a profit share. In this case the question is whether the company has a trade separate to the trade carried on in partnership. The company cannot claim expenses against the net profit allocated by the partnership. For further information on partners' expenses see BIM82075.

See 86.4 (Mixed partnerships code).

85.11 Limited partnership

The BI Manual provides an overview of limited partnership law:

> **BIM82101 Partnerships: Limited Partnership: Overview** [Jun 2016]
> A limited partnership is one in which at least one of the partners restricts their liability for the debts and obligations of the firm to a pre-determined sum, instead of bearing unlimited liability as a partner normally does.
> A limited partnership is governed by the Limited Partnerships Act

[56] *BCM* only concerned years up to 2013.

> 1907. In addition a limited partnership is subject to the Partnership Act 1890 and general partnership law except where these are overruled by the Limited Partnerships Act 1907.[57]
>
> The limited partnership must consist of at least one general partner who manages the business and bears unlimited liability to creditors, and at least one limited partner. The limited partner must contribute a specified amount of capital on joining the firm, which they cannot withdraw as long as they remain a limited partner. They cannot be made to bear any liability to creditors or their fellow partners in excess of that amount plus any undrawn profits. A limited partnership must register with the Registrar of Limited Partnerships in Cardiff, Edinburgh or Belfast as appropriate. Failure to register deprives it of its limited liability.
>
> The limited partner may not bind the firm and may not take part in the management of the firm's business. If they do, they lose their limited liability.
>
> Because they are bound by the partnership deed and because their general partners act as their agent, a limited partner does carry on the business of the firm despite the restrictions on their rights and powers.
>
> Limited partners, in the same way as other partners in the partnership are taxed on their share of the profit from a trade or profession carried on by the partnership as if it were derived from a 'notional' trade or profession that they carry on alone...

For tax purposes, a private fund limited partnership is treated the same way as a limited partnership.

85.12 Investment partnership

The BI Manual provides:

> **BIM82001 Partnerships General Notes: Definition** [Jun 2016]
>
> ...[Business] includes a business of making investments. Simply making an investment is not enough, there has to be sufficient organisation, continuity to make the activity a business.

85.12.1 *Partnership holding securities*

The CT Manual provides:

> **CTM36560 investment partnerships** [Feb 2018]
>
> There cannot be a partnership without a 'business'. Most partnerships

[57] The original erroneously reads "Limited Partnership Act 1907".

> carry on a trade or profession. But it is possible for an activity not to amount to a trade or profession and still be within the definition of 'business' in the Partnership Act 1890. Property and investment management, carried on as a commercial venture, may fall into this narrow category. Such partnerships are sometimes known as 'investment partnerships'...
>
> Limited partnerships have become more common since 1987, when the British Venture Capital Association (BVCA) published guidelines on how they might be used as investment funds. They are almost always company partnerships. ...

The CT Manual provides:

> **CTM36580 BVCA statement and guidelines** [Feb 2018]
>
> ...The Board of Inland Revenue has agreed with the Taxation Committee of the BVCA the tax treatment of partnerships established under the Limited Partnerships Act 1907 and used as vehicles for raising funds wholly or partly for equity investment in unquoted companies...
>
> **1) Taxation treatment of the partnership**
>
> 1.1) A limited partnership established for the purpose of raising funds for investment into companies will be regarded as carrying on a business and will represent a partnership within the definition in section 1 of the Partnership Act 1890 for the purposes of UK taxation.

85.12.2 *Partnership investing in land*

The PI Manual provides:

> **PIM1030 jointly owned property & partnerships** [Apr 2018]
>
> **Jointly owned property**
>
> Where property is owned jointly with one or more other persons the way the rental income is taxed depends on whether the letting is carried on in partnership. Joint letting does not, of itself, make the activity a partnership.
>
> Usually, there won't be a partnership and the customer's share from the jointly owned property will be included as part of their personal rental business profits.
>
> Less commonly, the joint letting may amount to a partnership. If this is the case the share of the profit or loss must be kept separate from any other letting income. A partnership loss can't be deducted from a personal rental profit and vice versa.
>
> The property income rules will not alter a customer's status. A partner will not cease to be a partner just because of the current rules. Equally,

if a customer was not a partner before, they will not become a partner just because of the current rules. See below for more about the cases where a partnership exists.

customers who have jointly owned property should know who is keeping the records and have access to them. They are personally responsible for including their share of the income in their own tax return even if they agree that someone else will keep the records.

Jointly owned property: no partnership

...

If a customer's only income from land and property in the UK comes from a jointly owned property, that share alone will form the rental business. If a customer has other income from land and property in the UK, whether in their name alone or owned jointly with other people, their share from the jointly owned property will form a part of their rental business along with the other income and expenses on any other properties which they own alone. Once again, however, shares held in a different capacity (partner, trustee, executor) must be kept separate.

Jointly owned property: partnership

A customer may jointly own properties which are let out as part of a partnership business. This might occur where:

- they are in a trading or professional partnership which also lets some of its land or buildings (but see BIM41015 about the inclusion of rents from the temporary letting of surplus business accommodation in the trading or professional profit), or
- more rarely, they are in a partnership which runs an investment business which does not amount to a trade and which includes, or consists of, the letting of property.

A partnership rental business of either type is treated as a separate business from any other rental business carried on by the individual partners on their own account. Each partner's share of the profits or losses arising from the partnership rental business can't be added to or subtracted from any individual rental business profits or losses. If customers are in more than one partnership, each is dealt with as a separate rental business and the profits of one can't be set against the losses of another....

When does a partnership exist?

Whether or not a customer is a member of a partnership depends on the facts. A partnership is unlikely to exist where the customer is one of a group of joint owners who merely let a property that they jointly own. On the other hand, there could be a partnership where the customer is one of a group of joint owners who:

- let the jointly owned property, and

- provide significant additional services in return for payment.

Much depends on the amount of business activity involved. The existence of a partnership depends on a degree of organisation similar to that required in an ordinary commercial business.

Bear in mind that the existence of a partnership can have important legal consequences quite apart from tax; the customer may be liable for partnership debts for example. ...

Legislation

You need to distinguish between:

- income derived from property held by a partnership (ITTOIA05/ S859 (2)). In this case the income does not belong to the individual partner in his personal capacity and is not part of his own rental business, and
- income derived from property which is jointly owned in circumstances which do not amount to partnership. In this case the individual joint owner does receive his share of the income in his personal capacity, and it does form part of his own rental business.

Merely holding property jointly does not constitute a partnership. An Officer of [HMRC] should see any case in which there is doubt as to whether a partnership exists and should consider it in the light of the guidance below.

When does a partnership exist? - more detail

[The Manual refers to s.1 Partnership Act 1890 and continues:] It is not enough to constitute a partnership that property is jointly owned or that the joint owners receive a share in the rents derived from it (Section 2 Partnership Act 1890). For there to be a partnership there must be a business. This is defined in Section 45 Partnership Act 1890 as including ‘every trade, occupation or profession’ and is a wider concept than ‘trade’. *Griffiths v Jackson* [1982] 56 TC 583 suggests that letting property may sometimes be a business.

Most cases of jointly owned property will fall short of the degree of business organisation needed to constitute a partnership. To accept that a partnership exists you would have to be satisfied that there is a similar degree of business organisation as in an ordinary commercial business. This means more than treating rental income as derived from a business of letting property - it must be business apart from that. See also the general guidance on the nature of partnerships at BIM72000 onwards.

On the other hand, where it has been accepted that a partnership already exists and has income from property belonging to the partnership, the presumption would normally be that the letting is part of the partnership business and there is more than mere joint

> ownership.
>
> Whether a case is partnership or only joint ownership could become material where there are losses involved in that or other lettings. If there is a partnership, the letting will be part of a separate rental business and it will not be pooled with profits or losses from properties held by the partners individually.
>
> There is advice on the basis of assessment to be used in the case of partnership property income at PIM1040 ...[58]

85.13 Partnership/co-ownership compared

This section considers the differences between an investment partnership and co-ownership. The issue may arise consciously, where a choice is made between the two arrangements. It may arise accidentally, where a purported investment partnership agreement does not constitute a valid partnership because, say, the "partners" are not carrying on a business.

General (non-tax) law differences include different rules for payment of partnership liabilities and for succession. However:

(1) A purported partnership agreement (which would more accurately be called a co-ownership agreement) would in principle still constitute a valid contract and govern the rights of the parties. The failure to constitute a valid partnership would not invalidate the agreement (just as a joint venture agreement which unintendedly creates a partnership is still a valid contract).

(2) In particular, the co-ownership agreement would determine who was entitled to income and gains from the property (and so who is taxable on that).

HMRC agree. The PI Manual provides:

> **PIM1030 jointly owned property & partnerships** [Apr 2018]
> ... Where there is no partnership, the share of any profit or loss arising from jointly owned property will normally be the same as the share owned in the property being let. But joint owners can agree a different division of profits and losses and so occasionally the share of the profits or losses will be different from the share in the property. The share for tax purposes must be the same as the share actually agreed...

Tax provisions which refer to partnerships will not apply to a co-ownership arrangement which is not a partnership. For instance:

[58] The Manual also supplies pre-rewrite (ICTA) references, but I omit these here.

(1) Different IHT situs rules apply.
(2) Different remittance rules apply.
(3) Different rules may apply to income losses.
(4) For completeness (the point is not likely to arise): Spouse partnership falls outside s.836 ITA (which applies to income arising from spouse co-ownership).[59]

But IT and CGT transparency will apply to a co-ownership arrangement, as the statutory rules relating to partnership transparency (in short) reflect what the position would be without statutory rules.

In general, accidental invalidity of a partnership is not likely to cause tax problems, though IHT situs and other specialist issues could arise. This is sensible as the relationship between partners is very similar to the relationship between co-owners who are not partners.

85.14 Partnership: person/body corporate

The next sections discuss:

(1) Whether a partnership is:
  (a) a person
  (b) a body corporate
  (c) a body
  (d) a body of persons
(2) Whether a partner holds an office

85.14.1 *Partnership: a person?*

The use of the word "person" requires some care.[60]

An English partnership is not a legal person in English law, that is to say, it is not a legal entity distinct from the partners, or a unit capable of rights or duties:

> As a strict proposition of English law, there is no doubt at all that a partnership is not, as such, a single juristic person. ... In English law a firm as such has no existence; partners carry on business both as principals and as agents for each other within the scope of the partnership business; the firm name is a mere expression, not a legal entity ... It is not correct to say that a firm carries on business; the

[59] See 94.7 (Property held jointly by spouses).
[60] See App 2.6 (Person/legal personality).

> members of a firm carry on business in partnership under the name or style of the firm.[61]

Context may show that the word "person" is used loosely, so as to include a partnership;[62] but in practice that is rare.

The rule that an English partnership is not a legal person could have been (more or less) undone by the Interpretation Act 1978 definition:

> "Person" includes a body of persons corporate or unincorporate.[63]

A partnership has been said to be a "body of persons" in the ordinary sense of that expression,[64] and it is "unincorporate". If that is right, an English partnership would seem to be a person in the Interpretation Act sense. But even if the position were that references to person in Acts of Parliament prima facie include an English partnership, the rule that English partnerships are not legal persons is deeply ingrained and in practice no-one usually takes notice of the Interpretation Act 1978

[61] *R v General Commissioners ex p. Gibbs* 24 TC 221 at p.244.

[62] Eg *R v General Commissioners ex p. Gibbs* 24 TC 221 at p.419:

> "Having regard to the special vocabulary of the Income Tax legislation, I find no difficulty in interpreting the words "a person charged" in Rule 9 to include the case of several persons associated together in partnership for the purpose of carrying on a trade in common ..."

This should not be surprising, because in ordinary language, 'partnership' is a person word, just like 'company'. 'The land is owned by a partnership.' 'The partnership is liable for the debt.' Ordinary language is right.

[63] Sch 1 Interpretation Act 1978.

Of course, Scotland needs its own equivalent, for the interpretation of Acts of the Scottish Parliament and Scottish instruments (discussed below in relation to Scots partnerships). Northern Ireland also has a definition for the interpretation of Acts of the Parliament of Northern Ireland: s.34 Interpretation Act (Northern Ireland) 1954. But those definitions do not apply for general UK tax legislation, and (on the view taken here) they are substantially the same as the Interpretation Act 1978 definition (though more appropriately drafted).

[64] "A partnership is, as a matter of the ordinary use of English, plainly a body of persons"; *Padmore v IRC* 62 TC 352 at p.377. But this is in fact far from plain. We are looking at a legal term which is not ordinary English (and rarely used in modern legal English). The group of shareholders in company X is not a body of persons. The group of owners of this book is not a body of persons. So what is it which turns a group of persons with something in common into a "body of persons"? Even if the term has an ordinary fixed meaning, of course context may otherwise provide. For instance, it appears that a partnership is not a body of persons within the definition in s.989 ITA: see *Padmore* at p.377.

definition.[65] There are two ways to reach this conclusion:

(1) To say that "the context otherwise requires" .

(2) Or it may be that a partnership is not, in fact, a body of persons, at least within the meaning of the phrase used in the Interpretation Act.

These are two routes to the same destination. This definition is directed to 19th century organs of local government,[66] and was not intended to apply to partnerships.

The same applies to a partnership governed by the law of Northern Ireland.

85.14.2 *Is partnership a body corporate?*

An English partnership is clearly not a "body corporate".

A Scottish partnership is a legal person, though in practice that usually makes no difference for tax purposes.[67] But it is not a body corporate as it lacks perpetual succession, and is created by agreement and not by statutory authority.[68]

This view is supported by many sources. EN Companies Act 2006 refers to:

[65] Maitland agrees, "Trust and Corporation" (1904): "It would be easy ... to attach too much importance to the fact that since 1889 we have had upon our statute-book the following words: [Maitland sets out what is now the Interpretation Act 1978 definition of person and continues:] I can imagine a country in which a proposal to enact such a clause would give rise to vigorous controversy; but I feel safe in saying that there was nothing of the sort in England... It is not inconceivable that the above cited section of the Act of 1889 may do some work hereafter; but I have not heard of its having done any work as yet".
https://oll-resources.s3.us-east-2.amazonaws.com/oll3/store/titles/873/Maitland_0242-03_EBk_v6.0.pdf
The statutory definition misled the author of the Partnership Manual, who said, wrongly: "PM120100 **What is a partnership** [Jul 2019]

> ...You should note that a partnership, although it may not be a legal person, is still a 'person' (!) for the purposes of the Taxes Acts, unless the contrary intention appears. A 'person' includes 'a body of persons corporate or unincorporate' and a partnership is a body of persons unincorporate."

[66] Maitland, "Trust and Corporation" (1904): "For some years past a similar statutory interpretation had been set upon the word "person" in various Acts of Parliament relating to local government. Some of our organs of local government, for example, the "boards of health" had not been definitely incorporated, and it was, I suppose, to meet their case that the word "person" was thus explained."

[67] See 85.3.3 (Scots partnership).

[68] See 90.9.3 (What is a body corporate?).

> partnerships that are legal persons but are not regarded as bodies corporate (as under Scots law).[69]

The Law Commission express the same view.[70] Likewise sch 1 Interpretation and Legislative Reform (Scotland) Act 2010:

> 'person' includes a body of persons corporate or unincorporated and a partnership constituted under the law of Scotland.

Likewise the CT Manual:

> **CTM00510: Meaning of company, profits and income** [Jun 2019] [The Manual considers the meaning of "body corporate" and continues] That excludes Scottish partnerships which have no perpetual succession and are formed by the partners, notwithstanding their legal personality.

The drafter of s.995 ITA also assumed that a partnership is not a body corporate:

> (2) In relation to a body corporate ... "control" means ...
> (3) In relation to a partnership, "control" means ...[71]

I set this out at length because some older Scots cases take the contrary view, though they might be explained on the basis that context showed the expression "body corporate" was used in a non-standard sense to include Scots partnerships. I think it is settled law that a Scots partnership is not a body corporate in the normal Scots law sense of that expression. The expression "body corporate" has the same meaning in England and in Scotland.

Does it matter? Probably not very much. If (contrary to the above) a Scots partnership were a body corporate, it would still not be a company

[69] Para 1488, commenting on s.1173(1) CA 2006:
"In the Companies Acts—
"body corporate" and "corporation" ... do not include ... a partnership that, whether or not a legal person, is not regarded as a body corporate under the law by which it is governed".

[70] Law Com 283, *Partnership Law* (2003) para 5.38: "Adopting an entity approach to partnership does not mean that a partnership becomes a body corporate". *http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc283_Partnership_Law.pdf*

[71] Likewise s.14(1) Bribery Act 2010 referring to an offence "committed by a body corporate or a Scottish partnership".

within the standard tax definition (which excludes partnerships); but it would be a company within non-standard definitions (which say that any body corporate is a company and do not exclude partnerships).

85.14.3 *LLP: Person/body corporate*

An LLP is a legal person, and a body corporate,[72] but for tax purposes it is generally treated in the same way as an ordinary partnership.[73]

85.15 Partnership: Body/office

The word "body" is occasionally used in isolation. For instance, s.547 ITA refers to:

> A payment made, or to be made, to a body situated outside the UK...[74]

HMRC Guidance Note Annex ii takes a broad view of the meaning of body:

> 9.3 ... payment(s) to a body outside the UK ... include monetary payments sent outside the UK to charities, companies, agents, partners and individual persons outside the UK.[75]

Trustees have been described as a body.[76]

Section 86(1) IHTA (Employee benefit trusts) provides relief:

> Where settled property is held on trusts which... do not permit any of the settled property to be applied otherwise than for the benefit of—
> (a) persons of a class defined by reference to
> [i] employment in a particular trade or profession, or
> [ii] employment by, or office with, a body carrying on a trade, profession or undertaking ...

This raises the question whether a partnership is a body, and whether partners hold an office. Here HMRC seem to take a narrower view:

The IHT Manual provides:

[72] See 85.21 (Limited liability partnership).

[73] See 85.22.2 (Income tax treatment of LLP).

[74] For this provision, see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 6.6 (Foreign body rule) online version *https://www.taxationofcharities.co.uk*

[75] *https://www.gov.uk/government/publications/charities-detailed-guidance-notes/annex-ii-non-charitable-expenditure*

[76] See 63.1.1 (Separate sub-fund trustees).

> **IHTM42925: Employee benefit trusts: conditions for relief: partnerships** [Oct 2020]
> England, Wales and Northern Ireland
> A trust does not qualify under IHTA84/S86 if it is for the benefit only of a particular sole trader or partnership. This is because an individual sole trader or partner is not:
> - a 'body' within IHTA84/S86(1)(a), or
> - a class of people defined by a trade, profession or undertaking of the employer.
>
> The 'employees' of a partnership are the individual partners who carry on their trade, profession or undertaking in an association governed by their Articles so they are not employed by a 'body'.

It is suggested that a English partnership is a body: body is wider than "body corporate". A trust for partners does not qualify as an EBT because partners are not employees and do not hold an office.[77] But a trust for employees of a partnership may qualify as an EBT.

The Manual continues:

> **Scotland**
> In Scotland a partnership is a separate legal persona, so it could create an employee benefit trust within the terms of IHTA84/S86.

A trust for partners of a Scots partnership only qualifies as an EBT if the partners hold an office. That is a question of Scots law, but it seems doubtful. A trust for employees of a Scots partnership may qualify as an EBT.

This analysis avoids an anomaly between Scottish and other UK partnerships.

Likewise, members of a LLP do not hold an office but a trust for employees of an LLP could qualify as an EBT.

I note that the word "office" is not used to describe the status of a partner in either the Partnership Act 1890 or the LLPA 2000.

It would be better if statute did not use the word body, but clarified its intention with more precise terminology; but there it is.

85.16 Partnership transparency: IT/CT

85.16.1 *English partnership*

Partnerships are transparent for IT/CT, in the sense that partnership

[77] See 34.3.1 (Offices).

income/losses are regarded as income/losses of the partners and not of the partnership as such. In my terminology, IT adopts in this context the co-ownership (transparent) analysis of a partnership share.[78] That must be the right analysis, as an English partnership does not have legal personality, ie it is not itself a person. Unless partnership income arises to the partners, it would not arise to anyone, and partnership income must arise to some person or persons if it is to be taxed as it arises.

85.16.2 *Scots partnership*

Scots partnerships are likewise transparent in that sense. In *Memec v IRC*:[79]

> It is not difficult to see why an English partnership (including a limited partnership) is treated as transparent, the partners carrying on business (whether by themselves or by the other partners as their agents) in common and owning the business and having a beneficial interest in the partnership assets and profits.
>
> The justification for treating a Scottish partnership as transparent, though it may be less obvious because of the interposition of the partnership as a legal entity between the partners and the profits of the partnership, can be perceived in that in substance the position of the partners in relation to the profits is the same as in an English partnership:
>
> [1] those profits are earned by the partners carrying on business in common together and are shared in the same way and
>
> [2] the partners, whilst not directly owning the business and assets, indirectly do so and have an indirect interest in them...[80]

The Law Commission say:[81]

> The Inland Revenue justify their approach to UK partnerships[82] by reference to the following three characteristics:
>
> (1) the partners carry on the business of the partnership with a view to

[78] See 85.3 (Nature of partnership share).

[79] 71 TC 77 at p.113.

[80] This passage continues: "...which is capable of being arrested [ie seized] by the creditor of a partner". But what is seized is the debtor's partnership share, not the partnership property.

[81] Law Com 283, *Partnership Law* (2003) para 4.28.

[82] Footnote original: This covers both the English partnership and the Scots partnership notwithstanding that the former has no separate legal personality and the latter has separate legal personality.

> profit;
> (2) every partner is liable jointly or jointly and severally with the other partners for all the debts and obligations of the partnership; and
> (3) the partners own the business, each having at least an indirect share in the net assets of the partnership.

So the fact that a Scots partnership does have legal personality does not entail the conclusion that partnership income accrues to the partnership rather than the partners.

The courts' inclination to minimise tax differences between English and Scots partnerships must also have been an influence in reaching this conclusion.[83]

85.17 Entity-disregard rule

s. 848 ITTOIA	**s. 1258 CTA 2009**
Unless otherwise indicated (whether expressly or by implication), a firm is not to be regarded for income tax purposes as an entity separate and distinct from the partners.	Unless otherwise indicated (whether expressly or by implication), a firm is not to be regarded for corporation tax purposes as an entity separate and distinct from the partners.

I refer to this as the **"entity-disregard rule"**.

85.17.1 *Purpose of entity disregard*

In order to understand the entity-disregard rule, it is necessary to know its history.

Prior to the current statutory provision, partnership tax was governed by s.111 ICTA 1988. In its original form this provided:

> *Where a trade or profession is carried on by two or more persons jointly,*
> *[1] income tax in respect thereof*
> *[a] shall be computed and stated jointly, and in one sum, and*
> *[b] shall be separate and distinct from any other tax chargeable on those persons or any of them, and*
> *[2] a joint assessment shall be made in the partnership name.*

In short, there was a system of joint assessment. This became impossible

[83] See 85.3.6 (English/Scots partnership tax aligned).

after the introduction of self-assessment in 1994.[84] The entity-disregard rule abolished that system.

This history explains why:

(1) It says that a partnership is not an "entity" (rather than saying it is not a "person").

(2) The heading to s.848 is: "Assessment of partnerships" and the heading to s.1258 is, similarly, "Assessment of firms".

So the entity-disregard rule is concerned with the process of assessment.

EN ITTOIA provides:

> 1712. In the case of firms established under English law this provision [the entity-disregard rule] merely confirms their position under that law. But Scottish firms, for example, are legal entities [more correctly, legal persons]. This provision ensures that all firms are treated in the same way.

This suggests that the entity-disregard rule is the reason or basis for partnership transparency for Scots partnerships (though it is not strictly needed for English partnerships). That analysis is not correct: transparency follows from basic principles, not from the entity-disregard rule. That is clear for two reasons:

(1) The entity-disregard rule dates from 1994. However, IT transparency of partnerships has been settled law since the beginning of Income Tax.[85]

(2) The purpose of the rule relates to assessment procedures, not transparency.

The practical reader might ask impatiently whether it matters whether IT transparency follows from basic nature of a partnership, or from the entity-disregard rule. It does not matter so far as the settled rule is that partnership income arises to the partners. But I think the issue does matter, because a reader who studies the topic will identify the false reasoning and be left confused; and when other questions arise, identifying the nature of a partner's right to income may be a central issue, and misunderstanding the role of the entity-disregard rule may lead to the wrong result.[86]

[84] The entity-disregard rule derives from s.215 FA 1994.

[85] It was accepted without question as the background to the issue in *Dreyfus v IRC* 14 TC 560.

[86] See 18.49 (Partnerships).

For completeness: the entity-disregard rule might be relevant if one could envisage a foreign body which (1) was classified as a partnership within the meaning of the entity-disregard rule, but (2) under which income arose to the partnership and not to the partners; but I doubt if that could ever happen, because unless income arises to the partners, a body is not likely to be classified as a partnership.

85.18 "Trade"

The income taxation of partnerships is mostly in Part 9 ITTOIA/Part 17 CTA 2009. This uses an idiosyncratic definition of "trade":

s. 847 ITTOIA	**s.1257 CTA 2009**
(2) The provisions of this Part [Part 9 ITTOIA] which are expressed to apply to trades also apply, unless otherwise indicated (whether expressly or by implication)—	(2) This section and sections 1259 to 1266 are expressed to apply to trades, but unless otherwise indicated (whether expressly or by implication) also apply
(a) to professions, and (b) in the case of this section and sections 849, 850, 857 and 858 to businesses that are not trades or professions.	to businesses that are not trades.
(3) In those sections as applied by subsection (2)(b)—	(3) In those sections as applied by subsection (2)—
(a) references to a trade are references to a business, and (b) references to the profits of a trade are references to the income arising from a business.	[identical]

Thus the word "trade" in Part 9 ITTOIA always includes profession (it would be appropriate to simplify the law by a general rule that trade includes profession for all tax purposes).[87] That does not apply for CT on the basis that a company cannot carry on a profession.

[87] The taxation of trades and professions should be aligned. If (which I doubt) there are any points where different rules are needed, that should be dealt with by express provisions.

The word "trade" sometimes includes "business". Since it is not convenient to use the same word in two different senses, when trade is used in the wider sense, I refer to it as "**trade (including business)**".

85.19 Partnership income: Remittance basis

Section 857 ITTOIA provides:

> (1) This section applies if—
> (a) a firm carries on a trade [including business] wholly or partly outside the UK,[88]
> (b) the control and management of the trade [including business] is outside the UK, and
> (c) section 809B, 809D or 809E of ITA 2007 (remittance basis) applies to a partner for a tax year.
>
> (2) The partner's share of the profits of the trade [including business] arising in the UK is determined in accordance with sections 849 to 856.
> (3) The partner's share of the profits of the trade [including business] arising outside the UK is treated as relevant foreign income.

The main significance of s.857(3) – treating partnership income as RFI – is that the income can qualify for the remittance basis.

Normally a remittance basis taxpayer will want to argue that a partnership trade is controlled abroad, to qualify for the remittance basis, and HMRC will want to argue that control is here. However, if the partnership makes losses the boot may be on the other foot: UK partners may argue for control in the UK, to obtain more generous loss relief.

85.19.1 *Segregating partnership profit*

Suppose:

(1) profits of a partnership trade arise partly in and partly outside the UK; and
(2) a partner receives a share of those profits.

There is an apportionment to determine the profits arising in/outside the UK.[89] The profits that the partner receives constitute a mixed fund, partly RFI (mixed fund category (d)) and partly other income (mixed fund category (i)). A remittance from such a fund follows the mixed fund rule; later years before earlier, and RFI of a year before the other income of the

[88] Section 857(1)(a) appears to be otiose because if the condition in s.857(1)(b) is met the condition in s.857(1)(a) must be met. But it does not matter.

[89] See 21.21 (Trade partly in UK: Apportionment).

year.

On the other hand, suppose:

(1) profits of a partnership trade arise partly in and partly outside the UK; and
(2) a partner receives a share of profits arising outside the UK only.

In that case all the income that the partner receives is RFI. If a partnership includes partners who are remittance basis taxpayers, it may therefore be important for a partnership, if it can, to segregate the two parts of its trade so it can identify which parts of its profits arise in and which parts arise outside the UK.

85.19.2 *Control and management*

The question of partnership control and management matters for various purposes:

Topic	**See para**
Test for RFI in s.857	*Discussed here*
Partnership residence	85.23
Situs of partnership share for IHT	102.35

The test in s.857(1)(b) is control and management of the trade, not control and management of the partnership, but that will usually come to the same thing.

The former International Tax Handbook provided at para 1613:

> [Section 857 ITTOIA] refers simply to control and management being abroad and the view which we have, in general, adopted in determining whether the Section applies is that this means control etc must be wholly abroad. The strength of this view has never been tested in the Courts and the word 'wholly' does not appear in the Act. It is sometimes put to us that where control and management is partly abroad then [section 857] applies. On the other hand, we have argued that because the Section says 'is situated abroad' it means just that and if control is partly here then it is not abroad.

85.19.3 *What is control/management*

The expression "control and management" is of course derived from the company residence test, and it should be given the same meaning here. In *Mark Higgins Rallying v HMRC*:[90]

[90] [2011] UKFTT 340 (TC) at [51].

> We consider the appropriate test for the location of control and management of the business of a partnership is that adopted by the courts in relation to residence of companies.[91]

Thus company residence case law offers guidance.[92]

The former International Tax Handbook provided at para 1612:

> Generally speaking we follow the thinking on companies and look at the place of the highest level of management rather than day-to-day management. Outside textbooks follow the same line.
>
> In deciding the location of the control and management of a firm with both UK and overseas partners, we would usually regard as significant such factors as the comparative seniority of the partners in age and experience (a simple head count will not do of course), the extent of their interests in the firm, the source and control of the finance, the places of decision on policy and major transactions, the places and locations of partners' meetings and what was done at those meetings. The place of meetings incidentally is not a conclusive factor any more than it is – or ought to be – for companies. So the nature of the business done at the meeting is important. Is it really about control and management or just part of a facade to mislead us about the place of actual control and management?

85.19.4 *Where is control/management*

The Commissioners would normally adopt a broad approach, looking at the whole picture in order to identify one overall place of control where possible, and situations where control was located in the UK and abroad would be rare.

The place of control and management is distinct from:

(1) The place where the partners reside[93]

(2) The law of the partnership, which is not relevant

85.19.5 *Dual partnership arrangements*

The former International Tax Handbook provided:

[91] See 8.6 (Central management/control test).

[92] There was a discussion in the former International Tax Handbook at para 1614 as to whether "control and management" are two distinct tests with distinct meanings, or a composite phrase, but the latter is the better view, and that is the approach adopted for the purposes of company residence.

[93] There is no concept here of carrying on business by tacit oversight; contrast 21.4 (UK resident trader: IT).

1622. Normal professional partnership: foreign partnership treatment

In the *Frost* case[94] we tried to argue before the Commissioners that control and management was not abroad. That is our approach to any case where partnerships appear to have been set up for the purpose of avoidance and Case V [RFI] is of advantage...

1623. Foreign partnership treatment: artificial arrangements

But a common situation in professions such as engineers and accountants is one where

[1] there is a UK partnership and

[2] a separate partnership formed abroad with one or more non-UK resident partners in which some or all of the UK partnership partners are members.

Generally speaking where the non-resident partners are professionally qualified and the overseas partnership takes on work which is reasonably local to the place where the partnership is based, it is possible to take a fairly relaxed view and accept a claim to Section [857] treatment. That was so even when Case V was on the remittance basis. If, however, the prima facie evidence against this view were very strong, we would look much more closely.

It seems obvious that in these cases there will be some control in the UK – although proving that that is so is a different matter – but usually the UK resident partners will make visits to the overseas office and there is a case for saying that the management of the partnership is abroad. (This harks back to the Solicitor's Opinion considered in ITH1614.) It may be that some of the overseas partnership work is done in the UK by the UK partnership but this normally happens – or is said to happen – through the UK partnership acting as subcontractor for the overseas partnership.

1624. Foreign partnership treatment: income that of partnership?

If, however, one reaches the position that the ultimate control is in the UK and the bulk of the work is actually done here – albeit under subcontract – then that would be a case for a possible challenge. Cases have been seen where the arrangements were plainly offensive and amounted to no more than attempts to park UK-earned profits in a Section [857] partnership with the admitted intention of avoiding UK tax.

We would certainly want to attack these devices and argue, for example, that the work done in the UK by partners who were also members of the overseas firm was done in their capacity as members of that overseas firm. We could then establish that the profits from those activities could be assessed under Case II. Our Solicitor, on particular cases, has not been discouraging about the chances that we may succeed and in the days of the remittance basis there was some success in settling cases on Case II lines rather than Case V. However, these cases turn crucially on questions of fact and degree and there is the usual difficulty of obtaining information.

1625. Foreign partnership treatment: income that of partnership?

Sometimes we have had to consider whether there is in fact an overseas partnership and/or whether amounts claimed to be receipts of an overseas

[94] *Newstead v Frost* 53 TC 525.

> partnership are in fact receipts of the UK partnership which is seeking to avoid tax. We have had some success with the latter line under circumstances which gave grounds for quiet satisfaction. A firm of UK solicitors which had profited from its fees for advice about the setting up of a well-known tax avoidance scheme, sought to avoid tax on those fees by arranging to park them in a Channel Islands finance and brokerage partnership to which Section [857] was said to apply. This was insult added to injury with vengeance.
>
> Our Solicitor's advice was that we could not challenge the view that control and management was abroad. However, there was considerable artificiality in the arrangements which led ultimately to the fees landing in the accounts of the Jersey partnership. We argued that the amounts were in fact receipts of the UK solicitor's practice and we were aided in this by the fact that it was probably improper for a UK solicitor to enter into a partnership with a non-solicitor to do what they claimed to do in Jersey. This line was eventually conceded and we got tax on the Channel Island profits accruing to the UK partners.

85.20 Partnership transparency: CGT

Readers who find this topic difficult may take comfort from the OTS:

> No-one understands CGT in relation to partnerships.[95]

Section 59(1) TCGA provides:

> Where 2 or more persons carry on a trade or business in partnership—
> (a) tax in respect of chargeable gains accruing to them on the disposal of any partnership assets shall, in Scotland as well as elsewhere in the UK, be assessed and charged on them separately, and
> (b) any partnership dealings shall be treated as dealings by the partners and not by the firm as such.

Para (a) relates to the process of assessment (the metaphor sometimes used is machinery provision); it is drafted in the context of the former IT rule that income tax was assessed and charged on the partners jointly.[96] The rule for CGT has always been to assess and charge the partners separately (the IT rule was later aligned with this.)

That leaves para (b), which is somewhat scanty foundation for the CGT treatment of partnerships.[97] It is supplemented by SP D12:

[95] "Review of partnerships: interim report" (2014) para 6.1 *https://www.gov.uk/government/publications/partnerships-review*

[96] See 85.17.1 (Purpose of entity disregard).

[97] The Law Commission put the point more tactfully: "The working out of this concept [s.59 TCGA] in practice has not been easy, and has had to be regulated by

> **Disposals of assets by a partnership**
> 2.1. Where an asset is disposed of by a partnership to an outside party, each of the partners will be treated as disposing of his fractional share of the asset...
> **5. Contribution of an asset to a partnership**
> ... 5.2. Where an asset is transferred to a partnership by means of a capital contribution, the partner in question has made a part disposal of the asset equal to the fractional share that passes to the other partners. The market value rule applies if the transfer is between connected persons or is other than by a bargain at arm's length. Otherwise the consideration for the part disposal will be a proportion of the total amount given by the partnership for the asset. That proportion equals the fractional share of the asset passing to the other partners.
> 5.3. A sum credited to the partner's capital account represents consideration for the disposal of the asset to the partnership. Although this is similar to a change in partnership sharing ratios, it is not possible to calculate the disposal consideration on a capital contribution by reference to section 4, as the asset does not have a balance sheet value in the partnership accounts. In these circumstances HMRC accepts the apportionment of allowable costs on a fractional basis as provided for in section 4, rather than by reference to the statutory A/A+B formula.
> 5.4. A gain arises on a contribution of an asset where the disposal consideration, calculated according to the fractional proportion of the total consideration or, in appropriate cases, a proportion of the market value of the asset, exceeds the allowable costs, based on a fraction of the partner's capital gains base cost.

So partnerships are transparent for CGT, in the sense that gains/losses on disposals of partnership assets accrue to the partners (not to the partnership). For reasons similar to those discussed above for IT,[98] this result follows from first principles, and the statutory provision merely confirms that.

In determining whether gains are foreign chargeable gains (which may qualify for the remittance basis) one has regard to the situs of the partnership assets; the situs of the partnership share is irrelevant.[99]

The question then is to identify the fractional share of each partner, and

extra-statutory guidance;" Law Com 283, *Partnership Law* (2003) para 3.51. *http://www.lawcom.gov.uk/wp-content/uploads/2015/03/lc283_Partnership_Law.pdf*

[98] See 85.16 (Partnership transparency: IT/CT).

[99] See 103.3 (Co-owned assets).

that can be tricky as partners do not always have easily quantifiable fractional shares. For income, there are express provisions which deal with the point[100] but these do not apply for CGT. Instead SP D12 provides:

> In computing gains or losses the proceeds of disposal will be allocated between the partners in the ratio of their share in asset surpluses at the time of disposal. Where this is not specifically laid down, the allocation will follow the actual destination of the surplus as shown in the partnership accounts; regard will of course have to be paid to any agreement outside the accounts.
> 2.2. If the surplus is not allocated among the partners but, for example, put to a common reserve, regard will be had to the ordinary profit sharing ratio, which is likely to be indicative in the absence of a specified asset-surplus-sharing ratio.
> 2.3. Expenditure on the acquisition of assets by a partnership will be allocated between the partners according to the same principles at the time of the acquisition. This allocation may require adjustment if there is a subsequent change in the partnership sharing ratios see (section 4).

Assignments of partnership interests, and changes in partnership sharing ratios, are interesting topics, but they are not discussed here. The CG Manual has worked examples.

85.21 Limited liability partnership

85.21.1 *Definition and nature of LLP*

Section 1(2) Limited Liability Partnerships Act 2000 provides:

> [A] A limited liability partnership is a body corporate (with legal personality separate from that of its members) which is formed by being incorporated under this Act; and—
> [B] (a) in the following provisions of this Act (except in the phrase "oversea limited liability partnership"), and
> (b) in any other enactment (except where provision is made to the contrary or the context otherwise requires),
> references to a limited liability partnership are to such a body corporate.

So in UK legislation (including tax, and unless the context otherwise requires) the expression "LLP" means a UK LLP (one incorporated under

[100] See 86.3 (Partnership income: Attribution),

the LLPA 2000). "LLP" does not include a foreign LLP.[101] Occasionally the drafter overlooks the statutory definition, and states that LLP has the meaning given in s.1(2) LLPA.[102] But this is otiose.

An LLP (despite its name) is not a partnership in the strict sense of the word (which I call ordinary partnerships).[103] Where the distinction matters, one should not use the word partnership to refer to an LLP. But where the distinction does not matter, as is generally the case for tax, one might use the word partnership loosely to refer to LLPs as well as to ordinary partnerships.[104]

Likewise, in strictness, a LLP has "members" (not "partners"). But where the distinction does not matter, one might use the word partner loosely to include members of a LLP.

Similarly, one might use the word LLP to include foreign LLPs, when the distinction does not matter; but for tax this distinction does matter.

It would have been simpler if a LLP had been a type of partnership. Avery Jones explains why it is not:

> Presumably the reason for creation of this new type of corporate body is that its limited liability is more likely to be accepted in other countries, although this carries with it the corresponding disadvantage that if other states base their tax treatment on its non-tax law characteristics they are likely to classify it as a corporation.[105]

85.21.2 *LLP: View to profit*

Section 2(1) LLPA 2000 provides:

[101] See 90.37 (Foreign LLP).

[102] MLR 2017 is an example; see 131.18 (Beneficial owner: Partnership).

[103] This is clear from the definition in s.1(2) LLPA; this view is also supported by s.1(5) LLPA:

> "... except as far as otherwise provided by this Act or any other enactment, the law relating to partnerships does not apply to a limited liability partnership."

Likewise s.1(2) PA 1890:

> "But the relation between members of any company or association which is—
> (a) registered under the Companies Act 2006, or
> (b) formed or incorporated by or in pursuance of any other Act of Parliament ...

is not a partnership within the meaning of this Act."

The drafter assumed this in s.863(2) ITTOIA.

[104] This is self-evident, but if authority is needed, see *Sword Services v HMRC* [2016] EWHC 1473 (Admin) at [55] - [64].

[105] "Characterisation of other states' partnerships for income tax" [2002] BTR 375.

> For a limited liability partnership to be incorporated—
>
> (a) two or more persons associated for carrying on a lawful business with a view to profit must have subscribed their names to an incorporation document ...

Thus at the time of incorporation the members must have a view to profit. This is similar to an ordinary partnership. But a LLP continues to exist if it subsequently ceases to carry on business, or ceases to have a view to profit. In this respect an LLP is different from an ordinary partnership.

85.21.3 *LLP law background*

The BI Manual provides a basic summary:

> **BIM82110 Limited Liability Partnership: Overview** [Jun 2016]
> ... Except where specifically provided for in the LLP legislation, partnership law does not apply to LLPs. The way that LLPs are regulated is similar to that for companies and a number of provisions of the Companies Act 2006 also apply to LLPs.
>
> An LLP can be formed by two or more persons who are carrying on a partnership type business. The LLP has to be registered at Companies House.
>
> LLPs are seen as a flexible business model. As with partnerships, LLPs are governed by the agreement between the members. There are default positions set out in the LLP regulations however in most cases these will be overridden by the agreement between the members...
>
> *Members*
>
> A LLP must have at least two registered members.
>
> The first members are those who signed the document incorporating the LLP. Other people can be admitted by agreement with the existing members.
>
> Where a person becomes a member of a LLP or ceases to be a member of a LLP the LLP must give notice of this to the Registrar of Companies within 14 days.
>
> If a new member has, as a matter of fact, been admitted to the partnership by entering into an agreement with the other members, but the LLP failed to update their register of members, then the new member is still a member of the LLP and liable for tax on their share of the profits.
>
> Individuals, corporates (including other LLPs), and Scottish partnerships are eligible to be members of a UK LLP.
>
> No entity without a discrete, separate legal identity can be a member of an LLP. In particular, a firm such as an English partnership (or an

English Limited Partnership) cannot, itself, be a member of a UK LLP

Designated members

The term designated member is used in the LLP legislation. It simply means a member with additional duties under the LLP legislation. The term has no significance for tax purposes...

BIM82112 LLP Agreement [Jan 2019]

The UK LLP is a body corporate that is governed by an agreement, the 'LLP Agreement'.

There are default provisions on how an LLP will operate which are set out in the LLP Regulations, but these will rarely apply as in most cases they are overridden by what is set out in the LLP Agreement.

It is important to recognise that the LLP Agreement is not simply the document labelled 'LLP Agreement'.

The LLP Agreement is much wider than that document and includes not only written agreements but it also includes verbal or implied agreements.

The LLP Agreement includes any agreement that governs:

- The relationship between members of the LLP
- The relationship between the LLP and its members

It does not include agreements between the LLP and non members or between members and non members.

The document labelled 'LLP Agreement' may contain a clause saying that it is the entire agreement between the members. This may not be correct in all cases however, as that agreement can be amended by any subsequent agreement entered into.

For example, when a new member joins the LLP, there may be a specific agreement between the individual and the LLP, this is sometimes called the 'deed of adherence', and is part of the LLP Agreement.

When asking for a copy of the LLP Agreement it is worth making it clear that it is the agreement as defined in regulation 2 of the LLP Regulations 2001 and therefore that any side agreements and amendments ought to be disclosed as well. This might include minutes of meeting of the LLP or of boards and committees that regulate the conduct of the LLP or decide upon issues that govern the relationship of the LLP and its members, e.g. remuneration/ management committees, etc.

When looking at a particular member it is important to ask for a copy of any deed of adherence under which they became a member as well as any other written or oral agreements that they have entered into with the LLP.

85.22 Tax treatment of LLP

85.22.1 *LLP: Default rule*

An LLP is a body corporate. So an LLP is in principle classified as a company for tax purposes.[106] However this default position is subject to such wide exceptions that it hardly ever applies.

85.22.2 *LLP treated as partnership*

s.863(1) ITTOIA	**s. 1273(1) CTA 2009**
For income tax purposes, if a limited liability partnership carries on a trade, profession or business with a view to profit[107]—	For corporation tax purposes, if a limited liability partnership carries on a trade or business with a view to profit—
(a) all the activities[108] of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such),	[identical]
(b) anything done by, to or in relation to the limited liability partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and	[identical]
(c) the property of the limited liability partnership is treated as held by the members as partnership property.	[identical]

For CGT, s.59A(1) TCGA provides effectively the same rule. Section

[106] See 90.8 (Definition of "company").

[107] See App.5.3 (A view to profit).

[108] The last paragraph of s.863(1) provides:
"References in this subsection to the activities of the limited liability partnership are to anything that it does, whether or not in the course of carrying on a trade, profession or business with a view to profit."
The last para of s.1273(1) is identical except for the omission of the word "profession".

59A may be easier to follow if set alongside s.59(1) from which it derives:[109]

s.59A TCGA (LLP)	**s.59 TCGA (ordinary partnership)**
Where a limited liability partnership carries on a trade or business with a view to profit—	Where 2 or more persons carry on a trade or business in partnership—
(a) assets held by the limited liability partnership are treated for the purposes of tax in respect of chargeable gains as held by its members as partners, and	[No equivalent; none needed]
(b) any dealings by the limited liability partnership are treated for those purposes as dealings by its members in partnership (and not by the limited liability partnership as such);	(b) any partnership dealings shall be treated as dealings by the partners and not by the firm as such.[110]
[c] and tax in respect of chargeable gains accruing to the members of the limited liability partnership on the disposal of any of its assets shall be assessed and charged on them separately.	(a) tax in respect of chargeable gains accruing to them on the disposal of any partnership assets shall, in Scotland as well as elsewhere in the UK, be assessed and charged on them separately,

The default (corporate, non-transparent) treatment applies to:
(1) LLPs which do not carry on business with a view to profit[111]
(2) Hybrid LLPs[112]

85.22.3 *LLP: Partnership terms applied*

s.863(2) ITTOIA	**s.1273(2) CTA 2009**	**s.59A(2) TCGA**
For all purposes, except as otherwise	For all purposes, except as otherwise	For all purposes, except as otherwise

[109] See 85.20 (Partnership transparency: CGT).

[110] I have put para (a)(b) in reverse order to set them opposite the equivalents in s.59. Why was the order reversed?

[111] See 85.22.4 (Cessation of LLP business).

[112] Section 259GE TIOPA.

provided, in the Income Tax Acts—	provided, in the Corporation Tax Acts—	provided, in the enactments relating to tax in respect of chargeable gains—
(a) references to a firm or partnership include a limited liability partnership in relation to which subsection (1) applies,	[identical]	[identical]
(b) references to members or partners of a firm or partnership include members of such a limited liability partnership,	[identical]	[identical]

And conversely s.863(2) ITTOIA/s.1273(2) CTA 2009/s.59A(2) TCGA provide:

(c) references to a company do not include such a limited liability partnership,[113] and
(d) references to members of a company do not include members of such a limited liability partnership.

In short, an LLP is (generally, ie provided it is carrying on a business with a view to profit) regarded as a partnership and not a company.[114]

An LLP is nevertheless a person, and a body corporate, and so the starting point is that references in tax legislation to person/body corporate do include an LLP unless the context otherwise requires. The rule that references to a *company* do not include an LLP does not expressly extend to references to a person/body corporate. But given that a general partnership is not a person/body corporate, and references to a partnership

[113] Para (c) may be otiose, since standard tax definitions of "company" exclude partnerships; but perhaps it is for the avoidance of doubt; or perhaps it might apply to some non-standard definition of company.

[114] If authority is needed, see *HMRC v Vaines* [2018] EWCA Civ 45 at [15]: "For income tax purposes, however, limited liability partnerships are treated in the same way as an ordinary English partnership. This is achieved by s.863 ITTOIA ..."

do include an LLP, it is suggested that the inference can easily be made that references in IT/CGT/CT legislation to person/body corporate do not include an LLP; though this is (needless to say) subject to context.

In *Margott v HMRC*[115] the FTT noticed (which I confess I had not) that s.863(1) applies for *income tax purposes*, but s.863(2) applies for the *Income Tax Acts*; and the latter term, surprisingly, was said not include the TMA. The result was that penalty provisions dealing with partnerships did not apply to LLPs. This seems to have been corrected in *HMRC v Inverclyde Property Renovation LLP*.[116]

85.22.4 *Cessation of LLP business*

Section 863(1) ITTOIA only applies if the LLP carries on business[117] with a view to profit.

Section 863(3)(4) ITTOIA/s.1273(3)(4) CTA 2009/s.59A(3)(4) TCGA deal with the position where the LLP ceases to carry on business:

> (3) Subsection (1) continues to apply in relation to a limited liability partnership which no longer carries on any trade, profession or business with a view to profit—
> (a) if the cessation is only temporary, or
> (b) during a period of winding up following a permanent cessation, provided—
> (i) the winding up is not for reasons connected in whole or in part with the avoidance of tax, and
> (ii) the period of winding up is not unreasonably prolonged.
> This is subject to subsection (4).
> (4) Subsection (1) ceases to apply in relation to a limited liability partnership—
> (a) on the appointment of a liquidator or (if earlier) the making of a winding-up order by the court, or
> (b) on the occurrence of any event under the law of a territory outside the UK corresponding to an event specified in paragraph (a).[118]

It follows that (almost) any comment about the treatment of LLPs needs to be qualified by the word *generally*, as the position will be different for

[115] [2017] UKFTT 894 (TC).
[116] [2020] UKUT 161 (TCC).
[117] I use the word business to include a trade/profession.
[118] I have ignored trivial differences in the wording of the CGT provision.

an LLP not carrying on a business.

What is the reason for this rule?

Bayonet Ventures v HMRC concerned a dormant LLP (it had not begun to carry on a business). Accordingly, s.863(1) did not apply to it.[119] But that situation will not often arise.

For CGT, s.59A TCGA concludes with two provisions which have no IT/CT equivalent:

> (5) Where subsection (1) above ceases to apply in relation to a limited liability partnership with the effect that tax is assessed and charged—
> (a) on the limited liability partnership (as a company) in respect of chargeable gains accruing on the disposal of any of its assets, and
> (b) on the members in respect of chargeable gains accruing on the disposal of any of their capital interests in the limited liability partnership,
>
> it shall be assessed and charged on the limited liability partnership as if subsection (1) above had never applied in relation to it.
>
> (6) Neither the commencement of the application of subsection (1) above nor the cessation of its application in relation to a limited liability partnership shall be taken as giving rise to the disposal of any assets by it or any of its members.

Section 156A TCGA (not discussed here) provides for a clawback of roll-over relief on cessation of a LLP business.

85.22.5 *LLP CGT: HMRC practice*

SP D12 provides:

> TCGA92/S59A(1) complements TCGA92/S59 in treating any dealings in chargeable assets by a limited liability partnership as dealings by the individual members, as partners, for CGT purposes. Each member of a limited liability partnership to which TCGA92/S59A(1) applies has therefore to be regarded, like a partner in any other (non-corporate) partnership, as owning a fractional share of each of the partnership assets and not an interest in the partnership itself.

[119] [2018] UKFTT 262 (TC) at [33] -[46]. Fortunately for the taxpayer, HMRC (not represented by Counsel) did not think through the implications of this; the consequence would have been that the LLP was taxed as a company, and the loan from the LLP to a member would have given rise to a charge under the close company rules.

> This statement of practice was therefore extended to limited liability partnerships which meet the requirements of TCGA92/S59A(1), so that capital gains of a limited liability partnership fall to be charged on its members as partners. Accordingly, in the text of the statement of practice, all references to a ‘partnership’ or ‘firm’ include reference to limited liability partnerships to which TCGA92/S59A(1) applies, and all references to ‘partner’ include reference to a member of a limited liability partnership to which TCGA92/S59A(1) applies.
>
> For the avoidance of doubt, this statement of practice does not apply to the members of a limited liability partnership which ceases to be ‘fiscally transparent’ by reason of its not being, or it no longer being, within TCGA92/S59A(1).

85.22.6 *LLPs: IHT*

Section 267A IHTA provides:

> For the purposes of this Act and any other enactments relating to inheritance tax—
>
> (a) property to which a limited liability partnership is entitled, or which it occupies or uses, shall be treated as property to which its members are entitled, or which they occupy or use, as partners,
>
> (b) any business carried on by a limited liability partnership shall be treated as carried on in partnership by its members,
>
> (c) incorporation, change in membership or dissolution of a limited liability partnership shall be treated as formation, alteration or dissolution of a partnership, and
>
> (d) any transfer of value made by or to a limited liability partnership shall be treated as made by or to its members in partnership (and not by or to the limited liability partnership as such).

This is similar to the IT/CT/CGT rules, but the wording is not exactly the same.

Unlike those taxes, the IHT provision applies whether or not the LLP is carrying on a business with a view to profit. Presumably it was thought appropriate that IHT rules (such as situs rules) should apply equally to all LLPs, whether or not carrying on a business.[120]

[120] See 102.35.3 (Situs of LLP).

85.23 Residence of partnership

The residence of a partnership is not often important for tax, but it matters occasionally:

Topic	Reference	See para
DTR disallowance	Partnership resident outside UK	85.25
Chargeable overseas earnings	Partnership/employer resident outside UK	34.15
Treaty-residence	UK-law residence of a partnership	9.22[121]

Until 1995 the position was governed by s.112(1) ICTA 1988:

> *Where a trade or business is carried on by two or more persons in partnership, and the control and management of the trade or business is situated abroad, ... the partnership shall be deemed to reside outside the UK ...*

This was absent-mindedly repealed, and now there is no statutory definition of partnership residence; but it is considered that the test of partnership residence is still control and management. This is consistent with the general scheme of UK taxation of partnerships.[122] EN ITTOIA agrees, in the passage set out above ("For UK tax purposes, if it is necessary to consider where a firm is resident, the question is likely to be decided by the place where the firm's business is controlled and managed.")[123]

HMRC agree. The former International Tax Handbook provided:

> **1609. Residence**
> In English law a partnership is not a person and it has long been assumed that it cannot in fact have a residence. Although Scottish partnerships are persons we have not made any distinction. ... But there has been some nibbling away of the principle that a partnership does not have a residence. The concept of residence and partnerships appears in other Sections of the Taxes Acts. For example in [the definition of chargeable overseas earnings] there is the concept of a partnership, 'resident outside and not resident in the UK'. The transfer pricing provisions ... apply to partnerships but their effect may depend

[121] This is no longer relevant for UK tax because of the treaty override, but may be relevant for foreign tax.

[122] See 85.19.4 (Where is control/management).

[123] See 85.25 (DT relief: Partnership).

> on whether or not the buyer or seller is resident in the UK.[124] It is probable that if residence of a partnership in these contexts ever had to be put to the test the criterion of control and management would be used.
>
> More important is the case of *Padmore v IRC* 62 TC 352. This concerned the effect of the Double Taxation Agreement with Jersey on the liability of UK resident partners of a partnership controlled and managed in Jersey. Jersey law has a provision very similar to Section 112 [ICTA 1988]. Both the High Court and the Court of Appeal considered that it must be deduced from the respective Sections that both Jersey and UK law attach tax consequences to the residence of partnerships and that residence is determined by control and management.

85.24 Partnerships: Group reliefs

85.24.1 *The issues*

This section considers how partnerships are treated in the context of group reliefs.

There are many group reliefs:

Relief	**Provision**	**See para**
CG group reliefs		
UK-group	s.170-181 TCGA	64.27
Non-resident group	s.3F TCGA	64.31
Group loss relief	Pt 5, ss97-188 CTA 2010	*See below*
Stamp Duty group relief	s.42 FA 1930	*See below*
SDLT group relief	sch 7 FA 2003	*See below*

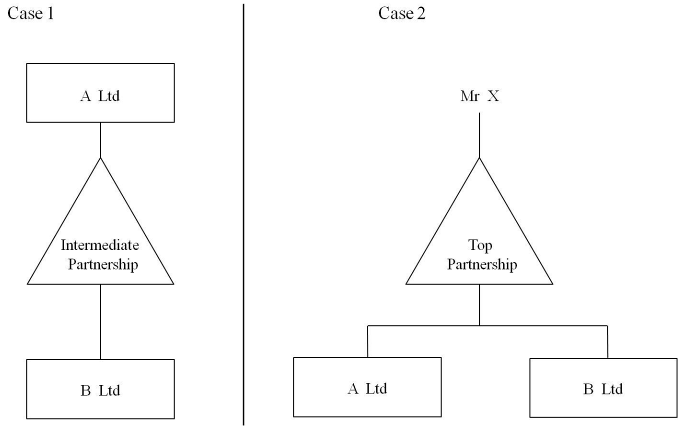
A feature of group reliefs is where they are expressed to apply to a company, they use that word with a non-standard definition:

Relief	**Definition of company**
CG group reliefs	Company means specified corporate bodies excluding LLPs[125]
Loss relief	Company means body corporate: s.188(1) CTA 2010
SDLT	Company means body corporate: para 1 sch 7 FA 2003

[124] Author’s footnote: This ceased to be the case when the transfer pricing rules were re-written in 1998.

[125] See 64.26.8 (“Company”).

Stamp Duty group relief is expressed to apply to a body corporate, not to a company, which is another route to the same destination.



The main questions which arise are:

(1) Does the intermediate partnership, in the middle of the structure, block a group: in case 1, are A & B a group?

(2) Does the top partnership create a group: in case 2, are A & B a group?

The partnership may be English, Scots or an LLP; and each relief must be considered separately. So there are many permutations.

One might paraphrase the question by saying, is a partnership transparent for group relief, but that does not make the question any easier, and it may add to the confusion, for transparency has many aspects.[126]

A third question is whether the partnership might itself claim a group relief, eg on a transfer from a company in the structure to the partnership, or vice versa; but the answer to that, unsurprisingly, turns out to be, no.

85.24.2 *Group loss relief*

CTM provides:

> **CTM80152 Groups: Group Relief And Partnerships** [Dec 2019]
> The group and consortium conditions (respectively CTA10/S131, and

[126] See 90.6.4 (Transparent/opaque: Caution).

> S132 with S133) establish that the group relief provisions can only apply to companies. CTA10/S188 defines a company for group relief purposes as any body corporate.
>
> General partnerships governed by the Partnership Act 1890 and Limited Partnerships registered under the Limited Partnerships[127] Act 1907 cannot claim or surrender group relief. They are not bodies corporate...
>
> A trading partnership in England, Wales or Northern Ireland has no legal personality and cannot own assets, so the assets of the partnership are treated as beneficially owned by the partners. This will generally be in proportion to the members' partnership shares, determined by the partnership agreement, but see BIM82058 for more details on the property of partnerships....
>
> Similar principles apply to groups for the purposes of chargeable gains.[128]
>
> A UK Limited Liability Partnership (LLP) is by statute a body corporate, but is specifically excluded from the definition of company by CTA09/1273 (2)(c), so an LLP cannot claim or surrender group relief.

That is clear: partnerships do not qualify for group loss reliefs. Since partnerships are transparent for IT/CT, in the sense that partnership income and losses accrue to the partners, that must obviously be the case.

Turning to the question of a structure with an intermediate partnership:

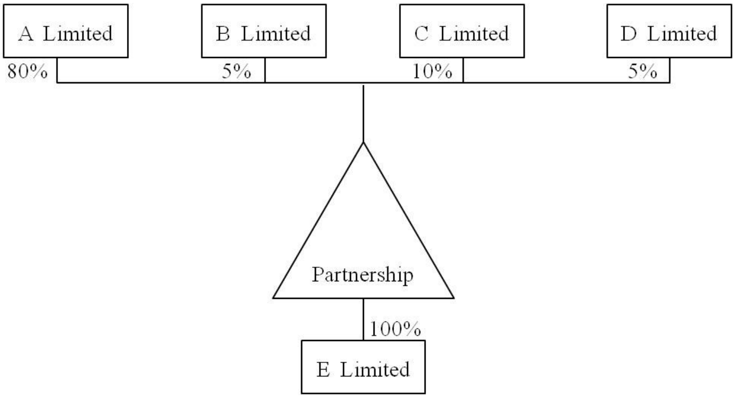
> CTA09/S1273 (1)(c)[129] treats the property of an LLP carrying on a trade or business with a view to profit as held by the members as partnership property. It follows that for group relief purposes any ordinary share capital held by an LLP is treated as beneficially owned by the LLP members in the proportion of each member's share in the LLP, and thus an LLP can be "looked through" to establish a group relationship...

Thus in case 1, A and B do form a group for group loss relief and CG relief: the intermediate partnership does not block the group. The CTM provides an example of a group with an intermediate partnership, which is essentially the same as my case 1:

[127] The original erroneously reads "Limited Partnership Act 1907".

[128] See 64.26 ("51/75/90% subsidiary").

[129] See 85.22.2 (LLP treated as partnership).



> The English general partnership owns 100% of the share capital in E Limited. A, B, C, and D Limited are members of the partnership and each own a proportion of the partnership assets as shown in the diagram.
> The beneficial ownership of the partnership assets is considered to belong to the members in proportion to their partnership shares. Hence A Limited will own (80% × 100%) = 80% of the ordinary share capital in E Limited.
> B and D Limited will each own 5%, and C will own 10%. This means that A and E will be in a group relationship because E is a 75% subsidiary of A (CTM80151).

While one might refer to the entity-disregard rule, I think this follows from adopting a co-ownership (transparent) analysis to the partnership.

85.24.3 *SD/SDLT: English partnership*

Stamp duty and SDLT are outside the scope of this book, but an HMRC statement ("**the SD Partnership statement**")[130] is of wider interest, as it illustrates the nature of a partnership share.

To follow this one needs to have in mind the basic requirements of the relief. I do not consider the (avoidance related) exceptions.

Section 42 FA 1930 provides SD group relief. In outline:

> (1) Stamp duty under Part I of Schedule 13 to the Finance Act 1999 (transfer on sale), shall not be chargeable on an instrument to which this section applies ...

[130] *https://www.gov.uk/government/publications/group-relief-for-stamp-duty-land-tax-and-stamp-duty-partnerships* (2014).

> (2) This section applies to any instrument as respects which it is shown to the satisfaction of the Commissioners that—
>
> (a) the effect of the instrument is to convey or transfer a beneficial interest in property from one body corporate ("the transferor") to another ("the transferee"), and
>
> (b) the bodies in question are associated at the time the instrument is executed ...

The key term is associated:

> (2A) For the purposes of this section bodies corporate are associated at a particular time if at that time
>
> [a] one is the parent of the other or
>
> [b] another body corporate is the parent of each.

Para 1 sch 7 FA 2003 provides SDLT group relief:

> (1) A transaction is exempt from charge if the vendor and purchaser are companies that at the effective date of the transaction are members of the same group.
>
> (2) For the purposes of group relief--
>
> (a) "company" means a body corporate, and

This is a non-standard definition of company.

> (b) companies are members of the same group if one is the 75% subsidiary of the other or both are 75% subsidiaries of a third company.

The SD/SDLT definitions of parent/75% subsidiary are essentially the same:

SD: s.42(2B) FA 1930	**SDLT: para 1 sch 7 FA 2003**
(2B) For the purposes of this section one body corporate is the parent of another at a particular time if at that time the first body—	(3) For the purposes of group relief a company ("company A") is the 75% subsidiary of another company ("company B") if company B–
(a) is beneficial owner of not less than 75 per cent of the ordinary share capital of the second body;	(a) is beneficial owner of not less than 75% of the ordinary share capital of company A,
(b) is beneficially entitled to not less than 75 per cent of any profits	(b) is beneficially entitled to not less than 75% of any profits

available for distribution to equity holders of the second body; and	available for distribution to equity holders of company A, and
(c) would be beneficially entitled to not less than 75 per cent of any assets of the second body available for distribution to its equity holders on a winding-up.[131]	(c) would be beneficially entitled to not less than 75% of any assets of company A available for distribution to its equity holders on a winding-up.[132]

85.24.4 *English partnerships*

The SD partnership statement applies the co-ownership (transparent) analysis for group relief:

> **English partnerships**
> As English limited and general partnerships do not have legal personalities separate from the persons who are the partners they must be 'looked through' when establishing bodies corporate that form a

[131] Section 42 continues with provisions not discussed here:
"(3) The ownership referred to in paragraph (a) of subsection (2B) is ownership either directly or through another body corporate or other bodies corporate, or partly directly and partly through another body corporate or other bodies corporate, and Part I of schedule 4 to the Finance Act 1938 (determination of amount of capital held through other bodies corporate) shall apply for the purposes of that paragraph.
(5) Chapter 6 of Part 5 of the Corporation Tax Act 2010 shall apply for the purposes of paragraphs (b) and (c) of subsection (2B) as it applies for the purposes of section 151(4)(a) and (b) of that Act; but this is subject to subsection (6).
(6) In determining for the purposes of this section whether a body corporate is the parent of the transferor, sections 171(1)(b) and (3), 173, 174 and 176 to 178 of the Corporation Tax Act 2010 shall not apply for the purposes of paragraph (b) or (c) of subsection (2B)."

[132] Para 1 continues with provisions not discussed here:
(4) The ownership referred to in sub-paragraph (3)(a) is ownership either directly or through another company or companies.
For the purposes of that provision the amount of ordinary share capital of company A owned by company B through another company or companies shall be determined in accordance with sections 1155 to 1157 of the Corporation Tax Act 2010....
(6) Chapter 6 of Part 5 of the Corporation Tax Act 2010 (group relief: equity holders and profits or assets available for distribution) applies for the purposes of sub-paragraphs (3)(b) and (c) above as it applies for the purposes of section 151(4)(a) and (b) of that Act.
6A In that Chapter as it applies for the purposes of subparagraphs (3)(b) and (c) above, sections 171(1)(b) and (3), 173, 174 and 176 to 178 of that Act are to be treated as omitted.

> group for Stamp Duty Land Tax and Stamp Duty purposes. As such the companies that are the partners of an English general or limited partnership can, depending upon the facts, be grouped with those companies that are below the partnership in the group structure.

Again, in case 1, A and B do form a group for SD/SDLT relief: the intermediate partnership does not block the group.

This is so even though there are no statutory deeming provisions such as might be said to support the conclusion for CG and CT group reliefs.

85.24.5 *SD/SDLT: Scots partnership*

According to HMRC, the position is different in Scotland:

> **Scottish partnerships**
> Both Scottish limited and general partnerships have legal personalities separate from the persons who are the partners. They cannot therefore be 'looked through' when establishing bodies corporate that form a group. But they are not bodies corporate and so cannot be the parent of a group of companies.

On the HMRC view, in case 1, if the intermediate partnership is a *Scots* partnership, A and B do not form a group for SD/SDLT relief: the partnership in the middle of the structure does block the group.

But the legal personality of a Scots partnership does not carry that implication;[133] and it is considered that the position for a Scots partnership is the same as an English one.

85.24.6 *SD/SDLT group relief: LLPs*

The SD Partnership statement provides:

> **Group relief for SDLT and Stamp Duty: partnerships**
> **Stamp Duty Land Tax - a change in HMRC's view of the law**
> [The statement summarises the group relief and continues]:
> A 'company' for group relief purposes is defined in Schedule 7 FA 2003 as a 'body corporate'. HMRC did not consider that a 'body corporate' for the purposes of Part 1 Schedule 7 FA 2003 included a Limited Liability Partnership incorporated under the Limited Liability Partnerships Act 2000 (LLP), so that LLPs were disregarded ('looked through') when considering whether a group relationship existed, the members of the LLP being treated as the beneficial owners of the LLP

[133] See 85.3.6 (English/Scots partnership tax aligned).

> assets.
> This view has recently been challenged. Following legal advice, HMRC now accepts that, for the purposes of SDLT group relief, a 'body corporate' does include an LLP. An LLP can therefore be the parent in a group structure.

This has the remarkable result that in my case 2, the effect of the top LLP is that the two companies A & B are grouped for SDLT (and SD) purposes; though that would not be the case for group loss relief or CG group relief. The reader may wonder if that can be right.

> However, as an LLP does not itself have issued ordinary share capital it cannot be the subsidiary of other companies. This also means that any subsidiaries of the LLP cannot be grouped with the companies that are the corporate members of the LLP.
> ... An LLP cannot claim group relief itself because its chargeable interests in land are treated as held by or on behalf of the individual members (Paragraph 2 Schedule 15 FA 2003), and this position is unchanged. As such, in broad terms, an LLP continues to be disregarded if it is the vendor or purchaser in a transaction. In such a transaction group relief may be, in part at least, available if some or all of its members (which are incorporated companies) are themselves grouped.
> It also follows that if an LLP transfers land to a company that it owns, and that is within the LLP headed group, no group relief will be available as the land is deemed to be owned by the members of the LLP, and those members are not within the same group as the company owned by the LLP...

On the HMRC view, in case 1, if the intermediate partnership is a LLP, A and B do not form a group for SD/SDLT relief: the LLP in the middle of the structure does block the group.

The SD/SDLT provisions are essentially the same, so whatever is the analysis for one will govern the other. HMRC's SD analysis is therefore the same as their analysis for SDLT:

> **Stamp Duty**
> [The text summarises SD group relief and continues:] In general, HMRC has taken the view that an LLP, as a body corporate, can be the ultimate parent of a group for the purposes of Section 42 FA 1930. Furthermore, as an LLP does not itself have issued ordinary share capital it cannot be the subsidiary of another company.
> Transfers of stock and marketable securities may be made to the parent

LLP from a subsidiary body corporate in the same group and qualify for group relief and vice versa. Group relief cannot be claimed on the transfer of stock and marketable securities from a body corporate parent of an LLP to the LLP or to a body corporate subsidiary of the LLP.

85.24.7 *Partnership block in group*

So does an intermediate partnership block a group? In summary, the answers are:

	English P'ship	**Scots P'ship**	**LLP**
CG reliefs	No	No	No
Loss reliefs	No	No	No
SDLT/SD	No	No: JK/Yes: HMRC	Yes

85.25 DT relief: Partnership

85.25.1 *Cross references*

For the question whether a partnership can be a treaty-resident for DTA purposes, see 9.22 (Treaty-residence: Partnerships).

See Avery Jones, "Partnerships and Double Taxation Agreement: Padmore v IRC" [1987] BTR 88.

OTS make some interesting comments on overlap relief and double taxation[134] which I hope to consider in a future edition.

85.25.2 *DT relief before 1987*

In order to understand the law it is helpful to know its history.

A partnership is commonly not a treaty-resident of a foreign state, because it is not liable to tax. However a partnership may be a treaty-resident if:

(1) The treaty has a non-standard definition of residence; or
(2) The partnership is foreign-law opaque (a hybrid entity)[135]

OECD Commentary provides:

> 6.1 ... Where a partnership is treated as a resident of a Contracting State, the provisions of the Convention that restrict the other

[134] OTS, "Review of partnerships: final report" (2015) para 4.32 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/396668/ots_partnerships_report_final.pdf*

[135] See 91.1 (Hybrid entities: Introduction).

> Contracting State's right to tax the partnership on its income do not apply to restrict that other State's right to tax the partners who are its own residents on their share of the income of the partnership.

But this does not represent the position, at least in UK law, for in *Padmore v IRC* UK-residents did qualify for treaty relief on partnership income of a partnership which was treaty-resident in Jersey.

85.25.3 *DT relief: Partnership income*

Section 858 ITTOIA disapplies DT relief on partnership income of UK residents. Section 858(1) ITTOIA/s.1266 CTA 2009 provides:

> This section applies if—
> (a) a UK resident ("the partner") is a member of a firm which—
> (i) resides outside the UK, or
> (ii) carries on a trade [including business] the control and management of which is outside the UK, and
> (b) by virtue of any arrangements having effect under section 2(1) of TIOPA 2010 ("the arrangements") any of the income of the firm is relieved from income tax in the UK.

EN ITTOIA explains the need for s.858(1)(a)(ii):

> 1777. For UK tax purposes, if it is necessary to consider where a firm is resident, the question is likely to be decided by the place where the firm's business is controlled and managed. But it is possible that, under foreign law, a firm may be considered to be resident elsewhere, for example, by reference to where the firm was established. So the section uses both the "control and management" test and the "resides" test.

s. 858(2) ITTOIA	**s.1266 CTA 2009**
The partner is liable to income tax on the partner's share of the income of the firm despite the arrangements.	The partner is liable to corporation tax on the partner's share of the income of the firm despite the arrangements.

This disapplies treaty relief.

EN ITTOIA provides:

> 1774. This section ensures that a UK resident partner's share of the income of a foreign firm remains liable to UK tax even though the income of the firm as a whole is exempt from UK tax in accordance with a double taxation agreement...
> 1775. The business profits article of the UK/Jersey double taxation

> arrangement exempts the profits of a Jersey firm from UK tax. In the case of *Padmore v IRC* 62 TC 352, the Court of Appeal decided that the exemption extended to the share of the profits arising to a UK resident individual. The rules [now in s.858 ITTOIA] were enacted in 1987 to remove the exemption.
>
> 1776. Subsection (1) sets out the type of individual and firm with which the section is concerned. It goes on to identify the sort of exemption from tax that was considered in the *Padmore* case. ...
>
> 1778. Subsection (2) makes it clear that the section does no more than remove any exemption under a double taxation arrangement. It does not deny other reliefs, such as tax credit relief. See Change 145 in Annex 1.[136]

This provision dates back to 1987. Interestingly, in those days retrospective legislation and breach of treaty obligations were thought to require special justification.[137]

[136] Change 145 is as follows:

"This change enacts the Inland Revenue practice of giving a narrow interpretation to the word 'affect' in section 112(4) of ICTA.

The business profits article of the UK/Jersey double taxation agreement exempts the profits of a Jersey firm from UK tax. In the case of *Padmore v IRC* 62 TC 352 the Court of Appeal decided that the exemption covered the share of the profits arising to a UK resident partner. The rules in section 112(4) and (5) of ICTA were enacted in 1987 to remove the exemption.

It was intended, in the case of income tax, that the 1987 legislation should do no more than remove the exemption claimed in the *Padmore* case. The words used in section 112(4) of ICTA are 'shall not affect any liability to tax'. On the face of it, these words could deny the partner any relief, including tax credit relief, under a double taxation treaty. Section 858(2) of this Act makes it clear that it is only the partner's chargeability to tax that is preserved, overriding any provision to the contrary in a double taxation treaty. No other effect of the treaty is overridden.

This change is in principle in taxpayers' favour but is expected to have no practical effect as it is in line with current practice."

[137] The former International Tax Handbook para 1660 provided:

"The retrospective nature of the legislation [in 1987] provoked comment in the professional press and in Parliament. The Government, and later the House, were persuaded as to the propriety of this action because the Section does no more than restore the general understanding of the law and retrospection prevents third parties suddenly deriving a substantial windfall benefit for six years. Although the Section protects from retrospection only those taxpayers who gained a Commissioners' or Court decision before 17 March 1987, similar treatment was allowed to a small number of other taxpayers who were told by the Revenue that their cases would follow the *Padmore* decision.

The provision survived an attack in *Padmore v IRC (No 2)* [2001] STC 280 and survived an EU-law challenge.[138] The same result would now be achieved under the OECD Savings Clause, if applicable.[139]

85.25.4 *"Members of a firm"*

Section 858 only applies to a "member of a firm" and assumed that partnership income could only accrue to the members. This gave rise to a simple avoidance scheme under which:

(1) Two IIP trusts were created.
(2) The trusts carried on business in partnership.

The trustees were members of the partnership, but partnership income accrued to the life tenants who were not members of the partnership and so outside s.858.[140]

Section 858(4) blocked this by giving a wider definition to "members of a firm":

> For the purposes of this section, the members of a firm include any person entitled to a share of income of the firm.

Section 58(4) FA 2008 provides:

> The amendments made by subsections (1) to (3) are treated as always having had effect.

Criticism was also made because the legislation is intended to override the effect of the Jersey Arrangement and any other treaty which the Courts might have found to have similar effect. This 'treaty override' was defended on similar grounds – that it merely puts into effect what was generally understood to be the position. It has not met with any objection from treaty partners."

[138] *Shiner (R, oao) v HMRC* [2011] STC 1878 raising free movement of capital issues.

[139] See 109.5.2 (OECD Model Savings Clause).

[140] The EN to the draft clause published 12 March 2008 provides a somewhat untechnical explanation:
"8. An avoidance scheme purports to exempt from UK tax income received by UK resident individuals by using certain provisions in the UK's bilateral Double Taxation Treaties.
9.This scheme involves the establishment of offshore trusts, (of which the UK individuals are both settlors and beneficiaries) and partnerships (of which the foreign trustees of those trusts are partners).
10. The partnerships acquire the rights to receive the UK individuals' income but the terms of the trusts are such that, as beneficiaries of the trust, the UK individuals retain beneficial entitlement to the income – with the trustees obliged to remit the income to the UK individuals as it arises."

Retrospective legislation without limit of time! The EN to the draft clause provided:

> 11. The users of the scheme claim that, under the terms of the relevant Double Taxation Treaty, the UK is not entitled to tax the partnership income of the foreign trustees. As that income is precisely the same income as that received by the UK individuals as beneficiaries of the trust, they argue that the UK is not entitled to tax the UK individuals on it.
> 12. Legislation was introduced in Finance (No 2) Act 1987, which provided that (as had almost universally been assumed to be the case until a High Court decision to the contrary,) a Double Taxation Treaty did not affect UK residents' liability to UK tax on their share of income or gains from a foreign partnership.
> This new avoidance scheme purports to get round that legislation by claiming that the foreign trustees are the partners rather than the UK individuals.
> 13. The Government believes that a partner for the purposes of that legislation has always included all those persons entitled to a share of income or capital gains of the partnership. As such, the UK individuals remain liable to UK tax despite the elaborate, artificial structure designed to exempt them. This clause will put it beyond doubt that the legislation has always had that effect.

As a matter of tax law, was it the case (before the retrospective legislation) that "member of a firm" for the purposes of that legislation has always included all those persons entitled to a share of income or capital gains of the partnership? The answer is, no.[141]

As a matter of fact, did the Government believe that to be the case? I think it is a safe bet that if HMRC received expert and impartial advice on the point, it would have been hedged with caveats such that the terms of EN para 13 would not represent a fair and accurate summary of the position.[142]

[141] Partner is a term of partnership law, and in the partnership law sense a person who is entitled to income or gains of a partnership is not as such a partner. HMRC would have to argue that "partner" in s.858 was not used in its partnership law sense, which is a difficult line to take (even in these times of purposive interpretation, though in a tax avoidance case nothing is impossible)+. This is confirmed in *Huitson (R, oao) v* HMRC [2010] STC 715 at [71]; the point was not considered by the CoA.

[142] In Parliament the statement was described as "disingenuous": Public Bill Cttee debate on Finance Bill, 22 May 2008 Hansard col 371. In *Huitson* HMRC wisely

A pressure group lobbied on the issue[143] but that did not produce more than a House of Commons paper on the topic.[144] In the 2013/14 edition of this work, I said:

> Even if the campaign is not successful in repealing s.58 FA 2008, it may have the effect of reducing government enthusiasm for future retrospective legislation.[145]

I doubt if this has proved to be the case.

85.25.5 *DT relief: Partnership gains*

Section 59 TCGA sets out the same rules for CGT:

> (2) Subsection (3) applies if—
>
> (a) a person resident in the UK ("the resident partner") is a member of a partnership which resides outside the UK or which carries on any trade, profession or business the control and management of which is situated outside the UK, and
>
> (b) by virtue of any arrangements that have effect under section 2(1) of TIOPA 2010 ("the arrangements") any of the capital gains of the partnership are relieved from capital gains tax or corporation tax in the UK.
>
> (3) The arrangements (so far as providing for that relief) do not affect any liability to capital gains tax or corporation tax in respect of the resident partner's share of any chargeable gains of the partnership.
>
> (4) For the purposes of subsections (2) and (3) the members of a partnership include any person entitled to a share of chargeable gains of the partnership.

claimed legal professional privilege: [2010] STC 715 at [71].

[143] *http://notoretrotax.org.uk*

[144] House of Commons Library, "Retrospective taxation: section 58 of the FA 2008" SN06361 (2013). *http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN06361*

[145] See the 12th ed. if this work, (2013), Vol. 2 pp. 1728, para 41.9.1 ("Members of a firm"); and see 2.9 (Retrospective tax legislation).

CHAPTER EIGHTY SIX

PARTNERSHIP INCOME: ATTRIBUTION

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86.1 Partnership income: outline

MacKinlay v Arthur Young McClelland Moores explains the three-stage process for the assessment of partnership profits:[1]

[1] 62 TC 704 at 724.

> There are, in effect, three stages.
>
> [1] [*Computation of partnership income*] First, the profits of the firm for an appropriate basis period must be ascertained. What has to be ascertained is the profits of the firm and not of the individual partners....
>
> [2] [*Allocation of partnership income*] The income of the firm for the year is then treated as divided between the partners who were partners during the year to which the claim relates ... That is the second stage.
>
> [3] [*Computation of tax*] The tax payable is then calculated according to the circumstances of each partner—that is, after taking into account on the one hand any personal allowances, reliefs or deductions to which he is entitled and any higher rate of tax for which he is liable.

86.2 Partnership income: Computation

s.849 ITTOIA	**s.1259 CTA 2009**
(1) If— (a) a firm carries on a trade[2], and (b) any partner in the firm is chargeable to income tax,	(1) This section applies if a firm carries on a trade and any partner in the firm ("the partner") is a company within the charge to corporation tax.
the profits or losses of the trade are calculated on the basis set out in subsection (2) or (3), as the case may require.	(2) For any accounting period of the firm, the amount of the profits of the trade ("the amount of the firm's profits") is taken to be the amount determined, in relation to the partner, in accordance with subsection (3) or (4).
(2) For any period of account in which the partner is a UK resident	(3) If the partner is UK resident— (a) determine what would be the

[2] "Trade" includes business; and s.851 ITTOIA extends the general rule to non-trading income:

> (1) This section applies if—
>
> (a) sections 849 and 850 apply in relation to the profits or losses of a trade carried on by a firm, and
>
> (b) the firm has other income or losses.
>
> (2) Those sections also apply as if references to the profits or losses of the trade were references to the other income or losses.

individual, the profits or losses of the trade are calculated as if the firm were a UK resident individual.	amount of the profits of the trade chargeable to corporation tax for that period if a UK resident company carried on the trade, and (b) take that to be the amount of the firm's profits.
(3) For any period of account in which the partner is non-UK resident, the profits or losses of the trade are calculated as if the firm were a non-UK resident individual...	(4) If the partner is non-UK resident— (a) determine what would be the amount of the profits of the trade chargeable to corporation tax for that period if a non-UK resident company carried on the trade, and (b) take that to be the amount of the firm's profits.

Section 849(4) ITTOIA, which concerns losses, is not considered here. EN ITTOIA explains:

> 1714. If some of a firm's partners are resident in the UK and some are not, the profits of the firm's trade must be calculated on different bases. For the resident partners, the calculation includes profits arising outside the UK; for the non-resident partners, the calculation is restricted to profits arising in the UK...
> 1716. ... It is possible for a partner to be both resident (for one tax year) and non-resident (for another) within a single period of account. In such a case, the firm's profit has to be calculated twice to arrive at the partner's share of the profits.
> 1717. Subsection (2) sets out the normal basis for calculating the profits, for an individual resident in the UK. The profits are calculated as if the firm were an individual resident in the UK.
> 1718. Subsection (3) sets out an additional basis for calculating the profits. If the partner (who may be a non-resident company liable to income tax) is not resident in the UK the profits of the firm are calculated as if the firm were an individual not resident in the UK.

In *Vaines v HMRC*:[3]

> The trade in question is the actual trade of [the partnership], which section 863 (1) treats as carried on in partnership by its members. It is

[3] [2018] EWCA Civ 45 at [17].

> not a separate trade carried on by [the UK partner] alone, but the trade of [the partnership] carried on collectively by himself and his fellow partners

The BI Manual provides:

> **BIM72235 computation and assessment: individual, company and non-resident members** [Dec 2013]
> ... where one or more of the partners is a non-resident individual then the share of profits allocated to any such partner must be computed as if the partnership were a non-UK resident individual. In such case the partnership may need to submit an additional set of computations.
> ***Example*** (Mr Armstrong and Mrs Beeton)
> Mr A, a UK resident, and Mrs B, a non-resident, are in partnership. The partnership's world-wide trade profit amount to £10,000 and included in that sum is its UK profit of £7,500. Partnership profits are shared equally. Two tax computations are required on the following lines

Computation for resident partner

Step 1	Trade profits		£10,000
Step 2	Allocation	Mr A	£5,000
		Mrs B	£5,000
Step 3	Profit taxable on Mr A		£5,000

Computation for non-resident partner

Step 1	Trade profits		£7,500
Step 2	Allocation	Mr A	£3,750
		Mrs B	£3,750
Step 3	Profit taxable on Mrs B		£3,750

The BI Manual provides:

> **BIM82015 Separate Business For Tax Purposes** [May 2020]
> Where persons join in partnership, the business carried on by the partnership is a separate business and a separate source for Income Tax and Corporation Tax purposes.
> The business carried on by a partnership of X & Y is separate from any business carried on separately by either X or Y.

86.2.1 *Split years*

Section 849(3A) ITTOIA provides a split-year relief:

> For any tax year that is a split year as respects the partner, this section has effect as if the partner were non-UK resident in the overseas part of the year.

This is the same as the split year relief which applies to trading income; see 21.4.5 (Trading income of split year).

86.3 Partnership income: Attribution

The general rule is that the partners may share income as they wish, and the tax follows accordingly. Section 850 ITTOIA/s.1262 CTA 2009 provide:

s. 850 ITTOIA	**s.1262 CTA 2009**
(1) For any period of account a partner's share of a profit or loss of a trade carried on by a firm is determined for income tax purposes in accordance with the firm's profit-sharing arrangements during that period. This is subject to sections 850A to 850D [Allocation of losses; mixed partnership code].	(1) For any accounting period of a firm a partner's share of a profit or loss of a trade carried on by the firm is determined for corporation tax purposes in accordance with the firm's profit-sharing arrangements during that period. This is subject to sections 1263 to 1264A [allocation of losses; mixed partnership code adjustment for CT][4] and section 12ABZB of TMA 1970 (partnership return is conclusive).
(2) In this section and sections 850A and 850B	(4) In this section and sections 1263 and 1264
"profit-sharing arrangements" means the rights of the partners to share in the profits of the trade and the liabilities of the partners to share in the losses of the trade.	[identical]

The BI Manual provides:

> **BIM82055 Sharing Profits/Losses** [May 2020]
> Profits, losses or other income may be shared as the partners may mutually agree from time to time. The sharing ratio need not be in proportion to contributions of effort or capital. It is not necessary for the partners to share profits and losses in the same proportions, nor income from other sources in the same proportions as trading or professional

[4] See 86.16.3 (Adjustment for corporation tax).

> income. A partner's share of the income on which they are chargeable to tax is computed according to their entitlement in the partnership's period of account.
>
> The allocation of profits or losses for a period of account cannot be varied retrospectively after the end of that accounting period - see *Bucks v Bowers* [1969] 46 TC 267...

In *HMRC v BlueCrest Capital Management*:[5]

> [There is no] necessary correlation between the size of a partner's share and the nature or value of the partner's contribution to the business. In principle, it is open to the partners to agree the shares in which the profits will be divided between them, and tax law normally follows and respects such agreement.

In the same case, the UT said:[6]

> ... partners are taxed on their shares of the profits of the partnership for a particular accounting period and a partner's drawings (either in anticipation of, or on account of annual profits) or the withdrawal of partnership capital or property are not taxable income in his or her hands.

This work does not discuss:

Topic	**ITTOIA**	**CTA 2009**
Computation of losses		
Attribution of losses	s.850A, 850B	s.1263, 1264
Salaried members/disguised employment	s.863A-863L	

These topics would require chapters to themselves, though I hope to consider them in a future edition.

86.3.1 *Salary/Guaranteed profit share*

In *Mackinlay v Arthur Young Mcclelland Moores*:[7]

> A partner working in the business or undertaking of the partnership is in a very different position from an employee. He has no contract of employment .. If, with the agreement of his partners, he pays himself a "salary," this merely means that he receives an additional part of the profits before they fall to be divided between the partners in the

[5] [2023] EWCA Civ 1481 at [72].

[6] [2022] UKUT 200 (TCC) at[89]. The point was not questioned on appeal.

[7] [1990] 2 AC 239 at p.249

appropriate proportions. But the "salary" remains part of the profits.

The CT Manual provides:

> **CTM36560 investment partnerships** [May 2020]
> ...The business of [investment] partnerships is the making and managing of investments. Although they are partnerships and the taxation rules apply on that basis, the limited partners probably regard the scheme as a form of unit trust or other investment fund. They put up capital for investment in a number of unquoted companies on their behalf. They expect to pay to have the fund managed, so they let the general partner take a share of the income and gains in excess of their or its contribution of capital.
> If this were an ordinary investment fund, and not a partnership, the general partner would be the fund manager and its share of the partnership profits would be the annual percentage management fee. A feature of these partnerships is that in years when the profits are too low to meet the general partner's guaranteed profit share, the general partner will probably take an interest free loan from the capital accounts of the other partners. Such a loan is not regarded as taxable income in the hands of the general partner. The loan will be repaid out of its share of future partnership profits and the general partner will be taxed on it at that stage.

For fund managers, this is now caught by the disguised investment management fee code;[8] but the point would still apply to other partnerships.

86.4 Mixed partnership code

Sections 850C-E ITTOIA and s.1264A CTA 2009 provide a set of rules which I call **"the mixed partnership code"**. The PM uses the term "mixed membership partnerships".

In general:

(1) The use of a UK company to save the difference between IT and CT rates is not regarded as objectionable, even if the tax saving is boosted by providing services to the company at an undervalue.[9]

(2) Partners may attribute partnership income between the partners as they wish.[10]

[8] See 73.3 ("Disguised fee").

[9] See 47.3.2 (Underlying company income).

[10] See 86.3 (Partnership income: Attribution).

The mixed partnership code provides limited exceptions to these general rules.

The background can be found in consultation and response papers:[11]

- Partnerships: A review of two aspects of the tax rules (May 2013)
- Partnerships: A review of two aspects of the tax rules: Summary of Responses (Dec 2013)

These are now of historical interest only.

The main rule is in s.809C and this is supplemented by s.809D. The s.809D rule is restricted by tax-advantage purpose requirement, but the s.809C rule is not, so it may apply to wholly commercial arrangements without a tax advantage purpose.

86.5 s.850C application conditions

Section 850C(1) ITTOIA provides:

> Subsections (4) and (5) apply if—
> (a) for a period of account ("the relevant period of account")—
> (i) the calculation under section 849[12] in relation to an individual partner ("A") (see subsection (6)) produces a profit for the firm, and
> (ii) A's share of that profit determined under section 850[13] or 850A ("A's profit share") is a profit or is neither a profit nor a loss,
> (b) a non-individual partner ("B") (see subsection (6)) has a share of the profit for the firm mentioned in paragraph (a)(i) ("B's profit share") which is a profit (see subsection (7)), and
> (c) condition X or Y is met.

I refer to these conditions as **"s.850C application conditions"**.

In *Walewski v HMRC*:[14]

> Section 850C applies "for a period of account" (see subsection (1)(a)). Absent any words of limitation, it applies if the various conditions are met at any point in the period of account. As a matter of construction, there is no requirement that A be a partner for more than a moment of

[11] *https://www.gov.uk/government/consultations/a-review-of-two-aspects-of-the-tax-rules-on-partnerships*

[12] See 86.2 (Partnership income: Computation).

[13] See 86.3 (Partnership income: Attribution).

[14] [2021] UKUT 133 (TCC) at [32].

> time within the relevant period of account for the purposes of section 850C, so long as A receives a share of some profit (see subsection (1)(a)(ii)).

Our dramatis personae are A and B.[15] One might refer to them as

A: transferor/individual member
B: transferee/corporate member

(using the terms transferor/transferee loosely but not inappropriately).

86.5.1 *Individual/non individual*

Under s.850C application conditions (a) and (b):
(1) A (the transferor) must be an individual partner
(2) B (the transferee) must be a non-individual partner

Section 850C(6) ITTOIA provides:

> [a] A partner in a firm is an "individual partner" if the partner is an individual and "non-individual partner" is to be read accordingly;
> [b] but "non-individual partner" does not include the firm itself where it is treated as a partner under section 863I (allocation of profit to AIFM firm).[16]

This definition only applies for s.850C, so it has to be incorporated by reference into s.850D.[17]

86.6 Condition X: Deferred profit

Section 850C(2) ITTOIA provides:

> Condition X is that it is reasonable to suppose[18] that—
> (a) amounts representing A's deferred profit (see subsection (8)) are included in B's profit share, and
> (b) in consequence, both
> [i] A's profit share and
> [ii] the relevant tax amount (see subsection (9))
> are lower than they would otherwise have been.

[15] The drafter may have in mind the characters A and B in *Mikado* Act 2 ("See how the Fates their gifts allot").

[16] See 86.17 (Alternative investment fund manager).

[17] See s.850D(6) ITTOIA.

[18] See App. 2.24 (Reasonable-to-assume).

Condition X is a set of three conditions, which I call Condition X(a) and X(b)[i] and [ii].

If condition X(a) is met, conditions X(b)[i] is bound to be satisfied, and condition X(b)[ii] is highly likely to be satisfied.

HMRC refer to condition X cases as “deferred profit arrangements”.

86.6.1 *Deferred profit*

This is the key term for condition X. Section 850C(8) ITTOIA provides a wide definition:

> “A’s deferred profit”—
> (a) [i] is any remuneration or other benefits or returns the provision of which to A has been deferred
> [ii] (whether pending the meeting of any conditions (including conditions which may never be met) or otherwise), and
> (b) [i] includes A’s share (as determined on a just and reasonable basis) of any remuneration or other benefits or returns the provision of which to A and one or more other persons, taken together, has been deferred
> [ii] (whether pending the meeting of any conditions (including conditions which may never be met) or otherwise).

This only applies for s.850C, so it has to be incorporated by reference into s.850D.[19]

The Partnerships consultation paper provides:

> 3.17 Such provisions are most commonly seen in employment contracts where a company wishes to incentivise long term performance of its employees. However, the same effects can be produced by partnership agreements. For example, a partnership that manages investments will make profits through fees paid to it by the funds. The partnership remuneration agreement may allot those profits to particular members but, in order to incentivise long-term performance, may require a proportion of those profits to be retained within the partnership until a deferral period expires. To reduce the upfront tax charge, such “retained” profits can, instead, be initially allocated to a company member in which the members of the partnership hold an equity stake. When the profits finally vest with the member, the company is dissolved and the proceeds are distributed to the member.
> ..

[19] See s.850D(11) ITTOIA.

> 3.19 In working capital arrangements, the partnership business model envisages that profits will be retained in the business, to be used as additional "working capital" to finance the growth of the business. The post-tax working capital can be maximised by allocating profits to a company member that pays tax at a rate lower than that of the individual members.

PM provides 2 straightforward examples:

> **PM218000 — Condition X** [July 2019]
>
> ...
>
> *Example 1 (Kate)*
>
> This example looks at a deferred remuneration scheme, where a bonus is initially allocated to a corporate member.
>
> K is a member of XYZ LLP. She is awarded a bonus that is conditional upon the successful outcome of a project she has been involved in. The bonus is initially allocated to XYZ Corporate Member Ltd.
>
> This is a deferred profit arrangement; the fact that it is conditional upon a future event does not alter this.
>
> The profit deferral arrangements may operate in relation to a class of members rather than a particular individual, as set out in the example below:
>
> *Example 2*
>
> Y LLP has 50 individual members and a corporate member N Ltd. The 50 individual members are the shareholders in N Ltd. Profits allocated to N Ltd are injected as capital contribution into Y LLP; they are not paid out, by dividend or otherwise to the shareholders. However Y LLP keeps a memorandum note which tracks the longer-term entitlement of each of the individual members to a respective portion of each year's N Ltd profit allocation based on the partnership's profit sharing arrangements in that year. When an individual member retires from the LLP, he is paid out that cumulative entitlement and he ceases to participate as a shareholder in N Ltd.
>
> The profit share of N Ltd is attributable to each of the individual members in proportion to the entitlements tracked within the memorandum note and which will be paid out to them on retirement. The amounts represent the deferred profits of each individual which will be reallocated under the excess profits allocation rules.
>
> If there were no separate memorandum, but the ultimate entitlement in relation to the profits allocated to N Ltd were to depend upon discussion at the time of the individual member's retirement, then each year's reallocation would be based on an assessment of how much of the total deferred profit allocated to N Ltd in that year is, on a just and

> reasonable basis, properly attributable to the individual. This would in practice mean that the total of N Ltd's profit for each year would have to be re-allocated amongst the individuals to whom the deferred profit arrangements were relevant. No profit would remain chargeable to corporation tax on N Ltd.

86.6.2 *"The relevant tax amount"*

This term matters for conditions X(b)[ii] and Y: the relevant tax amount must be lower than it would otherwise have been. Section 850C(9) ITTOIA provides the definition:

> "The relevant tax amount" is the total amount of tax which, apart from this section, would be chargeable in respect of A and B's income as partners in the firm.

86.7 Condition Y: Excess profit allocation

Section 850C(3) ITTOIA provides:

> Condition Y is that—
> (a) B's profit share exceeds the appropriate notional profit (see subsections (10) to (17)),
> (b) A has the power to enjoy B's profit share ("A's power to enjoy") (see subsections (18) to (21)), and
> (c) it is reasonable to suppose that—
> (i) the whole or any part of B's profit share is attributable to A's power to enjoy, and
> (ii) both A's profit share and the relevant tax amount (see subsection (9)) are lower than they would have been in the absence of A's power to enjoy.

Condition Y contains a set of 3 conditions, which I call Conditions Y(a), Y(b), and Y(c).

The PM refers to condition Y as "excess profit allocation rules".

86.8 Condition Y(a): Profit share excessive

Section 850C(3) ITTOIA provides:

> Condition Y is that—
> (a) B's profit share exceeds the appropriate notional profit

Under condition Y(a) we need to ascertain:
(1) The profit share of B (transferee) and
(2) B's appropriate notional profit

PM provides:

> **PM219000 - Condition Y** [July 2019]
> ... The fact that the Condition was not met in a particular period does not mean that it will not be met later even if the members of the partnership and ownership of the non-individual member remain the same.
> It is therefore important to check every period.

86.8.1 *B's profit share*

This term is defined twice in the excess profits code, but in effectively the same terms. It is convenient to set the definitions side by side:

s.850C(7) ITTOIA	**s.850D(7) ITTOIA**
B's profit share is to be determined by applying section 850 and, if relevant, section 850A in relation to B for the relevant period of account (whether or not B is chargeable to income tax) on the assumption that the calculation under section 849 in relation to B produces the profit for the firm mentioned in subsection (1)(a)(i).	B's profit share is to be determined by applying section 850 and, if relevant, section 850A in relation to B for the relevant period of account (whether or not B is chargeable to income tax) on the assumption that the calculation under section 849 in relation to B produces the profit for the firm mentioned in subsection (1)(b).

This only applies for s.850C/D, so it has to be incorporated by reference into s.850E.[20]

86.9 Appropriate notional profit

This is a key term for condition Y(a): B's profit share must exceed the appropriate notional profit. Section 850C(10) ITTOIA provides the definition:

> "The appropriate notional profit" is the sum of
> [a] the appropriate notional return on capital and
> [b] the appropriate notional consideration for services.

86.9.1 *Notional return on capital*

This is the first element of appropriate notional profit. Section 850C(11)

[20] See s.850E(3) ITTOIA.

ITTOIA provides:

> "The appropriate notional return on capital" is—
>
> (a) the return which B would receive for the relevant period of account in respect of B's contribution to the firm were the return to be calculated on the basis mentioned in subsection (12), less
>
> (b) any return actually received for the relevant period of account in respect of B's contribution to the firm which is not included in B's profit share.

86.9.2 *B's contribution to firm*

Section 850C ITTOIA provides:

> (13) For the purposes of subsections (11) and (12) B's contribution to the firm is amount A determined under section 108 of ITA 2007 (meaning of "contribution to the LLP").
>
> (14) That section is to be applied—
>
> (a) reading references to the individual as references to B and references to the LLP as references to the firm, and
>
> (b) with the omission of—
>
> (i) subsections (5)(b) and (9), and
>
> (ii) in subsection (6) the words from "but" to the end.

Amended as s.850C(14) directs, s.108 ITA provides:

(2) Amount A is the amount which ~~the individual~~ B has contributed to the ~~LLP~~ firm as capital less so much of that amount (if any) as is within subsection (5).

(3) In particular, ~~the individual~~ B's share of any profits of the ~~LLP~~ firm is to be included in the amount which ~~the individual~~ B has contributed to the ~~LLP~~ firm as capital so far as that share has been added to the ~~LLP~~ firm's capital.

(4) In subsection (3) the reference to profits is to profits calculated in accordance with generally accepted accounting practice (before any adjustment required or authorised by law in calculating profits for income tax purposes).

(5) An amount of capital is within this subsection if it is an amount which–

(a) ~~the individual~~ B has previously drawn out or received back,

~~(b) the individual draws out or receives back during the period of 5 years beginning with the relevant time,~~

(c) ~~the individual~~ B is or may be entitled to draw out or receive back at any time when ~~the individual~~ B is a member of the ~~LLP~~ firm, or

(d) ~~the individual~~ B is or may be entitled to require another person to reimburse to ~~the individual~~ B.

(6) In subsection (5) any reference to drawing out or receiving back an amount is to doing so directly or indirectly but does not include drawing out or receiving back an amount

which, because of its being drawn out or received back, is chargeable to income tax as profits of a trade.

(7) Amount B is the amount of ~~the individual~~ B's liability on a winding up of the ~~LLP~~ firm so far as that amount is not included in amount A.

(8) For the purposes of subsection (7) the amount of ~~the individual~~ B's liability on a winding up of the ~~LLP~~ firm is the amount which–

(a) ~~the individual~~ B is liable to contribute to the assets of the ~~LLP~~ firm in the event of its being wound up, and

(b) ~~the individual~~ B remains liable to contribute for the period of at least 5 years beginning with the relevant time (or until the ~~LLP~~ firm is wound up, if that happens before the end of that period).

~~(9) This section needs to be read with [section 113A and any regulations made under section 114 (exclusion of amounts]1 in calculating the individual's contribution to the LLP for the purposes of section 107).~~

PM provides:

> **PM221000 - The appropriate notional return on capital** [July 2019]
> ... The capital is the amount of money or other property that all the members have contributed, to the permanent endowment of the firm. If the member has contributed an asset, rather than money, then the capital contribution is the market value at the time of transfer.
>
> *Example 1*
> C Ltd transferred a property to the LLP. It had originally cost £100,000, but the market value at the time of transfer was £250,000. The capital account of C Ltd was credited with £100,000, the historic cost rather than the market value. The property is currently worth £500,000
> The capital contributed was the market value at the date that it was contributed, £250,000.
>
> **Capital is at risk**
> The capital contributed does not include sums that the member is entitled to withdraw, or sums that they do not really have at risk, because there are arrangements under which they will be reimbursed.
>
> **Current Account is not capital**
> In addition to their capital, a member is likely to have what is sometimes called a current account. This account reflects the member's day-to-day balance with the firm reflecting things such as their entitlement to a profit share, tax account and drawings. The current account balance is not capital contributed.
>
> **Undrawn Profits are not capital**
> An undrawn profit share is not capital, but the members can agree to convert it into capital just as they can agree to pay a further sum in as capital.

In *Walewski v HMRC*:[21]

> 177. the £10 million of unallocated, undrawn capital retained in AAM ... cannot be treated as "capital" for these purposes.
> 178. We say this for three reasons:
> (1) In order to constitute a "contribution" of capital, it must first belong to the entity (W Ltd) which is making the contribution. ... this £10 million had not been allocated to W Ltd and therefore did not belong to W Ltd. In accordance with AAM partnership agreement, profits had to be allocated by the management committee and unallocated profits were held in a retention account for the benefit of AAM. We do not see how the fact that W Ltd had paid tax on this amount under the specific tax code applying to LLPs alters this conclusion.
> (2) Even if we are wrong on this, we did not see any evidence that this £10 million had been properly characterised as "capital" by AAM, certainly not in the technical sense required by s 850C(3) and not in any other meaningful sense, such as in accordance with the relevant SORP.
> (3) Finally, Mr Walewski's interpretation, that the provision of any "capital like" funds which generated value for AAM should be taken account of as part of the notional consideration provided by W Ltd, however defined, is not tenable in the context of this legislation which has a specific provision dealing with returns on capital as defined.

86.9.3 *Rate of interest*

Section 850C(12) ITTOIA explains basis of the notional profit computation:

> The return mentioned in subsection (11)(a) is to be calculated on the basis that it is a return which is—
> (a) by reference to the time value of an amount of money equal to B's contribution to the firm, and
> (b) at a rate which (in all the circumstances) is a commercial rate of interest.

PM provides:

> **PM221000 - The appropriate notional return on capital** [July 2019]
> *Rate of Interest*
> The legislation does not set a specific rate. The rate will vary as the appropriate commercial rate will vary from case to case and from time to time:

[21] [2020] UKFTT 58 (TC).

- The commercial rate will reflect the level of risk involved.
- Where the level of capital varies during the relevant period of account, the notional return must be calculated on these varying amounts.

The rate however must be limited to a reasonable rate of interest. It is not relevant that an equity return on the same investment might have been much greater.

The rates charged by so-called "payday" lenders or on credit card debts are not appropriate commercial comparators.

If the member receives some other form of return on capital, other than a share of the profit (for example, a fee), then this is deducted in arriving at the limit on the notional return.

Example 2

This example shows that the notional return is based upon a commercial rate of interest.

B Ltd has invested £10,000 in ABC LLP. It receives no return on this other than its profit share.

ABC LLP is paying 2% on loans on the commercial market, reflecting its good credit rating. This represents a commercial rate, so B Ltd has an appropriate notional return on capital of £200.

86.9.4 *Notional consideration for services*

This is the second element of appropriate notional profit. Section 850C ITTOIA provides:

> (15) "The appropriate notional consideration for services" is—
>
> (a) the amount which B would receive in consideration for any services provided to the firm by B during the relevant period of account were the consideration to be calculated on the basis mentioned in subsection (16), less
>
> (b) any amount actually received in consideration for any such services which is not included in B's profit share.
>
> (16) The consideration mentioned in subsection (15)(a) is to be calculated on the basis that B is not a partner in the firm and is acting at arm's length from the firm.

PM provides:

> **PM222000 - The appropriate notional consideration for services**
> [July 2019]
>
> The appropriate notional consideration for services is the arm's length value of any services provided by that member for the period, less any other amount received for those services (for example, a service fee)

that is not part of the profit share.

In most cases, this notional consideration should be no more than the cost to the company in providing the services plus a modest mark-up. If any services provided involve other members of the partnership (including in particular all the individual members), then the value of these services is not included in arriving at the notional return, for further guidance on this see PM223000.

Example 1

This example shows that it is important to look at what service is actually being provided.

The members of Farm LLP are two individuals, A and B, and their company C Ltd. In addition to being a member of Farm LLP, C Ltd provides contractor services to farms in the area. C Ltd also leases equipment to farms, including Farm LLP.

Farm LLP is a mixed membership partnership. C Ltd is providing services to Farm LLP, so the question is what is the appropriate notional consideration for services?

C Ltd is being paid for contractor services on an arm's length basis directly by its customers. This is separate from any services that C Ltd provides to Farm LLP so is not taken into account under the mixed membership rules.

In addition, C Ltd is providing the use of its equipment to Farm LLP. The arm's length value of this, using the amounts it charges to other farms as a comparable, is £10,000.

C Ltd has an appropriate notional consideration for those services of £10,000. This is because it is providing equipment to Farm LLP.

Example 2

This example looks at where a corporate member provides the partnership with the use of an asset, such as land.

The members of Agri LLP are two individuals, H and J, and their company HJ Ltd. HJ Ltd owns some of the land farmed by Agri LLP, no rent is being charged by HJ Ltd.

Agri LLP is a mixed membership partnership. HJ Ltd is providing services to Agri LLP, so the question is what is the appropriate notional consideration for services?

The appropriate notional consideration for services is the arm's length rent for the land.

Example 3

This example looks at where the partnership is paying rent but the terms have not been reviewed.

The facts are the same as in example 6, except that a rent is being paid.

> This was set a number of years ago, and has not been reviewed.
> The appropriate notional consideration for services is the arm's length rent for the land less the rent paid.

86.9.5 *Disregard of partner services*

Section 850C(17) ITTOA provides:

> Any services, the provision of which involves any partner in the firm in addition to B, are to be ignored for the purposes of subsection (15).

PM provides:

> **PM223000 - The appropriate notional consideration for services: restriction** [July 2019]
> ... A purpose of the excess profit allocation rules is to ensure that the profits generated by an individual's work for the partnership are taxed on that individual rather than on a corporate partner at CT rates.
>
> - This includes where the individual carries out work for the partnership either as an employee or contractor to the corporate member.
> - It applies where there is a chain of intermediaries between the partnership and the individual, no matter how long the chain, nor how complex.
>
> This prevents arguments about whether the individual carries out some services as a partner other as employee of the corporate member. The legislation operates on the premise that the company is not to be entitled to any profit share for these services and as if any profit actually allocated to the company were treated for tax as reallocated to the individual member.

PM provides three straightforward examples:

> *Example 1*
> This example shows how there is no notional consideration for services when the services involve other partners.
> Continuing with example 3 at PM222000, B Ltd is a member of ABC LLP and provides advertising services for ABC LLP. The work is carried out for B Ltd by A, who is also a member of ABC LLP. B Ltd provides no other services to ABC LLP.
> B Ltd is treated as providing no services as the only service provided involves another member of the LLP. Therefore, the appropriate notional consideration for services is nil.
> As such, B Ltd has an appropriate notional profit of £200, consisting purely of its notional return on capital.

Example 2
This example looks at where the partners themselves are also working for the corporate member.
HED LLP has as members D, E, F, G and H together with a corporate member, HED Ltd. HED Ltd provides management services to the LLP which is carried out by H, E and D as directors of HED Ltd.
Whilst the work was carried out by the directors of the company, these directors are also members in their own right. As the work was done by members the appropriate notional consideration for services is NIL. That the work was done in their capacity as directors of the corporate member makes no difference.
Sometimes work may be done partly by other members and partly by non-members.

Example 3
This example looks at where people other than the partners themselves are working for the corporate member.
DHE LLP has as members D, E, F, and H together with a corporate member, DE Ltd. DE Ltd provides management services to the LLP which is carried out by three unconnected individuals and D and E as directors of DE Ltd.
The appropriate notional consideration for the work done by D and E, who are members of DHE LLP, services is NIL. That the work was done in their capacity as directors of the corporate member makes no difference.
If the work done by the three non-members can be distinguished from the work done by the members then the appropriate notional consideration for services is arm's length value of these services. If the work cannot be distinguished then the appropriate notional consideration is NIL.

Example 4
This example looks at where the services are provided by members via a chain of intermediaries.
The members of FM LLP are the individuals M, N & O and a corporate member X Ltd.
M, N and O are also employees of Y Ltd an offshore employer.
Y Ltd contracts with X Ltd to supply it with the services of M, N and O.
X Ltd is the managing member of FM LLP, with the work being done by M, N and O on secondment to X Ltd. X Ltd receives a profit share for acting as managing member.
The question is what is the appropriate notional consideration for

services?

The legislation looks at whether the work involves any member other than that corporate member. It does not look at the link between that member and the corporate member.

In this case, the work is actually done by individuals who are members of FM LLP. As a result the appropriate notional consideration for services is NIL.

Example 5

This example looks at how the test is whether the individual provides the services, not the nature of the services.

EHD LLP has as members D, E, F, G and H together with a corporate member EHD Ltd. Under the LLP agreement the management of the LLP is delegated to EHD Ltd, the individual members are specifically excluded from taking part. As members, the individuals D, E and H manage portfolios of investments. As directors of EHD Ltd, they manage the LLP.

The LLP is managed by the directors of the company, these directors are also members in their own right. As the work was done by members the appropriate notional consideration for services is NIL.

The fact that under the LLP agreement the individuals are not allowed to take part in the management of the LLP does not affect the position under the excess profits allocation rules. The services provided by the corporate member involved individual members, so no credit is given for the services provided.

86.10 Condition Y(b): Power to enjoy

Section 850C(3) ITTOIA provides:

> Condition Y is that ...
>
> (b) A has the power to enjoy B's profit share ("A's power to enjoy")...

Section 850C(18) ITTOIA provides:

> A has the power to enjoy B's profit share if—

There follow 3 sets of conditions, which I call **"PtoE conditions (a)(b)(c)"**.

I write Power to Enjoy with initial capitals, to indicate the technical nature of the term, but it is so wide as to justify using scare quotation marks.

The definition only applies for s.850C, so it has to be incorporated by reference into s.850D.[22]

86.10.1 *PtoE condition (c): Enjoyment conditions*

It is convenient first to consider PtoE condition (c).
Section 850C(18) ITTOIA provides:

> A has the power to enjoy B's profit share if ...
> (c) any of the enjoyment conditions (see subsection (20)) is met in relation to B's profit share or any part of B's profit share.

Section 850C(20) ITTOIA provides:

> The enjoyment conditions are—
> (a) B's profit share, or the part, is in fact so dealt with by any person as to be calculated at some time to enure for the benefit of A, whether in the form of income or not;
> (b) the receipt or accrual of B's profit share, or the part, by or to B operates to increase the value to A of any assets held by, or for the benefit of, A;
> (c) A receives or is entitled to receive at any time any benefit provided or to be provided (directly or indirectly) out of B's profit share or the part;
> (d) A may become entitled to the beneficial enjoyment of B's profit share, or the part, if one or more powers are exercised or successively exercised by any person;
> (e) A is able in any manner to control (directly or indirectly) the application of B's profit share or the part.

This part of the definition of Power to Enjoy is based on power to enjoy in s.731.[23] But the scope is greatly increased by s.850C(21) ITTOIA:

> In subsection (20) references to A include any person connected with A apart from B.

PM provides:

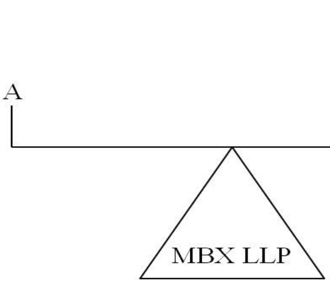
> **PM227000 Enjoyment Conditions** [July 2019]
> ... *Example 1*
> This is an example of a farming partnership where the landlord is represented by a corporate member.
> A farm in Scotland is run as a partnership between the tenant farmer

[22] See s.850D(13) ITTOIA.
[23] See 49.15 ("Power to enjoy").

and a limited company owned by the landlord, who is not connected to the tenant.
This is a mixed membership partnership, but none of the enjoyment conditions are met.
The tenant farmer has no connection with the corporate member other than that they are partners in running the farm. The excess profit allocation rules do not apply.

The excess profit allocation rules are about the "power to enjoy". The fact that the individual is not currently withdrawing any form of value from the non-individual does not alter the position.

Example 2
This example looks at where the enjoyment conditions are met but the profits are not currently being paid out.



A and his personal company A Ltd are both members of MBX LLP. Profits that can be withdrawn are allocated to A. The profits that A does not need to withdraw, for example as the LLP needs the money to finance expansion, are allocated to his personal company. In practice, A does not withdraw any money from A Ltd.
The excess profit allocation rules apply.
The key is that A Ltd is only getting the profit share because of A's power to enjoy and the relevant tax amount is lower as a result of the arrangements. That A chooses not to extract the profits allocated to A Ltd at that time does not alter the fact that he has the power to enjoy them.
It is also possible that Condition X (deferred profit arrangements) applies to this arrangement, see PM218000.[24]

86.10.2 *Condition (a): A connected with B*

Section 850C(18) ITTOIA provides:

[24] See 86.6 (Condition X: Deferred profit).

> A has the power to enjoy B's profit share if—
>
> (a) A is connected with B by virtue of a provision of section 993 of ITA 2007 (meaning of "connected" persons) other than subsection (4) of that section ...

This applies where A is connected with B but for this purpose the connection of being a partner (s.993(4)) does not count.[25] That rule is needed because otherwise A is always connected with B.

By contrast, in applying the connected person test for condition (c) (enjoyment conditions) A's partners (other than B) and their relatives do count as connected persons.

86.10.3 *PtoE condition (b): CT arrangements*

Section 850C(18) ITTOIA provides:

> A has the power to enjoy B's profit share if ...
>
> (b) A is a party to arrangements[26] the main purpose, or one of the main purposes, of which is to secure that an amount included in B's profit share—
>
> (i) is charged to corporation tax rather than income tax, or
>
> (ii) is otherwise subject to the provisions of the Corporation Tax Acts rather than the provisions of the Income Tax Acts ...

PM provides:

> **PM226000 - Arrangements to secure corporation tax rather than income tax treatment** [July 2019]
>
> [PM summarises s.850C(18)(b) and continues:] This may, for example, be the case because the corporate member is able to obtain relief under Corporation Tax rules for amounts that would not be deductible under Income Tax provisions.
>
> This rule applies even if there is no economic connection between the individual and the corporate member.
>
> The legislation applies both where the intention is to ensure that the sum is taxed at Corporation Tax rates, rather than Income Tax rates, and also where the aim is to access a relief that is only available for corporation tax payers.

[25] See 104.18 (Connected: Partners).

[26] Section 850C(19) provides the standard (unnecessary) IT definition of "arrangements"; see App.2.2.3 (Definitions of "arrangement").

86.11 PtoE condition Y(c): PtoE is cause

Section 850C(3) ITTOIA provides:

> Condition Y is that ...
> (c) it is reasonable to suppose[27] that—
> (i) the whole or any part of B's profit share is attributable to A's power to enjoy, and
> (ii) both
> [A] A's profit share and
> [B] the relevant tax amount (see subsection (9))
> are lower than they would have been in the absence of A's power to enjoy.

Condition Y(c) is itself a set of 2 conditions, which I call Y(c)(i) and Y(c)(ii), and Y(c)(ii) can itself be regarded as two conditions [A] and [B].

In short, the Power to Enjoy must be the driver of the arrangement.

A corporate partner may be used for technical reasons (because a LLP cannot have just one member) and only receive nominal profits. The nominal profits would not be attributable to A's power to enjoy and would not meet condition Y(c)(i).

HMRC guidance paraphrases the test in the following ways:

- *Influence:* Is the profit share influenced by the power to enjoy?
- *But-for test:* would B (the corporate member) not have received this profit but for A's power to enjoy? Would A allow profits to be allocated to B Ltd if A did not have the power to enjoy those profits?
- *Economic connection:* does the economic connection between A and B result in profit being shifted from A to B, the non-individual

These may be helpful paraphrases, though one must finally return to the words of the statute. The first two of these paraphrases are in this PM passage:[28]

> **PM228000 Is The Profit Share Influenced By The Power To Enjoy?**
> [July 2019]
> ...If one or more individual members own the corporate member, and the corporate member is allocated any residual profit, after the individuals have been allocated a share, then it is reasonable to suppose that the

[27] See App.2.24 (Reasonable-to-assume).

[28] For the economic consequences, see 86.18 (Business transferred to partnership).

corporate member would not have received this profit but for the power to enjoy.

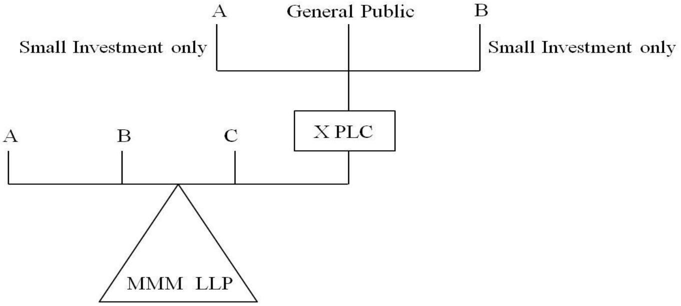
The individual may have an interest in the non-individual partner but this may be so small that it is clear that on a realistic view of the facts the profit share has not been affected.

Example 1

This example looks at where an individual member has a small investment in a corporate member such as a quoted company.

MMM LLP has members, A, B and C, together with X Plc, which is a listed on a major exchange.

A has a small investment in X Plc as part of a share portfolio. B has a small investment as she used to work for X Plc and received the shares under an incentive scheme. There are no other arrangements by which they can benefit from the profit share of X Plc



The HMRC analysis is as follows:

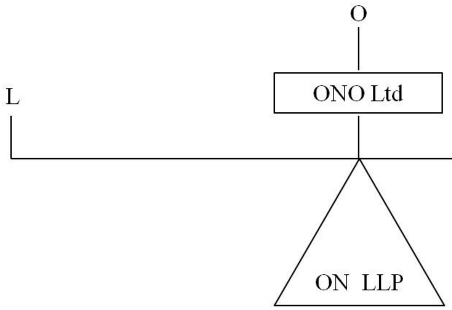
It would not be reasonable to suppose that the profit share of X Plc has been increased because A and B have shares. Their holdings are such that they could not have influenced the allocation of profits to X Plc.

The crucial factor for the mixed membership partnership legislation to apply is that there has been a diversion of profits from an individual to a non-individual member. Profits of a non-individual member can only be reallocated to an individual member to the extent that it is reasonable to suppose that those profits are attributable to the individual member’s power to enjoy them. This is to be determined on a just and reasonable basis.

Example 2

This example looks at where an individual assigns part of their interest in the LLP to their company.

O is a member of ON LLP. He sells part of his interest in the LLP to his company ONO Ltd, which becomes a member of ON LLP.



Following the sale, O's share of the profit is reduced, and what he terms an "equity profit" is allocated to ONO Ltd.

ON LLP is a mixed membership partnership. ON Ltd provides no services or capital to ON LLP so the appropriate notional profit is NIL.

It is reasonable to assume that ONO Ltd is receiving this profit because of O's power to enjoy and profits should be reallocated accordingly.

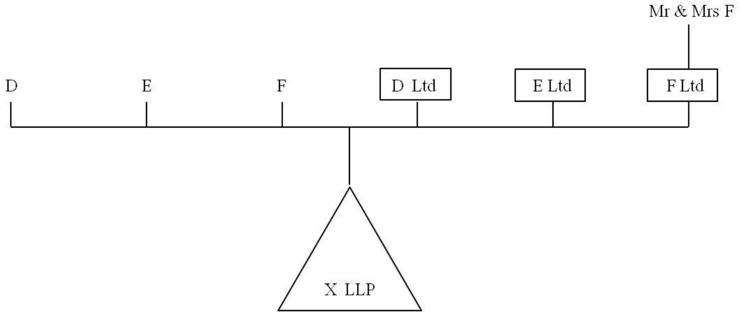
If O withdrew from the partnership to prevent the mixed membership rules from applying then he would continue to be taxed as a partner as a result of S850D ITTOIA 2005, with the excess allocation to the company then being treated as his profit share.

Example 3

This example looks at a situation where there are a number of corporate members.

X LLP has individual members D, E and F together with three companies D Ltd, E Ltd and F Ltd. D is the 100% shareholder of D Ltd. E is the 100% shareholder of E Ltd. The shareholders of F Ltd are F and his spouse.

Prior to the admission of the three corporate members D, E and F shared profits 60:20:20 and following the admission of the corporate members their individual profit share entitlements are each reduced by the amount allocated to their respective companies. D Ltd, E Ltd and F Ltd are not entitled to any profit share if D, E and F respectively cease to be LLP members.

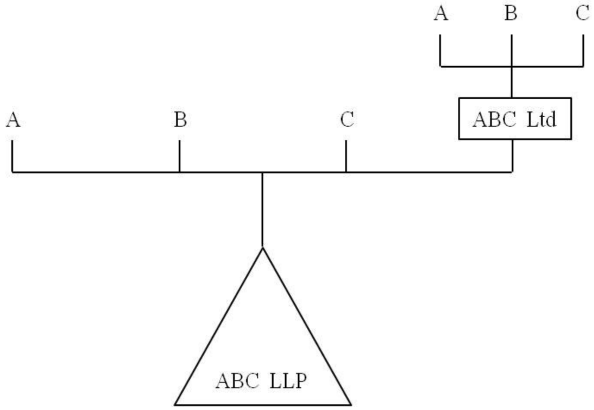


The profit shares of D Ltd, E Ltd and F Ltd are attributable to D, E and F respectively. It is reasonable to ascribe direct causal connection between the profit share allocated to D Ltd (for example) and D’s status as a member of X LLP and shareholder in D Ltd. It is also clear that D’s profit share (for example) is lower than it would have been had he not been shareholder in D Ltd with ability to access the profit share allocated to D Ltd.

Example 4

This is a general example looking at what happens under the new legislation when individuals use a corporate member to defer paying tax. The membership of ABC LLP consists of three individuals, A, B and C, who decide that they want to retain funds in the LLP for working capital. In order to avoid the retained profits being taxed at higher income tax rates, they introduce a corporate member, ABC Ltd, which is fully owned by A, B and C.

ABC Ltd does not provide any services and only a nominal amount of capital.



A, B and C work out what they wish to draw personally and allocate the balance of the profit to ABC Ltd. The profit share allocated is invested or retained in the partnership by the company member as additional partnership capital or advances.

The individual members meet the enjoyment conditions in relation to the sums allocated to their company.

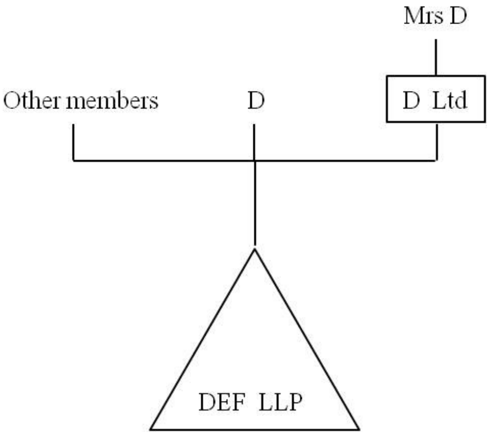
The three individual members are taxed on an additional profit, split on a just and reasonable basis, equal to the profit share allocated to ABC Ltd, less a sum that represents an appropriate notional return on the nominal amount of capital introduced by ABC Ltd.

It is also likely that this is an arrangement that has a main purpose of securing Corporation Tax treatment of the profit. It is also possible that

Condition X (profit deferral) applies see PM219000.[29]

The reader may wonder whether a policy which discourages re-investment of partnership profit is a wise one. But there it is.

Example 5
This is a further general example where an individual diverts profits through a company owned by a close relative.
D is a member of DEF LLP. All the members of the LLP agree to introduce D Ltd as a member. D Ltd is a company that is owned by his wife. D continues to be a member of the LLP, only now he does some work for the LLP through D Ltd. D Ltd provides only a nominal amount of capital.
The only change is that the profit share, previously allocated to D, is now allocated partly to D himself, but mainly to D Ltd.
D Ltd is owned by the wife of D, so a connected person is in a position to enjoy the profits of D.



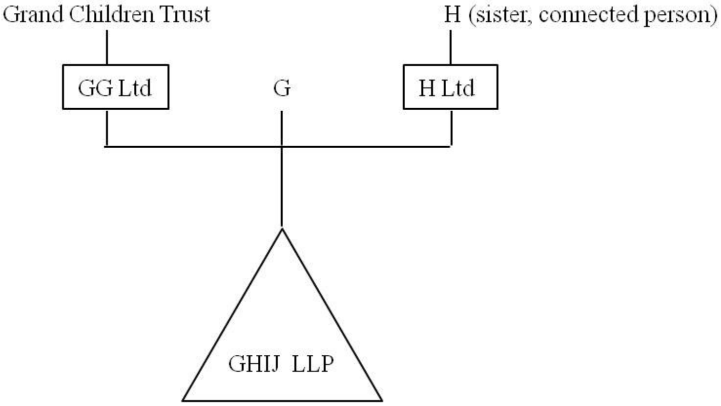
D is taxed on an additional profit equal to the profit share allocated to D Ltd. Whilst D Ltd is providing services to DEF LLP, the reality is that the work is such services as are being provided by D, another member. These services are ignored in determining the appropriate notional consideration for services. D Ltd provides no other services, so the appropriate notional consideration for services is nil.

Example 6
This example looks at the question of whether the profit share is

[29] See 86.6 (Condition X: Deferred profit).

influenced by the power to enjoy.

G is a member of GHIJ LLP. Since it was formed in 2007 there have been two corporate members. H Ltd is owned by, and provides the services of, H, the sister of G. H has never been a member. GG Ltd is owned by trustees on behalf of the grandchildren of G.



G has the power to enjoy for both H Ltd and GG Ltd. The question is whether the profit shares are influenced by the power to enjoy.

In the case of H Ltd, the facts show that H is working for the LLP and all profits allocated to H Ltd properly reflect that work. The profit share is not affected by the power to enjoy and the legislation does not apply to H Ltd's share of the profit.

In the case of GG Ltd, the profit share is influenced by the fact that G wants the money to pass to his grandchildren. The excess profit allocation rules apply to the profit share, and G will be taxed on the profit share, subject to any notional profit.

86.12 s.850C counteraction: Income reallocation

Assuming the s.850C application conditions are satisfied, we move on. Section 850C(4) ITTOIA provides:

> A's profit share is increased by so much of the amount of B's profit share as, it is reasonable to suppose[30], is attributable to—
> (a) A's deferred profit, or
> (b) A's power to enjoy,
> as determined on a just and reasonable basis. But any increase by virtue of paragraph (b) is not to exceed the amount of the excess mentioned in

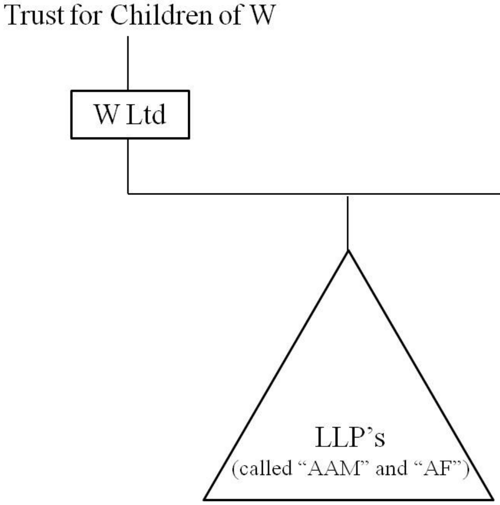
[30] See App.2.24 (Reasonable-to-assume).

subsection (3)(a) after deducting from that amount any increase by virtue of paragraph (a).

A does not have an indemnity against B for the tax, so if A has "Power to Enjoy" without any actual interest in the profits, the consequence may be very harsh.

86.12.1 *Attribution*

In *Walewski v HMRC*[31] the business structure, simplified, amounted to this:



Mr W had power to enjoy. He argued that he provided services to W Ltd, which W Ltd provided to the partnership, so W Ltd earned its profit share and none of it should be attributed to the power to enjoy.

If that is right then the mixed partnership code would be easy to avoid.

On the facts, the arrangement was not scrupulously carried out. Mr W kept no records or timesheets to show when he was acting on behalf of the W Ltd. He entered into contracts of employment with W Ltd and with another entity, both of which required full time work! Clients were unaware of the arrangement. But even if these facts had been better (which would not have been easy to arrange) the tribunal would not have accepted that he provided services via the company:

[31] [2020] UKFTT 58 (TC). In the appeal this was regarded as a matter of fact and unchallengeable: [2021] UKUT 133 (TCC) at [43]. The reader may be surprised that permission was given to appeal.

> 170 Mr Walewski's work for W Ltd, AAM and AF was fungible; it is not possible on the basis of any evidence which we saw, to separate his role into discrete components; his work for one was his work for each and all of those entities. [A witness] described Mr Walewski's roles for the three entities as "very interlinked", we think they were more than interlinked, we think Mr Walewski was essentially playing only a single role, but for the benefit of all three entities.
> 171. Mr Walewski was described as "wearing a number of hats", again, in our view this does not do justice to the truly fungible nature of his activities for these entities, all of whose decisions and strategies began and ended with Mr Walewski, as the only director and employee of W Ltd, as a member of AAM and only member of its management committee and as an employee and member of AF.
> 172. There was no commercial, physical or temporal separation of Mr Walewski's activities. ...
> 173. ... if W Ltd's profit allocation cannot be explained by Mr Walewski's earning power as its employee, what other alternative reasonable explanation can there be for the profits being allocated to W Ltd other than Mr Walewski's power to enjoy them ?
> 175. ... In our view the test which we must apply to determine whether W Ltd has earned its share of attributed profits is a test of substance and not just form.

This is a test which could never be met no matter how well the arrangement had been carried out. Once one disregards the employment with W Ltd, the result is inevitable:

> 191. On the contrary, our view is that the only reasonable explanation for the allocation of profit to W Ltd from AAM and AF is by reason of Mr Walewski's ability to enjoy those profits.
> 192. This conclusion is supported by the fact that:
> (1) The 2006 amended partnership agreement of AAM gave W Ltd a right to 99.9% of AAM's profits, independent of any services provided by Mr Walewski or the terms of any employment contract.
> (2) Mr Walewski's salary from W Ltd, while significant, was modest in terms of the industry in which he worked and the level of profit which was being generated in AAM and AF...
> (3) Mr Walewski did not take a bonus from W Ltd under his employment contract.
> (4) We find it hard to understand why someone in Mr Walewski's position would have been willing to give away such a large percentage of the profits which he had generated if there was not some benefit to

himself. In our view, the only reason he would do that is if he knows that he has the power to enjoy the profits of the company in some other way.
(5) Mr Walewski would be an unusual, if not unique, member of the finance industry if he not only failed to take the full amount of his contracted salary, but also did not claim any amount of bonus and allowed a company to take all of the fruits of his labour...
(6) At the relevant time there was a significant difference between the 45% income tax which Mr Walewski suffered on payments made directly to him and the 21% corporation tax suffered by W Ltd.
(7) It seems reasonable to conclude that changes made in the Alken group structure were made not for commercial reasons, but in response to the PWC advice given about ways to mitigate the impact of the mixed partnership rules and ensure that the tax differential between W Ltd and Mr Walewski could be retained.

86.13 A (transferor) not partner: s.850D

Section 850C ITTOIA only applies if A (the transferor/individual) is a partner, so it could be avoided by arranging that A is not a partner.

Section 850D(1) ITTOIA deals with this. It may be helpful to read this side by side with s.850C, to identify the differences:

s.850D(1) application conditions	**s.850C(1) application conditions**
Subsections (4) and (5) apply if—	Subsections (4) and (5) apply if—
(a) at a time during a period of account (“the relevant period of account”) in respect of a firm, an individual (“A”) personally performs services for the firm,	[No equivalent]
(b) if A had been a partner in the firm throughout the relevant period of account, the calculation under section 849 in relation to A for the relevant period of account would have produced a profit for the firm,	(a) for a period of account (“the relevant period of account”)— (i) the calculation under section 849 in relation to an individual partner (“A”) (see subsection (6)) produces a profit for the firm, and (ii) A’s share of that profit determined under section 850 or 850A (“A’s profit share”) is a profit or is neither a profit nor a loss,

(c) a non-individual partner (“B”) in the firm (see subsection (6)) has a share of that profit (“B’s profit share”) which is a profit (see subsection (7)),	(b) a non-individual partner ("B") (see subsection (6)) has a share of the profit for the firm mentioned in paragraph (a)(i) ("B's profit share") which is a profit (see subsection (7)), and
(d) it is reasonable to suppose[32] that A would have been a partner in the firm at a time during the relevant period of account or any earlier period of account but for the provision contained in section 850C (see also subsections (8) to (10)), and	[no equivalent]
(e) condition X or Y is met.	(c) condition X or Y is met.

I coin some terminology, and in the discussion below:
The conditions in para (e) are **“s.850D condition X/s.850D condition Y”**
The conditions in s.850C are the **“s.850C conditions X and Y”**.

86.13.1 *s.850D condition X*

Section 850D(2) ITTOIA provides:

> Condition X is that it is reasonable to suppose[33] that amounts representing A’s deferred profit (see subsection (11)) are included in B’s profit share.[34]

Section 850D condition X is the same as s.850C condition X(a): see 86.6 (Condition X: Deferred profit).

86.13.2 *s.850D condition Y*

Section 850D(3) ITTOIA provides:

> Condition Y is that—
> (a) B’s profit share exceeds the appropriate notional profit (see subsection (12)),

[32] See App.2.24 (Reasonable-to-assume).

[33] See App.2.24 (Reasonable-to-assume).

[34] See 86.8.1 (B’s profit share).

> (b) A has the power to enjoy B's profit share ("A's power to enjoy") (see subsection (13)),[35] and
>
> (c) it is reasonable to suppose[36] that the whole or any part of B's profit share is attributable to A's power to enjoy.

Section 850D condition Y contains 3 conditions, or sets of conditions, which I call Condition Y(a), (b) and (c).

Section 850D conditions Y(a)(b) and (c) are equivalent to s.850C conditions Y (a)(b) and (c)(i): see 86.7 (Condition Y: Excess profit allocation).

86.14 s.850D counteraction: deemed partner

Assuming s.850D conditions X or Y are satisfied, we move on. Section 850D(4) ITTOIA provides:

> A is to be treated on the following basis—
>
> (a) A is a partner in the firm throughout the relevant period of account (but not for the purposes of section 863I (allocation of profit to AIFM firm[37])),
>
> (b) A's share of the firm's profit for the relevant period of account is so much of the amount of B's profit share as, it is reasonable to suppose[38], is attributable to—
>
> (i) A's deferred profit, or
>
> (ii) A's power to enjoy,
>
> as determined on a just and reasonable basis, and
>
> (c) A's share of the firm's profit is chargeable to income tax under the applicable provisions of the Income Tax Acts for the tax year in which the relevant period of account ends.
>
> But A's share of the firm's profit by virtue of paragraph (b)(ii) is not to exceed the amount of the excess mentioned in subsection (3)(a) after deducting from that amount A's share of the firm's profit (if any) by virtue of paragraph (b)(i).

[35] Section 850D(13) provides:

> "Section 850C(10) to (17) applies for the purpose of determining "the appropriate notional profit"; and A is to be treated as a partner in the firm for the purposes of section 850C(17)."

See 86.9 (appropriate notional profit).

[36] See App.2.24 (Reasonable-to-assume).

[37] See 83.16 (Alternative investment fund manager).

[38] See App.2.24 (Reasonable-to-assume).

86.15 Associated partnership

Section 850D(1) provides:

> (1) Subsections (4) and (5) apply if...
> (d) it is reasonable to suppose that A would have been a partner in the firm at a time during the relevant period of account or any earlier period of account but for the provision contained in section 850C

Section 850D(8) ITTOIA provides:

> The requirement of subsection (1)(d) is to be assumed to be met if, at a time during the relevant period of account, A is a member of a partnership[39] which is associated with the firm.

86.15.1 *"Associated"*

Section 850D(9) ITTOIA provides:

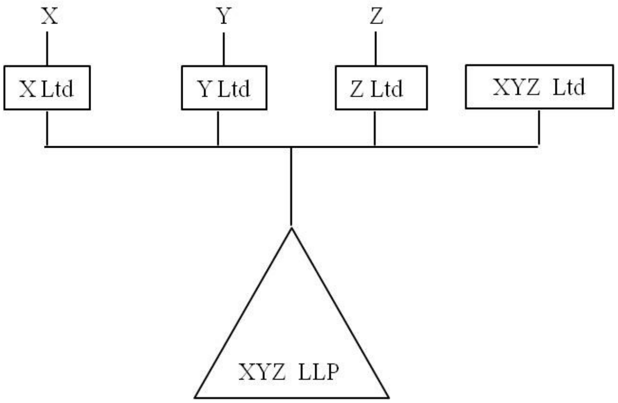
> A partnership is "associated" with the firm if—
> (a) it is a member of the firm, or
> (b) it is a member of a partnership which is associated with the firm (whether by virtue of paragraph (a) or this paragraph).

86.15.2 *HMRC examples*

PM provides:

> *Example 1*
> This example demonstrates the effect of the anti-avoidance rules where individual members resign and are replaced by personal service companies.
> X, Y, Z and XYZ Ltd are the members of XYZ LLP. In response to the new legislation, they decide that all the individual members should cease to be members of the LLP with effect from 6 December 2013 being replaced by their personal service companies.
> X, Y and Z continue to work for XYZ LLP, it is reasonable to suppose that they would have continued to be members but for the introduction of the legislation.

[39] Section 850D(10) ITTOIA provides:
"In subsections (8) and (9) "partnership" includes a limited liability partnership whether or not section 863(1) applies in relation to it."
But tt will be rare to have an LLP to which s.863 does not apply. See 85.22.2 (LLP treated as partnership).



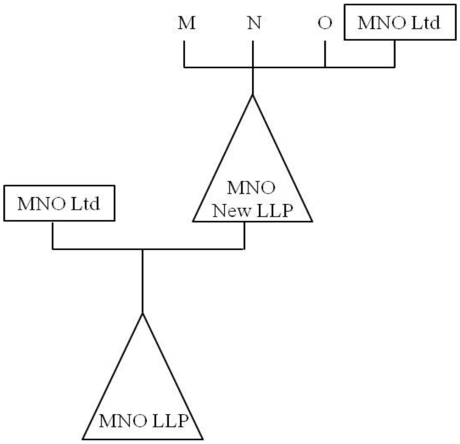
X, Y and Z are treated as members and the mixed membership partnership legislation applied accordingly.

Their share of the firm's profit, determined under the mixed membership rules, is chargeable to income tax for the tax year in which the relevant period of account ends...

Example 2

Example of the impact of the anti-avoidance rules.

M, N, O and MNO Ltd are the members of MNO LLP. In response to the new legislation, they decide that from 1 April 2014 all the individual members should become members of MNO New LLP. From 1 April 2014, the members of MNO LLP will be MNO Ltd and MNO New LLP. Whilst M, N and O are the members of MNO New LLP.



As MNO New LLP is an associated partnership it is assumed that M, N and O would have been members of MNO LLP. The mixed membership partnership legislation applies on the basis that they are deemed to have been members of MNO LLP.

Example 3
Example of where the anti-avoidance rules do not apply to events before 5 December 2013.
Firm A has only individual members. Before 5 December 2013, the individual partners decide to retire and transfer their interests in the partnership to limited companies which would become partners in their place. The actual transfer was carried out on 12 December 2013.
Although the change was not made until 12 December, there is clear evidence to show that the decision was made before 5 December so the partners could not be aware of the mixed membership partnership legisla-tion as at that time the new rules had not been published. As a result, the anti-avoidance provisions do not apply.
The excess profit allocation legislation came into force when it was announced on 5 December 2013. It cannot be inferred that an individual would have been a member but for the new rules if the individual withdrew from a partnership before that date.

86.16 Reliefs for B (transferee)

86.16.1 *Adjustment for B*

s.850C(5) ITTOIA	**s.850D(5) ITTOIA**
If B is chargeable to income tax, in applying sections 850[40] to 850B in relation to B for the relevant period of account, such adjustments are to be made as are just and reasonable to take account of the increase in A's profit share under subsection (4).	If B is chargeable to income tax, in applying sections 850 to 850B in relation to B for the relevant period of account, such adjustments are to be made as are just and reasonable to take account of A's share of the firm's profit under subsection (4).
(This subsection does not apply for the purposes of subsection (7) or section 850D(7).)	(This subsection does not apply for the purposes of subsection (7) or section 850C(7).)

This will not often apply, as B will normally be a company.

86.16.2 *Distribution relief*

Section 850E ITTOIA provides:

[40] See 86.3 (Allocation of profit to partners).

> (1) Subsection (2) applies in a case in which section 850C(4) or section 850D(4) applies if—
>
> (a) there is an agreement in place in relation to the excess part of B's profit share,
>
> (b) as a result of the agreement, B makes a payment to another person out of the excess part of B's profit share, and
>
> (c) the payment is not made under any arrangements[41] the main purpose, or one of the main purposes, of which is the obtaining of a tax advantage for any person.
>
> (2) For income tax purposes, the payment—
>
> (a) is not to be income of the recipient,
>
> (b) is not to be taken into account in calculating any profits or losses of B or otherwise deducted from any income of B, and
>
> (c) is not to be regarded as a distribution.
>
> (3) In this section—
>
> "the excess part of B's profit share" means so much of the amount of B's profit share as is represented by the amount of, as the case may be—
>
> (a) the increase under section 850C(4), or
>
> (b) A's share of the firm's profit under section 850D(4), and
>
> "tax advantage" has the meaning given by section 1139 of CTA 2010.

PM manual provides:

> **PM232000 Payments By The Non-Individual Out Of Its Reallocated Profit Share** [July 2019]
>
> ... *Example 2*
>
> This example addresses two concepts, the first where a payment made to a person connected to the indi-vidual member does not attract additional taxation, and the second where the payments are made after passing through a holding company partly owned by an unconnected party.
>
> AA Ltd receives £150,000 as its share of the profit of AA LLP. Under the excess profit allocation rules A is taxed on £130,000 of this by virtue of their power to enjoy the sum allocated to A Ltd.
>
> The excess part of AA Ltd's profits share is £130,000.
>
> AA Ltd agrees to pay A £100,000. It pays £40,000 as a dividend to its parent company AABC Ltd.
>
> AABC Ltd pays a dividend to its shareholders, A, B and C, who each receive £10,000.

[41] Section 850E(3) provides the standard (unnecessary) IT definition of "arrangements"; see App.2.2.3 (Definitions of "arrangement").

The payment of £100,000 is made as part of an agreement in connection with AA Ltd's excess profit share. A is not taxable on this sum and it is not taken into account in arriving at the profits of AA Ltd.
The dividends received by A, B and C were not paid to them by AA Ltd and so fall outside the scope of the legislation.

86.16.3 *Adjustment for corporation tax*

Section 1264A CTA 2009 provides:

> (1) Subsection (2) applies in a case in which—
> (a) section 850C(4) or 850D(4) of ITTOIA 2005 applies for a period of account ("the relevant period of account"), and
> (b) the partner who is "B" for the purposes of section 850C or 850D of that Act (as the case may be) is a company.
> (2) In applying sections 1262 to 1264 in relation to the company—
> (a) for the accounting period of the firm which coincides with the relevant period of account, or
> (b) if no accounting period of the firm coincides with the relevant period of account, for accounting periods of the firm in which the relevant period of account falls,
> such adjustments are to be made as are just and reasonable to take account of the increase under section 850C(4) of ITTOIA 2005 or A's share of the firm's profit under section 850D(4) of that Act.
> (3) Sections 850C(23) and 850E(2) of ITTOIA 2005 apply for corporation tax purposes as they apply for income tax purposes.

86.17 Alternative investment fund manager

An AIFM firm is a partnership the business of which is managing one or more AIFs. AIFM firms are required to subject part of the "remuneration" of key individuals to performance conditions and to defer when those individuals can access that remuneration.[42]

A member of an AIFM firm (including an LLP), is chargeable on the profits of the partnership as they arise rather than when they are received.

The AIFM tax provisions allow the AIFM partnership to elect to be treated as a partner in itself in order to pay tax on a member's remuneration on behalf of the member. If it does so, the AIFM firm is treated as an individual member of the partnership, not as a non-individual member for the purposes of the mixed membership rules.

As part of EU-wide strategy for investor protection, members of

[42] Alternative Investment Fund Managers Directive (2011/61/EU).

partnerships that are Alternative Investment Fund Managers (AIFM) may have their access to their profit shares deferred for a period of time. The partnership may choose to allocate these deferred profits to a non-individual partner.

Section 850C ITTOIA provides:

> (22) Subsection (23) applies if—
> (a) the increase under subsection (4), or any part of it, is allocated by A to the firm itself under section 863I (allocation of profit to AIFM firm), and
> (b) B makes a payment to the firm representing any income tax for which the firm is liable by virtue of section 863I in respect of the amount of the increase allocated to it.
> (23) For income tax purposes, the payment—
> (a) is not to be income of any partner in the firm, and
> (b) is not to be taken into account in calculating any profits or losses of B or otherwise deducted from any income of B.

I do not consider the special rules for AIFM trades (see s.863H - 863L ITTOIA).

86.18 Business transferred to partnership

PM provides:

> **PM236000 Businesses Transferred To The Partnership** [July 2019]
> This section looks at the tax treatment of the transfer of a business to a partnership by a company, where:
> - the company and a shareholder of the company both become (or are) partners in the firm,
> - the consideration given for the transfer is in the form of an equity stake in the partnership.
>
> The question is whether the excess profit allocation rules apply because of the shareholders power to enjoy?
> *Appropriate notional return on capital*
> The position is that the transferor company has transferred the business to the LLP and in return has been credited with having contributed capital to the firm.
> For the purposes of the excess profit allocation rules the amount of capital contributed is the open market value of the assets transferred at the time of transfer, not the historic or book value.
> The fact that the transferor company has contributed assets rather than cash as capital makes no difference.
> If the transferor company can draw on the sum then it is not capital

contributed for the purposes of the excess profit allocation rules, see PM221000.

The appropriate notional profit for the transferor company includes an appropriate notional return on capital based on the open market value of the assets transferred as capital at the time of transfer.

The appropriate notional return on capital is calculated in line with a commercial rate of interest.

There is no higher "equity return" based on the fact that the transferor company transferred a business. The value of that business transferred has already been recognised in the value of the capital account.

Appropriate notional return for services;

If the transferor company retains assets which it makes available to the LLP then the appropriate notional profit includes an appropriate notional consideration for services (less any amount actually paid by the partnership for the use of the asset), see PM222000.

Profit share exceeds appropriate notional profit:

The legislation recognises the value of the business transferred.

If the profit share allocated to the transferor company exceeds the "appropriate notional profit" then the question is whether the transferor company has received that excess by reason of the ability of an individual member to enjoy the profit.

Where a shareholder continues to be involved in the business after the transfer, it will nearly always be reasonable to conclude that the excess allocation of profits to a company which they substantially own (whether or not with connected individuals) is attributable to their continuing involvement with the firm, with the result that any such profit allocated to the corporate member will be reallocated to the individual.

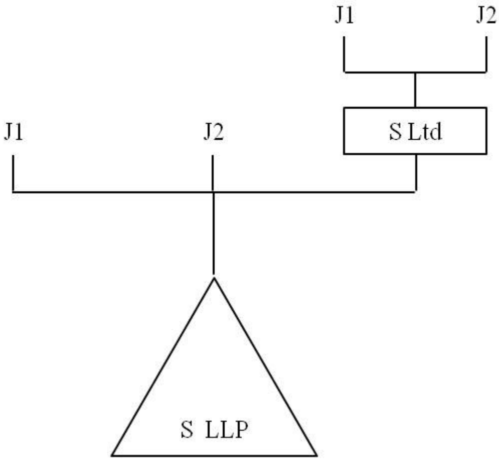
Cases where this is not the case will be exceptional. The most likely scenario is where the company is widely owned and there are a majority of shareholders unconnected with the partner, and who are not involved with the business but who get the benefit of the profits allocated to the company. In those circumstances it is very unlikely that the individual members are using the company member to alienate their income since the effect of allocating excess profits to the company would also be to give them away to third parties.

Examples of how the excess profit allocation rules apply to transfers of businesses can be found at PM237000

PM237000 Businesses Transferred To The Partnership: Examples
[July 2019]

This section sets out how the excess profit allocation rules, as set out at PM236000, apply to examples where a company transfers its business to an LLP.

Example 1 (John and Jane[43])
This example looks at the basic situation where a business is transferred from a company to an LLP.
J1 and J2 are shareholders in a company, S Ltd, which runs a securities trading business. J1 has 90% and J2 has 10%. Both are highly qualified and work in the business. The company transfers its business to a partnership, S LLP, and it, J1 and J2 become partners in the business. The partnership agreement provides that 50% of the profits of the firm are paid to the company indefinitely, and the individual partners share the rest of the profit equally (i.e. 25% each).



S Ltd will be entitled to be taxed on an appropriate notional return on capital (in this case, the value of the assets contributed by the firm[44]). The question is then whether any profits in excess of this allocated to S Ltd are attributable to J1 and J2's power to enjoy those profits. Given the nature of the business, and the fact that J2 and J1 are still as actively involved in it as they always were, HMRC would consider that all of the excess profit should be reallocated from S Ltd to J1 and J2. This is a 'people' business and the profits rely on J1 and J2's continuing involvement in the business. J2 and J1 control the profit allocation and it is not reasonable to suppose that they would allow profits to be allocated to S Ltd if they did not have the power to enjoy those profits.

[43] The Manual sometimes refers to Jane and sometimes to Janet

[44] Author's footnote: This should read: the value of the assets contributed to the LLP by the company S Ltd.

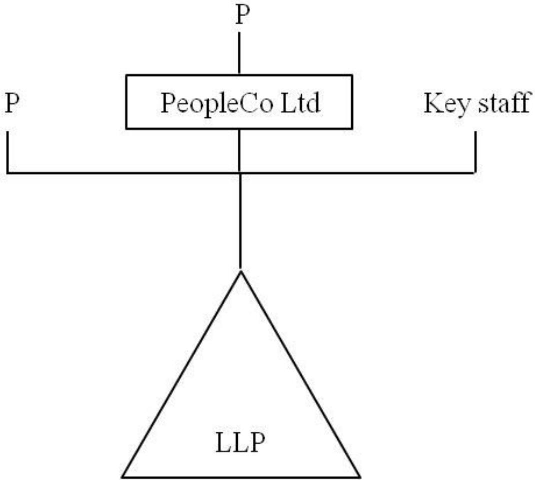
Example 2

This is another example of a transfer of a business from a company to an LLP.

PeopleCo Ltd is a professional firm that had been trading for many years. A few years ago P, the 100% owner of PeopleCo Ltd decided that he wanted to reorganise the business to motivate his key staff and give them an ownership interest. He was also considering succession of the business, when in due course he retires. Recognising that PeopleCo Ltd was a people business, he set up an LLP, whose members are P, PeopleCo Ltd and the key staff who he hopes will take over the business. PeopleCo Ltd transfers the business to the LLP.

PeopleCo Ltd receives the profit share agreed when the business was transferred to the LLP.

P remains a member of PeopleCo LLP and receives a personal profit share.



PeopleCo Ltd will be entitled to be taxed on an appropriate notional return on capital (again, the value of the assets contributed to the firm). The question is then whether any further profits allocated to PeopleCo Ltd in fact reflect the work done by P. As he is continuing to work in the business in the same way as he has done previously, it would be expected that the profits for periods after the transfer should be allocated to him and not to the company.

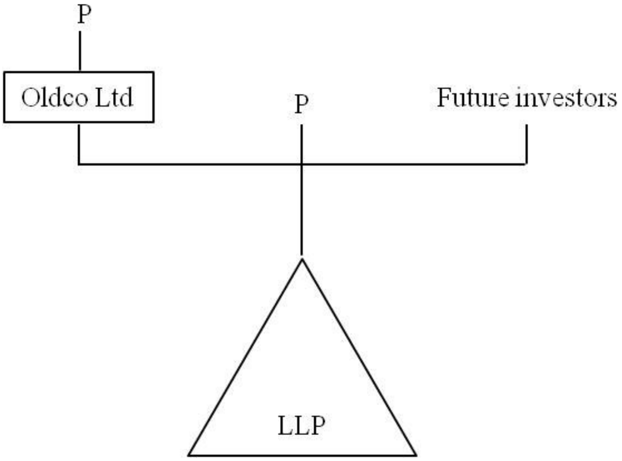
A helpful way to look at this is to ask whether the profit sharing arrangement between PeopleCo Ltd and the LLP is the same as it would have been had P actually retired, and whether P's own profit share is commensurate with the work done.

Example 3

This looks at an example of a transfer of a business from a company to an LLP where the founder is retiring.

Oldco Ltd had been trading for many years. A few years ago P, the owner of Oldco Ltd decided that he wanted to retire. He set up an LLP, whose members are P, Oldco Ltd and a number of individuals who he hoped would take over the business. The business is then transferred to the LLP and Oldco Ltd is credited with the value of the business as capital introduced. Oldco Ltd receives a profit share.

P is working a reduced number of hours in the business and receives a small personal profit share that is commensurate with the work he does.



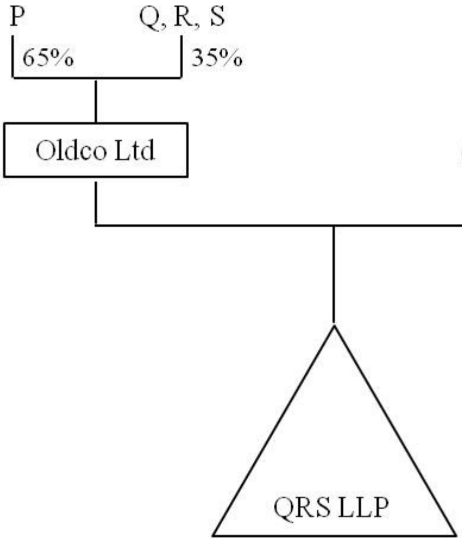
The first question is whether the profit share received by Oldco Ltd exceeds the appropriate notional profit. If the profit share is less than the appropriate notional profit then there is no reallocation.

Assuming that there is such an excess allocation the next question is whether this is by reason of the economic connection. It is likely that it is, but if the particular facts show that any economic connection between the individual and non-individual members does not result in profit being shifted from the individual partners to the non-individual, the mixed membership partnership legislation will not apply.

Example 4

This example looks at where a company transfers its business to an LLP some of whose members are minority shareholders in the company.

Oldco Ltd is a manufacturing firm that had been trading for many years. A few years ago P, the majority owner of Oldco Ltd decided that he wanted to retire. He set up QRS LLP, whose members are Oldco Ltd and a number of unconnected individuals whom he hoped would take over the business, three of whom, Q R and S, were minority shareholders in Oldco, holding 35% of the ordinary shares between them, P holding the remaining 65%.



Oldco Ltd receives the profit share agreed when the business was transferred to the LLP.

P retires at the time of the transfer of the business and subsequently provides no services to the LLP.

Q, R and S will potentially receive part of Oldco's profit shares in the form of dividends. The question is whether the share allocated to Oldco exceeds the notional profit because they are shareholders. The shares in Oldco all carry equal voting rights and rights to a dividend, and P, a non-member of the LLP, controls Oldco, holding 65% of the shares. In this case there is nothing to suggest that the connection Q, R and S have with Oldco has influenced the profit-sharing arrangements - in particular, most of the profits flow to an unconnected individual who is no longer a member. The position could be different if P, Q, R and S held different classes of shares with different rights.

86.19 Takeover of LLP

PM provides:

PM238000 Takeover Of The LLP [July 2019]

Although usually treated for UK tax purposes as a partnership, an UK LLP is a body corporate.

This section looks at where the LLP is subject to a takeover by another

> body corporate.
> The way that the excess profit allocation rules apply to takeovers will vary from case to case, depending on the facts of that case.
> It is worth remembering that the principle behind the excess profit allocation rules is that they apply where an individual, or individuals, divert all or part of their profit share to a non-individual member or members, usually a company or companies, in order to reduce tax on their profit share or as part of profit deferral arrangements.
> At the same time, the excess profit allocation rules do not apply to mixed membership partnerships in which the individual and non-individual partners are genuinely acting at arm's length and not intending to defer a profit share or secure a tax advantage.
>
> *Example 1*
> This example looks at whether a sum is deferred profit?
> XYZ PLC acquires an interest in ABC LLP from the existing members who continue to be involved in the LLP as members following the transfer. Prior to becoming a member of the LLP, XYZ PLC was unconnected to ABC LLP or its members.
> The sale price agreed is the open market value of that interest in ABC LLP as at that date. To protect the value of the business being bought, the terms of sale are that part of the consideration is deferred for two years. If the individuals leave in that time they will forfeit all or part of the consideration.

The HMRC analysis is as follows:

> XYZ PLC, an unconnected party, acquired an interest for the OMV [open market value] at the time. On a realistic view of the facts the sum deferred is a not a remuneration or benefit from the LLP. It is not linked to the profits made in the period in which XYZ PLC is a member of the LLP.
>
> This can be contrasted with:
> [Example 1B]
> XYZ PLC agrees that, if they remain members for three years, the individual members will receive an additional sum based upon the profits of ABC LLP over that period.

The HMRC analysis is as follows:

> This is a share of the profits that has been deferred and it is no different to any other case where a share of the profit is deferred. Condition X is satisfied.

Example 2

This example looks at a takeover where the previous members retain an equity stake after the takeover.

The new owners may want to ensure that the existing members remain with the business. This will particularly be true where it is a "people business".

RSTU LLP is a consultancy business. The ABC Corporation sees RSTU as a way of entering the UK market, however it sees it as important to retain the services of R, S, T and U, the existing members, and wants them to retain an interest in the LLP.

ABC buys a majority stake (80%) in RSTU LLP with each of the existing members retaining a 5% share.

It is recognised that R is looking to partially retire. It is agreed that in three years' time ABC will buy 20% of R's stake at the then OMV. It will buy a further 20% a year later and the balance when R decides to retire. The LLP Agreement provides that the individual partners must sell all their interests on retirement.

It is assumed that Condition Y is not satisfied as R does not have the power to enjoy the profit share allocated to the ABC Corporation.

The HMRC analysis is as follows:

The question is whether Condition X is satisfied? Is it reasonable to suppose that the purchase by the corporate member of R's interest in the LLP represents "remuneration or other benefits or returns" that have been deferred?

Reasonable to suppose means that you take a realistic view of the facts and use a balanced common sense approach.

Possible pointers include:

- The ABC Corporation is a large independent concern; it is not a money box retaining profits for the purpose of buying out interests.
- What are the profit sharing arrangements? Is there anything that looks as if it is money being held back from the individual members?
- Would the ABC Corporation have sufficient funds to buy the interest held by R regardless of the profitability of the LLP?
- How did R acquire the interest - was it acquired by purchase at arm's length or as an initial investor?

The question then is does it look as if the sum paid includes any profit held back, or does it look like the terms on which an independent party would buy that interest?

86.20 Private equity investment

PM provides:

PM239000 Private Equity Investment [July 2019]

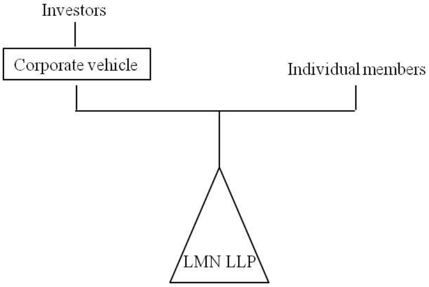
In some cases an outside investor, such as a private equity fund will become a partner, directly or indirectly and inject capital into the firm. If they chose to do so through a corporate vehicle then it may make the firm a mixed membership partnership.

In some cases the excess profit allocation rules will not apply as the individual members do not meet the power to enjoy requirement (see PM224000).

Example 1

Example looking at where capital is injected by external investors using a corporate vehicle.

LMN LLP has received an injection of capital from a group of external investors, none of whom are members of LMN LLP. The investors have chosen to invest through a limited company.



This is a mixed membership partnership but the legislation does not apply as the individual members do not benefit from the sums allocated to the company.

If one of the individual partners in the firm had a small stake in the private equity fund then the question is whether it is reasonable to suppose that part of the profit is allocated to the corporate partner as a result of that stake.

The way to approach the issue is to ask whether the power to enjoy condition is met, in which case the mixed membership partnership legislation will apply, unless it is not reasonable to suppose that any part of the corporate member's profit share can be attributed to the power to enjoy.

Example 2

This example looks at where the corporate member is jointly owned by the private equity fund and the individual members.

The question is whether it is reasonable to suppose that the corporate member's profits have been increased as a result (Condition Y at S850C

(3) see PM219000 for further guidance).

MNO LLP has received an injection of capital from a private equity fund via a corporate member, MNO Ltd, which is jointly owned by the fund and the individual members of MNO LLP.

This is a mixed membership partnership and the individual members are in a position to enjoy profits paid via the corporate member. However, that does not necessarily mean that the excess profit allocation rules apply. Is there any evidence that the profit share allocated has not been influenced by the power to enjoy?

[Example 2B]

Additional facts:

MNO Ltd has ordinary share capital and preference shares. All the preference shares are held by the private equity fund. The profit share allocated to MNO Ltd is calculated so that it is enough to pay the dividend on the preference shares only.

Condition Y is not satisfied as it is not reasonable to suppose that the profit share allocated to MNO Ltd is attributable to the fact that the individual members could benefit.

[Example 2C]

Alternatively:

MNO Ltd is jointly owned by the fund and the individual members of MNO LLP. MNO Ltd only has one class of shares, of which the fund holds 60%.

Why would the members choose to put money into their firm in this format? Is there, for example a tax advantage for them in so doing?

Example 3

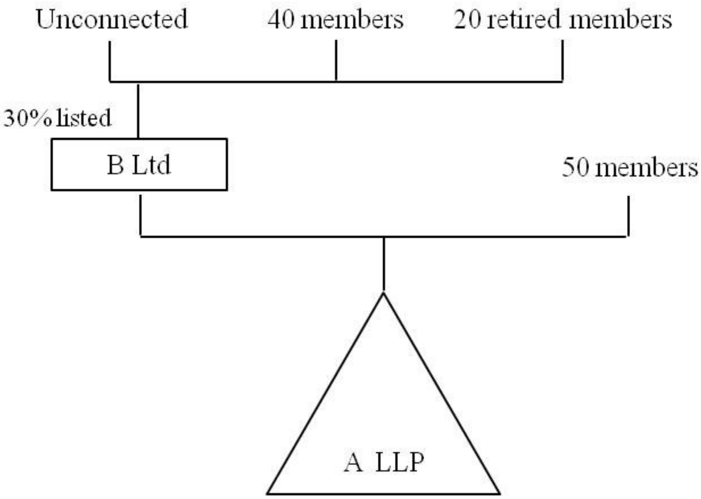
This is a more complex example:

A LLP has 50 individual members and a corporate member B Ltd with 100 issued ordinary shares. 30 of the shares of B Ltd are listed on AIM and owned by investors otherwise unconnected to the LLP or its individual members. The remainder of the shares are owned by 40 of the individual members together with 20 former LLP members (who no longer provide services of any form to the LLP).

So as to attract the initial investment on IPO and to retain the external investor appetite, B Ltd has 100% control of A LLP including control of any changes to the contractual profit share entitlements of the individual members which are determined entirely at its discretion and in accordance with market rate levels of remuneration.

Most of the Directors of B Ltd are also members of A LLP; they are subject to Directors fiduciary duties to ensure that every decision taken

> is in the best interests of the shareholders; that is as shareholders and not in their role as members.



The HMRC analysis is as follows:

> The answer to this example will turn upon the facts. It is, however, helpful to remember that the purpose of the excess profits allocation legislation is to prevent partners from obtaining tax advantages by using the mixed membership structure to alienate their personal income.
> A useful question to ask is would B Ltd would receive the same profit share if/when the member-shareholders were no longer members of the LLP and/or if/when they remain members but are no longer shareholders?

86.21 Share issue

PM provides:

> **PM240000 Share Issues** [July 2019]
> This section looks at the position where a partnership or LLP wishes to raise external finance and chooses to do so by setting up a company which issues shares that external investors can buy and sell on a stock exchange.
> In some cases the individual partners will have no interest in the corporate member, in which case the mixed membership partnership legislation will not apply.
>
> *Example 1*
> Example looking at where external investors invest through a corporate

> vehicle floated on a stock market.
>
> LMN LLP has set up a corporate member, LMN Ltd, which is floated on the AIM market. None of the individual members of LMN LLP are shareholders in LMN Ltd.
>
> This is a mixed membership partnership but the legislation does not apply as the individual members do not benefit from the sums allocated to the company.
>
> If the individual partners hold shares in the corporate partner then it is a question whether on the facts of that case the mixed membership partnership legislation applies.
>
> In cases where the shares are traded on a stock exchange, the question is likely to be whether on the facts of that case Condition Y applies. For further guidance on this, see PM219000.
>
> If an individual partner purchased shares as part of the Initial Public Offering or on the stock market and had no priority in buying those shares then Condition Y is unlikely to be satisfied as it is not reasonable to suppose that a part of the corporate partner's profits come from that member's power to enjoy.
>
> If an individual partner has invested in a collective investment scheme and that scheme buys shares in the corporate partner as part of its ordinary investment portfolio then Condition Y is unlikely to be satisfied as it is not reasonable to suppose that a part of the corporate partner's profits come from that member's power to enjoy.

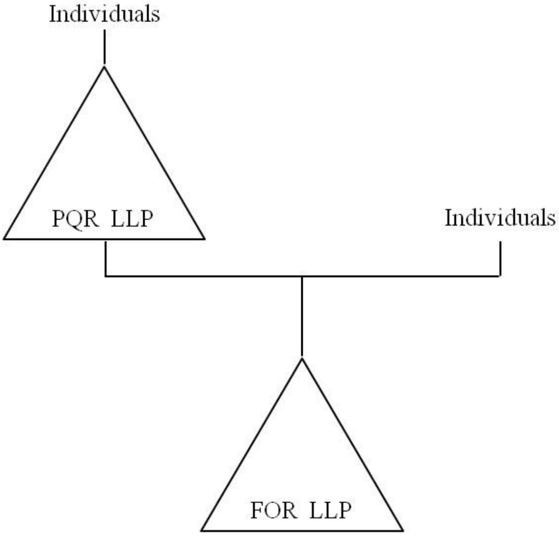
"Unlikely" seems something of an understatement. But HMRC do not with to give hostages to fortune.

86.22 International aspects

PM provides:

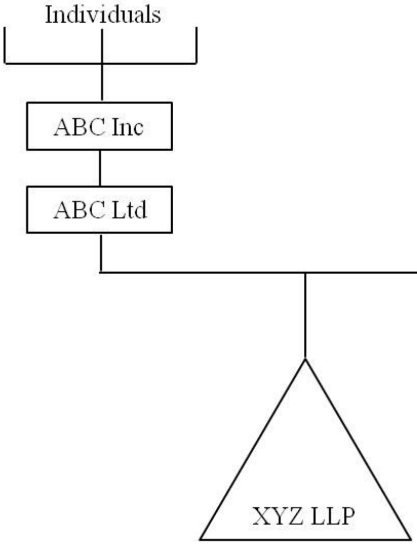
> **PM241000 Pseudo Share Schemes/Membership Benefit Schemes** [Jan 2020]
>
> This section looks at how the mixed membership partnership legislation applies to cases where partnerships, and in particular LLPs, form part of structures that cross international boundaries.
>
> *Example 1*
>
> This looks at a case where one member is a tax transparent entity.
>
> PQR LLP only has individuals as members, so it is not a mixed membership partnership.
>
> Rather than have a branch, the members decide to ring-fence a new business venture overseas. They set up FOR LLP, which is a UK LLP whose members are PQR LLP and those individual members of PQR

LLP involved in the project, a mixture of individuals resident in the UK and in the country where the firm operates.



Profits allocated by FOR LLP to PQR LLP are in turn allocated to the members of that firm all of whom are individuals resident in the UK.
FOR LLP is a mixed membership partnership as one of the members is an LLP, which is not an individual. As noted above, the fact that some individual members are non-UK resident does not make it a mixed membership partnership.
However the Mixed Membership Partnership legislation is unlikely to apply. All the profits are allocated to, and taxed upon individual members. In this case the relevant tax amount is not lower as a result of the structure.

Example 2
This example looks at where the UK firm is a subsidiary part of a wider global network.
XYZ LLP is the UK operation of ABC, a global business with substantial operations in a number of jurisdictions.
XYZ LLP has a number of individual members and ABC Ltd.
ABC Ltd is owned, via one or more intermediate entities, by ABC Inc, the ultimate parent of the global business.
ABC Inc is owned by an unconnected external corporate investor and a number of individuals several of whom are also individual members of XYZ LLP.



As the membership of XYZ LLP consists of individuals and ABC Ltd, XYZ LLP is a mixed membership partnership so that the excess profit allocation rules apply.

The question that needs to be considered is what part (if any) of the profit allocated to ABC Ltd can be said to be attributable to the fact that individual members of XYZ LLP are also amongst the ultimate owners of ABC Ltd?

If the members of XYZ LLP have a minority interest in ABC Inc (and assuming they receive only a corresponding minority benefit from ABC Inc's share of XYZ LLPs' profit) then this is a strong indicator that the profit allocation is not linked to the fact that the members of XYZ LLP are also members of ABC Inc.

If a member of XYZ LLP receives their profit share from ABC rather than XYZ UK LLP then that is an indicator that the excess profit allocation rules will apply.

If the members of XYZ LLP receive a priority distribution out of ABC then that is an indicator that the excess profit allocation rules will apply.

Example 3

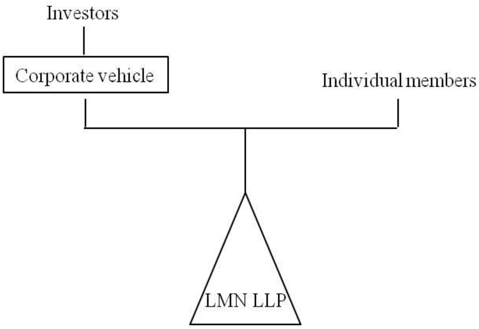
This example looks at where a member of the UK firm is rewarded from of an international network.

DEF LLP is the UK operation of DEF US.

The members of DEF LLP are individuals and a company owned by DEF US (DEF Ltd).

DEF Ltd receives a profit share from DEF LLP. This is paid by dividend

to DEF US.
A is a member of both DEF LLP and DEF US. He works in the UK for DEF LLP, but receives no profit share from DEF LLP, only from DEF US.
Under the agreement A receives a profit share from DEF US that is 75% of the profit share received from DEF LLP via DEF Ltd.



DEF LLP is a "mixed partnership" as it has both individual and a corporate member.
A is a member of DEF LLP, working in the UK for DEF LLP but he receives no profit share from that firm, only one from DEF US.
A works for DEF LLP and receives his profit share via the profit allocated to DEF Ltd. The legislation applies, with the result that A will be subject to increased profits under S850C(4).

86.23 International structures

PM provides:

PM242000 International Structures [Jul 2019]
This section looks at how the mixed membership partnership legislation applies to cases where partnerships, and in particular LLPs, form part of structures that cross international boundaries.

Example 1
This looks at a case where one member is a tax transparent entity.
PQR LLP only has individuals as members, so it is not a mixed membership partnership. Rather than have a branch, the members decide to ring-fence a new business venture overseas. They set up FOR LLP, which is a UK LLP whose members are PQR LLP and those individual members of PQR LLP involved in the project, a mixture of individuals resident in the UK and in the country where the firm operates.
Profits allocated by FOR LLP to PQR LLP are in turn allocated to the members of that firm all of whom are individuals resident in the UK.

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- If the members of XYZ LLP receive a priority distribution out of ABC then that is an indicator that the excess profit allocation rules will apply

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TAXATION OF NON-RESIDENTS AND FOREIGN DOMICILIARIES 2024-25

by

JAMES KESSLER KC

VOLUME SEVEN

Chapters 87 - 91 Entities
Chapters 92 - 100 Topics Affecting More Than One Tax

TWENTY FOURTH EDITION

Key Haven Publications Ltd
P. O. Box 669, Oxford, OX3 3AU
Tel: 01865 352121
http://www.khpplc.co.uk

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87.1 Definitions of "settlement"

There are three tax definitions of "settlement", or of what amounts to a settlement. The definitions are different, and this has important consequences:

- One should not use the term settlement without specifying which definition applies (unless the context makes that clear).
- One should not ask if an entity is a settlement "for tax purposes". One must ask if it is a settlement for IT/CGT, or for IHT purposes, or if it is a settlement-arrangement (unless the context makes that clear). An entity may be a settlement within one, two, or all three definitions.

87.1.1 *Settlement terminology*

We need labels to distinguish the definitions, and I use the following terms:

Definition of settlement	**Application**	**See para**
Classic trust	Trust in the general (trust-law) sense	87.2
Standard IT/CGT definition	Default IT/CGT/CT/SDLT definition	87.3
Settlement-arrangement definition	Settlor-interested trust code, & more	87.4
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In referring to a statutory provision it is generally best to use the statutory term, here, "settlement". But in this particular case, I generally prefer:

- "trust" for classic trusts and the standard IT/CGT definition of settlement
- "settlement-arrangement" for the settlement-arrangement definition of settlement

But in many contexts the terms settlement/trust are interchangeable.

87.2 Classic trust

A **"classic trust"** is a trust in the general (trust law) sense. This convenient term was first used in *Chinn v Collins*[1] and adopted in *Jones v Garnett*.[2]

[1] 54 TC 311 at p.339,

[2] [2007] UKHL 35 at [43].

A classic trust (other than a bare trust) will be a settlement under the IHT and standard IT/CGT definitions, and (if there is bounty, ie gratuitous intent, as is usually the case) it will be a settlement under the settlement-arrangement definition.

What amounts to a classic trust is a matter of trust law. *Lewin on Trusts* para 1.001 (Definition of trust) discusses four definitions. But normally we know whether or not an entity is a trust.

87.3 Settlement: Standard IT/CGT definition

It is convenient to read the IT/CGT/SDLT definitions side by side:

s.466 ITA	**s.68 TCGA**	**Para 1 sch 16 FA 2003**
(1) This section applies for the purposes of the Income Tax Acts, except so far as, in those Acts, the context otherwise requires.[3]	In this Act, unless the context otherwise requires,	(1) In this Part [Part 4, SDLT]
(2) "Settled property" means any property held in trust other than property excluded by subsection (3).	"settled property" means any property held in trust other than property to which section 60 applies	"settlement" means a trust that is not a bare trust.

The sense is the same, though the wording is different.

The exception in s.466(3) ITA/s.60 TCGA relates to bare trusts.[4]

For CT, s.1169 CTA 2010 applies the IT definition by reference.[5] For ATED, s.95(4) FA 2013 applies the SDLT definition by reference.[6]

The IT/CGT provision is formally a definition of "settled property" not "settlement". But where the standard IT/CT definition of settled property applies, "settlement" is used to mean an entity which holds settled

[3] In some cases the context does "otherwise require" because the settlement-arrangement definition is applied. I cannot think of any other case where the context would "otherwise require".

[4] See 87.7 (Bare trust/nomineeship).

[5] "Chapter 2 of Part 9 of ITA 2007 (which relates to settlements and trustees) applies for the purposes of the Corporation Tax Acts as it applies for the purposes of the Income Tax Acts."

[6] "In this section "settlement" has the same meaning as in Part 4 of FA 2003 (see paragraph 1 of schedule 16 to that Act)."

property, ie it means a classic trust (other than a bare trust).[7] In other words, the definition of the term "settled property" also amounts to or implies a definition of the word "settlement".

I refer to this as the **"standard IT/CGT definition"** of settlement/settled property.[8]

87.3.1 *Property comprised in settlement*

s.466 ITA	**s.68 TCGA**
(1) This section applies for the purposes of the Income Tax Acts, except so far as, in those Acts, the context otherwise requires.[9]	In this Act, unless the context otherwise requires,...
(4) References, however expressed, to property comprised in a settlement are references to settled property.	[identical]

I refer to this as the statutory IT/CGT definition. It seems a commonsense definition, but if "property comprised in a settlement" means "settled property" one might as well refer to "settled property" and not use the expression "property comprised in a settlement". It is unnecessary to have *two* expressions meaning the same thing.

In fact it is confusing or at least unhelpful, because the term "property comprised in a settlement" is used in contexts where the settlement-arrangement definition applies, ie where the context shows the statutory IT/CGT definition does not apply.[10]

Strictly, one should not use the expression "property comprised in a settlement" without specifying whether the statutory IT/CGT definition applies; but the context will generally make that clear. The term is only found in the protected-settlements code, and a few dusty corners, so it

[7] This is self-evident, but support, if needed, can be found in provisions such as:

Provision	**Wording (in short)**	**See**
s.466(4) ITA	Settled property is "property comprised in a settlement"	87.3.1
s.70 TCGA	Transfer into settlement is a disposal of the settled property	56.21.4

[8] This term is not wholly apt, as what I call the "standard IT/CGT" definition also applies for CT, SDLT and ATED; but it is convenient and reflects the focus of this work.

[9] In some cases the context does "otherwise require" because the settlement-arrangement definition is applied. I cannot think of any other case where the context would "otherwise require".

[10] See 47.3.1 (Property comprised in a settlement).

does not much matter.

87.4 Settlement-arrangement definition

Section 620(1) ITTOIA provides:

> In this Chapter [Chapter 5 Part 5, settlor-interested trust code]
> [a] "settlement" includes[11] any disposition, trust, covenant, agreement, arrangement or transfer of assets
> [b] (except that it does not include a charitable loan arrangement).[12]

I refer to this as the **"settlement-arrangement"** definition of settlement.[13] An intention to avoid tax is not required.[14]

87.4.1 *Non-trust arrangement*

The paradigm example of a settlement-arrangement is a classic trust made by a settlor for his family. However, a settlement-arrangement need not involve a classic trust. Examples include:

Settlement-arrangement	**See**
Outright gift[15]	
Outright gift to spouse	93.15

[11] The context shows this is an exhaustive definition, ie the word "includes" really means "means".

[12] The exemption for charitable loans is not discussed here. See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 20.2 (Settlor-interested trust code) online version *https://www.taxationofcharities.co.uk*

[13] A note on terminology: The term occasionally used is "statutory settlement".
In early editions of this work I called this the "IT definition" of settlement. But I do not use that term now as (1) it became inappropriate following the introduction of the standard IT/CGT definition in 2006; and (2) the settlement-arrangement definition is also used in CGT/CT.

[14] This is self-evident, but if authority is needed, see *Jones v Garnett* [2007] UKHL 35 at [48]:

> "An intention to avoid tax is not ... absolutely essential. It is possible to imagine that an arrangement planned for some other purpose (such as pre-empting the consequences of insolvency or divorce) could ... amount to an arrangement (and so to a settlement)."

There is likewise no avoidance requirement in the other definitions of settlement (the standard IT/CGT definition and the IHT definition).

[15] It seems self-evident that an outright gift is a settlement-arrangement, but presumably it was not always so, as there is a House of Lords decision on the point: *Thomas v Marshall* 34 TC 178.

Issue of shares:	
(a) at an undervalue	99.40.2
(b)at market value, intending to add value to the company later	87.5.5
Dividend waiver ("Dividend-waiver settlement")	99.19
Alphabet shares ("Alphabet share arrangement")	99.20
Partnership ("partnership-settlement")	99.21
Covenant to make Annual Payments	[16]
A gift subject to an option to reacquire the gifted property	47.6.8

I refer to this as a **"non-trust settlement-arrangement"**. In this case:

(1) The label "settlement" is inapt. The terms trust/settlement are usually synonymous, but not here. This should not be too confusing - as long as one bears the definition in mind. It is generally helpful to avoid the word "settlement" and instead say "settlement-arrangement", or use a clearer and more specific term, such as "partnership-settlement", or at least write "settlement" with scare quotation marks.

(2) The term "settlor" may be inapt; it is a little strange for a trust lawyer to use the word settlor where there is no classic trust. One refers to a "donor" of an outright gift, not a settlor; but no difficulty should arise.

(3) Other trust-vocabulary is likewise inapt or potentially confusing, because it is used in a different sense. In particular:

  (a) The term "trustee" may be used but there are no trustees in the trust-law sense; this is dealt with by the deemed-trustee rule.[17]

  (b) The term "property comprised in the settlement" may be used but:

    (i) There is no "settled property" (in the normal sense, or within the standard IT/CGT definition)

    (ii) There is no "property comprised in a settlement" (within the statutory IT/CGT definition where the term just means "settled property")

  Here the statutory IT/CGT definition does not apply. This term is elucidated in case law discussed at 47.3.1 (Property comprised in a settlement).

87.4.2 *Trust + steps arrangement*

A settlement-arrangement may involve a number of steps; the steps may

[16] Covenanted Annual Payments have ceased to matter now that Annual Payments by individuals are (more or less) taken out of tax: see 31.6 (Annual Payment exemption). But I include covenants in this list as the law reports include many old cases, some still important, where the settlement-arrangement consisted of a deed of covenant.

[17] See 87.8.2 (Non-classic trust: Deemed trustee).

include:
(1) a classic trust[18] *and*
(2) other steps (before or after the making of the classic trust)

Then the arrangement is not just the classic trust alone. I refer to that as a **"trust + steps arrangement"**.

The terms trust/ settlement are usually synonymous, but not here. So the use of the label "settlement" for this situation is confusing. One needs to distinguish:
(1) the classic trust and
(2) the "settlement" (ie the settlement-arrangement) of which the trust forms part

This distinction may[19] matter for the following purposes:
(1) The settlor (or settlors) of the settlement-arrangement may not be the same as the settlor of the classic trust
(2) The beneficiaries of the settlement-arrangement may not be the same as the beneficiaries of the classic trust
(3) The property comprised in the settlement-arrangement may not be the same as the trust property held in the classic trust
(4) The income arising under the settlement-arrangement may not be the same as the trust income arising under the classic trust

In this context it helps clarity of thought:
- to refer to the trust as a "classic trust"
- to avoid the word "settlement" and instead say "settlement-arrangement" (or at the very least, write "settlement" with scare quotation marks)

In these circumstances, the taxpayer has frequently argued that the arrangement is the trust alone, but the Courts have generally found that the arrangement includes other steps (preliminary to making the trust).

Fortunately, this situation, a "trust + steps arrangement", does not arise very often. The reported cases are mostly tax avoidance schemes which

[18] Or even more than one classic trust, but I do not consider that here.

[19] I stress the word "may" because more often than not, the settlor (etc) of the classic trust is the same as the settlor of the settlement-arrangement, and it makes no difference whether one identifies the arrangement as the classic trust alone, or as the classic trust and other steps.

failed, and should not be repeated.[20] But sometimes they are.

For the position of a trust-company structure, see 47.3.2 (Underlying company income).

87.4.3 *Estate/trust on intestacy*

Is an estate of a deceased person, or a trust under a will or intestacy, a settlement-arrangement? This question does not arise for the purposes of the settlor-interested trust code. Even if it is a settlement-arrangement, it is not settlor-interested,[21] and a deceased settlor cannot be subject to tax. The settlement-arrangement definition is used in other contexts where the issue does arise.[22]

87.5 Bounty requirement

The settlement-arrangement definition is an outstandingly bad definition, because, taken literally, it covers every conceivable transaction.[23] It has been left to the courts to define the term. In *Jones v Garnett*:[24]

> Not every transfer of property is a settlement for the purposes of [the settlement-arrangement definition]. There has to be an "element of bounty" in the transaction.[25]

By contrast, the standard IT/CGT and IHT definitions of "settlement" do not include a bounty requirement.[26]

Case law has also decided that bounty is an implied requirement for

[20] For an example, see App. 2.2.7 (Pre-arrangement steps).

[21] The settlor cannot benefit (being dead); the settlor's spouse cannot benefit because a widow is not a spouse.

[22] See 88.8.1 (Is estate a "settlement" for s.87).

[23] Tax is not the only context where the word "settlement" has been used loosely, to include more or less any arrangement, not just classic trusts. Another example is s.24 Matrimonial Causes Act 1973, see *Brooks v Brooks* [1996] AC 375 at p.392: "The authorities have consistently given a wide meaning to settlement in this context".

[24] [2007] UKHL 35 at [7].

[25] HMRC agree. The TSE Manual provides:
"**TSEM4110 scope of statutory definition of settlement** [Jul 2017]
The potential scope of the 'settlement' is extremely wide. Given the breadth of the unrestricted term the Courts have concluded that it is appropriate to impose some limitation on its scope. ... Settlement must include an element of bounty, as decided in the tax case of *CIR v Plummer* (54 TC 1)."

[26] This is self-evident, but if authority is needed, see *Nader v HMRC* [2018] UKFTT 0294 (TC) at [206] -[208].

"providing" property (which is the main part of the definition of settlor).[27]

87.5.1 *"Bounty": Terminology*

A note on terminology. In *Jones v Garnett*:[28]

> This old-fashioned phrase ["bounty"] ... conjuring up the image of Lady Bountiful in *The Beaux' Stratagem*, is perhaps not the happiest way of describing a provision for a spouse or minor children.

This is true, but "bounty" is likely to continue as the technical term. It is short, accurate, memorable if archaic, and a change in terminology comes at a cost in terms of inconvenience, complication and perhaps uncertainty.[29] But for clarity I prefer to use the expression **"bounty (gratuitous intent)"**. Statute, understandably, does not use the word bounty, but it does use the term gratuitous intent.[30] Some writers express unease by putting the word in scare quotation marks.

87.5.2 *A judicial gloss*

There is an important difference between statutory language and a judicial explanation or gloss on the statutory language. In *Chinn v Collins*:[31]

> ... the word "bounty" appears nowhere in the Statute. It is not a word of definition. It is a judicial gloss upon the Statute descriptive of those classes of cases which are caught by the section in contrast to those which are not. The courts must, I think, be extremely careful not to interpret this descriptive word too rigidly.[32]

[27] See 99.39.3 (Settlor of commercial trust: IT/CGT/IHT definitions).

[28] [2007] UKHL 35 at [7].

[29] This is self-evident but if authority is needed, see *Jones v Garnett* [2007] UKHL 35 at [76]:

"The word 'bounty' rings slightly uncomfortably, at least to my ears. … However, in the light of the judicial decisions on these provisions, it seems to me that the law is now tolerably clear and sensible, and, particularly given the need for clarity and the room for difficulties in this area, it would be inappropriate to risk introducing uncertainty or new complications by redefining the principles, even if only linguistically."

[30] Eg s.10 IHTA: see 74.13 (Arm's length disposal relief).

[31] 54 TC 311 at p.357.

[32] The passage cites an aphorism of Frankfurter J: "A phrase begins life as a literary expression; its felicity leads to its lazy repetition; and repetition soon establishes it as a legal formula, undiscriminatingly used to express different and sometimes contradictory ideas."

This is a point of general application. It applies for instance to the judicial gloss which limits s.720 to the "transferor".[33]

Similarly, the *Rangers* case comments on glosses intended to elucidate the concept of earnings "from" an employment:[34]

> ... the courts at the highest level have repeatedly warned of the need to focus on the words of the statute and not on judicial glosses, which may clarify or illustrate in a particular case but do not replace the statutory words. Thus in *Hochstrasser v Mayes*,[35] in which the House of Lords was considering whether an emolument could be said to arise "from" a taxpayer's employment or office, Lord Radcliffe cited various judicial statements and stated:
>
> > "These are all glosses, and they are all of value as illustrating the idea which is expressed by the words of the statute. But it is perhaps worth observing that they do not displace those words". [36]

87.5.3 *Bounty: Meaning*

What does bounty mean? In *Jones v Garnett*:[37]

> ... the general effect of the cases is that, under the arrangement [the settlement under the settlement-arrangement definition], the settlor must provide a benefit which would not have been provided in a transaction at arm's length.

In *Chinn v Collins*:[38]

> What the cases have sought to do is to distinguish between those cases where the recipient has in return for that benefit which he has received accepted some obligation which he has to perform, either before receiving the benefit or at some stated time thereafter, and those cases where the recipient benefits without any assumption by him of any correlative obligation

[33] See 49.4 (Who is the transferor).

[34] *RFC 2012 Plc v AG* [2017] UKSC 45 at [11].

[35] See 34.5 (Earnings causation tests).

[36] If further authority is needed, which I doubt, see *Laidler v Perry* [1966] AC 16:
"... various glosses on or paraphrases of the words in the Act appear in judicial opinions, including speeches in this House. No doubt they were helpful in the circumstances of the cases in which they were used, but in the end we must always return to the words in the statute …"

[37] [2007] UKHL 35 at [7].

[38] 54 TC 311 at p.357.

The TSE Manual provides:

> **TSEM4110 scope of statutory definition of settlement** [Jul 2017]
> ... Settlement must include an element of bounty... Bounty is the provision of value without any corresponding quid pro quo, usually a gift or a transfer at less than full value.
> Where a settlor enters into an arrangement that he or she would not have entered into with someone with whom the individual was acting at arm's length, the arrangement is susceptible to the legislation...

In short, bounty means gratuitous intent.

In a commercial transaction or arrangement there is no bounty. In *IRC v Levy*:[39] "a commercial transaction devoid of any element of bounty is not within the definition". In that case an interest-free loan to a company wholly owned by the lender was held to be a *simple case of a commercial transaction devoid of any element of bounty* and so not a settlement-arrangement. Bearing in mind that "commercial" is itself a somewhat vague concept, this may not take us very far. And the converse does not hold, ie a non-commercial arrangement may lack bounty.

87.5.4 *Applying bounty test*

At first sight bounty seems to be just another item in the arm's length/full consideration vocabulary cluster, which I consider elsewhere.[40] But there is a difference in that arm's length/full consideration are concepts that are usually applied to one-off transactions. Bounty is a concept that is applied to an arrangement, which may include a number of steps, and which may take place over time.

It seems necessary to identify the arrangement before applying the bounty test.[41] But identifying the arrangement is not usually crucial.

In *Jones v Garnett*[42] the steps were:

Step 1 Creation of company: Mr Jones and his wife acquired a new company; the formation agent sold them the two issued £1 shares for £1 each.

Step 2 Operation of company:

(a) The company entered into contracts with customers to provide the

[39] 56 TC 68 at p.87.

[40] See App 4.1 (Consideration/arm's length/full value).

[41] See App 2.2.4 (Identifying the arrangement).

[42] [2007] UKHL 35.

services of Mr Jones. These services generated the company's income.

(b) Mrs Jones did the bookkeeping. This took about 4 hours a week and she was paid market value, £3.6k (£16 per hour). Mr Jones took £6.5k as salary which was far less than market value.

(c) The company distributed most of its profits as dividends.

In short, Mr. Jones worked for a company held equally by himself and his wife. The advantages to Mr and Mrs Jones of receiving the company's earnings as dividends rather than salary were, in short, (1) a dividend paid to Mrs Jones was taxable at a lower rate than Mr Jones, and (2) avoiding NIC. So step 2 was contemplated from the outset.

If the arrangement consisted of steps 1 and 2, it clearly passed the bounty test. However the arrangement consisted of step 1 alone: the issue of shares to Mrs Jones at step 2 - the operation of the company - constituted post-arrangement step(s) which were not part of the arrangement:

> [HMRC argued] that the transfer of the share [to Mrs Jones] was not the whole of the arrangement, which included the provision of services by Mr Jones, the dividend policy and so forth. ... The transfer of the share was in my opinion the essence of the arrangement. The expectation of other future events [i.e. provision of services by Mr Jones and company profits distributed by dividend] gave that transfer the necessary element of bounty but the events themselves did not form part of the arrangement.[43]

So it did not matter that the arrangement consisted of step 1 alone, as step 1 alone had an element of bounty, the *expectation* of dividends for Mrs Jones. at step 2 This is right because the bounty test is a gloss which is to be applied broadly and not strictly. It is a sensible outcome because it is then not necessary to ask the question of exactly which steps are included in, or constitute the settlement-arrangement, which is imponderable.[44] So as far as the bounty test is concerned, it did not matter whether or not step 2 was not part of the arrangement.

[43] [2007] UKHL 35 at [29]. Lord Walker said the same at [54] stressing the absence of a contract of employment. But the contract would make no difference; see Lord Hoffmann at [20] (with whom 3 other judges agreed). It would be strange if a contract made a difference for tax, as in a family situation it makes no commercial difference and it is within the ability of the parties to choose to have a contract or not. If another example is needed, see at [22] discussing *Butler v Wildin*.

[44] See App 2.2.4 (Identifying the arrangement).

87.5.5 *When to test bounty*

One assesses bounty at the time of the arrangement, which if the later steps do not form part of the arrangement, means at the outset. It is sufficient if bounty is intended to come some time after the (perhaps) arm's length transaction which constitutes the settlement-arrangement:

> when considering whether there ... an arrangement, which involved an element of bounty, one should assess the position at the time that the alleged arrangement was made, but, in carrying out that exercise, one should not disregard what happened thereafter. In particular, if the parties intended an element of bounty to accrue, and that element of bounty does indeed eventuate, then, absent any other good reason to the contrary, there is indeed an "arrangement" within the meaning of [the settlement-arrangement definition].[45]

87.5.6 *Retesting bounty*

It seems that one does not assess (or retest) bounty on a year-by year basis. In *Jones v Garnett:*[46]

> the Revenue is anxious to catch only one of the following examples:
> (i) [Husband and wife] may expect that each will make a contribution to the company's earnings of roughly equal financial value;
> (ii) they may expect that each will make a contribution which is equal in terms of effort but ... unequal in terms of earnings for the company;
> (iii) they may expect that each will contribute what they can but that those contributions will vary over time ... or
> (iv) as here, they may expect that one will contribute the work which brings in the money from outside while the other will contribute the limited but necessary ancillary services to make that work possible but bring in no independent money from outside.
>
> There are many variations and permutations between these possibilities. I would have found it easier to understand the Revenue's case if it had adopted a year by year approach: looking at each tax year, has one of the spouses worked for a salary which is seriously less than his services are worth to the company in order to boost the company's profits which can then be distributed equally between the spouses as dividend? In other words, has there been a gratuitous transfer of income between husband and wife? ...

[45] *Jones v Garnett* [2007] UKHL 35 at [79].

[46] [2007] UKHL 35 at [67] - [69].

> But the Revenue has expressly eschewed that approach. It relies on the initial acquisition of the company's shares [by Mrs Jones] as the 'settlement'. It has also expressly eschewed the intention of catching any other type of arrangement than that in example (iv) above. It is not interested in picking apart genuinely co-operative family ventures, even if on analysis the contribution of one spouse is worth more than the contribution of another.

HMRC's view is that arrangements (i) to (iii) are "genuinely co-operative family ventures" but arrangement (iv) is not.

> Nor can it [HMRC] be interested in arrangements which start out as roughly equal ventures but ... become less equal as time goes by. On the Revenue's case, it is only a 'settlement' if a substantial element of 'bounty' - that is, gratuitous transfer - is contemplated at the outset. It must follow that unanticipated later events cannot transform the character of the initial transfer of property or arrangement.

And again:[47]

> a different approach would involve considering what transpired each year, when it was decided how much of the company's gross profit should be attributable to Mr and Mrs Jones' respective wages, and how much should be distributed by way of dividend. ...Neither [Counsel for the Revenue] (no doubt reflecting the Revenue's policy) nor [Counsel for the taxpayer] (as it would involve his clients losing on this issue) was prepared to adopt this approach. Although it appears to me to be logically attractive, it would be inconvenient in practice, in that it would be difficult to administer, and it might well produce unfair, even arbitrary, results.[48]

This approach should be followed, at least below the level of the Supreme Court. It derives from a concession by the parties which had less than enthusiastic support from the Supreme Court, but they appear to have accepted it.

A no-retesting rule helps the taxpayer when arrangements "start out as roughly equal ventures but become less equal as time goes by." But the

[47] at [89]. See too 99.25 (Provision of services).

[48] Annual retesting would clearly be difficult to administer. Lord Neuberger does not identify the "unfair" results which follow from an annual retesting approach. One problem would be this: On the year by year (retesting) approach, what if income was retained in the company and later distributed after circumstances had changed?

rule would help HMRC if it were the other way round, ie what starts as an unequal venture later becomes an equal one. Suppose after the Jones' company was set up there was a change so that:

(1) Mrs Jones' work generated half the company's profits; or
(2) Mrs Jones worked full time on administration, so making "a contribution which is equal in terms of effort but unequal in terms of earnings".

Would there still be a settlement? On the facts of *Jones v Garnett* that would not matter because the s.624 spouse exemption applied.[49] But that would not help if Mr and Mrs Jones had not been married, but (say) cohabitees.

It would be sensible if the issue of bounty could be revisited, in the event of a major unanticipated changes on the basis that a new arrangement has replaced the old one. That does not require the annual retesting which was rejected in *Jones v Garnett.*

87.5.7 *Trust appointment: Filling blanks*

Chinn v Collins[50] concerned an avoidance scheme (known as a "contingent interest scheme"). The object was to transfer the trust fund ("trust shares") from a trust, to UK beneficiaries ("the children"), without a CGT charge. The 3 scheme steps (all carried out on the same day) were, in short:

Step 1 appointment: Trustees of the non-resident trust (the "classic trust") appointed the trust shares to the children contingent on the children surviving 3 days (as in due course they did).

Step 2 sale of contingent interest: The children agreed to sell their contingent interest in the trust shares to a non-resident company for £352k.[51]

Step 3 purchase of trust assets: The children agreed to buy the trust shares back from the company for £355k (effectively funded by the sale proceeds at step 2).[52]

[49] See 93.15 (s.624 spouse exemption).

[50] 54 TC 311.

[51] Other than the interest under the contracts at step 2 and 3, the children had no interest in the company.

[52] A scheme of this kind would not work today. Among other issues, there would now be a CGT charge at step (2) on the disposal of an interest in a non-resident trust; see 56.21.3 (Non-resident trust interest). But the points from the case discussed here are

The object was that the children were not beneficiaries of the settlement after the sale at step 2, and so outside the scope of the predecessor to s.87. The children did indeed cease to be beneficiaries of the classic trust after they sold their contingent interest to the company. But the relevant definition of settlement was the settlement-arrangement definition. HMRC argued:

(1) the 3 steps constituted a settlement-arrangement
(2) the children were "beneficiaries" of the "settlement"[53] and as such taxable under the predecessor to s.87.

The 3 steps constituted an arrangement. But where was the bounty? It was found in the trust appointment at step 1:

> ... there was a very real "bounty" conferred when the trustees with the settlor's consent exercised the power of appointment in question [in favour of the children]. As [Counsel for the Crown] put it, when the power of appointment was exercised a blank was filled in the original settlement which left blank how the final distribution of the trust's assets was to be made.[54] That in my judgment was a clear act of "bounty".[55]

That was sufficient to get the Revenue home. But I would have thought that there was another, simpler, analysis: that the arrangement consisted of *four* steps: the original creation of the trust, along with the three scheme steps, all constituted one arrangement. The four steps have "sufficient unity" and it does not matter that the three scheme steps were not contemplated at the time of the original settlement. On that basis the bounty lay in the creation of the original settlement, not in filling in its blanks. But perhaps the filling-blanks analysis, which identified the

still import.
The analysis would be the same without step 3.

[53] The children were presumably beneficiaries of the settlement as they were entitled:
(1) to the £352k purchase price of the contingent interest, and/or
(2) to an interest in the trust assets (as a result of their agreement to purchase the trust assets).

[54] The idea that a trust appointment "fills in blanks" goes back to *Muir v Muir* [1943] AC 468 at p.483: "It is as though the settlor had left a blank in the settlement which B fills up for him if and when the power of appointment is exercised." The "filling-blanks analysis" arises in many tax contexts, such as the question of who is the settlor after a transfer between trusts; see eg 99.12 (Inter-trust transfer: IHT).

[55] 54 TC 311 at p.357. Likewise at p.351

bounty as the appointment at step 1, comes to the same thing.

There were other reasons that the contingent interest scheme failed, but our concern here is the light the case sheds on settlement-arrangements, and the bounty test, so I do not pursue that here.

87.5.8 *No intention to benefit others*

It often happens that a person creates a settlor-interested trust with only his own interest in mind. No-one ever suggested that this is not a settlement, or they are not the settlor, for lack of bounty. But now there is authority to confirm the point. In the *Clipperton/Dunsby* "dividend replacement strategy" cases[56] the appellants argued that they were not settlors because:

(1) They had no bounty (gratuitous intent)
(2) A person not providing bounty (gratuitous intent) could not be a settlor

This argument failed at point (1).[57] It is true that the shareholders did not intend to, and did not in fact, confer any substantial benefit on any other person. The large majority of the funds which C Ltd paid to Newco were received by the appellants, as always intended. However there is no *de minimis* threshold for bounty. When property is provided to a substantive trust, there must be an *element* of bounty because there are (and must be) other beneficiaries. Had there not been, there would have been no trust.[58]

87.5.9 *Bounty: Divorce settlement*

In *Harvey v Sivyer*[59] a separated husband made payments to his minor children under a separation agreement. The payments were not voluntary; they were pursuant to an obligation to maintain the children and contained no element of bounty (gratuitous intent).[60] The taxpayer argued that for this reason that there was no "settlement" within the settlement-arrangement definition. The argument was rejected and the taxpayer was held to be the settlor. The judge tentatively reconciled his decision with

[56] For these cases, see App. 2.2.7 (Pre-arrangement steps).

[57] For point (2), see 99.2.6 (Providing property: Bounty).

[58] [2022] UKUT 351 (TCC) at [133] - [134] reversing the FTT decision for precisely the reasons set out in the 2022/23 edition of this work. It is also relevant to note here that the bounty test is a non-statutory gloss. not to be applied rigidly; see 87.5.2 (A judicial gloss).

[59] 58 TC 569.

[60] 58 TC 569 at p.572.

the bounty requirement because:

> the natural relationship between parent and young child was one of such deep affection and concern that there must always be an element of bounty by the parent, even when the provision is on the face of things made under compulsion.[61]

This is romantic fiction. The better way to reach the decision is that the bounty requirement is a non-statutory gloss, and not to be applied rigidly.[62] The CoA noted in an earlier case, "if the legislature had set a limit to the extent to which a taxpayer may divest himself for tax purposes of income by voluntary means, I see no reason why the same principle should not be applied to income of which the taxpayer is compulsorarily divested".[63] So this is simply an exception or refinement to the bounty requirement. On this analysis, *Harvey v Sivyer* was correctly decided, though not for the right reasons. Does that matter? Probably not, but it is good to know what we are talking about.

87.6 Definition of "IHT-settlement"

Section 43(2) IHTA provides the IHT definition:

> "Settlement" means any disposition[64] or dispositions of property, whether effected by instrument, by parol or by operation of law, or partly in one way and partly in another, whereby the property is for the time being—
>
> (a) held in trust
> [i] for persons in succession or
> [ii] for any person subject to a contingency, or
> (b) held by trustees
> [i] on trust to accumulate the whole or part of any income of the property or
> [ii] with power to make payments out of that income at the discretion of the trustees or some other person, with or without power to accumulate surplus income, or
> (c) charged or burdened
> [i] (otherwise than for full consideration in money or money's worth paid for his own use or benefit to the person making the disposition)

[61] 58 TC 569 at p.577.

[62] See 87.5.2 (A judicial gloss).

[63] *Yates v Starkey* 32 TC 38 at p.53.

[64] See 74.4 (Disposition).

[ii] with the payment of any annuity or other periodical payment payable for a life or any other limited or terminable period,

[d] or would be so held or charged or burdened if the disposition or dispositions were regulated by the law of any part of the UK;

[e] or whereby, under the law of any other country, the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were so held, charged or burdened.

The definition of "settlement" requires a combination of two things:

(1) a disposition (or dispositions) of property

(2) a state of affairs, or, I would say, an entity, brought about by the disposition(s), whereby the property is held in the ways specified in limbs (a) to [e][65]

In this section I consider point (2), whether the entity falls within what I call **"limbs (a) to [e]"** of the definition.[66]

Limbs [d] and [e] are unique to the IHT definition of "settlement" and are not found in other definitions.[67]

87.6.1 *Undistributed trust income*

Undistributed income of a discretionary trust is not "settled property" for IHT purposes. Even if it falls within the opening 3 lines of the definition, which is debatable, it does not fall within any of limbs (a) to [e]. It becomes settled property if it is accumulated (added to trust capital).[68]

87.6.2 *Limb (a): Persons in succession*

Limb (a) refers to property "held in trust" and limb (b) refers to property "held by trustees" but the meaning must be the same.

The expression "for persons in succession" has a history. It originated in the definition of settlement in the Settled Land Act 1882, which passed to the Settled Land Act 1925.[69] The Settled Land Act definitions were

[65] This is self-evident, but if authority is needed, see *Barclays Wealth Trustees v HMRC* [2017] EWCA Civ 1512 at [31].

[66] For point (1) and the first 3 lines of the definition, see 75.15 (Adding property: Change of domicile); 79.3 (One IHT-settlement or more).

[67] See 87.1 (Definitions of "settlement").

[68] This is recognised in the exit charge rules; see 76.7.2 (Undistributed trust income).

[69] There are minor differences in the wording of the definitions but they do not seem relevant for present purposes.

incorporated by reference into Estate Duty. There is a substantial case law, discussing whether Victorian jointures, portions and annuities constitute a settlement. Unsurprisingly, this does not shed much light on current issues; indeed it needs a legal historian to fully understand it. Some general comments are perhaps worth noting. In *Attorney-General v Owen*:

> 'By way of succession' seems to me to be a phrase to which one ought, in dealing with this Act, not to assign a narrow or strictly technical meaning, but to treat it as equivalent to 'successively upon death'.[70]

But this statement, while no doubt correct, does not take us very far.

More important is the rule that a gift to a trust for A for life, with remainder to A's PRs, operates as an absolute gift to A.[71] Such a gift is not a settlement, because it is not a trust for persons in succession. The successors have no interest in the property during the life of A.

For this reason a will is not an IHT-settlement. Likewise foreign law entities similar to a will.

87.6.3 *Limb (b): Income powers*

Where trustees hold property on trust for a minor absolutely, s.31 Trustee Act 1925 provides (so far as relevant):

> (1) ... the trustees may... pay to his parent or guardian, if any, or otherwise apply for or towards his maintenance, education, or benefit, the whole or such part, if any, of the income of that property as the trustees may think fit...
> (2) ... the trustees shall accumulate all the residue of that income ... and the trustees shall hold the accumulations in trust for such person absolutely.

The IHT Manual summarises:

> **IHTM16068 Absolute trusts for minors (England & Wales)** [Sep 2018]
> In relation to trusts for minors, the provisions of s.31 Trustee Act 1925

[70] [1899] 2 Q B 253. Similarly, *Mundy & Roper's Contract* [1899] 1 Ch 275 at p.290: "The words ["stands for the time being limited to or in trust for any persons by way of succession"] have no technical force. I see no sufficient reason for restricting their meaning".

[71] *Re Brooks* [1928] Ch 214.

> will usually apply during the minority of a beneficiary. This means that the trustees will have discretion to apply the income of a trust fund for the maintenance, education or benefit of a beneficiary. Under s.31 (2) Trustee Act 1925, any surplus income must be accumulated.
>
> This raises the question whether an absolute trust for a minor can be regarded as a 'settlement' for IHT purposes under s.43 (2) IHTA. ...

At first sight there appears to be an IHT-settlement within (b), either because there is a trust to accumulate income or because the trustees have power to make payments out of the income. However, a bare trust does not constitute an IHT settlement. This is for two reasons (or for one reason which can be put in two different ways):

(1) The provisions of s.31 (both the power to maintain and the trust to accumulate) are administrative and not dispositive.[72]

(2) The provision for accumulation does not constitute "accumulation" in the correct (trust law) sense of the word.[73]

HMRC agree. The Manual continues:

> In our view, an absolute trust of this kind is not a settlement for IHT purposes. S.31 Trustee Act, including s.31(2), contains provisions which are essentially administrative in nature rather than dispositive. The trustees' discretion in relation to an absolute trust is limited to deciding how much income they spend for the benefit of the beneficiary and how much they retain on the beneficiaries behalf.
>
> The express trusts in such a case will remain for the minor beneficiary absolutely - that is, the beneficiary has an immediate and absolute right to both capital and income, and only their minority will prevent them for requiring the trustees to convey the trust property to them. Any accumulations will be held for the beneficiary if they attain 18 or (by virtue of the original gift, not s.31 Trustee Act) for their estate if they die under that age. The trust property will form part of the beneficiary's estate for IHT purposes.

[72] For this terminology and its tax implications, see Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 16.1 (Administrative, dispositive, beneficial: terminology).

[73] See *re Berkeley* [1968] Ch 744 at p.772: "Accumulation to my mind involves the addition of income to capital, thus increasing the estate in favour of those entitled to capital and against the interests of those entitled to income. The mere retention of income [to meet a possible liability] does not alter its nature: it remains income and will be paid out to the income beneficiaries when no longer required."

> As a result, a lifetime gift on trust for a minor absolutely, whether or not the provisions of s.31 Trustee Act are excluded, is a potentially exempt transfer.

87.6.4 *Limb (d): So held by UK law*

This limb provides:

> [d] or would be so held or charged or burdened if the disposition or dispositions were regulated by the law of any part of the UK;

Limb [d] is present for historical reasons. The former estate duty definition of "settlement" in s.22(1)(i) FA 1894 provided (so far as relevant):

> The expression 'settlement' means any instrument, whether relating to real property or personal property, which
> [A] is a settlement within the meaning of the Settled Land Act, 1925, or
> [B] if it related to real property would be a settlement within the meaning of that Act

Dick Taverne, then Financial Secretary to the Treasury, explained a problem with this definition:

> The definition is primarily by reference to the Settled Land Act 1925, but it brings in property other than settled land by references to instruments which if related to real properly in England and Wales would be a settlement within the meaning of the Act. We now see that it is arguable that we have done no more than equate an English settlement of personalty with one of realty and that we have not caught foreign settlements.[74]

Hence s.36(5) FA 1969 extended the definition:

> In the enactments relating to estate duty—
> (a) the expression 'settlement'— (i) for the avoidance of doubt is hereby declared to include ...
> (bb) any disposition regulated by the law of a territory outside Great Britain which would constitute a settlement within the meaning of section 22(1)(i) of the FA 1894 if it had been regulated by the law of England or, as the case may require, of Scotland;

[74] Hansard Standing Committee F, 24 June 1969, col 721.

The words in s.43(2)[d] IHTA derive from this. But now, the definition of settlement for IHT does not incorporate the SLA 1925 definition by reference, and applies to UK and foreign law trusts; so the words in (bb) were not needed. The drafter of the current definition possibly did not notice, but probably thought the words desirable to preclude an argument that "trust" in s.43(2) IHTA meant a trust governed by a UK law. That argument might have been weak, but given the history of the provisions it would not have been self-evidently wrong.

Limb (d) therefore has (more or less) no practical effect; but it does no harm.

In contemporary legal English one would refer to a disposition *governed* by UK law, rather than *regulated* by UK law, but the meaning is the same.

87.6.5 *Limb (e): Equivalent to a trust*

This limb provides:

> [e] or whereby, under the law of any other country [other than the UK], the administration of the property is for the time being governed by provisions equivalent in effect to those which would apply if the property were so held, charged or burdened.

The standard IT/CGT definition of settlement has no equivalent of s.43(2)[e]. So while the IT/CGT definition requires that property is held "in trust" it is sufficient for IHT that the administration of the property is governed by provisions equivalent in effect to those which would apply if the property was (in short):

(a) held in trust for persons in succession, or for a person subject to a contingency, (eg an IIP trust) or

(b) held by trustees on trust to accumulate the income of the property or with power to make income payments (eg a discretionary trust); or

(c) charged with payment of an annuity (in practice this is rare).

The statute refers to the *administration* of the property being governed by equivalent provisions. Trust law draws a distinction between administrative and dispositive provisions, but the context here shows that limb (e) is referring to all the provisions which govern the property, and not just administrative provisions in the strict sense.

Two difficulties lie in the short phrase "equivalent in effect":

(1) "Equivalent" no doubt requires effective (or substantive) rather than exact equivalence, but equivalence comes in degrees and ways: one cat might sound like another, but look slightly different. Where does one draw the line?

(2) A trust can have (more or less) the same effect as an entail, usufruct, will, company, partnership, charge by way of security over assets, power of attorney, and so on, though it is not any of those things. A trust is a flexible, protean institution which can have markedly different effects. Likewise companies, partnerships, and other entities can have quite different effects. Much depends on the drafting of the relevant documentation. However, difficulties arising from the amorphous nature of trusts and other entities are mitigated by two considerations:

   (a) The question is not whether a general type of entity is equivalent, (eg, if a Foundation is not a trust, is it at least equivalent to a trust?); the question is whether one particular entity (eg, is the specific Foundation made on [date]) equivalent?)

   (b) The question is not whether the particular entity is equivalent to a trust; it is whether it is equivalent to a trust for persons in succession (etc). In short, is it equivalent to an IIP or discretionary trust?

I abbreviate limb [e] to "equivalent to a trust" but that is a convenient shorthand, not a full statement of the statutory test. In deciding whether a foreign entity is equivalent to a trust, one should have regard to the context: is it appropriate in the scheme of IHT that an entity should be subject to IHT in the same manner as a trust?

Because of limb [e], it appears at first sight that an entity within the IHT-settlement definition need not be a classic trust. On the other hand references in a UK statute to a trust should include a foreign entity which is equivalent to a trust, applying the common-law resemblance test, even without limb [e]. So limb [e] could be regarded as a foreign-entity clause with little (if any) practical effect.[75] But it does not matter.

It appears from *Hansard* that limb [e] was drafted with Liechtenstein Foundations in mind.[76]

For discussion of whether specific entities are IHT-settlements, see:

[75] See 90.3.3 (Foreign-entity clauses).

[76] See 90.14.9 (Foundation an IHT-settlement).

Entity	**Para**
US revocable (grantor) trust	90.9
Foundation	90.14.9
Fideicommissum	90.20
Usufruct	90.25.3
Stichting Administratiekantoor (STAK)	90.40.2
Bewind	90.42

87.7 Bare trust/nomineeship

87.7.1 *"Bare trust" and related terms*

There are three tax definitions of bare trust, or of what amounts to a bare trust. These are intertwined with the definitions of settled property/ settlement, as follows:

Provision	**Defined term/concept**	**Applies for**
s.466(2) ITA	Settled property	IT/CT
s.466(3) ITA	Bare trust	IT/CT
s.68 TCGA	Settled property	CGT
s.60 TCGA	Bare trust	CGT
Para 1(1) sch 16 FA 2003	Settlement	SDLT
Para 1(2) sch 16 FA 2003	Bare trust	SDLT

It is convenient to read these side by side. The effect is the same, though the wording differs.

The statute begins with the definitions of settlement/settled property, set out at 87.1 (Definitions of "settlement"). With that text in mind we can turn to the tax definition of bare trust, or what amounts to a definition:

s.466 ITA	**s.60 TCGA**	**Para 1(2), 3(1) sch 16 FA 03**
(3) Property is excluded for the purposes of subsection (2) and so not "settled property" if—	(1) In relation to property	**Para 1(2)** In this Part a "bare trust" means a trust under which property is held by a person as trustee—
(a) it is held by a person as nominee for another person,	held by a person as nominee for another person,	[equivalent text is differently placed: see row 5 below]
(b) it is held by a person as trustee for another person who is absolutely entitled to the property as against the trustee, or	or as trustee for another person absolutely entitled as against the trustee,	(a) for a person who is absolutely entitled as against the trustee,

(c) it is held by a person as trustee for another person who would be absolutely entitled to the property as against the trustee if that other person were not an infant or otherwise lacking legal capacity.	or for any person who would be so entitled but for being an infant or other person under disability	or who would be so entitled but for being a minor[77] or other person under a disability, or
(6) References to a person who is or would be so entitled include references to two or more persons who are or would be jointly absolutely entitled as against the trustee.	(or for 2 or more persons who are or would be jointly so entitled),	(b) for two or more persons who are or would be jointly so entitled, and includes a case in which a person holds property as nominee for another.
	this Act shall apply as if the property were vested in, and the acts of the nominee or trustee in relation to the property were the acts of, the person or persons for whom he is the nominee or trustee (acquisitions from or disposals to him by that person or persons being disregarded accordingly).	**Para 3(1)** Subject to sub-paragraph (2),[78] where a person acquires a chargeable interest or an interest in a partnership as bare trustee, this Part applies as if the interest were vested in, and the acts of the trustee in relation to it were the acts of, the person or persons for whom he is trustee.

For CT, s.1169 CTA 2010 applies the IT definition by reference.[79]

87.7.2 *Bare trust terminology*

The term "bare trust" is not used much in ITA, but is apt to describe trusts within s.466(3). The term "bare trust" is not used in TCGA, but s.60 is

[77] Sub-para (4) caters for Scots terminology: "In sub-paragraph (2) "minor", in relation to Scotland, means a person under legal disability by reason of nonage."

[78] This exception concerns the grant of a lease by a nominee; see 98.28.3 (Bare trust).

[79] "Chapter 2 of Part 9 of ITA 2007 (which relates to settlements and trustees) applies for the purposes of the Corporation Tax Acts as it applies for the purposes of the Income Tax Acts."

headed "Nominees and bare trustees", which is close.

I use the following terms:

"**Bare trust**" is a trust of property:

(1) within s.466(3) ITA/s.60 TCGA and so not a settlement for IT/CGT: (in short, someone is absolutely entitled as against the trustee); and
(2) not a settlement for IHT: (in short, not held on trust for persons in succession or governed by provisions equivalent in effect).[80]

The two definitions (IT/CGT, and IHT) are not quite identical, but in practice they usually amount to the same.

This has become standard usage among UK private client practitioners, in the context of UK taxation. But it needs to be kept in mind, especially outside UK tax contexts, that the expressions bare trust/ nominee may not necessarily be used in this sense.[81]

"*Substantive* trust" is a trust that is not a bare trust.[82]

The rule in s.60(1) TCGA[83] is the **"CGT bare-trust disregard"**.

The terms bare trustee/nominee, and bare trust/nomineeship, are generally used synonymously.

87.7.3 *Entitled against trustee*

s.466(5) ITA	**s.60(2) TCGA**	**Para 1(3) sch 16 FA 2003**
A person is absolutely entitled to property as against a trustee if[84]	It is hereby declared that references in this Act to any property held by a	In sub-paragraph (2)(a) and (b) the references to a person being absolutely

[80] See 87.6 (Definition of "IHT-settlement").

[81] The old cases, and a variety of different senses of these somewhat imprecise terms, are assembled in *Re Blandy Jenkins* [1917] 1 Ch 46. That is mainly of historical interest, but may still be relevant in considering the meaning of bare trust/nominee in, say, trust or other non-tax legislation. See too see *Herdegen v FCT* (1988) 84 ALR 271 at p.281-282.

There has also been some debate as to whether what I call a bare trust should necessarily be described a "trust"; but that generally makes no difference for tax purposes.

[82] A note on terminology. *Lewin on Trusts* describes non-bare trusts as "special trusts": 20th ed para 1-028 (Bare or simple trusts and special trusts). But "substantive trust" is clearer, and the term "special trust" is not used in this sense in practice, or at least, not nowadays.

[83] That is, in short, the rule that the TCGA applies as if the property were vested in, and the acts of the nominee/trustee were the acts of, the beneficial owner.

[84] The context suggests that this is an exclusive definition: "if" means "if and only if".

	person as trustee for another person absolutely entitled as against the trustee are references to a case where	entitled to property as against the trustee are references to a case where
the person has the exclusive right to direct how the property is to be dealt with (subject to the trustees' right to use the property for the payment of duty, taxes, costs or other outgoings).	that other person has the exclusive right, subject only to satisfying any outstanding charge, lien or other right of the trustees to resort to the property for payment of duty, taxes, costs or other outgoings, to direct how that property shall be dealt with.	the person has the exclusive right, subject only to satisfying any outstanding charge, lien or other right of the trustee, to resort to the property for payment of duty, taxes, costs or other outgoings or to direct how the property is to be dealt with.

The phrase “absolutely entitled as against the trustee” marks the border between bare/substantive trusts. It is not as simple as it seems.

The CG Manual provides:

> **CG37000: Absolute entitlement** [Nov 2023]
>
> The case of *Stephenson v Barclays Bank Trust Co Ltd*, 50 TC 374, illustrates the general principles for determining when absolute entitlement occurs.
>
> The facts (simplified) are as follows. Under the will of W, his daughters C D and E were entitled to annuities of £300 a year during widowhood. Subject to the annuities the property was to be held in trust for such of his grandchildren as should reach the age of 21. There were two grandchildren, A and B, who both reached 21 before CGT was introduced in 1965.
>
> In 1969 the trustees, the daughters and the grandchildren entered into a deed under which specific funds should be set aside to meet the annuities and the rest of the property should be paid over to the grandchildren. In fact however the trustees held onto this property.
>
> The Revenue argued that A and B became absolutely entitled when the deed was executed.
>
> The trustees’ arguments were
>
> i) that absolute entitlement had occurred before 1965, because the annuities were merely `outgoings’ under TCGA92/S60 (2), see CG34320. The judge rejected this argument. The annuities were interests under the settlement. The grandchildren were not then

absolutely entitled because there were other beneficiaries with different interests.

ii) that absolute entitlement would only occur when the assets were distributed. This was held to be incorrect because Section 60(2) is clearly referring to a time when the settled property is still in the trustees' hands. Therefore absolute entitlement must precede the actual transfer.

iii) that an individual grandchild had to be entitled to specific property. The judge considered that the two grandchildren together were entitled to the whole of the settled property. Therefore they were 'jointly' absolutely entitled as against the trustees when the deed was executed.

The case law is conveniently summarised in *McLaughlin v HMRC*[85] but it is not necessary to discuss this here.

In the TCGA the phrase is used on a number of occasions, so with an economy of drafting, s.60(2) TCGA provides a TCGA-wide definition, which I call the **"standard CGT definition"**. That definition is drafted with the s.60(2) context in mind, and is not altogether suitable for the other places where it is used. It may seem like a commonsense definition but it is not quite. Where a trustee/nominee holds on trust absolutely for a minor or other person under a legal disability, the beneficiary (although absolutely entitled in the general sense of the word) cannot "direct how the property is to be dealt with" so appears strictly not to be within the definition of "absolutely entitled as against the trustee". In the context of s.71 TCGA (trust termination), this is dealt with by extending the statutory CGT definition to cover this case.[86] In other contexts a purposive construction might be needed to reach the (obviously sensible) position that a beneficiary who is a minor or under a disability should still be said to be absolutely entitled. But in practice the issue will rarely if ever arise.

The phrase is also used in other income tax contexts, though only very occasionally, where the usual statutory definition has to be repeated; or else the phrase is left undefined and so should have its normal meaning, but the above is (more or less) the normal meaning.

87.7.4 *Tax treatment of bare trust*

I have generally preferred to deal with bare trust issues as they arise in the

[85] [2012] UKFTT 174 (TC) at [111].

[86] See 56.21.5 (Disposal on trust termination).

context of other topics; see below for navigation. This section considers aspects of bare trusts which are conveniently addressed in isolation.

In almost all cases a bare trust is transparent, ie ignored for tax purposes. In particular:

(1) A bare trust is transparent for CGT, and, generally, for IT/IHT.
(2) A bare trust is not a settlement in the standard IT/CGT sense.
(3) A bare trust is not an IHT-settlement.
(4) A bare trust may be a settlement-arrangement.[87]
(5) A share subscription by a bare trustee is regarded as made by the beneficial owner.[88]

But transparency is not an absolute rule. It occasionally happens that a bare trust is not disregarded, either because statutory provisions require that, or because rights of a beneficiary under a bare trust are different from the rights of a legal owner, and these differences can have tax as well as non-tax consequences, or because of unusual features of the bare trust.

87.7.5 *Distribution of trust assets by bare trustee*

The CG Manual provides:

> **CG37100 Absolute entitlement: effects: deemed disposal** [Nov 2023]
> Following the occasion of charge under Section 71(1), when beneficiaries become entitled to the whole of the trust assets, the trustees may distribute the assets to the beneficiaries under a scheme of division otherwise than in accordance with their proportionate shares. In this situation there are good grounds for saying that there is a chargeable disposal by each beneficiary by way of an exchange of assets.
> Similarly specific assets may be appropriated by trustees to a beneficiary who has become absolutely entitled to a proportion of the settled property. In this case the exchange is between the trustees and the beneficiary.
> It is however possible that the principles of *Warrington v Brown* may be applicable in these two situations, see CG37410+, so that there is no second disposal following shortly after the Section 71 (1) occasion. If

[87] In the case of a bare trust for the settlor, there is no bounty (gratuitous intent) and hence no settlement-arrangement. There is a settlement-arrangement where a settlor creates a bare trust for the benefit of another person. The position is the same where a settlor makes an outright gift to another person without a bare trust: the bare trust as such makes no difference.

[88] HMRC Brief 41/10; this was common ground in *McLocklin v HMRC* [2014] UKFTT 042 (TC).

> the trustees and beneficiaries seek to apply those principles, no objection should be made, although any attempt to treat a subsequent disposal of an asset on an inconsistent basis should be resisted.

87.7.6 *Bare trusts: Navigation*

For other aspects of bare trusts, see:

Topic	**See para**
Residence of bare trustees	7.21
Income taxation	15.8
Remittance investment relief	19.3.1
s.87	61.3.1
Nominee partner	85.7
IHT definition of settlement	87.6.3
ATED	98.28.3
Reporting & Compliance	121.5
TRS	131.5

87.8 Other trust terminology

87.8.1 *Property comprised in settlement*

Where the standard IT/CGT definition of settlement applies, the term "property comprised in a settlement" is not likely to cause difficulties, but for completeness, it is given a commonsense definition. Section 466(4) ITA/s.68 TCGA provide:

> References, however expressed, to property comprised in a settlement are references to settled property.

For this term where "settlement" has the settlement-arrangement definition, see 47.3.1 (Property comprised in a settlement).

87.8.2 *Non-classic trust: Deemed trustee*

A classic (trust-law) trust must have trustees. A settlement-arrangement, and an IHT settlement, may not be a classic trust. I refer here to such an arrangement as a "settlement" with scare quotation marks. The "settlement" will not have trustees in the usual (trust-law) sense. However one needs to identify trustees of the "settlement" for a number of purposes, in particular:

Purpose	**See para**
To ascertain trust residence for s.87	61.4

To ascertain s.1(3) amounts (trust gains)[89]	
For the definition of connected person	104.14.2
To ascertain who is liable for IHT	125.3.4

There is a standard-form definition which addresses this issue. The provisions are conveniently read side by side:

s.97(7A) TCGA	**s.286(3ZA)(b) TCGA**	**s.994(3) ITA/s.1123(3) CTA10**	**s.45 IHTA**
In this section, sections 86A to 96 and Schedule 4C	For the purpose of [s.286(3)]	For the purposes of section 993	In this Act
"trustee", in relation to a settlement [settlement-arrangement definition] in relation to which there would be no trustees apart from this subsection,	[identical to s.97(7A)]	[identical to s.97(7A)]	"trustee", in relation to a settlement [IHT definition] in relation to which there would be no trustees apart from this section,
means any person in whom the settled property or its management is for the time being vested ...[90]	[identical to s.97(7A)]	means any person— (a) in whom the property comprised in the settlement is for the time being vested, or (b) in whom the management of that property is for the time being vested.[91]	[identical to s.97(7A)]

These are effectively identical; the Tax Law Rewrite improved the

[89] These are the amounts on which "the trustees of the settlement" would be chargeable to CGT if UK resident.

[90] Section 97(7A) was introduced by para 15 sch 12 FA 2006. Para 15(3) provides:

> "This paragraph shall come into force on 6th April 2006 (in relation to settlements whenever created)."

This raises the interesting possibility that s.87 did not apply to a Foundation before 2006 as a Foundation has no "trustees" in the normal (trust law) sense. So pre-2006 gains would not be s.1(3) amounts (trust gains). It is suggested that the context shows that the word "trustee" should be construed widely enough to include a Foundation, before 2006, and the pre-2006 law was the same as now. But the question will not often arise.

[91] This continues: "Section 466(4) does not apply for the purposes of this subsection." That disapplies an inappropriate definition of "property comprised in the settlement".

drafting by adding paragraphing.

I refer to this as the **"deemed-trustee rule"**[92] and in this book:

A **"trust-law trustee"** is a trustee in the usual (trust-law) sense

A **"deemed trustee"** is a trustee in the extended sense (where there would be no trustees but for the deemed-trustee rule).

In practice this issue arises most commonly in a s.87 context.[93]

87.9 3 ½ types of invalidity

87.9.1 *Outline*

In classifying an entity as a substantive trust, four rules of trust law/ property law need consideration. In outline:

(1) *General powers or equivalent:* A general power is "tantamount to ownership", and the powerholder is treated as owner for some purposes but not for others:
   (a) The underlying trust property is available to satisfy involvency/ family law claims; for this purpose a general power is treated like simple ownership
   (b) A trust which confers a general power may be a valid, substantive trust; for this purpose a general power is not treated as simple ownership (which would be inconsistent with a trust).

(2) *Illusory trusts:* A trust which appears to take the form of a substantive trust, but which (on its true construction) has only one beneficiary, is an *illusory* trust.

(3) *Testamentary dispositions*: A testamentary disposition does not take effect during the life of the testator (purported settlor).

(4) *Sham*: the parties to the trust do not intend to follow its terms.

In cases (2)-(4), the (purported) trustees generally hold on bare trust for the (purported) settlor. There will be a bare trust, if the trust property is vested in trustees (nominees) and not the beneficial owner; but what matters is that there is no effective *substantive* trust. One might describe the trust as "ineffective" or "invalid". In the first case, general powers, the position is more nuanced. Hence the heading of this section is "3½ types of invalidity".

Much has been written on sham, and on illusory trusts, (rather less on

[92] The deemed-trustee rule also crops up by mistake in the definition of relevant person for remittance purposes; see 18.6 (Relevant person: Trusts).

[93] See 61.3 (Non-classic trust).

testamentary dispositions). That focuses on the general law position, and the recent cases have all been insolvency/family law cases. But the rules affect the tax position, in particular, whether an entity is a settlement within the standard IT/CGT and IHT definitions. In order to address that, one has to consider the topic generally.

87.9.2 *When the issues arise*

These issues have arisen in modern case law where a settlor desires:

(1) to obtain desirable consequences of a substantive trust, ie one or more of:
 (a) asset protection: trust fund not exposed to insolvency/family law claims
 (b) succession law treatment: trust property to pass under the terms of the trust and not under the rules which would apply to the settlor's free estate (will, forced heirship, or otherwise)
 (c) tax treatment: to create an effective settlement within the standard IT/ CGT or IHT definitions

and

(2) to avoid unwanted consequences of a trust, ie loss of ownership and control, and so to retain:
 (a) benefits or rights equivalent to beneficial ownership, and
 (b) control of trust property

Responses to this dilemma have included:

(1) Execute a discretionary trust in the common form, but administer the trust property as if it still belonged to the settlor. In short, the trust may be treated like a bank account. That takes us to the territory of sham.

(2) Give the settlor a general power of appointment (or a power of revocation, which is equivalent). That creates an effective settlement for tax purposes, but loses asset protection.

(3) Draft the trust:
 (a) to restrict the rights of beneficiaries other than the settlor;
 (b) (i) If the settlor is trustee, to increase the rights of the trustee.
  (ii) If the settlor is not trustee, to give him control over the trustee.

 That takes us to the territory of general powers, testamentary dispositions and illusory trusts.

These rules apply to trusts but not to other entities such as companies.

One of the intuitions underlying the these rules, though generally unexpressed, may be that a settlor should not "have his cake and eat it". But this overused metaphor does not help analysis. Perhaps it is not usual to analyse folk wisdom of this kind, but here we need to. It means that one cannot have two incompatible things, such as spending and saving. But it begs two questions:

(1) What exactly are the things which are said to be incompatible?
(2) Are they in fact incompatible?

Or to put it another way, it does not answer when a trust becomes illusory.

The old cases on testamentary dispositions prevent the carrying out of this intuition to its logical conclusion, as it is clear that the settlor may have both:

(1) power of revocation, or a general power, and
(2) a substantive trust.

But note in this case the settlor does not obtain the benefit of asset protection; if that is the desired cake, the settlor cannot have it as well as a general power.

87.10 General power

87.10.1 *General power: Terminology*

Powers are traditionally divided into:

(1) general powers or
(2) not general powers: the American term **"non-general"** is the clearest word. A traditional trust law term is "special power"; one sometimes sees "limited power".

In *Re Dilke*:[94]

> General powers are such as the donee can exercise in favour of such person or persons as he pleases, including himself.
> [Non-general powers] are such as the donee can exercise only in favour of certain specified persons or classes.

I refer to this as a general power **"in the strict sense"**.

In *TMSF*,[95] the settlor had a power of revocation. A power of revocation is not a general power in the strict sense, but it is equivalent to a general power in that it is:

[94] [1921] 1 Ch 34 at p.42 citing *Farwell on Powers* (3rd ed., 1916), p.8.
[95] *TMSF v Merrill Lynch Bank* [2011] UKPC 17.

(1) a right tantamount to ownership, and so
(2) a right which could be taken and used by his receivers in bankruptcy.[96]

I refer to any unrestricted power which the powerholder can use to transfer trust property to himself or herself (whether or not it can be used to transfer trust property directly to others) as a general power **"in the wide sense"**. In my terminology, a power of revocation exercisable by the settlor is a general power in the wide sense.

Whether a power is a general power ie tantamount to ownership, might be clear from the trust document; if not, it is a matter of construction.

I refer to the person who exercises a power of appointment as the "**powerholder**". The traditional trust law term is "donee" (that is, the person to whom the power is given).

I refer to the property over which the power is exercisable as the **"underlying property"**.

87.10.2 *General power/ownership distinction*

The traditional view is that power and property are distinct concepts:
(1) A power is not "property" (in the general sense of the word).
(2) The powerholder is not treated as owning the underlying property over which the power is exercisable.

One might refer to this as a technical view. *Re Armstrong* states this view with what seems to me an element of hyperbole:[97]

> No two ideas can well be more distinct the one from the other than those of 'property' and 'power' ... A 'power' is an individual personal capacity of the donee of the power to do something. That it may result in property becoming vested in him is immaterial; the general nature of the power does not make it property. The power of a person to appoint an estate to himself is, in my judgment, no more his "property" than the power to write a book or to sing a song. The exercise of any one of those three powers may result in property, but in no sense which the law recognises are they 'property.'

On the contrary:
(1) When defined, "property" is often given a wide definition to include general powers expressly, or to include "rights and interests" which

[96] See Russen, "The Reserved Powers Trust; when might Power be Property" [2013] JITTCP 239.

[97] (1886) 17 QBD 521 at p.531.

may be understood to include general powers. When undefined, context may show that property (undefined) includes general powers.

(2) When the distinction is drawn, the difference between owning a general power and owning the underlying property seems trivial. In *Re Churston*:[98]

> [the powerholder] was in substance the owner of the property, and consequently free to deal with it in any way she pleased. One must put in the words 'in substance' or 'practically,' because even a person having a general power of appointment is not quite in the same position as an owner. True, he can give it to anybody he likes inter vivos. True, he can dispose of the property by will without referring to the power at all provided that he makes a residuary gift, but he may make a will which contains no residuary gift, or more probably, he may make no will at all, and in those circumstances the property will go as in default of appointment. So, as I have said, it is not absolutely true that even a person having a common general power of appointment is in quite the same position as an owner. Still, I think that the basis of the doctrine [relating to the rule against perpetuity] is that he is treated as though he were for all practical purposes the owner.

The commercial reality is obviously that a general power is tantamount to ownership.

87.10.3 *Why general powers matter*

The concept of general powers matters in the following tax contexts:

Term	**Topic**	**See para**
General power of appointment	Who is settlor	99.14
General power over non-settled property	IHT joint accounts	94.3.1
General power over pension fund	Pension schemes	84.12
Settlement power	IHT settlement-power relief	74.10

These are niche topics.

The concept matters for trust law rules restricting to delegation of powers and the rule against perpetuities. These are again niche topics.

The concept matters for insolvency and family law (asset protection) rules. That is the context of the modern cases.

(1) The holder of a general power must use it to pay their debts before using it to benefit others.

[98] [1954] 1 Ch 334, at p.343.

(2) If an insolvent holder of a general power (which for this purpose includes a power of revocation) refuses to exercise the power in their own favour, the court will appoint a receiver who can exercise the power.[99]

87.10.4 *Jointly held power*

Churlston decided that a joint power (a power to appoint to whoever two persons jointly direct) is not a general power. That seems self evident.

The same conclusion was reached in *Law Society v Dua*.[100]

87.10.5 *Validity of trust with general power*

What matters for tax purposes is that a trust with a general power may be a substantive trust, ie it is not necessarily an illusory trust. But of course a trust with a general power may be illusory. An important point here is whether the power is vested in the trustee or a non-trustee:[101]

> ... a power vesting in a trustee without any effective accountability to the beneficiaries is anathema to a trust.

By contrast, if the settlor has a power of revocation, the trustee's fiduciary obligations may continue, and a settlement within the standard tax definitions may exist, unless and until the power of revocation is exercised.[102]

Perhaps for the power to vest in only one of the trustees is sufficient to make the trust illusory:

> In our view, if it could be said that Marcus [one of the trustees] holds a general power of appointment of the income and assets of the trust without such accountability, then it would necessarily follow that there is no valid trust.

87.11 Illusory trust

87.11.1 *Illusory: terminology*

The term "**illusory trust**" is not an established term of trust law.[103] I use

[99] *TMSF v Merrill Lynch Bank* [2011] UKPC 17.

[100] [2020] EWHC 3528 (Ch) at [157].

[101] at [116].

[102] *Clayton v Clayton* [2016] NZSC 29 at [125].

[103] The word illusory has a long legal history, but the concept of illusory trusts starts with Mowbray, "Shams, Pretences, Blackmail and Illusion" [2000] PCB 105.

it to describe a trust which:

(1) at first glance, seems to be a substantive trust but
(2) when carefully construed, confers rights only on the settlor

The terminology is currently controversial. In *Clayton v Clayton:*[104]

> we do not see any value in using the "illusory" label: if there is no valid trust, that is all that needs to be said.

Likewise in *Pugachev*:[105]

> One can see why someone might have described the trust in *Clayton v Clayton* as illusory because no doubt at first sight, the deed looks as though Mr Clayton has divested himself of control over the property whereas after careful consideration one reaches the conclusion that he has not. However the word is not helpful and I will only use it in this judgment as a label.

These objections are misplaced. We need labels and the term conveniently expresses a specific ground of invalidity. To describe a trust as "invalid" is not to say all that needs to be said. There are numerous reasons which may render a trust invalid and we need words to describe them. Strictly, perhaps, it is not the trust, but the interests of (purported) beneficiaries which are illusory, but it comes to the same thing. Perhaps there is a better term than illusory, but I cannot think of one. "Illusory" is a new way of describing an old rule (a valid trust requires beneficiaries who can enforce it) but it describes a new phenomenon, a new style of drafting (purported) trusts.

Webb v Webb proposed the term "objective nullity"[106] (objective, to distinguish the concept of sham, which depends on the parties' subjective intention). But that term is opaque and less precise. It would also be apt to describe a trust which is void for perpetuity, say, or void because the (purported) settlor lacked capacity. But those are different grounds for holding a (purported) substantive trust to be invalid.

In the trusts considered here, the settlor will be the principal beneficiary, and I refer to others as "secondary beneficiaries".

[104] [2016] NZSC 29 at [123].

[105] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) at [169].

[106] [2020] UKPC 22 at [73].

87.11.2 *Test for illusory trust*

Webb v Webb[107] puts the test this way:

> whether those powers were so extensive that Mr Webb can be said never to have disposed of any of the property purportedly settled on or acquired by the trusts.
> In this connection one might also ask whether the trusts lacked the irreducible core of obligations owed by trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust.[108]

Adopting *Webb's* wording, the test of an illusory trust is:

(1) whether the powers were so extensive that the settlor can be said not to have disposed of the property purportedly settled; or

(2) whether the trust lacks the irreducible core of obligations owed by trustees to secondary beneficiaries and enforceable by them.

These may be regarded different ways of saying the same thing. But the absence of a disposal is the consequence, not the test, of an illusory trust. A trust is not illusory because there is no disposal; there is no disposal because it is illusory. The test is whether the trust lacks the irreducible core of obligations. Another way to put the test, in legal terms, is whether secondary beneficiaries have any interest at all. Or to put it another way: could a secondary beneficiary sue for breach of trust? If not their interest can properly be called illusory.

This test requires one to ascertain what are the powers/interests of the beneficiaries. That is a matter of construction of the trust deed.

While a trust will normally be illusory (or not) from the outset, it is possible that a valid trust may become illusory (or an illusory trust may become valid) as a result of an exercise of trust powers which alters the

[107] [2020] UKPC 22 at [89].

[108] The reference is to *Armitage v Nurse* [1998] Ch 241 at p.253:

> "there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts."

Likewise Hague Convention art.2: "A trust has the following characteristics ... (c) the trustee has the power and the duty, *in respect of which he is accountable,* to manage, employ or dispose of the assets in accordance with the terms of the trust ...". The rule goes back to *Morice v The Bishop of Durham* (1804) 9 Ves Jun 399 at p.405: "There must be someone in whose favour the Court can decree performance."

terms of the trust.

Clayton v Clayton puts the test slightly differently:[109]

> The concept of "illusory trust" was described ... as a trust under which the trustee retains such control that the proper construction is that
> [1] he did not intend to give or part with control over the property sufficient to create a trust.
> [2] The essence of the concept appears to be that the trust as constituted has the attributes of a trust, including the imposition on the Trustee of the obligation to act honestly and in good faith; but the powers given to the Trustee and, we would add in this case, the Principal Family Member, given that Mr Clayton had both roles, are so broad that the Trustee can 'basically … do whatever he wants with the property'...
> The issue would be whether the powers held by Mr Clayton are so broad that what he intended to be a trust was not, in fact, a trust.

I do not think it is satisfactory to identify an illusory trust by asking whether the primary beneficiary can "basically do whatever he wants" as that language describes a general power which is consistent with a substantial (non-illusory) trust. "Control" is also a broad and imprecise term (which is why it is almost always given a definition).

87.11.3 *Applying the test*

I start with what is not necessarily inconsistent with a valid trust. Article 2 of the Hague Convention of the Law Applicable to Trusts[110] provides:

> The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.

The wording of s.70 TCGA[111] assumes that a trust is not necessarily invalid where:

(1) The trust is revocable
(2) The settlor has "some interest" as beneficiary
(3) The settlor is sole trustee

[109] Cited in *Pugachev* at [163], [135].

[110] The Convention is incorporated into UK law by the Recognition of Trusts Act 1987, and it is generally accepted that its definition of trust represents the UK law concept.

[111] Set out at 56.21.4 (Disposal on transfer into trust).

The wording of s.5(2) IHTA[112] assumes that a trust is not necessarily invalid where a person has a general power of appointment.

Case law shows that there may be a valid trust under which the settlor ("S") has both a power of revocation and a life interest. The trust is not classified as testamentary and having been upheld, it cannot be classified as illusory.[113]

It is not inconsistent with a valid trust that the interests of secondary beneficiaries have nil economic value.

While these features individually are consistent with a valid trust, one needs to look at the trust as a whole. There have been a few recent cases which offer examples.

87.12 Construction of trust: Comments

There have been six recent cases on the construction of trust deeds to determine whether the trust (1) was illusory or (2) conferred a general power:

Case	**General power**	**Illusory**
AQ Revocable Trust	-	Yes
Pugachev	-	Yes
Webb v Webb	Yes	Undecided
Clayton v Clayton	Yes	Undecided
Cooper v Pinney	No, but ongoing	No
Law Society v Dua	No	No

The focus of investigation in all these cases is whether the settlor's powers are constrained or unconstrained, ie:

(1) powers which the settlor could lawfully exercise in a selfish way in favour of himself and against the interests of the other Discretionary Beneficiaries; or

(2) powers which could only properly be exercised for the purpose of furthering the interests of the Discretionary Beneficiaries as a class on the other hand. One might refer to this as "fiduciary powers". The word fiduciary is vague and covers a variety of different obligations. but that does not matter here.[114] Or one might say that the duty is at least to act honestly but a requirement of honesty does suffice for a

[112] Set out at 94.3.1 (Account in both a/c holders estates).

[113] See 87.13.2 (What is testamentary?)

[114] See *Pugachev* at [186].

valid trust, as the settlor may be selfish and honest.

Each case turns on the wording of the trust. Trust deeds are long, a short summary can mislead, but a short table may be a useful starting point:

Feature	***AQ***	***Pugachev***	***Webb***	***Clayton***	***Cooper***	***Dua***
Sole trustee	Y	N	Y	Y	N	Joint trustee
Power to remove trustee		Y			Y	
Ditto without cause	Y	Y			Disputed	
Beneficiary	Y	Y	Y	Y	Y	Y
Exercisable in own favour		Y	Y	Y		
Other special feature	Y					
Outcome	Ill.	Illusory	GP	GP	Valid	Valid

87.12.1 *Worldly realism/Angoran cats*

The question should be addressed with "worldly realism".[115] *Pugachev* makes a similar point referring to Angoran cats:[116]

> Professor Mario Franzosi likens a patentee to an Angora cat. When validity is challenged, the patentee says his patent is very small: the cat with its fur smoothed down, cuddly and sleepy. But when the patentee goes on the attack, the fur bristles, the cat is twice the size with teeth bared and eyes ablaze...
>
> The problem can apply to any written instrument and this case provides another example in a different context. When the validity or effect of the trust is challenged, the trustee can put forward emollient submissions about Protector's powers being confined and narrow as a result of their

[115] *Clayton v Clayton* [2016] NZSC 29 at [79].

[116] at [438] - [441].

> fiduciary nature. That has happened in these proceedings. But in other circumstances, for example when Mr Pugachev needs collateral for a bank loan, a completely different stance can be taken in relation to the very same instrument. Mr Pugachev can be presented as the owner of the trust assets. This latter event has happened too... when a bank asked for collateral for a loan, Mr Pugachev's family office presented a trust asset ... as an asset owned by Mr Pugachev ...
> I do not believe this characteristic of the deeds in this case is accidental. ... the whole scheme always was in truth that the settlor would exercise covert control of the trustee and both settlor and trustee always intended that that would be so...

87.12.2 *AQ Revocable trust*

In *Re the AQ Revocable Trust* the facts were very strong:

(1) The settlor was sole trustee and a beneficiary.

(2) He was (importantly, and unusually) entitled to release trustees from liability.

The interests of beneficiaries (other than the settlor) during the settlor's lifetime were held to be illusory and the rest was testamentary:

> [29] ... the concatenation of rights and powers in the settlor, when coupled with the fact that he was the sole trustee at the time of the constitution of the trusts, rendered this trust illusory during his lifetime. ... the cumulative effect of the trust documents, when taken with the de facto situation, means that the settlor as trustee could not effectively be called to account during his lifetime. Crucial to this conclusion is art VIII H, which allows the settlor to absolve himself as trustee from any and all breaches of trust.

This clause provided:

> The written approval by the Donor [the settlor] of any trust transaction during his lifetime shall be a complete release of the Trustee (including the Donor) of any liability or responsibility of the Trustee to any person with respect to this transaction.

Palmer argues, I think correctly, that this clause alone is sufficient to show that the trust is illusory even if the settlor was not a trustee.[117] But the Court did not have to go that far because the settlor was sole trustee:

[117] Palmer, "Controlling the Trust" (2011) 12 Otago LR 473 *http://www.nzlii.org/nz/journals/OtaLawRw/2011/3.html*

> While it may be that I would not have come to that conclusion had art VIII H been coupled with a distinct and independent trustee, in this case it is the combination which pushes it over the top. Given that the trust agreements are constituted on their face with the settlor as sole trustee, and that no further appointment was made at the time, I consider that arts I and II were void on the face of the documents at the inception of the trust agreements, and that the remaining trusts created by the agreements were therefore testamentary in nature.[118]

I do not think that is contentious.

87.12.3 *Pugachev*

Pugachev is the first case in the English courts.[119]

(1) The settlor was protector and beneficiary.
(2) The trust provided that the protector may remove trustees without cause, and the trustees could not distribute without the consent of the protector.

The judge found that the powers were unconstrained, exercisable freely for the settlors's own benefit:[120]

> 268. The fundamental reason for why I reach this conclusion is having regard to the extensive nature of the Protector's powers combined with the fact that the First Protector is the settlor of all the trust assets and is also one of the named Discretionary Beneficiaries. If such extensive powers had been conferred on a third party as protector, with provisions barring that person from being a beneficiary, then I can see that a different result might follow but the fact it is a beneficiary on whom these powers are conferred militates against the idea of a limitation. One would expect a beneficiary ordinarily to be entitled to act in their own interests. Conversely if less extensive powers were conferred on a beneficiary/protector then again one might arrive at a different result but that is not this case.

[118] *Re the AQ Revocable Trust,* also reported under the name *BQ v DQ,* [2010] SC (Bda) 40 Civ.

[119] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch). This concerned a New Zealand trust, but the parties agreed that English/New Zealand law were the same on this point; see at [112]. That is not binding in other cases. It is convenient that trust jurisdictions should adopt the same test, and likely though not inevitable that they will.

[120] at [267] to [275].

> 269. The fact that Mr Pugachev is also the settlor reinforces the conclusion....
> 272. The fact that the power of removal of trustees is expressed to be "with or without cause" is significant. In the context of all the other factors in this case, to go to the trouble of saying expressly that removal of a trustee may be without cause seems to me to negative any idea that the power is subject to a limitation of any kind ...
> 275. ... the provisions about the Protector being Under a Disability defined as to include a disability by operation of law support the same conclusion. The arrangements have been set up so that if the Protector is subject to a court order requiring him to do something he does not want to do, he ceases to be the Protector and his son Victor stands in his place. If required to act against his will Mr Pugachev can truly say to the court that he has none of the Protector's powers. If the Protector's powers under the deed were limited to acting only in the best interests of the Discretionary Beneficiaries as a class, rather than in his own selfish interests, then I doubt this provision would be necessary. What it does is allows Mr Pugachev's effective complete control of the trusts to cease to exist the moment he is compelled to do something he does not want to do, like hand over the assets to a creditor. It is an attempt to make the trust judgment proof and should not be accepted.

So the trust was held to be illusory. Trust practitioners have criticised *Pugachev* for its construction of the particular trust deed and for lack of clarity of analysis. But the decision also has its supporters and, I think, its merits.[121]

87.12.4 *Clayton v Clayton*

In *Clayton v Clayton* the powers of the settlor were again extensive. The settlor was sole trustee and a beneficiary, and his power to appoint the property to himself was unconstrained, because of the following provisions:
cl 14: Self benefit:

> A Trustee who is also a Beneficiary may exercise any power or

[121] Brightwell, "Mezhprom v Pugachev: bold new approach or illusory development?" [2018] Trusts & Trustees p. 398; Nitikman. "More about illusory trusts" [2021] Trusts & Trustees p.69; *Lewin on Trusts* 20th ed (2020) para 15-053 ("We consider this decision to be doubtful"). *Law Society v Dua* [2020] EWHC 3528 (Ch) described Lewin's criticism as "unfounded". In the first supplement to *Lewin* (2024) the discussion is rewritten but still describes *Pugachev* as doubtful; see para 5-035A.

> discretion vested in the Trustees in his, her or its favour.

cl 11: Unfettered discretion:

> notwithstanding anything in this deed or any rule of law which imposes upon the Trustees the duty to act impartially towards Beneficiaries, the Trustees shall have unfettered discretion as to the exercise of the powers and discretions conferred upon them by this deed even though:
>
> (a) the interests of all Beneficiaries are not considered by the Trustees;
>
> (b) the exercise would or might be contrary to the interests of any present or future Beneficiary ...

cl 13: Negation of conflict:

> A Trustee may act as such and exercise all of that Trustee's powers and discretions notwithstanding that ...
>
> (c) the interests or duty of that Trustee in any particular matter may conflict with the duty of that Trustee to the Trust Fund or any Beneficiary

The Supreme Court found that the powers were (in my terminology, general powers (the statutory term was "relationship property") ie tantamount to ownership[122]; and so available for the claims of the divorcing spouse. They left the issue of illusory trusts for another day.[123]

87.12.5 *Webb v Webb*

The next case is *Webb v Webb*[124]. The terms of the trust were again extreme:

(1) The settlor was sole trustee and a beneficiary.

(2) The settlor as trustee was permitted to exercise the trust's powers notwithstanding that his interests may conflict with his duties as trustee. The settlor had power to nominate himself as sole beneficiary in place of the existing beneficiaries. This power was not subject to any fiduciary duty.

[122] at [58].

[123] [2016] NZSC 29 at [127]: The issue was "a matter of some complexity on which the court does not have a concluded unanimous view. In light of that, we do not intend to determine the issue because the settlement of the proceedings makes it unnecessary to do so."

[124] [2020] UKPC 22.

(3) The settlor had power without giving reasons to remove trustees.

And so on. In short, the settlor had power to arrange that he alone would hold the trust property on trust for himself alone. In these circumstances:

> 89. ... the powers reserved to Mr Webb under the trust deeds may be analysed in two different ways.
> [1] One is to consider whether those powers were so extensive that Mr Webb can be said never to have disposed of any of the property purportedly settled on or acquired by the trusts. In this connection one might also ask whether the trusts lacked the irreducible core of obligations owed by trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust.
> [2] The other is to ask whether the powers reserved to Mr Webb were so extensive that in equity he can be regarded as having had rights which were tantamount to ownership. ...
> in this case it can make no difference to the outcome which of these two analytical routes is taken.

This is true of all asset protection cases.

> I will therefore confine myself to the substantive question whether Mr Webb's powers under each of the trust deeds were such that, in equity and in all of the circumstances of this case, he can be regarded as having had rights in the trust assets which were indistinguishable from ownership. In my view he plainly can... In my opinion ... the trust deeds failed to record an effective alienation by Mr Webb of any of the trust property. The bundle of rights which he retained is indistinguishable from ownership.

That seems self-evident, but it follows that in asset protection cases, the Court will never have to decide the illusory issue. For the terms which suggest that the settlor has a general power will be similar to those which suggest that the trust is illusory.

The important question for tax is the question which the Court chose not to decide. Was the trust:

(1) an illusory trust, taking effect as a bare trust; or
(2) a valid substantive trust with a general power, tantamount to ownership, and so making the trust property available to creditors?

The question will never have to be decided in ordinary trust litigation. One may argue for the latter. If so, the trust would be an settlement within the UK tax definitions. But I would not plan on that basis.

87.12.6 *Law Society v Dua*

The most recent English case is *Law Society v Dua*.[125] This was a trust in the form in my book *Drafting Trusts & Will Trusts*.

(1) The settlors were Mr and Mrs Dua.
(2) The settlors were trustees.
(3) They had power to add beneficiaries. It was assumed for the purposes of discussion that they had power to add themselves as beneficiaries.

However:

> [157] A conclusion by me that the powers reserved to Mr and Mrs Dua are tantamount to beneficial ownership would require me to treat:
> (1) the powers vested in Mr and Mrs Dua as trustees as free from any fiduciary responsibility, fetter or limitation, when that is not the case in this Deed;
> (2) the beneficiary's entitlement to be considered for appointment as if it did not exist, when such a proviso is not present; and
> (3) Mr and Mrs Dua as operating as one, when they are separate persons.
> In my judgment this is not open to me, or in any event goes too far

87.12.7 *Cooper v Piney*

Forthcoming we will have *Cooper v Pinney*[126] where:

(1) The principal beneficiary was one of the trustees and one of the beneficiaries.
(2) The principal beneficiary had power to remove a trustee without giving reasons. The Court was split over whether this was a beneficial power which the settlor could exercise for his own benefit, for instance, to appoint a corporate trustee which he controlled, thus giving himself full control.

The split on point (2) was the key to a split on the outcome of the the question of construction, holding 2:1 that the principal beneficiary did not have powers tantamount to ownership, because "he cannot unilaterally appoint income or property to himself".[127] That case concerned a more conventionally drafted discretionary trust, and the question was whether

[125] [2020] EWHC 3528 (Ch) at [157].
[126] [2023] NZCA 62.
[127] at [111].

the settlor had a general power or equivalent; CoA agreed it was not an illusory trust.

87.12.8 *Summary*

To summarise the case law: *AQ* is a clear case of invalidity, on wording not found (I think) outside US grantor trusts. *Clayton* and *Webb* are indecisive on the illusory trust question. *Pugachev* is the most far-reaching case of a trust found to be illusory, because it concerns trust wording of a type more often found. *Law Society v Dua* was a clear case of validity, because of the unusual fact that there were two settlors who were both trustees. It does not give us the answer if the same trust had one settlor who was sole trustee.

Powers vested in trustees are not likely to be construed to be general powers, as trustees cannot in principle use their powers as they please, to benefit themselves. Different considerations apply if the settlor is trustee.

Further clarification will have to wait for more case law. In *Cooper v Pinney*:[128]

> There is some ambiguity regarding illusory trusts: the debate extends to what is the irreducible core of a trust, whether a formal or contextual approach should be taken to analysis of a trust relationship, and what are the permissible limits of settlor or trustee control...
>
> There is some debate about the degree of accountability required to establish a valid trust. A conservative approach finds it sufficient that trustee powers are formally fiduciary in nature; in principle, the beneficiary in such a case can invoke the duty to administer the trust honestly, considering the interests of the beneficiary. A purposive approach holds that, having regard to the objects of the PRA, accountability must be meaningful or effective and a court may look beyond the form of the trust deed to the substance of the arrangement.

The point may be clearer when the New Zealand Supreme Court has given its decision.

87.12.9 *How far can the drafter go?*

In the 2016/17 edition of this work I said: “It would be wise for the trust drafter to keep a little distance from this still rather indeterminate boundary.” That seems confirmed by the decisions in *Pugachev* and

[128] [2023] NZCA 62 at [57], [66] and [81] (footnotes omitted).

Webb. I think that advice remains sound.

How far should the drafter go? The answer depends on whether the settlor wants (1) asset protection or (2) only the tax consequences of creating a settlement. The latter is easier to achieve, for instance, a revocable trust has the tax consequences desired, without providing asset protection. In general, it is suggested that if it is desired to have a trust which is valid for tax purposes, and asset protection is not required:

(1) The settlor should not be trustee or protector.
(2) The settlor should not have power (directly or indirectly) to control or replace the trustee or protector.
(3) The settlor may have power of revocation or a general power of appointment.

87.13 Testamentary disposition

87.13.1 *Why testamentary matters*

English law (and foreign laws which adopt common law principles) distinguish between:

(1) testamentary dispositions
(2) non-testamentary dispositions (which might be called "lifetime dispositions")

The distinction matters for many reasons including the following:

(1) *Formalities*: Stricter formalities apply for the validity of a testamentary disposition (eg 2 witnesses are usually required).
(2) *Rules of revocation*: A testamentary disposition is normally revoked by making a new will or by marriage. These events do not normally revoke a non-testamentary disposition.
(3) *Date disposition takes effect*: A testamentary disposition takes effect on death. A lifetime disposition normally takes effect when executed. If a disposition which creates a trust is a testamentary disposition, the trust must be a bare trust during the life of the settlor/testator.

Statute law recognises and indeed requires a testamentary/non-testamentary distinction but gives no guidance on where to draw the line.[129] The testamentary/non-testamentary distinction derives from 19th century case law, but it is being applied now in new contexts.

[129] Section 1 Wills Act 1837 states that the term "will" includes a testamentary disposition, but does not define "testamentary disposition".

87.13.2 *What is testamentary?*

A disposition is testamentary if it is the intention of the writer of the document "that death was the event that was to give effect to it".[130]

A disposition which confers a life interest on the settlor and also a power of revocation is in principle a valid lifetime substantive trust, not testamentary. In *Thompson v Browne*:[131]

> If there be anything in that decision [*Attorney-General v Jones*] to support the notion, that where a person by deed settles property to his own use during his life, and after his decease for the benefit of other persons, a power of revocation reserved in such a deed alters the character of the instrument, and renders it testamentary ... I can only say that, if this were law, a great number of transactions of which the validity has never been doubted would be liable to be impeached.

Likewise a trust may confer a general power of appointment. The remainder beneficiaries of a trust in this form have an equitable interest from the date of the gift, known as a present future interest. They could take proceedings in the event of a breach of trust. However in practice this may be a theoretical possibility only. The difference between a testamentary disposition and a trust of this kind is then one of form and not one of substance. There is no economic difference. Their interest has a nil economic value.

In cases of this kind it may be harder to construe the document and determine whether the intention of the writer is:

(1) to confer a present future interest or
(2) that death is the event which gives effect to the document.

Since it makes no practical (economic) difference, the writer of the document may not have formed a clear intention on the point, or even if they have, they may not have expressed that intention clearly in the document. In these cases the form of the document is an important guide to construction. If the document takes the form of a will, (ie describing

[130] *Milnes v Foden* (1890) 15 PD 105 at p.107; or (which comes to the same thing) "it is dependent on the death for its vigour and effect"; *Cock v Cooke* (1866) 1 P&D 241 at p.243. If the document calls itself a will, the intention is obvious, but it is not necessary to use the word "will". For instance, a conveyance "not to take effect until after my decease" is testamentary: *In the Goods of Morgan* (1866) 1 P&D 214.

[131] (1835) 3 My & K 32. The point is also stated in *Baird v Baird* [1990] 2 AC 548 at p.556.

itself as a will and executed with the formalities of a will) the intention of the writer must be that it is testamentary. If it takes the form of a lifetime settlement (ie describing itself as such and executed as a deed), the intention of the writer must be that it is a lifetime disposition. Of course the form of the document is not decisive. The context may show otherwise. However, the form certainly gives some indication of intention, and in the absence of contrary indications it should be determinative.

Thus in *Corlet v Isle of Man Bank Limited*[132] and *Anderson v Patton*[133] lifetime trusts conferred what one might regard as minimal future revocable interests on beneficiaries other than the settlor, but the trusts were not testamentary. The latter case concerned a document reciting:

> received from A $5,000 which I am to hold in trust for A and which I am to pay out as instructed to X and Y if anything should happen to A. The money will be returned if A should demand it.

The court held by a majority that even this was non-testamentary. The reader may prefer the minority view that this should have been construed as testamentary.

87.14 Sham

The sham rule is (in short) that a trust is invalid if the settlor (and trustees) lack the intention to create a substantive trust.

The word sham has a long legal history, though I do not think anyone thought much about sham trusts before *Rahman v Chase Bank (CI) Trust Co.*[134]

The *Pugachev* case comments on terminology:[135]

> Despite the frequent references to a “sham trust”, there is not really any such thing. What may or may not be a sham are the acts or documents which purport to set up the trust.

It seems to me that “sham trust” is a convenient term to describe what purports to be a trust, but is invalid under the sham rule: the objection is pedantic. I would say that the acts/documents which purport to set up the

[132] [1937] 3 DLR 163.

[133] [1948] 2 DLR 202.

[134] [1991] JLR 103.

[135] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) at [169].

trust, and the trust itself, should *both* be described as sham.

I do not consider sham further here, as the case law is extensive, and it has been extensively written up elsewhere.

87.15 Invalidity rules compared

87.15.1 *Apparent overlap*

The same provisions in a trust may tend to suggest that:
- a trust is illusory
- powers are general powers
- the trust is testamentary

So all three points may be argued, and rules which are conceptually distinct can seem to overlap.

87.15.2 *Illusory/testamentary rules*

A trust may be illusory but not testamentary. They are distinct concepts:

(1) In the case of an illusory trust, the question is whether a beneficiary other than the settlor has any rights.

(2) In the case of a testamentary trust, there would be someone who is intended to benefit after the death of settlor/testator, and the question is whether they are intended to have rights immediately or not until the death of the settlor.

87.15.3 *Sham/illusory trust*

The sham rule is distinct from the rules a trust may be classified as a testamentary disposition or an illusory trust. The difference is that:

(1) Sham depends on the (subjective) intention of the parties as, typically, shown by their conduct after the creation of the trust, which is a question of fact.

(2) The testamentary/illusory trust rules depend on the construction of the document, which is a question of law and an objective matter.[136]

In *Webb v Webb*:[137]

> 87. There is ... no inconsistency between
>
> [1] the finding by Potter J, upheld by the Court of Appeal, that

[136] See *Clayton v Clayton* [2015] NZCA 30 at [78]: “the two concepts [sham and illusory trust] are quite different and the distinction is important.”

[137] [2020] UKPC 22.

> the trusts are not shams and
>
> [2] a conclusion that Mr Webb's attempts to create the trusts have failed or are defeasible.
>
> Acceptance that Mr Webb intended to create trusts does not in any way preclude a finding that he reserved such broad powers to himself as settlor and beneficiary that he failed to make an effective disposition of the relevant property. ...

In fact a finding that a trust is illusory is logically inconsistent with a finding of sham. An illusory trust fulfils the settlor's intention which is to retain control and beneficial ownership. But the consequence - invalidity - is the same, so it does not generally matter for practical purposes.

87.15.4 *Illusory trust/general powers*

The distinction between an illusory trust, and valid trust conferring a general power, may be a fine one. But as *Cooper v Pinney* put it:[138]

> To find that the trustee's powers and entitlements amount to a general power of appointment is to accept that the trust relationship exists; that is to say, the settlor succeeded in creating a trust ... an illusory trust must be invalid for all purposes, not merely as between the parties to relationship property litigation. That need not be the case where trust powers (or assets) are classified as relationship or separate property for purposes of the PRA.

87.16 Foreign applicable law

Common law jurisdictions generally follow English law principles; indeed the cases cited above are drawn from multiple jurisdictions. But the terms of the statutory trust laws of tax haven jurisdictions would need consideration.

I would be interested to hear from Scottish readers if Scots law is the same.

In civil law jurisdictions it should not be assumed that common law principles apply.

87.16.1 *Foreign law sham*

The validity of a trust is a matter of the governing law, and UK tax must be applied on the basis that the trust has the effect it has under the

[138] at [77].

governing law. It may be that:
(1) a trust would be classified as sham under English trust law principles; but
(2) it is not classified as sham under its governing law, perhaps some civil law jurisdiction which recognises trusts or trust-like entities, but does not share our concept of sham.

87.16.2 *Foreign law illusory trust*

The question of what are the rights of the beneficiaries are a matter for the proper law; but after that, the tax analysis is a matter of UK law.

Most tax haven jurisdictions have legislation which states that giving specified powers to the settlor ("reserved powers") will not invalidate the trust. Details vary. A reserved powers law may merely declare the common law rules[139] in which case it makes no difference. But it is possible that there may be an entity or arrangement (to use a neutral word) which:
(1) the proper law regards as a substantial trust; but
(2) if UK law applied to the trust, it would be an illusory trust.

I refer to that as a **"reserved-power "trust" arrangement"**. What is the UK tax analysis? This is unexplored territory.

Suppose a reserved-power "trust" arrangement, where the settlor is sole trustee, ie, suppose a trust such as in the *AQ* case, but assume that the proper law contained a reserved-power rule under which the trust was effective. It is considered that in UK law, and so for UK tax purposes, there is no trust, and hence no settlement, under the standard IT/CGT or IHT definitions. A UK court is not bound to classify an arrangement (to use a neutral word) as a trust (for the purposes of the UK tax definitions of settlement) just because the foreign law says there is a trust.[140]

Suppose a straightforward bare trust to which (under the foreign law) the rule in *Saunders v Vautier* does not apply: the beneficiary is not entitled to call for the trust property from the trustees. It is suggested that the UK tax analysis is:

[139] In *Re the AQ Revocable Trust* also reported under the name *BQ v DQ,* [2010] SC (Bda) 40 Civ at [17] the court held that reserved power provisions in the then Bermudan trust legislation merely codified the common law rules (but the Bermudan law has since changed).

[140] See 90.4 (How terminology may mislead).

(1) This is *not* a settlement within the IHT definition, because the property is held on trust, but not on trust for persons in succession.[141]

(2) This *is* a settlement within the standard IT/CGT definition, because the property is held on trust, and the settlor is not entitled to direct the trustees how to deal with the trust property.

Suppose a reserved-power "trust" arrangement, where the settlor is not trustee, ie, suppose a trust such as in the *Pugachev* case but assume that the proper law contained a reserved-power rule under which the trust was effective. It is arguable that the UK tax analysis is the same as a bare trust to which *Saunders v Vautier* does not apply. But while this is not a settlement within the IHT definition, the better view is that this is also not a settlement within the IT/CGT definition, as the settlor is entitled to direct the trustees how to deal with the trust property (by exercising the powers conferred by the trust deed).

87.16.3 *Foreign law testamentary trust*

It may be that:

(1) a trust would be classified as testamentary under English law principles; but

(2) it is not classified as testamentary under its proper law.

English law may recognise the validity of the testamentary provision under the Wills Act 1963. If the disposition is void in English law but valid in foreign law, the applicable conflict of law principles must be applied to see which legal system has priority. The starting point is the domicile of the settlor and the situs of immovable property. Prior to the death, there is a bare trust, at least for UK tax purposes, just as for an illusory trust.

This particular conflict issue arises with American grantor trusts, see 90.10 (US grantor trust).

87.17 Consent powers

The question arises as to the classification of a power to appoint to whoever the powerholder directs, subject to the consent of a second person. I refer to that as "**a consent power**".

A consent power is not a general power. This was decided in *Re*

[141] Another possible analysis is that the settlor has a general power over non-settled property. A general power over non-settled property is property for IHT purposes; in particular, it is not a "settlement power" (which is disregarded for IHT purposes).

Churston and is clearly right on principle:

> the reason why a general power of appointment in the ordinary sense starts a new settlement, and has not got to be read back into the original settlement, is because the property is treated as vesting in the donee of the general power, though it is not quite strictly accurate to say that it does so; or, in other words, that the test really is: is there somebody who for all practical purposes can be treated as the owner? [142]

A consent power is not the equivalent of ownership.

Churston, it seems to me, successfully cleared up a confusion left by three earlier cases: *Watts*, *Dilke*, and *Philips*. For completeness I consider these cases to explain that confusion.

In *Re Watts*,[143] a consent power was also held not to be a general power. In this case however the court laid some stress on particular features of the power concerned:

(1) The consent power was conferred by a trust made in consideration of marriage.
(2) The consent power was exercisable during the lifetime of the consentor.
(3) The consentor had to consent both to the exercise of the power of revocation and to the exercise of the power of new appointment.

But as *Churston* pointed out, these features have no bearing on the central question of whether the power is equivalent to ownership.

> I cannot think that for the purpose of applying the rule against perpetuities a power to appoint as A thinks fit with the consent of B can have a different effect according to whether it is in a marriage settlement or in any other settlement.[144]

Quite so.

> a power to A to appoint to anybody he thinks fit during the life of B would be a general power of the common kind, though it could not be exercised after the death of B; by the terms of its creation it would thereupon cease to be a power at all. Likewise, a power to A to appoint to anybody he might think fit during a period of 21 years would appear to me to be a general power of the common kind, though obviously it

[142] [1954] Ch 334 at p.347.
[143] [1931] 2 Ch 302.
[144] [1954] Ch 334 at p.342.

> could not be exercised after the expiration of the term of 21 years...[145]

Quite so.

> Then he said that regard must also be had to the fact of "her consent in writing being given both to the exercise of the power of revocation and to the exercise of the power of new appointment." Again, I cannot appreciate the bearing of that. The two things are different things.[146]

So in conclusion:

> I therefore cannot say that I can see any real ground of distinction on those facts between *In re Watts* and *In re Dilke* and *In re Phillips*, neither of which, as far as I can make out, really throws any particular light on the present question.[147]

So the decision in *Watts* was correct; but not on the ground that its consent power was different from powers which *Dilke* and *Phillips* considered to be general powers; but on the ground that those cases were not relevant to the definition of "general power".

What were those two cases? *Re Dilke*[148] concerned a consent power which the powerholder exercised so as to confer a general testamentary power on herself, which did not require a consent.[149] The question was whether the consent power was validly exercised. This was a question of construction, and the exercise of the power was rightly held valid. The court described the power as "a general power of appointment to be exercised with certain consent". The question whether the consent power had to be categorised as a general power did not arise and I do not think that the court decided it.

Re Phillips[150] concerned the insolvent powerholder rule: the holder of a consent power exercised the power and then died insolvent. The question was whether the appointed funds were available for the disappointed creditor – and it was held that they were. The case could have been decided on the basis that the consent power was a general power; but it

[145] [1954] Ch 334 at p.342.

[146] [1954] Ch 334 at p.342

[147] [1954] Ch 334 at p.343

[148] [1921] 1 Ch 34.

[149] [1921] 1 Ch 34. It seems that this was done because of a concern that the donee may lose mental capacity. I suspect there were death duty implications; but it does not matter.

[150] [1931] 1 Ch 347.

could equally have been decided on the basis that the insolvent powerholder rule applied on the exercise of a consent power even though it was not a general power: "the equity of the creditors is as strong as if it were an unfettered general power which the testator could exercise without consent." The court did not clearly distinguish the two possible analyses, but the consent power was not held, or at least not clearly held, to be a general power.

Churlston was approved in *Re Triffitt's Settlement*, which again concerned a consent power:

> for the purposes of the rule against perpetuities, a power such as I have read must be treated as a special or limited power. That seems to be the effect of *In re Watts* and *In re Churston Settled Estates*.[151]

[151] [1958] Ch 852 at p.861. For completeness: the Judge continued: "... On the other hand, under the now obsolete Legacy Duty Act, 1796, it would seem that a power in these terms has the character of a general power: see *Platt v Routh* (1841) 3 Beav 257." But *Platt v Routh* did not concern a consent power, but a general testamentary power exercisable by will in favour of anyone in the world other than three named families; so this is not relevant here.
Re Churlston was also approved in *TMSF v Merrill Lynch Bank* [2011] UKPC 17.

CHAPTER EIGHTY EIGHT

ESTATES OF DECEASED PERSONS: CGT

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88.14 Succession under foreign law

Cross references

The following topics are considered elsewhere:
89.21 (Tax returns & registration)

88.1 Succession law background

On the death of a person domiciled in England (the "**deceased**"):

(1) Their property passes to their personal representatives ("**PRs**").[1] The

[1] Scots law is in this respect the same: *Cochrane's Executors v IRC* 49 TC 299. Further consideration is needed if a foreign law applies: see 88.14 (Succession under foreign law).

property is known as the "**deceased's estate**" or more formally, the estate of a deceased person in the course of administration. Where the context is clear this may be abbreviated to "**estate**".

(2) Provided that there are sufficient assets available, the PRs:
  (a) pay the deceased's debts, and taxes
  (b) pay pecuniary legacies
  (c) transfer property which the deceased has specifically gifted

(3) Finally, the PRs transfer the residue of the estate to the residuary legatees. Thus on completion of the administration, the residuary legatees become entitled to the assets of the estate, and any income which the PRs have not spent.

(4) It is possible for PRs to transfer specific assets to beneficiaries before completion of administration.[2]

When PRs transfer an asset to a beneficiary, the formal legal terminology is that they "assent to the vesting of the asset in the beneficiary",[3] which may be abbreviated to "**assent**". But outside formal legal contexts, I prefer the word "transfer". That seems clearer to readers unfamiliar with succession law terminology; there are differences between an assent and other types of transfer, but they are not relevant here.

88.1.1 *Estate is not a trust*

During the period of administration, the PRs alone are said to be entitled to the assets which are comprised in the estate. The beneficiaries of the estate have a chose in action, the right to compel due administration of the estate. But it is well settled that:

(1) Beneficiaries have no legal or equitable interest in the assets of the estate.[4]

(2) Property in the estate is not settled property, and an estate is not a trust or settlement, in the normal sense of those words or within the

[2] CG30920 raises the possibility that this is not the case in Scotland.

[3] See s.36 Administration of Estates Act 1925, set out at 89.5 (Income from specific legacy).

[4] *Sudeley v Attorney-General* [1897] AC 11; this principle was re-affirmed in *CSD v Livingston* [1965] AC 694. For a survey of the cases, see *Re Hemming* [2009] Ch 313. At first sight the principle seems rather odd, at least to an English lawyer; for an explanation and legal analysis of the nature of an estate, see Smith, "Scottish Trusts in the Common Law" (2013) 17(3) Edin LR 283 reprinted in Valsan (ed), *Trusts and Patrimonies* (2015) chap 7 at p.133.

IT/CGT or IHT definitions.[5] This is so even if the will creates a trust.

Special tax rules apply during this period of administration. The rules produce some curious results where the deceased, or a beneficiary, is a remittance basis taxpayer or non-resident. There can sometimes be scope for tax planning.

This chapter considers CGT, and the following chapter income tax.

The starting point is that PRs are "persons" (though not "individuals") so they are in principle subject to IT and CGT. An estate, like a trust, is not itself a legal person.[6]

Similar issues arise where charities are beneficiaries of estates, as to which see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*.[7]

88.2 Period of administration

How long does the administration period last? This is a question of succession law, not tax law, but it often arises in tax contexts, including income tax, CGT, and IHT, and has given rise to a substantial case law.

In *Sudeley v Attorney-General*:[8]

> The thing that the legatee was entitled to was one-fourth share of a residuary estate, consisting, it may be, of many things; and I think it was fallacious on the part of [counsel] to say that the residue was very nearly ascertained, because the question is not only of amount – although I think that of itself would not be sufficient if it were only of amount – but it is a question of substance as well as a question of amount. It is uncertain until the residuary estate has been ascertained of what it will consist ...
>
> Until the thing has been ascertained, until the trust fund has been constituted, the thing of which the trustees are the trustees has not been ascertained. Whether you treat them, therefore, as trustees or executors, the same consideration arises. Now, if the only thing that the legatee is

[5] This rule is sometimes reversed by express statutory provisions.

[6] This is self-evident, but if authority is needed, see *Piggott v Aulton* [2003] EWCA 24. Although Arden LJ at [21] referred to an estate as "a person without legal personality" it would be more accurate to refer to it as an *entity* without legal personality.

[7] (14th ed., 2024-25), Ch's 33/34 (Estates of Deceased Persons: CGT/Income Tax) online version *https://www.taxationofcharities.co.uk*

[8] [1897] AC 11.

> entitled to is the fourth share of an ascertained residuary estate, I say that to my mind it is impossible to maintain that the character of any part of that estate can be ascertained so as to make it possess a specific locality until that has happened; it is a condition precedent to know what the residuary estate is, and until that has been ascertained you cannot tell of what it will "consist."

In *IRC v Aubrey Smith* the CoA cited this and said:

> .... until the fact is ascertained, or can or ought to be inferred, that the residue has become defined so that the aliquot portion passing to the beneficiary can also be defined, the beneficiary has not, until that time, a definite interest in the sum which will ultimately fall to him. ... it appears to me ... that it is largely a question of fact. ...
> What has to be determined here ... is: Is it clear that the portion of each of the sons is ascertained, or has been ascertained, or is capable of ascertainment, and that ascertainment has been assented to by the executor-trustees?[9]

The important points which emerge from the case law are that PRs continue to hold an asset as PRs until:

(1) they transfer an asset to a beneficiary; or
(2) the administration of the estate is complete (at which point there is an implied assent). For this purpose:
    (a) The estate must be completely ascertained. It remains in the course of administration even though this work is nearly done.
    (b) The fact that debts of the deceased remain unascertained or unpaid is a relevant factor but not decisive.
    (c) The fact that the PRs regard themselves as administering the estate (producing "estate accounts" and not trust accounts) is a relevant factor but not decisive.
    (d) In a marginal case the issue is classified as one of fact and there is a broad "grey area" in which the courts will not interfere with a decision of the first-tier tribunal.

The TSE Manual provides:

> **TSEM7360 Definition Of Period Of Administration** [Oct 2019]
> The period during which the personal representatives are settling the estate is called the period of administration. It starts on the day

[9] 15 TC 661 at p.672.

> following[10] the date of death of the deceased person and ends when the personal representatives have taken all the steps necessary to complete the administration of the estate.
>
> The question of when an administration period ends is essentially one of fact and will depend on individual circumstances. It may in some cases coincide with the date when the residue of the estate can be identified. Sometimes the date of issue of the Inheritance Tax clearance certificate is taken as the date the administration was completed.
>
> You should normally accept that the administration ended on the date the personal representatives tell you it did. ...

The CG Manual provides:

> **CG30700 Period of administration** [Jul 2019]
>
> The period during which the personal representatives are settling the estate is called a period of administration. The period starts with the death of the deceased person. The date on which it ends is a question of fact which is often difficult to resolve. During this period the liability for CGT on sales of assets from the estate falls on the personal representatives unless they have taken specific steps to vest the ownership of the assets involved in legatees in advance of the sale, see CG30900.
>
> When considering when administration is complete the Courts look for a construction of the law that leads to an early conclusion of administration. The leading case in this respect is *IRC v Aubrey Smith* 15 TC 661.
>
> In his judgement Lord Hanworth MR set out a principle of general application when he said, at the bottom of page 675, top of page 676
>
> > "The question is, in all cases: has the administration of the Estate reached a point of ripeness at which you can infer an assent, at which you can infer that the residuary estate has been ascertained and that it is outstanding and not handed over merely for some other reason."
>
> On this basis we would normally argue that the period of administration ends when residue has been ascertained, see CG30780+.
>
> **CG30710 Extended period of administration** [Jul 2019]
>
> There are some exceptional cases where all the figures are apparently available to enable residue to be ascertained but it has to be accepted that the period of administration is continuing.
>
> One example is where distributing shares in accordance with legatees' fractional entitlements to residue would result in one legatee receiving a majority shareholding whilst the other legatees would only receive minority holdings. Because of the disparity in values between majority and minority holdings it may be necessary for the personal representatives to apply the rule from *Lloyd's*

[10] Author's footnote: Whether period starts on the death, or on the day following the death, depends on rules relating to whether the law takes regard of parts of a day; but the issue is not likely to arise in practice.

Bank v Duker and others [1987] 3 All ER Ch D 193. This would require them to sell these shares rather than distributing them in specie.

The period of administration would continue in such a case until the shares were sold and the CGT liability arising to the personal representatives was quantified.

The rule referred to above is of fairly limited application. The fact that a majority shareholding would be broken into minority holdings on distribution should not be accepted as preventing distribution of shares and thus the ending of the period of administration. Nor should minor valuation differences between minority shareholdings passing to the legatees be accepted as covered by the rule in the *Duker* case.

The period of administration may also be extended where the distribution of the estate is being challenged. The personal representatives may be unable to distribute the estate pending the outcome of litigation.

CG30720 Confusion over terminology [Jul 2019]

Even where ascertainment of residue marks the end of the administration period for CGT purposes, assets may remain in the hands of the personal representatives after that date. They may have to carry out administrative acts regarding transfer of assets to legatees. In some cases they may sell assets. If so they will be doing this as bare trustees for the legatees. Personal representatives and their agents sometimes regard these acts as forming part of the period of administration. This may lead to confusion when references are made to the period of administration.

Because of the possible confusion it is important to establish precisely what is meant when a reference is made to a period of administration. From HMRC's side we can try to avoid this confusion for the majority of cases by referring to events as falling before or after residue has been ascertained rather than simply referring to the period of administration.

CG30780 Necessary to establish if residue ascertained [Jul 2019]

There are a number of circumstances where it is important to establish whether residue has been ascertained, see CG30700, because it significantly affects the amount of CGT payable. Depending on the circumstances, the personal representatives and legatees may be arguing for residue having been ascertained at an early date or, less commonly, at a late date.

CG30781 Early date [Jul 2019]

If there is a will the personal representatives and legatees may claim that administration has ceased and residue has been ascertained at an early date if:

- the legatees would be liable at a lower rate of CGT than the personal representatives on the disposal of assets in the estate
- have any unused annual exemption that could be used to cover the gains
- the legatee is a charity and any gain on the disposal would be exempt.

You will only see claims under the first two bullet points in cases of intestacy as a charity will not qualify as a legatee under the rules of intestacy.

Applying the rule that assets remain vested in the personal representatives until residue has been ascertained unless specific steps have been taken to vest the assets in advance of ascertainment of residue usually defeats unwarranted claims in this area.

CG30790 Late date [Jul 2019]

There may be cases where it will be to the taxpayers' advantage to argue that there has been an extended period of administration. For example, there may be a small advantage if the personal representatives have any unused annual exempt amount and the legatee doesn't or the personal representatives may have unused losses that will be lost.

Unless it is an exceptional case where there are good reasons for accepting that the period of administration must be extended beyond the date residue is ascertained, see CG30710, you should seek the full facts to enable you to determine when residue became ascertainable. You should then argue that the beneficial ownership of the assets vested in the legatees at that date. As stated in CG30700 the attitude of the Courts is to look for an interpretation that allows administration to be completed at an early date.

Unquantified debts

One claim that is sometimes met is that there is an unquantified debt preventing residue being ascertained. This may not be sufficient to prevent the administration period being treated as at an end. Such a situation was considered in *IRC v Aubrey Smith* 15 TC 661. Lord Hanworth commented at page 674

> 'For my own part I think the question of a mortgage debt or any other debt must take its proper place in perspective. It may be in some cases that that is a factor from which a strong inference may be drawn. It may be on the other hand that the device of leaving a debt unpaid is resorted to in order to pretend that the residue of the estate has not been ascertained and is not ascertainable. If such a device were resorted to in any case it ought to be held ineffective'.

When a Solicitor or other professional person is employed by the personal representatives to deal with the administration of the estate, his or her fees will be one of the estate's debts. Sometimes when personal representatives wish to extend the period of administration they arrange that the Solicitor, etc, does not submit a bill in respect of at least some part of his or her fees. They then argue that this has prevented ascertainment of residue and has caused the period of administration to be extended. Any such claim should be resisted on the basis of the above quotation. It should be contended that the information to quantify the bill must be in the Solicitor's records and that administration should therefore be considered to have ended.

CG30800 How residue is ascertained [Jul 2019]

In order to ascertain residue the personal representatives must identify all the assets and liabilities of the estate. They then need to quantify these.

In the case of taxation liabilities this process will start with settling any Income Tax and CGT liabilities to the date of death. If any income arises to the personal representatives or if they realise any chargeable gains during the period of administration they will also need to agree their own liabilities for this period.

As far as Inheritance Tax is concerned the personal representatives will need to inform HMRC - Trusts and Estates IHT whether any liability arises and if so in what amount. As part of the process of seeking a grant of probate or letters of administration (or, in Scotland, a confirmation) the personal representatives have to supply HMRC - Trusts and Estates IHT with a provisional computation of the Inheritance Tax due. HMRC - Trusts and Estates IHT will review this

> and, where necessary, check valuations. When the amount, if any, of Inheritance Tax payable has been quantified HMRC - Trusts and Estates IHT will issue clearance. We would not normally accept that residue had been ascertained at a date before the date of issue of a clearance. See IHTM05001+ for detailed guidance on the Inheritance Tax procedures.
>
> **CG30810 Providing funds** [Jul 2019]
>
> When the assets and liabilities have been quantified the personal representatives have to consider how they can pay
>
> - the estate's liabilities and
> - any pecuniary legacies provided for in the will.
>
> If they do not have sufficient liquid funds they will have to sell assets in order to raise funds. Occasionally they may agree with legatees entitled to pecuniary legacies that the legatee should accept an asset in satisfaction or part satisfaction of the pecuniary legacy.
>
> Disposing of assets may give rise to further CGT liabilities which have to be agreed before residue can be ascertained.
>
> Residue is only ascertained when the personal representatives have both established the net worth of the estate and provided the liquid funds to pay liabilities and pecuniary legacies. Once that point is reached residue is ascertained and it is irrelevant that the assets have not been distributed.

Administration is normally completed on approval of final estate accounts, unless the executors postpone making final accounts for some non-estate reason (eg to obtain a tax advantage); or if they decide not to produce final accounts (eg if they decide not to bother).

An application for an IHT certificate of discharge may have the effect of extending the administration period, which may be advantageous.[11]

88.2.1 *Executor's year*

Section 44 AEA 1925 provides:

> ...a personal representative is not bound to distribute the estate of the deceased before the expiration of one year from the death.

The CG Manual provides:

> **CG30820 Executor's year** [Jul 2019]
>
> [The Manual refers to s.44 AEA 1925 and continues:] This is commonly referred to as the executor's year.
>
> When dealing with a dispute about whether a disposal was by personal representatives in that capacity or in their capacity as bare trustees for legatees we would not normally contend that the disposal was on behalf of the legatees if it took place during the executor's year.

[11] See 125.17.9 (Informal IHT clearance).

> Although personal representatives cannot be compelled to distribute assets during the executor's year there is no bar to them doing so. In a simple estate they may have ascertained residue well before the year ends. If there is evidence that they have done and have then distributed assets to the legatees we can accept that the liability relating to disposals during that year but after the date assets were distributed does lie with legatees.
>
> *Scotland*
>
> In Scotland the rule is that the personal representatives are entitled to distribute the estate after six months from the deceased's death if they have provided funds for payment of all the estate debts and made reasonable enquiries for claims.

88.2.2 *Importance of assent*

PRs transfer assets to beneficiaries by means of an "assent". The assent is fundamental:

(1) A sale after an assent to a non-resident or a remittance basis taxpayer may in broad terms be free of CGT and a sale before assent may not.

(2) Conversely a sale by non-resident PRs or PRs with losses may be CGT free and a sale after an asset may be taxable.

An assent of land in England and Wales must be in writing. An assent of other property may be oral or implied by conduct. No formal written assent is required if (say) shares are simply transferred to the name of a beneficiary by stock transfer form. If shares are registered in the names of PRs (or their nominees), and the legatee wants them to be sold, it may be administratively convenient if an assent is made under which the PRs (or their nominees) become nominees for the legatee. Then the shares can be sold without CGT (assuming a non-resident legatee or if the remittance basis applies) without the formality of a transfer of legal title to the legatee.

88.3 PRs: Meaning for CGT/IT/CT

Section 1119 CTA 2010/s.989 ITA provide the same definition. For the purposes of the Corporation Tax/Income Tax Acts:

> "personal representatives", in relation to a person who has died, means—
>
> (a) in the UK, persons responsible for administering the estate of the deceased, and
>
> (b) in a territory outside the UK, those persons having functions

> under its law equivalent to those of administering the estate of the deceased.

Section 288 TCGA incorporates this definition for CGT:

> "personal representatives" has the same meaning as in the Corporation Tax Acts (see section 1119 of CTA 2010);

So the same definition applies for CGT/IT/CT.[12] This might be regarded as a commonsense definition.

88.4 Residence of PRs for CGT

PRs are a distinct taxable unit for CGT.[13]
Section 62(3) TCGA provides:

> In relation to property forming part of the estate of a deceased person
> [a] the PRs shall for the purposes of this Act be treated as being a single and continuing body of persons (distinct from the persons who may from time to time be the PRs), and
> [b] that body shall be treated as having the deceased's residence and domicile at the date of death.

Section 62(3)[a] is similar to the distinct-person rule which applies to trustees.[14] The minor differences in wording[15] do not seem significant.

The definition of PRs' residence for CGT is different from the definition for IT.[16]

The residence and domicile of the PRs in their private capacity is irrelevant.

The reference to domicile is otiose, as there are no provisions where the domicile of PRs matters for CGT purposes; though there have been such provisions in the past.

88.5 Acquisition by PRs

88.5.1 *Rebasing on death*

Section 62(1) TCGA provides:

[12] But there is a different definition for IHT: see 125.2 (Meaning of "PRs" for IHT).

[13] See 7.3 (Trustees a distinct person).

[14] See 7.3 (Trustees a distinct person).

[15] Trustees are treated as a single person; PRs are treated as a single and continuing body of persons.

[16] See 89.3 (Residence of PRs for IT).

> For the purposes of this Act the assets of which a deceased person was competent to dispose—
>
> (a) shall be deemed to be acquired on his death by
>
> [i] the personal representatives or
>
> [ii] other person on whom they devolve[17]
>
> for a consideration equal to their market value at the date of the death...

I refer to this as **"CGT rebasing on death"**; the terms "uplift/forgiveness on death" are also used.

Rebasing will also nullify a capital loss, although losses are less common, given that gains/losses are calculated without regard to inflation; and there may be scope for tax planning to avoid this.[18]

88.5.2 *No disposal by deceased*

Section 62(1) TCGA provides:

> For the purposes of this Act the assets of which a deceased person was competent to dispose ...
>
> (b) shall not be deemed to be disposed of by him on his death (whether or not they were the subject of a testamentary disposition).

88.5.3 *Competent to dispose*

Section .62(10) TCGA defines the expression "assets of which a deceased person was competent to dispose":

> In this section references to assets of which a deceased person was competent to dispose
>
> [a] are references to assets of the deceased which (otherwise than in right of a power of appointment or of the testamentary power conferred by statute to dispose of entailed interests) he could, if of full age and capacity, have disposed of by his will, assuming that
>
> [i] all the assets were situated in England and,
>
> [ii] if he was not domiciled in the UK, that he was domiciled in England,
>
> [b] and include references to his severable share in any assets to which, immediately before his death, he was beneficially entitled as a joint tenant.

[17] See 88.14 (Succession under foreign law).

[18] See 65.12.2 (Unrealised loss at death).

88.5.4 *Legatee given share of assets*

The CG manual provides:

> **CG31140: acquisitions by legatees** [Jul 2019]
> ... Where a single asset passes to a legatee this is straightforward. Where divisible assets such as a holding of shares have to be shared out amongst legatees or where legatees become joint owners of an indivisible asset such as land, the acquisition cost of each legatee's share is an appropriate fraction of the market value of the holding or asset acquired by the personal representatives, see CG74244.
> **Example**
> On 31 December 2013 personal representatives acquire the deceased's shareholding of 600 shares in a company. This represents a 60% holding in that company and is valued at £60,000 or £100 per share. On the date of death a holding of 200 shares or 20% of the company would have been valued at £2,000 or £10 per share.
> When residue is ascertained each of the three legatees receives 200 shares from the personal representatives. They are each treated as having an acquisition cost of one-third of £60,000 (the personal representatives acquisition value). Their acquisition cost is thus £20,000 not the value of £2,000 that would have been placed on a 20% shareholding.
> In addition the personal representatives acquire the sole ownership of a parcel of land. This is valued at £100,000 at the date of death. On this date a 50% interest in the land would have been valued at £45,000.
> When residue is ascertained two legatees become equal joint owners of the land. They are each treated as having an acquisition cost of one-half × £100,000 (the personal representatives acquisition cost). Their acquisition cost is thus £50,000 for their 50% interest not the value of £45,000 that would otherwise have been placed on such a holding at the date of death.

88.5.5 *Rebasing on death: Planning*

CGT rebasing on death allows CGT avoidance which HMRC regard as acceptable, or at least, effective. The GAAR guidance provides two examples. This does not directly concern the themes of this book, but I discuss it as it sheds light on tax planning involving inter-spouse transfers, discussed elsewhere.

The first example concerns an inter-spouse gift made four months before death:

D19 Gifts between spouses: Mr and Mrs Jones

This example is intended to illustrate standard tax planning on gifts between spouses.

D19.1 ***Background***

D19.1.1 This example considers the CGT position on an arrangement involving a gift of shares between spouses, followed by death of the transferee.

D19.2 ***The facts***

D19.2.1 In January 2012 Mr and Mrs J are told that Mrs J is terminally ill.

In February Mr J gives his shares in an investment company,[19] which are standing at a significant gain, to his wife.

Under the terms of her Will as drafted at the date of the gift he will inherit those shares when she dies. Mrs J has full capacity at the time of the gift.

D19.2.2 Mrs J dies in June and the shares pass to Mr J under the terms of her Will.

Mrs J has not executed a new Will since the gift.[20] ...

D19.4 ***The taxpayer's tax analysis***

D19.4.1 The gift of the shares is a transfer between a husband and wife who are living together. This transaction is treated by s58 TCGA 1992 as taking place for such consideration as will give rise to neither a gain nor a loss.

D19.5 All the assets of the deceased which pass to his or her personal representatives are deemed to have been acquired by them at market value at the date of death under s62(1)(b) TCGA 1992. When beneficial ownership of any asset of the estate passes from the personal representatives to a legatee, S62(4)(a) TCGA 1992 provides that no chargeable gain shall accrue to the personal representatives.

D19.5.1 In summary, there is no chargeable gain on the gift of shares by Mr J to Mrs J and Mr J re-acquires the shares at market value at the date of his wife's death. In effect, the gain that has accrued during the earlier ownership of shares by Mr J has disappeared.

D19.6 ***What is the GAAR analysis under s.207(2) FA 2013?***

D19.6.1 The main purpose of the arrangement is to obtain a tax advantage. The gift of shares was made by Mr J in the hope of washing[21] out the gains on the understanding that his wife would leave them back to him.

D19.6.2 *Are the substantive results of the arrangements consistent with any principles on which the relevant tax provisions are based (whether express or implied) and the policy objectives of those provisions?*

Yes. The principle of s58 TCGA 1992 is to allow assets to be transferred between spouses and between civil partners on the basis of no gain/no loss.

Assets passing on death to personal representatives are treated as taking place

[19] The nature of the company is not significant. Perhaps the point is that the company does not qualify for BPR, but nothing much follows from that.

[20] It can hardly make a difference if Mrs J changes her existing will (under which, we are told, the shares return to Mr J).

[21] I would hesitate to use the term "wash", but the GAAR guidance uses it in an apparently neutral non-pejorative sense.

> at market value and no gain is charged when the assets are passed to the legatees.
> D19.6.3 *Do the means of achieving the substantive tax results involve one or more contrived or abnormal steps?*
> The means of achieving the tax results depend upon the gift, the death of Mrs J and her choosing to leave the shares to Mr J in her Will. There are no abnormal or contrived steps here; the transactions are normal arrangements between spouses or civil partners.
> D19.6.4 *Are the arrangements intended to exploit any shortcomings in the relevant tax provisions?*
> No.
> D19.6.5 *Do the tax arrangements accord with established practice and has HMRC indicated its acceptance of that practice?*
> Yes. HMRC sets out in its instruction manuals how these transactions are to be treated for CGT purposes.[22]
> D19.7 ***Conclusion***
> D19.7.1 These arrangements can reasonably be regarded as a reasonable course of action in relation to the tax provisions having regard to all the circumstances. The GAAR would not apply.

In the second example the gift is made on the day of death:

> D19.8 ***An alternative arrangement - What if the facts were the same as those above but the gift of shares was made on the day of Mrs J's death?***
> D19.8.1 HMRC's view is that so long as Mrs J was in full capacity at the time of the gift the analysis would be the same and that the GAAR would not apply. This assumes of course that the gift was validly completed prior to death.

The GAAR analysis is shallow. Guidance to the opposite effect in example 1 would read no less convincingly, and the acceptance of the scheme in the second example is surprising, at least at first glance. But if the first example is right, and the second is GAARable, it would be impossible to see where to draw the line between them. An advantage of the GAAR guidance view is that there is no need to draw that line.

Border demarcation issues still arise. For instance:

(1) If one accepts that the GAAR does applies in the case a gift to a spouse with no legal capacity made the day before the death, what about a gift made (say) four months before the death? Or 12 months? Or if the will made provision to a child, but either the property qualified for BPR or else there was an IoV back to Mr J?

[22] Is this correct? The guidance does not give a Manual reference. As far as I am aware, the avoidance scheme is not considered anywhere in the CG Manual.

(2) The example assumes that Mrs J has an extant will in favour of Mr J. What if she did not, but made a new Will?

(3) What if there was a sale to Mrs J with the purchase price left outstanding (in which case the terms of the will would not matter much)?

Some commentators say that experienced advisers approaching the question ‘Is this arrangement abusive?’ with an open mind “are likely to be able to reach a reasonably accurate assessment of the answer”.[23] Readers who grapple with these issues may find it hard to agree. But perhaps it depends on the nuance one gives to the word “likely”.

In practice perhaps this planning does not happen much, but I wonder about that. Some empirical research would be needed to find the answer.

88.5.6 *Rebasing on death: Critique*

Some commentators call for the abolition of CGT rebasing on death. Thus the IFS:

> This is highly distortionary: it encourages people to hold on to assets that have risen in value, even if in the absence of tax considerations they would prefer to sell them and use the proceeds in some other way. It also encourages people to buy assets that yield returns in the form of capital gains rather than income and to convert income into capital gains where possible, in order to escape income tax. There is a strong case for getting rid of this relief.[24]

The usual answer to the abolitionists is that this would give rise to double taxation: CGT and IHT on death.[25] That response is emotively and politically effective; though it is not true economic double taxation.

[23] For instance, Jolyon Maugham KC in his blog: *http://waitingfortax.com/2014/11/14/a-gaar-specific-penalties-regime-some-policy-choices-taxnerdery/* (2014).

[24] IFS Green Budget: October 2018 *https://www.ifs.org.uk/publications/13508*

[25] More radically, abolition of IHT and imposition of CGT on death would be a simplification. See Kessler, “The Quest for Fair Inheritance Taxation of Trusts” (2015)
https://www.kessler.co.uk/wp-content/uploads/2014/08/Kessler-The-Quest-for-Fair-Inheritance-Taxation-of-Trusts.pdf
OTS briefly float the idea, without conclusions: OTS, “Inheritance Tax Review – second report: Simplifying the design of Inheritance Tax” (July 2019) para 4.5ff. estimating a £1.6 billion loss to HMRC. It is a pity that the opportunity was lost to consider the point in depth.

OTS suggest replacing rebasing on death with a no gain/no loss transfer in situations where an IHT exemption applies. There is logic in that; though the proposal is the opposite of simplification.[26]

The law which allows the planning discussed above is hardly satisfactory. Assuming CGT rebasing on death remains, the solution, it seems to me, is to abolish the CGT spouse exemption. It might usefully be replaced by hold-over relief on divorce, where CGT hold-over relief *is* needed.[27]

88.6 Rebasing on death of life tenant

Although not strictly relating to the *estate* of a deceased person, this is a convenient place to consider the similar rebasing which applies on the death of a life tenant with an estate IIP. The drafting is clumsy, no doubt in part for historical reasons. The rules are set out in s.72/73 depending on whether the trust terminates/continues. It is convenient to consider these side by side:

s.72(1) TCGA (trust terminates)	**s.73(1) TCGA (trust continues)**
On the termination, on the death of the person entitled to it, of an interest in possession in all or any part of settled property	[i] Where, by virtue of section 71(1), the assets forming part of any settled property are deemed to be disposed of and reacquired by the trustee on the occasion when a person becomes (or would but for a disability become) absolutely entitled thereto as against the trustee,[28] [ii] then, if that occasion is the death of a person entitled to an interest in possession in the settled property

[26] OTS, "Inheritance Tax Review – second report: Simplifying the design of Inheritance Tax" (July 2019) para 4.27 ff. OTS ducks the technical challenges ("The government would need to consider how this could be done in a way which minimised valuation complexities where assets are only partially exempt from Inheritance Tax.") *https://www.gov.uk/government/publications/ots-inheritance-tax-review-simplifying-the-design-of-the-tax*

[27] The professional bodies have lobbied unsuccessfully for this over the decades. The CGT spouse exemption is not usually applicable on a divorce (because that exemption applies only in a year where spouses are living together; and by the time of the transfer, cohabitation is likely to have ceased).

[28] See 56.21.5 (Disposal on trust termination).

(a) the whole or a corresponding part of each of the assets forming part of the settled property and not ceasing at that time to be settled property shall be deemed for the purposes of this Act at that time to be disposed of and immediately reacquired by the trustee for a consideration equal to the whole or a corresponding part of the market value of the asset; but	
(b) no chargeable gain shall accrue on that disposal...	(a) no chargeable gain shall accrue on the disposal ...

Section 72(1A)/73(2A) restrict rebasing to estate interests in possession:

(1A) Where the interest in possession mentioned in subsection (1) above is one to which the person becomes entitled on or after 22nd March 2006, the first sentence of that subsection applies in relation to that interest only if (a) immediately before the person's death, the interest falls within subsection (1B) below, or (b) the person dies under the age of 18 years and, immediately before the person's death, section 71D of the Inheritance Tax Act 1984 (age 18-to-25 trusts) applies to the property in which the interest subsists.	(2A) Where the interest in possession referred to in subsection (1) above is one to which the person becomes entitled on or after 22nd March 2006, subsections (1) and (2) above apply in relation to that interest only if (a) immediately before the person's death, the interest falls within section 72(1B), or (b) [identical]

Section 72(1B) TCGA (which applies for both s.72/73) provides the standard concept of (what I call) an estate IIP:

> (1B) An interest falls within this subsection if
>
> (a) the interest is
>
> (i) an immediate post-death interest, within the meaning given by section 49A of the Inheritance Tax Act 1984,
>
> (ii) a transitional serial interest, within the meaning given by section 49B of that Act, or
>
> (iii) a disabled person's interest, within the meaning given by section 89B of that Act, or
>
> (b) section 71A of that Act (trusts for bereaved minors) applies to the property in which the interest subsists.

88.6.1 *Rules applicable to s.72 & s.73*

Section 73(3) TCGA provides:

> The last sentence of subsection (1) of section 72 and subsections (3) to (6) of that section shall apply for the purposes of this section as they apply for the purposes of section 72(1).

These provisions of s.72 are therefore apply equally to s.72/73. Section 72 TCGA provides:

> (1) ... For the purposes of this subsection an interest which is a right to part of the income of settled property shall be treated as an interest in a corresponding part of the settled property.

Next a set of rules for annuities (now never seen in practice):

> (3) This section shall apply on the death of the person entitled to any annuity payable out of, or charged on, settled property or the income of settled property as it applies on the death of a person whose interest in possession in the whole or any part of settled property terminates on his death.
>
> (4) Where, in the case of any entitlement to an annuity created by a settlement some of the settled property is appropriated by the trustees as a fund out of which the annuity is payable, and there is no right of recourse to, or to the income of, settled property not so appropriated, then without prejudice to subsection (5) below, the settled property so appropriated shall, while the annuity is payable, and on the occasion of the death of the person entitled to the annuity, be treated for the purposes of this section as being settled property under a separate settlement.
>
> (5) If there is an interest in a part of the settled property and, where that is an interest in income, there is no right of recourse to, or to the income of, the remainder of the settled property, the part of the settled property in which the interest subsists shall while it subsists be treated for the purposes of this section as being settled property under a separate settlement.

Lastly the specialist topic of disabled person’s interests:

> (6) An interest which is a disabled person's interest by virtue of section 89B(1)(a) or (b) of the Inheritance Tax Act 1984 is to be treated as an interest in possession for the purposes of this section.

88.6.2 *Rules applicable to s.73 only*

Section 73(1)(b) TCGA disapplies rebasing where the trust property reverts to the settlor:

> if on the death the property reverts to the disponer,
> [i] the disposal and reacquisition under that subsection shall be deemed to be for such consideration as to secure that neither a gain nor a loss accrues to the trustee, and
> [ii] shall, if the trustee had first acquired the property at a date earlier than 31 March 1982, be deemed to be at that earlier date.

For completeness: s.73(1A) TCGA deals with sub-fund settlements.[29] But since the sub-fund regime is dead-letter law (hardly ever found in practice) the point does not matter.[30]

Section 73(2) TCGA deals with interests in possession in part:

> Where the interest referred to in subsection (1) above is an interest in part only of the settled property to which section 71 applies, subsection (1)(a) above shall not apply but any chargeable gain accruing on the disposal shall be reduced by a proportion corresponding to that represented by the part.

88.6.3 *Rule applicable to s.72 only*

For completeness: s.72 TCGA deals with the death of a life tenant where the interest continues, for instance, if A is given property for the lifetime of B (in practice this does not happen outside the textbooks):

> (1C) Subsection (1A) above does not have effect in relation to the operation of subsection (1) above as applied by subsection (2) below (but see subsection (2A) below).
> (2) Subsection (1) above shall apply where the person entitled to an interest in possession in all or any part of settled property dies (although the interest does not then terminate) as it applies on the termination of such an interest.

[29] "Subsection (1)(b) above shall be treated as having effect in relation to a sub-fund settlement if the property does not revert to the trustees of the principal settlement in relation to that sub-fund settlement by reason only that
(a) a sub-fund election is or has been made in respect of another sub-fund of the principal settlement, and
(b) the property becomes comprised in that other sub-fund settlement on the death of the person entitled to the interest in possession."

[30] See 63.2 (Sub-Fund regime).

> (2A) Where the interest in possession mentioned in subsection (2) above is one to which the person becomes entitled on or after 22nd March 2006
> (a) subsection (2) above, and
> (b) the first sentence of subsection (1) above as applied by subsection (2) above,
>
> apply in relation to that interest only if, immediately before the person's death, the interest falls within subsection (1B)(a) above.

88.7 Transfer from PRs to beneficiaries

88.7.1 *Transfer from PRs to legatee*

Section 62(4) TCGA provides:

> On a person acquiring any asset as legatee (as defined in section 64)—
> (a) no chargeable gain shall accrue to the personal representatives, and
> (b) the legatee shall be treated as if the personal representatives' acquisition of the asset had been his acquisition of it.

88.7.2 *"Legatee"*

The question whether a person acquires as legatee matters for 3 CGT purposes. In the case of an acquisition as legatee:

Rule	**Asset**	**See**
There is no disposal by PRs	Any	88.7.1
PRs expenditure deductible from legatee's gain on future disposal	Any	[31]
The legatee qualifies for CGT debt exemption on future disposal	Debt	56.22.1

Section 64(2) TCGA provides:

> In this Act, unless the context otherwise requires, "legatee" includes
> [a] any person taking under a testamentary disposition or on an

[31] Section 64(1) TCGA provides:

"In the case of a gain accruing to a person on the disposal of, or of a right or interest in or over, an asset held by another person as trustee, or as a personal representative of a deceased person, to which he became absolutely entitled as legatee or as against the trustee—

(a) any expenditure within section 38(2) incurred by him in relation to the transfer of the asset to him by the personal representative or trustee, and

(b) any such expenditure incurred in relation to the transfer of the asset by the personal representative or trustee,

shall be allowable as a deduction in the computation of the gain accruing to that person on the disposal."

> intestacy or partial intestacy, whether he takes beneficially or as trustee ...

Note this is an inclusive definition.

The definition is for the purposes of the TCGA, but similar wording is used elsewhere.

88.7.3 *Gift in anticipation of death*

Section 64(2) TCGA provides:

> In this Act, unless the context otherwise requires, "legatee" includes ...
>
> [b] a person taking under a donatio mortis causa [gift in anticipation of death] shall be treated (except for the purposes of section 62) as a legatee and his acquisition as made at the time of the donor's death.

Gift in anticipation of death is a specialist topic, as the arcane Latin tag suggests, but it does arise from time to time and also has some role in tax planning.[32]

The CG Manual provides:

> **CG30400: Donatio Mortis Causa** [Jul 2019]
>
> **Definition**
>
> A donatio mortis causa is a gift made in contemplation of the death of the donor which is intended to take effect only if the donor dies. If the donor recovers from his or her illness, etc., or if the donee dies first, then the gift is to have no effect i.e. it is void. If the gift is made in contemplation of death, it is presumed to be a donatio mortis causa even if the donor does not say that the gift is intended to be conditional on death occurring.
>
> Since the individual has given away these assets before his or her death, he or she is not able to dispose of them by will. They are therefore not `assets of which the deceased was competent to dispose'.
>
> **No gain /loss**
>
> For Capital Gains Tax purposes the practical effects of a donatio mortis causa are very similar to those for assets transferred on death. However the legislation arrives at this result in a different way. Instead of deeming there to be no disposal of the asset by the deceased, the legislation in TCGA92/S62 (5) says that no chargeable gain accrues to the person making the disposal. As allowable losses are to be computed

[32] See 67.5 (OIG charge on death).

in exactly the same way as gains, TCGA92/S16 (1), it also follows that no loss is allowable in respect of such a gift.

Position of donee

As TCGA92/S62 (5) merely removes the charge on the donee this means that for all other purposes the transfer by donatio mortis causa, being a gift, takes place at market value, TCGA92/S17 (1). Accordingly the donee is deemed to have acquired the asset at market value.

Donee: spouses or civil partners

Where a gift is made from one spouse or from one civil partner to the other, normally TCGA92/S58 (1) would say that the disposal should occur at such a figure as to give rise to no gain/no loss and TCGA92/S17 (1) would not apply. However, in the case of a donatio mortis causa this rule is disapplied by TCGA92/S58 (2). Thus all gifts by way of donatio mortis causa are dealt with in the same way.

Acquisition date for donee

A person acquiring an asset under a donatio mortis causa is treated as acquiring the asset at the time of the donor's death, TCGA92/S64 (2). In view of this the market value at which the asset is acquired is the market value at the date of death

CG31130: recipient under Donatio Mortis Causa is legatee [Dec 2018]

A person who receives a gift by way of donatio mortis causa, see CG30500+, is to be treated as a legatee for some limited purposes (TCGA92/S64 (2)). The person is not to be treated as a legatee for any of the purposes of TCGA92/S62 but is to be so treated for all other purposes of the Capital Gains Tax Acts. In particular this means that the provisions in TCGA92/S64 (1) allowing a deduction to a legatee for the cost of transferring an asset to that legatee, see CG31190, are to apply to such a recipient.

88.7.4 *Appropriation to legatee*

Section 64(3) TCGA provides:

[a] For the purposes of the definition of "legatee" above, and of any reference in this Act to a person acquiring an asset "as legatee",

[b] property taken under a testamentary disposition or on an intestacy or partial intestacy includes

[c] any asset appropriated by the personal representatives in or towards satisfaction of

  [i] a pecuniary legacy or

  [ii] any other interest or share in the property devolving under the disposition or intestacy.

In particular, if PRs appropriate assets in satisfaction of a pecuniary legacy, the beneficiary acquires as legatee. This is so even if the appropriation needs the consent of the beneficiary.[33]

If the PRs had no power of appropriation, then an "appropriation" could be authorised only on the basis that it was in fact a sale of the asset to a beneficiary coupled with payment of the legacy by way of set-off. In that case, the beneficiary may acquire as purchaser and not as legatee. In practice, PRs do generally have a power of appropriation,[34] so the issue does not often arise.

Further consideration is needed for foreign jurisdictions, especially civil law jurisdictions, where there may be no PRs in the UK law sense.[35]

Suppose:

(1) Under a civil law jurisdiction property passes on death to A and B in equal shares. A and B take as legatees.

(2) A and B then enter into a succession or partition agreement under which A takes some property and B takes other property (of equal value).

That agreement does not constitute a disposal for CGT purposes. In *Warrington v Brown* a division of land between co-owners (a partition

[33] Although for stamp duty purposes the transfer of the asset to a legatee constitutes a conveyance on sale, if the consent of the legatee is required: *Jopling v IRC* [1940] 2 KB 282.

For completeness: CCAB Statement June 1967 provided:

> "The Revenue stated that in their view [TCGA s.62(4)] does not apply in all cases where assets are transferred to beneficiaries in specie. Where assets are appointed by personal representatives to satisfy a legacy in circumstances where such appropriation requires the legatee's consent, ie where the personal representatives do not have (whether by the terms of the will or under the Administration of Estates Act 1925 s.41) powers of appropriation without consent, the Revenue are advised that the acquisition of the asset has a contractual basis and is not strictly an acquisition qua legatee. In practice, however, the disposal of appropriated assets by the personal representatives to a legatee in these circumstances is not treated as an occasion of charge on the personal representatives provided that both they and the legatee agree that the legatee should be treated as acquiring the assets concerned as legatee for the purposes of [TCGA s.62(4)]."

This was written before the enactment of what is now s.64(3) TCGA in 1969. This brought the law into line with what was formerly HMRC practice. So the CCAB Statement is obsolete.

[34] Section 41 Administration of Estates Act 1925.

[35] See 88.14 (Succession under foreign law).

agreement) was held not to constitute a disposal for CGT purposes:[36]

> Their interests in the mass precisely reflect the individual interests which they had before the deed was entered into. … one looks at the mass and not at the individual case in transactions such as the present, where property was put into a pool, and where that result is reached (that the interests in the mass precisely reflect the individual interests before the [division] deed was entered into) there is for capital gains tax purposes no disposal.

The reader may regard this as a surprising decision, but it is long established, not judicially doubted, and should be followed at least up to the level of the CoA. It should follow that A and B acquire their separate assets as legatees.

88.7.5 *Trustee as legatee*

CG Manual provides:

> **CG31110: who is a legatee: trustee as legatee** [Jul 2019]
> If a trust is created by the will or intestacy and does actually come into existence then the trustees of that trust are legatees in precisely the same way as, for example, an individual taking an absolute interest in an asset. This is confirmed by TCGA92/S64 (2). As a result the personal representatives are not liable to Capital Gains Tax for disposals after assets have vested in the trustees, see CG30760, and the trustees acquire the assets at market value, see CG31140.

88.7.6 *Trust ends during admin period*

CG Manual provides:

> **CG31110: who is a legatee: trustee as legatee** [Jul 2019]
> ...
> When assets pass to the remainderman of the will trust when it comes to an end, the remainderman does not receive the assets from the trust as legatee of the will but as a beneficiary of the trust. The transfer is therefore not exempted by reason of TCGA92/S62 (4), see CG31140. Unless any other exemption applies there will be a chargeable gain on the trustees at that time by reason of TCGA92/S71 (1), see CG37100+. This is in contrast to the position when a will or intestacy sets out to create a life interest trust but the life tenant dies during the period of

[36] Also called *Jenkins v Brown* 62 TC 226 at p.252.

> administration. In those circumstances no trust over specific assets ever comes into existence. The remainderman of the trust becomes the legatee under the will in place of the trustee. When the assets vest they vest directly in that remainderman. Accordingly the remainderman takes as legatee, there is no Capital Gains Tax charge at that time and the remainderman's acquisition cost is the market value at the date of death.

88.7.7 *Executors appoint to beneficiary*

Where executors exercise a power to appoint trust property to a beneficiary, that beneficiary takes under the appointment "as legatee". This follows from the trust law principle that, for the purposes of the rules relating to perpetuities, where trustees exercise a power of appointment, the deed of appointment is read back into the original trust instrument. It is treated as coming into operation at the date of the instrument that creates the power.[37]

Quite apart from that, the beneficiary would take as "legatee" in the general sense of the expression. The definition in s.64(2) is inclusive and not a comprehensive definition. The reason that the beneficiaries take as legatee is that they acquire under an assent. They acquire from the PRs acting in their capacity as PRs.

This conclusion is consistent with the general scheme of the TCGA. A person who acquires under an appropriation acquires "as legatee". It would be anomalous if a person who acquired under an appointment would not.[38]

HMRC agree. CG Manual provides:

> **CG31430 power to appoint** [Dec 2021]
> Where a deceased person's will directs that when assets of the estate vest they are to be held on trust, then the terms of that trust specified in the will may empower the trustees to appoint assets out of the trust to legatees. This is frequently because IHTA84/S144 (see IHTM35181) in specified cases treats the appointment, provided it is made within 2 years of death, for all IHT purposes as if it had been made in the will. There is no corresponding provision for CGT.
> The assets will normally vest in the trustees on the ascertainment of residue, see CG30940+. But, occasionally, specific steps may be taken

[37] See 87.5.7 (Trust appointment: Filling blanks).

[38] A power of appropriation is sometimes regarded as a dispositive power: *Re Freeston* [1978] Ch 741, though I would not regard that as essential to the argument.

> to vest assets in will trustees in advance of residue being ascertained see CG30900+. Where the trustees exercise their powers of appointment AFTER the assets have vested then the assets concerned will already have passed out of the estate and into the hands of the trustees. In these circumstances the exercise of the power of appointment so that a beneficiary becomes absolutely entitled amounts to a disposal for CGT purposes.
>
> Where the trustees exercise their powers of appointment before the assets have vested in them then the assets are still in the hands of the personal representatives at the time of the exercise. Even though these may be the same individuals as the trustees they are different bodies of persons for CGT purposes, see CG31110+. If, in these circumstances, the trustees make an appointment under the specific powers given to them in the will, then when the asset(s) vest they should be treated as passing direct to the appointee.
>
> The asset(s) appointed should be treated as never becoming subject to the trust. In effect, the appointment is read back into the will. It is treated as though the deceased had intended the assets concerned to pass directly to the legatee rather than into trust. The appointee then takes those asset(s) as legatee and therefore acquires the asset(s) at probate value by reason of TCGA92/S62 (4), see CG31140+. The time limits and procedures in TCGA92/S62(6) and (7) do not apply to this treatment.

88.7.8 *Beneficiary pays for asset*

The CG Manual provides:

> **CG31175: payments by legatees to PRs** [Jul 2019]
>
> If an estate has insufficient liquid assets to pay its liabilities and a legatee wishes to receive a particular asset rather than it being sold on the open market by the personal representatives the legatee may agree with the personal representatives that he will provide them with sufficient funds to settle the estate’s liabilities in return for them transferring the asset to him. Such an arrangement was considered in the case of *Passant v Jackson*, 59 TC 230. The Appeal Court held that the arrangement was a sale of the property. So in any case involving a similar arrangement it should not be accepted that there was merely a transfer of an asset to a legatee under cover of TCGA92/S64 (4).

88.7.9 *Transfer to will trust*

If the will appoints non-resident trustees, the PRs may transfer the assets to the trustees without a CGT charge.

If the will appoints UK resident trustees, the PRs may transfer the assets to the trustees but the trust will be within the charge to CGT. If non-resident trustees are subsequently appointed, there will in principle be an exit charge.

It should normally be possible to arrange that:

(1) The PRs appoint that the assets are to be transferred to trustees of a new non-resident trust.
(2) The PRs then transfer the assets to the non-resident trustees.

As long as this is done during the administration of the estate, the assets may then become held in a non-resident trust without a charge to CGT.

88.8 Deceased not UK resident

If the deceased was not UK resident at the time of their death (regardless of domicile) the PRs are in general outside the scope of CGT.[39]

88.8.1 *Is estate a "settlement" for s.87*

Is a deceased's estate a "settlement" for the purposes of s.87? The question matters, because if an estate were a "settlement" then:

(1) Gains accruing to non-resident PRs would be s.1(3) amounts (trust gains) for the purposes of s.87 TCGA; so
(2) Capital payments from the PRs to UK resident beneficiaries would in principle be subject to tax under s.87; and
(3) If the will created a will trust, or made a gift to a lifetime trust, unmatched s.1(3) amounts of the PRs might be transferred to the trust on completion of the administration of the estate.[40]

The word "settlement" is used with different definitions; in the terminology of this book:

(1) The **"standard IT/CGT definition"** (a classic settlement)
(2) The "**settlement-arrangement**" definition[41]

An estate is not a settlement in the standard IT/CGT sense. If the will creates a will trust, a settlement in the standard IT/CGT sense comes into existence when the administration is complete (or if property is transferred

[39] See 56.6.3 (Territorial scope: Summary).

[40] See 61.39 (Transfer between trusts). It might be said that s.90 TCGA does not apply because PRs do not "transfer" assets to beneficiaries. But if it is right that an estate is not a "settlement" for s.87, this issue does not arise.

[41] See 87.4 (Settlement-arrangement definition).

to the trustees sooner).[42] However, for the purposes of the s.87 charge, the settlement-arrangement definition applies,[43] so the question is whether an estate may be a settlement-arrangement.

One might have thought that an estate is a "settlement-arrangement". There is an element of bounty in that the deceased decides who should benefit (or by not making a will, decides that the intestacy rules should apply). However in *IRC v Buchanan* 37 TC 366 at p.374, Lord Goddard said:

> I do not think for a minute that a will of a testator comes within section 20[44] at all; it is not a settlement to which the Act applies.

Lord Goddard did not actually say that a will is not a settlement-arrangement and if that is what he meant, the comment is surprising. However, Lord Goddard's comment was loyally followed.[45] Accordingly CG Manual is right to provide:

> **CG14590 Connected persons: Trustees** [Jul 2019]
> ... a will trust cannot be a Settlement for these purposes [for the purposes of the settlement-arrangement definition].

For this reason an estate is not a "settlement" within s.87.

This is in fact the sensible result. The scheme of s.87 is designed with trusts in mind and would not work well if extended to estates:

(1) Suppose a will left legacies to (UK resident) legatees, and the residue on trust ("the will trust"). It would be odd if the legatees were subject to CGT under s.87 by reference to gains accruing to the estate, or, subsequently, to the will trust. But that would (almost[46]) necessarily follow, if the estate were a settlement-arrangement.

(2) Suppose a testator left their estate for such of their children as attain the age of 30, and one child reaches that age before death, or during the period of administration. The executors would transfer half of the estate to the older child and (on completion of administration) hold

[42] See 99.3 (Will trust or intestacy).

[43] This provides: "settlement" has the meaning given by s.620 of ITTOIA.

[44] Section 20 FA 1943, the predecessor of s.644 ITTOIA.

[45] *Willingale v Islington Green Investment* 48 TC 547 at p.556. (This point was not argued on appeal.)

[46] A possible way to avoid this unsatisfactory result might be to say that payment or assent of a legacy is not a "capital payment". But that is a stretch, given the definition that payment includes the transfer of an asset.

> the other half on trust for the younger child until it reached the vesting age. It would be odd if the older child were subject to CGT under s.87 by reference to gains accruing to estate, or to the younger child's will trust fund.

I have considered one possible argument to the contrary. Section 87(6) TCGA provides:

> For the purposes of this section a settlement arising under a will or intestacy shall be treated as made by the testator or intestate at the time of death.[47]

In order to understand this one needs to know the history. The s.87 code dates back to 1981. At that time, "settlement" was not expressly defined for the purposes of the s.87 code; so (what I call) the standard IT/CGT definition applied. (This was changed to the settlement-arrangement definition in 1984.[48]) So in 1981 it was clear that an estate was not a settlement, and that a will trust was a settlement. However there would be doubt as to whether the testator or intestate was the "settlor" of the will trust, and when that settlement was made. These matters are resolved by (what is now) s.87(6).[49] The provision is still needed: the identity of the settlor and domicile at the time of making the settlement are still relevant for s.87, though the relevance is now for transitional relief only.

The context shows that "settlement" in s.87(6) has the standard IT/CGT meaning. An effect of s.87(6) now is to make it clear that a will trust is a "settlement" for the purposes of s.87. But it does *not* deem an estate to be a settlement for s.87 purposes.

88.8.2 *Non-resident testator: Planning*

The estate of a non-resident testator is in principle a CGT free vehicle.

In principle, it would be desirable to arrange that gains accrue to PRs during the period of administration, and not to beneficiaries subsequently. If the PRs transfer assets to UK resident individuals who sell the assets, the gain on the sale is chargeable (in full or on the remittance basis). If the PRs transfer assets to non-resident trustees, who sell the assets, the gain

[47] The wording was previously in s.97(7) TCGA but moved in the 2006 reforms.

[48] Section 71 FA 1984.

[49] The same thinking is found in the drafting of Article 1 Trusts (Jersey) Law 1984: "'settlor' means a person who provides trust property or makes a testamentary disposition on trust or to a trust".

on the sale is a s.1(3) amount (trust gain). If the will creates a will trust, the trust comes into the scope of s.87 when administration of the estate is completed (or when property is transferred to the trust, if sooner).

By contrast, assets with losses should be transferred to beneficiaries of the estate *in specie*.

It may also be desirable to extend the administration period as long as possible.

If a will creates a will trust, it may be desirable that capital payments are made by the PRs, during the period of administration, not by trustees subsequently. If the trust fund is entirely distributed, no settlement ever comes into existence and s.87 does not operate.

Suppose:

(1) A will creates a will trust.
(2) The PRs exercise their powers[50] to make a distribution to a beneficiary during the administration period.

There is (at the time) no settlement and no s.87 charge. After the completion of administration, the capital payment is not matched to future s.1(3) amounts (trust gains) of the trust. It is considered that s.87(6) TCGA does not retrospectively alter the position. That is not the purpose of the deeming provision.

The position is different if:

(1) A will makes a gift to a separate trust ("the lifetime trust").
(2) The trustees of the lifetime trust exercise their powers to direct the PRs to make a distribution to a beneficiary during the administration period.

That is a capital payment from the trustees of the lifetime trust, which can be matched to trust gains of the lifetime trust and so give rise to a s.87 charge on the beneficiary. An Instrument of Variation may be appropriate.

88.9 Non-resident co held by non-resident PRs

Suppose:

(1) PRs hold a non-resident company.
(2) The company disposes of an asset and realises a gain, which I call "the company gain".

[50] It is assumed that the PRs have power to do this.

88.9.1 *Position of company and PRs*

The company is in principle not subject to tax on the company gain because it is not UK resident.

The PRs are participators. But if they are not UK resident, they are not treated as if the company gain had accrued to them. The condition in s.3(2) TCGA is not satisfied.

88.9.2 *Position of legatee*

Assume that under the terms of the will the shares pass to a legatee. Is it possible that the legatee should be treated as if the company gain accrued to the legatee, so that:

(1) a UK resident legatee would be subject to tax on the gain under s.3(2)(a) TCGA; or

(2) a non-resident trust legatee would be treated as receiving a s.1(3) amount (trust gain) under s.3(2)(b) TCGA?

88.9.3 *Legatee during administration*

The first question is whether, at the time the gain accrues to the company (while the estate is still in the course of administration) the legatee is a participator. Section 3B(1) TCGA provides:

> "Participator" has the meaning given by section 454 of CTA 2010."

A legatee is a participator under this definition.[51]

However s.3(3) TCGA (identifying the part of the chargeable gain which is deemed to accrue to the participator) provides:

> The proportion of the amount of the gain to be apportioned to each person corresponds to the extent of the person's *interest* in the company as a participator or indirect participator.

Residuary[52] beneficiaries of an estate have no legal or equitable interest in the assets of the estate.[53] They have the right to enforce its proper

[51] See 104.23.8 (PRs and beneficiaries of estates).

[52] There is however no difference between residuary beneficiaries and specific legatees. The origin of the principle that a residuary legatee has no "interest" in the estate is historical: until the mid 19th century, estates were administered in the ecclesiastical courts and not the Chancery courts. That reasoning would apply to a specific legatee as to a residuary legatee.

[53] See 88.1 (Succession law background).

administration but that right is not properly described as an “interest” in the assets. It is therefore considered that during the period of administration the legatee does not have an “interest” as a participator.[54] Thus it does not matter that they are participators because nothing can be attributed to them under s.3.

The context can show that the word “interest” is to be understood in a loose or non-technical sense, in which case it might include the rights of a beneficiary of an estate. But there is no reason here to say the word is used loosely or non-technically. My conclusion is supported by the fact that it is not clear what would be the “just and reasonable” apportionment of the gain as between UK resident PRs and legatees. Also if the will creates a will trust, the trust does not come into existence until completion of the administration of the estate.

88.9.4 *Legatee on transfer of shares*

That is not the end of the matter. Normally, on the completion of the administration of the estate the PRs will transfer the shares to the legatee. What is the position of the legatee then?

The legatee is treated as having acquired the shares on the death.[55] Does this deeming apply for the purposes of s.3 TCGA, so the legatee is retrospectively treated as if the company gain accrued to them?

I first consider the position of a residuary legatee, and consider a specific legatee separately below. For a residuary legatee, it is the old question of how far one carries the deeming.[56] In principle, one carries the deeming all the way and retrospectivity would then follow. However, several difficulties then arise:

(1) Suppose the PRs were UK resident. They would have been taxed in the first instance on the company gain under s.3 TCGA. There is nothing to give them relief on their subsequently transferring the shares to a legatee. (Section 62(4)(b) TCGA states that the *legatee* shall be treated as if the PRs acquisition had been theirs. It makes no

[54] See *Willingale v Islington Green Investment* 48 TC 547 at p.562D.
Section 3B(2) TCGA provides: “Any reference to a person's interest as a participator in a company is to the interest in it represented by all the factors by reference to which the person is a participator.” This does not turn a legatee’s right into an “interest” if it is not already an interest.

[55] See 88.7.1 (Transfer from PRs to legatee).

[56] See App 8.2 (Deeming provisions: Construction).

comment about the position of the PRs. Relief might perhaps be implied.)

(2) Another problem would arise if the PRs receive a dividend from the company, before distributing the shares to the legatee. The legatee would receive the shares but the company at that time may no longer hold funds representing the gain, so it would not be fair that the company gain should be treated as accruing to the legatee. Company distribution relief[57] would not work properly.

(3) There would be an anomalous distinction between:
   (a) an assent of the shares (s.3 applies to the legatee); and
   (b) sale (or liquidation) of the company and assent of the proceeds to the legatee (s.3 TCGA does not apply).

For these reasons it is suggested that the deeming of s.62(4)(b) TCGA does not extend to deem the legatee to receive the company gains under s.3. This construction is also consistent with the limited view of the deeming provision taken in *Marshall* v *Kerr* 67 TC 56.

The arguments are more finely balanced in the case of a specific legacy. In that case, the assent operates retrospectively, as a matter of general law, at least, unless the assent otherwise provides.[58] But it would be anomalous if there were a distinction between a specific legatee and a residuary legatee, and it is suggested that no distinction should be drawn between the two cases.

88.10 Capital payment from co in estate

Suppose:

(1) An estate holds shares in a non-resident company.[59]

(2) Under the will, the shares are pass to a non-resident trust ("the lifetime trust").

(3) The company makes a capital payment to a beneficiary. This may happen, for instance, if an interest free loan is left outstanding.

The capital payment may be provided directly or indirectly by the lifetime trust, in which case it is potentially subject to tax under s.87 like any other capital payment.

[57] See 64.20 (s.3 distribution relief).

[58] See 89.5 (Income from specific legacy).

[59] Similar issues could arise for a UK resident company, but in practice a payment from such a company is less likely to be a capital payment.

If that is not the case, the capital payment may be deemed to be provided by the lifetime trust, under s.96(1) TCGA.[60] That will be the case if the company is "controlled" by the trustees, in the defined sense.

88.11 Deceased UK resident

If the deceased was UK resident and domiciled, the PRs are UK resident and domiciled, and so subject to CGT on all chargeable gains (less losses).

88.11.1 *Deceased UK resident non-dom*

Suppose at the time of death the deceased was UK resident but foreign domiciled. The PRs are treated as UK resident but not UK domiciled. CG Manual provides:

> **CG30660 Remittance basis not in administration period** [Jul 2019]
> If the deceased was resident but not domiciled in the UK before his or her death, then on disposing of assets outside the UK he or she would have benefited from the application of the remittance basis in s.12 TCGA ... Although the PRs have the same residence and domicile status as the deceased had, if they realise chargeable gains from disposals of assets situated outside the UK but do not remit those gains to the UK immediately they cannot benefit from this treatment. This is because the remittance basis applies only to individuals but s.65(2) says that the body of PRs is not to be treated as an individual.

At first sight this seems surprising, but on reflection, it is not absurd to draw a distinction between:
(1) a UK resident foreign domiciled individual, taxed on the remittance basis, and
(2) the PRs of that individual, taxed on an arising basis.
A remittance basis makes less sense for PRs whose role is generally short term.[61]

Of course, if the PRs are actually outside the UK, especially if they are

[60] See 61.10 (Payment from close co: s.96(1)).

[61] It was formerly argued that the HMRC view is wrong. The argument was largely based on the supposed anomalous position of PRs. Following the 2008 reforms, the anomalies work the other way (for if the remittance basis applied, it would be anomalous that PRs did not pay the remittance basis claim charge). The argument would require the word "individual" in para 1 sch 1 TCGA to include PRs, which is contrary to general statutory usage. So I do not think the argument now merits serious attention (but readers can find further discussion in the 2008/09 edition of this work).

outside the EU, HMRC may not, in practice, be able to recover the tax.

DTR is in principle available to treaty non-resident PRs, which may solve this problem.

88.12 CGT planning for UK PRs

If PRs sell assets in the period of administration, then any gain will be subject to CGT, even though the net proceeds of sale will in due course pass to a remittance basis taxpayer. If, by contrast, PRs transfer an asset *in specie* to a legatee, then the PRs will not realise any chargeable gain but the base cost of the recipient beneficiary will be that of the PRs.[62] Where the legatee is a remittance basis taxpayer (or a non-UK resident, or a charity), they will often be able to dispose of the asset free of CGT.

It is thus a fundamental principle of CGT planning that PRs should generally avoid, wherever possible, making disposals of assets which pass under the will to remittance basis taxpayers, non-residents or charities, if a gain (less losses) arises on the disposal.

Suppose that a remittance basis taxpayer is entitled to a pecuniary legacy of £1m under a will. The estate holds a foreign situate asset which had a value of £600k at the date of the death of the deceased and which is now worth £1m. If the PRs sell the asset in order to pay the legacy, they will be liable to CGT. This liability can be avoided by the PRs agreeing to transfer the property to the legatee in satisfaction of their pecuniary legacy.

Suppose the PRs inherit an asset belonging to the deceased which is the subject matter of a specific gift in their will; that they then sell the asset, the sale giving rise to a charge to CGT, and that they subsequently transfer the whole or part of the proceeds of sale to the specific legatee.[63] So if there is such a sale, the PRs bear the CGT and transferring the proceeds of sale to the remittance basis taxpayer does not confer any exemption.

It may be necessary to sell some assets to pay liabilities of the PRs, and it may be that the assets available for sale will give rise to a chargeable gain.

[62] See 88.7 (Transfer from PRs to beneficiaries).

[63] Income tax sometimes applies the common law doctrine of relation back; see 89.5 (Income from specific legacy). But this does not apply here. This doctrine would operate only where an asset owned by the deceased is subsequently transferred to the legatee. In any case, the express provisions of the TCGA deal so comprehensively with the situation that any application of the doctrine of relation back to CGT is by necessary implication excluded.

One solution is as follows:

(1) The PRs transfer the asset to the beneficiary subject to a charge for their liabilities under s.36(10) Administration of Estates Act 1925.
(2) The beneficiary then sells the asset: any gain on the sale accrues to the beneficiary: s.26(2) TCGA.
(3) Under the charge the proceeds are used to pay the PRs' liability.

These principles are confirmed, if confirmation is needed, in *McLaughlin v HMRC*[64] where a marketed tax avoidance scheme involved bringing in a nondom beneficiary artificially. This survived a technical challenge; and (on its facts rather surprisingly) a *Ramsay*/realistic view challenge.

88.13 CGT planning by IoV

Where there is more than one residuary legatee and some are remittance basis taxpayers, non-residents or charities, it would often make sense for assets with inherent capital gains to be transferred to them rather than to UK resident and domiciled individuals. This can often be done by means of an appropriation under s.41 Administration of Estates Act 1925, but (depending on the terms of the will) an instrument of variation may be necessary. The variation must be made within two years of the death of the deceased.

In principle, the approach should be to redirect foreign assets of the estate with inherent capital gains to the remittance basis taxpayer. UK resident and domiciled beneficiaries would instead receive cash or assets without inherent gains. The remittance basis taxpayer might in due course realise the gains free of tax. There would be an overall tax saving, which could be shared between the remittance basis taxpayer and the other beneficiaries by negotiation, or which could be allowed to accrue entirely to the remittance basis taxpayer if the other beneficiaries were so minded.

88.14 Succession under foreign law

Further consideration is needed if the succession is governed by a foreign law. Section 62(1) TCGA provides:

> For the purposes of this Act the assets of which a deceased person was competent to dispose—
>
> (a) shall be deemed to be acquired on his death by the personal

[64] [2012] UKFTT 174 (TC). The artificial planning in this case would now be caught by the GAAR.

> representatives *or other person on whom they devolve* for a consideration equal to their market value at the date of the death...[65]

In civil law jurisdictions, property devolves directly on the beneficiary without the intervention of PRs during an administration period. *Bentley v Pike* concerned the position under German law (the deceased died intestate owning a share of land in Germany). The evidence showed:

> ... the principle of *Universalsukzession* ... means that on the death of a person, his or her entire property passes immediately and automatically to his or her heirs. ... No distinction is made between movable and immovable property: on the death of the deceased person both types of property are automatically and without any interval in time or any further outward action of any kind vested in the heirs, whoever they may be, no matter whether they are known or whether it is necessary to take steps to ascertain their identity.[66]

In these circumstances, the ownership of the property passed to the beneficiary immediately on the death. The gain on the sale of the property after the death therefore accrued to the beneficiary, and not to the German (rough) equivalent of PRs.

However the position may be fact sensitive, and one should not assume that all civil law jurisdictions are the same. In Quebec, the executor's right of *saisine* [seizin, ie, possession] has priority over the legatee, and income and gains during the administration period accrue to the executor, not the legatee;[67] so it seems that for UK tax purposes, gains should be regarded as accruing to PRs and not the legatee.

[65] See 88.5 (Acquisition by PRs).

[66] 53 TC 590 at p.594. See § 1922 Bürgerliches Gesetzbuch.

[67] Canada Revenue Agency, Technical Interpretation 2004-0100621E5, "Application of s. 164(6) in a Civil Law Context" (2006).

CHAPTER EIGHTY NINE

ESTATES OF DECEASED PERSONS: INCOME TAX

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Cross references

The following topics are considered elsewhere:
  88.1 (Succession law background)

89.1 Income taxation of estates

This chapter considers the income taxation of personal representatives and beneficiaries of estates of deceased persons. A full discussion needs a book to itself. I try to focus on matters closest to the themes of this book, but that can only be done in the context of a more general discussion of the rules.

I do not consider the equivalent provisions applicable for corporation tax which would apply to corporate beneficiaries.

89.2 Meaning of "PRs" for IT

The same commonsense definition of PRs applies for IT/CGT/CT; it is discussed at 88.3 (PRs: meaning for CGT/IT/CT).

There is no rule for IT purposes that PRs are a single and continuing body distinct from the persons who are actually the PRs.[1] This is anomalous, for that rule applies to PRs for CGT[2] and a similar rule applies to trustees for both taxes. It is suggested that there should be a rule. However it may be implied[3] and it will not often matter.

89.3 Residence of PRs for IT

One must identify the PR's actual place of residence in their personal capacities, applying the statutory residence test to PRs who are individuals,[4] and the corporate residence test to corporate PRs.

PRs are UK resident for income tax if they are all UK resident in their personal capacity. They are non-resident if they are all non-resident in their personal capacity. HMRC agree. Form SA906 (Notes) 2023 (Notes on Trust and Estate Non-Residence 2022/23) provides:

> ***Deciding the personal representatives' residence status for Income Tax purposes***
> You can find out the personal representatives' residence status for Income Tax purposes by working through questions 4 to 6.
> 4. Were **all** the personal representatives resident in the UK for the year to 5 April 2023?
> If Yes, the personal representatives as a whole are resident in the UK

[1] For completeness: there is a rule for the purposes of the transactions in land code, see s.517P(4) ITA.

[2] See 88.4 (Residence of PRs for CGT).

[3] See 104.23.8 (PRs and beneficiaries of estate).

[4] See 6.3.1 (SRT: Application to trustees/PRs).

> for Income Tax purposes. Tick box 6.1 of the 'Trust and Estate Non-residence' pages [Resident in the UK for Income Tax purposes]. Go to question 7.
> If No, go to question 5.
> 5. Were **all** the personal representatives not resident in the UK for the year to 5 April 2023?
> If Yes, the personal representatives as a whole are not resident in the UK for Income Tax purposes. Tick box 6.2 of the 'Trust and Estate Non-residence' pages [Not resident in the UK for Income Tax purposes]. Please also complete boxes 6.7 to 6.12 as appropriate. Go to question 7.
> If No, go to question 6 [mixed resident PRs].[5]

The position where an estate has both resident and non-resident PRs is governed by s.834 ITA:

> (1) This section applies for income tax purposes if the personal representatives of a deceased person ("D") include one or more persons who are UK resident and one or more persons who are non-UK resident.
> (2) If the following condition is met, the person or persons who are non-UK resident are treated, in their capacity as personal representatives, as UK resident.
> (3) The condition is that when D died D was UK resident or domiciled[6] in the UK.
> (4) If that condition is not met, the person or persons who are UK resident are treated, in their capacity as personal representatives, as non-UK resident.

Thus it is possible to arrange that PRs are not UK resident for income tax purposes. All of the PRs must be non-resident in their private capacities, (except in the case of a non-resident non-domiciled testator where only one PR need be non-resident).

There are no statutory rules for domicile, but the domicile of PRs does not matter for IT purposes.

The definition of PRs' residence is different for CGT.[7]

[5] *https://www.gov.uk/government/publications/self-assessment-trust-and-estate-non-residence-sa906*

[6] Section 834(5) ITA provides: "Section 835BA (deemed domicile) applies for the purposes of subsection (3)." This is the standard wording to apply the deemed domicile rules.

[7] See 88.4 (Residence of PRs for CGT).

There is a transitional rule for death before 6 April 2013.[8]

89.4 Income taxation of PRs

PRs are "persons" and so pay income tax at the basic rate (or dividend ordinary rate) on the income of the estate if:
(1) the PRs are UK resident, or
(2) the income has a UK source.

Until 2016/17 that liability was usually be covered by deduction at source (or a tax credit), but that is no longer the case. PRs do not qualify for personal allowance or a dividend allowance or a savings rate band. HMRC provide a somewhat miserly exemption for interest up to £100 tax (equivalent to £500 interest).

> In 2016, HMRC introduced an interim arrangement so that trustees or personal representatives do not have to submit returns, or make payments under informal arrangements, where the only source of income is savings interest and the tax liability is below £100.The arrangement has been subsequently extended, see the Trust and Estate Newsletters April 2017 and August 2019. The arrangement has now been further extended to include the 2021 to 2022 and 2022 to 2023 tax years.HMRC will continue to review the situation longer term.[9]

89.4.1 *Foreign domiciled testator*

Form SA906 (Notes) 2023 (Notes on Trust and Estate Non-Residence 2022/23) provides under the heading "Personal representatives: application to Income Tax":

> [1] If the personal representatives are resident in the UK, their taxable income will depend on the domicile of the deceased, whose estate is being administered, at the date of death.
> [2] If the deceased was domiciled in the UK, then the personal representatives will be taxable in the normal way on both UK and overseas income.
> [3] If the deceased was domiciled outside the UK, they will be taxable only on UK income. In such circumstances, do not include overseas

[8] I discussed this in the 2021/22 edition of this work para 85.3.1 (Death before 2013) but omit the discussion now as the issue will not often arise.

[9] HMRC, Trusts and Estates Newsletter (May 2021) *https://www.gov.uk/government/publications/hm-revenue-and-customs-trusts-and-estates-newsletters/hmrc-trusts-and-estates-newsletter-may-2021*

income. Please also tick box 6.6 of the 'Trust and Estate Non-residence' pages.[10]

Point [3] is not right as a matter of law. UK resident PRs are as a matter of law liable to income tax on foreign income regardless of the domicile of the deceased. (Domicile of the deceased is sometimes relevant to the separate question of whether PRs are UK resident, but it is possible for a foreign domiciled deceased to have UK resident PRs.)

One is nevertheless entitled (perhaps bound) to assume that HMRC mean what they say, in a document as formal as guidance notes to a tax return, unless it is clear that there has been a blunder, that is, if it is clear that they cannot mean what they say. HMRC clearly do mean what they say as they say it more than once and have said it for many years.[11]

There is therefore an informal concessionary practice. A concession is logical where the beneficiary of the estate is non-resident since income tax paid on foreign income would be reclaimed later when the income is paid to the beneficiary. The concession does raise a puzzle where the beneficiary is UK resident and the income is paid to the beneficiary: one might think that the foreign income should not be taken into account in computing the beneficiary's estate income, but that must be too good to be true. I think the effect of the concession should be to treat the PRs as non-resident for IT purposes and that should be followed through for payments made by the PRs (who therefore constitute a foreign estate). Thus a payment of the income to a UK resident beneficiary is taxable under the estate income regime, but a payment to a non-resident (or treaty non-resident) is not.

89.5 Income from specific legacy

This section considers the position where a testator by their Will gives specific assets to a beneficiary.

In the first instance, the PRs will acquire the assets and they will receive the income arising from them. If they do not need to use the assets or

[10] *https://www.gov.uk/government/publications/self-assessment-trust-and-estate-non-residence-sa906* The reference is to box 6.6 in form SA906 (Trust and Estate Non-Residence) which reads: "Tick box 6.6 if the deceased whose estate is being administered was domiciled outside the UK at the date of death".

[11] The point has been made in the equivalent notes going back at least to the 2005 notes. Similar wording is found in form SA904 (Notes) (Notes on Trust and Estate Foreign 2022/23) under the heading "Special circumstances – personal representatives."

income for the purpose of paying debts, taxes, etc., the PRs will in due course transfer the assets and income to the beneficiary (the formal legal terminology is that the PRs "assent to the vesting of the assets in the beneficiary").

In the first instance, the PRs usually pay tax at the basic rate (or dividend ordinary rate) on income arising from the assets. If the PRs asset and its income vesting in the beneficiary, something rather peculiar happens. The beneficiary is deemed to have been the owner of the asset since the death. The assent is said to "relate back" - that is, it operates retrospectively. For personal property this is a common law rule; for land, it is in s.36 Administration of Estates Act 1925 which provides:

> (1) A personal representative may assent to the vesting, in any person who (whether by devise, bequest, devolution, appropriation or otherwise) may be entitled thereto, either beneficially or as a trustee or personal representative, of any estate or interest in real estate to which the testator or intestate was entitled ....
> (2) The assent shall operate to vest in that person the estate or interest to which the assent relates, and, unless a contrary intention appears, the assent shall relate back to the death of the deceased.

This rule operates for income tax purposes: *IRC v Hawley* 13 TC 327. The beneficiary will, retrospectively, be treated as having received the income year by year as it arose and the PRs will be treated as if they had not received it. The PRs may have paid UK tax. This will retrospectively be treated as being paid by the PRs on behalf of the beneficiary. Thus a beneficiary who is a remittance basis taxpayer can reclaim tax paid by UK resident PRs on unremitted foreign income. A non-resident beneficiary can also reclaim tax (it is not necessary to rely on ESC A14).

TSE Manual provides:

> **TSEM7490 Beneficiaries of estates: legacies** [Aug 2019]
> **Tax rules for specific legacies.**
> A legacy may take the form of an asset that does not produce income – for example a picture or a piece of jewellery. The beneficiary does not receive income and has no tax liability in respect of the legacy.
> Other assets can produce income – for example a bank account, shareholding or land. The general rule is that the beneficiary is entitled to the income arising to that asset from the death of the deceased person. Sometimes however the personal representatives may by law be entitled to use the income for some other purpose.
> If the beneficiary gets the income it should be treated as his income for

the year in which it arises. The authority for this is *IRC v Hawley* 13 TC 327. The beneficiary cannot however be taxed on or given repayment on income that he did not receive.

89.6 Income from residuary estate

89.6.1 *Background law*

During the period of administration, the PRs alone are entitled to the assets in the residue of the estate and its income. On completion of the administration, the residuary legatee becomes entitled to the assets which at that time form part of the estate, and any income which the PRs have not expended in the course of administration. It is possible for PRs to transfer specific assets to a beneficiary before completion of administration.

89.6.2 *History*

In order to appreciate the income tax law it is helpful to understand its history. In *R v Special Commissioners, ex p. Dr Barnado's Homes* 7 TC 646, the residuary legatee was a charity. Income arose to the PRs during the period of administration on which the PRs paid income tax. The residuary legatee was not entitled to the income of the residuary estate as it arose during the period of administration, so it could not at that time reclaim income tax paid. Instead it sought to recover the tax when it actually received the income, on completion of administration. The House of Lords held that although the sum received by the charity represented (or was derived from) the PR's income, it was received by the charity as a capital receipt (like accumulated income of a trust). The payment on the completion of administration did not operate retrospectively, the PR's income could not be treated as arising to the residuary legatee. So income tax paid by the PRs could not be recovered by the charity. The rule that an assent of a specific legacy relates back to death was not extended to gifts of residue. The reader may think that the charity had the better argument.[12] But that is now of academic interest: the law is settled.

[12] See Nitikman, "The Forgotten Law of Assent" Trusts & Trustees, Vol. 18, No. 7, August 2012, p.672. Perhaps the House of Lords was motivated by the (unmentioned) policy argument that any other decision would be inconvenient to the point of unworkable in practice. If so they were right, as the tax rules which have replaced their decision do not work: see 89.22 (Income tax of estates: Critique).

That was a victory for the Revenue, who were no doubt unperturbed about the unfairness to the charity. But subsequently, predictably, individual residuary legatees successfully contended that they were not liable to super-tax (which became surtax in 1927 and is now higher rate tax) on the income of a residuary estate arising during the administration period.[13] The Revenue then realised they had made a rod for their own back. Legislation was therefore brought in which is now to be found in Chapter 6 Part 5 ITTOIA.

89.7 Types of interest in residue

The legislation distinguishes absolute/limited/discretionary interests in residue.

89.7.1 *Absolute interest in residue*

Section 650(1) ITTOIA provides a fairly commonsense definition:

> A person has an absolute interest in the whole or part of the residue of an estate for the purposes of this Chapter if—
> (a) the capital of the residue or that part is properly payable to the person, or
> (b) it would be so payable, if the residue had been ascertained.

89.7.2 *Limited interest in residue*

Section 650(2) ITTOIA provides a fairly commonsense definition:

> A person has a limited interest in the whole or part of the residue of an estate during any period for the purposes of this Chapter if—
> (a) the person does not have an absolute interest in it, and
> (b) the income from it would be properly payable to the person if the residue had been ascertained at the beginning of that period.

In practice the usual example of a limited interest is a life interest.

89.7.3 *Discretionary interest in residue*

Section 650(3) ITTOIA provides a fairly commonsense definition:

> A person has a discretionary interest in the whole or part of the residue of an estate for the purposes of this Chapter if—
> (a) a discretion may be exercised in the person's favour, and

[13] eg *Corbett v IRC* 21 TC 449. There are several income tax cases on the issue of whether administration was completed.

> (b) on its exercise in the person's favour any of the income of the residue during the whole or part of the administration period (see section 653) would be properly payable to the person if the residue had been ascertained at the beginning of that period.

Section 650(4), (6) ITTOIA defines "properly payable" and s.650(5) deals with the situation where PRs have an interest in another estate.

89.8 "UK estate" and "foreign estate"

The legislation distinguishes "UK estates" and "foreign estates". The distinction matters for two purposes:

(1) Computation of the basic amount.
(2) Source of income (relevant to remittance basis taxpayers and non-residents).

These terms are defined in s.651(1) ITTOIA:

> "UK estate", in relation to a tax year, means an estate[14] which meets conditions A and B, or condition C, for that year, and
> "foreign estate", in relation to a tax year, means an estate which is not a UK estate in relation to that year.

I refer below to "**estate conditions A to C**". Unfortunately these conditions are in a tangle.

An estate may be a UK estate in one year and a foreign estate in another year. The question must be addressed each year.

89.8.1 *Estate conditions A and B*

Section 651 ITTOIA provides:

> (2) Condition A is that all the income of the estate either—
> (a) has borne UK income tax by deduction, or
> (b) is income in respect of which the personal representatives are directly assessable to UK income tax for the tax year.
>
> (3) Condition B is that none of the income of the estate is income for which the personal representatives are not liable to UK income tax for the tax year because they are not UK resident.

[14] Section 649(2) ITTOIA provides a commonsense definition of "estate":
In this Chapter—
"estate" means the estate of a deceased person (whether a UK estate or a foreign estate).

89.8.2 *Disregarded income and estate condition C*

Section 651(4) ITTOIA provides:

> For the purposes of conditions A and B sums within section 680(3) or (4) (sums treated as bearing tax) are ignored.

The list of disregards in s.680 ITTOIA is as follows:

> (3) The following sums are treated as bearing income tax at the dividend ordinary rate—
> (a) a sum charged under Chapter 3 of Part 4 (dividends etc. from UK resident companies etc.), or
> (b) a sum that is part of the aggregate income of the estate because of falling within—
> (i) section 664(2)(c) (stock dividends), or
> (ii) section 664(2)(d) (release of loan to participator in close company where debt due from personal representatives).
> (4) A sum that is part of the aggregate income of the estate because of falling within section 664(2)(e) (gains from life insurance contracts etc) is treated as bearing income tax at the basic rate.

It is convenient to have a term to describe these categories of income, so I call it "**disregarded income**".

Why is this income disregarded? Prior to 1996, s.233(1) ICTA 1988 (repealed) provided:

> *Where in any year of assessment the income of any person, not being a company resident in the UK, includes a distribution in respect of which that person is not entitled to a tax credit*
> *(a) no assessment shall be made on that person in respect of income tax at the basic rate on the amount or value of the distribution*
> ...

Thus non-resident PRs who received dividend income would not be assessable and so would count as a foreign estate.

Section 651(5) ITTOIA provides:

> Condition C is that the aggregate income of the estate for the tax year consists only of sums within section 680(3) or (4).

89.8.3 *Examples*

If the PRs are UK resident:

(1) Estate condition A is satisfied (the PRs are directly assessable to IT).

(2) Estate condition B is satisfied[15]
so the estate is a UK estate.

If the PRs are UK resident but the testator was foreign domiciled, it appears that the estate is by concession treated as a foreign estate.[16]

If the PRs are non-resident, and have some foreign source income:
(1) Estate condition A is not satisfied (some of the PR's income is not taxable).
(2) It does not matter whether estate condition B is satisfied
(3) Estate condition C is not satisfied
so the estate is not a UK estate.

If the PRs are non-resident but have only UK source taxable income,
(1) estate condition A is satisfied (they are assessable)
(2) Estate condition B is satisfied (no foreign income) so the estate is a UK estate.

If the PRs are non resident and have some UK income which qualifies for exemption (eg gilts) the estate is a foreign estate.

It is easy to procure that an estate with non-resident PRs qualifies as a "foreign estate" by arranging that there is some foreign income or FOTRA securities.

89.9 Other definitions

89.9.1 *"Payment"*

The legislation uses the word "payment" but (like "capital payment" for s.87) this is widely defined. Section 681 ITTOIA provides:

> (1) For the purposes of this Chapter—

[15] It takes more than one reading to comprehend the triple negative in condition B (the source legislation was clearer before the ITTOIA rewrite). Suppose PRs are not UK resident and receive foreign source income. The position is that condition B is not satisfied because:
(1) The PRs are not liable to IT on that income
(2) The reason they are not liable is that they are not UK resident: had they been UK resident, they would have been liable.
(3) Thus it is not the case that "none of the income of the estate is income for which the personal representatives are not liable to UK income tax for the tax year because they are not UK resident".
The same applies if non resident PRs receive income from FOTRA securities.

[16] See 89.4.1 (Foreign domiciled testator).

> (a) a transfer of assets, or
> (b) the appropriation of assets by personal representatives to themselves,
>
> is treated as the payment of an amount equal to the assets' value at the date of transfer or appropriation.
>
> (2) The set off or release of a debt is treated for the purposes of this Chapter as the payment of an amount equal to it.
>
> (3) If at the end of the administration period—
> (a) there is an obligation to transfer assets to any person, or
> (b) personal representatives are entitled to appropriate assets to themselves,
>
> an amount equal to the assets' value at that time is treated as payable then for the purposes of this Chapter.
>
> (4) If at the end of the administration period—
> (a) there is an obligation to release or set off a debt owed by any person, or
> (b) personal representatives are entitled to release or set off a debt in their own favour,
>
> a sum equal to the debt is treated as payable then for the purposes of this Chapter.

89.9.2 *"Administration period"*

Section 653 ITTOIA provides:

> (1) In this Chapter "the administration period", in relation to the estate of a deceased person, means the period beginning with the deceased's death and ending with the completion of the administration of the estate.
>
> (2) In the application of subsection (1) to Scotland, the reference to the completion of the administration is to be taken as a reference to the date at which, after discharge of, or provision for, liabilities falling to be met out of the deceased's estate, the free balance held in trust for the residuary legatees or for the persons with the right to the intestate estate has been ascertained.

This is, I think, the ordinary meaning of the term; see 88.2 (Period of administration).

89.9.3 *"Final tax year"*

Section 653(3) ITTOIA provides:

> In this Chapter "the final tax year" means the tax year in which the administration period ends.

89.10 Charge to tax on estate income

Beneficiaries are subject to tax on estate income. There are essentially three parts to the legislation:

(1) The charge to tax on estate income.
(2) The definition of when estate income arises.
(3) The quantification of the amount of estate income.

Section 649(1) ITTOIA provides the charge to tax:

> Income tax is charged on estate income.

Section 659 ITTOIA identifies the person liable:

> (1) If the estate income is from a person's absolute interest or limited interest, that person is liable for any tax charged under section 649 unless subsection (3) or (4) provides that another person is liable.
> (2) If the estate income is from a discretionary interest, the person in whose favour the discretion is exercised in making the payment in question is liable for any tax charged under section 649.

Section 659(3)(4) (not set out here) deal with successive interests.

89.11 Estate income

Estate income is a label which brings in different sets of rules for the different types of interest in residue.

Section 649(2) ITTOIA provides:

> (2) In this Chapter—
> "estate income" means the income treated under this Chapter as arising from an absolute, limited or discretionary interest in the whole or part of the residue of an estate ...
> (3) Estate income is treated as income for income tax purposes.
> (4) If different parts of an estate are subject to different residuary dispositions, those parts are treated for the purposes of this Chapter as if they were separate estates.

The circumstances in which estate income is treated as arising depend on the type of interest in residue. These are set out in ss.652–655 ITTOIA. These provisions state *when* estate income is treated as arising. The question of the *amount* of estate income is addressed separately.

89.11.1 *When estate income arises: Absolute interest*

Section 652 ITTOIA provides:

> (1) Income is treated as arising in a tax year from a person's absolute interest in the whole or part of the residue of an estate if—
>
> (a) the person has an assumed income entitlement for the tax year in respect of the interest (see sections 665 to 670), and
>
> (b) condition A or B is met.
>
> (2) Condition A is that a payment is made in respect of the interest in the tax year and before the end of the administration period (see section 653).
>
> (3) Condition B is that the tax year is the final tax year (see section 653).
>
> (4) Income treated as arising as a result of this section is estate income for the purposes of this Chapter.

The key term here is "assumed income entitlement;" see 89.14 (Assumed income entitlement).

89.11.2 *When estate income arises: Limited interest*

Section 654 ITTOIA provides:

> (1) Income is treated as arising in a tax year from a person's limited interest in the whole or part of the residue of an estate in cases A, B and C.
>
> (2) Case A is where—
>
> (a) the interest has not ceased before the beginning of the tax year, and
>
> (b) a sum is paid in respect of the interest in that year and before the end of the administration period.
>
> (3) Case B is where—
>
> (a) the tax year is the final tax year,
>
> (b) the interest has not ceased before the beginning of that year, and
>
> (c) a sum remains payable in respect of the interest at the end of the administration period.
>
> (4) Case C is where—
>
> (a) the tax year is a year before the final tax year,
>
> (b) the interest ceases in the tax year, and
>
> (c) a sum is paid in respect of the interest in a later tax year but before the end of the administration period, or remains payable in respect of it at the end of that period. ...
>
> (6) Income treated as arising as a result of this section or section 674 is estate income for the purposes of this Chapter.

89.11.3 *When estate income arises: Discretionary interest*

Section 655 ITTOIA provides:

> (1) Income is treated as arising in a tax year from a person's discretionary interest in the whole or part of the residue of an estate if a payment is made in the tax year in exercise of the discretion in that person's favour.
> (2) Income treated as arising as a result of this section is estate income for the purposes of this Chapter.

89.12 Amount of estate income

There are two aspects to the rules: quantifying the "basic amount", and grossing up.

89.12.1 *UK estate*

Section 656(1) ITTOIA provides:

> In the case of a UK estate, tax is charged under section 649 on the amount of estate income treated as arising in the tax year.

Section 656 defines the amount of estate income:

> (2) That amount is the basic amount of that income for the tax year (see subsection (4)) grossed up by reference to the applicable rate for that year (see section 663).
> (3) The gross amount is treated as having borne income tax at that rate.

The applicable rate is not discussed here. The key term is the "basic amount" of estate income.

89.12.2 *Foreign estate*

Section 657(1) ITTOIA provides:

> In the case of a foreign estate, tax is charged under section 649 on the full[17] amount of estate income treated as arising in the tax year.

The section goes on to specify the amount:

> (2) That amount depends on whether the estate income arising in the tax year is paid from sums within section 680(3) or (4) (sums treated as bearing income tax).
> (3) So far as the estate income is paid from such sums, that amount is the basic amount of that income for the tax year grossed up by reference to the applicable rate for that year (see section 663).

[17] Section 657 refers to the "full amount" and s.656 refers only to the "amount", but the word "full" is clearly otiose: there is no difference in meaning.

> (4) That gross amount is treated as having borne income tax at that rate.
> (5) So far as the estate income is not paid from sums within section 680(3) or (4), the amount of estate income treated as arising in the tax year is the basic amount of that income for that year.

The difference between UK and foreign estates is that in the latter case there is no grossing up.

We turn at last to the key concept "basic amount".

89.13 "Basic amount of estate income"

The quantum of the "basic amount of estate income" depends on the type of interest in residue, ie whether there is an absolute, limited or discretionary interest.

89.13.1 *Basic amount: Absolute interest*

Section 660 ITTOIA provides:

> (1) The basic amount of estate income relating to a person's absolute interest in the whole or part of the residue of an estate for a tax year before the final tax year is the lower of—
> (a) the total of all sums paid in the tax year in respect of that interest, and
> (b) the amount of the person's assumed income entitlement for the tax year in respect of it.
> (2) The basic amount for the final tax year is equal to the amount of the person's assumed income entitlement for that year in respect of that interest.

The next key term is "assumed income entitlement".

89.13.2 *Basic amount: Limited interest*

Section 661(1) ITTOIA provides:

> (1) The basic amount of estate income relating to a person's limited interest in the whole or part of the residue of an estate for a tax year is the total of the sums within section 654(2)(b), (3)(c) and (4)(c) for that year.

89.13.3 *Basic amount: Discretionary interest*

Section 662 ITTOIA provides:

> The basic amount of estate income relating to a person's discretionary interest in the whole or part of the residue of an estate for a tax year is

> the total of the payments made in the tax year in exercise of the discretion in favour of the person.

89.14 Assumed income entitlement

The key term "assumed income entitlement" is relevant to computation of the basic amount. For absolute interests, this is (in brief) calculated as follows.

89.14.1 *"Aggregate income of estate"*

First one calculates the "aggregate income of the estate". This has a broadly commonsense definition in s.664 ITTOIA:

> (1) For the purposes of this Chapter the aggregate income of the estate for a tax year is
> [a] the total of the income and amounts specified in subsection (2), but
> [b] excluding the income specified in subsection (5).
> (2) The income and amounts are—
> (a) the income of the deceased's personal representatives in that capacity which is charged to UK income tax for the tax year,
> (b) the income of the deceased's personal representatives in that capacity on which such tax would have been charged for the tax year if—
> (i) it was income of a UK resident, and
> (ii) it was income from a source in the UK,[18]

Paragraphs (c) to (e) deal with somewhat specialist topics:

> (c) any amount of income treated as arising to the personal representatives under section 410(4) (stock dividends) that would be charged to income tax under Chapter 5 of Part 4 if income arising to personal representatives were so charged (see section 411),
> (d) in a case where section 419(2) applies (release of loans to participator in close company: loans and advances to persons who die), the amount that would be charged to income tax under Chapter 6 of Part 4 apart from that section, and
> (e) any amount that would have been treated as income of the personal representatives in that capacity under section 466 if the condition in section 466(2) had been met (gains from contracts

[18] I cannot see the point in (ii). If it is income of a UK resident, why does the source matter?

for life insurance).

Section 664(3)(4) deal with deductions:

> (3) In calculating the amount of the income within subsection (2)(a), any allowable deductions are to be taken into account.
> (4) In calculating the amount of the income within subsection (2)(b), any deductions which would be allowable if the income had been charged to UK income tax are to be deducted from the full amount of the income actually arising in the tax year.

Section 664(5) identifies two categories of income not included in "estate income". The first is income from specific legacies:

> (5) The excluded income is—
> (a) income to which any person is or may become entitled under a specific disposition[19]

That is excluded from estate income as the income is deemed to accrue to the legatee.[20]

> (5) The excluded income is ...
> (b) income from property devolving on the personal representatives otherwise than as assets for payment of the deceased's debts.

That would include property which vests in the PRs under the obsolescent settled land act regime.

89.14.2 *"Residuary income of estate"*

Armed with the figure for "the aggregate income of the estate", one next computes "the residuary income of the estate". This brings in rules for "allowable estate deductions". Section 666(1) ITTOIA provides:

> For the purposes of this Chapter the residuary income of an estate for a tax year is

[19] Defined in subsection (6): "In subsection (5)(a) 'specific disposition' means a gift of specific property under a will, including—
(a) the disposition of personal chattels by section 46 of the Administration of Estates Act 1925 (succession on intestacy), and
(b) any disposition which under the law of another country has a similar effect to a gift of specific property by will under the law of England and Wales,
but excluding real property included in a residuary gift made by will by a specific or general description of it or, in Scotland, heritable estate included in such a gift."

[20] See 89.5 (Income from specific legacy).

> [1] the aggregate income of the estate for that year, less
> [2] the allowable estate deductions for that year.
>
> This is subject to section 669 (reduction in residuary income: inheritance tax on accrued income).[21]

There are four categories of deductions. Section 666(2) ITTOIA provides:

> The allowable estate deductions for a tax year are—
> (a) all interest paid in that year by the personal representatives in that capacity (but see section 233 of IHTA 1984: exclusion of interest on unpaid inheritance tax),
> (b) all annual payments for that year which are properly payable out of residue,[22]
> (c) all payments made in that year in respect of expenses incurred by the personal representatives in that capacity in the management of the assets of the estate,[23] and
> (d) any excess deductions from the previous tax year.[24]
>
> This is subject to subsections (3) to (5).

Subsections (3)(4) prevent double allowances:

> (3) No sum is to be treated as an allowable estate deduction if it is allowable in calculating the aggregate income of the estate.
> (4) No sum is to be counted twice as an allowable estate deduction.

89.14.3 *"Assumed income entitlement"*

Armed with the figure for the residuary income of the estate, we are at last in a position to compute the assumed income entitlement. Section 665 ITTOIA provides:

> (1) Whether a person has an assumed income entitlement for a tax year in respect of an absolute interest in the whole or part of the residue of an

[21] Section 669 ITTOIA is not considered here.

[22] Para (b) should be deleted, as Annual Payments are not now generally allowable; but it does no harm.

[23] Section 666(5) restricts this to income expenses: "Payments in respect of expenses are only allowable estate deductions if they are properly chargeable to income (ignoring any specific direction in a will)."

[24] This is defined in s.666(6):

> "In this section 'excess deductions from the previous tax year' means so much of the allowable deductions for the previous tax year as exceeded the aggregate income of the estate for that year."

This allows unused expenses to be carried forward.

> estate depends on the results of the following steps.
> *Step 1* Find the amount of the person's share of the residuary income of the estate that is attributable to that interest for that tax year and each previous tax year during which the person had that interest (see sections 666 to 669).
> *Step 2* If the estate is a UK estate in relation to any tax year for which an amount has been found under step 1, deduct from that amount income tax on that amount at the applicable rate for that year (see section 670).
> *Step 3* Add together the amounts found under step 1 after making any deductions necessary under step 2.
> *Step 4* Add together the basic amounts relating to the person's absolute interest in respect of which the person was liable for income tax for all previous tax years (or would have been so liable if the person had been a person liable for income tax for those years).
> (2) For the purposes of this Chapter the person has an assumed income entitlement for the tax year if the amount resulting from step 3 exceeds the amount resulting from step 4.
> (3) The assumed income entitlement is equal to the excess.
> (4) [This deals with successive interests].

89.15 Beneficiary a discretionary trust

Section 483 ITA provides:

> (1) This section applies if, during or at the end of the administration period for an estate—
> (a) the personal representatives pay the trustees of a settlement a sum representing[25] income of the personal representatives, and
> (b) if this Chapter had applied to personal representatives, income tax would have been charged on that income at the dividend trust rate or at the trust rate.
> (2) The sum is treated as—
> (a) being paid as income, and
> (b) having borne income tax at the applicable rate.

Lastly we have some definitions by reference (which would have been unnecessary had there been taxes-act-wide definitions):

> (3) In this section—
> "administration period" has the meaning given by section 653 of ITTOIA 2005, and
> "the applicable rate" means the rate referred to in section 663(1) of

[25] See App 2.9 ("Representing assets).

> ITTOIA 2005 (the applicable rate for grossing up basic amounts of estate income).

The drafter has failed to incorporate the extended definition of "payment" but perhaps that may be implied.

89.16 Estate income remittance basis

Section 658 ITTOIA brings in the remittance basis:

> (1) The charge to tax under section 649 on the amount of income arising in a tax year is subject to Part 8 (foreign income: special rules).
> (2) For the purposes of section 830(1) (meaning of "relevant foreign income") amounts charged to tax under section 649—
> (a) are treated as arising from a source outside the UK if the estate is a foreign estate, and
> (b) are treated as not arising from such a source if the estate is a UK estate.

The section uses the words "treated as" because the income (being fictional income) does not have a source.[26]

If a beneficiary is a remittance basis taxpayer, it is important to ensure that the estate is a "foreign estate" and not a "UK estate" because the remittance basis only applies to a foreign estate.

Since the estate income is deemed income, not real income, it cannot be remitted. There is no rule that the PRs income or the beneficiary's actual receipts are is deemed to be derived from the estate income.

89.17 Non-resident beneficiary of UK estate: DT relief

International Manual provides:

> **INTM367510 Claims by beneficiaries of a UK estate** [Sep 2021]
> A distribution made to a beneficiary of income received by a UK estate during its administration period is considered to be a source of income in its own right.[27]
> Where a beneficiary receives a distribution of income that has arisen during the administration of a UK estate, that beneficiary may be entitled to relief on the income under a Double Taxation treaty. Relief will be available in one of two ways:
> - Other Income article: where an other income article of a treaty does

[26] See 16.6 (No source/deemed source).

[27] Author's footnote: That is, the estate is not considered to be transparent.

> not exclude income paid out of a UK estate, that income is considered as other income. ...
>
> The beneficiary is entitled to full relief from the total tax deemed to have been paid on the income.
>
> - Extra Statutory Concession A14: where it is not possible to relieve the income under an other income article, Extra Statutory Concession A14 allows us to look through to the underlying sources of income received by an estate and allow relief as if the beneficiary owned the sources of income in their own right.[28] ...

International Manual para 367530 sets out a list of countries where relief is available under the Other Income article on distributions made by UK estates. For this list see 41.12.1 (Other Income article).

> **INTM367540 How to give relief by 'looking through'** [Sep 2021]
>
> A repayment claim will be supported by an R185 (Estate Income) (or an R185E) tax certificate prepared by the personal representative(s) showing the rate(s) at which the sources of income have been taxed.
>
> It should be possible to identify the sources of income from the R185 (Estate Income). If so, you should apply relief at the treaty rate for the type of income. It may not be possible to identify the sources of income on an R185E; if so you will need to find out what they are. Remember that you will have to open an SA enquiry to ask for the information you need. See INTM331200 for guidance on how to open an enquiry. You should ask the claimant or their representative for a breakdown of the underlying sources of income arising to the estate.
>
> (This content has been withheld because of exemptions in the Freedom of Information Act 2000)

89.18 Non-resident beneficiary of UK estate: Concessionary relief

ESC A14 provides:

> **Deceased person's estate: residuary income received during the administration period**
>
> A beneficiary who for a year of assessment is not resident or not ordinarily resident in the UK, and is deemed under ITTOIA ss.657, 658(2) and 830(1) to have received income from a UK estate in that year, may claim to have their tax liability on that income from the estate adjusted to what it would be if such income had arisen to them directly and as a result they—

[28] See 89.18 (Non-resident beneficiary of UK estate: concessionary relief).

> [1] could claim relief under TA 1988 s.278 (claim to personal reliefs by certain non residents); or
> [2] could claim entitlement to exemption in respect of FOTRA Securities issued in accordance with ITTOIA s.714; or
> [3] could claim relief under the terms of a double taxation agreement; or
> [4] would not have been chargeable to income tax.

The ESC goes on to specify the conditions for the relief.

> Relief or exemption, as appropriate, will be granted to the beneficiary only if the personal representatives of the estate—
> - have made estate returns for each and every year for which they are required, and
> - have paid all tax due and any interest, surcharges and penalties arising, and
> - keep available for inspection any relevant tax certificates, together with copies of the estate accounts for all years of the period of administration showing details of all sources of estate income and payments made to beneficiaries.
>
> Relief or exemption, as appropriate, will be granted to the beneficiary on a claim made within five years and ten months of the end of the year of assessment in which the beneficiary is deemed to have received the income.
>
> No tax will be repayable to the beneficiary in respect of income they are deemed to have received where the basic amount of estate income, if received by a UK resident beneficiary of an estate, is paid sums within ss.657(3), (4) and 680(3), (4) ITTOIA.

This is the equivalent of ESC B18 for trusts.[29]

89.19 Time limit for claim/assessment

Section 682 ITTOIA provides:

> (1) This subsection applies if after the administration period ends it is apparent that a person is liable for income tax on estate income for any tax year who previously appeared not to be so liable or to be liable for tax on a lesser amount.
> (2) If subsection (1) applies—
> (a) the person may be assessed and taxed for the tax year, and
> (b) any relief or additional relief to which the person may be entitled for the tax year is to be allowed if a claim is made.

[29] See 41.9 (Discretionary trust transparency: beneficiaries reliefs).

> (3) This subsection applies if after the administration period ends it is apparent that a person who previously appeared to be liable for income tax on estate income for any tax year is not so liable or is liable for tax on a lesser amount.
>
> (4) If subsection (3) applies—
>
> (a) all necessary adjustments and repayments of income tax for the tax year are to be made, and
>
> (b) if the person has been allowed relief which exceeds the relief that could have been given by reference to the amount actually charged for the tax year, income tax is charged on the person for that year under this subsection on the excess.
>
> (4A) The excess charged under subsection (4)(b) is treated as an amount of income for income tax purposes, except so far as it represents a tax reduction given effect at Step 6 of the calculation in section 23 of ITA 2007.
>
> (5) An assessment or adjustment made for the purposes of this Chapter or a claim made as a result of this Chapter may be made after the end of the period otherwise allowed if it is made on or before the third anniversary of the normal self-assessment filing date for the tax year in which the administration period ends.

International Manual provides:

> **INTM367560 Statutory time limit for claims by beneficiaries** [Sep 2021]
>
> It is possible that a beneficiary may receive a distribution from an estate which includes income received by the personal representative outside the normal statutory time limit. However, Section 700(3) ICTA 1988 allows beneficiaries until 3 years from 31 January following the year in which administration was completed to make their claims. This means that a beneficiary is not prevented from claiming relief from UK tax because of the time taken to complete the administration of the estate.
>
> For example, a death occurs during 1994/95. In the normal course of events, the time limit for a beneficiary to claim on administration period income arising in that year would have expired on 5 April 2001. However, if the administration of the estate is not completed until 2002/03 the time limit is extended and the beneficiary has until 31 January 2007 to make the claim.

89.20 HMRC practice: Conventional basis

The statutory rules are too complicated, and in practice no-one usually takes much notice of them. The TSE Manual first outlines the law:

> **TSEM7655. Statutory - conventional basis of taxation** [Mar 2018]
> **The statutory basis**
> The statutory basis is provided in ITTOIA/Ss654, 656 and 661 for non-corporate beneficiaries, and in CTA 2009/Ss939, 941 and 944 for corporate beneficiaries. This requires all sums paid during or payable on completion of the administration period to be taxed over the course of the administration period. The amounts are allocated to tax years as follows:-
> 1. where
>   - the interest has not ceased before the beginning of the tax year
>   - the administration period continues after the end of the tax year
>
> then the amount is the sum paid in the tax year
> 2. where
>   - the interest has not ceased before the beginning of the tax year
>   - the administration period ends in the tax year
>
>   then the amount is the total of
>   [a] any sum paid in the tax year before the end of the administration period plus
>   [b] any amount still due to the beneficiary at the end of the administration period...
>
> The amounts allocated to each year are then deemed to be the net income of the beneficiary for that year. The amount concerned is grossed at the applicable rate...

The TSE Manual then provides a concession:

> **The conventional basis**
> The beneficiary is treated as if he had been entitled to the income of the estate (or an appropriate part of the estate) as and when the income arose to the personal representatives. The basis applies for all purposes including repayments.
> It is unlikely that there will be cases where it is worthwhile insisting on the statutory basis. If the beneficiary asks for the statutory basis to be applied, they should supply HMRC with a computation on that basis. If there are any problems with such a computation, advice should be requested from HMRC Administration of Estates Cardiff.

In other words, the estate is by concession treated as transparent for IT purposes. That will normally suit remittance basis taxpayers.

89.21 Tax returns & registration

89.21.1 *Simple estates*

HMRC Trusts and Estates Newsletter provides:[30]

> **Administration period of Deceased's Estates: IT and CGT Informal Payment Arrangements**
> The tax liability of most deceased's estates during the administration period is straightforward and can be dealt with by HMRC Pay As You Earn and Self-Assessment.
> Personal representatives (executors or administrators) provide HMRC with a calculation of the amount of tax due. HMRC will then provide a payment slip with a reference number, for this payment only, for the Personal Representative to then make a one-off informal payment of the total tax liability for the whole period of administering the deceased's estate, provided certain conditions are met.
> The main condition is that the total tax liability (Income Tax plus Capital Gains Tax) for the entire administration period is £10,000 or less. The other conditions are that the:
> [1] probate or confirmation value of the estate is not more than £2.5m
> [2] proceeds of assets sold by the personal representatives in any one tax year are
> [a] not more than £250,000, for deaths up to 5 April 2016 or
> [b] not more than £500,000 for deaths after 5 April 2016
> [3] estate is not regarded as complex, so it can be dealt with without the personal representatives having to complete a Self-Assessment return
> All informal payments made for the administration period, should include the reference number provided by HMRC for payment of the administration period tax due.
> Any payments made by cheque should include on the reverse the following information:
> - the name of the deceased
> - the last private address of the deceased
> - the deceased's National Insurance number or Self-Assessment UTR or reference which has been provided by HMRC for this payment
> - the reason for this payment indicating Administration Period
>
> The covering letter with the cheque for payment of the tax due should be sent to HMRC.

[30] *https://www.gov.uk/government/publications/hm-revenue-and-customs-trusts-and-estates-newsletters/hmrc-trusts-and-estates-newsletter-august-2018*

89.21.2 *Complex estates*

HMRC Trusts and Estates Newsletter continues:

> HMRC Administration of Estates Cardiff is responsible for dealing with all aspects of the period of administration where the case is regarded as a complex case (subject to the exceptions at TSEM7366).
>
> An estate is considered complex if:
>
> [1] the probate or confirmation value of the estate is more than £2.5 million
>
> [2] tax due, Income Tax and, or Capital Gains Tax for the whole of the administration period exceeds £10,000
>
> [3] the proceeds of assets sold by the personal representative in any one tax year for date of deaths up to 5 April 2016 exceeds
>
> [a] £250,000 or
>
> [b] £500,000 for date of deaths after 5 April 2016
>
> If the estate does not fall into any of the above categories but it cannot easily be dealt with under the informal payments procedures, contact HMRC Administration of Estates Cardiff for advice on who should deal with the administration period liability.
>
> Estates are not part of the TRS requirements under the legislation that transposed 4MLD, but the method by which complex estates register with HMRC is through the same online process. Personal representatives of complex estates are required to use the TRS to obtain a UTR number for the estate they are administering. The register will ask for basic information, including the identification of the deceased and the personal representatives. For more information, read how to register an estate on TRS.
>
> If an estate is considered complex, Self-Assessment Trust & Estate tax return SA900 will be required for each year of the Administration period. Self-Assessment deadlines for the late submission of tax returns and penalties for late payment of tax apply.
>
> It should be evident when gathering assets and if dealing with the Inheritance Tax account if the probate or confirmation value of the estate is over £2.5m and the estate is therefore considered by HMRC as complex for the Income Tax and Capital Gains Tax of the administration period. Equally, the value of an asset will be required at date of death, which should give some indication if the value is likely to exceed £500,000 when the Executor is selling the asset.
>
> For Income Tax due over £10,000 the estate would be in receipt of gross income exceeding £50,000 during the whole of the administration period which could be from one or various sources: bank and building society interest, dividends, property related income and many more. Again, this

should be evident from assets held in the estate but may not be clear early in the administration period. The informal payment procedures can only be used once and only when the administration period has ended. If the £10,000 Income Tax due is exceeded HMRC should be notified as a Self-Assessment Trust & Estate tax return SA900 will be required to be submitted.

Only rarely, should an estate be reported as informal at the end of the administration period and then subsequently, a criterion for complex estate is triggered. This could be a previously unknown assets comes to light which exceeds the informal criterion values. In these circumstances, the estate should be registered on the TRS in order to request a UTR and a Self-Assessment Trust & Estate tax return SA900 will be required for each year of the administration period to declare all the income and, or capital gains information. Any payment previously made using the informal route will be transferred and used against the total tax now due and included in the Self Assessment statement of account.

89.21.3 *Reporting closure of estate*

HMRC refer to completion of administration as closure of an estate. ATT say:[31]

> In April 2020, the functionality of the TRS was increased, and in the August Trust and Estates newsletter, HMRC asked for personal representatives to make notifications of changes to the personal representative's details and notify the "closure" of the estate (i.e. the end of the administration period) via the TRS.
>
> Given that reporting the "closure" of an estate via the TRS effectively meant reporting the end of the administration period to HMRC twice (in addition to being very time-consuming to complete as it requires the executors to set up a Government Gateway and complete a digital handshake to authorise their agents), members asked on what basis HMRC were asking them to do this extra step.
>
> We raised these concerns with HMRC who have now confirmed to us (and other professional bodies) in email correspondence this month that, unlike for registered trusts where certain legal obligations apply regarding when details held on the Trust Register must be updated, estates are not similarly bound.
>
> HMRC have shared the following with us.
>
> "The requirement to update details on TRS applies only to taxable 'relevant' trusts which are registered for the purposes of the 4th Money

[31] *https://www.att.org.uk/technical/news/estates-trusts-registration-service* (Nov 2020)

> Laundering Directorate. The requirement does not extend to estates, which are registered to obtain a UTR for SA purposes. HMRC would prefer PRs and agents to use TRS to notify the closure of a registered estate but there is no obligation to do so. Notification can be made by letter or via a SA return if that is more convenient.
>
> "For registered estates where a closure notification has already been made by letter or in a SA return, HMRC does not expect PRs [Personal representatives] or agents to go back and update TRS as this will be done by HMRC staff.
>
> "TRS should be used to notify HMRC that the name or address of a PR has changed."[32]

If on completion of the administration a trust comes into effect, it is in principle necessary to report that trust under TRS.[33]

89.21.4 *Reporting estate distributions*

ICAEW say:

> **Distributions from estates in administration – completing self assessment tax returns and R40s**
>
> HMRC has provided the following clarification on how to report distributions from estates in administration on self assessment tax returns and R40 forms.
>
> When income from an estate in administration is paid out to beneficiaries the executors need to tell the beneficiaries:
>
> - How much income they are entitled to, and
> - How much of the entitlement is made up of dividends received before and after 6 April 2016, and
> - Whether there is any untaxed bank interest included in their entitlement
>
> **Untaxed bank interest**
>
> The R185 statement of estate income is not required where the only income is untaxed bank interest of less than £100 so in this situation the executors have to provide the beneficiaries with a breakdown of any untaxed bank interest on a separate sheet and the beneficiaries should declare the bank interest received in box 2 on page TR3 of the SA100. The R185 has a separate box for the pre April 2016 dividends, box 20,

[32] The TRS Manual makes similar points: see TRSM27010 - Types of trust that need to be registered: contents: registrable estates.

[33] Registration may not be required within 2 years of death; see 131.11 (Excluded trusts).

but the new instructions from HMRC appear to advocate ignoring that box. The instructions on the R185 for box 20 is to simply enter these dividends into the white space.

If the beneficiary is a taxpayer in self assessment, they will have to transfer the details in box 18 on the R185 estate income into box 18 on their SA107. They will then need to note in box 25, the white space, of the SA107 how much dividend income was received by the estate before 6 April 2016 but not paid out until after 6 April 2016. They need to do this so that the pre April 2016 tax credit can be taken into account and is not repaid.

By entering all the dividends onto the self assessment return then, provided the beneficiary is not in a tax repayment situation, it seems that the tax will be correctly calculated. If the beneficiary is in a repayment situation it may be necessary to do a manual calculation to ensure the non repayable dividend tax credit is excluded from any repayment.

If the beneficiary is a non-taxpayer, the beneficiary will instead have to transfer the details in box 18 on the R185 statement of estate income into box 4.11 or 6.1 on the R40 depending on whether the dividends were UK or foreign dividends. They need to do this because individuals are entitled to a dividend allowance and will be entitled to a tax rebate or credit against their tax charge of the tax paid on dividends received by the estate after 6 April 2016. There is no additional information box on the R40 so the beneficiary will have to tell HMRC on a separate sheet which dividends were received after 6 April 2016 so that the refund can be calculated.[34]

89.22 Income tax of estates: Critique

There could hardly be a stronger condemnation of the current rules than the statement in the Manual that *It is unlikely that there will be cases where it is worthwhile insisting on the statutory basis*. The code needs to be rethought and replaced with something simpler. But that is outside the scope of this book.

[34] *https://wayback.archive-it.org/15130/20201013123300/https://ion.icaew.com/taxfaculty/b/weblog/posts/distributions-from-estates-in-administration-completing-self-assessment-tax-returns-and-r40s?CommentSortBy=Votes&CommentSortOrder=Descending* (July 2017)

CHAPTER NINETY

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90.1 Foreign entities: Introduction

UK law recognises many types of entity:

(1) Entities which are legal persons, eg companies and Scots partnerships

(2) Entities which are not legal persons, eg English partnerships, trusts and estates (though partners/trustees/PRs are legal persons)

Three issues, or sets of issues, arise in relation to foreign entities:

(1) *Application of entity vocabulary:* Whether a foreign entity is a company, partnership, trust, person, etc, in the general sense of the word.

(a) If so, a statutory entity term such as company, partnership, trust, person, etc will (subject to context) include that foreign entity.

(b) If not, the statutory term (subject to context) will not include that entity.

For in general, references to companies, partnerships, trusts, etc are not restricted to UK entities.[1] I call this issue **"entity classification"**.

(2) *Application of other legal vocabulary*: Whether a right in a foreign entity constitutes "share capital", or an "interest in possession", or a "interest" in the entity, etc. Again:
   (a) If so, a statutory term such as share capital, or interest in, will (subject to context) include that foreign right.
   (b) If not, the statutory term (subject to context) will not include that right.

(3) *Transparency issues:* Whether a foreign entity is transparent (or opaque), in the sense that income/gains are regarded as arising to its members[2] (or to the entity itself), or in some other sense.

The answer to issue (1) (entity classification) may answer, or help to answer, issues (2) and (3) (other legal vocabulary/transparency). Conversely, the answer to issues (2) and (3) may help to answer issue (1). The issues strongly interlink, and discussion easily segues from one to the other, so that sometimes they are not regarded as different questions at all. However these are distinct issues, it is better, sometimes necessary, to consider them separately, and failure to do this can cause confusion.

Issue (1) is aptly called "entity classification". One might also refer to issues (2) and (3) as "classification" of entities, or of interests in entities. But for clarity of analysis I prefer not to use that term for those issues.

The issues raise more or less difficulty, depending on the similarity of the law of the entity, or country, to UK law.

Similar issues arise in the application of DTAs to foreign (and UK) entities, for instance, whether an entity is a "person" or a "body corporate" for the purpose of a DTA. Similar issues arise in non-tax contexts.

90.2 Roles of UK/foreign law

90.2.1 *Domestic law matters*

When UK court has to apply the provisions of an UK taxing statute to some transaction, arrangement or entity which is governed by UK law:

[1] LLP is an exception as this term is defined to mean a UK LLP; see 85.21.1 (Definition and nature of LLP).

[2] In the context of foreign entities, it is convenient to use the word "member" loosely, to include any person with an interest in any entity.

(1) The court will obviously apply general UK law principles in order to determine the nature and characteristics of the transaction, arrangement or entity.

(2) Having informed itself in this way, the court must then apply the taxing statute.

In *AC v DC*:[3]

> The law of tax is not an island entire of itself. Unless a taxing statute says to the contrary the right of the state to charge tax in relation to a given transaction is subject to the effect of that transaction as defined by the general law.

Other countries adopt the same approach:[4]

> 11. In most [OECD] Member countries, as a matter of principle, tax laws apply on the basis of the legal relationship deriving from other branches of the law. Thus the tax laws of these countries, when referring to partnerships, will, absent special tax definitions, refer to those entities that constitute partnerships according to domestic civil or commercial law.

90.2.2 *Foreign law matters*

Turning to foreign law matters, in *Memec v IRC*:[5]

> When an English tribunal has to apply the provisions of an UK taxing statute to some transaction, arrangement or entity which is governed by a foreign system of law,
>
> [1] the tribunal must take account of the rules of that foreign system (properly proved if not admitted) in order to determine the nature and characteristics of the transaction, arrangement or entity.
>
> [2] But having informed itself in this way, the tribunal must then apply the taxing statute as part of English law.[6]

[3] [2012] EWHC 2032 (Fam) at [31].

[4] OECD, "The Application of the OECD Model Tax Convention to Partnerships" (1999) available (at a small charge) from *http://www.oecd.org*

[5] 71 TC 77 (HC) at p.92, approved *Anson v HMRC* [2015] UKSC 44 at [51].

[6] If further authority is needed, which I doubt, see Rowlatt J in *Garland v Archer-Shee*: 15 TC 693 at p.711:

"...it is not a question of American law whether something is or is not within the Income Tax Acts. The question of the American law is, what are exactly the rights and duties of the parties under an American trust, and when you find what those rights and duties are, you see what category they come in, and the place they fill in

The only difference is that English law is regarded in English courts as law and foreign law is regarded as fact.[7]

Unsurprisingly, other countries adopt a similar approach. In *Biddle v Commissioner*[8] the issue was whether tax deducted at source on a dividend by a UK company[9] was regarded as income tax paid by a shareholder, for the purposes of a US statute[10]:

> At the outset it is to be observed that decision must turn on the precise meaning of the words in the statute which grants to the citizen taxpayer a credit for foreign "income taxes paid." The power to tax and to grant the credit resides in Congress, and it is the will of Congress which controls the application of the provisions for credit. The expression of its will in legislation must be taken to conform to its own criteria unless the statute, by express language or necessary implication, makes the meaning of the phrase "paid or accrued," and hence the operation of the statute in which it occurs, depend upon its characterization by the foreign statutes and by decisions under them. ...
>
> ... The phrase "income taxes paid," as used in our own revenue laws, has for most practical purposes a well understood meaning to be derived from an examination of the statutes which provide for the laying and collection of income taxes. It is that meaning which must be attributed to it as used in § 131.
>
> Hence the board's finding... that "the stockholder receiving the dividend is regarded in the English income tax acts as having paid 'by deduction or otherwise'[11] the tax 'appropriate' to the dividend" is not conclusive. At most it is but a factor to be considered in deciding whether the stockholder pays the tax within the meaning of our own statute. That must ultimately be determined by ascertaining from an examination of the manner in which the British tax is paid[12] and collected, what the stockholder has done in conformity to British law,

the scheme of the English Income Tax Acts which the courts here must construe." This passage has often been approved; see *Rae v Lazard* 41 TC 1 at p.31; *Memec v IRC* 71 TC 77 at p.111.

[7] See 90.60 (Ascertaining foreign law).

[8] 302 U.S. 573 (1938).

[9] Before the introduction of Corporation Tax.

[10] Section 131 [US] Revenue Act 1928, which allowed foreign tax credit relief in respect of "income … taxes paid or accrued during the taxable year to [a] foreign country".

[11] See App.2.3.2 (Bear tax by deduction or otherwise).

[12] I have corrected an apparent typo: the original reads "laid"; but it does not matter.

> and whether it is the substantial equivalent of payment of the tax as those terms are used in our own statute.

Other countries may adopt the same approach, or similar:[13]

> 12. Difficulties often arise, however, where income is derived by [arises to] an entity organised under the laws of another jurisdiction. In that case, the entity will have to be classified for purposes of the application of the tax laws of the country where the income is derived, regardless of whether or not that classification is compatible with the civil or commercial law system of the jurisdiction from which the entity derives its legal status.
> 13. For example, if the tax system of a country recognises only individuals, companies and partnerships (but not trusts) as taxpayers and provides for a different tax treatment for these three types of taxpayers, that country will have to 'force' foreign entities in one or the other of these categories (with more or less difficulty depending on the similarity of the civil and commercial law of the countries concerned) for purposes of applying its tax system to domestic income derived by these foreign entities.
> 14. In doing so, the practice of most countries is to adopt the same approach as the one they apply in a purely domestic context. They will therefore apply their domestic tax classification to foreign entities on the basis of the foreign law's legal characteristics of the entity. In the previous example, the country, for the purposes of taxing the domestic income of a trust established under the law of a foreign jurisdiction, will typically examine the legal characteristics of the trust as they derive from the trust law of the foreign jurisdiction in order to determine whom it should tax and whether that person should be taxed as an individual, company or partnership, which are the only categories recognised under its tax law.

So far as the topic raises issues of foreign law I necessarily rely on limited material available to an English lawyer. I would be interested to hear from readers with expertise on entities discussed in this chapter.

[13] OECD, "The Application of the OECD Model Tax Convention to Partnerships" (1999) available (at a small charge) from *http://www.oecd.org*
In Ireland this approach was adopted in *Quigley v Harris* [2008] IEHC 403. In that case the approach was said to derive from the principle of comity of nations, that is, that the courts of one jurisdiction recognise and give effect to rights and obligations relating to foreign entities, in accordance with the law of the state where the entity is established.

90.3 Entity classification test(s)

The question whether, in any particular statutory provision, a reference to (say) a trust or trustee includes some particular foreign entity or person, raises some fundamental questions:

(1) What is the definition, or determinative characteristic(s), of (say) a trust/trustee? a question of UK law

(2) Does the foreign entity or person have those characteristics? a question of the foreign law

There is an important distinction between well-defined and vaguely defined terms.

90.3.1 *Well-defined terms*

Sometimes a UK entity (or other legal term) has an authoritative statutory definition. This is the case, for instance, for a partnership: a partnership (in short) exists when persons carry on business in common, and if they do not carry on business (or not in common) a partnership does not exist.[14] So here, the entity classification question is a focussed one: whether the members of the entity carry on business in common.

Sometimes a UK entity has a reasonably clear non-statutory definition. This is the case, for instance, for "body corporate" (which is, importantly, usually a company for tax purposes). An entity is a body corporate if and only if it has legal personality, perpetual succession and state sanction.[15] So here, the entity classification question is also a focussed one: whether the entity has these three characteristics.

I refer to these as **"well-defined terms"**.

90.3.2 *Vaguely-defined terms*

Sometimes a UK entity (or other legal term) does not have an precise or authoritative definition. Definition(s) are more or less imprecise, or there is no definition at all. Textbooks may offer a variety of definitions, or none. Examples are perhaps the words "debenture", "security", "shares" and "trust"[16]. I refer to these as **"vaguely defined terms"**.In the absence of a sufficiently clear definition, the entity classification question must be

[14] See 85.2.1 (Definitions of "partnership").

[15] See 90.9.3 (What is a body corporate?); 90.8.4 (Company: undefined/general sense).

[16] See 87.2 (Classic trust).

less focussed; in determining whether a foreign entity is a trust, one might ask: does the entity have trust-like features, or sufficient trust-like features. There is a multi-factorial test. I refer to this way to classify an entity, as the **"entity-resemblance test"**. One could use the term "hallmarks test" and one could refer to tests, in the plural, as there is no single test which applies to all types of entity. These are vague tests, as first one has to identify the features (or hallmarks) of an entity, as a matter of UK law, and then one has to deal with the foreign-law problem of whether the foreign entity under consideration has those features, or sufficient of them. So if a reasonably appropriate definition can be found, that is the better way to address classification issues.

As always, these questions arise "subject to context" because definitions or determinative characteristics may vary according to the purposes we have in mind. An entity might be (say) a partnership or company for one purpose and not for another. But in practice I doubt if that happens much.[17]

90.3.3 *Foreign-entity clauses*

Statutes occasionally contain definitions to govern the meaning of foreign entities or terms. For instance these definitions of trust and partnership:[18]

> "trust" includes arrangements-
> (a) which have effect under the law of a country or territory outside the UK, and
> (b) under which persons acting in a fiduciary capacity hold and

[17] Except where statute expressly so provides.

[18] These definitions of trust and partnership are both to be found in:

Provision	Topic	See para
s.517N(4) ITA/s.356ON CTA 2010	Transactions in land	22.11.2
Para 11 sch 4 FA 2019	Profit fragmentation	53.19

The partnership foreign-entity clause is slightly more common, dating back to s.57 Pensions Act 2004. The trust foreign-entity clause derives from s.6B Building Societies Act 1986 (inserted 1997).

Foreign-entity clauses are also found in non-tax legislation, eg s.1208 Companies Act 2006:

> "partnership" means—
> (a) a partnership within the Partnership Act 1890, or
> (b) a limited partnership registered under the Limited Partnerships Act 1907,
> or a firm or entity of a similar character formed under the law of a country or territory outside the UK.

> administer property on behalf of other persons
>
> "partnership" includes an entity established under the law of a country or territory outside the UK of a similar character to a partnership

I refer to provisions of this kind as **"foreign-entity clauses"**.

Under the above definition of trust, a trust includes a foreign entity under which "persons acting in a fiduciary capacity hold and administer property on behalf of other persons". That is a fair definition of what a trust is. I cannot think of an entity which is not a trust in the normal sense of the word, which is a trust under this definition.

Under the above definition of partnership, a partnership includes a foreign entity "of a similar character to a partnership". The position here depends on the elastic word "similar". Perhaps one could find an entity which:

(1) is not a partnership (because its business is not carried on by the partners); but
(2) is similar to a partnership (because it has sufficient partnership-like features).

This is unexplored territory. Possible examples are:

(1) A foreign LLP
(2) An LLC

These are not partnerships, but might be regarded as similar. The answer would depend on which view better fits the context of the particular case. It is not possible to say any more on the issue in the absence of context.

Another example of this type of clause is para 4(6) sch 1B TCGA:

> In applying the domestic concepts of law mentioned in this paragraph to land outside the UK, this paragraph is to be read so as to produce the result most closely corresponding with that produced in relation to land in the UK.

I am not sure that clauses of this kind do much good, but they do no harm. Perhaps fortunately, they are not common.

90.3.4 *An entity spectrum?*

In *Anson* at first instance, the FTT said:[19]

[19] Reported under the pseudonym *Swift v HMRC* [2010] UKFTT 88 (TC) at [20]. The FTT decision was eventually upheld by the SC, and it is suggested that this passage

> There is a spectrum running from
> (1) the English partnership: not a legal person, with the partners owning the assets jointly and incurring the liabilities, carrying on the business, and being entitled to the profits; through
> (2) the Scots partnership: legal person ... owning the assets and incurring the liabilities with a secondary liability on the partners, with the partners nevertheless carrying on the business (since that is the definition of partnership) and being entitled to the profits; to
> (3) the UK company: legal person ... owning the assets and incurring the liabilities with no liability on the members (or a liability only on winding-up for an unlimited company) and carrying on its business with the members holding shares and being entitled to profits only after either payment by the directors or recommendation by the directors and a resolution to declare dividends by the members. ... the articles of a UK company could provide for automatic dividends.

The metaphor or image of a "spectrum" might be helpful up to a point; but I doubt it. It requires a simplification of facts which do not fit neatly on a straight line. I think it is no more than an attractive way of restating an entity-resemblance test.

90.4 How labels may mislead

90.4.1 *English language terminology*

The fact that a foreign entity is called, say, a trust or company under the foreign law does not entail that the entity is necessarily a trust or company in UK law, or for the purposes of UK tax. This is so even if the foreign country uses English and the same English term is used in both countries. In *HMRC v First Nationwide*:[20]

> The meaning of the word [dividend] in the tax legislation is a matter of English law not of Cayman law.
> Although Cayman law uses the word "dividend" to cover the distributions made in the present case ... it does not follow that the Preference Dividends are therefore "dividends" with the meaning of the

is correct.

[20] [2011] UKUT 174 (TCC) at [23]. Although the decision was reversed on appeal, this point was not doubted. Other examples:

Example	**See para**
US grantor trust not necessarily a trust for UK tax purposes	90.10
US limited liability company not necessarily a company for UK tax	90.40.1

UK tax legislation.

The use of scare quotation marks may be helpful here.

90.4.2 *Foreign language terminology*

Similarly, the fact that entities are described by the same foreign term in two countries does not entail that they are necessarily the same kind of entity. For instance a Fideicomiso in one jurisdiction may be a trust but a Fideicomiso in another jurisdiction may not.[21] Article 31(1) AMLD refers to

> types of legal arrangements, such as, inter alia, fiducie, certain types of Treuhand or fideicomiso, where such arrangements have a structure or functions similar to trusts[22]

The underlined words illustrate that the entities named are sometimes similar to trusts and sometimes not.

90.4.3 *Entity documentation*

One should not assume that two entities are classified the same way just because they are the same type of entity under foreign law. The drafting of the constitution of an entity may make a difference to its UK tax classification. For instance:

(1) a Foundation with Founder's Rights may be classified as a company and one without Founder's Rights may be classified as a trust

(2) a US grantor trust (or indeed a UK law trust) may be a substantive trust or a bare trust depending on the terms of the trust deed

90.5 Foreign law classification/treatment

Four types of questions may be distinguished:

(1) How does a foreign law classify or treat entities of its own jurisdiction, that is, entities governed by that foreign law, eg:
   (a) is a US LLC a corporation or a partnership (or something else) in US law?
   (b) is a US LLC transparent in US tax law?

(2) How does a foreign law classify or treat entities from other foreign jurisdictions, eg:
   (a) does Canadian law classify a Liechtenstein Foundation, or a US

[21] See 90.20 (Fideicomiso/Fideicommissum).

[22] See 131.3 (MLR: EU law background).

LLC, as a company?

(b) does Canadian tax law treat such entities as transparent?

The CTM provides:

> **CTM80152 Groups: Group Relief And Partnerships** [Dec 2019]
> ... Institutions organised outside the UK and considered to be partnerships in their home territory may be 'companies' for the purposes of group relief, depending on the facts and circumstances of the institution concerned. Classification under UK law does not necessarily follow treatment in the home territory. ...

Similarly, the INTM (discussing transparency) provides:

> **INTM180020 How HMRC arrives at a general view of foreign entities** [Dec 2023]
> How the entity is classified for tax purposes in any other country is not relevant.

So far as these issues are prescribed by foreign tax statutes, it will have little if any relevance in the UK. US tax law, for instance, has express entity classification rules.[23]

So far as entity classification is discussed in foreign case law, it should have some persuasive authority if the foreign law applies the same entity-classification test as the UK.

If the foreign tax law is sufficiently similar to UK law, it is considered that a foreign law classification as transparent/opaque ought to be relevant, though not of course decisive. An incidental attraction of this course is that it reduces the number of hybrid entities, which give rise to difficulties.[24] But in the event of a dispute, the question whether the foreign law is "sufficiently similar" is likely to be contested.[25] Indeed, I wonder if there is any jurisdiction which is sufficiently similar to the UK.

It has been said that in Canada, all legal persons (other than natural persons) are (or at least should be) classified as corporations.[26] That rule is different from the test which apply in the UK.[27] To the extent that

[23] Eg "check-the-box" rules; see 90.43.1 (LLC: US law background).

[24] See 91.1 (Hybrid entities).

[25] See too 90.4 (How terminology may mislead).

[26] See Welters, "Towards a Singular Concept of Legal Personality" , 2014 CanLIIDocs 142 *https://canlii.ca/t/28g3*

[27] It is a simpler test, though it still leaves the question of what amounts to legal personality, and whether any particular body has it.

Canada does adopt that rule, or is influenced by it, entity classification in Canadian case law should not be regarded as persuasive authority in the UK. I am not sure how far Canadian law actually adopts that rule.[28] That only goes to show how difficult it is to apply foreign case law in the UK. Perhaps it is better not to try.

90.5.1 *Foreign material: Conclusion*

In short, foreign law material (terminology, or statute or case law) needs to be carefully evaluated before it is relied on in the UK for issues of classification. This applies even to material from a common law jurisdiction such as Canada, whose trust and company law is in many respects similar to English law.

90.6 Transparency issues

90.6.1 *Transparent/opaque terminology*

UK tax law may categorise entities as "**transparent**" or "**opaque**".[29] The International Manual explains this terminology:

[28] Blanchard "The Tax Significance of Legal Personality: A U.S. View" (2015):

"In 2000, a Canadian government official discovered that a general partnership formed under Delaware's newly-revised version of RUPA possessed legal personality. In July of 2000, Canada announced that Delaware general partnerships would henceforth be treated as corporations, with the result that – because partnerships do not pay taxes at the entity level - treaty benefits would be denied to U.S. persons investing in Canada through such partnerships. Predictably, uproar ensued. It was pointed out that all U.S. partnerships, regardless of the state in which they were formed and regardless of whether they were general or limited partnerships, possessed legal personality in the sense "discovered" by Canada in 2000... Following this incident, Canada relented. In November of 2000, it was announced that henceforth Canada would not apply the legal personality criterion to partnerships."

https://www.law.nyu.edu/sites/default/files/upload_documents/Kimberly%20S.%20Blanchard2.pdf

What I think this story illustrates is that short statements of law will frequently mislead.

[29] The term sometimes used is "fiscally" transparent/opaque. In a tax context that is synonymous with transparent/opaque but the expression may be useful to distinguish:

(1) the tax concept, and
(2) non-tax uses of the term, where "transparency" refers to the values of openness, communication and accountability

The American legal English term "pass-through" is synonymous with transparent.

> **INTM180010 Foreign entity classification for UK tax purposes: Introduction** [Dec 2023]
> When we describe a foreign entity as "transparent" in INTM180000+, we mean that its members will generally be liable to UK tax on the profits, income or gains of the entity rather than only on any distributions from the entity. When an entity is described as "opaque", its members will generally be taxed only on the distributions made by the entity.

OECD discuss the term in the context of art 1(2) OECD Model and make the same point in another way:[30]

> The concept of "fiscally transparent" used in [OECD Model para 1(2)[31]] refers to situations where, under the domestic law of a Contracting State, the income ... of the entity or arrangement is not taxed at the level of the entity or the arrangement but at the level of the persons who have an interest in that entity or arrangement.

90.6.2 *Consequences of transparency*

OECD Commentary continues:

> This will normally be the case where
> [1] the amount of tax payable on a share of the income of an entity or arrangement is determined separately in relation to the personal characteristics of the person who is entitled to that share so that the tax will depend
> [a] on whether that person is taxable or not,
> [b] on the other income that the person has,
> [c] on the personal allowances to which the person is entitled and
> [d] on the tax rate applicable to that person;
> [2] also,
> [a] the character and source,
> [b] as well as the timing of the realisation,
> of the income for tax purposes will not be affected by the fact that it has been earned through the entity or arrangement.

One might regard that either as consequences or aspects or hallmarks of transparency, depending on one's perspective.

OECD identify a feature which does not amount to a hallmark of

[30] Commentary on OECD Model art 1(2), para 9.
[31] See 91.4 (OECD hybrid-entity rules).

transparency:

> The fact that the income is computed at the level of the entity or arrangement before the share is allocated to the person will not affect that result.[32]

The terminology is used similarly for CGT:

(1) In the case of a transparent entity, members are regarded as being entitled to the gains of the entity as they accrue.

(2) In the case of an opaque entity, members are in principle taxed only on distributions made by the entity; the entity itself is a taxable unit regarded as receiving the gains. For instance, partners are regarded as entitled to the gains of a partnership as they accrue, and are charged to CGT on that basis; so a partnership is said to be transparent for CGT.

90.6.3 *Further uses of the terminology*

The sense(s) explained above is the paradigm use of the terms transparent/opaque. However the terminology is used in an analogous way in many other contexts. For instance,

(1) A partnership or other entity may be said to be transparent in the sense that:

    (a) the entity's business is regarded as carried on by its members[33]

    (b) entity employees are regarded as employees of the members[34]

    (c) entity assets are regarded as held or owned by the members[35]

(2) A partnership may be said to be opaque (not transparent) for IHT situs rules, because the situs of a partner's interest in a partnership is not the situs of the partnership assets.[36]

One should not use the term transparent/opaque without identifying the

[32] An example is a UK partnership which is transparent even though income is comuted at a partnership level; see 86.1 (Partnership income: outline).
OECD here refer to OECD Partnerships Report para 37- 40; for the relevant text see 9.22.2 (Partnership "liable to tax").

[33] See 91.6.1 (Considered as income: Effect).

[34] See 37.15 (Employer a partnership).

[35] See 30.15.6 (Receipt via transparent entity).

[36] Another example: a partnership may be said to be opaque for the purposes of the ITA remittance basis, in the sense that property brought to the UK by the partnership is not regarded as remitted by the partners; see 18.49.1 (Partnership opaque for remittance basis).

provision or context involved, as an entity may be transparent for one purpose and not for another. For instance, a partnership is transparent for IT/CGT but not for IHT. Hence this section is headed "Transparency issues" (in the plural).

90.6.4 *Transparent/opaque: Caution*

Terms which can be used in so many senses, or which carry so many implications, need to be used with caution.

UK tax statutes do not generally use the term "transparent", though it is occasionally found in recent provisions.[37] Thus the person liable for income tax is generally the person receiving or entitled to the income.[38] The correct statutory question to ask here is therefore not whether the entity is transparent, but whether a member of an entity is a person receiving or entitled to the income. Similarly, the person chargeable to CGT is the person to whom gains accrue.[39] The correct statutory question to ask is therefore whether a gain accrues to the members or to the entity. For IHT situs, the correct statutory question to ask is, what is the situs of the partner's interest in the entity, not whether the entity is transparent. For remittances, the correct statutory question to ask should be framed in the terms of remittance condition A, and not in terms of transparency.

In other words, in cases where statute does not use the word "transparent":

(1) The labels transparent/opaque may be a convenient shorthand; but
(2) It is necessary to remember the words of the statute: if that is not done, the terminology may mislead.

In these cases the labels transparent/opaque are better used to summarise a conclusion rather than as the reason for reaching that conclusion.

The FTT has made this point:

> The issue is whether the UK tax is 'computed by reference to the same profits or income' ... Asking whether [the Delaware LLC] is transparent or opaque may be another way of asking the same question but we consider that it is preferable to apply the words of the Treaty.[40]

[37] For instance in the OFTR: see 67.24.1 ("Transparent fund").

[38] See 15.2.1 (Receipt/entitlement basis of liability).

[39] See 15.2.4 (Accruing: Gains).

[40] *Anson v HMRC* reported under the pseudonym *Swift v HMRC* [2010] UKFTT 88 (TC) at [18].

The Supreme Court agreed that questions of this kind should not be conflated:

> The issue in this case [*Anson*]
> [1] is not whether the receipts of the LLC from third parties are to be regarded as having been paid to the members of the LLC, but
> [2] whether the income on which Mr Anson paid tax in the US is the same[41] as the income on which he is liable to tax in the UK....
> That issue is different from the issue considered in *Memec*.[42] The answer to the question whether the receipts and expenditure of an entity are paid to and by its members does not necessarily determine whether, when a profit arises in a given accounting period, that profit constitutes the income of the members.[43]

It can only confuse the issue to describe both questions as whether an LLC is transparent, because they are (or may be) distinct questions. One may say, as the Supreme Court did in *Anson,* "transparent" *in the sense that*...[44]

This is especially important outside the paradigm context, but the same point arises even there. For instance, classification of an entity as transparent for IT, in the paradigm sense that the income is treated as the income of the members of the entity, may seem to entail that the entity itself is regarded as *not* entitled to the income. Thus a partnership is transparent, and income accrue to the partners and not to the partnership. But this is not always the case. For instance, an IIP trust is transparent, but the trustees may still be taxable on the trust income.[45] That seems illogical only if one fails to ask the correct, *statutory* question. Trustees of an IIP trust may be persons who receive trust income even if they are not persons who are entitled to the income, so they may be liable to income tax.[46]

HMRC agree. The INT Manual provides:

> **INTM180010 Foreign entity classification for UK tax purposes: Introduction** [Dec 2023]
> ... However, it is important to remember that "transparent" and "opaque" are not terms which are usually used in the legislation (an

[41] See 111.5 (Same income rule).

[42] The issue in *Memec* was whether a dividend received by a stille Gesellschaft was *paid to* the "silent partner"; see 90.30 (Stille Gesellschaft).

[43] [2015] UKSC 44 at [109].

[44] [2015] UKSC 44 at [43]. The quotation marks are original.

[45] Likewise a settlor-interested trust within s.624.

[46] See 42.2 (Taxation of IIP trustees).

example of an exception would be CTA09/S438).[47] Rather, they are informal labels which we use in this guidance to describe who is liable to UK tax on what profits, income or gains. As such, it will always be necessary to consider the particular UK taxation provision under which the matter must be considered.

For example, if you need to consider whether a UK resident individual member of a foreign entity is liable to UK tax on the trade profits, you will need to consider whether the member can be regarded as "receiving or entitled to the profits" for the purposes of ITTOIA05/S8.[48] If they can, the entity could be described as "transparent" in the sense that the member is liable to UK tax on the profits.

If the entity is a company (within the meaning of CTM00510) which is resident in the UK (INTM120000) or carrying on a trade in the UK through a permanent establishment (INTM260000), you may also need to consider whether the profits are "of" the company for the purpose of CTA09/S2.[49] If so, the entity could be described as "opaque" in the sense that the company is liable to UK tax on the profits.

90.7 How to determine transparency

90.7.1 *Statutory provisions*

Occasionally statute answers the question whether an entity is transparent or opaque. For instance, s.65(2) TCGA provides that trusts and estates are (generally) opaque for CGT:

> Subject to section 60 and any other express provision to the contrary,
> [1] chargeable gains accruing to the trustees of a settlement or to the personal representatives of a deceased person, and
> [2] capital gains tax chargeable on or in the name of such trustees or personal representatives,
> shall not be regarded for the purposes of this Act as accruing to, or chargeable on, any other person ...

Conversely, s.60 TCGA provides that a bare trust is transparent for CGT.[50]

90.7.2 *Transparency-factors test*

More often it is a matter of applying general principles.

[47] Section 438 CTA 2009 relates to the niche topic of european cross-border mergers, but for an example relevant to this work, see 66.24 (Transparent fund exemption).

[48] See 15.2.1 (Receipt/entitlement basis of liability).

[49] See 15.2.5 (Profits of companies).

[50] See 87.7 (Bare trust/nomineeship).

The International Manual provides (in the context of transparency)

> **INTM180020 How HMRC arrives at a general view of foreign entities** [Dec 2023]
> To reach a general view [as to whether bodies are transparant or opaque], we take into account the following factors:

I call this the **"transparency-factors test"**: HMRC give a list of six factors (**"transparency factors"**).[51] In short:

Factor		**Suggestive of**	
		Transparency	*Opacity*
1	Separate legal personality		
	(a) exists	n	y
	(b) does not exist	y	n
2	Share capital or something like it		
	(a) exists	n	y
	(b) does not exist	y	n
3	Who carries on the business:		
	(a) the entity	n	y
	(b) its members	y	n
4	Members entitled to profits		
	(a) as they arise	y	n
	(b) on subsequent distribution	n	y
5	Liability for debts:		
	(a) the entity	n	y
	(b) its members	y	n
6	Ownership of assets		
	(a) by entity	n	y
	(b) by the members	y	n

I consider these factors separately.

90.7.3 *Factor 1: Legal personality*

> Does the foreign entity have a legal existence separate from that of the persons who have an interest in it?

"Separate legal existence" means existence separate from the members of the entity. I think that must mean legal personality, in the UK law sense that the entity is capable of holding property, and it would be clearer to use

[51] This list of factors derives from HMRC Tax Bulletins 29 (1997) and 39 (1999) and obtains some support from *Dreyfus v IRC* 14 TC 560.

that term.

Assuming separate legal existence means legal personality, the question arises whether any particular foreign entity has it.[52]

In *Anson v HMRC*:[53]

> ... it would be unusual but not impossible for an entity with a separate legal personality, such as a company, to be tax transparent for English law purposes. One example would be the Scottish partnership where the partnership is a separate legal entity and holds the assets of the business, but the partners have an (indirect) interest in the assets and carry on business in common: this has been held by this court to be tax transparent and [HMRC] assured the court that nothing in [its] submissions was intended to undermine that position.

90.7.4 *Factor 2: Share capital/similar*

> Does the entity issue shares in
> [1] its capital or
> [2] something else which serves the same function as shares in capital (for these purposes, "shares" should be interpreted in line with CTA10/S1117(1) to include any other interest of a member in a company- see CTM00513 and below for further guidance)?

This can be problematic: what is share capital? when does something else serve its functions? what are the functions of share capital which is typically a nominal £1?[54] In practice this is likely to be contestable.

The INT Manual has further comments on this factor:

> **INTM180020 How HMRC arrives at a general view of foreign entities** [Dec 2023]
> Share capital in a UK-registered company is what the members contribute and under UK company law reflects a nominal value, although the shares may be issued at a premium. The shares issued will reflect members' proportionate interests in the share capital according to

[52] See App.2.6 (Person/legal personality). At first sight it is difficult to tax an entity which does not have legal capacity, so one might think that an entity without legal capacity cannot be opaque; in which case legal personality may be fundamental; but one might find persons who can be taxed on behalf of the entity (such as trustees, or the treasurer or board of an unincorporated association).

[53] *Anson v HMRC* [2013] EWCA Civ 63 at [63]. The decision was reversed on appeal, and the first sentence may now be doubted, but the second sentence stands good.

[54] See 90.55 (Ordinary share capital).

> nominal value (although the actual value of the shares will usually be different from the capital contributed as the actual value will usually reflect undistributed profits or the discounted value of the expected dividend stream rather than entitlement to assets in liquidation).
> However, the important point here is that the share capital concept reflects not UK company law formalities but members' ownership interests in what has been called the "corpus" of the company (see *Rae v Lazard* (1963) 41 TC 1).

I do not think the word "corpus" is helpful here.[55]

> When considering whether a foreign entity issues something similar to share capital in a UK-registered company, it is therefore important to remember that whilst foreign company law may be significantly different from UK company law (for example, there may be no nominal capital), it may still issue something that serves the same purpose of reflecting members' ownership interests in the "corpus" of the entity. See CTM00515-6 for further guidance.

Gerald Montagu questions this factor:[56]

> A focus on share capital becomes even more questionable in light of the recent developments relating to companies with no par value shares in a number of offshore jurisdictions and the related move from company law regimes based on the maintenance of capital to hybrid regimes in which solvency based tests come very much to the fore (and the vestige that remains of the maintenance of capital rules can seem to lack real substance).

90.7.5 *Factor 3: Who carries on business*

> Is the business carried on
> [a] by the entity itself or
> [b] jointly by the persons who have an interest in it that is separate and distinct from the entity?

This may be problematic. The answer may be both, as is the case for a Scots partnership.[57]

[55] See 30.9.2 (Corpus intact).

[56] "Anson and entity classification revisited in light of Brexit: can an LLC constitute a body corporate?" [2016] BTR 466.

[57] See 85.8.2 (Tiers: Tax analysis).

90.7.6 *Factor 4: Entitlement to profits*

[a] Are the persons who have an interest in the entity entitled to share in its profits as they arise; or

[b] does the amount of profits to which they are entitled depend on a decision of the entity in accordance with its constitution, usually made by its directors (or their equivalents), or members collectively, after the profits have been measured (a distribution)?

As a matter of partnership law, a partnership may (and often is) entitled to retain some partnership profits for capital growth. But that does not matter as for income tax purposes the partners are regarded as entitled to the profits.[58]

In *Anson v HMRC*:[59]

> [HMRC] submits that it is impossible for the profits of a business to belong to a person other than the person carrying on the business. I agree that it is difficult to think of examples where this would be the case, save perhaps in one case. That is the case of an agency company, that is, a company which carries on its own business so far as its dealings with the outside world are concerned but which in fact holds its assets as agent for another (usually another group company) and draws up its own accounts on that basis. But even in that example, the agency company may be little more than a nominee. There may be other cases.

As a matter of company law, a company normally falls within [b]: it makes a decision to distribute its profits (or not) by way of dividend. But it is possible for company articles to require automatic distribution of all its profits. Then factor 4 suggests transparency, but if it is the only factor, that would not be enough to alter the outcome, at least in the case of a UK company.[60]

[58] See 15.2.1 (Receipt/entitlement basis of liability).

[59] *Anson v HMRC* [2013] EWCA Civ 63 at [63]. This was not questioned on the appeal.

[60] If authority is needed, this view may be supported by a comment in *Dreyfus v IRC* 14 TC 560. Section 20(ii) ITA 1918 provided:

> The income of a partner from a partnership ... shall be deemed to be the share to which he is entitled during the year to which the claim relates.

Rowlatt J said at p.572:

> a small number of persons being members of an English private company, carrying on business with articles of association however much reproducing in their provisions the usual features of partnership articles ... could not be charged with

90.7.7 *Factor 5: Liability for debts*

> Who is responsible for debts incurred as a result of the carrying on of the business: the entity or the persons who have an interest in it?

The answer may not be a simple yes or no, as in the case of a limited partnership (some members liable, some not); or a Scots partnership (partnership primarily liable, partners secondarily liable); likewise an unlimited company.

90.7.8 *Factor 6: Ownership of assets*

> Do the assets used for carrying on the business belong beneficially to the entity or to the persons who have an interest in it?

This factor overlaps with factor 1, separate legal personality.

The answer to factor 6 may not be a simple yes or no, as in the case of an English partnership, where ownership of partnership assets is nuanced.

90.7.9 *Factors test: Discussion*

The 6 transparency factors may require a detailed enquiry into the constitution of the foreign entity and its governing law.

They are sometimes problematic or difficult to determine. The answer may be unclear or unanswerable, because (in the foreign jurisdiction) it may make no difference whether (say) the business is said to be carried on by the entity or by the members, so the applicable law need not and generally will not address the question. The questions may be arid and essentially meaningless in the foreign jurisdiction.

If any one individual factor is unanswerable, it may matter less, because no one of the transparency factors is determinative: if one does not know it, one can turn to the others.

The six factors should not be regarded as a comprehensive.

The problem may come that different factors point different ways.

The INT Manual provides:

> **INTM180020 How HMRC arrives at a general view of foreign entities** [Dec 2023]
> Note that the above factors may be relevant when coming to a definitive view on how a particular statutory provision applies in a particular

Super-tax under [s.20(ii)], by reason of the substantial character of their association.

> situation (as at INTM180040). However, the extent to which each factor may be relevant will depend on what exactly the statutory question to answer is.
>
> Some of those factors may point in one direction; others may point in another. An overall conclusion is reached from looking at all the factors together, though some have more significance than others.

The passage does not say which have more significance than others. An earlier version stated at this point: "Particular attention is paid to factors 3 [who carries on business] and 4 [entitlement to profits]". I wonder if the omission is deliberate or accidental.

> These factors overlap. For example, as part of considering factor 4 [entitlement to profits] it is useful to consider the extent to which the entity displays what some commentators call 'entity shielding', which refers to the protection of the entity assets from members and their creditors. If it displays strong entity shielding, that would indicate that the members are not entitled to the profits which correlate to the assets in the balance sheet as they arise.
>
> To shield assets in this manner, the entity will need a separate legal existence (factor 1) with the ability to carry on business as an entity distinct from the members jointly or in common (factor 3) . Business assets will generally belong to the entity (factor 6), supporting their shielding or partitioning away from members and their creditors. If the entity is responsible for the debts (factor 5), that would be a pointer that it carries on the business itself, and strong entity shielding will often be a feature associated with members' limited liability.
>
> A consequence of entity shielding is that members' interests are not directly in the assets of the entity, but in the entity itself. This interest in the entity is likely to serve the same function as share capital in a UK-registered company (factor 2).

Foreign law plays its usual role:[61]

> In considering the factors above it is also important to remember that we look at the foreign commercial law under which the entity is formed and at the internal constitution of the entity.

Applying the transparency-factors test, as best I can, to UK entities whose transparency status is uncontroversial:

[61] See 90.2 (Roles of UK/foreign law).

Entity	**Factors suggesting transparency:**							**Transparent for:**	
	1	**2**	**3**	**4**	**5**	**6**	**Total**	**Income**	**Gains**
UK company	n	n	n	n	n	n	0	no	no
LLP (not deemed p'ship)	n	y	n	y	n	n	2	no	no
General partnerships									
English partnership	y	y	y	y	y	y	6	yes	yes
Scots partnership	n	y	y	y	y	n	4	yes	yes
Limited partnerships									
English partnership	y	y	y	y	n	y	5	yes	yes
Scots partnership	n	y	y	y	n	n	3	yes	yes
IP trust	y	y	n	y	n	n	3	yes	no
Discretionary trust	y	y	n	n	n	n	2	no	no
Deceased's estate	y	y	n	n	n	n	2	no	no

90.7.10 *A question of "substance"?*

In *Memec v HMRC*:[62]

> ...technical differences in the nature of rights should not cause cases which are in substance identical to receive different UK tax treatment.

But the questions discussed in this chapter often turn on distinctions, such as contractual/proprietary rights (*in rem/in personam*), which could properly be described as technical. It would assist clarity of thought not to use the word "technical" here.[63] A search for underlying "substance" is not going to help.[64]

90.7.11 *Transparency/entity classification compared*

The expressions "transparent" and "opaque" are not interchangeable with "partnership" and "company" or "body corporate". A fiscally transparent entity is not necessarily a partnership. A fiscally opaque entity is not necessarily a "body corporate" or a "company" for UK tax purposes.[65]

Similarly, in *Memec*:

> the question was not whether the silent partnership was a partnership for English law purposes but whether the arrangements were tax transparent

[62] 71 TC 77 at p.113.

[63] See App.1.8 (Technical).

[64] This view is supported by the comment in *Dreyfus*, set out in a footnote in 90.7.6 (Factor 4: Entitlement to profits), rejecting reliance on the "substantial character" of the association.

[65] The point was formerly made in INTM180020 (Considerations when using the List of Classifications of Foreign Entities for UK tax purposes) [Dec 2019] and though it is not in the current version, the point remains valid.

> so as to make the source of M's share of the subsidiaries' profits the same as that of the profits distributed to the intermediate holding company.[66]

Although the expressions are not interchangeable, the issues overlap:

(1) A transparent entity is not necessarily a partnership[67] but *if* the entity is classified as a partnership, it must be transparent for IT/CT and CGT.[68] Conversely an opaque entity is not necessarily a company/ body corporate, but if the entity is classified as a company, it is (at least, usually) opaque for tax purposes.

(2) The transparency-factors test is similar to the test for the classification of entities, ie the factors which suggest an entity is opaque (in the sense that income arises to the members not to the entity) are (broadly speaking) the same or similar to the factors which suggest that an entity is (say) a company.

90.8 Definition of "company"

There are about a dozen definitions of company relevant to this book. They can be categorised as follows:

Definition	**See**
Standard tax definition of company	*Discussed here*
Non-standard tax definitions of company:	
CG group relief	64.25
SDLT/ATED	98.2.2
Transactions in securities	55.2.1
Sale of occupation income	s.789 ITA
Notice of accounting period	121.23.1
OECD Model definition of company	30.15.4
Company in general sense	*Discussed here*
Companies Act definition of company	*Discussed here*

Strictly, one should not use the word company without specifying which definition applies; but in practice the context will generally supply that; and references to company in this work generally mean a company in the standard tax sense.

[66] *Anson v HMRC* [2013] EWCA Civ 63 at [44]. Although the decision was reversed on appeal, this point was not doubted.

[67] For instance, an IIP trust is also transparent: see 42.9 (Life tenant: Source of Income).

[68] See 85.16 (Partnership transparency: IT/CT); 85.20 (Partnership transpa rency: CGT).

90.8.1 *Company: Standard tax sense*

It is helpful to set out the CT/IT/CGT/SDLT definitions side by side:

s.1121 CTA 2010	**s.992 ITA**	**s.288 TCGA**	**s.100(1) FA 2003**
(1) In the Corporation Tax Acts "company" means	(1) In the Income Tax Acts "company" means	In this Act, unless the context otherwise requires ... "company" includes [1]	In this Part [Part 4, SDLT] "company", except as otherwise expressly provided, means
[a] any body corporate or unincorporated association, but	any body corporate or unincorporated association, but	[a] any body corporate or unincorporated association but	any body corporate or unincorporated association, but
[b] does not include [i] a partnership,	does not include [i] a partnership,	[b] does not include a partnership,	does not include a partnership.
[ii] a co-ownership scheme (as defined by [s.235A FSMA])			
[iii] a local authority or a local authority association. [2]	[ii] a local authority or a local authority association.		
(2) Subsection (1) needs to be read with section 617 (under which the trustees of an authorised unit trust are treated for certain purposes as a UK resident company).	(2) Subsection (1) needs to be with read with section 617 of CTA 2010 (authorised unit trust treated as UK resident company).[3]	[c] and shall be construed in accordance with section 99.[4]	

1. Although the word here is "includes" it is difficult to envisage an entity which is a company in the general sense of the word but which is not a body corporate; so "includes" here means "means".
2. This is subject to some minor (unnecessarily complicated) exceptions not considered here.
3 See 69.4.2 (Income arising to AUT).

Section 993(3) ITA signposts 3 sets of exceptions:
(a) Part 6 ITA: venture capital trusts
(b) Chap 1,4 Pt 13: transactions in securities & sales of occupation income
(c) s.993/994 ITA: meaning of connected person
The exception in the transactions in land code was removed when that code was rewritten in 2016; the need to amend s.993(3) to remove this reference was overlooked.

4 Section 99 TCGA relates to unit trusts; see 69.8 (CGT: Deemed-company fiction).

I refer to these definitions individually as the CT/IT/CGT/SDLT definitions and together (ignoring small differences between them) as the **"standard tax definition"**; and a body within this definition is a company in the **"standard tax sense"**.

The standard tax definition expressly excludes partnerships. This does not seem strictly necessary. It might have been done for the avoidance of doubt:

(1) In case it was argued that a partnership was a company in some loose or archaic sense of the word
(2) In case it was argued that a partnership was a body corporate (and so a company within the standard tax definition). This may apply in particular to:
    (a) Some foreign law entities which are partnerships and are or might be argued to be bodies corporate; and
    (b) A Scots partnership: The IT/CT definition was drafted in 1965[69] and at that time it might have been argued that a Scots partnership was a body corporate.[70]

An LLP is a body corporate but is (generally) outside the standard tax definition of company for two reasons (either would suffice): an LLP counts as a partnership, and is also expressly excluded from the tax definition of company.[71]

A corporate trustee in its trustee capacity is a notional person, but that person is not a company in the standard tax sense.[72]

[69] Section 45 FA 1965.

[70] It is now generally thought that a Scots partnership is not a body corporate; see 85.14.2 (Partnership: a body corporate?). But perhaps the position was less clear in 1965.

[71] See 85.22.2 (Income tax treatment of LLP).

[72] See 7.3 (Trustees a distinct person). SDLT needs further consideration as (subject to context) the distinct-person rule does not apply; but I do not consider this here.

90.8.2 *Company: tax definitions compared*

The IT definition is wider than the CT definition as it may include a co-ownership scheme. But I am not sure if that matters.

The CGT definition is wider than the IT/CT definitions as it includes:
(1) unit trusts and
(2) local authorities[73]

The CTM provides:

> **CTM00510 Meaning of company, profits and income** [Jun 2019]
> [The Manual cites the CT definition, considers the history from 1799, and continues:] The nomenclature is highly confusing.
> "Company" is customarily used congruently with incorporated company but has a tax definition that largely for historical reasons goes wider but nevertheless excludes partnerships.
> "Company" is not always congruent with "legal person" either since in Scotland a partnership has legal personality. Moreover an unincorporated association (which is neither a legal person nor a partnership) is within the tax definition of company mentioned above.

It is correct that the standard tax sense of company is wider than the general sense, as it includes unincorporated associations. The full details are, admittedly, quite intricate; but one does not often need to consider them. That does not seem confusing, by the standards of tax legislation. Perhaps the passage was written before tax legislation reached its current level of complexity.

90.8.3 *Company: IHT sense*

IHTA does not provide a definition of "company"; but the definition of close company in the IHT close-company code incorporates the CT definition.[74]

In IHT law, and tax law generally, the concepts of partnership and company are mutually exclusive. So in an IHT context it is considered that "company" (where undefined) means companies formed under UK company law, and foreign entities similar to such companies; but it does

[73] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), Chapter 45 (Local Authorities)
online version *https://www.taxationofcharities.co.uk*

[74] See 81.1.1 ("Close company").

not include Scots law partnerships, or foreign entities similar to such partnerships.

90.8.4 *Company: undefined/general sense*

Where the word company is not defined, it should take its ordinary meaning, subject to context. But it is difficult to say what that ordinary meaning is.

One would not expect the word "company", an entity with a long and complex history, to have a short, comprehensive, and generally agreed definition. On the contrary: the word "has no strictly technical meaning".[75] But one might have expected at least some attempts to encapsulate the modern concept in a sentence or two. *Lewin on Trusts* para 1-001 is headed "definition of a trust" and discusses four of them. It notes that they contain "large (though incomplete) elements of mere description" but what is wrong with that? A definition which identifies the main features of an entity is a useful tool, provided its limitations are recognised. The reader of this chapter will be looking to see what distinguishes a company from a non-company such as a partnership. But UK company law textbooks do not offer much help. *Halsbury's Laws* para 1(1) states:

> The general sense of the word 'company' denotes an association of individuals formed together for some common purpose.

That was the way that the word was used in the distant past, but not used now, when simple partnerships are not regarded as companies and single member companies are permitted.

Company lawyers tend to use the word company to mean entities formed and registered under the Companies Acts, because that is the definition in s.1(1) Companies Act 2006, which applies for the purposes of the Companies Acts.[76] This, I think, is why *Halsbury's Laws* distinguishes body corporate and company:

> There are many bodies corporate which ... are not commonly described as companies. These fall broadly into two categories:
> (1) those incorporated pursuant to some general Act of Parliament permitting incorporation to be effected by any body of persons which fulfils specified conditions: of these the chief examples are building societies and ... co-operative societies and community benefit

[75] *Re Stanley* [1906] 1 Ch 131 at p.134.

[76] This provision is set out in 64.27.8 ("Company").

> societies;
>
> (2) those known as public corporations: these are created to fulfil in each case some special social or economic purpose, and are created either by royal charter or, more commonly, by statute ... examples include the British Broadcasting Corporation...

This recognises that these bodies corporate are, at least sometimes, described as companies, though not governed by the Companies Act 2006. Halsbury does not attempt to explain what is a body corporate.

The ordinary meaning of company is wide: the word company includes LLPs and, possibly, Scottish partnerships, or so it has been suggested.[77] On that basis, I think (contrary to *Halsbury's Laws,* or at least, in the context of tax) that body corporate and company (undefined) are generally used synonymously.

Likewise I think company and corporation are generally used synonymously. "Corporation" might perhaps be preferred for bodies incorporated by royal charter, or by statute, rather than under the Companies Act, as "corporation" carries more prestige. But even if that is the usage in company law, it is not a distinction which matters for tax which (apart from the reference to "corporation tax") always refers to companies, rather than corporations.

The meaning of company in an undefined/general sense is not usually an issue for tax, because we have the tax definitions. But it arises when discussing whether a foreign entity, such as a Foundation, is a company (or body corporate, if one distinguishes the two).

There is much to be said for the definition of the US professor Lewis Haney:[78]

> A company is an artificial person created by law, having separate entity, with a perpetual succession and common seal.[79]

This is followed in HMRC's definition of a body corporate[80] and has echoes in Blackstone's Commentaries.[81]

[77] *Glasgow City Council v Unison* [2014] CSIH 27 at [46].

[78] Business Organization and Combination, (1913) *https://socialsciences.mcmaster.ca/econ/ugcm/3ll3/haney/BusinessCombination.pdf*

[79] But a seal is not now required.

[80] See 90.9.3 (What is a body corporate?).

[81] Book 1 Chap 18: Of Corporations *https://avalon.law.yale.edu/18th_century/blackstone_bk1ch18.asp*

90.8.5 *EU company list*

Art 2(a) EU Parent/Subsidiary directive[82] provides:

> For the purposes of this Directive the following definitions shall apply:
> (a) 'company of a Member State' means any company which:
> (i) takes one of the forms listed in Annex I, Part A ...

The annex sets out a list of entities which it appears should be treated as companies (and as bodies corporate) for UK tax purposes (even post-Brexit):

EU entities
Societas Europea
Societas cooperativa Europaea
Austria
Companies known as
(1) Aktiengesellschaft
(2) Gesellschaft mit beschränkter Haftung
(3) Versicherungsvereine auf Gegenseitigkeit
(4) Erwerbs- und Wirtschaftsgenossenschaften
(5) Betriebe gewerblicher Art von Körperschaften des öffentlichen Rechts
(6) Sparkassen
Other companies constituted under Austrian law subject to Austrian corporate tax
Belgium
Companies known as
(1) société anonyme/naamloze vennootschap
(2) société en commandite par actions/commanditaire vennootschap op aandelen
(3) société privée à responsabilité limitée/besloten vennootschap met beperkte aansprakelijkheid
(4) société coopérative à responsabilité limitée/coöperatieve vennootschap met beperkte aansprakelijkheid
(5) société coopérative à responsabilité illimitée/coöperatieve vennootschap met onbeperkte aansprakelijkheid
(6) société en nom collectif/vennootschap onder firma
(7) société en commandite simple/gewone commanditaire vennootschap
Public undertakings which have adopted one of the abovementioned legal forms
Other companies constituted under Belgian law subject to Belgian corporate tax

[82] The full title is: Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States. I have for clarity slightly amended the wording and layout of the list.
More or less the same list is found in Annex 1 Mergers Directive 2009/133/EC. However, the 2011 Directive includes some entities not in the 2009 Directive.

Bulgaria

Companies known as:

(1) събирателно дружество

(2) командитно дружество

(3) дружество с ограничена отговорност

(4) акционерно дружество

(5) командитно дружество с акции

(6) неперсонифицирано дружество

(7) кооперации

(8) кооперативни съюзи

(9) държавни предприятия constituted under Bulgarian law and carrying on commercial activities

Croatia

Companies under Croatian law known as:

(1) dioničko društvo

(2) društvo s ograničenom odgovornošću

Other companies constituted under Croatian law subject to Croatian profit tax

Cyprus

εταιρείες as defined in the Income Tax laws

Czech republic

Companies known as:

(1) akciová společnost

(2) společnost s ručením omezeným

Denmark

Companies known as

(1) aktieselskab

(2) anpartsselskab.

Other companies subject to tax under the Corporation Tax Act in so far as their taxable income is calculated and taxed in accordance with the general tax legislation rules applicable to aktieselskaber

Estonia

Companies known as:

(1) täisühing

(2) usaldusühing

(3) osaühing

(4) aktsiaselts

(5) tulundusühistu

Finland

Companies known as

(1) osakeyhtiö/aktiebolag

(2) osuuskunta/andelslag

(3) säästöpankki/sparbank

(4) vakuutusyhtiö/försäkringsbolag

France

Companies known as

(1) société anonyme

(2) société en commandite par actions
(3) société à responsabilité limitée
(4) sociétés par actions simplifiées
(5) sociétés dassurances mutuelles
(6) caisses dépargne et de prévoyance
(7) sociétés civiles which are automatically subject to corporation tax
(8) coopératives unions de coopératives industrial and commercial public establishments and undertakings

Other companies constituted under French law subject to French corporate tax

Germany

Companies known as
(1) Aktiengesellschaft
(2) Kommanditgesellschaft auf Aktien
(3) Gesellschaft mit beschränkter Haftung
(4) Versicherungsverein auf Gegenseitigkeit
(5) Erwerbs- und Wirtschaftsgenossenschaft
(6) Betriebe gewerblicher Art von juristischen Personen des öffentlichen Rechts

Other companies constituted under German law subject to German corporate tax

Greece

Companies known as
(1) ανώνυμη εταιρεία
(2) εταιρεία περιορισμένης ευθύνης (Ε.Π.Ε.)·

Other companies constituted under Greek law subject to Greek corporate tax

Hungary

Companies known as:
(1) közkereseti társaság
(2) betéti társaság
(3) közös vállalat
(4) korlátolt felelősségű társaság
(5) részvénytársaság
(6) egyesülés
(7) szövetkezet

Ireland

Companies incorporated or existing under Irish law

Bodies registered under the Industrial and Provident Societies Act

Building societies incorporated under the Building Societies Acts

Trustee savings banks within the meaning of the Trustee Savings Banks Act 1989

Italy

Companies known as
(1) società per azioni
(2) società in accomandita per azioni
(3) società a responsabilità limitata
(4) società cooperative
(5) società di mutua assicurazione

Private and public entities whose activity is wholly or principally commercial

Latvia

Companies known as:

(1) akciju sabiedrība

(2) sabiedrība ar ierobežotu atbildību

Lithuania

Companies incorporated under the law of Lithuania

Luxembourg

Companies known as

(1) société anonyme

(2) société en commandite par actions

(3) société à responsabilité limitée

(4) société coopérative

(5) société coopérative organisée comme une société anonyme

(6) association dassurances mutuelles

(7) association dépargne-pension

(8) entreprise de nature commerciale

(9) industrielle ou minière de lEtat des communes des syndicats de communes des établissements publics et des autres personnes morales de droit public

Other companies constituted under Luxembourg law subject to Luxembourg corporate tax

Malta

Companies known as:

(1) Kumpaniji ta Responsabilita Limitata

(2) Soċjetajiet en commandite li l-kapital tagħhom maqsum fazzjonijiet

Netherlands

Companies known as

(1) naamloze vennootschap

(2) besloten vennootschap met beperkte aansprakelijkheid

(3) open commanditaire vennootschap

(4) coöperatie

(5) onderlinge waarborgmaatschappij

(6) fonds voor gemene rekening

(7) vereniging op coöperatieve grondslag

(8) vereniging welke op onderlinge grondslag als verzekeraar of kredietinstelling optreedt

Other companies constituted under Dutch law subject to Dutch corporate tax

Poland

Companies known as:

(1) spółka akcyjna

(2) spółka z ograniczoną odpowiedzialnością

(3) spółka komandytowo-akcyjna

Portugal

(1) sociedades comerciais (commercial companies)

(2) sociedades de direito civil sob forma comercial (civil law companies having a commercial form)

(3) cooperativas e empresas públicas constituídas nos termos do direito português (cooperatives and public undertakings incorporated in accordance with Portuguese law)

Romania
Companies known as:
(1) societă i pe ac iuni
(2) societă i în comandită pe ac iuni
(3) societă i cu răspundere limitată
(4) societă i în nume colectiv
(5) societă i în comandită simplă
Spain
Companies known as:
(1) sociedad anónima
(2) sociedad comanditaria por acciones
(3) sociedad de responsabilidad limitada
Public law bodies which operate under private law.
Other entities constituted under Spanish law subject to Spanish corporate tax (Impuesto sobre Sociedades)
Slovakia
Companies known as:
(1) akciová spoločnosť
(2) spoločnosť s ručením obmedzeným
(3) komanditná spoločnosť
Slovenia
Companies known as:
(1) delniška družba
(2) komanditna družba
(3) družba z omejeno odgovornostjo
Sweden
Companies known as
(1) aktiebolag
(2) försäkringsaktiebolag
(3) ekonomiska föreningar
(4) sparbanker
(5) ömsesidiga försäkringsbolag
(6) försäkringsföreningar

90.9 Body corporate

90.9.1 *Why body corporate matters*

The question whether an entity is a body corporate matters because:

(1) A body corporate is (subject to certain exceptions) a company in the standard tax sense.
(2) There are some specific rules which apply to a body corporate.[83]

[83] This may be done in a straightforward manner by referring expressly to a body corporate; or in a roundabout manner referring to a "company" but defining

Examples include:

Topic	**See para**
SD/SDLT group relief (eg for partnerships)	85.24
Definition of "51/75/90 % subsidiary" for group reliefs	64.26
Definition of mutual fund	66.15

90.9.2 *Company/body corporate compared*

There are 2 or 3 distinct concepts:

(1) Company in the tax sense (a defined term)

(2) Company (undefined, in the general sense) and body corporate (undefined, in the general sense) which I think have the same meaning, but a distinction is sometimes drawn between them.

They normally overlap, in that a company in the general sense is normally a company in the tax sense and a body corporate; but a body within one concept may not be within the others. A number of permutations are possible:

Entity	**Co**	**Co**	**Body corporate**	**See**
	tax sense	***general sense***		
Company	yes	yes	yes	
Unincorporated association	yes	no	no	
Foreign LLP[84]	yes	yes	yes	
UK LLP	no (usually)	yes	yes	85.21

None of this should cause confusion as long as one bears in mind that "company" does not have a single general meaning.

90.9.3 *What is a body corporate?*

How does one decide whether an entity is a body corporate? There is no definition in tax statutes. As the postpositive adjective[85] suggests, the term is ancient and somewhat archaic. A body corporate means a corporate (or incorporated) body. I think it is (more or less) synonymous with company in the general sense.[86] But that only takes us on to the

"company" to mean body corporate (overriding the standard tax definition of company).

[84] A Co-operative & mutual benefit society is also an example of this.

[85] Other examples in legal vocabulary are: court martial, fee simple, letters patent; see *https://en.wikipedia.org/wiki/Postpositive_adjective*

[86] Corporate/unincorporate are just archaic terms for incorporated/unincorporated. This is self-evident, but if necessary, and assuming general statutory definitions can shed

question of what is the meaning of company (in the general sense).

CT Manual provides:

> **CTM00510: Meaning of company, profits and income** [Jun 2019]
> Nor is there any definition of body corporate, though it appears to mean a legal person of full capacity distinct from its members with perpetual succession created by, or observing provisions required by, authority, whether Crown or Parliament.

This accords with the general concept of a company.[87] Thus there appear to be 3 requirements:
(1) legal personality
(2) perpetual succession
(3) created by Crown or statutory authority ("state sanction")

The term "body corporate" also assumes, or requires, that one or more persons have come together in the form of a single, distinct legal person.

"Perpetual succession" is a technical term. It means that there is no change in the ownership of property of the body corporate on the death of a member or on a transfer of shares. The US expressions "continuity of life" or "perpetual existence" seem better, but "perpetual succession" is too well established a term to change. It is possible for company articles to provide that a company must be wound up at a certain date. The entity still has "perpetual succession" and so is still a body corporate.

It is possible for an entity to have legal personality and lack perpetual succession and so not to be a body corporate. A Scots partnership is an example (it also lacks state sanction, so it fails of 2 of the 3 requirements).

It is possible for an entity to have perpetual succession and not legal personality. A trust might be an example: it may be said to have perpetual succession in the sense that it continues despite the deaths of trustees or beneficiaries (again, a trust also lacks state sanction, so it fails of 2 of the 3 requirements).

It may be possible for an entity to have legal personality and perpetual succession and still not to be a body corporate. A Foundation may be an

light on the general meaning of words, support might be had from:
(1) s.1173 Companies Act 2006, providing that "body corporate" includes a body incorporated outside the UK.
(2) Sch 1 Interpretation and Legislative Reform (Scotland) Act 2010, providing that 'person' includes a body of persons corporate or unincorporated.

[87] See 90.8.4 (Company: undefined/general sense).

example.

After discussing the position of trade unions, the Scottish Law Commission say:

> 2.26 There are other examples of statutory provisions which have been held to create what were described as "quasi-corporations",[88] that is, bodies created by statute with certain attributes of legal personality but without corporate status. By way of contrast, the case of *J H Rayner (Mincing Lane) Ltd v DTI*[89] concerned the International Tin Council which ... was created by an Order in Council which provided that the ITC "shall have the capacities of a body corporate". After the ITC became insolvent, the House of Lords rejected the argument of its creditors that a distinction could be drawn between a body corporate on the one hand and an entity with "the capacities of a body corporate" on the other, so as to impose liability on members in the latter case. Lord Oliver of Aylmerton observed:
>
> …the undoubted existence of capacities may lead and, in some circumstances, must lead to a necessary inference of the status of the person on whom they are conferred. Whether that is expressed… by saying that the status is the sum total of the capacities or that the status may be deduced from the capacities is really a question of purely academic interest and does not affect the ultimate result.[90]

Avery Jones comments:[91]

> The International Tin Council had legal personality under the treaty creating it, including the capacity to contract and acquire and dispose of movable and immovable property and to institute legal proceedings, but the UK legislation giving effect to the treaty in internal law, provided that it had the legal capacities of a body corporate, without making it a body corporate (which would have had the undesirable effect of making it, as an international body, subject to UK law on, for example, winding-up). This was held by the House of Lords in *J.H. Rayner v Department*

[88] Footnote original: Eg *IRC v Bew Estates Ltd* [1956] Ch 407 at p.415 (the War Damage Commission); *Knight and Searle v Dove* [1964] 2 QB 631 at p.643 (the London Trustee Savings Bank). The Scottish Law Commission may afford another example. For further discussion, see also Wedderburn, "Corporate personality and social policy: the problem of the quasi-corporation" (1965) 28 MLR 62.

[89] [1990] 2 AC 418.

[90] at p.504.

[91] Avery Jones et al, "Characterisation of Other States' Partnerships for Income Tax" [2002] BTR 375.

> *of Trade* to have created a separate legal person with the result that the members of it were not liable for its liabilities.[92]

UK law sometimes stipulates that an entity is a body corporate. For instance, s.16(2) CA 2006 provides:

> The subscribers to the memorandum, together with such other persons as may from time to time become members of the company, are a body corporate ...

There are similar provisions for the following:

Entity	**See**
Charitable incorporated organisation	s.205(1) CA 2011
Scottish charitable incorporated organisation	s.49(2) CTISA 2005
Co-operative & community benefit society	s.3 Co-operative & Community Benefit Societies & Credit Unions Act 2014

90.9.4 *Foreign law body corporate status*

Foreign law sometimes stipulates that an entity is (or is not) a body corporate; for instance:

Limited Partnerships (Guernsey) Law 1995	*Separate Ltd Partnerships (Jersey) Law 2011*
Art 9A(5) For the avoidance of doubt (!) ... a limited partnership with legal personality is a body corporate.[93]	**Art 3(5)** An SLP is a legal person but not a body corporate.

Foreign provisions of this kind do not necessarily mean that the entity is (or is not) a body corporate in UK law or, more accurately, for the purposes of any particular UK statutory provision using that expression.[94] What matters is whether the entity meets the criteria of a body corporate in UK law. The statutory provision should have some weight, but only if the position were otherwise unclear.

90.9.5 *Body corporate lists*

Here is a list of entities discussed elsewhere:

[92] See too 90.40.4 (Stichting a treaty-person).

[93] Similarly, s.1 Limited Liability Partnerships (Guernsey) Law 2013.

[94] See 90.4.1 (English language terminology).

Entity	**Body corporate**	**See**
Scots partnership	No	85.14.2
Unit trust	No	69.2
OEIC	Yes	66.3.4
Foundation	No (probably)	90.14.4
Limited liability company	Yes	90.45.2

A trustee is a notional person, but that person is not a body corporate.[95]

The former Stamp Taxes Manual also provided a list identifying foreign entities as body corporate or not:

> **6.124 Foreign Companies**
> Some foreign companies have been accepted as falling within the term 'body corporate' for the purposes of the intra group relief. The following is a list of examples of foreign bodies accepted by us as falling within the definition of "body corporate" for Section 42 [FA 1930] and Section 151 [FA 1995] purposes:–

Although the list is expressed to be for the purposes of two specific provisions, there is no specific definition of "body corporate" in those sections; if an entity is a body corporate for those purposes, it is in principle a body corporate in the general sense of the word, and a company in the standard tax sense.

Australia	Private companies which do not need to comply with certain requirements, are known as 'proprietary' companies. Such companies registered in New South Wales are bodies corporate.
Bahamas	Companies described as limited.
Belgium	Société de personnes à responsabilité limitée (descussocies).[96]
Bermuda	Companies described as limited.
BVI	A company described as limited and which is incorporated under the Companies Act 243.
Canada	Companies described as limited.
Cayman Islands	Companies described as Ltd.
Denmark	A company described as an A/S.
Finland	An 'Oy' (Osakeyhtiö) is a Finnish limited company which may be public or private.
France	Société Anonyme and Société en commandite par actions.
Germany	Aktiengesellschaft. Gesellschaft mit Beschränkte Haftung. Kommanditgesellschaft[97] auf Aktien.

[95] See 7.3 (Trustees a distinct person).

[96] "Descussocies" is a misprint but I do not know what is intended.

[97] HMRC text erroneously reads: Kommanditfellschaft.

Guernsey	A company constituted under the laws of Guernsey and registered before the Royal Court.
Holland	Naamloze Vennootschap. Besloten Vennootschap.
Hong Kong	Companies described as limited.
Irish Minister of State	An Irish minister may be accepted as a parent body corporate for S42 purposes
Italy	Societa per Azioni.
Liberia	Companies described as limited but note that we may require to see the Certificate of Incorporation.
Malaysia	A company which includes the word 'Berhad' as part of and at the end of its name.
Netherlands Antilles[98]	Naamloze Vennootschap.
Norway	Aksjeselskap (et) or Aktieselskap[99] (et).
Panama	Sociedad Anonima. 'Corp.' 'Inc.' Note that 'Ltd' is not conclusive.
Portugal	A body which is a Sociedade por Quotas.
Saudi Arabia	A company organised pursuant to the laws of the Kingdom of Saudi Arabia has been accepted although it did not have perpetual succession.
Singapore	Companies described as limited.
South Africa	A Company which is 'limited by shares'.
Spain	Sociedad Anonima and Sociedad de Responsabilidad Limitada.
Sweden	Aktiebolaget. Also The Kingdom of Sweden.
Switzerland	Société Anonyme, Société en commandite[100] par actions and Aktiengesellschaft. A verein.[101]
Trinidad	A company limited 'by shares'.
USA	Corporations (usually described as 'Corporation' 'Company' or 'Incorporated') organised under the laws of various states. Delaware Limited Liability Companies.
Venezuela	Corporations organised under the laws of Venezuela.

90.9.6 *Body corporate: Critique*

Why do some tax rules (such as group relief) refer to *body corporate* rather than *company*? It may be that the drafter intended the distinction (eg to exclude unincorporated associations and include LLPs). That is, it may be intended that:

(1) A partnership which is a body corporate (such as an LLP) may be the parent company of a group, though not a subsidiary (as it will not have ordinary share capital).

[98] Netherlands Antilles ceased to exist in 2010 and is now Curaçao and Sint Maarten. The law of the former Netherlands Antilles continues to apply unless and until amended.

[99] HMRC text erroneously reads: Aktieselscap.

[100] HMRC text erroneously reads: commandit.

[101] "A verein" is a misprint but I do not know what is intended.

(2) An unincorporated association, not a body corporate, cannot be a member of a group (even though it is subject to corporation tax).

It may be for historical reasons, particularly if the drafting dates back to before the introduction of the standard tax definition of company in 1965. Or it may be that the drafter gave no particular attention to the matter and regarded the terms as synonymous (as is nearly the case, but not quite).

There is scope for simplification here, though as always, reform would need consultation and thinking through. Except in the definition of company, the term "body corporate" need not and should not be used in UK tax law.

90.10 US revocable (grantor) trust

Revocable trusts are commonly used in the USA for estate planning.[102] With an American settlor these are almost always classified as grantor trusts (a US tax concept) and transparent for USA tax purposes as to income and capital gains, though with non-USA settlors they are only transparent in limited circumstances.

The classification of a US revocable trust turns on the nature of the rights conferred by the trust, which depends on the drafting and governing law of the trust.[103] Only general comments are possible here.

Under a common form grantor trust, the settlor (the synonymous terms grantor, trustor, creator or donor are also used) is sole trustee, the trust is revocable, and the income and capital is paid to the settlor on demand. Section 603 America Uniform Trust Code provides:[104]

[102] I am grateful to Ian Watson (of 3 Stone Buildings) for his comments on this section.

[103] Each USA state is a separate jurisdiction, with its own trust law, derived from English law but with statutory and case law variations.

[104] *https://www.uniformlaws.org/viewdocument/final-act-132?CommunityKey=193ff839-7955-4846-8f3c-ce74ac23938d&tab=librarydocuments*

The uniform code project is an attempt to standardise US law, but adoption of uniform codes is far from universal, and states may adopt them with variations. Some states (eg, s.15800 California Probate Code) impose rules almost identical in effect to s.603 UTC, but independently of the uniform code project. The general trend in American jurisprudence is towards uniformity even in the absence of express statutory provision.

The text of s.603 has been amended, but the changes do not seem relevant for present purposes.

Strictly it would be necessary to obtain foreign law tax advice on this issue, but that is not entirely straightforward, as US law does not use the UK concept of a bare

> (a) To the extent a trust is revocable by a settlor, a trustee may follow a direction of the settlor that is contrary to the terms of the trust. To the extent a trust is revocable by a settlor in conjunction with a person other than a trustee or person holding an adverse interest, the trustee may follow a direction from the settlor and the other person holding the power to revoke even if the direction is contrary to the terms of the trust.
>
> (b) To the extent a trust is revocable [and the settlor has capacity to revoke the trust],[105] rights of the beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to, the settlor.
>
> (c) During the period the power may be exercised, the holder of a power of withdrawal has the rights of a settlor of a revocable trust under this section to the extent of the property subject to the power.

A USA revocable trust of this kind is not a trust in the standard IT/CGT sense, as the property is not held "in trust". The trust is illusory.[106] This may seem paradoxical, but only if one forgets that "trust" in a foreign law may not have the same meaning as it has in a UK statute.[107] The US revocable trust may appear at first sight to grant rights to beneficiaries, but during the lifetime of the settlor (or at least while the settlor has mental capacity) the rights are unenforceable and under UK law do not amount to "rights" at all.

If the settlor is not the sole trustee, there is a trust; but if (in the words of the Uniform Trust Code) "the duties of the trustee are owed exclusively to the settlor" then the US revocable trust is a bare trust for UK tax purposes.

(1) For IT/CGT, the settlor is absolutely entitled as against the trustee.

(2) The trust is not an IHT-settlement, since:

  (a) The property is not held in trust for persons in succession.

  (b) The USA revocable trust is not equivalent to a trust for persons in succession. The element of succession is that of a will.

  (c) The USA revocable trust is not equivalent to a trust with power to make payments out of that income at the discretion of the trustees or some other person.

trust. It is sometimes possible to obtain legal advice that local law is the same as the UTC on the relevant point.

[105] Square brackets in original, as the wording is optional.

[106] See 87.11 (Illusory trust).

[107] See 90.4.1 (English language terminology); 90.4.3 (Entity documentation).

In short, a USA revocable trust of this kind is classified in UK tax law as a bare trust and a testamentary disposition.[108]

This view is supported by *Re the AQ Revocable Trust*.[109] Here a Bermuda law trust deed, drafted in US grantor trust form, executed by a Bermuda domiciled settlor, was held to be illusory and testamentary, and invalid (it originally took effect as a valid will, but was revoked by a subsequent marriage). Had the settlor been US domiciled, the trust would (I expect) not have been revoked by the subsequent marriage, and so would have taken effect on death as a testamentary disposition, recognised in English law; but it would not have constituted a substantive trust for UK tax purposes during the settlor's lifetime.

Depending on the drafting, a USA revocable trust of this kind may cease to be a bare trust, and become a settlement (for IHT and IT/CGT) if the settlor loses mental capacity. This could of course have significant UK tax consequences.

One could if desired draft a trust which meets the USA requirements to be a grantor trust and which is a settlement for IT/CGT and IHT purposes. It would need to be one where (during the lifetime of the settlor) the trustees owed duties to beneficiaries other than just the settlor.

It is understood that as at Dec 2020, HMRC were planning to take a case on the s.603 issue "in the near future (2 years)" and were unwilling to give rulings or indeed any comment to their customers, in the meantime. Perhaps, given the lapse of time, that case has settled. I would be grateful to any reader who knows the current position.

90.11 *Garland* trusts

The distinctive feature of *Garland* trusts (unlike English law trusts) is that beneficiaries have no interest in the trust property. Their right is *in personam* (against the trustees) not *in rem* (against the property). In other respects *Garland* trusts are like English trusts. A *Garland* trust is in principle a settlement within the standard IT/CGT and IHT definitions.

The approach of the tax code is to make some statutory provision in relation to Scotland, and otherwise to ignore the problems.

For the income taxation of *Garland* trusts, and the trust law background,

[108] See 87.7 (Bare trust/nomineeship). Underhill & Hayton agree at para 104.159 (Changing the governing law): *Law of Trusts & Trustees* (20th ed., 2022).

[109] See 87.11 (Illusory trusts).

see 42.9 (Life tenant: Source of Income); 42.11.3 (Garland trusts); 42.12 (Baker or Garland trust?). This section considers IHT and CGT.

90.11.1 *IIP in Garland trust*

The question arises whether a beneficiary of a *Garland* trust should be regarded as having an interest in possession in settled property. (This question does not often matter for IHT for trusts made after 2006.)

"Interest in possession" is a concept of English trust law which has no equivalent in Scots trust law, and maybe in other trust laws. But that does not prevent a beneficiary under a foreign law trust from having an interest which is an IIP within the meaning of a UK tax statute. A beneficiary under a Garland trust has an "interest" and if that interest gives an entitlement to income, it is an interest "in possession".

However under a *Garland* trust, a beneficiary does not have an interest *in settled property*. The beneficiary does not have an interest in trust property at all.

In relation to Scots law trusts, the IHT problem is resolved by statute. Section 46 IHTA provides:

> In the application of this Act to Scotland,
> [1] any reference to an interest in possession in settled property is
> [a] a reference to an interest of any kind under a settlement by virtue of which
> [i] the person in right of that interest is entitled to the enjoyment of the property or
> [ii] would be so entitled if the property were capable of enjoyment,
> [b] including an interest of an assignee under an assignation of an interest of any kind (other than a reversionary interest) in property subject to a proper liferent;
> [2] and the person in right of such an interest at any time shall be deemed to be entitled to a corresponding interest in the whole or any part of the property comprised in the settlement.

There is no equivalent provision for CGT (except for Scots proper liferents, which are not trusts). HMRC practice is to treat life tenants in *Garland* trusts as if they had an interest in possession in the settled property. The CG Manual provides:

> **CG31301 Scottish proper liferents** [Jul 2019]
> ... There are two ways in which a liferent [roughly, life interest] can be

> set up. In the first case, where the interest is known as an improper liferent, the property is vested in trustees who administer the property and pay the income to the liferenter. In general the trustees have the power to sell the property in question and replace it by other property, whether land and buildings or other assets.

An improper liferent is clearly a trust. HMRC continue:

> On the death of the liferenter the provisions of s.72, s.73 and s.74 TCGA apply as appropriate.

A court applying a purposive approach may well reject as too subtle a distinction between an interest in settled property and an interest under a settlement which is not an interest in settled property. Since this will usually suit taxpayers, it will not often be challenged.

90.11.2 *Reversionary interest: Garland trust*

Section 47 IHTA provides:

> In this Act "reversionary interest" means a future interest under a settlement, whether it is vested or contingent (including an interest expectant on the termination of an interest in possession which, by virtue of section 50 below, is treated as subsisting in part of any property)...

A beneficiary of a *Garland* trust may have a reversionary interest, within this definition, as although it is not strictly an interest in settled property, it is an interest under a settlement.

90.11.3 *Garland trust: SDLT*

Para 2 sch 16 FA 2003 addresses the issue for SDLT:

> Where property is held in trust under the law of Scotland, or of a country or territory outside the UK, on terms such that, if the trust had effect under the law of England and Wales, a beneficiary would be regarded as having an equitable interest in the trust property—
>
> (a) that beneficiary shall be treated for the purposes of this Part as having such an interest notwithstanding that no such interest is recognised by the law of Scotland or, as the case may be, the country or territory outside the UK, and
>
> (b) an acquisition of the interest of a beneficiary under the trust shall accordingly be treated as involving the acquisition of an interest in the trust property.

90.12 Liechtenstein: Introduction

Liechtenstein has 4 types of entity that may be used in wealth-holding arrangements:

Entity	Translation	See para
Stiftung	Foundation	90.14
Anstalt	Establishment	90.15
Treuunternehmen	Trust Enterprise	90.16
Treuhandschaft	Trust	90.17

I consider these separately, but here make some comments which apply to all these entities.

The law is in the Liechtenstein *Personen- und Gesellschaftsrecht*.[110]

Liechtenstein publishes English translations.[111] However these do not have official status, and are not updated with PGR amendments. The style of translation is very literal. I have not followed them exactly in my translations below.

HMRC expressed their views in the Liechtenstein disclosure facility.[112]

[110] *https://www.llv.li/files/rdr/pdf-llv-rdr-Gesamtdokument.pdf* (German).

[111] *http://www.icnl.org/research/library/files/Liechtenstein/liechcomp.pdf* (English)
Note that the following translations are not up to date:
Spitz & Clarke, Offshore Tax Service (looseleaf)
Glasson, "International Trust Laws" (looseleaf)

[112] See the Second Joint Declaration by the Government of the Principality of Liechtenstein and HMRC Concerning the Memorandum of Understanding Relating to Cooperation in Tax Matters (2010)
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/387491/Second_joint_declaration_Memorandum_of_Understanding.pdf
The Second Joint Declaration replaced the First Joint Declaration (2009) but there are no significant changes in the passages quoted here, apart from strengthening the disclaimer. See
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/387490/Joint_decleration_Memorandum_of_Understanding.pdf
The Second Joint Declaration is subject to this disclaimer and qualification:

> "The Government of the Principality of Liechtenstein and HMRC have considered and agreed the following guidance on characterisation, recognition and treatment of certain legal entities and fiduciary relationships to assist taxpayers and financial intermediaries in meeting their obligations for the purposes of the MOU. This guidance is based on Liechtenstein and UK laws as of 1 January 2010. The parties may review and revise this guidance to reflect relevant changes in those laws in the future. Where a person has an interest in

Foundations are found in many jurisdictions, but Anstalt and Trust Enterprise are unique to Liechtenstein.

In the USA, a Foundation is classified as a trust for tax purposes, and an Anstalt and Trust Enterprise are classified as a company.[113] However the USA has express entity classification rules, which are different from UK tax law, so the USA material has no relevance in the UK.

90.13 Beneficiary rights

It has been argued that beneficiaries of a Foundation, in standard form,[114] have no enforceable rights; and likewise for other Liechtenstein entities. If correct, that would have certain UK tax advantages. (There would of course be a non-tax disadvantage that there would be nothing beneficiaries could do if the Foundation board decided to keep the trust fund for themselves or their friends). But the proposition seems absurd. What would be the point of any Foundation law if it conferred no enforceable rights?

For Liechtenstein, Art 2 PGR provides an answer:

Jedermann hat in der Ausübung seiner Rechte und in der Erfüllung seiner Pflichten nach Treu und Glauben zu handeln.	A person must act in good faith when exercising their rights or performing their duties.

> a type of entity that is not specified below, they must provide complete information about the entity to HMRC to enable a view to be given.
>
> For avoidance of doubt, nothing contained in this appendix is to affect the ability of affected persons to rely on UK law or practice permitting alternative characterisation, recognition and treatment. The parties further recognise that the ultimate UK taxation consequences for UK taxpayers will depend on the particular facts relating to specific entities or fiduciary relationships.
>
> Nothing in this appendix affects how those entities or relationships are treated for any purposes outside the MOU."

(The first Joint Declaration contained a similar disclaimer, but without the last sentence).

[113] IRS Memorandum AM2009-012, 2009, (Entity Classification of Liechtenstein Anstalts and Stiftungs) *http://www.irs.gov/pub/irs-utl/am2009012.pdf*
Michaels "US tax treatment of the Liechtenstein trust enterprise (Trust Reg.)" [2010] Trusts & Trustees 405.

[114] Beneficiaries' rights depend on the constitution of the entity, and no doubt express wording could confer rights, or confer them more clearly. But entities in more common form do not take this course, apart from those with Founder's Rights.

Likewise art 182 PGR:

b) Befugnisse und Pflichten aa) Im Allgemeinen	Powers and duties: General
1) Die Verwaltung hat alle Befugnisse und Pflichten, die nicht einem anderen Organ übertragen oder vorbehalten sind ... Sie hat insbesondere auch für die Erhaltung des Grundkapitals sowie für die Sicherstellung und den Erfolg des Unternehmens im Rahmen ihrer gesetzlichen Pflichten und der dargebotenen Möglichkeiten besorgt zu sein.	The Board [entity administrators] shall have all the powers and duties not transferred to or reserved for another body ... In particular, the Board are responsible for the preservation of Entity capital, and, in the context of their statutory duties and investment opportunities, with the safety and success of the undertaking.
2) Sie hat das Unternehmen der Verbandsperson mit Sorgfalt zu leiten und zu fördern und haftet für die Beobachtung der Grundsätze einer sorgfältigen Geschäftsführung und Vertretung. Ein Mitglied der Verwaltung handelt im Einklang mit diesen Grundsätzen, wenn es sich bei seiner unternehmerischen Entscheidung nicht von sachfremden Interessen leiten liess und vernünftigerweise annehmen durfte, auf der Grundlage angemessener Information zum Wohle der Verbandsperson zu handeln....	The Board shall promote the entity's undertaking with due care and shall observe the principles of prudent business management and agency. A member of the Board acts in accordance with these principles if it does not take into account extraneous interests, acts in the interest of the entity prudently, and is properly informed...
4) Die Verwaltung ist der Verbandsperson gegenüber verpflichtet, alle Beschränkungen einzuhalten, die durch Gesetz, Statuten, Beschluss des zuständigen Organes oder in anderer Weise festgesetzt sind.	The Board is responsible to the entity to observe all restrictions laid down by law, articles, resolutions of the competent body, or in any other manner.
5) Soweit es nicht anders bestimmt ist, kommen der Verwaltung einer Verbandsperson die gleichen Befugnisse und Pflichten zu, wie der Verwaltung bei eingetragenen Genossenschaften.	Subject to any provision to the contrary, the Board of an Entity has the same powers and responsibilities as the Board of a registered Association.

Biedermann explains:

Since, in most cases, the Liechtenstein foundation has legal personality,

> it is subject to the general provisions concerning legal persons and it has a corporate structure with a board of foundation. The *in rem* aspect of the beneficial rights under trusts, i.e. non-reachability of trust property by creditors of the trustee, is not necessary for foundations, since the foundation has its own personality. The beneficial rights under a foundation may be less strong, because there is no specific tracing possibility *vis-à-vis mala fide* purchasers and volunteers. However, this deficiency is overcome by the public faith principle, since anyone dealing with a foundation has to look at the objects and competence clause of a foundation in order to know whether a board of foundation is entitled to *e.g.* sell some specific foundation property.[115]

Similar points arise for other Liechtenstein entities: Trust Enterprise and Anstalt.

Similar points arise for Foundation laws in other jurisdictions. For instance, in Jersey, art 25(1) Foundations (Jersey) Law 2009 provides:

> A beneficiary under a foundation –
> (a) has no interest in the foundation's assets; and
> (b) is not owed by the foundation or by a person appointed under the regulations of the foundation a duty that is or is analogous to a fiduciary duty.[116]

Art 22 Foundations (Jersey) Law is the equivalent of art 182 PGR:

> (1) The members of the council of a foundation must conduct the

[115] Biedermann, "Foundations vs Trusts" [1993] PCB 283. The 2008 amendment to the law of Foundations does not affect art 2 PGR.

[116] A different rule applies when a beneficiary becomes entitled to a benefit. Art 25(2) Foundations (Jersey) Law provides: "However, if –
(a) a beneficiary under a foundation becomes entitled to a benefit under the foundation in accordance with the charter or the regulations of the foundation; and
(b) the benefit is not provided,
the beneficiary may seek an order of the Royal Court ordering the foundation to provide the benefit.
(3) Except as provided by paragraph (4), the beneficiary must seek the order within the period of 3 years from the time when the beneficiary became aware of his or her entitlement to the benefit.
(4) If the beneficiary has not attained the age of 18 years when he or she became aware of his or her entitlement to the benefit, the period referred to paragraph (3) begins to run on the day on which the beneficiary attains that age."
But it seems doubtful if that applies to a merely discretionary beneficiary.

foundation's affairs in accordance with its charter and regulations and this Law.

(2) The members of the council of a foundation must –

(a) act honestly and in good faith with a view to the best interests of the foundation; and

(b) exercise the care, diligence and skill that reasonably prudent persons would exercise in comparable circumstances.

The misconception may be due to ambiguity in the expression "no enforceable rights", compounded by problems of translation between civil law/common law jurisdictions. A discretionary beneficiary of a Foundation, Trust Enterprise or Anstalt may have no interest in the entity's property. But that is also broadly true of a beneficiary of a discretionary trust and under a *Garland* trust. It is also true of a shareholder in a company. That does not entail that they have no enforceable rights of any kind. In the event of a breach by a governing body, the remedy may be to petition the Court to replace the Board/Council members.[117]

90.13.1 *Founder's Rights*

The content of founder's rights strictly depends on the constitution of the entity.[118] But founder's rights typically confer power to decide distributions (to the founder or to others); and the entity has no duties to anyone other

[117] Thus the Australian and the Canadian analyses of a Foundation proceed on the basis that beneficiaries do have rights: see 90.14.5 (Australian law views); 90.14.8 (Canadian law views).

[118] For instance, art 18 Foundations (Jersey) Law 2009 provides:

(1) A founder of a foundation has such rights (if any) in respect of the foundation and its assets as are provided for in its charter and regulations.

(2) Any rights a founder of a foundation may have in respect of the foundation and its assets may be assigned to some other person if the charter or regulations of the foundation so provide.

(3) Where –

(a) a founder of a foundation has rights in respect of the foundation and its assets; or

(b) a person has been assigned any rights of a founder in respect of a foundation and its assets,

and the founder or person, as the case may be –

(c) dies; or

(d) in the case of a founder or a person that is not an individual, ceases to exist,

those rights vest in the guardian of the foundation unless its charter or regulations provide otherwise.

than the founder. I use the term Founder's Rights (with initial capitals) in that sense.[119]

An entity with Founder's Rights cannot be a settlement (under the IT/CGT and IHT definitions) because the only person who has any rights in relation to the entity is the founder.[120] An entity with Founder's Rights cannot be a settlement-arrangement, as there is no bounty. In these circumstances a Foundation and an Anstalt[121] should be classified as a company.[122]

If that is right, then termination of Founder's Rights (by an alteration of the constitution or by death of the founder) change the characterisation from company to trust. But there is no reason why that should not be so. It does not involve a disposal for CGT purposes, as the entity continues in existence: only its characterisation has changed.[123] But it may constitute an alteration in share capital for the IHT close-company code.[124]

90.14 Stiftung/Foundation

I here consider categorisation issues (ie, is a foundation a trust or a company?); for other aspects of foundations see:

Topic	**See para**
s.87 TCGA/Who are foundation trustees	61.3.3
s.3 TCGA	64.36
Trust registration	131.19.5

The classic Foundation jurisdictions are Liechtenstein, Austria and Panama. The latter two are based on the Liechtenstein model.

The Foundation is a civil law entity with a long history. The *Code Napoléon* 1804 abolished Foundations, as institutions intended to perpetuate wealth in the aristocracy. So jurisdictions which adopted that

[119] The Liechtenstein disclosure facility uses the term in this sense: "For avoidance of doubt, in case of an establishment with founder's rights as used above, the founder (settlor) with founder's rights has full powers to decide upon who the beneficiaries are and to change the beneficiaries, and such powers are transferable."
For the meaning of "Founder" see 90.14.3 (Definition of Founder). But the identity of the Founder does not matter for the purposes of categorisation.

[120] See 90.10 (US grantor trust).

[121] See 90.15 (Anstalt/Establishment).

[122] Founder's Rights are similar to shares. Unless the documentation otherwise provides, Founder's Rights can be assigned by a lifetime disposition or by will.

[123] See too 90.58 (Change of entity type).

[124] See 81.7 (Change in share capital/rights).

Code rejected Foundations, but some subsequently restored them. Foundations are now established by statute in most tax havens. Modern English language Foundation laws follow the civil law model: their purpose is to constitute an entity which civil lawyers will recognise and understand, for use in civil law jurisdictions which recognise Foundations but are not familiar with trusts.

While Foundation jurisdictions differ, I am not aware of differences which significantly affect UK tax categorisation issues, though that is possible. Foundations also differ in their drafting of their constitutions. But (apart from the special case of Founder's Rights), I am not aware of drafting points which should significantly affect UK tax categorisation issues, though that too is possible.

For the Foundation law background, see Panico, *Private Foundations Law and Practice* (1st ed, 2014).

90.14.1 *Foundation terminology*

The German term Stiftung is conventionally translated as "foundation". I expect that is because the French/Latin equivalents are foundation/ fundatio. The English word does not itself convey any information about the entity. If anything, it could be misleading. In the UK, the word "foundation" is used to refer to a nonprofit organisation,[125] and is most commonly found as a name for a charity (eg the British Heart Foundation). In the USA, "private foundation" is a technical term used to describe a specific category of charities and NPOs, in short, those which receive their funds from one person and which are regarded as donor-controlled.[126] These native English meanings of foundation are not relevant here.

I call it a Foundation, with an initial capital to reflect the technical nature of the word.

90.14.2 *Definitions of Foundation*

Gretton says:

[125] See Companies House Guidance, "Sensitive words and expressions specified in regulations that require the prior approval of the Secretary of State to use in a company or business name" *https://www.gov.uk/government/publications/incorporation-and-names/annex-a-sensitive-words-and-expressions-or-words-that-could-imply-a-connection-with-government*

[126] See US Internal Revenue Code § 509 (Private foundation defined).

> Eventually the civil law tradition came to recognise two sorts of juristic person: the *universitas personarum*, the corporation, and the *universitas rerum*, the foundation. (The common law tradition has not gone down this road, recognising only corporations.)[127]
> A foundation is a juristic person which is not a corporation. It has no members. It is an autonomous patrimony dedicated to a purpose - a *Zweckvermögen.* Some writers regarded the *Zweckvermögen* as having no owner at all. Others described it as owning itself. Others argued that it was "owned" by the "purpose" itself. Others again argued that notionally one could distinguish the juristic person (though memberless) from the estate which was owned: this latter is the dominant conception.[128]

Liechtenstein Foundations are governed by Part 5 PGR.[129] The law was revised in 2008, with effect from 1 April 2009.

Art 552(1) PGR provides a definition:

I. Begriff und Zweck 1. Umschreibung und Abgrenzung 1) Eine Stiftung im Sinne dieses Abschnittes ist ein rechtlich und wirtschaftlich verselbständigtes Zweckvermögen, welches als Verbandsperson (juristische Person) durch die einseitige Willenserklärung des Stifters errichtet wird.	**Concept and purpose** Description and definition A Foundation within the meaning of this Part is a legally and economically independent purpose fund [sometimes translated: dedicated patrimony] which is formed as a legal entity (legal person)[130] by a unilateral declaration of the founder.
Der Stifter widmet das bestimmt bezeichnete Stiftungsvermögen und legt den unmittelbar nach aussen gerichteten, bestimmt bezeichneten Stiftungszweck sowie Begünstigte fest.	The founder provides the specifically designated Foundation assets, specifies the purpose of the Foundation, entirely non-self-serving and specifically designated, and also specifies the beneficiaries.

[127] Author's footnote: I wonder if this is an over-generalisation. Where would a Scots partnership fit into this scheme?

[128] Gretton "Trusts Without Equity" (2000) 49 ICLQ 599 reprinted in Valsan (ed), *Trusts and Patrimonies* (2015) chap 5; footnotes omitted.

[129] See 90.12 (Liechtenstein: Introduction).

[130] A Foundation is a legal person, unlike a Trust Enterprise, which may be formed with or without legal personality.

2) Eine Stiftung darf ein nach kaufmännischer Art geführtes Gewerbe nur dann ausüben, wenn es der Erreichung ihres gemeinnützigen Zwecks unmittelbar dient oder aufgrund einer spezialgesetzlichen Grundlage zulässig ist. Soweit es die ordnungsgemässe Anlage und Verwaltung des Stiftungsvermögens erfordert, ist die Einrichtung eines kaufmännischen Betriebes auch bei privatnützigen Stiftungen zulässig.

A Foundation is only permitted to carry on a business activity if that is directly in furtherance of its charitable object or is expressly permitted by statute. So far the orderly investment and management of the Foundation assets require, a business activity is also permissible for private Foundations.

This may be compared to the definition in Austria. Article 1 Privatstiftungsgesetz 1993[131] provides the definition:

(1) Die Privatstiftung im Sinn dieses Bundesgesetzes ist ein Rechtsträger, dem vom Stifter ein Vermögen gewidmet ist, um durch dessen Nutzung, Verwaltung und Verwertung der Erfüllung eines erlaubten, vom Stifter bestimmten Zwecks zu dienen; sie genießt Rechtspersönlichkeit und muß ihren Sitz im Inland haben.

A private Foundation within the meaning of this law is a legal person, whose property is provided by the settlor, for its use, management and investment, for the purpose specified by the settlor; it possesses legal personality and must have its management [Seat] in Austria.

(2) Eine Privatstiftung darf nicht
1. eine gewerbsmäßige Tätigkeit, die über eine bloße Nebentätigkeit hinausgeht, ausüben;
2. die Geschäftsführung einer Handelsgesellschaft übernehmen;
3.unbeschränkt haftender Gesellschafter einer eingetragenen Personengesellschaft sein.

A private Foundation must not
1. carry on a commercial activity that is more than merely ancillary;
2. conduct the management of a trading company;
3. be a general partner of a registered partnership.

[131] *https://www.jusline.at/gesetz/psg*

90.14.3 *Definition of Founder*

Art 552(4) PGR provides:

1) Stifter können eine oder mehrere natürliche oder juristische Personen sein. Eine durch letztwillige Verfügung errichtete Stiftung kann nur einen Stifter haben.	Founders may be one or more natural persons or legal entities. A foundation established by testamentary disposition can only have one founder.
2) Hat eine Stiftung mehrere Stifter, so können die dem Stifter zustehenden oder vorbehaltenen Rechte nur von allen Stiftern gemeinsam ausgeübt werden, es sei denn, die Stiftungserklärung sieht etwas anderes vor. Fällt einer der Stifter weg, so erlöschen im Zweifel die vorgenannten Rechte.	If a foundation has several founders, the rights to which the founder is entitled or which are reserved to the founder may only be exercised jointly by all the founders, unless the foundation declaration provides otherwise. If one of the founders dies, then in case of doubt the aforementioned rights expire.
3) Wird die Stiftung durch einen indirekten Stellvertreter errichtet, so gilt der Geschäftsherr (Machtgeber) als Stifter. Handelt auch dieser als indirekter Stellvertreter für einen Dritten, so gilt dessen Geschäftsherr (Machtgeber) als Stifter. In jedem Fall ist der indirekte Stellvertreter verpflichtet, dem Stiftungsrat die Person des Stifters bekannt zu geben.	If the foundation is formed by an indirect representative, the principal (authoriser) shall be deemed to be the founder. If this person also acts as an indirect representative for a third party, then his principal (authoriser) is deemed to be the founder. In either case, the indirect representative must notify to the Foundation board the name of the founder.

90.14.4 *Foundation: IT/CGT trust*

A Foundation might be classified in one of three ways:
(1) A trust in the standard IT/CGT sense;[132] or
(2) A company in the standard tax sense;[133] or
(3) A legal person, but neither a trust nor a company in those senses

This work up to the 2018/19 edition took the view that property of a

[132] See 87.3 (Settlement: Standard IT/CGT definition).

[133] See 90.8 (Definition of "company")

Foundation was not held "in trust", and so a Foundation was not a trust in the standard IT/CGT sense. Instead it was a company:

> A characteristic of a trust is that "the assets constitute a separate fund and are not a part of the trustee's own estate".[134] A Foundation does not have this characteristic: A Foundation holds property, but there is only one fund, not a fund separate from the Foundation's own assets (as would be the case for a trustee). So it is not an IT/CGT settlement.
>
> There are of course other significant differences between a Foundation and a trust, in particular the beneficiaries of a Foundation have different and perhaps weaker rights. But the failure to meet what the Hague convention on the law applicable to trusts identifies as a defining characteristic is the most significant point.
>
> A Foundation is a body corporate. It is therefore a company for UK tax purposes. A Foundation is therefore subject to UK corporation tax on its income and gains if it is UK resident and in principle subject to income tax on UK source income at the basic rate if non-resident. The test of residence is the company test of central management and control.

But on further reflection I am inclined to think, with HMRC, that

(1) A Foundation is a trust within the standard IT/CGT definition, and
(2) A Foundation is not a company in the standard tax sense

The reasons are as follows:

(1) A Foundation is a trust in the standard IT/CGT sense because:
   (a) It must benefit others, not itself ("unmittelbar nach aussen gerichteten ... Stiftungszweck").
   (b) In applying statutory words (here, "Settled property" means any property held in trust ...") to a foreign law entity, a certain amount

[134] Footnote original: See Article 2 Hague Convention on the Law applicable to Trusts and on their Recognition. See too Hayton "Principles of European Trust Law" p.23 in *Modern International Developments in Trust Law* (1999) ed. Hayton: "While many mainland European jurisdictions have the functional equivalent of a charitable purpose trust in the guise of a foundation which has legal personality, we deliberately rejected extending our [conception of] trust to cover such functions. It is because a trust is not a company, not a corporate person, but a segregated fund owned by trustees, that different rules from those for companies developed for trusts."
It is hard to make any comment about trusts without qualification. Assets of a charitable trustee incorporated under s.251 Charities Act 2011 might not constitute a separate fund. But that is an anomalous and unusual case and perhaps itself not a "trust" in the ordinary sense.

> of flexibility is appropriate. Applying the entity-resemblance test, a Foundation is more like a trust than a company.

This is consistent with practice in Australia, which is well-reasoned.

The argument to the contrary was that:

(1) A foundation is a body corporate.

(2) Company (in the standard tax sense) is defined to include a body corporate; indeed body corporate is synonymous with company, in the general sense.

But it is suggested that a foundation is not a body corporate, or at least not in the relevant sense. The term "body corporate" assumes, or requires, that one or more persons have come together in the form of a single, distinct legal person.[135] Who is the "body", in the absence of shareholders or members? It can hardly be the Board of the Foundation. Gretton in the passage cited above states that a Foundation "is not a corporation".

Different legal systems describe Foundations in different ways. In Guernsey, "Foundations have legal personality but are not bodies corporate";[136] that adopts the view taken here.

On the other hand, Art 30 Foundations (Jersey) Law 2009 provides:

> **30 Corporate status**
> (1) A foundation is an incorporated body with the name specified in respect of it in the register.
> (2) ... a foundation, acting through its council, is capable of exercising all the functions of a body corporate.

It might be that Jersey Foundations should be classified differently from other Foundations. But it is suggested that even a Jersey Foundation is not a body corporate for UK tax law purposes, on the basis that it should be taken to follow the civil law model.[137]

[135] See 90.9.3 (What is a body corporate?).

[136] See States of Guernsey, "Consultation on the potential enactment of LLC legislation in Guernsey" p.8 (2019)
https://www.weareguernsey.com/media/6971/llc-consultation-report.pdf

[137] For completeness I should mention a sentence in the OECD Commentary. This is a comment on Art 3(1) OECD Model which provides:

> "a) the term "person" includes an individual, a company and any other body of persons;
> b) the term "company" means any body corporate or any entity that is treated as a body corporate for tax purposes"

The OECD Commentary on art 3, para 2, provides:

A Foundation does have legal personality but what that entails must be understood in the context of the applicable law's concept of legal personality, not English law.[138] It does not follow from foreign law legal personality that a Foundation is a body corporate in the UK law sense.[139]

Even if (contrary to the above) a Foundation is a body corporate, it does not matter because:

(1) It is a trustee, and so (except where the context otherwise requires), it is treated as a distinct notional person which is not a body corporate[140] or

(2) Context shows that it is not intended to be within the definition of company.

If (contrary to all the above) a Foundation is not a trust in the standard IT/CGT sense, it would *still* not be a company in the standard tax sense. If not a trust, a Foundation should be regarded as a legal person other than a company in the standard tax sense.

A Foundation is a settlement-arrangement[141] so it is a "settlement" for the purposes of s.87 TCGA.[142]

90.14.5 *Australian law view*

The Australian Taxation Office categorise a Liechtenstein Foundation as a trust, for the purposes of Australian tax law.

> "... the term 'person' includes any entity that, although not incorporated, is treated as a body corporate for tax purposes. Thus, e.g. a foundation (fondation, Stiftung) may fall within the meaning of the term 'person'."

This suggests that a Foundation is a person (as defined in the Model treaty) because (1) a Foundation is not incorporated and (2) it is treated as a body corporate for tax purposes. The proposition at (1) supports the view taken here. But I would not put much weight on such a short and unconsidered comment. The OECD reasoning rests on generalisations about foundations. Its analysis may be correct in some legal systems, but in others (1) a Foundation may be incorporated or (2) it may not be treated as a body corporate for tax purposes. I would say that a Foundation is a person in the general sense, so it is not necessary to rely on the Commentary's reasoning to support the conclusion that a Foundation is a person.

For these reasons, it seems to me that the comment in the Commentary does not shed any light on the question of how a Foundation should be classified in UK law.

[138] See App.2.7.2 (Legal person: Foreign law).

[139] See 90.9.3 (What is a body corporate?)

[140] See 7.3 (Trustees a distinct person).

[141] Assuming (as will generally be the case) that the bounty requirement is met.

[142] See 61.2 ("Settlement"/"settled property").

Status of a Liechtenstein Foundation
Question 1: Is the X Foundation, a Liechtenstein foundation, a trust estate for the purposes of Division 6 of Part III of the [Australia] Income Tax Assessment Act 1936 (ITAA 1936)?
Answer: Yes ...
Relevant facts:
The X Foundation
The X Foundation is a Liechtenstein foundation known as a Stiftung...

The ruling sets out a detailed description of the Foundation; but it is sufficient here to note that the Foundation was in common form, and did not confer Founder's Rights.

Reasons for decision:
... ***Nature of the foundation***
The Liechtenstein foundation is similar to a corporation in that it can enter into contracts, sue, be sued and hold bank accounts, in its own name. However, unlike the corporation, the foundation itself has no members or shareholders. Similarly, the founder has no ownership rights to the independent assets. The foundation has beneficiaries but they are not owners of the foundation.
The foundation above all constitutes a relationship of trust between persons. In practice, the founder authorises the foundation board to administer his personal assets, or a part thereof, in the interest of one or more beneficiaries.

90.14.6 *Trust concept in Australia*

The ATO statement continues:

... 'Trust estate' is not defined in the ITAA 1936 or the Income Tax Assessment Act 1997 (ITAA 1997) as no definition of a trust seems to have been accepted as comprehensive and exact. French J in *Harmer v FCT* (1989) 20 ATR 1461; 89 ATC 5180 (*Harmer Case*) stated that a trust is notably 'a definition of a relationship by reference to obligations'. As to what constitutes a 'trust relationship' should therefore be determined in accordance with guidance provided by the Courts.
The 7th edition of Jacobs' *Law of Trusts in Australia* (Chapter I paragraph 103)[143] defines a trust relationship as:

> '...the whole relationship which arises between the parties in respect of the property the subject of the trust, and the obligation of the trustee to the beneficiary, and the interest of the beneficiary in the property may be regarded as results flowing from the existence of that relationship.'

Following from the above definition, the four essential elements of a 'trust relationship' are identified in paragraph 104, Chapter I, of the previously stated edition of Jacobs' *Law of Trusts in Australia*. Those essential elements were quoted with approval in the *Harmer Case* at 89 ATC 5187, as follows:

[143] Paragraph 1-03, in the 8th edition (2016). The passage quoted is unchanged in the current edition.

- The existence of a trustee who holds a legal or equitable interest in the trust property,
- The existence of trust property which must be property capable of being held on trust and which includes a chose in action,
- The existence of one or more beneficiaries other than the trustee, and
- A personal obligation on the trustee to deal with the trust property for the benefit of the beneficiaries

[The ruling refers to ATO Interpretative decision ATO ID 2008/2 which concludes that a Dutch Stichting is a 'trust', and ATO ID 2008/62 which concludes that as the Stichting is created under Netherlands law and has a legal personality under Netherlands law, it should be recognised as a legal entity in Australia; see 90.40 (Dutch stichting/ Foundation).]

In regards to the creation of a 'trust' and the role of a trustee', the majority of the High Court in *The Registrar of the Accident Compensation Tribunal (Vic) v FCT* 93 ATC 4835 at 4842 clarified that:

> 'A trust may be created without use of the word "trust". And, unless there is something in the circumstances of the case to indicate otherwise, a person who has "the custody and administration of property on behalf of others" or who "has received, as and for the beneficial property of another, something which he is to hold, apply or account for specifically for this benefit" is a trustee in the ordinary sense.'

On the concept of a trust there is no difference between Australian and English law.

90.14.7 *Categorisation of Foundation*

The ATO statement continues:

The X Foundation has been established consistent with Article 552 §§ 1-41 of the PGR as a separate legal entity intended to serve private or personal purposes in accordance with its declaration of establishment.

The By-Laws of the X Foundation provide that it was formed by the trustee company, acting as the Founder. For the purposes of the PGR, the trustee company has the role of an indirect representative giving effect to the declared wishes of Mr. Y as the principal (authoriser). Mr. Y is therefore deemed to be the Founder of the X Foundation.

The underlying purpose of the Foundation, pursuant to the declaration establishment and the By-Laws, is to invest, manage and administer the foundation assets, in the nature of investment products for the support and/or benefit of all or any one or more of the beneficiaries of the Foundation.

The declaration of establishment and the By-Laws authorise the foundation board to determine the beneficiaries and make distributions of the foundation assets to designated beneficiaries in their entirety or in parts at any time and at the free discretion of the foundation board.

In summary, having regard to its declaration of establishment and By-Laws:

The X Foundation has legal ownership and possession of the foundation assets;

The foundation assets are capable of being held on trust;

The foundation board, in the role of a trustee, manages and administers the foundation assets for the benefit of beneficiaries of the Foundation;

The beneficiaries of the Foundation are expressly identified in the By-Laws; and

The terms of the declaration of establishment and the By-Laws impose on the foundation board, a personal obligation to deal with the foundation assets strictly for the benefit of the beneficiaries as the foundation board may in its absolute discretion think fit.

It is considered that, in respect of the X Foundation, all four essential elements identified in the *Harmer Case* as giving rise to a trust relationship exist between the Foundation, the foundation board and the persons entitled to benefits (the beneficiaries) from the foundation.

In *Mulherin v. CT* 2013 FCAFC 115 ('*the Mulherin Case*'), the Full Federal Court found that the AAT had correctly affirmed the Commissioner's decision to assess the taxpayer's income from a Liechtenstein Foundation established by the taxpayer. The premise of the assessments, as determined by the Commissioner and accepted by the taxpayer, was that the income represented the taxpayer's present entitlement in respect of a 'resident trust estate'.

In conclusion, based on the interpretation of the Liechtenstein Foundation Law and the views held by Australian Courts, it is considered that the X Foundation is a 'trust estate' for the purposes of Division 6 of Part III of the ITAA 1936 for the income years covered by this ruling.[144]

The same reasoning should apply in the UK.

A Guernsey consultation paper takes the same view:[145]

> Foundations have legal personality but are not bodies corporate.

90.14.8 *Canadian law view*

An Austrian Privatstiftung (non-charitable Foundation) has been categorised as a company, not a trust, for Canadian tax law:

> [39] ... the law of Austria does not recognize trusts as understood in Canadian law. However, it is evident that as a practical matter ... Herbert Sommerer may well have achieved many of the objectives that could have been achieved in a common law jurisdiction by settling a trust for Peter Sommerer, his spouse and their children. He did so by creating and endowing the Sommerer Private Foundation under the Austrian Private Foundations Act and naming Peter Sommerer, his spouse, and their children as beneficiaries and ultimate beneficiaries. But that does not mean as a matter of law that the creation and endowment of the Sommerer Private Foundation was the settlement of a trust...
>
> [40] As mentioned above, an Austrian private foundation is a juridical

[144] ATO "Status of a Liechtenstein Foundation" (2017) *https://www.ato.gov.au/law/view/view.htm?docid=EV/1051209890341&PiT=99991231235958*

[145] Consultation on the Potential Enactment of LLC Legislation in Guernsey (2021) para 5.2 *https://www.weareguernsey.com/media/6971/llc-consultation-report.pdf*

> person with the legal capacity to own property in its own right and to deal with its property on its own account. The legal right of an Austrian private foundation to deal with its own property is the same as the legal right of a Canadian corporation to deal with its own property. That is so despite the fact that the board of an Austrian private foundation must manage its affairs in furtherance of the purposes stipulated in its constating documents. The board of directors of a corporation is similarly constrained, in the sense that it must manage the affairs of the corporation in its best interests, subject to any terms and conditions in its constating documents.
>
> [41] A corporation does not hold its property in trust for its shareholders or members, except to the extent that a trust deed or an analogous legal instrument imposes the legal and equitable obligations of a trustee on the corporation with respect to specific corporate property. Assuming it is theoretically possible for an Austrian private foundation to hold its property in trust (that is, subject to conditions that are analogous to the legal and equitable obligations of a trustee in a common law jurisdiction), that possibility cannot be realized unless those conditions are formally established. Nothing in the constating documents of the Sommerer Private Foundation or the law of Austria ... supports the conclusion that the right of the Sommerer Private Foundation to deal with its property is constrained by any legal or equitable obligations analogous to those of a common law trustee.
>
> [42] Looking at the situation from another point of view, a shareholder or member of a corporation, as such, is not the beneficial owner of any property or the corporation, and has no legal or equitable claim to the corporate property ... a shareholder or member has only an inchoate right to receive distributions of corporate property from time to time at the discretion of the board of directors, and to share in the distribution of the corporate property upon its dissolution. The same can be said of the interest of a beneficiary or an ultimate beneficiary in the property of an Austrian private foundation. Nothing in the Austrian Private Foundations Act or the constating documents of the Sommerer Private Foundation gives Peter Sommerer a legal or equitable claim to the corporate property that is different from that of a shareholder or member of a corporation.
>
> [43] For these reasons, I doubt that the Sommerer Private Foundation holds any of its property in trust for Peter Sommerer.[146]

The Australian/Canadian positions could be reconciled on the basis that

[146] *Canada v Sommerer* [2012] FCA 207, 15 ITELR 426; *http://www.canlii.org*

Liechtenstein/Austrian Foundations are different,[147] so that one could be regarded as a trust and the other as a company. But Austrian Foundations are modelled on Liechtenstein.[148] The better analysis is to say that Australian/Canadian tax laws are different, so they can categorise the same entities in different ways.[149] If that is wrong, and they are incompatible, rival, analyses, it is considered that the Australian analysis is to be preferred in the UK.

90.14.9 *Foundation an IHT-settlement*

Foundation property is normally held for persons in succession or with power to make payments out of Foundation income.[150] The question then is (in short) whether a Foundation is a trust, or equivalent in effect to a trust.[151]

This raises a question as to the effect of a Foundation. For Liechtenstein, Lorenz says:

> It now appears that the Liechtenstein Supreme Court has used Liechtenstein trust law as a basis for the development of a coherent pattern of principles applicable to all types of Liechtenstein asset planning devices, in particular foundations and establishments, and not just the trust …
> … the internal design of foundations will increasingly come to resemble that of trusts, and that disputes relating to foundations will increasingly be resolved by applying principles of trust law.[152]

Biedermann says:

> Operationally speaking, there is no difference between a family foundation and a family trust.[153]

CRS guidance refers to Foundations as "functionally similar to trusts" and

[147] See 90.14.2 (Foundation definition).

[148] Panico, *Private Foundations Law and Practice* (1st ed, 2014) para 1.21.

[149] See 90.5 (Foreign law classification/treatment).

[150] See 87.6.3 (Limb (b): Income powers).

[151] See 87.6 (Definition of "IHT-settlement").

[152] *Disputes involving Trusts*, ed. Vogt, 1999, p.213.

[153] Biedermann, "Foundations vs Trusts" [1993] PCB 283. Noseda makes a similar point: "The Foundations (Jersey) Law 2009: A Civilian Perspective" [2010] The Jersey & Guernsey Law Review 48 at [13].

MLR describes a Foundation as "similar to a trust".[154]
The Liechtenstein disclosure facility[155] provides:

> a business activity is only allowed in the case of charitable foundations or private foundations where a respective law specifically permits it. In the case of family foundations, business activity ("*nach kaufmännischer Art geführtes Gewerbe*") is not permitted. Accordingly, while a foundation has its own legal personality, its essence and purpose, like those of a trust, is to preserve and maintain assets for the beneficiaries

Similarly in Ireland:

> Any entity which is similar in its effect to a discretionary trust (such as "foundations", the European equivalent of trusts) shall be treated as a discretionary trust irrespective of how it is described in the place where it is established.[156]

It is considered that a Foundation is an IHT-settlement on the basis that:
(1) it is a trust; or
(2) even if not a trust, it is at least equivalent to a trust[157]

This view is also supported by *Hansard*. Dr John Gilbert MP (then Financial Secretary to the Treasury) said:

> The words [para (e) of the IHT definition of settlement] are intended to widen the definition of a settlement so that it is capable of applying to entities such as family foundations which can be set up in some countries abroad. Although such an entity may enable property to be administered for the benefit of a family and produce the same practical effects as a

[154] See 130.27 (Controlling person: Foundation); 131.19.5 (Foundation/trust equivalent).

[155] See 90.12 (Liechtenstein: Introduction).

[156] Capital Acquisitions Tax Consolidation Act 2003: Notes for Guidance (2015) *https://www.revenue.ie/en/tax-professionals/documents/notes-for-guidance/cat/cat-act-guidance-notes-2015.pdf*

[157] This view has some support in *Hamilton v Hamilton* [2016] EWHC 1132 (Ch) at [20] ("... the assumption (which would have been hard to resist) that the establishment of [the Liechtenstein Foundation] created a settlement, within the very wide definition of that term in s.43(2) IHTA...").
The contrary argument would focus on the word "equivalent", and state that since there are undoubtedly some differences, the two are not equivalent. The statute is looking at the broad substance rather than absolute equivalence but where to draw the line is hard to tell. But if a Foundation *is* a trust the issue does not arise.

> settlement, it would fall outside the concept of a settlement as recognised by our law. This is why the words at the end of the definition are required.[158]

It has been argued that a Foundation cannot be an IHT-settlement because beneficiaries of the Foundation have no interest in Foundation property. But even if the premise is correct, the conclusion does not follow. Beneficiaries of a *Garland* trust have no interest in trust property. A charitable trust generally confers no rights on beneficiaries,[159] and a charitable trust is clearly an IHT-settlement. All that matters is that there is some legal mechanism which recognises their rights and prevents the board of a Foundation treating the Foundation property as their own.

It is considered that a charitable Foundation (as opposed to a private Foundation) is not an IHT-settlement. It is closer to a charitable company, and so should not regarded as equivalent in effect to a charitable trust.

90.14.10 *Founder's Rights: a company*

The position is different for a Foundation with Founder's Rights.[160] This cannot be a settlement or a settlement-arrangement. The choice is between a bare trust for the founder, and a company beneficially owned by the founder; a company seems the best analysis.

90.14.11 *HMRC view*

The Liechtenstein disclosure facility[161] provides:

> ... foundations ("Stiftungen") [are] to be characterised, recognised and

[158] Hansard, 17 February 1975 (Finance Bill, Standing Committee A) column 1736, referring at column 1737 specifically to Liechtenstein. John Pardoe MP concluded the debate with these words:

> "I suppose from now on [para [e] of the definition of IHT-settlement] will be called the Liechtenstein subparagraph in the history of constitutional law. I am not entirely satisfied that I know that the words mean anything important, or that the Financial Secretary knows that they mean anything important, but it is clear that the Revenue thinks that they mean something, so I suppose we had better leave it that way."

See *https://www.foreigndomiciliaries.co.uk/index.php/Documents_archive*

[159] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 12.5.1 ("Beneficiary" of charity).

[160] See 90.13.1 (Founder's Rights).

[161] See 90.12 (Liechtenstein: Introduction).

treated as trusts for UK tax purposes.[162]

The former TDSI Guidance Notes[163] provided:

> [1] ... Stiftungs are Liechtenstein business entities which are fiscally opaque. ...
> [2] The current HMRC view is that Stiftungs are Trusts for UK tax purposes. For TDSI purposes, the deposit should be considered to belong to the settlor[164] and the TDSI treatment depends on the nature of the settlor – so if the settlor is an individual, BRT [basic rate of tax] must be deducted.
> [3] If the settlor can show that they have not retained an interest, the Financial Institution can treat the Stiftung as an interest in possession trust ... and the TDSI position will depend on the nature of the beneficiary. If the beneficiary is an individual, BRT must be deducted.

Point [3] assumes that a Foundation can be transparent for IT which contradicts point [1].[165]

HMRC do not refer to statutory provisions but are clearly saying that in their view Foundations are trusts for all tax purposes.

It is true that HMRC recognise that there may be special circumstances, but in the absence of special circumstances, if it suits the Foundation to take the view that the Foundation is a trust for all tax purposes, including the IT/CGT definition, it can properly do so. That might be helpful, for instance, if the taxpayer wishes to argue that:

[162] The same point is made in the INT Manual:
INTM600380 Person abroad - examples [Jul 2023] "... Generally we treat ... a Stiftung like a discretionary trust."
Again, in the context of s.720 protected-trust relief, HMRC guidance states that "settlement" (here, the standard IT/CGT definition) includes "foreign entities that fall to be treated like trusts under the principle in *Memec plc v IRC* e.g. certain types of foundations"; See 92.13.2 (Condition (b): Settlement).

[163] HMRC, "Tax Deduction Scheme for Interest: Guidance Notes for Financial Institutions (2012) para 2.3.
https://www.gov.uk/government/publications/guidance-notes-for-financial-institutions
TDSI was abolished in 2016, and the Guidance Notes withdrawn. But the general point made here remains relevant, and there is no reason to think that HMRC practice has changed.

[164] Author's footnote: It is assumed that the Foundation is a settlor-interested trust.

[165] HMRC classify Liechtenstein as a *Garland* jurisdiction: see 42.12 (Baker or Garland trust?).

- income of a company held by a Foundation is protected s.720 income[166]
- ESC B18 applies
- a Foundation is an IIP trust and transparent for income tax purposes
- ATED does not apply[167]

90.14.12 *Foundation: IIP trust?*

Since a Foundation is an IHT-settlement, the question may arise whether a beneficiary's interest under the settlement is an interest in possession. (This question does not often matter for IHT for Foundations made after 2006.)

This raises two issues:

(1) What is the test for an "interest in possession". This is a question of UK tax law; "interest in possession" is a technical term of English trust law, and (subject to any particular provisions in the tax statute concerned) it should have its English trust law meaning.

(2) Whether any particular interest meets those requirements; this is a matter of applying the governing law to the document in question.

An interest in possession is a current right to current income. If a Foundation confers such a right, the beneficiary has an interest in possession. Whether that should be regarded as an interest in possession *in settled property* is at first sight more doubtful.[168] However as "settlement" is given an extended meaning, it is suggested that the meaning of related expressions such as "interest in possession in settled property" should be given a comparable extended meaning. Thus a beneficiary has an IIP if they have the right to the income of the Foundation as it arises.[169]

Whether a beneficiary has the right to income as it arises depends on the drafting (construed in accordance with the governing law). At the borderline, the distinction between IIP and non-IIP trusts is one of form rather than substance, and not appropriate to a Foundation which is not even a trust, but merely equivalent in effect. In such cases one can only answer the question on the basis of "doing the best one can" and with the benefit of appropriate foreign law advice.

[166] See 92.14.1 (Cond. (c): Trustee participator).

[167] See 98.27 (Co. purchaser (non-natural person)).

[168] See 90.13 (Beneficiary rights).

[169] See 90.11.1 (IIP in Garland trust).

90.14.13 *Foundation: Income distributions*

This section considers the taxation of a UK resident beneficiary on a distribution from a Foundation.

If a Foundation is a trust, within the standard IT/CGT definition, and not transparent (ie there is no interest in possession), an income receipt from a Foundation is classified as an Annual Payment and not a distribution. (The same should apply if, contrary to the view taken in this book, a Foundation is an entity which is neither a company nor an trust). For arising basis taxpayers, this makes a difference as the rates of tax for Annual Payments and company distributions are different.

If that is right, the position depends on the drafting of the power which the Foundation uses to make or authorise the distribution.[170] If the receipt is classified as income, it is classified as an Annual Payment, like a trust distribution. If the receipt is classified as capital the usual s.731/s.87 rules will apply.

90.15 Anstalt/Establishment

The term Anstalt is conventionally translated as "establishment". I expect that is because the French equivalent is *établissement.* But the English word itself does not convey any information about the entity. One might call it an Establishment, with an initial capital to reflect the technical nature of the expression, but I prefer to use the word Anstalt. The term must not be confused with *Permanent Establishment* which is a different concept.

An Anstalt is governed by Part 5 PGR.[171] Art 534(1) PGR provides the definition:

A. Begriff und Abgrenzung	**Concept and definition**
Anstalt (Etablissement) im Sinne dieses Titels ist ein nach den folgenden Vorschriften rechtlich verselbständigtes und organisiertes, dauernden wirtschaftlichen oder anderen Zwecken gewidmetes, ins Öffentlichkeitsregister als Anstaltsregister eingetragenes	An Anstalt (Establishment) within the meaning of this Part [Part 5 PGR], and pursuant to the following regulations, is a legally independent and organised undertaking, dedicated to permanent economic or other objects, and entered in the Public Anstalt Register, which holds

[170] See 41.8 (Trust payment: Income/capital).

[171] See 90.12 (Liechtenstein: Introduction). See too "Half Trust, Half Company, All Anstalt" Bulletin for International Taxation, 1999 (Volume 53), No 8.

Unternehmen, das einen Bestand von sachlichen, allenfalls persönlichen Mitteln aufweist und nicht öffentlich-rechtlichen Charakter hat oder eine andere Form der Verbandsperson aufweist.	tangible or personal property, and is not a public law institution or any other type of legal entity.

The former TDSI Guidance Notes provided:

> **Anstalts & Stiftungs**
> Anstalts ... are Liechtenstein business entities which are fiscally opaque. The current HMRC view is that Anstalts should all be dealt with as if they are companies. For TDSI, this means that Anstalts should receive gross interest.[172]

Despite this statement, and classification in the HMRC transparent/opaque list as "opaque", HMRC practice has not always been consistent.[173] The Liechtenstein disclosure facility[174] takes a different approach:

> 1) An establishment ("Anstalt") in Liechtenstein to be characterised, recognised, and treated for UK tax purposes as follows:
> a) An establishment that according to its articles is permitted to undertake a business activity ("*nach kaufmännischer Art geführtes Gewerbe*"), and therefore is obliged to have an audit, to be characterised, recognised, and treated for UK tax purposes as a company.
> b) An establishment that according to its articles is *not* permitted to undertake a business activity ("*nach kaufmännischer Art geführtes Gewerbe*"), and therefore is *not* obliged to have an audit, to be characterised, recognised, and treated for UK tax purposes as follows:
> i) An establishment with founder's rights[175] or shares[176] to be characterised, recognised and treated as a company.

[172] HMRC, "Tax Deduction Scheme for Interest: Guidance Notes for Financial Institutions (2012) para 2.3.
https://www.gov.uk/government/publications/guidance-notes-for-financial-institutions
TDSI was abolished from 2016/17, and the Guidance Notes withdrawn. But the general point made here remains relevant.

[173] Private correspondence.

[174] See 90.12 (Liechtenstein: Introduction).

[175] For Founder's Rights (Gründerrechte) see 90.13.1 (Founder's Rights).

[176] Author's footnote: An Anstalt with shares (Anstaltsanteile) is possible but not common.

ii) An establishment with no founder's rights or shares to be characterised, recognised and treated as a trust.

Other Liechtenstein treaties also draw distinctions between Anstalts (and Trust Enterprises) carrying on commercial /non-commercial activity, and those with/without Founder's Rights. For instance, under Liechtenstein FATCA, an Anstalt with non-commercial objects is classified as a trust.[177]

An Anstalt with Founder's Rights cannot be a settlement under the IT/CGT or IHT definitions, or a settlement-arrangement.[178] The choice is between a bare trust for the founder, and a company beneficially owned by the founder; company seems the best analysis.

Article 545(2) PGR provides:

> Vom Anstaltsvermögen darf nur ein dem Überschuss des Reinvermögens über den statutarisch eingezahlten oder sonst gedeckten Anstaltsfonds entsprechender Betrag nach allfälligen Rücklagen in die durch die Statuten vorgesehenen Reservefonds, als verfügbarer Reingewinn entnommen werden.

> Only an amount corresponding to the surplus of net assets in excess of the establishment capital paid in pursuant to the articles or otherwise covered may be withdrawn from the Anstalt's assets as available net profit, after allowance has been made for anticipated reserves to be paid into the reserve fund provided for in the articles

[177] The full title is: Agreement between the Government of the United States of America and the Government of the Principality of Liechtenstein to Improve International Tax Compliance and to Implement FATCA. This provides:

> The term "Trust" shall include trusts, foundations and non-commercial establishments ("Anstalten") if the foundation or establishment is created for the primary purpose of protecting or conserving the property of the foundation or establishment on behalf of beneficiaries.

> Der Ausdruck "Trust" umfasst Trusts, Stiftungen und nicht kommerziell tätige Anstalten, sofern die Stiftung oder Anstalt für den vorrangigen Zweck errichtet wurde, das Eigentum der Stiftung oder Anstalt für die Begünstigten zu schützen oder zu erhalten.

https://home.treasury.gov/system/files/131/FATCA-Agreement-Liechtenstein-5-19-2014.pdf

https://www.gesetze.li/konso/pdf/2015005000?version=2

Similarly, I understand that under the Liechtenstein/Austria Tax Cooperation Agreement, a Trust Enterprise with no Founder's Rights and non-commercial objects is classified as a Foundation; but I have not seen the relevant treaty text.

[178] See 90.13.1 (Founder's Rights).

While not determinative, this does seem a very company-like feature of an Anstalt.

Matthews says that "the structure much more resembles a company than a trust" and goes on to say that the PGR envisages 3 kinds of Anstalt:[179]

> (i) the one-man Anstalt
> (ii) the trust-like Anstalt
> (iii) the company-like Anstalt
> The first is like a one-man company. The founder is the only beneficiary and controls everything that the Anstalt does.
> The second is where the founder gives control to a board of directors and the beneficiaries are other people.
> The third is where two or more founders create a structure to benefit themselves, retaining control in their hands.

It makes sense to treat type (i) and (iii) as a company and type (ii) as a trust.[180]

90.16 Treuunternehmen/Trust Enterprise

90.16.1 *Treuunternehmen terminology*

Treuunternehmen is literally and conventionally translated "trust enterprise" (sometimes "trust undertaking"). But the English expression does not itself convey much information about the entity. I call it a Trust Enterprise, with initial capitals to reflect the technical nature of the expression, though there is something to be said for using the German term.

The term Geschäftstreuhand is a synonym.[181] I translate this "Business

[179] "Some Alternatives to Trusts" [1995] OTPR 31.

[180] Though in practice there may be borderline cases. Matthews says: "Of course, it is possible to design and form an Anstalt which falls between these different types. For example, the founder might remain the principal beneficiary during his life, and retain control of the Anstalt activities as well, but on his death cede control to a board of directors and appoint third party beneficiaries. Or he might appoint third party beneficiaries straightaway, but retain control."

[181] Art 1032a PRG, amended 2010, provides:

> In der Firma oder in einem Zusatz muss "registriertes Treuunternehmen" stehen, oder eine ähnliche Bezeichnung, wie "registrierte Geschäftstreuhand",

> (A Trust Enterprise that does not carry on business must include in its name (or by its name) the words "registered Trust Enterprise" or a

Trust", again with initial capitals to indicate that it is a technical term.

It is sometimes called Trust reg. (reg for registered)[182]; that does not seem wholly apt but it might again be regarded as a technical expression.

A Trust Enterprise is governed by art 932a PGR.[183] Art 932a(1) PGR provides the definition:

a) Treuunternehmen ohne und mit Persönlichkeit	**Trust Enterprises with and without legal personality**
1) Treuunternehmen als eigentliche Geschäftstreuhand nach dem Gesetze ist ein auf Grund der Treusatzung von einem oder mehreren Treuhändern (als treuhänderischen Inhabern) unter eigenem Namen oder eigener Firma geführtes beziehungsweise weiter betriebenes, rechtlich verselbständigtes, organisiertes, wirtschaftlichen oder anderen Zwecken dienendes und mit eigenem Vermögen bewidmetes Unternehmen ohne Persönlichkeit, für dessen Verbindlichkeiten eine Haftung gemäss diesem Gesetze besteht ("Treuunternehmen ohne Persönlichkeit") und das weder öffentlich-rechtlichen Charakter hat noch eine andere privatrechtliche Rechtsform aufweist.	A Trust Enterprise which constitutes a true Business Trust according to the law, is an undertaking, managed or operated on the basis of the trust articles by one or more trustees (as fiduciary owners), under their own name or a firm name, which, legally autonomous and organised, pursues economic or other objects, and is endowed with its own assets, without legal personality, whose liabilities are governed by this law ("Trust Enterprise without legal personality") and that is not a public law institution or any other private law legal entity.
2) Wird unter sinngemässer Anwendung des vorausgehenden Absatzes ein Unternehmen in der nach den Vorschriften dieses Gesetzes aufgestellten Treusatzung (Errichtungsurkunde) ausdrücklich als Treuunternehmen mit Persönlichkeit errichtet, so finden auf dieses uneigentliche Treuunternehmen im übrigen die Bestimmungen über die eigentliche Geschäftstreuhand, insbesondere jene über	Where, by analogous application of the above paragraph, an undertaking is created as a Trust Enterprise with legal personality expressly stated in the trust articles (formation deed), which are drawn up pursuant to the provisions of this law, the provisions concerning a true Business Trust shall also apply to this quasi Trust Enterprise, in particular, those relating

"registrierte Salmannschaft", "registrierte Treustiftung", "registriertes Treuinstitut", bei einem Treuunternehmen, das kein nach kaufmännischer Art geführtes Gewerbe betreibt ...	similar expression such as registered Geschäftstreuhand [Business Trust]/Salmannschaft/Treustiftung/ Treuinstitut

[182] See above footnote.

[183] See 90.12 (Liechtenstein: Introduction).

die Haftung für die Verbindlichkeiten entsprechende Anwendung ("Treuunternehmen mit Persönlichkeit").	to liability ("Trust Enterprise with legal personality").

The Liechtenstein disclosure facility[184] records the HMRC view:

> A trust enterprise ("*Treuunternehmen*") in Liechtenstein is to be characterised, recognised, and treated for UK tax purposes in an analogous way to an establishment ("*Anstalt*").[185]

The Trust Enterprise was introduced in 1928.

It is said to be modelled on the US (or Massachusetts) business trust.[186] That does not take a UK practitioner very far, because

(1) The US business trust is an unfamiliar institution, (if indeed it is a clearly defined institution); and
(2) It is not clear how closely the Trust Enterprise follows that model.[187]

PGR describes Trust Enterprises with/without legal personality as *eigentliche/uneigentliche* Treuunternehmen, which might be translated as *true/quasi* Trust Enterprises. It is suggested that the distinction does not affect the entity classification for UK tax purposes, because (apart from legal personality, which should not be decisive by itself)[188] the same principles govern both; and the HMRC statement does not distinguish them. In practice, Trust Enterprise with legal personality is the standard form.

90.17 Treuhandschaft (trust)

PGR uses the term Treuhänderschaft, but the term Treuhandschaft is also used, and I think the meaning is the same. This is translated as "trust".

PGR devotes a chapter to the topic, articles 897-932. Spitz & Clarke say

[184] See 90.12 (Liechtenstein: Introduction).

[185] See 90.15 (Anstalt/Establishment).

[186] This explains why PGR treats the terms Treuunternehmen (Trust Enterprise) and Geschäftstreuhand (Business Trust) as synonyms.

[187] A Trust Enterprise seems quite different from the business trust considered by the Supreme Judicial Court of Massachusetts in *State Street Trust Co. v. Hall* 311 Mass. 299 (Mass. 1942).

For what it is worth, note that the Massachusetts business trust is classified as transparent in the HMRC transparent/opaque list: See 90.54 (HMRC transparent/opaque list).

[188] A Trust Enterprise which is a legal person is not a body corporate: the terms are not identical; see 90.9.3 (What is a body corporate?)

that the entity “is based to a great extent, but not exclusively, upon the common law model”.[189] Biedermann similarly states that "the Treuhänderschaft is based on the common law trust”.[190]

Art 897 PGR[191] provides a definition:

> Treuhänder (Trustee oder Salmann) im Sinne dieses Gesetzes ist diejenige Einzelperson, Firma oder Verbandsperson, welcher ein anderer (der Treugeber) bewegliches oder unbewegliches Vermögen oder ein Recht (als Treugut), welcher Art auch immer, mit der Verpflichtung zuwendet, dieses als Treugut im eigenen Namen als selbständiger Rechtsträger zu Gunsten eines oder mehrerer Dritter (Begünstigter) mit Wirkung gegen jedermann zu verwalten oder zu verwenden.

> Trustee (in German, Treuhänder or Salmann[192]) within the meaning of this law is an individual, firm or company to whom another (the settlor) transfers movable or immovable property or a right (trust property), of any kind, with the obligation to administer or use it, in his own name as an independent owner, for the benefit of one or more third parties (beneficiaries), with effect against all other persons.

This is a fair definition of a common law trust. On the basis of this, it is considered that a Treuhandschaft is a trust in the normal sense of the word, and a settlement under the standard IT/CGT definition (and in principle under the other tax definitions).

The Liechtenstein disclosure facility[193] provides:

> Trusts (“*Treuhandschaften*”) ... are to be characterised, recognised and treated as trusts for UK tax purposes.

90.18 Civil law trust equivalents

Honoré says:[194]

> The recent series of historical essays edited by Helmholz and Zimmermann[195] ... tend to undermine the idea put forward by Maitland

[189] Spitz & Clarke, *Offshore Service* (looseleaf) para LIE.501.

[190] *The Trust in Liechtenstein Law: a comparison with its prototype in the common law trust* (1984), p.2

[191] See 90.12 (Liechtenstein: Introduction).

[192] In practice I do not think that the word *Salmann* is used now.

[193] See 90.12 (Liechtenstein: Introduction).

[194] “On Fitting Trusts into Civil Law Jurisdictions” (2008) *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1270179*

[195] *Itinera Fiduciae. Trust and Treuhand in Historical Perspective*, ed. Helmholz and Zimmermann, 2008. p.27 n.2, citing Hein Kötz, ‘Abscheid von der Rechts-

> in England and von Gierke in Germany that there is a great gulf fixed between the trust of Anglo-American law and the fiduciary institutions of European continental law[196]. There were fiduciary institutions in Roman law and have always been such institutions in the civil law systems influenced by Roman law and also in Germanic customary law. It is true that on the continent of Europe, unlike in English law, these did not give rise to separate courts of equity or to a distinction between legal and equitable title to property[197]. There was no exact equivalent of the English use or trust in the early historical record of continental law. But the history of fiducia and Treuhand presents more than a few parallels reflecting similar social conditions. They and institutions such as guardianship and curatorship provided and continue to provide a legal framework for the administration of the assets of another person, earmarked as separate, in the interest not of the administrator but of the owner or a third person or of an abstract purpose. Those who are charged with the administration - let us call them administrators - performed and still perform in civil law systems many of the functions that the trustee has traditionally fulfilled in Anglo-American systems.

If that is right, it would not be surprising to find that the civil law fiducie and the German /Austrian Treuhand may be classified as trusts.

In English trust law, the trustee has legal title (or at least the right to call for it) and beneficiaries have an equitable title, or equitable ownership. This arose because of the existence of separate courts of Equity, no longer exist in England or anywhere else. But this is not an essential feature of a trust.[198]

I am not sure just how important the Roman law background is to understanding civil law today, but it is always referred to, and no doubt informs the general understanding.

Art 31(10) AMLD requires Member States to identify "trusts and similar legal arrangements"[199] and a report has assessed whether they had done so. I refer to this as the MLR Trust Categorisation Report.[200]

kreislehre?' (Goodbye to the doctrine of families of law?) ZEuP 6 (1998) 493ff.

[196] F.W.Maitland, 'The Unincorporate Body', in The Collected Papers of Frederic William Maitland (ed. H.A.L.Fisher 1911) vol. 3 p.272.

[197] H.Coing, Die Treuhand kraft privaten\ Rechtgeschäfts (1973) p.11ff.2

[198] See 42.9.3 (New York and "Garland" trusts).

[199] See 131.3 (MLR: EU law background).

[200] COM(2020) 560 final "Report from the Commission to the European Parliament and the Council assessing whether Member States have duly identified and made

90.19 Fiducie/fiducia

Fiducie is a common entity in Europe and Latin American countries. Fiducie originates in Roman law; the Latin term is fiducia.[201]

90.19.1 *France/Luxembourg/Romania*

Three countries identified their Fiducie as "similar to trusts" for MLR purposes:

Entity	**Country**	**Ref**
Fiducie	France	Art 2013 French Civil Code
Contrats fiduciaires	Luxembourg	Law of 27 July 2003
Fiducia	Romania	Arts 773-791 Romanian Civil Code

90.19.2 *Italy: Mandato fiduciario*

The MLR Trust Categorisation Report provides:

> In other cases, a similar arrangement is based on the general principle of the autonomy of the contracting parties, and is delimited by court judgements and doctrine. This is the case, for instance, of the fiduciary mandate (mandato fiduciario), notified by Italy. Although there are no national provisions regulating this type of contract, it customarily takes the form of a scheme that corresponds to that of a fiducie, with the same effects as regards the separation and transfer of assets to a fiduciary for the benefit of one or more beneficiaries.

90.19.3 *Spain: Fiducia*

The MLR Trust Categorisation Report provides:

> Like the Italian *mandato fiduciario*, the Spanish *fiducia* is also based on the autonomy of the contracting parties set out in Article 1255 of the Spanish Civil Code. Under this arrangement, the fiduciary holds a title to the assets, which does not transfer him the ownership but permits him to act as an owner regarding third parties, and to administer the property with full powers. This arrangement has not been notified by Spain as it considers that this type of contract cannot be considered similar to a trust, in that the fiduciary's ownership is only formal and there is no

subject to the obligations of Directive (EU) 2015/849 all trusts and similar legal arrangements governed under their laws" *https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2020)560&lang=en*

[201] See Johnston, "Trusts and Trust-like Devices in Roman Law", in *Itinera Fiduciae. Trust and Treuhand in Historical Perspective* (ed. Helmholz and Zimmermann).

> transmission of property stricto sensu. However, this arrangement grants an effective, albeit limited, title to the property to the fiduciary, comparable to that of other trust-like arrangements analysed in this report. The lower degree of protection of the beneficiary's rights compared to a trust is also comparable to that of other trust-like arrangements analysed here. Moreover, the absence of a public form of notice of the existence of the fiduciary title will make the fiduciary appear as the sole owner of the assets in front of bona fide third parties. All these similarities suggest that the Spanish fiducia presents a similar function to that of a trust, which would have justified its notification under Article 31(10) of the AMLD...[202]

90.19.4 *Netherlands Fiducie*

The MLR Trust Categorisation Report provides:

> Another example where the literature considers that, unless prohibited by law, arrangements based on the Latin fiducia are similar to trusts is the Netherlands, which did not notify this arrangement either.[203]

90.19.5 *Hungary: bizalmi vagyonkezelõ*

The MLR Trust Categorisation Report provides:

> The category [Fiducie] could be further extended to include other legal arrangements recognised under national law, which present similar features despite some differences, for instance, in the nature of the bond established between the parties. With regard to this group, the *bizalmi vagyonkezelõ* [Fiduciary property management contract] notified by Hungary (Act V of 2013 on the Civil Code and Act XV of 2014 on trustees and the rules governing their activities) is a relevant example.23 Under this arrangement, the trustee has the duty to manage the property transferred into his ownership by the settlor in his own name, for the benefit of the beneficiary, for which the settlor is obliged to pay a fee.[204]

90.19.6 *Italy: Vincolo di destinazione*

The MLR Trust Categorisation Report provides:

[202] Footnote original: Martin, S."Trusts in American law and some of their substitutes in Spanish law: Part II", Trusts & Trustees, Vol. 13 p. 242-251 (2007) .

[203] Footnote original: van Veen and Duin,"Dutch Trusts and Trust-Like Arrangements", European Review of Private Law, 2016, p. 973–994.

[204] Sandor, "The legal institution of the trust in the economy and law of Eastern European countries", European Scientific Journal 2015 special edition p. 139-149.

> Another example [of arrangements which have a structure or function similar to trusts] is the vincolo di destinazione, notified by Italy (Article 2645-ter of the Italian Civil Code), which consists of a scheme where the owner of immovable property or assets registered in public registers establishes a bond over such property. By virtue of this bond, the assets can be managed and used only for serving a specific purpose identified by the owner.

90.20 Fideicomiso/Fideicommissum

Fideicomiso likewise originates in Roman law; the Latin term is fideicommissum.[205]

90.20.1 *Fideicomiso in Latin America*

The MLR Trust Categorisation Report provides:

> The *fideicomiso* is among the legal arrangements explicitly identified as being similar to trusts in both FATF standards and the AMLD. This arrangement is most common in Latin America, where it is equivalent to the *inter vivos* common law trust.

90.20.2 *Fideicommissum in Europe*

The MLR Trust Categorisation Report provides:

> Other legal arrangements in the EU share the same origin of the fideicomiso in the Latin *fideicommissum* (e.g. the *fideicommis, fedecommesso, familienfideikommis*). In most cases, these arrangements have either been abolished or only allow legal guardians to look after the assets of a minor or developmentally disabled person. Literature[206] recognises that these arrangements, where a testator identifies a guardian who will manage certain assets for the benefit of a beneficiary, present structural similarities with common law trusts. They should therefore fall under the scope of Article 31 [AMLD]. However, none of these arrangements has been notified by Member States.

90.20.3 *Substitution fidéicommissaire*

This entity is also known as residual fideicommissum or fideicommissum do residuo.

[205] See 90.18 (Civil law trust equivalents).

[206] Honoré "On Fitting Trusts into Civil Law Jurisdictions", University of Oxford Legal Research Paper Series, Paper No 27/2008 *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1270179*

The Swiss Civil Code[207] is divided into parts ("Titles"), sub-parts ("Chapters") and subchapters identified by letter and article number. The provisions dealing with substitutions fidéicommissaires are in Title 14 Chapter 3F. This is not lengthy so I set it out in full:

Titre quatorzième: Des dispositions pour cause de mort Chapitre III: Des modes de disposer F. Substitutions fidéicommissaires	Title Fourteen: Testamentary Dispositions Chapter Three: Types of Disposition F. Remaindermen
I. Désignation des appelés Art.488 1 Le disposant a la faculté de grever l'héritier institué de l'obligation de rendre la succession à un tiers, l'appelé. 2 La même charge ne peut être imposée à l'appelé. 3 Ces règles s'appliquent aux legs.	I. Designation of a remainderman Art 488 1 The testator is entitled in his or her dispositions to require the named heir, as provisional heir, to deliver the estate to a third party, as remainderman. 2 No such obligation may be imposed on the remainderman. 3 The same provisions apply to legacies.
II. Ouverture de la substitution Art. 489 1 La substitution s'ouvre, sauf disposition contraire, à la mort du grevé. 2 Lorsqu'un autre terme a été fixé et qu'il n'est pas échu au décès du grevé, la succession passe aux héritiers de celui-ci, à charge par eux de fournir des sûretés. 3 La succession est définitivement acquise aux héritiers du grevé dès le moment où, pour une cause quelconque, la dévolution ne peut plus s'accomplir en faveur de l'appelé.	II. Time of delivery Art. 489 1 Except where the disposition stipulates otherwise, the time of delivery is deemed to be the death of the provisional heir. 2 Where a different time is specified and that time has not yet occurred on the death of the provisional heir, the inheritance passes to his or her heirs against security. 3 If for whatever reason that time may no longer occur, the inheritance passes unreservedly to the heirs of the provisional heir.
III. Sûretés Art. 490 1 L'autorité compétente fait dresser inventaire de la succession échue au grevé.	III. Security Art. 490 1 In all cases in which remaindermen are designated, the competent authority must order an inventory to be

[207] The Swiss Civil Code is available in the four national languages of Switzerland, and English. The English translation has no legal force. See: https://www.fedlex.admin.ch/eli/cc/24/233_245_233/en

2 Sauf dispense expresse de la part du disposant, la succession n'est délivrée au grevé que s'il fournit des sûretés; lorsqu'elle comprend des immeubles, les sûretés peuvent consister dans l'annotation au registre foncier de la charge de restitution.

3 Il y a lieu de pourvoir à l'administration d'office de la succession, lorsque le grevé ne peut fournir des sûretés ou qu'il compromet les droits de l'appelé.

IV. Effets de la substitution
1. Envers le grevé
Art. 491
1 Le grevé acquiert la succession comme tout autre héritier institué.

2 Il devient propriétaire, à charge de restitution.

2. Envers l'appelé
Art. 492
1 La substitution s'ouvre en faveur de l'appelé, lorsqu'il est vivant à l'échéance de la charge de restitution.

2 En cas de prédécès de l'appelé, les biens substitués sont, sauf dispositions contraires, dévolus au grevé.

3 L'appelé succède au disposant, lorsque le grevé meurt avant ce dernier, est indigne ou répudie.

V. Descendants incapables de discernement
Art. 492a
1 Si un descendant est durablement incapable de discernement et qu'il ne

drawn up.
2 Delivery of the inheritance to the provisional heir is made only against security, except where the testator has expressly released him or her from such an obligation; in the case of immovable property, security may be provided by entering the delivery obligation under priority notice in the land register.
3 If the provisional heir is unable to provide security or jeopardises the remainderman's expectancy, the inheritance must be placed under probate administration.

IV. Legal status
1. Of the provisional heir
Art. 491
1 A provisional heir acquires the inheritance in the same manner as any named heir.
2 He or she becomes the owner of the inheritance with an obligation to deliver it.

2. Of the remainderman
Art. 492
1 The remainderman acquires the testator's bequest if he or she is alive at the stipulated delivery time.

2 If he or she dies before then, the inheritance passes to the provisional heir unless the testator has ordered otherwise.
3 If the provisional heir dies before the testator or is unworthy of inheritance or disclaims the inheritance, it passes to the remainderman.

V. Issue lacking capacity of judgement
Art. 492a[438]

1 If any issue permanently lacks capacity of judgement and if he or she

laisse ni descendant ni conjoint, le disposant peut ordonner une substitution fidéicommissaire pour le surplus.
2 La substitution s'éteint de plein droit si le descendant, contre toute attente, devient capable de discernement.

is not survived by issue or a spouse, the testator may designate a remainderman in respect of the residue.
2 The designation of the remainderman ceases to apply by law if the issue, contrary to expectation, becomes capable of judgement.

I understand that in Swizterland there are two types of substitution fidéicommissaire:

(1) *Substitution fidéicommissaire ordinaire*: the deceased bequeaths property to an heir (*héritier*), with the obligation that the heir bequeaths the property to a third party (l'appelé, the remainderman) on the death of the heir. An inventory is drawn up and the heir has to provide security (in the case of land, by an entry in the land register). The heir has to assign all the property to the remainderman. the heir cannot dispose of the property, or diminish its value, and must keep it in good condition.

(2) *Substitution fidéicommissaire réduite au solde*: Here the heir enjoys the property without restriction and without having to account for the use he has made of it. He does not have to provide security. The remainderman will only acquire what (if anything) is left at the time of the heir's death, and has no action against the heir if he receives nothing, subject only to a claim for abuse of rights if the heir acted fraudulently (eg deliberately destroying the assets).

The MLR Trust Categorisation Report considers the latter kind of substitution fidéicommissaire:

... dans le cas d'une substitution fidéicommissaire ou de constructions telles que le fidéicommis de residuo, le destinataire des actifs en est le seul propriétaire et les actifs (ou ce qu'il en reste) ne sont transférés à un bénéficiaire qu'au décès du premier. Dans ces cas, le gestionnaire des actifs peut jouir pleinement de leur propriété, sans les limites qui caractérisent habituellement un accord fiduciaire. Ainsi, une telle construction s'écarte à la fois de la structure et de la fonction d'une fiducie/d'un trust, à savoir

... in the case of fideicommissary substitution or arrangements such as the residual fideicommissum, the asset recipient is the sole proprietor, and the assets (or the remainder) are passed on to a beneficiary only upon his/her death. In these cases, the person managing the assets can benefit from their property in full, without the limitations that usually characterise a fiduciary agreement. Thus, such an arrangement fails to replicate either the structure or the function of the trust of separating title to, or management of, certain assets

> dissocier la propriété de certains actifs, ou leur gestion, du bénéficiaire effectif. Qu’un autre bénéficiaire obtienne (éventuellement) la propriété des actifs restants n’a aucun effet sur la construction, car elle ne devient effective qu’au décès du premier bénéficiaire. Par conséquent, comme l’ont fait observer plusieurs États membres, ces constructions ne doivent pas être considérées comme étant similaires à des fiducies/trusts.

> from their beneficial ownership. The (possible) residual title to the assets of a further beneficiary has no impact on the arrangement, as it takes effect only upon the first beneficiary’s death. Thus, as noted by several Member States, it appears that these arrangements should not be considered similar to trusts.

This kind of substitution fidéicommissaire is not a settlement within the standard IT/CGT definition. It is also not an IHT-settlement. The owner during their lifetime owes no fiduciary duty to any other person. There is an element of succession but that is more like a will than a trust. The position is unlike a normal English will in that it cannot be revoked, so the closest analogy is to the situation which arises under mutual wills (in English law) where an individual is not entitled to revoke their will; or to a forced heirship jurisdiction where the individual is unable to make a will. A mutual will does not create an IHT-settlement during the lifetime of the individual. There is a constructive trust of a somewhat unusual kind, which is said to float during the individual’s lifetime, and only crystallise (ie take effect) on their death. And no-one says that there is an IHT-settlement just because succession is governed by a forced heirship regime. A *substitution fidéicommissaire réduite au solde* is not within s.87 for two reasons (either would suffice):

(1) If made by will, it is not a settlement-arrangement, and so not a settlement for s.87 purposes,

(2) Gains on disposals of *substitution fidéicommissaire* property accrue to the heir, not to trustees or indeed anyone else; the gains are not s.1(3) amounts (trust gains) for s.87 purposes.

90.21 Treuhand: Austria/Germany

The MLR Trust Categorisation Report provides:[208]

> *Treuhand* are among the legal arrangements explicitly identified as being similar to trusts in both FATF standards and the AMLD. The *Treuhand*

[208] See 90.18 (Civil law trust equivalents).

is a legal arrangement without legal personality derived from the principle of the autonomy of the contracting parties, typical of the German and Austrian legal systems. According to this scheme, a person (*Treugeber*) transfers certain assets or ownership rights to another person (*Treuhänder*), who is authorised to manage such assets in accordance with the contract between the two parties. Such a contractual relationship can fulfil different functions. Most commonly, as also recognised by the OECD[209], it serves the purpose of an escrow agreement. This suggests that these types of *Treuhand* should not be considered similar to trusts. However, due to its flexibility, the *Treuhand* can also be structured in such a way as to play a function similar to a trust. This can be the case, for example, of a *Treuhand* used to transfer and manage company shares[210]. The OECD[211] confirmed the AML/CFT [counter-terrorist financing] relevance of this type of *Treuhand* and noted that it should be subject to transparency obligations as regards beneficial ownership.

The *Treuhand* was not notified by any Member State. Member States pointed to the lack of comparability between the *Treuhand* and a trust, especially given that the *Treuhänder* cannot keep the assets separate from its own patrimony and that the arrangements is most commonly used as an escrow relationship.

Literature indicates that the *Treuhand* presents features similar to trusts, even notwithstanding some structural differences intrinsic to the civil law origin of the *Treuhand*. The common use of *Treuhand* as escrow relationships is also acknowledged. Yet, as noted above, this does not appear the only function that a *Treuhand* can exercice, as it could also serve as for example a private wealth management mechanism.[212] The information above, alongside the fact that both Austria and Germany introduced the obligation for *Treuhand* holding company assets to

[209] OECD, Global Forum for Transparency and Exchange of Information for Tax Purposes – Peer Review Report on Exchange of Information on Request – Austria 2018.

[210] In these cases, both Austria and Germany inserted provisions under their national laws to provide for the disclosure of the parties to the Treuhand. For example, the Austrian beneficial ownership register for legal entities provides information on the Treugeber and the Treuhänder when Treuhand own more than 25% of a legal entity.

[211] OECD, Global Forum for Transparency and Exchange of Information for Tax Purposes – Peer Review Report on Exchange of Information on Request – Austria and Germany 2018

[212] Schmidt,"Trust as a Legislative Challenge: Bipolar Relation vs Quasi-Corporate Status? – Basic Trust Models in Legal Practice, Theory, and Legislation", European Review of Private Law (2016) p. 995–1010.

disclose their beneficial ownership, suggests that *Treuhände* should be considered legal arrangements similar to trusts.

90.22 AG/GmbH/SE

The Liechtenstein disclosure facility[213] provides:

> A European Union harmonised company form, such as
> [1] "Aktiengesellschaft" or "AG";
> [2] "Gesellschaft mit beschränkter Haftung" or "GmbH";
> [3] "Societas Europaea" or "SE"
> is to be characterised, recognised and treated as a company for UK tax purposes.

90.23 Proper liferent (Scotland)

90.23.1 *Scots law background*

The CG Manual explains the Scots law background:

> **CG31301 Scottish proper liferents** [Jul 2019]
> In Scotland the expression 'liferent' is used to describe the situation where the income from particular property is to be paid to a person, the liferenter, for a specified period, generally his or her lifetime. At the end of the period the property will generally pass to a person known as the fiar.
> There are two ways in which a liferent can be set up ... In the second case, the title to heritable property (land and/or buildings) is held by the liferenter. In this situation he or she is a proper liferenter. A proper liferenter cannot dispose of a greater title than his own. He cannot dispose of the property in his will. On his death the property passes to the fiar.
> Where property in Scotland passes to a person for life under a will, and there is no suggestion that it is to be held by trustees, he has a proper liferent.

A proper liferent is rare in practice.[214] I discuss it here because (aside from the intrinsic interest of the questions which arise) that sheds light on the

[213] See 90.12 (Liechtenstein: Introduction).

[214] See *Stronach's Exrs v Robertson* [2002] SC 540 at p.553: "Liferent and fee is a form of land tenure fairly infrequently used in the 21st century. We agree with the sheriff that its lack of popularity might well be attributable, at least in part, to the fiar's inability to control the actings of the liferenter during the currency of the liferent." Note that a trust is significantly different on this point.

treatment of civil-law usufructs.

A proper liferent is a Scottish version of the civil-law usufruct. Erskine states:

> The only one of these servitudes which has been received into our law, is usufruct; which is defined by the Romans, a right which one has to use and enjoy a subject during life, without destroying or wasting its substance;[215] which definition is well enough adapted to the nature of our liferents.[216]

90.23.2 *Proper liferent: CGT*

The CG Manual provides:

> **CG31301 Scottish proper liferents** [Jul 2019]
> ... A proper liferent does not make the relevant property settled property [for CGT].

That is correct: a proper liferent is not a trust within the standard IT/CGT definition,[217] as there is no property "held in trust".[218] The Manual continues:

> Section 43(4)(c) IHTA 1984 provides that it is settled property for IHT purposes. TCGA does not go so far, but Section 63 provides that the person entitled to possession on the death of a proper liferenter shall be deemed to have acquired all the assets forming part of the property at their market value at death.

Section 63 TCGA provides:

[215] See 90.25.1 (Usufruct law background).

[216] Institute II, Title IX, 39. Stair Memorial Encyclopaedia, Vol. 13, para. 1601 cites this passage from Erskine and says:

> "The historical development of liferents awaits examination. It is not clear whether the concept of liferent derived directly from the Civilian usufruct or was an indigenous - if analogous - concept which was subsequently identified by later writers as being the Civilian usufruct. The prevalence of the non-Civilian terminology of 'fee' and 'liferent' is perhaps evidence in favour of the latter possibility."

But for present purposes it does not much matter whether the Scots law concept derives directly from Roman law usufruct or was originally distinct but later identified as a usufruct.

[217] See 87.3 (Settlement: Standard IT/CGT definition).

[218] For the same reason a proper liferent was not regarded as settled property for Estate Duty: *Dymond's Death Duties* (15th ed., 1973) p.303-304.

> **63 Death: application of law in Scotland**
>
> (1) The provisions of this Act, so far as relating to the consequences of the death of a proper liferenter of any property, shall have effect subject to the provisions of this section.
>
> (2) On the death of any such liferenter the person (if any) who, on the death of the liferenter, becomes entitled to possession of the property as fiar[219] shall be deemed to have acquired all the assets forming part of the property at the date of the deceased's death for a consideration equal to their market value at that date.

This allows CGT rebasing on death[220] but it does not make the proper liferent a settlement for CGT purposes.

A sale of the underlying property involves a disposal by the liferenter and by the fiar of their respective interests. The CGT position is in short as follows:

(1) A gain on a disposal of the liferent is in principle a chargeable gain:
  - (a) The relief for disposals of trust interests does not apply.[221]
  - (b) The liferenter can qualify for CGT private residence relief.[222]
  - (c) The liferent may be a wasting asset (expected life of less than 50 years). If so it would reduce the base cost and increase the gain.[223]

(2) A gain on a disposal of the interest of the fiar is in principle a chargeable gain:
  - (a) The relief for disposals of trust interests does not apply.
  - (b) The fiar will not qualify for CGT private residence relief (unless they occupy the property as their main residence, which would be unusual). The relief in s.225 TCGA will not apply.

In practice, if CGT private residence relief may apply, it is better to create a classic settlement and not a proper liferent, because then the property can be sold during the lifetime of the liferenter free of CGT.

[219] Some databases erroneously read "heir".

[220] See 88.5.1 (Rebasing on death). This applies even if the liferent is not an estate IIP: the drafter of the 2006 reforms overlooked Scottish liferents.

[221] See 56.21.2 (Trust interest not chargeable asset).

[222] HMRC agree. The CG Manual provides:

> "The disposal or termination of a proper liferent may qualify for private residence relief under section 222 TCGA as it is an interest in land."

[223] Section 46 TCGA.

90.23.3 *Proper liferent: IHT*

The IHT Manual provides:

> **IHT16071 Introduction** [Jun 2016]
> The original view was that a proper liferenter was beneficially entitled to the property which was the subject of the liferent and that a proper liferent was a "settlement" within the meaning of [s.43 IHTA 1984] with the result that the liferenter fell to be treated as beneficially entitled to the settled property.[224]
> However the Board were advised that a proper liferenter was beneficially entitled only to his right to the liferent and not to the property itself so that on the death of a proper liferenter the liferenter was beneficially entitled to the liferent and not to the capital in which it subsisted. It follows that on the death of the liferenter the value to be placed on the proper liferent was nil.
> **16072. IHT position** [Jun 2016]
> Section 93 FA 1980 [now s.43(4)(c) IHTA] brought proper liferents into line with the settled property regime of the [IHTA] ...

Section 43(4) IHTA provides:

> In relation to Scotland "settlement" also includes...
> (c) any deed[225] creating or reserving a proper liferent of any property whether heritable or moveable (the property from time to time subject to the proper liferent being treated as the property comprised in the settlement);

Section 46 IHTA provides that references to an interest in possession include a proper liferent.[226]

Section 47 IHTA provides:

> In this Act "reversionary interest" ... in relation to Scotland includes an interest in the fee of property subject to a proper liferent.

[224] This is considering a pre-2006 liferent, which would have conferred an estate interest in possession.

[225] Section 43(4) provides a definition: "for the purposes of this subsection "deed" includes any disposition, arrangement, contract, resolution, instrument or writing." That definition has no relation to the English law sense of the word "deed". But the word "deed" is used differently in Scots law: see 102.17 (Jurisdictions without "deeds").

[226] See 90.11.1 (IIP in Garland trust).

Lastly, s.142(7) IHTA provides that for the purposes of s.142 IHTA (deeds of variation):

> In the application of subsection (4) above[227] to Scotland, property which is subject to a proper liferent shall be deemed to be held in trust for the liferenter.

This is needed as while a proper liferent is an IHT-settlement, there is no property held "in trust".

90.24 Legal life interest (N. Ireland)

90.24.1 *NI law background*

A Northern Ireland legal life interest is rare in practice, except in home made wills. The CG Manual provides:

> **CG31303 Northern Ireland** [Mar 2017]
> The land law of Northern Ireland, except where there is specific legislation to the contrary, is basically the same as the pre-1925 law of England & Wales. Accordingly it is possible to have a legal interest 'limited for life'...

90.24.2 *Legal life interest: CGT*

Section 63A TCGA provides:

> (1) The provisions of this Act, so far as relating to the consequences of the death of a person to whom property in Northern Ireland stands limited for life ("the deceased"), shall have effect subject to the provisions of this section.
> (2) A person who acquires property in fee simple absolute or fee tail in possession as a consequence of the deceased's death shall be deemed to have acquired all the assets forming part of the property at the date of the deceased's death for a consideration equal to their market value at that date.

The CG Manual provides:

[227] Section 142(4) IHTA provides (so far as relevant): "Where a variation ... results in property being held *in trust* for a person for a period which ends not more than two years after the death, this Act shall apply as if the disposition of the property that takes effect at the end of the period had had effect from the beginning of the period..."

> **CG31303 Northern Ireland** [Mar 2017]
> Under Section 43(5) IHTA 1984 in such a situation the property is deemed to be settled property.
> There was no comparable provision for CGT until Section 63A TCGA 1992 was enacted in FA 2006 with effect from 6 April 2006. Under this provision where a person with a legal interest limited for life dies, a person who acquires in fee simple or fee tail in possession as a consequence of the former person's death is deemed to acquire all the assets forming part of the property at market value at death. This does not apply to land outside Northern Ireland.

Section 63A is modelled on s.63 TCGA.[228] It allows CGT rebasing on death[229] but does not make the legal life interest a settlement within the IT/CGT definition.

A sale of the underlying property involves a disposal by the life tenant and by the remainderman of their respective interests. The CGT position is in short as follows:

(1) A gain on a disposal of a legal life interest is in principle a chargeable gain:
   (a) The relief for disposals of trust interests[230] does not apply.
   (b) The life tenant can qualify for CGT private residence relief.
   (c) The legal life interest may be a wasting asset (expected life of less than 50 years). If so it would reduce the base cost and increase the gain.[231]

(2) A gain on a disposal of the reversionary interest is in principle a chargeable gain:
   (a) The relief for disposals of trust interests does not apply.
   (b) The reversionary interest will not qualify for CGT private residence relief (unless the remainderman occupies the property as their main residence, which would be unusual). The relief in s.225 TCGA will not apply.

In practice, if private residence relief may apply, it is better for CGT to create a classic settlement, not a legal life interest, because then the

[228] See 90.23.2 (Proper liferent: CGT).

[229] See 88.5.1 (Rebasing on death). This applies even if the life interest is not an estate IIP: the drafter of the 2006 reforms overlooked Northern Ireland life interests.

[230] See 56.21.2 (Trust interest not chargeable asset).

[231] Section 46 TCGA.

property can be sold during the lifetime of the life tenant free of CGT.

90.24.3 *Legal life interest: IHT*

Section 43(5) IHTA provides:

> In the application of this Act to Northern Ireland this section shall have effect as if references to property held in trust for persons included references to property standing limited to persons...

90.25 Usufructs

Usufruct jurisdictions differ. I am not aware of differences between jurisdictions which should significantly affect UK tax categorisation issues, though that is not impossible. Usufructs also differ in their drafting of their constitutions. But I am not aware of drafting points which should significantly affect UK tax categorisation issues, though that too is not impossible.

For an English language discussion, see Verbeke, Verdickt & Maasland, "The Many Faces of Usufruct".[232]

90.25.1 *Usufruct law background*

Article 578 French Code Civil provides a short definition:

L'usufruit est le droit de jouir des choses dont un autre a la propriété, comme le propriétaire lui-même, mais à la charge d'en conserver la substance.[233]	A usufruct is the right to enjoy property belonging to another, as if its owner, at the expense of preserving that property.

Similarly article 467 Spanish Código Civil:

El usufructo da derecho a disfrutar los bienes ajenos con la obligación de conservar su forma y sustancia, a no ser que el título de su	A usufruct gives the right to enjoy the property of others with the obligation to preserve its form and substance, unless the terms of its

[232] in Merwe & Verbeke (eds), Time Limited Interests in Land (2012) ("Verbeke") *https://www.researchgate.net/publication/322754722_2012_Many_faces_of_usufruct*

[233] The Code Civil in French is at *http://www.legifrance.gouv.fr* The definition derives from Roman law: *Usus fructus est ius alienis rebus utendi fruendi salva rerum substantia*. (Paul, Vitellius, book 3).

constitución o la ley autoricen otra cosa.[234]	constitution or the law otherwise provide.

Article 1439 Portuguese Código Civil:

Usufruto é o direito de gozar temporária e plenamente uma coisa ou direito alheio, sem alterar a sua forma ou substância.[235]	Usufruct is the right to enjoy temporarily and fully a thing or right of others, without changing its form or substance

The Swiss civil code does not provide a short definition, but its provisions on usufructs[236] cover these points.

In the following discussion:

The "**usufructuary**" is the owner of the right of enjoyment (the usufruct). The "**encumbered owner**" is the owner of the property subject to that right. (I think this is a clearer term than "bare owner" or "naked owner" which is a more literal translation of the French term *nu-propriétaire*).[237] The **"usufructuary property"** is the land or other asset under which the interests of the usufructuary and the encumbered owner subsist.

Verbeke says: "Usufruct is a real right, that is, a right on the property itself and not merely a right in relation to the property's profits." So the interest of the usufructuary is an interest in the usufructuary property, and situate where that property is situate. The interest of the usufructuary is immoveable property (assuming the usufructuary property is immoveable property).[238]

A usufruct may subsist over land or shares or other types of property.

The IHT Manual provides:

> **IHTM27054: usufruct** [Sep 2018]
> Usufruct is a civil law term referring to right of one individual to use and

[234] The code in Spanish is at *https://boe.es/buscar/act.php?id=BOE-A-1889-4763&p=20151006&tn=2*

[235] The code in Portuguese is at *https://www.pgdlisboa.pt/leis/lei_mostra_articulado.php?nid=775&tabela=leis&*

[236] Art 745 ff Swiss Civil Code. This is available in English at: *https://www.fedlex.admin.ch/eli/cc/24/233_245_233/en#art_745*

[237] Though in Louisiana, an English language civil law jurisdiction, the legislation uses the term "naked owner".

[238] This has been stated in relation to DTAs, see 24.7.1 ("Immovable property"); but I think it is true in other contexts also.

enjoy the property that is vested in another, provided the property concerned is neither impaired nor altered. The right of ownership gives the owner the ability to

- use the property, or live in it,
- receive the income from it, for example in the form of rent, and
- sell or otherwise dispose of the property.

The owner can split his ownership in two so that there is

- the usufruct; which is right to use the property and receive the income from it, and
- the bare ownership of the property, which includes the right to dispose of it.

The person who holds the right to use and enjoy the property is known as the usufructuary and the person who holds the right to dispose of the property is known as the bare owner – in French, the 'usufruitier' and the 'nu-propriétaire'

You may come across a usufruct where an estate includes land and buildings in EU or other foreign countries. It may be referred to as a usufruct or 'usufruit' in French, or given another name such as a 'Niessbrauch' in German.[239] But no matter how it is labelled, it is important to identify the underlying rights of the arrangements and understand the circumstances that apply to the usufruct in each case. For example, another means of providing an income for life in Germany is a 'Leibrente' – which may be closer to an annuity than the rights under a usufruct.

90.25.2 *Usufruct: CGT*

The CG Manual provides:

> **CG31305 Other interests** [Jul 2019]
> ... A usufruct governed by French law would be regarded as a non-trust arrangement as it is broadly similar to a Scottish proper liferent.

That is correct: a usufruct is not a settlement within the standard IT/CGT definition,[240] as there is no property held "in trust".[241]

[239] Author's footnote: The position in Germany is governed by art.100 and 1030 Bürgerliches Gesetzbuch.

[240] See 87.3 (Settlement: Standard IT/CGT definition).

[241] This is almost self-evident, but if authority is needed, see *Lewin on Trusts* (20th ed, 2020) para 1-001 (Definitions and descriptions) and 1-027 (Unique features stated in civilian terms).

In the past, however, HMRC have more than once expressed the view that a usufruct

A sale of the usufructuary property involves a disposal by the usufructuary and by the encumbered owner of their respective interests. The CGT position is in short as follows:

(1) A gain on a disposal of the interest of the usufructuary is in principle a chargeable gain:
   (a) The relief for disposals of trust interests[242] does not apply.
   (b) The usufructuary can qualify for CGT private residence relief.
   (c) The interest of the usufructuary may be a wasting asset (expected life of less than 50 years). If so it would reduce the base cost and increase the gain.[243]

(2) A gain on a disposal of the interest of the encumbered owner is in principle a chargeable gain:
   (a) The relief for disposals of trust interests does not apply.
   (b) The encumbered owner will not qualify for CGT private residence relief (unless they occupy the property as their main residence, which would be unusual). The relief in s.225 TCGA will not apply.

CGT rebasing does not apply on the death of the usufructuary.[244]

is a trust for CGT purposes. (Private correspondence).

[242] See 56.21.2 (Trust interest not chargeable asset).

[243] Section 46 TCGA.

[244] See 88.5.1 (Rebasing on death). A Scottish proper liferent qualifies for CGT rebasing on death: see s.63 TCGA. discussed at 90.23.2 (Proper liferent: CGT). However s.63 TCGA does not apply to a foreign law usufruct because:
(1) The expression "proper liferenter" is a technical Scots law term which is not apt to include a usufructuary under a non-Scots law usufruct.
(2) The heading to the section ("Death: application of law in Scotland") shows the intention to restrict the application to Scotland.
(3) The section in its original form provided (word repealed in 2006 are underlined):

> "(1) The provisions of this Act, so far as relating to the consequences of the death of an heir of entail in possession of any property in Scotland subject to an entail, whether sui juris or not, or of a proper liferenter of any property, shall have effect subject to the provisions of this section.
> (2) For the purposes of this Act, on the death of any such heir or liferenter the heir of entail next entitled to the entailed property under the entail or, as the case may be, the person (if any) who, on the death of the liferenter, becomes entitled to possession of the property as fiar shall be deemed to have acquired all the assets forming part of the property at the date of the deceased's death for a consideration equal to their market value at that date."

The underlined words contain references to Scotland which make it clear that the

The result is a CGT discrimination against usufructs, which might have breached EU law, though that matters less after Brexit.[245]

If an individual creates a usufruct under which they retain an interest, this is a part disposal for CGT purposes, as the rule for transfers into trust[246] does not apply.

A usufruct may be a settlement within the settlement-arrangement definition, but it is not within the scope of s.87.[247]

90.25.3 *Is usufruct an IHT-settlement*

The question discussed here is whether a usufruct constitutes a settlement within the IHT definition.[248]

The IHT Manual provides:

> **IHTM27054: usufruct** [Sep 2018]
> In HMRC's view, a usufruct should be treated as a settlement for IHT purposes given the closing words of IHTA84/S43(2), '….or would be so held charged or burdened if the disposition were regulated by the law of any part of the UK….'. This creates a fiction solely for the purposes of charging IHT and requires us to look at the outcome of the disposition and then consider how that outcome could be achieved under the law of any part of the UK. Bearing in mind the nature of the split in ownership that a usufruct achieves, the closest equivalent under UK law is a life interest settlement, with the bare owners holding the property for the benefit of the usufructuary (life tenant) with remainders to themselves.[249]

entire section is restricted to property in Scotland; and the repeal of those words was not intended to alter that.

I set this out at length because the contrary view has been suggested.

[245] This issue was raised in *Findlay v HMRC* which is reported at a preparatory stage: [2018] UKFTT 217 (TC). The case did not go to full trial.

[246] See 56.21.4 (Disposal on transfer into trust).

[247] See 61.3.2 (Usufruct: Deemed trustee).

[248] Strictly the term usufruct means the right of the usufructuary to enjoy the property; so the statutory question is whether the creation of a usufruct is a disposition whereby property is held on trust (etc) for persons in succession. Or to put it another way, the question is not whether a usufruct *constitutes* a settlement but whether it *entails* a settlement. But the question is conveniently abbreviated into asking whether a usufruct is a settlement. The usufruct is here regarded as an entity, and not (or not just) the usufructuary's right to enjoyment.

[249] HMRC practice has not always been consistent. HMRC, "Trusts and Estates newsletter" (Sep 2015) provides:

"... Since April 2013, HMRC has dealt with a small number of cases where the

HMRC's argument relies on s.43(2)[d].[250] It is not correct.

(1) Para [d] does not "require us to look at the outcome of the disposition and then consider how that outcome could be achieved under the law of any part of the UK":
    (a) The purpose of para [d] is to deem a foreign trust to be a UK law trust, to preclude an argument that the words "on trust" (or "in trust") in the definition apply to UK-law trusts and do not apply to foreign-law trusts.
    (b) According to HMRC, para [d] poses a hypothetical question: what would result if a foreign disposition creating, a usufruct, or, say, a Liechtenstein Treuunternehmen, were governed by a UK law. That is an impossible question as UK law has no such entity.
    (c) The HMRC view leaves no purpose for para [e].
(2) If, contrary to the above, para [d] did require one to ask whether the property would be held on trust if the disposition were regulated by the law of any part of the UK" HMRC's answer to that hypothetical question is wrong. It is not the case that "the closest equivalent under UK law is a life interest settlement":

> estate included a usufruct and in each case, the facts were less than straightforward. HMRC applied its approach to the facts of each case as it understood them to be, and in each case, the difference between the value reported by the taxpayer and the value that emerged following HMRC's approach was not sufficient to warrant pursuit. So in accordance with its Litigation and Settlement Strategy, HMRC adopted the value reported by the taxpayer.
>
> But HMRC remains of the view that, generally, a usufruct should be treated as giving rise to a settlement for IHT purposes and will pursue the collection of tax on that basis."

https://www.gov.uk/government/publications/hm-revenue-and-customs-trusts-and-estates-newsletters/hmrc-trusts-and-estates-newsletter-september-2015

The IHT Manual provides an element of pragmatism:

> **IHTM27054: usufruct** [Sep 2018]
>
> The correct treatment of a usufruct for IHT purposes is not universally accepted. One leading commentator refers to it as a 'toss of a coin matter'; some accept HMRC's view, whilst others are strongly opposed to it. It is for this reason that any case where the taxpayer is not prepared to proceed along the lines above should, once the detailed facts have been ascertained, be referred to Technical to consider how to take the case forward. It is possible that the value for tax that emerges from applying HMRC's approach may not be (so) very different from the value offered by the taxpayer, particularly where there are encumbrances against the property; but each case will need to be considered on its own merits.

[250] See 87.6.4 (Limb (d): So held by UK law).

(a) There is no such thing as "UK law" (at least as far as property/trust law is concerned). The laws of Scotland/Northern Ireland/England are distinct.

(b) In fact Scots law does have a usufruct (by another name). If the disposition were regulated by Scots law, it should constitute a proper liferent, which is deemed to be an IHT- settlement, but is not deemed to constitute property held on trust,[251] so para [d] would not be met. Likewise if the disposition were regulated by the law of Northern Ireland, it would constitute a legal life interest.

(c) If one had to find the closest equivalent in English law, it would be a lease for life, which is not a trust.

HMRC do not argue in the Manual that a usufruct is a settlement under s.43(2)[e], ie, that under the law of the usufruct, the administration of the property is governed by provisions "equivalent in effect to those which would apply if the property were held on trust for persons in succession."[252] Note how the HMRC paraphrase ("how that outcome could be achieved under the law of any part of the UK") is an easier test to pass than the terms of para [e].

I think HMRC are right to take the view that para [e] is not satisfied. There is an element of succession, but that is not enough. The usufruct must be equivalent in effect to *a trust* for persons in succession. There are important differences between a usufruct and a trust:

(1) There is no settled property
(2) There are no actual trustees[253]
(3) The usufructuary has the right to enjoy the property in specie, unlike a beneficiary of a trust of land
(4) A sale of the usufructuary property in its entirety requires the consent of both the encumbered owner and the usufructuary

For all these reasons, a usufruct is more like a lease for life or a legal life interest than a classic settlement.

Overall a usufruct is sufficiently unlike a trust that it is suggested that the

[251] See 87.6.4 (Proper liferent: IHT).

[252] See 87.6.5 (Limb (e): Equivalent to a trust).

[253] If a usufruct were an IHT settlement, it is difficult even to identify deemed trustees: see 61.3 (Non-classic trust: Trustee). This also supports the view that a usufruct is not an IHT settlement.

two should not be regarded as equivalent, so it is not an IHT-settlement.[254]

It might be said that there would be an anomaly if:

(1) a usufruct is not an IHT-settlement; but
(2) a Scots proper liferent (which is a usufruct or usufruct-like entity) is an IHT-settlement.

But the boot is on the other foot: if a usufruct were an IHT-settlement, there would have been an anomaly between the introduction of CTT in 1975 and the enactment of (what is now) s.43(4)(c) IHTA, during which time a proper liferent was not an IHT-settlement. The enactment of a provision dealing with Scots law liferents should not affect the position of foreign law usufructs.

90.25.4 *IHT if usufruct is a settlement*

If a usufruct is an IHT-settlement, there would in principle be charges to IHT on the following occasions:

(1) On the creation of the usufruct
(2) On ten-year anniversaries[255]
(3) On the death of the usufructuary

The usufructuary property may qualify as excluded property, depending of course on the domicile of the settlor (and, if a spouse has an initial estate IIP, the domicile of the spouse).

DT relief will sometimes be available.

The IHT Manual provides:

> **IHTM27054: usufruct** [Sep 2018]
> On the footing that a usufruct should be treated as interest in possession settlement, the following consequences will flow.

Note that it is assumed throughout the Manual passage that a donor creates a usufruct by way of lifetime gift, and that the donor is UK domiciled. On that basis, the pre-2006 position was relatively straightforward:

> [1] Where the usufruct was created prior to 22 March 2006, it should be treated as an interest in possession created prior to that date. Consequently,

[254] This issue did not arise for proper liferents (Scotland) or legal life interests (Northern Ireland) since the para [e] of the definition (dealing with provisions "equivalent in effect") only applies to non-UK legal systems.

[255] Not for a usufruct created on death, which will qualify as an IPDI.

[a] if the donor gave a property to their children, retaining the usufruct, there will be no loss to their estate at that time; but the property, at the open market value, will remain part of their estate on death.

[b] If a husband gave his wife a usufruct over his property, the transfer will benefit from spouse or civil partner exemption and the property, at the open market value, will form part of the spouse's estate on her death.

[c] If a father gave a usufruct over his property to his children, the transfer will be a PET.

[d] In all cases, the bare ownership of the property should be treated as a reversionary interest and will normally be excluded property under IHTA84/S48(1).

The Manual then turns to consider the post-2006 position:

> [2] Where the usufruct is created on or after 22 March 2006,
>
> [a] the settlement will be a relevant property settlement.
>
> [b] On creation of a usufruct:
>
> [i] the donor will be making an immediately chargeable transfer of the full value of the property[256]
>
> [ii] [the property] will then be subject to relevant property charges.
>
> [iii] No spouse or civil partner exemption will be due.
>
> [c] If the donor has retained a usufruct over the property, they may well have reserved a benefit in the property,
>
> [d] but otherwise, no part of the property will form part of any person's estate.[257]

The author has not worked through the IHT issues here. One might have some sympathy, as the position is so complicated; but it is HMRC who are responsible for that.

A common case is where an owner of property ("S") creates a usufruct under which S is the usufructuary and a child is the encumbered owner. If the usufruct is an IHT-settlement, and S is UK domiciled, then:

(1) S makes a transfer of value equal to the value of the property.[258]

[256] Author's footnote: This is not necessarily correct, either as the donor may retain an interest (which reduces the value transferred) or as the gift may partly be a PET.

[257] Author's footnote: this is not correct, as the reversionary interest is in the estate of the encumbered owner.

[258] See s.3(1) IHTA; the value of the usufructuary's interest is disregarded as an interest in possession in settled property: s.5(1)(a)(ii) IHTA.

(2) The gift is a PET so far as attributable to the child's reversionary interest.[259]

That is so strange as to make one question whether the analysis that a usufruct is an IHT-settlement can be correct.

(3) In principle the creation of a usufruct is not a gift with reservation of benefit as the donor enjoys no benefit from the property given away (the reversion). But if the usufruct is created over land, then it will normally be deemed to be a GWR under s.102B FA 1986 (not discussed here).

(4) The pre-owned asset issues are wonderfully intricate. (Of course, no attention was given to usufructs when the legislation was enacted.) In outline:

 (a) If the gift is a GWR then POA does not apply.

 (b) If the gift is not a GWR (eg a usufruct over shares, or over land acquired more than 7 years before the gift) POA may apply; it is necessary to consider the POA land, chattel or intangible property charge as applicable.[260]

(5) The interest of the encumbered owner is a reversionary interest[261] and so in principle excluded property, which is advantageous if the encumbered owner is UK domiciled.

(6) The IHT spouse exemption would in principle be available on the creation of a usufruct on death.

Further consideration is needed if the creation of the usufruct is by way of sale and not by way of gift.

Depending on the circumstances it will sometimes be in the taxpayers' interest to accept the HMRC view (that a usufruct is an IHT-settlement), and sometimes to challenge it.

90.25.5 *Usufruct: Valuation*

It may be necessary to value:

(1) The interests of the usufructuary and the encumbered owner

[259] See s.3A(1)(c) and 3A(2)(a) IHTA. The interest of the encumbered owner (the child) is excluded property but nevertheless it forms part of their estate (except on death).

[260] See 83.1 (Pre-owned assets: Introduction).

[261] It is considered that the encumbered owner's interest is a "future interest" and so within the definition in s.47 IHTA, which is set out at 90.11.2 (Reversionary interest: Garland trust).

(2) The usufructuary property, which in the HMRC view is settled property.

Some foreign tax laws (eg France) have tax rules to value the interests of the usufructuary and the encumbered owner. Those rules do not apply for UK tax purposes, so the usual market value rules must be applied.[262]

Valuation of these interests should take into account the costs of possible IHT charges (which if due would in principle be borne out of the encumbered owner's interests), or the costs and risks of debating whether these IHT charges actually arise.

The IHT Manual provides:

> **IHTM27054: usufruct** [Sep 2018]
> ... The property over which the usufruct exists should be valued on the open market basis, without regard to the values that may be ascribed to the different rights by the relevant foreign law. The property is treated for IHT purposes as regulated by UK law – which does not recognise any other statutory regime for valuation – leaving us with the usual valuation approach under IHTA84/S160.
> But it is important to establish the detail of the circumstances surrounding the property because if the property is mortgaged, the mortgage is an incumbrance against the property which is very likely to be a valid deduction against the property under IHTA84/S162(4).
> If the property is subject to a lease, that too will reduce the value of the property depending on the terms of the lease. The terms of some overseas leases, particularly around renewal, may be quite onerous and have a significant impact on the value of the property.
> If the property is farmland in the European Economic Area, it may also qualify for agricultural relief in view of IHTA84/S115(5)(b).
> Shares and Assets Valuation are responsible for valuing overseas property and they should provide the open market value with vacant possession of the property. The question of any reduction in value to reflect the impact of a lease should be referred to Technical, once the open market value has been agreed, as should any case where the taxpayer does not accept the position outlined above.

90.25.6 *Usufructs: Critique*

There are two problems: (1) it is unclear whether a usufruct is an IHT-

[262] It may be that foreign valuation rules happen to produce the market value figure, but that is not necessarily (perhaps not even usually) the case.

settlement; and (2) if it is an IHT-settlement, the IHT treatment is absurd. The second problem cannot be solved unless one addresses the mess which is the Inheritance Taxation of trusts.[263] In the absence of wholescale reform, the second best course would be to solve the first problem (and avoid the second) by a provision (in my view confirming the existing law) that a civil-law usufruct is not an IHT-settlement. Then at least taxpayers would know where they stand. The problem of transitional rules for existing usufructs would need consideration.[264]

I suspect that only EC pressure could give sufficient impetus to yield reform on this point, and post-Brexit that seems unlikely.

The conclusion to draw for practical purposes is that UK domiciled individuals should not create a usufruct, except:

(1) by will; or
(2) possibly, if the value of the property falls within the general nil rate band(s) of the owner(s), or if DT relief is applicable.

90.26 Foreign partnership: Legal person

In discussing the question whether a foreign partnership/partnership-like entity has legal personality, bear in mind that this term can have different meanings in UK/foreign law,[265] and that it is possible for a body with legal personality to be a partnership.[266]

Avery Jones says:[267]

> In Germany, Switzerland and Italy partnerships are not legal persons because partnership is a personal relationship that does not survive changes in the partners (except in Italy), and the liability of at least one of the partners is unlimited. It follows that in those countries a formal partnership... can have partial legal capacity without being a legal person

[263] As to which, see Kessler, "The Quest for Fair Inheritance Taxation of Trusts" [2013] Trusts & Trustees 364 *https://www.kessler.co.uk/wp-content/uploads/2014/08/Kessler-The-Quest-for-Fair-Inheritance-Taxation-of-Trusts.pdf*

[264] Section 93(4) FA 1980 (turning Scottish proper liferents into IHT-settlements) offers a precedent.

[265] See App.2.6 (Person/legal personality).

[266] See 85.3.6 (English/Scots partnership tax aligned); 85.16 (Partnership transparency: IT/CT).

[267] 'Characterisation of Other States' Partnerships for Income Tax' [2002] BTR 375. Some footnotes are omitted or abbreviated.

> since it lacks the continuity necessary to be a legal person in their law. If a body identical to a German, Swiss or Italian formal partnership existed in most other civil law countries, its capacity would result in its being a legal person.
>
> In France on the other hand, partnerships formed under both the Commercial Code and Civil Code ... are legal persons following registration in spite of the partners being liable for the legal person's liabilities, but an unregistered, in our terms, informal, partnership is not a legal person. ...

90.27 German partnerships

I consider the partnerships governed by the following laws:

Country	**Business code**
Germany	Handelsgesetzbuch (HGV)[268]
Austria	Unternehmensgesetzbuch (UGB)[269]

Entity	**English**	**See para**	**HGB Book 2**	**UGB Book 2**
Offene Handelsgesellschaft	General partnership	90.28	Part 1 ss 105-	Part 1 ss 105-
Kommanditgesellschaft	"Ltd partnership"	90.29	Part 2 ss 161-[270]	Part 2 ss 161-
GmbH & Co KG		90.29		
Stille Gesellschaft	"Silent partnership"	90.30	Part 3 ss 230-	Part 3 ss 179-

A number of other countries have entities based on the German model.

90.28 Offene Handelsgesellschaft

Offene Handelsgesellschaft may approximately be translated as a general partnership; though it would be more precise to use the German term.

Section 105 HGB provides:

[268] *https://www.gesetze-im-internet.de/hgb* (German); Official English translation *http://www.gesetze-im-internet.de/englisch_hgb/englisch_hgb.html* but I have not followed this exactly.

[269] *https://www.ris.bka.gv.at/GeltendeFassung.wxe?Abfrage=Bundesnormen&Gesetzesnummer=10001702*

[270] Part 1 Book 2 is also applicable, so far as not altered by Part 2. Section 161(2) HGB provides:

Soweit nicht in diesem Abschnitt ein anderes vorgeschrieben ist, finden auf die Kommanditgesellschaft die für die offene Handelsgesellschaft geltenden Vorschriften Anwendung.	Unless this Part provides otherwise, the provisions applicable to a general partnership apply to a limited partnership.

Section 161(2) UGB is substantially the same.

(1) Eine Gesellschaft, deren Zweck auf den Betrieb eines Handelsgewerbes unter gemeinschaftlicher Firma gerichtet ist, ist eine offene Handelsgesellschaft, wenn bei keinem der Gesellschafter die Haftung gegenüber den Gesellschaftsgläubigern beschränkt ist.	(1) A partnership formed for the purpose of carrying on a commercial business under a joint business name is a general partnership if no partner's liability is limited vis-à-vis the partnership's creditors.
(2) Eine Gesellschaft, deren Gewerbebetrieb nicht schon nach § 1 Abs. 2 Handelsgewerbe ist oder die nur eigenes Vermögen verwaltet, ist offene Handelsgesellschaft, wenn die Firma des Unternehmens in das Handelsregister eingetragen ist. § 2 Satz 2 und 3 gilt entsprechend.	(2) A partnership, whose commercial enterprise is not a commercial business pursuant to Section 1(2), or which manages only its own assets, is a general partnership if the business name of the enterprise is registered in the Commercial Register. Section 2, second and third sentences, shall apply mutatis mutandis.

Section 124(1) HGB provides:

Die offene Handelsgesellschaft kann unter ihrer Firma Rechte erwerben und Verbindlichkeiten eingehen, Eigentum und andere dingliche Rechte an Grundstücken erwerben, vor Gericht klagen und verklagt werden.	A general partnership can, under its business name, acquire rights and enter into obligations, acquire ownership and other rights in rem in real property and sue and be sued in court.

Both general and limited partnerships have legal personality in the (English law) sense that they are capable of rights and duties. But German (and Swiss) partnerships do not survive a change in the partners,[271] so that they do not have legal personality in the (German law) sense.[272]

The HMRC transparent/opaque list classifies an Offene Handelsgesellschaft as transparent.

[271] Avery Jones et al, "Characterisation of Other States' Partnerships for Income Tax" [2002] BTR 375 (footnotes omitted).

[272] See 90.26 (Foreign partnerships: Legal capacity).

90.29 Kommanditgesellschaft

90.29.1 *German law background*

Art 161(1) HGB provides:

Eine Gesellschaft, deren Zweck auf den Betrieb eines Handelsgewerbes unter gemeinschaftlicher Firma gerichtet ist,	A partnership formed for the purpose of carrying on a commercial business under a joint business name
ist eine Kommanditgesellschaft, wenn bei einem oder bei einigen von den Gesellschaftern die Haftung gegenüber den Gesellschaftsgläubigern auf den Betrag einer bestimmten Vermögenseinlage beschränkt ist (Kommanditisten),	is a *Kommanditgesellschaft* (limited partnership) if the liability of one or more of the partners is limited vis-à-vis the partnership's creditors to the amount of a specific contribution of assets (limited partners),
während bei dem anderen Teil der Gesellschafter eine Beschränkung der Haftung nicht stattfindet (persönlich haftende Gesellschafter).	while the other partners have unlimited liability (general partners).

Kommanditgesellschaft may approximately be translated as limited partnership, though it would be more precise to use the German term. A partner with limited liability is a "Kommanditist" and a partner with unlimited liability is a "Komplementär".

Avery Jones et al state:[273]

> Limited partnerships are used extensively in Germany, particularly the type known by the name GmbH & Co KG where the general partner is a limited company (ie, a GmbH) often taking no share in the profits of the partnership and with its shares being held by the limited partners who can be authorised by the general partner by power of attorney to manage the partnership without losing their limited liability. In this way, the partners, either as limited partners or as shareholders in the limited company, all have limited liability, but the partnership is transparent for tax purposes.

[273] Avery Jones et al, "Characterisation of Other States' Partnerships for Income Tax" [2002] BTR 375 (footnotes omitted).

90.29.2 *Austrian law background*

Section 161 UGB provides:

Begriff, Anwendung der Vorschriften über die offene Gesellschaft § 161. (1) Eine Kommanditgesellschaft ist eine unter eigener Firma geführte Gesellschaft, bei der die Haftung gegenüber den Gesellschaftsgläubigern bei einem Teil der Gesellschafter auf einen bestimmten Betrag (Haftsumme) beschränkt ist (Kommanditisten), beim anderen Teil dagegen unbeschränkt ist (Komplementäre).	**Concept, and application of provisions applicable to general partnerships** A Kommanditgesellschaft is a partnership, operating under a firm name, under which the liability of some of the partners (Kommandististen) to the partnership creditors is limited to a specified contribution (Haftsumme), and the other partners (Komplementäre) have unlimited liability.

This is not the same as the HGB wording, but the differences are not material for present purposes. The Austrian KG is a "Gesellschaft", a category of partnership, and apart from the limited liability of the limited partners, the rules applicable to general partnerships generally apply.

90.29.3 *UK tax analysis*

The HMRC transparent/opaque list classifies as transparent:
(1) Kommanditgesellschaft in Germany, Austria and Switzerland
(2) GmbH & Co KG in Germany and Austria[274]

Similarly, the Liechtenstein disclosure facility[275] provides:

> 2) A business formed as "Kommanditgesellschaft" or "KG" or "Kollektivgesellschaft" is to be characterised, recognised and treated as a partnership for UK tax purposes.

90.30 Stille Gesellschaft

90.30.1 *German law background*

Section 230 HGB provides:

(1) Wer sich als stiller Gesellschafter an dem Handelsgewerbe, das ein anderer betreibt, mit einer	(1) A person who participates as a silent partner in a business carried on by another person, by means of a contribution of assets, shall arrange

[274] No doubt the omission of Switzerland is accidental, not deliberate.
[275] See 90.12 (Liechtenstein: Introduction).

Vermögenseinlage beteiligt, hat die Einlage so zu leisten, daß sie in das Vermögen des Inhabers des Handelsgeschäfts übergeht.	that the contribution is transferred to the assets of the owner of the business.
(2) Der Inhaber wird aus den in dem Betrieb geschlossenen Geschäften allein berechtigt und verpflichtet.	(2) The owner alone shall have the rights and obligations arising from transactions made in the course of the business.

"Stille Gesellschaft" is literally and conventionally translated "silent partnership". That expression conveys no information about the entity. It is better to use the German term. If English is used, it would be appropriate to write "silent partnership" and "silent partner" with scare quotation marks.

Memec v IRC summarised the essential characteristics of a stille Gesellschaft:[276]

> ... the silent partner (stille gesellschafter) makes a capital contribution to a commercial enterprise run by another person who is designated as the owner (inhaber).
>
> The owner remains the owner of the business assets, and of the income from those assets as it accrues. The silent partner has no proprietary interest in the assets but has a contractual right to payment of his share of the annual profits (if any) as shown by the partnership accounts, and can sue for damages in the event of any misappropriation.
>
> The owner runs the business, though the silent partner has access to information about it. The silent partner is not responsible for liabilities of the partnership beyond the amount of his contribution, but his share of any loss will be debited to his contribution, and must be made good out of his share of profits of alter years before any share of profits is distributed to him.
>
> On termination of the partnership the silent partner gets a return of his capital contribution, so far as it has not been lost.
>
> A silent partnership has no separate legal personality under German law. Its existence is often unknown to customers dealing with the owner.

90.30.2 *UK tax analysis*

The tax treatment of a stille Gesellschaft arose in *Memec v IRC*. In this

[276] 71 TC 77 at p.113.

case a stille Gesellschaft was inserted into a group structure; the business of the stille Gesellschaft was to hold group subsidiary companies and distribute their dividends to Memec PLC, thus:

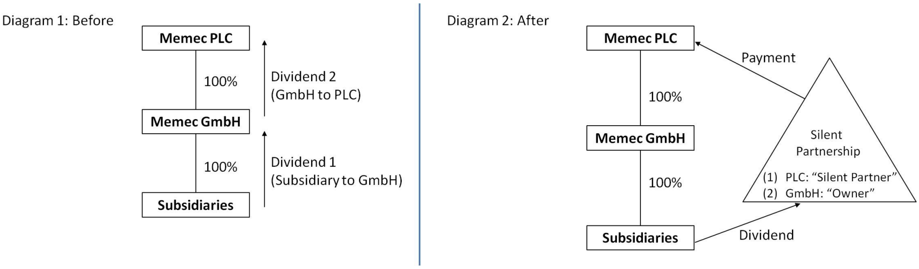


Diagram 1: Before
Memec PLC
100%
Dividend 2
(GmbH to PLC)
Memec GmbH
100%
Dividend 1
(Subsidiary to GmbH)
Subsidiaries
Diagram 2: After
Memec PLC
Payment
100%
Memec GmbH
Silent
Partnership
(1) PLC: "Silent Partner"
(2) GmbH: "Owner"
100%
Subsidiaries
Dividend

In *Memec v IRC*:[277]

> A silent partnership, whilst being similar to an English partnership in not being a separate legal entity, differs from both English and Scottish partnerships in a number of respects.

The Court identified two key differences:

(1) The "silent partner" has no proprietary right in the property of a Stille Gesellschaft.

(2) The "partners" of a Stille Gesellschaft do not carry on business in common.

Both points follow clearly from the HGB provision cited above.

It follows from the second point alone that a Stille Gesellschaft is not a partnership, because partnership is *defined* as carrying on business in common. That does not determine the actual question which arose in *Memec*, which was whether a dividend was "paid by the subsidiaries to PLC", for the purposes of the relevant DTA provision (credit for underlying tax), notwithstanding that the payment was made through the stille Gesellschaft.[278] This was paraphrased by asking whether the stille Gesellschaft was transparent, or whether the subsidiaries were the source of PLC's income. I think these paraphrases are appropriate, as long as one remembers that they are a paraphrase of the actual question. Nothing turns on the use of the specific word "paid".[279]

The Court decided firstly that the arrangement was not a partnership

[277] 71 TC 77 at p.113.

[278] See *Anson v HMRC* [2015] UKSC 44 at [104].

[279] See 15.3 (Recognition/attribution: Analysis).

under the entity-resemblance test:

> The position of plc [the "silent partner"] seems to me to be that of a purchaser who, for a consideration consisting of the contribution of a capital sum and an undertaking to contribute to losses of the owner of a business up to the amount of the contribution, purchases a right to income of a fluctuating amount calculated as a share of the annual profits of the business. Neither in English or Scottish law would that leave plc a partner with GmbH [the "owner"].

Next the Court correctly noted:

> That in itself is not determinative of transparency

But the arrangement was not transparent:

> But I see insufficient justification present in the circumstances of the silent partnership for treating the share of the profits of the GmbH business received by plc as the same as the profits of the subsidiaries or the dividends which were paid to GmbH alone as shareholder and not to plc. ...
> The [stille Gesellschaft] agreement was, in my judgment, the source of plc's share of the profits of the GmbH business, not the trading operations of the subsidiaries or the shares owned by GmbH in the subsidiaries producing the dividends paid to GmbH.[280]

A stille Gesellschaft is transparent for the owner, but not for the "silent partner", who is like a creditor of a debt with a profit-related return. In English law terms, the rights of a "silent partner" to partnership income are contractual rather than proprietary, *in personam* rather than *in rem*.[281] That is an important distinction for tax, even though it does not normally matter for the partners.

90.31 Société en nom collectif

The former International Tax Handbook provided:

> **304. Company and partnership distinguished**
> [The manual made some general comments on differences between

[280] The SC in *Anson* went out of its way to say its decision did not affect *Memec*. So the decision in *Memec* is binding at all levels below the Supreme Court.

[281] More accurately, that was the position of *this* stille Gesellschaft on the basis of the facts found. But there is no reason to think that another tribunal would find different facts.

> companies and partnerships, and continued:] Considerations of this sort are important when dealing with some unfamiliar European company cum partnership creations. The French Société Civile is one such body and the Société en nom Collectif is another. Broadly speaking we regard the first as a company the second as a partnership. Both have legal personality but in the former case the profits arise to the body itself and in the latter case we take the view that the profits arise to the partners. ...
>
> **1673. Establish facts**
>
> The first stage is one of factual enquiry and in relation to any appeal procedure is a matter for the Appeal Commissioners. It can be a difficult stage – even for trained Revenue lawyers. Experts have been known to differ and in a case about these bodies *Dreyfus v IRC* 14 TC 560 we think the Commissioners came to a wrong decision and we do not follow the Courts ruling. The case involved a French SNC and the Courts said it was a company, being guided by the Commissioners' finding of fact about foreign law. We – after listening to expert advice – think it analogous to a partnership...
>
> There are no hard and fast rules governing this question of foreign law; every association has to be considered separately and in the light of its Articles of Association or equivalent code. We look for indicators as to whether the Association carries on the business itself or whether the participators do so jointly; and whether the profits accrue directly to the participators or whether they accrue to the Association which then distributes them to the participators. These conclusions should then help us decide whether the members of the Association are carrying on a trade, profession or vocation solely or in partnerships and, if so, whether the income is immediately derived by the member from the carrying on of that trade.

Avery Jones discusses the issue at length and concludes wistfully:

> My preferred approach to the categorisation of a foreign entity would be to weigh up the degree of legal personality and, if this was significantly less than the absolute legal personality of a corporation, even one with unlimited liability, then the body should be categorised as a partnership (or transparent). This was more the approach in an even earlier case[282], which was not cited in the English *Dreyfus* case, that had decided that a French SNC could not be sued in the partnership name on the ground that it was a partnership and the rules of court only enabled an English partnership to be sued in the firm name. One of the judges said;

[282] *von Hellfeld v E Rechnitzer and Mayer Freres & Co* [1914] 1 Ch 748.

> According to our modern practice there are three classes who can sue, or appear to writs, - persons, corporations and firms.[283]

This was commented upon in a recent case concerning whether the partners of a Swiss SNC[284] could be sued in which a judge stated that in this quotation "corporations" was used in its correct sense as meaning legal persons wholly distinct from their individual members. Another judge, Mummery LJ, described the Swiss SNC as "not a corporation but is a separate entity with many of the characteristics of a corporation[285]." That seems neatly to encapsulate the whole problem of categorising other states' entities.[286]

90.32 Société civile

90.32.1 *French law background*

Frimston & Urquhart say:

> French *sociétés* are different from English companies. The word *'société'* can be used to describe either what we, in England, would call a company, firm, or partnership. French *sociétés* are divided into the following general categories:
>
> - *société commerciale* — a company that is formed for the purposes of trade;
> - *société civile* — an entity (company or partnership) that does not primarily trade;
> - *société de capitaux* — a company with limited liability and where subscribers or shareholders provide its capital;
> - *société de personnes* — an entity with unlimited liability which groups persons together rather than capital.
>
> Two main types of société civile (there are various other types) are:

[283] at p.754.

[284] *Oxnard Financing SA v Rahn and others* [1998] 1 WLR 1465. A Swiss SNC, in contrast to the French, is not a legal person, although that is more a difference in the meaning of corporation than the nature of the partnership; a partnership with the same capacity would be classified as a corporation in both France and the UK. ... The decision was that it could be sued in England in the names of the partners, making it clear that they were being sued in their capacity as partners, rather than in the partnership name. But it could equally well have been sued in the partnership name.

[285] At p.1470E.

[286] "The English Dreyfus Case, Categorisation of French SNC for Tax Purposes in the UK" in *Fiscalité et enterprise: politiques et pratiques, Mélanges en l'honneur de Jean-Pierre Le Gall* (2007), p.315.

- *société civile immobilière* — civil property holding entity;
- *société civile professionnelle* — civil professional partnership (used for law firms, etc.).

From the legal point of view, *sociétés civiles immobilières* are subject to the general laws governing *sociétés civiles* contained in the French Civil Code, although certain types of investment vehicles known as *sociétés civiles de placement immobilier* or *sociétés civiles* constituted for the purpose of building properties with a view to resale (*construction vente*) or *sociétés civiles d'attribution en jouissance à temps partagé* (timeshare companies) have specific regulations attaching to them.

A *société civile* is civil by its character when it:

- has a civil activity or business; and
- is not a *société* on which the law confers a commercial character by reason of its form or its objects.

Sociétés civiles are principally governed by Section IX of Book III of the French Civil Code, particularly Articles 1832 to 1873. Commercial companies (*société anonyme, société à responsabilité limitée*) are governed by the French Commercial Code.

Individual members of a *société civile immobilière* by virtue of its constitution usually have joint unlimited liability for its debts, but the unlimited nature of their liability is usually only in proportion to and to the extent of their holdings, i.e. it is not several. The usual constitution can however be varied to make the liability of the members expressly both joint and several.

A *société civile immobilière* is for legal purposes a separate legal entity from that of its members and therefore is capable of owning assets, which do not merge with the assets of each individual member.

The principal consequences usually attached to a separate legal entity, a *personnalité distincte de ses membres*, in French law are:

- it may own property;
- it may enter into contracts in its own name;
- it may sue and be sued;
- it will not be wound up by the death of one of its members.

However, in the case of a société civile immobilière, the consequences of being a separate legal entity from its members are not in French law as strong as for a trading company for the following reasons.

- *Sociétés civiles* (including a *société civile immobilière*), although separate entities from their members, are created by contract between the members and are therefore based on a relationship that is intuitus personae. This is to say that the personality, efforts and interests of each individual member have an important, perhaps essential, part to play in the formation, management and subsequent dissolution of sociétés civiles.

- A *société civile immobilière* is both a collective entity with a legal personality of its own and a contract between its various members. Article 1832 of the French Civil Code defines 'a société as a contract by which two or more persons agree to combine assets or contributions of work with a view to sharing profits or benefiting from the savings therefrom …'.
- A *société civile immobilière* must have at least two members (who may be husband and wife).
- A *société civile immobilière* does not (and cannot) have a board of directors nor any directors nor a chairman. It is managed on a day-to-day basis by the *gérant* (manager), appointed by the statuts which are the regulations or deed creating and governing the *société civile immobilière*. Since the vast majority of *société civile immobilière* companies are wholly passive, and do not trade in any sense, except for, perhaps, letting a property, the term 'management' should be tightly construed. The duties of the *gérant* generally consist of merely convening a routine annual general meeting and signing the accounts (if any).
- Although French commercial companies such as an 'SA' have their capital divided into shares called *actions*, the capital of the *sociétés civiles* (including *sociétés civiles immobilières*) is not divided into *actions* but into *parts d'intérêt*, (participation holdings), the transfer or assignment of which is restricted.

From the legal point of view, a *société civile immobilière* is a single purpose land holding vehicle whose only use is the purchasing and holding of property, land, and the like. Such a vehicle cannot be used for any other purpose.[287]

90.32.2 *Société civile immobilière*

The Employment Income Manual provides:

> **EIM11371 Homes outside the UK owned through a company: general background** [Jan 2018]
>
> ...Meaning of company
>
> [The Manual refers to the statutory definition of "company"[288] and continues:] This wide definition is not restricted to companies registered

[287] Frimston and Urquhart, "La Vie en France" Taxation Magazine, 13 June 2002, p.296.

[288] See 90.8 (Definition of "company").

> in the UK and includes a number of entities formed under foreign law through which individuals may acquire homes outside the UK. Such entities will generally be classified as opaque for UK tax purposes. Examples include the ownership of a home in France through a "Société Civile Immobiliere" (SCI) or in the United States through a Limited Liability Company.

The view that a SCI is a company for UK tax purposes is controversial.[289] A société civile is classified as a partnership in the UK/France IHT DTA.[290] The introduction of benefit in kind foreign homes relief and the France/UK DTA made the issue somewhat less important but it still matters.

The issue arose in *Joseph Carter v Baird* 72 TC 303 where a company sold land and purchased a SCI. The company claimed roll-over relief which only applied on a purchase of land. The company failed since it acquired an interest in the SCI and not land. Unfortunately the question of whether an SCI was transparent for CGT was not argued and the necessary expert evidence was not put to the general commissioners. (The litigant appeared in person and was not represented by counsel). The case therefore has no authority at all, and on another occasion there is nothing to stop a taxpayer putting forward the argument for transparency, properly supported by evidence.

90.33 Société en commandite par actions

Fraser says:[291]

> Société en Commandite par Actions (Luxembourg) ... seems to be a hybrid form, which does not occur in English law, that is essentially a limited partnership in which the limited partner interests are divided into freely transferable shares. This form of business association appears also to be found in the legal systems of France, Germany (Kommandit-gesellschaft auf Aktien), recognised by the Stamp Office as a body corporate and Spain (Sociedad comanditaria por acciones). Its classification as "opaque" in the direct tax list classification is in

[289] See Frimston and Urquhart, "La Vie en France" Taxation Magazine, 13 June 2002, p.296.

[290] See 115.10.2 (Treaty-situs: France/Italy). See too Avery Jones et al, "Characterisation of Other States' Partnerships for Income Tax", [2002] BTR at p.425.

[291] "Respectez les animaux etrangers! The Inland Revenue lists on entity classification" [2001] BTR 158.

> accordance with the EU directives and with [the OECD Partnerships Report].

This term is sometimes translated as "limited partnership with share capital"[292] and sometimes, though perhaps less often, as "company limited by shares"[293]. It is better to use the French term.

90.34 Commanditaire vennootschap (Netherlands)

Fraser says:[294]

> ... both "open" and "closed" forms are classified in the direct tax list as transparent. However, it appears from the [OECD Partnerships Report] that the "open" form has affinities with the French/Luxembourg société en commandite par actions.

90.35 Sociedad civil (Spain)

Fraser says:[295]

> ... although this is classified in the direct tax list as "opaque", its name is translated in [the OECD Partnerships Report] as "civil law partnership" and the other data on this form of business association in the report is suggestive of transparency.

90.36 Jersey partnerships

A Jersey general partnership is transparent.[296]

HMRC classify a Jersey limited partnership as transparent in the transparent/opaque list.[297]

[292] Eg para 1 OECD Commentary on art 10; see 30.15.7 ("Dividends"). Likewise the IATE database.

[293] The OECD Partnerships Report translates *Société en commandite par actions* as "Company limited by shares" in the list of Belgium entities, and as "Limited partnership with share capital" in the list of French entities. Is that just an accident, or does it reflect differences in French/Belgium law?

[294] "Respectez les animaux etrangers! The Inland Revenue lists on entity classification" [2001] BTR 158.

[295] See above fn.

[296] *Padmore v IRC* 62 TC 352; see Jersey Law Commission "The Jersey Law of Partnership" (consultation paper, 2008) para 21.12 ("Viewed as a whole, in fact the law of partnership of [England and Jersey is] essentially the same...") *https://www.jerseylawcommission.org.je/_files/ugd/f5ec37_0b83dbc3fc6740c79296c14b0c0582f0.pdf*

[297] See 90.54 (HMRC transparent/opaque list).

A Jersey separate limited partnership (SLP) is a legal person but not a body corporate.[298] In that respect it is like a Scots partnership. But art 12 Separate Limited Partnerships (Jersey) Law 2011 provides:

> (1) The property of a separate limited partnership shall be held for the benefit of the partners in accordance with the terms of the partnership agreement ...
> (2) The property of the SLP shall be so held in undivided shares, and –
> (a) as between the partners, no partner shall be entitled individually to exercise proprietary rights in respect of the property; and
> (b) in relation to third parties, the partners shall be collectively entitled to the property.

This is like an English partnership, not a Scots partnership (where the property belongs to the partnership and not the partners).[299] If one can imagine entities on a spectrum running from an English partnership, through the Scottish partnership, to a UK company, a SLP stands somewhere between an English and a Scottish partnership So it is clearly on the partnership side of the company/partnership dividing line, and should be classified and taxed as a partnership for UK tax law.

One difference between a SLP and UK partnerships is that a UK partnership must be carried on "with a view of profit", but a SLP may be formed for any lawful purpose. It could happen that a SLP is not carrying on business a view to profit. That might also happen with other foreign partnerships. Would a not-for-profit foreign partnership constitute be a partnership for UK tax purposes? Discuss. In practice the question will rarely (if ever) arise.

Crossley & Baldwin consider Jersey incorporated limited partnerships, and conclude these are transparent for IT/CGT;[300] though the position may depend on the drafting.

90.37 Foreign LLP

References to an LLP in UK legislation are references to UK incorporated

[298] Art 3(4) Separate Limited Partnerships (Jersey) Law 2011 states this expressly, but a SLP is in any event not a body corporate within the UK law meaning; see 90.9.3 (What is a body corporate?).

[299] See 85.3 (Nature of partnership share).

[300] *Taxation of Partnerships and LLPs* (1st ed, 2021) para 6.12, 6.13.

LLP (unless the context otherwise requires).[301] It is considered that the statutory rules which (generally) make a UK LLP transparent for tax purposes[302] do not apply to a foreign LLP.

HMRC agree. Business Income Manual provides:

> **BIM82145 Limited Liability Partnership: International aspects** [Jun 2016]
> **UK branches of overseas LLPs**
> The tax treatment of a UK branch of an overseas LLP, and the members of such a LLP, depends on how the foreign entity is regarded for the purposes of the UK taxation provisions. Where the foreign LLP is regarded as a 'body corporate' for the purposes of the UK Taxes Acts the profits of the UK branch will be chargeable to CT. On the other hand if it is regarded as a partnership then members are separately liable to Income Tax on their share of the branch's profits under the legislation for partnerships. The Limited Liability Partnerships Act 2000 only applies to UK registered LLPs.

This discrimination would be in breach of EU law but that matters rather less after Brexit.

HMRC classify a Jersey LLP as opaque in the transparent/opaque list. This is controversial.[303] However the issue seems unimportant because (partly as a result of the HMRC view and partly due to burdensome Jersey law requirements) the number of Jersey LLPs is small.[304]

90.38 European Economic Interest Grouping

90.38.1 *EEIG law background*

The BI Manual provides:

> **BIM82160 EEIGs: background information** [Jun 2016]
> A European Economic Interest Grouping (EEIG) is a form of business entity governed by EU regulation. The members of an EEIG may be companies, individuals or partnerships from two or more member states of the EU or the European Economic Area. ... An EEIG that has

[301] See 85.21.1 (Definition of LLP).

[302] See 85.21 (Limited liability partnership); 102.35.3 (Situs of LLP).

[303] Walker, "Limited Liability Partnerships: True Partnerships" [1998] JLR 1 argues that a Jersey LLP is a partnership in the ordinary sense of the word. In *R v IRC ex p. Bishopp* 72 TC 322 the court was asked but refused to decide the point.

[304] The number is 104 as at January 2020: *https://www.jerseyfsc.org/registry/documentsearch*

registered its official address in the UK is a body corporate with a legal personality.

See too App.2.7.2 (Legal person: Foreign law).

90.38.2 *EEIG tax treatment*

s.842 ITA	**s.990 CTA 2010**	**s.285A TCGA**
(1) The following rules about UK Economic Interest Groupings and European Economic Interest Groupings[305] apply for the purposes of charging income tax—	(1) The following rules about UK Economic Interest Groupings and European Economic Interest Groupings apply for the purposes of charging corporation tax in respect of income—	(1) The following rules about UK Economic Interest Groupings and European Economic Interest Groupings apply for the purposes of charging tax in respect of chargeable gains—
Rule 1 A grouping is treated as acting as the agent of its members.	[Identical]	[Identical]
Rule 2 The activities of a grouping are treated as those of its members acting jointly.	[Identical]	[Identical]
Rule 3 Each member of a grouping is treated as having a share of the grouping's property, rights and liabilities.	[Identical]	[Identical]
Rule 4 Any trade or profession carried on by the grouping is treated as carried on in partnership by the members of the grouping.	*Rule 4* Any trade carried on by the grouping is treated as carried on in partnership by the members of the grouping.	[Identical to ITA rule]
		Rule 5 A person is to be regarded as acquiring or

[305] Defined s.842(5) ITA/s.990(7) CTA 2010/s.285A(5) TCGA.

		disposing of a share of the assets of the grouping not only where there is an acquisition or disposal of assets by the grouping while he is a member of it, but also where he becomes or ceases to be a member of a grouping or there is a change in his share of the property of the grouping.
(2) For the purposes of Rule 3, a member's share of any property, rights or liabilities of a grouping is determined according to the contract under which the grouping is established.	(2) For the purposes of Rule 3, a member's share of any property, rights or liabilities of a grouping is determined in accordance with the contract under which the grouping is established.	[Identical to ITA rule]
(3) If the contract does not provide for this, the member's share is determined by reference to the share of the profits of the grouping to which the member is entitled under the contract.	[Identical]	[Identical]
(4) If the contract does not provide for this either, the members are treated as having equal shares of the property, rights and liabilities of the grouping.		

Section 990(5)(6) CTA 2010 addresses loan relationships aspects for CT purposes:

> (5) Part 5 of CTA 2009 (loan relationships) applies in relation to a grouping as it applies in relation to a firm.
> (6) For the purposes of subsection (5) see in particular the following provisions of Part 5 of CTA 2009—

> Chapter 9 (partnerships involving companies),
> section 467 (connections where partnerships involved),
> section 472 (meaning of "control"), and
> sections 473 and 474 (meaning of "major interest" etc).

The BI Manual provides:

> **BIM82160 EEIGs: background information** [Jun 2016]
> ...For the purposes of UK taxation of profits or losses an EEIG is fiscally transparent.

90.39 Common investment fund

The UK and the Netherlands have agreed the application of the Netherlands/UK DTA to UK pension scheme and charity investors in UK common investment funds ("CIFs"):

> A CIF is an arrangement whereby a number of registered pension schemes have pooled some or all of their investments into a common fund for investment purposes. The CIF must be no more than an investment agency for the assets of participating schemes. A CIF cannot be a registered pension scheme in its own right (See the HMRC Guidance).
>
> Charity CIFs are set up by Schemes made by the Charity Commission (the Commission) under [what is now] sections 96 to 99 of the Charities Act 2011. They operate as investment vehicles and are deemed by law to be charities themselves. They are therefore eligible for registration as charities in their own right.
>
> This Agreement applies to UK CIFs whose investors are:
>
> (a) Pension schemes which qualify for benefits under the above Convention;[306]
> (b) Charity organisations which qualify for benefits under the above Convention;[307] and
> (c) Other investors which qualify for benefits under a Convention for the avoidance of double taxation to which the Netherlands is a Contracting State.
>
> A CIF can act as a pooled investment vehicle for the assets of pension schemes or charities. The CIF invests these assets on behalf of those investors.

[306] Article 3, paragraph 1, letter l of the Convention and Article III, letter b of the Protocol.

[307] See Article 4, paragraph 2, letter b of the Convention.

The competent authorities of the Netherlands and the UK agree that a CIF is regarded as fiscally transparent in both countries. Since a CIF is fiscally transparent, all income and gains derived by the fund from the fund assets are allocated to the investors in the CIF in proportion to their participations in the CIF.

Request for application of the benefits of a Convention on behalf of the participants

A CIF which is established in the UK and which derives income and gains arising in the Netherlands may itself, represented by its custodian, manager or depository, in lieu of and instead of the investors in the CIF, claim the benefits of an agreement for the avoidance of double taxation to which the Netherlands is a Contracting State and which is applicable to those investors, on behalf of those investors in the CIF and according to the conditions of such agreement.

Such claims may be subject to enquiry and, where requested, a custodian, manager or depository shall provide relevant information which may include a schedule of investors and allocated income relevant to a claim. A CIF may not make a claim for benefits on behalf of any investor in the CIF if the investor has itself made a claim for benefits in respect of the same income. If a CIF intends to make a claim for benefits on behalf of an investor, the custodian, manager or its depository should clearly communicate this to the investor to avoid duplicate claims in respect of the same income.

90.40 Dutch stichting/Foundation

A note on terminology. The German word *Stiftung* and the Dutch word *Stichting* are both translated by the English word "foundation". However the entities are used in different ways, and do not necessarily have the same nature for UK tax purposes. Strictly, one should not use the word "foundation" without specifying the type of foundation referred to, but the context will generally make that clear. When referring to the Dutch entity, I use the word *Stichting* and prefer to avoid *foundation*.

90.40.1 *Stichting*

Article 2.285 of the Dutch Burgerlijk Wetboek (Civil Code) provides:[308]

1. Een stichting is een door een rechtshandeling in het leven	1. A stichting is a legal person formed by means of a juridical act,

[308] Dutch Civil Code, available in English on *http://www.dutchcivillaw.com*

geroepen rechtspersoon, welke geen leden kent en beoogt met behulp van een daartoe bestemd vermogen een in de statuten vermeld doel te verwezenlijken.

that has no members, and that intends to carry out an object, specified in its articles of incorporation, by using capital (property) which has been provided for this purpose....

3. Het doel van de stichting mag niet inhouden het doen van uitkeringen aan oprichters of aan hen die deel uitmaken van haar organen noch ook aan anderen, tenzij wat deze laatsten betreft de uitkeringen een ideëele of sociale strekking hebben.

3. The objects of a stichting may not include the making of distributions to its founders (incorporators) or to those who are participating in its bodies or to others, except, as regards the latter, when these distributions are made for charitable (philanthropic) or social purposes.

Para 1 is comparable to the definition of a Liechtenstein Foundation.

The Australian Taxation Office classifies a pension fund stichting as a trust:

> **Facts**
>
> An overseas pension fund is constituted as a Stichting that is a legal person under Dutch legal concepts.
>
> Under the bye-laws the purpose of the fund is to protect employees, former employees and their legal heirs from the consequences of old age, disablement and death in accordance with the pension regulations.
>
> The property of the pension fund consists of contributions by affiliated employers, investments and fund earnings.
>
> The pension fund is administered by a Board of trustees. The Board is authorised to undertake all actions relating to management and disposition within the framework of the objectives of the fund...
>
> **Reasons for Decision**
>
> [The ruling refers to the definition of "trust" in *Harmer v.FCT*; see 90.14.6 (Trust concept in Australia), and continues:]
>
> Having regard to the Bye-laws of the pension fund (the Stichting), all four elements are present so as to give rise to a trust relationship between the Stichting and those individuals entitled to benefits from the pension fund for the purposes of section 115-10 of the ITAA 1997.
>
> The Stichting has ownership and possession of the trust property and is the trustee. The trust property consists of the contributions made to the fund, investments and fund earnings. The beneficiaries are the

> employees, former employees and their legal heirs.
>
> The Bye-laws of the Stichting impose on it a personal obligation to deal with the trust property for the benefit of the beneficiaries.
>
> Having regard to the relationship between the Stichting, contributors, beneficiaries and potential beneficiaries and the express intention that the Stichting hold the property not exclusively for itself, but subject to an equitable obligation to deal with the property for the benefit of the beneficiaries the relationship constitutes a trust for the purposes of section 115-10 of the ITAA 1997.[309]

90.40.2 *Stichting Administratiekantoor*

de Vries explains:

> In the corporate environment, as a vehicle for orphan structures, foundations are used to hold the shares in financing bodies.
>
> In an estate planning environment or employee benefit scheme the foundation can be a vehicle to hold shares and exercise the voting rights or shares, whereas the economic rights related to the shares are transferred through depository receipts to the beneficiaries. This structure is a popular means to address the fact that the separation of voting rights from economic rights on shares in Dutch limited liability companies is not possible. In such cases the board of directors of the foundation are formed by independent persons (in estate planning structures usually persons trusted by the family) or, for example, the management board of other entities in the structure that holds a larger share of the entity which shares are partly transferred to the foundation. The foundation in these structures is usually referred to as a STAK (*stichting administratiekantoor*).
>
> In the field of estate planning, foundations are used to own and manage estates whereby the foundation can have a purpose incorporated in the articles of association comparable to a 'letter of wishes', which mandates the board of the foundation to make funds of the foundation available for certain designated purposes, such as funding the education for certain beneficiaries.
>
> ... a foundation is a separate legal entity under Dutch law, which is formed through the execution of a deed of incorporation by the civil law notary, and managed by its board of directors. The board of directors may consist of private individuals, but can also be legal entities, like other foundations or companies. Like other Dutch legal entities, a

[309] ATO Interpretative Decision ID 2008/2
https://www.ato.gov.au/law/view/document?locid=aid/aid20082

> foundation can hold assets in its own name, can enter into agreements etc. A foundation must have a specific objective (for example, the financing of the education of family members, the protection of the family wealth, and management of certain assets), to be specified in its articles of association.
>
> ...
>
> A further legal characteristic of a foundation is that it does not have members or shareholders, which is sometimes considered slightly odd by practitioners in common law jurisdictions, from the author's experience. The foundation can have beneficiaries, but the distribution prohibition (referred to above) establishes that the beneficiaries cannot be the same as the contributors or members of the board of the foundation (an important difference with the private foundation as indicated above regarding the distribution prohibition). A way to work around the distribution prohibition for a foundation may be to issue depositary receipts (*certificaten*) that give beneficial rights to assets that are legally owned by the foundation. It is common practice that through issuing depositary receipts the voting rights and economic rights of the assets (usually shares) are split: the voting rights of the shares remain with the foundation whereas the economic ownership of the assets rests with the holder of the depositary receipts. As referred to above, such a foundation is referred to as a STAK and is often used for asset protection or estate planning. Further a STAK may be used for employment benefit schemes. A STAK is in principle considered transparent for Dutch income tax purposes, and consequently the owners of the depository receipts will be taxed on income derived from the shares/assets held by the STAK. In the case of estate planning the board of the STAK will often be the parents whereas the depository receipts may be issued to the children. In such a way, the parents have control over the estate and can decide upon distributions to the children.[310]

Panico comments:

> the Dutch and Belgian practice of Stichting administratiekantoor (StAK) achieves a result that is functionally equivalent to an interest in possession trust. Under such an arrangement a foundation issues asset-backed notes or 'certificates' linked to some underlying assets (usually corporate shareholdings)so that the holders of such certificates are entitled to the income resulting from such underlying assets (eg dividends). The title to such assets vests in the foundation and the

[310] De Vries,"The Dutch Foundation" [2011] Journal of International Tax, Trust and Corporate Planning, p.299.

> functional outcome may be described as if the foundation held them on trust for the certificate holders. The Dutch expression reads that the assets are held by the foundation ten titel van beheer (literally 'by way of administration'),which is often rendered in English as 'on trust' for the certificate holders.
>
> The main defining element of the Dutch model foundation is its corporate nature as a legal person, as opposed to the Germanic and 'classic' reliance to the enforcement of the founder's 'unilateral declaration of will'. For this reason, Dutch foundations are often referred to as 'orphan corporate entities',ie ownerless incorporated legal persons, and as such they may be used in corporate arrangements such as securitization transactions, off-balance sheet collaterals, and top holding structures.[311]

A STAK is not an IHT-settlement as there is no element of succession. It is not an IT/CGT settlement as (if it is a trust) it is a bare trust. There is usually no element of bounty, in which case it is not a settlement-arrangement.

In the case of a STAK, the important question is what is the nature of the depositary receipt. It is tentatively suggested that the depositary receipt confers a proprietary interest on the holder and so is transparent.[312] The holder is treated for IT and CGT purposes as entitled to the dividends from the underlying assets held by the STAK. HMRC agree: they classify a Dutch stichting as transparent.[313] HMRC are presumably considering a STAK here, though that is not expressly stated.

90.40.3 *Stichting holds CCF*

The Australian Taxation Office discusses a Dutch pension fund stichting holding an Irish common contractual fund:

> **Issue**: Does Australia have the right to tax Australian sourced business profits that a Dutch Stichting (Stichting) receives as a unitholder in an Irish Common Contractual Fund (CCF), under Article 7 of Schedule 10 of the International Tax Agreements Act 1953 (the Netherlands Agreement)?
>
> **Decision**: No. Australia does not have the right to tax the Australian source business profits the Stichting receives as a unitholder in a CCF under Article 7 of the Netherlands Agreement.

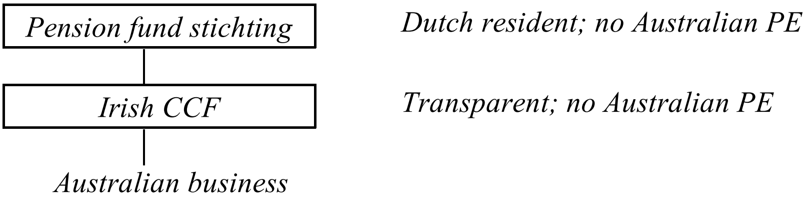
[311] Panico, "Private foundations and trusts: just the same but different?" [2016] Trusts & Trustees 132.

[312] See 71.2.6 (Denmark, Germany, Netherlands, Switzerland).

[313] See 90.54 (HMRC transparent/opaque list).

Facts
The Stichting is a legal entity incorporated in the Netherlands.
The Stichting is a pension fund whose sole purpose is to provide superannuation benefits for non-resident persons upon retirement or death.
The Stichting is exempt from income tax in the Netherlands under the tax laws of the Netherlands.
The Stichting has received a declaration from the Netherlands Inspector of Tax Administration to the effect that it is a resident of Netherlands for tax treaty purposes.
The Stichting is not a resident of Australia for the purposes of Australian tax.
The Stichting does not carry on business through a permanent establishment in Australia.
The Stichting is the only unitholder in an Irish CCF.
[The ruling refers to the definition of an Irish CCF; see 69.13 (Irish Common Contractual Fund).]
The CCF is not a resident of Ireland or Australia for the purposes of the tax treaty between Australia and Ireland.
The CCF receives Australian source business profits from investing the funds of the CCF.
The CCF does not carry on business through a permanent establishment in Australia.
The relationship between the manager and custodian of the CCF and the Stichting is considered a trust relationship for Australian tax purposes. The manager and custodian are the trustees, and the Stichting is the beneficiary.

I think the last sentence means that a CCF is transparent, which is also the HMRC view. Thus to summarise the structure:


Pension fund stichting
Dutch resident; no Australian PE
Irish CCF
Transparent; no Australian PE
Australian business

Reasons for Decision
[The statement sets out art. 7 (business profits), art. 3 (definition of 'enterprise of one of the States'; these are not set out here as they follow OECD Model form.]
Accordingly, for Article 7(1) of the Netherlands Agreement to apply to the Australian sourced business profits derived by the Stichting, the Stichting must be:

- a person
- a resident of the Netherlands, and
- an enterprise.

for the purposes of the Netherlands Agreement.

90.40.4 *Stichting a treaty-person*

The Australian Taxation Office say:

Is the Stichting a 'person' for the purposes of the Netherlands Agreement?
Article 3(1)(d) of the Netherlands Agreement defines the term 'person' to mean 'an individual, a company and any other body of persons'. The term 'company' is defined in

Article 3(1)(e) of the Netherlands Agreement to mean ‘any body corporate or any entity which is assimilated to a body corporate for tax purposes’. The term ‘body corporate’ is not defined for the purposes of the Netherlands Agreement, and in accordance with Article 3(3) of the Netherlands Agreement, the term takes its meaning from the tax laws of Australia unless the context otherwise requires.

As there is no definition of the term ‘body corporate’ under Australia’s domestic tax law provisions, the ordinary meaning of the term applies as per tax treaty interpretation principles contained in Taxation Ruling TR 2001/13 Income tax: Interpreting Australia’s Double Tax Agreements.

The Butterworths Concise Australian Legal Dictionary 2nd ed. defines a body corporate as ‘an artificial legal entity having separate legal personality’.

[The statement sets out Article 285 of the Dutch Civil Law Code and continues:]

As the Stichting is created under Netherlands law and has a legal personality under Netherlands law, it should be recognised as a legal entity in Australia in accordance with the principle in *Chaff and Hay Acquisition Committee v Hemphill* (1947) 74 CLR 375 (Chaff’s Case).

In Chaff’s Case, it was found by the High Court that a committee constituted in South Australia under the Chaff and Hay (Acquisition) Act 1944 (SA) was a legal entity despite not being incorporated under South Australian law. Chief Justice Latham found that as the committee was a legal entity in South Australia as distinct from the legal personalities of the natural persons who constitute it, then it is by comity recognised as a legal entity elsewhere. His Honour went on to state (at 384-5) that the same principle applied to the recognition of bodies created by foreign law which have the rights and liabilities distinct from those of the natural persons who constitute them. Justice Starke J further stated (at 388) that ‘recognition is given in the case of companies or artificial persons which have come into existence in countries whose law of incorporation is based on principles different from those of England and Australia’.

This principle is also recognised in the Foreign Corporations (Application of Laws) Act 1989. This Act applies in determining a question arising under Australian law where it is necessary to determine the question by reference to a system of law other than Australian law. Section 7(2) provides that any question relating to whether a body or person has been validly incorporated in a place outside Australia is to be determined by reference to the law applied by the people in that place.[314]

As the Stichting is a legal entity created by legal authority in the Netherlands to achieve certain purposes, the Stichting has the features of a body corporate under the ordinary meaning of the term. As such, the Stichting is a ‘person’ for the purposes of the Netherlands Agreement.

90.40.5 *Is stichting treaty-resident*

The Australian Taxation Office say:

> **Is the Stichting a resident of the Netherlands for the purposes of the Netherlands Agreement?**

[314] The same applies in the UK: see Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 30R-009 (Status).

> [Article 4 of the Netherlands Agreement provides:
> "For the purposes of this Agreement, a person is a resident of one of the States ... (b) in the case of the Netherlands, if the person is a resident of the Netherlands for the purposes of Netherlands tax but not if he is liable to tax in the Netherlands in respect only of income from sources therein."]

The Australian Taxation Office treat this issue briefly:

> The Stichting here has received a declaration from the Netherlands Inspector of Tax Administration to the effect that it is a resident of Netherlands for tax treaty purposes. The Stichting therefore satisfies this requirement.

Article 4 of the Netherlands Agreement was not OECD Model form definition of residence, so the position may be different under UK tax law.

90.40.6 *Is stichting an enterprise*

The Australian Taxation Office say:

> **Is the Stichting an enterprise for the purposes of the Netherlands Agreement?**
> The High Court in *Thiel v FCT*[315] considered the meaning of the expression 'the profits of an enterprise of one of the contracting states' in the Business Profits Article of the tax treaty between Australia and Switzerland.
> Chief Justice Mason and Justices Brennan and Gaudron stated:
>
> > this statement recognises that an activity, as well as a framework within which activities are engaged in, may constitute an "enterprise" for the purposes of the Agreement.
> > ... an enterprise "may consist of an activity or activities and be comprised of one or more transactions provided they were entered into for business or commercial purposes".[316]
>
> In carrying out the activities of a pension fund, the Stichting is considered to constitute an enterprise as the activities it conducts are entered into for business or commercial purposes.
> **Conclusion**
> Accordingly all the necessary elements of Article 7(1) of the Netherlands Agreement are satisfied by the Stichting in order for the taxing rights of the Netherlands and Australia to be determined under Article 7(1) of the Netherlands Agreement.
> The Stichting does not have a permanent establishment in Australia and Article 7(1) of the Netherlands Agreement provides a residence-only taxing right to the Netherlands over the business profits of the Stichting. Accordingly, Australia, as the country of source of the business profits, does not have a right to tax the business profits under the Netherlands Agreement.[317]

[315] (1990) 171 CLR 338; (1990) 21 ATR 531; 90 ATC 4717.

[316] (1988) 21 FCR 122 at p.146.

[317] ATO ID 2008/62 (April 2008) *https://www.ato.gov.au/law/view/view.htm?docid=AID/AID200862/00001&PiT=99991231235958*

90.41 Fonds voor gemene rekening

The UK and the Netherlands have agreed the application of the Netherlands/UK DTA to *fonds voor gemene rekening* (closed funds for mutual account,[318] "closed FGR"):

> This Agreement applies to closed FGRs formed in conformity with the Decree of 11 January 2007, CPP2006/1870M, Dutch. Gov. Gaz. No 15, 2007. A closed FGR can act as a pooled investment vehicle for the assets of pension funds and other investors. The closed FGR invests these assets on behalf of those investors.
>
> The competent authorities of the Netherlands and the UK agree that a closed FGR is fiscally transparent.
>
> A closed FGR can also consist of several closed FGRs as described in par. 4 of the Decree of 11 January 2007, CPP2006/1870M, Dutch. Gov. Gaz. No 15, 2007. Such an umbrella fund is also fiscally transparent.
>
> Since a closed FGR is fiscally transparent, all income and gains derived by the fund from the fund assets are allocated to the investors in the closed FGR in proportion to their participation in the fund.
>
> *Request for application of the benefits of a Convention on behalf of the participants*
>
> A closed FGR which is established in the Netherlands and which receives income arising in the UK may itself, represented by its fund manager or its depository, in lieu of and instead of the investors in the closed FGR, claim the benefits of an agreement for the avoidance of double taxation to which the UK is a party and which is applicable to those investors on behalf of those investors in the closed FGR.
>
> Such claims may be subject to enquiry and, where requested, a fund manager or depository shall provide relevant information which may include a schedule of investors and allocated income relevant to a claim.
>
> A closed FGR may not make a claim for benefits on behalf of any investor in the closed FGR if the investor has itself made a claim for benefits in respect of the same income. If a closed FGR intends to make a claim for benefits on behalf of an investor, the fund manager or its depositary should clearly communicate this to the investor to avoid duplicate claims in respect of the same income.
>
> This Agreement shall be subject to regular review.

90.42 Bewind

Bewind is a distinctively Dutch institution, found only in Dutch law and in the Roman-Dutch system of South African law.

[318] This may also be translated as 'fund for mutual account' or 'fund for joint account'.

Bewind may be translated as fiduciary administration or administratorship. Under a bewind, a bewindvoerder (fiduciary administrator) has power to manage the assets of another person, the rechthebbende (literally, the person entitled; one might translate as "beneficiary" but that term is inapt if it is taken to suggest the existence of a trust).

A bewind may be made by will[319] or by lifetime gift.[320]

It may also be used to manage the assets of a person lacking capacity (the English law equivalent is a deputy appointed by the Court of Protection, or an attorney appointed by the individual under a lasting power of attorney).

Kortmann and Verhagen say:

> The *bewind* cannot be characterised as a trust in the sense of Article 1 of the Principles. A trust in the sense of the Principles only exists in situations where the trustee legally owns the assets to be managed, which is not so in the case of *bewind*. In the case of *bewind* the beneficiary is legal owner of the assets to be managed. There are, however, restrictions on the beneficiary's right to dispose of the assets placed under *bewind*. Either the legal owner cannot dispose of these assets at all, or he can only do so subject to the *bewind*. The *bewindvoerder*, as the administrator is usually called, acts in the case of *bewind* only as agent for the owner of the assets (the beneficiary). Because the assets to be managed are not legally owned by the *bewindvoerder*, the assets remain unaffected by the bankruptcy of the *bewindvoerder*.[321]

There is no close equivalent of a bewind in English or Scots law. It is similar in effect to an irrevocable power of attorney, a type of agency. In some ways it is similar in effect to bare trust: the administrator has power to manage the assets similar to a bare trustee; but it is irrevocable (in the sense that the owner cannot call for the assets and terminate the bewind) and it is not a trust in that the assets are not held in the name of the fiduciary administrator on trust.[322]

[319] A testamentair bewind, Dutch Civil Code Book 4 art 153-178.

[320] A schenkingsbewind, Dutch Civil Code Book 7 art 182.

[321] Hayton, Kortmann and Verhagen, *Principles of European Trust Law, Law of Business and Finance* Vol 1 (1999), p.199. Similarly Gretton "Trusts Without Equity" (2000) 49 ICLQ 599 reprinted in Valsan (ed), *Trusts and Patrimonies* (2015) chap 5: "Though it functions as a trust, the *bewind* is not a trust, for a simple reason: the location of legal title is the reverse of the trust."

[322] See 87.7 (Bare trust/nomineeship).

A bewind is not a settlement within the standard IT/CGT definition, as if it is a trust, if falls within the bare trust disregard. It is transparent for IT/CGT purposes.

A simple bewind is not an IHT-settlement as property is not held for persons in succession,[323] or to accumulate income, or with discretionary power over income.[324] It is transparent for IHT purposes.

Vruchtgebruikbewind (administration in respect of a usufruct) and tweetrapsmakingbewind (administration of fideicommissary disposition) raise different issues, and the question of whether they are equivalent to a trust for persons in succession would need further consideration.

It appears that the South Africa Bewind is similar to the Netherlands.[325]

90.43 Limited liability company

90.43.1 *LLC: US law background*

In UK law, the terms "company" and "corporation" are (more or less) synonymous.[326] But in US law, a corporation and a limited liability company are distinct types of entity.

Field explains the US law background:

> In 1977, in an effort to develop a vehicle that provided owners corporate-like protection from liability for the entity's debts while attempting to achieve pass-through tax treatment under the Kintner regulations,[327] the Wyoming legislature enacted the country's first legislation authorizing LLCs. LLCs combined very desirable characteristics: limited liability for all members, partnership features such as dissolution at will and lack of free transferability ...
>
> In 1988, the IRS finally resolved the issue of the tax classification of an LLC formed under Wyoming's LLC statute. In a published revenue ruling, the Service concluded that any LLC formed under Wyoming's LLC statute to carry on a business and divide the gains therefrom would necessarily (by virtue of the terms of the LLC statute itself) lack the corporate characteristics of continuity of life and free transferability of

[323] See 87.6.2 (Limb (a): persons in succession).

[324] See 87.6.3 (Limb (b): accumulation /power to make income payment).

[325] See du Toia, "The South African Trust in the Begriffshimmel? Language, Translation and Taxonomy" (2015) *https://www.researchgate.net/publication/283661102_The_South_African_Trust_in_the_Begriffshimmel_Language_Translation_and_Taxonomy*

[326] See 90.8.4 (Company: undefined/general sense).

[327] See 90.57 (UK check-the-box rules?).

> interests, and therefore would be classified as a partnership for federal tax purposes. The Service reached this conclusion despite the fact that neither the managers nor the members of the LLC are personally liable for the LLC's debts and obligations.
>
> After this IRS pronouncement clarifying the federal tax classification of LLCs, demand for LLCs grew rapidly, and states quickly began enacting their own LLC statutes. Some of these state statutes, like Wyoming's LLC statute, were "bullet-proof," causing any LLC formed thereunder to necessarily lack at least two corporate characteristics, thereby automatically resulting in partnership classification. Other state statutes were sufficiently flexible so as to allow the LLC to qualify as either a partnership or a corporation for federal tax purposes, depending on the terms of the specific LLC agreement.
>
> This flexibility afforded under some state LLC statutes highlighted the failure of the resemblance test. One commentator explained that, "practically speaking, there is no difference between a closely-held entity that is organized as an LLC and one that is organized as a corporation .... Left unchanged, two very different tax regimes will govern entities with almost identical management and perhaps even similar financial structures." The failure of the corporate resemblance test was also illustrated by professional corporations and limited partnerships, which are also business organizations that could be classified for tax purposes as partnerships under the corporate resemblance test while retaining significant corporate features like limited liability. Moreover, given the bright line rules set forth in the Kintner regulations and the flexibility afforded under the applicable state business statutes, practitioners were often able to create LLCs and other business entities with a carefully tailored set of rights and responsibilities so as to achieve tax classification as either a corporation or a partnership, as desired by the client, while retaining significant features of the other classification.[328]

A paper entitled "Choice of Business Entity" provides:[329]

[328] "Checking in on Check-the-Box" 42 Loy. L.A. L. Rev. 451 (2009) (footnotes omitted) *http://digitalcommons.lmu.edu/llr/vol42/iss2/4* Footnotes are omitted. For a history which traces LLCs back to 19th century US limited partnership associations, and to German law, see Gazur and Goff, "Assessing the Limited Liability Company" (1991) 41(2) Case Western Reserve Law Review 389; Gazur, "The Limited Liability Company experiment: unlimited flexibility, uncertain role" (1995) 58(2) Law and Contemporary Problems 135, 139 n.2.

[329] Joint Committee on Taxation, (2015) *https://www.jct.gov/publications.html?func=startdown&id=4765*

> LLCs are neither partnerships nor corporations under applicable State law, but they generally provide limited liability to their owners for obligations of the business. LLCs are generally treated as partnerships for Federal tax purposes, unless an election is made to be treated as a corporation. Specifically, under regulations promulgated in 1996, any domestic unincorporated entity with two or more members that is not publicly traded is treated as a partnership under the default rules but may elect to be treated as a corporation for Federal income tax purposes, and any single-member unincorporated entity is disregarded (*i.e.*, treated as not separate from its owner) for Federal income tax purposes under the default rules (though it may elect to be treated as a corporation). These regulations, known as the check-the-box regulations, were a response, in part, to the growth of LLCs.

To a UK reader, it may seem paradoxical to say that a limited liability *company* may be a partnership for US tax purposes, but:

(1) "Company" in foreign law may not have the same meaning as it has in UK law, or UK tax law.[330] It is no more paradoxical than to say:
    (a) An unincorporated association (which is not a company in the general sense) is a company for UK tax purposes.
    (b) A LLP (which is a body corporate) is a partnership for UK tax purposes

(2) In any case, a LLC is not actually a partnership or a corporation, for general US law purposes, but simply *treated* as one or the other for US tax purposes.

90.43.2 *Varieties of LLC*

There are differences between LLC laws in different US states. The INT Manual provides:

> **INTM180050 HMRC view of Delaware LLCs in light of Anson** [Dec 2023]
> HMRC understand that the LLC law of other US states is substantially the same as that of Delaware and, as such, do not believe members of other US LLCs will generally receive or be entitled to profits either.

A number of tax haven jurisdictions have enacted LLC legislation, based on the Delaware model.

I focus on Delaware LLCs but occasionally refer to others. I am not aware of differences that matter for UK tax.

[330] See 90.4.1 (English language terminology)

90.44 Delaware LLC Act

Delaware LLCs are governed by the Delaware Limited Liability Company Act (LLCA), which is in chapter 18 Title 6 of the Delaware Code.[331] That is divided into 12 subchapters, numbered 18-101, 18-201, etc. I here set out the provisions of the LLCA which are most important for the UK tax analysis.

90.44.1 *LLC agreement/LLC interest*

Art 18-101(9) Delaware LLCA provides:

> "Limited liability company agreement" means any agreement (whether referred to as a limited liability company agreement, operating agreement or otherwise), written, oral or implied, of the member or members as to the affairs of a limited liability company and the conduct of its business. ... A limited liability company (including any protected series or registered series thereof) is not required to execute its limited liability company agreement. A limited liability company (including any protected series or registered series thereof) is bound by its limited liability company agreement whether or not the limited liability company (or any protected series or registered series thereof) executes the limited liability company agreement...

Art 18-101(10) Delaware LLCA provides:[332]

> "Limited liability company interest" means a member's share of the profits and losses of a limited liability company and a member's right to receive distributions of the limited liability company's assets.

90.44.2 *Legal personality*

Art 18-201(b) Delaware LLCA provides:

> A limited liability company formed under this chapter shall be a separate legal entity, the existence of which as a separate legal entity shall continue until cancellation of the limited liability company's certificate of formation.

That is, a LLC has legal personality.

90.44.3 *Perpetual succession*

Art 18-801(a) Delaware LLCA provides:

[331] *https://delcode.delaware.gov/title6/c018/index.html*

[332] Formerly Art 18-101(8) Delaware LLCA.

> (a) A limited liability company is dissolved and its affairs shall be wound up upon the first to occur of the following:
> (1) At the time specified in a limited liability company agreement, but if no such time is set forth in the limited liability company agreement, then the limited liability company shall have a perpetual existence;

That is, a LLC has perpetual succession.

90.44.4 *Who carries on LLC business*

Art 18-106(a) Delaware LLCA provides:

> A limited liability company may carry on any lawful business, purpose or activity ...

It seems clear that the business of a LLC is carried on by the LLC and not by its members.[333]

90.44.5 *Entitlement/distribution of LLC profit*

Art 18-503 Delaware LLCA provides:

> The profits and losses of a limited liability company shall be allocated among the members, and among classes or groups of members, in the manner provided in a limited liability company agreement. If the limited liability company agreement does not so provide, profits and losses shall be allocated on the basis of the agreed value (as stated in the records of the limited liability company) of the contributions made by each member to the extent they have been received by the limited liability company and have not been returned.

Art 18-601 Delaware LLCA provides:

> Except as provided in this subchapter, to the extent and at the times or upon the happening of the events specified in a limited liability company agreement, a member is entitled to receive from a limited liability company distributions before the member's resignation from the limited liability company and before the dissolution and winding up thereof.

Art 18-606 Delaware LLCA provides:

> Subject to §§ 18-607 and 18-804 of this title, and unless otherwise provided in a limited liability company agreement, at the time a member

[333] The FTT found as a fact that this was the case for Mr Anson's LLC, see *Swift v HMRC* [2010] UKFTT 88 (TC) at [6](1). I expect the same is true of every LLC.

> becomes entitled to receive a distribution, the member has the status of, and is entitled to all remedies available to, a creditor of a limited liability company with respect to the distribution. A limited liability company agreement may provide for the establishment of a record date with respect to allocations and distributions by a limited liability company.

Art 18-607 Delaware LLCA provides:

> (a) A limited liability company shall not make a distribution to a member to the extent that at the time of the distribution, after giving effect to the distribution, all liabilities of the limited liability company, ... exceed the fair value of the assets of the limited liability company

Art 18-804 Delaware LLCA provides:

> (a) Upon the winding up of a limited liability company, the assets shall be distributed as follows:
> (1) To creditors, including members and managers who are creditors, to the extent otherwise permitted by law, in satisfaction of liabilities of the limited liability company (whether by payment or the making of reasonable provision for payment thereof) ...
> (2) Unless otherwise provided in a limited liability company agreement, to members and former members in satisfaction of liabilities for distributions under § 18-601 or § 18-604 of this title...
> (b) A limited liability company which has dissolved:
> (1) Shall pay or make reasonable provision to pay all claims and obligations, including all contingent, conditional or unmatured contractual claims, known to the limited liability company;
> (2) Shall make such provision as will be reasonably likely to be sufficient to provide compensation for any claim against the limited liability company which is the subject of a pending action, suit or proceeding to which the limited liability company is a party; and
> (3) Shall make such provision as will be reasonably likely to be sufficient to provide compensation for claims that have not been made known to the limited liability company or that have not arisen but that, based on facts known to the limited liability company, are likely to arise or to become known to the limited liability company within 10 years after the date of dissolution...

90.44.6 *Liability for debts*

Art 18-303 Delaware LLCA provides:

> (a) Except as otherwise provided by this chapter, the debts, obligations and liabilities of a limited liability company, whether arising in contract,

> tort or otherwise, shall be solely the debts, obligations and liabilities of the limited liability company, and no member or manager of a limited liability company shall be obligated personally for any such debt, obligation or liability of the limited liability company solely by reason of being a member or acting as a manager of the limited liability company.[334]

Turning to the question of whether a LLC is liable for a member's debts:

> 18-703. Member's limited liability company interest subject to charging order.
> (a) On application by a judgment creditor of a member or of a member's assignee, a court having jurisdiction may charge the limited liability company interest of the judgment debtor to satisfy the judgment. To the extent so charged, the judgment creditor has only the right to receive any distribution or distributions to which the judgment debtor would otherwise have been entitled in respect of such limited liability company interest...
> (d) The entry of a charging order is the exclusive remedy by which a judgment creditor of a member or a member's assignee may satisfy a judgment out of the judgment debtor's limited liability company interest and attachment, garnishment, foreclosure or other legal or equitable remedies are not available to the judgment creditor, whether the limited liability company has 1 member or more than 1 member.
> (e) No creditor of a member or of a member's assignee shall have any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the limited liability company.

90.44.7 *Ownership of assets*

Para 18.701 Delaware LLCA provides:

> A member has no interest in specific limited liability company property.

90.45 LLC: Entity categorisation

90.45.1 *LLC: Partnership?*

A LLC is not a partnership in US law. That does not mean that:

[334] For completeness, this continues:

> (b) Notwithstanding the provisions of subsection (a) of this section, under a limited liability company agreement or under another agreement, a member or manager may agree to be obligated personally for any or all of the debts, obligations and liabilities of the limited liability company.

But that must be true of all entities.

(1) It *cannot* be classified as a partnership in the general UK law sense; or

(2) References in a UK statute to a partnership cannot (in context) include an LLC.

In *Anson* the FTT seem to say that an LLC is (or more accurately, that Mr Anson's LLC was) a partnership in the UK law sense:[335]

> [1] [The LLC] stands somewhere between a Scots partnership and a UK company, having
>
> [a] the partnership characteristics of the members being entitled to profits as they arise and owning an interest comparable to that of a partnership interest, and
>
> [b] the corporate characteristics of carrying on its own business without liability on the members and there being some separation between Managing Members and other members falling short of the distinction between members and directors.
>
> [2] Since we have to put it on one side of that dividing line we consider that it is on the partnership side ...[336]

The FTT did not have to determine whether the LLC was a partnership, the question it had to decide was a different one.[337] None of the courts on appeal addressed this classification issue directly.

It is considered that an LLC is not to be classified as a partnership in UK law, because the *definition* of partnership in UK law requires that the partnership business is carried on by the partners; and that is not the case for an LLC.[338] An LLC may have partnership-like features, as the FTT found that it did, but it is still not classified as a partnership in UK law, if it does not meet the statutory definition.

[335] Reported under the pseudonym *Swift v HMRC* [2010] UKFTT 88 (TC) at [52]. The SC commented [2015] UKSC 44 at [37]:

> "given the points of similarity, the comparison made by the FTT between the LLC and a Scottish partnership was understandable".

This leaves the classification of entity question open.

[336] The FTT added "...particularly in relation to its income". But it is not possible that an entity is a partnership in relation to its income and not in relation to its capital gains.

[337] See 90.47.1 (LLC: Other tax issues).

[338] See 90.44.4 (Who carries on LLC business); 90.3 (Entity classification test(s)).

90.45.2 *LLC: Body corporate/company*

The Delaware LLCA does not use the term "body corporate"; perhaps this term is regarded as archaic and not much used in US domestic law. But a LLC is classified as a body corporate in UK law, as meets the requirements of a body corporate: it has legal personality, perpetual succession, and state sanction.[339]

A consultation paper on Guernsey LLCs provides:[340]

> An LLC may, most naturally, fall to be described as a body corporate with legal personality, notwithstanding that the intention is that it would not, by default, be taxed as a company.

The position is the same for a Bermuda LLC. Section 31(6) [Bermuda] LLCA 2016 provides that a Bermuda LLC is:

> a separate legal entity, the existence of which as a separate legal entity shall continue until the LLC is dissolved, and the LLC shall not be dissolved by reason only that the LLC has no members.

Section 9(3) [Cayman Islands] Limited Liability Companies Law 2016 expressly provides that a LLC is a body corporate:

> a limited liability company shall be a body corporate (with legal personality separate from that of its members from time to time)...[341]

On the basis that a LLC is a body corporate and not a partnership, it is a company within the standard tax definition.[342]

[339] See 90.44.2 (Legal personality); 90.44.3 (Perpetual succession); 90.9.3 (What is a body corporate?).
A Canadian court reached a similar conclusion in *Boliden Westmin v British Columbia* [2007] BCSC 351. A Nevada LLC had hallmarks of a corporation: limited liability, legal personality, shares of some sort though of a different name, right to deal with property, to contract, to sue, in its own name. The LLC was a corporation for Canadian tax purposes. The Court applied a resemblance test not quite the same as UK law; see too 90.5 (Foreign law classification/treatment) for possible differences between Canadian and UK entity classification.

[340] States of Guernsey, "Consultation on the potential enactment of LLC legislation in Guernsey" p.8 (2019).
https://www.wearguernsey.com/media/6971/llc-consultation-report.pdf

[341] The wording is derived from s.1(2) LLPA 2000.

[342] See 90.8 (Definition of "company").

90.45.3 *Jersey LLC: a body corporate?*

Jersey appears to be different. Section 2(2) Limited Liability Companies (Jersey) Law 2018 provides:

> A limited liability company has legal personality that is separate from that of its members but is not a body corporate.

The Guernsey consultation paper comments:[343]

> ... some jurisdictions have provided for an LLC to have legal personality, without being a body corporate. It is thought that this may be
> [1] to assist in determining domestic tax treatment and/or
> [2] to strengthen the argument that other jurisdictions should not treat LLCs (or at least those which have not elected to be taxed as companies) as companies for tax purposes in those jurisdictions.

Point [2] does not work, or at least, not in the UK, because whether an entity is a body corporate in the UK depends on whether it fits the UK criteria of a body corporate (which a Jersey LLC actually does). In other words, it is a matter for Jersey law to decide if a Jersey LLC is a body corporate in Jersey law, but it is a matter of UK law to decide if a Jersey LLC is a body corporate in UK law.[344] If it is desired "to strengthen the argument" that the UK should not treat a Jersey LLC as a company for UK tax purposes, that can only be achieved by altering the *characteristics* of a LLC, not by giving it a different label. "The manufacture of a five-pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade."[345]

I would be grateful for any reader who could identify discussion on the Jersey provision, but an unsympathetic commentator may regard it as no more than an attempt to pull the wool over the eyes of a foreign revenue.

90.46 LLC: US tax credit

This section considers the position of UK resident members of an LLC who do not qualify for the corporate US tax credit relief because:

[343] States of Guernsey, "Consultation on the potential enactment of LLC legislation in Guernsey" p.8 (2019) *https://www.weareguernsey.com/media/6971/llc-consultation-report.pdf*

[344] See 90.4.1 (English language terminology).

[345] *Street v Mountford* [1985] AC 809 at p.819.

(1) they are not companies, or
(2) they are companies but hold less than 10% of the votes in the LLC.[346]

In *Anson v HMRC* the taxpayer was a member of a Delaware LLC. For US tax purposes, the LLC was treated as a partnership, and transparent in the sense that the taxpayer was liable to US tax on his share of the LLC profits. Anson was a remittance basis taxpayer, but remitted the income (less US tax) to the UK, and so was liable to UK income tax on the amount remitted.

The taxpayer was an individual and so did not qualify for corporate tax credit. He claimed DTA Tax Credit under art 24(4)(a) USA/UK DTA[347] and Unilateral Tax Credit.[348] There was no material difference between these[349] and I refer to the current DTA.

So far as relevant, art 24(4)(a) USA/UK DTA provides:

> United States tax ... shall be allowed as a credit against any UK tax computed by reference to the same ... income ... by reference to which the United States tax is computed.[350]

SC held that this relief applied.

I think an unstated intuition underlying the SC (and FTT) decisions is that the US and UK taxes combined, then amounting to a 67% tax rate, would be egregious double taxation, and the DTA should be construed to prevent that.[351]

The FTT noted that its decision was limited to Anson's LLC and may not be of general application,[352] but it has been said that Anson's LLC did not have any particularly unusual features.[353]

[346] See 90.48 (LLC: Corporate tax credit).

[347] *Anson* also claimed relief under the previous DTA, but there was no material difference between them, so I refer only to the current DTA. For side by side comparison of these DTAs, see *https://www.foreigndomiciliaries.co.uk/index.php/Documents_archive*

[348] See 111.1 (Credit for foreign tax).

[349] *Anson v HMRC* [2015] UKSC 44 at [27].

[350] See 111.5 (Same income rule).

[351] See 107.4 (Co/shareholder double taxation).

[352] [2010] UKFTT 88 (TC) at [17].

[353] Sullivan & Cromwell LLP, "Recent Developments Regarding Entity Classification for UK Tax Purposes" (2013) *https://www.lexology.com/library/detail.aspx?g=7eee05e2-6afe-41c7-86a7-51842386586a*

90.46.1 *Anson: Findings of fact*

The key findings of fact were as follows. The FTT identified art 18-101(10) and art 18-503 Delaware LLCA as particularly important[354] and continued:[355]

> This means that the profits do not belong to the LLC in the first instance and then become the property of the members because there is no mechanism for any such change in ownership, analogous to the declaration of a dividend. It is true ... that the assets representing those profits do belong to the LLC until the distribution is actually made but we do not consider that this means that the profits do not belong to the members... Conceptually, profits and assets are different, as is demonstrated by the reference to both in the definition of "limited liability company interest" ... Accordingly, our finding of fact ... is that the members of [the LLC] have an interest in the profits of [the LLC] as they arise.

There was some debate about what the FTT actually found. The UT and CoA understood the FTT's finding that the profits belonged to the members as meaning the members had a proprietary entitlement to the profits. But the SC held that this was not the finding of fact:

> [38] ... It is clear from the FTT's decision that it understood that, as it said, "conceptually, profits and assets are different". It also understood that the assets of the business were the property of the LLC. It based its conclusion that "the profits belong as they arise to the members" not upon a confusion between profits and assets, but upon the expert evidence as to the combined effect under Delaware law of sections 18-101(8) and 18-503 of the LLC Act, which respectively defined a member's interest in an LLC as his share of profits and losses, and required the profits and losses to be allocated among the members in the manner provided in the LLC agreement, and article IV of the LLC agreement itself, which required all income and expenditure to be respectively credited and debited to the members' capital accounts in accordance with their profit shares. The natural reading of the FTT's decision, in those circumstances, is that when it described the profits as belonging to the members it was referring to a right *in personam* rather than a right *in rem*...
> [51] ...The questions whether the members had a right to the profits,

[354] See 90.44.5 (Members entitlement to LLC profit).

[355] [2010] UKFTT 88 (TC) at [10].

> and as to the nature of that right, were questions of non-tax law, governed by the law of Delaware. The FTT's conclusion, whether correctly construed
>
> [1] as a finding that Delaware law had the effect of conferring on the members of the LLC an automatic statutory (or contractual) entitlement to the profits of the LLC, or
>
> [2] as a finding that Delaware law vested the members with a proprietary right to the profits as they arose,
>
> was on either view a finding of fact. Secondly, domestic tax law - in this case, the relevant double taxation agreements as given effect in UK law - then fell to be applied to the facts as so found...
>
> [119] It is relevant to note, in the first place, that the rights of a member of the LLC were found to arise from the LLC Act, combined with the LLC agreement. Secondly, that agreement was not a contract between the LLC and its members: the LLC was not a party to it, but was brought into being by it, on the terms set out in it and in the provisions of the LLC Act. It was thus the constitutive document of the LLC. It was against that background that the FTT made findings which contradict the premise that the profits belong to the LLC in the first instance and are then transferred by it to the members. Their conclusion, on the contrary, was that, under the law of Delaware, the members automatically became entitled to their share of the profits generated by the business carried on by the LLC as they arose: prior to, and independently of, any subsequent distribution.
>
> [121] Mr Anson was entitled to the share of the profits allocated to him, rather than receiving a transfer of profits previously vested (in some sense) in the LLC, it follows that his "income arising" in the US was his share of the profits. That is therefore the income liable to tax under UK law, to the extent that it is remitted to the UK. There is no dispute as to the income which was taxed in the US: that was Mr Anson's share of the profits of the LLC. Mr Anson's liability to UK tax is therefore computed by reference to the same income as was taxed in the US. He accordingly qualifies for [Foreign Tax Credit relief under art 24(4)(a) USA/UK DTA].

The SC were therefore saying it didn't matter whether the FTT was describing a proprietary or non-proprietary contractual entitlement (if the non-proprietary entitlement here can be described as contractual).

If the members did have a proprietary entitlement to the profits, even the CoA would have agreed that the income on which Mr Anson was taxable in both countries was the same. But the SC said that it didn't matter whether they had a merely contractual entitlement. It was sufficient for the

FTT to find that Mr Anson was entitled to the profits and therefore the income he was liable to UK tax on was the same as in the US.

90.46.2 *HMRC ability to challenge facts*

HMRC revised their view in the INTM in December 2023. I refer to this as the HMRC post-2023 view.

> **INTM180050 HMRC view of Delaware LLCs in light of Anson** [Dec 2023]
> The Supreme Court held that if Mr Anson was entitled to the share of profits allocated to him, rather than receiving a transfer of profits previously vested (in some sense) in the LLC, it followed that his "income arising" in the US was his share of profits. Based on the FTT's findings of fact, the Supreme Court held that Mr Anson was entitled to DTR as he was liable to UK and US taxes on his share of the profits.

The Manual continues:

> The Supreme Court held that the FTT's finding that the profits did not belong to the LLC in the first instance and that the members had an interest in the profits as they arose was a finding of fact on foreign law. As such, it is not binding in subsequent cases.

Of course courts do from time to time make wrong findings of foreign law, and foreign law is classified as fact, and so there are no binding precedents.[356]

90.46.3 *HMRC view of LLC law*

HMRC say:

> **INTM180050 HMRC view of Delaware LLCs in light of Anson** [Dec 2023]
> ... In reaching this finding, the FTT regarded it as important
> [1] that Del s18-101(8) (now re-written to s18-101(10)) defined a LLC Interest as "a member's share of the profits and losses of a [LLC] and a member's right to receive distributions of the [LLC's] assets" and
> [2] that Del s18-503 provided a default rule for the allocation of profits and losses among the members, and noted the US tax returns showed that the whole of the book profits were allocated to the members' capital accounts.

[356] See 90.60 (Ascertaining foreign law).

> [3] The FTT considered that the terms of the LLC agreement in view of s18-503 meant that profits allocated to the members' capital accounts evidenced a liability to the members.
>
> Based on HMRC's understanding of Delaware LLC law (as at 06 December 2023), and contrary to the conclusion reached by the FTT in *HMRC v Anson (sub nom Swift)* [2010] UKFTT 88 (TC), HMRC continue to believe that the profits of an LLC will generally belong to the LLC in the first instance and that members will generally not be treated as "receiving or entitled to the profits" of an LLC (see INTM180040). HMRC consider the following provisions of the Delaware LLC Act in particular support this conclusion:
> a) The LLC will usually carry on the business (Del s18-106(a))[357], and incur the expenses and receive the income, which gives rise to the profits.

That is correct.

> It is the LLC which earns the profits rather than the members.
> b) LLCs are separate legal entities distinct from its members (Del s18-201(b)).[358] They are therefore capable of receiving and being entitled to profits.

That is correct as far as it goes.

> c) The LLC will usually own the assets which are used in carrying on the business. The members have no interest in specific property of the LLC (Del s18-701).
> d) The LLC will usually be responsible for the debts, obligations and liabilities of the LLC (Del s18-303). Any losses suffered are, like profits, those of the LLC.
> e) Members only achieve the status of a creditor to the LLC with regards to their economic interest in the LLC when they become entitled to a distribution (Del s18-606).
> f) A member is only entitled to receive an interim distribution to the extent provided by the LLC agreement (Del s18-601). Furthermore, the LLC would not be permitted to make a distribution to the extent that the LLC is insolvent or would make the LLC insolvent (Del s18-607).

Would a partnership be so permitted?

[357] See 90.44.4 (Who carries on LLC business).

[358] See 90.45.2 (LLC: Body corporate/company)?

> g) Creditors of members have no right to the property of the LLC. It is only where a court makes a charging order against a member's "LLC Interest" that a creditor will have a right to receive any distribution which the member would otherwise have been entitled in respect of such "LLC Interest" (Del s18-703).
>
> h) On a winding up of the LLC, assets have to be distributed to the creditors of the LLC ahead of members (Del s18-804)

HMRC say:

> i) The LLC is bound by the LLC agreement and is therefore party to it (Del s18-101(9) and *Seaport Village Ltd v Seaport Village Operating Company LLC* CA No 8841-VCL (Del Ct Ch 24 September 2014)). In HMRC's view, the LLC agreement along with the Delaware LLC Act provide the mechanism for the transfer of profits from the LLC to the members.

An LLC was clearly bound by an LLC agreement because that is what the Delaware LLC Act says; s18-101(9). But that does not mean that an LLC is *party* to the LLC agreement. It should be clear from the LLC agreement who are the parties: they are the persons named in the agreement and who are said to make or enter into it. Perhaps in practice LLCs are sometimes party to the agreement, but that was not the case in *Anson*.

> HMRC does not believe Del s18-101(10) or Del s18-503 are significantly relevant (as also indicated by the fact that neither appear in the in the Revised Uniform LLC Act (RULLCA) or the LLC Acts of many US states).

It is a question of US law, but I wonder whether RULLCA (or the LLC Acts of other States) is significantly relevant to Delaware law. The RULLCA might perhaps provide context, but I would have thought that you need to look at the LLC Act of the relevant State.

> HMRC understands that the purpose of Del s18-101(10) is to distinguish a member's transferrable economic interest in an LLC and other non-economic interests (such as the right to vote and inspect the records) which are transferrable only with consent - see Del s18-702 and s18-301 to s18-305. The RULLCA achieves the same result by including a definition of "transferrable interest", which refers solely to a member's right to a distribution, and confirming that a transfer of such an interest does not entitle the member to participate in the management of or have access to the records of the LLC (RULLCA s102(24) and s502(a)(3)). The fact that a member's economic interest in an LLC is transferrable

may compensate for the fact that they cannot withdraw assets unilaterally.

The Official Comment to RULLCA s404 "Sharing of and Right to Distributions before Dissolution" suggests the reason why it does not contain a provision equivalent to s18-503 is because "[c]apital accounts are maintained for one purpose, to determine how distributions will be made to members…If the statute has a simple default rule for how distributions are to be made to the members, providing an additional set of default profit and loss allocation provisions and capital account rules will be, at best, duplicative and, at worse, inconsistent with the distribution rules.".

HMRC also understands that the default rule in Del s18-503 (allocation of profits and losses), and indeed in Del s18-504 (allocation of distributions), is unlikely ever to apply in practice because if there is no agreement as to how the members will share in the capital and distributions of the LLC, it is unlikely that there would be the necessary agreement to be members in the first place. Furthermore, Del s18-503 itself states that the profits and losses are "of" the LLC which then have to be allocated amongst the members.

Contrary to the FTT's view, HMRC understands that an allocation of profits to a member's capital account does not evidence a liability to the member. Capital accounts are an equity concept and therefore appear in the equity, rather than the liability, section of the LLC's balance sheet. HMRC understands that a positive balance on a member's capital account does not provide a member with a right to a distribution. A member will only be entitled to a distribution to the extent provided by the LLC agreement and LLC Act, as above. Member creditors cannot seek recovery out of LLC assets merely by virtue of profits being allocated to a capital account. A member's capital account therefore represents the member's share of the net worth of the LLC and is fundamentally no different to a shareholder's net worth share of a corporation.

HMRC also understands that if an LLC were to elect to be treated as a corporation for US tax purposes, such capital accounts would not be expected to feature. It is usually only as a consequence of an LLC being treated as a partnership for US tax purposes that they are maintained. How the LLC elects to be treated for US tax purposes however does not fundamentally change the rights of the members to the profits of the LLC.

Whilst the FTT were correct to note that profits and assets are different concepts, there must be a correlation between the two (see

INTM180040).[359]

HMRC conclude:

> A member of a Delaware LLC will not therefore usually receive or be entitled to the profits of the LLC for the purposes of s8 ITTOIA because the LLC would normally carry on the business on its own behalf and earns the profits which belong to the LLC in the first instance. The fact that LLCs display 'strong entity shielding' such that its assets are protected from the members and creditors of members supports the conclusion that members are not entitled to the profits for the purposes of s8 ITTOIA (see INTM180020 and INTM180040). Whether the LLC is treated as a partnership (or is disregarded) or company for US tax purposes makes no difference to this analysis.

An assessment of the strength of the HMRC position requires expert US law advice. Unless US experts generally form the view that HMRC was right, a rerun of the *Anson* litigation seems very likely.

It might be that the availability of FTCR in *Anson* is further supported by provisions elsewhere in the 2001 DTA.[360]

90.47 LLC: Transparency

Needless to say, the transparency-factors test[361] does not answer the question of whether LLC's are transparent, in the sense that LLC income arises to the members, because key factors are disputed:

Factor	**Suggestive of**	**See**
1: Legal personality	Opacity	90.44.2
2: Share capital or something like it?	*Disputed; FTT say no*	90.55.13
3: Entity carries on the business	Opacity	90.44.4
4: Members entitled to profits as they arise?	*Disputed*; *FTT say yes*	90.44.5

[359] The relevant passage provides:
"Note that in *HMRC v Anson* [2010] UKFTT 88 (TC), the US expert appearing on behalf of Mr Anson made the point, accepted by the First Tier Tribunal, that profits and assets are different concepts. That is correct, but there must be a correlation between the two in the accounts. When profits are earned, the balance sheet will reflect a correlating increase in net assets. When profits are withdrawn or distributed, there will be a correlating decrease in net assets. It is therefore relevant to establish the rights of members to the assets when considering whether the correlating profits belong to them as they arise."

[360] See 111.8.1 (Treaty-source rules).

[361] See 90.7.2 (Transparency-factors test).

5: Liability for debts on the entity	Opacity	90.44.6
6: Ownership of assets by the entity	Opacity	90.44.7

The INT Manual provides:

> **INTM180050 HMRC view of Delaware LLCs in light of Anson** [Dec 2023]
> For the reasons stated above,
> [1] HMRC generally regard members of Delaware LLCs as not being in receipt of or entitled to the profits of the LLC and
> [2] individual members will therefore only be liable to UK tax on any dividends or other distributions from the LLC (see SAIM5020 and SAIM5210 for guidance on the charge to tax on dividends and other distributions from UK and non-UK resident companies, and CTM15100 for general guidance on distributions). They will therefore be taxed at the dividend rate and entitled to dividend allowance (see SAIM1080). If the LLC is treated as a partnership or is disregarded for US tax purposes such that the member suffers US tax on their share of the profits, they will not be entitled to DTR (as the same profits, income or gains would not be taxed in both countries – see INTM161040). Nor will any deduction be available under TIOPA10/S112 in respect of such US tax.

The DTR Manual provides:

> **DT19853A US limited liability companies** [Jan 2020]
> Generally speaking, United States federal income tax is charged on the profits of United States LLCs on the basis that they are fiscally transparent, that is, tax is imposed on the members of the LLC and not on the LLC itself.
> However, for the purposes of UK tax we have taken the view in relation to those LLCs that we have so far considered that they should be regarded as taxable entities and not as fiscally transparent. Accordingly, we tax a UK member of an LLC by reference to distributions of profits made by the LLC and not by reference to the income of the LLC as it arises. ...

LLCs are said to be opaque on the HMRC transparent/opaque list.

90.47.1 *LLC: 1st ground of appeal*

The Supreme Court in *Anson* went to some length to distinguish two questions:

(1) The actual question in *Anson*: was UK tax “computed by reference to

the same income by reference to which the US tax was computed" (within the meaning of the DTA).[362]

(2) The actual question in *Memec*: were dividends paid by the company to a person, when the dividends were:
   (a) paid by the company but
   (b) received by person who was not a shareholder of the company, but a member of a stille Gesellschaft which was the shareholder[363]

The SC decided *Anson* on the narrowest possible basis. It decided foreign tax credit applied. It did not decide other questions. Most importantly, it did not decide whether Anson's income from the LLC should be regarded for UK tax purposes as:

(1) dividend income or
(2) the same income (trading income) as received by the LLC

In other words, was the source of the member's LLC income the LLC or the trade; ie was the LLC transparent in that sense?[364]

SC noted that "source" in art 24 had a different meaning from source in UK domestic tax.[365]

This question did not arise in *Anson*, though they obviously affect other taxpayers. Eg a UK domiciled taxpayer would need to know whether they received trading or dividend income, as different rates apply.

It is generally supposed, assuming *Anson* was correctly decided, that the answer to question (1) is that the LCC was transparent for UK tax purposes, in the sense that its members received trading income.

[362] at [109]: "The issue in this case is not whether the receipts of the LLC from third parties are to be regarded as having been paid to the members of the LLC, but whether the income on which Mr Anson paid tax in the US is the same as the income on which he is liable to tax in the UK."

[363] See 90.30.2 (UK tax analysis); 91.7.9 (Hybrids: art.24 tax credit).

[364] Other questions not decided in *Anson* are:
(1) Whether income of the LLC was "paid" by the LLC to the members so that it could qualify for a US tax credit under art. 24(4)(b) USA/UK DTA, ie, is the LLC transparent in that sense?
(2) If a member received capital gains accruing to the LLC, whether:
   (a) these should be regarded as the same gains, or indeed,
   (b) whether they should be regarded as gains (rather than income)?
(3) Whether the LLC was a partnership for UK tax purposes (though I think it is clear that it was not).

[365] [2015] UKSC 44 at [97] - [100].

But it seems to me equally consistent with *Anson* to say:

(1) The income of the member is "the same" as the income taxed in the US for the purposes of DT tax credit relief but:

(2) (a) The income is the income of the LLC

(b) What the member receives is a distribution (not income of the type which the LLC receives)

This is on the basis that the test of what is "the same" is loose and pragmatic, and need not be determined by reference to UK concepts of source. We are construing a DTA and not a UK tax statute.

Against this view is the fact that the SC rejected the first ground of appeal. The ground was that, "assuming that:

(1) US tax was charged on the profits of the LLC, and

(2) that Mr Anson was liable to UK tax only on distributions made out of those profits",

the US and UK tax were nevertheless charged on "the same profits or income", within the meaning of the DTA.[366]

SC said:

> In relation to the first ground of appeal, the argument advanced on behalf of Mr Anson focused on the provision made in article 23(2)(a) in respect of dividends. The argument runs as follows. When UK tax is payable on a dividend received from a US corporation, and US tax has been paid by the corporation on the profits out of which the dividend was paid, there can be no question of the UK tax being "computed by reference to the same profits or income" as the profits of the corporation, if the source of the income is identified on the basis of UK (or, indeed, US) tax law. A dividend is a paradigm case of income which does not have the same source, under UK or US tax law, as the profits out of which it is paid.

The argument went on to say that certain parts of the DTA showed that this rule did not apply, and that argument was rejected. It seems to me that this does not decide the question because it is not looking at the position of LLCs in particular, but at US corporations in general.

The LLC income and the member's income are *mathematically* equal. That alone is not enough. Suppose a person ("the lender") holds a contractual right such as a profit participating loan. The payment under the loan is not the same as the income of the borrower, even if it

[366] See at [53].

mathematically equal to the income. One might ask if they are the same in economic reality, but I do not think that references to reality help much if at all.[367] The key difference is that the LLC member's right arises *under the constitution* of the LLC; in the case of the profit related loan, the lender's right arises under a contract which is independent of the constitution of the borrower. On this basis *Anson* and *Memec* may be reconciled.

90.47.2 *Tax return disclosure*

A taxpayer may wish to argue against the HMRC view. It would be necessary to disclose the position taken in the tax return.[368]

The INT Manual provides:

> **INTM180050 HMRC view of Delaware LLCs in light of Anson** [Dec 2023]
> If any customer requires confirmation of HMRC's view of whether a particular US LLC will be treated as transparent or opaque for the purposes of determining what profits, income or gains a member will be liable to UK tax on, they should contact the Base Protection Team following the guidance at INTM180060.

No-one would expect applications for clearance, as the HMRC view seems clear enough. Perhaps the point is to make it easier to criticise taxpayers who take a view on the transparency issue without disclosing it.

90.47.3 *Re-opening closed years*

HMRC Brief 15/2015 provided:

> *HMRC has after careful consideration concluded that the decision is specific to the facts found in the case.... Individuals claiming double tax relief and relying on the Anson v HMRC decision will be considered on a case by case basis.*[369]

"Considered on a case by case basis" was not exactly guidance, but I took

[367] See 7.1 (What do we mean by "Real"?); 7.9.2 (Cardinal principle affirmed).

[368] See 122.9 (When disclosure required).

[369] Brief 15/2015 "HMRC response to the Supreme Court decision in *Anson v HMRC*" *https://www.gov.uk/government/publications/revenue-and-customs-brief-15-2015-hmrc-response-to-the-supreme-court-decision-in-george-anson-v-hmrc-2015-uksc-44/revenue-and-customs-brief-15-2015-hmrc-response-to-the-supreme-court-decision-in-george-anson-v-hmrc-2015-uksc-44*

the statement to mean that if the facts were the same as *Anson* (ie if the LLC agreement had the same effect as in *Anson*) then the same result would follow.

> **INTM180050 HMRC view of Delaware LLCs in light of Anson** [Dec 2023]
> This guidance is to provide further clarification[370] of HMRC's view of LLCs following Anson with regards to who the profits belong to and the availability of DTR.

The HMRC 2023 view differs materially from the view expressed earlier, because previously the issue was to be considered on a case by case basis, but now there is a general rule. There is no discussion of transitional issues.

> If an individual member has claimed double taxation relief in respect of US tax on the profits, income or gains of a LLC, or any customer has otherwise self-assessed on the basis that the profits belong to the members rather than the LLC, HMRC will consider opening an enquiry or making a discovery assessment in accordance with its normal risk-based approach.
> (This content has been withheld because of exemptions in the Freedom of Information Act 2000)

In the 2023/24 edition of this work I said:

> UK resident members of an LLC should check that, as was held to be the case in *Anson*,[371] the LLC is under an obligation to distribute its profits as they arise, (ie it does not have power to retain its profits). I expect that is generally the case. Provided that is so, they should on the basis of *Anson* be entitled to foreign tax credit relief.

If HMRC seek to re-open closed years, the position is likely to turn on whether the tax return met the full-disclosure requirement.[372]

90.47.4 *LLC: Tax planning*

Where a LLC has a UK resident member, subject to US advice, solutions to the difficulties and uncertainties might be:

[370] See App 1.2 (Clarify/modernise/reform).

[371] though in *Anson* the LLC operating agreement was not as clear as it might have been.

[372] See 121.10 (Full-disclosure requirement). It is also possible that an established practice defence could be made out; see 121.9.3 (Prevailing practice defence).

(1) to arrange that the entity is transparent in both USA and UK, by converting it into a limited partnership
(2) to arrange that the entity is opaque in both USA and UK:
  (a) transfer the LLC (or the member's interest in it) to a holding company
  (b) convert the LLC into a corporation or
  (c) elect that the LLC is treated as a corporation for US tax purposes
(3) for a remittance basis taxpayer, not to remit the income

See too 26.31.3 (S corp/LLC lender); 90.58 (Change of entity type).

90.47.5 *UK source income of LLC*

The DTR Manual provides:

> **DT19853A USA: US limited liability companies** [Jan 2020]
> ... If an LLC derives income from the UK, the question arises of whether it is entitled to claim relief from UK tax under the agreement. A key issue is whether, under the conditions laid down in the agreement, which in this respect does not follow the approach of the OECD Model (DT153), the LLC can be said to be a resident of the United States. In our view an LLC cannot be said to be a resident of the United States within the terms of the agreement:
> [1] it is not a United States corporation,
> [2] nor is it a person resident in the United States for the purposes of United States tax (because the United States taxes the profits of an LLC not on the LLC itself but on its members).

HMRC may be right to say that the LLC is not a "resident of the USA" as defined in the USA/UK DTA. But HMRC do not take the point:

> However, we decided as a matter of practice that, in order to relieve double taxation under the agreement where tax would otherwise be imposed on the same income both in the UK and in the United States, we will accept claims to relief from UK tax under the agreement from an LLC, but only to the extent that the income in question is subject to United States tax in the hands of those members of the LLC who are residents of the United States. Subject to the same condition, we will pay a full tax credit to a United States LLC, less the 15% deduction provided for by Article 10(2)(a)(ii) of the agreement.
> Under the new [2001] Agreement, this practice is formalised by Article 1(8).[373]

[373] See 91.4.3 (USA hybrid-entity rule).

90.48 LLC: Corporate tax credit

Art. 24(4)(b) USA/UK DTA provides foreign tax credit for underlying tax paid by a company:

> in the case of a dividend
> [i] paid by a company[374] which is a resident of the United States
> [ii] to a company
> [a] which is a resident of the UK and
> [b] which controls directly or indirectly at least 10% of the voting power in the company paying the dividend ...

I refer to that as **"corporate tax credit"**. This will apply to an LLC if it elects to be treated as a US corporation (and so pays US tax).[375]

The INT Manual provides:

> **INTM180050 HMRC view of Delaware LLCs in light of Anson** [Dec 2023]
> However, if the LLC is treated as a company for US tax purposes, individual members will be entitled to credit in respect of US tax charged on any distributions from the LLC (subject to the amount the US could tax in accordance with Article 10 of the UK/US DTC and all other conditions being met) or a deduction under TIOPA10/S112 (see INTM161050).
> Likewise, HMRC do not believe corporate members would generally be regarded as being liable to UK tax on the profits of a Delaware LLC (the profits are "of" the LLC, not the corporate member – see CTA09/S2).
> A UK resident corporate member may be entitled to distribution exemption if the relevant conditions have been met (INTM650000).
> However, if the UK corporate member is a small company and the US LLC is treated as a partnership or is disregarded for US tax purposes, that may mean that such exemption will not be available as the US LLC would not be a resident of the US for the purpose of CTA09/S931B.
> If distribution exemption is not available, a UK resident corporate member may be entitled to DTR in respect of any US tax withheld on

[374] Art 3(a)(b) USA/UK DTA defines company in the same way as the OECD Model; see 30.15.4 (Company: DTA definition). An LLC is a company within this definition, for two reasons (either would suffice):
(1) It is a body corporate; or
(2) Assuming an appropriate election is made, it is treated as a body corporate for US tax.

[375] See 111.26 (Credit for underlying US co tax).

> the distributions (subject to the amount the US could tax in accordance with Article 10 of the UK/US DTC and all other conditions being met) and any US tax suffered on the profits (underlying tax) where the conditions of Article 24(4)(b) have been met (see DT19853).

The DTR Manual provides:

> **DT19853A USA: US limited liability companies** [Jan 2020]
> If tax is paid in the United States on the profits of the LLC, we regard that tax as underlying tax (INTM164010) and credit relief is available for it if the member is a UK company which controls, directly or indirectly, at least 10% of the voting power in the LLC.

90.49 US limited partnership

90.49.1 *US law background*

In the USA, most states have adopted the [US] Revised Uniform Partnership Act 2004. I focus on Delaware, but what I say here should apply generally.

A US limited partnership has been described as a hybrid business entity with partnership and company features, though it does not appear to be very different from a Scottish limited partnership.

Section 201(a) [US] Delaware Revised Uniform Partnership Act (DRUPLA) provides:

> A partnership is a separate legal entity which is an entity distinct from its partners unless otherwise provided in a statement of partnership existence or a statement of qualification and in a partnership agreement.

This applies to a limited partnership as well as to a general partnership, because s.202 (a) provides:

> A limited liability partnership is for all purposes a partnership.

A LP is treated as a partnership (and so is fiscally transparent) for US federal tax purposes and not as a taxable unit. US resident partners are subject to US tax on all income arising to a LP.

Blanchard comments:[376]

> Delaware did this to accommodate concerns of non-US investors needing an entity lacking legal personality. Whether this "presto change-o" provision is effective is unclear. ... this provision of Delaware

[376] Blanchard "The Tax Significance of Legal Personality: A U.S. View" (2015):

> law has never been used or tested in the courts. It may be simply window-dressing, intended to fool foreign countries into believing that there is such a thing as a Delaware general partnership that lacks legal personality.

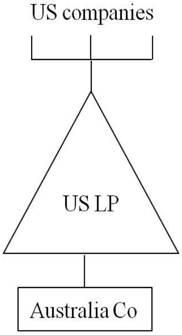
In the UK, legal personality (or not) of a US partnership should make no difference, but it might matter elsewhere.

90.49.2 *Australian analysis of US LP*

The Australian Taxation Office discuss whether a Delaware limited partnership is a "company" for the purposes of the Australia/US DTA:[377]

> **US Limited Partnership: whether it is a company for the purposes of Article 10 of the US Convention**
> **Issue**
> Is a United States limited partnership (US LP), which is treated as a partnership for US federal tax purposes, a company for the purposes of Article 10 of the [US/Australia DTA (1983)[378]] (the US Convention)?
> **Decision**: No...
> US LP is a limited partnership established under the Delaware Revised Uniform Limited Partnership Act (DRULPA). All partners are US resident corporations.
> US LP is not treated as a company by the US for tax treaty purposes because it is treated as a partnership for US federal tax purposes.
> US LP owns all the shares in an Australian resident company. During the income year the Australian resident company paid an unfranked dividend (not assessable income and not exempt income) to US LP, which was legally and beneficially entitled to that dividend.
> US LP would be taxed as a company under Australian domestic law (Division 5A of the Income Tax Assessment Act 1936, ITAA 1936) if it derived Australian source assessable income. US LP is not a resident of Australia under section 94T of Division 5A of the ITAA 1936.

Diagrammatically:



[377] ATO ID 2010/81, 9 April 2010, I have somewhat abbreviated the original text.
[378] *http://www.irs.gov/pub/irs-trty/aus.pdf*

Reasons for Decision

To qualify for benefits under the US Convention the claimant must first be a ‘person’ and a ‘resident’ for the purposes of the US Convention. In this case US LP, being a US domestic partnership, is both a ‘person’[379] and a US ‘resident’[380] according to the terms of the US Convention. Note that the US Convention is unusual in that it applies treaty benefits for income derived through fiscally transparent entities such as a partnership, at the level of the entity (in this instance US LP).

Article 10 of the US Convention provides that certain cross-border inter-corporate dividends flowing between Australia and the US are either:

- subject to a maximum of 5% rate of source country tax if the person beneficially entitled to those dividends is a company which holds directly at least 10% of the voting power in the company paying the dividends (Article 10(2)(a) of the US Convention); or
- exempt from source country tax where the person beneficially entitled to the dividends is a company that has owned shares representing 80% or more of the voting power of the company paying the dividends for a 12 month period ending on the date the dividend is declared, and satisfies certain other conditions (Article 10(3) of the US Convention).

For the reduced dividend withholding tax rates under Article 10(2)(a) or Article 10(3) of the US Convention to apply to an unfranked dividend paid by an Australian resident company, the person beneficially entitled to the dividend must be a ‘company’. Here, the ‘person’ beneficially entitled to the dividends paid by the Australian resident company is US LP.

The question which interests us is whether the US LP is a “company”.

Article 3(1)(b) of the US Convention defines ‘company’ for the purposes of the Convention ‘unless the context otherwise requires’, to mean ‘any body corporate or any entity which is treated as a company or body corporate for tax purposes’.[381]

Accordingly, for the purposes of our analysis, US LP will be a ‘company’ for the

[379] The DTA has US Model wording (unlike the OECD Model) under which “person” includes a partnership: see 9.4.1 (Person: Treaty definition).

[380] Article 4(1)(b)(ii) of the Australia/US DTA provides:

> b) a person is a resident of the United States if the person is:
>
> (i) a United States corporation; or
>
> (ii) any other person (except a corporation or unincorporated entity treated as a corporation for United States tax purposes) resident in the United States for purposes of its tax, provided that, in relation to any income derived by a partnership, an estate of a deceased individual or a trust, such person shall not be treated as a resident of the United States except to the extent that the income is subject to United States tax as the income of a resident, either in its hands or in the hands of a partner or beneficiary, or, if that income is exempt from United States tax, is exempt other than because such person, partner or beneficiary is not a United States person according to United States law relating to United States tax.

(The US/UK DTA is different here).

[381] This is also OECD Model form: see 30.15.4 (Company: DTA definition).

purposes of the US Convention if:

(a) it is a body corporate; or

(b) it is an entity that is treated as a company or body corporate for tax purposes - unless the context of the US Convention otherwise requires.

(a) Is US LP a 'company' for the purpose of the US Convention by virtue of being a 'body corporate' ?

US LP is not a 'company' for the purpose of the US Convention by virtue of being a 'body corporate' for Australian purposes.

The term 'body corporate' is not defined in the US Convention. Thus, in accordance with Article 3(2) of the US Convention, the term will generally take its meaning from the taxation laws of the country applying the tax treaty (being in this case Australia), 'unless the context otherwise requires'. As 'body corporate' is not defined in Australia's domestic income tax law legislation, the ordinary meaning of the term in Australia may then apply.[382]

The ruling then discusses the meaning of "body corporate" in Australia:

The *Butterworths Australian Legal Dictionary*, 1997 defines a 'body corporate' as 'an artificial legal entity having separate legal personality'. The Macquarie Dictionary, 4th ed., 2005 defines 'body corporate' in its legal context, as 'a person, association or group of persons legally incorporated in a corporation'. Generally a 'body corporate' is established under an Act of Parliament or under a statutory procedure of registration, such as the Corporations Act 2001 (refer to paragraphs 22-23 of Taxation Ruling IT 2634 and paragraphs 30-34 of Miscellaneous Taxation Ruling MT 2006/1).

As US LP is created under Delaware state law and has a legal personality under that law, it should be recognised as a legal entity in Australia.[383]

While US LP is a legal entity having legal personality, it is essentially quite different in character from the bodies which are incorporated under corporations law in Australia.

[1] For example, while a corporation continues in existence until it is dissolved notwithstanding changes in its membership or business, a limited partnership formed under the DRULPA is usually formed for a limited period of time and terminates in the same way as a partnership. A corporation in Australia has perpetual succession, a personality that is continuous and free transferability of interests. US LP does not.

[2] Further, the partners of US LP derive the profits made by US LP, [ie LP profits arise to the partners] and a partner's individual share of the profits in US LP is ascertained in accordance with its interest in US LP, rather than on the basis of distributions made.

Notwithstanding, as US LP is an artificial legal entity having a form of separate legal personality, it is prima facie a 'body corporate' under the ordinary meaning of the term in Australia. Although, generally a 'body corporate' has the 'ability to continue in existence indefinitely and to keep its identity regardless of changes to its membership' (see paragraph 30 of MT 2006/1) and US LP does not enjoy such a continued existence.

[382] See 107.12 (Undefined treaty terms).

[383] The ruling refers to *Chaff and Hay Acquisition Committee v Hemphill* which is considered at 90.40.4 (Stichting a treaty-person).

In UK law a Delaware LP is *not* a body corporate. The fact that a partnership has legal personality does not entail the conclusion that it is a body corporate.[384] That is, it seems that "body corporate" may have a different meaning in Australia, though Australian ruling is slightly tentative on the point ("prima facie"). But it turns out not to matter:

> But, as highlighted above, the requirement in Article 3(2) of the US Convention to in this case interpret an undefined term such as 'body corporate' in accordance with Australian taxation law, applies only if the 'context' does not require an alternative interpretation. [The statement makes some general observations on treaty interpretation[385] and continues:]
>
> Paragraph 12 of the OECD Commentary on Article 3 emphasises that the interpretation set out in the 'undefined terms' provision applies 'only if the context does not require an alternative interpretation'.[386] It adds that the 'context' is determined in particular by the intention of the Contracting States, as well as 'the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based)'. However, US federal tax law does not specifically define the term 'body corporate'.
>
> In this case, the OECD Commentary on the definition of 'company' is particularly relevant to the context of the term 'body corporate'. Paragraph 3 of the OECD Commentary on Article 3 provides the following:
>
> > 3. The term "company" means in the first place any body corporate. In addition, the term covers **any other taxable unit** that is treated **as a body corporate according to the tax laws** of the Contracting State in which it is **organised**. The definition is **drafted with special regard to the Article on dividends**.
>
> It follows from the OECD Commentary's statement that the second limb of the term covers any other taxable unit, that the first limb of the definition of 'company' is designed to deal only with entities which are bodies corporate under general law and also taxable units under tax law (which is a central consideration in applying the terms of Australia's tax treaties).
>
> While the requirement for the entity to also be a 'body corporate' for tax law purposes under the first limb is not explicit, treaties should be interpreted more 'liberally' than domestic legislation to smooth over the gaps, imprecision and ambiguities in the treaty text in a way that addresses the context and meets the object and purpose of the treaty. Where the context of a term allows a specific tax law meaning and a non-tax law meaning, the former should prevail (see paragraph 68 of TR 2001/13).
>
> In addition, it is clear from the OECD Commentary on Article 3 that the question of whether a dividend recipient is an entity 'treated as a body corporate' for tax purposes must be made by reference to 'the tax laws of the Contracting State in which it is organised' - and not the state of source. Thus, paragraph 3 of the OECD Commentary on

[384] See 90.9 (Body corporate).

[385] Referring to TR 2001/13; see 107.10 DTA interpretation principles) and following paragraphs.

[386] See 107.12 (Undefined treaty terms).

Article 3 provides with regard to the terms ‘company’ and ‘body corporate’ that the relevant taxation laws to consider are those of the country in which the entity was created (i.e. being the domestic laws that apply to the entity). The ‘context’ requires an examination of US taxation law and not Australian taxation law to determine whether a US entity is a ‘company’ for the purpose of qualifying for the reduced rate of withholding tax on inter-corporate dividends.

Hence, in determining whether an entity is treated as a ‘body corporate’ for tax treaty purposes, reference is not made to the tax law of the country applying the treaty (in this case Australia), unless the entity was organised there. Specifically, as indicated above, the ‘context’ surrounding the terms ‘company’ and ‘body corporate’ in the US Convention, for the purpose of US LP qualifying for the either of the reduced rates of withholding tax on the unfranked dividends paid by the Australian resident company, requires an examination of US taxation law.

Accordingly, to determine whether US LP is a ‘body corporate’ under the US Convention, the relevant consideration is where US LP was organised. US LP was not organised in Australia, but in the US. Hence, the potential Australian tax treatment of US LP (that is, that the entity can be treated as a company for Australian tax purposes by virtue of Division 5A of the ITAA 1936) is irrelevant. Rather, only the US tax treatment of US LP is relevant.

US LP is not a taxable unit and so is not treated and taxed as a ‘body corporate’ for US federal tax purposes - but is treated and taxed as a partnership.

Finally and importantly, paragraph 3 of the OECD Commentary on Article 3 emphasises that the definition of ‘company’ is ‘**drafted with special regard to the Article** on dividends’ and ‘the term “company” has a bearing only on that Article, paragraph 7 of Article 5, and Article 16.’

Paragraphs 10-11 of the OECD Commentary on Article 10 explains the rationale behind reduced taxation rates for inter-corporate dividends as follows:

> 10. On the other hand, a lower rate (5%) is expressly provided in respect of dividends paid by a subsidiary company to its parent company. If a **company** of one of the States owns directly a holding of at least 25% in a company of the other State, it is reasonable that **payments of profits by the subsidiary to the foreign parent company** should be taxed less heavily to avoid recurrent taxation and to facilitate international investment. The realisation of this intention depends on the **fiscal treatment of the dividends** in the State of which the **parent company is a resident**..
>
> 11. If a partnership is **treated as a body corporate under the domestic laws** applying to it, the two Contracting States may agree to modify sub-paragraph (a) of paragraph 2 in a way to give the benefits of the reduced rate provided for parent companies also to such partnership. (Emphasis added)

Paragraph 2 of Article 10 of the OECD Model Tax Convention is not materially different from paragraph 2 of Article 10 in the US Convention, with the exception of the differences in the percentage holding thresholds in the respective treaties.

Klaus Vogel on Double Tax Conventions[387], 1997, 3rd edn. makes the following statements (at pages 583-584 and 599) about paragraph 2 of Article 10 of the OECD

[387] See *Klaus Vogel on Double Taxation Conventions* (4th ed., 2015). The text of the current edition has changed somewhat.

Model Tax Convention:

> Art. 10 is still completely geared to the 'classical' system of company taxation. and is, consequently, based on the conception that it is appropriate to subject income derived by a company (within the meaning of Art. 3(1)(b)MC) to a tax of its own distinct and separate from the tax imposed on the distributions received by a company's shareholders
>
> . the maximum rates on inter-company dividends should differ from those on 'all other' dividends.. Such preferential treatment, however, applies only where direct investments are held by companies and does not apply where a substantial interest is held by an individual or a partnership..
>
> If, under the law of its State of residence, a partnership is considered a body corporate, but is not itself subjected to tax. There would be no justification for allowing it to benefit from the limited rate of 5%, because its interposition actually does not result in any double taxation.

It is apparent, from all of the above, that the intention of Article 10(2) of the OECD Model Tax Convention is to provide reduced rates of withholding tax for dividends derived by companies from direct investments on a reciprocal basis. It would be contrary to the intention of Article 10(2) if the reduced inter-corporate dividend withholding tax rate was to apply where the tax law of the resident country treated the beneficial owner of the dividends as a partnership.

Specifically, in the case of US LP, it would be inappropriate for a partnership formed under US state law and treated as a partnership for US tax purposes, to be able to access the inter-corporate rate of withholding tax for dividends under either Article 10(2) or Article 10(3) of the US Convention. The purpose behind Article 10(2) and 10(3) is to prevent multiple layers of taxation of corporate economic groups. Where the recipient does not have tax imposed (that is, because it is treated as a partnership in its state of residence), the rationale for granting the reduction in (or exemption from) withholding tax disappears.

The context of Article 10 and the OECD Commentary requires the implicit inclusion in the first limb of the definition of 'company', that a 'body corporate' is a taxable unit under the relevant taxation laws. Further, the relevant taxation laws are clearly the domestic laws affecting the entity - that is, those laws under which the entity is organised or created.

US LP is not a taxable unit and not a 'body corporate' for US tax purposes. Therefore, US LP does not satisfy the first limb of the meaning of the term 'company' in Article 3(1)(b) of the US Convention. It follows that US LP will not be a 'company' for the purposes of Article 10 of the US Convention by virtue of being a 'body corporate' for Australian purposes.

(b) Is US LP a 'company' for the purpose of the US Convention under the second limb of the meaning of the term 'company' - that Is to say, is US LP an entity that is treated as a 'company' or 'body corporate' for tax purposes ?

The OECD Commentary on the definition of 'company' (outlined above) makes it clear that, under the second limb of the definition, the determination is to be made by reference to the laws of the State in which the entity is **organised** (in this case US federal tax law). US LP is not taxed as a 'company' or 'body corporate' for US federal tax purposes. Rather it is treated and taxed as a partnership. This is essentially because, although US LP has a form of separate legal personality under Delaware state law, the US federal tax

position is that while state law attributes of an entity control various aspects of business relations, they are not controlling under US tax law (unless the tax law so provides).
[The ruling considers the US tax law and concludes:] US LP is taxed as a partnership unless it elects to be taxed as a corporation. As no such election was made by US LP, it is not a taxable unit and is not taxed as a corporation under the tax laws of the US.
Hence, US LP is not an 'entity that is treated as a company or body corporate for tax purposes' and so does not satisfy the second limb of the meaning of the term 'company' for the purposes of the US Convention.
Conclusion
For the purpose of the US Convention, US LP is neither a 'body corporate' nor an 'entity that is treated as a company or body corporate for tax purposes'. Consequently it is not a 'company' for the purpose of Article 10 of the US Convention, and does not qualify for either of the reduced rates for certain cross-border inter-corporate dividends flowing between Australia and the US.
This is consistent with the US position for tax treaty purposes which is that a US partnership which does not elect to be taxed as a corporation will not be a 'company' for US treaty purposes. The Issues in International Taxation No. 6 'The Application of the OECD Model Tax Convention to Partnerships' report includes the US response to the OECD Partnership Report at page 127. This response states that US partnerships (including limited partnerships such as Delaware limited partnerships, but also US LLCs and LLPs) not electing to be treated as corporations are not considered to be companies for the purposes of US tax treaties.

90.50 Cell companies

90.50.1 *Cells: Background law*

The GI Manual provides:

> **GIM11020 - Captive insurers: tax havens and local organisation** [Aug 2016]
> **Cell companies**
> These take two forms, protected cell companies (PCCs) and incorporated cell companies (ICCs). PCCs were originally developed in Guernsey in 1997, and now exist in other territories such as Jersey, Cayman Islands, Irish Republic and Bermuda. ICCs were developed more recently, in Guernsey and Jersey in 2006.
> The essential difference between them is that an ICC's cells are legal entities in their own right, unlike the cells of a PCC.

A variety of terminology is used. What the Manual here calls protected cells are also called unincorporated cells, which is a clearer term. The Irish Collective Asset-management Vehicle Act 2015 refers to an IVAC as having "sub-funds", but these sub-funds equate to cells of a cell company. We also have "divided company".

> The advantage of cell companies lies in the cost and regulatory time saving in the creation of new cells. Cells of ICCs, with legal personality, can more easily transact with third parties, and the ring fencing is stronger, which is an advantage in relation to use in securitisations and structured financial products. Each cell of the PCC or ICC has the same directors, secretary and registered office as the PCC/ICC but different shareholders.
>
> PCCs were originally developed to make the benefits of captive insurance available to smaller companies by reducing costs. Different classes of business can be written into different cells within one vehicle, with one set of formation costs, a single capital requirement and easier repeat transactions. This improved 'rent a captive' arrangements which formerly relied upon only a contractual separation of assets. ICCs take the separation a stage further.

The INT Manual provides:

> **INTM236500 Cell companies or similar entities and control** [Jun 2018]
>
> A protected cell company PCC can be thought of as being a standard limited company that has been separated into legally distinct portions i.e. cells. The income, assets and liabilities of each cell are kept separate from all other cells. Each cell has its own separate portion of the PCC's overall share capital, allowing shareholders to maintain sole ownership of an entire cell while owning only a small proportion of the PCC as a whole. Legally a PCC is a single company, but each shareholder/investor retains a separate interest in the company. Similar structures to the PCC include the incorporated cell company (ICC) where each cell is treated as a separate incorporated entity to provide greater protection still for the individual shareholder's assets and income.

Cell companies also exist in UK law.[388] Of course what is commercially the same outcome can be reached without cells, by an arrangement under which:

(1) A company holds subsidiaries, and
(2) Shareholders hold shares conferring rights over a specific subsidiary.

90.50.2 *Cells: Legal personality*

Dicey states:

> It is well established that a corporation duly created in a foreign country

[388] Part 4 Risk Transformation Regulations 2017.

> is to be recognised as a corporation in England.[389]

Land Registry practice guide 78 (Overseas companies & LLPs) provides:[390]

> **4.7 Protected cell companies and incorporated cell companies**
> Some jurisdictions provide for protected cell companies and incorporated cell companies. This enables various assets and liabilities of the company to be partitioned off into separate 'cells', which may or may not have a separate legal personality. The precise nature of a protected cell company or incorporated cell company will depend on the law in the territory of their creation. When an application is made to register a protected cell company or incorporated cell company as proprietor of an estate or charge we will need evidence as to the constitution and legal personality of the applicant.
>
> For example, under Guernsey law, a protected cell company is a single legal person and distinct cells within the protected cell company structure are not legal persons. A registered estate or registered charge can therefore be registered only in the name of the protected cell company whether or not the property belongs to the core of the protected cell company or only a cell. If the cell has its own trading name and a specific request is made in the application form or in a letter, then this will be included in the register entry.
>
> In view of the company structure, an application for registration of a protected cell company may be accompanied by an application for entry of a restriction.
>
> Unlike a protected cell company, if an incorporated cell company, under Guernsey law, creates a cell within its structure, each incorporated cell is a separate legal person.

The applicable foreign law governs the legal position elsewhere:

(1) A company with unincorporated cells (a PCC) is one legal person, and the cells are not separate legal persons[391]

(2) Where a company has incorporated cells, each cell is a legal person,

[389] See Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 30R-009 (Status). No doubt the same applies elsewhere.

[390] *https://www.gov.uk/government/publications/overseas-companies-and-limited-liability-partnerships-pg78* (Last updated 10 July 2023)

[391] For a UK Cell company, reg 12(7) Risk Transformation Regulations 2017 deals with the point expressly: " The core and the cells do not have legal personality distinct from the protected cell company, but are nevertheless segregated from each other ..."

and so is the company itself.

The same will apply for UK tax purposes unless the context or specific provision otherwise provides. HMRC agree.[392]

For some purposes the general law analysis is altered by statute:

(1) Offshore funds: see 66.17 (Umbrella arrangements)
(2) CFCs (see below)
(3) Insurance premium tax (see below)

I review these here as (although the topics are some way from the themes of this book) the legislation and Manual discussion confirm the view taken above.

90.50.3 *Cell co: CFCs*

Section 371VE(1) TIOPA provides:

> This Part [Part 9A, CFCs] applies in relation to unincorporated cells and incorporated cells as if they were non-UK resident companies.

Section 371VE TIOPA sets out its definition of unincorporated cell:

> (2) An "unincorporated cell" is an identifiable part (by whatever name known) of a non-UK resident company which meets the following condition.
> (3) The condition is that, under the law under which the non-UK resident company is incorporated or formed, under the articles of association or other document regulating the non-UK resident company or under any arrangement entered into by or in relation to the non-UK resident company—
> (a) assets and liabilities of the non-UK resident company may be wholly or mainly allocated to the part of the company in question,
> (b) liabilities so allocated are to be met wholly or mainly out of assets so allocated, and
> (c) there are members of the non-UK resident company who have rights in relation to the company's assets which cover only or mainly assets so allocated.
> (4) Subsection (1) does not affect the status of the non-UK resident company mentioned in subsection (2) as a company for the purposes of this Part; but its assets and liabilities are to be apportioned between it and the unincorporated cell (and any other unincorporated cells which

[392] See quote from IPT manual: "it is the PCC as a whole that is the corporate body". Also see McCarthy, "Protected Cell Companies and s.13 TCGA" [2009] PCB 316.

> are part of the company) on a just and reasonable basis.

Section 371VE TIOPA then sets out the definition of incorporated cell:

> (5) An "incorporated cell" is an entity (by whatever name known) established under the articles of association or other document regulating a non-UK resident company—
>
> (a) which, under the law under which the non-UK resident company is incorporated or formed, has a legal personality distinct from that of the non-UK resident company, but
>
> (b) which is not itself a company (ignoring this section).

But I would have thought that an incorporated cell would be a company within the standard tax definition.

> (6) Subsection (1) does not affect the status of the non-UK resident company mentioned in subsection (5) as a company for the purposes of this Part.

The INT Manual provides:

> **INTM236500 Cell companies or similar entities and control** [Jun 2018]
> ... [Cell] arrangements can be used to sidestep the CFC rules (including those on control) by allowing UK resident unconnected parties to run their insurance or investment activities alongside each other within the structure whilst only holding a minority of the total shares in the PCC/ICC and only being entitled to a small proportion of the total profits. The intention and effect is quite different to holding a small passive investment in a third party entity. These structures are replicating the effect of each shareholder controlling their own separate entity. Accordingly for the purposes of Part 9A and in particular the control rules each individual cell is be taken to be a non-UK resident company in its own right.
> [The Manual sets out the relevant definitions and continues]
> So in determining whether an individual cell should be taken to be a CFC for the purposes of Part 9A, the control rules will be applied to an individual cell as if it were a non-UK resident company in order to determine whether it is controlled by a UK person or persons under the legal and economic control tests ...
> However this does not affect the status of the host entity, either the PCC or ICC (or similar entities) irrespective of whether there are separate cells within those entities treated as CFCs. Regardless of the treatment of the individual cells within the companies, the PCC or ICC will also be treated as a non-UK resident company for the purposes of Part 9A. This means that the control rules will also apply to the company as a whole in determining whether it is controlled by a UK person or UK persons. In the case of a PCC or similar entity, where cells are unincorporated, assets and liabilities are to be apportioned between the cells and the company on a just and reasonable basis. In the case of an incorporated cell company the incorporated nature of the cells means that this further apportionment provision is not needed.

HMRC give the example of an unincorporated cell company:

> *Example*
> Company X is established by UK resident company Y in an overseas territory. X provides captive insurance facilities to unconnected UK resident companies A to J through ten unincorporated cells. X itself has "core" shares and "cell" shares. The core shares have voting rights and the right to appoint directors; the shares are wholly owned by Y. The cell shares are separate shares issued for each cell and are wholly owned by the unconnected UK resident companies A to J (so that A owns all the cell shares in the first cell, B owns all the shares in the second cell and so on).
> Each cell prepares its own accounts, and the assets of each cell are protected from the others. So if one cell makes a loss, it has no impact on the other cells. If a cell were to become insolvent, the creditors have no recourse to the assets held in other cells. However the cells cannot contract in their own name; contracts of insurance are entered into by X but the risks and benefits of the contract are specified to particular cells.
> X provides management and underwriting services for each of the ten cells and makes profits that are not included in any of the accounts prepared for the individual cells.
> Each separate cell is subject to a test of control and each cell is deemed to be a CFC of each of A to J respectively because of the legal control each has over their cell. The profits potentially subject to a CFC charge are the profits derived from the contracts of insurance (underwriting profits and investment profits).
> X is clearly controlled by Y given it owns all of the shares in X (i.e. has legal control) and so is a CFC. The profits potentially subject to a CFC charge are the profits derived from the management and underwriting services.

90.50.4 *Cell company: IPT*

Para 3A sch 6A FA 1994 provides (in short):

> (6) For the purposes of this paragraph-
> (a) a company is a "divided company" if under the law under which the company is formed, under the company's constitution or under arrangements entered into by or in relation to the company-
> (i) some or all of the assets of the company are available primarily, or only, to meet particular liabilities of the company, and
> (ii) some or all of the members of the company, and some or all of its creditors, have rights primarily, or only, in relation to particular assets of the company;
> (b) a "division" of such a company means an identifiable part of it (by whatever name known) that carries on distinct business activities and to which particular assets and liabilities of the company are primarily or wholly attributable.

> (7) ... the company shall be treated as connected with any person with whom a division of that company would be connected if it were a separate company.

The IPT Manual provides:

> **IPT04930 Higher rate of IPT: Protected cell companies** [Sep 2018]
> ... The defining feature of [PCCs] is that they have within them units that are usually called cells. These cells can be separately owned and they are segregated from one another's assets and liabilities. In effect a cell can be run as if it was a separate company although it remains part of the larger corporate body, the PCC, which itself is a single legal entity.
> Prior to the Budget measure, a PCC could be used to avoid the higher rate. Under the Taxes Act, a connected person, in the case of companies, is defined as one person having a controlling share of the company (normally this would be a 51% shareholding in the company). Because of the cellular structure of a PCC, it is possible for a person to wholly own a cell, but only have a minority shareholding in the PCC overall. Thus, a PCC could be set up in such a way that it would not be caught by the connected person definition and it could be used to avoid higher rate IPT.
> To close this loophole the Budget measure introduced a new paragraph 3A to schedule 6A of the Finance Act 1994, which extended the definition of connected persons in the higher rate IPT legislation. In practice this meant that to establish whether a PCC was connected for the purpose of the higher rate, you could look at the individual cells of the PCC and consider whether, if the cells were separate entities, they would meet the connected person test. If the answer to that question was yes, then the PCC was to be regarded as connected to the supplier...
> To ensure all PCC type companies are covered, by whatever name they are known, the legislation uses the term divided companies.

90.51 Hindu undivided property

The CG Manual provides:

> **CG31305 Other interests** [Jul 2019]
> ... a case involving Hindu Undivided Property would be regarded as a discretionary trust rather than an unincorporated association.

This entity is referred to as Hindu Undivided Family ('HUF'). Whether it is a trust or a company, and if a trust, whether a discretionary trust, requires further examination.

90.52 Tokkin (Japan)

HMRC regard a tokkin as transparent. The INTM provides:

> **355160 Claims by Japanese "Tokkin" funds** [May 2012]
> 'Tokkin' is an abbreviation of 'tokutei kinsen', and means 'designated monetary trust'.
> Cash or other assets for this type of fund are deposited by the investor(s) with a trustee who manages them on behalf of the investor(s), and in accordance with his/her/their instructions. The tokkin is set up and managed under the terms of a written agreement between the parties, drawn up under Law No 62 of 21/4/1922 of Japan.
> Because the Dividends and Interest Articles of the convention provide for relief **only to the beneficial owner** (INTM332000) of the income, claims in respect of income paid to tokkin funds **must** be made by the beneficial owner of the tokkin (the 'investor(s)'above), and **cannot** validly be made by the tokkin's manager.
> So if you see a claim or supporting voucher which makes any reference to tokkin, you should ensure that you consider only claims made by the beneficial owner, that is, the **original investor**, in respect of his/her/their share in the tokkin.
> There is no reason why a single investor should not own **all** the funds in a tokkin, but you should make certain that your claim has been made by the beneficial owner and not by the trustee, or an investment manager.
> The original investors/beneficial owners may be either individuals or companies.
> But it should be clear in either case that **no** relief can be due to the tokkin **itself**.

90.53 Hapja Hoesa (Korea)

The Australian Taxation Office have guidance on this:

Classification of a Korean Hapja Hoesa for Australian income tax purposes
Issue
Is the Korean Hapja Hoesa a company pursuant to the definition within section 995-1 of the Income Tax Assessment Act 1997 (ITAA 1997)?
Decision: Yes. The Korean Hapja Hoesa is a company within the meaning of section 995-1 of the ITAA 1997.
Facts
The Hapja Hoesa is a legal form of corporation, which may be established under the Korean Commercial Act (Commercial Act). The Hapja Hoesa is also a private equity fund which is regulated by the Korean Indirect Investment Asset Management Business Act (IIAMBA).
In essence, the Hapja Hoesa is an unlimited investment specialty vehicle that is

established for the purpose of investing the assets of the entity into the shares or equity of other entities - with the purpose of increasing the value of such entities through participation in the management of the entities or improving the business structure or control structure of the entities. The Hapja Hoesa may be used only for private equity investment purposes.

Currently under Korean legislation, a Hapja Hoesa has the following features:

- a Hapja Hoesa is in
corporated, and is formed by registering its incorporation (Article 144-5(2) of the IIAMBA; Article 172 of the Commercial Act);
- a Hapja Hoesa has a legal personality that is separate from the members (Article 171(1) of the Commercial Act);
- a Hapja Hoesa does not have partners, it has members (Article 268 of the Commercial Act);
- a Hapja Hoesa has members with limited liability and members with unlimited liability (Article 144-3 of the IIAMBA; Article 268 of the Commercial Act);
- a Hapja Hoesa has articles of incorporation (Article 144-5 of the IIAMBA; Article 178 of the Commercial Act);
- a Hapja Hoesa exists for a specific term, which must be specified in the articles of incorporation, but after the term expires, the Hapja Hoesa may continue with consent of all or some members (Article 144-5(1) of the IIAMBA; Article 229 of the Commercial Act);
- a member's interest in a Hapja Hoesa is referred to as a share (Article 197 of the Commercial Act);
- in order to transfer their share in the Hapja Hoesa, a member needs the consent of other members (Article 197 of the Commercial Act);
- members can transact with the Hapja Hoesa (Articles 199 and 275 of the Commercial Act);
- subject to limitations for Limited Liability Members, members are jointly and severally liable if assets of the company are insufficient to satisfy its obligations (Articles 212 and 279(1) of the Commercial Act);
- distributions by the Hapja Hoesa are referred to as 'dividends' (Article 279(1) of the Commercial Act).

The articles of incorporation of this particular Hapja Hoesa include the following terms:

- a Limited Liability Member may not transfer any part of their interest in the Hapja Hoesa without the consent of all Unlimited Liability Members;
- an Unlimited Liability Member may not transfer any part of their interest without the consent of all members;
- a Limited Liability member may not withdraw from the Hapja Hoesa without transferring their interest, and the transfer of an interest requires the consent of all Unlimited Liability Members;
- a member does not have a right to a distribution of distributable cash. Instead, a resolution of members is required before any profits can be distributed;
- meetings of the Hapja Hoesa will be convened by the Manager or on request of members;
- a member has one vote per unit of their interest in the Hapja Hoesa;
- members may pass resolutions on dissolution of the Hapja Hoesa; extension or reduction in the term of the Hapja Hoesa; approval of distributions;

· business cannot be transacted at a meeting of the Hapja Hoesa unless a quorum is present;

· the Hapja Hoesa will be dissolved on expiration of its term; with a resolution of the Members; on bankruptcy or insolvency; on an order of the court; or if the Korean Financial Supervisory Commission denies or cancels registration.

Reasons for Decision

'Company' is defined in section 995-1 of the ITAA 1997 as:

(a) a body corporate; or

(b) any other unincorporated association or body of persons;

but does not include a partnership or a non-entity joint venture.[393]

As the term 'body corporate' is not defined in Australia's income tax legislation, the ordinary meaning of the term applies. The Butterworths Concise Australian Legal Dictionary 2nd ed., defines a body corporate as 'an artificial legal entity having separate legal personality'.

Being an entity that was created by registration, and that has separate legal personality, the Hapja Hoesa is a 'body corporate'. Consequently, it will be a company under paragraph (a) of the definition of 'company' in section 995-1 of the ITAA 1997, providing that it is not also a partnership.

Section 995-1 of the ITAA 1997 defines 'partnership' as:

(a) a body of persons (other than a company or limited partnership) carrying on business as partners or in receipt of ordinary income or statutory income jointly; or

(b) a limited partnership.

The Hapja Hoesa has some features commonly associated with a partnership, and some features associated with a company.

The following features favour characterisation of this particular Hapja Hoesa as a company.

· a resolution of members is required before profits can be distributed. This indicates that profits belong to the Hapja Hoesa, and that the members are not in receipt of income jointly;

· distributions are referred to in the Commercial Act as 'dividends' rather than as a share of profits;

· the Hapja Hoesa was formed by registration of its incorporation, whereas a partnership is generally formed by a partnership agreement between the partners;

· the Hapja Hoesa has members rather than partners;

· the Hapja Hoesa has articles of incorporation, and not a partnership agreement;

· the Hapja Hoesa has a form of perpetual succession. It will not terminate on the withdrawal of a member, as is the case with a partnership. Instead, it will continue until the occurrence of one of the events specified in its articles of incorporation.

The features which favour characterisation of this Hapja Hoesa as a partnership include:

· to withdraw from the Hapja Hoesa a Limited Liability Member in effect needs the consent of all Unlimited Liability Members;

· members' interests are not freely transferable; in order to transfer their share in the Hapja Hoesa, a member needs the consent of other members.

The predominance of characteristics favours classification as a company rather than a

[393] The same applies in the UK; see 90.8 (Definition of "company").

partnership. Further, as the Hapja Hoesa does not have partners who carry on its business or who receive income jointly, it is not a partnership for the purpose of the definition of 'partnership' or 'company' in section 995-1 of the ITAA 1997.
As the Hapja Hoesa is a body corporate and not a partnership, it follows that it is a company within the meaning of section 995-1 of the ITAA 1997.[394]

It is considered that the same reasoning should apply in the UK.

90.54 HMRC transparent/opaque list

The International Manual provides:

> **INTM180040 How HMRC arrives at a definitive view of specific foreign entities** [Dec 2023]
> **General view**
> INTM180030 includes a list of foreign entities where we have provided a general view as to whether they can be described as "transparent" or "opaque" within the meaning explained at INTM180010. This list is intended to provide HMRC officers and customers with a general view as to whether the members will be liable to UK tax on the profits, income or gains of the entities or only on any distributions made by the entities. However, our view may vary depending on -
> - the specific terms of the UK taxation provision under which the matter must be considered;
> - the provisions of any legislation, articles of association, by-laws, agreement or other document governing the entity's creation, continued existence and management; and
> - the terms of any relevant double taxation agreement.

HMRC do not guarantee that the list is up to date:

> Our view of the entities shown on the list may also change if:
> - HMRC's view was given many years ago, and there have been significant changes in the relevant foreign law
> - there are any significant changes in foreign law after the publication of this guidance.
>
> Furthermore, whilst one type of foreign entity may share certain characteristics with another, it does not necessarily follow that HMRC would have the same general view as to whether they are "transparent" or "opaque" or that a specific UK taxation provision would apply to them in the same way. Each entity would need to be considered in accordance with its own characteristics.

[394] ATO ID 2010/27 (28 January 2010).

> The general view provided in the list may therefore help inform customers and HMRC officers when planning their affairs and risk assessing respectively. However, the UK tax treatment will depend on the facts of the case and the application of the specific UK tax provision to those facts. If any customer would like certainty to HMRC's view in a particular case, they can apply for a clearance in accordance with INTM180060.

I refer to this as the "**HMRC transparent/opaque list**" and set out the list below.[395]

I add an English translation, mainly from the IATE database.[396] There are no exact equivalents. A legal concept is not just a word: it is a vast theoretical construction, the world in a grain of sand. Some terms can be brought over into English easily; others require a long explanation. There is not often a single standard or correct translation: the IATE database usually offers choices. In cases where the foreign entity does not have a close English law equivalent, it is better to use the foreign language term rather than a potentially misleading English translation.

I mention in footnotes where OECD, "The Application of OECD Model Tax Convention to Partnerships" (1999) suggests that the tax treatment is different in the foreign state, which would result in a hybrid entity. In some cases the foreign tax treatment is more complex and the entity may be party hybrid, but that is too complex to address in a footnote.

Country/name of entity	**UK tax status & date considered**[397]	**See para**	**Translation**
ANGUILLA			
Partnership	Transparent 1991		
Limited liability company	Opaque 2008		
ARGENTINA			
Sociedad de responsabilidad limitada	Opaque 1958		Limited liability co
ARMENIA			
Limited liability company	Opaque 2006		
AUSTRALIA			
Limited partnership	Transparent 2007		
Unit trust	Transparent 2007	69.7.1	
AUSTRIA			
Kommanditgesellschaft	Transparent 1971	90.29	Limited partnership

[395] I have restored diacritical marks, which HMRC somewhat illiterately omitted in the transparent/opaque list, and omit the abbreviations.

[396] *http://iate.europa.eu* This provides some details about the entities.

[397] The HMRC Manual gives the month as well as the year, but I omit that here.

Kommandit[398] Erwerbsgesellschaft	Transparent 2003	90.29	Limited partnership
GmbH & Co KG	Transparent 2002	90.29	
Gesellschaft mit beschränkter Haftung	Opaque 2005		Limited liability co
Aktiengesellschaft	Opaque 2005		Public limited co
BELGIUM			
Société privée à responsabilité limitée[399]	Opaque 1994		Limited liability partnership
Société en nom collectif[400]	Transparent[401] 1992	90.31	General partnership
Société anonyme/Naamloze vennootschap[402]	Opaque 2005		Co limited by shares
Société en commandite par actions/ Commanditaire venootschap op aandelen[403]	Opaque 2005		
BERMUDA			
Limited partnership with legal personality	Transparent 2007		
BRAZIL			
Sociedade[404] por quotas de responsabilidade limitada	Opaque 1977		
Fundo de Investimento em[405] Participações	Transparent 2007		
BVI			
Limited partnership	Transparent 2009		
CANADA			
Partnership and limited partnership	Transparent 2005		
CAYMAN ISLANDS			
Exempted Limited partnership	Transparent 2015		
Limited partnership	Transparent 1993		
CHILE			
Sociedad de responsabilidad limitada	Transparent 2003		Limited liability co
CHINA			
Wholly foreign owned entity	Opaque 2005		
CZECH REPUBLIC			
Akciová společnost	Opaque 2005		Societas Europaea
Společnost s ručením omezeným	Opaque 2005		Limited liability co
DENMARK			
Danske Investingsforening	Opaque 2009		
EUROPEAN UNION			
Societas Europeas	Opaque 2005	8.23	

[398] HMRC text erroneously reads: Kommand.

[399] HMRC text reads (perhaps erroneously): Société de privée à responsabilité limitée The equivalent Dutch term is Besloten venootschap met beperkte aansprakelijkheid

[400] The equivalent Dutch term is Vennotschap onder firma.

[401] OECD, "The Application of the OECD Model Tax Convention to Partnerships" (1999) p.71 suggests this is treated as opaque in Belgium.

[402] These are the French/Dutch terms for the same entity (HMRC erroneously lists them as separate entities).

[403] These are the French/Dutch terms for the same entity (HMRC erroneously lists them as separate entities, and erroneously reads: Commanditaire venootschap opaandelen). See 90.33 (Société en commandite par actions).

[404] HMRC text erroneously reads: Sociedad.

[405] HMRC text erroneously reads: en.

FINLAND			
Kommandiittiyhtiö	Transparent 1991		Limited partnership
Osakeyhtiö	Opaque 2005		Limited co
Aktiebolag	Opaque 2005		Limited co
FRANCE			
Groupement d'intérêt économique	Transparent 1988		Economic interest grouping
Société en nom collectif	Transparent 2000	90.31	General partnership
Société civile immobilière	Opaque 2005	90.32.2	Property investment co
Société civile exploitation agricole[406]	Opaque 1998		
Société en commandite simple	Transparent 1997		Limited partnership
Société en participation	Transparent 1992		Special partnership
Société à responsabilité limitée	Opaque		Limited liability co
Fonds commun de placement à risques	Transparent 1997	69.12	Venture capital mutual fund
Société par actions simplifiée	Opaque 2004		Simplified joint stock co
Société anonyme	Opaque 2004		Co limited by shares
Groupement foncier d'agricole[407]	Opaque 2001		
Société civile	Opaque 2005	90.32	Civil society
Société en commandite par action	Opaque 2007		Limited p'ship with share capital
GERMANY			
Stille Gesellschaft	Opaque 1998	90.30	Silent partnership
Kommanditgesellschaft[408]	Transparent 1997	90.29	Limited partnership
Offene Handelsgesellschaft	Transparent 1996	90.28	General partnership
Gesellschaft mit beschränkter Haftung	Opaque 1997	90.55.14	Limited liability co
GmbH & Co KG	Transparent 1997	90.29	
GmbH & Co KGa	Opaque 2008	90.29	
Gesellschaft des bürgerlichen Rechts[409]	Transparent 1994		Civil law partnership
Aktiengesellschaft	Opaque 2005		Limited liability co
GIBRALTAR			
Limited partnership	Transparent 2009		
GUERNSEY			
Limited partnership	Transparent 2005		
Protected cell company	Opaque 2004	90.50	
Open ended investment company with limited liability	Opaque 2004		
HUNGARY			
Korlátolt felelösségü társaság	Opaque 2005		Limited liability co
Részvénytársaság	Opaque 2005		Societas Europaea
ICELAND			
Hlutafélag	Opaque 2005		Public limited liability co
IRELAND			
Limited partnership	Transparent		

[406] Tax Bulletin 83 referred to a Société civile agricole which I assume is the same entity.

[407] This is a misprint but I do not know what is intended.

[408] HMRC text erroneously reads: Kommandit Gesellschaft.

[409] I think the form Gesellschaft bürgerlichen Rechts is more correct.

Irish investment limited partnership	Transparent		
Common contractual fund	Transparent 2004	69.13	
Unit trust	Opaque 2008	69.7.1	
ISLE OF MAN			
Limited liability company	Opaque 2008		
ITALY			
Società per azioni	Opaque 2005		Public limited co
Società a responsabilità limitata	Opaque 2008		Private limited co
JAPAN			
Goshi-Kaisha	Transparent[410] 1997		
Gomei Kaisha	Transparent[411]		
Tokumei Kumiai	Transparent 2005		
Kabushiki Kaisha	Opaque 2005		Joint stock co
Yugen-kaisha	Opaque 2005		Limited liability co
JERSEY			
Limited liability partnership	Opaque 2001	90.37	
Limited partnership	Transparent		
KAZAKHSTAN			
Limited liability company	Opaque 2006		
LIECHTENSTEIN			
Anstalt	Opaque 2004	90.15	Establishment
LUXEMBOURG			
Société en commandite par actions	Opaque 1992		Limited partnership with share capital
Fonds commun de placement	Transparent 2005	69.12	Mutual fund
Société anonyme	Opaque 2005		Co limited by shares
Société à responsabilité limitée	Opaque 2005		Limited liability co
Société en nom collectif	Transparent 2007	90.31	General partnership
Société civile	Opaque 2007	90.32	Civil society
Société d'investissement à capital variable	Opaque[412] 2008		Venture capital fund
Societe en commandite speciale	Transparent 2017		
MALTA			
Société d'investissement à capital variable	Opaque[413] 2008		Special-purpose fund
[Société] en nom collectif	Transparent 2007	90.31	General partnership
Société civile	Opaque 2007	90.32	Civil society
NETHERLANDS			
Vennootschap onder firma	Transparent 1995		General partnership
Commanditaire vennootschap both "open" and "closed"	Transparent 2000		Limited p'ship with share capital

[410] OECD, "The Application of the OECD Model Tax Convention to Partnerships" (1999) p.71 suggests this is treated as opaque in Japan.

[411] OECD, "The Application of the OECD Model Tax Convention to Partnerships" (1999) p.71 suggests this is treated as opaque in Japan.

[412] This may not be correct: it has been said that a SICAV SIF can be transparent or opaque.

[413] But see footnote on Luxembourg SICAVs, above.

Naamloze vennootschap	Opaque 1981		Limited co[414]
Besloten vennootschap met beperkte aansprakelijkheid[415]	Opaque 1981		Ltd liability co[416]
Maatschap	Transparent 1993		Partnership
Stichting	Transparent 2005	90.40	Dutch Foundation
Cooperatie uitsluiting aansprakelijkheid[417]	Opaque 2000		
Cooperatie beperkte aansprakelijkheid[418]	Transparent 2008		
Cooperatie wettelijke aansprakelijkheid[419]	Transparent 2008		
Besloten fonds voor gemene rekening	Transparent 2008	90.41	
Association	Opaque 2017		
NEW CALEDONIA			
Société en nom collectif	Transparent 2005		General partnership
NORWAY			
Aksjeselskap[420]	Opaque		Limited liability co
Kommandittselskap[421]	Transparent 1981		Limited partnership
OMAN			
Limited liability company	Opaque 2008		
POLAND			
Spólka z ograniczona odpowiedzialnoscia[422]	Opaque 1996		Limited co
PORTUGAL			
Sociedade por quotas	Opaque 1993		Limited co
Sociedade anónima	Opaque 1993		Limited co
RUSSIA			
Joint Venture under "Decree No. 49"	Opaque 1993		
Limited liability company	Opaque 2003		
SEYCHELLES			
Limited partnership	Transparent 2009		
SLOVAK REPUBLIC			
Spoločnost' s ručenim obmedzeným[423]	Opaque 2005		Limited liability co
SOUTH AFRICA			
Close Corporation	Opaque 2005		
SPAIN			
Fondo de Capital Riesgo	Transparent 2008		Venture capital fund

[414] Literally translated "open corporation"; sometimes translated: public limited liability company.

[415] HMRC text erroneously reads: Aansprakelijheid.

[416] Literally translated "closed corporation".

[417] This is not in the 2023 version of INTM180030, it is not clear whether the omission is accidental or deliberate. The HMRC text erroneously read: Aansprakelijheid.

[418] HMRC text erroneously reads: Aansprakelijheid.

[419] This is not in the 2023 version of INTM180030, it is not clear whether the omission is accidental or deliberate.

[420] HMRC text erroneously reads: Alkjeselskap.

[421] HMRC text erroneously reads: Kommandittselkap.

[422] HMRC text erroneously reads: Spolkaz ograniczonaodpowiedzialnoscia.

[423] HMRC text reads (I think erroneously): Spolocnost's rucenim obmedzenim

Sociedad Civil[424]	Opaque[425]1980		Civil law partnership
Sociedad Anónima	Opaque 2005		Co limited by shares
Comunidad de bienes	Transparent 2001		Co-ownership
Sociedad Collectiva	Opaque 2008		
Sociedad Civil Professional	Transparent 2008		Society
Sociedad Commanditaria[426] Simple	Transparent 2007		
Uniones Temporales de Empresas	Transparent 2008		
Sociedad de Responsabilidad Limitada	Opaque 2005		Limited liability co
SWEDEN			
Aktiebolag	Opaque 2005		Limited co
Kommanditbolag	Transparent 2005		Limited partnership
SWITZERLAND			
Société simple[427]	Transparent 1990		Limited partnership
Gesellschaft mit beschränkter Haftung[428]	Opaque 2005		Limited liability co
Kommanditgesellschaft[429]	Transparent 2007	90.29	
TURKEY			
Attorney partnership[430]	Transparent 2004		
Anonim Şirket	Opaque 2005		Joint stock co
Limited Şirket	Opaque 2005		Limited liability co
USA			
Partnership under Uniform Partnership Act	Transparent 1983		
Limited Partnership under Uniform Limited Partnership Act	Transparent 2000	90.49	
Limited Liability Co including New York LLC	Opaque 1997	90.43	
Limited Liability Partnership	Transparent 1999		
Massachusetts Business Trust	Transparent 1980	90.16.1	
S Corporation	Opaque 2005	9.28	
Real Estate Investment Trust	Opaque 2007		
Limited liability limited partnership under Revised Uniform Limited Partnership Act	Transparent 2007		

90.54.1 *HMRC entity clearance*

The INT Manual provides:

> **INTM180060 Contacts and clearances** [Dec 2023]
> (This content has been withheld because of exemptions in the Freedom

[424] HMRC text erroneously reads: Civila.

[425] OECD, "The Application of the OECD Model Tax Convention to Partnerships" (1999) p.71 suggests this is treated as transparent in Spain.

[426] HMRC text erroneously reads: Comanditaria,

[427] The equivalent expression in German is: Einfache Gesellschaft.

[428] The equivalent expression in French is: Société à responsabilité limitée.

[429] The equivalent expression in French is: Société en commandite.

[430] This seems to refer to a partnership of Turkish Attorneys (ie, lawyers); I am not sure if it is actually a type of Turkish law entity as such.

> of Information Act 2000)
> **Contacts and Clearances**
> We will provide our view of whether we consider a particular foreign entity to be transparent or opaque in specific cases in line with our guidance on non-statutory clearances[431]
> Applications should be made in writing and include -
> - the name and address of the entity to be considered
> - why HMRC's view is being requested
> - consideration of factors 1 to 6 in INTM180020
> - if a view is required in respect of a particular source of income, your view of how that source is taxed in the UK
> - copies of any legislation, articles of association, by-laws, agreements or other documents governing the entity's creation, continued existence and management, including any amending documents
>
> Applications should be made by email to *entityclassification mailbox@hmrc.gov.uk* or by post to [specified address]

And again:

> The views expressed in the list are disclaimed as "general" views, and clearance applications are encouraged for a view on a specific case. Should a sufficient number of clearances be received HMRC will always look to update any relevant guidance.[432]

I would be interested to hear from readers who have obtained HMRC clearance on bodies not in the transparent/opaque list.

90.55 Ordinary share capital

The definitions of this term are as follows:

Provision	**Applies for**
s.989 ITA	Income Tax Acts
s.1119 CTA 2010	Corporation Tax Acts
s.42(4) FA 1930	SD group relief
Para 1 sch 7 FA 2003	SDLT group relief

[431] *http://www.gov.uk/guidance/non-statutory-clearance-service-guidance*

[432] HMRC "Taxing gains made by non-residents on UK immovable property Summary of Responses" (July 2018) para 3.16. *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/722418/Taxing_gains_made_by_non-residents_on_UK_immovable_property_summary_of_responses.pdf*

The IT/CTA definitions are the same, and the SD/SDLT definitions are also the same except that they refer to a body corporate rather than a company. It may be helpful to set out the IT/SD provisions side by side:

s.989 ITA	**s.42(4) FA 1930**
The following definitions apply for the purposes of the Income Tax Acts...	In this section
"ordinary share capital", in relation to a company, means all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits	"ordinary share capital", in relation to a *body corporate*, means all the issued share capital (by whatever name called) of the body corporate, other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the profits of the body corporate.

90.55.1 *Equity share capital compared*

For company law, s.548 Companies Act 2006 provides:

> In the Companies Acts "equity share capital", in relation to a company, means its issued share capital excluding any part of that capital that, neither as respects dividends nor as respects capital, carries any right to participate beyond a specified amount in a distribution.

The CT Manual comments:

> **CTM00511 meaning of ordinary share capital: general** [Dec 2021]
> ... The tax and company law definitions are quite similar in effect; "distribution" under company law is defined at CA06/S829 in terms that include "every description of distribution of a company's assets to its members, whether in cash or otherwise" but excludes capital operations such as bonus (capitalisation) issues, capital reductions, redemptions or purchases of shares out of capital and distributions in a winding-up.
> The Corporation Tax definition of "distribution" at CTA10/PART23 is somewhat broader. It reflects anti-avoidance provisions, aimed for example at certain interest payments which have the character of profit distributions, and covers some capital operations. But the tax definition [of ordinary share capital] focuses on "dividends".

90.55.2 *Significance of ordinary share capital*

The term is used very frequently in tax legislation and it is not practical to give a full list. It is used in particular in the definition of group for group reliefs.

90.55.3 *"However described"*

CTM provides:

> **CTM00511 meaning of ordinary share capital: general** [Dec 2021]
> **Types of share capital**
> The reference in the tax definition to "however described" reflects the fact that commercial practice employs a variety of descriptions of types of share capital which broadly describe their characteristics but are not definitive without reference to the articles or other constitutional documents of the issuing company. Examples are deferred ordinary shares; participating preferred ordinary shares; participating preference shares. Sometimes shares will be labelled "non-voting", "redeemable", "cumulative" or "convertible". These are helpful pointers, but the articles must always be consulted.

90.55.4 *"Share capital"*

We do not have a short authoritative definition of share capital in UK law. Section 545 CA 2006 provides:

> References in the Companies Acts to a company having a share capital are to a company that has power under its constitution to issue shares.

CTM refers to this and provides:

> **CTM00512 share capital** [Dec 2021]
> ... Share capital is the amount appearing in the balance sheet from the issue of shares and if shares are issued at a premium over their nominal value the premium is reflected in a share premium account separate from the nominal share capital, although for both company law purposes (CA06/S610 (4)) and tax law purposes (CTA10/S1025 (2)) the premium is treated as forming part of the share capital for the purposes of its "reduction" under company law and its "repayment" under tax law.
> This means that share capital reflects the equity (ownership) interests of the company members in their company and, in liquidation, the value of the interests (if any) after creditors have been repaid.

> Historically, share capital reflects shares in the "joint-stock" lying in the hold of a merchant adventurer trading vessel.

I am not sure that the history is relevant to the present law, though it explains the expression "joint stock company".

> Originally investors owned their own trading stock but as time went on it was held jointly and divided into shares. The important point in modern terms is that share capital, together with share premium, other reserves and undistributed profit, reflects company assets net of liabilities, and thus ownership (not creditor claims).

The Manual refers to s.1041 Companies Act 2006 which provides:

> (1) For the purposes of section 1040 (companies authorised to register under this Act) "joint stock company" means a company—
>
> (a) having a permanent paid-up or nominal share capital of fixed amount
>
> [i] divided into shares, also of fixed amount, or
>
> [ii] held and transferable as stock, or
>
> [iii] divided and held partly in one way and partly in the other, and
>
> (b) formed on the principle of having for its members the holders of those shares or that stock, and no other persons.
>
> (2) Such a company when registered with limited liability under this Act is deemed a company limited by shares.

The Manual continues:

> Members' liability in the case of a limited company is limited to the nominal amount of the share capital they hold. Limited companies are much the most common, for commercial reasons, but companies may be formed without a share capital and members' liability may be limited by guarantee. Companies limited by guarantee are generally formed by non-profit seeking members who nevertheless wish to operate via a corporate entity, and are commonly used for charities. Some companies limited by guarantee with a share capital still exist, but since 22 December 1980 (in Great Britain, but 1 July 1983 for Northern Ireland) may no longer be formed.
>
> Unlimited companies are fairly rare but continue to be formed due to their limited reporting requirements. Their members may choose whether or not to have a share capital.
>
> In 1999 the Special Commissioners considered the status of "founders' deposits" with a company limited by guarantee in the case *South Shore*

> *Mutual Insurance Co Ltd v Blair* 1999 STC (SCD) 296. The Special Commissioners came to the conclusion that the deposits were not issued share capital; the company did not, in fact, have any authorised share capital and, as a consequence, could not have issued share capital. Companies Act 2006 abolished the requirement for a company to have an authorised share capital with effect from 1 October 2009, but the case contains a useful review of authorities on share capital.

90.55.5 *"Shares"*

The CT Manual provides:

> **CTM00513 what is meant by "shares"** [Dec 2021]
> [The Manual makes some general comments companies and company shares, and continues;] Lord Millett gives a useful summary of the "juridical nature of a share" in *IRC v Laird Group plc* [2003] UKHL 54 at [37]. Shares are often described as a bundle (or "fasciculus") of rights and liabilities. See Lord Wright in *Lowry v Consolidated African Selection Trust Ltd* (1938-41) 23 TC 259 at 298.

90.55.6 *Issue/allotment of shares*

The IHT Manual continues:

> **Issue and allotment of shares**
> Possession of a share certificate is prima facie evidence of ownership of a share, CA06/S127. This does not, of itself, confirm ownership and certificates are not essential to demonstrate that share capital has been issued. However, in order to be a member of a company under the UK Companies Acts, a person must be entered in the company's register of members, CA06/S112. From 30 June 2016 certain private companies can report changes of membership to Companies House to be reflected in a public register rather than keeping their own. The issue of share capital is only complete when the processes of application, allotment and issue are complete: *National Westminster Bank plc v IRC* [1994] STC 580. Shares are allotted when a person acquires the unconditional right to be included in the company's register of members: CA06/S554. TCGA92/S288 (5) provides that, for chargeable gains purposes, shares are treated as issued if they are to be issued under the terms of an unconditional letter of allotment or similar instrument.

90.55.7 *Dividend at fixed rate*

The CT Manual provides:

CTM00514 how "ordinary" shares are distinguished [Dec 2021]

The general meaning of ordinary share capital (see CTM00511) depends on identifying and excluding capital to which the holders have a right to a dividend at a fixed rate but have no other right to share in a dividend. (There are, though, some slightly different definitions of ordinary shares or shares for specific purposes, see for example CTA10/S160 (group relief, CTM81010) and CTA09/S931U (distribution exemption, INTM653050)).

The concept of "ordinary capital" originated in the wartime Excess Profits Duty at F(2)A1915/SCH4/PART1/PARA6, for the purposes of applying the tax to a subsidiary as though it were a branch of the parent; the aim of that rule being to distinguish equity capital from loan capital for this purpose.

That distinction remains relevant today and is expressed in the current definition. The aim of the current tax legislation is to exclude instruments that are in legal terms shares but in effect represent perpetual debt, namely fixed rate preference shares. The definition appears fairly straightforward but has given rise to a number of issues, addressed in the following table.

Some of the issues are finely balanced, and the table is, except where authority is quoted, only a guide. If arrangements appear to reflect uncommercial elements designed to circumvent the purpose of the legislation in identifying ordinary share capital the principles will be applied accordingly.

Description	**Ordinary Share Capital**	**Comment**
Share with no dividend rights	Yes	CTA10/S1119 is silent on rights other than fixed rate of return
Fixed rate preference share with zero coupon	Yes	Right to nothing is not a right to something. See *McQuillan v HMRC* [2017] UKUT 344
Fixed rate preference share with small coupon	No-but see comment	Could be fact dependent, particularly where there are avoidance concerns
Fixed rate of 10% cumulative	No	Holder knows return is fixed even when profits not available
Fixed rate of 10% non-cumulative	Yes	Some years no dividend will be paid so is more like equity than debt
Preference share with right to "tiered"	Yes	Rate is not fixed as can change depending on tier. There is more than

dividends, meaning they increase on a pattern over time		one fixed rate, and in context this is not a case where the singular should include the plural
Right to greater of specified sum or dividend paid in respect of another class of shares	Yes	Rate is not fixed and similar analysis applies as for tiered dividends - there is right to a return at one of two fixed rates
Fixed rate preference share but with rights in liquidation	No - but this is finely balanced and may depend on facts of case	A distribution in liquidation is of surplus assets rather than of profits. But, depending on the circumstances, a purposive approach might point to a different conclusion
Preference share with 2 alternative fixed rates	Yes	No fixed rate but a rate that varies between two fixed levels. Similar analysis as for tiered dividends
Fixed rate preference share but with right to further dividend payment were certain events to occur (e.g. breach of banking covenants)	Yes	Right to further payment is another right to share in the profits. But conclusion might be different if circumstances very unlikely to materialise
Preference shares where coupon compounds over time or a preference share where a rate of interest is added if dividend is unpaid	Borderline – this is finely balanced and may depend on facts of case. See *Stephen Warshaw v HMRC*, an FTT case TC/2017/08674 which is of persuasive rather than precedent authority	If the rate is fixed and cumulative arguably the shares are not ordinary share capital as there is in the end nothing beyond a right to a return at a fixed rate, albeit that the coupon compounds. Where a further rate of interest is added if the dividend is unpaid, the issue is whether the additional interest is seen as a return on the original investment, which would support fixed rate. But if seen as a separate return on amounts outstanding there would be a right to two differing fixed rates, and the tiered dividends analysis would apply
Fixed rate of 10% cumulative but	Depends on whether	Third party involvement does not affect underlying right to income.

dividend only paid on regulator authorisation/fixed rate of 10% non-cumulative but dividend can only be paid if regulator authorises	cumulative or non-cumulative	There is an underlying fixed rate where it is cumulative and the regulator can only prevent payment.
LIBOR plus a fixed percentage	Yes	Rate is not fixed because LIBOR varies – doesn't matter that it is a fixed point of reference

90.55.8 *Permanent interest bearing shares*

HMRC say:

> HMRC has also concluded that building society permanent interest bearing shares (PIBS), which are in reality subordinated debt instruments, also should not have been accepted as 'shares' in capital.

90.55.9 *Swiss Participation Certificate*

HMRC say:

> However, Swiss Participation Certificates (with par value, as distinct from Profit Sharing Certificates) will qualify as shares in company capital.
> With immediate effect, the 'shares' which are not shares in company capital will no longer be accepted as meeting the ordinary shares requirement for Corporation Tax relief under Part 12, CTA 09, on employee share acquisitions.

90.55.10 *Foreign companies*

The difficulty is that foreign laws may not have the UK concept of share capital. We have to apply a resemblance test appropriate to vague terms. The CT Manual provides:

> **CTM00515: foreign registered companies** [Dec 2021]
> The UK tax rules are based on UK company law. This means that companies formed under foreign law will usually require analysis of at least some of their features by comparison and analogy with the UK Companies Acts.
> In *Ryall v The Du Bois Co Ltd* (1933) 18 TC 431, Lord Hanworth MR said, "a share in a foreign company may be something different from

and, indeed, is almost necessarily different from, a share as we know it in an incorporated company", and Slesser LJ said, "we have to consider what would be analogous to stocks and shares in Germany in dealing with what is a company, and allowing for differences of law in that country". Approach by analogy is applied generally in addressing foreign registered companies.

The key feature of issued share capital is that the issuing body has full legal personality separate and distinct from that of its members, able to carry on business and to own assets in its own right. This establishes proprietorial interest though the holding of issued share capital in the body in contrast to partnership interests. In UK partnership law partnership property is held and applied by the partners for the purposes of the partnership (PA1890/S20 (1)) and the partnership is the relation between the persons carrying on the business (PA1890/S1 (1)).

(In Scotland a firm is a legal person distinct from its members, PA1890/S4 (2), but S1 (1) and S20 (1) still apply. This is because, whether partnership property is held in the name of the firm, or in the name of partner or partners, the persons ultimately beneficially interested in it are the partners according to their partnership rights – per The Scottish Land Court SLC/248/04) following an examination of the authorities. Partnerships established under Continental civil law present similar challenges; their "legal personality" may mask what is under civil law known as intuitu personae, or originating in the persons).

Capital in this context means a contribution that provides the contributor with an equity interest in (i.e. part ownership of) the body, as reflected in the proportion and nature of shares held in the fixed capital. CA06/S5 (3), in considering the remaining class of companies limited by guarantee with a share capital (see CTM00512), observes that any provision that divides a company's undertaking into shares or interests is a provision for share capital.

This means dividing the company itself, its "corpus", as referred to in *Rae v Lazard Investment Co Ltd* (1961-64) 41 TC 1. An equity or ownership interest in a body is distinguished from a debt claim against it.

The Special Commissioners in the *South Shore Mutual Insurance* case (see CTM00512), identified characteristics of "incidents" of share capital, but these are pointers rather than absolute requirements. For instance, shares may be non-voting. Important incidents, in relation to members' interests are:

- whether they are like shares in share capital (a portion of the capital of the corporate body) or like debt (money owed by the body corporate to the members),

- what proprietary rights characteristic of shares attach to them, both economic and voting, and what responsibilities,
- how they are legally evidenced in accordance with local law,
- whether they are denominated in a stated fixed value,
- whether the members' interests compose a fixed and certain amount measuring the company's capital which creditors may look to as security, and
- whether the members' interests are capable of transfer and if so whether such a transfer would amount to transferring of a portion of the capital of the company, with attendant proprietary rights and responsibilities (rather than a claim as creditor).

90.55.11 *No nominal capital*

The CTM provides:

> **CTM00516 foreign registered companies: particular issues** [Dec 2021]
>
> **No nominal capital**
>
> Since the 1960s there has been an international move away from the "capital maintenance" approach still central to UK company law. Some US jurisdictions, the California Corporations Code for example, dispense with the concept of nominal capital and others, for example Delaware, allow the issue of shares with nil nominal value. A similar approach has been adopted in a number of other jurisdictions. Such shares may be referred to as "zero par" shares or simply "zeroes".
>
> An adaptable and pragmatic approach is adopted when dealing with overseas company law which does not straightforwardly align with that of the UK (although UK tax and company law are distinct, aspects of UK Corporation Tax law are unmistakably based on the company law capital maintenance principle, for example the distributions code at CTA10/PART23, see CTM00511).
>
> Where there is no nominal capital requirement under overseas law, an amount on the facts subscribed as fixed capital analogous to share premium over nil nominal value shares will be treated as share capital by analogy with CTA10/S1025 (2) for the purposes of determining repayment of share capital.

90.55.12 *SCA: Share capital*

The CTM provides:

> **CTM00516 foreign registered companies: particular issues** [Dec 2021]
> **Continental (civil law) "partnerships" with share capital**
> Such an institution as a French société en commandite par actions may often be translated as a "limited partnership with a share capital" into English. The word "société" is in fact indeterminate and cannot be definitively translated as company or partnership for the purposes of UK tax law, but the share capital aspect reflects its nature as a société de capitaux (in civil law generally, Latin intuitu pecuniae – compare the reference to intuitu personae at CTM00515). This is consistent with the classification of a French SCA as opaque at INTM180030.

90.55.13 *LLC: Share capital*

For LLCs generally, see 90.43 (Limited liability company). This section considers whether an LLC has share capital.

Art 18-702(c) Delaware LLCA provides:

> Unless otherwise provided in a limited liability company agreement, a member's interest in a limited liability company may be evidenced by a certificate of limited liability company interest issued by the limited liability company.

CG Manual formerly referred to this and said:

> **CG-APP11 Meaning of Ordinary Share Capital** [Nov 2018]
> If a DLLC issues "shares" in this way and the other factors relating to the company suggest that it has share capital then we will accept that these "shares" may be regarded as "ordinary share capital" for the purpose of [s.989 ITA/s.1119 CTA 2010].
> It should be noted that not all DLLCs issue share certificates but they may still have "ordinary share capital". Regard must be had to the particular terms of the agreement by which the LLC has been created.
> In any case of doubt or difficulty regarding the status of the share certificates HMRC will advise in particular cases in line with the non-statutory business clearances. Please send in any applications to [address]
> Other States within the United States of America have comparable legislation to Delaware. Where it can be shown that a particular State has legislation analogous to the Delaware legislation with which we are familiar, HMRC would expect to be able to provide advice in line with that for DLLCs.

Although that is not in the current Manual, there is no reason to think that the HMRC view has changed. The CTM provides:

> **CTM00516 foreign registered companies: particular issues** [Dec 2021]
> **Certificates**
> To take an example, a Limited Liability Company (LLC) organised under the law of a US state may issue transferrable interests analogous to shares in share capital but these will not necessarily be evidenced by a certificate of interest (see US Revised Uniform Limited Liability Company Act, Section 502(d)). If there are no certificates, this is not necessarily fatal to the conclusion that the members' interests are analogous to shares in ordinary share capital, provided (as would be expected to be the case) that the interests are clearly defined and recognisable as equity (ownership) interests in the entity.

The FTT has found as a fact that the membership interest in a Delaware LLC was not similar to share capital, but rather similar to partnership capital of an English partnership.[433] The membership interest would not have been ordinary share capital. But HMRC do not propose to follow that view:

> HMRC ... proposes to continue its existing approach to determining whether a US LLC should be regarded as issuing share capital.[434]

In practice this view will often favour the taxpayer, who will not complain. This also has the attraction of leaving the position as it was generally thought to be before *Anson*, and so not upsetting existing arrangements.

90.55.14 *Share capital: GmbH*

CG Manual formerly provided:

> **CG-APP11: Meaning of Ordinary Share Capital** [Nov 2018]
> A Gesellschaft mit beschränkter Haftung (GmbH) in Germany, literally

[433] *Anson v HMRC*, reported under the pseudonym *Swift v HMRC* [2010] UKFTT 88 (TC) at [7(1)]. There is no indication of whether the membership interest was certified, and no discussion of whether certification makes a difference.

[434] HMRC Brief 15/2015 "HMRC response to the Supreme Court decision in *Anson v HMRC*"
https://www.gov.uk/government/publications/revenue-and-customs-brief-15-2015-hmrc-response-to-the-supreme-court-decision-in-george-anson-v-hmrc-2015-uksc-44/revenue-and-customs-brief-15-2015-hmrc-response-to-the-supreme-court-decision-in-george-anson-v-hmrc-2015-uksc-44
See 90.47.1 (LLC: Opaque).

> a ‘company with limited liability’, is an entity of a very similar kind to a UK private limited liability company. An Aktiengesellschaft (AG), sometimes called a “joint stock company” may be considered more akin to a UK public limited liability company (plc) as its stock may be listed. Under German law, the capital of a GmbH is not divided up into small units. However, a GmbH has a fixed amount of capital (Stammkapital) which corresponds to the maximum amount of share capital that the company may issue, similarly to a UK limited liability company’s “authorised share capital”. The amounts originally contributed (Stammeinlagen) by the members (Gesellschafter) will also be noted, just as in the UK the initial subscriber shares will be noted in the memorandum of a limited liability company.
>
> Article 5 of the German GmbH law sets out a minimum amount of Stammkapital (authorised share capital) as €25,000, and the minimum amount of Stammeinlage (original contribution/subscription) of each Gesellschafter (member) at €100.[435]
>
> Based upon GmbH cases HMRC has previously considered, the amounts of Stammeinlage subscribed by the members may normally be regarded as issued share capital for the purposes of the Taxes Acts.
>
> **Note**
>
> The above information has been set out in order to assist companies and their advisers understand HMRC’s present interpretation of [the definition of “ordinary share capital”] in the context of non-UK entities. The above note reflects our approach as taken in the context of a number of particular cases. Due to the particular facts that will be relevant in each individual case it is not possible for HMRC to offer a general advisory service in respect of other kinds of body throughout the world.

Fraser says:[436]

> *Ryall v Du Bois*[437] encourages a generous construction of the word “shares”. The issue in that case was whether the interest of a member in a German GmbH, which appeared not to be divided into fractional units (in the way that share capital is) or to be registered in a register, was “stocks” or “shares” within the meaning of the then Rule 1 applicable to Case V for Schedule D. The decision may not be

[435] Article 5 Gesetz betreffend die Gesellschaften mit beschränkter Haftung *https://www.gesetze-im-internet.de/gmbhg/__5.html*

[436] “Respectez les animaux etrangers! The Inland Revenue lists on entity classification” [2001] BTR 158.

[437] 17 TC 431.

absolutely conclusive that the interest of a member in a GmbH (or other overseas entity the ownership interests in which do not have the attributes of shares in an English company) is issued share capital, in that there may still be some room for distinguishing between "issued share capital" for the purposes of group relief from tax and "shares" within the meaning of Rule 1. Rule 1 appears to have been principally intended to distinguish between investment income on the one hand and income from active overseas businesses, on the other. Nevertheless, a conclusion that a GmbH does not have "issued share capital" would appear to be perverse in the extreme. The author would argue that these concepts no longer serve any useful purpose but they can, if strictly construed, create unnecessary hindrances to cross-border investment, where, for instance, a relevant company is incorporated in a jurisdiction where UK concepts of "issue" of shares are not in practice applied.

90.55.15 *Genußscheine/jouissance shares*

HMRC say:

> **Definition of ordinary share capital for employee share schemes**
> Certain tax advantaged share schemes have awarded interests in, or options over, particular types of instruments. As there is no direct English translation, these types of instruments are known as 'jouissance shares' ('actions de jouissance' in French and 'Genußscheine' in German) and HMRC has previously approved such schemes.
> Instruments of this type are generally issued by companies in Switzerland, Germany, Austria and France.
> After careful consideration HMRC has concluded that such instruments do not satisfy the ordinary share capital conditions as provided for in various parts of the employment related securities legislation in ITEPA 2003. While 'Genußscheine' and 'actions de jouissance' are frequently translated as shares, the better translation of 'scheine' and 'actions' is 'certificates'. The concept of ordinary share capital is used elsewhere in the taxes acts and will be interpreted accordingly.
> Share capital represents the ownership interest of members in the corpus or assets of a company reflected in its balance sheet after liabilities.
> Although 'Genußscheine' and 'actions de jouissance' carry an interest in dividends and in a winding-up to unpaid dividends, they do not carry an interest in company capital. This means they cannot be shares in share capital.
> HMRC will honour existing advantageous Income Tax treatment in relation to interests in or options over such certificates or 'shares'

> already granted, but from 6 April 2019 we will no longer accept these as satisfying the ordinary share capital condition and as such the requirements of the employment related securities legislation will also not be satisfied.

Similarly the CTM provides:

> **CTM00512 share capital** [Dec 2021]
> ... It follows that certificates that simply give rise to an interest in distributions of profit, an income stream, sometimes called "jouissance" shares, are not shares in share capital. The French term is used because there is no (common law) English equivalent. And the translation of "actions de jouissance" or in German "Genussscheine" is closer to "enjoyment certificates" than to "shares".

90.56 Capital contribution

90.56.1 *Company law background*

Capital contribution is a common method for Delaware companies to raise capital. The CG Manual explains the company law background:

> **CG43500 General** [Dec 2021]
> The company law provisions of some foreign jurisdictions, notably the USA, provide for the making of capital contributions to companies. A capital contribution is a contribution to the equity capital of a company, but is not made in exchange for shares issued to the contributor and it does not constitute a separate asset in its own right...
> An overseas company receiving a capital contribution may treat it in a number of ways, depending on the law of the foreign jurisdiction concerned and the conditions attaching to the payment. These may give the company a choice whether to designate the contribution as 'surplus' or as 'capital'. Amounts designated as 'surplus' may be available for distribution to shareholders, subject to solvency requirements. Amounts designated as 'capital' may only be repayable by way of a capital reduction. A company's balance sheet will generally show capital contributions made to it as an item of shareholders' funds separate from paid up share capital. Capital contributions may be described, for example, as 'additional paid in capital'.
> Capital contributions are not recognised under UK company law and if a payment is not made as part of the terms of issue of shares, it is possible it is either a loan or a gift. If a UK taxpayer contends that a sum paid to an overseas company is a capital contribution rather than a loan or gift, evidence to support that contention should be sought.

> For example if a UK company suggests a payment to an overseas affiliate is a capital contribution rather than a loan or gift there should be evidence of the appropriate treatment in the company accounts. If however there is a possibility that the money can be repaid, it is likely to be a debt within the loan relationships regime, see CFM30000. It is therefore necessary to examine all the circumstances surrounding the money transfer before coming to any conclusion as to what the nature of the payment is. If however agreement cannot be reached as to the nature of the payment and therefore the tax consequences (see CG43501 and CG43502 below), the decision lies with the Tribunals and the courts.

90.56.2 *Capital contribution to UK co*

The passage continues:

> Occasionally a capital contribution may be made to a UK company. As capital contributions are not a concept formally recognised within UK company law, a contribution received by a UK company should be reported within distributable reserves either as a gift or possibly a donation. If however it can be repaid in any circumstances it should be considered as a loan falling within the loan relationships regime.

The International Manual also makes some comments:

> **INTM502050 Issues affecting equity function cases** [Sep 2021]
> ... **Capital contributions**
> ... A capital contribution is ... not a loan and creates no obligation to transfer economic benefit to the maker of the contribution.
> In the UK there is no company law provision regarding capital contributions. If a UK company receives a capital contribution it will appear as such on the balance sheet within shareholders' funds. If the company makes a capital contribution, it will normally be included in the accounts as an added cost of investment in a subsidiary.
> If a UK company contends that a sum paid to an overseas affiliate is a capital contribution rather than a loan, HMRC can only accept the contention if there is clear evidence supporting it. For example, there should be a written agreement that a capital contribution has been made rather than a loan, and evidence of the appropriate treatment in the company accounts. If there is a possibility that the money can be repaid, it is a 'money debt' under the loan relationships legislation. It is necessary to examine all the circumstances surrounding the money transfer before making a decision. From HMRC's point of view, the amount contributed should not be distributable.

In *Fenston v HMRC* the position was explained as follows:

> ... assuming that at all relevant times the assets of the Company exceeded its liabilities ... as a result of the Contributions, the state of the Company's stock changed in the sense that the amount of funds distributable with respect to the Shares as a dividend or upon liquidation was increased by the amount of the Contributions.
>
> Under Delaware law, the funds available for payment of dividends, if and when declared by a corporation's board of directors, are payable out of "surplus". "Surplus" is defined in relation to "capital". "Capital" with respect to no par stock, such as the Shares, is defined as that portion of the consideration received by a corporation for the issued shares of its capital stock that the directors determine to be capital, or if no such determination is made, the amount of consideration received. The excess, if any, at any given time, of the net assets of the corporation over the amount so determined to be capital shall be "surplus". "Net assets" means the amount by which total assets exceed total liabilities. Therefore, the "surplus" of a corporation is an amount equal to the total assets of the corporation, minus the total liabilities of the corporation, minus the capital of corporation, minus the total liabilities of the corporation, minus the capital of the corporation (as just described). Here, the Contributions increased the Company's net assets, and thus its surplus, thus increasing the amount of funds the Company could lawfully have distributed to the trustees (as stockholders) as a dividend. With respect to entitlement to distributions on dissolution, when a corporation dissolves, its assets are held in trust for the benefit of creditors, and if creditors are paid in full, the stockholders. Accordingly, when a corporation dissolves it must first pay or provide for its creditors, both fixed and contingent, in full before any distribution can be made to stockholders. However, once creditors are paid or provided for, any residual assets are to be distributed to the corporation's stockholders. As described above, the Contributions increased the Company's total assets. If the Company had been dissolved immediately after such Contributions had been made ... then the amounts the trustees (as stockholders) would have been entitled to receive as stockholders upon dissolution with respect to the Shares would [have] been increased by the amount of the Contributions assuming, in each case, that amounts would remain for distribution to the stockholders following the payment in full of the Company's creditors.
>
> Therefore, the Contributions would have increased the amounts that could have been distributed with respect to the Shares either as a

dividend or as a liquidating distribution.[438]

90.56.3 *Capital contribution: CGT*

Section 38(1)(b) TCGA allows a deduction for:

> [I] the amount of any expenditure wholly and exclusively incurred
> [a] on the asset by him or on his behalf
> [b] for the purpose of enhancing the value of the asset,
> [c] being expenditure reflected in the state or nature of the asset at the time of the disposal

I refer below to **"CGT deduction conditions [a] - [c]"**.

> [II] and any expenditure wholly and exclusively incurred by him in establishing, preserving or defending his title to, or to a right over, the asset

The CG Manual provides:

> **CG43501 Made under terms of share issue** [Dec 2021]
> A shareholder may make a capital contribution to a company at the same time as the shareholder acquires shares in the company. If the capital contribution is made as part of the terms of issue of the shares, then the capital contribution should be accepted as consideration given wholly and exclusively for the acquisition of the shares within s.38(1)(a) TCGA.
> If a capital contribution is made as part of the terms of a share issue which is treated as a reorganisation for capital gains purposes, then the capital contribution should be accepted as consideration given for the new holding for the purposes of s.128(1) TCGA. The amount of the capital gains deduction will remain subject to the other general rules, such as s.17 TCGA and s.128(2) TCGA ...

So far so good. However the Manual continues:

> **CG43502. Other contributions not allowable** [Dec 2021]
> Where shares are disposed of in a company to which a capital contribution has been paid a claim may be made for a deduction in respect of that contribution in the capital gain computation. The claim will normally be for the contribution to be allowable as enhancement expenditure under s.38(1)(b) TCGA 1992.
> Although a capital contribution will typically affect the value of the

[438] [2007] UKSPC SPC00589 at [9]; I omit references to the Delaware General Corporation Law.

shares in the company to which the contribution is made, it does not represent either

[1] expenditure on the shares,[439] or

[2] expenditure reflected in the state or nature of the shares at the time of their disposal.

The Special Commissioners decision in the case of *The Trustees of the F. D. Fenston Will Trusts v HMRC* (SpC589/07) confirmed that a capital contribution which is not made as part of the terms for the issue of shares is not, in the absence of anything to indicate that the rights and privileges attaching to the shares have been enhanced, an allowable deduction within s.38 TCGA 1992 when shares in the company are disposed of. In particular, the capital contribution does not represent enhancement expenditure within s.38(1)(b) TCGA 1992.

In applying this decision it may be argued there are circumstances were the tax result will be distorted if the amount of tax payable takes account of value realised, directly or indirectly, by a shareholder from a capital contribution, but the capital contribution itself is not reflected in allowable expenditure for capital gains purposes. Below are some examples where such distortion may be alleged.[440]

[1] A capital contribution is returned by a company to its shareholders as a dividend or distribution and they are taxed on the distribution but the shareholder will have had no deduction for the contribution. Our view is that a dividend or distribution is paid out of the surplus of the company so therefore is not a direct return of the capital contribution paid by the shareholder (in which case it is probably a loan). The nature of the receipt is changed when a dividend or distribution is made in comparison with the time when the capital contribution was paid.

[2] A capital contribution is retained by the company at a time when there is a sale of shares in the company. The contribution may be reflected in an increased consideration for the disposal of the shares but a capital gains deduction will not be given.

[3] There is similar scope for distortions where a capital contribution is followed by a share exchange, reconstruction or amalgamation treated as a share reorganisation for capital gains purposes, see CG52500+. This is then followed by a disposal of the new holding for an amount which reflects the capital contribution made to the

[439] Author's footnote: Point [1] is wrong and directly contradicted by the decision in *Fenston* but it would be sufficient if HMRC are right on point [2].

[440] Author's footnote: "Distortion" is a euphemism for unfairness, and "alleged" is tendentious since the unfairness of [2] and [3] is obvious.

> company in which the original shares were held, and the capital contribution is not allowable expenditure on the original shares.
>
> In these last two cases, unless the capital contribution resulted in a change in the rights and privileges attaching to the shares, and that change is reflected in the nature of the shares at the time of their disposal, it is not an allowable deduction within s.38(1)(b) TCGA 1992 when those shares in the company, or replacement shares in that or a different company acquired by virtue of a share reorganisation are disposed of.

In *Fenston*, the Special Commissioners held that the capital contribution was expenditure "on the asset for the purpose of enhancing the value of the asset." So CGT deduction condition [a] was met. Unfortunately they held that the expenditure was not reflected in the state or nature of the asset at the time of the disposal so deduction condition [c] was not met

> 23 ... [1] Further, 'state and nature' for these purposes must be something other than merely the value of the asset—otherwise this phrase [CGT deduction condition [c]] would add nothing to the immediately preceding words.
>
> [2] In this case the capital contributions did not result in any increase in the number of shares in issue, or result in any change in the rights or restrictions attaching to the shares. The only effect of the capital contributions was to increase the surplus of the company—which would increase the amount available for distribution to shareholders, and therefore presumably the value of the shares. We do not consider this sufficient for the expenditure on the capital contributions to be reflected in the state and nature of the shares, either at the time the expenditure was incurred or at any time subsequently.

Point [1] is wrong[441] and point [2] is not convincing. However, the case was approved by the CoA in *Blackwell v HMRC,*[442] so the law is for most practical purposes settled. But it ought to be changed by extending allowable deductions to include capital contributions, and expenditure of the kind disallowed in *Blackwell*. The current law is an example of

[441] The words "reflected in the state or nature of the asset" are needed to cover this situation: suppose T spends £x on a kitchen in T's home. 15 years later that is replaced by a new kitchen. The £x was "incurred on the asset for the purpose of enhancing the value of the asset" but was not "reflected in the state or nature of the asset" at the time of disposal. In this case it is sensible to disallow the capital expenditure in a CGT computation.

[442] [2017] STC 1159 at [26].

egregious over-taxation.[443]

The CG Manual discusses the possibility of relief under s.38(1)(b)[II] TCGA which allows a deduction for expenditure "establishing, preserving or defending his title to, or to a right over, the asset:"

> There may also be cases where companies call on their shareholders to provide further capital to meet a specified purpose, in circumstances where a shareholder who fails to provide the additional funds may lose the entitlement to the shares held. In this situation, depending on the particular facts, the shareholder may be able to establish that the additional payment represents expenditure on preserving or defending the title to the shares within the terms of Section 38(1)(b) TCGA 1992.

90.56.4 *Planning*

Companies should in general be funded by share subscription or loan, and not by capital contribution, because the expense of the capital contribution will in general be disallowed for CGT purposes.

The HMRC view that "If there is a possibility that the money can be repaid, it is likely to be a debt" mitigates some of the unfairness of the treatment of capital contributions by reducing the number of occasions where a transaction is categorised as a capital contribution.

90.57 UK check-the-box rules?

Heather Field explains:[444]

> In 1995, the Service acknowledged that the flexibility afforded by applicable state laws undermined the theory of the corporate resemblance test and explained:
>
>> [M]any states recently have revised their statutes to provide that partnerships and other unincorporated organizations may possess characteristics that have traditionally been associated with corporations, thereby narrowing considerably the traditional distinctions between corporations and partnerships....
>>
>> One consequence of the narrowing of the differences under local law between corporations and partnerships is that taxpayers can achieve partnership tax classification for a non-publicly traded organization that, in all meaningful respects, is virtually

[443] See the discussion of egregious over-taxation at 2.5.4 (Pro-avoidance rationale).

[444] "Checking in on Check-the-Box" 42 Loy. L.A. L. Rev. 451 (2009) *http://digitalcommons.lmu.edu/llr/vol42/iss2/4*

> indistinguishable from a corporation. The Service and Treasury recognize that there is considerable flexibility under the current rules to effectively change the classification of an organization at will ....[445]

Accordingly, the preamble to the proposed CTB regulations explained that the "Treasury and the IRS believe[d] that it [was] appropriate to replace the increasingly formalistic rules under the [Kintner] regulations with a much simpler approach that generally is elective."[446] Moreover, the Service acknowledged that, under the Kintner regulations, "taxpayers and the IRS must expend considerable resources on classification issues."[447]... Presumably, taxpayers also incurred significant legal fees in obtaining advice on these classification issues. Further, the Service noted that small businesses could be particularly hard hit by the considerable costs of obtaining advice regarding how to structure business entities to obtain the most favourable combination of state law and tax treatment.[448] These additional cost, resource allocation, and distributive considerations contributed to the Service's decision to move to a simplified elective entity classification regime, where taxpayers could "elect to treat certain domestic unincorporated business organizations as partnerships or as associations for federal tax purposes,"[449] while still availing themselves of the local laws' flexibility for structuring unincorporated businesses.[450]

Staff of the Joint Committee on Taxation, "Choice of Business Entity"

[445] Footnote original: I.R.S. Notice 95-14, 1995-14 I.R.B. 7.

[446] Footnote original: Simplification of Entity Classification Rules, 61 Fed. Reg. 21,989, 21,990 (proposed May 13, 1996) (to be codified at 26 C.F.R. pt. 301).

[447] Footnote original: *Id.*

[448] Footnote original: *Id.*; see also Garcia, "Treasury Officials Address Check-the-Box Entities", 67 TAX NOTES 1009 (1995) (A Treasury official explained: "It's a resource allocation question .... Too many resources have been wasted both by the IRS and the private sector in resolving classification issues, even though in the end the taxpayer gets the desired status .... Classification becomes a very intricate game that if you have counsel, you get out of the maze and you're home free.") (internal quotations omitted).

[449] Footnote original: I.R.S. Notice 95-14, 1995-14 I.R.B. 7

[450] Footnote original: Simplification of Entity Classification Rules, 61 Fed. Reg. at 21,990. This goal of increased flexibility in organizational choice actually dates back to the adoption of subchapter S, enacted to enable "certain corporations to opt out of the double tax system so as to maximize organizational choice for small business owners." Steven A. Bank, The Story of Double Taxation: A Clash over the Control of Corporate Earnings, in Bus. Tax Stories 153, 178 (Stephen A. Bank & Kirk J. Stark, eds., 2005) (citing S. Rep. No. 85-1983, at 87 (1958)).

provides:[451]

> From the 1950s to 1996, the determination of whether a business entity was a C corporation [non-transparent] or a partnership was governed by case law and by 1960 regulations[452] that set forth factors considered indicative of corporate status. These corporate characteristics are (1) continuity of life, (2) centralization of management, (3) limited liability for owners of the entity, and (4) free transferability of interests. An unincorporated entity was classified as a partnership if it lacked any two or more of the four corporate characteristics...
>
> In late 1996, the IRS adopted new entity classification regulations known as the check-the-box regulations.[453] These regulations allow tax classification as either a partnership or a corporation to be explicitly elective subject to minimal restrictions for any domestic nonpublicly traded unincorporated entity with two or more members. The check-the-box regulations also provide that a single-member unincorporated entity may be disregarded for Federal tax purposes, that is, treated as not separate from its owner.

The Institute of Directors argue for a similar regime in the UK:

> Trading companies should be allowed to opt out of corporation tax by electing for a 'tax transparent' treatment on a similar basis to the successful "S-Corporations" regime in the USA.[454]

This would be beneficial; though the development of the idea to a consultation stage would require some investment in time and resources. It may be objected that this proposal would increase the number of hybrid entities which can be used for avoidance; but the answer to that is a regime which deals with the problems of hybrid entities.

Ideally the issue would be dealt with at an EU or OECD level, but that is not likely to happen.

90.58 Change of entity type

It is possible for an entity to change to another type of entity, eg a Foundation may become an Anstalt; a charitable company may become

[451] (2015) *https://www.jct.gov/publications.html?func=startdown&id=4765*

[452] Footnote original: Former Treas. Reg. sec. 301.7701-2. These were known as the Kintner regulations because they were based on the analysis in *U.S. v Kintner*, 216 F.2d 418 (9th Cir. 1954). See also *Larson v Commissioner*, 66 TC 159 (1976), acq. 1979-2 C.B. 1.

[453] Treas. reg. secs. 301.7701-1 through 301.7701-3.

[454] Institute of Directors, "GE2015: The IoD's Key Priorities for Tax Reforms" (2015).

a CIO; an AG may become a GmbH; an ordinary company may become a cell company. If the applicable law regards the new entity as the same as the previous entity, UK law will follow that analysis,[455] so the change does not in principle involve a disposal and acquisition which would be a chargeable event for CGT.[456]

The CT Manual considers conversion between a company and a mutual benefit society, which illustrates the point:

> **CTM40550 conversion to a Companies Act company and vice versa**
> [Dec 2021]
> Where a registered society converts to a Companies Act company under CCBS14/S112, or a Companies Act company converts to a registered society under CCBS/S115, this does not cause one entity to cease and another to come into being. They are treated as the same legal entity both before and after the conversion. No change of UTR should be necessary.
> ... such conversions do not generally give rise to any deemed or actual disposal of chargeable assets or distributions and there is no cessation and recommencement of the business...
> Where a registered society is a principal member of a group, a conversion will not stop it being the principal member of that group. Furthermore, where the registered society had acquired an asset in an intra-group transaction, the conversion will not lead to an occasion of charge for CG purposes.

90.59 Redomiciliation

The term "redomiciliation" is used to describe two distinct types of arrangement.

90.59.1 *Redomiciliation in strict sense*

Some jurisdictions[457] allow a company to change its place of registration/

[455] See Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), section 2 (Status).

[456] I say "in principle". Suppose (say) a foreign partnership (with legal personality, but whose assets are regarded as vested in the partners for CGT) converted into a company (which would be beneficial owner of its assets). That might be regarded as involving a disposal by the partners, even if the partnership and the company were regarded as the same person by the foreign law. And likewise if a company converted into a partnership. This is unexplored territory.

[457] See for instance [Isle of Man] Companies (Transfer of Domicile) Act 1998.
It is proposed to allow this in the UK; see HMRC, "Corporate re-domiciliation: consultation" (2021); "Corporate re-domiciliation: summary of responses" (2022)

incorporation. Under legislation which recognises and regulates the procedure:

(1) The company is registered in a new jurisdiction.
(2) The company is struck off the register in its original jurisdiction of incorporation ("the old jurisdiction")

The process brings about a change in company domicile and place of registration/incorporation.

A key question is whether the company post-redomiciliation:

(1) is the same company despite the change (the position may be compared to an individual changing domicile and citizenship); or
(2) a separate company from the company pre-domiciliation

The intention is usually that the company remains the same. The view taken by third countries depends on the applicable conflict of law rules. But in principle if the old and new jurisdictions both consider the company continues despite the change, this should be accepted in third countries. The Land Registry agree. Practice guide 78 (Overseas companies & LLPs) provides:[458]

> **4.5 Change of domicile**
> Where an overseas company has changed its territory of incorporation we will require the following forms of evidence to be lodged:
> - a letter from a qualified lawyer practising in territory A (the original place of incorporation) that makes it clear whether the company will either:
>   - cease to be incorporated in that territory, or
>   - continue to be incorporated in that territory as well as in territory B
>
> The letter must also state that the law of territory A recognises the company incorporated in territory B as the same legal person as the company that is or was formerly incorporated in territory A, and:
> - a letter from a qualified lawyer practising in territory B (the new place of incorporation) that makes it clear that:
>   - the company has been incorporated in territory B (not just registered as a foreign company with a branch or place of business there), and:
>   - the law of territory B regards the company as the same legal

https://www.gov.uk/government/consultations/corporate-re-domiciliation

[458] *https://www.gov.uk/government/publications/overseas-companies-and-limited-liability-partnerships-pg78* (Last updated 10 July 2023) para 4.5.

> person as the company that is or was formerly incorporated in territory A, rather than as a new company, and:
> - either a duly completed certificate in Form 7 by a qualified lawyer practising in territory B or a certified copy of the charter, statute, rules, memorandum and articles of association or other document(s) reconstituting the company in territory B....
>
> Unless the laws of both territories treat the company registered in territory B as the same legal person as the company registered, or formerly registered, in territory A, the company in territory B must be regarded as a new and different legal person, in which case it cannot be entered in the register unless the estate or charge is transferred to it by the company incorporated in territory A, or its liquidator, in the usual way.

The INTM has an extract from the ITH:

> **ITH356 Company residence: incorporation rule**
> ... Under company law relating to the UK a company cannot move its place of incorporation or registered office out of the country in which it is domiciled whilst at the same time retaining its identity, except by Private Act of Parliament. Some countries - Switzerland and Spain are examples - have procedures whereby a foreign incorporated company can reincorporate in those countries and retain its identity although Switzerland may now require the procedure to be recognised by the company's country of origin. In English law an English company which uses those procedures and is struck off the English register ceases to exist. The company, now foreign incorporated, is considered to be a different company.

This assumes that UK company law does not regard the foreign company as having the same identity.. That would no doubt change with the proposed law reform.

90.59.2 *Redomiciliation by reorganisation*

The term redomiciliation is also used to describe a more traditional type of reorganisation, under which:

(1) Existing shares of a company ("Oldco") are cancelled.
(2) Oldco issues shares to a new company ("Newco") in a new jurisdiction.
(3) Newco issues shares to the former shareholders of Oldco.

In this procedure neither company actually changes its place of registration/domicile: instead shareholders effectively swap shares in a company for shares in another company incorporated in another jurisdiction. Strictly speaking, the term redomiciliation is used rather loosely here; but the usage is common[459] and it is pedantic to object.[460]

90.60 Ascertaining foreign law

As similar rules apply in England, Scotland and Northern Ireland, I refer in this section to "UK law".

90.60.1 *Foreign law a question of fact*

Foreign law is regarded as a question of fact, and so needs to be proved by evidence.

Dicey says:[461]

> In any case to which foreign law applies, that law must be pleaded and proved as a fact to the satisfaction of the judge by expert evidence or sometimes by certain other means.

A court may direct, in an appropriate case, that foreign law should be ascertained by Counsel's submissions, rather than by expert evidence.

As foreign law is a matter of fact, a UK court decision is not a binding precedent. In *Baker v Archer-Shee* and *Archer-Shee v Garland*, the taxpayer lost in the first case, and succeeded in the second case, because in the first case the taxpayer provided no evidence of New York law, and it was assumed that it was the same as English law; in the second case the taxpayer provided evidence that New York trust law was different from English trust law.[462]

HMRC are currently challenging the decision in *Anson* on the grounds that the FTT made a mistake as to the foreign law. This was not the same situation as in *Baker/Garland*: there was no evidence as to US law in Baker but there was in Garland, so the courts were looking at the factual position under US law afresh. HMRC have to say that on the evidence available to the FTT in *Anson*, they should have come to a different finding of fact. Therefore, whilst another FTT is not bound by the FTT's

[459] For an example, see *Randall & Quilter Investment Holdings* [2013] EWHC 4357 (Comm) at [2].

[460] See too 58.7 (Redomiciled (ex-UK) securities).

[461] Dicey, Morris & Collins, *The Conflict of Laws* (16th ed, 2022) para 3R-001 (1); cited *Hartogs v Sequent (Schweiz) AG* [2019] EWHC 1915 (Ch).

[462] See 42.9 (Life tenant: Source of income)

finding in *Anson* and HMRC can certainly challenge it, in practice HMRC needs clearer evidence to win than in *Garland*.

In *Dreyfus* the taxpayer did provide evidence of French law which was accepted by the Tribunal, but the decision is not binding as it concerns a question of fact, HMRC do not follow it, and in practice that seems to have been accepted.[463]

This raises the question of what constitutes "foreign law". The tax tribunals (FTT and UT) and the Supreme Court, have UK-wide jurisdiction, so Scots law (in England) and English law (in Scotland) are not regarded as foreign law, and are classified as questions of law and not of fact. That applies too in appeals from the tax tribunals to the CoA and Court of Session.[464] Thus, for instance, the English CoA expressed its view on issues of Scots partnership law, in *Memec.*

90.60.2 *UK law assumed to apply*

Dicey says:[465]

> In the absence of satisfactory evidence of foreign law, the court will apply English law to such a case.

That may of course suit the taxpayer. But a taxpayer who wrongly proceeds on the basis that foreign law is the same as English law would be subject to penalties if they know, or if a reasonably careful taxpayer would know, that the foreign law is different; and in legal proceedings, misleading the Tribunal by failure to bring relevant facts to its attention may constitute professional misconduct.

Similarly, in Scotland, the court will assume in the absence of evidence that Scots law applies.

90.60.3 *Civil law comprehension gap*

Questions of foreign law which arise in the context of UK tax are often difficult. Where the foreign law is a common law it will share basic concepts with English law and that eases things a little. If the foreign law is a civil law the chances of a communications gap developing between a foreign expert adviser and an English lawyer seeking their advice are greater.

[463] See 90.31 (Société en nom collectif).

[464] *Spring Capital v HMRC* [2023] UKUT 91 (TCC).

[465] *Dicey* para 3R-001(2); see above fn.

CHAPTER NINETY ONE

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91.1 Hybrid entities: Introduction

I use the following terminology.

A "**hybrid entity**" is an entity which is:

(1) transparent[1] in one State, in the sense that the entity's income is regarded as income of its members[2] and
(2) opaque in another State[3]

If an entity is transparent in (say) the USA, I call the entity **"USA-transparent"** and USA is the **"transparent State"**.

A **"non-hybrid"** entity is one which is not hybrid.

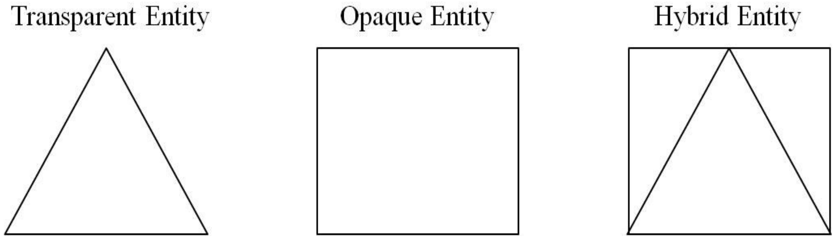
[1] See 90.6.1 (Transparent/opaque terminology).

[2] In the context of hybrid entities, it is convenient to use the word "member" loosely, to include any person with an interest in any entity. TIOPA uses the word "investor" and USA regulations use the term "interest holder". As "entity" covers a wide range, there is no one word which perfectly fits all the circumstances.

[3] For a more elaborate statutory definition, see 91.15 (Hybrid entity).

In structure diagrams in this chapter:

- a triangle represents a transparent non-hybrid (typically a partnership)
- a rectangle represents an opaque non-hybrid (typically a company)
- a combination of the two represents a hybrid entity



Strictly, one should not use the term hybrid/non-hybrid in the abstract. An entity can only be hybrid in relation to two particular States. But where the context is clear it is permissible simply to refer to an entity as hybrid (or not).

Hybrids may concern three distinct States:

My term	**Meaning**	**OECD Partnerships Report Term**
Source State	Where income arises	State S
Entity State	Where entity is established[4]	State P (for **P**artnership)
Member state	Where members are resident[5]	State R

Use of hybrid entities to produce double non-taxation has been called tax arbitrage; this unhelpful term was used as a heading in F(no.2)A 2005. But the current legislation in Part 6A TIOPA has adopted the better, if longer, heading "Hybrid and Other Mismatches".

Hybrids may also give rise to double taxation[6]; (so of course may non-hybrid companies, tax on the company and tax on a distribution).

In *Columbus Container Services* the advocate-general observed:

> International tax studies on the problem of the transparency of partnerships have highlighted the incredible complexity of this branch

[4] It is assumed that the entity is resident where established. BEPS Action 2 Report uses the term "establishment jurisdiction".
Further issues arise if different States apply different tests as to where a entity is established or resident (is it management and control, governing law, etc). But that is not pursued here.

[5] If members are resident in different States, each State needs to be considered separately.

[6] See *Anson v IRC* discussed 90.43 (Limited liability company).

> of law...[7]

But the topic is now much more complex, as a result of OECD model hybrid entity rules and ATAD/Part 6A TIOPA.

91.2 *Background and guidance*

For background to this topic, see:

DTA and *ATAD/TIOPA issues*
OECD, "Neutralising the Effects of Hybrid Mismatch Arrangements" (**"BEPS Action 2 Report"**)[8]

DTA hybrid issues
OECD, "The Application of OECD Model Tax Convention to Partnerships"("**OECD Partnerships Report**") (1999)
Nikolakakis *et al* "Some Reflections on the Proposed Revisions to the OECD Model and Commentaries, and on the Multilateral Instrument, with Respect to Fiscally Transparent Entities"[9]
Brabazon, "Holding Proteus: Emerging Treaty Practice on Hybrid and Fiscally Transparent Entities" [2020] BTR 670
Wheeler, ed *The Aftermath of BEPS* (2019)

ATAD/TIOPA issues
Brabazon, "BEPS Action 2: Trusts as Hybrid Entities" [2018] BTR 211

91.3 Hybrid categories

91.3.1 *Examples of hybrid entities*

Examples of (potentially) hybrid entities include:

Entity	**UK law**	**Foreign law**	**See para**
UK LLP	UK-transparent	Likely foreign-law opaque	85.21; 85.22
USA LLC	UK-opaque	US-transparent[10]	90.43; 91.7.1
USA S Corp	UK-opaque	US-transparent[11]	9.28.1
Unit trust/FCP	Sometimes opaque	Might be anything	69.7

[7] *Columbus Container Services v Finanzamt Bielefeld-Innenstadt* [2008] STC 2554 at [40].

[8] Final Report (2015) *http://www.oecd.org/ctp/neutralising-the-effects-of-hybrid-mismatch-arrangements-action-2-2015-final-report-9789264241138-en.htm*

[9] [2017] BTR 295 *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3005860*

[10] Unless the LLC elects to be treated as a company for USA tax purposes.

[11] Assuming the Corporation elects to be treated as transparent for USA tax purposes.

91.3.2 *Hybrid: Avoidance attribution rules*

UK anti-avoidance provisions may turn an opaque entity (typically a discretionary trust or a company) into one which may be regarded as UK-law transparent, or effectively transparent:

Entity	**Anti-avoidance Rule**	**Provision**
Clearer examples		
Settlor-interested trust	Trust income treated as arising to settlor	s.624
Non-resident company	Gains treated as accruing to participator	s.3
Further examples		
Entity within s.720	Income treated as arising to transferor	s.720
Company subsidiary	Profits treated as accruing to parent	CFC rules

To regard entities within s.720/CFC as transparent requires one to overlook that s.720 and CFC income has been categorised as a different source of income, distinct from the income of the CFC/person abroad to which it relates.[12] But it is suggested that the DTA hybrid-entity rule should not be construed so technically.

Since a foreign state is likely[13] to view the trust/company as opaque, the UK anti-avoidance provisions create what may be regarded as a hybrid.

The same may apply the other way round for a foreign State if that State has comparable rules, and assuming the UK rules do not apply. An example is a USA grantor trust, which is US-transparent[14] but may be UK-opaque.

A comparable situation may arise when two States both agree that an entity is transparent, but take different views as to who is entitled to the income. An example is a settlor-interested IIP trust within s.624: in the UK trust income is treated as arising to the settlor, but in another State it may be regarded as arising to the life tenant (who may not be the settlor). For lack of a better term, I refer to that as a **"quasi-hybrid"**.

Do these types of hybrid count as hybrid within the scope of the DTA hybrid-entity rules? Under the USA/UK DTA the answer is, yes.[15] In other cases, the position has been doubted, but the object and purpose of the rule suggests that the answer ought to be the same.

[12] See 107.22 (Characterisation).

[13] If both countries apply similar anti-avoidance rules the entity may be regarded as a transparent non-hybrid.

[14] See 91.7.1 (US-transparent entities).

[15] See 91.7.8 (s.624/720 income; s.3/86 gain).

91.3.3 *Classic & Reverse hybrids*

In the case of a source State/member state DTA (which one may call the paradigm case) there are four permutations:

Entity category	**Source State**	**Member state**	**Model art 1(2)**
Non-hybrid			
Transparent	Transparent	Transparent	n/r
Opaque	Opaque	Opaque	n/r
Hybrid			
Classic[16]	Opaque	Transparent	Applies DT relief
Reverse	Transparent	Opaque	Denies DT relief

We are concerned with *Classic* and *Reverse* hybrids. Classic/Reverse hybrids are (if one may use the word) rather opaque terms; so I add *(member State transparent/opaque)* and use initial capitals. Strictly, one should not use the terms Classic/Reverse hybrid in the abstract. An entity can only be a Classic/Reverse hybrid in relation to a particular source State and a particular member state. But where the context is clear it is permissible simply to refer to an entity as a Classic/Reverse hybrid.

In the case of a hybrid, I note to the right of the diagram whether it is a Classic or a Reverse hybrid.

91.3.4 *Bilateral/triangular situations*

I have not found bilateral/triangular terminology to be helpful when grappling with the issues of hybrids. But I set it out because other writers use this terminology.

In a **"triangular"**[17] situation, three different States are involved: Source state, entity state and member state.

In a **"bilateral"** situation, only two States are involved. This obviously happens if two of the states are the same, ie:

Two states the same	**Third state different**
Member state & entity State	source State
Source State & entity State	member state
Source State & member state	entity State

But even if the 3 States are different, we may simply be concerned with

[16] Classic hybrid is my term; others refer to this as just a hybrid.

[17] The word "triangular" is conventional here, though "trilateral" would be more apt.

one treaty, made between two of the States, and for the purposes of that treaty the position under the law of the third State does not matter. We may be concerned with:

Treaty	**Topic: Taxation of**
Source/member states DTA	Income of members & of entity
Source/entity States DTA	Income of entity
Members/entity States DTA	Distribution by entity

In a triangular situation, the entity may be transparent or opaque, under the laws of (1) the member state (2) the entity State and (3) the source State. So there are eight permutations:

Case no.	**Source-State law**	**Entity-State law**	**Member-State law**
1	Transparent	Transparent	Transparent
2	Transparent	Transparent	Opaque
3	Transparent	Opaque	Transparent
4	Transparent	Opaque	Opaque
5	Opaque	Transparent	Transparent
6	Opaque	Transparent	Opaque
7	Opaque	Opaque	Transparent
8	Opaque	Opaque	Opaque

Cases 1 and 8 should raise no difficulties. We are concerned with 6 triangular cases, cases 2 - 7.

Triangular arrangements may concern 2 or even 3 DTAs:

(a) The source/member states DTA
(b) The source/entity States DTA
(c) The entity/member states DTA

It seems at first that this generates up to 18 permutations, ie it is necessary to consider the application of (up to) 3 DTAs to each of the 6 cases (no's 2-7). But it is not that complicated, because if we are looking at a treaty between any two States:

(1) It will not matter what is the law of the third State
(2) In some of the permutations, the two treaty States will agree that the entity is transparent, or may both agree that the entity is opaque, so in relation to those States, the entity is non-hybrid.

A triangular situation is just a combination of two bilateral situations. Thus:

Case no.	Source-State law	Entity-State law	Member-State law	*DTA status*[18]
2	Transparent	Transparent	Opaque	
	2a: application of source/member state DTA			*Reverse hybrid*
	2b: application of source/entity State DTA			*Non-hybrid*
3	Transparent	Opaque	Transparent	
	3a: application of source/member state DTA			*Non-hybrid*
	3b: application of source/entity State DTA			*Reverse hybrid*
4	Transparent	Opaque	Opaque	
	4a: application of source/member state DTA			*Reverse hybrid*
	4b: application of source/entity State DTA			*Reverse hybrid*
5	Opaque	Transparent	Transparent	
	5a: application of source/member state DTA			*Classic hybrid*
	5b: application of source/entity State DTA			*Classic hybrid*
6	Opaque	Transparent	Opaque	
	6a: application of source/member state DTA			*Non-hybrid*
	6b: application of source/entity State DTA			*Classic hybrid*
7	Opaque	Opaque	Transparent	
	7a: application of source/member state DTA			*Classic hybrid*
	7b: application of source/entity State DTA			*Non-hybrid*

91.4 DTA hybrid-entity rules

91.4.1 *Terminology*

There are (at least) 3 DTA hybrid-entity rules. I coin the following terminology:

Term	**Rule found in:**
OECD hybrid-entity rule(s):	
OECD Model hybrid-entity rule	art 1(2) OECD Model
BEPS MLI[19] hybrid-entity rule	art 3(1) BEPS MLI
USA hybrid-entity rule	art 1(8) USA/UK DTA; art 1(6) USA Model

Actual treaties vary in their wording, so it is necessary to check the treaty in each case.

91.4.2 *OECD hybrid-entity rules*

Art 1(2) OECD Model and art 3(1) BEPS MLI are effectively identical (with changes only to conform to MLI's terminology):

[18] That is, the status of the entity in relation to the two treaty States concerned.

[19] See 107.15 (BEPS MLI).

Art 1(2) OECD Model	**Art 3(1) BEPS MLI**
[a] For the purposes of this Convention, income derived[20] by or through an entity or arrangement[21] that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State	[a] For the purposes of a Covered Tax Agreement, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting Jurisdiction
shall be considered to be income of a resident of a Contracting State	shall be considered to be income of a resident of a Contracting Jurisdiction
[b] but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.	[b] but only to the extent that the income is treated, for purposes of taxation by that Contracting Jurisdiction, as the income of a resident of that Contracting Jurisdiction.

It is essential to keep in mind which State is which; art 1(2) is easier to follow if it is expanded thus:

> For the purposes of this Convention, income derived by or through an entity or arrangement that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State

[a] shall be considered to be income of a resident of [the UK]	[b] shall be considered to be income of a resident of [the foreign State]
but only to the extent that the income is treated, for purposes of	but only to the extent that the income is treated, for purposes of

[20] In British legal English, one would more idiomatically refer to:
(1) Income arising to/received by an opaque entity
(2) Income arising to/received by a member through a transparent entity
But the meaning is the same. See 15.11.1 ("Deriving" income).

[21] Is it possible to envisage an arrangement which is not an entity? The word "entity" is used widely, to include arrangements without legal personality, such as English partnerships and trusts, (ie not just legal persons). So the words "or arrangement" seem otiose, at least for the UK. But there may be jurisdictions where the point might otherwise have been unclear, and the OECD Model is intended to be used everywhere.

taxation by [the UK], as the income of a resident of [the UK]

taxation by [the foreign State], as the income of a resident of [the foreign State].

91.4.3 *USA hybrid-entity rule*

The version relevant to this work is that in the USA/UK DTA. Article 1(8) provides:

> An item of income, profit or gain derived through a person that is fiscally transparent under the laws of either Contracting State shall be considered to be derived by a resident of a Contracting State to the extent that the item is treated for the purposes of the taxation law of such Contracting State as the income, profit or gain of a resident.[22]

It is essential to keep in mind which State is which; art 1(8) is easier to follow if it is expanded to read:

> An item of income/gain derived through a person that is fiscally transparent under the laws of either Contracting State shall be considered
>
> [a] to be derived by [ie, arising to] a resident of [the UK] to the extent that the item is treated for the purposes of the taxation law of [the UK] as the income/gain of a resident of [the UK]
>
> [b] to be derived by [ie, arising to] a resident of [the USA] to the extent that the item is treated for the purposes of the taxation law of [the USA] as the income/gain of a resident of [the USA].

91.4.4 *OECD/US rules compared*

The OECD wording is derived from the USA DTA hybrid-entity rule, and the differences do not seem to be significant:

> [a] For the purposes of this Convention, ~~an item of income, profit or gain~~ income derived by or through ~~a person~~ an entity or arrangement that is treated as wholly or partly fiscally transparent under the ~~laws~~ tax law of either Contracting State shall be considered to be ~~derived by~~ income of a resident of a Contracting State

[22] This rule is in art 1(6) USA Model Income Tax Convention, from 1996, and is standard in USA treaties. See Wheeler, *The Missing Keystone of Income Tax Treaties* (2012) para 2.4.5 (Concluded treaties).
The current (2016) USA Model made minor changes to the wording but as the USA/UK DTA was made in 2001, this does not seem relevant to the UK.

> [b] but only to the extent that the ~~item~~ income is treated, for the purposes of ~~the taxation law of such Contracting State~~ taxation by that State, as the income~~, profit or gain~~ of a resident of that State.[23]

91.4.5 *Use of OECD Partnerships Report*

OECD Partnerships Report analysed partnership hybrid entities[24] under the OECD Model in its pre-2007 form (ie lacking art 1(2), the OECD hybrid-entity rule). This is important for older treaties if they lack a hybrid-entity rule (which may be the case if the foreign State has opted out of the MLR hybrid-entity rule). The Report also continues to be relevant to DTAs in post-2007 form. OECD Commentary provides:

> 2. [OECD Model art 1(2)] addresses the situation of the income of entities or arrangements that one or both Contracting States treat as wholly or partly fiscally transparent for tax purposes. The provisions of the paragraph ensure that income of such entities or arrangements is treated, for the purposes of the Convention, in accordance with the principles reflected in [the OECD Partnerships Report]. That report therefore provides guidance and examples on how the provision should be interpreted and applied in various situations.

The conclusions of the OECD Partnerships Report were later set out in the OECD Commentary, so may not be necessary to look back to the text of the Report itself.

91.5 MLI hybrid-entity rule: Application

This section considers how the MLI hybrid-entity rule is slotted into pre-2017 DTAs.

91.5.1 *Pre-2017 hybrid rules overridden*

Article 3(4) BEPS MLI provides:

> [Art 3(1), MLI hybrid rule] (as it may be modified by paragraph 3[25]) shall apply in place of or in the absence of provisions of a Covered Tax

[23] Where they differ, OECD wording is underlined and USA wording in strikeout.

[24] The OECD Commentary provides: "3. The [OECD Partnerships Report], however, dealt exclusively with partnerships and whilst the Committee recognised that many of the principles included in the report could also apply with respect to other non-corporate entities, it expressed the intention to examine the application of the Model Tax Convention to these other entities at a later stage..."

[25] See 82.5.4 (BEPS MLI Savings Clause).

> Agreement to the extent that they address whether income derived by or through entities or arrangements that are treated as fiscally transparent under the tax law of either Contracting Jurisdiction
> [a] (whether through a general rule
> [b] or by identifying in detail the treatment of specific fact patterns and types of entities or arrangements)
> shall be treated as income of a resident of a Contracting Jurisdiction.

In short, the BEPS MLI hybrid rule has priority over a treaty hybrid rule. MLI article 3 refers several times to "a provision described in para (4)", ie in art 3(4). I gloss that as a **"pre-2017 hybrid-entity rule"**.

91.5.2 *Art 3(1) MLI opt-outs*

Article 3(5) BEPS MLI provides a variety of options to opt-out of the art 3(1) BEPS MLI hybrid rule:

> A Party may reserve the right:
> a) for the entirety of this Article not to apply to its Covered Tax Agreements;
> b) for paragraph 1 [MLI hybrid-entity rule][26] not to apply to its Covered Tax Agreements that already contain a provision described in [art 3(4), pre-2017 hybrid-entity rule];
> c) for paragraph 1 not to apply to its Covered Tax Agreements that already contain a provision described in paragraph 4 which denies treaty benefits in the case of income derived by or through an entity or arrangement established in a third jurisdiction;
> d) for paragraph 1 not to apply to its Covered Tax Agreements that already contain a provision described in paragraph 4 which identifies in detail the treatment of specific fact patterns and types of entities or arrangements;
> e) for paragraph 1 not to apply to its Covered Tax Agreements that
> [i] already contain a provision described in paragraph 4 which identifies in detail the treatment of specific fact patterns and types of entities or arrangements and
> [ii] denies treaty benefits in the case of income derived by or through an entity or arrangement established in a third jurisdiction; ...[27]
> g) for paragraph 1 to apply only to its Covered Tax Agreements

[26] For art 3(1) see 91.4.2 (OECD hybrid-entity rules).

[27] I deal with para (f) in the next section.

> that already contain a provision described in paragraph 4 which identifies in detail the treatment of specific fact patterns and types of entities or arrangements.

The UK has not made these reservations.

91.5.3 *Art 3(2) MLI*

Article 3(5) BEPS MLI allows States to opt-out of art 3(2) BEPS MLI:

> A Party may reserve the right:
>
> f) for paragraph 2 not to apply to its Covered Tax Agreements;

The UK has reserved the right under para 3(5)(f) for art 3(2) not to apply; in short, it has adopted BEPS MLI art 3(1) but opted out of art 3(2).[28]

91.5.4 *BEPS MLI Savings Clause*

For completeness: art 3(3) BEPS MLI provides:

> With respect to Covered Tax Agreements for which one or more Parties has made the reservation described in subparagraph a) of paragraph 3 of Article 11 (Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents),[29] the following sentence will be added at the end of paragraph 1:
>
> "In no case shall the provisions of this paragraph be construed to affect a Contracting Jurisdiction's right to tax the residents of that Contracting Jurisdiction."

This applies a Savings Clause to the BEPS MLI hybrid-entity rule in cases where the Savings Clause is not more generally applicable.

The UK has not made the reservation described in art 11(3)(a),[30] ie it has not opted out of the BEPS MLI Savings Clause. So this would only be relevant if another jurisdiction has done so. But I wonder how often that

[28] For completeness, art 3(2) provides:

> "Provisions of a Covered Tax Agreement that require a Contracting Jurisdiction to exempt from income tax or provide a deduction or credit equal to the income tax paid with respect to income derived by a resident of that Contracting Jurisdiction which may be taxed in the other Contracting Jurisdiction according to the provisions of the Covered Tax Agreement shall not apply to the extent that such provisions allow taxation by that other Contracting Jurisdiction solely because the income is also income derived by a resident of that other Contracting Jurisdiction."

The reader may be relieved: this para does not yield its meaning on a first reading.

[29] See 109.5.4 (BEPS MLI Savings Clause).

[30] See 109.5.7 (Application of BEPS Savings Clause).

will happen.

91.5.5 *Notifications*

Article 3(6) BEPS MLI provides:

> [a] Each Party that has not made a reservation described in subparagraph a) or b) of paragraph 5 shall notify the Depositary of
>
> [i] whether each of its Covered Tax Agreements contains a provision described in paragraph 4 that is not subject to a reservation under subparagraphs c) through e) of paragraph 5,
>
> [ii] and if so, the article and paragraph number of each such provision.

That applies to the UK, which has published a list of 17 DTAs which contain a provision described in Article 3(4) that is not subject to a reservation under Article 3(5)(c) through (e).[31]

Article 3(6) BEPS MLI continues:

> [b] In the case of a Party that has made the reservation described in subparagraph g) of paragraph 5, the notification pursuant to the preceding sentence shall be limited to Covered Tax Agreements that are subject to that reservation.
>
> [c] Where all Contracting Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, that provision shall be replaced by the provisions of paragraph 1 (as it may be modified by paragraph 3) to the extent provided in paragraph 4.
>
> [d] In other cases, paragraph 1 (as it may be modified by paragraph 3) shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 1 (as it may be modified by paragraph 3).

The UK has not opted in to MLI art 5 (Hybrid Mismatches: Methods for elimination of double taxation).

91.6 Hybrid-entity rule: Effect

Para 1(2) OECD Model (the OECD hybrid-entity rule) can be divided into its separate elements as follows:

[31] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725261/Final_list_of_UK_reservations_and_notifications_made_on_deposit_of_the_instrument_of_ratification.pdf*

Text of rule	**Comment**
[a] For the purposes of this Convention,	Scope of rule
[b] income derived by or through an entity or arrangement [c] that is treated as wholly or partly fiscally transparent under the tax law of either Contracting State	Conditions for application of rule
[d] shall be considered to be income of a resident of a Contracting State [e] but only to the extent that the income is treated, for purposes of taxation by that State, as the income of a resident of that State.	Effect of rule

The effect of the rule is that:

(1) To the extent that the member State considers the income to arise to the member in that State:
    (a) Income arises to the member
    (b) Income does not arise to the entity

(2) To the extent that the member State does *not* consider the income to arise to the member:
    (a) Income arises to the entity
    (b) Income does not arise to the member

In short, the member State rules determine the issue of transparency /opacity and trump the source State rules. One might say that a Classic hybrid is deemed to be transparent, and a Reverse hybrid is deemed to be opaque. The consequence may be to apply or disapply DT relief:

Hybrid	**Treated as**	**DT relief**
Classic (member-State transparent)	Transparent non-hybrid	Applied
Reverse (member-State opaque)	Opaque non-hybrid	Disapplied

In short, the rule is to avoid double taxation as well as to avoid double non-taxation.

91.6.1 *Considered as income: Effect*

OECD Commentary provides:

> 12. By providing that the income to which it applies will be considered to be income of a resident of a Contracting State for the purposes of the Convention, [art 1(2)] ensures that the relevant income is attributed to

> that resident for the purposes of the application of the various allocative rules of the Convention [ie the rules allocating taxing rights to one or other State].
>
> Depending on the nature of the income, this will therefore allow the income to be considered, for example, as
> [1] "income derived by" for the purposes of Articles 6, 13 and 17,
> [2] "profits of an enterprise" for the purposes of Articles 7, 8 and 9 (see also paragraph 4 of the Commentary on Article 3[32]) or
> [3] dividends or interest "paid to" for the purposes of Arts 10 and 11.

These 3 expressions raise the same issue, or essentially the same issue, namely, when income/gains should be *recognised,* or *attributed to* a person.[33] So the rule applies in the same way to each.

> [4] The fact that the income is considered to be derived by a resident of a Contracting State for the purposes of the Convention also means that where the income constitutes a share of the income of an enterprise in which that resident holds a participation, such income shall be considered to be the income of an enterprise carried on by that resident (e.g. for the purposes of
> [a] the definition of enterprise of a Contracting State in Article 3[34] and
> [b] [art 21(2)[35]]).

I think the point is that the enterprise (business) of a Classic hybrid (member-State transparent) is deemed to be carried on by the members, not by the entity.

91.6.2 *Hybrid is nominee/agent*

In the case of a Classic hybrid, where the source State is required to consider the income to be the income of/paid to the members, it must normally be required to consider members to be beneficial owners of the income. Otherwise relief in articles 10/11/12 would never apply. That assumes of course that the members of the entity hold their interest in the entity beneficially.

OECD Commentary provides:

> 13. Whilst the paragraph ensures that the various allocative rules of the

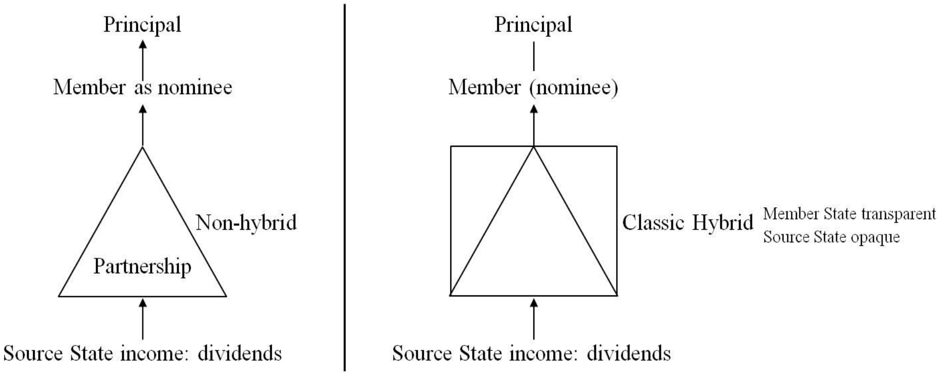
[32] See 21.23.2 ("Enterprise").
[33] See 15.11 (Income recognition in DTAs).
[34] See 21.23.2 ("Enterprise").
[35] See 107.9.2 (Income through PE).

> Convention are applied to the extent that income of fiscally transparent entities is treated, under domestic law, as income of a resident of a Contracting State, the paragraph does not prejudge the issue of whether the recipient is the beneficial owner of the relevant income.

The commentary gives an example:

> Where, for example, a fiscally transparent partnership receives dividends as an agent or nominee[36] for a person who is not a partner, the fact that the dividend may be considered as income of a resident of a Contracting State under the domestic law of that State will not preclude the State of source from considering that neither the partnership nor the partners are the beneficial owners of the dividend.

Diagrammatically:


Principal
Member as nominee
Non-hybrid
Partnership
Source State income: dividends
Principal
Member (nominee)
Classic Hybrid
Member State transparent
Source State opaque
Source State income: dividends

If the member state was the UK, the hybrid entity rule would not apply here, on the basis that para [e] is not met, ie assuming that the nominee is not resident in the UK, the income is not treated, for purposes of taxation by the UK, as the income of a resident of the UK. But maybe this observation is relevant in some other countries.

91.6.3 *Income derived by/through entity*

OECD Commentary provides:

> 7. The reference to "income derived by or through an entity or arrangement" has a broad meaning and covers any income that is earned by or through an entity or arrangement,
> [a] regardless of the view taken by each Contracting State as to who

[36] Author's footnote: The correct analysis in English law would be that the partners are nominees rather than the partnership. But nothing turns on that.

> derives that income for domestic tax purposes and
> [b] regardless of whether or not that entity or arrangement has legal personality or constitutes a person as defined in subparagraph 1 a) of Article 3.
>
> It would cover, for example, income of any partnership or trust that one or both of the Contracting States treats as wholly or partly fiscally transparent.

Note that the rule applies if *both* States consider the entity to be transparent. This would apply to what I call a quasi-hybrid entity (where both states agree the entity is transparent, but do not agree on who is regarded as receiving the income.[37]

91.6.4 *Gains*

The OECD hybrid-entity rule refers to income and does not mention gains, but the omission is not intended to be significant. OECD Commentary provides:

> 8. The word "income" must be given the wide meaning that it has for the purposes of the Convention and therefore applies to the various items of income that are covered by Chapter III of the Convention (Taxation of Income) [art 6-21], including, for example, profits of an enterprise and capital gains.

91.6.5 *Partly transparent*

OECD Commentary considers the situation where an entity is "partly treated as a taxable unit and partly disregarded for tax purposes":

> 4. [Art 1(2) OECD Model] addresses this particular situation by referring to entities that are "wholly or partly" treated as fiscally transparent. Thus, the paragraph not only serves to confirm the conclusions of the Partnership Report but also extends the application of these conclusions to situations that were not directly covered by the report ....
>
> 10. In the case of an entity or arrangement which is treated as partly fiscally transparent under the domestic law of one of the Contracting States, only part of the income of the entity or arrangement might be taxed at the level of the persons who have an interest in that entity or arrangement as described in the preceding paragraph whilst the rest would remain taxable at the level of the entity or arrangement.

[37] See 91.3.2 (Hybrid: Avoidance attribution rules).

That seems self-evident.

> This, for example, is how some trusts and limited liability partnerships are treated in some countries (i.e. in some countries,
> [1] the part of the income derived through a trust that is distributed to beneficiaries is taxed in the hands of these beneficiaries whilst
> [2] the part of that income that is accumulated is taxed in the hands of the trust or trustees;

This may have been the case for UK discretionary trusts before 1973, but that is not the case now.[38]

> similarly, in some countries, income derived through a limited partnership is taxed in the hands of the general partner as regards that partner's share of that income but is considered to be the income of the limited partnership as regards the limited partners' share of the income).

This is not the case for UK partnerships.

> To the extent that the entity or arrangement qualifies as a resident of a Contracting State, the paragraph will ensure that the benefits of the treaty also apply to the share of the income that is attributed to the entity or arrangement under the domestic law of that State (subject to any anti-abuse provision such as a limitation-on-benefits rule)...
> 11. As with other provisions of the Convention, the provision applies separately to each item of income of the entity or arrangement.
> Assume, for example, that the document that establishes a trust provides that all dividends received by the trust must be distributed to a beneficiary during the lifetime of that beneficiary but must be accumulated afterwards. If one of the Contracting States considers that, in such a case, the beneficiary is taxable on the dividends distributed to that beneficiary but that the trustees are taxable on the dividends that will be accumulated, the paragraph will apply differently to these two categories of dividends even if both types of dividends are received within the same month.

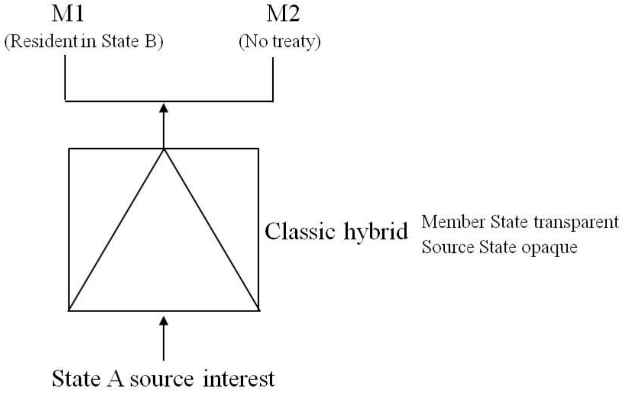
That seems self evident.

91.6.6 *OECD example: Classic hybrid*

OECD Commentary provides:

[38] See 41.3.1 (Source/categorisation of income). It could be the case if a trust held two sub-funds on distinct terms.

> 6. The following example illustrates the application of the paragraph:
> State A and State B have concluded a treaty identical to the Model Tax Convention.
> State A [the source State] considers that an entity established in State B is a company and taxes that entity on interest that it receives from a debtor resident in State A.
> Under the domestic law of State B, [the member state] however, the entity is treated as a partnership and the two members in that entity, who share equally all its income, are each taxed on half of the interest.
> One of the members ["M1"] is a resident of State B and the other [member "M2"] is a resident of a country with which States A and B do not have a treaty.



OECD analysis is:

> The paragraph provides that in such case, half of the interest shall be considered, for the purposes of Article 11 [interest article], to be income of a resident of State B.

In more detail, my analysis would be:

State A is the source State.
State B is the member state.
We are concerned with the State A/State B DTA (the source/member state DTA).

M1's share:
The entity is a Classic hybrid (member state transparent).
State A must apply the OECD hybrid-entity rule, so M1's income is deemed to arise to M1, the treaty-resident member of the entity, rather than

the entity itself.

As M1 is resident of State B, treaty relief applies.

M2's share:

As M2 is not resident of State B, the State A/B (source/member states) DTA does not apply.

The OECD Commentary provides:

> Also, as illustrated in example 2 of the [OECD Partnerships Report], it does not matter where the entity or arrangement is established: [art 1(2)] applies to an entity established in a third State to the extent that, under the domestic tax law of one of the Contracting States, the entity is treated as wholly or partly fiscally transparent and income of that entity is attributed to a resident of that State.

Regardless of where the entity is established, and regardless of the law of the entity State, the State A/State B DTA (the source/member states DTA) applies for M1's income but not for M2's income.

91.6.7 *Tax on entity: OECD Model*

OECD Commentary provides:

> 14. [Art 1(2)] applies for the purposes of the Convention and does not, therefore, require a Contracting State to change the way in which it attributes income or characterises entities for the purposes of its domestic law. In the example in paragraph 6 above,[39] whilst [art 1(2)] provides that half of the interest shall be considered, for the purposes of Article 11, to be income of a resident of State B, this will only affect the maximum amount of tax that State A will be able to collect on the interest and will not change the fact that State A's tax will be payable by the entity.
> Thus, assuming that the domestic law of State A provides for a 30% withholding tax on the interest, the effect of [art 1(2)] will simply (?) be
> [1] to reduce the amount of tax that State A will collect on the interest so that
> [a] half of the interest would be taxed at 30% [State A WHT rate]
> [b] and half at 10% under the treaty between States A and B)[40] and

[39] See 91.6.6 (Example: Classic hybrid).

[40] It is assumed the DTA is in Model form, which provides for a 10% cap on the source State's rate of tax on the interest..

[2] will not change the fact that the entity is the relevant taxpayer for the purposes of State A's domestic law.

Point [2] could be justified in two ways:

(1) From the point made here that art 1(2)] "applies for the purposes of the Convention"
(2) From the OECD Savings Clause[41]

Following through the example: suppose the entity received interest of £100. Ignoring tax in the residence/entity State, the position would be:

	Pre-tax profit	**Tax rate**	**Tax**	**Post-tax profit**
M1's share	£50	10%	£5	£45
M2's share	£50	30%	£15	£35
Total	£100	20%	£20	£80

Would the hybrid entity distribute the post-tax profit:

(1) to each member equally ignoring DT relief (£40 each), or
(2) to each member after DT relief (£45 to M1, £35 to M2)

In principle, route (2) seems fairer; but the answer depends on the entity's constitution and governing law.

91.7 USA hybrid-entity rule: Guidance

91.7.1 *US-transparent entities*

The USA/UK DTA Technical Explanation of para 1(8) identifies the following as US-transparent entities:[42]

(1) partnerships
(2) common investment trusts under s.584 USA Internal Revenue Code
(3) grantor trusts
(4) USA LLCs that are treated as partnerships for USA tax purposes

91.7.2 *IRS examples*

IRS give some examples. As the USA/UK wording is similar to the OECD Model, these should also be relevant to OECD Model DTAs.

[41] See 91.7.7 (Tax on entity: USA Model); 91.5.4 (BEPS MLI Savings Clause). This would be relevant if a DTA lacked the words "for the purposes of the Convention"; though only if the entity is resident in the source State.

[42] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

Examples 1 - 3 concern UK source income where the issue is whether UK relief is available under USA/UK DTA. In order to follow the examples, one needs to bear in mind that the USA/UK DTA provides that UK source interest which is beneficially owned by a USA resident is not taxed in the UK.[43] The question is whether DT relief applies when interest is "derived through a person that is fiscally transparent".

91.7.3 *USA example: Classic hybrid*

The first IRS example is equivalent to that in the OECD Commentary.[44] This concerns UK source interest paid to a US-transparent entity with USA members:

> [1] [a] For example, if a UK company pays interest to an entity that is treated as fiscally transparent for USA tax purposes, the interest will be considered derived [ie received] by a resident of the USA only to the extent that the taxation laws of the United States treats one or more USA residents (whose status as USA residents is determined, for this purpose, under USA tax law) as deriving [ie, receiving] the interest for USA tax purposes.[45]

In this example:
UK is the source State.
USA is the member state.
The entity is US-transparent.
We are not told if the entity is UK-transparent or UK-opaque.

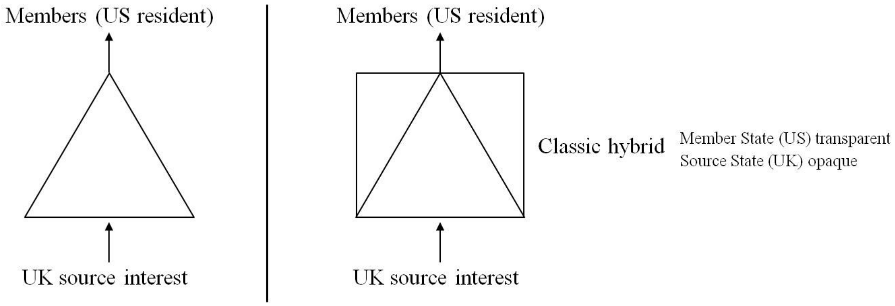
(a) If the entity is UK-transparent, then it is a transparent non-hybrid, and no difficulty arises.
(b) If the entity is UK-opaque, it is a Classic hybrid (member state transparent). The member state (USA) rules determine the issue of transparency and override the source state (UK) rules, so treaty relief applies.

Diagrammatically:

[43] See 26.27.2 (DTAs with 100% interest relief).

[44] See 91.6.6 (OECD example: Classic hybrid).

[45] The Technical Explanation continues: "In the case of a partnership, the persons who are, under USA tax laws, treated as partners of the entity would normally be the persons whom the USA tax laws would treat as deriving [receiving] the interest income through the partnership."
This is straightforward in the UK, as a partnership is also UK-transparent, so a partnership is a non-hybrid.



Example 2 is the same but with non-US resident partners:

> [2] Also, it follows that persons whom the United States treats as partners but who are not USA residents for USA tax purposes may not claim a benefit for the interest paid to the entity under the [USA/UK] Convention, because they are not residents of the United States for purposes of claiming this treaty benefit.

In this case the USA/UK DTA does not provide relief. But of course a member state/UK DTA could do so:

> If, however, the country in which they are treated as resident for tax purposes, as determined under the laws of that country, has an income tax convention with the UK, they may be entitled to claim a benefit under that convention.

91.7.4 *USA as entity State*

The next example concerns UK source interest arising to a US-opaque entity which is USA resident:

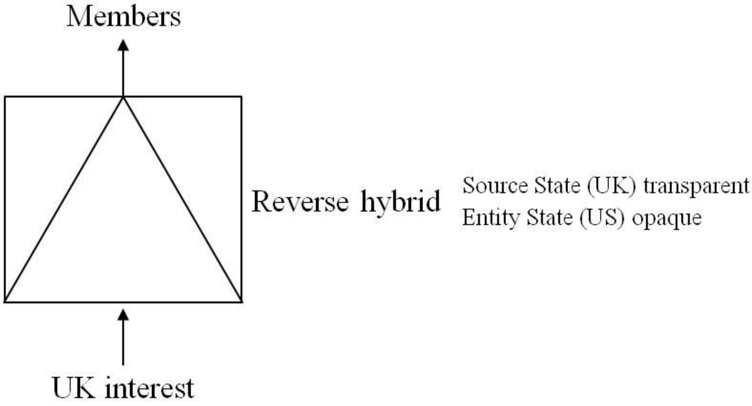
> In contrast, if, for example, an entity is organized under USA laws and is classified as a corporation for USA tax purposes, interest paid by a UK company to the USA entity will be considered derived by a resident of the United States since the USA corporation is treated under USA taxation laws as a resident of the United States and as deriving the income.

In this example:
UK is the source State.
USA is the entity State.
The entity is US-opaque.
Again, we are not told if the entity is UK-transparent or UK-opaque.

(a) If the entity is UK-opaque, then it is a non-hybrid, and no difficulty arises.

(b) If the entity is UK-transparent, it is a Reverse hybrid (member state opaque). The member state (USA) rules determine the issue of opacity and override the source state (UK) rules.

Diagrammatically:



Treaty relief applies.

The following factors do not matter:

(1) the UK tax classification as transparent/opaque

(2) a third State's tax classification as transparent/opaque

> [4] The same result obtains even if the entity were viewed differently under the tax laws of the UK (e.g., as not fiscally transparent in the first example above where the entity is treated as a partnership for USA tax purposes).
> Similarly, the characterization of the entity in a third country is also irrelevant, even if the entity is organized in that third country. The results follow regardless of whether the entity is disregarded as a separate entity under the laws of one jurisdiction but not the other, such as a single owner entity that is viewed as a branch for USA tax purposes and as a corporation for UK tax purposes. These results also obtain regardless of where the entity is organized (i.e., in the United States, in the UK, or, as noted above, in a third country).

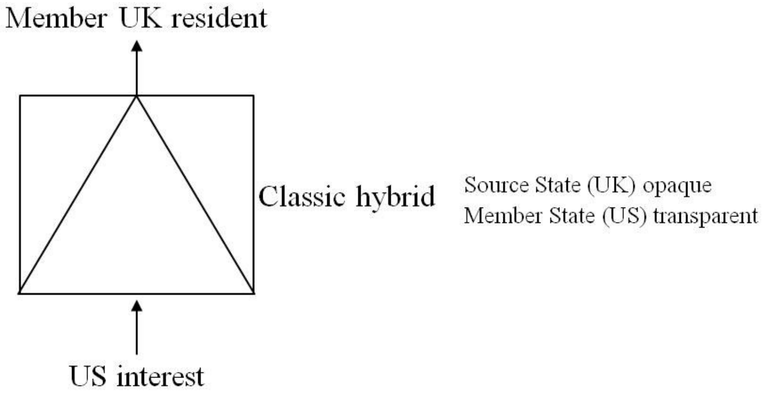
91.7.5 *Reverse hybrid*

The example given considers USA source income accruing to an entity which is UK-opaque.

> [5] For example, income from USA sources received by an entity

> organized under the laws of the United States, which is treated for UK tax purposes as a corporation and is owned by a UK shareholder who is a UK resident for UK tax purposes, is not considered derived by the shareholder of that corporation even if, under the tax laws of the United States, the entity is treated as fiscally transparent. Rather, for purposes of the treaty, the income is treated as derived by the USA entity.

Diagrammatically:



The UK member is not entitled to interest relief under the USA/UK DTA even if the income is distributed to them, though FTCR may apply.

91.7.6 *US-transparent trust*

> These principles also apply to trusts to the extent that they are fiscally transparent in either Contracting State.

The next example concerns a trust which is US-transparent:

> For example, if X, a resident of the UK, creates a revocable trust in the United States[46] and names persons resident in a third country as the beneficiaries of the trust, X would be treated under USA law as the beneficial owner of income derived from the United States. In that case, the trust's income would be regarded as being derived by a resident of the UK only to the extent that the laws of the UK treat X as deriving the income for UK tax purposes by application of the UK "settlor trust" rules.

If s.624 ITTIOA applies, the trust is UK-transparent and is a transparent

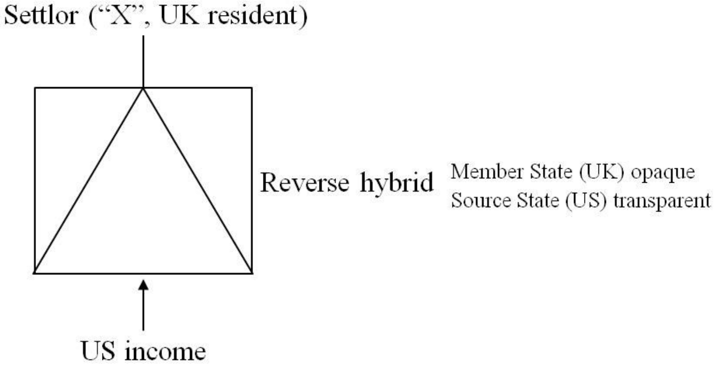
[46] I am not sure that it matters where the trust is established; but that is a matter of USA law.

non-hybrid, and no difficulty arises. But s.624 is not likely to arise, as the trust is likely be a protected trust (alternatively, possibly, the remittance basis may apply).

If the trust is discretionary in form, it is UK-opaque, it is a Reverse hybrid (member state opaque). The member state (UK) rules determine the issue of transparency and override the source state (USA) rules, so treaty relief does not apply.

The trust might be interest in possession in form, in which case it is actually UK transparent. But it may be regarded as a hybrid, or at least treated as one, because under USA law the income accrues to X (UK resident), but under UK law it accrues to the beneficiary (resident in a third country).

Diagrammatically:



91.7.7 *Tax on entity: USA Model*

An Exchange of Notes between the UK and USA discusses the taxation of the entity itself:

> *With reference to paragraph 8 of Article 1 [USA hybrid-entity rule]—*
> [1] it is understood that where an item of income, profit or gain is derived through a person which is a resident of a Contracting State the provisions of the paragraph shall not prevent that Contracting State from taxing the item as the income, profit or gain of that person.

The OECD commentary makes the same point.[47] The USA/UK DTA Technical Explanation[48] justifies the point by reference to the USA Savings

[47] See 91.6.7 (Tax on entity: OECD Model).

[48] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

Clause:[49]

> [7] [Art 1(8) USA/UK DTA, the USA hybrid entity rule] is not an exception to the saving clause of [art 1(4)]. Accordingly, the notes confirm that [art 1(8)] does not prevent a Contracting State from taxing an entity that is treated as a resident of that State under its tax law.
> For example, if a USA LLC with UK members elects to be taxed as a corporation for USA tax purposes, the United States will tax that LLC on its worldwide income on a net basis, without regard to whether the UK views the LLC as fiscally transparent.[50] The portion of the notes relating to Article 24 (Relief from Double Taxation)[51] provides rules for determining which Contracting State has the primary right to tax and which State must provide a credit in such circumstances.

The Exchange of Notes continues:

> [2] It is further understood that, where, by virtue of [art 1(8)],
> [a] an item of income, profit or gain is considered by a Contracting State to be derived by a person who is a resident of that Contracting State, and
> [b] the same item is considered by the other Contracting State to be derived [by that person or][52] by a person who is a resident of that other Contracting State,
>
> [art 1(8)] shall not prevent either Contracting State from taxing the item as the income, profit or gain of the person considered by that State to have derived the item of income, profit or gain.

It is essential to keep in mind which State is which; this paragraph is easier to follow if it is expanded to read:

It is further understood that, where, by virtue of art 1(8),

[a] an item of income, profit or gain is considered by the UK to be derived by a person who is a resident of the UK and	[a] an item of income, profit or gain is considered by the US to be derived by a person who is a resident of the US and
[b] the same item is considered by	[b] the same item is considered by

[49] See 109.5 (Savings Clause).

[50] Author's footnote: The UK will normally view a LLC as opaque, but it might be transparent if ToA rules apply.

[51] See 91.7.9 (Hybrids: art.24 tax credit).

[52] I do not understand the words in brackets and would be grateful to any reader who could explain.

the US to be derived [by that person or] by a person who is a resident of that the US,	the UK to be derived [by that person or] by a person who is a resident of that the UK,

[art 1(8)] shall not prevent the UK or the US from taxing the item as the income, profit or gain of the person considered by that State to have derived the item of income, profit or gain.

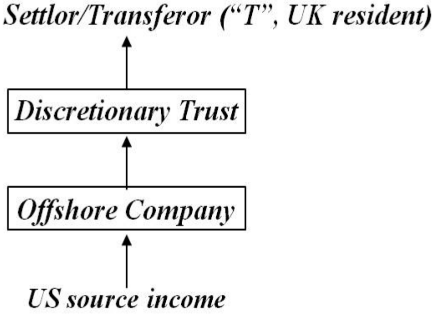
91.7.8 *s.624/720 income; s.3/86 gain*

The Exchange of Notes continues:

> [3] It is further understood that, in applying [para 1(8)], the UK shall, exceptionally, regard an item of income, profit or gain arising to a person as falling within the paragraph where another person is charged to UK tax in respect of that item of income, profit or gain—
> (a) under [what is now s.624 ITTOIA & s.720 ITA]; or
> (b) under section [77 or[53]] 86, TCGA 1992.
> [4] It is further understood that, in applying the paragraph, a person shall be regarded as fiscally transparent under the laws of the UK in relation to an item of income, profit or gain where a charge is made on another person on that item either—
> (a) by virtue of [what is now s.3 TCGA]; or
> (b) because that other person has (or, under [what is now s.464 ITA[54]], is treated as having) an equitable right in possession in a trust.

Thus trusts within s.624 and companies within s.720 are regarded as UK-transparent for IT; trusts within s.86 and companies within s.3 are regarded as UK-transparent for CGT.

Take a standard structure:



[53] Author's footnote: I add the brackets because s.77 is now repealed.

[54] See 42.9.4 (Scots trusts).

Suppose:

(1) T is UK-law UK resident but treaty-resident in the USA.
(2) The entities are US-transparent, so T regarded for USA purposes as receiving OC's income.
(3) Section 720 applies so T is taxed for UK tax purposes on OC's income

For USA/UK DTA purposes, T is treated as receiving OC's income. Thus for USA tax, USA should allow treaty relief even if in the USA the structure is opaque.[55]

91.7.9 *Hybrids: art.24 tax credit*

Foreign Tax Credit Relief is provided by art 24 USA/UK DTA.[56] The Exchange of Notes provides:

> *With reference to Article 24 (Relief from double taxation)—*
> [1] It is understood that, under paragraph 4 or 8 of Article 1 (General scope) [USA Savings Clause/US hybrid-entity rule], the provisions of the Convention
> [a] may permit the Contracting State of which a person is a resident (or, in the case of the United States, a citizen),[57] to tax an item of income, profit or gain derived through another person (the entity) which is fiscally transparent under the laws of either Contracting State, and
> [b] may permit the other Contracting State to tax
> (a) the same person [the entity member];
> (b) the entity; or
> (c) a third person
> with respect to that item.
> [2] Under such circumstances, the tax paid or accrued by the entity shall be treated as if it were paid or accrued by the first-mentioned person [the entity member] for the purposes of determining the relief from double taxation to be allowed by the State of which that first-mentioned person [the entity member] is a resident (or, in the case of the United States, a citizen),

As usual, it is essential to keep in mind which State is which; the text is easier to follow as it applies to the UK if it is expanded to read (in short):

[55] The transferor is entitled to the relief as a matter of UK law; see 49.30 (DT relief: s.720 income).

[56] See 111.2 (DTA/Unilateral Credit compared).

[57] The Exchange of Notes describes this person as "the first-mentioned person" but for clarity I gloss this as the "entity member".

> [1] .. the provisions of the Convention
> [a] ...permit [the UK] [the Contracting State of which [the member of the entity] is a resident ... [58] to tax an item of income, profit or gain derived through another person (the entity) which is fiscally transparent under the laws of either Contracting State, and
> [b] ... permit [the USA] [the other Contracting State] to tax
> (a) the same person [the UK resident entity member];
> (b) the entity; or
> (c) a third person
> with respect to that item.
> [2] Under such circumstances, the tax paid or accrued by the entity shall be treated as if it were paid or accrued by the first-mentioned person [the UK resident entity member] for the purposes of determining the relief from double taxation to be allowed by the State of which that first-mentioned person [the entity member] is a resident

The rule is modified in the case of land:

> [3] except that, in the case of
> [a] an item of income from real property to which paragraph 1 of Article 6 (Income from real property) of the Convention applies, or
> [b] a gain from the alienation of real property to which paragraph 1 of Article 13 (Gains) applies,
> the tax paid or accrued by the person who is a resident of the Contracting State in which the real property is situated shall be treated as if it were paid or accrued by the person who is a resident of the other Contracting State.

The Exchange of Notes continues:

> [4] [A] In the case where the same item of income, profit or gain derived through a trust is treated by each Contracting State as derived by different persons resident in either State, and
> (a) the person taxed by one State is the settlor or grantor of a trust; and
> (b) the person taxed by the other State is a beneficiary of that trust,
> the tax paid or accrued by the beneficiary shall be treated as if it were paid or accrued by the settlor or grantor for the purposes of determining the relief from double taxation to be allowed by the State of which that

[58] The Exchange of Notes describes this person as "the first-mentioned person" but for clarity I gloss this as the "entity member".

> settlor or grantor is a resident (or, in the case of the United States, a citizen),

The rule is again modified in the case of land:

> [4B] except that,
>
> [a] in the case of an item of income from real property to which paragraph 1 of Article 6 (Income from real property) of the Convention applies, or
>
> [b] a gain from the alienation of real property to which paragraph 1 of Article 13 (Gains) applies,
>
> the tax paid or accrued by the person who is a resident of the Contracting State in which the real property is situated shall be treated as if it were paid or accrued by the person who is a resident of the other Contracting State.
>
> [5] It is further understood that paragraphs 2 and 5 of Article 24 shall apply to such an item of income, profit or gain to the extent necessary to provide relief from double taxation.

In *Anson v HMRC,* US income arose to an LLC which was transparent for USA purposes. The CoA held the LLC was not transparent for UK purposes: it was a Reverse hybrid.

The income was distributed to a UK resident member. The taxpayer claimed credit relief for US tax, and sought to rely on the Exchange of Notes. Unfortunately the CoA refused to consider the point (on the grounds that the taxpayer raised it too late).[59] But it is not clear how the Exchange of Notes would help.

[59] [2013] EWCA Civ 63 at [92]:

> "There is clearly some dispute as to the mischief to which the exchange of notes is directed. There would have to be further evidence to resolve that dispute."

Presumably the reference to "evidence" is to such background material as is relevant to the construction of a DTA.

Perhaps it is better that the CoA did not address the point, as they did not seem sympathetic to the taxpayer:

> "Moreover, the words "with respect to that item", ... are, on the face of it, consistent with [counsel for HMRC's] principal submission that no change is made in the requirement for the profits taxed in each jurisdiction to be the same profits in order to qualify for DTR. If an alteration to article 23 [of the 1980 USA/UK DTA, now article 24 of the 2001 DTA] was intended, it is surprising that it was dealt with in this oblique way."

On appeal, SC held that FTCR applied for other reasons; see 111.5 (Same income rule).

91.8 Hybrid entities: Part 6A TIOPA

91.8.1 *Anti-tax avoidance directive*

Council Directive (EU) 2016/1164 (Anti-Tax Avoidance Directive, known as "ATAD") was adopted on 12 July 2016.

Council Directive (EU) 2017/952, sometimes called "ATAD 2", was adopted on 27 May 2017. It amended ATAD by introducing hybrid mismatch rules: articles 2, 9, 9a and 9b ATAD.

ATAD did not have direct effect. The rules in the UK are implemented by Part 6A TIOPA (Hybrid and other mismatches).

91.8.2 *Scope of ATAD*

Article 1 ATAD provides:

> This Directive applies to all taxpayers that are subject to corporate tax in one or more Member States, including permanent establishments in one or more Member States of entities resident for tax purposes in a third country.

In short, ATAD only applies to "corporate tax". So it applies to Corporation Tax; does it also apply to income tax when payable by companies? HMRC must have thought not, as the UK rules in Part 6A TIOPA apply to corporation tax, though it can affect LLPs not otherwise subject to CT.[60] But the issue is less important now that property income of non-resident companies has moved from IT to CT.

91.8.3 *TIOPA Part 6A: Navigation*

The numbering system of Part 6A is idiosyncratic.[61] Each Chapter is designated by a letter: A, B, etc, up to N for Chapter 14. Each section in a Chapter begins with 259, then the Chapter letter, and sections after the first are numbered A, B, etc; so the sections of Chapter 2 are numbered 259B, 259BA, etc up to 259BF. Sections introduced subsequently are slotted in with an additional letter, such as s.259NEA.

Chapter/Letter/Sections			Topic
1	A	259A	Overview
2	B	259B-259BF	Key definitions

[60] But see 91.22.5 (Charge to CT).

[61] See App.13.3 (Section numbering system).

Deduction/non-inclusion mismatches		
3 C	259C-259CE	Payments under financial instruments
4 D	259D-259DG	Repos/stock lending/ transfers of financial instruments
5 E	259E-259ED	Payments: payer a hybrid entity
6 F	259F-259FB	Internal transfer: from UK PE to where co is resident
7 G	259G-259GE	Payments: payee a hybrid entity
8 H	259H-259HC	Payments: payee a multinational company
Double deduction mismatches		
9 I	259I-259ID	Hybrid entity
10 J	259J-259JD	Dual resident company/multinational company
11 K	259K-259KD	Imported mismatches
12 L	259L-259LD	Adjustment where (a) supposition was mistaken (b) Deduction denied under Part 6A, & income arises later
12A	259ZM - s59ZMF	Groups
Supplemental provisions		
13 M	259M	Hybrid & mismatch TAAR
13A	259MA-MD	Transparent funds
14 N	259N-259NF	Definitions and interpretation

I here consider Chapter 7; I hope to consider some other Chapters in subsequent editions; others mainly concern corporate tax practitioners. I do not consider the rules relating to CFCs.

91.8.4 *Part 6A definitions: Navigation*

Part 6A TIOPA has a specialist technical vocabulary.

Chapter 2 contains a dozen "key" definitions; Chapter 14 has half a dozen or so definitions, and other terms are defined where they are used. In this work I only discuss terms employed in Chapter 7:

Term	**See para/section**
Control group	91.25
Equivalent provision	91.24.3
Financial instrument	s.259N
Hybrid entity	91.15
Investor	91.15.4
Investor jurisdiction	91.15.4
Mismatches	91.9
Ordinary income	91.14
-do- included in profits	s.259BC(8)
Partnership income	91.26
Payee	91.12; 91.11
Payer	91.10; 91.11
Payment	91.10
Permanent Establishment	s.259BF
Quasi-payment	91.11
Related person	s. 259NC
Relevant deduction	91.10
Relevant investment fund	s.259NA
Tax	91.24.1
Taxable period	91.24.4
50% / 25% investment	105.8

91.8.5 *Introduction to Part 6A*

This is a daunting topic. BEPS Action 2 Report, and HMRC hybrid guidance,[62] are each nearly 500 pages in length; and a full discussion would require more than one volume.

Changes were made to the rules in 2017, 2018, and in 2019 in the light of ATAD 2 and again in FA 2021. It is questionable whether the current law is stable.

The background to Part 6A TIOPA can be found in consultation papers in 2014 and December 2016, but these are now of historical importance only.

A further consultation paper was published in March 2020,[63] which is the background to the 2021 changes.

INTM provides this introduction:

> **INTM550020: Hybrids: Chapter 1 - Introduction: What is a hybrid or other mismatch?** [Dec 2019]
> Part 6A of Taxation (International and Other Provisions) Act 2010 (TIOPA 2010) addresses arrangements that give rise to hybrid mismatch outcomes leading to a tax mismatch.
> The legislation is based on the OECD recommendations in relation to Action 2 of the Base Erosion Profit Shifting (BEPS) project. The legislation is deliberately broader in scope than the OECD recommendations in some areas. Consequently, outcomes under this legislation may differ from those under the OECD recommendations.
> For example, the UK's hybrid mismatch legislation includes:
>
> - rules to deal with mismatches involving permanent establishments, and
> - rules that counter hybrid mismatches where a hybrid entity is in a territory with no corporate income tax.
>
> Mismatches can involve either double deductions for the same expense,

[62] See INTM850000 (Hybrid and other mismatches) published on *http://www.hmrc.gov.uk/gds/INTM/images/INTM850000_hybrids.pdf*
The text is not published online with the rest of the INTM, so it is missing in publishers tax databases.
CIOT expressed concern that the draft of this guidance was "used as a substitute for clear, well targeted legislation and that it conflicts with the wording of the legislation".

[63] HMRC "Hybrid and other Mismatches" *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/873562/Consultation_Hybrid_and_other_mismatches.pdf*

or deductions for an expense without the corresponding receipt being fully taxed.

Hybrid mismatch outcomes can arise from hybrid financial instruments and hybrid entities, and from arrangements involving permanent establishments. They can also arise from hybrid transfers and dual resident companies.

The legislation aims to neutralise the tax mismatch created under these arrangements by altering the tax treatment of either the deduction or the receipt, depending on the circumstances. The rules are designed to work whether both the countries affected by a cross-border arrangement have introduced rules based on the OECD recommendations, or just the UK.

This legislation follows the OECD recommendations in providing alternative responses to mismatches which fall within the scope of the legislation. These are described as a 'primary response' and a 'secondary response'.

In the case of deduction/non-inclusion, the primary response is generally to deny a deduction to the payer. If this does not occur, the secondary defensive response is to bring the receipt into charge for the payee.

In the case of double deductions the primary response is to deny a deduction to the parent or investor company. If this does not occur (because the tax law in the country in which the parent or investor company is resident does not provide for this), the secondary response is to deny the deduction to the hybrid entity or permanent establishment, as appropriate.

91.9 Mismatches

Part 6A TIOPA identifies two types of mismatch:

(1) a deduction/non-inclusion ("D/NI") mismatch

(2) a double deduction mismatch

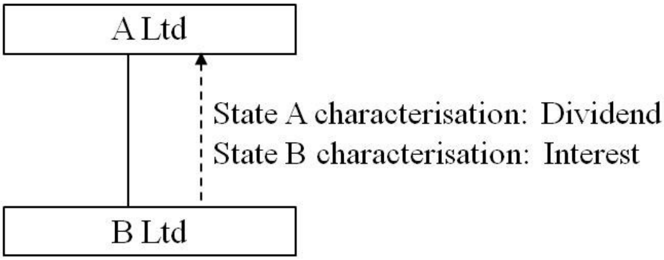
91.9.1 *Deduction/non-inclusion mismatch*

Section 259A(2) TIOPA provides:

> A deduction/non-inclusion mismatch arises where an amount is deductible from a person's income-
>
> (a) without a corresponding amount of ordinary income arising to another person, or
>
> (b) where an amount of ordinary income does arise to a person but is under taxed.

This can happen with a hybrid entity.

It also happens in other circumstances. A mismatch may happen if States characterise a payment in different ways, for example:


A Ltd
State A characterisation: Dividend
State B characterisation: Interest
B Ltd

State A may characterise the payment as dividend (perhaps not taxed)
State B may characterise the payment as interest (perhaps deductible)

A mismatch may happen if States differ on what constitutes a PE; for example State A may characterise the arrangement as a permanent establishment, whose profits are taxable in State B; and State B may not regard it as a PE, and regard the profits as taxable in State A. One might describe that as a "**hybrid PE**".

This chapter only considers the issues of hybrid entities.

91.9.2 *Double deduction mismatch*

Section 259A(3) TIOPA provides:

> A double deduction mismatch arises where-
> (a) an amount is deductible from more than one person's income, or
> (b) an amount is deductible from a person's income for the purposes of more than one tax.

This can happen with a hybrid.

It also happens in other circumstances, for instance, a company may make a gift to charity which qualifies for gift aid relief in the UK and a similar relief elsewhere. But I do not consider double deduction mismatches in this chapter.

91.9.3 *Other mismatches*

Mismatches are not caught unless they are of one of these kinds. Brabazon comments:

> It is difficult to see why the "D" element of a D/NI outcome should be required where arbitrage is based on differences in the tax treatment of a reverse hybrid trust. Arbitrage is successfully achieved if income, which might be derived from a stranger and may or may not be deductible to that person, is untaxed or lightly taxed at source and then

> escapes effective residence taxation in any jurisdiction. This might be called a NI/NI (double no-inclusion) outcome. There are plenty of investments, particularly passive ones, that produce cross-border income subject to zero or light source taxation. A trust is perfectly adapted to make such investments and, if it is a reverse hybrid, a NI/NI outcome is the obvious consequence.[64]

The rules were created by corporation tax practitioners with multinational groups in mind, and without much regard for private client aspects.

See too 111.9 (Tax in accordance with DTA).

91.10 Payment

Section 259BB(1) TIOPA provides:

> In this Part [Part 6A, hybrids/mismatches] "payment" means any transfer-
> (a) of money or money's worth directly or indirectly from one person ("the payer") to one or more other persons, and
> (b) in relation to which (disregarding this Part and any equivalent provision under the law of a territory outside the UK) an amount (a "relevant deduction") may be deducted from the payer's income for a taxable period (the "payment period") for the purposes of calculating the payer's taxable profits.

"Payment" has an artificial definition: it means a *deductible* payment. I write it with an initial capital to reflect the technical nature of the word.

How is the payee meant to know whether a Payment is deductible? It has to be "reasonable to suppose" a Payment; that recognises that the question is imponderable, but does not actually help.[65]

91.11 "Quasi-payment"

Section 259BB(2) TIOPA provides:

> For the purposes of this Part [Part 6A, hybrids/mismatches], there is a "quasi-payment", in relation to a taxable period (the "payment period") of a person ("the payer"), if (disregarding this Part and any equivalent provision under the law of a territory outside the UK)-

Two conditions then follow:

> (a) an amount (a "relevant deduction") may be deducted from the

[64] [2018] BTR at 225.

[65] See App.2.24 (Reasonable-to-assume).

payer's income for that period for the purposes of calculating the payer's taxable profits, and

This is the same condition as for "Payment".

(b) making the assumptions in subsection (4), it would be reasonable to expect an amount of ordinary income to arise to one or more other persons as a result of the circumstances giving rise to the relevant deduction.

> **INTM550540 Payment and quasi-payment, Securitisation companies** [Dec 2019]
> ...In most instances a payment will also fall within the definition of a quasi payment.
> A simple example of a quasi-payment would be an interest free convertible loan note being treated as issued at a discount that qualifies for finance relief (see example at INTM551280). The deduction arises from the terms of the loan note, which creates economic rights between the payer and payee.
> In contrast, a deduction granted by a territory for an amount of deemed interest on an interest free loan would not be a quasi-payment (see example at INTM551270). The deemed deduction does not arise from the terms of the existing loan nor from any amendment to it. It arises from the operation of the territory's tax rules.
> **Securitisation Companies**
> For the avoidance of doubt, payments or quasi-payments could arise to an entity which is charged to corporation tax under Regulation 14 of The Taxation of Securitisation Companies 2006 (SI 2006/3296). This could occur where transactions giving rise to the Retained Profit (on which the CT charge is calculated) represent an allowable deduction.

Section 259BB(5) TIOPA provides:

> In this Part [Part 6A, hybrids/mismatches]-
> (a) references to a quasi-payment include all the circumstances giving rise to the relevant deduction mentioned in subsection (2)(a), and
> (b) references to a quasi-payment being made are to those circumstances arising.

91.11.1 *Deemed income*

Section 259BB(3) TIOPA provides:

> But a quasi-payment does not arise under subsection (2) if-
> (a) the relevant deduction is an amount that is deemed, under the

> law of the payer jurisdiction, to arise for tax purposes, and
> (b) the circumstances giving rise to the relevant deduction do not include any economic rights, in substance, existing between the payer and a person mentioned in subsection (2)(b).

91.11.2 *Quasi-payment assumptions*

Section 259BB(4) TIOPA provides:

> The assumptions are that (so far as would not otherwise be the case)-
> (a) any question as to whether an entity is a distinct and separate person from the payer is determined in accordance with the law of the payer jurisdiction,
> (b) any persons to whom amounts arise, or potentially arise, as a result of the circumstances giving rise to the relevant deduction adopt the same approach to accounting for those circumstances as the payer, and
> (c) any persons to whom amounts arise, or potentially arise, as a result of those circumstances-
> (i) are, under the law of the payer jurisdiction, resident in that jurisdiction for tax purposes, and
> (ii) carry on a business, in connection with which those circumstances arise, in the payer jurisdiction.

91.12 Payer/Payee/Relevant deduction

91.12.1 *Payer/relevant deduction*

Definitions of payer and relevant deduction are found in the definitions of payment and quasi-payment set out above.

91.12.2 *Payee*

Section 259BB(6) TIOPA provides:

> In this Part [Part 6A, hybrids/mismatches] "payee" means-
> (a) in the case of a payment, any person-
> (i) to whom the transfer is made as mentioned in subsection (1)(a),[66] or
> (ii) to whom an amount of ordinary income arises as a result of the payment, and
> (b) in the case of a quasi-payment, any person-
> (i) to whom it would be reasonable to expect an amount of

[66] See 91.10 (Payment).

ordinary income to arise as mentioned in subsection (2)(b), or

(ii) to whom an amount of ordinary income arises as a result of the quasi-payment.

91.12.3 *Payer is also payee*

Section 259BB(7) TIOPA provides:

> For the purposes of this Part [Part 6A, hybrids/mismatches], in the case of a quasi-payment, the payer is "also a payee" if-
> (a) an entity is not a distinct and separate person from the payer for the purposes of a tax charged under the law of the UK,
> (b) that entity is a distinct and separate person from the payer for the purposes of a tax charged under the law of the payer jurisdiction, and
> (c) it would be reasonable to expect an amount of ordinary income to arise to that entity as mentioned in subsection (2)(b).

The INT Manual provides:

> **INTM550550 Payer and payee** [Dec 2019]
> ... **Payer is also payee**
> The payer can also be a payee where the entity is treated as the payer under UK law, but as a separate entity in the other jurisdiction.
> For example, a payment made by a partnership to one of the partners has the same payer and payee from a UK perspective.

91.13 "Payer/payee jurisdiction"

Section 259BB TIOPA provides:

> (8) In this section "payer jurisdiction" means the jurisdiction under the law of which the relevant deduction may (disregarding this Part [Part 6A, hybrids/mismatches] and any equivalent provision under the law of a territory outside the UK) be deducted.
> (9) In this Part [Part 6A, hybrids/mismatches] "payee jurisdiction", in relation to a payee, means a territory in which-
> (a) the payee is resident for tax purposes under the law of that territory, or
> (b) the payee has a permanent establishment.

91.14 "Ordinary Income"

"Ordinary income" matters for the definition of deduction/non-inclusion mismatch.

91.14.1 *Basic rule*

Section 259BC(1) TIOPA provides:

> This section has effect for the purposes of this Part [Part 6A, hybrids/mismatches].

The definition uses the term relevant tax.

Section 259BC(9) TIOPA provides:

> In this section "relevant tax" means a tax other than the CFC charge or a foreign CFC charge.

Armed with that definition, we can turn to the definition of ordinary income. Section 259BC(2) TIOPA provides:

> "Ordinary income" means income that is brought into account, before any deductions, for the purposes of calculating the income or profits on which a relevant tax is charged ("taxable profits").

In short: Ordinary Income means taxable income. I write it with initial capitals, to reflect the technical nature of the term.

91.14.2 *"Brought into account"*

Section 259BC(3) TIOPA provides:

> But an amount of income is not brought into account for those purposes to the extent that
> (a) it is charged to the relevant tax at a nil rate, or
> (b) it is excluded, reduced or offset by any exemption, exclusion, relief, or credit-
> (i) that applies specifically to all or part of the amount of income (as opposed to ordinary income generally), or
> (ii) that arises as a result of, or otherwise in connection with, a payment or quasi-payment that gives rise to the amount of income.

91.14.3 *Tax refunded*

Section 259BC TIOPA provides:

> (4) If all the relevant tax charged on taxable profits is, or falls to be, refunded, none of the income brought into account in calculating those taxable profits is "ordinary income".

> (5) If a proportion of the relevant tax charged on taxable profits is, or falls to be, refunded, the amount of any income brought into account in calculating those taxable profits that is "ordinary income" is proportionally reduced.
> (6) For the purposes of subsections (4) and (5) an amount of relevant tax is refunded if and to the extent that-
> (a) any repayment of relevant tax, or any payment in respect of a credit for relevant tax, is made to any person, and
> (b) that repayment or payment is directly or indirectly in respect of the whole or part of the amount of relevant tax,

91.14.4 *Loss relief*

Section 259BC(6) TIOPA concludes:

> but an amount refunded is to be ignored if and to the extent that it results from qualifying loss relief.

Section 259BC(7) TIOPA provides:

> In subsection (6) "qualifying loss relief" means-
> (a) any means by which a loss might be used for corporation tax or income tax purposes to reduce the amount in respect of which a person is liable to tax, or
> (b) any corresponding means by which a loss corresponding to a relevant tax loss might be used for the purposes of a relevant tax other than corporation tax or income tax to reduce the amount in respect of which a person is liable to tax,
> (and in paragraph (b) "relevant tax loss" means a loss that might be used as mentioned in paragraph (a)).

> **INTM550560 Ordinary income** [Dec 2019]
> [The Manual refers to the definition in s259BC(2) and continues:]
> Entities such as charities and many pension funds may not have ordinary income where the income received falls wholly within relevant exemptions. This is because that income is not brought into account in calculating profits on which a relevant tax is charged...
> A receipt may remain within the definition of ordinary income even where it has been characterised differently under the payee regime. For example, a finance return may be characterised as proceeds from a share sale by a share trader, but still be included within trading profits as income. In those circumstances the receipt is taxed at the same rate as a finance return would have been and so is ordinary income. See the example at INTM551380...
> A qualifying loss relief is a loss that might be used to reduce the amount

on which a person is liable to income tax or corporation tax on income in the UK, or a corresponding non-UK loss. This will include, for example, refunds arising from relief for or equivalent to

- UK group relief,
- UK loss carry back
- UK generic allowable expenditure incurred in earning the profits that exceeds the income received.

A full or partial refund of the relevant tax as a consequence of anything that is not a qualifying loss relief will result in the amounts being excluded from ordinary income. This may occur where it is a feature of the relevant jurisdiction's tax regime that the tax on income can be refunded, whether to the company or another person, without the application of a qualifying loss relief, but perhaps because it is income of a specified character..

91.15 Hybrid entity

91.15.1 *Hybrid entity*

Section 259BE(1) TIOPA provides:

> For the purposes of this Part [Part 6A, hybrids/mismatches], an entity is "hybrid" if it meets conditions A and B.

I refer to **"hybrid conditions A & B"**.

91.15.2 *Hybrid condition A: personality*

Section 259BE(2) TIOPA provides:

> Condition A is that the entity is regarded as being a person for tax purposes under the law of any territory.

The entity must be a person in at least one territory: if not, it cannot be hybrid. I refer to it as the **"entity-person"**.

91.15.3 *Hybrid condition B*

Section 259BE TIOPA provides:

> (3) Condition B is that-

There are two ways to satisfy Hybrid condition B, which I call condition B(a) and B(b). Condition B(a) is:

> (a) some or all of the entity's income or profits are treated (or would be if there were any) for the purposes of a tax charged under the law of any territory, as the income or profits of a person or persons other

than the person mentioned in subsection (2)

In short, in some territory the entity-person is not taxable on its profits. Condition B(b) is:

> (b) [i] under the law of a territory other than the one mentioned in subsection (2),
> [ii] the entity is not regarded as a distinct and separate person to an entity or entities that are distinct and separate persons under the law of the territory mentioned in that subsection.

In short, in some territory the entity-person lacks personality. But in that case it cannot be taxable on its profits: what does this add to condition B(a)? Perhaps the purpose is to facilitate the definition of "investor" set out below.

> **INTM550580 Hybrid entities, residence, investors and investor jurisdiction** [Dec 2019]
> ... For example, a UK company which has elected to be disregarded for USA tax purposes under the check the box regime will satisfy condition B.
> Hybrid entities within Part 6A will include -
> - those where applying the domestic law of two territories to the general characteristics of the entity leads to different outcomes as to whether the entity should be regarded as opaque or transparent for tax purposes.
> - those where a territory's domestic law treats an entity of a specific type in a certain manner for tax purposes and that treatment is not followed under the domestic law of other territories.
>   For example, the income and gains of a UK Limited Liability Partnership (LLP) that carries on a business are treated as transparent under UK tax law. Other territories may treat a UK LLP in line with its form, as a body corporate, and regard it a distinct taxable entity in its own right.
> - those where a territory's domestic law allows certain entities to determine whether they are to be treated as opaque or transparent for tax purposes.
>   For example the USA tax code allows entities to make an election to be treated as transparent or opaque for tax purposes under their check the box rules.

91.15.4 *Investor in hybrid*

Section 259BE(4) TIOPA provides:

> For the purposes of this Part [Part 6A, hybrids/mismatches]-
> (a) where subsection (3)(a) applies, a person who is treated as having the income or profits of the hybrid entity is an "investor" in it,
> (b) where subsection (3)(b) applies, an entity that-
> (i) is regarded as a distinct and separate person to the hybrid entity under the law of the territory mentioned in subsection (2), but
> (ii) is not regarded as a distinct and separate person to the hybrid entity under the law of another territory,
> is an "investor" in the hybrid entity...

In a case within para (a), the investor will normally be a member of the entity. In a para (b) case the entity itself is the "investor" in the entity.

91.15.5 *Investor jurisdiction*

Section 259BE TIOPA provides:

> (4) For the purposes of this Part [Part 6A, hybrids/mismatches] ...
> (c) any territory under the law of which an investor is within the charge to a tax is an "investor jurisdiction" in relation to that investor.

91.16 Chap 7 application conditions

Section 259GA contains the conditions that must be met for Chapter 7 to apply. Section 259GA(1) TIOPA provides:

> This Chapter [Chapter 7] applies if conditions A to E are met.

I refer to **"Chapter 7 conditions A to E"**.

91.16.1 *Chap 7 condition A: arrangement*

Section 259GA(2) TIOPA provides:

> Condition A is that a payment or quasi-payment is made under, or in connection with, an arrangement.

It is hard to see how there could not be an arrangement.

91.16.2 *Chap 7 condition B: hybrid payee*

Section 259GA(3) TIOPA provides:

> Condition B is that a payee is a hybrid entity (a "hybrid payee").

91.16.3 *Chap 7 condition C: CT payer/investor or LLP*

Section 259GA(4) TIOPA provides:

> Condition C is that-
> (a) the payer is within the charge to corporation tax for the payment period,
> (b) an investor in a hybrid payee is within the charge to corporation tax for an accounting period some or all of which falls within the payment period, or
> (c) a hybrid payee is a limited liability partnership.[67]

These are alternatives: only one need be satisfied.

91.17 Chap 7 condition D: D/NI mismatch

Section 259GA(5) TIOPA provides:

> Condition D is that it is reasonable to suppose[68] that, disregarding the provisions mentioned in subsection (6), there would be a hybrid payee deduction/non-inclusion mismatch in relation to the payment or quasi-payment (see section 259GB).

Section 259GA(6) TIOPA identifies the disregarded provisions:

> The provisions are-
> (a) This Chapter [Chapter 7] and Chapters 8 to 10, and
> (b) any equivalent provision under the law of a territory outside the UK.

91.17.1 *Hybrid payee D/NI mismatch*

"Hybrid payee deduction/non-inclusion mismatch" is a clumsy phrase, but it is difficult to think of a better one.

Section 259GB defines:

(1) hybrid payee deduction/non-inclusion mismatch and
(2) the amount of the mismatch

Section 259GB(1) TIOPA provides:

> There is a "hybrid payee deduction/non-inclusion mismatch", in relation to a payment or quasi-payment, if-
> (a) the relevant deduction exceeds the sum of the amounts of

[67] See 91.22 (Hybrid LLP payee).

[68] See App.2.24 (Reasonable-to-assume).

> ordinary income that, by reason of the payment or quasi-payment, arise to each payee for a permitted[69] taxable period, and
>
> (b) all or part of that excess arises by reason of one or more payees being hybrid entities.

91.17.2 *Amount of mismatch*

Section 259GB TIOPA provides:

> (2) The extent of the hybrid payee deduction/non-inclusion mismatch is equal to the excess that arises as mentioned in subsection (1)(b).
>
> (2A) No excess is to be taken to arise by reason of a hybrid payee being a hybrid entity for the purposes of subsection (1)(b) so far as it is attributable to a qualifying institutional investor based in a territory under the law of which—
>
> (a) the income or profits of the hybrid entity are not treated as income or profits of the investor, or
>
> (b) the hybrid entity is regarded as a distinct and separate person to the investor.
>
> (2B) Excess is attributable to such a qualifying institutional investor to the extent that ordinary income (arising by reason of the payment or quasi-payment) would fall to be brought into account by the investor if—
>
> (a) where subsection (2A)(a) applies, under the law of the territory the income or profits of the hybrid entity were treated as income or profits of the investor, and
>
> (b) where subsection (2A)(b) applies, under the law of the territory the hybrid entity were not regarded as a distinct and separate person to the investor.
>
> (2C) To determine if a "qualifying institutional investor" is "based" in a particular territory for the purposes of subsections (2A) and (2B) see section 259NDA.

[69] Defined in subsection (6): "A taxable period of a payee is "permitted" in relation to an amount of ordinary income that arises as a result of the payment or quasi-payment if-

(a) the period begins before the end of 12 months after the end of the payment period, or

(b) where the period begins after that-

(i) a claim has been made for the period to be a permitted period in relation to the amount of ordinary income, and

(ii) it is just and reasonable for the amount of ordinary income to arise for that taxable period rather than an earlier period."

91.17.3 *Deemed mismatch amount*

Section 259GB TIOPA provides:

> (3) A relevant amount of the excess is to be taken (so far as would not otherwise be the case) to arise as mentioned in subsection (1)(b) where-
>
> (a) a payee is a hybrid entity,
>
> (b) there is no territory-
>
> (i) where that payee is resident for the purposes of a tax charged at a higher rate than nil under the law of that territory, or
>
> (ii) under the law of which ordinary income arises to that payee, by reason of the payment or quasi-payment, for the purposes of a tax that is charged on that payee by virtue of that payee having a permanent establishment in that territory, and
>
> (c) no income arising to that payee, by reason of the payment or quasi-payment, is brought into account in calculating chargeable profits[70] for the purposes of the CFC charge or a foreign CFC charge.
>
> (4) For the purposes of subsection (3), the "relevant amount" of the excess is the lesser of-
>
> (a) the amount of the excess, and
>
> (b) an amount equal to the amount of ordinary income that it is reasonable to suppose[71] would, by reason of the payment or quasi-payment, arise to the payee for corporation tax purposes, if-
>
> (i) the payee were a company, and
>
> (ii) the payment or quasi-payment were made in connection with a trade carried on by the payee in the UK through a permanent establishment in the UK.

91.17.4 *Mismatch: partnership payee*

Section 259GB(4A) TIOPA provides:

> In applying subsection (4)(b) in a case where the payee is a partnership,[72]

[70] Defined in subsection (5): "In subsection (3)(c) "chargeable profits"-
(a) in relation to the CFC charge, has the same meaning as in Part 9A (see section 371VA), and
(b) in relation to a foreign CFC charge, means the concept (by whatever name known) corresponding to chargeable profits within the meaning of that Part."

[71] See App.2.24 (Reasonable-to-assume).

[72] Defined s.259GB(4B) TIOPA: "In subsection (4A) "partnership" has the meaning given by section 259NE(4)." See 91.26 (Partnership income).

> it is to be assumed that no amount of ordinary income arises to the payee, by reason of the payment or quasi-payment, if-
>
> (a) a partner in the partnership is entitled to the amount, and
>
> (b) having regard only to-
>
> (i) the law of the territory where the partnership is established, and
>
> (ii) the law of the territory where the partner is resident for tax purposes or, if the partner is not resident anywhere for tax purposes, where the partner is established,
>
> the payee would not be regarded as a hybrid entity.

For a worked example, see 91.27.2 (LLP example: Condition D).

Pibworth explains:

> Prior to a recent change to the Hybrid Rules (see below), in certain circumstances, the application of Part 6A Chapter 7 TIOPA potentially gave rise to odd outcomes where there was a partnership in the structure. Let us say that there are three corporate partners (each incorporated in different jurisdictions) each holding a 33.33% share in an English limited partnership, with the partnership holding 100% of the shares in a UK company. The limited partnership advances a loan to the UK company. The UK company is able to claim a deduction for UK corporation tax purposes in respect of interest payments on the loan. Under applicable law, each of the UK company debtor and two of the partners treat the English limited partnership as tax transparent but the third corporate partner treats the partnership as tax opaque.
>
> Given that the English partnership is treated as transparent by two of the partners but opaque by the other, the partnership is treated as a hybrid entity for the purposes of the Hybrid Rules, and so is a hybrid payee for the purposes of Part 6A Chapter 7 TIOPA. On one reading of Chapter 7 it was arguable that because one partner treated the partnership as opaque, then Chapter 7 had the effect of denying in full the deduction for the UK debtor on interest payments to the partnership even though, economically, there was only a deduction/non-inclusion mismatch in respect of 33.33% of any interest paid.
>
> The Hybrid Rules have now been amended to address this outcome where the hybrid payee is a partnership.26 The effect of this change is to apply Chapter 7 on a partner-by-partner basis which means that there should only be a counteraction under Chapter 7 to the extent of the actual deduction/non-inclusion mismatch. So, in the example above, 33.33% (rather than 100%) of the deduction claimed by the UK debtor would be counteracted under Chapter 7. Helpfully, the Guidance also includes an example addressing this specific scenario noting that the purpose is to

ensure that "any disallowance is proportionate".[73]

91.17.5 *Amortisation*

Section 259GB(1A) TIOPA provides:

> But there is no hybrid payee deduction/non-inclusion mismatch so far as the relevant deduction is-
> (a) a debit in respect of amortisation that is brought into account under section 729 or 731 of CTA 2009 (writing down the capitalised cost of an intangible fixed asset), or
> (b) an amount that is deductible in respect of amortisation under a provision of the law of a territory outside the UK that is equivalent to either of those sections.

91.18 Chap 7 condition E

Section 259GA(7) TIOPA provides:

> Condition E is that-
> (a) [i] it is a quasi-payment that is made as mentioned in subsection (2) and
> [ii] the payer is also a hybrid payee (see section 259BB(7)),
> (b) the payer and a hybrid payee or an investor in a hybrid payee are in the same control group (see section 259NB) at any time in the period-
> (i) beginning with the day on which the arrangement mentioned in subsection (2) is made, and
> (ii) ending with the last day of the payment period, or
> (c) that arrangement is a structured arrangement.

These are alternatives: only one need be satisfied.

91.18.1 *Structured arrangement*

This brings in a purpose test. Section 259GA TIOPA provides:

> (8) The arrangement is "structured" if it is reasonable to suppose[74] that-
> (a) the arrangement is designed to secure a hybrid payee deduction/non-inclusion mismatch, or
> (b) the terms of the arrangement share the economic benefit of the mismatch between the parties to the arrangement or otherwise reflect the fact that the mismatch is expected to arise.

[73] [2018] BTR 247.

[74] See App.2.24 (Reasonable-to-assume).

> (9) The arrangement may be designed to secure a hybrid payee deduction/non-inclusion mismatch despite also being designed to secure any commercial or other objective.

91.19 Chap 7 counteraction: Outline

Assuming the Chapter 7 application conditions are met, we move on. Chapter 7 counteracts D/NI mismatches in three ways. In order of priority:

Response	**Section**	**Condition**	**Counteraction**	**See para**
Primary	259GC	Payer within CT	Non-deduction	91.20
Secondary	259GD	Investor within CT	Charge on investor	91.21
Tertiary	259GE	Hybrid LLP	Treat LLP as corporate	91.22

91.20 Counteraction: Disallow deduction

Section 259GC counteracts the D/NI mismatch where the payer is within the charge to corporation tax.

Section 259GC TIOPA provides:

> (1) This section applies where the payer is within the charge to corporation tax for the payment period.
> (2) For corporation tax purposes, the relevant deduction that may be deducted from the payer's income for the payment period is reduced by an amount equal to the hybrid payee deduction/non-inclusion mismatch mentioned in section 259GA(5).

91.21 Counteraction: CT charge

Section 259GD counteracts the D/NI mismatch where:

(1) an investor in the payee is within the charge to corporation tax and
(2) the mismatch is not counteracted by s.259GC

Section 259GD(1) TIOPA provides:

> This section applies in relation to an investor in a hybrid payee where-
> (a) the investor is within the charge to corporation tax for an accounting period some or all of which falls within the payment period, and
> (b) it is reasonable to suppose[75] that-
> (i) neither section 259GC[76] nor any equivalent provision under the law of a territory outside the UK applies, or

[75] See App.2.24 (Reasonable-to-assume).

[76] See 91.21 (Counteraction: Payer within CT).

> (ii) a provision of the law of a territory outside the UK that is equivalent to section 259GC applies, but does not fully counteract[77] the hybrid payee deduction/non-inclusion mismatch mentioned in section 259GA(5).

91.21.1 *Relevant amount*

Section 259GD(3) TIOPA provides:

> In this section "the relevant amount" is-
> (a) in a case where subsection (1)(b)(i) applies, an amount equal to the hybrid payee deduction/non-inclusion mismatch, or
> (b) in a case where subsection (1)(b)(ii) applies, the lesser of-
> (i) the amount by which that mismatch exceeds the amount by which it is reasonable to suppose[78] the relevant deduction is reduced by a provision of the law of a territory outside the UK that is equivalent to section 259GC, and
> (ii) the amount of the relevant deduction that may still be deducted as mentioned in subsection (2)(b).

91.21.2 *Charge on investor*

Section 259GD TIOPA provides:

> (4) If the investor is the only investor in the hybrid payee, the appropriate proportion of the relevant amount is to be treated as income arising to the investor for the counteraction period.
> (5) If there is more than one investor in the hybrid payee, an amount equal to the investor's share of the appropriate proportion of the relevant amount is to be treated as income arising to the investor for the counteraction period...

The charge is under the miscellaneous income sweep up charge. Section 259GD(8) TIOPA provides:

> [a] An amount of income that is treated as arising under subsection (4)

[77] Defined in subsection (2): "A provision of the law of a territory outside the UK that is equivalent to section 259GC does not fully counteract that mismatch if (and only if)-
(a) it does not reduce the relevant deduction by the full amount of the mismatch, and
(b) the payer is still able to deduct some of the relevant deduction from income in calculating taxable profits."

[78] See App.2.24 (Reasonable-to-assume).

or (5) is chargeable under Chapter 8 of Part 10 of CTA 2009 (income not otherwise charged)[79]

[b] (despite section 979(2) of that Act).[80]

91.21.3 *Appropriate proportion*

Section 259GD TIOPA provides:

> (6) For the purposes of subsections (4) and (5) the "appropriate proportion of the relevant amount"-
> (a) if the hybrid payee is the only hybrid payee, is all of the relevant amount, or
> (b) if there is more than one hybrid payee, is the proportion of the relevant amount apportioned to the hybrid payee upon an apportionment of that amount between all the hybrid payees on a just and reasonable basis having regard (in particular) to-
> (i) any arrangements as to profit sharing that may exist between some or all of the payees, and
> (ii) the extent to which it is reasonable to suppose[81] that the hybrid payee deduction/non-inclusion mismatch mentioned in section 259GA(5) arises by reason of each hybrid payee being a hybrid entity.
>
> (7) The investor's share of the appropriate proportion of the relevant amount is to be determined by apportioning that proportion of that amount between all the investors in the hybrid payee on a just and reasonable basis, having regard (in particular) to any arrangements as to profit sharing that may exist between some or all of those investors.

91.21.4 *Counteraction period*

Section 259GD(9) TIOPA provides:

> The "counteraction period" means-
> (a) if an accounting period of the investor coincides with the payment period, that accounting period, or
> (b) otherwise, the first accounting period of the investor that is wholly or partly within the payment period.

[79] See 33.1 (Misc Sweep-up Income).

[80] Section 979(2) provides that deemed income is not within Chapter 8 Part 10, so it needs to be disapplied to tax the deemed income in this case. See 33.1.3 (Deemed income).

[81] See App.2.24 (Reasonable-to-assume).

91.22 Hybrid LLP payee

Section 259GE counteracts the mismatch where

(1) a payee is a hybrid entity and limited liability partnership and
(2) the mismatch is not otherwise counteracted

Section 259GE TIOPA provides:

> (1) This section applies in relation to a hybrid payee where
> [A] the hybrid payee is a limited liability partnership and
> [B] it is reasonable to suppose[82] that-
> (a) none of the following provisions applies-
> (i) section 259GC;
> (ii) section 259GD;
> (iii) any provision under the law of a territory outside the UK that is equivalent to either of those sections, or
> (b) [i] one or more of those provisions apply, but
> [ii] the hybrid payee deduction/non-inclusion mismatch mentioned in section 259GA(5) is not fully counteracted.

91.22.1 *Fully counteracted*

Section 259GE TIOPA provides:

> (2) The mismatch is not fully counteracted if (and only if), after the application of such of those provisions as apply-
> (a) the relevant deduction is not reduced by the full amount of the mismatch,
> (b) the payer is still able to deduct some of the relevant deduction from income in calculating taxable profits, and
> (c) the lesser of-
> (i) the difference between the amount of the mismatch and the amount by which it is reasonable to suppose the relevant deduction is reduced, and
> (ii) the amount of the relevant deduction that may still be deducted,
> exceeds the sum of any amounts of income treated as arising under section 259GD or any equivalent provision under the law of a territory outside the UK.

91.22.2 *"The relevant amount"*

Section 259GE(3) TIOPA provides:

[82] See App.2.24 (Reasonable-to-assume).

> In this section "the relevant amount" is-
> (a) in a case where subsection (1)(a) applies, an amount equal to the hybrid payee deduction/non-inclusion mismatch mentioned in section 259GA(5), or
> (b) in a case where subsection (1)(b) applies, an amount equal to the excess mentioned in subsection (2)(c).

91.22.3 *Charge on LLP*

Section 259GE(4) TIOPA provides:

> If the hybrid payee is the only hybrid payee, an amount equal to the relevant amount is to be treated as income arising to the hybrid payee on the last day of the payment period.

91.22.4 *Multiple hybrid payees*

Section 259GE TIOPA provides:

> (5) If there is more than one hybrid payee, an amount equal to the hybrid payee's share of the relevant amount is to be treated as income arising to the hybrid payee on the last day of the payment period.
> (6) The hybrid payee's share of the relevant amount is to be determined by apportioning that amount between all the hybrid payees on a just and reasonable basis, having regard (in particular) to-
> (a) any arrangements as to profit sharing that may exist between some or all of the payees, and
> (b) the extent to which it is reasonable to suppose[83] that the hybrid payee deduction/non-inclusion mismatch mentioned in section 259GA(5) arises by reason of each hybrid payee being a hybrid entity.

91.22.5 *Charge to CT*

Section 259GE(7) TIOPA provides:

> An amount of income that is treated as arising under subsection (4) or (5) is chargeable to corporation tax on the hybrid payee (as opposed to being chargeable to tax on any of its members) under Chapter 8 of Part 10 of CTA 2009 (income not otherwise charged) (despite section 979(2) of that Act).

This is the same as the charge on the investor in the hybrid; see 91.21.2 (Charge on investor).

[83] See App.2.24 (Reasonable-to-assume).

Section 259GE(8) TIOPA provides:

> [a] Section 863 of ITTOIA 2005 (treatment of certain limited liability partnerships for income tax purposes) and
> [b] section 1273 of CTA 2009 (treatment of certain limited liability partnerships for corporation tax purposes)[84]
> are disapplied in relation to the hybrid payee to the extent necessary for the purposes of subsection (7).

This switches off the usual LLP deemed partnership/transparency rule. But other transparent entities are not affected.

91.22.6 *Pt 6A chapters priority*

Section 259GE(9) TIOPA provides:

> This section is to be disregarded for the purposes of determining whether the hybrid payee is within the charge to corporation tax for the purposes of any other provision of this Part [Part 6A, hybrids/mismatches], except section 259M (anti-avoidance).

91.23 Hybrids TAAR

Section 259M(1) TIOPA provides:

> This section applies where-
> (a) relevant avoidance arrangements exist,
> (b) as a result of those arrangements, any person (whether party to the arrangements or not) would, apart from this section, obtain a relevant tax advantage, and
> (c) that person is-
> (i) within the charge to corporation tax at the time the person would obtain the relevant tax advantage, or
> (ii) would be within the charge to corporation tax at that time but for the relevant avoidance arrangements.

91.23.1 *Counteraction*

Section 259M TIOPA provides:

> (2) The relevant tax advantage is to be counteracted by making such adjustments to the person's treatment for corporation tax purposes as are just and reasonable.
> (3) Any adjustments required to be made under this section (whether or

[84] See 85.22.2 (LLP treated as partnership).

> not by an officer of Revenue and Customs) may be made by way of an assessment, the modification of an assessment, amendment or disallowance of a claim, or otherwise.

This is a counteraction-style TAAR.

91.23.2 *Relevant tax advantage*

Section 259M TIOPA provides:

> (4) A person obtains a "relevant tax advantage" if-
> (a) the person avoids, to any extent, any provision of this Part [Part 6A, hybrids/mismatches], or any equivalent provision of the law of a territory outside the UK, restricting whether or how that person may make a deduction from income for the purposes of calculating taxable profits, or
> (b) the person avoids, to any extent, an amount being treated as income of that person under any provision of this Part [Part 6A, hybrids/mismatches] or any equivalent provision of the law of a territory outside the UK, or
> (c) the person does anything which, to any extent, results in an amount being treated as dual inclusion income of that person under any provision of this Part.

91.23.3 *Relevant avoidance arrangements*

Section 259M(5) TIOPA provides:

> "Relevant avoidance arrangements" means arrangements the main purpose, or one of the main purposes, of which is to enable any person to obtain a relevant tax advantage.

So far this is standard "tax advantage" wording, but s.259M then brings in an avoidance test (already suggested by use of the word "avoids" in the definition of "relevant tax advantage"):

> (6) But arrangements are not "relevant avoidance arrangements" if the obtaining of the relevant tax advantage can reasonably be regarded as consistent with the principles on which the provisions of this Part [Part 6A, hybrids/mismatches], or the equivalent provisions under the law of a territory outside the UK, that are relevant to the arrangements are based (whether express or implied) and the policy objectives of those provisions.
> (7) For the purposes of determining the principles and policy objectives mentioned in subsection (6), regard may, where appropriate, be had to the Final Report on Neutralising the Effects of Hybrid Mismatch

> Arrangements published by the Organisation for Economic Cooperation and Development ("OECD") on 5 October 2015 or any replacement or supplementary publication.[85]

91.24 Minor definitions

91.24.1 *"Tax"*

Section 259B TIOPA provides:

> (1) In this Part [Part 6A, hybrids/mismatches] "tax" means-
> (a) income tax,
> (b) the charge to corporation tax on income,
> (c) diverted profits tax,
> (d) the CFC charge,
> (e) foreign tax, or
> (f) a foreign CFC charge.
> (2) In subsection (1) "foreign tax" means a tax chargeable under the law of a territory outside the UK so far as it-
> (a) is charged on income and corresponds to UK income tax, or
> (b) is charged on income and corresponds to the UK charge to corporation tax on income.
> (3) A tax is outside the scope of subsection (2) if it-
> (a) is chargeable under the law of a province, state or other part of a country, or
> (b) is levied by or on behalf of a municipality or other local body.
> (3A) The payment of any withholding tax in respect of any amount is to be ignored for the purposes of this Part [Part 6A, hybrids/mismatches].

CGT is not within the definition of tax; likewise CT on chargeable gains. So CGT mismatches are not caught.

The INT Manual provides:

> **INTM550520 Meaning of tax** [Dec 2019]
> ... For example, USA Federal taxes on income correspond to the UK taxes, being imposed at national level, and so are regarded as foreign tax within Part 6A. USA State taxes are not foreign tax within Part 6A - they do not correspond to UK taxes on income because they are not imposed at national level and there is another tax in the USA that is.
> Sales or turnover taxes are not foreign taxes that correspond to the UK

[85] Defined in s.259M(8) TIOPA: "In subsection (7) "replacement or supplementary publication" means any document that is approved and published by the OECD in place of, or to update or supplement, the report mentioned in that subsection (or any replacement of, or supplement to, it)."

income tax or charge to corporation tax on income in the UK. Withholding taxes are specifically excluded from Part 6A (259B(3A)).

91.24.2 *“Residence*”

Section 259B(5) TIOPA provides:

> In any case where-
> (a) a person is resident in a territory outside the UK generally for the purposes of the law of the territory or for particular purposes under that law, and
> (b) the law of the territory has no provision for a person to be resident for tax purposes under its law,
>
> any reference in Chapter 8 or 11 to a person’s residence for tax purposes in the territory is to be read as a reference to the person’s residence as mentioned in paragraph (a).

91.24.3 *Equivalent foreign provision*

Section 259BA TIOPA provides:

> (1) A reference in this Part [Part 6A, hybrids/mismatches] to provision under the law of a territory outside the UK that is equivalent to-
> (a) this Part [Part 6A, hybrids/mismatches], or
> (b) a provision of this Part,
>
> is to be read in accordance with subsection (2).
>
> (2) The reference is to provision under the law of a territory outside the UK that it is reasonable to suppose[86]-
> (a) is based on the Final Report on Neutralising the Effects of Hybrid Mismatch Arrangements published by the Organisation for Economic Cooperation and Development (“OECD”) on 5 October 2015 or any replacement or supplementary publication, and
> (b) has effect for the same, or similar, purposes to this Part or (as the case may be) the provision of this Part.
>
> (3) In paragraph (a) of subsection (2) “replacement or supplementary publication” means any document that is approved and published by the OECD in place of, or to update or supplement, the report mentioned in that paragraph (or any replacement of, or supplement to, it).

91.24.4 *“Taxable period”*

Section 259NF ITTOIA provides a commonsense definition:

[86] See App.2.24 (Reasonable-to-assume).

> "taxable period" means—
> (a) in relation to corporation tax, an accounting period,
> (b) in relation to income tax, a tax year,
> (c) in relation to the CFC charge, a relevant corporation tax accounting period (within the meaning given by section 371BC(3)),
> (d) in relation to a foreign CFC charge, a period (by whatever name known) that corresponds to a relevant corporation tax accounting period, and
> (e) in relation to any other tax, a period for which the tax is charged;

91.25 "Control group"

This matters for Chapter 7 Condition E, among other matters.

Section 259NB(1) TIOPA provides:

> A person ("A") is in the same control group as another person ("B")-
> (a) throughout any period for which they are consolidated for accounting purposes,
> (b) on any day on which the participation condition is met in relation to them, or
> (c) on any day on which the 50% investment condition is met in relation to them.

Thus there are three conditions, or sets of conditions, only one of which needs to be satisfied.

91.25.1 *Consolidated for accounting*

Section 259NB(2) TIOPA provides:

> A and B are consolidated for accounting purposes for a period if-
> (a) their financial results for the period are required to be comprised in group accounts,[87]
> (b) their financial results for the period would be required to be comprised in group accounts but for the application of an exemption, or
> (c) their financial results for the period are in fact comprised in group accounts.

[87] Defined in subsection (3): "In subsection (2), "group accounts" means accounts prepared under-
(a) section 399 of the Companies Act 2006, or
(b) any corresponding provision of the law of a territory outside the UK."

91.25.2 *Participation condition*

Section 259NB(4) TIOPA provides:

> The participation condition is met in relation to A and B ("the relevant parties") on a day if, within the period of 6 months beginning with the day-
> (a) one of the relevant parties directly or indirectly participates in the management, control or capital of the other, or
> (b) the same person or persons directly or indirectly participate in the management, control or capital of each of the relevant parties.

This brings in a wide and complex set of tests.[88]

91.25.3 *50% investment condition*

Section 259NB(6) TIOPA provides:

> The 50% investment condition is met in relation to A and B if-
> (a) A has a 50% investment in B, or
> (b) a third person has a 50% investment in each of A and B.

The definition of "50% investment" is in s.259ND TIOPA; see 105.8 (% investment tests).

91.25.4 *Acting together*

Section 259ND TIOPA provides:

> (6) For the purposes of subsections (3) and (4), in determining what percentage investment a person ("P") has in another person ("U"), where P acts together with a third person ("T") in relation to U, P is to be taken to have all of T's rights and interests in relation to U.
> (7) P is to be taken to "act together" with T in relation to U if (and only if) subsection (7A) or (7B) applies.
> (7A) This subsection applies if—
> (a) P and T are party to a partnership agreement that—
> (i) it is reasonable to suppose[89] is designed to affect the value of any of T's rights or interest in relation to U, or

[88] Section 259NB(5) provides a signpost: "For the interpretation of subsection (4), see sections 157(1), 158(4), 159(1) and 160(1) (which have the effect that references in subsection (4) to direct or indirect participation are to be read in accordance with provisions of Chapter 2 of Part 4)." See 105.1 (Participation).

[89] See App.2.24 (Reasonable-to-assume).

(ii) relates to the exercise of any of T's rights in relation to U, or

(b) the same person manages—

(i) some or all of P's rights or interests in relation to U, and

(ii) some or all of T's rights or interests in relation to U.

(7B) This subsection applies if P has a relevant investment in U and—

(a) P and T are connected (within the meaning given by section 163),

(b) for the purposes of influencing the conduct of U's affairs—

(i) P is able to secure that T acts in accordance with P's wishes,

(ii) T can reasonably be expected to act, or typically acts, in accordance with P's wishes,

(iii) T is able to secure that P acts in accordance with T's wishes, or

(iv) P can reasonably be expected to act, or typically acts, in accordance with T's wishes, or

(c) P and T are party to any arrangement that—

(i) it is reasonable to suppose is designed to affect the value of any of T's rights or interests in relation to U, or

(ii) relates to the exercise of any of T's rights in relation to U.

(7C) To determine whether P has a "relevant investment" in U at a particular time, subsections (3) and (4) apply but as if—

(a) for "an X%", in both places, there were substituted "a relevant", and

(b) for "X% or more", in each place, there were substituted "greater than 5%".

(7D) For that purpose—

(a) subsection (6) is to be ignored, and

(b) P's rights and interests are to be aggregated with the rights and interests of persons connected to P (within the meaning given by section 1122 of CTA 2010, ignoring subsection (4) of that section)."

(8) P does not "act together" with T in relation to U under paragraph (b) of subsection (7A) where-

(a) the person who manages the rights or interests of P mentioned in sub-paragraph (i) of that paragraph, does so as the operator of a collective investment scheme,[90]

(b) that person manages the rights or interests of T mentioned in

[90] Defined by reference in subsection (9): "In subsection (8) "collective investment scheme" and "operator" have the same meaning as in Part 17 of the Financial Services and Markets Act 2000 (see sections 235 and 237 of that Act)."

> sub-paragraph (ii) of that paragraph as the operator of a different collective investment scheme, and
>
> (c) the Commissioners are satisfied that the management of the schemes is not coordinated for the purpose of influencing the conduct of U's affairs.

91.26 Partnership income

Section 259NE TIOPA provides:

> (1) This section applies where a person is a member of a partnership.[91]
> (2) Any reference in this Part [Part 6A, hybrids/mismatches] to income, profits or an amount of the person includes a reference to the person's share of (as the case may be) income, profits or an amount of the partnership.

That seems self evident, since partnerships are transparent.

> (3) For this purpose "the person's share" of income, profits or an amount is determined by apportioning the income, profits or amount between the partners on a just and reasonable basis.

The INT Manual provides:

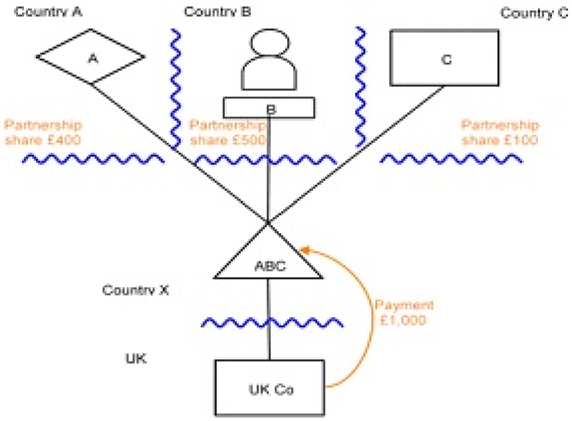
> **INTM550630 Partnership and partnership members** [Dec 2019]
> **Partnerships**
> There is no definition of a partnership for the purposes of Part 6A TIOPA 2010, so the term will take its usual meaning in UK law, that is, the relation between persons carrying on a business in common with a view to profit.
> 259NE considers partnerships and the treatment of a person who is a member of a partnership.
> A partnership is a person for the purposes of the hybrid mismatch rules.
> A partnership is regarded as transparent for UK tax purposes, with the result that the partnership's income, profits etc. are treated as the income, profits etc. of its partners. However, some partnerships may be treated as opaque under the tax laws of other territories, leading to potential hybrid mismatches.
> S259NE(4)(a) includes entities established under the law of a territory

[91] Section 259NE(4) TIOPA provides a foreign entity definition: " In this section-
(a) "partnership" includes an entity established under the law of a territory outside the UK of a similar character to a partnership, and
(b) "member" of a partnership is to be read accordingly."
This is unnecessary but harmless; see 90.3.3 (Foreign-entity clauses).

> outside the UK that are of a similar character to a UK partnership. An entity regarded as transparent is not necessarily of a similar character to a UK partnership and must be considered on the full facts and characteristics. This subsection is intended to ensure that the treatment of non-UK partnerships, for Part 6A purposes, is consistent with the treatment of UK partnerships and not to extend the definition of a partnership...

91.27 HMRC example: LLP

INTM555210 Calculating the mismatch where there are multiple payees [Dec 2019]



Background

- ABC Partnership is established in Country X, which regards it as transparent for tax purposes.
- ABC Partnership holds all the issued share capital in UK Co, which is resident in the UK and liable to tax there. The UK regards ABC Partnership as transparent for tax purposes.
- Trust A, which is established in Country A, is a partner in ABC Partnership. Country A regards ABC Partnership as transparent for tax purposes.
- Trust A is entitled to a 40% share of the profits etc. of ABC Partnership.
- Trust A is a tax exempt entity in Country A, and is not taxed on profits etc. derived from ABC Partnership.
- Individual B, who is resident in Country B, is a partner in ABC Partnership. Country B regards ABC Partnership as transparent for tax purposes.
- Individual B is entitled to a 50% share of the profits etc. of ABC Partnership.
- Individual B is liable to tax in Country B on the profits etc. derived from ABC Partnership.
- C Co, resident in Country C, is a partner in ABC Partnership. Country C regards ABC Partnership as opaque.
- C Co is entitled to a 10% share of the profits etc. of ABC Partnership.
- C Co is liable to tax on its own profits etc. in Country C, but is not liable to tax on

profits etc. derived from ABC Partnership.

- UK Co makes a payment of interest to ABC Partnership in respect of a loan from ABC Partnership.

Dramatis personae: State	**Taxed in home State**	**State view LLP**	**Payee**
LLP: State X	No (as transparent)	Transparent	
UK Co	Yes (subject to CT)	Transparent	Yes
Trust A: State A	No (as tax exempt)	Transparent	No
B: State B	Yes	Transparent	Yes
C Ltd: State C	No (as LLP opaque)	Opaque	No

91.27.1 *LLP: Chap 7 application conditions*

Analysis – Applying the tests in s259GA TIOPA 2010
Does the interest payment satisfy the relevant conditions and fall within the scope of the hybrid payee deduction/non-inclusion mismatch rules?

I think the chapter 7 application conditions are straightforward, apart from condition D.

Condition A: Is a payment made under, or in connection with, an arrangement?
There is a payment of interest by UK Co to ABC Partnership under the loan agreement. The loan agreement is an arrangement.
Condition A is satisfied.

Condition B: Is a payee a hybrid entity?
ABC Partnership is a hybrid entity because Country C regards it as a person for tax purposes, whilst Countries A, B, X and Z treat some or all of its income or profits as belonging to another person/persons for tax purposes.

[Who are Payees]
Trust A is not a payee because
[1] it is not a person to whom a transfer is made,[92] and
[2] as a tax-exempt entity, ordinary income is not brought into account for the purposes of calculating the profits on which a relevant tax is charged.

Company C is not a payee because
[1] it is not a person who whom a transfer is made, and
[2] because Country C regards ABC Partnership as opaque, so ordinary income does not arise on Company C as a result of the payment.

Condition B is satisfied.

Condition C: Is the payer or an investor within the charge to corporation tax for the relevant period, or is the hybrid payee a limited liability partnership?
The charge to corporation tax is the charge to corporation tax in the UK. UK Co, the payer, is liable to corporation tax in the UK.

[92] Author’s footnote: Point [2] is right but is point [1] right and does it matter?

Condition C is satisfied.

91.27.2 *LLP example: Condition D*

Condition D: Is it reasonable to suppose that there is, or will be, a hybrid payee deduction/non-inclusion mismatch in relation to the payment?

It is reasonable to suppose that UK Co will be permitted a deduction of £1,000 from income for the interest payment made (the relevant deduction) for a taxable period.

It is also reasonable to suppose that
- ABC Partnership does not have any ordinary income arising as a result of the payment,
- Individual B will have ordinary income of £500 representing 50% of the payment.
- Neither Trust A nor C Co have ordinary income arising as a result of the payment made by UK Co.

There is a hybrid payee deduction/non-inclusion mismatch under s259GB(1) if
- the relevant deduction exceeds the sum of ordinary income arising to each payee, and
- all or part of the excess arises by reason of one or more payees being hybrid.

In this case, the relevant deduction of £1,000 is matched by ordinary income of £500 arising to a payee (Individual B). The excess is therefore £500, representing the amounts attributable to Trust A and C Co by ABC Partnership.

The next step is to test whether that excess of £500 arises by reason of ABC Partnership being a hybrid entity. Part of the excess, the amount of £100 allocated to C Co, arises by reason of ABC Partnership being a hybrid entity. If Country C viewed ABC Partnership as transparent, then the amount allocated to C Co would be ordinary income of C Co and no mismatch would arise.
The £400 allocated to Trust A, does not arise by reason of ABC Partnership being a hybrid entity as both Country X and Country A view ABC Partnership as transparent. However, the provisions at section 259GB(3) that may apply to treat part of the excess as arising by reason of ABC Partnership being a hybrid entity (to the extent that is not already the case).

Section 259GB(3) treats a relevant amount of the excess to arise by reason of one on the payees being a hybrid entity where -
- a payee is a hybrid entity, and
- that payee is not resident for tax purposes in any territory,
- that payee does not have ordinary income from a permanent establishment in any territory as a consequence of the payment, and
- income arising to that payee is not brought into account in computing profits for a CFC charge.

Applying these tests to the facts given –
- ABC Partnership is a payee
- ABC Partnership is a hybrid entity,
- there is no territory where ABC Partnership is resident for the purposes of a tax charged under the law of that territory,
- there is no territory where ABC Partnership has ordinary income arising from a permanent establishment and

- no income arises to ABC Partnership which is brought into account for the purposes of a CFC charge.

As the conditions for s259GB(3) are met the next step is to establish what the relevant amount of the excess is that needs to be considered. The relevant amount is computed as set out in s259GB(4), as amended by s259GB(4A) in partnership cases.

Section 259GB(4) defines the relevant amount of the excess as the lower of –

- the amount of the excess, and
- an amount equal to the amount of ordinary income that it is reasonable to suppose would arise to the payee if the payee were a company trading in the UK through a UK permanent establishment and the payment was received in connection with that trade.

This amount of ordinary income to be used in this comparison is amended by s259GB(4A) where –

- the payee is a partnership,
- a partner in the partnership is entitled to an amount of the payment, and
- the partnership would not be regarded as a hybrid entity under the laws of the territories where the partnership and the relevant partner are tax resident/established.

If these conditions are met, it is assumed that no ordinary income arises to the payee for the amount of the payment to which the partner is entitled when carrying out the comparison at s259GB(4).

In this example, the conditions under s259GB(4A) are met in relation to Trust A as -

- ABC Partnership is a payee and is a partnership
- Trust A is entitled to £400 of the payment of £1,000 received by ABC Partnership
- ABC Partnership would not be regarded as a hybrid entity if only the laws of Country A and Country X applied.

Consequently, for the purposes of the comparison at s259GB(4) it is assumed that no ordinary income arises to the ABC Partnership to the extent of the amount of £400 to which Trust A is entitled.

The conditions under s259GB(4A) are also met in relation to Individual B as -

- ABC Partnership is the payee and is a partnership
- Individual B is entitled to £500 of the payment of £1,000 received by ABC Partnership
- ABC Partnership would not be regarded as a hybrid entity if only the laws of Country B and Country X applied.

Consequently, for the purposes of the comparison at s259GB(4) it is assumed that no ordinary income arises to the ABC Partnership to the extent of the amount of £500 to which Individual B is entitled.

The conditions under s259GB(4A) are not met in relation to C Co as ABC Partnership is regarded as a hybrid entity if the laws of Country C and the UK are applied.

Returning to comparison under s259GB(4) the relevant amount of the excess is £100, that is, the lower of–

- £500, the excess, and
- £100, the amount of ordinary income that would arise to ABC Partnership in respect of the payment of £1,000, as reduced in respect of Trust A and Individual B under s259GB(4A).

As the relevant amount of the excess is the £100 already identified as a hybrid payee deduction/non-inclusion mismatch under s259GB(1)(b), there is no need to deem a further

amount of the excess as arising by reason of the hybridity of ABC Partnership.
Condition D is satisfied, and the extent of the hybrid payee deduction/non-inclusion mismatch is £100.

Condition E: Are the payer and the hybrid payee or investor in the same control group or is there a structured arrangement?
UK Co (the payer) and ABC Partnership (the hybrid payee) are in the same control group as ABC Partnership owns 100% of the issued shares in UK Co.
UK Co (the payer) and Individual B (an investor in the hybrid payee) are in the same control group as Individual B has a 50% investment in UK Co.
Condition E is satisfied.
There is no indication that this is a structured arrangement.

Conclusion
All the relevant conditions are satisfied to characterise the arrangement as a hybrid payee deduction/non-inclusion mismatch, so the relevant counteractions will need to be considered.

91.27.3 *LLP example: Counteraction*

Counteraction where the UK is the payer jurisdiction
Primary Response
As the UK is the payer jurisdiction, s259GC applies to reduce the deduction available to UK Co by the extent of the hybrid payee deduction/non-inclusion mismatch.
In this instance, UK Co would be denied £100 of the £1,000 deduction.

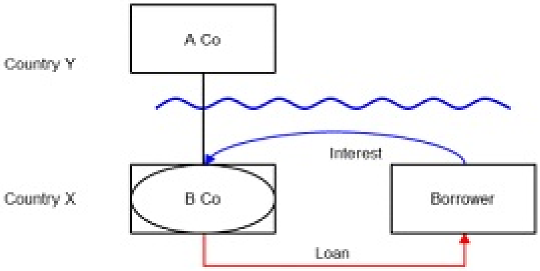
Counteraction where the UK is in the position of Country B (investor jurisdiction)
Secondary Response
If the UK were in the position of Country B, counteraction under s259GD should be considered to the extent that the mismatch is not countered under s259GC (or a non-UK equivalent provision).
In this instance, s259GD cannot apply as Individual B includes their share of the income from the partnership as ordinary income, and in any case an individual is not within the charge to corporation tax.
[If Individual B were a company (B Co), it did not include its 50% share of partnership income in ordinary income and there was no primary response to counter this mismatch, s259GD(4) would apply to treat the hybrid payee deduction/non-inclusion mismatch as income of B Co].

Counteraction where a hybrid payee is a UK Limited Liability Partnership (LLP) (UK is Country X)
Tertiary response
If ABC Partnership were a UK LLP then, to the extent that the hybrid payee deduction/non-inclusion mismatch has not already been fully counteracted under s259GC or s259GD (or non-UK equivalent provisions), s259GE applies.
Under s259GE(4) an amount equal to the hybrid payee deduction/non-inclusion mismatch (that is, £100 of the deduction claimed by UK Co) is treated as income of ABC Partnership arising on the last day of the payment period. This income is brought within the charge to corporation tax on ABC Partnership under Chapter 8 of Part 10 of CTA 2009.

S259GE(8) dis-applies s863 ITTOIA 2005 (treatment of certain limited liability partnerships for income tax purposes) and s1273 CTA 2009 (treatment of certain limited liability partnerships for corporation tax purposes) in relation to ABC Partnership to the extent needed to give effect to the counteraction under s259GD.

91.28 HMRC example: tax-exempt investor

INTM555220: Hybrids: Chapter 7 - Hybrid Payee: Example: investor is a tax-exempt entity [Dec 2019]



Background

Note: A reverse hybrid is any person that is treated as a separate entity by an investor and as transparent under the laws of the establishment jurisdiction. A deductible payment made to a reverse hybrid payee may give rise to a mismatch in tax outcomes, where that payment is not included in the ordinary income in the jurisdiction where the payee is established, or in the jurisdiction of any investor in that payee.

- A Co is a company resident in Country Y
- A Co is exempt from tax under Country Y law
- B Co is an entity incorporated in Country X and is wholly owned by A Co
- Country X treats B Co as transparent for X tax purposes, i.e. it is not a separate taxable person from A Co
- Country Y treats B Co as opaque, i.e. as a separate taxable person from A Co
- Borrower Co is a company resident in Country X, and is not connected to either A Co or B Co
- Borrower Co borrows money from B Co on arm’s length and standard commercial terms (the Loan)
- Country X allows Borrower Co a deduction for interest payments made on the loan
- Country X does not tax the interest receipt by B Co as it regards the income as belonging to A Co.
- Country Y does not tax the interest receipt as it regards the income as belonging to B Co (a company resident in Country X).
- The arrangements have been designed to secure a hybrid mismatch.

Analysis – Applying the tests in s259GA TIOPA 2010

Do the interest payments satisfy the relevant conditions and thus fall within the scope of the hybrid payee deduction/non-inclusion mismatch rules?

Condition A: Are payments made under, or in connection with, an arrangement?

Transactions took place resulting in a transfer of money (the interest payments) directly from Borrower Co (payer) to B Co (payee), which represents a payment.

There was an arrangement (the Loan agreement), and payments were made under that arrangement.

Condition A is therefore satisfied.

Condition B: Is the payee a hybrid entity?

B Co is the payee. Country X regards B Co as transparent for tax purposes, so the income or profits are treated by Country X as those of A Co. Country Y treats B Co as a taxable person separate from A Co, and regards the income as arising to B Co (a company resident in Country X).

B Co has the characteristics of a hybrid entity, and Condition B is met.

When a person (in this instance, B Co) is treated as a separate entity by an investor (A Co) and as transparent under the laws of the establishment jurisdiction (Country X), this is a reverse hybrid.

Condition C: Is the payer or investor within the charge to corporation tax for the relevant period, or is the hybrid payee a limited liability partnership?

The charge to corporation tax is the charge to corporation tax in the UK. In this example condition C will be satisfied if

- the UK is Country X, or
- the UK is Country Y, or
- the hybrid payee is a LLP

If none of these circumstances are satisfied then Condition C is not met, and it is not necessary to consider the remaining conditions.

Condition D: Is it reasonable to suppose that there is, or will be, a hybrid payee deduction/non-inclusion mismatch in relation to the payment?

Given the background above it is reasonable to suppose that if the hybrids legislation, or its foreign equivalent, did not apply

- Borrower Co would deduct an amount from income for the interest paid on the Loan (the relevant deduction), and
- Neither B Co nor A Co would include the interest received from Borrower Co in its ordinary income.

This mismatch arises as a consequence of the contrasting treatment of B Co for tax purposes in Country X and Country Y, so is directly attributable to the fact that B Co is a hybrid entity. If B Co had been recognised as an entity separate from A Co in Country X it is reasonable to suppose that B Co would have included the interest payments in its ordinary income.

Condition D is satisfied.

Condition E: Is the payer also a hybrid payee, are the payer and either the hybrid payee or the investor within the same control group or is there a structured arrangement?

This condition has three possible tests that can be met, so we must examine these in turn. If any of the three are met then this condition is met.

In this example, the payer (Borrower Co) is not a hybrid payee. Condition E is not met by this test.

The hybrid payee, B Co, is not in the same control group as Borrower Co. Condition E is not met by this test.

However, the arrangements were designed to secure the mismatch, so there is a structured arrangement.

Condition E is satisfied.

Amount of the mismatch

If conditions A to E are satisfied, the payment of interest by Borrower Co under the Loan is a hybrid payee deduction/non-inclusion mismatch, and UK counteraction must be considered.

The extent of the mismatch must be calculated by quantifying the excess, which in this example is given by

- the amount of Borrower's deduction from income for the interest paid, less
- the amount of that interest payment included as ordinary income of A Co and B Co.

How much of that amount arises because B Co is a hybrid entity is then considered. In this example, if B Co were not a hybrid entity then either B Co would be recognised by Country X as a separate taxable person or Country Y would recognise it as a transparent entity. In either scenario it would be reasonable to suppose that the amount of ordinary income, equal to the interest received, would be recognised, and that a mismatch would not arise.

The extent of the mismatch arising by reason of B Co being a hybrid entity is therefore the full amount of the interest.

Conclusion

Assuming all the relevant conditions are satisfied to characterise the arrangement as a 'hybrid payee deduction/non-inclusion mismatch', the relevant counteractions will need to be considered.

Counteraction

The counteraction applicable will depend upon whether the UK is in the position of Country X or Country Y or if B Co is an LLP.

Counteraction where the UK is in the position of Country X (payer jurisdiction)

Primary Response

The primary counteraction is against the payer.

If the UK is Country X (the payer jurisdiction) Borrower Co's deduction for interest payments to B Co is restricted (s259GC).

Counteraction where the UK is in the position of Country Y (investor jurisdiction)

Secondary Response

In this example, if the UK is Country Y and it is concluded that Country X has no provisions that apply to counteract the mismatch on the payer, then the UK legislation applies to treat the entire mismatch as income of A Co.

If it is concluded that Country X has provisions that apply but they do not fully counteract the mismatch then the UK provisions apply to treat part of the mismatch as income of A Co, to ensure the hybrid payee deduction/non-inclusion mismatch is fully counteracted.

Counteraction where B Co is an LLP

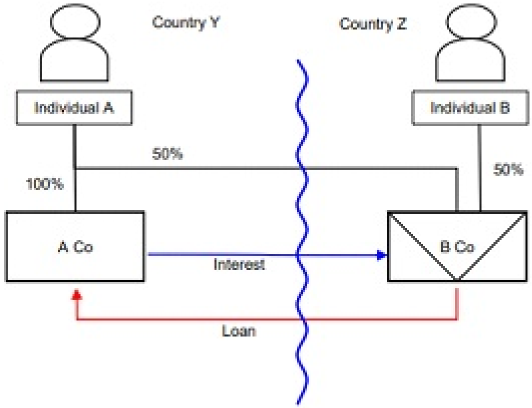
Tertiary Response

In this example the tertiary response (counteraction against a LLP that is a hybrid payee) is unlikely to apply - as both the payer and the hybrid payee are resident in the UK, the primary response applied against the payer takes priority, and will fully counteract the mismatch.

91.29 HMRC example: Reverse hybrid

INTM555230: Example: Payments to hybrid entity (reverse hybrid) partially

excluded [Dec 2019]



Background

- Two individuals, one resident in Country Y (Individual A) and one in Country Z (Individual B) agree to make a loan to A Co.
- Individual A wholly owns A Co.
- Individual A and Individual B each hold 50% of the voting power in B Co.
- B Co is incorporated in Country Z.
- B Co is treated by Country Z as transparent (i.e. its income or profits are treated in Country Z as those of Individual A and Individual B).
- Individuals A & B do not make the loan directly to A Co but make equal contributions of the relevant amount into B Co, which then loans this amount to A Co (the Loan).
- The Loan does not satisfy the conditions required to fall within the ‘hybrids and other mismatches from financial instruments’ rules. This is because the mismatch does not arise from a feature of the instrument but rather because of the presence of a hybrid entity.
- A Co pays interest on the Loan and may claim a deduction for that expense in Country Y.
- B Co attributes half the interest receivable to Individual A and half to Individual B.
- Individual B is subject to tax on his share of the interest receivable at the full marginal rate applicable to interest income in Country Z.
- Individual A does not include the interest receivable in his ordinary income in either Country Z or Country Y. Country Z does not tax foreign source income attributable to a non-resident person. Country Y recognises B Co as a separate person for tax purposes so Individual A is not subject to tax on income from B Co.

Note: In practice the background above may not be easily obtained from the relevant tax return. If standard information requests to the relevant company do not address concerns it may be necessary to consider other powers available, such as 3rd party information notices or potential cross-country information requests (through JITSIC). Your local International Tax Specialist may have further information on how certain entities are characterised for tax purposes under foreign tax regimes.

Analysis – Applying the tests in s259GA TIOPA 2010

Do the interest payments satisfy the relevant conditions and thus fall within the scope of the hybrid payee deduction/non-inclusion mismatch rules?

Condition A: Are payments made under, or in connection with, an arrangement?

Transactions took place resulting in a transfer of money (the interest payments) from A Co. (payer) to B Co (payee), which represents a payment.

There was an arrangement encompassing the contributions to B Co, the Loan agreement with A Co, and the allocation of that interest to Individual A and Individual B.

Condition A is satisfied.

Condition B: Is a payee a hybrid entity?

The payees are B Co (the person receiving the interest payment), and Individual B (who has ordinary income arising as a result of the payment).

Country Y regards B Co as a separate taxable person to Individual A. Country Z regards B Co. as transparent so treats B Co's interest receipts as ordinary income of Individual A and Individual B. .

B Co has the characteristics of a hybrid entity, and Condition B is met. A reverse hybrid is any person that is treated as a separate entity by an investor and as transparent under the laws of the establishment jurisdiction.

Individual B is not a hybrid entity, as he is regarded as a person under the laws of both Country Z and Country Y.

Condition C: Is the payer or an investor within the charge to corporation tax for the relevant period, or is the hybrid payee a limited liability partnership?

The charge to corporation tax is the charge to corporation tax in the UK. In this example condition C can be satisfied if

- the UK is Country Y (the payer jurisdiction), or
- the UK is Country Z and the hybrid payee is a LLP.

If the UK is neither Country Y nor Country Z condition C is not met, and it is not necessary to consider the remaining conditions.

If that is the case, and the mismatch is not countered by another territory, the imported mismatch rules at Chapter 11 should be considered.

Condition D: Is it reasonable to suppose that there is, or will be, a hybrid payee deduction/non-inclusion mismatch in relation to the payment?

It is reasonable to suppose that A Co will be permitted a deduction against its ordinary income for the interest payments made under the Loan (the relevant deduction) for a taxable period.

It is also reasonable to suppose that neither B Co nor Individual A will be charged to tax on the interest receipts attributable to Individual A.

Consequently, this mismatch is attributable to the contrasting treatment of B Co for tax purposes in Country Y and Country Z, and so results from the fact that B Co is a hybrid entity. If either:

- B Co had been recognised as an entity separate from Individual A in Country Z, or
- B Co had not been recognised as an entity separate from Individual A in Country Y

then it is reasonable to suppose that either B Co (in the former situation) or Individual A (in the latter situation) would have included the interest payments in its ordinary income. It therefore arises by reason of B Co (a payee) being a hybrid entity.

Condition D is therefore satisfied.

To the extent that the amounts attributable to Individual B have been subject to tax in Country Z, there will be no hybrid payee deduction/non-inclusion mismatch arising from those payments.

The extent of the hybrid payee deduction/non-inclusion mismatch is equal to the payments attributable to Individual A.

Condition E: Are the payer and the hybrid payee or investor in the same control group or is there a structured arrangement?

A Co (payer) and B Co (reverse hybrid) are all part of the same control group, as defined under s259NB, as Individual A, who holds at least 50% of the voting power both companies.

(Even if Individual A were to hold less than 50% of the voting power in B Co, the facts suggest that the arrangement was designed to secure a hybrid payee deduction/non-inclusion mismatch, and therefore it may qualify as a structured arrangement).

Condition E is met.

Conclusion

As all the relevant conditions are satisfied to characterise the arrangement as a hybrid payee deduction/non-inclusion mismatch, the extent of the mismatch and counteractions need to be considered.

Counteraction

As all of the conditions are met the mismatch should be counteracted under Chapter 7.

Counteraction where the UK is in the position of Country Y (payer and investor jurisdiction)

Primary Response

Where the UK is in the position of Country Y, then A Co will be denied a deduction to the extent of the hybrid payee deduction/non-inclusion mismatch, which in this instance would be the full amount of the hybrid payee deduction/non-inclusion mismatch (being 50% of the payments).

Secondary Response

If the UK is the investor jurisdiction, there is no secondary response under s259GD as Individual A is not within the charge to corporation tax.

Counteraction where a hybrid payee is a UK Limited Liability Partnership (LLP)

Where B Co is an LLP the UK then, to the extent that the hybrid payee deduction/ non-inclusion mismatch has not already been fully counteracted in Country Y, then the remaining amount of the mismatch (i.e. the amount attributable to Individual A) will be treated as income arising to B Co on the last day of the payment period. If no counteraction has been applied, then the counteraction under s259GE TIOPA 2010 will apply to the full amount attributed to Individual A.

This income will be brought within the charge to corporation tax on B Co under Chapter 8 of Part 10 of CTA 2009.

Section 863 ITTOIA 2005 (treatment of certain limited liability partnerships for income tax purposes) and section 1273 of CTA 2009 (treatment of certain limited liability partnerships for corporation tax purposes) may apply to allocate the income of an LLP to its members where that LLP is carrying on a trade, business or (if income tax) profession with a view to profit. For the purposes of these rules, s259GE(8) will dis-apply those sections for the purposes of bringing this income into charge on B Co.

91.30 Interaction with other provisions

Between Pt. 6A Chapters

Section 259A TIOPA provides:

> (19) Each of Chapters 3 to 10 contains provision specifying that some or all of this Part [Part 6A, hybrids/mismatches] (and any corresponding provision under the law of a territory outside the UK) is to be disregarded when determining whether a mismatch arises for the purposes of that Chapter and, if so, in what amount, see-
> (a) section 259CA(4) and (5),
> (b) section 259DA(5),
> (c) section 259EA(5) and (6),
> (d) section 259FA(4), (5) and (6),
> (e) section 259GA(5) and (6),
> (f) section 259HA(6) and (7),
> (g) section 259IA(2) and (3), and
> (h) section 259JA(5).
> (20) The effect of the provisions mentioned in subsection (19) is that Chapters 3 to 10 (or any corresponding provision under the law of a territory outside the UK) have effect in the following sequence-
> (a) Chapter 4,
> (b) Chapter 3,
> (c) Chapter 5,
> (d) Chapter 6,
> (e) Chapter 7,
> (f) Chapter 8,
> (g) Chapter 9, and
> (h) Chapter 10.

Why the non-numerical order?

91.30.1 *Corporate interest restriction*

Section 259NEA TIOPA provides:

> For the purposes of this Part [Part 6A, hybrids/mismatches], the provisions of Part 10 (corporate interest restriction) are to be treated as of no effect.

I do not discuss s.259NEB - 259NEF.

91.30.2 *Interaction with other legislation*

INTM550080: Hybrids: Chapter 1 – Introduction: Interaction with other legislation [Dec 2019]

Counteraction under Part 6A TIOPA 2010 should be considered alongside the UK's other domestic rules. Examples of the type of rules that might be applicable are

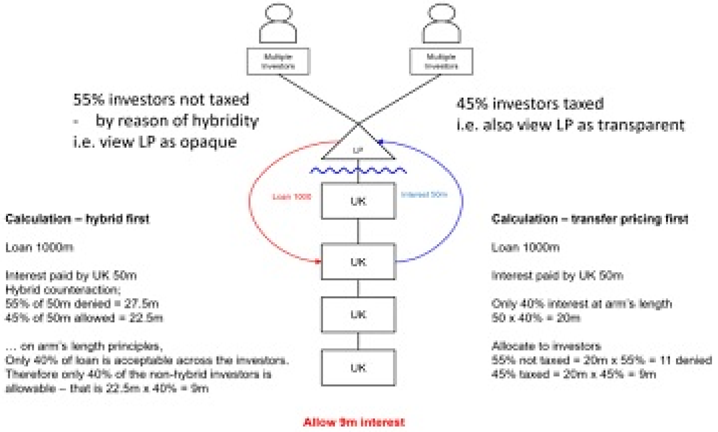
[1] distribution exemption,
[2] transfer pricing
[3] group mismatch legislation [Part 21B CTA 2010] and
[4] unallowable purpose for loan relationships.[93]

We would expect to apply the hybrids mismatch legislation in priority to the corporate interest restriction rules.

Although there is no statutory provision requiring it to be considered in priority, the distribution exemption provisions may also be considered before applying the hybrid mismatch rules – see INTM551170.

The hybrid mismatch rules do not contain a priority order for considering the application of other legislation. This means that customers will need to consider all relevant rules as part of their self-assessment. In general the hybrid rules will need to be considered whenever a mismatch within scope of Part 6A arises, unless the application of other rules removes the mismatch entirely.

Interaction with Transfer Pricing



55% investors not taxed
- by reason of hybridity
i.e. view LP as opaque

45% investors taxed
i.e. also view LP as transparent

Calculation – hybrid first

Loan 1000m

Interest paid by UK 50m
Hybrid counteraction;
55% of 50m denied = 27.5m
45% of 50m allowed = 22.5m

... on arm's length principles,
Only 40% of loan is acceptable across the investors.
Therefore only 40% of the non-hybrid investors is allowable – that is 22.5m x 40% = 9m

Calculation – transfer pricing first

Loan 1000m

Interest paid by UK 50m

Only 40% interest at arm's length
50 x 40% = 20m

Allocate to investors
55% not taxed = 20m x 55% = 11 denied
45% taxed = 20m x 45% = 9m

Allow 9m interest

For example, a customer may need to consider both transfer pricing and Part 6A in relation to a deduction arising in connection with a hybrid financial instrument. If a transfer pricing adjustment reduced the

[93] See 3.19.6 (Loan relationship TAAR guidance).

allowable deduction to the point where there was no mismatch in connection with the hybrid financial instrument, then Part 6A would not apply. If there were still a mismatch after the transfer pricing adjustment was made, Part 6A would apply to the extent of the remaining mismatch. A similar result would be expected if Part 6A were considered in priority to transfer pricing. If the deduction after adjusting for the mismatch under Part 6A were still in excess of the arm's length price, then the transfer pricing rules would apply to further reduce the deduction to the arm's length price.

In the same circumstances, the transfer pricing and Part 6A rules may have to be applied to different amounts within the same deduction, where the deduction includes a number of payments/quasi-payments in connection with more than one financial instrument.

CHAPTER NINETY TWO

PROTECTED TRUSTS

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92.1 Protected-trust regime

This chapter contains:
(1) An outline of the protected-trust regime
(2) The definitions of "protected foreign-source income"
(3) Protected-trust reliefs

The general scheme is that:
(1) UK resident foreign domiciliaries qualify for the remittance basis on their own income/gains until they become deemed domiciled.
(2) Trusts made by foreign domiciliaries have a protected status, both before and after the settlor becomes deemed domiciled.[1] In short:
    (a) Trust income/gains are not taxed on the usual settlor-interested trust rules (s.624, s.720, s.86)
    (b) The income/gains are taxed on distribution/receipt of benefits:
        (a) on general principles; or
        (b) under special provisions which only apply to protected trusts

It is helpful to coin some terminology, and in this book:
– I refer to these rules as the **"protected-trust regime"**
– A trust within the regime is a **"protected trust"**

There are four parts to the regime:
(1) **Protected-trust reliefs**, which prevent charges on the settlor under s.86, 624, 720, and associated provisions
(2) **Close-family/settlor charges** which apply to benefits from protected trusts to close-family/settlors
(3) **Settlor-attribution rules** which attribute income/gains of close-family to the settlor
(4) **Onward-gift rules**

It is best to consider these as separate topics. However the rules interact, and the resulting picture is a complex one.

The protected-trust reliefs are as follows:

Charge	**Relief**	**Tax**	**Topic**
s.86 TCGA	para 5A sch 5 TCGA	CGT	Settlor-interested trust
s.624 ITTOIA	s.628A ITTOIA	IT	Settlor-interested trust

[1] Protected-trust relief does not apply to formerly-domiciled residents. References in this chapter to deemed domicile are references to deemed domicile under the 15-year rule only.

s.629 ITTOIA	s.630A ITTOIA	IT	Payment to child of settlor
s.633 ITTOIA	s.635(2) ITTOIA	IT	Capital payment to settlor
s.720 ITA	s.721(3B) rule 2	IT	ToA transferor charge
s.727 ITA	s.728(1A) rule 2	IT	ToA capital sum charge

I refer to all these as reliefs, though in some cases they are expressed in the form of a relief (eg “The rule in s.624 does not apply...”) and in other cases the rule slots in the relevant provisions and is not expressed in the style of a relief.[2] It comes to the same thing.

The close-family/settlor charges are:

Section	**Name of charge**	**See para**
s.643A(1) ITTOIA	s.643A close-family benefit charge	47.19
s.731(1A)/s.732(1)(d) ITA	s.731 extended to transferor	50.16

These charges are not closely aligned, because there was already a ToA charge on benefits, s.731; but the scope of the s.731 charge has been extended to include transferors and some benefits to non-resident beneficiaries.

There is no CGT equivalent because there was already a charge on benefits, which included benefits conferred on the settlor.

The settlor-attribution rules are:

Section	**Name (my terminology)**	**See para**
s.87G, 87H TCGA	s.87 settlor-attribution rule	61.29
s.643A(3)(4), E, ITTOIA	s.643A settlor-attribution rule	47.28
s.733A, 735B ITA	s.731 settlor-attribution rule	50.48

The onward gift rules are:

Section	**Name (my terminology)**	**See para**
s.87 I - M TCGA	s.87 onward gift rule	61.30
s.643 I - N ITTOIA	s.643A onward gift rule	47.31
s.733B - E ITA	s.731 onward gift rule	50.52

92.1.1 *Protected-trust guidance*

Guidance (my terminology)	**Date**	**ICAEW ref**	**Issued by**
HMRC protected-trust guidance[3]	2018	-	HMRC

[2] Eg s.720 relief is in s.721(3B) rule 2; s.633 relief slots in the definition of “available income”, see 47.14.1 (“Available income”).

[3] *https://www.gov.uk/government/publications/trust-protections-and-capital-gains-tax-changes*

Protected-trust Q&As[4]	2018	Taxguide 07/18	Professional bodies
Protected-trust Note[5]	2020	Taxguide 02/21	Professional bodies

HMRC protected-trust guidance was lengthy but rudimentary.

The Protected-trust Q&As asked 18 pages of questions, with suggested answers. It would have been interesting to see the answers, but HMRC did not provide them. Perhaps it was filed as too difficult.

In 2020, as it was clear that HMRC were not going to answer the Protected-trust Q&As, the professional bodies issued the Protected-trust Note. This (broadly) restates views expressed as suggested answers in the 2018 Q&As, but some material in the 2018 Q&As was not restated in the Protected-trust Note, or the matter is dealt with differently, so the 2018 [6]

Background can be found in a series of papers listed at 5.1 (Deemed domicile: Introduction), but that is now of historical interest only.[7]

92.2 Protected trusts: Policy

In the absence of protected-trust reliefs of some kind, wealthy foreign

[4] The full title is "Deemed domicile changes – trust protections" (2018). See: *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2018/taxguide-0718-deemed-domicile-changes--trust-protections.ashx*
This document is not to be confused with (what I call) the Protected-trust Note (2020), which has the same title (see the next footnote).

[5] The full title is "Deemed Domicile Changes - Trust Protections - Notes on practical points and areas of uncertainty" (2020). See:
https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/764d01e8-989d-404c-aa90-af0168a87dd2/DeemedChanges.pdf or
https://www.step.org/sites/default/files/2020-12/deemed_domicile_changes_trust_protections_note_041220.pdf
This document is not to be confused with (what I call) Protected-trust Q&As, which has the same title (see the previous footnote). Needless to say, the Note contains the usual disclaimers.

[6] To make life more difficult, there are also changes in the order of questions and headings. For assistance on navigation around the two sets of guidance, a comparative index is available in the TFD Resource Archive
https://foreigndomiciliaries.co.uk/index.php/Documents_archive

[7] Draft provisions were published in December 2016. They were intended for the FA 2017, but dropped because they were not ready in time: HMRC, "Guidance - Non-domicile taxation: technical briefing on overseas trusts" (March 2017)
https://www.gov.uk/government/publications/non-domicile-taxation-technical-briefing-on-overseas-trusts/non-domicile-taxation-technical-briefing-on-overseas-trusts
But the drafts of December 2016 and September 2017, like the background papers, are now of historical interest only.

domiciliaries would have a strong incentive to leave the UK, before becoming deemed domiciled under the 15-year rule, at which point all their income/gains (including income/gains of settlor-interested trusts) would become taxable on an arising basis. The regime represents a new solution to an old problem, namely, how much can HMRC squeeze out of the UK's foreign domiciled long-term residents, before they leave? or more precisely, before the loss due to leavers exceed the gain from those who stay. The 2017 regime aims to collect more from those who chose to stay, but does not charge tax so far as income/gains accumulate in non-resident trusts.

On the Conservatives' view:

> It is vital that these changes [deemed domicile for IT/CGT] are not introduced in a way that would drive non-doms out of the UK altogether.[8]

Of course the current rules are not satisfactory to those who believe there should be no distinction between deemed domiciliaries and UK domiciliaries:

> The changes in the [F(no.2)A 2017] are superficial ... and designed to give the impression that the Government are seriously clamping down on tax avoidance. Why else would an exemption be built into the measures for offshore trusts? ... those are things that the architect of the measures would do if they were of a mind to completely undermine the measures' effectiveness...
> What we want is genuinely not unrealistic or far removed from the observations of most members of the public, which is, in short, the removal of the exemption for offshore trusts...[9]

Some settlors will be better off under the protected-trust regime, as they do not have to pay the remittance basis charge in order to qualify for protected-trust reliefs. By and large, tax liabilities will increase. So it is dispiriting to read the Labour claim (the relief will "completely undermine

[8] Mel Stride (Paymaster General) Hansard, 19 Oct 2017 *https://hansard.parliament.uk/commons/2017-10-19/debates/f87da5ea-33a7-4a01-b497-1f3aaa15830e/FinanceBill(FourthSitting)*

[9] Peter Dowd (Labour Shadow Chief Secretary to the Treasury) Hansard, 19 Oct 2017 *https://hansard.parliament.uk/commons/2017-10-19/debates/f87da5ea-33a7-4a01-b497-1f3aaa15830e/FinanceBill(FourthSitting)*

the measures' effectiveness"[10]) and the Government's counter-claim:

> The changes ... will bring an end to permanent non-domicile tax status. When people live in the UK permanently, it is right that they should pay the same tax as everyone else.[11]

Were the speakers ill-informed, exaggerating, misleading or dishonest? Discuss.

The rules were introduced in 2017 and 2018. The changes went far beyond what was necessary to accommodate the 2017 deemed domicile rules: HMRC took the opportunity for a wide-ranging reform of offshore trust taxation.[12]

92.3 s.86 protected-trust relief

The s.86 charge does not apply to a foreign domiciled settlor.[13] The following is therefore relevant to a deemed-domiciled settlor.

Para 5A(1) sch 5 TCGA provides:

> Section 86 does not apply in relation to a year ("the particular year") if Conditions A to D are met.

I refer to these as **"s.86 protected-trust conditions".**

92.3.1 *Condition A: 2017/18 or later*

Para 5A(2) sch 5 TCGA provides:

> Condition A is that the particular year is—
> (a) the tax year 2017-18, or
> (b) a later tax year.

This is just a commencement provision and (read with para 5A(1)) it is also a roundabout way of defining "particular year".

[10] Peter Dowd (Shadow Chief Secretary to the Treasury) Hansard, 19 Oct 2017 *https://hansard.parliament.uk/commons/2017-10-19/debates/aea0b4b1-dc6c-4153-a24f-09fb6be7d155/FinanceBill(FourthSitting)*

[11] Mel Stride (Paymaster General) Hansard, 19 Oct 2017 *https://hansard.parliament.uk/commons/2017-10-19/debates/f87da5ea-33a7-4a01-b497-1f3aaa15830e/FinanceBill(FourthSitting)*
The wording (coincidentally?) echoes that of Miliband speaking for Labour, two years previously; see 1.5.2 (Are non-dom reliefs fair).

[12] See too 1.10.5 (2017 enactment process).

[13] See 60.10 (Settlor residence/domicile conditions).

92.3.2 *Conditions B/C: Non-dom settlor*

Para 5A(3) sch 5 TCGA provides:

> Condition B is that when the settlement is created the settlor—
> (a) is not [actually] domiciled in the UK, and
> (b) if the settlement is created on or after 6 April 2017, is not deemed domiciled in the UK.
>
> (4) Condition C is that there is no time in the particular year when the settlor is—
> (a) [actually] domiciled in the UK, or
> (b) deemed domiciled in the UK by virtue of Condition A in section 835BA of ITA 2007 [formerly-domiciled resident[14]].

That is:

(1) s.86 protected-trust relief ceases to apply to those who become actually UK domiciled

(2) The relief does not apply to formerly-domiciled residents

92.4 Condition D: Tainting

The next condition concerns adding to the trust. Para 5A(5) sch 5 TCGA provides:

> Condition D is that
> [A] no property or income is provided directly or indirectly for the purposes of the settlement
> [B] by
> [i] the settlor, or
> [ii] the trustees of any other settlement of which the settlor is a beneficiary or settlor,
> [C] at a time in the relevant period[15] when the settlor is—
> (a) [actually] domiciled in the UK, or
> (b) deemed domiciled[16] in the UK.

[14] See 5.4.2 (IT/CGT formerly-dom resident rule).

[15] Defined para 5A(6): "In sub-paragraph (5) "relevant period" means the period—
(a) beginning with the start of 6 April 2017 or, if later, the creation of the settlement, and
(b) ending with the end of the particular year."
Tainting during the year removes protected status for the entire year. Split year rules do not apply.

[16] Para 5A(9) provides the expected definition: "In this paragraph "deemed domiciled" means regarded for the purposes of section 86(1)(c) as domiciled in the UK as a result

The wording is based on 1998/1991 transitional reliefs for s.86.[17] SP 5/92 gave extensive guidance on the 1991 s.86 transitional relief. I discuss this material here, as this is the context in which it now arises. There are some differences of wording between the 1991 transitional relief and 2017 protected-trust relief; but most of the guidance is still applicable.

Condition D applies if property is provided by:

(1) the settlor, or
(2) a settlor-connected trust (trust where the settlor is a beneficiary or settlor)

I refer to a person who is not within (1) or (2) as a **"third party"**.

What if property is provided to a trust by a third party? That does not affect protected trust-relief. (Though the third party may be taxed as joint settlor on gains attributable to the addition). In this respect the 2017 tainting rule is more sensible than the 1998/1991 transitional reliefs for s.86.

92.4.1 *Inter-trust tainting*

The condition is (in short) that:

> [A] no property or income is provided directly or indirectly for the purposes of the settlement by ... the trustees of any other settlement of which the settlor is a beneficiary or settlor

I refer to this as **"inter-trust tainting"** and use the following terms:

Term	**Meaning**
Transferor trust	Trust providing property
Transferee trust	Trust to which property is provided (which may be tainted)
Settlor-connected trust	Settlor of transferee is settlor/beneficiary of transferor trust

I would have said that the trustees of the transferor trust do not "provide" property, as they are only fiduciaries. But the context shows that for tainting purposes, it is possible for one trust to provide property to another. Providing property includes gratuitous transfer and transactions at an undervalue.

Suppose property is provided to a protected trust by another *protected* trust. If the provision is construed literally, the transferee trust may

of section 835BA of ITA 2007 having effect."

[17] See 60.6.1 (Trigger 1: Providing property); 99.6 (Tainting).

become tainted and lose protected status. There is no good reason to penalise inter-trust transfers of this kind, and it could be argued that on a purposive construction this is not caught. Perhaps this issue does not often arise.

92.4.2 *Meaning of "Beneficiary"*

"Beneficiary" matters because the inter-trust tainting rule applies if the settlor of the transferee trust is a beneficiary of the transferor trust. The word is not defined. Para 3 Protected-trust Note provides:

> Most settlements contain a wide power of addition so virtually any settlement from which the settlor is not specifically excluded enable the settlor to be added as a beneficiary even if that person is not currently a beneficiary. But, unless and until someone is added, they are not in fact a beneficiary, and the trustees do not need to consider whether to confer any benefits on them.
> It is therefore considered that a 'beneficiary' in this context means someone who is currently a beneficiary of the settlement. Until a person is added as a member of the class of beneficiaries that person is not a beneficiary.

This is correct if it is true as a matter of trust law to say that "unless and until someone is added, they are not in fact a beneficiary, and the trustees do not need to consider whether to confer any benefits on them." But if English trust law principles apply, is that really so?[18] It would not be wise to rely on this view.

92.4.3 *Adding value*

Para 5A(7) sch 5 TCGA provides:

> For the purposes of Condition D, the addition of value to property comprised in the settlement is to be treated as the direct provision of property for the purposes of the settlement.

I refer to this as the **"adding-value rule"**. Anyone who provides property (and so is a settlor) has also added value. But perhaps it is possible to add value without providing property. Examples are perhaps:

(1) Failure to exercise a right of reimbursement[19]

[18] See 78.6.1 (Gift to settlor-interested trust).

[19] See 101.5.1 (Settlor/tainting issues).

(2) Providing services to a trust, or an underlying company, at less than market remuneration[20]

(3) A person who provides property which ceases to be comprised in a settlement ceases to be a settlor, under the IT/CGT definition,[21] but may be caught by the adding-value rule.

Whether these were actually the purpose of the adding-value rule is speculation; more likely, I think, the drafter had some inchoate concern that the traditional wording ("providing property") might possibly leave a gap which an adding-value rule might possibly fill.

Para 1 Protected-trust Note provides:

> The words 'provided …for the purposes of the settlement' connote an intention on the part of the provider to confer some bounty on the settlement or its beneficiaries...[22] Under the tainting rules an addition of value to the property comprised in the settlement is deemed to be a provision without regard to intention, but the basic requirement that bounty be intended is preserved by the rule requiring the provision of property or income to be ignored if there is no intention to confer gratuitous benefit [in my terminology, disregard (b)].

I would have thought that adding value, like providing property, required or implied some mental element. However that may be, it was clearly not the purpose of the adding-value rule to remove the "bounty" requirement, because disregard (b) restores or restates it.[23]

The general question of what amounts to tainting is discussed in 99.6 (Tainting), but this chapter deals with the statutory provisions specifically applicable to protected trusts.

92.5 The 7 disregards

Para 5B sch 5 TCGA provides:

> (1) This paragraph applies for the purposes of Condition D in paragraph 5A.
> (2) Ignore—

A set of 7 items then follow, which I call "**disregards (a) - (g)**". Some of

[20] See 99.25 (Provision of services).
[21] See 99.2.12 (Ceasing to be settlor).
[22] See 99.2.6 (Providing property: bounty).
[23] See 92.5.1 (Gratuitous intent: Disregards (a)(b)).

these derive from 1998/1991 transitional reliefs for s.86, in sch 5 TCGA:[24]

Disregard: Topic	**1998 relief: sch 5**	**1991 relief: sch 5**	**See**
(a): Arm's length transaction	Para 2A(2)(a)	Para 9(3)(a)	92.5.1
(b): Gratuitous intent	-	-	92.5.1
(c)-(e): Loans	-	-	92.7
(f): Pre-2017 liability	Para 2A(2)(b)	Para 9(3)(b)	92.5.2
(g): Expenses	Para 2A(3)	Para 9(3) proviso	92.5.3

The 1998/1991 transitional reliefs are not now important, but guidance in SP 5/92 on the 1991 relief is relevant to protected trusts, so references to para 9(3) sch 5 TCGA are still common. It would be helpful if SP 5/92 could be reissued to refer expressly to the current protected-trust code; but that does not seem likely to happen: *Autres temps, autres mœurs*.

92.5.1 *Gratuitous intent: Disregards (a)(b)*

The first two disregards are conveniently read side by side:

Disregard (a): arm's length transaction	**Disregard (b): gratuitous intent**
property or income provided under a transaction, other than a loan,	property or income provided, otherwise than under a loan,
where the transaction is entered into on arm's length terms,	without any intention by the person providing it to confer a gratuitous benefit on any person

Disregard (a) seems otiose because a case within disregard (a) must fall within disregard (b).[25]

Disregard (b) is otiose because "providing property" requires an element of bounty (gratuitous intent), but it might be needed (if only for the avoidance of doubt) to restrict the adding-value rule.

However that may be, these two disregards do no harm.

A transaction between connected persons is treated for CGT as "otherwise than by way of a *bargain* made at arm's length".[26] But apparently it may still be a *"transaction* entered into on arm's length terms" for the purpose of disregard (a). SP 5/92 provides:

> 12. ... This [disregard (a)] applies irrespective of whether the parties to

[24] See 60.6.1 (Trigger 1: provide property); 60.8.2 (Trigger 1: Providing property).

[25] See App.4.10 (Arm's length).

[26] See App.4.10.9 (Deemed non-arm's length).

> the transaction are connected persons under TCGA 1992 s 286.[27]

That leads to the sensible result that the protected-trust rules are the same for IT and CGT, even though IT does not have the CGT connected person rule.[28] But if it is right to say that disregard (a) is otiose, then this is not important.

For the purposes of disregards (a) and (b), there is no difference between a transaction with the trustees and a transaction with a company held by the trust.

HMRC protected-trust guidance provides:

> 5.5 ... Where the valuation of benefit rules in section 6 apply and the reimbursement to the trustees is at the level of the benefit that would otherwise arise, this will not be regarded as tainting the trust. An exception would be where acquisition costs have been intentionally inflated over the current value of the property.
>
> For example, the settlor has the use of an asset which the new benefit valuation rules require her to pay £15,750 per annum so as not to have a benefit. And on the other hand the commercial rental value of said asset is £14,000. This would prima facie constitute tainting. HMRC however will not enforce the law in this scenario if the settlor pays the £15,750. However, if there is evidence that trustees are themselves renting assets from a third party for £14,000 so they can rent them to the settlor for £15,750 so as to add property to the trust, HMRC will treat this as a tainting event.

92.5.2 *Pre-2017 liability: Disregard (f)*

Para 5B sch 5 TCGA provides:

> (2) Ignore ...
>
> (f) property or income provided in pursuance of a liability incurred by any person before 6 April 2017

This relief may be overridden by the tainting-loan rules.

Para 1 Protected-trust Note provides:

> If property is transferred to the trust in pursuance of a liability incurred before an individual becomes deemed domiciled, it is not considered

[27] See too 61.7.8 (Arm's length relief).

[28] An alternative argument would be to say that context shows that the deeming in s.17 TCGA does not apply in the context of tainting. That is another route to the same destination .

tainting occurs as the provision is made when the obligation to provide the property is incurred. The disregard in TCGA 1992 Schedule 5 paragraph 5B(2)(f) and the equivalent income tax provisions might indicate that property is provided when it is transferred to the trust not when the liability is incurred. It is however considered that the specific disregard in Schedule 5 paragraph 5B(2)(f) is for the avoidance of doubt. But the liability must be legally binding prior to the settlor becoming deemed domiciled even if it is conditional on certain events occurring.

92.5.3 *Expenses: Disregard (g)*

Para 5B sch 5 TCGA provides:

> (2) Ignore ...
> (g) where the settlement's expenses relating to taxation and administration for a tax year exceed its income for that year, property or income provided towards meeting that excess if the value of any such property and income is not greater than the amount of—
> (i) the excess, or
> (ii) if greater, the amount by which such expenses exceed the amount of such expenses which may be paid out of the settlement's income.

SP 5/92 provides:

> 26 The following items are not regarded as "expenses relating to administration" within the terms of the proviso ...—
> – loan interest (other than interest on a loan taken out to meet expenses of administration within the terms of the proviso);
> – the costs of acquiring, enhancing or disposing of an asset;
> – expenses incurred in connection with a particular trust asset to the extent that such expenditure can be set against income arising from that asset. For the purpose of the proviso ... , the measure of the gross income from such a source is net of expenses.
>
> 27 The term "expenses relating to… taxation" ... is regarded as encompassing UK or foreign taxes to which the trustees are liable, along with any interest and penalties due on that tax. It could also include certain costs incurred by the trustees under the terms of the trust in obtaining information regarding the beneficiaries' tax liabilities. One example might be where the trustees, in order to ensure they were acting in a beneficiary's best interests, had to ascertain the tax implications for the beneficiary in adopting a particular course of action.

> 28 It is only the settlement's expenses relating to administration or taxation which are within the terms of the proviso ... Expenses of, for example, a company wholly owned by the trustees fall outside its scope....
>
> 30 Normally the specific date on which the liability to an expense relating to administration or taxation was incurred determines the year into which it falls for the purpose of applying the proviso ... Where, however, the expense is incurred for a period rather than on a specific date, the basis of allocating expenses adopted by the trustees in preparing trust accounts or returns is, generally, regarded as acceptable provided that this basis is consistently adopted and is in accordance with conventional trust accounting practice.
>
> 31 Additions to meet the difference between expenses relating to administration and taxation and any income arising to the trust do not have to be made by 5 April in the relevant year of assessment. There must, however, be a clear connection between the amount added and the computed shortfall. Additions should, therefore, be made as soon as the relevant figures are available.
>
> 32 Income, for the purposes of the proviso ... is the total income which arises to the trustees in the relevant year, rather than the income which is (or would be if the trust were resident in the UK) subject to UK tax. Usually, items of income will need to be allocated to the year in which they arise for the purposes of the proviso, but, in practice, income arising from a trade carried on by the trustees may be apportioned on a time basis, provided that this basis is consistently followed.

92.6 Sale for instalments of capital

An individual might consider selling an asset to a trust for a series of instalments of capital.

In order for the payments received by the seller to constitute capital and not income, the payments should be fixed and should continue to fall due notwithstanding the death of the seller.

The total value of the instalments would, of course, be greater than the current market value, to compensate the seller for delay in payment. In calculating the price for the asset, the parties and their advisers would take into account interest rates for the relevant period. It is important, however, that the documentation is in terms of instalments of capital. Otherwise, each payment may consist of partly capital and partly interest.[29]

[29] See *IRC v Church Commissioners* 50 TC 516.

If the instalments are due over a very long period, part of the payment may constitute interest even if it is described as capital in the documentation.[30] If instalments are index-linked, the indexation should not be interest; but this is contentious.[31]

In the case of a sale for instalments of capital the consideration is deemed to be the total amount receivable without a discount for postponement of the right to receive it.[32] This rule could throw up an artificial capital gain. Fortunately, if the sale is to a connected person, the transaction would be deemed to be for market value of the asset and not the total amount of the capital payments.[33]

92.7 Payments under loans

92.7.1 *Loan payments: Introduction*

Loans typically involve three types of payments:

(1) Money ("principal") lent from lender to borrower
(2) Interest paid from borrower to lender
(3) Money ("principal") repaid from borrower to lender

Each of these payments may constitute providing property. If this property is provided from the settlor (or a settlor-connected trust) to a protected trust, the protected trust may be tainted. Of course, tainting difficulty only arises if the property is provided (1) to a protected trust (2) by the settlor or a settlor-connected trust. In summary:

Type of payment	**Payor**	**Payee**	**Matters only if**:	
			Borrower	*Lender*
Payment of principal	Lender	Borrower	Protected trust	Settlor/con^{d} trust
Payment of interest	Borrower	Lender	Settlor/con^{d} trust	Protect^{d} trust
Repayment of principal	Borrower	Lender	Settlor/con^{d} trust	Protect^{d} trust

These rules concern loans to or from a trust where the parties to the loan (whether as lender or borrower) are:

(1) the trust and
(2) the settlor or a settlor-connected trust (a trust of which the settlor is beneficiary/settlor)

[30] See 26.2.5 (Sum indivisible or dissected?)

[31] See 26.4 (Premium).

[32] Section 48 TCGA. HMRC have some discretion to allow payment of tax by instalments.

[33] See App.4.8 (CGT market value rule).

The tainting rules do not apply to a loan made by or to a third party.

Para 5B sch 5 TCGA provides that one should ignore:

> (a) property or income provided under a transaction, other than a loan, where the transaction is entered into on arm's length terms,
>
> (b) property or income provided, otherwise than under a loan, without any intention by the person providing it to confer a gratuitous benefit on any person

So disregards (a) and (b) do not apply to loans.

Para 5B has 3 express disregards of payments relating to certain loans if the Arm's Length condition is met. In summary:

Loan	**Disregard**	**Para 5B(2)**	**See para**
to trust	Lender paying principal to trust borrower	(c)	92.7.3
from trust	Borrower paying interest to trust lender	(d)	92.7.4
from trust	Borrower repaying principal to trust lender	(e)	92.7.5

Para 5B identifies 2 circumstances in relation to loan to a trust where property is deemed to be provided (so the trust may become tainted):

Loan	**Deemed provision**	**Provision**	**See para**
to trust	Non-payment of interest/variation	5B(3)(4)	92.7.3
to trust	Pre-deemed-dom loan left outstanding	5B(5)-(7)	92.7.8; 92.7.13

"Loan" is not defined, so in all these provisions it bears its strict meaning: loan of money.[34]

92.7.2 *Arm's-Length & other loans*

Para 5B(8) sch 5 TCGA provides two definitions of the expression "Arm's Length Loan". It is convenient to read these side by side:

> For the purposes of this paragraph a loan is on "arm's length terms"—

(a) in the case of a loan made to the trustees of a settlement,	(b) in the case of a loan made by the trustees of a settlement,
only if interest at the official rate[35]	only if any interest payable under

[34] See App.2.5 (Loan).

[35] Defined by reference in para 5B(9):

> "official rate", in relation to interest, means the rate of interest applicable from time to time under section 178 of the Finance Act 1989 for the purposes of Chapter 7 of Part 3 of ITEPA 2003.

See 40.5 (Official rate of interest).

or more is payable at least annually under the loan;	the loan is payable at no more than the official rate

This is not the normal meaning of "arm's length terms": it is an artificial definition. I write it with initial capitals, to reflect the technical nature of the expression, some may prefer scare quotation marks. In this section **"Arm's-Length Loan"** is a loan on "Arm's Length Terms".

The definition does have the advantage that it is easy to see whether a loan is on Arm's Length Terms, as it is not necessary to consider what would be market rates.

What if a loan is made to trustees of one trust (the borrower) by the trustees of another trust (the lender)? The loan is within para (a) *and* para (b) but these offer different definitions! The context shows that:

(a) In considering the application of the rules to the borrower-trust (whether the borrower-trust is tainted by the payment of the principal to the borrower) one applies definition (a).

(b) In considering the application of the rules to the lender-trust (whether the lender-trust is tainted by the payment of interest to the lender) one applies definition (b).

Tax normally distinguishes between loans with:

(1) commercial terms

(2) beneficial terms (beneficial to borrower, eg interest-free)

(3) onerous terms (onerous to borrower, eg above market interest; in practice this is rare)

A commercial loan confers no benefit (or at least no valuable benefit) on anyone. A beneficial loan (eg interest free) benefits the borrower. An onerous loan (eg high interest) benefits the lender.

In the present context there are potentially six types of loan:

(1) "Arm's-Length Loan" which may be on:
   (a) commercial terms
   (b) beneficial terms
   (c) onerous terms

In practice, perhaps, "Arm's Length Terms" will generally amount to commercial terms.

(2) "Non-Arm's-Length Loan" which may be on:
   (a) commercial terms
   (b) beneficial terms

(c) onerous terms

92.7.3 *Loan **to** trust: Disregard (c): Principal*

Para 5B sch 5 TCGA provides:

> (2) Ignore ...
> (c) the principal of a loan which is made to the trustees of the settlement on arm's length terms

Para 5B(3) sch 5 TCGA provides for a deemed provision of property (which may cause a trust to become tainted):

> Where—
> (a) a loan is made to the trustees of the settlement by
> [i] the settlor or
> [ii] the trustees of a settlement connected with the settlor, and
> (b) the loan is on arm's length terms, but
> (c) a relevant event occurs,
> the principal of the loan is to be regarded as having been provided to the trustees at the time of that event (despite sub-paragraph (2)[36]).

There are 3 types of relevant event. Para 5B(4) sch 5 TCGA provides:

> In sub-paragraph (3) "relevant event" means—
> (a) capitalisation of interest payable under the loan,
> (b) any other failure to pay interest in accordance with the terms of the loan,

HMRC protected-trust guidance provides:

> HMRC will not seek to apply the tainting provisions for a minor failure to pay interest on time i.e. as per the first example below where the payment was ten days late.

The guidance gives 3 examples:

> *Example* (Maria)
> M remains in the UK, and the facts are the same as those in paragraph 5.3.[37] In May 2021 the trustees pay the quarterly interest due on the loan ten days late, due to an administrative oversight. This would not

[36] Subpara (2) contains the 7 disregards, so the tainting-loan rules override the usual disregard for pre-2017 liabilities.

[37] I think this is a reference to the example in para 5.5 of the guidance, which is set out in 92.7.9 (Change in official rate).

> be regarded as a failure to pay interest in accordance with the terms of the loan. The settlement would not be tainted and the foreign-source income would remain protected.
>
> *Example*
>
> M remains in the UK, and the facts are the same as those in paragraph 5.3. From February 2022 the trustees do not pay the quarterly interest due on the loan on time. Payments are made between a week and several months late. This would be regarded as a failure to pay interest in accordance with the terms of the loan. The settlement would be tainted and the foreign-source income would cease to be protected with effect from February 2022.
>
> *Example*
>
> M remains in the UK, and the facts are the same as those in paragraph 5.3. The trustees initially pay the interest in accordance with the terms of the loan but in June 2023 they request that the interest is made payable annually with immediate effect. M accedes to the request and the terms of the loan are varied accordingly. It is necessary to consider whether there has been a relevant event. There has been no capitalisation of the interest payable and no failure to pay it in accordance with the terms of the loan, but there has been a variation in the terms of the loan. Have the terms ceased to be on arm's length? The interest rate of the loan has not changed at June 2023 and the interest is payable annually. The official rate of interest rose to 3.25% from April 2022. This did not cause the tainting of the trust at that time, but the loan as varied carries interest at below the official rate from June 2023. The principal of the loan is therefore treated as having been provided to the trustees in June 2023. The settlement is tainted and condition F is no longer met. The foreign-source income ceases to be protected.

The third type of relevant event is:

> (c) variation of the terms of the loan such that they cease to be arm's length terms.

Suppose:

(1) a payment of principal under a loan from the settlor or settlor-connected trust to a protected trust

(2) the loan is on commercial terms but not Arm's Length Terms

One might have thought that lending money (paying the principal to the borrower/trustees) on commercial terms is not providing property, even if it is not on "Arm's Length Terms". But the context of:

(1) the relevant event rule, and
(2) the rule for pre-deemed dom loans (see below)
suggests that payment of the principal on such a loan is the provision of property, even though the loan is on commercial terms, if it is not on "Arm's Length Terms".

Disregards (a) and (b) exclude loans, so the payment of principal under a loan does not benefit from those disregards.

92.7.4 *Loan **from** trust: Disregard (d) (interest)*

Para 5B sch 5 TCGA provides:

> (2) Ignore ...
> (d) the payment of interest to the trustees of the settlement under a loan made by them on arm's length terms

Suppose:
(1) A payment of interest under a loan made from the settlor or settlor-connected trust to a protected trust
(2) The loan is on commercial terms but not Arm's Length Terms?

One might have thought that paying interest under a loan on commercial terms is not providing property, even if it is not on "Arm's Length Terms". But the context of:
(1) disregard (d), and
(2) the rule for pre-deemed dom loans (see below)
suggests that payment of the interest is the provision of property, even if it is on commercial terms, if it is not on "Arm's Length Terms".

Disregards (a) and (b) exclude loans, so the payment of interest does not benefit from those disregards.

92.7.5 *Loan repayment: Disregard (e)*

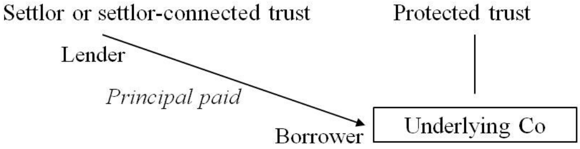
Para 5B sch 5 TCGA provides:

> (2) Ignore ...
> (e) repayment to the trustees of the settlement of the principal of a loan made by them

In the case of repayment, it does not matter whether the loan is on "Arm's Length Terms".

92.7.6 *Principal paid to underlying co*

Suppose principal is paid under a loan from the settlor or a settlor-connected trust to an underlying company held by a protected trust.



The payment of principal is not within disregard (c) (even if the loan is on "Arm's Length Terms"). It is considered the payment is providing property if the loan is on beneficial terms, but not if it is on commercial or onerous terms.

Para 16 Protected-trust Note provides:

> The provisions regarding arm's length loans are expressed in terms of loans to or interest paid to the trustees of the settlement. It is not considered this prescriptive language extends to loans to or interest paid to underlying companies. On a literal view at least the exclusion of transactions at arm's length or not intended to confer gratuitous benefit do not cover these loans either. However such loans would only constitute tainting if property has been provided to the settlement or value added to it. It is therefore considered loans on arm's length terms do not amount to tainting. Strictly the requirement that interest be paid as distinct from compounded would not be in point, but it is considered that to run an argument on these lines would be provocative.[38]

[38] The passage continues:

> HMRC's published guidance indicates that in HMRC's view loans to and interest paid to underlying companies should be treated in the same way as loans to and interest paid to the settlement.

I think this refers to HMRC protected-trust guidance para 5.5

> ... although reference is made in the following example to additions being made to trusts, it is considered that the same consequences will arise where additions are made to companies owned by the non-resident trustees. The tainting rules are not avoided by making additions to such underlying companies rather than to the trusts that own them.

As a general proposition that is correct. But this passage is not considering the case of commercial loans, which raise special considerations.

Para 16 Protected-trust Note concludes:

> Should interest at the official rate differ from the arm's length it will be a matter of judgement as to whether to rely on apparent HMRC practice.

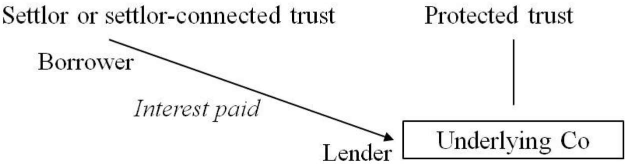
The last sentence while true is not exactly guidance. Perhaps it is intended as a tactful warning that it is not safe to rely on HMRC guidance.

One cannot ignore the underlying company (pierce the corporate veil) and treat the matter as if the loan was made to the trustees of the protected trust.[39]

Could the context show that the payment of principal here is to be regarded as provision of property (as in the simple case where the payment is made to the trustees and not to the underlying company)? It is considered the answer is no. The contextual argument in the simple case is based on disregard (c) and the rule for pre-deemed-dom date loan.[40] These rules do not apply here.

92.7.7 *Interest paid to underlying co*

Suppose interest is paid under a loan to an underlying company held by a protected trust from the settlor or a settlor-connected trust.



The interest paid is not within disregard (d) (even if the loan is on "Arm's Length Terms"). It is considered the payment is providing property if the loan is on onerous terms (high interest rate), but not if it is on commercial or beneficial terms (low interest rate).

This is consistent with the position on payment of the principal of a loan, see above. Could the context show that the payment of interest here is to be regarded as provision of property (as in the simple case where the interest is paid to the trustees and not to the underlying company)? It is considered the answer is, no. The contextual argument in the simple case is based on disregard (d). That rule does not apply here.

92.7.8 *Loan pre-deemed-dom date*

A loan from the settlor to a trust made at a time when the settlor is not UK domiciled (or deemed domiciled) does not in principle matter, as the tainting rule only applies if property is provided by a settlor (or settlor-connected trust) at a time when the settlor is UK domiciled (or deemed

[39] See App.7.12 (Pierce corporate veil/ facade).

[40] See 92.7.8 (Loan pre-deemed dom date).

domiciled).[41] So the loan need not be on Arm's Length Terms. However para 5B sch 5 TCGA provides:

> (5) Sub-paragraph (6) applies (subject to sub-paragraph (7))[42] where—
> (a) the settlor becomes deemed domiciled in the UK on or after 6 April 2017,
> (b) before the date on which the settlor becomes deemed domiciled in the UK ("the deemed domicile date"), a loan has been made to the trustees of the settlement by—
> (i) the settlor, or
> (ii) the trustees of a settlement connected with the settlor,
> (c) the loan is not entered into on arm's length terms, and
> (d) any amount that is outstanding under the loan on the deemed domicile date ("the outstanding amount") is payable or repayable[43] on demand on or after that date.
> (6) Where this sub-paragraph applies, the outstanding amount is to be regarded as property directly provided on the deemed domicile date by the lender for the purposes of the settlement (despite sub-paragraph (2)[44]).

92.7.9 *Change in official rate*

HMRC protected trust guidance para 5.5 gives examples (relating to "Maria"):

> In February 2020 M lends the trustees of the M 2019 Discretionary Settlement €250,000, repayable in quarterly instalments over ten years. The loan carries interest at 3% per annum, payable quarterly in arrears. The capital and interest are repaid in accordance with the terms of the loan. The loan principal can be ignored and does not taint the settlement, as the loan is made on arm's length terms, for these purposes, by M, the interest rate being the official rate in February 2020 and the interest being payable at least annually.
> In 2022-23 the official rate rises, but a change in the official rate of interest does not mean that the trust will become tainted.
> In May 2020 the trustees of the M 2019 Discretionary Settlement lend M US$20,000. The loan carries interest at 3.0% per annum, payable

[41] See 92.4 (Condition D: Tainting).

[42] See 92.7.13 (Pre-2017 loan).

[43] "Payable or repayable" is a somewhat pedantic phrase, and either "payable" or "repayable" would have been sufficient; but nothing turns on that.

[44] Subpara (2) contains the 7 disregards, so the tainting-loan rules override the usual disregard for pre-2017 liabilities.

> six-monthly. This is no more than the official rate in May 2020 and so the payment of the loan interest can be ignored, as the loan is made on arm's length terms, for these purposes, by the trustees. It does not taint the settlement.
>
> In April 2021 the official rate falls to 2.5%. There is no need for the interest rate on the loan to be reduced (unless a relevant event occurs) because the loan was entered into on terms which were arm's length at that time.

Protected-trust Q&As Question 21 provides:

> HMRC's guidance indicates that a loan is on arm's length terms if the interest rate is equal to the official rate at the date the loan is entered into ... It is not however clear whether:
>
> a. it makes any difference whether the loans are for a fixed term or whether they are repayable on demand; or
> b. HMRC will also accept that the loans are on arm's length terms if, in fact, the terms of the loans provided for the interest rate to be varied so as to track the official rate from time to time.
>
> *Suggested answer:*
>
> 1. Provided that the interest rate is equal to the official rate at the date of the loan, it makes no difference whether the loan is for a fixed term or repayable on demand.
>
> 2. HMRC also accepts that the loan is on arm's length terms if the interest rate is at the official rate at the date the loan is entered into and the loan agreement provides that thereafter the interest rate will track the official rate from time to time.[45]

Point 2 is correct but point 1 is not clear.

92.7.10 *Borrower funds interest payment*

Para 20 Protected-trust Note provides:

> It is not considered tainting occurs if interest is paid using further funds provided by the lender, provided the provision is itself a loan on arm's length terms as required by the legislation

92.7.11 *Swiss franc/Japanese yen loan*

Para 19 Protected-trust Note provides:

> There are different official rates for loans denominated in Swiss francs and Japanese yen subject to certain conditions. It is not considered that

[45] The same point is made in para 18 Protected-trusts Note.

> these separate rates must be used in respect of loans denominated in these currencies as they apply only to loans made by reason of employment to individuals who normally live in Switzerland or Japan.[46]

92.7.12 *Fixed term loan: IHT*

Para 23 Protected-trust Note provides:

> For example, trustees may make a ten year fixed term loan to a UK resident settlor at a rate that does not exceed the official rate of interest in circumstances where a bank would charge interest at a rate that exceeds the official rate of interest. The settlor cannot pay a higher rate without tainting the settlement. It is considered that the provisions of IHTA 1984 section 10[47] would apply because paying interest at no more than the official rate
> [1] is not intended to confer a benefit on any person[48] and
> [2] is required under the capital gains tax and income tax rules for the purpose of ensuring that the loan is deemed to be on arm's length terms.

However, the loan may be (and usually is) made repayable on demand, so this IHT issue does not usually arise.

92.7.13 *Pre-2017 loan*

Para 5B(7) sch 5 TCGA provided a one year's grace to put a pre-2017 loan on "Arm's Length Terms", where the individual became deemed domiciled on 6 April 2017. The relief is not just of historical interest, because its application affects the question of whether a trust is a protected trust, which will continue to matter for the lifetime of the settlor, (or at least, for as long as the protected-trust regime continues). But I omit it here, as by now it will not often need to be considered.[49]

92.8 Protected income: Terminology

"Protected foreign-source income" is one of three distinct terms with almost identical labels:[50]

[46] See 40.5.1 (Foreign currency loan).

[47] See 74.13 (Arm's length disposal relief).

[48] Author's footnote: but this depends on the facts of the case.

[49] See the 2021/22 edition of this work para 88.7.10 (2017 domicile: transitional relief).

[50] In addition statute uses the term "Transitionally protected income" but it is not necessary to consider that here; see 92.15.3 (Pre-2017 s.720 income).

Term	**Use**	**See para**
Protected foreign-source income	Throughout protected-trust code	*Discussed here*
Protected Income	s.731 protected-trust close-family/settlor charges	50.48
PFSI	s.643A protected-trust close-family/settlor charges	47.22.1

The term "protected foreign-source income" itself has *three* distinct definitions. It is necessary to distinguish them. Statute refers to:

> protected foreign-source income for the purposes of section 628A(1)
> protected foreign-source income as defined by section 721A
> protected foreign-source income as defined by section 729A

Or else statute applies one of the definitions by reference:

> Sections 628A(2) to (12) and 628B (meaning of "protected foreign-source income") have effect also for this purpose.

I coin the following terms to describe the different types of protected foreign-source income:

My terminology	**Definition**
Protected s.624 income	s.628A ITTOIA
Protected s.720 income	s.721A ITA
Protected s.720 trust income	s.721A(3) ITA
Protected s.720 company income	s.721A(4) ITA
Protected s.727 income	s.729A ITA
Protected s.727 trust income	s.729A(3) ITA
Protected s.727 company income	s.729A(4) ITA

To describe the statutory terminology as clumsy or bad drafting scarcely does it justice. Perhaps the Parliamentary Counsel Office held an internal competition for the most unhelpfully labelled set of definitions; by that measure the drafter has excelled. But the reader will simply have to bear in mind that statute distinguishes about a dozen concepts, and describes them with labels using slight variants of the words "protected income"; and it then becomes possible to proceed.

There is no comparable definition of "protected gains" for the purposes of CGT protected-trust relief, as all gains are protected, (ie all gains of non-resident trusts qualify for s.86 protected-trust relief), whether UK source or not.

92.8.1 *Why protected foreign-source income matters*

The term "protected foreign-source income" is used in the following contexts:

(1) Protected-trust reliefs:
   (a) s.624 (and s.629) protected-trust relief
   (b) s.720 protected-trust relief
   (c) s.727 protected-trust relief
   (d) Transitional reliefs for pre-2007 s.624/s.720 income
(2) Protected-trust close-family/settlor charges:
   (a) The definition of "Protected Income" for s.731[51]
   (b) The definition of PFSI for s.643A[52]

92.9 Protected s.624 income

Protected s.624 income matters because:
(1) It qualifies for s.624 protected-trust relief and so is not taxed under s.624 on the arising or remittance basis.
(2) It is potentially taxable under the s.643A close-family charge.

Section 628A(2) ITTOIA provides the definition of "protected foreign-source income", which I call **"protected s.624 income"**:

> For this purpose, income arising under a settlement in a tax year is "protected foreign-source income" for the tax year if Conditions A to F are met.

I refer to these as **"s.624 protected-trust conditions"**.

For the related term "protected s.720 income" see 92.12 (Protected s.720 income).

For this purpose, s.628A(13) contains the standard form to disapply the artificial s.624 remittance basis timing rule.[53]

The definition is said to be for the purpose of s.628A (which I call s.624 protected-trust relief); but it applies more widely, as it is incorporated by reference elsewhere.[54]

92.9.1 *Condition A: RFI*

Section 628A(3) ITTOIA provides:

> Condition A is that the income would be relevant foreign income if it were income of a UK resident individual.

[51] See 50.44 ("Protected Income").
[52] See 47.22.1 (PFSI).
[53] See 47.8.4 (Remittance basis timing rule).
[54] The list includes: s.633C(3)(c) ITTOIA.

I call this the **"RFI condition"**.

The drafting is based on the wording of the s.720 remittance basis,[55] and there is a similar requirement in the s.624 remittance basis.[56]

92.9.2 *Originating from settlor*

Section 628A(4) ITTOIA provides:

> Condition B is that the income is from property originating from the settlor (see section 645).

This deals with the issue of multiple settlors.[57]

92.9.3 *Cond. C/D: non-dom settlor*

Section 628A ITTOIA provides:

> (5) Condition C is that when the settlement is created the settlor—
> (a) is not [actually] domiciled in the UK, and
> (b) if the settlement is created on or after 6 April 2017, is not deemed domiciled in the UK.
> (6) Condition D is that there is no time in the tax year when the settlor is—
> (a) [actually] domiciled in the UK, or
> (b) deemed domiciled in the UK by virtue of Condition A in section 835BA of ITA 2007 [formerly-domiciled resident[58]].

This is the equivalent of s.86 protected-trust conditions B and C.[59] The difference in the wording (particular year has become tax year) does not seem material.

Conditions C/D are satisfied for the tax year even if the settlor dies during the year.

92.9.4 *Non-resident trustees*

Section 628A(7) ITTOIA provides:

> Condition E is that the trustees of the settlement are not UK resident for the tax year.

[55] See 49.26 (s.720 remittance basis). For the reason for the wording ("would be RFI if it were the individual's"), see 16.9.3 (Relevant foreign income).

[56] See 47.8.2 (Remittance basis rule).

[57] See 100.1.2 (Multiple settlor provisions).

[58] See 5.4.2 (IT/CGT formerly-dom resident rule).

[59] See 92.3.2 (Conditions B/C: Non-dom settlor).

Individuals are resident (or not) *for* a tax year.[60] That is not the case for trustees: the drafter has used the wrong phrase. But it does not matter. In context, the meaning is that trustees must be non-resident throughout the tax year.

92.9.5 *Condition F: Tainting*

Section 628A(8) ITTOIA provides:

> Condition F is that no property or income is provided directly or indirectly for the purposes of the settlement by the settlor, or by the trustees of any other settlement of which the settlor is a beneficiary or settlor, at a time in the relevant period[61] when the settlor is—
> (a) [actually] domiciled in the UK, or
> (b) deemed domiciled in the UK.[62]

This is the equivalent of s.86 protected-trust condition D.[63]

Section 628A(10) and s.628B ITTOIA are the equivalent of the CGT tainting rules in para 5A(7) and para 5B sch 5A.[64] The wording is identical, so these provisions need not be set out again here.

92.10 s.624 protected-trust relief

Armed with the definition of protected s.624 income, we can turn to the s.624 protected-trust relief.

S.624 protected-trust relief is not like s.86 protected-trust relief, because the s.86 relief applies to all trust gains, but s.624 relief applies only to protected s.624 income.

Section 624 provides the general rule that income of a settlor-interested

[60] See 10.1 (Residence throughout tax year).

[61] Defined s.628A(9) ITTOIA: "In subsection (8) "relevant period" means the period—
(a) beginning with the start of 6 April 2017 or, if later, the creation of the settlement, and
(b) ending with the end of the tax year."

[62] Section 628A(12) ITTOIA defines deemed domicile in a clumsy fashion: "In this section "deemed domiciled" means regarded for the purposes of section 809(1)(b) of ITA 2007 as domiciled in the UK as a result of section 835BA of ITA 2007 having effect."

[63] See 92.4 (Condition D: Tainting).

[64] See 92.4.3 (Adding value) ff, Although the wording is the same, there is a difference in that the word "settlement" in the settlor-interested trust rules has the settlement-arrangement meaning and not the standard IT/CGT meaning. But in practice that does not usually matter; see 47.3.1 (Property comprised in settlement).

trust is treated as income of the settlor.

Section 628A(1) ITTOIA provides the relief:

> The rule in section 624(1) does not apply to income which arises under a settlement if it is [s.624] protected foreign-source income for a tax year.

Section 624 protected-trust relief is better than the s.624 remittance basis, which applies to a remittance basis settlor in the absence of protected-trust relief, because:

(1) To obtain protected-trust relief it is not necessary to claim the remittance basis (which involves losing personal allowances as well as the remittance basis claim charge).

(2) Protected s.624 income is not subject to income tax even if remitted to the UK.

92.10.1 *Pre-2017 income: Outline*

There are two reliefs for pre-2017 income. In outline:

Charging section	**Statutory term**	**Relief**	**See para**
s.624	Transitional trust income	s.628C ITTOIA	92.10.2
s.720	Transitionally protected income	s.726(6)(7) ITA	92.15.3

It is a pity that these two reliefs are not better aligned.[65] But there it is.

92.10.2 *Pre-2017 s.624 income*

Section 624 income arising before 2017/18 did not qualify for s.624 protected-trust relief, but it could qualify for the s.624 remittance basis.

Section 628C(1) ITTOIA provides:

> For the purposes of applying section 809L of ITA 2007 (meaning of remitted to the UK) in relation to transitional trust income, “relevant person” in that section does not include the trustees of the settlement concerned.

[65] CIOT commented on the draft legislation: "Given the significant overlap in the scope of the settlements code and the transfer of assets provisions, we strongly urge a consistent approach in terms of drafting." See CIOT, “Deemed domicile: Income and Capital Gains Tax – draft clauses published 13 July 2017: Response by the Chartered Institute of Taxation” (2017). But no-one took any notice, and this is now of historical interest only.

Section 628C(2) ITTOIA provides the definition of "transitional trust income":

> "Transitional trust income" means income—

Four conditions then follow:

> "Transitional trust income" means income—
> (a) that arises under a settlement in the period
> [i] beginning with the tax year 2008-09[66] and
> [ii] ending with the tax year 2016-17 ("the protection period"),

I refer to income within that period as "2008-2017 income".[67]

> "Transitional trust income" means income ...
> (b) that would be protected foreign-source income[68] for the purposes of section 628A(1) if section 628A(2)—
> (i) had effect for the protection period, and
> (ii) so had effect with a reference to conditions A to E (instead of A to F),

Para (b)(ii) disapplies condition F.[69] The point is that additions to a trust, which (post-2017) would taint the trust and lose s.624 protected-trust relief, do not affect the transitional relief for 2008-2017 income.

> "Transitional trust income" means income ...
> (c) that prior to 6 April 2017 has neither been
> [i] distributed by the trustees of the settlement nor
> [ii] treated under section 624(1) as income of the settlor,[70] and
> (d) that would for the tax year in which it arose under the settlement have been treated under section 624(1) as income of the settlor if the settlor had been domiciled in the UK for that year.

So a receipt in the UK of 2008-2017 trust income by trustees of a settlor-interested trust does not constitute a taxable remittance. This is of limited importance, though it might facilitate UK investment by the trust.

[66] The reason for this start date is that pre-2008 income qualified for a different transitional relief: see 47.8.5 (Pre-2008 income: Transitional).

[67] There is a separate relief for pre-2008 income; see 47.8.5 (Pre-2008 income: Transitional).

[68] See 92.9 (Protected s.624 income).

[69] See 92.9.5 (Condition F: Tainting).

[70] Para [ii] is otiose: it would only arise if the s.624 income was remitted pre-2017.

For this purpose, s.628C(3) ITTOIA contains the standard form to disapply the artificial s.624 remittance basis timing rule.[71]

Protected-trust guidance provides:

> Importantly this provision only removes trustees from the definition of "relevant person" in s809L ITA 2007. Underlying companies etc. will all remain relevant persons. Hence a loan of unremitted trustee income from, say, 2010 to an underlying company would trigger a taxable remittance upon subsequent use by the company in the UK. This will also include investing funds in the UK save where Business Investment Relief is applicable.[72]

That is strange, perhaps absurd, because the same relief for s.720 is more generous; but it appears to have been a deliberate decision. In practice, UK investment by the trustees (ie at trust level rather than underlying company level) is likely to be ruled out for IHT reasons. The reader may wonder whether this has been properly thought through.

It would be sensible if the restriction on the concept of "relevant person" applied generally, as the definition is too wide;[73] in that respect, this particular transitional rule might be viewed as a timid step in the right direction.

Protected-trust guidance provides:

> The rules on transitional trust income apply only to income that would for the tax year it arose have been treated as that of the settlor under S624(1) if the settlor had been domiciled in the UK. The transitional provisions do not extend to income treated as that of the settlor under S629(1) or S633.

But this will not often be important.

92.10.3 *Planning: Segregate income*

In the following discussion **"unprotected income"** is income of a settlor-interest trust which is not protected s.624 income. This will normally

[71] Section 628C(3) sets out the standard form which disapplies the artificial remittance basis timing provision; "Section 648(3) to (5) (relevant foreign income treated as arising under settlement only if and when remitted), and corresponding earlier enactments, do not apply for the purposes of subsection (2)(a) and (d)." See 47.8.4 (Remittance basis timing rule).

[72] Para 2.19.

[73] See 18.12 (Relevant person: Critique).

constitute pre-2017 trust income.[74]

There are now two different regimes for foreign income of a settlor-interested trust:

(1) Protected s.624 income: not taxed if remitted to the UK
(2) Unprotected income: taxed if remitted to the UK

It may be advantageous to segregate the two types of income, so trustees can use one or the other as desired. If the two are brought together, there is a mixed fund and mixed fund rules apply.

It may be advantageous to segregate UK source income, as that can be distributed without a further tax charge.

92.11 s.629 protected-trust relief

Section 629 ITTOIA provides the general rule that (in short) income of a minor child of the settlor is treated as income of the settlor.[75]

Section 628A(1) ITTOIA provides the protected-trust relief:

> The rule in section 629(1) does not apply to income which arises under a settlement if it is [s.624] protected foreign-source income[76] for a tax year.

Section 630A(3) ITTOIA contains the standard form to disapply the artificial remittance basis timing rule.[77]

92.12 Protected s.720 income

Protected s.720 income matters because:

(1) It qualifies for s.720 protected-trust relief, and so is not taxed under s.720 on the arising or the remittance basis.
(2) The transferor is potentially taxable on it under s.731 close-family rules.
(3) The s.731 onward gift rule applies only if s.731 income is matched to protected s.720 income.

Section 721A ITA provides the definition of "protected foreign-source

[74] For periods during which the settlor is UK resident; I simplify the discussion by assuming that the settlor is UK resident throughout.

[75] See 47.15 (Payment to settlor's child).

[76] Section 631A(2) ITTOIA provides the definition by reference: "Sections 628A(2) to (12) and 628B (meaning of "protected foreign source income") have effect also for this purpose." See 92.9 (Protected s.624 income).

[77] See 47.8.4 (Remittance basis timing rule).

income" (which I call **"protected s.720 income")**.[78]

Section 721A(1) ITA provides:

> This section has effect for the purposes of rule 2 of section 721(3B)[79] (cases where the individual [transferor] is not UK domiciled and is not deemed domiciled by virtue of Condition A in section 835BA [formerly-domiciled resident[80]]).

The definition is said to be for the purpose of s.721(3B) rule 2 (which I call s.720 protected-trust relief); but it applies more widely, as it is incorporated by reference elsewhere.[81]

Section 721A(2) ITA provides:

> The income of the person abroad is "protected foreign-source income" so far as it is within subsection (3) or (4).

So there are two types of protected s.720 income:

Type of income (my terminology)	**ITA**	**See para**
Protected s.720 trust income	s,721A(3)	92.13
Protected s.720 company income	s.721A(4)	92.14

92.13 Protected s.720 trust income

Section 721A ITA provides:

> (2) The income of the person abroad is "protected foreign-source income" so far as it is within subsection (3) or (4).
> (3) Income is within this subsection if—

A set of 5 conditions then follow, which I call **"s.720 protected-trust conditions"**.

92.13.1 *Condition (a): RFI*

Section 721A ITA provides:

> (3) Income is within this subsection if—
> (a) it would be relevant foreign income if it were the individual's

This is similar to s.624 protected-trust condition A, but not quite the

[78] See 92.8 (Protected income: Terminology).

[79] See 92.15.2 (Transferor not UK domiciled).

[80] See 5.4.2 (IT/CGT formerly-dom resident rule).

[81] The list includes: s.731(1A) ITA: see 50.45 (Non-resident receives benefit); s.733A(1)(b(i) (s.731 close-family charge); s.733B(1).

same.[82] I call it the **"RFI condition"**.

If the individual (ie, the transferor) is non-resident, the income does not meet this requirement,[83] so it is not protected s.720 income. Similarly if the individual has died, the income is not protected s.720 income.[84]

The individual (the transferor) will normally be the settlor, but that need not necessarily be the case.

For whether offshore income gains/accrued income profits constitute protected s.720 income, see 67.12.2 (OIG: Protected s.720 income?); 28.15 (AIP: Protected-trust reliefs).

92.13.2 *Condition (b): Settlement*

Section 721A ITA provides:

> (3) Income is within this subsection if ...
>
> (b) the person abroad is the trustees of a settlement

Trust-protection guidance notes that for this purpose, "settlement" includes "foreign entities that fall to be treated like trusts under the principle in *Memec plc v IRC* e.g. certain types of foundations".

Company income does not meet this condition: it may instead come within s.721A(4) discussed below.

92.13.3 *Cond. (c): Non-resident trust*

Section 721A ITA provides:

> (3) Income is within this subsection if ...
>
> (c) the trustees are non-UK resident for the tax year

Condition (c) is the equivalent of s.624 protected-trust condition E.[85]

[82] See 92.9.1 (Condition A: RFI). For the reason for the wording ("would be RFI if it were the individual's"), see 16.9.2 (Relevant foreign income).

[83] See 17.4.1 ("Relevant foreign income").

[84] This is also the view of the professional bodies in their paper "Finance Act 2018 Section 35 and sch 10 Settlements: Anti-avoidance Notes on practical points and areas of uncertainty" (Mar 2019): "The transfer of assets onward gift rules can only apply if the original benefit is matched against "protected foreign source income". This requires the income to have arisen after 5 April 2017 at a time when the settlor is UK resident."
https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2019/taxguide-03-19-fa-2018-section-35.ashx

[85] Se 92.9.4 (Non-resident trustees).

92.13.4 *Cond. (d): Non-dom transferor*

Section 721A ITA provides:

> (3) Income is within this subsection if ...
> (d) when the settlement is created, the individual [transferor] is—
> (i) not [actually] domiciled in the UK, and
> (ii) if the settlement is created on or after 6 April 2017, not deemed domiciled[86] in the UK

The individual will usually be the settlor as well as the transferor, but that is not necessarily the case, and is not required.

92.13.5 *Condition (e): Tainting*

Section 721A ITA provides:

> (3) Income is within this subsection if ...
> (e) no property or income is provided directly or indirectly for the purposes of the settlement by the individual [transferor], or by the trustees of any other settlement of which the individual is a beneficiary or settlor, at a time in the period—
> (i) beginning with the start of 6 April 2017 or, if later, the creation of the settlement, and
> (ii) ending with the end of the tax year,
> when the individual [transferor] is domiciled or deemed domiciled in the UK.

Condition (e) is the tainting rule which applies for all the protected-trust reliefs.[87] The wording here is different from the TCGA and ITTOIA equivalents, but there is no difference in meaning.

Section 721B (tainting) is the equivalent of the rule in para 5B sch 5A TCGA. The wording here is identical, so these provisions need not be discussed again here.

92.13.6 *s.624/s.720 compared*

It may be helpful to set out the definitions of protected s.624 income/ protected s.720 trust income, side by side, for comparison:

[86] Section 721A(7) ITA provides the standard IT definition.

[87] See 92.4 (Condition D: Tainting).

s.628A: protected s.624 income	**s.721A(3): s.720 prot’d trust income**
(3) Condition A is that the income would be relevant foreign income if it were income of a UK resident individual.	(3) Income is within this subsection if— (a) it would be relevant foreign income if it were the individual’s [the transferor’s],
[No equivalent as s.624 requires income arising under a settlement]	(b) the person abroad is the trustees of a settlement,
(4) Condition B is that the income is from property originating from the settlor (see section 645).	
(5) Condition C is that when the settlement is created the settlor— (a) is not domiciled in the UK, and (b) if the settlement is created on or after 6 April 2017, is not deemed domiciled in the UK.	(d) when the settlement is created, the individual [the transferor] is— (i) not domiciled in the UK, and (ii) if the settlement is created on or after 6 April 2017, not deemed domiciled in the UK, and
(6) Condition D is that there is no time in the tax year when the settlor is— (a) domiciled in the UK, or (b) deemed domiciled in the UK by virtue of Condition A in section 835BA of ITA 2007.	
(7) Condition E is that the trustees of the settlement are not UK resident for the tax year.	(c) the trustees are non-UK resident for the tax year,
(8) Condition F is that no property or income is provided directly or indirectly for the purposes of the settlement by the settlor, or by the trustees of any other settlement of which the settlor is a beneficiary or settlor, at a time in the relevant period when the settlor is— (a) domiciled in the UK, or (b) deemed domiciled in the UK.	(e) no property or income is provided directly or indirectly for the purposes of the settlement by the individual [transferor], or by the trustees of any other settlement of which the individual is a beneficiary or settlor,

(9) In subsection (8) "relevant period" means the period—	at a time in the period—
(a) beginning with the start of 6 April 2017 or, if later, the creation of the settlement, and	(i) beginning with the start of 6 April 2017 or, if later, the creation of the settlement, and
(b) ending with the end of the tax year.	(ii) ending with the end of the tax year,
	when the individual is domiciled or deemed domiciled in the UK.

92.14 Protected s.720 company income

Section 721A ITA provides:

> (2) The income of the person abroad is "protected foreign-source income" so far as it is within subsection (3) or (4)...
> (4) Income is within this subsection if—

A set of 7 conditions then follow, which I call **"s.720 protected-company conditions"**. These are (more or less) the same as the five s.720 protected-trust conditions, except:

(1) Para (b) requires that the person abroad is a company (rather than a trust); and
(2) Paras (c)(d) are added.

92.14.1 *Cond. (c): need for trust*

Section 721A ITA provides:

> (4) Income is within this subsection if...
> (c) the trustees of a settlement—
> (i) are participators[88] in the person abroad
> (ii) are participators in the first in a chain of two or more companies
> [A] where the last company in the chain is the person abroad and
> [B] where each company in the chain (except the last) is a participator in the next company in the chain,

Company income is not protected s.720 income unless trustees are

[88] Section 721A(7) ITA provides the standard definition: "In this section "participator", in relation to a company, has the meaning given by section 454 of CTA 2010".

participators. If the transferor holds a company directly, without a trust, there is no s.720 protected-trust relief. In short, condition (c) (bolstered by (d), considered below) requires that the company is held in a trust.

That seems surprising, but the rule is deliberate.[89] No reason has been given. I infer the reason is that allowing protected-trust relief to a structure is part of a package which also includes the application of s.731 to funds extracted from the structure. In the absence of condition (c) a transferor holding a company absolutely could:

(1) obtain the benefit of s.720 protected-trust relief
(2) enjoy that benefit without the burden of an income tax charge on extracting funds from the structure (eg by calling in a debt owed to the transferor).

If a company within s.720 is transferred to a trust, income arising after the transfer will meet condition (c) and can qualify as protected s.727 company income.

92.14.2 *Chains of companies*

Section 721A ITA provides:

> (4) Income is within this subsection if...
> (c) the trustees of a settlement ...
> (ii) are participators in the first in a chain of two or more companies
> [A] where the last company in the chain is the person abroad and
> [B] where each company in the chain (except the last) is a participator in the next company in the chain

Para 12 Protected-trust Note considers chains of companies:

> Read literally, this could mean income arising to intermediate companies in the chain cannot be PFSI. However, a purposive construction avoids this result, if ‘the last company in the chain’ is taken to be the company which has received the income, even if that company may have direct or indirect subsidiaries. It is considered this purposive construction must be correct.

[89] HM Treasury, “Reforms to the taxation of non-domiciles: response to further consultation” (Dec 2016) para 2.3.3. *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/574450/non_doms_consultation_response_final.pdf*

This is correct, but it does not require a particularly loose or purposive construction to reach that conclusion.

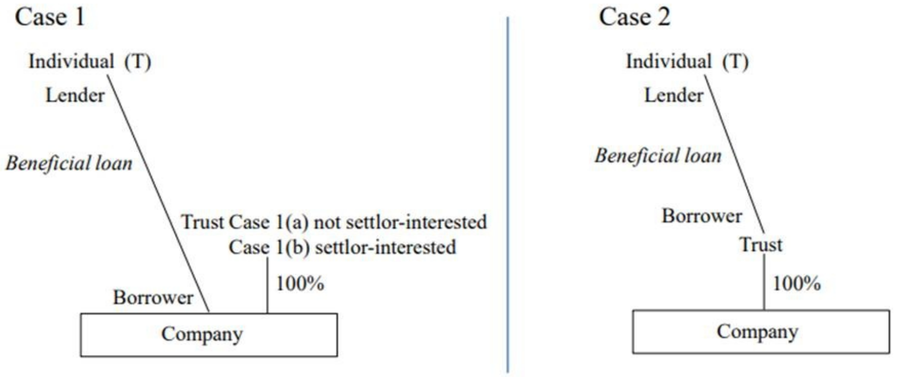
92.14.3 *Condition (d): interest outside trust*

Section 721A ITA provides:

> (4) Income is within this subsection if...
>
> (d) the individual's power to enjoy the income results from the trustees being participators as mentioned in paragraph (c)(i) or (ii)

"Results from" is the language of causation, and causation often causes intractable legal puzzles.

Suppose this structure:


Case 1
Individual (T)
Lender
Beneficial loan
Trust Case 1(a) not settlor-interested
Case 1(b) settlor-interested
100%
Borrower
Company
Case 2
Individual (T)
Lender
Beneficial loan
Borrower
Trust
100%
Company

Suppose for simplicity that all the company income arises directly or indirectly from the loan. That is, the company has no significant assets other than funds derived (directly or indirectly) from the loan.

Case 1(a): the trust excludes T and T's spouse. In this case T in principle has power to enjoy the company's income.[90] T has that power as a result of the loan, not as a result of the trustees being participators, so the company income is not s.720 protected income.

Case 1(b): T is a beneficiary of the trust. In this case the individual in principle has power to enjoy the company's income for two reasons, either of which would suffice:

(1) the trust's shareholding *and*

(2) the benefit of the loan.

[90] See 49.18.1 (Power to enjoy: Loans).

In this case does the power to enjoy result from the trustees being participators? In philosophical terms, where either A or B are sufficient to cause a result, the result is said to be overdetermined. Can one say that A caused the result? In legal terms the answer depends on the context.

Condition (d) does not say expressly whether or not the individual's power to enjoy must result *only* from the trustees being participators. In this situation one should ask what solution makes more sense having regard to the object of the rule. The protected trust regime allows protected-trust relief to a structure but only as part of a package which also includes the application of s.731 to funds extracted from the structure. The object of condition (d) is to prevent avoidance of that charge. In the absence of condition (d), under the structure in Case 1(b), the transferor could:

(1) obtain the benefit of s.720 protected-trust relief and
(2) enjoy that benefit without the burden of an income tax charge on extracting funds from the structure (by calling in the loan).

If that is right then the company income in case 1(b) should not be protected income. The analogy with case 1(a) also supports the view that the income is not protected.

Section 727 also needs consideration, as the capital receipt conditions are likely to be met.[91] The s.727 analysis provides further support for the view that the income is not s.720 protected income.

In practice the solution may be for T to transfer the loan to the trust.

Case 2: Again, T has power to enjoy the income of the company for two reasons, either of which would suffice:

(1) as beneficiary of the trust (if T is a beneficiary); and
(2) as holder of the loan[92] (whether or not T is a beneficiary)

But in either case the individual has power to enjoy the income of the company only because the trustees own the company and so are participators in it. So condition (d) is met, and the company income is s.720 protected income.

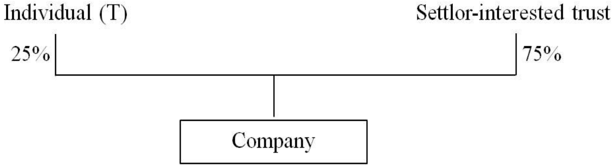
The position is more complicated if the company has assets in addition to the loaned funds. In that case there would have been other significant transfers of assets, a transfer to the trust and a transfer to the company:

[91] See 92.16 (s.727 protected-trust relief).
[92] See 49.18.1 (Power to enjoy: Loans).

(1) Who are the transferors in relation to each transfer? The analysis is simpler if T made all the transfers, but that need not be the case.
(2) What is the income arising to the company (the person abroad) as a result of each of those transfers? It would then be necessary to consider:
   (a) "Company loan income": income arising to the company as a result of the loan
   (b) Company non-loan income: other income of the company

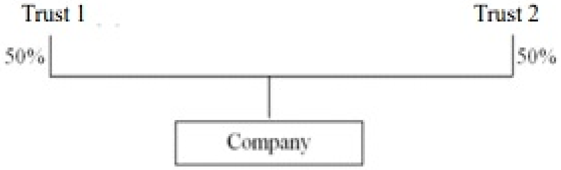
I do not pursue these permutations here.

Suppose:



T's power to enjoy 25% of the company's income results from his or her shareholding, and power to enjoy 75% of the income results from the trustees being participators. It is suggested one can apportion and 75% of the company's income is protected s.720 company income. But it would be better to avoid this problem.

Suppose one company is held by two settlor-interested trusts:



It is suggested that the company income can be protected s.720 income, as the singular includes the plural.

92.14.4 *Protected trust/co income compared*

It may be helpful to set out the definitions of protected s.720 trust/co income side by side for comparison:

Protected s.720 *trust* income	**Protected s.720 *company* income**
(3) Income is within this subsection if— (a) it would be relevant foreign income if it were the individual's,	(4) [identical]

(b) the person abroad is the trustees of a settlement,	(b) the person abroad is a company,
[No equivalent]	(c) the trustees of a settlement— (i) are participators in the person abroad, or (ii) are participators in the first in a chain of two or more companies where the last company in the chain is the person abroad and where each company in the chain (except the last) is a participator in the next company in the chain,
[No equivalent]	(d) the individual's power to enjoy the income results from the trustees being participators as mentioned in paragraph (c)(i) or (ii),
(c) the trustees are non-UK resident for the tax year,	(e) [identical to (c)]
(d) when the settlement is created, the individual is— (i) not domiciled in the UK, and (ii) if the settlement is created on or after 6 April 2017, not deemed domiciled in the UK, and	(f) [identical to (d)]
(e) no property or income is provided directly or indirectly for the purposes of the settlement by the individual, or by the trustees of any other settlement of which the individual is a beneficiary or settlor, at a time in the period— (i) beginning with the start of 6 April 2017 or, if later, the creation of the settlement, and (ii) ending with the end of the tax year, when the individual is domiciled or deemed domiciled in the UK.	(g) [identical to (e)]

92.15 s.720: Protected-trust relief

Armed with the definition of "protected s.720 income" we can turn to the s.720 protected-trust relief.

Section 721(3B) ITA provides:

> The amount of the income treated as arising under subsection (1) [the amount of s.720 income] is (subject to sections 724 and 725[93]) given by the following rules-

92.15.1 *Transferor UK domiciled*

Section 721(3B) ITA provides:

> *Rule 1*
> The amount is equal to the amount of the income of the person abroad if the individual [transferor]-
> (a) is [actually] domiciled in the UK at any time in the tax year, or
> (b) is at any time in the tax year regarded for the purposes of section 718(1)(b) as domiciled in the UK as a result of section 835BA having effect because of Condition A in that section being met [formerly-domiciled resident[94]].

In para (b) the words *for the purposes of section 718(1)(b)* are not apt. That section defines the expression "person abroad".[95] We are concerned here with the (deemed) domicile of the transferor, not the person abroad. The words should be disregarded under the slip rule, or para (b) cannot be applied at all.

92.15.2 *Transferor not UK domiciled*

Section 721(3B) ITA continues:

> *Rule 2*
> In any other case ...

That is, if the transferor is not actually UK domiciled, and not a formerly-domiciled resident (this requirement is the effective equivalent of s.86 protected-trust condition C[96]):

> ... the amount is equal to so much of the income of the person abroad as is not protected foreign-source income (see section 721A).

In short, protected foreign-source income (which I call protected s.720

[93] The exceptions referred to in brackets will rarely if ever apply. For s.724, see 49.22.3 (Amount of charge: enjoyment condition C). s.725 concerns interaction with CFC rules.

[94] See 5.4.2 (IT/CGT formerly-dom resident rule).

[95] See 48.5 ("Person abroad").

[96] See 92.3.2 (Conditions B/C: Non-dom settlor).

income) is not subject to the s.720 charge. The wording seems exceptionally clumsy, but it works.

I refer to this rule as **"s.720 protected-trust relief"** though it is not expressed in the form of a relief.

Section 720 protected-trust relief is better than the s.720 remittance basis, which applies to remittance basis transferors in the absence of protected-trust relief, because:

(1) To obtain protected-trust relief it is not necessary to claim the remittance basis (which involves losing personal allowances as well as the remittance basis claim charge)

(2) s.720 protected-trust income is not subject to income tax even if remitted to the UK.

92.15.3 *Pre-2017 s.720 income*

Section 720 income arising before 2017/18 did not qualify for s.720 protected-trust relief, but it could qualify for the s.720 remittance basis.

There is a relief for this income.[97] Section 726(6) ITA provides:

> In addition,[98] where the tax year in which any foreign deemed income [foreign source s.720 income] arises is earlier than the tax year 2017-18, section 832 of ITTOIA 2005 does not apply to the foreign deemed income so far as it—
>
> (a) is remitted to the UK[99] in the tax year 2017-18 or a later tax year, and
>
> (b) is transitionally protected income.

Section 726(7) ITA provides the definition of "transitionally protected income":

> In subsection (6) ...
>
> "transitionally protected income" means any foreign deemed income where the income mentioned in section 721(2 [that is, the income of the person abroad])—
>
> (a) arises in a tax year earlier than the tax year 2017-18,
>
> (b) would be protected foreign-source income as defined by section 721A[100] if section 721A—
>
> (i) had effect for tax years earlier than the tax year 2017-18,

[97] There is a similar relief for s.624 income; see 92.10.1 (Pre-2017 income: Outline).

[98] The words "In addition" are otiose; but it does not matter.

[99] See 18.1 (ITA remittance basis).

[100] See 92.12 (Protected s.720 income).

and

(ii) so had effect with the omission of its subsections (3)(e), (4)(g), (5) and (6) [tainting rule], and

(c) has not prior to 6 April 2017 been distributed by the trustees of the settlement concerned.

The conditions in para (a) to (c) are similar to s.624 transitional relief for pre-2017 income,[101] but the relief is wider:

(1) In this case, s.832 is disapplied so there is no charge on remittance.[102]

(2) The relief applies to all pre-2017 income (not just income in the period 2008 - 2017).

That seems generous, but it makes sense because the transferor is (from 2017/18) within the scope of s.731 in relation to pre-2017 s.720 income (which is relevant income); that is a retrospective extension of the scope of the charge.[103]

Remittance of the income of the person abroad is also relevant for the s.731 remittance basis.

92.16 s.727 protected-trust relief

Section 729A ITA sets out the definition of protected foreign-source income (which I call **"protected s.727 income"**)[104] for the purposes of s.727 protected-trust relief.

Just as for protected s.720 income, there are two types of protected s.727 income:

Type of income (my terminology)	**ITA**
Protected s.727 trust income	s.729A(3)
Protected s.727 company income	s.729A(4)

I need not discuss this definition in full, because it mostly follows the definition of protected s.720 income.[105] There are however two differences between the definitions of s.720/727 protected company income:

(1) Para (d) of the definition is worded differently for s.727/s.720

[101] See 92.10.2 (Pre-2017 s.624 income).

[102] See 17.13 (Charge on remitted RFI).

[103] See 50.15.3 (Transferor not relevantly domiciled).

[104] See 92.8 (Protected income: Terminology).

[105] See 92.12 (Protected s.720 income).

(2) Para (e) of the definition is added

This is easier to follow if the definitions are set out side by side, and para (d) needs to be read with para (c):

***s.720* protected co income: S.721A(4)**	***s.727* protected co income: s.729A(4)**
(c) the trustees of a settlement— (i) are participators in the person abroad, or (ii) are participators in the first in a chain of two or more companies where the last company in the chain is the person abroad and where each company in the chain (except the last) is a participator in the next company in the chain,	(c) [identical]
(d) the individual's power to enjoy the income results from the trustees being participators as mentioned in paragraph (c)(i) or (ii)	(d) the condition in paragraph (c) is met as a result of a relevant transaction (whether or not it is also met otherwise than as a result of a relevant transaction)
[No equivalent]	(e) the income has become the income of the person abroad as a result of that relevant transaction

Protected-trust Q&As Question 15 provides:

> Read literally, [conditions (d) and (e)] could mean that there are many circumstances where the income of such a company would not be PFSI [in my terminology, s.727 protected company income] for the purposes of the capital sum rules [s.727].

The first example concerns an outright transfer of funds to a company which subsequently becomes held in a trust:

> For example, if
> [1] a settlor establishes an overseas investment company and transfers £10 million to that company before
> [2] subsequently transferring the shares in the company to a trust,
> the trustees become participators as a result of the transfer of the shares to the trustees but the income arises in the company as a result of the

> original transfer of the £10 million to the company – these are different relevant transactions.
>
> Is it accepted that, in these circumstances, the income of the company is PFSI within ITA 2007 s.729A(4) (assuming the other conditions are satisfied)?
>
> *Suggested answer:* the intention is that the income of an underlying company in these circumstances should be PFSI for the purposes of the capital sum rules to the extent of the trustees' interest in the company as a participator.
>
> Therefore, if the company is wholly owned by the trustees and there are no external interests, it is accepted that the income qualifies as PFSI. This is on the basis of a purposive construction of s.729A(4)(e) so that the condition is treated as being satisfied as long as the income arises as a result of any 'relevant transaction' rather than the income having to arise as a result of exactly the same relevant transaction by which the trustees became participators in the company.[106]

The answer is correct, but does not require a particularly loose or purposive construction. The condition in para (e) refers to that "relevant transaction", not that "transfer of assets". Relevant transaction includes associated operations.[107] In the example, the transfer of cash to the company, and the transfer of the shares to the trust, are in principle associated operations. So the company income can in principle meet condition (e) and can be protected s.727 income.

If there were a problem, a solution may be to wind up the company so the assets are held directly by the trust.

The second example concerns a loan to a company held in a trust:

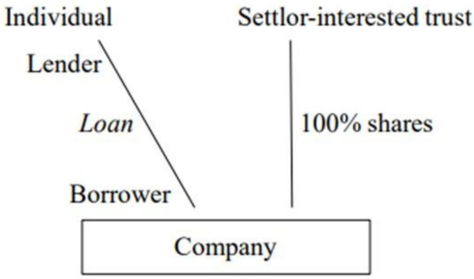
> The position would however be different if, for example,
>
> [1] the settlor had made a loan to the company as a result of which income arose to the company and
>
> [2] the settlor retained the benefit of the loan [and
>
> [3] the settlor transferred the shares to the trust[108]].

Diagrammatically:

[106] Para 13 Protected-trust Note makes the same point.

[107] See 48.12 (Why associated operations matter).

[108] It must be envisaged that the shares are held by the trust. It is not stated in the example whether the shares became held in the trust before or after the loan was made to the company; it probably makes no difference.



> In these circumstances, the income of the company which was attributable to the loan would not be PFSI for the purposes of the capital sum rules.
> This is because the series of 'relevant transactions' giving rise to the trustees' participation in the company is completely separate to the chain of 'relevant transactions' which results in income from the proceeds of the loan being received by the company. There is therefore no link between the relevant transaction resulting in the trustees becoming participators in the company and the relevant transaction giving rise to the income.

But s.727 does not matter, because in this situation the income would not be protected s.720 company income: HMRC need not rely on s.727.[109]

92.17 Protected-trust conditions: Navigation

It may help navigation to summarise the protected-trust conditions in 3 tables:

s.86 protected-trust conditions

Condition	*sch 5 para*	*Rule*	*See para*
A	5A(2)	2017/8 or later (commencement)	92.3.1
B	5A(3)	Settlor non-dom when trust made	92.3.2
C	5A(4)	Settlor non-dom in year	92.3.2
D	5A(5)	Tainting	92.4

s.624 protected-trust conditions

Condition	*Section*	*Rule*	*See para*
A	628A(3)	Foreign income	92.9.1
B	628A(4)	Multiple settlor rule	92.9.2

[109] See 92.14.3 (Condition (d): interest outside trust).

C	628A(5)	Settlor non-dom when trust made	92.9.3
D	628A(6)	Settlor non-dom in year	92.9.3
E	628A(7)	Non-resident trust	92.9.4
F	628A(8)	Tainting	92.9.5

s.720 protected-trust conditions and s.624/87 equivalents

Company	***Trust***	***Rule***	***Equivalent:* s.624**	**s.86**
721A(4)(a)	721A(3)(a)	Foreign income	A	–
721A(4)(b)	721A(3)(b)	Person abroad is co/trust	–	–
721A(4)(c)	–	Need for trust	–	–
721A(4)(d)	–	No interest outside trust	–	–
721A(4)(e)	721A(3)(c)	Non-resident trust	E	–
721A(4)(f)	721A(3)(d)	Settlor non-dom when trust made	C	B
721A(4)(g)	721A(3)(e)	Tainting	F	D
721(3B) Rule 2[110]	*ditto*	Settlor non-dom in year	D	C

It would have been better if the wording was more closely aligned; but there it is.

92.18 Protected-trusts: Commencement

Para 39 sch 8 F(no.2)A 2017 provides:

> The amendments made by paragraphs 19 to 38 have effect for the tax year 2017-18 and subsequent tax years.

Paras 19-38 include all the ITTOIA and ITA protected-trust provisions, including the settlor-interested trust rules in s.628A-C ITTOIA, and the ToA rules in s.721A-B, s.733A, 735B ITA.

Pre-2017 income is not protected s.624/s.720 income.[111]

For CGT commencement, see 92.3.1 (Condition A: 2017/18 or later).

[110] This is not expressed as part of the definition of "protected s.720 income" but it is effectively a condition of s.720 protected-trust relief.

[111] The professional bodies agree. Para 24 Protected-Trust Note provides:

> "relevant income cannot be PFSI unless it arose after 5 April 2017 as the changes only apply for the tax year 2017/18 onwards. Income before that date cannot be PFSI. The amendments made to section 726 introducing sub-sections (6) and (7) refer specifically to PFSI and earlier years thereby providing further confirmation."

For this document, see 92.1.1 (Protected-trust guidance); for s.726(6)(7) see 92.15.3 (Pre-2017 s.720 income).

92.19 Tax return: Protected income/gain

Protected income/gains is not taxable. No formal claim is required and tax returns do not require full details. Form SA106 (2022/23) boxes 10/12 ask about income received by a person abroad, but SA106 (notes) 2022/23 provides:

> If the income received by the person abroad is 'protected foreign income', do not enter details of protected foreign income in boxes 10 to 13.2.

However disclosure is required by Box 23 in form SA109 (2022/2023). The caption by this box states: *If you are domiciled outside the UK and it is relevant to your Income Tax or Capital Gains Tax liability for 2022–23, put 'X' in the box. Please explain in box 40 [Any other information] how your domicile is relevant to your Income Tax or Capital Gains Tax liability* Further information relating to domicile is then required in boxes 24-27. Form SA109 Notes 2022–23 provides:

> Box 23 refers to your domicile status in general or common law. So if you're domiciled outside the UK and it is relevant to your UK tax liability, tick the box. If you're deemed domiciled and so chargeable on the arising basis there should be:
> - 'X' in box 23
> - followed by 'X' in either 23.1 or 23.2
> - then complete boxes 23.3 to 27 if you're taking advantage of the trust protections so that you would only be taxed on the benefits that you derived from a protected trust, rather than on the income and gains in the trust as they arise

CHAPTER NINETY THREE

NON-DOM/NON-RESIDENT SPOUSE

93.1 Non-dom/non-resident spouse
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93.17 Gifts to spouse: GAAR

Cross references

Joint bank accounts are considered elsewhere:
94.3 (Joint account: IHT)
94.6 (Remittance from joint account)

93.1 Non-dom/non-resident spouse

This chapter considers tax issues which arise where:

(1) a UK domiciliary has a foreign domiciled spouse[1]

(2) a UK resident has a non-resident spouse[2]

FA 1988 abolished the former rule that income/gains of a married women

[1] "Spouse" here includes a civil partner; see App 3.2 ("Spouse"); App 3.3 ("Civil partner").

[2] I do not consider the temporary non-residence rules in this chapter.

were deemed to accrue to her husband, and established the general principle of independent taxation of husband and wife. The rules must be understood in that context, and in the light of conflicting policy considerations:

(1) Tax should be marriage-neutral: marriage should not impose additional tax or give a tax advantage
(2) To facilitate inter-spouse transfers by reliefs for tax charges which arise on other transfers
(3) (a) To prevent avoidance;
    (b) More fundamentally, to determine what in this context constitutes avoidance, and what is acceptable tax planning[3]

CGT/IT/IHT raise (more or less) the same policy issues but the solutions are all different, so each tax need to be considered separately. Such is the patchwork nature of UK taxation.

93.2 Restricted IHT spouse exemption

93.2.1 *The restriction*

The IHT spouse exemption normally provides complete exemption for transfers between spouses.[4] Section 18(2) IHTA provides an important exception:

> If, immediately before the transfer, the transferor but not the transferor's spouse or civil partner is domiciled in the UK the value in respect of which the transfer is exempt (calculated as a value on which no tax is chargeable) shall not exceed
> [a] the exemption limit at the time of the transfer,
> [b] less any amount previously taken into account for the purposes of the exemption conferred by this section.

So where:
(1) the transferor is UK domiciled (or deemed UK domiciled), and
(2) the transferee (the spouse of the transferor) is foreign domiciled
the exemption is in principle restricted to the specified amount. I refer to this as the "**restricted IHT spouse exemption**".

This restriction does not apply the other way round, where the foreign

[3] See 2.5.9 (Views of non-tax practitioners) under the heading *Spouses sharing income.*

[4] For the IHT spouse exemption generally, see 76.5.1 (Spouse exemption: Introduction); see too 78.10 (GWR spouse exemption).

domiciled individual makes a transfer to their UK domiciled spouse. That makes sense because such a transfer brings assets which would have been outside the scope of IHT within its scope.

The restriction does not apply where neither spouse is domiciled in the UK.

The transferee spouse may elect to be treated as UK domiciled so as to avoid the restriction.[5]

The restriction is modified by some IHT DTAs:

Treaty	**See para**
Switzerland	118.9
USA	119.12

Transfers which do not qualify for the IHT spouse exemption will be PETs unless some other exemption is in point.

93.2.2 *Amount of restricted relief*

Where the IHT spouse exemption is restricted, s.18 provides that the amount of relief is:

> [a] the exemption limit at the time of the transfer,
> [b] less any amount previously taken into account for the purposes of the exemption conferred by this section.

The exemption limit is defined in s.18(2A) IHTA:

> For the purposes of subsection (2), the exemption limit is the amount shown in the second column of the first row of the Table in Schedule 1 (upper limit of portion of value charged at rate of nil per cent).

That is the nil-rate band amount, which is fixed at £325k until end 2020/2021.[6]

An inter-spouse gift within the limit of the restricted spouse exemption is *not* a PET. Section 3A(1A)(b) IHTA provides that a PET is a transfer of value "which, apart from this section, would be a chargeable transfer".[7] So if one spouse makes a gift to the other, that gift uses up the exemption limit even though the gift is made more than seven years from the death

[5] See 5.14 (Spouse election domicile).

[6] Section 10 F(no.2)A 2015.

[7] Transfers before 22 March 2006 are governed by s.3A(1) IHTA but the wording on this point is the same.

and would otherwise qualify as an exempt transfer, as a PET.

The position is different for a gift of excluded property.[8] Such a gift is not a transfer of value at all and therefore it is not a transfer which qualifies for the spouse exemption and does not use up the exemption limit.

The position is less clear for a transfer (outside s.11) which qualifies for the annual or normal expenditure exemptions. Such a transfer is an exempt transfer under those exemptions: does it also use up the limit for inter-spouse gifts? There is no clear answer in the legislation but it is suggested that these transfers do not use up the limit. That would better fit the scheme of the legislation.

The IHT Manual provides:

> **IHTM11033. Spouse or civil partner domiciled outside UK** [Jan 2017]
>
> ... The restriction applies to
>
> - the value before grossing (IHTM26121)
> - the cumulative total of all transfers to a spouse or civil partner. So you must take into account the amounts allowed under earlier transfers to a spouse or civil partner whether or not they were domiciled or treated as domiciled in the UK at the time in considering whether the restriction is exceeded, and
> - since the exemption applies to transfers made by a individual, if that person has been married or in civil partnership with more than person, the restriction applies to the cumulative total of all transfers to all spouses or civil partners.
>
> Where the appropriate limit is exceeded, you should allocate the exemption in the way which is most favourable to the spouse or civil partner. Factors you should bear in mind include which assets bear the tax and whether business relief (IHTM25131), agricultural relief (IHTM24001) or any other reliefs are available.
>
> ***Example 1** (Mr and Mrs Allsop)*
>
> In May 2012, Mr A, who was domiciled in the UK transferred £200,000 to Mrs A, who was not domiciled in the UK.
>
> Of this transfer, £55,000 is exempt under IHTA1984/S18(2), and £145,000 is a PET (IHTM04057) and assumed to be exempt.
>
> Mr A dies in 2020 and leaves all his property to his wife, who remains domiciled outside the UK.
>
> On Mr A's death, the limited exemption under IHTA1984/S18(2) has

[8] Likewise a gift within s.11 IHTA; see 93.4 (Disposition for maintenance of spouse).

increased to £325,000, so that exemption of
£270,000 (£325,000 - £55,000)
is now available on his death.

Example 2 *(Mr and Mrs Costa)*

In January 2013 Mr C transfers a UK property worth £200,000 to Mrs C. Both are domiciled outside the UK. Exemption under IHTA1984/S18 (1) is available in full.

In June 2013 Mr C is deemed to be domiciled in the UK and gives another UK property worth £300,000 to his wife, who remains domiciled outside the UK. The restriction on the exemption under IHTA1984/S18 (2) applies at this point.

At the time of the transfer that triggered the restriction, the spouse exemption available to Mr C was £325,000. He has already made a gift to Mrs C that qualified for exemption under IHTA84/S18 of £200,000, so the exemption available against this transfer is £125,000. This is because IHTA84/S18(2) reduces the amount of the limited exemption available by 'any amount previously taken into account for the purposes of the exemption conferred by this section'. This means that £175,000 of the transfer will be a PET to Mrs C and chargeable to tax if Mr C dies before July 2020.

93.3 Settlor spouse/widow: trust receipt

The termination of an estate interest in possession (during the life of the life tenant) is a transfer of value under s.52 IHTA.[9] Section 53(4) IHTA provides:

> Tax shall not be chargeable under s.52 above if on the occasion when the interest comes to an end—
> (a) the settlor's spouse or civil partner, or
> (b) where the settlor has died less than two years earlier, the settlor's widow or widower or surviving civil partner,
>
> becomes beneficially entitled to the settled property and is domiciled in the UK.[10]

This relief only applies if the spouse is UK domiciled (or has made a spouse election). The restriction on s.53(4) relief is broadly consistent with the restriction to the spouse exemption considered above.

Section 54(2) IHTA sets out similar rules for the termination of an estate interest in possession on the death of the life tenant.

[9] See 76.10 (Termination of estate IIP).

[10] Section 53 goes on to set out some exceptions not discussed here.

93.4 Disposition for maintenance of spouse

Where the IHT spouse exemption does not apply, another exemption may sometimes fill the gap. An inter-spouse gift may qualify for relief under s.11(1) IHTA:

> A disposition is not a transfer of value if it is made by one party to a marriage[11] or civil partnership in favour of the other party ... and is—
>
> (a) for the maintenance of the other party ...[12]

This should normally[13] apply, in particular, to the common case where an individual gives a half share in the family home to their spouse. The most basic requirement of "maintenance" is to have a secure roof over one's head.[14] In *Phizackerley v IRC*[15] the Special Commissioners correctly stated that the normal reason for such a gift is to give the donee spouse security in her own home. Unfortunately he concluded that it was not "for the maintenance" of the other party, it was to give the other party security. With respect, this can hardly be right, because "security" and "maintenance" are not alternatives. It is because the gift gives the spouse security that it is for her maintenance. But it will now be necessary to appeal to the Upper Tribunal to establish this point.

A gift which is within s.11 IHTA (Disposition for family maintenance) is outside the scope of the GWR rules. For such a disposition is not a transfer of value; so it is deemed not to reduce the transferor's estate: s.3 IHTA. So by implication it must be treated as not being a "disposal by way of gift". (Any other conclusion would lead to absurd results. For a disposition between spouses within s.11 is not a transfer of value, and so not within the IHT spouse exemption, and so would come within the

[11] "Marriage" is defined to include a former marriage in certain cases: s.11(6) IHTA.

[12] I mention for completeness the further relief in s.11(3) which overlaps with s.11(1). In practice an inter-spouse gift which qualifies under s.11(3) will also qualify under s.11(1).

[13] It would be different if the purpose of the gift was not to provide for the spouse but some other purpose, such as IHT planning.

[14] Lump sum payments can constitute "maintenance". Contrast s.2(1)(b) Inheritance (Provision for Family and Dependants) Act 1975 (formerly s.1(4) Inheritance (Family Provision) Act 1938) which states that lump sum payments may constitute "maintenance" for the purpose of the Act. This is also assumed in sch 15 para 10(1)(d) FA 2004 (which takes gifts within s.11 out of the pre-owned assets rules).

[15] [2007] STC (SCD) 328.

GWR rules even if both spouses were UK domiciled.)[16]

The normal expenditure exemption (s.21 IHTA) may also be in point. Gifts which qualify for this exemption are still within the reservation of benefit rule.

93.5 Transferable nil-rate band

93.5.1 *The two nil-rate bands*

For deaths from 6 April 2017, we have two distinct nil-rate bands:
(1) The General Nil-rate band (GNRB)
(2) The Residence Nil-rate band (RNRB)

See too 114.8 (Nil-rate band and DTAs).

93.5.2 *General nil-rate band*

Section 8A(1) IHTA provides:

> This section applies where—
> (a) immediately before the death of a person (a "deceased person"), the deceased person had a spouse or civil partner ("the survivor"), and
> (b) the deceased person had unused nil-rate band on death.

Section 8A(2) IHTA defines "unused nil-rate band on death":

> A person has unused nil-rate band on death if M > VT where—
> M is the maximum amount that could be transferred by a chargeable transfer made (under section 4 above) on the person's death if it were to be wholly chargeable to tax at the rate of nil per cent. (assuming, if necessary, that the value of the person's estate were sufficient but otherwise having regard to the circumstances of the person); and
> VT is the value actually transferred by the chargeable transfer so made (or nil if no chargeable transfer is so made).

The amount of the unused nil-rate band depends on the amount of the chargeable transfer on the death of the first spouse. If there is no chargeable transfer, the full nil-rate band is unused and is transferable.[17]

[16] If my view were wrong the further anomaly would arise that gifts of qualifying investments to charity would fall within the scope of GWR, because such gifts fall within s.12 IHTA and not s.102(5)(d) FA 1986; but it is not necessary to pursue that here.

[17] Section 8A(3)(4) IHTA.

93.5.3 *Transfer of GNRB non-dom spouse*

The IHT Manual provides:

> **IHTM43042 Domicile of first spouse or civil partner to die** [Sep 2018]
> Every person, UK domiciled or not, is entitled to the full nil rate band to be set against their estate that is subject to IHT.
> The availability of TRNB on the estate of the first to die of a non domiciled spouse or civil partner is calculated only by reference to property that is potentially subject to an UK IHT charge. For a non domiciled spouse or civil partner, **VT** [IHTM43020] will be calculated only by reference to their estate in the UK. Assets held outside the UK, by a person not domiciled, or deemed domiciled in the UK, regardless of the devolution of those assets are not taken into account when calculating the available unused nil rate band.
> Thus where the survivor dies in the UK and their spouse or civil partner, who held no UK assets, died domiciled abroad leaving all their overseas assets to their children, none of the nil rate band was used on the first death. The personal representatives of the survivor may claim to transfer 100% of the nil rate band to the estate of the survivor.
> *Example*[18] (Abdul, Soroya and Jamil)
> A [died] domiciled abroad.
> His only asset situated in the UK was a US dollar account containing US$250,000.
> He left this and the remainder of his estate to his son, J who lives in the UK.[19] After the death, his wife, S, moved to the UK to live with J and died domiciled in the UK.[20]
> The assets situated outside the UK are not liable to IHT.
> The US dollar account is left out of account [IHTM04380] in determining A's estate at death.[21]
> So although the whole estate passed to J, no property was chargeable to IHT, leaving the nil rate available for transfer in full on S's death..

The next section needs to be amended to reflect the increase in the limit

[18] The HMRC example, as is the current trend, contains several facts which are wholly irrelevant to the tax position which makes it harder to identify the relevant points. The following footnotes identify these.

[19] Where the son lives, and where he is domiciled (which may not be the same) are irrelevant to the example.

[20] Where the widow lives and where she dies domiciled, are irrelevant to the example.

[21] See 76.13 (Foreign currency account). It must be assumed that A is non-resident as well as non-domiciled at the time of his death.

for the restricted spouse exemption and the possibility of an IHT spouse election; but it still illustrates relevant points.

> **IHTM43043 calculation where the domicile of the survivor at the first death is outside the UK** [Sep 2018]
>
> On the death of a first spouse or civil partner who was domiciled in the UK, exemption for assets passing to the surviving spouse or civil partner will be limited by IHTA84/S18(2) to £55,000 for transfers before 6 April 2013, and the applicable nil-rate band for transfers on or after this date, if the surviving spouse or civil partner was not domiciled or deemed domiciled in the UK. (IHTM11033)
>
> If the entire estate passed to the surviving spouse or civil partner, anything over the S18(2) limit is a chargeable legacy. Where the net estate is above the nil rate band plus the S18(2) limited exemption there will be no nil rate band to transfer, as illustrated below.
>
> **Example**
>
> Susan died on 1 June 2008, domiciled in the UK. She left an estate worth £450,000 all to her husband Lars who is domiciled in Sweden.
>
> **Unused nil rate band calculation**
>
> **M** = £312,000
>
> **VT** = £395,000 (Estate of £450,000 less limited spouse exemption of £55,000)
>
> **M** is not greater than **VT**, so there is nothing to transfer.
>
> Where the net estate is less than the nil rate band plus the S18(2) limit, there will still be an amount of nil rate band available to transfer. The following example shows how both the amount that the net estate is below the nil rate band, and limited spouse exemption, combine to produce the amount of nil rate band available to transfer.
>
> **Example**
>
> Charles died on 1 October 2014, domiciled in the UK. He left an estate worth £520,000 all to his wife Helga who is domiciled in Sweden.
>
> **Unused nil rate band calculation**
>
> **M** = £325,000
>
> **VT** = £195,000 (Estate of £520,000 less limited spouse exemption of £325,000)
>
> **M** is greater than **VT** by £130,000
>
> **Transferable nil rate band calculation**
>
> **E** =£130,000
>
> **NRBMD** = £325,000 so
>
> (130,000 ÷ 325,000) × 100 = 40.0000%
>
> On Helga's death, the nil rate band on her death would be uprated by 40%. This approach will be appropriate on the death of the survivor

when either

- they remain domiciled abroad and their UK assets exceed the single nil rate band, or
- between the first death and their own, they became domiciled or deemed domiciled in the UK.

However, if Helga elects to be treated as if she is domiciled in the UK (IHTM13040) under the provisions of IHTA84/S267ZA and S267ZB from a date before Charles's death, the limit on the amount of spouse exemption will not apply and the nil rate band on her death would then be uprated by 100%.

93.6 Residence Nil-rate Band

93.6.1 *Tapered withdrawal of RNRB*

There is a tapered withdrawal of the residence nil-rate band for estates over £2 million. The withdrawal rate of £1 for every £2 over this threshold.

Section 8D(5) IHTA provides:

> (g) the person's "adjusted allowance" is—
> (i) the person's default allowance, less
> (ii) the amount given by—
> (E −TT) ÷ 2
> but is nil if that amount is greater than the person's default allowance.

The key terms are E (**E**state) and TT (**T**aper **T**hreshold).

TT is a fixed sum: £2m (+ indexation): s.8D(5)(b)(c) IHTA.

Section 8D(5)(d) IHTA provides:

> E is the value of the person's estate immediately before the person's death.

Excluded property is not part of a person's estate immediately before death[22] so does not reduce the the RNRB.

93.6.2 *Withdrawal of transferable RNRB*

Section 8G(5) IHTA provides for taper of transferable RNRB

> If the value ("RPE") of the related person's estate immediately before the related person's death is greater than £2,000,000, the amount treated under subsection (4)(a) as available for carry-forward is reduced (but not

[22] 1See 74.2 ("Estate").

> below nil) by—
> (RPE – £2,000,000) ÷ 2

For the same reason, excluded property will not reduce the transferable RNRB.

93.7 Gift of BPR/APR property to spouse

This section considers a gift of property qualifying for 100% business or agricultural property relief from a UK domiciled individual to their non-UK domiciled spouse. It is necessary to consider IHT on the gift and the gift with reservation rules. For convenience I refer to business property but similar rules govern agricultural property.

93.7.1 *IHT on gift*

In the normal case of a gift of property qualifying for 100% BPR, the value transferred by the gift is nil. However, s.113A IHTA provides:

> **Transfers within seven years before death of transferor**
> (1) Where any part of the value transferred by a potentially exempt transfer which proves to be a chargeable transfer would (apart from this section) be reduced in accordance with the preceding provisions of this Chapter, it shall not be so reduced unless the conditions in subsection (3) are satisfied.

The conditions which must be satisfied are set out in subsection (3):

> The conditions referred to in subsections (1) and (2) above are—
> (a) that the original property was owned by the transferee throughout the period beginning with the date of the chargeable transfer and ending with the death of the transferor; and
> (b) except to the extent that the original property consists of shares or securities to which subsection (3A) below applies that, in relation to a notional transfer of value made by the transferee immediately before the death, the original property would (apart from s.106 above) be relevant business property.

In brief, BPR is lost unless the property is retained by the donee for seven years. (There is an exception for replacement property which is not discussed here.)

93.7.2 *GWR if donor survives 7 years*

What about GWR? The position varies according to whether or not the donor survives seven years from the gift.

If the donor does survive seven years then s.113A has no application. By subsection (1) it applies to a PET *which proves to be a chargeable transfer*. If the donor survives seven years then the PET does not "prove to be a chargeable transfer". Accordingly the value transferred by the gift remains at nil. The gift therefore normally qualifies as an exempt transfer under:

(1) s.20 IHTA (small gifts); or
(2) s.18 IHTA (IHT spouse exemption).

The gift therefore falls outside the scope of the GWR rules by virtue of s.102(5) FA 1986.

The principle applies to:

(1) outright gifts of 100% BPR property whether or not to spouses;
(2) gifts to trusts under which the spouse has an interest in possession even if such gifts are not "outright gifts" (but consider s.102(5A)).

It does not matter that the property is sold or disposed of by the donee within the seven years as long as the donor has survived seven years. Section 113A(7A) IHTA provides:

> The provisions of this Chapter for the reduction of value transferred shall be disregarded in any determination for the purposes of this section of whether there is a potentially exempt or chargeable transfer in any case.

This is irrelevant because the disregard is only for the purposes of s.113A, not for the purposes of ss.18, 20 IHTA and s.102 FA 1986.

93.7.3 *GWR if donor dies in 7 years*

The position is different if the donor dies within seven years. Suppose:

(1) H (UK domiciled) gives 100% BPR property to W (foreign domiciled);
(2) H dies within seven years;
(3) The conditions in s.113A(3) are not satisfied (for instance the property has been sold[23] or disposed of by the donee).

In that case the value transferred is *not* reduced: s.113A(1). It is considered that the disallowance of BPR applies for all purposes of IHT. So the gift falls outside the protection of ss.18 and 20 IHTA (assuming the

[23] Though there is a possibility of reinvestment relief in this case: see s.113B IHTA.

value transferred exceeds the nil-rate band limit and £250 respectively) and the GWR provisions can in principle apply.

It is impossible to believe anybody actually thought through these rules at the time the legislation was enacted. But these are the consequences of the words used and the result, if a little complicated, is relatively sensible.

93.8 Divorce settlement

Suppose:

(1) H transfers assets to W in order to settle a divorce claim, and
(2) The disposition falls outside the IHT spouse exemption.[24]

No IHT charge arises. First, the disposition is not a transfer of value, if made under court order.[25] Secondly, s.10 IHTA provides:

> **Dispositions not intended to confer gratuitous benefit**
> (1) A disposition is not a transfer of value if it is shown that it was not intended, and was not made in a transaction intended, to confer any gratuitous benefit on any person and either—
> (a) that it was made in a transaction at arm's length between persons not connected with each other, or
> (b) that it was such as might be expected to be made in a transaction at arm's length between persons not connected with each other.

H does not normally intend to confer any "gratuitous benefit" on W. (Assume the divorce settlement is negotiated at arm's length.) Accordingly the disposition falls within s.10 IHTA and is not a transfer of value for IHT purposes.

There is a theoretical HMRC argument that the condition in s.10(1)(b) IHTA is not satisfied. The argument would be that a divorce settlement cannot be "such as might be expected to be made in a transaction at arm's length between persons not connected with each other" since persons not connected with each other would not be in a divorce situation. In my view this argument is not correct. It is the old question of how far one carries the deeming.[26] The argument carries it too far because it reaches a

[24] This may be because H is UK domiciled and W is not; or because the transfer is made after the marriage is dissolved.

[25] See *McCutcheon on IHT* (7th ed., 2017), para 2.35. Relief may also be available under s.11 IHTA; see 93.4 (Disposition for maintenance of spouse).

[26] See App 8.2 (Deeming provisions: Construction).

conclusion which does not fit in with the scheme of the IHTA. IHT Manual (while not explicit) suggests that HMRC do not take the point.[27]

93.9 Spouse gift: Associated operations

For the background law, see 74.16.1 (Channelling). The IHT manual provides:

> **IHTM14833 Gifts between spouses or civil partner** [Sep 2018]
> Where property
> - given unconditionally by one spouse or civil partner (IHTM11032) to the other is
> - subsequently transferred by the latter to a third party,
>
> you cannot use the associated operations provisions to attribute the transfer to the first spouse or civil partner.
> The Chief Secretary to the Treasury assured Parliament that this would be HMRC's practice,[28] and it was publicised in a Press Release dated 8

[27] IHTM04165 [September 2008]: "Dispositions made on divorce or dissolution of a civil partnership for the benefit of a former spouse or civil partner, whether under a Court Order or as a result of arm's length negotiations, are normally within s.10 IHTA 1984."

[28] Lord Barnett, then Chief Secretary to the Treasury, said (Hansard HC Deb, 10 Mar 1975, vol 888 col 56):

> "... it is reasonable for a husband to share capital with his wife when she has no means of her own. If she chooses to make gifts out of the money she has received from her husband, there will be no question of using the associated operation provisions to treat them as gifts made by the husband and taxable as such.
> In a blatant case, where a transfer by a husband to a wife was made on condition that the wife should at once use the money to make gifts to others, a charge on a gift by the husband might arise under the clause..."

But the conditional gift would not qualify for the IHT spouse exemption.

> "I want to give an example of certain circumstances that could mean the clause having to be invoked. There are complex situations involving transactions between husband and wife and others where, for example, a controlling shareholder with a 60% holding in a company wished to transfer his holding to his son. If he gave half to his son, having first transferred half to his wife, and later his wife transferred her half share to the son, the effect would be to pass a controlling shareholding from father to son. The Revenue would then use the associated operations provisions to ensure that the value of a controlling holding was taxed."

But this overlooks s.161 IHTA (related property).

> "There are ordinary, perfectly innocent transfers between husband and wife. For example, where a husband has the money and the wife has no money—or the other way round, which happens from time to time—and the one with the money gives something to the other to enable the spouse to make a gift to a son or a daughter on

April 1975.[29]

93.10 Non-dom spouse: IHT planning

93.10.1 *Gift to non-dom spouse*

A simple short- and medium-term course is:

(1) the UK domiciled spouse should give assets to their foreign domiciled spouse absolutely;

(2) the foreign domiciled spouse keeps the assets in a form where remain excluded property (in short, non UK situate).

The gift may be a PET but that may not in practice be a serious concern. If the reservation of benefits rule applies, however, this effectively neutralises any tax saving. Indeed it may make the position worse. See 78.19 (GWR on death: Spouse exemption). This often makes simple gifts impractical.

93.10.2 *Gift to spouse + gift to trust*

A longer term approach may be:

(1) the UK domiciled spouse gives assets to their foreign domiciled spouse; and

(2) the foreign domiciled spouse subsequently gives the assets to a settlement.

In principle the property in the settlement may be excluded property. One advantage of this is if the donee spouse later becomes UK domiciled. [30]

> marriage, that transaction would not be caught by the clause. It would be a reasonable thing to do."

But there is no mention of reasonableness in the associated operations rules, and the IHT Manual does not seek to read it in.

This illustrates one of the difficulties in relying on Hansard: the author was not familiar with the newly introduced CTT rules, and his answer would not have reached a pass standard in the CTA examination. However one can collect from the earliest times a strong inclination not to apply associated operations to inter-spouse transfers

[29] [1975] STI 191: "Section [286] is not seen as affecting the ordinary case where a gift between husband and wife is followed by a gift from the recipient spouse to a third party, unless it was a condition of the first gift that the second should be made. It may, however, be apt to apply in more complex situations where a transfer between husband and wife forms part of a series of associated operations, the effect of which as a whole are merely the means whereby one of them makes a disposition in favour of a third party."

[30] See 76.17.2 (Anticipation of UK domicile).

Another advantage is CGT planning. A third advantage is that this should avoid the gifts with reservation rule.[31] This arrangement only works if the UK domiciled spouse is not a settlor.[32]

93.11 CGT spouse exemption

Section 58 (1A) TCGA provides:

> If an individual ("A") disposes of an asset to another individual ("B") in circumstances where any of subsections (1B) to (1D) applies, A and B are to be treated as if B acquired the asset from A for a consideration of such amount as would secure that on the disposal neither a gain nor a loss would accrue to A.

I refer to this as the "**CGT spouse exemption**".

There are three circumstances where the spouse exemption applies. The first concerns spouses living together:

> (1B) This subsection applies where the disposal is made while A and B—
>
> (a) are married to, or are civil partners of, each other, and
>
> (b) are living together.[33]

FA 2023 has extended the exemption to cases of separation and divorce:[34]

> (1C) This subsection applies where the disposal is made—
>
> (a) while A and B are married to, or are civil partners of, each other,
>
> (b) at a time when A and B have ceased to live together, and
>
> (c) before the earlier of—
>
> (i) the last day of the third tax year after the tax year in which A and B ceased to live together, or
>
> (ii) the day on which a court grants an order or decree for A and B's divorce, the annulment of their marriage, the dissolution or annulment of their civil partnership, their judicial separation or, as the case may be, their separation in accordance with a separation order.

[31] See 78.16 (Gift to non-dom who creates trust).

[32] See 99.41 (Planning to create excluded property trust).

[33] See App 3.4.3 (Living together: married couple).

[34] This followed an OTS recommendation; see *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1037446/FINAL_FST_response_to_OTS.pdf*
It is not in fact a simplification, but it is an improvement, so one should not quibble.

> (1D) This subsection applies where—
> (a) 5A and B have ceased to be, or are in the process of ceasing to be, married to, or civil partners of, each other, and
> (b) the disposal of the asset is in accordance with an agreement or order within subsection (2)(a) or (b) of section 225B (disposals in connection with divorce etc).

The CGT spouse exemption applies regardless of the domicile of the spouses. It applies to sales at market value as well as gifts.

The relief does not apply to:

(1) Unmarried couples
(2) Married couples living apart after 3 years of separation

Section 58(2) TCGA provides two exceptions:

> This section shall not apply—
> (a) if until the disposal the asset formed part of trading stock of a trade carried on by the one making the disposal, or if the asset is acquired as trading stock for the purposes of a trade carried on by the one acquiring the asset, or
> (b) if the disposal is by way of donatio mortis causa [gift in anticipation of death][35]

Section 58(2) TCGA provides:

> ... but this section shall have effect notwithstanding the provisions of section 18[36] or 161 [appropriation to trading stock], or of any other provisions of this Act fixing the amount of the consideration deemed to be given on a disposal or acquisition.

93.12 Non-dom spouse: CGT

Suppose the UK domiciled spouse owns an asset which will give rise to a gain on a disposal. A simple course is:

(1) The UK domiciled spouse transfers[37] the asset to their foreign domiciled spouse.
(2) The foreign domiciled spouse may be in a position to sell the asset

[35] See 88.7.3 (Gift in anticipation of death).

[36] See App 4.10.9 (Deemed non-arm's length).

[37] The transfer may be a gift or a sale at market value. The latter avoids the IHT problems discussed at 93.2 (Restricted IHT spouse exemption) and 78.10 (GWR spouse exemption) but take care on implementation, especially s.58(2) TCGA. In the case of a sale the transferee spouse will need independent legal advice.

without CGT.[38]

The same may apply if one spouse claims the remittance basis and the other does not.

The same applies the other way if the asset will give rise to a loss on a disposal.

93.13 Non-resident spouse: CGT

Section 282 ICTA 1988, which also applied for CGT purposes, formerly provided (so far as relevant):

> *(1) A married woman shall be treated for income tax purposes as living with her husband unless ...*
>
> *(b) they are in fact separated in such circumstances that the separation is likely to be permanent.*
>
> *(2) Where a married woman is living with her husband and ...*
>
> *(a) one of them is, and the other is not, resident in the UK for a year of assessment ...*
>
> *the same consequences shall follow for income tax purposes as would have followed if, throughout that year of assessment, they had been in fact separated in such circumstances that the separation was likely to be permanent.*

The effect was that the CGT spouse exemption did not apply where one spouse was non-resident. This had two consequences:

(1) On a gift from a non-resident spouse to a UK resident spouse, the UK resident took the asset at its market value, which was (likely to be) an advantage

(2) On a gift from a UK resident spouse to a non-resident, the disposal was at market value which was (likely to) give rise to a charge to tax.

However s.282(2) was repealed in 1988, as part of the introduction of separate taxation for husband and wife. So now the CGT spouse exemption applies regardless of residence, provided they are "living together" or (in short) recently separated.

The CG Manual provides:

> **CG22300 NR spouse or NR civil partner** [Dec 2021]
>
> ... There is no longer any authority to treat a non-resident spouse as separated from a resident spouse merely because of their residence

[38] See 56.6 (Territorial scope of CGT).

> status. Similarly a non-resident civil partner may not be treated as separated from a resident civil partner merely because of their residence status.

The point is repeated in CG26060.

It follows that CGT planning by a transfer to non-resident spouses is not tax avoidance, in the strict sense: by repealing s.282(2) Parliament has accepted it.[39]

The temporary non-residence rules need to be considered.[40]

93.13.1 *CGT spouse exemption: Critique*

There is something to be said stopping CGT planning by a transfer from a UK resident to a non-resident spouse. There are various ways this may be done. The basic idea would be a rule that an inter-spouse gift should not qualify for the CGT spouse exemption if:

(1) The donor spouse ("H") was UK resident; and
(2) The donee spouse ("W") was non-resident

The IHT spouse exemption may be regarded as a precedent (ignoring the complication of spouse-election domicile).

One might supplement that with a further rule which also prevented the CGT spouse exemption if the gift was to W when UK resident but

(1) the gift was made in anticipation of W becoming non-resident; or
(2) a clawback if W becomes non-resident within (say) 6 years (a more objective rule, following the precedent of hold-over relief[41]).

[39] The position was different before 1988 when s.282(2) was in force. The pre-1988 law is of historic interest only, but the question of when use of non-resident status constitutes tax avoidance is as current as ever. On this point the pre-1988 case of *R v IRC ex p. Fulford-Dobson* 60 TC 168 remains of interest. The facts were:
(1) In 1980, W made a gift to H when he was UK resident (so the CGT spouse exemption applied)
(2) H became non resident and disposed of the gifted asset. Had H waited until the next tax year the planning would have succeeded. But the sale took place in the same tax year as the migration. H had to rely on ESC D2 (prior to the current split year rules, this concession provides CGT relief on a disposal during a non-resident part of a split year.)

The concession did not apply in cases of avoidance. And it was "plain as a pikestaff upon the facts that this was tax avoidance"; see p.179.

[40] In particular, the usual CGT relief for post-departure acquisitions does not apply. See 11.7 (Post-departure acquisitions).

[41] See 12.2 (Hold-over clawback: Emigration of individual).

As always, the trade-off rests between complexity and efficacy. But there is no reason to think this reform will happen.

93.14 Non-dom/non-resident spouse: IT

A simple course is:

(1) The UK domiciled spouse ("donor spouse") may give assets to their foreign domiciled spouse absolutely; and
(2) The foreign domiciled spouse may invest in foreign property giving rise to foreign investment income which is not remitted.

Similarly:

(1) A UK resident spouse ("donor spouse") may give assets to their non-resident spouse absolutely; and
(2) The non-resident spouse invests in property whose income is not subject to IT (foreign source or within the non-residents income tax exemption).

93.15 s.624 spouse exemption

An inter-spouse gift is a settlement-arrangement,[42] and in principle the settlor would be taxed under s.624 ITTOIA. However, s.626(1) ITTOIA provides relief:

> The rule in s.624(1) does not apply in respect of an outright gift—
> (a) of property from which income arises[43],
> (b) made by one spouse to the other or one civil partner to the other, and
> (c) meeting conditions A and B.

I refer to this as the **"s.624 spouse exemption"**.

There are (in short) three main conditions: outright gift, condition A and condition B.

This relief applies regardless of the residence and domicile of the spouses.

93.15.1 *Outright gift*

Section 626(4) ITTOIA provides:

[42] See 87.4 (Settlement-arrangement definition).

[43] The words "from which income arises" seems otiose, because if no income arises, s.624 cannot operate. But it explains the reference to "the income" in condition A.

> A gift is not an outright gift for the purposes of this section if—
> (a) it is subject to conditions, or
> (b) there are any circumstances in which the property, or any related property[44]—
> (i) is payable to the giver,
> (ii) is applicable for the benefit of the giver, or
> (iii) will, or may become, so payable or applicable.

In *Young v Pearce* the issue of shares at an undervalue was an outright gift:

> If the creation and allotment of the preference shares constituted a settlement, the subject-matter of which was the preference shares allotted to the wife of each of the taxpayers, it must follow that the allotment of the preference shares taken by each wife was an outright gift from which income (the dividends paid on the preference shares) arose.[45]

In *Jones v Garnett* the purchase of shares of an "off the shelf" company was an outright gift:[46]

> The Revenue say ... there was no gift of the share by Mr Jones to Mrs Jones. He never owned the share which she took. It belonged to the formation agents and Mrs Jones bought it from them for £1.
> It was Mr Jones's consent to the transfer of a share with expectations of dividend to Mrs Jones for £1 which gave the transfer the "element of bounty" for the purposes of [the settlor-interested trust code]. By the same token, I think it made the transfer a "gift" for the purposes of [what is now s.626(4)]. And there is no dispute that, if it was a gift, it was outright.

And again:

> Mr Jones did not actually make a transfer by way of gift to his wife of one of the two issued shares in Arctic. She bought it at par from the company formation agents. But it was not the sort of arrangement that would have been made between strangers dealing with each other at

[44] s.626(5) ITTOIA provides a referential definition: 'Related property' has the same meaning in this section as in s.625. See 47.6.2 ("Settlor-interested" for s.624").

[45] 70 TC 331 at p.345.

[46] [2007] UKHL 35 at [27] and [53]. For other aspects of this case, see App.2.2.6 (Identifying the arrangement).

> arm's length. Arctic was the chosen vehicle through which Mr Jones was to offer his valuable services as an IT consultant, and it was an act of bounty on his part to permit his wife to acquire half its equity for the nominal sum of £1. In my opinion that amounted to an outright gift of the share within the meaning of [what is now s.626(4)].

In strictness, I would have thought that a purchase of the share was an arm’s length transaction between Mrs Jones and the company formation agent vendors; and it was not “made by one spouse to the other”. The reader may think that both these cases have adopted a loose and generous reading. But it is purposive and sensible, avoids anomalies,[47] and the law is settled.

A dividend waiver is not an outright gift of property from which income arises.[48]

93.15.2 *Subject to conditions*

TSEM provides a straightforward example:

> **TSEM4205 outright gifts between spouses or civil partners** [Jul 2017]
>
> ...
>
> **Example 4 - outright gift**
>
> X owns a property that is let at a commercial rent to an unconnected third party. X transfers the property by outright gift to his spouse Y who then receives the rents. X has no further interest in or rights over the property. The rents that Y receives are not subject to the settlements legislation. They are Y’s income for tax purposes.

That is self-evident. The point is to set the scene for the next example.

> **Example 4a - no outright gift**
>
> The facts are as in example 4 but the gift is subject to an agreement under which X can require his spouse to return the property to him at a future date. This is a gift with conditions and there are circumstances in which the gifted property may return to the giver so it is not an outright gift. The rents that Y receives are subject to the settlements legislation.

[47] Mr Jones could have subscribed for the 2 shares himself, and then given one to his wife. Indeed, if he had been better advised, that is what he would have done. That would have more clearly been an outright gift made by one spouse to the other. But the end result is the same.

[48] This is self-evident, but if authority is needed, see *Donovan v HMRC* [2014] UKFTT 048 (TC) discussed at 99.19 (Dividend-waiver settlement).

They are X's income for tax purposes.

93.15.3 *Condition A*

Section 626(2) ITTOIA provides:

> Condition A is that the gift carries a right to the whole of the income.

This is otiose, as if the gift does not carry the right to the whole of the income, it is surely not an outright gift.

93.15.4 *Condition B*

Section 626(3) ITTOIA provides:

> Condition B is that the property is not wholly or substantially a right to income.

In *Young v Pearce*[49] a company owned jointly by A & B issued preference shares to the spouses of A and B, for a nominal £50.

The preference shareholders were entitled to:

(1) 30% of the dividends (if dividends were declared)
(2) on liquidation, repayment of the £50 subscribed for the shares
(3) to speak but not to vote at shareholder meetings

So apart from the right to income, the only rights were to repayment of the nominal £50 paid on the issue of the shares, to attend but not vote at shareholder meetings, and general shareholder rights such as the right not to be unfairly prejudiced. The rights attached to the preference shares were not wholly a right to income. But the rights were "substantially" a right to income.

Contrast an ordinary share. In *Jones v Garnett*:[50]

> ... the revenue say that the property given, i.e. the share, was "wholly or substantially a right to income". It is true that the value in the share arose from the expectation that it would generate income. But that is true of many shares, even in quoted companies. The share was not wholly or even substantially a right to income. It was an ordinary share conferring a right to vote, to participate in the distribution of assets on a winding up, to block a special resolution, to complain under [what is now s.994 CA 2006]. These are all rights over and above the right to income. The ordinary share is different from the preference shares in

[49] 70 TC 331.
[50] [2007] UKHL 35 at [30].

> *Young v Pearce*, which conferred nothing except the right to 30% of the net profits before distribution of any other dividend and repayment on winding up of the nominal amount subscribed for their shares. Those shares were substantially a right to share in the income of the company.

I would have said the Revenue argument was almost hopeless, but one judge found the point "rather difficult".[51]

See too 99.21.1 (Partnership with spouse).

93.16 Gift to spouse: s.720

A non-resident or non-domiciled individual is a "person abroad". A gift to a non-resident or non-dom spouse is (at least at first sight) a relevant transfer.[52] The transferor has "power to enjoy" the income of the "person abroad".[53] So (at least at first sight) the transferor (the donor spouse) is in principle taxed under s.720 ITA.

However RI 201 states that HMRC do not take this point:

> Unless transactions are part of a wider arrangement, Revenue practice is not to seek to assess a UK domiciled individual on the income of a non-UK domiciled spouse,[54] where that income
> [1] arises from a transfer of assets by that spouse and
> [2] would be outside the charge to tax under [s.720 ITA] by virtue of the provisions of [s.726 ITA, ToA remittance basis].

The INT Manual cites this and continues:

> **INTM600460 General Conditions: The Individual** [Jul 2023]
> In general (unless there are wider arrangements), HMRC will not use the transfer of assets legislation to charge tax on one spouse or civil partner in respect of the income arising to the other, where
> [1] that spouse or civil partner has made a transfer of assets
> [2] but is, for example, outside the charge because they are a remittance basis user.[55]

[51] at [56].

[52] See 48.3 ("Relevant transfer") and 48.5 ("Person abroad").

[53] See 48.18 (Spouses of individuals).

[54] Tax Bulletin 81 states (obviously) that the same practice applies to civil partners.

[55] For completeness, the INT Manual continues:

"In effect the general approach will be to apply the word individual (where the individual has a spouse or civil partner) in a way that is consistent with the individual who has the power to enjoy income of a person abroad, entitlement to a capital sum, or who receives a benefit as a result of relevant transactions. But it may

This confirms the practice in RI 201. RI 201 does not consider the case of a transfer to a non-resident donee spouse, but the same principle must apply, and that is also suggested by the words "for example" in the INT Manual.

Is this law or concession? The transferor may not mind if they are untaxed by law or concession, but the issue might arise:

(1) If HMRC change their practice, or argue that it does not apply in a particular case.

(2) Before a tribunal, which will apply the law and not a concession.[56]

It is considered that the practice is correct in law. An inter-spouse transfer is not a transfer of assets, for the purposes of the ToA rules, and so not a relevant transfer. References to an individual include the spouse,[57] and one cannot transfer an asset to oneself. This is consistent with the purpose of the deeming provision: In the age of independent taxation, it is not likely to be the intention of parliament to tax the donor spouse on a straightforward inter-spouse transfer.

be equally valid in this context to use the term in a way that is consistent with an individual who, by means of relevant transactions, seeks to avoid a liability to income tax.

Where spouses or civil partners are in some way connected with relevant transactions and the results of such transactions, regard will be had to the particular facts where the extended meaning of individual may impact upon the potential charge.

Example

Mrs A is UK resident but not UK domiciled and is also a remittance basis user. She is married to Mr A, who is both UK resident and domiciled.

Mrs A has owned foreign investments for a number of years and she decides to transfer these investments to an overseas company in exchange for shares in the offshore company. Mrs A is a remittance basis user who, although potentially liable to tax on the income of the overseas company under ITA07/S720, will not be liable unless the income of the company is remitted to the UK.

As the relevant transfer is not part of a wider arrangement and Mr A does not have the power to enjoy the income of the overseas company, HMRC would not seek to assess him under ITA07/S720 as the spouse of Mrs A."

[56] The motive defence may also be in point, but no-one expects the transferor to claim the motive defence in their tax return.
This issue might arise in the context of divorce, where the spouses would need to ascertain their potential tax liabilities, as both transferor and transferee are potentially liable, if the ToA rules apply; but in practice the issue is not likely to cause concern.

[57] See 48.18 (Spouse of transferor).

93.17 Gifts to spouse: GAAR

GAAR example D19[58] is not is not precisely on-topic, but it does support the view that inter-spouse transfers discussed in this chapter are not within the scope of the GAAR.

[58] See 88.5.5 (Rebasing on death: Planning).

CHAPTER NINETY FOUR

JOINT ACCOUNTS

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94.1 Introduction

This chapter considers a joint bank or building society account held by two account holders. I refer to money in the account as “account money”.

I consider the following topics:

(1) IHT on payments in and out of the account
(2) Who is the settlor on a payment from the account to a trust
(3) Taxation of income arising from the account
(4) Remittances from the account

94.2 Property law background

First one must ascertain the rights of the account holders. It would need a chapter to analyse the relevant case law.[1]

[1] For a summary see *Dymond’s Capital Taxes* (looseleaf), para 10.400; Law Commission, “Cohabitation: the financial consequences of relationship breakdown” Law Com No 307 (2007), para A.46

There is an important distinction between:

(1) an account on which a transfer can be made by either account holder
(2) an account on which a transfer needs the approval of both account holders

This chapter only considers the first type of account.

In outline, three distinct questions arise:

(1) *Beneficial ownership of the account money while in the account*. The possibilities are:
    (a) Entitlement in equal shares (the most common case)
    (b) Entitlement in proportion to contributions and withdrawals[2]
    (c) One account holder beneficially entitled to the whole
(2) *Beneficial ownership of money withdrawn from the account* (or assets purchased with that money). The possibilities are:
    (a) Individual who withdraws funds becomes beneficial owner (the most common case)[3] or

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/228881/7182.pdf
Further consideration is needed for an account not governed by English law; but an English court will assume English law principles apply in the absence of evidence to the contrary, see 90.60.2 (UK law assumed to apply). I expect English law/common law principles apply in most common law jurisdictions; eg in Ireland, Lynch v Burke ITR Vol 5, p.271.

[2] In practice the court will assume this is not the case unless there is evidence, such as appropriate records kept by the account holders. *Sillars v IRC* [2004] STC (SCD) 180 at [11] gives cogent reasons for rejecting this analysis for the parent/child account.

[3] See *Re Bishop* [1965] Ch 450 at p.456:

> “Where a husband and wife open a joint account at a bank on terms that cheques may be drawn on the account by either of them, then, in my judgment, in the absence of facts or circumstances which indicate that the account was intended, or was kept, for some specific or limited purpose, each spouse can draw upon it not only for the benefit of both spouses but for his or her own benefit. Each spouse, in drawing money out of the account, is to be treated as doing so with the authority of the other and, in my judgment, if one of the spouses purchases a chattel for his own benefit or an investment in his or her own name, that chattel or investment belongs to the person in whose name it is purchased or invested: for in such a case there is, in my judgment, no equity in the other spouse to displace the legal ownership of the one in whose name the investment is purchased. What is purchased is not to be regarded as purchased out of a fund belonging to the spouses in the proportions in which they contribute to the account or in equal proportions, but out of a pool or fund of which they were, at law and in equity, joint tenants. It also follows that if one of the

   (b) Same as beneficial ownership of the account money (as to which see above)
(3) *Beneficial ownership of account money after death of an account holder.* The possibilities are:
   (a) The survivor is beneficially entitled by survivorship
   (b) The deceased owner's share (as to which see (1) above) passes under their will or intestacy

The answer to one of these questions does not determine the answers to the others. For instance, account money may belong beneficially to one of the account holders, eg H and W may hold as nominees for H. Such an account may be held on terms that:
(a) on the death of H, the account money passes to W by survivorship;[4] or
(b) the account money may pass under the will of H.

The permutations are almost endless. Note that joint tenancy/tenancy in common is not a comprehensive categorisation since those two terms alone are insufficient to determine the answers to the three questions which may arise.

The property law position depend on the account documentation. That should answer the question, but if it does not, the position depends on the intention of the account holders.[5] In practice spouses and cohabitees generally operate joint accounts without giving any consideration to the ownership of the money; there is just a general desire to pool resources. A search for intention is unrealistic.

Account documentation can vary, as can the intentions of account holders, but the usual position is that:
(1) Account money is beneficially owned in equal shares
(2) Withdrawals belong to the account holder who withdraws the funds
(3) Beneficial ownership passes by survivorship

spouses draws on the account to make a purchase in the joint names of the spouses, the property purchased, since it is purchased in joint names, is, prima facie, joint property and there is no equity to displace the joint legal ownership. There is, in my judgment, no room for any presumption which would constitute the joint holders as trustees for the parties in equal or some other shares."

[4] As in the parent/child joint account *O'Neill v IRC* 1998 STC (SCD) 110; the apparent breach of the Wills Act 1837, and the possibility that this is a settlement for IHT, are tacitly ignored.

[5] *Whitlock v Moree* [2017] UKPC 44.

I refer to this as a "**common form account**".

The circumstances in which parent/child joint accounts arise are different so the rights of the account holders tend to be different. For instance, the terms of the account may be that:

(a) One account holder ("P") may withdraw up to the whole amount of P's benefit and the others may make no withdrawal at all during P's lifetime.

(b) The balance may pass to the survivor by survivorship.[6]

In this case the fund is in the estate of P for IHT purposes. The funds are not in the estate of the other account holder during the life of P: their rights have no substantial value.

The following analysis applies to a common form account.

Further consideration is needed if one account holder has lost legal capacity.[7]

94.3 Joint account: IHT

94.3.1 *Account in both a/c holders estates*

In strict law the *whole* of the account money is in the estate of *both* account holders, under s.5(2) IHTA which provides:

> A person who has a general power which enables him... to dispose of any property other than settled property, ... shall be treated as beneficially entitled to the property ... and for this purpose "general power" means a power or authority enabling the person by whom it is exercisable to appoint or dispose of property as he thinks fit.[8]

[6] This was found to be the case on the facts in *Sillars v IRC* [2004] STC (SCD) 180.

[7] Office of the Public Guardian, "Manage a bank account for someone else" provides:
"If one joint account holder loses mental capacity, banks and building societies can decide whether or not to temporarily restrict the use of the account to essential transactions only (for example, living expenses and medical or residential-care bills) until a deputy has been appointed or a power of attorney registered."
https://www.gov.uk/government/publications/deputy-and-attorney-guidance-dealing-with-banks/manage-a-bank-account-for-someone-else-web-version (May 2023)
I find that somewhat surprising, but it may depend on the documentation of the account.

[8] This was accepted without discussion in *IRC v Melville* EWCA Civ 1247 at [36]:
"... the inheritance tax regime produces instances of double taxation ... A clear example is one falling within s 5(2) of the Act, the very common case of a joint bank account which permits any holder to draw on that account. The same property, the

Beneficial ownership is therefore irrelevant for IHT and GWR is irrelevant on death of an account holder.

94.3.2 *Account holder pays into joint a/c*

Payment into the joint account by an account holder is not a transfer of value because the estate of the payor is not decreased by the payment. HMRC agree. The IHT Manual provides:

> **IHTM15043 Lifetime gifts arising out of a transfer of an account into joint names** [May 2020]
> If A places money in a joint account (IHTM15042) in the names of A and B as joint tenants (IHTM15082) and retains the right to withdraw the whole of it, as a general rule there will not be a lifetime transfer (IHTM15060) at the time the money is paid into the account. ...

Payment into the joint account by an account holder is not a GWR. HMRC do not accept that[9] but in practice GWR does not often matter.

94.3.3 *Death of account holder*

Each account holder is strictly subject to IHT on death on the whole of the account money (subject to exemptions such as the spouse exemption). This rule would result in double taxation but that is undone by concession.

moneys in the account, is under s 5(2) taxable on the death of each holder. The Revenue in practice do not strictly enforce that provision and treat each holder as beneficially entitled only to the proportion of monies in the account which he has contributed."

[9] The IHT Manual is garbled; so far as relevant it provides:

> **"IHTM15061 Gifts with reservation** [May 2020]
> An example of a joint ownership arrangements involving a GWR is ... if ... A transfers ... a joint money account into joint beneficial ownership of himself and his son, and then A either
> - receives (or has the right to receive) all the ... interest for his own benefit or
> - has the right to withdraw all the money in the joint account for his own benefit."

Possibly the Manual means to say that there is a GWR if A transfers *his money* into a joint account and has the right to withdraw all the money. This view is supported by *Sillars v IRC* [2004] STC (SCD) 180 (where the taxpayer was not represented by counsel). But it is considered that a payment into an account of this kind is not a disposal by way of gift. If it were a GWR, many difficulties arise which the Tribunal did not consider in *Sillars*. On the death of A, however, since the property is in the estate of the individual, it does not matter whether payment into the account was a GWR.

The IHT Manual provides:

> **IHTM15042 Joint money accounts** [Dec 2021]
> Applying the Inheritance Tax provisions (IHTM15012) to joint accounts can be particularly difficult. In practice:
>
> - You should normally regard each account holder as beneficially entitled (IHTM15011) to the proportion of the account which is attributable to their contributions. So - if the deceased provided the whole of the money, the whole of the account at death should be included in the IHT400 (IHTM10021)
> - When calculating this proportion you should assume that any money withdrawn by each person should be set as far as possible against their own contributions, despite the rule in *Clayton's Case* [1816] 1 Mer 572
> - You may want to make enquiries about any withdrawals made from funds the deceased provided by the other joint owner(s) as these are likely to be lifetime transfers (IHTM15043). You should pay particular attention to joint accounts opened shortly before the death.
> - In most cases each joint owner has an unrestricted right to withdraw any part of the amount in credit in the account and keep the funds for their own use (for example, see *Re Bishop* [1965] Ch 450). *You should not use the fact that this right exists to argue that tax is due (for example, by referring to the definition of 'property' in IHTA84/S272 or the 'general power' provision in IHTA84/S5(2)) on a share of the account that is greater than the share provided by the joint owner.*
> - When establishing the share based on the deceased's contributions you should note that the true legal position is far from clear so it is important to establish the facts and obtain any relevant documents, such as application forms, withdrawal mandates, passbooks, terms and conditions of account before considering the legal and equitable rules...

94.3.4 *IHT spouse exemption on death of a/c holder*

This section considers the IHT spouse exemption on the death of an account holder. For the IHT spouse exemption generally see 76.5.1 (IHT spouse exemption).

There are two possibilities:

(1) The account holders may not qualify for the spouse exemption because:

(a) They are married but one is, and one is not, UK domiciled.[10] (This scenario is closest to the themes of this book, but one cannot examine it in isolation from the others.)
(b) They are cohabitees.
(c) There is some other unmarried relationship, such as parent and child.

(2) The account holders may qualify for the IHT spouse exemption.

In the second case, the IHT spouse exemption applies to the transfer of value on the death of an account holder. HMRC agree. The IHT Manual passage continues:

> Refer to TG (IHTM01081) any case in which the parties dispute the claim. However, there is no need to refer if the deceased's interest passes to an exempt beneficiary, such as a surviving spouse or civil partner (IHTM11032). You should also avoid questions and arguments on this subject unless the amount of tax at stake is substantial.

This is correct, though it needs a slightly purposive construction to say that property "becomes comprised" in the estate of the surviving spouse when the property is already in that estate.

94.3.5 *One a/c holder pays in, other withdraws*

Suppose:
(1) A transfers A's money into the joint account held by A and B and
(2) B withdraws that money into B's own name.

A's estate is reduced at stage (2).

A does not make a transfer of value at stage (2) within the normal definition, in s.3(1) IHTA, as that requires a disposition.[11] A does not make a disposition.

One might think that A makes a transfer of value by omission under s.3(3) IHTA.[12] This provides:

> Where the value of a person's estate is diminished, and the value—
> (a) of another person's estate ...
> is increased by the first-mentioned person's omission to exercise a right,

[10] In this section I ignore the limited IHT spouse exemption and spouse election rules.

[11] See 74.3 (Transfer of value/value transferred).

[12] See 74.5 (Omission: Deemed disposition).

> he shall be treated for the purposes of this section as having made a disposition at the time (or latest time) when he could have exercised the right ... .

But the value of the estate of B, the account holder who withdraws the funds, is not increased, so s.3(3) does not apply.

However, s.272 IHTA provides an extended definition of "disposition":

> "disposition" includes a disposition effected by associated operations;

It is considered that A makes a disposition (and hence a transfer of value) by associated operations at stage (2). The associated operations are:
(1) A's payment into the account
(2) B's withdrawal from the account[13]

HMRC agree. The IHT Manual provides:

> **IHTM15043 Lifetime gifts arising out of a transfer of an account into joint names** [May 2020]
> If A places money in a joint account (IHTM15042) in the names of A and B as joint tenants (IHTM15082) and retains the right to withdraw the whole of it, as a general rule there will not be a lifetime transfer (IHTM15060) at the time the money is paid into the account. But if any part is subsequently withdrawn for the benefit of B, the other joint owner, there may be a transfer at that time.
> Refer to Technical any case where
> - a withdrawal of this kind has been made
> - it is claimed that there was an immediate gift when the money was paid into the joint account
> - there is evidence that an immediate gift was intended, or
> - the position is more complicated - for example where withdrawals need both signatures
>
> **(This content has been withheld because of exemptions in the Freedom of Information Act 2000)**
> **IHTM15042 Joint money accounts** [May 2020]
> ...You may want to make enquiries about any withdrawals made from funds the deceased provided by the other joint owner(s) as these are likely to be lifetime transfers (IHTM15043). You should pay particular attention to joint accounts opened shortly before the death.....

[13] See 74.11 ("Associated operation") and 74.16 (Transfer of value by 2 operations). It might be argued that the associated operation is A's omission to withdraw from the account; it makes no difference if this is the case.

94.3.6 *IHT spouse exemption on withdrawal*

The IHT spouse exemption may apply to the transfer of value on the lifetime withdrawal by an account holder. Since HMRC accept the application of the spouse exemption on death, they must also accept its application during the lifetime of the account holders.

The exemption does not of course apply when one spouse is and the other is not UK domiciled because the IHT spouse exemption is restricted. The transfer of value takes place when the funds are withdrawn from the account so that is the point where the conditions for the spouse exemption need to be satisfied. For instance if:

(1) Year 1: H makes a payment into the joint account
(2) Year 2: W makes a payment from the joint account

The IHT spouse exemption applies if the conditions for the exemption are satisfied in Year 2. It does not matter whether or not they are satisfied in Year 1.

94.3.7 *One a/c holder pays in & withdraws*

Suppose:
(1) A transfers A's money into the joint account held by A and B.
(2) A withdraws that money into A's own name.

A does not make a transfer of value. What about B? B's estate is reduced at stage (2). But it is considered that B makes no transfer of value. Section 3(3) IHTA does not apply.[14] It might be said that B makes a transfer of value by associated operations, but although B makes an omission, which is an associated operation, B does not make a transfer of value by associated operations, since he does not make a disposition. That is consistent with the policy of s.3(3) IHTA.

94.3.8 *Third party pays in*

The discussion above assumes that the account money is provided by one or both account holders.

Suppose:
(1) A third party ("C") transfers C's money into a joint account held by A and B.
(2) A dies.

[14] See 94.3.5 (1account holder pays in and other withdraws).

In strictness A is taxed on the whole account, but by concession it appears that A is taxed on half. The IHT Manual provides:

> **IHTM15042 Joint money accounts** [May 2020]
> *Example*
> A, B and C share a joint account. They all contribute to it. A dies and his proportion of the account passes by survivorship to B and C. After A's death, the entitlement of B and C should take into account A's contributions.
> **(This content has been withheld because of exemptions in the Freedom of Information Act 2000)**

Presumably this means that after A's death, B and C are each regarded as entitled to (1) their own contributions to the account and (2) half of the contribution of A.

Suppose:

(1) A third party transfers their money into a joint account held by A and B and
(2) A withdraws that money into A's own name.

It is considered that B does not make a transfer of value; see 94.3.7 (One a/c holder pays in, other withdraws).

94.3.9 *Gift from account*

If B draws on the account to make a gift to a third party donee, B makes a transfer of value.

If A had paid the account money into the joint account A has also made a transfer of value by associated operations at the time of B's withdrawal.[15] But that is not the case if B, or a third party, has provided the funds. Thus the gift by B gives rise to two transfers of value, a transfer of value by A and a transfer of value by B. It may be in practice HMRC would allow some concession.

94.4 Trust from joint account: Who is settlor

If a trust is created by a payment from a joint account, it is considered that the account holder who writes the cheque or makes the transfer is the settlor. The other account holder is only the settlor if they have provided

[15] A does not make a transfer of value under s.3(3) IHTA because although the estate of the third party donee is increased, it is not increased by any failure to exercise a right. But A does make a transfer of value by associated operations.

the property indirectly for the settlement, which requires some element of arrangement; see 99.7 (A gives to B, B gives to trust).

But STEP CRS guidance provides:

> 1.4 ... an alternative scenario where (C) and (D) are joint settlors. For example, it may not be uncommon for a husband and wife to make a transfer of assets to a trust for their children and wider family. If, in these circumstances, C and D contribute assets to the trust from assets that they hold jointly, then it would be fair to regard both parties as 'joint' settlors for CRS purposes.[16]

This seems a common sense view, but it does not take full account of the nature of the joint account. In practice the issue may not often arise.

94.5 Scottish joint account

The IHT Manual provides:

> **IHTM15050. Special destinations and proof of donation** [May 2020]
> If two or more people purchase an asset jointly there may be a contractual agreement between them which determines how the property passes on death. If the title is just in their joint names, such as to A and B, they own an equal share which passes to their executors (IHTM05012) on their deaths and is part of their free estate.
> But if the title is to A and B and the survivor and they have paid equally for the asset, the survivor will be entitled to the whole on the death of the first to die (*Perrett's Trs v Perrett* [1909] 46 SLR 453). This is known as special (or survivorship) destination.
> Both parties do, however, have the right to dispose of their shares in life (*Steele v Caldwell* [1979] SLT 228), which will defeat the operation of the special destination.
> If the price was not provided equally the question of whether the donor has conferred an immediate beneficial interest (IHTM15011) on the other party will depend on their intention. Such a donor can revoke the survivorship destination, explicitly, by Will (IHTM12047) under s.30 Succession (Scotland) Act 1964. But the donee may not do the same to defeat the donor's right to the whole of the asset.
> If the whole of a joint asset was provided by one person they retain ownership of the whole until they put title into joint names, or, by some other act, show they intend to make an immediate gift to the other joint owner.
>
> - Proof of gift requires evidence of both intention and delivery. Evidence of intention does not need to be in writing and oral evidence is acceptable.
> - Delivery may be:
>   - actual, for example, physically handing over the asset to the donee, or

[16] For the CRS consequences, see 121.23.3 (Joint settlors).

- constructive, for example, handing over one book from a collection.

If there is no immediate gift (by intention and delivery) the asset remains part of the provider's estate and will only pass to the other under the survivorship destination on their death, unless the Will contains a clause that explicitly revokes it and conforms to s.30 Succession (Scotland) Act 1964....

IHTM15051. Joint money accounts [May 2020]

The fact that a bank account is held in joint names and that receipts for deposits into it are issued in joint names does not necessarily mean it is held in equal shares. Neither does it mean there is survivorship destination. The extent of each owner's interest will be a question of fact depending on

- the extent of their identifiable contributions, and
- if contributions are unequal whether there can successfully be established donation (IHTM15050) by the greater contributor to the other, or alternatively, whether the asset was held in joint names merely for administrative convenience

You should resist any suggestion by the taxpayer or agent that the terms in which the account is held can effect either a lifetime gift - or pass the property to a survivor, unless there is other supporting evidence. Any cases of difficulty should be referred to Technical.

IHTM15052. Land [May 2020]

The title to heritage is proof of its ownership, and the owners interests in it – unless there is evidence to the contrary, normally by way of written document.

If there is no special destination (IHTM15050) and there is equal provision of the price, each co-owner can dispose of his own share as part of his estate and there is no accretion among them.

If spouses or civil partners (IHTM11032) are the joint owners you should keep the 'related property' (IHTM09731) provisions in view (S.161 IHTA 1984).

If it is claimed the beneficial interests (IHTM15011) vary from those indicated by the title and the absence of gift is claimed, strong proof is required of the parties intentions such as a contemporaneous writing. In cases of difficulty refer to Technical.

IHTM15053. Which law to apply to joint investments owned by someone domiciled in Scotland [May 2020]

Scottish law applies to shares of a company registered in Scotland. If the IHT400 (IHTM10021) or other account does not indicate whether a company is Scottish or not, you should be able to find this information on the Internet. If the taxpayer is of Scots domicile (IHTM13000) a joint holding in Government Stock may be regarded as subject to Scots law (*Cunningham's Trs v Cunningham* [1924] SLT 502).

IHTM15054. Joint money accounts and special destination May 2020]

Under Scots Law, where Bank or Building Society Accounts are held in joint names the special (or survivorship) destination (IHTM15050) does not by itself pass the ownership of the money in the account to the survivor.

An account with a Bank or Building Society is not a document of title as it is not a Deed of Trust in terms of the Bank Bonds and Trusts Act 1696. It is a contract between the Bank and the customer which regulates the conditions on which the account is to be operated and is for administrative convenience only. See for

> example *Cairns v Davidson* 1913 SC 1054.
>
> For this reason the ownership of the funds in the account is determined according to the ordinary principles of ownership. The owner of the funds in the account remains the owner unless and until some transfer of ownership occurs.
>
> Example
>
> James and Lucy (who are married) open an account, governed by Scots law, in their joint names and James has provided all the funds. James dies and is survived by his wife, Lucy. On his death:
>
> • In the absence of any act of transfer of ownership to Lucy (for example, a separate Deed of Gift) the whole account should be included in the IHT400.
>
> •If the account passes to (say) the children under the terms of James' Will then the asset will be chargeable to Inheritance Tax
>
> • If the account passes to Lucy under the terms of the will (IHTM11032) then exemption under IHTA84/S18 will apply/
>
> This applies to all Bank/Building Society accounts governed by Scots Law. So it will apply to taxpayers living in England, Wales and Northern Ireland who have an account which is governed by Scots Law.

For the Scots law position see Meston, "Survivorship destinations and bank accounts" 1996 SLPQ 315; Kerrigan, "Special destinations – survivorship and bank accounts revisited" 2011 SLT 5; the Trusts Discussion Forum (May 2007) under the thread "Scottish bank accounts".[17]

94.6 Remittance from joint account

This section considers remittance aspects of joint accounts.

The RDR Manual provides:

> **RDRM33510 Joint Accounts** [Jan 2022]
>
> ... **Analysing the account**
>
> Where an individual has a 'joint account' with someone else and one or both of them chooses to be taxed on the remittance basis, it is necessary to fully analyse the account (with due regard being given to the 'exceptions' identified above). You will need to do this in order to apply Step 1 ITA07/s809Q(3) (refer to RDRM35200: Mixed funds), which deals with transfers from mixed funds and requires you to find each of the categories of the remittance basis user's income and gains in the mixed fund. A joint account will almost certainly be a mixed fund.
>
> Such an analysis will also be required if a decision is made to cleanse the account, under the mixed fund cleansing provisions. (Refer to RDRM35600 onwards for further details).
>
> Analyse the account by putting each credit to the account into separate columns,

[17] *http://www.trustsdiscussionforum.co.uk*

divided between each individual, for each year.
Likewise with the debits; transfers out of the account that are clearly made by or for one or other of the individuals and intended to be made out of "their" share of the income should be debited "under" their column.
"Joint" expenses, for example items such mortgage payments where the debt is held jointly, or council tax bills and so on may, if appropriate, be split equally between each individual. Alternatively, such debits may be fully appropriated to just one of the account holders if that reflects the reality of their joint financial arrangements; for example it may be that only one partner is working and contributes most of the "credits" to the account in the form of their income. In such circumstances it may be more appropriate to attribute all expenditure to that partner in so far as the overall balance of the account permits. When separating the account in this way it is important that the overall balance remains consistent. In practice you should try to take the most pragmatic approach that best reflects the reality of both individuals' situations.

94.6.1 *One account holder remittance basis user*

The RDR Manual provides:

RDRM33510 Joint Accounts [Jan 2022]
...Individuals who are not using the remittance basis are liable to tax on the arising basis, so they will, where appropriate, have paid UK tax in respect of their share of the income and gains that have been credited to the joint account in the tax year. Because UK tax has been (or will be) paid by that individual he or she may bring to the UK or otherwise use their share of the funds that are in the account in any way they wish without triggering an additional tax charge.
However, if at any time during the year they bring to the UK or otherwise use amounts in excess of their share of the funds in the joint account at that point in time then they will be regarded as using their partner's income or gains instead.
Example[18]
An offshore bank account was opened on 20 June. It is held jointly by A and B, who are civil partners. A claims the remittance basis in this year. The account shows:

Date	**Credit (Debit)**	**Balance**	**Attributable to**
		£0	Opening Balance
20 June	£2,000	£2,000	A – foreign earnings
27 June	£1,000	£3,000	A – relevant foreign income
1 July	(£800)	£2,200	B – cash taken out in London
27 July	£90	£2,290[19]	B – UK rental income

In analysing the account you need to look at what was in the account i**mmediately before** each debit. In this case, the cash withdrawn by B in London

[18] I have slightly changed the format of the example for clarity

[19] I have corrected an arithmetical mistake in the original. The figures in this line do not matter for the example (but would be relevant if there is a further transfer).

on 1 July can only be attributed to A's income credits and, as B is a relevant person, A will be regarded as having remitted that £800. ...

Remember that in most cases the account holders are likely to be relevant persons in relation to each other, so even transfers from the non-remittance basis using individual may be a taxable remittance on the other partner if it is regarded as consisting of or deriving from the other partner's foreign income or gains.

94.6.2 *Both account holders remittance basis users*

The RDR Manual provides:

RDRM33510 Joint Accounts [Jan 2022]

You will still need to analyse the account in order to determine which transfers from the mixed fund are taxable remittances, and to determine which account holder is liable to pay any tax due. Again, you should try to take the most pragmatic approach that best reflects the reality of the situation.

Once the account has been split between the individual account holders, any taxable remittances of the foreign income or gains that are the property of the remittance basis user are subject to the normal "ordering" rules that apply to remittances from a "mixed fund".

The example at RDRM33515 demonstrates the principles of analysing a joint account and then determining whether the "transfers" are a taxable remittance from a mixed fund. You will also need to refer to RDRM35230 Remittances from mixed funds.[20]

RDRM33515 Joint Accounts - example [May 2020]

(*Erica ("W") and John ("H"*)

W and H have been married for several years, and currently live in the UK. H is domiciled within the UK. W is not domiciled in the UK. W decides to claim the remittance basis for this year.

Both W and H have employment income that is credited to the account. For most of the year W works in the UK but she also has a separate part-time employment with a foreign employer outside of the UK for part of the year.

W and H have a joint bank account in the Isle of Man. Into this account is paid both of their salaries, and some bank interest. They use the account to pay their household bills, including the mortgage on their jointly owned UK home.

Table to show the amounts credited to the account[21]

Date		**Income of**	**Credit (Debit)**	**Balance**
	Opening Balance			£0
30 April	UK salary	W	£3,000	£3,000
30 April	UK salary	H	£2,000	£5,000
30 April	Overseas salary[22]	W	£2,000	£7,000
30 April	Bank interest not taxed	Both	£200	£7,200

[20] See 20.2.3 (When are funds mixed).

[21] I have slightly altered the format for clarity

[22] The example adds: *not subject to foreign tax*.

1 May	Direct debit - UK energy co		(£200)	£7,000
5 May	Cash withdrawal (UK)		(£1,000)	£6,000
10 May	Cash withdrawal (UK)		(£1,000)	£5,000
17 May	Direct debit - mortgage		(£3,000)	£2,000
31 May	UK salary	W	£3,000	£5,000
31 May	UK salary	H	£2,000	£7,000
31 May	Overseas salary	W	£800	£7,800
1 June	Direct debit - UK energy co		(£200)	£7,600
5 June	Cash withdrawal (UK)		(£1,000)	£6,600
10 June	Cash withdrawal (UK)		(£800)	£5,800
17 June	Direct debit - mortgage		(£3,000)	£2,800

The credits and the debits account can be analysed between W and H with the following results:

		W Credit	**W Balance**	**H Credit**	**H Balance**	**Joint a/c Balance**	**Note**
30 Apr	UK salary	£3,000	£3,000			£3,000	1
30 Apr	UK salary			£2,000	£2,000	£5,000	1
30 Apr	Overseas salary	£2,000	£5,000			£7,000	
30 Apr	Bank interest	£100	£5,100	£100	£2,100	£7,200	2
1 May	Debit to UK co	(£100)	£5,000	(£100)	£2,000	£7,000	
5 May	Cash to UK	(£1,000)	£4,000			£6,000	3
10 May	Cash to UK			(£1,000)	£1,000	£5,000	3
17 May	Mortgage pay't	(£2,000)	£2,000	(£1,000)	£nil	£2,000	4
31 May	UK salary	£3,000	£5,000			£5,000	
31 May	UK salary			£2,000	£2,000	£7,000	
31 May	Overseas salary	£800	£5,800			£7,800	
1 Jun	Debit to UK co	(£100)	£5,700	(£100)	£1,900	£7,600	
5 Jun	Cash to UK	(£1,000)	£4,700			£6,600	
10 Jun	Cash to UK			(£800)	£1,100	£5,800	
17 Jun	Mortgate pay't	(£1,900)	£2,800	(£1,100)	Nil	£2,800	4

Note 1: Earned income is attributed to the employee only.

Note 2: Because this is a joint account, the interest arising on it is split equally between W and H.

Note 3: This money is withdrawn in the UK by H and W to meet their own personal expenditure, for example travel, meals and so on.

In this example H's "personal expenditure" can be attributed to his "income" credits into the account.

If instead the withdrawals by H were regarded as coming from W's "portion" of the pot, because H is a relevant person and money has been brought into the UK by a relevant person (so Condition A of s.809L(2)(a) ITA 2007 is met) there might still be a taxable remittance, with the tax due payable by W (see below).

Note 4: The mortgage payment is made to a UK bank. The mortgage is held on H and W's UK home and is a joint debt of W and H, and each contributes half of the cost. To the extent that H has money in the account it can be accepted that he has used his taxed income to pay his share of the mortgage.

Money has been brought into the UK to pay this mortgage, so Condition A of s.809L(2)(a) ITA 2007 is met and there is a "transfer" from a mixed fund.

Because this is a mixed fund s.809Q(2) ITA 2007 is in point. So in order to determine whether this money is regarded as consisting of, or deriving from, a remittance basis users' foreign income or gains (such that there is a taxable remittance under Condition B of s.809L(2)(a) ITA 2007) it is necessary to look at the composition of the fund immediately before the "transfer".

This shows that £2,000 of the mortgage payment made on 17 May must be attributable to W's income or gains in the mixed fund. Similarly, £1,900 of the mortgage payment of 17 June is attributable to W's income in the mixed fund.

So far as W is concerned, her share of the account shows (for the purposes of calculating if and to what extent she has made a taxable remittance of her overseas income) is as follows:

W's share of the account		**Credit (Debit)**	**W's balance**	**Category**
30 April	UK salary	£3,000	£3,000	(a)
30 April	Overseas salary[23]	£2,000	£5,000	(b)
30 April	Bank interest	£100	£5,100	(d)
1 May	Direct Debit (energy co)	(£100)	£5,000	
10 May	Cash	(£1,000)	£4,000	
17 May	Direct Debit (mortgage)	(£2,000)	£2,000	
31 May	UK salary	£3,000	£5,000	(a)
31 May	Overseas salary	£800	£5,800	(b)
1 June	Direct Debit (energy)	(£100)	£5,700	
5 June	Cash	(£1,000)	£4,700	
17 June	Direct Debit (mortgage)	(£1,900)	£2,800	

Applying the rules at s809Q ITA 2007 to the first "transfer" to the UK, which is the payment to the energy company on 1 May. Remember the mixed fund rules require the account to be analysed before every "transfer"

Step 1 – Identify the "amount of transfer" in the relevant year		**£100**
Analyse mixed fund to identify the separate amounts of income, capital gains and capital present for each tax year immediately before the date of the transfer	**Para (a)** Employment income (UK employment income)	£3,000
	Para (b) Relevant foreign earnings (not subject to a foreign tax)	£2,000
	Para (d) Relevant foreign income (not subject to a foreign tax)	£100
Step 2 – Identify the earliest paragraph above for the relevant year, which has an amount of income or gain in the mixed fund	**Para (a)**	£3,000

Step 3 If the amount at Step 2 is equal to or more than the amount of the transfer treat the whole of the remaining amount of the transfer as coming from that item of income or gain

> So W's transfer of £100 is treated as coming from her UK employment income; it is not thus a "taxable" remittance when brought to the UK.

[23] The example adds: *not subject to foreign tax*.

Then apply the rules at s.809Q ITA 2007 to the next "transfer" to the UK, which is the cash withdrawal.

Apply the rules at s.809Q ITA 2007 to the next "transfer" to the UK, which is the cash withdrawal

Step 1 – Identify the "amount of transfer" in the relevant year		**£1,000**
Analyse mixed fund to identify the separate amounts of income, capital gains and capital present for each tax year immediately before the date of the transfer	**Para (a)** Employment income (UK employment income)	£2,900
	Para (b) Relevant foreign earnings (not subject to a foreign tax)	£2,000
	Para (d) Relevant foreign income (not subject to a foreign tax)	£100
Step 2 – Identify the earliest paragraph above for the relevant year, which has an amount of income or gain in the mixed fund	**Para (a)**	£1,900

Step 3 If the amount at Step 2 is equal to or more than the amount of the transfer (the last time step 3 was completed) treat the whole of the remaining amount of the transfer as coming from that item of income or gain

So W's transfer of £1,000 is treated as coming from her UK employment income; it is not thus a "taxable" remittance when brought to the UK.
Then apply the rules at s809Q ITA 2007 to the next "transfer" to the UK, which is the mortgage payment.

Then apply the rules at s809Q ITA 2007 to the next "transfer" to the UK, which is the mortgage payment

Step 1 – Identify the "amount of transfer" in the relevant year		**£2,000**
Analyse mixed fund to identify the separate amounts of income, capital gains and capital present for each tax year immediately before the date of the transfer	**Para (a)** Employment income (UK employment income)	£1,900
	Para (b) Relevant foreign earnings (not subject to a foreign tax)	£2,000
	Para (d) Relevant foreign income (not subject to a foreign tax)	£100
Step 2 – Identify the earliest paragraph above for the relevant year, which has an amount of income or gain in the mixed fund	**Para (a)**	£1,900
Step 3 Where the amount transferred is greater than the amount identified at Step 2 the amount transferred is treated as reduced by the amount identified in Step 2.		£2,000 -£1,900 £100
Step 4 - Find the next paragraph/amount for that tax year. In the order of preference listed above repeat Steps 2 and 3.		
Step 2 - repeated	**Para (b)**	£100

Step 3 If the amount at Step 2 is equal to or more than the amount of the transfer (the last time step 3 was completed) treat the whole of the remaining amount of the transfer as

coming from that item of income or gain

> £1,900 of the transfer is treated as coming from W's UK employment income; it is not thus a "taxable" remittance when brought to the UK. The remaining £100 is treated as a remittance of £100 of W's untaxed overseas earnings.

The HMRC analysis stops here. There are in fact three more debits to analyse, but the reader will have the idea. Note that the incomplete analysis of a bank account with only 15 entries has taken 5 pages. It seems safe to say that these are rules which never have, never can and never will be applied in practice. I expect HMRC will accept any reasonable approximation.

In practice it is imperative for remittance-basis taxpayers to avoid joint accounts, and best to avoid mixed accounts.

94.7 Property held jointly by spouses

Section 836 ITA provides:

> (1) This section applies if income arises from property held in the names of individuals—
> (a) who are married to, or are civil partners of, each other, and
> (b) who live together.
> (2) The individuals are treated for income tax purposes as beneficially entitled to the income in equal shares.

Section 836(3) sets out 7 exceptions, numbered non-numerically. The first two are the most important:

> But this treatment does not apply in relation to any income within any of the following exceptions.
> *Exception*[24]
> *A* Income to which neither of the individuals is beneficially entitled.
> *B* Income in relation to which a declaration by the individuals under section 837 has effect (unequal beneficial interests).
> *C* Income to which Part 9 of ITTOIA 2005 applies (partnerships).
> *D* and *DA* *[These related to furnished holiday accommodation. Spring Budget 2024 announced the abolition of the Furnished Holiday Lettings tax regime, so presumably this will cease to be the case. The legislation was not in the Finance (no.2) Bill 2024, but is promised to follow in due course.]*
> *E* Income consisting of a distribution arising from property consisting

[24] I have altered the layout here for clarity.

of—

(a) shares in or securities of a close company to which one of the individuals is beneficially entitled to the exclusion of the other, or

(b) such shares or securities to which the individuals are beneficially entitled in equal or unequal shares...[25]

F Income to which one of the individuals is beneficially entitled so far as it is treated as a result of any other provision of the Income Tax Acts as—

(a) the income of the other individual, or

(b) the income of a third party.

94.7.1 *Settlor-interested trust*

The income taxation of joint accounts has been thrown into disarray by the decision in *Bingham v HMRC*.[26] In this case, Mr Bingham ("H") transferred money into an account in the joint names of himself, his wife and his adult children. The object was to ensure that the wife and children had income within their personal allowances. The tribunal held that H remained beneficial owner of the money. H, a solicitor, should have paid more attention to documentation (to declare that his children had the desired interest) and implementation (the children did not hold chequebooks so they could not draw out what was said to be their money from the account). So far this is straightforward.

More intriguingly, even if the children held money in the account beneficially, the tribunal would "likely"[27] have held that H was *still* taxable on all the income under s.624, on the grounds that:

(1) The account was a "settlement" (that is clearly right); and

(2) H had an interest since he could withdraw the funds.

It seems to me that point (2) is wrong. If H draws out money for his own benefit, he only does so with the authority of the joint account holders, and the possibility that a donee may give funds back to the donee does not constitute an interest.[28]

[25] Exception E goes on to incorporate the standard distribution code definition of shares and securities: "Shares" and "securities" have the same meaning as in section 1117 of CTA 2010. See App. 2.13 (Security: 5 statutory definitions).

[26] [2013] UKFTT 110 (TC).

[27] at [62]

[28] *Glyn v IRC* 30 TC 321 at p.329; *West v Trennery* [2003] EWHC 676 (Ch) at [51] (point not discussed on appeal).

I think it is safe to say that no account has ever been dealt with that way in the history of taxation, and the practical difficulties would be immense. In *Bingham* there was clearly a settlement as H provided all the funds. What if the joint account owners provide funds, but unequally? What if a couple shares an account for ordinary domestic purposes?

The problems would attach to husband and wife accounts: the settlor-interested trust provisions take priority over s.836 ITA. The s.624 spouse exemption would not apply.[29] If *Bingham* were right, a payment into a joint account would not be an outright gift under the definition in s.626(4) ITTOIA.

These arguments were not put to the Tribunal.

94.7.2 *Remittance basis and spouses joint accounts*

How does this interrelate with the remittance basis? Suppose:

(1) Property is held in the names of H and W, but belongs in equity to H alone.
(2) Section 836 applies so that half the income is deemed to be the income of W.
(3) W is a remittance basis taxpayer.

Income of W arising before 2008/09, being merely deemed income, could not be remitted and could not be subject to tax. But income arising from 2008/09 counts as remitted if it is remitted by H, since H is a relevant person in relation to W.

94.8 Planning for joint account

The best way to avoid the IHT difficulties discussed in this chapter is that substantial sums should not be put in joint accounts (except where the account holders qualify for the full IHT spouse exemption).

Joint accounts may be useful as a means of probate planning, as the funds in a joint account should be immediately available to the survivor; by contrast, funds in a sole account are not available until probate is obtained, which will involve delay and, often, cost as IHT must be paid upfront in order to obtain probate. In this case, the parties should specify the terms on which the account is held, and (if appropriate) keep a record of who provided the funds so the IHT position is clear.

It is recommended that remittance basis taxpayers do not use foreign

[29] See 93.15 (s.624 spouse exemption).

joint accounts, if the remittance tracing problems discussed above will arise. There will be no problem if:

(1) no substantial interest arises to the account
(2) no remittance is made from the account to the UK
(3) interest is paid to a separate account from which no remittance is made to the UK or
(4) interest is paid to separate account of each account holder in equal shares.

CHAPTER NINETY FIVE

FOREIGN CURRENCY ISSUES

95.1 Foreign currency: Introduction
95.2 CGT: Currency conversion date
95.3 Trading and property income
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95.6.1 HMRC view
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95.7 Sub-£2k taxpayer: Currency conversion date
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95.9 Foreign tax credit: Currency conversion date
95.10 Foreign currency bank account: CGT
95.11 Foreign banknotes/coins
95.11.1 Foreign currency for personal expenditure
95.11.2 Critique
95.12 Interaction with mixed fund rules: HMRC examples
95.13 Foreign currency issues: Critique

Cross references

The following topics are considered elsewhere:

Topic	**See para**
Transfer of assets abroad: Forex income:	48.16.4
Offshore funds: OIG in foreign currency	70.3.4
Deeply discounted security in foreign currency	29.4
Unremittable assset relief	97.9
Foreign currency bank account: IHT excluded property	76.13

The position of UK resident companies is not considered.

95.1 Foreign currency: Introduction

It is generally accepted that UK tax is assessed in sterling. For instance, the RDR Manual provides:

> **RDRM31190 Exchange Rates** [Jan 2019]
> All entries on the SA Return should be in pounds sterling.

Foreign currency must be translated into sterling. For this purpose it is necessary to identify the date on which the exchange rate is determined ("**currency conversion date**").

HMRC put their views in a technical note dated 12 October 2009 (the "**HMRC currency technical note**").

Once one has identified the currency conversion date, one needs to ascertain the exchange rate on that date. HMRC publish:

- Spot currency exchange rates. Spot rates are published on 31st March and 31st December every year. It reflects the exchange rate at midday of that day.[1]
- Monthly currency exchange rates. Monthly rates are published on the penultimate Thursday of every month. They represent the exchange rate as of midday the day before publication and are intended to apply to the following calendar month.[2]
- Average rates on 31st March and 31st December. This reflects the mean average of all exchange rates which have been present in all Monthly exchange rate files for the 12 month period leading up to the given Average rate publication.[3]

Daily rates can be found on commercial websites. These no doubt use different criteria, and disagree slightly among themselves, but in practice any published rate is acceptable.[4]

HMRC say:

[1] *https://www.trade-tariff.service.gov.uk/exchange_rates/spot*

[2] *https://www.trade-tariff.service.gov.uk/exchange_rates*

[3] *https://www.trade-tariff.service.gov.uk/exchange_rates/average*

[4] The SAI Manual provides:

> "**SAIM4310. Special calculations: Foreign currency securities** [Dec 2019]
> ...Although the London closing rate should in strictness be used in all the above cases, figures of rates of exchange supplied by taxpayers or their agents should normally be accepted, provided that they come from a reputable source (for example, an exchange rate quoted by the taxpayer's bank for the day in question) and the basis is used consistently."

Similarly, International Manual provides:

> "**INTM162620. Rate of exchange to use** [Dec 2019]
> ... Any reasonable established basis of conversion which has previously been applied in any particular case may continue to be used in that case if the customer agrees to its consistent application. If there is a dispute which cannot be resolved within the terms of the established practice, the general basis described above should be adopted."

Where the official rate of exchange is different, it is considered that one should use commercial (black market) rates; this view is adopted in the USA: *Cinelli v Commissioner of Internal Revenue* (1974) 502 F2d 695 US Court of Appeals, Sixth Circuit.

> HMRC publishes average monthly exchange rates as a guide but customers and their advisors are welcome to use actual daily rates were appropriate for transactions. HMRC may however challenge customers on the rates used and so it would be prudent to keep a record of the rates and dates involved should evidence be required.[5]

95.2 CGT: Currency conversion date

There are two possible ways to compute the gain where an asset is purchased and sold in a foreign currency.

Method 1:

(a) Compute the gain in foreign currency. For instance, suppose an asset is purchased for $100 and sold for $200; the gain is the $ sale price less the $ acquisition price = $100.

(b) Then convert that foreign currency gain to sterling at the date of disposal.

Method 2:

(a) Compute the sale price converted to sterling at the rate on the date of disposal

(b) Then deduct allowable expenditure, in short:

  (i) The acquisition cost converted to sterling at the rate on the date of acquisition

  (ii) Any improvement costs converted to sterling at the rate on the date the costs were paid

For CGT it is settled that method (2) is correct. In *Bentley v Pike* 53 TC 590 the taxpayer inherited German property when it was worth DM132k, and later sold it for DM152k. She argued that the gain was the difference between the two Deutschmark values, ie DM30k, and the currency conversion date was the date of disposal. The court held that the gain was the sterling value of the DM proceeds (currency conversion date at the date of disposal) less the sterling value of the property at the time of acquisition. This decision was approved in *Capcount Trading v Evans* 65 TC 545 where the issue was argued more fully before the CoA. In short, the taxpayer acquired shares for $85m and sold them for $50m. The taxpayer argued that they made a loss of $35m. That was rejected. The

[5] Expatriate Forum Minutes Oct 2019 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/855596/Expat_Forum_minutes_10_October_2019.pdf*

gain/loss was calculated as the value of the proceeds (converted into sterling at the date of disposal) less the acquisition cost (converted into sterling at the dates of acquisition).[6]

The CG Manual provides:

> **CG25391 Remittance basis: gains to be computed in Sterling** [Nov 2019]
> Sterling is the currency in which capital gains computations are carried out (see *Bentley v Pike*, (53 TC 590) and *Capcount Trading v Evans* (65 TC 545)). You should therefore carry out a computation of the gain arising on the disposal of the foreign assets in sterling. Where transactions take place in foreign currency you should convert each separate entry for the computation into sterling using the spot rate applying at the date that part of the transaction occurred.

In *Goodbrand v Loffland Brothers North Sea Inc*:[7]

> The legislation does not in terms prescribe that the tax computation must be carried out in sterling, but it has been held that sterling is "the only permissible unit of account" for capital gains tax purposes... For the purposes of capital gains tax, foreign currency is not "money" but "money's worth".

This method of computation is used whether the gain is taxed on an arising or the remittance basis. The RDR Manual provides:

> **RDRM31190 Exchange Rates** [May 2020]
> *Foreign Chargeable Gains*
> Foreign chargeable gains are calculated using sterling translations at the date of acquisition and the date of disposal. So the consideration received will be translated into sterling using the exchange rate at the time of disposal and allowable deductions will be translated using the exchange rate(s) at the time the expenditure was incurred (for example, when the asset was acquired). Thus the gain will be denoted in pounds sterling and will be the same whether taxed on the arising or the remittance basis.

[6] If the law were otherwise, further difficulties would arise. What would the position be if an asset was purchased in one currency and sold for a different currency? Would the basis of computation depend on the situs, bearing in mind that situs is itself a somewhat artificial concept? But as the law is settled, it is not necessary to pursue this.

[7] 71 TC 57 at p.70.

The Manual continues:

> If the gain is held as foreign currency, the taxable sterling amount of the gain will not change, but separate gains or losses may accrue if the foreign currency gains or loses value with respect to sterling before the gain is remitted...

This sentence is more than a decade out of date: it represents the law before 2012.[8]

See too 56.3.4 (Deferred foreign currency consideration).

95.3 Trading and property income

The position for trading income subject to income tax is governed by SP 2/02 (Exchange rate fluctuations); this is not discussed here.

Property income is computed on accountancy principles, like trading income, so the same practice applies. Likewise Misc Sweep-up Income.

95.4 Arising basis: Conversion date

The RDR Manual 31190 provides:

> **RDRM31190 Exchange Rates** [Jan 2019]
> *Foreign Income*
> Foreign income taxed on the arising basis is converted to pounds sterling at the exchange rate applicable on the day that it arose overseas.

Similarly, the EI Manual provides:

> **EIM40033 Earnings paid in foreign currency** [Nov 2019]
> **General earnings taxable when received**
> General earnings that are taxable when received by virtue of the charging provisions in Sections 15 or 27 ITEPA ... will be chargeable whether paid or payable in foreign currency. It is simply necessary to quantify the amount chargeable in pounds sterling.
> The amount chargeable is strictly the sterling equivalent at the date the employee becomes entitled to be paid the earnings or, if earlier, the date they are paid. This can be calculated using the relevant exchange rates in operation at the time.
> No deduction can be given for costs of converting currency or for losses incurred on the exchange.

This is not controversial. HMRC accept the use of the average rate for a

[8] See 95.10 (Foreign currency bank account: CGT).

tax year where income arises regularly through the year.[9]

95.5 Income converted to foreign currency

The HMRC currency technical note provides:

> 6. Income that is regarded as 'foreign income' may be received offshore in sterling. It may later be converted into a foreign currency, for example if paid into a non-sterling account. In such cases the amount of a remittance basis user's foreign taxable income will be the amount actually due and originally received in sterling. It is of no relevance whether the eventual 'taxable remittance' that is, or that is derived from, that income is made in a foreign currency or is converted back into sterling before being remitted.

This is not controversial.

95.6 Remittance basis: Conversion date

Where income is taxed on the remittance basis, there are two possible views:

(1) The currency conversion date is the date of remittance. I refer to this as the "**HMRC view**".

(2) The currency conversion date is the date that the income arises. I refer to this as the "**practitioners view**" since it is adopted by ICAEW and the great majority of practitioners.

An intermediate, pragmatic view would allow either approach as long as it is adopted consistently.

95.6.1 *HMRC view*

The RDR Manual 31190 provides:

> **RDRM31190 Exchange Rates** [Jan 2019]
> *Foreign Income*
> ... Foreign income taxed on the remittance basis ... is subject to UK tax only when it is remitted to the UK. This remitted income should be translated into sterling at the exchange rate prevailing on the date of remittance.

The Manual gives a straightforward example.[10]

[9] Private correspondence.

[10] "*Example (remittance) - Christophe*
C is a remittance basis user and has €8,000 income paid into his French bank account

Similarly, the EI Manual provides:

> **EIM40033 Earnings paid in foreign currency** [Nov 2019]
> **... General earnings taxable when remitted to the UK**
> For earnings that are taxable when remitted to the UK the conversion should be made at the date they were remitted.

95.6.2 *Basis of HMRC view*

The HMRC currency technical note sets out HMRC's arguments in support of the view that the currency conversion date is the date of remittance and not the date of receipt.

> 5. [1] Remittance basis users may receive income offshore in a foreign currency.
> [2] Such foreign income and earnings which are chargeable to tax on the remittance basis only become chargeable to UK tax when they are remitted to the UK. The remittance to the UK is the event that triggers the UK tax charge.
> [3] It is only at this point that it is necessary to ascertain the taxable amount (in sterling) remitted to the UK that is taxable as foreign income.
> [4] It follows that it is the date on which that amount is treated as remitted to the UK that the translation to sterling should occur.

Para 5[2] is not correct. RFI is chargeable whether or not remitted, though the amount on which tax is charged is limited to what is remitted.[11] The same applies for RFE.[12]

Para 5[3] is correct but [4] does not follow from it. For CGT it is likewise only necessary to ascertain the taxable amount when there is a remittance but no-one suggests that gains are converted at the date of remittance.

The HMRC currency technical note contains a lengthy discussion of case law, but there are no cases which address the issue, and analogies from

in June 2011 when the exchange rate is €0.705 to the pound, the equivalent of £5,642. He remits all €8,000 of this foreign income on 1 May 2013 when the exchange rate was €0.681.
He uses this 1 May exchange rate to convert this amount, giving a remitted amount of foreign income of £5,453; this is the amount he is taxed on."

[11] See 2.3.1 (Unremitted RFI "chargeable").

[12] Chargeable gains actually are chargeable on remittance but HMRC do not say that gains are converted at the date of remittance.

CGT and IT cases in other contexts are not decisive. HMRC say:

> 15. There is little case law that addresses this point directly. Some early case law from the 1920s and 1930s deals with the taxation of companies and whether foreign exchange gains or losses should be regarded as capital or investment items, or form part of the company's trade. It is possible to draw only tentative principles from this, especially as in many cases the issue of arising or remittance basis was not in point.
>
> 16. The 1933 case of *Magraw v Lewis* (18 TC 222) concerned a pension of 229 South African pounds, paid to a UK resident, which had been awarded by the Government of the Union of South Africa and was paid by them through the High Commissioner of the Union Government in London. At the time such foreign income was chargeable when received in the UK. The case concerned certain deductions made by the SA Government from the pension, but during the case the issue of how much should be taxed in British pound sterling was raised. In *Magraw*, the *pension was actually paid to the appellant in the UK in sterling,* so the exchange issue was a little different.[13] In the course of his judgement at the High Court Finlay J said, at page 225,
>
>> What happened was this. The Appellant was paid a particular sum in UK pounds and by reason of the state of the exchange, the amount which he was paid in UK pounds was larger-a greater number of pounds-than the pension awarded to him in South Africa reckoned in South African pounds.
>>
>> He says that he ought not to pay Income Tax upon the amount which he has received in this country. I am bound to say that in regard to that the law appears to be as plain as in the other case...It is clear that the Income Tax authorities can have regard only to what is paid. What is paid is a pension of a particular amount in UK pounds, £268 I think it is -but the exact amount does not matter- that is paid to the Appellant.
>>
>> That is what he has to pay tax upon, and he has to pay on that in the appropriate number of pounds in British currency. As I say, about that point there does not appear to be any legal difficulty-indeed, I do not think there is any legal difficulty about either point...I cannot myself see that any one, even a layman, could conceive that there was any grievance when he gets a particular income in UK pounds, in paying tax in UK pounds at the appropriate rate upon that income.
>
> 17. In *Thomson v Moyse* 39 TC 291, whilst addressing a point about whether a remittance required a transmission from abroad, at the House of Lords Lord Reid said at p329 (bold emphasis added)
>
>> Before considering these authorities, I think it well to see what the effect would be if this view were right. I take a case which no one has ever even suggested would not be within the scope of these provisions - the case of a bank acting as a collecting agent. If a customer hands to an English bank for collection a cheque drawn on a foreign bank, the English bank will send the

[13] [Author's note] Since the pension was paid in sterling, the exchange issue did not arise at all.

> cheque abroad for collection and, when notified that the money has been collected, it will give to the customer in this country the equivalent in sterling **at the current rate of exchange**.

18. References to other case law have been made to HMRC with regard to this issue.

Bentley v Pike [1981] STC 360 and *Capcount Trading v Evans* [1993] STC 11 - these concern Capital Gains Tax on chargeable gains accruing on the disposal of an asset, and therefore have no bearing on the issue of overseas income. They state that where there is an acquisition and disposal in a foreign currency the taxable capital gain is calculated by deducting the sterling value of the acquisition at the time of acquisition from the sterling value of the sale proceeds at the time of sale.

Pattison v Marine Midland 57 TC 219 related to tax on trading profits and the House of Lords upheld the decision of the Court of Appeal rejecting HMRC's contention that, with respect to a loan made by a company, the difference in sterling terms between the value of the dollars at the time of the loan and the time of the repayment represented a taxable trading profit of the company.

In *Capcount* the Court of Appeal specifically distinguished *Marine Midland* on the basis that it was concerned with trading profits whereas *Capcount* was concerned with capital gains. Nolan LJ states:

> "Against that background I do not find it surprising that, in the case of trading companies operating abroad the commercial accounting procedures which, it seems, commonly result in the profit being first computed in the particular overseas currency and then translated into sterling for tax purposes should be adopted and accepted by the Revenue...the income tax legislation, unlike the capital gains tax legislation, is not generally concerned with the measurement of a gain or loss on a single disposal but with a balance at the year end and computed on accounting principles."

19. The calculation of gains arising on non-sterling acquisitions and/or disposals in sterling is different from the calculation of the amount of taxable income in sterling; it is clear from *Bentley v Pike* that the sterling translation must be made using the exchange rate in force at the dates of the transaction (i.e. date of acquisition for acquisition cost, and disposal for disposal proceeds) and the calculation completed in sterling. This is understandable for CG calculation purposes, as CG is fundamentally a transaction-based tax.

20. Apart from the £2,000 threshold (see below), this note only concerns remittances of foreign income. *Bentley* and *Capcount* concern capital gains, not income, and are therefore not relevant. *Marine Midland* supports the approach taken by HMRC in the guidance. *Marine Midland* concerned trading profits rather than income but an individual's income is more on a par with the profits of a business than with capital gains because neither an individual's income nor the profits of a business require individual disposals. Consequently, there is no conflict between the principles established in *Marine Midland* and HMRC's position on the treatment of an individual's income.

For completeness, the HMRC currency technical note also states:

> 7. In all cases HMRC will tax the individual's foreign income as income; the question is simply what sterling value to give that income, and more importantly, when is it necessary to calculate that value. HMRC will never tax an amount greater than the income received; for example, if $50,000 US dollars are received then only $50,000 US dollars will ever be subject to tax - that is, the sterling equivalent of that $50,000 for income tax purposes at the time at which the UK tax liability occurs.
> 8. For a remittance basis user whose foreign income is received offshore in, say, dollars, there is no requirement to value the dollars twice (that is on date of receipt offshore and on the date an amount becomes taxable by virtue of being remitted to the UK). In other words, for income tax purposes, in order to tax the income received in dollars the conversion into sterling should only be made once, namely on the occasion that the income comes into charge...
> 12. This approach is in the remittance basis user's favour. This is because, whether the exchange rate on the date the income arises or the date it is remitted is used to translate the foreign income into sterling, there has to be consistency between the two - it has to be one or the other. An individual has an element of control over the date of remittance and can choose to remit income when the exchange rate is in his favour or not to remit income when the exchange rate is not in his favour. An individual does not generally have similar control over the date on which foreign income arises.

These are not arguments, or at least not arguments to be taken seriously.

95.6.3 *Conversion date: correct view*

Since there is no statutory guidance, and no clear guidance from the case law, the right answer is that which best suits the scheme of the provisions. It is considered that the correct view is that the currency conversion date is the time the income arises, not the date of remittance. I call this the practitioners view.

The HMRC view gives rise to many anomalies. Firstly, contrast the arising basis where the currency conversion date is the date income arises. Secondly, contrast the CGT remittance basis where the currency conversion date is (in short) when the gain arises. The anomaly is more striking when one bears in mind that offshore income gains are computed on CGT principles but subject to income tax on remittance. Thirdly, contrast the IT remittance basis where income is received in sterling and immediately converted into a foreign currency.[14] Fourthly, contrast tax credits in a foreign currency where the currency conversion date is the date

[14] The HMRC view assumes that one always knows what currency income is received, but in the case of deemed income that is not the case, and in the case of trading income it may depends on arbitrary choice of accounting practice.

the income arises, or near that date.[15]

The HMRC view does not work in cases of double representation, ie where there are two distinct assets which both represent the same income/gains.[16]

The next set of problems arises on the HMRC view if a remittance basis taxpayer receives foreign currency income and converts it into another asset, rather than paying it directly into a bank account. In these circumstances HMRC appear to have accepted (inconsistently) that their view does not apply.[17]

Suppose T receives income in euros, converts the euros into sterling, and remits the sterling.

(1) Does T adopt the euro rate at the time of conversion into sterling? Then tax depends on administrative acts such as how the receipt is dealt with.

(2) Does T then adopt the euro rate at the time of remittance? That would be absurd and also gives rise to this further problem: Suppose T receives equal amounts of (a) foreign interest in euros and (b) foreign interest in sterling; T converts the euros to sterling and pays all the interest into one foreign sterling account, and later remits one half of the account to the UK. If one converts at the time of remittance T needs to decide whether T has remitted the sterling interest or the (former) euro interest. The answer is far from clear. On the practitioners view this tracing problem does not arise.

Section 731 raises further problems on the HMRC view. If relevant income arises in a foreign currency, when does one convert that to sterling? If one converts at the time the income arises there is a further anomaly between s.731 and ordinary income. If one converts at the time there is a benefit, then a currency conversion may have to be done every time a benefit is conferred, which is unworkable.

95.6.4 *Foreign currency depreciates*

HMRC say that their view (currency conversion date is the date of remittance) produces the right result where foreign currency depreciates against sterling, whereas the practitioners view causes an additional tax

[15] See 95.9 (Foreign tax credit: currency conversion date).

[16] See 18.18.9 (Double representation).

[17] See 56.16.10 (Rebasing: currency fluctuation).

charge for taxpayers which HMRC are anxious to avoid. The HMRC currency technical note provides:

> 13. ... Compare two taxpayers: Mr A is taxed on the arising basic. Mrs R on the remittance basis. Both receive RFE:
>
> *Exchange rates:*

1 May	Year 1	$1 = £1.20
1 May	Year 2	$1 = £1.10
1 May	Year 3	$1 = £1.50

> Mr A and Mrs R receive $100,000 on 1 May in Year 1.
>
> Mr A will have to pay tax on £120,000 in Year 1. Whether he brings the $100,000 in to the UK on 1 May in Year 1 when it is worth £120,000, or on 1 May in Year 2 when it is worth £110,000, or on 1 May in Year 3, when it is worth £150,000, has no impact on Mr A's income tax liabilities.

That is correct.

> If Mrs R, on the other hand, translates her foreign income into sterling on 1 May Year 1 she will, on [the practitioners view], be said to have taxable RFE of £120,000.
>
> - In Year 2, she could remit every one of the $100,000 dollars received, which would translate only to £110,000 and yet still pay tax on £120,000 - which would appear that we are taxing an additional $9090,[18] or we are applying a tax rate of c.43.5%.
>
> 14. ...Theoretically, given large fluctuations in currency exchange rates, or with changes in higher tax rates, a situation could arise in which the tax due is actually more than the monies the individual actually receives in the UK ...

It is indeed unfair for a remittance basis taxpayer to be taxed on an amount larger than the sum which they remit to the UK. But this observation does not much support the HMRC view. This is in the HMRC view the position on the remittance of an asset derived from foreign income/gains, if the asset has fallen in value. In this case, HMRC appear to have no compunction in taxing a larger amount than remitted. In the HMRC view "a situation could arise in which the tax due is actually more than the monies the individual actually receives in the UK."[19]

95.6.5 *Pragmatic approach*

Cleansing Q&As[20] Question 1 provides:

[18] The correct figure appears to be $10,000.

[19] See 18.35.2 (Change in property value).

[20] For this document, see 20.12 (Cleansing mixed funds).

Foreign domiciliaries will often have foreign currency bank accounts. As such, mixed fund analysis of foreign currency accounts will often need to be carried out. The HMRC Manuals deal will some very simplified examples and suggest that the analysis should take place in the foreign currency with the conversion to sterling only occurring when the remittance takes place.

There is no legislation covering the issue and no specific case law.

Case law is definitive about the need for chargeable gains to be computed in sterling. In addition, from a practical perspective it is difficult to see how anything other than a sterling analysis can (without extreme complexity) work where there are multiple transfers (in some cases hundreds if not thousands) between accounts in multiple currencies. To add to the difficulties in such situations you can have numerous instances of investments acquired using funds from one currency, where the investment is denominated in a separate currency and the sale proceeds go into a third account in another currency.

Since the area is not covered by any legislation there should be a pragmatic position taken. Provided the individual is consistent year on year when the analysis is prepared for a foreign currency account he or she should be able to carry out the mixed fund analysis in either the foreign currency or in sterling. Does HMRC agree?

Suggested answer: Provided a consistent year on year approach is taken for each specific foreign currency account a mixed fund analysis can be carried out in either the foreign currency or in sterling.

Example (Clara)

C is a UK resident foreign domiciliary. She meets the criteria such that she can cleanse her mixed fund accounts. She has:

- a Swiss franc account with QRS Offshore Bank; and
- five different foreign currency accounts with LMS Offshore Bank (Swiss francs, US dollars, Euros, Australian dollars and Canadian dollars) as well as a sterling account and an active trading portfolio (buying and selling investments in various different currencies often with the currency used for the purchase not being the same as the currency the investment is denominated in and with the sale proceeds being in a different currency and going to a different account). Various transfers are made between the different currency accounts.

The account with QRS Offshore bank is analysed in Swiss francs.

The complexity of the issues with respect to the accounts with LMS Offshore Bank means that all those foreign currency accounts are analysed in sterling.

In both cases a consistent year on year approach is taken with respect to the mixed fund analysis, so both the analysis for the QRS Offshore bank

> and the accounts with LMS Offshore Bank are acceptable.

This would be sensible, if extra-statutory, but the HMRC response was negative:

> **HMRC Comments**
> - Analyse in currency held in the account as per current guidance[21], converted to sterling if/when remitted to the UK. Strictly this isn't a cleansing question.
> - You can cleanse in any currency as long as there is a consistent approach (see also response to question 50).

Also see 56.16.10 (Rebasing: currency fluctuation).

95.6.6 *Conclusion*

Cleansing Q&As provides:

> It should be noted that we think that the HMRC view is not the better technical interpretation so, it is our view that, provided disclosure is made there are good grounds for not filing on that basis. This issue was discussed with HMRC in 2012 and 2013. The conclusion of these discussions was an agreement to differ in our technical opinions.[22]

It is considered that the HMRC view is clearly wrong, so that a tax return could properly be made on that basis even without disclosure, though full disclosure would be required if it was desired to achieve finality by the end of the enquiry period, ie to prevent a discovery assessment.[23]

95.7 Sub-£2k taxpayer: Currency conversion date

The RDR Manual provides:

> **RDRM31190 Exchange Rates** [Jan 2019]
> *Remittance basis users below the "£2,000 threshold"*
> ... For the purposes of determining whether the amount of an individual's foreign income which is "not remitted" in a tax year is below £2,000 they obviously cannot apply [what HMRC regard as] the usual principle for remittance basis users of using the exchange rate at the time of

[21] Footnote original: That is for foreign currency bank accounts, the HMRC Guidance says perform the mixed fund analysis in the currency concerned with the conversion to sterling only occurring when the remittance takes place.

[22] "Cleansing of mixed funds – professional bodies Q&As" (version 3) question 2 *https://www.icaew.com/-/media/corporate/files/technical/tax/tax-faculty/taxguides/2019/taxguide-02-19--cleansing-of-mixed-funds.ashx*

[23] See 121.10 (Full-disclosure requirement).

> remittance. Instead the balance of the unremitted foreign income is converted to pounds sterling *at the rate of exchange prevailing on the last day of the tax year*.
>
> ITA07/s809D(2) provides that the amount of an individual's "unremitted" foreign income and gains for a tax year is-
>
> (a) the total amount of what would (if this section applied) be the individual's foreign income and gains for that year, minus
>
> (b) the total amount of those income and gains that are remitted to the UK in that year.
>
> So the above formula may be carried out in the foreign currency, looking at total income received and total income remitted, per currency, during the tax year. The balance which is left is the "unremitted foreign income". This is translated into sterling using the exchange on the last day of the tax year (5 April) to ascertain whether the 'unremitted foreign income' is below the £2,000 limit.

Thus the currency conversion date is that on 5th April of each year. I refer to this as the "**5 April conversion view**". This practice only applied for the purposes of the £2k test and only for income, not for gains:

> This practice applies for the purposes of deciding whether ITA07/s809D applies ONLY. All of the individual's foreign income amounts for a tax year must be taken into account.
>
> *Example: Michaela*
>
> M received foreign income on 10 April of $5,000 when the exchange rate was (£1=$2).
>
> She remitted $1,500 to the UK on 15 May when the exchange rate was £1=$1.50 She will pay tax on the sterling amount of £1,000.
>
> At the end of the tax year, M's 'unremitted foreign income' will be calculated using the exchange rate at the end of the tax year, which is £1=$1.80.
>
> This is calculated as follows:

Total foreign income and gains for that year	$5,000
less	
Amount of that foreign income remitted during year	($1,500)
Unremitted foreign income	$3,500

> $3,500 is £1,944 using the exchange rate at the end of the tax year; she may use s809D if she wishes to use the remittance basis.
>
> If the exchange rate at the end of the year was £1=$1.50 then the $3,500 unremitted foreign income would be £2,333, which is above the threshold. ...

The HMRC currency technical note provides the reason for the 5 April conversion view:

> 29. On further consideration of the wording of s809D, HMRC took the view that for foreign income, this calculation can only be made on the last day of the tax year, as that is the only date an individual's total and unremitted foreign income for a tax year can be ascertained. Consequently the foreign currency should be translated into sterling on that date also, for both the total foreign income and the remitted foreign income for the purposes of s.809D only.
> 30. Although UK income tax is charged on sterling amounts, it does not follow that the calculations to get to an income threshold such as this in s809D necessarily have to be made in sterling. Consequently the formula of deducting the remitted income from the total income can be carried out in the foreign currency on the last day of the tax year and then the balance which is left namely the "unremitted foreign income" can be translated into sterling on that date to ascertain whether it is below the £2,000 limit.

Thus the basis for the 5 April conversion view is the (erroneous) HMRC view that the currency conversion date for remitted income is the date of remittance. If the practitioners view is accepted, that the currency conversion date is the date that the income arises, s.809D does not raise any problem, as obviously the same approach should apply there also.

95.8 Nominated income/gains: Currency conversion date

The RDR Manual provides:

> **RDRM31190 Exchange Rates** [Jan 2019]
> *Nominated income and gains*
> Nominated income and gains are charged to UK tax on the arising basis... This means that any foreign income that is nominated for the purpose of the Remittance Basis Charge is converted to pounds sterling at the exchange rate that applied on the date the income arose.
> Foreign chargeable gains are always calculated in pounds sterling at the rate of exchange that applied on the date the gain is realised.

The Manual gives a straightforward example.[24]

95.9 Foreign tax credit: Currency conversion date

International Manual provides:

[24] "*Example (Francoise)*
F is a non-domiciled individual who is subject to the Remittance Basis Charge. She decides to nominate €20,000 of foreign income. The exchange rate on the date the income arose was €0.744 to the pound. She uses this rate to calculate the equivalent nominated amount of foreign income in sterling, which is £14,880."

> **INTM162620. Rate of exchange to use** [Dec 2019]
>
> For the purpose of computing tax credit relief, foreign tax, payable directly or by deduction, should be converted into sterling at the rate of exchange obtaining on the date when the foreign tax for which credit is to be allowed becomes payable.
>
> *In practice*
>
> 1. Officers need not make enquiries in all cases in order to establish the precise date on which the foreign tax became payable under the foreign country's laws. Where the date is not known, the date of payment of the tax can normally be taken as the payable date. Where the foreign tax has been deducted at source from income, for example, from dividends, interest or royalties, the payable date will normally be the same date as the date on which the income is paid. If, however, the customer objects, or a substantial amount of tax is involved, the actual payable date should be determined. In many cases the date can be obtained from the demand note, provided that there has been no appeal against the foreign charge. If any difficulty arises in determining the payable date, in a case where such date is material, or if the customer objects to this basis, the case should be submitted to the Business, Assets & International, Assets Residence & Valuation in the case of individuals and to CSTD, Business Assets & International, Base Protection Policy Team in all other cases. See, however, INTM167190 in the case of interest on a loan relationship.
>
> Any reasonable established basis of conversion which has previously been applied in any particular case may continue to be used in that case if the customer agrees to its consistent application. If there is a dispute which cannot be resolved within the terms of the established practice, the general basis described above should be adopted.

The Manual does not distinguish between an arising basis taxpayer and a remittance basis taxpayer. So on the HMRC view, the currency conversion date for remitted income is the date of remittance, but the currency conversion date for the tax credit on the same income is the date that the tax was paid, which may not even be close. That is yet another anomaly arising from the HMRC view that the currency conversion date is the date of remittance.

See *Greig v Ashton* 36 TC 581.

95.10 Foreign currency bank account: CGT

The TCGA deals separately with foreign currency bank accounts and foreign currency not in a bank account (banknotes and coins).[25] But bank accounts are the usual way to hold money, so that is the more important area.

A bank account is a debt, and a chargeable gain does not usually arise from a debt, because of the CGT debt exemption in s.251(1) TCGA.[26]

Section 252(1) TCGA provides:

> [A] Section 251(1) does not apply in relation to a gain accruing to a person on a disposal of a foreign currency debt (or an interest in such a debt)
> [B] unless that person is--
> (a) an individual,
> (b) the trustees of a settlement, or
> (c) the personal representatives of a deceased person.

Section 252(2) TCGA defines "foreign currency debt":

> A "foreign currency debt" is a debt–
> (a) owed by a bank[27] in a currency other than sterling, and
> (b) represented by a sum standing to the credit of an account holder in an account in that bank.[28]

The label "foreign currency debt" is not apt; "foreign currency bank account debt" would be better; but there it is. Adopting the terminology of s.252(1)[A], it notionally disapplies CGT debt exemption, in the case of a "foreign currency debt". But then para [B] then adds an exception so large that the exemption is (more or less) restored.

The relief in para [B] does not apply to companies, but that does not matter, as:

(1) UK companies are governed by the loan relationship rules (not discussed here).
(2) Foreign currency debts of non-resident companies are essentially outside the scope of CGT.[29]

[25] See 95.11 (Foreign banknotes/coins).

[26] See 56.22.1 (CGT debt exemption).

[27] "Bank" is not defined, but it does not matter.

[28] CG Manual 78330 formerly provided: "Foreign currency certificates of deposit in bearer form are not within TCGA 1992, s.252." The passage was deleted in 2010. One is left to speculate as to whether HMRC have changed their view. The issue would require an examination of the nature of certificates of deposit.

[29] See 64.4 (Computing gains: CT rules).
HMRC say: "There is no need to include companies in the exemption because

It would have been simpler to apply CGT debt exemption to all persons, ie to repeal the whole of s.252 TCGA; but there it is.

There could be a chargeable gain on a foreign currency debt (even a bank account debt), if s.251 relief did not apply, such as a secondhand debt or a debt on a security. But it is not necessary to consider the topic here.[30]

95.11 Foreign banknotes/coins

Foreign banknotes/coins are assets on which a gain may accrue.[31]

CG Manual provides:

> **CG78316 Identification of disposals with acquisitions** [Jul 2019]
> Foreign currency is subject to the same rules of identification and pooling as unquoted shares and securities. See CG50500+.

The share pooling/matching rules apply.[32]

95.11.1 *Foreign currency for personal expenditure*

There is an exemption for foreign currency needed for personal expenditure abroad. This is not likely to affect remittance basis taxpayers, as gains on disposals of this kind are not likely to be remitted, but it is important for others. Section 269 TCGA provides:

> A gain shall not be a chargeable gain if accruing on the disposal by an individual of currency of any description acquired by him for the personal expenditure outside the UK of himself or his family or dependants (including expenditure on the provision or maintenance of any residence outside the UK).

Cryptoassets (such as bitcoin) are not currency[33] and so outside this exemption. But the point is not likely to arise.

companies' returns from FCBAs [foreign currency bank accounts] are not liable to tax on capital gains." Reform of the taxation of non-domiciled individuals: summary of responses to consultation (2011) para 2.102
http://webarchive.nationalarchives.gov.uk/20130129110402/http://www.hm-treasury.gov.uk/d/condoc_responses_non_domicile_reform.pdf

[30] See the 2011/12 edition of this work chap 49 (Foreign currency issues).

[31] See 56.3.2 ("Assets")

[32] See 56.12 (Share pooling and matching).

[33] See 96.5 (Cryptoassets: Currency/money?).

95.11.2 *Critique*

The taxation of foreign banknotes/coins should be the same as foreign currency bank accounts, and the relief in s.251 should be extended. However in practice this is not so important as it would be unusual for a person to hold substantial foreign currency outside a bank account (except perhaps as trading receipts outside CGT).

95.12 Interaction with mixed fund rules: HMRC examples

The CG Manual provides examples of the following:
(1) Remittance of part of FC account holding capital gain (Fatima)
(2) Ditto with previous offshore transfer (example 2)
(3) Remittance of part of FC account holding income & gain (example 3)
The RDR Manual provides examples of the following:
(4) Remittance of part of FC account holding income (Julius).
(5) Remittance of part of FC account holding RFI and RFE (Tom)
(6) Ditto with previous offshore transfer (Gelda)

The examples are discussed in the 2011/12 of this work, but this is not set out here as it is overtaken by the 2012 reforms.

95.13 Foreign currency issues: Critique

The 2012 reform, which was advocated in the 2011/12 edition of this book, genuinely deserves the title of simplification. The problems which remain could be solved as follows.

Annual exchange rate averaging The problem (for arising basis and remittance basis taxpayers) is the general impracticability when there are a significant number of transactions of converting foreign currency to sterling at a variety of moments during the year: the moment that income arises, the moment that gains arise, and the moment that capital expenditure is incurred. The solution is in the HMRC practice to allow use of an annual average rate in any currency during the year and to average out acquisitions and disposals. HMRC should publish rates each year for every currency. Provided taxpayers are not allowed to switch adventitiously between accurate and average exchange rates, this would have no significant cost implications.

Currency conversion date The second set of problems (for remittance basis taxpayers) arise from HMRC's mistaken view that the currency conversion date for income of a remittance basis taxpayer is the date of remittance. The solution is to recognise the existing law, or (if that is not accepted) to amend the law to the practitioners view. This would have no cost implications.

CHAPTER NINETY SIX

CRYPTOASSETS[1]

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[1] I am very grateful to Mark Pearce of Gateley Legal for his assistance with aspects of this chapter.

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Cross references

The following topics are considered elsewhere:

Pooling/matching: Cryptoassets	56.14
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96.1 Cryptoasset guidance

The discussion in this chapter draws on the following:

General law
Law Commission:[2]
Digital assets Final report ("Law Com Report") (2023)
Digital Assets Consultation paper ("Law Com Paper") (2022)
Digital assets and ETDs in private international law: Call for Evidence (2024)
UK Jurisdiction Taskforce, Legal statement on cryptoassets & smart contracts (2019)[3]
Cryptoassets Taskforce Final Report (Taskforce report)[4] (2018)

The starting point is the Law Com Report, which draws on the earlier papers.

Tax
Location of Cryptocurrencies – an alternative view (STEP crypto note)[5]

[2] *https://lawcom.gov.uk/project/digital-assets/*
https://lawcom.gov.uk/project/digital-assets-and-etds-in-private-international-law-which-court-which-law/

[3] *https://www.blockchain4europe.eu/wp-content/uploads/2021/05/6.6056_JO_Cryptocurrencies_Statement_FINAL_WEB_111119-1.pdf* (2019)

[4] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752070/cryptoassets_taskforce_final_report_final_web.pdf* (2018)

[5] *https://www.step.org/system/files/media/files/2021-09/step_note_location_of_cryptocurrencies-an_alternative_view_0.pdf* (Sep 2021). This is issued with the usual disclaimer.

HMRC, The taxation of Decentralised Finance involving the lending and staking of cryptoassets:[6]
Consultation paper ("the HMRC staking paper") (2023)
Call for evidence outcome (2023)

HMRC guidance is in the Cryptoasset Manual.

I go beyond the themes of this book and address the topic as a whole, but do not consider Corporation Tax or VAT.

96.2 Cryptoasset terminology

96.2.1 *"Cryptoasset"*

Cryptoasset does not have a widely agreed definition. A variety of definitions have been proposed, and different definitions may be appropriate in different contexts.

Regulation 14A(3) MLR 2017 adopts this definition:

> For the purposes of this regulation—
> (a) "cryptoasset" means
> [i] a cryptographically secured digital representation of value or contractual rights
> [ii] that uses a form of distributed ledger[7] technology and
> [iii] can be transferred, stored or traded electronically; ...
> (c) in sub-paragraphs (a), (b) and (c) of paragraph (1), "cryptoasset" includes a right to, or interest in, the cryptoasset.[8]

The Crypto Manual also adopts this definition:

[6] *https://www.gov.uk/government/consultations/the-taxation-of-decentralised-finance-involving-the-lending-and-staking-of-cryptoassets*
https://www.gov.uk/government/calls-for-evidence/call-for-evidence-the-taxation-of-decentralised-finance-involving-the-lending-and-staking-of-cryptoassets/the-taxation-of-decentralised-finance-involving-the-lending-and-staking-of-cryptoassets-call-for-evidence

[7] The glossary to the Law Commission crypto paper provides:
Distributed ledger A digital store of information or data. A distributed ledger is shared (that is, distributed) among a network of computers (known as nodes) and may be available to other participants. Participants approve and eventually synchronise additions to the ledger through an agreed consensus mechanism.

[8] This wording is based on the Taskforce Report para 2.2. It is copied in later statutory instruments regulating cryptoassets, eg the Sanctions (EU Exit) (Miscellaneous Amendments) Regulations 2022 and the Sanctions (EU Exit) (Miscellaneous Amendments) (No.2) Regulations 2022. Perhaps it will become the standard definition.

> **CRYPTO10100: what are cryptoassets** [Apr 2021]
> Cryptoassets (also referred to as 'tokens' or 'cryptocurrency') are cryptographically secured digital representations of value or contractual rights that can be transferred/stored/traded electronically
> While all cryptoassets use some form of Distributed Ledger Technology (DLT) not all applications of DLT involve cryptoassets.

I refer to that as the MLR/HMRC definition of cryptoasset, and that is the definition used in this chapter.[9]

There are not (yet) any statutory definitions of cryptoasset for tax, for there are not (yet) any statutory tax provisions which deal with cryptoassets; but that is just a matter of time.

Cryptoasset may be abbreviated to crypto, which may in the future become the usual word; but in this work I only use that term in headings where space is short.

"Stablecoins" are crypto-tokens with a value that is intended to be pegged, or tied, to a currency, commodity or financial instrument. But it makes no difference for tax whether a cryptoasset has stablecoin status.

96.2.2 *Law Commission terminology*

The Law Commission Report uses different terminology:

Digital asset, defined as:

> Any asset that is represented digitally or electronically. There are many different types of digital assets, not all of which will be capable of being

[9] The HMT paper "Cryptoasset promotions: Consultation response" would tweak the definition:

"4.17 The government has reassessed the necessity of specifying the type of underlying technology a cryptoasset uses in a legal definition. While most cryptoassets currently use DLT, it might be that this changes as the technology and industry evolve. Therefore, the government proposes to remove the reference to DLT from the definition of qualifying cryptoassets. This will future-proof the definition for innovations in the underlying technology that cryptoassets utilise. This technology-agnostic definition is in line with the definition proposed by the government in its consultation on the regulatory treatment of stablecoins.

4.18 In line with the policy set out here, the government intends to define the scope of 'qualifying cryptoasset' as any cryptographically secured digital representation of value or contractual rights which is fungible and transferable."

See *https://www.gov.uk/government/consultations/cryptoasset-promotions*

I do not think that change fundamentally alters the concept.

> things to which personal property rights can relate. In this report, we use the term in a broad sense."

Crypto-token defined as:

> A crypto-token exists as a notional quantity unit manifested by the combination of the active operation of software by a network of participants and network-instantiated data. For more detail, see Chapter 4 (Third thing in practice).

The Law Commission Report uses a different definition of Cryptoasset:

> A cryptoasset, in the sense we use it in this report, refers to a crypto-token which has been "linked" or "stapled" to a legal right or interest in another thing. Linking or stapling refers to a legal mechanism whereby the holder of a legal right or interest in a thing is identified by reference to a crypto-token. For more detail, see Chapter 8 (Collateral arrangements).

But in this chapter I use the term cryptoasset in the MLR/HMRC sense.

96.2.3 *Types of cryptoasset*

The Taskforce report provides:

> 2.11 The Taskforce considers there to be three broad types of cryptoassets:
> A. **Exchange tokens** – which are often referred to as 'cryptocurrencies' such as Bitcoin, Litecoin and equivalents. They utilise a DLT platform and are not issued or backed by a central bank or other central body. They do not provide the types of rights or access provided by security or utility tokens, but are used as a means of exchange or for investment.
> B. **Security tokens** – which amount to a 'specified investment' as set out in the Financial Services and Markets Act (2000) (Regulated Activities) Order. These may provide rights such as ownership, repayment of a specific sum of money, or entitlement to a share in future profits. They may also be transferable securities or financial instruments under the EU's Markets in Financial Instruments Directive II (MiFID II).
> C. **Utility tokens** – which can be redeemed for access to a specific product or service that is typically provided using a DLT platform.

This chapter is concerned with exchange tokens. The tax treatment of security tokens is different. It would aid clarity of thought not to use the word cryptoasset to describe both exchange tokens and security tokens.

96.3 Assets which are not cryptoassets

96.3.1 *Underlying non-crypto asset*

The Crypto Manual provides:

> **CRYPTO22600: location of exchange tokens** [Feb 2022]
> ...**Underlying Asset**
> ... Where the cryptoasset is simply a digital representation of an underlying asset then the location of the underlying asset will determine the location of the cryptoasset.
> **Example**
>
> > ABC Ltd buys and sells gold bullion on behalf of clients. ABC Ltd issues the GoldABC Coin where each token represents the beneficial interest in one gold bar. The GoldABC Coin is a digital representation of a physical asset – the gold bar – and we 'look through' the GoldABC Coin and establish the location of the GoldABC Coin by reference to the underlying asset, being gold bar.
> > It is possible for a cryptoasset to be a digital representation of another intangible asset, such as share capital or debt, and the relevant rule for determining the location of the underlying asset would determine the location of the cryptoasset.

I think it is not helpful to call this a cryptoasset. The "cryptoasset" is an entry in a ledger which is merely evidence of ownership of the underlying asset.[10] If the term crypto is used here, it should be borne in mind that this is a different use of the word.

The Law Commission paper terminology makes the distinction by referring to: (1) crypto- token (the code or register) and (2) cryptoasset (a separate asset to which the token relates).[11] Perhaps that will catch on.

The same applies to a "non-fungible token" which is a crypto-token that has an individual identification number (hence, not fungible) and evidences ownership of an asset, (a digital asset, eg digital art, or a physical asset); or which may be used to certify that a physical asset such as an item of clothing is genuine.

96.3.2 *Cryptoasset derivative*

The Crypto Manual provides:

[10] UK Jurisdiction Taskforce agree: Legal Statement on Cryptoassets and Smart Contracts para 95.

[11] Para 14.3 ff.

> **CRYPTO10150: Derivatives over cryptoassets** [Feb 2022]
> A derivative is a financial instrument where the performance is based on the movement of the price of the underlying asset. Under a derivative the holder does not hold the underlying asset. Some businesses offer the ability for individuals and companies to gain exposure to the movements in the cryptoasset market by using a derivative.
> The nature of a derivative is typically very different to directly holding a cryptoasset. In particular, a derivative will give rise to contractual rights and obligations between the two parties. As a result, where a cryptoasset derivative has been entered into the guidance in this manual will not generally apply.
> Where a company enters into a derivative over a cryptoasset this will typically constitute a 'derivative contract' within Part 7 of CTA09...

In short, a cryptoasset derivative is not a cryptoasset, just as a gold derivative is not gold.

96.4 Cryptoassets: Property

Everyone agrees that:

(1) Cryptoassets are property, of a somewhat novel kind.[12]

(2) Cryptoassets are property for IHT purposes, and assets for CGT purposes, and so within IHT/CGT.[13]

96.5 Cryptoassets: Currency/money?

96.5.1 *Terminology: Currency/money*

Statute uses the terms money/currency/cash. These are used (more or less) synonymously, though when discussing statutory provisions it is best to use the same term as the statute, and not a synonym.

There is generally no statutory definition so (subject to context) the words have their normal meaning. But of course the words have a range of meanings. Mann and Proctor on the Law of Money[14] states that

[12] Law Commission Report para 3.40 ff. Underlying the statement that cryptoassets are property are deep questions as to the meaning of property. See the Law Commission Crypto paper chapter 2, especially 2.10:

> "This consultation paper endorses an understanding of property as 'a socially approved power-relationship in respect of socially valued assets, things or resources'."

[13] There are of course wide definitions; see 56.3.2 ("Assets"); 74.2.1 ("Property"). But it is not necessary to rely on them here.

[14] Proctor, *Mann and Proctor on the Law of Money* (8th ed, 2022), chap 1.

economists define money by reference to some of its functions, namely:
(1) a medium of exchange
(2) a measure of value
(3) a store of wealth
(4) a unit of account

There is no single widely agreed legal definition of money, and no reason why economists and lawyers should use the same definition, but to simplify a long discussion, these functions, especially the first, may be regarded as indicia of money in the legal sense. As it is a question of fact whether (or to what extent) an asset fulfills these functions, the question of whether an asset is money is a mixed question of fact and law.

96.5.2 *Cryptoassets not currency/money*

It is generally agreed that cryptoassets are not currency/money. The Taskforce Report provides:

> 2.13 While cryptoassets can be used as a means of exchange, they are not considered to be a currency or money... They are too volatile to be a good store of value, they are not widely-accepted as means of exchange, and they are not used as a unit of account.

The Crypto Manual provides:

> **CRYPTO22550 Currency** [Feb 2022]
> HMRC does not consider cryptoassets to be currency or money.

The Law Commission Report provides:[15]

> 6.71 The characterisation of crypto-tokens as money or otherwise is outside the scope of this report. However, we make three observations on the point. First, the debate on whether a crypto-token is "money" has largely focused on a specific sub-set of crypto-tokens over the last few years (that is, those that are intended to function in a similar way to money), rather than on crypto-tokens in general. However, other crypto-tokens are not designed to replicate the functionality or characteristics of money. So the special defence applicable to money would remain inapplicable to those types ofcrypto-token.
> 6.72 Second, whether a crypto-token (or specific crypto-token) is

[15] Original footnotes omitted.

> characterised as money is likely to depend on the law of the particular jurisdiction in question and this characterisation might be different across different jurisdictions. Indeed, some crypto-tokens are already recognised as legal tender in some jurisdictions. It is also possible that some jurisdictions will adopt central bank digital currencies, which might be given "monetary" status by legislation.
>
> 6.73 Third,”the property regime applying to money is just one of a number of legal devices by which the state can support the efficiency of monetary functions”. It is therefore less accurate to ask “are crypto-tokens money?” than to ask the specific question as to whether the law is able to characterise crypto-tokens as something that should enjoy a privileged proprietary status which other kinds of assets or things do not enjoy. This question can be asked separately for each distinct "legal device" by which the state can support the efficiency of monetary functions...

In other words, it is better not to have to ask whether cryptoassets are money. But when statutes use the word money/currency, the question cannot be avoided.

In 2021 El Salvador (population 6m, GDP 25 billion USD, in 2020) recognised Bitcoin as “legal tender”. But in assessing whether that turns Bitcoin into money, one needs to look beyond the label. National Bureau of Economic Research reports:[16]

> Although the law requires all firms to accept bitcoin, in reality only 20% do so. Roughly 5% of all sales have been paid in bitcoin through Chivo Wallet, and just as most households using Chivo prefer to keep their money in cash rather than in bitcoin, 88% of firms convert their bitcoin into dollars.

In the UK, the Foreign Office advise:

> British Nationals considering using Bitcoin should ensure that they understand the processes and risks involved, and that they have access to US dollars if they need them.[17]

In 2022, the Central African Republic (population 5m, GDP 2 billion

[16] Alvarez, Argente & Patten, “Are Cryptocurrencies Currencies? Bitcoin as Legal Tender in El Salvador” NBER Working Paper 29968 (2022) *https://www.nber.org/papers/w29968*

[17] *https://www.gov.uk/foreign-travel-advice/el-salvador/money*

USD, in 2020) also made Bitcoin legal tender, or at least so it said. Though BBC report that “There has certainly not been a sudden explosion in the capital, Bangui, of businesses such as shops or cafes accepting Bitcoin as a means of payment.”

The change of asset status from not being currency/money to being currency/money would have profound implications for tax and, even more, I suspect, for non-tax purposes. So the change should not be inferred lightly, eg from legal constructs in small and remote developing countries, and particularly where the legal theory is not reflected in actual practice.

Closer to home, the UK Government considers that stablecoins linked to currency:

- share characteristics with e-money; and
- have the potential to develop into a widespread means of payment and store of money[18]

The government intends “to legislate to bring stablecoins – where used as a means of payment – within the payments regulatory perimeter”.[19] If that happens, it is possible that these stablecoins may become currency/money; though that change would only affect a small proportion of the totality of cryptoassets.

96.5.3 *Non-money status: Tax consequences*

It follows that statutory references to money/currency do not in principle apply to cryptoassets. (Context could of course show that the term currency is used widely, or loosely, and includes cryptoassets. That is the case for VAT.[20])

References to “money” in tax provisions do not apply to cryptoassets,

[18] HM Treasury, “UK regulatory approach to cryptoassets, stablecoins, and distributed ledger technology in financial markets: Response to the consultation and call for evidence” (April 2022) para 1.5; 2.30; 2.42. But this will not apply to unbacked stablecoins that seek to maintain a stable value by using algorithms, or those linked to assets other than currency. These are said to be unlikely to meet the requirements for retail payments: para 2.46; 2.53.
https://www.gov.uk/government/consultations/uk-regulatory-approach-to-cryptoassets-and-stablecoins-consultation-and-call-for-evidence

[19] Press release, 4 April 2022
https://www.gov.uk/government/news/government-sets-out-plan-to-make-uk-a-global-cryptoasset-technology-hub

[20] *Skatteverket v David Hedqvist* C-264/14.

with the following consequences:[21]

(1) Payment for use of cryptoassets is not interest (defined as payment by time for the use of money)
(2) An obligation to transfer cryptoassets is not a loan relationship (the definition requires a money debt)[22]
(3) Giving cryptoassets to charity does not qualify for Gift Aid relief, (which requires a gift of a sum of money)

The word "payment" (or "paid") when used in its strict sense means payment of money, and when used in that sense does not include a transfer of cryptoassets. For instance, a transfer of cryptoassets to a registered pension scheme does not qualify for relief, as pension contributions must be paid in money.[23]

References to "currency" in tax provisions, which do not apply cryptoassets, include the CGT relief for personal expenditure.[24] But as that relief is limited to personal expenditure, the point is not likely to arise, except, perhaps, for visitors to El Savador and Central African Republic.

References to "cash" in tax provisions, which do not apply cryptoassets, include CGT incorporation relief, which requires assets other than cash to be transferred.

A debt in its natural sense means an obligation to pay money so an obligation to transfer cryptoassets (**"a cryptoasset obligation"**) is not a debt. References to debt in statutory provisions, which do not include a cryptoasset obligation, include the CGT exemption for debts and foreign currency bank accounts.[25]

If cryptoassets become money, then:

(1) An cryptoasset obligation will be a debt and may be a loan relationship; but
(2) Directly held cryptoassets would not be a debt, or a loan relationship.

That would be anomalous.

In the (perhaps unlikely) event that regulatory reforms give cryptoassets

[21] Of course this list is not comprehensive. Some minor remittance basis provisions refer to money; see 18.13.1 (Property" and "money").

[22] See 64.5.1 ("Loan relationship").

[23] See 15.2.3 (Payment: WHT, PAYE).

[24] See 95.11.1 (Foreign currency for personal expenditure).

[25] See 56.22.1 (CGT debt exemption). The relief would still apply if the debt were a foreign currency debt (as defined); see 95.10 (Foreign currency bank account: CGT).

the status of money, these issues would need to be considered further.

96.6 Cryptoasset situs

96.6.1 *Case law and HMRC view*

In *Fetch AI Ltd v Persons Unknown*:[26]

> It was submitted that [cryptocurrency] was property located in England because that was, in essence, the country where the owners of the assets concerned were located. In that regard, I adopt, with respect, the conclusions reached by Butcher J in *Ion Science v Persons Unknown*[27] ...
>
> > ...lex situs of a cryptoasset is the place where the person or company who owns it is domiciled.

It is considered that the test of situs adopted here is residence of the owner. The judgment cites Prof Dickinson (see below) who refers (in short) to residence. In the *Fetch AI* judgment we have the words "located" and "domiciled". But the context shows that "domicile" is not a reference to common law domicile, but has a sense similar to that in CJJA 1982 which amounts to jurisdiction-residence.[28] That may be the definition of domicile which first comes to the mind of a practitioner in private international law. And "located" must be read in the same sense. This view is now supported by *Tulip Trading Ltd v Bitcoin Association For BSV*.[29]

[26] [2021] EWHC 2254 (Comm) at [14]. This was an application attended by one party only. Such a judgment is not citable in court, unless it contains an express statement that it purports to establish a new principle or to extend the present law. But that requirement appears to be met. See Practice Direction (Citation of Authorities) [2001] 1 WLR 1001.
https://webarchive.nationalarchives.gov.uk/ukgwa/20110204002153/http://www.hmcourts-service.gov.uk/cms/814.htm
For completeness: The comment was again cited and approved in *Danisz v Persons Unknown* [2022] EWHC 280 at [17], another application attended by one party only. But that does not add anything.

[27] Unreported, 21 December 2020 at [13]; I have not seen a copy of this judgment.

[28] Section 41 CJJA 1982 provides: "An individual is domiciled in the UK if and only if—
(a) he is resident in the UK; and
(b) the nature and circumstances of his residence indicate that he has a substantial connection with the UK."

[29] [2022] EWHC 667 (Ch) [142] - [148]; the question of situs was not discussed on the appeal.

HMRC (more or less) agree. The Crypto Manual provides:

> **CRYPTO22600: location of exchange tokens** [Feb 2022]
> **... No Underlying Asset**
> Where the cryptoasset is an asset distinct from any underlying asset then HMRC's view is that none of the statutory rules in the TCGA 1992 apply...
> For Inheritance Tax, common law is relevant to the extent that Double Taxation Agreements do not determine the location.[30]

So the common law rules situs apply to CGT and IHT.

> Instead it is HMRC's view that:
> - exchange tokens have an economic value as they can be 'turned to account' - for example, exchanging them for goods, services, fiat currency or other tokens;
> - exchange tokens are a new type of intangible asset (different to other types of intangible assets, such as shares or debentures); and
> - the only identifiable party to consider is the beneficial owner of the exchange token,
>
> such that the location of the cryptoasset will be determined by the residency of the beneficial owner
> Using the residency of the beneficial owner of the exchange tokens to determine the location gives a clear, logical, predictable and objective rule which can be easily applied. This means that a person who holds exchanges tokens is liable to pay UK tax if they are a UK resident (as determined by the Statutory Residence Test, see RDRM11000) and carry out a transaction with their tokens which is subject to UK tax...

96.6.2 *Which residence test?*

The Manual agrees with *Fetch AI* that the test of situs is residence of the beneficial owner. The difference, if such it be, is that HMRC say the test of residence should be the SRT. The SRT is the definition of residence which first comes to the mind of a tax practitioner. But the SRT cannot be the applicable test of residence for situs, because:

(1) Situs is a general law concept.
(2) The SRT applies for limited tax purposes. For instance, it does not apply to companies or to trusts.
(3) What matters for situs is the situs at any particular moment, whereas the SRT determines residence for a tax year, and it may not be

[30] Author's footnote: Existing DTAs do not determine the location of cryptoassets.

determined until well after the end of the year.

It is clear that the residence test should be the same as for debts, ie residence here means jurisdiction-residence.[31]

For individual owners, that will generally give the same result as the SRT, so the point will rarely if ever arise in practice. Perhaps HMRC only mean to say that the SRT is a convenient rule of thumb which they use to identify jurisdiction-residence.

Where the individual is dual-resident a tie-breaker test of chief residence would be appropriate.

Similarly for companies, the test is jurisdiction-residence, but that will generally give the same result as the corporate tax residence tests.

Where cryptoassets are held by a trust, the test is the jurisdiction-residence of the trustees (not the IT/CGT trustee residence test). Some tiebreaker rule must be applied if the trust has trustees resident in different jurisdictions, but the issue will not often arise, except, perhaps, by accident.

96.6.3 *Prof Dickinson's view*

Fetch.AI and *Ion Science* refer to Dickinson's essay in *Cryptocurrencies in Public and Private Law*:[32]

> 5.109 ... the benefits accruing to a person who is a participant[33] in a cryptocurrency system such as Bitcoin or Ripple (i) are a species of intangible property in the English conflict of laws, which (ii) arises from the participation of an individual or entity in the cryptocurrency system, and (iii) is appropriately governed by the law of the place of residence or business of the participant with which that participation is most closely connected.
>
> Rather than deciding a fictional situs, the choice of law rule can be more straightforwardly, and appropriately, expressed in the terms that the

[31] See 102.14.2 ("Jurisdiction-residence"). STEP crypto guidance agrees: "residence must surely be tested by reference to relevant common-law principles and not by reference to the tax definition contained in the statutory residence test. The reason for this is that, as explained above, the location of an asset is a general common law concept and is relevant for purposes which go beyond taxation."

[32] Chapter 5, "Cryptocurrencies and the Conflict of Laws"; Ed Fox & Green, (1st ed, 2019) para 5.106-5.112; footnotes are omitted.

[33] Author's footnote: Dickinson does not define "participant" but the context shows the meaning is "owner", which is word used in *Fetch AI*.

> proprietary effects outside the cryptocurrency system of a transaction relating to cryptocurrency shall in general be governed by the law of the country where the participant resides or carries on business at the relevant time or, if the participant resides or carries on business in more than one place at that time, by the law of the place of residence or business of the participant with which the participation that is the object of the transaction is most closely connected.

At first sight this passage is not relevant to the question of cryptoasset situs. The author does not say that the situs of a cryptoasset is the place of residence or business. He says that (for the purpose of ascertaining what is the law applicable to a dispute) private international law should reject a situs test.[34] He proposes a place of residence/business without using the word or concept of situs. He prefers to avoid what he calls a fictional situs (though I would use the softer word "technical"[35]). However that may be, *Fetch.AI* regarded the passage as supporting a place of residence/business test for situs, and when situs has to be determined, it seems sensible to have regard to the relevant private international law rule, even if that rule is formulated without using the word *situs*.

96.6.4 *STEP view*

The STEP crypto note floats another view:

> a case could be made for allocating the location of cryptocurrency to the place where it can effectively be dealt with

"A case could be made" is somewhat tentative guidance.[36] But adopting that test, where can cryptoassets be dealt with?

> it can only be dealt with by the use of the private key and, arguably, its location should therefore be linked to the location
> [1] of the private key or
> [2] of the person who has control of the private key (who may or may not be the beneficial owner).

As to [1], the private key is a code or number, which does not have a physical location, even if it is held on a hard drive which has a physical

[34] This is a widely held view; see 102.1.1 (Situs in tax/private international law).

[35] See 102.2.1 (Is situs fictional?).

[36] "Arguably" in the passage which follows emphasises the tentative nature of the guidance.

location. The hard drive is not the code: it is merely a record of the code.[37]

As to [2], in principle the owner will have control of the key. So that takes us back to what STEP call the location (meaning, I assume, residence) of the owner.

Amy Held rejects the STEP suggestion:[38]

> ... the UK Financial Markets Law Committee has identified a potential solution emphasising the private key.[39] Two possibilities for an artificial situs stem from such premise:
>
> (i) the place where the private key is situate; or
>
> (ii) the place where the system participant transferring the crypto asset – using the private key – is resident, or has its centre of main interests, or is domiciled.
>
> The primary difficulty with this approach lies in the nature of the private key itself as a large and unique number generated according to cryptographic standards of randomness. Private keys are, thus, in themselves just as much an intangible concept as the crypto asset itself. Accordingly, any proposed solution to the problem of localising a crypto asset based on the private key merely defers consideration of the issue: where then is the private key situate for the purpose of proposal (i) above? In addition, the ease with which infinite copies of a private key,

[37] Dickinson agrees, at 5.89:

> "It is important to distinguish the proprietary aspect of a cryptocurrency from questions of title to any computer or other device on which the information relating to a cryptocurrency (including, for example, a private key or a copy of the blockchain) is held."

Likewise the Law Commission crypto paper 10.34:

> "a private key, which is not an instantiated data structure in itself, should simply be conceptualised as information that is not capable of attracting property rights."

The UKJT Statement made this point forcefully:

> "[A private key] is no more than an item of pure information and, like a password or a telephone number, it cannot itself be treated as property."

[38] Amy Held,, "Crypto Assets and Decentralised Ledgers: Does Situs Actually Matter" (2023) *https://brill.com/edcollchap-oa/book/9789004514850/BP000017.xml?body=pdf-60830*

See too, Amy Held, "Cryptoassets as property under English law Pt II: ownership, situs and the circular question of jurisdiction" (2023) 4 Journal of International Banking and Financial Law 236.

[39] Financial Markets Law Committee, "Issues of Legal Uncertainty Arising in the Context of Virtual Currencies" (2016), para 6.21 ff *http://fmlc.org/report-virtual-currencies-18-july-2016/*

> once generated, may be made poses significant difficulties for identifying which copy is definitive for the purpose of a legally valid transfer. In the absence of a definitive register linking private keys with users, the difficulty in identifying who in fact used a private key to propose a change in state within an unpermissioned network – and whether the law considers that they were entitled to do so – renders proposal (ii) above untenable.

It may be possible to arrange that use or access to the key is constrained. For example, some 'closed-systems' require the key to be inputted from a certain physical location. If that requirement could not be altered, that location might be the situs. That is where the asset must be dealt with. But I wonder if the requirement could actually be made unalterable.

This takes us to the topic of "cold wallets". A cold wallet is a piece of hardware such that a transfer of cryptoassets to which it relates requires the physical use of the cold wallet. It might be said that the cold wallet contains the cryptoassets, but it may be more accurate to say it contains the key to the intangible cryptoassets. Still, some argue,[40] the location of the cold wallet is the situs for the cryptoassets to which it relates. Alternatively it might be said that the situs of the cold wallet is where the cryptoassets are dealt with. This analysis would allow taxpayers, through the use of cold wallets, to arrange cryptoassets to have non-UK situs for UK tax purposes. That is an attractive outcome for taxpayers, but not for HMRC. In a tax appeal, at least, the courts are not likely to be sympathetic to a taxpayer who has used a cold wallet for tax reasons of tax planning (which a court may regard as tax avoidance). In practice cold wallets may however be preferred for non-tax reasons, as they are more secure. Even then, a court may still prefer a rule which does not permit taxpayers to chose the situs.

If there were a single place where the register or record is kept, that should be the situs. But as I understand the technology, there need not be, and generally will not be, any single place where the register or record is kept, so this is not a workable test.[41]

There is no requirement that the test of situs is the same for all cryptoassets. Suppose one could identify a class of cryptoassets where there is a clear place where:

[40] See Brockhurst, *Cryptoassets for Private Clients: A Practitioner's Guide* (1st ed, 2023).

[41] See 102.6.3 (Dematerialised register).

(1) the register or record is kept, or
(2) the cryptoasset can be dealt with.

Then one might say that place is the situs of for that class, with a different rule (residence of the owner) for other types of cryptoassets.[42] But I wonder if one can identify any class of cryptoassets where there is a clear place where the register or record is kept, or where the cryptoassets can be dealt with, except perhaps by the technique of cold wallets, which are manipulable and easily reversible.

Law Commission, "Digital assets and ETDs in private international law; Call for Evidence" considers a range of other proposals.[43]

96.6.5 *Cryptoasset co-ownership*

In cases of simple co-ownership, situs of each co-owner's interest depends on that co-owner's residence. HMRC agree:

> **CRYPTO22600: location of exchange tokens** [Feb 2022]
> If an exchange token is co-owned between two or more beneficial owners, then section 275C TCGA 1992 applies (for Capital Gains Tax).[44] Each beneficial owner's interest in the asset will be where that beneficial owner is resident. If one or more of the co-owners are UK resident, this will not affect the location for those co-owners who are not UK residents.

In cases of intermediated ownership, the IHT/CGT situs rules differ. Situs for IHT is governed by the common law rules which govern intermediated securities.[45] These rules do not apply for CGT.[46]

Of course, if co-ownership takes the form of a unit trust, then unit trust rules apply.[47]

96.6.6 *Cryptoasset situs planning*

To avoid UK situs for IHT and CGT purposes, a UK resident foreign

[42] Shares offer an analogy, with the distinct rules that registered shares are situate where registered, and bearer shares (which by definition have no register) are situate where the physical bearer certificate is located.

[43] See p.234 (Potential solutions to the lex situs rule).

[44] See 103.3 (Co-owned assets).

[45] See 71.3 (Transparent intermediated security: Situs for IHT/IT).

[46] See 71.4 (Proprietary intermediated security: Situs for CGT). Insofar as it suggests the contrary, the STEP crypto note should not be followed.

[47] See 69.10 (Situs of unit).

domiciliary may hold cryptoassets through a non-resident trust, company, or trust/company structure.

The cost of sheltering a gain is that it would restrict the use of a loss, if a loss accrues on a disposal, a company to a greater extent than a trust.

A foreign partnership would avoid UK situs for IHT though not for CGT purposes.

96.7 Crypto activity: Trading?

This section considers whether various activities involving cryptoassets constitute trading.

Cryptoassets are not securities, but they are in some ways analogous to financial products. The question whether cryptoasset activities are trading is governed by the same principles as for other financial products.[48]

96.7.1 *Buying/selling crypto: Trading*

The Crypto Manual provides:

> **CRYPTO10450 Why HMRC Does Not Consider Buying And Selling Cryptoassets To Be Gambling** [Apr 2022]
> HMRC does not consider the buying and selling of cryptoassets to be the same as gambling.

This is clearly not gambling in the strict sense of betting/wagering.[49]

> **CRYPTO20250: What is trading** [Apr 2021]
> Only in exceptional circumstances would HMRC expect individuals to buy and sell exchange tokens with such frequency, level of organisation and sophistication that the activity amounts to a financial trade in itself...
> As with any activity, the question whether cryptoasset activities amount to trading depends on a number of factors and the individual circumstances. Whether an individual is engaged in a financial trade through the activity of buying and selling tokens will ultimately be a question of fact...
> A trade in exchange tokens would be similar in nature to a trade in shares, securities and other financial products. The approach to be taken in determining whether a trade is being conducted or not would also be similar, and guidance can be drawn from the existing case law on trading in shares and securities.

[48] See 72.15 (What is a financial trade?).

[49] See 72.15.4 ("Gambling").

The Crypto Manual takes the same view for companies:

> **CRYPTO40150 Trading In Exchange Tokens** [Apr 2021]
> Only in exceptional circumstances would HMRC expect businesses to buy and sell exchange tokens with such frequency, level of organisation and sophistication that the activity amounts to a financial trade in itself.

But it is possible for individuals to trade, and if transactions are very numerous, say, many thousands of transactions each year, then trading is likely; and companies may trade more easily than individuals. See 70.15 (What is a financial trade?).

96.7.2 *Is lending a trade*

The Crypto Manual provides:

> **CRYPTO61211 Making A Defi Loan: Introduction** [Feb 2022]
> ... Much like when a person buys and sells cryptoassets, HMRC expects that individuals will only be carrying on a trade involving the making of DeFi loans in exceptional circumstances (see CRYPTO20250).
> The relevant factors for consideration when determining whether an individual has a trade involving the making of DeFi loans would be similar to those applied to transactions in shares, securities and other financial products, the guidance for which can be found at BIM56800.

The Crypto Manual provides:[50]

> **CRYPTO21200 Staking** [Feb 2022]
> ... Whether [staking] amounts to a taxable trade (with the tokens as trade receipts) depends on a range of factors such as: degree of activity/organisation/risk/commerciality

There is not much guidance there, but perhaps it is the best that can be done. I would have thought that the test of what is trading should be the same for lending and for staking, but what matters is not what the activity is called but what the activity involves.

96.7.3 *Mining: Trading*

The Crypto Manual uses the same text as for staking:[51]

> **CRYPTO21150 Income Tax: Mining Transactions** [Apr 2021]
> ... Whether [mining] amounts to a taxable trade (with the tokens as trade

[50] The text is repeated in relation to companies: CRYPTO40250 (Staking).

[51] The text is repeated in relation to companies: CRYPTO40200 (Mining Transactions).

receipts) depends on a range of factors such as: degree of activity/organisation/risk/commerciality

96.8 Lending/staking cryptoassets

96.8.1 *Staking/lending terminology*

The glossary to the Law Commission crypto paper provides:

> The term staking derives from its use within the "proof-of stake" type of consensus mechanism used by certain blockchains or crypto-token systems to achieve distributed consensus. Under proof-of-stake consensus mechanisms, validators transfer or "stake" capital or value into a smart contract within the system. This staked value then acts as collateral that can be destroyed if the validator behaves in certain, pre-agreed ways which are considered to be negative for the overall consensus mechanism or system security (such as acting dishonestly or lazily). The validator is then responsible for checking that new blocks propagated over the network are valid and occasionally creating and propagating new blocks themselves. The validator is rewarded (often with new crypto-tokens) for undertaking this process (and contributing to the overall security of the consensus model) and penalised by the destruction of some or all of its staked collateral if it behaves in certain negative ways.
>
> The term staking has recently been used by market participants in a broader, less specific way, simply to refer to transferring or locking certain capital or value to smart contracts in return for a reward, even where no positive contribution is made by the staker and/or where the staked capital or value is not at risk.

The Crypto Manual uses the term in the second of these two senses:

> **CRYPTO61120 Meaning Of 'Loan' And 'Staking'** [Feb 2022]
>
> [*Lending:*] A person ("lender") transfers the control of tokens to another person ("borrower"). At the time that transfer occurs, the lender acquires a right to demand that the borrower transfers to the lender the control of an equivalent quantity of tokens at a time in the future to satisfy the loan.
>
> [*Staking:*] A person ("liquidity provider") transfers the control of tokens to a DeFi lending platform.[52] This type of transaction may be termed

[52] The Law Commission crypto paper glossary provides:
Decentralised finance (DeFi): A general term for automated and purportedly decentralised and/or disintermediated applications providing financial services on a

> "staking" or "providing liquidity". At the time when the transfer occurs, the DeFi lending platform transfers control of one or more different tokens to the liquidity provider.
> The DeFi lending platform has the ability to transfer the control of tokens provided to it by the liquidity provider to other persons ("borrowers"). It will normally do so on terms that mean the borrower has to provide a return to the DeFi lending platform in excess of the quantity of tokens that the borrower initially received. This return, or a part of it, will be passed onto the liquidity provider as their compensation for providing the liquidity to the DeFi lending platform.

The parties to a loan of cryptoassets (**"a crypto-loan"**) are the lender and the borrower.

HMRC refer to the parties to staking as (1) "the liquidity provider" and (2) "the DeFi lending platform", and they refer to the transaction as "providing liquidity". It might be easier to refer to the parties as (1) the **"staker"** and (2) the **"stakee"**.

The difference is that:

(1) Lending constitutes a transfer of ownership (and so a disposal) by the lender.

(2) Staking does not, or may not, do so.

However (assuming the solvency of the stakee!) the economic effect is the same, so I prefer use the term loan to include staking, and lender/borrower includes parties to staking. After all, these are all broad terms covering a wide range of transactions. At present, there are no precise terms or definitions.

96.8.2 *Position if trading*

The Crypto Manual makes the obvious points:

> **CRYPTO61211 Making A Defi Loan: Introduction** [Feb 2022]
> **Treatment where a trade is carried on**
> ... If an individual is considered to be carrying on a trade involving the making of DeFi loans/staking, then the activity that falls within the scope of that trade will be subject to Income Tax under Section 5 ITTOIA 2005. Income Tax will take priority over Capital Gains Tax and apply to the profits (or losses) of the trade.

(generally decentralised and often blockchain-based) settlement layer, including payments, lending, trading, investments, insurance, and asset management.

If there is a trade involving cryptoassets, those assets may potentially be held as either trading stock or as investment assets outside of the trade. Consideration will need to be given as to whether there have been any appropriations to or from trading stock.

96.8.3 *Position if not trading*

The Crypto Manual makes the obvious points:

Treatment where a trade is not carried on
If a trade is not carried on by an individual, or the activity which generates the return falls outside the scope of any trade, then the making of a DeFi loan/staking may give rise to a disposal of a chargeable asset (see CRYPTO61600). Where this is the case, Capital Gains Tax will apply to the disposal.
However, in exchange for making a DeFi loan/staking, the lender/liquidity provider will sometimes receive a reward for providing those services. For example, a lender of tokens may charge the borrower an agreed rate of return for the period of the lending. This return may be subject to Income Tax rather than Capital Gains Tax.
CRYPTO61212 Making A Defi Loan: Taxing Provisions [Feb 2022]
Capital Receipt
If the return has the nature of capital, then the return will not be chargeable to Income Tax and will instead be within the scope of Capital Gains Tax (see CRYPTO61630).
Revenue Receipt
If the return has the nature of income, then it will be within the scope of Income Tax. On the assumption that the transactions are not part of a trade carried on by the customer, the receipt will be within the scope of the miscellaneous income provisions (Part 5 ITTOIA 2005)...[53]
CRYPTO61213 Making A Defi Loan: Amount Chargeable To Income Tax [Feb 2022]
The miscellaneous income sweep-up provisions will only subject the return (see CRYPTO61130) received by the lender/liquidity provider and not the repayment of the principal to Income Tax. The repayment of the principal will be a capital transaction (see CRYPTO61620).
The return earned by the lender/liquidity provider will be a non-cash receipt. The amount to be charged under sections 687-689 ITTOIA 2005 is the money's worth of the receipt (see BIM100150). This will be the pound sterling value of the tokens received by the lender.

[53] The Manual makes some basic comments on Misc Sweep-up Income, which I omit; see 33.1 (Misc Sweep-up Income).

In some cases, the trading and miscellaneous income allowance may apply.

96.8.4 *Income or capital receipt*

The Crypto Manual provides:

CRYPTO61214 Making A Defi Loan: Nature Of The Return [Feb 2022]
...You will need to determine whether the return has the nature of income in the hands of the lender/liquidity provider or whether the return has the nature of capital. That is, was the return earned by the lender/liquidity provider by providing a service to the borrower/DeFi lending platform, or was the return realised from the capital growth of an asset owned by the lender/liquidity provider?

Due to the various operating models, the answer may not always be clear. Below is a list of factors which will help determine the nature of the return:

- Whether the return to be received by the lender/liquidity provider is known at the time the agreement is made. If the return to be received has been agreed, for example 5% per annum, this would indicate a revenue receipt. If the return to be received is unknown and speculative (and could result in a loss from the activity), this would indicate a capital receipt.
- If the return is realised through the disposal of a capital asset, this would indicate a capital receipt. If the return is paid by the borrower/DeFi lending platform to the lender/liquidity provider, this would indicate a revenue receipt.
- Whether the return is paid periodically throughout the period of the lending/staking or whether it is paid upon repayment of the principal. A one-off payment is more likely to have the nature of capital while a recurring payment is more likely to have the nature of income.
- Whether the period of the lending is fixed or indefinite, short-term or long-term.

This list is by no means exhaustive, and no single factor is determinative.

When the return may have the nature of revenue

In some cases, the return will be received by the lender/liquidity provider in return for the service of lending the tokens to the borrower/staking tokens with a DeFi lending platform. This may be compared to interest which is received by a lender in exchange for the service of lending of money (despite the return paid for the service of lending tokens not being considered, for tax purposes, as interest).

For example, a borrower may agree to pay 5% per annum of the principal to the lender over the period of the borrowing. In this case, the return is received by the lender in exchange for the provision of a service. If interest can be defined, in summary, as compensation for the use of money, then by analogy the return received by the lender/liquidity provider may similarly be thought of as compensation for the use of the tokens. As a result, in such circumstances it is

expected that the return will, disregarding that it is not paid in respect of money or currency (CRYPTO61110), have a similar nature to interest.
[The Manual cites *Ryall v Hoare*, see 33.2 (General principles: Income), and continues:]
Using the above analogies, interest earned from the lending of money is the "interest or fruit" while the money advanced is the "principal or tree". In circumstances where the return can be considered remuneration for the provision of a service of lending/staking tokens, the return is the "interest or fruit" while the tokens are the "principal or tree": the return will therefore be a revenue receipt.
It will generally be expected that where it can be demonstrated that the return is paid to remunerate the lender/liquidity provider for the provision of a service of lending/staking tokens, the return received by the lender/liquidity provider will have the same nature as interest and so be considered to be an income (revenue) receipt...

96.8.5 *Return is not interest*

The Crypto Manual provides:

> **CRYPTO61110 Introduction** [Feb 2022]
> The return received by a lender may be described or referred to as 'interest' by individuals or companies entering into these types of transactions. HMRC does not consider the return received by the lender to be interest for tax purposes.

That follows from the fact that cryptoassets are not money.[54] I refer to this as **"crypto-rent"**.

Crypto-rent is not within the disguised interest code[55] for two reasons (either would suffice):

(1) it is not "economically equivalent to interest" (as defined), again because cryptoassets are not money
(2) the charge to Misc Sweep-up Income has priority

96.9 Computation of income

The Crypto Manual provides:

> **CRYPTO21200: Cryptoassets for individuals: Income Tax: staking** [Feb 2022]
> If the activity does not amount to a trade, the pound sterling value (at the

[54] See 26.2 (Definition of interest).
[55] See 26.25 (Disguised interest).

> time of receipt) of any tokens awarded will be taxable as income (miscellaneous income) with any appropriate expenses reducing the amount chargeable.

This leads to the risk that when earned the cryptoasset is worth significantly more than when that taxpayer comes to calculate tax due. Given the fluctuations in certain cryptoassets, for example see the collapse of Luna, tax liabilities could exceed the total value of the assets received. Computations may also be difficult, if the activity has many receipts at different times. For traders subject to IT, SP 2/02 (Exchange rate fluctuations) deals with this (in short) creating a pooling system for assets and liabilities. It is suggested that the same principles apply to the computation of Misc Sweep-up Income, which is likewise computed on accountancy principles.

96.10 Capital receipt

The Crypto Manual provides:

CRYPTO61214 Making A Defi Loan: Nature Of The Return [Feb 2022]
When the return may have the nature of capital
There may be cases where the return received by the lender/liquidity provider is not comparable to interest, or a reward for the provision of a service, but rather is considered to be a capital return. This will be the case where the lender/liquidity provider is not rewarded by the borrower or the DeFi platform for providing their services, but rather the lender/liquidity provider seeks to benefit from their activities through the growth in value of a capital asset.
For example, it may be the case that the lender realises their return through disposing of a capital asset, which represents their lending and where the disposal proceeds are uncertain and speculative, rather than receiving an agreed rate of return from the borrower. Depending on the specific facts, it may be considered that the lender has realised their return from the increase in value of a capital asset and it will therefore be considered a capital receipt.
If, however, the disposal proceeds of the capital asset which represents the tokens lent/staked by the lender/liquidity provider is agreed when the tokens are advanced, then the return may have the nature of income rather than capital as the lender/liquidity provider will be providing a service for an agreed reward. This highlights the need to obtain all the facts of a transaction before reaching a conclusion as to the nature of the return.
It should be noted that the above examples are demonstrative only. In a real-world example there would be additional factors to consider which may change the conclusion reached.
If you encounter difficulty with determining the nature of the return then please

refer the case for advice, following the guidance at CRYPTO100500.

96.10.1 *Disposal on making loan?*

The Crypto Manual provides:

> **CRYPTO61620 Making A Defi Loan** [Feb 2022]
> It is important to consider whether the lender/liquidity provider actually transfers their beneficial ownership of the tokens to the borrower/DeFi lending platform. This will require an examination of the contract/terms and conditions. Where the recipient of the tokens has the ability to deal with the tokens received as they want then this will be a strong indicator that the recipient has acquired the beneficial ownership of those tokens. Conversely if the recipient is specifically restricted from dealing with the tokens received, this will be a strong indicator that the recipient does not have beneficial ownership of the tokens received.

Well drafted documentation will make it clear whether there is a transfer of beneficial ownership. It would be naive to hope that documentation would always be well drafted.

Similar issues arise for loans of securities, which are important for general law purposes, but not for CGT, as the repo code applies.[56]

> Where the making of a loan/staking (as described at CRYPTO61120) results in the lender/liquidity provider transferring their beneficial ownership of the tokens to the borrower/DeFi lending platform, this will give rise to a disposal of the loaned/staked tokens. The disposal will occur at the time that the lender/liquidity provider transfers the beneficial ownership of their tokens to the borrower/DeFi lending platform...

Actually, the disposal is at the time of the contract, but I expect in practice contract and transfer are simultaneous.

96.11 Computation of gain

The Crypto Manual provides:

> **CRYPTO61620 Making A Defi Loan** [Feb 2022]
> **Lender transfers control of tokens to a borrower**
> A lender makes a disposal of tokens for a right to receive a future quantity of tokens. This right represents deferred consideration (see CG14850P). The Chargeable Gains (CG) treatment of deferred consideration depends on whether the quantity of tokens to be received

[56] See 71.2 (Transparent/contract-based securities).

> in the future is ascertainable or unascertainable. Where the consideration is in "money's worth", such as a quantity of foreign currency or shares, then it is necessary to consider if the quantity of that asset that is to be received in the future is known. This approach was confirmed by the Court of Appeal in *Goodbrand v Loffland Bros North Sea Inc* (71 TC 57). Although the facts of that case related to sale proceeds in a currency other than sterling, Millett L.J. also considered the same analysis would apply to proceeds which consisted of assets (such as shares).

The position depends on whether the consideration is known or unknown, and whether it is income or capital.

96.11.1 *Fixed consideration*

The Crypto Manual provides:

> **CRYPTO61620 Making A Defi Loan** [Feb 2022]
>
> Where the quantity of tokens to be received in the future is known then section 48(1) TCGA 1992 will apply. The lender should value the quantity of tokens to be received in the future at their sterling value at the time the loan is made.
>
> Where there is no agreed return (see CRYPTO61130), then the borrower will be obliged to transfer to the lender the same quantity of tokens as they have borrowed. In such a case, section 48(1) TCGA 1992 should always apply.[57]
>
> For an example of a CG computation where section 48(1) TCGA 1992 applies, see CRYPTO61671.
>
> The treatment of a loan that includes a return to the lender can be more complicated. The position will depend on whether the return means that the future quantity of tokens that will be received by the lender is ascertainable or unascertainable.
>
> Where the quantity of tokens that the borrower will need to transfer to the lender, including the return, is known or can be calculated then the total quantity of tokens that the lender will receive is ascertainable (see CG14881). However, if the sterling value of the tokens that represent the return will be taxed as income when they are finally received then section 37 TCGA 1992 will apply (see CG14300). Section 37 TCGA 1992 excludes from the consideration the sterling amount that is being taxed as income. This is to prevent double taxation.
>
> For an example of a CG computation where section 37 TCGA 1992 applies, see CRYPTO61672.

[57] See 56.4.2 (Deferred consideration)

96.11.2 *Consideration not fixed*

The Crypto Manual provides:

> **CRYPTO61620 Making A Defi Loan** [Feb 2022]
> Where the quantity of tokens to be received in the future is unknown then the lender holds a right to receive unascertainable deferred consideration. In the House of Lords case of *Marren v Ingles* (54 TC 76) this type of right was found to be an asset for CG purposes (see CG14990). The lender's consideration will be the market value of that right at the time it is received. For further guidance on obtaining a valuation of a '*Marren v Ingles* right' see CG14950.
> It will be unusual for the total quantity of tokens to be given to the lender to be unknown. This is because the loan will be for a known quantity of tokens (the principal), so the lender will know the quantity of tokens to be returned to satisfy the principal of the loan. It will be the return only that can be unknown. In that situation you would treat the principal as a known quantity of tokens to which section 48(1) TCGA 1992 applies. Only the right to the return on the loan would represent a '*Marren v Ingles* right'.
> For an example of a CG computation involving a *'Marren v Ingles* right', see CRYPTO61673.
> Section 37 TCGA 1992 is not capable of applying to exclude any of the value of the '*Marren v Ingles* right' from the CG computation. This is because none of the value of the right will be subject to Income Tax. This means that a loss may arise on the disposal of the right when the loan is satisfied by the borrower (see CRYPTO61650). It may be possible to elect to set that loss against any gain that arose on the making of the loan. For more information about this election see CG15080 onwards.

96.11.3 *Crypto for crypto exchange*

The Crypto Manual provides:

> **CRYPTO61620 Making A Defi Loan** [Feb 2022]
> **Liquidity provider transfers the control of tokens to a DeFi lending platform in return for the DeFi lending platform transferring the control of one or more tokens**
> This is an exchange of one token for another token. The consideration for the disposal will be the market value in sterling of the token received from the DeFi lending platform. The acquisition price of the token received from the DeFi lending platform will be the market value in sterling of the token transferred to the DeFi lending platform.

> Where the liquidity provider needs to transfer more than one type of token to the DeFi lending platform to receive a token from the DeFi lending platform, the value of the token received from the DeFi lending platform should be apportioned between the disposals of the tokens on a just and reasonable basis.
>
> For an example of a CG computation where tokens are exchanged for a liquidity token, see CRYPTO61674.

96.12 Borrowing

The Crypto Manual provides:

> **CRYPTO61630 Borrowing** [Feb 2022]
>
> Where a person borrows tokens, they are making an acquisition. When a borrower enters into a loan agreement, they are giving a promise to the lender that they will do something: they will transfer a quantity of tokens to the lender in the future. In the High Court case of *Chaney v Watkis* (58 TC 707), it was found that an obligation to do something was "money's worth" and capable of being expenditure. This means that the value of the borrower's obligation to transfer a quantity of tokens to the lender in the future will be the acquisition cost of the tokens borrowed. For further guidance about allowable costs see CRYPTO22150. For guidance about the pooling of tokens and their associated allowable costs see CRYPTO22200.

96.13 Collateral

96.13.1 *Giving collateral: a disposal?*

The Crypto Manual provides:

> **CRYPTO61640 Collateral** [Feb 2022]
>
> Many DeFi lending platforms require a borrower to provide collateral before they are allowed to borrow from the DeFi lending platform. It will be necessary to consider the terms and conditions of the DeFi lending platform to understand whether the giving of collateral is a disposal.
>
> Where, under their terms and conditions, a DeFi lending platform is allowed to deal as it wishes with the tokens received as collateral, this will be a strong indicator that the DeFi lending platform has acquired the beneficial ownership of those tokens. If the DeFi lending platform has acquired the beneficial ownership of the tokens then the borrower will have disposed of their beneficial ownership of those tokens.

That arrangement is not aptly described as collateral; but never mind.

> Conversely if the DeFi lending platform is specifically restricted from dealing with the tokens received as collateral, this will be a strong indicator that the DeFi lending platform has not acquired beneficial ownership of those tokens. Therefore the borrower has retained beneficial ownership of the tokens and has not made a disposal.

96.13.2 *Consequences of disposal*

The Crypto Manual provides:

> **CRYPTO61640 Collateral** [Feb 2022]
>
> Where the facts show that a disposal has occurred, the consideration for the disposal will be the market value in sterling of the tokens given. The gain or loss will then be computed as normal.
>
> When the collateral is withdrawn from the DeFi lending platform then this will be an acquisition. The acquisition cost of the tokens will be the market value in sterling of the tokens received.
>
> If the borrower's position becomes liquidated by the DeFi lending platform then this won't have any Chargeable Gains (CG) consequences. This is because the borrower will have already disposed of the tokens when they were transferred to the DeFi lending platform.

96.13.3 *Position if no disposal*

The Crypto Manual provides:

> **CRYPTO61640 Collateral** [Feb 2022]
>
> Where the facts show that a disposal has not occurred, section 26 TCGA 1992 will apply.
>
> When the collateral is withdrawn from the DeFi lending platform then this has no CG consequences. This is because the borrower has retained the beneficial ownership of the tokens while they were in the control of the DeFi lending platform.
>
> If a borrower's position needs to be liquidated by the DeFi lending platform then section 26(2) TCGA 1992 will apply. The DeFi lending platform is treated as a nominee for the borrower, so that the dealings of the DeFi lending platform with the collateral/security are, for CG purposes, dealings of the borrower. Consequently any gain or loss on a disposal of the tokens held as collateral by the DeFi lending platform is deemed to be the gain or loss of the borrower. The tokens disposed of to settle the borrower's position are treated as disposed of at their market value in sterling.
>
> When a liquidation of a borrower's position occurs, it is common for the DeFi lending platform to offer the position to third parties, referred to

as liquidators. The liquidator takes on the borrower's obligation to repay some or all of the loan to the DeFi lending platform. As an incentive to the liquidators for doing this, the DeFi lending platform may take an extra proportion of the borrower's collateral as a penalty and then provide that quantity of tokens to the liquidator as a bonus.

Tokens taken from the borrower as a penalty will not satisfy section 38 TCGA 1992 meaning that the market value of those tokens will not be an allowable deduction in calculating any gain or loss for CG purposes. Section 38 TCGA 1992 is a restrictive provision, only allowing a deduction for expenditure that satisfies one of the subsections. The tokens taken as the penalty can't be said to be expenditure to acquire or provide an asset, expenditure to enhance an asset, expenditure to establish, preserve or defend the person's rights to an asset, or incidental costs of acquiring or disposing of an asset as per the list in section 38(2) TCGA 1992.

For an example of a CG computation where the borrower's collateral is liquidated, see CRYPTO61675.

96.14 Satisfaction of loan

The Crypto Manual provides:

> **CRYPTO61650 Satisfaction Of A Defi Loan And Withdrawal Of A Stake** [Feb 2022]
>
> When a loan/stake is satisfied there will be tax consequences for both the borrower and the lender/liquidity provider. 'Satisfaction' in this context means either:
>
> - the borrower transfers tokens to the lender to meet the borrower's obligations under the terms of the loan agreement, or
> - the liquidity provider withdraws their staked tokens from the liquidity pool of a DeFi lending platform

96.14.1 *Position of borrower*

The Crypto Manual continues:

> When the borrower satisfies the loan, the borrower transfers the beneficial ownership of tokens to the lender. This is a disposal of those tokens by the borrower.
>
> To compute the gain or loss arising from this disposal, the Chargeable Gains (CG) computation needs to use the market value in sterling of the tokens given as their consideration. This includes any tokens given to the lender as a return on the loan.
>
> The borrower will be able to deduct allowable costs when computing any gain or loss arising on their disposal to the lender. For further

guidance about allowable costs see CRYPTO22150.
For an example of a CG computation where the borrower satisfies the loan, see CRYPTO61676.

96.14.2 *Position of lender*

The Crypto Manual continues:

> The position for the lender at the satisfaction of the loan depends on how the making of the loan was treated for CG purposes (see CRYPTO61620).
>
> Lender originally transferred the control of tokens to the borrower
>
> There are different treatments of the lender depending on how the original disposal was treated.
>
> Where the lender treated the future quantity of tokens to be received as ascertainable (see CG14881) then the lender should have applied section 48(1) TCGA 1992. The sterling value of the tokens at the time the loan was made should have been included in the CG computation of the disposal by way of the loan being made.
>
> When the lender enters into the loan agreement, they received a right to receive a future quantity of tokens. When the borrower satisfies the loan then the tokens received by the lender are a capital sum derived from that right. This results in a disposal by the lender under section 22(1) TCGA 1992. This approach was confirmed by the Court of Appeal in *Goodbrand v Loffland Bros North Sea Inc* (71 TC 57). Millett L.J. said:
>
>> "But the example demonstrates that, in any case where an asset is sold for a deferred consideration in money's worth, there are at least two, and maybe three, separate disposals each of which has its own tax consequence. There is first the disposal of the original asset. The chargeable gain or allowable loss is computed in accordance with [section 48(1) TCGA 1992], which produces a sterling value for the disposal consideration and therefore the acquisition cost of the right to receive it. The second disposal occurs when the deferred consideration is received and a new asset, in the form of the actual consideration, is received in satisfaction of the right to receive it (see [section 22(1) TCGA 1992])."
>
> The acquisition price of the right to receive a future quantity of tokens will be the sterling value that the lender included in the CG computation of the disposal by way of the loan being made. The disposal by the lender on the receipt of the tokens from the borrower will effectively reflect any change in value of the tokens during the term of the loan. If the tokens increased in value during the term of the loan, then the lender will realise a further gain. If the tokens decreased in value during the

term of the loan, then the lender will realise a loss.

If section 37(1) TCGA 1992 applied to that first CG computation, then the sterling value of those tokens will also be excluded in this second CG computation.

For examples of CG computations where the loan of an ascertainable quantity of tokens is satisfied, see CRYPTO61677 and CRYPTO61678.

Where the lender treated the future quantity of tokens to be received as unascertainable then the lender will have acquired a '*Marren v Ingles* right' (see CG14990). The lender should have included the value of the '*Marren v Ingles* right' in the CG computation of the disposal by way of the loan being made.

When the borrower satisfies the loan then the tokens received by the lender are a capital sum derived from the '*Marren v Ingles* right'. This results in a disposal by the lender under section 22(1) TCGA 1992. The acquisition price of the '*Marren v Ingles* right' will be the value of the right that the lender included in the CG computation of the disposal by way of the loan being made.

Where the disposal of the '*Marren v Ingles* right' gives rise to a loss, it may be possible to elect to set that loss against any gain that arose on the making of the loan. For more information about this election see CG15080 onwards.

For an example of a CG computation where the loan of an unascertainable quantity of tokens is satisfied, see CRYPTO61679.

96.14.3 *Disposal of staked tokens*

The Crypto Manual provides:

> **CRYPTO61640 Collateral** [Feb 2022]
>
> **Liquidity provider originally transferred the control of tokens to a DeFi lending platform in return for the DeFi lending platform transferring the control of one or more tokens**
>
> When the liquidity provider wishes to withdraw their staked tokens from the DeFi lending platform, the liquidity provider will dispose of the tokens originally received from the DeFi lending platform. In return they will receive tokens from the DeFi lending platform. This is an exchange of one token for another token and so is a disposal by the liquidity provider. The liquidity provider's consideration for the disposal will be the market value in sterling of the tokens received from the DeFi lending platform.

96.15 Transfer between ledgers

The Crypto Manual provides:

CRYPTO22110 Transferring Tokens Between Distributed Ledgers
Transferring tokens between distributed ledgers [Feb 2022]
Tokens cannot simply be transferred from the distributed ledger for one cryptoasset to the distributed ledger for a different cryptoasset. For example, a bitcoin cannot exist on the Ethereum blockchain. An effect comparable to a 'swap' can be achieved using a smart contract and secure public address. The holder of the tokens uses a smart contract to transfer tokens to a public address that they don't control. An equivalent amount of tokens of the second cryptoasset are transferred from a secure public address to a public address controlled by the person.

The question that arises is whether this type of transactions results in a disposal for CGT purposes (for guidance on the general interpretation of disposal see CRYPTO22100. HMRC's view is that the answer will depend on the facts.

'One-way' transfers

Some transfers can only go in one direction, meaning that once the transfer has been made it cannot be undone or transferred back at a future date.

An example of this can be seen with the Ethereum blockchain. Currently ether are on the Ethereum 'mainnet' (short for main network, the main public Ethereum blockchain). Holders of ether can choose to transfer their tokens from the mainnet to a different blockchain called the 'Beacon Chain'. The Beacon Chain blockchain is where Ethereum's 'Proof of Stake' will be implemented (for more information on Proof of Stake see CRYPTO10300. It will be impossible to transfer ether from the Beacon Chain to the mainnet, making transfers a one-way process only.

HMRC's view is that TCGA92/S43 applies to this type of transaction. The allowable costs in respect of the first cryptoasset are attributed in full to the second cryptoasset. A gain or loss will accrue as normal on a subsequent disposal of the second cryptoasset.

96.16 CGT allowable expenses

The Crypto Manual provides:

CRYPTO22150 Allowable Expenses [Feb 2022]
When a person calculates their gains/losses from the disposal of tokens, not all costs are allowable as a deduction.

Section 38 of the TCGA 1992 provides for the types of costs which can be deducted. HMRC's view is that these include:

- the consideration (in pound sterling) originally paid for the asset
- transaction fees paid for having the transaction included on the distributed

ledger

- advertising for a purchaser or a vendor
- professional costs to draw up a contract for the acquisition or disposal of the tokens
- costs of making a valuation or apportionment to be able to calculate gains or losses

Any costs deducted against profits for Income Tax, see CG10260, are not allowable as a deduction for Capital Gains Tax.

Exchange Fees

It is common for people to use an exchange to perform transactions, as explained at CRYPTO10250. Some fees charged by exchanges are allowable, but not all of them. Below is a list of common fees charged by exchanges and whether they satisfy section 38 TCGA 1992:

Situation in which an exchange fee may be incurred	**Treatment of fee for section 38 TCGA 1992**
Exchange (swap) sterling for a fiat currency other than sterling	Section 38(1)(a) - allowable as a cost of acquiring the fiat currency other than sterling
Exchange (swap) fiat currency other than sterling for sterling	Section 38(1)(c) - allowable as an incidental cost of disposing of the fiat currency other than sterling
Deposit sterling with an exchange	Sterling isn't an asset for CGT purposes so not an allowable cost
Deposit fiat currency other than sterling with an exchange	The depositor retains beneficial ownership of the fiat currency other than sterling so there's no acquisition or disposal that the costs can be attributed to
Use sterling to purchase tokens	Section 38(1)(a) - allowable as a cost of acquiring the tokens
Use fiat currency other than sterling to purchase tokens	Section 38(1)(a) - allowable as a cost of acquiring the tokens
Exchange (swap) token A for token B	See below
Dispose of tokens for sterling	Section 38(1)(c) - allowable as an incidental cost of disposing of the tokens

Dispose of tokens for fiat currency other than sterling	Section 38(1)(c) - allowable as an incidental cost of disposing of the tokens
Withdraw sterling from the exchange	Sterling isn't an asset for CGT purposes so not an allowable cost
Withdraw fiat currency other than sterling from the exchange	The withdrawer retains beneficial ownership of the fiat currency other than sterling so there's no acquisition or disposal that the costs can be attributed to

Exchange (swap) token A for token B: the fee paid is in relation to the whole of the transaction, that is for a disposal of one asset and the acquisition of another asset. This means that the fee is attributable to both assets. HMRC's view is that this fee would be allowable as a deduction in computing the disposal in respect of token A under section 38(1)(c), and that it would be allowable as a deduction in computing the eventual disposal of token B under section 38(1)(a). TCGA92/S52(1) makes it clear that a sum may be allowed as a deduction only once in computing a disposal.

Where an allowable cost relates to more than one asset, the cost should be apportioned between those assets on a just and reasonable basis (TCGA92/S52(4)). You can accept that apportioning this type of fee equally between the assets disposed of and the assets acquired (that is a 50/50 split) is just and reasonable in these circumstances. If the customer chooses to apply a different approach, then this can be considered on a case by case basis.

Mining

Costs for mining activities (for example equipment and electricity) do not count toward allowable costs in respect of tokens because they're not wholly and exclusively to acquire the tokens, and so cannot satisfy the requirements of section 38(1)(a) TCGA 1992. It may be possible to deduct some of these costs against profits for Income Tax purposes. The costs incurred to acquire equipment used for mining may be allowable as a deduction in a disposal of that equipment subject to relevant provisions such as the chattels exemption and the wasting assets exemption.

If the mining amounts to a trade for tax purposes the tokens will initially form part of trading stock. If these tokens are transferred out of trading stock, the business will be treated as if they bought them at the value used in trading accounts. Businesses should use this value as an allowable cost in calculations when they dispose of the tokens. More information can be found in CG69220.

96.17 HMRC Examples

The Crypto Manual provides 10 examples. I lightly amend the text for clarity. In accordance with the casual Manual style, the examples use personal names; but when the transaction involves a loan, I refer to the borrower and lender as B and L. The Manual here refers to tokens rather than cryptoassets, but it means the same thing.

In each example it is assumed that B and L are not trading, so the transaction is within CGT. That will usually be the case for individual lenders; though in practice I expect that the borrower is likely to be a DeFi platform, and carrying on a trade.

I set out the examples in the following order:

No.	**Facts**
Making crypto loan: position of lender	
1	Fixed-term rent-free loan
2	Fixed-term loan + crypto-rent
3	On-demand loan + crypto-rent
5	L sells B's collateral
Repayment of crypto loan	
6	Fixed-term loan repaid + crypto-rent
7	Fixed-term loan repaid from pool
8	Fixed-term loan repaid + crypto-rent
9	On-demand loan repaid + crypto-rent
Crypto for crypto exchange	
4	Crypto for crypto exchange
10	Crypto for crypto exchange

96.18 Borrowing/lending examples

96.18.1 *Eg 1: Fixed-term rent-free loan*

We first consider the taxation of the lender of cryptoassets ("L").

> **CRYPTO61671 Example 1: Loan of tokens** [Feb 2022]
> *[Bruce ("L") & Terri-Jay ("B")]*
> L holds 100 tokens with a total acquisition cost of £200.
> L enters into an agreement with B to loan her the 100 tokens for 12 months.
> At the time the loan is made, the tokens have a sterling value of £1.50 each.

The HMRC analysis is as follows:

> L's disposal is for a right to receive a future quantity of tokens. The

future quantity of tokens is 100 so the future quantity of tokens is known. This means that section 48(1) TCGA will apply. Section 48(1) TCGA brings the full quantity of tokens into the CG computation straight away.

The tokens will need to be brought into the CG computation at their sterling value at the time of the disposal. The consideration in the computation will therefore be 100 tokens multiplied by £1.50 to give total consideration of £150.

L's CG computation will be as follows:

		£
Consideration	s.48 TCGA: 100 × £1.50	150
Allowable costs		-200
Loss		-50

The facts are artificial, and L's disposal is not on arm's length terms. But the purpose is to set the scene for the examples which follow.

96.18.2 *Eg 2: Fixed-term loan + crypto-rent*

The next example is the same, except the lender receives a crypto-rent.

CRYPTO61672 Example 2: Loan of tokens with a return on the loan [Feb 2022]

[Keri ("L") and Chris ("B")]

L holds 100 tokens with a total acquisition cost of £200.

L enters into an agreement with B to loan them the 100 tokens for 12 months.

The loan agreement includes that B will pay a return of 5% [of the tokens] at the end of the loan.

At the time the loan is made, the tokens have a sterling value of £1.50 each.

The HMRC analysis is as follows:

When the loan is satisfied by B, L will treat[58] the tokens received as the 5% rate of return on the loan [crypto-rent] as miscellaneous income that will be subject to tax on income.

L's disposal is for a right to receive a future quantity of tokens. The future quantity of tokens is 105 so the future quantity of tokens is known. This means that section 48(1) TCGA will apply. Section 48(1) TCGA brings the full quantity of tokens into the CG computation straight away.

The tokens will need to be brought into the CG computation at their sterling value at the time of the disposal. The consideration in the computation will

[58] The wording here (and in the examples below) would suggest that B has a choice in the matter, but that cannot be intended.

therefore be 105 tokens multiplied by £1.50 to give total consideration of £150. Section 37(1) TCGA excludes from the computation an amount which is chargeable to tax on income. The sterling value of the 5 tokens representing the 5% rate of return on the loan [crypto-rent] is therefore excluded from the CG computation.
L's CG computation will be as follows:

		£
Consideration	s.48 TCGA: 105 × £1.50	157.5
	less s.37 TCGA: 5 × £1.50	-7.5
		150
Allowable costs		-200
Loss		-50

In this computation, the crypto-rent is added in and then subtracted. It might as well be ignored. So it comes down to a simple market value disposal and the outcome is the same as example 1.

96.18.3 *Eg 3: On-demand loan + crypto-rent*

The next example is the same except the crypto-loan is repayable on demand, not a fixed term loan.

CRYPTO61673 Example 3: Loan of tokens where the quantity of tokens is unascertainable [Feb 2022]
[Beverley ("L") and Alex ("B")]
L holds 100 tokens with a total acquisition cost of £200.
L enters into an agreement with B to loan him the 100 tokens with no fixed end date to the loan. L can make a demand for the loan to be satisfied or at any time before that B can choose to satisfy the loan.
They agree an annual percentage rate of 5% on the quantity of tokens loaned [crypto-rent].
At the time the loan is made, the tokens have a sterling value of £1.50 each.

The HMRC analysis is as follows.

L's disposal is for a right to receive a future quantity of tokens. L knows that she will receive 100 tokens to satisfy the principal of the loan. This means that section 48(1) TCGA 1992 will apply to those 100 tokens. Section 48(1) TCGA 1992 brings the 100 tokens into the CG computation straight away.
L also has a right to receive a 5% return per annum over an unknown period of time. It won't be possible to establish the quantity of tokens until the loan is satisfied, as that will fix the date for which that rate of return is applied up to. This means that L also has acquired a right which is an asset for CG purposes.

L will need to establish the market value of that right and include that value in the CG computation. L establishes the market value of that right to be £15. The value of that right won't be taxed as income, so section 37(1) TCGA won't apply.

L's CG computation is as follows:

		£
Consideration	Tokens to be received 100 × £1.50	150
	plus market value of right	15
Total consideration		165
Allowable costs		-200
Loss		-35

L suffers double taxation here, ie CGT on the right to income and income tax on the income (though on the posited values , the double taxation is masked by the fact that a loss arises). (Conversely, B would get a double deduction, for CGT, but B is likely to be a platform, and trading). The moral is that L should not enter into arrangements of this kind.

But there is an error in the example, because the market value of the right to income [crypto-rent] must be nil, not £15. No-one would pay for the right, as they could (and probably would) receive nothing as immediately after they acquired it, L can make a demand for the loan to be satisfied or B can choose to satisfy the loan. The right would have a value if there were a minimum term to the loan.

In the future, the proposed repo loan reforms may solve this problem.[59]

96.18.4 *Eg 5: L sells B's collateral*

CRYPTO61675 Example 5: disposal when a borrower's collateral is liquidated (Lucas) [Feb 2022]

L holds 100 tokens with a total acquisition cost of £500.

L provides the 100 tokens as collateral to a DeFi lending platform and then takes out a loan.[60]

During the term of the loan, the market price of the borrowed tokens falls. On 01/07/20XX the price of the borrowed tokens falls to the point where a liquidation of some of L's collateral occurs. 10 of the tokens given by L to the DeFi lending platform as collateral get transferred to a liquidator, along with 1 additional token as the penalty. The tokens have a market value of £6 each at the time of the liquidation.

[59] See 96.23 (Lending: repo treatment).

[60] The following sentence shows that L borrows tokens ("the borrowed tokens"). L does not borrow money. But it does not matter what L borrows.

The HMRC analysis is as follows.

L's CG computation of this disposal will be as follows:

		£
Consideration	11 × £6	66
Allowable costs	s.104 pool £500 × 11 / 100	-55
Gain .		11

L's s.104 pool will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	100	500
01/07/20XX	-11	-55
Closing balance	89	445

96.18.5 *Eg 6: Fixed-term loan repaid + crypto-rent*

This example has essentially the same material facts as example 2, but we are now looking at the taxation of the borrower on repayment of the crypto-loan and payment of the crypto-rent.

CRYPTO61676 Example 6: Borrower satisfies the loan [Feb 2022]
[Paula ("L") & Glyn ("B")]
L loaned 500 tokens to B for 12 months.
The loan agreement included that L would receive a 5% rate of return on the loan [crypto-rent].
On 20/05/20XX, B transferred 525 tokens to L to satisfy the terms of the loan.
The tokens had a pooled acquisition cost of £5,250.
At that time of the transfer to satisfy the loan, the tokens had a market value of £12 each.

The HMRC analysis is as follows.

B's CG computation will be as follows:

		£
Consideration	525 × £12	6,300
Allowable costs	s.104: £5,250 × 525 / 525	-5,250
Gain		1,050

In short, a market value disposal.

B's s.104 pool will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	525	5,250
20/05/20XX	-525	-5,250
Closing balance	0	0

96.18.6 *Eg 7: Fixed-term loan repaid from pool*

This example is materially the same as example 6 with the complication of a part disposal of a s.104 pool.

CRYPTO61677 Example 7: lender's loan of an ascertainable quantity of tokens is satisfied, the value of the tokens increased (Lorraine ("L") & Martin) ("B") [Feb 2022]
L holds 1,000 tokens with a total acquisition cost of £1,500.
On 30/09/20XX, L enters into an agreement with B to loan B 100 tokens for 12 months.
The loan agreement includes that B will pay a return of 5% [crypto-rent] at the end of the loan.
At the time the loan is made, the tokens have a sterling value of £1.50 each.

The HMRC analysis first considers the position of the lender.

When the loan is satisfied by B, L will treat the tokens received as the 5% rate of return on the loan [crypto-rent] as miscellaneous income that will be subject to tax on income.
L's disposal is for a right to receive a future quantity of tokens. The future quantity of tokens is 105 so the future quantity of tokens is known. This means that section 48(1) TCGA will apply. Section 48(1) TCGA brings the full quantity of tokens into the CG computation straight away.
The tokens will need to be brought into the CG computation at their sterling value at the time of the disposal. The consideration in the computation will therefore be 105 tokens multiplied by £1.50 to give total consideration of £150.
Section 37(1) TCGA excludes from the computation an amount which is chargeable to tax on income. The sterling value of the 5 tokens representing the 5% rate of return on the loan is therefore excluded from the CG computation.
L's CG computation of the initial disposal will be as follows:

		£
Consideration	s.48 TCGA: 105 × £1.50	157.5
	less s.37 TCGA: 5 × £1.50	- 7.5
		150
Allowable costs	s.104 - £1,500 × 100 / 1,000	-150
Gain		0

L's s.104 pool will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	1,000	1,500
30/09/20XX	-100	-150
Closing balance	900	1,350

So far, nothing new. We then turn to consider the position of the borrower.

On 29/09/20XX, B satisfies the loan with a transfer of 105 tokens to L.
At the time the loan is satisfied, each token is worth £1.60.

The HMRC analysis is as follows.

L treats the receipt of 5 of the tokens as miscellaneous income for tax purposes. This means that 5 tokens × £1.60 = £8.00 is subject to tax on income.
The sterling value of the remaining 100 tokens will be a capital sum that is derived from L's right to receive a future quantity of tokens. L's CG computation of the disposal of her right is as follows:

		£
Consideration	105 × £1.60;	168
	less s.37 TCGA: 5 × £1.60	-8
		160
Allowable costs	Value of right to receive a future quantity of tokens	-150
Gain		10

L receives 5 tokens which are treated as miscellaneous income, so they are acquired at £1.60 each. L also receives 100 tokens derived from her right to receive a future quantity of tokens, which are also acquired at £1.60 each. L's s.104 pool will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	900	1,350
29/09/20XX	+5	+8
	+100	+160
Closing balance	1,005	1,518

Overall L pays tax on her income of 5 tokens at £1.60 each, and tax on her chargeable gain of £10, which is the value by which her 100 tokens had increased by the time the loan was satisfied by B.
L's s.104 pool also reflects the increased token value of £18 (5 tokens × £1.60 = £8, 100 tokens × £0.10 = £10) for any future disposals that she may make.

96.18.7 *Eg 8 : Fixed-term loan repaid + crypto-rent*

CRYPTO61678 Example 8: Lender's loan of an ascertainable quantity of tokens is satisfied, the value of the tokens decreased (Chris ("L") & Amy ("B")) [Feb 2022]
L holds 1,000 tokens with a total acquisition cost of £1,500.
On 30/09/20XX, L enters into an agreement with B to loan B 100 tokens for 12 months. The loan agreement includes that B will pay a return of 5% at the end

of the loan.
At the time the loan is made, the tokens have a sterling value of £1.50 each.

The HMRC analysis is as follows.

When the loan is satisfied by B, L will treat the tokens received as the 5% rate of return on the loan [crypto-rent] as miscellaneous income that will be subject to tax on income .
L's disposal is for a right to receive a future quantity of tokens. The future quantity of tokens is 105 so the future quantity of tokens is known. This means that section 48(1) TCGA will apply. Section 48(1) TCGA brings the full quantity of tokens into the CG computation straight away.
The tokens will need to be brought into the CG computation at their sterling value at the time of the disposal. The consideration in the computation will therefore be 105 tokens multiplied by £1.50 to give total consideration of £150.
Section 37(1) TCGA excludes from the computation an amount which is chargeable to tax on income. The sterling value of the 5 tokens representing the 5% rate of return on the loan is therefore excluded from the CG computation.
L's CG computation of the initial disposal will be as follows:

		£
Consideration	s.48 TCGA: 105 × £1.50	157.5
	less s.37 TCGA: 5 × £1.50	- 7.5
		150
Allowable costs	s.104 - £1,500 × 100 / 1,000	-150
Gain		0

L's s.104 pool will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	1,000	1,500
30/09/20XX	-100	-150
Closing balance	900	1,350

On 29/09/20XX, B satisfies the loan with a transfer of 105 tokens to L.
At the time the loan is satisfied, each token is worth £1.20.
L treats the receipt of 5 of the tokens as miscellaneous income for tax purposes.
This means that 5 tokens × £1.20 = £6.00 is subject to tax on income.
The sterling value of the remaining 100 tokens will be a capital sum that is derived from L's right to receive a future quantity of tokens. L's CG computation of the disposal of his right is as follows:

		£
Consideration	105 × £1.20; less s.37 TCGA: 5 × £1.20	120
Allowable costs	Value of right to receive a future quantity of tokens	-150
Loss		-30

L receives 5 tokens which are treated as miscellaneous income, so they are acquired at £1.20 each. L also receives 100 tokens derived from his right to receive a future quantity of tokens, which are also acquired at £1.20 each. L's s.104 pool will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	900	1,350
29/09/20XX	+5	+6
	+100	+120
Closing balance	1,005	1,476

Overall L pays tax on income on his receipt of 5 tokens at £1.20 each, and realises a loss of £30, which is the value by which his 100 tokens had decreased by the time the loan was satisfied by B.

L's s.104 pool also reflects the decreased token value of (£24) (5 tokens × £1.20 = £6,100 tokens × £0.30 = (£30)) for any future disposals that he may make.

96.18.8 *Eg 9: On-demand loan repaid + crypto-rent*

CRYPTO61679 Example 9: Lender's loan of an unascertainable quantity of tokens is satisfied (Robert ("L") & Samantha ("B")) [Feb 2022]

L holds 4,000 tokens with a total acquisition cost of £2,000.

On 15/04/20XX, L enters into an agreement with B to loan B 1,000 tokens with no fixed end date to the loan. L can make a demand for the loan to be satisfied or at any time before that B can choose to satisfy the loan.

They agree an annual percentage rate of 5% on the quantity of tokens loaned [crypto-rent].

At the time the loan is made, the tokens have a sterling value of £1.00 each.

L's disposal is for a right to receive a future quantity of tokens. L knows that he will receive 1,000 tokens to satisfy the principal of the loan. This means that section 48(1) TCGA will apply to those 1,000 tokens. Section 48(1) TCGA brings the 1,000 tokens into the CG computation straight away.

L also has a right to receive a 5% return per annum over an unknown period of time. It won't be possible to establish the quantity of tokens until the loan is satisfied, as that will fix the date for which that rate of return is applied up to. This means that L also has acquired a right which is an asset for CG purposes. L will need to establish the market value of that right and include that value in the CG computation. L establishes the market value of that right to be £100. The value of that right will not be taxed as income, so section 37(1) TCGA will not apply.

L's CG computation is as follows:

		£
Consideration	s.48 TCGA: 1,000 × £1.00	1,000
	plus market value of right - £100	100
		1,100
Allowable costs	s.104 - £2,000 × 1,000 / 4,000	-500
Gain		600

As in example 3, there is an error in the example, because the market value of the right to income must be nil, not £100. No-one would pay for the right, as they could (and probably would) receive nothing as immediately after they acquired it, L can make a demand for the loan to be satisfied or B can choose to satisfy the loan. The right would have a value if there were a minimum term to the loan, though I wonder if that happens in practice.

L's s.104 pool will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	4,000	2,000
15/04/20XX	-1,000	-500
Closing balance	3,000	1,500

On 14/04/20X3, B satisfies the loan with a transfer of 1,150 tokens to L. At the time the loan is satisfied, each token is worth £0.85.

L treats the receipt of 150 of the tokens as miscellaneous income for tax purposes. This means that 150 tokens × £0.85 = £127.50 is subject to tax on income.

The sterling value of the remaining 1,000 tokens will be a capital sum that is derived from L's right to receive a future quantity of tokens. L's CG computation of the disposal of his right is as follows:

		£
Consideration	1,000 × £0.85	850
Allowable costs	Value of right to receive a future quantity of tokens	-1,000
Loss	.	-150

L's CG computation of the disposal of his '*Marren v Ingles* right' is as follows:

		£
Consideration	150 × £0.85; less s.37 TCGA: 150 × £0.85	0
Allowable costs	Value of '*Marren v Ingles* right'	-100
Loss	.	-100

L receives 150 tokens which are treated as miscellaneous income, so they are acquired at £0.85 each. L also receives 1,000 tokens derived from his right to receive a future quantity of tokens, which are also acquired at £0.85 each. L's s.104 pool will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	3,000	1,500
14/04/20X3	+150	+128
	+1,000	+850
Closing balance	4,150	2,478

96.19 HMRC examples: Token exchange

96.19.1 *Eg 4: Token exchange*

The next example is not a loan, but a token for token exchange, with the complication of a part disposal from a s.104 pool

CRYPTO61674 Example 4: Loan of tokens to a platform in exchange for liquidity tokens [Feb 2022]
[Jack ("J")]
J wishes to provide liquidity to a DeFi lending platform. He holds:

- 100 token A. These are in a s.104 pool with a total acquisition cost of £100.
- 100 token B. These are in a s.104 pool with a total acquisition cost of £50.

On 01/06/20XX, J transfers 10 token A and 5 token B to the DeFi lending platform. The DeFi lending platform transfers a liquidity token to J.
At the time of this exchange:

Token	**Value**
token A	£1.00 each
token B	£0.60 each.
liquidity token	£15.00 each.

J decides (?) that a just and reasonable basis for apportioning the value of the liquidity token is in proportion to the market value of the tokens he disposes of. The total market value of the tokens he disposes of is
£10 (10 token A × £1 each) plus £3 (5 token B × £0.60 each) equals £13.

The transaction is assumed to be a disposal at arm's length between unconnected persons. Though it is a strange deal where J disposes of assets worth £13 for an asset worth £15.
The HMRC analysis is as follows.

Disposal of token A
J's CG computation of his disposal of his token A is as follows:

Consideration	Liquidity token - £15 × 10 / 13	12
Allowable costs	s.104 pool - £100 × 10 / 100	-10
Gain		2

J's s.104 pool for token A will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	100	100
01/06/20XX	-10	-10
Closing balance	90	90

Disposal of token B

J's CG computation of his disposal of his token B is as follows:

		£
Consideration	Liquidity token: £15 × 3 / 13	3
Allowable costs	s.104 pool £50 × 5 / 100	3
Gain		0

J's s.104 pool for token B will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	100	50
01/06/20XX	-5	-3
Closing balance	95	47

J will be treated as having acquired the liquidity token for the total market value of the token A and token B that J transfers to the DeFi lending platform. This is £10 (10 token A × £1 each) plus £3 (5 token B × £0.60 each) equals £13.

96.19.2 *Eg 10: Token exchange*

CRYPTO61680 Example 10: Exchange of liquidity provider tokens for tokens (Georgia) [Feb 2022]

G wishes to provide liquidity to a DeFi lending platform. She holds:

Asset in s.104 pool	**Total acquisition cost of pool**
1,000 token A	£1,000.
1,000 token B	£500.

On 11/11/20XX, G transfers 50 token A and 100 token B to the DeFi lending platform. The DeFi lending platform transfers 10 liquidity tokens to G.

At the time of this exchange:

Token	**Value**
token A	1.20 each
token B	£0.60 each
liquidity pool token	£12.00 each

The HMRC analysis is as follows.

G decides (?) that a just and reasonable basis for apportioning the value of the liquidity pool token is in proportion to the market value of the tokens she disposes of.

The total market value of the tokens she disposes of is

50 token A × £1.20 each	60
plus(100 token B × £0.60 each	60
	£120

G's CG computation of her disposal of her token A is as follows:

		£
Consideration	Liquidity pool token - £120 × 60 / 120	60
Allowable costs	s.104 pool - £1,000 × 50 / 1,000	- 50
Gain	.	10

G's s.104 pool for token A will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	1,000	1,000
11/11/20XX	-50	-50
Closing balance	950	950

G's CG computation of his disposal of her token B is as follows:

		£
Consideration	Liquidity pool token - £120 × 60 / 120	60
Allowable costs	s.104 pool - £500 × 100 / 1,000	- 50
Gain		10

G's s.104 pool for token B will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	1,000	500
11/11/20XX	-100	-50
Closing balance	900	450

G will be treated as having acquired the liquidity token for the total market value of the token A and token B that G transfers to the DeFi lending platform. This is £60 (50 token A × £1.20 each) plus £60 (50 token B × £0.60 each) equals £120. This will go into a new s.104 pool:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	0	0
11/11/20XX	+10	+120
Closing balance	10	120

Next there is a disposal of some liquidity tokens.

On 24/05/20X1, G decides to withdraw half of her stake in the liquidity pool. She transfers 5 liquidity pool tokens to the DeFi lending platform.

At that time the balance of tokens in the liquidity pool has changed so that each liquidity pool token represents 5 token A and 20 token B. In return for the 5 liquidity pool tokens, the DeFi lending platform transfers 25 token A and 100 token B to G.
At the time of this exchange

Token	**Value**
token A	£1.50 each
token B	£0.50 each
liquidity tokens	£17.50 each

G decides that a just and reasonable basis for apportioning the value of the liquidity token is in proportion to the market value of the tokens she receives. The total market value of the tokens she receives is £37.50 (25 token A × £1.50 each) plus £50 (100 token B × £0.50 each) equals £87.50.

G's CG computation of her disposal of her liquidity pool tokens is as follows:

		£
Consideration	Token A: 25 × £1.50;	37.5
	plus Token B: 100 × £0.50	50
		87.50
Allowable costs	s.104 pool - £120 × 5 / 10	-60
Gain		27.50

G's s.104 pool for her liquidity pool tokens will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	10	120
24/05/20X1	-5	-60
Closing balance	5	60

G will be treated as having acquired the token A for an appropriate proportion of the market value of the liquidity pool tokens she transferred to the DeFi lending platform. This is £37.50 (£87.50 × 37.50 / 87.50). G's s.104 pool for token B will be adjusted as follows:

Date	**Quantity of tokens**	**Allowable costs (£)**
Opening balance	950	950.00
24/05/20X1	+25	+37.50
Closing balance	975	987.50

G will be treated as having acquired the token B for an appropriate proportion of the market value of the liquidity pool tokens she transferred to the DeFi lending platform. This is £50.00 (£87.50 × 50.00 / 87.50). G's s.104 pool for token B will be adjusted as follows:

Date	Quantity of tokens	Allowable costs (£)
Opening balance	900	450
24/05/20X1	+100	+50
Closing balance	1,000	500

96.20 Lending: Repo treatment

96.20.1 *The repo code*

The HMRC staking paper summarises the repo regime:

Overview of the Repo regime
A repo is a financing arrangement which is structured as a sale and repurchase of securities. The original owner of securities 'borrows' cash by selling securities to the other party of the transaction. At the end of the arrangement, the original owner repurchases the securities from the other party. The repurchase price is generally higher than the sale price as it includes the 'interest' element of the transaction.
In a repo transaction there is an actual sale of securities, with the beneficial ownership in those securities being disposed of by the original owner. However, economically a repo is not a true sale of securities but is in effect a financing transaction. The tax legislation has therefore been amended to treat repos as loans and not as sales of securities.
This is achieved by disregarding the sale (and subsequent repurchase) from Capital Gains Tax (s263A(1) TCGA) and by taxing as interest the return paid by the other party to the original owner (under Part 4 Chapter 2A ITTOIA 2005).
Overview of the Stock Lending regime
Stock Lending enables market makers and other securities dealers to obtain securities to meet deliveries on sales of those securities. This could be the case for example when dealers borrow securities to settle 'short' sales (selling securities they do not own) and hope to profit by buying equivalent securities at a lower price to return to the lender when the loan matures.
The transfers under a stock lending agreement are not sales, but, despite their name, they are not loans. Full beneficial and legal ownership is transferred, so that if the borrower wishes it can on-lend the securities or sell them, purchasing replacement securities at a later date to fulfil its obligation to return equivalent securities when the stock loan matures.
The lender, despite transferring the beneficial ownership in the securities, retains all the risks and benefits arising from the movements in the price of the securities. As the lender retains these risks economically, the tax legislation disregards the disposal of securities for Capital Gains Tax (under s263B(2) TCGA).
Further, any payments made by the borrower to the lender based on any income generated by the securities while they were lent (such as dividends for shares or interest for debt securities) will be taxed as manufactured payments. In general, the tax legislation ensures that a manufactured payment is taxed on the lender as if the lender had received that payment directly. For example, manufactured dividends received by the lender of shares from the borrower will be taxed on the lender as if the lender had received the dividends directly.

96.20.2 *Crypto outside repo regime*

The Crypto Manual provides:

> **CRYPTO61610 Defi Lending And Repos** [Feb 2022]
> [The Manual refers to the definition of "securities" for the repo code,[61] and continues:]
> It will be a question of fact whether the tokens being loaned and borrowed or staked (as applicable) can satisfy this definition to be securities for the purposes of sections 263A or 263B TCGA 1992. Generally tokens will not be securities for this purpose.
> If you come across a case where the customer is arguing that section 263A or 263B TCGA 1992 applies then you should refer the case for advice, following the guidance at CRYPTO100500.

But it seems obvious that cryptoassets (in the normal sense of the term) are not securities.

96.20.3 *The future*

The HMRC staking paper proposes (in short) that the repo and stock lending regimes apply to transfers of securities, or similar rules, should be applied to cryptoassets.

96.21 Mining cryptoassets

96.21.1 *What is mining*

> **CRYPTO10300: proof of work and proof of stake** [Apr 2021]
> Many cryptoasset networks are not controlled by a single body or person. Typically, the network of users of a specific token play a role in verifying transactions or making technological changes.
> This mechanism is often referred to as a 'consensus' because a sufficient proportion of the network must agree to a transaction or technological change before it can go ahead.
> For example, if A wishes to send 500 tokens to B, it must first be verified that A does indeed hold that many tokens. If the network agrees that this is the case, the transaction is added to the distributed ledger.
> **Proof of Work**
> The most well-known consensus system is Proof of Work, which is used by Bitcoin (amongst others). Here, the right to add a new entry to the distributed ledger is only available to the first person to solve a randomly generated complex cryptographic puzzle. That person then

[61] See App. 2.13 (Security: 5 statutory definitions).

> creates the new entry and it is shared with all holders of the distributed ledger. The time and energy required to solve the puzzle is the proof of work, the right to add the entry is the primary reward. The person with that right will be entitled to any fees available for including transactions in that entry and they will be allocated with a quantity of new tokens that are released into circulation. This process is known as 'mining' and serves to maintain the network of a given cryptoasset.
>
> **Proof of Stake**
>
> This has developed as an alternative to Proof of Work due to the significant amount of energy and computing power that system requires. Under Proof of Stake, the ability to create a new entry is determined by a user's wealth in the cryptoasset (or 'stake') rather than them having the computer power to solve a puzzle before anyone else does. Here, those verifying transactions are rewarded with fees for facilitating the transaction instead of any new tokens.

96.21.2 *Mining: Tax analysis*

The Crypto Manual makes the obvious points:[62]

> **CRYPTO21150 Income Tax: Mining Transactions** [Apr 2021]
>
> If the mining activity does not amount to a trade, the pound sterling value (at the time of receipt) of any tokens awarded will be taxable as income (miscellaneous income) with any appropriate expenses reducing the amount chargeable.[63]
>
> If the individual keeps the awarded assets, they may have to pay Capital Gains Tax when they later dispose of them.

96.22 Blockchain forks

The Crypto Manual provides:

> **CRYPTO22300: Blockchain forks** [Feb 2021]
>
> Some cryptoassets are not controlled by a central body or person but operate by consensus amongst that cryptoasset's community. When a significant minority of the community want to do something different, they may create a 'fork' in the distributed ledger.
>
> There are two types of forks, a soft fork and a hard fork. A soft fork updates the protocol and is intended to be adopted by all. No new tokens, or distributed ledger, are expected to be created. A hard fork is different and can result in new tokens coming into existence. Before the fork

[62] The text is repeated in relation to companies: CRYPTO40200 (Mining Transactions).

[63] See 33.17 (Sweep-up income: Computation).

> occurs there is a single distributed ledger. Usually, at the point of the hard fork a second branch (and therefore a new cryptoasset) is created. The distributed ledger for the original and the new cryptoassets have a shared history up to the fork. If an individual held tokens of the cryptoasset on the original distributed ledger they will, usually, hold an equal numbers of tokens on both distributed ledgers after the fork.

I expect this does not happen often. The HMRC analysis is as follows:

> The value of the new tokens is derived from the original tokens already held by the individual. This means that section 43 TCGA 1992 will apply.[64]
> After the fork the new tokens need to go into their own s.104 pool. Any allowable costs in the s.104 pool of the original cryptoassets are split between the two s.104 pools for the original tokens and the new tokens.
> If an individual holds their tokens through an exchange, the exchange will make a choice whether to recognise the new tokens created by the fork.
> Costs must be split on a just and reasonable basis under section 52(4) TCGA 1992. HMRC does not prescribe any particular apportionment method. HMRC has the power to enquire into an apportionment method that it believes is not just and reasonable.
> The new tokens can only be disposed of if the exchange recognises the new tokens. If the exchange chooses not to recognise the new tokens then the individual may seek to apportion all of the allowable costs to the original tokens. You will need to decide whether this is just and reasonable in the circumstances. The individual may instead apportion the costs but seek to make a negligible value claim in respect of the new tokens. You will need to consider whether the conditions for making a negligible value claim have all been satisfied. In cases of difficulty you should seek technical advice using the process for your business area.

96.23 Airdrops

The glossary in the Law Commission crypto paper provides:

> Airdrop: A distribution of an allocation of crypto-tokens, often unsolicited and normally for free.

The Crypto Manual provides:

> **CRYPTO22350 Airdrops** [Feb 2022]
> An airdrop is when an individual receives an allocation of tokens. For

[64] See 56.4.10 (Asset derived from asset).

> example, tokens that are given as part of a marketing or advertising campaign.
>
> The cryptoasset using the airdrop typically has its own infrastructure (which may include a smart contract, blockchain or other form of distributed ledger technology) that operates independently of the infrastructure for an existing cryptoasset.
>
> The airdropped tokens will need to go into their own s.104 pool unless the recipient already holds tokens of that cryptoasset, in which case the airdropped tokens will go into the existing s.104 pool. The value of the airdropped cryptoasset does not derive from existing tokens held by the individual, so section 43 TCGA 1992 does not apply.[65]

I suspect this is a rather broad analysis of complex arrangements which would need further examination in order to determine the tax analysis.

96.24 Loss of cryptoassets

96.24.1 *Negligible value claims*

The Crypto Manual provides:

> **CRYPTO22500 S24 And Negligible Value** [Feb 2022]
>
> As with other types of assets, individuals can crystallise losses for tokens that they still own if they become worthless or of 'negligible value' while owned.
>
> A negligible value claim treats the tokens as being disposed of and immediately re-acquired at an amount stated in the claim. As tokens are pooled, the negligible value claim needs to be made in respect of the whole s.104 pool, not the individual tokens.
>
> The negligible value claim will need to state the:
>
> - asset which is the subject of the claim
> - amount the asset should be treated as disposed of (which may be £nil)
> - date that the asset should be treated as being disposed of and immediately reacquired
>
> The disposal produces a loss that needs to be reported to HMRC. Negligible value claims can be made to HMRC at the same time as reporting the loss.

96.24.2 *Loss of key*

The Crypto Manual provides:

[65] See 56.4.10 (Asset derived from asset).

> **CRYPTO22400: Losing private keys** [Feb 2022]
>
> If an individual misplaces their private key (for example throwing away the piece of paper it is printed on), they will not be able to access their tokens. The private key still exists as part of the cryptography, albeit it is not known to the owner any more. Similarly the tokens will still exist in the distributed ledger. This means that misplacing the key does not count as a disposal for Capital Gains Tax purposes. More information can be found in CG13155.
>
> If it can be shown there is no prospect of recovering the private key or accessing the tokens, a negligible value claim could be made. If HMRC accepts the negligible value claim, the individual will be treated as having disposed of and re-acquiring the tokens they cannot access so that they can crystallise a loss.

96.24.3 *Theft of cryptoasset*

The Crypto Manual provides:

> **CRYPTO22450: Being defrauded** [Feb 2022]
>
> HMRC does not consider theft to be a disposal, as the individual still owns the stolen asset and has a right to recover it. This means victims of theft cannot claim a loss for Capital Gains Tax.
>
> Individuals who contract to acquire tokens but then do not receive the tokens they have paid for may not be able to claim a capital loss.
>
> Individuals who contract to acquire tokens and do actually receive tokens, may be able to make a negligible value claim to HMRC if those tokens become worthless. If the tokens are worthless when acquired then a negligible value claim won't be allowed. This won't affect the ability of the individual to dispose of the tokens by other means to crystallise the capital loss.

96.25 Stamp duty/SDRT

The Crypto Manual provides:

> **CRYPTO24000 Stamp Duty, Stamp Duty Reserve Tax And Stamp Duty Land Tax** [Apr 2021]
>
> **Stamp Duty and Stamp Duty Reserve Tax**
>
> **...Transfer of exchange tokens**
>
> For the transfers of exchange tokens to fall within the scope of Stamp Duty or SDRT, they would need to meet the definition of 'stock or marketable securities' or 'chargeable securities' respectively.
>
> This will be considered on a case-by-case basis, dependent on the characteristics and nature of the cryptoasset, rather than any labels

attached to them.

However, as of the original date of publication of this paper, HMRC's view is that existing exchange tokens would not be likely to meet the definition of 'stock or marketable securities' or 'chargeable securities'.

Exchange tokens given as consideration

Exchange tokens could be given as consideration for purchases of 'stock or marketable securities' and/or 'chargeable securities'.

For Stamp Duty, chargeable consideration is 'money', 'stock or marketable securities' or 'debt'. For SDRT it is defined as 'money or money's worth'.

If exchange tokens are given as consideration, this would count as 'money's worth' and so be chargeable for SDRT purposes. Tax will be due based on the pound sterling value of the exchange tokens at the relevant date.

HMRC does not consider exchange tokens to be currency or money, so they do not meet the definition of 'money' for Stamp Duty consideration purposes. They will also generally not count as 'stock or marketable securities'.

Broadly, 'debt' counts as chargeable consideration for Stamp Duty in the following scenarios:

- release of a debt - The seller has an outstanding debt to the purchaser (which could be in the form of exchange tokens). The seller transfers shares to the purchaser, and in consideration the purchaser releases the seller from the debt.
- debt is assumed - A third party has an outstanding debt to the purchaser (which could be in the form of exchange tokens). The seller transfers shares to the purchaser, and in consideration the seller is assigned the right to the debt from the third party.

Stamp Duty Land Tax

... Transfer of exchange tokens

HMRC does not consider transfers of exchange tokens to be land transactions. This means that SDLT will not be payable on such transfers.

Exchange tokens given as consideration

Chargeable consideration for the purposes of SDLT comprises anything given for the transaction that is 'money or money's worth'. As a general rule, any non-monetary consideration should be valued at its market value on the effective date of the transaction.

Accordingly, if exchange tokens are given as consideration for a land transaction, these would fall within the definition of 'money or money's worth' and so be chargeable to SDLT.

CHAPTER NINETY SEVEN

UNREMITTABLE ASSETS

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97.1 Unremittable assets: Introduction

There are five reliefs for receipts which cannot be brought to the UK, typically due to exchange control:

Provision	**Relief for:**
s. 842 ITTOIA	Foreign income
Chap 13 pt 2 ITTOIA	Trading receipts
s.668, 669 ITA	Accrued income profits
s.279 TCGA	Foreign gains
s.1275 CTA 2009	CT

In this chapter I focus on the reliefs for foreign income/gains, which I call "**unremittable income/gains relief**".

The SAIM provides:

> **SAIM1150 unremittable income** [Feb 2020]
> Some countries impose exchange controls to regulate the flow of money. Where a person has income arising in one of these countries, it may be impossible to bring the income into the UK either because it is not permitted by the authorities in that country or because it is difficult to

> obtain foreign currency there. In these circumstances, tax could become due on income that was not available to pay the tax bill and hardship could result. Special rules in Chapter 4 Part 8 of ITTOIA 05 allow an individual or trustee to claim that unremittable income should not be brought into charge when it arises.
> The most common example is that of a UK resident who has a bank account in a country that imposes restrictions on the movement of currency...

It might be noted that although the legislation (e.g. s841(3)(c) ITA 2007) refers to the "impossibility" of obtaining currency, HMRC's guidance is more lenient, referring to "difficult to obtain" A current example might be Zimbabwe where a monthly auction of foreign currency is always oversubscribed and, in reality, it is a lottery whether foreign currency can be obtained.

97.2 Unremittable asset relief

For foreign income, s.841(1) ITTOIA provides:

> This Chapter applies if—
> (a) a person is liable for income tax on income arising in a territory outside the UK, and
> (b) the income is unremittable.

The CGT equivalent is s.279(1) TCGA which provides:

> Subsection (2) below applies where—
> (a) chargeable gains accrue from the disposal of assets situated outside the UK, and
> (b) the person charged or chargeable makes a claim, and
> (c) the conditions set out in subsection (3) below are, so far as applicable, satisfied as respects those gains ("the qualifying gains");...[1]

What is the interaction of these provisions - for instance where only a limited amount of foreign currency is available but an individual has both unremittable income and unremittable capital gains? In the absence of any statutory provisions, it is assumed that the pre-2008 mixed-fund rules - see 20.17 (Pre-2008 mixed fund rules) - will apply.

[1] For completeness: s.279(1) concludes with provision for pre-TCGA 1992 claims (which will now be very rare): "... and subsection (2)(b) also applies where a claim has been made under section 13 of the 1979 Act."

97.3 "Unremittable" income

Section 841(2) ITTOIA provides:

> For the purposes of this Chapter, income is unremittable if conditions A and B are met.

I refer to "**unremittable income conditions A and B**".

97.3.1 *Cond. A: Cannot transfer to UK*

For foreign income, s.841(3) ITTOIA provides:

> Condition A is that the income cannot be transferred to the UK by the person who is liable for income tax in respect of the income because of—
> (a) the laws of the territory where the income arises,
> (b) executive action of its government, or
> (c) the impossibility of obtaining there currency that could be transferred to the UK.

For CGT, s.279(3) TCGA provides:

> (3) The conditions are—
> (a) that the claimant was unable to transfer the qualifying gains to the UK, and
> (b) that the inability was due to the laws of the territory where the assets were situated at the time of the disposal, or to the executive action of its government, or to the impossibility of obtaining foreign currency in that territory, and
> (c) that the inability was not due to any want of reasonable endeavours on the part of the claimant.

The predecessor provision in ICTA included a requirement that the income was unremittable notwithstanding the taxpayer's reasonable endeavours. This remains for CGT but was omitted in the ITTOIA rewrite, as it added little if anything to the general rule that the income cannot be transferred. That condition is not met if reasonable endeavours could procure a transfer. EN ITTOIA provides:

> The condition contained in section 585(1)(c) of ICTA and the similar words about "reasonable endeavours" in section 584(2) of ICTA are not rewritten in [ITTOIA]. They are regarded as adding little to the requirements of sections 584(1)(a) and 585(1)(a) and (b) of ICTA. If, by reasonable endeavours, the taxpayer could transfer the income to the United Kingdom, the test in section 584(1)(a) of ICTA of his being prevented from transferring it and the similar tests in section 585(1)(a)

> of ICTA about being unable to transfer the income or remit the proceeds of transfer must not be met, and there would then be no inability to transfer because of local law, government action or the impossibility of obtaining foreign currency as required under section 585(1)(b) of ICTA.

The SAIM provides:

> **SAIM1150 unremittable income** [Feb 2019]
> ... The earlier [ICTA] rules also required that the income should not be unremittable due to 'want of reasonable efforts' on the taxpayer's part, but this requirement was omitted from ITTOIA05 and should not be interpreted harshly for 2004-05 and earlier years.
> Example (*Laura*)
> L has a bank account in another country where money is deposited from her mother's estate. She cannot bring the money back to the UK because of strict exchange controls. She has the option of putting the money into low yield government bonds in that country, and income from these bonds can be remitted to the UK. HMRC will accept that it is not reasonable for L to have to put the money in low yield bonds, and that the interest on the account is unremittable.

Although in origin a comment on the "reasonable endeavours" requirement (still applicable to CGT but not now to IT) the example is also relevant to the question of whether unremittable income condition A is met, ie whether it is the case that the income "cannot" be transferred.

In *Coxon v HRMC* the taxpayer purchased a property in Cyprus "off plan", that is, the property was not then constructed but the vendor developer undertook to build the property. The taxpayer transferred funds to a Cyprus bank account in his name. The funds could not be transferred to the UK because:

(1) Under the contract with the developer, they were to be released to the developer in installments as the development proceeded, an arrangement known as an escrow account.
(2) The funds were also charged for a debt to the bank.

Interest on the funds could not be transferred to the UK. But this was because of the contracts the taxpayer had chosen to make, and not because of the laws of Cyprus (even though the contracts were governed by Cyprus law):

> We do not consider that s 841(3)(a) [ITA] assists Mr Coxon. We consider that provision applies to overseas legislation such as foreign exchange control restrictions, or blocked funds accounts arising from

> trading boycott sanctions. It is not sufficient to cover an inability to transfer funds to the UK because of a contractual provision restricting one party's ability to deal with those funds (here, the bank's security charge over the Escrow Account). [The taxpayer's representative] made reference to Cypriot banking laws but, at least in the absence of further detail, we conclude that a contractual restriction, albeit one legally enforceable under Cypriot law, is insufficient to bring s 841(3)(a) into play.[2]

97.3.2 *Cond. B: Remittable funds*

Section 841(4) ITTOIA provides:

> Condition B is that the person who is liable for income tax in respect of the income has not realised it outside that territory for an amount in sterling or in another currency which the person is not prevented from transferring to the UK.

It is difficult to see what this adds to unremittable income condition A; but it does not matter.

97.4 The relief

For foreign income, s.842(1) ITTOIA provides:

> If a person liable for income tax on unremittable income makes a claim for relief under this section in respect of that income, it is not taken into account for income tax purposes.

The CGT equivalent is s.279(2)(a) TCGA which provides:

> For the purposes of capital gains tax—
> (a) the amount of the qualifying gains shall be deducted from the amounts on which the claimant is assessed to capital gains tax for the year in which the qualifying gains accrued to the claimant.

97.5 ECGD payment

97.5.1 *Payment before claim*

For foreign income, s.842 ITTOIA provides:

> (3) No claim under this section may be made in respect of any income so

[2] [2013] UKFTT 112(TC) at [19].

> far as an ECGD payment has been made in relation to it.
> (4) In subsection (3) "ECGD payment" means a payment made by the Export Credit Guarantee Department under an agreement entered into as a result of arrangements made under—
> (a) section 2 of the Export and Investment Guarantees Act 1991 (insurance in connection with overseas investment), or
> (b) section 11 of the Export Guarantees and Overseas Investment Act 1978.[3]

The CGT equivalent is s.279(4) TCGA which provides:

> Where under an agreement entered into under arrangements made by the Secretary of State in pursuance of
> [a] section 1 of the Overseas Investment and Export Guarantees Act 1972[4] or
> [b] section 11 of the Export Guarantees and Overseas Investment Act 1978[5]
> any payment is made by the Exports Credits Guarantee Department in respect of any gains which cannot be transferred to the UK, then, to the extent of the payment, the gains shall be treated as gains with respect to which the conditions mentioned in subsection (3) above are not satisfied (and accordingly cannot cease to be satisfied).

97.6 Claims

Both CGT and IT require a claim.

The claim for foreign income is made by ticking box 1 of form SA106 (Foreign) 2022/23 The rubric to the box reads:

> **Unremittable income If you were unable to transfer any of your overseas income to the UK, put 'X' in the box** – and give details in the 'Any other information' box on your tax return or on a separate sheet

Section 842(5) ITTOIA provides:

> A claim under this section must be made on or before the first anniversary of the normal self-assessment filing date for the tax year for which the income would be charged to tax if no claim were made.

[3] This Act was repealed by the Export and Investment Guarantees Act 1991but the need to update was overlooked.

[4] This Act was repealed by the Overseas Development and Co-operation Act 1980 but unfortunately the need to update the reference was overlooked.

[5] This Act was repealed by the Export and Investment Guarantees Act 1991 but unfortunately the need to update the reference was overlooked.

EN ITTOIA provides:

> The time limit is tied to the tax year for which the income would otherwise be chargeable, rather than to the tax year in which the income arises (as in the source legislation). This brings the time limit into line with the normal time limit for claims. See Change 140 in Annex 1.

But following the abolition of the preceding year basis, there are not many cases where income arises in one year and is chargeable in another. Perhaps the remittance basis offers an example.

The SAIM provides:

> **SAIM1160 unremittable income: claims** [Jan 2020]
> ... A claim under ITTOIA/S842 does not mean that the income can be omitted from the tax return. The income must still be declared on the tax return but it will not be brought into charge if the claim is valid. This ensures that the amount of the income for each year is known so it can be assessed when the income becomes remittable.

That follows from s.42(1A) TMA: see 123.3 (Quantification of claim).

The CGT time limit is different. Section 279(5) TCGA provides:

> No claim under this section in respect of a chargeable gain shall be made—
> (a) in the case of a claim for the purposes of capital gains tax, at any time not more than 4 years after the end of the year of assessment in which the gain accrues; or
> (b) in the case of a claim for the purposes of corporation tax, more than 4 years after the end of the accounting period in which the gain accrues.

For gains, the claim is made in form SA108 (2022/23) box 54 (Any other information). HMRC, "Capital Gains Tax summary notes" (2022/23) provides:

> Please put any additional information in this box. For example ... any gains out of your computations, such as foreign gains that you are unable to bring into the UK

97.7 Remittance basis claimant

EN ITTOIA provides:

> The relief [in chapter 4] applies only to income charged on the arising

basis so does not apply to income charged on the remittance basis.[6]

This was the case in the pre-ITTOIA legislation. The former s.584 ICTA1988 applied:

> *Where a person is chargeable to tax by reference to the amount of any income arising in a territory outside the UK ...*

That relief only applied to arising basis taxpayers.[7] Now it is considered that an individual who is a remittance basis taxpayer at the time the unremittable income arises may also qualify for unremittable income relief; but that issue only arises in circumstances where the income is:

(1) unremittable (for the purposes of unremittable income relief) but
(2) treated as remitted under the ITA remittance basis (so a claim is needed for unremittable income relief).

That would not happen before the extension of the remittance basis in 2008 and even now will rarely happen. If it did, there is no good reason for not applying the relief, and that would be consistent with the position for unremittable gains relief.

97.8 Clawback of unremittable income relief

For foreign income, s.843(1) ITTOIA provides:

> This section applies if—
> (a) a claim under section 842[8] has been made in relation to any income, and
> (b) either—
> (i) the income ceases to be unremittable, or
> (ii) an ECGD payment is made in relation to it.

If these conditions are satisfied, the relief is withdrawn. Section 843(3)

[6] The same point was made in the former HMRC6 para 12.27 (Unremittable income): "Unremittable income should not be confused with unremitted foreign income and gains which is relevant only if you use the remittance basis.
Having unremittable income is relevant to your tax affairs only if you use the arising basis."

[7] Contrast the former s.585 ICTA 1988 which applied if: "A person charged or chargeable for any year of assessment in respect of income from any source with tax which (apart from this section) falls to be computed ... on the amount of income received in the UK..."

[8] This will include a claim made under the pre-2005 legislation, if the income ceases to be unremittable after 2005.

ITTOIA provides:

> If income ceases to be unremittable, the income is treated as arising on the date on which it ceases to be unremittable.

For gains, s.279(2)(b) TCGA provides for withdrawal of the relief:

> (b) the amount so deducted shall be assessed to capital gains tax on the claimant (or his personal representatives) as if it were an amount of chargeable gains accruing in the year of assessment in which the conditions set out in subsection (3) below cease to be satisfied.

The remittance basis may apply on a clawback of the relief.

If the individual (or the PRs) are non-resident in the year the gain accrues, there is no charge to CGT.[9]

CG Manual gives this example:

> **CG78408 - Foreign currency: example** [Jul 2019]
> In 1983, Ms A who is both resident and domiciled[10] in the UK buys a property overseas for foreign currency, which she acquired for £50,000 on the date of purchase of the property ....
> In 1986-87 she sells the property for 3,000,000 units of the foreign currency at a time when the exchange rate is 40 to £1. The sterling equivalent of the currency so obtained is therefore £75,000.
> The chargeable gain (subject to expenses) is £75,000 less £50,000 equals £25,000, before indexation, and this is assessable for 1986-87.
> Ms A makes a claim under TCGA92/S279 and establishes that she is unable to transfer any of the sale proceeds to the UK because of the foreign country's currency regulations. The gain of £25,000 less indexation is no longer assessable for 1986-87, and any assessment which may have been made should be adjusted accordingly.
> In 1991-92, the foreign country relaxes its currency regulations and Ms A is then able to transfer the sale proceeds to the UK. She becomes assessable for that year (whether or not she remits the sale proceeds to the UK) on £25,000 less indexation (that is, the amount by which the assessment for 1986-87 was reduced) ...

The SAIM provides:

> **SAIM1160 unremittable income: claims** [Jan 2020]
> ...Relief continues until the income becomes remittable. Exchange

[9] Except for NRCGT?

[10] The point of mentioning domicile is that Ms A is an arising basis taxpayer.

controls do change so anyone who makes a claim must check that the conditions for relief continue to be satisfied each year.

Withdrawal of relief

The income is assessable at the time it becomes possible to remit the income to the UK (ITTOIA05/S843). There is no requirement that the income must actually be remitted in order for the charge to arise. If the source has ceased, the income is taxed as if the source had not ceased (ITTOIA05/S844).

97.8.1 *Clawback: after ECGD payment*

Section 843(4) ITTOIA provides:

> If an ECGD payment[11] is made in relation to income, the income is treated, to the extent of the payment, as arising on the date on which the ECGD payment is made.

97.8.2 *Clawback: after source ceased*

Section 844 ITTOIA provides:

> (1) This section applies if—
> (a) income is treated as arising as a result of section 843, and
> (b) at the time it is so treated the person who would have become liable for income tax as a result of that section—
> (i) has permanently ceased to carry on the trade, profession, vocation or property business from which the income arises, or
> (ii) in the case of income from another source, has ceased to possess that source.
> (2) In the case of income from a trade, profession or vocation—
> (a) the income is treated as a post-cessation receipt for the purposes of Chapter 18 of Part 2 (trading income: post-cessation receipts), but
> (b) in the application of that Chapter to that income, section 243 (extent of charge to tax) is omitted.
> (3) In the case of income from a property business—
> (a) the income is treated as a post-cessation receipt from a UK property business for the purposes of Chapter 10 of Part 3 (property income: post-cessation receipts), but
> (b) in the application of that Chapter to that income, section 350

[11] Defined by reference in s.832(2) ITTOIA: “In this section “ECGD payment” has the meaning given by section 842(4).”

> (extent of charge to tax) is omitted.
> (4) In the case of income from another source, the income is taxed as if the person continued to possess that source.

97.8.3 *Remittance basis taxpayer*

The rules here are odd. The position depends on whether or not the source of income exists at the time that the relief is withdrawn. If it does, then the income is relevant foreign income and if the individual is a remittance basis taxpayer at the time the income arises, the remittance basis will apply.

If the source has ceased, however, the income is within s.844 ITTOIA, and s.830(3) ITTOIA provides:

> But "relevant foreign income" does not include income chargeable as a result of section 844 (unremittable income: income charged on withdrawal of relief after source ceases).

The surprising consequence is that the remittance basis does not apply to income deemed to arise on a withdrawal of relief after the source of the income has ceased.[12]

The reason for this is historical. EN ITTOIA provides:

> Income charged by virtue of [section 844] is not "relevant foreign income", as defined in section 830 (see subsection (3) of that section). In the source legislation, the charge is under Schedule D Case VI (rather than Schedule D Cases IV or V). The potential relevance of such income to relief under section 392 of ICTA (Case VI losses) has been preserved by the appropriate entry in section 836B of ICTA (introduced by paragraph 340 of Schedule 1 to this Act).

It is obvious that s.830(3) serves no useful purpose, and should be repealed, if only for the sake of simplification; in practice I expect the point will rarely arise; if it does, it would often be overlooked.

97.8.4 *Clawback: Non-resident*

As the income is foreign source income, there is no tax charge if the taxpayer is then non-resident. In appropriate cases, split-year rules, temporary non-resident rules and DT relief need to be considered.

[12] The law ought to be simplified by repealing s.830(3): see 16.9.4 (RFI definition: Critique).

97.8.5 *Death before relief withdrawn*

For foreign income, s.843(7) ITTOIA provides:

> If a person who would have become liable for income tax as a result of this section has died—
> (a) the personal representatives are liable for the tax instead, and
> (b) the tax is a debt due from and payable out of the estate.

The PRs tax liability is on the basis that the income is treated as accruing to the estate when it becomes remittable. That seems reasonable as the PRs should receive the (formerly unremittable) income.

In the case of a remittance basis taxpayer, it could work unfairly if the PRs do not qualify for the remittance basis. But a remittance basis taxpayer will not normally claim unremittable income relief.

If the PRs are non-resident, they will not be taxable.

The CGT equivalent is s.279(6) TCGA which provides:

> The personal representatives of a deceased person may make any claim which he might have made under this section if he had not died.

Why was this thought to be necessary?

97.8.6 *Clawback: Income computation*

Section 843(5) ITTOIA provides:

> The income treated as arising under subsection (3) or (4), and any tax payable in respect of it under the law of the territory where it arises, are taken into account for income tax purposes at their value at the date on which the income is treated as arising.

The SAIM provides:

> **SAIM1160 unremittable income: claims** [Jan 2020]
> ... The income is treated as arising on the date on which the qualifying conditions cease to be satisfied. The foreign currency amount is translated into sterling at the market rate on that date, or if there is no market in the currency, the official exchange rate for the country concerned (ITTOIA05/S845).
> *Example (Martin)*
> M has income from an interest-bearing account in Ruritania. Ruritania has exchange controls, and he cannot remit the income to the UK. The income first arises in 2002/03, when the account earns interest of 1,000 Ruritanian doubloons (RUD). RUD 1,250 arises in 2003/04, and RUD

> 1,600 in 2004/05. In March 2005, M travels to Ruritania, closes the account and spends the money.
> On 1 January 2008, Ruritania lifts the exchange controls and the income becomes remittable.

The HMRC analysis is as follows:

> M has validly claimed relief under ITTOIA/S842 (1). But in 2007/08, the income is brought back into charge under ITTOIA/S843. It does not matter that he no longer possesses the source of income (ITTOIA05/S844 (4)). M must include total income of RUD 3,850 (1,000 + 1,250 + 1,600), translated into sterling at the exchange rate prevailing on 1 January 2008, in his 2007/08 self-assessment.

97.8.7 *Prevention of double charge*

Section 843(6) ITTOIA provides:

> Subsections (3) to (5) do not apply so far as the income has already been treated as arising as a result of this section.

EN ITTOIA provides:

> For example, if relief has been withdrawn because an ECGD payment is received, there is no further charge under this section – to the extent of that payment – if the income itself subsequently becomes remittable.

97.9 Position if no relief claim made

A claim should normally be made, but it may occasionally be better not to claim, to avoid clawback issues when unremittable income will subsequently become remittable:

(1) Bunching income and bringing it into a higher rate.
(2) If it is anticipated that the foreign currency may appreciate against sterling.
(3) A remittance basis taxpayer at the time the income arises does not usually need the relief.

If no claim is made for the relief, an arising basis taxpayer will be chargeable, but on what amount? Section 845 ITTOIA provides:

> (1) If no claim is made under section 842 in relation to unremittable income arising in a territory outside the UK, the amount of the income to be taken into account for income tax purposes is determined as follows.

> (2) If the currency in which the income is denominated has a generally recognised market value in the UK, the amount is determined by reference to that value.
> (3) In any other case, the amount is determined according to the official rate of exchange of the territory where the income arises.

97.10 Unremittable trading/property income

The former ESC B38 explains the limits of s.841 unremittable income relief:

> 1. A person resident in the UK who carries on a trade partly overseas and partly in the UK is normally liable to UK income or corporation tax on all the profits from that trade. For this purpose the calculation of profits will include, in respect of overseas transactions–
> (i) amounts paid to the trader which are not remittable to the UK
> (ii) amounts owed to the trader which temporarily cannot be paid, and
> (iii) amounts owed to the trader which even when paid will not be remittable to the UK.
> solely as a consequence of local foreign exchange control restrictions.
> 2. Relief from tax is not available for such amounts under [s.841 unremittable income relief] ... because the profits of the trader of which they are a component part do not arise outside the UK. Nor does the fact that the amounts are unremittable to the UK entitle the trader to relief under [s.35 ITTOIA] (bad and doubtful debts).

Instead, Chapter 13 Part 2 ITA 2007 provides relief. Section 272 ITTOIA applies that Chapter for the purposes of Part 3 of ITTOIA (property income). This is too specialist a topic to consider here.

97.11 Unremittable accrued income profits

Section 841 would not apply to accrued income profits as the proceeds of the sale of accrued income securities are not the income. But in any event, s.841(5) ITTOIA provides:

> This Chapter does not apply to accrued income profits which a person is treated as making under Chapter 2 of Part 12 of ITA 2007, but see sections 668 and 669 of that Act (which make similar provision).

Instead, ss 668, 669 ITA provide relief. This is too specialist a topic to consider here.

97.12 Interaction with anti-avoidance rules

Interactions of unremittable income relief and various anti-avoidance provisions raise a fine set of puzzles.

97.12.1 *Unremittable s.3 gains*

Van-Arkadie v Plunket concerned a minority shareholder in a company resident in Rhodesia. The company realised a gain, part of which was treated as accruing to to the shareholder under s.3 TCGA. The company could not transfer its gain to the UK. The claim for unremittable gains relief was refused:

> Section [279 TCGA] is concerned only with the case where a chargeable gain accruing on an actual or deemed disposal is represented by something, money or money's worth, which comes into the hands of the taxpayer. It is only in respect of that money or money's worth that it can be sensibly asked whether the taxpayer was unable to transfer it to the UK, and if he was whether the inability was due to the laws of the territory where the gain accrued and whether, if it was, that inability was due to any want of reasonable endeavours on his part. That last requirement seems to me in itself conclusive against the Respondent's case. In this case the Respondent's inability to remit the gain on which he is chargeable was not due to any want of reasonable endeavours to remit moneys to the UK; it was due to the fact that the company did not distribute and that he could not as a minority shareholder compel it to distribute the gain.[13]

This was an unfair result, but in practice the restrictions on s.3 introduced in 2013 reduce the problem significantly.

A shareholder with a majority of the company could compel the company to distribute, and in those circumstances unremittable gain relief should be available.

97.12.2 *s.624/720 income or benefit*

If the income is unremittable income of a settlor-interested trust, it is suggested that unremittable income relief is available if the income is actually received by the settlor who is unable to remit it.

If a transferor receives s.720 income, it is suggested that unremittable income relief does not apply, though the contrary view is arguable.

[13] 56 TC 310 at p.316. Although there was a DTA with Rhodesia, it did not cover CGT.

If a beneficiary receives a benefit within s.731/s.643A/s.87, and is unable to remit the benefit, it is suggested that unremittable income or gain relief applies, but in any event, the benefit must be valued taking into account the restriction on remittance, so it may not have much value.

CHAPTER NINETY EIGHT

ATED AND SDLT

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98.1 ATED regime

This chapter considers:

(1) Annual Tax on Enveloped Dwellings (“**ATED**”)
(2) Aspects of SDLT:
    (a) 15% SDLT rate on acquisition within ATED (“**ATED-SDLT**”)
    (b) SDLT surcharge on acquisition by non-residents

The focus of this chapter is ATED. I deal with the SDLT topics, which are in part related, but in less detail. I do not consider LBTT/LTT (the Scots/Welsh equivalents of SDLT) though I hope to do so in a future edition.

A third part of the former ATED regime, CGT on property within ATED (“ATED-CGT”), has long gone: that is now superseded by the general charge on UK property of non-residents.

A full discussion of ATED would require a book to itself and SDLT would need several volumes. I focus on the aspects most important to the themes of this book, but include a general discussion, as it is necessary to view the rules in the round.

HMRC have published over 100 pages of guidance (“**HMRC ATED guidance**”).[1]

The development of the law can be traced from:

(1) A consultation document tendentiously entitled “Ensuring the fair taxation of residential property transactions”.[2] I refer to it as the “**Residential Property Consultation Document**”.
(2) A consultation response document, which I call the “**Residential Property Consultation response**”.[3]

[1] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/375750/ated-tech-guide.pdf* supplemented by guidance on completing the ATED return *https://www.gov.uk/government/publications/stld-annual-tax-on-enveloped-dwellings-ated*

[2] *https://assets.publishing.service.gov.uk/media/5a798f7b40f0b63d72fc6c87/consult_ensuring_fair_taxation_residential_property_transactions.pdf* (May 2012).

[3] HMRC, “Ensuring the fair taxation of residential property transactions: summary of responses” (December 2012) *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/19*

These are now of historical interest only.

The ATED/ATED-SDLT legislation is found in two distinct places:

(1) ATED is in FA 2013
(2) ATED-SDLT is in sch 4A FA 2003

ATED and ATED-SDLT share a common framework and common terminology, even though the common definitions are written out twice. Brevity and simplicity were not material considerations in the ATED regime.

98.2 ATED terminology

98.2.1 *"Partnership" for ATED/SDLT*

"Partnership" matters for the following purposes for ATED/SDLT:

(1) ATED applies if residential property is held by a partnership including a company.
(2) ATED-SDLT applies if residential property is acquired by a partnership including a company.

For SDLT, para 1 sch 15 FA 2003 provides a definition:

> In this Part of this Act a "partnership" means—
> (a) a partnership within the Partnership Act 1890,
> (b) a limited partnership registered under the Limited Partnerships Act 1907, or
> (c) a limited liability partnership formed under the Limited Liability Partnerships Act 2000 or the Limited Liability Partnerships Act (Northern Ireland) 2002,
> [d] or a firm or entity of a similar character to any of those mentioned above formed under the law of a country or territory outside the UK.

Para [d] brings in foreign law LLPs, which are not classified as partnerships for other tax purposes, so this definition is wider than the normal tax sense of the word.

Section 167 FA 2013 provides the identical definition for ATED.[4] So I refer to this as the **"ATED/SDLT definition of partnership"**.

0256/summary_of_responses_ensuring_fair_taxation_of_residential_property_transactions.pdf

[4] Except that s.167(1)(a) erroneously reads "Partnerships Act 1890", which is a surprising error, as the Act was correctly named in the FA 2003.

98.2.2 *"Company" for ATED/SDLT*

The ATED and ATED-SDLT definitions are similar, and conveniently read side by side:

s.166(1) FA 2013: ATED

> In this Part "company" means a body corporate[5] but does not include—
> (a) a corporation sole,[6] or
> (b) any partnership (see section 167(1)).

Para 9 sch 4A FA 2003: ATED-SDLT

> In this Schedule—
> "company" means a body corporate other than a partnership.

The rules apply to UK and non-UK resident companies.

This is narrower than the standard tax definition (which classifies an unincorporated association as a company).[7]

98.2.3 *"Collective investment scheme"*

The FSMA definition applies: see para 9 sch 4A FA 2003 (for ATED-SDLT) and s.174 FA 2013 (for ATED).[8]

98.2.4 *"Connected person"*

Section 172(1) FA 2013 incorporates the standard definition[9] by reference:

> Section 1122 of the Corporation Tax Act 2010 (connected persons) has effect for the purposes of this Part (except where otherwise stated).

Section 172 goes on to provide a definition of "connected" in relation to a collective investment scheme, which is not discussed here.

98.2.5 *"Non-natural person"*

HMRC use the term "**non-natural**" person as label for a body which is a company, a partnership with a company partner, or a CIS. The term is inapt and tends to conceal the complex and arbitrary nature of the concept(s) to which it refers. However it is useful to have a label, and no short label could correctly describe this disparate group of entities. It is

[5] See 90.9 (Body corporate).

[6] Corporation sole is a very specialist topic, of mainly ecclesiastical interest.

[7] See 90.8 (Definition of "company").

[8] See App 66.3 (Mutual fund/CIS/OIEC).

[9] See 98.2.4 ("Connected person").

also convenient to adopt a consistent usage. In order to keep in mind the artificiality of the expression I refer to "non-natural persons" using scare quotation marks.

The following do not count as "non-natural persons" and so are not within the scope of ATED or ATED-SDLT:

Trustees
Personal representatives
Clubs and unincorporated associations[10]

98.2.6 *Enveloping/De-enveloping*

Budget 2012 referred to acquisition of a residence by companies as "**enveloping**". At the time, I half balked at that neologism: it is a simplistic reification which hinders clarity of thought. In 2013 it was put into the name of the tax, ATED, and since then we have become familiar with it. It is now perhaps too pointed to put scare quotation marks around the word but its arbitrary nature should be kept in mind.

Winding up the company is called **"de-enveloping"**. I did not originally favour this neologism, particularly when we have the established term "disincorporation" (or indeed liquidation); but language evolves and now it has become familiar it seems an acceptable shorthand.

98.3 "Chargeable interest"

For this term see App 2.21 (Interest in land/chargeable interest).

Section 107(2) FA 2013 provides:

> Where two or more persons are jointly entitled to a chargeable interest the chargeable interest is not regarded, for the purposes of this Part [Part 3 FA 2013, ATED], as consisting of separate interests corresponding to the shares (if any) that those persons have by virtue of their joint entitlement.

98.4 Annual tax on enveloped dwellings

Section 94(1) FA 2013 provides the charge to ATED:

> A tax (called "annual tax on enveloped dwellings") is to be charged in accordance with this Part.

A note on terminology: Budget 2012 proposed the term"Annual Residential Property Tax". That changed to ATED in 2013. No reason

[10] See 98.2.2 ("Company" for SDLT/ATED).

was given for the change, but "ATED" is more focussed, and was probably thought to sound less threatening to taxpayers worried about wider reaching residential property taxation. Names are important in politics; contrast community charge/poll tax, and bedroom tax/ under-occupancy penalty, in the context of housing benefit. But the extension of CGT to non-residents in 2019 shows that taxpayers would have been right to be concerned.

Section 94(2) FA 2013 provides the charge to ATED:

> Tax is charged in respect of a chargeable interest[11] if on one or more days in a chargeable period–
>
> (a) the interest is a single-dwelling interest and has a taxable value of more than £500,000, and
>
> (b) a company, partnership or collective investment scheme meets the ownership condition with respect to the interest.

SDLT is a tax on acquisition of a chargeable interest, so it is charged once, on acquisition. ATED is a tax on ownership, and is charged annually.

98.5 Corporate ownership condition

Section 94(2)(b) FA 2013 provides that ATED is charged if:

> a company, partnership or collective investment scheme meets the ownership condition with respect to the interest.

There has to be a company, partnership or CIS, ie a "non-natural" person. ATED-SDLT is the same.[12]

Section 94 FA 2013 provides:

> (4) A company meets the ownership condition with respect to a single-dwelling interest on any day on which the company is entitled to the interest (otherwise than as a member of a partnership or for the purposes of a collective investment scheme).
>
> (5) A partnership meets the ownership condition with respect to a single-dwelling interest on any day on which a member of the partnership that is a company is entitled to the interest (as a member of the partnership).
>
> (6) A collective investment scheme meets the ownership condition with respect to a single-dwelling interest on any day on which the interest is held for the purposes of the scheme.

[11] See 98.3 ("Chargeable interest").

[12] See 98.27 (Co purchaser (non-natural person))

I refer to this as the "**ATED corporate ownership condition**". It is the ATED equivalent of ATED-SDLT corporate purchaser condition.

98.5.1 *"Entitled"*

Section 95(1) FA 2013 provides:

> In this Part [Part 3 FA 2013, ATED] "entitled" means beneficially entitled—
> (a) whether solely or jointly with another person, and
> (b) whether as a member of a partnership or otherwise.
> This is subject to subsection (2).

Section 95(2) FA 2013 provides 3 exceptions:

> References in this Part to entitlement to a single-dwelling interest (or any other chargeable interest) do not include—
> (a) entitlement in the capacity of a trustee[13] or personal representative, or
> (b) entitlement as a beneficiary under a settlement[14].
> (3) Subsection (1)(b) does not apply where the contrary is specified.

A corporate trustee does not meet the ATED corporate ownership condition as it is not "beneficially" entitled to the interest.

98.5.2 *Co in liquidation not beneficial owner*

The CT Manual provides:

> **CTM36125 company winding up etc: beneficial ownership of shares** [Jun 2016]
> When winding-up begins, a company loses beneficial interest in and ownership of its assets, although retaining legal title to and possession of them. Assets include shares owned in other companies (see *Ayerst v C and K (Construction) Ltd* (1974) 50 TC 651). The effect is that, where the provisions of the Taxes Acts depend on such shareholdings, they can no longer be taken into account when the company owning the shares commences winding-up.

Does the charge to ATED cease when winding up commences?
Further consideration is needed if the company is governed by foreign law.

[13] The reference to trustee is otiose, since a trustee is not beneficially entitled.

[14] See 87.3 (Settlement: Standard IT/CGT definition).

98.5.3 *Joint ownership*

Section 94(7) FA 2013 provides:

> If a company is jointly entitled[15] to a chargeable interest (as a member of a partnership or otherwise), then regardless of whether the company is entitled as a joint tenant or tenant in common (or, in Scotland, as a joint owner or owner in common) the ownership condition is regarded as met in relation to the whole chargeable interest.

This is an unfair rule, but the provisions are intended to be penal. The same rule applies for ATED-SDLT.[16]

98.6 Chargeable person

Section 96(1) FA 2013 provides:

> The chargeable person is liable to pay tax charged under this Part [Part 3 FA 2013, ATED].

The definition of chargeable person is broadly what one would expect.

98.6.1 *Chargeable person: Company*

Section 96(2) FA 2013 provides:

> "The chargeable person" means–
> (a) in relation to tax charged by virtue of section 94(4), the company;

98.6.2 *Chargeable person: Partnership*

Section 96(2) FA 2013 provides:

> "The chargeable person" means ...
> (b) in relation to tax charged by virtue of section 94(5), the responsible partners.[17]

[15] Section 174 FA 2013 provides a commonsense definition:
"jointly entitled" means–
(a) in England and Wales, beneficially entitled as joint tenants or tenants in common,
(b) in Scotland, entitled as joint owners or owners in common,
(c) in Northern Ireland, beneficially entitled as joint tenants, tenants in common or coparceners.

[16] See 98.27.1 (Joint purchasers).

[17] Section 95(5) FA 2013 provides the definition: "The reference in this section to "the responsible partners" are to all the persons who are members of the partnership

Section 96(4) FA 2013 provides:

> The liability of the responsible partners to pay tax charged on them under this Part [Part 3 FA 2013, ATED] is joint and several.

98.6.3 *Joint owners*

Section 97 FA 2013 provides:

> (1) Subsection (2) applies if
> (a) a company is within the charge for a chargeable period with respect to a single-dwelling interest by virtue of section 96(2)(a) and
> (b) one or more other persons are jointly entitled to the interest on the first day in that period on which the company is within the charge with respect to it.
> (2) The company and the other person or persons are jointly and severally liable for the tax charged for that period with respect to the interest (whether or not those other persons are also within the charge with respect to the interest on the day in question).

Presumably a right of reimbursement is implied.

98.6.4 *Chargeable person: CIS owner*

Section 96(3) FA 2013 provides:

> In relation to tax charged by virtue of section 94(6) "the chargeable person" means–
> (a) if the collective investment scheme is a unit trust scheme, the trustee of the scheme;
> (b) if the collective investment scheme is an open-ended investment company, the body corporate referred to in section 236(2) of the Financial Services and Markets Act 2000;
> (c) in relation to an EEA UCITS which is not an open-ended investment company or unit trust scheme, the management company for that UCITS;
> (d) in any other case, the person who has day-to-day control over the management of the property subject to the scheme.

98.6.5 *More than 1 chargeable person*

There may be more than one chargeable person where:

concerned on the first day in the chargeable period on which the partnership meets the ownership condition with respect to the single-dwelling interest."

(1) property is owned by a partnership
(2) property is owned jointly

Section 104 FA 2013 prevents a double charge:

> Tax in respect of a given single-dwelling interest is charged only once for any chargeable day even if more than one person is "the chargeable person" with respect to the tax charged

98.7 Rates of ATED

Section 99 FA 2013 provides:

> (1) The amount of tax charged for a chargeable period with respect to a single-dwelling interest is stated in subsection (2) or (3).
> (2) If the chargeable person is within the charge with respect to the single-dwelling interest on the first day of the chargeable period, the amount of tax charged is equal to the annual chargeable amount.

This is straightforward unless there is a change of ownership during the chargeable period.

98.7.1 *"Annual chargeable amount"*

For the year to 31/3/24, s.99(4) FA 2013 provides:

The annual chargeable amount for a single-dwelling interest and a chargeable period is determined in accordance with the following table, by reference to the taxable value of the interest on the relevant day.

Annual chargeable amount	*Taxable value of the interest on the relevant day*	
	More than	*but not more than*
£4,500	£500,000	£1 million
£9,000	£1 million	£2 million
£30,550	£2 million	£5 million
£71,500	£5 million	£10 million
£143,550	£10 million	£20 million
£287,500	£20 million	

Rather than charging a straightforward percentage of market value, ATED uses a banding system. The consequence is that:

(1) The lower value properties in each range pay the highest rate of tax (computed as a proportion of property value).
(2) Striking results as the value tips over to the next band:
   (a) Residential property worth £500k will not attract ATED, but if it is worth 1p more then ATED of £4.5k p/a is payable.
   (b) Residential property worth £2m will pay ATED of £9,000 p/a, but

if it is worth 1p more the rate will be £30k; etc.

This may be pejoratively described as a "cliff-edge" system, but it does have the merit of avoiding the necessity for more exact valuations.[18] In the early days of ATED, I thought banding was the better solution, despite the anomalies, but the subsequent increases in ATED rates have increased the unfairness. But there it is.

The unfairness at the margins might in theory be mitigated by planning: perhaps renovate the kitchen leaving work outstanding on the valuation date; the ATED saving may be more than fund the renovation. But valuation is not an exact science.

98.7.2 *Indexation of ATED rates*

Section 101 FA 2013 provides for indexation of the rates:

> (1) If the consumer prices index for September in 2013 or any later year ("the later year") is higher than it was for the previous September, section 99(4) applies in relation to chargeable periods beginning on or after 1 April in the year after the later year with the following amendments.
> (2) For each of the annual chargeable amounts stated in the table in section 99(4) (as it applies in relation to chargeable periods beginning in the previous 12 months) there is substituted the indexed amount.
> (3) "The indexed amount" is found by–
> (a) increasing the previous amount by the same percentage increase as the percentage increase in the consumer prices index, and
> (b) rounding down the result to the nearest multiple of £50.
> (4) In this section "consumer prices index" means the all items consumer prices index published by the Statistics Board.
> (5) The Treasury must, before 1 April 2014 and before each subsequent 1 April, make an order stating the amounts that by virtue of this section are to be the annual chargeable amounts for chargeable periods beginning on or after that date.

Indexation is by reference to CPI, not RPI.[19] But the bands (as opposed

[18] Unlike SDLT, where valuations are not usually needed. So for SDLT, the banding system (abolished for residential property but still in force for non-residential property) has no practical advantage to set against the unfairness.

[19] CPI and RPI are similar. The precise weight attached to individual items differs and the RPI includes items representing owner-occupier housing costs, such as mortgage interest and depreciation, which are excluded from the CPI. See

to the rates) are not index-linked, so over time properties will gradually come to fall within a higher band.

98.8 Change of ownership

It is necessary to consider the position of the previous owner and the new owner (for convenience here called vendor and purchaser, though the rules do not require a sale).

98.8.1 *Position of purchaser*

The rule is commonsense expressed in a complex way.

The starting point is s.99(3) FA 2013. One needs to read (3) with (2) to follow the sense:

> (2) If the chargeable person is within the charge with respect to the single-dwelling interest on the first day of the chargeable period, the amount of tax charged is equal to the annual chargeable amount.
> (3) Otherwise, the amount of tax charged is equal to the relevant fraction of the annual chargeable amount.

98.8.2 *"Relevant day"*

The definition of relevant fraction uses the term relevant day.

Section 99(5) FA 2013 provides:

> The "relevant day" is ...
> (b) for the purposes of subsection (3), the first day in the chargeable period on which the chargeable person is within the charge with respect to the interest.

98.8.3 *"Relevant fraction"*

Section 99(6) FA 2013 provides:

> The relevant fraction is (N ÷ Y) where–
> "N" is the number of days from (and including) the relevant day to the end of the chargeable period;
> "Y" is the number of days in the chargeable period.

http://www.ons.gov.uk/ons/rel/cpi/cpi-rpi-basket/2012/index.html
Parliament decided about 2012 to use the CPI instead of the RPI, CPI is said to be a more appropriate measure of price levels, a more accurate reflection of consumer shopping patterns, and more consistent with international indices. It is the basis of the Bank of England's inflation target.

98.8.4 *Relief for vendor*

The vendor is in the first instance charged for the entire chargeable period, even if there is a disposal during the period.

Section 106 FA 2013 provides the relief:

> (1) Where
>
> [a] tax is charged for a chargeable period with respect to a single-dwelling interest and
>
> [b] the adjusted chargeable amount is greater than the initial charged amount,
>
> the amount of tax charged is taken to be increased to the adjusted chargeable amount...
>
> (3) Subsection (4) applies where–
>
> (a) tax is charged for a chargeable period with respect to a single-dwelling interest,
>
> (b) the adjusted chargeable amount is less than the initial charged amount, and
>
> (c) a claim for relief is made under this subsection.
>
> (4) The amount of tax charged for the period with respect to the interest is taken to be reduced (at the end of the chargeable period) to the adjusted chargeable amount.
>
> (5) Relief under subsection (3) must be claimed–
>
> (a) in an ATED return, or
>
> (b) by amending an ATED return.
>
> (6) The claim must be delivered by the end of the chargeable period following the one to which the claim relates.
>
> (7) Relief under subsection (3) may be given by repayment of tax or otherwise.

98.8.5 *"Initial charged amount"*

Section 106(2) FA 2013 provides:

> In this section "the initial charged amount" means the amount of tax charged under section 99 for the period in respect of the interest.

98.8.6 *Adjusted chargeable amount*

Section 105 FA 2013 provides:

> (1) In relation to a person on whom tax is charged for a chargeable period with respect to a single-dwelling interest, the "adjusted chargeable amount" is the total of the daily amounts for all the days in the period on which the chargeable person is within the charge with

> respect to the interest.
>
> (2) The daily amount for any such day ("the actual day") is–
>
> (1 ÷ Y) × A

That could be written more simply as (A ÷ Y)

> where–
>
> "Y" is the number of days in the chargeable period;
>
> "A" is the annual chargeable amount for the single-dwelling interest, determined (under section 99(4)) on the basis that the actual day is the relevant day.

98.9 Taxable value

Section 102(1) FA 2013 provides:

> The taxable value of a single-dwelling interest on any day ("the relevant day") is equal to its market value at the end of the latest day that–
>
> (a) falls on or before that day, and
>
> (b) is a valuation date in the case of that interest.

Valuation is on the "valuation date".

98.9.1 *Ascertaining market value*

CGT rules apply for determining market value. Section 98(8) FA 2013 provides:

> For the purposes of this Part [Part 3 FA 2013, ATED] "market value" is to be determined as for the purposes of the TCGA 1992 (see, particularly, section 272 of that Act).

One is valuing the interest held by the chargeable person, not the land as such. The Residential Property Consultation Document provides:

> 2.32 Where there is a freehold interest and one or more subordinate leasehold interests in the same dwelling, and each is owned by unconnected persons within the charge, each will need to value their distinct interest and each may be liable to the annual charge based on those valuations. So, for example, when a property is purchased on a lease but the freehold is owned by a separate company, then both the freehold and the leasehold will be valued and the annual charge applied separately to the freehold (if valued over £2 million) and the leasehold (if valued over £2 million if also owned by a non-natural person).

There is no deduction for a mortgage, as CGT principles apply: see s.26(3) TCGA:

> An asset shall be treated as having been acquired free of any interest or right by way of security subsisting at the time of any acquisition of it, and as being disposed of free of any such interest or right subsisting at the time of the disposal...

It is considered that this rule is implied by applying CGT valuation principles.

The Residential Property Consultation Document provides:

> 2.44 ... 'Market value' will be defined in similar terms to the definitions used for capital gains tax, as described in the Royal Institution of Chartered Surveyors Valuation Standards UKGN3 and the VOA Guidance Manuals: *http://www.voa.gov.uk/*

98.9.2 *"Valuation date"*

Section 102 FA 2013 provides:

> (2) Each of the following is a valuation date in the case of any single-dwelling interest–
> (a) 1 April 2012;
> (b) each 1 April falling 5 years, or a multiple of 5 years, after 1 April 2012.
> (2A) But a day that is a valuation date only because of subsection (2)(b) (a "5-yearly valuation date") is to be treated as if it were not a valuation date for the purpose of determining the taxable value of a single-dwelling interest on any day in the chargeable period beginning with that 5-yearly valuation date.

In short, we revalue every 5 years, so 1 April 2022 is the valuation date for chargeable periods from 1 April 2023.

98.9.3 *Revaluation on disposal*

Section 102 FA 2013 provides:

> (3) The following are also valuation dates in the case of any single-dwelling interest to which a company is entitled on the relevant day (otherwise than as a member of a partnership)–
> (a) the effective date of any substantial acquisition by the company of a chargeable interest in or over the dwelling concerned;
> (b) the effective date of any substantial disposal of part (but not the whole) of the single-dwelling interest.

Section 102 FA 2013 provides equivalent rules for a corporate partnership and a CIS:

> (4) The following are also valuation dates in the case of any single-dwelling interest to which a company is entitled on the relevant day as a member of a partnership–
>
> (a) the effective date of any substantial acquisition as a result of which a chargeable interest in or over the dwelling concerned became an asset of the partnership,
>
> (b) the effective date of any substantial disposal of part (but not the whole) of the single-dwelling interest.
>
> (5) The following are also valuation dates in the case of any single-dwelling interest that is on the relevant day held for the purposes of a collective investment scheme–
>
> (a) the effective date of any substantial acquisition, made for the purposes of the scheme, of a chargeable interest in or over the dwelling concerned;
>
> (b) the effective date of any substantial disposal of part (but not the whole) of the single-dwelling interest.

98.9.4 *"Disposal" and "acquisition"*

Section 102 FA 2013 provides:

> (6) In this section references to a disposal of part of a single-dwelling interest include the grant of a chargeable interest out of the single-dwelling interest.
>
> (7) The grant of an option does not count as the grant of a chargeable interest for the purposes of subsection (6).

98.10 Valuation for ATED

Valuation is needed to identify the applicable ATED band.

98.10.1 *Valuation practice*

The Residential Property Consultation Document provides:

> 2.37 Property valuations for the annual charge will be self-assessed by the persons liable to the charge and submitted to HMRC as part of their annual charge tax return. HMRC will have powers to enquire into returns and also to make assessments so that non-compliance can be effectively challenged.

98.10.2 *Is expert valuation needed*

The Residential Property Consultation Document provides:

> 2.39 HMRC guidance will set out that a valuation provided to a

> taxpayer by a suitably qualified valuer of real estate would normally protect the taxpayer from possible penalties should it be subsequently established that their property has been significantly undervalued. A self valuation would bear a higher risk of not providing such protection.

That depends on the facts and will not be true in all cases.

> 2.40 Non-natural persons who believe they own a residential dwelling below, but in the region of, [the ATED threshold] may be liable to penalties if they fail to take proper care to establish a correct valuation on the appropriate date, and the property interest is in fact worth more than [the threshold]....
> 2.42 The valuation should provide a point valuation (i.e. a specific price)...

There is no need for a point valuation, but it would help HMRC identify borderline cases, and it is required for an HMRC pre-return banding check.

> 2.43 Valuations submitted to HMRC will be subject to checking by the Valuation Office Agency (VOA).

HMRC offer inconsistent advice on the issue of whether an independent valuation is needed:

> 3.49 HMRC will not routinely expect taxpayers to commission a professional valuation of their property, which may be expensive. It will seek to use information it already possesses or can readily access to check a customer's declaration.
> 3.50 Just like for any other tax, the taxpayer must make an honest self appraisal of its liability, or lack of liability, and provide a reasonable valuation of the dwelling.
> 3.51 HMRC is not specifying any particular requirements for this: it is up to the taxpayer to decide what is appropriate in particular circumstances, taking into account when the property was bought and what comparisons can be made from local sales and purchases.

98.10.3 *HMRC valuation service*

HMRC say:

> **Pre-return banding checks**
> In certain circumstances, you can ask HMRC to carry out a check on your property details and valuation to see if you need to pay ATED. This is called having a 'pre-return banding check' (PRBC).

When to ask for a PRBC

Customers might want to contact HMRC where a property is valued at an amount close to one of the band thresholds. This is so they can agree which ATED band the property falls into, or whether it falls outside the tax as it is deemed to be under the ... threshold. This is called having a PRBC and is available to customers who meet the following:

- you are not due a relief that will reduce the ATED charge to nil
- the value you have placed on the property falls within 10 per cent of a banding threshold

If your property is valued between the thresholds shown below you may be able to apply for a PRBC using the form that will be available on the HMRC website from 1 June 2013.

When they receive your PRBC application form, HMRC will send you an acknowledgement and provide you with a reference number. They aim to provide a response to your application within 30 working days of receiving it.

HMRC will only confirm that they agree to the banding you propose, and not the specific valuation of the property. You can't use this confirmation for any other taxation purposes.

HMRC will either:

- agree that the band that you have chosen is appropriate based on the information you have provided
- ask for further information from you to help them make a decision about whether you have chosen the correct band
- tell you that they don't agree with the valuation band you have chosen

If you decide you need a PRBC, it's important that you apply at least 30 working days before the date on which you need to send your return - the earlier the better. This means HMRC can tell you their decision - particularly if they need more information before giving that decision - in time for you to use it when sending your return.

In some cases, the inside of the building might need to be inspected as part of the check. HMRC will normally be able to accept valuations prepared by a professional property valuer but they reserve the right to:

- enquire into any subsequent ATED returns
- challenge valuations included in those returns where they consider there is a risk that the return or valuation is wrong

What to do if you don't receive your PRBC in time

If you didn't leave enough time for HMRC to give you a PRBC decision, or they have asked you for more information, you might not get their decision in time for the date you need to send your ATED return. If you think you might need to pay ATED then you should send the return along with the appropriate payment of tax. That way you can

> avoid accruing interest or becoming liable for a penalty for sending the return late.
>
> You should base your ATED return on the banding you think is most appropriate. HMRC may decide to open an enquiry into your return to enable them to continue considering the appropriate banding for your property.
>
> You must include your PRBC reference number on any return or correspondence that you sent to HMRC.
>
> Remember that if you don't complete and send HMRC a return or payment, or you send it late or make a mistake on it, you may have to pay a penalty and interest.
>
> If, after you've sent your return and payment, HMRC tells you that they don't agree with your valuation and you have underpaid, you should complete an amended return and send it, with the additional payment, as soon as you can.
>
> Interest will be payable on any ATED paid late, but HMRC won't charge a penalty if you were waiting for a PRBC decision when your return was due.
>
> If HMRC tells you that they don't agree with your valuation and you've overpaid then you need to send an amended return with a claim for repayment. HMRC will repay you any ATED you've overpaid, and you might be able to claim interest.
>
> **If you don't agree with HMRC's decision**
>
> You should send your return based on your best estimate of the value of your property. HMRC may decide to open an enquiry into your return to enable them to look in more detail at the appropriate banding for your property.
>
> Where you believe that your property is worth £2 million[now £500k] or less and that a return is not due, HMRC may issue a 'determination' to you based on the banding that they believe to be correct. A 'determination' is where HMRC makes a 'best estimate' of the ATED that you owe based on their valuation of your property and issues a demand for payment. You can appeal against this determination if you don't agree with it.
>
> You should include your PRBC reference number on any return or correspondence that you send to HMRC.[20]

The disadvantage of a PRBC may be a greater likelihood of a valuation dispute.

[20] *https://www.gov.uk/annual-tax-on-enveloped-dwellings-pre-return-banding-checks*

98.11 "Chargeable period"

This term matters because ATED is charged by reference to chargeable periods.

Section 94 FA 2013 provides:

> (3) The tax is charged for the chargeable period concerned...
> (8) The chargeable periods are–
> (a) the period beginning with 1 April 2013 and ending with 31 March 2014, and
> (b) each subsequent period of 12 months beginning with 1 April.

98.12 "Single-dwelling interest"

This term matters as ATED only applies if the chargeable interest is a single-dwelling interest.

98.12.1 *The general rule*

Section 108 FA 2013 provides the general rule:

> (1) References in this Part [Part 3 FA 2013, ATED] to a "single-dwelling interest" are to be read in accordance with this section.
> (2) A chargeable interest that is exclusively in or over land consisting (on any day) of a single dwelling is a single-dwelling interest (on that day).

Section 108 FA 2013 defines "in":

> (5) A single dwelling interest is referred to as a single-dwelling interest "in" the dwelling concerned.
> (6) A single-dwelling interest in one dwelling is distinct from any single-dwelling interest in another dwelling, even if the dwellings stand successively on the same land.

Is this looking at the position if a building is knocked down and rebuilt?

98.12.2 *Interest in multiple dwellings*

Section 108(3) FA 2013 deals with a single interest in multiple dwellings:

> Where a person is entitled to a chargeable interest that is exclusively in or over land consisting (on any day) of two or more single dwellings–
> (a) provisions referring to a "single-dwelling interest" operate as if the person had (on that day) a separate chargeable interest in or over each dwelling, and

> (b) the chargeable interest in or over each dwelling is therefore a single-dwelling interest.

This would arise in relation to flat management companies.[21]

98.12.3 *Interest in dwelling+ other land*

Section 108(4) FA 2013 deals with a single interest in a dwelling and other land (eg a farm or estate including one or more dwellings):

> Where a person is entitled to a chargeable interest in or over land that on any day consists of one or more single dwellings and non-residential[22] land–
>
> (a) provisions referring to a "single-dwelling interest" operate as if the person had (on that day) a separate chargeable interest in or over each dwelling and a further separate chargeable interest in or over the non-residential land, and
>
> (b) the chargeable interest in or over each dwelling is therefore a single-dwelling interest.

98.12.4 *"Dwelling"*

See App 2.22 (Dwelling/residential property).

Section 108(7) FA 2013 provides:

> In this section ...
>
> (b) references to a dwelling include a part of a dwelling.

Unlike ATED-SDLT, ATED provides for the amalgamation of property interests in some circumstances so that a 'dwelling' for the purposes of ATED may encompass a number of single dwellings in a building or which stand in the same grounds, if there is private access between them.

98.13 Different interests in 1 dwelling

Section 109 FA 2013 provides:

> (1) Subsection (2) applies if on one or more days in a chargeable period–
>
> (a) a company is entitled to two or more single-dwelling interests in the same dwelling, or

[21] See 98.14.4 (Flat management company).

[22] Section 108(7) FA 2013 provides a commonsense definition of non-residential land:
"In this section–
(a) "non-residential land" means land that is not a dwelling or part of a dwelling."

> (b) two or more single-dwelling interests in the same dwelling are held for the purposes of the same collective investment scheme.
>
> (2) This Part [Part 3 FA 2013, ATED] has effect with respect to that chargeable period as if those separate interests constituted just one single-dwelling interest, the taxable value of which on any day is the sum of the taxable values of the separate interests.

Why is this needed?

Section 109(3) FA 2013 deals with valuation of multiple interests:

> In calculating the taxable values of the separate interests for the purposes of subsection (2), the market value of each interest is determined, under the provisions of TCGA 1992 applied by section 98(8), on the assumption that the other interest or interests are placed on the open market with that interest (on the valuation date appropriate to that interest).

98.14 Interests of connected person

The rule that the taxable value is the value of the interest held by the chargeable person would give rise for scope for tax planning by splitting interests and arranging them to be held by different persons.

Section 110(1) FA 2013 deals with this:

> (1) If on any day ("the relevant day")
>
> [i] a company ("C") is entitled to a single-dwelling interest in a dwelling and
>
> [ii] another person ("P") who is connected[23] with C is entitled to a different single-dwelling interest in the same dwelling,
>
> this Part [Part 3 FA 2013, ATED] has effect–
>
> (a) in relation to C as if C were on that day entitled to P's single-dwelling interest as well as C's single-dwelling interest, and
>
> (b) (if P is a company) in relation to P as if P were on that day entitled to C's single-dwelling interest as well as P's single-dwelling interest.

I refer to this as the "**aggregation rule**".

See 98.6.3 (Joint owners).

98.14.1 *Exemptions for individuals*

There are exceptions to the aggregation rule where P is an individual.

[23] See 98.2.4 ("Connected person").

Prior to 2015, the position was simple. Section 110(2) FA provided:

> *...Where P is an individual, C is not treated on the day in question as entitled to P's single-dwelling interest unless on that day C is entitled to a single-dwelling interest in the dwelling that is a freehold or leasehold interest with a taxable value of more than £500,000.*

There are now two narrower exceptions.

Section 110(2) FA 2013 provides:

> This subsection provides for an exception to subsection (1).
> Where P is an individual, C is not treated as entitled to P's single-dwelling interest on the relevant day unless on that day C is entitled to a single-dwelling interest in the dwelling that is a freehold or leasehold interest[24] with a taxable value of more than £250,000.

This disapplies the aggregation rule where C's interest is worth up to £250k.

Section 110 FA 2013 provides:

> (2A) Subsection (2B) applies in any case where—
> (a) C would (without subsection (2B)) be treated, as a result of subsection (1) (read with section 109),[25] as entitled to a single-dwelling interest with a taxable value (on the relevant day) of more than £2 million, but
> (b) C would not be so treated if the value specified in subsection (2) were £500,000 (instead of £250,000).
> (2B) Subsection (2) has effect as if the value specified in it were £500,000 (instead of £250,000).

This disapplies the aggregation rule where C's interest is worth up to £500k, but only if the aggregate of P and C's interests exceeds £2m. It is hard to make sense of that. EN FB 2015 says something different. First it correct summarises the pre-2015 rule:

> 4. The ATED legislation contains a rule which provides that where two or more chargeable interests are held in the same dwelling by connected persons, then those interests must be aggregated and ATED paid on the aggregate amount, where that amount falls within the ATED entry threshold. However, the legislation provides for an exception to this rule

[24] Section 110(7) FA 2013 provides the appropriate definitions of freehold and leasehold interests for land in Scotland.

[25] See 98.13 (Different interests in 1 dwelling).

> where the connected person is an individual. In this case the company's interest must be more than £500,000 for the aggregation rule to apply.

Then it explains the intention of subsections (2A) and (2B):

> 5. Following the lowering of the ATED entry threshold from properties valued at more than £2 million to properties valued at more than £500,000, an additional limit of £250,000 is introduced for interests valued up to £2 million. The changes have effect for chargeable periods beginning on or after 1 April 2015.

Perhaps that is how HMRC will apply the legislation in practice.

98.14.2 *Collective investment scheme*

Section 110 FA 2013 goes on to provide an aggregation rule for a CIS. This is not discussed here.

98.14.3 *Interaction with reliefs*

Section 111(1)(2) FA 2013 (in short) disapplies the aggregation rule where an interest is held by charities, public bodies, or qualifies for IHT conditional exemption. These specialist exemptions are not discussed here.

Section 111 FA 2013 continues:

> (3) Subsection (4) applies where the separate interests (the "relevant interests") that under section 110 (or that section and section 109) are treated as constituting, on a day, just one single-dwelling interest ("the combined interest") include—
> (a) a freehold or leasehold interest,[26] and
> (b) a leasehold interest ("the inferior interest") granted out of that interest.
> (4) If the inferior interest is the most inferior relevant interest, the combined interest, and the dwelling itself (where relevant), are regarded for the purposes of the relevant relieving provisions as being exploited, on the day mentioned in subsection (3), in the way the inferior interest is exploited on that day.
> (5) If the inferior interest is an interest in part only ("the sub-let part")

[26] Subsection (8) provides: "In this section the reference to a leasehold interest includes the interest of a lessee under an agreement for a lease." Subsection (9) provides the appropriate definitions of freehold/leasehold/agreement for a lease, for land in Scotland.

> of the land that is the subject-matter of the combined interest, subsection (4) has effect in relation to the combined interest only so far as that interest relates to the sublet part.
> (6) In this section "the relevant relieving provisions" means sections 132 to 150.
> (7) The inferior interest counts as "the most inferior relevant interest" if no relevant interest (see subsection (3)) is a leasehold interest granted out of it.

In particular, in order to decide whether the property rental business exemption applies,[27] one must look at whether the inferior interest is being exploited in a property business (not the company's interest).

98.14.4 *Flat management company*

A common arrangement is that:

(1) A flat management company owns the freehold (or superior lease) of a block of flats.

(2) The tenants (who hold long leases of the flats) own the company and are directors.

The company would be within ATED (even without the aggregation rule) if its interest was above the ATED minimum threshold. But that would not arise for a normal flat management company. One looks at the value for each individual dwelling, not the total value of the interest.[28]

The company would be within ATED if:

(1) the aggregation rule applies to aggregate the value of the company's interest and that of the tenants or some of them and

(2) the aggregate value exceeds the ATED minimum threshold.

The issue is whether the tenants are connected with the company. This subdivides.

A tenant is connected with the company if they personally have control over the company owner but in practice that would not be the case for a flat management company.

A tenant is connected with the company if the tenant and persons connected with them has control of the company. That could happen (eg in a block of 3 flats of which 2 are held by relatives) but in practice it would be rare, for a flat management company.

[27] See 98.18.3 (Relief for property business).

[28] See 98.12.2 (Interest in multiple dwellings).

Tenants are connected with the company if they act together to exercise control of the company but HMRC say this is not normally the case.[29]

If the company's interest exceeded the ATED band, the last question would be whether the property rental business exemption would apply. This depends on use by the tenant, not use by the company, and in practice exemption would not generally apply.[30]

As CIOT note, whatever may be the purpose of ATED, it is not to catch flat management companies. If, exceptionally, cases are caught, I expect the point will be overlooked or ignored by noncompliant taxpayers, and HMRC may not spot it or turn a blind eye.

98.15 Partnerships

98.15.1 *ATED treatment of partnership*

Section 167(2) FA 2013 provides:

> This Part [Part 3 FA 2013, ATED] has effect as follows in relation to a partnership (for instance, a limited liability partnership formed as mentioned in subsection (1)(c)) that is itself capable of being entitled to, or of acquiring or disposing of, a chargeable interest–

An English partnership is not capable of being beneficially entitled to any interest. But this would apply to an LLP (which the drafter had in mind with the words in brackets) and a Scots partnership.

Section 167(2) continues:

> (a) transactions entered into on behalf of the partnership are treated as entered into by or on behalf of the partners;
> (b) where the partnership is entitled to a single-dwelling interest, this Part has effect as if the partners were jointly entitled to the interest (and the partnership had no entitlement to it).

This makes partnerships transparent for ATED. It is the rough equivalent of the LLP provisions governing IT, CGT and IHT.[31]

> (3) For the purposes of this Part a partnership is treated as the same partnership despite a change in membership if any person who was a member before the change remains a member after the change.
> (4) For the purposes of this Part—

[29] See 104.15.8 (Acting together to control).

[30] See 98.14.3 (Interaction with reliefs).

[31] See 85.21 (Limited liability partnership); 102.35.3 (Situs of LLP).

> (a) a collective investment scheme is not regarded as a partnership, and
>
> (b) accordingly, a member of a partnership by or on whose behalf a single-dwelling interest is held for the purposes of a collective investment scheme is not regarded as entitled to the interest as a member of the partnership.

98.15.2 *Administration*

Section 167 FA 2013 provides:

> (5) Anything required or authorised by this Part [Part 3 FA 2013, ATED] to be done by or in relation to the responsible partners for a partnership may instead be done by or in relation to any representative partner or partners.
> (6) A representative partner means a partner nominated by a majority of the partners to act as the representative of the partnership for the purposes of this Part of this Act.
> (7) Any such nomination, or the revocation of such a nomination, has effect only after notice of the nomination, or revocation, has been given to an officer of Revenue and Customs.

98.16 Tax consequences of paying ATED

Where the property is owned by a company which is owned by a settlement, the payment of tax by a beneficiary could be a transfer of value for IHT but the normal expenditure exemption will often apply. Does it make the beneficiary a settlor? Probably not.[32]

Bringing funds into the UK to pay the ATED may be a taxable remittance of the funds.

98.16.1 *ATED deduction for CGT*

CIOT ask:

> 2.12 Where it is not possible to fall within a relief from ATED (for example due to the connection conditions and definition of non-qualifying persons), but nevertheless the property is used for business purposes (for example a property letting business) please can you confirm that the ATED would be deductible for corporation tax (or income tax in the case of a non-resident landlord company) purposes in computing the profits assessable to UK tax.

[32] See 99.29 (Payment of admin expenses).

In principle a deduction should be available.

98.17 ATED reliefs

Section 132 FA 2013 provides:

> (1) Subsection (2) applies where tax is charged, in respect of a single-dwelling interest, for a chargeable period that includes one or more days that are relievable as a result of any of the provisions listed in subsection (3) (or for more than one such period).
> (2) For any such period, the adjusted chargeable amount is to be calculated on the basis that the chargeable person is not within the charge with respect to the interest on any relievable day.

Section 132(3) FA 2013 sets out 12 reliefs:

The provisions are—[33]

Topic	**FA 2013**	**See para**
Property rental business	s.133	98.18
Rental property: preparation for sale	s.134	
Dwellings opened to the public	s.137	
Property developers	s.138	
Property developers: exchange of dwellings	s.139	
Property traders	s.141	
Financial institution acquiring in course of lending	s.143	
Regulated home reversion plans	s.144A	
Occupation by employee/partner of qualifying trade/rental business	s.145	
Caretaker flat owned by management company	s.147A	
Farmhouses	s.148	98.20
Social housing	s.150	

The only reliefs discussed in this work are ATED rental relief and farmhouse relief

98.17.1 *DT relief*

ATED is not a tax similar to IT or CGT, so it will not fall within DTAs in OECD Model form.

98.18 ATED rental relief

It is convenient to start with some definitions:

[33] For clarity I have set this out in tabular form and use my own terminology, rather than a precise quote of the statute.

98.18.1 *"Property rental business"*

Section 133(4) FA 2013 puts (I think) a commonsense definition in convoluted drafting:

> A business is a "property rental business" for the purposes of subsection (3) if it is a property business as defined in Chapter 2 of Part 4 of CTA 2009, but–
>
> (a) the question whether or not a business is a property rental business for the purposes of subsection (3) is determined without reference to whether or not any profits of the business are chargeable to corporation tax (and section 204(2) of CTA 2009 is therefore disregarded), and
>
> (b) for the purposes of this subsection the "rents or other receipts" referred to in section 207(1) of CTA 2009 are taken not to include excluded rents.

The definition incorporates the CTA 2009 definition with amendments.[34]

Para (a) makes sense: s.204(2) CTA 2009 would restrict the term to property business within the scope of corporation tax; that is disapplied, so the ATED definition extends to a property business of a non-resident company, which falls within the scope of income tax.

One disregards "excluded rents". Section 133(6) FA 2013 provides:

> In this Part [Part 3 FA 2013, ATED] "excluded rents" means rents within any of classes 2 to 6 in the table in section 605(2) of CTA 2010.

So we turn to s.605(2) CTA 2010:

> Class 2 Rent in respect of an electric-line wayleave.
> Class 3 Rent in respect of the siting of a pipeline for gas.
> Class 4 Rent in respect of the siting of a pipeline for oil.
> Class 5 Rent in respect of the siting of a mast or similar structure designed for use in a mobile telephone network or other system of electronic communication.
> Class 6 Rent in respect of the siting of a wind turbine.

I would be grateful for any reader who could suggest why this is needed.

98.18.2 *"Qualifying" rental business*

Section 133(3) FA 2013 provides:

[34] For that definition, see 24.2 ("Property business": Terminology).

> In this Part "qualifying property rental business" means a property rental business that is run on a commercial basis and with a view to profit.[35]

98.18.3 *Relief for property business*

Armed with these definitions, we can turn to the relief. Section 133(1) FA 2013 provides:

> A day in a chargeable period is relievable in relation to a single-dwelling interest if on that day the interest–
> (a) is being exploited as a source of rents or other receipts (other than excluded rents) in the course of a qualifying property rental business carried on by a person entitled to the interest, or
> (b) steps are being taken to secure that the interest will, without undue delay, be so exploited in the course of a qualifying property rental business that is being carried on, or is to be carried on, by a person entitled to the interest.

I refer to this as "**ATED rental relief**".

98.18.4 *Property for sale or conversion*

The relief in s.133(1) would not apply if the property is for sale or being converted. Section 134(1) FA 2013 provides a further relief:

> A day ("day X") on which a person ("P") is entitled to a single-dwelling interest is relievable in relation to that interest if–
> (a) on day X the dwelling is unoccupied and any of the first to fourth conditions is met (see below),

I refer to "**rental relief conditions 1-4**"

> (b) day X is preceded by one or more days ("qualifying days") that are relievable under section 133 in relation to the interest and on which P, or a relevant partner,[36] was entitled to the interest, and
> (c) the days (if any) between day X and the last of the qualifying days to precede day X are all relievable under this section.

98.18.5 *Rental relief conditions*

Section 134(1) FA 2013 continues:

[35] See App 5.1 (Commercial basis/view to profit).

[36] Defined in s.134(3) FA 2013: "relevant partner", where P is (on day X) entitled to the interest as a member of a partnership, means a person who was at the time in question carrying on the qualifying rental property business concerned as a member of that partnership.

> *First condition* [property for sale]
> The first condition is that steps are being taken to secure that the interest will be sold without undue delay.
> *Second condition* [demolition]
> The second condition is that–
> (a) steps are being taken to secure that the dwelling will be demolished without undue delay, and
> (b) if it is intended that a new dwelling will be constructed on the site of the existing dwelling, the intention is that it will be used in a relievable way.
> *Third condition* [conversion]
> The third condition is that–
> (a) steps are being taken to secure that the dwelling will be converted into a different dwelling without undue delay, and
> (b) it is intended that the new dwelling will be used in a relievable way.
> *Fourth condition* [conversion]
> The fourth condition is that steps are being taken to secure that the dwelling will be converted into a building other than a dwelling without undue delay.
> (2) A dwelling is "used in a relievable way" for the purposes of subsection (1) if the single-dwelling interest in question is exploited in such a way, or held in such a way and for such purposes, (or, as the case requires, the dwelling itself is exploited or used in such a way) that a day of such exploitation, ownership or use would be relievable under any of sections 133, 137, 145 and 148.

98.18.6 *"Without undue delay"*

Section 133(5) FA 2013 tries to define "undue delay":

> "In subsection (1)(b)
> "without undue delay" means without delay except so far as delay is justified by commercial considerations or cannot be avoided."

Since this definition (if it can be called such) only applies for s.133, it is repeated verbatim in s.134(3).

98.18.7 *Non-qualifying occupier*

Section 133(2) FA 2013 provides:

> A day is not relievable by virtue of subsection (1) or section 134 in the case of a single-dwelling interest if on that day a non-qualifying individual is permitted to occupy the dwelling.

98.18.8 *Disapplication of future relief*

Section 135 FA 2013 provides:

> (1) Subsection (2) applies if on a day in a chargeable period ("the day of non-qualifying occupation")–
>
> (a) a single-dwelling interest to which a person ("the landlord") is entitled is being exploited as mentioned in section 133(1)(a) or steps are being taken to secure that the interest will be so exploited, as mentioned in section 133(1)(b), and
>
> (b) a non-qualifying individual is permitted to occupy the dwelling.
>
> If this condition is satisfied, s.135(2) disapplies rental property relief (in short) for the next 3 years:
>
> (2) No subsequent day in that chargeable period, or in any of the subsequent 3 chargeable periods, that meets the continuity of ownership condition and would (in the absence of this subsection) be relievable by virtue of section 133(1)(b) is treated as relievable by virtue of that provision unless a day of qualifying use falls between that day and the day of non-qualifying occupation.
>
> (3) A day meets the continuity of ownership condition if on that day—
>
> (a) the landlord is entitled to the single-dwelling interest, or
>
> (b) if the landlord carried on or (as the case requires) intended to carry on the property rental business in partnership, another member of the partnership is entitled to the interest.

98.18.9 *Disapplication of past relief*

Section 135(4) FA 2013 provides:

> Subsection (5) applies if a person who is a non-qualifying individual in relation to a single-dwelling interest occupies the dwelling on a day in a chargeable period ("the day of non-qualifying occupation").

If that condition is satisfied, s.135 disapplies past relief for the present and preceding year:

> (5) An earlier day in that or the preceding chargeable period ("the earlier day") is not relievable by virtue of section 133(1)(b) or 134 if a relevant person is entitled to the single-dwelling interest on that day.
>
> (6) In subsection (5) "relevant person" means—
>
> (a) a person who is entitled to the single-dwelling interest on the day of non-qualifying occupation, or
>
> (b) if a person falling within paragraph (a) is or has been a member of a partnership whose members have at any time exploited the single-dwelling interest as a source of rents and receipts in a

> property rental business, any other member of that partnership.
>
> (7) Subsection (5) does not apply in relation to the earlier day if a day that is relievable by virtue of section 133(1)(a) falls between that earlier day and the day of non-qualifying occupation.
>
> (8) For the purposes of this section—
>
> (a) "day of qualifying use", in relation to a single-dwelling interest, means a day that is relievable in the case of the interest by virtue of section 133(1)(a);
>
> (b) occupation of any part of a dwelling is regarded as occupation of the dwelling.

98.19 Non-qualifying individual

98.19.1 *"Non-qualifying individual"*

Section 136 FA 2013 provides about the widest definition that the drafter could devise:

> (1) In sections 133 and 135 "non-qualifying individual", in relation to a single-dwelling interest, means any of the following–
>
> (a) an individual who is entitled to the interest (otherwise than as a member of a partnership),
>
> (b) an individual ("a connected person") who is connected with a person entitled to the interest,
>
> (c) if a person is entitled to the interest as a member of a partnership, an individual who is, or is connected with, a qualifying member of that partnership,
>
> (d) an individual ("a relevant settlor") who is the settlor in relation to a settlement[37] of which a trustee[38] is (in the capacity of trustee) connected with a person who is entitled to the interest,
>
> (e) the spouse or civil partner
>
> [i] of a connected person or
>
> [ii] of a relevant settlor,
>
> (f) [i] a relative[39]
>
> [A] of a connected person or

[37] Defined by reference in s.136(7) FA 2013: In this section ... "settlement" and "settlor" have the same meaning as in Chapter 5 of Part 5 of ITTOIA 2005 (see section 620 of that Act).

[38] Defined by reference in s.136(8): In subsection 1(d) "trustee" is to be read in accordance with section 1123(3) of CTA 2010 ("connected persons": supplementary).

[39] Defined in s.136(7): (7) In this section ... "relative" means brother, sister, ancestor or lineal descendant.

[B] of a relevant settlor,

[ii] or the spouse or civil partner

[A] of a relevant of a connected person or

[B] of a relevant settlor,

Thus an uncle or aunt of T is not a connected person; but they are non-qualifying individuals because they are "relatives" (defined to include brother or sister) of a connected person (the parent of T). But the nephew or niece of T is a qualifying individual, as they are not "relatives" (as defined) of any connected person.

(g) a relative of the spouse or civil partner of a connected person or of a relevant settlor,

(h) the spouse or civil partner of a person falling within paragraph (g), or

(i) an individual who is

[i] a major participant in a relevant collective investment scheme or

[ii] is connected with a major participant in a relevant collective investment scheme.

98.19.2 *Supplemental definitions*

Section 136 FA 2013 provides supplemental definitions:

> (2) In subsection 1(c) "qualifying member", in relation to a partnership, means an member of the partnership who is entitled to a 50% or greater share–
>
> (a) in the income profits of the partnership, or
>
> (b) in the partnership's assets.
>
> (3) In subsection (1)(i) "relevant collective investment scheme", in relation to a single-dwelling interest, means a collective investment scheme that meets the ownership condition with respect to the interest.
>
> (4) A person who participates in a collective investment scheme is a "major participant" in the scheme if the person–
>
> (a) is entitled to a share of at least 50% either of all the profits or income arising from the scheme or of any profits or income arising from the scheme that may be distributed to participants, or
>
> (b) would in the event of the winding up of the scheme be entitled to 50% or more of the assets of the scheme that would then be available for distribution among the participants.
>
> (5) The reference in subsection (4)(a) to profits or income arising from the scheme is to profits or income arising from the acquisition, holding, management or disposal of the property subject to the scheme.

Lastly, s.136(6) tinkers with the usual definition of "connected person":

> For the purpose of subsection (1), section 1122 of CTA 2010 (as applied by section 172)[40] has effect as if subsections (7) and (8) of that section (application of rules about connected persons to partnerships) were omitted.

98.20 Farmhouses

Section 148 FA 2013 provides:

> (1) This section applies where on a day in a chargeable period—
> (a) a dwelling ("the farmhouse") forms part of land occupied for the purposes of a qualifying trade[41] of farming,[42] and
> (b) a person carrying on the trade is entitled to, or connected with a person who is entitled to, a single-dwelling interest in the farmhouse.
>
> (2) That day is relievable in relation to the single-dwelling interest if on that day the farmhouse is occupied—
> (a) by a farm worker who occupies[43] it for the purposes of the trade, or
> (b) by a former long-serving farm worker, or the surviving spouse or civil partner of a former farm worker.

This is different from the IHT agricultural property relief rules.

98.20.1 *"Farm worker"*

Farm worker is defined in s.149 FA 2013:

> (1) An individual is a "farm worker" in relation to the qualifying trade of farming mentioned in section 148(1) at any time when the individual has a substantial involvement in—

[40] See 98.2.4 ("Connected person").

[41] Defined in s.148(3) FA 2013: A trade of farming is a "qualifying trade of farming" only if it is carried on—
(a) on a commercial basis, and
(b) with a view to profit.

[42] Defined in s.148(4) FA 2013: In this section—
"farming" has the same meaning as in the Corporation Tax Acts (see section 1125 of CTA 2010), except that in this section "farming" includes market gardening;
"market gardening" has the same meaning as in the Corporation Tax Acts (see section 1125(5) of CTA 2010).

[43] Defined in s.149(4) FA 2013: "A person occupying part of a dwelling is regarded as occupying the dwelling for the purposes of this section and section 148."

> (a) the day-to-day work of the trade, or
> (b) the direction and control of the conduct of the trade.

98.20.2 *Former farm worker*

Former long-serving farm worker is elaborately defined in s.149 FA 2013:

> (2) Where section 148 applies, an individual occupying the farmhouse on the day mentioned in section 148(1) is a "former long-serving farm worker" if the individual had, before that day, been a farm worker in relation to the qualifying trade of farming for—
> (a) a qualifying period of 3 or more years, or
> (b) qualifying periods together amounting to 3 or more years within a 5 year period.
>
> (3) In subsection (2) "qualifying period" means a period throughout which—
> (a) the individual occupied the farmhouse for the purposes of the trade,
> (b) the land of which the farmhouse forms part was occupied for the purposes of the trade,
> (c) the trade was carried on by—
> (i) a person who is entitled to the single-dwelling interest in the farmhouse on the day mentioned in section 148(1), or
> (ii) a person connected with such a person, and
> (d) a person who is entitled to the single-dwelling interest in the farmhouse on the day mentioned in section 148(1) was entitled to that interest.

98.21 "Chargeable", "within the charge"

Section 170 FA 2013 provides:

> (1) Any day on which the conditions in section 94(2) are met with respect to a single-dwelling interest is a "chargeable day" for that interest;
>
> (2) Where a day is a chargeable day as a result of subjection (1), the chargeable person is "within the charge" with respect to a single-dwelling interest on that day.

98.22 ATED returns

Returns are governed by the Annual Tax on Enveloped Dwellings (Returns) Regulations 2013, which is not considered here.

98.23 SDLT: Introduction

A full discussion of SDLT would require many volumes. A brief outline is needed in order to see ATED-SDLT in its context.

98.23.1 *Charge to SDLT*

Section 42 FA 2003 provides the charge to SDLT:

> (1) A tax (to be known as "stamp duty land tax") shall be charged in accordance with this Part on land transactions.
> (2) The tax is chargeable—
> (a) whether or not there is any instrument effecting the transaction,
> (b) if there is such an instrument, whether or not it is executed in the UK, and
> (c) whether or not any party to the transaction is present, or resident, in the UK.

98.23.2 *"Land transaction"*

Section 43(1) FA 2003 provides:

> In this Part a "land transaction" means any acquisition of a chargeable interest.

98.23.3 *"Chargeable transaction"*

Section 49(1) FA 2003 provides:

> A land transaction is a chargeable transaction if it is not a transaction that is exempt from charge.

98.24 Ordinary SDLT rates

98.24.1 *Residential property*

Section 55 FA 2003 sets out the usual SDLT rates:

> (1) The amount of tax chargeable in respect of a chargeable transaction to which this section applies is determined in accordance with subsections (1B) and (1C).
> (1A) This section applies to any chargeable transaction other than a transaction to which paragraph 3 of Schedule 4A or step 4 of section 74(1A) (higher rate for certain transactions) applies.
> (1B) If the transaction is not one of a number of linked transactions, the amount of tax chargeable is determined as follows—

Step 1
Apply the rates specified in the second column of the appropriate table below to the parts of the relevant consideration specified in the first column of the appropriate table.
The "appropriate table" is—
(a) Table A, if the relevant land consists entirely of residential property, and
(b) Table B, if the relevant land consists of or includes land that is not residential property.

Step 2
Add together the amounts calculated at Step 1 (if there are two or more such amounts).

Table A: Residential

Relevant consideration	*Percentage*
So much as does not exceed £125,000	0%
So much as exceeds £125,000 but does not exceed £250,000	2%
So much as exceeds £250,000 but does not exceed £925,000	5%
So much as exceeds £925,000 but does not exceed £1,500,000	10%
The remainder (if any)	12%

98.24.2 *Non-residential property*

We are not concerned with non-residential property in this chapter, but for completeness, s.55 FA 2003 provides:

Table B: Non-residential or mixed

Relevant consideration	*Percentage*
So much as does not exceed £150,000	0%
So much as exceeds £150,000 but does not exceed £250,000	2%
The remainder (if any)	5%

98.24.3 *"Relevant land/consideration"*

Section 55(3) FA 2003 provides:

> For the purposes of subsection (1B)
> (a) the relevant land is the land an interest in which is the main subject-matter of the transaction, and
> (b) the relevant consideration is the chargeable consideration for the transaction.

98.24.4 *"Chargeable consideration"*

Para 1(1) sch 4 FA 2003 defines "chargeable consideration":

> The chargeable consideration for a transaction is, except as otherwise expressly provided, any consideration in money or money's worth given for the subject-matter of the transaction, directly or indirectly, by the purchaser or a person connected[44] with him.

See App 4.2 (Consideration).

98.25 ATED-SDLT rate

ATED-SDLT overrides the rates set out above. Para 3 sch 4A FA 2003 provides:

> (1) Where this paragraph applies to a chargeable transaction—
> (a) the amount of tax chargeable in respect of the transaction is 15% of the chargeable consideration for the transaction ...
> (2) This paragraph applies to a chargeable transaction if—
> (a) the transaction is a high-value residential transaction, and
> (b) the condition in sub-paragraph (3) is met.

98.26 "High-value" transaction

There is the usual cascade of definitions.

98.26.1 *Appurtenant rights*

First para 1(1) sch 4A FA 2003 provides a commonsense definition:

> In this paragraph "interest in a single dwelling" means so much of the subject-matter of a chargeable transaction as consists of a chargeable interest in or over a single dwelling (together with appurtenant rights).

"Appurtenant rights" are aggregated with the dwelling so:

(1) Their value is taken into account in determining whether market value passes the SDLT threshold.
(2) Appurtenant rights are charged at ATED-SDLT.

Para 9 sch 4A FA 2003 provides a commonsense definition:

> In this Schedule—
> "appurtenant rights", in relation to a chargeable interest that is, or is part of, the subject-matter of a transaction, means any rights or interests appurtenant or pertaining to the chargeable interest that are acquired

[44] Defined para 1(2) sch 4 FA 2003: "Section 1122 of the CTA 2010 (connected persons) applies for the purposes of sub-paragraph (1)."

> with it.

Where will one draw the limit of gardens and grounds? CGT private residence cases may be helpful, though without the limit to the "permitted area" of (in short) half a hectare.

98.26.2 *"Higher threshold interest"*

Para 1(2) sch 4A FA 2003 defines "higher threshold interest":

> An interest in a single dwelling is a higher threshold interest for the purposes of this Schedule if chargeable consideration of more than £500,000 is attributable[45] to that interest.

98.26.3 *High-value residential transaction*

Para 2 sch 4A FA 2003 defines "high-value residential transaction":

> (1) Sub-paragraphs (2) to (8) apply to a chargeable transaction whose subject-matter consists of or includes a higher threshold interest.
> (2) If the main subject-matter of the transaction consists entirely of higher threshold interests, the transaction is a high-value residential transaction for the purposes of paragraph 3.

In 2013, when the ATED threshold was £2m, the expression "high-value" residential transaction was apt. Now it is reduced to £500k it is no longer apt. When discussing the statutory provision, it may be easier to continue to apply the statutory terminology, but scare quotation marks would be appropriate.

98.27 Co. purchaser (non-natural person)

ATED-SDLT applies if the condition in para 3(3) sch 4A FA 2003 is satisfied. This provides:

> The condition is that—
> (a) the purchaser is a company,
> (b) the acquisition is made by or on behalf of the members of a partnership one or more of whose members is a company, or
> (c) the acquisition is made for the purposes of a collective investment scheme.

I refer to the condition in para 3(3) as the "**ATED-SDLT corporate**

[45] The drafter attempts to define "attributable" in para 9 sch 4A FA 2003: "attributable" means attributable on a just and reasonable basis.

purchaser condition".

HMRC appear to have anticipated that the corporate purchaser condition may not be well drafted. Para 3(10) sch 4A FA 2003 provides power to amend by statutory instrument:

> The Treasury may by order amend this paragraph for the purpose of limiting the circumstances in which the condition in subparagraph (3) is to be treated as met.

98.27.1 *Joint purchasers*

Para 3(5) sch 4A FA 2003 deals with joint purchasers:

> If there are two or more purchasers acting jointly, the condition in sub-paragraph (3) [the corporate purchaser condition] is treated as met if it is met in relation to at least one of those purchasers.

This is not fair, but the provision is intended to be penal.

98.28 Trusts

98.28.1 *Trustee purchaser*

Para 3(4) sch 4A FA 2003 excludes corporate trustees:

> References in sub-paragraph (3) corporate purchaser condition] to a company do not include a company acting in its capacity as trustee of a settlement.

This is needed as SDLT does not have the IT/CGT rule that trustees are deemed to be a distinct person.[46]

98.28.2 *Beneficiary purchaser*

A purchaser of an equitable interest may be caught by ATED-SDLT as they may acquire a chargeable interest.

98.28.3 *Bare trust*

Para 3(8) sch 4A FA 2003 provides:

> For the purposes of sub-paragraph (3), paragraph 3 of Schedule 16 (bare trustees) applies as if sub-paragraphs (2) and (3) of that paragraph were omitted.

[46] See 7.3 (Trustees a distinct person).

To follow this one needs to set out para 3 sch 16, amended as para 3(8) directs:

> (1) Subject to sub-paragraph (2), where a person acquires a chargeable interest or an interest in a partnership as bare trustee, this Part applies as if the interest were vested in, and the acts of the trustee in relation to it were the acts of, the person or persons for whom he is trustee.
> ~~(2) Sub-paragraph (1) does not apply in relation to the grant of a lease.~~
> ~~(3) Where a lease is granted to a person as bare trustee, he is treated for the purposes of this Part, as it applies in relation to the grant of the lease, as purchaser of the whole of the interest acquired.~~
> (4) Where a lease is granted by a person as bare trustee, he is to be treated for the purposes of this Part, as it applies in relation to the grant of the lease, as vendor of the whole of the interest disposed of.

Para 3(1) is the commonsense rule that a bare trust is transparent for SDLT.

The exception in para 3(2)(3) is to block an avoidance scheme under which a rack rent lease was granted to a nominee of the vendor, and then assigned for no value to the tenant.

Para 3(2)(3) sch 16 FA 2003 is excluded for ATED because otherwise a company purchaser might avoid the ATED-SDLT rate by arranging for the vendor to grant a lease to a non-corporate nominee for the purchaser.[47]

The reason for the exception in para 3(4) is unclear but as the charge is paid by the purchaser, not the vendor, it may not matter.

98.29 Linked transactions

Para 4 sch 4A FA 2003 provides:

> (1) Sub-paragraphs (2) and (3) apply if—
> (a) the subject-matter of a chargeable transaction includes a chargeable interest in or over a dwelling,
> (b) one or more land transactions, the subject-matter of each of which includes a chargeable interest in or over the dwelling, are linked to that chargeable transaction, and
> (c) the total consideration attributable to the interests mentioned in paragraphs (a) and (b) (and to any appurtenant rights, but disregarding any rent) is more than £500,000.
>
> (2) Each of those chargeable interests is treated as a higher threshold interest for the purposes of this Schedule.

[47] I am grateful to Justin Bryant for his comments on this provision.

> (3) If the condition in paragraph 3(3) is met in the case of the transaction mentioned in sub-paragraph (1)(a), it is also treated as met in the case of each transaction mentioned in sub-paragraph (1)(b) that is a chargeable transaction.

98.30 ATED-SDLT reliefs

ATED-SDLT has the following reliefs:

Relief	**Sch 4A**
Letting, trading or redeveloping properties	para 5
Dwelling available to the public	para 5B
Financial institution acquiring dwelling in course of lending	para 5C
Dwellings for occupation by employees/partners	para 5D
Farmhouses	para 5F

I hope to consider these in a future edition.

98.31 SDLT on winding up company

In the course of winding up a company holding a UK residence, the company (acting by its liquidator) will normally transfer the property to the shareholders. I refer to this as the "**transfer on liquidation**". This section considers whether the transfer is subject to SDLT.

A transfer on liquidation is a land transaction.

The transfer on liquidation is a chargeable transaction.

The amount of SDLT depends on the amount of the chargeable consideration. If there is no chargeable consideration there is no SDLT. A transfer on liquidation is in principle not made for consideration, and so is in principle not subject to SDLT.[48]

98.31.1 *Transfer to co. shareholder*

Further consideration is needed when the transferee is a company.

Section 53 FA 2003 provides:

> (1) This section applies where the purchaser [ie, transferor] is a company and—
>
> (a) the vendor is connected with the purchaser...
>
> (1A) The chargeable consideration for the transaction shall be taken to be not less than—
>
> (a) the market value of the subject-matter of the transaction as at the effective date of the transaction...

[48] See App 4.5 (Transfer on liquidation).

However in the case of a transfer on liquidation, s.54 FA 2003 will normally provide relief:

> (1) Section 53 (chargeable consideration: transaction with connected company) does not apply in the following cases.
> In the following provisions "the company" means the company that is the purchaser in relation to the transaction in question...

Where the transfer is to a corporate trustee, relief is in principle available under case 2:

> (3) Case 2 is where—
> (a) immediately after the transaction the company holds the property as trustee, and
> (b) the vendor is connected with the company only because of section 1122(6) of the Corporation Tax Act 2010.[49]

If case 2 does not apply (ie if the company purchaser is not a trustee) relief is in principle available under case 3:

> (4) Case 3 is where—
> (a) the vendor is a company and the transaction is, or is part of, a distribution of the assets of that company (whether or not in connection with its winding up), and
> (b) it is not the case that—
> (i) the subject-matter of the transaction, or
> (ii) an interest from which that interest is derived,
> has, within the period of three years immediately preceding the effective date of the transaction, been the subject of a transaction in respect of which group relief was claimed by the vendor.

It is possible to envisage circumstances where relief does not apply, but that will rarely happen in practice.

98.32 Company in liquidation owes debt

Suppose the company owes a debt. This typically arises if the company has borrowed to purchase the property and owes money to a bank. The company cannot transfer the property to the shareholders and simply leave the debt outstanding, at least if the debt is to non-shareholders.

Para 8(1) sch 4 FA 2003 provides:

[49] See 104.14 (Connected: Trustees).

> Where the chargeable consideration for a land transaction consists in whole or in part of—
> (a) the satisfaction or release of debt[50] due to the purchaser or owed by the vendor, or
> (b) the assumption of existing debt[51] by the purchaser,
> the amount[52] of debt satisfied, released or assumed shall be taken to be the whole or, as the case may be, part of the chargeable consideration for the transaction.

This applies only if the release or assumption of the debt is consideration for the transaction. The point is that the consideration for SDLT purposes is deemed to be the face value of the debt (the amount owed), instead of its market value (which may be less).

Para 8(2) sch 4 FA 2003 provides a cap on the charge:

> If the effect of this paragraph would be that the amount of the chargeable consideration for the transaction exceeded the market value of the subject-matter of the transaction, the amount of the chargeable consideration is treated as limited to that value.

Thus there is a SDLT charge if there is an arrangement under which the shareholders undertake to pay (in the statutory terminology, assume) the company's debt, in consideration for the transfer. In contract law terminology, the arrangement is known as a novation. The charge is on the lower of the amount of the debt and the market value of the land.

Para 8(1A) sch 4 FA 2003 provides:

> Where—
> (a) debt is secured on the subject-matter of a land transaction immediately before and immediately after the transaction, and
> (b) the rights or liabilities in relation to that debt of any party to the transaction are changed as a result of or in connection with the

[50] Para 8(3) sch 4 FA 2003 provides a commonsense definition: "In this paragraph–
(a) "debt" means an obligation, whether certain or contingent, to pay a sum of money either immediately or at a future date".

[51] Para 8(3) sch 4 FA 2003 provides a commonsense definition: "In this paragraph ...
(b) "existing debt", in relation to a transaction, means debt created or arising before the effective date of, and otherwise than in connection with, the transaction".

[52] Para 8(3) sch 4 FA 2003 provides a commonsense definition: "In this paragraph ...
(c) references to the amount of a debt are to the principal amount payable or, as the case may be, the total of the principal amounts payable, together with the amount of any interest that has accrued due on or before the effective date of the transaction."

> transaction,
>
> then for the purposes of this paragraph there is an assumption of that debt by the purchaser, and that assumption of debt constitutes chargeable consideration for the transaction.

This will not apply if the debt is unsecured, before or after the transaction.

98.32.1 *Joint vendors/purchasers*

Para 8 continues with provisions dealing with apportionment in the case of joint vendors or joint purchasers. This is less likely to arise but I cover it for completeness:

> (1B) Where in a case in which sub-paragraph (1)(b) applies—
>
> (a) the debt assumed is or includes debt secured on the property forming the subject-matter of the transaction, and
>
> (b) immediately before the transaction
>
> [i] there were two or more persons each holding an undivided share of that property, or
>
> [ii] there are two or more such persons immediately afterwards,
>
> the amount of secured debt assumed shall be determined as if the amount of that debt owed by each of those persons at a given time were the proportion of it corresponding to his undivided share of the property at that time.
>
> (1C) For the purposes of sub-paragraph (1B), in England and Wales and Northern Ireland each joint tenant of property is treated as holding an equal undivided share of it.

The SDLT Manual comments on the apportionment provisions:

> **SDLTM04040A Assumption or release of a debt: Examples** [Nov 2019]
>
> **Example 1**
>
> A property is transferred by V into the ownership of V and P in equal shares subject to a subsisting mortgage.
>
> P assumes liability for all or part of the debt.
>
> Notwithstanding P's actual liability, which is probably for all of the debt, P is treated as assuming debt equal to 50% of the amount owing. This is because he is treated as owing none before the transaction and 50% after it.
>
> **Example 2**
>
> A property is owned by V and P in 70:30 shares.
>
> It is transferred to the sole ownership of P subject to a subsisting mortgage.

> Assuming V is released from the debt or P agrees to indemnify V there is an assumption of debt by P.
> P is treated as assuming debt equal to 70% of the amount owning.
> This is because P is treated as owing 30% before the transfer and 100% after it.

98.32.2 *Company debt to shareholders*

Suppose the company owes a debt to its shareholders. This typically arises if the shareholders have lent funds to purchase the property.
The SDLT Manual provides:

> **SDLTM04043 Transfer of property on winding up - loan from shareowners** [Nov 2019]
> ... We would not seek to argue that the dividend in specie should bear SDLT in a situation for example where A owns the shares of B Ltd. A lends money to the company to buy property, the loan being secured by mortgage on the property.
> Later B Ltd is wound up and there is a transfer to A as beneficial owner of the equity. That is the reason for the Transfer. The loan is not released etc, but obviously the mortgage will be taken off as the lender also owns the property because of the liquidation.
> Clearly (?) in this scenario A has not assumed any liability or given any other form of consideration.

The position does not seem so clear to me, but HMRC do not take the point.

98.32.3 *Co. debt to non-shareholders*

The SDLT Manual continues:

> **SDLTM04042 SDLT on de-enveloping transactions** [Feb 2020]
> ...However, where there is a third party (non-shareholder) loan secured on the property when the company is liquidated, the transfer of the property by the company on a distribution will attract SDLT under paragraphs 1 and 8 of Schedule 4 FA 2003 where there is an assumption by the shareholder(s) of liability for the debt. ...

Suppose:

(1) Shareholders subscribe for new share capital.
(2) The company uses the proceeds of the share subscription to repay the debt.
(3) The company is put into liquidation.

This is not caught by para 8(1) as the satisfaction of the debt is not consideration for the land transaction; it is not caught by para 8(1A) as the debt will not be secured at the time of the transaction. The question is whether it is caught by s.75A FA 2003 (anti-avoidance).

98.33 Section 75A: Anti-avoidance

98.33.1 *Basic requirements*

Section 75A(1) FA 2003 sets out the basic requirements:

> This section applies where—
>
> (a) [i] one person (V) disposes of a chargeable interest and
> [ii] another person (P) acquires either it or a chargeable interest deriving from it,
>
> (b) a number of transactions (including the disposal and acquisition) are involved in connection with the disposal and acquisition ("the scheme transactions"), and
>
> (c) the sum of the amounts of stamp duty land tax payable in respect of the scheme transactions is less than the amount that would be payable on a notional land transaction effecting the acquisition of V's chargeable interest by P on its disposal by V.

In *Project Blue v HMRC:*

> It is clear from (i) subsection (1)(a), which refers to P acquiring either V's chargeable interest "or a chargeable interest deriving from it", and (ii) subsection (3)(a), which refers to "the acquisition by P of a lease deriving from a freehold owned *or formerly owned* by V" (emphasis added), that the section may operate not only when P acquires the chargeable interest directly from V but also when P acquires a chargeable interest, such as a lease, which is derived from a chargeable interest which V formerly owned. Thus the section can cover a series of transactions by which V disposes of its chargeable interest which comes to be acquired by another person and P ultimately acquires a chargeable interest derived from it from that other person.[53]

98.33.2 *"Transaction"*

Section 75A(2) FA 2003 provides just about the widest definition the author could devise:

> In subsection (1) "transaction" includes, in particular—

[53] [2018] UKSC 30 at [45].

> (a) a non-land transaction,
> (b) an agreement, offer or undertaking not to take specified action,
> (c) any kind of arrangement whether or not it could otherwise be described as a transaction, and
> (d) a transaction which takes place after the acquisition by P of the chargeable interest.

98.33.3 *"Scheme transaction"*

Scheme transactions are the transactions (including the disposal and acquisition) "involved in connection with the disposal and acquisition". Section 75A(3) FA 2003 provides:

> The scheme transactions may include, for example—
> (a) the acquisition by P of a lease deriving from a freehold owned or formerly owned by V;
> (b) a sub-sale to a third person;
> (c) the grant of a lease to a third person subject to a right to terminate;
> (d) the exercise of a right to terminate a lease or to take some other action;
> (e) an agreement not to exercise a right to terminate a lease or to take some other action;
> (f) the variation of a right to terminate a lease or to take some other action.

In *Project Blue v HMRC* in the Upper Tribunal:

> The scheme transactions are not necessarily confined to those transactions which took place between the disposal by V and the acquisition by P. Paragraphs (b) and (c) of section 75A(3) plainly contemplate that the scheme transactions can involve persons in addition to V and P. Section 75A(2)(d) shows that a transaction which takes place after the acquisition by P can be relevant; this is subject to the other parts of section 75A and 75B which require that a scheme transaction is "involved in connection with" the acquisition. Section 75B(3)(c) shows that a transaction for the purposes of funding an acquisition can be part of the scheme.[54]

The first-tier tribunal made some general comments on the phrase "in connection with"[55] and said:

[54] [2014] UKUT 564 (TCC) at [64].

[55] See App 2.4.2 (In connection with).

> 250. ... in section 75A the phrase "in connection with" is deliberately used in conjunction with the word "involved." In our view, the word "involved" must be intended to qualify the phrase "in connection with." The word "involved" denotes some form of participation (i.e. involvement). Thus, a transaction which is part of a series of transactions will not be "involved" with other transactions simply because it is part of a series or sequence of successive conveyancing transactions. The linkage must be more than merely being a party in a chain of transactions and the test must be more than a "but for" test ... otherwise the word "involved" would be deprived of significant meaning.[56]

98.34 Notional land transaction

Section 75A(4) FA 2003 provides:

> Where this section applies—
> (a) any of the scheme transactions which is a land transaction shall be disregarded for the purposes of this Part, but
> (b) there shall be a notional land transaction for the purposes of this Part effecting the acquisition of V's chargeable interest by P on its disposal by V.

Section 75C(10) FA 2003 provides:

> Stamp duty land tax paid in respect of a land transaction which is to be disregarded by virtue of section 75A(4)(a) is taken to have been paid in respect of the notional transaction by virtue of section 75A(4)(b).

98.34.1 *Notional consideration*

Section 75A(5) FA 2003 defines the notional chargeable consideration:

> The chargeable consideration on the notional transaction mentioned in subsections (1)(c) and (4)(b) is the largest amount[57] (or aggregate amount)—
> (a) given by or on behalf of any one person by way of consideration for the scheme transactions, or
> (b) received by or on behalf of V (or a person connected with V within the meaning of section 1122 of the Corporation Tax Act 2010) by way of consideration for the scheme transactions.

[56] [2013] UKFTT 378 (TC).

[57] Section 75C(9) FA 2003 provides: "For the purposes of section 75A a reference to an amount of consideration includes a reference to the value of consideration given as money's worth."

98.34.2 *Notional effective date*

Section 75A(6) FA 2003 defines the effective date:

> The effective date of the notional transaction is—
> (a) the last date of completion for the scheme transactions, or
> (b) if earlier, the last date on which a contract in respect of the scheme transactions is substantially performed.

98.34.3 *Incidental transactions*

Section 75B(1) FA 2003 provides a relief for incidental transactions:

> In calculating the chargeable consideration on the notional transaction for the purposes of section 75A(5), consideration for a transaction shall be ignored if or in so far as the transaction is merely incidental to the transfer of the chargeable interest from V to P.

This overlaps with the definition of scheme transaction, as if a transaction is merely incidental, then it may not be involved in connection with the disposal and acquisition (within the meaning of the section).

"Incidental" is undefinable, but s.75B FA 2003 seeks to define it. Section 75B(2) FA 2003 identifies some non-incidental transactions:

> A transaction is not incidental to the transfer[58] of the chargeable interest from V to P—
> (a) if or in so far as it forms part of a process, or series of transactions, by which the transfer is effected,
> (b) if the transfer of the chargeable interest is conditional on the completion of the transaction, or
> (c) if it is of a kind specified in section 75A(3).[59]

Section 75B(3) FA 2003 then suggests some incidental transactions:

> A transaction may, in particular, be incidental if or in so far as it is undertaken only for a purpose relating to—
> (a) the construction of a building on property to which the chargeable interest relates,
> (b) the sale or supply of anything other than land, or
> (c) a loan to P secured by a mortgage, or any other provision of finance to enable P, or another person, to pay for part of a

[58] Section 75B(6) FA 2003 defines transfer: "In this section a reference to the transfer of a chargeable interest from V to P includes a reference to a disposal by V of an interest acquired by P."

[59] See 98.33.2 ("Transaction").

> process, or series of transactions, by which the chargeable interest transfers from V to P.
>
> (4) In subsection (3)—
>
> (a) paragraph (a) is subject to subsection (2)(a) to (c),
>
> (b) paragraph (b) is subject to subsection (2)(a) and (c), and
>
> (c) paragraph (c) is subject to subsection (2)(a) to (c).

This only goes so far as to say that the transaction *may* be incidental, though one may infer that the transaction would be incidental unless there are some special circumstances.

Section 75B(5) FA 2003 deals with cases of partial relief:

> The exclusion required by subsection (1) shall be effected by way of just and reasonable apportionment if necessary.

98.34.4 *Transfer of securities*

Section 75C(1) FA 2003 provides:

> A transfer of shares or securities shall be ignored for the purposes of section 75A if but for this subsection it would be the first of a series of scheme transactions.

98.34.5 *Reliefs and other interactions*

Section 75C FA 2003 provides:

> (2) The notional transaction under section 75A attracts any relief under this Part which it would attract if it were an actual transaction (subject to the terms and restrictions of the relief).
>
> (3) The notional transaction under section 75A is a land transaction entered into for the purposes of or in connection with the transfer of an undertaking or part for the purposes of paragraphs 7 and 8 of Schedule 7, if any of the scheme transactions is entered into for the purposes of or in connection with the transfer of the undertaking or part.
>
> (4) In the application of section 75A(5) no account shall be taken of any amount paid by way of consideration in respect of a transaction to which any of sections 60, 61, 63, 64, 65, 66, 67, 69, 71, and 74, or a provision of Schedule 6A or 8, applies.

These provisions are not relevant here. They concern:

Section	**Topic**
s.60, 61	Compulsory purchase/Compliance with planning obligations
s.63, 64	Demutualisation of insurance company/building society
s.65	Incorporation of LLP

s.66, 67	Public bodies/parliamentary constituencies
s.69, 71	National Bodies/Registered social landlords
s.74	Collective rights of tenants of flats

> (5) In the application of section 75A(5) an amount given or received partly in respect of the chargeable interest acquired by P and partly in respect of another chargeable interest shall be subjected to just and reasonable apportionment.
> (6) Section 53 applies to the notional transaction under section 75A.[60]
> (7) Paragraph 5 of Schedule 4 [exchanges] applies to the notional transaction under section 75A.
> (8) For the purposes of section 75A—
> (a) an interest in a property-investment partnership (within the meaning of paragraph 14 of Schedule 15) is a chargeable interest in so far as it concerns land owned by the partnership,[61]
> (8A) Nothing in Part 3 of Schedule 15 [transactions involving partnerships] applies to the notional transaction under section 75A.

98.34.6 *Minor exceptions*

Section 75A(7) FA 2003 provides:

> This section does not apply where subsection (1)(c)[62] is satisfied only by reason of—
> (a) sections 71A to 73, or
> (b) a provision of Schedule 9.

These exceptions are not relevant here. They concern:
71A-73: Alternative property finance (Sharia finance)
sch 9: Tenants right to buy and similar transactions

98.34.7 *Avoidance not required*

The SDLT Manual provides:

> **SDLTM09175 Section 75A FA 2003, Overall approach** [Nov 2019]
> Section 75A is an anti-avoidance provision. HMRC therefore takes the view that it applies only where there is avoidance of tax.

This view does not bear much examination, as the Supreme Court observed:

[60] See 98.31.1 (Transfer to co. shareholder).

[61] Subsection 8(b) has been repealed.

[62] See 98.33.1 (Basic requirements).

> The heading of the section, "Anti-avoidance", is the only indication in the section which could support [the taxpayer's] contention. The heading is relevant to assist an understanding as to the mischief which the provision addresses, but it says nothing as to the motives of the parties to the scheme transactions. There is nothing in the body of the section which expressly or inferentially refers to motivation. The provision was enacted to counter tax avoidance which resulted from the use of a number of transactions to effect the disposal and acquisition of a chargeable interest. It is sufficient for the operation of the section that tax avoidance, in the sense of a reduced liability or no liability to SDLT, resulted from the series of transactions which the parties put in place, whatever their motive for transacting in that manner. This is clear (?) from subsection (1)(c) which compares the amount of SDLT payable in respect of the actual transactions against what would be payable under the notional land transaction in section 75A(4), by which P acquired V's chargeable interest on its disposal by V.[63]

The Manual will need to be rewritten.

98.34.8 *Application on liquidation*

The SDLT Manual provides:

> **SDLTM04042 SDLT on de-enveloping transactions** [Feb 2020]
> ... There may be situations where a company had a third party debt that has been repaid as a result of shareholder action (either through the subscription for more issued share capital or by replacing the third party debt with shareholder debt), prior to its liquidation. In such cases it is possible that on distribution of the property there will be no charge to SDLT as it will be a distribution in similar circumstances to the first two situations outlined above.
> However, section 75A FA 2003 could apply where the shareholder of a company provides funds to the company to allow it to discharge its debt, before acquiring the property from the company if those actions are involved in connection with that disposal or acquisition. Whether section 75A applies will depend on the facts of each case.
> There will be cases where discharging the debt has not occurred as part of the arrangements for the transfer of the property from the company to the shareholders. Equally, there will be cases where the discharge of the debt was one of a number of transactions involved in connection with the disposal and acquisition of the property.

[63] *Project Blue v HMRC* [2018] UKSC 30 at [42].

> ... In a straightforward de-enveloping situation, the company should be 'V' and the shareholder(s) 'P'. ...

CIOT say:

> 2.2 In our view, the capitalisation of debt should not comprise a 'scheme transaction' for the purposes of Section 75A. Ownership of shares is clearly a pre-requisite to distributing the property out by way of liquidation but this could be by virtue of its existing shareholding. There is no need for the capitalisation to establish the shareholding necessary for the distribution. The capitalisation will clearly be a step in the transfer of the property, but it does not affect the nature or interest of the property which is being transferred on the liquidation.
> 2.3 We therefore do not believe that Section 75A should apply, since the capitalisation is not a scheme transaction and consequently the only transaction which takes place is the real transaction, namely the transfer of the property from the company to the individual or trustee.[64]

98.35 Charities and ATED taxes

A charitable trust does not fall within ATED as it is not a "non-natural" person. A charitable company would fall within ATED. Relief is available under s.151 FA 2013.[65]

Similarly a charity purchaser should not be subject to ATED-SDLT, as the usual charity SDLT exemption should apply.

98.36 ATED in Scotland\Wales

ATED applies to a chargeable interest, defined as an interest in land in the UK, so it applies in Scotland and Wales.

Section 80I Scotland Act 1998 provides:

> (1) A tax charged on any of the following transactions is a devolved tax—
>
> (a) the acquisition of an estate, interest, right or power in or over land in Scotland;

[64] CIOT, "Removing barriers to de-enveloping residential property" (Jun 2016). *https://www.step.org/sites/default/files/2021-11/de-enveloping-22-june-2016.pdf*

[65] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 39.14 (Annual tax on enveloped dwellings) online version *https://www.taxationofcharities.co.uk*

(b) the acquisition of the benefit of an obligation, restriction or condition affecting the value of any such estate, interest, right or power.[66]

ATED is not a tax charged on acquisition, so it is not a devolved tax. By contrast, LBTT/LTT (the Scots/Welsh equivalents of SDLT) are devolved taxes. If the object of ATED is the prevention of avoidance of SDLT/LBTT/LTT, then ATED ought to be a devolved tax also. Perhaps no-one noticed, or cared, or perhaps it was thought too difficult. Perhaps a UK-wide tax was thought to be simpler; but simplicity is not compatible with devolution.

98.37 De-enveloping

Where a property is held in a company, the question is whether to wind up or retain.

Advantages of retention: In return for paying ATED, a shareholder may have the advantages of being able to sell the company rather than the land:

(1) SDLT advantage of being able selling shares in the company free of SDLT. It takes between 4 and 30 years for ATED to equal the SDLT on a non-corporate sale, about 15 years on average;[67] but ATED is payable sooner and will be index-linked (at least). It will not be cost-effective to continue to pay ATED, just for the SDLT saving, unless a fairly prompt sale of the company is expected.

(2) A purchaser who will be within ATED (in short, intending to use the property as a home) may prefer to purchase the property, not the company or may want a discount to reflect the disadvantages of holding through a company. On the other hand, a purchaser for investment, who can qualify for ATED rental relief,[68] and who is prepared to undertake corporate due diligence, is likely to prefer to purchase the company.

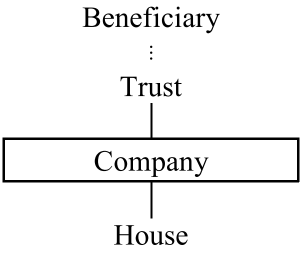
98.38 Methods of de-enveloping

This section considers some methods of de-enveloping where (as is common) the house is held in a company held in a trust made by a foreign domiciled settlor. Diagrammatically:

[66] See s. 15 Wales Act 2014 for the Welsh equivalent.

[67] See 98.7 (Rates of ATED).

[68] See 98.18 (ATED rental relief).



In the following discussion:
The "**house value**" is the market value of the house.
The **"2015 rebased gain"** is the gain allowing for 2015 rebasing.
The "**house gain**" is the gain on the disposal of the house: the amount by which the house has risen in value since acquisition.
The "**company share value**" is the market value of the company shares. This is likely to be less than the value of the house (the company's asset).[69]

It is assumed (to avoid having to cover some less likely permutations) that:

(1) There is at least some house gain. (At the higher end of the market this may not be the case).
(2) The trust has no trust gains (other than those which accrue on disposals discussed below) and no trust losses.
(3) The beneficiary is UK resident.
(4) The settlor was not UK domiciled when the trust was made.

SDLT issues are discussed elsewhere; see 98.31 (SDLT on winding up company).

98.38.1 *Trust winds up co*

One straightforward proposal is:

(1) the trustees wind up the company and
(2) the trustees transfer the house to a beneficiary.[70]

The tax implications of the trustees winding up the company are:

(1) A gain (the 2015 rebased gain) will accrue to the company on the disposal of the house. That gain will be subject to corporation tax.

[69] See 82.20 (Co holds residence: valuation).

[70] There could be two transfers: (1) the liquidator transfers the house to the trustees (2) the trustees transfer the house to the beneficiary. In practice the trustees may direct the liquidator to transfer the house directly to the beneficiary, but that is just a matter of conveyancing.

(2) A gain will accrue to the trustees on the disposal of the shares, on the liquidation ("the trustee shareholder gain")
   (a) The gain is computed by reference to the value of what the trustees receive (the house less the CT charge paid by the company)
   (b) This gain will be a s.1(3) amount (trust gain).

The tax implications of the trustees transferring the house to the beneficiary will be:

(1) The transfer will be a capital payment.
   (a) The amount of the capital payment is equal to the value of what the beneficiary receives (which may be the house less the CT charge).
   (b) The capital payment will be matched to trust gains so there will be a s.87 charge.
   (c) The capital payment will not qualify for the remittance basis as the benefit is received in the UK.
(2) There may also be a small IHT exit charge.[71]

98.38.2 *Trust transfers co to beneficiary*

Another straightforward proposal is:

(1) The trustees transfer the shares in the company to the beneficiary.
(2) The beneficiary winds up the company.

The tax implications of the transfer of the company shares from the trust to the beneficiary will be:

(1) A gain will accrue to the trustees on the disposal of the shares, on the transfer ("the trustee shareholder's gain").
   (a) This gain is computed by reference to the market value of the shares (which will be less than the house value, to reflect the drawbacks of corporate ownership).
   (b) This gain will be a s.1(3) amount (trust gain).
   (c) This gain will not be immediately charged to tax.
(2) The transfer of the shares to the beneficiary will be a capital payment.
   (a) The amount of the capital payment will be equal to the market value of the shares.
   (b) The capital payment will be matched to the trust gains.
   (c) If the beneficiary is a remittance basis taxpayer, the s.87 charge

[71] See 76.9.2 (Excluded property time apportionment).

will in the first instance qualify for the remittance basis as the benefit is received outside the UK.

(3) There may be a small IHT exit charge.

The tax implications of the beneficiary winding up the company are:

(1) A gain (the 2015 rebased gain) will accrue to the company on the disposal of the house. That gain will be subject to corporation tax.
(2) A gain may accrue to the individual on the disposal of the shares, on the liquidation ("the liquidation gain").
    (a) The liquidation gain will not qualify for the remittance basis as the proceeds of the liquidation are received in the UK.
    (b) The amount of the liquidation gain will in principle be small, or nil, as the shares are acquired at market value.[72]
(3) If the remittance basis applied to the capital payment, it now comes into charge, as the beneficiary receives the benefit (the house) in the UK.

The trustee shareholders gain could qualify for hold-over relief, in which case there would be no trust gain to match to the capital payment, but that is matched by a larger gain on the liquidation.

An option may be to transfer the property to a non-resident beneficiary, if there is someone suitable, but the onward gift rules would need consideration.

98.38.3 *Non-tax aspects of unwinding*

The beneficiary who acquires the property will need to review their will, as the property will pass under the will rather than under the terms of the settlement. A new UK-law will may be needed for this purpose.

98.38.4 *De-enveloping mistakes*

The Court has set aside a de-enveloping transaction by way of distribution where the parties overlooked a "very significant risk" of SDLT liability.[73]

98.39 ATED regime: Critique

ATED and ATED-SDLT share rules and objectives; they should be evaluated together.

[72] If there is a gain, company distribution relief avoids a double CGT charge (on the liquidation gain and the s.3 gain); see 64.20 (s.3 distribution relief).

[73] *Representation of Crestbridge Trustees re Avocado Trust* [2021] JRC 171.

98.39.1 *Number of homes held by co*

It is relevant to consider how many homes are currently held by companies within ATED. In summary, for 2018/19 the figures are[74]

Properties held by companies				**ATED**
Property band	**no properties**	**% of total**	**ATED rate**	**receipts £m**
£500k-£1m	1880	30%	£3k	6
£1m-£2m	1860[75]	29%	£7k	12
£2m – £5m	1660	26%	£25k	37
£5m – £10m	590	9%	£59k	31
£10m - £20m	200	3%	£118k	21
£20m -	150	2%	£237k	32
Total	6340	100%		139

Relief declarations	
Rental relief	15260
Development relief	2730
Other reliefs	1690
Total	19670

I noted in 2015 that "One would expect the figure to diminish as in many cases the companies would be unwound if possible" and that has proved to be correct. There may be additional cases of accidental or deliberate non-notification, though how many is a matter of speculation.

A consultation paper[76] gave the figure of properties registered in the names of foreign companies as "up to 100,000 titles"![77] (The words "up to" are revealing.) But the number (whatever it actually was) will include non-residential property, and residential property held by

(1) corporate trustees
(2) nominees

[74] HMRC, "ATED Statistics 2018/19" (Mar 2020) *https://www.gov.uk/government/statistics/uk-ated-statistics*

[75] In 2015, I guessed that "the number of properties under £2m may not be large (was it worth using a company for relatively small value properties?) and the yield is likely to be limited."

[76] Department for Business Innovation & Skills, "Beneficial Ownership Transparency" (2016) para 44 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/512333/bis-16-161-beneficial-ownership-transparency.pdf*

[77] The statistic was misreported in the press as meaning that 100,000 (The Guardian), or "more than 100,000" (The FT), properties are owned by foreign companies. But that is just sloppy journalism.

(3) diversely held entities (outside the scope of ATED)
(4) sovereign bodies (outside the scope of taxation)

So the figure of properties registered in the names of foreign companies, whatever it may be, gives little if any indication of how many companies fall within ATED or the IHT residential-property code.

98.39.2 *Objections to ATED*

There are so many objections to ATED that it is hard to know where to begin.

Reasonable to use companies to hold land: There are non-tax reasons why it may be desired to hold a residence in a company.[78]

Most offshore trusts used foreign companies to hold land, as a matter of routine, regardless of tax, because of issues relating to:

(1) Limited liability
(2) Conflict of laws; the validity of a disposition of immovable property may but need not necessarily be determined by the law of the State where the property is situated.
(3) Segregation of a trustees assets.

This is recognised in the relief given to companies holding non-UK properties.[79]

Complexity and administrative burden: ATED extends to 80 sections and 3 schedules. There are very few tax problems to which 100 pages of legislation is the best answer. The House of Lords Economic Affairs Committee agreed:

> We share our witnesses' concern about whether the problem the legislation seeks to address justifies its length and complexity, particularly in view of the Government's commitment (!) to a simpler tax system. In line with our earlier recommendation on better consultation, we think that there were probably simpler and more

[78] I think this is self-evident to practitioners. But this is confirmed (if that were necessary) by HMRC Research Report 384 "Views and behaviours in relation to ATED" (2015) section 5 (why are properties enveloped), citing privacy, foreign succession law, and asset protection among non-tax reasons for use of companies. *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/457946/HMRC_Research_Report_384_-_Views_and_behaviours_in_relation_to_the_Annual_Tax_on_Enveloped_Dwellings.pdf*

[79] See 39.28 (Foreign homes relief).

> effective ways of achieving the Government's objectives.[80]

Uncertainty and instability: There is the uncertainties of the statutory rules, which contain about the same level of uncertainty as any other 100 pages of tax legislation. Now that ATED has been around for a decade or so, it seems to have settled down, though there was an initial period of instability.

98.39.3 *ATED purpose at outset*

The Residential Property Consultation Response Document provides:

> 1.8 One of the sources of property tax avoidance ...is the way some people avoid the stamp duty the rest of the population pays including by using companies to buy expensive residential property.
> 1.9 To address this form of avoidance, and to ensure the owners of high value residential property pay their fair share of tax, the Chancellor announced a threefold approach [ATED, ATED-SDLT and the former ATED-CGT].

The reason for the introduction of the ATED regime in 2013 was to prevent SDLT avoidance by corporate ownership of land. No other object was mentioned.

While views on the priority of preventing avoidance may differ, it seems to me that very few of those who actually have to grapple with the provisions would consider SDLT saving an adequate benefit to set against the objections to the ATED regime outlined above.

In any event SDLT was not a major driver in the use of companies. The 2015 IHT residential-property paper belatedly acknowledges that mistake:

> 19. Properties held in companies or other envelopes can be 'sold' by transferring the shares of that company. Such a transaction is not subject to any SDLT. ATED was introduced in FA 2013 to ensure that people enveloping residential property in corporate vehicles pay a price for that privilege by a higher SDLT rate on entry into the corporate structure and ATED. ATED is targeted only at residential property held through a company where it is occupied rather than let out to an unconnected

[80] House of Lords Select Committee on Economic Affairs *The Draft Finance Bill 2013* (2013) para 213
http://www.publications.parliament.uk/pa/ld201213/ldselect/ldeconaf/139/139.pdf
The passage concluded: " We recommend that the lessons from the development of these measures should be learned and applied to the design of future tax policies."
But of course no-one took any notice of that.

> person. Properties let to unconnected parties qualify for relief and are therefore exempt from the ATED charge.
>
> 20. HMRC's research suggests that the most common reason for enveloping properties is IHT planning undertaken by non-doms.

HMRC research states what every practitioner knew.[81] It follows that the ATED regime was misconceived, insofar as it was aimed at SDLT planning or avoidance.[82]

In this context it is worth noting that the ATED regime was introduced in breach of the Tax Consultation Framework.[83] The ATED regime was the rabbit out of a hat approach to tax reform which the Tax Consultation Framework tried, not very successfully, to abolish.[84]

Readers may think it pointless to cry "foul" in a game which has no referee, and whose result has been declared. But I think the story deserves to be noted, not just as a lesson in how not to legislate, for which tax provides so many, but because this history supports the case that the case for ATED and ATED-SDLT needs to be thought through: there was no such thinking when it was introduced.

98.39.4 *Role of ATED today*

The starting point is that ATED is not a tax of a conventional kind, but:

(1) a penalty (the principal element in a set of penalties) for entering into certain arrangements or for not unwinding them; or

[81] This is confirmed (if that were necessary) by HMRC Research Report 384 "Views and behaviours in relation to ATED" (2015) para 5.18: "... avoiding SDLT was not often mentioned by agents as a main driver for enveloping a property" and citing an interviewee as saying (rightly) "the scale of the stamp duty avoidance was vastly exaggerated."
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/457946/HMRC_Research_Report_384_-_Views_and_behaviours_in_relation_to_the_Annual_Tax_on_Enveloped_Dwellings.pdf

[82] One might infer from an absence of comment in the HMRC announcements that those who introduced the ATED regime were unaware of any IHT implications until they were pointed out in the consultation process. The chutzpah of the Residential Property Response Document deserves to be recorded:
"3.71 ...The likelihood that the measures would impact on non-domiciled individuals more than UK citizens was also raised as a concern.
Government Response
3.72 The Government has taken on board comments raised through this question."

[83] See 1.12 (State of UK tax reform).

[84] The ATED regime was also a breach of the promise of stability on foreign domicile taxation. See 1.11 (The promise of stability).

(2) a charge for certain tax privileges (avoidance of SDLT)

This is not itself a criticism. It may be sensible to have such a charge and there are precedents.[85] But it does follow that an assessment of the ATED regime requires an analysis of the tax advantages and disadvantages of corporate ownership. These changed in 2015 (NRCGT) and again in 2017 (IHT residential-property code) and again in 2019 (CGT on sale of land-rich companies). So fresh assessment is needed.

The advantage today is a possible SDLT saving by a sale of the company rather than a sale of property. The advantage has increased following the 2015 increase of SDLT residential property rates.

"Possible" avoidance of SDLT raises the question: How much SDLT has been or would be avoided in this way? Back in 2013, not much.[86] Subsequent increases in SDLT residential property rates increase the benefit of this SDLT planning, perhaps to the point where it becomes attractive.

Assessing the advantage one has to allow for the fact that UK resident and domiciled purchasers (certainly the large majority by number) are likely to prefer to purchase the property, not the company.

98.39.5 *The way forward*

A rational reform would be as follows:

(1) Abolish ATED-SDLT:[87] there is little point in extravagantly complex rules which (in short) only raise the marginal SDLT rate by 0%-3%

(2) Make ATED avoidable by an election (irrevocable once made) that the company should be regarded as transparent for SDLT. The election out of the POA charge is a precedent.[88] That would allow the use of companies for non-tax reasons to continue. It avoids the

[85] In this respect ATED is like the pre-owned asset tax; see 83.39 (Critique).
One might say that ATED, despite its name, is not a tax at all. But the border between taxation and non-tax disincentives is fraught, and the general question whether ATED is correctly described as a tax is best avoided (except in contexts where the distinction makes a practical difference).

[86] See 98.39.3 (ATED purpose at outset).

[87] A more radical reform would be the repeal of SDLT, in accordance with Mirrlees recommendations ("a strong contender for the UK's worst-designed tax") and replace it with a form of rates. See IFS Green Budget 2013
https://ifs.org.uk/sites/default/files/output_url_files/gb2013.pdf

[88] See 83.33 (POA election). The US tick the box regime is another precedent. Double taxation aspects would need consideration but would not be insoluble.

unfairness that ATED is a fixed charge for potential tax advantages the benefit of which (if any) varies considerably from one case to another. It also allows effective unwinding of existing structures.

(3) Set ATED rates to broadly match the tax advantages of corporate status. This would result in an increase which compensates (or if desired, may more than compensate) for the loss of tax in points (1) and (2).

The result would, I think, be reasonably satisfactory and a considerable simplification on the current position.

A further reform still would be to abolish the IHT residential-property code and set ATED rates to collect the IHT saved by use of companies.[89]

An important question is why the ATED regime should be restricted to residential property, or whether it should be extended to non-residential property. Holding land through companies allows SDLT saving (though the rates are much lower) and IHT saving, similar to residential property. Perhaps the policy here is governed by economic considerations: not to affect the commercial property market, while accepting, or perhaps welcoming, the effects on the residential property market. Perhaps the current rules reflect an unexamined assumption that tax planning involving residential properties is more objectionable than other tax planning. But this is speculation as the policy reasons have never been discussed.

98.39.6 *A new unwinding relief*

The absence of relief for unwinding existing structures means that in many, perhaps most, cases, unwinding companies is prohibitively expensive. If an object of the reforms is to encourage winding up companies, that object has not been and will not be achieved. Instead the owners bear the brunt of ATED in an arbitrary and unfair way. The House of Lords Economic Affairs Committee made this point:

> We recommend that the Government should consider whether more could be done, possibly deferring the charge on any gain, to help those affected to de-envelope their properties without incurring high tax costs.[90]

[89] See 82.22.2 (Replace residence-code with ATED).

[90] House of Lords Select Committee on Economic Affairs *The Draft Finance Bill 2013* (2013) para 196

The 2015 IHT residential-property paper provided hope for optimism.[91] But the 2016 consultation paper rejected the idea:

> At the 2015 Summer Budget, the government said that it would consider the cost associated with de-enveloping of properties. However, while the government can see there might be a case for encouraging de-enveloping, it does not think it would be appropriate to provide any incentive to encourage individuals to exit from their enveloped structures at this time.
>
> **Question 9**: Are there any hard cases or unintended consequences that will arise as a result of there not being any tax relief for those who want to exit their enveloped structures?

The answer to the question seems to be that:

(1) There are hard cases; but
(2) They are not unintended.

98.40 SDLT non-resident surcharge

The background can be found in HMRC consultation papers:

SDLT: non-UK resident surcharge consultation (2019)
Non-UK Resident SDLT Surcharge Summary of Responses (2020) ("the surcharge response paper")[92]

The surcharge response paper provides:

> 4.6 The government does not propose altering the application of the surcharge in relation to collective enfranchisement arrangements or first-time buyers' relief.[93]

http://www.publications.parliament.uk/pa/ld201213/ldselect/ldeconaf/139/139.pdf

[91] "21. ... some non-doms and trusts may wish to remove the envelope and move into a simpler more straightforward structure outside the scope of future ATED charges, ATED reporting or ATED-related CGT. If the property is mortgaged or has increased in value since 2013 there may (?) however, be significant costs in de-enveloping.
22. The government will consider the costs associated with de-enveloping and any other concerns stakeholders may have during the course of the consultation regarding de-enveloping."

[92] *https://www.gov.uk/government/consultations/stamp-duty-land-tax-non-uk-resident-surcharge-consultation*

[93] The surcharge consultation paper at 5.4 states: Non-UK residents who meet the criteria for first time buyers' relief (FTBR) will pay the surcharge at 1% on the chargeable consideration between £0 - £300,000 and 6% (5% + the 1% surcharge)

> 4.7 Changing the rules to exempt purchasers where first-time buyers' relief is claimed would place additional pressures on HMRC to establish if an individual benefitting from relief plans to use the property as his/her main residence. All first-time buyers will be able to benefit from a refund of the surcharge under the refund rules set out above.

The term surcharge was used in the consultation and response papers, but the FA chose the more anodyne term "additional rate".

98.41 Non-resident surcharge

Section 75ZA FA 2003 provides:

> (1) In its application for the purpose of determining the amount of tax chargeable in respect of a chargeable transaction that is a non-resident transaction, this Part has effect as if 2% were added to each rate specified in the rate-specifying provisions.
> (2) The "rate-specifying provisions" are—
> (a) in section 55(1B), Table A;
> (b) in Schedule 4ZA, in paragraph 1(2), Table A;
> (c) in Schedule 4A, paragraph 3(1)(a);
> (d) in Schedule 5, in paragraph 2(3), Table A;
> (e) in Schedule 6ZA, in paragraph 4, Table A;
> (f) in section 74(1A), Step 4.

SDLT reliefs such as group relief and charities relief[94] will in principle apply.

98.42 "Non-resident transaction"

Para 2 sch 9A FA 2003 provides:

> (1) A chargeable transaction is a "non-resident transaction" for the purposes of this Part of this Act if—

A set of 4 conditions follows.

98.42.1 *Non-resident purchaser*

Para 2 sch 9A FA 2003 provides:

on any portion between £300,000 - £500,000. (The proposed 1% surcharge rate has become 2%).

[94] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 39.7.3 (Non-residents surcharge).
online version *https://www.taxationofcharities.co.uk*

> (1) A chargeable transaction is a "non-resident transaction" for the purposes of this Part of this Act if—
>
> (a) the purchaser is, or (if there is more than one) the purchasers include, a person who is non-resident in relation to the transaction

98.42.2 *Major interest in dwelling*

Para 2 sch 9A FA 2003 provides:

> (1) A chargeable transaction is a "non-resident transaction" for the purposes of this Part of this Act if ...
>
> (b) the main subject-matter of the transaction consists of—
>
> (i) a major interest in one or more dwellings, or
>
> (ii) a major interest in one or more dwellings and other property,
>
> (c) that major interest, at the beginning of the effective date of the transaction, is not a term of years absolute or leasehold estate that has 7 years or less to run

Para 2(2) sch 9A FA 2003 provides:

> A reference in sub-paragraph (1)(b) or (c) to a major interest in a dwelling includes an undivided share in a major interest in a dwelling.

98.42.3 *De minimis test*

Para 2 sch 9A FA 2003 provides:

> (1) A chargeable transaction is a "non-resident transaction" for the purposes of this Part of this Act if ...
>
> (d) the de minimis threshold is exceeded.

The threshold is set low:

> (3) For the purposes of sub-paragraph (1)(d), the de minimis threshold is exceeded if—
>
> (a) in a case in which the chargeable consideration for the transaction does not consist of or include rent, the chargeable consideration for the transaction is £40,000 or more;
>
> (b) in a case in which the chargeable consideration for the transaction consists of or includes rent—
>
> (i) the chargeable consideration other than rent is £40,000 or more, or
>
> (ii) the annual rent is £1,000 or more.
>
> (4) In sub-paragraph (3) "annual rent" in relation to a transaction, means the average annual rent over the term of the lease to which the

> transaction relates or, if—
> (a) different amounts of rents are payable for different parts of the term, and
> (b) those amounts (or any of them) are ascertainable at the effective date of the transaction,
>
> the average annual rent over the period for which the highest ascertainable rent is payable.

98.43 SDLT residence test

Para 3 sch 9A FA 2003 provides:

> For the purposes of this Schedule, an individual is "non-resident" in relation to a chargeable transaction if the individual is not UK resident in relation to the transaction (see paragraphs 4 and 5).

So we move on to para 4 sch 9A FA 2003. Para 4(1) provides the basic rule:

> For the purposes of this Schedule, an individual is "UK resident" in relation to a chargeable transaction if the individual is present in the UK on at least 183 days during any continuous period of 365 days that falls within the relevant period.

Presence is decided by the usual midnight test. Para 4(4) sch 9A FA 2003 provides:

> References in this paragraph to an individual being present in the UK on a day are to the individual being present in the UK at the end of that day.

As this definition only applies for the purposes of para 4, it has to be repeated verbatim in para 5.

Although SDLT is only payable on land in England and Northern Ireland, for the purposes of the SDLT residence test it is days spent in the whole of the UK that count, not just days spent in England or Northern Ireland.

98.43.1 *Relevant period*

Para 4(2) sch 9A FA 2003 provides:

> "The relevant period" means the period that—
> (a) begins with the day 364 days before the effective date of the chargeable transaction, and
> (b) ends with the day 365 days after the effective date of the chargeable transaction.

So it may not be clear whether an individual meets the UK resident requirement until a year after the transaction. SDLT is then paid upfront, and reclaimed if appropriate.

98.43.2 *Residence: Policy issues*

The SDLT surcharge does not adopt the SRT definition of residence, because that was so complicated. HMRC give themselves a pat on the back for that. The surcharge response paper provides:

> many respondents spoke positively of the government's decision to favour simplicity, where possible, in designing the surcharge

The reader studying the 20 pages of text on this topic may think it is complicated. The weasel words are "where possible".
The surcharge response paper provides:

> 1.8 In recognition that most stakeholders welcomed the government's proposal for a simple test of an individual's residence for the purposes of the surcharge, the government will legislate the SDLT residence test for individuals as set out in the consultation.
> 1.9 While the government has considered whether special provisions are needed to allow for exceptional circumstances to be taken into account, on balance it believes that the residence test and the proposed approach to refunds as detailed in Chapter 3 provide sufficient flexibility for the vast majority of customers.
> 1.10 The government will not use the SRT to determine the residence status of an individual for the purposes of the surcharge. Using the SRT, a test based on a tax year is ill suited for a transaction tax like SDLT and would be complicated as individuals would have to judge their residence under the SRT in almost all cases before the tax year has ended. This would create burdens for HMRC to check taxpayers' declarations whilst also complicating the surcharge as taxpayers who do not routinely assess their tax residence could be forced to engage with the SRT rather than the more straightforward SDLT test.

98.44 When post-acquisition period ignored

Para 5 sch 9A FA 2003 provides:

> (1) For the purposes of this Schedule, an individual is "UK resident" in relation to a chargeable transaction to which this paragraph applies if the individual is present in the UK on at least 183 days during the period that—
>
> (a) begins with the day 364 days before the effective date of the chargeable transaction, and

> (b) ends with the effective date of the chargeable transaction.
>
> (2) This paragraph applies to a chargeable transaction if any of conditions A to C is met in relation to the transaction.

98.44.1 *Company purchaser*

Para 5 sch 9A FA 2003 provides:

> (3) Condition A is that the purchaser is, or (if there is more than one) the purchasers include—
>
> (a) a company, or
>
> (b) a person acting as a trustee of a unit trust scheme.

98.44.2 *Partnership purchaser*

Para 5 sch 9A FA 2003 provides:

> (4) Condition B is that the purchaser is, or (if there is more than one) the purchasers include, an individual who is treated as entering into the transaction by virtue of paragraph 2 of Schedule 15 (transaction entered into for the purposes of a partnership treated as entered into by partners).

The surcharge response paper provides:

> 2.12 ... for SDLT purposes partnerships are treated as if the partners are joint purchasers of partnership property.[95] In line with this, the government proposed that the surcharge would apply where any one of the partners was non-UK resident as defined by the relevant residence tests for individuals and non-natural persons set out in the consultation.
>
> 2.13 As was also set out in the consultation, there are special rules that apply to partnership transactions involving the transfer of property. The government proposed that where, under these rules, the partnership is treated as the purchaser, the above rules will apply. Where conversely, the purchaser is or includes a partner, former partner or person connected with either a partner or former partner, the residence status of the purchaser alone will determine whether the surcharge applies.
>
> 2.14 A number of respondents expressed concern that the proposed treatment of partnerships would be unfair and disproportionate for the residence status of one partner to render the entire partnership liable to the surcharge, with several questioning the policy rationale of deeming purchases by a partnership comprising wholly of UK residents as preferable to those of a partnership comprising a single non-UK resident.

[95] Para 2 sch 15 FA 2003.

> 2.15 Some commented that it would be onerous for large partnerships and complex fund structures to establish the residence of every partner for the purposes of the surcharge using a test other than the existing SRT.
> 2.16 A significant number of respondents advocated in favour of a threshold, under which minor non-UK resident interests would be disregarded for the purposes of the surcharge. A smaller number were in favour an apportionment test that would restrict the amount of the surcharge payable to reflect the proportion of nonUK resident interests in the partnership. Government response
> 2.17 The government will legislate for the surcharge to apply to partnerships as set out in the consultation. It is usual practice within SDLT to treat partners as joint purchasers of a property and for joint purchaser rules to apply irrespective of the relative interests being purchased by different partners.

98.44.3 *Trust purchaser*

Para 5 sch 9A FA 2003 provides:

> (5) Condition C is that—
> (a) the purchaser is, or (if there is more than one) the purchasers include, an individual who is acting as a trustee of a settlement, and
> (b) under the terms of the settlement no beneficiary is entitled—
> (i) to occupy the dwelling or dwellings for life, or
> (ii) to income earned in respect of the dwelling or dwellings.

The consultation response paper provides:

> 2.23... the residence status of a trustee is determined using the relevant SDLT residence test (depending on whether the trustee is an individual or company). Where there are multiple trustees, the trust will be UK-resident only if all the trustees are UK-resident under the SDLT tests.

98.45 Crown employees

Para 6 sch 9A FA 2003 provides:

> (1) For the purposes of paragraphs 4 and 5, an individual is (subject to sub-paragraph (3)) treated as present in the UK at the end of a day if at that time the individual—
> (a) is in Crown employment, and
> (b) is present in a country or territory outside the UK for the purpose of performing activities in the course of that

> employment.
>
> (2) For the purposes of paragraphs 4 and 5, an individual is (subject to sub-paragraph (3)) treated as present in the UK at the end of a day if at that time the individual—
>
> (a) is the spouse or civil partner of an individual who is treated as present in the UK at the end of that day under sub-paragraph (1), and
>
> (b) is living with[96] that spouse or civil partner. (3) Sub-paragraph (1) or (2) applies in relation to an individual only if a claim that it should so apply is included in a land transaction return or an amendment of such a return.
>
> (4) "Crown employment" means employment under the Crown—
>
> (a) which is of a public nature, and
>
> (b) the earnings from which are payable out of the public revenue of the UK or of Northern Ireland.

There is no relief for other employees seconded abroad. The Surcharge response paper provides:

> 3.6 ... The application of the Income Tax legislation for crown employees places them in a materially different position to other Income Tax payers, making it appropriate for the government to provide a relief for this category of taxpayer.

98.46 Non-resident company

Para 7 sch 9A FA 2003 provides:

> (1) For the purposes of this Schedule a company is "non-resident" in relation to a chargeable transaction if either of the following conditions is met.
>
> (2) The first condition is that, on the effective date of the chargeable transaction, the company is not UK resident for the purposes of the Corporation Tax Acts (see Chapter 3 of Part 2 of CTA 2009).

98.47 Foreign-controlled company

The surcharge response paper provides:

> 2.4 For UK resident close companies, the government proposed looking through to the residence of participators and apply the surcharge where control could be directly or indirectly exercised by one or more non-UK

[96] Para 6(5) incorporates the standard tax definition of "living together": see App 3.4.3 (Living together: Married couple).

> resident person(s). The residence status of the participators will be determined as if they were direct purchasers of the property acquired by the close company using the SDLT residence test set out in this document. This treatment was proposed to prevent non-UK residents using UK resident companies to circumvent the surcharge.

Anyone using a UK resident company to avoid the surcharge would need their head examined. But there it is.

Para 7 sch 9A FA 2003 provides:

> (1) For the purposes of this Schedule a company is "non-resident" in relation to a chargeable transaction if either of the following conditions is met...
> (3) The second condition is that, on the effective date of the chargeable transaction, the company (though UK resident for the purposes of the Corporation Tax Acts)—
> (a) is a close company (see paragraph 8),
> (b) meets the non-UK control test in relation to the transaction (see paragraphs 9 and 10), and
> (c) is not an excluded company (see paragraph 11).

98.47.1 *"Close company"*

Para 8 sch 9A FA 2003 tinkers with the standard definition:

> (1) For the purposes of this Schedule, a company is a "close company" if it is a close company within the meaning given by Chapter 2 of Part 10 of CTA 2010 (basic definitions), applying that Chapter subject to the following modifications.
> (2) Section 444 (companies involved with close companies) applies as if condition A in that section were omitted.
> (3) Section 446 (particular types of quoted company not treated as close) is treated as omitted.

This brings certain open companies into the scope of the SDLT surcharge: see 104.31 (Open company exemption); 104.33 (Quoted company exemption).

98.48 *Non-UK control*

Para 9 sch 9A FA 2003 provides:

> (1) For the purposes of this Schedule, a company meets the "non-UK control test" in relation to a chargeable transaction if it is a close company within the meaning given by Chapter 2 of Part 10 of CTA 2010 (basic definitions), applying that Chapter subject to the following

> modifications.
> (2) Section 439 (“close company”) applies as if—
> (a) references to a participator were to a relevant participator, and
> (b) references to five or fewer participators were to any number of relevant participators.

Amended as para 9(2) requires, s.439 CTA 2010 provides:

> (1) For the purposes of the Corporation Tax Acts, a “close company” is a company in relation to which condition A or B is met.
> (2) Condition A is that the company is under the control—
> (a) of 5 or fewer relevant participators, or
> (b) of relevant participators who are directors.
> (3) Condition B is that 5 or fewer relevant participators, or relevant participators who are directors, together possess or are entitled to acquire—
> (a) such rights as would, in the event of the winding up of the company (“the relevant company”) on the basis set out in section 440, entitle them to receive the greater part of the assets of the relevant company which would then be available for distribution among the participators, or
> (b) such rights as would, in that event, so entitle them if there were disregarded any rights which any of them or any other person has as a loan creditor (in relation to the relevant company or any other company).

Para 9(4)(5) extend the concept of close co by repeating verbatim the rules set out in para 8; see 98.47.1 (“Close company”).

98.48.1 *Relevant participator*

Para 9 sch 9A FA 2003 provides:

> (3) In sub-paragraph (2), “relevant participator” means a participator (within the meaning given by Chapter 2 of Part 10 of CTA 2010) who—
> (a) is non-resident in relation to the chargeable transaction (within the meaning of this Schedule), and
> (b) is not a general partner in a limited partnership.[97]

[97] Para 9(7) sch 9A FA 2003 provides: “The reference in sub-paragraph (3)(b) to a general partner does not include a general partner who possesses, or is entitled to acquire, rights that entitle the general partner, in the event of the winding up of the company or in any other circumstances, to receive more than 1% of the assets of the company which would then be available for distribution among its members.”

98.49 Attribution of rights and powers

Para 9 sch 9A FA 2003 provides:

> (6) Section 451 (attribution of rights and powers) has effect subject to the limitations set out in paragraph 10.

So we move on to para 10 sch 9A FA 2003, which tinkers with the Associate-attribution rule[98]:

> (1) This paragraph sets out limitations on the rights and powers of a person (A) that, apart from this paragraph, would be capable of being attributed to another person (B) under section 451(4) of CTA 2010, as that provision applies for the purposes of paragraph 9(1).

98.49.1 *Attribution: Partners*

Para 10 sch 9A FA 2003 provides:

> (2) Where A and B are partners in a partnership, no rights and powers of A may be attributed to B under paragraph (c) or (d) of section 451(4) of CTA 2010 by virtue of that fact.

98.49.2 *Attribution: Spouse*

Para 10 sch 9A FA 2003 provides:

> (3) Where—
> (a) A and B are spouses or civil partners of each other,
> (b) A and B are living together,[99] and
> (c) A is UK resident in relation to the chargeable transaction,
> no rights and powers of A may be attributed to B under paragraph (c) or (d) of section 451(4) of CTA 2010 by virtue of the fact mentioned in paragraph (a).

98.49.3 *Attribution: De minimis rule*

Para 10 sch 9A FA 2003 provides:

> (4) Where A's interest in a company is de minimis, no rights and powers of A in relation to the company may be attributed to B under any of paragraphs (a) to (d) of section 451(4) of CTA 2010.
> (5) For this purpose, A's interest in a company is "de minimis" if—

[98] See 104.7 (Associate-attribution rule).

[99] Para 10(7) incorporates the standard tax definition of "living together": see App 3.4.3 (Living together: Married couple).

> (a) the proportion of the share capital or issued share capital in the company that A possesses or is entitled to acquire is less than 5%,
> (b) the proportion of the voting rights in the company that A possesses or is entitled to acquire is less than 5%,
> (c) the issued share capital in the company that A possesses or is entitled to acquire would, on the assumption that the whole of the income of the company were distributed among the participators, entitle A to receive less than 5% of the income so distributed, and
> (d) A's rights in the company entitle A, in the event of the winding up of the company or in any other circumstances, to less than 5% of the assets of the company which would then be available for distribution among the participators.
>
> (6) Any rights A has as a loan creditor are to be disregarded for the purposes of the assumption in sub-paragraph (5)(c).

98.50 Funds

98.50.1 *Excluded companies*

REITs are generally required to be open companies, but can under certain exemptions be close.

Para 11 sch 9A FA 2003 provides:

> (1) A company is an "excluded company" for the purposes of paragraph 7(3)(c) if it is any of the following—
> (a) a PAIF [property authorised investment fund];
> (b) a body corporate that is a 51% subsidiary of PAIF;
> (c) a company UK REIT;
> (d) a company that is a member of a group UK REIT.
>
> (2) In this paragraph—
> (a) "PAIF" means a body corporate that is a property AIF for the purposes of Schedule 7A to this Act by virtue of paragraph 2(2) of that Schedule;
> (b) "51% subsidiary" has the same meaning as in the Corporation Tax Acts (see Chapter 3 of Part 24 of CTA 2010);[100]
> (c) "company UK REIT" has the same meaning as in Part 12 of CTA 2010 (see section 524(5) of that Act);
> (d) "group UK REIT" has the same meaning as in Part 12 of CTA 2010 (see section 523(5) of that Act).

[100] See 64.26 ("51/75/90 % subsidiary").

98.51 *Co-ownership contractual scheme*

Para 15 sch 9A FA 2003 provides:

> (1) Subject to sub-paragraph (2), a co-ownership authorised contractual scheme is not "non-resident" in relation to any chargeable transaction.
> (2) A collective investment scheme that is a co-ownership authorised contractual scheme by virtue of section 102A(7) (EEA schemes) is "non-resident" in relation to all chargeable transactions.

The surcharge response paper provides:

> 2.3 The consultation also set out how entities regarded as companies for SDLT purposes would be treated. Where the entity is a unit trust, residence will be based upon the SDLT residence principles as related to trusts. Where the entity is a co-ownership authorised contractual scheme (CoACS), the scheme will be treated as non-UK resident if it is constituted by arrangements that create rights in the nature of co-ownership where the arrangements take effect as a result of the law of a territory outside of the UK

98.52 Spouses

Para 12 sch 9A FA 2003 provides:

> (1) This paragraph applies where—
> (a) there are two or more purchasers in relation to a chargeable transaction who are or will be jointly entitled to the interest acquired, and
> (b) the following conditions are met in relation to those purchasers.
> (2) The conditions are—
> (a) that, on the effective date of the transaction, the purchasers, or (if there are more than two) two of them, are spouses or civil partners of each other;
> (b) that, on the effective date of the transaction, those spouses or civil partners are living together;[101]
> (c) that one of those spouses or civil partners is UK resident in relation to the chargeable transaction;
> (d) that (apart from this paragraph) one of those spouses or civil partners is non-resident in relation to the chargeable transaction;
> (e) that neither of the spouses or civil partners is acting as a trustee of a settlement.

[101] Para 12(4) incorporates the standard tax definition of "living together": see App 3.4.3 (Living together: Married couple).

> (3) For the purposes of this Schedule, the spouse or civil partner mentioned in sub-paragraph (2)(d) is UK resident in relation to the chargeable transaction.

98.53 Bare trust acquiring lease

Para 13 sch 9A FA 2003 provides:

> (1) Sub-paragraph (2) applies to a chargeable transaction if—
> (a) the purchaser is, or (if there is more than one) the purchasers include, a person (P) who is acting as a trustee of a bare trust, and
> (b) paragraph 3(3) of Schedule 16 (trustee of bare trust granted a lease treated as purchaser of the whole of the interest acquired) applies in relation to P.
>
> (2) In determining for the purposes of this Part of this Act whether the chargeable transaction is a "non-resident transaction", paragraph 2(1)(a) (condition that purchaser be non-resident) has effect as if a reference to the purchaser or purchasers—
> (a) included the beneficiary or beneficiaries of the bare trust, and
> (b) did not include P.

98.54 Trust purchaser

Para 14 sch 9A FA 2003 provides:

> (1) Sub-paragraph (2) applies to a chargeable transaction if—
> (a) the purchaser is, or (if there is more than one) the purchasers include, a person (P) who is acting as a trustee of a settlement,[102] and
> (b) under the terms of the settlement a beneficiary is entitled—
> (i) to occupy the dwelling or dwellings for life, or
> (ii) to income earned in respect of the dwelling or dwellings.
>
> (2) In determining for the purposes of this Part of this Act whether the chargeable transaction is a "non-resident transaction", paragraph 2(1)(a) (condition that purchaser be non-resident) has effect as if a reference to the purchaser or purchasers—
> (a) included the beneficiary or beneficiaries of the settlement, and
> (b) did not include P.

98.55 Alternative property finance

Para 16 sch 9A FA 2003 deals with alternative property finance (Sharia

[102] For completeness: para 14(3) provides: "In this paragraph "settlement" does not include a settlement under a unit trust scheme." Was it necessary to say this?

finance) and is not discussed here.

98.56 SDLT surcharge: administration

The Stamp Duty Land Tax (Administration) (Amendment) Regulations 2021 amended the return form.

Para 18 sch 9A FA 2003 provides:

> (1) Sub-paragraph (2) applies in relation to a land transaction return in respect of a chargeable transaction if—
> (a) in order to determine whether the chargeable transaction is a non-resident transaction, it is necessary to determine whether one or more individuals are UK resident in relation to the transaction under paragraph 4(1), and
> (b) that individual or any of those individuals, at the beginning of the day on which the land transaction return is delivered, has not yet met the condition in that provision (but might turn out to do so depending on their residence during the remainder of the relevant period).
> (2) The land transaction return must be prepared on the assumption that the individual or (as the case may be) each of the individuals is resident outside the UK throughout the period—
> (a) beginning with the day on which the land transaction return is delivered, and
> (b) ending at the end of the relevant period.
> (3) In this paragraph "the relevant period" has the same meaning as in paragraph 4(1).

98.56.1 *Individual becomes UK resident*

Para 19 sch 9A FA 2003 provides:

> (1) Sub-paragraph (2) applies where—
> (a) a land transaction return in respect of a chargeable transaction is prepared on the assumption mentioned in paragraph 18(2), and
> (b) the individual or (as the case may be) each of the individuals in respect of whom the assumption was made subsequently meets the condition in paragraph 4(1) (with the result that the transaction is not a non-resident transaction).
> (2) The land transaction return may be amended, at any time before the end of the period of 2 years beginning with the day after the effective date of the transaction, to take account of the fact that the transaction is not a non-resident transaction.
> (3) Where a land transaction return is amended under sub-paragraph (2),

> paragraph 6(2A) of Schedule 10 (notice of amendment of return to be accompanied by the contract for the transaction etc) does not apply in relation to the amendment.

98.57 Dwelling

Para 20 sch 9A FA 2003 provides:

> (1) This paragraph sets out rules for determining what counts as a dwelling for the purposes of this Schedule.
> (2) A building or part of a building counts as a dwelling if—
> (a) it is used or suitable for use as a single dwelling, or
> (b) it is in the process of being constructed or adapted for such use.
> (3) Land that is, or is to be, occupied or enjoyed with a dwelling as a garden or grounds (including any building or structure on that land) is taken to be part of that dwelling.
> (4) Land that subsists, or is to subsist, for the benefit of a dwelling is taken to be part of that dwelling.
> (5) The main subject-matter of a transaction is also taken to consist of or include an interest in a dwelling if—
> (a) substantial performance of a contract constitutes the effective date of that transaction by virtue of a relevant deeming provision,
> (b) the main subject-matter of the transaction consists of or includes an interest in a building, or a part of a building, that is to be constructed or adapted under the contract for use as a single dwelling, and
> (c) construction or adaptation of the building, or part of a building, has not begun by the time the contract is substantially performed.
> (6) In sub-paragraph (5)—
> "contract" includes any agreement;
> "relevant deeming provision" means any of sections 44 to 45A or paragraph 5(1) or (2) of Schedule 2A or paragraph 12A of Schedule 17A;
> "substantially performed" has the same meaning as in section 44.
> (7) A building or part of a building used for a purpose specified in section 116(2) or (3) is not used as a dwelling for the purposes of sub-paragraph (2) or (5).
> (8) Where a building or part of a building is used for a purpose mentioned in sub-paragraph (7), no account is to be taken for the purposes of sub-paragraph (2) of its suitability for any other use.

98.58 Surcharge: Commencement

Para 6 sch 16 FA 2021 provides:

> 6 (1) The amendments made by this Schedule have effect in relation to any land transaction of which the effective date is, or is after, the commencement date.
>
> (2) But those amendments do not have effect in relation to—
>
> (a) a transaction effected in pursuance of a contract entered into and substantially performed before the commencement date, or
>
> (b) a transaction that—
>
> (i) is entered into pursuant to a contract entered into before 11 March 2020, and
>
> (ii) is not excluded for the purposes of this paragraph.
>
> (3) A transaction is excluded for the purposes of paragraph (b) of subparagraph (2) if—
>
> (a) there is any variation of the contract, or assignment of rights under the contract, on or after 11 March 2020,
>
> (b) the transaction is effected in consequence of the exercise on or after that date of any option, right of pre-emption or similar right, or
>
> (c) on or after that date there is an assignment, subsale or other transaction relating to the whole or part of the subject-matter of the contract as a result of which a person other than the purchaser under the contract becomes entitled to call for a conveyance.
>
> (4) In this paragraph "the commencement date" means 1 April 2021.

Para 17 sch 9A FA 2003 provides:

> In a case within section 44(8) (contract substantially performed and subsequently completed by a conveyance) the later of the notifiable transactions mentioned in that provision is a "nonresident transaction" for the purposes of this Part if and only if the earlier of those notifiable transactions is a non-resident transaction for the purposes of this Part.

CHAPTER NINETY NINE

WHO IS THE SETTLOR?

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Cross references

The following topics are considered elsewhere:

Topic	**See**
Transferor/settlor compared	49.12
Trust from joint account: Who is settlor	94.4
Failure to claim right of reimbursement	101.5

99.1 Why settlors matter

This chapter discusses:

(1) The definition(s) of settlor

(2) Subsidiary questions:

- If a settlement has two settlors, what property has each settlor provided

- Whether a settlor provides additional property
- When a settlor provides property
- The concept of adding property (if different from providing property)

The identity of the settlor(s) of a settlement is important for many tax purposes. It is not practical to compile a full list, but the rules include:

Topic	**See**
Taxing settlor on trust income/gains	47.1 (Trust income); 60.3 (Trust gains)
IHT taxation of trusts	75.1 (Excluded property)
Connected person rules	104.14 (Connected: Trustees)
Reverter to settlor IHT exemption	s.54 IHTA

Residence/domicile of the settlor are appropriate connecting factors for taxation of settlors, trustees and beneficiaries. So the question of the identity of the settlor often arises in matters concerning foreign domiciliaries.

The identity of the settlor also matters for non-tax purposes. For instance, a settlor is a "controlling person" whose details need to be disclosed under CRS, and a "beneficial owner" whose details need to be disclosed under TRS.[1] The identity of the settlor may be relevant to the construction of the trust deed[2] and to the administration of the trust.

The focus of this chapter is identifying settlors; but it is sometimes convenient to address other aspects of a topic together with settlor questions.

99.2 Definitions of "settlor"

99.2.1 *Terminology*

There are three tax definitions of settlement.[3] For the purposes of this chapter (who is the settlor), the differences between them do not usually matter.

There are five tax definitions of "settlor". We need labels to distinguish them, and I use the following terms:

Definition of settlor	**Application**
Standard IT/CGT definition(s)	Default definition(s) for IT/CGT/CT
Settlement-arrangement definition	Settlor-interested trust code, & more

[1] See 130.23 (Controlling Person: Trust); 131.19 (Beneficial owner: Trust).

[2] See 87.12.3 (*Pugachev).*

[3] See 87.1 (Definitions of "settlement").

CGT s.86 definition	Applies for s.86 TCGA
IHT definition	Applies for IHT

Equipped with this terminology we can now consider the various definitions of settlor.

99.2.2 *The 5 tax definitions*

Armed with this terminology, we can turn to the definitions. It is helpful to see them side by side:

IT definition	**CGT definition**	**Settlement-arrangement**	**IHT definition**	**CGT s.86 def'n**
s.467 ITA	**s.68A TCGA**	**s.620 ITTOIA**	**s.44(1) IHTA**	**sch 5 TCGA**
(1) In the Income Tax Acts (except where the context otherwise requires)	(1) In this Act, unless the context otherwise requires—	(1) In this Chapter [Chapter 5 Part 5 ITTOIA]—	(1) In this Act	**7** For the purposes of section 86 and this Schedule,
"settlor", in relation to a settlement, means	(a) "settlor" in relation to a settlement means	"settlor", in relation to a settlement, means	"settlor", in relation to a settlement, includes	a person is a settlor in relation to a settlement if
the person, or any of the persons, who has made the settlement.	the person, or any of the persons, who has made, or is treated for the purposes of this Act as having made, the settlement ... [*note 1*]	any person by whom the settlement was made.	any person by whom the settlement was made directly or indirectly,	the settled property consists of or includes property originating from him.
(3) A person ("S") is treated for the purposes of the Income Tax Acts as having made a settlement if—.	(2) A person is treated for the purposes of this Act as having made a settlement if—	(2) A person is treated for the purposes of this Chapter as having made a settlement if	and in particular (but without prejudice to the generality of the preceding words) includes	
(a) S has made or entered into the settlement (directly or indirectly) ... [*note 2*]	(a) he has made or entered into the settlement, directly or indirectly, [*note 2*]	the person has made or entered into the settlement directly or indirectly.	[words *directly or indirectly* already included, see above]	
(5) In particular, S is treated for the purposes of the	(3) A person is, in particular, treated for the purposes	(3) A person is, in particular, treated as having made a		**8(1)** References in section 86 and this Schedule to

Income Tax Acts as having made a settlement if—	of this Act as having made a settlement if—	settlement if the person—		property originating from a person are references to—
(a) S has provided property for the purposes of the settlement (directly or indirectly), or	(a) he has provided property directly or indirectly for the purposes of the settlement, or	(a) has provided funds directly or indirectly for the purpose of the settlement,	any person who has provided funds directly or indirectly for the purpose of or in connection with the settlement	(a) property provided by that person; [*note 3*]
(b) S has undertaken to do that.	(b) he has undertaken to provide property directly or indirectly for the purposes of the settlement.	(b) has undertaken to provide funds directly or indirectly for the purpose of the settlement		

Notes

1 For s.68A(1)(b) TCGA see 99.2.12 (Property of which S is settlor)

2 For s.467(3)(b) and (4) ITA/s.68A(2)(b) TCGA, see 99.2.11 (Will trust or intestacy)

3 Para 8(1) sch 5 TCGA continues with provisions dealing with "representing" assets,[4] and para 8(7) provides:

> For the purposes of this paragraph property or income is provided by a person if it is provided directly or indirectly by the person.

For the provisions dealing with reciprocal arrangements, see 99.4 (Reciprocal arrangements).

The standard IT definition is incorporated by reference for CT.[5]

The settlement-arrangement definition originated in 1936 and is the ancestor of the other definitions.

99.2.3 *Definitions: General comments*

The first four definitions are mostly the same, and the CGT s.86 definition is only slightly different. So case law, and guidance, in the context of one definition is generally relevant to them all.

The common theme to all 5 definitions is that the settlor is the person who provides funds/property. (Two of the definitions use the word

[4] See 100.1.3 (Originating).

[5] Section 1169 CTA 2010.

"funds" where others use the word "property" but the words are synonymous; I just use the word property.) Property includes both income and capital.

The legislation sometimes refers to purpose of the settlement (in the singular) and sometimes purposes (in the plural) but there is no distinction.[6]

In most cases, the same person, the person providing funds, is the settlor under all 5 definitions and in the general sense.

Unpacking definitions 1-4, a person is a settlor if, directly or indirectly, they provide funds or:

(1) Made/enter into the settlement
(2) Undertake to provide funds

But points (1) and (2) are only relevant to a person who does not provide funds; if they provide funds, it does not matter whether they also make/enter into the settlement, or undertake to provide funds.

99.2.4 *Guidance*

Para 9(3) sch 5 TCGA refers to "providing property" for the purposes of a settlement;[7] this is the wording at the heart of the tax definitions of settlor. **SP 5/92** gives guidance on para 9(3) which is therefore relevant to all the definitions of settlor.

Similar wording is found in the definition of protected trusts. Guidance in the **Protected-trust Note**[8] is therefore also relevant.

I also refer to STEP guidance on the concept of settlor for CRS (**"STEP CRS guidance"**).[9]

99.2.5 *Are the definitions exclusive?*

The IT/CGT definitions apply "unless the context otherwise requires". This acknowledges that in some cases the settlement-arrangement or the CGT s.86 definitions may apply instead. I cannot think of any other case

[6] This is self-evident, but if authority is needed, see *Crossland v Hawkins* 39 TC 493 at p.507: "The statute seems to me to use the word 'purpose' and 'purposes' indiscriminately".

[7] See 60.8.2 (Trigger 1: Providing property).

[8] See 92.1.1 (Protected-trust guidance).

[9] CRS and Trusts (March 2017) *https://www.step.org/system/files/media/files/2020-03/Guidance_note_CRS_and_trusts.pdf*

where the context would "otherwise require".

The IT/CGT/Settlement definitions use the word "means" which is the term used for an exhaustive definition. The context shows that the words "is treated as" in the later part of these definitions also constitute an exhaustive (not inclusive) definition.[10]

The IHT definition (unlike the other definitions) uses the non-exhaustive term, "includes". The drafter of the IHT provision must have had in mind the possibility that a person might be the settlor of a settlement in the natural sense of the word, but was not within the IHT definition. It is difficult to think of such a case, but it is also difficult to say it could not happen. However that may be, for practical purposes at least, "includes" here means "means".

99.2.6 *Providing property: Bounty*

The concept of bounty (gratuitous intent) is a requirement of:

(1) the settlement-arrangement of settlement[11]

(2) providing property for the purposes of a settlement, which is part of the definition of settlor.

So cases discussing settlement-arrangement/bounty can also be relevant to the question of who is the settlor; and vice versa.[12] The common theme to the definitions is that the settlor is the person who provides property, and providing property requires an element of bounty (gratuitous intent).

The CG Manual provides:

> **CG33220: Basic terms** [Dec 2021]
> Basically under S68A(1) to (3) [TCGA] a person is a settlor if ... he has provided property for the purposes of the settlement. On the basis of *IRC v Leiner* 41 TC 589 these words are regarded as applying only where there is 'bounty'.

Similarly, Para 1 Protected-trust Note[13] provides:

[10] See App 8.4 (Deemed/treated misused).

[11] See 87.4 (Settlement-arrangement definition).

[12] See *Jones v Garnett* [2007] UKHL 35 at [83]:

> "... the definition of settlement ... and of the settlor [both in s.620 ITTOIA] are closely connected, and it appears to me to be perfectly proper to rely upon observations as to what can be taken into account when considering who is a settlor, when deciding whether there is a settlement."

[13] For the Protected-trust Note, see 99.2.4 (Guidance).

> The words 'provided …for the purposes of the settlement' connote an intention on the part of the provider to confer some bounty on the settlement or its beneficiaries (see *IRC v Leiner* (1964) 41 TC 589).

For completeness: This issue was floated in *Clipperton v HMRC*:[14]

> Where an arrangement has been found to be a settlement, which means that it involves the necessary element of bounty, we are not persuaded that a person can only be a settlor if they provide an element of bounty to that settlement. ... However, we do not need to determine this issue, and it is appropriate to leave it to a case where it is dispositive.

I do not think any inference should be drawn from a comment such as this, not just because the issue was left for another time, but because there is so much to say which the Court does not begin to consider. There are different parts to the definition of settlor. It is considered that there must be an element of bounty in order to "provide" property, and so to be a settlor under that part of the definition; any other decision would throw well established law into confusion and uncertainty. But an element of bounty is not necessary in order to make or enter into a settlement, and so to be a settlor under that part of the definition.[15]

99.2.7 *Make/enter into settlement*

A person is a settlor under three of the definitions if they make/enter into a settlement directly or indirectly. It is not obvious how one can make/enter into a settlement indirectly, but the words do show that "make/ enter into" is not to be narrowly understood.

The words "enter into" are not found in the IHT definition of "settlor". That does not make any difference. Perhaps the drafter thought that make/enter into are synonymous and there was no need for both. Or perhaps the reason is that:

(1) In the context of the settlement-arrangement definition, the word "settlement" includes not just a trust, but also an agreement or arrangement. One makes a trust. One "enters into" an agreement or arrangement.

(2) The IHT definition does not include an agreement or arrangement.

If that is right, the drafter of the standard IT/CGT definitions did not

[14] [2022] UKUT 00351 (TCC) at [129]. But the case is not yet final.

[15] See 99.39.2 (Commercial trust: Settlor).

realise it, so those definitions include the words "enter into", I think infelicitously; but no harm is done.

99.2.8 *Settlor: settlement-arrangement*

The definition of settlor for the purposes of the settlement-arrangement definition is worded (more or less) identically to the standard IT/CGT definition. But the definitions are different because although each definition uses the same word, "settlement", the word here has a different definition: it means settlement-arrangement. Where a settlement-arrangement involves a trust and other steps, it is possible that the settlor of the trust (who is the settlor under the standard IT/CGT definition) may not be the same as the settlor of the arrangement. Though in practice this has not happened. The point has been argued in the actor cases, and in the *Clipperton/Dunsby* "dividend replacement strategy" cases.[16] In *Dunsby v HMRC*:[17]

> 100. Given our conclusion as to the scope of the settlement, there is no real doubt as to the identity of the settlor – the settlor was Mr Dunsby and not G.

Why?

> ... Mr Dunsby put in place the entire arrangement that constituted the Scheme. He (as the sole shareholder of the Company) passed the resolutions that created the S share, following which (as shareholder and sole director) he permitted G to acquire the S share at its nominal value. G subsequently put that share in the Trust pursuant to arrangements again put in place by, and directed by, Mr Dunsby. The Company's board of directors, with Mr Dunsby as sole director, then resolved to pay the dividend of £200,000 in respect of the S share, which gave rise to the direct payment to him of £195,400 as we have described above.

What about G?

> 101. G was, as the FTT held at [126], "little more than a functionary" in that process. She did not have any independent role; rather she simply carried out the steps required of her under the Scheme established by Mr Dunsby, effectively as Mr Dunsby's agent or nominee.

[16] For these cases, see App. 2.2.7 (Pre-arrangement steps).

[17] For the facts see App.2.2.7 (Pre-arrangement steps).

The word “effectively” does a lot of work here.

> Nor, as the FTT noted, did she provide funds to the settlement. Her initial subscription of £100 for the S share was (in effect) refunded through the payment to her of that sum when the Company’s dividend was declared; thereafter she stood to receive 1.5% of any dividend declared by way of remuneration for her role in the Scheme. The funds settled on the Trust came entirely from the decision of the Company, with Mr Dunsby as sole director, to declare a dividend on the S share. In those circumstances we do not think that, on any realistic view, G can be described as having either “made” or “entered into” the settlement for the purposes of s 620(2) ITTOIA.

The word “realistic” does a lot of work here, as it often does. But the settlor is the same even if one looks at the classic trust alone:

> 102. We would, moreover, reach the same conclusion even if we had concluded that the settlement should be narrowly drawn by reference solely to the creation of the Trust of the S share. For the reasons set out at [100] and [101] above, we consider that the settlor of that Trust would on that hypothesis still be Mr Dunsby and not G.

One might reached the same conclusion in an easier way by saying Mr Dunsby was the settlor on the grounds that he provided that property indirectly, or that G acted at his behest.[18] There are many routes to the same destination.

99.2.9 *Undertaking to provide*

The IT/CGT and settlement-arrangement definitions provide that a person is a settlor if they undertake to provide funds directly or indirectly for the purpose of the settlement. The IHT and CGT s.86 definitions omit the reference to undertakings, but that should make no difference. An undertaking to provide is provision of property, namely, a chose in action (the undertaking).

TSE Manual formerly provided at TSEM4120:

> *In practice if someone has undertaken to provide funds, but actually does not, we would not seek to apply s.624 or s.629 ITTOIA.*

The passage was deleted in 2007, though there is no reason to think that HMRC practice has changed. It is difficult to see how s.624/629 could

[18] See 99.8 (B makes trust at A’s request).

apply, as no income arises from an undertaking (unless and until followed up by a payment).

Undertakings to provide funds are rarely found in practice so this has limited practical importance. See too 99.27 (Indemnities and guarantees).

99.2.10 *Settlor: IHT definition*

The IHT definition (only) provides that a person is settlor if they provide funds"for the purpose of or in connection with the settlement". It is considered that the additional (underlined) words make no or no significant difference, for if something is provided "in connection with" a settlement it must be provided "for the purpose of" the settlement; bearing in mind that "purpose" does not need to be a very focussed or intense purpose.[19] The attraction of this view is that it makes the "who is the settlor" area of tax law more coherent if (so far as possible) the same test applies for all the taxes.[20]

There are specific IHT provisions which may affect the identity of the settlement and settlor for IHT.[21] So sometimes a person who is the actual settlor in the general sense is not regarded as the settlor for IHT. This chapter considers the general sense of settlor.

99.2.11 *Settlor: CGT s.86 definition*

The wording is derived from the provisions dealing with multiple settlors.[22]

There are two differences between the CGT s.86 definition and the other definitions of settlor, which can be important.

The CGT definition does not have the words "make/enter into a

[19] See 99.32 (Purpose: Inattentive settlor).

[20] Why did the drafter use a different form of words, if they wanted the same result? Perhaps the reason is that "settlement" for IHT is somewhat narrower than settlement-arrangement. The drafter may have considered cases where it may have been argued that A is a settlor of a settlement-arrangement (providing property for the purpose of the *arrangement*) but A is not a settlor for IHT purposes (not providing for the purposes of the IHT-settlement). For instance in *Crossland v Hawkins* 39 TC 493 the taxpayer accepted that (if there were an arrangement) he would be the settlor of the settlement-arrangement; but he argued (unsuccessfully) that he was not the settlor of the classic settlement. To anticipate such arguments, perhaps, the drafter added the words "or in connection with".

[21] See 79.2 (Addition/transfer to trust); 75.13 (Initial interest of settlor/spouse).

[22] See 100.1.2 (Multiple settlor provisions).

settlement". This is deliberate, to exclude from s.86 an employer who makes a pension or other commercial trust.

Under the CGT s.86 definition, the settlor must provide "settled property". Under the other definitions, the settlor must provide property "for the purposes of the settlement". The s.86 definition is slightly narrower. Providing property for a company held by a trust is the provision of property for the purposes of the settlement, but it is not the provision of settled property.[23]

99.2.12 *Ceasing to be settlor*

IT definition: s.469 ITA	**CGT definition: s.68A(6) TCGA**
(1) A person ("S") who is a settlor in relation to a settlement ceases to be so when the following condition is met.	A person who has been a settlor in relation to a settlement shall be treated for the purposes of this Act as having ceased to be a settlor in relation to the settlement if—
(2) The condition is that—	
(a) no property of which S is the settlor[24] is comprised in the settlement,	(a) no property of which he is a settlor is comprised in the settlement,
(b) S has not undertaken to provide property (directly or indirectly) for the purposes of the settlement in the future, and	(b) he has not undertaken to provide property directly or indirectly for the purposes of the settlement in the future, and
(c) S has not made reciprocal arrangements with another person for that other person to enter into the settlement in the future.	(c) he has not made reciprocal arrangements with another person for that other person to enter into the settlement in the future.

The CG Manual provides a straightforward example:

> **CG33245 Settlor: from 6 April 2006: Basic principles** [Jul 2019] [The Manual paraphrases s.68A(6) TCGA and continues:] For example A and B execute a deed of variation under which property left to them by their father's will is resettled on behalf of their children. Broadly speaking half the income and capital is held for the children of A and the other half for the children of B. From the time the variation is made,

[23] See 99.24 (Property provided to co in a trust).

[24] See 99.2.13 (Property of which S is settlor).

> A and B are settlors of the settlement (see CG 33248).
> In due course the share relating to A's children has been wholly distributed. In this case we should say that A was no longer a settlor.

This rule does not apply for the settlement-arrangement definition of settlor.[25] That would not matter for the purposes of s.624, as if property is not comprised in the settlement, no income can arise from it; but it would matter for the definition of connected person. On the facts of the example in the CG Manual above, A would continue to be connected with the trustees even after the share relating to his children had been distributed, because the settlement-arrangement definition of settlor applies here. It is possible to envisage circumstances where this has important consequences, but that would not be common.

There is no equivalent in the IHT definition of "settlor", but if it mattered, the separate-settlement fiction would have a similar effect.[26]

99.2.13 *Property of which S is settlor*

This expression is used in two (relatively unimportant) provisions:

Topic	**Section**	**See**
Ceasing to be settlor	s.469 ITA/68A(6) TCGA	99.2.12
Instruments of variation		99.37

IT definition: s.467(2) ITA	**CGT definition: s.68A(1) TCGA**
In the Income Tax Acts (except where the context otherwise requires) a person is a settlor of property if—	In this Act, unless the context otherwise requires ... (b) a person is a settlor of property which—
(a) the property is settled property because of—	(i) is settled property by reason of
(i) the person's having made the settlement, or	his having made the settlement
(ii) an event which leads to the person being treated by this Chapter	(or by reason of an event which causes him to be treated under this

[25] Section 467(8) ITA provides: "This section and sections 469 to 473 do not apply for the purposes of Chapter 5 of Part 5 of ITTOIA 2005 (amounts treated as income of settlors)."

[26] See 79.5 (Separate-settlement fiction).

[Chapter 2 Part 9 ITA] as having made the settlement, or	Act as having made the settlement), or
(b) the property derives from settled property within paragraph (a).	(ii) derives from property to which sub-paragraph (i) applies.

99.2.14 *"Derives"*

"Derive" is used in the definition of settlor in s.467 ITA/68A TCGA; s.471 ITA/68B TCGA (inter-trust transfer) and the IoV settlor provisions.

IT definition s.465(7) ITA	**CGT definition s.68A(7) TCGA**
For the purposes of this Chapter [Chapter 2 Part 9 ITA] property is derived from other property if—	(7) For the purpose of this section and sections 68B and 68C property is derived from other property—
(a) it derives (directly or indirectly and wholly or partly) from that other property or any part of that other property, and	(a) if it derives (directly or indirectly and wholly or partly) from that property or any part of it, and
(b) in particular, if it derives (directly or indirectly and wholly or partly) from income from that other property or any part of that other property.	(b) in particular, if it derives (directly or indirectly and wholly or partly) from income from that property or any part of it.

99.2.15 *Settlor definitions: Critique*

Three definitions of "settlement" seems complicated, but there are material differences between them, and each definition is appropriate in its own context. However, five definitions of "settlor" is extravagant, as four of them are (more or less) identical, and the CGT s.86 definition has only small differences (and needs even fewer).

A rational tax system would have one standard definition of settlor, which would apply generally, subject to specific amendment where needed.[27] We live in bad times for UK tax policy, but eventually, perhaps,

[27] The s.86 definition needs to be different in one respect only.
Of course the definitions of settlor developed piecemeal as the tax system evolved. The FA 2006 introduced the standard IT/CGT definition but only applied it for some (not all) purposes of IT and CGT. It therefore increased the number of definitions of "settlor" and made a complex situation rather more complex. This is curious because

someone will tidy up this mess. It should not be so hard.

99.2.16 *Settlor: Non-tax definitions*

Outside tax, the word "settlor" is often used with no definition, for instance in MLR 2007.[28] Subject to context, it has its normal meaning. It is considered that means, a person who provides property for the purposes of a trust.[29] The CRS definition is (more or less) the same.[30]

99.3 Will trust or intestacy

IT definition: s.467 ITA	**CGT definition: s.68A TCGA**
(3) A person ("S") is treated for the purposes of the Income Tax Acts as having made a settlement if ... (b) the settled property, or property from which the settled property derives, is or includes property within subsection (4)	(2) A person is treated for the purposes of this Act as having made a settlement if ...
(4) Property is within this subsection if—	
(a) the settlement arose on S's death (whether by S's will, on S's intestacy or in any other way), and (b) immediately before S's death, the property was property of S— (i) which was disposable property (see section 468), or (ii) which represented S's severable share in any property to which S was beneficially entitled as joint tenant.	(b) [i] the settled property, or property from which the settled property is derived, is or includes property of which he was competent to dispose immediately before his death, and [ii] the settlement arose on his death, whether by will, on his intestacy, or otherwise.
	(5) In subsection (2)(b) "property of which he was competent to dispose immediately before his death" shall be

the authors of the 2006 reforms were emphatic that the two formerly distinct definitions of trustee residence (CGT and IT definitions) should be replaced by a single definition. But this is now of historical interest only.

[28] See 131.19 (Beneficial owner: trusts).

[29] For completeness: Art 1 Trusts (Jersey) Law 1984 provides:

> "settlor" means a person who provides trust property or makes a testamentary disposition on trust or to a trust.

This definition is (more or less) the same as the natural meaning.

[30] See 130.23.2 (Settlor).

	construed in accordance with section 62(10) (reading each reference to “assets” as a reference to “property”).

Disposable property/competent to dispose is defined as follows:

s.468 ITA	**s.62(10) TCGA as amended by s.68A(5)**
(1) This section applies for the purposes of section 467(4)(b)(i).	In this section
(2) Property is disposable if S could have disposed of it by S's will. (3) In working out whether any property could have been so disposed of— (a) make the assumptions mentioned in subsection (4), and (b) ignore the powers mentioned in subsection (5).	references to ~~assets~~ property of which a deceased person was competent to dispose are references to ~~assets~~ property of the deceased which (otherwise than in right of a power of appointment or of the testamentary power conferred by statute to dispose of entailed interests) he could, if of full age and capacity, have disposed of by his will,
(4) Assume that— (a) S is of full age and capacity,	[words *full age & capacity* already included, see above]
(b) the property is situated in England and Wales, and	assuming that all the ~~assets~~ property were situated in England
(c) if S is not domiciled in the UK, S is domiciled in England and Wales.	and, if he was not domiciled in the UK, that he was domiciled in England,
(5) The powers to be ignored are— (a) any power of appointment giving S the right to dispose of the property, and (b) any testamentary power conferred by statute to dispose of entailed interests.	and include references to his severable share in any ~~assets~~ property to which, immediately before his death, he was beneficially entitled as a joint tenant.

One might have thought that this was not needed. An intestate does not make/enter into a trust arising on intestacy; and it might perhaps be argued that a testator does not make/enter into a trust arising under their will. One might have thought that a testator or intestate provided property for the purposes of the settlement. But the cases do not support that view,[31] so express provision is needed.

This rule does not apply for the settlement-arrangement definition of

[31] See 88.8.1 (Is estate a “settlement” for s.87).

settlor.[32]

99.4 Reciprocal arrangements

A reciprocal settlement is just another way of providing property indirectly, but it is dealt with expressly in each of the five definitions:

s.467(6) ITA	**s.68A(4) TCGA**	**s.620(3) ITTOIA**	**s.44(1) IHTA**	**p.8(3) sch 5 TCGA**
If a person (“A”) makes or enters into a settlement in accordance with reciprocal arrangements with another person (“B”)—	Where one person (A) makes or enters into a settlement in accordance with reciprocal arrangements with another person (B), for the purposes of this Act—	A person is, in particular, treated as having made a settlement if the person ...	In this Act “settlor”, in relation to a settlement ... includes any person who ...	Where a person who is a settlor in relation to a settlement makes reciprocal arrangements with another person for the provision of property or income, for the purposes of this paragraph—
(a) B is treated for the purposes of the Income Tax Acts as having made the settlement, and	(a) B shall be treated as having made the settlement, and	(c) has made a reciprocal arrangement with another person for the other person to make or enter into the settlement.	has made with any other person a reciprocal arrangement for that other person to make the settlement	(a) property or income provided by the other person in pursuance of the arrangements shall be treated as provided by the settlor, but
(b) A is not to be treated for the purposes of the Income Tax Acts as having made the settlement just because of the reciprocal arrangements.	(b) A shall not be treated as having made the settlement by reason only of the reciprocal arrangements.			(b) property or income provided by the settlor in pursuance of the arrangements shall be treated as provided by the other person (and not by the settlor).

It is considered that the differences in wording do not matter.

Three of the definitions say expressly that each party is be treated as only

[32] Section 467(8) ITA provides: “This section and sections 469 to 473 do not apply for the purposes of Chapter 5 of Part 5 of ITTOIA 2005 (amounts treated as income of settlors).”

having made one settlement, not both; but that should be implied for the other two.

It sometimes happens that spouses (or other members of one family) make trusts at the same time, and each settlor may benefit under the other's trust. It is considered that these are not "reciprocal settlements" unless one trust is specifically made in return for the other.[33] The mere knowledge the two settlements are being made at the same time is not enough.

99.5 Nominal settlor

The document which creates a trust (the trust deed[34]) is typically made between two parties:
(1) a person described in the trust deed as "the settlor" and
(2) the original trustees

Sometimes the person named as settlor provides only a nominal amount of trust property (eg £10).[35] Such a person is a settlor under the standard IT/CGT definition, the settlement-arrangement definition and the IHT definition. This is for two reasons (either one would suffice):
(1) They make/enter into the settlement
(2) They provide property (even though only a nominal amount)

Such a person is called a nominal settlor. The nominal settlor is not usually the only settlor, for there will be another person who provides more substantial trust property. Practitioners sometimes express the distinction by using the term "economic settlor" to describe the person who provides the substantial trust property.[36]

[33] There is an interesting discussion of reciprocity from a sociological perspective in Bauman, *Postmodern Ethics* (1st ed, 1993), pp. 56-58.
https://www.kessler.co.uk/wp-content/uploads/2012/04/Bauman_Postmodern_Ethics.pdf
Bauman rightly observes that the essential element of reciprocity is that it affects motive. The distinction is between (1) disinterested generosity and (2) conduct inspired by considerations of self-interest. Reciprocity (like so much in life) offers shades of grey, matters of fact and degree, which the tax system must resolve into black or white.

[34] If the document is not made by deed, the correct term is "trust instrument".

[35] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 10.14 (Nominal settlor), where this style of drafting is discouraged.

[36] See App 7.7.1 (Economic terms with antonym).

The fact that the nominal settlor has provided a nominal sum, and is a settlor within the tax definitions, does not normally matter for tax. It does not normally matter for trust/property law purposes.[37] But it matters for CRS. STEP CRS guidance provides:

> **'nominal' and joint settlors**
> There may be trusts in existence where an individual (X) acts as the named settlor of the trust and contributes a nominal amount on its creation but where another individual (Y) then makes the substantive contribution of assets to the trust. In circumstances where trustees satisfy themselves that X has only made a nominal contribution to trust assets and that Y has made the substantive contribution, then applying AML/KYC [anti-money laundering/know your client] principles, Y should be regarded as the settlor of the trust for CRS purposes rather than X. However, in accordance with CRS and FATF recommendations, HMRC consider that it is also necessary to identify and disclose X as a settlor and that the full value of the trust assets should be reported with respect to both X and Y notwithstanding the fact that X had added only a nominal amount.[38]

Sometimes the person named as settlor may not provide any property at all. The trust documentation typically says or suggests that they have, but in practice I suspect it is often not done. In these cases it is suggested that:

(1) The nominal settlor is not a settlor for CRS purposes as they have not provided any property.

(2) The nominal settlor is still a settlor under those three (wider) tax definitions, because they make/enter into the settlement by signing the trust deed and assuming such powers and position as the trust deed may provide.

Sometimes the nominal sum provided by the nominal settlor is spent. The nominal settlor then ceases to be a settlor for IT/CGT purposes but

[37] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) at [214]: "At times the defendants made submissions about the intentions of the "settlor", by which they meant the trust companies. I reject that approach. It is true that these deeds are drafted so that the declaration of trust is over a nominal sum and so from that perspective the trust company could be called a settlor. However this is unreal. The real settlor of these trusts is Mr Pugachev."

[38] CRS and Trusts (2017) para 1.3 *https://www.step.org/system/files/media/files/2020-03/Guidance_note_CRS_and_trusts.pdf*

continues to be a settlor under the settlement-arrangement definition.[39]

A nominal settlor is typically the "settlor" for the purposes of the trust deed, as the term settlor is defined that way. That definition does not determine who is (and who is not) the settlor within the various tax definitions but some aspects of the general sense of settlor may seep into the statutory definitions. This may explain why no-one suggests that the original trustees are settlors, though they are parties to the trust deed. Likewise the protector is not a settlor, though the protector is sometimes a party to the trust deed.

99.6 Tainting

It does not generally matter if someone provides a trivial amount of property to a trust. But sometimes important tax consequences follow if anything is provided, even if very little. This is known as "**tainting**" a trust.[40] This may be the case whether the funds are provided by the settlor or by someone who was not the settlor.

In particular, provision of trivial funds may lose the benefit of the following reliefs:

Relief	**See para**
Protected-trust reliefs (for s.86, s.624, s.720)	92.4; 92.9.5; 92.13.5
Various transitional reliefs:	
1991 and 1998 transitional reliefs for s.86	60.6; 60.8
1998 transitional relief for s.87	61.41
Trust residence for mixed resident trustees	7.7

Unfortunately the statutory drafting is different in each of these reliefs. This does make a coherent explanation more difficult, but such is the patchwork nature of UK tax.

Para 2 Protected-trust Note[41] comments on trivial additions:

> HMRC has given no indication they would be willing to apply a de minimis disregard even though it would obviate the administrative burden of establishing evidence of intent or inadvertency. It follows that even a minimal addition can taint a settlement. However, in practice many minimal additions are unintentional and here absence of gratuitous intent would prevent tainting.

[39] See 99.2.12 (Ceasing to be settlor).

[40] This term was adopted by Parliament in F(no.2)A 2017.

[41] For the Protected-trust Note, see 99.2.4 (Guidance).

Provision of trivial funds in principle makes the provider a settlor and so a connected person.

In these cases, the question of when funds are provided may also arise.

For the position where a lender leaves a loan outstanding, see 99.26 (Loans).

99.7 A gives to B, B gives to trust

Suppose:

(1) A gives property to B unconditionally;[42] and
(2) B gives the same[43] property to a trust.

Two "settlor" questions arise:[44]

(1) In what circumstances does one say that A is the settlor of the trust, having provided the property indirectly? That is, what is the meaning of "providing indirectly"?
(2) If A is the settlor (having provided property indirectly), can one say that B is not a settlor, perhaps on the grounds that A is the "real" settlor?

One might expect to find guidance to these questions in *Hatton v IRC*.[45] The facts were as follows:

(1) Mrs Cole ("the mother") made a settlement ("the first settlement")

[42] The position is different if:
(1) The gift from A to B is made on terms which require B to transfer the property to the trust, or
(2) B holds on trust for A (which seems unlikely but that was the case in *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch), see at [205])

In these cases, clearly:
(1) A would be the settlor,
(2) B would not be a settlor.

It is also different if the gift from A to B is made by instrument of variation: see 99.37 (Trust made by deed of variation).

[43] Similar points arise if B gives other property (not the property given by A) if this is part of an arrangement between A and B.

[44] Other issues may also arise. If A is a beneficiary of the trust, A's gift to B may become a gift with reservation: see 78.6.3 (A gives to B, B gives to trust). Note that even if A is a settlor of the discretionary trust, A has not made a chargeable transfer and no IHT is payable by A on the gift to the trust by B.

[45] 67 TC 759. For another aspect of this decision see 99.33 (Purpose: Settlor's adviser/agent).

conferring on Mrs Hatton ("the daughter") a valuable equitable interest.

(2) The daughter transferred her interest to a new settlement ("the second settlement").

So this was a case of a gift to B followed by gift to trust by B.
It is important to note the background facts:

> Once the first settlement had been executed ... it was a virtual certainty that the second would be made on the following day provided that [the mother] was then still living.[46]

99.7.1 *Is A an indirect settlor?*

The Special Commissioners held:

> [the mother] was a settlor of the second settlement having directly or indirectly provided the only funds which were subjected to it.[47]

The judge held:

> The Special Commissioners ... held that [the mother] was properly to be treated as a settlor of the second settlement on the ground that, by making the first settlement, [the mother] was a person who had provided funds directly or indirectly for the purpose of or in connection with the second settlement; and so, in relation to the second settlement, fell within the definition [of settlor]. In my view, they were entitled to reach that conclusion on the facts.[48]

Hatton is a clear case of providing funds indirectly because the two gifts (from A to B, and from B to the trust) were part of an arrangement and it was a "virtual certainty" that the second gift would follow the first. Are these essential requirements? Unfortunately the Special Commissioners, and the court, did not address this point.

It is clearly not sufficient that B's funds are historically derived from A.[49]

[46] 67 TC at p.771. The Special Commissioners added:

> [The daughter] was content to leave the details to [the mother's advisers]. There was no real likelihood that she would reject the suggestion that she should make the second settlement when Mr Willcox [her adviser] put it to her.

But nothing turns on that.

[47] At p.768G.

[48] 67 TC at p.789.

[49] This is self-evident; but if authority is needed, see the quote from *Fitzwilliam* at 99.9 (Trust appoints to B, B gives to new trust).

Something more is required, but what? It might be said that all paraphrases are suspect and the court must return to the words of the statute. But when the words are so vague, some gloss is necessary to avoid hopeless uncertainty. At first sight, the concept of a "clean break" seems a useful one for determining whether property is provided indirectly. That is, if there is a clean break between A's gift to B, and B's gift to the trust, A has not provided property indirectly. But "clean break" is only a metaphor which itself needs elucidation. It is not much more than a colourful label. It is suggested that A is a settlor (having provided property indirectly) if and only if (like *Hatton*) there is an arrangement under which:

(1) A makes a gift of property to B, and intends that B should promptly make the gift to the trust.
(2) B gives the property to a trust in fulfilment of the wishes of A.
(3) It is virtually certain that B's gift will be made.

Of course, this formulation will not solve all problems, since the factual questions may arise as to whether there is an "arrangement", what is A's intention and whether B makes a gift in fulfilment of A's wishes. But this is probably the best that can be done. It is consistent with the "conscious association" comments in *Fitzwilliam*.[50] It might be said that this is too narrow a test and it favours the taxpayer as it allows tax planning of the kind considered in 99.41 (Planning to create excluded property trust). However, the planning is not all that easy! No looser test can be applied without considerable uncertainty. Moreover (see below), the consequences of A being an indirect settlor is that B is not a settlor; this suggests a narrower test is appropriate, for if B is a genuinely independent agent B should be the settlor.

99.7.2 *Is B also a settlor?*

In *Hatton* the Special Commissioners held that the daughter did not provide the funds for the second settlement.[51] The reason was, it appears, that the mother had provided the funds indirectly and this excluded the possibility that the daughter had provided them.

[50] See 99.9 (Trust appoints to B, B gives to new trust).

[51] at p.768H. Confusingly, the Special Commissioners also say that the daughter *was* a settlor within the IHT definition. The reason, presumably, is that, although she did not provide property, she was a person by whom the second settlement was made. But nothing turns on that.

The judge held on the appeal that it was immaterial (for the purposes of the IHT provisions being considered) whether the daughter was also a settlor of the settlement.[52] The judge did suggest that the daughter might also be a settlor.[53]

Approaching the matter as one of principle, untrammelled by authority, it is suggested that the Special Commissioners' approach is to be preferred. As a matter of logic it is possible for A to provide property indirectly, and B to provide it directly, but the legislation is framed on the basis that trust property can have only one "provider". This is clearly the case for the IT and CGT settlor-interested trust provisions.[54] It is suggested that the IHT definition should be construed in the same way. If property is provided indirectly by A, it should not be regarded as provided by B.

A similar issue arises in the definition of capital payment (receipt of a benefit directly or indirectly from the trustees) where a similar analysis applies.[55]

99.7.3 *HMRC views*

The TSE Manual provides:

> **TSEM4300 settlement for unmarried minor child** [Sep 2021]
> **Indirect gift of shares from parent**
> Mr J owns 60 of the 100 issued £1 shares in J Limited. Mr J is the sole company director and is the person responsible for making all the company's profits because of his knowledge, expertise and hard work. On starting up the company, Mr J allowed his mother to subscribe £40 for 40% of the shares but *shortly afterwards* she gifted them to her grandchildren. The circumstances are such that the decision to issue 40 shares at par is a bounteous arrangement (as were the shares in *Jones v Garnett*). ...

This is essentially a case of:

(1) A gift from Mr J to the grandmother; and
(2) A gift from the grandmother to the grandchildren.

[52] at p.791B.

[53] The conclusion that the mother was a settlor "did not lead, necessarily, to the further conclusion that [the daughter] was not also a settlor". See p.791B.

[54] See 100.2.1 (Direct and indirect settlors).

[55] See 61.8.1 (Indirect receipt from trust).

The Manual's tax analysis is as follows:

> The true settlor here is Mr J *rather than the children's grandmother*. Section 629 [ITTOIA] therefore applies and attributes the dividends received by the children to Mr J for tax purposes.

The words in italics suggest that HMRC accept the view set out above: if J is the settlor then the grandmother is not.

Similarly Helpsheet 270 (Trusts and settlements – income treated as the settlor's) (2016, updated 2021):

> **Example 1** (Sue and Roger)
> S gives £1,000 to her brother R to put into trust for her children. R sets up a trust with this money and although he is the named settlor in the trust deed, S is treated as the real settlor because it was she who indirectly provided (or settled) the funds.

It is implied that R is not the settlor.

99.8 B makes trust at A's request

In *Mills v IRC*:[56]

> Suppose
> [1] that a man owing a debt of honour or of gratitude to a friend, without any legal obligation proposed to discharge it by paying £1,000 to the friend, and
> [2] that the latter asks that the sum be paid not to him but to the trustees of a settlement, which is done.
>
> The payment of the money to the trustees would obviously be a provision of funds for the settlement. On a purely objective view the payer could be said to have made that provision, but I think that the friend should properly be regarded as the person making this provision. It would be just as if the money had been first paid to him and then paid by him to the trustees. *The payer would have acted at his behest*. ... the payer of the £1,000 would not have been actuated by any desire to benefit the persons interested under the trusts. Although in this instance his action would not have been self regarding, it would not have been related to any motive connected with the settlement.

In this scenario there are two persons involved, who I call the payer and

[56] 49 TC 367 at p.387 (CoA). Note that while the friend is the settlor, the friend does not make a transfer of value for IHT: only the payer makes a transfer of value.

the friend.

The comment in *Mills* is right if (as is assumed) the payer agrees (albeit without legal obligation) to make the payment at the direction of the friend so that the friend has *de facto* (though not *de jure*) power of disposition of the funds. But in practice this is not likely to arise very much. The facts have to be unusual.

The position is different if a parent proposed to make a gift to a child, and the child merely *asks* that the sum be paid to trustees of a settlement for themselves and their family. For a parent will feel moral obligations to his grandchildren as well as to the child; the parent has no (even non-binding) obligation to make a payment to the child; the child has no *de facto* power of disposition over the funds; in such circumstances the parent (not the child) is the settlor. The child has not provided funds even indirectly.

The position is different if the friend explains to the payer that the gift to the trust is the best way to benefit the friend, for then the decision to make the gift to the trust is that of the payer, not the friend.

Suppose:

(1) A asks B to transfer a nominal sum as an initial trust fund, and
(2) B does so, not because B wishes to benefit the beneficiaries by the payment, but because A has asked B to, as a favour to A

Applying the principle from *Mills*, A is the (indirect) settlor of the nominal sum. But in practice that is not likely to matter.

99.9 Trust appoints to B, B gives to new trust

Fitzwilliam v IRC concerned an arrangement under which:

(1) Trustees of a will trust exercised their power of appointment ("step 3") to confer a valuable equitable interest on a beneficiary.
(2) After a short interval,[57] the beneficiary ("B") transferred this interest to a new trust ("step 5").

So this was in essence a case of an appointment from a trust to B,

[57] Steps 3/5 took place on 14 Jan/7 Feb, so the time gap was 24 days. (The taxpayer's advisers described this a "respectable interval"). During this time the beneficiary received separate legal advice. But the decision did not turn on those facts.
The outcome would have been different if the beneficiary had been under an obligation to create the settlement at step 5 (though this possibility did not arise on the facts and was not discussed.)

followed by a gift to a new trust by B (though in the context of two artificial IHT avoidance schemes). One question was: who was the settlor of the new trust: the beneficiary or the testator of the will trust (or both). Lord Keith said:

> The argument for the Crown is that, by virtue of the appointment contained in step 3, property was provided to [B] directly or indirectly for the purpose of or in connection with the settlement which [B] later made under step 5. The person who provided that property is said to be [the testator], because the appointment by the trustees falls to be read back into his will, under the principle ... that for the purposes of the Scottish rule against successive liferents and the English rule against perpetuities the exercise of a power of appointment must be written into the instrument creating the power.[58]

This argument was rejected:

> [The testator] is, therefore, to be treated as the settlor so far as concerns the trust purposes contained in the appointment made by his trustees under step 3, but he cannot reasonably be regarded as having provided property directly or indirectly for the purpose of or in connection with the settlement made by [B] under step 5.
>
> The words "for the purpose of or in connection with" connote that there must *at least be a conscious association of the provider of the funds* with the settlement in question. It is clearly not sufficient that the settled funds should historically have been derived from the provider of them. If it were otherwise anyone who gave funds unconditionally to another which that other later settled would fall to be treated as the settlor or as a settlor of the funds. It is clear that in the present situation there cannot possibly have been any conscious association of [the testator] with [B's] settlement.[59]

It seems therefore that if:

(1) A trust ("trust 1") exists and A is its settlor
(2) There is an arrangement under which:
  (a) the trustees of trust 1 appoint trust property unconditionally to B
  (b) B gives the property to a separate trust ("trust 2")

then B will be the settlor of trust 2, and A will not be a settlor, unless the creation of trust 2 is envisaged by A at the time that trust 1 is made.

[58] See 87.5.7 (Trust appointment: Filling blanks).

[59] *Fitzwilliam v IRC* (1993) 67 TC 614 at p.732, emphasis added. HL split 3:2 on the main issue (the *Ramsay* doctrine) but the minority did not dissent on this point.

The "conscious association" test is an understandable and generally helpful paraphrase of the statutory words, though it does not solve much as:

(1) The question may arise as to what is a "conscious association".
(2) Lord Keith said there must *at least* be a conscious association, suggesting that it is a necessary, but may not be a sufficient, condition.

STEP CRS guidance adopts this approach:

> **settlors following absolute appointments**
> There will be circumstances where
> [1] trust assets are appointed from an existing trust (Trust 1) settled by A outright to B.
> [2] B then, in due course,[60] transfers some of those assets to a new trust, Trust 2.
>
> In this scenario, B should be regarded as the settlor of Trust 2 under AML/KYC principles because he has become the outright owner of assets that have then subsequently been contributed to a new trust arrangement. In these circumstances, only B should be reported as the settlor for CRS purposes.[61]

The application of the conscious association test in the context of an appointment followed by a gift is surprising, but the House of Lords have spoken. In editions of this work up to the 2021/21 edition I said "The matter is for most practical purposes ended – unless and until the Supreme Court speaks again". But time has moved on, and perhaps that exaggerates the doctrine of precedent. I do not think anyone should be surprised if the decision is narrowly interpreted, distinguished perhaps on the basis that it is a question of fact in each case, and finally, reversed.

This has implications for tax planning, see 99.41 (Planning to create excluded property trust).

99.10 Inter-trust transfer: Trust law background

A note on terminology: A transfer from one trust to another may be described as a resettlement, but I prefer to use the more transparent term

[60] Author's footnote: I think the words *in due course* suggest a fact pattern similar to *Fitzwilliam*, ie a short time gap but no obligation on B to make the transfer to trust 2.

[61] CRS and Trusts (2017) para 1.9 *https://www.step.org/system/files/media/files/2020-03/Guidance_note_CRS_and_trusts.pdf*

"**inter-trust transfer**".

99.10.1 *Role of trust law principles*

There are trust law rules which determine for trust law purposes:

(1) Whether one trust exists, or whether two (or more) distinct and separate trusts exist

(2) If two distinct trusts exist, whether trust property can be transferred, or has been transferred, from one to the other

Subject to context, and specific tax rules, these rules apply for tax purposes. That is, in the absence of specific context or rules, these questions are governed by trust law principles. These are sometimes called "general trust law" rules, meaning, I think, non-tax law rules.

There are of course differences in the trust laws of different jurisdictions. But as far as I am aware, there are no differences which might affect the question of what constitutes a separate trust for UK tax purposes, and what constitutes a transfer between trusts. In addition, in the absence of evidence to the contrary, an English court would in any event assume that English trust law principles apply.

99.10.2 *Inter-trust transfers*

There are (at least) 4 ways by which property can move between trusts (without a person becoming beneficially entitled to the property in the meantime):

(1) Trustees may exercise a power to transfer trust property to another trust. This is in practice the most common way.[62]

(2) A beneficiary with a power of appointment (typically a general power) may exercise it so as to transfer property to another trust.

(3) (a) A beneficiary who is entitled to a contingent or reversionary interest in the capital of the trust fund of trust 1 may assign that interest to trust 2; and
(b) the trustees of trust 2 in due course become absolutely entitled to the trust fund of trust 1.

(4) Beneficiaries absolutely entitled to trust property may direct the transfer of the property to another trust.[63]

[62] See 99.22 (Resettlement by beneficiaries).

[63] Further consideration is needed if the trust is not governed by English law or English law principles. In Scotland, for instance, a beneficiary with an alimentary liferent

A transfer to a separate trust needs to be distinguished from the situation where steps take place which vary the trust, but without giving rise to a transfer to another trust.

Where there is a transfer from trust 1 to trust 2, the question discussed here is who is the settlor of trust 2. Is it the settlor of trust 1 or the person(s) who brought about the transfer?

99.11 Inter-trust transfer: Appointment

99.11.1 *Trust law background*

Trustees may have power:

(1) to vary the terms of the trust ("a variation")[64]; or

(2) to transfer trust property to a distinct trust ("an inter-trust transfer").

In *Roome v Edwards*, after some general comments on the distinction,[65] the House of Lords comment in the context of trustees powers:[66]

> It is established doctrine that the trusts declared by a document exercising a special power of appointment[67] are to be read into the original settlement... If such a power is exercised, whether or not separate trustees are appointed, I do not think that it would be natural ... to say that a separate settlement had been created: still less so if it were found that provisions of the original settlement continued to apply to the appointed fund, or that the appointed fund were liable, in certain events, to fall back into the rest of the settled property.
>
> On the other hand, there may be a power to appoint and appropriate a part or portion of the trust property to beneficiaries and to settle it for their benefit.[68] If such a power is exercised, the natural conclusion might be that a separate settlement was created, all the more so if a complete new set of trusts were declared as to the appropriated property, and if it

cannot dispose of his interest in this way.

[64] One might emphasise the distinction by referring to a *mere* variation. "Appointment" is a broader term, referring to an exercise of trustees powers which may be a mere variation of the trust or an inter-trust transfer.

[65] See 99.22.2 (Variation or resettlement?).

[66] 54 TC 359 at p.390.

[67] A special power is one which is not a general power; see 87.10.1 (General power: Terminology).

[68] Modern trusts do not usually include a power in these terms, but they confer an express power to transfer to a new trust, where it is clear that the effect is an inter-trust transfer.

> could be said that the trusts of the original settlement ceased to apply to it.

These are easy cases. The passage continues:

> There can be many variations on these cases each of which will have to be judged on its facts.

See too SP 7/84.

A general power of appointment may similarly be used:

(1) in a manner which creates a new trust, or
(2) in a manner which merely varies an existing trust.

In case (2) it is considered that the powerholder is not in principle the settlor.[69]

99.11.2 *Appointment rule conditions*

There are IT/CGT rules to address trust transfers. The rules are set out twice, once for IT[70] and again for CGT.

s.470(1) ITA	**s.68B(1) TCGA**
Section 471 applies in relation to a transfer of property from the trustees of one settlement ("settlement 1") to the trustees of another settlement ("settlement 2") if the transfer—	This section applies in relation to a transfer of property from the trustees of one settlement ("Settlement 1") to the trustees of another ("Settlement 2") otherwise than—
(a) is not for full consideration,	(a) for full consideration, or
(b) is not by way of a bargain made at arm's length, and	(b) by way of a bargain made at arm's length.
(c) is not excluded by subsection (2).	

The expression "transfer of property" is widely defined:

s.470 ITA	**s.68B(2) TCGA**
(3) In this section 'transfer of property' means—	[identical]
(a) a disposal of property by the trustees of settlement 1,	

[69] The position is analogous to 99.22 (Resettlement by beneficiaries).
[70] The IT rules are incorporated by reference for CT: s.1169 CTA 2010.

and
(b) the acquisition by the trustees of settlement 2 of—
(i) property disposed of by the trustees of settlement 1, or
(ii) property created by the disposal.

and a reference to transferred property is a reference to property acquired by the trustees of Settlement 2 on the disposal.

(4) For the purposes of subsection (3) there is an acquisition or disposal of property if there would be an acquisition or disposal of property for the purposes of TCGA 1992.

Thus the grant of a lease, for example, is a "transfer" of property.

At first sight s.470 seems wide enough to cover every transfer between trusts. But the exclusions in s.470(2) are also wide,[71] and in practice s.471 usually applies on a transfer between trusts by exercise of a power of appointment. So I refer to the rules in s.470, 471 (and the CGT equivalent) as the "**IT/CGT appointment rule**". That label does not encapsulate all the circumstances where s.471 may apply, but no short label could do that.

The CG Manual explains the need for para (a) and (b):

> **CG33220: Basic terms** [Dec 2021]
> ... The reason for having these two alternatives is to allow for the possibility that S1 and S2 are connected persons (so that any transaction between them is not at arm's length by virtue of TCGA92/S18), and S1 sells an asset to S2 for its full market value. In such a case we do not want section 18 to cause section 68B to apply...

99.11.3 *IT/CGT appointment rule*

Assuming the conditions for the IT/CGT appointment rule are satisfied, we journey on:

[71] See 99.17.1 (Beneficiary assigns to trust); 99.14 (Inter-trust transfer: General power); 99.37.3 (IT/CGT: IoV post-2006).

s.470(1) ITA	**s.68B(3) TCGA**
If there is a transfer of property in relation to which this section applies, then the following subsections apply for the purposes of the Income Tax Acts, except so far as, in those Acts, the context otherwise requires.	For the purposes of this Act, except where the context otherwise requires–

Although the drafter includes the words "except where the context otherwise requires", I cannot think of a case where the context would "otherwise require". Perhaps the drafter has copied without much thought the wording used (appropriately) in s.467 ITA.[72] But perhaps a case of this kind might happen.

s.470(2) ITA	**s.68B(1) TCGA**
The settlor (or each settlor) of the property disposed of by the trustees of settlement 1 ("the disposed property") is treated from the time of the disposal as having made settlement 2.	(a) the settlor (or each settlor) of the property disposed of by the trustees of Settlement 1 shall be treated from the time of the disposal as having made Settlement 2, and

In short, the settlor of trust 1 is the settlor of trust 2.

The IT/CGT appointment rule applies for the standard IT/CGT definition, the settlement-arrangement definition, and the CGT s.86 definition.[73]

s.470 ITA	**s.68B TCGA**
(3) If there is more than one settlor of the disposed property, each of them is treated in relation to settlement 2 as the settlor of a proportionate part of the property	(b) if there is more than one settlor of the property disposed of by the trustees of Settlement 1, each settlor shall be treated in relation to Settlement 2 as the settlor of a

[72] See 99.2.1 (Terminology).

[73] For completeness: the IT/CGT appointment rule would not apply on a transfer to or from an entity which was not a settlement within the standard IT/CGT definition. A Liechtenstein Stiftung (Foundation) might perhaps be an example. But the common law rules discussed below in relation to IHT would normally give the same result; though that may depend on the terms of the Stiftung.

acquired by the trustees of settlement 2 on the disposal.	proportionate part of the transferred property.
(4) So far as the disposed property— (a) was provided for the purposes of settlement 1, or (b) was derived from property so provided, the property acquired by the trustees of settlement 2 on the disposal is treated from the time of the disposal as having been provided for the purposes of settlement 2.	(4) For the purposes of this Act, except where the context otherwise requires, if and to the extent that the property disposed of by the trustees of Settlement 1 was provided for the purposes of Settlement 1, or is derived from property provided for the purposes of Settlement 1, the transferred property shall be treated from the time of the disposal as having been provided for the purposes of Settlement 2.
(5) If as a result of subsection (4), property ("the transferred property") is treated as having been provided for the purposes of settlement 2— (a) the person who provided the disposed property, or the property from which it was derived, for the purposes of settlement 1 is treated as having provided the transferred property for the purposes of settlement 2, and (b) if more than one person provided the disposed property, or the property from which it was derived, for the purposes of settlement 1, each of them is treated as having provided a proportionate part of the transferred property for the purposes of settlement 2.	(5) If transferred property is treated by virtue of subsection (4) as having been provided for the purposes of Settlement 2— (a) the person who provided the property disposed of by the trustees of Settlement 1, or property from which it was derived, for the purposes of Settlement 1 shall be treated as having provided the transferred property, and (b) if more than one person provided the property disposed of by the trustees of Settlement 1, or property from which it was derived, for the purposes of Settlement 1, each of them shall be treated as having provided a proportionate part of the transferred property.

This could have been expressed more concisely, but it works.[74]

[74] Trust law questions also arise: whether a power can be exercised to transfer to another trust, and restrictions on perpetuity/accumulation periods. This is not discussed here.

99.11.4 *Inter-trust value shift*

The IT/CGT appointment rule only applies on a transfer of property from the trustees of trust 1 to the trustees of trust 2. So it does not apply on a transfer from a company held by trust 1; or on a transfer to a company held by trust 2. But in these cases the common law rules apply, and in principle the settlor of trust 1 becomes the (or a) settlor of trust 2.

The IT/CGT appointment rule does not apply to a transfer for full consideration, so it does not apply to an interest free loan from trust 1 to trust 2. But again, the common law rules will apply so that the settlor of trust 1 may become a settlor of trust 2.

99.12 Inter-trust transfer: IHT

The IT/CGT appointment rule only applies for IT/CGT and CT purposes. IHT has no statutory equivalent. But the IT/CGT appointment rule only codifies the general law position, which I call the "common law rules"; so the same principles apply for IHT.[75] If there is a transfer from trust 1 to trust 2, by exercise of a power of appointment, the settlor of trust 1 is in principle[76], to the extent of the transferred property, the settlor of trust 2 for IHT purposes.

HMRC agree. The CG Manual provides:

> **CG33220: Basic terms** [Dec 2021]
> ... It is not unusual for trustees to appoint or advance assets to a newly created trust. See for example *Hart v Briscoe* 52 TC 53. Courts have said, see for example *Chinn v Collins* 54 TC 311, that the trustees in such a situation are perfecting the settlor's original gift in settlement.[77] Therefore in such a case section 68B has the effect that it is the original settlor of S1 who is the settlor of S2. The property is treated as having been provided for the purposes of S2.
> [The Manual notes the 3 exceptions in s.470(2) and continues:]
> It is not considered that section 68B effected any change in the law.

Likewise, STEP CRS guidance provides:

[75] This explains why the statutory provisions (which originated in the FA 2006) were backdated and apply even if the transfer between trusts was made before 2006.

[76] This section considers the general sense of settlor for IHT purposes. Some special IHT rules apply in particular circumstances: see 79.2 (Addition/transfer to trust).

[77] Author's footnote: For the passage referred to, see App 87.5 (Providing property/bounty).

> **trust to trust appointment**
> In some cases, trusts are not established directly by a transfer of assets from an individual but by a transfer from an existing trust or similar entity such as a foundation. In these circumstances, applying AML/KYC principles, it would be necessary for a trustee of the receiving trust (Trust 2) to make enquiries of the appointing trust (Trust 1) as to who its economic settlor was when it was created. In the absence of any 'break in continuity' (for instance where the assets pass to an individual and become that individual's personal property), it will normally be safe to assume that the settlor of Trust 1 should also be regarded for CRS purposes as the settlor of Trust 2.[78]

99.12.1 *Transfer: A's trust to B's trust*

Suppose:

(1) A transfers property ("A's fund") to a trust ("trust 1"). The trustees have the standard power to transfer property to another trust.
(2) B transfers property ("B's fund") to a separate trust ("trust 2").
(3) The trustees of trust A transfer A's fund to trust 2.[79]

Trust 2 now has two settlors: A has provided A's fund indirectly, and B has provided B's fund directly. The issue was settled in CGT cases before the IT/CGT appointment rule was enacted. In *Eilbeck v Rawling*:[80]

(1) A Gibraltar trust ("Trust 1") made by A held £600k.
(2) A Jersey trust ("Trust 2") made by B held £100.
(3) £315k was transferred from Trust 1 to Trust 2 by exercise of the trustee's powers.

Buckley LJ summarised the trust law background:

> When [the donee of a special power of appointment] exercises that discretion in making an appointment, he acts as the delegate of the settlor. What the donee does in exercise of a special power of appointment is done vicariously by the settlor.

[78] CRS and Trusts (2017) para 1.2 *https://www.step.org/system/files/media/files/2020-03/Guidance_note_CRS_and_trusts.pdf*

[79] If there is an arrangement under which (1) A transfers to trust 1 and (2) the trustees transfer to trust 2, ie the transfer to Trust 2 is in contemplation at the outset, then A is the settlor of Trust 2. It is here assumed that the transfer was not in contemplation at the time of the creation of Trust A.

[80] 54 TC 101.

The answer is then clear:

> If one asks who was the settlor of the £315,000 appointed by the appointment ... the only possible answer is [A,] the settlor of the £600,000 comprised in [Trust 1]. [B] did not settle[81] the £315,000; he settled only £100. The [trustee of Trust 1] did not settle the £315,000; it was not the ... trustee's to settle, and making the appointment the ... trustee was only exercising a fiduciary power conferred on him by the settlor [A], whose delegate he was as donee of the power. The exercise of the power had, in my opinion, precisely the same effect as if the [trustee of Trust 1] had appointed the £315,000 in favour of the [trustee of Trust 2] to be held upon trusts identical with the trusts of [Trust 2] but set out in extenso in the appointment without reference to [Trust 2]. If the appointment had taken that form, there could, I think, be no doubt that the trusts so appointed would be trusts taking effect under [Trust 1].

The House of Lords approved this reasoning on appeal.[82]

HMRC agree. The CG Manual provides:

> **CG33220: Basic terms** [Dec 2021]
> ... Where trustees exercise a special power of appointment, or power of advancement, in such a way as to create a new settlement, see CG33800+, the settlor of the new settlement is the person who was the settlor of the old one. See, for example, *Pilkington v IRC*, 40 TC 416, p.442[83] and *Chinn v Collins*, 54 TC 311, p.351H.[84]

It is considered that the same applies to a transfer for less than full

[81] Buckley is using the word "settle" as a paraphrase of the statutory word "provide".

[82] It may be objected that this is not consistent with *Fitzwilliam*: see 99.9 (Trust appoints to B, B gives to new trust). There is no "conscious association" between A and Trust 2. However, *Fitzwilliam* was a case where the court found that an individual beneficiary who assigned an asset to the new trust was the "settlor". The beneficiary displaced the testator from being a settlor by their independent act. There is no equivalent here.
The alternative conclusion that Trust 2 has no settlor for general tax purposes would have the result, attractive to taxpayers but absurd, that the property in Trust 2 could be excluded property, as one could not say that "the settlor" was domiciled in the UK at the time that the trust was made! That can hardly be right.
If (which is doubtful) further authority is needed, see *Trennary v West* [2005] UKHL 5 at [49].

[83] Author's footnote: See 99.13 (Inter-trust transfer: Advancement) where this passage is set out.

[84] The same point is made again at CG Manual 34802.

consideration made in exercise of trustees dispositive powers, and to an interest-free loan from trust 1 to trust 2.

99.12.2 *Transfer to new trust*

Suppose:

(1) Trustees of a trust made by A ("trust 1") have power to transfer to a new trust.

(2) The trustees transfer the trust fund to new trustees to hold on the terms of a newly created trust, trust 2. All the funds of trust 2 are derived from trust 1.

Who is the settlor (in the general sense) of Trust 2? The trustees of Trust 1 cannot be the settlor as they have merely exercised a fiduciary power. So either A is the settlor or there is no settlor. The answer is that A is the settlor of Trust 2.

99.12.3 *Appointment rules: Critique*

It was not necessary to enact the IT/CGT appointment rule. But at present we have statutory rules for IT/CGT/CT and case law rules for IHT, the worst of both worlds. It would have been better if the IT/CGT appointment rule had not been enacted. Now we have it, a small simplification would be to extend the statutory rule to IHT so the three taxes are aligned. This would not change the law, but it would make its explanation slightly easier. But the change is more trouble than it is worth, unless it is part of a wider reform of aligning the various definitions of settlor.[85]

99.13 Inter-trust transfer: Advancement

Suppose:

(1) Trustees of trust 1 have a power of advancement (that is, a power to apply trust property for the benefit of a beneficiary).

(2) They use that power to transfer trust property to a new trust ("trust 2").[86]

The position for IT/CGT is covered by the IT/CGT appointment rule: the settlor of trust 1 is also the settlor of trust 2.

[85] See 99.2.15 (Definitions of "settlor": Critique).

[86] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 11.7 (Power of advancement used to create new trusts).

The same applies for IHT. The consent of the beneficiary is not needed and therefore the beneficiary is not the settlor of the new trust.

Pilkington v IRC concerned a proposal to transfer property to a new trust by exercise of a power of advancement in favour of a Miss Penelope:

> When one asks what person can be regarded as the settlor of Miss Penelope's proposed settlement, I do not see how it is possible to say that she is herself or that the trustees are. She is the passive recipient of the benefit extracted for her from the original trusts; the trustees are merely exercising a fiduciary power in arranging for the desired limitations. It is not their property that constitutes the funds of Miss Penelope's settlement: it is the property subject to trusts by the will of the testator and passed over into the new settlement through the instrumentality of a power which by Statute is made appendant to those trusts.[87]

HMRC agree: see CG33241 set out in 99.12.1 (Transfer: A's trust to B's trust).

If the power of advancement is used to alter the terms of an existing trust, without a transfer to a new trust, then *a fortiori* neither the trustees nor the object of the power are settlors.

In short, as far as the identity of the settlor is concerned, there is no difference between a power of appointment and a power of advancement.

The position is probably different if trust 1 is a bare trust. The beneficiary of a bare trust has in a sense provided property taken from the bare trust to trust 2, for it belonged wholly to the beneficiary before the power of appointment was exercised.

99.14 Inter-trust transfer: General power

Section 470(2) ITA/s.68B(6) TCGA set out three exceptions to the IT/CGT appointment rule. The second is:

s.470(2)ITA	**s.68B(6) TCGA**
A transfer of property is excluded for the purposes of subsection (1) if ... (b) it occurs only because of the exercise of a general power of appointment	But subsections (3) and (4) do not apply in relation to a transfer of property ... (b) which occurs by reason only of the exercise of a general power of appointment

[87] *Pilkington v IRC* 40 TC 416 at p.442.

This excludes the operation of (what I call) the IT/CGT appointment rule. It does not expressly say who is the settlor: general principles apply. The answer is clear enough.

The CG Manual provides:

> **CG33220: Basic terms** [Dec 2021]
> ... However there are three specific cases which are excluded...
> [2] Under the terms of S1 D may have a general power of appointment. If so D is the settlor (or additional settlor) of S2.

For the meaning of general power, see 87.10.1 (General power: Terminology).

99.15 Power of revocation

HMRC say:[88]

> [1] Certain trusts require the settlor to have the power to revoke the trust to safeguard the position of beneficiaries.
> [2] HMRC will not regard the failure to exercise such a power the same as an addition of property or value to the trust and therefore it will not cause the trust to lose its protection [protected trust status].

Point [1] may be a reference to US tax law, under which a power of revocation may be required for a trust to qualify as a grantor trust.[89] But the proposition at [2] must apply to all revocable trusts. It gives a sensible result. It is consistent with the rules for disclaimer.[90] It applies for IT, CGT and IHT.[91]

It is considered that waiver or non-exercise of the power does not make the powerholder a settlor or constitute a transfer of assets for ToA purposes.

[88] Open letter from HMRC to CIOT, 14 Feb 2017, posted on Trusts Discussion Forum. The same point is made in HMRC protected-trust guidance:

> 5.9 In relation to what would constitute the addition of value or property to the settlement or any underlying entity the failure of a settlor to exercise a power of revocation in respect of the settlement will not be considered as an addition of value and therefore will not taint the trust.

[89] See 90.10 (US grantor trust).

[90] See 99.18 (Disclaimer).

[91] In relation to IHT the principle could also be justified by settlement-power relief; see 74.10 (Settlement power). But it is not necessary to rely on that.

Assuming this is right, why could there be a provision of property in the case of a failure to exercise other rights, such as a right to indemnity or a right to call in a loan?[92] The difference is that a power of revocation arises under the terms of the settlement, and the other rights arise outside the settlement.

99.16 Consent to exercise power

A trust sometimes provides that the trustees can only exercise a power of appointment with the consent of a particular beneficiary (typically the life tenant). If the power of consent is wholly personal (ie proprietary),[93] this raises some intriguing questions. A concise exposition is difficult because of the variety of possible circumstances and taxes. In outline the position is as follows:

(1) A gratuitous consent to an appointment which terminates the consentor's interest in trust income probably makes the consentor the settlor, for the purposes of the settlement-arrangement definition. The consentor has provided income for the purpose of the settlement-arrangement because they have effectively given up their right to the income by their consent.[94]

[92] See 100.5 (failure to claim indemnity); 98.26.2 (On-demand loan left unpaid),

[93] On this terminology and powers of consent generally see Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 7.35 (Nature and scope of protector's power and duties).

[94] The position is analogous to an assignment or surrender of a life interest. The analogy is not exact. In one case the arrangement consists of the assignment/ surrender alone. In the other case the arrangement consists of the consent and the exercise of the trustees' power of appointment. So in a sense there is an arrangement with two settlors: (i) the consentor and (ii) the (actual) settlor of the classic settlement who conferred the power of appointment on the trustees. But HMRC (or the actual settlor) may plausibly argue that the consentor (not the actual settlor) is the settlor for the purposes of s.624. They may take support from *Braybrooke v AG* 9 HLC 149 at p.165 at *http://www.commonlii.org* (A case on the Succession Duty Act 1853 whose provisions are analogous to current definitions of settlor. Since Succession Duty was only abolished in 1949, the drafter of the original settlor-interested trust code doubtless had it in mind.) The ground of the decision in *Braybrooke* was:

> "that, although the estate of the son arose under a joint power of appointment made by his father and himself, and although therefore the father was in a sense one of the settlors, yet he was not a settlor from whom the interest or any part of the interest of the son, in his character of successor, was derived. And the decision shews that, in order to ascertain who is the settlor 'from whom the interest of the successor is derived,' we must inquire, not who are the parties by whose

(2) For similar reasons a gratuitous consent to an appointment which terminates the consentor's contingent interest in trust capital probably makes the consentor the settlor, for the purposes of standard IT/CGT and IHT[95] definitions, from the time that the contingency is satisfied. The consentor has provided capital for the purposes of the settlement because they have effectively given up their right to the capital by virtue of their consent.

(3) By contrast, the giving of the consent to an appointment does not make the consentor a settlor (for any purpose) if:
   (a) the consentor had no interest in the trust immediately before giving the consent; or
   (b) the appointment leaves the interest of the consentor in the trust unaffected.[96]

   In these cases the consentor has not provided any property by their consent.

(4) The giving of a consent is probably not a disposal for CGT[97] of:
   (a) the right to consent (even if it is extinguished); or
   (b) the consentor's interest in the trust (even if that is extinguished).

   The contrary is arguable but it would not normally matter.[98]

(5) The power to consent is not an asset in the estate of the consentor

conveyance the estate has been created, but who is the conveying party out of whose estate the interest in question has been derived." See *Att-Gen. v Charlton* (1877) 2 Ex D 398 at p.417.

[95] It is arguable that the consentor is not a settlor for IHT because the power of consent is a settlement power and so not property for IHT purposes. It is the old question of how far one carries the deeming. See App 8.2 (Deeming provisions: Construction). The better view is that the deeming does not carry that implication.

[96] This is fairly clear from first principles, but some support can be found in two cases. In *Braybrooke* (see fn above) a tenant in tail exercised his power to dispose of the lands entailed, with the consent of the protector. The protector was not the creator of the disposition: "It cannot be argued that a person whose consent is apparently necessary to a disposition, makes that disposition." In *Mills v IRC* the father's consent was apparently thought necessary for the daughter (Hayley Mills) to enter into the arrangements: see 49 TC 367 at p.403. This did not prevent Hayley being a settlor.

[97] Under general principles or by virtue of s.24 TCGA (extinction of an asset constituting a disposal).

[98] It will matter if the usual CGT exemption on the disposal of an equitable interest does not apply (eg offshore trusts). It could matter if the conditions of TCGA Sch 4A are satisfied, but that would be unusual.

because:

(a) it is not property in the general sense, or

(b) if it is property in the general sense, it is a “settlement power” and so not property for IHT.[99]

(6) The giving of the consent does not give rise to a gift with reservation since:

(a) A consent is probably not a “disposal” for the purposes of the gift with reservation rule.[100]

(b) In any event, a consent is not a disposal of property: see above.

(7) Waiver or non-exercise of the power does not make the powerholder a settlor or constitute a transfer of assets for ToA purposes.

HMRC do not appear to take any of these points at present; but cautious advisers may think that it is in principle better not to make a power of appointment subject to the consent of the life tenant (or any other beneficiary).

99.17 Beneficiary assigns interest

99.17.1 *Beneficiary assigns to trust*

Section 470(2) ITA/s.68B(6) TCGA set out three exceptions to the IT/CGT appointment rule. The first is:

s.470(2) ITA	**s.68B(6) TCGA**
A transfer of property is excluded for the purposes of subsection (1) if— (a) it occurs only because of the assignment by a beneficiary under settlement 1 of an interest in that settlement to the trustees of settlement 2	But subsections (3) and (4) do not apply in relation to a transfer of property— (a) which occurs by reason only of the assignment or assignation by a beneficiary under Settlement 1 of an interest in that settlement to the trustees of Settlement 2,

[99] See 74.10 (Settlement power).

[100] See *Baird v Baird* [1990] 2 AC 548 at 557 [the exercise of a power of appointment] “disposes of no property of the appointor”. HMRC agreed. The former CTO Advanced Instruction Manual E.91 provided:

> “Nor should you regard the giving of a consent by a limited owner to the exercise of the power of advancement as the making of a disposition.”

This passage does is not in the current IHT Manual. But there is no reason to think that HMRC have changed their view.

This excludes the operation of (what I call) the IT/CGT appointment rule. It does not expressly say who is the settlor: general principles apply. The answer is clear enough. The CG Manual provides:

> **CG33220: Basic terms** [Dec 2021]
> ... However there are three specific cases which are excluded.
> [1] A beneficiary, B, of S1 may transfer to S2 his interest in S1. In this case it is B who is the settlor (or an additional settlor) of S2.

A person who assigns an equitable interest under Trust 1 to Trust 2 is the settlor of Trust 2 but does not of course become the settlor of Trust 1.

99.17.2 *B assigns to individual*

If a person ("the assignor") assigns an equitable interest under Trust 1 to another individual there is no "Trust 2".

If the assignment is for no consideration:

(1) the assignor is the settlor for the settlement-arrangement definition[101] so far as they have provided income, but
(2) the assignor is not a settlor of Trust 1 for the IHT definition, the CGT s.86 definition, or the standard IT/CGT definition.

HMRC agree: CG Manual provides:

> **CG33220: Basic terms** [Dec 2021]
> ... Normally the same person was the settlor for both Income Tax and Capital Gains Tax. But this was not the case where a person had assigned a right to income. Such an assignment could not have affected the identity of the settlor for Capital Gains Tax purposes.

The CG Manual also provides:

> **CG34801. Meaning of settlor** [Jul 2019]
> In general if HMRC Trusts Head Office Bootle or Edinburgh, or their predecessors Financial Intermediaries and Claims Office or Claims Branch have advised or ruled that a person is the settlor for ... Part 5 Chapter 5 ITTOIA 2005 purposes then the same person should be regarded as the settlor for the purposes of these provisions. In exceptional cases, eg the assignment of a life interest, a person may have settled a right to income under an existing settlement without thereby creating a new settlement for CGT purposes. Although the Income Tax Settlements Legislation may apply as regards that income, that person is

[101] *IRC v Buchanan* 37 TC 362.

> not thereby a settlor of the main settlement. ...

The position is similar to a variation of trust by beneficiaries; see below.

If the assignment is for full consideration, the assignor is not the settlor.

Nader v HMRC concerned a tax avoidance scheme whose facts are perhaps unlikely to recur, but I mention it for completeness. There was an arrangement under which, in short:

(1) £1m was transferred (the details are not entirely clear) to a new trust under which a life tenant had an equitable interest ("the trust").

(2) D purchased the equitable interest for £1m.[102]

D was held to be the settlor of the trust. That is right, because D provided property for the purposes of the trust (looking at the arrangement as a whole); or because D provided property in connection with the trust.[103]

99.17.3 *Beneficiary surrenders interest*

If a person ("the surrenderor") surrenders an equitable interest under Trust 1 there is no "Trust 2". In that case:

(1) the surrenderor is the settlor for the settlement-arrangement definition[104] so far as they have provided income, but

(2) the surrenderor is not a settlor of Trust 1 for the IHT definition, the CGT s.86 definition, or the standard IT/CGT definition.

That is, as far as the identity of the settlor is concerned, there is no difference between a surrender and an assignment.

99.18 Disclaimer

99.18.1 *Disclaimer/waiver: Terminology*

One should distinguish between waiver and disclaimer. One usually refers to:

- **waiver** (or release) of a right which exists, eg a debt, whether payable immediately or in the future; or rent; or dividends declared but not yet

[102] The interest was in fact worthless, though in the event the trust fund passed to Miss D's family, as intended. But that makes no difference as far as the "who is a settlor" issue is concerned.

[103] [2018] UKFTT 0294 (TC). This is not quite the way that the Tribunal put the point, and there are some gaps in the Tribunal's analysis; but the Tribunal dealt with the matter very briefly, as the scheme had already failed for two other reasons.

[104] *IRC v Buchanan* 37 TC 362.

paid, or fixed dividends
- waiver of future dividends which have not been declared (where no right to the dividends exists until the dividends are declared.) I think the word disclaimer may also be apt here.
- **disclaimer** of a gift that has been made but not accepted

The words are not wholly interchangeable. One might perhaps refer to the disclaimer of a gift as a waiver; but I think it is clearer to keep the word disclaimer for this case.

99.18.2 *Disclaimer/waiver: General law*

In *Re Paradise Motor Co Ltd*:[105]

> a disclaimer operates by way of avoidance, and not by way of disposition.

TSEM provides a brief outline:

> **TSEM1840 Deed of disclaimer** [Sep 2021]
> A person uses a true disclaimer to refuse a gift due under a trust. Effectively the person steps aside. This allows subsequent provisions of the trust to take effect.
> A disclaimer can relate to
> • capital
> • income
> • both.
> A disclaimer has retrospective effect. It applies from the date that the entitlement arose. There may be a lapse of time between the entitlement arising and the disclaimer. This is not conclusive evidence that the deed cannot be a true disclaimer...
> The person making a disclaimer may still benefit from another part of the trust income or capital. This is irrelevant. If that person seeks to impose new trusts, the deed is not a disclaimer. It is an assignment (TSEM1845).
>
> **IHTM16180: Settled property: disclaimers** [Mar 2022]
> ... A disclaimer need not be made in writing. Disclaimer by action is possible although, apart from writing, an oral message to the trustees might be more common.
> Disclaimer cannot be made if the interest has been accepted, i.e. if any

[105] [1968] 1 WLR 1125 at p.1143 followed *Allied Dunbar v Fowle* [1994] BCC 422.

> benefit has been taken under it. However, where an interest in possession has vested the beneficiary can validly disclaim before any benefit has been accepted...
> Under a true disclaimer, the beneficiary in question falls out of the picture and the trusts of the will or settlement take effect ignoring that beneficiary. It follows that the beneficiary cannot purport to disclaim and redirect the benefit to someone else...

A disclaimer, if possible, may be preferable to a surrender or assignment. The distinction between disclaimer and surrender/assignment is therefore important.

In English law, there are no formal requirements for disclaimer of a gift. Waiver of a dividend usually requires a notice in writing.[106] Waiver of other rights or claims usually requires a deed to be valid. Further consideration is needed if foreign law applies.

For income tax, validity of a waiver may not matter much, as if interest/dividends are purportedly waived, the sum is not likely to be paid, even if the waiver is invalid; and income tax depends on payment. Validity could matter for other purposes.

99.18.3 *Disclaimer: IHT consequences*

There are a number of IHT provisions which say, in short, that waivers and disclaimers operate retrospectively for IHT purposes, or are to be ignored for IHT purposes.

Section 93 IHTA deals with disclaimer of an equitable interest:

> Where a person becomes entitled to an interest in settled property but disclaims the interest, then, if the disclaimer is not made for a consideration in money or money's worth, this Act shall apply as if he had not become entitled to the interest.[107]

The IHTM provides:

[106] Article 35 Model Articles for Private Companies Limited by Shares provides: "Distribution recipients may waive their entitlement to a dividend or other distribution payable in respect of a share by giving the company notice in writing to that effect...".

[107] See IHTM16180: Settled property: disclaimers [May 2020]: "The interest capable of being disclaimed need not be an interest in possession. It can be a reversionary interest, or a right under a non-interest in possession settlement. S93 says 'interest' and in the case of a NIIP [non-IIP] settlement the object has the right to be considered; which is his 'interest'."

> **IHTM16180: Settled property: disclaimers** [Mar 2022]
> ... There is no time limit within which the person may disclaim [under s.93]. This is a necessary provision because the person taking the (unwanted) benefit might do so as a result of an unexpected contingency, and many years after the trusts began.

Section 17 IHTA deals with instruments of variation:

> None of the following is a transfer of value—
> (a) a variation or disclaimer to which section 142(1) below [instruments of variation] applies ...

Section 15 IHTA deals with the waiver of dividends:

> A person who waives any dividend on shares of a company within twelve months before any right to the dividend has accrued does not by reason of the waiver make a transfer of value.

This may be otiose, on the basis that a waiver of a dividend before the right to the dividend has accrued is not a disposition, and so cannot be a transfer of value. But the point is not likely to arise.

The IHT Manual provides:

> **IHTM04220: Waiver of dividends** [Jul 2020]
> IHTA84/S15 applies only to the waiver of a dividend on shares in a company. It does not apply to the waiver or release of any other form of income, such as rent or interest on any form of debt, including debentures and loans.
> IHTA84/S15 provides only that a person does not make a transfer of value 'by reason of the waiver'. You need to be careful if the situation you are concerned with
> • is not a straightforward waiver, but
> • appears to be part of a series of operations aimed at achieving a transfer of value not related solely to the dividend waived.
> In such a situation, you should not comment on the application of IHTA84/S15 but simply obtain the facts and, when you have received them, refer the case to Technical.

99.18.4 *Disclaimer: Other tax consequences*

As a matter of property law, a disclaimer operates retrospectively between the parties to a disposition: their position is as if the disclaimed disposition had not been made. For tax law, absent a statutory provision to that effect, it is a matter of looking at the applicable provisions. There is no general principle that a disclaimer operates retrospectively for tax purposes.[108]

What if an individual disclaims a gift (lifetime gift or under a will) which is not an interest in settled property? Section 93 IHTA does not apply, but it is not needed. A disclaimer is not a disposition, so it is not a transfer of value.[109] A disclaimer is likewise not a disposal, so GWR does not apply.[110] A disclaimer may be a disposal for CGT, on the basis that it amounts to the entire loss, destruction, dissipation or extinction of an asset.[111] But a disclaimer promptly on acquisition is not likely to give rise to a gain.

It is considered that a disclaimer is not a transfer of assets for ToA purposes.

For waivers, see 15.7.1 (Waiver: Navigation).

99.18.5 *Person disclaiming: a settlor?*

TSEM provides:

> **TSEM1840 Deed of disclaimer** [Sep 2021]
> ...The person disclaiming is not a "settlor" within [the settlement-arrangement definition]. Subsequent trusts that result from the disclaimer retain their original settlor.

This is right for IHT, either as a disclaimer is not a disposition, and so not an IHT settlement; or because of s.93 IHTA discussed above. It is right for CGT.[112]

It is not clear that the TSEM statement is correct for the settlor-arrangement definition; but taxpayers will not often wish to argue the contrary, and the amounts involved are not likely to be very great.

99.18.6 *Partial disclaimer*

IHTM provides:

> **IHTM16180: Settled property: disclaimers** [May 2022]
> At English law a partial disclaimer is not possible so that the whole of the interest must be disclaimed (this however is subject to the terms of the trust)...

[108] *Re Stratton's disclaimer* [1958] Ch 42.

[109] See 74.3 (Transfer of value/value transferred).

[110] See 78.5 (Disposal by way of gift).

[111] See 56.3.1 ("Disposal").

[112] See 99.17.2 (B assigns to individual).

SP E18 provides:

> **Partial disclaimers of residue**
> Under Scots law there are certain circumstances in which a residuary legatee can make a partial disclaimer. Where this is possible the Commissioners for HMRC accept that the provisions of IHTA 1984 s 142 which deal with disclaimers, apply.

More analytically, a partial disclaimer (if possible) is a disclaimer in the ordinary sense of the word, so references to disclaimer in statutory provisions in principle include a partial disclaimer.

99.18.7 *Foreign law disclaimer*

Where the disposition is governed by foreign law, the disclaimer/ assignment distinction may be more difficult to draw.

For instance, art 10A Jersey (Trusts) Law 1984 provides:

> (1) Despite the terms of the trust, a beneficiary may disclaim, either permanently or for such period as he or she may specify, the whole or any part of his or her interest under a trust if he or she does so in writing.
> (2) Paragraph (1) applies whether or not the beneficiary has received any benefit from the interest.
> (3) Subject to the terms of the trust, if the disclaimer so provides it may be revoked in accordance with its terms.

If so, it is suggested that an act (to use a neutral term) which Jersey law describes as a "disclaimer" is not a disclaimer in the UK law sense, and in particular, is not within s.93 IHTA, if:

(1) If a beneficiary keeps a benefit; or
(2) The disclaimer is revocable (though I wonder if that ever happens in practice)

Of course the fact that Jersey law calls an act a "disclaimer" does not make it so in UK law.[113] In English law it may be an assignment or perhaps a surrender. The drafting of the legal document is likely to be very important here.

99.19 Dividend-waiver settlement

There have been two dividend-waiver cases.[114] Simplifying to bare

[113] See 90.4.1 (English language terminology).

[114] *Donovan v HMRC* [2014] UKFTT 48 (TC); *Buck v HMRC* [2008] UKSPC SPC00716.

essentials: in *Donovan,* shares were held by H (80%) and W (20%).[115] In *Buck* the disparity was more extreme as H had 999 shares and W had 1 share. In both cases, H waived dividends, so that W received dividends (and the object was that these should be taxable at W's lower rate).

Running through the s.624 issue list:[116]

(1) The waiver is a settlement-arrangement. I refer to this as a **"dividend-waiver settlement"**.
(2) H (the waiving shareholder) is the settlor.
(3) The income arising under the settlement is the additional dividend received by W (the dividend recipient) as a result of the waiver (the **"waiver-enhanced dividend"**).
(4) The property from which that income arose is:[117]
    (a) W's shares; or arguably
    (b) H's shares
    Either way this is property in which the settlor (H) had an interest.[118]
(5) The s.624 spouse exemption did not apply.[119]

Accordingly, in both cases, H is taxed on the waiver-enhanced dividend under s.624.

In the reported cases the amounts involved were modest, and the tribunal did not have the benefit of full argument by Counsel for each side. These cases did not explore two issues which might arise with waivers:

- How does one ascertain the amount of the waiver-enhanced dividend? In both reported cases dividends could not have been declared in the absence of the waivers because there were insufficient profits available for distribution. Is that essential?
- What is the property from which the waiver-enhanced dividend arises? It arises directly from W's shares, but indirectly from H's shares (which provided the waiver which allowed the waiver-enhanced dividend to be received by W).

TSEM provides:

[115] In point of detail, the company was held by two individuals and their spouses, in the proportion 80% (husbands) and 20% (spouses). But nothing turns on that.

[116] See 47.5 (Settlor-interested trust). See too 15.7 (Waiver of interest/dividends).

[117] See 47.3.1 (Property comprised in a settlement).

[118] See 47.6.2 ("Settlor-interested" for s.624).

[119] Because the arrangement is not an outright gift; see 93.15 (s.624 spouse exemption). If H had given the shares to W outright, this exemption would have applied.

> **TSEM4220: about dividend waivers** [Sep 2021]
> Where a close company declares a dividend and one or more of the shareholders waives the dividend in circumstances where other shareholders may benefit, there may be an arrangement where the settlements legislation could apply.
> In such cases, we argue that the person making the waiver has indirectly provided funds for an 'arrangement' or 'settlement' by giving up a sum to which he or she is, or may become, entitled.
> The bounty will be represented by the enhanced part of the dividend that the non-waiving shareholders received.
> Such a dividend waiver is a settlement of income and where the person benefiting under the arrangement is a spouse or civil partner the settlor will have retained an interest and ITTOIA/S624 will apply. Where the person benefiting under the arrangement is a minor child of the settlor ITTOIA/S629 will apply.

99.19.1 *Donee not spouse/minor child*

What about a dividend waiver where the dividend recipient (the non-waiving shareholder) is not a spouse/minor child of the waiving shareholder, but, say, an adult child or cohabitee? TSEM continues:

> Where the person benefiting under the arrangement is not a spouse, civil partner or minor child the settlements legislation will not apply unless there are arrangements under which the money will be paid, or used to benefit the settlor (or spouse etc).

The income arising under the settlement is the waiver-enhanced dividend. The HMRC analysis assumes, I think generously, that the property from which that income arises is the shares held by the dividend recipient (the non-waiving shareholder). Adopting the "broad and realistic" approach, which *Jones v Garnett* commends, the better view that the property from which waiver-enhanced dividend arises is or includes the settlor's shares which made the waiver possible. If that is right, then s.624 will apply even if the dividend recipient under the waiver-settlement is not a spouse or minor child. Perhaps the issue will not arise very often.

The waiver would also be caught by the income-stream code.[120]

99.19.2 *Amount of enhanced dividend*

TSEM provides:

[120] See 54.6 ("Transfer"). This was not discussed in *Donovan* and *Buck*, because they were before the income-stream code was enacted.

> **TSEM4225 dividend waiver: when settlements legislation may apply** [Sep 2021]
> Not all dividend waivers are vulnerable to challenge ...You should look out for the following factors, which would indicate that the settlements legislation is likely to apply.
> [1] The level of retained profits, including the retained profits of subsidiary companies, is insufficient to allow the same rate of dividend to be paid on all issued share capital.
> [2] Although there are sufficient retained profits to pay the same rate of dividend per share for the year in question, there has been a succession of waivers over several years where the total dividends payable in the absence of the waivers exceed accumulated realised profits.
> [3] There is any other evidence, which suggests that the same rate would not have been paid on all the issued shares in the absence of the waiver.
> [4] The non-waiving shareholders are persons whom the waiving shareholder can reasonably be regarded as wishing to benefit by the waiver.
> [5] The non-waiving shareholder would pay less tax on the dividend than the waiving shareholder...
>
> **Example 12 - dividend waivers**
> Mrs H owns 80 ordinary shares in H Limited. Mr H owns 20 shares.
> In 2020, the company made a profit of £25,000.
> Mrs H waived her right to any dividend. The company then declared a dividend of £1,000 per share, and Mr H, who had no other income, received a dividend of £20,000.

The HMRC analysis is as follows:

> No property has been transferred so the settlement is one of income. As such, the exemption for outright gifts to spouses is not in point

This is correct.

> and we would apply the settlements legislation in these circumstances. Clearly a dividend of this amount could not have been paid from the company's profits on all the shares,

That is correct assuming there are no profits available for distribution carried forward from earlier years. Perhaps with small family companies that is typically the case.

> so the waiver arrangement enhanced the dividend paid to Mr H.

> £16,000 of the dividend paid to Mr H is attributed to Mrs H under ITTOIA/S624 because the waiver was a bounteous arrangement.

The implication is that if (or so far as) the company had sufficient profits to pay the dividends without the dividend waiver(s) then there is no income arising under the settlement, in my terminology, no waiver-enhanced dividends. And that seems right, because if the company did have sufficient profit to pay all the dividends without the waiver, the effect of the waiver is not to benefit the dividend recipient (typically the spouse) directly; the effect of the waiver is to benefit the company (which enures to the benefit of all shareholders including the waiving shareholder (who is typically the largest shareholder, as was the case in *Donovon* and *Buck*).

99.20 Alphabet share arrangement

This section considers arrangements under which a company with different classes of shares may pay dividends to one class, to the exclusion of others. This is sometimes called **"alphabet shares"** and I use that term for lack of better.[121] The effect is in some ways similar to a discretionary trust, but the powers of individual(s) with control are not fiduciary, and the tax analysis is different.

Running through the s.624 issue list[122] the position is in principle as follows:

(1) The arrangement is a settlement-arrangement.[123] I refer to this as an **"alphabet-share settlement"**.
(2) A person who controls the company[124] is the settlor of the dividends because they provide the dividends (indirectly).
(3) The income arising under the settlement is the whole of the dividends.
(4) The property from which that income arose is the shares which carry

[121] The idea is an old one: it was used in *Chamberlain v IRC* where it was defeated on the Revenue's second attempt, (1945) 28 TC 88, on the basis of (now repealed) close company apportionment provisions. Alphabet shares are similar to partnerships which provide that profits are payable to partners as the partners agree. So the arrangement should not be described as contrived or artificial.

[122] See 47.5 (Settlor-interested trust).

[123] This is self-evident, but if authority is needed, see *Patmore v HMRC* [2010] UKFTT 334 (TC) at [72]: "a decision by the controlling shareholder to only issue a dividend on one class of shares rather than another ... can be an arrangement caught by [s.624]."

[124] Further thought would be needed if there is no one person with control. If two persons have control, would they be joint settlors?

control together with the shares which pay the dividends.[125]

(5) The settlor has an "interest" in that property.[126]

(6) The s.624 spouse exemption does not apply.[127]

TSEM provides:

> **TSEM4225 dividend waiver: when settlements legislation may apply** [Sep 2021]
> **Example 13 - dividends on certain shares**[128]
> Mrs I owns 80 "A" shares and Mr I owns 20 "B" shares. Both A and B shares rank equally.
> Profits of £25,000 are made and a dividend of £20,000 is voted on the B shares while no dividend is voted on the A shares.

This describes an alphabet-share arrangement. Under the company articles, typically, Mrs I (as she has control) could procure the dividend to be paid any shareholder, including herself.

The HMRC analysis is as follows:

> Clearly by not voting dividends on the A shares (which rank equally with the B shares) this is a bounteous arrangement as the dividend paid on the B shares could only be paid if no dividend was declared in respect of the A shares.[129]

There is a bounteous arrangement (ie, a settlement-arrangement) whether or not a dividend could have been paid on the A shares, since Mrs I could have paid the dividends to herself.

> £16,000 of the dividend paid to Mr I is attributed to Mrs I under ITTOIA/S624 because the decision only to vote dividends on certain shares was a bounteous arrangement.

[125] See 47.3.1 (Property comprised in a settlement).

[126] See 47.6.2 ("Settlor-interested" for s.624).

[127] See 93.15 (s.624 spouse exemption). The moral is that H should give the shares to W outright, in which case the spouse exemption would apply.

[128] I have restated the facts for clarity. The original reads:
"As in example 1, [this should read, example 12, for which see 99.19 (Dividend-waiver settlement] but in this case Mrs I owns A shares and Mr I owns B shares. Both A and B shares rank equally. Again profits of £25,000 are made and a dividend of £20,000 is voted on the B shares while no dividend is voted on the A shares."

[129] Author's footnote: It is assumed there are no profits available for distribution carried forward from earlier years.

The entire dividend of £20k should be attributed to the settlor, not just 80%. The analysis of the Manual follows its analysis of dividend waivers. But the analogy is mistaken, assuming (as is typically but not necessarily the case) that the holder of B shares has no right to any dividends unless the shareholder with control votes to declare them.

What if the B shares were held by a person other than the spouse or minor child of the settlor? The example suggests that s.624 does not apply, though the contrary view is arguable.[130]

The topic arose in *Patmore v HMRC*[131] but the facts were unusual. The judge found that the beneficial ownership of the shares was as follows:

	A shares	**B shares**[132]	**Total**
H	57.5	0	67.5
W	42.5[133]	10	52.5
Total	100	10	110

Dividends were paid on A and B shares, the amounts varying from one year to the next. The judge's solution was:

(1) Ascertain the total annual dividends, whether paid on A or B shares
(2) 42.5% of the total is regarded as income of W
(3) The balance was regarded as income of H

This could be justified by a "broad and realistic" view of what is the income arising under the settlement.[134] The key fact was that W (in short) provided 42.5% of the consideration for the acquisition of the shares. More commonly, where alphabet shares and dividend waivers are concerned, the recipient-shareholder (typically, a spouse or children or a family trust) under the arrangement does not provide any consideration. Then the *Patmore* approach will not apply.

Alphabet shares raise other issues in addition to the settlor-interested trust code. The list includes:

[130] For the reasons see 99.19.1 (Donee not spouse/minor child).

[131] [2010] UKFTT 334 (TC).

[132] The B shares had no votes, but it would make no difference if they did have one vote each, as the A shares would still have control.

[133] This was on the basis of a somewhat implausible constructive trust, but the outcome should have been the same even without the constructive trust; what mattered was that W provided (in short) 42.5% of the consideration.

[134] The tax analysis proposed here is not quite that of the judge, but once again, the judge did not have the benefit of hearing Counsel for both sides.

(1) The dividends may be employment income[135]
(2) The shares may be employment-related securities (not discussed here)
(3) The creation of alphabet shares may give rise to an IHT charge[136]
(4) Importantly: company law issues. An arrangement which works when a family is united may become unsatisfactory when members of the family fall out. Do unfair prejudice rules constrain the power of controlling shareholder(s) to declare dividends on alphabet shares to the detriment of minority shareholders?

Further thought is needed if a recipient-shareholder is non-resident or non-domiciled (ToA needs consideration) or, of course, if the company is non-resident.

Although alphabet shares are sometimes recommended as a means of holding and transferring wealth, the reader may think that taxpayers may be playing with fire. But HMRC set up a unit to review the topic of family investment companies in 2019, and announced in August 2021 that no changes were thought necessary. So they appear to have accepted the status quo. Of course, the HMRC report was not published, exactly what practices were considered and found unobjectionable is a matter of speculation, and whatever HMRC decided then, they may change their minds in the future.

The transfer of funds to a UK resident family investment company (whether with alphabet shares or not) brings the cost of a double tax charge (tax on profits at company level and tax on extraction of profits). That significant cost (to the taxpayer), or gain (to HMRC), may have informed HMRC's thinking; again, a matter of speculation.

99.21 Partnership-settlement

A partnership may of course be a settlement. TSEM provides:

> **TSEM4215: Settlements legislation: partnerships** [Jul 2017]
> The creation of a partnership may be regarded as an arrangement for transferring income from a settlor to members of his or her immediate family - see BIM82065.
> Where the incoming partner receives a share of profits out of all

[135] See 14.7.12 (Dividend/employment income). Disguised remuneration also needs consideration.

[136] See 81.7 (Change in share capital/rights). But if the company is a trading company, IHT business property relief is likely to apply.

proportion to the contribution made to the partnership, the arrangement would include an element of bounty.

99.21.1 *Partnership with spouse*

This is a settlement-arrangement (assuming bounty/gratuitous intent) and so within s.624 unless the s.624 spouse exemption applies.[137]
TSEM provides:

> **TSEM4215: Settlements legislation: partnerships** [Sep 2021]
> Where the incoming partner is a spouse or civil partner and he or she acquires an unlimited share in the partnership assets and income and there are no other arrangements or conditions applied to the gift then the exemption for outright gifts will apply and a challenge under the settlements legislation is not appropriate.
> The settlements legislation will apply where there is an arrangement under which the property received by the spouse or civil partner is wholly or mainly a right to income.

HMRC give some straightforward examples:

Example	**Facts**	**Analysis**
8	Arm's length terms (no bounty)	No settlement
Arrangements with bounty:		
9	P'ship share of income + capital	Settlement but s.624 spouse exemption
10	P'ship share of income only	Settlement, no exemption
11	P'ship capital reverts to settlor	Settlement, no exemption

> **Example 8 sleeping partner - settlements legislation does not apply**
> Mr and Mrs O and their friend Mr P have a business idea. They want to open a Cycle Repair Shop. Mrs O does not want to work but agrees to invest in the business without taking an active part, that is to say she is a sleeping partner. Each partner invests £10,000 and the £30,000 is used to lease a shop, buy equipment and stock and keep the business going until trade builds up. Under the partnership agreement Mr O and Mr P receive £500 a week with all the remaining profits split three ways between the partners.
> The business is a huge success and makes large profits and continues to grow. Within five years Mrs O is receiving £50,000 a year as her share of the partnership profits.
> Although Mrs O does not work in the business, and her initial investment has turned out to be very successful, the settlements

[137] See 93.15 (s.624 spouse exemption).

legislation would not apply to treat her share of the partnership profits as Mr O's. Mrs O's original investment was vital to get the business started and she risked losing it if the business failed.

More analytically, there is no element of bounty (gratuitous intent) and so no settlement. Though had there been a settlement, it would not have been settlor-interested.

Example 9 - Gifted shares in partnership as an outright gift not wholly or substantially a right to income
Mr Alpha and Mr Beta are in partnership as second-hand car dealers. They own the freehold premises through which the partnership trades (valued at £200,000) and routinely carry a stock of 50 used cars. The business is successful and has established goodwill in the locality as a reliable trader. It employs a number of salesmen and office staff. Profits of £100,000 a year are split equally between the partners. They decide to admit their wives to the partnership and amend the partnership agreement in order to split profits and capital equally four ways. Mrs Alpha and Mrs Beta do no work in the partnership. Although this is a bounteous transaction it is an outright gift that is not substantially a right to income and is excluded from the definition of settlement by ITTOIA/S626.

Example 10 - sleeping partner - settlements legislation does apply
Mr Y, an architect, commences business as a sole trader. The business is successful and a few years later annual profits are in the region of £80,000. The business is transferred to a new partnership of Mr & Mrs Y. A deed is executed under which income profits are to be shared equally but the rights to share in capital profits belong solely to Mr Y. Mrs Y subscribes no new capital and carries out no work whatsoever for the partnership, that is to say she is a sleeping partner. Profits for the year are £80,000 and £40,000 belongs to Mrs Y. This is a bounteous arrangement transferring income from one spouse to another. The settlements legislation will apply and Mrs Y's share of the profits will continue to be assessed on Mr Y.

99.21.2 *Partnership with non-spouse*

Where the incoming partner is not a spouse or civil partner the legislation [the settlements code] will not apply unless there are arrangements or conditions where the property can revert to the settlor (or spouse or civil partner).

Example 11 - Gift with conditions attached
Mr T is in partnership with his wife Mrs T. Their daughter is a university student. The deed is altered to admit the daughter as a partner.

> All the partners agree that on finishing her course the daughter's interest in the partnership will come to an end. The amendment of the partnership agreement under which the daughter is included without any additional capital or value being added by her is an arrangement with the requisite element of bounty. The gift from the parents is subject to conditions under which the property given will revert to them. The daughter's income is therefore treated as the income of the parents under ITTOIA/S624...

The income-stream codes also need consideration.[138]

99.22 Resettlement by beneficiaries

99.22.1 *Power to vary/resettle: Trust law background*

Beneficiaries absolutely entitled[139] under a trust may in principle:

(1) transfer trust property to a distinct trust ("a resettlement") or
(2) vary the terms of a trust ("a variation").[140]

The same trust law rules apply to an estate of a deceased person: where an estate creates a will trust, or intestacy, the beneficiaries of the estate may in principle vary or resettle the property of the estate.[141]

The variation/resettlement distinction matters for various purposes; I discuss it here because one must identify the settlement in order to identify

[138] See 54.13 (Partnership income stream).

[139] If there are minor and unborn beneficiaries, a variation requires the consent of the court under the VTA 1958 discussed in the next section.

[140] See s.1(1) VTA 1958 which assumes that beneficiaries have power to vary a trust:

> "... the court may ... approve on behalf of [unborn or unascertained beneficiaries] any arrangement ... *varying* or revoking all or any of the trusts..."

The court only approves on behalf of unborn or unascertained beneficiaries, and adult beneficiaries can make a variation without approval of the court. See *Re Holt* [1969] 1 Ch 100 at p.120:

> "Any variation owes its authority not to anything in the initial settlement but to the statute and the consent of the adults coming, as it were, ab extra. *This certainly seems to be so in any case not within the Act where a variation or resettlement is made under the doctrine of Saunders v Vautier by all the adults joining together*; and I cannot see any real difference in principle in a case where the court exercises its jurisdiction on behalf of the infants under the Act of 1958."

Further consideration is required if the trust is not governed by English law, or by a jurisdiction which adopts English law principles.

[141] But the tax consequences for an estate may be different: see 99.37 (Trust made by deed of variation).

the settlor.

99.22.2 *Variation or resettlement?*

Careful drafting can normally achieve whichever is desired.

The leading case is *Roome v Edwards* where the issue was whether the exercise of a power of appointment gave rise to a new trust distinct from the original trust. The House of Lords comment on what constitutes a distinct trust:

> There are a number of obvious indicia which may help to show whether a settlement, or a settlement separate from another settlement, exists. One might expect to find
> [1] separate and defined property;
> [2] separate trusts;
> [3] separate trustees.
> [4] ... a separate disposition bringing the separate settlement into existence.

Nowadays one would also expect to find separate registration under CRS and TRS.[142] The case continues:

> These indicia may be helpful, but they are not decisive. For example, a single disposition, eg, a will with a single set of trustees, may create what are clearly separate settlements, relating to different properties, in favour of different beneficiaries, and conversely separate trusts[143] may arise in what is clearly a single settlement, eg when the settled property is divided into shares. There are so many possible combinations of fact that even where these indicia or some of them are present, the answer may be doubtful, and may depend upon an appreciation of them as a whole.
> ... I think that the question whether a particular set of facts amounts to a settlement should be approached by asking what a person, with knowledge of the legal context of the word under established doctrine and applying this knowledge in a practical and common-sense manner to the facts under examination, would conclude.[144]

[142] See 130.23.5 (Sub-funds).

[143] The term usually used now is “sub-funds”.

[144] 54 TC 359 at p.389. Practicality and common sense seem a sound basis for approaching most questions, but how far do they take us? I suspect they are invoked most often when the writer is unable to articulate anything precise or conceptual. Lord Wilberforce also said that “settlement” and “trusts” are “terms which are also used by businessmen or laymen in a business or practical sense.” But they are not.

The CG Manual provides:

> **CG 37881 Variations of trusts** [Dec 2021]
> It is also possible, with the consent of the trustees, to vary the terms of the trust. There are all kinds of variation possible. Some property may pass absolutely to beneficiaries or existing separate settlements. Clearly this must involve disposals under TCGA 1992, s. 71(1). Other property is held on the same trusts as before and/or on different trusts.
>
> **CG37882 Separate settlements: variations of trusts: by agreement** [Dec 2021]
> In such circumstances it is necessary to consider, in the light of the principles set out in the preceding paragraphs and also CG33290-33304, what the correct analysis is. The alternatives are
> [1] mere variation of the terms of the existing settlement
> [2] continuation of the old settlement as regards part of the property, with the remainder being held on one or more new settlements
> [3] termination of the old settlement in its entirety being replaced by one or more new settlements. This last is an unlikely analysis unless a significant part of the property is being distributed absolutely. In such circumstances it may be helpful to refer to *Ewart v Taylor*[145] where one reason for the court holding that a new settlement had come into existence was that it was part of a scheme for winding up the old settlement.
>
> ...
>
> **CG37887 Separate settlements: variations of trusts: instrument of variation of will or intestacy** [Dec 2021]
> If, however, in a case where there is no such election or statement of intent [under s.62(6)(7) TCGA], the will or intestacy provided for property to be held subject to trusts, and these trusts are varied or replaced by the deed of variation, then there are two questions to be answered.
> a. Is there a new separate settlement?
> b. If so, who is the settlor of that settlement?
>
> If there are only minor variations clearly there is no new settlement and the deceased remains the settlor. Minor variations would include for instance changes in the administrative powers of the trustees, or the provision of an ultimate gift over, that is, a provision saying to whom

If business or lay persons were asked what these terms meant, they would say "You had better ask a lawyer".

But perhaps nothing turns on these observations.

[145] 57 TC 401 at p.468, Section I.

> the property is to pass if the trusts fail, or the appropriation of property to particular funds within the settlement. Otherwise it is necessary to determine whether there is a new settlement in accordance with the principles explained at CG37882, and see CG37889. If there is a new settlement then the identity of the settlor should be determined in accordance with CG37900. ...

99.22.3 *Will varied: NRB band trust*

The CG Manual provides:

> **CG37889 Separate settlements: variations of trusts: instrument of variation of will or intestacy** [Dec 2021]
> One situation which has been quite common[146] is where under the will there is a life interest trust for the spouse of the deceased. For Inheritance Tax reasons this is partly varied so that there is a discretionary trust up to the amount of the Inheritance Tax nil rate band. In such a case, where the spouse continues to be a beneficiary of the new discretionary trust, it would often be appropriate to regard this, except for the purposes of Inheritance Tax, as little more than a cosmetic arrangement, particularly if the broad intention is that the bulk of the income should be paid to the spouse. So this would be regarded for Capital Gains Tax purposes as a variation of the original will trust, and not as giving rise to a new separate settlement. The deceased remains the settlor.

Is the arrangement is aptly described as "little more than cosmetic"? If that is how the parties understand it, have they have misunderstood the position? Discuss. But it does not much matter.

More analytically, whether or not the discretionary trust fund constitutes a distinct trust from the rest of the trust fund would depend on the drafting: it would be possible to achieve a resettlement. But in practice the drafting is not likely to be done that way. If the parties to the variation are the spouse and the trustees but not all the other beneficiaries, there could not be a resettlement. See too 99.17 (Beneficiary assigns interest).

99.22.4 *Resettlement: Who is settlor?*

A resettlement (unlike a variation) involves a possible change of settlor.

The CG Manual provides:

[146] Author's footnote: This ceased to be common after the introduction of transferable nil-rate bands in 2007, but that does not affect the point being made.

> **CG37900. Identity of settlor** [Dec 2021]
> Where there is a variation of a trust of the kind described in CG37880+ [variation by beneficiaries] it is necessary to identify the settlor. If the conclusion taken is that there are no new settlements then for CGT purposes the identity of the settlor is unaffected. However if in effect interests in income have passed from one person to another, the former may well be the settlor of an arrangement for Income Tax purposes.
>
> **CG37901. Identity of settlor** [Dec 2021]
> If however one or more new settlements have come into existence, then the settlors of those settlements are one or more of the parties to the variation. The question should be tackled on a practical basis by determining where each beneficiary's share has gone. ...
>
> **CG37903. Example** [Dec 2021]
> Under a settlement made by X, A and B are each entitled to half the income. On A's death his son P will get half absolutely. On B's death her daughter Q will get half absolutely. The values of their respective interests are, say:

A's life interest	£60,000 [30% total value]
P's remainder	£40,000 [20% total value]
B's life interest	£75,000 [37.5% total value]
Q's remainder	£25,000 [12.5% total value]

> Under the variation, executed when all the beneficiaries are adults, which is considered to terminate the old settlement:
> A takes 30% of the property.
> 20% goes to a new accumulation and maintenance settlement for P's children.
> B takes 25% of the property.
> The rest [25%] is held for Q for life with remainder to Q's son R.
> P should be regarded as the settlor, for the purpose of the annual exempt amount, of the accumulation and maintenance settlement, because this is how his share has been dealt with.
> B and Q should be regarded as the settlors of the other settlement. ...

B and Q are joint settlors: see 100.1 (Trusts with two settlors).

99.23 Variation under VTA 1958

99.23.1 *VTA law background*

Section 1 VTA 1958 provides (so far as relevant):

> (1) ... the court may ... approve on behalf of—
>
> (a) any person ... who by reason of infancy or other incapacity is incapable of assenting, or

> (b) any person ... who may become entitled... to an interest ... or
> (c) any person unborn, or
> (d) any person in respect of any discretionary interest of his under protective trusts ...
>
> any arrangement ... varying ... the trusts ...
> Provided that except by virtue of paragraph (d) of this subsection the court shall not approve an arrangement on behalf of any person unless the carrying out thereof would be for the benefit of that person.

The CG Manual summarises:

> **CG37883. Under Variation of Trusts Act** [Dec 2021]
> The trusts of an existing settlement may be varied (in particular when the interests of unborn or minor beneficiaries are involved) by way of an Arrangement agreed between those parties of full age and approved by a Court Order under the Variation of Trusts Act 1958 (in Scotland Section 1 Trusts (Scotland) Act 1961) on behalf of those unable to give consent. ...

99.23.2 *VTA variation or resettlement*

The CG Manual provides:

> **CG37884 Separate settlements: variations of trusts: under Variation of Trusts Act** [Dec 2021]
> If so the principles of CG37880 – CG37882 apply. The degree of variation may exceptionally be such as to involve the termination of the original settlement in whole or in part and the creation of a new settlement. The fact that the courts may only consent to variation of the trusts does not prevent this. (If so then consideration must be given to the identity of the settlor, see CG37900.) ...

But the power under the VTA is a power to *vary* trusts, so the court order cannot have the result of an inter-trust transfer. This is confirmed by *Wyndham v Egremont*:

> [25] ... The concern here is whether, on the ground that they give rise to a resettlement, the variations to the trust, principally the extension of the trust period, might be said to give rise to a 'deemed disposal' under s 71(1) TCGA or might lead to adverse consequences for inheritance tax or stamp duty land tax purposes. I propose to take this very shortly because, in my view, [*Roome v Edwards*] is in point. I do not consider ... that the arrangement does give rise to a resettlement.[147]

[147] 12 ITELR 461 at p.471.

99.23.3 *Tax consequences of variation*

Where a court approves a variation of trust on behalf of a minor beneficiary, under the VTA, it is considered that the minor beneficiary does not become a settlor for two reasons (either of which would suffice):

(1) It is not likely that the minor provides any property. The variation must be for the benefit of the minor.

(2) The court in giving its approval does not merely act on behalf of the minor: the court has a wider role.[148] The position is analogous to trustees exercising a power of advancement.[149]

HMRC may not agree with point (2). CG Manual provides:

> **CG37902 Minor as settlor** [Dec 2021]
> It is considered that where a court has given consent on behalf of a minor, that minor can be a settlor. The authority lies in *Yates v Starkey*, 32 TC 38, where it was held that a person could be a settlor under compulsion, and *Mills v IRC*, 49 TC 367, where it was held that a minor with very little involvement in the transactions could be the settlor because she provided the property.

Neither of these cases compels a court to accept the HMRC view. But in practice the issue is unlikely to arise.

99.24 Property provided to co in a trust

HMRC take the view that providing property to a company owned by a trust is in principle provision of property for the purposes of the trust, and so makes the provider a settlor. SP 5/92 provides:[150]

> 16 The condition in TCGA Sch 5 para 9(3) may be satisfied where property or income is provided to a company in which the trustees are participators.[151]

[148] *Re Steed* [1960] 1 Ch 407; *Re Remnant* [1970] Ch 560. This view is consistent with the fact that where a court approves a variation on behalf of an unborn beneficiary, that beneficiary clearly does not become a settlor.
Further consideration is needed if foreign trust laws apply.

[149] See 99.13 (Inter-trust transfer: Advancement).

[150] For SP 5/92 and para 9(3) see 99.2.4 (Guidance).

[151] The SP continues with an exception:
"Where, however, the transaction is carried out with the sole object of leaving funds within the company for the company's purposes and it can be shown that any indirect benefit to the trust is merely incidental to that object, the transaction

This is supported by some case law.[152] It is correct for 3 definitions of settlor: the standard IT/CGT definition, the settlement-arrangement definition and the IHT definition.

However, for the CGT s.86 definition of settlor, the question is not whether a person has provided property for the purpose of the settlement. The question is whether a person has provided *settled property*. So if a person only provides property for a company held by a trust, the person is not the settlor under this definition.[153] It is suggested that the s.86 definition wording ought to be aligned with the other definitions.

99.24.1 *Transfer within trust/co group*

SP 5/92[154] para 18 provides:

> In general, transactions between trustees and companies which they, directly or indirectly, wholly own, or between such companies, are outside the scope of TCGA 1992 Sch 5 para 9(3).[155]

This is right. There can be no element of bounty (gratuitous intent) so a wholly-owned company cannot "provide" property to its owner, just as a 100% shareholder cannot "provide" property to their company.

> is disregarded for the purposes of para 9(3).
> 17 Examples of transactions which may be so disregarded are—
> – where another shareholder waives an entitlement to all or part of a dividend; or
> – where a director restricts withdrawals of remuneration voted,
> in order to assist the company's cash flow, and no payments are made, directly or indirectly, to the trustees as a result of this. All relevant factors will be considered in determining whether it is appropriate to apply this practice in a particular case."

[152] Comments in *Crossland v Hawkins* 39 TC at p.506 followed in *Mills v IRC* 49 TC 367.

[153] See *Coombes v HMRC* [2007] EWHC 3160 (Ch) discussed App 2.9.6 (Do shares represent co assets).

[154] For SP 5/92 and para 9(3), see 99.2.4 (Guidance).

[155] The SP sets out a commonsense definition of "wholly owned" and continues with a qualification:

> "This approach may not, however, be taken where, on the facts of a particular case, it appears that the transaction has been entered into solely or mainly for the purposes of obtaining a UK tax advantage."

Similarly, para 17 Protected-trust Note provides:

> "A loan or other transaction between the trustees and a company wholly owned by the trust cannot result in tainting as no value is being provided to the trust structure."

For s.87 aspects of transactions within a trust/company structure, see 61.12 (Trust/company group disregard).

99.25 Provision of services

99.25.1 *Service envisaged at outset*

It is clear that a person who provides services ("a service-provider") may be a settlor; but not everyone who provides services is a settlor.

In the following discussion:

(1) **"Settlor-services"** make the service-provider a settlor
(2) **"Non-settlor services"** do not make the service-provider a settlor

Two cases (the "film star" cases) provide examples of settlor-services. In these cases:

(1) A friendly third party created a trust.
(2) The trust acquired a company.[156]
(3) A well-known actor (Jack Hawkins/Hayley Mills) entered into a contract[157] to provide services to the company at an undervalue.
(4) The company resold the actor's services and duly received what the earlier case described as an "enviable" fee.
(5) The company made profits and paid dividends to the trustees.

In both cases the classic trust created at step (1) was a settlement-arrangement. The question was who was the settlor. It now seems obvious that the actor was the settlor. By the time of *Jones v Garnett*, where Mr Jones worked at an undervalue for the one-man company owned by himself and his wife, everyone agreed he was the settlor.

Viscount Dilhorne in *Mills v IRC* considered two situations where the provision of services did not make a service-provider a settlor:

[156] The company was UK resident, so transfer of assets abroad issues did not arise. In *Crossland v Hawkins* the company was created first, and it was said (implausibly) that the trust was not contemplated at that time; but that made no difference: see App 2.2.4 (Identifying the arrangement).

[157] The position is clearer where there is a contract between the service-provider and the underlying trust company. Then the service-provider indirectly provides *two* assets for the purposes of the settlement:
(1) the contract; and
(2) the dividends
So then there are *two* reasons why the service-provider is a settlor. But provision of dividends alone, without a contract, is sufficient to make the service-provider a settlor. In *Jones v Garnett* there was no contract between the service-provider (Mr Jones) and the company, but that made no difference. A contract also makes no difference to the issue of bounty (gratuitous intent); see 87.5.4 (Applying bounty test).

(1) Employees of a company held by trustees increase the company's profits, and the trust income, by their work.
(2) A stockbroker who gives good advice increases the trust fund.

> in a sense all the employees of a public company, some shares in which are held by trustees of a settlement, could be said to contribute to the profits of the company and so to the shareholders' dividends or the value of their shares, and so to the income of the settlement or the value of its capital assets. If ... activities which result in an increase in the income or value of a settled fund can constitute the provision of funds for the settlement, it might be said that every employee of such a company in some measure provides funds for a settlement on the trusts of which some shares of the company are held; but it would be ridiculous to suppose that Parliament intended that in such a case every employee of the company should be treated as a settlor.
>
> A stockbroker who advised trustees of a settlement to invest part of their trust fund in shares of a company which he expects to be shortly taken over on advantageous terms, including, perhaps, a payment in cash over and above the existing market value of the shares, might in the event of his expectations being fulfilled be said in a sense to have provided funds for the purpose of the settlement. The exercise of his personal skill or specialised knowledge would have resulted in an increase in the assets of the trust, but I cannot suppose that Parliament intended that such a man should be treated as a settlor.

No-one would suggest otherwise, but why not? There are two reasons, either of which would suffice. The first is that the service-provider may not act with bounty (gratuitous intent). In the CoA:

> One reason, in my opinion, why the definition of "settlor" ... would not apply to either of these cases is that neither the employees of the company nor the stockbroker would have been concerned with the objects or purposes of the settlement. The employees of the company would in all probability have been entirely ignorant of the settlement.[158] The stockbroker would have been likely to have known of the settlement's existence and would have advised the trustees with a view to advancing the interests of the trust, but would have done so for reward in the ordinary course of his professional business.[159]

In these cases there is no element of bounty (gratuitous intent). Clearly a

[158] But nowadays the beneficial ownership of the company may be publically known.

[159] 49 TC 367 (CoA) at p.387.

service-provider is not a settlor unless they provide bounty (gratuitous intent) but what if they do act with gratuitous intent? For instance, suppose the stockbroker chose not to charge for their services?[160] Viscount Dilhorne did not rely only on the bounty point:

> The difference between those cases, on the one hand, and *Crossland v Hawkins* and this case [*Mills*], on the other, is that in *Crossland v Hawkins* and in this case funds which ordinarily would have been received by Mr. Hawkins and by Miss Mills for their acting were diverted to companies which were channels for their transmission to trustees. It is not the provision of services but of funds which comes within the section.[161]

The distinction is not between provision of services and provision of funds, because the actors did provide services; the key feature is the provision of services which yields funds *which would otherwise be received by the provider*. It is considered that someone who provides services is a settlor if one can identify funds which:

(1) would (in the absence of the settlement) have been received by the individual, but
(2) were diverted to the trust.

If that is right, settlor-services are effectively restricted to "one-man companies" with no substantial capital (as was the case in *Mills, Hawkins*, and *Jones v Garnett*).

It appears that HMRC agree. The TSE Manual provides:

> **TSEM4300 - Settlement For Minor Child** [Sep 2021]
> **...Indirect gift of shares from parent**
> Mr J owns 60 of the 100 issued £1 shares in J Limited. Mr J is the sole company director and is the person responsible for making all the company's profits because of his knowledge, expertise and hard work. On starting up the company, Mr J allowed his mother to subscribe £40 for 40% of the shares but shortly afterwards she gifted them to her grandchildren.

There is clearly a settlement-arrangement, but who is the settlor, is it J or his mother? There are two reasons why J may be the settlor:

[160] It is still a principle (notwithstanding wide exceptions) that trustees should act gratuitously; but no-one suggests that trustees thereby become settlors.

[161] 49 TC 367 at p.408.

(1) J has provided the grandchildren's shares indirectly by an arrangement under which J provided the shares to his mother, and the grandmother to the grandchildren.
(2) J has provided the dividends paid to the grandchildren by providing his services to the company at an undervalue.

The HMRC analysis takes point 1:

> The circumstances are such that the decision to issue 40 shares at par is a bounteous arrangement (as were the shares in *Jones v Garnett*). The true settlor here is Mr J rather than the children's grandmother. Section 629 [ITTOIA] therefore applies and attributes the dividends received by the children to Mr J for tax purposes.

The example derives from Tax Bulletin 64 Example 9, where the HMRC analysis takes point 2:

> Since Mr. J
> [1] is the person responsible for making the company's profits and
> [2] decides on the level of dividends paid,[162]
> it is Mr. J who is the settlor rather than the children's grandmother.[163]

Suppose an investment adviser who is well disposed to the trust (perhaps a trustee or a beneficiary or a parent of beneficiaries) gives free investment advice to trustees to invest in quoted (easily obtainable) investments, and the trust profits from acting on their advice. There is an element of bounty but the adviser has not provided funds and is not the settlor. One cannot identify funds which would ordinarily have been received by the adviser. On the contrary, the adviser was free (if they had the resources) to make the same investments as those recommended to the trustees. This is a clear case.

Suppose a property developer who is well disposed to the trust gives free property market advice to trustees, and the trustees use their own funds invest in land successfully because of the advice. The developer has not provided property and is not the settlor. One cannot identify funds which

[162] It is hard to see the relevance of [2]; point [1] is the key point.

[163] The passage continues: "The legislation could apply in a similar way if the children had subscribed for shares themselves with money received from a third party or even from bank accounts in their own names." That is correct as a matter of tax law, but from a company law viewpoint, the children (minors) could not properly subscribe for shares.)

would ordinarily have been received by the developer.[164]

Suppose a director of a company held on trust seems reasonably well remunerated but HMRC argue that the remuneration is insufficient. Even if HMRC are right, the individual is not the settlor, because one cannot identify funds which would have been received by the director.

99.25.2 *Service not envisaged at outset*

What is the position if:

(1) a company is up and running and well established;

(2) an individual ("T") *subsequently* provides services at an undervalue (to benefit shareholders).

The question may arise in three circumstances:

Case 1 Shares may be held by a spouse or minor children
Case 2 Shares may be held by a trust:
Case 2(a): of which some other person is the settlor; or
Case 2(b): of which T is the settlor

In case 1 there is (or may be) no settlement-arrangement before T begins to provide T's services. The question is whether a settlement-arrangement comes into existence.

In case 2 there is a settlement already. The question in Case 2(a) is whether T becomes the settlor. In case 2(b) T is already the settlor. The question is whether T provides further property (which might taint the settlement).[165] Of course, all these questions are related and they come down to the same question: does T (gratuitously) provide property for the purposes of the settlement? It is suggested that the answer is, strictly, yes, if one can identify funds that T has provided, in short, if T is a one-man company; see above. But it appears that HMRC do not take the point.[166]

99.25.3 *Providing investment opportunity*

Suppose:

(1) an individual ("T") has an opportunity of purchasing land, or shares in a private company;

(2) T allows the trust to take up the offer by advising the trust and not

[164] But the transactions in land code would need consideration; see 22.5 (Transactions in land: Introduction).

[165] See 99.6 (Tainting).

[166] See 87.5.6 (Retesting bounty).

pursuing the opportunity themselves;

(3) had the trust not taken up the offer T would have done so.

This may be regarded as the provision of a service; service is a wide word. But it is not exactly like the services provided by the actors which were sold on to third parties.

In this case is T a settlor? T has provided an opportunity, but that is not "property". In practice it may be hard to provide an opportunity without providing some property, as in *Butler v Wildin*, where the settlors provided a bank guarantee.

Perhaps T might be a settlor where the trust only invested a nominal amount in the project. But if the trust provides substantial funds for the development, one cannot identify any income as coming specifically from T. One should not apportion the profits between T's contribution (advice) and the settlement's contribution (finance). It is impractical to do so as there is no clear answer to how the apportionment should be made.

It is different if T has contractual rights to the assets, as then T has provided property.

If the trust is non-resident, ToA needs consideration.[167]

99.25.4 *Employment-related shares*

Protected-trust Q&As[168] Question 6 provides:

> **Does ongoing employment by the settlor taint a protected settlement**
> Assume that a protected settlement owns shares of a company in which the settlor is a senior employee. The shares contain the usual good-leaver / bad-leaver provisions, such that if the settlor leaves employment with the company then the shares are lost (either through forfeiture, conversion into deferred shares, change in share rights, sale back to the company, compulsory sale to other shareholders or some other similar mechanism). If the settlor is a 'bad-leaver' then the shares will be lost on disadvantageous terms (eg they may have to be sold back to the company for only £1).
> Does the settlor remaining in employment – thereby preserving the value of the shares for the trustees – constitute an 'addition of value' to the settlement thereby causing the settlement to lose protected status?
> *Suggested answer:* No. The settlor remaining in employment merely preserves the value of the shares rather than adding to their value.

[167] See 49.9 (Quasi-transferor when individual is direct transferor).

[168] For this document, see 92.1.1 (Protected-trust guidance).

> However, even if there were some enhancement of the value of the shares, the use of the term ‘provided’ in Condition D indicates, as in other tax contexts, that there must be some element of bounty or gratuitous intent on the part of the settlor ... Typically, the settlor will wish to remain in employment for other reasons unconnected to the shares. Except in extreme cases (for instance where the employment is contrived and the overall terms of employment are not undertaken on a commercially justifiable basis), it is not thought that this would constitute the direct or indirect provision of property or income within Condition D.

That must be right, assuming employment is fully remunerated.

> **Question 6a – share options or deferred shares**
> As above, save that the settlement owns shares under an American-style deferred shares plan (or alternatively owns options under a European-style option-scheme). Under the deferred shares plan, restrictions on the shares fall away as the shares ‘vest’. Typically, this will be because the settlor remains in employment with the company in question. This more clearly ‘enhances’ the value of the shares...
> *Suggested answer:* ... Although the settlor remaining in employment may enhance the value of the shares or options, as long as the overall terms of employment are undertaken on a commercially justifiable basis), this would not be considered to be the provision of property or income or the addition of value which disapplied Condition D. Only in extreme cases, where the settlor deliberately acted solely with the objective of enhancing the value of the shares or the share-option scheme was otherwise contrived to achieve this result, would this taint the settlement.

That is less clear, but the issue is fact-sensitive. The Protected-trust Note restates this view.[169]

[169] For the Protected-trust Note, see 99.2.4 (Guidance). It provides:

> “A trust may own shares/share options or an interest in a business which have been awarded as a result of the settlor's work/employment. These awards may be subject to vesting provisions (or the economic equivalent) under which the award may increase in value the longer the settlor works or if certain targets are met but which may also decrease in value or become worthless if the settlor ceases to work in the business or for the relevant company.
> As long as the award was held by the trust before the settlor became deemed domiciled, the fact it may increase in value as a result of the settlor's work is not in general considered to amount to a provision of property or an addition of value. The reason for this is that any gratuitous intent existed only when the award was

99.26 Loans

Lending on commercial terms will not make lender (or borrower) a settlor, as there is no element of bounty (gratuitous intent).

The following discussion mostly refers to interest-free loans, which are common; but the same will apply to a low-interest loan, or any loan on terms favourable to the borrower.[170]

99.26.1 *Making a loan*

A person who makes an interest-free loan to a trust[171] is in principle[172] a settlor. HMRC agree. SP 5/92[173] para 22 provides:

> A loan made, directly or indirectly to a relevant settlement after 19 March 1991 on non-commercial terms, eg at a low or nil rate of interest is regarded as a provision of funds for the purposes of TCGA 1992 Sch 5 para 9(3). This is the case whether the loan is for a fixed period or repayable on demand.[174]

While a person who lends interest-free is in principle a settlor, what is the property provided, and when is it provided? It is considered that the property provided is the money lent. It is provided at the time that the interest-free loan is made. If the money lent is spent on expenses, there is no property derived from the loan and the lender ceases to be a settlor.

made/transferred to the trust. The settlor has no gratuitous intent when continuing to work in the business or for the company.

The position may be different where the overall terms of the work/employment were or are not arms' length or the settlor deliberately acted with the objective of enhancing the value of the award held by the trust or the terms of the award were otherwise contrived to achieve this result. It is likely that, in these circumstances, such an arrangement would taint the settlement."

[170] As to whether an interest-free loan makes the trust a settlor-interested trust, see 47.6.4 (Beneficial loan or guarantee).

[171] Likewise a loan to a company held by a trust; see 99.24 (Property provided to co in a trust).

[172] It is assumed that the loan is made with gratuitous intent. The position is different if the loan (though on favourable terms) is made without gratuitous intent. That is conceivable, for instance, in the case of a loan from a life tenant, if trust income roughly matches interest foregone.

[173] For SP 5/92 and para 9(3), see 99.2.4 (Guidance).

[174] Likewise Tax Bulletin 8: "Our view is that a person making a loan to the trustees on better than commercial terms is ... a settlor ... and within the provisions of [Chapter 5 Part 5 ITTOIA] ..."

See too 101.5 (Failure to claim statutory indemnity).

99.26.2 *On-demand loan left unpaid*

This section considers whether a person provides property by allowing an interest-free repayable on demand loan to remain outstanding after it has been made. This typically arises where:

(1) Year 1: A settlor while non-domiciled lends money to a trust. The loan is interest-free and repayable on demand.
(2) Year 2: The settlor becomes deemed domiciled in the UK and leaves the loan outstanding.

It is suggested that the settlor has not provided property in year 2: for what is the "property" which the settlor has provided? It is not the funds lent, which were provided in year 1; it is not the interest foregone, as that does not exist.[175] If that is right, tainting rules only apply where the statute makes express provision for loans or adding value. This is consistent with the principle that failure to exercise a power of revocation is not providing property.[176]

99.26.3 *Fixed-term loan*

In practice fixed-term loans are less common that on-demand loans, but I will consider them here. There are two separate issues: the position during the term of the fixed-term loan, and the position if the loan is left outstanding at the end of the term.

SP 5/92 provides:

> 19 A fixed-period loan made, directly or indirectly, to a relevant settlement prior to 19 March 1991 on non-commercial terms, eg at a low or nil rate of interest is, generally, regarded as a provision of property in pursuance of a liability incurred before 19 March 1991, provided the loan remains outstanding on the same terms. As such, it falls within the terms of TCGA 1992 Sch 5 para 9(3)(b) and the first condition set out in para 9(3) is not met.[177]

[175] Contrast *Re Marshall* [1965] NZLR 851: the New Zealand CoA held that where interest on a debt is payable on demand, but the right to call for payment is not exercised, there is no gift of the interest foregone. Also see 83.6 ("Provide").

[176] See 99.15 (Power of revocation). The same reasoning may apply to the case considered in the next paragraph, of a fixed-term loan which is left outstanding, but that seems less clear.

[177] For SP 5/92 and para 9(3), see 99.2.4 (Guidance).

More correctly, a fixed-term loan, on favourable terms, is a provision of property at the time of the loan, and no property is provided subsequently during the term of the loan. It is not necessary to rely on para 9(3)(b). But the HMRC analysis leads to the same result.

Turning to the position if the loan is not repaid at the end of the term:

> 20 There would, however, be a direct or indirect provision of property for the purposes of the settlement where a fixed-period loan falls to be repaid after 18 March 1991 but repayment is not made and so becomes a repayable on demand loan.

This is in principle correct, for on the expiry of the fixed-term loan, credit is granted; in effect, a favourable loan comes into existence. This assumes the loan was deliberately left outstanding. It would be different if the repayment were simply overlooked.

For completeness: ESC D41 provided:

> **Non-resident Trusts: Loans Repayable on Demand**
> ... A repayable on demand loan which was made, directly or indirectly, to a relevant trust prior to 19 March 1991 on non-commercial terms, eg at a low or nil rate of interest will, generally, be regarded as a provision of property for the purposes of the settlement. Consequently, where, after 18 March 1991, a loan has not been repaid or adjusted to commercial terms, the condition in TCGA 1992 Sch 5 para 9(3) would be met.

The concession was as follows:

> The condition is not, however, regarded as met where, before 31 July 1992, the loan is either -
> (a) repaid in full, together with any outstanding interest ; or
> (b)[i] made subject to fully commercial terms, including a commercial rate of interest payable at least annually for the year ending 5 April 1993 and subsequent years
> [ii] and, in addition, interest at a commercial rate or a sum in lieu thereof has been paid in respect of the year ended 5 April 1992.

The concession then discusses the consequences of paying a sum in lieu of interest (under para (b)[ii]):

> Amounts paid under an agreement entered into by the trustees after 5 April 1992 under (b) above in respect of the year ended 5 April 1992 are treated as capital payments under TCGA 1992 s 97, made in 1992-93.

> Where the lender is not a beneficiary of the trust, the payment is not treated as falling within the scope of TCGA 1992 Sch 5 para 9(6). In addition, where such payments are matched, under TCGA 1992 ss 92-95, to qualifying amounts for 1990-91, TCGA 1992 s 91(2) does not apply.
> Amounts paid under (b) above under an agreement entered into by the trustees before 6 April 1992, or in respect of periods after 5 April 1992, are regarded as interest in the hands of the recipient and taxable accordingly.[178]

99.26.4 *Back-to-back loan*

The same points apply to a back-to-back loan. In *IRC v Wachtel*:

(1) Trustees borrowed from a bank.
(2) An individual guaranteed the trustee loan and deposited with the bank funds equal to the trustee borrowing.
(3) The trustees paid only 1% interest on their loan.

The individual was rightly held to be a settlor.[179]

99.26.5 *Repayment of loan*

SP 5/92 para 23 provides:

> [1] The repayment of any loan made, directly or indirectly, to any person by the trustees is not generally regarded as the provision of funds for the purposes of the settlement under TCGA 1992 Sch 5 para 9(3).
> [2] This does not, however, apply where
> [a] more is repaid than is due under the original terms of the loan or,
> [b] in the case of loans made after 19 March 1991, where the interest charged under the terms of the loan exceeds a commercial rate.[180]

This is considering a loan the other way: a loan from the trust to another person.

The points made are straightforward, indeed self-evident. In case [1] there is no element of bounty (gratuitous intent). The borrower pays the trustees what is due. In case [2][a] the borrower provides bounty (repaying the trustees more than is due) and so becomes a settlor.

[178] [1992] STI p.535.

[179] 46 TC 543 at p.554I - 555.

[180] For SP 5/92 and para 9(3), see 99.2.4 (Guidance).

Similarly in case [2][b]: if the borrower pays the trustees interest exceeding a commercial rate, of course the borrower becomes a settlor (in principle by virtue of the loan agreement rather than by the subsequent payment, but that is not likely to matter). This point is not likely to arise as excessive interest (if it be interest) is likely to be taxable or raise other tax issues.

99.27 Indemnities and guarantees

A note on terminology:

Term	**Meaning**
Indemnity	Enforceable promise to reimburse for a specified loss
Warranty	Statement of fact in a contract, a contractual assurance, giving rise to damages if broken
Guarantee	A secondary liability that arises only on a default by another person (unlike an indemnity which is a primary liability)

However for present purposes (who is a settlor) these differences are not important.

Indemnities and guarantees may be given in a wide variety of circumstances.

An indemnity/guarantee may be given:

(1) with an element of bounty (gratuitous intent)

(2) without bounty (being part of a commercial transaction or for full consideration)

In the latter case the promisor/guarantor is not a settlor and giving the indemnity/guarantee is not provision of property or adding value.

99.27.1 *Giving an indemnity*

SP 5/92 provides:

> 34 An indemnity given by the new trustees to retiring trustees is not considered as the provision of funds for the purposes of the settlement under TCGA 1992 Sch 5 para 9(3).[181]

This is right for two reasons (either would suffice):

(1) There is no element of bounty (gratuitous intent).

(2) The benefit of the indemnity is held by the *former* trustees, so it is not property comprised in the settlement.

[181] For SP 5/92 and para 9(3), see 99.2.4 (Guidance).

SP 5/92 continues:

> Other types of indemnity are considered in light of the facts of a particular case.

That is not exactly guidance.

It is standard form for a beneficiary who receives trust capital to give an indemnity to the trustees. This is not the provision of funds, it is made in consideration of the trustees releasing their trustee lien; there is no bounty (gratuitous intent).[182]

99.27.2 *Giving a guarantee*

If trustees borrow, the lender may require a guarantee.

SP 5/92 provides:

> 35 The giving of a guarantee is regarded as an indirect provision of funds under the terms of TCGA 1992 Sch 5 para 9(3).[183]

But para 6 Protected-trust Note[184] provides:

> Where trustees borrow commercially from a bank and pay an arm's length rate of interest the bank may require the settlor to guarantee the loan. The bank does not require collateral for the guarantee. No payment is made by the trustees to the settlor for giving the guarantee as there is no realistic risk that the trustees will not be able to repay the loan.
> SP5/92 takes the position on a generic basis that the guarantee by the settlor of an obligation of the trustees is to be treated as the provision of property for the purposes of the settlement. It was widely considered SP5/92 was incorrect in taking this position on the basis that there is no provision of property to the trustees unless and until the guarantee is

[182] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 34.3 (Trustees lien).

[183] SP 5/92 goes on to deal with the CGT implications of a guarantee given before 19 March 1991. This is not now important but is set out here for completeness:
"Payment of an obligation under a guarantee given before 9 March 1991 is, in general, regarded as a payment in pursuance of a liability incurred before 19 March 1991 and within para 9(3)(b). This may not, however, apply where-
- the contingent liability under the guarantee cannot be quantified with a sufficient degree of accuracy, eg where the guarantee is open-ended or the contingency is remote; or
- the guarantor does not take reasonable steps to pursue his rights against the debtor."

[184] For the Protected-trust Note, see 99.2.4 (Guidance).

> called. In the case of a loan the trustees have borrowed money but they have the obligation to repay the money along with an arm's length rate of interest. There is no risk in reality that they will default on their obligations.
>
> In practice, a third party providing a guarantee to the bank in these circumstances would charge a fee. On one view, failure by the settlor to charge a fee does not taint the settlement as it is not an addition of value to the particular items of property comprised in the settlement. The more prudent view is that this distinction is too technical, and accordingly that failure to charge a fee would amount to tainting.
>
> A secured guarantee could on one view be said to be the direct or indirect provision of the property over which security is provided even though the property in question never becomes comprised in the settlement. It is considered necessary for an arms' length fee to be charged in order to avoid any risk of the borrowing trust being tainted. The fee may be small if there is no realistic prospect of a default.

It may not be possible to identify the property which a guarantor provides.[185] If so, the guarantee may amount to tainting a trust, but it does not give rise to income/gains chargeable under s.624/s.86.

The position is different if there is not merely a guarantee but also a back-to-back arrangement of the kind found in *Wachtel*;[186] or if the trustees had no property of their own, as in *Butler v Wildin.*[187]

99.28 Transaction on favourable terms

A sale to a trust at a conscious undervalue is the provision of property: the seller is a settlor. Likewise a purchase from a trust at a conscious overvalue: the purchaser is a settlor.

Likewise a person is a settlor if they hold all the shares in a company and consent or procure the company to issue shares to a trust at a conscious undervalue.[188] The TSE Manual provides a straightforward example:

[185] A guarantee is a chose in action, but the owner of the chose in action may not be the trustee. Further consideration would be needed if the guarantee is called on. See too 99.2.9 (Undertaking to provide).

[186] See 99.26.4 (Back-to-back loan).

[187] 61 TC 666.

[188] This proposition is self evident but if authority is needed, see *Crossland v Hawkins* 39 TC 493 at pp.506–507; *Young v Pearce* 70 TC 331. An issue of shares at an undervalue also raises issues of value shifting for CGT purposes, the IHT close-company code, and if a non-resident trust or company is involved, ToA.

> **TSEM4120 Definition Of Settlor** [Sep 2021]
> ***Example 1***
> X is the director and owns all the 150 issued ordinary £1 shares of X Ltd. X Ltd issues 100 new ordinary £1 shares which are acquired for £100 by the X Family Trust.[189]
> The trust has been established for the benefit of X's family by his father, X Senior, who created the trust by settling cash of £100.
> Shortly after the issue of the new shares, a dividend of £100 per share is declared and paid and the trust receives dividends of £10,000.

The HMRC analysis is as follows:

> X controlled the arrangement for the issue of the shares at par followed by the dividend. X is therefore the true settlor of the settlement from which income of £10,000 arose. The original settlement of £100 by X Senior is usually disregarded on de minimis grounds.

A sale at market value is not the provision of property. HMRC agree. The CG Manual provides:

> **CG34891. Multiple settlors** [Jul 2019]
> Where property is acquired as a result of an arms length transaction the third party is not to be regarded as providing property for the purposes of the settlement, thereby becoming a settlor. Instead the property is regarded as representing the cash previously held.

A bargain at arm's length (at a price regarded by both sides as market value) is not the provision of property even if the parties have mistaken the value and the property is sold at an undervalue.[190]

Similar issues arise in multi-party transactions where a trust is one of the parties. For instance, a company may issue loan notes and shares, in a transaction where an individual subscribes to the loan notes and a trust subscribes to the shares. The question then arises how to apportion the total subscription price between the loan notes and the shares. An under apportionment to the trust would in principle make the individual a settlor. A valuation reached honestly and bona fide between parties acting at

[189] Author's footnote: The issue of shares at an undervalue would also constitute a transfer of value for IHT, and a value-shifting disposal for CGT, but it is not necessary to pursue that here.

[190] This is consistent with the principles that a settlement-arrangement must have an element of bounty: see 87.4 (Settlement-arrangement definition), and that arm's length sales confer no "benefit": see 50.4.1 (Arm's length transaction).

arm’s length binds HMRC.[191]

99.29 Payment of admin expenses

99.29.1 *Trust income used to pay expenses*

SP 5/92 specifies two cases where payment of capital expenses out of a life tenant’s income does not make the life tenant a settlor:[192]

> 29 An expense on capital account paid out of trust income is not treated as a provision of income by a beneficiary for the purposes of TCGA 1992 Sch 5 para 9(3) provided that either—
> [1] the trust deed permits payment of capital expenses from income and the beneficiary is entitled only to net income after such payments;[193] or
> [2] the trustees borrow money from the income account which is subsequently restored, along with interest over the period of the loan. The appropriate rate of interest is considered to be that which a Court of Equity would order on the replacement of trust income.[194]

The question, more analytically, is whether the life tenant has provided intentional and gratuitous benefit to the trust. Clearly, in the two cases mentioned, the life tenant does not do this and so does not become a

[191] See App 4.4 (Value of consideration).

[192] For SP 5/92 and para 9(3), see 99.2.4 (Guidance).

[193] For completeness, Tax Bulletin 8 expands on this:
“Para 29 of the Statement of Practice concerns, inter alia, trust deeds which permit capital expenses to be paid out of the income account. Neither the existence nor the exercise of this power would cause the trust to lose an interest in possession status for IHT purposes.”

[194] The words borrow and loan are used loosely here, as what is envisaged is not a loan or borrowing in the strict sense.
For completeness: Tax Bulletin 8 expands on this; it sets out para 29[2] and continues:

> “The appropriate rate of interest is considered to be equal to the rate payable on the Basic Account administered by the Court Office of the Supreme Courts of Justice. Such interest will constitute taxable income in the hands of the income beneficiary (either when it is credited in the case of a life tenant, or when it is paid or applied for the benefit of a discretionary beneficiary). It may also be treated as ‘relevant income’ for [s.731 ITA] purposes.
> Income beneficiaries will only be liable on the net amount of income available after deduction of any income which has been applied to meet expenses on capital account. Only when the income account is made good will that income become taxable on the beneficiary.”

settlor. The consent of the life tenant is not normally needed.

99.29.2 *Payment of expenses*

Where a trust has no income, someone (typically a beneficiary) may voluntarily pay trust expenses. In this case there may also be no gratuitous element. It may be in the beneficiary's interest to make the payment. Subject to that, the SP tacitly suggests that the intentional and gratuitous payment of trustees' expenses *does* make the payor a settlor. But this is not correct. First, in some cases, the payment of expenses may be a provision of services to the trust rather than the provision of property.[195] Secondly, if a non-settlor pays trustees expenses, or pays a sum to the trustees which are immediately consumed in payment of expenses "no property of which S is the settlor" is comprised in the settlement, so the payor of expenses is not the settlor.[196]

HMRC agree. A STEP/CIOT Q&A[197] considers the IHT issues that arise when:

(1) a person (after 2006) adds property to an estate IIP trust and
(2) the property is spent on trust expenses.

> **Question 37(2)**
> ... if an addition of cash was made which was then spent by the trustees and HMRC regard this addition as within the relevant property regime (eg an addition to pay expenses or improve properties), how would the proportion of the settled property subject to the new rules be calculated? Would a valuation be needed of the property before and after the improvement?
> **HMRC Answer**
> If a payment of cash was made and then spent immediately on, say, a tax liability or another administration expense, then that short period will be the extent of its time as "relevant property" and there will be no question of having to consider what proportion of the existing settled property represents it going forward.
> If a payment was made towards the improvement of a property, then this would appear to require "with" and "without" valuations when there is

[195] See 99.25 (Provision of services).

[196] See 99.2.12 (Ceasing to be settlor).

[197] "Questions by STEP/CIOT and Answers From HMRC to sch 20 FA 2006". Ths most recent version is dated October 2008 and the text can be found in Tolley's Yellow Tax Handbook.

> a chargeable event.[198]
> *Note added 6 August 2008: HMRC have indicated that they are actively reconsidering this response with a view to producing further guidance shortly.*[199]

99.30 Property maintenance/management

This raises similar questions. Para 7 Protected-trust Note provides:[200]

> It is not considered the settlor taints a settlement where he keeps a trust property in good order and repair if he is living rent-free in the property and the cost to the settlor is no more than the rent he would have to pay if he was renting the property on arm's length terms. Should the settlor pay for improvements, it is considered tainting occurs if the value of the property is increased by the improvements.

Para 8 Protected-trust Note[201] provides:

> It is considered that tainting does not occur if the trustees own rental property and the settlor assists the trustees on an occasional basis with certain practical day-to-day matters such as interviewing new tenants, assisting with rent collection and generally in answering practical queries and passing these onto the trustees. The position could be otherwise if the settlor is in the business of property management and does not charge a fee.

99.31 Retaining life tenant income

SP 5/92 para 33 provides:

> A life tenant is not regarded as having provided income or property for the purposes of the settlement merely because there is an administrative

[198] The question goes on to ask: In HMRC's view, do all subsequent post Budget additions need to be kept physically segregated? HMRC say no, which is just as well as money spent can hardly be regarded as segregated:

> "It is clearly up to trustees to decide whether to keep post-Budget additions separate from the rest of the trust fund. We think that it may be sensible to do so—or, at least, to keep good records of additions. (The trustees of discretionary trusts already need to do this, of course, in order for the 10-year anniversary value of each addition to be identified correctly in light of the relief in s 66(2) IHTA for property that has not been 'relevant property' for a full 10-year period)."

[199] No guidance has been produced. Perhaps the issue was filed as too difficult, or perhaps on reconsideration HMRC were satisfied with their original answer.

[200] For the Protected-trust Note, see 99.2.4 (Guidance).

[201] For the Protected-trust Note, see 99.2.4 (Guidance).

> delay in paying out the income that has vested in that beneficiary. If, however, the beneficiary directs the trustees to retain this income on the terms of the settlement, this is regarded as a provision of funds within TCGA 1992 Sch 5 para 9(3).[202]

That is self-evident.

HMRC protected-trust guidance provides:

> 5.9 ... if the settlement is a life interest trust with underlying companies there is no requirement for the profits of those underlying companies to pay dividends up to the trustees of the settlement. The retention of such profits in the underlying companies will not be considered as an addition of value for the purposes of the tainting rules.

That is also self-evident.

99.32 Purpose: Inattentive settlor

In *Mills v IRC* 49 TC 367, the trust funds were derived from acting work of Hayley Mills, then aged 14. She was supposedly[203] unaware of the settlement to which at her direction her earnings were paid. The argument was that she had not provided funds for the *purpose* of the settlement. Viscount Dilhorne said:

> [1] I do not agree with Lord Denning MR that the word "purpose" in this section connotes a mental element or with Buckley LJ that there must be a motivating intention. I do not myself think that it assists to consider whether the question he posed is to be answered objectively or subjectively. I do not consider it incumbent, in order to establish that a person is a settlor as having provided funds for the purpose of a settlement, to show that there was any element of mens rea.

[202] The same point is made in para 5 Protected-trust Note. For SP 5/92 and para 9(3), see 99.2.4 (Guidance).

[203] The actual evidence recorded that she was "not very interested", which is not the same. The case should have been decided on the simple factual basis that Hayley Mills *did* intend to provide funds for the purpose of the settlement, even if she did not trouble to think very much about it. In the High Court, the judge made this point at p.378:

> "The case was put on a factual assumption that Hayley Mills did not subjectively intend to provide funds. This was factually incorrect, and not even conceivable, because it was completely inconsistent with the view that the contract she signed was valid. If Hayley had not thought about it at all, the contract which she signed would be void under the rule *non est factum*."

> [2] Where it is shown that funds have been provided for a settlement a very strong inference is to be drawn that they were provided for that purpose,
> [3] an inference which will be rebutted if it is established that they were provided for another purpose.

This is poorly expressed.[204] It is not that purpose is irrelevant: see [3]. The sentence at [1] might suggest the contrary, depending perhaps what Dilhorne meant by *mens rea*; but "purpose" inescapably connotes a mental element, and so does "provide"[205].

The explanation I prefer is that this passage is considering the situation like the facts in *Mills* where Hayley Mills *did* intend to provide funds for the purpose of her trust (in the sense that intention can be inferred by her signing a contract which had that effect); that is so even though she took (more or less) no personal interest in the matter, or had (more or less) no personal knowledge of it; she no doubt signed what was put in front of her. A person who is in that sense a source of funds is not permitted to say that they did not intend to provide them because they were not paying attention. The comment is applicable to a person who creates a settlement, as Britain was said to have conquered half the world, "in a fit of absence of mind".

An alternative explanation is that this is a case where the Courts just abandoned the usual concept of purpose (subjective intention) because the consequences were unacceptable; or to put it another way, it was such an obvious case that "the facts spokes for themselves".[206]

99.33 Purpose: Settlor's adviser/agent

In ascertaining purpose, one should have regard not only to the mind of the settlor, but also the mind of those acting for or advising them.[207] In *Crossland v Hawkins*:[208]

> The mere fact that he did not concern himself with some of the 'steps' in the legal machinery involved does not make it any the less his arrangement within the section. A man does not avoid the incidence of

[204] Dilhorne was "not in the highest flight of English lawyers" (Oxford Dictionary of National Biography).

[205] See 87.4 (Settlement-arrangement definition).

[206] See 3.8.1 (The limit of subjectivity).

[207] See too 3.10 (Purpose: Party's adviser/agent).

[208] 39 TC 439 at p.508.

> [the settlor-interested trust code] by merely being absent from and leaving to his solicitors and accountants certain parts of the legal machinery if he is aware of the proposals for an 'arrangement' or a settlement and actively forwards them by personally carrying out and assisting in the vital parts in which his performance and co-operation are necessary. Nor can he avoid liability by merely giving his solicitors carte blanche to effect some scheme for the benefit of his family and refusing to concern himself with its precise form.

On this analysis many apparent difficulties fall away.

In *Mills*, the father acted on behalf of the daughter.[209] The purpose of the father was to provide the daughter's funds for the purpose of the settlement. That suffices to make the daughter the settlor if she had no purpose of her own. Likewise in *Hatton*[210] the purposes of Mrs Cole's attorney was to provide funds for the settlement, and this purpose should be regarded as the purpose of Mrs Cole.

99.34 Trust by court: Person lacking capacity

The court has power to make a settlement for a person lacking capacity "on his behalf". It is considered that the person lacking capacity is the settlor.[211] The Court of Protection agree:

> Trusts set up by an order of the Court of Protection will take the form of a settlement, with the patient being the settlor. ... in the case of trusts set up by an order of the Court of Protection, provision can be made for income to be accumulated, if appropriate, for the lifetime of the patient as section 164(1)(a) Law of Property Act 1925 applies.[212]

99.35 Trust by compromise: Minor/person lacking capacity

Parties to litigation may make a settlement under a compromise on behalf

[209] See 49 TC 367 at p.382 and p.385.

[210] This is self evident, but if necessary, see 99.7 (A gives to B, B gives to trust).

[211] Sections 16, 18(h) Mental Capacity Act 2005. The tax position is the same for settlements made under the previous legislation, the Mental Health Act 1983. Further consideration would be needed in the case of Scotland or foreign jurisdictions.

[212] Court of Protection Practice Note, 15 November 1996, para 4. The point of the last sentence is that under pre-2009 law, accumulation was permitted during the lifetime of the settlor (but not during the lifetime of other persons). As the rule against accumulation is, happily, abolished, the Practice Note has become obsolete. But the implicit point that the patient is the settlor remains important.

of a claimant who is a minor or person lacking capacity.[213] The Court of Protection say:

> An award of damages can be settled, by consent, in trust for the patient as part of the terms of compromise of the action between the plaintiff and the defendant, with the approval of the High Court, in circumstances where the award never becomes the absolute property of the patient.
> Trusts set up following an order of the High Court can only be done in the form of a declaration of trust by the trustees ... . The period over which income can be accumulated by the trustees is restricted to 21 years.[214]

This assumes that the minor/person lacking capacity is not a settlor for trust law purposes. The first sentence (which is presumably the basis for the conclusion) is unsound. While the *award* never becomes the absolute property of the patient, the award represents the claim, which is the property of the claimant.[215]

But HMRC accept in practice that there is no settlor.[216] It would follow that trust property is excluded property if it is not UK situate, or an AUT/OEIC.

99.36 Trust under Criminal Injuries Compensation Scheme

An award under the Criminal Injuries Compensation Scheme (or the may be transferred to a trust.[217] The applicant under the Criminal Injuries Compensation Scheme is not the settlor of such a trust.[218] That is

[213] See Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), Chapter 28 (Trusts of Damages).

[214] Court of Protection Practice Note on the settlement of personal injury awards to patients, 15 November 1996, paras 2 and 4; formerly set out in the White Book (Civil Procedure) para 6B-119.

[215] This is self-evident, but if authority is needed, see *Zim Properties v Proctor* 58 TC 371.

[216] Private correspondence.

[217] Para 106 Criminal Injuries Compensation Scheme 2012.

[218] The drafter of Part 2 Chapter 4 FA 2005 assumed this, though one needs to dig a little into the provisions to see why this is so:
(1) CICS trusts are within the provisions: s.35 FA 2005.
(2) Settlor-interested trusts are outside the scope of the provisions: see s.25(3) and 30 FA 2005. (In relation to CGT this was clearer before s.77 TCGA was repealed in 2008).
(3) The claimant under the CICS would always be a beneficiary, so if he was the

consistent with the position under the VTA. However, HMRC have apparently expressed the view that the claimant is the settlor, and in practice this view may well favour the taxpayer (as s.624 ITTOIA reduces the IT charge if the settlor is not a higher rate taxpayer).

The same applies to the Victims of Overseas Terrorism Compensation Scheme.[219]

99.37 Trust made by deed of variation

99.37.1 *The general rule*

Suppose:

(1) B inherits property absolutely from the estate of a deceased, D.[220]
(2) B varies the will so as to create a settlement of that property; and s.142 IHTA and s.62 TCGA apply.

B is clearly the settlor in the general sense.[221]

CG Manual provides:

> **CG37886. Instrument of variation of will or intestacy** [Dec 2021]
> It is quite common for instruments of variation of wills or intestacies to be executed within two years of the testator's (or intestate's) death. In England & Wales the usual form of the instrument is a deed. The general guidance is at IHTM35011+ and guidance on CGT at CG31600+. If an instrument of variation creates a continuing trust which replaces absolute interests in the original will, and there is no statement of intent in the deed or before 1 August 2002 no election, under Section 62(7) TCGA 1992, the person who gives up the absolute interest in favour of the trustees is to be regarded as the settlor for the purposes of the annual exempt amount. His personal position is considered at CG32000+, assuming the variation is gratuitous.

99.37.2 *Settlor for IHT*

For inheritance tax purposes, the effect of s.142 IHTA is probably to override the general sense; the settlor is D and not B. HMRC agree. (The

settlor the trust would be settlor-interested.

So the drafter must have assumed that the claimant was not the settlor, or the provisions make no sense.

[219] Para 99 Victims of Overseas Terrorism Compensation Scheme 2012.

[220] For where beneficiaries vary/resettle a will trust, see 99.22 (Resettlement by beneficiaries).

[221] See 99.7 (A gives to B, B gives to trust).

contrary view is arguable but it will not usually be in the taxpayer's interest to argue it.) IHT Manual provides:

> **IHTM35151 IHT implications of IOV: effect of coming within s.142**
> [May 2020]
> When a variation satisfies the requirements of s.142(1) IHTA and there is a valid election or, on or after 1 August 2002, a valid statement of intent
> - the variation is not a transfer of value, and
> - the IHTA applies as if the deceased had effected the variation
>
> Consequently, for example ...
> [1] if a variation sets up a non-interest in possession trust, the deceased is treated as the settlor, and
> [2] the GWR rules in s.102 FA 1986 cannot apply to a disposition which is accepted as a variation within s.142(1) IHTA. This is because the effect of s.142(1) IHTA is that the deceased is treated as the donor.

Point [1] states that the deceased is the settlor if a variation sets up a non-interest in possession trust. The same rule must in principle apply if the variation sets up an interest in possession trust (but with the added complication of s.80 IHTA rules, if applicable). Likewise Tax Bulletin 15 provides:

> Our view is that, as the relevant IHT legislation differs from the CGT provisions which were considered in *Marshall v Kerr*, that decision has no application to IHT. Variations which meet all the statutory conditions will continue to be treated for IHT purposes as having been made by the deceased.

99.37.3 *IT/CGT: IoV post-2006*

Section 470(2) ITA/s.68B(6) TCGA set out three exceptions to the IT/CGT appointment rule. The third is:

s.470(2) ITA	**s.68B(6) TCGA**
A transfer of property is excluded for the purposes of subsection (1) if ...	But subsections (3) and (4) do not apply in relation to a transfer of property ...
(c) section 473(4) applies in relation to it.	(c) to which section 68C(6) applies.

This excludes the operation of (what I call) the IT/CGT appointment rule. Instead the position is governed by s.472, 473 ITA. Section 472 ITA provides:[222]

> (1) This section applies if—
> (a) a disposition of property following a person's death is varied, and
> (b) section 62(6) of TCGA 1992 applies in relation to the variation.
>
> (2) [i] If property becomes settled property because of the variation
> [ii] and would not, but for the variation, have become settled property),
>
> a person within subsection (3) is treated for the purposes of the Income Tax Acts (except where the context otherwise requires)—
> (a) as having made the settlement, and
> (b) as having provided the property for the purposes of the settlement.
>
> (3) The persons within this subsection are—
> (a) a person who immediately before the variation was entitled to the property, or to property from which it derived, absolutely as legatee,[223]
> (b) a person who immediately before the variation would have been so entitled if that person had not been an infant or otherwise lacking legal capacity,
> (c) a person who, but for the variation, would have become so entitled, and
> (d) a person who, but for the variation, would have become so entitled if that person had not been an infant or otherwise

[222] The CGT equivalent is s.68C TCGA.

[223] Section 472 provides:
"(4) For the purposes of subsection (3)—
(a) 'legatee' includes a person taking property—
(i) under a testamentary disposition or on an intestacy or partial intestacy, whether beneficially or as trustee, or
(ii) under a donatio mortis causa, and
(b) a person who is a legatee as a result of para (a)(ii) is treated as acquiring the property when the donor dies.
(5) For the purposes of subsection (4)(a) property taken under a testamentary disposition or on an intestacy or partial intestacy includes any property appropriated by the personal representatives in or towards satisfaction of—
(a) a pecuniary legacy, or
(b) any other interest or share in the property devolving under the disposition or intestacy."
This is based on the CGT definition: see 88.7.2 ("Legatee").

lacking legal capacity.

Section 472 (and its CGT equivalent, s.68C TCGA) applies in the usual situation, where a beneficiary absolutely entitled to property under a will varies the will so as to create a settlement. Section 68C TCGA enacts the HMRC view that the beneficiary is the settlor for CGT. Section 472 confirms (which no-one ever doubted) that the beneficiary is the settlor for IT.

This applies not just for the standard IT/CGT definition, but for all purposes of IT and CGT. Although the drafter adds the words except "where the context otherwise requires", I cannot think of a case where the context would "otherwise require"; and I expect the drafter has copied without much thought the wording used (appropriately) in s.467 ITA.

Section 473 ITA provides:

> (1) This section applies if—
> (a) a disposition of property following the death of a person ("D") is varied, and
> (b) section 62(6) of TCGA 1992 applies in relation to the variation.
> (2) If—
> (a) property would have become comprised in a settlement within subsection (3), but
> (b) as a result of the variation, the property, or property derived from it becomes comprised in another settlement,
> D is treated for the purposes of the Income Tax Acts (except where the context otherwise requires) as having made the other settlement.
> (3) A settlement is within this subsection if—
> (a) it arose on D's death (whether by D's will or on D's intestacy or in any other way), or
> (b) it was in existence immediately before D's death (whether or not D was a settlor in relation to it).
> (4) If—
> (a) immediately before the variation property is comprised in a settlement and is property of which D is a settlor, and
> (b) immediately after the variation the property, or property derived from it, becomes comprised in another settlement,
> D is treated for the purposes of the Income Tax Acts (except where the context otherwise requires) as having made the other settlement.
> (5) A settlement treated as made by D as a result of this section is treated for the purposes of the Income Tax Acts as made by D

> immediately before D's death.
> (6) But subsection (5) does not apply in relation to a settlement which arose on D's death.

Section 473 applies in the highly unusual situation where property settled by will is re-settled by beneficiaries.[224] Here the opposite rule is enacted: the beneficiaries are *not* settlors for IT or CGT.

Where s.472 applies, s.472(2) imposes two rules:

(a) the beneficiary ("B") is deemed to have made the settlement;
(b) B is deemed to have provided the property for the purposes of the settlement.

By contrast, where s.473 applies, we only have rule (a): the deceased is deemed to have made the settlement. By implication, rule (b) must also apply: the deceased must be deemed to have provided the property.

CG Manual 37888 [June 2016] provides:

> Where the instrument was executed on or after 6 April 2006 and notice is given under Section 62(7) Section 68C TCGA 1992 applies with these consequences.
> - Where under the will or intestacy property was to pass absolutely to an individual, and a variation is executed settling that property (or property deriving from that property), then the person to whom the property would have passed is the settlor with regard to that property.
> - Where under the will or intestacy property was to be settled, but the variation is such that a new settlement is created (see CG37887) then the deceased is the settlor.
> - Where under the will or intestacy property was to be settled, but the variation is minor, then the deceased would be the settlor without the new legislation in FA 2006 and therefore this case is not provided for specifically.

99.37.4 *Settlor for IT: IoV Pre-2006*

B is the settlor for IT purposes in the case of variations made before 6 April 2006.

99.37.5 *Settlor for CGT: Pre-2006*

The identity of the settlor for CGT is an unresolved question.[225] The issue is whether s.62 TCGA overrides the general sense of settlor. The House

[224] See 99.22 (Resettlement by beneficiaries).
[225] See Sokol "*Marshall v Kerr* Revisited", Taxation, 3 May 2001.

of Lords held in *Marshall v Kerr*[226] that for CGT the settlor is the beneficiary making the variation, not the testator. However, the reasoning relies on the fact that the beneficiary settled a share in an unadministered estate. The position is therefore different if:

(1) the IoV is made after administration of the estate has been completed; or
(2) the will or intestacy is governed by the law of a jurisdiction (such as a civil law jurisdiction) which (unlike common law jurisdictions) does not recognise personal representatives and an administration period; or
(3) the disposition varied is a joint tenancy (because, as in (2), there is no administration period in respect of property passing by survivorship).

In the following discussion cases (1) to (3) above are called "non-administration" cases, and cases where the estate was in administration (like *Marshall v Kerr*) are called "administration cases".

The reasoning of the House of Lords suggests that the law is as follows:

(1) In non-administration cases whenever the IoV is made, the deceased is the settlor.
(2) In administration cases:
    (a) If the IoV is made before 31 July 1978 (the passing of the FA 1978) the beneficiary is the settlor: that, at least, is clear from *Marshall v Kerr*.
    (b) If the IoV is made after 31 July 1978, it is suggested that the deceased is the settlor. *Marshall v Kerr* has been reversed by (what is now) s.62(9) TCGA: this subsection was not in force in the tax years relevant to *Marshall v Kerr*.

To distinguish between administration and non-administration cases is highly anomalous, so this view of s.62(9) TCGA brings welcome consistency into the law. It also brings CGT into line with IHT.

It appears to be the HMRC view that the beneficiary is the settlor even in cases (2) and (3). CG Manual provides:

> **CG37886: instrument of variation of will or intestacy** [Dec 2021]
> ... The Revenue had always considered that Section 62(7) was

[226] 67 TC 56. Lord Walker found the House of Lords' reasoning unpersuasive: "'As If...'—The Wonderland of Statutory Hypotheses" [2016] Statute Law Rev 37. The reader may agree. But courts below the level of the Supreme Court ought to follow it.

> concerned with computational matters only, and had no effect on the question whether a new settlement had come into existence or the identity of the settlor. The majority of the House of Lords, in *Marshall v Kerr*, 67 TC 56, preferred slightly different reasoning in holding that a residuary legatee, who had executed an instrument of variation so that her 50 per cent share of the estate was settled, was the settlor for the purposes of TCGA92/S87 (charge on beneficiaries of non-resident settlements). It may be noted that the case was concerned with the pre-1978 version of the relevant legislation and it is considered that the Revenue's arguments in that case are stronger under the later legislation. Where the instrument was executed before 6 April 2006 this decision should be applied for the purposes of TCGA92/S77 & TCGA92/S86 (charge on settlors of certain settlements) and TCGA92/SCH1 (annual exempt amount for trustees).[227]

The author would have expected litigation on this aspect, but it has not happened. In view of the 2006 reforms, HMRC may not dispute the position for variations before 6 April 2006.

99.37.6 *Settlor of IoV: Critique*

What is the reason for s.473? Perhaps because it can be hard to identify settlors on variations of settlements. Perhaps because, if the will actually settled the property, there is little need or scope for tax planning by IoVs. In practice s.473 is not important. It appears to be dead letter tax law (not the only dead letter tax law enacted under the banner of trust modernisation). Does it matter to have on the statute book complex provisions that never apply and no-one need take notice of? I think it does, and maybe some day some reformer will sweep it away, and bring CGT and IHT into alignment. The IHT rule is a sensible one, for it fits the object of the IoV rules, which is to allow beneficiaries to avoid the tax unfairnesses of badly drafted wills, and to avoid the need for testators to review their wills annually, as tax law changes.

99.38 Charitable trust

HMRC say:

[227] Likewise TSEM1815 [January 2013]:
"The settlor of a trust created by a deed is not the deceased, unless it's a disclaimer (TSEM1840). It is the person who was entitled to the gift that has now gone into trust. The gift can be capital or income or both. The case of *Marshall v Kerr* (67 TC 56) is relevant. There may be more than one settlor."

> **Are donors to a charity to be treated as settlors and therefore his or her details need to be registered?**
> We do not consider donors to be settlors and therefore the details of a donor does not need to be included on the TRS as long as he or she has no influence or control over the trust nor receives a financial benefit from the trust.[228]

That seems a purposive interpretation, as donors do provide (some) property for the purposes of a charitable trust. But perhaps it is assumed that ordinary donations are spent, at which point the donor ceases to be a settlor. Or perhaps it is just impractical to keep track of small donors and so by implication the charity is not expected to.

The statement relates to TRS, but the same points apply to identifying settlors for tax purposes.

99.39 Pension/employee benefit trust

99.39.1 *Is pension/EBT a settlement*

Employers generally create pension trusts and employee benefit trusts for commercial reasons. There is typically:

(1) No bounty (gratuitous intent) on the part of the employer; and
(2) No bounty on the part of the employee, who is not in a position to negotiate or reject the arrangements.

Such a trust is here called "**a commercial trust**".

A commercial trust is a classic trust, and so is a settlement under the IT/CGT definition. However, a commercial trust is not a settlement under the settlement-arrangement definition.

HMRC agree. CG Manual provides:

> **CG14596 Pension funds** [Jul 2019]
> [1] ... It is considered that for the purposes of Income Tax[229] a pension fund, certainly an approved one, is not a settlement, because of the absence of 'bounty'; (see *Berry v Warnett*, 55 TC 92 for a discussion of the bounty test).

[228] TRS FAQs (2017). The point about the exceptional cases for influence/control/ financial benefit is that the donor will be a "beneficial owner" (as defined) without being a settlor. Though in practice a donor should not receive financial benefits from the trust.

[229] The author means, for the purposes of the settlement-arrangement definition of "settlement".

[2] Accordingly transfers of assets to Pension Funds are not connected persons transactions and there is no restriction of availability of losses under section 18(3) TCGA 1992.[230]

99.39.2 *Commercial trust: Settlor*

Since a commercial trust is not a settlement-arrangement, the question of who is the settlor does not arise when the settlement-arrangement definition of settlement is applicable. However the question arises as to who is the settlor of the commercial trust where a classic definition of settlement is applicable.

The answer depends on which definition of settlor applies.

99.39.3 *Settlor of commercial trust: IT/CGT/IHT definitions*

Let us look first at the standard IT/CGT definition and the IHT definition of settlor. Under these definitions "settlor" includes (1) the person who provides property and (2) the person who makes the settlement. It is considered that the position is as follows:

(1) Providing property requires an element of bounty, and no-one can be said to "provide" property to a commercial trust.
(2) To make (or enter into) a settlement does not require an element of bounty.

HMRC agree. The CG Manual provides:

> **CG33220: Basic terms** [Dec 2021]
> ... Basically under S68A(1) to (3) a person is a settlor if:
> [1] he made or entered into the settlement. This describes the person who has had the deed drawn up on his behalf. The property may come from elsewhere; or the transfer of property to the settlement may be without 'bounty' (see next bullet),
> [2] he has provided property for the purposes of the settlement. On the basis of *CIR v Leiner* 41 TC 589 these words are regarded as applying only where there is 'bounty'.
> [3] the property is settled as a result of his will or intestacy.

The employer normally "makes" a commercial trust (normally the employer is a party to the trust deed and the deed is drawn on his behalf)

[230] Point [2] is correct but only relevant for individuals, as a corporate settlor is not connected with the trustees; see 104.14.1 (Settlor/connected persons). For the restriction on losses, see 65.19 (Loss on connected person disposal).

and so the employer is a settlor under the standard IT/CGT definition and the IHT definition.

Similarly, HMRC Business Brief 18/11:

> The settlor of an Employee Benefit Trust will usually be the company, whether or not it is a Close Company.

If the employer is the settlor, and is a company, it follows that excluded property status depends on the domicile (ie place of incorporation) of the company. That is a relatively sensible rule. IHT cannot normally operate on the basis that employees are the settlors of an EBT, since they are normally a large and fluctuating body. It would be odd if an EBT had no settlor for IHT purposes.

99.39.4 *Settlor of commercial trust: s.86 definition*

The CGT s.86 definition of "settlor" is different and does *not* include the person who makes or enters into a settlement. So the employer is not a settlor for the purposes of s.86. HMRC agree:

> **CG38445: Settlor - TCGA92/S86** [Jul 2019]
> [The Manual refers to the CGT s.86 definition and continues:] The basic requirement is that the property is provided by them. *CIR v Leiner* 41 TC at page 596 shows that the word "provided" must connote bounty in appropriate circumstances. Therefore a settlement devoid of bounty is not within section 86. An example would be a genuine commercial arrangement by a company to attract, retain and motivate good quality staff. HMRC published this view in Tax Bulletin 16.

99.39.5 *Employee settlor of EBT*

CG Manual para 35020 [June 2016] states in relation to unapproved pension schemes:

> ... it can also be argued that the employees themselves are also settlors.

Similarly, the comment that employers and employees are not settlors is said in the passage set out above to apply only to "normal commercial arrangements".

Why are employees not settlors in normal cases? There may be two reasons:

(1) The employee may not have provided anything as they normally gave up no rights when the employer made the transfer to the trust. The trust is created at the discretion of the employer and these employees

play no part in it.

(2) Common form employee benefit trusts benefit a wide class of beneficiaries, so one may not be able to identify any particular part of the trust fund as provided by any particular employee (even if it is the case that a class of employees have jointly provided the trust property). That would preclude any charge to tax on any employee.

Employees may be settlors where these factors are both absent.

The TSE Manual provides:

> **TSEM5350 Settlements legislation for EFRBS** [Sep 2021]
> The Settlements legislation in Chapter 5 Part 5 ITTOIA will not apply if the scheme is operating on bona fide commercial lines, as part of an employment package. But in certain circumstances, the Settlements legislation may apply to charge the EFRBS trust's income on a director/member.
> The Settlements legislation provisions can apply if the trust is not genuinely to provide retirement benefits and/or the beneficiary of the trust has directly or indirectly provided funds for the settlement (see TSEM4120).
> The Settlements legislation will not apply where only the employer makes contributions - unless the contributions are
> - made by a close company which a member controls and
> - unrealistically large by normal commercial standards.
>
> For example, if there is only one director who is also the sole shareholder of the employing company and substantial contributions are made into the EFRBS, the Settlements legislation may apply to treat the director/shareholder as the settlor. The Settlements legislation will not apply if a member makes contributions that are reasonable compared to their salary. If you think the Settlements Legislation may apply, see (TSEM4000) onwards...

In *Brooks v Brooks*, a family law case:[231]

> The settlor was the husband [the employee] not the company. The company was not the settlor, because the provision it made for the husband by the scheme was in his capacity as an employee. This provision was in the nature of deferred remuneration. Thus this surplus, belonging as it does to the company, was never brought into the settlement made by the husband. It does not form part of the settled

[231] [1996] AC 375 at p.394.

property.
As between the company and the husband the scheme represented deferred remuneration. The position is different as between the husband and the wife. As between them the benefits which the husband and his family acquired under the scheme formed the property of a marriage settlement. But those benefits did not include any entitlement to the surplus money.

99.40 Property provided by company

The position is complicated by differences in the definitions of settlor.

99.40.1 *Co settlor: s.86 definition*

The s.86 definition of settlor is unique in that it makes express provision to treat shareholders and certain other participators as settlors, where a close company provides property.

Para 8(4) sch 5 TCGA provides:

> For the purposes of this paragraph...

The rule depends on whether the company is controlled:
(a) by one person alone
(b) by 2 or more persons (taking each one separately)
(c) by 2 or more persons (taking them together)

Para (a) - (c) are conveniently read side by side:

Para 8(4)(a) **Control by: one person**	**Para 8(4)(b)** **persons separat ely**	**Para 8(4)(c)** **persons together**
where property is provided by a qualifying company[1] controlled[2] by one person alone at the time it is provided,	where property is provided by a qualifying company controlled by 2 or more persons (taking each one separately) at the time it is provided	where property is provided by a qualifying company controlled by 2 or more persons (taking them together) at the time it is provided,
that person shall be taken to provide it;	those persons shall be taken to provide the property and	the persons who are participators[3] in the company at the time it is provided shall be taken to provide it and

	each one shall be taken to provide an equal share of it;	each one shall be taken to provide so much of it as is attributed to him on the basis of a just apportionment;
		but where a person would be taken to provide less than one-twentieth of any property by virtue of paragraph (c) above and apart from this provision, he shall not be taken to provide any of it by virtue of that paragraph.

[1] Para 8(5) sch 5 TCGA provides: "For the purposes of sub-paragraph (4) above a qualifying company is a close company or a company which would be a close company if it were resident in the UK." For a note on this terminology, see 104.29.1 (Non-resident close company).
[2] See 60.4.2 ("Control" and "participator").
[3] See 60.4.2 ("Control" and "participator").

The wording is based on s.96(3)-(5) TCGA; see 61.11.2 (Consequence of capital payment to co).

Why does the s.86 definition have this provision which is not found in any other definition of settlor? The answer may be because the s.86 definition is narrower than the others, lacking the rule that someone who makes a settlement is a settlor.[232]

If para 8 applies (so that identified person(s) are "taken to provide" the trust property) it is considered that no other person should be taken to provide the property; in particular, the close company itself is not the settlor for s.86 purposes (even if it may otherwise be said to provide property). But the point may not arise.[233]

99.40.2 *Co settlor: Other definitions*

In *Copeman v Coleman* a company held equally by husband and wife issued shares at an undervalue to their children. This was a settlement-arrangement and the husband was a settlor:

> [the husband] was a[234] 'settlor' ... I am unable to see how the word

[232] See 99.39.4 (Settlor of commercial trust: s.86 definition).
[233] See 60.16 (Corporate settlor).
[234] In fact, husband and wife were joint settlors, though this was not specifically addressed. It did not need to be, as at the time:

> "indirectly" can be limited in the way which is suggested so as to exclude the settlements which are made through the interposition of a company.[235]

The company may also be a settlor, having provided the property directly, but it will not normally matter if it is.[236]

Para 21 Protected-trust Note[237] provides:

> It is considered that a loan (unless on arms' length terms) or other provision to the trust by a company owned by the settlor normally amounts to a provision of property by the settlor. This may not be so if the provision is for the purposes of the company's business and is in the interests of the company as distinct from those of its shareholder(s).

In the 2023/24 edition of this work I summarised the law as follows:

> Where a company makes a settlement, by providing its own property or issuing shares at an undervalue, the individual controlling shareholder(s) will be settlor(s) on the basis that they have provided the property indirectly.
>
> In relation to companies with only one shareholder, it will usually be clear that the shareholder is providing property indirectly, assuming an element of bounty (gratuitous intent).
>
> The same applies to quasi-partnership companies, that is, companies that are in practical terms run as a partnership between the shareholders.

The question arises as to whether this is still right after *HMRC v Fisher*, which held where a company makes a transfer, the shareholders (even 100% shareholders) are not "transferors" for s.720 purposes.[238] The SC gave 4 reasons for its decision. They do not apply in the present context:

Reason 1: ToA had no apportionment provision. But for settlors, there is likely to be one.[239]

(1) Tax was deducted from dividends and could be reclaimed if the recipient was not taxable. The case concerned a claim by the children for a refund of tax.

(2) The income of a married woman was deemed to arise to her husband.

[235] 22 TC 594 at p.601, followed in *Young v Pearce* 70 TC 331. Further authority is not needed, but for completeness there is also *Bird v HMRC* [2008] UKSPC SPC00720 (noteworthy for finding that the taxpayer was not negligent for having failed to understand the definition of "settlement") and *Clipperton* discussed below.

[236] A corporate settlor matters for CRS, see 130.23.4 (Co settlor: change of owner).

[237] For the Protected-trust Note, see 99.2.4 (Guidance).

[238] See 49.6 (Shareholders not transferors).

[239] See for instance 100.1 (Trust with multiple settlors); but other provisions dealing with settlors often make provision for multiple settlors.

Reasons 2 & 3: If we have a rule for controlling shareholders, we need to know what is meant by control. A rule which distinguishes active/knowledgeable shareholders from passive ones is a difficult line to draw and ToA does not specify the tests. But for settlors, the bounty test deals with these points.

Reason 4: Motive defence issues, which apply for s.720 but not for provisions dealing with settlors.

SC were also influenced by what they regarded as the exceptionally penal nature of the ToA code.[240]

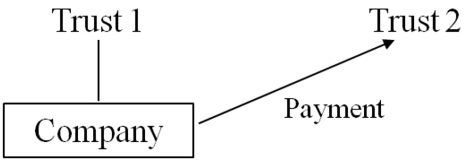
So *Fisher* does not alter the rule that shareholders may be settlors, provided their involvement with the company's actions which created the settlement contains an element of bounty. The position is perhaps clearer when the settlement-arrangement definition is applicable, as the involvement of shareholders may be one of the steps which may constitute the settlement-arrangement.[241] But the position is the same when the other definitions of settlement apply. In practice the issue does not arise for settlors as much as it does for ToA, because arm's length transactions for full value are transfers of assets, but not likely to create settlements.

99.40.3 *Transaction with underlying company*

Of course the position is different if a company is wholly owned by the trust: transactions between a trust and its underlying companies cannot amount to providing property, so the company cannot be a settlor.[242]

99.40.4 *Company held by trust*

Suppose a transfer from a company held by trust 1 to trust 2:



The settlor of trust 1 will be a settlor of trust 2, having provided the

[240] It is difficult to generalise, as "settlor" is used in so many cases. Some settlor rules may be regarded as penal, such as tainting rules, but still, not as penal as ToA.

[241] See *Clipperton*, discussed at App. 2.2.7 (Pre-arrangement steps).

[242] See 99.24.1 (Transfer within trust/co group).

property indirectly.

What about the s.86 definition? As trust 1 controls the company, para 8(4) states that the trustees of trust 1 are taken to have provided the property! But the context shows that here too, the settlor of trust 1 is the settlor of trust 2; and the para 8(4) deeming is not intended to apply to make the trustees of trust 1 settlors of trust 2: the scheme of the TCGA is that trustees are fiduciaries and cannot be settlors.

99.41 Planning to create excluded property trust

The "who is the settlor" question may arise in a tax planning context where it is desired to create an excluded property trust by transferring property to a foreign domiciliary, who will then make a settlement. These arrangements are always challenging and sometimes impossible to carry out in practice, for the outcome depends ultimately on intention, and that cannot be manufactured to suit the circumstances.

Example 1
(1) H (UK domiciled) gives property to W (not UK domiciled).
(2) W gives the property to a trust.

Who is the settlor: H or W or both?

The success of schemes involving a transfer to a foreign domiciliary who creates a settlement depends on how the transaction is carried out. Does W have a sufficiently independent role?[243] It is suggested that W should retain the property for at least one year; that no decision be made as to whether or not to create a settlement at the time of the gift from H to W; *a fortiori* no decision should be made on the terms of the trust; and W should receive independent legal[244] advice on any proposed gift to a settlement.

Example 2
(1) Trustees of a trust (with a UK domiciled settlor) appoint property to a beneficiary ("B") (not UK domiciled).
(2) B gives the property to a new trust.

In principle, the settlor of the new trust will be B, not the settlor of the old

[243] See 99.7 (A gives to B, B gives to trust).

[244] W may also need tax advice, but what matters here is that W has independent advice on the property law aspects of the gift.

trust.[245] But it is different if B is acting at the behest of the settlor.[246]

Watch the proper purpose rule, and the GAAR. It would be better if the terms of the new settlement are different from the terms of the old. For an (almost unbelievable) example of botched execution of this planning, see *Anker-Petersen v Christensen*.[247]

[245] See 99.9 (Trust appoints to B, B gives to new trust).

[246] See 99.8 (B makes trust at A's request).

[247] [2001] EWHC B3 (Ch).

CHAPTER ONE HUNDRED

MULTIPLE SETTLORS

100.1 Trust with multiple settlors
100.1.1 Where multiple settlor provision does not apply
100.1.2 Multiple settlor provisions
100.1.3 Originating
100.1.4 Two settlors: CGT guidance
100.2 Just & reasonable apportionment
100.2.1 Direct and indirect settlors
100.2.2 Loan/guarantee/paying trust expenses

Cross references

The following topics are considered elsewhere:

Topic	**See**
Settlor-interested trusts with only one settlor	47.1 (Income Tax); 60.1 (CGT)
Beneficiary relief conditions	47.10.1
IHT aspects of trusts with two or more settlors	79.2

100.1 Trust with multiple settlors

This chapter considers the IT and CGT position where a settlor-interested trust has more than one settlor. I deal with this in one chapter as the IT/CGT issues overlap. For IHT issues, see 79.5 (Separate-settlement fiction).

100.1.1 *Where multiple settlor provision does not apply*

In *Herbert v IRC*,[1] the facts (in short) were:

(1) Property was held on trust for L for life, remainder to R.
(2) L and R directed that the property should be transferred to a new trust.
(3) The trust was revocable (and so settlor-interested).

R was assessed on the income of the new trust under a provision

[1] 25 TC 93.

equivalent to s.624 ITTOIA.[2] The judge observed:

> [R] is not the only settlor. [L] is also a settlor... the Act does not prescribe what is to happen when there is more than one settlor ... It is not suggested that all the settlors can all be assessed in respect of all the income. That, indeed, would seem to be an extravagant proposition. Nor is it suggested by the Crown that the income should be distributed between them....
> The interpretation of the Section put forward on behalf of the [Revenue] was that where there are two or more settlors the Crown has the option to assess any one of the settlors to the exclusion of the other, and that, in the case of an assessment to Income Tax ... the option must be exercised by the local Inspector of Taxes and that there was no right of appeal by the taxpayer against the Inspector's choice. ... I find myself unable to accept that interpretation. It seems to me fantastic to suppose that Parliament has conferred upon Inspectors of Taxes, or even upon the Special Commissioners, a choice as to whether A, or B, or C should be liable to Income Tax...

What seemed "fantastic" in 1943 does not seem so today. The reader may wonder if a Court would have reached the same decision today: the answer is no, see below.

100.1.2 *Multiple settlor provisions*

Section 644 ITTOIA now makes provision for a settlement with multiple settlors:

> (1) In the case of a settlement where there is more than one settlor, this Chapter has effect in relation to each settlor as if that settlor were the only settlor.
> (2) This works as follows.
> (3) In this Chapter, in relation to a settlor—
> (a) references to the property comprised in a settlement include only property originating from the settlor, and
> (b) references to income arising under the settlement include only income originating from the settlor.
> [Subsections (4) and (5) deal with ss.629-632 ITTOIA (settlements for minor children of the settlor) which is not discussed here.]

Similarly, for s.86, para 7 sch 5 TCGA provides:

[2] I guess that L was not assessed because he was non-resident.

> For the purposes of section 86 and this Schedule, a person is a settlor in relation to a settlement if the settled property consists of or includes property originating from him.[3]

100.1.3 *Originating*

There are commonsense definitions of property/income “originating from” a person:

s.645 ITTOIA	**para 8 sch 5 TCGA**
(1) References in sections 628A and 644 to property originating from a settlor are references to—	(1) References in section 86 and this Schedule to property originating from a person are references to—
(a) property which the settlor has provided directly or indirectly[4] for the purposes of the settlement,	(a) property provided by that person;
(b) property representing[5] property so provided, and	(b) property representing property falling within paragraph (a) above;
(c) so much of any property which represents both property so provided and other property as, on a just and reasonable apportionment, represents the property so provided.	(c) so much of any property representing both property falling within paragraph (a) above and other property as, on a just apportionment, can be taken to

[3] See 60.11 (Section 86 gains condition); 99.2.11 (CGT s.86 definition of “settlor”).

[4] Section 645(3) ITTOIA deals with reciprocal arrangements: “In this section references to property or income which a settlor has provided directly or indirectly—
(a) include references to property or income which has been provided directly or indirectly by another person under reciprocal arrangements with the settlor, but
(b) do not include references to property or income which the settlor has provided directly or indirectly under reciprocal arrangements with another person.”
See 99.4 (Reciprocal arrangements).

[5] See App 2.9 (“Representing assets). There is the standard provision:

s.645(4) ITTOIA	**para 8(6) sch 5 TCGA**
In this section references to property which represents other property include references to property which represents accumulated income from the other property.	For the purposes of this paragraph references to property representing other property include references to property representing accumulated income from that other property.

	represent property so falling.
(2) References in sections 627 and 644 to income originating from a settlor are references to—	(2) References in this Schedule to income originating from a person are references to—
(a) income from property originating from the settlor, and (b) income provided directly or indirectly by the settlor.	(a) income from property originating from that person; (b) income provided by that person.
	(7) For the purposes of this paragraph property or income is provided by a person if it is provided directly or indirectly by the person.

Thus on the facts of *Herbert*, the income of the new trust would in principle be treated as the income of L for his life, under s.624, and as the income of R after the death of L. How would gains be apportioned? It is suggested, by reference to actuarial values at the date of the resettlement. But it will not happen often, if at all.

Section 644 applies where there is *one* settlement with more than one settlor. In some IT cases one might say that there are two settlement-arrangements. Eg suppose:

(1) S creates a trust
(2) Subsequently, and independently, X adds to it.

One might say that:

(1) there are two distinct settlement-arrangements (even if there is only one classic settlement)
(2) S and X are the (sole) settlors of their settlement-arrangement.

However s.644 is another route to the same destination. It does not matter which analysis one takes, though s.644 seems a clearer solution.

100.1.4 *Two settlors: CGT guidance*

The CG Manual contained guidance which related to s.77 -79 TCGA. Those sections were repealed in 2008 but the guidance remained in the Manual until 2020 when it was finally removed. I set it out here as it is still relevant to s.86:

> **CG34893 Multiple settlors** [Version of Jul 2019, removed 2020]
> Section 79 [TCGA] provides that trust gains are only to be attributed to each settlor to the extent that those gains accrue on property originating from that person. Where the assets provided by two or more settlors are managed as separate funds, there should be no difficulty in determining to which settlor the gains on the disposal of particular items of property should be attributed. Where the assets provided by different settlors are not appropriated into separate funds, the legislation provides for a just apportionment as between the settlors.
> **CG34894 Multiple settlors** [Version of Jul 2019, removed 2020]
> If HMRC Trusts Head Office Bootle or Financial Intermediaries and Claims Office (formerly Claims Branch) have given advice on apportionment for Income Tax purposes, this should be followed for CGT. Otherwise, if settlors together make the settlement, the gains in such a case should be apportioned according to the amounts each put in. If a settlor adds to a settlement, then the amount put in should be compared with the value of the settlement at that time. Trust Offices should endeavour to reach a fair and easily worked solution.
> **CG34895 multiple settlors** [Version of Jul 2019, removed 2020]
> If one settlor is within Section 79 [TCGA] and the other is not, the gains are apportioned on the lines suggested, but those relating to the settlor who is outside Section 79 are assessed on the trustees in the normal way after deducting the trustees' annual exempt amount.
> **CG34900 Example 1** [Version of Jul 2019, removed 2020]
> A and B each settle ordinary shares in X Limited on a trust under which both Mrs A and Mrs B have an interest as defined by the new provisions. A settles 500 such shares and B 1500. It is accepted that there is only one settlement for CGT purposes and the shares are not appropriated into separate funds.
> In 1988-89 there is a gain of £2,000 on the sale of some of the shares, [there is] a loss of £400 on the sale in 1989/90 of further shares and in 1990-91 a gain of £500 on the sale of shares in Y Limited acquired with the sale proceeds of the shares in X Limited.

The HMRC analysis is as follows:

> In 1988-89, as A and B settled property in the proportion 1:3, there is, on a just apportionment, a chargeable gain of £500 (2000 × ¼) accruing to A.
> Similarly a gain of £1500 is treated as accruing to B. Each is assessed as appropriate.

That is straightforward. The example then turns to consider the loss in the next year and the gain in the following year:

> The loss of £400 in 1989-90 is apportioned £100 to A and £300 to B. The gain of £500 in 1990-91 is apportioned £125 to A and £375 to B. The loss of £100 in respect of the property provided by A is set against the gain of £125, leaving a net gain of £25 to be attributed to A. Similarly the loss of £300 in respect of the property provided by B is set against the gain of £375 on the property provided by him, leaving a net gain of £75 assessable on B.

More analytically, the loss is not attributed to A or to B (either under the former s.77 or under the existing s.86.) It is carried forward and set against future gains of the trustees. The net gain in 1990/91 is £100 which is apportioned £25 to A and £75 to B. But the end result is the same.

> **CG34901 Example 2** [Version of Jul 2019, removed 2020]
> The facts are as in Example 1 except that by a deed executed during 1988-89 Mrs B irrevocably excludes herself from the class of beneficiaries.

The HMRC analysis is as follows:

> The gains of that year are apportioned and attributed as before because Mrs B had an interest in the settlement at some time during the year.

More analytically, this result obtains because at some time in the year *Mr* B had an interest in the settlement, for the purposes of s.77 TCGA, because his spouse Mrs B could benefit.[6] But the end result is the same.

> The losses of 1989-90 and the gains of 1990-91 are apportioned in the same way, and the net gains of £25 for 1990-91 are attributed to A.

More analytically, the losses are set against the trustees gains; but it is correct that of the net £100 gains, £25 is attributed to A on a just and reasonable apportionment.

> There can be no attribution to B in 1990-91 because neither he nor his spouse has an interest in the settlement in that year. Accordingly the gains on the assets deriving from the property provided by B are assessable on the trustees and the trustees can claim the annual

[6] The trust created in the example is unusual, because the settlors Mr A and Mr B are excluded, but their spouses are beneficiaries. But this might be done in practice, to avoid GWR issues.

exemption due to them...[7]

100.2 Just & reasonable apportionment

The multiple settlor provisions are straightforward if two individual ("A" and "B") directly transfer property to a trust. A and B are both settlors and the property originating from A and B can be identified.

100.2.1 *Direct and indirect settlors*

Suppose there is an arrangement under which:
(1) A makes a gift of property to B, and
(2) B gifts the property to a trust.

A is a settlor (having provided property indirectly) and it seems at first as if B is also a settlor (having provided the property directly).[8] But A and B have provided the *same* property. There is no provision how to apportion trust income or gains between A and B and, since the income and gains cannot be subject to tax twice, it is considered that s.624 and s.86 do not apply at all; see 100.1.1 (Where multiple settlor provision does not apply). The solution to the problem is that A is the "real" settlor, and B is not to be regarded as the settlor.

This issue sometimes arises in the context of failed tax planning of the kind discussed at 99.41 (Planning to create excluded property trust).

In *Clipperton*[9]

> 158. We consider that on a straightforward construction of sections 644 and 645, those provisions are sufficiently wide to encompass a situation where the same property can be said to have been provided by more than one settlor. The definition of "settlor" in section 620 is, as we have seen, very wide ... Where there is more than one person falling within the definition, Section 644(1) then operates to treat each of them as the only settlor, and to treat references in the settlements code to property comprised in the settlement or income arising under the settlement as including only property or income originating from the person treated as the only settlor.
>
> in principle sections 644 and 645 could lead to "double taxation".

[7] The Manual continues with some (I think erroneous) comments on the interaction of the annual exemption and loss relief; but it is not necessary to pursue that here.

[8] See 99.7 (A gives to B, B gives to trust).

[9] Clipperton is discussed 87.5.8 (No intention to benefit others).

It might have been different if *Herbert* had been cited. An easy way to conclude the matter is to say that for the purposes of the settlor-interested trust code, the shareholder should be treated as the real or effective settlor.

A higher court may well prefer the solution of a just and reasonable apportionment. But on the facts here, these are two different routes to the same destination

100.2.2 *Loan/guarantee/paying trust expenses*

Similar issues arise where:

(1) S makes a settlement; and

(2) X provides further funds indirectly to the settlement, for instance by way of beneficial loan, guarantee, or payment of trust expenses.

X may be a joint settlor, but (even if the trust is settlor-interested) s.624 still does not apply to X unless it is possible to identify the income provided by X, ie arising from X's act of bounty. In some cases one may say that all the income originates from S, so that s.624 applies to S but not to X. In other cases the contribution of S may be nominal, and one may be able to say that all the income originates from X.

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TAXATION OF NON-RESIDENTS AND FOREIGN DOMICILIARIES 2024-25

by

JAMES KESSLER KC

VOLUME EIGHT

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Chapter 107 - 113 Double Taxation Agreements IT/CGT
Chapters 114 -120 Double Taxation Agreements IHT
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TWENTY FOURTH EDITION

Key Haven Publications Ltd
P. O. Box 669, Oxford, OX3 3AU
Tel: 01865 352121
http://www.khpplc.co.uk

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CHAPTER ONE HUNDRED AND ONE

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101.1 Statutory tax indemnities

The taxes acts often authorise a taxpayer to recover tax from another person. I refer to these as **"statutory tax indemnities"**. They arise in a variety of cases.

Settlors have an indemnity in the following cases:

Tax charge on settlor	**Indemnity**	**Indemnity against**	**See**
s.624/629 ITTOIA	s.646 ITTOIA	Trustees + others	101.2
s.86 TCGA	para 6 sch 5 TCGA	Trustees	101.2
Policy/chargeable event gain	s.538 ITTOIA	Trustees	101.2
Settlor-attribution rules	s.87G(3) TCGA	Original recipient	61.28

Agents have an indemnity against their principal in the following cases:

Topic	**Indemnity**	**See para**
Non-resident landlord representative	s.971 ITA	24.17
Agent of non-UK resident	s.835X ITA	124.6.4

Other more specialist statutory tax indemnities include:

Topic	**Indemnity to**	**Statutory ref**	**See**
Clawback of hold-over relief	Donor	s.168(9) TCGA	12.2
Trust migration	Retired trustee	s.82(4) TCGA	12.5
Disposal of equitable interest	Disponor	para 11 sch 4A TCGA	-

In other cases there is no statutory indemnity, but there is some tax relief which allows the relevant person to make a payment to the taxpayer if they chose to do so, without the usual tax consequences of a voluntary payment.[1]

The focus of this chapter is settlor indemnities against trustees. However similar considerations can apply to other types of indemnity, including indemnities in non-tax statutes, and non-statutory indemnities.[2]

101.2 Settlor trust-tax indemnities

The indemnities for the settlor against trustees use standard form wording:

s.646(1) ITTOIA	**Para 6 sch 5 TCGA**	**s.538 ITTOIA**
“s.624 indemnity”	**“s.86 indemnity”**	**“chargeable event indemnity”**
	(1) This paragraph applies where any tax becomes chargeable on, and is paid by, a person in respect of gains treated as accruing to him in a year under section 86(4).	(1) This section applies if— (a) immediately before a chargeable event the rights under the policy or contract, or the part of or share in them in question, were held on non-charitable trusts, (b) an individual is liable for tax under this Chapter for the tax year on the gain from the event, and (c) the income tax for which the individual is liable for the tax year, after any relief available in respect of the gain under section 535 (top slicing relief),[3] exceeds that for which the individual would have been liable apart from the event.
A settlor is entitled to recover from— (a) any trustee, or	(2) The person shall be entitled to recover the amount of the tax from	(2) The individual is entitled to recover that excess from the trustees, subject to the

[1] See 64.22 (Reimbursement by non-resident co); 51.5 (Distribution relief).

[2] On whether person granting an indemnity to a trust provides property, or adds value, see 99.27 (Giving an indemnity).

[3] Section 538(4) ITTOIA provides

> “If the individual's relief under section 535 for the tax year does not relate only to the gain from the event in question, for the purposes of subsection (1)(c) a proportionate part of that relief is taken to be relief in respect of that gain.”

(b) any other person to whom the income is payable in connection with the settlement,[4] the amount of any tax paid by the settlor which became chargeable on the settlor under section 624 or 629.	any person who is a trustee of the settlement.	restriction specified in subsection (3).
[No equivalent]	[No equivalent]	(3) The amount recovered must not exceed the total of— (a) any sums received by the trustees because of the chargeable event, and (b) the value of any benefits so received.

These indemnities do not extend to interest or penalties.

The settlor may not need the s.624 indemnity, because in the case of a settlor-interested trust, the trustees will normally pay the tax (and the settlor will have a tax credit for that payment).[5] The s.624 indemnity might be needed if the trustees do not pay the tax (eg in the case of a non-resident settlor-interested trust). Though I wonder how often it is used. The chargeable event indemnity is niche. So the s.86 indemnity is the most important.

Where the settlor has an indemnity against the trustees it is the beneficiaries who ultimately bear the burden of the tax charge, but they do so at the settlor's marginal rates. This may favour the taxpayer, because trust income may otherwise be taxed at the trust rates, ie the top rates; so in a very rough and ready way the rules can mitigate the unfairness of taxing trust income at the trust rates, when beneficiaries may be lower rate taxpayers.

The s.624 indemnity is wider than the other two, as it allows a claim against any person to whom the income is payable in connection with the settlement, but I doubt if that is much used.

It might happen that:

(1) The settlor ("S") pays tax to HMRC

[4] The same wording is used in s.646(4), see 47.11.3 (Excess credit returned to trust).

[5] See 47.11 (Trustees of settlor-interested trust).

(2) S recovers that tax from the trustees under a statutory indemnity
(3) S later obtains a repayment of the tax from HMRC

The trustees would in principle have the right to recover the repayment under the law of restitution.

101.2.1 *Certificate of tax paid*

s.646 ITTOIA	**Para 6 sch 5 TCGA**	**s.538 ITTOIA**
(2) For this purpose, the settlor may require an officer of Revenue and Customs to provide the settlor with a certificate specifying— (a) the amount of income in respect of which the settlor has so paid tax, and	(3) For the purposes of recovering that amount, the person shall also be entitled to require an inspector to give him a certificate specifying— (a) the amount of the gains concerned, and	(5) An individual may require an officer of Revenue and Customs to certify an amount recoverable by the individual under this section.
(b) the amount of tax so paid.	(b) the amount of tax paid,	
(3) A certificate provided under subsection (2) is conclusive evidence of the facts stated in it.	and any such certificate shall be conclusive evidence of the facts stated in it.	(6) Such a certificate is conclusive evidence of the amount.

101.3 Procedural issues

101.3.1 *Indemnity time limit*

Section 9(1) Limitation Act 1980 provides:

> An action to recover any sum recoverable by virtue of any enactment shall not be brought after the expiration of six years from the date on which the cause of action accrued.

Different time limits may apply in foreign court proceedings.

The cause of action accrues when the tax due is paid. Tax may be assessed up to 20 years after the income or gain arises, and following assessment, tax may not be paid until subsequent appeal and collection proceedings have been completed, so it is possible that trustees may be subject to an indemnity to pay tax due in respect of income or gains which accrued 30 or more years previously; though one hopes that would rarely if ever happen in practice.

101.3.2 *Change of trustees*

As trustees are a single and continuing body, for tax purposes, it is suggested that the indemnity lies against the person who is trustee when proceedings for the indemnity commence, not the person (if different) who was trustee when the income/gains arose.

101.3.3 *Enforceability of indemnity*

For enforceability of statutory tax indemnities in foreign jurisdictions, see:

Campbell, " CGT: The Settlor's Predicament" [1999] PCB 277
Peacock, "CGT: A Worthless Right?" [1999] PCB 204
Sartin, "Tax Recovery Claims by the Settlor" [1999] PTPR 237

101.4 Tax on indemnity payment

SP 5/92 provides:

> 8[1] The settlor's right, under Para 6 Sch 5 TCGA, to reimbursement (or any payment in reimbursement) of tax paid under that Schedule is not regarded as creating an interest in a trust for the settlor under the provisions of [the settlor-interested trust code] where the settlor, the settlor's spouse, and any companies in which they are participators cannot otherwise benefit from the trust, eg where the only beneficiaries are the settlor's children.
> [2] Similarly, this statutory right to, or payment in, reimbursement is not regarded as bringing the settlor within the provisions of [s.633 ITTOIA, and the ToA provisions],
> [3] nor as a capital payment for the purposes of s.97 TCGA.[6]
> 9[1] Further, this statutory right is not regarded as a reservation of benefit for inheritance tax purposes;
> [2] nor is a provision in the trust deed either requiring the trustees to recognise the settlor's right to reimbursement under Para 6 Sch 5 TCGA

[6] The CG Manual makes same point:

> **"CG38625: Capital payments** [Jul 2019]
> A beneficiary or settlor who has pays tax in respect of a non-resident settlement may have a statutory right to recover that tax from the trustees. For example, a repayment of Income Tax to a settlor under ITTOIA05/S646 or Capital Gains Tax under TCGA92/Sch 5 para 6. This is not treated as a capital payment."

Likewise reimbursement is not a benefit for ToA purposes, the concept of benefit is the same. That is self-evident, but if authority is needed, see Protected-trust Note para 22: "Reimbursement of tax paid by the settlor is not a benefit under the transfer of assets rules provided the right to reimbursement is statutory".

> or to reimburse the settlor...[7]
>
> 10 A provision written into a settlement deed requiring the trustees to recognise the settlor's right to reimbursement under Para 6 Sch 5 TCGA, or to reimburse the settlor,
>
> [a] is not, of itself, regarded as giving the settlor an interest in the settlement for the purposes of Sch 5,
>
> [b] nor as bringing into play the provisions of [s.624 ITTOIA, and the ToA Provisions].

There are many points bundled in this list, but they all arise from the same fundamental point, namely, that a payment to the settlor under a settlor trust-tax indemnity is not a benefit to the settlor.

Why not, when the exercise of the indemnity involves the payment of a sum to the settlor? The answer may be that one looks at the matter as a whole: the settlor has received £x and paid £x in tax; so looked at overall, the settlor is no better off than before.

Another possible answer may be that before the repayment the settlor has a valuable right - the right to the repayment, so the settlor is no better off after the payment. This answer requires one to ignore the possibility, which will sometimes be the case, that the indemnity is not in fact enforceable.

The same applies to:

(1) All statutory tax indemnities
(2) Trust law indemnities[8]
(3) Contractual indemnities, such as may arise on retirement of trustees
(4) Equivalent foreign tax law indemnities

A settlor is not entitled to claim under the indemnity until they have paid the tax due to HMRC. What if reimbursement is made sooner, before the

[7] SP 5/82 makes similar points for the indemnity to a former trustee of an exit charge:

> 6 An amount recovered from present trustees by a former trustee in respect of capital gains tax under TCGA 1992 s 82 is not regarded as a capital payment under s 97. Further, such amounts do not fall within the provisions of [what is now s.720, 727 or 731 ITA] nor are there any inheritance tax implications.

See 12.5 (Trustees liable for exit charge).

[8] Eg s.31 Trustee Act 2000 which provides:

> "A trustee-
>
> (a) is entitled to be reimbursed from the trust funds, or
>
> (b) may pay out of the trust funds,
>
> expenses properly incurred by him when acting on behalf of the trust."

settlor has paid the tax? It is considered that there is no benefit (or the value of the benefit is nil) when trustees pay a sum to a settlor in *bona fide* settlement of a claim or prospective claim for reimbursement.[9]

Income spent in meeting a statutory indemnity ceases to be relevant income for s.731.[10] See too 98.27 (Indemnities and guarantees).

101.5 Failure to claim indemnity

101.5.1 *Settlor/tainting issues*

SP 5/92 para 24 provides:

> [1] Failure, by or on behalf of any relevant person, to exercise statutory rights to reimbursement e.g. under [s.646 ITTOIA],[11] may be regarded as the provision of funds for the purposes of the settlement under TCGA 1992 Sch 5 para 9(3).[12]

Point [1] only applies to a failure to exercise rights with gratuitous intent (ie with an element of bounty). This is the reason for the exceptional case which para 24 then mentions:

> [2] The settlement could (?) remain outside the terms of para 9(3) where the exercise of the right to reimbursement is unsuccessful, provided it could be shown that there had been a genuine attempt to enforce rights to reimbursement.

[9] HMRC once floated the contrary view, but it was a bad point, and perhaps they have now dropped it.

[10] See 50.28 (Relevant income spent).

[11] See 101.2 (Settlor trust-tax indemnities).

[12] For SP 5/92 and para 9(3), see 99.2.4 (Guidance).
For completeness, Tax Bulletin 8 correctly qualifies para 24:

> "Para 24 of the Statement of Practice [5/92] points out that failure to exercise statutory rights to reimbursement against non-resident trustees may be regarded as the provision of funds for the purposes of the settlement under para 9(3) of Schedule 5, TCGA 1992. This will not, however, apply in respect of a settlor's non-exercise of statutory rights to reimbursement out of the trust income account where the settlor has a life interest in all the assets of the trust. In such circumstances, failure to exercise the right to reimbursement would, effectively, not add funds to the trust since all income would, in any ease, either be paid to the settlor under the terms of the trust deed or be used to meet expenses chargeable against income.
> But even in such cases the settlor may have rights to reimbursement out of the trust capital account, eg in relation to accrued income charges, which if not exercised will be regarded as the provision of funds."

The exception is stingily worded.[13] It is not necessary to show "a genuine attempt to enforce rights to reimbursement". It is sufficient to show that:

(1) such rights are not enforceable, or
(2) a decision not to obtain reimbursement is a commercial one because enforcement, or even just taking advice on enforcement, would not be or does not seem cost-effective, or
(3) the point was simply overlooked and the decision not to claim reimbursement was not a conscious one.

It is strongly arguable that even a deliberate and gratuitous refusal to exercise a right of reimbursement does not amount to providing property. For what is the property provided? It would however count as adding value.

Protected-trust Note para 22 provides:[14]

> The published guidance indicates at the end of 5.5 that:
>
> *A failure by a settlor to reclaim tax from the trustees could taint a trust, but provided that the settlor claims reimbursement within a reasonable time the trust will not be regarded by HMRC as tainted.*
>
> In relation to income which arose before 6 April 2017, it is considered that if, prior to that date a reasonable time has passed since the right of reimbursement first arose, tainting has not occurred. This is because any addition would have taken place when the right had not been exercised within a reasonable time after it has arisen. There is no further addition if the settlor continues to fail to exercise the right.

I would have thought that what matters is not whether a reasonable time has passed (whatever that means) but whether the claim is statute barred.

101.5.2 *Failure to claim: IHT issues*

SP 5/92 provides:

> 9... where a settlor does not pursue the statutory right to reimbursement, the failure to exercise this right may give rise to an inheritance tax claim under s.3(3) IHTA,[15] in which case the usual rules for lifetime transfers would apply.

[13] Here, as elsewhere, SP 5/92 gives the impression that it was intended to make life as difficult as possible for offshore trusts. In 1992 that was considered striking; though nowadays it would hardly merit a mention.

[14] For this Note, see 92.1.1 (Protected-trust guidance).

[15] See 74.5 (Omission: Deemed disposition).

The IHT normal expenditure exemption may apply:

(1) In the case of income tax indemnities, if income arises regularly; and

(2) In the case of CGT indemnities, if such gains arise regularly and the tax is paid out of income.[16]

But the amounts are not likely to be so great.

A statutory indemnity is not a settlement power, and so does not qualify for settlement-power relief.[17]

[16] For completeness: the same could apply to chargeable event gains, but in practice that would be rare.

[17] See 74.10 (Settlement power).

CHAPTER ONE HUNDRED AND TWO

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The following topics are considered elsewhere:

Topic	**See para**
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102.1 Concepts of situs

Situs[1] of assets matters for many tax and some non-tax purposes. It is not practical to draw up a full list; the most important are:

(1) IHT excluded property (which applies to non-UK situate assets)

(2) CGT remittance basis (which applies to non-UK situate assets)

[1] A note on terminology. IHTA and TCGA generally refer to the “situation” of assets though the heading to s.275 TCGA refers to “location”. Section 59 Stamp Act 1891 (repealed) used the term “locally situate” and some older cases referred to the “local situation”. Practice Direction 6B (Service out of the Jurisdiction) refers to property “within” the jurisdiction:. These expressions are synonymous.
Some old cases were uncomfortable with the concept of situs of intangible property, and used the term “quasi locality”, but this has not been adopted and situs is the current term.
“Situs” has become adopted into legal English, and should not be written in italics.

(3) ITA remittance rules (there is a remittance if an asset is received in the UK, ie, UK situate when received)[2]

Situs (like domicile) is a concept of private international law[3] which has been adopted whenever tax statutes (or other statutes) refer to the location of property (typically referring to property "in" or "within" or "outside" a state). The rules are laid down by the common law.[4] The common law rules apply for tax, except so far as modified by specific rules in tax legislation. Thus one might refer to these rules as common law rules, private international law rules, or IHT rules.

IHT situs is almost entirely based on the common law rules. These are discussed in this chapter. Some IHT double tax treaties override the usual IHT situs rules.[5]

CGT has statutory situs rules which cover most situations, and the common law is only needed to fill a few gaps. So CGT situs is best regarded as a separate subject, though in a few cases the common law/IHT rules still apply for CGT. The statutory CGT rules are discussed in the next chapter.

The rules which determine the location of a source of income for income tax purposes are distinct from the rules which determine the situs of assets. For instance, the source of dividends is the place where the company is resident, but the situs of shares is the place where the shares are registered. Situs of assets only occasionally matters for IT, but where it does, then (subject to any overriding rule of IT law) the common law rules discussed in this chapter will apply.

As there are diverse statutory situs rules, one should (strictly speaking) not refer to situs in the abstract, but to situs for a specific purpose (CGT,

[2] Other tax issues where situs matters include:
(1) Foreign IHT and CGT credit relief
(2) Stamp duty; see s.14(4) Stamp Act 1891
(3) Penalties
In most cases the issue is whether or not the asset is situated in the UK, and if outside the UK it does not matter where. However in cases of foreign IHT and CGT credit relief, it may be necessary to identify the state where assets are situated.

[3] This topic is also called "Conflict of Laws" but (notwithstanding Dicey's book of that name) I think "private international law" is the better label.

[4] I use the term "common law" here to mean judge-made law, including the pre-1857 ecclesiastical law from which the present law is derived.

[5] See 115.10 (Treaty-situs); 119.9 (Dual-situate asset).

IHT, or whatever). However context may supply the reference, and in this chapter, situs means situs as determined by the common law rules which apply for IHT purposes.

Scots situs law is the same as English law,[6] except where situs depends on concepts of property law which are different in Scotland.[7] Northern Ireland situs law is the same as English law.

102.1.1 *Situs in tax/private international law*

In considering which country's laws should be used to determine the effect of property transactions, judges have traditionally applied the law of the country where the property is situated.

Dicey takes the view that situs for tax purposes may be different from situs for the purpose of private international law.[8] But this expression conceals a muddle or a mistake. One may correctly refer to situs for *specific* tax purposes, such as CGT, or IHT DTAs, which have statutory situs rules. But in the absence of contrary intention, references in a tax statute (or any statute) to the situs or location of property are taken as references to the private international law concept of situs. The law does not distinguish between situs for (general) tax purposes and situs for private international law purposes. *AG v Bouwens* (the leading tax case) adopts the situs rules which were developed "to prevent conflicting jurisdictions between different ordinaries".[9] Non-tax situs cases[10] routinely cite and follow tax cases, and vice versa. In a stamp duty case, Lord Lindley referred to situs "for *legal* purposes" (not *tax* purposes) and

[6] For instance, *Laidlay v Lord Advocate* (1890) 15 App Cas 468 followed the Scots case *Commissioner of Stamp Duty v Salting* [1907] AC 449; see 102.35 (Situs of partnership share).

[7] See 102.18.2 (Situs in Scots law).

[8] Dicey, Morris & Collins, *The Conflict of Laws* (16th ed, 2022) chap 23 frequently refers to situs for taxation purposes; eg para 23-032, 23-133 (Specialties).

[9] See the quote at 102.14 (Simple contract debt). The argument that situs rules should be limited to their original context of probate cases was rejected in *English, Scottish & Australian Bank v IRC* [1932] AC 238 at p.257:

> "It was suggested that the doctrine just enunciated was peculiar to probate cases. Apart from the illustrations of its application in other departments of the law which [counsel] adduced, I venture to express my agreement with Lord Lindley, who said: "The authorities which bear upon the locality of incorporeal personal property for purposes of probate appear to me to afford the best guides for the solution of the case before us."

[10] Such as *New York Life Insurance Co v Public Trustee* [1924] 2 Ch 101.

added:

> It may perhaps be true that property which has no physical existence may, if necessary, be treated for some purposes in one locality, and for other purposes in some other locality. But, until the necessity for so treating it is apparent, I see no justification for introducing confusion by judicially holding the same property to be legally situate in two different places at one and the same time. But this confusion would be introduced if your Lordships were to decide that the analogy of probate cases was to be no guide in dealing with liability to stamp duty.[11]

It would of course be possible for the common law to develop different situs rules for different purposes. But (subject to statutory exceptions) a distinction between situs for one purpose and situs for another purpose should be avoided so far as possible, and in practice the common law has not gone down this path.[12]

The law of the jurisdiction where an asset is situate is conventionally called the *lex situs*. The role of situs (or *lex situs*) in private international law has decreased. Some say it would be better if it was not used at all.[13]

[11] *IRC v Muller & Co's Margarine* [1901] AC 217 at p.237.

[12] Except for a line of Canadian case law concerning expropriation, which requires a lot of explanation, but which does not affect the point being made here.

[13] See Rogerson "The Situs of Debts in the Conflict of Laws - Illogical, Unnecessary and Misleading" [1990] CLJ 441. Similarly, the UNCITRAL Legislative Guide on Secured Transactions (2010), Chapter X para 20 discussing conflict rules for security rights provides:

> "the Guide does not consider the location of the asset as being the appropriate connecting factor for intangible assets and favours an approach generally based on the law of the location of the grantor".

Similarly UK Jurisdiction Taskforce, Legal statement on cryptoassets & smart contracts (2019) para 96, 97; and Amy Held, "Crypto Assets and Decentralised Ledgers: Does Situs Actually Matter" (2023) *https://brill.com/edcollchap-oa/book/9789004514850/BP000017.xml?body=pdf-60830*

I do not set out the arguments against the use of situs in private international law, because this of only theoretical interest, at least to readers who are private client lawyers:

(1) Although private international law might improve if it did not use a concept of situs, in relation to intangible property, at present it still does.

(2) Even private international law was changed, so it did not refer to situs, the concept of situs would survive elsewhere as long as tax or other statutes continue to refer to the situation/location of assets.

But at present, situs still matters sometimes, in private international law.[14]

102.1.2 *History and terminology*

To understand the old case law one needs to know some of its history and historic terminology.[15]

As mentioned above, the common law has adopted situs rules which were originally developed "to prevent conflicting jurisdictions between different ordinaries".[16]

The "**ordinary**" was the judge of an ecclesiastical court with jurisdiction to grant probate for personal property situate in his province or diocese.

Blackstone explains:

> If all the goods of the deceased lie within the same jurisdiction, a probate before the ordinary, or an administration granted by him, are the only proper ones; but if the deceased had *bona notabilia*, or chattels to the value of a hundred shillings in two distinct dioceses or jurisdictions, then the will must be proved, or administration taken out, before the metropolitan of the province, by way of special prerogative; whence the court where the validity of such wills is tried... is called the prerogative court.[17]

[14] Eg, a claimant may serve a claim form out of the jurisdiction with the permission of the court where (inter alia) "The subject matter of the claim relates wholly or principally to property within the jurisdiction"; see Practice Direction 6B (service out of the jurisdiction) para 3.1(11).

[15] For a discussion of this interesting corner of legal history, see Outhwaite, *The Rise and Fall of the English Ecclesiastical Courts, 1500-1860.*

[16] See the quote at 102.14 (Simple contract debt).

[17] Commentary on the Laws of England, Book 2 p.509. There were about 250 local courts, and two prerogative courts, in Canterbury and York.
The Solicitor-General said in argument in *AG v Bouwens* (1838) 4 M & W 171 *http://www.commonlii.org* at p.189:

> "that doctrine [*bona notabilia*] has no application as between goods in one province or diocese, and out of the kingdom. The defendants must establish that these instruments have no value in the kingdom."

In order to understand this, one needs to understand what the Solicitor-General meant by the doctrine of bona notabilia. The Solicitor-General is *not* referring to the set of rules which determine where assets are situate. He is referring to the rule that where the deceased had bona notabilia in more than one diocese, the will must be proved in the prerogative court. Obviously that rule has no application in tax cases such as *Bouwens* where the issue is whether property is situate in the UK or outside the UK. This comment does not cast any doubt on the application of the situs principles developed in the ecclesiastical probate cases and now adopted in the common law.

The term "***bona notabilia***" in the wider sense meant "such goods and debts of a deceased person as require administration being taken thereto, [ie which require a grant of probate or administration] and are therefore denominated *notable*." The term was more often used to mean "goods and debts belonging or owing to any person at the time of his death, in any other diocese or peculiar jurisdiction, within the province... besides the goods in the diocese or peculiar jurisdiction where he dwelt".[18] The detailed rules of what counted as bona notabilia (and so required probate) need not be considered here.

In 1857 the jurisdiction of the ecclesiastical courts passed to the Court of Probate. The concept of bona notabilia (in the sense of assets not in the diocese where the deceased was resident) then became obsolete, though the term continued to be used: "bona notabilia" in a certain place became a traditional way of referring to the assets of the deceased situate in that place.

In 1875 the jurisdiction passed to the Chancery Division of the High Court.

102.1.3 *Inconsistent case law*

As in any large body of case law – and the body of situs case law is very large – it is usually possible to find cases or dicta supporting inconsistent views. In 1914, Hohfeld said of the subject of conflict of laws:

> This is a branch of municipal law as to which... the Anglo-American system ... has conspicuously failed both in England and in the United States. We have, even in relation to some of the most basic principles, which ought above all others to be uniform, certain, and knowable, a veritable chaos of opinion and decision.[19]

Private international law has largely been codified by international treaties. But some of this confusion survives today, particularly in the situs of debts secured on land. It may be possible to reconcile some

I mention this because the comment has sometimes been misunderstood.

[18] Lawton, *A Brief Treatise of Bona Notabilia* (1825) p.2. Comyn's Digest (Administration, B6): "If the testator had *bona notabilia*, the administration belongs to the archbishop of the province... If the testator had not *bona notabilia*, it belongs to the bishop of the diocese...".

[19] Hohfeld, "A vital school of jurisprudence and law: Have American universities awakened to the enlarged opportunities and responsibilities of the present day?"

inconsistent cases by saying that there is one situs for tax and another for private international law; or that an asset may be dual situate. But where inconsistency exists it would be better to grasp the nettle and prefer one line of authority to the other.

102.2 Intangible property has a situs

In *R v Williams*:[20]

> Shares in a company are "things in action" which have in a sense no real situs, but it is now settled law that for the purposes of taxation ... they must be treated as having a situs which may be merely of a fictional nature.

There are two points here:
(1) Shares (and other choses in action) have a situs.
(2) That situs is "fictional".[21]

The first point is a straightforward rule of law: all property has a situs.[22]

102.2.1 *Is situs fictional?*

The second point is a point of jurisprudence. It is of course true that intangible property, such as a debt, shares, or other chose in action, has no material position in the material world. Nevertheless a better analysis is to say that "situs" (of intangible property) is a term describing an abstract concept, not a physical concept. The situs of intangible property is not

[20] [1942] AC 541 at p.549.

[21] Similarly, in *New York Life Insurance v Public Trustee* [1924] 2 Ch 101 at p.119 the situs rules for choses in action were described as "legal fictions"; also *English Scottish & Australian Bank v IRC* [1932] AC 238 at p.248 ("*fictionem legis*").

[22] If further authority is needed, see *English Scottish and Australian Bank v IRC* [1932] AC 238 at p.244: "it is desirable that [debts] should possess a locality"; at p.248: the legal conception of property involves the legal conception of existence somewhere"; even, at p.251, with an element of hyperbole: " it is not easy to form a conception of property having no local situation". Similarly *IRC v Muller & Co's Margarine Ltd* [1901] AC 217 at p.236:

> "Goodwill is only taxable as property; and the legal conception of property appears to me to involve the legal conception of existence somewhere. Incorporeal property has no existence in nature and has, physically speaking, no locality at all. We, however, are dealing not with anything which in fact fills a portion of space, but with a legal conception, or, in other words, with rights regarded as property. But to talk of property as existing nowhere is to use language which to me is unintelligible."

"fictional", but "real" (or at least as real as other legal concepts such as "residence" or "domicile" or indeed "intangible property"). The concept may be described as technical. It might be described as metaphorical (at least in origin), or as "artificial" (though that also has a pejorative nuance which is not apt here). Lawyers are entitled to use ordinary words in special senses and to call a situs (of a chose in action) a "fiction" is inapt.[23] If we talk of fiction, we suggest that we are using words in their ordinary sense and are pretending that something exists to which they apply.[24] It would be better not to use the word fiction in this content. It may not matter, in that the use of the word "fiction" may not lead to difficulty or error, but it is good to see clearly what we are talking about.

Similarly, for private international law purposes, intangible property is categorised as movable or immovable property; but I am not aware of anyone describing that as a fiction.[25]

102.2.2 *Situs connecting factors*

Once one accepts that intangible assets (shares, debts, etc) have a situs, the law must choose connecting factors to identify the situs, in short, to link the asset to a jurisdiction. There is a large choice of possible connecting factors, and the selection of the determining factor must sometimes be arbitrary:

> probably any system of rules for determining the constructive locality of intangible property must be more or less arbitrary.[26]

One might think that it would not matter much what the rule was, as long as there is some rule and its application is clear. But sometimes choices have to be made between more formal rules (easy to apply) and more substantive rules (which aim to track the economic realities more

[23] See Baker, *The Law's Two Bodies* (2001), Lecture 2 ("Legal Fictions"); MacCormick, *Institutions of Law* (2007), p.136. Dumbledore makes the same point: "Of course it is happening inside your head, Harry, but why on earth should that mean that it is not real?"

[24] Hart, "Definition and Theory in Jurisprudence" (1953).

[25] "Much of the difficulty, as regards legal terminology, arises from the fact that many of our words were originally applicable only to physical things; so that their use in connection with legal relations is, strictly speaking, figurative, or fictional" Hohfeld, *Fundamental Legal Conceptions,* (1923) p.30.

[26] *Royal Trust Co v Provincial Secretary-Treasurer of New Brunswick* [1925] SCR 94 at p.99.

closely).[27] The desirable rule (at least from the HMRC viewpoint) is one which minimises the scope for persons to choose the situs of assets, as that would allow tax planning. The common law rules do not achieve that. Inasmuch as they were devised for conflicts purposes, there is no reason why they should. In the context of private international law, there is no objection to parties being able to choose a situs and it may be convenient if they can do so. The common law situs rules are not so well suited to serve as a territorial limitation for tax. It is not surprising that the common law rules have been modified for CGT.

102.3 Every asset has one situs

Under the common law rules, every asset is situate in a jurisdiction and only in one jurisdiction. In *R v Williams*:

> Property, whether movable or immovable, can ...[28] have only one local situation.[29]

This rule is self-evidently necessary if situs rules in private international law are to achieve their object, which is to resolve conflicts of jurisdiction, and if situs rules in tax law are to achieve the object of avoiding double taxation.

It is also implicit in the word situs: a physical object (let us ignore quantum physics) can be situate in only one place.

I stress this as some old cases considered one asset could be situate in two jurisdictions. They no longer represent the law. It is however possible that what appears at first sight to be one asset (eg copyright) is in

[27] A similar distinction arises in determining the location of a source of income: see 16.5 (Formal/substantive source rules).

[28] The omitted words are "... for the purposes of determining situs as among the different provinces of Canada in relation to the incidence of a tax imposed by a provincial law upon property transmitted owing to death". These words do not qualify the general principle as there is only one common law situs concept and (subject to statute) that applies for all purposes.

[29] [1942] AC 541 at p.559. Likewise *Laidlay v Lord Advocate* (1890) 15 App Cas 468 at p.483: "locality cannot be both England and India—the choice has to be made between the two". Likewise *Toronto General Trusts Co v The King* [1919] AC 679 at p.684: "it is plainly impossible to hold that [the debts] were situate in both provinces at once." Likewise *Ex p. Coote* (1948) 49 SR (NSW) 179 at p.184: "Unless there is some special reason which makes it necessary so to hold, property should not be regarded as legally situate in two different places at the same time." Likewise *New York Life Insurance v Public Trustee* [1924] 2 Ch 101 at p.120.

fact a set of distinct assets, situate in different jurisdictions.

An asset must be situate in a single legal jurisdiction. The expression "**UK situate**" is in a literal sense inapt because an asset must be situate in England, Scotland or Northern Ireland. It is, however, universally used to describe an asset which is situate in England, Scotland or Northern Ireland. For tax purposes it usually makes no difference where in the UK an asset is situate, though for non-tax purposes that could be important.

102.4 Situs of shares: General principle

In *Brassard v Smith*:[30]

> This is, in their Lordships' opinion, the true test. Where could the shares be effectively dealt with?

R v Williams referred to this and continued:[31]

> ... the phrase used in laying down the principle clearly means "where the shares can be effectively dealt with as between the shareholder and the company, so that the transferee will become legally entitled to all the rights of a member," e.g., the right of attending meetings and voting and of receiving dividends. If the phrase only meant "effectively dealt with as between transferor and transferee of shares," the test would obviously be almost completely useless, since the rights of a shareholder as between himself and a transferee can, speaking generally, effectively be transferred in any part of the world.

These cases concerned registered shares, but the principle applies to bearer shares too.

France and Italy IHT DTAs apply different rules.[32]

The question which follows from this test is: How to identify the place where shares can be dealt with?

102.5 Situs of registered shares

Place-of-register rule

In *AG v Higgins*:[33]

[30] [1925] AC 371 at p.376.

[31] [1942] AC 541 at p.557-558.

[32] See 115.10 (Treaty-situs).

[33] (1857) 2 H & N 339 at p.351 *https://www.kessler.co.uk/wp-content/uploads/2012/04/AGvHiggins.pdf* This passage was quoted and approved in *Brassard v Smith* [1925] AC 371 at p.376.

> the evidence of title to these shares is the register of shareholders, and that being in Scotland this property is located in Scotland

The IHT Manual states the same rule:

> **IHTM27121 Usual location** [July 2016]
> For the purposes of Inheritance Tax an inscribed[34] and registered security[35] (a shareholding in a Company, for example) is located at the place where the title of ownership must be registered – see *AG v Higgins*.
> It makes no difference that the business of the company is totally administered outside the country in which the register is kept: see *Baelz v Public Trustee* [1926] Ch 863.

I call this the "**place-of-register rule**". The rule is grounded on the general principle that shares are situate where they can be dealt with. Dicey states the same rule:

> If shares may be transferred only by registration on a particular register, they will be regarded as situate at the place where the register is kept.[36]

Underhill & Hayton, *Law of Trusts and Trustees* states the same rule:

> if shares are only transferable by entry on the register, they are situated in the country where the register is kept.[37]

102.5.1 *An incorporation test?*

I set this out at length because an alternative view has been suggested. In *Macmillan v Bishopsgate Trust (No. 3),* surprisingly, one judge stated without discussion that the situs is the place of incorporation, another inclined to the same view but expressed himself more cautiously, and a

Similarly *Baaelz v Public Trustee* [1926] Ch. 863 at p.868: "For the contributory's title to his shares, his status as a shareholder and the enforcement of his rights, recourse must be had to the statutory register, which remains localized at the registered office, and to the Court, with which alone, under [what is now s.125 CA 2006] , abides the power to rectify the register." And again, *Re Aschrott* [1927] 1 Ch 313 at p.33.

[34] Author's footnote: "Inscribed" securities are those whose legal owners are inscribed in a register; the term is, I think, an old-fashioned synonym of "registered".

[35] Author's footnote: "Securities" here includes shares as well as debt-securities.

[36] Dicey, Morris & Collins, *The Conflict of Laws* (16th ed, 2022) para 23-042 (Shares in companies) and 23-043.

[37] 20th ed (2022) para 104.128 (Intangible movable property).

third adopted the place-of-register rule.[38] *Akers v Samba Financial Group* also raised the possibility of an incorporation test for situs. Lord Mance (with whom the rest of the Court agreed) said:

> The situs or location of shares and of any equitable interest[39] in them is in the jurisdiction where the company is incorporated or the shares are registered (which is presently unimportant, since in this case they coincide in Saudi Arabia).[40]

The place-of-register rule and an incorporation test are conceptually distinct rules, but in practice they will almost always lead to the same result. That was the position in both *Macmillan* (incorporated and share register kept in New York) and *Akers* (incorporated and share register kept in Saudi Arabia). The rival tests might have different results, if:
(1) a company had two share registers (as in *R v Williams)* or
(2) a company has an overseas branch register

But I wonder if that will happen nowadays.

As *Akers* and *Macmillan* were cases where the court did not have to decide between place-of-register and place of incorporation as rival situs rules, the court's attention was not on the point and the relevant authorities were not discussed. If the question ever needed to be decided, a Court

[38] [1996] 1 WLR 387 at p.423F, p.405E, and p.411E.

[39] On the facts of the case, this is a reference to an equitable interest under a bare trust; different principles apply to an interest under a substantive trust and intermediated securities.

[40] [2017] UKSC 6 at [19]. Lord Manse mentioned 3 authorities without discussing them:
(1) Dicey, Morris & Collins, *The Conflict of Laws* (16th ed, 2022) para 23-042 (Shares in companies) and 23-043. But Dicey supports the place-of-register rule: see above.
(2) Underhill and Hayton, *Law of Trusts and Trustees* (20th ed, 2022), para 104.128-129. Lord Manse cited an old edition, and erroneous para reference. But both old and current editions of Underhill support the place-of-register rule: see above.
(3) *Re Berchtold* [1923] 1 Ch 192 and *Philipson-Stow v IRC* [1961] AC 727 at p.762. But these cases say nothing about the situs of shares.

To compound the confusion, in the same case Lord Sumption said at [80], inconsistently and evidently without consideration: "The ... lex situs... in the case of registered shares is the law of the company's incorporation, in this case Saudi Arabia. This proposition is well established and was not seriously disputed: see *Macmillan v Bishopsgate (No 3)*."

ought to reject the place of incorporation test and follow the well established principles. The overwhelming body of authority states that situs is the place where the register is kept.

The IHT Manual tactfully ignores these cases. The reader may think it unfortunate that *Macmillan* accidentally introduced into the law if not an uncertainty, at least an inconsistency which needs to be explained away.

See Venables, "The Situs of Registered Shares", PTPR Vol 9 p.115.[41]

102.5.2 *SDRT comparable rule*

The territorial limitation for SDRT also refers to where a share register is kept. In outline, s.99(4) FA 1986 provides:

> "Chargeable securities" does not include securities ... which are issued or raised by a body corporate not incorporated in the UK unless—
> (a) they are registered in a register kept in the UK by or on behalf of the body corporate by which they are issued or raised ...

So (more or less) the same test, and the same issues, arise for SDRT.

102.6 Place-of register rule: Application

102.6.1 *Company law background*

Since situs generally depends on where a company's share register is kept, it is necessary to consider the company law rules relating to share registers and their location. The following sets out the relevant UK company law. Further consideration is needed if foreign company law adopts different principles.

Section 113(1) CA 2006 provides:

> Every company must keep a register of its members.

Section 114(1) CA 2006 provides

> A company's register of members must be kept available for inspection—
> (a) at its registered office ...

There are minor exceptions to these requirements which are not relevant for present purposes.

When a company is formed, its registered office must be in the UK. A

[41] *http://www.khpplc.co.uk/reviews*

company may move its registered office but it must remain in the UK.[42]

102.6.2 *"Keeping" the register*

There are two aspects to "keeping" a register:

(1) Possessing and retaining the register

(2) Making new entries in the register, as share ownership changes, ie keeping it up to date.

Many, perhaps most, companies outsource share register administration to a third-party, known as a registrar. For listed UK companies, CREST keeps the share register.[43] That does not matter, the question becomes: where does the registrar or agent keep the share register on behalf of the company.

The place-of-register rule requires one to ask where the share register is kept. The rule arose at a time when the register was a paper book, and it was easy to see where the register was kept. Sometimes that will still be the case.

102.6.3 *Dematerialised register*

Nowadays share registers are likely to be computerised, not on paper.[44] It may still be possible to identify one computer on which the register is kept, but if, as I expect is commonly the case, the data is stored (or at least, backed up) on multiple servers, the share register has no simple single identifiable physical location. If the share register has no single physical location, the Court will need to devise some rule to determine where a share register is "kept".

It is suggested that a dematerialised register is "kept" where the company (or if appropriate, the company's registration agent or CREST) *effects*

[42] See s.9 and 87 CA 2006; Palmer's Company Law (looseleaf) para 2.507: "The company can change the situation of its registered office only in the part of Great Britain in which it is registered. Consequently, an English company cannot change its registered office to an address in Scotland nor vice versa."

[43] See 99.9 (CREST).

[44] Articles of association sometimes provide:

> "The register of members may be in any such form as the Directors may approve but, if it is in magnetic, electronic or other data storage form, the Company must be able to produce legible evidence of its contents."

But even without that provision, everyone would agree that a company may use an electronic register.

entries to the register, if that place can be identified. Making entries in the register may be described as "keeping" the register.

It may be that place cannot be identified, because entries in the register are made (or at least can be made) by authorised users logging on to the system anywhere in the world. In that case it is suggested that the solution is that the share register is "kept" where company law *requires the register to be to be kept available for inspection*. That is a single identifiable place. It is not difficult to say that a register is (at least, notionally) "kept" where it is required to be kept available for inspection.

An alternative approach is to say that where the place-of-register rule does not work, because no place can properly be identified, another rule is needed. If another rule is needed, the place of incorporation test is the best rule to apply. So far as we are dealing with a common law rule, the common law may develop in the light of changed circumstances. But this approach does not wholly solve the problem, because statutes refer to the place where the register is kept:

(1) for SDRT (as mentioned above)
(2) for CGT, the situs of shares in foreign companies is the place where they are registered (or where the principal register is kept).[45]

So in those contexts, at least, the question of where the share register is kept should be answered, it should not be abandoned in favour of another rule.

To summarise, the following rules should determine where the share register is kept, in order of priority:

(1) If the share register is kept on paper, where the paper share register is kept.
(2) If the share register is kept on one computer, where the computer is kept, if that can be identified.
(3) Where the company (or its agent) effects entries to the register, if that place can be identified
(4) Failing that, where company law requires the register to be to be kept available for inspection. (A less attractive alternative being where the company is incorporated, but in practice that broadly comes to the same thing).

The same rules should apply to other assets whose situs is determined by

[45] See 103.6 (Registered security: Non-UK co).

where the register of legal owners is kept, such as intermediated securities, and, perhaps, some types of cryptoasset.

102.7 More than one register

If a company has more than one register, in different jurisdictions, that raises a problem for a place-of-register rule.

102.7.1 *Overseas branch register*

A UK company may in some cases have an overseas branch register.[46] I wonder how often overseas branch registers are used now, since computerisation should make them unnecessary. I address the point for completeness, though the issue will not often arise, except, possibly, in some tax planning contexts.

Section 133 CA 2006 provides:

> (1) Shares registered in an overseas branch register must be distinguished from those registered in the main register.
> (2) No transaction with respect to shares registered in an overseas branch register may be registered in any other register.
> (3) An instrument of transfer of a share registered in an overseas branch register—
> (a) is regarded as a transfer of property situated outside the UK, and
> (b) unless executed in a part of the UK, is exempt from stamp duty.

In *Brassard v Smith*[47] the company (Royal Bank of Canada) was governed by a similar rule, and shares registered in a Novia Scotia branch office were situate there, though the head office of RBC was in Montreal, Quebec (as it still is).

Thus an overseas branch register, when company law permits, allows a UK company to have foreign situate shares.

The IHT Manual provides:

> **IHTM27122 Branch registers** [May 2020]
> ... If a company has more than one register, and any changes must be recorded on one of the registers, the relevant securities are sited in the place where that register is required by law to be kept – not in the place of the head office of the company. ...

This requires an examination of company law to identify which of the two

[46] Section 129 CA 2006.
[47] [1925] AC 371.

registers is the one where changes must be recorded. The IHT Manual summarises the UK company law background:

> **IHTM27124 Overseas branch registers of UK companies** [May 2020]
> ... Under UK law a share cannot, at one and the same time, be registered on more than one register.
> The rule applies even to overseas branch registers (these are branch registers of members resident in the country to which the register relates). ... shares on the overseas branch register of a UK company are situated, for Inheritance Tax purposes, in the country where the register is kept.

102.7.2 *Transfer office*

Another solution may be that the company has only one register and merely a "transfer office" elsewhere. The IHT Manual provides:

> **IHTM27125 Duplicate or multiple registers of non-UK companies** [May 2020]
> ... Some overseas company laws allow a shareholder to use duplicate (or multiple) share registers to record the transfer of their securities.
> The South African Companies Act, for example, authorises South African companies to maintain branch registers in any foreign country. Shares can be transferred on any register, but no transfer of shares passing on death can be registered in the UK until any death duty claimed by South Africa on the shares has been paid.
> Remember that some registers merely record information about transfer of securities without providing the legal basis for the transfer. These registers do not affect the locality of the security (IHTM27071)
> Details of transfer arrangements given in the Stock Exchange Year-Book[48] do not always make the position clear and, if necessary, you must ask the taxpayer to explain. ...

102.7.3 *Two effective registers*

In *R v Williams*[49] a company incorporated in Ontario had two share registers, in New York and in Ontario, and a transfer could have been dealt with in either jurisdiction. The share certificate, held in New York,

[48] Author's footnote: The Stock Exchange Official Year Book has long ceased publication; it was first published in 1876 and the most recent edition I have been able to trace was 1994.

[49] [1942] AC 541.

was endorsed with a signed blank transfer form (that is, the name of the transferee was left blank). The Court held that where a company has more than one effective register, so the transfer may be dealt with in more than one jurisdiction, one must look for a tie-breaker test between the two competing jurisdictions.[50] In this case, the shares were situate where the share certificate/transfer form was situate: the form acted as the tie-breaker.[51] But these facts are not likely to arise now, because a company is not likely to have two share registers in different places, and because signed blank transfer forms, described as usual in 1942, are no longer usual.

R v Williams did not consider what tie-breaker would apply in the absence of the signed transfer form in one of the two competing jurisdictions.[52] But the IHT Manual provides:

> **IHTM27150 share certificates endorsed in blank** [Sep 2018]:
> If the company has more than one register on which the holding could be effectively transferred, and the share certificates are found at the material time at a place where a register is located, the holding is for Inheritance Tax purposes situated at that place – see *R v Williams* [1942] AC 541. Cases where none of the effective registers is located where the certificates are found must be referred to Technical.

This suggests that a share certificate which does not contain a signed transfer form in blank will still act as a tie-breaker. That seems sensible.

The IHT Manual discusses an alternative tie-breaker:

> **IHTM27125 - Duplicate or multiple registers of non-UK companies** [May 2020]
> Where there are many registers the register upon which the shares would normally be dealt with in the ordinary course of business is the register that determines the situs of the security – see *Treasurer of Ontario v Aberdein* [1947] AC 24.

But which is the register which would normally be used? The Manual explains:

> If the share certificates are in the UK, one of the alternative registers is in the UK, and transfers can be effected here the shares will normally

[50] at p.559.
[51] at p.560.
[52] at p.560.

> be regarded as legally situated here (*Re Clark, McKechnie v Clark* [1904] Ch 294.)

The IHT Manual continues:

> This is only an assumption and can be rebutted by the particular circumstances of the case (see *Standard Chartered Bank Ltd v IRC* [1978] 1 WLR 1160). But if tax is offered on shares in a foreign company with transfer facilities in the UK, you can assume that the register in the UK is the one on which the shares would normally be dealt with in the ordinary course of business.

102.7.4 *Ineffective register*

The IHT Manual provides:

> **IHTM27123 Effectiveness of register** [May 2020]
> ... If shares are entered on a list which does not affect the legal holding of the security (even though the list could be called a register) the location of the list does not affect the situs of the security.
> In *Erie Beach v AG for Ontario* [1930] AC 161, certain shares (on the view that they could, under the Ontario Companies Act, be effectively dealt with only in Ontario) were held to be situated in Ontario for the purposes of Ontario Succession Duty, although they had in fact been entered on a 'register' opened elsewhere.
> It was explained however, in *R v Williams*, that the *Erie Beach* decision was based on the finding that the particular shares in question could be dealt with effectively in Ontario only. In this case it was explained that the decision was 'not an authority for holding that any company subject to the Ontario Companies Act is precluded from establishing registers outside Ontario on which effective transfers can be made, and Ontario companies like other Canadian companies may establish branch registers kept by 'transfer agents' which are equivalent to duplicate or multiple registers (IHTM27125)'.

102.7.5 *Register of share transfers*

The IHT Manual provides:

> **IHTM27127 Transfer agencies** [May 2020]
> Many companies incorporated under Canadian law keep a register, or branch register, of transfers kept by one of the company's duly appointed 'transfer agents', not a register of shareholders as with UK companies.
> When considering the question 'where could the shares be effectively

dealt with?' (*Brassard v Smith*), to find out where the shares can be taxed we must find out where the company has established transfer agents to operate a register, or branch register, of transfers. There is usually more than one transfer agent to which the shareholder could transfer their holding, regardless of where the share certificate was issued. Some (but relatively few) companies have transfer agents in the UK. These equally available transfer arrangements in various places are said to be 'interchangeable'. For the purposes of situs in relation to Inheritance Tax they can be taken as equivalent to duplicate or multiple registers (IHTM27125).

This applies:

- to shares registered in the name of the taxpayer or their nominee (including marking names),
- whether or not the share certificates are endorsed in blank (*Treasurer of Ontario v Aberdein* [1947] AC 24),
- whether the company in question was incorporated under Canadian dominion or provincial law.

102.7.6 *Miscellaneous*

The IHT Manual provides:

> **IHTM27128 Branch registers of British Colombian and Newfoundland companies** [May 2020]
>
> Branch registers of companies in these two provinces of Canada can be kept outside the province, so the location of the shares will be determined by the location of the branch register.
>
> In certain circumstances shares registered on a branch register in the name of a deceased member can be transferred only on a duplicate register kept at the registered office of the company. This restriction does not affect locality for Inheritance Tax purposes on the deceased's death.
>
> **IHTM27129 - Canadian companies: Nova Scotia companies** [May 2020]
>
> Every company incorporated under the laws of Nova Scotia must keep a duplicate of any branch register kept outside the province at its registered office in the province. In respect of lifetime transfers, we understand that there is a distinction between:
>
> - Companies incorporated under the Nova Scotia Companies Acts, in which case a lifetime transfer on a branch register appears to be valid and effective. Accordingly if the securities are registered on a branch register in the UK they must be treated as situated in the UK.
> - Companies incorporated under other Acts, in which case no transfer

> on a branch register is effective until entered in the principal register. In this case , registered securities may be regarded as situated in Nova Scotia, even though they may be registered on a branch register in the UK.
>
> This restriction does not affect locality for Inheritance Tax purposes on the deceased's death.

102.8 Registered debt-securities

The rules for registered debt-securities[53] are, in general, the same as for registered shares; the passage from the IHT Manual set out above refers to securities, generally meaning both shares and debt-securities.

A UK company is not expressly required by company law to keep a register of debenture holders, but it is difficult to see how it could manage without one.[54] A register of debenture holders (like a share register) must be kept available for inspection in the UK.[55] But planning by converting registered securities into bearer securities may be possible.[56]

102.8.1 *Place-of-register v specialty rule*

Shares are not "specialties" so the specialty situs rule cannot apply to them.[57]

A debenture may be a specialty so the question arises as to the priority between the place-of-register rule and the specialty situs rule. The specialty situs rule overrides the place-of-register rule. For HMRC views as to which securities are "specialties", see 102.15.1 (Situs of specialty).

102.9 Bearer and negotiable instruments

102.9.1 *General law background*

"Bearer" shares or securities are transferable by delivery of the document of title, so that the person who holds the document has legal title to them.[58]

An instrument is "**negotiable**" if

[53] I use the term "debt-securities" to mean securities which are debts, not shares.

[54] A "register" is only a record of stockholders and their assignees; this is self-evident but if authority is needed, see *Ramsay v IRC* 54 TC 101 at p.133.

[55] Section 743 Companies Act 2006.

[56] See 102.9.2 (Bearer shares and securities).

[57] See 102.15 (Specialty obligation).

[58] Bearer shares are not possible in UK company law: s.84 Small Business, Enterprise and Employment Act 2015. But bearer debt-securities are possible, and bearer shares may remain possible for some foreign company laws.

(1) Legal title to it is transferable by delivery or by endorsement and delivery; and

(2) In the hands of a "holder in due course" (broadly a good faith purchaser for value without notice that has satisfied relevant formalities), it is enforceable despite a defect in the title of any prior holder. In other words, the transferor who negotiates a bill to a holder in due course can pass a better title than they themselves possess. The transferee has the right to sue in his own name all parties to the instrument.[59] Bills of exchange and promissory notes are typically (though not necessarily) negotiable.

Thus bearer instruments and negotiable instruments are distinct but overlapping categories: bearer instruments are negotiable but negotiable instruments are not necessarily bearer.

Negotiable instruments (other than shares) may be made by deed, and so specialties, in which case situs is governed by the specialty situs rule. But they may not be specialties, in which case the specialty situs rule does not apply.

102.9.2 *Bearer shares and securities*

The place-of-register rule cannot apply to bearer shares or securities as there is no register of shareholders or security holders.

The situs of bearer shares and bearer debt-securities is where the document is to be found. This is consistent with the nature of bearer and negotiable instruments:[60]

> ... commercial practice has over time resulted in certain types of document being elevated beyond a mere record of obligations in writing to something more — an *embodiment* of the right to claim performance of the obligations recorded in the document. These types of documents can be issued either as "bearer documents" or as "order documents". This determines the method of transfer used to transfer the document. ... the transfer of such a document does not require the consent of any other party, nor does it require any actions to be taken other than those described above. In the case of both bearer documents and order documents, the right to claim performance of the relevant obligation simply "travels with the document".

[59] *Byles on Bills of Exchange and Cheques* (30th ed., 2019), para 1-004 (Negotiability).

[60] Law Commission: Digital assets Final report (2023) para 4.56; footnotes omitted. *https://lawcom.gov.uk/project/digital-assets/*

The IHT Manual provides:

> **IHTM27076 Bearer securities**[61] [May 2020]
> A bearer security was situated, for Inheritance Tax purposes, in the place where the document of title is found at the material time. .. This does not apply to certain qualifying international securities (IHTM27141).

Dicey agrees:

> For taxation purposes, bonds, bills of exchange and other securities which can be validly and effectively transferred by delivery with or without endorsement are situate in the country where the paper representing the security is itself from time to time to be found.[62]

This is consistent with the general principle that shares are situate where legal title can be transferred.[63]

Situs of UK registered debt-securities can be changed by converting them into bearer securities and taking the document outside the UK. Similarly, foreign shares and securities could be made UK situate. Stamp duty needs consideration. This planning has been described as tax mitigation, not avoidance,[64] though views may differ, and the abolition of bearer shares for UK companies reduces the practical importance of the issue.

AG v Bouwens concerned foreign government bonds (not specialties) which were bearer instruments so it was not necessary to do any act outside England in order to transfer them. The court said:

> No ordinary[65] in England could perform any act of administration within his diocese, with respect to debts due from persons resident abroad, or with respect to shares or interests in foreign funds payable abroad, and incapable of being transferred here; and therefore no duty would be payable on the probate or letters of administration in respect

[61] Author's footnote: This passage applies to both shares and debt-securities.

[62] *Conflict of Laws* (16th ed., 2022), para 23-038 (Negotiable instruments and securities transferable by delivery). Dicey cites: *AG v Bouwens*; *AG v Glendining* (1904) 92 LT 87; *Winans v AG (no 2)* [1910] AC 27; *Provincial Treasurer of Manitoba v Bennett* (1937) 2 DLR 1; *Re Moore* [1937] 2 DLR 746; *Lunn v Barber* [1949] OR 34; *Favorke v Steinkopff* [1922] 1 Ch 174.

[63] See 102.4 (Situs of shares: General principle).

[64] See 52.21.2 (Transfer for avoidance).

[65] See 102.1.2 (History and terminology).

> of such effects. But, on the other hand, it is clear that the ordinary could administer all chattels within his jurisdiction; and if an instrument is created of a chattel nature, capable of being transferred by acts done here, and sold for money here, there is no reason why the ordinary or his appointee should not administer that species of property. Such an instrument is in effect a saleable chattel, and follows the nature of other chattels as to the jurisdiction to grant probate.[66]

102.9.3 *Negotiable instrument not bearer*

The IHT Manual gives guidance on bearer securities but does not consider other negotiable instruments (that is, those which are transferable by endorsement and delivery). But the passage from Dicey set out above states that the same rules apply. The same rule applies in Australia:

> *negotiable instruments and securities transferable by delivery* for taxation purposes, bonds, bills of exchange and other securities which can be validly and effectively transferred by delivery with or without endorsement are situate in the country where the paper representing the security is itself from time to time found.[67]

In *Bouwens* the court stressed that there was an active market in England for the bonds (the Royal Exchange). Some cases suggest that this might be a requirement for situs:

> A negotiable instrument will be situate where the instrument is, *at any rate where there is an available market for its negotiation*.[68]

However I think the general trend of the authorities is that the situs of the instrument prevails and whether or not there is a market (which in modern conditions would be difficult to determine) is not relevant.[69] This is the view of the textbooks cited above. In particular, it would be strange to draw a distinction between bearer instruments (which HMRC accept are situate where the document is, regardless of whether there is a market) and other negotiable instruments.

[66] (1838) 4 M & W 171 at p.192 *http://www.commonlii.org* This was approved in *AG v Winans (No. 2)* [1910] AC 27.

[67] Taxation Ruling TR 2008/9 *https://www.ato.gov.au/law/view/document?DocID=TXR/TR20089/NAT/ATO/00001*

[68] *Kwok Chi Leung Karl v CED* [1988] STC 728 at p.732 (emphasis added); the same point is made in *AG v Bouwens* at p.192.

[69] But for a dissenting view, see 102.12 (Letter of allotment of shares).

102.9.4 *Eurobonds*

HMRC have commented specifically on the situs of eurobonds in a passage which I mention for completeness but which adds nothing to the general principles:

> ... in the Revenue's view, the *situs* for IHT purposes of Eurobonds and similar fungibles in any issue depends on the terms of that issue and, in particular, where under those terms the bondholder's rights to or rights of action for property exist. Those rights will be determined by reference to general, not Revenue, law principles. So where title to the rights under an issue passes by delivery, the *situs* for IHT purposes of such rights is where the instrument of title is physically.[70]

102.10 CREST

The Law Commission explain the securities law background:

> 2.21 Investment securities constituted under English, Scots and Northern Irish law can take either certificated or dematerialised ('uncertificated') form. CREST is the main securities settlement system in the UK and settles securities in uncertificated form. Unlike system operators in most national settlement systems, CREST does not hold domestically issued securities[71] as a central securities depository for account holders. CREST has no proprietary rights in the securities and is not treated as 'holding' these securities from the issuer on behalf of its participants. Rather, the CREST member is treated as holding directly from the issuer. This CREST member alone is entitled to exercise voting, dividend and other rights attaching to the shares and may do so directly against the issuer.

[70] [1994] PCB 139. For completeness, the passage concludes:

> "There is little we can add to the foregoing guidance. In particular we cannot offer any undertaking about the likely future IHT liability which may arise in respect of rights to particular Eurobond issues currently extant or which may be issued in future.
>
> However, in order to be as helpful as possible, we can say that where a Eurobond issue satisfies the terms and conditions of section 124 ICTA 1988, the Revenue will treat for IHT purposes the rights and interests of the beneficiary-investors in such issues as rights to and interests in a bearer security."

A eurobond within s.124 (now repealed) had to be a bearer security, so this does not take matters much further.

[71] Footnote original: That is, in the UK, Republic of Ireland, Isle of Man, Guernsey and Jersey.

> 2.22 Instead, it is the register operated by CREST which, in the case of UK securities, is actually constituted by statute[72] as the sole legal record of entitlement to the securities. Although the issuer will maintain a regularly reconciled record of what is held in CREST for corporate events purposes, it is the CREST register that confers legal title and which determines the person or entity named in the register as the shareholder for company law purposes.[73]

The first footnote at para 2.22 is important. It provides:

> For UK companies it is the entry in the CREST register that confers legal title on the owner.[74]
> For Irish, Manx, Guernsey and Jersey securities, the pre-2001 system still operates. Settlement is through CREST but legal title is transferred when the entry is made in the issuer's register.

Registered securities are in principle situate where the register of title is kept.

For listed UK companies, the register of legal title is the CREST register; the situs of the securities is in the UK, assuming (as is no doubt the case) that the CREST register is kept, or is regarded as kept, in the UK.[75]

For listed Irish, IoM and Channel Island companies whose shares are registered on CREST, the company law is different: the register of legal title is the company's register. So registering a security on CREST does not make any difference as to situs.[76]

It is possible for retail investors to have a personal CREST account, but it has become expensive and unusual. Securities are in practice held through intermediaries, which alters the situs position.[77]

[72] This footnote is set out in the text below.

[73] Law Commission, *The UNIDROIT Convention on Substantive Rules regarding Intermediated Securities Further Updated Advice to HM Treasury* (2008). See too Law Commission, *Intermediated securities: who owns your shares?* (2020) para 2.12ff and 2.56ff.

[74] Reg 24, Uncertificated Securities Regulations 2001.

[75] This has the curious consequence that Scots and Northern Ireland companies registered on CREST are situate in England, not in Scotland or Northern Ireland. But this makes no difference for tax, and I suspect would only rarely matter for non-tax purposes.

[76] Further thought would be needed if the relevant company law were to change from the position which the Law Commission describe in 2008.

[77] See 71.1 (Intermediated securities).

102.11 Share certificate endorsed in blank

The IHT Manual explains the background law and practice as follows:

> **IHTM27150 Share certificates endorsed in blank** [May 2020]
> Certificates of many American and Canadian railroads and of certain other companies include a printed transfer form or power of attorney. When this is signed or endorsed by the registered holder it enables the certificates to be transferred by delivery.
> Often these certificates are 'endorsed in blank', This means the endorsement is to be signed by the registered owner as transferor, and the name of the transferee is left blank.
> Dividends are paid by the company to the registered owner, and if these shares have in fact changed hands by delivery, the beneficial owner for the time being recovers their dividends from the registered owner.
> Usually the shares are registered in the name of a recognised broker, bank or discount house. These are known in the UK as a 'good Marking Name' or, in the USA, as a 'Street Name'. This helps to make sure that the purchaser receives their dividends with minimum of trouble and risk.
> A list of good Marking Names recognised by the London Stock Exchange is printed in the Stock Exchange Official Year Book.[78]
> However the beneficial owner can have them registered in their own name, or in the name of some nominee other than a good Marking Name.

This is mainly of historical interest, but I set out the HMRC comments for completeness:

> The location of the shares for Inheritance Tax purposes is determined as follows:
> [a] If the registered owner is a good Marking Name, the shares are situated where the register is kept, not where the certificates are found. ...[79]
> [b] The location of the shares is determined in the same way if the registered owner is also the beneficial owner, or a nominee of the beneficial owner, or, in the case of settled property, the trustees of

[78] Author's footnote: The Stock Exchange Official Year Book has long ceased publication; it was first published in 1876 and the most recent edition I have been able to trace was 1994.

[79] Omitted text set out at 102.7.1 (Overseas branch register).

> the settlement or their nominees.[80]

The HMRC view is that one ignores the fact a share transfer form has been endorsed in blank. This is right, because the endorsed certificate does not alter the place where registered shares are dealt with as between shareholder and company.[81] At this point the Manual becomes confused:

> [d] If the registered owner is neither:
> a good Marking Name,
> the beneficial owner, or
> any of the other persons named above, and
> the certificates are physically present in the UK at the material time,
> the shares are located in the UK for Inheritance Tax purposes, (Stern v The Queen [1896] 1 QB 211).

I find it hard to see how [d] can apply: the registered owner will always be one of the persons named at [b] (beneficial owner or a nominee).

> Certificates of this kind, that do not contain any express obligation or promise, are not specialty (IHTM27079) debts - see the *Williams* case at [1942] AC 556.

That is correct.

102.12 Letter of allotment of shares

A letter of allotment confers the right to an issue of shares. The letter is normally transferable by delivery: it is a bearer security. One would have thought that the bearer security situs rule would apply. However, in *Young v Phillips*[82] a letter of allotment in respect of a company with UK registered shares was held to be situate in the UK, not where the letter of allotment was held. Nicholls J cited the passage in *AG v Bouwens* set out

[80] The Manual continues:
> "[c] In the cases outlined in the bullet points above we consider that the only legal title the holder has to the shares is their registration as owner. If the owner brings the certificates to the UK they could sell the shares to a UK purchaser, so the equitable interest in the shares would be situated here. But, until the sale takes place the beneficial interest has not been severed from the legal interest so their location has not changed."

This is muddled and wrong.

[81] See 102.4 (Situs of shares: general principle).

[82] 58 TC 232 This case concerned the common law rules before s.275A TCGA and is still relevant for situs for IHT, and for CGT in the case of foreign incorporated companies.

above[83] and said:

> From this it is apparent that for an instrument to be treated as analogous to a chattel for situs purposes more is required of it than mere transferability of title by delivery. A simple contract debt owed by a foreign debtor to a person resident in England and evidenced by a promissory note might be, and normally would be, freely and effectively transferable in England, but such a debt has as its situs the country where the debtor resides, not the place where the creditor lives or currently holds the promissory note. What is required is that in practice the value of the instrument can be realised by a sale of the instrument for money in the country where the instrument is found: the reason being that if an instrument in England could be so sold, the ordinary could properly and effectively administer that asset by selling it here, there being no need in such a case to have recourse to where the foreign debtor lived. When so saleable an instrument is in practice realisable in the same way as a saleable, valuable chattel, and hence, for situs purposes, it falls to be treated in the same way. ...

This approach requires an investigation into whether a market exists. The judge said:

> In the instant case there are no grounds for concluding that in practice the value of the letters of allotment, *which were issued with a life-span of a little over two months*, could have been realised by a sale of those documents for money wherever they were to be found. The Special Commissioners pointed out that no evidence had been led before them to prove that there existed a market in letters of allotment of shares in private companies. Having regard to the fact that shares in private companies may not be the subject of a public issue, they expressed themselves as being far from prepared to assume the existence of such a market. With that approach I agree. And it is to be noted that the "sales" of the letters of allotment which did take place in Sark were not arm's length transactions but were to purchasers wholly under the control of the vendors, and they had been prearranged even before the letters of allotment were issued. Accordingly, applying the principles I have mentioned to the facts of this case, the renounceable letters of allotment in the UK companies do not fall to be treated as saleable chattels, realisable where they might be found from time to time. They are documents evidencing rights against UK companies, which rights were enforceable in the UK.
> (Emphasis added)

[83] See 102.9.2 (Bearer shares and securities).

The requirement for "marketability" is not supported in textbooks, or much supported in the cases, nor does it make good sense. A buyer could be found for any valuable asset in any community where private property exists, and one buyer makes a market.[84] Whether a market exists is a question of fact, so application of the marketability test will result in assets moving from one jurisdiction to another as markets come and go. It is conceivable that there was no market in Sark (population 600). But with improved communications markets are no longer local to jurisdictions, as was assumed in *Young v Phillips*. An asset can be sold anywhere, even in Sark.

It seems that *Young v Phillips* stretched the law in order to defeat a tax avoidance scheme, and in doing so has left something of a mess.

The CG Manual provides:

> **CG12440 Shares and securities etc** [May 2020]
> **Letters of allotment**
> Letters of allotment should be treated as located in the country where the company issuing the letters is registered. In the case of *Young v Phillips* 58 TC 232 bonus shares were issued in respect of registered shares located in the UK. The issue was made in letter of allotment form. The letters were then taken to the Channel Islands and disposed of there. It was held that the letters of allotment were located in the UK because they evidenced rights which were properly enforceable only in the UK.

Thus in the HMRC view *Young v Phillips* is relevant to letters of allotment only, it has no relevance to the situs of bearer debt-securities or shares.[85] It is suggested that the reasoning should be restricted to short life assets (such as the letters of allotment in that case which, it was stressed, had a life of only two months).

[84] This is self-evident, but for an illustration see *FGP v Union of India* 2004 (168) Excise Law Times 289 (Supreme Court of India)
https://www.kessler.co.uk/wp-content/uploads/2012/04/FGPvUnion-of-India.pdf
Contrast the sophisticated definition of "asset for which there is a liquid market" in ICAEW Tech 7/03 para 19 (Guidance on the determination of realised profits and losses in the context of company distributions).

[85] In *Mehjoo v Harben Barker* [2013] EWHC 1669 (QB) at [267] ff it was found that HMRC's practice was not to take any *Young v Phillips* point in relation to bearer shares. The point was not considered on appeal.

Even letters of allotment may be situate where the letter is situate, if there is a "market" there (whatever that may require).

102.13 International organisation security

For convenience this section deals with CGT situs as well as IHT situs, as the rules are the same. Exemptions are made pursuant to international agreements and the International Organisations Act 1968.

102.13.1 *Designated organisations*

It is helpful to read the IHT and CGT legislation side by side.

Section 126 FA 1984	**Section 265 TCGA**
(1) Where— (a) the UK or any of the Communities is a member of an international organisation; and (b) the agreement under which it became a member provides for exemption from tax in relation to the organisation, of the kind for which provision is made by this section;	[Identical]
the Treasury may, by order made by statutory instrument, designate that organisation for the purposes of this section.	the Treasury may by order designate that organisation for the purposes of this section.
(4) The Treasury may, by order made by statutory instrument, designate any of the Communities or the European Investment Bank for the purposes of this section, and references in subsections (2) and (3) above to an organisation designated for the purposes of this section include references to a body so designated by virtue of this subsection.	(2) The Treasury may by order designate any of the Communities or the European Investment Bank for the purposes of this section.
(2) Where an organisation has been so designated, the provisions mentioned in subsection (3) below shall, with the exception of any which may be excluded by the designation order, apply in relation to that organisation. .	

(3) The provisions are (b)[86] any security issued by the organisation shall be taken, for the purposes of capital transfer tax [now IHT[87]] to be situated outside the UK; ..	(3) Where an organisation has been designated for the purposes of this section, then any security issued by the organisation shall be taken, for the purposes of this Act, to be situated outside the UK.

The IHT Manual provides:

> **IHTM27141 List of non-UK situs organisations** [May 2020]
> Unless they are bearer securities (IHTM27076) and situated physically in the UK[88] securities issued by the following organisations are effectively outside the charge to IHT where:
>
> - they form part of the estate of a person domiciled outside the UK; or
> - they are comprised in a settlement and the settlor was not domiciled in the UK at the time the settlement was made:
> - ○ the International Monetary Fund:
>   ○ The Bretton Woods Agreement Order in Council, 1946, SR & O 1946 no.36
>   ○ the International Bank for Reconstruction and Development[89]:
>   ○ The Bretton Woods Agreement, as above
>   ○ the International Finance Corporation:
>   ○ The International Finance Corporation Order, 1955 (SI 1955/1954)
>   ○ the International Development Association:
>   ○ The International Development Association Order, 1960 (SI 1960/1383)
>
> This list of organisations may not be complete. If you receive a claim for exemption for a security issued by any other international body you should refer the case to Technical.
> **27142 Designated as non-UK by Treasury** [May 2020]
> ... The following organisations have been so designated.
>
> - The Asian Development Bank: under the International Organisations (Tax Exempt Securities) Order 1984 (SI 1984/1215) made on 2 August 1984
> - The African Development Bank: under the International Organisations (Tax Exempt Securities) (No 2) Order 1984 (SI 1984/1634) made on 22 October 1984
> - The European Community; The European Coal and Steel Community; The European Atomic Energy Community; The European Investment Bank - under the European Communities (Tax Exempt Securities) Order 1985 (SI

[86] para (a) has been repealed.
[87] See 74.1.1 ("CTT" now refers to IHT).
[88] I do not understand the basis for this exception, but in practice the point may never arise.
[89] Author's footnote: More commonly known as the World Bank.

1985/1172) made on 25 July 1985.

- The European Bank for Reconstruction and Development - under the International Organisations (Tax Exempt Securities) Order 1991 (SI 1991/1202) made on 16 May 1991.

Any security issued by these organisations automatically has a foreign situs for IHT, where the event occurred on or after the date of the order. ...

The CG Manual provides:

> **CG12440 Types of asset (2): Shares and securities etc** [May 2020]
> *Securities of International or European Organisations*
> Special rules are provided for dealing with securities issued by certain designated international organisations.
> Section 265 TCGA 1992 allows the Treasury to designate for special treatment certain organisations whose membership includes the UK or any of the Communities of which the UK is a member. Once such an organisation has been designated any securities issued by it are deemed for the purposes of Capital Gains Tax to be located outside the UK. The list of organisations that have been designated under this provision is as follows.
> - International Bank for Reconstruction and Development
> - Asian Development Bank
> - African Development Bank
> - The European Economic Community
> - The European Investment Bank
> - The European Bank for Reconstruction and Development
> - The European Coal and Steel Community
> - The European Atomic Energy Community ...

102.13.2 *Inter-American Development Bank/ OECD support fund*

Article XI Section 9 of the Agreement Establishing the Inter-American Development Bank provides:

> **Immunities from Taxation**
> a) The Bank, its property, other assets, income, and the operations and transactions it carries out pursuant to this Agreement, shall be immune from all taxation and from all customs duties. The Bank shall also be immune from any obligation relating to the payment, withholding or collection of any tax, or duty.
> b) No tax shall be levied on or in respect of salaries and emoluments paid by the Bank to executive directors, alternates, officials or employees of the Bank
> c) No tax of any kind shall be levied on any obligation or security issued by the Bank, including any dividend or interest thereon, by whomsoever held:
> i) which discriminates against such obligation or security solely

> because it is issued by the Bank; or
>
> ii) if the sole jurisdictional basis for such taxation is the place or currency in which it is issued, made payable or paid, or the location of any office or place of business maintained by the Bank.
>
> d) No tax of any kind shall be levied on any obligation or security guaranteed by the Bank, including any dividend or interest thereon, by whomsoever held:
>
> i) which discriminates against such obligation or security solely because it is guaranteed by the Bank; or
>
> ii) if the sole jurisdictional basis for such taxation is the location of any office or place of business maintained by the Bank.

I suspect this is standard form for international organisations.

It is helpful to read the IHT/CGT exemptions side by side:

Section 131 FA 1976	**Section 266 TCGA**
A security issued by the Inter-American Development Bank shall be taken for the purposes of capital transfer tax [now IHT[90]] to be situated outside the UK.	A security issued by the Inter-American Development Bank shall be taken for the purposes of this Act to be situated outside the UK.

In practice one would expect the securities to be non-UK situate in any event, but this does no harm.

For completeness: s.4(1) OECD Support Fund Act 1975 provides similar relief for a financial support fund of the OECD, but despite an initial agreement to do so, the fund was never in fact established.[91] Perhaps at some point the Act will be repealed.

102.14 Simple contract debt

A "**simple**" debt is one which is not a specialty (in short, not made by deed).

The basic principles are well established:

> to prevent conflicting jurisdictions between different ordinaries, with respect to choses in action ... it was established as law, that judgment debts were assets, for the purposes of jurisdiction, where the judgment

[90] See 74.1.1 ("CTT" now refers to IHT).

[91] See Cohen, "The Financial Support Fund of the OECD: A Failed Initiative" (1997) *https://ies.princeton.edu/pdf/E204.pdf*

> is recorded; ... specialty debts, where the instrument happens to be; and simple contract debts, where the debtor resides ...[92]

The IHT Manual provides:

> **IHTM27091 Debts: contractual** [May 2020]
> In English law a **simple contract** debt is situated where the debtor resides: *AG v Bouwens*;[93] *English, Scottish and Australian Bank v IRC* [1932] AC 238...

Dicey states:

> Subject to the exceptions set out below, a debt is situate in the country where the debtor resides.[94]

I call this the "**place-of-debtor rule**". Along with the specialty situs rule, this rule can be traced back to Elizabethan times.[95]

There are many cases which state this rule: the most frequently cited, which may be called the leading cases, are *English, Scottish and Australian Bank* (mentioned above) and *New York Life Insurance Co v Public Trustee*[96] (affirming the passage from *Bouwens* set out above).

A winding-up order against the debtor does not affect the situs of a debt,[97] but judgment against the debtor (turning the debt into a judgment debt) does do so.[98]

France/Italy IHT DTAs apply different rules.[99]

102.14.1 *Debts within scope of rule*

The focus of discussion concerns debts. But the same rules apply to other choses in action,[100] which are not or may not be debts.[101] There does

[92] *AG v Bouwens* (1838) 4 M & W 171 *http://www.commonlii.org* The same applies in Australia: *Haque v Haque* (No.2) (1965) 114 CLR 98 at p.137.

[93] See above fn.

[94] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022) para 23-026 (Debts).

[95] See 102.15.1 (Situs of specialty).

[96] [1924] 2 Ch 101.

[97] *Wight v Eckhardt* [2004] 1 AC 147. In practice this issue will not usually arise.

[98] See 102.22 (Judgment debt).

[99] See 115.10 (Treaty-situs).

[100] Thus *Jabbour* applied the place-of-debtor rule for "not only debts, but also other choses in action"; see 102.14.7 (Place-of-enforceability: Synonym of place-of-debtor rule).

[101] "Debt" is not a very precise term, but so far as the same rules apply to debts and other chose in action, it is not necessary for situs purposes to determine what is or

however need to be an identifiable person, comparable to a debtor, whose residence should determine the situs under the place-of-debtor rule.

The position is different for swaps, spread bets, and similar financial instruments. These are choses in action. But during the lifetime of the contract, it is not clear which party will have to pay a sum to another. There is no identifiable "debtor" until the instrument matures. There is no authority, but:

(1) It is reasonably clear that the place-of-debtor rule cannot apply.
(2) It is considered the instrument (if not a specialty) is situated where payment is to be made, or where enforceable (which will normally be the same).
(3) It is suggested that the situs should not change when the instrument matures, ie the situs will not then be changed to the place of residence of the party who has to make the payment; though a judgment giving rise to a judgment debt could change the situs.

102.14.2 *"Jurisdiction-residence"*

In order to apply the place-of-debtor rule one needs to determine where the debtor resides.

"Residence" in this context is not quite the same as residence for tax purposes. It is necessary to have different terms: I use "**tax-residence**" and "**jurisdiction-residence**". It seems surprising to use the term "residence" in a non-tax sense but it is understandable when one bears in mind the history: the situs rule emerged in the context of private international law, not in the context of tax.

A UK incorporated company is deemed UK resident for IT/CT/CGT purposes.[102] This rule does not apply for the purpose of ascertaining the situs of debts owed by the company. Clearly the rule does not apply for IHT purposes, and even where situs is relevant for IT/CT/CGT purposes, it is considered that this deemed tax residence is to be ignored. But the question will not often arise.

The common law test of corporate residence for tax purposes (management and control) also does not apply. The test is where the company carries on business:

> Now, when you are dealing with a corporation, ... you have to examine

is not a debt; see too 102.25 (Insurance policy).

[102] See 8.3 (The incorporation rule).

> the question where the debt can be said to be situate. It appears to me plain that a corporation according to our law is deemed to reside for the purposes of suit in the place where it carries on business in its own name ...[103]

Moreover for this purpose a company is always resident in the place where it is incorporated and has its registered office, whether or not it is carrying on business in any other place.[104]

What is the test of residence of an individual, for the purposes of the place-of-debtor rule? Here jurisdiction-residence adopts the ordinary meaning of residence, sometimes called the common law meaning of residence.[105] This is (more or less) the same as the concept of residence applied for tax purposes before the SRT. In practice the SRT and jurisdiction-residence will usually come to the same thing, since the SRT is intended to encapsulate the ordinary meaning of the word residence. But there are some differences:

(1) Under the SRT, an individual is resident (or not) in the UK; for jurisdiction-residence the question is whether an individual is resident in England, or Scotland, or Northern Ireland, or in which jurisdiction they are resident outside the UK.

(2) Under the SRT, an individual is resident for a tax year. A person may be jurisdiction-resident in part of a tax year. Unlike the SRT, jurisdiction-residence commences immediately on arrival if the intention is to stay.[106]

102.14.3 *Dual-resident debtor*

A company may be jurisdiction-resident in two states. It has been said that an individual cannot be dual jurisdiction-resident.[107] But I do not

[103] *New York Life Insurance v Public Trustee* [1924] 2 Ch 101 at p.120; followed *Kwok Chi Leung Karl v CED* [1988] STC 728 at p.733.

[104] *Kwok Chi Leung Karl v CED* [1988] STC 728 at p.733. This may be justified on the basis that a company must be carrying on business where it has its registered office.

[105] *OJSC Oil Co Yugraneft v Abramovich* [2008] EWHC 2613 (Comm) (also reported under the name *Yugraneft v Abramovich*) at [461]: "... the courts have sought to give the word [residence] the same 'ordinary' meaning in both tax cases ... and jurisdiction cases ... It makes sense to do so. Resident for jurisdiction purposes but not resident for tax purposes is a distinction to be avoided if possible."

[106] Similar issues arise for domicile-residence; see 4.6 ("Domicile-residence").

[107] *New York Life Insurance Co v Public Trustee* [1924] 2 Ch 101 at p.114.

understand why; an individual could be dual tax-resident under the common law definition of residence.[108]

Where the debtor is jurisdiction-resident in two states, the place-of-debtor rule does not provide a solution. A tie-breaker is needed, and the solution adopted in *New York Life Insurance v Public Trustee*[109] is to prefer the state of jurisdiction-residence where the debt is payable.

The position where the debtor is jurisdiction-resident in two states and the debt is payable in a *third* state has not been considered. Perhaps in relation to a company this cannot happen, as if the debt is payable in a state the company will be carrying on business there, so it must be jurisdiction-resident there.

The position where the debtor is jurisdiction-resident in two states and the debt is payable in *both* states has not been considered. Some suitable tie-breaker must be devised; it is suggested that the proper law of the contract would be suitable.

102.14.4 *Identifying the debtor*

In order to apply the place-of-debtor rule one needs to identify the debtor. The identity of the debtor does not usually change, but it may do so:

(1) By operation of law (eg on death of the debtor) or
(2) By a novation (under which an existing debt is discharged and a new debt created)[110]

102.14.5 *Joint debtors*

Where a guaranteed debt is in default, the creditor may sue the debtor or the guarantor. This should not affect the situs of the debt, which is the jurisdiction-residence of the debtor, not the guarantor.

Hillside (New Media) v Baasland raised the problem of a debt under a contract with an agent acting for an undisclosed principal. The Judge said:

> [35] ... Hillside ... dealt with Mr Baasland in two capacities, (i) as principal in respect of [some funds] and (ii) as agents for an undisclosed principal (or undisclosed principals) in respect of [other funds]. In

[108] See the 2012/13 edition of this work para 3.13 (Dual residence/dual ordinary residence).

[109] [1924] 2 Ch 101 followed *Kwok Chi Leung Karl v CED* [1988] STC 728 at p.733.

[110] For an example of this issue arising (though on slightly unusual facts) see 26.10.4 (*Hafton Properties*).

> either case, Hillside are liable for the debt represented by the funds ... That chose in action was situate in England
> [36] However, if this analysis is correct, ... Hillside Gibraltar [a Gibraltar company], as an undisclosed principal of Hillside, would also have been liable to Mr Baasland in debt in respect of [certain funds], and that debt would have been situate in Gibraltar. Similarly, Bet 365 NV [a Netherlands Antilles company] would also have been liable for a debt in respect of [certain funds], and that debt would have been situate in the Netherlands Antilles.[111]

The better analysis of an undisclosed principal case is that the creditor has distinct claims (against the agent and against the undisclosed principal) but the claims relate to one single asset. An asset should be regarded as situate in only one place, so here we need a tie-breaker between the jurisdiction-residence of the agent and the jurisdiction-residence of the principal. The jurisdiction-residence of the undisclosed agent has the stronger claim as the test of residence. The position of the undisclosed principal is analogous to a guarantor. This is the practical solution, as the creditor needs to know the situs, but may not know about the residence, or even the existence, of the undisclosed principal.

There is no case discussing the situs of a debt owed by a partnership. On first principles, it is considered that the situs is where the partnership is jurisdiction-resident, on common law principles. That is where the partnership business is carried on.[112] If the partnership carries on business in more than one location, it is considered that the tie-breaker test should be the same as for a company which is dual resident, ie where the debt is due and payable.[113]

A debt may be owed by several debtors, whether jointly or severally, who are jurisdiction-resident in different places and not partners. Here again some tie-breaker is needed, and the logical one (as in the case of a dual-resident debtor) is the place where the sum is payable. This was the

[111] [2010] EWHC 3336 (Comm).

[112] See Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 11-043, 11-049 (Partnerships). Dicey records that before 1891, jurisdiction residence turned on the residence of the partners, not the place of business of the partnership; but it is suggested that situs of a partnership debt should follow the post-1891 test of jurisdiction.

[113] For partnership tax-residence see 85.23 (Residence of partnership). But here we are concerned with jurisdiction-residence.

solution adopted in *Cambridge Credit Corporation v Lissenden*[114] where the asset was an insurance policy issued by a dozen or more underwriters resident in the UK and the USA. Each underwriter was severally liable for a percentage of the amounts due under the policy. The policy was situate in New South Wales, where sums due were payable, even though none of the underwriters (debtors) were resident there.

102.14.6 *Place-of-enforceability: Rationale of place-of-debtor rule*

In *New York Life Insurance v Public Trustee* the court said:

> The rule of law with regard to the locality of simple contract debts is that it is determined by the residence of the debtor at the material moment. That has been well settled for a long time, and I think the reason for that is that it is
>
> [1] the residence of the debtor which determines the place where he may be sued, prima facie at all events, and
>
> [2] is in general the place where the means of satisfying any judgment may be discovered,
>
> but whatever the reason is, there is no doubt that this is the rule.[115]

These are not absolutely compelling reasons for the place-of-debtor rule. Even when the rule was first laid down, it was not necessarily the case that the debtor could only be sued in his place of residence, or that their assets were there and not elsewhere. Nowadays these are less safe assumptions than formerly; though even now, they are still the case more often than not. However there is no reason why the debt situs rule must have a compelling reason. In fact any situs rule is bound to be slightly arbitrary and any clear rule is better than none.

102.14.7 *Place-of-enforceability: Synonym of place-of-debtor rule*

In *Jabbour v Custodian of Absentee's Property* the court said:

> It is established by the decided cases that not only debts, but also other choses in action, are for legal purposes localised and are situated where they are properly recoverable and are properly recoverable where the debtor resides.[116]

[114] [1987] NSWLR 411 accessible *https://www.kessler.co.uk/wp-content/uploads/2015/07/Cambridge-Credit-Corp-v-Lissenden.pdf*

[115] [1924] 2 Ch 101 at p.114; similarly at p 119.

[116] [1954] 1 All ER 145 at p.151.

Similarly, Dicey rule 129 provides:

> Choses in action generally[117] are situate in the country where they are properly recoverable or can be enforced.[118]

I think that "properly recoverable" and "can be enforced" are synonyms, so Dicey is propounding one test expressed in two different ways. I call this the "**place-of-enforceability test**".

If this test is synonymous with jurisdiction-residence, it is correct. It is however a confusing and inapt way of expressing the place-of-debtor rule. It would be better to refer to place of residence rather than place of enforceability. All the leading cases use the term residence;[119] though there are some cases which (under the influence of Dicey) have expressed the rule in terms of a-place-of enforceability test.[120]

102.14.8 *Place-of-enforceability: Rival to place-of-debtor rule*

The difficulty with the place-of-enforceability test is that a debt is *not* necessarily recoverable in the place of residence of the debtor, and if that is understood, a place-of-enforceability test is not consistent with the place-of-debtor rule.

The question has been settled in a number of cases which have held that a debt is situate where the debtor is resident, even if the debt is enforceable elsewhere:

> a simple contract debt ... is deemed by English law to be situated in the place where the debtor resides. The reason for assigning this locality to a simple contract debt was that the place where the debtor resides was in nearly every case the place where it was recoverable. Even in earlier times, it might, of course, occasionally have happened that judgment could be obtained against a debtor in a country where he did not reside. But it was probably thought desirable for the sake of uniformity to adopt in all cases the test of residence rather than the test of recoverability.

[117] I think "generally" recognises (inter alia) the exceptional case that where the place of residence and the place of enforceability are different, the place of enforceability is not the situs of the debt; it also recognises other exceptions such as specialties, judgment debts).

[118] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), 23R-023 (1).The statement is found already in the 1st edition *A Digest of the Law of England with Reference to the Conflict of Laws* (1896) p.318.

[119] *AG v Bouwens*; *English, Scottish and Australian Bank v IRC* [1932] AC 238.

[120] For instance, *Kwok Chi Leung Karl v Commissioner of Estate Duty* [1988] STC 728 at p.732.

> However, whatever the reason may have been, the rule was laid down, was I have stated it, in *AG v Bouwens*, and was recognised by this court as still being the rule in *New York Life Insurance v Public Trustee*.

A debt from a non-resident is recoverable in the UK if (in short) the court gives permission, but that does not alter situs:

> The debt was also recoverable here ... had the plaintiffs been successful in obtaining leave to serve the defendant bank out of the jurisdiction. But I know of no authority for the proposition that a simple contract debt is situate in this country, at a time when the debtor is not resident here, merely because he can be sued by putting into operation the provisions of R.S.C., Ord. 11.[121] It would be strange if it were so. For it is always in the discretion of the court in cases coming within the rule, to give or refuse leave for service out of the jurisdiction, a discretion depending upon the balance of convenience. A debt due from a debtor resident out of the jurisdiction cannot therefore be deemed to be in this country until an application has been made for service of the writ out of the jurisdiction and that application has been acceded to. If leave were obtained, the question would then arise whether the order granting leave brought the debt into this country for the first time, or established its presence here as from some earlier date... But I need not attempt to answer this question, for in my judgment the fact that a simple contract debt can be recovered here from a debtor out of the jurisdiction does not establish an English locality for the debt....[122]

I set this out at length because unfortunately the contrary view was reached in *Hillside (New Media) v Baasland*. In this case Baasland ("the creditor") deposited money with Hillside ("the debtor"), creating a debt. The debtor was resident in England. The court should have held that the debt was situate in England because of the residence of the debtor but it did not. The Judge cited the Dicey rule set out above[123] and continued:

> Although at common law this principle led to the general rule that (with some exceptions that are irrelevant for present purposes) debts are situate where the debtor resides...[124], its application in a case such as this, where

[121] Now 6.30 Civil Procedure Rules 1998.

[122] *Re Banque Des Marchands De Moscou (Koupetschesky)* [1954] 2 All ER 746 at p.752 citing *Deutsche Bank v Banque des Marchands de Moscou* (unreported). The passage was also followed in *Re Helbert Wagg & Co* [1956] 1 All ER 129 at p.137.

[123] 102.14.7 (Place-of-enforceability: Synonym of place-of-debtor rule).

[124] The judge refers to the 14th edition of *Dicey*. The text has not changed in the current 16th edition, now found at 23-026.

> the debtor is a corporation and the case is covered by the Lugano Convention, depends, as I see it, upon the debtor's domicile. That is the primary ground on which a court takes jurisdiction under article 2 of the Lugano Convention. The domicile of a corporation is determined in accordance with section 42 of the Civil Jurisdiction and Judgments Act, 1982. It depends upon where it has its "seat", and this in turn depends upon where it was incorporated and has its registered or other official address or where its central management and control is exercised.[125]

I do not think any weight should be given to the comments on situs in *Hillside*, as the relevant cases were not cited.[126] *Hillside* illustrates how the place-of-enforcement test can mislead if it is intended to be synonymous with the place-of-debtor rule: it ought to be abandoned.

Although jurisdiction was the historical reason for adopting the place-of-debtor rule, now the rule has been chosen, jurisdiction-residence determines situs regardless of where the debt would actually be enforced. So a debt is situate where the debtor resides even though enforceable elsewhere, eg under an exclusive jurisdiction clause in the debt contract. If the historical reason for the place-of-debtor rule now holds less validity, or even no validity (though I think that would be an exaggeration) the rule is still as good as any other. Well-established precedents are not overturned merely because the historical reason for selecting that rule has become less compelling.

The place-of-debtor situs rule is in fact better than a place-of-enforceability rule for several reasons:

(1) It is generally easier to ascertain where a debtor is resident than where a debt may be enforced.
(2) The place of enforcement changes with developments in international law.
(3) A debt may be enforceable in several places against the same debtor.

102.15 Specialty obligation

102.15.1 *Situs of specialty*

If any rule of law can be called established, it is the rule that a debt due

[125] [2010] EWHC 3336 (Comm) at [33]. The comment was not a necessary part of the decision, as the place of residence and place of enforceability were both in England, so it is not binding.

[126] The creditor (probably insolvent) was not represented.

under a deed or other specialty is situate where the deed is situate.[127] I call this the "**specialty situs rule**". This rule (along with the place-of-debtor rule) can be traced back to Elizabethan times.[128]

The same rule applies in Australia:

> *specialties* (such as a policy of insurance) - a debt created by deed (a 'specialty') has been held to be located where the deed itself is to be found...[129]

So a debt due from a UK resident can be made non-UK situate for IHT by drafting the debt as a specialty and keeping the document offshore. Conversely a debt, policies, and other specialities can be made UK situate for IHT by bringing the deed here.

France/Italy IHT DTAs apply different rules.[130]

102.15.2 *Reason for specialty situs rule*

What is the reason for the specialty situs rule? *R v Williams* offers this explanation:

> [A specialty debt] was for centuries treated as very different from an ordinary debt. Indeed, the act of creating a specialty by deed was at one time possible only to men of the highest rank. Unlike debt, it was enforced by an action of covenant.[131] The deed itself was the foundation of the action, the original debt, if any, being merged. The terms of the deed were conclusive. Specialty debts till recent [?] times conferred

[127] *AG v Bouwens* (1838) 4 M & W 171 *http://www.commonlii.org* This was approved in *AG v Winans (No. 2)* [1910] AC 27; *Comr of Stamps (New South Wales) v Hope* [1891] AC 476. Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 23-032 (Specialties) cite another half dozen cases and the discussion is found already in the first edition *A Digest of the Law of England with reference to the Conflict of Laws* (1896), p.320.

[128] *Byron v Byron* Cro. Eliz. 472: "The debt is where the bond is, being upon a speciality; but debt upon a contract follows the person of the debtor; and this difference has been oftentimes agreed."

[129] Taxation Ruling TR 2008/9 *https://www.ato.gov.au/law/view/document?DocID=TXR/TR20089/NAT/ATO/00001*
The Ruling cites: *Shaw v R* (1895) 21 VLR 338; 1 ALR 122; *Haque v Haque (No.2)* (1965) 114 CLR 98 at p.137.

[130] See 115.10 (Treaty-situs).

[131] The Privy Council refer to Holdsworth, *A History of English Law* (3rd ed., 1908), vol. iii., p.417; now Holdsworth, *A History of English Law* (5th ed., 1991), vol. iii., p.417. This rule was abolished by the Civil Procedure Act 1833.

> special rights. They used to rank in the administration of the estate of a deceased person in priority to simple contract debts;[132] and, unlike such debts, were enforceable against the real estate.[133] They were said to be "of a higher nature" than debts by contract. It is, therefore, not surprising that specialty debts by deed were treated from an early date as *bona notabilia*[134] where the deeds were found at the time of the death, unlike ordinary debts which were said "to follow the person of debtor".[135]

The higher status attributed to a deed made sense several centuries ago. Important legal arrangements were recorded in deeds. Less important or casual legal arrangements were not. The rule that a deed was of a higher nature than a simple contract reflected the views of the community and the manner in which business was conducted.

The specialty rules mentioned by the Privy Council had (by 1942) long ceased to be valid in English law, but it continues to be the case that a specialty has a higher status, for instance, preferential treatment in the law of limitation. In common law jurisdictions it is still the case, in Blackstone's words, that a deed is "the most solemn and authentic act that a man can possibly perform with relation to the disposal of his property".[136]

None of this justifies the specialty situs rule, but it does show that a distinction between situs rules for a specialty debt and other debts should not be regarded as surprising or anomalous. Still, one might conclude that the specialty situs rule has no reason, but *Commissioner of Stamps v Hope* offers a good explanation:

> ... the distinction drawn and well settled has been and is whether it is a debt by contract or a debt by specialty. In the former case, the debt being merely a chose in action – money to be recovered from the debtor and nothing more – could have no other local existence than the personal residence of the debtor, where the assets to satisfy it would presumably be, and it was held therefore to be bona notabilia[137] within the area of the local jurisdiction within which he resided; but this residence is of course of a changeable and fleeting nature, and depending upon the movements of the debtor, and inasmuch as a debt under seal or specialty had a species of corporeal existence by which its locality might be reduced to

[132] This rule was abolished by the Administration of Estates Act 1869.
[133] This rule was abolished by the Administration of Estates Act 1833.
[134] See 102.1.2 (History and terminology).
[135] [1942] AC 541 at p.555.
[136] Commentaries Book II (1st ed., 1766), p.297.
[137] See 102.1.2 (History and terminology).

> a certainty ... it was settled in very early days that such a debt was bona notabilia where it was "conspicuous", i.e. within the jurisdiction within which the specialty was found at the time of death: see *Wentworth on the Office of Executors*, ed. 1763, pp.45, 47, 60(1).[138]

The reason for the specialty situs rule is not that the specialty has a "species of corporeal existence" though of course the deed does have physical existence. The reason is that the physical existence of the specialty allows the location of the debt to be a matter of certainty: the rule is more certain and easier to apply than a place-of-debtor rule. There is good sense in that. The specialty situs rule reflects a rational choice in the policy dilemma - common in tax and other areas of law[139] - of balancing the advantage of certainty against other criteria.

102.15.3 *HMRC view(s)*

HMRC formerly accepted that the specialty situs rule was correct.[140] HMRC announced a change of practice in 2013, but rightly abandoned the position(s) that specialty debts were (or were likely to be), situate where the debtor resides.[141]

After a number of iterations, IHTM now provides:

> **IHTM27079 Specialty debts: bonds and debentures under seal** [May 2020]
> ... HMRC has revised its previous approach to the Inheritance Tax (IHT) treatment of such debts, which was that where the debt is situated depends on where the relevant document is to be found. HMRC will take the following approach, which will apply regardless of when the specialty debt was created.
> [Comment on secured specialty debts, discussed below; see 102.19 (Mortgage debt).]
> **Unsecured specialty debts**
> [1] Where the debt is not secured the view of the Courts is that the situs

[138] [1891] AC 476 at p.481. The passage from Wentworth is at *https://www.kessler.co.uk/wp-content/uploads/2013/12/wentworth-on-executors.pdf*

[139] See 16.5 (Formal/substantive source rules).

[140] The IHT Manual formerly provided:
*"**IHTM27091 Contractual** [February 2006]*
A specialty debt is situated where the instrument happens to be."

[141] The point was considered in detail in the 2017/18 edition of this work, para 94.13 (Specialty obligation), concluding: "It seems safe to predict that the statement will be withdrawn."

> of the debt is usually (!) where the relevant deed or instrument evidencing the debt is found. HMRC will generally adopt this approach to unsecured specialty debts.
> [2] However, it is possible to exploit this approach artificially by, for example, removing the document from the UK to avoid an IHT charge. Where the creditor and debtor are both resident in the UK but the deed evidencing the debt has been removed from the UK, it may be possible for HMRC to argue that the debt is nevertheless situated in the UK for the purposes of the IHT charge. For this reason all cases in which a specialty debt is claimed to be situated outside the UK should be referred to Technical.

The tentative[142] suggestion is that the speciality situs rule may not apply for IHT purposes where:
(1) the creditor is UK resident
(2) the debtor is UK resident
(3) the deed has been removed from the UK

There is no basis for this view, other than, conceivably, the GAAR, but I do not think it can sensibly be said that the example constitutes abusive arrangements, within the meaning of the GAAR. HMRC, I think wisely, do not give any reason. Nor do HMRC claim, as they did before, that their view is supported by legal advice. But condition (3) is not likely to arise (in practice the deed will never enter the UK) so the issue will probably never arise.

As the statement falls into the category of "clearly wrong" I see no need to disclose to HMRC occasions where a tax charge would arise if their view were right.[143]

Perhaps the passage is just there to minimise embarrassment at the change of position.

102.15.4 *Specialty situs rule: Critique*

There is something to be said for statutory abolition of the specialty situs rule.[144] The change would not bring in any significant amount of tax (as

[142] It is qualified by the words "for example" and "... it may be possible for HMRC to argue ..."

[143] See 122.9.2 (Disclosure to avoid misconduct).

[144] There are precedents for statutory reform: the specialty situs rule was amended for probate duty: s.39 Revenue Act 1862; and it does not usually apply for CGT. Dymond states:

> "It was formerly considered that s.39 Revenue Act 1862 (which provided that, for

debts could be held by companies whose shares would be non-UK situate) but it would be a simplification. The transitional rules would need thought. If the object is simplification, the new rules should not just apply to new debts. A fair rule would be to apply the new rules after a reasonable delay, say 12 months, to allow taxpayers to review their position. The cost of taxpayers reviewing their affairs ought to be taken into account. After factoring that in, I would not have thought that the improvement was worth the trouble involved in achieving it.

If it could be done as a quid pro quo of a wider review and simplification of the unsatisfactory CGT debt and debenture situs rules[145] the law would be left in a better state. But the best solution is to look at the wider picture altogether: treat all assets other than UK land and securities as non-UK situate for the purposes of IHT and CGT.[146]

102.16 Meaning of "specialty"

"Specialty" is an opaque technical term whose meaning can only be ascertained from the case law. Four categories of asset are "specialties":

(1) Obligations under deeds:
   (a) The paradigm example of a specialty is a debt due under a deed.
   (b) The term also applies to deeds which create or record obligations which are not (or may not be) debts.[147] A life policy, contract for deferred annuity, capital redemption policy and the like are specialties if made by deed. Shares are not specialties.[148]

(2) For completeness the term also includes some liabilities which are not deeds:

> Probate Duty purposes, specialty debts owing from persons in the UK, and forming part of the free estate, were to be treated as though they were simple contract debts), was incorporated for estate duty purposes... The Irish Court, however, decided in *Re Finance Act, 1894 and Deane* [1936] Ir R 556 that [this was not the case] and, accepting this interpretation as correct, such debts are to be regarded as subject to the ordinary rule applicable to specialty debts."

See Dymond's Death Duties (15th ed, 1973) p.1267. Of course all this is inconsistent with the current HMRC view.

[145] See 103.8.4 (Critique); 103.13.5 (UK law rule: Critique); 103.9 (Debt situs rule); 103.11 (Critique).

[146] See 102.37 (Reform of IHT/CGT situs rules).

[147] In *Aiken v Steward Wrightson Agency* [1995] 1 WLR 1281 the term was applied to a contract by deed to provide services (so a claim for breach of contract was "an action upon a specialty" which qualified for a 12-year limitation period).

[148] *R v Williams* [1942] AC 541 at p.556.

(a) A debt incurred under a statute.[149]
(b) Certain debts are by statute given the status of a specialty.[150]

So the terms "deed" and "specialty" are not strictly synonymous, but in most cases a deed is a specialty and vice versa.

102.16.1 *What is a "deed"*

Since a specialty is a deed, the question arises as to what is a deed.

For a document to be a "deed" in English law it was formerly a requirement that the document must be sealed but that is not usually now the case. The current rules of what is a deed govern the meaning of "specialty". So a seal is not usually required for an English law document to be a "specialty".[151] No particular form is necessary to be a "specialty" beyond the formalities of a deed.

The same applies in Northern Ireland.[152]

As a shorthand, a deed was formerly referred to as a document "under seal" and a non-deed as a document "under hand". This usage is now out of date (at least in England) but it is still found in HMRC Manuals.

A full discussion requires a long chapter to itself. I set out the current law, in less than full detail; though it will sometimes be necessary to consider the old law.

102.16.2 *Intended to be a deed*

Section 1(2)(a) Law of Property (Miscellaneous Provisions) Act 1989 sets out the first requirement which applies both to individuals and to companies:

> (2) An instrument shall not be a deed unless—
> (a) it makes it clear on its face that it is intended to be a deed by the person making it or, as the case may be, by the parties to it (whether by describing itself as a deed or expressing itself to be executed or signed as a deed or otherwise)...
>
> (2A) For the purposes of subsection (2)(a) above, an instrument shall not

[149] *Royal Trust v AG for Alberta* [1930] AC 144.

[150] In this category there now remain only a few Victorian antiquities of no practical importance, such as s.14 Metropolitan Fire Brigade Act 1865.

[151] The Law Commission took this view in Working Paper No. 85 (1985) and Report No. 253, para 2.12.44. Dicey agrees: *Conflict of Laws* (16th ed., 2022), [Dicey's footnote] para 23-032 footnote 86

[152] Article 3 Law Reform (Miscellaneous Provisions) (NI) Order 2005.

> be taken to make it clear on its face that it is intended to be a deed merely because it is executed under seal.

102.16.3 *Executed as a deed*

Section 1(2)(b) Law of Property (Miscellaneous Provisions) Act 1989 provides:

> (2) An instrument shall not be a deed unless ...
> (b) it is validly executed as a deed—
> (i) by that person or a person authorised to execute it in the name or on behalf of that person, or
> (ii) by one or more of those parties or a person authorised to execute it in the name or on behalf of one or more of those parties.

The phrase "validly executed as a deed" is a label for a set of requirements which vary depending on whether the party is an individual or a company.

102.16.4 *Execution by individual*

Section 1(3) Law of Property (Miscellaneous Provisions) Act 1989 provides:

> An instrument is validly executed as a deed by an individual if, and only if—
> (a) it is signed—
> (i) by him in the presence of a witness who attests the signature; or
> (ii) at his direction and in his presence and the presence of two witnesses who each attest the signature; and
> (b) it is delivered as a deed.

Land Registry Practice Guide 8 – Execution of deeds (June 2023)[153] contains a helpful summary. It comments on "delivery" and attestation:

> **2.1.3 Delivery**
> [The guidance sets out s.1(3)(b), LP(MP)A 1989 and continues]:
> Delivery requires that the person expressly or impliedly acknowledges, by words or conduct, an intention to be bound by its provisions.
> Where a conveyancer, in a transaction involving the disposal or creation of an interest in land, purports to deliver a document as a deed on behalf of a party to

[153] *https://www.gov.uk/government/publications/execution-of-deeds/practice-guide-8-execution-of-deeds*

> it, there is a conclusive presumption in favour of a purchaser that the conveyancer is authorised to deliver it (s.1(5), LP(MP)A 1989). In practice, we assume that a document has been delivered as a deed unless there is some indication to the contrary. So if, for example, the words of execution have been modified to provide that delivery has not taken place, or that delivery is not to be presumed until some condition has been fulfilled, we will require evidence that delivery has subsequently taken place.
>
> **2.2 Attestation clause**
>
> The general law does not require a particular attestation clause. It is sufficient if the clause makes clear that the signatures of the parties to the deed are intended to be by way of execution and that they were made in the presence of the witnesses. The wording should also state that the document has been executed "as a deed". Then, even if it is not clear elsewhere in the document that it is intended to be a deed, the words of execution will make this apparent ...

102.16.5 *Execution by company*

In relation to a company, the requirements for a deed are supplemented by requirements for execution of a document by a company which apply to deeds and to non-deeds. Section 44 CA 2006 provides:

> (1) Under the law of England and Wales or Northern Ireland a document is executed by a company—
>
> (a) by the affixing of its common seal, or
>
> (b) by signature in accordance with the following provisions.
>
> (2) A document is validly executed by a company if it is signed on behalf of the company—
>
> (a) by two authorised signatories, or
>
> (b) by a director of the company in the presence of a witness who attests the signature.
>
> (3) The following are "authorised signatories" for the purposes of subsection (2)—
>
> (a) every director of the company, and
>
> (b) in the case of a private company with a secretary or a public company, the secretary (or any joint secretary) of the company.

Section 46 CA 2006 provides:

> (1) A document is validly executed by a company as a deed for the purposes of section 1(2)(b) of the Law of Property (Miscellaneous Provisions) Act 1989 and for the purposes of the law of Northern Ireland if, and only if—
>
> (a) it is duly executed by the company, and
>
> (b) it is delivered as a deed.
>
> (2) For the purposes of subsection (1)(b) a document is presumed to be

delivered upon its being executed, unless a contrary intention is proved.

102.16.6 *Scottish company*

Land Registry Practice Guide 8 – Execution of deeds provides:

> **3.6 Execution by Scottish companies registered under the Companies Acts**
> The question of whether a disposition of land in England and Wales is formally valid must be determined in accordance with the lex situs, that is, the law of England and Wales. It is our view, therefore, that the requirements for an effective transfer etc. of registered land are the same where the disposition is by a Scottish company registered under the Companies Acts as for a disposition by English and Welsh companies so registered.
> S.48 CA 2006 provides that "a document signed or subscribed by or on behalf of the company in accordance with the provisions of the Requirements of Writing (Scotland) Act 1995 shall have effect" as if executed by a company affixing its common seal. However, the section begins: "The following provisions form part of the law of Scotland only." It is difficult to see, therefore, how s.48 CA 2006 can be relevant where it is registered land that is being disposed of.
> The Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 includes provisions as to execution by overseas companies, but a Scottish company is not an overseas company.

102.16.7 *LLPs*

Land Registry Practice Guide 8 – Execution of deeds provides:

> **5.2 Limited liability partnerships**
> ... Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009 (SI 2009/1804) applies ss.44-47, CA 2006 to limited liability partnerships, so they may execute deeds as provided by s.44 CA 2006. The regulations modify s.44 CA 2006 so that the references to a director and the secretary, or two directors, of the company are to be read as references to two members of the limited liability partnership (Regulation 4). ...

102.16.8 *Foreign company*

Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 provides:

> Sections 43, 44 and 46 of the Companies Act 2006 apply to overseas companies, modified so that they read as follows ...
>
> **44 Execution of documents**
>
> (1) Under the law of England and Wales or Northern Ireland a document is executed by an overseas company—
>
> (a) by the affixing of its common seal, or
>
> (b) if it is executed in any manner permitted by the laws of the territory in which the company is incorporated for the execution

> of documents by such a company.
>
> (2) A document which—
>
> (a) is signed by a person who, in accordance with the laws of the territory in which an overseas company is incorporated, is acting under the authority (express or implied) of the company, and
>
> (b) is expressed (in whatever form of words) to be executed by the company,
>
> has the same effect in relation to that company as it would have in relation to a company incorporated in England and Wales or Northern Ireland if executed under the common seal of a company so incorporated...
>
> (4) Where a document is to be signed by a person on behalf of more than one overseas company, it is not duly signed by that person for the purposes of this section unless he signs it separately in each capacity.
>
> (5) References in this section to a document being (or purporting to be) signed by a person who, in accordance with the laws of the territory in which an overseas company is incorporated, is acting under the authority (express or implied) of the company are to be read, in a case where that person is a firm, as references to its being (or purporting to be) signed by an individual authorised by the firm to sign on its behalf.
>
> (6) This section applies to a document that is (or purports to be) executed by an overseas company in the name of or on behalf of another person whether or not that person is also an overseas company.
>
> **46 Execution of deeds**
>
> (1) A document is validly executed by an overseas company as a deed for the purposes of section 1(2)(b) of the Law of Property (Miscellaneous Provisions) Act 1989 and for the purposes of the law of Northern Ireland if, and only if—
>
> (a) it is duly executed by the company, and
>
> (b) it is delivered as a deed.
>
> (2) For the purposes of subsection (1)(b) a document is presumed to be delivered upon its being executed, unless a contrary intention is proved.

Practice guide 78 (July 2023) provides:

> **5. Execution of deeds by overseas companies**
>
> The Overseas Companies (Execution of Documents and Registration of Charges) Regulations 2009 (OCR 2009) allow an overseas company to execute a document in one of the following three ways. The OCR 2009 apply section 44 of the Companies Act 2006 with some amendments.
>
> Questions as to who is duly authorised to act on behalf of an overseas company in making a contract or executing a document are determined by the law of the company's domicile, not the governing law of the contract or document (*Integral Petroleum SA v Scu-Finanz AG* [2015] EWCA Civ 144).

Unless the overseas company is already the proprietor of the land or charge, we will need to see evidence of their corporate status, which may consist of either a certificate in Form 7 provided by a qualified lawyer practising in the territory of incorporation or a certified copy of the constitution of the corporation - see Evidence required on registration of overseas company as proprietor of an estate or charge.

If the manner of execution by an overseas company includes an electronic signature, then the signature must comply with our requirements in practice guide 82: electronic signatures accepted by HM Land Registry. For the purposes of practice guide 82, "conveyancer" has the meaning given by rule 217A of the Land Registration Rules 2003 and "individual conveyancer" means an individual described in paragraph (2)(a) or (b) of that rule.

5.1 Execution under a common seal

An overseas company that has a common seal may execute deeds using that seal provided the deed is executed in a form appropriate to a company registered under the Companies Act, with such adaptations as may be necessary. Practice guide 8: execution of deeds – section 3.1 Execution by a company under its common seal sets out the methods by which a deed may be executed in this manner.

Where the seal is affixed in the presence of and attested by a permanent officer of the corporation who is not a clerk (or their deputy) or secretary (or their deputy), a note is required to be added to the description below the signature to the effect that the signatory is, in fact, a permanent officer of the corporation. A similar such note is required where the seal is affixed in the presence of and attested by a member of the governing body where their title does not make this clear...

5.2 Execution in a manner permitted by local law

Under Regulation 4 of the OCR 2009 a deed may be executed "in any manner permitted by the laws of the territory in which the company is incorporated for the execution of documents by such a company". In this instance we will require evidence (which might include a letter from a qualified lawyer practising in or familiar with the domestic legislation of the territory of incorporation) to establish that the manner of execution used is indeed effective according to the law of the territory of incorporation. Such evidence must not be conditional or qualified in any way.

Any documentation in a language other than English or Welsh must be accompanied by a certified or notarised translation.

5.3 Execution by signature of authorised persons

5.3.1 Authorised person as an individual

The OCR 2009 apply s.44(2), CA 2006 amended as follows:

> "(2) A document which:
>
> (a) is signed by a person who, in accordance with the laws of the territory in which an overseas company is incorporated, is acting under the authority (express or implied) of the company, and
>
> (b) is expressed (in whatever form of words) to be executed by the company,
>
> has the same effect in relation to that company as it would have in relation to a company incorporated in England and Wales or Northern Ireland if

> executed under the common seal of a company so incorporated." ...

102.16.9 *Which debts are specialties*

The specialty situs rule requires one to ascertain whether any particular debt is a specialty, which depends on the documentation. The specialty situs rule overrides the place-of-register rule: see 102.5 (Situs of registered shares).

The IHT Manual provides:

> **IHTM27080 specialty debts: Treasury Bills, British Savings Bonds, National Savings Income Bonds** [May 2020]
> Treasury Bills and British Savings Bonds are treated as specialty debts and situs will follow the normal principles for unsecured specialty debts (IHTM27079). Any claim that such assets should be regarded as non UK situs at a chargeable event must be referred to Technical.

It is difficult to see why the claim to apply "the normal principles for unsecured specialty debts" should be referred to Technical, but there it is. In practice I would not expect Technical to challenge situs.

> **IHTM27091: Foreign property: debts: contractual** [May 2020]
> ... Corporation mortgages, issued by local authorities under seal, and Northern Irish Land Bonds are examples of specialty debts. You should be careful not to confuse corporation mortgages with corporation stock, which is far more common and which is a registered security, situated where the register is kept.

102.16.10 *Isle of Man deeds*

The position is as follows:

> While there is no doubt that seals have never been used in the Isle of Man, except by corporations, and that the formality of affixing a seal has never been, and is not now, required in order to constitute a written paper a deed, in my view for a written paper to be a deed there must be some evidence that the parties intended it to be a deed. That will normally be found in the words of the document itself.[154]

102.17 Jurisdictions without "deeds"

Common law jurisdictions employ the concept of a "deed", ie

[154] *Aall Trust & Banking Corporation v Samuel McCormick* 2 OFLR 85, Butterworths Offshore Service Cases, Vol 2, p.479.

(1) They draw a distinction between:
   (a) a "deed" (a technical term meaning a document which meets some set of formal requirements of execution) and
   (b) an informal document (which does not meet those requirements).

(2) The distinction matters for various purposes, eg certain dispositions of land require a deed; limitation and situs rules differ; etc.

Both the requirements and the consequences of being a deed have varied over the years, but there is a sufficient core to yield a stable and meaningful concept. As far as I know, other jurisdictions do not have this concept or anything very closely comparable.

102.17.1 *Channel Islands*

Jersey and Guernsey law does not have the common law concept of a deed and prefer to avoid the word or (if used) to give it an express definition.[155]

102.17.2 *Scotland*

Scots law does use the word "deed"[156] but not as a technical term:

> [16]... it is clear that the word "deed" has no technical meaning in Scots law. In *Henderson's Trs v IRC*, 1913 SC 987, a case dealing with the question of whether a minute of acceptance of office by trustees engrossed upon a trust disposition and settlement was a deed for the purposes of the Stamp Act 1891, ... Lord Kinnear stated (at 990):
>
> > "... for the purpose of this case the word 'deed' is a word of ordinary language, because it is not in our system a term of art. I agree also that it is unnecessary to attempt any exact definition of what the word 'deed' means; but I take the definition ... that a deed was any formal instrument which creates a legal relation".
>
> ... It is unnecessary for present purposes to attempt any definition of the word "deed". Nevertheless, I take from these cases that the significant characteristics of a deed are first that it should have some degree of formality and secondly that it must demonstrate an intention to create a legal relation.
>
> [17] The minute of the board meeting of a company, duly signed by the chairman, is to my mind clearly a formal document. Section 382 of the

[155] Kessler & Matthams, *Drafting Trusts and Will Trusts in the Channel Islands* (2nd ed., 2013), para 9.1.

[156] For instance, "trust deed" (broadly defined) is used frequently in the Trusts (Scotland) Act 1921.

> Companies Act 1985 [now s.248 CA 2006]... provided ... that every company shall cause minutes of all proceedings at meetings of its directors to be entered in books kept for that purpose. The reason for that provision is that the minutes serve an important purpose in recording the formal decisions of the board, which is of course the body that is responsible for managing the company. Thus board minutes are important documents. Subsection (2) then provides:
>
> > "Any such minute, if purporting to be signed by the chairman of the meeting at which the proceedings were had... is evidence of the proceedings".
>
> That too indicates a degree of formality in the notion of board minutes; they may have to be relied on in future, and it is important to establish precisely what the directors decided on any particular matter. Apart from the provisions of the Companies Act, section 2 of the Trusts (Scotland) Act 1921 states that the expression "trust deed" shall mean and include "any... resolution of any corporation". That again suggests that formal resolutions taken by a company, whether in general meeting or through its board of directors, are to be regarded as documents that have the requisite degree of formality to constitute a deed. ...[157]

In short, Scots law has a concept of "deed" (albeit somewhat vague) but that is not the common law concept. The use of the same word should not be allowed to obscure the difference. Scots law does not have the concept of a "specialty".[158] Accordingly, Scots law cannot have the rule that a specialty is situate where the document is.

102.18 Specialties: Conflict of laws

102.18.1 *Situs in English law*

An English[159] court may have to determine the situs of a debt governed by a foreign law. If the foreign law recognises the concept of a deed (in practice, if it is a common law jurisdiction) then it is considered:

(1) The question whether the document is a deed (and so a specialty) is

[157] *Low & Bonar Pension Trustees v Mercer* [2010] CSOH 47.

[158] This is recognised in former companies act legislation; for instance, s.14(2) Companies Act 1985 provided: "Money payable by a member to the company under the memorandum or articles is a debt due from him to the company, and *in England and Wales* is of the nature of a specialty debt." There is no equivalent in the current companies legislation.

[159] The same would apply in Northern Ireland.

governed by the law of the document.[160]

(2) If the document is a specialty under that law, one applies the English law (common law) rule that the situs is where the document is.

It has been suggested that the specialty situs rule may only apply if the document is situate in a jurisdiction which applies the specialty situs rule. So the situs of a specialty debt would be (say) the Isle of Man if the document was there, but it would be the residence of the debtor if the document was moved to (say) Jersey or Scotland. But there is no authority which supports that, and it is clearly wrong on principle. The question of situs in an English court is decided according to English law rules and under English law an asset may be situate in (say) Ruritania even if under Ruritanian law the asset is not situate there. Those who are concerned about the point will keep the documents in a common law jurisdiction, but that is not strictly necessary.

What is the position if a document is governed by a law which does not have the concept of a deed? There is authority that the document will be a specialty if it is executed in accordance with the English law requirements of a deed.[161] But in practice if one wishes to rely on the specialty situs rule, it is possible to avoid the issue, and choose a common law governing law, which does recognise deeds so the issue need not arise.

102.18.2 *Situs in Scots law*

If one turns to the Scots law textbooks on private international law, one finds no discussion at all on the situs of debts. Scotland did not have the jurisdiction of the Ordinary, where the common law rules arose;[162] and its private international law has managed to develop without reference to the situs of debts. I would be grateful to any reader who could direct me to relevant Scots authority if there is any.

Whatever the rule of Scots law on the situs of debts, it seems safe to say that it does not apply the specialty situs rule as Scots law does not recognise that concept. It might apply the place-of-debtor rule: a debt is situate where the debtor resides. I would not have thought that was

[160] In practice it would be unusual that a document which is a deed under the governing law does not meet the English law requirements for a deed, so the issue of which law applies for this purpose will not often arise.

[161] *Alliance Bank of Simla v Carey* (1880) 5 CPD 429.

[162] See 102.1.2 (History and terminology).

inevitable. The common law cases are not binding in Scotland. But in the absence of other authority, a solution which is more consistent with foreign jurisdictions seems preferable. This is the view of Dymond's Death Duties:

> The English specialty rule is unknown to Scottish law, so that debts owing by a person resident in Scotland, whether secured by a document under seal or not, are situate there [under Scottish law].[163]

Take the following examples; assume a specialty debt, and (if it matters) governed by English or IoM law (ie a law recognising deeds):

Case	Specialty in	Debtor resident	Situs (Scots law)	Situs (English law)
1	IoM	Scotland	Scotland	IoM
2	Scotland	IoM	IoM	Scotland

The situs of the debt (and whether it is excluded property) can hardly depend on whether the issue is litigated in England or in Scotland. It is suggested that the solution to the conundrum is to say that an asset is situated in the UK if it is:

(1) situate in England according to English law
(2) situate in Scotland according to Scots law, or
(3) situate in Northern Ireland according to NI law.[164]

It is situate outside the UK if none of those apply.

On that analysis the debt in case 1 is situate in the UK and the debt in case 2 is situate outside the UK. The answer in case 2 is perhaps surprising but the facts of case 2 will not often arise.

The IHT Manual provides:

> **IHTM27092 debts in Scotland** [May 2020]
> In Scotland, the rule that a debt is situated where the debtor resides applies to both specialty debts (IHTM27079) and to those due on simple contract. For Inheritance Tax purposes debts due from people or companies who are resident or based in Scotland are regarded as situated there. If the taxpayer or agent disputes this rule, refer the case to Technical.
> Any case where a Scottish instrument under seal is outside the UK and the locality of the asset determines whether or not Double Taxation Relief under IHTA84/S159 (IHTM27185) applies must also be referred

[163] *Dymond's Death Duties* (15th ed., 1973), p.1267.
[164] See too 4.18 (Child's domicile: Scotland).

> to Technical.
> The guidance on this page relates to specialty debts generally. It covers, for example, mortgages under seal, policies under seal, and covenant debts, and also applies to debts due from the Crown, or due under a statute.

No reason is given, but the result (although surprising at first sight) is consistent with the analysis of case 1 above.

102.19 Mortgage debt

102.19.1 *Property law background*

This section considers the situs of a debt charged or secured on land ("**mortgage debt**"). The borrower is the "**mortgagor**" and the creditor is the "**mortgagee**". Although the discussion focuses on land, the same should apply if a debt is charged on other property, such as shares.

It is not necessarily the case that all mortgage debts should be treated the same way. In English law, mortgages have a long and complex history; in other jurisdictions the nature of a mortgage will vary. The rights of the mortgagee will also depend to some extent on the documentation. However the situs cases have never investigated this, and we may proceed on the basis that all mortgages should in principle be governed by the same situs test(s).

A mortgage debt has a twofold character:

(1) It is an interest in land, conferring (at least when the debt is due and unpaid):
 (a) right to possession
 (b) power of sale
 (c) right to foreclose

(2) It is a debt, conferring a right of action against the debtor (like an unsecured debt)

In short, a mortgage debt confers a bundle of rights. It should however be regarded as a single asset, and not as two assets. The bundle is indivisible:

> If [the mortgagee] sues on the covenant to pay he must reconvey the land on payment.[165] If he has parted with the land, otherwise than in exercise of a power of sale, he would be restrained from suing on the covenant...

[165] Author's footnote: The equivalent in modern law would be a duty to support an application to the land registry to de-register the mortgage.

> The result is that a mortgagee cannot assign the mortgage debt effectually without also transferring the security upon the land.[166]

Since rules applicable to land are often different from rules applicable to debts, the question of how to classify a mortgage debt has often arisen, and has been answered in different ways. That is not surprising, as a mortgage debt partakes of both qualities, and the answer has depended on the context.

At common law, on the death of an individual, real property passed to the heir and personal property passed to the personal representatives.[167] *Thornborough v Baker* held that a mortgage debt is personalty, so that on the death of the mortgagee it passed to his personal representatives. The mortgagee's legal title to the land passed to the heir but he held it on trust for the PRs:

> for in natural justice and equity the principal right of the mortgagee is to the money, and his right to the land is only as a security for the money.[168]

Again:

> a charge to secure a liability of the chargor to the chargee is a secondary benefit. It is available only for the purpose of enforcing the primary benefit, namely the underlying personal liability which the chargor owes him.[169]

On the other hand, a mortgage debt is an interest in land; a gift by will to a charity was void under the Charitable Uses Act 1735. In *Re Hoyles* a testator domiciled in England gave to charity mortgage debts charged on land in Ontario. The majority of the CoA held that a mortgage debt was immovable property, at least for the purpose of the conflicts rule that succession to immovable property was governed by the law of the place where the land was. The 1735 Act applied in Ontario, so the gift was void.

[166] *Re Hoyles* [1911] 1 Ch 179 at p.184. Although this relates to a pre-1925 mortgage (which took the form of the conveyance of land to the mortgagee subject to a right of reconveyance) the same applies to a modern mortgage (a charge by way of legal mortgage).

[167] Hence the name "personal representatives". After s.30 Conveyancing Act 1881, the mortgagee's legal title to the land passed to the PRs; but the point would still arise even now if a will gave real property to A and personal property to B: the mortgage debt would pass to B.

[168] (1675) 3 Swans 628 at 630 *http://www.commonlii.org*

[169] *SOCA v Szepietowski* [2013] UKSC 65 at [79].

The principle that a mortgage debt was personal property was limited (or brushed aside):

> It is true that a mortgage is as between mortgagor and mortgagee regarded as personal estate for many purposes; ... but the fact that it is so for certain purposes in questions between our fellow subjects here has no bearing on the question whether such a mortgage should be regarded as movable or not in questions of international law. The mortgage undoubtedly affects the land directly; the mortgagee can enter and take possession at any time after his estate has become absolute at law;[170] he can by foreclosure acquire the full title to the land in fee, and the [Charitable Uses Act 1735] has forbidden any devises of land for any estate or interest whatsoever in any way charged or incumbered by any person or persons whatsoever in trust or for the benefit of any charitable use whatsoever and has made them void.[171]

This was a case where the court decided the answer first and the analysis came second:

> [Counsel] invites us to leave the Mortmain Act out of sight and decide as a preliminary abstract question whether mortgages on land are movable or immovable. But we should fail in our duty if we did not consider that Act and the effect of our decision upon devises within it. We must have regard to the fact that such gifts have been regarded as prejudicial to and against the public utility and a public mischief, and we must accordingly come to such conclusion as will avoid these evils.[172]

102.19.2 *A principled analysis*

There are four possible solutions:

(1) The asset is situate only where the land is.
(2) The asset is situate only where the debt is.
(3) The asset is double situate, ie fully situate in both jurisdictions.
(4) The asset is partly situate in both jurisdictions:
    (a) situate where the land is, to the extent of the value of the land, and
    (b) situate where the debt is, if and so far as the value of the asset exceeds the value of the land.

[170] This is not the case for a mortgage under modern law.

[171] [1911] 1 Ch 179 at p.187.

[172] [1911] 1 Ch 179 at p.187.

Solution (3) must be rejected if one accepts the view in this book that one asset cannot be situate in two places.[173]

Solution (2) is rational. It provides a reasonable result even in a case where the debtor has no assets other than the land, so the debt is paid out of the land. An unsecured debt may be situate in state A even though the debtor's assets used to pay the debt are all in state B.

Solution (1) - that situs depends solely on location of the land - is not a sensible or workable rule for the following reasons:

(1) One debt may be charged on land in two different countries.
(2) The rule becomes absurd if a large debt happens to be secured on an asset of small value. Would one say a £100m debt is situate in Jersey if it is secured on Jesey land, or indeed shares, worth £100k?

Solution (4) may be said to best track the economic reality - though one might doubt how far economic reality may be said to apply to situs rules of unsecured debts. It is not necessarily inconsistent with the principle that a mortgage debt is one asset and not two. Perhaps it is like a chattel which might perch across both sides of a border, whose situs may be split in the same way. If situs depends on values of the debt and the land, the proportions may fluctuate from time to time, but that too is not an insuperable objection.

102.19.3 *Mortgage situs: Case law*

All the solutions have some support in case law.[174] At some point the courts will have to review the cases and decide which to prefer.

102.19.4 *Situs of debt prevails*

These cases in this camp go back at least to *Commissioner of Stamps v Hope* [1891] AC 476. Here:

(1) The testator entered into a contract to sell land in New South Wales for a purchase price payable (in part) by 12 promissory notes falling due at various dates. The contract and promissory notes created simple contract debts (not made by deed).
(2) Subsequently the purchaser granted a mortgage of the land by deed. This deed included a covenant to pay the promissory notes.

[173] See 102.3 (Every asset has one situs).

[174] See Hopley, "Reaping the Succession Duty Field: Mortgages and the One Local Situation Rule" (1958) 16 University of Toronto Faculty Law Review 8.

The testator died before the last promissory note was payable, so the question arose as to the situs of the debt. The Revenue argued that the testator held a simple contract debt situate where the debtor was resident (New South Wales). There was some debate about the simple contract debt had merged into the mortgage deed. Under the doctrine of merger, a simple contract debt could merge into a later deed (ie be superceded by the deed) in which case the simple contract debt ceased to exist.[175] Had that happened here then there would only have been a specialty debt. But the court did not have to decide whether there had been a merger, as even if that had not happened, the debt was a specialty debt:

> The [mortgage] deed contains an express covenant to ... pay the promissory notes; between the same parties it was an existing security under seal, at the time of the testator's death, for the balance then due; it would continue to be a security for a much longer period, and would be attended with advantages not belonging to debt by simple contract. Although it never became necessary to act upon the [mortgage] deed by taking possession or seeking any remedy under it, it was and remained ... of full force and validity. *There is but one debt*, whether in Victoria or New South Wales; and their Lordships fail to see how it can be said that that debt has not become a debt by specialty.[176]

Since the deed was kept in Victoria, the debt was situate there. The Revenue did not argue that the situs of the land in NSW made any difference to the situs of the debt but the court can hardly have overlooked that fact.

Toronto General Trust Corporation v The King [1919] AC 679 supports the same approach. Here a mortgage debt was represented by two duplicate deeds, one in Ottawa and one in Alberta. In such a case one cannot apply the rule that the debt is situate where the deed is situate. The court cited *Hope* and distinguished it (there was only one deed in that case) but would otherwise have followed it. Had there been only one deed, the court would have held the debt to be situate where the deed was.

A comment of the Special Commissioner in *Hafton Properties v McHugh* also supports this view[177] and the same view has been reached in India.[178]

[175] Merger was important when there were different remedies for simple contract debts and specialties; but now the doctrine is (more or less) obsolete.

[176] [1891] AC 476 at p.484

[177] "... the debt was a mortgage debt. Such a debt is regarded for private international law purposes ... as a speciality debt, the situs of which is to be found where the

102.19.5 *Situs of land prevails*

The starting point on this side of the fence is the decision of the Privy Council in *Walsh v The Queen*.[179] Here there were a variety of debts owed by non-residents secured on property in Queensland. The documents were kept outside Queensland. Whether one applied the place of debtor rule or the specialty rule, the debts were not situate in Queensland. It was held that the debt should be regarded as being in Queensland up to the lower of the value of the debt and the value of the Queensland property.[180]

I have wondered if one could explain *Walsh* on the basis that it did not concern the common law situs rule. The case turned on an income tax statute (the [Queensland] Dividend Duty Act 1890) which could have operated a different situs rule. But the view that *Walsh* only concerned the Dividend Duty Act and was not a common law situs case is difficult to maintain after the probate duty case *Henty v The Queen*. Here a debt was secured on land in New South Wales. In a comment which was not a necessary part of the decision, and so is non-binding, the Privy Council said:

> according to the principles recognised by this Board in *Walsh v. Reg*. the security held by [the creditor] is as much an asset in New South Wales as the real estate there which it affects.[181]

If the court was applying the common law situs rule, the Privy Council in should have referred to *Commissioner of Stamps v Hope* (which the taxpayer cited in argument) or to other leading situs cases. Perhaps the PC thought that *Hope* was wrong and chose to ignore it since they could not overrule it. Or perhaps they thought that the debt was dual-situate.

102.19.6 *Mortgage debt dual-situate*

Payne v R [1902] AC 552 concerned a debt charged on land in Victoria. The debtor was resident in New South Wales. The Privy Council held (without citing authority) that the mortgage debt was an asset in New

mortgage deed is to be found;" 59 TC 420 at p.426.

[178] *Dharanidhar Roy v Sethi AIR* 1933 Cal 379 *http://www.indiankanoon.org/doc/959534*

[179] [1894] AC 144 also reported under the name *Walsh v Regina.*

[180] Where the debt was secured on property in Queensland and elsewhere, there was an apportionment.

[181] [1896] AC 567 at p.574.

South Wales *and* tentatively suggested it was situate in Victoria too:

> The debtor as well as the testator resided in Victoria and was domiciled there. The debt, though a specialty debt in New South Wales, was a simple contract debt in Victoria. That being so, it seems to their Lordships that ... the debt was an asset in Victoria and recoverable under a Victorian probate, although it may well be that in order to discharge the mortgage probate duty would also have to be paid in New South Wales, and the debt, if recovered in Victoria, might be retained in Court until the mortgagees were in a position to discharge the mortgage.[182]

The attraction of this solution is that all the cases adopting the situs of debt approach can be reconciled with those adopting the situs of land approach. But there is only one asset which cannot be dual situate.[183] The comment in *Payne* was not a necessary part of the decision, and should be dismissed as now overruled.

102.19.7 *Textbooks*

Dicey notes that in practice mortgages on land in England are usually specialties and continues:[184]

> [1] A mortgage of land confers an interest in land and will be held situate where the land is situate,[185]
>
> [2] but where it is necessary (e.g. for taxation purposes) to distinguish between the situs of the mortgagee's interest in land and that of the mortgagor's personal obligation to repay, then the latter (if in the form of a specialty) will be held situate where the deed is situate from time to time.[186] …
>
> [3] In the conflict of laws the distinction between the interest in land and the personal obligation is not normally made for the purposes of situs, and the asset is regarded as a unity which is situate in the country where the land lies.[187]

[182] [1902] AC 552 at p.560

[183] See 102.3 (Every asset has one situs) and 102.1.3 (Inconsistent case law).

[184] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 23-033.

[185] [Dicey's footnote] *Re Hoyles* [1911] 1 Ch 179.

[186] [Dicey's footnote] See *Walsh v The Queen* [1894] AC 144; *Payne v R* [1902] AC 552. Also *Henty v The Queen* [1896] AC 567.

[187] [Dicey's footnote] *Re Hoyles* [1911] 1 Ch 179; *Dicey*; cf Falconbridge, *Selected Essays on the Conflict of Laws* (2nd ed., 1954), pp.573–580 for an acute discussion of the problem raised in this paragraph.

Dicey's view at [1] and [3] is that the location of the land prevails. This overlooks the authorities cited above. The case cited, *Re Hoyles*, does not support Dicey. It shows that the succession law which applies to a mortgage debt is the law where the land is situate. However, it does not follow from this that the debt should be regarded as situate in that country. This is a case where succession law does not follow the situs of the asset. Situs as such is nowhere discussed in *Re Hoyles*. The suggestion at [2] is that tax law may distinguish between the mortgagee's interest in land and the mortgagees's right to payment. But tax law does not have different situs rules from the general law.

HMRC adopt the view that the location of the land prevails. IHTM provides:

> **IHTM27079 Bonds and debentures under seal** [May 2020]
> **Secured specialty debts**
> Where the debt is solely secured on land or other tangible property situated in the UK the situs of the debt will also be in the UK. HMRC considers the situs of the debt follows the genuine interest of the creditor in the secured property, not merely the personal obligation of the debtor to repay (which may be situated elsewhere, for example where the debtor is resident).
> Any claim that a debt secured on UK assets is not UK situs property must be sent to Technical.

102.19.8 *Conclusion*

There is a lot to be said for the view that a mortgage debt is situate where the debt is, and not where the land is, and this was the view formerly taken in this work. But it is tentatively suggested that the best solution is solution (4), the situs is the situs of the land, except so far as the value of the debt exceeds the value of the land. This does mean that the situs of an debt can be changed by charging it on land; but that is not absurd, because the charge alters the nature of the asset. It may not be inconsistent with the HMRC view, as the Manual passage above may not be considering the case where the debt exceeds the value of the land.

102.20 Claim for breach of trust

If a trust makes a distribution in breach of trust, or a company makes an unlawful distribution, the transferor acquires two remedies:

(1) A claim *in personam* against the recipient, for an amount equal to the sum distributed

(2) A claim *in rem* for the asset transferred, which the recipient holds on constructive trust for the transferor

The transferor holds a chose in action which is one asset, not two. It is suggested that the situs of this asset is:

(1) The situs of the asset transferred, or assets to which it may be traced, up to the value of those assets; and
(2) If and so far as the value of the claim exceeds the value of those assets, the situs is where the recipient is resident.

The argument is similar to the situs of a mortgage, but stronger, in that the transferor has the beneficial interest, not just a security interest, in the asset transferred.[188]

102.21 Debt under letter of credit

The IHT Manual provides:

> **IHTM27091: debts: contractual** [May 2020]
> A debt under a letter of credit has been held to be situated in the place where it is in fact payable against documents (*Power Curber International Ltd v National Bank of Kuwait* [1981] 3 All ER 607).

In *Power Curber International*, the debtor bank was resident in Kuwait but the debt was payable in Carolina. The majority of the CoA held the debt was situate in Carolina. The decision on this point was not necessary for the decision, not fully argued, and the dissenting view was the better one. But the issue will not often arise in an IHT context, as letters of credit are likely to be held by companies, so the situs of the debt will not often matter for tax purposes. If it did arise, the lower courts are likely to follow the majority view of the CoA, and even the Supreme Court should prefer to maintain the stability which results from following a decision which has been unchallenged for so long. So the law should be regarded as settled.

102.22 Judgment debt

A judgment debt is situate where the judgment is recorded.[189] Obtaining judgment may therefore have the effect of changing situs, for better or worse.

[188] See 102.19 (Mortgage debt); 103.21 (Bare trust or nomineeship).

[189] *AG v Bouwens* (1838) 4 M & W 171 on *http://www.commonlii.org*

102.23 Bank account

The IHT Manual provides:

> **IHTM27093 Debts: Bank accounts** [May 2020]
> A bank account is a debt, and under general law is situated at the branch of the bank where the account is kept: *R v Lovitt*[190] [1912] AC 212...

This is not a special rule for bank accounts: it is an application of the general rule for debts; in particular, in the case of a company carrying on business in two places, a simple debt is situate where payable.[191]

UK bank accounts may qualify for IHT relief.[192] Guidance on what constitutes a branch of a bank can be found in the discussion of branch and PE.[193]

102.24 Building society account

A standard form building society account is not a debt, it is an interest in the society, so corporation situs rules rather than debt rules should be applied.

The IHT Manual provides:

> **IHTM27151 [Bank or]**[194] **building society accounts in Channel Islands and Isle of Man** [May 2020]
> Any case where it is claimed that an account with a UK Building Society must be treated as situated in the Channel Islands or the Isle of Man, so it is exempt from IHT, must be referred to Technical.

102.25 Insurance policy

For the purpose of common law situs rules a policy is treated in the same way as a debt, so the place-of-debtor and specialty situs rules apply.[195] That makes sense if one bears in mind the insurance law background: under insurance law/property law, a policy is classified as a contingent

[190] In the Law Reports the name of this case is: *The King v Lovitt.*

[191] See 102.14.3 (Dual resident debtor).

[192] See 76.13 (Foreign currency account).

[193] See 106.2 (Meanings of permanent establishment); 106.27 (Meaning of "branch or agency").

[194] The reference to a "bank" in the heading seems to be erroneous since the text only relates to building societies.

[195] *New York Life Assurance v Public Trustee* [1924] 2 Ch 101.

debt,[196] even though in a CGT context one would not describe a policy as a "debt", as policies are taxed differently from normal debts.[197]

France/Italy IHT DTAs apply different rules.[198]

The IHT Manual provides:

> **IHTM27101 Foreign Property: Money From A Life Policy: General Rule** [May 2020]
>
> When a life policy is not made by way of deed the policy monies are situated where the debtor (the company) is resident. This is generally the head office of the company.
>
> You can find more information on policies at IHTM20000 onwards.
>
> **IHTM27102 Payment Made At Place Other Than Head Office** [May 2020]
>
> Where under the terms of the policy, payment is to be made at some place other than the residence of the head office the monies are deemed to be situated at the place of payment' (*New York Life Insurance Co v Public Trustee* [1924] 2 Ch 101).
>
> So, if the policy proceeds are to be paid in the UK the policy proceeds are UK sited and chargeable to Inheritance Tax.
>
> **HTM27103 Policy Issued At Branch Office** [May 2020]
>
> The proceeds of a policy are usually taxed where they are sited (IHTM27071).
>
> If a policy:
>
> - is issued by, or through, a branch office of a UK company that is outside the UK, and
> - no reference is made in the terms of the policy as to the place where the policy monies are to be paid,
>
> policy monies are to be treated as situated in the country of the branch office as long as the whole course of business in relation to the policy had been transacted in that country.
>
> The 'whole course of business' means that all the following events must happen in the country of the branch office:
>
> - The policy is issued to a resident in that country from the branch in that country.

[196] *Foskett v McKeown* [2001] 1 AC 102 at p.134: "The word "policy" is here used to describe the bundle of rights to which the policyholder is entitled in return for the premiums. These rights, which may be very complex, together constitute a chose in action, viz, the right to payment of a debt payable on a future event and contingent upon the continued payment of further premiums until the happening of the event."

[197] See 56.22.1 (CGT debt exemption).

[198] See 115.10 (Treaty-situs).

> - The holder of the policy remains resident and retains the policy there, pays the premiums to the branch there, and dies there.
> - The grant of representation to the policy holder's estate is taken out there and the proceeds are collected there.
>
> You should not assume that the policy was situated in the UK without considering all the circumstances surrounding the policy, even if, at the date of the life assured's death:
>
> - the policy is in the UK at the Assurance Company's head office, and
> - the life assured has assigned the policy to the assurance company as security for a loan.
>
> Each case must be considered on its own facts. If a small detail prevents the conditions from being fully met this may still mean that the policy is situated outside the UK. But any case where this applies, or where the locality of the policy has to be determined before the policy holder's death must be referred to Technical.
>
> Where a policy not made by way of deed has terms that provide for payment either at its head office or at a branch office, and the 'whole course of business', takes place in the country of the branch office, the monies are also treated as locally situated in that country.

Some of para 27103 is doubtful but the practice will normally favour the taxpayer so the issues will not often arise.

102.25.1 *Policy made by deed*

The IHT Manual provides:

> **IHTM27104 Policies Under Seal** [May 2020]
>
> Policies by way of deed or under seal are specialty debts (IHTM27079). Where the policy holder is non UK domiciled and there is no evidence to suggest the location of the policy documents has been artificially arranged, HMRC will treat such policies as situated where the deed is to be found. You should refer to Technical any case in which it is claimed that a policy under seal held by a person domiciled in the UK is not situated in the UK.

But if the policy is held by a UK domiciliary, the issue of situs will not often arise.

It is necessary to investigate whether policies are specialties. The IHT Manual gives a little guidance:

> Most Lloyds policies are embossed with a seal but they are not specialty debts unless they also bear the witnessed personal signature of the General Manager of Lloyds Policy Signing Office. Lloyds policies that

> do not bear this signature are chargeable to Inheritance Tax in the country where the debtor (the company) resides (IHTM27101).

On IHT treatment of UK situate policies see 70.23 (Policy held by non-dom: IHT).

102.26 Land

The IHT Manual provides:

> **IHTM27074 Land and interest in land** [May 2020]
> Immovable property is situated where it is actually located.

That seems self-evident; but if authority is needed, see *Haque v Haque (No 2)* (1965) 114 CLR 98 at p.136.

The Manual continues with a discussion of the meaning of "land":

> But, different legal systems may take opposing views as to whether some types of interest in land or relating to land are movable or immovable property.
> These differences are resolved (under Private International Law, and also by specific provision in Double Taxation Conventions where these apply)[199] by the adoption of the view taken by the law of the country in which the land itself is 'situated': *Johnstone v Baker* (1817) 4 Madd 474; *Macdonald v Macdonald* (1932) SLT (HL) 381.[200]
> Land is usually classed as immovable property, so is generally governed by the law of the country in which it is situated ...

102.27 Chattels

The rule is what one would expect. The IHT Manual provides:

> **IHTM27075 Chattels** [May 2020]
> ... (chattels) are situated where they happen to be at the relevant time.[201]

It is suggested that this applies even where:
(1) a chattel is moved out of the UK;
(2) the chattel is transferred to another person or trust;
(3) the chattel is returned to the UK.

The temporary removal of the asset at the time of the disposal cannot be

[199] See 24.7.1 ("Immovable property").

[200] Accessible *http://uniset.ca/other/cs5/1932SLT381.html*

[201] The text is found twice: IHTM21047 [May 2020] and IHTM27075 [May 2020]. For a concession on works of art see 76.14 (Works of art).

ignored, for tax purposes, even if the time spent out of the UK is short.

102.28 Ships and aircraft

The IHT Manual provides:

> **IHTM27073 Ships** [May 2020]
> A ship on the high seas is deemed to be situated at its port of registry but when it comes within territorial waters this artificial situs is displaced by the actual situs: *Trustees Executors & Agency Co Ltd v IRC* [1973] Ch 254.

Dornoch v Westminster International[202] raises the issue of the situs of a ship, but muddles what ought to be two distinct issues, namely, (1) situs and (2) what system of law governs the transfer of title to a ship.[203]

In *Air Foyle v Centre Capital*:

> Although there is a somewhat tentative and limited suggestion in Dicey that an aircraft "may at some times be deemed to be situate in its country of registration"[204], there are overwhelming reasons for treating an aircraft as situate in the State where it physically is for the time being, at least unless it is either over the high seas or over or on territory which is not under the sovereignty of any State.[205]

It is suggested that the ship rule is the most sensible solution for aircraft.

It is suggested that a satellite in orbit is situate where it is registered.

102.29 Goodwill

Goodwill is property, and the property is situate where the business to which it relates is carried on.[206] In *Star Industrial v Yap Kwee Kor*:[207]

> Goodwill, as the subject of proprietary rights, is incapable of subsisting by itself. It has no independent existence apart from the business to which it is attached. It is local in character and divisible; if the business is carried on in several countries a separate goodwill attaches to it in each.

[202] [2009] EWHC 889 (Admlty) at [90] - [103].

[203] This relates to the debate over the role of situs in private international law; see 102.1.1 (Situs in tax/private international law).

[204] The passage is still in the current ed: Dicey, Morris & Collins, *The Conflict of Laws* (16th ed, 2022), para 23E-060 (Exception 2).

[205] [2002] EWHC 2535 (Comm) at [40].

[206] *IRC v Muller & Co's Margarine Ltd* [1901] AC 217.

[207] [1976] FSR 256 at p.269.

102.30 Intellectual property

Intellectual property is likewise divisible, and is regarded as a separate asset situate in each jurisdiction where it can be enforced.[208] In *Peer International v Termidor Music Publishers*:[209]

> The essence of an intellectual property right is the owner’s right to take action to prevent others from engaging in certain types of activity in a given territory without the owner's permission. Although patents, trade marks and copyright are classified as moveables, they share some of the characteristics of immovables in the sense that the rights which they confer are territorially limited. It follows that a patent, a trade mark or copyright is situate in the country whose law governs its existence... although a wholly abstract concept, English copyright is inevitably located in England, or, as may be more appropriate in light of the provisions of the Copyright, Designs and Patents Act 1988, UK copyright is inevitably located in the UK.

The textbook *Copinger & Skone James on Copyright* explains:[210]

> ... there is no such thing as global or world-wide copyright... In respect of any particular work, separate copyrights or equivalent rights subsist in different territories throughout the world. Copyright is only situated here in so far as it is protected here by the Copyright, Designs and Patents Act 1988. The rights in works which are protected in other countries by other laws are situate in those countries and not in the UK.

A share in a patent granted in New South Wales, and a licence to use it in New South Wales, was (after some vacillation) held to be property situate in New South Wales.[211]

These issues will not often arise for IHT, because intellectual property is mostly held by companies or partnerships, not directly by individuals; and because of BPR.

102.31 Land subject to contract of sale

An interest in English land subject to a contract of sale is still situated in

[208] See 24.5 (Source of non-trade IP income); *Foster's Australia v CIT* 302 ITR 289 (AAR) 10 ITLR 939.

[209] [2002] EWHC 2675 (Ch) at [22] [23].

[210] 18th ed, (2020) para 2-26, 29-31 (non-domiciled individuals).

[211] *English Scottish & Australian Bank v IRC* [1932] AC 238 at p.249.

the UK. It is suggested that a contract of sale does not affect situs.[212]

102.32 Bare trust or nomineeship

The interest of a beneficial owner in property held by a nominee or bare trustee[213] is situate where the underlying asset is situate: a nomineeship or bare trust is transparent for situs. That is almost self-evident, but if authority is needed, see *Re Clore, IRC v Stype Investments* where a Jersey nominee held land in England:[214]

> Immediately after the conveyance of [the land] to [the Jersey nominee] and the execution of the declaration of trust which acknowledged that [the land] would "continue to remain in the beneficial ownership of Sir Charles," [the land] belonged in equity to Sir Charles in fee simple and his interest constituted property situate in England. [The Jersey nominee] was entitled to be paid any outgoings or charges in respect of the land, but this entitlement did not affect the nature, quality or situation of the interest of Sir Charles in the [land].

The position is different for unit trusts[215] and intermediated securities[216], which are not straightforward bare trusts, and best not described as bare trusts at all.[217]

102.33 Interest under substantive trust

The situs of an equitable interest under a substantive[218] trust is not often relevant for IHT, but it may matter, eg where a reversionary interest is not excluded property for IHT.

102.33.1 *Baker trusts*

An equitable interest under a *Baker* type trust (ie English law or a jurisdiction following English trust law principles)[219] has a twofold character:

[212] See *Re Clore, IRC v Stype Investments* [1982] STC 625; see too 82.19.2 (Contract to buy/sell asset).

[213] For present purposes the terms bare trustee/nominee are used synonymously.

[214] [1982] STC 625 at p.633-4.

[215] See 69.10 (Situs of unit).

[216] See 71.3 (Transparent intermediated security: Situs for IHT/IT).

[217] See 87.7.1 ("Bare trust" and related terms).

[218] By "substantive" I mean a trust other than a bare trust (nomineeship) or unit trust.

[219] For the trust law background, see 42.9 (Life tenant: Source of Income); 42.12 (Baker or Garland trust?).

(1) It provides rights enforceable against the trustee.
(2) It is an interest in the trust property.

There are many connecting factors which might be used to attribute a situs to an equitable interest, and the courts have not had to consider all possible permutations. *Favorke v Steinkopff*[220] concerned an English law will trust, with English trustees, but German situate property; the equitable interests of an annuitant, life tenant and remaindermen were held to be situate in England. It is suggested that an equitable interest is in principle situate where the trustees are resident. If the trustees are resident in different jurisdictions, situs would be determined by an exclusive jurisdiction clause if there is one, or failing that, by the proper law.[221]

This is consistent with the rule that the equitable interest is classified as moveable (not immovable) property. The High Court of Australia said:[222]

> The mere fact that there is land subject to the trust would not result in the beneficiary's interest in the fund being an immovable in the place where the land is situated. The interest in the fund is situated in the country which is the forum of administration of the trust or whose law is the proper law of the trust.

There is a sound basis to say that situs of the assets of the trust fund is not relevant to the situs of the equitable interest. If the trust assets are situate in different jurisdictions it would be impossible to ascertain the situs of the equitable interest (if the equitable interest is regarded as a single asset). An equitable interest such as a life or reversionary interest should not be regarded as several separate interests in as many assets as are held by the trustees. Such an equitable interest is generally regarded as one asset and not as many assets as there are items of trust property.

Where the equitable interest is a power of revocation the same applies, but situs does not matter for IHT because of settlement-power relief.[223]

Where the equitable interest is an annuity, it would often be impossible to locate the annuity by reference to the situs of the trust assets, because

[220] [1922] 1 Ch 174.

[221] For a contrary view see Harris, *The Hague Trusts Convention* (1st ed, 2002), Chapter 9 (Situs of equitable interests) and Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 23-046 (Interests under trusts).

[222] *Haque v Haque (No 2)* [1965] HCA 38; (1965) 114 CLR 98 at [2] citing *Ewing v Orr Ewing* (1883) 9 App Cas 34.

[223] See 74.10 (Settlement power).

one cannot identify any particular trust asset and say that asset is (to any fixed extent) the source of the annuity.

102.33.2 *Garland trusts*

An interest under a Scots law or other *Garland* type trust is not an interest in the trust property, so the situs of the trust property is irrelevant to situs.

102.34 Estate of deceased person

The IHT Manual provides:

> **IHTM27072 Unadminstered estates** [May 2020]
> In general, a person who takes an absolute interest in the residue of an estate is entitled, not to the assets **of the testator, but to a right of action**, enforceable against the executors. This is the case under English law and many other legal systems.[224]
> This means the executors must administer the estate and transfer the clear residue, or a share of it to the beneficiary. The same rule applies in the case of intestacy.
> This is a similar rule to the jus crediti to which a beneficiary is entitled in Scotland.

The chose in action is situate where it is enforced, ie where the executors are. The situs of the assets of the estate is not relevant. See *CSD v Livingston* [1965] AC 694. The IHT Manual continues:

> But, for IHT, the deceased is treated as having a direct interest (in the whole or a share) in the net assets of the residuary estate. See IHTM22031[225]
> For this reason you must consider the situs of each of the underlying assets separately.
> For example, the excluded property provisions in s.6(2) IHTA may apply to qualifying securities included in the unadministered estate (IHTM04260) and as a result they may not be chargeable to IHT.

102.35 Situs of partnership share

The situs of a partnership share may not matter for IHT, because:

- BPR may apply

[224] Author's footnote: Further consideration will be required for jurisdictions other than England and Wales, especially civil law jurisdictions.

[225] See s.91 IHTA.

- The value of a share in a partnership providing services may be nil, particularly at the time of the death of the partner

However the issue does arise for investment partnerships.

102.35.1 *Partnerships (except LLPs)*

A partnership share may be analysed as an asset (a chose in action) distinct from the assets of the partnership, or as co-ownership.[226] In the context of situs, the chose in action analysis applies, and so a partnership share has its own situs distinct from the situs of the partnership assets. That must be the appropriate analysis, given the impracticality of ascertaining all the assets of the partnership and their situs.

There are several factors that the court might have used to determine situs. In practice the situs of an interest in a partnership is the place where the partnership business is carried on.[227] I refer to that as the "**place-of-business situs test**".

On identifying the place where the partnership business is carried on, see 85.19.4 (Where is control/management).

What if a partnership carries on one business in two places? Dicey says: "Where the business is carried on in more than one country then it is submitted that the share is situate in the country where the headquarters of the business is to be found."[228] HMRC agree. The Partnership Manual provides:

> **PM274500 IHT: Situs of partnership interest** [Jul 2019]
> ... In relation to a partnership interest, situs will be in the jurisdiction in which the overall management and control of the business is exercised.

What if a partnership is carrying on *two* businesses in different places? This arose in *Beaver v Master in Equity*[229] where the partnership had three businesses, in London, Melborne and Adelaide. The solution adopted was

[226] See 85.3 (Nature of partnership share).

[227] See *Laidlay v Lord Advocate* (1890) 15 App Cas 468, a Scots case concerning an English partnership (see p.480). This was followed in *Commissioner of Stamp Duty v Salting* [1907] AC 449, an Australian case concerning an English or New South Wales partnership (the court did not ask which, no doubt it would make no difference).

[228] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 23-047 (Shares in a partnership business).

[229] [1895] AC 251.

that the partnership businesses were situate in different places; the Melborne business was therefore situate in the state of Victoria. The distinction between one single business and two (or more) separate businesses could be somewhat fragile. The issue will not often arise, except, possibly, in some tax planning contexts.

102.35.2 *Partnership holding land*

This section considers the position where partnership assets consist of or include land.

Dicey states (tentatively) that "A share in land belonging to the partnership may however be situate where the land is situated."[230] But there is only one case which takes that view. It is wrong in principle as a partnership share is one asset. "An interest in a partnership is not to be fragmented into as many different interests as the partnership has assets with the consequence that each fragment should be treated as located where the asset with which it is concerned might happen to be".[231] It is also out of line with the authorities. The law is correctly stated in *Livingston v Commissioner of Stamp Duties*:[232]

> the local situation of the interest in the partnership as a whole being considered in law to be where the business is carried on, so also is the partner's interest in a partnership asset:[233] it occurred to no one to distinguish for the purposes of locality between the interest in the partnership and the interest in the assets; and indeed in *Beaver v Master in Equity* the emphasis given by the Privy Council to the fact that the business of the partnership in Melbourne was a distinct business from others which the partnership carried on in London and Adelaide indicates that the partner's interest in the Melbourne assets would not have been treated as situate there if there had been only a single business and that had been carried on in London. There is a case in the Supreme Court of Canada in which the contrary view was taken by a majority of

[230] Dicey, Morris & Collins, *Conflict of Laws* (16th ed., 2022), para 23-047 (Shares in a partnership business). Dicey cites: *Boyd v AG for British Columbia* (1916) 54 SCR 532; *Haque v Haque (No. 2)* (1965) 114 CLR 98 but the majority in *Haque* do not support Dicey's view.

[231] *Haque v Haque (No 2)* [1965] HCA 38; (1965) 114 CLR 98 at [2].

[232] High Court of Australia, 107 CLR 411, at [14].

[233] The Court referred to: *In the Goods of Ewing* (1881) 6 PD 19, at p.23, *Laidlay v Lord Advocate* (1890) 15 App Cas 468, *Beaver v Master in Equity* [1895] AC 251 and *Stamp Duties Commissioner v Salting* [1907] AC 449.

> the Court, but, with respect, I would prefer the dissenting judgment of Anglin J: *Boyd v AG for British Columbia*[234].

This is consistent with the rule that even if partnership assets include land, a partnership share is classified as:
(1) moveable (not immovable) property[235] and
(2) personal (not real) property.[236]

The position is perhaps even clearer for a Scots partnership, under which the partners have no direct proprietary interest in the partnership assets.

HMRC agree.[237] The rule may work in favour of HMRC, in that a UK situate partnership with foreign land is a UK situate asset.

If the partnership business is letting land in the UK, it will be a business carried on in the UK and so the partnership interest is UK situate. If that is right, partnerships (unlike companies) cannot easily be used to transfer situs of property outside the UK.

It follows that the existence of a partnership may be important for situs, as the interest of a co-owner of land (in the absence of partnership) is situate where the land is situate. If what purports to be a partnership merely allows a partner to occupy the land, there is no business and so the arrangement does not constitute a valid partnership (which requires a business).[238]

[234] (1917) 36 DLR 266.

[235] *Re Stokes* (1890) 38 WR 535, 62 LT 176, 6 TLR 154; *Haque v Haque (No 2)* [1965] HCA 38; (1965) 114 CLR 98 Menzies J at [2] sets out the majority view.

[236] Until 1996 it was clear that a partnership interest was personal (not real) property, as there was a common law rule to that effect. The rule applied for fiscal purposes: *Forbes v Steven* (1870) LR 10 Eq 178. The rule was codified in s.22 Partnership Act 1890. TOLATA 1996 misguidedly repealed s.22 in England, leaving English law confused but probably unaltered. (Section 22 continues to apply in Scotland). But whatever the effect (if any) of the repeal of s.22, it does not affect situs.

[237] HMRC, "Technical Briefing on Non Dom/IHT Residential property changes" (2015) provides: "The government intends to amend the rules on excluded property so that trusts or individuals owning UK residential property through an offshore company, *partnership* or other opaque vehicle, will pay IHT on the value of such UK property..."
https://www.gov.uk/government/publications/technical-briefing-on-foreign-domiciled-personsinheritance-tax-residential-property-changes/technical-briefing-on-foreign-domiciled-personsinheritance-tax-residential-property-changes
This amendment was subsequently made; see 82.4 (Residence-partnership).

[238] See 85.12.2 (Partnership holding land).

102.35.3 *Situs of LLP*

An LLP is a body corporate. The situs of a member's interest in an LLP for the purposes of private international law will be determined by the rules applying to companies.

For IHT, however, s.267A IHTA provides:

> property to which a limited liability partnership is entitled, or which it occupies or uses, shall be treated as property to which its members are entitled, or which they occupy or use, as partners...[239]

A foreign LLP is not an LLP for this purpose[240] and references to an LLP in the discussion here are to a UK LLP.

Section 267A deems the LLP's property to be property to which its members are entitled *as partners*. It does not deem the members to be directly entitled to the assets: it puts an LLP in the same position as a general partnership. CIOT correctly say:

> The general intention of s.267A IHTA 1984 would appear to be to treat LLPs as though they were general partnerships for IHT purposes, and the wording of the section would seem to be sufficiently clear to achieve this.[241]

It follows that (for IHT) the place-of-business situs test determines the situs of an interest in an LLP, as for a general partnership. The same applies for IT.[242]

The place-of-business situs test does not work if the partners are not carrying on a business. In the case of a general partnership, this situation cannot arise. A partnership only exists while partners are carrying on a business. If they are not doing that, there is no partnership:[243] the arrangement is classified as joint ownership. An LLP which is not

[239] See 85.22.6 (LLPs: IHT).

[240] See 85.21.1 (Definition and nature of LLP); 90.37 (Foreign LLP).
HMRC agree: see ICAEW Tax Faculty, CIOT and STEP, "IHT Business Property Relief – Interests in Partnerships/LLPs and Surplus Cash Holdings" (2014) para 15: "We confirm that s.267A IHTA 1984 relates solely to UK LLPs."
https://www.icaew.com/restrictedmedia?mediaItemId=4aed2a6e-ed18-40ae-be24-83d1d761d297
ICAEW ref: TECH 01/14 TAX

[241] See 85.21.1 (Definition of LLP).

[242] See 85.22.2 (Income tax treatment of LLP).

[243] See 85.5.1 ("Business") .

carrying on a business is still an LLP. It is considered that for IHT purposes the members are then treated as joint owners.

The IHT Manual provides:

> **IHTM25094 Limited liability partnerships** [May 2020]
> ... [1] The effect of [s.267A] is that we look through LLPs so that they will be treated in the same way as traditional partnerships. The result of this is that:
>
> - Where a traditional partnership incorporates itself as a LLP, a partner's period of ownership for the purposes of qualifying for business (or agricultural) relief will not be regarded as being interrupted.
> - The normal reliefs and exemptions available to partners in a traditional partnership will also be available to members of a LLP...
>
> [2] A further change is that an interest in a LLP is deemed to be an interest in each and every asset of the partnership, while an interest in a traditional partnership is a 'chose in action', valued by reference to the net underlying assets of the business.
> [3] This may require you to consider issues of situs of assets. In cases of doubt refer to Technical for advice.

Paragraph [2] is terse. It floats the suggestion that an LLP is treated as co-ownership (rather than partnership) for IHT purposes, specifically for valuation, and (logically) for other purposes. But that is wrong and in practice HMRC do not apply that approach in relation, for instance, to BPR (which is considered later in the same paragraph of the Manual). I would be surprised if HMRC seriously argue that the test for situs of an interest in an LLP is different from the test for situs of an interest in a general partnership; I do not think that para [3] should be read as expressing a view on that question, beyond the instruction to refer difficulties on to TG.

102.36 Situs of pension and death benefits

Death in service benefits payable in respect of service under the Crown, local authorities or overseas governments are generally payable at discretion and so not liable to IHT. However the situs does matter in the exceptional case where the benefit is an asset in the estate of the deceased.

Section 153 IHTA provides:

> (2) For the purposes of this Act—
> (a) a pension paid under the authority of a scheme made under section 2 of the Overseas Pensions Act 1973 which

[i] is constituted by the Pensions (India, Pakistan and Burma) Act 1955 or

[ii] is certified by the Secretary of State for the purposes of this section to correspond to the said Act of 1955

shall be treated as if it had been paid by the Government of India or the Government of Pakistan (according as the arrangements in pursuance of which the pension was first paid under the said Act of 1955 were made with the one or the other Government);

(b) a pension paid out of any fund established in the UK by the Government of any country which, at the time when the fund was established, was, or formed part of, a colony, protectorate, protected state or UK trust territory shall, if the fund was established for the sole purpose of providing pensions, whether contributory or not, payable in respect of service under the Government be treated as if it had been paid by the Government by which the fund was established;

(c) a pension paid out of the Central African Pension Fund established by section 24 of the Federation of Rhodesia and Nyasaland (Dissolution) Order in Council 1963 shall be treated as if it had been paid by the Government of a territory outside the UK; and

(d) so much of any pension paid to or in respect of any person under—

(i) the scheme which by virtue of subsection (3) of section 2 of the Overseas Pensions Act 1973 is constituted under that section by section 2 or subsection (2) of section 4 of the Overseas Service Act 1958 or

(ii) such other scheme made under section 2 of the Overseas Pensions Act 1973 as is certified by the Secretary of State for the purposes of the Taxes Act to correspond to section 2 or subsection (2) of section 4 of the Overseas Service Act 1958

as is certified by the Secretary of State to be attributable to service under the Government of an overseas territory shall be treated as if it had been paid by the Government of that territory.

(3) ... for the purposes of subsection (2) above—

(a) "pension" includes a gratuity and any sum payable on or in respect of death, and a return of contributions with or without interest thereon or any other addition thereto;

(b) "UK trust territory" means a territory administered by the Government of the UK under the trusteeship system of the United Nations;

(c) "overseas territory" means any country or territory outside the UK;

(d) references to the Government of any such country or territory as is mentioned in paragraph (b) or (d) of that subsection include a Government constituted for two or more such countries or territories and any authority established for the purpose of providing or administering services which are common to, or relate to matters of common interest to, two or more such countries or territories.

(4) If, by reason of Her Majesty's Government in the UK having assumed responsibility for a pension, allowance or gratuity within the meaning of section 1 of the Overseas Pensions Act 1973 payments in respect of it are made under

> that section, this section shall apply in relation to the pension, allowance or gratuity, exclusive of so much (if any) of it as is paid by virtue of the application to it of any provisions of the Pensions (Increase) Act 1971 or any enactment repealed by that Act, as if it continued to be paid by the Government or other body or fund which had responsibility for it before that responsibility was assumed by Her Majesty's Government in the UK.

The important effect of this is that the pension (defined to include a death benefit) is not UK situate if it is treated as payable by a foreign government. The IHT Manual provides:

> **IHTM17058 Pensions: IHT charges: Crown, local authorities and overseas governments** [May 2020]
> Death in service benefits payable in respect of service under the Crown, local authorities or overseas governments are generally (but not always) payable at the discretion of the pension provider (IHTM17051), so they are not liable to Inheritance Tax.
> The following guidance is only general and will not cover every situation. Scheme rules may change and you should check the latest position or ask for advice from Technical. ...
> **Overseas Service**
> Sums payable on death to personal representatives by way of return of subscriptions under the regulations of:
> - the Indian Military Widows and Orphans Fund;
> - the Superior Services (India) Family Pension Fund
> - the Indian Military Service Family Pensions Fund; and
> - the Indian Civil Service family pension fund
>
> Are not included as part of the estate (IHTA84/S153 (1)).
> A lump sum payable on death to personal representatives under a scheme constituted under the Pensions (India, Pakistan and Burma) Act 1955 or a corresponding scheme (a foreign asset by virtue of S153 (2)(a) is part of the estate if the deceased died domiciled (IHTM13000) in the UK. It is excluded property under IHTA84/S6 (1) if the deceased was domiciled outside the UK.
> Benefits payable to personal representatives as of right on death of a Colonial Government servant (a foreign asset under S153 (2)(b) are part of the estate if the deceased died domiciled in the UK). They are excluded property under IHTA84/S6 (1) if the deceased was domiciled outside the UK.
> Benefits payable under s.1 Overseas Pensions Act 1973 other than 'statutory increases' thereof (a foreign asset by virtue of S153 (4) and S153 (2)(b)) are part of the estate if the deceased died domiciled in the UK. They are excluded property under IHTA84/S6 (1) if the deceased was domiciled outside the UK.
> Benefits payable out of the Central African Pension Fund (a foreign asset by virtue of S153 (2)(c)) are part of the estate if the deceased died domiciled in the UK. They are excluded property under IHTA84/S6 (1) if the deceased was domiciled outside the UK.
> Lump sum payable on death to personal representatives as of right under a scheme constituted under the Overseas Service Act 1958, or a corresponding

scheme (a foreign asset by virtue of S153 (2)(d)) are part of the estate if the deceased died domiciled in the UK. They are excluded property under IHTA84/S6 (1) if the deceased was domiciled outside the UK.

102.37 Reform of IHT/CGT situs rules

Amendment of situs rules for IHT purposes is difficult because of the problem of double inheritance taxation. To the extent that different states adopt the same common law situs rules, they effectively prevent double taxation which otherwise arises if state A regards an asset as situate in state A for IHT purposes and state B regards the same asset as situate in state B. That explains why in 1974 CTT (now IHT) adopted the common law situs rules and not the CGT statutory situs rules. The disparities between CGT and IHT situs are not accidental.[244]

The reform to improve the position would be to treat all assets as non-UK situate for the purposes of IHT (and also CGT) except for:
(1) UK land
(2) Securities (either all securities or just unquoted securities).

That would be a simplification and it is most unlikely that the IHT (or CGT) charge on such assets of foreign domiciliaries brings in any significant tax. There is a precedent in the abolition of stamp duty on UK situate property (other than securities and land).

[244] It could of course arise that state A regards an asset as situate in state A for CGT purposes and state B regards the same asset as situate in state B; however that is not likely to cause problems in practice, because (in short): (1) a non-resident does not usually pay CGT so double capital gains taxation does not usually arise; (2) a DTA following OECD Model convention will normally resolve the problem if it does arise.

CHAPTER ONE HUNDRED AND THREE

SITUS OF ASSETS FOR CGT

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Cross references

The following topics are considered elsewhere:

Topic	**See**
Situs of unit for CGT	69.10.2
Intermediated securities	71.1
Partnership transparency: CGT	85.20
Crypto asset situs	96.6
International organisation security	102.13

103.1 Asset situs for CGT: Introduction

This chapter deals with situs of assets for CGT. Strictly one should not refer to situs in the abstract, but to situs for a specific purpose (CGT, IHT, or whatever).[1] But the context may supply the reference, and in this chapter references to situs means situs for CGT purposes.

103.2 "Shares" and "debentures"

The CGT situs rules make specific provision for shares and debentures, so it is necessary to consider the meaning of these terms.

The meaning of debenture is particularly important, because there is an significant distinction for CGT situs between:

(1) Debts which are not debentures, whose situs is generally the residence of the creditor.[2]

(2) Debts which are debentures, whose situs is:
   (a) UK, if issued by UK incorporated company, or
   (b) if registered and issued by a non-UK incorporated company, the place of the register.

There are two statutory provisions which relate to the definitions but they are of limited scope. It is convenient to mention them first to clear them out of the way.

103.2.1 *No share capital*

Section 275(2)(a) TCGA provides:

> In subsection (1) above—
> (a) in paras (d), (da) and (e), the references to shares or debentures, in relation to a company that has no share capital, include any interests in the company possessed by members of the company ...

In UK company law, the only significant type of company with no share capital is a company limited by guarantee. There are also foreign entities which are classified as companies for tax purposes which have no share capital, but I cannot think of any to which s.275(2)(a) is likely to be significant.

So far as it concerns *shares* the rule makes sense. In particular, the

[1] See 102.1 (Concepts of situs).

[2] See 103.9 (Debt situs rule).

effect is that "shares" includes the interest of members of a guarantee company. In practice the situs of interests in guarantee companies will rarely if ever arise. A provision of this kind is quite common in tax.[3] The rule was enacted in other areas to prevent avoidance and perhaps the drafter put it in here without much thought as to whether it was actually needed.

The reference to *debentures* is otiose. A debenture is a right against the company, not an interest in the company. Whether a company has share capital is (in the absence of the definition) important in deciding whether an asset is a "share" but it is irrelevant in deciding whether an asset is a "debenture". In practice it does no harm.

103.2.2 *Securities of non-company*

Section 275(2)(b) TCGA provides:

> in paras (d) and (e), the references to debentures, in relation to a person other than a company, include securities.

This assumes that (in the absence of this definition) securities issued by a non-company would not be, or may not be, debentures. I think that is doubtful. The term "debenture" is normally used in the context of companies, but the concept is not restricted to companies.[4]

Section 275(1)(d) refers to debentures issued by a government authority.[5] Treasury gilts, though "securities", are not normally called "debentures" so perhaps the provision is useful to avoid doubt.

Similarly, other non-companies, such as trusts or individuals, can in theory issue "securities" and if such assets might not be regarded as "debentures" then this provision could be needed.

Even if unnecessary, this provision does no harm.

103.2.3 *Security/debenture distinction*

Before 2005 the legislation referred to "securities" where it now has the

[3] There are too many to list; see for instance s.135(4)(5) TCGA.

[4] See Gower and Davies, *Principles of Modern Company Law* (7th ed., 2003), p.806:

> "The word "debenture" is not restricted to securities of companies or bodies corporate. Clubs not infrequently issue debentures and the name may even be applied to bonds issued by an individual; eg to those issued by the Tichborne Claimant..."

This passage is not in the current edition but the point is sound.

[5] See 103.4 (Municipal/government security).

word “debentures.” HMRC explained the reason for the change:

> The scope of the existing rules in s 275 which apply in relation to securities will be extended so that they apply in relation to debentures - this means, for example, that ... all registered debentures (rather than just those which are securities) of a company which is not incorporated in the UK will be treated as being situated where they are registered ...[6]

HMRC were concerned that there might be a debenture which was not a security. One might have thought that a debenture must necessarily be a security.[7] Perhaps the point is that a “security” must be marketable and transferable; a debt which is not assignable, or which is repayable on demand, might not have been a security[8] for the purpose of the pre-2005 situs rules.[9]

The reform raises the question of whether a corporate debt could be a security but not a debenture; if there were such an asset the effect of the 2005 reform was to take it outside the scope of the statutory situs rules applicable to debentures, which was not intended! The better view is that any registered debt security is a debenture so this problem does not arise.

103.2.4 *“Debenture”*

In the absence of special context, the word “debenture” should be given its normal meaning. It is wide and vague:

> If we begin by asking what the word “debenture” means, apart from any definition, the reply must be that it has no precise meaning. Chitty J. observed[10] that the word “means a document which either creates a debt or acknowledges it, and any document which fulfills either of these conditions is a debenture.” ... Sir Nathaniel Lindley had previously stated simply, “What the correct meaning of ‘debenture’ is I do not know”.[11] In *Lemon v Austin Friars Investment Trust*[12], the same ignorance was professed in the Court of Appeal. Warrington LJ in

[6] BN 36, 16 March 2005.

[7] Contrast s.738 CA 2006: “In the Companies Acts “debenture” includes debenture stock, bonds and any other securities of a company...”

[8] See App.2.15.2 (Marketability).

[9] The concern that a debenture may not be a “security” (within the s.132 definition) is also found in s.251(6) TCGA: “... a debenture ... shall be deemed to be a security (as defined in section 132) ...”

[10] *Levy v Abercorris Slate and Slab Co* (1887) 37 Ch D 260.

[11] *British India Steam Navigation Co v IRC* (1881) 7 QBD 165.

[12] [1926] 1 Ch 1.

> particular, after observing that it had been said "by a wiser man than himself" that it was impossible to give an exhaustive definition of the word "debenture," went on to remark that he did not propose to incur the reproach of venturing where wise men fear to tread. The textbooks are agreed at least in this that no accurate definition of the word can be found.[13]

Company law draws a distinction between an ordinary debenture and debenture stock:

> Debenture stock is merely borrowed capital consolidated into one mass for the sake of convenience. Instead of each lender having a separate bond or mortgage, he has a certificate entitling him to a certain sum, being a portion of one large loan; and generally debenture stock differs from a debenture in form rather than in substance.[14]

No-one doubts that debenture stock is within the general meaning of "debentures".

In this chapter, I use the word "**securities**" to mean either shares or debentures.

103.3 Co-owned assets

Section 275C(1) TCGA provides:

> This section applies for determining for the purposes of this Act—
> (a) the situation of an interest (see subsection (4)) in an asset, or
> (b) whether the situation of an interest in an asset is in the UK.[15]

"Interest" is normally a wide term, but s.275C(4) defines it narrowly:

> In this section "interest", in relation to an asset, means an interest as a co-owner of the asset (whether the asset is owned jointly or in common and whether or not the interests of the co-owners are equal).

I refer to this as a "**co-ownership interest**". Section 275C applies to co-owned assets of all kinds but the most important cases are intermediated securities, and other co-owned securities, debts and cryptoassets.

Section 275C goes on to lay down the rules which govern situs of co-ownership interests:

[13] *Knightsbridge Estates Trust v Byrne* [1940] 1 AC 613 at p.621, approved *Fons HF v Corporal* [2015] 1 BCLC 320.

[14] *Re Herring* [1908] 2 Ch 493 at p.497.

[15] Paragraph (b) is otiose since the matter is fully covered by (a); but it does not matter.

> (2) The situation of the interest in the asset shall be taken to be the same as the situation of the asset, as determined in accordance with subsection (3) below.
> (3) The situation of the asset for the purposes of subsection (2) above shall be determined on the assumption that the asset is wholly-owned by the person holding the interest in the asset.

I refer to these as "**co-ownership situs rules**".

At first sight it is hard to see the point of these rules. If an asset is situate in a jurisdiction, a co-ownership interest would normally be situate in the same place and a statutory provision to that effect seems unnecessary. But s.275C does have a role to play, because:

(1) In the case of intermediated securities, the common-law situs of the co-ownership of the holders *is* different from the situs of the underlying securities.[16]

(2) Section 275 stipulates the situs of shares, debentures, debts, etc and it might be argued that a person who owns a co-ownership interest in a share, debenture, debt, etc does not own a share, debenture, debt, etc; so it might be argued that these statutory situs rules do not apply to co-ownership interests.[17]

Section 275C is also important where situs depends on the residence of the owner and the asset is co-owned. For instance, if a debt or a ship or a cryptoasset is jointly owned by two persons, one UK resident and one non-resident, the interest of the UK resident is regarded as UK situate and the interest of the non-resident is regarded as non-UK situate.

The CG Manual provides:

> **CG12470 interests of co-owners** [Nov 2023]
> ...Assets held by a partnership, in which the partners therefore each have an interest, are within the scope of this provision.

103.4 Municipal/government security

Section 275(1)(d) TCGA provides:

> shares or debentures[18] issued by any municipal or governmental

[16] See 71.4 (Proprietary intermediated security: Situs for CGT).

[17] Of course the context may show that a reference to a share includes a fractional share; for a discussion from another context, see Tax Policy Associates, "Fractional shares and ISAs – HMRC are probably wrong" *https://www.taxpolicy.org.uk/*

[18] For the meaning of "debentures" see 103.2.2 (Securities of non-company).

> authority, or by any body created by such an authority, are situated in the country of that authority.

The CG Manual provides:

> **CG12440 Location of assets: Shares and securities** [Nov 2023]
> [The Manual sets out s.275(1)(c) and continues:] This applies to shares and securities issued by such bodies whether they are in registered form or in bearer form. ...

103.5 Securities of UK company

Section 275(1)(da) TCGA provides:

> Subject to para (d) above, shares in or debentures of a company incorporated in any part of the UK are situated in the UK.

This rule prevents planning under which remittance basis taxpayers used to turn UK situate assets (securities in UK incorporated companies) into non-UK situate assets, by converting them to bearer securities or by foreign share registers.[19] There is still scope for planning if action is taken at the time the company is set up (rather than at the time of disposal). See too 58.7 (Redomiciled (ex- UK) securities)[20]

103.6 Registered security: Non-UK co

Section 275(1)(e) TCGA provides:

> subject to paras (d) and (da) above, registered shares or debentures are situated where they are registered and, if registered in more than one register, where the principal register is situated.

This applies to shares/debentures of foreign incorporated companies but not UK incorporated companies. It (more or less) restates the common law rule.[21]

The CG Manual provides:

> **CG12440 Types of asset (2): Shares and securities etc** [Nov 2023]
> *Shares and securities*
> ...Registered shares and securities[22] other than those dealt with in the

[19] The spur to the 2005 reform was probably *Chandrasekaran v Deloitte & Touche* [2004] EWHC 1378 which discussed and raised awareness of this planning.

[20] See 103.24.4 (UK resident, non-UK situs).

[21] See 102.5 (Situs of registered shares).

[22] Following the 2005 reforms, the reference to securities should strictly read “debentures” as that is now the statutory term. But it makes no difference.

> previous two paragraphs are situated where they are registered. This will normally be in the country where the company was incorporated. If they are registered on more than one register then they are located where the principal register is located, Section 275(1)(e) TCGA 1992. Which register is the principal register is a question of fact.

103.7 Bearer shares

Bearer shares of non-UK incorporated companies are governed by the common law rule.[23] They are situate where the document is situate.

103.8 Bearer debenture: Non-UK co

What is the position for bearer debentures? Unless one of the statutory situs rules applies, the common law rule will apply and the debenture will be situate where the document is situate.

Debentures are normally registered or bearer. If not registered or bearer, they are at least negotiable and treated in the same way as bearer debentures. If neither bearer nor negotiable, the debt is not likely to be a debenture.

Two statutory rules need consideration: the debt situs rule and the UK-law rule.

103.8.1 *Does debt situs rule apply*

Section 275(1)(c) TCGA (the debt situs rule) provides:

> subject to the following provisions of this subsection, a debt, secured or unsecured, is situated in the UK if and only if the creditor is resident in the UK.[24]

Debenture stock is not a debt[25] so the debt situs rule does not apply to debenture stock.[26]

[23] See 102.9 (Bearer and negotiable instruments).

[24] See 103.9 (Debt situs rule).

[25] For the meaning of "debenture stock" see 103.2.4 ("Debenture"). A person who holds debenture stock is not a creditor: *Re Dunderland Iron Ore* [1909] 1 Ch 446. So the asset is not a "debt".

[26] Against this, it might be argued that the co-ownership situs rule applies so the situs of the debenture stock is the situs of the underlying debenture. But it is considered that (1) the co-ownership situs rule does not apply in this case and (2) even if it does, the situs of the underlying debenture is not governed by the debt situs rule as the underlying debenture is not a debt for the purposes of that rule.

An ordinary debenture (not debenture stock) is a debt in the normal sense of the word. At first sight it seems that the debt situs rule applies, so a bearer debenture is situate where the creditor is resident. If that were right the situs of the document of a bearer debenture would never determine situs. However it is considered that the context of s.275, the reference to a debt in the debt situs rule means a simple debt and not a debenture. The debt situs rule does not apply to any debentures.

HMRC agree. The CG Manual provides:

> **CG12440 Types of asset (2): Shares and securities etc** [Nov 2023]
> *Shares and securities*
> ... The location of bearer securities issued by any body other than
> - a municipal or governmental authority or
> - any body created by such an authority, or
> - a company incorporated in the UK
>
> is not covered by a specific capital gains rule. Therefore it has to be decided in accordance with general law, see CG12420-CG12421. General law provides that such securities are located where the certificate is located. As for chattels, the location can change if the certificate is moved in or out of the UK.

103.8.2 *Does UK-law rule apply*

A debenture is an intangible asset and if it is "subject to UK law" (as widely defined) then in principle it appears that the UK-law rule applies, and the debenture will be UK situate.[27]

The CG Manual does not refer to the UK-law rule. One might argue that the reference to an intangible asset in s.275A means intangible assets other than debentures, in which case a debenture of a foreign incorporated company is not UK situate even if it is subject to UK law. This appears to be the HMRC view since the Manual passage above says that the location of bearer securities "is not covered by a specific capital gains rule".

103.8.3 *Planning*

Remittance basis taxpayers will generally avoid investing in debentures which are UK situate for CGT purposes. Non-UK incorporated companies who issue debentures and want their investors to include remittance basis taxpayers will in principle wish to ensure that their

[27] See 103.13.4 (UK-law rule).

debentures should not be UK situate for CGT purposes.

To achieve this:

(1) The debenture could be registered and the register kept outside the UK; in that case the position is clear.

(2) The debenture could be a bearer instrument and
   (a) kept outside the UK and
   (b) not "subject to UK law" (as defined) though that may not be necessary.

103.8.4 *Security situs: Critique*

The combination of statutory and common law rules for securities of non-UK incorporated companies is intricate and sometimes impractical. It has never been thought through. It is suggested that *all* corporate securities should be situate in the place of incorporation of the company. That would be logical, and a simplification, with no loss of tax.

103.9 Debt situs rule

A debt is in some cases a chargeable asset for CGT, so its situs may be relevant for CGT. Section 275(1)(c) TCGA provides:

> subject to the following provisions of this subsection, a debt, secured or unsecured, is situated in the UK if and only if the creditor is resident in the UK.

I refer to this as "**the debt situs rule**". This is different from the common law rule because:

(1) Under the common law rule, a simple debt is situate where the *debtor* is resident.

(2) Under the common law rule, the test of residence is jurisdiction-residence; under the CGT rule, the test of residence is tax-residence (as residence in a tax statute means tax-residence). Thus a debt is UK situate under the CGT rule if the creditor is dual-resident.

It is suggested that "debt" has the same meaning as in the CGT debt exemption.[28]

This provision overrides the UK-law rule and common law rules such as the specialty rule and the bearer security rule. However, it is subject to the rules relating to:

[28] See 56.22 (CGT treatment of debts).

Topic	**See para**
Debentures	98.5; 98.6; 98.8
Judgment debts	98.10
Bank accounts	98.12

103.10 Judgment debt

Section 275(1)(k) TCGA provides:

> a judgment debt is situated where the judgment is recorded.

The CG Manual explains:

> **CG12430 Land, tangible property and debts** [Nov 2023]
> Judgment debts, that is, debts created by the judgments, decrees, etc, of courts of record, are located where the judgment is recorded, Section 275(1)(k) TCGA 1992.

Obtaining judgment may have the effect of changing situs.

103.11 Debt rules: Critique

The effect of the debt situs rule is generally[29] to disapply the CGT remittance basis for debts, because a debt owned by a remittance basis taxpayer is deemed UK situate so the gain from the debt is taxed on an arising basis. That is anomalous, counter-intuitive and a trap for the ill advised foreign domiciliary. I can see no good reason for the rule and it is suggested that s.275(1)(c) should be replaced by a statutory rule that a debt is situate where the debtor is resident (applying the UK tax definition of residence). This would bring CGT and IHT into line.

It is considered that there is no point in a separate rule for judgment debts, and s.275(1)(k) should be repealed. That would be a small but worthwhile simplification. The statutory rule is based on the common law rule, but that is no reason to retain it.

But the best solution is to look at the wider picture altogether: treat all assets other than UK land and securities as non-UK situate for the purposes of IHT and CGT.[30] The debt situs rule and judgement debt rule would fall by the wayside.

103.12 Bank account

A foreign currency bank account is not normally a chargeable asset for

[29] An exception is if the individual disposes of the debt while temporarily non-resident.
[30] See 102.37 (Reform of IHT/CGT situs rules).

CGT[31] so the question of situs does not normally arise.

If it mattered, s.275(1)(l) TCGA provides:

> a debt which—
> (i) is owed by a bank, and
> (ii) is not in sterling, and
> (iii) is represented by a sum standing to the credit of an account in the bank of an individual who is not domiciled[32] in the UK,
>
> is situated in the UK if and only if
> [a] that individual is resident in the UK and
> [b] the branch or other place of business of the bank at which the account is maintained is itself situated in the UK.

In short, for UK resident foreign domiciled individuals, the situs of a foreign currency account is the situs of the branch. This restates the common law rule for bank accounts; it is needed because without this provision the situs of the account would be the residence of the creditor (ie the account holder). In cases where the conditions (i), (ii) and (iii) are not all satisfied, the usual CGT debt rule applies.

Section 275(1)(l) only applies to individuals' bank accounts. However the situs of a bank account held by a trust or a company does usually matter for CGT.[33]

103.13 UK-law rule

Section 275A TCGA provides a situs rule for intangible assets which I call "**the UK-law rule**". It is convenient to deal with some definitions before turning to the rule itself.

103.13.1 *"Intangible asset"*

Section 275A(2) TCGA provides a commonsense definition of "intangible

[31] See 95.10 (Foreign currency bank account: CGT).

[32] Section 275(3A) TCGA provides: "Section 835BA (deemed domicile) applies for the purposes of subsection (1)(l)(iii)." This is the standard wording to apply the deemed domicile rules.

[33] If it did matter, the usual CGT debt rule would apply so all accounts held by a non-resident trust or non-resident company would be non-UK situate, as situs would depend on residence of the account holder. This means that UK services relating to the account qualify for foreign services relief under s.809W ITA. That could be important for a bank account held by a non-resident close company, which is a relevant person, but in practice the point will rarely if ever arise as such a company would not normally use a UK account.

asset":

> In this section "intangible asset" means—
> (a) intangible or incorporeal property and includes a thing in action[34], or
> (b) anything that under the law of a country or territory outside the UK corresponds or is similar to intangible or incorporeal property or a thing in action.

This includes policies and bonds, futures and options.

103.13.2 *Situs otherwise undetermined*

Section 275B(1) TCGA provides a commonsense explanation of "not otherwise determined":

> For the purposes of section 275A, the situation of an asset is not otherwise determined if, apart from that section, this Act does not make any provision for determining—
> (a) the situation of the asset, or
> (b) whether the situation of the asset is in the UK.

Thus the statutory situs rules in s.275 TCGA have priority to the UK-law rule. For instance, a debt held by a foreign creditor is not UK situate even if subject to UK law; an option to purchase a non-UK situate chattel is not UK situate, even if governed by UK law.[35]

103.13.3 *"Subject to UK law"*

The expression "subject to UK law" is widely defined in s.275B(2):

> For the purposes of section 275A, an intangible asset is subject to UK law at a particular time if any right or interest which comprises or forms part of the asset is, at that time,—
> (a) governed by, or otherwise subject to, or
> (b) enforceable under,
> the law of any part of the UK.

[34] A note on terminology. This is commonly called a chose in action. It is desirable to avoid Law French, where there is an alternative English term which is more easily understood; but "thing in action" is as opaque as "chose in action", if not more. But the Law Commission preferred "thing in action" in the consultation paper on digital assets (2022). For now, I prefer to use the traditional term, but it is possible that "thing in action" may become the standard term in the future.

[35] See 103.17 (Chattels).

Whether or not an asset is subject to UK law depends on the documentation. That will vary from case to case, but I understand that the position for some standard financial contracts is as follows.[36]

LIFFE FTSE 100 index future contracts are subject to UK (English) law.[37]

Eurex contracts and CME contracts are not subject to UK law. They are governed by German law[38] and US law.[39]

103.13.4 *UK-law rule*

Section 275A(1)(3) TCGA need to be read together to follow the sense:

> (1) This section applies for the purpose of determining whether the situation of an intangible asset ("asset A") is in the UK if the situation of asset A is not otherwise determined (see section 275B(1))...
> (3) If asset A is subject to UK law (see section 275B(2)) at the time it is created, it shall be taken for the purposes of this Act to be situated in the UK at all times.

103.13.5 *UK-law rule: Critique*

The UK-law rule was introduced (in accordance with the practice before the Tax Consultation Framework) without consultation or debate. It should be repealed as:

(1) It is impractical for remittance basis taxpayers who want to know how to invest or what to declare in their returns. Only the wealthiest taxpayers with a significant budget for UK tax advice can be expected to research what law governs the assets concerned.

(2) It is contrary to UK legal commercial interests, discouraging the use of UK law and UK jurisdictions (at least to the extent that those who draft contracts are aware of the rule.)

(3) It brings in no tax.

But the best solution is to look at the wider picture altogether: treat all

[36] I am grateful to Lindsay Pentelow of Mazars LLP for his research in this area.

[37] See cl 13 of Exchange Contract 29, issue date 3 Sept 2007.

[38] *https://www.eurex.com/resource/blob/316842/88b1e8d5bfa9ebc18506e4f6d4f584c5/data/2018_04_23_history_cc_4_en.pdf*
Clearing Agreement between Eurex Clearing AG and a Clearing Member 26.11.2018 para 13.

[39] CME Chapter 9, Rule 905 (Choice of Law)
https://www.cmegroup.com/content/dam/cmegroup/rulebook/CME/I/9/9.pdf

assets other than UK land and securities as non-UK situate for IHT and CGT.[40] The UK-law rule would fall by the wayside.

103.14 Futures/options

Section 275A contains situs rules for futures and options which I call "**future/option rules**".

In the absence of these provisions, remittance basis taxpayers could invest in a foreign law future/option which tracks the value of UK situate intangible assets (because the underlying assets are UK situate). I surmise that these rules are intended to prevent that.

The drafting makes some formal gestures to the conventions of plain English legal drafting, but its structure is remarkably convoluted. If the Parliamentary Counsel Office held a competition for the most obscure drafting, within a plain legal English format, this should make the shortlist.

It is convenient to deal with some definitions before turning to the rule itself. The definitions are derived from the corporation tax derivatives code now in Part 7 CTA 2009. The definitions of expressions used in the UK-law rule are also relevant here.

103.14.1 *"Future"*

Section 275B(3) TCGA provides:

> In section 275A—
> "future" has the meaning given by section 581 of CTA 2009,

So we turn to s.581 CTA 2009 which defines a "future":

> (1) In this Part "future" means a contract for the sale of property under which delivery is to be made—
> (a) at a future date agreed when the contract is made, and
> (b) at a price so agreed,
> but this is subject to subsection (3).
> (2) For the purposes of subsection (1)(b), a price is agreed when the contract is made even if—
> (a) the price is left to be determined by reference to the price at which a contract is to be entered into on a market or exchange or could be entered into at a time and place specified in the contract, or

[40] See 102.37 (Reform of IHT/CGT situs rules).

(b) in a case where the contract is expressed to be by reference to a standard lot and quality, provision is made for a variation in the price to take account of any variation in quantity or quality on delivery.

103.14.2 *"Option"*

Section 275B(3) TCGA provides:

> In section 275A ...
> "option" has the meaning given by section 580 of [CTA 2009].

So we turn to s.580(1) CTA 2009 for a partial definition of option:

> In this Part "option" includes a warrant.

Section 710 CTA 2009 defines "warrant":

> In this Part [Part 7]
> "warrant" means an instrument which entitles the holder to subscribe for—
> (a) shares in a company, or
> (b) assets representing a loan relationship of a company,
> whether or not the shares or assets exist or are identifiable.

103.14.3 *Cash-settled future/option*

Sections 580/581 CTA 2009 exclude most cash-settled options and futures. They are conveniently read side by side:

s.580 CTA 2009 (Options)	**s.581 CTA 2009 (Futures)**
(2) References in this Part to an option do not include a contract whose terms—	(3) References in this Part to a future do not include a contract whose terms—
(a) provide— (i) that, after setting off their obligations to each other under the contract, a cash payment is to be made by one party to the other in respect of the excess, if any, or (ii) that each party is liable to make to the other party a cash payment in respect of all that party's obligations to the other under the contract, and	[identical]

(b) do not provide for the delivery of any property.	[identical]
(3) Subsection (2) does not prevent an option whose underlying subject matter is currency from being an option.	(4) Subsection (3) does not prevent a future whose underlying subject matter is currency from being a future.

So cash-settled futures and options do not count, except for currency futures. The exception does not matter as currency futures/options are outside the scope of the future/option rules.

103.14.4 *"Underlying subject matter"*

Section 275B(4) TCGA provides a commonsense definition:

> For the purposes of section 275A—
> (a) the underlying subject matter of a future is the property which, if the future were to run to delivery, would fall to be delivered at the date and price agreed when the contract is made, and
> (b) the underlying subject matter of an option is the property which would fall to be delivered if the option were exercised.

In the case of options, the language of s.275B(4)(b) seems to assume that the option is a call option and that the underlying subject matter is therefore what is received. However, options can also be structured as put options. It is unclear, with a put option, whether the underlying subject matter is what is put, or what is received in return. In a simple case where the price for delivery is currency, one assumes that the underlying subject matter is what is put. The position is more complex where the option is between two currencies (say sterling and dollars). In such a case it would be possible either to call for dollars (paying sterling) or to put sterling (being paid in dollars). However, this may not make a difference given the discussion below regarding options over currency. Presumably a situation where one tried to mis-characterise a call option as a put option - for instance purporting to put sterling in return for securities - would be looked through to the underlying reality and treated as a call option over the securities.[41]

[41] I am grateful to John Barnett for this observation.

103.14.5 *Futures/options rules*

Armed with these definitions, we can turn to the future/option rules.

Section 275A(4) TCGA provides:

> Subsections (5) to (9) below have effect if asset A [the intangible asset]—
> (a) is a future or option (see section 275B(3)), and
> (b) is not subject to UK law at the time it is created.

The point of (b) is that a future/option which is subject to UK law is UK situate under the UK-law rule and the future/option rules are not needed. We are therefore only concerned with a foreign law future/option.

One needs to read s.275A(5)(6) together to follow the sense, and it easier to read them in reverse order. Section 275A(6) TCGA provides:

> That rule is that where, in the case of any intangible asset,—
> (a) the asset is a future or option,[42]
> (b) the underlying subject matter (see section 275B(4)) of the asset consists of or includes an asset which is an intangible asset,
> and
> (c) either—
> (i)[A] that intangible asset [the underlying subject matter] is subject to UK law at the time it is created and,
> [B] on the assumption that there were no rights or interests in or over that asset,[43] the situation of that asset [the underlying subject matter] would not be otherwise determined, or
> (ii) that intangible asset is treated by this subsection as being so subject [ie subject to UK law] at that time,
> the intangible asset mentioned in para (a) above [i.e. the future/ option] is to be treated for the purposes of subsection (5) above and this subsection as being so subject [ie subject to UK law] at the time it is created.

This triggers s.275A(5) TCGA:

> If, as a result of the application of the rule in subsection (6) below in relation to asset A or any other asset or assets, asset A falls to be treated as being subject to UK law at the time it is created, it shall be taken for

[42] Para (a) is otiose, since it repeats s.275A(4)(a); but it does not matter.

[43] The words "on the assumption that there were no rights or interests in or over that asset" are difficult to understand, as situs of an asset does not depend of whether there are rights or interests in the asset. I think the words are otiose.

> the purposes of this Act to be situated in the UK at all times.

In short, a foreign law future/option over a UK law underlying intangible asset is UK situate.

EN FB 2005 explains the point of s.275A(6)(c)(ii):

> These rules apply recursively. In any case where there is a "nested sequence" of futures or options in which the underlying subject matter of each contract in the sequence consists of or includes the next contract in the sequence, subsection (5) has effect to provide that the first contract is taken for TCGA purposes to be situated in the UK at all times if the [relevant] requirements ... are met in relation to any of the contracts in the sequence.

Suppose:

(1) Option 1 is a foreign-law option over UK intangible property.
(2) Option 2 is a foreign-law option over option 1.

Option 1 is UK situate under s.275A(6)(c)(i) and option 2 is UK situate under s.275A(6)(c)(ii).

Section 275A(6) leaves one gap: it does not apply where the situs of the underlying subject matter is "otherwise determined".[44]

Suppose, for instance, a foreign-law option over shares in a UK incorporated company. That is not caught by s.275A(5)(6). The gap is filled by the second of the three future/option rules, which is in s.275A(7)(8). These subsections follow much of the format of s.275A(5)(6) and I need not repeat the drafting points that they have in common.

One needs to read (7) and (8) together to follow the sense and it easier to read them in reverse order. Section 275A(8) TCGA provides:

> That rule is that where, in the case of any intangible asset,—
> (a) the asset is a future or option, and
> (b) the underlying subject matter of the asset consists of or includes an asset—
> (i) which is, by virtue of
> [A] subsection (9) below or of

[44] At first sight there is a second gap: s.275A does not apply where the underlying subject matter of the future/option is a tangible asset. But that is not a gap, as in such a case the future/option is an interest in that asset, and situs is determined by s.275(1)(b) TCGA.

> [B] any provision of this Act apart from this section, situated in the UK at any time, or
>
> (ii) which is treated by this subsection as being so situated [ie UK situate] at any time,
>
> the intangible asset mentioned in para (a) above [the future/option] is to be treated for the purposes of subsection (7) above and this subsection as being so situated [ie UK situate] at that time.

This triggers s.275A(7) TCGA:

> If—
>
> (a) asset A [the future/option] is not taken to be situated in the UK by virtue of subsection (5) above, and
>
> (b) as a result of the application of the rule in subsection (8) below in relation to asset A or any other asset or assets, asset A falls to be treated as being situated in the UK at any time,
>
> it shall be taken for the purposes of this Act to be situated in the UK at that time.

Suppose:

(1) Option 1 is a foreign-law option over a UK security.

(2) Option 2 is a foreign-law option over option 1.

Option 1 is UK situate under s.275A(8)(b)(i) and option 2 is UK situate under s.275A(8)(b)(ii).

The rules in s.275A(5)(6) and (7)(8) only apply where there is an identifiable underlying asset in existence. A future/option over an asset class (such as gold) rather than any specific asset is not caught. If the underlying asset is currency, say, rather than a specific asset the future/option rules do not apply. Hence it does not matter that cash-settled currency future/option are within the definition of future/option, as they are not within the scope of the future/option rules.

103.14.6 *Unissued securities*

Section 275A(9) TCGA deals with the case where the underlying subject matter is unissued shares or debentures:

> Where—
>
> (a) the underlying subject matter of a future or option consists of or includes shares or debentures issued by a company incorporated in any part of the UK, but
>
> (b) at the time the future or option is created, those shares or debentures have not been issued,

> the underlying subject matter of the future or option, so far as consisting of or including those shares or debentures, is to be taken, for the purposes of subsection (8) above, to consist of or include an asset which is situated in the UK at all times.

103.15 Insurance policy

The situs of policies rarely matters for CGT, because of the relief for policies. UK policies will be UK situate under the UK-law rule and for others the common law rule will apply.[45]

103.16 Land

Section 275(1)(a) TCGA provides:

> the situation of rights or interests (otherwise than by way of security) in or over immovable property is that of the immovable property.

The CG Manual provides:

> **CG12430 Land, tangible property and debts** [Nov 2023]
> *Land and buildings (Section 275(1)(a) TCGA 1992)*
> Land and buildings are located in the country where they are found. This applies to all rights and interests in the land and buildings. It will therefore apply to leases of land, tenancies etc.

103.17 Chattels

Section 275(1)(b) TCGA provides:

> subject to the following provisions of this subsection,[46] the situation of rights or interests (otherwise than by way of security) in or over tangible movable property is that of the tangible movable property.

Thus an option to purchase a UK situate chattel (even if governed by a foreign law) is a UK situate asset. The CG Manual provides:

> **CG12430 Land, tangible property and debts** [Nov 2023]
> *Chattels (Section 275(1)(b) TCGA 1992)*
> Items of tangible moveable property (chattels) are located where they are found at any point in time. This applies to all rights and interests over such assets also. Therefore a lease of a chattel can change from being located in the UK to being located elsewhere if the chattel is

[45] A policy is not a debt for the purposes of the CGT debt situs rule.
[46] This is referring to the special rules for ships and aircraft.

removed from the UK to another country.

For chattels temporarily exported, see 102.27 (Chattels).

103.18 Ships and aircraft

Section 275(1)(f) TCGA provides:

> a ship or aircraft is situated in the UK if and only if the owner is then resident in the UK, and an interest or right in or over a ship or aircraft is situated in the UK if and only if the person entitled to the interest or right is resident in the UK.

The CG Manual provides:

> **CG12430 Land, tangible property and debts** [Nov 2023]
> *Ships and aircraft (Section 275(1)(f) TCGA 1992*)
> Contrary to the general rules of international law,[47] for capital gains purposes the location of a ship or aircraft does not depend on its country of registration. Instead the ship or aircraft is located in the UK if and only if the owner is resident in the UK. Similarly any interest or right in or over the ship or aircraft is located in the UK if and only if the owner of the interest or right is resident in the UK.

This generally[48] disapplies the CGT remittance basis since a ship/aircraft owned by a remittance basis taxpayer is deemed UK situate and the gain taxed on an arising basis. If the individual holds the ship/aircraft through a non-resident company the asset is treated as not UK situate which has two remittance basis advantages:

(1) The s.3 remittance basis is available on a disposal by the company.
(2) Relief is available under s.809W ITA for services relating to the asset.

103.19 Goodwill

Section 275(1)(g) TCGA provides:

> the situation of good-will as a trade, business or professional asset is at the place where the trade, business or profession is carried on.

[47] The Manual reflects Dicey's view (that under private international law ships and aircraft are situate where registered) but this is contentious: see 102.28 (Ships and aircraft).

[48] An exception is if the individual disposes of the asset while temporarily non-resident.

The CG Manual provides:

> **CG12450 Intangible assets - goodwill, patents, trademarks etc** [Nov 2023]
> *Goodwill (Section 275(1)(g) TCGA 1992)*
> Goodwill which is an asset of a trade, profession or vocation is located where the trade, profession or vocation is carried on. If the trade etc is carried on in more than one country part of the goodwill appropriate to the part of the trade etc carried on in any one country should be treated as located in that country.

103.20 Intellectual property

Section 275(1)(h) TCGA provides:

> [a] patents, trade marks, registered designs and corresponding rights[49] are situated where they are registered, and if registered in more than one register, where each register is situated, and
> [b] licences or other rights in respect of any such rights are situated in the UK if they or any right derived from them are exercisable in the UK

A different solution must be found for copyright and similar rights which do not need registration. Section 275(1)(j) TCGA provides:

> copyright, design right, franchises, and corresponding rights,[50] and licences or other rights in respect of any such rights, are situated in the UK if they or any right derived from them are exercisable in the UK.

This will not often concern remittance basis taxpayers. It could be important for non-residents carrying on a trade in the UK through a permanent establishment, who are (in short) subject to CGT/CT on UK situate trade assets.

It seems at first sight that intellectual property is (uniquely) capable of being situate for CGT purposes in more than one jurisdiction. But intellectual property exercisable in a number of jurisdictions should be regarded as a number of separate assets, one situate in each jurisdiction.[51]

[49] "Corresponding rights" has a commonsense definition in s.275(3) TCGA:

> In subsection (1) above, in each of paras (h) and (j), "corresponding rights" means any rights under the law of a country or territory outside the UK that correspond or are similar to those within that paragraph.

[50] See above footnote.

[51] See 102.30 (Intellectual property).

103.21 Bare trust or nomineeship

The interest of a beneficial owner in property held by a nominee or bare trustee is situate where the underlying asset is situate: the CGT bare trust disregard[52] reinforces the common law rule on this point.

Also see 69.10.2 (Situs of unit for CGT).

103.22 Substantive trust interest

The situs of an equitable interest under a substantive trust only rarely matters for CGT because of the exemption for equitable interests. However it may matter, eg in the case of a purchased interest or an interest under a non-resident trust.

If the trust is "subject to UK law" (as defined) the interest will be situate in the UK. This clearly includes the case of a trust with a UK governing law; it may arguably apply to any trust with UK trustees. In other cases the common law rules will apply.

103.23 Estate of deceased person

If the estate is subject to UK law, it is UK situate for CGT. Other estates are governed by the common law rule.[53]

103.24 Planning: Changing situs

103.24.1 *Moveable assets in UK*

Moveable assets could in principle be moved offshore prior to a disposal. Consider whether an export licence is needed.

103.24.2 *Unincorporated UK business*

A business could sometimes be transferred to a foreign incorporated company under s.162 TCGA and shares later sold.[54] Watch stamp duty. If the company were subsequently to become non-resident, eg on emigration of shareholder/directors, no tax would arise except on growth in value since transfer to the company.

103.24.3 *Debts*

There are two ways to deal with a UK situate debt on a security. It may

[52] See 87.7 (Bare trust/nomineeship).

[53] See 102.34 (Estate of deceased person).

[54] For an unsuccessful example of similar planning using hold-over relief, see 104.8 (Ultra-wide control: Critique).

be possible to make the asset non-UK situate. It might be possible to make the asset a simple debt (not a debt on a security) so it falls within the relief given by s.251 TCGA. It is important to do this by varying the existing debt, and not by ending the existing debt and creating a new one.[55]

103.24.4 *UK resident, non-UK situs*

It is not ideal for a foreign domiciled individual to hold a UK incorporated company directly, as a disposal of that asset would give rise to CGT. If the foreign domiciliary does not want to go to the trouble and expense of using an offshore trust, what is the alternative? One possibility is to use a foreign incorporated UK resident company. The shares in the company will not be UK situate for CGT.[56]

[55] But see App.2.15.8 (Date to test security).

[56] See 103.6 (Registered security: Non-UK co).

CHAPTER ONE HUNDRED AND FOUR

CONTROL, CONNECTED, CLOSE AND RELATED EXPRESSIONS

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104.1 Introduction

This chapter considers the terms "control", "connected person", "close company", and related terms such as "associate" and "participator".

Control is the most fundamental, as this term is used in the definitions of connected person and close company.

The layout of this chapter is as follows:

Topic	**See para**
Control	104.2
Associate	104.6
Connected person	104.12
Control/connected person: Examples	104.20

Participator	104.22
Close company	104.26

These terms are also used in non-tax law, with similar definitions, and discussion from there may be relevant for tax. See for instance Pollard, *Connected & Associated: Insolvency & Pensions Law* (1st ed, 2022).

104.2 Control

104.2.1 *Why control matters*

Control of a company is a concept used throughout tax legislation, and it is not practical to write a full list.

The concept is important in particular for the definition of connected person: a person is connected with a company they control. The concepts of control and connected overlap.

104.2.2 *Definitions of "control"*

There are two main definitions of control in tax legislation, as well as many other definitions. The legislation does not have terminology to describe them, so I coin the following:

Type of control	**Provision**	**See para**
Control in **ultra-wide** sense	s.450 CTA 2010	104.3
Control in **strict** sense	s.995 ITA; s.1124 CTA 2010	104.9
Other senses of control	*Meaning*	
Boardroom control	Power to make *directors* decisions	
Shareholder level control	Power to make *shareholders* decisions	
Control in **natural (undefined)** sense	Vague & context-sensitive	

The word control is used in accountancy, where it has another set of definitions again.[1] Those definitions do not apply for tax, so a person who has control in one of the tax senses may not be the person named in company accounts as the ultimate controlling party of the company.

Strictly, one should not use the word "control" without specifying which definition applies, but the context may make that clear.

It is not helpful, and perhaps not even meaningful, to refer to the "real" sense of control, for in the absence of context the word is vague: it has no precise fixed meaning. The strict sense of control is not exactly the

[1] FRS 102 (The Financial Reporting Standard applicable in the UK and Republic of Ireland) para 9.4; IFRS 10 (Consolidated Financial Statements) para 5.

natural (undefined) sense. The ultra-wide sense of control is very distant from the natural (undefined) sense.

Statute formerly used the expression "controlling interest" (undefined). This generated a large case law.[2] But it seems to me that those cases shed little light on the current statutory concepts of strict-sense/ultra-wide control, which are both elaborately defined. The drafter learnt the lesson that "control" is too vague a concept to use without some explanation. Careful thought is needed before using cases discussing "controlling interest" to shed light on the meaning of strict-sense or ultra-wide control.

Where there is control in the strict sense, there is usually control in the ultra-wide sense. Where appropriate, I refer to that as control **"in every sense"**.

104.2.3 *Default meaning of control*

s.989 ITA	**s.1316(2) CTA 2009 & s.1176(2) CTA 2010**	**s.288(1) TCGA**
The following definitions apply for the purposes of the Income Tax Acts— "control", in relation to the control of a body corporate or a partnership, is to be read in accordance with section 995.[3]	Section 1124 (meaning of control in relation to a body corporate or partnership) applies for the purposes of this Act unless otherwise indicated (whether expressly or by implication).	In this Act, unless the context otherwise requires— "control" shall be construed in accordance with sections 450 and 451 of CTA 2010;

Thus:

(1) For IT and CT the strict sense is the default meaning. However, in practice the ultra-wide sense is more commonly applied.

(2) For CGT the ultra-wide sense is the default meaning.

[2] These cases are discussed in Venables, "Corporate Relationships" (2003) Corporate Tax Review Vol 4 p.1.

[3] For completeness: The point is sometimes repeated elsewhere:

s.719 ITEPA/s.1021(2) ITA	**s.878(6) ITTOA**
Section 995 (meaning of "control") applies for the purposes of this Act unless otherwise indicated.	Section 995 of ITA 2007 (meaning of "control") applies for the purposes of this Act unless otherwise indicated (whether expressly or by implication).

This is not strictly necessary, but either for historical reasons or in accordance with a Plain English penchant for signposts.

For IHT, s.269 IHTA provides yet another definition of control. Such is the patchwork nature of UK taxation. The IHT definition is not discussed here as it does not arise in the IHT issues closest to the themes of this book.

104.3 Control: Ultra-wide sense

104.3.1 *Five heads of control*

This section considers the concept of control in the ultra-wide sense. Section 450(1) CTA 2010 provides:

> This section applies for the purpose of this Part [Part 10 CTA 2010, close companies].

The definition is also applied by reference in many other contexts.

> (2) A person ("P") is treated as having control of a company ("C") if P—
> (a) exercises,
> (b) is able to exercise, or
> (c) is entitled to acquire,
> direct or indirect control over C's affairs.
> (3) In particular, P is treated as having control of C if P possesses or is entitled to acquire—
> (a) the greater part of the share capital or issued share capital of C,
> (b) the greater part of the voting power in C,
> (c) so much of the issued share capital of C as would, on the assumption that the whole of the income of C were distributed among the participators, entitle P to receive the greater part of the amount so distributed, or
> (d) such rights as would entitle P, in the event of the winding up of C or in any other circumstances, to receive the greater part of the assets of C which would then be available for distribution among the participators.

Thus there are five heads of control in the ultra-wide sense:

Type of control	**CTA 2010**	**My term**
Control of company affairs	s.450(2)	General control
Majority of share capital	s.450(3)(a)	Para (a) control (shares)
Majority of voting power	s.450(3)(b)	Para (b) control (votes)
Majority of company income	s.450(3)(c)	Para (c) control (income)
Majority of company assets	s.450(3)(d)	Para (d) control (assets)

These rules overlap, and there is usually more than one reason why a person "controls" a company, in the ultra-wide sense, particularly after allowing for the associate-attribution rule, discussed below; but that does not matter.

104.3.2 *What rights are possessed?*

In order to apply these rules it is necessary to ascertain what are the rights which a person possesses.

In *HMRC v UBS*, the company's articles provided (in short) that while UBS was shareholder, its shares carried (more or less) no rights. The purpose was to ensure that when UBS held the shares it did not have control. An argument that this should be ignored as a sham was curtly rejected:

> There was no finding that the participants did not intend article 2(15) to take effect according to its terms and so the argument that it was a sham was rightly rejected. Once this point is reached, I am at a loss to know on what basis article 2(15) can be airbrushed out of the scheme.[4]

Sham is however fact sensitive, and in other circumstances an article of that kind might perhaps be ignored as a sham.

HMRC discuss the position of a vendor between contract and completion:[5]

> In order for capital treatment to apply, s.1042 CTA 2010 imposes a condition that the seller must not, immediately after the purchase, be connected with the company making the purchase (or any other company which is a member of the same group). Section 1062 CTA 2010 sets out when a person is connected with a company for these purposes, in particular that:
>
> A person is connected with a company if the person directly or indirectly possesses, or is entitled to acquire, more than 30% of–
>
> (a) the issued ordinary share capital of the company,
>
> (b) the loan capital and the issued share capital of the company, or
>
> (c) the voting power in the company.

This wording is drawn from the definition of control, and the same points arise. The HMRC analysis is as follows:

[4] [2014] EWCA Civ 452 at [107].

[5] *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/c0957d52-b133-4b2c-9743-88ba49b443f8/220218%20HMRC%20note%20on%20PoS.pdf* The note states that HMRC manuals will be updated to make this point.

> HMRC's view is that the word "possesses" in s.1062(2) CTA 2010 refers to legal, as opposed to beneficial, ownership. When shares are subject to a sale under a multiple completion contract, the seller may (depending on the terms of the contract) lose beneficial ownership of all of the shares on the date of the contract. However, the legal ownership of the shares is retained until the sale of those particular shares has completed. This is the case even if those remaining shares are converted to so-called deferred shares with no voting or economic rights in the company on completion of the first tranche.
>
> Therefore, as long as the seller remains a legal owner of so many "non-completed" shares that exceeds the 30% limit, they will remain connected with the company by virtue of s1062(2)(a) – possession of ordinary share capital. In such circumstances, the seller would not qualify for capital treatment under s1033 CTA 2010.

It is in principle correct that between contract and completion:

(1) The seller is said not to have beneficial ownership (or better, full beneficial ownership) of the shares.

(2) Pending payment of the purchase price, the seller owes duties to the purchaser, and is sometimes described as a trustee.

However this is an unusual kind of trust, under which the seller retains substantial rights over the property being sold. It is therefore correct to say that the seller "possesses" share capital, votes, and entitlements on a winding up, and so may have control; though to describe the seller as having mere "legal ownership" seems to me slightly misleading. But while one might refine the analysis, HMRC's conclusion is correct. The rather unsatisfactory body of case law on the meaning of beneficial ownership for the purposes of group relief[6] does not govern the meaning of the word possess, in this very different context.

While the position might be altered by the terms of the contract, in practice that would be unusual. If it is desired to avoid this outcome, the answer is to arrange that there is no gap between contract and completion. Indeed for share sale contracts (as opposed to sales of land) that is what is normally done, so this issue will not often arise.

104.3.3 *General control*

> *P is treated as having control of C if P—*
>
> *(a) exercises,*

[6] See App 6.2 (English-law beneficial ownership).

> *(b) is able to exercise, or*
> *(c) is entitled to acquire,*
> *direct or indirect control over C's affairs.*

I refer to this as **"general control under s.450(2)"**.

In the last line of this head, "control" is used in a natural (undefined) sense. So this head seems similar to strict-sense control (company affairs conducted in accordance with P's wishes).[7] But there are differences:

(1) Strict-sense control requires boardroom control, not control at shareholder level.
(2) Strict-sense control requires legal control conferred by a company's governing documents, not de facto control or control conferred in some other way.

Para (a) concerns someone who *actually* exercises control. That includes a case where P exercises *de facto* control but has no right of control.[8]

Para (b) concerns someone *able* to exercise control. It does not matter if they choose not to exercise control. It is suggested that although para (a) applies where P exercises mere *de facto* control, para (b) only applies if P has a right of control, ie *able* means legally entitled to. An attraction of this reading is that para (a) and (b) both have some role to play. For if para (a) required a right of control, then (b) would be otiose; if para (b) did not require a right of control, then para (a) would be otiose.[9]

However it may be rare for someone to actually exercise control without having a right to do so, and so fall within para (a) but not (b).

104.3.4 *Shareholder level control*

In *Steele v EVC International*:

> ... control of the affairs of the company in [s.450] means control at the level of general meetings of the company ... control at that level carries with it the power to make the ultimate decisions as to the business of the company and in that sense to control its affairs.[10]

[7] See 104.2.3 (Control: Strict sense).

[8] This was accepted as the position in *UBS v HMRC* where the issue was whether a company exercised *de facto* control despite having no legal power to do so.

[9] This view is also consistent with the meaning of "able to control" in ToA enjoyment condition E: see 49.17 (Enjoyment condition E: control).

[10] 69 TC 88 at p.127. See too 8.7 (Control: company law background).
I am not sure if it is necessary, even in a work which seeks to be comprehensive, to

The CT Manual provides:

> **CTM60220 Control: Over the company's affairs** [Nov 2020]
> ... As regards the level at which control is exercised, the judgment in *Steele v EVC International NV* 69 TC 88 confirms that what is required is control at the participator or general meeting level, not at administrative or board level.

SP 1/01 provides:

> 54. Where the establishment of a connected persons relationship depends on the question of whether a person falls to be regarded as having control of a company's affairs within the terms of [s.450 CTA 2010], it is not considered that a persons ability (whether de facto or de jure) to appoint the majority of the Board of directors will itself constitute control of the company's affairs unless, that is, the Board exercises powers which would normally be exercised by the shareholders at a general meeting.

Power to appoint directors confers boardroom control, but that is not the test of control in the ultra-wide sense. Appointment of directors is also one of the affairs of a company which is dealt with at shareholder level. But control of one isolated issue is not sufficient to constitute control of the company's *affairs* in general.

See too 8.7 (Control: company law background).

104.3.5 *Partial control*

The issue of partial control arises for:

(1) Ultra-wide sense of control first head (general control under s.450(2)): what is the position if a person has power of control over some of a company's affairs at shareholder level but not others?

(2) Strict-sense control: what is the position if a person has power of

refer to FTT decisions which overlook relevant case law. But for completeness; this was overlooked in the FTT decision of *Hunters Property v HMRC* [2018] UKFTT 96 (TC). In this case a group company was sole member of a company limited by guarantee ("the guarantee company"). The issue was whether the appellant "controlled" the guarantee company (in the ultra-wide sense). The FTT held that the appellant was had control under s.450(2)(b) (able to exercise control) as it could appoint and dismiss directors. The correct analysis was that the appellant had control under s.450(2)(b) because as the sole member of the guarantee company it had control at the level of company meetings. There is no difference between a guarantee company and a company with share capital. The test is control at shareholder/ company member level. But the end result would be the same.

> control over some of a company's affairs at boardroom level but not others?

Control (in its natural, undefined sense) is a matter of degree, and the law as so often has to resolve shades of gray into black/white, control/non-control.

The requirement is to have control over company "affairs" in general. Control over one matter alone is not control over affairs in general:

> ... ability to achieve an isolated result, the power to carry a particular resolution, is insufficient to establish control in the statutory sense; and that what is required is power to secure the continuing conduct of the company's affairs in accordance with the will of the person...[11]

The textbook TCCR agrees:

> the ability to control only some aspects of the company's affairs is insufficient.[12]

In *Keighley v HMRC*:[13]

> ... we do not agree .. that, as a general principle, if a single affair of the company is not conducted in accordance with the person's wishes, that person has no control. It would seem odd to us that if there was a provision in a shareholders agreement which obliged the majority shareholders to take into account the wishes of a minority shareholder if the company wants to buy more than 50 paperclips in one batch, then that would prevent those majority shareholders from controlling the company. To our mind when considering the affairs of the company, one needs to look more deeply into the affairs of the company.
>
> There must be a consideration in each particular case, which is bound to be fact dependent, as to whether the specific activities of the company in question are conducted in accordance with a person's wishes. And, without making any hard and fast rule (which we do not need to do in this case) the relevant affairs and activities of the company which need to be considered will vary on a case-by-case basis.

In that case, two shareholders had a majority of the shares, but a shareholders agreement with the third shareholder prevented them having

[11] *IRC v Lithgows* 39 TC 270 at p.278.

[12] *Taxation of Companies and Company Reconstructions*, Looseleaf, para D1.1.4 (General test of control).

[13] [2024] UKFTT 30 (TC) at [111] ff.

control over the affairs of the company:[14]

> It is our view that the provisions of clause 11 of the shareholders agreement, which contains a raft of restrictions on the otherwise unfettered right of the majority shareholders to control the company, mean that they do not control the company. The clause 11 actions require the consent of [the third shareholder]. These include changing the constitution the company or its name, issuing debt instruments, forming subsidiaries, merging or winding up the business, changing the nature of the business carried on by the company, making loans, permitting transactions with associated companies or shareholders, and other similar provisions.
>
> These matters are fundamental to the running of the company at both an operational and strategic level. They are clearly within the ambit of the affairs of the company. Since the majority shareholders do not have the power to secure that these are conducted in accordance with their wishes, it is our view that they do not have control of the company.

At the other extreme, all shareholders/directors are subject to some constraints on how they conduct the affairs of the company, at board/ shareholder level, for instance, restrictions on distributions; but that does not stop them having control over company affairs in general.[15]

It is suggested that the constraints on charitable companies are so far reaching that the members of a charitable company should not be regarded as having control of the company in the strict sense (though they do have control in the ultra-wide sense, because they possess voting power which confers para (b) control).[16] But this question will not often arise.

104.3.6 *De facto control*

If one accepts that de facto control is sufficient to amount to control in the

[14] [2024] UKFTT 30 (TC) at [115] ff.

[15] For completeness: An old case held that a 51% shareholder had a "controlling interest" (undefined); it was not relevant that a 75% majority was required to carry out some shareholder level decisions. See *British-American Tobacco v IRC* 29 TC 49 at p.67. But the relevance of cases on "controlling interest" to strict-sense and ultra-wide control is doubtful. This particular issue does not however arise, for those definitions, as:

(1) a 51% shareholder has strict-sense control (a 51% shareholder has power to appoint directors and so has boardroom control);

(2) a 51% shareholder has ultra-wide sense control (majority of voting power confers para (b) control).

[16] See 104.3.8 (Votes: para (b) control).

ultra-wide sense, it is necessary to identify what constitutes that control.

Mere influence does not constitute control: *de facto* control would only apply if the person with legal control surrenders independence and acts as a "rubber stamp".

In *HMRC v UBS* one issue was whether a company (DB) exercised *de facto* control over another (in which it was a minority shareholder), so that it had control in the ultra-wide sense:

> ... the scheme was pre-ordained and involved a co-ordinated course of action between the participants, with Investec and DB, two wholly independent companies, playing pre-ordained and co-ordinated roles, with each having its own commercial interests in bringing the scheme to fruition. It does not, however, begin to follow from this that DB was in relevant [ultra-wide sense] control of Investec. If
> [1] A Ltd proposes to B Ltd, an unconnected and independent company, a co-ordinated course of action with a view to achieving a commercial end to the benefit of both, and
> [2] B Ltd agrees to the proposal and co-operates in its implementation,
> it is beyond my comprehension why such a state of affairs should be thought to justify the inference that, in playing its own part in the operation, B Ltd is to be regarded as being 'controlled' in what it does by A Ltd. The proposition is wrong. B Ltd will, by inference, want to take part, and will do so. But there will ordinarily be no basis for an inference that the decisions it makes en route to the ultimate goal will be decisions it makes other than independently, and in its own interests, in achieving the proposed end.[17]

104.3.7 *Shares: Para (a) control*

> *P is treated as having control of C if P possesses or is entitled to acquire ... (a) the greater part of the share capital or issued share capital of C.*

This is (relatively) straightforward.

104.3.8 *Votes: Para (b) control*

> *P is treated as having control of C if P possesses or is entitled to acquire ... (b) the greater part of the voting power in C.*

Children's Investment Fund Foundation v AG considered whether a member of a charitable company was entitled to exercise voting power, for

[17] [2014] EWCA Civ 452 at [139].

the purpose of the Companies Act rule that a director is connected with a body corporate if:

> entitled to exercise ... more than 20% of the voting power.[18]

The member argued that she was not "entitled to exercise voting power", because of the extensive charity law restraints on use of that power.[19] This argument was summarily dismissed:

> The fact is that Ms Cooper is the only member of [the charity], which is a company limited by guarantee without a share capital. She is, therefore, entitled to exercise... 100% of the voting power in [the charity] ...[20]

It is suggested that the same applies for para (b) control: members of a charitable company possess voting power, and so "control" the company in the ultra-wide sense.

At first sight, para (b) control is otiose, since a person with the greater part of the voting power has general control under s.450(2) CTA 2010: they are able to exercise control over the company's affairs. But it might be argued that a 51% shareholder does not have general control, at shareholder level, as they are unable to pass a special resolution. In the case of a charity it might be argued that the members rights as a whole fall short of general control. So para (b) control (votes) is required to cover these cases.

104.3.9 *Income: Para (c) control*

> *P is treated as having control of C if P possesses or is entitled to acquire ... (c) so much of the issued share capital of C as would, on the assumption that the whole of the income of C were distributed among the participators,[21] entitle P to receive the greater part of the amount so distributed.*

[18] s.254(2)(b) Companies Act 2006

[19] The member referred specifically to restraints due to:
(1) The Foundation's charitable objects
(2) Statutory rules such as s.201 Charities Act 2011
(3) Restricted uses to which charity funds could be put (a grant agreement required charity funds to be used as an endowment for specified charitable purposes)
But clearly one should look at the totality of the restraints imposed by charity law.

[20] [2017] EWHC 1379 (Ch) at [99]. The point was common ground on appeal. But see 104.23.10 (Member of charitable co).

[21] See 104.22 (Definitions of participator).

Section 450(4) CTA 2010 provides:

> Any rights that P or any other person has as a loan creditor are to be disregarded for the purposes of the assumption in subsection (3)(c).

This will not normally make any difference, as a company would not normally distribute income to loan creditors. But it would apply in special cases where interest is treated as a distribution.

The CT Manual provides:

> **CTM60240. Control: Summary** [Nov 2020]
> ... The test ... depends on the dividend rights of the issued capital and will be mainly of interest where shares with no voting rights carry the right to a high dividend..

But this is not the only case. The life tenant of an IIP trust holding a majority of the shares in a company in principle has control of the company under this head.

104.3.10 *Assets: Para (d) control*

> *P is treated as having control of C if P possesses or is entitled to acquire ... (d) such rights as would entitle P,*
> *[i] in the event of the winding up of C*
> *[ii] or in any other circumstances,*
> *to receive the greater part of the assets of C which would then be available for distribution among the participators.*[22]

The CT Manual provides:

> **CTM60230. Control: Right to receive most assets** [Nov 2020]
> Control ... exists where a person or persons have a right to receive the greater part of the assets then available for distribution among participators, in any circumstances, (for example, on redemption of redeemable share capital or on repayment of loans to the company) but also, specifically, on a winding up of the company.
> ‘Participators’ for this purpose includes loan creditors (unlike (c) of CTM60220). ... If a loan creditor is an open company, see CTM60300. The test under CTA2010/S450 (3) ... only applies to the assets that would come to a participator in that capacity. In the case of a bank, for example, no regard would be had to any assets that would come to it in respect of loans made in the ordinary course of its banking business,

[22] See 104.22 (Definitions of participator).

> because it is not deemed to be a loan creditor (and, hence it is not a participator) in respect of such loans by virtue of CTA2010/S453 (4) ...

Suppose a company owes a debt of £x to a loan creditor. If the assets of the company are less than £2x, then the loan creditor has control. If the assets are more than £2x (plus a little for the notional costs of a notional liquidation) then the loan creditor does not have control under this head. It may not be easy to know whether they have control or not.

If a company has no net assets (liabilities exceed value of net assets) then shareholders do not have control under this head, because nothing would be distributed to them on a winding up. Loan creditors may still have control, unless the company has no assets at all.

"Other circumstances" means circumstances in which a distribution is made to participators. The example given in the CT Manual is a redemption of redeemable shares.[23] The CT Manual provides:

> **CTM60240. Control: Summary** [Nov 2020]
> ...The test in CTM60230 will normally be of interest only where
> [1] loan creditors are participators (see CTM60130) or
> [2] there exist special rights to participate in the assets available for distribution in a winding-up or in any other circumstances for example, on redemption of redeemable share capital.

But these are not the only cases where the test may be satisfied. If trustees hold a company on trust for A for life, remainder to B absolutely, then B has control under para (d) (assets): for B will in the future be entitled to the assets of the company. If trustees hold a company on trust for B contingently (eg on attaining the age of 25, if B is under 25) then B does not have control under para (d).

104.3.11 *"Entitled to acquire"*

Section 451 CTA 2010 provides:

> (1) This section applies for the purposes of section 450 ["control" in ultra-wide sense].
> (2) A person is treated as entitled to acquire anything which the person—
> (a) is entitled to acquire at a future date, or
> (b) will at a future date be entitled to acquire.

[23] In the absence of these words, avoidance might perhaps have been possible by giving redeemable shares smaller rights on a winding up than on a redemption.

I find the difference between para (a) and (b) hard to grasp, but it does not matter.

I refer to this as the **"entitled-to-acquire rule"**.

The wording is often used. The INT Manual comments on the rule in the CFC legislation:

> **INTM210050 'Entitled to acquire' and 'entitled to secure'** [May 2012]
>
> The terms 'entitled to acquire' and 'entitled to secure' in (a), (b) and (c) of INTM210040 apply both where a person is presently entitled to acquire or secure an asset at a future date and where a person will at a future date be entitled to acquire or secure that asset. They do not extend to situations where, in an entirely arm's length transaction, one party temporarily has future rights over the other's property, for instance, in the period between exchange of contracts and completion of a sale of land.
>
> A person whose entitlement to acquire or secure is contingent on a default of any person, including the controlled foreign company in question, will not be treated as having an interest in the controlled foreign company, unless that default has occurred.
>
> So, for example, a person will have an interest in a controlled foreign company if, by means of a contractual right or some other arrangement, he can
>
> - require a shareholder to transfer shares to him, or
> - secure the issue to him of unissued share capital of the company, or
> - secure that if a distribution is made by the company he has a share in the distribution or premium.
>
> A person will not have an interest in a controlled foreign company solely by virtue of rights over the income or assets of the company which are exercisable on the default of any person. Thus the contingent rights of banks, trade creditors, etc. to acquire some or all of the company's assets in the event of a default would not amount to an interest in the company in advance of the default.

See too 104.23.11 ("Entitled to do").

104.4 Trustees of settlement

This section considers trustees of a substantive trust.[24]

Trustee shareholders are constrained by fiduciary duties, for instance, they may be unable to remunerate themselves as directors. These

[24] For nominees, see the next section. Also see 104.10.1 (Trustee in personal capacity).

restraints do not prevent trustees from having control in the ultra-wide sense:

(1) Trustees may be said to be have general control. Fiduciary control is sufficient.
(2) Trustees may be said to "possess", or to be "entitled to acquire":
    (a) Share capital
    (b) Voting power
    (c) Share capital entitling them to receive income distributions
    (d) Rights entitling them to receive capital distributions

Words such as possess/entitled to, do not require *beneficial* possession/ entitlement. Trustees of a substantive trust have legal ownership, or the right to call for legal ownership, and a better title than any other single person to exercise powers over the trust property.

This is confirmed by the rule that trustees may be associates.

104.5 Nominees: Control

104.5.1 *Nominee-attribution rule*

Section 451(3) CTA 2010 provides (for the purposes of the definition of control in the ultra-wide sense):

> If a person—
> (a) possesses any rights or powers on behalf of another person (A), or
> (b) may be required to exercise any rights or powers on A's direction or behalf,
>
> those rights or powers are to be attributed to A.

I refer to this as the **"nominee-attribution rule"**.

104.5.2 *Position of beneficial owner*

In the case of a straightforward nomineeship, where N holds on trust for A, then A possesses and is entitled to the rights or powers of the trust property, and there is no need for the nominee-attribution rule.

Cases where a person "may be required to exercise rights on A's direction" extend beyond the case where the person is nominee for A in the strict sense of nominee. Even then, the rule is (more or less) otiose, for if a person may be required to exercise rights on the direction of A, or on behalf of A, then these are rights which A possesses or is entitled to acquire, so the rights would be taken into account in any event in the test of control.

So perhaps the point of the rule is that as the rights are to be attributed to A (the beneficiary) they are not to be attributed to the nominee.

It is unclear whether the nominee-attribution rule would apply where a person possesses rights on behalf of more than one person, but the question may not often arise.

104.5.3 *Position of nominee*

A nominee has some rights, and although it is usually the case that one ignores and looks through nominees for tax purposes[25] that is not an absolute rule.[26]

If N holds a majority shareholding on trust for B absolutely, it is suggested that N does not necessarily have control in the ultra-wide sense, on the basis that:

(1) The statutory words “possess” and “able to exercise” and “entitled”, while not requiring beneficial possession (etc), are not apt to describe the limited rights of a bare nominee.[27]

(2) The nominee-attribution rule which attributes rights (etc) to B, by implication requires that N does not possess (etc) those rights.[28]

On the other hand, if:

(1) N holds the shares on as nominee for a number of beneficiaries in undivided shares, and

(2) The beneficiaries are not entitled to call for the transfer of their shares or to give directions to N

then it is suggested that N may “possess” the share capital and voting power of the shares.

[25] See 87.7.4 (Tax treatment of bare trust).

[26] Contrast *Atlasview v Brightview* [2004] EWHC 1056 (Ch) which held that a nominee had an interest for the purposes of (what is now) s.994 Companies Act 2006 (unfair prejudice to shareholders).

[27] There is some support for this view at the CoA level in *Bibby v IRC* 27 TC 167 at p.173 where CoA said in a passing comment that a bare trustee did not have a "controlling interest" (the term was not defined). The point was left open by the House of Lords on the appeal, because it was appreciated that the term bare trustee was ambiguous and needed further consideration.

[28] Note that the nominee-attribution rule states that the rights “are to be” attributed to A; contrast the associate-attribution rule, which is that an associate’s rights “may be” attributed to a person; see 104.7 (Associate-attribution rule).

In other words, the term "nominee" actually covers a variety of different circumstances.[29]

A nominee may also have control in the ultra-wide sense on the basis that it exercises *de facto* control, but that depends on the facts.

A similar approach applies to the question whether a nominee is a participator; see 104.23.6 (Nominees: Participators).

104.6 Associates

104.6.1 *Associate/connected: Concepts*

"Associate" is one of a cluster of similar concepts:

Term	**Definition**	**Application**	**See**
Associate	s.448 CTA 10	*Various:*[30]	*Discussed here*
		- Associate-attribution rule	104.7
		- Loan/benefit from Close co	40.8; 40.9
		- Temporary non residence	11.12.2; 11.14.3
Associate	s.713(1) ITA	Transactions in securities	55.2.3
Associate	s.253 ITA	Enterprise investment scheme	*Not discussed*
Connected person	-	*Very widely used*	104.12
Associated co	*Various*	Small profits rate; Close co	104.17.1

The word "associate" has various definitions. So strictly one should not use the term without a definition; but the context may provide the definition and in this chapter the word is used in the s.448 sense.

The most important concepts in this list are associate (in the s.448 sense) and connected person. The definitions are similar but not the same. It may be that:

(1) A is connected with B but not an associate of B; or

(2) A is an associate of B but not connected with B.

I note the differences in the discussion below.

This section considers the definition of associate; the next section considers the associate-attribution rule; and the following section gives examples and discusses difficulties caused by the width of the definition.

[29] Lord Simonds made the point in *Bibby v IRC* 27 TC 167 at p.185: "I would reserve further consideration [for] the case of the so-called bare trustee. ...I should myself require a more satisfactory explanation than has yet been given of a term which, though it has statutory sanction, has never, I believe, received statutory definition."

[30] This list is not comprehensive.

104.6.2 *Definition of "associate"*

Section 448(1) CTA 2010 provides:

> In this Part [Part 10 CTA 2010, close companies] "associate", in relation to a person ("P"), means ...

There follows a set of seven categories of associate, as follows:

Type of associate	**s.448(1) para**	**See para**
Relatives	(a)	104.6.3
Partners	(a)	104.6.4
Trustees	(b)(c)(d)	104.6.6, 104.6.7
Companies	(e) (g)	104.6.8
Personal representatives	(f)	104.6.9

The definition refers to an associate *in relation to* P. The associate-attribution rule (and other rules) refer to an associate *of* a person ("P").[31] But nothing turns on the preposition: if X is an "associate in relation to P" then X is an "associate *of* P"; the expressions mean the same thing. But the latter expression is clearer, so that is the one I generally use.

Strictly one should not use the term "associate" in the abstract. An associate can exist only in relation to another person. But where the context is clear it is permissible to refer to "an associate" in isolation (meaning, an associate of P, but leaving the identity of P to be inferred).

104.6.3 *Associates: Relatives*

Section 448(1) CTA 2010 provides:

> In this Part [Part 10 CTA 2010, close companies] "associate", in relation to a person ("P"), means—
> (a) any relative ... of P

There are two distinct definitions of "relative" relevant for this chapter:
(1) The definition for "associate"
(2) The definition for "connected person"[32]

Strictly, one should not use the word "relative" without specifying which definition applies, but the context may make that clear.

Section 448(2) CTA 2010 defines relative for the purpose of "associate":

[31] Section 1069 CTA 2010 also refers to an associate *of* a participator.

[32] See 104.13.1 (Relative).

> In this section, "relative" means—
>
> (a) a spouse or civil partner,
> (b) a parent or remoter forebear,
> (c) a child or remoter issue, or
> (d) a brother or sister.[33]

The definition of "relative" for the connected person rule is wider. An individual is not an associate of the spouse of a sibling, etc, but the individual is connected with the spouse.[34]

104.6.4 *Associates: Partners*

Section 448(1) CTA 2010 provides:

> In this Part [Part 10 CTA 2010, close companies] "associate", in relation to a person ("P"), means—
>
> (a) any ... partner of P

The definition of connected person is slightly narrower, as (in short) it does not apply to commercial acquisitions/disposals of partnership assets.

104.6.5 *Trustees & settlor/relatives*

Section 448(1) CTA 2010 provides:

> In this Part [Part 10 CTA 2010, close companies] "associate", in relation to a person ("P"), means ...
>
> (b) the trustees of any settlement in relation to which P is a settlor,
> (c) the trustees of any settlement in relation to which any relative of P (living or dead) is or was a settlor

The definition of connected person is different in several ways. In particular:[35]

(1) After the death of a settlor: Trustees are associates of a relative of a deceased settlor, but the trustees are not connected with the relative. This is an important difference.

(2) "Settlement" here has the standard IT/CGT meaning. Contrast the definition of connected person where the word has the settlement-arrangement meaning.[36]

[33] For the meaning of these terms, see App 3.1 (Family terms: Introduction).

[34] See 104.13 (Connected: Family members).

[35] See 104.14 (Connected: Trustees).

[36] See 87.1 (Definitions of "settlement").

(3) The trustees are associates of the settlor, but the settlor is not an associate of the trustees.[37] Likewise, the trustees are associates of relatives of the settlor, but relatives of the settlor are not associates of the trustees.

A person may be a spouse at one time and not at another time. One must look at the position from time to time. Thus:

(1) If S is a settlor, the trustees are associates of the spouse of S; but if there is a divorce, the trustees cease to be associates of the (former) spouse under s.448(1)(c).[38]
(2) If S marries, then the trustees become associates of the spouse under s.448(1)(c).

The CT Manual provides:

> **CTM60170 trustees, executors, etc** [Dec 2021]
> [1] The trustee or trustees of any settlement to which (b) of CTM60150 applies[39] are associates of the participator and therefore any rights or powers which they possess as trustees of that settlement may be attributed to the participator.
> [2] This does not, however, apply to any rights or powers such trustees possess in other capacities, for example, in relation to shares owned by them personally or as trustees of other settlements of which neither the participator nor any of his or her relatives (living or dead) within (a)(ii) to (iv) of CTM60150 is or was the settlor.
> [3] You should note that the rights and powers of the settlor and his or her relatives may not be attributed to the settlement trustees under (b) of CTM60150, that is, this association is one way only.

Point [2] is right as trustees are deemed to be a separate person.

104.6.6 *Trustees and beneficiaries*

Section 448(1) CTA 2010 provides:

> In this Part [Part 10 CTA 2010, close companies] "associate", in relation to a person ("P"), means ...
> (d) if P has an interest in any shares or obligations of a company which are subject to any trust, the trustees of any settlement concerned

[37] See 104.6.7 (One-way association).

[38] But if P is a beneficiary, the trustees are associates of P under para (d).

[39] The reference is to s.448(1)(b).

If trustees hold shares or securities on trust for A for life, remainder to B, then the trustees are associates of A and B. The trustees are associates of any person entitled on the termination of the trust (the default beneficiary).

What if P is a beneficiary of a discretionary trust? The question is whether P has an "interest" in the company.[40] If so, the trustees are associates of P.

Trustees are not associates of P under s.448(1)(d) where P does not have an interest under the trust, even if P's relatives have an interest.[41]

There is no equivalent rule for connected persons, which is narrower on this point.

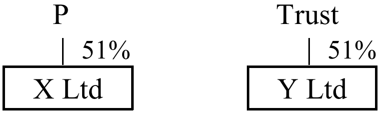
The CT Manual continues:

> **CTM60170 trustees, executors, etc** [Dec 2021]
>
> ...
>
> [1] Where (c) of CTM60150 applies,[42] a participator interested by virtue of the trust in shares or obligations of the company which are subject to the trust has as his or her associate only the trustee or trustees of that trust.
>
> [2] Any rights and powers they possess as trustees are deemed to belong to him or her but not any rights and powers they possess in any other capacity.
>
> [3] As with (b) of CTM60150 the association is one way only.[43]

The reason is the same as before. Point [2] is right as trustees are deemed to be a separate person. Point [3] is saying that the trustees are associates of the beneficiary, but the beneficiary is not an associate of the trustees.

104.6.7 *One-way association*

"Associate" is not a symmetrical relationship, that is to say, if A is an associate of B, it does not necessarily follow that B is an associate of A.[44] Suppose:



[40] See 104.23.4 (Trustees and beneficiaries).

[41] But if P (or a relative) is settlor, the trustees are associates of P under para (b) or (c).

[42] The text of CTM60150 seems to have changed, but the reference is to s.488(1)(d).

[43] See 104.6.5 (Trustees & settlor/relatives); 104.6.7 (One-way association).

[44] "Connected person" is different: see 104.12.4 (Reciprocity of connection).

Suppose the settlor of the trust is P or a relative of P:

(1) The trustees are associates of P. So P "controls" Y Ltd in the ultra-wide sense.

(2) P is not an associate of the trustees, so the trustees do not "control" X Ltd.

HMRC agree. See the Manual passages cited at 104.6.5 (Trustees & settlor/relatives) and 104.6.6 (Trustees and beneficiaries).

104.6.8 *Associates: Companies*

s.448(1)(e)	**s.448(1)(g)**
In this Part [Part 10 CTA 2010, close companies] "associate", in relation to a person ("P"), means ...	In this Part [Part 10 CTA 2010, close companies] "associate", in relation to a person ("P"), means ...
(e) if P—	(g) if P—
(i) is a company, and	(i) is a company, and
(ii) has an interest in any shares or obligations of a company which are subject to any trust,	(ii) has an interest in any shares or obligations of a company which are part of the estate of a deceased person,
any other company which has an interest in those shares or obligations	any other company which has an interest in those shares or obligations.

Section 448(1)(e) might apply if A Ltd is held on trust for X Ltd for a period, with remainder to Y Ltd, but it is not likely to arise in practice. Section 448(1)(g) is also a rare case.

If A controls a company, the company is connected with A, but the company is *not* an associate of A. For the purposes of the associate-attribution rule (discussed below), this rule makes no difference, as the associate-attribution rule attributes interests of controlled companies as well interests of associates. But it matters in other places where the term associate is used; for instance, the charge on benefits or loans from a close company, which applies if benefits or loans are conferred on a participator, or an associate.

104.6.9 *Personal representatives*

Section 448(1) CTA 2010 provides:

> In this Part "associate", in relation to a person ("P"), means ...

> (f) if P has an interest in any shares or obligations of a company which are part of the estate of a deceased person, the personal representatives of the deceased

There is no equivalent rule for connected persons, which is narrower on this point.

104.7 Associate-attribution rule

Section 451(4) CTA 2010 provides (for the purposes of the definition of control in the ultra-wide sense):

> There may also be attributed to a person all the rights and powers—
> (a) of any company of which the person has, or the person and associates of the person have, control,[45]
> (b) of any two or more companies within paragraph (a),
> (c) of any associate of the person, or
> (d) of any two or more associates of the person.[46]

In short, a person is treated as holding the rights of:
(1) their associates
(2) companies (not associates) which:
  (a) they control or
  (b) they and their associates control

I refer to this as the "**associate-attribution rule**". (This label is not ideal, as under the rule applies to controlled companies which are not associates; but no short label will neatly fit all the circumstances.)

Section 451(5) CTA 2010 provides (for the purposes of the definition of control in the ultra-wide sense):

> The rights and powers which may be attributed under subsection (4)—
> (a) include those attributed to a company or associate under subsection (3) [nominees], but
> (b) do not include those attributed to an associate under subsection (4).

One is not treated as holding the rights of an associate of an associate.

Section 451 uses the word "may". Section 451(6) CTA 2010 provides (for the purposes of the definition of control in the ultra-wide sense):

[45] Control here has the ultra-wide meaning: see s.450(1) CTA 2010 set out in 104.3.1 (Introduction).

[46] Para (b) and (d) must be otiose, but it does not matter.

> Such attributions are to be made under subsection (4) as will result in a company being treated as under the control of 5 or fewer participators if it can be so treated.

The point is that an attribution could have the result that a company is not a close company (because if the rights are attributed to the person, they are not attributed to the associate); in such a case the attribution is not to be made.

This rule does not apply for the purposes of the definition of participator (that is, the fact that A is an associate of a participator does not entail that A is a participator).

104.8 Ultra-wide control: Critique

In *R v IRC ex p. Newfields Developments*:

> [10] It will be seen that although this definition starts in subs (2) with a concept of control which reflects its meaning in ordinary speech ('a person shall be taken to have control of a company if he exercises, or is able to exercise or is entitled to acquire, direct or indirect control over the company's affairs'), that fairly simple notion is enormously widened by subsequent subsections. ...
> [11]… The effect of those cumulative definitions is that for the purpose of deciding whether a person 'shall be taken to have control of a company' under [what is now s.450], it may be necessary to attribute to him the rights and powers of persons over whom he may in real life have little or no power of control. Plainly the intention of the legislature was to spread the net very wide.[47]

The attribution rule - together with the wide definition of associates - is what makes the s.450 definition of control ultra-wide. It is so wide that the word "control" is not apt to describe the concept ("some loose association" would be nearer the mark). It is confusing to depart from statutory terminology, but where the ultra-wide sense of control is used, the actuality demands quotation marks. For instance:

(1) A has "control" of a company owned by a relative (say, a sister) even though A has no beneficial interest in the company, and, of course, A's knowledge of the company is limited to information in the public domain.
(2) A has "control" of a company owned by a trust of which a relative is

[47] 73 TC 532 at p.556.

a settlor, even though A is not a beneficiary and has no right to know that the trust had been made, or to know anything about the trust or its property. Indeed the relative need not be the settlor but only *a* settlor, so the rule would apply if (say) a sister provides a nominal amount of property to a trust.

(3) A partner has "control" of a company owned by a partnership even if it is an investment partnership with a large number of unconnected partners. The modern use of partnerships as a collective investment vehicle raises this problem, because investment partnerships have large numbers of partners,[48] and partners do not know who their fellow partners are.

Hold-over relief illustrates the problem. The relief applies on a gift of a business asset to a company. This rule formerly allowed (relatively) straightforward avoidance by a gift to a company held by a non-resident trust. To counter this, s.167 TCGA provides (so far as relevant):

> (1) [Hold-over relief] shall not apply where the transferee is a company which is within subsection (2) below.
> (2) A company is within this subsection if it is controlled by a person who, or by persons each of whom—
> (a) is not resident in the UK, and
> (b) is connected with the person making the disposal.

It is sensible that the relief should not apply on a gift to, say, a company owned by a non-resident. But the effect of the ultra-wide definition of control is that the relief is disapplied where there is any person in existence who:

(1) is an associate of the person
(2) is connected with the person and
(3) is non-resident

Such a person would "control" the company (because the powers of the associate are attributed to them). This arose in *Reeves v HMRC*[49] where the taxpayer made a gift to a company which he owned. The disponor had

[48] In 2014 there were 500 partnerships which filed an SA800 return and had more than 50 partners; some have more than 1,000 partners (unfortunately HMRC software did cope with more than 999) and, anecdotally, one had more than 20,000 partners; data from OTS "Review of partnerships: interim report" (2014) para 5.25 and appendix A. *https://www.gov.uk/government/publications/partnerships-review*

[49] [2018] UKUT 293 (TCC).

a wife and children who were not UK resident. Each of them "controlled" the company (in the ultra-wide sense) as the taxpayer was their associate, and his powers were attributed to them. So the relief was disapplied under s.167. Had the taxpayer been single, that is, unmarried and childless, the relief would have applied. How absurd is that? In this case, the UT somehow amended the provision under the guise of purposive construction. The reader may prefer the reasoning of the FTT, and suspect this will be a case more often cited than followed.

The vast extent of the ultra-wide definition of control has three noteworthy consequences.

The first is practical: it is not possible for a person to know whether they control a company, or to draw up a list of all companies which they control. In practice there is substantial innocent non-compliance, and selective or arbitrary enforcement, where HMRC sufficiently dislike a taxpayer to make enquiries not normally made.

The second point is presentational, but presentation is important: anti-avoidance provisions which refer to control appear to the non-tax specialist to be reasonable because control seems a sensible limiting factor; but they operate unreasonably widely (because the meaning of *control* is so wide).

Thirdly, this leads to complexity. On occasions, where the difficulty caused by the extravagant definition has been recognised, the definition of control[50] is restricted.[51] However this is done on a piecemeal basis, typically where taxpayer lobbying has for some reason given rise to government action. So the result is a complexity which would not arise if a more restrained definition of control had been adopted in the first

[50] or some concept in which the word control is used, such as associate or connected person.

[51] For instance, ss.27, 29, 30 CTA 2010. Section 27 CTA 2010 provides:

> "(2) In the application of section 451 (meaning of 'control': rights to be attributed) for the purposes of the determination, the references in section 451(4) and (5) to an associate of a person ("P") include a partner of the person only if the condition in subsection (3) below is met.
>
> (3) The condition is that tax planning arrangements which—
>
> (a) involve P and the partner, and
>
> (b) secure a relevant tax advantage,
>
> have at any time had effect in relation to the taxpayer company."

For other examples, see 60.4.2 ("Control" and "participator"); 72.10.3 (20% rule: HMRC practice); 129.8.2 ("Connected").

place.

The same difficulties apply to provisions using the term "connected person" (since that term uses the concept of "control" in the ultra-wide sense). It will in practice be impossible for a person to identify all persons who are "connected" with them. One individual might easily have 500 persons connected with them. If one could write a full list, it would vary continuously. Even an attempt to enquire would be grossly intrusive.

The point was made in responses to a consultation on the substantial donor rules:

> charities described the connected persons rule as an "impossible requirement", a "substantial administrative burden" and a "compliance nightmare".[52]

There was nothing particularly unusual in the substantial donor rules, except, perhaps, that the charities who responded to the consultation felt a greater obligation than most taxpayers to seek to comply with the law. This difficulty applies generally to the use of the concepts of control and connected persons. But there it is. HMRC's priority in anti-avoidance legislation is not to produce legislation with which everyone can comply: it is to produce legislation which catches everyone they wish to catch.[53]

104.9 Control: Strict sense

This section considers the concept which I call strict-sense control.[54] The definition is found in (at least) three places:

Definition (my terminology)	**Section**
IT/CT definition	s.995 ITA/1124 CTA 2010
Loan relationships definition	s.472 CTA 2009

s.995(1) ITA	**s.1124 CTA 2010**	**s.472 CTA 2009**
This section has effect for the purposes of the provisions of the Income Tax Acts which apply	This section has effect for the purposes of the provisions of the Corporation Tax Acts	This section has effect for the purposes of any provisions of this Part [Part 5, Loan

[52] HMRC, Substantial Donors to Charity Consultation Responses Document (2009), para 3.12, [2009] STI 65.

[53] Thus the definition of connected person in the tainted donation rules (which replaced the short-lived substantial donor rules) is even wider than the standard ultra-wide definition! See s.809ZQ ITA.

[54] See 104.2.2 (Definitions of "control").

this section.	which apply this section (or to which this section is applied).	Relationships] which apply this section (but this does not affect the application of section 1316(2) (meaning of “control”) for other purposes of this Part).

This is misleading as the IT/CT definition (in s.995/1124) is the default definition of control in the IT and CT Acts.[55] But it does not matter. The definition is as follows:

s.995(2) ITA/1124(2) CTA 2010 **IT/CT definition**	**s.472(2) CTA 2009** **Loan relationships definition**
In relation to a body corporate (“company A”), “control” means the power of a person (“P”) to secure—	For those purposes “control”, in relation to a company, means
	the power of a person to secure that the affairs of the company are conducted in accordance with the person's wishes—
(a) by means of the holding of shares or the possession of voting power in relation to that or any other body corporate, or	(a) by means of the holding of shares or the possession of voting power in or in relation to the company or any other company, or
(b) as a result of any powers conferred by the articles of association or other document regulating that or any other body corporate,	(b) as a result of any powers conferred by the articles of association or other document regulating the company or any other company.
that the affairs of company A are conducted in accordance with P’s wishes.	

The definitions are (more or less) identical, except that:

(1) The Loan Relationships definition refers to company rather than body

[55] See 104.2.3 (Default meaning of control).

corporate.[56]

(2) The Loan Relationships definition has further provisions relating to trading shares and partnerships, which I do not discuss here.

So cases on the Loan Relationships definition are relevant to the IT/CT definition.

104.9.1 *Boardroom control*

The CT Manual provides:

> **CTM80175: Groups: group relief: arrangements, effect** 2 [Jun 2016]
> ... **Control at various levels**
> The ability to secure that the affairs of the company are conducted in accordance with a persons wishes includes consideration of how the business of the company as managed by its Board. Usually shareholders cannot dictate to or overrule the Board on management matters entrusted to the Board. So a necessary element of control is the ability to determine the composition of the Board, or failing that, to appoint directors who have the power to impose their decisions on directors appointed by any other shareholder.
> The voting rights shareholders can exercise in general meetings will normally include the right to vote on the appointment and removal of directors. However, it is not safe to assume that possession of the majority of voting rights will bring automatic control of the Board. In *Irving v Tesco Stores (Holdings) Ltd* 58 TC 1, the claimant did not have Boardroom control of the surrendering company because:
> - more than half of the directors were to be appointed by the minority shareholder and could not be removed without his consent, and
> - the directors appointed by the claimant could not impose their decision on the directors appointed by the minority shareholder.

The Employee Tax Advantaged Share Scheme User Manual provides:

> **ETASSUM43140 Control of the scheme company** [Mar 2022]
> ... [The Manual refers to the definition of control in the strict sense, and continues:]
> Control will not necessarily be obtained simply because of the size of a share holding in the scheme company. Shareholders cannot ordinarily dictate to or overrule the Board of Directors in respect of matters of management entrusted to them. So a necessary element of control is (by

[56] See 90.9 (Body corporate).

> voting powers or other powers) to have economic control of the company and the power of a person to secure that the affairs of the company are conducted in accordance with their long term wishes. The ability to determine the composition of the Board, or failing that, to appoint directors who have the power to impose their decisions on directors appointed by any other shareholder are indicators of control.
>
> ...

The Corporate Finance Manual provides:

> **CFM35120. What is control?** [Aug 2018]
>
> ***Meaning of Control***
>
> Section 472 CTA 2009 gives the meaning of control.[57] The test is whether a person can 'secure that the company's affairs are conducted in accordance with his wishes'. A person (an individual or company) can do this by
>
> - holding most of the shares, or
> - holding most of the voting rights in the company (or another company, such as the ultimate parent), or
> - through any other powers, given through any document (such as the company's Memorandum and Articles of Association).
>
> ***Control through shares***
>
> A majority shareholding will usually ensure control, unless different classes of shares carry different voting rights. Share held on trading account and their voting rights are ignored for this purpose.
>
> ***Control through voting rights: example***
>
> MK Ltd's issued share capital is made up of
>
> - 1,000 ordinary shares, carrying one vote each
> - 2,000 'A' ordinary shares with no voting rights.
>
> KB Ltd owns 800 ordinary shares.
>
> JR Ltd owns 200 ordinary shares and 2,000 'A' ordinary shares.
>
> Although JR Ltd has the majority of the issued shares, KB Ltd has control because it has the majority of the shares with voting rights, and can therefore use those voting rights to ensure that MK Ltd acts according to its wishes.
>
> ***Control through other powers: example***
>
> AV Ltd owns 40% of the shares of BK Ltd, but it has the power, through BK Ltd's Articles, to appoint more than half of BK Ltd's board of directors. These directors will manage the business according to AV Ltd's wishes, so AV Ltd has control...

[57] Author's footnote: This definition is based on the definition of control in the strict sense.

The decision in *Tesco* - that strict-sense control refers to boardroom control - was approved in *Farnborough Airport v HMRC.*[58]

It follows that shareholders do not have strict-sense control after a receiver is appointed. They still have power to appoint directors, but that does not confer boardroom control, as the authority of the directors to carry out the business of the company is suspended.[59]

See too 8.7 (Control: company law background); 104.3.5 (Partial control).

104.9.2 *Joint control*

Two shareholder who together hold a majority of the shares may have joint control. In *Keighley v HMRC*:[60]

> Nor do we agree ... that the statutory test can be supplemented by a rule of thumb that the persons need to act "as one". We need to consider the statutory test. We ask ourselves whether the rights attaching to the shares, the articles, or the shareholders agreement (which in our view falls within the ambit of another document regulating the company) give [the two shareholders] the power to secure that the affairs of the company are conducted in accordance with their wishes.
>
> We also accept the argument that person for these purposes can be persons by dint of the Interpretation Act.

104.9.3 *Power to obtain control*

In *Farnborough,* although the shareholders lost strict-sense control on appointment of a receiver, they could at any time pay off the debt so that the receiver would cease to act. They were able (at a cost) to re-acquire control. That made no difference:

> 77. We can see that if this argument were correct, it would give rise to immense scope for avoidance of what we consider to be the clear purpose of these provisions. It would allow for the creation of structures in which control of a company would for all practical purposes be lost but could be retained for group relief purposes by the inclusion of artificial provisions in appropriate terms allowing for control to be "regained" at some future date. We do not consider such an

[58] [2019] EWCA 118 at [30]. See Howard, "Remote Control" Taxation Practitioner, Sep 2011 p.45.

[59] *Farnborough Airport v HMRC* [2019] EWCA 118.

[60] [2024] UKFTT 30 (TC) at [113] ff.

> interpretation of the provisions would be consistent with their overall purpose and we therefore reject it.

The difficulty with this purposive argument is that strict-sense control applies not only in the context of group relief, but in many other contexts, so there should be no scope for purposive construction based on what suits the group relief rules. But the conclusion could be justified without the purposive argument. The definition of strict-sense control (unlike control in the ultra-wide sense) does not have any provision about the ability to secure control.

The non-tax case *R v Radio Authority ex p. Guardian Media Group*[61] concerned statutory wording equivalent to strict-sense control. The parties entered into an arrangement with the intention that

(1) Company A should not have strict-sense control of company B; but
(2) A should have the ability to acquire control of B by use of put and call options.

The judgement discussed the expression "able to secure" without coming up with any clear answers, but it favoured the view that A did not have strict-sense control.

104.9.4 *Governing documents*

The power of control must arise:

> (a) by means of the holding of shares or the possession of voting power in relation to that or any other body corporate, or
> (b) as a result of any powers conferred by the articles of association or other document regulating that or any other body corporate ...

De facto control is not enough.[62] Legal power of control is not enough, unless it arises from matters within (a) or documents within (b). Thus directors by definition have boardroom control, but they do not necessarily have strict-sense control.

Farnborough Airport Properties v HMRC comments on what documents fall within (b):

> It is clear from the syntax that the words "regulating that or any other

[61] [1995] 1 WLR 334.

[62] This is self-evident, but if authority is needed, see *Keighley v HMRC* [2024] UKFTT 30 (TC) at [107].

> body corporate" refer back both to 'the articles of association" and to the 'other document' contemplated in section 1124(2)(b) [CTA 2010 = s.995(2)(b) ITA], and accordingly the type of regulation being referred to must be similar in relation to both. Therefore, the phrase 'other document regulating that or any other body corporate' when read in context must, in our view, refer to a constitutional document akin to articles of association (i.e. one which sets out the governance arrangements for a body corporate which is binding upon members and officers by virtue of their status as such, without the need for them to agree separately to its terms). We infer that in referring to "other document", the draftsman had mainly in mind the constitutional documents governing "non-standard" types of body corporate (e.g. companies incorporated overseas or bodies established by Royal Charter, where the legal terminology often does not include the phrase "articles of association").[63]

In *Farnborough Airport Properties v HMRC* the first-tier tribunal held that a receiver had power to secure that the affairs of the company were conducted in accordance with its wishes.[64] But even so, the receiver did not have control in the strict sense, according to the Upper Tribunal, because the debenture under which the receiver was appointed was not a "document regulating" the company. The issue did not arise in the CA. I do find that surprising, but the law is settled below the level of the CoA. The question may not often arise.

104.10 Strict-sense control: Trusts

104.10.1 *Trustee in personal capacity*

Trustees are generally treated as a separate notional person.[65] So an individual (or company) who is a trustee, even sole trustee, does not have control of a company owned by the trust, in their personal capacity, in any sense of control; only the trustees (the separate, notional trustee-person) can have control.

Cases from before the notional person rule was introduced are not now

[63] *Farnborough Airport Properties v HMRC* [2017] UKUT 394 (TCC) at [57].

[64] This point was left open at the UT appeal. In the CoA the issue did not arise and was not discussed. But the wide powers normally exercisable by a receiver clearly constitute boardroom control.

[65] See 7.3 (Trustees a distinct person).

relevant on this point.[66]

104.10.2 *Trustee as notional person*

Trustees of a substantive trust are constrained by fiduciary duties, for instance, they may be unable to remunerate themselves as directors. These matters do not prevent trustees from having strict-sense control of a company held by the trust.[67]

On the other hand, a person with power to appoint trustees does not have strict-sense control of a company held by a trust, as they cannot require the trustees to act in accordance with their wishes. The same applies to a person with power to appoint directors of a corporate trustee.

104.11 Control of partnership

Although there are two principal definitions for control of companies (ultra-wide and strict-sense), there is only one definition of control of partnerships, which one may therefore call the standard definition.

Section 995(3) ITA provides:

> In relation to a partnership, "control" means the right to a share of more than half the assets, or of more than half the income, of the partnership.

That might be regarded as a slightly artificial definition, as it has nothing to do with control in the natural sense, but it is precise.

104.12 Connected person

There are separate definitions for the separate taxes. There are more

[66] For completeness: In *IRC v Lithgows* 39 TC 270, an individual (Sir Andrew Macharg, a leading Scottish accountant) was one of four trustees of a trust. The trust held a company whose shares were registered in the names of the trustees. Sir Andrew was the first named on the share register. HMRC argued that Sir Andrew personally controlled the company. The court rejected that argument. Although his was the only vote counted by the company, see (what is now) s.286 Companies Act 2006, Sir Andrew was only one of the trustees, and had to use his vote in accordance with the direction of the trustee majority, regardless of his own wishes.

In *Bibby v IRC*, the trustees were directors; it was held that the trustees jointly had a "controlling interest" (the term was not defined).

[67] This is almost self-evident; but if authority is needed, see *Bibby v IRC* 27 TC 167 which held that trustees of a substantive settlement may have a "controlling interest" (the term was not defined): the fact that they were trustees was not relevant.

definitions elsewhere, sometimes the same and sometimes different. However the IT/CT/CGT definition(s) considered in this chapter may be considered to represent a single and (more or less) standard definition.

It is a pity that the Tax Law Rewrite did not tidy up this mess; but there it is. The following table may assist navigation:

Tax	**Definition**	**Applied by**
CGT	s.286 TCGA	-
IT	s.993/994 ITA	s.989 ITA
CT	s.1122(1) CTA 2010	s.1316 CTA 2009; s.1176(1) CTA 2010
IHT	s.270 IHTA	-

SDLT does not have a default definition of "connected person", but where the word is used, the CT definition is incorporated by reference.[68]

104.12.1 *Connected: IT/CGT/CT*

s.286 TCGA	**s.989 ITA**	**s.1122(1) CTA 2010**
Any question whether a person is connected with another shall for the purposes of this Act be determined in accordance with the following subsections of this section ...	The following definitions apply for the purposes of the Income Tax Acts— "connected", in relation to two persons being connected with one another, is to be read in accordance with sections 993 and 994.[69]	This section has effect for the purposes of the provisions of the Corporation Tax Acts which apply this section (or to which this section is applied).

The CGT and IT definitions are (almost[70]) the same, but the ITA drafting in some respects improves on the TCGA.

[68] Eg, s 53 and s.108 FA 2003

[69] For completeness: The point is sometimes repeated elsewhere:

s.1021(1) ITA	**s.718 ITEPA**	**s.878(5) ITTOIA**
Section 993 (meaning of "connected" persons) applies for the purposes of this Act unless otherwise indicated	Section 993 of ITA 2007 (how to tell whether persons are connected) applies for the purposes of this Act.	Section 993 of ITA 2007 (how to tell whether persons are connected) applies for the purposes of this Act unless otherwise indicated (whether expressly or by implication).

This is not strictly necessary, but either for historical reasons or in accordance with a Plain English penchant for signposts.

[70] See 104.18 (Connected: Partners).

For CT, at first sight it seems s.1122(1) CTA 2010 applies for limited, specified CTA purposes. But s.1176(1) CTA 2010 provides:

> Section 1122 (how to tell whether persons are connected) applies for the purposes of this Act unless otherwise indicated (whether expressly or by implication).

Section 1316 CTA 2009 is identical. Thus the CT s.1122 definition applies for the whole of the CTAs 2009 and 2010 unless disapplied. It could have been drafted more neatly.

The statutory expression is connected *with*, not connected *to.* Nothing should turn on the choice of preposition, but when using the term in the statutory sense it is better to follow the statutory language.

104.12.2 *Connected: IHT definition*

For IHT, s.270 IHTA provides:

> For the purposes of this Act any question whether a person is connected with another shall be determined as, for the purposes of the 1992 Act it falls to be determined under section 286 of that Act, but as if in that section
> [a] ‘relative’ included uncle, aunt, nephew and niece and
> [b] ‘settlement’, ‘settlor’ and ‘trustee’ had the same meanings as in this Act.

Thus IHT adopts the CGT definition of “connected person” with a little tweaking.

104.12.3 *Definition in outline*

The definition of connected person is set out in five parts:

(1) Family members
(2) Trustees
(3) Companies held by trusts
(4) Partnerships
(5) Companies generally

104.12.4 *Reciprocity of connection*

s.286(1) TCGA	**s.994(4) ITA/s.1123(4)CTA 2010**
... (any provision that one person is connected with another being taken	If any provision of section 993 provides that a person (“A”) is connected with

to mean that they are connected with one another)..	another person ("B"), it also follows that B is connected with A**.**

The meaning is that "connected" is a symmetrical relationship: if A is connected with B, then B is connected with A.

104.13 Connected: Family members

s. 286(2) TCGA	**s. 993(2) ITA/s.1122(5) CTA 2010**
A person is connected with an individual if that person is	An individual ("A") is connected with another individual ("B") if—
[a] the individual's spouse or civil partner,	(a) A is B's spouse or civil partner,
[b] or is a relative,	(b) A is a relative of B,
[c] or the spouse or civil partner of a relative,	(c) A is the spouse or civil partner of a relative of B,
[i] of the individual, or	(d) A is a relative of B's spouse or civil partner, or
[ii] of the individual's spouse or civil partner.	(e) A is the spouse or civil partner of a relative of B's spouse or civil partner.

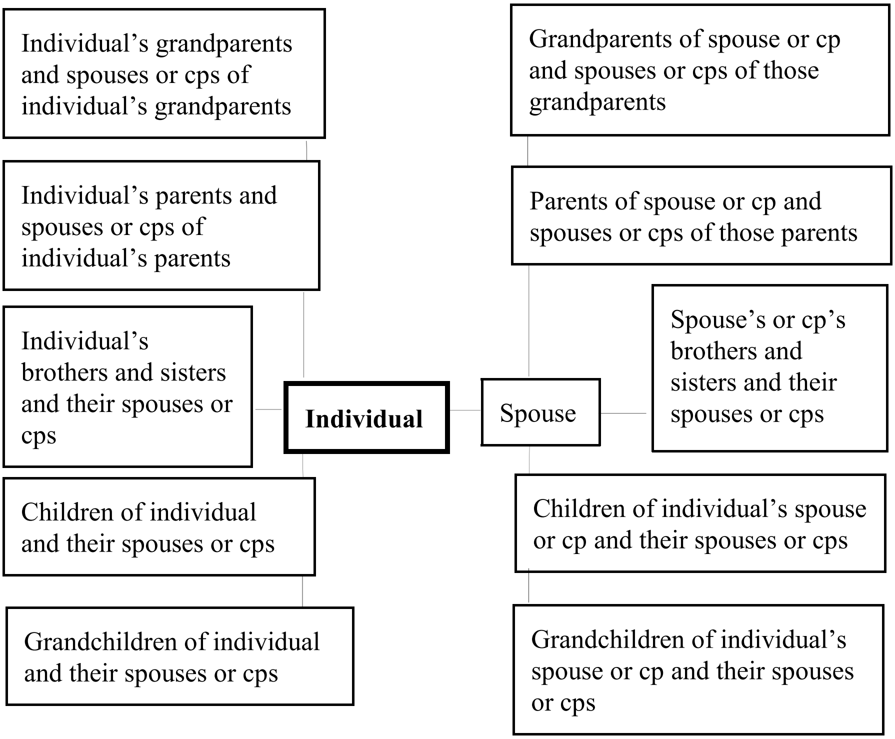
104.13.1 *Relative*

s. 286(8) TCGA	**s.994(1) ITA/s.1123(1) CTA 2010**
In this section	In [s.993 ITA/s.1122 CTA 2010] and this section–
"relative" means brother, sister, ancestor or lineal descendant.	"relative" means brother, sister, ancestor or lineal descendant,

The CG Manual provides:

> **CG14580. Connected persons** [Mar 2017]
> ... The term 'relative' does not cover all family relationships. In particular, it does not include nephews, nieces, uncles and aunts.
> **14580. Connected persons** [Mar 2017]
> The following diagram illustrates the provisions of Section 286(2) TCGA 1992. All of the people in the diagram are connected with the individual. They are not all connected with each other[71]

[71] In this diagram "spouse" includes civil partner.


Individual's grandparents and spouses or cps of individual's grandparents
Individual's parents and spouses or cps of individual's parents
Individual's brothers and sisters and their spouses or cps
Individual
Children of individual and their spouses or cps
Grandchildren of individual and their spouses or cps
Grandparents of spouse or cp and spouses or cps of those grandparents
Parents of spouse or cp and spouses or cps of those parents
Spouse
Spouse's or cp's brothers and sisters and their spouses or cps
Children of individual's spouse or cp and their spouses or cps
Grandchildren of individual's spouse or cp and their spouses or cps

All the persons in the diagram are connected with the individual. Excluded are the widows or widowers, or surviving civil partners, of deceased persons, or relatives of a deceased spouse or of a deceased civil partner unless connection can be established by a route not involving the deceased. A dissolution of a civil partnership or a divorce can similarly lead to persons in addition to the former civil partner or spouse ceasing to be connected with the individual.

Readers are invited to speculate whether this diagram is or is not a useful aid to comprehension.

In the definition of connected person for IHT, "relative" also includes an aunt, uncle, nephew and niece.[72] A two dimensional diagram could not do justice to that.

104.14 Connected: Trustees

104.14.1 *Settlor/connected persons*

s.286(3) TCGA	**s.993(3) ITA/s.1122(6) CTA 2010**
A person, in his capacity as trustee of a settlement, is connected with–	A person, in the capacity as trustee of a settlement, is connected with–

[72] See 104.12.2 (Connected: IHT definition).

(a) any individual who in relation to the settlement is a settlor,	(a) any individual who is a settlor in relation to the settlement,
(b) any person who is connected with such an individual ...	(b) any person connected with such an individual

A trustee is not connected with a corporate settlor, because the word used is "individual"; but that does not often arise.

The CG Manual provides:

> **CG14590. Connected persons: Trustees** [Jul 2019]
> ... The trustees are no longer connected to the persons connected to the settlor after the settlor has died.

More accurately, trustees are not connected with family or other individuals who would have been connected with the settlor when the settlor was alive.[73]

The CG Manual continues:

> A settlor is considered to be connected with the trustee at the moment when property is put into the settlement.

Thus if an individual gives property to a trust, a loss arising on the disposal is a clogged loss[74] even if the individual was not a settlor before the gift was made. That view is supported by the context.

The CG Manual continues:

> For the purposes of determining whether a trustee is connected with an individual, the identity of the trustee is irrelevant. So, for example, if the trustee is the spouse or civil partner of the individual, he or she is only connected in his or her capacity as trustee if the case is within one of the three cases in CG14590.

This is correct since trustees are regarded as a notional person distinct from the persons who are actually the trustees.

The CG Manual continues:

[73] The FTT took this view in *Harris v HMRC* [2010] UKFTT 385 (TC) at [33]: "Section 839(3)(b) [ICTA] is expressed in the present tense, and s 839(3)(a) requires the settler at the relevant time to be an individual who *is* the settlor. None of this is apt to include a deceased settlor." In s.993 ITA, the Tax Law Rewrite deleted the second *is*, but that makes no difference.
Contrast the definition of associates; see 104.6 (Associates).

[74] See 65.9 (Loss on connected person disposal).

> Although under the tests outlined an individual is not connected with particular trustees, this may not prevent him or her from being connected with a company controlled by the trustees.

This is correct: see 104.15 (Connected: company). The Manual continues:

> Under s.454 CTA, a beneficiary of a trust can be attributed with the rights and powers of trustees. In such circumstances he or she may control the company through the tests in s.450 CTA and hence be connected under s.286 TCGA.

There is no general rule that the rights of trustees are attributed to beneficiaries. However the attribution will often be made on the grounds that beneficiaries are relatives of the settlor[75] or (sometimes) that beneficiaries possess rights to income or capital.[76]

For the position if trusts own companies, see 104.20.5 (Two trusts each own company).

For completeness: s.286(3)(d)(e) TCGA deals with sub-fund settlements.[77] But since the sub-fund regime is dead-letter law (hardly ever found in practice) the point does not matter.[78]

104.14.2 *"Settlement"/"trustee"*

s.286(3ZA) TCGA	**s.994(1) ITA/s.1123(1) CTA 2010**
For the purpose of subsection (3) above– (a)"settlement" has the same meaning as in section 620 of ITTOIA 2005	In [s.993 ITA/s.1122 CTA 2010] and this section– "settlement" has the same meaning as in Chapter 5 of Part 5 of ITTOIA 2005 (see section 620 of that Act)

I refer to this as the "settlement-arrangement definition".[79]

Why is this definition applied here? (Contrast the definition of associate.)

Perhaps non-corporate employers complained that a transfer by them to a pension fund was (before 2006) a connected person transaction, whereas

[75] See 104.7 (Associate-attribution rule).

[76] See 104.3.9 (Income: Para (c) control); 104.3.10 (Assets: Para (d) control).

[77] "(d) if the settlement is the principal settlement in relation to one or more sub-fund settlements, the trustees of the sub-fund settlements, and
(e) if the settlement is a sub-fund settlement in relation to a principal settlement, the trustees of any other sub-fund settlements in relation to the principal settlement."

[78] See 63.2 (Sub-Fund regime).

[79] See 87.4 (Settlement-arrangement definition).

a transfer by a company to a pension fund was not. Now a transfer to a pension fund is not a connected person transaction, as the transferor is not in principle connected with the trustees of a pension trust.[80] But that is speculation as no reason was ever provided.

Before 2006, the settlement-arrangement definition applied for IT but not for CGT. Perhaps the reason for the CGT change might have been that the same rule should apply for both taxes. Of course an alternative would have been to bring IT in line with CGT. Had a reason for the change been given, the issues could have been discussed. But there it is.

A consequence is that will trusts are not settlements for the purposes of the connected persons rules, which is odd.[81] It does not matter for s.286(3)(a)(b) (settlor/settlor-connected persons) because that rule only applies when the settlor is alive. But it matters for s.286(3)(c) (company connected with trust participator).

Section 286(3ZA)(b) TCGA/s.994(3) ITA/s.1123(3) CTA 2010 provide the standard deemed-trustee rule to deal with the situation where the settlement-arrangement is not a classic trust, and does not otherwise have trustees.[82] Though in practice that problem will rarely arise.

There is no definition of settlor. Since settlement has the settlement-arrangement definition, it is considered that settlor should also have the settlement-arrangement definition.[83] But the point will not often arise.

For the definition of connected person for IHT, settlement (and the associated terms settlor/trustee) have their IHT meanings: s.270 IHTA.

104.15 Connected: Company

104.15.1 *Outline*

In outline:

Connection	**See para**
A *person* (individual/co/trust/PRs) may be connected with a co	
1 person has control	104.15.3
Connected persons have control	104.15.4
Persons act together to exercise control	104.15.8

[80] See 99.39.1 (Is pension/EBT a settlement).

[81] See 88.8.1 (Is estate a "settlement" for s.87). For completeness: This was overlooked in a passing comment in *Harris v HMRC* [2010] UKFTT 385 at [32] where the relevant authorities were not cited.

[82] See 87.8.2 (Non-classic trust: Deemed trustee).

[83] See 99.2 (Definitions of "settlor").

A *company* may be connected with another company	
One person has control of both companies	104.15.5
Connected persons have control of both companies	104.15.6
One group of persons has control of both companies	104.15.7

A *trust* may be connected with a company	
Close company in which the trust has an interest	104.16
Subsidiary of such a company	104.16

These rules overlap, so there may be more than one reason why a person is connected with a company, but that does not matter.

For completeness: the standard IT/CT definitions of company are disapplied for the purposes of the definition of connected person in s.993/994 ITA & 1122/1123 CTA 2010.[84] Instead, s.994 ITA/s.1123 CTA 2010 provide their own definition of company, in terms equivalent to the CGT definition of company.[85] But since all these definitions are (almost) the same, this makes (almost) no difference.[86]

104.15.2 *"Control" test*

s. 288(1) TCGA	**s.994(1) ITA/s.1123(1) CTA 2010**
In this Act, unless the context otherwise requires... "control" shall be construed in accordance with sections 450 and 451 of CTA 2010	In [s.993 ITA/s.1122 CTA 2010] and this section ... "control" is to be read in accordance with sections 450 and 451 of CTA 2010 (except where otherwise indicated)

"Control" in the connected person test is generally used in the ultra-wide sense. The words in brackets allude to two minor exceptions:

(1) In the phrase "acting together to secure or exercise control", the context shows that control is used in a natural sense.

[84] See 90.8 (Definition of "company").

[85] Section 994 ITA/s.1123 CTA 2010 provide:

> "(1) In section 993/1122 and this section ... 'company' includes any body corporate or unincorporated association, but does not include a partnership (and see also subsection (2)).
>
> (2) For the purposes of section 993/1122—
>
> (a) a unit trust scheme is treated as if it were a company, and
>
> (b) the rights of the unit holders are treated as if they were shares in the company."

[86] The only difference concerns the specialist topic of local authorities; see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 45.8.1 (Group relief) online version *https://www.taxationofcharities.co.uk*

(2) In the (relatively unimportant) context of s.993(3)(e)[87] the word control is used in the strict sense.

For this reason the concept of being connected with a company is ultra-wide, and no-one could draw a complete list of all the companies with which they are connected.

104.15.3 *Person controls company*

s. 286(6) TCGA	**s. 993 (6) ITA/s.1122(3) CTA 2010**
A company is connected with another person, if	A company is connected with another person ("A") if—
[a] that person has control of it ...	(a) A has control of the company

Since control is ultra-wide, this head of connection is also ultra-wide. See 104.20.2 (Two persons each own co).

104.15.4 *Connected persons control co*

s. 286(6) TCGA	**s. 993 (6) ITA/s.1122(3) CTA 2010**
A company is connected with another person, if...	A company is connected with another person ("A") if—
[b] if that person and persons connected with him together have control of it.	(b) A together with persons connected with A have control of the company.

If two persons ("X" and "Y") are associates, this is not needed because the rights of X are attributed to Y.[88] For instance, suppose:
(1) X and Y are relatives or partners.
(2) X and Y each own 30% of A Ltd.

X "controls" A Ltd so this provision is not needed. It is only relevant in a case where two persons are connected but not associates.
Suppose:
(1) A and B are connected persons but not associates.
(2) B controls X Ltd and A has no interest in X Ltd.

It is considered that A is connected with X Ltd. It might be argued that A

[87] See 104.16 (Company connected with trust).

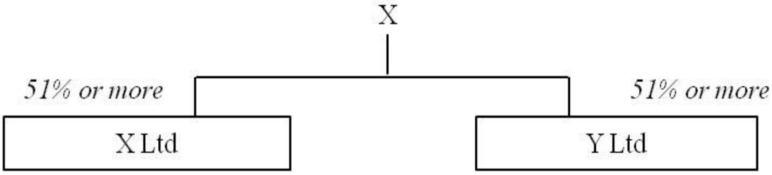
[88] See 104.7 (Associate-attribution rule).

and B do not *together* have control, but various anomalies would arise, and that is reading too much into the word *together*.

104.15.5 *One person controls 2 co's*

s. 286(5)(a) TCGA	**s. 993 (5) ITA/s.1122(2) CTA 2010**
A company is connected with another company	A company is connected with another company if–
(a) if the same person has control of both...	(a) the same person has control of both companies,

A simple case is if one person owns two companies:



X Ltd is connected with Y Ltd.

104.15.6 *Connected persons control 2 companies*

s. 286(5)(a) TCGA	**s. 993 (5) ITA/s.1122(2) CTA 2010**
A company is connected with another company	A company is connected with another company if–
(a) if .. [i] a person has control of one and [ii] [A] persons connected with him, or [B] he and persons connected with him, have control of the other	(b) a person ("A") has control of one company and persons connected with A have control of the other company,

If two persons ("X" and "Y") are associates, this is not needed because:

(1) the rights of X are attributed to Y,[89] so
(2) Y"controls" the company, so
(3) Y is connected with the company.

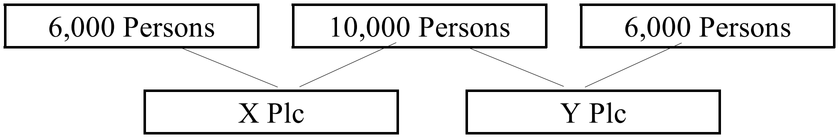
The rule is relevant in a case where two persons are connected but not associates.

[89] See 104.7 (Associate-attribution rule).

104.15.7 *Group controls 2 companies*

s. 286(5)(b) TCGA	**s. 993 (5) ITA/s.1122(2) CTA 2010**
A company is connected with another company...	A company is connected with another company if–
(b) if [i] a group of 2 or more persons has control of each company, and [ii] the groups either [A] consist of the same persons or [B] could be regarded as consisting of the same persons by treating (in one or more cases) a member of either group as replaced by a person with whom he is connected.	(d) a group of two or more persons has control of both companies and the groups either consist of the same persons or could be so regarded if (in one or more cases) a member of either group were replaced by a person with whom the member is connected.

The group may be vast and does not need any common purpose or identity. In *Kellogg Brown v HMRC*[90] two quoted companies each with over 16,000 shareholders were connected since there was sufficient overlap between the two groups.



X Plc and Y Plc are connected. The reader may think this a somewhat unimaginative construction of this head.

104.15.8 *Acting together to control*

s. 286(7) TCGA	**s. 993 (7) ITA/s.1122(2) CTA 2010**
Any 2 or more persons acting together to secure or exercise control of a company shall be treated in relation to that company as connected	In relation to a company, any two or more persons acting together to secure or exercise control of the company are connected with—
[i] with one another and	(a) one another, and
[ii] with any person acting on the directions of any of them to secure or exercise control of the company.	(b) any person acting on the directions of any of them to secure or exercise control of the company.

[90] *Kellogg Brown & Root Holdings (UK) v HMRC* [2010] EWCA Civ 118.

I refer to this as the **"acting-together rule"**. The CGT rule is narrower than the IT/CT rule as it only applies "in relation to the company".

The fact that persons are acting together, and so become connected with each other, may have the consequence that they become connected with the company.

For the purposes of discussion I abbreviate "secure or exercise control" to "control".

The CG Manual comments on the phrase "acting together to control":

> **CG14622 2 or more persons acting together to control** [Jul 2019]
> ... For this subsection to operate it is not sufficient for the persons to have control of the company, the persons do have to act in some way to control the company. However, for example, exercising control could mean refraining from voting in a particular way and so enabling another person to win a vote, as well as by actually voting.

In *Steele v EVC International* one issue was whether two joint shareholders were "acting together". The CoA said:[91]

> the mere coincidence of voting the same way at general meetings is insufficient. Likewise, combining together to carry a particular resolution would not normally be sufficient to constitute acting together to exercise control ...

So far so good. The court continued:

> ... the shareholders' agreement set out in great detail how EVC was to be constituted and administered. At all material times the agreement was in force and performed and observed by each of the shareholders. ... such performance and observation constituted the necessary "acting together".

The existence of a shareholder agreement does not show that the shareholders are acting together to control. It depends on the terms of the agreement. In *EVC*, most of the shareholder agreement seems to be indicative of each side protecting its interest acting separately! The agreement ensured that the company was deadlocked at board level as it was at general meeting level. However one important clause did suggest the shareholders were acting together:

[91] 69 TC 88 at p.127.

> EniChem and ICI should procure that not less than two-thirds of the profits of the joint venture available for dividend should be distributed to the shareholders and should procure that the shareholders vote accordingly to achieve this.

The issue of acting together has been discussed in the context of flat management companies, where there could be an ATED charge if the members of the company act together to exercise control.[92] CIOT express concern:

> This state of affairs might not be so unusual. Even if there is no formal agreement, there may be an understanding that decisions are only taken unanimously. While there are clearly cases where it would be possible to say that the shareholders of a flat management company, even if they are all directors, do not act in concert, there may be an agreement to that effect. In our members' experience, some management companies that act effectively as "cooperatives" will have put in place shareholder agreements that new flat owners have to sign up to as a condition of becoming shareholders that will produce the necessary nexus.[93]

The better view is that "acting together to control" requires more than acting collegiately, or even an agreement to act so far as possible with unanimity. If so it will be rare for the acting-together rule to apply to flat management companies. HMRC agree:

> we think that although this might be possible in the case of these types of companies, it must be unusual. You cite the case of *Steele v EVC International NV* (69 TC 88) which looked at the phrase "acting together". In that case the two shareholders entered into a shareholders agreement which continued to be recognised and implemented by the parties. The shareholders agreement was a very long document making the most extensive provision of the joint venture between two shareholders. It was found on those particular facts that the two were acting together.
>
> It seems unlikely that an ordinary memorandum and articles of association will constitute the shareholders "acting together". In fact, it would be unconscionable (?) because it would follow that all shareholders in a company would be connected. The cases it [the acting-together rule] would affect would be where there is a

[92] See 98.14.4 (Flat management company).

[93] CIOT, open letter to HMRC "Application of ATED to flat management companies" (2014).

> comprehensive shareholders agreement which would dictate how the company would be run.[94]

Of course the issue depends on the facts, and in particular on the terms of a shareholder agreement; but the fact that shareholders act collegiately should not be sufficient.

Foulser v MacDougall is another example of acting together, but the facts were unusual. An individual (in short) owned a company through a life policy wrapper. He arranged the sale of the company on behalf of its insurance company shareholder. The insurance company shareholder and the individual were held to be acting together to control.

A and B may be acting together even though A owns all the shares and B owns none. *Foulser* was such a case. The court said:

> there is no reason why the concept of two or more persons "acting together to … exercise control of a company" should, necessarily, be confined to cases where each of the persons acting together has less than a controlling shareholding, so that (absent some combination between them) none would be able to exercise control individually. It seems to me that the concept is sufficiently wide to include cases where one person (who has shareholder or voting control) agrees to exercise that control in accordance with the wishes of another.[95]

But in such a case the individual will also have general control under s.450(2); see 104.3.6 (De facto control).

The Takeover Code[96] has a comparable concept, "acting in concert", and guidance in the code may be relevant to the acting-together rule.

104.15.9 *Directors*

The CG Manual considers the position of directors:

> **CG14623. Directors of a company** [Jul 2019]
> Directors of a company are not necessarily connected persons in relation to transactions between themselves. Whether or not one of them controls the company or two or more together control the company, they are not connected persons unless they are 'relatives', see CG14580, or partners, see CG14610. TCGA92/S286 (7) makes two or more directors connected persons only in relation to transactions with the company.

[94] Open email from HMRC to CIOT (26 July 2015) (emphasis added).

[95] [2007] STC 973 at [42].

[96] *http://www.thetakeoverpanel.org.uk/the-code/download-code*

The last sentence means that if directors are shareholders and are acting together to control at shareholder level, they are connected persons only in relation to transactions with the company.

104.15.10 *Personal representatives*

The definition of connected person does not mention PRs (unlike the definition of "associates"). PRs cannot be connected with individuals or trustees.[97]

PRs may be connected with a company. They are "persons" so they are connected if (inter alia) they have control of the company or if they act together with others to exercise control.

104.16 Company connected with trust

s. 286(3)(3A) TCGA	**s.993(3) ITA/s.1122(6) CTA 2010**
A person, in his capacity as trustee of a settlement,[98] is connected with ...	A person, in the capacity as trustee of a settlement, is connected with–
(c) any body corporate[99] which is connected with that settlement, (3A) For the purpose of subsection (3) above a body corporate is connected with a settlement if- (a)[i] it is a close company (or only not a close company because it is not resident in the UK) and [ii] the participators[100] include the trustees of the settlement; or	(c) any close company whose participators include the trustees of the settlement, (d) any non-UK resident company which, if it were UK resident, would be a close company whose participators include the trustees of the settlement,
(b) it is controlled (within the meaning of section 1124 of the Corporation Tax Act 2010 [control in strict sense]) by a	(e) any body corporate controlled (within the meaning of section 995) by a company within paragraph (c) or (d)

[97] The same conclusion was reached, though in a more roundabout way, in *Harris v HMRC* [2010] UKFTT 385 at [31] - [33].

[98] The phrase "A person, in his capacity as trustee of a settlement" is just a roundabout way of saying "a trustee", because a trustee is regarded as a distinct person.
A settlement here does not include a will trust: see 104.14.2 ("settlement/"trustee").

[99] It seems odd that the subsection refers to body corporate, rather than company. This is for historical reasons: the subsection originates from para 21 sch 7 FA 1965, which incorporated s.411(4) ITA 1952, in which the term used was "body corporate". But it does not matter, because unless the body corporate is a close company it does not fall within (3A). See 90.9 ("Body corporate").

[100] See 104.22 (Definitions of participator).

company falling within paragraph (a) above.

In TCGA, it is confusing that the drafter used the expression "connected with a settlement" since in that expression the term "connected" is not used in the normal CGT sense of connected persons. But it does not matter. The IT equivalent is better drafted.
Thus trustees are connected with a close company in which they have any interest, no matter how small, which is not the case for non-trustees.

104.17 Associated co/joint control

104.17.1 *"Associated company"*

There is no single or standard definition of associated company for tax purposes. Among others:

Definition	**Section**	**See para**
Close-co definition	s.449 CTA 2010	*Discussed here*
Small-profits definition	s.18E CTA 2010	*Discussed here*
Group relief definition		*Discussed elsewhere;* see 64.32.4

Strictly, one should not use the expression without specifying which definition applies; but the context may make that clear.

"Associated company" matters for the following topics:

Topic	**Applicable definition**	**See para**
Close company	Close-co definition	104.32; 104.34.3
s.86 TCGA	Close-co definition (tweaked)	60.4.3
Small profits rate	Small-profits definition	43.20.1
Group relief	Group relief definition	64.32.4

I consider the close-co and small-profits definitions together, as they are similar, so guidance on one sheds light on the other. The issue will arise most often in the context of the small profits rate.

Close-co definition: s.449 CTA 2010	**Small-profits definition: s.18E(4)**[101]
For the purposes of this Part [Part 10 CTA 2010, close companies], a	For the purposes of this Part, [Part 3A CTA 2010, small profits rate] a

[101] The definition of associated company was in s.25 CTA, which was repealed in 2014, but re-enacted in s.18E CTA 2010. Pre-2014 material which refers to associated companies is therefore relevant again today.

company is another's "associated company" at a particular time if, at that time or at any other time within the preceding 12 months— (a) one of them has control of the other, or (b) both are under the control of the same person or persons.	company is an associated company of another at any time when— (a) one of the two has control of the other, or (b) both are under the control of the same person or persons.

There are three possibilities which may make companies associated:
(1) One controls the other
(2) One person controls both
(3) The same group of persons controls both

I refer to (3) as **"joint control"**.

Associated companies will necessarily be connected with each other.

It is possible for connected companies not to be associated companies, though that will not often arise in practice. An example is if:
(1) A owns A Ltd
(2) B (who is connected with A but not an associate of A) owns B Ltd

A Ltd and B Ltd are connected with each other but not associated companies.

104.17.2 *Joint control*

Joint control matters for many purposes. The most important for this book are:
(1) Definitions of associated company
(2) Connected persons[102]

The CT Manual discusses the issue in the context of the small profits rate.

Section 450(5) CTA 2010 provides:

> If two or more persons together satisfy any of the conditions in subsections (2) and (3), they are treated as having control of C.

Suppose A and B (not associates) each hold 50% of a company. A does not have control, and B does not have control. A and B together do have control.

In *HMRC v UBS*:

[102] See 104.15.7 (Group controls 2 companies).

> The UT's view ... appears to have been that if DB controlled Investec in relation to the latter's voting at general meetings of Dark Blue, then 'the test of control in section 416(3) [ICTA = s.450(5) CTA 2010] was satisfied'. [Counsel for the taxpayer] submitted, and I agree, that section [450(5)] is irrelevant to our facts. Investec, by virtue of its holding in Dark Blue, was formally in control of Dark Blue within the meaning of section 416(1) [ICTA = 449 CTA 2010, definition of "associated company"]. The relevant question for our purposes, however, is whether Investec was, vis-à-vis its role as a Dark Blue shareholder, itself in the control of DB. If it was, the opening words of section 416(2) [ICTA = s.450(2) CTA 2010] are satisfied and DB and Dark Blue are associated companies. If it was not, those words are not satisfied. I do not understand what section [450(5)] is thought to have to do with it. It is contemplating a case in which, for example, DB and X Ltd together had relevant control of Dark Blue via their combined control of Investec. On no footing is that this case.[103]

The CT Manual provides:

> **CG60250 Control: In multiple** [Mar 2020]
> More than one person or one group of persons may 'control' a company. For example, one person may have the greater part of the voting power, while two people hold the greater part of the issued share capital and a group of three people are entitled to the greater part of the assets in a winding up. All three combinations of people can be taken to have control of the company at the same time.
> If say three persons, A, B and C, each hold one third of the shares in a company, and they are not connected[104] in any way which would allow the rights and powers of one to be attributed to another, then control is held by A and B, or B and C, or A and C but not A, B and C together. This is because in determining whether companies are 'associated companies' the focus is on 'minimum' controlling combinations, disregarding those containing superfluous members. Thus, a company controlled by unconnected persons A, B and C, but not by any one or two of them alone, is not regarded as associated with any company controlled by one of them alone (as in the first paragraph above) or by any two of them (as in the second paragraph). See CTM03730 for an example.
> However deciding on the 'minimum' controlling combination for any

[103] [2014] EWCA Civ 452 at [133].

[104] Author's footnote: The correct term is "associated".

of the tests set out at s.416(2)(a) to (d) CTA does not mean you have to establishing the smallest controlling combination of each company when determining whether companies are associated companies.

In his High Court judgment in *R v IRC ex p. Newfields Developments* (73 TC 532 at page 541B) Moses J said that [what is now s.450 CTA 2010] had to be exercised for the statutory purposes for which it was conferred:

> "In the context of Section 13 [ICTA, later s.24, 25 CTA 2010], that purpose is to ascertain whether, in the instant case, two companies are under the control of the same person pursuant to Section 13(4) [ICTA, later s.25(4) CTA 2010]. That is the statutory question. If it is possible to answer that in the affirmative, by exercising the power of attribution, in my judgment, that power must be exercised. Conversely, if that question, namely, are the two companies under the control of the same person, can only be answered in the affirmative by refraining from the exercise of the power, then the power should not be exercised".

So in the first sub-paragraph above, it may be able to determine that two companies are associated because the three people who together have an entitlement to the greater part of the assets in a winding up also together hold the greater part of the voting power in another company. In that case this group would control the company and not the single or two person combinations. The identical controlling combination does not need to be established by the same test in each company.

In *Ghelanis Superstore v HMRC*[105] two family companies were, I think, held as follows:

Shareholder	**Company X**		**Company Y**	
	Own	**Own + associates**	**Own**	**Own + associates**
Father	12.5%	50%[106]	9%	51%
Mother	12.5%	50%	8%	51%
Son 1 (S1)	12.5%	62.5%[107] [control]	17%	67% [control]
Wife of S1	12.5%	25%[108]	16%	33%
Son 2 (S2)	12.5%	62.5% [control]	17%	67% [control]
Wife of S2	12.5%	25%	16%	33%
Unconnected	25%	25%	17%	17%
Total	100%		100%	

[105] [2014] SFTD 835.

[106] The father's associates are the mother and the two sons.

[107] The son's associates are his wife, his brother, and his parents.

[108] The wife's associate is her husband.

The two companies are connected (and were associated companies) as they are both under the "control" (in the ultra-wide sense) of one person, namely S1 (and the same could be said of S2). If that is right, the tribunal (in which the parties were not represented by Counsel) reached the right result for the wrong reason.

Suppose the facts were those assumed by the Tribunal, in short:

Shareholder	**Company X**	**Company Y**
A[109]	25%	17%
B	25%	33%
C	25%	33%
D	25%	17%

Company X is controlled by any 3 of the 4 shareholders thus allowing the following combinations:

A+B+C	(75%)
A+B+D	(75%)
A+C+D	(75%)
B+C+D	(75%)

Company Y is controlled by any of the following combinations:

B + C	(66%)
A+B+D	(67%)
A+C+D	(67%)

On this basis:

(1) The companies were associated companies as one group (A + B + D) controlled both (the same could be said of the group A + C + D).

(2) The companies were also connected with each other, for that reason (along with others).

104.18 Connected: Partners

s. 286(4) TCGA	**s.993(4) ITA**	**s.1122(7)-(8) CTA 2010**
Except in relation to acquisitions or disposals of	A person who is a partner in a partnership is connected with—	(7) [identical to ITA]

[109] The tribunal treated married couples as one unit with no other associates; the fact that a parent and child are associates, and that siblings are associates, was overlooked.

partnership assets pursuant to bona fide commercial arrangements, a person is connected with		
[a] any person with whom he is in partnership,	(a) any partner in the partnership,	[identical to ITA]
[b] and with [i] the spouse or civil partner	(b) the spouse or civil partner of any individual who is a partner in the partnership, and	[identical to ITA]
[ii] or a relative of any individual with whom he is in partnership.	(c) a relative of any individual who is a partner in the partnership	[identical to ITA]
	But this subsection does not apply in relation to acquisitions or disposals of assets of the partnership pursuant to genuine commercial arrangements.	(8) But subsection (7) does not apply in relation to acquisitions or disposals of assets of the partnership pursuant to genuine commercial arrangements.

The CGT definition is narrower than the IT definition, as it contains the exception for disposals of partnership assets under commercial[110] arrangements.

A partner is connected with a company controlled by a partnership because the partner has "control" of the company[111] and a person is connected with a company which they "control".[112] See too 104.8 (Ultra-wide control: Critique).

104.19 Connected: Unit trust

A unit trust is not a settlement,[113] so the trustee connected person rules do not apply.

[110] See App 5.2.3 (Commercial).

[111] See 104.6.4 (Associates: Partners).

[112] See 104.15.3 (Person controls company).

[113] Because there is no element of bounty (gratuitous intent); see 104.14.2 ("settlement/"trustee").

TCGA	**s.994(2) ITA/s.1123(2) CTA 2010**
[No provision]	For the purposes of [s.993 ITA/s.11222 CTA 2010]– (a) a unit trust scheme is treated as if it were a company, and (b) the rights of the unit holders are treated as if they were shares in the company.

I refer to this as the **"deemed-company fiction"**. This applies the company connection person rules to a unit trust.

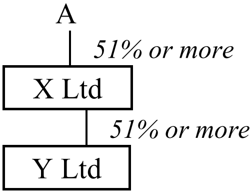
The deemed-company fiction generally applies for CGT (but it applies for all purposes, not just for the connected person rule).[114] But there is a gap: for CGT, the deemed-company fiction does not apply to a unit trust which is a transparent offshore fund.[115] So a unit trust of that kind is not connected with anybody.

104.20 Examples

The following examples address two questions:
(1) who has "control" (in the ultra-wide sense)
(2) who is connected

104.20.1 *Chain of companies*

Suppose a straightforward chain of companies:



Control
A controls X Ltd in every sense.
A controls Y Ltd in every sense. More specifically, A controls Y Ltd in the ultra-wide sense for two independent reasons:
(1) A has indirect control over the affairs of Y Ltd.
(2) A controls X Ltd so its rights are attributed to A.[116]

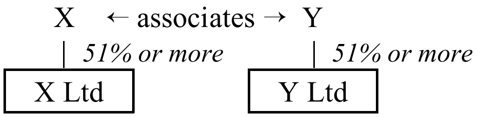
[114] See 69.8 (CGT: Deemed-company fiction).
[115] See 69.9 (Tax transparent funds).
[116] See 104.7 (Associate-attribution rule).

Connected persons
A is connected with X Ltd and with Y Ltd, because A has control of them.
X Ltd is connected with Y Ltd because X Ltd has control of it.

That is a commonsense result, but common sense does not take us far in this area of law.

104.20.2 *Two persons each own co*

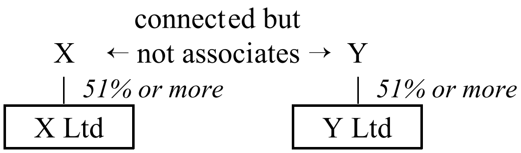
Suppose two individuals are associates and each own a company:



Control
X controls X Ltd in every sense.
X "controls" Y Ltd in the ultra-wide sense, because Y is an associate so the rights of Y are attributed to X.[117]

Connected persons
(1) X is connected with X Ltd and with Y Ltd (because X has "control").
(2) X Ltd is connected with Y Ltd (because one person has "control" of both companies).
(3) X is not necessarily connected with Y (because associates are not necessarily connected persons, though the definitions do overlap).

Suppose X and Y are connected individuals but not associates:



Control
X controls X Ltd in every sense.
X does not "control" Y Ltd.

Connected persons
(1) X is connected with X Ltd.
(2) It is considered that X is connected with Y Ltd (because a connected

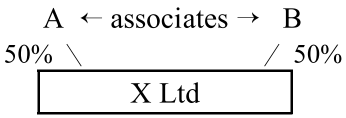
[117] See 104.7 (Associate-attribution rule).

person has control).[118]

(2) X Ltd is connected with Y Ltd (because X has control of X Ltd and a person connected with X has control of Y Ltd).[119]

104.20.3 *Two persons jointly own co*

Suppose individuals A and B are associates and each own 50% of X Ltd.

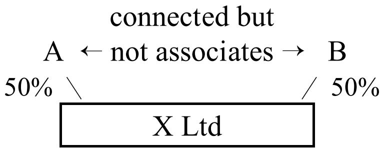


Control
A "controls" X Ltd in the ultra-wide sense, because B is an associate so the rights of B are attributed to A.[120]

Connected persons

(1) A is connected with X Ltd (because A has "control").
(2) A is not necessarily connected with B (because associates are not necessarily connected persons, though the definitions do overlap).

Suppose A and B are connected individuals but not associates: for instance, if they are acting together to control, so that they are treated in relation to that company as connected with one another:

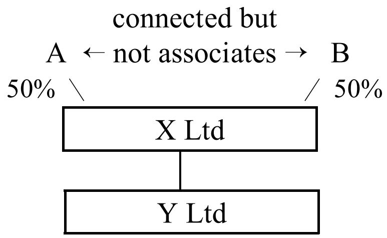


Control
A does not control X Ltd.

Connected person
A is connected with X Ltd (because A and a connected person together have control).[121]

Suppose X Ltd has a subsidiary thus:

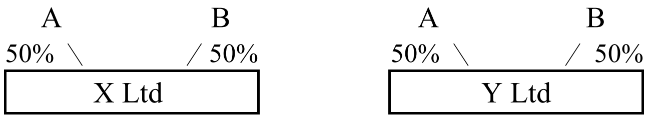
[118] See 104.15.4 (Connected persons control co).
[119] See 104.15.6 (Connected persons control 2 companies).
[120] See 104.7 (Associate-attribution rule).
[121] See 104.15.4 (Connected persons control co).


connected but
A ← not associates → B
50%
50%
X Ltd
Y Ltd

It is considered that A is connected with Y Ltd since A and persons connected with A (either B or X Ltd) together control Y Ltd.[122]

104.20.4 *Two persons jointly own 2 cos*

Suppose A and B jointly own two companies thus:


A
B
50%
50%
X Ltd
A
B
50%
50%
Y Ltd

X Ltd is connected with Y Ltd even if A and B are not connected and not associates, as the one group of persons (A and B) has control of each company.[123]

The same would apply if Y Ltd were owned by A and C, if C was connected with B.

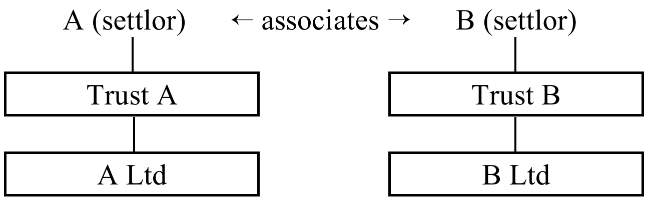
The same would apply if Y Ltd were owned by C and D, if C was connected with A, and D was connected with B.

104.20.5 *Two trusts each own company*

Suppose:

(1) A creates a trust (trust A) which owns a company (A Ltd)

(2) B (an associate of A) creates a trust (trust B) which owns a company (B Ltd), thus:


A (settlor)
← associates →
B (settlor)
Trust A
Trust B
A Ltd
B Ltd

[122] See 104.15.4 (Connected persons control co).

[123] See 104.15.7 (Group controls 2 companies).

Control

(1) A has "control" of A Ltd (the trustees of trust A are associates of A, because A is the settlor; so their rights are attributed to A)

(2) A has "control" of B Ltd (the trustees of trust B are associates of A; so their rights are attributed to A)

Connected person

(1) A is connected with Trust A (because A is the settlor)

(2) A is connected with A Ltd (because A "controls" A Ltd)

(3) A is connected with B Ltd (because A "controls" B Ltd)

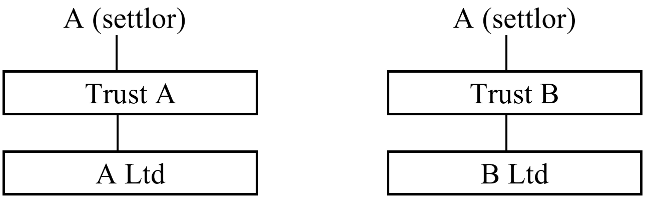
(4) A Ltd is connected with B Ltd (because A has "control" of both)

(5) A is not necessarily connected with B or trust B (because associates are not necessarily connected persons, though the definitions do overlap).

(6) The trustees of trust A are not connected with the trustees of trust B, but that does not stop their companies from being connected. Note that it is not necessarily possible for A Ltd or the trustees of trust A to know that A Ltd is connected with B Ltd.

What if A and B have died? If there is any person alive who is a relative of A and B, within the associates definition, that person has "control" of both companies and so A Ltd and B Ltd are still connected. But if A and B have no relatives (as defined) then the two companies are not in principle connected.

Suppose A is the settlor of both trusts, thus:



The analysis is as follows:

Control

(1) A has "control" of A Ltd and B Ltd.

Connected person

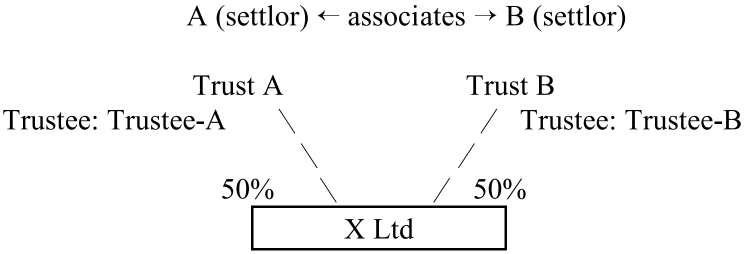
(1) A is connected with Trust A and with Trust B (because A is the settlor).

(2) A is connected with A Ltd and with B Ltd (because A has “control”).
(3) A Ltd is connected with B Ltd (because A has “control” of both).
(4) The trustees of trust A are not connected with the trustees of trust B but that does not stop their companies from being connected.

What if A has died? If there is any person alive who is a relative of A, within the associates definition, the relative has “control” of both companies and so A Ltd and B Ltd are still connected. But if A has no relatives (as defined) then the two companies are not in principle connected.

104.20.6 *Two trusts jointly own co*

Suppose individuals A and B are settlors of trusts which each own 50% of X Ltd. The trustees are Trustee-A and Trustee-B:



The analysis is as follows:

Control
(1) The trustees of trust A and trust B are associates of A.
(2) A has “control” of X Ltd (because the associates’ rights are attributed to A).

Connected person
(1) A is connected with Trust A (because A is the settlor).
(2) A is connected with X Ltd (because A “controls” X Ltd).
(3) A is not necessarily connected with B or trust B (because associates are not necessarily connected persons, though the definitions do overlap).

Suppose A is the settlor of both trusts. The analysis is as follows:

Control
(1) A has “control” of A Ltd and B Ltd.

Connected person

(1) A is connected with Trust A and with Trust B (because A is the settlor).

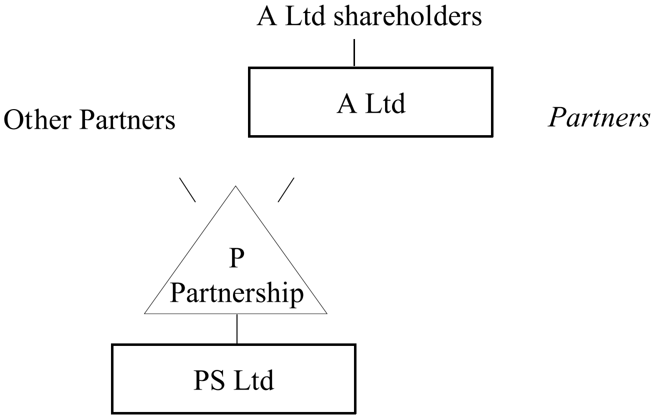
(2) A is connected with X Ltd (because A has "control").

(3) The trustees of trust A are not connected with the trustees of trust B but that does not stop A from being connected with X Ltd.

104.20.7 *Shareholders in partner co*

Suppose a partnership (P) has a corporate partner (A Ltd) and P holds an underlying company (PS Ltd).

Diagrammatically:



The partners in P are associates.

Each partner "controls" PS Ltd, because their associates' rights are attributed to them. So each partner is connected with PS Ltd.

PS Ltd is in principle close.[124]

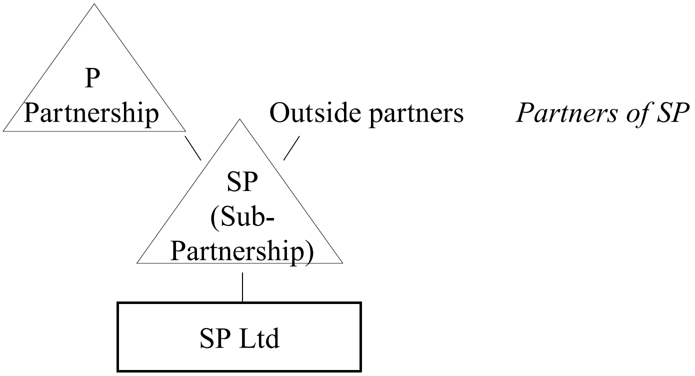
Are the A Ltd shareholders participators in PS Ltd, or connected with PS Ltd?

104.20.8 *Partnership is partner*

Suppose a partnership (P) is partner in a sub-partnership with outside investors. The sub-partnership has an company (SP Ltd)

Diagrammatically:

[124] Unless the partners are all open companies, see 104.31 (Open company exemption); but one individual or close company would lose the benefit of that exemption.



The position depends on whether the partners of P are regarded as partners in the sub-partnership; see 85.8 (Tiered partnership).

104.21 Why participators matter

The term "participator" is used frequently in tax legislation, and it is not practical to write a full list. For the purposes of this book, the term is important in particular in the following contexts:
(1) The definition of "relevant person" for the remittance basis
(2) s.3 TCGA (non-resident company gains attributed to participators)
(3) The definition of "close company"
(4) Ultra-wide sense "control" of a company
(5) Whether trustees are connected with a company[125]

104.22 Definitions of participator

There are two main definitions of participator in tax legislation (as well as numerous specialist definitions not considered here). The legislation does not have terminology to describe them, so I coin the following:

Definition	**Provision**	**See para**
Standard definition of participator	s.454 CTA 2010	104.23
Extended definition of participator	s.455(5) CTA 2010	104.24

104.23 Participator: Standard definition

104.23.1 *Participator: s.454 definition*

Section 454(1) CTA 2010 provides:

[125] See 104.16 (Company connected with trustees).

> For the purposes of this Part [Part 10 CTA 2010, close companies], "participator", in relation to a company, means a person having a share or interest in the capital or income of the company.

Section 454(2) CTA 2010 goes on to list five specific categories of participator:

> In particular, "participator" includes—
> (a) a person who possesses, or is entitled to acquire, share capital or voting rights in the company,
> (b) a loan creditor[126] of the company,
> (c) a person who possesses a right to receive or participate in
> [i] distributions[127] of the company or
> [ii] any amounts payable by the company (in cash or in kind) to loan creditors by way of premium on redemption,
> (d) a person who is entitled to acquire such a right as is mentioned in paragraph (c), and
> (e) a person who is entitled to secure that income or assets (whether present or future) of the company will be applied directly or indirectly for the person's benefit.

The wording is in part drawn from the definition of control in the ultra-wide sense, and some of the discussion on that is relevant here too.

Subsection (2) is so wide that it is hard to identify a case within subsection (1) which is not also within (2). A possible example is a beneficiary of a discretionary trust. The beneficiary does not fall within (2) but may arguably have an interest and so fall within (1).[128]

The definition is expressed to apply for the purposes of Part 10 CTA 2010, but it should be a taxes-act-wide definition. When the word participator is used in connection with close companies, this definition is generally incorporated and where there is no definition it may be implied.

The associate-attribution rule does not apply to determine who is a participator. Eg if A owns a company, then B (an associate of A) has "control" of it, in the ultra-wide sense, because A's rights are attributed to

[126] See 104.25 (Loan creditor).

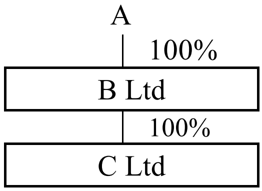
[127] Section 454(4) CTA 2010 tinkers with the standard definition of "distribution": "In subsection (2) 'distribution' is to be construed without regard to section 1000(2) (extended definition of distribution for close companies)."

[128] See 104.23.5 (Discretionary beneficiary).

B; but B is not a participator.

104.23.2 *Chain of wholly-owned co's*

Suppose a chain of wholly-owned companies:



B Ltd is obviously a participator in C Ltd. But A is also a participator in C Ltd, under:

(1) s.454(2)(a): A is entitled to acquire share capital in C Ltd
    (a) by putting B Ltd into liquidation or
    (b) by procuring B Ltd to make a dividend in specie of C Ltd shares;
(2) s.454(2)(e) CTA 2010: A is entitled to secure that income is applied for its benefit, by procuring dividends from C Ltd to B Ltd and from B Ltd to A.[129]

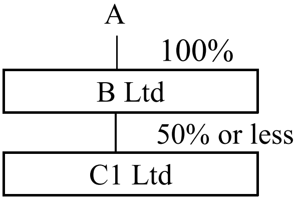
This is so wherever the companies are resident. The same applies to longer chains of 100% owned companies, and chains of less than 100% (as long as they confer control in the natural sense).

104.23.3 *Chain of partly-owned co's*

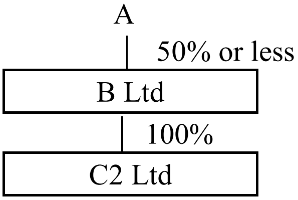
Suppose a chain of partly-owned companies which do not confer control (in the natural sense) such as:

[129] This view ("the wider view") is not universally held. On the alternative view ("the narrow view") , one company can sometimes be used to block a person from being a participator in another company. It comes down to the meaning of "entitled" to acquire/secure.
This does not much matter in practice, however, because other rules fill the gap, eg:
(1) Attribution rules which apportion gains, etc, to participators may allow further apportionment to participators of participators.
(2) Rules imposing charges on loans or benefits to participators also apply if the loan or benefit is provided to an associate of a participator.
In favour of the narrow view one might say that s.455(5) CTA 2010 (and perhaps other provisions) seem to be drafted on the assumption that the narrow view is correct; see 104.24 (Participator: extended definition).

Example 1



Example 2



A is obviously a participator in B Ltd.

In example 1, it is considered that A is a participator in C1 Ltd under s.454(2)(a): A is entitled to acquire share capital in C1 Ltd:

(a) by putting B Ltd into liquidation or
(b) by procuring B Ltd to make a dividend in specie of C1 Ltd shares.[130]

In example 2, it is considered that A is not a participator in C2 Ltd. It might be argued that A's rights as minority shareholder of B Ltd are such that A is a participator in C2 Ltd under s.454(2)(e) - ie that A has the right to secure that income or assets of C2 Ltd is applied for A's benefit. I refer to this as the wide view. But this is very doubtful and in practice it appears that HMRC do not take the wide view.[131] The extended definition of participator covers this case, if it applies.[132]

104.23.4 *Trustees and beneficiaries*

This section considers substantive trusts.[133]

Suppose trustees hold a shares in a company. The trustees are participators under s.454(1) CTA 2010. A person holding shares as trustee is not a participator in their personal capacity since trustees are (at least for IT/CGT/CT purposes) deemed to be a separate person.

Beneficiaries of a *Baker* trust, other than merely discretionary beneficiaries, are also participators under s.454(1) since they too have an interest in the trust property. Beneficiaries of a *Garland* trust do not have an interest in trust property. However they are participators under s.454(2)(a)(c)(d) by virtue of their right to compel administration of the trust.

[130] This view is not universally held; see above fn: the same arguments (more or less) apply. It comes down to the meaning of "entitled to acquire".

[131] See 104.24 (Participator: extended definition).

[132] See 104.24 (Participator: extended definition).

[133] For nominees, see the next section.

HMRC agree. The VC Manual provides:

> **VCM11100 the investor: meaning of 'associate'** [Mar 2022]
> **'Interested in'**
> For the purpose of d.[134], the words 'interested in' have a wide meaning. For example, where shares are held by trustees, the trustees, the beneficiaries and the remainderman (if any) of the trust are all interested in the shares. Where shares are held by trustees under a will for persons in succession, the life tenant and the remainderman, as well as the trustees, are interested in the shares. (See, in this connection, *CIR v Park Investments Ltd*, 43 TC 200, particularly the judgment of Danckwerts L J at page 225, *CIR v Tring Investments Ltd*, 22 TC 679, and *Alexander Drew and Sons Ltd v CIR*, 17 TC 140).

104.23.5 *Discretionary beneficiary*

What about beneficiaries of a discretionary trust? The question is whether they have an "interest" in the company. The general rule is that:

> A beneficiary under a discretionary trust has a right to be considered as a potential recipient of benefit by the trustees. That is an interest which equity will protect... But that right is not a proprietary interest in the assets held by the trustees, although it can be described as an interest of sorts.[135]

In short, the word "interest" is ambiguous and may or may not be taken to include the rights of a discretionary beneficiary: the context must decide

[134] The reference is so s.253(1)(c) ITA, which is equivalent to s.448(1)(d)(f) CTA 2010.

[135] *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2015] EWCA Civ 139 at [13].
But contrast *Lewis v Tamplin* [2018] EWHC 777 (Ch) at [39]:

> "A beneficiary or object may have rights in relation to the trust fund which are good, not only against the trustees, but also against third parties, which thus may properly be called property rights, without necessarily having a vested interest in possession or in remainder in a particular income stream or capital asset. If the trustee of a discretionary trust in breach of trust gave away a trust asset to a third party, no-one can doubt that even a discretionary object of the trust in whose favour an appointment could still be made would have standing to sue the third party for the return of the asset to the trust fund."

If that is correct, a discretionary beneficiary has a right against third parties, which is the definition of a proprietary right. But I wonder if it is in fact correct.

the question.[136] The difficulty is that the concept of participator is used in many contexts, and the definition section itself does not offer much context. The textbook TCCR takes the view that beneficiaries of a discretionary trust are participators,[137] and for practical purposes it would be safest to proceed on the basis that this may well be correct.

104.23.6 *Nominees: Participators*

If N holds as nominee for B, then B is of course a participator.

The textbook TCCR states:

> A nominee shareholder is still a "participator".[138]

That is, the nominee is a participator in addition to the beneficiary.

The question is (in short) whether the words "share or interest" in the definition of participator include the interest of a bare nominee. The answer probably depends on the nature of the nomineeship.[139]

The question may arise, but not often:

(1) If the nominee is a participator, a loan from a UK resident close company to a nominee may be taxable;[140] but such loans are not likely to be made unless the nominee has some share or interest in the company in addition to holding as nominee (in which case the nominee is in any event a participator).

(2) If the nominee is a participator, that may make the company close; but only if (in short):
    (a) the participator can be said to exercise control, which depends on the facts; or
    (b) the participator can be said to possess share capital or voting rights, which again depends on the nature of the nomineeship.[141]

104.23.7 *Partnerships*

Suppose a partnership holds a company, thus:

[136] *Leedale v Lewis* 56 TC 501. The problem is fundamentally one of terminology. See *Comr of Stamp Duties v Livingston* [1965] AC 694 at p.712: "The terminology of our legal system has not produced a sufficient variety of words to represent the various meanings which can be conveyed by the word 'interest'."

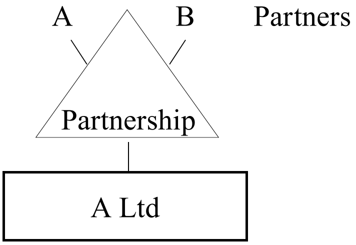
[137] *Taxation of Companies and Company Reconstructions* (looseleaf) para D1.2.4.

[138] *Taxation of Companies and Company Reconstructions* (looseleaf) para D1.1.8.

[139] See 104.5.3 (Position of nominee).

[140] See 40.8 (Loan to participators).

[141] See 104.5.3 (Position of nominee).



The partners are not participators under s.454(1) as they do not hold a share or interest in the company, at least if the partnership is a Scottish partnership, and arguably if it is an English partnership and one adopts the chose in action analysis. However that does not matter, because they are participators under s.454(2)(c)(d)(e) CTA 2010.

104.23.8 *PRs and beneficiaries of estate*

Suppose personal representatives hold shares in a company. The PRs are participators under s.454(1) CTA 2010.

A person holding shares as PR is not a participator in their private capacity for CGT purposes as for CGT the PRs are deemed to be a separate person. The Tribunal sensibly reached the same conclusion for IT purposes even in the absence of a provision expressly deeming PRs to be a separate person.[142]

Beneficiaries of an estate are not participators under s.454(1) since they do not have a legal or equitable "interest" (in the strict sense) in the assets of the estate. However they are participators under s.454(2)(a)(c)(d) by virtue of their right to compel administration of the estate.

The VC Manual provides:

> **VCM11100 the investor: meaning of 'associate'** [Mar 2022]
> **'Interested in'**
> ...The executors or administrators are interested in the assets of a deceased person's estate during the period of administration, (*Willingale v Islington Green Investment Co*, 48 TC 547). The beneficiaries should

[142] *Harris v HMRC* [2010] UKFTT 385 (TC) at [31]:
"There must be a distinction between a benefit being received by an individual beneficiary and a benefit being received, albeit by the same person, in a representative capacity.... Otherwise a different result would obtain depending on whether the residuary beneficiaries were the same persons as, or different persons from, the personal representatives."
However *Bibby v IRC* 29 TC 167 was not cited.

be regarded as interested in any assets of the estate from which they may benefit.

104.23.9 *Charge over shares*

Suppose a person has a charge over shares to secure a debt. The charge is an interest in the shares of the company, but is it an interest in the capital or income of the company? If not, a chargee is not necessarily a participator.

104.23.10 *Member of charitable co*

Is a member of a charitable company a participator in the company? Members do not fall within s.454(1) CTA 2010 (they have no share or interest in the capital or income of the company) and they do not fall within s.454(2)(b)-(e) (various financial rights). The question is whether a member falls within s.454(2)(a) on the ground that they possess "voting rights".

Members of a charitable company can of course vote, but they are curtailed in that the vote must be used for the charitable purposes of the company. The expression "voting *rights*" should be read in the context of the definition which refers to rights held beneficially as against the company. A member of a charitable company does not possess voting rights within the meaning of the provision. There are only voting duties.[143] So it is suggested that a member of a charitable company is not a participator.

A charitable company is close if (in short) it is under the control of 5 or fewer participators, so it would follow that a charitable company is not usually close.[144]

This view would reduce anomalies between charitable trusts and companies.

HMRC do not agree. The HMRC charity guidance note provides:

> Many charitable companies are close companies for tax purposes (that's under the control of 5 or fewer participators).[145]

[143] Note the corresponding company law provision, and the definition of control in the ultra-wide sense, refer to voting *power*, not voting *rights*; see 104.3.8 (Votes: para (b) control).

[144] A charitable company could be close if under the control of a loan creditor.

[145] HMRC, "Charities: detailed guidance notes" Annex III.8.1 *https://www.gov.uk/government/publications/charities-detailed-guidance-notes/a*

If that were right, then a charitable company would also be close if the directors (regardless of their number) were a majority of the members (and so "control" the company in the ultra-wide sense).

The issue is untested, and one should proceed on the cautious view that a member of a charitable company may be a participator, and a charitable company could be close. In practice it will not normally matter whether a charitable company is close or not.

104.23.11 *"Entitled to"*

"Entitled to" is used in:

(1) s.454(2)(a) and (d): entitled to acquire

(2) s.454(2)(3) entitled to secure

Section 454(3) CTA 2010 provides:

> For the purposes of subsection (2) [standard definition of participator[146]], a person is treated as entitled to do anything which the person—
>
> (a) is entitled to do at a future date, or
>
> (b) will at a future date be entitled to do.

In this definition, "to do" stands for the words which are used in s.454(2), ie, to acquire and to secure.

The CT Manual provides:

> **CTM60120. Entitled to acquire or secure** [Sep 2018]
>
> The words 'entitled to acquire' and 'entitled to secure' introduce the concept of a potential participator. So, for example, a person is a participator if, by means of a contractual right or by rights arising under a trust deed, they can:
>
> - require a shareholder to transfer shares to that person, or
> - secure the issue to that person of unissued capital of the company, or
> - secure that if the company makes a distribution or if a loan is redeemed by the company at a premium, that person has a share in the distribution or the premium. ...

Similarly, a person is a participator if by means of a contractual right or some other arrangement they can secure that income or assets of the company will be applied directly or indirectly for their benefit. See too

nnex-iii-approved-charitable-investments-and-loans

[146] See 104.23.1 (Participator: s.454 definition).

104.3.11 ("Entitled to acquire").

104.23.12 *Participator in non-resident co*

Where the term "close company" is extended to include a non-resident close company, the term "participator" is sometimes defined with a similarly extended meaning. For instance, s.102 IHTA:

> "participator", in relation to any company, means any person who is (or would be if the company were resident in the UK) a participator in relation to that company within the meaning given by section 454 of the Corporation Tax Act 2010...

But the underlined words are otiose, as the definition of "participator" is not limited to close companies. So it does not matter that in most cases where the term "close company" is extended to include non-resident close companies, the definition of "participator" is not extended in that way.

104.24 Participator: Extended definition

Occasionally the standard definition of participator is adopted with an extension. Section 454(6) CTA 2010 anticipates this:

> This section does not affect any provision of this Part requiring a participator in one company to be treated as being also a participator in another company.

Section 455(5) CTA 2010 provides:

> If a company (C) controls[147] another company (D), a participator in C is to be treated for the purposes of this section as being also a participator in D.

I refer to this as the **"extended definition of participator"**.

The extended definition is expressed to apply for s.455 (loans to participators), so it has to be repeated in 459(4) CTA 2010 (loan treated as made to participator). It is also incorporated by reference in a few other places, in particular:

Context	**See**
Definition of relevant person in ITA remittance basis	18.5.1
Benefit from close company to participator	40.9

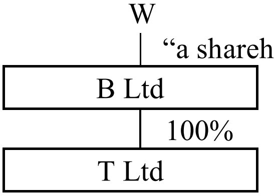
[147] The ultra-wide definition of "control" applies: see 104.3 (Control: Ultra-wide sense).

The CT Manual provides:

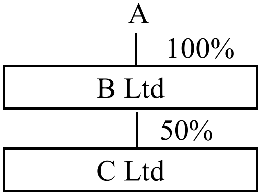
> **CTM60110 Participator: Extended meaning of** [Sep 2018]
> ... If, for example, Company B holds all the issued share capital of Company T and Company T makes a loan to W, a shareholder in Company B, that loan is within s.455 CTA 2010 [loans to participators] since W as well as being a participator in Company B is deemed also to be a participator in Company T.

Diagrammatically:

Example 1



Example 2



The HMRC example is example 1 above. Under the extended definition, W is a participator in T Ltd.[148]

What about example 2? A is a participator in C Ltd under the standard definition, and the extended definition is not needed.[149]

104.25 Loan creditor

104.25.1 *Why loan creditors matter*

The term "loan creditor" is used frequently in tax legislation, and it is not practical to write a full list. The term is important in the following contexts:

(1) A loan creditor is a participator.
(2) The expression is used in the definition of close company.

104.25.2 *"Loan creditor"*

This is a technical term. Section 453(1) CTA 2010 provides:

> For the purposes of this Part [Part 10 CTA 2010, close companies], "loan creditor", in relation to a company, means a creditor—

[148] This assumes that W (at least, if a minority shareholder) would not be a participator under the standard definition, ie what I call the wide view is not correct; that is why the extended definition of participator is needed. See 104.23.3 (Chain of partly owned co's).

[149] See 104.23.3 (Chain of partly owned co's).

> (a) in respect of any debt within subsection (2), or
> (b) in respect of any redeemable loan capital issued by the company.
>
> But this is subject to subsection (4).[150]

There are 3 categories of debts within para (a) and ss(2), so there are four altogether:

Category	**s.435(1)**	**s.435(2)**	**See para**
Debt for money/capital assets	(1)(a)	(2)(a)	104.25.3
Debt is right to income	(1)(a)	(2)(b)	104.25.4
Debt not for full consideration	(1)(a)	(2)(c)	104.25.5
Redeemable loan capital	(1)(b)	-	104.25.6

A creditor may be a participator even though they do not fall within these categories (and so are not a "loan creditor"). The CT Manual provides:

> **CTM60130. Loan creditor** [Dec 2021]
> It should be borne in mind that s.1000(1)(E) CTA 2010 ... provides that the interest etc on certain loans is a distribution. As regards such loans, the creditor is in any case a participator as he or she 'possesses a right to receive or participate in distributions of the company' (see [s.454(2)(c)]).[151]

104.25.3 *Debt for money/capital assets*

Section 453(2) CTA 2010 provides:

> (2) Debt is within this subsection if it is incurred by the company—
> (a) for any money borrowed or capital assets acquired by the company

This is the main category of loan creditor. Of course it does not cover all types of debt. The CT Manual provides:

> **CTM60130. Loan creditor** [Dec 2021]
> A person is not a participator merely because he or she is a normal trade creditor of the company.

A vendor under a hire purchase contract is not a loan creditor. The CT Manual provides:

> **CTM60130. Loan creditor** [Dec 2021]
> Payments to be made under a hire purchase agreement would not

[150] See 104.25.11 (Bank creditor).

[151] See 104.23.1 (Participator: s.454 definition).

> normally be regarded as part of the company's loan capital. This is because under the usual hire purchase agreement there will be no debt for capital assets acquired by the company. The terms of the typical agreement make it clear that the assets remain in the ownership of the hire company until the final instalment is paid. The payments not made in order to acquire a capital asset, but rather they are rent for the use of the asset.

104.25.4 *Debt is right to income*

Section 453(2) CTA 2010 provides:

> (2) Debt is within this subsection if it is incurred by the company ...
> (b) for any right to receive income created in favour of the company

The CT Manual provides:

> **CTM60130. Loan creditor** [Dec 2021]
> An example of a sum owing in the circumstances described in [s.453(2)(b)] is where a person contracts to make annual payments to the company, in return for a capital sum due at some later date. The capital sum is treated as loan capital of the company and the person will be a participator.

In practice this does not happen.

104.25.5 *Debt not for full consideration*

Section 453(2) CTA 2010 provides:

> (2) Debt is within this subsection if it is incurred by the company ...
> (c) for consideration the value of which to the company was (at the time when the debt was incurred) substantially less than the amount of the debt (including any premium on the debt).

If a company dividend is due and payable, but not paid, the shareholder has the benefit of a debt, but is not a loan creditor, as the debt is not incurred for consideration. The shareholder is a participator, so it will not usually matter whether they are also a loan creditor, but there are circumstances where it might matter.

If a company purchases its own shares, and the purchase price is due and payable but not paid, the vendor is a loan creditor. The debt is incurred for consideration (surrender of the shares) but the value to the company of the consideration is nil.

104.25.6 *Redeemable loan capital*

Section 453(1) CTA 2010 provides:

> "loan creditor", in relation to a company, means a creditor ...
> (b) in respect of any redeemable loan capital issued by the company.

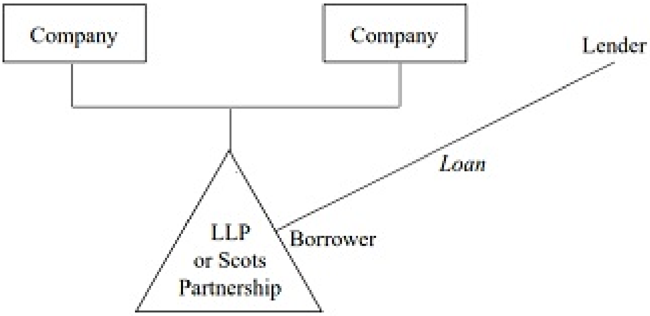
The CT Manual provides:

> **CTM60130. Loan creditor** [Dec 2021]
> As the normal debenture issued by a company is redeemable, debenture holders are participators.

A debenture is a debt, and the debenture holder is a loan creditor, under s.453(2)(a) (debenture issued for full consideration) or s.453(2)(c) (debenture issued for less than full consideration) or s.453(1)(b) (redeemable loan capital).

104.25.7 *Loan to corporate partnership*

Suppose a person lends to a LLP or Scots partnership which has corporate members, eg:



Is the lender a loan creditor of the companies? The question is whether the debt is incurred by the companies. As a matter of general law, it is not. But for tax purposes, it is suggested that one should treat the partnership as transparent, in the sense that the loan is regarded as made to the partners, and so the lender is a loan creditor of the companies.

104.25.8 *Promise to make loan*

In *Taylor v HMRC*:[152]

[152] [2010] UKFTT 115 (TC).

> [25] We think that the claimants are wrong in contending that the expression 'loan capital' covers amounts that [the borrower] company is entitled to receive as well as amounts actually received by the borrower company, ie Wrapit. The claimants say that principles of accrual accounting required by FRS 5 demands that Wrapit should recognise both the amounts actually paid by way of directors' loans and amounts that are committed to be paid later; these latter amounts should be recognised as assets or liabilities in its balance sheet.[153]
> [26] Focussing on Mr Taylor's commitment to provide a further £50,000 of loan to Wrapit at the end of 2004, it seems to us that at most Wrapit then had the benefit of his covenant to advance that amount. The covenant may have been enforceable but the £50,000 had not by then become 'loan capital' within the meaning of that expression in s 291B [ICTA 1988]. Subsection (7) defines loan capital as including 'any debt incurred by the company … for any money borrowed by the company'. At that time Wrapit had not borrowed the £50,000 and Mr Taylor had not lent it. There was no 'loan' of the £50,000 that could have ranked as such in law. We acknowledge that FRS5 might require the benefit of Mr Taylor's undertaking to lend £50,000 to be recognised in Wrapit's balance sheet ... But that does not make that amount 'loan capital' ...

As often happens, lawyers and accountants see things differently.

The question in *Taylor* was the amount of loan capital. It did not include the future borrowing. The entitled-to-acquire rule[154] apparently did not alter this conclusion.

104.25.9 *Series of loans*

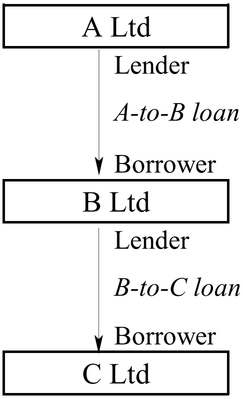
Suppose:

(1) A lends to B ("the A-to-B loan")
(2) B lends to C Ltd ("the B-to-C loan")

Diagrammatically:

[153] Para 20 FRS5 provided:
"Where a transaction results in an item that meets the definition of an asset or liability, that item should be recognised in the balance sheet if—
(a) there is sufficient evidence of the existence of the item (including, where appropriate, evidence that a future inflow or outflow of benefit will occur), and
(b) the item can be measured at a monetary amount with sufficient reliability."

[154] Section 291B(8) ICTA 1988 was equivalent to the current entitled-to-acquire rule; see 104.3.11 ("Entitled to acquire").



A is not a loan creditor of C Ltd.

Suppose in addition:

(3) The A-to-B loan is interest free, or on favourable terms, and
(4) B does not have the resources to pay the A-to-B loan, except by calling in the B-to-C loan

In those circumstances it may be said that A is a participator in C Ltd under 454(2)(e) CTA 2010 on the grounds that A will in the future be entitled to secure that assets of C Ltd will be applied indirectly for A's benefit.

104.25.10 *Interest in debt*

Section 453(3) CTA 2010 provides:

> A person who—
> (a) is not the creditor in respect of any debt or loan capital to which subsection (1) applies, but
> (b) has a beneficial interest in that debt or loan capital,
> is, to the extent of that interest, treated for the purposes of this Part as a loan creditor in respect of that debt or loan capital (but this is subject to subsection (4) [bank creditor]).

The words "to the extent of that interest" are not apt, since a person either is or is not a loan creditor. One cannot be a loan creditor "to an extent". But it does not matter.

104.25.11 *Bank creditor*

Section 453(4) CTA 2010 provides:

> A person carrying on a business of banking is not treated as a loan

> creditor in respect of any debt or loan capital incurred or issued by the company for money lent by the person to the company in the ordinary course of that business.

The CT Manual provides:

> **CTM60130. Loan creditor** [Dec 2021]
> *Banking business*
> ... There is no statutory definition of what constitutes carrying on a banking business (the definition of bank in s.1120 CTA 2010 ... does not apply to s.453 CTA 2010 ...) so we rely instead on the common characteristics of banking established in the (non-tax) case of *United Dominions Trust Ltd v Kirkwood* [1966] 2 QB 431 and endorsed in *Hafton Properties Ltd v McHugh* 59 TC 420...

104.26 Close company: Introduction

"Close" company is a concept used throughout tax legislation and it is not practical to write a full list. For the purposes of this book, the concept is important in particular in the definitions of relevant person (for remittances); connected person, and for the application of s.3 TCGA and IHT residential property rules.

A company which is not close is known as an "**open company**".

"Close company" is one of the most elaborately defined expressions in the taxes acts, and that is really saying something.

The definition in the CTA is for the purposes of the Corporation Tax Acts. This is extended to income tax and CGT:

s.989 ITA	**s.288(1) TCGA**
The following definitions apply for the purposes of the Income Tax Acts— "close company" is to be read in accordance with Chapter 2 of Part 10 of CTA 2010 (see in particular section 439 of that Act	In this Act, unless the context otherwise requires— "close company" shall be construed in accordance with Chapter 2 of Part 10 of CTA 2010 (see in particular section 439) (subject to section 138ZA(6))[155]

An entity which is not a company[156], such as a partnership, cannot be a close company.

[155] It was unnecessary to flag up this niche exception; see 58.7 (Redomiciled (ex- UK) securities). But it does not matter.

[156] See 90.8 (Definition of "company").

As to whether a charitable company is close, see 104.23.10 (Member of charitable co).

104.27 Control test

Section 439(1) CTA 2010 provides:

> For the purposes of the Corporation Tax Acts, a "close company" is a company in relation to which condition A or B is met.

I refer to "**close co conditions A and B**"

Thus there are two tests of close, which I call:

(1) the control test
(2) the winding up test

104.27.1 *Condition A: Control test*

Section 439(2) CTA 2010 provides:

> Condition A is that the company is under the control—
> (a) of 5 or fewer participators[157]...

Control has the ultra-wide sense.

A company must in principle be close if:

(1) It has less than 10 shareholders , as 5 of them will have control.
(2) It has more than 10 shareholders, but less than 10 unassociated shareholders as 5 of them will have "control".

104.27.2 *Participator-directors*

Section 439(2) CTA 2010 provides:

> Condition A is that the company is under the control ...
> (b) of participators who are directors

This takes us to the idiosyncratic definition of director in s.452(1) CTA 2010:

> In this Part [Part 10 CTA 2010, close companies], "director", in relation to a company, includes—
> (a) a person occupying the position of director of the company, by whatever name called,
> (b) a person in accordance with whose directions or instructions the directors of the company are accustomed to act, and
> (c) a person within subsection (2).

[157] See 104.22 (Definitions of participator).

(1)(a)(b) are standard form; but (c) leads to a distinctly non-standard extension:

> (2) A person (P) is within this subsection if P—
> (a) is a manager of the company or otherwise concerned in the management of the company's trade or business, and
> (b) is—
> (i) the beneficial owner of, or
> (ii) directly or indirectly able to control,
> at least 20% of the ordinary share capital of the company.
>
> (3) For the purposes of subsection (2)(b), P is treated as owning or controlling (as the case may be) what any associate of P owns or controls.

Control of a company is a common concept in tax. But the issue here is control of shares. This means power to exercise rights of ownership, eg trustees have control of shares held in trust; shareholders of a parent company have (indirect) control of shares held by the company.

A company controlled by director-participators is a close company, even if the number of director-participators exceeds five. Directors have "control" of a company if (*inter alia*) they exercise direct or indirect control over the company's affairs. This is puzzling as (under standard articles)[158] company law directors manage the business of the company, and may exercise all the powers of the company. In one sense, directors always control their company. It cannot be that every company whose directors happen to be participators is made a close company under this part of the definition. The answer is that "control" here means control at shareholder level, the ability to pass an ordinary resolution in general meeting. Directors do not "control" a company, in the relevant sense, unless they control the company at that level.[159]

As to whether a foundation is a close company, see 90.14.4 (Foundation: IT/CGT trust).

104.27.3 *HMRC examples*

The CT Manual gives some examples:[160]

[158] Sch 1 para 3 Companies (Model Articles) Regulations 2008; (formerly Table A paragraph 70).

[159] See 104.3.4 (Shareholder level control).

[160] In these examples I omit internal Manual cross references and alter the formatting for increased clarity.

> **CTM60420 - Close companies: tests: examples** [Jun 2016]
> ... The examples refer to companies having shares that are not dealt in or quoted on a stock exchange.
> **Example 1** [attribution of trustee-associates]
> Company X has 1,000 issued shares of £1 held as below.
>
> | | |
> |---|---|
> | Trustees of A's settlement | 449 |
> | Mrs A (settlor) | 60 |
> | Ten other shareholders | 491 |
> | Total issued ordinary shares | 1,000 |
>
> The ten shareholders are not associated with each other or with A or Mrs A and no one of them holds more than 50 shares.
> The trustees of A's settlement are associates of Mrs A by virtue of CTA2010/S448 (1) (b) and (c) ... and their rights and powers may be attributed to Mrs A who therefore controls the company.
> Company X is therefore a close company.

This is correct, but it is not necessary to rely on the associate-attribution rule to reach the conclusion that the company is close. The company would be close even if Mrs A were not the settlor since it is under the control of two (less than five) persons.

The Manual continues:

> **CTM60420 - Close companies: tests: examples** [Jun 2016]
> ... **Example 2** [Ordinary shares & preference shares]
> The £1 issued shares in a trading company are owned as follows.
>
> | | |
> |---|---|
> | **Ordinary shares** | |
> | Directors | |
> | A | 4 |
> | B (cousin of A) | 4 |
> | Others: 12 individuals equally, none of whom is a nominee, associate, etc, of any other shareholder | 4,992 |
> | Total issued ordinary shares | 5,000 |
> | **5% preference shares** | |
> | A (see above) | 5,000 |
> | **Total nominal and issued capital** | 10,000 |
>
> There are no loan creditors ranking as participators or members.
> Control by reference to possession of the greater part of the issued share capital (s.450(3) CTA...).
> The company is a close company because A possesses more than half the issued capital.

This is straightforward.

The Manual continues:

> **CTM60420 - Close companies: tests: examples** [Jun 2016]
> ... **Example 3** [Associate-attribution rule]
> The issued ordinary shares in a trading company carry one vote each but the 'A' ordinary shares do not confer voting rights. The shareholders are as below.

	Ordinary	'A' ordinary
A	280	(non-voting)
Wife of A	100	
B (brother of A)	10	
Trustees of A's settlement	40	
Company X (controlled by A)	80	
Total	*510*	
Mrs C (daughter of B)	20	
10 other equal holdings	470	500
Total issued shares	1,000	500

> The shares carry equal rights to dividend. A's wife has made a loan of £20,000 to the company at 5% interest. There is no share premium account or other comparable account.
> Control by voting rights (CTA2010/S450 (3) ...
> The associates of A are:
> - his wife and his brother, (ICTA88/S417 (3)(a) and (4), ... and
> - the trustees of A's settlement, CTA2010/S448 (1) (b) and (c)...
> The rights and powers attributable to A are:
> - the rights and powers of his associates (CTA2010/S451 (4) to (6) ... and
> - the rights and powers of Company X (CTA2010/S451 (4) to (6)).
> As a total of 510 votes are thus possessed by A or attributable to him, the company is a close company controlled by one person.

This is correct, but it is not necessary to rely on the associates rule. The company would be close even if none of the shareholders were associates, since it is under the control of five participators. A's wife's loan is irrelevant and it is difficult to see why the example mentions it.

> Alternatively control by holding the greater part of the issued share capital, (s.450(3) CTA), - any eight of the other equal holdings will control the company by holding the greater part of the issued share capital.

I do not understand this comment. Perhaps the text of the example is corrupt.

CTM60420 - Close companies: tests: examples [Jun 2016]

... **Example 4**

The authorised and issued share capital of Company X is £1,000 in the form of 1,000 ordinary shares of £1 each, held as below.

A	200	20%
B	100	10%
C	50	5%
D	50	5%
E	40	4%
Company Y	99	9.9%
Other shareholders	461	46.1%
Total issued ordinary shares	1000	100%

A, B and C are directors.

The issued capital of Company Y, is £100 in the form of 100 ordinary shares of £1 each, held by:

F (son of E)	60
G	40
Total issued shares	100

The shareholders in Company X, other than Company Y, are all individuals and none are related or otherwise associated. No 'other shareholder' holds more than 50 shares.

The HMRC analysis is as follows:

Control - the rights in the shares held by Company Y in Company X may be attributed to F who controls that company (CTA2010/S451 (4) to (6) ...

F is an associate of E but the rights attributed to F cannot be further attributed to E (CTA2010/S451 (4) to (6)).

No group of five participators or fewer can control Company X, nor do the director/participators control, and nor would the winding up test be of assistance here.

Company X is not a close company.

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... **Example 5**

The facts are the same as in Example 4 except that F is the holder of one share in Company X.

Control rights can be attributed to F as below.

Shares held in own right	1
Shares held by E (an associate)	40
Shares held by Company Y (controlled by F)	99
	140

> Thus A, B, C, D and F hold (or have attributed to them) the rights in 540 shares and control the company.
> Company X is a close company.

This example neatly illustrates the arbitrary border of the close/open distinction. At the margin, there is obviously some scope for planning.

> **CTM60420 - Close companies: tests: examples** [Jun 2016]
> ... **Example 6** [Entitlement to acquire shares]
> Company X has authorised capital of £5,000 in £1 ordinary shares of which £3,000 is issued as below.
>
> | | |
> |---|---|
> | A | 150 |
> | B | 150 |
> | C | 150 |
> | D | 250 |
> | E | 250 |
> | F | 250 |
> | 20 other shareholders (no one holder having over 100 shares) | 1800 |
> | Total issued ordinary shares | 3000 |
>
> The 20 other shareholders are individuals and none of the shareholders is an associate of any other. A, B and C are the directors. They each enter into a service agreement providing
> [1] that they are to remain directors for five years from 1 January 1992,[161] and
> [2] that on 31 December 1996, they shall each have the right to [subscribe for][162] 500 £1 shares in the company at par.
> Control - A, B and C each exercises or is entitled to acquire rights in 650 shares (CTA2010/S450 (3) ... and CTA2010/S451 (2) ...- CTM60220).
> Thus A, B, C, D and E (or A, B, C, D and F, or A, B, C, E and F) together constitute a group which is 'able to exercise or is entitled to acquire, control' of the company (with 2,450 shares out of 4,500, i.e. the 3,000 issued plus the 1,500 to be issued to the directors).
> The company is a close company from 1 January 1992.

104.28 Close co winding-up test

Condition B provides for a case where the participators have rights which do not confer control. I refer to this as the close co winding-up test.

[161] The entitlement to remain a director is not relevant.

[162] The Manual says "purchase"; it is later clarified that a share issue is contemplated.

It is helpful to read this side by side with the similar test for para (d) control (assets):

Close co winding-up test s.439(3) CTA 2010	**Control test para (d) (assets) s.450(3)(d) CTA 2010**
Condition B is that 5 or fewer participators, or participators who are directors, together possess or are entitled to acquire—	... P is treated as having control of C if P possesses or is entitled to acquire—
(a) such rights as would, in the event of the winding up of the company ("the relevant company") on the basis set out in section 440, entitle them to receive	(d) such rights as would entitle P, in the event of the winding up of C or in any other circumstances, to receive
the greater part of the assets of the relevant company which would then be available for distribution among the participators, or	the greater part of the assets of C which would then be available for distribution among the participators
(b) such rights as would, in that event, so entitle them if there were disregarded any rights which any of them or any other person has as a loan creditor (in relation to the relevant company or any other company).	

The word "distribution" clearly includes repayment of a loan creditor.

Para (a) applies the test is applied on the basis that loan creditors are included as participators and para (b) on the basis that they are disregarded. The company is close if it satisfies the test on either basis.

104.28.1 *s.440 winding-up basis*

Section 440 CTA 2010 sets out the basis of the notional winding-up for the close co winding-up test:

> (1) This section applies for the purposes of section 439(3).
> (2) In the notional winding up of the relevant company, the part of the assets available for distribution among the participators which any person is entitled to receive is the aggregate of—
> (a) any part of those assets which the person would be entitled to

> receive in the event of the winding up of the relevant company, and
>
> (b) any part of those assets which the person would be entitled to receive if—
>
> (i) any other company which is a participator in the relevant company and is entitled to receive any assets in the notional winding up were also wound up on the basis set out in this section, and
>
> (ii) the part of the assets of the relevant company to which the other company is entitled were distributed among the participators in the other company in proportion to their respective entitlement to the assets of the other company available for distribution among the participators.
>
> (3) In the application of subsection (2)—
>
> (a) to the notional winding up of the other company mentioned in paragraph (b) of that subsection, and
>
> (b) to any further notional winding up required by that paragraph (or by any further application of that paragraph),
>
> references to "the relevant company" are to be read as references to the company concerned.

In short, the effect is to look through participators which are companies.

Section 441 CTA 2010 tweaks the definition of participator for this purpose. Section 441(1) CTA 2010 provides:

> The following provisions apply for the purpose of determining whether under subsection (3) of section 439
>
> [a] five or fewer participators, or
>
> [b] participators who are directors,
>
> together possess or are entitled to acquire rights such as are mentioned in paragraph (a) or (b) of that subsection.

That is, s.441 applies for all purposes of the close co winding-up test.

Section 441(2) CTA 2010 provides:

> A person is to be treated as a participator in or director of the relevant company if the person is a participator in or director of any other company which would be entitled to receive assets in the notional winding up of the relevant company on the basis set out in section 440.

This is comparable to the extended definition of participator.[163]

[163] See 104.24 (Participator: extended definition).

Section 441 CTA 2010 continues:

> (3) No account is to be taken of a participator which is a company unless the company possesses or is entitled to acquire the rights in a fiduciary or representative capacity.
> (4) But subsection (3) does not apply for the purposes of section 440.

This makes sense because for this test one looks through companies to non corporate shareholders.

104.28.2 *HMRC example*

The CT Manual provides an example of the close co winding-up test:

> **CTM60420 - Close companies: tests: examples** [Jun 2016]
> ... **Example 7** (Winding up test)
> The authorised and issued capital of an investment company is £33,000 and is owned equally by eleven individuals who are not associated.
> The loan creditors are:

A (director and shareholder)	£35,000
B (not a shareholder)	£13,500

> Neither A nor B is a bank. B is not an associate of a [participator].[164]
> In a winding up, the value of the net assets distributable among members, including loan creditors, would be £120,000 as below.

Deposits with local authorities	£30,000
Market value of quoted investments (representing the remainder of the assets)	£110,000
Total assets	£140,000
Deduct sundry creditors	
Management expenses	£300
Bank overdraft	£19,700
Total deductions	£20,000
Value of net assets	£120,000

The HMRC analysis is as follows:

> Control - the company cannot be shown to be controlled by five or fewer participators under CTA2010/S450 (3) (a) to (c)...

That is, the company is not close under the usual condition A test (control by 5 participators).

[164] The Manual says "director" but I think participator is the right word.

In a liquidation, the assets would, however, be distributed as below.

A as loan creditor	£35,000
B loan creditor	£13,500
Shareholders (£6,500 each)	£71,500
Value of net assets	£120,000

More than half of this sum would be received by three persons, that is:

A (£35,000 plus £6,500)	£41,500
B	£13,500
Any shareholder other than A	£6,500
Distribution to three persons	£61,500

The company is therefore a close company by reference to s.450(3)(d) CTA 2010[165] ... because the inclusion of loan creditors as participators shows that it is controlled by three participators.

104.29 Non-close companies

104.29.1 *Non-resident close company*

Section 442 CTA 2010 provides:

> A company is not to be treated as a close company if—
> (a) it is non-UK resident

A note on terminology. The rule that only a UK resident company counts as a close company is often disapplied. A variety of drafting techniques are used to achieve this:

(1) Refer to a company "which would be a close company if it were resident in the UK"[166]

(2) Extend (or redefine) the term "close company", to include a non-resident close company[167]

(3) Adopt the statutory definition "with the omission of section 442(a)"

(4) Use a separate term, defined to mean a close or a non-resident close company. The following have been used:

Term	**See**
Qualifying company	61.10.1; 99.40.1
Closely-held company	49.6.3

[165] See 104.3.10 (Assets: para (d) control).

[166] Eg s.809M(2)(f) ITA; see 18.5 (Relevant person: Companies).

[167] For examples, see 30.14.2 (Condition B: Close company); 55.2.1 ("Close company"); 81.1.1 ("Close company").

Thus there is no consistent terminology across tax legislation. Perhaps that is too much to expect. As long as the reader is aware, it does not matter much. In this book I refer to "**a non-resident close company**" which I think is the clearest term.

104.29.2 *Co-operative/community benefit/building society*

For completeness: s.442 CTA 2010 provides:

> A company is not to be treated as a close company if ...
> (b) it is a registered society, or
> (c) it is a building society.

104.30 State-controlled company

Section 443 CTA 2010 provides:

> (1) A company is not to be treated as a close company as a result of section 439(2) if it is controlled by or on behalf of the Crown.
> (2) A company is "controlled by or on behalf of the Crown", for the purposes of this section, if it is under the control of the Crown or of persons acting on behalf of the Crown, independently of any other person.
> (3) But a company is not controlled by or on behalf of the Crown, for the purposes of this section, if it is a close company as a result of being under the control of persons acting independently of the Crown.

EN CTA 2010 provides:

> 1340. [The words *as a result of section 439(2)*] leave it open for a company controlled by or on behalf of the Crown to be a close company if condition B in section 439(3) is met.[168] ...
> 1342. In short, section 414(1)(c) of ICTA is a qualified exception to [close company condition A, control of five or fewer participators] but not an exception to [condition B, close co winding up test].

So strictly the exemption for crown controlled companies is limited. If the crown own all the shares, the company is close under close company condition B. The exemption would only apply if the crown held voting shares only. That must be rare.

It is not at all clear that that was in fact the pre-rewrite position, though if so it was more likely a mistake of the drafting than a deliberate decision.

[168] See 104.28 (Close co winding-up test).

Perhaps it will not often matter, but the CT Manual suggests that HMRC do not take that point:

> **CTM60270 Control: By the Crown** [Sep 2018]
> A company is to be treated as controlled by or on behalf of the Crown (and therefore not a close company) if, and only if, it is by any of the control tests under the control of the Crown or of persons acting on behalf of the Crown, independently of any other person. If, however, it can be shown that under some other control test:
> - five or fewer participators, or
> - participators who are directors,
>
> control the company and those participators (or director/participators) act independently of the Crown, the company is a close company.
> The Crown for this purpose includes any Minister, Government Department or other person acting on behalf of the Crown.

104.30.1 *Foreign government/local authorities*

The next paragraph extends the exemption, though on what authority I do not know:

> **60280. Control: Overseas governments and local authorities** [Jun 2016]
> A company should not be treated as a close company if the only persons who can be taken to have control of that company are any of the following:
> - Overseas governments.
> - The Crown Agents for Overseas Governments and Administrations.
> - Local authorities or local authority associations exempt from tax under Section 984 CTA 2010 ...

This seems a somewhat loose reading of the statutory expression "the Crown"; but the outcome is sensible.

104.30.2 *State/open company control*

CT Manual provides:

> **CTM60280. Control: Overseas governments and local authorities** [Jun 2016]
> ... Nor should a company be treated as a close company if the only persons who can be taken to have control of that company are any of the above together with:
> - a company or companies resident in the UK which are not close, or

- an overseas company or companies which, if resident in the UK, would not be close.

104.31 Open company exemption

Section 444(1) CTA 2010 provides:

> A company is not to be treated as a close company if condition A or B is met.

I refer to **"open company conditions A and B"**.

Section 444(2) CTA 2010 concerns the main close co definition (control by 5 or fewer participators):

> (2) Condition A is that the company—
> (a) is controlled by one or more companies none of which is a close company, and
> (b) cannot be treated as a close company except by taking, as one of the 5 or fewer participators requisite for its being so treated, a company which is not a close company.
>
> (4) References in subsections (2) and (3) to a close company include a company which, if UK resident, would be a close company.

Section 444(3) CTA 2010 concerns the close co winding-up test:

> Condition B is that the company—
> (a) would not be a close company were it not for
> [i] paragraph (a) of section 439(3) [winding up test] or
> [ii] paragraph (d) of section 450(3) [winding up test], and
> (b) would not be a close company if the references in those paragraphs to participators did not include loan creditors which are companies other than close companies.

The CT Manual provides:

> **CTM60300 Open company loan creditor** [Sep 2018]
> [The Manual summarises s.444 (3) and continues:]
> If the open company loan creditor also holds shares in the company, it will remain a participator in respect of that holding and any amount which would be distributed to it in respect of those shares should be taken into account for the purposes of s.450(3)(d) CTA2010 and s.439(3)(a) CTA2010.

The CT Manual provides two straightforward examples of the open company exemption:

> **CTM60420 Close companies: tests: examples** [Jun 2016]
> ... **Example 8**
> The issued ordinary capital of a trading company (other issued capital having no voting rights) is held as below.

Company A (not a close company)	280
Company B (a close company)	270
Company C (not a close company)	230
D (director)	40
E (director)	30
F (an individual)	30
20 others	120
Total issued ordinary shares	1,000

> Control - the requirements of CTA2010/S444 (2)(a) ... are regarded as satisfied because, upon one combination of shareholdings, control is in the hands of Company A and Company C, even though by other combinations a controlling group which includes only one of those companies may be established.
> The company is not a close company if the requirements of CTA2010/S444 (2) (b) ... are also satisfied, that is, if none of the control tests enables control by five or fewer participators to be established without including a non-close company among those participators, and the company is not controlled by its directors and cannot be shown to be close on the or winding up test (CTM60320) without including a non-close company among the five or fewer participators (see, however, Example 9 below).

In short, the company is not close unless one adds to the facts, as in example 9:

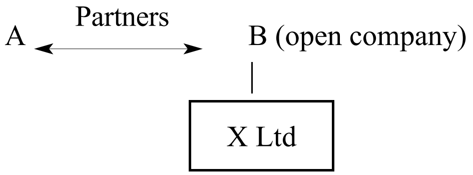
> **Example 9**
> The ordinary shares are held as in Example 8.
> G, an individual, holds redeemable loan stock and would receive in a winding-up more than half of the assets available for distribution among the participators.
> Control - as G is in control of the company by reference to s.450(3)(d) CTA 2010[169] ... the requirements of CTA2010/S444 (3) ... are not met and, irrespective of the control by open companies, the company is a close company.

More analytically:

[169] See 104.3.10 (Assets: para (d) control).

(1) Open company condition A is not met:
    (a) The requirement in s.444(2)(a) is met (control by open companies)
    (b) But the requirement in s.444(2)(b) is not met, because G "controls" the company
(2) Open company condition B is not met, because neither of the requirements in s.444(3) are met.

Suppose:



A "controls" X Ltd (because B's rights are attributed to A).
X Ltd is not close, as open company condition A is satisfied.

Now suppose A (not an open company) were either a loan creditor of X Ltd, or held say a 1% shareholding in X Ltd. A is now a participator in X Ltd. Construed strictly, X Ltd is now close: the open company exemption does not apply, as X Ltd is "controlled" by A. But that is a strange result, and one might construe the open company exemption purposively, so that it applies in this case to prevent the attribution.

104.32 Pension schemes

Section 445 CTA 2010 provides:

> (1) If shares in a company ("C") are held on trust for a registered pension scheme, the persons holding the shares are to be treated, for the purposes of section 444(2) and (3)—
> (a) as the beneficial owners of the shares, and
> (b) in that capacity, as a company which is not a close company.
> (2) But subsection (1) does not apply if the scheme is established wholly or mainly for the benefit of—
> (a) directors, employees, past directors or past employees of a company within subsection (3), or
> (b) dependants of an individual within paragraph (a).
> (3) The companies within this subsection are—
> (a) C,

> (b) an associated company[170] of C,
> (c) a company which is under the control of—
> (i) a director of C,
> (ii) an associate of a director of C, or
> (iii) two or more persons each of whom is such a director or associate, and
> (d) a close company.

The CT Manual summarises this and provides:

> **CTM60290 Control: By another company** [Sep 2018]
> The broad effect of the above conditions is that the fund or scheme must be one established for the benefit of employees, etc, of an unrelated company which is not close. A joint fund for the benefit of employees of two or more companies is not disqualified if the majority of the beneficiaries are or were employees of qualifying companies or are dependants of such employees.

104.33 Quoted company exemption

Section 446(1) CTA 2010 provides:

> A company is not to be treated as a close company at a particular time if—
> (a) shares in the company carrying at least 35% of the voting power in the company have been allotted unconditionally to, or acquired unconditionally by, and are at that time beneficially held by, the public, and
> (b) [i] any such shares have within the preceding 12 months been the subject of dealings on a recognised stock exchange,[171] and
> [ii] the shares have within those 12 months been listed on such an exchange.

104.34 Principal members: Vote cap

Section 446 CTA 2010 provides:

> (2) But subsection (1) does not apply to a company at any time when the total percentage of the voting power in the company possessed by all of the company's principal members exceeds 85%.
> (3) For the purposes of this section, a person is a principal member of a

[170] See 104.17.1 ("Associated company").

[171] See App 2.18 (Listed/Recognised stock exchange).

> company if the person possesses a percentage of the voting power in the company of more than 5% (but see subsection (4)).
> (4) If there are more than 5 persons within subsection (3), a person is a principal member of the company only if—
> (a) the person is one of the 5 persons who possess the greatest percentages, or
> (b) in a case where there are no such 5 persons because two or more persons possess equal percentages of the voting power in the company, the person is one of the 6 or more persons (including those two or more who possess equal percentages) who possess the greatest percentages.

Section 446(5) CTA 2010 applies the usual nominee and associate-attribution rules:[172]

> In determining for the purposes of this section the voting power which a person possesses, there is to be attributed to the person any voting power which would be attributed to the person if section 451(3) to (6) applied for the purposes of this section.

104.34.1 *"Shares"*

Section 446(6) CTA 2010 provides:

> In this section "shares"—
> (a) include stock, but
> (b) do not include shares entitled to a fixed rate of dividend, whether with or without a further right to participate in profits.

The CT Manual provides:

> **CTM60310 35% or more voting power held by public** [Sep 2018]
> ... The total voting power for the purpose of [s.446(1) and (2)] is that of all the issued shares (or stock) including that of shares, etc, entitled to a fixed dividend, etc, which are excluded under [s.446(1)] in determining the voting power in the hands of the public. ...

104.34.2 *"Held by public"*

Section 447 CTA 2010 defines "beneficially held by the public":

> (1) For the purposes of section 446, shares in a company (C) are beneficially held by the public if they are—
> (a) beneficially held by a UK resident company which is not a close

[172] See 104.5.1 (Nominee-attribution rule); 104.7 (Associate-attribution rule).

> company, or by a non-UK resident company which would not be a close company if it were UK resident,
>
> (b) held on trust for a registered pension scheme, or
>
> (c) not comprised in a principal member's holding...
>
> (4) The reference in section 446(1) to shares which have been allotted unconditionally to, or acquired unconditionally by, the public is to be read in accordance with subsections (1) to (3).
>
> (5) For the purposes of subsection (1), a principal member's holding consists of the shares which carry the voting power possessed by him.
>
> (6) The reference in subsection (2) to shares held by any person includes shares the rights or powers attached to which would be attributed to the person if section 451(3) applied for the purposes of that subsection.[173]
>
> (7) Subsections (3) to (5) of section 446 (meaning of "principal member" and determination of voting power possessed) apply for the purposes of this section as they apply for the purposes of that section.
>
> (8) In this section, "shares" includes stock.

The CT Manual provides:

> **CTM60310 35% or more voting power held by public** [Sep 2018]
> Where the company holding the shares loses its beneficial interest on commencement of winding-up (see CTM36125) you should not normally contend that a company which was not close before the commencement of that winding-up, thereby becomes a close company.
> Shares beneficially held by an authorised unit trust (see CTM48200 onwards) are to be regarded as beneficially held by a company which is not a close company unless five or fewer persons hold more than half of the units issued by the trust. In determining the number of units held by a person, there should be attributed to him or her any units held by his or her associates (see CTM60150) or by his or her nominees or by any company (or companies) of which he/she has, or he/she and his associates have, control...
> For the purpose of [s.447(1)], shares held in accordance with [s.447(1)(a) or (b)] are deemed to be beneficially held by the public (provided that they are not [otherwise] excluded) even if they are comprised in a principal member's holding.

104.34.3 *Not "held by public"*

Section 447 CTA 2010 provides:

[173] See 104.5.1 (Nominee-attribution rule); the associate-attribution rule is not applied here.

> (2) But shares are not beneficially held by the public if they are held—
>
> (a) by a director of C,
>
> (b) by an associate of such a director,
>
> (c) by a company which is under the control of one or more persons each of whom is such a director or associate,
>
> (d) by an associated company of C, or

The CT Manual provides:

> **CTM60310 35% or more voting power held by public** [Sep 2018] Where a company in [s.447(2)(c)(d)] above loses its beneficial interest in the shares, etc, on commencement of winding-up (see CTM36125) you should not normally accept that a company which was close before the commencement of that winding-up, thereby ceases to be close. ...

Section 447 CTA 2010 continues:

> (2) But shares are not beneficially held by the public if they are held ...
>
> (e) as part of a fund the capital or income of which is applicable or applied wholly or mainly for the benefit of any of individuals within subsection (3).
>
> (3) Those individuals are—
>
> (a) employees, directors, past employees or past directors of C or of any company within subsection (2)(c) or (d), and
>
> (b) dependants of any individuals within paragraph (a)...
>
> (6) The reference in subsection (2) to shares held by any person includes shares the rights or powers attached to which would be attributed to the person if section 451(3) applied for the purposes of that subsection.[174]

[174] See 104.5.1 (Nominee-attribution rule); the associate-attribution rule is not applied here.

CHAPTER ONE HUNDRED AND FIVE

PARTICIPATION & % INVESTMENT TESTS

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105.1 Participation

This term is elaborately defined in s.159-162 TIOPA. The concept (subject to modifications here or there) is used in a number of contexts:

Topic	**Provision**	**See para**
Transfer pricing	Part 4 TIOPA	25.8
Royalty DTA override	s.917A ITA	32.13
Offshore receipts from IP	s.608U ITTOIA	32.33.2
Royalty influenced by special relationship	s.132 TIOPA	*Not discussed*
Hybrid entities	s.259NB TIOPA	91.25.2
Advance pricing agreements	s.219(2) TIOPA	*Not discussed*
Corporate interest restriction	s.463 TIOPA	*Not discussed*

So there is some economy of drafting, and it is convenient to consider the matter as a separate topic, rather than in any particular context in which it may arise.

A modified version also applies for diverted profits tax, but that is outside the scope of this book.

105.2 Direct participation

105.2.1 *Application of s.157*

Section 157(1) TIOPA provides:

> Subsection (2) applies for the purposes of—
> (a) this Part [Part 4 TIOPA Transfer pricing]
> (b) in Part 2, section 132(7)
> (c) in Part 5, section 219(2)
> (d) in Part 6A, section 259NB(4),
> (e) in Part 10, section 463(4), and
> (f) section 608T of ITTOIA 2005.

105.2.2 *Direct participation test*

Section 157(2) TIOPA provides:

> A person is directly participating in the management, control or capital of another person at a particular time if (and only if) that other person is at that time—
> (a) a body corporate or a firm, and
> (b) controlled by the first person.

"Control" means control in the strict sense.[1] But we then need to consider the indirect participation tests.

105.3 Indirect participation tests

Section 158 TIOPA provides:

> (1) This section is about how to read the references, in this Part and in some other provisions of this Act, to indirect participation.
> (2) For the purposes of sections 148(2)(a) and (3)(a) and 175(2)(a), a person is indirectly participating in the management, control or capital of another person only if section 159, 160 or 161 so provides.
> (3) For the purposes of sections 148(2)(b) and (3)(b) and 175(2)(b), a person is indirectly participating in the management, control or capital of another person only if section 159, 160 or 162 so provides.

[1] See s.217 TIOPA; 104.9 (Control: Strict sense).

(4) For the purposes of—
 (a) sections 154(5) and 204(4),
 (b) in Part 2, section 132(7)
 (c) in Part 5, section 219(2), and
 (d) in Part 6A, section 259NB(4),
a person is indirectly participating in the management, control or capital of another person only if section 159 or 160 so provides.

This is easier to follow in a table format:

Provision in TIOPA	**Topic**	**Apply**
148(2)(a)/(3)(a), 175(2)(a)	Transfer pricing	s.159/160/161
148(2)(b)/(3)(b), 175(2)(b)	Transfer pricing	s.159/160/162
154(5), 204(4)	Transfer pricing	s.159/160
132(7)	DT royalties article	s.159/160
219(2)	Advance pricing agreements	s.159/160
259NB(4)	Hybrid entities	s.159/160

105.4 Indirect participation: s.159

105.4.1 *Application of s.159*

Section 159(1) TIOPA provides:

> Subsection (2) applies for the purposes of—
> (a) sections 148(2) and (3), 154(5), 175(2) and 204(4),
> (b) in Part 2, section 132(7),
> (c) in Part 5, section 219(2),
> (d) in Part 6A, section 259NB(4),
> (e) in Part 10, section 463(4)]2[, and
> (f) section 608T of ITTOIA 2005.

Section 159 applies in all cases where the participation test is applied.

105.4.2 *Indirect participation test*

Section 159(2) TIOPA provides:

> A person ("P") is indirectly participating in the management, control or capital of another person ("A") at a particular time if
> [a] P would be directly participating in the management, control or capital of A at that time
> [b] if the rights and powers attributed to P included all the rights and powers mentioned in subsection (3) that are not already attributed to P for the purpose of deciding under section 157 whether P is directly participating in the management, control

or capital of A.

105.4.3 *Attributed rights*

Section 159(3) TIOPA provides:

> The rights and powers referred to in subsection (2) are—

There follow five paragraphs of attributed rights.

105.4.4 *Future rights*

Section 159(3) TIOPA provides:

> The rights and powers referred to in subsection (2) are—
> (a) rights and powers which P is entitled to acquire at a future date,
> (b) rights and powers which P will, at a future date, become entitled to acquire,

The wording is taken from the definition of control in the ultra-wide sense; see 104.3.11 ("Entitled to acquire").

Section 159(5) TIOPA provides:

> In subsections (3)(c) to (e) and (4), the references to a person's rights and powers include references to any rights or powers which the person either—
> (a) is entitled to acquire at a future date, or
> (b) will, at a future date, become entitled to acquire.

105.4.5 *Beneficial/fiduciary rights*

Section 159(3) TIOPA provides:

> The rights and powers referred to in subsection (2) are...
> (c) rights and powers of persons other than P so far as they are rights or powers falling within subsection (4),

That takes us to s.159(4) TIOPA:

> Rights and powers fall within this subsection so far as they—
> (a) are required, or may be required, to be exercised in any one or more of the following ways—
> (i) on behalf of P,
> (ii) under the direction of P, or
> (iii) for the benefit of P, and
> (b) are not confined, in a case where a loan has been made by one person to another, to rights and powers conferred in relation to

property of the borrower by the terms of any security relating to the loan.

105.4.6 *Connected person's rights*

Section 159(3) TIOPA provides:

> The rights and powers referred to in subsection (2) are...
> (d) rights and powers of any person with whom P is connected (see section 163),

Section 163 TIOPA defines "connected":

> (1) Subsections (2) and (3) apply for the purposes of section 159 and this section.
> (2) Two persons are connected with each other if one of them is an individual and the other is—
> (a) the individual's spouse or civil partner,
> (b) a relative of the individual,
> (c) a relative of the individual's spouse or civil partner, or
> (d) the spouse, or civil partner, of a person within paragraph (b) or (c).
> (3) Two persons are connected with each other if one of them is a trustee of a settlement and the other is—
> (a) a person who in relation to that settlement is a settlor, or
> (b) a person who is connected with a person within paragraph (a).
> (4) In this section—
> "relative" means brother, sister, ancestor or lineal descendant, and
> "settlement" and "settlor" have the same meaning as in section 620 of ITTOIA 2005.

This is a truncated version of the standard definition of "connected person".[2]

"Connected" is a symmetrical relationship: if A is connected with B, then B is connected with A.

If S is the settlor of two trusts (T1 and T2) then:

(1) S is connected with T1 and T2, under 163(3)(a).
(2) T1 and T2 are connected, under s.163(3)(b).

105.4.7 *Indirectly connected rights*

Section 159(3) TIOPA provides:

[2] See 98.12 (Connected person).

> The rights and powers referred to in subsection (2) are...
> (e) rights and powers which would be attributed by subsection (2) to a person with whom P is connected were it being decided under that subsection whether that connected person is indirectly participating in the management, control or capital of A.

Thus if A is connected to B, and B is connected to C, the rights of C are attributed to A.

Section 159(6) TIOPA provides:

> In paragraph (e) of subsection (3), the reference to rights and powers which would be attributed to a connected person includes a reference to rights and powers which, by applying that paragraph wherever one person is connected with another, would be so attributed to the connected person through a number of persons each of whom is connected with at least one of the others.

This seems to mean that if A is connected to B, and B is connected to C, and so on to Z and beyond, one attributes to A the rights of B, C, and so on to Z and beyond. There is no limit to the number of connected persons. No-one could draw up a list of persons to whom they may be connected via an unlimited number of intermediate connected persons. But unworkability is a common feature of connected person tests.

105.4.8 *Joint powers*

Section 159(7) TIOPA provides:

> References in this section—
> (a) to rights and powers of a person, or
> (b) to rights and powers which a person is or will become entitled to acquire,
>
> include references to rights or powers which are exercisable by that person, or (when acquired by that person) will be exercisable, only jointly with one or more other persons.

105.5 Major participant: s.160

105.5.1 *Application of s.160*

Section 160(1) TIOPA provides:

> Subsection (2) applies for the purposes of—
> (a) sections 148(2) and (3), 154(5), 175(2) and 204(4),

(b) in Part 2, section 132(7), and
(c) in Part 5, section 219(2)
(d) in Part 6A, section 259NB(4),
(e) in Part 10, section 463(4), and
(f) section 608T of ITTOIA 2005.

Section 160 applies in all cases where the participation test is applied.

105.5.2 *Major participant test*

Section 160(2) TIOPA provides:

> A person is indirectly participating in the management, control or capital of another person at a particular time if the first person is, at that time, one of a number of major participants in that other person's enterprise.

105.5.3 *"Major participant"*

Section 160(3) TIOPA provides the definition of "major participant"

> For the purposes of this section, a person ("A") is a major participant in another person's enterprise at a particular time if at that time—
> (a) that other person ("the subordinate") is a body corporate or firm, and
> (b) the 40% test is met in the case of each of two persons—
> (i) who, taken together, control the subordinate, and
> (ii) of whom one is A.

105.5.4 *40% test*

Section 160(4) TIOPA provides:

> For the purposes of this section, the 40% test is met in the case of each of two persons wherever each of them has interests, rights and powers representing at least 40% of the holdings, rights and powers in respect of which the pair of them fall to be taken as controlling the subordinate.

105.5.5 *Attributing rights for 40% test*

Section 160(5) TIOPA provides

> For the purposes of this section—
> (a) the question whether a person is controlled by any two or more persons taken together, and
> (b) any question whether the 40% test is met in the case of a person who is one of two persons,

> is to be determined after attributing to each of the persons all the rights and powers which would be attributed by section 159(2) to a person were it being decided under section 159(2) whether that person is indirectly participating in the management, control or capital of another person.

Section 160(6) TIOPA copies s.159(7); see 105.4.8 (Joint powers).

105.6 s.161 test: s.148/175 financing

Section 161 TIOPA provides:

> (1) Subsection (2) applies for the purposes of sections 148(2)(a) and (3)(a) and 175(2)(a).
>
> (2) A person ("P") is indirectly participating in the management, control or capital of another ("A") at the time of the making or imposition of the actual provision if—
>
> (a) the actual provision relates, to any extent, to financing arrangements for A,
>
> (b) A is a body corporate or firm,
>
> (c) P and other persons acted together in relation to the financing arrangements, and
>
> (d) P would be taken to have control of A if, at any relevant time, there were attributed to P the rights and powers of each of the other persons mentioned in paragraph (c).
>
> (3) It is immaterial for the purposes of subsection (2)(c) whether P and the other persons acting together in relation to the financing arrangements did so at the time of the making or imposition of the actual provision or at some earlier time.
>
> (4) In subsection (2)(d) "relevant time" means—
>
> (a) a time when P and the other persons were acting together in relation to the financing arrangements, or
>
> (b) a time in the period of six months beginning with the day on which they ceased so to act.
>
> (5) In determining for the purposes of subsection (2)(d) whether P would be taken to have control of another person ("A"), the rights and powers of any person (and not just P) are to be taken to include those that would be attributed to that person by section 159(2) were it being decided under section 159(2) whether that person is indirectly participating in the management, control or capital of A.
>
> (6) In this section "financing arrangements" means arrangements made for providing or guaranteeing, or otherwise in connection with, any debt, capital or other form of finance.

105.7 s.162 test: Other financing

Section 162 TIOPA provides:

> (1) Subsection (2) applies for the purposes of sections 148(2)(b) and (3)(b) and 175(2)(b).
> (2) A person ("Q") is indirectly participating in the management, control or capital of each of the affected persons at the time of the making or imposition of the actual provision if—
> (a) the actual provision relates, to any extent, to financing arrangements for one of the affected persons ("B"),
> (b) B is a body corporate or firm,
> (c) Q and other persons acted together in relation to the financing arrangements, and
> (d) Q would be taken to have control of both B and the other affected person if, at any relevant time, there were attributed to Q the rights and powers of each of the other persons mentioned in paragraph (c).
> (3) It is immaterial for the purposes of subsection (2)(c) whether Q and the other persons acting together in relation to the financing arrangements did so at the time of the making or imposition of the actual provision or at some earlier time.
> (4) In subsection (2)(d) "relevant time" means—
> (a) a time when Q and the other persons were acting together in relation to the financing arrangements, or
> (b) a time in the period of six months beginning with the day on which they ceased so to act.
> (5) In determining for the purposes of subsection (2)(d) whether Q would be taken to have control of another person ("A"), the rights and powers of any person (and not just Q) are to be taken to include those that would be attributed to that person by section 159(2) were it being decided under section 159(2) whether that person is indirectly participating in the management, control or capital of A.
> (6) In this section "financing arrangements" means arrangements made for providing or guaranteeing, or otherwise in connection with, any debt, capital or other form of finance.

105.8 % investment tests

This concept is elaborately defined. It is used in a number of contexts:

Topic	**Reference**	**Definition**	**See para**
Property-rich companies	para 9 sch 1A TCGA	Set out in full	57.7; 57.10
Transactions in land	s.356OT CTA 2010	Adopts s.259NC	22.9.3; 57.7

Intellectual property	s.608U ITTOIA	Set out in part	32.32
Hybrid entities	s.259NB TIOPA	Set out in full	91.25
Permanent establishment	s.1143 CTA 2010	Adopts s.259NC	106.20
Corporate interest restriction	s.464 TIOPA	Set out in full	*Not discussed*

So:
On 3 occasions, the definition is set out in full.
Once, in s.609U, the definition is set out in part.[3]
On 2 occasions, the s.259NC definition is incorporated by reference.

Such is the patchwork nature of taxation. There is however a common template so it is convenient to consider the matter as a separate topic, rather than in any particular context in which it may arise.

105.8.1 *The definition(s)*

In outline, the basic definition has four or five limbs, most of which have parallels in the definitions of control/close company, so discussion in that context is relevant here:

Limb	**Control**	**Close co**	**Notes**
Share capital	104.3.7		Only in s.259ND
Votes	104.3.8		
Receipt on disposal	-	-	
Income test	104.3.9		
Winding up test	104.3.10;	104.28	

In full detail:

para 9(1) sch 1A TCGA	**s.259ND(3) TIOPA/s.259ND(4) TIOPA**		**s.608U(1) ITTOIA**
A person ("P") has a 25% investment in a company ("C") if—	(3) A person ("P") has an X% investment in a company ("C") if it is reasonable to suppose[4] that—	(4) A person ("P") has an X% investment in another person ("Q") if it is reasonable to suppose that—	A person (P) has a 51% investment in another person (C) if any of the following apply—

[3] The other part incorporates the rules from the corporate interest definition. Section 608U ITTOIA provides:

> (3) Section 464(2) to (11) and section 465 of TIOPA 2010 apply for the purposes of subsections (1) and (2) of this section.
> (4) In the application of section 464(10) of TIOPA for the purposes of subsection (1), the reference to a "25% investment" is to be read as a "51% investment".

[4] See App.2.24 (Reasonable-to-assume).

	[***Share capital limb***] (a) P possesses or is entitled to acquire X% or more of the share capital or issued share capital of C,		
[***Voting limb***] (a) P possesses or is entitled to acquire 25% or more of the voting power in C,	(b) P possesses or is entitled to acquire X% or more of the voting power in C, or		(a) P possesses or is entitled to acquire more than half of the voting power in C;
[***Disposal limb***] (b) in the event of a disposal of the whole of the equity in C, P would receive 25% or more of the proceeds,	(c) if the whole of C's share capital were disposed of, P would receive (directly or indirectly and whether at the time of disposal or later) X% or more of the proceeds of the disposal.		(b) in the event of a disposal of the whole of the equity in C, P would receive more than half of the proceeds;
[***Distribution limb***] (c) in the event that the income in respect of the equity in C were distributed among the equity holders in C, P would receive 25% or more of the amount so distributed, or		(a) if the whole of Q's income were distributed, P would receive (directly or indirectly and whether at the time of the distribution or later) X% or more of the distributed amount, of	(c) in the event that the income in respect of the equity in C were distributed among the equity holders in C, P would receive more than half of the amount so distributed;
[***Winding-up limb***] (d) in the event of a winding-up of C or in any other		(b) in the event of a winding-up of Q or in any other	(d) in the event of a winding-up of C or in any other

circumstances, P would receive 25% or more of C's assets which would then be available for distribution among the equity holders in C in respect of the equity in C.		circumstances, P would receive (directly or indirectly and whether or not at the time of the winding-up or other circumstances or later) X% or more of Q's assets which would then be available for distribution.	circumstances, P would receive more than half of C's assets which would then be available for distribution among the equity holders in C in respect of the equity in C.

105.8.2 *Which percentage?*

s.259ND TIOPA	**s.608U ITTOIA**
(1) Where this section applies for the purposes of determining whether a person has a "50% investment" in another person for the purposes of section 259NB(6), references in this section to X% are to be read as references to 50%.	
(2) Where this section applies for the purposes of determining whether a person has a "25% investment" in another person for the purposes of section 259NC(2), references in this section to X% are to be read as references to 25%.	(2) A person (P) has a 25% investment in another person (c) where any paragraph of subsection (1) would apply if in that paragraph for "more than half" there were substituted "at least a quarter".

105.8.3 *"Equity in C"*

This expression is used several times in the % investment tests. Para 9(2) sch 1A TCGA/s.464(2) TIOPA provide:

> In this paragraph/section references to the equity in C are to—
> (a) the shares in C other than restricted preference shares, or
> (b) loans to C other than normal commercial loans.[5]

The definition of "equity in C" uses the expression "shares in C". Para

[5] See 57.11 (Normal commercial loan).

9(3) sch 1A TCGA/s.464(3) TIOPA provide:

> For this purpose "shares in C" includes—
> (a) stock, and
> (b) any other interests of members in C.

105.8.4 *Equity holder*

This expression is used several times in the % investment tests. Para 9(4) sch 1A TCGA/s.464(4) TIOPA provide:

> For the purposes of this paragraph/section a person is an equity holder in C if the person possesses any of the equity in C.

105.8.5 *"Receipt"*

This expression is used several times in the % investment tests:

para 9(7) sch 1A TCGA	**s.259ND(5) TIOPA**	**s.464(7) TIOPA**
In this paragraph references to a person receiving any proceeds, amount or assets include—	In this section, references to a person receiving any proceeds, amount or assets include	In this section references to a person receiving any proceeds, amount or assets include—
(a) the direct or indirect receipt of the proceeds, amount or assets, and		[Identical to para 9]
(b) the direct or indirect application of the proceeds, amount or assets for the person's benefit,	references to the proceeds, amount or assets being applied (directly or indirectly) for that person's benefit.	[Identical to para 9]
and it does not matter whether the receipt or application is at the time of the disposal, distribution, winding-up or other circumstances or at a later time.		[Identical to para 9]
(8) If— (a) here is a direct receipt or direct application of any proceeds, amount or assets by or for the		[Identical to para 9]

benefit of a person ("A"), and (b) another person ("B") directly or indirectly owns a percentage of the equity in A,	
there is, for the purposes of sub-paragraph (7), an indirect receipt or indirect application of that percentage of the proceeds, amount or assets by or for the benefit of B.	there is, for the purposes of subsection (7), an indirect receipt or indirect application of that percentage of the proceeds, amount or assets by or for the benefit of B.
(9) For this purpose the percentage of the equity in A directly or indirectly owned by B is to be determined by applying the rules in sections 1155 to 1157 of CTA 2010 with such modifications (if any) as may be necessary.[6]	[Identical to para 9]

105.8.6 *Commercial loan exemption*

Para 9(10) sch 1A TCGA	**s.464(10) TIOPA**
Sub-paragraph (7) is not to result in a person being regarded as having a 25% investment in another person merely as a result of their being parties to a normal commercial loan.[7]	Subsection (7) is not to result in a person being regarded as having a 25% investment in another person merely as a result of their being parties to a normal commercial loan.

Para 9(6) sch 1A TCGA/s.464(6) TIOPA provide:

> In a case where C is a company which does not have share capital, in applying for the purposes of this paragraph the definitions of "normal commercial loan" and "restricted preference shares"—
> (a) sections 160(2) to (7) and 161 to 164 of CTA 2010, and
> (b) any other relevant provisions of that Act,

[6] See 64.26.2 (Indirect ownership).

[7] See 60.12 (Normal commercial loan).

have effect with the necessary modifications.

105.8.7 *Connected persons*

Para 10 sch 1A TCGA	**s.456 TIOPA**
(1) In determining for the purposes of paragraph 9 the investment that a person (“P”) has in a company, P is to be taken to have all of the rights and interests of any person connected with P.	(1) In determining for the purposes of section 464 the investment that a person (“P”) has in another person, P is to be taken to have all of the rights and interests of— (a) any person connected with P, (b) any person who is a member of a partnership, or is connected with a person who is member of a partnership, of which P is a member, or (c) any person who is a member of a partnership, or is connected with a person who is a member of a partnership, of which a person connected with P is a member.

The standard definition of connected person is amended:

Para 10 sch 1A TCGA	**s.456 TIOPA**
(2) A person is not to be regarded as connected with another person for the purposes of this paragraph merely as a result of their being parties to a loan that is a normal commercial loan for the purposes of paragraph 9. (3) Section 286 (connected persons: interpretation) has effect for the purposes of this paragraph— (a) as if, in subsection (2), for the words from “, or is a relative” to the end there were substituted “or is a lineal ancestor or lineal descendant of the individual or of the individual's spouse or civil partner”, and (b) as if subsections (4) and (8) were omitted.	(2) For the purposes of subsection (1)— (a) section 1122 of CTA 2010 (“connected” persons) applies but as if subsections (7) and (8) of that section were omitted, but (b) a person is not to be regarded as connected with another person merely as a result of their being parties to a loan that is a normal commercial loan for the purposes of section 464.

These definitions have similarities but are not identical. I consider only the CGT definition here.

Amended as para 9(3)(a) directs, s.268(2) provides:

> A person is connected with an individual if that person is the individual's spouse or civil partner, ~~or is a relative, or the spouse or civil partner of a relative, of the individual or of the individual's spouse or civil partner~~ or is a lineal ancestor or lineal descendant of the individual or of the individual's spouse or civil partner.

The effect of deleting s.286(4) is that partners are not connected persons. Section 286(8) is the definition of relative; it is deleted for neatness as it is not needed, as a result of the amendment to s.268(2).

105.8.8 *Acting together*

The following rule does not apply for sch 1A TCGA:

s.259ND TIOPA	**s.465 TIOPA**
(6) For the purposes of subsections (3) and (4), in determining what percentage investment a person ("P") has in another person ("U"), where P acts together with a third person ("T") in relation to U, P is to be taken to have all of T's rights and interests in relation to U.[8]	(3) In determining for the purposes of section 464 the investment that a person ("P") has in another person ("U"), P is to be taken to have all of the rights and interests of a third person ("T") with whom P acts together in relation to U. ("P") has in another person ("U"),
(7) P is to be taken to "act together" with T in relation to U if (and only if) subsection (7A) or (7B) applies. (7A) This subsection applies if— (a) P and T are party to a partnership agreement that— (i) it is reasonable to suppose is designed to affect the value of any of T's rights or interest in relation to U, or (ii) relates to the exercise of any of T's rights in relation to U, or (b) the same person manages— (i) some or all of P's rights or interests in relation to U, and (ii) some or all of T's rights or interests in relation to U.	(4) For this purpose P "acts together" with T in relation to U if (and only if)— (a) for the purpose of influencing the conduct of U's affairs— (i) P is able to secure that T acts in accordance with P's wishes (or vice versa), or (ii) T can reasonably be expected to act, or typically acts, in accordance with P's wishes (or vice versa), (b) P and T are party to an arrangement that it is reasonable to conclude is designed to affect the value of any equity in U possessed by T, or (c) the same person manages some or all of any equity in U possessed by P and T. In paragraphs (b) and (c) references to equity in U are to be read in accordance with section 464.

[8] See 91.25.4 (Acting together).

(7B) This subsection applies if P has a relevant investment in U and—
(a) P and T are connected (within the meaning given by section 163),
(b) for the purposes of influencing the conduct of U's affairs—
(i) P is able to secure that T acts in accordance with P's wishes,
(ii) T can reasonably be expected to act, or typically acts, in accordance with P's wishes,
(iii) T is able to secure that P acts in accordance with T's wishes, or
(iv) P can reasonably be expected to act, or typically acts, in accordance with T's wishes, or
(c) P and T are party to any arrangement that—
(i) it is reasonable to suppose is designed to affect the value of any of T's rights or interests in relation to U, or
(ii) relates to the exercise of any of T's rights in relation to U.

(5) But P does not "act together" with T in relation to U under subsection (4)(c) if—
(a) the managing person does so as the operator of different collective investment schemes, and
(b) the management of the schemes is not coordinated for the purpose of influencing the conduct of U's affairs.
(6) For this purpose "collective investment scheme" and "operator" have the same meaning as in Part 17 of the Financial Services and Markets Act 2000 (see sections 235 and 237).

(7) In determining for the purposes of section 464 the investment that a person P is to be taken to have all of the rights and interests of one or more third persons with whom P has entered into a qualifying arrangement in relation to U.
(8) For this purpose P has entered into a qualifying arrangement with one or more third persons in relation to U if they are parties to an arrangement concerning U as a result of which, by reference to shares held, or to be held, by any one or more of them in U, they can reasonably be expected to act together—
(a) so as to exert greater influence in relation to U than any one of them would be able to exert if acting alone, or
(b) otherwise so as to be able to achieve an outcome in relation to U that, if attempted by any one of them acting alone, would be significantly more difficult to achieve.
(9) For this purpose the reference to shares in U includes shares in U that may be held as a result of the exercise of any right or power and includes rights or interests in U that are of a similar character to shares.
(10) In this section "arrangement" includes any agreement, understanding,

(7C) To determine whether P has a "relevant investment" in U at a particular time, subsections (3) and (4) apply but as if—
(a) for "an X%", in both places, there were substituted "a relevant", and
(b) for "X% or more", in each place, there were substituted "greater than 5%".
(7D) For that purpose—
(a) subsection (6) is to be ignored, and
(b) P's rights and interests are to be aggregated with the rights and interests of persons connected to P (within the meaning given by section 1122 of CTA 2010, ignoring subsection (4) of that section).

(8) P does not "act together" with T in relation to U under paragraph (b) of subsection (7A) where—
(a) the person who manages the rights or interests of P mentioned in sub-paragraph (i) of that paragraph, does so as the operator of a collective investment scheme,
(b) that person manages the rights or interests of T mentioned in sub-paragraph (ii) of that paragraph as the operator of a different collective investment scheme, and
(c) the Commissioners are satisfied that the management of the schemes is not coordinated for the purpose of influencing the conduct of U 's affairs.
(9) In subsection (8) "collective investment scheme" and "operator" have the same meaning as in Part 17 of the Financial Services and Markets Act 2000 (see sections 235 and 237 of that Act).

scheme, transaction or series of transactions (whether or not legally enforceable).

CHAPTER ONE HUNDRED AND SIX

PERMANENT ESTABLISHMENT AND BRANCH/AGENCY

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106.1 PE: Introduction

It is not practical to set out a full list of the tax significance of a UK PE, but the following are the most important.

PE is central to the territorial limitations of corporation tax:

(1) A non-resident company trading through a PE is subject to corporation tax on income linked to the PE.[1] In the absence of a PE, a non-resident company trading in the UK is not subject to CT. Instead the company is in principle[2] subject to income tax on its income.

(2) A company trading in the UK through a PE is subject to corporation tax on gains linked to the PE.[3] In the absence of a PE, a non-resident company is not in general subject to CT/CGT on its gains.

PE is central to DT relief: In the absence of a PE, a person treaty-resident in a foreign State with a DTA in OECD Model form generally qualifies for relief for UK source trading income, dividends, interest, royalties, capital gains and other income. All these reliefs are restricted for income/gains linked to a PE.

Corporation Tax may be collected from the PE.[4]

PE of a corporate trustee is relevant to trust residence.

If a non-resident *individual or trustee* is carrying on a trade in the UK,

[1] See 21.6 (CT territorial limit: Trading).

[2] I say "in principle" because::
(1) It is unusual for activity of a non-resident company to constitute trading in the UK but not trading through a PE; see 106.24 (Trade in UK without PE); and
(2) If it did happen, investment manager exemptions or DT relief will often apply.

[3] See 56.7 (Trade through UK branch/PE).

[4] See 124.2 (Tax collected from UK representative).

the UK domestic law tax position is not affected whether or not they are carrying on their trade through a PE; but similar rules apply if they are carrying on business through a branch/agency, which is a similar concept.[5]

A PE or branch is not a "person"[6] though for many purposes it is treated as one.

The topic of PE need a long book to itself and several such books have been written.[7] This chapter is a (relatively) brief introduction.

106.2 PE: UK-law/OECD Model meanings

There are two principal definitions of PE in tax legislation:

My term	**INTM term**	**Defined**
UK-law PE	Domestic law PE	s.1141 CTA 2010
OECD Model PE	Treaty PE[8]	Art 5 OECD Model

There are 2 principal types of PE:

Type of PE	**CTA 2010**	**OECD Model**	**See para**
Fixed place of business PE	s.1141(1)(a)	Art 5(1)	106.5
Agency-PE	s.1141(1)(b)	Art 5(5)	106.12

106.2.1 *Pre/post-2017 OECD Model*

The OECD Model was amended in 2017, so I refer to:

(a) Pre-2017 Model form

(b) Post-2017 Model form

The OECD Commentary was also amended in 2017. It comments on the changes:

> 3. In 2017, a number of changes were made to this Commentary. Some of these changes were intended to clarify the interpretation of the Article and, as such, should be taken into account for the purposes of the interpretation and application of conventions concluded before their

[5] See 106.26 (Why branch/agency matters).

[6] See App.2.6 (Person/legal personality).

[7] There is a bibliography in Reimer, Urban and Schmid (ed), *Permanent Establishments* (2011), para 1.3. See too IFA, *Is there a Permanent Establishment?* Cahiers du Droit International (Vol 94a, 2009); [2006] BTR at p.722. For Australian Revenue views, see Taxation Ruling TR 2002/5.

[8] I prefer the term "OECD Model PE" because treaty definitions are not all the same; see 106.23 (PE: Pre-1963 DTAs).

> adoption because they reflect the consensus of the OECD member countries as to the proper interpretation of existing provisions and their application to specific situations (see paragraph 35 of the Introduction).[9]
> 4. Changes to this Commentary related to the addition of paragraph 4.1 and the modification of paragraphs 4, 5 and 6 of the Article that were made as a result of the adoption of the Report on Action 7 of the OECD/G20 Base Erosion and Profit Shifting Project were, however, prospective only and, as such, do not affect the interpretation of the former provisions of the OECD Model Tax Convention and of treaties in which these provisions are included, in particular as regards the interpretation of paragraphs 4 and 5 of the Article as they read before these changes (see paragraph 4 of that Report).

106.2.2 *Scope of UK-law definition*

Section 1141(1) CTA 2010 provides:

> For the purposes of the Corporation Tax Acts a company has a permanent establishment in a territory if ...

This definition applies only for the purposes of the Corporation Tax Acts, so it needs to be incorporated when the same term is used elsewhere:

s.288 TCGA	**s.989 ITA**
In this Act, unless the context otherwise requires—	The following definitions apply for the purposes of the Income Tax Acts—
“permanent establishment”, in relation to a company, is to be read in accordance with Chapter 2 of Part 24 of CTA 2010	“permanent establishment”, in relation to a company, is to be read in accordance with Chapter 2 of Part 24 of CTA 2010

Thus the UK-law definition applies throughout the Taxes Acts, but it only applies in relation to companies.

If a UK tax statute used the expression PE in relation to a *non-company*, the statutory definition would not apply[10] and the expression would (subject to context) bear its normal meaning. I think OECD Model meaning is the normal meaning, though if the view expressed here is right, that UK-law PE has the same meaning as OECD Model PE, then it makes no difference.

[9] See 107.10.6 (Variations between DTAs).

[10] Unless expressly extended; for an example, see 32.8.3 (Deemed UK source).

106.2.3 *Role of OECD Model definition*

OECD Commentary provides:

> 9. ... the determination of whether or not an enterprise of a Contracting State has a permanent establishment in the other Contracting State must be made independently from the determination of which provisions of the Convention apply to the profits derived by that enterprise. For instance, a farm or apartment rental office situated in a Contracting State and exploited by a resident of the other Contracting State may constitute a permanent establishment regardless of whether or not the profits attributable to such permanent establishment would constitute income from immovable property covered by Article 6; whilst the existence of a permanent establishment in such cases may not be relevant for the application of Article 6, it would remain relevant for the purposes of other provisions such as:[11]
>
> | **Provision** | **Topic** | **See para** |
> |---|---|---|
> | Art 11(4) | Business income/interest overlap | 107.9.2 |
> | Art 11(5) | Source of interest | 26.27.6 |
> | Art 15(2) | Employment income: short term visitors | 37.12 |
> | Art 24(3) | Non-discrimination | - |

106.2.4 *Trading through PE*

UK tax provisions refer to a company carrying on a trade through a PE, so one might think that there are two distinct questions:

(1) whether a PE exists
(2) whether the company is carrying on a trade through the PE.

However PE is defined as "a fixed place of business through which the business of the company is carried on"; so if a company owns (say) an office building which it does not use (or which it does not use for its business) then strictly the office building is not a PE at all.

A let property is not normally a PE of the landlord; contrast 106.10.2 (Commencement/cessation of business).

106.2.5 *The future*

A consultation paper floats possible changes; see HMRC, "Reform of UK law in relation to transfer pricing, permanent establishment and Diverted

[11] For clarity I have set this out in tabular form rather than the layout of the Manual.

Profits Tax".[12]

106.3 PE in non-tax contexts

PE and branch/agency (or similar concepts) are also relevant for many non-tax purposes, such as civil jurisdiction.

In *Adams v Cape Industries*:[13]

> The English courts will be likely to treat a trading corporation incorporated under the law of one country ('an overseas corporation') as present within the jurisdiction of the courts of another country only if either (i) it has established and maintained at its own expense (whether as owner or lessee) a fixed place of business of its own in the other country and for more than a minimal period of time has carried on its own business at or from such premises by its servants or agents...; or (ii) a representative of the overseas corporation has for more than a minimal period of time been carrying on the overseas corporation's end business in the other country at or from some fixed place of business.

106.3.1 *Overseas Companies Regs 2009*

The concept of establishment is found in Overseas Companies Regulations 2009, which applies to an overseas company with a UK establishment. Reg 2 Overseas Companies Regulations 2009 provides:

> "establishment" means—
>
> (a) a branch within the meaning of the Eleventh Company Law Directive (89/666/EEC),[14] or
>
> (b) a place of business that is not such a branch,
>
> and "UK establishment" means an establishment in the United Kingdom;

We are in a similar line of country, here.

106.3.2 *VAT*

Section 9 VATA refers to a business establishment, or some other fixed establishment, again a similar line of country.

[12] *https://www.gov.uk/government/consultations/uk-law-reform-in-transfer-pricing-permanent-establishment-and-diverted-profits-tax/reform-of-uk-law-in-relation-to-transfer-pricing-permanent-establishment-and-diverted-profits-tax#permanent-establishments* (June 2023)

[13] [1990] 1 Ch 433.

[14] This directive, since repealed, used the word "branch" but did not provide a definition.

OECD Commentary provides:

> 5. In many States, a foreign enterprise may be allowed or required to register for the purposes of a value added tax or goods and services tax (VAT/GST) regardless of whether it has in that State a fixed place of business through which its business is wholly or partly carried on or whether it is deemed to have a permanent establishment in that State under paragraph 5 of Article 5. By itself, however, application of the definition of permanent establishment in the Convention; when applying that definition, one should not, therefore, draw any inference from the treatment of a foreign enterprise for VAT/GST purposes, including from the fact that a foreign enterprise has registered for VAT/GST purposes.[15]

106.4 Some general points

106.4.1 *Productive character irrelevant*

OECD Commentary provides:

> 7. It could perhaps be argued that in the general definition some mention should also be made of the other characteristic of a permanent establishment to which some importance has sometimes been attached in the past, namely that the establishment must have a productive character, i.e. contribute to the profits of the enterprise. In the present definition this course has not been taken. Within the framework of a well-run business organisation it is surely axiomatic to assume that each part contributes to the productivity of the whole. It does not, of course, follow in every case that because in the wider context of the whole organisation a particular establishment has a "productive character" it is consequently a permanent establishment to which profits can properly

[15] Footnote original: See paragraph 337 of the Report on Action 1 of the BEPS Project ("… it is important to underline that registration for VAT purposes is independent from the determination of whether there is a permanent establishment (PE) for income tax purposes."), OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, *https://doi.org/10.1787/9789264241046-en* Cf. footnote 24 of the International VAT/GST Guidelines ("For the purpose of these Guidelines, it is assumed that an establishment comprises a fixed place of business with a sufficient level of infrastructure in terms of people, systems and assets to be able to receive and/or make supplies. Registration for VAT purposes by itself does not constitute an establishment for the purposes of these Guidelines. Countries are encouraged to publicise what constitutes an "establishment" under their domestic VAT legislation."), OECD (2017), International VAT/GST Guidelines, OECD Publishing, Paris, *https://doi.org/10.1787/9789264271401-en*

be attributed for the purpose of tax in a particular territory (see Commentary on paragraph 4).

106.4.2 *Period of enquiry*

OECD Commentary makes an obvious point:

> 8. It is also important to note that the way in which business is carried on evolves over the years so that the facts and arrangements applicable at one point in time may no longer be relevant after a change in the way that the business activities are carried on in a given State. Clearly, whether or not a permanent establishment exists in a State during a given periodmust be determined on the basis of the circumstances applicable during that period and not those applicable during a past or future period, such as a period preceding the adoption of new arrangements that modified the way in which business is carried on.

106.5 Fixed place of business PE

The UK-law/OECD Model provisions are substantially the same:

s.1141(1) CTA 2010	**Art 5(1) OECD Model**
For the purposes of the Corporation Tax Acts a company has a permanent establishment in a territory if (and only if)—	For the purposes of this Convention, the term "permanent establishment" means
(a) it has a fixed place of business there through which the business of the company is wholly or partly carried on	a fixed place of business through which the business of an enterprise is wholly or partly carried on.

OECD Commentary provides:

> 6... This definition ... contains the following conditions:
> [1] the existence of a "place of business", i.e. a facility such as premises or, in certain instances, machinery or equipment;
> [2] this place of business must be "fixed", i.e. it must be established at a distinct place with a certain degree of permanence;
> [3] the carrying on of the business of the enterprise through this fixed place of business. This means usually that persons who, in one way or another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.

I refer to these as the geographic, permanence and personnel conditions.

106.6 Geographic condition

OECD Commentary provides:

> 10. The term "place of business" covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the enterprise. A place of business may thus be constituted by a pitch in a market place, or by a certain permanently used area in a customs depot (e.g. for the storage of dutiable goods). Again the place of business may be situated in the business facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise.
> 11. ... the mere fact that an enterprise has a certain amount of space at its disposal which is used for business activities is sufficient to constitute a place of business. No formal legal right to use that place is therefore required. Thus, for instance, a permanent establishment could exist where an enterprise illegally occupied a certain location where it carried on its business.

The Commentary defines "at the disposal of the employee":

> 12. Whilst no formal legal right to use a particular place is required for that place to constitute a permanent establishment, the mere presence of an enterprise at a particular location does not necessarily mean that that location is at the disposal of that enterprise. Whether a location may be considered to be at the disposal of an enterprise in such a way that it may constitute a "place of business through which the business of [that] enterprise is wholly or partly carried on" will depend on that enterprise having the effective power to use that location as well as the extent of the presence of the enterprise at that location and the activities that it performs there. This is illustrated by the following examples. Where an enterprise has an exclusive legal right to use a particular location which is used only for carrying on that enterprise's own business activities (e.g. where it has legal possession of that location), that location is clearly at the disposal of the enterprise. This will also be the case where an enterprise is allowed to use a specific location that belongs to another enterprise or that is used by a number of enterprises and performs its business activities at that location on a continuous basis during an extended period of time. This will not be the case, however, where the

> enterprise's presence at a location is so intermittent or incidental that the location cannot be considered a place of business of the enterprise (e.g. where employees of an enterprise have access to the premises of associated enterprises which they often visit but without working in these premises for an extended period of time). Where an enterprise does not have a right to be present at a location and, in fact, does not use that location itself, that location is clearly not at the disposal of the enterprise; thus, for instance, it cannot be considered that a plant that is owned and used exclusively by a supplier or contract-manufacturer is at the disposal of an enterprise that will receive the goods produced at that plant merely because all these goods will be used in the business of that enterprise (see also paragraphs 65, 66 and 121 below). ...
>
> 13. These principles are illustrated by the following additional examples where representatives of one enterprise are present on the premises of another enterprise.

The OECD commentary gives 4 examples. In outline:

Para: Facts	**PE**
14: Salesperson visits customer regularly	No
15: Employee of parent uses premises of subsidiary	Yes
16: Transportation enterprise uses delivery dock at customer's warehouse	No
17: Painter works in building 3 days/week for 2 years	Yes
18/19: Home office	Not usually[16]

> 14. A first example is that of a salesman who regularly visits a major customer to take orders and meets the purchasing director in his office to do so. In that case, the customer's premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a place of business through which the business of that enterprise is carried on (depending on the circumstances, however, paragraph 5 [agency-PE] could apply to deem a permanent establishment to exist).
>
> 15. A second example is that of an employee of a company who, for a long period of time, is allowed to use an office in the headquarters of another company (e.g. a newly acquired subsidiary) in order to ensure that the latter company complies with its obligations under contracts concluded with the former company. In that case, the employee is carrying on activities related to the business of the former company and the office that is at his disposal at the headquarters of the other company

[16] See 106.15 Remote working/home office).

> will constitute a permanent establishment of his employer, provided that the office is at his disposal for a sufficiently long period of time so as to constitute a "fixed place of business" (see paragraphs 28 to 34) and that the activities that are performed there go beyond the activities referred to in paragraph 4 of the Article [Preparatory/auxiliary activities].
>
> 16. A third example is that of a road transportation enterprise which would use a delivery dock at a customer's warehouse every day for a number of years for the purpose of delivering goods purchased by that customer. In that case, the presence of the road transportation enterprise at the delivery dock would be so limited that that enterprise could not consider that place as being at its disposal so as to constitute a permanent establishment of that enterprise.
>
> 17. A fourth example is that of a painter who, for two years, spends three days a week in the large office building of its main client. In that case, the presence of the painter in that office building where he is performing the most important functions of his business (i.e. painting) constitute a permanent establishment of that painter.

106.7 "Through which" enterprise carried on

The OECD commentary provides:

> 20. The words "through which" must be given a wide meaning so as to apply to any situation where business activities are carried on at a particular location that is at the disposal of the enterprise for that purpose. Thus, for instance, an enterprise engaged in paving a road will be considered to be carrying on its business "through" the location where this activity takes place.

106.8 Fixed/permanency condition

106.8.1 *"Fixed" place*

The OECD commentary provides:

> 21. According to the definition, the place of business has to be a "fixed" one. Thus in the normal way there has to be a link between the place of business and a specific geographical point. It is immaterial how long an enterprise of a Contracting State operates in the other Contracting State if it does not do so at a distinct place, but this does not mean that the equipment constituting the place of business has to be actually fixed to the soil on which it stands. It is enough that the equipment remains on a particular site (but see paragraph 57 below).
>
> 22. Where the nature of the business activities carried on by an enterprise is such that these activities are often moved between

neighbouring locations, there may be difficulties in determining whether there is a single "place of business" (if two places of business are occupied and the other requirements of Article 5 are met, the enterprise will, of course, have two permanent establishments). As recognised in paragraphs 51 and 57 below a single place of business will generally be considered to exist where, in light of the nature of the business, a particular location within which the activities are moved may be identified as constituting a coherent whole commercially and geographically with respect to that business.

23. This principle may be illustrated by examples. A mine clearly constitutes a single place of business even though business activities may move from one location to another in what may be a very large mine as it constitutes a single geographical and commercial unit as concerns the mining business. Similarly, an "office hotel" in which a consulting firm regularly rents different offices may be considered to be a single place of business of that firm since, in that case, the building constitutes a whole geographically and the hotel is a single place of business for the consulting firm. For the same reason, a pedestrian street, outdoor market or fair in different parts of which a trader regularly sets up his stand represents a single place of business for that trader.

24. By contrast, where there is no commercial coherence, the fact that activities may be carried on within a limited geographic area should not result in that area being considered as a single place of business. For example, where a painter works successively under a series of unrelated contracts for a number of unrelated clients in a large office building so that it cannot be said that there is one single project for repainting the building, the building should not be regarded as a single place of business for the purpose of that work. However, in the different example of a painter who, under a single contract, undertakes work throughout a building for a single client, this constitutes a single project for that painter and the building as a whole can then be regarded as a single place of business for the purpose of that work as it would then constitute a coherent whole commercially and geographically.

25. Conversely, an area where activities are carried on as part of a single project which constitutes a coherent commercial whole may lack the necessary geographic coherence to be considered as a single place of business. For example, where a consultant works at different branches in separate locations pursuant to a single project for training the employees of a bank, each branch should be considered separately. However if the consultant moves from one office to another within the same branch location, he should be considered to remain in the same

> place of business. The single branch location possesses geographical coherence which is absent where the consultant moves between branches in different locations.
> 26. A ship that navigates in international waters or within one or more States is not fixed and does not, therefore, constitute a fixed place of business (unless the operation of the ship is restricted to a particular area that has commercial and geographic coherence). Business activities carried on aboard such a ship, such as the operation of a shop or restaurant, must be treated the same way for the purposes of determining whether paragraph 1 applies (paragraph 5 could apply, however, to some of these activities, e.g. where contracts are concluded when such shops or restaurants are operated within a State).
> 27. [This para discusses the somewhat niche question of whether a geostationary satellite is a PE.]

106.8.2 *Degree of permanency*

The OECD Commentary provides:

> 28. Since the place of business must be fixed, it also follows that a permanent establishment can be deemed to exist only if the place of business has a certain degree of permanency, i.e. if it is not of a purely temporary nature.

That might also be inferred from the label *permanent* establishment. But what is "permanent" may be for quite a short period:[17]

> A place of business may, however, constitute a permanent establishment even though it exists, in practice, only for a very short period of time because the nature of the business is such that it will only be carried on for that short period of time. It is sometimes difficult to determine whether this is the case. Whilst the practices followed by member countries have not been consistent in so far as time requirements are concerned, experience has shown that permanent establishments normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months (conversely, practice shows that there were many cases where a permanent establishment has been considered to exist where the place of business was maintained for a period longer than six months).
> [1] One exception has been where the activities were of a recurrent

[17] Contrast 9.12.2 ("Permanent").

nature; in such cases, each period of time during which the place is used needs to be considered in combination with the number of times during which that place is used (which may extend over a number of years).

[2] Another exception has been made where activities constituted a business that was carried on exclusively in that country; in this situation, the business may have short duration because of its nature but since it is wholly carried on in that country, its connection with that country is stronger. ...

29. [Exception [1]] is illustrated by the following example. An enterprise of State R carries on drilling operations at a remote arctic location in State S. The seasonal conditions at that location prevent such operations from going on for more than three months each year but the operations are expected to last for five years. In that case, given the nature of the business operations at that location, it could be considered that the time requirement for a permanent establishment is met due to the recurring nature of the activity regardless of the fact that any continuous presence lasts less than six months; the time requirement could similarly be met in the case of shorter recurring periods of time that would be dictated by the specific nature of the relevant business.

30. [Exception [2]] is illustrated by the following example. An individual resident of State R has learned that a television documentary will be shot in a remote village in State S where her parents still own a large house. The documentary will require the presence of a number of actors and technicians in that village during a period of four months. The individual contractually agrees with the producer of the documentary to provide catering services to the actors and technicians during the four-month period and, pursuant to that contract, she uses the house of her parents as a cafeteria that she operates as sole proprietor during that period. These are the only business activities that she has carried on and the enterprise is terminated after that period; the cafeteria will therefore be the only location where the business of that enterprise will be wholly carried on. In that case, it could be considered that the time requirement for a permanent establishment is met since the restaurant is operated during the whole existence of that particular business. This would not be the situation, however, where a company resident of State R which operates various catering facilities in State R would operate a cafeteria in State S during a four-month production of a documentary. In that case, the company's business, which is permanently carried on in State R, is only temporarily carried on in State S.

...

> 32. As mentioned in paragraphs 44 and 55, temporary interruptions of activities do not cause a permanent establishment to cease to exist. Similarly, as discussed in paragraph 6, where a particular place of business is used for only very short periods of time but such usage takes place regularly over long periods of time, the place of business should not be considered to be of a purely temporary nature.
>
> 33. Also, there may be cases where a particular place of business would be used for very short periods of time by a number of similar businesses carried on by the same or related persons in an attempt to avoid that the place be considered to have been used for more than purely temporary purposes by each particular business. The remarks of paragraphs 52 and 53 on arrangements intended to abuse the twelve-month period provided for in paragraph 3[18] would equally apply to such cases.
>
> 34. Where a place of business which was, at the outset, designed to be used for such a short period of time that it would not have constituted a permanent establishment but is in fact maintained for such a period that it can no longer be considered as a temporary one, it becomes a fixed place of business and thus — retrospectively — a permanent establishment. A place of business can also constitute a permanent establishment from its inception even though it existed, in practice, for a very short period of time, if as a consequence of special circumstances (e.g. death of the taxpayer, investment failure), it was prematurely liquidated...

106.8.3 *Leasing*

OECD Commentary provides:

> 36. Where tangible property such as facilities, industrial, commercial or scientific (ICS) equipment, buildings, or intangible property such as patents, procedures and similar property, are let or leased to third parties through a fixed place of business maintained by an enterprise of a Contracting State in the other State, this activity will, in general, render the place of business a permanent establishment. The same applies if capital is made available through a fixed place of business. If an enterprise of a State lets or leases facilities, ICS equipment, buildings or intangible property to an enterprise of the other State without maintaining for such letting or leasing activity a fixed place of business in the other State, the leased facility, ICS equipment, building or intangible property, as such, will not constitute a permanent establishment of the lessor provided the contract is limited to the mere

[18] See 106.11.1 (Building/construction site).

leasing of the ICS equipment, etc. This remains the case even when, for example, the lessor supplies personnel after installation to operate the equipment provided that their responsibility is limited solely to the operation or maintenance of the ICS equipment under the direction, responsibility and control of the lessee. If the personnel have wider responsibilities, for example, participation in the decisions regarding the work for which the equipment is used, or if they operate, service, inspect and maintain the equipment under the responsibility and control of the lessor, the activity of the lessor may go beyond the mere leasing of ICS equipment and may constitute an entrepreneurial activity. In such a case a permanent establishment could be deemed to exist if the criterion of permanency is met. When such activity is connected with, or is similar in character to, those mentioned in paragraph 3, the time limit of twelve months applies. Other cases have to be determined according to the circumstances.

37. [This paragraph considers the niche topic of container leasing]

37. [This paragraph considers the niche topic of telecommunication networks]

106.8.4 *HMRC guidance*

The INT Manual provides:

INTM264435: fixed place of business [Jun 2023]

The following examples look at scenarios where employees of overseas businesses take advantage of increased flexibility and mobility in their working conditions to spend blocks of time working in the UK. This guidance focuses on the impact of the fixed place of business permanent establishment rules on these scenarios. In each case, a business would have to separately consider whether the trigger for a dependent agent PE may be met on the same facts and circumstances.

These examples are focused on corporation tax and therefore the personal or indirect tax consequences are not addressed here.

Example 1: [Juan]

J, who works for a foreign entity in State D, comes to Brighton on holiday and stays on to work here for a total of 40 calendar days including his holiday, using the office of a UK affiliate company as a base. He enjoys the experience so much he decides to do the same thing six months later.

Under such an arrangement, J's presence would not create a fixed place of business permanent establishment because, irrespective of any other conditions, the permanence test would not be met. However, if this arrangement was expected to be an annual occurrence for J and/or his

> successors or colleagues in his team, the business may have to consider whether the cumulative time spent in the UK could trigger a permanent establishment.

"The business may have to consider..." is not exactly guidance.

> *Example 2:* [Francine]
> F, a French national with an English partner, joins a French company on a permanent contract which permits her to spend a fixed three-month period each year working in the UK.
> Under such an arrangement, F's presence would meet the permanence test for a fixed place of business permanent establishment because the cumulative time she is anticipated to spend in the UK over the coming few years is significant and her presence in the UK is fixed and so not random or sporadic.
> Whether a PE would be created would depend on the wider facts and circumstances.

"Depends on the facts" is not exactly guidance".

> *Example 3:* [Alexei, Luca and Sara]
> Alexei, Luca and Sara all work for a foreign entity in State C. They come to the UK on holiday for the same part of the year with their families, staying at different addresses. They are all permitted to stay on an additional 30 days to work in the UK by their employer, using the office of a UK affiliate company as a base.
> Under such an arrangement, their presence would not create a fixed place of business permanent establishment because, irrespective of any other conditions, the permanence test would not be met.
> *Example 4:* [Company T]
> Company T has a team of staff in its Zurich office. Over the course of nine months, six staff are permitted to spend six weeks each, in turn, at an affiliate company's office in London working on a project. This scenario would meet the permanence test for a fixed place of business permanent establishment because the changing identity of the visiting personnel doesn't affect the continuity of Company T's presence in the UK.
> *Example 5:* [Jasmine]
> J, who works for a company based in the UK, is seconded to cover six months of maternity leave for a related foreign company in State E. She does this remotely from her UK office and her home in London.
> This will not automatically be exempted from triggering a fixed place of business PE of that related foreign company in the UK and the facts will have to be examined as usual in determining if a PE is triggered.

"The facts will have to be examined" is not exactly guidance.

106.9 Personnel condition

To apply the personnel condition one has to identify who are the personnel.

The OECD Model provides:

> 39. There are different ways in which an enterprise may carry on its business. In most cases, the business of an enterprise is carried on by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents). The powers of such personnel in its relationship with third parties are irrelevant. It makes no difference whether or not the dependent agent is authorised to conclude contracts if he works at the fixed place of business of the enterprise (see paragraph 100 below).

106.9.1 *Formal v effective employment*

The OECD Commentary applies the distinction between formal/effective employers which is used in the short term business visitor rules:[19]

> 39... As explained in paragraph 8.11 of the Commentary on Article 15, however, there may be cases where individuals who are formally employed by an enterprise will actually be carrying on the business of another enterprise and where, therefore, the first enterprise should not be considered to be carrying on its own business at the location where these individuals will perform that work. Within a multinational group, it is relatively common for employees of one company to be temporarily seconded to another company of the group and to perform business activities that clearly belong to the business of that other company. In such cases, administrative reasons (e.g. the need to preserve seniority or pension rights) often prevent a change in the employment contract. The analysis described in paragraphs 8.13 to 8.15 of the Commentary on Article 15 will be relevant for the purposes of distinguishing these cases from other cases where employees of a foreign enterprise perform that enterprise's own business activities

106.9.2 *Subcontractors*

The OECD Commentary provides:

[19] See 37.9 (Labour-hire arrangement).

40. An enterprise may also carry on its business through subcontractors, acting alone or together with employees of the enterprise. In that case, a permanent establishment will only exist for the enterprise if the other conditions of Article 5 are met (this, however, does not address the separate question of how much profit is attributable to such a permanent establishment). In the context of paragraph 1, the existence of a permanent establishment in these circumstances will require that these subcontractors perform the work of the enterprise at a fixed place of business that is at the disposal of the enterprise. Whether a fixed place of business where subcontractors perform work of an enterprise is at the disposal of that enterprise will be determined on the basis of the guidance in paragraph 12; in the absence of employees of the enterprise, however, it will be necessary to show that such a place is at the disposal of the enterprise on the basis of other factors showing that the enterprise clearly has the effective power to use that site, e.g. because the enterprise owns or has legal possession of that site and controls access to and use of the site. Paragraph 54 illustrates such a situation in the case of a construction site; this could also happen in other situations. An example would be where an enterprise that owns a small hotel and rents out the hotel's rooms through the Internet has subcontracted the on-site operation of the hotel to a company that is remunerated on a cost-plus basis.

106.9.3 *Equipment not personnel*

41. Also, a permanent establishment may exist if the business of the enterprise is carried on mainly through automatic equipment, the activities of the personnel being restricted to setting up, operating, controlling and maintaining such equipment. Whether or not gaming and vending machines and the like set up by an enterprise of a State in the other State constitute a permanent establishment thus depends on whether or not the enterprise carries on a business activity besides the initial setting up of the machines. A permanent establishment does not exist if the enterprise merely sets up the machines and then leases the machines to other enterprises. A permanent establishment may exist, however, if the enterprise which sets up the machines also operates and maintains them for its own account. This also applies if the machines are operated and maintained by an agent dependent on the enterprise.

106.10 The enterprise

In order to have a PE, there has to be an enterprise; for the definition see 21.23.2 ("Enterprise").

The OECD Commentary considers what amounts to a distinct enterprise:

> 42. It follows from the definition of "enterprise of a Contracting State" in Article 3 that this term, as used in Article 7, and the term "enterprise" used in Article 5, refer to any form of enterprise carried on by a resident of a Contracting State, whether this enterprise is legally set up as a company, partnership, sole proprietorship or other legal form.
>
> Different enterprises may collaborate on the same project and the question of whether their collaboration constitutes a separate enterprise (e.g. in the form of a partnership) is a question that depends on the facts and the domestic law of each State. Clearly, if two persons each carrying on a separate enterprise decide to form a company in which these persons are shareholders, the company constitutes a legal person that will carry on what becomes another separate enterprise. It will often be the case, however, that different enterprises will simply agree to each carry on a separate part of the same project and that these enterprises will not jointly carry on business activities, will not share the profits thereof and will not be liable for each other's activities related to that project even though they may share the overall output from the project or the remuneration for the activities that will be carried on in the context of that project. In such a case, it would be difficult to consider that a separate enterprise has been set up.[20] Although such an arrangement would be referred to as a "joint venture" in many countries, the meaning of "joint venture" depends on domestic law and it is therefore possible that, in some countries, the term "joint venture" would refer to a distinct enterprise.

106.10.1 *PE of partnership*

The OECD Commentary provides:

> 43. In the case of an enterprise that takes the form of a fiscally transparent partnership, the enterprise is carried on by each partner and, as regards the partners' respective shares of the profits, is therefore an enterprise of each Contracting State of which a partner is a resident. If such a partnership has a permanent establishment in a Contracting State, each partner's share of the profits attributable to the permanent establishment will therefore constitute, for the purposes of Article 7,

[20] The Commentary continues:
But in English law, at least, "joint venture" is a loose phrase which is applicable to a wide variety of legal arrangements, and does not convey much information about their nature. Contrast 85.5.6 (Partnership v joint venture).

> profits derived by an enterprise of the Contracting State of which that partner is a resident (see also paragraph 56 below).[21]

106.10.2 *Commencement/cessation of business*

The OECD Commentary provides:

> 44. A permanent establishment begins to exist as soon as the enterprise commences to carry on its business through a fixed place of business. This is the case once the enterprise prepares, at the place of business, the activity for which the place of business is to serve permanently. The period of time during which the fixed place of business itself is being set up by the enterprise should not be counted, provided that this activity differs substantially from the activity for which the place of business is to serve permanently.
>
> The permanent establishment ceases to exist with the disposal of the fixed place of business or with the cessation of any activity through it, that is when all acts and measures connected with the former activities of the permanent establishment are terminated (winding up current business transactions, maintenance and repair of facilities). A temporary interruption of operations, however, cannot be regarded as a closure.
>
> If the fixed place of business is leased to another enterprise, it will normally only serve the activities of that enterprise instead of the lessor's; in general, the lessor's permanent establishment ceases to exist, except where he continues carrying on a business activity of his own through the fixed place of business.

106.11 Items included as PE

The PE definitions provide a list of items which constitute a fixed place of business PE. The first seven are:

s.1141(2) CTA 2010	**OECD Model Art 5(2).**
For this purpose a "fixed place of business" includes (without prejudice to the generality of that expression)—	2. The term "permanent establishment" includes especially:
(a) a place of management,	a) a place of management;
(b) a branch,[22]	b) a branch;

[21] For para 56, see 106.11.1 (Building/construction site).

[22] See 106.27.2 ("Branch").

(c) an office,	c) an office;
(d) a factory,	d) a factory;
(e) a workshop,	e) a workshop, and
(f) an installation or structure for the exploration of natural resources,[23]	[No equivalent]
(g) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; ...	[Identical]

The INTM para 266110 [Jun 2016] summarises the article and continues:

> The wording of article 5(2)[24] make it clear that this is not an exhaustive list of the places that could be a permanent establishment.

Obviously. The INTM continues:

> Furthermore, it is clear that, to be a treaty permanent establishment, any of these types of places would also need to have the general attributes of a fixed place of business, i.e. the geographic, period of duration and personnel conditions.

The point was less clear and it is helpful to see it in writing.

106.11.1 *Building/construction site*

This is the eighth item in the list in s.1141(2) CTA 2010; OECD Model moves this item into a paragraph of its own, and the wording is not the same.

s.1141(2) CTA 2010	**art 5(3) OECD Model**
For this purpose a "fixed place of business" includes (without prejudice to the generality of that expression) ... (h) a building site or construction or installation project.	A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

[23] This is not in OECD Model definition.

[24] The text erroneously reads: 5(1).

This item, like the first seven in the list, is only a PE if it also meets the geographic, duration, and personnel conditions.

The INTM provides:

> **INTM266130 Building sites or construction or installation projects** [Aug 2017]
>
> The OECD Model Treaty Article 5 includes specific provisions in para 3 that a building site or construction or installation project constitutes a treaty permanent establishment only where it lasts more than 12 months. The commentary makes it clear that this includes also the construction of roads, bridges or canals, the renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals, the laying of pipes-lines and excavating and dredging. Additionally, the term 'installation project' is not restricted to an installation related to a construction project; it also includes the installation of new equipment, such as a complex machine, in an existing building or outdoors.
>
> The OECD member states have made this type of activity the subject of a specific rule because of the frequency with which it caused difficulties of interpretation. And, for clarity in the model treaty, 12 months duration has been taken to be a sufficient indication that the activity is a fixed place of business permanent establishment. Of course particular treaties may vary from the model in this respect and indeed different durations are included in many of the UK's treaties all of which can be referred to in full at DT2140 onwards. The UK domestic charging provisions in s.1141(2)(h) CTA 2010] define permanent establishment (see INTM264050) in a way that specifically includes all building sites or construction or installation projects without duration qualification. Although initially this may [!] appear inconsistent you should remember that the treaty provisions will override the domestic legislation. In that way, any duration specified in any applicable treaty within which the site will become a permanent establishment will be the duration that applies.
>
> If the non-resident is involved (directly or indirectly through subcontractors) in more than one site or project, each should be considered as a potential permanent establishment separately from the others. The 12 months or other duration test applies to each site or project. A site or project should be regarded as a single potential permanent establishment even if it is based on several contracts provided that it forms a coherent whole commercially and geographically. If it appears that a single site or project has been fragmented to avoid the appearance of being a PE the facts of the original tendering should be investigated.
>
> A site or project exists from when the contractor begins work, including any preparatory work, in the country where the construction etc. is to be established. It continues to exist until the work is completed or permanently abandoned. Temporary discontinuation, seasonal or other temporary interruptions should be ignored.

The OECD Commentary provides:

> 56. In the case of fiscally transparent partnerships, the twelve-month test is applied at the level of the partnership as concerns its own activities. If the period

> of time spent on the site by the partners and the employees of the partnership exceeds twelve months, the enterprise carried on through the partnership will therefore be considered to have a permanent establishment. Each partner will thus be considered to have a permanent establishment for purposes of the taxation of his share of the business profits derived by the partnership regardless of the time spent by himself on the site. Assume for instance that a resident of State A and a resident of State B are partners in a partnership established in State B which carries on its construction activities on a construction site situated in State C that lasts 10 months. Whilst the tax treaty between States A and C is identical to the OECD Model, paragraph 3 of Article 5 of the treaty between State B and State C provides that a construction site constitutes a permanent establishment only if it lasts more than 8 months. In that case, the timethreshold of each treaty would be applied at the level of the partnership but only with respect to each partner's share of the profits covered by that treaty; since the treaties provide for different time-thresholds, State C will have the right to tax the share of the profits of the partnership attributable to the partner who is a resident of State B but will not have the right to tax the share attributable to the partner who is a resident of State A. This results from the fact that whilst the provisions of paragraph 3 of each treaty are applied at the level of the same enterprise (i.e. the partnership), the outcome differs with respect to the different shares of the profits of the partnership depending on the time-threshold of the treaty that applies to each share.

OECD Covid guidance[25] provides:

> 25.It appears that many activities on construction sites are being temporarily interrupted by the COVID-19 pandemic. The duration of such an interruption of activities should, however, be included in determining the life of a site and therefore will affect the determination whether a construction site constitutes a PE. In general, a construction site will constitute a PE if it lasts more than 12 months under the OECD Model or more than six months under the UN Model. Paragraph 55 of the Commentary on Article 5(3) of the OECD Model explains that a site should not be regarded as ceasing to exist when work is temporarily discontinued (temporary interruptions should be included in determining the duration of a site). Examples of temporary interruptions given in the Commentary are interruptions caused by bad weather, a shortage of material or labour difficulties.
>
> 26.The Commentary does not include a bright line test on the meaning of "temporary" interruption, thus jurisdictions may have different views of the duration of a "non-temporary" interruption and on other conditions that make the interruption of a different nature than the examples of interruptions in paragraph 55 of the Commentary. Accordingly, some jurisdictions may consider that particular periods of interruption required by domestic COVID-19 restrictions in their jurisdiction should not be included in the calculation of the time

[25] See 106.14.1 (OECD Covid guidance).

> thresholds for construction PEs. Such an approach would result in those jurisdictions not asserting the existence of a PE if the duration test would only be satisfied by including days during which operations were prevented on the construction site as a result of COVID-19 restrictions. As noted above, this guidance cannot be relied on to create instances of double non-taxation.
>
> 27.In conclusion, a construction site PE would not be regarded as ceasing to exist when work in the site is "temporarily" interrupted, but jurisdictions may consider, in light of the extraordinary circumstances of the COVID-19 pandemic and based on the facts and circumstances, that certain periods where operations are prevented as a public health measure imposed or recommended by the government where the site is located to reduce the spread of the COVID-19 virus constitute a type of interruption that should be excluded from the calculation of time thresholds for construction site PEs.

106.12 Agency-PE

There are three (main) definitions of agency-PE:

(1) UK-law agency-PE
(2) OECD Model agency-PE; this was amended in 2017, so I refer to:
 (a) Pre-2017 Model form
 (b) Post-2017 Model form

Section 1141(1) CTA 2010 provides the UK-law definition:

> For the purposes of the Corporation Tax Acts a company has a permanent establishment in a territory if (and only if) ...
>
> (b) an agent acting on behalf of the company has and habitually exercises there authority *to do business on behalf of the company*.

Article 5(5) of the pre-2017 OECD Model provides:

> [a] Notwithstanding the provisions of paras 1 and 2, where a person – other than an agent of an independent status to whom para 6 applies – is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority *to conclude contracts in the name of the enterprise*, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise,
>
> [b] unless the activities of such person are limited to those mentioned in para 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.[26]

[26] See 106.19 (Preparatory/auxiliary activities).

I refer to this as "**agency-PE**". The term "dependent agency PE" is sometimes used (as an independent agent is not a PE).

As usual, the wording has varied over the years,[27] but without any change of meaning. OECD Commentary formerly provided:

> 31... The paragraph was redrafted in the 1977 Model Convention to clarify the intention of the corresponding provision of the 1963 Draft Convention without altering its substance apart from an extension of the excepted activities of the person.

This matters as pre-1977 wording survives, for instance in the Luxembourg/UK DTA.

This was rewritten in 2017 as part of the BEPS Action 7, to deal with commissionnaire arrangements. Existing DTAs could have been brought into line with new wording under art 12 MLI. However the UK opted out of art 12. So UK DTAs existing at the current time will retain the pre-2017 wording. Presumably, future DTAs are likely to use that wording and not the post-2017 wording, but that will depend on the views of treaty-partners, and HMRC practice in the future.

It may be helpful to set out the pre- and post-2017 OECD Model wording, to highlight the differences (which the UK has chosen to reject):

Pre-2017 OECD Model Art 5	**Post-2017 OECD Model Art 5**
Notwithstanding the provisions of paragraphs 1 and 2	Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6,
where a person other than an agent of an independent status to whom paragraph 6 applies is acting on behalf of an enterprise	where a person is acting in a Contracting State on behalf of an enterprise
and has, and habitually exercises, in a Contracting State, an authority to conclude contracts,	and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise,

[27] See Avery Jones, "The Origins of Article 5(5) and 5(6) of the OECD Model", 6 World Tax Journal 3 (2014).

	and these contracts are
in the name of the enterprise,	a) in the name of the enterprise, or b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or c) for the provision of services by that enterprise,
that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.	that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

The post-2017 OECD Commentary will not be relevant to DTAs with pre-2017 wording, so far as it discusses the post-2017 wording; instead the pre-2017 Commentary will still be applicable.[28]

106.12.1 *Agency-PE: Policy*

OECD Commentary provides:

> 82. It is a generally accepted principle that an enterprise should be treated as having a permanent establishment in a State if there is under certain conditions a person acting for it, even though the enterprise may not have a fixed place of business in that State within the meaning of paragraphs 1 and 2. [Article 5(5)] intends to give that State the right to

[28] See 106.2.1 (Pre/post-2017 OECD Model).

tax in such cases. Thus paragraph 5 stipulates the conditions under which an enterprise is deemed to have a permanent establishment in respect of any activity of a person acting for it.

106.12.2 *OECD/UK-law compared*

Dawn Primarolo (then Paymaster General) explained why the wording of UK-law PE differs from pre-2017 OECD Model PE:

> **Dawn Primarolo**: ... the wording used in clause 147(1)(b) [FB 2003, now s.1141 CTA 2010] to define "dependent agent" varies from the exact wording in article 5(5) of the OECD model tax convention. Instead, it is based on guidance given in the commentary on article 5 ... because article 5 refers to an agent who has the authority to conclude contracts in the name of the enterprise. However, the OECD commentary on article 5 makes it clear that that phrase is not necessarily to be taken at face value. For instance, it covers contracts in the name of an enterprise, contracts binding on the enterprise but not in its name, and contracts recognised by the agent but signed by some other person, while excluding contracts that do not relate to the business proper of the enterprise, although concluded by the agent. The area is very complicated and there is an interaction between the commentary and the article itself.
>
> UK legislation cannot be directly interpreted by reference to the commentary,[29] so the phrase used in clause 147 is intended to encapsulate the current OECD interpretation in respect of dependent agents. That would not have been achieved if the wording in article 5(5) were copied directly into UK domestic law.
>
> **Mr. Burnett:** The Paymaster General will recall ... that the Inland Revenue confirmed that the reference to an agent in clause 147 is restricted to those persons who contractually can and do bind their principals and not to persons acting in some other representative capacity falling short of having such authority. The Paymaster General is obviously well aware of *Pepper v Hart* and the reliance people may put on what she says in Committee. I would welcome her comments on that point raised by the Law Society.
>
> **Dawn Primarolo**: I was coming to that important point, which was outlined in a letter to the Law Society and the Chartered Institute of Taxation on 8 May.
>
> I was trying to explain that the article wording must be read in parallel with the commentary. The commentary needed to be part of the description that went into UK legislation in order to make that clear. In drafting the legislation, the importance of maintaining certainty on international understanding and practice on the OECD guidelines and model conventions while understanding how the commentary affects their operation was one of the major points, which was continually made to the Revenue and me. That is how we chose the clause's wording.
>
> Amendment No. 101 seeks to add to the definition of dependent agent used in

[29] This is not correct, but fortunately no-one reminded Ms Primarolo of (what is now) s.164 TIOPA (Application of OECD principles).

> clause 147(1)(b). It would mean that an agent would be a dependent agent of a foreign company as long as they had the authority to enter into arrangements on its behalf and had entered into contractually binding arrangements with it. That may not have been the amendment's intended effect, but I ask the Committee to reject it nevertheless. The suggested addition is unnecessary and the language used in clause 147(1)(b) already reflects the current OECD position on dependent agents. As such, no further clarification or definition is required.... The Bill does not extend the charge to tax on non-resident companies and there is no less certainty for an agent of a non-resident company on whether they are within the charge to corporation tax. The rules are set out in the OECD treaty and commentary and in UK law, which has had and will have specific rules to facilitate foreign investment in the City.[30]

Similarly, the INTM provides:

> **INTM264050 Permanent establishment – Domestic law definition** [Apr 2020]
>
> The definition of domestic law permanent establishment is at [FA 03 s.148]. This is similar to and has the same broad effect as the OECD Model article 5 definition of permanent establishment which is an important factor bearing in mind that treaty law takes precedence over domestic law. So it is unlikely that the application of a treaty that followed the model article 5 would cause any variance to the UK domestic charge to tax on a non-resident trading in the UK through a permanent establishment as defined under domestic law. Because of the similarities of wording and effect between PE under domestic law and under the OECD Model the guidance on interpretation of treaty PE at INTM266000 is understandably substantially applicable to domestic law PE as well.
>
> A lot of our interpretation of treaty PE is based on the Commentary to Article 5 of the OECD Model (INTM266030). Although the Commentary is not imported into UK domestic law the UK has contributed to and agreed the content except in specific instances where the UK has put on record either an observation or a reservation to a specific section of the Commentary. So, where the wording of the UK domestic law PE provisions are the same as those used in the OECD Model Article 5 then the commentary interpretation on those words will apply to those provisions and this guidance will contain cross-references into the guidance on treaty PE at INTM266000. If the Commentary interpretation of PE were to materially vary through periodic update or

[30] House of Commons Standing Committee B *http://www.publications.parliament.uk/pa/cm200203/cmstand/b/st030520/pm/part1/30520s06.htm*

> amendment the changes would have to be accepted by the UK Parliament before they could be taken to apply also to interpretation of UK domestic law PE.

The simpler way to achieve the intention would have been to incorporate OECD definition by reference, but it is considered that the UK-law definition has reached that destination, though by a less satisfactory route.[31] EN CTA 2010 agrees:

> 3253. This Chapter determines what constitutes a permanent establishment in a territory of a company which is not resident in that territory. ...
> 3254. The determination is in line with various internationally recognised characteristics commonly used in the UK's double tax agreements.

Likewise an HMRC press release when the current law was enacted:

> The rules also alter our current terminology so that in future we tax "permanent establishments", (a term recognised internationally and used in our double taxation agreements), rather than "branches". The new rules are to be interpreted in accordance with OECD guidelines, to ensure that the UK is in accord with international consensus that reflects UK agreement. If internationally agreed changes are made in the future, then any new guidance can be included to assist in the interpretation of the UK rules, if the UK government decides it wishes to adopt them.[32]

106.13 OECD Model agency-PE

This section focuses on the pre-2017 OECD Model form, though parts of the discussion would also be relevant for the post-2017 model.

106.13.1 *Agent*

OECD Commentary provides:

> 83. Persons whose activities may create a permanent establishment for the enterprise are persons, whether or not employees of the enterprise, who act on behalf of the enterprise and are not doing so in the course of carrying on a business as an independent agent falling under para 6. Such persons may be either individuals or companies.

[31] If that is right, it answers the concerns expressed in Nias, "Taxation of non-resident companies and the meaning of agent" [2003] BTR 468.

[32] REV BN 25 para 8 (17 April 2002).

106.13.2 *Authority to conclude contract*

The phrase *authority to conclude contracts in the name of the enterprise* is at the heart of pre-2017 OECD Model agency-PE.

106.13.3 *In the name of the enterprise*

Pre-2017 OECD Commentary provided:

> 32.1 Also, the phrase "authority to conclude contracts in the name of the enterprise" does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise.

The INTM provides:

> **INTM266160. UK common law varies from European civil law codes** [Apr 2020]
> The majority of European countries have civil law codes whereas the UK has a common law code. Any matters of interpretation of undefined terms used in the OECD Model, article 5 or any other article of a treaty should be interpreted in the UK under UK law or at least common meaning. The civil law concept of agency is different from that under common law in that civil law will not usually regard the actions of an agent as though they were the actions of the principal. Civil law separates the relationship between the principal and the agent on the one hand and that between the agent and the third party (including a customer) on the other. Thus civil law countries do not, as the UK does, necessarily see the presence of the non-resident principal in the actions of the resident agent. In the UK, under common law, we interpret any actions carried out by an agent as having been performed for the principal and binding the principal in the same way as though they had carried out those actions themselves. For example, a contract arranged by an agent in the UK to deliver goods owned by a foreign principal to a customer would be treated for UK tax purposes as though the foreign principal themselves had contracted in the UK for the delivery. This is the case, regardless of whether the contract is written in the name of the principal or in the name of the agent (commentary to model treaty article 5(5), para 32.1 of July 2010 version).

The former International Tax Handbook provided:

> **851.** Treaties following the example of the OECD Model are influenced by the civil law concept of agency. Para 5 of Article 5 of the Model

> deems an agent to be a permanent establishment if the agent has and habitually exercises an authority to conclude contracts in the name of the enterprise of the treaty partner state, unless the agent is an agent of independent status within para 6. There are two pointers here to civil law influence. One is 'contracts in the name of the enterprise', the other is 'agent of independent status'.
>
> **852. In the name of principal**
>
> The making of contracts in the name of the principal would be regarded by civil law countries as a characteristic of a dependent agent whereas contracts made in the agent's own name would be characteristic of independent status (though the wording of the Article does not preclude the possibility of independent status even if the contracts are in the name of the 'enterprise'). In our law, if the contracts are made on behalf of and with the authority of the principal the relationship of the agent to the principal is not affected by whether the contract is made in the name of the principal or in the agent's own name. So agents, who in all other respects would be dependent agents according to the OECD Model, could in our law make contracts in their own name. We would not wish such agents to be regarded as agents of independent status under a treaty and therefore resist the literal meaning of 'in the name of' and argue that the words should be interpreted as 'on behalf of', which is an acceptable translation of the words 'au nom de' which appear in the French version of the Model Convention. The commentary on Article 5 of the 1992 Model included a note of our view at para 45 and in 1994 a sentence was added to the commentary itself at para 32 confirming that this is now the accepted interpretation.

The INTM discussion of OECD Model PE at 266140 [September 2011] is a lightly adapted version of OECD Commentary, so is not set out here. Article 5(5) USA/UK DTA provides a definition of agency PE very similar to pre-2017 OECD Model form:

OECD Model para 5(5)	**USA/UK DTA para 5(5)**
Notwithstanding the provisions of paragraphs 1 and 2 where a person other than an agent of an independent status to whom paragraph 6 applies is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State, an authority to conclude contracts, in the name of the enterprise,	Notwithstanding the provisions of paragraphs 1 and 2 of this Article, where a person—other than an agent of an independent status to whom paragraph 6 of this Article applies—is acting on behalf of an enterprise and has and habitually exercises in a Contracting State an authority *to conclude contracts that are binding on the enterprise,*

that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.	that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities that the person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 of this Article that, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

The US Model DTA Technical Explanation provides:[33]

> The OECD Model uses the term "in the name of that enterprise" rather than "binding on the enterprise". There is no substantive difference. As indicated in paragraph 32 to the OECD Commentary on Article 5, paragraph 5 of the Article is intended to encompass a person who "concludes contracts which are binding on the enterprise, even if those contracts are not actually in the name of the enterprise".

106.13.4 *Authority to conclude contracts*

It seems to me that "agent" is used in (at least) three broad senses:

(1) A person who can *legally* enter into a contract which binds their principal. I refer to that as a "**contract-law agent**".

(2) A person who can *effectively decide* whether their principal will enter into a contract; and though a further step to create a contract is required, that may be regarded as a legal formality or "rubber stamping".

(3) In a looser, colloquial sense: an intermediary, spokesperson, or representative (who lacks power to make an effective decision)[34]

The meaning here is meaning (2). If in practice a person can give a commercial or substantial commitment, they will be regarded as having

[33] *http://www.irs.gov/pub/irs-trty/temod006.pdf*

[34] "The use of the word 'agent' in any mercantile transaction is, of itself, wholly uninformative of the legal relationship between the parties and the use of the words 'independent agent' takes the matter no further. Either is consistent with a self-employed person acting either as a true agent who puts his principal into a contractual relationship with a third party or with such a person acting as a principal." See *Potter v CE* [1985] STC 45 at p.51 cited with approval in *Umbro International v HMRC* [2009] STC 1345 at [29].

authority to conclude contracts, even if they lack formal authority of a contract-law agent, so that the contract needs to be "rubber stamped" by the principal before it takes effect.[35]

A company with an agent of this kind in a State may in fact be resident in that State: an agent who concludes contracts on behalf of the company in a State cause the effective management/management and control of the company to take place in that State.

106.13.5 *Exercise of authority in State*

What if negotiation is done by the agent in a State, but the contract is signed elsewhere? OECD Commentary provided:

> 97... Moreover, whether or not a person habitually concludes contracts or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise should be determined on the basis of the commercial realities of the situation. The mere fact that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has concluded contracts or played the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise.

OECD say:

> A commissionnaire arrangement may be loosely defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission). A foreign enterprise that uses

[35] See Dunahoo, "Contract Conclusion and Agency Permanent Establishments: Here, There and Everywhere" in Baker & Bobbett (eds) *Tax Polymath: a Life in International Taxation: Essays in Honour of John F. Avery Jones* (2010).
The point has been decided the same way in relation to branch/agency: see 106.27.4 (Branch/agency distinction).

a commissionnaire arrangement does not have a permanent establishment because it is able to avoid the application of Art. 5(5) of the OECD Model Tax Convention, to the extent that the contracts concluded by the person acting as a commissionnaire are not binding on the foreign enterprise. Since Art. 5(5) relies on the formal conclusion of contracts in the name of the foreign enterprise, it is possible to avoid the application of that rule by changing the terms of contracts without material changes in the functions performed in a State. Commissionnaire arrangements have been a major preoccupation of tax administrations in many countries, as shown by a number of cases dealing with such arrangements that were litigated in OECD countries. In most of the cases that went to court, the tax administration's arguments were rejected.

Similar strategies that seek to avoid the application of Art. 5(5) involve situations where contracts which are substantially negotiated in a State are not formally concluded in that State because they are finalised or authorised abroad, or where the person that habitually exercises an authority to conclude contracts constitutes an "independent agent" to which the exception of Art. 5(6) applies even though it is closely related to the foreign enterprise on behalf of which it is acting.

...

6. BEPS concerns arising from commissionnaire arrangements may be illustrated by the following example, which is based on a court decision that dealt with such an arrangement and found that the foreign enterprise did not have a permanent establishment:

– XCO is a company resident of State X. It specialises in the sale of medical products.
– Until 2000, these products are sold to clinics and hospitals in State Y by YCO, a company resident of State Y. XCO and YCO are members of the same multinational group.
– In 2000, the status of YCO is changed to that of commissionnaire following the conclusion of a commissionnaire contract between the two companies. Pursuant to the contract, YCO transfers to XCO its fixed assets, its stock and its customer base and agrees to sell in State Y the products of XCO in its own name, but for the account of and at the risk of XCO.
– As a consequence, the taxable profits of YCO in State Y are substantially reduced.[36]

7. Similar strategies that seek to avoid the application of Art. 5(5) involve situations where contracts which are substantially negotiated in a State are not concluded in that State because they are finalised or authorised abroad, or where the person that habitually exercises an authority to conclude contracts constitutes an "independent agent" to which the exception of Art. 5(6) applies even though it is closely related to the foreign enterprise on behalf of which it is acting.[37]

[36] The reference is to *Société Zimmer Ltd v Ministre de l'Économie* (2010) 12 ITLR 739 (with an English translation).

[37] OECD/G20 "Preventing the Artificial Avoidance of Permanent Establishment Status ACTION 7 Final Report (2015) p.28

106.13.6 *Auxiliary/preparatory work*

The article 5(4) exemption (auxiliary & preparatory work, etc)[38] applies to agents:

> Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.
>
> 33. The authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person has authority to engage employees for the enterprise to assist that person's activity for the enterprise or if the person were authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only.

The US Model DTA Technical Explanation provides a similar example:[39]

> The contracts referred to in paragraph 5 are those relating to the essential business operations of the enterprise rather than ancillary activities. For example, if the agent has no authority to conclude contracts in the name of the enterprise with its customers for the sale of the goods produced by the enterprise, but it can enter into service contracts in the name of the enterprise for the enterprise's business equipment used in the agent's office, this contracting authority would not fall within the scope of the paragraph, even if exercised regularly.

106.13.7 *Habitually*

"Habitually" echoes the requirement of "degree of permanency" for a fixed place of business PE. OECD Commentary provides:

> 83. ... The use of the term "permanent establishment" in this context presupposes, of course, that that person, or as a direct result of the actions of that person, takes place repeatedly and not merely in isolated cases.
>
> 33.1 The requirement that an agent must "habitually" exercise an authority to conclude contracts reflects the underlying principle in

http://www.oecd.org/ctp/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm

[38] See 106.19 (Preparatory/auxiliary activities).

[39] *http://www.irs.gov/pub/irs-trty/temod006.pdf*

> Article 5 that the presence which an enterprise maintains in a Contracting State should be more than merely transitory if the enterprise is to be regarded as maintaining a permanent establishment, and thus a taxable presence, in that State. The extent and frequency of activity necessary to conclude that the agent is "habitually exercising" contracting authority will depend on the nature of the contracts and the business of the principal. It is not possible to lay down a precise frequency test. Nonetheless, the same sorts of factors considered in para 6 would be relevant in making that determination.[40]

See too 106.14 (Home office due to Covid).

106.13.8 *Extent of agency-PE*

OECD comments on the extent of an agency-PE:

> 99. Where the requirements set out in paragraph 5 are met, a permanent establishment of the enterprise exists to the extent that the person acts for the latter, i.e. not only to the extent that such a person concludes contracts or plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise.

106.13.9 *Place of business/agency PE: Relationship*

OECD Commentary provides:

> 100. Under paragraph 5, only those persons who meet the specific conditions may create a permanent establishment; all other persons are excluded. It should be borne in mind, however, that paragraph 5 simply provides an alternative test of whether an enterprise has a permanent establishment in a State. If it can be shown that the enterprise has a permanent establishment within the meaning of paragraphs 1 and 2 (subject to the provisions of paragraph 4), [fixed place of business] it is not necessary to show that the person in charge is one who would fall under paragraph 5.

106.14 Home office due to Covid

106.14.1 *OECD Covid guidance*

OECD have produced a helpful paper (**"OECD Covid guidance"**). The edition history is:

[40] See 106.8.2 (Degree of permanency).

Apr 2020 Analysis of Tax Treaties and the Impact of the COVID-19 Crisis[41]
Jan 2021 Updated guidance on tax treaties and the impact of the COVID-19 pandemic[42]

References here are to the updated guidance.

106.14.2 *Fixed place of business*

OECD Covid guidance provides:

> 14.Whilst noting that the issue of whether a PE exists is a test based on facts and circumstances, in general, a place must have a certain degree of permanency and be at the disposal of an enterprise in order for that place to be considered a fixed place of business through which the business of that enterprise is wholly or partly carried on.
> 15.Paragraph 18 of the Commentary on Article 5 of the OECD Model explains that even though part of the business of an enterprise may be carried on at a location such as an individual's home office, that should not lead to the conclusion that that location is at the disposal of that enterprise simply because that location is used by an individual (e.g. an employee) who works for the enterprise. The carrying on of intermittent business activities at the home of an employee does not make that home a place at the disposal of the enterprise. A home office may be a PE for an enterprise if it is used on a continuous basis for carrying on business of that enterprise and the enterprise generally has required the individual to use that location to carry on the enterprise's business.
> 16.During the COVID-19 pandemic, individuals who stay at home to work remotely are typically doing so as a result of public health measures: it is an extraordinary event not an enterprise's requirement. Therefore, considering the extraordinary nature of the COVID-19 pandemic, teleworking from home (i.e. the home office) because of an extraordinary event or public health measures imposed or recommended by government would not create a PE for the business/employer, either because such activity lacks a sufficient degree of permanency or continuity or because the home office is not at the disposal of the enterprise. In addition, it still provides an office which in the absence of public health measures is available to the relevant employee. This applies whether the temporary work location is the individual's home or a temporary dwelling in a jurisdiction that is not their primary place of residence.
> 17.If an individual continues to work from home after the cessation of the public health measures imposed or recommended by government, the home office may

[41] OECD Secretariat(Apr 2020) *https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis*

[42] *https://read.oecd-ilibrary.org/view/?ref=1060_1060114-o54bvc1ga2&title=Updated-guidance-on-tax-treaties-and-the-impact-of-the-COVID-19-pandemic*
See too 9.31 (Covid and treaty-residence).

> be considered to have certain degree of permanence. However, that change alone will not necessarily result in the home office giving rise to a fixed place of business PE. A further examination of the facts and circumstances will be required to determine whether the home office is now at the disposal of the enterprise following this permanent change to the individual's working arrangements.
>
> 18.Paragraphs 18 and 19 of the Commentary on Article 5 of the OECD Model[43] indicate that whether the individual is required by the enterprise to work from home or not is an important factor in this determination. Paragraph 18 explains that where a home office is used on a continuous basis for carrying on business activities for an enterprise and it is clear from the facts and circumstances that the enterprise has required the individual to use that location (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office), the home office may be considered to be at the disposal of the enterprise. As an example, paragraph 19 notes that where a cross-border worker performs most of their work from their home situated in one jurisdiction rather than from the office made available to them in the other jurisdiction, one should not consider that the home is at the disposal of the enterprise because the enterprise did not require that the home be used for its business activities.
>
> 19.In conclusion, individuals teleworking from home (i.e. the home office) as a public health measure imposed or recommended by at least one of the governments of the jurisdictions involved to prevent the spread of the COVID-19 virus would not create a fixed place of business PE for the business/employer. Agency PE

106.14.3 *Agency PE*

OECD Covid guidance provides:

> 20.The question may also arise whether the activities of an individual temporarily working from home for a non-resident employer could give rise to a dependent agent PE. Under Article 5(5) of the OECD Model, the activities of a dependent agent such as an employee will create a PE for an enterprise if the employee habitually concludes contracts on behalf of the enterprise. Thus, in order to apply Article 5(5) in these circumstances, it will be important to evaluate whether the employee performs these activities in a "habitual" way.
>
> 21.An employee's or agent's activity in a jurisdiction is unlikely to be regarded as habitual if they are only working at home in that jurisdiction because of an extraordinary event or public health measures imposed or recommended by government. Paragraph 6 of the 2014 Commentary on Article 5 explains that a PE should be considered to exist only where the relevant activities have a certain degree of permanency and are not purely temporary or transitory. Paragraph 33.1 of the Commentary on Article 5 of the 2014 OECD Model provides that the requirement that an agent must "habitually" exercise an authority to conclude

[43] See 106.15 (Remote working/home office).

> contracts means that the presence which an enterprise maintains in a jurisdiction should be more than merely transitory if the enterprise is to be regarded as maintaining a PE, and thus a taxable presence, in that jurisdiction. Similarly, paragraph 98 of the 2017 OECD Commentary on Article 5 explains that the presence which an enterprise maintains in a jurisdiction should be more than merely transitory if the enterprise is to be regarded as maintaining a PE in that jurisdiction under Article 5(5).
>
> 22.A different approach may be appropriate, however, if the employee was habitually concluding contracts on behalf of enterprise in their home jurisdiction before the COVID-19 pandemic.
>
> 23.Likewise, if the employee continues to work from home for a non-resident employer after the COVID-19 pandemic, on a habitual basis and continues to conclude contracts on behalf of the enterprise, it would be more likely that the employee would be considered to habitually conclude contracts on behalf of the enterprise. As noted in paragraph 98 of the Commentary on Article 5 of the OECD Model, the extent and frequency of activity necessary to treat an agent as acting "habitually" depends on the nature of the contracts and the business of the enterprise. In that respect, the same sort of factors considered in paragraphs 28 to 30 of the Commentary on Article 5 of the OECD Model would be relevant. For example, those paragraphs, among other things, note that whilst the practices followed by member countries have not been consistent in so far as time requirements are concerned, experience has shown that PEs normally have not been considered to exist in situations where a business had been carried on in a country through a place of business that was maintained for less than six months (conversely, practice shows that there were many cases where a PE has been considered to exist where the place of business was maintained for a period longer than six months).
>
> 24.In conclusion, the agent's activity in a jurisdiction should not be regarded as "habitual" if they have exceptionally begun working at home in that jurisdiction as a public health measure imposed or recommended by at least one of the governments of the jurisdictions involved to prevent the spread of the COVID-19 virus and, therefore, would not constitute a dependent agent PE provided the person does not continue those activities after the public health measures cease to apply.

106.14.4 *HMRC view*

HMRC sing from the same songsheet:

> **INTM261010 HMRC Approach to UK Permanent Establishments in response to COVID-19 Pandemic** [May 2020]
>
> **Background**
>
> The COVID-19 pandemic has resulted in significant disruption to international travel and business operations, including the locations of directors, employees and other individuals.
>
> HMRC is very sympathetic to the disruption that is being endured.
>
> We have been asked about HMRC's response to the permanent establishment challenges posed by COVID-19. The presence of individuals in the UK as a

> consequence of COVID-19 raises questions about whether foreign companies could establish a taxable permanent establishment for UK corporation tax purposes
>
> **Overview**
>
> HMRC considers that the existing legislation and guidance in relation to permanent establishments, already provides flexibility to deal with changes in business activities necessitated by the response to the COVID-19 pandemic.
>
> We do not consider that a non-resident company will automatically have a taxable presence by way of permanent establishment after a short period of time. Similarly, whilst the habitual conclusion of contracts in the UK would also create a taxable presence in the UK, it is a matter of fact and degree as to whether that habitual condition is met. Furthermore, the existence of a UK PE does not in itself mean that a significant element of the profits of the non-resident company would be taxable in the UK...
>
> **UK Permanent Establishments**
>
> With regard to Permanent Establishments (PEs), we consider that the current legislation, treaties and related guidance provides sufficient flexibility with regard to whether a PE has been created in the UK. In particular, s1141(1) CTA 2010 requires either that a business is carried on through a fixed place of business in the UK, or that an agent acting on behalf of the company has and habitually exercises authority to carry out the company's business in the UK.
>
> As INTM264430 makes clear, HMRC considers that a non-resident company will not have a UK fixed place of business PE after a short period of time as a degree of permanence is required. Similarly, whilst the habitual conclusion of contracts in the UK would also create a Dependant Agent PE in the UK, it is a matter of fact and degree as to whether that habitual condition is met. Furthermore, the existence of a UK PE does not in itself mean that a significant element of the profits of the non-resident company would be taxable in the UK. The attribution of profits to a UK PE would depend on the level of activity in the UK, and the relative value of that activity, in accordance with the guidance at INTM26700 onwards.

RDR Manual provides:

> **RDRM13410 Annex D: International tax clarifications due to coronavirus (COVID 19) - Q&A** [Aug 2020]
>
> **Company residence**
>
> **12. Have HMRC considered the situation where people are working in a country they are not usually in and their company changing residence as a result of place of central management and control?**
>
> HMRC does not believe such travel restrictions will necessarily result in a change of a company's tax residence, or cause there to be a UK permanent establishment and has published guidance in INTM120185 and INTM261010. HMRC believes the guidance is consistent with the Analysis of Tax Treaties and the Impact of the COVID-19 pandemic guidance published by the OECD Secretariat on 3 April 2020.

106.15 Remote working/home office

The issue has become more important as home working has increased after Covid, including senior positions. The question arises whether the home office might be a PE.[44]

The OECD commentary discusses a home office.

> 18. Even though part of the business of an enterprise may be carried on at a location such as an individual's home office, that should not lead to the automatic conclusion that that location is at the disposal of that enterprise simply because that location is used by an individual (e.g. an employee) who works for the enterprise. Whether or not a home office constitutes a location at the disposal of the enterprise will depend on the facts and circumstances of each case. In many cases, the carrying on of business activities at the home of an individual (e.g. an employee) will be so intermittent or incidental that the home will not be considered to be a location at the disposal of the enterprise (see paragraph 12 above). Where, however,
>
> [1] a home office is used on a continuous basis for carrying on business activities for an enterprise and
>
> [2] it is clear from the facts and circumstances that the enterprise has required the individual to use that location to carry on the enterprise's business (e.g. by not providing an office to an employee in circumstances where the nature of the employment clearly requires an office),
>
> the home office may be considered to be at the disposal of the enterprise.
>
> 19. A clear example is that of a non-resident consultant who is present for an extended period in a given State where she carries on most of the business activities of her own consulting enterprise from an office set up in her home in that State; in that case, that home office constitutes a location at the disposal of the enterprise. Where, however, a cross-frontier worker performs most of his work from his home situated in one State rather than from the office made available to him in the other State, one should not consider that the home is at the disposal of the enterprise because the enterprise did not require that the home be used for its business activities. It should be noted, however, that since the vast majority of employees reside in a State where their employer has at its disposal one or more places of business to which these employees report, the question of whether or not a home office constitutes a location at the disposal of an enterprise will rarely be a practical issue. Also, the activities carried on at a home office will often be merely auxiliary and will therefore fall within the exception of paragraph 4 [Preparatory/auxiliary activities].

CIOT say:

> With traditional mobility (formal assignments) and business travel it is, generally, clearer that the individual would be working for the benefit of an

[44] There are also employment income and social security issues.

> entity in the destination country, including time physically in an office location there, working on projects with local staff or meeting local customers . In turn, these arrangements are more clear -cut and managed through secondment agreements clarifying the individuals are working for the benefit of the local entity, transfer pricing arrangements, payroll withholdings in the destination and so on. In remote work situations, these hallmarks tend not to be present, as individuals work from a home or holiday accommodation in the destination country and often have no interaction with the local entity, local teams or local customers.
>
> ... different countries take different interpretations of remote worker situations (and of the OECD guidance contained at paragraph 18 of the commentary) – some countries appear to have a default position that a home office cannot be at the disposal of the individual's employer, whilst other countries take the opposite view... In our view the OECD commentary [set out above] is not particularly helpful in the vast majority of situations that have arisen following the pandemic . This is because in these cases the choice to work remotely is the employee's, not the employer's, and it may only be for limited periods of time and not continuously, although many employees are now opting to work from home on a permanent basis.
>
> Issues on a practical level that must be considered include, inter alia, what activities the individual will be undertaking/how long for/whether other staff will be doing similarly in the same location/where the individual will be based . Where individuals are more senior and/or are front office staff then clearly the potential PE issue is accentuated. We recognise that the reality is that all the circumstances need to be worked through to determine the degree of risk in triggering a PE in the country concerned (and indeed in the UK when things are the other way round). ...
>
> The existing OECD guidance on PEs is potentially contradictory in places and more detail/clarification would be welcome. On the one hand, the guidance currently suggests that if there are relatively senior people in a territory making a significant contribution to the business, this activity cannot be preparatory or auxiliary in nature. Nevertheless, if they are working from home in that country including on a permanent basis, instead of being based in an office there, the guidance separately implies that cannot usually be a fixed place of business.[45]

See too 106.14 (Home office due to Covid).

106.16 Independent agent exemption

The rule in short is that an independent agent is not a PE. I refer to this as the "**independent agent exemption**".

There are three (main) versions of the independent agent exemption:

[45] CIOT, "Review of treaty policy positions - response" (2022) *https://www.tax.org.uk/ref1016*

(1) UK-law independent agent exemption
(2) OECD Model independent agent exemption; this was amended in 2017 so I refer to:
 (a) Pre 2017 OECD Model independent agent exemption
 (b) Post-2017 OECD Model independent agent exemption

Investment managers and brokers may be an agency-PE, but have a special exemption which is intended to clarify the independent agent exemption; see 72.1 (Investment manager exemptions - Introduction).

It is helpful to set out the UK-law and pre-2017 OECD model independent agent exemptions side by side:

s.1142(1) CTA 2010	**art 5(6) OECD Model (pre-2017)**
A company is not regarded as having a permanent establishment in a territory by reason of the fact that it carries on business there through an agent of independent status acting in the ordinary course of the agent's business.	An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

OECD Model is slightly differently worded, but the differences do not seem material.

OECD Model independent agent exemption was rewritten in 2017 as part of the BEPS project action 7, to deal with Commissionnaire arrangements. Existing DTAs could be brought into line with new wording under art 12 MLI. However the UK has opted out of art 12. So UK DTAs existing at the current time will retain the pre-2017 wording. Presumably, future DTAs are likely to use that wording and not the post-2017 wording, but that will depend on the views of treaty-partners, and HMRC practice in the future.

It may be convenient to set out the pre- and post-2017 OECD model wording, to highlight the differences (which the UK has chosen to reject):

Pre-2017 OECD Model	**Post 2017 OECD Model**
An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely	6. Paragraph 5 shall not apply where the person acting in a Contracting State on behalf of an

because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.	enterprise of the other Contracting State carries on business in the firstmentioned State as an independent agent and acts for the enterprise in the ordinary course of that business...

So far the post 2017 Model is just a plain English rewrite of the pre-2017 version, but the post-2017 Model then adds a further condition which has no equivalent in the earlier version:

> Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise...
> 8. For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person or enterprise shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50% of the beneficial interest in the other (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or if another person or enterprise possesses directly or indirectly more than 50% of the beneficial interest (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.

The post-2017 OECD Commentary will not be relevant to DTAs with pre-2017 wording, so far as it discusses the post-2017 wording; instead the pre-2017 commentary will still be applicable.

OECD Commentary summarises:

> 36. Where an enterprise of a Contracting State carries on business dealings through a broker, general commission agent or any other agent of an independent status, it cannot be taxed in the other Contracting State in respect of those dealings if the agent is acting in the ordinary course of his business (cf. paragraph 32 above). Although it stands to reason that such an agent, representing a separate enterprise, cannot constitute a permanent establishment of the foreign enterprise,

> paragraph 6 has been inserted in the Article for the sake of clarity and emphasis.

The point that the independent agent exemption is only inserted for the avoidance of doubt is important in contexts, such as pre-1963 DTAs, where the exemption is not stated expressly; but these are now rare.

> 37. A person will come within the scope of paragraph 6, i.e. he will not constitute a permanent establishment of the enterprise on whose behalf he acts only if
>
> a) he is independent of the enterprise both legally and economically, and
> b) he acts in the ordinary course of his business when acting on behalf of the enterprise.

The requirements of independent status and "ordinary course of business" overlap somewhat, but it is best to consider them separately.

106.17 Independent status

This is a multifactorial concept.

106.17.1 *Control by principal*

OECD Commentary provides:

> 104. Whether a person is independent of the enterprise represented depends on the extent of the obligations which this person has vis-a-vis the enterprise. Where the person's commercial activities for the enterprise are subject to detailed instructions or to comprehensive control by it, such person cannot be regarded as independent of the enterprise. Another important criterion will be whether the entrepreneurial risk has to be borne by the person or by the enterprise the person represents.
>
> 38.1 In relation to the test of legal dependence, it should be noted that the control which a parent company exercises over its subsidiary in its capacity as shareholder is not relevant in a consideration of the dependence or otherwise of the subsidiary in its capacity as an agent for the parent. This is consistent with the rule in paragraph 7 of Article 5. But, as paragraph 41 of the Commentary indicates, the subsidiary may be considered a dependent agent of its parent by application of the same tests which are applied to unrelated companies.
>
> 38.2 The following considerations should be borne in mind when determining whether an agent may be considered to be independent.
>
> 106. An independent agent will typically be responsible to his principal for the results of his work but not subject to significant control with respect to the manner in which that work is carried out. He will not be subject to detailed instructions from the principal as to the conduct of the work. The fact that the principal is relying on the special skill and knowledge of the agent is an

> indication of independence.
>
> 107. Limitations on the scale of business which may be conducted by the agent clearly affect the scope of the agent's authority. However such limitations are not relevant to dependency which is determined by consideration of the extent to which the agent exercises freedom in the conduct of business on behalf of the principal within the scope of the authority conferred by the agreement.
>
> 108. It may be a feature of the operation of an agreement that an agent will provide substantial information to a principal in connection with the business conducted under the agreement. This is not in itself a sufficient criterion for determination that the agent is dependent unless the information is provided in the course of seeking approval from the principal for the manner in which the business is to be conducted. The provision of information which is simply intended to ensure the smooth running of the agreement and continued good relations with the principal is not a sign of dependence.

106.17.2 *Multiple principals*

OECD Commentary provides:

> 109. Another factor to be considered in determining independent status is the number of principals represented by the agent. As indicated in paragraph 111, independent status is less likely if the activities of the agent are performed wholly or almost wholly on behalf of only one enterprise over the lifetime of the business or a long period of time. However, this fact is not by itself determinative. All the facts and circumstances must be taken into account to determine whether the agent's activities constitute an autonomous business conducted by him in which he bears risk and receives reward through the use of his entrepreneurial skills and knowledge. Where an agent acts for a number of principals in the ordinary course of his business and none of these is predominant in terms of the business carried on by the agent, dependence may exist if the principals act in concert to control the acts of the agent in the course of his business on their behalf.

The INTM provides:

> **INTM264080 Independent agents do not create a permanent establishment** [Apr 2020]
>
> [The INTM summarises s.1142(1) and continues:] Whether an agent is of independent status is tested by reference to the legal, financial and commercial characteristics of the particular business relationship between the non-resident and the agent. If the relationship between them is the same as a relationship between independent businesses dealing with each other at arms length then the agent will be 'an independent agent'. For example, an agent who acted for other independent unconnected businesses on the same terms as those under which he acted for the non-resident could be an 'independent agent' and it would be clear that the agent had been acting in the ordinary course of his business if his activities were repeated for various unconnected customers. Dependent or independent status does not turn on the shareholding relationship between

> principal and agent. The fact that an agent is a subsidiary company does not necessarily make it a dependent agent.[46] However, a subsidiary company will constitute a domestic law agency PE of its parent company in the same way as any other agent of the parent company if independence by reference to the factors detailed in the guidance that follows cannot be demonstrated.
>
> Whether an agent acts in the ordinary course of their own business is something that should be considered by reference to the behavioural facts as opposed to intentions not followed through in business performance. Matters relevant would include (but not necessarily be limited to) the number of unrelated principals that the agent acted for and the extent of the business activities customarily carried out by independent agents in the specific business sector concerned.
>
> Assuming they did act in the ordinary course of their own business, in general, an agent would be independent and would not constitute an agency PE of the foreign enterprise for which it acts where it is independent of the principal enterprise both legally and economically. The perspective of application of this test is with relevance to the business conducted by the agent for the principal rather than, for example, any shareholding relationship between the principal and agent. Other relevant factors of independence may include:
>
> - the extent of the obligations which the agent has vis-à-vis the non-resident;
> - whether the agent is subject to detailed instructions or comprehensive control;
> - whether the agent bears the entrepreneurial risk for the business that the agent carries out for the non-resident;
> - the degree of reliance on the agent's special skill and knowledge by the principal in the business done, and
> - Whether there is reference by the agent to the principal for approval of the manner in which the business is to be conducted.
>
> There will undoubtedly be circumstances where, whether deliberately or not, the relationship between a non resident and a UK agent is obscure or even where the declared terms of that relationship are very different from the actual terms. In such cases there is no substitute for detailed enquiry into the relationship to see whether it falls within the category of dependent or independent agent.

INTM discusses OECD Model wording. It partly duplicates the text of the discussion on domestic law agency-PE. The other parts provide:

> **INTM266150. Agent of independent status – Article 5(6)** [Aug 2017]
>
> ... The work done by an agent, where that work was all done for one non-resident client, is unlikely to be viewed as the conduct of his 'own business' but more likely that of the non-resident's business. An exception to that view might be where the concentration on one client was an unusual occurrence within a settled continuous trade involving several clients. ...

106.17.3 *"Ordinary course of business"*

OECD Commentary tries but cannot elucidate this:

[46] See 106.18 (Controlled companies/groups).

> 38.7 Persons cannot be said to act in the ordinary course of their own business if, in place of the enterprise, such persons perform activities which, economically, belong to the sphere of the enterprise rather than to that of their own business operations. Where, for example, a commission agent not only sells the goods or merchandise of the enterprise in his own name but also habitually acts, in relation to that enterprise, as a permanent agent having an authority to conclude contracts, he would be deemed in respect of this particular activity to be a permanent establishment, since he is thus acting outside the ordinary course of his own trade or business (namely that of a commission agent), unless his activities are limited to those mentioned at the end of paragraph 5.
>
> 38.8 In deciding whether or not particular activities fall within or outside the ordinary course of business of an agent, one would examine the business activities customarily carried out within the agent's trade as a broker, commission agent or other independent agent rather than the other business activities carried out by that agent. Whilst the comparison normally should be made with the activities customary to the agent's trade, other complementary tests may in certain circumstances be used concurrently or alternatively, for example where the agent's activities do not relate to a common trade.
>
> 39. [This deals with insurance companies and is not discussed here].

106.17.4 *USA DTA*

Article 4(6) USA/UK DTA is similar to OECD Model.[47]

The USA/UK DTA Technical Explanation provides:[48]

> Whether the agent and the enterprise are independent is a factual determination. Among the questions to be considered are the extent to which the agent operates on the basis of instructions from the enterprise. An agent that is subject to detailed instructions regarding the conduct of its operations or comprehensive control by the enterprise is not legally independent.
>
> In determining whether the agent is economically independent, a relevant factor is the extent to which the agent bears business risk. Business risk refers primarily to risk of loss. An independent agent typically bears risk of loss from its own activities. In the absence of other factors that would establish dependence, an agent that shares business risk with the enterprise, or has its own business risk, is economically independent because its business activities are not integrated with those of the principal. Conversely, an agent that bears little or no risk from the activities it performs is not economically independent and therefore is not described in paragraph 6.
>
> Another relevant factor in determining whether an agent is economically

[47] "An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent, or any other agent of an independent status, provided that such person is acting in the ordinary course of his business as an independent agent."

[48] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> independent is whether the agent has an exclusive or nearly exclusive relationship with the principal. Such a relationship may indicate that the principal has economic control over the agent. A number of principals acting in concert also may have economic control over an agent. The limited scope of the agent's activities and the agent's dependence on a single source of income may indicate that the agent lacks economic independence. It should be borne in mind, however, that exclusivity is not in itself a conclusive test; an agent may be economically independent notwithstanding an exclusive relationship with the principal if it has the capacity to diversify and acquire other clients without substantial modifications to its current business and without substantial harm to its business profits. Thus, exclusivity should be viewed merely as a pointer to further investigation of the relationship between the principal and the agent. Each case must be addressed on the basis of its own facts and circumstances.

106.17.5 *Broker/commission agent*

The precise meanings of broker and general commission agent in OECD Model PE definition do not greatly matter since both terms are subsumed into "other agent of independent status".

For completeness, "broker" is discussed at 72.5.2 ("Broker"). The former International Tax Handbook explained "general commission agent" in a passage too amusing to omit:

> **935. General commission agent**
> ... Although the words general commission agent appear in the legislation, nobody really knows what a general commission agent is and textbooks on agency make no reference to such a character; the expression is indeed used in our Double Taxation Agreements but it is not a term that our treaty partners are familiar with. They say it has no particular meaning for them and think that it is there because the British were rather insistent about it.
>
> **936. London Produce case**
> The one case to which we most often turn for guidance on who may or may not be a general commission agent is the London Produce case [*Fleming v London Produce Co* 44 TC 582]. The London Produce company acted as agents in importing meat from New Zealand and selling it for commission on the London market. 95% of its business was carried out for one principal. It claimed to be a general commission agent.
>
> Megarry J enjoyed himself with the expression saying that he found it puzzling and unidentified. He wondered whether he might get at a meaning by looking at the words general, commission and agent separately and then adding the constituent parts together. He felt, however, that that was not a good idea because one could not arrive at the meaning of a particular high office by adding together the separate words lord, privy and seal. He came to the conclusion that a general commission agent must have broker-like qualities as it is included in the term 'broker' in the Section and that it is someone who holds himself out as being ready to work for clients generally. In his view Section 82(1) [TMA] (then Section 373(1) ITA 1952) could not be relevant if 'in substance what is done is

> that (the non-resident) carries on business within the UK through the medium of an agent who is virtually a sole agent running the entire business for him and merely sending him remittances on request'. London Produce lost the case.
> The only other case is the earlier one of *Boyd v Stephen* [10 TC 698] (concerned with bacon) when Rowlatt rather summarily dismissed the suggestion that the agents were general commission agents on the grounds that they did much more than such an agent would normally do. What the words are probably getting at is somebody like an import commission agent. That is someone, probably more common in 1915, who, acting for a non-resident producer, will sell goods through a broker on the market in return for a commission. It is unlikely that the authors of the Section had in mind the smaller domestic markets such as meat and bacon.

106.17.6 *Agent of insurance company*

Article 5(6) of the UN Model Treaty provides:

> Notwithstanding the preceding provisions of this Article, an insurance enterprise of a Contracting State shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if
> [a] it collects premiums in the territory of that other State or
> [b] insures risks situated therein through a person
> other than an agent of an independent status to whom paragraph 7 applies.

The General Insurance Manual provides:

> **GIM10121 permanent establishment** [Jun 2016]
> The OECD Model does not contain an Article on the lines of Article 5(6)[49] of the UN Model Treaty (this tends to give greater taxing rights to the Host State, and is more often encountered in relation to developing countries, but the actual Treaty should always be examined). This Article deems a permanent establishment to exist in a State if the activities there include collecting premiums or insuring risks other than through an independent agent. GIM10115 explains that intention is important in construing treaties, and so the absence of such an Article will found an argument on *a contrario* lines that these features are not sufficient unless the treaty does contain the UN Model Article.
> This proposition was considered and approved in a Canadian case involving an insurer, *Knights of Columbus v HM Queen*.[50]
> It was also concluded that

[49] The original erroneously reads: article 6(5).

[50] 2008 TCC 307.
http://www.dentons.com/~/media/FMC%20Import/misc/pdf/r/reasons%20for%20judgement.pdf

[1] if an agency is legally or economically dependent, then Article V(5) applies and activities will amount to a permanent establishment if there is an authority to conclude contracts in the name of the business
[2] if, on the other hand, the agent is independent, then there will be a permanent establishment only if Article V(1) applies and the activities carried on through a fixed place of business are the business of the insurance company
[3] distinguishing between a place used for the agent's own activities and one used by the agent for the insurer's activities is assisted by the reference in the OECD Model Commentary to a fixed place of business being 'at the disposal' of the enterprise (insurance company, in this context): this does not mean having the key, it must be a place of permanence, through which the business is carried on, and indicative factors for being at the insurer's disposal are that it pays the expenses, requires the agent to use it, stipulates what the office will contain and that customers will be met there

- once it has been determined that the agent is in business on its own account, it is illogical to find that administrative operations it conducts, even if not at the home office, are anything other than activities of its own business
- if there is a dependent agent permanent establishment, the Article V(6) exclusions are applied in the light of all the agent's activities (not just at the home office), but if applying it to a fixed place of business, only the activities there are considered.

Although this case is of only persuasive authority, it suggests that, provided the insurance risk is genuinely borne elsewhere (see GIM10220), and the agent is independent, significant insurance-related activities can take place in a State without giving rise to a permanent establishment. In that case, focus is on the service fee charged to the agent.

106.18 Controlled companies/groups

Article 5(7) OECD Model provides:

> The fact that a company[51] which is a resident of a Contracting State controls or is controlled by a company
> [a] which is a resident of the other Contracting State, or
> [b] which carries on business in that other State (whether through a permanent establishment or otherwise),
> shall not of itself constitute either company a permanent establishment of the other.

OECD Commentary provides:

> 115. It is generally accepted that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company. This follows from the principle that, for the purpose of taxation, such a subsidiary company constitutes an independent legal entity. Even the fact

[51] See 30.15.4 (Company: DTA definition).

> that the trade or business carried on by the subsidiary company is managed by the parent company does not constitute the subsidiary company a permanent establishment of the parent company.
>
> 116. A parent company may, however, be found, under the rules of paragraph 1 or 5 of the Article, to have a permanent establishment in a State where a subsidiary has a place of business. Thus, any space or premises belonging to the subsidiary that is at the disposal of the parent company (see paragraphs 10 to 9 above) and that constitutes a fixed place of business through which the parent carries on its own business will constitute a permanent establishment of the parent under paragraph 1, subject to paragraph 3 and 4 of the Article (see for instance, the example in paragraph 15 above). Also, under paragraph 5, a parent will be deemed to have a permanent establishment in a State in respect of any activities that its subsidiary undertakes for the condition of that paragraph are met (see paragraphs 82 to 99 above), unless paragraph 6 of the Article applies.
>
> 117. The same principles apply to any company forming part of a multinational group so that such a company may be found to have a permanent establishment in a State where it has at its disposal (see paragraphs 10 to 19 above) and uses premises belonging to another company of the group, or if the former company is deemed to have a permanent establishment under paragraph 5 of the Article(see paragraphs 82 to 99 above). The determination of the existence of a permanent establishment under the rules of paragraph 1 or 5 of the Article must, however, be done separately for each company of the group. Thus, the existence in one State of a permanent establishment of one company of the group will not have any relevance as to whether another company of the group has itself a permanent establishment in that State.
>
> 118. Whilst premises belonging to a company that is a member of a multinational group can be put at the disposal of another company of the group and may, subject to the other conditions of Article 5, constitute a permanent establishment of that other company if the business of that other company is carried on through that place, it is important to distinguish that case from the frequent situation where a company that is a member of a multinational group provides services (e.g. management services) to another company of the group as part of its own business carried on in premises that are not those of that other company and using its own personnel. In that case, the place where those services are provided is not at the disposal of the latter company and it is not the business of that company that is carried on through that place. That place cannot, therefore, be considered to be a permanent establishment of the company to which the services are provided. Indeed, the fact that a company's own activities at a given location may provide an economic benefit to the business of another company does not mean that the latter company carries on its business through that location: clearly, a company that merely purchases parts produced or services supplied by another company in a different country would not have a permanent establishment because of that, even though it may benefit from the manufacturing of these parts or the supplying of these services.

There is no equivalent of art 5(7) in UK-law PE, but it is considered that the same rules should be implied.

106.19 Preparatory/auxiliary activities

It may be helpful to set out the UK law and OECD Model rules side by side:

Section 1143 CTA 2010	**OECD Model para 5(4)**
(1) If the condition in subsection (2) is met, a company is not regarded as having a permanent establishment in a territory by reason of the fact that— (a) a fixed place of business is maintained there for the purpose of carrying on activities for the company, or (b) an agent carries on activities there for and on behalf of the company.	Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include: any other activity;
(2) The condition is that, in relation to the business of the company as a whole, the activities carried on [a] are only of a preparatory or auxiliary character and [b] are not part of a fragmented business operation.[52]	[See proviso below]
(3) In this section “activities of a preparatory or auxiliary character” include (without prejudice to the generality of that expression)—	
(a) the use of facilities for the purpose of storage, display or delivery of goods or merchandise belonging to the company,	*a)* the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
(b) the maintenance of a stock of goods or merchandise belonging to the company for the purpose of storage, display or delivery,	*b)* the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

[52] See 106.20 (Fragmented business operation).

(c) the maintenance of a stock of goods or merchandise belonging to the company for the purpose of processing by another person, and	*c)* the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
(d) purchasing goods or merchandise, or collecting information, for the company.	*d)* the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
	e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise,
	f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparas *a)* to *e)*,
[See (2) above]	provided that such activity or, in the case of subpara *f)*, the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

The differences in wording do not seem significant.

INTM para 264050 discusses this, but need not be set out as it only refers to (and repeats some material from) the INTM discussion of OECD Model PE:

> **INTM266120 activities specifically excluded from the definition of permanent establishment** [Apr 2020]
> Model treaty Article 5(4) lists certain activities that are not to be treated as permanent establishments even if they are carried on through a fixed place of business. ...

The Manual sets out a précis of the article and continues:

> In deciding whether or not a fixed place of business of a non-resident enterprise is used for activities of a preparatory or auxiliary nature, consider the following factors:
>
> 1. Are the services it performs so remote from the actual realisation of profits by the enterprise that it would be difficult to allocate any part of the profit to the fixed place of business? If they are, then the fixed place of business

> will not be a permanent establishment. The benchmark to gauge the activities against is that of the trade as a whole entity. So, for example, if the UK activities are no different to the essence of the trade, e.g. the UK personnel collect market research information and the non-resident company's main trade is concerned with market research, then the activities in the UK would not be preparatory or auxiliary and there could be a permanent establishment in the UK.

An example is a research division of a trading or manufacturing company.

> 2. Does the activity of the fixed place of business form an essential and significant part of the enterprise as a whole?

This sentence is from OECD Commentary but it cannot be a correct or helpful test since all the activities specified as auxiliary are significant and some of them are essential.

> A fixed place of business whose general purpose is identical to the general purpose of the enterprise is not used for activities of a preparatory or auxiliary nature. Examples of this are fixed places of business used for the purpose of managing an enterprise, or where a fixed place of business is maintained to supply spare parts of machinery supplied by the enterprise to customers and to service such machinery.
>
> Note that the exclusion of activities of a preparatory or auxiliary nature from the definition of a permanent establishment only applies if these activities are solely for the non-resident enterprise. If the activities are performed not only for the enterprise but also for other enterprises, including other companies in the same group, then the fixed place of business will not be within the scope of the exclusion.

I find the last paragraph rather surprising though it is in OECD Commentary. OECD Commentary explains the reason for the exemption for collecting information:

> The reference to the collection of information in subpara d) is intended to include the case of the newspaper bureau which has no purpose other than to act as one of many "tentacles" of the parent body; to exempt such a bureau is to do no more than to extend the concept of "mere purchase".

106.20 Fragmented business operation

Section 1143 CTA 2010 provides:

> (2A) Activities are "part of a fragmented business operation" if—
>
> (a) they are carried on (whether at the same place or at different places in the same territory) by the company or a person closely

> related to the company,
>
> (b) they constitute complementary functions that are part of a cohesive business operation, and
>
> (c) subsection (2B) applies.
>
> (2B) This subsection applies if—
>
> (a) the overall activity resulting from the combination of the functions mentioned in subsection (2A)(b) is not activity that is only of a preparatory or auxiliary character, or
>
> (b) the company or a person closely related to the company has a permanent establishment in the territory by reason of carrying on any of those functions.
>
> (2C) A person who is not a company is to be treated for the purposes of subsection (2B)(b) as having a permanent establishment in a territory if, were the person a company, the person would have a permanent establishment in the territory.
>
> (2D) For the purposes of this section, one person ("A") is closely related to another person ("B") if—
>
> (a) A is able to secure that B acts in accordance with A's wishes (or vice versa),
>
> (b) B can reasonably be expected to act, or typically acts, in accordance with A's wishes (or vice versa),
>
> (c) a third person is able to secure that A and B act in accordance with the third person's wishes,
>
> (d) A and B can reasonably be expected to act, or typically act, in accordance with a third person's wishes, or
>
> (e) the 50% investment condition is met in relation to A and B.
>
> (2E) The 50% investment condition is met in relation to A and B if—
>
> (a) A has a 50% investment in B (or vice versa), or
>
> (b) a third person has a 50% investment in each of A and B, and section 259ND of TIOPA 2010 (meaning of "50% investment") applies for the purposes of determining whether a person has a "50% investment".[53]

This is the statutory equivalent of the OECD fragmentation rule.

106.20.1 *OECD fragmentation rule*

Article 5 OECD Model provides:

> 4.1 Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another

[53] See 105.8 (% investment tests).

> place in the same Contracting State and
> a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or
> b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,
> provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.
>
> 8.[a] For the purposes of this Article, a person or enterprise is closely related to an enterprise if, based on all the relevant facts and circumstances,
> [i] one has control of the other or
> [ii] both are under the control of the same persons or enterprises.
> [b] In any case, a person or enterprise shall be considered to be closely related to an enterprise if
> [i] one possesses directly or indirectly more than 50% of the beneficial interest in the other (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) or
> [ii] if another person or enterprise possesses directly or indirectly more than 50% of the beneficial interest (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise or in the two enterprises.

106.20.2 *BEPS MLI: fragmentation*

OECD BEPS MLI has restricted the preparatory/auxiliary activities exemption.[54] IFS summarise:

> The BEPS process sought to deal with concerns that companies are avoiding tax by structuring themselves such that they do not have a

[54] OECD/G20 "Preventing the Artificial Avoidance of Permanent Establishment Status ACTION 7 Final Report (2015) p.28 *http://www.oecd.org/ctp/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm*

> taxable presence (a PE) in a foreign jurisdiction by broadening the definition of PEs in international tax rules. The revisions are particularly focused on tackling issues related to the digital economy. Notably, entities are currently exempt from PE status if they undertake only activities of a 'preparatory or auxiliary character', such as storage and distribution. This means that a UK consumer may purchase a good via the website of a foreign company (such as Amazon) that is then delivered from a UK distribution centre, and that transaction will not lead to a UK corporate tax liability because there was no UK PE involved. This is the correct outcome under current law. But it leads to concerns that some activities are being undervalued and countries therefore missing out on taxable income. Storage and distribution facilities may actually constitute core business activities that contribute to the creation of value added (for example, by providing quick distribution or high levels of customer service).
>
> ... The rules dictating PE status will be revised to move where the dividing line is drawn. In particular, the revised rules will specify that storage and distribution activities will constitute the operation of a PE unless the activities are genuinely only preparatory and auxiliary in nature, which is, of course, still somewhat subjective...
>
> Redefining PE status should result in taxing rights that better reflect the source of profits if countries find a way to adjust bilateral treaties to implement a new PE definition, and if that works to redefine some activities that are currently deemed auxiliary. It is worth noting that this change may work in both directions for the UK. For example, more income (and therefore tax) could be received from the UK storage and distribution facilities of foreign multinationals (such as Amazon) – although some companies may choose to adjust their activities to avoid becoming a PE. At the same time, some UK multinationals may receive less foreign income if their foreign storage and distribution facilities are given PE status.[55]

Article 13 BEPS MLI provides:

> 1. A Party may choose to apply paragraph 2 (Option A) or paragraph 3 (Option B) or to apply neither Option.

The UK has chosen not to apply option A or B, so we move on to art 13(4):

> 4. A provision of a Covered Tax Agreement[56] (as it may be modified by

[55] IFS, "Green Budget" (2016) *https://ifs.org.uk/sites/default/files/2022-08/gb2016.pdf*

[56] See 107.16.3 (Covered Tax Agreement).

> paragraph 2 or 3) that lists specific activities deemed not to constitute a permanent establishment shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting Jurisdiction and:
>
> a) that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of a Covered Tax Agreement defining a permanent establishment; or
>
> b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,
>
> provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.
>
> 5. ...
>
> b) Paragraph 4 shall apply to provisions of a Covered Tax Agreement (as they may be modified by paragraph 2 or 3) that list specific activities that are deemed not to constitute a permanent establishment even if the activity is carried on through a fixed place of business (or provisions of a Covered Tax Agreement that operate in a comparable manner).
>
> 8. Each Party that has not made a reservation described in subparagraph a) or c) of paragraph 6 and does not choose to apply an Option under paragraph 1 shall notify the Depositary of whether each of its Covered Tax Agreements contains a provision described in subparagraph b) of paragraph 5, as well as the article and paragraph number of each such provision. Paragraph 4 shall apply with respect to a provision of a Covered Tax Agreement only where all Contracting Jurisdictions have made a notification with respect to that provision under this paragraph or paragraph 7.

UK MLI Notifications[57] sets out the list of 121 DTAs which contain a provision described in art 13(5)(b), and so fall within the scope of art 13.

106.21 Services PE clause

106.21.1 *UN Model services PE*

Para 5(3) UN Model Treaty provides:

> 3. The term "permanent establishment" also encompasses ...
>
> (b) The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by

[57] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725261/Final_list_of_UK_reservations_and_notifications_made_on_deposit_of_the_instrument_of_ratification.pdf*

> the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.

This clause is found in the UK/China DTA and is common for Asian treaties.

106.21.2 *OECD Model services PE*

OECD Commentary offers an optional clause which I call the **"OECD services PE clause"**. The clause is found in a few UK treaties,[58] though it is not common.

The clause has three limbs. It begins:

> [1] Notwithstanding the provisions of paragraphs 1, 2 and 3, where an enterprise of a Contracting State performs services in the other Contracting State
> a) [i] through an individual who is present in that other State for a period or periods exceeding in the aggregate 183 days in any twelve month period, and
> [ii] more than 50% of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual, or
> b) [i] for a period or periods exceeding in the aggregate 183 days in any twelve month period, and
> [ii] these services are performed for the same project or for connected projects through one or more individuals who are present and performing such services in that other State
> the activities carried on in that other State in performing these services shall be deemed to be carried on through a permanent establishment of the enterprise situated in that other State ...

Unpacking this clause, the requirements are:

(1) An enterprise of one State ("the enterprise State")
(2) The enterprise performs services in the other State ("the source State")
(3) The services are performed through an individual (or individuals)
(4) Conditions (a) or (b) are met:
   (a) Subparagraph a) looks at the duration of the presence of the individual through whom an enterprise derives most of its revenue

[58] Colombia, Kyrgystan, Norway, Panama.

(b) Subparagraph b) looks at the duration of the activities of the individuals

Para 132ff OECD Commentary discusses the policy background at some length, and is not discussed here.

I refer to a PE (or one might say, deemed PE) within this clause as a **"services PE"**.

106.21.3 *Services performed through an individual*

Para [3] of the Services PE clause explains what is meant by services performed by an enterprise through an individual:

> For the purposes of this paragraph, services performed by an individual on behalf of one enterprise shall not be considered to be performed by another enterprise through that individual unless that other enterprise supervises, directs or controls the manner in which these services are performed by the individual.

106.21.4 *Recipient of services unaffected*

OECD Commentary provides:

> 151. The provision applies to services performed by an enterprise. Thus, services must be provided by the enterprise to third parties. Clearly, the provision could not have the effect of deeming an enterprise to have a permanent establishment merely because services are provided to that enterprise. For example, services might be provided by an individual to his employer without that employer performing any services (e.g. an employee who provides manufacturing services to an enterprise that sells manufactured products). Another example would be where the employees of one enterprise provide services in one country to an associated enterprise under detailed instructions and close supervision of the latter enterprise; in that case, assuming the services in question are not for the benefit of any third party, the latter enterprise does not itself perform any services to which the provision could apply.

106.21.5 *Location of recipient n/r*

OECD Commentary provides:

> 152. Also, the provision only applies to services that are performed in a State by a foreign enterprise. Whether or not the relevant services are furnished to a resident of the State does not matter; what matters is that the services are performed in the State through an individual present in that State.

106.21.6 *Who performs services*

OECD Commentary provides:

> 153. The alternative provision does not specify that the services must be provided "through employees or other personnel engaged by the enterprise", a phrase that is sometimes found in bilateral treaties. It simply provides that the services must be performed by an enterprise. As explained in paragraph 39 above, the business of an enterprise (which, in the context of the paragraph, would include the services performed in a Contracting State)
>
> > "is carried on by the entrepreneur or persons who are in paid-employment relationship with the enterprise (personnel). This personnel includes employees and other persons receiving instructions from the enterprise (e.g. dependent agents)."
>
> For the purposes of the alternative provision, the individuals through which an enterprise provides services will therefore be the individuals referred to in paragraph 39,[59] subject to the exception included in the last sentence of that provision (see paragraph 164 below).

106.21.7 *Duration of residence*

The Services PE clause applies:

> where an enterprise of a Contracting State performs services in the other Contracting State
>
> a) [i] through an individual who is present in that other State for a period or periods exceeding in the aggregate 183 days in any twelve month period, and
>
> [ii] more than 50% of the gross revenues attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual ...

OECD Commentary provides:

> 155. Subparagraph a) deals primarily with the situation of an enterprise carried on by a single individual. It also covers, however, the case of an enterprise which, during the relevant period or periods, derives most of its revenues from services provided by one individual. Such extension is necessary to avoid a different treatment between, for example, a case where services are provided by an individual and a case where similar

[59] See 106.9.1 (Formal v effective employment).

> services are provided by a company all the shares of which are owned by the only employee of that company.
>
> 156. The subparagraph may apply in different situations where an enterprise performs services through an individual, such as when the services are performed by a sole proprietorship, by the partner of a partnership, by the employee of a company etc...
>
> 157. The first condition refers to the days of presence of an individual. Since the formulation is identical to that of subparagraph a) of paragraph 2 of Article 15, the principles applicable to the computation of the days of presence for purposes of that last subparagraph are also applicable to the computation of the days of presence for the purpose of the suggested paragraph.[60]
>
> 158. For the purposes of the second condition, according to which more than 50% of the gross revenues attributable to active business activities of the enterprise during the relevant period or periods must be derived from the services performed in that State through that individual, the gross revenues attributable to active business activities of the enterprise would represent what the enterprise has charged or should charge for its active business activities, regardless of when the actual billing will occur or of domestic law rules concerning when such revenues should be taken into account for tax purposes. Such active business activities are not restricted to activities related to the provision of services. Gross revenues attributable to "active business activities" would clearly exclude income from passive investment activities, including, for example, receiving interest and dividends from investing surplus funds. States may, however, prefer to use a different test, such as "50% of the business profits of the enterprise during this period or periods is derived from the services" or "the services represent the most important part of the business activities of the enterprise", in order to identify an enterprise that derives most of its revenues from services performed by an individual on their territory.

106.21.8 *Para (a) examples*

The OECD Commentary provides 3 simple, self-evident examples, concerned with a sole proprietorship and with companies:

> 159. The following examples illustrate the application of subparagraph a) (assuming that the alternative provision has been included in a treaty between States R and S):

[60] See 37.13 (STBV condition a: 183-day rule).

Example 1:
W, a resident of State R, is a consultant who carries on her business activities in her own name (i.e. that enterprise is a sole proprietorship). Between 2 February 00 and 1 February 01,
[a] she is present in State S for a period or periods of 190 days and
[b] during that period all the revenues from her business activities are derived from services that she performs in State S.
Since subparagraph a) applies in that situation, these services shall be deemed to be performed through a permanent establishment in State S.

Example 2:
X, a resident of State R, is one of the two shareholders and employees of XCO, a company resident of State R that provides engineering services. Between 20 December 00 and 19 December 01,
[a] X is present in State S for a period or periods of 190 days and
[b] during that period, 70% of all the gross revenues of XCO attributable to active business activities are derived from the services that X performs in State S.
Since subparagraph a) applies in that situation, these services shall be deemed to be performed through a permanent establishment of XCO in State S.

Example 4:
Z, a resident of State R, is one of 10 employees of ACO, a company resident of State R that provides accounting services. Between 10 April 00 and 9 April 01,
[a] Z is present in State S for a period or periods of 190 days and
[b] during that period, 12% of all the gross revenues of ACO attributable to its active business activities are derived from the services that Z performs in State S.
Subparagraph a) does not apply in that situation and, unless subparagraph b) applies to ACO, the alternative provision will not deem ACO to have a permanent establishment in State S.

Example 3 concerns a partnership, which is less straightforward:

Example 3:
X and Y, who are residents of State R, are the two partners of X&Y, a partnership established in State R which provides legal services. For tax purposes, State R treats partnerships as transparent entities.
Between 15 July 00 and 14 July 01,
[a] Y is present in State S for a period or periods of 240 days and
[b] during that period, 55% of all the fees of X&Y attributable to X&Y's active business activities are derived from the services that

> Y performs in State S.
>
> Subparagraph a) applies in that situation and, for the purposes of the taxation of X and Y, the services performed by Y are deemed to be performed through a permanent establishment in State S.

106.21.9 *Duration of services*

The Services PE clause applies:

> where an enterprise of a Contracting State performs services in the other Contracting State ...
>
> b) [i] for a period or periods exceeding in the aggregate 183 days in any twelve month period, and
>
> [ii] these services are performed for the same project or for connected projects through one or more individuals who are present and performing such services in that other State

OECD Commentary provides:

> 160. Subparagraph b) addresses the situation of an enterprise that performs services in a Contracting State in relation to a particular project (or for connected projects) and which performs these through one or more individuals over a substantial period. The period or periods referred to in the subparagraph apply in relation to the enterprise and not to the individuals. It is therefore not necessary that it be the same individual or individuals who perform the services and are present throughout these periods. As long as, on a given day, the enterprise is performing its services through at least one individual who is doing so and is present in the State, that day would be included in the period or periods referred to in the subparagraph. Clearly, however, that day will count as a single day regardless of how many individuals are performing such services for the enterprise during that day.
>
> 161. The reference to an "enterprise … performing these services for the same project" should be interpreted from the perspective of the enterprise that provides the services. Thus, an enterprise may have two different projects to provide services to a single customer (e.g. to provide tax advice and to provide training in an area unrelated to tax) and whilst these may be related to a single project of the customer, one should not consider that the services are performed for the same project.
>
> 162. The reference to "connected projects" is intended to cover cases where the services are provided in the context of separate projects carried on by an enterprise but these projects have a commercial coherence (see paragraphs 24 and 25 above). The determination of whether projects are connected will depend on the facts and circumstances of each case but factors that would generally be relevant for that purpose include:
>
> – whether the projects are covered by a single master contract;
> – where the projects are covered by different contracts, whether these different contracts were concluded with the same person or with related persons and

whether the conclusion of the additional contracts would reasonably have been expected when concluding the first contract;

- whether the nature of the work involved under the different projects is the same;
- whether the same individuals are performing the services under the different projects.

163. Subparagraph b) requires that during the relevant periods, the enterprise is performing services through individuals who are performing such services in that other State. For that purpose, a period during which individuals are performing services means a period during which the services are actually provided, which would normally correspond to the working days of these individuals. An enterprise that agrees to keep personnel available in case a client needs the services of such personnel and charges the client standby charges for making such personnel available is performing services through the relevant individuals even though they are idle during the working days when they remain available.

164. As indicated in paragraph 153 above, for the purposes of the alternative provision, the individuals through whom an enterprise provides services will be the individuals referred to in paragraph 39 above. If, however, an individual is providing the services on behalf of one enterprise, the exception included in the last sentence of the provision clarifies that the services performed by that individual will only be taken into account for another enterprise if the work of that individual is exercised under the supervision, direction or control of the last-mentioned enterprise. Thus, for example, where a company that has agreed by contract to provide services to third parties provides these services through the employees of a separate enterprise (e.g. an enterprise providing outsourced services), the services performed through these employees will not be taken into account for purposes of the application of subparagraph b) to the company that entered into the contract to provide services to third parties. This rule applies regardless of whether the separate enterprise is associated to, or independent from, the company that entered into the contract.

165. The following examples illustrate the application of subparagraph b) (assuming that the alternative provision has been included in a treaty between States R and S):

- Example 1: X, a company resident of State R, has agreed with company Y to carry on geological surveys in various locations in State S where company Y owns exploration rights. Between 15 May 00 and 14 May 01, these surveys are carried on over 185 working days by employees of X as well as by self-employed individuals to whom X has sub-contracted part of the work but who work under the direction, supervision or control of X. Since subparagraph b) applies in that situation, these services shall be deemed to be performed through a permanent establishment of X in State S.
- Example 2: Y, a resident of State T, is one of the two shareholders and employees of WYCO, a company resident of State R that provides training services. Between 10 June 00 and 9 June 01, Y performs services in State S under a contract that WYCO has concluded with a company which is a resident of State S to train the employees of that company. These services are performed in State S over 185 working days. During the period of Y’s

presence in State S, the revenues from these services account for 40% of the gross revenues of WYCO from its active business activities. Whilst subparagraph a) does not apply in that situation, subparagraph b) applies and these services shall be deemed to be performed through a permanent establishment of WYCO in State S.

- Example 3: ZCO, a resident of State R, has outsourced to company OCO, which is a resident of State S, the technical support that it provides by telephone to its clients. OCO operates a call centre for a number of companies similar to ZCO. During the period of 1 January 00 to 31 December 00, the employees of OCO provide technical support to various clients of ZCO. Since the employees of OCO are not under the supervision, direction or control of ZCO, it cannot be considered, for the purposes of subparagraph b), that ZCO is performing services in State S through these employees. Additionally, whilst the services provided by OCO's employees to the various clients of ZCO are similar, these are provided under different contracts concluded by ZCO with unrelated clients: these services cannot, therefore, be considered to be rendered for the same or connected projects.

106.21.10 *Abuse: fragmentation*

OECD Commentary provides:

> 166. The 183-day thresholds provided for in the alternative provision may give rise to the same type of abuse as is described in paragraph 52 above.[61] As indicated in that paragraph, apart from the fact that such abuses may, depending on the circumstances, fall under the application of legislative or judicial anti-avoidance rules, these abuses could also be addressed through the application of the anti-abuse rule of paragraph 9 of Article 29. Some States, however, may prefer to deal with them by including a specific provision in the Article. Such a provision could be drafted along the following lines ...

106.21.11 *Scope of Services PE*

OECD Commentary provides:

> 167. According to the provision, the activities carried on in the other State by the individuals referred to in subparagraph a) or b) through which the services are performed by the enterprise during the period or periods referred to in these subparagraphs are deemed to be carried on through a permanent establishment that the enterprise has in that other State. The enterprise is therefore deemed to have a permanent establishment in that other State for the purposes of all the provisions of the Convention (including, for example, paragraph 5 of Article 11 and

[61] See 106.11.1 (Building/construction site).

> paragraph 2 of Article 15) and the profits derived from the activities carried on in the other State in providing these services are attributable to that permanent establishment and are therefore taxable in that State pursuant to Article 7.
>
> 168. By deeming the activities carried on in performing the relevant services to be carried on through a permanent establishment that the enterprise has in a Contracting State, the provision allows the application of Article 7 and therefore, the taxation, by that State, of the profits attributable to these activities. As a general rule, it is important to ensure that only the profits derived from the activities carried on in performing the services are taxed; whilst there may be certain exceptions, it would be detrimental to the cross-border trade in services if payments received for these services were taxed regardless of the direct or indirect expenses incurred for the purpose of performing these services.

106.21.12 *Preparatory/auxiliary services*

The second limb of the services PE clause is an exemption for preparatory/auxiliary services:[62]

> [2] unless these services are limited to those mentioned in paragraph 4 which, if performed through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

OECD Commentary provides:

> 169. This alternative provision will not apply if the services performed are limited to those mentioned in paragraph 4 of Article 5 which, if performed through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph. Since the provision refers to the performance of services by the enterprise and this would not cover services provided to the enterprise itself, most of the provisions of paragraph 4 would not appear to be relevant. It may be, however, that the services that are performed are exclusively of a preparatory or auxiliary character (e.g. the supply of information to prospective customers when this is merely preparatory to the conduct of the ordinary business activities of the enterprise; see paragraph 71 above) and in that case, it is logical not to consider that the performance of these services will constitute a permanent establishment.

[62] See 106.19 (Preparatory/auxiliary activities).

106.22 Alternative finance arrangements

Section 1144 CTA 2010 deals with sharia-compliant arrangements for interest. This is not discussed here.

106.23 PE: Pre-1963 DTAs

Pre-1963 DTAs[63] provide another definition of PE. I take art 2(1)(k) Belize/UK treaty as an example:

> [1] The term "permanent establishment", when used with respect to an enterprise of one of the territories, means
>
> [a] a branch, management or other fixed place of business,
>
> [b] but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf.
>
> [2] An enterprise of one of the territories shall not be deemed to have a permanent establishment in the other territory merely because it carries on business dealings in that other territory through a bona fide broker or general commission agent acting in the ordinary course of his business as such.
>
> [3] The fact that an enterprise of one of the territories maintains in the other territory a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute that fixed place of business a permanent establishment of the enterprise.
>
> [4] The fact that a company which is a resident of one of the territories has a subsidiary company which is a resident of the other territory or which is engaged in trade or business in that other territory (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary company a permanent establishment of its parent company.

The wording of [1] is based on s.17 FA 1930 and is clearly an ancestor of OECD Model PE.

106.24 Trade in UK without PE

In *Brackett v Chater*:

> ... I find it difficult to imagine how a non-resident company which carries on a trade with any degree of continuity in the UK can do so

[63] See 107.24 (Pre-1963 DTAs).

> otherwise than through a "branch or agency" as defined in the Taxes Management Act 1970.[64]

Given the breadth of the expression this seems right, but as a general rule, it is not as an absolute rule. This applies to a PE as well as to a branch/agency.

The former International Tax Handbook at para 846 took the view that trading in the UK without a branch or agency was rare:

> Although such cases are rare it is possible for a non-resident individual to trade here other than through a branch or agency. A non-resident individual might come to this country for a short time so as not to become resident and carry on an itinerant trade. There would in such a situation be no branch and no agency. It is rather more difficult to imagine situations of that sort where the person concerned is a company. But notwithstanding the judge's comments in the *Brackett* case there may be cases where the UK activities of a non-resident company are divided between various persons in such a way that, although the activities amount to trading here, no one person or group of persons can be identified as a branch or agency through which the trade is carried on.

Similarly HMRC say:

> a trade carried on in the UK otherwise than through a permanent establishment which, technically, remains within the charge to UK income tax ... in practice applies to only a very small number of companies.[65]

106.25 Definitions of PE: Critique

We only need one definition of PE and it is suggested that the UK-law definition of PE should be repealed and replaced by a rule that PE has the same meaning as in OECD Model definition at the current time. That is indeed what the current statutory definition is intended to achieve. There could usefully be a power to adopt subsequent changes to OECD Model definition by statutory instrument.

[64] 60 TC 134 at p.149.

[65] HMRC, "Non-resident companies chargeable to Income Tax and non-resident CGT (March 2017) para 2.4 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/601032/Non-resident_companies_chargeable_to_Income_Tax_and_non-resident_CGT_-_consultation.pdf*

106.26 Why branch/agency matters

It is not practical to set out a full list of the significance of branch/agency for tax, but the following are the most important.

In the absence of a branch/agency, a non-resident individual or trust is not generally subject to CGT. An individual or trust trading in the UK through a PE is subject to CGT on gains linked to the branch/agency.[66]

IT and CGT may be collected from the branch/agency.[67]

A branch/agency of an individual who is a trustee is relevant to trust residence.

Lastly, the branch/agency is likely to be a PE, which is relevant for DTAs.

Branch/agency is not relevant to companies. In theory one could envisage a situation where a non-resident company does not have a UK PE but does have a UK branch/agency, and such a company would be within the scope of CGT.[68] In practice, this does not happen, or if it does, no-one takes any notice.[69]

106.27 Meaning of "branch or agency"

106.27.1 *Statutory (non-)definition*

Section 1B(5) TCGA provides:

> In this Act, unless the context otherwise requires, "branch or agency"—
> (a) means any factorship, agency, receivership, branch or management, but
> (b) does not include any person within any of the exemptions under sections 835G to 835K of ITA 2007 (persons who are not UK representatives).

The exceptions in s.1B(5)(b) concern agents, brokers, investment managers, alternative finance arrangements (Sharia-compliance) and Lloyds agents.[70]

[66] See 56.7 (Trade through UK branch/PE).

[67] See 124.2 (Tax collected from UK representative).

[68] See 56.6.5 (CGT/CT charge: non-residents).

[69] See for instance the HMRC trustee residence guidance which states conveniently (if not strictly accurately):
"This is in line with [what is now s.2B(3) TCGA] *which has the effect that an overseas company is not taxed on the gains made by a UK branch or agency, but only on those made by a permanent establishment here*." (Emphasis added).

[70] See 124.5 (UK representatives: Exemptions).

The definition in s.1B(5)(a) is useless, since it incorporates both words being defined, merely adding three further obscure or archaic terms which seem to mean "agent" if they mean anything.[71] The INTM expresses the same point more tactfully:

> **INTM264090. Branch or agency – Statutory definition and practical recognition of a branch** [Apr 2020]
> ... There is a statutory definition of 'branch or agency' ... thus – "any factorship, agency, receivership, branch or management". This is not particularly helpful so we must look for authority elsewhere including case law.

106.27.2 *"Branch"*

The former International Tax Handbook stated at para 842:

> There is very little guidance on the meaning of 'branch'. We have been advised that the presence of a principal (in the case of a sole trader or partnership) or of employees on a more or less regular basis is likely to be an essential ingredient of a branch (though employees may also be agents).

That repeats the personnel condition in the definition of PE. The INTM provides:

> **INTM264090. Branch or agency – Statutory definition and practical recognition of a branch** [Apr 2020]
> ... Most people recognise a branch of a foreign business when they see one and the impression given to the public is helpful in deciding whether or not a branch exists. For example there are many branches of foreign banks that trade on the High Streets of many towns and cities in the UK. We know this, whether we bank with these branches or not,

[71] The former International Tax Handbook explained at 842:

> "Factorship and receivership are forms of agency and so, usually, would 'management' be. The former two categories are found in the 1842 machinery provisions, 'Management' was added in 1915 but has acquired more modern associations with the growth in the use of managers such as project managers and investment managers."

To be fair, s.1B(5)(a) was not intended to be a definition as such, but simply as an abbreviation, to avoid the more cumbersome wording of, e.g. s.370 ITA 1952:

> "A non-resident person shall be assessable and chargeable in respect of any profits or gains arising, whether directly or indirectly, through or from any factorship, agency, receivership, branch or management, and shall be so assessable and chargeable in the name of the factor, agent, receiver, branch or manager."

> because the name of the foreign bank will be displayed across the shop front of the UK branch. The personnel running the UK branch will be carrying on the part of the foreign bank's trade that takes place in the UK. This amounts to the UK presence of the foreign bank's trade, i.e. a branch of its trade. That's an easy example in part because banks actually call themselves branches but it is worth stressing that whatever terminology is used it is the activities carried on in the UK in relation to the foreign enterprise's overall business activities that are most relevant in deciding whether the UK activities are a branch of the foreign business.

See too 124.14.1 (Branch).

106.27.3 *"Agency"*

The "agent" need not be an agent in the contract law sense of a person empowered to enter into contracts on behalf of a principal.[72]

106.27.4 *Branch/agency distinction*

It is considered that "branch" should have (more or less) the same meaning as fixed place of business PE, and "agency" should have (more or less) the same meaning as agency-PE, so the composite expression has (more or less) the same meaning as PE.

HMRC agree. The SALF Manual provides:

> **SALF704 UK representatives of non-residents chargeable under Case I and II Schedule D** [Jan 2019]
> *Definition of UK representative*
> Branch or agency has the statutory definition at s.126(8) FA 1995 of 'Any factorship, agency, receivership, branch or management' but it is interpreted on broadly equal lines to 'permanent establishment'...[73]

In *Brackett v Chater*,[74] the Special Commissioners took a different approach. They treated the term "branch or agency" as composite phrase containing a single concept. They did not think it correct to consider separately whether there was a branch, and whether there was an agent.

[72] See *Brackett v Chater* 60 TC 134.

[73] Similarly the HMRC trustee residence guidance: "The examples all relate to non-UK resident companies that are trustees. The same principles would apply for other non-UK resident persons who are trustees (and for whom the relevant UK-based entity would be a branch or agency rather than a permanent establishment)."

[74] 60 TC 134 & 639, at p.646.

The difficulty with this approach is that it is far from clear what the single concept is, if it is distinct from the concepts of branch and agency and PE. (The statutory definition, as noted, does not help.) The Special Commissioners' solution is to ignore the wording altogether.[75] It is not necessary to go that far, even when dealing with these 19th century fossils, and at a time when more emphasis is placed on a purposive approach.

The Special Commissioners continued:

> Mr. Brackett represents Drishane in this country and is in sole charge of the day to day conduct of the trading operations other than the formation of contracts. It is not straining language, in our opinion, to say that by entrusting those operations to his care Drishane has established at least a branch in this country. Alternatively Mr. Brackett can properly be described as the manager of those operations, because he personifies them. Nor can we accede to Mr. Brackett's argument that it is inappropriate to assess him as "agent for Drishane" because he does not have the status of an agent under the general law. The definition of "branch or agency" in s 118 Taxes Management Act adds that "branch or agent" shall be construed accordingly. We take that to mean that the term "agent" is used as the cognate noun to describe a person who represents a branch or agency. Mr. Brackett is undoubtedly the personification of the branch or management of Drishane's business in this country and is, in our opinion, properly assessed as "agent for Drishane" on the authority of s 79.

This conclusion does follow from the finding of fact in the first sentence, though the only support it received in the High Court was that the decision was one which the Special Commissioners were entitled to reach.

106.28 Branch/agency: Critique

The FA 2003 replaced "branch or agency" with "PE" for the purposes of corporation tax. The reason was to achieve consistency with international tax law. A press release explained the reason:

> The rules also alter our current terminology so that in future we tax "permanent establishments", (a term recognised internationally and used in our double taxation agreements), rather than "branches". The new rules are to be interpreted

[75] "It would, in our view, be perverse to hold that [the non-resident company], which was effectively trading only in this country, through Mr. Brackett, is not within the charge to tax because of some semantic difficulty in fitting its arrangements with him to the wording of the definition of a branch or agency."

> in accordance with OECD guidelines, to ensure that the UK is in accord with international consensus that reflects UK agreement.[76]

This was a good reason to change corporation tax, and it is an equally good reason to bring IT and CGT into line. We do not need both concepts. The term PE should replace "branch or agency" altogether. This would be a worthwhile and trouble-free simplification in the law. It would make no difference in practice, because in practice the two terms come to much the same thing, and no-one takes much notice of such differences as there may be, but the reform would remove some puzzles and much complexity and duplication.

[76] REV BN 25 para 8 (17 April 2002).

CHAPTER ONE HUNDRED AND SEVEN

DOUBLE TAXATION ARRANGEMENTS: INTRODUCTION

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Cross references

In this chapter I consider some general aspects of DTAs. The following chapters consider:

(1) anti-abuse rules (including Savings Clauses)
(2) foreign tax credit relief

DT exemptions for specific types of income/gains are considered in the chapter on that topic, see:

DT exemptions for specific types of income/gains are considered in the chapter on that topic, see:

DT relief	**Para**		
Trading income	21.23	s720 income	49.30
Property income	24.7	s.731 income	50.61
Interest income	26.27	Offshore income gains	67.25
Dividend income	30.15	Accrued income scheme	28.16
Royalties	32.16	Capital gains	56.23
Misc Sweep-up Income	33.20	s.86 gains	60.19
Employment income	37.2	s.87 gain	61.60
Pension income	38.8	s.3 gain	64.40
s.624 income	47.18		

IHT treaties are considered separately:

Topic	**Para**		
IHT DTAs: Introduction	114.1	South Africa	117.1
India, Pakistan, Italy, France	115.1	Switzerland	118.1
Netherlands	116.1	USA	119.1

The following topics are considered elsewhere:

Topic	**See**
Treaty-residence	9.1
DT relief: Partnership	85.25
DT relief: IP trusts	42.11
Discretionary trusts	41.9; 41.12

Charities	Kessler, Wong & Borlace, *Taxation of Charities & Nonprofit Organisations*[1]

I do not consider corporation tax.
I hope to address some post-Brexit issues in a future edition.

107.1 DT reliefs: Introduction

There are three model double tax treaties:

Short name	**Published by**	**Full name**
OECD Model	OECD	Model Tax Convention on Income and on Capital[2]
UN Model	United Nations	Model Double Taxation Convention between Developed and Developing Countries
US Model	United States	Model Income Tax Convention

The discussion in this book is mainly by reference to the OECD Model. This has been the basis for most tax treaties between developed countries since published (in draft in 1963, and finally in 1977). In particular, UK DTAs since 1963 have usually been based on OECD Model. But fortunately all 3 Models have much in common.

A new edition of the OECD Model was published in 1992. Since then OECD has published updates rather than a new edition. There have been updates every 2 or 3 years.

The US Model was revised in 1996, 2006 and 2016.[3] I do not consider this Model as such, but I do consider the USA/UK DTA (2001).

OECD publish a lengthy commentary on the OECD Model (**"OECD Commentary"**); the "condensed" version is nearly 700 pages. The UN also publish a commentary. The US have published commentaries on:

- the general US Model (**"US Model DTA Technical Explanation")**[4]
- the USA/UK DTA (**"USA/UK DTA Technical Explanation")**[5]

[1] (13th ed., 2022-23), Chapter 14 (Double Taxation Treaties and Charities) online version *https://www.taxationofcharities.co.uk*

[2] Where it is necessary to distinguish this from the OECD IHT Model, I refer to it as the **"IT/CG model"**.

[3] *https://www.irs.gov/businesses/international-businesses/united-states-model-tax-treaty-documents*

[4] *https://www.irs.gov/businesses/international-businesses/united-states-model-tax-treaty-documents* This has commentaries on the 1996 and 2006 US Models, but not on the 2016 Model.

[5] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf* The Courts have found this "helpful": *Aozora GMAC Investment (R, oao) v HMRC* [2017] EWHC 2881 (Admin) at [27].

A full discussion of the OECD Model would need a volume for every article, except art 7 (business profits) which would require several volumes. These books have been written, and the total would fill a bookcase. This literature includes a book on art 16 (directors fees) which is only a single sentence of 44 words. The OECD Model is used worldwide, so we benefit in the UK from scholars, practitioners, Revenue authorities, and case law, across the world - at least so far as written in English.

Of these books, *Vogel on Double Taxation Conventions* is the most frequently cited, with a judicial accolade in *O'Brien v Quigley*:[6]

> the academic work which I found most helpful of all of the documents put before the Court ... (no less than fifty-five in number)

But applying the treaty to UK tax legislation is of course a UK domestic law exercise.[7]

I only consider the UK side of the matter, ie whether a DTA provides exemption from UK tax and whether foreign tax can be used as a credit against UK tax. In any particular case it will also be necessary to consider the foreign tax position.

I refer at points to the UN Model and to specific treaties. In any particular case the DTA concerned would need to be reviewed.[8]

The UK's network of DTAs is extensive, there are more than 100 treaties. But there are gaps; for example, there is no treaty with Peru, and gaps in Africa include Tanzania and most Francophone countries.

107.2 Treaty terminology

OECD (both in the Model and in other materials, such as the Commentary and MLI) has a vocabulary, sometimes a technical (specialist) vocabulary, which can be unidiomatic.[9] But when discussing the Model, it is generally best to adopt the OECD dialect, because the alternative ends up even more confusing.

In the context of DTAs, the terms treaty/convention/arrangement/

[6] [2013] IEHC 398 at [41].

[7] See Avery Jones, "The Interaction Between Tax Treaty Provisions and Domestic Law" in Tax Treaties and Domestic Law (2006) ed Maisto, IBFD.

[8] Is this so obvious that it does not need saying? It is not: see *Evans v PricewaterhouseCoopers* discussed at 9.18.6 (A cautionary tale).

[9] But OECD- English has not drifted as far from British English as EU-law English.

agreement are synonymous. OECD Model use the word "convention" and UK tax legislation uses the term "double taxation arrangements". I prefer the word "treaty" as it seems clearest, but adopt the abbreviation DTA which has become standard usage.

The State where the income arises is the "**source State**" and the State where the individual is treaty-resident is the "**residence State**".

107.2.1 *"State"/"Territory"*

The OECD model refers to a "Contracting State" but I abbreviate this to "**treaty State**" or just "**State**" and where that State is not the UK, I refer to it as the "**foreign State**".

UK legislation generally uses the word "territory" which is wider than "State", and includes:

(1) Subdivisions and local authorities
(2) Crown dependencies and British Overseas Territories, which are territories but not (independent) States; the UK is responsible for their international relations[10]

OECD writes "State" with an initial capital.[11] I follow that here, though a lower case "s" is also acceptable and perhaps more common.

107.3 Types of double taxation

The expression "double taxation" seems straightforward, but it covers a variety of different situations.

The OECD Commentary begins:

> International juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more) States
> [1] on the same taxpayer
> [2] in respect of the same subject matter and
> [3] for identical periods.

Anson v HMRC adopts this definition (but omits point [3]):[12]

> [*Juridical* double taxation] is usually considered to arise where two

[10] See 107.23 (Channel Islands/IoM DTAs).

[11] Perhaps this is influenced by the French version, where "État" is written with an initial capital, but Fowler's *Modern English Usage* (4th ed, 2015) also recommends an initial capital in this context.

[12] [2015] UKSC 44 at [57]. The definition in OECD Commentary on article 23A and 23B, para 1, 2 is (more or less) the same.

> jurisdictions impose income taxes on the same person in respect of the same income.
> [*Economic* double taxation] is usually considered to arise where there is taxation of the same or derivative income in separate hands.

The purposes of the OECD Model, as stated in its preamble, include "the avoidance of double taxation".[13] In *Anson v HMRC*:[14]

> The preamble does not indicate more precisely what is meant by double taxation: in particular, whether the Convention is restricted to 'juridical double taxation', or can also extend to 'economic double taxation'.

But it is well established that the OECD Model can provide relief in cases where taxes are imposed in two States on different taxpayers in respect of the same subject matter.[15]

107.4 Co/shareholder double taxation

In a domestic context, where a business is carried on by a company, there are two charges to UK tax:
(1) Corporation tax on the company profits
(2) Income tax on the distribution

This is not juridical double taxation, as tax is paid by different persons, and dividends are regarded as a separate source.[16] It is a case of economic double taxation. It is of course double taxation which the current UK tax system accepts, but various rules mitigate the double taxation. In particular:
(1) Profits are taxed in the hands of the company at a corporate tax rate, which is (generally) lower than personal income tax rates.
(2) Dividends are taxed at dividend rates, which are (slightly) lower than the main income tax rates.
(3) A company does not normally distribute all its profits.
(4) Proceeds of liquidation are subject to CGT, at CGT rates, not IT.[17]
(5) If the shareholder is a company, further reliefs are available: the

[13] See 108.2 (DTA title/preamble/purpose).
[14] [2015] UKSC 44 at [57].
[15] *Anson* is one such case; see 90.47.1 (LLC: Opaque). For another example, see 111.5.5 (Tax on different person/time).
[16] See 30.2 (Dividends a separate source).
[17] Subject to anti-avoidance rules such as the winding-up TAAR and Transactions in Securities.

dividend it receives from an underlying company may be exempt, or may qualify for group relief, or for a DT credit for foreign tax paid by the underlying company.

Similar points arise where:

(1) Income is received by a company in State A and taxed in State A; and
(2) The income is distributed to shareholders in State B and taxed in State B.

That is also a type of economic double taxation. It may be mitigated by the rules set out above. But the Courts may regard it with equanimity. The point arise in *Memec v HMRC:*[18]

> In so far as plc is claiming that it has the merits on its side, I do not think that these points carry much weight. Prior to the agreement, plc accepts, economic double taxation was suffered through the group structure it had chosen to adopt. It is common ground that the new structure has achieved its intended purpose of reducing the burden of German tax by eliminating German corporation tax in respect of plc's share of the profits of the silent partnership. Whether the new structure has achieved the further benefit for plc of a credit against UK corporation tax for the trade tax paid by the subsidiaries seems to me to be a dry question of law unencumbered by the merits.

That is right, because even in a purely domestic context, eg a UK company distributes profits to UK shareholders, there is an element of (domestic) double taxation: CT on the company and IT on the shareholders.

There are different types of economic double taxation; and relief is sometimes available and sometimes not. To ask whether the OECD Model applies to economic double taxation is to approach the issue at a high a level of generality. To answer the question in any particular case is a matter of descending to construe the relevant provisions ("a dry question of law unencumbered by the merits").

But merits may still affect outcomes. In *Anson v HMRC*,[19] the mitigation rules set out above did not apply: the LLC (albeit a company) had to distribute all its income, the taxpayer was subject to US tax at personal rates and UK tax at personal rates, the total rate being 67%.[20] Does this

[18] 71 TC 77 at p.106; for the *Memec* structure, see 90.28 (Stille Gesellschaft).

[19] See 90.46 (LLC US tax credit).

[20] [2015] UKSC 44 at [25]: "The question is whether he is liable to pay [at] an effective rate of taxation of 67% (ie £45 in US taxes for every £100 of income, plus £22 in UK

matter? The UT and CoA seemed unconcerned by that unfairness. Or perhaps they thought that hard cases make bad law? Or perhaps they were concerned not to upset existing arrangements? Did the perceived fairness of the outcome affect the FTT and SC decisions in favour of Mr Anson? Is there is simply judicial inconsistency, ie some judges are more concerned about fairness than others? Discuss.

107.5 DT exemption/credit compared

OECD Model confers two types of DT relief: Exemption and Credit.[21]

107.5.1 *DT exemption*

On 16 occasions, the OECD Model provides that income/gains *"shall be taxable only"* in one State. This is the wording used to confer exemption in the other State.

It may be helpful to outline the main cases of DTA exemption:

Art: Heading	**Income qualifying for exemption**	**Taxed in State of**
7: Business profits	Profits of enterprise of a Contracting State (in absence of PE)	Enterprise
12: Royalties	Royalties arising in Contracting State, beneficially owned by resident of other Contracting State	Residence
13: Capital gains	Most types of gains	Residence
15(1): Employment	Remuneration of resident of Contracting State (unless employment exercised in other Contracting State)	Residence
15(2): Employment	Short term business visitor	Residence
18: Pensions	Pensions paid to resident of Contracting State in consideration of past employment	Residence
19: Government service	Remuneration paid by Contracting State to individual in respect of services rendered to that State	Government
21: Other income	Income of resident of a Contracting State, not dealt with in other Articles	Residence

107.5.2 *FDT credit*

In 16 cases the OECD Model provides that income/gains *"may be taxed in that other State"* (that is, in the source State). In these cases, the residence State gives credit for the foreign tax. In the case of dividends

tax, calculated as 40% of the £55 remitted after payment of US taxes), or is entitled to double taxation relief."
Remitted dividends do not qualify for dividend rates. The 40% rate would now be 45% (47% in Scotland) so the effective rate of tax would now be about 70%.

[21] This is self-evident from the text of the OECD Model, though this observation has also been made judicially.

and interest there is also a limit on the source State's tax. It may be helpful to give an outline of the main cases of DTA credit:

Art:Heading	**Income subject to credit relief**
6: Immovable property	Income derived by resident of a Contracting State from immovable property situated in other Contracting State
7: Business profits of PE	Profits of PE of enterprise of a Contracting State if the enterprise carries on business in the other Contracting State through a PE situated therein
10: Dividends	Dividends paid by company which is a resident of a Contracting State to resident of the other Contracting State
11: Interest	Interest arising in a Contracting State and paid to resident of the other Contracting State
13: Capital gains	Gains derived by resident of a Contracting State from the alienation of immovable property situated in the other Contracting State
15(1): Employment	Remuneration derived by resident of a Contracting State in respect of an employment exercised in the other Contracting State
16: Directors fees	Directors' fees derived by resident of a Contracting State in his capacity as a member of the board of directors of a company which is a resident of the other Contracting State

107.5.3 *Exemption/credit terminology*

We need terms for the various types of DT relief, and in this chapter I use the following terminology.

"**DT exemption**" applies where a DTA provides an exemption from tax. **"Foreign tax credit relief"** applies where foreign tax is set against UK tax. This may be:

(a) "**DTA tax credit relief**" where a DTA confers a credit or

(b) "**Unilateral tax credit relief**" where UK tax law (not a DTA) confers a credit.

The terms sometimes used are "exemption" and "set-off" methods of relief.

"**IT/CGT computation deduction**" applies where foreign tax is deducted in computing income or gains.

I refer to these reliefs together as "**DT reliefs**".

107.6 Double non-taxation

Double non-taxation may arise because:

(1) Both States provide treaty relief on the same income/gains ("double exemption"); or

(2) One State provides treaty relief, and the other State does not seek to

tax the income/gains because there is no domestic-law charge, or some domestic-law relief applies.

These raise different issues, and confusion arises if they are bundled into a single category.

107.6.1 *Abusive double non-taxation*

Tax avoidance DTA cases will generally involve double non-taxation. In *Huitson (R, oao) v HMRC*:[22]

> [Double taxation agreements] respect the principle of taxation by the state of residence. They aim to avoid the taxation of residents twice over on the same income. What DTAs do not aim to do is
> [1] to facilitate the avoidance of tax, or
> [2] its reduction below the level of tax ordinarily paid by residents.[23]
> In those circumstances it is a legitimate aim of the public policy of the state in fiscal matters to ensure that DTAs relieve double taxation of residents rather than serve as an instrument used by taxpayers who choose to participate in artificial arrangements to avoid or reduce their level of taxation.

In *Bayfine UK v HMRC,* CoA commented on a DTA using the 1992 wording which referred to "the prevention of fiscal evasion":[24]

> These words ... make it clear (!) that the primary purposes of the Treaty are,
> [1] on the one hand, to eliminate double taxation and,
> [2] on the other hand, to prevent the avoidance of taxation.
> ... the Treaty should be interpreted to avoid the grant of double relief as well as to confer relief against double taxation.[25]

Similarly GAAR guidance provides:[26]

> ... The express purpose of DTAs is to avoid double taxation and prevent fiscal evasion, not to facilitate double non-taxation. This is clear from the judgment of the High Court and the Court of Appeal in *Huitson (R,*

[22] [2011] EWCA Civ 893 at [34].

[23] Limb [2] of this sentence is muddled or misconceived.

[24] The case concerned the 1980 USA/UK treaty. For the 1992 wording, see 108.2.3 (1992 form: Fiscal evasion).

[25] [2011] EWCA Civ 304 at [17].

[26] Para D 12.5.1. *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

oao) v HMRC, and the Court of Appeal in the case of *Bayfine UK v HMRC*.

In the context of avoidance cases this is not surprising, and the approach is now endorsed by BEPS MLI and the 2017 OECD Model. But how far does the principle apply that DTAs "should be interpreted to avoid the grant of double relief" when there is no avoidance in the strict sense?

107.6.2 *Acceptable double non-taxation*

Abuse will normally involve double non-taxation, and in such cases implied and express anti-avoidance rules can apply. But it is not the case that all double non-taxation constitutes abuse. DTA tax credit reliefs allow taxing rights to both States and seek only to avoid double taxation. DT exemptions assign taxing rights to one State alone. If that State chose not to exercise those taxing rights, a claim for treaty relief is not abuse, even though the result is double non-taxation.

Examples are:

(1) Foreign alimony payments received by UK residents. These are exempt from foreign tax under OECD Model, but the UK does not tax them.[27]

(2) Foreign income received by UK charity or pension scheme

In these cases DT relief on foreign income/gains results in double non-taxation, but not contrary to the intention of the treaties.

The purpose of double tax treaties may be to avoid double taxation, but one of the methods by which they do this is to allocate taxing rights between countries, which allows for the possibility of double non-taxation.

In other words, States sometimes *intend* double non-taxation. Suppose a country wished to encourage immigration, and did so by exempting foreign pension income of new immigrants. This policy would be frustrated if the effect of the domestic law exemption is just to replace domestic tax (residence-state tax) with foreign tax (source-state tax).[28] Contrary to the statement in *Bayfine*, DTAs are not, or not only, to avoid double taxation, but to allocate taxing rights; the State to which the taxing rights are allocated is not required to exercise those rights, and sometimes may want not to do so. The statement in *Bayfine* should be read in its context, which involved a tax avoidance scheme.

[27] See 31.9 (Foreign maintenance payments).

[28] The example is from Israel; see 108.13 ("Subject to tax").

In *Gladden Estate v The Queen*, the Canadian court said:

> ... double taxation is neither a condition nor a prerequisite for invoking the protection of the treaty. The non-resident can benefit from the exemption regardless of whether or not he is taxable on that capital gain in his own country.[29] If Canada or the U.S. were to abolish capital gains completely, while the other country did not, a resident of the country which had abolished capital gains would still be exempt from capital gains in the other country. This in effect was the situation between the time the treaty took effect and Canada in fact first imposed a capital gains tax. During that period Canadians could benefit from Article VIII.[30]

This is what happened in the India and Pakistan IHT DTAs. India and Pakistan abolished their estate duty, but the DTAs continues to provide exemption for UK IHT, and no-one suggests the contrary, notwithstanding the double non-taxation which results.[31]

Klaus Vogel agrees:

> Dual taxability of the income or capital is not necessary for residents to be entitled to treaty benefits... double non taxation is acceptable, because it is a conscious decision of the Contracting States whether or not they enter into a tax treaty which leaves open the possibility of double non-taxation.[32]

[29] Article VIII Canada/USA DTA (1942) provided: "Gains derived in one of the Contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other Contracting State shall be exempt from taxation in the former State, provided such resident or corporation or other entity has no permanent establishment in the former State."

[30] 85 DTC 5188 at p.5192.
Similarly, OECD Commentary on art.23A (exemption method) provides:
"33. In the Article it is laid down that the State of residence R shall exempt from tax income and capital which in accordance with the Convention "may be taxed" in the other State E or S.
34. The State of residence must accordingly exempt income and capital which may be taxed by the other State in accordance with the Convention whether or not the right to tax is in effect exercised by that other State. This method is regarded as the most practical one since it relieves the State of residence from undertaking investigations of the actual taxation position in the other State."
(Emphasis added).

[31] See 115.10.1 (Treaty-situs: India/Pakistan).

[32] 4th ed, 2015, para 4.26 (footnotes omitted).
Of course if the Contracting States do wish to restrict a DT exemption so it only

It is also desirable that treaties based on the OECD Model are so far as possible interpreted in the same way, which would not be the case if construction took into account foreign taxes which vary from one State to another, and indeed from one time to another.

This is confirmed by s.3(2) TIOPA:

> Section 2(1) gives effect to arrangements even if the arrangements include—
>
> (a) provision as to income that is not subject to double taxation[33]

Nevertheless. Except in clear or meritorious cases, if there are any, the Courts may be unsympathetic to taxpayers if the outcome is double non-taxation. In *Fowler v HMRC*:[34]

> 4. ... In fact, such an outcome [application of DT relief in the UK]could mean that Mr Fowler was not taxable in either country ... To the extent that domestic South African tax legislation did not tax the earnings of residents employed abroad he would not be taxable there or in the UK. There is no general provision in this Treaty, as there is in many others, to deal with what is called "double non-taxation".[35] But the question whether South Africa did tax the earnings of its residents employed abroad was not investigated in these proceedings so it would be inappropriate to place any weight on this consideration in construing the Treaty.

The reader may detect a hint that the Court would have been more sympathetic to the taxpayer if there had been evidence that he was in fact taxable in South Africa (as may indeed have been the case).

107.7 Types of residence/dual residence

The starting point is to note that there are (at least) three distinct concepts of residence. We need terms to describe them, and I coin the following terminology.

applies to income/gains actually subject to tax in the other State, it seems easy for a DTA to say so; see 108.13 ("Subject to tax"). But I do not think any inference should be drawn from an omission of those words, which are not common.

[33] The reference is to a "subject to tax" clause but these are in practice not general provisions nor are they used very often; see 108.13.7 (Subject to tax: Critique).

[34] [2020] UKSC 22.

[35] The judge is referring to a "subject to tax" restriction on treaty relief; but he is mistaken in assuming that such provisions are common; see 108.13 ("Subject to tax").

(1) "**UK-law residence**" means residence as defined in UK tax law.
 (a) A person who is resident in the UK within the UK tax law definition is "**UK-law UK resident**"
 (b) A person who is not resident in the UK within the UK tax law definition is "**UK-law non-UK resident**".
(2) "**Treaty-residence**" means residence as defined in a DTA.
 (a) A person who is a resident of the UK within a DTA definition is "**treaty-resident in the UK**".
 (b) A person who is resident in the foreign State within a DTA definition is "**treaty-resident in the foreign State**". One could use the term "treaty-resident outside the UK." Statute sometimes calls this "*treaty non-resident*" but I think my term is clearer.

"**Foreign-law residence**" means residence as defined in some foreign tax law.

"**Domestic law**" means the law of the UK, or of a foreign State, as opposed to treaty law or international law.

Since UK-law residence and treaty-residence are distinct concepts,[36] a person who is UK-law UK resident may be:
(1) treaty non-UK resident (under the tie-breaker test);[37] or
(2) not treaty non-UK resident: described as having "**sole UK residence**".[38]

These are somewhat clumsy terms but it is difficult to think of better. For a discussion of these terms, see 9.1 (Treaty-residence: Introduction).

"**Dual residence**" means residence in two countries, but is an ambiguous term until one specifies what types of residence are involved. In its widest sense it means a person who is UK-law UK resident and also foreign-law resident in a foreign State. A dual resident person in that sense may be:
(a) treaty-resident in a foreign State
(b) treaty-resident in the UK or
(c) not treaty-resident anywhere (if there is no applicable DTA).

[36] See 9.2 (Treaty/UK-law residence).

[37] It would be useful to have a short term to describe someone who is UK-law UK resident but treaty-resident outside the UK (= treaty non-UK resident). But *dual resident* and *semi-resident* do not encapsulate the concept; *treaty tie-breaker non-UK resident*" does encapsulate the concept but it is so long-winded it seems better just to use the full expression when it is needed.

[38] See 11.3.4 ("Sole UK residence").

The term "dual resident" is sometimes used specifically to mean a person within (a)[39] and that may be a convenient shorthand when the meaning is clear; but that usage is not adopted in this chapter.

107.8 DTA: Classes of residents

DT reliefs matter to all individuals, but different classes of individual are interested in different aspects of the reliefs. The permutations can be summarised thus:

Case (1): Individuals who are UK-law UK resident and not treaty-resident in a foreign State. Where there is an applicable DTA they will also be treaty-resident in the UK.

Case (2): Individuals who are UK-law UK resident and also resident in a foreign State under the tax laws of that State. These may be:
(a) treaty-resident in a foreign State
(b) treaty-resident in the UK or
(c) not treaty-resident anywhere (if there is no applicable DTA).

Case (3): Individuals who are not UK-law UK resident. These may be:
(a) treaty-resident in a foreign State
(b) not treaty-resident anywhere (if there is no applicable DTA).

Case 1: UK-law UK resident and not treaty-resident in a foreign State. These do not directly qualify for any DT exemption but they may qualify for foreign tax credit relief (or IT/CGT computation deduction). They may also qualify for third-party DT relief if income or gains accruing to a trust or company which is treaty-resident in a foreign State are deemed to accrue to them under an anti-avoidance provisions such as s.624, ToA, s.3, etc.

Case (2)(a): UK-law UK resident and treaty-resident in a foreign State. As UK residents they are in principle subject to IT or CGT on all UK and foreign income and gains (subject where applicable to the remittance basis). However as treaty-resident in a foreign State they may qualify for DT exemptions from UK and foreign source income and gains.

Case (2)(b)(c): UK law UK resident and treaty-resident in the UK or not treaty-resident anywhere. These are in the same position as case 1.

Case (3)(a): Not UK-law UK resident and treaty-resident in a foreign State. As non-residents they are in principle subject to IT on UK source

[39] See 61.38 (Dual resident trust: s.88 TCGA).

income only. As treaty-resident in a foreign State they may qualify for some DT exemptions (eg the Other Income article and relief for UK source interest under the some treaties).

Case (3)(b) Not UK-law UK resident and not treaty-resident anywhere. As non-residents they are in principle subject to IT on UK source income (though the non-residents exemption will mitigate this). They will not qualify for any DT exemptions.

107.9 DTA income categories

Under DTAs, income must be categorised according to its type, because different types of income are governed by different articles:

OECD Model article/Income type

6	Immovable property income	15	Employment income
7	Business profits	16	Directors' fees
8	Shipping/air transport	17	Entertainers and sportspersons
10	Dividends	18	Pensions
11	Interest	19	Government service
12	Royalties	20	Students
13	Capital gains	21	Other Income

DTA categorisation is not the same as UK domestic law.[40]

107.9.1 *Category overlaps*

These categories can overlap, and overlaps are addressed in the following articles:[41]

Article	**Overlap**	**See para**
6(4)	Immovable property	24.7.2
7(4)	Business income	107.9.3
10(4)	Dividends	107.9.2
11 (4)	Interest	107.9.2
12 (3)	Royalties	107.9.2
17(1)(2)	Entertainers/sportspersons	23.15
15(1), 18, 19(3)	Employment income/pensions	37.1; 38.8
21(2)	Other Income	107.9.2

107.9.2 *Income through PE*

Income may fall into two categories:

[40] See 14.6 (Income categories).

[41] This is a slightly more comprehensive list than that supplied in the Commentary.

(1) business profits and
(2) dividend/interest/royalty/Other Income.

OECD Model arts 10/11/12/21 address this and (in short) give priority to art 7 (business profits):

10(4): Dividends	**11(4): Interest**	**12(3): Royalties**	**21(2): Other Income**
The provisions of paragraphs 1 and 2 shall not apply if	The provisions of paragraphs 1 and 2 shall not apply if	The provisions of paragraph 1 shall not apply if	The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if
the beneficial owner of the dividends,	the beneficial owner of the interest,	the beneficial owner of the royalties,	the recipient of such income,
being a resident of a Contracting State,	being a resident of a Contracting State,	being a resident of a Contracting State,	being a resident of a Contracting State,
carries on business in the other Contracting State of which the company paying the dividends is a resident through a permanent establishment situated therein	carries on business in the other Contracting State in which the interest arises through a permanent establishment situated therein	carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein	carries on business in the other Contracting State through a permanent establishment situated therein
and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment.	and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment.	and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment.	and the right or property in respect of which the income is paid is effectively connected with such permanent establishment.
In such case the provisions of	[Identical]	[Identical]	[Identical]

Article 7 shall
apply.

See 107.14 (Effectively connected with PE).

107.9.3 *Other business profit overlaps*

Article 7(4) OECD Model deals with other overlap between business profits and other types of income:

> Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

OECD Commentary on art 7 provides:

> 72. Absent [art 7(4)], this interpretation of the term "profits" could have given rise to some uncertainty as to the application of the Convention. If the profits of an enterprise include categories of income which are dealt with separately in other Articles of the Convention, e.g. dividends, the question would have arisen as to which Article should apply to these categories of income, e.g. in the case of dividends, this Article [art 7] or Article 10.
> 73. To the extent that the application of this Article and of the relevant other Article would result in the same tax treatment, there is little practical significance to this question.
> Also, other Articles of the Convention deal specifically with this question with respect to some types of income...
> 74. The question, however, could arise with respect to other types of income and it has therefore been decided to include a rule of interpretation that ensures that Articles applicable to specific categories of income will have priority over Article 7. It follows from this rule that Article 7 will [only] be applicable
> [1] to business profits which do not belong to categories of income covered by these other Articles, and, in addition,
> [2] to income which under paragraph 4 of Articles 10 and 11, paragraph 3 of Article 12 and paragraph 2 of Article 21, fall within Article 7.

Of course these rules only apply for treaty purposes:

> This rule does not, however, govern the manner in which the income will be classified for the purposes of domestic law; thus, if a Contracting State may tax an item of income pursuant to other Articles of this Convention, that State may, for its own domestic tax purposes, characterise such income as it wishes (i.e. as business profits or as a

> specific category of income) provided that the tax treatment of that item of income is in accordance with the provisions of the Convention.
> It should also be noted that where an enterprise of a Contracting State derives income from immovable property through a permanent establishment situated in the other State, that other State may not tax that income if it is derived from immovable property situated in the first-mentioned State or in a third State (see paragraph 4 of the Commentary on Article 21 and paragraphs 9 and 10 of the Commentary on Articles 23 A and 23 B).

Para 74 was followed in *Fowler v HMRC*.[42]

Marsh v HMRC considers the position of a person resident in a foreign treaty State, who carries on the trade of dealing in land in the UK, without a PE. Prior to the 2016 reforms, one would expect article 7(1) relief to have applied so the profits were not taxable in the UK.[43] But maybe not. To recap the relevant articles:

Article 7(1) UK/USA DTA is the same as the OECD Model:

> The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.

Article 13(1) UK/USA DTA is the same as the OECD Model:

> Gains derived by a resident of a Contracting State that are attributable to the alienation of real property situated in the other Contracting State may be taxed in that other State.

Article 7(6) UK/USA DTA is the same as OECD Model art 7(4):

> Where business profits include items of *income* [emphasis added] that are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

The Tribunal said:[44]

> 86. Thus if “gains from the alienation of real property” are “income”

[42] [2018] EWCA Civ 2544 at [13], [47]. For another aspect of this case see 37.9.2 (Employment: OECD commentary).

[43] The position from 2016 is different: see 22.3 (Dealing/developing UK land).

[44] [2017] UKFTT 320 (TC) at [86] ff.

> for the purposes of the convention then article 13 takes precedence and no PE is required...
> 88. In the USA capital gains are included in income ... That this includes what would, in the UK, be regarded as capital gains...
> 91. In the UK a trade of dealing in real property will in nearly all cases involve the alienation of real property, and would in this case. But it could be difficult to characterise the sales of property in such a trade as themselves being "items of income": that term is much easier to ascribe to things such as interest or dividends received by a financial trader such as a bank or an insurance company.
> 92. We note though that art 13 of the UK/USA DTA is headed "Gains", but the equivalent article in the OECD Model is headed "Capital Gains". If art 13 of the UK USA DTA were headed "Capital Gains" it would be much easier to conclude that it did not cover gains that were made in the course of a trade. The difference must (?) be of some significance...
> 94. The answer may depend whether "income" in art 7(6) has an autonomous meaning or must be construed by reference to domestic law, and if so, which state's.

The question does not now arise for property development income, but it may arise in other cases.

107.9.4 *Other DTA category overlaps*

Avery Jones considers the position of share option gains which may be gains within art 13 and employment income within article 15:

> The problem is that these items fall within both the employment income and the capital gains articles. This is not a problem in internal law because something which is taxed as income and is also a capital gain cannot be taxed as a capital gain since the income tax charge has priority. But this is not an internal law question. The Model resolves a number of situations where articles overlap, but it does not deal with this one. It is suggested that the way to resolve the problem that two treaty articles are applicable is to look at the more specific article. This is clearly the employment income article as the items are peculiar to employment, whereas the capital gains article applies to all types of gain. These items should therefore for treaty purposes be treated as falling solely within the employment income article.[45]

[45] Avery Jones, "Problems of categorising income and gains for tax treaty purposes" [2001] BTR 382.

That may well be the right conclusion, though I would hesitate to use the word "clearly".

107.10 DTA interpretation principles

Short formulations of the principles of interpretation can only be expressed at a high level of generality which makes their application doubtful and their usefulness to the practitioner questionable. In short, as Voltaire is said to have observed, language is difficult to put into words. Nevertheless most treaty cases start with these generalities, so a brief summary is appropriate here.[46]

One might identify three approaches to interpretation, stressing:

(1) Objective interpretation (meaning of the words)
(2) Subjective interpretation (intention of the parties)
(3) Teleological/purposive interpretation (the purpose of the document)

The starting point is article 31(1) of the Vienna convention on the law of treaties[47] ("Vienna Convention") which draws on each of these:

> A treaty[48] shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

One can identify four elements here:

[46] See Bjorge, "The Vienna Rules on Treaty Interpretation Before Domestic Courts" [2015] LQR 78.

[47] The rules of interpretation in arts 31 and 32 Vienna Convention are rules of customary international law and so applicable even if a party to the treaty is not a party to the Vienna Convention. See for instance *Anson v HMRC* [2015] UKSC 44 at [54]: "as international treaties, the [USA/UK DTAs] have to be interpreted in accordance with articles 31 and 32 of the Vienna Convention on the Law of Treaties. That is so notwithstanding that, although the US is a signatory of the Vienna Convention, the US Senate has not given its consent to it: the provisions of articles 31 and 32 can in any event be applied, since they have been accepted by the International Court of Justice (and also, in this country, by the House of Lords) as being an accurate statement of customary international law."

[48] Article 2(1)(a) Vienna Convention provides:

> ""Treaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation".

That would include an Exchange of Notes. In *Macklin v HMRC* [2015] UKUT 39 (TCC) at [44]: "It was common ground that the Exchange of Notes can be taken into account when interpreting the DTA".

(1) Good faith
(2) Ordinary meaning
(3) Context
(4) Object and purpose

This is no different from the approach to UK statutory interpretation: while there are differences between treaty interpretation and UK statutory interpretation, it seems to me that they arise from differences of context, not from differences of fundamental principles.

"Object and purpose" is a composite phrase. In discussion of domestic law, English lawyers tend to use the word "policy" (though "purpose" is also common); but the meaning is the same.

107.10.1 *Context of treaties*

Article 31(2) Vienna Convention provides:

> 2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
> (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
> (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

107.10.2 *Material taken into account*

Article 31 Vienna Convention provides:

> 3. There shall be taken into account, together with the context:
> (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
> (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
> (c) any relevant rules of international law applicable in the relations between the parties.
>
> 4. A special meaning shall be given to a term if it is established that the parties so intended.
>
> **Article 32 Supplementary means of interpretation**
>
> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

> (a) leaves the meaning ambiguous or obscure; or
> (b) leads to a result which is manifestly absurd or unreasonable.

There is a distinction between:

(1) Article 31(3) material (agreements, notes, protocols) etc which *must* be taken into account; and

(2) Article 32 material (OECD Commentary, statements of Revenue authorities, etc) which *may* be taken into account.

107.10.3 *DTA/UK statutes compared*

In the “well known passage”[49] of *Fothergill v Monarch Airlines*:[50]

> The language of an international convention has not been chosen by an English parliamentary draftsman. It is neither couched in the conventional English legislative idiom nor designed to be construed exclusively by English judges. It is addressed to a much wider and more varied judicial audience than is an Act of Parliament that deals with purely domestic law. It should be interpreted... "unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptation."

107.10.4 *Summary*

IRC v Commerzbank[51] contains a convenient summary of principles, often approved:

> (1) It is necessary to look first for a clear meaning of the words used in the relevant article of the convention, bearing in mind that “consideration of the purpose of an enactment is always a legitimate part of the process of interpretation”... . A strictly literal approach to interpretation is not appropriate in construing legislation which gives effect to or incorporates an international treaty .... A literal interpretation may be obviously inconsistent with the purposes of the particular article or of the treaty as a whole. If the provisions of a particular article are ambiguous, it may be possible to resolve that ambiguity by giving a purposive construction to the convention, looking at it as a whole by reference to its language as set out in the relevant UK legislative instrument....

[49] *Royal Bank of Canada v HMRC* [2023] EWCA Civ 695 at [28].

[50] [1981] AC 251 at p.281; the observation applies to all international treaties, tax and non-tax.

[51] 63 TC 218 at p,235, What was (perhaps informally) still called England in 1990 became called the UK by the time of *Fowler* in 2015.

> (3) Among those principles is the general principle of international law, now embodied in Article 31(1) of the Vienna Convention on the Law of Treaties. ... references to the primary necessity of giving effect to “the plain terms” of a treaty or construing words according to their “general and ordinary meaning”, or their “natural signification” are to be a starting point or prima facie guide and “cannot be allowed to obstruct the essential quest in the application of treaties, namely the search for the real intention of the contracting parties in using the language employed by them”.
> (4) If the adoption of this approach to the article leaves the meaning of the relevant provision unclear or ambiguous or leads to a result which is manifestly absurd or unreasonable recourse may be had to “supplementary means of interpretation” including travaux préparatoires:
> ...
> (6) Aids to the interpretation of a treaty such as travaux préparatoires, international case law and the writings of jurists are not a substitute for study of the terms of the convention. Their use is discretionary, not mandatory, depending, for example, on the relevance of such material and the weight to be attached to it...[52]

And again, more recently:

> The terms of the 1975 Convention reflect the intentions of the US as much as those of the UK. They are intended to impose reciprocal obligations... . The terms ... are important to businesses in the US as well as to the UK investors ... In that context, one would be predisposed to favour an interpretation which reflected the ordinary meaning of the words used and the object of the Convention. This is indeed a point which has been repeatedly made, in other cases concerned with the construction of the UK/US double taxation conventions, in the face of narrow and technical constructions...[53]

107.10.5 *Treaty in two languages*

Article 33 Vienna Convention provides:

> 1. When a treaty has been authenticated in two or more languages, the text is equally authoritative in each language, unless the treaty provides or the parties agree that, in case of divergence, a particular text shall

[52] *IRC v Commerzbank* 63 TC 218 at p.235; I omit references given in the original. See Avery Jones, “More on Treaty Interpretation: IRC v Commerzbank” [1990] BTR 88; and “*Memec:* the treaty interpretation issue” [1997] BTR 194.

[53] *Anson v HMRC* [2015] UKSC 44 at [111].

> prevail.
> 2. A version of the treaty in a language other than one of those in which the text was authenticated shall be considered an authentic text only if the treaty so provides or the parties so agree.
> 3. The terms of the treaty are presumed to have the same meaning in each authentic text.
> 4. Except where a particular text prevails in accordance with paragraph 1, when a comparison of the authentic texts discloses a difference of meaning which the application of articles 31 and 32 does not remove, the meaning which best reconciles the texts, having regard to the object and purpose of the treaty, shall be adopted.

DTAs are of course in many languages, though in practice 80% of treaties have English as at least one of the languages.

I am not aware of any UK case where reference has been made to a language other than French. That is in fact quite pragmatic:

(1) A judge is not likely to have the necessary language skills.
(2) Use of experts to assist is expensive and the benefit is not likely to justify the cost (whether assessed on a case by case basis or overall).
(3) It is desirable that treaties based on the OECD Model are so far as possible interpreted in the same way. Of course that cannot be fully achieved; but it is desirable. If reliance is placed on particular foreign language in one treaty, it is likely that other treaties not in that language will be construed differently; or else any exercise of construction would have to review many or perhaps all foreign language versions of the Model treaty, and a polyglot exercise of that kind is impractical.

In the case of French, these objections apply to a lesser extent, as UK lawyers and judges are likely to have at least a basic knowledge of French.

The OECD Model and commentary are issued in English and French. Reference may be made to the French version even the treaty being considered is not itself in French. In *Hankinson v HMRC*:[54]

> In ... *Lingle v R* 12 ILTR 55, Campbell J makes the point that the French equivalent to an habitual abode is *où elle séjourne d'une façon habituelle* which means "where one stays[55] in an habitual way." He was

[54] [2009] UKFTT 384 (TC); the issue was not discussed in the appeal.

[55] Footnote original: We also point out that *séjourne* is also translated as "is present" in art 15(2)(c) of the Model: *le bénéficiaire séjourne dans l'autre État pendant une période ou des périodes n'excédant pas au total 183 jours durant toute période de*

> dealing with the US-Canada treaty the official languages of which are English and French whereas we are dealing with the Treaty, which is in English and Dutch but as the French is the same in the French official version of the OECD Model we consider that it is permissible to look at it to confirm the meaning of the expression in English ...

But in practice references to the French version are extremely rare.[56]

107.10.6 *Variations between DTAs*

In *Macklin v HMRC*:

> Comparison of the language of the DTA which we are called upon to construe with the language of another double taxation convention ... would be a very unsure basis to reach a conclusion contrary to the one we have reached by reference to directly related materials (particularly the exchange of notes) and we reject it.[57]

The Australian Taxation Office discuss this issue in more detail:

> 46. It is important for interpretation purposes to remember that each DTA is the product of a separate bilateral negotiation process. While, therefore, there is a general template structure to Australia's DTAs, each contains variations in terms from other DTAs because they are negotiated against the background of the particular languages, legal systems, tax rules, tax treaty and wider economic policies and expectations of the respective countries at the time, as well as some historical influences.
> 47. Those factors, and the fact that treaty negotiations are conducted against the general background of the OECD and United Nations Model Tax Conventions (which, being products of international compromise and consensus, are couched

douze mois….("the recipient is present in the other state for a period or periods not exceeding in aggregate 183 days in any twelve month period…").

[56] Examples are:
(1) *Royal Bank of Canada v HMRC* [2023] EWCA Civ 695 at [81]
(2) Reference OECD model French version; see 9.19.3 (POEM: Real management)
(3) Reference to OECD commentary French version: see 9.14 (Habitual abode)

[57] *Macklin v HMRC* [2013] UKFTT 554 (TC) at [109]. The Upper Tribunal agreed [2015] UKUT 39 (TCC) at [36].
The same point is made in *Fryett v HMRC* [2014] UKFTT 220 (TC) at [81]: "We approach with caution any suggestion that because one country has worded its DTA with another country in a particular way, the absence of wording or different wording can throw interpretative light on how a DTA negotiated between different countries should be interpreted. This is the case even if the DTA has one party in common. On this basis any insight that may be gained from looking at the UK's other DTAs, or at Hong Kong's other DTAs is immaterial to the matter before us."

in comparatively broad terms) mean that the Australian negotiators, administrators and courts cannot expect the terms of the DTAs to be expressed with the same precision as our ordinary domestic tax legislation. Nor is it possible to always maintain consistency in how the terms of a particular Article are expressed in the various DTAs, because of the different 'mix' of the above factors in different negotiations and the 'give and take' that is a necessary incident of international negotiations.

48. This is an important point to bear in mind, because it means that the network of DTAs is not drafted in an absolutely uniform manner in relation to residents of all treaty partners, or in relation to similar activities or situations.

49. Differing wording in two DTAs may represent the same intended meaning (such as, in the ATO's view, the terms 'beneficial entitlement' in the Dividends, Interest and Royalties Articles of some DTAs and 'beneficial ownership' in the corresponding Articles in other DTAs). Often such differences exist because a country wants to avoid unintentionally 'picking up' a domestic law usage for an undefined term that may be different to the international tax meaning of the phrase more usually relied on. Alternatively, it may be because a country does not recognise a particular concept and regards the use of a term as potentially creating uncertainty before its courts and in the administration of the DTA.

50. In other cases, differences in wording may represent specific negotiating intentions (e.g., the reference simply to 'income' rather than 'income, profits or gains' in many of our pre-capital gains DTAs is, in the ATO's view, significant as is noted in Taxation Ruling TR 2001/12).[58]

51. It is sometimes possible that the same wording in different DTAs could present a different intended meaning. DTA negotiators will generally seek to identify the differences between a DTA under negotiation and their existing treaty network wording and as far as possible avoid the same wording having different usages, but that will not always be possible.

52. One practical example of the potential significance of different wording between DTAs is that, although the business profits/ permanent establishment ('PE') principle is common to all the DTAs, the definition of a PE in one DTA may be substantively different to the definition in another DTA.

53. For example, the definition of a PE in the United States Convention is wider than the definition in the Japanese Agreement. Accordingly, Australia may have a taxing right under the Business Profits Article of the United States Convention in respect of certain profits of a United States enterprise but not under the Business Profits Article of the Japanese Agreement in respect of like profits of a comparable Japanese enterprise.[59]

OECD Commentary comments on the significance of changes between current and earlier OECD models:

[58] Footnote original: At paragraphs 56 and 59.

[59] Taxation Ruling TR 2001/13 Income tax: Interpreting Australia's Double Tax Agreements; some footnotes omitted.

> 35. Needless to say, amendments to the Articles of the Model Convention and changes to the Commentaries that are a direct result of these amendments are not relevant to the interpretation or application of previously concluded conventions where the provisions of those conventions are different in substance from the amended Articles (see, for instance, paragraph 4 of the Commentary on Article 5). ...
> 36. ... the Committee ... disagrees with any form of *a contrario* interpretation that would necessarily infer from a change to an Article of the Model Convention ... that the previous wording resulted in consequences different from those of the modified wording. Many amendments are intended to simply clarify, not change, the meaning of the Articles ... and such *a contrario* interpretations would clearly be wrong in those cases.

However the attitude of the UK courts has not been entirely consistent.[60]

107.10.7 *Amendments to DTAs*

In *HMRC v Smallwood*:[61]

> The introduction of provisions designed to deal with specific schemes and to resolve any issues as to whether they are effective under the existing legislation cannot be construed as statutory admissions that the provisions in their unamended form were inadequate. We are not therefore, in my view, assisted by the later version of Article 13(5) in determining the effect of Article 13(4).

107.10.8 *Foreign court decisions*

In *IRC v Commerzbank*[62]

> decisions of foreign courts on the interpretation of a convention or treaty text depend for their authority on the reputation and status of the Court in question...

The Australian Taxation Office discuss this issue:

> 119. Since Australian courts have recognised that interpretation in a way conducive to producing a uniform international interpretation is an important goal in interpreting treaties,[63] it follows that foreign court decisions on similar provisions may give valuable guidance about the meaning of a term. They need

[60] See *Royal Bank of Canada v HMRC* [2023] EWCA Civ 695 at [88].

[61] [2010] EWCA Civ 778 at [22].

[62] 63 TC 218 at p,235.

[63] See paragraph 87.

to be treated with some caution, since they may be founded on different interpretative principles or approaches. Some courts may, for example, less strictly follow the Vienna Convention rules, or may apply a domestic law meaning of a term when they should apply an accepted international tax meaning. A court may also, quite properly, apply a domestic law meaning to a term left undefined by the DTA, whereas the same approach before Australian courts may lead to a different domestic law meaning being 'picked up'.

120. Nevertheless, a foreign court's decisions, including on the foreign language text, may provide important insights. Some foreign courts have considerable experience and expertise in interpreting DTAs. In *Lamesa*, the Full Federal Court did not need to (or wish to) express a concluded view on the issue. The Court noted, however, that:[64]

> ... where the construction of an international treaty arises, evidence as to the interpretation of that or subsequent treaties in one of the participating countries forms part of a matrix of material to which reference could properly be made in an appropriate case. As presently advised we would not wish it to be thought that a limited view of the material to which reference could be made in interpreting a double tax treaty should be taken. Had there been some decision of an appropriate Dutch court interpreting a treaty with identical or similar language, then, in our view, evidence of such a decision might well have been admissible.

121. There are also strong reasons to consider, as a matter of practice, the decisions of courts from countries other than the treaty partner (an issue not addressed by the Lamesa Court). Any such consideration would need to be consistent with the comments of the High Court in *Cook v Cook*[65] that:

> Subject, perhaps, to the special position of decisions of the House of Lords given in the period in which appeals lay from this country to the Privy Council, the precedents of other legal systems are not binding and are useful only to the degree of the persuasiveness of their reasoning.[66]

107.10.9 *Foreign revenue guidance*

The Australian Taxation Office discuss this issue:

> 125. Extrinsic materials of various types are extensively relied on by some countries. Some, such as the 'Technical Explanations' which are a feature of United States domestic procedures for consideration of a DTA, may help explain the views being put by the relevant DTA partner or a taxpayer. As the 'Technical Explanations' are, however, developed as part of the internal processes of the United States when implementing a DTA, they are of little or no usefulness in objectively proving the

[64] 97 ATC 4229 at 4757.

[65] (1986) 162 CLR 376 at 390.

[66] Taxation Ruling TR 2001/13 Income tax: Interpreting Australia's Double Tax Agreements.

> intent of both parties to a DTA. They are primarily designed to reflect the views of the United States negotiators, upon which there may not necessarily be a consensus ad idem ('meeting of minds'), but they may in some cases provide useful signposts to that consensus.[67] Even if they might not be admissible in court, or might be of little probative value, they may better inform an understanding of the DTA as a whole.[68]

GE Financial Investments v HMRC took a more parochial view:[69]

> 48. I should also mention the 1992 MOU. Mr Miller drew attention to this in his expert report ... concluding that it appears to presuppose that a stapled Dutch corporation is a resident of the US for the purposes of the US-Netherlands treaty.
> 49. Mr Baker submits that the 1992 MOU is clarificatory and confirms that the US authorities regarded such a stapled corporation to be a resident of the US, a position accepted by the Dutch revenue authorities. However, I agree with Ms McCarthy that, in the absence of any similar memorandum between the UK and US, it is not possible to derive any assistance from the 1992 MOU (which was specifically negotiated between the US and the Netherlands), in interpreting Article 4(1) of the Convention.
> 50. Neither, for that matter, can I derive any assistance from the view of the IRS which would appear, from correspondence referred to me by Mr Baker, to be that it considered GEFI was resident in the US. The correspondence, as Mummery J observed in *Inland Revenue Comrs v Commerzbank AG* [1990] STC 285, at 301-302, in relation to a joint statement issued in 1977 by the IRS and the Board of Inland Revenue setting out their agreement on the treatment of dividends and interest as commercial profits under the Convention:
>
> > "… has no authority in the English courts. It expresses the official view of the Revenue authorities of the two countries. That view may be right or wrong. Although art XXA authorises the competent authorities to communicate with each other directly to implement the provisions of the convention and 'to assure its consistent interpretation and application' it does not confer any binding or authoritative effect on the views or statements of the competent authorities in the English courts."

But while no-one suggests that such materials have "binding or authoritative effect" it seems odd to disregard them completely, especially as regard is had to foreign case law.

[67] Footnote original: See on the use of United States materials and the different approaches taken to such materials by the courts of other countries, Edwardes-Ker *Tax Treaty Interpretation* (1994) at paragraph 25.04. Edwardes-Ker notes, importantly, that this does not supplant the rule that a treaty must be interpreted in accordance with the common intention of both States.

[68] Taxation Ruling TR 2001/13 Income tax: Interpreting Australia's Double Tax Agreements.

[69] [2021] UKFTT 210 (TC). But the case is not yet final.

107.10.10 *Retrospectivity*

Article 28 Vienna Convention provides:

> Unless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party.

In practice, as far as I am aware, DTAs are always expressed to be prospective in effect.

107.10.11 *Territorial extent*

Article 28 Vienna Convention provides:

> Unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory.

Tax advantaged zones within the territory of a Contracting State qualify for treaty relief, unless the treaty provides otherwise.

107.11 OECD Commentary

107.11.1 *Use of OECD Commentary*

In *Sun Life Assurance Co of Canada v Pearson*:

> ... the Commentaries can and indeed must be referred to as a guide to the interpretation of the Treaty.[70]

In *Smallwood v HMRC*:[71]

> ... how the commentary fits into arts 31 and 32 of the Vienna Convention. Our view is that the negotiators on both sides could be expected to have the commentary in front of them and can be expected to have intended that the meaning in the commentary should be applied in interpreting the treaty when it contains the identical wording.

The Commentary is relevant even if one or both parties to the treaty are not OECD members. *Smallwood* continues:[72]

[70] 59 TC 250 at p.310.

[71] [2008] UKSPC SPC669 at [98]. The point was not discussed on appeal.

[72] If further authority is needed, which I doubt, see *Oppenheimer v HMRC* [2022] UKFTT 112 (TC) at [24] concerning South Africa, which is not an OECD member,

> This is as much true of the UK which is a member of the OECD as it is of Mauritius, which is not. The difference is that the UK had the opportunity of stating that it disagreed with any part of the commentary by making an observation, while Mauritius did not, although the commentary does now contain observations by a number of non-OECD member countries, but not including Mauritius.

Smallwood continues:

> ... If the commentary contains a clear explanation of the meaning of the term [POEM] it seems clear that the parties to the treaty intended that such explanation should be more important than the ordinary meaning to be given to the terms of that phrase. This is either on the basis that the existence of the model and commentaries demonstrate that the parties intended it as a special meaning within art 31(4) of the Vienna Convention, or that the Vienna Convention does not purport to be a comprehensive statement of the method of treaty interpretation. Its own commentary states that 'Accordingly the [International Law] Commission confined itself to trying to isolate and codify the comparatively few general principles which appear to constitute general rules for the interpretation of treaties' (Introduction para (5))

HMRC have argued that recourse to the OECD Commentary is only relevant where there is ambiguity, but the better view is that it is always relevant; or perhaps there is always ambiguity.

Of course the OECD Commentary is not decisive, so it may not ultimately matter whether one says that one has no recourse to it on the grounds that the text is unambiguous; or that one has recourse to it but it does not affect the end result. But the latter is the better approach.

OECD have adopted the following formal recommendation:

> THE COUNCIL ... RECOMMENDS the Governments of Member countries ...
> 2. When concluding new bilateral conventions or revising existing bilateral conventions, to conform to the Model Tax Convention, as interpreted by the Commentaries thereon;
> 3. That their tax administrations follow the Commentaries on the Articles of the Model Tax Convention, as modified from time to time, when applying and interpreting the provisions of their bilateral tax conventions that are based on these Articles.[73]

though it is a “key partner”.

[73] C(97)195/FINAL 23 October 1997; I omit the recitals.

OECD Commentary provides:

> 29. As the Commentaries have been drafted and agreed upon by the experts appointed to the Committee on Fiscal Affairs by the Governments of Member countries, they are of special importance in the development of international fiscal law. Although the Commentaries are not designed to be annexed in any manner to the conventions signed by Member countries, which unlike the Model are legally binding international instruments, they can nevertheless be of great assistance in the application and interpretation of the conventions and, in particular, in the settlement of any disputes.
> 29.1 The tax administrations of Member countries routinely consult the Commentaries in their interpretation of bilateral tax treaties. The Commentaries are useful both in deciding day-to-day questions of detail and in resolving larger issues involving the policies and purposes behind various provisions. Tax officials give great weight to the guidance contained in the Commentaries.
> 29.2 Similarly, taxpayers make extensive use of the Commentaries in conducting their businesses and planning their business transactions and investments. The Commentaries are of particular importance in countries that do not have a procedure for obtaining an advance ruling on tax matters from the tax administration as the Commentaries may be the only available source of interpretation in that case.
> 29.3 Bilateral tax treaties are receiving more and more judicial attention as well. The courts are increasingly using the Commentaries in reaching their decisions. Information collected by the Committee on Fiscal Affairs shows that the Commentaries have been cited in the published decisions of the courts of the great majority of Member countries. In many decisions, the Commentaries have been extensively quoted and analysed, and have frequently played a key role in the judge's deliberations. The Committee expects this trend to continue as the world-wide network of tax treaties continues to grow and as the Commentaries gain even more widespread acceptance as an important interpretative reference.

The Australian Taxation Office refer to the OECD resolution and say:

> 101. ... While not binding (since they are not formal OECD 'Decisions', binding on OECD Members under the OECD Constitution), the OECD Model and Commentaries create a general or 'quasi-political', rather than 'legal', expectation that OECD Members will basically comply, subject to specific 'Observations' and 'Reservations' lodged with the OECD...
> 102. In *Thiel*, the High Court judges all accepted that the OECD Model Taxation

Convention's official Commentaries may be relevant to the interpretation of DTAs based on the OECD Model. In *Thiel*, McHugh J (with whom the majority agreed in their joint judgment) approved recourse to the OECD Model and Commentaries under Article 32 of the Vienna Convention (that is, as supplementary means only available for consideration when there is ambiguity or the like, or to confirm a meaning reached by examining Article 31 materials).[74]

103. Dawson J also approved reference to the Model and Commentaries 'as a supplementary means of interpretation to which recourse may be had under Article 32 of the Vienna Convention'.[75] His Honour went further than the other judges, however, by expressing the view that the OECD Model and Commentaries were also relevant under Article 31 of the Vienna Convention, as primary materials to be considered even when there was no ambiguity or the like.[76] In so doing, Dawson J nevertheless acknowledged that 'some doubts have been expressed about the applicability, as a matter of language, of Article 31 to the Commentaries in the case of a bilateral treaty such as a double taxation agreement'.[77]

104. The Commentaries, with the various Observations and Reservations of OECD Member countries which they reproduce (and which are further considered below),[78] therefore provide important guidance on interpretation and application of the OECD Model and as a matter of practice will often need to be considered in interpretation of DTAs, at least where the wording is ambiguous, which ... is inherently more likely in treaties than in general domestic legislation.

105. In addition, the Commentaries, with the Observations and Reservations, do provide part of the historical context of the DTA negotiations. They also have a role in testing the interpretation reached by other means, although if they conflict with, rather than confirm, that interpretation there may be an issue of whether this would be admissible in a court, since the matter was left unresolved by the *Thiel* judgments.[79]

[74] *Thiel v FCT* (1990) 90 ATC 4717, at 4727 and 4720. See 107.10.2 (Material taken into account).

[75] *Ibid*, at 4723.

[76] Footnote original: Dawson J, in his discussion of Article 31 of the Vienna Convention at 4723, had stated: "For my part, I do not see why the OECD Model convention and commentaries should not be regarded as having been made in connection with and accepted by the parties to a bilateral treaty *subsequently concluded* in accordance with the framework of the model". (emphasis added).

[77] Footnote original: *Thiel v FCT* (1990) 90 ATC 4717, at 4723. He cited, as to the doubts, Avery Jones et al Part II at 92. Edwardes-Ker *Tax Treaty Interpretation* (1994) similarly considers that OECD Commentaries do not fall within the meaning of Article 31(2) of the Vienna Convention: paragraph 15.03.

[78] Paragraph 109ff.

[79] Taxation Ruling TR 2001/13 Income tax: Interpreting Australia's Double Tax Agreements.

See Lang and Brugger "The role of the OECD Commentary in tax treaty

107.11.2 *Post-DTA Commentary changes*

Where changes are made to the Commentary, which happens all the time, there are two possible approaches:

(1) **"Ambulatory"** : Consider the current form, including all changes

(2) **"Static"**: Disregard changes made after a treaty takes effect

An intermediate approach would be to consider the changes but give them a lower status or scrutinise them more carefully.

Fowler v HMRC deals with the point in one cursory sentence:[80]

> The OECD Commentaries are updated from time to time, so that they may (and do in the present case) post-date a particular double taxation treaty. Nonetheless they are to be given such persuasive force as aids to interpretation as the cogency of their reasoning deserves.

In *Irish Bank Resolution Corporation v HMRC*[81] the 2008 version of the Commentary was considered in interpreting a treaty made in 1976.

There are Rule of Law points here. To have regard to post-treaty changes in the Commentary breaches the rule that tax should be laid down by Parliament. To have regard to changes made after income/gains have accrued breaches the prohibition on retrospectivity. But the Rule of Law is only one virtue of a legal system; and if one calls this an infringement,

interpretation"(2008) 23 Australian Tax Forum *https://research.wu.ac.at/en/publications/the-role-of-the-oecd-commentary-in-tax-treaty-interpretation-14*

[80] [2020] UKSC 22 at [18]. This derives from *IRC v Commerzbank* 63 TC 218 at p,235:

> Subsequent commentaries on a convention or treaty have persuasive value only, depending on the cogency of their reasoning.

Likewise *Oppenheimer v HMRC* [2022] UKFTT 112 (TC) at [28]:

> "Technically, resort should be had to the commentary as in force at the date that the DTC was agreed and then more recent versions only to the extent that they are cogent and assist the determination by the Tribunal."

But the 2017 changes to the 2002 treaty were said to be helpful, and I expect that post-treaty changes almost always will be.

The 2020/21 edition of this work, para 71.8.2 (Changes to OECD Commentary), pursued other aspects of this issue, in particular the *Indofood* case where 2003 amendments to the Commentary were relevant to how the Indonesian courts would apply the Netherlands/Indonesia DTA which was made in 2002. But I omit that now as after *Fowler* this discussion is of very limited interest.

[81] [2020] EWCA Civ 1128.

the Rule of Law may be infringed to attain other ends.[82] This is not significantly different from the rule that the Courts may have regard to textbooks, even though written after the date of the statute under discussion.

The static approach has unattractive practical consequences:

(1) Anyone considering a treaty would need to note its date and apply the historical version of the Commentary in effect on that date.

(2) Identically worded treaties could be construed differently.

Under the ambulatory approach, anyone considering a decided case needs to note its date and consider whether subsequent changes in the Commentary may have altered the position. But:

(1) It is not difficult to do that.

(2) The problem can arise under the static approach, if when considering a treaty made on a later date, there is a relevant case on another treaty made at an earlier date, and the commentary has changed in the meantime.

Contrast the position for changes in the text of the OECD Model itself; see 107.10.6 (Variations between DTAs).

OECD Commentary provides:

> 35. Needless to say, amendments to the Articles of the Model Convention and changes to the Commentaries that are a direct result of these amendments are not relevant to the interpretation or application of previously concluded conventions where the provisions of those conventions are different in substance from the amended Articles (see, for instance, paragraph 4 of the Commentary on Article 5).[83] However, other changes or additions to the Commentaries are normally applicable to the interpretation and application of conventions concluded before their adoption, because they reflect the consensus of the OECD Member countries as to the proper interpretation of existing provisions and their application to specific situations.
>
> 36. Whilst the Committee considers that changes to the Commentaries should be relevant in interpreting and applying conventions concluded before the adoption of these changes, it disagrees with any form of *a contrario* interpretation that would necessarily infer from a change to an Article of the Model Convention or to the Commentaries that the

[82] See 2.8.2 (Rule of Law v. other values).

[83] See 106.12 (Agency-PE).

previous wording resulted in consequences different from those of the modified wording. Many amendments are intended to simply clarify, not change, the meaning of the Articles or the Commentaries, and such *a contrario* interpretations would clearly be wrong in those cases.

36.1 Tax authorities in Member countries follow the general principles enunciated in the preceding four paragraphs.

Avery Jones says:

> If the OECD suddenly came up with a better model, it would be a long time before it generally was adopted in practice and meanwhile, there would be a long transition while the existing 1,400 treaties were renegotiated. There is therefore a tendency to change the Commentary instead. The hope is that the new Commentary then will apply to all the existing treaties. As someone said, it is like the Bible; the words stay the same, only the commentary changes. Does anyone know what courts will do when they are faced with interpreting a treaty when the Commentary makes fundamental changes subsequent to the treaty? There are few cases so far, probably because many of the fundamental changes are recent. Unless there is a reasonable expectation that courts will give effect to some of the fundamental changes that are being made to the Commentary, and I doubt if this is the case, there is no point in making fundamental changes to the Commentary. In fact, from the point of view of the tax authority, changing the Commentary in this way could make matters worse. In light of statements in the Introduction to the Model Treaty that existing treaties should be interpreted in light of new Commentaries, the tax authority may feel that it cannot properly argue against the interpretation contained in Commentaries made later than the treaty in question, but the taxpayer can, and probably will succeed if he does. It follows that the only fundamental changes that can have effect are those in favour of the taxpayer, which may not be quite what tax authorities sitting round the OECD table in Paris intend.
>
> [Avery Jones sets out the comments of the Commentary on the issue and continues]: It seems to me that too little attention is paid to the legal effect of later Commentaries in internal law, and I am doubtful about whether any legal weight should be given to the Committee's retrospective views about proper interpretation. Tax treaties are different from normal international treaties under which the contracting states can agree to any interpretation;[84] they are also part of internal tax law affecting taxpayers and subject to interpretation by courts in that country. In relation to the latter, these statements in the Introduction may be wishful thinking on the part of the members of the Committee rather than a statement of what the legal position actually is. ...I think we would say in the UK, that later Commentaries should not even be considered.
>
> ...On the other hand, it does seem odd that if a country makes a new treaty today, which in a particular respect is in exactly the same form as an older one made

[84] Footnote original: Under art. 31(3) of the Vienna Convention on the Law of Treaties, subsequent agreements between the parties have the same status as context.

> with another country at the time of an earlier Commentary, the two treaties will have different meanings, which does seem contrary to the whole principle of having Commentaries. It is not as if parliaments (certainly in my country) take any notice of changes in the Commentary in approving treaties, particularly so when there is no mention of the Commentary in the treaty. If - and this may be a big if - parliaments were prepared to approve a statement in the treaty that it was to be interpreted in the light of the Commentaries from time to time in force, would this be desirable? It effectively would be a statement that the parties intended that a special meaning, determined in the future by the OECD, should apply, which as far as the two tax authorities are concerned, is of course exactly what they do intend, as the Introduction makes clear.[85]
>
> There must be a boundary between interpretation and change. If the later Commentary says that black now means white, there seems little doubt that article 32 will not help to give a treaty that interpretation. If, on the other hand, the parties have stated in advance that, as a special meaning to be determined later, black does mean white, a court might give effect to it. You may say that this is so extreme an example that it would never happen. Unfortunately, there are examples of the Commentary changing its meaning from black to white....[86]
>
> If changes in the Commentary in the past had been restricted to what might be argued to be interpretation, there would be a strong case for an approach giving effect to future Commentaries as a special meaning, always assuming that parliaments would accept it. But, as the OECD has made such major changes to later Commentaries, it is very doubtful that this solution will now be acceptable. ... The extent to which the later Commentary has effect is in the hands of the court, which will not accept that a change from black to white is confirming the ordinary meaning or resolving ambiguities or obscurity, or avoiding manifestly absurd or unreasonable results. On the other hand, it is likely that more minor changes will be effective, which will assist the harmonization of interpretation of treaties. It is already the case that courts in many countries do refer to later Commentaries in the case of minor changes and including something to that effect in the treaty will encourage courts in all countries to do so.[87]

The Australian Taxation Office say:

> **Subsequent revisions to OECD Commentaries**
>
> 106. There is some debate over whether subsequent changes to the OECD Commentaries should be used as an aid to interpretation of earlier DTAs. On one hand, there is the view that the OECD Commentaries are only relevant to those DTAs subsequently concluded. Einfeld J expressed this view in the Federal

[85] OECD Commentary, note 31, Introduction, PP33-36.

[86] Avery Jones gives the example of the 1992 change to the Commentary art 15(2) (Short Term Business Visitor relief); see 24.6.2 (Employment: OECD Commentary). Another example is the 1993 change discussing tax avoidance; see 72.2.4 (Avoidance: OECD Commentary).

[87] Avery Jones, “Are Tax Treaties Necessary?” (1999) 53 Tax Law Review 1.

Court decision of the first instance in *Lamesa Holdings BV v FC of T*. His Honour referred to the Full High Court decision in *Thiel* and to the comments made by Dawson J in that case:[88]

> Further extrinsic material, referred to in *Thiel* as permissible ... is consideration of the 1977 OECD Model and Commentaries in construing a double tax agreement. Dawson J added an important caveat to this view, namely that the OECD model and commentaries are only applicable to those bilateral treaties subsequently concluded.

107. On the other hand, the Introduction to the OECD Commentaries now indicates more clearly that the later Commentaries are intended by OECD Member states to be used for interpretation and application of DTAs concluded before their adoption, except where the OECD Model has been changed in substance. The Year 2000 update to the OECD Model and Commentaries states: [text set out above]...

108. These changes to the Commentaries reflect the fact that the Commentaries are usually expressed not as forming an agreement between countries as to a new meaning but as reflecting a common view as to what the meaning is and always has been. Accordingly, unless it is apparent that the substance of the OECD Model has itself changed since a DTA was negotiated or the treaty in question does not conform to the OECD Model, or unless the Commentaries make clear that a former interpretation has actually been substantively altered, rather than merely elaborated, the ATO considers it appropriate, as a matter of practice, to consider, at least, the most recently adopted/published OECD Commentaries ... as well as others which may have been available at the time of negotiation.[89] Often, if a DTA provision is to be fully understood, the changes that have occurred to the relevant OECD Commentaries over time will need to be examined and considered.[90]

[88] 97 ATC 4229 at 4237.

[89] Footnote original: This approach may also be justified in terms of Article 31(3) of the Vienna Convention, with the Commentaries representing either ‘a subsequent agreement between the parties regarding the interpretation of the treaty’ (Article 31(3)(a)) or ‘any subsequent practice in the application of the treaty which establishes the agreement of the parties relating to its interpretation’ (Article 31(3)(b)). In *Lamesa*, Einfeld J in fact referred to the 1977 OECD Commentaries when interpreting the 1976 Netherlands Agreement (Schedule 10 to the Agreements Act) on the basis that the relevant part was based on an OECD Report released in 1974 and widely available.

[90] Footnote original: An example is the amendment to paragraph 8 of the 1977 Model Commentaries on Article 5 (permanent establishments) by the 1992 Commentaries (in response to a 1983 Report). The amendments treated the leasing of industrial, scientific and commercial equipment as a matter for the Business Profits Article, rather than the Royalties Article. Australia and some other countries disagreed, and lodged a ‘Reservation’ (a concept discussed at paragraph 109ff) to OECD Model Royalties Article, to this effect: see paragraph 39 of OECD Commentary on Article 12. ...

CFE discuss the point in connection with use of the OECD Commentary to interpret EU directives:[91]

> ...it seems that the Court endorsed an ambulatory (dynamic) use of the OECD MC Commentaries by referring to its own descriptions of the "beneficial ownership" concept in the 1977 OECD MC and the 2003 OECD Update, which addressed certain conduit companies. The Court, however, did not (explicitly)[92] refer to the 2014 OECD Update,[93] which might either imply that it did not want to go "fully dynamic" or that it did not consider it necessary. Moreover, the Court's seemingly dynamic approach might not technically be "dynamic" at all: While the IRD was proposed in 1998, it was adopted in Council on 3 June 2003, whereas the 2003 OECD Update was adopted by the OECD Council already on 28 January 2003[94] and was based on an even earlier 2002 Report,[95] i.e., both before the IRD was passed. However, a dynamic approach would not be surprising as the ECJ in *Berlioz*[96] had already used the 2012 OECD MC Commentaries Update on Article 26 OECD MC[97] to interpret the concept of foreseeable relevance in the 2011

[91] CFE Opinion Statement ECJ-TF 2/2019. *https://taxadviserseurope.org/new_ahgency/wp-content/uploads/2019/06/ECJ-TF_2-2019_Beneficial-Ownership.pdf*

[92] Footnote original: It did, however, implicitly refer to a notion that was introduced by the 2014 OECD Update (the "in substance"-criterion) in explaining the indicia for abuse; see *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16), para. 132, and the discussion *infra* in Chapters II.3. and III.C..

[93] Footnote original: It should be noted that the Court referred to the "development - as set out in paragraphs 4 to 6 above - of the OECD Model Tax Convention and the commentaries", with paras 4 and 5 dealing with the 1977 OECD MC and para. 6 dealing with the revision of the OECD MC Commentaries in 2003, while para.7 of the judgment mentions the 2014 OECD Update of the commentaries (see *N Luxembourg I et al* [C-115/16, C-118/16, C-119/16 and C-299/16], paras. 9

[94] Footnote original: As "The 2002 Update to the Model Tax Convention".

[95] Footnote original: Entitled "Restricting the Entitlement to Treaty Benefits" (adopted by the OECD Committee ion Fiscal Affairs on 7 November 2002).

[96] Footnote original: ECJ (Grand Chamber), 16 May 2017, C682/15, *Berlioz Investment Fund SA v Directeur de l'administration des contributions directes*, EU:C:2017:373, para.66.

[97] Footnote original: "Update to Article 26 of the OECD Medoel Tax Convention and its Commentary", adopted by the OECD Council on 17 July 2012, and later included in the 2014 Update to the OECD Model Tax Convention, adopted by the OECD Council on 16 July 2014.

> Mutual Assistance Directive.[98] It is, however, hard to see how such dynamic understanding would fit into the EU legal order, since – as AG Kokott, who certainly prefers a static approach,[99] succinctly pointed out – "[o]therwise the contracting countries to the OECD would have the power to decide on the interpretation of an EU directive".[100]

107.11.3 *Incorporation of Commentary*

Sometimes the issue is addressed directly in the DTA. For instance, the Protocols to DTAs with Jersey, Guernsey, IoM and Gibraltar:

> It is understood that both Territories will apply this Agreement in the light of the Commentaries on the OECD Model Tax Convention as they may read from time to time, having regard to any observations or other positions that they may have expressed thereon.

107.11.4 *Commentary: Summary*

A great deal of ink has been spilt on this topic, but a reader inclined to legal realism, or a cynic, may conclude that all it comes down to is this: a judge may ignore OECD Commentary if sufficiently minded to do so, and may ignore post-treaty amendments to the Commentary with a relatively easy conscience; but if they want to they can and will rely on it.

For further reading, see Ward et al, *The Interpretation of Income Tax Treaties with Particular Reference to the Commentaries on OECD Model* (2006).

107.11.5 *Commentary in other contexts*

The US, as usual, marches to a different drum. It is a member of OECD but its treaties are based on the US model. However there is a good deal of

[98] Footnote original: Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, [2011] OJ L 64, p.1.

[99] Footnote original: See the Opinions of AG Kokott of 1 March 2018 in C-115/16 *(N Luxembourg 1,* EU:C:2018:143, para. 52), C-118/16 *(X Denmark*, EU:C:2018:146, para. 52), and C-119/16 (*C Danmark I*, EU:C:2018:147, para. 52), noting that "[a]t most, should it transpire from the wording and history of the directive that the EU legislature was guided by the wording of an OECD Model Tax Convention and the commentaries (available at the time) on that OECD Model Tax Convention, a similar interpretation might be appropriate".

[100] Footnote original: Opinion of A G Kokott in *Z Denmark* (C-299/16), para. 53.

common ground. In *Crown Forest Industries v Canada*[101] the Canadian Supreme Court had regard to OECD Commentary as extraneous material relevant to the 1980 US/Canada DTA (based on the US model).

The CJEU have used the OECD Commentary to explain the Interest and Royalties Directive, though perhaps that does not matter, post-Brexit.[102]

107.11.6 *Observations & reservations*

OECD Commentary Introduction provides:

> 30. Observations on the Commentaries have sometimes been inserted at the request of Member countries that are unable to concur in the interpretation given in the Commentary on the Article concerned. These observations thus do not express any disagreement with the text of the Convention, but usefully indicate the way in which those countries will apply the provisions of the Article in question. Since the observations are related to the interpretations of the Articles given in the Commentaries, no observation is needed to indicate a country's wish to modify the wording of an alternative or additional provision that the Commentaries allow countries to include in their bilateral conventions.
>
> **Reservations of certain Member countries on some provisions of the Convention**
>
> 31. Although all Member countries are in agreement with the aims and the main provisions of the Model Convention, nearly all have entered reservations on some provisions, which are recorded in the Commentaries on the Articles concerned. ... It is understood that insofar as a Member country has entered reservations, the other Member countries, in negotiating bilateral conventions with the former, will retain their freedom of action in accordance with the principle of reciprocity.
>
> 32. The Committee on Fiscal Affairs considers that these reservations should be viewed against the background of the very wide areas of agreement that has been achieved in drafting this Convention.

The Australian Taxation Office say:

> **Observations & Reservations**
>
> 109. A further point which needs to be considered is the relevance for interpretation purposes of the previously mentioned Observations and Reservations of individual OECD Member countries to the OECD Model Tax Convention and its Commentaries, as Australia, like some of its DTA

[101] [1995] 2 SCR 802 at [55].

[102] See 108.10.8 (Beneficial ownership: EU law).

> partners, sometimes depart significantly from the OECD Model. OECD Member Countries lodge 'Reservations' when they do not agree with either the relevant text of an OECD Model Article or any variations in text permitted by the Commentaries (and where they therefore wish to put other countries on notice of their views and intentions in negotiating the terms of the DTA). Countries enter 'Observations' if they do not object to the Model Article's text, but do not concur with the interpretation of that text set out in the Commentaries...
> 111. Observations and Reservations may be of considerable relevance in explaining variations from the OECD Model, both when interpreting implementing legislation under section 15AA of the [Australia] Acts Interpretation Act 1901 and when applying Article 31 of the Vienna Convention. They may not ultimately be admissible in court except to confirm the interpretations otherwise reached under those provisions or when considering ambiguous provisions under Article 32 of the Vienna Convention or, possibly, under section 15AB of the [Australia] Acts Interpretation Act 1901.[103]

107.11.7 *United Nations Commentary*

The UN Commentary to the UN Model is obviously relevant where:

(1) The OECD and UN models differ, and a treaty follows the latter; or

(2) Supplementary DTA materials[104] refer to the UN Model or Commentary

In other cases, the UN Commentary ought at least to have "persuasive value, depending on the cogency of its reasoning", like any other textbook. It is suggested that citation of the UN Model is best avoided where it contains only broad generalities and self-evident observations (as was the case in *Oppenheimer*). The 700 pages of the OECD Commentary are sufficient.

In *Oppenheimer v HMRC*[105] the FTT cited the UN Model in a case on treaty-residence under the South Africa/UK DTA, where the relevant text of the Models was the same. It did so "because the RSA is a signatory to the

[103] Taxation Ruling TR 2001/13 Income tax: Interpreting Australia's Double Tax Agreements.
See Lang and Brugger "The role of the OECD Commentary in tax treaty interpretation"(2008) 23 Australian Tax Forum
https://research.wu.ac.at/en/publications/the-role-of-the-oecd-commentary-in-tax-treaty-interpretation-14

[104] See 107.10.2 (Material taken into account).

[105] See 9.13.1 (CVI test).

UN Model Double Taxation Convention". In fact the UN Model does not have signatories, though South Africa is represented from time to time at meetings of the UN Tax Committee.[106] I am not aware of other cases citing the UN Commentary.

107.12 Undefined treaty terms

Terms in the OECD Model, or in any treaty, may have:

(1) a **"domestic-law meaning"** (the meaning in UK domestic law) or

(2) an **"autonomous meaning"**, or treaty-meaning, (distinct from UK law)

107.12.1 *Domestic-law meaning*

Article 3(2) OECD Model provides:

> [a] As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless
> [i] the context otherwise requires or
> [ii] the competent authorities agree to a different meaning pursuant to the provisions of Article 25 [mutual agreement],[107]
> have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies,
> [b] any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

The wording of art 3(2) has changed over time, but the changes were said to clarify rather than to alter the meaning, so older treaties using the older wording should not have a different effect.

Avery Jones states:

> At first sight, it seems obvious that a treaty term should mean the same in both states, rather than have different internal law meanings in each of them; indeed, there are those who advocate this. But this approach overlooks that the tax systems in internal law do not have the same scope. Article 3(2) has the effect that the relieving provisions of the treaty correspond exactly to the taxing provisions of internal law. If expressions meant the same in both countries, this would not be the result. It would not lead to a sensible result if one country had a wider meaning of a type of income that it had to exempt than the other, and the treaty meaning was the same in both countries. The likely result would be that something covered by the internal law charge would not be exempt as a result of the

[106] Hattingh and Avery Jones [2022] BTR 245 at p.249.

[107] In practice this does not seem to be common.

> treaty, or, less importantly, part of the treaty meaning would have no effect.
>
> A problem that article 3(2) appears to encourage is for each state to use its own meaning of terms not only when relieving tax in the source state, which is mainly what the treaty is about, but also when it is giving relief as the residence state. This can lead to double taxation when the residence state says that if it had been the source state, it would not have taxed, so it will not give any relief for the tax that the source state, in fact, has charged because on its interpretation, the treaty does not prevent it. Or the reverse, when the residence state says that it would have taxed if it had been the source state, and so it will exempt the income even though the source state did not tax ... I do not believe that either result is intended by the Model Treaty; it would be a strange model treaty if it did. It would be nice if the Commentary said so plainly, rather than implying the reverse in an obscure section dealing with thin capitalization.[108] I shall not set out the arguments here as my co-authors and I have written extensively about it.[109] It would be a considerable improvement to the Model Treaty and Commentaries if this point were clarified.[110]

The solution to the problem lies in the words "unless the context otherwise requires."

In practice the UK courts have regard to the foreign State's understanding of the provisions, and may take expert evidence on the issue if relevant.[111]

107.12.2 *Time to ascertain meaning*

Article 3(2) OECD Model provides:

> As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall ... have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies...

Thus the meaning of a word is its domestic-law contemporary meaning, rather than that historically used at the date of the treaty. But the words in

[108] See para 68 of OECD commentary to arts 23A and 23B.

[109] Footnote original: See Avery Jones *et al* "Credit and Exemption Under Tax Treaties in Cases of Differing Income Characterization" (1996), 36 European Taxation 118.

[110] Avery Jones, "Are Tax Treaties Necessary?" 53 Tax Law Review 1.

[111] *Macklin v HMRC* [2013] UKFTT 554 (TC) at [71] to [75]. The Upper Tribunal [2015] UKUT 39 (TCC) dismissed the evidence as inadmissible, but while experts should not opine on the meaning of the treaty, which is a matter for the court, they may be needed in relation to issues of foreign law and practice.

treaties are not likely to change meaning over time.

A note on terminology. In *Fowler v HMRC*:

> [Art 3(2)] provides an "always speaking" means of ascertaining the meaning of terms in the Treaty which are undefined therein. It is always speaking because it requires meaning to be ascertained by reference to the national law of a Contracting State "at that time", that is at the time when the Treaty falls to be applied.

I am not sure that "always speaking" is the best label to use here, because that term is quaint, and because it is best reserved for a principle which is wider than the mere interpretation of terms:

> In the classic work of Sir Rupert Cross (Statutory Interpretation, 3rd ed. (1995), pp. 51-52) the position is explained as follows:
>
>> The somewhat quaint statement that a statute is 'always speaking' ... is often taken to mean that a statutory provision has to be considered first and foremost as a norm of the current legal system, whence it takes its force, rather than just as a product of an historically defined Parliamentary assembly. It has a legal existence independently of the historical contingencies of its promulgation, and accordingly should be interpreted in the light of its place within the system of legal norms currently in force. Such an approach takes account of the viewpoint of the ordinary legal interpreter of today, who expects to apply ordinary current meanings to legal texts, rather than to embark on research into linguistic, cultural and political history, unless he is specifically put on notice that the latter approach is required.
>
> In other words, it is generally permissible and indeed necessary to take into account the place of the statutory provision in controversy in the broad context of the basic principles of the legal system as it has evolved.[112]

I prefer to describe the timing aspect of the art 3(2) rule as an **"ambulatory"** approach to construction. But it does not matter which term one uses.

OECD Commentary provides:

> 11. ... the question arises which legislation must be referred to in order to determine the meaning of terms not defined in the Convention, the choice being between the legislation in force when the Convention was signed or that in force when the Convention is being applied, i.e. when the tax is imposed. The Committee on Fiscal Affairs concluded that the latter

[112] *Turkington v Times Newspapers* [2000] UKHL 57.

interpretation should prevail, and in 1995 amended the Model to make this point explicitly.

107.12.3 *Tax meaning (if any)*

Article 3(2) OECD Model provides:

> ... any term not defined therein shall ...have the meaning that it has ... under the law of that State for the purposes of the taxes to which the Convention applies...

Thus the meaning of a word is its tax meaning, not any general law meaning, if different. This assumes of course that (1) domestic tax law does provide a meaning for a term; and (2) domestic tax law only provides one meaning. But where there are multiple definitions, as happens very often, it may be possible to identify a principal definition.

If domestic tax law does not provide a meaning, one would fall back on domestic general law (on the basis that tax law would adopt the general law meaning). It is possible that Scots general law and English general law may have different meanings, but that will not often, if ever, arise.

What if the treaty term is not used in domestic tax law? In practice I do not think there are any words in the OECD Model which are not also found in UK tax statutes, and the words as used in the UK tax statutes have UK tax meanings; and so there must in all cases be some UK tax law meaning. But those meanings may be context dependent and there may not be a general tax law meaning.

Avery Jones addresses this point when considering the meaning of "salaries, wages and other similar remuneration" in art 15:

> "Salaries, wages and other similar remuneration..." is not a term found in internal law since the internal law tax charge is on the emoluments of an office or employment...[113]
>
> Although Article 3(2) can be read more strictly as referring to the meaning of terms used in the treaty which are identical to those in internal law, this does not take into account the different terms which might be expected to be used in internal law in different countries. Although the particular treaty being interpreted is a bilateral one, it should be borne in mind that the treaty was not drafted solely with the particular countries' tax systems

[113] Author's footnote: the charge is now on earnings, which includes salary, wages and other profits; see 26.4.1 ("Ordinary" earnings). But that does not matter for the points being made here.

> in mind when it follows the wording of the Model. There can also be language differences in construing treaties, when two languages are equally authentic but terms have different meanings in each language. It is impossible to equate the meaning of treaty terms to identical internal law terms where the only official language of a treaty may not be the country's own language; some Japanese treaties are, for example, only in English. It seems necessary therefore to interpret undefined terms in the treaty in accordance with internal tax law, not only when the terms are identical, but also where they are recognisably the same concept. Thus "salaries, wages, and other similar remuneration … in respect of an employment" should ... be taken to mean anything taxed as employment income under internal law.[114]

OECD Commentary provides:

> 13.1 [Art 3(2)] was amended in 1995 to conform its text more closely to the general and consistent understanding of member states. For purposes of [art 3(2)], the meaning of any term not defined in the Convention may be ascertained by reference to the meaning it has for the purpose of any relevant provision of the domestic law of a Contracting State, whether or not a tax law. However, where a term is defined differently for the purposes of different laws of a Contracting State, the meaning given to that term for purposes of the laws imposing the taxes to which the Convention applies shall prevail over all others, including those given for the purposes of other tax laws.

The Australian Taxation Office follow OECD Commentary approach.[115]

107.12.4 *Subject to context*

The rule in art 3(2) applies "unless the context otherwise requires". OECD Commentary provides:

> 12. ... The context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State (an implicit reference to the principle of reciprocity on which the Convention is based)...

[114] Avery Jones, "Problems of categorising income and gains for tax treaty purposes" [2001] BTR 382.

[115] TR 2001/13 Income tax: Interpreting Australia's Double Tax Agreements para 63-76.

> 13. Consequently, the wording of [art 3(2)] provides a satisfactory balance between,
> [a] on the one hand, the need to ensure the permanency of commitments entered into by States when signing a convention (since a State should not be allowed to make a convention partially inoperative by amending afterwards in its domestic law the scope of terms not defined in the Convention) and,
> [b] on the other hand, the need to be able to apply the Convention in a convenient and practical way over time (the need to refer to outdated concepts should be avoided).

The context will often show that an autonomous meaning of undefined terms is appropriate. For examples see 109.4.1 (Characterisation: Better view); 9.26.2 (Substantial presence).

Art 3(2) does not apply to terms defined in the treaty. But treaty definitions are themselves subject to context, and context might suggest domestic-law meaning should apply. Also the definitions will themselves use undefined terms.

The position is normally put in terms of stark alternatives: the meaning must be either domestic-law or autonomous. But the context may support an intermediate position. One may start with domestic-law meaning, and generally stop there; but in limited aspects only where domestic-law does not fit the treaty, the domestic law meaning may not be applied. An example (a variant of the facts of *Fowler*) might be that the meaning of employment normally follows domestic law; but if domestic law deemed a diver's trade to be an employment, the deeming should not apply for treaty purposes.

107.13 Taxes Covered

107.13.1 *Scope of DTA*

I refer to article 2 OECD Model as the Taxes Covered clause, with initial capitals to reflect the technical nature of the expression.

Article 2(1) OECD Model provides:

> This Convention shall apply to
> [a] taxes on income and on capital
> [b] imposed on behalf of a Contracting State or of its political subdivisions or local authorities,
> [c] irrespective of the manner in which they are levied.

There are three distinct points here.

107.13.2 *Taxes on income and capital*

Art 2(2) OECD Model defines the expression "taxes on income and capital":

> There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation

The OECD Commentary provides:

> 3. This paragraph gives a definition of taxes on income and on capital. Such taxes comprise taxes on total income and on elements of income, on total capital and on elements of capital. They also include taxes on profits and gains derived from the alienation of movable or immovable property, as well as taxes on capital appreciation. Finally, the definition extends to taxes on the total amounts of wages or salaries paid by undertakings ("payroll taxes"; in Germany, "*Lohnsummensteuer*"; in France, "*taxe sur les salaires*"). Social security charges, or any other charges paid where there is a direct connection between the levy and the individual benefits to be received, shall not be regarded as "taxes on the total amount of wages".
>
> 4. Clearly a State possessing the right to tax an item of income or capital under the Convention may levy the taxes imposed by its legislation together with any duties or charges accessory to them: increases, costs, interest, penalties etc. It has not been considered necessary to specify this in the Article, as it is obvious that a Contracting State that has the right to levy a tax may also levy the accessory duties or charges related to the principal duty. Most States, however, do not consider that interest and penalties accessory to taxes covered by Article 2 are themselves included within the scope of Article 2 and, accordingly, would generally not treat such interest and penalties as payments to which all the provisions concerning the rights to tax of the State of source (or situs) or of the State of residence are applicable, including the limitations of the taxation by the State of source and the obligation for the State of residence to eliminate double taxation. Nevertheless, where taxation is withdrawn or reduced in accordance with a mutual agreement under Article 25, interest and administrative penalties accessory to such taxation should be withdrawn or reduced to the extent that they are directly connected to the taxation (i.e. a tax liability) that is relieved under the mutual agreement. This would be the case, for example, where the additional charge is computed with reference to the amount of the underlying tax liability and the

> competent authorities agree that all or part of the underlying taxation is not in accordance with the provisions of the Convention. This would also be the case, for example, where administrative penalties are imposed by reason of a transfer pricing adjustment and that adjustment is withdrawn because it is considered not in accordance with paragraph 1 of Article 9.

107.13.3 *Subdivisions/local authorities*

Art 2(3) USA/UK DTA provides:

> The existing taxes to which this Convention shall apply are—
> (a) in the case of the United States—
> (i) the Federal income taxes imposed by the Internal Revenue Code (but excluding social security taxes); and
> (ii) the Federal excise taxes imposed on insurance policies issued by foreign insurers and with respect to private foundations;...

The USA/UK DTA differs from the OECD Model[116] in that it applies to federal taxes but not to state or city taxes. Perhaps there are constitutional principles involved here. But unilateral relief in principle applies where DTA tax credit is not available.

107.13.4 *Manner of levying tax*

Art 2(1)OECD Model directs that the treaty applies "irrespective of the manner in which the taxes are levied".

The OECD Commentary on art 2(1) explains what is meant by this:

> The method of levying the taxes is equally immaterial: by direct assessment or by deduction at the source, in the form of surtaxes or surcharges, or as additional taxes (*centimes additionnels*), etc.

Art 2(1) was relied on, though unnecessarily and perhaps only rhetorically, in *Fowler v HMRC.*[117]

107.13.5 *List of taxes covered*

Article 2(3) OECD Model provides for a list of taxes covered:

> The existing taxes to which the Convention shall apply are in particular:
> a) (in State A): ....
> b) (in State B): ....

[116] See 9.7 (State/subdivision/local authority).

[117] See 109.4.1 (Characterisation: Better view).

107.13.6 *Taxes covered: UK practice*

There are some UK treaties which adopt the wording of OECD Model art 2(1)(2). But much more often, these provisions are omitted and article 2 of the DTA (headed "Taxes Covered") provides: "The Agreement shall apply to the following taxes..." and sets out a list. Presumably that is thought to be more precise. I cannot see that the omission has any significance.

107.13.7 *Substantially similar taxes*

Article 2(4) OECD Model provides:

> [a] The Convention shall apply also to any identical or substantially similar taxes that are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes.
> [b] The competent authorities of the Contracting States shall notify each other of any significant changes that have been made in their taxation laws.

This is standard in UK treaties (unlike art 2(1)(2)).

107.14 Effectively connected with PE

This phrase is found in a number of OECD Model articles. Discussion on one may be helpful to the others, so it may be convenient to set out the list here:

Article	**Phrase (in outline)**	**See para**
10(4)	Holding in respect of which dividends are paid is effectively connected with a PE	107.9.2
11(4)	Debt-claim in respect of which interest is paid is effectively connected with a PE	107.9.2
11(5)	A PE in connection with which the indebtedness on which the interest is paid was incurred	26.27.6
12(3)	Royalties arise through a PE and the right or property in respect of which the royalties are paid is effectively connected with such PE	107.9.2
13(2)	Business property of a PE[118]	56.24.2
21(2)	The right or property in respect of which the income is paid is effectively connected with a PE	107.9.2

107.15 BEPS multilateral instrument

This section discusses the treaty whose long title is "the Multilateral

[118] This phrase is different but the meaning will be (more or less) the same.

Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting". I call it the "**BEPS MLI**" or where the context is clear, just MLI.

The MLI is supplemented by:

- An explanatory statement ("MLI ES")[119]
- A commentary
- Guidance for the development of synthesised texts[120]
- OECD Peer Review Report on Treaty Shopping[121]

The object and purpose of the MLI is to implement the BEPS measures which related to DTAs.[122] The background can be found in BEPS Action 15 Report, "Developing a Multilateral Instrument to Modify Bilateral Tax Treaties".

The MLI implemented the following BEPS Actions:

Action	**Topic**	**Adopted by UK**
2	Hybrids	Adopted in part
6	Treaty abuse	Adopted in part
7	Permanent Establishment	Adopted in part
14	Dispute resolution	Adopted but not discussed

OECD publish a database of countries which have signed the MLI and their choices of optional provisions.[123]

The UK has published a document ("UK MLI Notifications")[124] which set

[119] *https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf*
Para 12 MLI ES provides: "While this Explanatory Statement is intended to clarify the operation of the Convention to modify Covered Tax Agreements, it is not intended to address the interpretation of the underlying BEPS measures (except with respect to the mandatory binding arbitration provision contained in Articles 18 through 26)."

[120] *http://www.oecd.org/tax/treaties/beps-mli-guidance-for-the-development-of-synthesised-texts.pdf* (Nov 2018)

[121] *https://www.oecd-ilibrary.org/docserver/9789264312388-en.pdf?expires=1550998970&id=id&accname=guest&checksum=0714C894B29FF51D6F78DD798D16F034* (2019)

[122] Para 12 MLI ES, referring to art 31 Vienna Treaty; see 107.10 (DTA interpretation principles).

[123] *http://www.oecd.org/tax/treaties/mli-database-matrix-options-and-reservations.htm*

[124] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725261/Final_list_of_UK_reservations_and_notifications_made_on_deposit_of_the_instrument_of_ratification.pdf*

out:
(1) DTAs covered by the MLI
(2) UK opt-outs and opt-ins

The UK has not adopted some of the MLI provisions relating to Action 2 or Action 7, taking the view that current provisions are sufficient.

The MLI is incorporated into UK law by the Double Taxation Relief (Base Erosion and Profit Shifting) Order 2018.[125]

The MLI is in English and French, "both texts being equally authentic".[126] But I suspect that (as with the OECD Model) reference to the French version will be very rare.[127]

HMRC publish convenient synthesised texts of DTAs as amended by the MLI.[128]

107.15.1 *Navigation*

I discuss the specific MLI provisions in the context where they arise. This chapter covers MLI issues which are more conveniently dealt with as a discrete topic.

Article	**Topic**	**See**
Part I	*Scope and Interpretation*	
1	Scope	107.17
2	Interpretation	107.16
3(1)	Transparent Entities	91.4
3(2)	Transparent Entities	*Not adopted*
4	Dual Resident Entities	9.18
Part II	*Hybrid Mismatches*	
5	Elimination of Double Taxation	*Not adopted*
Part III.	*Treaty Abuse*	
6	Purpose of DTAs	107.3
7	Prevention of Treaty Abuse	108.8
	(1) - (7) (Prevention of treaty abuse)	108.8
	(8) - (17) (Limitation on Benefits)	*Not adopted;* see 110.1
8	Dividend Transfer Transactions	*Not adopted*
9	Gains from assets deriving value from land	*Not adopted*
10	PE situated in 3rd Jurisdiction	*Not adopted*
11	Savings Clause	109.5.2

[125] See 107.19 (Incorporation of DTAs in UK law).
[126] These words are in the final paragraph of the MLI.
[127] See 107.10.5 (Treaty in two languages).
[128] *https://www.gov.uk/government/collections/tax-treaties*

Part IV	*Avoidance of Permanent Establishment Status*	
12	Commissionnaire Arrangements	*Not adopted*
13	Specific Activity Exemptions	106.20.2
14	Splitting-up Contracts	*Not adopted*
Part V.	*Improving Dispute Resolution*	*Part V not discussed*
15-17:	Mutual Agreement Procedure	
Part VI	*Arbitration*	*Part VI not discussed*
18-26	*Arbitration*	
Part VII	*Final Provisions*	
27	Signature and Ratification, Acceptance or Approval	
28	Reservations	
29	Notifications	
30	Subsequent Modifications	
31	Conference of the Parties	
32	Interpretation and Implementation	
33	Amendment	
34	Entry into Force	107.18.1
35	Entry into Effect	107.18.2
36	Entry into Effect of Part VI	
37	Withdrawal	
38	Relation with Protocols	
39	Depositary	

A full discussion requires a book to itself, and such books have been written.

107.16 Definitions

The MLI writes defined terms with initial capitals, so I adopt that here.

107.16.1 *Party*

Art 2(1) BEPS MLI provides:

> b) The term "Party" means:
> i) A State for which this Convention is in force pursuant to Article 34 (Entry into Force); or
> ii) A jurisdiction which
> [A] has signed this Convention pursuant to subparagraph b) or c) of paragraph 1 of Article 27 (Signature and Ratification, Acceptance or Approval)
> [B] and for which this Convention is in force pursuant to Article 34 (Entry into Force).

107.16.2 *Contracting Jurisdiction/Signatory*

Art 2(1) BEPS MLI provides some commonsense definitions:

> c) The term "Contracting Jurisdiction" means a party to a Covered Tax Agreement.

The term "Contracting Jurisdiction" refers to the States, jurisdictions or territories that are parties to a Covered Tax Agreement. It is used instead of the more common terms "Contracting State" (because the MLI may apply to DTAs to which a non-State jurisdiction is a party) and "Contracting Party" (because "Party" refers to a party to the MLI).

> d) The term "Signatory" means a State or jurisdiction which has signed this Convention but for which the Convention is not yet in force.

107.16.3 *Covered Tax Agreement*

Art 2(1)(a) BEPS MLI provides:

> The term "Covered Tax Agreement" means an agreement for the avoidance of double taxation with respect to taxes on income (whether or not other taxes are also covered):
> i) that is in force between two or more:
> A) Parties; and/or
> B) jurisdictions or territories which are parties to an agreement described above and for whose international relations a Party is responsible; and
> ii) with respect to which each such Party has made a notification to the Depositary listing the agreement as well as any amending or accompanying instruments thereto (identified by title, names of the parties, date of signature, and, if applicable at the time of the notification, date of entry into force) as an agreement which it wishes to be covered by this Convention.

Covered Tax Agreements are listed, so it is clear what is covered. UK IHT DTAs are not Covered Tax Agreements.

107.16.4 *Undefined terms*

Art 2(2) BEPS MLI provides:

> As regards the application of this Convention at any time by a Party, any term not defined herein shall, unless the context otherwise requires, have the meaning that it has at that time under the relevant Covered Tax Agreement.

For the position in the absence of express definitions, see 107.12 (Undefined treaty terms).

107.17 Scope of BEPS MLI

Article 1 provides:

> This Convention modifies all Covered Tax Agreements as defined in subparagraph a) of paragraph 1 of Article 2 (Interpretation of Terms).[129]

The MLI makes changes to DTAs where both States have opted to make the change. If both States select a particular amendment, it is included in the revised version of the treaty between them. If either State does not select it, it is not included and the original treaty provisions continue to apply.

UK MLI Notifications lists 121 UK DTAs which it wishes to be covered by the MLI. That is most but not quite all of the UK DTAs as at 2017.

The following States are not listed. Instead, bilateral negotiations have updated, or will update, these agreements:

State	**Status of DTA with UK**
Austria	New treaty (2018)
Colombia	New treaty (2016)
Germany	Existing treaty (2010) yet to be amended
Switzerland	Existing treaty (2012) amended 2017
Taiwan	Existing treaty (2002) yet to be amended

The following jurisdictions are not listed since these are Crown Dependencies/overseas territories. Some have new DTAs; presumably the others will be updated in due course, but have lower priority.

Jurisdiction	**Status of UK DTA**
Crown Dependencies	
Jersey	New treaty (2018)
Guernsey	New treaty (2018)
Isle of Man	New treaty (2018)
British overseas territories	
Cayman Islands	Existing treaty (2009) yet to be amended
Falkland Islands	Existing treaty (1997) yet to be amended
Gibraltar	New treaty (2019)
Montserrat	Existing treaty (1947, 2009) yet to be amended
British Virgin Islands	Treaty yet to be concluded

[129] See 107.16.3 (Covered Tax Agreement),

The US, as usual, marches to a different drum. It has not ratified the MLI. But some MLI provisions have followed US Model precedent.

107.18 BEPS MLI commencement

107.18.1 *Entry into force*

Entry into force is governed by Art 34(1)(2) BEPS MLI. I discussed that in detail in previous editions of this work[130] but time has passed, and it is sufficient to note that the MLI entered into force in the UK on 1 October 2018.

107.18.2 *Entry into effect*

Art 35 BEPS MLI provides:

> 1. The provisions of this Convention shall have effect in each Contracting Jurisdiction with respect to a Covered Tax Agreement:
>
> a) with respect to taxes withheld at source on amounts paid or credited to non-residents, where the event giving rise to such taxes occurs on or after the first day of the next calendar year that begins on or after the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement; and
>
> b) with respect to all other taxes levied by that Contracting Jurisdiction, for taxes levied with respect to taxable periods beginning on or after the expiration of a period of six calendar months (or a shorter period, if all Contracting Jurisdictions notify the Depositary that they intend to apply such shorter period) from the latest of the dates on which this Convention enters into force for each of the Contracting Jurisdictions to the Covered Tax Agreement.[131]

[130] See the 2022/23 edition para 105.17.1 (Entry into force).

[131] Article 35 continues with two options, but the UK has not adopted these. They will be relevant of other Parties adopt them. These are:
"2. Solely for the purpose of its own application of subparagraph a) of paragraph 1 and subparagraph a) of paragraph 5, a Party may choose to substitute "taxable period" for "calendar year", and shall notify the Depositary accordingly.
3. Solely for the purpose of its own application of subparagraph b) of paragraph 1 and subparagraph b) of paragraph 5, a Party may choose to replace the reference to "taxable periods beginning on or after the expiration of a period" with a reference to "taxable periods beginning on or after 1 January of the next year beginning on or after the expiration of a period", and shall notify the Depositary accordingly."

There are further commencement rules (not discussed here) for mutual agreement procedures and arbitration, and some scope for States to amend these rules.

In short:

(1) Withholding tax changes have effect from 1 January 2019.

(2) Other tax changes have effect for taxable periods beginning on or after 1 April 2019.

This timetable applies to DTAs with the six States which ratified before the UK: Austria, New Zealand, Poland, Serbia, Slovenia and Sweden. For most treaties, commencement will take effect by reference to the date of entry into force of the other State.

On 15 March 2021, the Conference of the Parties to the MLI approved an opinion on art 35 MLI, in particular on withholding tax where the latest of the dates of entry into force of the MLI for a pair of Contracting Jurisdictions is on 1 January of a year.[132]

107.19 Incorporating DTAs in UK law

International treaties (including DTAs) do not automatically become part of UK law, but must be incorporated into UK law by authority of statute. Accordingly, s.2(1) TIOPA provides:

> If Her Majesty by Order in Council declares—
>
> (a) that arrangements specified in the Order have been made in relation to any territory outside the UK with a view to affording relief from double taxation[133] in relation to taxes within subsection (3), and
>
> (b) that it is expedient that those arrangements should have effect,
>
> those arrangements have effect.

107.19.1 *DTA approval procedure*

Section 5(2) TIOPA provides a procedural rule:

> An Order under section 2 is not to be submitted to Her Majesty in Council

[132] *https://www.oecd.org/tax/treaties/oecd-publishes-30-country-profiles-applying-arbitration-under-the-multilateral-beps-convention.htm*

[133] This is expanded by s.2(1A) TIOPA which was added in order to authorise the BEPS MLI: "For the purposes of this section, arrangements made with a view to affording relief from double taxation include any arrangements which modify the effect of arrangements so made."

> unless a draft of the Order has been laid before and approved by a resolution of the House of Commons.

Art. 30 OECD Model provides:

> 1. This Convention shall be ratified and the instruments of ratification shall be exchanged at .... as soon as possible.
> 2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:
>   a) (in State A): ....
>   b) (in State B): ....

Thus for example art.31 (Entry into Force) of the UK/France DTA provides:

> (1) Each of the Contracting States shall notify to the other the completion of the procedures required by its law for the bringing into force of this Convention. This Convention shall enter into force on the date the later of these notifications has been received.
> (2) The provisions of this Convention shall have effect:
>   (a) in the UK:
>   (i) in respect of income tax and capital gains tax, for any year of assessment beginning on or after 6th April in the calendar year next following that in which this Convention enters into force;
>   (ii) in respect of corporation tax, for any financial year beginning on or after 1st April in the calendar year next following that in which this Convention enters into force;
>   (b) in France ...

The INTM summarises the procedure:

> **INTM152020 Negotiation of agreements** [Jan 2018]
> ... HMRC are responsible for the negotiation of the terms of agreements, subject to ministerial approval. Once the draft agreement is agreed by the representatives of both countries they initial the draft. The final text is subsequently signed on behalf of both countries and in the UK is then laid before the House of Commons in the form of a draft Statutory Instrument. When approved, it receives the Royal Assent by Order in Council (TIOPA10/S2).
> Each country has to notify the other that it has done everything necessary to give the agreement the force of law and only when each country has done so does the agreement come into force. ...

The UK parliamentary process is brief, and it is not usual to produce a detailed explanatory note. But other treaty States may produce such material, which is relevant in the UK.[134]

107.19.2 *Taxes within s.2 TIOPA*

Section 2(3) TIOPA provides:

> The taxes are—
> (a) income tax,
> (b) corporation tax,
> (c) capital gains tax,
> (d) petroleum revenue tax, and
> (e) any taxes imposed by the law of the territory that are of a similar character to taxes within paragraphs (a) to (d).

IHT has its own procedure.[135]

107.19.3 *Effect of DTAs*

Section 2(2) TIOPA provides:

> If arrangements have effect under subsection (1), they have effect in accordance with section 6.

So we turn to s.6 TIOPA. Section 6(1) provides:

> Subject to this Part and Part 18 of ICTA, double taxation arrangements have effect in accordance with subsections (2) to (4) despite anything in any enactment.

So DTAs override domestic UK tax legislation. In *Anson v HMRC*:[136]

> The provisions of the ... Convention therefore override inconsistent provisions in domestic UK tax legislation, other than those concerned with double taxation relief.

Section 6(2)(3) TIOPA set out the matters which a DTA can achieve for IT/CT and CGT: it is helpful to read them side by side:

s.6(2) TIOPA: IT/CT	**s.6(3) TIOPA: CGT**
Double taxation arrangements have effect in relation to income tax and corporation tax so far as the arrangements provide—	Double taxation arrangements have effect in relation to capital gains tax so far as the arrangements provide—

[134] See 107.10.9 (Foreign revenue guidance).

[135] See 114.6 (IHT DTAs: Incorporation in UK law).

[136] [2015] UKSC 44 at [112].

(a) for relief from income tax or corporation tax,	(a) for relief from capital gains tax,
(b) for taxing income of non-UK resident persons[137] that arises from sources in the UK,	(b) for taxing capital gains accruing to non-UK resident persons on the disposal of assets in the UK, .
(c) for taxing chargeable gains accruing to non-UK resident persons on the disposal of assets in the UK,	[no equivalent]
(d) for determining the income or chargeable gains to be attributed to non-UK resident persons,	(c) for determining the capital gains to be attributed to non-UK resident persons,
(e) for determining the income or chargeable gains to be attributed to agencies, branches or establishments in the UK of non-UK resident persons, or	(d) for determining the capital gains to be attributed to agencies, branches or establishments in the UK of non-UK resident persons, or
(f) for determining the income or chargeable gains to be attributed to UK resident persons who have special relationships with non-UK resident persons.[138]	(e) for determining the capital gains to be attributed to UK resident persons who have special relationships with non-UK resident persons

Para (a) is what one would expect. In practice, as far as I am aware, DTAs are not used for taxing income or chargeable gains, so s.6(2)(b)(c) and s.6(3)(b) are not needed.

Section 3(2) TIOPA extends this:

> Section 2(1) gives effect to arrangements even if the arrangements include—
> (a) provision as to income that is not subject to double taxation,
> (b) provision as to chargeable gains that are not subject to double taxation
> (c) [This relates to oil taxation]
> (d) provision conferring (with or without other functions) functions relating to the determination of matters arising under the

[137] Defined by reference in ss(7): "In subsection (3) 'UK resident person' and 'non-UK resident person' have the meaning given by section 989 of ITA 2007."

[138] This relates to adjustments under article 9.

> arrangements on a public authority in the UK or in a territory outside the UK.

These provisions give effect to most treaty provisions, though there could be gaps.[139]

DTA relief overrides domestic charging provisions, even if enacted after the DTA.[140]

107.19.4 *Retrospective relief*

Section 3(1) TIOPA authorises retrospective relief:

> Section 2(1) gives effect to arrangements even if the arrangements include—
> (a) provision for relief from tax for periods before the passing of this Act, or
> (b) provision for relief from tax for periods before the making of the arrangements.

107.19.5 *"Double taxation"*

Section 4 TIOPA provides:

> (1) For the purposes of sections 2 and 3, any amount within subsection (2) is to be treated as having been payable.
> (2) An amount is within this subsection if it is an amount of tax that would have been payable under the law of a territory outside the UK but for a relief—
> (a) given under the law of the territory with a view to promoting industrial, commercial, scientific, educational or other development in a territory outside the UK, and
> (b) about which provision is made in double taxation arrangements.
> (3) References in sections 2 and 3 to double taxation are to be read in accordance with subsection (1).

EN TIOPA provides:

> 35.Sections 2 and 3 [TIOPA] refer to "double taxation" in general terms. Broadly speaking, there is double taxation if the same (for example) income is taxed in more than one territory. But that will not be the case if

[139] *NEC Semi-Conducters Ltd v HMRC* [2006] EWCA Civ 25; *Boake Allen v HMRC* [2007] 1 WLR 1386.

[140] The doctrine of implied repeal does not operate to double tax treaties: see *Irish Bank Resolution Corporation Ltd v HMRC* [2020] EWCA Civ 1128 at [55]-[57].

> the income (in this example) is not in fact taxed in one of the territories concerned as a result of a relief. [Section 4] supplements sections 2 and 3. It requires certain reliefs to be ignored, with the result that one is to assume in certain cases that tax has been paid even though it has in fact not been paid. This deemed tax (in the territory giving the relief), taken with the actual tax (in the other territory), then means that there is "double taxation". As a result of this section, therefore, statutory effect can be given to provisions in arrangements which are about such cases.

107.19.6 *BEPS MLI*

Section 2(1A) TIOPA provides:

> For the purposes of this section, arrangements made with a view to affording relief from double taxation include any arrangements which modify the effect of arrangements so made.

This is intended to facilitate the implementation of the BEPS multilateral instrument.

107.19.7 *Revocation of DTAs*

The esoteric topic of revocation of DTAs enjoyed an unexpected outing in *Miller (R, oao) v Secretary of State for Exiting the European Union*, the cause célèbre which decided that government had no power to revoke EU treaties without authority of Parliament.

In the High Court, the government's skeleton argument provided:

> Double taxation treaties must be domestically implemented through secondary legislation to have effect upon the rights and liabilities of taxpayers, and are periodically renegotiated by the Crown. Such renegotiations involve terminating the existing treaty and enacting replacement secondary legislation. Parliament does not authorise the termination of an existing treaty, notwithstanding the effect that a change in the international rules is intended to produce on the rights and liabilities of taxpayers. Still less does it authorise the Crown to commence negotiations on changes to existing treaties. Its role is to scrutinise the secondary legislation implementing a new treaty once it has been agreed by the Crown. ... [s.2 TIOPA][141] authorised neither the termination of an existing treaty nor the commencement of negotiations on changes to an existing treaty nor the agreement of a new treaty. The fact that, under [s.5(2) TIOPA], the House of Commons (and not, it is to be noted,

[141] The original referred to ICTA 1988; but nothing turns on that.

> Parliament) had a role in scrutinising a new treaty once it had been agreed does not affect the point made.[142]

Where a new treaty replaces an old one, under the s.2 TIOPA procedure, there *is* statutory (parliamentary) authority for the revocation of the old treaty.

Section 5(1) TIOPA provides:

> If an Order under section 2 ("the later Order") revokes an earlier Order under that section, the later Order may contain transitional provisions that appear to Her Majesty to be necessary or expedient.

So the government's argument - that this situation constituted an example of the government's power to abolish statutory rights without authority of parliament - is invalid. The High Court, I think understandably, did not even mention it, and the Supreme Court dismissed it briefly:

> ... DTTs are an unsatisfactory analogy. By ... TIOPA, Parliament provided in primary legislation that arrangements agreed by ministers in a DTT at international level will have effect in national law, but only if those arrangements are specified in an Order in Council which is approved by the House of Commons. Thus, unlike EU law which becomes part of UK law automatically as a result of the 1972 Act, the arrangements under a DTT do not take effect automatically as a result of ... TIOPA, but only through a specific Order in Council which has to be approved by Parliament.[143]

On the other hand, if the government (acting under the dignified label, "the Crown") could validly revoke an existing DTA *without* any replacement (and thus without following the s.2 TIOPA procedure and without Parliamentary authority) then that would have supported the government's argument in *Miller* that the government could similarly revoke the EU treaty. The reader may think that if the government in *Miller* had wanted to

[142] *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/558592/Miller_v_SSExEU_-_Skeleton_Argument_of_the_Secretary_of_State_300916.pdf* (footnotes omitted).
The same point is made, more briefly, in the Crown's case before the Supreme Court, para 45: *https://www.supremecourt.uk/news/article-50-brexit-appeal.html*
The argument is discussed by Finnis at:
http://judicialpowerproject.org.uk/wp-content/uploads/2016/11/Finnis-2016-Supplementary-Note-pg.pdf

[143] *Miller (R, oao) v Secretary of State for Exiting the European Union* [2017] UKSC 5 at [89].

raise tax arguments, it would have done well to seek the input of tax counsel. But it seems unlikely that this argument, however put, would have affected the final result.

It was therefore doubtful whether the government could validly revoke an existing DTA without any replacement (and thus without following the s.2 TIOPA procedure, and without parliamentary authority). But now s.2(1A) TIOPA may fill that gap.

107.19.8 *DTA/UK law conflict*

The INTM provides:

> **INTM152020 Negotiation of agreements** [Jan 2018]
> ... In the UK, taxpayers have no rights under the agreement itself; the rights arise under the Statutory Instrument and the legislation which gives the agreement the force of law (*IRC v Collco Dealings Ltd* 39 TC 509).

In some States, treaty obligations override their domestic law; but if there is a conflict between the terms of a treaty and UK domestic law, UK domestic law prevails and overrides treaty obligations.[144]

However even in the UK, conflict matters, or should matter, as:

(1) It may affect construction: the courts should seek to construe domestic law consistently with treaty obligations.
(2) It may affect policy debate and law reform, at least to the extent that those framing UK taxation, or their treaty-partners, believe that the UK ought to comply with its treaty obligations and not to impose tax in breach of them.

107.20 Claim for DT reliefs

Section 6(6) TIOPA provides:

> Relief under subsection (2)(a), (3)(a) or (4) requires a claim.

Subsection (2)(a) and (3)(a) provide IT/CT and CGT relief.[145] (Subsection (4) relates to petroleum revenue tax, not discussed here)

In short, a claim for relief is needed in all cases.[146]

[144] *Padmore (No 2) v IRC* 73 TC 470.

[145] See 107.19.3 (Effect of DTAs).

[146] This seems self-evident, but the contrary view has been repeatedly argued, and rejected: *Davies v HMRC* [2020] UKUT 67 (TCC) at [84]; *Uddin v HMRC* [2020] UKFTT 441 (TC); *Hargreaves Property Holdings Ltd v HMRC* [2023] UKUT 120 (TCC) at [52].

Form HS302 (Dual residents) provides a claim form for individuals who are UK resident under the SRT, but treaty-resident in a foreign State.

In addition, dual resident companies must make a claim under the mutual agreement tie-breaker;[147] but perhaps that does not happen often.

107.21 Remittance basis income

107.21.1 *Unremitted income*

The Commentary to art 1 OECD Model provides:

> 108 ...[Remittance basis taxpayers are not] subject to potential double taxation to the extent that foreign income is not remitted to their State of residence and it may be considered inappropriate to give them the benefit of the provisions of the Convention on such income. Contracting States which agree to restrict the application of the provisions of the Convention to income that is effectively taxed in the hands of these persons may do so by adding the following provision to the Convention ...

The OECD proposed text is as follows:

> Where under any provision of this Convention
> [a] income[148] arising in a Contracting State is relieved in whole or in part from tax in that State and
> [b] under the law in force in the other Contracting State a person, in respect of the said income, is subject to tax by reference to the amount thereof which is remitted to or received in that other State and not by reference to the full amount thereof,
>
> then any relief provided by the provisions of this Convention shall apply only to so much of the income as is taxed in the other Contracting State.

See too 123.1 (Claims).

The application of s.6(2)(b)-(f) and s.6(3)(b)-(e) TIOPA does not depend on a claim, but these provisions are not reliefs: they may operate in favour of HMRC; see 107.19.3 (Effect of DTAs).

[147] See 107.20 (Tie-breaker: Mutual agreement).

[148] Author's footnote:
References to income in this discussion in principle include gains.
The draft clause refers only to income, but in the UK foreign gains also qualify for the remittance basis, so DTAs with a capital gains article generally extend the rule to gains.
If the applicable DTA fails to do this then there may appear to be double non-taxation in that gains which are (un)taxed in the UK on the remittance basis are not taxed in the foreign State because of DT relief. But the word "income" would probably be construed to include gains.

I refer to this as a "**remittance basis DTA override**".

Although this text was only added to OECD Commentary in 2003, a provision of this kind is found in most UK DTAs.[149]

USA/UK DTA Technical Explanation gives a straightforward example:[150]

> For example, if a UK resident who is not domiciled in the UK maintains a brokerage account in Ireland into which is paid $100 in U.S.-source dividend income, the United States may impose withholding tax at the statutory rate of 30% because the dividend income will not be taxed in the UK as it has not been remitted to the UK. If the dividend income instead is paid into a brokerage account in London, the UK resident will be subject to tax in the UK and the United States will reduce the rate of withholding tax to 15%.

Note that it is foreign tax (in this case, US tax), not UK tax, which is in issue here. (UK tax issues only arise where the UK has a treaty with another State where the *foreign* State has a remittance basis. The only examples of which I am aware are Ireland[151] and Japan.)

107.21.2 *Remitted income*

Suppose:

(1) Year 1: T (a remittance basis taxpayer) receives income subject to foreign tax

(2) Year 2: T remits the income

In year 1, no DT relief is available, and so foreign tax is payable without DT relief. In year 2, the foreign tax can then be reclaimed under the relevant DTA - if foreign law allows. And what are the time limits if the remittance takes place many years after receipt? It may be easier to remit the income in year 1.

A claim for relief should be made when the income is remitted, not when it arises.

107.22 Characterisation

OECD Model articles deal separately with particular types of income, so it is necessary to classify the type of income which the taxpayer receives, ie to

[149] See too 9.5 ("Liable to tax").

[150] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf* The remittance basis DTA override is in art 1(7) USA/UK DTA.

[151] Ireland/UK DTA art.6 (Limitation of relief) and art.14(5) (gains).

decide whether any particular item constitutes remuneration from an employment, or business income, or Other Income, etc. This is traditionally referred to as "characterisation" though those who prefer plain English may say "classification".

The borderlines between different types of income are often difficult to draw, and that needs to be discussed in the context of each article. The issue also arises in relation to third-party DT relief, which I consider elsewhere: see 109.4 (Characterisation: Same income?).

Hughes v Bank of New Zealand[152] concerned the domestic tax exemption for interest on FOTRA securities, not a DTA, but the issue of classification of income is not restricted to DT reliefs: it can arise wherever a rule applies to particular types of income.

(1) The taxpayer was a non-resident bank with a UK branch. The branch's profit was taxable in the UK.

(2) The branch's trading receipts included interest from FOTRA securities (exempt from UK tax in the hands of a non-resident).

The FOTRA exemption applied:[153]

> [*Hughes*] is authority for the proposition that exempt interest retains its character as interest even when it is taxable as a component element of the recipient's trading profits. ... Interest from exempt securities does not cease to be such by being included as a component element of the recipient's taxable profit.[154]

On the other side of the line, according to *Bricom*, is *IRC v Australian Mutual Provident Society*.[155]

(1) The taxpayer was a non-resident life assurance company with a UK branch. The branch's profit was taxable.

(2) The taxable profit was calculated in an unusual way: the relevant rule provided that an unidentifiable portion of the worldwide income of the company derived from the investment of its life assurance fund, calculated in accordance with a mathematical formula, should be charged to tax. That worldwide income included interest.

It was held that the rule did not tax the company's investment income as

[152] 21 TC 472.

[153] See 22.4.2 (Trading receipts/deductions).

[154] *Bricom v IRC* 70 TC 272 at p.290.

[155] 28 TC 388 "as explained by Lord Radcliffe" in *Ostime v Australian Mutual Society* 38 TC 492.

such but something different, described as "a conventional sum"; that sum was not interest, even though interest from FOTRA securities constituted an element in the computation:

> ... the question turns on the nature of the statutory process... where tax is charged on a conventional or notional sum which exists only as the product of a calculation, the fact that one of the elements in the calculation is measured by reference to the amount of exempted income does not make the exempted income the subject of the tax: *Australian Mutual Provident Society*.[156]

107.22.1 *Deemed classification*

The characterisation issue arose in *Fowler v HMRC*.[157] The taxpayer was an employed diver, whose employment was exercised in the UK, and so his remuneration was taxable in the UK under UK domestic law. He was treaty-resident in South Africa, but treaty relief under the employment income article did not apply.[158] However there is a special UK law rule for North Sea divers: for IT purposes their employment is treated as a trade.[159]

The taxpayer claimed treaty relief under the business profits article, on the basis that his income constituted business profits. The SC held that the deemed-trade fiction did not apply for treaty purposes so the income was not business profits and did not qualify for relief under that article. A number of reasons were given.

There were said to be some indications in the ITEPA wording, though the reader who studies the wording may regard this as less than decisive.

The application of the deemed-trade fiction to the DTA was said to be contrary to the purpose of the fiction:

> If one asks, as is required, for what purposes and between whom is the fiction created, it is plainly not for the purpose of rendering a qualifying diver immune from tax in the UK, nor adjudicating between the UK and South Africa as the potential recipient of tax. It is for the purpose of adjusting the basis of a continuing UK income tax liability which arises from the receipt of employment income. Therefore to apply the deeming provision in section 15(2) so as to alter the meaning of terms in the Treaty with the result of rendering a qualifying diver immune from UK taxation

[156] *Bricom v IRC* 70 TC 272 at p.290..

[157] [2020] UKSC 22.

[158] See 37.2 (Employment income DT relief).

[159] See 37.16.1 (Deemed non-employment).

> would be contrary to its purpose...[160]

There is a risk in this line of argument, as there is in all purposive arguments, of firstly assuming the answer and then identifying the purpose to fit.

Next, and more fundamentally, the deemed-trade fiction was contrary to the purpose of the DTA:

> 34. Nor should article 3(2) of the Treaty be construed so as to bring a qualifying diver within article 7 [business profits] rather than article 14 [employment income]. To do so would be contrary to the purposes of the Treaty. This is because, as is recognised by article 2(1), the Treaty is not concerned with the manner in which taxes falling within the scope of the Treaty are levied. Section 15 [ITEPA], understood in the light of section 6(5) of ITEPA, charges income tax on the employment income of an employed diver, but in a particular manner which includes the fiction that the diver is carrying on a trade.

It seems to me that art 2(1) does not shed much light on the issue.[161] There is however a sound argument in favour of the decision which is hinted in the above. Suppose one asks: should the deemed-trade fiction apply if it *disallowed* treaty relief, as opposed to conferring it? If so treaty relief could be unilaterally disapplied by a State which provided by its domestic law that, say, a trade was to be treated as an employment. Suppose, for instance, that the facts of *Fowler* were reversed. Suppose:

(1) The taxpayer was UK resident and UK treaty-resident.
(2) The taxpayer traded as a diver in South Africa.

Under the treaty, the profits of the trade would be taxable in the UK and not in South Africa, under art 7 (business profits). But suppose South Africa domestic law said that the trade was deemed to be an employment, and so taxable in South Africa, under article 15, thus disapplying art 7. Would that allow South Africa to tax the profits? The OECD Commentary says that is not the case.[162] The South African deeming provision would not determine the question of whether there is an employment for the purposes of the treaty. (It may be that South Africa could breach the treaty, but that would be a matter of treaty override, not treaty interpretation.)

Although not cited, this conclusion is consistent with *Melford*

[160] At [15].
[161] See 107.13.4 (Manner of levying tax).
[162] See 37.9.8 (Limit on source State powers).

Developments discussed elsewhere.[163]

On this analysis *Fowler* was correctly decided, though not for the most clearly expressed or best reasons. Does it matter? Discuss! The analysis above might perhaps help those who study the decision and would find it puzzling.

107.23 Channel Islands/IoM DTAs

A protocol to the Jersey/UK DTA provides:

> The Territories acknowledge that the UK continues to be responsible for the international relations of Jersey in international law. This Agreement cannot therefore create obligations which are binding under international law and is not intended to alter or affect the constitutional relationship between Jersey and the UK.

There is identical wording for Guernsey, IoM and Gibraltar.

The constitutional relationship between the Crown Dependencies and the UK raises deep questions. But this will not arise for day-to-day purposes of the DTA.

107.24 Pre-1963 DTAs

A few treaties survive from before the development of OECD Model. I refer to these as "**pre-1963 DTAs**". The expression sometimes used is "colonial model". This model was not published as such; the expression is used to refer to early UK DTA practice within the Commonwealth.

Pre-1963 DTAs survive in Greece and a few remote corners of the world:

Antigua (1947)
Belize (1947)
Brunei (1950)
Burma/Myanmar (1950)
Grenada (1949)
Greece (1953)
Kiribati (1950)
Greece (1953)
Kiribati (1950)
Malawi (1955)
Monserrat (1947)
St Kitts & Nevis (1947)
Tuvalu (1950)

Notwithstanding variations in the wording of standard definitions, a multiplicity of concepts should be avoided or minimised so far as possible. It is suggested that the courts ought to have regard to the general international law understandings and where the context permits, construe

[163] See 109.4.1 (Characterisation: Better view).

pre-1963 DTAs to be consistent with the OECD Model. Otherwise we will never know much about the pre-1963 DTAs as there will never be the litigation to answer all the puzzles which could arise.

It would be a simplification if the pre-1963 DTAs could be updated to OECD Model wording. The 2018 Channel Islands/IoM DTAs are a step in the right direction.

107.25 Treaty commencement dates

I take the 2022 Luxembourg/UK treaty as an example. Article 29 provides:

> The Contracting States shall notify each other in writing, through diplomatic channels, that the procedures required by its law for the entry into force of this Convention have been satisfied. This Convention shall enter into force on the date of receipt of the later notification and shall thereupon have effect:
>
> a) in the UK:
>
> (i) in respect of taxes withheld at source, to income derived on or after 1 January of the calendar year next following the year in which this Convention enters into force;
>
> (ii) in respect of income tax and capital gains tax, for any year of assessment beginning on or after 6 April of the calendar year next following the year in which this Convention enters into force;
>
> (iii) in respect of corporation tax, for any financial year beginning on or after 1 April of the calendar year next following the year in which this Convention enters into force;

The treaty entered into force on 27 November 2023, each State having given notice that their domestic procedures for entry into force were completed. It has effect in the UK as follows:

Context	**Effect from**
Withholding tax	Income derived (ie arising) on or after 1 January 2024
Income tax/CGT	6 April 2024
CT	Financial years beginning on or after 1 April 2024

Financial year has its UK law meaning.[164]

CIOT say:[165]

[164] See 107.12.1 (Domestic-law meaning); 14.3.2 (Tax year/financial year).

[165] CIOT, letter to HMRC 31 Oct 2023 re the UK/Luxembourg DTA *https://www.tax.org.uk/ref1240*

> For a company with an accounting period that straddles 1 April 2024 for example, a calendar year accounting period ending on 31 December 2024, the existing [Luxembourg/UK] treaty would apply to a gain accruing on or before 31 March 2024 and the new treaty to a gain accruing from 1 April 2024.
>
> We are also working on the basis that the normal rules apply to any capital gains realised by a company, ie any deferred and ascertainable consideration is treated as arising at the time of the contract for sale becoming unconditional and taxed according to the rules in place at that time. For instance, a disposal taking place prior to 31 March 2024 where some of the consideration is deferred (and ascertainable) and received after 1 April 2024 can still benefit from the old [Luxembourg/UK] treaty.

107.25.1 *Disposal for unascertained consideration*

CIOT continue with a point of somewhat specialist interest, relating to s.48A TCGA (disposal of land/land-rich asset for unascertainable consideration):[166]

> ... if it is considered that s.48A TCGA would apply for the purposes of corporation tax it is not clear that any gain that is treated as arising on or after 1 April 2024 (as determined under 'step 3' in s.48A(2)) would fall to be taxed in the UK (by virtue of article 13 of the new treaty) where the original disposal of UK property rich shares (falling within s.2B(4)(b) TCGA) arose before 1 April 2024. It would appear that the original disposal would not fall to be taxed in the UK under the existing [Luxembourg/UK] treaty and the disposal of the '*Marren v Ingles* right' would not fall to be taxed in the UK (under either the existing or the new treaty (article 13)).

It will be interesting to see how HMRC respond. But the point will not often arise.

107.26 The future

CIOT continue to lobby:

> following the UK's exit from the EU at the end of 2020, HMRC will continue to prioritise renegotiation of European DTAs to try and replicate the benefits of the Interest and Royalty and Parent and Subsidiary Directives. As we have previously noted, UK companies have also lost the benefit of the Merger Directive and would, therefore, benefit from a new

[166] See 57.36 (Unascertainable consideration),

> addition to Article 13 of the OECD Model for treaties with EU/EEA members that would extend the Merger Directive bilaterally.[167]

But that has not happened, or at least, not yet.

[167] Letter to HMRC, 25 January 2022 *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/979c1fc1-598a-4ab4-ae5b-e9f2f1a98c4e/220125%20Review%20of%20Double%20Taxation%20Treaties%202022-23%20-%20CIOT%20response.pdf*

CHAPTER ONE HUNDRED AND EIGHT

DTA ANTI-ABUSE RULES

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108.1 DTA anti-abuse rules: Introduction

There are various types of DTA anti-avoidance rules:

Rule	**See para**
Express DTA rules:	
Principal purpose test	108.8
Savings Clause	109.5
Conduit arrangements	108.9
Beneficial ownership	108.10
Limitation on Benefits	110.1
Implied DTA anti-avoidance rule	108.6
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The GAAR	
Treaty override provisions	

A full discussion of each rule requires a book to itself, and indeed many books have been written on these topics.

108.2 DTA title/preamble/purpose

The purpose of the OECD Model DTA, like the purpose of any legal document, should be construed from the DTA as a whole. However purpose may be stated expressly in the title, and/or in a preamble, and it may be discussed in the OECD Commentary.

The wording of these has changed over time.

108.2.1 *1963/1977: Double taxation*

The title in the 1963 Draft Model and the 1977 Model was:

> Convention between (State A) and (State B) *for the avoidance of double taxation* with respect to taxes on income and on capital

So the purpose, or at least the main purpose, was the avoidance of double taxation.

108.2.2 *1992 form: Fiscal evasion*

Subsequently, in 1992, the title of the OECD Model was amended to delete the reference to double taxation:

> Convention between (State A) and (State B) with respect to taxes on income and on capital.

This reflected an understanding that the OECD Model was not just for the avoidance of double taxation. Instead, a footnote provided:

> States wishing to do so may follow the widespread practice of including in the title a reference to either
> [1] the avoidance of double taxation or
> [2] to both the avoidance of double taxation and the prevention of fiscal evasion.

The UK followed approach [2] and the title to UK DTAs typically identified two purposes:

> Agreement between [the UK and State X] *for the avoidance of double taxation and the prevention of fiscal evasion* with respect to taxes on income and on capital[1]

The OECD Commentary did not discuss the meaning of "fiscal evasion". The expression could be used to include avoidance/abuse as well as fraud;[2] but I would have thought it self-evident that the reference in the context of a DTA was to articles 26 (exchange of information) and 27 (assistance in the collection of taxes). The evasion countered by the DTA is non-payment of tax lawfully due.[3] But the CoA stretched the expression to make it include tax avoidance.[4]

[1] Sometimes the wording is set out, or repeated, in a preamble. For instance the UK/USA DTA provides that the parties are:
"Desiring to conclude a new Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains".
But the title itself is relevant to interpretation, see 107.10.1 (Context of treaties), so a recital using the same words does not add anything except, perhaps, emphasis. That is the UK law rule; conceivably the preamble was thought to be significant in the USA.

[2] An avoidance/evasion distinction very similar to the present was recognised very early (and was surely self-evident at any time) but at first there was no terminology, or at least no commonly agreed terminology, to express it. In 1860 Turner LJ suggested evasion/contravention (where evasion stood for the lawful side of the divide). See 2.2.2 (Avoidance/evasion distinction).

[3] If authority is needed, see *Fowler v HMRC* [2020] UKSC 22 discussing the South Africa/UK DTA (2002). The treaty has a preamble in (more or less) standard 1992 form, referring to "a new Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital gains". SC stated at [15]: "the recited objective of dealing with tax evasion is dealt with by provisions for exchange of information and mutual assistance in tax collection in articles 25 and 25A".

[4] See 107.6.1 (Abusive double non-taxation).

108.2.3 *Avoidance: OECD Commentary*

Until 1977, OECD Commentary did not comment on avoidance or evasion.

In 1977 the following text was added:

> 7. The purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons; they should not, however, help tax avoidance or evasion. True, taxpayers have the possibility, double taxation conventions being left aside,[5] to exploit differences in tax levels between States and the tax advantages provided by various countries' taxation laws, but it is for the States concerned to adopt provisions in their domestic laws to counter such manoeuvres. Such States will then wish, in their bilateral double taxation conventions, to preserve the application of provisions of this kind contained in their domestic laws.

This made it clear that OECD Model did *not* contain an anti-abuse rule.

The text remained essentially unchanged until 2003, which substituted the current text:[6]

> 54. The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons. *As confirmed in the preamble of the Convention, it is also part of the purposes of tax conventions to prevent tax avoidance and evasion.*

The second sentence is (more or less) the opposite of what was said in 1977. OECD described the change as "clarification"[7] but there is a long tradition of misdescribing substantial tax changes as clarification.[8]

[5] In 1995 there was a stylistic change which did not affect the meaning: the phrase "double taxation conventions being left aside" became: "irrespective of double taxation conventions".

[6] Pursuant to the 2002 Reports Related to the OECD Model Tax Convention: "Restricting the Entitlement to Treaty Benefits", "Treaty Characterisation Issues Arising from E-Commerce", "Issues Arising Under Article 5 (Permanent Establishment) of the Model Tax Convention".

[7] OECD/G20 "Base Erosion and Profit Shifting Project Preventing the Granting of Treaty Benefits in Inappropriate Circumstances (2015) provides: "In 2003, [paragraph 7] was amended *to clarify* that the prevention of tax avoidance was also a purpose of tax treaties."

[8] See App.1.2 (Clarify/modernise/reform).

108.2.4 *2017 Model form*

The current (2017) Model form has a revised title:

> ***Title***
> Convention between (State A) and (State B) for the elimination of double taxation with respect to taxes on income and on capital and the prevention of tax evasion and avoidance

The reference to fiscal evasion has been replaced by "the prevention of tax evasion and avoidance".

A new preamble also identifies the purpose(s) of the DTA:[9]

> ***Preamble to the Convention***
> (State A) and (State B),
> [1] Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,
> [2] Intending to conclude a Convention for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third States),
> Have agreed as follows...

I refer to these as:
(1) The economic co-operation preamble
(2) The tax avoidance preamble

It is difficult to see that the economic co-operation preamble has any legal effect, though I suppose the exhortation might inform the approach adopted by HMRC and their foreign counterparts.

108.3 BEPS MLI preambles

The BEPS MLI (in short) brings older DTAs into line with 2017 OECD Model form.

108.3.1 *Anti-avoidance preamble*

Art 6(1) BEPS MLI provides:

[9] In English domestic drafting, this would normally be called a recital, rather than a preamble, but the words are synonymous here. When discussing the OECD Model, it is normally better to use the OECD terminology, but it does not matter.

> 1. A Covered Tax Agreement[10] shall be modified to include the following preamble text:
>
> > "Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions),".

This is substantially the same as the OECD model anti-avoidance preamble, with changes only to conform to MIL terminology.

Art 6(2) BEPS MLI provides:

> 2. The text described in paragraph 1 shall be included in a Covered Tax Agreement in place of or in the absence of preamble language of the Covered Tax Agreement referring to an intent to eliminate double taxation, whether or not that language also refers to the intent not to create opportunities for non-taxation or reduced taxation.

Art 6 BEPS MLI provides an opt-out:

> 4. A Party may reserve the right for paragraph 1 not to apply to its Covered Tax Agreements that already contain preamble language describing the intent of the Contracting Jurisdictions to eliminate double taxation without creating opportunities for non-taxation or reduced taxation, whether that language is limited to cases of tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in the Covered Tax Agreement for the indirect benefit of residents of third jurisdictions) or applies more broadly.

The UK has exercised this opt-out, but only in relation to the 3 contracting jurisdictions whose DTAs already contain the preamble: Belarus, Ukraine and Uzbekistan.[11]

108.3.2 *Economic cooperation*

Art 6 BEPS MLI provides:

[10] See 107.16.3 (Covered Tax Agreement).

[11] UK MLI Notifications *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725261/Final_list_of_UK_reservations_and_notifications_made_on_deposit_of_the_instrument_of_ratification.pdf*

> 3. A Party may also choose to include the following preamble text with respect to its Covered Tax Agreements that do not contain preamble language referring to a desire to develop an economic relationship or to enhance co-operation in tax matters:
>
> > "Desiring to further develop their economic relationship and to enhance their co-operation in tax matters,".

This is identical to the OECD Model economic co-operation preamble. The UK has opted to adopt this provision. But as noted above, it will have little if any legal effect.

108.4 *Purpose of DTAs: Summary*

It is necessary to distinguish:
(1) Treaties using 2017 Model text, or BEPS MLI text
(2) Other DTAs ("Old-style DTAs").

The position for DTAs in the first category is clear. It is stated from the title or preamble that at least one of the purposes is the prevention of avoidance. As these treaties also have express principal purpose test, this text is simply dotting *I*'s and crossing *T*'s.

Old-style DTAs are diminish in number so the identifying their purpose is perhaps of decreasing interest. If one could apply a strict approach, the position must be that is no anti-abuse in the pre-MLI OECD Model, and no anti-abuse purpose should be implied:
(1) Pre-1995 DTAs should be construed without regard to the current commentary.
(2) 1977-1995 treaties should be construed on the basis that the then applicable commentary broadly regarded anti-avoidance as a matter of domestic law.
(3) Post-1995 treaties should be construed on the same basis, as the current commentary text is unjustified.

But courts hostile to abuse will not find that a palatable view.

Se non è vero, è ben trovato. The BEPS MLI introduced a principal purpose test[12] "to mirror the guidance".[13] That rather makes the point, as commentary is normally intended to mirror the text, rather than text inserted to mirror the commentary.

[12] See 108.8 (Principal purpose test).
[13] OECD Draft Commentary to principal purpose test, para 1.

108.5 Domestic anti-abuse rules

This section discusses the question whether domestic law anti-abuse rules which override a treaty would breach treaty obligations.[14]

OECD Commentary states that domestic law anti-abuse rules do not conflict with the Model treaty:

> ... as a general rule, there will be no conflict between [domestic anti-abuse] rules and the provisions of tax conventions.[15]

The GAAR guidance is therefore correct, or at least, supported by OECD Commentary, in stating that the GAAR may override DTAs:

> ... where there are abusive arrangements which try to exploit particular provisions in a double tax treaty, or the way in which such provisions interact with other provisions of UK tax law, then the GAAR can be applied to counteract the abusive arrangements. See the example at D12 (Huitson - DTAs).[16]

The reader may find OECD reasoning unconvincing;[17] but a breach of the treaty (even if there were a breach) would not matter in a jurisdiction like the UK where domestic law may override treaty agreements.

[14] As to how far a conflict actually matters, see 107.19.8 (Conflict between DTAs and UK law).

[15] OECD Commentary on Art 1, para 58.

[16] HMRC, "GAAR Guidance" (2017) para B5.3. *https://www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules*

[17] OECD Commentary on art 1 provides: "58. Many States address that question by taking account of the fact that taxes are ultimately imposed through the provisions of domestic law, as restricted (and in some rare cases, broadened) by the provisions of tax conventions. Thus, any abuse of the provisions of a tax convention could also be characterised as an abuse of the provisions of domestic law under which tax will be levied. For these States, the issue then becomes whether the provisions of tax conventions may prevent the application of the anti-abuse provisions of domestic law, which is the question addressed in paragraphs 66 to 80 below. As explained in these paragraphs, as a general rule, there will be no conflict between such rules and the provisions of tax conventions"

Para 22.1 formerly provided: "2.1 Such rules are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability; these rules are not addressed in tax treaties and are therefore not affected by them. Thus, as a general rule and having regard to paragraph 9.5, there will be no conflict."

108.6 Implied treaty anti-abuse rule

An implied treaty anti-abuse rule is important where there are no domestic anti-abuse rules, as was (more or less) the case in the UK before the GAAR.

An implied treaty anti-abuse rule may of course overlap with domestic law anti-abuse rules. Substance over form rules, or economic substance rules, may be classified as treaty-based (construction of the treaty), or as domestic anti-abuse rules. They are two routes to the same destination.

OECD Commentary on art 1 supports the view that the OECD model convention includes an implied anti-abuse rule:

> 59. Other[18] States prefer to view some abuses as being abuses of the convention itself, as opposed to abuses of domestic law. These States, however, then consider that a proper construction of tax conventions allows them to disregard abusive transactions, such as those entered into with the view to obtaining unintended benefits under the provisions of these conventions. This interpretation results from the object and purpose of tax conventions as well as the obligation to interpret them in good faith.[19]
>
> 60. Under both approaches, therefore, it is agreed that States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into.

I am not sure about the reasoning, but the conclusion is clear.

In practice the courts will construe a DTA to avoid double non-taxation in abuse cases, and maybe even in some non-abuse cases: see 107.6 (Double non-taxation).

108.7 OECD-concept abuse

108.7.1 *"OECD concept abuse"*

If there is an anti-abuse rule in a DTA (or if domestic-law rules may override a treaty provision where there is abuse) then it is necessary to

[18] Strictly the reference to "other" states cannot be right: *all* states should seek to construe DTAs the same way. But the Commentary adopts a pragmatic approach. A state with domestic anti-avoidance rule need not bother about construction of the treaty: it does not matter what the treaty says.

[19] The Commentary refers to art 31 Vienna Convention; see 107.10 (DTA interpretation: Principles).

consider what constitutes abuse.

OECD Commentary provides:

> It is important to note, however, that it should not be lightly assumed that a taxpayer is entering into the type of abusive transactions referred to above.
>
> A guiding principle is that the benefits of a double taxation convention should not be available where
>
> [a] a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and
>
> [b] obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions.[20]

I refer to this as "**OECD-concept abuse**".

OECD Commentary uses the term avoidance as well as abuse, but does not draw a distinction between them, and I think they are used synonymously. Given OECD meaning, the term "abuse" seems more apt, at least for tax practitioners who choose their words carefully.

OECD Commentary gives two examples of abuse. The first example may be described as treaty-shopping:

> This would be the case, for example, if a person (whether or not a resident of a Contracting State), acts through a legal entity created in a State essentially to obtain treaty benefits that would not be available directly.[21]

Treaty-shopping was in the OECD view "unsatisfactory" as far back as 1986.

108.7.2 *Emigration to treaty-state*

The second example of abuse in OECD Commentary is emigration by an individual to a foreign treaty-state. The Commentary continues:

> Another case would be an individual
>
> [1] who has in a Contracting State ["the original home State"] both
>
> [a] his permanent home and
>
> [b] all his economic interests, including a substantial shareholding in a company of that State, and

[20] OECD Commentary on Art 1, para 61.

[21] OECD Commentary on Art 1, para 56.

> [2] who, essentially in order to sell the shares and escape taxation in that State on the capital gains from the alienation (by virtue of [Art 13(5), DTA CG relief]), transfers his permanent home to the other Contracting State, where such gains are subject to little or no tax.[22]

It is considered that emigration by an individual should not be categorised as abuse, even in a case where:

(1) the purpose of emigration to a treaty State is to qualify for DTA relief; and

(2) the individual retains their economic interests in the original State.[23]

Emigration by a *company* to a treaty jurisdiction might be abuse, in the absence of economic substance. That would be the EU-law approach.[24] But in the case of an individual, the permanent home (which is, in short, required to be treaty-resident) effectively constitutes economic substance.

Conceivably an individual approaches the abusive end of the spectrum if the period of treaty non-residence is kept as short as the "permanent home" requirement may permit.[25] The concept of abuse is not only vague and subjective but also very fact sensitive.

108.7.3 *UN Model Commentary*

The UN Model Commentary (rewritten in 2017) agrees with OECD, but contains a slightly more comprehensive discussion. The UN Commentary approves the OECD conclusion that "States do not have to grant the benefits of a double taxation convention where arrangements that constitute an abuse of the provisions of the convention have been entered into."[26] It continues:

> 23. That conclusion leads logically to the question of what is an abuse of a tax treaty. The OECD did not attempt to provide a comprehensive reply

[22] For this planning, see 11.2.1 (TNR gains).

[23] This view is supported by *McCabe v HMRC* [2022] UKFTT 356 (TC) at [216]. As this case concerns tax residence as well as treaty-residence, I discuss it at 6.39.1 (Avoidance irrelevant to residence).

[24] See 6.39 (Non-residence & tax avoidance).

[25] That may be quite short: see 9.12.2 ("Permanent"). In the UK planning by short-term residence in a foreign treaty-state would now be caught by the TNR rules. Prior to the introduction of those rules, HMRC accepted that DT relief could apply.

[26] See 108.6 (Implied treaty anti-abuse rule).

> to that question, which would have been difficult given the different approaches of its member countries. Nevertheless, the OECD presented the following general guidance, which was referred to as a "guiding principle".
>
> [The commentary quotes OECD Commentary on art 1, para 61[27] and continues]:
>
> 24. The members of the Committee endorse that principle. They considered that such guidance as to what constitutes an abuse of treaty provisions serves an important purpose as it attempts to balance the need to prevent treaty abuses with the need to ensure that countries respect their treaty obligations and provide legal certainty to taxpayers. Clearly, countries should not be able to escape their treaty obligations simply by arguing that legitimate transactions are abusive and domestic tax rules that affect these transactions in ways that are contrary to treaty provisions constitute anti-abuse rules.
>
> 25. Under the guiding principle presented above, two elements must therefore be present for certain transactions or arrangements to be found to constitute an abuse of the provisions of a tax treaty:
>
> [1] a main purpose for entering into these transactions or arrangements was to secure a more favourable tax position, and
>
> [2] obtaining that more favourable treatment would be contrary to the object and purpose of the relevant provisions.

This quotes the OECD commentary (more or less) exactly.

> 26. These two elements will also often be found, explicitly or implicitly, in general anti-avoidance rules and doctrines developed in various countries.
>
> 27. In order to minimize the uncertainty that may result from the application of that approach, it is important that this guiding principle be applied on the basis of objective findings of facts, not solely the alleged intention of the parties. Thus, the determination of whether a main purpose for entering into transactions or arrangements is to obtain tax advantages should be based on an objective determination, based on all the relevant facts and circumstances, of whether, without these tax advantages, a reasonable taxpayer would have entered into the same transactions or arrangements.

This is similar to the EU-law concept of abuse. That is not surprising. It is also similar to "abusive" as defined in the GAAR.

[27] See 108.7.1 ("OECD concept abuse").

GAAR guidance gives the scheme in *Huitson* as an example of an abuse which would be caught by the GAAR, and no doubt constitutes OECD-abuse.[28] As is common in GAAR guidance examples, that is both an easy case and somewhat academic (as the scheme has been stopped by legislation).

108.7.4 *Canadian approach*

Courts in other common law jurisdictions have not been as obliging in categorisation of abuse as tax administrations would desire. The Canadian Revenue say:

> ... the leading Canadian treaty shopping case involving the GAAR was decided in favour of the taxpayer. In *MIL (Investments) SA*,[29] the corporate taxpayer was continued [migrated] from Cayman Islands (a jurisdiction with which Canada does not have a tax treaty) to Luxembourg (a treaty country) shortly before it realized capital gains on the disposition of taxable Canadian property.[30]

In UK legal terminology, the company migrated to Luxembourg and became treaty-resident there. This is the example which OECD identified as abuse in the case of an individual;[31] one might have thought that the case of a company was clearer. But the court found this was not abuse:

> Upon its continuance [migration] to Luxembourg, the corporate taxpayer became a resident of Luxembourg for purposes of the Canada-Luxembourg Convention, positioning it to make a claim under the Convention to exempt the capital gain from tax in Canada. The Crown argued that this case involved treaty shopping and, as such, represented an abuse of the provisions of the Convention that exempted the capital gain from tax in Canada. The Tax Court of Canada concluded that the GAAR was not applicable and that there was no inherent anti-abuse rule in the Convention. The Tax Court stated:

[28] HMRC, "GAAR Guidance" (2017) para D12 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/605502/gaar-part-d-2017.pdf* for the *Huitson* scheme, see 85.25 (DT relief: Partnership).

[29] [2007] DTC 5437.

[30] Footnote original: A non resident of Canada is taxable in Canada on, among other things, capital gains arising on the disposition of taxable Canadian property, subject to the provisions of an applicable tax treaty.

[31] See 108.7.2 (Emigration to treaty-state).

> "…I do not agree that Justice Iaccobucci's obiter dicta can be used to establish a prima facie finding of abuse arising from the choice of the most beneficial treaty. There is nothing inherently proper or improper with selecting one foreign regime over another. Respondent's counsel was correct in arguing that the selection of a low tax jurisdiction may speak persuasively as evidence of a tax purpose for an alleged avoidance transaction, but the shopping or selection of a treaty to minimize tax on its own cannot be viewed as being abusive. It is the use of the selected treaty that must be examined."[32]

In a short decision, the Federal Court of Appeal dismissed the Crown's appeal in *MIL (Investments)* on the basis that it was unable to find an object or purpose of the exempting provision of the Convention whose abuse would justify a departure from the plain meaning of the words of the provision. This decision is a particularly strong statement by the Federal Court of Appeal, indicating that the courts in Canada require further legislative direction before finding that treaty shopping is an improper (and abusive) use of tax treaties.[33]

108.7.5 *Treaty-shopping*

OECD returned to this topic in 2015:

> *a) Treaty shopping*
>
> 17. The first requirement that must be met by a person who seeks to obtain benefits under a tax treaty is that the person must be "a resident of a Contracting State", as defined in Article 4 of the OECD Model Tax Convention. There are a number of arrangements through which a person who is not a resident of a Contracting State may attempt to obtain benefits that a tax treaty grants to a resident of that State. These arrangements are generally referred to as "treaty shopping". Treaty shopping cases typically involve persons who are residents of third States attempting to access indirectly the benefits of a treaty between two Contracting States.[34]

[32] See at [72].

[33] Department of Finance Canada "Consultation Paper on Treaty Shopping – The Problem and Possible Solutions" (2013) *https://thor.ca/blog/wp-content/uploads/2013/08/Consultation-Paper-on-Treaty-Shopping.pdf*

[34] Footnote original: Cases where a resident of the Contracting State in which income originates seeks to obtain treaty benefits (e.g. through a transfer of residence to the other Contracting State or through the use of an entity established in that other State)

108.8 Principal purpose test

108.8.1 *OECD Model/BEPS PPT*

The principal purpose test (PPT) in OECD Model and BEPS are effectively identical (with changes only to conform to MLI terminology):

Art 29(9) OECD Model	**Art 7(1) BEPS MLI**
Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital	Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital
[a] if it is reasonable to conclude,[35] having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit,	[a] [identical]
[b] unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention.	[b] unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.

The PPT is a TAAR by another name. Instead of "tax avoidance" (ie evident intention of parliament), we have "object and purpose" of the DTA. This is a nod to the Vienna Convention,[36] but the concepts are (more or less) the same.

Art 7(1) BEPS MLI continues:

> 2. Paragraph 1 shall apply in place of or in the absence of provisions of a Covered Tax Agreement that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or

could also be considered to constitute a form of treaty shopping...

[35] The wording adopts current UK drafting practice; see App.2.24 (Reasonable-to-assume).

[36] See 107.9 (DTA interpretation principles).

> transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits.
>
> 3. A Party that has not made the reservation described in subparagraph a) of paragraph 15 may also choose to apply paragraph 4 with respect to its Covered Tax Agreements.
>
> 4. Where a benefit under a Covered Tax Agreement is denied to a person under provisions of the Covered Tax Agreement (as it may be modified by this Convention) that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits, the competent authority of the Contracting Jurisdiction that would otherwise have granted this benefit shall nevertheless treat that person as being entitled to this benefit, or to different benefits with respect to a specific item of income or capital, if such competent authority, upon request from that person and after consideration of the relevant facts and circumstances, determines that such benefits would have been granted to that person in the absence of the transaction or arrangement. The competent authority of the Contracting Jurisdiction to which a request has been made under this paragraph by a resident of the other Contracting Jurisdiction shall consult with the competent authority of that other Contracting Jurisdiction before rejecting the request.
>
> 5. Paragraph 4 shall apply to provisions of a Covered Tax Agreement (as it may be modified by this Convention) that deny all or part of the benefits that would otherwise be provided under the Covered Tax Agreement where the principal purpose or one of the principal purposes of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits.

The UK has chosen to opt in to article 7(4).[37]

OECD Commentary is somewhat verbose, but it is necessary to consider all of it.

It has become common for UK domestic law to adopt this wording in a treaty-override:

Topic	**See para**	**Date**
Trading in land	22.4.2	2016
Transactions in land	22.16.1	2016

[37] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725261/Final_list_of_UK_reservations_and_notifications_made_on_deposit_of_the_instrument_of_ratification.pdf*

Royalty withholding tax	32.13	2016
Offshore IP receipts	32.35	2019
UK land/land rich asset: Non-residents CGT/CT	57.13.2	2019

108.8.2 *PPT/LoB: Relationship*

OECD Commentary on art 29 provides:

> 171. Paragraph 9 supplements and does not restrict in any way the scope or application of the provisions
> [1] of paragraphs 1 to 7 (the limitation-on-benefits rule)[38] and
> [2] of paragraph 8 (the rule applicable to a permanent establishment situated in a third jurisdiction):
> a benefit that is denied in accordance with these paragraphs is not a "benefit under the Convention" that paragraph 9 would also deny. Moreover, the guidance provided in the Commentary on paragraph 9 should not be used to interpret paragraphs 1 to 8 and vice-versa.
> 172. Conversely, the fact that a person is entitled to benefits under paragraphs 1 to 7 does not mean that these benefits cannot be denied under paragraph 9. Paragraphs 1 to 7 are rules that focus primarily on the legal nature, ownership in, and general activities of, residents of a Contracting State. As illustrated by the example in the next paragraph, these rules do not imply that a transaction or arrangement entered into by such a resident cannot constitute an improper use of a treaty provision
> 173. ... Assume, for instance, that a public company whose shares are regularly traded on a recognised stock exchange in the Contracting State of which the company is a resident derives income from the other Contracting State. As long as that company is a "qualified person" as defined in paragraph 2, it is clear that the benefits of the Convention should not be denied solely on the basis of the ownership structure of that company, e.g. because a majority of the shareholders in that company are not residents of the same State. The object and purpose of subparagraph c) of paragraph 2 is to establish a threshold for the treaty entitlement of public companies whose shares are held by residents of different States. The fact that such a company is a qualified person does not mean, however, that benefits could not be denied under paragraph 9 for reasons that are unrelated to the ownership of the shares of that company. Assume, for instance, that such a public company is a bank that enters into a conduit financing arrangement intended to provide indirectly to a resident of a third State the benefit of lower source taxation under a tax treaty. In that case, paragraph 9 would apply to deny that benefit because

[38] See 110.1 (Limitation on Benefits).

> subparagraph c) of paragraph 2, when read in the context of the rest of the Convention and, in particular, its preamble, cannot be considered as having the purpose, shared by the two Contracting States, of authorising treaty-shopping transactions entered into by public companies.

108.8.3 *"Benefit"*

OECD Commentary provides:

> The term "benefit" includes
> [1] all limitations (e.g. a tax reduction, exemption, deferral or refund) on taxation imposed on the State of source under Articles 6 through 22 of the Convention,
> [2] the relief from double taxation provided by Article 23, and
> [3] the protection afforded to residents and nationals of a Contracting State under Article 24 or any other similar limitations.
> ... When a tax convention includes other limitations (such as a tax sparing provision), the provisions of this Article also apply to that benefit.[39]

108.8.4 *Directly or indirectly*

OECD Commentary on art 29 provides:

> 176. The phrase [arrangement or transaction] "that resulted directly or indirectly in that benefit" is deliberately broad and is intended to include situations where the person who claims the application of the benefits under a tax treaty may do so with respect to a transaction that is not the one that was undertaken for one of the principal purposes of obtaining that treaty benefit. This is illustrated by the following example:

The example is the assignment of a debt to a treaty resident group company:

> TCo, a company resident of State T, has acquired all the shares and debts of SCo, a company resident of State S, that were previously held by SCo's parent company. These include a loan made to SCo at 4% interest payable on demand.
> State T does not have a tax convention with State S and, therefore, any interest paid by SCo to TCo is subject to a withholding tax on interest at a rate of 25% in accordance with the domestic law of State S.
> Under the State R-State S tax convention, however, there is no withholding tax on interest paid by a company resident of a Contracting State and beneficially owned by a company resident of the other State;

[39] Commentary on art 29, para 175.

> also, that treaty does not include provisions similar to paragraphs 1 to 6. TCo decides to transfer the loan to RCo, a subsidiary resident of State R, in exchange for three promissory notes payable on demand on which interest is payable at 3.9%.
>
> In this example, whilst RCo is claiming the benefits of the State R-State S treaty with respect to a loan that was entered into for valid commercial reasons, if the facts of the case show that one of the principal purposes of TCo in transferring its loan to RCo was for RCo to obtain the benefit of the State R-State S treaty, then the provision would apply to deny that benefit as that benefit would result indirectly from the transfer of the loan.

This is the same as the example considered in the context of the US DTA conduit arrangement rule; see 108.9.3 (Conduit: Interest WHT).

108.8.5 *"Arrangement"*

OECD Commentary on art 29 provides:

> 177. The terms "arrangement or transaction" should be interpreted broadly and include any agreement, understanding, scheme, transaction or series of transactions, whether or not they are legally enforceable.

One can detect UK influence in the drafting here.[40]

> In particular they include the creation, assignment, acquisition or transfer of the income itself, or of the property or right in respect of which the income accrues. These terms also encompass arrangements concerning the establishment, acquisition or maintenance of a person who derives the income, including the qualification of that person as a resident of one of the Contracting States, and include steps that persons may take themselves in order to establish residence. An example of an "arrangement" would be where steps are taken to ensure that meetings of the board of directors of a company are held in a different country in order to claim that the company has changed its residence. One transaction alone may result in a benefit, or it may operate in conjunction with a more elaborate series of transactions that together result in the benefit. In both cases the provisions of paragraph 9 [PPT] may apply.

108.8.6 *Principal purpose*

OECD Commentary on art 29 provides:

> 178. To determine whether or not one of the principal purposes of any

[40] See App 2.2.3 (Definitions of "arrangement").

> person concerned with an arrangement or transaction is to obtain benefits under the Convention, it is important to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it. What are the purposes of an arrangement or transaction is a question of fact which can only be answered by considering all circumstances surrounding the arrangement or event on a case by case basis. It is not necessary to find conclusive proof of the intent of a person concerned with an arrangement or transaction, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the principal purposes of the arrangement or transaction was to obtain the benefits of the tax convention. It should not be lightly assumed, however, that obtaining a benefit under a tax treaty was one of the principal purposes of an arrangement or transaction and merely reviewing the effects of an arrangement will not usually enable a conclusion to be drawn about its purposes. Where, however, an arrangement can only be reasonably explained by a benefit that arises under a treaty, it may be concluded that one of the principal purposes of that arrangement was to obtain the benefit...
> 180. The reference to "one of the principal purposes" in paragraph 7 means that obtaining the benefit under a tax convention need not be the sole or dominant purpose of a particular arrangement or transaction. It is sufficient that at least one of the principal purposes was to obtain the benefit.

There is an echo of *Brebner* here.[41]

> For example, a person may sell a property for various reasons, but if before the sale, that person becomes a resident of one of the Contracting States and one of the principal purposes for doing so is to obtain a benefit under a tax convention, paragraph 9 could apply notwithstanding the fact that there may also be other principal purposes for changing residence, such as facilitating the sale of the property or the re-investment of the proceeds of the alienation.

This is questionable.[42]

> 181. A purpose will not be a principal purpose when it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining the benefit was not a principal consideration and would not have justified entering into any arrangement or transaction that has, alone

[41] See 3.12 (Consequence and purpose).
[42] See 108.7 (OECD-concept abuse).

> or together with other transactions, resulted in the benefit. In particular, where an arrangement is inextricably linked to a core commercial activity, and its form has not been driven by considerations of obtaining a benefit, it is unlikely that its principal purpose will be considered to be to obtain that benefit. Where, however, an arrangement is entered into for the purpose of obtaining similar benefits under a number of treaties, it should not be considered that obtaining benefits under other treaties will prevent obtaining one benefit under one treaty from being considered a principal purpose for that arrangement. Assume, for example, that a taxpayer resident of State A enters into a conduit arrangement with a financial institution resident of State B in order for that financial institution to invest, for the ultimate benefit of that taxpayer, in bonds issued in a large number of States with which State B, but not State A, has tax treaties. If the facts and circumstances reveal that the arrangement has been entered into for the principal purpose of obtaining the benefits of these tax treaties, it should not be considered that obtaining a benefit under one specific treaty was not one of the principal purposes for that arrangement. Similarly, purposes related to the avoidance of domestic law should not be used to argue that obtaining a treaty benefit was merely accessory to such purposes.
>
> 182. The following examples illustrate the application of the paragraph (the examples included in paragraph 187 below should also be considered when determining whether and when the paragraph would apply in the case of conduit arrangements)

A set of examples now follow. They are lengthy, but we are spared the childish names and irrelevant details that characterise examples in HMRC domestic-law guidance.[43] In summary:

Example	**Facts**	**Abuse**
A, B	Assignment of dividends	Yes
C, D	Investment in treaty jurisdiction	No
E	Acquisition to meet 25% (non-portfolio) test	No
F	Acquisition of Co	No
G, H	Setting up management Co	No
I	Copyright licence arrangement	No
J	Fragmentation to avoid PE	Yes

108.8.7 *Dividend assigned to treaty-co*

Example A is the assignment of a right to a dividend:

[43] See App 1.9 (Technical Notes).

> TCo, a company resident of State T, owns shares of SCo, a company listed on the stock exchange of State S. State T does not have a tax convention with State S and, therefore, any dividend paid by SCo to TCo is subject to a withholding tax on dividends of 25% in accordance with the domestic law of State S. Under the State R-State S tax convention, however, there is no withholding tax on dividends paid by a company resident of a Contracting State and beneficially owned by a company resident of the other State.
> TCo enters into an agreement with RCo, an independent financial institution resident of State R, pursuant to which TCo assigns to RCo the right to the payment of dividends that have been declared but have not yet been paid by SCo.

OECD analysis is as follows:

> In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes for the arrangement under which TCo assigned the right to the payment of dividends to RCo was for RCo to obtain the benefit of the exemption from source taxation of dividends provided for by the State R-State S tax convention and it would be contrary to the object and purpose of the tax convention to grant the benefit of that exemption under this treaty-shopping arrangement.

Example B is the same, but the assignment is by way of a 3 year usufruct:

> SCo, a company resident of State S, is the subsidiary of TCo, a company resident of State T. State T does not have a tax convention with State S and, therefore, any dividend paid by SCo to TCo is subject to a withholding tax on dividends of 25% in accordance with the domestic law of State S. Under the State R-State S tax convention, however, the applicable rate of withholding tax on dividends paid by a company of State S to a resident of State R is 5%. TCo therefore enters into an agreement with RCo, a financial institution resident of State R and a qualified person under subparagraph 3 a) of this Article, pursuant to which RCo acquires the usufruct of newly issued non-voting preferred shares of SCo for a period of three years. TCo is the bare owner of these shares. The usufruct gives RCo the right to receive the dividends attached to these preferred shares. The amount paid by RCo to acquire the usufruct corresponds to the present value of the dividends to be paid on the preferred shares over the period of three years (discounted at the rate at which TCo could borrow from RCo).

OECD analysis is as follows:

> In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes for the arrangement under which RCo acquired the usufruct of the preferred shares issued by SCo was to obtain the benefit of the 5% limitation applicable to the source taxation of dividends provided for by the State R-State S tax convention and it would be contrary to the object and purpose of the tax convention to grant the benefit of that limitation under this treaty-shopping arrangement.

108.8.8 *Investment in treaty State*

Example C is choice of investment in a treaty-favoured jurisdiction:

> RCo, a company resident of State R, is in the business of producing electronic devices and its business is expanding rapidly. It is now considering establishing a manufacturing plant in a developing country in order to benefit from lower manufacturing costs. After a preliminary review, possible locations in three different countries are identified. All three countries provide similar economic and political environments. After considering the fact that State S is the only one of these countries with which State R has a tax convention, the decision is made to build the plant in that State.

OECD analysis is as follows:

> In this example, whilst the decision to invest in State S is taken in the light of the benefits provided by the State R-State S tax convention, it is clear (!) that the principal purposes for making that investment and building the plant are related to the expansion of RCo's business and the lower manufacturing costs of that country. In this example, it cannot reasonably be considered that one of the principal purposes for building the plant is to obtain treaty benefits.
> In addition, given that a general objective of tax conventions is to encourage cross-border investment, obtaining the benefits of the State R-State S convention for the investment in the plant built in State S is in accordance with the object and purpose of the provisions of that convention.

The second argument is more convincing than the first, though either would suffice.

Example D is the same but the investor is a collective investment scheme:

> RCo, a collective investment vehicle resident of State R, manages a diversified portfolio of investments in the international financial market. RCo currently holds 15% of its portfolio in shares of companies resident

> of State S, in respect of which it receives annual dividends. Under the tax convention between State R and State S, the withholding tax rate on dividends is reduced from 30% to 10%.
> RCo's investment decisions take into account the existence of tax benefits provided under State R's extensive tax convention network. A majority of investors in RCo are residents of State R, but a number of investors (the minority investors) are residents of States with which State S does not have a tax convention. Investors' decisions to invest in RCo are not driven by any particular investment made by RCo, and RCo's investment strategy is not driven by the tax position of its investors. RCo annually distributes almost all of its income to its investors and pays taxes in State R on income not distributed during the year.

OECD analysis is as follows:

> In making its decision to invest in shares of companies resident of State S, RCo considered the existence of a benefit under the State R-State S tax convention with respect to dividends, but this alone would not be sufficient to trigger the application of paragraph 9 [PPT]. The intent of tax treaties is to provide benefits to encourage cross-border investment and, therefore, to determine whether or not paragraph 9 applies to an investment, it is necessary to consider the context in which the investment was made. In this example, unless RCo's investment is part of an arrangement or relates to another transaction undertaken for a principal purpose of obtaining the benefit of the Convention, it would not be reasonable to deny the benefit of the State R-State S tax treaty to RCo.

108.8.9 *Shares acquired to meet 25% test*

Example E is a share acquisition to meet a 25% test:

> RCo is a company resident of State R and, for the last 5 years, has held 24% of the shares of company SCo, a resident of State S. Following the entry-into-force of a tax treaty between States R and S (Article 10 of which is identical to Article 10 of this Model), RCo decides to increase to 25% its ownership of the shares of SCo. The facts and circumstances reveal that the decision to acquire these additional shares has been made primarily in order to obtain the benefit of the lower rate of tax provided by Article 10(2)a) of the treaty.

OECD analysis is as follows:

> In that case, although one of the principal purposes for the transaction through which the additional shares are acquired is clearly to obtain the benefit of Article 10(2)a), paragraph 9 [PPT] would not apply because it

> may be established that granting that benefit in these circumstances would be in accordance with the object and purpose of Article 10(2) a). That subparagraph uses an arbitrary threshold of 25% for the purposes of determining which shareholders are entitled to the benefit of the lower rate of tax on dividends and it is consistent with this approach to grant the benefits of the subparagraph to a taxpayer who genuinely increases its participation in a company in order to satisfy this requirement.

Example F is a commercial acquisition:

> TCO is a publicly-traded company resident of State T. TCO's information technology business, which was developed in State T, has grown considerably over the last few years as a result of an aggressive merger and acquisition policy pursued by TCO's management. RCO, a company resident of State R (a State that has concluded many tax treaties providing for no or low source taxation of dividends and royalties), is the family-owned holding company of a group that is also active in the information technology sector. Almost all the shares of RCO are owned by residents of State R who are relatives of the entrepreneur who launched and developed the business of the RCO group. RCO's main assets are shares of subsidiaries located in neighbouring countries, including SCO, a company resident of State S, as well as patents developed in State R and licensed to these subsidiaries. TCO, which has long been interested in acquiring the business of the RCO group and its portfolio of patents, has made an offer to acquire all the shares of RCO.

OECD analysis is as follows:

> In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that the principal purposes for the acquisition of RCO are related to the expansion of the business of the TCO group and do not include the obtaining of benefits under the treaty between States R and S. The fact that RCO acts primarily as a holding company does not change that result. It might well be that, after the acquisition of the shares of RCO, TCO's management will consider the benefits of the tax treaty concluded between State R and State S before deciding to keep in RCO the shares of SCO and the patents licensed to SCO. This, however, would not be a purpose related to the relevant transaction, which is the acquisition of the shares of RCO.

108.8.10 *PPT: Treaty-shopping*

OECD Commentary provides:

> TCO, a company resident of State T, is a publicly-traded company

> resident of State T. It owns directly or indirectly a number of subsidiaries in different countries. Most of these companies carry on the business activities of the TCO group in local markets. In one region, TCO owns the shares of five such companies, each located in different neighbouring States. TCO is considering establishing a regional company for the purpose of providing group services to these companies, including management services such as accounting, legal advice and human resources; financing and treasury services such as managing currency risks and arranging hedging transactions, as well as some other non-financing related services. After a review of possible locations, TCO decides to establish the regional company, RCO, in State R. This decision is mainly driven by the skilled labour force, reliable legal system, business friendly environment, political stability, membership of a regional grouping, sophisticated banking industry and the comprehensive double taxation treaty network of State R, including its tax treaties with the five States in which TCO owns subsidiaries, which all provide low withholding tax rates.

OECD analysis is as follows:

> In this example, merely reviewing the effects of the treaties on future payments by the subsidiaries to the regional company would not enable a conclusion to be drawn about the purposes for the establishment of RCO by TCO. Assuming that the intra-group services to be provided by RCO, including the making of decisions necessary for the conduct of its business, constitute a real business through which RCO exercises substantive economic functions, using real assets and assuming real risks, and that business is carried on by RCO through its own personnel located in State R, it would not be reasonable to deny the benefits of the treaties concluded between State R and the five States where the subsidiaries operate unless other facts would indicate that RCO has been established for other tax purposes or unless RCO enters into specific transactions to which paragraph 7 [PPT] would otherwise apply (see also example F in paragraph 15 below with respect to the interest and other remuneration that RCO might derive from its group financing activities).
>
> TCO is a company resident of State T that is listed on the stock exchange of State T. It is the parent company of a multinational enterprise that conducts a variety of business activities globally (wholesaling, retailing, manufacturing, investment, finance, etc.). Issues related to transportation, time differences, limited availability of personnel fluent in foreign languages and the foreign location of business partners make it difficult for TCO to manage its foreign activities from State T. TCO therefore establishes RCO, a subsidiary resident of State R (a country where there

> are developed international trade and financial markets as well as an abundance of highly-qualified human resources), as a base for developing its foreign business activities. RCO carries on diverse business activities such as wholesaling, retailing, manufacturing, financing and domestic and international investment. RCO possesses the human and financial resources (in various areas such as legal, financial, accounting, taxation, risk management, auditing and internal control) that are necessary to perform these activities. It is clear that RCO's activities constitute the active conduct of a business in State R.
>
> As part of its activities, RCO also undertakes the development of new manufacturing facilities in State S. For that purpose, it contributes equity capital and makes loans to SCO, a subsidiary resident of State S that RCO established for the purposes of owning these facilities. RCO will receive dividends and interest from SCO.

OECD analysis is as follows:

> In this example, RCO has been established for business efficiency reasons and its financing of SCO through equity and loans is part of RCO's active conduct of a business in State R. Based on these facts and in the absence of other facts that would indicate that one of the principal purposes for the establishment of RCO or the financing of SCO was the obtaining of the benefits of the treaty between States R and S, paragraph 9 [PPT] would not apply to these transactions.

108.8.11 *Copyright licences*

OECD Commentary on art 29 provides:

> RCO, a company resident of State R, is one of a number of collective management organisations that grant licenses on behalf of neighbouring right and copyright holders for playing music in public or for broadcasting that music on radio, television or the internet. SCO, a company resident of State S, carries on similar activities in State S.
>
> Performers and copyright holders from various countries appoint RCO or SCO as their agent to grant licenses and to receive royalties with respect to the copyrights and neighbouring rights that they hold; RCO and SCO distribute to each right holder the amount of royalties that they receive on behalf of that holder minus a commission (in most cases, the amount distributed to each holder is relatively small).
>
> RCO has an agreement with SCO through which SCO grants licenses to users in State S and distributes royalties to RCO with respect to the rights that RCO manages; RCO does the same in State R with respect to the rights that SCO manages.

> SCO has agreed with the tax administration of State S that it will process the royalty withholding tax on the payments that it makes to RCO based on the applicable treaties between State S and the State of residence of each right holder represented by RCO based on information provided by RCO since these right holders are the beneficial owners of the royalties paid by SCO to RCO.

OECD analysis is as follows:

> In this example, it is clear that the arrangements between the right holders and RCO and SCO, and between SCO and RCO, have been put in place for the efficient management of the granting of licenses and collection of royalties with respect to a large number of small transactions. Whilst one of the purposes for entering into these arrangements may well be to ensure that withholding tax is collected at the correct treaty rate without the need for each individual right holder to apply for a refund on small payments, which would be cumbersome and expensive, it is clear that such purpose, which serves to promote the correct and efficient application of tax treaties, would be in accordance with the object and purpose of the relevant provisions of the applicable treaties.

108.8.12 *Fragmentation*

Example J is a division of a contract to avoid a PE:

> RCO is a company resident of State R. It has successfully submitted a bid for the construction of a power plant for SCO, an independent company resident of State S. That construction project is expected to last 22 months. During the negotiation of the contract, the project is divided into two different contracts, each lasting 11 months. The first contract is concluded with RCO and the second contract is concluded with SUBCO, a recently incorporated wholly-owned subsidiary of RCO resident of State R. At the request of SCO, which wanted to ensure that RCO would be contractually liable for the performance of the two contracts, the contractual arrangements are such that RCO is jointly and severally liable with SUBCO for the performance of SUBCO's contractual obligations under the SUBCO-SCO contract.

OECD analysis is as follows:

> In this example, in the absence of other facts and circumstances showing otherwise, it would be reasonable to conclude that one of the principal purposes for the conclusion of the separate contract under which SUBCO agreed to perform part of the construction project was for RCO and SUBCO to each obtain the benefit of the rule in paragraph 3 of Article 5

> of the State R-State S tax convention. Granting the benefit of that rule in these circumstances would be contrary to the object and purpose of that paragraph as the time limitation of that paragraph would otherwise be meaningless.

108.8.13 *EC principal purpose test*

The EC recommendation is slightly different:

> Where Member States, in tax treaties which they conclude among themselves or with third countries, include a principal purpose test based general anti-avoidance rule in application of the template provided for in the OECD Model Tax Convention, Member States are encouraged to insert in them the following modification:
>
> > "Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that it reflects a genuine economic activity or that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention."[44]

We will have to wait and see what effect this may have.

108.8.14 *IRD anti-abuse rule*

A different PPT is found in the Interest and Royalties Directive. Art 5 IRD provides:

> 1. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse.
> 2. Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive.

CFE say:

[44] C(2016) 271 Commission Recommendation of 28.1.2016 on the implementation of measures against tax treaty abuse *https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32016H0136*

9. Secondly, the Court addressed the question whether there is the need for a specific domestic or agreement based provision implementing the general anti-abuse reservation of Article 5 of the IRD, according to which the IRD "shall not preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse" and "Member States may, in the case of transactions for which the principal motive or one of the principal motives is tax evasion, tax avoidance or abuse, withdraw the benefits of this Directive or refuse to apply this Directive". The referring Danish court asked whether Danish domestic law or the beneficial ownership clauses in the applicable tax treaties were a sufficient implementation of Article 5 of the IRD. The Grand Chamber of the Court took a different approach: It discounted the implementation requirement seemingly established in *Kofoed*[45] (on which AG Kokott's Opinion relied in rejecting the idea that non-implemented anti-avoidance provisions of the company tax directives could be applied directly against taxpayers)[46] and instead focused on the "general legal principle that EU law cannot be relied on for abusive or fraudulent ends".[47] This general principle, according to the Court, has been established in the context of the fundamental freedoms,[48] in various fields of EU law,[49] and more specifically also in the area of customs (e.g., in *Emsland-Stärke*)[50] and VAT (e.g., in *Italmoda and Cussens*).[51] Applying that principle

[45] Footnote original: ECJ, 5 July 2007, C-321/05, *Hans Markus Kofoed v Skatteministeriet*, EU:C:2007:408, paras 41-42.

[46] Footnote original: See the Opinions of AG Kokott of 1 March 2018 in Cases C-115/16, *N Luxembourg* 1, EU:C:2018:143, paras 98-113, C-116/16, *T Danmark*, EU:C:2018:144, paras 94-109, C-117/16, *Y Denmark*, EU:C:2018:145, paras 94-109, C-118/16, *X Denmark*, EU:C:2018:146, paras 108-123, C-119/16, *C Danmark I*, EU:C:2018:147, paras 96-111, and C 299/16, *Z Denmark*, EU:C:2018:148, paras 98-113.

[47] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 95-122.

[48] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 96, referring, inter alia, to ECJ, 9 March 1999, C212/97, *Centros Ltd v Erhvervs- og Selskabsstyrelsen*, EU:C:1999:126, para. 24; ECJ, 21 February 2006, C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise*, EU:C:2006:121, para. 68; ECJ, 12 September 2006, C-196/04, Cadbury Schweppes, EU:C:2006:544, para. 35; ECJ, 22 November 2017, C-251/16, *Edward Cussens and Others v T. G. Brosman*, EU:C:2017:881, para. 27.

[49] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 100, mentioning case-law in fields such as the free movement of goods, the freedom to provide services, public service contracts, freedom of establishment, company law, social security, transport, social policy, restrictive measures and value added tax (VAT).

[50] Footnote original: See, e.g., ECJ, 27 October 1981, Case 250/80, *Anklagemyndigheden v Schumacher*, EU:C:1981:246, para. 16; ECJ, 3 March 1993, C-8/92, *General Milk Products GmbH v Hauptzollamt Hamburg-Jonas*, EU:C:1993:82, para. 21; ECJ, 14 December 2000, C-110/99, *Emsland-Stärke*

and its considerations in Cussens to the IRD, the Court stated that where a case is about the abuse of a Directive's provision, the general principle of EU law applies irrespective of any domestic implementation:

> "In the main proceedings, the rules that are claimed by SKAT to have been abused are the provisions of [the IRD], which was adopted in order to foster the development of a single market having the characteristics of a domestic market and provides for an exemption, in the source Member State, of interest paid to an associated company established in another Member State. As is apparent from the proposal for a directive referred to in paragraph 90 above, certain definitions set out in Directive 2003/49 are based on the definitions in Article 11 of the OECD 1996 Model Tax Convention. […] Whilst Article 5(1) of [the IRD] provides that the directive is not to preclude the application of domestic or agreement-based provisions required for the prevention of fraud or abuse, that provision cannot be interpreted as excluding the application of the general principle of EU law […] that abusive practices are prohibited. The transactions alleged by SKAT to constitute an abuse of rights fall within the scope of EU law […] and could prove incompatible with the objective pursued by that directive. […] Furthermore, whilst Article 5(2) of [the IRD] provides that Member States may, in the event of evasion, avoidance or abuse, withdraw the benefits of the directive or refuse to apply it, that provision likewise cannot be interpreted as excluding the application of the principle of EU law that abusive practices are prohibited, since the application of that principle is not — as the provisions of the directive are — subject to a requirement of transposition […]".[52]

Focusing on the objective of the IRD to eliminate double taxation of interest and royalties, the Court noted that it would not be consistent with such objectives "[t]o permit the setting up of financial arrangements whose sole aim is to benefit from the tax advantages resulting from the application" of the IRD and, on the contrary, "would undermine economic cohesion and the effective functioning of the internal market by distorting the conditions of competition".[53] This would also be the case if the transactions do not exclusively pursue such an aim, as it is sufficient for the general principle of prohibition of abusive practices in tax matters to apply "where the accrual of a tax advantage constitutes the essential aim of the transactions at issue".[54] Neither taking advantage of tax

GmbH v Hauptzollamt Hamburg-Jonas, EU:C:2000:695, para. 59.

[51] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 102, referring to ECJ, 18 December 2014, C-131/13, C-163/13 and C-164/13, *Staatssecretaris van Financiën v Schoenimport 'Italmoda' and Turbu.com BV and Turbu.com Mobile Phone's BV v Staatssecretaris van Financiën*, EU:C:2014:2455, and *Cussens* (C-251/16).

[52] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 103-105.

[53] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 106-107.

[54] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para 106, referring to ECJ, 21 February 2008, C-425/06, *Ministero*

competition between Member States nor a taxpayer's right to pursue the most favorable regime allows a taxpayer to "enjoy a right or advantage arising from EU law where the transaction at issue is purely artificial economically and is designed to circumvent the application of the legislation of the Member State concerned".[55] It is therefore "incumbent upon the national authorities and courts to refuse to grant entitlement to rights provided for by [the IRD] where they are invoked for fraudulent or abusive ends",[56] even in the absence of domestic or agreement-based anti-abuse provisions.[57] The Court moreover held that Kofoed must not be misunderstood to require implementing legislation,[58] specifically

> "since […] abusive or fraudulent acts cannot found a right provided for by EU law, the refusal of an advantage under a directive […] does not amount to imposing an obligation on the individual concerned under that directive, but is merely the consequence of the finding that the objective conditions required for obtaining the advantage sought, prescribed by the directive as regards that right, are met only formally […]".[59]

This, however, is not only an option for Member States, but, as the Court stated, an obligation: The general principle that abusive practices are prohibited forces national authorities and courts to refuse the advantage resulting from the IRD in such circumstances, even if there are no domestic or agreement-based provisions providing for such a refusal.[60]

10. Thirdly, without mentioning the recent landmark decisions on the concept of abuse in the PSD in *Eqiom*[61] and *Deister and Juhler*,[62] the Court *(a)* identified a number of

dell'Economia e delle Finanze v Part Service Srl, EU:C:2008:108, para. 45, and *Cussens* (C-251/16), para. 53.

[55] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 108-109, referring, inter alia, to *Cadbury Schweppes* (C-196/04), para. 51, ECJ, 7 November 2013, C-322/11, K, EU:C:2013:716, para. 61, and ECJ, 25 October 2017, C-106/16, *Polbud — Wykonawstwo*, EU:C:2017:804, paras 61 to 63.

[56] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 110.

[57] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 111.

[58] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 112-118.

[59] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 119.

[60] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 120 ("must … refuse").

[61] Footnote original: ECJ, 7 September 2017, C-6/16, *Eqiom SAS, formerly Holcim France SAS and Enka SA v Ministre des Finances et des Comptes publics*, EU:C:2017:641; see for a detailed discussion ECJ CFE Task Force, Opinion Statement ECJ-TF 2/2018 on the CJEU decision of 7 September 2017 in C-6/16, *Eqiom*, concerning the compatibility of the French anti-abuse rule regarding outbound dividends with the Parent-Subsidiary Directive and fundamental freedoms,

constituent elements of an abuse of rights and the relevant evidence,[63] *(b)* determined the effect of tax treaty benefits on the finding of abuse,[64] and *(c)* addressed the allocation of the burden of proof:[65]

a. As for the constituent elements of an abuse of rights, the Grand Chamber of the Court clarified that abuse consists of an objective and a subjective element, noting that “proof of an abusive practice requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the EU rules, the purpose of those rules has not been achieved and, second, a subjective element consisting in the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it”.[66] This requires an examination of the facts to “establish whether the constituent elements of an abusive practice are present, and in particular whether economic operators have carried out purely formal or artificial transactions devoid of any economic and commercial justification, with the essential aim of benefiting from an improper advantage”.[67] While this is the task of the domestic court (including to establish whether the indications of abuse are objective and consistent, and whether the applicants in the main proceedings have had the opportunity to adduce evidence to the contrary), the Grand Chamber went on to specify a number of indicia: ? The Court first noted that “[a] group of companies may be regarded as being an artificial arrangement where it is not set up for reasons that reflect economic reality, its structure is purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose of the applicable tax law. That is so inter alia where, on account of a conduit entity interposed in the structure of the group between the company that pays interest and the entity which is its beneficial owner, payment of the tax on the interest is avoided.”[68]

   - It is therefore an indication of the existence of an arrangement intended to obtain

ET 2018, 471 et seq.

[62] Footnote original: ECJ, 20 December 2017, C-504/16 and C-613/16, *Deister Holding AG and Juhler Holding A/S v Bundeszentralamt für Steuern*, EU:C:2017:1009.

[63] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 124-133.

[64] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 134-138.

[65] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 140-144.

[66] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 124, referring to *Emsland-Stärke* (C-110/99), paras 52 and 53, and ECJ, 12 March 2014, C-456/12, *O. v Minister voor Immigratie* EU:C:2014:135, para. 58.

[67] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 125.

[68] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 127.

improper entitlement to the exemption under the IRD "that all or almost all of the aforesaid interest is, very soon after its receipt, passed on by the company that has received it to entities which do not fulfil the conditions for the [IRD], either because those entities are not established in any Member State, or because they are not incorporated in one of the forms referred to in the annex to the directive, or because they are not subject to one of the taxes listed in Article 3(a)(iii) of the directive without being exempt, or because they do not have the status of associated company within the meaning of Article 3(b) of the directive."[69] This would be the case where the beneficial owners are entities resident for tax purposes outside the European Union.

- Likewise, "the artificiality of an arrangement is capable of being borne out by the fact that the relevant group of companies is structured in such a way that the company which receives the interest paid by the debtor company must itself pass that interest on to a third company which does not fulfil the conditions for the application of [the IRD], with the consequence that it makes only an insignificant taxable profit when it acts as a conduit company in order to enable the flow of funds from the debtor company to the entity which is the beneficial owner of the sums paid."[70] An entity's characteristic as a "conduit company" may be established where its "sole activity is the receipt of interest and its transmission to the beneficial owner or to other conduit companies".[71] The absence of actual economic activity must, "in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has".[72]
- Also, "indications of an artificial arrangement may also be constituted by the various contracts existing between the companies involved in the financial transactions at issue, giving rise to intragroup flows of funds which, as is mentioned in Article 4 of [the IRD], may have the aim of transferring profits from a profit-making commercial company to shareholding entities in order to avoid the tax burden or reduce it as much as possible. The way in which the transactions are financed, the valuation of the intermediary companies' equity and the conduit companies' inability to have economic use of the interest received may also be used as indications of such an arrangement."[73]
- In that connection the Court also indirectly addressed a question that the

[69] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 128.

[70] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 130.

[71] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 131.

[72] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 131.

[73] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 132.

domestic referring court raised with regard to the 2014 OECD Update on "beneficial ownership",[74] where the OECD clarified that an entity is not the beneficial owner of interest income where "that recipient's right to use and enjoy the interest is constrained by a contractual or legal obligation to pass on the payment received to another person", a conclusion that would normally derive from relevant legal documents "but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to another person".[75] Addressing that "in substance"-determination, the Court noted that the above indications "are capable of being constituted not only by a contractual or legal obligation of the company receiving interest to pass it on to a third party but also by the fact that, 'in substance' […] that company, without being bound by such a contractual or legal obligation, does not have the right to use and enjoy those sums."[76]

- Finally, the Court argued that "such indications may be reinforced by the simultaneity or closeness in time of, on the one hand, the entry into force of major new tax legislation, such as the Danish legislation at issue in the main proceedings, which some of the groups of companies strive to circumvent and, on the other hand, the setting up of complex financial transactions and the grant of intragroup loans".[77]

b. The second and third issue, i.e., the impact of a tax treaty and the burden of proof, are somewhat intermingled: AG Kokott had, inter alia, argued that an abuse within the meaning of Art 5 of the IRD would only exist where "interest disbursed directly" to the (third state) beneficial owner "would have been taxed accordingly in Denmark".[78] Such taxation would, however, be precluded under Danish law if, disregarding the conduit companies, "the actual interest recipient is also an undertaking registered in a different Member State or the interest recipient is resident in a State with which Denmark has concluded a DTC".[79] Consequently, "in order to determine whether a more favourable tax result is achieved as a result of the arrangement qualified as abusive", AG Kokott concluded "that a Member State that does not wish to recognise a company resident in a different Member State, to which the interest was paid, as the beneficial owner of the interest must in principal state

[74] Footnote original: See question (1)(f) in C-115/16, C-118/16 and C-119/16, respectively.

[75] Footnote original: Art. 11 no. 10.2 OECD MC Comm. 2017.

[76] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 132.

[77] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 133.

[78] Footnote original: See the Opinions of AG Kokott of 1 March 2018 in C-115/16 (*N Luxembourg 1*, EU:C:2018:143, para. 95), C-118/16 (*X Denmark*, EU:C:2018:146, para. 106), C-119/16 (*C Danmark I*, EU:C:2018:147, para. 93), and C 299/16 (*Z Denmark*, EU:C:2018:148, para. 95).

[79] Footnote original: *Id.*

whom it considered to be the beneficial owner in order to assume that abuse exists", but that "[i]n particular in cross-border cases, the taxable person may have an enhanced duty to assist".[80] The Court's Grand Chamber, however, arrived at a different conclusion: "The existence of such a convention cannot in itself rule out an abuse of rights"[81] and that "the existence of a double taxation convention is not, as such, capable of establishing that a payment was really made to recipients resident in the third State with which that convention has been concluded",[82] but that (if the "beneficial owner" is not in a third State)[83]

> "it remains possible, in a situation where the interest would have been exempt had it been paid directly to the company having its seat in a third State, that the aim of the group's structure is unconnected with any abuse of rights. In such a case, the group cannot be reproached for having chosen such a structure rather than direct payment of the interest to that company".[84]

c. As for the burden of proof, the Court referenced the obligation of a company to establish that it is the beneficial owner of the interest (Art 1(11), (12) and (13)(b) of the IRD) on the one hand and the obligation of the tax authorities, when refusing the exemption under Art 1(1) IRD based on abuse, to establish the existence of elements constituting an abuse practice while taking account of all the relevant factors, in particular the fact that the company to which the interest has been paid is not its beneficial owner on the other hand.[85] However, as the Court found in contrast to AG Kokott's Opinions,[86] the tax authority has no obligation to identify the entity or entities which it regards as being the beneficial owner or owners of the interest. In the words of the Court, it:

> "has the task not of identifying the beneficial owners of that interest but of

[80] Footnote original: See the Opinions of AG Kokott of 1 March 2018 in C-115/16 (*N Luxembourg 1*, EU:C:2018:143, para. 96), C-118/16 (*X Denmark*, EU:C:2018:146, para. 105), C-119/16 (*C Danmark I*, EU:C:2018:147, para. 96), and C 299/16 (*Z Denmark*, EU:C:2018:148, para. 96).

[81] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 135.

[82] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 136.

[83] Footnote original: The Court had also noted the different effects of the beneficial ownership requirement and the anti-abuse principle, as – irrespective of any finding of fraud or abuse – "beneficial owners" in third states are not beneficiaries of the IRD in the first place (see *N Luxembourg I* et al [C-115/16, C-118/16, C-119/16 and C-299/16], para. 138).

[84] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 137.

[85] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 140-142.

[86] Footnote original: See the Opinions of AG Kokott of 1 March 2018 in C-115/16 (*N Luxembourg 1*, EU:C:2018:143, para. 96), C-118/16 (*X Denmark*, EU:C:2018:146, para. 105), C-119/16 (*C Danmark I*, EU:C:2018:147, para. 94), and C 299/16 (*Z Denmark*, EU:C:2018:148, para. 96).

> establishing that the supposed beneficial owner is merely a conduit company through which an abuse of rights has been committed. Indeed, identification of that kind may prove impossible, in particular because the potential beneficial owners are unknown. Given the complexity of certain financial arrangements and the possibility that the intermediary companies involved in the arrangements are established outside the European Union, the national tax authority does not necessarily have information enabling it to identify those owners. That authority cannot be required to furnish evidence that would be impossible for it to provide. […] Furthermore, even if the potential beneficial owners are known, it is not necessarily established which of them are or will be the actual beneficial owners. Thus, where a company receiving interest has a parent company, which itself has a parent company, the tax authorities and courts of the source Member State are, in all probability, unable to determine which of those two parent companies is or will be the beneficial owner of the interest. Moreover, the allocation of that interest may have been decided upon after the tax authority's findings relating to the conduit company."[87] [88]

Clearly, treaty abuse is a subset of a wider set of issues relating to abuse of law.

108.9 USA DTA: Conduit arrangement

The USA/UK DTA adopts different anti-abuse methods:

(1) excluding conduit arrangements from relief[89]
(2) its own limitation on benefit rule[90]

OECD summarise:

> The United States has implemented LOB clauses in most of its agreements. It started to include anti-treaty-shopping measures in 1962, and since the seventies, LOB clauses (which initially targeted investment or holding companies) have appeared in agreements concluded by the United States. All of the United States' agreements are supplemented by its anti-conduit regulations.[91]

[87] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 143-144.

[88] CFE Opinion Statement ECJ-TF 2/2019 *https://taxadviserseurope.org/new_ahgency/wp-content/uploads/2019/06/ECJ-TF_2-2019_Beneficial-Ownership.pdf*

[89] The term is used in art 7 (Business Profits), art 10 (Dividends), art 11 (Interest), art 12 (Royalties), and art 22 (Other Income).

[90] See 110.1 (Limitation on benefits).

[91] Footnote original: See I.R.C. §7701(l), Treas. Reg. § 1.881-3, added to the Internal Revenue Code by section 13238 of the Omnibus Budget Reconciliation Act of 1993, P.L. 103-66. It allows the Internal Revenue Service to re-characterise any

> The 2016 US Model Convention contains an express statement that the tax treaty should not create opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third states).
> The United States expects to comply with the minimum standard through a detailed LOB which is not available through the MLI. Therefore, the United States did not sign the MLI and will implement the minimum standard bilaterally.[92]

The term "conduit arrangements" is defined in article 3(1)(n) USA/UK DTA:

> the term "conduit arrangement" means a transaction or series of transactions—
> (i) which is structured in such a way that
> [A] a resident of a Contracting State entitled to the benefits of this Convention receives an item of income arising in the other Contracting State but
> [B] that resident pays, directly or indirectly, all or substantially all of that income (at any time or in any form) to another person
> [1] who is not a resident of either Contracting State and
> [2] who, if it received that item of income direct from the other Contracting State, would not be entitled under a convention for the avoidance of double taxation between the state in which that other person is resident and the Contracting State in which the income arises, or otherwise, to benefits with respect to that item of income which are equivalent to, or more favourable than, those available under this Convention to a resident of a Contracting State; and
> (ii) which has as its main purpose, or one of its main purposes, obtaining such increased benefits as are available under this Convention.

multiple-party financing transaction as being a transaction directly among any two or more of its parties whenever appropriate to prevent the avoidance of the United States' tax.

[92] OECD "OECD/G20 Base Erosion and Profit Shifting Project Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping" (2019) p.241 *https://www.oecd-ilibrary.org/docserver/9789264312388-en.pdf?expires=1550998970&id=id&accname=guest&checksum=0714C894B29FF51D6F78DD798D16F034*

Although not treaty usage, I write Conduit Arrangement with initial capitals, to reflect the technical nature of this definition.

The US Treasury Technical Explanation of the Convention[93] provides:

> The term is not used in the OECD or U.S. Model, but is included here at the request of the UK in order to ensure that each of the Contracting States can prevent residents of third countries from improperly obtaining the benefits of the Convention. For the UK, these transaction-based anti-abuse rules are a necessary supplement to the entity-based anti-treaty shopping rules in Article 23 (Limitation on Benefits). On the other hand, U.S. domestic law provides specific anti-conduit rules ... as well as a number of other domestic anti-abuse principles (such as the business purpose doctrine) that apply in the treaty context.

An exchange of letters provides:

> With respect to the United States, we intend to interpret the conduit arrangement provisions of the Convention in accordance with U.S. domestic law as it may evolve over time. The relevant law currently includes in particular the rules of regulation section 1.881-3 and other regulations adopted under the authority of section 770 l(1) of the Internal Revenue Code. Therefore, the inclusion of the conduit arrangement rules in the Convention does not constitute an expansion (or contraction) of U.S. domestic anti-abuse principles (except with respect to the application of anti-conduit principles to the insurance excise tax).
>
> We understand that the UK does not have domestic law provisions relating to conduit transactions. It has, however, entered into a number of treaties which include provisions aimed at dealing with conduit-type arrangements. We understand that the UK will, subject to the limitations in Article 3(l)(n), interpret the provisions in the proposed convention in a manner consistent with its practice under those other treaties.
>
> In practice, of course, such general principles and practice will be applied to particular fact patterns in determining whether the anti-conduit provisions will apply. In order to further develop our mutual understanding of how we each propose to apply the language, I have set out below a number of examples together with the U.S. view regarding whether benefits would be denied in each case.

HMRC consider the same examples from a UK perspective: It is helpful to read the examples side by side, followed by the US/HMRC analyses. There are 6 examples:

[93] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

No	Topic
1	Dividend withholding tax
2	Simple inter-group dividend
3	Conduit arrangement: Interest WHT
4	Simple US/UK bank loan
5	"Normal" inter-group royalty
6	"Normal" inter-group finance

108.9.1 *Dividend withholding tax*

US example 1

UKCo, a publicly traded company organized in the UK, owns all of the outstanding stock of USCo. XCo, a company organized in a country that does not have a tax treaty with the US, would like to purchase a minority interest in USCo, but believes that the 30% U.S. domestic withholding tax on dividends would make the investment uneconomic.

UKCo proposes that

[1] USCo instead issue preferred stock to UKCo, paying a fixed return of 4% plus a contingent return of 20% of USCo's net profits. The maturity of the preferred stock is 20 years.

[2] XCo will enter into a separate contract with UKCo pursuant to which it pays to UKCo an amount equal to the issue price of the preferred stock and will receive from UKCo after 20 years the redemption price of the stock. During the 20 years, UKCo will pay to XCo [a fixed return of] 3% plus 20% of USCo's net profits.

UK example 1

UsCo, a publicly traded company organised in the US, owns all of the outstanding stock of UKCo. XCo, a company organised in a country that does not have a tax treaty with the UK, would like to purchase a minority interest in UKCo.

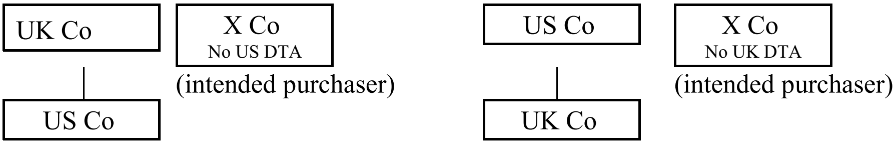
USCo proposes that

[1] UKCo issue preferred stock to USCo, paying a fixed return of 4% plus a contingent return of 20% of UKCo's net profits.

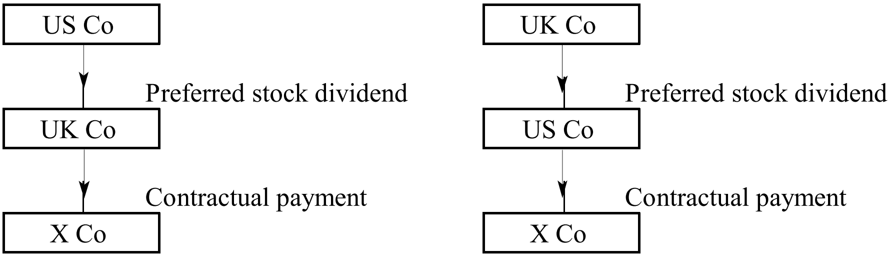
The maturity of the preferred stock is 20 years.

[2] XCo will enter into a separate contract with USCo pursuant to which it pays to USCo an amount equal to the issue price of the preferred stock and will receive from USCo after 20 years the redemption price of the stock. During the 20 years, USCo will pay to XCo 3 % [of the preferred stock subscription price] plus 20% of UKCo's net profits.

Share structure:


UK Co
US Co
X Co
No US DTA
(intended purchaser)
US Co
UK Co
X Co
No UK DTA
(intended purchaser)

Income flow:


US Co
Preferred stock dividend
UK Co
Contractual payment
X Co
UK Co
Preferred stock dividend
US Co
Contractual payment
X Co

The US analysis is as follows:

> This arrangement constitutes a conduit arrangement because UKCo participated in the transaction in order to achieve a reduction in U.S. withholding tax for XCo.

The HMRC analysis is as follows:

> The UK considers this arrangement would meet the objective definition of a conduit arrangement at Article 3(l)(n)(i) but because the UK has no withholding tax on dividends the motive test at Article 3(l)(n)(ii) would not be met because no increased treaty benefit would be obtained by the routing through the U.S. Therefore the arrangement would not constitute a conduit arrangement as defined by the treaty.

108.9.2 *Simple inter-group dividend*

US example 2

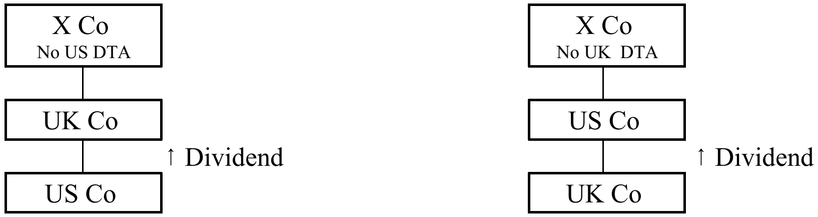
USCo has issued only one class of stock, common stock that is 100% owned by UKCo, a company organized in the UK. UKCo also has only one class of common stock outstanding, all of which is owned by XCo, a company organized in a country that does not have a tax treaty with the US. UKCo is engaged

UK example

UKCo has issued only one class of stock, common stock that is 100% owned by USCo, a company organized in the US. USCo also has only one class of common stock outstanding, all of which is owned by XCo, a company organized in a country that does not have a tax treaty with the UK. USCo is engaged in the manufacture of in the manufacture of electronics products, and USCo serves as UKCo's exclusive distributor in the US. Under paragraph 4 of Article 23 (Limitation on Benefits), UKCo will be entitled to benefits with respect to dividends received from USCo, even though UKCo is owned by a resident of a third country.

electronics products, and UKCo serves as USCo's exclusive distributor in the UK. Under paragraph 4 of Article 23 (Limitation on Benefits), USCo will be entitled to benefits with respect to dividends received from UKCo, even though USCo is owned by a resident of a third country.

Share structure:



The US analysis is as follows:

> Because the common stock owned by UKCo and XCo does not represent a "financing transaction" within the meaning of regulation section 1.881-3 as currently in effect, on these facts, this will not constitute a conduit arrangement.

The HMRC analysis is as follows:

> This seems to be a perfectly acceptable and normal commercial structure with real economic activity in both the U.S. and the UK The payment of dividends by subsidiary companies is a normal feature of commercial life. Accordingly, in the absence of evidence that dividends were flowed through to XCo, these transactions would not constitute a conduit arrangement.

This is straightforward.

108.9.3 *Conduit: Interest WHT*

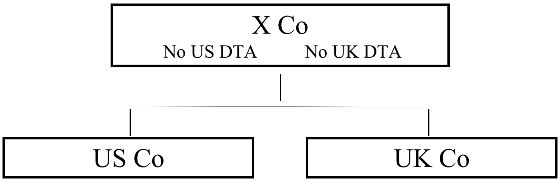
US example 3
XCo, a company organized in a country that does not have a tax treaty with the US, loans $1,000,000 to USCo, its wholly-owned U.S. subsidiary in

UK example 3
XCo, a company organized in a country that does not have a tax treaty with the UK, loans $1,000,000 to UKCo, its wholly-owned UK subsidiary in exchange for a note issued by UKCo.

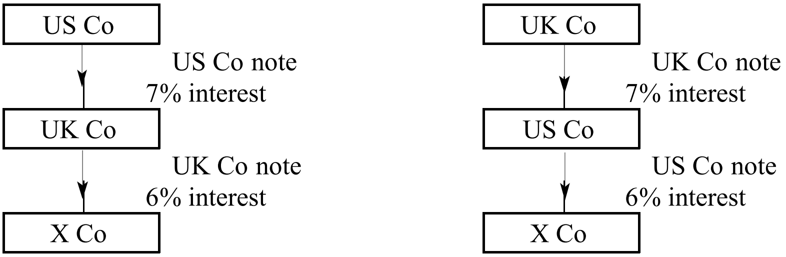
exchange for a note issued by USCo. XCo later realizes that it can avoid the U.S. withholding tax by assigning the note to its wholly-owned subsidiary, UKCo. Accordingly, XCo assigns the note to UKCo in exchange for a note issued by UKCo. The USCo note pays 7% and the UKCo note pays 6%.

XCo later realizes that it can avoid the UK withholding tax by assigning the note to its wholly-owned subsidiary, USCo. Accordingly, XCo assigns the note to USCo in exchange for a note issued by USCo. The UKCo note pays 7% and the USCo note pays 6%.

Diagrammatically:


X Co
No US DTA
No UK DTA
US Co
UK Co

Income flow:


US Co
US Co note
7% interest
UK Co
UK Co note
6% interest
X Co
UK Co
UK Co note
7% interest
US Co
US Co note
6% interest
X Co

This is a classic conduit arrangement, not just one within the DTA definition. This is the same as the example considered in the context of the PPT test; see 108.8.4 (Directly or indirectly).

It therefore also raises the question whether beneficial ownership requirement of DTA interest relief is met.[94] But because of the Conduit Arrangement provision, it is not necessary for the Revenue authorities to rely on that point.

The example does not consider the taxation of the 6% interest paid to X

[94] See 108.10 (DTA beneficial owner rule).

Co but no doubt it is assumed some relief applies.

The US analysis is as follows:

> The transaction constitutes a conduit arrangement because it was structured to eliminate the U.S. withholding tax that XCo otherwise would have paid.

The HMRC analysis is the same:

> The loan note was assigned to avoid UK income tax on the payment of interest. The transaction constitutes a conduit arrangement as defined in the treaty as both the objective definition and the motive test at Article 3(l)(n)(i) and (ii) respectively are met.

108.9.4 *Simple USA/UK bank loan*

US example 4

XCo, a company organized in Country X, which does not have a tax treaty with the US, owns all of the stock of USCo, a company resident in the US. XCo has for a long time done all of its banking with UKCo, a company organized in the UK, because the banking system in Country X is relatively unsophisticated. As a result, XCo tends to maintain a large deposit with UKCo. UKCo is unrelated to XCo and USCo.

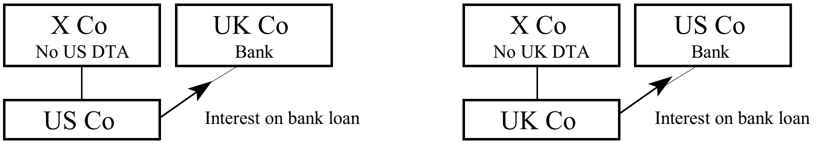
When USCo needs a loan to fund an acquisition, XCo suggests that USCo deal with UKCo, which is already familiar with the business conducted by XCo and USCo. USCo discusses the loan with several different banks, all on terms similar to those offered by UKCo, but eventually enters into the loan with UKCo, in part because interest paid to UKCo would not be subject to U.S. withholding tax, while interest paid to banks organized in Country X would be.

UK example 4

XCo, a company organized in Country X, which does not have a tax treaty with the UK, owns all of the stock of UKCo, a company resident in the UK. XCo has for a long time done all of its banking with USCo, a company organized in the US, because the banking system in Country X is relatively unsophisticated. As a result, XCo tends to maintain a large deposit with USCo. USCo is unrelated to XCo and UKCo.

When UKCo needs a loan to fund an acquisition, XCo suggests that UKCo deal with USCo, which is already familiar with the business conducted by XCo and UKCo. UKCo discusses the loan with several different banks, all on terms similar to those offered by USCo, but eventually enters into the loan with USCo, in part because interest paid to USCo would not be subject to UK withholding tax, while interest paid to banks organized in Country X would be.

Company/income flow diagram:



The US analysis is as follows:

> The US will consider the fact that UKCo is unrelated to USCo and XCo in determining whether there is a conduit arrangement. Accordingly, this will be treated as a conduit arrangement only if UKCo would not have entered into the transaction on substantially the same terms in the absence of the XCo deposit. Under these facts, there is no conduit arrangement.

The HMRC analysis is as follows:

> The fact that UK/US treaty benefits are available if UKCo borrows from USCo, and that similar benefits might not be available if it borrowed elsewhere, is clearly a factor in UKCo's decision (which may be influenced by advice given to it by its 100% shareholder). It may even be a decisive factor, in the sense that, all else being equal, the availability of treaty benefits may swing the balance in favour of borrowing from USCo rather than from another lender. However, whether the obtaining of treaty benefits was "the main purpose or one of the main purposes" of the transaction would have to be determined by reference to the particular facts and circumstances.
>
> Similarly, for the anti-conduit provision to apply it would have to be established that the interest paid by UKCo was "flowing through" USCo to XCo. The fact that XCo has historically maintained large deposits with USCo might, if anything, be a counter-indication. Against that, there is the question why a cash-rich company would want to increase its overall debt exposure in this way. XCo could redirect its balance with USCo and lend it to UKCo in which case it would face UK withholding tax. It chooses not to, so there is a possible argument that the transactions were structured to avoid UK withholding tax by obtaining benefits under the treaty.
>
> On the specific facts as presented, the transactions would not constitute a conduit arrangement as defined by the treaty.
>
> However, if USCo's decision to lend to UKCo was dependent on XCo providing a matching collateral deposit to secure the loan, the indication

would be that XCo was in substance lending to UKCo direct but in form routing the loan through a bank with whom it has a close relationship in order to obtain the benefit of the treaty. In such circumstances the transactions would constitute a conduit arrangement as defined by the treaty.

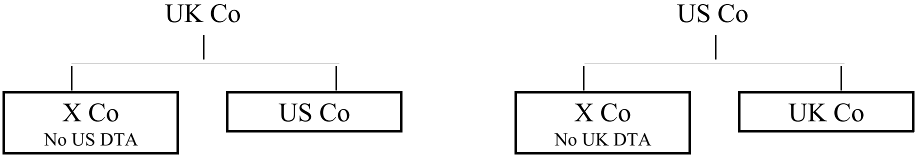
It would be surprising if an arrangement as simple as a single bank loan were caught.

108.9.5 *"Normal" inter-group royalty*

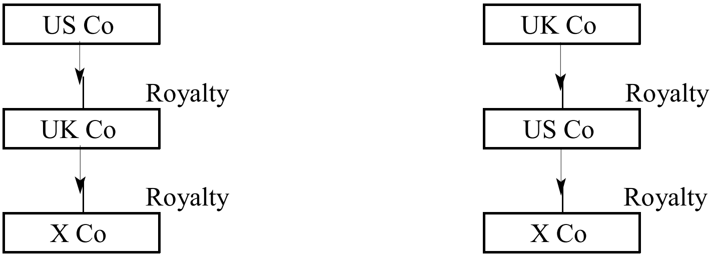
US example 5
UKCo, a publicly-traded company organized in the UK, is the holding company for a manufacturing group in a highly competitive technological field. The manufacturing group conducts research in subsidiaries located around the world. Any patents developed in a subsidiary are licensed by the subsidiary to UKCo, which then licenses the technology to its subsidiaries that need it. UKCo keeps only a small spread with respect to the royalties it receives, so that most of the profit goes to the subsidiary that incurred the risk with respect to developing the technology. XCo, a company located in a country with which the US does not have a tax treaty, has developed a process that will substantially increase the profitability of all of UKCo's subsidiaries, including USCo, a company organized in the US. According to its usual practice, UKCo licenses the technology and sub-licenses the technology to its subsidiaries. USCo pays a royalty to UKCo, substantially all of which is paid to XCo.

UK example 5
USCo, a publicly-traded company organized in the US, is the holding company for a manufacturing group in a highly competitive technological field. The manufacturing group conducts research in subsidiaries located around the world. Any patents developed in a subsidiary are licensed by the subsidiary to USCo, which then licenses the technology to its subsidiaries that need it. USCo keeps only a small spread with respect to the royalties it receives, so that most of the profit goes to the subsidiary that incurred the risk with respect to developing the technology. XCo, a company located in a country with which the UK does not have a tax treaty, has developed a process that will substantially increase the profitability of all of USCo's subsidiaries, including UKCo, a company organized in the UK. According to its usual practice, USCo licenses the technology and sub-licenses the technology to its subsidiaries. UKCo pays a royalty to USCo, substantially all of which is paid to XCo.

Company structure:



Income flow:



The US analysis is as follows:

> Because UKCo entered into these transactions in the ordinary course of its business, and there is no indication that it established its licensing business in order to reduce its U.S. withholding tax, the arrangements among USCo, UKCo and XCo do not constitute a conduit arrangement.

The HMRC analysis is as follows:

> Because XCo is conforming to the standard commercial organisation and behaviour of the group in the way that it structures its licensing and sub-licensing activities and assuming the same structure is employed with respect to other subsidiaries carrying out similar activities in countries which have treaties which offer similar or more favourable benefits, the inference would be that the absence of a treaty between country X and the UK is not influencing the motive for the transactions described.
>
> Therefore even though the specific fact pattern, as presented, meets the first part of the definition of a "conduit arrangement" at Article 3(l)(n)(i), on balance the conclusion would be that "the main purpose or one of the main purposes" of the transactions was not the obtaining of UK/US treaty benefits. So the structure would not constitute a conduit arrangement.

108.9.6 *"Normal" inter-group finance*

US example 6

XCo is a publicly traded company resident in Country X, which does not have a tax treaty with the US. XCo is the parent of a worldwide group of companies, including UKCo, a company resident in the UK, and USCo, a company resident in the US. USCo is engaged in the active conduct of a trade or business in the US. UKCo is responsible for coordinating the financing of all of the subsidiaries of XCo. UKCo maintains a centralized cash management accounting system for XCo and its subsidiaries in which it records all intercompany payables and receivables. UKCo is responsible for disbursing or receiving any cash payments required by transactions between its affiliates and unrelated parties. UKCo enters into interest rate and foreign exchange contracts as necessary to manage the risks arising from mismatches in incoming and outgoing cash flows. The activities of UKCo are intended (and reasonably can be expected) to reduce transaction costs and overhead and other fixed costs. UKCo has 50 employees, including clerical and other back office personnel, located in the UK.

XCo lends to UKCo DM 15 million (worth $10 million) in exchange for a 10-year note that pays interest annually at a rate of 5% per annum. On the same day, UKCo lends $10 million to USCo in exchange for a 10-year note that pays interest annually at a rate of 8% per annum.

UK example 6

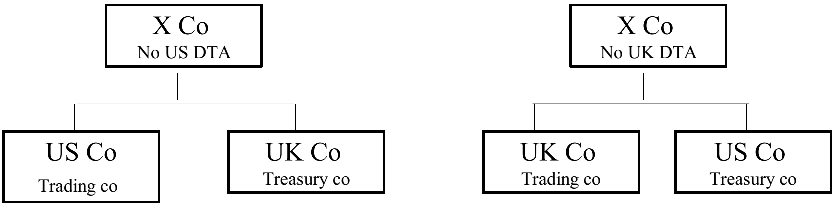
XCo is a publicly traded company resident in Country X, which does not have a tax treaty with the UK. XCo is the parent of a worldwide group of companies, including USCo, a company resident in the US, and UKCo, a company resident in the UK. UKCo is engaged in the active conduct of a trade or business in the UK. USCo is responsible for coordinating the financing of all of the subsidiaries of XCo. USCo maintains a centralized cash management accounting system for XCo and its subsidiaries in which it records all inter-company payables and receivables. USCo is responsible for disbursing or receiving any cash payments required by transactions between its affiliates and unrelated parties. USCo enters into interest rate and foreign exchange contracts as necessary to manage the risks arising from mismatches in incoming and outgoing cash flows. The activities of USCo are intended (and reasonably can be expected) to reduce transaction costs and overhead and other fixed costs. USCo has 50 employees, including clerical and other back office personnel, located in the US.

XCo lends to USCo DM 15million (worth $10 million) in exchange for a 10-year note that pays interest annually at a rate of 5% per annum. On the same day, USCo lends $10 million to UKCo in exchange for a 10-year note that pays interest

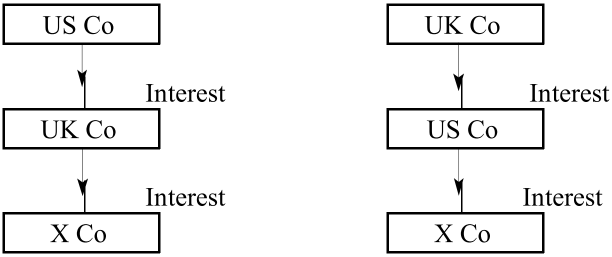
UKCo does not enter into a long-term hedging transaction with respect to these financing transactions, but manages the interest rate and currency risk arising from the transactions on a daily, weekly or quarterly basis by entering into forward currency contracts.

annually at a rate of 8% per annum. USCo does not enter into a long-term hedging transaction with respect to these financing transactions, but manages the interest rate and currency risk arising from the transactions on a daily, weekly or quarterly basis by entering into forward currency contracts.

Company structure:


X Co
No US DTA
US Co
Trading co
UK Co
Treasury co
X Co
No UK DTA
UK Co
Trading co
US Co
Treasury co

Income flow structure:


US Co
Interest
UK Co
Interest
X Co
UK Co
Interest
US Co
Interest
X Co

The US analysis is as follows:

> Because UKCo performs significant activities with respect to the transactions between USCo and XCo, the participation of UKCo is presumed not to have as one of its main purposes the avoidance of U.S. withholding tax. Accordingly, based upon the foregoing facts, the loan from XCo to UKCo and the loan from UKCo to USCo do not constitute a conduit arrangement under the Convention.

The HMRC analysis is as follows:

> UKCo appears to be a real business performing substantive economic functions, using real assets and assuming real risks. USCo appears to be bearing the interest rate and currency risk. It is assumed that the

transactions are typical of USCo's normal treasury business and that that business was carried on in a commercial manner.
So, on the specific facts presented, the transactions would not constitute a conduit arrangement as defined by the treaty.

108.10 DTA beneficial owner rule

108.10.1 *Beneficial-owner reliefs*

Beneficial ownership is a requirement of DT relief in 3 OECD Model articles:

Article	**Topic**	**See para**	**OECD Commentary**
10	Dividends	30.15	Commentary on art 10, para 12
11	Interest	26.27	Commentary on art 11, para 9
12	Royalties	32.16	Commentary on art 12, para 4

I refer to these as the three **"beneficial-owner reliefs"**.

Beneficial ownership has various meanings[95] and I refer to the meaning here as "DTA beneficial ownership".

This concept of "beneficial owner" was introduced in 1977.

The Commentary material is repeated three times, in the Commentary on arts 10/11/12 (Dividends/Interest/Royalties). So it is sufficient to consider the Commentary on one article; I consider article 11.[96] This repetition tends to make discussion more difficult, but there it is.

108.10.2 *Beneficial owner: References*

DTA beneficial ownership in the following contexts is considered elsewhere:

Context	**See para**
Settlor-interested trusts	47.18.3
Fictional income	50.61.2
Hybrids	91.6.2

For further reading, see:

Wheeler, The Missing Keystone of Income Tax Treaties (2012) para 2.4.3 (Beneficial ownership)

[95] See App.6.1 (Beneficial ownership: Meanings).

[96] I select art 11 because in a UK private client context, the issues perhaps arise most often in relation to interest; though it does not matter.

OECD, “Report of the Informal Consultative Group on the Taxation of Collective Investment Vehicles” (2009) Annex 1: Background Regarding the Meaning of “Beneficial Owner” in Tax Treaties[97]
Avery Jones et al, “The Origins of Concepts and Expressions used in OECD Model” [2006] BTR 695 at p.747
JBD Oliver et al, “Beneficial Ownership and OECD Model” [2001] BTR 27

108.10.3 *Beneficial owner: Commentary*

DTA beneficial ownership is not defined, but it is discussed in the OECD Commentary. The Commentary is not lengthy, but it is of course important:

> The requirement of beneficial owner was introduced in [art 11(2)] to clarify the meaning of the words “paid to a resident” as they are used in [art 11(1)]. It makes plain that the State of source is not obliged to give up taxing rights over interest income merely because that income was paid direct to a resident of a State with which the State of source had concluded a convention.[98]

The word “clarify” would allow an argument that:

(1) Pre-1977 treaties, which do not refer to beneficial ownership, should be construed in the same way.
(2) Other articles of the OECD model, which do not refer to beneficial ownership, should be construed in the same way.[99]

But given the other DTA anti-abuse rules now applicable, the issue may not arise.

108.10.4 *DTA meaning: General*

OECD Commentary on art 11 provides:

> 9.1 Since the term “beneficial owner” was added to address potential difficulties arising from the use of the words “paid to a resident” in [art 11] paragraph 1, it was intended to be interpreted in this context and not to refer to any technical meaning that it could have had under the domestic law of a specific country (in fact, when it was added to the paragraph, the term did not have a precise meaning in the law of many countries). The term “beneficial owner” is therefore not used in a narrow

[97] *http://www.oecd.org/dataoecd/34/26/41974553.pdf*
[98] OECD Commentary on art 11, para 9.
[99] But see App.1.2 (Clarify/modernise/reform).

> technical sense[100] (such as the meaning that it has under the trust law of many common law countries[101]), rather, it should be understood in its context, in particular in relation to the words "paid to a resident", and in light of the object and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance.

DTA beneficial ownership is distinct from (what I call) money-laundering beneficial ownership. OECD Commentary on art 11 discusses this:

> 10.4 The above explanations concerning the meaning of "beneficial owner" make it clear that the meaning given to this term in the context of [Article 11] must be distinguished from the different meaning that has been given to that term in the context of other instruments[102] that concern the determination of the persons (typically the individuals) that exercise ultimate control over entities or assets. That different meaning of "beneficial owner" cannot be applied in the context of the Convention. Indeed, that meaning, which refers to natural persons (i.e. individuals), cannot be reconciled with the express wording of subparagraph 2 a) of Article 10, which refers to the situation where a company is the beneficial owner of a dividend. In the context of Articles 10 and 11, the term "beneficial owner" is intended to address difficulties arising from the use of the words "paid to" in relation to dividends and interest rather than difficulties related to the ownership of the shares or debt-claims on

[100] Author's footnote: For "technical" as a term of abuse, see App 1.8 (Technical); for the 3 principal senses of beneficial ownership, see App 6.1 (Beneficial ownership: Meanings).

[101] Footnote original: For example, where the trustees of a discretionary trust do not distribute dividends earned during a given period, these trustees, acting in their capacity as such (or the trust, if recognised as a separate taxpayer), could constitute the beneficial owners of such income for the purposes of Article 11 even if they are not the beneficial owners under the relevant trust law.

[102] The Commentary gives 2 illustrations:
(1) A moneylaundering definition, from Financial Action Task Force, "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation – The FATF Recommendations" (2012), which defines beneficial owner (at p.110): "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement." This is standard in a moneylaundering context; see for example 131.15 (MLR beneficial ownership).
(2) OECD Steering Group on Corporate Governance, "Behind the Corporate Veil: Using Corporate Entities for Illicit Purposes" (2001), at p.14. I do not set out the definition here, as it does not take the discussion any further.

> which dividends or interest are paid. For that reason, it would be inappropriate, in the context of these Articles, to consider a meaning developed in order to refer to the individuals who exercise "ultimate effective control over a legal person or arrangement"

The INT Manual provides:

> **INTM332010 Double Taxation Claims And Applications: What Beneficial Ownership Is** [Jun 2016]
> Beneficial ownership can be defined as: 'the sole and unfettered right to use enjoy or dispose of' the asset or income in question.

This is not an accurate definition, though it may be a usable rule of thumb.

108.10.5 *Beneficial owner: agent/nominee*

OECD Commentary on art 11 provides:

> 10. Relief or exemption in respect of an item of income is granted by the State of source to a resident of the other Contracting State to avoid in whole or in part the double taxation that would otherwise arise from the concurrent taxation of that income by the State of residence. Where an item of income is paid to a resident of a Contracting State acting in the capacity of agent or nominee it would be inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption merely on account of the status of the direct recipient of the income as a resident of the other Contracting State. The direct recipient of the income in this situation qualifies as a resident but no potential double taxation arises as a consequence of that status since the recipient is not treated as the owner of the income for tax purposes in the State of residence.

That is not controversial; now comes the extended meaning to catch conduit companies:

108.10.6 *Beneficial owner: Conduit co*

OECD Commentary on art 11 provides:

> 10.1 It would be equally inconsistent with the object and purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies" concludes that a

> conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.
>
> 10.2 In these various examples (agent, nominee, conduit company acting as a fiduciary or administrator), the direct recipient of the interest is not the "beneficial owner" because that recipient's right to use and enjoy the interest is constrained by a contractual or legal obligation to pass on the payment received to another person.
>
> Such an obligation will normally derive from relevant legal documents but may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to another person. This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as
>
> [1] an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or
>
> [2] typical distribution obligations of pension schemes and of collective investment vehicles entitled to treaty benefits under the principles of paragraphs 22 to 48 of the Commentary on Article 1.
>
> Where the recipient of interest does have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to another person, the recipient is the "beneficial owner" of that interest. It should also be noted that Article 11 refers to the beneficial owner of interest as opposed to the owner of the debt-claim with respect to which the interest is paid, which may be different in some cases.

This passage was added to the OECD Commentary in 2003. But there is some tension if not inconsistency in saying:

(1) a company is not the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties; but

(2) This type of obligation would not include contractual or legal obligations that are not dependent on the receipt of the payment by the direct recipient such as

  (a) an obligation that is not dependent on the receipt of the payment and which the direct recipient has as a debtor or as a party to financial transactions, or

(b) typical distribution obligations of pension schemes and of collective investment vehicles

108.10.7 *Indofood*

In *Indofood*,[103] a company ("the Indonesian co") wished to borrow by issuing loan notes to investors ("noteholders") not resident in Indonesia. Had it done so itself, it would be obliged to deduct 20% withholding tax from (Indonesian-source) interest payable to the noteholders. So instead:

(1) A subsidiary in Mauritius ("the Mauritian SPV[104]") issued the loan notes.
(2) The Mauritian SPV lent the capital it raised to the Indonesian co.
(3) The Indonesian co paid (Indonesian-source) interest to the Mauritian SPV, but under the Indonesia/Mauritius DTA (which was so far as relevant in OECD Model form)[105] the rate of withholding tax on the interest was reduced to 10%.

This was a standard conduit arrangement. All went well until Indonesia decided to revoke the Mauritian DTA. In consequence the withholding tax on interest paid from the Indonesian co to the Mauritian SPV would increase to 20%.

The loan notes could be redeemed early if:

(1) There were a change in the law under which withholding tax on from interest payable from the Indonesian co to the Mauritian SPV exceeded 10%; and
(2) The withholding tax could not be avoided by taking "reasonable measures".

The noteholders[106] argued that the reasonable measure was an arrangement under which:

(1) The Mauritian SPV assigned the benefit of the debt to a new Netherlands company, ("the Dutch SPV"), in consideration of a new debt.

[103] *Indofood International Finance v JP Morgan Chase Bank* [2006] EWCA Civ 158.

[104] SPV is (as is often in this context) a euphemism for conduit company; but I use the more neutral term.

[105] See 26.27 (DT relief: Interest income).

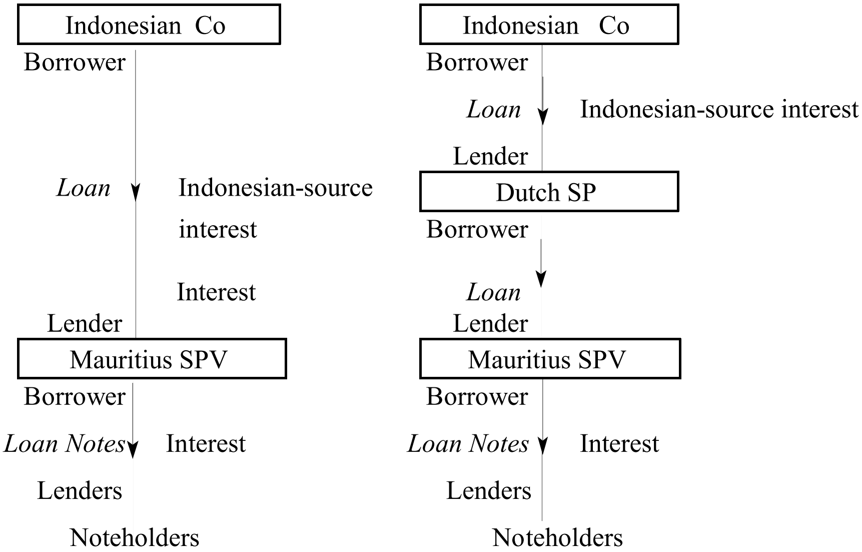
[106] For completeness: the noteholders were represented by JP Morgan as trustee, but nothing turns on that so I refer to the noteholders.

(2) The Indonesian company would pay interest to the Dutch SPV. The Netherlands/Indonesia DTA was also (so far as relevant) in OECD Model form, so the rate of withholding tax should remain 10%.
(3) The Dutch SPV would pay interest to the Mauritian SPV, which would then pay the noteholders.

In short, this was the same conduit arrangement as before, but using a group company in the Netherlands rather than Mauritius, as the conduit company.

Diagrammatically:

Original structure **Proposed structure**


Indonesian Co
Borrower
Loan
Indonesian-source
interest
Interest
Lender
Mauritius SPV
Borrower
Loan Notes
Interest
Lenders
Noteholders
Indonesian Co
Borrower
Loan
Indonesian-source interest
Lender
Dutch SP
Borrower
Loan
Lender
Mauritius SPV
Borrower
Loan Notes
Interest
Lenders
Noteholders

The question therefore arose whether the Dutch SPV would be the beneficial owner of the interest which the Indonesian co paid to it (ie whether the beneficial ownership requirement under the Netherlands/ Indonesia DTA was met. The CoA read the OECD Commentary and concluded that the beneficial ownership requirement would not be met:

> The fact that neither the Issuer [Mauritian SPV] nor Newco [the Dutch SPV] was or would be a trustee, agent or nominee for the noteholders or anyone else in relation to the interest receivable from the Parent Guarantor [the Indonesian co] is by no means conclusive. Nor is the absence of any entitlement of a noteholder to security over or right to call for the interest receivable from the Parent Guarantor. ... the term

> "beneficial owner" is to be given an international fiscal meaning not derived from the domestic laws of contracting states. As shown by those commentaries and observations, the concept of beneficial ownership is incompatible with that of the formal owner who does not have "the full privilege to directly benefit from the income"...

Turning to the facts:

> The legal, commercial and practical structure behind the loan notes is inconsistent with the concept that the Issuer or, if interposed, Newco could enjoy any such privilege. In accordance with the legal structure the Parent Guarantor is obliged to pay the interest two business days before the due date to the credit of an account nominated for the purpose by the Issuer. The Issuer is obliged to pay the interest due to the noteholders one business day before the due date to the account specified by the Principal Paying Agent. The Principal Paying Agent is bound to pay the noteholders on the due date. It is hard to see how Newco could be interposed in that chain without some change to the Loan Agreement, but, be that as it may, the Issuer is bound to pay on to the Principal Paying Agent that which it received from the Parent Guarantor because it is precluded from finding the money from any other source by the Note Conditions ...

Applying the law to these facts:

> But the meaning to be given to the phrase "beneficial owner" is plainly not to be limited by so technical and legal an approach. Regard is to be had to the substance of the matter. In both commercial and practical terms the Issuer is, and Newco would be, bound to pay on to the Principal Paying Agent that which it receives from the Parent Guarantor. ... In practical terms it is impossible to conceive of any circumstances in which either the Issuer or Newco could derive any 'direct benefit' from the interest payable by the Parent Guarantor except by funding its liability to the Principal Paying Agent or Issuer respectively. Such an exception can hardly be described as the 'full privilege' needed to qualify as the beneficial owner, rather the position of the Issuer and Newco equates to that of an "administrator of the income".

This was consistent with the purpose of a DTA:

> Such a conclusion appears to me to be consistent with the evident purpose and object of the Mauritian DTA and the Dutch DTA. Their primary purpose is apparent from their respective titles. Accepting that the Dutch DTA also had as its object the encouragement of long term foreign loans, hence the inclusion of Article 11.4, none of such purposes

> is furthered by affording tax relief to the Parent Guarantor because it has a Mauritian or Dutch Subsidiary when such relief would not have been afforded to the Parent Guarantor had the loan been made direct to it.[107]

It followed that the *original* structure should also not have worked: the Mauritian SPV was also not beneficial owner of the Indonesia-source interest. But there it is. The practice of the Indonesian Revenue had changed by the time the use of the Dutch SPV was proposed. No doubt at some point HMRC's own practice changed in the same way.

Would outcome have been different if the noteholders had offered to guarantee the Indonesian co's costs of trying out the proposed arrangement? It should have been easier to argue that was a reasonable measure, if it did not cost the Indonesian company anything. And how should loan note documentation be drafted if it is desired to address this issue in the light of *Indofood*? Discuss.

HMRC naturally approve of the *Indofood* decision. The INT Manual provides:

> **INTM332050 HMRC Reaction To Indofood Case** [Jun 2018]
> 1 As can be seen from the above, the Court did not interpret the various DTAs in the light of Indonesian law but adopted an interpretation consistent with OECD interpretations. Following legal advice, HMRC's view is that the "beneficial ownership" decision, as far as it relates to Double Taxation Conventions (DTCs), is now part of UK law.

More analytically, the decision is one of fact, not law (namely, how would Indonesian Court decide the matter?); so it is persuasive rather than binding in the UK. However the UK courts can be expected to follow this, so the matter is settled below the level of the Supreme Court.

> The decision is also likely to be of persuasive force where related issues for UK DTCs are being considered and that, where it is relevant, HMRC is obliged to follow it. Since the Court of Appeal decision is fully consistent with the UK's existing policy HMRC does not think that, in general, the case will have a significant impact on its current practice.

HMRC summarise the decision thus:

> 2 The key point is that, in Indofood, the Court of Appeal has simply confirmed that, in line with the OECD Commentary, beneficial ownership "should be understood in its context and in light of the object

[107] *Indofood* para [42] - [45].

> and purposes of the Convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance" and that tests of the legal structure, and of the commercial and practical substance of the scheme, should be adopted to determine beneficial ownership. The Court of Appeal decision is consistent with HMRC's view of all DTC articles referring to beneficial ownership. This covers the Articles on interest, royalties and if appropriate dividends. The comments made in this guidance regarding interest will also apply to royalty and dividend payments.
> 3 It is HMRC policy that, where there is treaty abuse (such as, say, "treaty shopping"), interpreting "beneficial ownership" in what the Court of Appeal called its "narrow technical" UK domestic law meaning would not give effect to the purpose and object of the DTC of preventing fiscal evasion, indeed it would be contrary to the object of the DTC to allow such treaty abuse. On the other hand, interpreting "beneficial ownership" in what the Court of Appeal called its "international fiscal meaning" clearly gives effect to the purpose and object of the DTC by excluding abusive cases such as "treaty shopping" from the benefits of a DTC.

108.10.8 *Beneficial ownership: EU law*

Art 1(1) Interest and Royalties Directive[108] provides:

> Interest or royalty payments arising in a Member State shall be exempt from any taxes imposed on those payments in that State ... provided that the beneficial owner of the interest or royalties is
> [a] a company of another Member State or
> [b] a permanent establishment situated in another Member State of a company of a Member State.

In this case (unlike the OECD Model) there is a definition of beneficial ownership. Article 1(4) IRD provides:

> A company of a Member State shall be treated as the beneficial owner of interest or royalties only if it receives those payments for its own benefit and not as an intermediary, such as an agent, trustee or authorised signatory, for some other person.

Perhaps this does not take us far.

CJEU compared the different language versions of the directive, which express the beneficial ownership condition in different ways, whose

[108] 2003/49/EC (3 June 2003).

English equivalents are given as:

- Beneficiary/recipient[109]
- Beneficial owner/actual beneficiary[110]
- Owner/person entitled to use[111]
- Person entitled in the end[112]

CJEU said:

> The use of those various expressions underscores that the term ‘beneficial owner’ concerns not a formally identified recipient but rather the entity which benefits economically from the interest received and accordingly has the power freely to determine the use to which it is put...

Apart from the Dutch version, perhaps, the reader may question that reasoning; but there it is.

> 90 ... the directive draws upon Article 11 of the OECD 1996 Model Tax Convention and pursues the same objective, namely avoiding international double taxation. The concept of ‘beneficial owner’, which appears in the bilateral conventions based on that model, and the successive amendments of that model and of the commentaries relating thereto are, therefore, relevant when interpreting Directive 2003/49.
> 92 It is clear from the development ... of the OECD Model Tax Convention and the commentaries relating thereto that the concept of ‘beneficial owner’ excludes conduit companies and must be understood not in a narrow technical sense but as having a meaning that enables double taxation to be avoided and tax evasion and avoidance to be prevented.
> ... Article 1(1) of Directive 2003/49, read in conjunction with Article 1(4) thereof, must be interpreted as meaning that the exemption of interest payments from any taxes that is provided for by it is restricted solely to the beneficial owners of such interest, that is to say, the entities which actually benefit from that interest economically and accordingly have the power freely to determine the use to which it is put.

In principle this should be welcomed, as the fewer concepts of Beneficial Ownership, the better.

[109] Bulgarian, French, Latvian, Romanian

[110] Spanish, Czech, Estonian, English, Italian, Lithuanian, Maltese, Portuguese, Finnish

[111] German, Danish, Greek, Croat, Hungarian, Polish, Slovak, Slovenian, Swedish

[112] Dutch.

108.10.9 *Abuse of rights*

CJEU continue:

> The general principle of EU law that EU law cannot be relied on for abusive or fraudulent ends must be interpreted as meaning that, where there is a fraudulent or abusive practice, the national authorities and courts are to refuse a taxpayer the exemption of interest payments from any taxes that is provided for in Article 1(1) of Directive 2003/49, even if there are no domestic or agreement-based provisions providing for such a refusal.
>
> 127 A group of companies may be regarded as being an artificial arrangement where it is not set up for reasons that reflect economic reality, its structure is purely one of form and its principal objective or one of its principal objectives is to obtain a tax advantage running counter to the aim or purpose of the applicable tax law. That is so inter alia where, on account of a conduit entity interposed in the structure of the group between the company that pays interest and the entity which is its beneficial owner, payment of the tax on the interest is avoided.
>
> 128 Thus, it is an indication of the existence of an arrangement intended to obtain improper entitlement to the exemption provided for in Article 1(1) of Directive 2003/49 that all or almost all of the aforesaid interest is, very soon after its receipt, passed on by the company that has received it to entities which do not fulfil the conditions for the application of Directive 2003/49, either because those entities are not established in any Member State, or because they are not incorporated in one of the forms referred to in the annex to the directive, or because they are not subject to one of the taxes listed in Article 3(a)(iii) of the directive without being exempt, or because they do not have the status of associated company within the meaning of Article 3(b) of the directive.

108.10.10 *Beneficial owner/abuse compared*

CJEU continue:

> 131 The fact that a company acts as a conduit company may be established where its sole activity is the receipt of interest and its transmission to the beneficial owner or to other conduit companies. The absence of actual economic activity must, in the light of the specific features of the economic activity in question, be inferred from an analysis of all the relevant factors relating, in particular, to the management of the company, to its balance sheet, to the structure of its costs and to expenditure actually incurred, to the staff that it employs and to the premises and equipment that it has.

> 132 Indications of an artificial arrangement may also be constituted by the various contracts existing between the companies involved in the financial transactions at issue, giving rise to intragroup flows of funds which, as is mentioned in Article 4 of Directive 2003/49, may have the aim of transferring profits from a profit-making commercial company to shareholding entities in order to avoid the tax burden or reduce it as much as possible. The way in which the transactions are financed, the valuation of the intermediary companies' equity and the conduit companies' inability to have economic use of the interest received may also be used as indications of such an arrangement. In this connection, such indications are capable of being constituted not only by a contractual or legal obligation of the company receiving interest to pass it on to a third party but also by the fact that, 'in substance', ... that company, without being bound by such a contractual or legal obligation, does not have the right to use and enjoy those sums.
>
> 133 Moreover, such indications may be reinforced by the simultaneity or closeness in time of, on the one hand, the entry into force of major new tax legislation, such as the Danish legislation at issue in the main proceedings, which some of the groups of companies strive to circumvent and, on the other hand, the setting up of complex financial transactions and the grant of intragroup loans.

CFE say:

25. The concepts of beneficial ownership and abuse of law are intertwined in the Court's analysis. This may not seem surprising at first, considering the indubitable purpose of the beneficial ownership concept in tax treaties to counter some specific forms of tax avoidance, i.e., "those involving the interposition of a recipient who is obliged to pass on the interest to someone else".[113] Just like in the OECD MC, however, the "beneficial ownership" concept merely aims at avoiding specific types of abuses and not all possible avoidance structures. As pointed out by AG Kokott, the concerns addressed by the abuse concept and the beneficial ownership concept are fundamentally different,[114] and also the Court appears to recognize the difference between both concepts at certain stages of its analysis, making it clear that denial of a benefit based on a lack of "beneficial ownership" (e.g., because the beneficial owner is an entity resident in a non-EU Member State) does not require tax authorities to prove abuse of law.[115] That seems to be a reasonable understanding of the IRD, which explicitly contains a "beneficial owner" requirement, but needs some purposive interpretation of the PSD, which does not explicitly contain such

[113] Footnote original: See, e.g., Art 11 no. 10.3 OECD MC Comm. 2017.

[114] Footnote original: See, e.g., the Opinion of AG Kokott in *N Luxembourg 1* (C-115/16), para. 60.

[115] Footnote original: See *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 138, and *T Danmark et al* (C-116/16 and C-117/16), para. 111.

a requirement. Essentially avoiding the Danish court's question whether the tax treaty concept of beneficial ownership can constitute a legal basis for combating fraudulent and abusive practices in the context of (old) Art 1(2) PSD,[116] the Court took a different path from AG Kokott's Opinions[117] and seems to assume that a "beneficial owner" requirement is implicit in the PSD as stand-alone anti-avoidance tool.[118] Even in non-abuse situations, therefore, the PSD's withholding tax exemption in the source Member State would not be applicable if the "beneficial owner" of a dividend resides outside the EU. The Court finds support for that conclusion based on the aim of the PSD to avoid double taxation of profit distributions within the EU[119] and moreover ensures teleological consistency between the IRD and the PSD despite their different wording and definitions.

26. However, "beneficial ownership"-related elements also found their way into the Court's list of indicative criteria for abuse. As for "beneficial ownership" the Court confined itself to the statement that it is an economic concept denoting the "entity which benefits economically from the interest received and accordingly has the power freely to determine the use to which it is put".[120] The Court's subsequent analysis regarding the constituent elements of abuse of rights also employs some similar notions – e.g., the reference to "the conduit companies' inability to have economic use of the interest received"[121] or "that all or almost all of the aforesaid interest is, very soon after its receipt, passed on by the company that has received it to entities which do not fulfil the conditions

[116] Footnote original: *T Danmark et al* (C-116/16 and C-117/16), para. 93.

[117] Footnote original: See the Opinions of AG Kokott of 1 March 2018 in C-116/16 (*T Danmark*, EU:C:2018:144, paras 78-86) and C-117/16 (*Y Denmark*, EU:C:2018:145, paras 78-86).

[118] Footnote original: *T Danmark et al* (C-116/16 and C-117/16), para. 111 ("[W]here the beneficial owner of dividends paid is resident for tax purposes in a third State, refusal of the exemption provided for in Article 5 of [the PSD] is not in any way subject to fraud or an abuse of rights being found").

[119] Footnote original: See *T Danmark et al* (C-116/16 and C-117/16), para. 113: "The mechanisms of Directive 90/435, in particular Article 5, are therefore intended for situations in which, if they were not applied, the exercise by the Member States of their powers of taxation might lead to the profits distributed by the subsidiary to its parent company being subject to double taxation […]. Such mechanisms are not, on the other hand, intended to apply when the beneficial owner of the dividends is a company resident for tax purposes outside the European Union since, in such a case, exemption of those dividends from withholding tax in the Member State from which they are paid could well result in them not actually being taxed in the European Union." It might be noted in passing that this argument is not fully intuitive, as the PSD would always lead to non-taxation of the distribution (if the parent company's Member State has chosen the exemption method under Art 4 PSD); what the Court seems to imply is that a withholding tax exemption in a Member State should not economically benefit a third State.

[120] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 89.

[121] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 132.

for the [IRD]"[122] – but moreover refers to the situation of a recipient company that does not "in substance" have the right to use and enjoy the sum it received: Indications for abuse "are capable of being constituted not only by a contractual or legal obligation of the company receiving interest to pass it on to a third party but also by the fact that, 'in substance' […] that company, without being bound by such a contractual or legal obligation, does not have the right to use and enjoy those sums."[123] This ostensibly goes beyond the OECD MC Commentary's guidance on "beneficial ownership" since the 2014 Update, which confines the denial of treaty benefits to situations where such contractual or legal obligation exists.[124] While that conclusion would normally derive from relevant legal documents, it "may also be found to exist on the basis of facts and circumstances showing that, in substance, the recipient clearly does not have the right to use and enjoy the interest unconstrained by a contractual or legal obligation to pass on the payment received to another person".[125] While the latter "in substance"-determination under the OECD MC might reasonably be understood as a mere procedural standard of proof, the context of the Court's inquiry suggests that it did not interpret the concept of beneficial ownership in this context but rather within the concept of artificial arrangements. As a result, this may be best understood as clarifying the relationship between beneficial ownership and the abuse of law: An entity may well be the beneficial owner (as interpreted in conformity, most likely, with the OECD material), yet still be denied the directive's benefits due to the artificiality of the legal structure.

27. As for the constituent elements of an abuse of rights and the relevant evidence, it is quite surprising that the Court refrained from utilizing its recent decisions on the concept of abuse in the PSD in *Eqiom*[126] and *Deister and Juhler*.[127] Possibly creating "new" standards that foreshadow the imminent interpretation of the GAAR in Art 6 ATAD and the minimum anti-avoidance standard in (new) Art 1(2), (3) PSD, the Court identifies a set of indicia that national courts must take into account in assessing whether a transaction abusive.[128] Those criteria include the conduit role of an entity, lack of economic substance

[122] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 128.

[123] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 132.

[124] Footnote original: See, e.g., Art 10 no. 12.4 OECD MC Comm. 2017.

[125] Footnote original: Art. 11 no. 10.2 OECD MC Comm. 2017.

[126] Footnote original: ECJ, 7 September 2017, C-6/16, *Eqiom SAS v Ministre des Finances*, EU:C:2017:641; see for a detailed discussion ECJ CFE Task Force, Opinion Statement ECJ-TF 2/2018 on the CJEU decision of 7 September 2017 in C-6/16, *Eqiom*, concerning the compatibility of the French anti-abuse rule regarding outbound dividends with the Parent-Subsidiary Directive and fundamental freedoms, ET 2018, 471 et seq.

[127] Footnote original: ECJ, 20 December 2017, C-504/16 and C-613/16, *Deister Holding AG and Juhler Holding A/S v Bundeszentralamt für Steuern*, EU:C:2017:1009.

[128] Footnote original: See *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 124-133, and *T Danmark et al* (C-116/16 and C117/16), paras 97-114.

and exercise of very limited activities (to be inferred from an analysis of all the relevant facts, including the management of the company, the cost structure, the presence of staff, premises and equipment) and that the structure was put in place simultaneously or shortly after the introduction of changes in the tax laws of the source EU Member State or any other (third) State.[129] Needless to say, all those criteria on one hand may help national courts to identify abusive situations but, on the other hand, they are necessarily vague and may lead to quite some uncertainty going forward.

28. It seems, moreover, that the Court wanted to put a "sword" in the hands of national tax authorities also with regard to the allocation of the burden of proof:

a. First, the Court was rather reluctant to fully embrace the obvious argument that no abuse exists where the same tax burden would result without the interposition of EU intermediary companies because a tax treaty would grant the same benefits also to the "direct" third-State recipients[130] (and the corresponding reasoning of AG Kokott).[131] It is, however, hard to see how a "tax advantage" (as required by the general principle as well as, e.g., by Art 6 ATAD) would be obtained if the "genuine" arrangement, e.g. direct ownership, would have triggered the same (low) tax burden in the source State.[132] The Court seems to recognize that argument half-heartedly by noting that "it remains possible, in a situation where the interest would have been exempt had it been paid directly to the company having its seat in a third State, that the aim of the group's structure is unconnected with any abuse of rights. In such a case, the group cannot be reproached for having chosen such a structure rather than direct payment of the interest to that company".[133] Moreover, the Court had also noted the different effects of the beneficial ownership requirement and the anti-abuse principle, as – irrespective of any finding of fraud or abuse – "beneficial owners" in third states are not beneficiaries of the IRD in the

[129] Footnote original: See *T Danmark et al* (C-116/16 and C-117/16), para. 106, referring to the United States legislation under the 2004 American Jobs Creation Act, which temporarily provided for a favorable repatriation of foreign profits.

[130] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 134-137, and *T Danmark et al* (C-116/16 and C117/16), paras 107-110.

[131] Footnote original: See the Opinions of AG Kokott of 1 March 2018 in C-115/16 (*N Luxembourg 1*, EU:C:2018:143, para. 96), C-118/16 (*X Denmark*, EU:C:2018:146, para. 105), C-119/16 (*C Danmark I*, EU:C:2018:147, para. 94), and C 299/16 (*Z Denmark*, EU:C:2018:148, para. 96) and in C-116/16 (*T Danmark*, EU:C:2018:144, paras 87-92) and C-117/16 (*Y Denmark*, EU:C:2018:145, paras 87-92).

[132] Footnote original: See also, e.g., Opinion AG Kokott, 19 January 2017, C-6/16, *Eqiom SAS, formerly Holcim France SAS and Enka SA v Ministre des Finances et des Comptes publics*, EU:C:2017:34, para. 26 with footnote 14, where a holding of a French subsidiary not through an interposed EU company but rather directly by the Swiss parent would likewise not have triggered a withholding tax because of Art 15 of the EU-Swiss Agreement, [2004] OJ L 385, p. 30 (now Art 9 of the EU-Swiss Agreement, [2015] OJ L 333, p. 12).

[133] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 137.

first place.[134]

b. Second, the Court found that the tax authorities are not even required to identify the entity which they regard to be the beneficial owner[135] (again departing from AG Kokott's conclusions).[136] The Court based that latter conclusion on the fact that "the national tax authority does not necessarily have information enabling it to identify those owners" so that it "cannot be required to furnish evidence that would be impossible for it to provide";[137] and even if they were known, said the Court, "it is not necessarily established which of them are or will be the actual beneficial owners".[138] That said, it is not entirely clear if the taxpayers could nevertheless show – in line with their burden of proof[139] – who the beneficial owner really is and claim corresponding benefits. Assume, for example, that the beneficial owner is a qualified EU company on top of a chain of (artificially interposed) third-State and EU-entities. In that case the Court – in line with the current OECD MC Commentaries[140] – clearly prefers an approach that "ignores" the non-beneficial owners and grants the IRD's benefits if the beneficial owner is indeed a qualified EU company.[141] [142]

[134] Footnote original: See *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 138.

[135] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), paras 143-144, and *T Danmark et al* (C-116/16 and C117/16), paras 97-120.

[136] Footnote original: See the Opinions of AG Kokott of 1 March 2018 in C-115/16 (*N Luxembourg 1*, EU:C:2018:143, para. 96), C-118/16 (*X Denmark*, EU:C:2018:146, para. 105), C-119/16 (*C Danmark I*, EU:C:2018:147, para. 94), and C 299/16 (*Z Denmark*, EU:C:2018:148, para. 96) and in C-116/16 (*T Danmark*, EU:C:2018:144, paras 87-92) and C-117/16 *(Y Denmark*, EU:C:2018:145, paras 87-92).

[137] Footnote original: See, e.g., *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 143.

[138] Footnote original: See, e.g., *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 144.

[139] Footnote original: See *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 140, finding that, "[a]s is apparent from Article 1(11) and (12) and Article 1(13)(b) of Directive 2003/49, the source Member State may require the company which has received interest to establish that it is its beneficial owner".

[140] Footnote original: See Art 11 no. 11 OECD MC Comm. 2017.

[141] Footnote original: *N Luxembourg I et al* (C-115/16, C-118/16, C-119/16 and C-299/16), para. 94, finding "that the mere fact that the company which receives the interest in a Member State is not its 'beneficial owner' does not necessarily mean that the exemption provided for in Article 1(1) of [the IRD] is not applicable. It is conceivable that such interest will be exempt on that basis in the source State when the company which receives it transfers the amount thereof to a beneficial owner who is established in the European Union and furthermore satisfies all the conditions laid down by [the IRD] for entitlement to such an exemption."

[142] CFE Opinion Statement ECJ-TF 2/2019 *https://taxadviserseurope.org/new_ahgency/wp-content/uploads/2019/06/ECJ-TF_2-2019_Beneficial-Ownership.pdf*

108.10.11 *Beneficial owner in treaty State*

CJEU continue:

> 134 The referring courts are also unsure, in essence, whether there can be an abuse of rights where the beneficial owner of interest transferred by conduit companies is ultimately a company whose seat is in a third State with which the source Member State has concluded a tax convention under which no tax would have been withheld on the interest if the interest had been paid directly to the company having its seat in that third State.
>
> 135 In that regard, when examining the structure of the group it is immaterial that some of the beneficial owners of the interest paid by the conduit company are resident for tax purposes in a third State which has concluded a double taxation convention with the source Member State. The existence of such a convention cannot in itself rule out an abuse of rights. Thus, a convention of that kind cannot call into question that there is an abuse of rights where its existence is duly established on the basis of a set of facts showing that economic operators have carried out purely formal or artificial transactions devoid of any economic and commercial justification, with the essential aim of benefiting improperly from the exemption from any taxes that is provided for in Article 1(1) of Directive 2003/49.
>
> 136 It should be added that, whilst taxation must correspond to economic reality, the existence of a double taxation convention is not, as such, capable of establishing that a payment was really made to recipients resident in the third State with which that convention has been concluded. If the company owing the interest wishes to benefit from the advantages of such a convention, it is open to it to pay the interest directly to the entities that are resident for tax purposes in a State which has concluded a double taxation convention with the source State.
>
> 137 That said, it remains possible, in a situation where the interest would have been exempt had it been paid directly to the company having its seat in a third State, that the aim of the group's structure is unconnected with any abuse of rights. In such a case, the group cannot be reproached for having chosen such a structure rather than direct payment of the interest to that company.
>
> 138 Furthermore, where the beneficial owner of interest paid is resident for tax purposes in a third State, refusal of the exemption provided for in Article 1(1) of Directive 2003/49 is not in any way subject to fraud or an abuse of rights being found. As has been stated, in essence, in paragraph 86 above, that provision is designed to exempt interest payments in the source Member State only where the beneficial owner of the interest is

> a company established in another Member State or a permanent establishment situated in another Member State belonging to a company of a Member State.[143]

108.10.12 *Beneficial ownership: Transparent entity*

What is required is beneficial ownership of the dividend/interest/royalty; not beneficial ownership of the underlying shares/loan/intellectual property. See too 91.6.2 (Hybrid is nominee/agent).

108.11 Bona fide conduit co

The INT Manual provides:

> **INTM332050 HMRC Reaction To Indofood Case** [Jun 2018]
> 4 Although, in the context of DTCs, beneficial ownership will take what the Court of Appeal decision accepted as an "international fiscal meaning" rather than a UK domestic meaning, in HMRC's view there are unlikely to be many cases where the difference is material.

The reader may wonder about point 4. The next para of the INT Manual observes that "Many capital market transactions involve SPVs which may not satisfy the test of beneficial ownership under an international fiscal meaning." But the author is anticipating the passage which follows:

> ... The issue would only arise when the substance of an arrangement amounts to an improper use of the relevant DTC in the light of the DTC's object of prevention of fiscal evasion and avoidance, for example "treaty shopping". Treaty shopping is only likely to take place
> [1] where the "real" beneficial owner of the income, such as "the immediate underlying lender" in the case of interest, is resident in a state with which the UK has either no DTC or a DTC less favourable than the DTC applicable to the intermediate lender, or
> [2] if the recipient of an income stream into which an intermediate lender has been interposed is resident in such a state (regardless of whether they themselves are the beneficial owner).
> These are the only situations where HMRC believe further consideration of the "international fiscal meaning" will be needed.
> 5 Where both the intermediate and the underlying lender are resident in

[143] *Skatteministeriet v Danmark* C-115/16. See CFE Opinion Statement ECJ-TF 2/2019 *https://taxadviserseurope.org/new_ahgency/wp-content/uploads/2019/06/ECJ-TF_2-2019_Beneficial-Ownership.pdf*

states with which the UK has essentially similar DTCs, no issue is likely to arise, even where the intermediate lender is not, under the so called "international fiscal meaning" of the phrase, the beneficial owner of the interest, as there would be no fiscal evasion or avoidance. This is because in these circumstances it is unlikely that the effect of the arrangement is the avoidance of UK withholding tax, since the level of UK withholding tax would have been the same with or without the intermediate lending.

INTM332060 Indofood: Impact On Particular Cases [Jun 2018]
1 Many capital market transactions involve SPVs which may not satisfy the test of beneficial ownership under an "international fiscal meaning". Securitisation programmes, for example, in respect of mortgage backed loans and other debt receivables are commonplace ways of raising finance. Typically such programmes involve a SPV which issues bonds to third party investors and employs the proceeds from the bonds to purchase the receivables or debt secured on the receivables (see below where these are quoted Eurobonds). The SPV is typically required to pass on the income received from the underlying assets to the bondholders (subject to hedging arrangements and less a small spread to cover fees etc). Where the SPV is resident outside the UK, an application will have to be made by the non-resident to enable the interest that is backed by the receivables to be paid gross to the SPV. The SPV in such an arrangement may not be the beneficial owner of the income under the international fiscal meaning; it often has very narrow powers over the income and its obligations to the bondholder mean that it is unlikely to 'enjoy the full privilege to directly benefit from the income'.
2 However, as indicated above in applying the beneficial ownership concept in the context of Double Taxation Conventions (DTCs), regard should be had to the objective of the DTC. Where there is no abuse of the DTC, there is no need, in practice, to apply the "international fiscal meaning" of beneficial ownership. The object of the treaty is likely to be met just as easily using the UK domestic law meaning of beneficial ownership.
3 HMRC will also accept that there is no need to invoke the "international fiscal meaning" of beneficial ownership to deny treaty benefits where the lender receiving income directly from the SPV (the "true" beneficial owner of the interest) would, if they had been the direct recipient of the interest, have been entitled to treaty benefits as a resident of a state with which the UK has a DTC with zero withholding on

> interest. It is not necessary for the beneficial [owner[144]] in this scenario to have made a formal claim for treaty benefits in order to assess what entitlement to claim would have arisen.

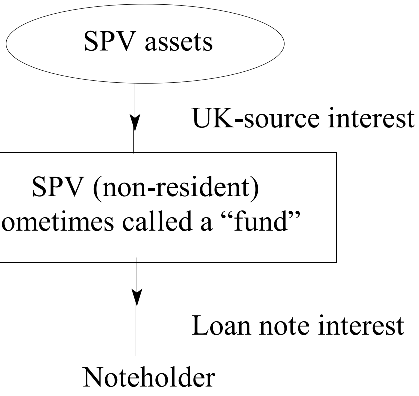
So HMRC allow the 3 beneficial-owner reliefs to a company where:

(1) The company is the beneficial owner in the English law sense (equitable ownership)
(2) The person is not the beneficial owner (in the DTA sense) but
(3) There is no treaty abuse

In the following discussion, I refer to the company as the **"bona fide conduit company"**, and the practice is the **"bona fide conduit concession"**.

The reader may think it a flaw in the *Indofood* decision that it did not mention these difficulties; but there it is.

The examples which follow concern the following structure (or some variant):



108.11.1 *Eurobonds*

The INT Manual continues:

> 1 Many of the transactions involve SPVs issuing Quoted Eurobonds. No UK withholding tax is payable on interest from Quoted Eurobonds so no treaty claim is needed.
> 2 HMRC therefore accept that the question of invoking the "international fiscal meaning" of beneficial ownership to deny treaty benefits will not arise where the bond issued by the non-resident SPV is a Eurobond as defined in ITA07/S987.

[144] The original erroneously reads: lender.

One might have thought that what matters is whether the bonds *acquired* by the SPV are Eurobonds (not the bond *issued* by the SPV). It is interest paid to the SPV frm the SPV assets which require withholding tax relief of one kind or another. Clearly if the SPV assets are quoted Eurobonds, which are not subject to withholding tax,[145] the issue of DTA relief does not arise.

108.11.2 *Fund investing in UK loans*

The INT Manual continues:

> 1 A recent capital market development has been the establishment of various types of European-based funds that purchase loans to UK borrowers. Funds of this type include Collateralised Debt Obligations (CDOs) and Collateralised Loan Obligations (CLOs) in addition to mezzanine funds. They will typically own a portfolio of assets and issue several classes of securities whose performance reflects the performance of the underlying assets. For a number of reasons such funds may not be resident in the UK. They are therefore required to make treaty applications to receive the interest of the purchased loan assets without deduction of tax.
> 2 As with securitisation SPVs, many of these arrangements may not satisfy the test of beneficial ownership under an "international fiscal meaning". The fund often has very narrow powers over the income and its obligations to the investors in the securities mean that it is unlikely to 'enjoy the full privilege to directly benefit from the income'. It may therefore appear that such funds would be denied treaty benefits under the "international fiscal meaning" of beneficial ownership.
> 3 However, as indicated above, [the bona fide conduit concession] in applying the beneficial ownership concept in the context of DTCs regard should be had to the object of the DTC. Where there is no abuse of the DTC, there is no need, in practice, to apply the "international fiscal meaning" of beneficial ownership. The object of the treaty is likely to be met just as easily using the UK domestic meaning.
> 4 As with securitisation SPVs, many of these types of transactions involve Quoted Eurobonds. For the reasons set out above, the intervention of the non-UK SPV does not reduce the level of UK withholding tax. HMRC will therefore accept that there is no need to invoke the "international fiscal meaning" of beneficial ownership to deny treaty benefits where the bond issued by the non-resident SPV is a Quoted Eurobond as defined in ITAO7/S987.

108.11.3 *Syndication/sub-participation*

The INT Manual continues:

> 1 A loan which is made as a normal part of banking business and which is subsequently subject to sub-participation, again in the ordinary course of banking business, is unlikely to have been so structured with the aim of taking advantage of treaty benefits. Subsequent participation will not cause HMRC to change its view on the application of the

[145] See 26.23.7 (Quoted Eurobond).

"international fiscal meaning" to the original lending.
2 However treaty abuse would arise where lenders who would not be entitled to treaty benefits, arrange for the loan to be initiated via a bank lender in a treaty country. HMRC does not consider this to be normal commercial syndication as part of the ordinary course of banking business - the interposition of the bank lender merely serves to gain treaty benefits that would not otherwise have accrued.
3 Examples of the application of the HMRC view are included at INTM332080. These are illustrative only and should not be taken as limiting the circumstances in which HMRC will apply the "international definition".
4 The general principle underlying HMRC interpretation is that treaty abuse will not normally arise where the interposition of an intermediate lender would not improve the withholding tax position of interest paid by the UK borrower, when compared to the withholding tax that would have arisen had that intermediate lender not been interposed. Cases falling outside the examples would need to be considered on an individual basis.

108.11.4 *Claims for DTA relief*

> **INTM332070 DT Applications And Claims: Indofood: Existing And New Cases** [May 2019]
> 1 Where structures are within the ambit of the Indofood decision, that is to say the structure has the accessing of treaty benefits as one of its effects, it is possible that applications to HMRC for benefits under a Double Taxation Convention (DTC) will fall at the first hurdle unless the applicant can demonstrate beneficial ownership. The application might simply be regarded as invalid and never reach the stage where it can be considered in terms of the object and purpose of the particular DTC under which the application is made.
> 2 However, where the claimant Special Purpose Vehicle (SPV) does not satisfy the "international fiscal meaning" of beneficial ownership but believes that it is still able to obtain treaty benefits because of the policy confirmed in this guidance, it should make its claim and include a note to that effect. To ease consideration of the claim, the note should include full details as to
> - A full structure diagram and explanation of the capital and interest flows;
> - why the SPV is considered to be the beneficial owner within the "international fiscal meaning"; or
> - demonstrate that the structure does not abuse the DTC under which the claim is made either relating the structure to the examples at INTM332080 or otherwise.

HMRC give 8 examples:

No	Facts	Relief
1	Securitisation using offshore SPV funded by listed bonds	Yes
2	Securitisation using offshore SPV funded by listed bonds and UK bank debt	Yes

3	Securitisation using offshore SPV funded by listed bonds and unlisted debt from resident of a "zero rate country"	Yes
4	Securitisation of non-corporate assets using offshore SPV	Yes
5	Access to US commercial paper market using US SPV	Yes
6	Access to US commercial paper market using US and Irish SPVs	Yes
7	Access to group-sourced funding from Non treaty country using Lux. conduit co	No
8	Access to group-sourced funding from Treaty country using Lux. conduit co	Yes

INTM332080 Double Taxation Applications And Claims: Indofood: Examples Of Application [Jun 2018]

Example 1: Securitisation using offshore Special Purpose Vehicle (SPV) funded by listed bonds

As part of a securitisation arrangement, an SPV is established in Ireland. It purchases UK interest bearing receivables, funding itself with listed bonds which, if issued by a UK resident company, would qualify for exemption from withholding tax by virtue of the quoted Eurobond exemption at ITA07/S882.[146] The UK source interest is paid to the SPV which, in turn, pays interest to the bondholders who are resident in a variety of different countries.

The SPV is not the beneficial owner of the income within the "international fiscal meaning" of that phrase because it has only narrow powers over the income and its obligations to the bondholders mean that it is unlikely to 'enjoy the full privilege to directly benefit from the income'.

But in these circumstances, it is unlikely that the purpose of the arrangement is the avoidance of UK with holding tax, since the UK withholding tax on the UK source interest is the same with the SPV (nil because of the terms of the UK/Ireland Double Taxation Convention (DTC) which provide for a zero rate of UK withholding tax on interest) as it is without the SPV (nil because of ITA07/S882).

Accordingly HMRC will not question the treaty claim required to eliminate the withholding tax otherwise payable on the UK interest paid to the SPV on the grounds that the SPV is not the beneficial owner of the income within the "international fiscal meaning" of that phrase.

In considering the purpose and effect of the interposing of an SPV, it is also necessary to look at other costs and activities of the SPV. However, expenses which are derived from the financing but which are incidental to the purpose of that financing (such as hedging costs) will not affect the HMRC view set out in this guidance.

Example 2: Securitisation using offshore SPV funded by combination of listed bonds and UK bank debt

The facts are the same as Example 1 except that the SPV also issues unlisted debt which is held by a UK financial institution sponsor.

As in Example 1, it is unlikely that the purpose of the arrangement is the avoidance of UK withholding tax since, again, the UK withholding tax on the UK source interest is the same with the SPV (nil because of the terms of the UK/Ireland DTC) as it is without the SPV (nil: partly because of ITA07/S882 [quoted Eurobond exemption] and partly because of

[146] See 108.11.1 (Eurobonds).

section ITA07/S879(1) [interest paid to UK bank].[147]

As in Example 1, the SPV is not the beneficial owner of the income within the "international fiscal meaning" of that phrase. But, again, HMRC will not question the treaty claim required to eliminate the withholding tax otherwise payable on the UK interest paid to the SPV on the grounds that the SPV is not the beneficial owner of the income within the "international fiscal meaning" of that phrase.

Example 3: Securitisation using offshore SPV funded by combination of listed bonds and unlisted debt from resident of a "zero rate country"

The facts are the same as Example 1 except that the SPV also issues unlisted debt which is held by a US company.

As in Examples 1 and 2, the SPV is not the beneficial owner of the income within the "international fiscal meaning" of that phrase.

As in Examples 1 and 2, it is unlikely that the purpose of the arrangement is the avoidance of UK withholding tax, since, again, the UK withholding tax on the UK source interest is the same with the SPV (nil because of the terms of the UK/Ireland DTC) as it is without the SPV (nil: partly because of ITA07/S882 and partly because of the terms of the UK/US DTC which provide for a zero rate of UK withholding tax on interest).

But, again, HMRC will not question the treaty claim required to eliminate the withholding tax otherwise payable on the UK interest paid to the SPV on the grounds that the SPV is not the beneficial owner of the in come within the "international fiscal meaning" of that phrase.

Example 4: Securitisation of non-corporate assets using offshore SPV

The facts are the same as Example 1 except that the assets being securitised are loans made by a UK bank to a partnership.

As in Examples 1, 2 and 3, the SPV is not the beneficial owner of the income within the "international fiscal meaning" of that phrase.

As in Examples 1, 2 and 3, it is unlikely that the purpose of the arrangement is the avoidance of UK with holding tax, since, again, the UK withholding tax on the UK source interest is the same with the SPV (nil be cause of the terms of the UK/Ireland DTC) as it is without the SPV (nil: partly because of ITA07/S882 and partly because of ITA07/S879(1) [quoted Eurobond exemption/interest paid to UK bank].

But, again, HMRC will not question the treaty claim required to eliminate the withholding tax otherwise payable on the UK interest paid to the SPV on the grounds that the SPV is not the beneficial owner of the income within the "international fiscal meaning" of that phrase. The above principles would apply equally to collateralised loan arrangements - or indeed to any interest-bearing loans where the question of UK with holding tax is unaffected by the interposition of the intermediate lender.

Example 5: Access to US commercial paper market using US SPV

A US SPV is established to provide non-US borrowers with access to the US commercial paper market. On the instructions of a UK borrower, it issues discounted paper and passes the funds on to the UK borrower by way of an interest-bearing loan.

The SPV is not the beneficial owner of the income within the "international fiscal meaning" of that phrase because it has only narrow powers over the income and its obligations to the bondholders mean that it is unlikely to 'enjoy the full privilege to

[147] See 26.23.3 (Interest paid to UK bank).

directly benefit from the income'.

But in these circumstances, it is unlikely that the purpose of the arrangement is the avoidance of UK with holding tax, since the UK withholding tax on the UK source interest is the same with the SPV (nil because of the terms of the UK/US DTC which provide for a zero rate of UK withholding tax on interest) as it is without the SPV (nil because there is no UK withholding tax on discounts). HMRC will not question the treaty claim required to eliminate the withholding tax otherwise payable on the UK interest paid to the SPV on the grounds that the SPV is not the beneficial owner of the income within the "international fiscal meaning" of that phrase.

Example 6: Access to US commercial paper market using US and Irish SPVs

The facts are the same as in Example 5 except that the US SPV acts on instructions of an Irish SPV who is, in turn, acting for the UK borrower. The additional step is introduced to provide the UK borrower with the security that its funding needs will be met notwithstanding the state of the US market. To provide this security, the Irish SPV enters into arrangements with a UK bank that ensure the bank will provide funds if money cannot be raised at short notice from the US.

Neither SPV is beneficial owner of the relevant income within the "international fiscal meaning" of that phrase because both have only narrow powers over the income and their obligations to their creditors mean that they are unlikely to 'enjoy the full privilege to directly benefit from the income'.

But in these circumstances, it is unlikely that the purpose of the arrangement is the avoidance of UK with holding tax. The UK withholding tax on the UK source interest is the same with the SPVs (nil because of the terms of the UK/US and UK/Ireland DTCs which provide for a zero rate of UK withholding tax on interest) as it is without the SPVs (nil partly because there is no UK withholding tax on discounts and partly because of ITA07/S878(1). HMRC will not question the treaty claim required to eliminate the withholding tax otherwise payable on the UK interest paid to the Irish SPV on the grounds that it is not the beneficial owner of the in come within the "international fiscal meaning" of that phrase.

Example 7: Access to group-sourced funding from a Non treaty country using Luxembourg conduit company

A claim is made under the UK/Luxembourg DTA for relief from UK withholding tax in respect of a loan from a Luxembourg resident company (LuxCo) to a UK group borrower.

- LuxCo was set up (or has been maintained in the group) specifically to deal with this intra group loan and is taxed on a small "turn" for administering loans;
- the source of the loan is an affiliate in a territory with which the UK has no DTA (NoA Co)
- the NoA Co/LuxCo loan agreement shows that this interest bearing loan was predetermined to be on-lent to the UK
- similarly, the interest payable by the UK on its loan from LuxCo is predetermined to be passed on to NoA Co.

The conduit company is not beneficial owner of the relevant income within the "international fiscal meaning", because it has clear obligations to forward the interest to NoA Co.

The terms and conditions of the loan agreements show that the flow of income out of the UK is predestined to be passed on to NoA Co. It is clear that one of the main purposes of the Luxembourg company is to avoid the withholding tax which would be due on payments of interest to NoA Co. The interest will not benefit from the Luxembourg/UK treaty and tax will be withheld.

Example 8: Access to group-sourced funding from a Treaty country using Luxembourg conduit company

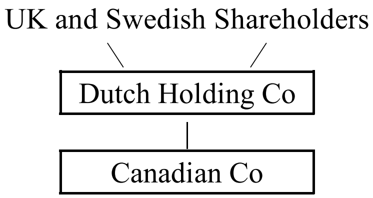
The facts are as in example 7 except that this time the source of the funds is a US taxpayer who receives interest directly from the Lux Company. If the interest had gone directly to the US recipient, it would have qualified for exemption under the US/UK treaty. Although the Lux Company will not satisfy the international fiscal meaning, this is irrelevant as its imposition into the arrangement does not affect the withholding tax position. The same conclusion could not be drawn if the US taxpayer had passed funds to a non treaty intermediary, which then lent the funds to the Lux Co.

108.12 Beneficial ownership: Canada

In Canada, treaty beneficial ownership has been understood more narrowly:

> In *Prévost Car Inc*,[148] the CRA challenged a treaty shopping case on the basis that a conduit entity was not the "beneficial owner" of the Canadian-source income on which treaty benefits were sought. The case involved dividends paid on the shares of a Canadian resident corporation that were held by a Dutch corporation which in turn was owned by corporate shareholders in Sweden and the UK.

Diagrammatically:



> The withholding tax rate on dividends paid to the Dutch holding company were lower than would have been the case had dividends been paid directly to the corporate shareholders in Sweden and the UK. Even though the terms of the shareholders agreement essentially required the Dutch holding company to pass through as dividends to its shareholders any dividends received from its Canadian subsidiary, the Tax Court found that the intermediary Dutch holding corporation was the beneficial owner of the dividends and the Federal Court of Appeal affirmed the Tax Court's interpretation of beneficial ownership.
>
> The narrow meaning ascribed to beneficial owner in *Prévost Car Inc* means that the beneficial ownership requirement in this context is not

[148] *Prévost Car Inc v The Queen* 2009 DTC 5053.

> sufficient to deny treaty benefits to an intermediary entity. In particular, even though the intermediary foreign holding company in this case was effectively a direct conduit (i.e., it did not pay tax on dividends received, distributed substantially all of its income to third country residents who owned it, and had no employees or activities other than with respect to the ownership of shares of a subsidiary), it was not denied treaty benefits on the basis of beneficial ownership.
>
> Similarly, the notion of beneficial owner was also argued by the Government in *Velcro Canada*[149] as the basis on which to deny treaty benefits in a treaty shopping case. In *Velcro Canada*, a corporation resident in the Netherlands Antilles, which would have been subject to a withholding tax rate in Canada of 25% on royalties paid by a Canadian company, incorporated an intermediary company in the Netherlands and essentially assigned to it the right to receive royalty payments from the Canadian company. The intermediary company in the Netherlands remitted 90% of the royalties received to its parent in the Netherland Antilles within 30 days, pursuant to a sub-licencing agreement between the Dutch intermediary and the Netherlands Antilles company. This was a classic "stepping stone" conduit structure.[150] The Government argued the case on the basis that the Dutch intermediary was not the beneficial owner of the royalties received. The court followed the decision in *Prévost Car Inc*.[151]

108.13 "Subject to tax"

Treaties occasionally provide exemption for income in one State only if it is "subject to tax" in the other State. This is not in OECD Model, and is only found in a diminishing number of treaties, but for instance Article XI(2) Israel/UK DTA formerly provided:

> Any pension ... derived from sources within the UK by an individual who is a resident of Israel and subject to Israel tax in respect thereof, shall be exempt from UK tax.[152]

[149] *Velcro Canada Inc v The Queen* 2012 DTC 1100.

[150] Footnote original: See OECD, "Double Taxation Conventions and the Use of Conduit Companies" (1986) para 4.

[151] Department of Finance Canada "Consultation Paper on Treaty Shopping – The Problem and Possible Solutions" (2013) *https://thor.ca/blog/wp-content/uploads/2013/08/Consultation-Paper-on-Treaty-Shopping.pdf*

[152] Under the 2019 Protocol, this has now been replaced by OECD model wording, resulting in double non-taxation of UK source pensions of residents in the foreign

In a treaty context, two issues may arise:

(1) Whether income is subject to UK tax, which matters in order to qualify for DT exemption in the foreign State

(2) Whether income is subject to foreign tax, which matters in order to qualify for DT exemption in the UK

Issue (1) would ultimately be decided by foreign tax authorities and courts, but the HMRC view of what counts as subject to UK tax may represent an international consensus.

108.13.1 *Subject to tax: History*

Avery Jones explains:

> The UK pioneered "subject to tax," including it in all its early treaties in relation to dividends, interest and royalties. The reason was not to cure the disconnect between the resident and the income but because of a quirk of UK tax law that would have enabled the UK to be used for what we would now call treaty shopping. In the absence of a subject to tax clause a resident of anywhere in the world (including a tax haven) could have held assets in the name of a UK resident nominee which would have enabled the taxpayer to have access to all the UK's tax treaties without paying any UK tax. This would have worked because of a combination of, first, the rule that a person receiving or entitled to income was taxable[153] ... thus making the nominee taxable in principle on account of receiving the income without being entitled to it.
>
> Secondly, just as a non-resident was not taxable on foreign income, a UK resident nominee for a non-resident was not taxable on foreign income either.[154]
>
> Thirdly, UK treaties defined resident for treaty purposes as a person who was resident in the UK and not resident in the other state, thus ducking the problem of dual residence.[155] The result was the same under the OEEC's definition of a resident as someone liable to tax as it did not then contain what is now the second sentence of Article 4(1) of the OECD Model,[156] which was not introduced until 1977.

treaty State. This is an example of intentional double non-taxation; see 107.6.2 (Acceptable double non-taxation).

[153] See 15.8 (Receipt by nominee/trustee).

[154] See 42.4 (Life tenant non-resident).

[155] See 9.29.2 (Residence: Pre-1963 DTAs).

[156] See 9.8 (Liable to source tax only). The OEEC (Organisation for European Economic Co-operation) became the OECD in 1961. OEEC's definition of

> Taking all three together resulted in the nominee being resident for the purposes of the treaty (either under the UK's usual [pre-1963] treaty definition, or under the OEEC's definition before the introduction of the second sentence). The ultimate recipient of the income would therefore have been entitled to the benefit of all UK treaties to reduce tax in the treaty partner state without actually being taxable on any such income in the UK because it was foreign income.
> Fortunately someone must have spotted this, and all UK treaties contained a subject to tax test for dividends, interest and royalties with the result that the treaty did not apply because the foreign dividends, interest and royalties were not subject to tax in the UK.[157]

The history does not much matter now. However this does explain what is otherwise puzzling, namely why "subject to tax" wording is found in pre-1977 treaties, but is (more or less) not found subsequently. The reason is that the wording was devised for a specifically UK problem, dealing with nominees, and since 1977 it ceased to be needed for that purpose.

108.13.2 *Subject to/liable: Ordinary meaning*

In ordinary speech, subject to tax and liable to tax are used synonymously, and the meaning is somewhat vague and context-dependent.

residence was (just about) the same as the first sentence of the OECD Model form. At first sight, a UK nominee for a non-resident principal would not be liable for tax "by reason of his residence". But there would be a possibility of a tax liability on foreign income which was not passed on to the principal, eg if retained for the nominees expenses. On that basis a UK nominee for a non-resident principal would be UK treaty-resident before the second sentence was introduced in 1977.

[157] Avery Jones, "Weiser v HMRC: why do we need 'liable to tax' and 'subject to tax' clauses?" [2013] BTR 9. Avery Jones discusses the point at greater length in "The Beneficial Ownership concept was never necessary in the Model", in Lang (ed) *Beneficial Ownership: Recent Trends* (2013).
Avery Jones continues with an intriguing comment: "Subject to tax is not a perfect solution because it prevents charities and pension funds from obtaining treaty benefits. Two solutions could deal with this. Either the second sentence of Article 4(1) of the OECD Model could be added, so that the nominee is no longer a treaty resident because he is not taxable on foreign income of a non-resident, coupled with the deletion of the subject to tax condition, which would enable charities and pension funds to qualify. Or, alternatively, "beneficial ownership" could be substituted for subject to tax, which would exclude nominees but include charities and pension funds. In fact, both solutions were adopted in the 1977 Model. Had anyone realised that the first alternative on its own would have sufficed we would not now still be arguing about the meaning of beneficial ownership."

In the context of the lower-paid employee exemption,[158] the RDR Manual provides:

> **RDRM0 - Remittance Basis: exemption for non-domiciles with small amounts of foreign employment income** [Jan 2019]
> *...Subject to Foreign Tax*
> Although 'subject to a foreign tax' might in some circumstances mean that the individual has actually paid some tax on the foreign income to a foreign tax authority, actual payment is not a necessary requirement to take advantage of this exemption.
> For example, given the levels of foreign income involved there might be nothing due to be paid on part or all of the income, as a result perhaps of a foreign countries' own personal allowances systems, or similar tax provisions which are akin to such allowances, such as a tax rate band of 0%. Such income would still be considered to be 'subject to a foreign tax' in the context of this exemption.

108.13.3 *Subject to/liable compared*

In a DTA context, subject to tax/liable to tax have distinct technical meanings, and discussion of one phrase sheds no light on the other. In *Weiser v HMRC*[159]:

> 22. ... There is, [counsel for HMRC] submitted, an internationally recognised distinction ... which gives the expression "liable to tax" a broader meaning that the expression "subject to tax"...
> 26. In *General Electric Pension Trust v Director of Income-tax* (2005) 8 ITLR 1053 ... Syed Shah Mohammed Quadri J said (at p 1061):
>
> > "It is worth pointing out that the phrase 'liable to tax' in para (1) and the phrase 'subject to tax' in proviso (b) are not synonymous. If both were read to be synonymous, proviso (b) would become otiose. Whereas para (1) speaks of being in the tax net, proviso (b) speaks of actual taxation."[160]

[158] See 34.42 (Lower-paid employee exemption).

[159] [2012] UKFTT 501 (TC).

[160] The definition provided: "For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature, provided however, that
(a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State; and
(b) in the case of income derived or paid by a partnership, estate, or trust, this

> 34. ... the distinction that must in my view be drawn between the use, in double tax treaties, of the expressions "liable to tax" and "subject to tax" ...

For "liable to tax" see 9.5 ("Liable to tax");App.2.3 (Chargeable/liable to tax).

108.13.4 *Subject to tax: DTA meaning*

The INTM Manual provides:

> **INTM332210 Subject to tax: Background** [June 2018]
> The expression "subject to tax" usually means that the person must actually pay tax on the income in their country of residence.
> However, a person is still regarded as "subject to tax" if, for example, he or she does not pay tax because their income is sufficiently small that it is covered by personal allowances that are available to set against liability to tax in the other country.
> A person is not regarded as "subject to tax" if the income in question is exempted from tax because the law of the other country provides for statutory exemption from tax. For example
> - the income is that of a charity
> - the income is that of an exempt approved superannuation scheme (pension fund).
>
> In such cases the "subject to tax" condition is not met and relief is not allowable.[161]

term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax in that State as the income of a resident, either in its hands or in the hands of its partners or beneficiaries."

[161] In *Weiser v HMRC* the FTT agreed with this passage: [2012] UKFTT 501 (TC) at [38]. Similar points are made in INTM162090:

'Subject to tax' [Jan 2014]

... Examples of where the income is regarded as 'subject to tax' but on which no or little tax is actually paid may include the following:

- The customer does not pay any UK tax because their income is covered by personal allowances and reliefs.
- The foreign income arises in a penultimate year and no penultimate year adjustment is made, so the income falls out of assessment in the UK.
- The income is wholly covered by capital allowances so that no UK tax is payable.
- The customer is entitled to a deduction under ITEPA03/S341 or S376.
- The remittance basis applies: the person is subject to tax only on the sums remitted.

In *Weiser v HMRC*[162] the taxpayer (not represented by counsel) claimed relief under Art XI(2) Israel/UK DTA which is set out above. The taxpayer was treaty-resident in Israel but unfortunately qualified for an Israeli tax exemption which applied to foreign source income of new immigrants for a 10 year period. The pension income was not "subject to tax" in Israel, so the DT exemption did not apply:

> 22. ... "Subject to tax"... requires income actually to be within the charge to tax in the sense that a contracting state must include the income in question in the computation of the individual's taxable income with the result that tax will ordinarily be payable subject to deductions for allowances or reliefs, etc....
>
> 24. An Australian case, *Emanuel v FCT* [1968] HCA 57, concerned the Australia/UK double tax treaty. ... Under the treaty, [the rate of tax on dividends] was reduced to 15% in the case of such dividends to a UK resident "who is subject to UK tax in respect thereof". The UK resident recipient was not domiciled in the UK, and so, although generally within the scope of UK tax as a resident, was chargeable on income from non-UK sources only to the extent that the income was remitted to the UK. The dividends had not been so remitted.
>
> 25. In the High Court of Australia, Windeyer J held that the taxpayer was not entitled to the reduced rate of withholding tax. He said (at [15]):
>
>> "... in respect of the dividends in question the 'remittance' basis would apply. Therefore, in my opinion, unless and until they be remitted and received by him in the UK he is not "subject to UK tax in respect thereof". These words I think describe a present liability of a person to tax, not the character of income in respect of which he will if it comes to him in the UK in the future incur then a liability to tax."
>
> 26. In *General Electric Pension Trust v Director of Income-tax (International Taxation)* (2005) 8 ITLR 1053, the Indian Authority for Advance Rulings held that a pension fund which was exempt from tax in the US under US tax law was not "subject to tax" in the US ...
>
> 34. In my view, consistent with what I regard as the purpose of the treaty in this regard, the ordinary meaning of Art XI(2) is that pension income derived from UK sources is only exempt from UK tax if that

A person is not regarded as subject to tax in the UK if the income in question is exempted from UK tax by an extra-statutory concession or is statutorily exempt from tax, for example the income is that of a charity ..."

[162] [2012] UKFTT 501 (TC).

> income is chargeable to Israel tax such that Israel tax will ordinarily be payable in respect of that income, subject to deductions for allowances and reliefs, etc. This follows from the distinction that must in my view be drawn between the use, in double tax treaties, of the expressions "liable to tax" and "subject to tax", and also by the requirement, under Art XI(2), that the individual concerned should not only be a resident of Israel (that is, resident in Israel for the purposes of Israel tax), but should be subject to tax in respect of the relevant income. ... This provision is not concerned with the status of the individual, but with the chargeability to tax of the specific income. Income which is exempted from taxation cannot during the currency of that exemption be income in respect of which an individual can be said to be subject to tax.

On the same facts, but under OECD Model wording (lacking the words "subject to tax") treaty relief would apply.[163]

108.13.5 *Election to waive exemption*

The INT Manual provides:

> **INTM162020 certificates of residence: information to be supplied with a request** [Feb 2020]
>
> ...
>
> Note that, under CTA09/Part 9A, UK companies are usually exempt from tax on the great majority of dividends received (see INTM650000). If a UK company is exempt from tax on the dividends it receives, HMRC will not be able to issue a CoR [Certificate of Residence] where the DTA in question states that the dividends must be subject to UK tax.
>
> UK companies can, however, elect (under CTA09/S931R(2)) for this exemption not to apply. If such an election is made, the dividends would be subject to UK tax and HMRC could issue a CoR. The company would then be able to claim relief from the foreign tax and if any foreign tax remains payable, credit for that tax may be available against the UK tax chargeable on the same income.
>
> UK companies in this situation should therefore consider whether it is in their interest to make an election under S931R(2) (so that the dividends are charged to UK tax with relief being available for the foreign tax under the terms of the DTA) or not (so that the dividends are not subject to UK tax but with no relief being available under the DTA for the foreign tax suffered).
>
> In any case where a company does require a CoR to claim relief from

[163] See 38.8 (DT relief: pension income).

foreign taxes on dividends where the DTA provides that they must be subject to tax on those dividends, the company should provide a copy of the S931R(2) election with their request along with confirmation that the election has not been subsequently revoked.

108.13.6 *Subject to tax/Beneficial ownership compared*

The INT Manual provides:

> **INTM332020 Double Taxation Claims And Applications: Why Beneficial Ownership Matters** [Jun 2016]
> In some countries, no distinction is made between the concepts of legal and beneficial ownership, so beneficial ownership as a condition for relief may thus not appear in a double taxation agreement between the UK and one of those countries. But in such cases, the agreement usually requires the income to be subject to tax (INTM332200) in the other country. The person who is subject to tax on the income in question can usually be treated for practical purposes of relief under the agreement as if they were its owner.

The first sentence muddles different meanings of beneficial ownership. But as the passage overall suggests,"subject to tax" was in its origin an attempt to provide a rule similar to that which is nowadays expressed in terms of beneficial ownership.

108.13.7 *Subject to tax: Critique*

Avery Jones says:

> ... do subject to tax clauses not demonstrate that there is something wrong with the structure of tax treaties? That the resident might not be taxable on the particular item of income because of a transitional exemption, as in the *Weiser* case, is only the beginning of the problem. Other issues include the not-uncommon situation in which one state attributes income to one person and the other state to a different person, or the person may be liable to one type of tax covered by the treaty but not another, or one person may be liable to one tax covered by the treaty and a different person liable to another tax, or one state charges a tax covered by the treaty on a source basis and the other state has no equivalent type of tax, and so on. In such cases, which were not foreseen when the definition of resident was initially drafted, the problem is that by historical accident there is no real connection between the source provisions of the treaty, deriving from impersonal taxes, and the definition of resident, deriving from income taxes. The problem seems to lie not with *subject to tax* but with *liable to tax*. Why should the treaty

> relief in the source state depend on whether someone is liable to tax in principle on at least some foreign income? Would it not be better for treaties specifically to connect the income to the resident and give a reduction of tax in the source state on particular income only if the income was actually taxed in the residence state (or would have been taxed but for some reason that would be set out, such as an exemption for income of a charity)?[164]

In short, a "subject to tax" requirement would prevent double non-taxation. The EC have made the same point:

> **3. Limitation to the application of rules intended to avoid double taxation**
>
> 3.1. Where Member States, in double taxation conventions which they have concluded among themselves or with third countries, have committed not to tax a given item of income, Member States should ensure that such commitment only applies where the item is subject to tax in the other party to that convention.
>
> 3.2. To give effect to point 3.1, Member States are encouraged to include an appropriate clause in their double taxation conventions. Such clause could read as follows:
>
> > "Where this Convention provides that an item of income shall be taxable only in one of the contracting States or that it may be taxed in one of the contracting States, the other contracting State shall be precluded from taxing such item only if this item is subject to tax[165] in the first contracting State."
>
> ...
>
> 3.3. Where, with a view to avoid double taxation through unilateral national rules, Member States provide for a tax exemption in regard to a given item of income sourced in another jurisdiction, in which this item is not subject to tax, Member States are encouraged to ensure that the item is taxed.[166]

But in practice the "subject to tax" requirement is not used in modern

[164] [2013] BTR 9 at p.14 (footnotes omitted). This idea has been developed in Wheeler, *The Missing Keystone of Income Tax Treaties* (2012).

[165] The Recommendation recognises that the expression "subject to tax" can be problematic and provides: "3.4. For the purposes of points 3.1, 3.2 and 3.3 an item of income should be considered to be subject to tax where it is treated as taxable by the jurisdiction concerned and is not exempt from tax, nor benefits from a full tax credit or zero-rate taxation."

[166] EC "Recommendation of 6.12.2012 on aggressive tax planning" C(2012) 8806 *https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32012H0772*

treaties. There are various possible reasons for this.

(1) The requirement is conceptually problematic, as the discussion above shows.

(2) The requirement is not always effective. The practical effect of the rule that income in a State must be subject to tax can be avoided or mitigated by provisions in the domestic law of that State, such as:
(a) A rule that income is subject to tax at a very low rate, say 1%
(b) An exemption that can be waived[167]

But these objections do not seem so serious in practice. "Subject to tax" is a rough and ready solution to the problem of avoiding double non-taxation, but there is no short form perfect solution, and to ask for one is to cry for the moon. Tax law often has to settle for the second-best. The test is workability rather than perfection.

The true objection may be that States sometimes *intend* to have double non-taxation.[168]

[167] See 108.13.5 (Election to waive exemption).

[168] See 107.6 (Double non-taxation).

CHAPTER ONE HUNDRED AND NINE

THIRD PARTY RELIEF/SAVINGS CLAUSE

109.1 Third-party DT relief/credit
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109.5.6 "Residence" in Savings Clause
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109.1 Third-party DT relief/credit

109.1.1 *The issue*

This chapter considers the position where:

(1) Income[1] arises to a person treaty-resident in a foreign treaty State (**"the foreign resident"**).

(2) A person who is tax-resident in the UK, and not treaty-resident in the foreign State (**"the UK resident"**) would under domestic law be taxed on the income.

How can it happen that a UK resident is taxable on income arising to the foreign resident? There are various possible reasons, including:

(1) Hybrid entities (UK-law transparent, foreign-law opaque)

(2) Anti-avoidance provisions (such as s.3, s.86, s.624, s.720, CFC rules)

The question is whether the UK resident qualifies for:

Relief	**Meaning**
Third-party DT relief	DT relief on the income
Third-party foreign tax credit	Credit for foreign tax paid on the income

[1] The same issues apply to gains, and references to income in this chapter include gains.

These raise similar questions but are best considered separately.

109.2 Third-party DT relief

109.2.1 *Third-party relief available*

Article 1 OECD Model provides:

> This Convention shall apply to persons who are residents of one or both[2] of the Contracting States.

DT relief is not in principle restricted to the person to whom the income arises. It can apply to any treaty-resident. Sections 2 and 6 TIOPA authorise DT relief to apply in this way, for they simply provide "relief", ie relief for anyone.[3]

So it seems self-evident that a UK resident can in principle qualify for third-party DT relief, and authority can be cited to that effect.

In *Padmore v IRC*[4] a partner was entitled to DT exemption on income of a Jersey partnership where the partnership was a person treaty-resident in Jersey but the partner was not.

Likewise, in *Lee v HMRC* trustees were entitled to DT exemption on a gain accruing to a Mauritian trust, which was a hybrid entity: it was regarded as a person in Mauritius, and treaty-resident in Mauritius; but in the UK the gain was regarded as accruing to the trustees who were not treaty-resident in Mauritius. The trustees could not be taxed on the same gain.[5]

In *Lord Strathalmond v IRC*:[6]

(1) US source income arose to Lady Strathalmond ("the wife") who was treaty-resident in the USA.

[2] The words "or both" are not otiose. Under the OECD Model, a person cannot usually be treaty-resident in *both* treaty States, given the tie-breaker; but, at least after 2017, it could happen for a dual-resident company if the Contracting States did not reach a mutual agreement .

[3] Wheeler discusses this issue in *The Missing Keystone of Income Tax Treaties* (2012) para 3.2 (Subjective/objective nature of treaties) but her proposed terminology (Objective/subjective) is not the most helpful.

[4] 62 TC 352. But the position for partnerships was later reversed by statute: see 85.25 (DT relief: Partnership).

[5] [2017] UKFTT 279 (TC) at [90]-[92]. The OECD hybrid-entity rule will now cover this case: see 91.4.2 (OECD hybrid-entity rule).

[6] 48 TC 537.

(2) The rule at that time (repealed in 1988) was that income of a married woman was deemed to arise to her husband, so in the absence of treaty relief, Lord Strathalmond would have been taxable. The husband was treaty-resident in the UK.

The husband was entitled to DT exemption. The treaty exempted the income, not the treaty-resident individual, so a third party otherwise taxed on the income could claim the benefit of treaty relief even though not treaty-resident in the USA. *Bricom v IRC* summarised the point:[7]

> [*Strathalmond*] shows that the relief from UK tax accorded by a double taxation agreement can enure for the benefit of a third party.

Other countries adopt the same view.[8]

109.2.2 *Third-party relief denied*

In all the above cases third-party DT relief produces a fair result. But in other cases it may override anti-avoidance provisions which deem foreign income of a non-resident to arise to a UK resident, and so it may facilitate tax avoidance.

One possible solution to this problem would be to construe it away; and there are occasional comments in case law[9] and in the OECD Commentary to the effect that DTAs generally do *not* provide third-party relief. But that cannot be right, at least as a general rule: it is contradicted by the authorities set out above.

A second possible reaction to the problem was ad hoc domestic law provisions overriding third-party DT relief, and there were examples of this:

Topic	**See para**
Trading income	21.23.7
Partnerships	85.25

A third solution is to say that the income which arises to the third party

[7] 70 TC 272 at p.290.

[8] In *Canada v Sommerer* 2012 FCA 207 a gain accrued to trustees who were treaty-resident in the foreign State. Under a Canadian tax legislation similar to s.86, the gain was deemed to accrue to the Canadian resident settlor. The Canadian Federal CoA held that the settlor could claim DT relief under a treaty in OECD Model form.

[9] See the Special Commissioner comments in *IRC v Willoughby* [1995] STC 143 at p.169.

under the anti-avoidance rules was different from that arising to the person treaty-resident in the treaty state. That raises the issue of characterisation, and examples of this are considered below.

What was needed was an amendment to DTAs generally. This was eventually achieved by the OECD Savings Clause, which is increasingly but not universally applicable.[10] When it applies it overrides all third-party DT relief.

109.3 Third-party tax credit relief

Similar points apply to third-party foreign tax credit. Suppose:

(1) Income arises to a person treaty-resident in a foreign treaty State (**"the foreign resident"**) who pays tax in that State.

(2) A person who is tax-resident in the UK, and not treaty-resident in the foreign State (**"the UK resident"**) would under domestic law be taxed on the same income.

Foreign tax credit is in principle available because s.6(1) TIOPA allows "credit" ie credit for anyone. In this case however it is always fair that the relief should be available, even in avoidance cases.

For examples of third-party tax credit relief see:

Topic	**See**
Company groups: SP 6/88 para 4 examples (ii)(iii)	111.1
Directors	37.19
s.86	60.19.1

Sometimes third-party tax credit relief is allowed by statute. A statutory provision is needed to confer the relief where the income of the UK resident is not the same as the income of the foreign resident. In other cases the statutory provision is not strictly needed, though it does not harm, and may be regarded as for the avoidance of doubt. Examples are:

Topic	**See**
ToA: s.720	49.30.1
Settlor-interested trusts: s.624	47.18.1

109.4 Characterisation: Same income?

Third-party DT relief is available only if the income of the the UK resident

[10] See 109.5.2 (OECD Model Savings Clause).

is the same as the income of the foreign person.[11] The characterisation (or classification) of income in the hands of the UK resident is therefore a central question. I refer to this as the "**characterisation issue**".

The way for a Court minded to deny third-party relief is to find that the income in the hands of the UK resident is not the same as the income of the foreign person. So the characterisation issue often arises in cases where third-party DTA relief is sought (though it is not restricted to such cases).

There are two possibilities:

(1)(a) Income arises to a person treaty-resident in a foreign State, which under the treaty cannot be taxed in the UK.

(b) The *same* income is deemed to arise to a UK resident.

(2)(a) Income arises to a person treaty-resident in a foreign State, which under the treaty cannot be taxed in the UK.

(b) *Different* income is deemed to arise to a UK resident: the deeming "changes the character" of the income

In case (1) DT relief/foreign tax credit in principle applies, and in case (2) it does not.[12]

In *Huitson* the rule is correctly stated, but in pejorative terms:

> [The DTA] issue has spawned a somewhat metaphysical debate as to whether the "notional" income under section 739 [ICTA, in my terminology, s.720 deemed income] is different from the "real" income in the hands of the foreign resident, so that taxation of the "notional" does not conflict with relief of the "real".[13]

[11] See 107.22 (Characterisation).

[12] The facts of *IRC v Willoughby* offer a clear example of case (2):

(1) A life assurance company was treaty-resident in the Isle of Man. The IoM DTA provided relief for the commercial profits of the company.

(2) UK resident was (in principle) subject to tax on the income arising to the life company from a premium he paid to the company for a policy.

The s.720 income on which the UK resident was taxed could not be characterised as the commercial profits of the life assurance company; the income was merely one (in the context of the whole, trivial) element by reference to which those profits were computed. So for this reason the UK resident could not claim third-party DT relief. Though this is not the way that the Special Commissioner dealt with the point: 70 TC 57 at p.90. The taxpayer wisely did not appeal on the DTA issue.

[13] *Huitson (R, oao) v HMRC* [2010] EWHC 97 (Admin) at [64]. The point was not discussed in the subsequent appeal.

The debate is no more metaphysical than any question raised by deeming provisions, which are very common in taxation.

109.4.1 *Characterisation: Better view*

Suppose:

(1) Income accrues to A ("A's actual income").

(2) A statutory provision ("the deeming provision") provides that income is deemed to accrue to B ("B's deemed income").

The deeming provision may or may not change the character of the income, that is, B's deemed income may or may not be a different type from A's actual income. It is a question of construction of the deeming provision.

When considering the characterisation issue in relation to deeming provisions, it is helpful to bear in mind that there are (at least) four different fictions that deeming provisions may be used to achieve:

(1) *Deeming which changes the recipient*: Statute may deem that although income actually arose to A, it is deemed to arise to B.

(2) *Deeming which changes timing*: Statute may deem that although income actually arose at one time, it is deemed to arise at another time.

(3) *Deeming which changes quantum*: Statute may deem that although the amount of income which actually arose to A was £x, it is deemed to be of a different amount, £y.

(4) *Deeming which changes character*:

   (a) Statute may deem that although income which actually arose was of type A, the taxpayer is deemed to receive income of another type (type B).

   (b) Statute may deem that although what arises is gains, it is deemed to be income.

   (c) Statute may deem that although no income arises to anyone, the taxpayer is deemed to receive income.

Case (1) does not by itself change the character of the income.

> Exempt income does not change its character or lose its exemption merely because it is deemed to be the income of another person or is imputed to him.[14]

[14] *Bricom v IRC* 70 TC 272 at p.290 citing *Strathalmond v IRC* 48 TC 537.

The same applies if the UK provision apportions income to the taxpayer: “apportion” has the same meaning as “deems to accrue to” or “impute”.[15] The term “attribute” is also the same.[16]

Likewise in cases (2) and (3) third-party DT relief can still apply.

In case (4)(a) DT relief applicable to type A income only (not type B income) will not exempt the taxpayer. Cases (4)(b)(c) need further consideration.

So the mere fact that the legislation uses the terminology or technique of deeming does *not* mean that DT relief ceases to apply. One must ask what is the deeming, and in particular, is it deeming which changes the character of the income?

If B’s deemed income is exactly equivalent in amount to A’s actual income, one might think that the character of the income should in prinicple be the same. That is, if there is a change in the character of the income, the legislation should say so.

One reason that this is the case is that otherwise there may be a breach of the treaty. If a DTA provides income is exempt, parliament may breach the treaty in a straightforward manner and provide that the income is still taxable. There is still a treaty breach, albeit of a more subtle manner, if Parliament recharacterises the income and taxes it under its new name. DTAs are not construed so technically. While the UK can breach a treaty, tax legislation should be construed in a treaty-consistent manner where possible.

A second reason is that in a simple case where B’s deemed income is exactly equivalent to A’s actual income, there is no rational distinction to be drawn between A’s income and B’s deemed income.

Statute sometimes refers to the income of the person abroad being treated as arising to the person in the UK, and sometimes it refers to “an amount equal to the income”. It might be argued that the different wording implies a different outcome, the latter (only) suggesting that the income has changed its character. The taxpayer raised the argument in *Bricom* but it was rejected.[17] Perhaps that is for the best. A general distinction

[15] *Bricom v IRC* 70 TC 272 at p.290.

[16] The terms “apportion” and “attribute” are used synonymously in s.3 TCGA; see 64.3 (s.3 gain attributed to participator).

[17] 70 TC 272 at p.289: “The taxpayer lays stress on the fact that what is apportioned under [the CFC rules] is not “a sum equal to the chargeable profits” but the chargeable profits themselves; and that the subject of the charge to tax in [the CFC

between income and "an amount equal to" is a distinction without a difference.

The Canadian Supreme Court decision *R v Melford Developments*[18] supports this view. It concerned the 1956 Canada/Germany DTA under which German residents were exempt from Canadian tax on (Canada source) industrial or commercial profits, but subject to tax on (Canada source) interest. Canada domestic law subsequently provided that interest included guarantee fees. The question was the characterisation of guarantee fees for the purposes of the DTA. The Revenue relied on (the equivalent of) OECD Model art 3(2) (that undefined terms have domestic law meanings).[19] But context showed that the domestic law meaning did not apply for treaty purposes:

> Laws enacted by Canada to redefine taxation procedures and mechanisms with reference to income not subjected to taxation by the Agreement are not, in my view, incorporated in the expression "laws in force" in Canada as employed [in the equivalent of OECD Model art 3(2)]. To read this section otherwise would be to feed the argument of the appellant, which in my view is without foundation in law, that subs. (2) authorizes Canada or Germany to unilaterally amend the tax Treaty from time to time as their domestic needs may dictate.[20]

But in practice the UK Courts have not gone down this path.

109.4.2 *Characterisation: Courts view*

Bricom v IRC concerned a claim for third-party DT relief against a CFC charge:

(1) Income accrued to a subsidiary company treaty-resident in a foreign State ("the CFC").
(2) The parent company ("the UK parent") was UK tax-resident and not treaty-resident in a foreign State.
(3) The parent was subject to tax under the Controlled Foreign Company ("CFC") provisions.

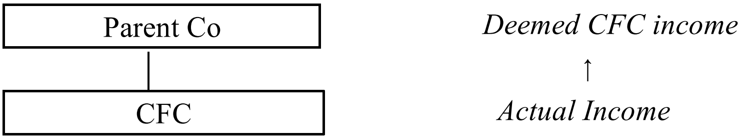
rules] is not "a sum equal to the apportioned part of the chargeable profits" but the apportioned part of the chargeable profits itself."

[18] [1982] 2 SCR 504 accessible *https://www.kessler.co.uk/tfd-archive*
Similar decisions were reached in *R v Associates Corporation of North America* 80 DTC 6094 and *Placements Serco v R* 84 DTC 6098.

[19] See 107.12 (Undefined treaty terms).

[20] at p.513

Diagrammatically:



According to CoA, the CFC provisions operate in three stages:

> Stage 1. *Ascertainment:* the CFC's chargeable profits are ascertained.
> Stage 2. *Apportionment*: the CFC's chargeable profits (less creditable tax) are apportioned among its shareholders. In *Bricom* the CFC was wholly-owned by the parent, so all its chargeable profits were attributed to the parent.
> Stage 3. *Assessment:* The parent is assessed on "a sum equal to corporation tax at the appropriate rate on that apportioned amount of profits" (less creditable tax) and the sum assessed is recoverable from the parent "… as if it were an amount of corporation tax chargeable on the parent".

The Special Commissioners held that interest received by the CFC lost its character as interest at stage 1. Millett LJ disagreed:

> It is ... a reflection of the Revenue's unsuccessful argument in *Hughes,* viz: that interest from exempt securities loses its character as income by being included in the computation of the recipient's trading profits.[21]

So far so good. But the interest lost its character at stage 2:

> The correct analysis is that the interest received by [the CFC] is not included in the sum apportioned to the taxpayer on which tax is chargeable. It merely provides a measure by which an element in a conventional or notional sum is calculated, and it is that conventional or notional sum which is apportioned to the taxpayer and on which tax is charged.[22]

In *Bricom* the parent company's income was not interest, because "the chargeable profits" as defined are *a notional sum.* Why are they more notional than the profits of any company?

> They do not represent any profits of [the CFC] on which UK

[21] *Hughes v Bank of New Zealand* 70 TC 272 at p.291; see xxx.
[22] 70 TC 272 at p.291.

> corporation tax is chargeable, for there are no such profits.[23]

This is no doubt correct, but why is it relevant? The question is not whether the parent's CFC income represented profits of the CFC *on which UK corporation tax is chargeable*. The question is whether it represented the profits of the CFC (or more accurately, whether its type is the same as those profits). The judgment then turns to this:

> Nor do they represent any actual payments or receipts of [the CFC], whether of interest or anything else.

Why not?

> They are merely the product of a mathematical calculation made on a hypothetical basis and making counterfactual assumptions.[24] The "chargeable profits" which are defined by s.747(6)(a) [ICTA] exist only as a measure of imputation. What is apportioned to the taxpayer and subjected to tax is not [the CFC's] actual profits but a notional sum which is the product of an artificial calculation.

The fact that taxable profits are ascertained by a mathematical calculation does not by itself change the character of the profits. The amount of profits on which tax is charged is in every case the product of a mathematical calculation.[25]

The result of *Bricom* may strike the reader as unfair, and the reasoning unconvincing.[26] However that may be, *Bricom* is clearly authority for two general propositions:

(1) The application of DT relief requires that the income of the taxpayer is the same income as that which qualifies for relief. (This is self-evident.)

(2) The characterisation issue is a matter of construction of the relevant provisions.

Bricom is authority for a third, narrower proposition: The CFC provisions

[23] 70 TC 272 at p.289.

[24] Millett wisely does not state what the hypothetical and counterfactual assumptions are: one must assume that the CFC is UK resident.

[25] CGT is charged on gains less losses; IT is charged on total income; CT is charged on profits.

[26] That unfairness may have been a factor in the ECJ decision that the CFC legislation was not EU-law compliant; see *Cadbury Schweppes v IRC* (2006) C-196/04. But post-Brexit, that does not matter.

specifically did alter the character of the income received by the parent.[27] The CFC provisions are now in Part 9A TIOPA, but no-one suggests that the position has changed.

The outcome in *Bricom* is supported by the OECD Commentary which states that the OECD Model is not intended to override CFC rules.[28] This is not mentioned in *Bricom*, but the Commentary, or the thinking behind it, lies behind the decision. The Savings Clause now gives effect to the Commentary's view.

The question after *Bricom* was whether its reasoning should be regarded as restricted to CFCs or whether it applied to other anti-avoidance provisions where third party-relief might apply. In earlier editions of this work I argued for the former view. But *Davies v HMRC*[29] applied *Bricom* reasoning in a ToA context, so I am now doubtful about that. Looking back on *Bricom*, after *Davies v HMRC,* it seems to me that

[27] I do not consider how convincing is the reasoning, but note that in France the opposite view was reached: *Re Société Schneider Electric* (2002) 4 ITLR 1077 (Conseil d'État).

[28] Article 7(1) OECD Model (business profits) provides:

> 1. Profits of an enterprise of a Contracting State shall be taxable only in that State ...

OECD Commentary on art 7 provides:

> 14. [Art 7(1)] does not limit the right of a Contracting State to tax its own residents under controlled foreign companies provisions found in its domestic law even though such tax imposed on these residents may be computed by reference to the part of the profits of an enterprise that is resident of the other Contracting State that is attributable to these residents' participation in that enterprise. Tax so levied by a State on its own residents does not reduce the profits of the enterprise of the other State and may not, therefore, be said to have been levied on such profits (see also paragraph 81 of the Commentary on Article 1).

This has been in the OECD Commentary since 2008; it was inserted following OECD Report "The 2008 Update to the Model Tax Convention". There was a trivial amendment in 2010, not relevant here.

The same point is made in OECD Commentary on article 1, which concludes:

> 81 ...whilst some countries have felt it useful to expressly clarify, in their conventions, that controlled foreign company legislation did not conflict with the Convention, such clarification is not necessary. It is recognised that controlled foreign company legislation structured in this way is not contrary to the provisions of the Convention.

A similar point is made in paragraphs 37 to 39 of the Commentary on art 10(5) (dividends), though that is not directly relevant in the UK as UK CFC rules do not work in the manner envisaged in those paragraphs.

[29] [2020] UKUT 67 (TCC).

recharacterisation has been used as a method of avoiding third-party relief, in the context of anti-avoidance provisions, where the Court considers that the relief ought not to apply: these are cases of result-driven reasoning.

In the following contexts, third-party DT relief is not available on the basis of *Bricom*-style reasoning:

Provision	**See**
s.720	49.30.3
s.86	60.19.1

In other contexts HMRC have accepted that third-party relief could be available, ie, the anti-avoidance rule did not change the character of the income:

Provision	**See**
s.624 ITTOIA	47.18.2
s.3 TCGA	64.40.2

s.77 TCGA (*repealed but HMRC formerly allowed 3rd- party relief)*; see 9.19.6

The reader may struggle to identify the difference in the statutory wording and wonder whether a Court would allow third-party relief here if it was challenged. But the question may never be litigated, because:

(1) Section 77 was long ago repealed.

(2) Going forward, the issue will generally be resolved in HMRC's favour by the Savings Clause

109.5 Savings Clause

109.5.1 *Terminology*

There are (at least) 3 DTA Savings Clause rules. I coin the following terminology:

Term	**Definition**
OECD Savings Clause(s):	
OECD Model Savings Clause	art 1(3) OECD Model
BEPS MLI[30] Savings Clause	art 11(1) BEPS MLI
US Savings Clause	art 1(4) USA/UK DTA

The term "Savings Clause" is used because, with limited exceptions, it preserves ('saves') the right of a State to tax its residents irrespective of other provisions of the treaty.

[30] See 107.15 (BEPS MLI).

I use initial capitals to reflect the technical nature of the expression.

109.5.2 *The Savings Clauses*

OECD Savings Clause **Art 1(3) OECD Model**	**BEPS MLI Savings Clause** **Art 11 BEPS MLI**	**US Savings Clause** **Art 1(4) USA/UK DTA**
		Notwithstanding any provision of this Convention except paragraph 5 of this Article,
[a] This Convention shall not affect the taxation, by a Contracting State, of its residents	1. A Covered Tax Agreement shall not affect the taxation by a Contracting Jurisdiction of its residents,	a Contracting State may tax [1] its residents (as determined under Article 4 (Residence), and [2] by reason of citizenship may tax its citizens, as if this Convention had not come into effect.
[b] except with respect to the benefits granted under paragraph 3 of Article 7, paragraph 2 of Article 9 and Articles 19, 20, 23 A [23 B], 24 and 25 and 28.	except with respect to the benefits granted under provisions of the Covered Tax Agreement: [for the list, See 109.5.4 (BEPS MLI Savings Clause Exceptions).	

109.5.3 *Exceptions to Savings Clauses*

The list of exceptions to the Savings Clause is quite limited

Article 1(3)[b] OECD Model provides 7 exceptions to the OECD Savings Clause:

Article	**Topic**
7(3)	Deduction for expenses of PE
9(2)	Transfer pricing
19	Government service
20	Students
23A/B	Foreign tax credit relief
24	Non-discrimination
25	Mutual agreement procedure

Art 1(5) USA/UK DTA sets out a list of exceptions to the US Savings

Clause, which is similar but not identical to the OECD Model:

> The provisions of paragraph 4 of this Article shall not affect—
>
> (a) the benefits conferred by a Contracting State under[31]

Article	**Topic**
Art 9(2)	Associated enterprises: transfer pricing
Art 17(1)(b), (3)-(5)	Pensions, social security, annuities, alimony, and child support
Art 18(1)(5)	Pension schemes
Art 24	Foreign tax credit relief
Art 25	Non-discrimination
Art 26	Mutual agreement procedure

The US Treasury Technical Explanation of the Convention[32] summarises the exceptions:

> Some provisions are intended to provide benefits to citizens and residents even if such benefits do not exist under internal law. Paragraph 5 sets forth certain exceptions to the saving clause that preserve these benefits for citizens and residents of the Contracting States.
>
> Subparagraph (a) lists certain provisions of the Convention that are applicable to all citizens and residents of a Contracting State, despite the general saving clause rule of paragraph 4:
>
> (1) Paragraph 2 of Article 9 (Associated Enterprises) grants the right to a correlative adjustment with respect to income tax due on profits reallocated under Article 9.
>
> (2) Subparagraph 1(b) and paragraphs 3 and 5 of Article 17 (Pensions, Social Security, Annuities, Alimony, and Child Support) provide exemptions from source or residence State taxation for certain pension distributions, social security payments and child support.
>
> (3) Paragraph 1 of Article 18 (Pension Scheme) provides an exemption for certain investment income of pension schemes located in the other State, while paragraph 5 provides benefits for certain contributions by or on behalf of a U.S. citizen to certain pension schemes established in the UK.
>
> (4) Article 24 (Relief from Double Taxation)[33] confirms the benefit of a credit to citizens and residents of one Contracting State for income taxes paid to the other, even if such a credit may not be available under the Code.

[31] For clarity, I set this out in a table format, and abbreviate the topic descriptions.

[32] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[33] See 111.25 (UK-resident USA citizen).

> (5) Article 25 (Non-Discrimination) requires one Contracting State to grant national treatment to nationals of the other Contracting State in certain circumstances. Excepting this Article from the saving clause requires, for example, that the United States give such benefits to a national of the UK even if that person is a citizen of the United States.
> (6) Article 26 (Mutual Agreement Procedure) may confer benefits on residents or nationals of the Contracting States. For example, the statute of limitations may be waived for refunds and the competent authorities are permitted to use a definition of a term that differs from the internal law definition. As with the foreign tax credit, these benefits are intended to be granted by a Contracting State to its citizens and residents.

The list of exceptions in art 1(5) continues:

> The provisions of paragraph 4 of this Article shall not affect ...
> (b) the benefits conferred by a Contracting State under
> [i] paragraph 2 of Article 18 (Pension Schemes) and
> [ii] Articles 19 (Government Service),
> [iii] Art 20 (Students),
> [iv] Art 20A (Teachers), and
> [v] Art 28 (Diplomatic Agents and Consular Officers)
> of this Convention, upon individuals who are neither citizens of, nor have been admitted for permanent residence in, that State.

The US Treasury Technical Explanation of the Convention[34] provides:

> Subparagraph (b) of paragraph 5 provides a different set of exceptions to the saving clause. The benefits referred to are all intended to be granted to temporary residents of a Contracting State (for example, in the case of the United States, holders of non-immigrant visas), but not to citizens or to persons who have acquired permanent residence in that State. If beneficiaries of these provisions travel from one of the Contracting States to the other, and remain in the other long enough to become residents under its internal law, but do not acquire permanent residence status (i.e., in the U.S. context, they do not become "green card" holders) and are not citizens of that State, the host State will continue to grant these benefits even if they conflict with statutory rules. The benefits preserved by this paragraph are: the host country exemptions for the following items: government service salaries and pensions under Article 19 (Government Service); certain income of visiting students, trainees, teachers, professors, and researchers under

[34] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> Articles 20 (Students) and 20A (Teachers); the income of diplomatic agents and consular officers under Article 28 (Diplomatic Agents and Consular Officers); and the beneficial tax treatment of pension fund contributions under paragraph 2 of Article 18 (Pension Schemes).

Green card holders are at a disadvantage compared to US citizens since they pay US taxes but do not have the same benefits under the treaty. HMRC say:

> HMRC explained that the UK was not obliged to give credit where the US taxed a green card holder on a world wide basis and the taxpayer was not tax resident in the US, but where we see a recharge to the US for US workdays we will accept the US has the primary taxing rights in the same way as for US citizens and we will give credit for the US tax paid on those US workdays by green cardholders. In the US a green card holder is debarred from claiming relief under a treaty. HMRC suggested that an individual who is taxed in the US on their world wide income because he retains his green card and so is treated as a resident of the US for the purposes of Article 1(4) even though they would be treaty resident in the UK may not have taken all reasonable steps to minimise their US liability, as required by s.795A ICTA if he were to qualify for credit relief. As such, although strictly Article 24(6) may not apply to green card holders in these circumstances, the effect of the minimisation requirement is that the UK will limit relief given in the UK under the treaty to that which would be given if Article 24(6) did apply. Representatives pointed out that giving up the green card might trigger expatriation taxes in the US.
>
> The HMRC position is that we will not give relief in the UK for tax paid in the US as a result of Article 1(4). We believe that the US will give unilateral relief for the UK tax paid on their income at least to the extent it arises in the UK so as far as we know this should not lead to double taxation although it could lead to higher tax payable in the US as a result of the alternative minimum tax provisions.[35]

109.5.4 *BEPS MLI Savings Clause Exceptions*

Article 11 BEPS MLI lists10 cases where the Savings Clause does not apply. Of course (unlike the OECD Model Savings Clause) this has to be specified in general terms, without reference to specific article numbers. The exceptions are benefits granted under provisions of the Covered Tax

[35] *http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/consultations/expat-mins-160409.htm*

Agreement:

Exception	**OECD Model**
a) which require that Contracting Jurisdiction to grant to an enterprise of that Contracting Jurisdiction a correlative or corresponding adjustment following an initial adjustment made by the other Contracting Jurisdiction, in accordance with the Covered Tax Agreement, to the amount of tax charged in the first-mentioned Contracting Jurisdiction on the profits of a permanent establishment of the enterprise or the profits of an associated enterprise;	7(3)
b) which may affect how that Contracting Jurisdiction taxes an individual who is a resident of that Contracting Jurisdiction if that individual derives income in respect of services rendered to the other Contracting Jurisdiction or a political subdivision or local authority or other comparable body thereof;	19
c) which may affect how that Contracting Jurisdiction taxes an individual who is a resident of that Contracting Jurisdiction if that individual is also a student, business apprentice or trainee, or a teacher, professor, lecturer, instructor, researcher or research scholar who meets the conditions of the Covered Tax Agreement;	20 -[36]
d) which require that Contracting Jurisdiction to provide a tax credit or tax exemption to residents of that Contracting Jurisdiction with respect to the income that the other Contracting Jurisdiction may tax in accordance with the Covered Tax Agreement (including profits that are attributable to a permanent establishment situated in that other Contracting Jurisdiction in accordance with the Covered Tax Agreement);	23A/B
e) which protect residents of that Contracting Jurisdiction against certain discriminatory taxation practices by that Contracting Jurisdiction;	24
f) which allow residents of that Contracting Jurisdiction to request that the competent authority of that or either Contracting Jurisdiction consider cases of taxation not in accordance with the Covered Tax Agreement;	25
g) which may affect how that Contracting Jurisdiction taxes an individual who is a resident of that Contracting Jurisdiction when that individual is a member of a diplomatic mission, government mission or consular post of the other Contracting Jurisdiction;	28
h) which provide that pensions or other payments made under the social security legislation of the other Contracting Jurisdiction shall be taxable only in that other Contracting Jurisdiction;	18

[36] Some treaties make provision for teachers etc, though this is not in the OECD Model.

i) which provide that pensions and similar payments, annuities, alimony payments or other maintenance payments arising in the other Contracting Jurisdiction shall be taxable only in that other Contracting Jurisdiction; or 18

j) which otherwise expressly limit a Contracting Jurisdiction's right to tax its own residents or provide expressly that the Contracting Jurisdiction in which an item of income arises has the exclusive right to tax that item of income. -

109.5.5 *Savings clause: Effect*

The effect (in the terminology of this book) is to override third-party DTA relief.[37]

The OECD drafting is based on the US Savings Clause. But the effect of the US Savings Clause is wider because the scope of US tax (citizenship-based taxation) is wider.

OECD commentary to art 1(3) provides:

> 17. Whilst some provisions of the Convention (e.g. Articles 23 A and 23 B) are clearly intended to affect how a Contracting State taxes its own residents, the object of the majority of the provisions of the Convention is to restrict the right of a Contracting State to tax the residents of the other Contracting State. In some limited cases, however, it has been argued that some provisions could be interpreted as limiting a Contracting State's right to tax its own residents in cases where this was not intended (see, for example, paragraph 81 below, which addresses the case of controlled foreign company provisions).
>
> 18. Paragraph 3 confirms the general principle that the Convention does not restrict a Contracting State's right to tax its own residents except where this is intended and lists the provisions with respect to which that principle is not applicable.

The suggestion is that the introduction of OECD Savings Clause does not change the law, and merely confirms the generally accepted interpretation. That is not correct, and the introduction of the OECD Savings Clause will have a significant effect in UK taxation.[38] But there is a long tradition of misdescribing substantial tax changes as clarification.

OECD had CFC rules in mind in particular. Whatever the position may have been before, third party DTA relief does not override CFC rules,

[37] See 109.1 (Third-party DT relief).

[38] See App 1.2 (Clarify/modernise/reform).

where a treaty includes the OECD Savings Clause. The Commentary to art 1(3) provides:

> 81. A significant number of countries have adopted controlled foreign company provisions to address issues related to the use of foreign base companies. Whilst the design of this type of legislation varies considerably among countries, a common feature of these rules, which are now internationally recognised as a legitimate instrument to protect the domestic tax base, is that they result in a Contracting State taxing its residents on income attributable to their participation in certain foreign entities. It has sometimes been argued, based on a certain interpretation of provisions of the Convention such as paragraph 1 of Article 7 and paragraph 5 of Article 10, that this common feature of controlled foreign company legislation conflicted with these provisions. Since such legislation results in a State taxing its own residents, paragraph 3 of Article 1 confirms that it does not conflict with tax conventions. The same conclusion must be reached in the case of conventions that do not include a provision similar to paragraph 3 of Article 1; for the reasons explained in paragraphs 14 of the Commentary on Article 7 and 37 of the Commentary on Article 10, the interpretation according to which these Articles would prevent the application of controlled foreign company provisions does not accord with the text of paragraph 1 of Article 7 and paragraph 5 of Article 10. It also does not hold when these provisions are read in their context. Thus, whilst some countries have felt it useful to expressly clarify, in their conventions, that controlled foreign company legislation did not conflict with the Convention, such clarification is not necessary. It is recognised that controlled foreign company legislation structured in this way is not contrary to the provisions of the Convention.

Similarly, with limited exceptions, the US Savings Clause preserves ('saves') the right of the US to tax its citizens/residents irrespective of any other provision of the treaty.

So subject to the art 1(5) exceptions:

(1) US may tax US citizens and US treaty-residents ignoring treaty relief.
(2) UK may tax UK treaty-residents ignoring treaty relief.

On the other hand, UK must allow treaty relief to US treaty-residents, and US must allow relief to UK treaty-residents who are not US citizens.

The US Treasury Technical Explanation of the Convention[39] provides:

[39] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> Paragraph 4 contains the traditional saving clause found in U.S. tax treaties. The Contracting States reserve their rights, except as provided in paragraph 5, to tax their residents and citizens as provided in their internal laws, notwithstanding any provisions of the Convention to the contrary. For example, if a resident of the UK performs professional services in the United States and the income from the services is not attributable to a permanent establishment in the United States, Article 7 (Business Profits) would by its terms prevent the United States from taxing the income. If, however, the resident of the UK is also a citizen of the United States, the saving clause permits the United States to include the remuneration in the worldwide income of the citizen and subject it to tax under the normal Code rules (i.e., without regard to Code section 894(a)). However, subparagraph 5(a) of this Article preserves the benefits of special foreign tax credit rules applicable to the U.S. taxation of certain U.S. income of its citizens resident in the UK. See paragraph 6 of Article 24 (Relief from Double Taxation).

109.5.6 *"Residence" in Savings Clause*

Of course "residence" here means treaty-residence. OECD Commentary provides:

> The term "resident", as used in paragraph 3 and throughout the Convention, is defined in Article 4. Where, under paragraph 1 of Article 4, a person is considered to be a resident of both Contracting States based on the domestic laws of these States, paragraphs 2 and 3 of that Article make it generally possible to determine a single State of residence for the purposes of the Convention. Thus, paragraph 3 does not apply to an individual or legal person who is a resident of one of the Contracting States under the laws of that State but who, for the purposes of the Convention, is deemed to be a resident only of the other Contracting State.[40]

The USA/UK DTA Savings Clause states expressly that residence means treaty-residence. The US Technical Explanation provides:

> For purposes of the saving clause, "residence" is determined under Article 4 (Residence). Thus, an individual who is a U.S. resident under the Internal Revenue Code but who is deemed to be a resident of the UK under the tie-breaker rules of Article 4 would be subject to U.S. tax only to the extent permitted by the Convention. For example, if an individual who is not a U.S. citizen is a resident of the United States under the

[40] Commentary on art 1, para 21.

> Code, and is also a resident of the UK under its law, and that individual has a permanent home available to him in the UK and not in the United States, he would be treated as a resident of the UK under Article 4 and for purposes of the saving clause. The United States would not be permitted to apply its statutory rules to that person if they are inconsistent with the treaty.[41]

109.5.7 *Application of BEPS Savings Clause*

Article 11(2) BEPS MLI provides:

> 2. Paragraph 1 shall apply in place of or in the absence of provisions of a Covered Tax Agreement stating that the Covered Tax Agreement would not affect the taxation by a Contracting Jurisdiction of its residents.

Article 11 BEPS MLI provides two possible opt-outs:

> 3. A Party may reserve the right:
> a) for the entirety of this Article not to apply to its Covered Tax Agreements;
> b) for the entirety of this Article not to apply to its Covered Tax Agreements that already contain the provisions described in paragraph 2.

The UK has not made either of the reservations described in art 11(3)(a)(b); in short, it has adopted the BEPS MLI Savings Clause.

> 4. [a] Each Party that has not made the reservation described in subparagraph a) or b) of paragraph 3 shall notify the Depositary of
> [i] whether each of its Covered Tax Agreements contains a

[41] The treaty continues with a comment that UK treaty-residence does not preclude US domestic-law residence, a point only relevant to the US (though a comparable rule applies in the UK): "However, the person would be treated as a U.S. resident for U.S. tax purposes other than determining the individual's U.S. tax liability. For example, in determining under Code section 957 whether a foreign corporation is a controlled foreign corporation, shares in that corporation held by the individual would be considered to be held by a U.S. resident. As a result, other U.S. citizens or residents might be deemed to be United States shareholders of a controlled foreign corporation subject to current inclusion of Subpart F income recognized by the corporation. See Treas. Reg. section 301.7701(b)-7(a)(3). The application of the saving clause to former citizens and long-term residents is addressed not in paragraph 4 but in paragraph 6."

provision described in paragraph 2,

[ii] and if so, the article and paragraph number of each such provision.

[b] Where all Contracting Jurisdictions have made such a notification with respect to a provision of a Covered Tax Agreement, [ie where all parties to a DTA have not opted out] that provision shall be replaced by the provisions of paragraph 1.

[c] In other cases, [ie where any party to a DTA has opted out] paragraph 1 shall supersede the provisions of the Covered Tax Agreement only to the extent that those provisions are incompatible with paragraph 1.

UK MLI Notifications[42] sets out a list of 23 jurisdictions which contain the provision described in art 11(2); these will fall within para 4[c] if the jurisdiction opts out of art 11.

[42] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725261/Final_list_of_UK_reservations_and_notifications_made_on_deposit_of_the_instrument_of_ratification.pdf*

CHAPTER ONE HUNDRED AND TEN

LIMITATION ON BENEFITS

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110.1 Limitation on Benefits

110.1.1 *Introduction*

"Limitation on Benefits" ("LoB") is a label for provisions of the type found in:

(1) Article 23 USA/UK DTA (headed *Limitation on Benefits*)

(2) OECD treaties:

(a) OECD Model art 29 (headed *Entitlement to Benefits)*: the Model itself has only an outline, but the Commentary has
(ii) a simplified version
(iii) a detailed version (references below are to this version unless otherwise stated)

(b) BEPS MLI article 7(8) - (13), which MLI calls the *Simplified Limitation on Benefits Provision*

I write it with initial capitals, to reflect the technical nature of the term.[1]

The UK has opted out of the MLI Simplified Limitation on Benefits Provision.[2] However it is possible that future treaties will contain provisions of that kind.

110.1.2 *The LoB rule*

The rule is broadly that treaty benefits are limited to Qualified Persons (elaborately defined):

art 29(1) OECD Model	**art 23(1) USA/UK DTA**
Except as otherwise provided in this Article, a resident of a Contracting State shall not be entitled to a benefit that would otherwise be accorded by this Convention (other than a benefit under paragraph 3 of Article 4, paragraph 2 of Article 9 or Article 25) unless such resident is a "qualified person", as defined in paragraph 2, at the time that the benefit would be accorded.	Except as otherwise provided in this Article, a resident of a Contracting State that derives income, profits or gains from the other Contracting State shall be entitled to all the benefits of this Convention otherwise accorded to residents of a Contracting State only if [a] such resident is a "qualified person" as defined in paragraph 2 of this Article and [b] satisfies any other specified conditions for the obtaining of such benefits.

If the US LoB provision applies, it is at present disputed whether unilateral relief applies: see 111.12 (DTA/Unilateral Credit: Priority).

The OECD exceptions referred to are not very significant:

Art	**Topic**	**See para**
4(3)	Tie-breaker: Mutual agreement	9.18
9(2)	Transfer pricing adjustment	*Not discussed*
25	Mutual agreement procedure	*Not discussed*

See too 108.8.2 (PPT/LoB: relationship).

[1] See Neidle, "The BEPS multilateral convention: who loves SLOBs?" Tax Journal, 30 June 2017.

[2] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725261/Final_list_of_UK_reservations_and_notifications_made_on_deposit_of_the_instrument_of_ratification.pdf*

110.2 Qualified persons

There are about 10 categories of qualified person. In summary:

Category	**OECD model**	**USA DTA**	**See**	**Jersey DTA**	**See**
Qualified persons			*This para:*		110.7
Individuals	29(2)(a)	23(2)(a)	110.2.1	11(3)(a)(i)	
Government entity	29(2)(b)	23(2)(b)	110.2.2	11(3)(a)(ii)	
Listed company	29(2)(c)	23(2)(c)	110.2.3	11(3)(a)(iii)	
Subsid/consortium co	29(2)(d)	23(2)(d)(ii)	110.2.4		
Charity/NPO	29(2)(e)(i)	23(2)(e)	110.2.5		
Pension//EBT/bank	29(2)(e)(ii)	23(2)(e)	110.2.6	11(3)(a)(v/vi)(vii)	
Foreign owned co	29(2)(f)	23(2)(f)	110.2.7		
CIS/unit trust	29(2)(g)	23(2)(d)(i)	110.2.8		
Trusts	-	23(2)(g)	110.2.9		
Other exemptions					
Active business	29(3)	23(3)	110.3		
PPT	23(5)/(6)	23(6)	110.5	11(3)(a)(v/vi)(vii)	

110.2.1 *Individuals*

art 29(2) OECD Model

2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is:
a) an individual;

art 23(2) USA/UK DTA

(2) A resident of a Contracting State is a qualified person for a taxable or chargeable period only if such resident is either—
(a) an individual;

This is straightforward.

110.2.2 *Governmental entity*

art 29(2) OECD Model

2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is ...
b) that Contracting State, or a political subdivision or local authority thereof, or an agency or instrumentality of that State, political subdivision or local authority;

art 23(2) USA/UK DTA

(2) A resident of a Contracting State is a qualified person for a taxable or chargeable period only if such resident is...
(b) a qualified governmental entity;

See 9.27.4 (Governmental entity).

110.2.3 *Quoted company*

art 29(2) OECD Model

2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is ...
c) a company or other entity, if, throughout the taxable period that includes that time, the principal class of its shares (and any disproportionate class of shares) is regularly traded on one or more recognised stock exchanges,

and either:
(i) its principal class of shares is primarily traded on one or more recognised stock exchanges located in the Contracting State of which the company or entity is a resident;
or
(ii) the company's or entity's primary place of management and control is in the Contracting State of which it is a resident;

art 23(2) USA/UK DTA

(2) A resident of a Contracting State is a qualified person for a taxable or chargeable period only if such resident is ...
(c) a company, if
(i) the principal class of its shares
[a] is listed or admitted to dealings on a recognised stock exchange specified in clauses (i) or (ii) of sub-paragraph (a) of paragraph 7 of this Article and
[b] is regularly traded on one or more recognised stock exchanges,

The OECD simplified version provides:

> c) a company or other entity, if the principal class of its shares is regularly traded on one or more recognised stock exchanges;

110.2.4 *Subsidiary/consortium company*

art 29(2) OECD Model

2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is ...
d) a company, if:
(i) throughout the taxable period that includes that time, at least 50% of the

art 23(2) USA/UK DTA

(2) A resident of a Contracting State is a qualified person for a taxable or chargeable period only if such resident is ...
(c) a company, if ...
(ii) shares representing at least 50% of the aggregate voting

aggregate vote and value of the shares (and at least 50% of the aggregate vote and value of any disproportionate class of shares) in the company	power and value of the company
is owned directly or indirectly by five or fewer companies or entities entitled to benefits under subparagraph c) of this paragraph,	are owned directly or indirectly by five or fewer companies entitled to benefits under clause (i) of this sub-paragraph,
provided that, in the case of indirect ownership, each intermediate owner is a resident of the Contracting State from which a benefit under this Convention is being sought or is a qualifying intermediate owner; and	provided that, in the case of indirect ownership, each intermediate owner is a resident of either Contracting State;
(ii) with respect to benefits under this Convention other than under Article 10, less than 50% of the company's gross income, and less than 50% of the tested group's gross income, for the taxable period that includes that time, is paid or accrued, directly or indirectly, in the form of payments that are deductible in that taxable period for purposes of the taxes covered by this Convention in the company's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested group, not including intra-group transactions) to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph a), b), c) or e);	

Indirect ownership is ownership through a tier of companies.

110.2.5 *Charity/NPO*

art 29(2) OECD Model	**art 23(2) USA/UK DTA**
2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by	(2) A resident of a Contracting State is a qualified person for a taxable

the Convention if, at that time, the resident is ...
e) a person, other than an individual, that:
(i) is a [agreed description of the relevant non-profit organisations found in each Contracting State],

or chargeable period only if such resident is ...
(e) a person described in sub-paragraph ... (c) of paragraph 3 of Article 4 (Residence) of this Convention,[3]

The OECD simplified version provides:

d) a person, other than an individual, that:
   (i) is a [agreed description of the relevant non-profit organisations found in each Contracting State],
   (ii) is a recognised pension fund;

110.2.6 *Pension scheme/EBT*

art 29(2) OECD Model

e) a person, other than an individual, that: ...
(ii) is a recognised pension fund to which subdivision (i) of the definition of recognised pension fund in paragraph 1 of Article 3 applies, provided that more than 50% of the beneficial interests in that person are owned by individuals resident of either Contracting State, or more than [__%] of the beneficial interests in that person are owned by individuals resident of either Contracting State or of any other State with respect to which the following conditions are met
A) individuals who are residents of that other State are entitled to the benefits of a comprehensive convention for the avoidance of double taxation between that other

art 23(2) USA/UK DTA

(2) A resident of a Contracting State is a qualified person for a taxable or chargeable period only if such resident is ...
(e) a person described in sub-paragraph (a), (b) ... of paragraph 3 of Article 4 (Residence) of this Convention,[1] provided that, in the case of a person described in sub-paragraph (a) or (b) of that paragraph, more than 50% of the person's beneficiaries, members or participants are individuals who are residents of either Contracting State;

[3] See 9.27.3 (Charity/NPO).

State and the State from which the benefits of this Convention are claimed, and

B) with respect to income referred to in Articles 10 and 11 of this Convention, if the person were a resident of that other State entitled to all the benefits of that other convention, the person would be entitled, under such convention, to a rate of tax with respect to the particular class of income for which benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or

(iii) is a recognised pension fund to which subdivision (ii) of the definition of recognised pension fund in paragraph 1 of Article 3 applies, provided that it is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in the preceding subdivision;

[1] See 9.27.1 (Pension scheme); 9.27.2 (Employee benefit trust).

110.2.7 *Structures*

Art 29(2) OECD Model provides:

> 2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is ...
>
> f) a person other than an individual, if
>
> (i) at that time and on at least half of the days of a twelve-month period that includes that time, persons who are residents of that Contracting State and that are entitled to the benefits of this Convention under subparagraph a), b), c) or e) own, directly or indirectly, shares representing at least 50% of the aggregate vote and value (and at least 50% of the aggregate vote and value of any

disproportionate class of shares) of the shares in the person, provided that, in the case of indirect ownership, each intermediate owner is a qualifying intermediate owner, and
(ii) less than 50% of the person's gross income, and less than 50% of the tested group's gross income, for the taxable period that includes that time, is paid or accrued, directly or indirectly, in the form of payments
[A] that are deductible for purposes of the taxes covered by this Convention in the person's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested group, not including intra-group transactions),
[B] to persons that are not residents of either Contracting State entitled to the benefits of this Convention under subparagraph a), b), c) or e) of this paragraph;

110.2.8 *Collective investment scheme*

Art 29(2) OECD Model provides:

2. A resident of a Contracting State shall be a qualified person at a time when a benefit would otherwise be accorded by the Convention if, at that time, the resident is ...
g) a collective investment vehicle [a definition of "collective investment vehicle" would then be included in paragraph 7]; *or*
g) a collective investment vehicle, but only to the extent that, at that time, the beneficial interests in the collective investment vehicle are owned by [residents of the Contracting Sate in which the collective investment vehicle is established or by[4]] equivalent beneficiaries; *or*
g) a collective investment vehicle, but only to the extent that, at that time, the beneficial interests in the collective investment vehicle are owned by residents of the Contracting State in which the collective investment vehicle is established.
or
g) a collective investment vehicle if the principal class of shares in the collective investment vehicle is listed and regularly traded on a recognised stock exchange.

Article 23 USA/UK DTA deals with unit trusts:

> (2) A resident of a Contracting State is a qualified person for a taxable or chargeable period only if such resident is ...

[4] Footnote original: The words "residents of the Contracting State in which the collective investment vehicle is established" would not be needed if the definition of "equivalent beneficiary" used for the purpose of that provision was identical to the detailed version of the definition of the term "equivalent beneficiary" in paragraph 7; see paragraph 145 below.

> (d) a person other than an individual or a company, if—
>
> (i) the principal class of units[5] in that person
>
> [a] is listed or admitted to dealings on a recognized stock exchange specified in clauses (i) or (ii) of sub-paragraph (a) of paragraph 7 of this Article and
>
> [b] is regularly traded on one or more recognised stock exchanges, or
>
> (ii) the direct or indirect owners of at least 50% of the beneficial interests in that person are qualified persons by reason of clause (i) of sub-paragraph (c) or clause (i) of this sub-paragraph;

110.2.9 *Trusts*

Article 23 USA/UK DTA deals with trusts

> (2) A resident of a Contracting State is a qualified person for a taxable or chargeable period only if such resident is ...
>
> (g) a trust or trustee of a trust in their capacity as such if at least 50% of the beneficial interest in the trust is held by persons who are either—
>
> (i) qualified persons by reason of sub-paragraphs (a), (b), clause (i) of sub-paragraph (c), clause (i) of sub-paragraph (d), or sub-paragraph (e) of this paragraph; or
>
> (ii) equivalent beneficiaries,
>
> provided that less than 50% of the gross income arising to such trust or trustee in their capacity as such for the taxable or chargeable period is paid or accrued, directly or indirectly, to persons who are not residents of either Contracting State in the form of payments that are deductible for the purposes of the taxes covered by this Convention in the Contracting State of which that trust or trustee is a resident (but not including arm's length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank, provided that where such a bank is not a

[5] Art 23(7) USA/UK DTA provides: (c) the term "units" as used in sub-paragraph (d) of paragraph 2 of this Article includes shares and any other instrument, not being a debt-claim, granting an entitlement to share in the assets or income of, or receive a distribution from, the person. The term "principal class of units" means the class of units which represents the majority of the value of the person. If no single class of units represents the majority of the value of the person, the "principal class of units" is those classes that in the aggregate represent the majority of the value of the person;

resident of a Contracting State such payment is attributable to a permanent establishment of that bank located in one of the Contracting States).

110.3 Active business

art 29(3) OECD Model	**art 23(3) USA/UK DTA**
3. a) A resident of a Contracting State shall be entitled to benefits under this Convention with respect to an item of income derived from the other Contracting State, regardless of whether the resident is a qualified person, if the resident is engaged in the active conduct of a business in the first-mentioned State and the income derived from the other State emanates from, or is incidental to, that business. For purposes of this Article, the term "active conduct of a business" shall not include the following activities or any combination thereof: (i) operating as a holding company; (ii) providing overall supervision or administration of a group of companies; (iii) providing group financing (including cash pooling); or (iv) making or managing investments, unless these activities are carried on by a bank or [list financial institutions similar to banks that the Contracting States agree to treat as such], insurance enterprise or registered securities dealer in the ordinary course of its business as such.	(a) Notwithstanding that a resident of a Contracting State may not be a qualified person, it shall be entitled to the benefits of this Convention with respect to an item of income, profit or gain derived from the other Contracting State, if the resident is engaged in the active conduct of a trade or business in the first-mentioned State (other than the business of making or managing investments for the resident's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer), the income, profit or gain derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business and that resident satisfies any other specified conditions for the obtaining of such benefits.
b) If a resident of a Contracting State derives an item of income from a business activity conducted by that resident in the other Contracting State, or derives an item of income arising in the other State from a connected person, the conditions described in subparagraph a) shall be considered to be satisfied with respect to such item only if the business activity carried on by the resident in the first-mentioned	(b) If a resident of a Contracting State or any of its associated enterprises carries on a trade or business activity in the other Contracting State which gives rise to an item of income, profit or gain, sub-paragraph (a) of this paragraph shall apply to such item only if the trade or business activity in the first-mentioned State is substantial in relation to the trade or business activity in the other State. Whether a trade or

State to which the item is related is substantial in relation to the same or complementary business activity carried on by the resident or such connected person in the other Contracting State. Whether a business activity is substantial for the purposes of this paragraph shall be determined based on all the facts and circumstances.

business activity is substantial for the purposes of this paragraph shall be determined on the basis of all the facts and circumstances.

c) For purposes of applying this paragraph, activities conducted by connected persons with respect to a resident of a Contracting State shall be deemed to be conducted by such resident.

(c) In determining whether a person is engaged in the active conduct of a trade or business in a Contracting State under sub-paragraph (a) of this paragraph, activities conducted by a partnership in which that person is a partner and activities conducted by persons connected to such person shall be deemed to be conducted by such person. A person shall be connected to another if one possesses at least 50% of the beneficial interest in the other (or, in the case of a company, shares representing at least 50% of the aggregate voting power and value of the company or of the beneficial equity interest in the company) or another person possesses, directly or indirectly, at least 50% of the beneficial interest (or, in the case of a company, shares representing at least 50% of the aggregate voting power and value of the company or of the beneficial equity interest in the company) in each person. In any case, a person shall be considered to be connected to another if, on the basis of all the facts and circumstances, one has control of the other or both are under the control of the same person or persons.

110.4 Derivative Benefits

In the commentary on art 29(4), OECD offer various versions:

4. A company that is a resident of a Contracting State shall also be entitled to a benefit that would otherwise be accorded by this Convention if:

a) at the time when the benefit otherwise would be accorded and on at least half of the days of any twelve-month period that includes that time, at least 95% of the aggregate vote and value of its shares (and at least 50% of the aggregate vote and value of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, provided that in the case of indirect ownership, each intermediate owner is a qualifying intermediate owner, and

b) less than 50% of the person's gross income, and less than 50% of the tested group's gross income, for the taxable period that includes that time, as determined in the person's Contracting State of residence, is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the taxes covered by this Convention in the person's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested group, not including intra-group transactions)
   i) to persons that are not equivalent beneficiaries;
   ii) to persons that are equivalent beneficiaries only by reason of paragraph 5 of this Article or of a substantially similar provision in the relevant comprehensive convention for the avoidance of double taxation;
   iii) to persons that are equivalent beneficiaries that are connected persons with respect to the company described in this paragraph and that benefit from a special tax regime, as defined in [reference to the paragraph of the convention that includes the definition of "special tax regime"] of this Convention, with respect to the deductible payment, provided that if the relevant comprehensive convention for the avoidance of double taxation does not contain a definition of a special tax regime analogous to the definition of that term included in this Convention, the principles of that definition shall apply, but without regard to the requirement in subdivision (v) of that definition; or iv) with respect to a payment of interest, to persons that are equivalent beneficiaries that are connected persons with respect to the company described in this paragraph and that benefit from notional deductions of the type described in [reference to the paragraph of Article 11 that relates to notional deductions for equity].

Alternatively:

4. A company that is a resident of a Contracting State shall also be entitled to a benefit that would otherwise be accorded by this Convention if:[6]

a) at the time when the benefit otherwise would be accorded and on at least

[6] or: 4. A company that is a resident of a Contracting State shall also be entitled to a benefit that would otherwise be accorded under Article 10 if:

half of the days of any twelve-month period that includes that time, at least 95% of the aggregate vote and value of its shares (and at least 50% of the aggregate vote and value of any disproportionate class of shares) is owned, directly or indirectly, by seven or fewer persons that are equivalent beneficiaries, provided that in the case of indirect ownership, each intermediate owner is a qualifying intermediate owner, and

b) less than 50% of the person's gross income, and less than 50% of the tested group's gross income, for the taxable period that includes that time, as determined in the person's Contracting State of residence, is paid or accrued, directly or indirectly, in the form of payments that are deductible for purposes of the taxes covered by this Convention in the person's Contracting State of residence (but not including arm's length payments in the ordinary course of business for services or tangible property, and in the case of a tested group, not including intra-group transactions)
   i) to persons that are not equivalent beneficiaries; or
   ii) to persons that are equivalent beneficiaries only by reason of paragraph 5 of this Article or of a substantially similar provision in the relevant comprehensive convention for the avoidance of double taxation.

OECD simplified version is:

> 4. A resident of a Contracting State that is not a qualified person shall nevertheless be entitled to a benefit that would otherwise be accorded by this Convention with respect to an item of income if, at the time when the benefit otherwise would be accorded and on at least half of the days of any twelvemonth period that includes that time, persons that are equivalent beneficiaries own, directly or indirectly, at least 75% of the shares of the resident.

Article 23(3) USA/UK DTA provides:

> Notwithstanding that a company that is a resident of a Contracting State may not be a qualified person, it shall be entitled to the benefits of this Convention otherwise accorded to residents of a Contracting State with respect to an item of income, profit or gain if it satisfies any other specified conditions for the obtaining of such benefits and—
>
> (a) shares representing at least 95% of the aggregate voting power and value of the company are owned, directly or indirectly, by seven or fewer persons who are equivalent beneficiaries; and
>
> (b) less than 50% of the company's gross income for the taxable or chargeable period in which the item of income, profit or gain arises is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments that are deductible for the purposes of the taxes covered by this

Convention in the State of which the company is a resident (but not including arm's length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank, provided that where such a bank is not a resident of a Contracting State such payment is attributable to a permanent establishment of that bank located in one of the Contracting States).

110.5 Principal purpose test

LoB provides a principal purpose test for persons who would otherwise lose the benefit of the DTA. In other words, the LoB rule is a safe haven rule specifying those who do not need to pass the PPT:

OECD model	**USA/UK DTA art 23(6)**
5/6. If a resident of a Contracting State is neither a qualified person pursuant to the provisions of paragraph 2 of this Article, nor entitled to benefits under paragraph 3[or 4 (simplified version)] [, 4 or 5 (detailed version)], the competent authority of the Contracting State in which benefits are denied under the previous provisions of this Article may, nevertheless, grant the benefits of this Convention, or benefits with respect to a specific item of income or capital, taking into account the object and purpose of this Convention, but only if such resident demonstrates to the satisfaction of such competent authority that neither its establishment, acquisition or maintenance, nor the conduct of its operations, had as one of its principal purposes the obtaining of benefits under this Convention. The competent authority of the Contracting State to which a request has been made, under this paragraph, by a resident of the other State, shall consult with the competent authority of that other State before either granting or denying the request.	(6) A resident of a Contracting State that is neither a qualified person nor entitled to benefits with respect to an item of income, profit or gain under paragraph 3 or 4 of this Article shall, nevertheless, be granted benefits of this Convention with respect to such item if the competent authority of the other Contracting State determines that the establishment, acquisition or maintenance of such resident and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under this Convention. The competent authority of the other Contracting State shall consult with the competent authority of the first-mentioned State before refusing to grant benefits of this Convention under this paragraph.

An Exchange of Notes provides:

With reference to paragraph 6 of Article 23 (Limitation on benefits)—it is understood that in applying paragraph 6 of Article 23, the competent authorities will consider the obligations imposed upon the UK by its membership of the European Community and by its being a party to the European Economic Area Agreement, and on the United States by its being a party to the North American Free Trade Agreement. In particular, they will have regard to any legal requirements for the facilitation of the free movement of capital and persons, the differing internal tax systems, tax incentive regimes and existing tax treaty policies among Member States of the European Community or European Economic Area states, or, as the case may be, parties to the North American Free Trade Agreement.

Paragraph 6 of Article 23 requires the competent authority of the State from which benefits are claimed to consider whether the establishment, acquisition or maintenance of a resident and the conduct of its operations had as one of its principal purposes the obtaining of benefits under the Convention. That competent authority may determine under a given set of facts that a change in circumstances that would cause a qualified person to cease to qualify for treaty benefits under paragraph 2 of Article 23 need not result in a denial of benefits. Such changes in circumstances may include—

(a) a change in the state of residence of a major participator in a company;

(b) the sale of part of the ownership interests in a company to a resident of another Member State of the European Community or another European Economic Area state or, as the case may be, another party to the North American Free Trade Agreement; or

(c) an expansion of a company's activities in other Member States of the European Community or other European Economic Area states or, as the case may be, other parties to the North American Free Trade Agreement,

all under ordinary business conditions.

If the competent authority is satisfied that these changed circumstances are not attributable to tax avoidance motives, this will be a factor weighing in favour of granting benefits in accordance with paragraph 6 of Article 23.

110.6 LoB: Definitions

110.6.1 *Recognised Stock Exchange*

This is straightforward:

OECD detailed version	**Simplified version**	
OECD Art 29(7)(a)	**OECD Art 29(6)**	**Art 23(7)(a) USA/UK DTA**
the term “recognised stock exchange” means:	[identical]	[identical]
(i) [list of stock exchanges agreed to at the time of signature]; and	(i) any stock exchange established and regulated as such under the laws of either Contracting State; and	(i) the NASDAQ System and any stock exchange registered with the US Securities and Exchange Commission as a national securities exchange under the US Securities Exchange Act of 1934; (ii) the London Stock Exchange and any other recognised investment exchange within the meaning of the Financial Services Act 1986 or, as the case may be, the Financial Services and Markets Act 2000; (iii) the Irish Stock Exchange, the Swiss Stock Exchange and the stock exchanges of Amsterdam, Brussels, Frankfurt, Hamburg, Johannesburg, Madrid, Milan, Paris, Stockholm, Sydney, Tokyo, Toronto and Vienna; and
(ii) any other stock exchange agreed upon by the competent authorities of the Contracting States;	[identical to OECD detailed version]	(iv) any other stock exchange which the competent authorities agree to recognise for the purposes of this Article;

110.6.2 *“Shares”*

OECD Model (simplified and detailed version) provides:

> b) with respect to entities that are not companies, the term “shares” means interests that are comparable to shares

OECD commentary provides:

> 120. Neither the simplified nor the detailed version contains an exhaustive definition of the term “shares”, which, under paragraph 2 of Article 3, should generally have the meaning which it has under the domestic law of the State that applies the Article. Subparagraph b), however, provides that the term “shares”, when used with respect to entities that do not issue shares (e.g. trusts), refers to interests that are

> comparable to shares. These will typically be beneficial interests that entitle their holders to a share of the income or assets of the entity.

This applies to unit trusts.

Art 23(7)(b)(ii) USA/UK DTA provides:

> the term "shares" shall include depository receipts thereof or trust certificates thereof;

110.6.3 *"Principal class of shares"*

OECD detailed version	**Art 23(7)(b)(i) USA/UK DTA**
c) the term "principal class of shares" means the ordinary or common shares of the company or entity, provided that such class of shares represents the majority of the aggregate vote and value of the company or entity. If no single class of ordinary or common shares represents the majority of the aggregate vote and value of the company or entity, the "principal class of shares" are those classes that in the aggregate represent a majority of the aggregate vote and value;	the term "principal class of shares" means the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. If no single class of ordinary or common shares represents the majority of the aggregate voting power and value of the company, the "principal class of shares" is that class or those classes that in the aggregate represent a majority of the aggregate voting power and value of the company;

OECD simplified version provides:

> c) the term "principal class of shares" means the class or classes of shares of a company or entity which represents the majority of the aggregate vote and value of the company or entity;

110.6.4 *"Connected person"*

OECD Model simplified & detailed versions provides:

> d) two persons shall be "connected persons" if one owns, directly or indirectly, at least 50% of the beneficial interest in the other (or, in the case of a company, at least 50% of the aggregate vote and value of the company's shares) or another person owns, directly or indirectly, at least 50% of the beneficial interest (or, in the case of a company, at least 50% of the aggregate vote and value of the company's shares) in each person. In any case, a person shall be

connected to another if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same person or persons.

110.6.5 *Regularly traded*

Art 23(7)(e) USA/UK DTA provides:

> For the purposes of paragraph 2 of this Article, the shares in a class of shares or the units in a class of units are considered to be regularly traded on one or more recognised stock exchanges in a chargeable or taxable period if the aggregate number of shares or units of that class traded on such stock exchange or exchanges during the twelve months ending on the day before the beginning of that taxable or chargeable period is at least six per cent of the average number of shares or units outstanding in that class during that twelve-month period.

An Exchange of Notes provides:

> With reference to sub-paragraph (e) of paragraph 7 of Article 23 (Limitation on benefits)—
> it is understood that, if a class of shares was not listed on a recognised stock exchange in the twelve months referred to in the sub-paragraph, that class of shares will be treated as regularly traded only if that class meets the aggregate trading requirements of the sub-paragraph for the taxable or chargeable period in which the income arises.

110.6.6 *Equivalent beneficiary*

OECD Model detailed version provides:

> e) the term "equivalent beneficiary" means:
> (i) a resident of any State, provided that:
> A) the resident is entitled to all the benefits of a comprehensive convention for the avoidance of double taxation between that State and the Contracting State from which the benefits of this Convention are sought, under provisions substantially similar to subparagraph a), b), c) or e) of paragraph 2 or, when the benefit being sought is with respect to interest or dividends paid by a member of the resident's multinational corporate group, the resident is entitled to benefits under provisions substantially similar to paragraph 5 of this Article in such convention, provided that, if such convention does not contain a detailed limitation on benefits article, such convention shall be applied as if the provisions of subparagraphs a) b), c) and e) of paragraph 2 (including the definitions relevant to the application of the tests in such subparagraphs) were contained in such convention; and

B) 1) with respect to income referred to in Article 10, 11 or 12, if the resident had received such income directly, the resident would be entitled under such convention, a provision of domestic law or any international agreement, to a rate of tax with respect to such income for which benefits are being sought under this Convention that is less than or equal to the rate applicable under this Convention. Regarding a company seeking, under paragraph 4, the benefits of Article 10 with respect to dividends, for purposes of this subclause:

I) if the resident is an individual, and the company is engaged in the active conduct of a business in its Contracting State of residence that is substantial in relation, and similar or complementary, to the business that generated the earnings from which the dividend is paid, such individual shall be treated as if he or she were a company. Activities conducted by a person that is a connected person with respect to the company seeking benefits shall be deemed to be conducted by such company. Whether a business activity is substantial shall be determined based on all the facts and circumstances; and

II) if the resident is a company (including an individual treated as a company), to determine whether the resident is entitled to a rate of tax that is less than or equal to the rate applicable under this Convention, the resident's indirect holding of the capital of the company paying the dividends shall be treated as a direct holding; or

2) with respect to an item of income referred to in Article 7, 13 or 21 of this Convention, the resident is entitled to benefits under such convention that are at least as favourable as the benefits that are being sought under this Convention; and

C) notwithstanding that a resident may satisfy the requirements of clauses A) and B) of this subdivision, where the item of income has been derived through an entity that is treated as fiscally transparent under the laws of the Contracting State of residence of the company seeking benefits, if the item of income would not be treated as the income of the resident under a provision analogous to paragraph 2 of Article 1 had the resident, and not the company seeking benefits under paragraph 4 of this Article, itself owned the entity through which the income was derived by the company, such resident shall not be considered an equivalent beneficiary with respect to the item of income;

(ii) a resident of the same Contracting State as the company seeking benefits under paragraph 4 of this Article that is entitled to all the benefits of this Convention by reason of subparagraph a), b), c) or e) of paragraph 2 or, when the benefit being sought is with respect to interest or dividends paid by a member of the resident's multinational corporate group, the resident is entitled to benefits under paragraph 5, provided that, in the case of a resident described in paragraph 5, if the resident had received such interest or dividends directly, the resident would be entitled to a rate of tax with respect to such income that is less than or equal to the rate applicable under this Convention to the company seeking benefits under paragraph 4; or

(iii) a resident of the Contracting State from which the benefits of this Convention are sought that is entitled to all the benefits of this Convention by reason of subparagraph a), b), c) or e) of paragraph 2, provided that all such residents' ownership of the aggregate vote and value of the shares (and any disproportionate class of shares) of the company seeking benefits under paragraph 4 does not exceed 25 per cent of the total vote and value of the shares (and any disproportionate class of shares) of the company.

Art 23(7)(d) USA/UK DTA provides:

an equivalent beneficiary is a resident of a Member State of the European Community or of a European Economic Area state or of a party to the North American Free Trade Agreement but only if that resident-

(i) (a) would be entitled to all the benefits of a comprehensive convention for the avoidance of double taxation between any Member State of the European Community or a European Economic Area state or any party to the North American Free Trade Agreement and the Contracting State from which the benefits of this Convention are claimed, provided that if such convention does not contain a comprehensive limitation on benefits article, the person would be a qualified person under paragraph 2 of this Article (or for the purposes of sub-paragraph (g) of paragraph 2, under the provisions specified in clause (i) of that sub-paragraph) if such person were a resident of one of the Contracting States under Article 4 (Residence) of this Convention; and

(b) with respect to income referred to in Article 10 (Dividends), 11 (Interest), 12 (Royalties) of this Convention, would be entitled under such convention to a rate of tax with respect to the particular class of income for which benefits are being claimed under this Convention that is at least as low as the rate applicable under this Convention; or

(ii) is a qualified person by reason of sub-paragraphs (a), (b), clause (i) of sub-paragraph (c), clause (i) of sub-paragraph (d), or sub-paragraph (e) of paragraph 2 of this Article.

For the purposes of applying paragraph 3 of Article 10 (Dividends) in order to determine whether a person, owning shares, directly or

> indirectly, in the company claiming the benefits of this Convention, is an equivalent beneficiary, such person shall be deemed to hold the same voting power in the company paying the dividend as the company claiming the benefits holds in such company.

CIOT ask:

> the US Limitation of Benefits tests includes tests for 'derivative benefits' and 'equivalent beneficiaries', which in some cases require investors to be located in the European Union (or EEA). We would be interested to understand what (if anything) HMRC is able to do to ensure continuation of benefits under the treaties between the US and other EU Member States with UK investors.[7]

110.6.7 *"Disproportionate class of shares"*

OECD Model detailed version provides:

> f) the term "disproportionate class of shares" means any class of shares of a company or entity resident in one of the Contracting States that entitles the shareholder to disproportionately higher participation, through dividends, redemption payments or otherwise, in the earnings generated in the other Contracting State by particular assets or activities of the company;

110.6.8 *"Primary place of management and control"*

OECD Model detailed version provides:

> g) a company's or entity's "primary place of management and control" is in the Contracting State of which it is a resident only if:
>
> (i) the executive officers and senior management employees of the company or entity exercise day-to-day responsibility for more of the strategic, financial and operational policy decision making for the company or entity and its direct and indirect subsidiaries, and the staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions, in that Contracting State than in any other State; and
>
> (ii) such executive officers and senior management employees exercise day-to-day responsibility for more of the strategic, financial and operational policy decision-making for the

[7] Letter , 4 December 2019 *https://library.croneri.co.uk/system/files/assets/tat/cch_uk/tat/pdf%3A05-12-19-review-of-double-taxation-treaties-2019-20-ciot-response.pdf*

company or entity and its direct and indirect subsidiaries, and the staff of such persons conduct more of the day-to-day activities necessary for preparing and making those decisions, than the officers or employees of any other company or entity;

110.6.9 *"Qualifying intermediate owner"*

OECD Model detailed version provides:

> h) the term "qualifying intermediate owner" means an intermediate owner that is either:
> (i) a resident of a State that has in effect with the Contracting State from which a benefit under this Convention is being sought a comprehensive convention for the avoidance of double taxation; or
> (ii) a resident of the same Contracting State as the company applying the test under subparagraph d) or f) of paragraph 2 or paragraph 4 to determine whether it is eligible for benefits under the Convention.

110.6.10 *"Tested group"*

OECD Model detailed version provides:

> i) the term "tested group" means the resident of a Contracting State that is applying the test under subparagraph d) or f) of paragraph 2 or under paragraph 4 or 5 to determine whether it is eligible for benefits under the Convention (the "tested resident"), and any company or permanent establishment that:
> (i) participates as a member with the tested resident in a tax consolidation, fiscal unity or similar regime that requires members of the group to share profits or losses; or
> (ii) shares losses with the tested resident pursuant to a group relief or other loss sharing regime in the relevant taxable period.

110.6.11 *Share class arrangements*

Article 23(5) USA/UK DTA provides:

> Notwithstanding the preceding provisions of this Article, if a company that is a resident of a Contracting State, or a company that controls such a company, has outstanding a class of shares—
> (a) which is subject to terms or other arrangements which entitle its holders to a portion of the income, profit or gain of the company derived from the other Contracting State that is larger than the portion such holders would receive in the

absence of such terms or arrangements; and

(b) 50% or more of the voting power and value of which is owned by persons who are not equivalent beneficiaries,

the benefits of this Convention shall apply only to that proportion of the income which those holders would have received in the absence of those terms or arrangements.

110.6.12 *Gross income*

OECD Model detailed version provides:

> j) the term "gross income" means gross receipts as determined in the person's Contracting State of residence for the taxable period that includes the time when the benefit would be accorded, except that where a person is engaged in a business that includes the manufacture, production or sale of goods, "gross income" means such gross receipts reduced by the cost of goods sold, and where a person is engaged in a business of providing non-financial services, "gross income" means such gross receipts reduced by the direct costs of generating such receipts, provided that:
>
> (i) except when relevant for determining benefits under Article 10 of this Convention, gross income shall not include the portion of any dividends that are effectively exempt from tax in the person's Contracting State of residence, whether through deductions or otherwise; and
>
> (ii) except with respect to the portion of any dividend that is taxable, a tested group's gross income shall not take into account transactions between companies within the tested group;

An Exchange of Notes provides:

> With reference to Article 23 (Limitation on benefits)—
> it is understood that the term "gross income" means the total revenues derived by a resident of a Contracting State from its principal operations, less the direct costs of obtaining such revenues.

110.6.13 *In connection with business*

An Exchange of Notes provides:

> With reference to paragraph 4 of Article 23 (Limitation on benefits)—
> it is understood that an item of income, profit or gain is to be considered as derived "in connection" with an active trade or business in a Contracting State if the activity generating the item in the other Contracting State is a line of business which forms a part of, or is

> complementary to, the trade or business conducted in the first-mentioned State. The line of business in the first-mentioned State may be "upstream" to that going on in the other State (eg providing inputs to a manufacturing process that occurs in that other State), "downstream" (eg selling the output of a manufacturer which is a resident of the other State) or "parallel" (eg selling in one Contracting State the same sorts of products that are being sold by the trade or business carried on in the other Contracting State).

110.6.14 *Incidental to business*

An Exchange of Notes provides:

> It is understood that an item of income, profit or gain derived from a Contracting State would be considered "incidental" to the trade or business carried on in the other Contracting State if the item is not produced by a line of business which forms a part of, or is complementary to, the trade or business conducted in that other Contracting State by the recipient of the item, but the production of such item facilitates the conduct of the trade or business in that other Contracting State. An example of such "incidental" item of income, profit or gain is interest income earned from the short-term investment of working capital of a resident of a Contracting State in securities issued by persons in the other Contracting State.

110.7 Channel Islands/IoM LoB

Jersey/Guernsey//IoM have non-standard LoB provisions in arts 11-13 [Interest/Royalties/Capital gains]. Article 11 Jersey/UK DTA provides:

> 1. Interest arising in a Territory and beneficially owned by a resident of the other Territory may be taxed in that other Territory.
> 2. However, interest arising in a Territory may also be taxed in that Territory according to the laws of that Territory, but if
> [a] the beneficial owner of the interest is a resident of the other Territory and
> [b] at least one of the conditions mentioned in paragraph 3 is met,
> that interest shall be taxable only in that other Territory.

110.7.1 *Conditions for full relief*

So full relief is in principle available if the art 11(3) conditions are met. Article 11(3) Jersey/UK DTA provides:

> The conditions mentioned in paragraph 2 are that:
> (a) the interest is beneficially owned by:

There follows a list of 8 items which broadly correspond to "qualified person" in the OECD Model/USA DTA:

> (i) that other Territory itself, one of its political subdivisions, local authorities, its Central Bank, or its statutory bodies;[8]
> (ii) an individual;
> (iii) a company in whose principal class of shares there is substantial and regular trading on a recognised stock exchange;[9]
> (iv) a company less than 25% of whose shares or other rights are owned,[10] directly or indirectly, by persons who are not residents of that other Territory;
> (v) a pension scheme;[11]
> (vi) a bank or building society;
> (vii) any other financial institution unrelated to and dealing wholly independently with the payer;[12] or
> (viii) any other person provided that the competent authority of the Territory which has to grant the benefits determines that
> [A] the establishment, acquisition or maintenance of that person, or
> [B] the conduct of its operations,
> does not have as its principal purpose or one of its principal purposes to secure the benefits of this Article;

Lastly, art 11(3) Jersey/UK DTA provides:

> The conditions mentioned in paragraph 2 are that ...

[8] Defined in art 11(4): "For the purposes of paragraph 3(a)(i), the term "statutory bodies" includes any institution wholly or mainly owned directly or indirectly by the Government of either Territory as may be agreed from time to time by exchange of letters between the competent authorities of the Territories."

[9] The Protocol provides a definition of this term.

[10] The context suggests that this means owned beneficially, not by a trust.

[11] Defined in art 3(1)(k): "the term "pension scheme" means any scheme or other arrangement which:
(i) is generally exempt from income taxation; and
(ii) operates to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such arrangements."

[12] Defined in para (vii): the term "other financial institution" here means an enterprise substantially deriving its profits by raising debt finance in the financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance.

(b) the interest is paid by a Territory, one of its political subdivisions, local authorities or statutory bodies.

CHAPTER ONE HUNDRED AND ELEVEN

CREDIT FOR FOREIGN TAX

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Cross references

The following topics are considered elsewhere:
11.8.1 (Foreign tax credit relief) - gains of temporary non-resident
23.15.5 (Foreign tax credit relief) - Entertainers and Sportspeople
28.16 (DT relief: AIP income)
36.14 (Foreign tax credit: EP app 5)
42.8 (Life tenant's foreign tax credit)
95.9 (Foreign tax credit: currency conversion date)
107.1 (DT reliefs: Introduction)

111.1 Credit for foreign tax

Foreign tax credit arises where a UK tax liability is reduced by foreign tax. This chapter considers foreign tax credit for IT/CGT/CT.[1]

The term sometimes used is "Foreign Tax Credit Relief" (FTCR). The credit may be:

Relief (my term)	**Statutory term**	**Given by**[2]	**See para**
DTA Credit	Credit under s.18(2)	DTA	111.2
Unilateral Credit	Unilateral relief arrangements		
Generally	Credit under s.9	s.9 TIOPA	111.2
Accrued income profits	Credit under s.9 or 10	s.9,10 TIOPA	28.16.2
Foreign Tax Credits (all types)	Credit under s.18(2)	s.18(2) TIOPA	111.12
Underlying relief	tax on co profits from which dividend paid		

I write the terms DTA Credit/Unilateral Credit with initial capitals to reflect the technical nature of the terms, and I use the term FTC to apply to both.

I do not consider:

- Relief for UK resident companies, subject to corporation tax
- Relief for underlying tax

I hope to cover these in a future edition.

111.1.1 *Unilateral relief arrangements*

Section 8(1) TIOPA defines this term:

> In this Part [Part 2 TIOPA] "unilateral relief arrangements", in relation to a territory outside the UK, means the rules set out in sections 9 to 17.

Unilateral relief dates from 1950.

[1] For IHT, see 120.1 (Credit for foreign IHT).

[2] Supplemented in each case by Part 2 TIOPA

111.1.2 *FTC policy background*

The Royal Commission on the Taxation of Profits and Income provides:[3]

> The system of relief is founded on acceptance of the principle that, when double taxation tends to arise, the aim should be either–
>
> (1) an arrangement between the two countries as to which of them is to have the exclusive right of taxing particular kinds of income, or
>
> (2) if other kinds of income are agreed to be capable of being taxed by two countries, an arrangement as to how the two taxes are to be adjusted between them and which is to have priority of claim.

(1) is the exemption method and (2) is the credit method, which is the topic of this chapter.

> Under (2) the normal basis of adjustment appears to be that the taxpayer's home country (which taxes him on the grounds of residence) should do no more than bring up the weight of the foreign tax to the home tax, treating the two virtually as one composite tax on whatever income may be in question. So far as the owner of the income is concerned the grant by his home country of credit for the foreign tax paid against the home tax prospectively payable on the same income means that the income is effectively diminished by an amount equal to, but not more than, the higher of the two taxes.

111.2 DTA/Unilateral Credit compared

DTA Credit depends on the wording of the DTA in point. OECD Model provides two alternative forms of relief, in articles 23 A/B, described as the exemption/credit methods. UK DTAs generally adopt a credit method, and there is a relatively standard form, but it does not follow the OECD wording.

It is helpful to read side by side:

- DTA Credit (I take the USA/UK DTA as an example) and
- s.9(1)(2) TIOPA, which provide Unilateral Credit for IT/CT and CGT

Art 24(4) USA/UK DTA	**s.9(1) TIOPA: IT/CT**	**s.9(2) TIOPA: CGT**
Subject to the provisions of the law of the UK regarding the allowance as a credit against UK tax of tax payable in a territory outside the UK (which		

[3] Final Report (1953) Cmd 9474.

shall not affect the general principle hereof)—		
	Credit for tax—	[Identical to s.9(1)]
(a) United States tax payable under the laws of the United States and in accordance with this Convention, whether directly or by deduction,	(a) paid under the law of the territory,	[Identical to s.9(1)]
on profits, income or chargeable gains from sources within the United States	(b) calculated by reference to income arising, or any chargeable gain accruing, in the territory, and	(b) calculated by reference to any capital gain accruing in the territory, and
(excluding, in the case of a dividend, United States tax in respect of the profits out of which the dividend is paid)		
	(c) corresponding to UK tax,	[Identical to s.9(1)]
shall be allowed as a credit against any UK tax computed by reference to the same profits, income or chargeable gains by reference to which the United States tax is computed;	is to be allowed against any income tax or corporation tax calculated by reference to that income or gain.	is to be allowed against any capital gains tax calculated by reference to that gain.

The differences between DTA/Unilateral Credit do not seem significant:

Requirement	**Comment**
Incorporation of general TIOPA rules	In opening words of DTA; not needed for Unilateral Credit
Tax paid/payable under laws of the territory	
Tax payable in accordance with DTA	Necessarily, applies to DTA only
...whether directly or by deduction...	Phrase not found in Unilateral Credit, but not significant
Foreign tax corresponds to UK tax	Unilateral Credit only (not needed for DTA as foreign tax is defined)

For Unilateral Credit, ss.9(1)(2) are identical, except that one refers to IT/CT, and the other refers to CGT. I comment on s.9(1) below but the same points will apply to s.9(2).

111.3 TIOPA restrictions on FTCR

DTAs incorporate the restrictions on FTCR which are set out in TIOPA. The wording varies, and I here set out for comparison the opening words of the Credit article of 2 sample DTAs:

USA/UK Credit art 24(4)	**Austria/UK Credit art24 (1)**
[*Proviso A*:] Subject to the provisions of the law of the UK regarding the allowance as a credit [i] against UK tax [ii] of tax payable in a territory outside the UK	[*Proviso A*:] Subject to the provisions of the law of the UK regarding the allowance as a credit [i] against UK tax [ii] of tax payable in a territory outside the UK
	[*Proviso B*] or, as the case may be, regarding the exemption from UK tax [i] of a dividend arising in a territory outside the UK or [ii] of the profits of a permanent establishment situated in a territory outside the UK
(which shall not affect the general principle hereof)–	[identical]

Proviso A (my terminology) authorises restrictions on FTCR under UK domestic law, such as:

- s.25-s.27 TIOPA (cases where credit not allowed)
- s.81-s.88 TIOPA (anti-avoidance)
- The GAAR

Of course these restrictions apply equally to Unilateral Credit.

111.4 Which foreign taxes give credit

Art 24(4) USA/UK DTA	**s.9(1) TIOPA: Unilateral Credit**
United States tax payable under the laws of the United States...shall be	Credit for tax (a) paid under the law of the

allowed as a credit against any UK tax	territory,... (c) corresponding to UK tax, is to be allowed against any income tax or corporation tax

111.4.1 *Which taxes: DTA Credit*

The USA/UK refers to "United States tax". The last sentence of art 24(4) USA/UK DTA incorporates the definition by reference:

> For the purposes of this paragraph, the income taxes referred to
> [i] in clause (i) of sub-paragraph (a) of paragraph 3[4] and
> [ii] in paragraph 4[5]
> of Article 2 (Taxes covered) of this Convention
> shall be considered United States tax.

111.4.2 *Which taxes: Unilateral Credit*

Section 9 TIOPA refers to tax "paid under the law of the territory". Section 8(2) TIOPA provides:

> In sections 11 to 17, and in Chapter 2 (except section 29) in its application to relief under unilateral relief arrangements, references to tax payable or paid under the law of a territory outside the UK include only—
> (a) taxes which are charged on income and which correspond to income tax,
> (b) taxes which are charged on income or chargeable gains and which correspond to corporation tax, and
> (c) taxes which are charged on capital gains and which correspond to capital gains tax.

Since this is expressed to apply only for the specified sections, the rule has to be set out again in s.9(4)(5) TIOPA.

"Correspondence" is a matter of degree. Section 8(3) TIOPA provides that local/provincial taxes may "correspond" to IT/CGT/CT, even though the latter are UK-wide taxes.[6]

[4] This refers to Federal income taxes imposed by the Internal Revenue Code (excluding social security taxes).

[5] This refers to identical/substantially similar taxes imposed in addition to/in place of existing taxes.

[6] See 43.3.5 (Devolved rates: DTAs).

> For the purposes of subsection (2), tax may correspond to income tax, corporation tax or capital gains tax even though it—
> (a) is payable under the law of a province, state or other part of a country, or
> (b) is levied by or on behalf of a municipality or other local body.

Since this is expressed to apply only for the specified sections, the rule has to be set out again in s.9(6) and 29(4) TIOPA.

The Royal Commission on the Taxation of Profits and Income Final Report provides:[7]

> 699. Some limitation to taxes that can be said to be in some sense equivalent to UK income tax and profits must, we think, be accepted. The forms of the taxes imposed throughout the world are multifarious and defy precise classification, but a "non-corresponding" tax will frequently belong to one or other of these four types—
> (1) a tax on articles of consumption comparable to the taxation administered in this country by the Commissioners of Customs and Excise—e.g., a general turnover tax having affinities with the UK purchase tax;
> (2) a payroll tax levied on employers as a contribution to the finances of a social security scheme;
> (3) a payment in the nature of a recurrent royalty which is exacted in return for the right to exploit certain natural resources;
> (4) a levy on real property appropriated towards the expenses of local government.
>
> Where trade is carried on in this country the trader's expenditure may well include the payment of excise duties, employer's national insurance contributions, mining royalties or local rates. It has never been suggested that his outlay of this sort should serve as an acquittance of the income tax and profits tax presumptively due from him. His outlay is simply a particular part of the costs he incurs for the purposes of his trade and the situation is sufficiently met by allowing him a deduction in arriving at the amount effectively charged as representing his net profit. If, however, parallel outlay in the case of trading operations that take place overseas, which is now a deduction in computing net taxable profit, were permitted instead to rank for tax credit relief the trader operating overseas would *pro tanto* receive more favourable tax treatment than that accorded when the trade is in this country. Each overseas tax ought to be tested on its own merits; and in the case of the overseas taxes under discussion we can see no way of devising a general rule to define how far, if at all, any of them ought to be regarded as a levy on the profits themselves rather

[7] (1953) Cmd 9474.

than a working expense in computing them. We therefore consider that the rule requiring the overseas tax to "correspond" to UK income or profits tax should be maintained.

700. In reaching this conclusion we have not ignored the fact that there may be territories which, for administrative or other reasons, are accustomed to rely upon such taxes as import and export duties for a much larger proportion of the total revenue than does a country with a fully developed system of taxes on profits and income. The duties levied in such a territory can be assumed to be in substitution for the taxation of profits and income that might have been levied there had conditions been more favourable; consequently, it is said, those duties do correspond in a special sense to UK income and profits tax. Nevertheless, we think that a general provision for unilateral relief much deal with broad categories only; a limited exception to the rule of correspondence for the purpose of meeting this situation would involve insuperable difficulties of demarcation.

111.5 Same income rule

Art 24(4) USA/UK DTA	**s.9(1) TIOPA: Unilateral Credit**
United States tax ... on profits, income or chargeable gains from sources within the United States ...	Credit for [foreign] tax ... (b) calculated by reference to income arising, or any chargeable gain accruing, in the territory ...
shall be allowed as a credit against any UK tax computed by reference to the same profits, income or chargeable gains by reference to which the United States tax is computed	is to be allowed against any income tax or corporation tax calculated by reference to that income or gain.

I refer to this as the **"same income rule"**.

As far as this rule is concerned, there is no difference between DTA Credit and Unilateral Credit.[8]

111.5.1 *The same: pragmatic approach*

In *Anson v HMRC*:[9]

[8] This is self-evident, but if authority is needed, see *Anson v HMRC* [2015] UKSC 44. This concerned both types of Credit, DTA Credit for federal tax and Unilateral Credit for state tax; the SC clearly assumed that the same principles applied for both.

[9] [2015] UKSC 44 at [114]. See too at [53] suggesting "a less technical approach than that ordinarily adopted in UK tax law".

> The words 'the same' are ordinary English words. It should however be borne in mind that a degree of pragmatism in their application may be necessary in some circumstances if the object of the Convention is to be achieved.

What is "the same" raises the question of identity. Despite apparent rigidity, identity is a matter of degree. (Is the reader the same person as when they left school? or in the classical formation, can a person step into the same river twice? Discuss.) What is required is sufficient similarity. The courts have generally reached - there is no other word - similar conclusions in other contexts where the question of identity arises.[10] But pragmatism is particularly needed in the context of DTCs which are intended to relieve double taxation, and which are not drafted with the precision of a UK tax statute, because they have to use wording applicable in the foreign state as well as in the UK.[11]

But in the context of DT exemption (as opposed to FTCR) the courts have not allowed any degree of pragmatism, with the consequence that the object of the DTA was not achieved.[12]

For the application of the same income rule in the context of LLCs, see 90.46 (LLC: US tax credit).

The INT Manual provides:

> **INTM161040: double taxation relief: Same income** [Dec 2023]
> [The Manual refers to the same income rule and continues:]
> As held by the Supreme Court in *Anson v HMRC* [2015] UKSC 44, the approach to take when considering whether the same profits, income or gains have been taxed in both countries is to:
> 1. Identify the profits, income or gains by reference to which the UK tax liabilities are computed. As confirmed by the Supreme Court, this is primarily a question of UK tax law. How the person is taxed in the foreign country is not relevant to this part of the analysis...
> 2. Identify the profits, income or gains by reference to which the foreign tax liabilities are computed. This is primarily a question of foreign tax law. Officers should seek copies of the foreign tax returns and

[10] See 51.6.2 (Identity of income condition). The level or type of similarity required may vary from one context to another, so cases from other areas are not directly applicable here, but what matters is the general approach, ie that what is "the same" is a matter of degree.

[11] See 107.10.3 (DTA/UK statutes compared).

[12] See 61.60.1 (Trustee treaty-resident outside UK).

> computations to evidence this.
> 3. Compare whether the profits, income and gains identified as above are the "same".
> As held by the Supreme Court, a degree of pragmatism may need to be applied when deciding whether the tax in both countries has been computed by reference to the same profits, income or gains (for example where differences between UK and foreign accounting and tax rules prevent a precise matching of income).

So far so good. The Manual then becomes more contentious:

> However, HMRC does not believe this degree of pragmatism extends to treating profits and distributions of profits as the same income. In this regard, note that the Supreme Court rejected Mr Anson's first ground of appeal that even if he was liable to tax in the US on his share of the profits and in the UK only on any distributions, the US and UK tax were nevertheless charged on the same profits or income.
> (This content has been withheld because of exemptions in the Freedom of Information Act 2000)
> In *Anson v HMRC* [2013] EWCA Civ 63, Mr Anson raised a new argument, based on the exchange of notes dated 24 July 2001 in relation to Article 24 (and Articles 1(4) and 1(8)) of the 2001 UK/US Double Taxation Convention (DTC), that it was no longer necessary to show that the UK and US tax was paid on the same profits for credit to be due under that DTC. However, the Court of Appeal refused Mr Anson permission to appeal and HMRC continue to believe that this does not override the requirement for the UK and US tax to be computed by reference to the same profits, income or gains.

111.5.2 *Timing/assessment period*

The INT Manual provides:

> **INTM169150. Amount of foreign tax credit relief: basis of allowance** [Sep 2021]
> Credit may be claimed for the foreign tax paid on foreign capital gains against the UK tax due on the same gain, irrespective of the tax year in which the foreign tax is charged.

In *Anson v HMRC*:[13]

> ... differences between UK and foreign accounting and tax rules prevent a precise matching of the income by reference to which tax is computed

[13] [2015] UKSC 44 at [114].

in the two jurisdictions. It appears that some potential difficulties of this kind are in practice avoided by the Commissioners' accepting that the profits on which foreign tax is computed and in respect of which relief can be claimed are not confined to those arising under UK tax principles in individual UK chargeable periods.

111.5.3 *Preceding year basis*

The phrase "computed by reference to", in the FTC article replaced the words "payable in respect of", which had been used in the older treaties. The new wording was introduced following *Duckering v Gollan*[14] a case on the New Zealand/UK treaty which allowed a credit against UK tax "payable in respect of that income". In New Zealand the preceding year basis was abolished in 1958 (a reform which the UK finally adopted in 1996). The position was:

Country	**Year of assessment**	**Computation** *by ref to income of*	**Basis of assessment**
UK	1958-1959	1957-1958	Preceding year basis
New Zealand	1957-1958	1956-1957	Preceding year basis
New Zealand	1958-1959	1958-1959	Current year basis

The taxpayer obtained a credit against his UK tax for 1958-1959 for the tax paid in New Zealand in 1958-1959, on the basis that he had paid tax in both countries "in respect of" the same income, despite the fact that the income by reference to which his tax liability was computed in the two jurisdictions was not the same. In the light of that decision, the wording was changed to use the phrase "computed by reference to".

The International Manual provides:

> **INTM161140: root income basis, statutory income basis** [May 2020]
> The following definitions apply for the purposes of foreign tax credit relief:
>
> a) 'Credit on the root income basis' means credit allowed for foreign tax against any UK tax computed by reference to the same income by reference to which the foreign tax is computed. For example, if interest of £100 has been taxed by the foreign country on a current year basis in 2010/11 and is taxed in the UK on the preceding year basis for 2011/12, credit should be allowed for the foreign tax charged for 2010/11 against the UK tax charged for 2011/12. Credit

[14] 42 TC 333 discussed in *Anson v HMRC* [2015] UKSC 44 at [85].

on the root income basis is the usual way in which credit is given.

b) 'Credit on the statutory income basis' means credit allowed in accordance with the decision in *Duckering v Gollan* 42 TC 333, that is the foreign tax on the foreign income is the foreign tax payable in respect of the income from the source, for the same year as that for which the UK tax is assessed. If in the example referred to in (a) above, credit was due upon the statutory income basis, credit for the foreign tax charged for 2010/11 would be allowed against the UK tax charged on income from the same source for 2010/11. Credit against UK tax for 2011/12 would be allowed for the foreign tax paid for 2011/12. Where the foreign basis period for assessment does not coincide with the UK basis period see INTM161220. See SI1997/405 for the treatment of foreign tax paid in respect of profits or losses arising from the business of a Lloyd's underwriter.

INTM161160: 'Root income' basis - legal position [May 2020]

The authority for the `root income' basis is found in the credit Article in double taxation agreements which have been negotiated or amended since the decision in *Duckering v Gollan* referred to in INTM161140 paragraph (b). This says `… tax payable under the laws of … and in accordance with this convention, whether directly or by deduction, on profits income or chargeable gains from sources within … shall be allowed as a credit against any UK tax computed by reference to the same profits income or chargeable gains by reference to which the … tax is computed'. TIOPA10/S9 (1)-(3) is the authority for unilateral relief purposes.

There are still a few agreements in force which have not been revised or amended and which provide for credit relief to be given on the statutory income basis. See, however, INTM161170 for guidance on the practice to be adopted where the statutory income basis is the strict legal basis.

INTM161170: 'Root income' basis - practice [May 2020

Tax credit relief should be allowed in all cases and for all years on the root income basis. Where relief is due strictly on the statutory income basis (see INTM161160, second paragraph), relief will be allowed on the root income basis unless the taxpayer specifically asks for the statutory income basis. Where the root income basis applies and the same foreign income is assessed once to UK tax and more than once to foreign tax, the total foreign tax is available for credit against the UK tax. Where the same foreign income is assessable to Income Tax for more than one UK year of assessment see INTM165100 onwards. Where the foreign income is not assessed for any UK year of assessment, no credit relief can be given

> The summaries of agreements under the respective country entries will show specifically where the statutory income basis applies. For all other countries the root income basis will apply.

The preceding year basis is now a matter of history and perhaps this does not matter now.

111.5.4 *Ownership period/rebasing*

HMRC Brief 17/10 provides:

> **Introduction**
> The purpose of this brief is to publicise a change to the established practice of restricting the amount of Foreign Tax Credit Relief (FTCR) that can be deducted when calculating the amount of UK tax due on a chargeable gain.
>
> **Background**
> Where a gain is chargeable to UK Capital Gains Tax or UK Corporation Tax and the same gain has also been taxed in another country then FTCR can be claimed in respect of the foreign tax paid.
>
> Our practice has been to restrict the amount of FTCR if different periods of ownership of the asset are considered when arriving at the gain assessable in the UK and the foreign gain, or if the amount of the UK gain is less than the foreign gain.
>
> We have reconsidered our view and are revising our practice so that the whole of the foreign tax is allowable as FTCR up to the amount of the UK tax on the gain.
>
> **The current practice**
> The established practice has been to restrict the amount of FTCR in the following two situations:
>
> **Situation one [different ownership periods]**
> The amount of gain charged to foreign tax may be calculated by reference to a longer period of ownership than the period on which the gain charged to UK tax is based. The most common instance is where assets were acquired before the 31 March 1982 and the gain chargeable in the UK is based only on the period from 31 March 1982 onwards. In such cases the established practice has been to restrict the FTCR due by the following calculation:[15]
>
> A/B × foreign tax = allowable FTCR where
> A = period of time assessed by UK
> B = period of time assessed by foreign authority

[15] I have put the wording into mathematical terms, for clarity.

> For example:
>
> - asset acquired on 31 March 1971
> - asset rebased for UK CGT on 31 March 1982
> - asset disposed of on 31 March 1993
> - foreign tax of £10,000 charged
>
> The maximum amount of FTCR would be restricted as follows:
>
> (period 31 Mar 1982 to 31 Mar 1993 = 11 years) ÷ (period 31 Mar 1971 to 31 Mar 1993 = 22 years) = 0.5
>
> 0.5 × £10,000 foreign tax, equals £5,000 tax credit.
>
> **Situation two [foreign chargeable gain exceeds UK gain]**
>
> Where the gain charged in the UK is less than the gain charged to foreign tax, the established practice has been to restrict the maximum amount of FTCR due by the following calculation:
>
> (amount of UK assessment) ÷ (amount of foreign assessment)
> multiplied by foreign tax = allowable FTCR
>
> For example, where
> the UK assessed a gain of £55,000,
> the gain charged to foreign tax was £75,000 and
> the foreign tax was £15,000
> then the FTCR would be restricted as follows:
>
> (£55,000 ÷ £75,000) × £15,000 = £11,000
>
> **How we intend to implement the revised practice**
>
> ... In all cases where FTCR is claimed against UK tax on chargeable gains, the whole of the foreign tax will be allowable up to the amount of the UK tax on the gain, provided that the gain charged in both countries relates to the same disposal.
>
> In the examples above, the maximum allowable FTCR would now be the full £10,000 of foreign tax in the first case and the full £15,000 of foreign tax in the second, provided, in each case, that this amount was less than or equal to the UK tax.
>
> This change will bring the chargeable gains practice in line with the Income Tax practice, which does not restrict the amount of FTCR allowed where the amount assessed in the UK is less than the amount of income assessed to foreign tax...

Could it be that HMRC's pre-2010 view in situation 1 (different ownership periods) was correct, and the current practice is concessionary? The difficulty is that there are so many ways of computing a gain. There may be different rules not just relating to periods of ownership, but to acquisition cost and to allowable expenditure. It is not practical to seek to identify differences and say that only the sum computed on UK principles is the same gain, albeit computed by different methods. We need that element of pragmatism referred to in *Anson.*

HMRC's pre-2010 view in situation 2 seems difficult to defend and it is considered that the present view is correct as a matter of law.

111.5.5 *Tax on different person/time*

SP 6/88 provides:

> **Double taxation relief: chargeable gains**
> 3 The principal requirement for the granting of credit for overseas tax against liability to capital gains tax (or corporation tax on chargeable gains) is therefore that the overseas tax should be computed by reference to the same gain as the UK tax. There is no requirement that the respective tax liabilities should arise at the same time nor that they should be charged on the same person.

INTM169040 [May 2020] gives an example where tax is charged on a different person:

> overseas tax is payable in its country of residence by a non-resident company on the disposal of an asset and in the UK the gain is charged on a UK resident individual under s.3 TCGA

See 64.42 (Foreign tax credit relief: s.3).

The INTM provides:

> **INTM161040: double taxation relief: Same income** [Dec 2023]
> Note that for credit to be allowed, it is not a requirement that the foreign tax has to be borne by the same person who is liable to UK tax on the same profits, income or gains. For example, if the foreign country taxes a settlor on the income of a UK resident beneficiary, who is chargeable to UK tax on that income, credit may be given to the beneficiary for the foreign tax paid by the settlor. However, it must be the same income which is being taxed in both countries. See also Statement of Practice 6/88 and INTM169040 in the capital gains context.
> Where directors' fees are treated as income of a partnership or of a company under ESC/A37 (or the relevant enactment in legislation from 6 April 2018, see EIM02500) credit relief is available to the partnership or company, regardless of the fact that the foreign tax may have been suffered by the director.

111.5.6 *Gain treated as income*

SP 6/88 provides:

> 4 The Revenue's view is that the following sets of circumstances fall

> within the terms of the standard credit article and [Part 2 TIOPA, Unilateral Credit] and may therefore give rise to a credit for overseas tax against UK capital gains tax or corporation tax on chargeable gains.
>
> (i) The overseas tax charges capital gains as income

This is consistent with the rule that a gain subject to income tax may qualify for DT relief under art 13(5) OECD Model.[16]

111.5.7 *Disposal after group transfer*

SP 6/88 provides:

> 4 The Revenue's view is that the following sets of circumstances fall within the terms of the standard credit article and [Part 2 TIOPA, Unilateral Credit] and may therefore give rise to a credit for overseas tax against UK capital gains tax or corporation tax on chargeable gains...
>
> (ii) [a] Overseas tax is payable on a disposal falling within TCGA 1992 s 171 (transfers within a group of companies treated as taking place on a no gain/no loss basis) and
>
> [b] a liability to UK tax arises on a subsequent disposal.[17]

The facts envisaged are:

(1) X transfers to Y within a group ("the first disposal"):
   (a) The disposal is not subject to UK tax (because of CG group relief)[18]
   (b) The disposal is subject to foreign tax (because the foreign tax does not allow a CG group relief)

(2) Y disposes of the property ("the second disposal")

The first disposal is treated for CGT as made for such amount as secures that no gain/loss accrues on the disposal, ie the historic base cost. On the second disposal, by Y, a chargeable gain accrues.[19] Foreign tax on the first disposal is regarded as tax on Y's gain. If one accepts that the foreign tax is on the same gain, it does not matter that:

[16] See 56.23.2 (Gain subject to income tax).

[17] The former International Tax Handbook para 619 explains the point more clearly: "A similar situation could occur with transfers under Section 171 TCGA 1992 between UK group companies. If the assets involved are situated abroad and the foreign tax authority taxes the UK company making the transfer, the benefit of that tax can be taken by the transferee group company when there is a disposal outside the group generating a UK tax charge on the relevant asset."

[18] See 64.24 (CG group reliefs).

[19] Assume the asset is sold for more than the historic base cost.

(1) X pays the foreign tax at the time of the first disposal.
(2) Y pays UK tax (subject to the tax credit) at the time of the second disposal.

111.5.8 *Foreign tax on unrealised gain*

SP 6/88 provides:

> 4 The Revenue's view is that the following sets of circumstances fall within the terms of the standard credit article and [Part 2 TIOPA, Unilateral Credit] and may therefore give rise to a credit for overseas tax against UK capital gains tax or corporation tax on chargeable gains...
> (iv)[a] Overseas tax is payable by reference to increases in the value of assets although there has been no disposal.
> [b] There is a subsequent disposal of the assets on which a liability to UK tax arises.

In the UK we do not usually tax chargeable gains without a disposal; but we often tax gains accruing on a deemed disposal, which comes to the same thing. In this case UK/foreign taxes are paid at a different times, but (at least in general) the taxes are paid by the same person.

111.6 Domestication relief

111.6.1 *The relief*

This is a niche topic, far from the interests of private client practitioners. But it illustrates the principle of what constitutes the same tax for the purposes of foreign tax credit. I set out only the provisions needed to understand the tax credit issue.

Section 140(1) TCGA provides:

> This section applies where a company resident in the UK carries on a trade outside the UK through a permanent establishment and—
> (a) that trade ...is transferred to a company not resident in the UK;
> (b) the trade ... is so transferred wholly or partly in exchange for securities consisting of shares, or of shares and loan stock, issued by the transferee company to the transferor company ...

HMRC refer to this as "domestication". Section 140 provides a form of incorporation relief:

> (2) In any case to which this section applies the transferor company may claim that this Act shall have effect in accordance with the following provisions.

> (3) ... (a) if the securities are the whole consideration for the transfer,
> [i] the whole of that gain shall be treated as not accruing to the transferor company on the transfer but
> [ii] an equivalent amount ("the deferred gain") shall be brought into account in accordance with subsections (4) and (5) below ...

111.6.2 *The clawback charges*

A clawback charge arises if the company disposes of the securities. Section 140 TCGA provides:

> (4) If at any time after the transfer the transferor company disposes of the whole or part of the securities held by it immediately before that time, there shall be deemed to accrue to the transferor company as a chargeable gain on that occasion the whole or the appropriate proportion of the deferred gain so far as not already taken into account under this subsection or subsection (5) below...
> (4A) A chargeable gain which is deemed to accrue under subsection (4) is in addition to any gain or loss that actually accrues to the transferor company on the disposal of the securities.

A clawback charge also arises if the subsidiary disposes of the trade. Section 140(5) TCGA provides:

> If at any time within 6 years after the transfer the transferee company disposes of the whole or part of the relevant assets held by it immediately before that time there shall be deemed to accrue to the transferor company as a chargeable gain on that occasion the whole or the appropriate proportion of the deferred gain...

SP 6/88 provides:

> 4 The Revenue's view is that the following sets of circumstances fall within the terms of the standard credit article and [Part 2 TIOPA, Unilateral Credit] and may therefore give rise to a credit for overseas tax against UK capital gains tax or corporation tax on chargeable gains...
> (iii)[a] An overseas trade carried on through a branch or agency is domesticated (ie transferred to a local subsidiary) and relief is given under TCGA 1992 s 140.
> [b] There is a subsequent disposal of the securities (or the subsidiary disposes of the assets within six years) giving rise to a liability to UK tax and overseas tax is charged in whole or in part by reference to the gain accruing at the

date of domestication.[20]

The facts envisaged are:

(1) X transfers a trade to Y, a subsidiary ("the first disposal"):
  (a) The disposal is not subject to UK tax (because of domiciliation relief)
  (b) The disposal is subject to foreign tax (because the foreign tax does not allow a domestication relief)

(2) A clawback charge on the disposal of the shares in the subsidiary by X, or on the disposal of the trade by Y ("the second disposal").

The first disposal is treated for CT as made for such amount as secures that no gain/loss accrues on the disposal, ie the historic base cost. On the second disposal a chargeable gain accrues. Foreign tax on the first disposal is regarded as a tax on the gain. This is a relatively easy case because:

(1) On a disposal of securities by X, a different asset is disposed of, but the gain accruing is "the deferred gain" (the gain otherwise payable on the first disposal)

(2) Likewise on a disposal of the trade by Y, the gain accrues to X.

111.7 Same gain: roll-over relief

111.7.1 *The relief*

We move on to a more familiar relief. Section 152(1) TCGA provides:

> (1) If
> [i] the consideration which a person carrying on a trade obtains for the disposal of, or of his interest in, assets ("the old assets") used, and used only, for the purposes of the trade throughout the period of ownership is applied by him in acquiring other

[20] The former International Tax Handbook para 619 explains the point more clearly: "An example of this situation is found in Section 140 TCGA 1992 which deals with the charge on capital gains where a branch or agency overseas is domesticated, that is to say transferred to a non-resident company in exchange for shares. In those circumstances a charge on the gains on branch assets transferred is deferred until either the transferor sells the shares or the transferee sells the assets (in the latter case the sale has to be within six years of the acquisition). In that latter instance where the transferee sells the asset, any foreign tax on the gains is paid by the transferee. But the UK company is charged in respect of the capital gains on those same assets and qualifies for credit relief because the gain has been taxed abroad, although the tax has actually been charged on the transferee."

> assets, or an interest in other assets ("the new assets") which on the acquisition are taken into use, and used only, for the purposes of the trade, and
>
> [ii] the old assets and new assets are within the classes of assets listed in section 155,
>
> then the person carrying on the trade shall, on making a claim as respects the consideration which has been so applied, be treated for the purposes of this Act—
>
> (a) as if the consideration for the disposal of, or of the interest in, the old assets were (if otherwise of a greater amount or value) of such amount as would secure that on the disposal neither a gain nor a loss accrues to him, and
>
> (b) as if the amount or value of the consideration for the acquisition of, or of the interest in, the new assets were reduced by the excess of the amount or value of the actual consideration for the disposal of, or of the interest in, the old assets over the amount of the consideration which he is treated as receiving under paragraph (a) above ...

111.7.2 *Roll-over: Foreign tax credit*

SP 6/88 provides:

> 5 ... where roll-over relief is claimed, for example under TCGA 1992 s 152, the gain on disposal of the old asset is not subjected to UK tax. The gain on realisation of the new asset remains a gain separate from that realised on sale of the old asset and overseas tax payable as a result of the sale of the old asset is not creditable against UK tax payable on the gain realised on sale of the new asset.

The facts envisaged are:

(1) A disposal of the old asset by X ("the first disposal") where the disposal is:

(a) not subject to UK tax (because of roll-over relief)

(b) subject to foreign tax (because the foreign tax does not allow a roll-over relief)

(2) A disposal of the new asset by X (the second disposal)

The first disposal is treated as made for an amount which secures that no gain/loss accrues on the disposal. On the second disposal a gain accrues. Foreign tax on the first disposal is *not* regarded as a tax on that gain.

What is the difference between (1) roll-over relief (no FTC) and (2) group/domiciliation reliefs (where Foreign Tax Credit applies)?

In a group relief case the gain arises on a disposal of the same asset. In the domestication case, there is tax on the deferred gain, ie the gain on the disposal of the first asset. But in a roll-over case there is a disposal of a different asset. In the HMRC view, the elastic of identity has snapped. The contrary is arguable, but what are the prospects of success? On one hand, the fact that HMRC's view has been unchallenged since (at least) 1988 is suggestive. On the other hand, *Anson* calls for "a degree of pragmatism, at least "in some circumstances".[21] The taxpayer has the merits; but (unlike *Anson)* the taxpayer has fall-back options of not claiming roll-over relief, or else a deduction for the tax. A topic for a student moot, perhaps? But I think HMRC have the stronger argument.

111.7.3 *Roll-over: Deduction*

SP 6/88 provides:

> However, in such circumstances [s.113 TIOPA] allows the overseas tax to be claimed as a deduction in computing the gain for roll-over relief purposes.

See 111.27 (CGT/IT computation deduction).

111.8 Foreign-source rule

Art 24(4) USA/UK DTA	**s.9(1) TIOPA: Unilateral Credit**
United States tax ... on profits, income or chargeable gains from sources within the United States ... shall be allowed as a credit against any UK tax	Credit for tax ... calculated by reference to income arising, or any chargeable gain accruing, in the territory... is to be allowed against any income tax or corporation tax

I refer to this as the **"foreign-source rule"**. It is therefore necessary to determine:

(1) For US FTCR, whether income/gains are from sources within the US
(2) For unilateral FTCR, where income/gains arise/accrue

This is the same question, though differently expressed

111.8.1 *Treaty-source rules*

DTAs may provide specific rules for determining the source of income,

[21] See 111.5.1 (The same: pragmatic approach).

for treaty purposes generally or for foreign tax credit specifically.[22]

DTAs may provide that for DTA purposes, interest, royalties and technical fees arise in the State where the payer is resident.[23]

Article 24(5) USA/UK DTA provides:

> For the purposes of paragraph 4 of this Article, profits, income and chargeable gains
> [a] owned[24] by a resident of the UK
> [b] which may be taxed in the United States in accordance with this Convention
> shall be deemed to arise from sources within the United States.

US Treasury refer to this rule as "re-sourcing".

The USA/UK DTA Technical Explanation provides:[25]

> Paragraph 5 provides a re-sourcing rule for gross income covered by paragraph 4 [UK FTCR]. This provision is intended to ensure that a UK resident can obtain a UK foreign tax credit for US taxes paid when the Convention assigns to the United States primary taxing rights over an item of gross income. Paragraph 5 provides that, if the Convention allows the United States to tax an item of gross income (as defined under UK law) derived by a resident of the UK, the UK will treat that item of gross income as gross income from sources within the United States for UK foreign tax credit purposes.

111.8.2 *Income from services/trading*

Section 9(3) TIOPA provides:

> For the purposes of subsection (1) [Unilateral Credit], profits from, or remuneration for, personal or professional services performed in the territory are to be treated as income arising in the territory.

In *Yates v GCA International*[26] a UK resident company provided services (an investigation into oil fields in Venezuela). Some of the work was done in Venezuela and some in the UK. The company (being UK resident) was in principle taxable on all trading income, but subject to foreign tax credit relief for Venezuela tax on income arising in Venezuela.

[22] See Avery Jones, "Tax treaty problems relating to source" [1998] BTR 222.

[23] See 21.26.6 (Source of interest for DTA); 24.16.7 (Source of royalties for DTA).

[24] See 15.11.2 ("Paid" and "payment").

[25] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[26] 64 TC 37.

Smidth principles were applied[27] and so (unsurprisingly) part of the profits were held to arise in Venezuela.

The INT Manual provides:

> **INTM161120 UK residents with foreign income or gains: double taxation relief** [May 2020]
>
> ... Where tax credit relief is allowable under a double taxation agreement, where a UK resident carries on a trade, profession or vocation etc. chargeable to either Income or Corporation Tax and earns profits partly in the UK and partly in a foreign country, that part of the profits earned in the foreign country is regarded, for credit purposes, as having a foreign source.
>
> Where tax credit relief is only allowable under the unilateral provisions, TIOPA10/S9(3) states that profits from, or remuneration for, personal or professional services performed in the foreign country are deemed to be income arising in that country. This is more narrowly drawn than the corresponding provision in an agreement (see above). In *Yates v GCA International Ltd* (64 TC 37), where services under a contract were performed partly in Venezuela and partly in the UK, it was held that unilateral credit relief was only allowable for the Venezuelan tax attributable to the fees paid for the services that were performed in Venezuela, limited to the UK tax charged on the profits to which those fees gave rise, after deduction of expenses.

111.8.3 *Channel Islands/Isle of Man*

Section 9(7) TIOPA provides:

> If the territory is the Isle of Man or any of the Channel Islands, subsections (1)(b) and (2)(b) have effect with the omission of "in the territory".

Amended as s.9(7) directs, s.9(1)(2) TIOPA provide:

s.9(1) TIOPA: IT/CT	**s.9(2) TIOPA: CGT**
Credit for tax—	[Identical to s.9(1)]
(a) paid under the law of the territory,	[Identical to s.9(1)]
(b) calculated by reference to income arising, or any chargeable gain accruing, ~~in the territory~~, and	(b) calculated by reference to any capital gain accruing ~~in the territory,~~ and

[27] See 21.14 (Services).

(c) corresponding to UK tax,	[Identical to s.9(1)]
is to be allowed against any income tax or corporation tax calculated by reference to that income or gain.	is to be allowed against any capital gains tax calculated by reference to that gain.

Since the Channel Islands and the IoM do not have CGT, it is not immediately obvious what is the role of s.9(2). Perhaps it applies where a gain is subject to IT in the Islands but subject to CGT in the UK.

The INT Manual provides:

> **INTM161120 UK residents with foreign income or gains: double taxation relief** [May 2020]
> **Exceptions to the source rule**
> Certain exceptions to the source rule (INTM161110) are provided for by statute and under particular agreements as follows:
> 1. Isle of Man and Channel Islands. TIOPA10/S9(7) provides that the limitation of unilateral relief to foreign tax on income arising in the foreign country is not to apply where the country concerned is the Isle of Man or any of the Channel Islands. Company dividends and debenture interest are excluded from the scope of the agreements with the Isle of Man (DT9950+), Guernsey (DT8600+) and Jersey (DT10750+) by the credit Articles of those agreements. Unilateral relief is therefore available for Manx and Channel Islands tax on debenture interest and on company dividends wherever such income arises, except where the recipient is a portfolio shareholder (see INTM164010 paragraph (f). See also DT8606, DT9955 and DT10755...

This needs to be reviewed in the light of the new Channel Islands/IoM treaties.

111.9 Tax in accordance with DTA

Art 24 USA/UK DTA provides credit for:

> United States tax payable ... in accordance with this Convention...

The same phrase is used in art 23B OECD Model:

> 1. Where a resident of a Contracting State derives income ... which may be taxed in the other Contracting State in accordance with the provisions of this Convention (except to the extent that these provisions allow taxation by that other State solely because the income is also income derived by a resident of that State ...), the first-mentioned State shall allow:

> a) as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in that other State...

The OECD Commentary is not usually relevant for DTA Credit, but on this point the wording is the same so it is applicable:

> 32.1 Both Articles 23 A and 23 B require that relief be granted, through the exemption or credit method, as the case may be, where an item of income or capital may be taxed by the State of source in accordance with the provisions of the Convention. Thus, the State of residence has the obligation to apply the exemption or credit method in relation to an item of income or capital where the Convention authorises taxation of that item by the State of source.
>
> 32.2 The interpretation of the phrase "may be taxed in the other Contracting State in accordance with the provisions of this Convention", which is used in both Articles, is particularly important when dealing with cases where the State of residence and the State of source classify the same item of income or capital differently for purposes of the provisions of the Convention.
>
> 32.3 Different situations need to be considered in that respect. Where, due to differences in the domestic law between the State of source and the State of residence,
>
> [1] the former applies, with respect to a particular item of income or capital, provisions of the Convention
>
> [2] that are different from those that the State of residence would have applied to the same item of income or capital,
>
> the income is still being taxed in accordance with the provisions of the Convention, as interpreted and applied by the State of source. In such a case, therefore, the two Articles require that relief from double taxation be granted by the State of residence notwithstanding the conflict of qualification resulting from these differences in domestic law.

In *G E Financial Investments v HMRC*:[28]

> the phrase "in accordance with the this Convention" requires that the imposition of US tax is not inconsistent with the Convention (ie is not tax in an amount in excess of that permitted by the Convention or on sums not taxable in the US under the terms of the Convention).

111.10 *Hybrid example: Tax a/c DTA*

The OECD Commentary gives the example of a hybrid entity:

[28] [2021] UKFTT 210 (TC) at [98].

> 32.4 This point may be illustrated by the following example.
> A business is carried on through a permanent establishment in State E by a partnership established in that State.
> A partner, resident in State R, alienates his interest in that partnership.
> State E treats the partnership as fiscally transparent whereas State R treats it as taxable entity.
> State E therefore considers that the alienation of the interest in the partnership is, for the purposes of its Convention with State R, an alienation by the partner of the underlying assets of the business carried on by the partnership, which may be taxed by that State in accordance with paragraph 1 or 2 of Article 13.
> State R, as it treats the partnership as a taxable entity, considers that the alienation of the interest in the partnership is akin to the alienation of a share in a company, which could not be taxed by State E by reason of paragraph 5 of Article 13.

OECD refer to this as a conflict of qualification, though this seems a rather opaque term. The OECD analysis is as follows:

> In such a case, the conflict of qualification results exclusively from the different treatment of partnerships in the domestic laws of the two States and State E must be considered by State R to have taxed the gain from the alienation "in accordance with the provisions of the Convention" for purposes of the application of Article 23 A or Article 23 B. State R must therefore grant an exemption pursuant to Article 23 A or give a credit pursuant to Article 23 B irrespective of the fact that, under its own domestic law, it treats the alienation gain as income from the disposition of shares in a corporate entity and that, if State E's qualification of the income were consistent with that of State R, State R would not have to give relief under Article 23 A or Article 23 B. No double taxation will therefore arise in such a case.

111.10.1 *Example: tax not a/c to DTA*

The OECD Commentary provides:

> 32.5 Article 23 A and Article 23 B, however, do not require that the State of residence eliminate double taxation in all cases where the State of source has imposed its tax by applying to an item of income a provision of the Convention that is different from that which the State of residence considers to be applicable. For instance, in the example above, if, for purposes of applying paragraph 2 of Article 13,
> [a] State E considers that the partnership carried on business through a

> fixed place of business but
>
> [b] State R considers that paragraph 5 applies because the partnership did not have a fixed place of business in State E,
>
> there is actually a dispute as to whether State E has taxed the income in accordance with the provisions of the Convention.
>
> The same may be said if State E, when applying paragraph 2 of Article 13, interprets the phrase "forming part of the business property" so as to include certain assets which would not fall within the meaning of that phrase according to the interpretation given to it by State R.
>
> Such conflicts resulting from different interpretation of facts or different interpretation of the provisions of the Convention must be distinguished from the conflicts of qualification described in the above paragraph where the divergence is based not on different interpretations of the provisions of the Convention but on different provisions of domestic law. In the former case, State R can argue that State E has not imposed its tax in accordance with the provisions of the Convention if it has applied its tax based on what State R considers to be a wrong interpretation of the facts or a wrong interpretation of the Convention. States should use the provisions of Article 25 (Mutual Agreement Procedure), and in particular paragraph 3 thereof, in order to resolve this type of conflict in cases that would otherwise result in unrelieved double taxation.

111.11 Tax credit: Dividends

Section 12(1) TIOPA provides:

> Credit under section 9 [Unilateral Credit] for overseas tax on a dividend paid by a company ("P") resident in the territory is allowed only if section 13, 14, 15 or 16 so provides.

Section 13 TIOPA provides:

> (1) This section applies for the purposes of section 12(1).
>
> (2) Credit under section 9 for overseas tax on a dividend paid by a company ("P") resident in the territory is allowed if—
>
> (a) the overseas tax is charged directly on the dividend (whether by charge to tax, deduction of tax at source or otherwise), and
>
> (b) neither P nor the recipient of the dividend would have borne any of that tax if the dividend had not been paid.

Why is that needed?

Sections 12(2) and 14 - 17 TIOPA apply where the recipient of the dividend is a company, and are not discussed here.

111.11.1 *DTA credit: Exclusion of underlying tax*

Art 24 USA/UK DTA provides credit but adds in brackets:

> (excluding, in the case of a dividend, United States tax in respect of the profits out of which the dividend is paid)

Underlying tax is not discussed here. However in the USA/UK DTA, these words are otiose, and present for historical reasons: see *Anson v HMRC* [2015] UKSC 44 at [60] - [96].

111.12 DTA/Unilateral Credit: Priority

Section 11 TIOPA provides:

> (1) Credit for tax paid under the law of the territory is not allowed under section 9 or 10 in the case of any income or gains if any credit for that tax is allowable in respect of that income or those gains under double taxation arrangements made in relation to the territory.
> (2) If credit in respect of an amount of tax may be allowed under double taxation arrangements made in relation to the territory, credit is not allowed under section 9 or 10 in respect of that tax.

In short, DTAs have priority over Unilateral Credit. It could have been more concisely expressed, but there it is.

The INT Manual provides:

> **INTM161030 Unilateral relief** [May 2020]
> Unilateral relief may be available against UK tax to a person resident in the UK for foreign tax charged on income arising in that foreign country, if relief is not available under an agreement. The relief may be due where either
> 1 there is no agreement with the country concerned, or
> 2 the income arises in a country with which there is an agreement but the agreement does not cover the category of income or foreign tax involved. For example, the agreement with the United States of America only covers the Federal Income Taxes and particular Federal excise taxes but not the taxes levied by the individual states. Unilateral relief is available for many of these state taxes (see DT19855 for example).

111.13 *DTA excluding tax credit*

Section 11(3) TIOPA provides:

> If double taxation arrangements made in relation to the territory contain express provision to the effect that relief by way of credit is not to be given under the arrangements in cases or circumstances specified or described in the arrangements, credit is not allowed under section 9 or 10 in those cases or circumstances.

In *Aozora GMAC Investment (R, oao) v HMRC,*[29] a UK company received US source interest from its US subsidiary. US interest received by a UK resident normally qualifies for relief from US tax under art 11 USA/UK DTA. However on this occasion US relief was not available because of the US Limitation on Benefits rule.[30] HMRC say that is an "express provision to the effect that relief by way of credit shall not be given". So wherever the LoB rule applies, s.11(3) TIOPA disapplies unilateral relief. Aozora contend that art 23 is not an "express provision". The appeal is pending.

This rule does not apply to pre-2000 DTAs. Para 13 sch 9 TIOPA provides:

> Section 11(3) does not have effect in relation to arrangements made before 21 March 2000.

111.14 Method of providing credit

Section 18 TIOPA provides:

> (1) Subsection (2) applies if—
> (a) under double taxation arrangements, or
> (b) under unilateral relief arrangements for a territory outside the UK,
>
> credit is to be allowed against any income tax, corporation tax or capital gains tax chargeable in respect of any income or chargeable gain.
> (2) The amount of those taxes chargeable in respect of the income or gain is to be reduced by the amount of the credit.

Section 18(6) TIOPA provides:

> Credit against income tax is given effect at Step 6 of the calculation in section 23 of ITA 2007.

[29] [2019] EWCA Civ 1643. An application for judicial review, based on a passage in the HMRC manual, was not successful.

[30] See art 23 USA/UK DTA; 110.1.2 (The LoB rule); [2017] EWHC 2881 (Admin) at [12]-[13]. UK readers may find that somewhat surprising, but that is a matter of US tax law.

111.14.1 *"Credit"*

Section 18 TIOPA provides:

> (3) In subsection (1) "credit"—
>
> (a) in relation to double taxation arrangements, means credit for tax payable under the law of the territory in relation to which the arrangements are made, and
>
> (b) in relation to unilateral relief arrangements for a territory outside the UK, means credit for tax payable under the law of that territory,
>
> but see sections 12(3) and 63(5) (dividends: certain tax payable otherwise than under the law of a territory treated as payable under that law)[31]...
>
> (5) Credit is allowed under subsection (2) against any tax only if, under the arrangements concerned, credit is allowable against that tax.

Section 22 – 24 TIOPA deal with credits where same income is charged to income tax in more than one tax year. This is not discussed here.

111.15 Foreign tax credit: Claim

Section 19 TIOPA provides:

> (1) Subsections (2) and (3) apply to a claim for relief under section 18(2) [DTA/Unilateral credit].
>
> (2) If the claim is for credit for foreign tax in respect of any income or chargeable gain charged to income tax or capital gains tax for a tax year, the claim must be made on or before—
>
> (a) the fourth anniversary of the end of that tax year, or
>
> (b) if later, the 31 January following the tax year in which the foreign tax is paid.

The standard claim procedure rules apply.[32] The INT Manual provides:

> **INTM161070 Withdrawal of credit claims** [May 2020]
>
> A claim to credit relief, once made, may be withdrawn at any time before the assessment giving effect to the claim becomes final and conclusive. Under self assessment, a claimant may amend the claim at any time during the 12 month period following the date on which it was made, unless the claim is under enquiry.

[31] Section 12(3) and s.63 TIOPA concern dividends paid to UK resident companies, and are not discussed here.

[32] See 123.1 (Claims).

If it is under enquiry, the claimant will be able to amend the claim when the enquiry is complete. If the claim to credit relief is withdrawn, the foreign tax is deductible under TIOPA10/S112-S113.[33] See INTM162580 where there has been an adjustment to the amount of foreign tax paid.

111.15.1 *Claim time limits*

Section 19 TIOPA provides an extended time limit where tax is paid late:

> (1) Subsections (2) and (3) apply to a claim for relief under section 18(2).
> (2) If the claim is for credit for foreign tax in respect of any income or chargeable gain charged to income tax or capital gains tax for a tax year, the claim must be made on or before—
> (a) the fourth anniversary of the end of that tax year, or
> (b) if later, the 31 January following the tax year in which the foreign tax is paid.
> (3) If the claim is for credit for foreign tax in respect of any income or chargeable gain charged to corporation tax for an accounting period, the claim must be made not more than—
> (a) four years after the end of that accounting period, or
> (b) if later, one year after the end of the accounting period in which the foreign tax is paid.

111.16 Tax sparing arrangements

Section 20 TIOPA provides:

> (1) Subsections (2) and (4) apply if the arrangements are double taxation arrangements.
> (2) For the purposes of this Chapter, any amount within subsection (3) is to be treated as having been payable.
> (3) An amount is within this subsection if it is an amount of tax that would have been payable under the law of a territory outside the UK but for a relief—
> (a) given under the law of that territory with a view to promoting industrial, commercial, scientific, educational or other development in a territory outside the UK, and
> (b) about which provision is made in double taxation arrangements.
> (4) References in this Chapter—

[33] See 111.27 (CGT/IT computation deduction).

> (a) to tax payable or chargeable, or
> (b) to tax not chargeable directly or by deduction,
>
> are to be read in accordance with subsection (2).
>
> (5) Subsections (2) and (4) have effect subject to—
> (a) subsection (6), and
> (b) sections 31(4) and 32(5) (income and gains not to be increased in calculations under section 31 or 32 by amounts treated by this section as having been payable).
>
> (6) If section 63(5) applies because conditions A and B in section 63 are met, relief is not given in accordance with section 63(5) (relief for certain tax underlying dividends paid between related companies) because of this section unless double taxation arrangements make express provision for the relief.
>
> (7) Subsection (6) does not affect the operation of section 17(2) (treatment, for purposes of unilateral relief, of dividend paid by foreign company that has received dividends from a company benefiting from tax-sparing relief).

111.17 When credit not allowed

Sections 25-27 provide 3 cases where credit is not allowed:

TIOPA	**Topic**
s.25	Relief for foreign tax
s.26	Non-resident claimant
s.27	Election against credit

111.17.1 *Relief for foreign tax*

Section 25 TIOPA provides:

> (1) Subsection (2) applies if relief may be allowed—
> (a) under the arrangements, or
> (b) under the law of the non-UK territory in consequence of the arrangements,
>
> in respect of an amount of tax that would, but for the relief, be payable under the law of that territory.
>
> (2) Credit under section 18(2) [DTA/Unilateral credit] is not allowed in respect of that tax, whether or not the relief has been used.

It is not common for UK tax law to allow a relief for UK tax but it does happen.[34] No doubt the same applies in foreign tax laws.

[34] See eg 64.20 (s.3 distribution relief); 51.1 (Overlapping ToA charges: Relief).

111.18 Restriction to UK residents

Section 26 TIOPA provides:

> (1) Credit under section 18(2) [DTA/Unilateral credit] against income tax, corporation tax or capital gains tax for a chargeable period[35] is not allowed unless the person in respect of whose income or chargeable gains the tax is chargeable is UK resident[36] for that period.
> (2) Sections 28 to 30 (credit under unilateral relief arrangements allowed to some non-UK resident persons) contain exceptions to subsection (1).

The exceptions are:

Section	**Topic**
28	Isle of Man/Channel Islands
29	Employment income
30	Non UK tax on non UK resident's branch/agency

I only discuss s.29.

111.18.1 *FTCR: Employment income*

Section 29 TIOPA provides an exception to the general rule that credit is restricted to a UK resident:

> (1) Subsection (3) applies if the arrangements are unilateral relief arrangements for a territory outside the UK.
> (3) Credit for overseas tax[37] may be allowed under section 18(2) [DTA/Unilateral credit] against income tax for a tax year—
> (a) calculated by reference to that income, and

[35] Section 26(3) defines "chargeable period": "In subsection (1) so far as it relates to capital gains tax "chargeable period" means tax year (see section 288(1ZA) of TCGA 1992)."

[36] Section 26(4) TIOPA defines "UK resident": In subsection (1) so far as it relates to capital gains tax "UK resident" has the meaning given by section 989 of ITA 2007."

[37] Defined in s.29(2) TIOPA:
In subsection (3) "overseas tax" means tax—
(a) paid under the law of the territory,
(b) charged on income and corresponding to income tax or to corporation tax, and
(c) calculated by reference to income from an office or employment the duties of which are performed wholly or mainly in the territory.
Section 29(4) TIOPA provides that local/provincial taxes may "correspond" to IT/CT, repeating the wording in s.8(3); see 111.4.2 (Which taxes: Unilateral Credit).

> (b) charged on employment income,
>
> if the person performing the duties is resident in the UK, or resident in the territory, for that year.

HMRC say:

> **Bermuda Payroll Tax**
>
> Is Bermuda Payroll Tax an admissible income tax for UK foreign tax relief purposes? It is not covered in the HMRC Double Taxation Manual.
>
> **Answer**
>
> As there is no tax treaty with Bermuda, unilateral relief will be available.[38]

111.19 Election against credit

Section 27 TIOPA provides:

> Credit under section 18(2) [DTA/Unilateral credit] against income tax, corporation tax or capital gains tax charged on any income or chargeable gains of a person is not allowed if the person elects for credit not to be allowed in respect of that income or those gains.

Why should a person elect for credit not to be allowed, rather than simply not making a claim for credit?

111.20 Computing FTC: Income

111.20.1 *Arising basis*

Section 31 TIOPA deals with computation of income/gains on the arising basis:

> (1) Subsection (2) applies if—
>
> (a) under the arrangements, credit is to be allowed for foreign tax in respect of any income or gain, and
>
> (b) section 32(2) (cases where UK tax payable by reference to amount received in UK) does not apply.[39]
>
> (2) In calculating the amount of the income or gain for the purposes of income tax, corporation tax or capital gains tax—
>
> (a) no deduction is to be made for foreign tax or special withholding tax, whether in respect of the same or any other income or gain...

[38] Expat Forum Q&A log (July 2019) (informally circulated).

[39] See 111.20.3 (Remittance basis: non-dividends).

The INT Manual provides:

> **INTM165030 Computation – assessable amount** [Sep 2021]
> Where credit is claimed against UK Income Tax for foreign tax paid on income from a foreign source, the amount of that income for all UK tax purposes is:
> **a) Foreign income assessable on the arising basis**
> No direct foreign tax is to be deducted. Where, exceptionally, the double taxation agreement provides for relief for underlying tax on a dividend (see INTM164410) the underlying tax should be added to the amount of the income...[40]
> *Example:*
> An individual receives a dividend of 100 from which 15 foreign withholding tax was deducted. The amount of income assessable is 100.

111.20.2 *FTC: Property income*

The Property Income Manual provides:

> **PIM4705 Rent from property outside the UK: CT** [May 2020]
> ***Foreign tax***
> If the overseas income has suffered foreign tax and a claim to tax credit relief is made, it will be necessary, for the purposes of the source by source rules (see INTM161210), to identify the amount of UK tax attributable to income from each particular property. Where, therefore, tax credit relief is claimed, separate computations of profits and losses for each property will be required.
> For the purposes of calculating tax credit relief, losses should be deducted in the order most favourable to the taxpayer's claim. Normally, this will mean that losses should be allocated first against the source that has suffered the lowest rate of foreign tax. ...

111.20.3 *Remittance basis*

Section 32 TIOPA provides:

> (1) Subsection (2) applies if—
> (a) under the arrangements, credit is to be allowed for foreign tax in respect of any income or capital gain, and

[40] The Manual continues: "Treat the whole of a foreign pension as chargeable to UK tax notwithstanding the deduction of one tenth under ICTA88/S65 (2)." The 10% deduction is (more or less) abolished, but see 38.7.4 (Commonwealth pension: Charge).

> (b) income tax or capital gains tax is payable by reference to the amount received in the UK.
>
> (2) For the purposes of whichever of income tax and capital gains tax is payable as mentioned in subsection (1)(b), the amount received is to be treated as increased—
>
> (a) by the amount of the foreign tax in respect of the income or gain,
>
> (b) by the amount of any special withholding tax levied in respect of the income or gain, but see subsection (4)

The INT Manual provides:

> **INTM165030 Computation – assessable amount** [May 2020]
>
> Where credit is claimed against UK Income Tax for foreign tax paid on income from a foreign source, the amount of that income for all UK tax purposes is: ...
>
> ***b) Foreign income assessable on the remittance basis***
>
> Add the amount of direct foreign tax attributable to the amount of income remitted. Where, exceptionally, the agreement provides for relief for underlying tax on a dividend (see INTM164410), the underlying tax should also be added to the amount of the dividend remitted. If you have difficulty in determining the amount of foreign tax attributed to income remitted, refer to CSTD, BAI, Assets Residence & Valuation.
>
> *Example*

[Gross foreign income]	£1,000
Foreign tax	£400
Net foreign income	£600
Remitted to UK	£300
UK measure of the income	
Income remitted	£300
Plus foreign tax (300/600 × 400)	£200
Therefore UK measure is	£500

Similarly for CGT; the INT Manual provides:

> **INTM169080. Remittance basis** [Sep 2021]
>
> An individual who is resident or ordinarily resident[41] but not domiciled in the UK and who makes a chargeable gain on the disposal of an asset situated outside the UK is only liable on the amount of the gain received in the UK ... When such an individual is chargeable on the gain received

[41] The reference to ordinary residence is out of date since 2013.

> in the UK and claims credit for foreign tax charged on the same gain, the liability in the UK will be on the sum of the amount remitted to the UK plus the foreign tax attributable to the amount remitted.
> Any difficulty in determining the correct addition for the foreign tax, should be referred to Personal Tax International (part of Charity, Assets & Residence).

111.21 Computing FTC: CGT

The INT Manual provides:

> **INTM169100. Amount of foreign tax credit relief – general** [May 2020]
> Similar principles to those set out in INTM161210 onwards for Income Tax apply to Capital Gains Tax. The amount of credit for foreign tax is not to exceed the lesser of
> - the foreign tax charged on the foreign gain and
> - the UK tax charged on the doubly taxed gain at the taxpayer's marginal rate.
>
> If the foreign tax exceeds the UK tax, the excess can neither be deducted from the amount of the gain chargeable to Capital Gains Tax, nor can it be repaid.
> The foreign tax should not be increased by any indexation allowance.
> A taxpayer's marginal rate for Capital Gains Tax is the rate at which the tax is charged for the year of assessment.

111.21.1 *More than one gain*

The INT Manual provides:

> **INTM169110. Amount of foreign tax credit relief – more than one gain** [May 2020]
> The amount of foreign tax credit relief must be calculated separately for each gain. An excess of foreign tax over UK tax on one gain cannot be credited against UK tax on another foreign gain or on the gain on the disposal of a UK asset.

111.21.2 *FTC: Capital losses*

The INT Manual provides:

> **INTM169120. Amount of foreign tax credit relief – losses** [May 2020]
> Where foreign tax credit relief is due, allowable capital losses should be utilised in such a way as to reduce the taxable amount of a gain down to a level where the UK tax due on the gain equals the foreign tax paid, and

> then allocate the remaining part of the loss to another gain, and so on. Where gains are subject to differing rates of UK capital gains tax, it would be in the customer's interest to offset the capital losses against those gains where, following any claim for a foreign tax credit, there remains a liability to UK capital gains tax by sorting the gains in descending order of UK tax rates applicable to those gains and applying the allowable losses firstly against those gains where the highest UK tax rate is applicable. This should secure the maximum amount of foreign tax credit relief, while at the same time ensuring that the losses reduce the amount of gains which are subject to the highest UK tax rates, thus minimising the overall tax charge.

See 65.11 (Losses used in best way).

111.21.3 *FTCR: CGT annual exemption*

The INT Manual provides:

> **INTM169130. Amount of foreign tax credit relief – exemption from tax** [May 2020]
> Where the total of the chargeable gains in any year of assessment exceeds the exempt amount... the exempt amount should, as far as possible, consist of gains on which no foreign tax has been charged. This will enable credit for foreign tax charged on the gains to be allowed against the UK Capital Gains Tax charged on those gains. ...

111.21.4 *HMRC example*

The INT Manual provides an example of the interaction of FTCR with loss relief and the CGT annual exemption, where the taxpayer has three gains: a UK gain, and two foreign gains taxable at different rates.

> **INTM169130. Amount of foreign tax credit relief – exemption from tax** [May 2020]
> ... The following example demonstrates the application of this paragraph and of INTM169120
> In 2009–10, an individual has the following chargeable gains:

Country	**Gain**	**Foreign tax**
UK	£10,000	-
Country X	£20,000	£2,000
Country Y	£6,000	£2,700

> He has losses of £6,000 available for deduction.
> The exemption limit for 2009–10 is £9,600.

The computation of his liability is as follows:

	UK Gain	**Country X Gain**	**Country Y Gain**
	£10,000	£20,000	£6,000
Less Loss	£6,000		
	£4,000	£20,000	£6,000
Less Exempt Amount	£4,000	£5,600	
	0	£14,400	£6,000
Tax at 18%	0	£2,592	£1,080
Less FTCR	0	£2,000	£1,080
Tax Payable	Nil	£592	Nil

The balance of Country Y's tax of £1,620 (2,700 less 1,080) cannot be set off against the Capital Gains Tax payable on the Country X gain and cannot be repaid.

111.22 Minimisation of foreign tax

Section 33 TIOPA provides:

> (1) The credit under section 18(2) must not exceed the credit which would be allowed had all reasonable steps been taken—
>
> (a) under the law of the non-UK territory, and
>
> (b) under double taxation arrangements made in relation to that territory,
>
> to minimise the amount of tax payable in that territory.
>
> (2) The steps mentioned in subsection (1) include—
>
> (a) claiming, or otherwise securing the benefit of, reliefs, deductions, reductions or allowances, and
>
> (b) making elections for tax purposes.
>
> (3) For the purposes of subsection (1), any question as to the steps which it would have been reasonable for a person to take is to be determined on the basis of what the person might reasonably be expected to have done in the absence of relief under this Part.

111.23 Limit on credit relief

s.36 TIOPA	**s.40 TIOPA**
(1) This section is about the amount of credit allowed under section 18(2) [DTA/Unilateral credit] against a person's income tax for any tax year.	(1) This section is about the amount of credit allowed under section 18(2) [DTA/Unilateral credit] against a person's capital gains tax for any tax year.

(2) The amount of credit in respect of income from any particular source must not exceed the difference between—	(2) The amount of credit in respect of any particular capital gain must not exceed the difference between—
(a) the amount of income tax to which the person would be liable for the tax year if the person were charged to income tax on TI – X, and	(a) the amount of capital gains tax to which the person would be liable for the tax year if the person were charged to capital gains tax on TG – X, and
(b) the amount of income tax to which the person would be liable for the tax year if the person were charged to income tax on TI – (X + C)	(b) the amount of capital gains tax to which the person would be liable for the tax year if the person were charged to capital gains tax on TG – (X + C).

TI stands for **T**otal **I**ncome
C stands for **C**redit
TG stands for **T**otal **G**ains

In full detail,

s.36(4) TIOPA: IT/CT	**s.40(4) TIOPA: CGT**
In subsection (2)—	In subsection (2)—
TI is the person's total income for the tax year,	TG is the total amount of the chargeable gains accruing to the person in the tax year,
X is the income (if any) to which subsection (2) has already been applied, and	X is the total amount of the gains (if any) to which subsection (2) has already been applied, and
C is the income in respect of which the credit is to be allowed.	C is the amount of the gain in respect of which the credit is to be allowed.

s.36(3)(5) TIOPA: IT/CT	**s.40(3)(5) TIOPA: CGT**
(3) If credit is allowed (whether or not under the same tax-relief	(3) If credit is allowed (whether or not under the same tax-relief

arrangements[42]) in respect of income from more than one source, apply subsection (2) successively to the income from each source, taking the sources in the order which will result in the greatest reduction in the person's income tax liability for the tax year...	arrangements) in respect of more than one capital gain, apply subsection (2) successively to each capital gain, taking the gains in the order which will result in the greatest reduction in the person's capital gains tax liability for the tax year.
(5) The rules for calculating an amount of income tax under subsection (2) are—	(5) The rules for calculating an amount of capital gains tax under subsection (2) are—
(a) the calculation is to be made in accordance with sections 31 and 32, and	[identical]
(b) no credit is to be allowed for foreign tax, and	(b) no credit is to be allowed for foreign tax.
(c) no reduction is to be made under section 26 of FA 2005 (trusts for the benefit of a vulnerable beneficiary), but	
(d) any other income tax reduction under the Income Tax Acts is to be made.	

In short, foreign tax credit relief must not exceed the lesser of:
(1) the foreign tax, and
(2) the UK tax

Sections 37, 38 TIOPA contain further rules for trading income and royalties, not discussed here.

The Royal Commission on the Taxation of Profits and Income Final Report provides:[43]

[42] Defined in s.36(7)/40(6) TIOPA: "For the purposes of subsection (3) the following are "tax-relief arrangements"—
(a) double taxation arrangements, and
(b) unilateral relief arrangements for a territory outside the UK."

[43] (1953) Cmd 9474.

CARRY-OVER OF UNRELIEVED OVERSEAS TAX

732. The situation in which the overseas tax exceeds the UK tax so that part of it is excluded from credit attracted some attention in the evidence we received. It will, we think, be generally accepted that there could be no question of allowing the surplus overseas tax to rank for credit against the UK tax on some altogether different source of income for the same year. That course would be anomalous. To take an extreme example, it would mean that a man with an income of £1,000 from UK sources who possessed also a net overseas income of £150, being the balance remaining after a gross income of £500 had been subjected to overseas tax at an assumed rate of 70 per cent would be asked to pay *less* UK tax than another man with like personal circumstances who also possessed an income of £1,000 from UK sources but had no overseas income. If the UK were to abate its charge on income from UK sources in this way the situation would come close to being one in which the overseas country was indirectly levying tax on the UK income of UK residents.

111.23.1 *Interaction with Gift Aid*

Section 41 TIOPA provides:

> (1) In subsection (2) "the total credit" means F + G
> where—
> F is the total credit, under all tax-relief arrangements,[44] allowed under section 18(2) [DTA/Unilateral credit] against a person's income tax for any tax year, and
> G is the total credit, under all tax-relief arrangements, allowed under section 18(2) [DTA/Unilateral credit] against the person's capital gains tax for that tax year.
> (2) The total credit is not to be more than—
> I + C - A

In short, I stands for **I**ncome, C stands for **C**GT and A stands for **A**mount. In full:

> I is the total income tax payable by the person for the tax year,
> C is the total capital gains tax payable by the person for the tax year, and
> A is the total amount of the tax treated under section 414 of ITA 2007 (gift aid) as deducted from gifts made by the person in the tax year.
> (3) In calculating I and C for the purposes of subsection (2), no reduction is to be made for credit under section 18(2) [DTA/Unilateral credit].

[44] Section 41(5) TIOPA repeats the s.36 definition verbatim: see above footnotes.

(4) Subsection (2) applies in addition to sections 36 and 40.

111.24 Credit for TNR CGT

This section considers the position where:

(1) An individual who is treaty-resident in the US realises a gain. The gain is subject to US tax and not UK tax.

(2) The individual (who is temporarily non-resident) returns to the UK and the gain is subject to UK tax under the TNR rules.[45]

The USA/UK DTA Technical Explanation provides:[46]

> Although the rules allow each of the Contracting States to apply their domestic anti-abuse rules, the foreign tax credit rules provided in paragraphs 2 and 4 of Article 24 (Relief from Double Taxation) ensure that the Contracting State applying an anti-abuse rule to a resident of the other Contracting State maintains only a residual right to tax. The primary right to tax remains with the country of residence. Accordingly, pursuant to subparagraph (b) of paragraph 2 of Article 24, if the gains subject to this rule are derived while the former UK resident was a resident of the United States, then such gains are considered to be gains from sources within the United States.[47]
>
> Pursuant to paragraph 4 of Article 24, the UK will grant a foreign tax credit for US tax imposed upon those gains.
>
> Example
>
> In year 1, UK resident A purchases stock in a Country X company for $1,000.[48]
>
> A moves to the United States in year 2, when the fair market value of the stock is $2,000.[49]
>
> In year 3, while A is still a US resident, A sells the Country X stock.
>
> In year 4, after the sale of the Country X stock, A moves back to the UK and re-establishes residence.
>
> Under Article 13 (6),[50] both the United States and the UK may tax the gain on the sale of the property in year 3.

Actually, the UK taxes the gain in the year of return, year 4. But FTCR is available so the US tax is set against UK tax:

[45] See 11.6 (TNR gains/losses).

[46] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[47] See 111.2 (DTA/Unilateral Credit compared).

[48] This fact is stated so that TNR relief for post-departure acquisitions is not applicable.

[49] The value in year 2 is not relevant for UK tax, but perhaps it is relevant for US tax.

[50] See 56.24.5 (Recently departed resident).

> Under Article 24, however, the gain from the sale of the Country X stock is deemed to be from sources within the United States because A was a US resident when the sale occurred and gains from the stock could be taxed by the UK only pursuant to paragraph 6 of Article 13 (that is, the stock could not be taxed under paragraph 1 or 3 of Article 13). Thus the UK is required to provide a foreign tax credit for US taxes paid with respect to gain on the disposition of the Country X stock.

111.25 UK-resident USA citizen

This section considers income/gains arising to an individual who is a US citizen, and is treaty-resident in the UK.

The starting point here is that the individual is subject to UK tax (as a resident) *and* US tax (as a citizen). The individual does not qualify for treaty exemptions because of the US Savings Clause, but they do qualify for FTCR under art 24.[51]

The USA/UK DTA Technical Explanation provides:[52]

> By virtue of subparagraph (a) of paragraph 5 of Article 1 (General Scope), Article 24 is not subject to the saving clause of paragraph 4 of Article 1. Thus, the United States will allow a credit to its citizens and residents in accordance with the Article, even if such credit were to provide a benefit not available under the Code (such as the re-sourcing provided by paragraph 2 and subparagraph 3(d)).

111.25.1 *Source outside USA*

Article 24(6) USA/UK DTA provides:

> Where the United States taxes, in accordance with paragraph 4 of Article 1 (General scope) of this Convention, a United States citizen, or a former United States citizen or long-term resident, who is a resident of the UK–
>
> (a) the UK shall not be bound to give credit to such resident for United States tax on profits, income or chargeable gains from sources outside the United States as determined under the laws of the UK;

An Exchange of Notes on the date of the Convention provides:

> With reference to paragraphs 1 and 4 of Article 24 (Relief from double

[51] See 109.5 (Savings Clause).

[52] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> taxation)—
> it is understood that, if a resident of a Contracting State [UK] receives a dividend that is described in sub-paragraph (b) of paragraph 1 or sub-paragraph (b) of paragraph 4 of Article 24, such dividend will be deemed to be income from sources in the other Contracting State [US], even if it may be taxed only in the first-mentioned Contracting State [UK] because of sub-paragraph (a) of paragraph 3 of Article 10 (Dividends).[53]

The USA/UK DTA Technical Explanation provides:[54]

> However, paragraph 6 of this article provides special rules where a US citizen resident in the UK is subject to tax in the United States by reason of his citizenship under the saving clause of paragraph 4 of Article 1 (General Scope).
> According to the MOU, if a UK resident receives a dividend described in subparagraph (b) of paragraph 4, it will be deemed to constitute income from sources within the United States, even if the dividend may be taxed only in the UK because the zero rate of withholding applies to it.
> Paragraph 6 provides special rules for the tax treatment in both States of certain types of income derived from US sources by US citizens who are resident in the UK. Since US citizens, regardless of residence, are subject to United States tax at ordinary progressive rates on their worldwide income, the US tax on the US source income of a US citizen resident in the UK may exceed the US tax that may be imposed under the Convention on an item of US source income derived by a resident

[53] Article 10(3)(a) USA/UK DTA provides:
"(3) Notwithstanding the provisions of paragraph 2 of this Article, dividends shall not be taxed in the Contracting State [US] of which the company paying the dividends is a resident if the beneficial owner of the dividends is a resident of the other Contracting State [UK] and either—
(a) a company that has owned shares representing 80 per cent or more of the voting power of the company paying the dividends for a 12-month period ending on the date the dividend is declared, and that—
(i) owned shares representing, directly or indirectly, at least 80 per cent of the voting power of the company paying the dividends prior to October 1st, 1998; or
(ii) is a qualified person by reason of sub-paragraph (c) of paragraph 2 of Article 23 (Limitation on Benefits) of this Convention; or
(iii) is entitled to benefits with respect to the dividends under paragraph 3 or paragraph 6 of that Article".

[54] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> of the UK who is not a US citizen. This confirms that the UK retains primary taxing rights with respect to income derived by a resident that the United States may tax pursuant to section 877 of the Code. Subparagraph (a) of paragraph 6 carries over a rule from the prior Convention which states that the UK is not bound to provide a credit for US taxes with respect to income from sources outside the United States, as determined under UK law.
>
> Thus, for example, if a US citizen resident in the UK derives income from sources within France, as determined under the source rules of the UK, then the UK is not required to give a credit for US income tax imposed upon that income. In that case, the United States would give a credit for the tax paid to the UK, as well as any French taxes, with respect to such income. This rule ensures that, as between the State of residence and the State of citizenship, the State of residence takes priority.

111.25.2 *Source within USA*

Article 24(6) USA/UK DTA provides:

> Where the United States taxes, in accordance with paragraph 4 of Article 1 (General scope) of this Convention, a United States citizen, or a former United States citizen or long-term resident, who is a resident of the UK ...
>
> (b) in the case of profits, income or chargeable gains from sources within the United States, the UK shall take into account for the purposes of computing the credit to be allowed under paragraph 4 of this Article only the amount of tax, if any, that the United States may impose under the provisions of this Convention on a resident of the UK who is not a United States citizen;

The USA/UK DTA Technical Explanation provides:[55]

> Subparagraph (b) follows the US Model by providing, with respect to items of income from sources within the United States, special credit rules for the UK. These rules apply to items of US-source income that would be either exempt from US tax or subject to reduced rates of US tax under the provisions of the Convention if they had been received by a UK resident who is not a US citizen. The UK tax credit allowed under paragraph 4 with respect to such items need not exceed the US tax that may be imposed under the Convention, other than tax imposed solely by reason of the US citizenship of the taxpayer under the provisions of the

[55] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> saving clause of paragraph 4 of Article 1 (General Scope).
>
> For example, if a US citizen resident in the UK receives portfolio dividends from sources within the United States, the foreign tax credit granted by the UK would be limited to 15% of the dividend – the US tax that may be imposed under subparagraph (b) of paragraph 2 of Article 10 (Dividends) – even if the shareholder is subject to US net income tax because of his US citizenship. With respect to royalty or interest income, the UK would allow no foreign tax credit, because its residents are exempt from US tax on these classes of income under the provisions of Articles 11 (Interest) and 12 (Royalties).

111.25.3 *Computing USA tax*

Article 24(6) USA/UK DTA provides:

> Where the United States taxes, in accordance with paragraph 4 of Article 1 (General scope) of this Convention, a United States citizen, or a former United States citizen or long-term resident, who is a resident of the UK ...
>
> (c) [i] for the purposes of computing United States tax on the profits, income or chargeable gains referred to in sub-paragraph (b) of this paragraph, the United States shall allow as a credit against United States tax the income tax and capital gains tax paid to the UK after the credit referred to in sub-paragraph (b) of this paragraph;
>
> [ii] the credit so allowed shall not reduce the portion of the United States tax that is creditable against the UK tax in accordance with sub-paragraph (b) of this paragraph; and
>
> (d) for the exclusive purpose of relieving double taxation in the United States under sub-paragraph (c) of this paragraph, profits, income and chargeable gains referred to in sub-paragraph (b) of this paragraph shall be deemed to arise in the UK to the extent necessary to avoid double taxation of such profits, income or chargeable gains under sub-paragraph (c) of this paragraph.

The USA/UK DTA Technical Explanation provides:[56]

> Paragraph 6(c) eliminates the potential for double taxation that can arise because subparagraph 6(b) provides that the UK need not provide full relief for the US tax imposed on its citizens resident in the UK. The subparagraph provides that the United States will credit the income tax paid or accrued to the UK, after the application of subparagraph 6(b). It

[56] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> further provides that in allowing the credit, the United States will not reduce its tax below the amount that is taken into account in the UK in applying subparagraph 6(b).
>
> Since the income described in paragraph 6(b) is US source income, special rules are required to re-source some of the income to the UK in order for the United States to be able to credit the UK tax. This re-sourcing is provided for in subparagraph 6(d), which deems the items of income referred to in subparagraph 6(b) to be from foreign sources to the extent necessary to avoid double taxation under paragraph 6(c). In most cases, the income described in subparagraph 6(a) will be from sources outside the United States under US rules, so it is not necessary for paragraph 6(d) to re-source the income in order to relieve double taxation.
>
> Subparagraph 3(e) of Article 26 (Mutual Agreement Procedure) provides a mechanism by which the competent authorities can resolve any disputes regarding whether income is from sources within the United States.

111.25.4 *Source within USA: Examples*

The USA/UK DTA Technical Explanation provides:[57]

> The following two examples illustrate the application of paragraph 6 in the case of a US-source portfolio dividend received by a US citizen resident in the UK.
>
> In both examples, the US rate of tax on residents of the UK, under subparagraph (b) of paragraph 2 of Article 10 (Dividends) of the Convention, is 15%.
>
> In both examples, the US income tax rate on the US citizen is 36%.
>
> In example 1, the UK income tax rate on its resident (the US citizen) is 25% (below the US rate), and in example 2, the UK rate on its resident is 40% (above the US rate).

[Art 24(6)] sub para (b)	Example 1	Example 2
US dividend declared	$100.00	$100.00
Notional US withholding tax (Art10(2)(b))	15	15
UK taxable income	100	100
UK tax before credit	25	40
UK foreign tax credit	15	15
Net post-credit UK tax	10	25
[Art 24(6)] sub paras (c) and (d)		
US pre-tax income	$100.00	$100.00

[57] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

US pre-credit citizenship tax	36	36
Notional US withholding tax	15	15
US tax available for credit	21	21
Income re-sourced from US to UK (see below)	27.77	58.33
US tax on re-sourced income	10	21
US credit for UK tax	10	21
Net post-credit US tax	11	0
Total US tax	26	25

In both examples, in the application of subparagraph (b), the UK credits a 15% US tax against its residence tax on the US citizen. In the first example, the net UK tax after the UK foreign tax credit is $10.00; in the second example, it is $25.00. In the application of subparagraphs (c) and (d), from the US tax due before credit of $36.00, the United States subtracts the amount of the US source tax of $15.00, against which no US foreign tax credit is allowed. This subtraction ensures that the United States collects the tax that it is due under the Convention as the State of source.

In both examples, given the 36% US tax rate, the maximum amount of US tax against which credit for the UK tax may be claimed is $21 ($36 US tax minus $15 US withholding tax). Initially, all of the income in both examples was from sources within the United States. For a US foreign tax credit to be allowed for the full amount of the UK tax, an appropriate amount of the income must be re-sourced to the UK under subparagraph (d).

The amount that must be re-sourced depends on the amount of UK tax for which the US citizen is claiming a US foreign tax credit. In example 1, the UK tax was $10. For this amount to be creditable against US tax, $27.77 ($10 UK tax divided by 36% US tax rate) must be resourced to the UK. When the UK tax is credited against the US tax on this resourced income, there is a net US tax of $11 due after credit ($21 US tax minus $10 UK tax). Thus, in example 1, there is a total of $26 in US tax ($15 US withholding tax plus $11 residual US tax).

In example 2, the UK tax was $25, but, because the United States subtracts the US withholding tax of $15 from the total US tax of $36, only $21 of US taxes may be offset by UK taxes. Accordingly, the amount that must be resourced to the UK is limited to the amount necessary to ensure a US foreign tax credit for $21 of UK tax, or $58.33 ($21 UK tax divided by 36% US tax rate). When the UK tax is credited against the US tax on this re-sourced income, there is no residual US tax ($21 US tax minus $21 UK tax). Thus, in example 2, there is a total of $15 in US tax ($15 US withholding tax plus $0 residual US tax). Although the UK tax was $25 and the US tax available for credit was

$21, there is no excess US tax credit available for carryover.

111.26 Credit for underlying USA co tax

Article 24(4)(b)-(d) USA/UK DTA relate to FTCR for corporation tax, which is outside the scope of this chapter, but I set it out here for completeness.

Article 24(4)(b) USA/UK DTA provides:

> ...
>
> (b) in the case of a dividend
>
> [i] paid by a company which is a resident of the United States
>
> [ii] to a company[58] which is a resident of the UK
>
> [iii] and which controls directly or indirectly at least 10% of the voting power in the company paying the dividend,
>
> the credit shall take into account (in addition to any United States tax for which credit may be allowed under the provisions of sub-paragraph (a) of this paragraph) the United States tax payable by the company in respect of the profits out of which such dividend is paid;

Contrast s.63 TIOPA.

111.26.1 *Hybrids*

Article 24(4)(c) USA/UK DTA provides an anti-avoidance rule for hybrids:

> (c) United States tax shall not be taken into account under sub-paragraph (b) of this paragraph for the purpose of allowing credit against UK tax in the case of a dividend paid by a company which is a resident of the United States if and to the extent that
>
> (i) the UK treats the dividend as beneficially owned by a resident of the UK; and
>
> (ii) the United States treats the dividend as beneficially owned by a resident of the United States; and
>
> (iii) the United States has allowed a deduction to a resident of the United States in respect of an amount determined by reference to that dividend;

The USA/UK DTA Technical Explanation provides:[59]

> Subparagraph (c) eliminates the UK credit otherwise provided for in

[58] Including an LLC: see 90.48 (Credit for LLC's US tax).

[59] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

> subparagraph (b) in certain circumstances. The rule is limited to certain cases where the two countries have a different view as to the ownership of dividends and, as a result, the United States has provided a tax deduction for payments that are measured by reference to the dividend. This rule is intended to apply to a particular type of financing transaction that has been widely used by UK resident companies to finance their US operations. In this transaction, a US holding company would sell stock in another US company to a UK company. At the same time, it would enter into a repurchase agreement that would allow it to buy back the stock at a pre-determined price. The parties would structure the transactions in such a way that the sale and repurchase transactions would be treated as a loan for US tax purposes. As a result, the dividends paid to the UK company are treated as payments of interest on the loan from the UK company to the US company. The UK had seen a number of these transactions and was concerned about their potential impact.
>
> UK law provides no mechanism by which to treat the sale and re-purchase in accordance with its economic substance. Accordingly, the UK is required by UK domestic law to treat the UK company as the owner of the dividends for purposes of its rules, and to provide a foreign tax credit for the taxes paid by the US company paying the dividends. However, recent changes to UK foreign tax credit rules allow the UK to deny credits if a tax treaty specifically so provides. The UK asked for the exception in paragraph (c) in order to conform the UK treatment of these transactions to the US tax treatment. Because the rule applies only with respect to the indirect tax credit, it will apply only with respect to transactions involving persons who own more than 10% of the underlying company. Moreover, the rule applies only if the US company receives an interest deduction that is based on the dividends paid with respect to the stock, while the deductible payments arising from standard sale-repurchase agreements would be based on a completely different measure, the current cost of funds. Accordingly, the rule should not (and is not intended to) affect most repos and similar transactions that take place in the public markets.

Article 1(2) USA/UK DTA provides:

> This Convention shall not restrict in any manner any benefit now or hereafter accorded—
>
> (a) by the laws of either Contracting State; or
>
> (b) by any other agreement between the Contracting States.

Article 24(4)(d) USA/UK DTA provides:

> (d) the provisions of paragraph 2 of Article 1 (General scope) of this

> Convention shall not apply to sub-paragraph (c) of this paragraph.

The USA/UK DTA Technical Explanation provides:[60]

> Subparagraph (c) would not be effective without subparagraph (d). Subparagraph (c) limits benefits that are otherwise available under domestic law and therefore would be inconsistent with the rules of paragraph 2 of Article 1 (General Scope), which provide that the tax treaty cannot limit benefits that are available under domestic law. Subparagraph (d) provides an exception from paragraph 2 of Article 1 with respect to subparagraph (c).

In *Aozora GMAC Investment (R, oao) v HMRC*:[61]

> I did read Article 24(4)(c) several times, in a futile endeavour to understand its purpose. Some enlightenment did, however, emerge from the helpful [US Treasury Technical Explanation] ("the Note").
>
> It appears from the Note that Article 24(4)(c) was inserted in the Treaty at the behest of the UK Government, as an anti-avoidance provision to deal with what was perceived to be a very specific arbitrage device intended to generate a tax credit against UK corporation tax that was considered to be unjustified. In the relevant scenario a US corporation would sell stock in a US subsidiary to a UK resident company, with an obligation at some point to repurchase the stock ("a repo"). US revenue law looked at the commercial reality, treated the repo as a secured loan to the US corporation, any "dividend" paid to the UK company as a payment of interest by the US corporation, and, semble, the stock and "dividend" as beneficially owned by the debtor US corporation. For UK corporation tax, however, the "dividend" had to be treated as genuine, and the UK company would be positioned to obtain credit against UK tax in respect of an appropriate part of the profits of the US corporation, notwithstanding the fact that the US corporation had fully deducted the "dividend"/interest payment for the purposes of stating its US taxable income – a form of double tax relief successfully arbitraged through the different treatment of the transaction in the two jurisdictions.

111.27 CGT/IT computation deduction

111.27.1 *Computation deductions*

Section 112 TIOPA provides:

> (1) The amount of any income arising in any place outside the UK is reduced for the purposes of the Tax Acts—

[60] *https://home.treasury.gov/system/files/131/Treaty-UK-Protocol-TE-7-22-2002.pdf*

[61] [2017] EWHC 2881 (Admin) at [27]-[28].

> (a) by any amount which has been paid in respect of non-UK tax[62] on that income in the place where the income arose...

Section 113 TIOPA has the equivalent rule for CGT:

> (1) Subsection (2) applies to tax if it is—
> (a) chargeable under the law of any territory outside the UK on the disposal of an asset, and
> (b) borne by the person making the disposal.[63]
> (2) The tax is allowable as a deduction in the calculation of the gain.

The INT Manual provides:

> **INTM169090. Deduction not credit** [May 2020]
> A deduction for the foreign tax should be made in the computation of the gain or loss when there is no claim to foreign tax credit relief or when no UK tax is chargeable on a gain; for example, when the UK computation shows a loss on the disposal and consequently there is no UK tax against which credit for any foreign tax can be given. No deduction is due, however, when credit relief is claimed, for any part of the foreign tax paid on a gain which does not qualify for credit because it exceeds the UK tax chargeable on the same gain.

INT Manual provides:

> **INTM161050. Deduction instead of credit** [May 2020]
> ... Section 112 refers to 'any sum which has been paid in respect of non-UK tax' on income. This means tax alone and not, for example, interest paid in the foreign country for late payment of the foreign tax. Nor may a deduction be allowed for 'tax spared' (INTM161270) as it is not tax which has been paid; nor for underlying tax (INTM164060 and INTM164360) as it is not paid on the dividend in question; nor for taxes similar to UK VAT (see, however, INTM161080). Refer to CSTD Business, Assets & International Base Protection Policy Team, any case where it is not clear that the tax for which a deduction is sought under Section 112 is a tax on income.
> Section 112 allows a deduction for foreign tax paid on income 'in the place where the income arose'. Refer to CSTD Business, Assets &

[62] Section 112(6) TIOPA provides a commonsense definition: "In subsection (1) "non-UK tax" means tax under the law of a territory outside the UK."

[63] Section 113(4) TIOPA provides: "In subsection (1) "asset" and "disposal" have the same meaning as in TCGA 1992 (see, in particular, section 21 and the following provisions of TCGA 1992)."

International Base Protection Policy Team, any case where a deduction is sought for foreign tax paid on income which arises wholly or partly from work carried out in the UK....

INTM161080 Deduction for taxes [May 2020]
For a deduction to be given for a foreign tax, TIOPA10/S112 requires the tax to be charged on income. If a tax is not charged on income, it may be inadmissible for tax credit relief and will also not be deductible under section 112. Examples of such taxes are those charged on turnover or on the capital value of assets used in the business. A deduction for such taxes may, nevertheless, be an allowable expense in computing the income taxable in the UK. See BIM45900 onwards as regards trading income and SAIM1130 as regards savings and investment income.

111.27.2 *Restrictions on deductions*

Section 112 TIOPA provides:

(2A) But if X is less than Y, an amount equal to the difference between X and Y must be subtracted from the amount by which any income of a person ("the relevant income") is reduced under subsection (1)(a).
(2B) In subsection (2A)—
X is the amount of the relevant income that the person would (disregarding this section) be required to bring into account for income tax or corporation tax purposes, less any deduction that the person would be allowed to make for the amount paid in respect of non-UK tax, and
Y is the amount of the relevant income (that is to say, the amount on which the amount in respect of non-UK tax is paid).

INTM161085 Amount Brought Into Account [May 2020]
The FA 2010 introduced some clarifications to TIOPA10/S112. The amendments confirmed that a person may only deduct foreign tax from any foreign income where that person has not already reduced his income by reference to the foreign tax, so ensuring the foreign tax is only deducted once.
The new sections 112(2A) and (2B) determine whether the foreign tax has already been taken into account by comparing what income the person brings into account for income, capital gains or corporation tax purposes less any deduction that the person would be allowed to make for the non-UK tax (amount X) to the gross amount of income arising outside the UK (amount Y). If X is the same as Y then the person has not already reduced his income by reference to the foreign tax and so the person can use section 112 to reduce his taxable income by the amount

of foreign tax. If X is less than Y by the amount of the foreign tax then the person has already deducted the foreign tax and should not have a further deduction under section 112.

For example:

Branch profits

If a company's foreign branch receives 100 of foreign income and incurs 15 of tax on its profits in the branch, amount X will be 100 because the company will bring 100 into account for corporation tax purposes and cannot deduct the branch profits tax as an expense (*IRC v Dowdall O'Mahoney & Co Ltd* [1952] 33 TC 259). Amount Y will be 100 being the income arising outside the UK. As there is no difference between X and Y, the company can deduct the foreign branch tax of 15 under section 112(1)(a).

Company with share on its balance sheet

Scenario 1: Non-financial trader not otherwise entitled to a deduction for foreign tax.

Where a company holds a share on its balance sheet and receives a foreign dividend of 85 which has suffered 15 of withholding tax, amount X should be 100 because the company should bring the gross dividend into account and cannot deduct the foreign tax absent section 112. Amount Y will be 100, being the income arising outside the UK. As there is no difference between X and Y, the company can deduct the foreign branch tax of 15 under section 112(1)(a).

Scenario 2: Financial trader entitled to a deduction for foreign tax.

On the above facts, amount X will be 85 because the trader will initially recognise 100 as income but will also recognise an expense of 15 in respect of the foreign tax. Amount Y will be 100, being the income arising outside the UK. As X is less than Y by the amount of the foreign tax, then the trader has already reduced his income by reference to the foreign tax so no further relief is due under section 112(1)(a).

Company with share off balance sheet

Where a company does not hold the share on balance sheet, then it will not recognise the gross dividend (i.e. 100) in its income statement. However, it will recognise the net dividend (i.e. 85) as a component of the underlying calculation of the financing return on the transaction. As a result, amount X will be 85. Amount Y will be 100, being the income arising outside the UK. As X is less than Y by the amount of foreign tax, the company has already effectively had a deduction for the foreign tax and so cannot then use section 112 to reduce its income further.

Credit must be given for a foreign income tax repayment:

(3) If—

> (a) income of any person ("P") is reduced under subsection (1) by an amount paid in respect of tax on that income in the place where the income arose, and
> (b) a payment is made by a tax authority to P, or any person connected[64] with P, by reference to that tax, the amount of P's income is increased by the amount of the payment.
>
> (4) Subsection (1)—
> (a) has effect subject to section 31(2)(a) (no deduction for foreign tax if credit allowed and UK tax calculated otherwise than by reference to the amount received in the UK),
> (b) has effect subject to section 143(5) and (6) (no deduction for special withholding tax if UK tax calculated otherwise than by reference to the amount received in the UK),
> (c) does not apply to income the tax on which is to be calculated by reference to the amount of income received in the UK, and
> (d) does not require any income to be reduced by an amount of underlying tax which, under section 60(3), is to be left out of account for the purposes of section 57.

Section 113 TIOPA provides:

> (3) Subsection (2) is subject to—
> (a) Chapters 1 and 2 so far as they apply for corporation tax purposes (see, in particular, section 31),
> (b) Chapters 1 and 2 so far as they apply for capital gains tax purposes (see, in particular, section 31), and
> (c) section 143 (which includes provision about taking account of special withholding tax when calculating a gain for capital gains tax purposes).

111.27.3 *Tax Credit/deduction interaction*

Thus DTA/Unilateral Foreign Tax Credit (if claimed) has priority over an IT/CGT computation deduction.

The IHT Manual provides:

> **INTM161090 Credit or deduction** [May 2020]
> Relief for the foreign tax paid on a particular item of income or gain cannot be claimed partly by way of credit relief and partly by deduction under TIOPA10/S112 or S113 (see Section 112(4)(a) & 113(3)(a) &

[64] Defined s.112(7) TIOPA: "For the purposes of subsection (3), whether a person is connected with P is determined in accordance with section 1122 of CTA 2010."

> (b), the sections can only operate where a claim has not been made for credit relief that brings TIOPA10/S31 into operation). However, credit may be claimed for the foreign tax paid on one item of income or gain against the UK tax charged on that item; and a deduction may be given for the foreign tax on a different item of income or gain, in determining the amount of that item chargeable to UK tax.
> However, see INTM168110 when foreign tax paid on certain foreign loan interest exceeds the amount for which credit is allowed.

111.27.4 *Use of computation relief*

At first sight it is not obvious when an IT/CGT computation deduction would be better than foreign tax credit relief. One case is where foreign CGT is payable but UK CGT is not (because of a difference in valuation rules or because some UK relief applies). In such a case the computation deduction may:

(1) increase the loss allowable for UK CGT purposes (similarly for IT) or
(2) decrease the amount of held-over or rolled-over gain[65]

INT Manual provides:

> **INTM161050. Deduction instead of credit** [May 2020]
> It may sometimes be to the taxpayer's advantage not to make a claim to tax credit relief, for example where a business's trading profits are wholly covered by capital allowances so that there is no Income Tax or Corporation Tax payable on those profits, or where the trading results show a loss. If, for any reason, tax credit relief is not claimed, the foreign tax paid must be deducted from the income from the foreign source in computing the amount of the income for UK tax purposes (TIOPA10/S112-115). This may serve to create or increase a loss which can be dealt with under the normal provisions for losses...

111.27.5 *Accrued income scheme*

For completeness: the AIS needs a separate rule. Section 112 TIOPA provides:

> (1) The amount of any income arising in any place outside the UK is reduced for the purposes of the Tax Acts ...
> (b) if subsection (2) applies, by the lesser amount mentioned in that subsection.
> (2) This subsection applies if credit would, were it allowable in respect

[65] See 111.7 (Roll-over relief).

of the income, be reduced under section 39 (reduction by reference to accrued income losses) to the lesser amount given by section 39(5).

CHAPTER ONE HUNDRED AND TWELVE

NON-DISCRIMINATION

112.1 Non-discrimination: OECD Model
112.2 Nationals discrimination
112.2.1 "Nationals"
112.3 Stateless persons discrimination
112.4 PE discrimination
112.5 Discrimination in tax deductions
112.6 Enterprise owned in other state
112.7 "Taxes"
112.8 "Non-discrimination provision"
112.9 Channel Islands/IoM DTAs

112.1 Non-discrimination: OECD Model

This chapter discusses:

(1) The OECD Model non-discrimination provision

(2) The definition of "Non-discrimination Provision" which occurs in UK tax legislation

The OECD Model non-discrimination rule has a lengthy commentary, which I hope to discuss in a future edition. But a full discussion needs a book to itself, and indeed such books have been written.

112.2 Nationals discrimination

Article 24 OECD Model provides:

> 1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected.
> This provision shall, notwithstanding the provisions of Article 1 [Persons covered], also apply to persons who are not residents of one or both of the Contracting States.

112.2.1 *"Nationals"*

Article 3(g) OECD Model provides:

> the term "national", in relation to a Contracting State, means:
> (i) any individual possessing the nationality or citizenship of that Contracting State; and
> (ii) any legal person, partnership or association deriving its status as such from the laws in force in that Contracting State;

112.3 Stateless persons discrimination

Article 24(2) OECD Model provides:

> Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.

This relates to the UN Convention relating to the Status of Stateless Persons (1954). There are approximately 10m stateless persons in the world, though I am not sure how often this provision will be relevant to them.

112.4 PE discrimination

Article 24(3) OECD Model provides:

> The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.
> This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

112.5 Discrimination in tax deductions

Article 24(4) OECD Model provides:

> Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a

> Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

The 3 exceptions concern transfer pricing.

112.6 Enterprise owned in other state

Article 24(5) OECD Model provides:

> Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

112.7 "Taxes"

Article 24(6) OECD Model provides:

> The provisions of this Article shall, notwithstanding the provisions of Article 2 [Taxes Covered], apply to taxes of every kind and description.

112.8 "Non-discrimination provision"

This expression is used in a number of definitions:

Topic	**Definition**	**Reference**	**See para**
Transfer pricing	Qualifying territory	s.173 TIOPA	25.17.1
Exempt distributions	Qualifying territory	s.931C CTA 2009	-
Intangible property	Full treaty territory	s.608E ITTOIA	32.19.3

s.174(4) TIOPA	**s.931C(4) CTA 2009**	**s.608E(2) ITTOIA**
For the purposes of subsection (2)(b) a "non-discrimination provision", in relation to any double taxation arrangements, is	In subsection (1) "non-discrimination provision", in relation to double taxation relief arrangements, means	In subsection (1) "non-discrimination provision", in relation to double taxation arrangements, means
a provision to the effect that nationals of a state	[Identical to TIOPA]	a provision to the effect that nationals of a state
which is a party to those arrangements (a		which is a party to those arrangements (a

“contracting state”) are not to be subject in any other contracting state to— (a) any taxation, or (b) any requirement connected with taxation, which is other or more burdensome than the taxation and connected requirements to which nationals of that other state in the same circumstances (in particular with respect to residence) are or may be subjected.		"contracting state") are not to be subject in the other contracting state to- (a) any taxation, or (b) any requirement connected with taxation, which is other or more burdensome than the taxation and connected requirements to which nationals of that other contracting state in the same circumstances (in particular with respect to residence) are or may be subjected.

The small differences in wording are not significant.

s.174(5) TIOPA	**s.931C(5) CTA 2009**	**s.608E(5) ITTOIA**
(5) In subsection (4) “national”, in relation to a state, includes—	In subsection (4) “national”, in relation to a contracting state, includes—	(3) In subsection (2) "national", in relation to a contracting state, includes-
(a) any individual possessing the nationality or citizenship of the state, and (b) any legal person, partnership or association deriving its status as such from the law in force in that state.	(a) an individual possessing the nationality or citizenship of the contracting state, and (b) a legal person, partner-ship or association deriving its status as such from the laws in force in that contracting state.	[Identical to CTA 2009]

Again, the small differences in wording are not significant. The wording is the same as the OECD Model, except that the definition here is inclusive; but it is difficult to see that that could make any difference.

112.9 Channel Islands/IoM DTAs

The Guernsey DTA is typical. It is helpful to read the Crown Dependency treaty/OECD Model side by side:

Art 24(1) Guernsey DTA	**Art 24(1) OECD Model**
A legal person, partnership or association deriving its status as such from the laws in force in a Territory	Nationals of a Contracting State
shall not be subjected in the other Territory to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which a legal person, partnership or association of that other Territory in the same circumstances, in particular with respect to residence, is or may be subjected.	shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected...

The Guernsey DTA applies to a legal person/partnership/association. It does not apply to individuals (who are natural persons, not "legal" persons). One might have thought that the reason was that citizens of the Crown Dependencies are British citizens, so a rule preventing discrimination against them is not needed.

It follows however that the DTA does not contain a "Non-discrimination" Provision in the statutory sense. The definition is a technical one, which ought to be written with scare quotation marks.

It follows that Guernsey is not a qualifying territory/full-tax territory within the statutory definitions which restrict that concept to territories with a "Non-discrimination Provision".

HMRC take this point. ORIP draft guidance provides:

> 7.3...Examples of some territories with which the UK has a double taxation agreement but which do not contain a relevant non-discrimination article include the UK's double taxation agreements with the Crown Dependencies, some British Overseas Territories, and some other territories such as Hong Kong and Saudi Arabia.

This seems an obscure way to exclude Crown Dependencies etc from the definition and the reliefs to which the definitions relates. But there it is.

ORIP draft guidance sets out a list of full treaty territories (though that should not be relied on without checking.)

CHAPTER ONE HUNDRED AND THIRTEEN

MUTUAL AGREEMENT PROCEDURE

113.1 Presentation of case
113.2 Resolution of case
113.2.1 Interim payment of tax
113.3 Inter-state agreements
113.4 Inter-state communications
113.5 Arbitration

Cross references

The following topics are considered elsewhere:

Topic	**See para**
Treaty residence: Mutual agreement procedure	9.18.2

113.1 Presentation of case

Art 25 OECD Model

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of either Contracting State. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.

Art 26 USA/UK DTA

(1) Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of this Convention or, if later, within six years from the end of the taxable year or chargeable period in respect of which that taxation is imposed or proposed.

Under the treaty, the taxpayer is allowed to "present his case". Apart from that, the taxpayer has no control over the process, and only limited input as, at least in the US:[1]

> the negotiation of a MAP [mutual agreement procedure] is a government-to-government process. A taxpayer has no legal right to attend negotiations between the competent authorities or to observe the negotiations. However, it is also recognised that the taxpayer is a key stakeholder in the MAP process. The competent authorities therefore agree that they will keep taxpayers informed about the progress of a case under the MAP and will invite them to provide such further information as may be helpful in reaching a resolution. At their discretion, they may allow information to be provided to them in a joint presentation by the taxpayer.

113.2 Resolution of case

Art 25 OECD Model	**Art 26 USA/UK DTA**
2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention.	(2) The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with this Convention.
Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.	Any agreement reached shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States, except such limitations as apply for the purposes of giving effect to such an agreement.

113.2.1 *Interim payment of tax*

The Exchange of Notes for the USA/UK DTA provides:

> With reference to paragraph 2 of Article 26 (Mutual agreement procedure)—
> it is understood that where the competent authorities are endeavouring to resolve a case pursuant to the Article, neither Contracting State shall seek to collect the tax which is in dispute until the mutual agreement

[1] IRS Release IR-2000-79, 13 November 2000, page 2.

procedure has been completed. Any tax which is payable following the completion of the mutual agreement procedure shall, however, be subject to interest charges, and, if appropriate, surcharges or penalties, as long as it remains unpaid.

113.3 Inter-state agreements

Art 25 OECD Model	**Art 26 USA/UK DTA**
3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.	(3) The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of this Convention.

The US/UK DTA adds:

> In particular the competent authorities of the Contracting States may agree—
>
> (a) to the same attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;
>
> (b) to the same allocation of income, deductions, credits, or allowances between persons;
>
> (c) to the same characterisation of particular items of income, including the same characterisation of income that is assimilated to income from shares by the taxation law of one of the Contracting States and that is treated as a different class of income in the other Contracting State;
>
> (d) to the same characterisation of persons;
>
> (e) to the same application of source rules with respect to particular items of income;
>
> (f) to a common meaning of a term;
>
> (g) that the conditions for the application of
>
> [i] the second sentence of Paragraph 5 of Article 7 (Business profits),
>
> [ii] paragraph 9 of Article 10 (Dividends),
>
> [iii] paragraph 7 of Article 11 (Interest),
>
> [iv] paragraph 5 of Article 12 (Royalties), or
>
> [v] paragraph 4 of Article 22 (Other income)
>
> of this Convention are met; and

(h) to the application of the provisions of domestic law regarding penalties, fines, and interest in a manner consistent with the purposes of this Convention.

The Exchange of Notes for the USA/UK DTA provides for publication:

> With reference to paragraph 3 of Article 26 (Mutual agreement procedure)—
> it is understood that any principle of general application established by an agreement between the competent authorities shall be published by both competent authorities.

113.4 Inter-state communications

Art 25 OECD Model	Art 26 USA/UK DTA
4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.	(4) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

It is not obvious that this is needed, though it does not harm.

In the context of a dispute about place of effective management, the FTT refused to order disclosure of documents relating to discussions between the UK and the foreign State.[2] That seems right, because what the States thought about POEM no relevance to the Tribunal hearing, which had to make up its own mind on the POEM issue on the basis of the factual evidence. It seems unlikely that the documents contained factual information about POEM unknown to the taxpayer. Perhaps this confidentiality facilitates frank discussion between States, though it can also cloud mistaken or improper decision making.

113.5 Arbitration

Art (5) of the OECD Model provides:

> 5. Where,
>
> a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the

[2] *McCabe v HMRC* [2020] UKUT 266 (TCC).

> actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and
>
> b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the date when all the information required by the competent authorities in order to address the case has been provided to both competent authorities,
>
> any unresolved issues arising from the case shall be submitted to arbitration if the person so requests in writing. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State. Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.

There is no equivalent in the US treaty.

Arbitration under the New Zealand/UK treaty is governed by a Memorandum of Agreement (October 2023).

CIOT say:

> we would like to encourage the government to step up the UK's policy for seeking to negotiate mandatory binding arbitration provisions in its treaty network, to reflect the UK's support of such provisions in the discussions around Action 14 of the G20/OECD BEPS project and the changes to the DTA landscape as a result of the BEPS MLI.[3]

[3] Letter to HMRC, 22 November 2023.

CHAPTER ONE HUNDRED AND FOURTEEN

IHT DOUBLE TAXATION TREATIES: INTRODUCTION

114.1 IHT double taxation treaties
114.2 Estate and inheritance taxes
114.3 OECD IHT Models
114.4 IHT DTAs: Taxes covered
114.5 Treaty-domicile
114.6 IHT DTAs: Incorporation in UK law
114.7 Claims for IHT DTA reliefs
114.7.1 UK domestic law
114.7.2 India and Pakistan
114.7.3 USA and Netherlands
114.8 Nil-rate band and DTAs
114.8.1 General NRB
114.8.2 Residence NRB
114.9 Deductions for DTA purposes

Cross references

The following topics are considered elsewhere:
82.18 (DTA override) (residential property)

114.1 IHT double taxation treaties

In recent times the UK has had three death/gift taxes:

Tax	**Dates**
Estate duty	1894 - 1974
Capital transfer tax	1974 - 1986
Inheritance tax	1986 -

The UK has IHT DTAs with 10 countries. They can be divided into two groups, those made under Estate Duty, and those made subsequently:

Country	**Date**	**See para**
DTAs made under Estate Duty		
India	1956	115.1
Pakistan	1957	115.1
France	1963	115.1
Italy	1966	115.1
DTAs made under CTT/IHT		
Netherlands	1979	116.1
South Africa	1978	117.1
Switzerland	1993	118.1
USA	1978	119.1

Ireland	1977	*Not discussed*[1]
Sweden	1980	*Not discussed*

I discuss the four estate duty DTAs together in the next chapter, and then each of the subsequent DTAs has its own chapter, followed by a chapter on foreign IHT credit relief, see 120.1 (Credit for Foreign IHT). This chapter considers some general issues relating to IHT DTAs, and some issues which the CTT/IHT DTAs have in common.

I comment only on the UK aspects of the treaties. Foreign law advice will also be needed in any case where a treaty applies. The provisions relating to exchange of information are not discussed.

114.2 Estate and inheritance taxes

Many states (though by no means all) impose tax on the transfer of wealth on death. These taxes may be divided into two types:

(1) The taxable person may be the deceased or their estate
(2) The taxable persons may be the beneficiaries of the estate (the heirs)

In international tax terminology, type (1) is called an estate tax and type (2) is called an inheritance tax. Under this terminology IHT is more like an estate tax[2] and its title "inheritance tax" is a misnomer. However no confusion arises as long as one remembers that, and I use the term "inheritance taxes" to include both types.

Jurisdiction to charge inheritance tax (as for income tax) is normally based one of two criteria:

(1) personal nexus to the state: domicile, residence or nationality or the deceased or of the beneficiary;
(2) situs of assets (a source rule).

These criteria are the cause of double inheritance taxation:

(1) **Residence-source conflict** when
    (a) State A imposes tax on the deceased (estate tax) or the heir (inheritance tax) because of their personal nexus to the state

[1] See Anketell and O'Hanlon, "Cross-Border Inheritance Tax in Ireland" Irish Tax Review, (2012) No 4, p.117; Avery Jones, "The Capital Transfer Taxes Double Taxation Convention with Ireland" [1979] BTR 1. I hope to discuss Ireland and Sweden in future editions.

[2] IHT might be described as a hybrid tax, as the tax can be collected from transferor and transferee, but it is the position of the transferor which matters for the quantum of tax, for instance, it is the donor and not the donee who has a nil-rate band.

(residence, domicile or nationality),

(b) State B imposes tax because the assets are situate in that state.

A residence-source conflict results in double taxation of assets situate in state B.

(2) **Residence-residence conflict** when more than one state imposes tax on the same person because of their residence, domicile or nationality. A residence-residence conflict results in double taxation on worldwide assets.

(3) **Source-source conflict** where state A regards an asset as situate in state A and state B regards the asset as situate in state B, because they have different rules determining situs. A source-source conflict results in double taxation on the dual situate assets.

For a general discussion of these problems, see Study on Inheritance Taxes in EU Member States and Possible Mechanisms to Resolve Problems of Double Inheritance Taxation in the EU.[3]

114.3 OECD IHT Models

OECD have published two model conventions:

Full Name	**Date**
Draft Estate and Inheritance Model Convention	1966
Model Double Taxation Convention on Estates and Inheritances and on Gifts	1982

I refer to these as the **"1966/1982 OECD IHT Models"**.

The 1982 Model extends the 1966 Model to include lifetime gifts. In other respects it does not differ much from the previous model. The models use concepts and definitions draw from the OECD IT/CG Model, so discussion of that model can also be relevant for IHT DTAs. The 1982 Model has not been updated since publication.

The UK's Estate Duty/IHT treaties were made before the publication of the 1966 Model and follow a different form.

Subsequent CTT/IHT DTAs were made after the 1966 Model and broadly follow that form. The standard form of these treaties is as

[3] Copenhagen Economics, commissioned by the EC Directorate-General for Taxation and Customs Union, 2010. *https://taxation-customs.ec.europa.eu/system/files/2016-09/inheritance_taxes_report_2010_08_26_en.pdf*

follows:

(1) Immovable property, business permanent establishments and (normally) ships/aircraft can be taxed on a situs basis.

(2) For other property, the state where the individual is treaty-domiciled has the primary taxing right and the other state may[4] have the secondary right (with credit for the tax in the treaty domicile state). Treaty-domicile is decided by each state law, with a tie-breaker in cases of dual domicile.

This pattern is not followed by:

(1) Switzerland (which is also the only treaty made after the 1982 Model).

(2) Ireland

114.4 IHT DTAs: Taxes covered

Article 2 OECD IHT Model 1982 provides:

> 3 The existing taxes to which the Convention shall apply are:
> (a) (in State A) ....
> (b) (in State B) ....
>
> 4 The Convention shall apply also to any identical or substantially similar taxes which are imposed after the date of signature of the Convention in addition to, or in place of, the existing taxes. At the end of each year, the competent authorities of the Contracting States shall notify each other of changes which have been made in their respective taxation laws.

This is (more or less) the same as the OECD IT/CG Model.[5]

IHT DTAs made between 1975 and 1986, which refer to CTT, now apply for IHT.[6]

114.5 Treaty-domicile

IHT DTAs use the term "domicile" in a defined sense, which I call **"treaty-domicile"**.

Article 4 OECD IHT Model 1966 provides:

> 1. For the purposes of this Convention, the question whether a person

[4] For example, if the deceased had a treaty domicile within the previous 10 years (South Africa), or was a national of the other state (US), or both of these (Netherlands, Sweden).

[5] See 107.13 (Taxes Covered).

[6] See 74.1.1 ("CTT" now refers to IHT).

> at his death was domiciled in a Contracting State shall be determined according to the law of that State.

Article 4(1) of the CTT/IHT DTA treaties adopt this as a principle. They adopt a (more or less) standard form to define treaty domicile in the UK:[7]

> For the purposes of this Convention, a person was domiciled:
> (a) in the UK if
> [i] he was domiciled in the UK in accordance with the law of the UK or
> [ii] is[8] treated as so domiciled for the purposes of a tax which is the subject of the Convention;
> (b) in [the foreign treaty state] if ...

Para (a) applies to a person who is:
(1) UK-law domiciled or
(2) Deemed domiciled under the main deemed domicile rules (the 15-year rule, 3-year rule and formerly-domiciled residents)

Spouse-election deemed domicile does not apply for this purpose.[9]

The definition of treaty-domiciled in the foreign treaty state varies in each case to fit the foreign tax regime.

The 1966 Model follows with a tie-breaker in OECD Model form.

114.6 IHT DTAs: Incorporation in UK law

International treaties (including DTAs) do not automatically become part of UK law, but must be incorporated into UK law by statute. Accordingly, s.158(1) IHTA provides:

> If Her Majesty by Order in Council declares—
> (a) that arrangements specified in the Order have been made with

[7]

Treaty	**For definition of treaty-domicile, see**
India/Pakistan/Italy/France DTAs	115.7 ff
Netherlands DTA	116.5
South Africa DTA	117.5
Switzerland DTA	118.5
USA DTA	119.5

[8] The provision twice uses the past tense ("was domiciled") which because it is looking back to the time of the death of the deceased. It seems strange that it here shifts to the present tense ("is treated"). Perhaps that is to match the use of the word "is" later in the sentence ("a tax which is the subject of the Convention") But it does not matter.

[9] See 115.8.2 (Spouse-election domicile disapplied).

> the government of any territory outside the UK with a view to affording relief from double taxation in relation to
> [i] capital transfer tax [now IHT][10] payable under the laws of the UK and
> [ii] any tax imposed under the laws of that territory which is of a similar character or is chargeable on or by reference to death or gifts inter vivos, and
>
> (b) that it is expedient that those arrangements should have effect,
>
> the arrangements shall, notwithstanding anything in this Act, have effect
> [i] so far as they provide for relief from capital transfer tax, or
> [ii] for determining the place where any property is to be treated as situated for the purposes of the tax.

Under s.158(1)(b)[ii], a DTA may *increase* the scope of IHT, by providing that property which is not UK situate on general principles is to be treated as UK situate.

For completeness: s.158 IHTA continues with some housekeeping rules:

> (1ZA) For the purposes of this section, arrangements made with a view to affording relief from double taxation include any arrangements which modify the effect of arrangements so made.
> (1ZB) Arrangements to which effect is given under this section may include provision conferring (with or without other functions) functions relating to the determination of matters arising under the arrangements on a public authority in the UK or in a territory outside the UK.
> (2) Any arrangements to which effect is given under this section may include provision for relief in cases occurring before the making of the arrangements and provisions as to property which is not itself subject to double taxation.
> (3) Any Order in Council under this section which revokes an earlier Order may contain such transitional provisions as appear to Her Majesty to be necessary or expedient.
> (4) An Order under this section shall not be submitted to Her Majesty in Council unless a draft of it has been laid before, and approved by resolution of, the House of Commons.
> (5) Where any arrangements have effect by virtue of this section, no obligation as to secrecy shall prevent the Board or an authorised officer of the Board from disclosing to any authorised officer of the government with which the arrangements are made such information as is required to be disclosed under the arrangements.

Section 158 is the IHT equivalent of s.2 TIOPA.[11]

[10] See 74.1.1 ("CTT" now refers to IHT). For Estate Duty treaties, see 115.2 (Estate duty DTAs applied to IHT).

[11] See 107.19 (Incorporation of DTAs in UK law).

114.7 Claims for IHT DTA reliefs

The position depends on what type of relief is in point:

(1) Claim for foreign IHT credit:
    (a) DTA IHT credit
    (b) Unilateral IHT credit
(2) Claim for IHT DTA exemption
(3) Claim for overpaid tax to be repaid

114.7.1 *UK domestic law*

There is no UK domestic law provision requiring a formal claim for unilateral IHT credit relief or for IHT DT relief (unlike the position for IT and CGT where a claim is required).

A formal claim is required to recover overpaid tax. Section 241(1) IHTA provides:

> If it is proved to the satisfaction of the Board that too much tax has been paid on the value transferred by a chargeable transfer or on so much of that value as is attributable to any property, the Board shall repay the excess unless the claim for repayment was made more than four years after the date on which the payment or last payment of the tax was made.

There is no requirement to make a formal claim for treaty IHT exemption. However if an IHT400 account is in principle required on a death,[12] the obligation to submit the account is not overridden by a treaty, even though it may provide that:

(1) duty "shall not be imposed"[13]
(2) property "shall not be taxable"[14] or "shall be taxable only" in the foreign state[15]
(3) "no account shall be taken in determining the amount or rate of duty of property situate outside [the UK]"[16]

Similarly, for an individual who is IHT deemed domiciled, the US treaty does not override the duty to disclose a lifetime chargeable transfer or the

[12] See 125.1 (Reporting on death).

[13] The wording of the India, France and Pakistan DTAs.

[14] The wording of the USA IHT DTA.

[15] The wording of the Netherlands and the Switzerland IHT DTAs.

[16] The wording of the Italy IHT DTA.

making of a non-resident settlement.[17]

So in these cases, the usual returns should be made, making it clear that DT exemption applies. The form IHT400 Calculation (12/19) has a section entitled Double taxation relief. The rubric at the top of this section provides:

> If you wish to claim double taxation or unilateral relief, enclose with form IHT400 a 'certificate of tax paid' from the overseas tax authority, if you already have one, showing the amount of foreign tax paid. We may ask more questions about the claim after the Grant is issued. You must also fill in schedule IHT417, 'Foreign assets' detailing the assets outside the UK.

The treaties alter the position slightly, as:

(1) They may assume that a claim is to be made for a credit and so by implication impose a formal claim requirement with a deadline for making the claim.

(2) They may alter the time limit for a claim to recover overpaid tax.

The Swiss IHT DTA does not refer to claims. In other cases, the wording varies between treaties.

114.7.2 *India and Pakistan*

Art 7 India & Pakistan DTAs	**Art 7 France & Italy DTAs**
1. Any claim for a credit or for a refund of duty founded on the provisions of the present Agreement shall be made within six years from the date of the death of the deceased person in respect of whose estate the claim is made,	1. Any claim for a credit or for a refund of duty founded on the provisions of the present Convention shall be made within five years from the date of the death of the deceased person in respect of whose estate the claim is made,
or, in the case of a reversionary interest where payment of duty is deferred until the date on which the interest falls into possession, within six years from that date. [note 1]	or, where the event causing duty to be payable occurs at some later date, within five years from that date.
2. Any such refund shall be made	2. Any such refund shall be made

[17] See 128.2 (IHT disclosure: creation of trust).

without payment of interest on the amount so refunded.	without payment of interest on the amount so refunded. [note 2]

Note 1: This refers to estate duty rules not now applicable.
Note 2: Italy DTA lacks para 2.

114.7.3 *USA and Netherlands*

Art 9(5) USA IHT DTA	**Art 14 Netherlands IHT DTA**
Any claim for a credit or for a refund of tax founded on the provisions of the present Convention shall be made within six years from the date of the event giving rise to a liability to tax or, where later, within one year from the last date on which tax for which credit is given is due.	Any claim for a credit or for a repayment of tax founded on the provisions of this Convention shall be made within six years from the date of the event giving rise to a liability to tax or, where later, within one year from the last date on which tax for which credit is given is due.
The competent authority may, in appropriate circumstances, extend this time where the final determination of the taxes which are the subject of the claim for credit is delayed.	[No equivalent]

114.8 Nil-rate band and DTAs

114.8.1 *General NRB*

If there would be a chargeable transfer, but for IHT DT relief, does a DTA (if applicable) make the transfer non-chargeable, so the nil-rate band, and (if appropriate) the unused transferable nil-rate band[18] is not used up by the transfer?

IHTM para 43025 provides:

[18] For the statutory provisions relating to the transferable general nil-rate band, see 86.5.2 (General nil-rate band). For present purposes, it is sufficient to note that the amount of the unused general nil-rate band depends on the amount of the chargeable transfer on the death of the first spouse to die. If there is no chargeable transfer, the full nil-rate band is unused and is transferable to the surviving spouse. See s. 8A(3)(4) IHTA.

> **interaction of ability to transfer unused nil rate band with double taxation agreements, double taxation relief and successive charges relief** [Sep 2018]
> The extent to which an estate is chargeable to tax may be governed by a double taxation Convention [IHTM27161], or a liability to tax may be reduced to nil by double taxation relief [IHTM27181] or successive charges relief [IHTM22041].
> [1] Where, under the terms of a double taxation Convention, an asset is not subject to tax, then if this means that the chargeable estate is below the nil rate band, the amount unused is available for transfer.
> [2] However, where there is a liability to tax that is reduced to nil by either
>
> [a] double taxation relief or
> [b] successive charges relief,
>
> the nil rate band remains fully used. We do not repay any 'excess' relief and 'excess' relief cannot be converted into unused nil rate band.

Unilateral IHT credit relief takes the form of a credit against IHT. It falls within [2]. Where that relief applies there is still a chargeable transfer so that transferable NRB relief does not become available. The same applies to foreign IHT credit relief under a DTA.

The India France and Pakistan IHT DTAs provide that "duty shall not be imposed" on certain property. The USA DTA provides that certain property "shall not be taxable" in the UK. These reliefs fall within [1]. It is not obvious that this prevents there being a chargeable transfer but it might be said to follow from a commonsense reading. Treaties are not to be construed technically. HMRC read the legislation in this way, so that the transferable nil-rate band is available to the surviving spouse.

The Italy IHT DTA provides that "no account shall be taken, in determining the amount or rate of duty" on death, in relation to certain property. It is considered that the effect is the same as the other estate duty/IHT DTAs.

114.8.2 *Residence NRB*

Does DTA relief reduce the value of the estate for the purposes of the residence nil-rate band?[19] In strictness the answer is no, but DTAs are not meant to be construed strictly.

[19] In short, there is a tapered reduction of the relief if the value of the person's estate immediately before death exceeds £2m; see 93.6 (Residence nil-rate band).

114.9 Deductions for DTA purposes

Minor differences in wording do not affect the meaning:

Art 5(1) Italy	**Art 10 Netherlands**	**Art 11(1) S. Africa**	**Art 8 USA DTA**
In determining the amount on which duty is to be computed, permitted deductions shall be allowed in accordance with the law in force in the territory in which the duty is imposed.	In determining the amount on which tax is to be computed deductions shall be allowed in accordance with the law of the State in which the tax is imposed.	In determining the amount on which tax is to be computed permitted deductions shall be allowed in accordance with the law in force in the territory in which the tax is imposed.	In determining the amount on which tax is to be computed, permitted deductions shall be allowed in accordance with the law in force in the Contracting State in which tax is imposed.

Equivalent or comparable wording is found in some other IHT treaties:

IHT DTA	**Article**	**Note**
Pakistan	5(3)	Text identical to Italy
Sweden	10	

This seems unnecessary. Perhaps there were estate duty or foreign law reasons for it? I would be grateful to any reader who could explain.

There is, or at least there was, a rule of Belgian tax law which disallowed a deduction for charges on Belgium property owned by a non-resident.[20] Maybe the provision was intended to undo discrimination of that kind? But the wording is not quite apt for that. Or possibly the point is to note for the avoidance of doubt that allocation of debt rules now in article 8 OECD IHT Model 1982 do not apply.

There is no equivalent in the India, France or Switzerland, DTA, but the omission does not seem to matter.

See too *Re Goetze, National Provincial Bank v Mond* [1953] Ch 96.

There is a similar rule in the OECD Model non-discrimination clause.[21]

[20] In *Eckelkamp* C-11/07 the rule was held to breach of EU free movement of capital.

[21] See 112.5 (Discrimination in tax deductions).

CHAPTER ONE HUNDRED AND FIFTEEN

IHT DTAs: INDIA, PAKISTAN, ITALY, FRANCE

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115.12 The future

Cross references

Issues which the estate duty/IHT DTAs have in common with other treaties are discussed elsewhere:

Topic	**See para**
Introduction to IHT DTAs	114.1
Claims for IHT DTA reliefs	114.7
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115.1 Estate duty/IHT treaties

This chapter considers the four IHT double tax treaties which were made in the estate duty era. I refer to these as the "**India/Pakistan/Italy/France IHT DTAs**" or together the "**estate duty/IHT DTAs**".

The India/Pakistan DTAs are important to those who are (in short) deemed UK domiciled, but actually domiciled in India/Pakistan.

The France/Italy DTAs are important to those who are:

(1) (a) deemed UK domiciled but not actually domiciled in the UK, and
(b) "domiciled" in Italy/France, under the law of those countries (roughly, tax-resident there) ; or

(2) (a) actually UK domiciled and
(b) "domiciled" in Italy/France, under the law of those countries (roughly, tax-resident there) and
(c) treaty-domiciled in Italy/France under the treaty tie-breaker

The 4 estate duty/IHT DTAs are similar but not identical. There are differences in wording which sometimes make no difference and sometimes do. This does make a coherent exposition more difficult. It is a pity that no standard model form was adopted, but there it is. It does make one appreciate the tremendous value of OECD IT/CG Model.

The treaties use Roman numbering, but for convenience I use normal (Arabic) numerals.

For some reason DTAs do not have short titles. The long titles are:

India DTA	*Pakistan DTA*	*France DTA*	*Italy DTA:*
Agreement between the Government of the United Kingdom and the Government of India	Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of Pakistan	Convention between the United Kingdom of Great Britain and Northern Ireland and France	Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Italian Republic
for the avoidance of double taxation and the prevention of fiscal evasion with respect to duties on the estates of deceased persons	[same as India DTA]	for the avoidance of double taxation with respect to duties on the estates of deceased persons	[same as India DTA]
SI 1956/998	SI 1957/1522	SI 1963/1319	SI 1968/304

The UK/France IHT DTA is in English and French,;[1] likewise the UK/Italy DTA is in English and Italian. In each case, both languages equally authoritative.

115.2 Estate duty DTAs applied to IHT

India DTA art 1	*Pakistan DTA art 1*	*France DTA art 1*	*Italy DTA art 1*
(1) The duties which are the subject of the present Agreement are	(1) [same as India DTA]	(1) The present Convention shall apply:	(1) The duties which are the subject of the present Convention are
(a) In India, the estate duty imposed under the Estate Duty Act, 1953, and	(a) In the United Kingdom, the estate duty imposed in Great Britain, and	(a) in France, to the duty imposed on successions by death;	(a) in the United Kingdom of Great Britain and Northern Ireland : the estate duty imposed in Great Britain
(b) In the UK, the estate duty imposed in Great Britain.	(b) In Pakistan, the estate duty imposed in Pakistan by or under the law of the Central Government.	(b) in the United Kingdom of Great Britain and Northern Ireland, to the estate duty imposed in Great Britain.	(b) in Italy : the succession duty and the estate duty (imposta sull'asse ereditario globale) imposed in Italy.

115.2.1 *Application of treaties to IHT*

The treaties refer to UK estate duty, but they apply to IHT. Section 158(6) IHTA provides:

> Where arrangements with the government of any territory outside the UK are specified under any Order in Council which—
> (a) was made, or has effect as made, under
> [i] section 54 of the Finance (No 2) Act 1945 or
> [ii] section 2 of the Finance Act (Northern Ireland) 1946, and
> (b) had effect immediately before the passing of this Act,
> [a] the Order shall, notwithstanding the repeal of that section by the

[1] The French title is: La convention entre la France et la Grande-Bretagne tendant à éviter les doubles impositions en matière d'impôts sur les successions du 21 juin 1963. *https://www.impots.gouv.fr/sites/default/files/media/10_conventions/royaume-uni/royaume-uni_convention-avec-le-royaume-uni-successions_fd_1790.pdf*

Finance Act 1975 remain in force and have effect as if any provision made by those arrangements in relation to estate duty extended to capital transfer tax [now IHT[2]] chargeable by virtue of section 4 above;

[b] but the Order may be amended or revoked by an Order in Council made under this section.

115.2.2 *Substantially similar taxes*

Pakistan DTA art 1	*France DTA art 1*	*Italy DTA art 1*
(2) The present Agreement shall also apply to any other duties of a substantially similar character imposed by either Contracting Government subsequently to the date of signature of the present Agreement or by the Government of any territory to which the present Agreement is extended under Article IX or applies under Article X.	(2) The present Convention shall also apply to any other duties of a substantially similar character to the duties referred to in para (1) above which may be imposed in Great Britain or Italy subsequently to the date of signature of the present Convention.	(2) The present Convention shall also apply to any other duties of a similar character imposed in France or Great Britain after the date of its signature or in any territory to which it may be extended under Article IX or applies under Article X.

But section 158(6)[a] is still needed in all four cases, as:

(1) CTT was probably not "of a substantially similar character" to estate duty (though IHT is substantially similar).

(2) In any case, DTAs need to be expressly incorporated into UK domestic law.[3]

The wording is similar to the OECD model.[4]

There is no equivalent provision in the India IHT DTA, but it makes no difference.

115.2.3 *Application to Northern Ireland*

India DTA art 10	*Pakistan DTA art 10*	*France DTA art 10*	*Italy DTA art 1*0
The present Agreement shall	The present Agreement shall	The present Convention shall	The present Convention shall

[2] See 74.1.1 ("CTT" now refers to IHT).

[3] See 107.19 (Incorporation of DTAs in UK law); 114.6 (IHT DTAs: Incorporation in UK law).

[4] See 114.4 (IHT DTAs: Taxes covered).

apply in relation to the estate duty imposed in Northern Ireland as it applies in relation to the estate duty imposed in Great Britain, but shall be separately terminable in respect of Northern Ireland by the same procedure as is laid down in Article XII.	apply in relation to the estate duty imposed in Northern Ireland as it applies in relation to the estate duty imposed in Great Britain, but shall be separately terminable in respect of Northern Ireland by the same procedure as is laid down in paragraph (2) of Article XII.	apply in relation to the estate duty imposed in Northern Ireland as it applies in relation to the estate duty imposed in Great Britain, but shall be separately terminable in respect of Northern Ireland in accordance with the provisions of Article XII.	apply in relation to Northern Ireland and to the estate duty imposed in Northern Ireland as it applies in relation to Great Britain and to the estate duty imposed in Great Britain, but shall be separately terminable in respect of Northern Ireland in accordance with the provisions of Article XII.

The DTAs refer to estate duty imposed in Great Britain, but also apply to estate duty (and now IHT) in Northern Ireland. This was because Northern Ireland was from 1921 a separate unit for estate duty purposes.

115.3 Interpretation

Art 2(1) of each of Estate Duty/IHT treaty sets out standard definitions of the countries concerned, territory, duty, and the standard provision dealing with undefined terms. I set these out for completeness (readers can generally skip what follows):

115.3.1 *United Kingdom/Great Britain*

All 4 estate duty treaties provide in art 2(1):

> The term "United Kingdom" means Great Britain and Northern Ireland;

That is the usual meaning. "Great Britain" is in turn defined:

India/Pakistan/France DTAs	**Italy DTA art 2(1)(b)**
The term "Great Britain" means England, Wales and Scotland and does not include the Channel Islands and the Isle of Man;	The term "Great Britain" means England, Wales and Scotland

That is the usual meaning.

115.3.2 *India/Pakistan/France/Italy*

India DTA art 2(1)	*Pakistan DTA art 2(1)*	*France DTA art 2(1)*	*Italy DTA art 2(1)*
(a) The term "India" means all the States and territories comprised in the Union of India;	(b) The term "Pakistan" means the Provinces of Pakistan and the Capital of the Federation;	(a) the term "France" means metropolitan France and the overseas *départements*;	(c) the term "Italy" means the Italian Republic;

"Metropolitan France" is the portion of France in continental Europe. The overseas departments and regions of France are now French Guiana, Guadeloupe, Martinique, Mayotte and Réunion, which have the same status are the regions and departments of mainland France.

115.3.3 *Territory*

India DTA art 2(1)	*Pakistan DTA art 2(1)*	*France DTA art 2(1)*	*Italy DTA art 2(1)*
(d) The term "territory" when used in relation to one or the other Contracting Government means India or Great Britain, as the context requires;	(d) The term "territory" when used in relation to one or the other Contracting Government means Great Britain or Pakistan, as the context requires;	(d) the term "territory" when used in relation to one or the other Contracting Party, means France or Great Britain, as the context requires;	(d) the term "territory" when used in relation to one or the other Contracting Party, means Great Britain or Italy, as the context requires;

115.3.4 *Duty*

There is then a straightforward definition of "duty":

India DTA art 2(1)	*Pakistan DTA art 2(1)*	*France DTA art 2(1)*	*Italy DTA art 2*(1)
(e) The term "duty" means the estate duty imposed in India or the estate duty imposed in Great Britain, as the context requires	(e) The term "duty" means the estate duty imposed in Great Britain or the estate duty imposed in Pakistan by the Central Government, as the context requires.	(e) the term "duty" means, as the context requires, the duty imposed in France on successions by death, or the estate duty imposed in Great Britain.	(e) the term "duty" means the estate duty imposed in Great Britain or the succession duty and estate duty imposed in Italy, as the context requires.

115.3.5 *Undefined treaty terms*

India DTA art 2(3)	*Pakistan DTA art 2(3)*	*France DTA art 2(2)*	*Italy DTA art 2*(3)
In the application of the provisions of the present Agreement by either Contracting Government, any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the law of that Contracting Government relating to duty.	In the application of the provisions of the present Agreement by either Contracting Government any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the law of that Contracting Government relating to the duties which are the subject of the present Agreement.	In the application of the provisions of the present Convention by either Contracting Party any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the law of that Party relating to the duties which are the subject of the present Convention.	In the application of the provisions of the present Convention by either Contracting Party any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the law in force in the territory of that Party relating to the duties which are the subject of the Convention.

This is (more or less) standard OECD Model wording: see 107.12 (Undefined treaty terms).

115.4 Treaty IHT exemption

Each IHT DTA provides an IHT exemption (“**treaty IHT exemption**”.) I set out the exemptions separately, as the variations in wording are too great to set out the provisions side by side. The differences here are important.

115.4.1 *India DTA exemption*

Art 3(3) India IHT DTA provides:

> [a] Duty shall not be imposed in Great Britain on the death of a person who
>
> [i] was not domiciled at the time of his death in any part of Great Britain but
>
> [ii] was domiciled in some part of India
>
> on any property situated outside Great Britain:
>
> [b] Provided that nothing in this paragraph shall prevent the imposition of duty in Great Britain on any property which passes under a disposition or devolution regulated by the law of some part of Great Britain.

115.4.2 *France IHT exemption*

Art 5(1) France IHT DTA	**Art 5(2) France IHT DTA**
Where a person was at the time of his death domiciled in some part of France duty shall not be imposed in Great Britain on any property which [a] neither is situated in Great Britain, [b] nor passes under a disposition or devolution regulated by the law of some part of Great Britain	Where a person was at the time of his death domiciled in some part of Great Britain duty shall not be imposed in France on any property not situated in France;
and, in determining the amount or rate of duty payable in Great Britain, such property shall be disregarded.	and in determining the amount or rate of duty payable on any property which is chargeable in France, any property not situated in France shall be disregarded.

115.4.3 *Italy IHT exemption*

Art 5(2) Italy IHT DTA provides:

> [a] Where duty is imposed in the territory of one Contracting Party on the death of a person who at the time of his death
> [i] was not domiciled in any part of that territory but
> [ii] was domiciled in some part of the territory of the other Contracting Party,
> no account shall be taken, in determining the amount or rate of such duty, of property situated outside the former territory,
> [b] provided that this paragraph shall not apply to duty imposed in the territory of a Contracting Party on property passing under a settlement governed by its law.

115.4.4 *Pakistan IHT exemption*

The Pakistan IHT DTA contains an amusing error. Art 5(2) Pakistan IHT DTA provides:

> Where a person at the time of his death was domiciled in some part of Pakistan and was not domiciled in some part of Great Britain, duty shall not be imposed in Great Britain on any property which for the purposes of duty passes or is deemed to pass on his death unless that property—

> (a) is situated in Pakistan [!], or
> (b) passes under a disposition or devolution regulated by the law of some part of Great Britain;
>
> and, in determining the amount or rate of duty payable in Great Britain, property not falling within sub-para (a) or (b) shall be disregarded.

There is an unfortunate typographical error here: the word "Pakistan" in (a) should read "Great Britain"![5] It is considered that the error can be corrected as a matter of construction under the slip rule. HMRC rightly adopt this view.[6]

115.4.5 *Scope of exemptions*

The exemption applies to duty imposed on death.[7] That includes the charge which applies to the following property (assuming the property is not UK situate):

(1) the individual's free estate
(2) property in an estate IIP trust

Property within the GWR charge on death ("GWR property") is treated as property to which the donor was beneficially entitled immediately before the death.[8] GWR property does not in fact "pass" on death, but it should

[5] I am grateful to Simon McKie for drawing this point to my attention. The corresponding mistake is made in Art 5(1):

> "Where a person at the time of his death was domiciled in some part of Great Britain and was not domiciled in some part of Pakistan, duty shall not be imposed in Pakistan on any property which for the purposes of duty passes or is deemed to pass on his death unless that property—
> (a) is situated in Great Britain [!], or
> (b) is settled property of which the deceased was life tenant where the settlor was domiciled in some part of Pakistan at the time that the settlement took effect, or
> (c) passes under a devolution regulated by the law of some part of Pakistan and in determining the amount or rate of duty payable in Pakistan, property falling within (a), (b), or (c) shall be disregarded.
>
> and, in determining the amount or rate of duty payable in Great Britain, property not falling within sub-para (a) or (b) shall be disregarded."

In some published versions the error has been corrected, but I am not aware of any authority for that. The original is at:
https://www.kessler.co.uk/wp-content/uploads/2012/05/Pakistan_IHT_DTT.pdf

[6] HMRC correspondence.

[7] This is stated expressly in the India, Pakistan and Italy IHT DTAs. In the France IHT DTA it is not stated expressly but is clearly implied.

[8] See 78.12 (GWR death charge).

be treated as if it did. GWR property does not in fact pass "under a disposition or devolution" but it should probably be treated as if it did. It is the old question of how far to carry the deeming.[9] But even then, the (deemed) disposition would not be not "regulated by the law of some part of Great Britain".

So under the India IHT DTA, it is considered that GWR property which is not situate in the UK may qualify for exemption, and is not within the proviso which applies to property which "passes under a disposition or devolution regulated by the law of some part of Great Britain." The same applies to Pakistan and France.

The position is the same in Italy, but clearer, as no-one could say that GWR property is caught by the proviso which applies to "property passing under a settlement governed by UK law".

115.4.6 *Failed PET*

What about the charge on a lifetime PET which becomes a chargeable transfer because the transferor dies within 7 years, known as a "**failed PET**"? The treaties must be considered separately, since the wording of each treaty IHT exemption varies.

India and Italy IHT DTAs provide exemption from duty *on the death*. In the case of a failed PET, the IHT charge is on the lifetime transfer of value. Strictly, the charge is not "on the death", even though it is only on the occasion of death that the transfer becomes chargeable. However a purposive construction is appropriate. The relief would have applied to the estate duty charge on lifetime gifts within 7 years of death. In substance the charge on failed PETs is a charge on death. This is a strong argument, for treaties are not interpreted strictly or literally. A relief for a charge "on" the death means a relief for a charge which becomes payable *at the time of* the death.[10]

In France, the IHT exemption does seem to apply to a failed PET since the words "on the death" are not present.

In Pakistan the case for IHT exemption seems somewhat weaker since it is a very loose construction to say that the charge on a failed PET is a

[9] See App 8.2 (Deeming provisions: Construction).

[10] Further support can be found from the area of transferable nil-rate bands. This relief increase the nil-rate band "for the purposes of the charge to tax *on the death* of the survivor"; see s.8A(3) IHTA. HMRC accept that this relief applies to the charge on a failed PET.

charge on property which "passes or is deemed to pass" on a death (the terminology is from estate duty legislation where it had a somewhat technical meaning). Nevertheless the purposive argument is still arguable.

However there is a serious difficulty. Section 158(6) IHTA provides that the estate duty/IHT DTAs:

> have effect as if any provision made by those arrangements in relation to estate duty extended to capital transfer tax chargeable by virtue of section 4 above ...

The treaties have effect in relation to IHT *chargeable by virtue of s.4 IHTA*. The IHT charge on a failed PET is not under s.4, so the treaty does not have effect in relation to that charge.[11] It is considered, therefore, that although the terms of the treaties of France (relatively clearly), India and Italy (reasonably clearly) and Pakistan (arguably) do provide relief for a failed PET, this does not help the taxpayer, because UK domestic law (in breach of the treaty obligations) does not do so.

Michael Firth argued against this view in an article I considered at length in the 2022/23 edition of the work.[12] I omit that here as I do not think the argument has gained much traction.

HMRC take the view that treaty relief does not apply to a failed PET. This can be inferred from a passage in the IHT Manual:

> **IHTM13024 Deemed Domicile** [Jan 2020]
> ... domicile does not include deemed domicile...when considering the double taxation agreements (IHTM27161) with France, Italy, India or Pakistan (though where there is a common law domicile in France, Italy, India or Pakistan, IHTA84/S267 can apply to chargeable lifetime transfers).

I agree: there is no treaty relief for a failed PET. This is odd, perhaps absurd. But the treaties give rise to many other anomalies. There is no relief on ten-year charges on trusts. There is no relief on a lifetime chargeable transfer which is not a PET, such as a lifetime gift to a trust.[13] That applies, I think, to the tax immediately payable, and the additional IHT payable within 3 years of death. The absence of treaty relief for a failed PET is consistent with that.

[11] For s.4 IHTA, see 76.4 (Death: IHT charge & exemption).

[12] Firth, "Failed PETs and Living Happily Ever After" [2016] PCB 1.

[13] It appears from an incoherent passage in IHTM para 13024 that HMRC agree.

115.4.7 *Planning*

This raises tricky choices for a person who qualifies for treaty IHT exemption. One approach is for an elderly individual *not* to make any gifts, to retain property until death. The lifetime gift may be taxable and the death estate tax free. But the risk of that approach is that by the time of the death:

(1) The treaty may have been repealed.[14]
(2) An inheritance tax in the foreign state may be re-imposed.

The lifetime gift may be better—if the donor survives seven, or at least three years.

Sometimes one spouse is and the other is not within the scope of the treaty. In that case inter-spouse gifts (or will trusts conferring an IIP on the spouse) will bring the property within the scope of treaty relief.

115.5 Reliefs extended: France

Art 5(3) France IHT DTA provides:

> Where a Contracting Party imposes duty on the death of a person who at the time of his death was domiciled in the territory of the other Contracting Party, the former Party shall allow any exemption, allowance or relief, or any remission or reduction of duty (other than in respect of duty imposed by the other Party or by any other country) which would have been applicable under its law if the deceased had been domiciled in its territory.

This is easier to follow if one specifies which State is which:

> Where [the UK] imposes duty on the death of a person who at the time of his death was domiciled in the territory of [France], [the UK] shall allow any exemption, allowance or relief, or any remission or reduction of duty (other than in respect of duty imposed by [France] or by any other country) which would have been applicable under its law if the deceased had been domiciled in [the UK].

I am unable to think of a case where this would apply in the UK, because there are no IHT reliefs which apply only if the deceased is UK domiciled. Perhaps the provision is aimed at French tax issues. That may explain why there is no equivalent in the other estate duty/IHT DTAs.

[14] See 115.12 (The future).

115.6 Proper-Law rule

Treaty IHT exemption in India, Pakistan and France does not apply to property which passes under a disposition or devolution regulated by the law of some part of Great Britain.[15] I refer to that as the "Proper-Law rule".

This rule follows estate duty principles. Section 28(2) FA 1949 provided estate duty did not apply if (among other conditions):

> ... the proper law regulating the devolution of the property so situate, or the disposition under or by reason of which it passes, is the law neither of England nor of Scotland

The Proper-Law rule is not appropriate for IHT, but logic is not to be expected when estate duty treaties are left unamended to apply to IHT.

As the drafting of the estate duty/IHT treaties is based on s.28(2) FA 1949, cases on that provision are relevant here.[16] The DTAs refer to "law" rather than "proper law" but that makes no difference: the word "proper" does not add anything.[17]

Italy is different. The restriction is that the exemption does not apply to property passing under a *settlement* governed by a UK law (so treaty exemption could apply in Italy to property passing under a UK law will).[18] I would be grateful for any reader who could suggest why this is the case.

Proper law is a complex topic.[19] The difficulty is that different laws may regulate different aspects of a disposition/devolution.

The starting point is *Philipson-Stow v IRC.*[20] This was a case on s.28(2) FA 1949, but the same principles will apply for the estate duty/IHT treaties, as the drafting is based on that section.

In *Philipson -Stow* a testator domiciled in England left a will governed

[15] See 115.4.1 (India DTA exemption); 115.4.2 (France IHT exemption); 115.4.4 (Pakistan IHT exemption).

[16] Similar rules also applied prior to 1949, so pre-1949 case law may also be relevant, though *Philipson-Stow* noted that the pre-1949 law may not have been identical.

[17] *Philipson-Stow v IRC* [1961] AC 727 at p.741: "I find myself unable to give any effective meaning to 'proper'." But it seems to me that "proper law" simply means, "applicable law".

[18] See 115.4.3 (Italy IHT exemption).

[19] For further discussion, see the scholarly Dymond's Death Duties, (15th ed., 1973), pp 1286–1312. See too 77.7.3 (Légitime and trust proper law).

[20] [1961] AC 727.

by English law. The estate included land[21] in South Africa. The proper law regulating the disposition of the land was the law of South Africa (not UK):

(1) on the death of the testator in 1908,[22] and

(2) on the subsequent death of the life tenant in 1954. The trust had retained the land; the position would have been different if the land had been sold before the death.) The domicile of the life tenant was irrelevant.

The following points were decided in *Philipson-Stow*:[23]

"Devolution" means devolution by operation of law, such as heirship, intestacy or survivorship. "Disposition" means a disposition by instrument, such as a will.[24] Devolution and disposition are mutually exclusive, and are exhaustive of the ways in which property can pass on death. So property passes on the death of a life tenant by a disposition (the testator's will) and not by devolution. (I am not sure this makes any difference, but it is good to know what we are talking about. In what follows I use the word "disposition" to include devolution.)

The "disposition" is not the will or settlement: it is the particular devise or bequest.

"Regulating" means the same as "governing" or "determining".

The disposition in *Philipson-Stow* was governed by South African law: "whether the question is one of capacity or formality or validity, it is South African law which governs the disposition, and it is in the courts of South Africa that the ultimate sanction for its enforcement lies". The validity of the will trust is itself a matter for South African law.[25] It is irrelevant that there is no conflict between the laws of England and South Africa: If there were a conflict, South African law would prevail.

Different dispositions in the same instrument may be governed by

[21] For completeness, the asset was a share in land, rather than land, but that made no difference.

[22] The testator was the diamond magnate Frederic Philipson-Stow. The issue in the case concerned tax on the death of the life tenant, not on the death of the testator, but it was said at p.742 that South African law governed the disposition of the South African land on death. This was common ground: p.749.

[23] The propositions are found in p.742-743 except where otherwise noted.

[24] at p.759. Disposition must also include a trust made orally, though in practice that may not arise.

[25] at p.745.

different laws. For instance:

(1) On the death of the testator, South African law applied to the disposition of his South African property, and English law to the disposition of his English property.

(2) On the death of the life tenant, South African law applied to the disposition of South African trust property, and English law to the disposition of English trust property.

The proper law may change with a change in the subject-matter. If the land in South Africa had been sold before the death of the life tenant, and not reinvested in other land, the disposition on the death of the life tenant would have been governed by English law.

A trust for sale made no difference, as it did not convert immovable property into movable property.[26]

115.6.1 *Choice of foreign law*

The position depends on whether the property concerned is immovable or movable.

For immovable property, the proper law is that where the land is situate, and no choice can be made (except by choosing where to buy land).

For movable property, a settlor can select the law which regulates dispositions under a lifetime trust.

A testator can also select the law which governs a will trust (as opposed to their estate). That is the law which regulates the dispositions made by the will trust, as the disposition is the provision of the will.

As a matter of English succession law, a testator cannot select the law which regulates the administration of their estate. The law which regulates the administration of movables in the estate must be the law of his domicile.[27] But it is common for a testator domiciled in one country to execute a will governed by the law of another. Suppose:

(1) A testator is UK domiciled (under UK law) but treaty-domiciled in France/Italy under the tie-breaker.

(2) The testator leaves a will governed by the law of another country, say, Jersey.

[26] I doubt if the question will now arise, but for completeness: In England the rule that a trust for sale converted real property into personal property was abolished by s.3 TOLATA 1996.

[27] See *Philipson-Stow* at p.748. Likewise Lord Denning at p.760-761. I expect the same rule applies in Scotland.

The proper law of the disposition should be that of Jersey. If the law of the domicile was dispositive, then the tie-breaker does not work.[28] This view also avoids an anomalous distinction between a lifetime trust and a will trust.

If treaty relief is lost, because English law governs a disposition, the problem might sometimes be solved by an IoV,[29] though the drafting would require some care.

115.6.2 *EU Succession Regulation*

EU regulation 650/2012 ("the Succession Regulation") applies to all EU states except Ireland and Denmark ("Succession Regulation states"). Art 22(1) Succession Regulation provides:

> A person may choose as the law to govern his succession as a whole the law of the State whose nationality he possesses at the time of making the choice or at the time of death.

Regulation 23(1) provides:

> The law determined pursuant to Article 21 or Article 22 shall govern the succession as a whole.

It does not matter that law chosen is not the law of a member state.[30] In short, a UK national may elect for UK law to apply to the succession as a whole. The election is effective in Succession Regulation states.

Suppose a UK national makes an election for UK law to apply to the succession. The position depends on whether the property concerned is:

(1) immovable and:
    (a) situate in a Succession Regulation state
    (b) situate elsewhere; or
(2) movable

For immovable property situate in a state other than a Succession Regulation state, the election makes no difference.

For immovable property situate in a Succession Regulation state, the

[28] Parkinson describes this as the view of most commentators: see his article, "A disposition or devolution regulated by the law of some part of Great Britain: the Proviso to the Limitation of Taxing Rights in the IHT Treaties with France, India and Pakistan" [2011] PCB 126.

[29] See 77.6 (Instrument of variation).

[30] Article 20

election does make a difference. The consequence is that the disposition of the immovable which (in the absence of an election) would be governed by the law of those states is instead governed by UK law. So treaty relief is not available for property in a Succession law state, under the India/Pakistan/France IHT DTAs.[31]

What if the testator makes an election for UK law to govern his estate, but leaves a will governed by another country? The election operates over French/Italian assets, which are governed by the law of the UK. But the election is not effective in the UK, so apart from that, the principles set out above continue to apply.

115.7 Domicile: applicable law

India DTA art 2(2)	*Pakistan DTA art 2(2)*	*France, art 2(3)(a)*	*Italy DTA art 2(2)(a)*
For the purposes of the present Agreement, the question whether a deceased person was at the time of his death domiciled in any part of the territory of one of the Contracting Governments shall be determined in accordance with the law in force in that territory.	For the purposes of the present Agreement, the question whether a deceased person was at the time of his death domiciled in any part of Great Britain or in any part of Pakistan shall be determined in accordance with the law in force in Great Britain and Pakistan respectively.	For the purposes of the present Convention, the question whether a deceased person was domiciled at the time of his death in any part of the territory of one of the Contracting Parties shall be determined in accordance with the law in force in that territory.	For the purposes of the present Convention, the question whether a deceased person was domiciled at the time of his death in any part of the territory of one of the Contracting Parties shall be determined in accordance with the law in force in that territory.

The wording varies but the meaning is the same:

(1) The question of whether a person is domiciled in the UK is determined according to UK legal principles.

[31] This was anticipated in *Philipson-Stow* [1961] AC 727 at p.741:

> "there may be ... cases where the law of a country, though it regards certain property as an immovable, may yet in certain circumstances regulate its devolution, etc., by reference to another law."

There is a contrary argument. Suppose (say) a UK national elects for English law which governs the succession of their land in France. It may be said that the disposition of the French land is governed by French law, because it is French law which determines that English law applies. In other words, English law is incorporated in and part of French law. But I think the better approach is to look at the substance, and the substance is that English law applies.

(2) The question whether a person is domiciled in the foreign state is determined according to the legal principles of that state.

This provision is needed in the UK for point (2) because (on general treaty interpretation principles[32]), in the application of the DTA in the UK, the term domicile would otherwise be given its UK law meaning.

115.8 UK-law domicile

UK-law domicile matters:

(1) For the India/Pakistan IHT DTAs where a requirement for IHT exemption in is that the individual must not be domiciled in the UK (according to UK law)
(2) For the France/Italy DTAs where the tie-breaker is only needed if the individual is domiciled in the UK (according to UK law)

115.8.1 *Deemed domicile disapplied*

Section 267(2) IHTA provides:

> Subsection (1) above ... shall not affect the interpretation of any such provision as is mentioned in section 158(6) above.

"Such provision as is mentioned in s.158(6)" means:

(1) the statutory provisions referred to [s.54 F (No 2) A 1945 and s. 2 FA (Northern Ireland) 1946] and
(2) The DTAs made pursuant to those provisions, ie the estate duty/IHT DTAs

Section 267(1) contains the main deemed domicile rules: the 15-year rule, 3-year rule and formerly-domiciled resident rule.[33] These rules are all disapplied by s.267(2).

The reason for disapplying deemed domicile is that estate duty had no equivalent of the CTT/IHT deemed domicile rules. The subsequent application of a deemed domicile rule to the estate duty/IHT DTAs would have raised a number of difficulties.[34] The obvious solution was to keep

[32] See 115.3.5 (Undefined treaty terms).

[33] See 5.2 (Deemed domicile: Outline).

[34] It is an interesting question whether it would have been a breach of the treaties. Even if not a technical breach, the treaty countries could reasonably have objected. IHT deemed domiciled individuals would have suffered double taxation.
An alternative would have been to renegotiate existing treaties (introducing new rules

the treaties free from the deemed domicile rules.

115.8.2 *Spouse-election domicile disapplied*

For spouse-election domicile,[35] s.267ZA(6) IHTA provides:

> An election under this section is to be ignored—
> (a) in interpreting any such provision as is mentioned in section 158(6)

Section 267ZA(6)(a) disapplies spouse-election domicile for IHT DTAs. The wording is based on s.267(2).

Section 267ZA(6)(b) provides:

> An election under this section is to be ignored...
> (b) in determining the effect of any qualifying double taxation relief arrangements in relation to a transfer of value by the person making the election.

"Qualifying" DTA is defined in s.267ZA(7) IHTA:

> For the purposes of subsection (6)(b) a qualifying double taxation relief arrangement is an arrangement which is specified in an Order in Council made under section 158 before the coming into force of this section [17 July 2013] (other than by way of amendment by an Order made on or after the coming into force of this section).

This disapplies spouse-election domicile for all of the UK's IHT DTAs, because they were all made before 2013.

115.9 Foreign-law domicile

The requirement for IHT exemption in each estate duty/IHT DTA is that the individual must be domiciled in the foreign state according to the law of that state. Since that law is not the same as UK law, I refer to **"India-law domicile"**, etc.

115.9.1 *India-law domicile*

The question whether an individual is domiciled in India is governed by the law of India.

The law of domicile in India is governed by the [India] Succession Act

at least for treaties which lacked a tie-breaker) but presumably that was thought to be impractical or too much trouble.

[35] See 5.14 (Spouse-election domicile).

1925.[36] That Act sets out statutory rules mostly based on the common law rules, and *Saini v State of Uttarakhand*[37] referred to Halsbury's Laws of England, so it seems that Indian domicile law has not moved from its common law origin. India still applies the common law rule (abolished in the UK in 1973) that a married woman has the domicile of her husband as a domicile of dependency.

There appear to be differences of view as to whether:

(1) India is a unitary state for domicile purposes, so a person is domiciled in India, not in any part of India; or

(2) India (like the UK) is a federal state for domicile purposes, so a person is strictly domiciled in one of the states which make up the Republic of India (and a reference to domicile in India strictly means domicile in any one of those states).

Perhaps one sometimes applies one rule and sometimes the other, depending on context.[38] In the context of the India IHT DTA, this issue will not often arise.

Section 11 [India] Succession Act 1925 contains one provision which is not in English law:

> Any person may acquire a domicile in India by making and depositing in some office in India, appointed in this behalf by the State Government, a declaration in writing under his hand of his desire to acquire such domicile; provided that he has been resident in India for one year immediately preceding the time of his making such declaration.[39]

[36] See Agrawal, Private International Law in India (1st ed., 2010) p.67; *Dr. Pradeep Jain v Union of India* AIR 1984 SC 1420; *Kedar Pandey v Narain Bikram Shah* 1966 AIR 160, 1965 SCR (3) 793.
The Succession Act is at *http://www.liiofindia.org/in/legis/cen/num_act/isa1925183/*
The part of the Act dealing with domicile does not apply if the deceased was a Hindu, Muslim, Buddhist, Sikh or Jaina, but I understand that the Act has been taken as stating the general law of domicile.

[37] AIR 2010 Utr 36 *https://indiankanoon.org/doc/42616100*

[38] See Noronha, *Private International Law in India* (2nd ed, 2013) chap 6 (Domicile). Article 3 India IHT DTA refers to a person being domiciled "in some part of India" so the drafter regarded India as a federal state for domicile purposes, at the time of the DTA (1956).

[39] This is derived from a UK statute: s.2 Domicile Act 1861. This anticipated conventions with foreign states under which such rules could be mutually agreed. But no conventions were ever concluded, so the 1861 Act was a dead letter and finally

But it has been said that this is dead letter law, as no offices are currently designated.[40]

115.9.2 *Pakistan-law domicile*

The question whether an individual is domiciled in Pakistan is governed by the law of Pakistan.

Dymond's Death Duties (15th ed., 1973) states at p. 1388:

> The Indian (and Pakistan) law (contained in the [India] Succession Act 1925) is basically similar to British law but somewhat less stringent in its requirements, ie. the conception of 'domicile' is a little nearer to that of 'residence'.

I would be grateful to any reader who could supply further information about Pakistani law of domicile.

115.9.3 *"Domicile" in France/Italy*

The question whether an individual is domiciled in France/Italy is governed by the law of France/Italy. The terms used for domiciled/ domicile in the French version of the treaty are *domiciliée* and *domicile*. But I suspect the meaning of the French term is not "domicile" as common lawyers understand it, but rather, is similar to habitual residence; and, I suspect, likewise in Italy[41] It is helpful to write "domicile" with scare quotation marks when used in the French/Italian law sense.

repealed in 1971.

[40] Mehta, "A tale of two domiciles" GITC Review Vol 15 (2019) *http://taxbar.com/wp-content/uploads/2018/03/NM_A-Tale-of-Two-Domiciles_GITCReview_XV_1.pdf*
If that is right, s.11 [India] Succession Act 1925 ought to be repealed in India, just as the UK 1861 Act has been repealed in the UK.

[41] Article 102 [French] Code Civil provides: "Le domicile de tout Francais est au lieu où il a son principal établissement" (The "domicile" of a French person is where he has his main establishment).
Article 43 [Italian] Codice Civile is headed: "Domicilio e residenza". It distinguishes the two terms:

> "Il domicilio di una persona è nel luogo in cui essa ha stabilito la sede principale dei suoi affari e interessi" (The "domicile" of a person is the place where he has established the main centre of his affairs and interests")
> "La residenza è nel luogo in cui la persona ha la dimora abituale" (Residence is in the place where the person has his habitual abode).

I would be grateful to any reader who could give references to further discussion.

It is therefore possible for an individual to be:

(1) "domiciled" in France/Italy (under French/Italian principles) and
(2) (a) deemed domiciled in the UK (but not actually UK domiciled) or
    (b) actually domiciled in the UK

In case (2)(a) the individual is treaty-domiciled in France/Italy, as deemed domicile does not count for the purposes of the DTAs. It is not necessary to rely on the tie-breaker.

The France/Italy DTAs have a tie-breaker for domicile in case (2)(b). (A tie-breaker is not needed for the India/Pakistan DTAs, where it is assumed that an individual could not be (or at least, in practice, would not be) actually domiciled in both countries[42]. The France/Italy tie-breaker is as follows:

Art 2(3)(b) France DTA

> Where by reason of the provisions of the preceding sub-paragraph [*Note 1*] a deceased person is deemed to be domiciled in the territory of each of the Contracting Parties, then this case shall be solved in accordance with the following rules:—

Art 2(2)(b) Italy DTA

> Where by reason of the provisions of the preceding paragraph [*Note 1*] a deceased person is deemed to be domiciled in the territory of each of the Contracting Parties, then this case shall be solved in accordance with the following rules:—

Note 1: For the "preceding paragraph" see 115.7 (Domicile: applicable law).

After that, the France/Italy tie-breakers continue in identical terms:

> (i) he shall be deemed to be domiciled in the territory of the Contracting Party in which he had a permanent home available to him at the time of his death; if he had a permanent home available to him in the territory of each of the Contracting Parties he shall be deemed to be domiciled in the territory of the Contracting Party with which his personal and economic relations were closest (centre of vital interests);

It is not often necessary to look beyond this point but, for completeness, the France/Italy DTAs continue, again in identical terms:

[42] One could imagine circumstances where a person is domiciled in (say) India for the purposes of Indian law, and domiciled in the UK for the purposes of UK law. An example is a woman domiciled in the UK (under UK law) married to a husband domiciled in India (who has a domicile of dependency under the law of India). As there is no tie-breaker, such a person would not qualify for treaty exemption under the India/UK treaty.

(ii) if the Contracting Party in whose territory he had his centre of vital interests cannot be determined, or if he had not a permanent home available to him in the territory of either Contracting Party, he shall be deemed to be domiciled in the territory of the Contracting Party in which he had an habitual abode;

(iii) if he had an habitual abode in the territory of each of the Contracting Parties, or in the territory of neither, he shall be deemed to be domiciled in that of which he was a national;

(iv) if he was a national of both territories or of neither of them, the taxation authorities of the Contracting Parties shall determine the question by mutual agreement.

The tie-breaker wording follows the tie-breaker in the definition of residence in the OECD income tax/CGT Model Convention, with immaterial differences. Reference should be made to the OECD Commentary.[43]

Exemption under the Italy IHT DTA requires that the person:

[i] was not domiciled in any part of that territory but

[ii] was domiciled in some part of the territory of the other Contracting Party,

Because of the tie-breaker, the words at [i] seem to be otiose. If Italy wins under the tie-breaker, the individual must be regarded as not UK domiciled. So the requirement at [i] to be non-UK domiciled seem to add nothing. (The answer cannot be that domicile here means domicile under UK/Italian law, not domicile under the tie-breaker, because then the tie-breaker would never apply.)

IHT exemption in the France IHT DTA (which also has a domicile tie-breaker) does not include the requirement that the individual is not domiciled in the UK. Since the Italy IHT DTA (1968) came after the France IHT DTA (1963) it is strange that the Italian wording did not copy the French precedent. But there it is.

115.10 Treaty-situs

The next requirement of treaty IHT exemption is that the property must not be situate in the UK. For this purpose the DTAs contain situs rules. It is therefore necessary to distinguish between ordinary IHT situs and what I call "**treaty-situs**". The rules are those recommended in a report

[43] See 9.11 (Tie-breaker tests: Individuals).

on Double Taxation prepared for the League of Nations in 1923 by Professors Bruins and Seligman and our own Sir Josiah (later, Lord) Stamp; the report is worth reading as it gives the background.

Some of the rules repeat the ordinary IHT situs rules and others are different.

115.10.1 *Treaty-situs: India/Pakistan*

Art 4(1) India IHT DTA provides:

> Subject to para (2) of this Article, where a person was at the time of his death domiciled in any part of the territory of one of the Contracting Governments ...

This is the case we are considering.

> ... the situs of any property *which for the purposes of duty passes or is deemed to pass on his death* shall, for the purposes
> [a] of the imposition of duty and
> [b] of the credit to be allowed under Art. VI,
> be determined exclusively in accordance with the rules in Art. V of the present Agreement.

However there is a condition in Art 4(2):

> Para (1) of this Article shall apply if, and only if, apart from the said Art. V—
> (a) duty would be imposed on the property under the law of each of the Contracting Governments; or
> (b) duty would be imposed on the property under the law of one of the Contracting Governments and would, but for some specific exemption, also be imposed thereon under the law of the other Contracting Government.

This condition is not satisfied under the India IHT DTA, since estate duty in India was repealed in 1985. (Significantly, about the same time, the Thatcher Government was drawing the teeth of CTT, though the UK did not follow India all the way to abolition.) So the treaty-situs rules in the India IHT DTA will not apply, unless India re-imposes an estate duty. Instead the IHT/international law situs rules will apply.

Pakistan is the same: Art 3 Pakistan IHT DTA. Pakistan's estate duty was abolished in 1979. One wonders why these treaties have survived so many decades after losing their *raison d'être*.

Treaty-situs: France/Italy

Article 3 France IHT DTA provides:

> (1) Where a person was at the time of his death domiciled in any part of the territory of one of the Contracting Parties, the situs of any property shall for the purposes
> [a] of the imposition of duty and
> [b] of any credit to be allowed under Article VI[44]
> be determined exclusively in accordance with the rules in Article IV.
> (2) Paragraph (1) of this Article shall apply only if, apart from the said Article IV—
> (a) duty would be imposed on the property under the law of each Contracting Party; or
> (b) duty would be imposed on the property under the law of one of the Contracting Parties and would, but for some specific exemption, be imposed thereon under the law of the other Contracting Party.

France retains its duty on successions on death, so the condition in Art 3(2) is satisfied, and the treaty-situs rules are relevant. I here set out the rules in Art 4 France IHT DTA highlighting in italic those significantly different from IHT-situs:

> The rules referred to in paragraph 1 of Article III are:
> (a) [i] land shall be deemed to be situated at the place where it is located;
> [ii] rights or interests (otherwise than by way of security) which constitute immovable property shall be deemed to be situated at the place where the land to which they relate is located; the question whether rights or interests constitute immovable property shall be determined in accordance with the law of the place where the land to which they relate is located;
> (b) [i] tangible movable property (other than such property for which specific provision is hereinafter made) and rights or interests (otherwise than by way of security) therein shall be deemed to be situated at the place where it is located at the time of the deceased person's death or, *if in transitu, at the place of destination*; and
> [ii] bank or currency notes or other forms of currency recognised as legal tender in the place of issue shall be treated as tangible movable property for the purpose of this subparagraph;
> (c) *debts, secured or unsecured, excluding those for which specific provision is made in this Article, but including debentures and debenture stock issued by a company, bills of exchange, promissory notes and cheques shall be deemed to be situated at the place where the deceased person was domiciled at the time of his death*;
> (d) *securities issued by any government, county council, dèpartement,*

[44] See 120.7 (France/Italy IHT credit).

municipality or other public authority shall be deemed to be situated at the place where the deceased person was domiciled at the time of his death;

(e) *shares or stock in a company (including any such property held by a nominee, whether the beneficial ownership is evidenced by scrip certificates or otherwise) shall be deemed to be situated at the place where the company was incorporated*;

(f) *moneys payable under a policy of assurance or insurance shall be deemed to be situated at the place where the deceased person was domiciled at the time of his death*;

(g) [i] an interest in a partnership, which term includes a société en nom collectif, a société en commandite simple *and a société civile* under French law, shall be deemed to be situated at the place where the business is principally carried on;

[ii] and in the case of a société civile immobilière this shall be where the land developed in accordance with the objects of the société is located;

(h) goodwill as a trade, business or professional asset shall be deemed to be situated at the place where the trade, business or profession to which it pertains is carried on;

(i) ships and aircraft and shares thereof shall be deemed to be situated at the place of registration of the ship or aircraft;

(j) *patents, trade marks, designs, copyright, and rights or licences to use any patent, trade mark, design or copyrighted material shall be deemed to be situated at the place where the deceased person was domiciled at the time of his death*;

(k) *rights or causes of action ex-delicto*[45] *surviving for the benefit of the estate of a deceased person shall be deemed to be situated at the place where the deceased person was domiciled at the time of his death*;

(l) *judgment debts shall be deemed to be situated at the place where the deceased person was domiciled at the time of his death*;

(m) *any other right or interest shall be deemed to be situated at the place determined by the law in force in the territory of the Contracting Party where the deceased person was not domiciled at the date of his death.*

The France IHT DTA may *increase* IHT on death, by providing that property which is not UK situate on general principles is to be regarded as UK situate.

For the position in Italy, see Saccardo, "Italian Inheritance and Gift Tax upon Non-residents" [2020] PCB 43.

115.11 Certificate of tax paid

115.11.1 *France*

The IHT Manual provides:

[45] ie torts, not contractual rights.

IHTM27174: certificate of tax paid: France [Oct 2016]

Certificate of French succession duty paid

Where the deceased had a fiscal domicile (IHTM13001) in France, the UK is required by Article V to waive its rights to tax on any of their assets that are deemed to be situated in France under the situs code at Article IV of the Double Taxation Convention. In view of the provisions of Article III (2), which restricts relief where the French tax has not been paid, it is desirable to have some confirmation of the French Revenue's position. Normally it will be sufficient to obtain a copy of the French return (Déclaration de Succession) and the French clearance certificate (Certificat d'Acquittement) to confirm that the French succession duty has been paid.

Where the deceased had a fiscal domicile (IHTM13001) in the UK and a double taxation credit is claimed from HMRC under Article VI, you may allow the amount shown in form IHT400 provisionally. But the case must not be closed until the payment has been certified by the French authorities. The form used for the certification is form No. 50, which is available from Technical.

If you think a credit is due, send two prints of form No. 50 to the taxpayer or agent. Ask them to complete the forms and return both copies to us. You should send the completed forms to Technical, who will send them on to the French authorities.

In due course, we will receive a certified form No. 50 back from France. You should check the certified form carefully, and allow the correct amount of credit. If you are uncertain about any aspect of the certified form No. 50, or you think that the Convention may not have been correctly applied, please refer the case to Technical, with a covering memo.

- The credit given for the French duty cannot be more than the amount of the UK tax due on the asset concerned.
- The provisions of the Convention only cover UK Inheritance Tax (IHT) that is due on death. They do not cover tax due on immediately chargeable lifetime transfers.

Certificate of IHT paid

Where the deceased had a fiscal domicile (IHTM13001) in the UK, France is required by Article V to waive its right to tax on any of their assets that are deemed to be situated in the UK under the situs code at Article IV of the Double Taxation Convention. You should consult Technical about any request for a confirmation of the UK's position in support of a claim to the French taxation authorities.

Where the deceased had a fiscal domicile (IHTM13001) in France and

> a double taxation credit is claimed from the French Revenue under Article VI a certificate of IHT paid is given on the French form No. 5180 once the IHT is finalised and paid.
> A stock of this form is held Technical. The taxpayer must complete it in triplicate and then return it to us.
> You should check the forms No. 5180. It is important that you do not mark the forms in any way. The file should be sent, with a note of any error or omission, to Technical. When the case is closed Technical will arrange for two copies to be certified and sent to the French authorities, together with a schedule of any amendments we have needed to make. We will keep the third copy of the form on our file. You should tell the taxpayer or agent that we have sent the certificate to France, and send them a copy of the schedule of amendments, if there is one.

115.11.2 *Italy*

The IHT Manual provides:

> **IHTM27175 certificate of tax paid: Italy** [Sep 2018]
> Where a double taxation credit is claimed for tax imposed in Italy or the taxpayer or agent asks for a certificate of the Inheritance Tax paid for the Italian authorities refer the file to Technical for advice.
> The Double Taxation Convention between the UK and Italy only covers the Italian equivalent of Inheritance Tax (known as imposta sulla successione). This tax was abolished for all deaths after 25 October 2001 but later reintroduced for deaths on or after 3 October 2006.
> You should also consider whether unilateral relief(IHTM27185) applies in respect of Italian taxes that fall outside the scope of the Double Taxation Convention. But it will only apply where the foreign tax is of a character similar to Inheritance Tax or is chargeable on or in connection with death or lifetime gifts. Italian imposta ipotecaria and imposta catastale are not of similar character to Inheritance Tax, because they are chargeable on a normal property purchase as well as on a death transfer.
> The provisions of the Convention only cover UK Inheritance Tax that is due on death. They do not cover tax due on immediately chargeable lifetime transfers.

115.12 The future

In 2015 the Law Society said:

> We understand the intention is for the UK to have priority taxing rights

> and to re-negotiate the [estate duty] treaties in the longer term.[46]

The lapse of time suggests the plan has been dropped. Could it be that the need to agree a post-Brexit trade agreement with India made this plan inopportune? No doubt HMRC would be pleased to respond to enquiries from their customers.

[46] Law Society, Response to HM Treasury consultation on reforms to the taxation of non-domiciles (2015).

CHAPTER ONE HUNDRED AND SIXTEEN

IHT DTA: NETHERLANDS

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116.4.1 National
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Cross references

Issues which the Netherlands IHT DTA has in common with other treaties are discussed elsewhere:

Topic	**See para**
Introduction to IHT DTAs	114.1
Claims for IHT DTA reliefs	114.7
Nil rate band and DTAs	114.8
France/Italy IHT credit	120.7
Deductions for DTA purposes	114.9

116.1 Netherlands IHT DTA

This chapter discusses the IHT treaty with the Netherlands , which I call the "Netherlands IHT DTA".[1]

116.2 Scope

Article 1 Netherlands IHT DTA provides:

[1] For some reason DTAs do not have short titles. The long title is: "Convention between the United Kingdom of Great Britain and Northern Ireland and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates of Deceased Persons and Inheritances and on Gifts"; SI 706/1980

> This Convention shall apply:
> (a) to estates of and gifts made by persons domiciled in one or both of the States at their death or at the time of the gift, as the case may be;
> (b) to property comprised in settlements made by persons domiciled in either State at the time when the settlement was made.

116.3 Taxes covered

Article 2(1) Netherlands IHT DTA provides:

> The taxes which are the subject of this Convention are:
> (a) in the UK, the [now IHT][2] (hereinafter referred to as "UK tax");
> (b) in the Netherlands, the succession duty (het recht van successie), the gift duty (het recht van schenking) and the transfer duty (het recht van overgang) (hereinafter referred to as "Netherlands tax").

Article 2(2) Netherlands IHT DTA extends the DTA to substantially similar taxes. The wording follows the OECD model.[3]

116.4 Definitions

The Netherlands IHT DTA provides commonsense definitions of the following terms, which are not discussed here: The Netherlands; UK; Competent Authority; State.

Article 3(1) Netherlands IHT DTA provides:

> (e) the term "tax" means United Kingdom tax or Netherlands tax as the context requires;
> (f) the term "person" includes an individual, a company and any other body of persons;

Article 3(2) Netherlands IHT DTA gives terms not otherwise defined their domestic law meanings, following OECD Model wording as it stood at the time of the DTA. See 107.12 (Undefined treaty terms).

116.4.1 *National*

Article 3(1) Netherlands IHT DTA provides:

[2] See 74.1.1 ("CTT" now refers to IHT). CTT/IHT are also "similar taxes" within art 2(2).

[3] See 114.4 (IHT DTAs: Taxes covered).

> (d) the term “national” means:
> (i) in relation to the UK, any British citizen or any British subject not possessing the citizenship of any other Commonwealth country or territory provided he had the right of abode in the UK at the time of the death or gift or any other material time;
> (ii) in relation to the Netherlands, any individual possessing the Nethzerlands nationality.

116.4.2 *Gift*

Article 3(1) Netherlands IHT DTA provides:

> (h) the term “gift” means in the UK a transfer of value other than one made on death and the term “donor” shall be construed accordingly.

116.5 Treaty-Domicile

Article 4 Netherlands IHT DTA provides:

> For the purposes of this Convention, a person was domiciled:
> (a) in the UK, if he was domiciled in the UK in accordance with its law or is treated as so domiciled for the purposes of a tax which is the subject of this Convention;[4]
> (b) in the Netherlands, if he was a resident of or is treated as a resident of the Netherlands for the purposes of a tax which is the subject of this Convention;
> provided that a person shall not be deemed to be domiciled in one of the States if on the death or gift that State imposes tax only by reference to property situated in that State.

116.5.1 *Tie-breakers*

Article 4 Netherlands IHT DTA provides:

> (2) Where by reason of the provisions of paragraph (1) of this Article an individual was domiciled in both States, then, subject to the provisions of paragraph (3) of this Article, his status shall be determined as follows:
> (a) he shall be deemed to be domiciled in the State in which he had a permanent home available to him; if he had a permanent

[4] Para (a) is standard wording, discussed at 114.5 (Treaty-domicile).

> home available to him in both States, the domicile shall be deemed to be in the State with which his personal and economic relations were closer (centre of vital interests);
>
> (b) if the State in which he had his centre of vital interests cannot be determined, or if he had not a permanent home available to him in either State, the domicile shall be deemed to be in the State in which he had an habitual abode;
>
> (c) if he had an habitual abode in both States or in neither of them, the domicile shall be deemed to be in the State of which he was a national;
>
> (d) if he was a national of both States or of neither of them, the competent authorities of the States shall settle the question by mutual agreement.

This is standard OECD Model wording.[5]

> (3) Notwithstanding the provisions of paragraph (2) of this Article, where by reason of the provisions of paragraph (1) of this Article an individual was at the time his domicile falls to be determined domiciled in both States and
>
> (a) was at that time a national of one of the States but not of the other, and
>
> (b) was resident in that other State but had been so resident for less than seven years out of ten years immediately preceding that time, and
>
> (c) did not intend to remain indefinitely in that other State,
>
> then he shall be deemed to be domiciled at that time in the State of which he was a national.
>
> For the purposes of this paragraph
>
> [A] where that other State is the UK the question whether a person was resident there shall be determined as for income tax purposes, but without regard to any dwelling-house available to him in the UK for his use[6] and
>
> [B] "years" shall be taken to mean income tax years of assessment ending with the year of assessment in which death or the making of a gift occurs.

[5] See 9.11 (Tie-breaker tests: Individuals).

[6] This sentence is based on wording formerly in the IHT deemed domicile rule, see 5.6.3 ("Residence" for 15-year rule). It is no longer appropriate, following the introduction of the statutory residence test, but in practice the point will only rarely arise.

116.6 Immovable property

Article 5 (more or less) follows the OECD IHT Model. Article 5 Netherlands IHT DTA provides:

> (1) Immovable property may be taxed in the State in which such property is situated.

Article 5(2) Netherlands IHT DTA defines "immovable property" in (more or less) OECD Model form:[7]

> (2) The term "immovable property" shall have the meaning it has under the law of the State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, an interest in the proceeds of sale of land which is held on trust for sale, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats, aircraft and debts secured by mortgage or otherwise shall not be regarded as immovable property.
> (3) The provisions of paragraphs (1) and (2) of this Article shall also apply to immovable property of an enterprise and to immovable property used for the performance of independent personal services.

116.7 Business property

Article 6 Netherlands IHT DTA provides:

> (1) Except for assets referred to in Articles 5 and 7 [immovable property/ships/aircraft], assets forming part of the business property of a permanent establishment of an enterprise may be taxed in the State in which the permanent establishment is situated.
> (2) For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
> (3) The term "permanent establishment" includes especially:
> (a) a place of management,
> (b) a branch,
> (c) an office,

[7] See 24.7.1 ("Immovable property").

(d) a factory,
(e) a workshop and
(f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

(4) A building site or construction or installation project constitutes a permanent establishment only if it lasts for more than twelve months.

(5) Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:

(a) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;
(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
(e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
(f) the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs (a) to (e) of this paragraph provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

(6) Except for assets described in Article 5, assets pertaining to a fixed base used for the performance of independent personal services may be taxed in the State in which the fixed base is situated.

(7) The provisions of paragraphs (1) and (6) of this Article shall apply to an interest in a partnership if an enterprise is carried on, or independent professional services are performed, by the partnership.

116.8 Ships and aircraft

Article 7 Netherlands IHT DTA provides:

> Ships and aircraft operated in international traffic and boats engaged in inland waterways transport, and movable property pertaining to the operation of such ships, aircraft and boats, may be taxed in the State in which the place of effective management of the enterprise is situated.

116.9 Other property

Article 8 Netherlands IHT DTA provides the main treaty exemption:

> Subject to the provisions of Article 11 property wherever situated and not dealt with in Articles 5, 6 and 7 [immovable/business property/ships/aircraft] shall be taxable only in the State in which the deceased or the donor was domiciled at the time of the death or gift.

116.10 Conflict on property nature

Article 9 Netherlands IHT DTA provides:

> If,
> [1] by the law of one of the States, any right or interest is regarded as property not falling within any of Articles 5, 6 and 7 [immovable/business property/ships/aircraft],
> [2] but, by the law of the other State, that right or interest is regarded as property falling within those Articles,
> then that right or interest shall for the purposes of this Convention be regarded as property falling within those Articles.

This is not a standard provision. I wonder if it is directed at some particular point of conflict.

116.11 Deductions

Article 10 Netherlands IHT DTA provides:

> In determining the amount on which tax is to be computed deductions shall be allowed in accordance with the law of the State in which the tax is imposed.

This article is found in several IHT DTAs; for discussion, see 114.9 (Deductions for DTA purposes).

116.12 Limitations on relief

Article 11 Netherlands IHT DTA provides:

> (1) If the deceased or the donor was
> [a] domiciled in one of the States at the time of the death or gift and
> [b] was at that time a national of the other State and
> [c] had been domiciled in that other State at any time within the ten years immediately preceding the death or gift,
> that other State may impose tax according to its domestic law.

116.13 Settled property

Article 11 Netherlands IHT DTA provides:

> (2) The UK may impose tax by reference to property comprised in a settlement unless at the time when the settlement was made the settlor was:
>
> (a) domiciled in the Netherlands; and
>
> (b) not a national of the UK who had been domiciled in the UK at any time within the immediately preceding ten years.

116.14 Requirement to pay foreign tax

Article 11(3) Netherlands IHT DTA provides:

> If
>
> [a] under the provisions of Article 8 any property would be taxable only in the Netherlands and
>
> [b] the deceased or donor
>
> [i] is either a national of the UK and not a national of the Netherlands or
>
> [ii] is treated for the purposes of Netherlands tax as a resident of the Netherlands under its unilateral 10-year rule,
>
> the UK may also impose tax, according to its law, by reference to such property, if the competent authority of the Netherlands notifies the competent authority of the UK that the Netherlands tax chargeable with respect to such property has not been paid (otherwise than as a result of a specific exemption, deduction, credit or allowance).

The IHT Manual provides:

> **IHTM27171: certificate of tax paid: Netherlands** [Dec 2021]
>
> Where the transferor was, according to the Double Taxation Convention:
>
> - domiciled in the Netherlands, and
> - had not been domiciled in the UK within the 10 years of the transfer.
>
> the UK must waive its taxing rights on any asset the transferor held that was within Article 8, even if it was situated in the UK. You should consult Technical about any proof of taxation in the Netherlands.
>
> When a double taxation credit is due under Article 13, you may allow the amount claimed in IHT400 provisionally. But the case should not be closed until the payment of Dutch succession duty has been certified by the Dutch authorities. There is no special form for a certificate. You

should tell the taxpayer or agent to obtain a statement from the Dutch authorities showing:

(a) the total tax attributable to the property in question (excluding any interest and penalties)
(b) the property and its value on which that tax was charged
(c) the date of payment of that tax
(d) that the tax was computed in accordance with the Convention
(e) that the tax is final
(f) that no application for a refund of tax is now pending or authorised and that, if a refund is made, due notice will be given to this Office.

The Dutch authorities will send the certificate in the form of a letter direct to us.

If you have any difficulty calculating the tax attributable to property, after you have received the certificate, you should ask for advice from Technical.

The credit given cannot be more than the amount of UK Inheritance tax payable on the property concerned.

Certificate of IHT paid

A certificate of IHT paid will also be a letter that we will issue if the taxpayer or agent requests one. It is prepared by Technical and sent to the Dutch authorities, with a copy to the applicant. If there is any adjustment of tax after a certificate has been issued, refer the file back to Technical to issue an amending certificate.

You should also refer the file to Technical if the taxpayer or agent asks for proof that the assets are subject to Inheritance tax in the UK in connection with Article 8.

116.15 Spouse exemptions

Article 12 Netherlands IHT DTA provides:

(1) Where

[a] property other than community property passes from a deceased person who was domiciled in the Netherlands to his or her spouse, and
[b] that property may be taxed in the UK solely by reason of Article 5, 6 or 7, and
[c] the spouse was not domiciled in the UK but the transfer would have been wholly exempt if the spouse had been so domiciled,

the UK shall exempt the property from tax to the extent of not less than 50 per cent of the value transferred, calculated as a value on which no tax is payable and after taking account of all exemptions except those

> for transfers between spouses.
> (2) Where
> [a] property other than community property passes from a deceased person who was domiciled in the UK to his or her spouse and
> [b] that property may be taxed in the Netherlands solely by reason of Article 5, 6 or 7,
>
> the Netherlands shall exempt from tax such property to the extent that 50 per cent of its value exceeds the amount of the personal exemption which under the law of the Netherlands is given to a surviving spouse. If however the deceased person was a resident of the Netherlands under its domestic law the preceding sentence shall apply only to the extent that it is shown that the tax so computed is not less than the tax which would have been imposed if the deceased person had been domiciled in the Netherlands for the purposes of this Convention.
> (3) Paragraph (2) shall not apply if at the time of death the UK under its domestic law taxes property passing from a deceased person to his or her spouse, who has the same domicile as that of the deceased person, to the extent of more than 50 per cent of its value.

116.16 Foreign tax credit

Article 13 Netherlands IHT DTA provides:

> (1) Where one of the States imposes tax in connection with any event by reference to any property which the other State may tax in accordance with Article 5, 6 or 7, the former State shall allow against so much of its tax (as otherwise computed) as is attributable to such property a credit (not exceeding the amount of tax so attributable) equal to so much of the tax imposed in the other State in connection with the same event as is attributable to such property.
> (2) Subject to paragraph (3) of this Article, where both States impose tax in connection with any event by reference to any property not being property referred to in Article 5, 6 or 7, the State which imposes tax by virtue of paragraph (1) of Article 11, shall allow against so much of its tax (as otherwise computed) as is attributable to such property a credit (not exceeding the amount of the tax so attributable) equal to so much of the tax imposed in the other State by virtue of Article 8 in connection with the same event as is attributable to such property.
> (3) Where by virtue of paragraph (2) of Article 11 the UK imposes tax in connection with any event by reference to any property comprised in a settlement not being property referred to in Article 5, 6 or 7, the UK shall allow against so much of its tax (as otherwise computed) as is attributable to such property a credit (not exceeding the amount of the

> tax so attributable to such property a credit (not exceeding the amount of the tax so attributable) equal to so much of the tax imposed in the Netherlands in connection with the same event as is attributable to such property.
>
> (4) For the purposes of this Article,
>
> (a) the tax attributable to any property imposed in one of the States is tax as reduced by the amount of any credit allowed by that State in respect of tax attributable to that property imposed in a territory other than one of the States;
>
> (b) where tax is imposed on the death of a person by reason of a gift made [within 7 years] preceding the death, whether in consequence of the fact that the gift is deemed to be derived from this estate or otherwise with respect to that gift, that tax shall be treated as if it were imposed in connection with that gift;
>
> (c) tax is imposed in one of the States if it is chargeable under the law of that State and duly paid.

116.17 Time limit

Article 14 Netherlands IHT DTA provides:

> Time Limit
>
> Any claim for a credit or for a repayment of tax founded on the provisions of this Convention shall be made within six years from the date of the event giving rise to a liability to tax or, where later, within one year from the last date on which tax for which credit is given is due.

116.18 Other articles

The following articles of the Netherlands IHT DTA are standard form and not discussed here:

Article	**Topic**
16	Mutual agreement procedure
17	Exchange of information
18	Diplomatic and consular officials
19	Territorial extension
20	Entry into force
21	Termination

CHAPTER ONE HUNDRED AND SEVENTEEN

IHT DTA: SOUTH AFRICA

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117.14 Deductions/allowances/reliefs
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117.18 Other articles

Cross references

Issues which the South Africa IHT DTA has in common with other treaties are discussed elsewhere:

Topic	**See para**
Introduction to IHT DTAs	114.1
Claims for IHT DTA reliefs	114.7
Nil rate band and DTAs	114.8
France/Italy IHT credit	120.7
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117.1 Introduction

This chapter considers the IHT Treaty with South Africa, which I call the "SA IHT DTA".[1]

John Avery Jones explains the background:[2]

[1] For some reason DTAs do not have short titles. The long title is: "Convention Between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates of Deceased Persons and on Gifts"; SI 1979/576

[2] Avery Jones, "The Estate and Gifts Tax Convention with South Africa" [1979] BTR 1. It is remarkable, almost unheard of, that tax scholarship more than 40 years old

The new South African convention relating to estate and gift taxes solves in a neat way the difficulties faced when one country taxes on the basis of domicile and the other on the basis of ordinary residence. The OECD Model singularly fails to do this in applying as the first test in the case of dual domicile, the country in which the taxpayer has a permanent home. A taxpayer from the "domicile" country acquiring a permanent home in the "ordinary residence" country will therefore under the Model shed his original domicile, while a taxpayer from the ordinary residence country is unlikely to acquire a domicile in the domicile country, and dual domicile will not therefore arise. Either way the domicile country loses.

The negotiators have solved this by applying a prior rule under which a person with UK, but not South African, nationality can be resident or ordinarily resident in South Africa for up to six out of the 10 tax yeas preceding the time of charge, without being considered to have a domicile in South Africa for the purposes of the convention. This provision is reciprocal in form but less likely to arise the other way round because either the visitor will not acquire a UK domicile or will not keep his South African ordinary residence. The same tests as in the OECD Model then apply only after the seven years or in the case of nationality in neither or both countries. A visitor from the UK, so long as he has UK nationality but not South African nationality, can therefore live in South Africa until he has been resident for seven tax years with immunity from South African gift and death duties, except on assets which South Africa can tax on the basis of situs.

When the seven years is reached he will, assuming he retains his UK domicile, have dual domicile under internal law which is solved for the purposes of the convention by applying the OECD Model tests in order. Normally he will have a permanent home in South Africa only which gives South Africa by the primary right to tax his world property, other than that which the UK can tax on the basis of situs under the convention: immovable property, permanent establishments, ships and aircraft, shares, debentures, and unit trusts. However, so long as he had a convention domicile within the UK during the previous 10 years the UK has a secondary right to tax his world assets after giving credit for the South African tax.[3] ...

remains of current significance. But such is the pace of change in the area of IHT DTAs.

[3] Footnote original: Arts. 5(1) and 12(2). This seems to be based on the proposal in para. 31 of the commentary on OECD Model Art. 10 but without using nationality as a test.

If the taxpayer had emigrated to South Africa and therefore in law shed his UK domicile immediately, the UK would claim deemed domicile for three years,[4] which, coupled with the seven out of 10 years rule, would make him remain domiciled in the UK for three years for the purposes of the convention, assuming that he had UK, but not South African, nationality. After that he would no longer have a double domicile and South Africa has taxing rights. The UK would theoretically have a secondary taxing right under the convention because of his domicile there within the 10 previous years. But there is no internal law permitting a charge, except on the basis of situs where the convention would not otherwise allow a charge, on an insurance policy for example. In relation to settlements, where the settlor had dual domicile when the settlement was made, but a convention domicile at that time in South Africa, the UK will not charge unless he had a convention domicile within the UK during the 10 previous years, which again means applying the OECD Model tests over this period.[5] In cases where the UK can charge, that is to say where the settlor did have a UK convention domicile within the previous 10 years, or a convention domicile in the UK when the settlement was made, South Africa has a primary right to charge where the person with an interest in possession is domiciled (for the purposes of the convention) in South Africa at the date of charge, and the UK would have a secondary taxing right.[6] In cases where this is not applicable, either because it is a discretionary trust or the person with an interest in possession is not domiciled for the purpose of the convention in South Africa, the UK would charge under internal law.

These provisions have an interesting effect in relation to new arrivals from South Africa who might be interested in making a settlement while still domiciled in South Africa which will therefore be outside the UK charge to capital transfer tax. Assuming such a person has South African, but not UK, nationality and still remains ordinarily resident in South Africa he will have a convention domicile in South Africa after arrival in the UK for up to seven tax years, although it is unlikely that ordinary residence in South Africa will last that long. The convention prohibits the UK from charging tax under such a settlement, assuming that there is no question of his having a UK convention domicile within the previous 10 years. It seems that settlements can be made in such a

[4] Footnote original: Under FA 1975, s.45(1)(a). The convention prohibits the extension of this period and therefore para (b) is inapplicable: Art. 4(4).

[5] Footnote original: Art. 5(2).

[6] Footnote original: Art. 12(3).

case even after arrival in the UK.

117.2 Scope

Article 1 SA IHT DTA provides:

> This Convention shall apply to any person who is within the scope of a tax which is the subject of this Convention.

117.3 Taxes covered

Article 2(1) SA IHT DTA provides:

> The taxes which are the subject of this Convention are--
> (a) in the UK, the capital transfer tax [now IHT[7]];
> (b) in South Africa, the estate duty and the donations tax.

Article 2(2) SA IHT DTA extends the DTA to substantially similar taxes. The wording follows the OECD model.[8]

117.4 Definitions

The SA IHT DTA provides commonsense definitions of the following terms, which are not discussed here: SA; UK; Competent Authority; Contracting State.

Article 3(2) SA IHT DTA gives terms not otherwise defined their domestic law meanings, following OECD Model wording as it stood at the time of the DTA. See 107.12 (Undefined treaty terms).

Article 3 SA IHT DTA provides:

> (1) In this Convention, unless the context otherwise requires--
> (c) the term "nationals" means--
> (i) in relation to the UK, any citizen of the UK and Colonies, or any British subject not possessing that citizenship or the citizenship of any other Commonwealth country or territory, provided in either case he had the right of abode in the UK at the time of the death or transfer or other material time;
> (ii) in relation to South Africa, any citizen of South Africa;
> (d) the term "tax" means--
> (i) the inheritance tax imposed in the UK, or
> (ii) the estate duty or the donations tax imposed in South Africa,

[7] See 74.1.1 ("CTT" now refers to IHT). CTT/IHT are also "similar taxes" within art 2(2).

[8] See 114.4 (IHT DTAs: Taxes covered).

or

(iii) any other tax imposed by a Contracting State to which this Convention applies by virtue of the provisions of paragraph (1) of Article 2,

as the context requires; ...

(g) the term "transfer" includes, in the case of South Africa, a donation and the term "transferor" shall be construed accordingly.

117.5 Treaty-domicile

Article 4(1) SA IHT DTA provides:

> For the purposes of this Convention an individual was domiciled--
>
> (a) in the UK if
>
> [i] he was domiciled in the UK in accordance with the law of the UK or
>
> [ii] is treated as so domiciled for the purposes of a tax which is the subject of this Convention;[9]
>
> (b) in South Africa if he was ordinarily resident in South Africa.

Article 4 SA IHT DTA then sets out two tie-breakers:

> (2) Subject to the provisions of paragraph (4) of this Article, where by reason of the provisions of paragraph (1) of this Article an individual was at any time domiciled in both Contracting States, and
>
> (a) was a national of the UK but not of South Africa, and
>
> (b) had not been resident or ordinarily resident in South Africa in seven or more of the ten income tax years of assessment immediately preceding that time,
>
> then he shall be deemed to be domiciled at that time in the UK.
>
> (3) Subject to the provisions of paragraph (4) of this Article, where by reason of the provisions of paragraph (1) of this Article an individual was at any time domiciled in both Contracting States, and
>
> (a) was a national of South Africa but not of the UK, and
>
> (b) had not been resident or ordinarily resident in the UK in seven or more of the ten income tax years of assessment ending with the year of assessment in which that time falls,
>
> then he shall be deemed to be domiciled at that time in South Africa. For the purposes of this paragraph the question whether an individual was resident or ordinarily resident in the UK shall be determined as for the purposes of income tax, but without regard to any dwelling-house

[9] Para (a) is standard wording, discussed at 114.5 (Treaty-domicile).

> available in the UK for his use.
> (4) An individual shall not, by virtue of paragraph (2) or (3) of this Article, be deemed to be domiciled at any time in a Contracting State if, under the law of that Contracting State other than its law relating to a tax which is the subject of this Convention, he had ceased to be domiciled in that Contracting State more than three years before that time.

If these tie-breakers fail to break the tie, then standard form OECD model tie-breakers apply.[10] Article 4(5) SA IHT DTA provides:

> Where by reason of the provisions of paragraph (1) of this Article, an individual was domiciled in both Contracting States, then, subject to the provisions of paragraphs (2), (3) and (4) of this Article, his status shall be determined as follows--
> (a) he shall be deemed to be domiciled in the Contracting State in which he had a permanent home available to him. If he had a permanent home available to him in both Contracting States, the domicile shall be deemed to be in the Contracting State with which his personal and economic relations were closer (centre of vital interests);
> (b) if the Contracting State in which he had his centre of vital interests cannot be determined, or if he had not a permanent home available to him in either Contracting State, the domicile shall be deemed to be in the Contracting State in which he had an habitual abode;
> (c) if he had an habitual abode in both Contracting States or in neither of them, the domicile shall be deemed to be in the Contracting State of which he was a national; and
> (d) if he was a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

117.6 Treaty reliefs

117.6.1 *Non-settled property*

Article 5(1) SA IHT DTA provides:

> Subject to the provisions of Articles 6, 7, 8 and 9 and the following paragraphs of this Article, if the deceased or the transferor was domiciled in, one of the Contracting States at the time of the death or

[10] See 9.11 (Tie-breaker tests: Individuals).

> transfer, property shall not be taxable in the other Contracting State unless he had been domiciled in the other Contracting State within the ten years immediately preceding the death or transfer.

The four exceptions referred to are:

Article	**Topic**	**See para**
6	Immovable property	117.8
7	Business property	117.9
8	Ships/aircraft	117.10
9	Shares/debentures/unit trusts	117.11

117.6.2 *Settled property*

Article 5(2) SA IHT DTA provides:

> [a] Paragraph (1) of this Article shall not apply in the UK to property comprised in a settlement;
> [b] but, subject to the provisions of Articles 6, 7, 8 and 9, such property shall not be taxable in the UK if at the time when the settlement was made
> [i] the settlor was domiciled in South Africa and
> [ii] had not been domiciled in the UK within the immediately preceding ten years.

117.7 Requirement to pay foreign tax

Article 5(3) SA IHT DTA provides:

> If by reason of paragraph (1) of this Article any property would be taxable only in one Contracting State and tax, though chargeable, is not paid (otherwise than as a result of a specific exemption, deduction, credit or allowance) in that Contracting State, tax may be imposed by reference to that property in the other Contracting State notwithstanding that paragraph.

117.8 Immovable property

Article 6(1) SA IHT (more or less) follows the OECD IHT Model.DTA:

> Immovable property may be taxed in the Contracting State in which such property is situated.

Article 6(2) SA IHT DTA defines "immovable property" in (more or less) OECD Model form:[11]

[11] See 24.7.1 ("Immovable property").

> (2) The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated provided always that debts secured by mortgage or otherwise shall not be regarded as immovable property. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.
>
> (3) The provisions of paragraphs (1) and (2) of this Article shall also apply to immovable property of an enterprise and to immovable property used for the performance of independent personal services.

117.9 Business property

Article 7 SA IHT DTA provides:

> (1) Except for assets referred to in Articles 6, 8 and 9, assets forming part of the business property of a permanent establishment of an enterprise may be taxed in the Contracting State in which the permanent establishment is situated.
>
> (2) --
>
> (a) For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
>
> (b) The term "permanent establishment" includes especially--
>
> (i) a place of management;
>
> (ii) a branch;
>
> (iii) an office;
>
> (iv) a factory;
>
> (v) a workshop;
>
> (vi) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources; and
>
> (vii) a building site or construction or installation project which exists for more than 12 months.
>
> (c) Notwithstanding the preceding provisions of this paragraph, the term "permanent establishment" shall be deemed not to include--
>
> (i) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;

(ii) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

(iii) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(iv) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

(v) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; or

(vi) the maintenance of a fixed place of business solely for any combination of activities mentioned in (i) to (v) of this sub-paragraph provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

(d) Notwithstanding the provisions of sub-paragraphs (a) and (b), where a person--other than an agent of an independent status to whom sub-paragraph (e) applies--is acting on behalf of an enterprise and has, and habitually exercises in a Contracting State, an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in sub-paragraph (c) which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that sub-paragraph.

(e) An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

(f) The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

(3) Except for assets described in Article 6, assets pertaining to a fixed base used for the performance of independent personal services may be

taxed in the Contracting State in which the fixed base is situated.

117.10 Ships and aircraft

Article 8 SA IHT DTA provides:

> Ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft may be taxed in the Contracting State in which the place of effective management of the enterprise is situated.

117.11 Shares/debentures/unit trusts

Article 9 SA IHT DTA provides:

> Property consisting of--
> (a) shares, stock, debentures and debenture stock issued by companies incorporated in one of the Contracting States (including any such property falling within the provisions of Article 7 [business property), and
> (b) rights of unit holders in any unit trust scheme where the register of unit holders is kept in one of the Contracting States,
> may be taxed by that Contracting State.

117.12 Dual nature property

Article 10(1) SA IHT DTA provides:

> If the deceased or the transferor was domiciled in one of the Contracting States at the time of death or transfer, and
> (a) by the law of that Contracting State any right or interest is regarded as property not falling within Articles 6, 7, 8, or 9, but
> (b) by the law of the other Contracting State that right is regarded as property falling within those Articles.
> then the Article of the Convention under which the property falls shall be determined by the law of the other Contracting State.

117.13 Dual situate property

Article 10(2) SA IHT DTA provides:

> If the deceased or the transferor was domiciled in neither Contracting State at the time of the death or transfer, and each Contracting State would regard any property as situated in its territory and in consequence tax would be imposed in both Contracting States, the competent authorities shall determine the situs of the property by mutual agreement.

117.14 Deductions/allowances/reliefs

Article 11(1) SA IHT DTA provides:

> In determining the amount on which tax is to be computed permitted deductions shall be allowed in accordance with the law in force in the territory in which the tax is imposed.

Article 11(1) is found in several IHT DTAs; for discussion, see 114.9 (Deductions for DTA purposes).

Article 11(2) SA IHT DTA provides:

> Nothing contained in this Convention shall be construed as obliging either Contracting State to grant to individuals not domiciled in that Contracting State, or to the estates of such individuals, any of the personal allowances, reliefs, and reductions for tax purposes which are granted to individuals so domiciled, or to their estates.

117.15 Foreign tax credit

Article 12 SA IHT DTA provides:

> (1) Where a Contracting State imposes tax in connection with any event by reference to any property which the other Contracting State may tax in accordance with Articles 6, 7, 8 or 9, the former Contracting State shall allow against so much of its tax (as otherwise computed) as is attributable to such property a credit (not exceeding the amount of tax so attributable) equal to so much of the tax imposed in the other Contracting State in connection with the same event as is attributable to such property.
>
> (2) Subject to paragraph (3) of this Article, where a Contracting State imposes tax in connection with any event by reference to any property not referred to in paragraph (1) of this Article and the deceased or transferor was domiciled in the other Contracting State at the time of the death or transfer, the first-mentioned Contracting State shall allow against so much of its tax (as otherwise computed) as is attributable to such property a credit (not exceeding the amount of tax so attributable) equal to so much of the tax imposed in the other Contracting State in connection with same event as is attributable to such property.
>
> (3) Where--
>
> (a) under paragraph (2) of Article 5 the UK imposes tax in connection with any event by reference to any property which is not referred to in paragraph (1) of this Article and which is comprised in the settlement in which an interest in possession subsists, and

> (b) at the time of the event giving rise to the liability to tax the individual entitled to that interest was domiciled in South Africa.
>
> the UK shall allow against so much of its tax (as otherwise computed) as attributable to such property a credit (not exceeding the amount of tax so attributable) equal to so much of the tax imposed in South Africa in connection with the same event as attributable to such property.
>
> (4) For the purposes of this Article--
>
> (a) the tax attributable to any property imposed in a Contracting Sate is tax as reduced by the amount of any credit imposed in a territory other than a Contracting State;
>
> (b) tax is imposed in a Contracting State if its is chargeable under the law of that Contracting State and duly paid; and
>
> (c) where tax is imposed on the death of a transferor by reason of a transfer made within the three years immediately preceding the death of a transfer in the transferor's estate or otherwise with respect of the transfer, that tax shall be treated as if it were imposed in connection with that transfer.

117.16 Time limit

Article 13 SA IHT DTA provides:

> Any claim for a credit or for a repayment of tax founded on the provisions of this Convention shall be made within six years from the date of the event giving rise to a liability to tax or, where later, within one year from the last date on which tax for which credit is given is due. The competent authority of a Contracting State may, in appropriate circumstances, extend this time limit where the final determination or the payment of tax in the other Contracting State is delayed.

117.17 Non-discrimination

Article 14 SA IHT DTA provides:

> (1) The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other Contracting State in the same circumstances are or may be subjected.
>
> (2) The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other Contracting State than the taxation levied on enterprises of that other Contracting State carrying on the

same activities.

(3) Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of that first mentioned State are or may be subjected.

(4) Nothing contained in this Article shall be construed as restricting the provisions of paragraph (2) of Article 11.

(5) In this Article the term "taxation" means taxes covered by this Convention.

117.18 Other articles

The following articles of the SA IHT DTA are standard form and not discussed here:

Article	**Topic**
15	Mutual agreement procedure
16	Exchange of information
17	Diplomatic and consular officials
18	Entry into force
19	Termination

CHAPTER ONE HUNDRED AND EIGHTEEN

IHT DTA: SWITZERLAND

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Cross references

Issues which the Swiss IHT DTA has in common with other treaties are discussed elsewhere:

Topic	**See para**
Introduction to IHT DTAs	114.1
Claims for IHT DTA reliefs	114.7
Nil rate band and DTAs	114.8
France/Italy IHT credit	120.7
Deductions for DTA purposes	114.9

118.1 Swiss IHT treaty

This chapter considers the IHT treaty with Switzerland, which I call the "Swiss IHT DTA".[1]

The Swiss treaty does not follow the OECD IHT Models.[2] Avery Jones

[1] For some reason DTAs do not have short titles. The long title is: "The Convention between the UK of Great Britain and Northern Ireland and the Swiss Federation for the avoidance of double taxation with respect to taxes on estates and inheritances"; SI 1994/3214

[2] See 114.3 (OECD IHT Models).

explains why:

> Switzerland, or strictly the Swiss Cantons, tax worldwide assets if the deceased was resident but tax only immovable property on a situs basis if the deceased was not resident. The Swiss Cantons do not give any relief for double taxation except on foreign immovable property; the UK gives probably the most generous unilateral relief in the world. Thus in almost all cases the UK could only lose from the treaty and Switzerland could gain...
>
> The result was that the normal [OECD Model] pattern applies only in single domicile cases,[3] and a different approach is adopted in cases of dual domicile. Here it is the situs state which has primary taxation rights, and not the treaty domicile state.[4] The treaty domicile merely determines the extent of secondary taxing rights in the UK: in all cases if treaty domicile was in the UK but only on UK nationals domiciled in the UK within the previous five years if treaty domicile was in Switzerland.[5] Switzerland retains no secondary taxing rights.
>
> The logic of the treaty seems to be that in a dual domicile case there would be unrestricted taxing rights under internal law and these should not be given up completely to the other state merely on account of the application of the tie-breaker rules. Thus the UK is giving up the minimum amount of tax in such a case. When the UK wins under the tie-breaker it gives up taxing rights only to the extent of giving credit for Swiss tax on Swiss property; when the UK loses under the tie-breaker it gives up nothing in relation to UK situs property, and in relation to other property it only retains the right to tax British nationals who have recently gone to live in Switzerland. From the point of view of Switzerland, Switzerland has no secondary taxing rights, so that it gives up all taxing rights over UK situs property if it wins under the tie-breaker, and over all non-Swiss situs property if it loses. ...
>
> The worst feature of the treaty is the drafting ... First it deals with property situated in one of the states, with different primary taxing rights stated for single and dual domicile cases, to which there are three different UK secondary taxing rights. Next the primary taxing rights are set out for third state assets, again with a different rule for single and dual domicile cases, with a secondary taxing right for the UK, which is

[3] Footnote original: The UK has a secondary taxing right over shares in UK incorporated companies which is a reservation the UK made in the OECD Model estate tax treaty and sometimes succeeded in including in its treaties.

[4] Footnote original: Art. 8(1)(a)(ii) and 8(1)(b)(ii).

[5] Footnote original: Art 8(3), (4).

the same as one of the previous ones but set out again. By the end the reader is hopelessly lost. In tabular form it looks like this for property other than immovable property, business permanent establishments and ships and aircraft:

	Sole domicile in UK	**Sole domicile in Switzerland**
Property not covered by situs charges[6]	UK: sole taxing right	Switzerland: primary taxing right UK: secondary taxing right on shares in UK incorporated companies
	Tie-breaker UK domicile	**Tie-breaker Swiss domicile**
UK other property	UK: Sole taxing right Switzerland: none	UK Sole taxing right Switzerland: none
Swiss other property	Switzerland: primary taxing right UK: Secondary taxing right	Switzerland: primary taxing right UK: secondary taxing right if UK (only) national domiciled within the previous 5 years
Third state other property	UK: sole taxing right Switzerland: none	Switzerland: primary taxing right UK: secondary taxing right if UK (only) national domiciled within the previous 5 years[7]

118.2 Scope

Article 1 Swiss IHT DTA provides:

> This Convention shall apply:
>
> (a) to estates and inheritances where the deceased was domiciled, at the time of his death, in one or both of the Contracting States; and
>
> (b) to property comprised in a settlement made by a person who was domiciled, at the time the settlement was made, in one or both of the Contracting States.

118.3 Taxes covered

Article 2(1) Swiss IHT DTA provides:

> The existing taxes to which this Convention shall apply are:
>
> (a) in the UK, the inheritance tax, insofar as it applies to the estate

[6] Immovable property, business establishments and ships/aircraft.

[7] Avery Jones, "The New Inheritance Double Taxation Agreement with Switzerland" [1995] BTR 1.

> of a deceased person (hereinafter referred to as "UK tax");
>
> (b) in Switzerland, the cantonal and communal taxes imposed on estates and inheritances (hereinafter referred to as "Swiss tax").

Thus there is no relief for IHT on lifetime gifts or for 10-year/exit charges on trusts. There is relief for trusts conferring an estate interest in possession.

Article 2(2) Swiss IHT DTA extends the DTA to substantially similar taxes. The wording follows the OECD Model.[8]

118.4 Definitions

The DTA provides commonsense definitions of the following terms, which are not set out here: UK; Switzerland; Contracting State; Enterprise; Competent Authority; tax.

Article 3(2) Swiss IHT DTA gives terms not otherwise defined their domestic law meanings, following OECD Model wording, as it stood at the time of the DTA.[9]

118.4.1 *"National"*

Article 3(1)(g) Swiss IHT DTA provides:

> (g) the term "national" means:
>
> (i) in relation to the UK, any British citizen or any British subject not possessing the citizenship of any other Commonwealth country or territory, provided he has the right of abode in the UK and any legal person, partnership, association or other entity deriving its status as such from the law in force in the UK;
>
> (ii) in relation to Switzerland, any Swiss citizen and any legal person, partnership, association or other entity deriving its status as such from the law in force in Switzerland;

118.5 Treaty-domicile

Article 4 Swiss IHT DTA defines domicile for the purposes of the USA IHT DTA ("**treaty-domicile**").

118.5.1 *UK domicile under art 4(1)*

Article 4(1) Swiss IHT DTA provides:

[8] See 114.4 (IHT DTAs: Taxes covered).

[9] See 107.12 (Undefined treaty terms).

> For the purposes of this Convention, a deceased person was domiciled:
>
> (a) in the UK if
>
> [i] he was domiciled in the UK in accordance with the law of the UK or
>
> [ii] is treated as so domiciled for the purposes of a tax which is the subject of the Convention;[10]

I refer to this as **"UK domiciled under art 4(1)"**.

118.5.2 *Swiss domicile under art 4(1)*

Article 4(1) Swiss IHT DTA provides:

> For the purposes of this Convention, a deceased person was domiciled...
>
> (b) in Switzerland if he was domiciled or was resident in Switzerland in accordance with the law of Switzerland or if he was a Swiss national and Swiss civil law requires his succession to be ruled in Switzerland.

I refer to this as **"Swiss domiciled under art 4(1)"**.

This appears to mean that a person was domiciled in Switzerland if:

> [i] he was domiciled *in Switzerland in accordance with the law of Switzerland* or
>
> [ii] was resident in Switzerland in accordance with the law of Switzerland or
>
> [iii] if he was a Swiss national and Swiss civil law[11] requires his succession to be ruled in Switzerland.

That is, the phrase "and Swiss civil law requires his succession to be ruled in Switzerland" only governs [iii].

The definition of domiciled/resident in Switzerland in accordance with the law of Switzerland is crucial: this is a matter of Swiss law.[12]

[10] Para (a) is standard wording, discussed at 114.5 (Treaty-domicile).

[11] The 1993 Protocol provides: "The reference to Swiss civil law concerns chapter 6 of the loi fédérale sur le droit international privé [Federal Code on Private International Law] of 18th December 1987." An English translation is available on *https://www.hse.ru/data/2012/06/08/1252692468/SwissPIL%20%D0%B2%20%D1%80%D0%B5%D0%B4.%202007%20(%D0%B0%D0%BD%D0%B3%D0%BB.).pdf*

[12] See (1) Swiss Civil Code art. 22 -26 (domicile) An English translation is available on *https://www.admin.ch/opc/en/classified-compilation/19070042/index.html#a22)* (2) art.20 loi fédérale sur le droit international privé (Domicile, Residence, and Citizenship).

118.5.3 *Taxation by situs only*

Article 4(1) Swiss IHT DTA continues:

> However, a deceased person shall be deemed not to be domiciled in one of the States if that State imposes tax only by reference to property situated in that State.

This does not apply to the UK; it is relevant in Switzerland.

118.5.4 *Tie breaker*

Article 4(2) Swiss IHT DTA sets out a series of tie-breakers to deal with persons who under art 4(1) would be domiciled in both jurisdictions:

> Where by reason of the provisions of paragraph (1) of this Article a deceased person was domiciled in both States, then, subject to the provisions of the attached Protocol, his status shall be determined as follows:
>
> (a) he shall be deemed to have been domiciled in the State in which he had a permanent home available to him; if he had a permanent home available to him in both States, he shall be deemed to have been domiciled in the State with which his personal and economic relations were closer (centre of vital interests);
>
> (b) if the State in which he had his centre of vital interests cannot be determined, or if he did not have a permanent home available to him in either State, he shall be deemed to have been domiciled in the State in which he had an habitual abode;
>
> (c) if he had an habitual abode in both States or in neither of them, he shall be deemed to have been domiciled in the State of which he was a national;
>
> (d) if he was a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

This is standard OECD Model wording.[13]

118.5.5 *Temporary employment*

The 1993 Protocol provides:

(3) OECD "Switzerland - Information on residency for tax purposes" *https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/Switzerland-Residency.pdf*

[13] See 9.11 (Tie-breaker tests: Individuals).

> (1) With reference to Article 4:
> An individual
>
> [i] who was a national of one of the Contracting States without being a national of the other Contracting State and
>
> [ii] who was domiciled in the State of which he was a national immediately before coming to the other State
>
> shall not be domiciled in the other State for the purposes of this Convention if:
>
> (a) [i] he was temporarily present in that other State by reason only of his employment or
>
> [ii] was a spouse or other dependent of a person temporarily in that other State for such purpose; and
>
> (b) that individual had retained the domicile of the State of which he was a national; and
>
> (c) that individual had no intention of becoming a permanent resident of the other Contracting State.

This could help a Swiss national who is a long term employee in the UK as it could confer better treaty relief even after they become deemed UK domiciled, but that will not often arise. It could similarly hinder a UK national who is an employee in Switzerland as it could prevent them claiming relief.

Avery Jones explains:

> This is different from the equivalent provision in other treaties in that there is no time limit and it is restricted to employment. An unsatisfactory feature ... is that it is contained in a Protocol applying "with reference to article 4", and provisions of the treaty make a distinction between a person who is domiciled solely in one or in both states by virtue of article 4(1) of the treaty.[14] Where this provision applies the person may well be domiciled in both states under that article, but it is presumed that, as the effect of this provision is to give a single domicile, on a purposive construction this is to be treated as overriding the literal effect of article 4(1).[15]

118.5.6 *Types of domicile*

The Swiss IHT DTA distinguishes between:

(1) "A person domiciled by virtue of the provisions of paragraph (1) of

[14] Arts. 8(1)(a), 8(1)(1)(b).

[15] Avery Jones, "The New Inheritance Double Taxation Agreement with Switzerland" [1995] BTR 1.

Article 4 solely in one of the Contracting States". I call that "**solely UK/Swiss domiciled**".

(2) "A person domiciled by virtue of the provisions of paragraph (1) of Article 4 in both Contracting States". I call that "**tie-breaker UK/Swiss domiciled**". Someone who is tie-breaker Swiss domiciled is UK domiciled under art 4(1) but treaty-domiciled in Switzerland because of the tie-breaker clause in art 4(2).

118.6 IHT exemptions

There are special rules for immovable property and permanent establishments (articles 5 and 6 discussed below) and ships/aircraft (article 7, not discussed here).

Subject to that, Article 8 Swiss IHT DTA provides various exemptions for individuals, which depend on domicile and situs.

118.6.1 *Situs rule*

The 1993 Protocol provides:

> (3) With reference to Article 8:
> The situs of any property dealt with in that Article shall be determined by the law of the UK in effect at the date of entry into force of this Convention.

Avery Jones explains:

> Given the importance given to situs it is surprising to find tucked away in the Protocol that this is to be determined by UK [sic] law[16] in force at the date of the entry into force of the treaty. Since Swiss Cantons tax only immovable property of those resident outside the Canton presumably there is no reason for Swiss law to have any situs rules, so they had to borrow the UK's and hide their embarrassment by putting it in the Protocol. If there is a conflict over whether property falls within the property taxable on a situs basis, immovable property, business establishments and ships and aircraft, this is determined by the state of non-treaty domicile in the same way as our other treaties.[17] This is likely to occur in relation to the question whether partnerships, trusts and

[16] Footnote original: Since English and Scots law could give a different answer, for example in relation to a specialty debt, the concept of which is unknown in Scotland, it is presumed that situs would be in practice be determined by the law of the applicable part of the UK. See 102.18.2 (Situs in Scots law).

[17] Footnote original: Art. 10(1).

unadministered estates are transparent.[18]

118.7 Solely Swiss domicile

118.7.1 *Swiss/UK property*

Article 8 Swiss IHT DTA provides:

> (1) Subject to the following provisions of this Convention:
> (a) property
> [i] not dealt with in Articles 5, 6 and 7
> [ii] which is situated in either Contracting State and
> [iii] forms part of the estate of a person ... (i) domiciled by virtue of the provisions of paragraph (1) of Article 4 solely in one of the Contracting States ...
> shall, subject to paragraph (2) of this Article, be taxable only in that latter Contracting State;

To this rule there are four exceptions. Firstly articles 5, 6, 7 (land, PEs, ships/ aircraft). Secondly, shares in UK incorporated companies, as art 8(2) provides:

> Shares in a company incorporated in the UK which form part of the estate of a person domiciled by virtue of the provisions of paragraph (1) of Article 4 solely in Switzerland at the time of his death may also be taxed in the UK.

These are quite large exceptions, but this treaty exemption provides relief for:

(1) Other UK situate property: eg UK situate loans, debentures, chattels, bank accounts

(2) Sch A1 (de-excluded) property[19]

This could be particularly useful for UK situate chattels, residence-companies, and relevant (de-excluded) loans (in short, a loan to buy a UK residence).

118.7.2 *Non-UK/Non-Swiss property*

I refer to property outside the UK and Switzerland as "**third-country property**".

[18] Avery Jones, "The New Inheritance Double Taxation Agreement with Switzerland" [1995] BTR 1.

[19] See 82.2 (De-exclusion of sch A1 property) and 82.18 (DTA override).

Article 8 Swiss IHT DTA provides

> (1) Subject to the following provisions of this Convention...
> (b) property not dealt with in Articles 5, 6 and 7 which is not situated in either Contracting State and forms part of the estate of a person:
> (i) domiciled by virtue of the provisions of paragraph (1) of Article 4 solely in one of the Contracting States shall be taxable only in that Contracting State;

Before 2017, art.8(1)(b)(i) is not relevant for IHT since non UK situate property of a solely Swiss domiciliary was excluded property.[20] But now the rule is be important for sch A1 property which is de-excluded under the IHT residential-property code.

118.8 Tie-breaker Swiss domicile

118.8.1 *Swiss property*

Article 8(1) Swiss IHT DTA provides:

> (1) Subject to the following provisions of this Convention:
> (a) property
> [i] not dealt with in Articles 5, 6 and 7
> [ii] which is situated in either Contracting State and
> [iii] forms part of the estate of a person ... (ii) domiciled by virtue of the provisions of paragraph (1) of Article 4 in both Contracting States
>
> shall, subject to paragraph (3) of this Article, be taxable only in the Contracting State in which it is situated;

Thus in principle Swiss situate property of a tie-breaker Swiss domiciliary qualifies for treaty IHT exemption on death even though not of course excluded property (because the individual is actually UK domiciled or IHT deemed domiciled). However five wide exceptions greatly restrict the scope of the rule. The first four are the exceptions mentioned above: articles 5, 6, 7 and 8(2) (UK land, PEs, ships and aircraft, and shares in UK companies.) Lastly, article 8(3) provides:

> Any property which is situated in Switzerland and which would be taxable only in Switzerland under paragraph (1)(a)(ii) of this Article may

[20] Except residence-value property, see 82.2 (De-exclusion of sch A1 property) and 82.18 (DTA override).

> also be taxed in the UK if the deceased was:
>
> (a) by virtue of the provisions of paragraph (2) of Article 4 domiciled in the UK at the time of his death; or
>
> (b) by virtue of those provisions domiciled in Switzerland at the time of his death but:
>
> (i) had been domiciled [ie treaty-domiciled] in the UK at any time within the five years preceding his death; and
>
> (ii) was at that time a national of the UK without being a national of Switzerland.

Thus a person who is a UK national[21] cannot take advantage of this treaty IHT exemption until they have been treaty-domiciled in Switzerland for 5 years. A UK national cannot avoid IHT by becoming treaty-domiciled in Switzerland shortly before death. However a non-UK national who is actually UK domiciled or IHT deemed domiciled could in principle do so.

118.8.2 *Non-UK/Non-Swiss property*

I refer to property outside the UK and Switzerland as "**third-country property**".

Article 8 Swiss IHT DTA provides

> (1) Subject to the following provisions of this Convention...
>
> (b) property not dealt with in Articles 5, 6 and 7 which is not situated in either Contracting State and forms part of the estate of a person ...
>
> (ii) domiciled by virtue of the provisions of paragraph (1) of Article 4 in both Contracting States shall, subject to paragraph (4) of this Article, be taxable only in the Contracting State in which, under paragraph (2) of Article 4, the deceased was domiciled at the time of his death.

In principle third-country property of a tie-breaker Swiss domiciliary qualifies for treaty IHT exemption on death even though not of course excluded property (because the individual is actually UK domiciled or deemed domiciled). However five wide exceptions greatly restrict the scope of the rule. The first four are the exceptions mentioned above: articles 5, 6, 7 and 8(2) (UK land, PEs, ships and aircraft, and shares in UK companies.) Lastly, article 8(4) Swiss IHT DTA provides a rule equivalent to article 8(3):

[21] Unless also a Swiss national, ie a dual national.

> Any property which is not situated in either Contracting State and which would be taxable only in Switzerland under paragraph (1)(b)(ii) of this Article may also be taxed in the UK if the deceased:
> (a) had been domiciled [ie treaty-domiciled] in the UK at any time within the five years preceding his death; and
> (b) was at that time a national of the UK without being a national of Switzerland.

Thus a person who is a UK national[22] cannot take advantage of this treaty IHT exemption until they have been treaty-domiciled in Switzerland for 5 years. A UK national cannot avoid IHT by becoming treaty-domiciled in Switzerland shortly before death. However a non-UK national who is actually UK domiciled or deemed domiciled could in principle do so.

118.9 IHT spouse exemption extended

Under domestic IHT law, the usual IHT spouse exemption may be restricted when the transferor is UK domiciled and the spouse is foreign domiciled.[23] Article 10(2) Swiss IHT DTA restricts this restriction:

> Property which passes to the spouse from a deceased person who was domiciled in or a national of Switzerland and which may be taxed in the UK shall, where:
> (a) the spouse was not domiciled in the UK but the transfer would have been wholly exempt had the spouse been so domiciled, and
> (b) a greater exemption for transfers between spouses would not have been given under the law of the UK apart from this Convention,
> be exempt from tax in the UK to the extent of 50 per cent of the value transferred, calculated as a value on which no tax is payable and after taking account of all exemptions except those for transfers between spouses.

Civil partners are not mentioned (as the treaty was made before the introduction of civil partnerships). One might construe spouse widely, to include "civil partner", particularly if Swiss tax law treats civil partners like spouses.

118.10 Immovable property

Article 5 (more or less) follows the OECD IHT Model.

[22] Unless also a Swiss national, ie a dual national.

[23] See 93.2 (Restricted IHT spouse exemption).

Article 5(1) Swiss IHT DTA provides:

> Immovable property which forms part of the estate of a person domiciled in a Contracting State and which is situated in the other Contracting State may be taxed in that other State.

Article 5(2) Swiss IHT DTA defines "immovable property" in (more or less) OECD Model form:[24]

> [a] The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated provided always that debts secured by mortgage or otherwise shall not be regarded as immovable property.
> [b] The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, an interest in the proceeds of sale of land which is held on trust for sale, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources;
> [c] ships and aircraft shall not be regarded as immovable property.

Article 5(3) Swiss IHT DTA deals with the interaction of articles 5 (immovable property) and 6 (business property):

> The provisions of paragraphs (1) and (2) of this Article shall also apply to immovable property of an enterprise and to immovable property used for the performance of professional services or other activities of an independent character.

Article 5 (more or less) follows the OECD IHT Model.

118.11 Business property

Article 6(1) Swiss IHT DTA provides:

> Except for assets referred to in Articles 5 and 7 and in paragraph (2) of Article 8, movable property of an enterprise which forms part of the estate of a person domiciled in a Contracting State which is the business property of a permanent establishment situated in the other Contracting State, may be taxed in that other State.

[24] See 24.7.1 ("Immovable property").

This (more or less) follows the OECD IHT Model.

I do not set out the lengthy provisions relating to permanent establishment, since this will rarely arise. They broadly follow the OECD IT/CG Model.

118.12 Other articles

The following articles of the Swiss IHT DTA are standard form and not discussed here:

Article	**Topic**
11	Non-discrimination
12	Mutual agreement procedure
13	Exchange of information
14	Diplomatic and consular officials
15	Entry into force
16	Termination

CHAPTER ONE HUNDRED AND NINETEEN

IHT DTA: USA

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Cross references

Issues which the USA IHT DTA has in common with other treaties are discussed elsewhere:

Topic	**See para**
Introduction to IHT DTAs	114.1
Claims for IHT DTA reliefs	114.7
Nil rate band and DTAs	114.8
France/Italy IHT credit	120.7
Deductions for DTA purposes	114.9

119.1 USA IHT treaty

This chapter considers the IHT treaty with the USA, which I call the "USA IHT DTA".[1]

[1] *http://uniset.ca/misc/us-uk_esttax.html*
For some reason DTAs do not have short titles. The full title is: "the Convention between the Government of the USA and the Government of the UK for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates of deceased persons and on gifts"; SI 1979/1454

119.1.1 *US/OECD Models compared*

US Treasury say:[2]

> **Question 1.** Explain the origin and development of the model estate and gift tax convention published by the Department of Treasury in 1977.
> **Answer.** The U.S. Treasury Department released its "model" estate and gift tax treaty on March 16, 1977 ... The general principle underlying the model is to grant to the country of domicile the right to tax the worldwide estate or gifts of a decedent or donor, with a credit for tax paid to the other State with respect to real property and business assets located therein.
> The emphasis on domiciliary-basis taxation also explains the origin of the model. All U.S. estate and gift tax treaties negotiated between 1946 and 1956 contain a comprehensive set of situs rules. Double taxation is eliminated by awarding the situs state the primary right to tax a given type of property. In 1966, however, the OECD published a model state tax convention (Draft Double Taxation Convention on Estates and Inheritances). The OECD model, which the United States helped develop, provides for domiciliary-basis taxation. ... Thus, the U.S. model estate and gift tax treaty reflects both the internationally-accepted concepts in the OECD model and our current treaty position.

119.1.2 *US Model & UK/USA DTA compared*

US Treasury say:[3]

> **Question 2.** Does the U.S.-U.K. Estate and Gift Tax Treaty differ from the U.S. model treaty, and if so, please explain the policy reasons for the difference.
> **Answer.** The U.S.-U.K. Estate and Gift Tax Treaty is similar, but not identical, to the model. It is similar in that both follow the principle of domiciliary-basis taxation. That is, the country of domicile may tax the worldwide estate or gifts of a decedent or donor. Immovable property and certain business assets are taxable in the Contracting State where situated.

[2] Written Responses by Treasury to Questions by the Committee Staff (1979) *https://uniset.ca/misc/us-uk1980.html*

[3] Written Responses by Treasury to Questions by the Committee Staff (1979) *https://uniset.ca/misc/us-uk1980.html*

> The U.S.-U.K. treaty is different from the model in that it includes the tax on generation-skipping transfers, imposed by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. This is purely a matter of timing. Although the model was not published until 1977, it was developed early in 1976. Consequently, it does not include the estate and gift tax modifications in the Tax Reform Act of 1976, which was signed in October of that year.
>
> Unlike the model, the U.S.-U.K. treaty does not provide for a reciprocal exemption of $30,000 for property that is taxable under the treaty on a situs basis. This part of the model refers to pre-Reform Act of 1976 law; the $30,000 exemption was converted to a $3,600 credit by the 1976 changes. This provision is not in the treaty because the U.K.'s capital transfer tax does not apply to the first £25,000 (roughly $50,000) of property transferred.

US Treasury have also published a technical explanation of the treaty.[4]

119.2 Scope

Article 1 USA IHT DTA provides:

> This Convention shall apply to any person who is within the scope of a tax which is the subject of this Convention.

Thus the DTA applies to trustees as well as to individuals, even if the trustees are not themselves US treaty-domiciled.

119.3 Taxes covered

Article 2(1) USA IHT DTA provides:

> The existing taxes to which this Convention shall apply are:
> (a) in the US: the Federal gift tax and the Federal estate tax, including the tax on generation-skipping transfers; and
> (b) in the UK: the capital transfer tax [now IHT[5]].

The DTA does not apply to US state taxes (though I do not know if there are any). In this respect the IHT DTA is similar to the IT/CGT DTA.[6]

Article 2(2) USA IHT DTA extends the DTA to substantially similar taxes. The wording follows the OECD model.[7]

[4] *https://uniset.ca/misc/us-uk1980.html*

[5] See 74.1.1 (“CTT” now refers to IHT).

[6] See 107.13.3 (Subdivisions/local authorities).

[7] See 114.4 (IHT DTAs: Taxes covered).

119.3.1 *"Tax"*

Article 3(1)(f) USA IHT DTA provides:

> the term "tax" means:
> (i) the Federal gift tax or the Federal estate tax, including the tax on generation-skipping transfers, imposed in the US, or
> (ii) the capital transfer tax [now IHT] imposed in the UK, or
> (iii) any other tax imposed by a Contracting State to which this Convention applies by virtue of the provisions of para (2) of Article 2 [substantially similar taxes], as the context requires.

119.4 Definitions

The USA IHT DTA provides commonsense definitions of the following terms, which are not discussed here: US; UK; Competent Authority; Contracting State.

Article 3(2) USA IHT DTA gives terms not otherwise defined their domestic law meanings, following OECD Model wording as it stood at the time of the DTA.[8]

119.4.1 *"National"*

Article 3(1)(e) USA IHT DTA provides:

> the term "nationals" means:
> (i) in relation to the US, US citizens, and
> (ii) in relation to the UK
> [A] any citizen of the UK and Colonies, or
> [B] any British subject not possessing that citizenship or the citizenship of any other Commonwealth country or territory,
> provided in either case he had the right of abode in the UK at the time of the death or a transfer.

119.4.2 *"Decedent"*

The USA IHT DTA uses the term "decedent" which is an Americanism for "deceased".

119.5 Treaty-domicile

Article 4 defines domicile for the purposes of the USA IHT DTA

[8] See 107.12 (Undefined treaty terms).

("**treaty-domicile**").

119.5.1 *US domicile under art 4(1)*

Article 4(1) USA IHT DTA provides:

> For the purposes of this Convention an individual was domiciled:
>
> (a) in the US:
>
> [i] if he was a resident (domiciliary) thereof or
>
> [ii] if he was a national thereof and had been a resident (domiciliary) thereof at any time during the preceding three years

I refer to this as **"US domiciled under art 4(1)"**.

The definition of "resident (domiciliary)" is crucial: this is a matter of USA law. It appears that the term "resident" here has a meaning broadly similar to "domiciled" in English law (there are some differences). The word in brackets (domiciliary) is intended as a synonym, or explanation, of "resident", in order to avoid confusion - though with perhaps the opposite effect.[9] It may aid clarity to write the word "resident" in this sense with scare quotation marks.

US Treasury say:[10]

> **Question 3.** How does the U.S.-U.K. treaty define domicile and how, or why, was this definition selected?
>
> **Answer.** ... The Convention uses the term "resident (domiciliary)" because U.S. domestic law equates the term "resident" with the term "domiciliary."
>
> The three-year rule simply parallels a provision in the U.K. capital transfer tax that a U.K. domiciliary will be deemed to be domiciled in the United Kingdom for a period of three years after a change of domicile is actually made. An individual is domiciled in the United Kingdom if he is (a) a U.K. domiciliary under general principles of U.K. law, or (b) treated as a U.K. domiciliary for purposes of the capital transfer tax.

US tax statutes do not define "resident" for estate and gift taxes (as they do for income and other taxes), but US Treasury Regulation 20.0-1(b)

[9] I am grateful to Ian Watson of 3 Stone Buildings, Lincoln's Inn for his help on this point.

[10] Written Responses by Treasury to Questions by the Committee Staff (1979) *https://uniset.ca/misc/us-uk1980.html*

states so far as relevant:

> A "resident" decedent is a decedent who, at the time of his death, had his domicile in the United States ... A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.[11]

I understand that a green card holder is not a "resident" of the US, for US estate tax purposes, unless domiciled in the relevant sense.

119.5.2 *UK domicile under art 4(1)*

Article 4(1) USA IHT DTA provides:

> For the purposes of this Convention an individual was domiciled: ...
> (b) in the UK:
> [i] if he was domiciled in the UK in accordance with the law of the UK
> [ii] or is treated as so domiciled for the purpose of a tax which is the subject of this Convention.[12]

I refer to this as **"UK domiciled under art 4(1)"**.

119.5.3 *Tie-breakers*

It is possible to be treaty domiciled under art 4(1) in both States (eg a US "resident" who is also deemed UK domiciled). So there are a series of tie-breakers to deal with this. It is helpful to read art 4(2)(3) side by side:

Art 4(2): UK national	**Art 4(3): US national**
Where by reason of the provisions of para (1) an individual was at any time domiciled in both Contracting States, and	Where by reason of the provisions of para (1) an individual was at any time domiciled in both Contracting States, and
(a) was a national of the UK but not of the US, and (b) had not been resident in the US	(a) was a national of the US but not of the UK, and (b) had not been resident in the UK

[11] *https://www.govinfo.gov/content/pkg/CFR-2008-title26-vol14/pdf/CFR-2008-title26-vol14-sec20-0-1.pdf*

[12] Para (a) is standard wording, discussed at 114.5 (Treaty-domicile).

for Federal income tax purposes in seven or more of the ten taxable years ending with the year in which that time falls,	in seven or more of the ten income tax years of assessment ending with the year in which that time falls,
he shall be deemed to be domiciled in the UK at that time.	he shall be deemed to be domiciled in the US at that time
	For the purposes of this paragraph, the question of whether a person was so resident shall be determined as for income tax purposes but without regard to any dwelling-house available to him in the UK for his use.

The last sentence of art 4(3) is based on wording formerly in the IHT deemed domicile rule.[13] It is no longer appropriate, following the introduction of the statutory residence test, but in practice the point will only rarely arise.

US Treasury say:[14]

> **Question 3.** How does the U.S.-U.K. treaty define domicile and how, or why, was this definition selected?
> **Answer.** ... Particularly important in this regard is the provision that a U.S. citizen, who is considered under the Convention to be domiciled in both the United Kingdom and the United States, shall be deemed to be domiciled in the United States if he had not been resident in the United Kingdom for at least 7 of the 10 years. This rule is based on the concept that a Contracting State should not tax the estate or other transfers of an individual on a domiciliary basis if the individual has not been present in that State for a significant period of time.
>
> **Question 5.** Why was the 7 out of 10 year rule used for the determination of domicile under the treaty?
> **Answer.** A basic concept of United States tax policy in this field is that a Contracting State should not tax the estate of other transfers of an individual on a domiciliary basis if the individual has not been present in that State for a significant period of time. Conversely, where an

[13] See 5.6.3 ("Residence" for 15-year rule).

[14] Written Responses by Treasury to Questions by the Committee Staff (1979) *https://uniset.ca/misc/us-uk1980.html*

> individual has been present for a significant period of time we believe that it is reasonable to permit the State to tax the individual's accumulation of wealth. The 7 out of 10 year rule represents, in our judgment, a sufficiently long period of presence to justify taxation and has been our treaty policy for a long time. ...
> It is also important to point out that a U.S. citizen will not automatically be deemed to be domiciled in the United Kingdom if he has been resident there for, say, 8 out of 10 years. In that case the determination of a single treaty domicile is settled by the tie-breaking rules. These are based on the concepts of permanent home, center of vital interests, habitual abode, nationality, and mutual agreement. Thus, it is possible that an individual could be resident in the United Kingdom for more than 7 years and still be treated as a U.S. domiciliary, if, for example, he maintained a permanent home in the United States.

Where these tie-breakers fail to break the tie, we turn to Art. 4(4):

> Where by reason of the provisions of para (1) an individual was domiciled in both Contracting States, then, subject to the provisions of paras (2) and (3), his status shall be determined as follows:
>
> (a) the individual shall be deemed to be domiciled in the Contracting State in which he had a permanent home available to him. If he had a permanent home available to him in both Contracting States, or in neither Contracting State, he shall be deemed to be domiciled in the Contracting State with which his personal and economic relations were closest (centre of vital interests);
> (b) if the Contracting State in which the individual's centre of vital interests was located cannot be determined, he shall be deemed to be domiciled in the Contracting State in which he had an habitual abode;
> (c) if the individual had an habitual abode in both Contracting States or in neither of them, he shall be deemed to be domiciled in the Contracting State of which he was a national; and
> (d) if the individual was a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

These tie-breaker rules are essentially those in the OECD and U.S. model treaties.[15]

119.5.4 *Resident of US possession*

Article 4(5) USA IHT DTA relates to nationality and treaty-domicile:

> An individual who was a resident (domiciliary) of a possession of the US

[15] See 9.11 (Tie-breaker tests: Individuals).

and who became a citizen of the US solely by reason of his

(a) being a citizen of such possession, or

(b) birth or residence within such possession,

shall be considered as neither domiciled in nor a national of the US for the purposes of this Convention.

US Revenue Ruling 109[16] lists the following as possessions of the United States: American Samoa, Puerto Rico, the Northern Mariana Islands, the United States Virgin Islands, Guam, and some (more or less) uninhabited islands.[17]

119.6 IHT exemptions: Individuals

Article 5 USA IHT DTA provides two exemptions for individuals. Article 5(1) provides:

(a) [i] Subject to the provisions of Articles 6 (Immovable Property (Real Property)) and 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services) and the following paragraphs of this Article,

[ii] if the decedent or transferor was domiciled in one of the Contracting States at the time of the death or transfer, property shall not be taxable in the other State.

(b) Sub-para (a) shall not apply if at the time of the death or transfer the decedent or transferor was a national of that other State.

This is easier to follow if one specifies which State is which:

UK treaty-domicile, US national	**US treaty-domicile, UK national**
(a) Subject to [Art 6, 7, and this Article],	(a) Subject to [Art 6, 7, and this Article],
if the decedent or transferor was domiciled in one of the Contracting States [the UK] at the time of the death or transfer, property shall not be taxable in the other State [the US].	if the decedent or transferor was domiciled in one of the Contracting States [the US] at the time of the death or transfer, property shall not be taxable in the other State [the UK].

[16] *https://www.irs.gov/irb/2003-42_IRB*

[17] Baker Island, Howland Island, Jarvis Island, Johnston Island, Kingman Reef, Midway Islands, Wake Islands.

(b) Sub-para (a) shall not apply if at the time of the death or transfer the decedent or transferor was a national of that other State [the US].	(b) Sub-para (a) shall not apply if at the time of the death or transfer the decedent or transferor was a national of that other State [the UK].

Para (b) is like the Savings Clause in the IT/CGT DTA,[18] and as a result, the relief is quite restricted. A US national does not get relief from US estate tax, and a UK national does not get relief from UK IHT. That is, to qualify for IHT exemption under Art. 5(1) the individual must be:

(1) treaty-domiciled in the USA and
(2) not a UK national.

In appropriate cases, UK nationals who are treaty-domiciled in the US may wish to consider renouncing UK citizenship, in order to qualify for this IHT exemption.

Article 5(2) USA IHT DTA provides:

> Subject to the provisions of the said Articles 6 and 7, if at the time of the death or transfer the decedent or transferor
> [a] was domiciled in neither Contracting State and
> [b] was a national of one Contracting State (but not of both),
> property which is taxable in the Contracting State of which he was a national shall not be taxable in the other Contracting State.

Can this confer IHT exemption? In order to need and qualify for IHT exemption under art. 5(2):

(1) The individual must be:
    (a) treaty-domiciled in neither state (so in particular not UK domiciled or deemed domiciled) and
    (b) a US national and not a UK national
(2) Property must be taxable in the UK (or no relief is needed) so it must be UK situate.
(3) The property must be taxable in the USA.

This is just possible. Condition (1) is possible because a US national is not necessarily treaty-domiciled in the USA. If such an individual held UK situate property, it would be exempt from IHT under Art. 5(2) provided it was taxable in the USA. In practice though this will be rare.

[18] See 109.5.2 (The Savings Clauses).

These two exemptions applies to charges on death and on lifetime gifts. The exemptions apply even to UK situate property (so long as the property is not land or a permanent establishment).

119.7 IHT exemptions: Trusts

Article 5(4) USA IHT DTA provides:

> [a] Paras (1) and (2) shall not apply in the UK to property comprised in a settlement;
>
> [b] but, subject to the provisions of the said Articles 6[19] and 7[20], tax shall not be imposed in the UK on such property if at the time when the settlement was made the settlor was domiciled in the US and was not a national of the UK.

Article 5(4)[b] provides exemption from:
(1) IHT 10 year and exit charges
(2) The charge on the death of an individual with an estate IIP
(3) GWR lifetime and death charges

To qualify for IHT exemption under Art. 5(4) the settlor must at the relevant time be:
(1) treaty-domiciled in the USA and
(2) not a UK national

The exemption applies even to UK situate assets (so long as the asset is not land or a permanent establishment).

It is an interesting question whether a common form grantor trust is a settlement for this purpose: it is (I think) a settlement for US purposes but not within the IHT definition.[21] It is also an interesting question whether or to what extent UK rules determining when a settlement is made (and who is the settlor) apply for the purposes of this relief. Subject to context, UK courts should apply the UK rules. But the best interpretation is that which gives effect to the object of avoiding double taxation without giving rise to double non-taxation.

119.8 Requirement to pay US tax

Article 5(5) USA IHT DTA provides:

[19] See 119.10 (Immovable property).

[20] See 119.11 (Business property).

[21] See 90.10 (American revocable trusts (grantor trust).

> If by reason of the preceding paragraphs of this Article
> [a] any property would be taxable only in one Contracting State and
> [b] tax, though chargeable, is not paid (otherwise than as a result of a specific exemption, deduction, exclusion, credit or allowance) in that State,
>
> tax may be imposed by reference to that property in the other Contracting State notwithstanding those paragraphs.

The IHT Manual provides:

> **27177 Certification of disclosure and tax enforcement procedure with the USA** [Dec 2022]
>
> Before we give up our right to tax assets under Article 5(1) of the double taxation convention (DTC) with the USA, we need the US authorities to certify that:
>
> - the assets have been disclosed to them and
> - any tax due has been paid or will be enforced.
>
> This is because Article 5(5) of the DTC allows us to tax the property if the USA is unable to enforce its right to tax. HMRC needs to give a similar certification if Article 5(1) of the DTC requires the US authorities to give up their right to tax property.
>
> Until we have a form 742[22] from the US authorities certifying that the property has been disclosed and that tax has been paid or will be enforced, you should not close any case where:
>
> Article 5(1) operates to exclude some UK property from the charge to IHT, and
>
> the case would be taxpaying without that exclusion.
>
> You should explain this requirement to the taxpayer and send them two prints of Form 742. You should draw their attention to the paragraphs of the form that they must complete. Where the UK is giving up its taxing rights under the convention, only para 1 applies and paras 2 to 7 are not appropriate. You can close your case when you have received a form that is correctly completed and certified. Refer the case to Technical if there are any errors or any problems arise.
>
> Where the USA gives up the right to tax property under Article 5(1), the US authorities will send two copies of US form 706 CE to us to certify.[23] Once you have checked the forms (you must not mark them in any way) you should send them to Technical together with the file and a note of

[22] Author's footnote: This is not a current form, and I wonder if it is in fact a typo: I would be grateful to any reader who can comment.

[23] Author's footnote: see *https://www.irs.gov/uac/form-706-ce-certificate-of-payment-of-foreign-death-tax*

any errors or omissions. Technical will then issue the appropriate certificate.

119.9 Dual-situate asset

Article 5(6) USA IHT DTA provides:

> If at the time of the death or transfer
> [a] the decedent or transferor was domiciled in neither Contracting State and
> [b] each State would regard any property as situated in its territory and
> [c] in consequence tax would be imposed in both States,
> the competent authorities of the Contracting States shall determine the situs of the property by mutual agreement.

This does not apply if the individual is treaty-domiciled in one or other contracting state, as then IHT exemption or USA tax exemption applies.

It is a different technique from dealing with the problem of dual-situate assets from that adopted in the estate duty DTAs, which set out their own treaty-situs rules (as did the former USA estate duty treaty).

119.10 Immovable property

Article 6 (more or less) follows the OECD IHT Models. Article 6(1) USA IHT DTA provides:

> Immovable property (real property) may be taxed in the Contracting State in which such property is situated.

Article 6(2) USA IHT DTA defines "immovable property" in (more or less) OECD Model form:[24]

> [a] The term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated,
> [b] provided always that debts secured by mortgage or otherwise shall not be regarded as immovable property.
> [c] The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural

[24] See 24.7.1 ("Immovable property").

> resources;
> [d] ships, boats, and aircraft shall not be regarded as immovable property.

Article 6(3) USA IHT DTA deals with the interaction of articles 6 (immovable property) and 7 (business property):

> The provisions of paras (1) and (2) shall also apply
> [a] to immovable property of an enterprise and
> [b] to immovable property used for the performance of independent personal services.

119.11 Business property

Article 7(1) USA IHT DTA provides:

> Except for assets referred to in Article 6 (Immovable Property (Real Property)) assets forming part of the business property of a permanent establishment of an enterprise[25] may be taxed in the Contracting State in which the permanent establishment is situated.

Article 7(2) defines "permanent establishment" in (more or less) OECD Model form; this is not set out here, since it will rarely arise.

Article 7(3) provides:

> Except for assets described in Article 6 (immovable property (real property)), assets pertaining to a fixed base used for the performance of independent personal services may be taxed in the Contracting State in which the fixed base is situated.

119.12 IHT spouse exemption extended

Under domestic IHT law, the IHT spouse exemption may be restricted when the transferor is UK domiciled and the spouse is foreign domiciled.[26] Article 8 restricts this restriction, ie it extends the spouse exemption. There are separate provisions for absolute transfers and for transfers to a trust under which the spouse has an IIP. There is no relief for the situation where H has an interest in possession and on H's death W acquires an interest in possession (where the IHT spouse exemption is sometimes available under s.49D IHTA).

[25] Article 7(1) USA IHT DTA provides the definition: "the term "enterprise" means an industrial or commercial undertaking".

[26] See 93.2 (Restricted IHT spouse exemption).

119.12.1 *Absolute inter-spouse transfer*

Article 8(3) USA IHT DTA provides:

> Property which passes to the spouse from a decedent or transferor who was domiciled in or a national of the US and which may be taxed in the UK shall, where
> (a) the transferor's spouse was not domiciled in the UK but the transfer would have been wholly exempt had the spouse been so domiciled, and
> (b) a greater exemption for transfers between spouses would not have been given under the law of the UK apart from this Convention,
> be exempt from tax in the UK to the extent of 50 per cent of the value transferred, calculated as a value on which no tax is payable and after taking account of all exemptions except those for transfers between spouses.

In order for this to be needed and to apply the following conditions must be satisfied:

The transferor is:

(a) Treaty-domiciled in the US or a US national.
(b) UK-law domiciled or deemed UK domiciled (or else the IHT spouse exemption is not restricted under IHT domestic law).

The transferee (spouse) is:

(a) not treaty-domiciled in the UK.
(b) not UK-law domiciled or deemed UK domiciled (or else the IHT spouse exemption is not restricted under IHT domestic law).

This relief applies on death and on lifetime transfers.

119.12.2 *"Spouse" in USA IHT DTA*

For IHT purposes, the term "spouse" has its UK law meaning.[27] Strictly

[27] See 107.12 (Undefined treaty terms).
A person who has entered into a same-sex marriage may be regarded as a spouse for US tax purposes, see *Obergefell v Hodges*. IRS Revenue Ruling 2013-17 states: "For Federal tax purposes, the term "marriage" does not include registered domestic partnerships, civil unions, or other similar formal relationships recognized under state law that are not denominated as a marriage under that state's law, and the terms "spouse," "husband and wife," "husband," and "wife" do not include individuals who have entered into such a formal relationship. This conclusion applies regardless of whether individuals who have entered into such relationships are of the opposite sex or the same sex."

a civil partner is not a spouse, so this is one of the rare occasions where there is a difference between the taxation of spouses and civil partners; but the introduction of same-sex marriages reduces the significance of that.[28] It is arguable that the word "spouse" here should be construed purposively, to include civil partners.

119.12.3 *Settlement with spouse IIP*

Article 8(4) USA IHT DTA provides:

> (a) Property which on the death of a decedent domiciled in the UK became comprised in a settlement shall,
> [i] if the personal representatives and the trustees of every settlement in which the decedent had an interest in possession immediately before death so elect
> [ii] and subject to sub-para (b),
> be exempt from tax in the UK to the extent of 50 per cent of the value transferred (calculated as in para (3)) on the death of the decedent if:
> (i) under the settlement, the spouse of the decedent was entitled to an immediate interest in possession,
> (ii) the spouse was domiciled in or a national of the US,
> (iii) the transfer would have been wholly exempt had the spouse been domiciled in the UK, and
> (iv) a greater exemption for transfers between spouses would not have been given under the law of the UK apart from this Convention.
>
> (b) Where the spouse of the decedent becomes absolutely and indefeasibly entitled to any of the settled property at any time after the decedent's death, the election shall, as regards that property, be deemed never to have been made and tax shall be payable as if on the death such property had been given to the spouse absolutely and indefeasibly.

In order for this to be needed and to apply the following conditions must be satisfied:
The transferor is:
(a) Treaty-domiciled in the UK.
(b) UK-law domiciled or deemed UK domiciled (or else the IHT spouse exemption is not restricted under domestic law).

[28] See App. 3.2 ("Spouse").

The transferee (spouse) is:

(a) treaty-domiciled in the US or a national of the US.

(b) not UK-law domiciled or deemed UK domiciled (or else the IHT spouse exemption is not restricted under domestic law).

In addition:

(1) An election is required.

(2) The spouse must be entitled to an immediate IIP (this probably rules out relying on s.144 IHTA (discretionary will trusts)).

(3) This relief only applies on the death of the transferor.

119.13 Non-discrimination

Article 10(1)(a) USA IHT DTA provides:

> Subject to the provisions of sub-para (b), nationals of a Contracting State shall not be subjected in the other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.

This broadly follows OECD IHT Models.

It would extend IHT agricultural property relief to USA agricultural property, which could be relevant to companies holding agricultural land, but the point will not often arise.

Article 10 continues:

> (2) The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.
>
> (3) Nothing contained in this Article shall be construed as obliging either Contracting State to grant to individuals not domiciled in that Contracting State any personal allowances, reliefs and reductions for taxation purposes which are granted to individuals so domiciled.
>
> (4) Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.
>
> (5) The provisions of this Article shall apply to taxes which are the subject of this Convention.

119.14 Other articles

The following articles of the USA IHT DTA are standard form and not discussed here:

Article	**Topic**
11	Mutual agreement procedure
12	Exchange of information
13	Diplomatic and consular officials
14	Entry into force
15	Termination

CHAPTER ONE HUNDRED AND TWENTY

CREDIT FOR FOREIGN IHT

120.1 Credit for foreign IHT
120.2 Unilateral IHT credit
120.3 Requirement to pay foreign IHT
120.4 Use of foreign IHT credit
120.5 Amount of credit
120.5.1 Situs in overseas territory
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120.5.4 Interaction of s.159(2)(3)
120.5.5 Unilateral/DTA credit: Interaction
120.5.6 Canada estate duty: Concession
120.6 Planning
120.7 France/Italy IHT credit
120.8 USA IHT credit

Cross references

The following topics are considered elsewhere:
80.17 (Deduction for foreign taxes) (as opposed to credit)
80.17.5 (Foreign tax on UK shares)
114.8 (Nil-rate band and DTAs)

120.1 Credit for foreign IHT

"**Foreign IHT credit relief**" arises where foreign tax is set against UK IHT. This may be:

(1) "**DTA IHT credit**" where a DTA confers a credit or
(2) "**Unilateral IHT credit**" where UK tax law (not a DTA) confers a credit

In this chapter I consider unilateral IHT credit, the four estate duty/IHT DTAs and the USA IHT DTA. I hope to deal with other treaties in future editions.

120.2 Unilateral IHT credit

Unilateral IHT credit is important as the UK does not have many IHT DTAs.

Section 159(1) IHTA provides:

> Where the Board are satisfied that in any territory outside the UK (an "overseas territory") any amount of tax imposed by reason of any

> disposition or other event is attributable to the value of any property, then, if—
>
> (a) that tax is
>
> [i] of a character similar to that of capital transfer tax[1] or
>
> [ii] is chargeable on or by reference to death or gifts inter vivos, and
>
> (b) any capital transfer tax chargeable by reference to the same disposition or other event is also attributable to the value of that property,
>
> they shall allow a credit in respect of that amount ("the overseas tax") against that capital transfer tax in accordance with the following provisions.

Statute calls this "unilateral relief" but I prefer the term "**unilateral foreign IHT credit**" (or foreign IHT credit relief) which seems clearer. I refer to the foreign tax (which statute calls "the overseas tax" as "**foreign IHT**".

Unilateral relief is based on the international understanding that the state where an asset is located has the primary right of taxation, and the state whose claim to tax depends on a personal nexus (residence or, as in the UK, domicile) should provide unilateral relief from double taxation.

The IHT Manual provides:

> **IHTM27185 Introduction** [May 2020]
>
> ... Under IHTA84/S159, credit can be allowed on death and also in respect of lifetime dispositions where some type of gift tax is charged in the foreign country. The basic conditions to be satisfied in connection with a lifetime or death transfer are:
>
> - that both Inheritance Tax (IHT) and overseas tax must be chargeable by reference to the same event and attributable to the value of the same property, and
> - that the foreign tax is similar in character to IHT.
>
> In cases of doubt, you must ask for advice from Technical.

120.3 Requirement to pay foreign IHT

The requirement that the foreign IHT must actually be paid is slipped into the definition of "tax imposed". Section 159(6) IHTA provides:

> In this section references to tax imposed in an overseas territory are

[1] References to CTT include IHT: s.100(1)(b) FA 1986.

> references to tax chargeable under the law of that territory and paid by the person liable to pay it.

The IHT Manual provides:

> **IHTM27185. Introduction** [May 2020]
> ... Before the relief can be finalised, the taxpayer or agent must produce evidence of payment of the foreign tax. This must be in the form of the assessment of foreign tax (or other document showing details of the property charged) and the official receipt.
> Once you decide the amount of relief available this should be entered in the 'reliefs against tax' box in the appropriate COMPASS screen. If necessary, you must apportion the relief between the instalment and non-instalment option property assessments. (See IHTM31189)

120.4 Use of foreign IHT credit

Credit is only set against "that capital transfer tax" ie IHT attributable to the same property as is subject to the foreign IHT.
The IHT Manual provides:

> **IHTM27185. Introduction** [May 2020]
> ... the relief cannot exceed the amount of Inheritance Tax (IHT) charged with respect to the particular item of property.
> For these purposes, the IHT attributable to any asset that is wholly exempt from IHT is nil. Where the item is partly exempt, any IHT charged will be attributed to the chargeable part.
> Where Quick Succession Relief (IHTM22041) is allowed, the amount of IHT attributable to the property is the net amount after allowing the relief.

120.5 Amount of credit

The rules determining the amount of IHT credit differ depending on
(1) situs of property under UK law and
(2) situs of property under the foreign law

The IHT Manual provides:

> **IHTM27185. Introduction** [May 2020]
> ... Because of the terms of s.159 (2), (3) and (4) IHTA 1984 you will need to consider the situs (IHTM27071) of property according to UK law and, possibly, foreign law when allowing a credit for foreign tax. You must raise any questions to establish the situs as soon as it seems likely that a s.159 IHTA credit will be claimed.

... The amount of the credit allowed under IHTA84/S159 is the Sterling equivalent of the foreign tax paid (converted using the exchange rate on the date of payment) so far as that tax is attributable to the foreign property on which IHT has been paid. Any part of the sum paid to the foreign Revenue authorities representing interest or penalties should be excluded. So should any part of the foreign tax that is attributable to income accruing since the date of the transfer. ...Shares and Assets Valuation (Foreign) will provide the exchange rate...

IHTM27186 Procedure with non-convention countries: which provision apply? [May 2020]

To work out whether relief is due and which provisions it is due under you will need to consider the following questions:

Is the property situated in the UK under UK law?

- If the answer is 'yes' and the property is also situated in the foreign country under the law of that country, relief is due under IHTA84/S159(3)(b),
- If the answer is 'yes' but the property is not situated in the foreign country under their law, no relief is due.
- If the answer is 'no' but the property is situated in the foreign country under UK law, relief is due under IHTA84/S159(2).
- If the answer is 'no' and the property is not situated in the foreign country under UK law, relief is due under IHTA84/S159(3)(a).

Relief should be given under IHTA84/S159 (2) rather than S159 (3)(a) where tax is paid, under an agreement between the provinces concerned:

- in Quebec or Ontario, or Quebec and British Columbia,
- on shares which are situated in the other province, under UK law.

Any case where the taxpayer or agent disagrees with our view that UK law applies, should be referred to Technical.

120.5.1 *Situs in overseas territory*

Section 159(2) IHTA provides:

> Where the property is situated in the overseas territory and not in the UK, the credit shall be of an amount equal to the overseas tax.

The IHT Manual provides:

> **IHTM27187. Relief under IHTA84/S159 (2)** [May 2020]
>
> Where the property concerned is situated (under UK law) in the foreign country, relief is due under IHTA84/S159 (2) and the credit due is equal to the foreign tax paid.
>
> In practice, the credit cannot be more than the Inheritance Tax (IHT) attributable to the property concerned.

More accurately, the *credit* (as defined) can exceed the IHT attributable to the property, but this credit is only set against the IHT attributable to the property, so the amount of the relief is the lesser of the credit and that IHT. The IHT Manual goes on to give an example:

> *Example* (Bernice)
> B died in September 2002, leaving an apartment in Spain valued at £50,000. B's total estate amounts to £300,000 (there were no lifetime gifts), with total IHT payable of £20,000.
> The Spanish authorities charge tax equivalent to Sterling £4,000 on the apartment on B's death.
> The IHT payable on the apartment is:
> £50,000 × (£20,000 ÷ £300,000) = £3,333.33
> So, the double taxation credit due under IHTA84/S159 (2) is restricted to £3,333.33.

The effect of the credit is that the total tax paid is the higher of the UK and the foreign IHT rates.

120.5.2 *Situs in 3rd country/dual situate*

Section 159(3) IHTA provides:

> Where the property—
> (a) is situated neither in the UK nor in the overseas territory, or
> (b) is situated both in the UK and in the overseas territory,
> the credit shall be of an amount calculated in accordance with the following formula—
>
> $$\frac{A}{A+B} \times C$$
>
> where
> A is the amount of the capital transfer tax,
> B is the overseas tax and
> C is whichever of A and B is the smaller.

The IHT Manual provides:

> **IHTM27188. Relief under IHTA84/S159 (3) and S159 (4)** [May 2020]
> Relief is due under s.159(3) IHTA 1984 where both the UK and another foreign country charge tax on the same property and that property is situated:
>
> - neither in the UK nor in the foreign country, or
> - both in the UK and in the foreign country.

> Where relief is due under IHTA84/S159 (3), it is given on a split credit basis and will be less than the foreign tax paid. [The Manual sets out the formula in s.159(3) and continues:]
>
> *Example 1*
>
> Country X and the UK both tax an item of property which is situated neither in Country X or the UK.
>
> Country X charges tax of £40
> The UK charges IHT of £60
>
> The credit is: 60 ÷ (60 + 40) × 40 = £24

HMRC IHT Customer Guide gives two examples of unilateral relief calculations:[2]

> **Example 1**
>
> Ann is domiciled in Ruritania, but is also treated as domiciled in the UK. She makes a gift of property situated in Utopia.

Item	*Amount*
UK inheritance tax (A)	£3,000
Ruritanian inheritance tax (B)	£1,000
C is the smaller of A and B	£1,000

> Credit against UK IHT is £3,000 / (£3,000 + £1,000) × £1,000 = £750

Net UK tax	**£2,250**

> **Example 2**
>
> Tom is domiciled in Utopia but holds shares in a Ruritanian company, which maintains a duplicate share register in the UK. Under UK law we regard the shares as situated in the UK,[3] but Ruritanian law regards them as situated in Ruritania. Tom dies (but his estate is not liable to Utopian tax).

Item	*Amount*
UK inheritance tax (A)	£1,000
Ruritanian inheritance tax (B)	£4,000
C is the smaller of A and B	£1,000

> Credit against UK IHT is £1,000 / (£1,000 + £4,000) × £1,000 = £200

Net UK tax	**£800**

This will only eliminate double taxation if the foreign state has the same rules. Where an IHT DTA applies a more generous form of credit may apply.

[2] *https://www.gov.uk/inheritance-tax-double-taxation-relief#15*

[3] Author's footnote: This is not a correct statement of the situs rule, but it does not matter for the purposes of the example.

120.5.3 *Tax in more than 1 state*

Section 159(4) IHTA provides:

> Where tax is imposed in two or more overseas territories in respect of property which—
>
> (a) is situated neither in the UK nor in any of those territories, or
>
> (b) is situated both in the UK and in each of those territories, subsection (3) above shall apply as if, in the formula there set out,
>
> B were the aggregate of the overseas tax imposed in each of those territories and
>
> C were the aggregate of all, except the largest, of A and the overseas tax imposed in each of them. ...

The IHT Manual provides an example:

> **IHTM27188 Relief under IHTA84/S159 (3) and S159 (4)** [May 2020]
> *Example 2*
> Each of Country X, Country Y and the UK tax an item of property which is not situated in Country X, Country Y nor the UK.
> Country X charges £40
> Country Y charges £20
> The UK charges IHT of £60
> The credit is 60 ÷ (60+40+20) × (40+20) = £30

120.5.4 *Interaction of s.159(2)(3)*

Section 159(5) IHTA deals with the interaction of the two reliefs:

> Where credit is allowed under subsection (2) above or section 158 above in respect of overseas tax imposed in one overseas territory, any credit under subsection (3) above in respect of overseas tax imposed in another shall be calculated as if the capital transfer tax were reduced by the credit allowed under subsection (2) or section 158; and where, in the case of any overseas territory mentioned in subsection (3) or (4) above, credit is allowed against the overseas tax for tax charged in a territory in which the property is situated, the overseas tax shall be treated for the purposes of those provisions as reduced by the credit.

The IHT Manual provides:

> **IHTM27188 Relief under IHTA84/S159 (3) and S159 (4)** [May 2020]
> ... If relief is due under IHTA84/S159 (3)(a) or IHTA84/S159 (4)(a), IHTA84/S159 (5) must be considered when calculating the foreign tax

> paid (B in the formulas above). If the foreign country has allowed a credit against its tax for tax paid in another foreign country, please refer to Technical.
>
> Where relief is due under IHTA84/S159 (3)(b) or IHTA84/S159 (4)(b), above, the foreign tax at B is simply the gross amount paid. You do not need to take account of any credit for tax paid in another country.
>
> **IHTM27189. Procedure when both IHTA84/S159 (2) and S159 (3) apply** [May 2020]
>
> It may happen that relief is due under s.159(2) IHTA 1984 (or convention relief under s.158 IHTA 1984) and also under s.159(3) IHTA 1984.
>
> If this is the case, s.159(5) states that the credit allowed under Section 159(3) must be calculated on the basis that A in the formula (the Inheritance Tax paid) is the net amount of Inheritance Tax after allowing the credit under s.158 or s.159(2)

120.5.5 *Unilateral/DTA credit: Interaction*

Section 159(7) IHTA provides:

> Where relief can be given both under this section and under section 158 above [double tax treaties], relief shall be given under whichever section provides the greater relief.

The IHT Manual provides:

> **IHTM27200. Procedure when both forms of relief apply** [May 2020]
>
> Unilateral relief and relief under a double taxation convention (DTC) are **not** mutually exclusive. Where both reliefs would appear to be due on the same item of property, relief is restricted by IHTA84/S159 (7) to whichever is the greater. In practice, where the amount of credit is the same under either, the credit should be treated as convention relief.
>
> In cases where, either;
>
> - both reliefs are due, but the unilateral relief appears to be the greater or
> - the interaction of the two reliefs is particularly difficult.
>
> You must refer the case to Technical.
>
> Unilateral relief may be given for a State tax as well as unilateral or convention relief in respect of tax due in the country where the State is situated.
>
> *Example* (Giles)
>
> G, a British citizen, dies domiciled in the UK. His estate includes an apartment in New York, stocks and shares in US Companies and a New York bank account.

> The world-wide estate will be subject to UK tax, but US Federal Estate Tax will (because of the terms of the DTC) be payable only on the immovable property in the USA. The UK will give credit for the US tax under the DTC.
> NY State will also charge State Estate Tax on the movable assets situated there and the UK will give unilateral relief for this tax.
> But the total unilateral and convention credit cannot exceed the amount of UK IHT payable on the property concerned.

120.5.6 *Canada estate duty: Concession*

The IHT Manual provides:

> **IHTM27186 Procedure Chart** [May 2020]
> ... Relief should be given under IHTA84/S159 (2) rather than S159(3)(a) where tax is paid, under an agreement between the provinces concerned:
> - in Quebec or Ontario, or Quebec and British Columbia,
> - on shares which are situated in the other province, under UK law.
>
> Any case where the taxpayer or agent disagrees with our view that UK law applies, should be referred to Technical.

Canada abolished estate duty in 1972. This passage is therefore 50 years out of date! For the current Canadian position, see 80.17.4 (Canadian income tax). However it illustrates an approach which may perhaps be applied to federal estate duties in other federal jurisdictions, if there are any.

120.6 Planning

The rule is in short that the relief is the lesser of (1) foreign IHT and (2) UK IHT attributable to the same property. This requires careful planning to maximise the benefit of the relief.

Suppose T owns land in country X which on T's death will bear IHT in country X. If T makes a chargeable gift of the land (eg a gift by will to T's children) then the foreign IHT credit is available. If T makes an exempt gift (eg to T's spouse or to charity) the foreign IHT credit is lost. Foreign jurisdictions do not normally allow death duty exemption on the grounds that a gift is made to a UK charity.[4] For instance, suppose T wishes to makes a will giving foreign property to a UK charity. The gift may bear

[4] In some cases EU member states may allow relief.

foreign death duties which are set against UK IHT so the effective IHT burden is reduced or eliminated.[5] It would be better:

(1) to give the foreign property to beneficiaries who are chargeable under UK law.

(2) to give other (perhaps UK) property to the UK charity which would otherwise bear inheritance tax at the full rate.

In some cases the matter could be put right by a deed of variation.

120.7 France/Italy IHT credit

Art 6 UK/France IHT DTA	**Art 6 UK/Italy IHT DTA**
Where one Contracting Party imposes duty	(1) Where one Contracting Party imposes duty.
on the death of a person who was domiciled in its territory at the time of his death	[no equivalent]
on any property which, under the present Convention, is situated in the territory of the other Contracting Party,	on any property which is not situated in its territory but is situated in the territory of the other Contracting Party ,
the former Party shall allow against so much of its duty, ascertained in accordance with its law,	the former Party shall allow against so much of its duty (as otherwise computed)
as is attributable to that property a credit (not exceeding the amount of the duty so attributable) equal to so much of the duty imposed by the other Contracting Party as is attributable to such property.	as is attributable to that property a credit (not exceeding the amount of the duty so attributable) equal to so much of the duty imposed in the territory of the other Contracting Party as is attributable to such property

Art 6 UK/Italy IHT DTA follows with a provision not in the French DTA:

> (2) For the purposes of this Article, the amount of the duty of a Contracting Party attributable to any property shall be ascertained after taking into account any credit, allowance or relief, or any remission or reduction of duty other than in respect of duty payable in the territory of the other Contracting Party

This does not add much to the unilateral IHT credit otherwise available

[5] The position may be complicated further by foreign rules which make the rate of death duty depend on the relationship of the beneficiary to the deceased; forced heirship rules may also need to be considered.

under domestic law but it would be relevant for an asset which is UK situate under domestic IHT situs rules but not UK situate under treaty-situs rules.[6]

India and Pakistan DTAs have comparable articles but since these countries do not impose IHT, the articles have no effect.

120.8 USA IHT credit

Article 9 USA IHT DTA provides foreign tax credit relief. This is important because the DTA exemption is quite restricted.[7]

Article 9(1) USA IHT DTA (not discussed here) provides US relief where UK IHT is paid.

Article 9(2) USA IHT DTA provides UK relief for non-trust property where US tax is paid:

> Where
> [i] under this Convention the UK may impose tax with respect to any property
> [ii] other than property which the UK is entitled to tax in accordance with the said Article 6 or 7[8]
> [iii] (that is, where the decedent or transferor was domiciled in or a national of the UK),
>
> then, except in the cases to which para (3) applies, double taxation shall be avoided in the following manner:
>
> (a) Where the US imposes tax with respect to property in accordance with the said Article 6 or 7, the UK shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the US with respect to that property.
>
> (b) Where
> [i] the US imposes tax with respect to property not referred to in sub-para (a) and
> [ii] the decedent or transferor was a national of the UK and was domiciled in the US at the time of the death or transfer,[9]
>
> the UK shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the

[6] See 115.10 (Treaty-situs).

[7] See 119.6 (IHT exemptions: Individual).

[8] Articles 6 and 7 concern immovable and business property: see 24.7.1 (Immovable property); 119.11 (Business property).

[9] See 119.6 (IHT exemptions: Individual).

US with respect to that property.

Article 9(3) USA IHT DTA provides the rule for trust property:

> Where both Contracting States impose tax on the same event with respect to property which
>
> [a] under the law of the US would be regarded as property held in a trust or trust equivalent and
>
> [b] under the law of the UK would be regarded as property comprised in a settlement,
>
> double taxation shall be avoided in the following manner:
>
> (a) Where a Contracting State imposes tax with respect to property in accordance with the said Article 6 or 7, the other Contracting State shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the first-mentioned Contracting State with respect to that property.
>
> (b) Where the US imposes tax with respect to property which is not taxable in accordance with the said Article 6 or 7 then
>
> (i) where the event giving rise to a liability to tax was a generation-skipping transfer and the deemed transferor was domiciled in the US at the time of that event,
>
> (ii) where the event giving rise to a liability to tax was the exercise or lapse of a power of appointment and the holder of the power was domiciled in the US at the time of that event, or
>
> (iii) where (i) or (ii) does not apply and the settlor or grantor was domiciled in the US at the time when the tax is imposed,
>
> the UK shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the US with respect to that property.
>
> (c) Where
>
> [i] the United States imposes tax with respect to property which is not taxable in accordance with the said Article 6 or 7 and
>
> [ii] sub-paragraph (b) does not apply,
>
> the United States shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the United Kingdom with respect to that property.

Article 9(4) USA IHT DTA provides some general rules for tax credits:

> [a] The credits allowed by a Contracting State according to the provisions of paras (1), (2) and (3) shall not take into account amounts of such taxes not levied by reason of a credit otherwise allowed by the other Contracting State.
>
> [b] No credit shall be finally allowed under those paragraphs until the tax (reduced by any credit allowable with respect thereto) for which the credit is allowable has been paid.
>
> [c] Any credit allowed under those paragraphs shall not, however, exceed the part of the tax paid in a Contracting State (as computed before the credit is given but reduced by any credit for other tax) which is attributable to the property with respect to which the credit is given.[10]

The IHT Manual explains the procedure for obtaining a credit:

> **IHTM27170: USA** [Dec 2021]
>
> ...Where a double taxation credit is due you may allow the amount claimed on form IHT400 provisionally but the case must not be closed until the payment has been certified by the US authorities on Form 742. If a credit seems appropriate, send the taxpayer or their agent two prints of Form 742, available from Technical. Ask them to complete the forms and to send both copies to the Washington address on the reverse
>
> Internal Revenue Service, 1111 Constitution Avenue NW:SE:LB:IN:ADCI:EOI M4-360, Washington DC 20224, United States of America.
>
> One of these copies is certified and returned to this office and the other is retained by the US authorities. The certified form must be checked and the appropriate credit allowed. If you have any difficulty applying the Double Taxation Convention or calculating the tax attributable to the property, please seek advice from Technical..
>
> The credit given cannot be more than the amount of tax payable in the UK on the property concerned.
>
> *Certificate of IHT paid for the US authorities*
>
> The US form 706 CE is forwarded to this Office in duplicate to be certified by us. The forms must be checked, but you must make sure you do not mark the forms themselves in any way. Send the forms and the file with a note of any error or omission to Technical once all the tax has been paid. If there no further enquiries and all the tax has been paid, Technical will arrange for one copy to be certified and sent with a schedule of any necessary amendments to the US authorities; the other copy is filed. The taxpayer is informed that the certificate has been sent

[10] Art 9(5) deals with claims; see 114.7 (Claims for IHT DTA reliefs).

and is provided with a copy of any amending schedule.

Where a certificate of tax paid cannot be issued on application - because the amount of tax has not been finalised and paid - you should explain this to the taxpayer or agents. You should also remind them that they can lodge a provisional claim for a credit with the US authorities (although there is a time limit – under Article 9). When the case is ready you should refer the application and the file to Technical to issue the certificate.

If there is any adjustment of tax after a certificate has been issued the file must again be referred to Technical to issue an amending certificate.

CHAPTER ONE HUNDRED AND TWENTY ONE

REPORTING AND COMPLIANCE

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Cross references

The question how specific types of income/gains are disclosed in a tax return is considered in chapters on that type of income:

Topic	**See para**	**Topic**	**See para**
Unremitted income/gains	17.27	Motive/EU-law defence	52.33
Discretionary trust income	41.3.6	Chargeable event	70.21
s.624 income	47.17	Disguised IM fees	73.33
s.720 income	49.29	Chargeable gains	56.27
s.731 income	50.60	s.87 gains	61.59

121.1 Reporting/compliance: Introduction

The layout of discussion as follows:

Topic	**See para**
Enquiries, assessment, carelessness/deliberate error: IT/CGT	*This chapter*
Tax return filing positions	122.1
Claims	123.1
Collection of IT/CGT from UK Representatives	124.1
Reporting/compliance for IHT	125.1
Penalties	126.1
Failure to prevent tax evasion	127.1
Reporting beneficial ownership/money laundering	
Common Reporting Standard	130.1
Trusts Registration Service	131.2
Customer Due Diligence	132.1
Reporting non-resident trusts	128.1
International movement of capital	129.1

Proceeds of Crime Act 2002	133.1

I go beyond the themes of this book and address the topics as a whole. But I do not seek to be completely comprehensive: a full discussion would need volumes.

Further disclosure duties may arise under:

(1) DOTAS (on which books have been written)
(2) DAC 6[1]

I do not consider these topics here, though I hope to do so in a future edition.

121.2 Duty to notify liability

The starting point is that a taxpayer liable to tax must give notice of liability to HMRC.

s.7(1) TMA (IT/CGT)	**para 2 sch 18 FA 1998** (CT)
Every person who—	(1) A company which—
(a) is chargeable to income tax or capital gains tax for any year of assessment, and	(a) is chargeable to tax for an accounting period, and
(b) falls within subsection (1A) or (1B),	b) has not received a notice requiring a company tax return,
shall, subject to subsection (3) below, within the notification period, give notice to an officer of the Board that he is so chargeable.	must give notice to an officer of Revenue and Customs that it is so chargeable.
	(2) The notice must be given within twelve months from the end of the accounting period.

I refer to this as a "notice of liability".[2]

Section 7(2) TMA defines the notification period:

[1] The Directive on Administrative Co-operation (2011/16/EU) with regard to cross-border arrangements, implemented by The International Tax Enforcement (Disclosable Arrangements) Regulations 2020 but partly repealed post-Brexit.

[2] Section 7(1) uses the word chargeable, but the heading to s.7, and s.7(7), use the word "liable". The two words have the same sense here, and are used interchangeably.

> In subsection (1) "the notification period" means—
> (a) in the case of a person who falls within subsection (1A), the period of 6 months from the end of the year of assessment, or
> (b) in the case of a person who falls within subsection (1B)—
> (i) the period of 6 months from the end of the year of assessment, or
> (ii) the period of 30 days beginning with the day after the day on which the notice under section 8 was withdrawn,
> whichever ends later.

For consequences of failure to comply see 121.18 (20 year limit: Failure to notify); 120.5 (Failure to notify liability).

In *Owens v HMRC* the taxpayer's accountant wrote to say "We are writing to give notice of liability to tax under TMA 1970 s 7(1) for tax year SA17." The FTT said:[3]

> Both parties accept that there is no specified wording for a taxpayer to notify HMRC of their chargeability to tax. However, the wording used by the Agent in his six letters to HMRC falls far short of the ordinary meaning of s7 TMA 1970. Upon receipt of the letters dated 5 February 2018 and 16 January 2019 HMRC were given no information as to what sort of tax the Appellant was liable for, no indication of the amount and no information concerning the source of the taxable income.

This is plainly wrong: the provision requires notice that the individual is chargeable to IT or CGT; and no further information is required to satisfy s.7. The recourse for HMRC is to issue a notice requiring a tax return, which requires the information.

121.2.1 *Persons required to notify*

Section 7 TMA provides:

> (1A) A person falls within this subsection if the person has not received a notice under section 8 requiring a return for the year of assessment of the person's total income and chargeable gains.
> (1B) A person falls within this subsection if the person—
> (a) has received a notice under section 8 requiring a return for the year of assessment of the person's total income and chargeable gains, and

[3] [2024] UKFTT 192 (TC) at [55]. But the parties were not represented by Counsel.

> (b) has received a notice under section 8B withdrawing the notice under section 8.

The starting point is that everyone is required to notify unless they receive a s.8 notice which requires them to put in a tax return, (in which case a s.7 notice is obviously unnecessary).

121.2.2 *Trustees duty to notify*

Section 7(2) TMA provides:

> In the case of persons who are chargeable as mentioned in subsection (1) above as the relevant trustees[4] of a settlement, that subsection and subsections (1A) to (1C) have effect as if references to a notice under section 8 were references to a notice under section 8A.

In *Trustees of the Paul Hogarth Life Interest Trust v HMRC:*[5]

> [Section 7 TMA] uses the word "persons" in relation to trustees and s 7(2) assumes that the persons who are chargeable, and who therefore have the obligation to notify, are "the relevant trustees". This is consistent with s 474 ITA.

121.2.3 *Simple assessments*

Section 7(2A) TMA provides:

> A person who—
> (a) falls within subsection (1A) or (1B), and
> (b) is notified of a simple assessment for the year of assessment,
> is not required to give notice under subsection (1) for that year unless the person is chargeable to income tax or capital gains tax for the year of assessment on any income or gain that is not included in the assessment.

121.3 Duty to notify: Exemption

Section 7(3) TMA provides:

> A person shall not be required to give notice under subsection (1) above in respect of a year of assessment if for that year—
> (a) the person's total income consists of income from sources falling within subsections (4) to (7) below,

[4] See 121.4.2 (Relevant trustees).

[5] [2018] UKFTT 595 (TC) at [18].

> (b) the person has no chargeable gains, and
> (c) the person is not liable to a high income child benefit charge.

Subsections (4) to (7) contain a set of 5 income categories which fall within this exemption.

121.3.1 *Payments within PAYE*

Section 7 TMA provides:

> (4) A source of income falls within this subsection in relation to a year of assessment if—
> (a) all payments of, or on account of, income from it during that year, and
> (b) all income from it for that year which does not consist of payments,
> have or has been taken into account in the making of deductions or repayments of tax under PAYE regulations.
> (5) A source of income falls within this subsection in relation to any person and any year of assessment if all income from it for that year has been or will be taken into account—
> (a) in determining that person's liability to tax, or
> (b) in the making of deductions or repayments of tax under PAYE regulations.

121.3.2 *Tax deducted at source*

Section 7(6) TMA provides:

> A source of income falls within this subsection in relation to any person and any year of assessment if
> [A] all income from it for that year is—
> (a) income from which income tax has been deducted; or
> (b) income from or on which income tax is treated as having been deducted or paid,
> [B] and that person is not for that year liable to tax at a rate other than the basic rate, the dividend nil rate, the Scottish basic rate, a Scottish rate below the Scottish basic rate, the Scottish intermediate rate, the Welsh basic rate, the dividend ordinary rate, the savings nil rate or the starting rate for savings.

Persons within [B] would once have been called basic rate taxpayers. Is it possible to read that list without a sigh for the simpler, pre-devolution days?

121.3.3 *Dividends within dividend nil-rate*

Section 7(6A) TMA provides:

> A source of income falls within this subsection in relation to any person and any year of assessment if for that year—
> (a) all income from the source is dividend income (see section 19 of ITA 2007),[6] and
> (b) the person—
> (i) is UK-resident,[7]
> (ii) is not liable to tax at the dividend ordinary rate,
> (iii) is not liable to tax at the dividend upper rate,
> (iv) is not liable to tax at the dividend additional rate, and
> (v) is not charged to tax under section 832 of ITTOIA 2005 (relevant foreign income charged on remittance basis) on any dividend income.

121.3.4 *No tax liability*

Section 7(7) TMA provides:

> A source of income falls within this subsection in relation to any person and any year of assessment if all income from it for that year is income on which he could not become liable to tax under a self-assessment made under section 9 of this Act in respect of that year.

This would apply to interest income taxable at the 0% rate.[8]

What about a person whose income falls within the personal allowance? The answer is that the personal allowance requires a claim,[9] so unless a claim is made, which is normally done in a return, notification is strictly required.

121.3.5 *HMRC practice*

HMRC offer an online tool which provides:[10]

> Use this tool to find out if you need to send a tax return for the 2022 to 2023 tax year (6 April 2022 to 5 April 2023).

[6] See 43.4.1 ("Dividend Income").

[7] If the individual is non-resident, dividend income of a basic rate taxpayer falls within s.7(6) because the non-resident has a tax credit: see 30.7 (Non-resident recipient).

[8] See 43.8 (Starting rate for savings); 43.9 (Savings nil rate).

[9] See 44.3 (IT personal allowances).

[10] *https://www.gov.uk/check-if-you-need-tax-return*

Context shows that this is referring to the duty to notify liability under s.7 TMA.

The user will be told “You do not need to send a Self Assessment tax return” (more accurately, a notice of liability) if (inter alia) meet the following conditions:

1 Have not worked as a sole trader, a business partner or a director of a limited company.
2. Did not work as an ‘off-payroll worker’ ie did not provide services to a client through an intermediary such as: a own limited company, partnership, personal service company, an individual
3 Total income less than £50k
4 No income from UK property or land
5 Less than £10k from dividends or savings and investments[11]
6 No need to pay tax on: trust income, foreign income, £2.5k commission or cash in hand payments, a private pension, a Self-Employment Income Support Scheme grant
7 No need to pay CGT
8 Not a religious minister, Lloyd’s underwriter, examiner, exam moderator or invigilator, or share fisherman

This is strictly a concession. It would be desirable to amend s.7, or to express the concession more formally, but there it is. In practice a person who meets these criteria cannot be expected to put in a notice of liability.

121.3.6 *Company director*

It is obvious that being a company director is not by itself sufficient to require a notice of liability under s.7. HMRC have *twice* argued the contrary, on the basis of their own guidance: but the guidance was simply wrong.[12]

121.4 Duty to make SA return

The rules are in s.8(1)/8A(1) TMA:

s.8(1) TMA: Non-trustees	**s.8A(1) TMA: Trustees**
For the purpose of establishing	For the purpose of establishing

[11] Author’s footnote: Presumably the £10k limit applies to the total of dividends and interest income.

[12] *Kadhem v HMRC* [2017] UKFTT 466 (TC). The reader may wonder how this ever came to the FTT. Yet the same point had to be made again in *Symes v HMRC* [2018] UKFTT 42 (TC).

[i] the amounts[13] in which a person is chargeable to income tax and capital gains tax for a year of assessment, and	[i] the amounts in which the relevant trustees of a settlement, and the settlors and beneficiaries, are chargeable to income tax and capital gains tax for a year of assessment, and
[ii] the amount payable[14] by him by way of income tax for that year,	[ii] the amount payable by him by way of income tax for that year,
he may be required by a notice given to him by an officer of the Board-	an officer of the Board may by a notice given to any relevant trustee require the trustee-
(a) to make and deliver to the officer, a return containing such information as may reasonably be required in pursuance of the notice, and	(a) to make and deliver to the officer, on or before the day mentioned in subsection (1A) below a return containing such information as may reasonably be required in pursuance of the notice, and
(b) to deliver with the return such accounts, statements and documents, relating to information contained in the return, as may reasonably be so required.	(b) [identical]
	and a notice may be given to any one trustee or separate notices may be given to each trustee or to such trustees as the officer thinks fit.

[13] Section 8(1AA)/8A(1AA) TMA provide: "For the purposes of subsection (1) above-
(a) the amounts in which a person is chargeable to income tax and capital gains tax are net amounts, that is to say, amounts which take into account any relief or allowance a claim for which is included in the return".

[14] Section 8(1AA)/8A(1AA) TMA provide: "(b) the amount payable by a person by way of income tax is the difference between the amount in which he is chargeable to income tax and the aggregate amount of any income tax deducted at source.
Section 8(5) TMA provides: "In this section and sections 8A, 9 and 12AA of this Act, any reference to income tax deducted at source is a reference to income tax deducted or treated as deducted from any income or treated as paid on any income."

Statute frequently refers to "a return under section 8 or 8A". I gloss that as a **"SA return"**.

121.4.1 *Small gains*

There is a relief for reporting small gains (within the CGT annual exemption). Section 8C(1) TMA provides:

> This section applies if—
>
> (a) the amount of chargeable gains accruing to a person in a tax year does not exceed the annual exempt amount for the year applicable to the person under section 1K of the 1992 Act,[15]
>
> (b) the total amount or value of the consideration for all chargeable disposals[16] of assets made by the person in the year does not exceed £50,000,
>
> (c) the person is not a remittance-basis individual for the year, and
>
> (d) a notice under section 8 or 8A is given to the person requiring information for the purpose of establishing the amount in which the person is chargeable to capital gains tax for the year.

Assuming these conditions are satisfied, s.8C(2) provides the relief:

> If the person makes a statement confirming the matters set out in subsection (1)(a) to (c), the statement constitutes sufficient compliance with that requirement.

Section 8C(4) TMA defines "remittance-basis individual":

> For the purposes of this section an individual is "a remittance-basis individual" for a tax year if—
>
> (a) section 809B of ITA 2007 applies to the individual for the year, or
>
> (b) paragraph 2 of Schedule 1 to the 1992 Act applies in relation to any gains that are treated as accruing to the individual in the

[15] See 44.2 (CGT annual exemption).

[16] Defined in s.8C(3) TMA:

(3) For the purposes of this section every disposal is a "chargeable disposal" other than–

(a) a disposal on which any gain accruing is not a chargeable gain, and

(b) a disposal to which section 58 of the 1992 Act applies (spouses and civil partners).

> year as a result of paragraph 1 of that Schedule.[17]

This disapplies the relief for reporting small gains where the CGT annual exemption is disapplied.[18]

121.4.2 *Relevant trustees*

The term "relevant trustees" matters for the duty to notify chargeability, to make a SA return, and for penalties.

Section 7(9) TMA provides:

> For the purposes of this Act the relevant trustees of a settlement are—
> (a) in relation to income (other than gains treated as arising under Chapter 9 of Part 4 of ITTOIA 2005),
> [i] the persons who are trustees when the income arises and
> [ii] any persons who subsequently become trustees; and
> (aa) in relation to gains treated as arising under Chapter 9 of Part 4 of ITTOIA 2005 [chargeable-event gains],
> [i] the persons who are trustees in the year of assessment in which the gains arise and
> [ii] any persons who subsequently become trustees; and
> (b) in relation to chargeable gains,
> [i] the persons who are trustees in the year of assessment in which the chargeable gains accrue and
> [ii] any persons who subsequently become trustees.

In *Trustees of the Paul Hogarth Life Interest Trust v HMRC:*[19]

> [1] The effect of the definition in s 7(9) is that a trustee who has ceased to act before the income or gain arises or accrues is not a relevant trustee for the purposes of notifying chargeability for the tax year in which the income arises.
> [2] But a trustee who is appointed after the date the income or gain arises or accrues is a relevant trustee (of course only if they are appointed before the obligation to notify has arisen).

Point [2] is not self-evident.

Hogarth also found that a notice to file cannot be given to the trustees of an IIP trust with all income mandated ot the life tenant and with no chargeable gains; that seems surprising.

[17] See 65.18 (Effect of loss election).
[18] See 44.6 (Allowances: remittance basis user).
[19] [2018] UKFTT 595 (TC) at [19].

Section 8A(5) TMA provides:

> The following references, namely-
>
> (a) references in section 9 or 28C of this Act to a person to whom a notice has been given under this section being chargeable to tax; and
>
> (b) references in section 29 of this Act to such a person being assessed to tax,
>
> shall be construed as references to the relevant trustees of the settlement being so chargeable or, as the case may be, being so assessed.

121.4.3 *Partnership*

Section 8 TMA provides:

> (1B) In the case of a person who carries on a trade, profession, or business in partnership with one or more other persons, a return under this section shall include each amount which, in any relevant statement, is stated to be equal to his share of any income, loss, tax, credit or charge for the period in respect of which the statement is made.
>
> (1C) In subsection (1B) above "relevant statement" means a statement which, as respects the partnership, falls to be made under section 12AB of this Act for a period which includes, or includes any part of, the year of assessment or its basis period.

121.4.4 *SA return time limits*

Section 8(1D) TMA provides:

> A return under this section for a year of assessment (Year 1) must be delivered-
>
> (a) in the case of a non-electronic return, on or before 31st October in Year 2, and
>
> (b) in the case of an electronic return,[20] on or before 31st January in Year 2.

There are minor exceptions. Section 8 TMA provides:

> (1E) But subsection (1D) is subject to the following two exceptions.
>
> (1F) Exception 1 is that if a notice in respect of Year 1 is given after 31st July in Year 2 (but on or before 31st October), a return must be delivered-

[20] Section 8(1H) TMA provides: "The Commissioners-
(a) shall prescribe what constitutes an electronic return, and
(b) may make different provision for different cases or circumstances."

> (a) during the period of 3 months beginning with the date of the notice (for a non-electronic return), or
> (b) on or before 31st January (for an electronic return).
> (1G) Exception 2 is that if a notice in respect of Year 1 is given after 31st October in Year 2, a return (whether electronic or not) must be delivered during the period of 3 months beginning with the date of the notice.

Section 8A TMA makes identical provision for trustees, but the provisions are s.8A(1D)-(1F).

121.4.5 *Scope of SA return*

Section 8(3)/8A(3) TMA provide:

> A notice under this section may require different information, accounts and statements for different periods or in relation to different descriptions of source of income.

Section 8(4)/8A(4) TMA provide:

> Notices under this section may require different information, accounts and statements in relation to different descriptions of person.

> Notices under this section may require different information, accounts and statements in relation to different descriptions of settlement.

That seems self-evident.

121.4.6 *Non-resident employer*

Section 8 TMA provides:

> (4A) Subsection (4B) applies if a notice under this section is given to a person within section 8ZA of this Act (certain persons employed etc by person not resident in UK who perform their duties for UK clients).
> (4B) The notice may require a return of the person's income to include particulars of any general earnings (see section 7(3) of ITEPA 2003) paid to the person.

Section 8ZA TMA provides:

> (1) For the purposes of section 8(4A) of this Act, a person ("F") is within this section if each of conditions A to C is met.
> (2) Condition A is that F performs in the UK, for a continuous period of 30 days or more, duties of an office or employment.

> (3) Condition B is that the office or employment is under or with a person who-
>
> (a) is not resident in the UK, but
>
> (b) is resident outside the UK.
>
> (4) Condition C is that the duties are performed for the benefit of a person who-
>
> (a) is resident in the UK, or
>
> (b) carries on a trade, profession or vocation in the UK.

121.4.7 *Withdrawal of notice*

Section 8B TMA provides:

> (1) This section applies to a person who is given a notice under section 8 or 8A.
>
> (2) Before the end of the withdrawal period, HMRC may withdraw the notice (whether at the request of the person or otherwise).
>
> (3) But the notice may not be withdrawn if-
>
> (a) the person has made a return under section 8 or 8A [SA return][21] in pursuance of the notice under that section, or
>
> (b) the person has been served with notice of a determination under section 28C by virtue of the notice under section 8 or 8A having been given to the person.
>
> (4) If HMRC decide to withdraw the notice under section 8 or 8A they must do so by giving the person a notice under this section.
>
> (5) A notice under this section must specify the date on which the notice under section 8 or 8A is withdrawn.
>
> (6) For the purposes of subsection (2) “the withdrawal period” means-
>
> (a) the period of 2 years beginning with the end of the year of assessment to which the notice under section 8 or 8A relates, or
>
> (b) in exceptional circumstances, such extended period as HMRC may determine2.
>
> (7) Withdrawal of a notice given to a person under section 8 or 8A in relation to a year of assessment does not prevent HMRC from giving the person a further notice under that section in relation to that year.
>
> (8) See paragraph 17A of Schedule 55 to FA 2009 as to the cancellation of liability to a penalty under any paragraph of that Schedule by including provision in a notice under this section.

I wonder how often that happens.

[21] See 121.4 (Duty to make SA return).

121.4.8 *Voluntary return*

Section 12D TMA provides:

> (1) This section applies where—
> (a) a person delivers a purported return ("the relevant return") under section 8, 8A or 12AA ("the relevant section") for a year of assessment or other period ("the relevant period"),
> (b) no notice under the relevant section has been given to the person in respect of the relevant period, and
> (c) HMRC treats the relevant return as a return made and delivered in pursuance of such a notice.
>
> (2) For the purposes of the Taxes Acts—
> (a) treat a relevant notice as having been given to the person on the day the relevant return was delivered, and
> (b) treat the relevant return as having been made and delivered in pursuance of that notice (and, accordingly, treat it as if it were a return under the relevant section).
>
> (3) "Relevant notice" means—
> (a) in relation to section 8 or 8A, a notice under that section in respect of the relevant period;
> (b) in relation to section 12AA, a notice under section 12AA(3) requiring the person to deliver a return in respect of the relevant period, on or before the day the relevant return was delivered (or, if later, the earliest day that could be specified under section 12AA).
>
> (4) In subsection (1)(a) "purported return" means anything that—
> (a) is in a form, and is delivered in a way, that a corresponding return could have been made and delivered had a relevant notice been given, and
> (b) purports to be a return under the relevant section.
>
> (5) Nothing in this section affects sections 34 to 36 or any other provisions of the Taxes Acts specifying a period for the making or delivering of any assessment (including self-assessment) to income tax or capital gains tax.[22]

121.5 Reporting bare trusts

Trustees of a bare trust are not "relevant trustees" as they are not trustees of a settlement. Although they are persons, they are not normally subject

[22] This reverses the decision in *Patel v HMRC* [2018] UKFTT 185 (TC). Section 87 FA 2019 provided a transitional rule for pre-2018 returns, now spent.

to reporting duties. TSEM provides:

> **TSEM1563: bare or simple trust** [Sep 2021]
>
> [1] The trustees of a bare trust may pay the tax due to HM Revenue & Customs on behalf of a beneficiary, but it is the beneficiary who is strictly chargeable to tax. The trustees are not required to make a tax return. They may complete the Trust and Estate Tax Return and account for any basic rate tax due on income.
>
> [2] However, bare trustees cannot return capital gains or any gains on life insurance policies, life annuities or capital redemption policies; these continue to be the beneficiaries' responsibility only.

Point [2] is soundly based on the CGT bare trust disregard and the chargeable events code. There is no express statutory provision for point [1], but the rule (or, if concessionary, the practice) is obviously sensible. The practice does not apply if bare trustees retain funds for their own benefit, in breach of trust.[23]

121.6 s.8 return: self-assessment

Section 9 TMA provides:

> (1) Subject to subsections (1A) and (2), every return under section 8 or 8A of this Act shall include a self-assessment, that is to say—
>
> (a) an assessment of the amounts in which, on the basis of the information contained in the return and taking into account any relief or allowance a claim for which is included in the return, the person making the return is chargeable to income tax and capital gains tax for the year of assessment; and
>
> (b) an assessment of the amount payable by him by way of income tax, that is to say, the difference between the amount in which he is assessed to income tax under paragraph (a) above and the aggregate amount of any income tax deducted at source
>
> but nothing in this subsection shall enable a self-assessment to show as repayable any income tax treated as deducted or paid by virtue of section 246D(1)of the principal Act, section 626 of ITEPA 2003 or section 399(2) or 530(1) of ITTOIA 2005.
>
> (1A) The tax to be assessed on a person by a self-assessment shall not include any tax which—
>
> (a) is chargeable on the scheme administrator of a registered

[23] See 87.7.6 (Bare trusts: Navigation).

pension scheme under Part 4 of the Finance Act 2004,

(aa) is chargeable, on the scheme manager of a qualifying recognised overseas pension scheme or a former such scheme, under Part 4 of the Finance Act 2004,

(ab) is chargeable on the sub-scheme administrator of a sub-scheme under Part 4 of the Finance Act 2004 as modified by the Registered Pensions (Splitting of Schemes) Regulations 2006, or

(b) is chargeable on the person who is (or persons who are) the responsible person in relation to an employer-financed retirement benefits scheme under section 394(2) of ITEPA 2003.

(2) A person shall not be required to comply with subsection (1) above if he makes and delivers his return for a year of assessment—

(a) on or before the 31st October next following the year, or

(b) where the notice under section 8 or 8A of this Act is given after the 31st August next following the year, within the period of two months beginning with the day on which the notice is given.

(3) Where, in making and delivering a return, a person does not comply with subsection (1) above, an officer of the Board shall if subsection (2) above applies, and may in any other case—

(a) make the assessment on his behalf on the basis of the information contained in the return, and

(b) send him a copy of the assessment so made;

(3A) An assessment under subsection (3) above is treated for the purposes of this Act as a self-assessment and as included in the return.

121.7 Amending a SA return

Section 9ZA TMA provides:

(1) A person may amend his return under section 8 or 8A [SA return] of this Act by notice to an officer of the Board.

(2) An amendment may not be made more than twelve months after the filing date.

(3) In this section "the filing date", in respect of a return for a year of assessment (Year 1), means—

(a) 31st January of Year 2, or

(b) if the notice under section 8 or 8A is given after 31st October of Year 2, the last day of the period of three months beginning with the date of the notice.

In *Re Webster*[24] a taxpayer sought to amend his return by the equitable remedy of rectification. No-one had ever thought of that before. A High Court master held that it had no jurisdiction to rectify a tax return, and while not strictly a citable precedent, because only one party was represented, that seems clearly right. Amendment is only possible under the statutory procedure.

121.8 SA Enquiries

Section 9A(1) TMA provides:

> An officer of the Board may enquire into a return under section 8 or 8A of this Act [SA return][25] if he gives notice of his intention to do so ("notice of enquiry")—
> (a) to the person whose return it is ("the taxpayer"),
> (b) within the time allowed.

HMRC do not need any justifiable suspicion in order to open an enquiry. That is inconsistent with the HMRC Charter ("We'll assume you're telling the truth, unless we've good reason to think you're not."). But no-one takes any notice of that.

121.8.1 *Enquiry time limit*

Section 9A(2) TMA provides:

> The time allowed is—
> (a) if the return was delivered on or before the filing date,[26] up to the end of the period of twelve months after the day on which the return was delivered;
> (b) if the return was delivered after the filing date, up to and including the quarter day[27] next following the first anniversary of the day on which the return was delivered;
> (c) if the return is amended under section 9ZA of this Act, up to and including the quarter day next following the first anniversary of the day on which the amendment was made.

[24] [2020] EWHC 2275 (Ch).

[25] See 121.4 (Duty to make SA return).

[26] Section 9A(6) TMA provides: "In this section "the filing date" means, in relation to a return, the last day for delivering it in accordance with section 8 or 8A."

[27] Section 9A(2) TMA provides: "For this purpose the quarter days are 31st January, 30th April, 31st July and 31st October."

In short, HMRC have 12 months in which to begin an enquiry into a tax return. I refer to this as the **"one-year enquiry window"**.

121.8.2 *Only one enquiry*

Section 9A(3) TMA provides:

> A return which has been the subject of one notice of enquiry may not be the subject of another, except one given in consequence of an amendment (or another amendment) of the return under section 9ZA of this Act.

In short, only one enquiry is allowed. But as an enquiry will normally take at least one year, this will not often arise.

121.8.3 *Scope of enquiry*

Section 9A TMA provides:

> (4) An enquiry extends to—
> (a) anything contained in the return, or required to be contained in the return, including any claim or election included in the return,
> (b) consideration of whether to give the taxpayer a transfer pricing notice under section 168(1) of TIOPA 2010 (provision not at arm's length: medium-sized enterprise),
> (c) consideration of whether to give the taxpayer a notice under section 81(2) of TIOPA 2010 (notice to counteract scheme or arrangement designed to increase double taxation relief),
> but this is subject to the following limitation.
> (5) If the notice of enquiry is given as a result of an amendment of the return under section 9ZA of this Act—
> (a) at a time when it is no longer possible to give notice of enquiry under subsection (2)(a) or (b) above,
> (b) after a final closure notice has been issued in relation to an enquiry into the return, or
> (c) after a partial closure notice has been issued in such an enquiry in relation to the matters to which the amendment relates or which are affected by the amendment,
> the enquiry into the return is limited to matters to which the amendment relates or which are affected by the amendment.

121.9 Assessment after enquiry window

Section 29(1) TMA provides an assessment may be made after the one-year enquiry window in certain cases:

> If an officer of the Board or the Board discover, as regards any person (the taxpayer) and a year of assessment—
>
> (a) that any income which ought to have been assessed to income tax, or chargeable gains which ought to have been assessed to capital gains tax, have not been assessed, or
>
> (b) that an assessment to tax is or has become insufficient, or
>
> (c) that any relief which has been given is or has become excessive,
>
> the officer or, as the case may be, the Board may, subject to subsections (2) and (3) below, make an assessment in the amount, or the further amount, which ought in his or their opinion to be charged in order to make good to the Crown the loss of tax.

Assessments under s.29 are known as "**discovery assessments**", but apart from s.29, there is no further power or kind of assessment.

Statute frequently refers to:

> the situation mentioned in subsection (1) above

I gloss this as the "**insufficiency in the assessment**" or just "**insufficiency**".

Discovery assessments are subject to a number of restrictions:

Restriction	**TMA**	**See para**
IT/CGT assessment time limits	*Various*	121.13
Prevailing practice defence	s.29(2)	121.9.3
Carelessness condition	s.29(4)	121.9.4
Full-disclosure requirement	s.29(5)	121.10

121.9.1 *Discovery requirement*

The requirement that HMRC must "discover" an insufficiency is not onerous, and taxpayers have not generally succeeded on arguments that an assessment is invalid because there have been no "discovery". In *Charlton v HMRC*:[28]

> [37] In our judgment, no new information, of fact or law, is required for there to be a discovery. All that is required is that it has newly appeared to an officer, acting honestly and reasonably, that there is an insufficiency in an assessment. That can be for any reason, including a change of view, change of opinion, or correction of an oversight. The

[28] [2012] UKUT 770 (TCC).

> requirement for newness does not relate to the reason for the conclusion reached by the officer, but to the conclusion itself...
> [44] ...a discovery assessment can be made merely where the original officer of HMRC changes his mind or where a different officer takes a different view.

121.9.2 *HMRC delay*

Delay by HMRC does not mean that there is no discovery. Efficiency and expedition in tax administration would no doubt be desirable; but the legislation does not make this a requirement. In *HMRC v Tooth*:[29]

> there is no place for the idea that a discovery which qualifies as such should cease to do so by the passage of time. That is unsustainable as a matter of ordinary language and, further, to import such a notion of staleness would conflict with the statutory scheme. That sets out a series of limitation periods for the making of assessments to tax, each of them expressed in positive terms that an assessment "may be made at any time" up to the stated time limit... it is perfectly possible, as a matter of ordinary language, to speak of someone making a discovery for himself or herself even if it is something already known to others. ... since section 29(1) is concerned, so far as is relevant, with a discovery made by an officer of the Board, the question is whether the officer of the Board who is deciding whether to make a discovery assessment under that provision has subjectively made a discovery that there has been an under-assessment of tax.

There is the possibility of judicial review in an extreme case; but the facts would have to be very unusual, and I doubt if it would ever happen.

121.9.3 *Prevailing practice defence*

Section 29(2) TMA provides:

> Where—
> (a) the taxpayer has made and delivered a return under section 8 or 8A of this Act [SA return][30] in respect of the relevant year of assessment, and
> (b) the situation mentioned in subsection (1) above [the insufficiency] is attributable to an error or mistake in the return as to the basis on which his liability ought to have been computed,

[29] [2021] UKSC 17 at [76]-[78].
[30] See 121.4 (Duty to make SA return).

> the taxpayer shall not be assessed under that subsection in respect of the year of assessment there mentioned if the return was in fact made on the basis or in accordance with the practice generally prevailing at the time when it was made.

What constitutes the "practice generally prevailing" is a question of fact.[31] A clear statement in an HMRC Manual is not conclusive proof of HMRC practice, but it is strong evidence.

The term is equivalent to "established practice" which is found in other contexts:

Context	**See para**
Meaning of avoidance/abuse	3.20.9; 3.26.1
Disqualified advice	126.12.2

The issue has given rise to much litigation. *Hargreaves v HMRC* summarised the law in numbered propositions:

> (1) The practice has to be one adopted by taxpayers and HMRC alike;
> (2) The practice must be capable of being readily ascertainable by the parties ie it must have substance (in the sense of not being inchoate), and be sufficiently precise and devoid of uncertainty as to its application;
> (3) A practice would not exist if it was equivocal or dependent on the ascertainment of facts, except where the criteria for its application by reference to the facts were themselves understood with a sufficient degree of precision so as the make the practice one that can be readily applied in any given case;
> (4) The practice must have been adopted by HMRC and generally, if not universally, by the taxpayer community;
> (5) A practice will not be generally prevailing if it is not agreed, or respected, as a whole, either by HMRC failing to apply every element of the practice in every case where it should be applied, or by taxpayers adopting only those parts that are favourable to them, but disputing others that are not;
> (6) The practice must be settled which will not be the case if it is articulated or applied otherwise than in a consistent manner or if it is based on criteria which are subject to change depending on the particular circumstances or the facts of a particular case;
> (7) If the facts are relevant to the application of a practice, the relevant

[31] This is self-evident, but if authority is needed, see *Boyer Allan Investment Services v HMRC* [2012] UKFTT 558 (TC); *Turners (Soham) v HMRC* [2019] UKFTT 131.

> factors must themselves be clear and unequivocal; and
> (8) Mere inactivity can in appropriate circumstances give rise to a practice. But such an omission must also be capable of articulation in the same way as a positive act. It must have both clarity and substance. Its parameters must be clearly defined so that the general acceptance amounts to the same unequivocal understanding.[32]

121.9.4 *Carelessness condition*

Section 29 TMA provides:

> (3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act [SA return][33] in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above—
> (a) in respect of the year of assessment mentioned in that subsection; and
> (b) in the same capacity as that in which he made and delivered the return,
>
> unless one of the two conditions mentioned below is fulfilled.
> (4) The first condition is that the situation mentioned in subsection (1) above [the insufficiency] was brought about carelessly or deliberately by the taxpayer or a person acting on his behalf.

I refer to this condition as the **"carelessness condition"**.

121.10 Full-disclosure requirement

Section 29 TMA provides:

> (3) Where the taxpayer has made and delivered a return under section 8 or 8A of this Act [SA return][34] in respect of the relevant year of assessment, he shall not be assessed under subsection (1) above—
> (a) in respect of the year of assessment mentioned in that subsection; and
> (b) in the same capacity as that in which he made and delivered the return,
>
> unless one of the two conditions mentioned below is fulfilled...

The second condition is:

> (5) The second condition is that at the time when an officer of the Board—

[32] [2019] UKFTT 244 (TC) at [24].

[33] See 121.4 (Duty to make SA return).

[34] See 121.4 (Duty to make SA return).

> (a) ceased to be entitled to give notice of his intention to enquire into the taxpayer's return under section 8 or 8A of this Act [SA return] in respect of the relevant year of assessment;[35] or
> (b) in a case where a notice of enquiry into the return was given—
>   (i) issued a partial closure notice as regards a matter to which the situation mentioned in subsection (1) above [the insufficiency] relates, or
>   (ii) if no such partial closure notice was issued, issued a final closure notice,
>
> the officer could not have been reasonably expected, on the basis of the information made available[36] to him before that time, to be aware of the situation mentioned in subsection (1) above [the insufficiency].

The wording is a little convoluted, but the question is essentially a short one: could HMRC be expected to be aware of the insufficiency?

Hicks v HMRC outlines the principle:

> The taxpayer is incentivised by the legislation to place HMRC in a position where he can put them to proof at the close of the enquiry window with the question "what more need I have disclosed to have placed the officer in a position to be justified in raising an assessment?"[37]

In the following discussion:

"Full disclosure" is disclosure that meets the condition in s.29(5)[38]

The officer in s.29(5) is the **"hypothetical officer"** or just "HMRC"

The advantage of full disclosure is that after the one-year enquiry window has passed, HMRC cannot raise a discovery assessment.[39] If a taxpayer wants finality, that a matter will be closed at the end of the enquiry year, it is therefore necessary to disclose sufficient facts that HMRC should be aware of any insufficiency.

Full disclosure is a voluntary matter. Taxpayers are entitled to weigh up the advantages of full disclosure (finality after the one-year enquiry

[35] See 121.8.1 (Enquiry time limit).

[36] See 121.11.6 (Information available to HMRC).

[37] [2018] UKFTT 22 (TC) at [87].

[38] "Full disclosure" is a context-sensitive term, but I use it to mean disclosure which meets the high standard which precludes a discovery assessment after the one-year enquiry window. I am not using the term literally, as obviously one cannot disclose everything.

[39] Except on the basis of careless/deliberate error.

window) against the advantages of lesser disclosure (letting sleeping dogs lie), provided they do disclose so far as required by law.[40]

121.11 Full-disclosure standard

Sanderson v HMRC sets out the law in numbered paragraphs:[41]

> (1) the officer [referred to in s.29(5)] is not the actual officer who made the assessment ... but a hypothetical officer;
> (2) the officer has the characteristics of an officer of general competence, knowledge or skill which include a reasonable knowledge and understanding of the law;

The hypothetical[42] officer is the counterpart of the reasonable taxpayer who sets a taxpayer's standard of care.

> (3) where the law is complex even adequate disclosure by the taxpayer may not make it reasonable for the officer to have discovered the insufficiency on the basis of the information disclosed at the time: see *Lansdowne* at [69];[43]

But in these complex cases, the taxpayer can deal with this by explaining in addition to the facts:
(1) The law
(2) The practice and guidance, where relevant (which it would be, if the taxpayer is not following HMRC practice or guidance)

> (4) what the hypothetical officer must have been reasonably expected to be aware of is an actual insufficiency: see *Langham v Veltema*:[44]
> 33. [Section 29(5)] is concerned, not with what an Inspector could reasonably have been expected to do, but with what he could have been reasonably expected to be aware of. It speaks of an Inspector's objective awareness, from the information made available to him by the taxpayer, of ... an actual insufficiency in the assessment, not an objective

[40] See 122.8 (Disclosing doubt/further information).

[41] [2016] EWCA Civ 19 at [17].

[42] Although the word hypothetical is always employed in this context, it does not add much. The hypothetical reasonable inspector is no more hypothetical than the reasonably careful taxpayer, or advisor, or anyone who is judged by an objective standard of reasonable care. But it does not matter.

[43] "...even where the taxpayer has disclosed enough factual information, there may be circumstances in which an officer could not reasonably be expected to be aware of an insufficiency by reason of the complexity of the relevant law."

[44] [2004] EWCA Civ 193.

> awareness that he should do something to check whether there is such an insufficiency...
>
> 34. ... the subsection provides an objective test of awareness of insufficiency... It also allows, as section 29(6) expressly does, for constructive awareness of insufficiency, that is, for something less than an awareness of an insufficiency, in the form of an inference of insufficiency.[45]

In *Langham v Veltema* the taxpayer argued that a reasonable officer should have:

(1) taken the view that an assessment based on a valuation needs checking (as the HMRC Manual directed);
(2) instructed Valuation Office to check, which would have revealed the £45k shortfall.

The CoA rejected the argument. The reader might think that the decision of the High Court, which CoA rejected, provided a better balance between the conflicting policy aims, that HMRC should collect tax where due, and that taxpayers should be able to obtain finality, so they can better conduct their lives; but the law is settled.

121.11.1 *Full-disclosure/discovery compared*

There can be an overlap between the issues in:

(1) The full-disclosure requirement in s.29(5) (HMRC expected to be aware of insufficiency)
(2) The discovery requirement in s.29(1)[46] (HMRC discover an insufficiency)

In *Sanderson v HMRC*:[47]

> The exercise of the s.29(1) power [to make a discovery assessment] is made by a real officer who is required to come to a conclusion about a possible insufficiency based on all the available information at the time when the discovery assessment is made.
>
> Section 29(5) operates to place a restriction on the exercise of that power by reference to a hypothetical officer who is required to carry out an evaluation of the adequacy of the return at a fixed and different point in time on the basis of a fixed and limited class of information. The

[45] [2016] EWCA Civ 19.

[46] See 121.9.1 (Discovery requirement).

[47] [2016] EWCA Civ 19 at [25].

> purpose of the condition is to test the adequacy of the taxpayer's disclosure, not to prescribe the circumstances which would justify the real officer in exercising the s.29(1) power.
> Although there will inevitably be points of contact between the real and the hypothetical exercises which ss.29(1) and (5) involve, the tests are not the same.

In *Hicks v HMRC*:[48]

> We know that by summer of 2014 the evidence of the real officer—relevant to subsection (1) but not subsection (5)—was that he had crossed the threshold for a discovery. While the real officer must not be confused with the hypothetical officer, it is in my opinion not unreasonable to assume that the hypothetical officer would be likely to be in a similar position by that stage in terms of his awareness of an insufficiency in the 2010-11 return.

121.11.2 *Full disclosure/carelessness compared*

A discovery assessment may raise issues of carelessness and full disclosure. There may be some tension between the two lines of argument. In *Cooke v HMRC*:[49]

> HMRC are arguing that the appellant's accountant was careless in not identifying that the claims were excessive, but at the same time an HMRC officer could not have been expected to pick the point up. The appellant argues the opposite: the accountant was not careless but an HMRC officer should have been able to spot the problem.

On the facts of that case, the taxpayer was not careless (having reasonably relied on faulty software) but the hypothetical officer should have been aware of the insufficiency.

121.11.3 *Disclosing valuations*

SP 1/06 provides:

> Most taxpayers who use a valuation in completing their tax return and state in the Additional Information space at the end of the Return that
> [1] a valuation has been used,
> [2] by whom it has been carried out, and
> [3] that it was carried out by a named independent and suitably qualified

[48] at [109].
[49] [2017] UKFTT 844 (TC) at [28].

> valuer if that was the case, on the appropriate basis,
>
> will be able, for all practical purposes, to rely on protection from a later discovery assessment, provided those statements are true.

The statements do not actually meet the full-disclosure standard, as interpreted in *Veltema,* because the hypothetical officer would not know the expert valuation was wrong. So this practice is concession not law.

A post-transaction valuation offers a route to finality; the form is CG34 (Post-transaction valuation checks for capital gains).[50]

121.11.4 *Allocation to income/capital*

SP 1/06 provides:

> Most taxpayers will be able to gain finality with exceptional items in accounts. An example might be a deduction in the accounts under Repairs. If an entry in the Additional Information space points out that a programme of work has been carried out that included repairs, improvements and new building work and that the total cost has been allocated to revenue and capital on a particular basis, the inspector should not enquire after the closure of the enquiry period unless he becomes aware that the statement was patently untrue or unreasonable.

This is unobjectionable as far as it goes; though in practice everything would depend on the wording of the statement in the return.

Would it suffice if the information was in a note to the accounts rather than in the white space in the return? Discuss.

121.11.5 *Disagreeing with HMRC view*

SP 1/06 provides:

> ***Taking a Different View***
>
> 18. It is open to a taxpayer properly informed or advised to adopt a different view of the law from that published as HMRC's view. To protect against a discovery assessment after the enquiry period, the return or accompanying documents would have to indicate that a different view had been adopted. This might be done by comments to the effect that the taxpayer has not followed HMRC guidance on the issue or that no adjustment has been made to take account of it. This would offer an opportunity to HMRC to take up the return for enquiry. It is not necessary to provide all the documentation that HMRC might need to quantify that insufficiency if an enquiry into the Return is made.

[50] See too 98.10 (Valuation for ATED); 122.9 (When disclosure required).

> 19. Provided the point at issue is clearly identified and the stance adopted is not wholly unreasonable, the existence of an under-assessment or insufficiency is demonstrated by the statement that a different view of the law has been followed. In these circumstances the taxpayer achieves finality if no enquiry is opened within the statutory time limit.

This applies when the HMRC view is published in a clear statement, typically in a SP or in a Manual. I think in principle if a failure to follow published guidance is not drawn to HMRC's attention they could not reasonably be expected to be aware of an insufficiency, so the full-disclosure requirement is not met.[51] This would not apply if the HMRC view was clearly wrong or out of date or not clearly stated.

By contrast, if there is no publically published view, there is no need to indicate that a different view has been adopted from one which may, or may not, be the HMRC view on this occasion.

In *Pattullo*[52] the taxpayer entered into a CGT avoidance scheme. He did not disclose that he had taken a different view from the CG manual.[53] The judge approved a submission made by HMRC in an earlier case, that:[54]

> Taxpayers who adopt a different view of the law from that published as HMRC's can protect against a discovery assessment after the enquiry period. The return and accounts would have to indicate that a different view had been adopted by entering comments to the effect that they did not follow HMRC guidance on the issue or that no adjustment had been made to take account of it.

Perhaps in a tax avoidance context, a higher standard is required to meet the full-disclosure requirement.

121.11.6 *Information available to HMRC*

Section 29(6) TMA provides:

[51] If the circumstances are such that a reasonable taxpayer would disclose, non-disclosure may constitute a failure to take reasonable care, see 122.9.2 (Disclosure that HMRC disagree).

[52] *Pattullo, Re Judicial Review* [2009] CSOH 137. For other aspects of this case, see above.

[53] That may be factually incorrect, the judge did not set out the relevant text of the Manual, but that does not affect the point of principle.

[54] [2009] CSOH 137 at [113] (claiming support from *Household Estate Agents v HMRC* 78 TC 705, I think wrongly, but that does not ultimately matter.)

> For the purposes of subsection (5) above, information is made available to an officer of the Board if—
>
> (a) [i] it is contained in the taxpayer's return[55] under section 8 or 8A of this Act [SA return] in respect of the relevant year of assessment (the return), or
>
> [ii] in any accounts, statements or documents accompanying the return;
>
> (b) [i] it is contained in any claim made as regards the relevant year of assessment by the taxpayer acting in the same capacity as that in which he made the return, or
>
> [ii] in any accounts, statements or documents accompanying any such claim;
>
> (c) it is contained in any documents, accounts or particulars which, for the purposes of any enquiries into the return or any such claim by an officer of the Board, are produced or furnished by the taxpayer[56] to the officer; or
>
> (d) it is information the existence of which, and the relevance of which as regards the situation mentioned in subsection (1) above [the insufficiency]—
>
> (i) could reasonably be expected to be inferred by an officer of the Board from information falling within paragraphs (a) to (c) above; or
>
> (ii) are notified in writing by the taxpayer to an officer of the Board.

These are the only sources of information to be taken into account for that purpose. That is, information counts as available *only* if it falls within the categories of s.29(6).[57]

Other information does not count as available, such as:

(1) Information (such as a valuation) not supplied to HMRC (though they

[55] Section 29(7) TMA provides: "In subsection (6) above—
(a) any reference to the taxpayer's return under section 8 or 8A of this Act in respect of the relevant year of assessment includes—
(i) a reference to any return of his under that section for either of the two immediately preceding years of assessment..."

[56] Section 29(7) TMA provides: "In subsection (6) above... (b) any reference in paragraphs (b) to (d) to the taxpayer includes a reference to a person acting on his behalf."

[57] This is self-evident, but if authority is needed, see *Sanderson v HMRC* [2016] EWCA Civ 19; *Langham v Veltema* [2004] EWCA Civ 193 at [36].

could and should have asked for it)[58]

(2) Form P11D (employee benefits) provided by the employer to HMRC;[59] or form P14 provided by the employer to the employee[60]

(3) Information obtained by HMRC as a result of its own investigation[61]

(4) Material which HMRC requested in correspondence but not supplied[62]

(5) Information supplied orally (unless later put in writing)[63]

Information which does count as "available" includes:

(1) Information which scheme promoters supplied HMRC in form AAG1 (DOTAS notification by scheme promoter) when the taxpayer gave the DOTAS reference number in the return. This is information "available" under s.29(6)(d)(i).[64] Information can fall within s29(6)(d)(i) even if it does not come from the taxpayer.

(2) Information in taxpayer correspondence with HMRC. This is information "available" under s.29(6)(d)(ii).[65]

121.11.7 *Information overload*

To provide HMRC with too much information may make it harder to identify what is relevant. Where does a wise man hide a leaf?

SP 1/06 provides:

> 9. A taxpayer can further restrict the opportunity for discovery [assessments] by providing enough information for an HMRC officer to realise within the enquiry period that the self-assessment is insufficient. However taxpayers are encouraged to submit the minimum necessary to make disclosure of an insufficiency. The *Veltema* judgement does not require the provision of enough information to quantify the effect on the assessment. Information will not be treated as being made available where the total amount supplied is so extensive that an officer 'could not have been reasonably expected to be aware' of the significance of

[58] See *Langham v Veltema* [2004] EWCA Civ 193 at [51]; followed on this point in *HMRC v Household Estate Agents* 78 TC 705.

[59] *Veltema v HMRC.*

[60] HMRC would know that the form existed, but not that it held relevant information: *Blum v HMRC* [2018] UKFTT 152.

[61] *Sanderson v HMRC* at [40].

[62] *Hicks v HMRC* at [100].

[63] *HMRC v Landsowne Partners Ltd Partnership* [2012] STC 533 at [48].

[64] *Charlton v HMRC.*

[65] *HMRC v Landsowne Partners Ltd Partnership* [2012] STC 533 at [63].

particular information and the officer's attention has not been drawn to it by the taxpayer or taxpayer's representative.

121.12 Full-disclosure: Examples

There are hundreds of cases. Although the decisions are "not always readily reconcilable"[66] there is no more disarray than usual in a large body of case law.

121.12.1 *Non-avoidance examples*

In *Langham v Veltema*[67] a company transferred a property to a director, whose income tax liability therefore depended on the market value of the property. The taxpayer obtained a professional valuation which valued the land at £100k. It was in fact worth £145k.

The return provided:

> Assets transferred/payments made for you: £100,000
> Other benefits-in-kind: Asset placed at disposal of Employee: £100,000

This indicated that the company had transferred an asset to the taxpayer, but did not identify the asset.[68]

It was said that the officer could reasonably infer that the tax return depended on a valuation (though that does not seem self-evident, if the asset transferred is not identified).

The disclosure fell short of the full-disclosure requirement:

> 38. On the facts of the case before the General Commissioners... there was no basis upon which they could have found that the Inspector ought reasonably to have been aware ... that information may well have led him to conclude that the assessment had been based on a valuation of £100,000, but there was nothing to suggest that the valuation was unreliable.

Once one accepts that the test is what the officer is aware of, rather than what the officer should be aware of if they made the enquiries they should, this answer is inevitable.

[66] *Hicks v HMRC* at [2018] UKFTT 22 (TC) at [76].

[67] [2004] EWCA Civ 193.

[68] The company's form P11D (employee benefits) identified the asset as a house, but that form was not "available" to the officer; see 121.11.6 (Information available to HMRC). In any case it would have made no difference if the asset had been identified as the house.

In *Cooke v HMRC*[69] the return gave the following information about foreign dividends:

Country	**Income before tax taken off**	**Foreign tax taken off/paid**
France	103,083	30,523
Canada	15,636	3,845

The mistake (caused by software error) was that claim for foreign tax credit relief was too large. It overlooked that the French/Canadian DTAs (following the OECD Model) reduced the French/Canadian tax on the dividend to 15% of the dividend.[70]

The tax return met the full-disclosure requirement:

> 37 ... the hypothetical officer ... could have been reasonably expected to be aware that the double tax relief claims in the appellant's return were excessive. I would expect any HMRC officer of general competence, knowledge or skill to have some understanding of double tax relief, including that there are limitations on the relief that can be claimed. 15% rate is a standard rate, and in fact generally the maximum treaty rate, for portfolio dividends from companies in jurisdictions with which the UK has double tax arrangements in place... The point is not a complex one, and in my view it did not require any "white space" entry or other flagging up ... A hypothetical officer with a "reasonable knowledge and understanding of the law" ... should have been able to ascertain that the claims were excessive. Although percentages are not included, it is pretty obvious from looking at the figures ... that the amounts claimed were materially in excess of 15%. The percentages claimed could readily be calculated from the figures in the return. This is well illustrated by the fact that [HMRC] did not require any additional information in order to raise the discovery assessment, or to conclude the enquiry for the subsequent year.
>
> 38. ... I do not think that a claim to double tax relief in respect of withholding tax on dividends is a matter of any real complexity or that it requires particular specialist knowledge within HMRC.

Thus the hypothetical reasonable inspector is expected to have a sound knowledge of tax; and the reader may think that is quite right, while still doubting how many inspectors actually pass that standard.

[69] [2017] UKFTT 844 (TC).

[70] See 30.15 (DT relief: Dividend income).

121.12.2 *Tax avoidance examples*

In *Pattullo, Re Judicial Review,*[71] the taxpayer entered into a CGT avoidance scheme using second-hand policies. The return provided:

> On [date] I settled an interest in possession trust with £6k.
> I had borrowed on commercial terms a sum of £2.665m from Investec Bank UK Ltd and settled this amount into the trust.
> The trustees used the funds to acquire a number of capital redemption contracts [and transferred them][72] to me on [date].
> I surrendered the capital redemption contracts on [date] and received redemption proceeds of £2.6m.
> This has given rise to a capital loss as a consequence of s.37(1) TCGA 1992 amounting to £2.665m.

This sets out exactly what happened. However the Court of Session held that this did not reach full-disclosure requirement. An officer knowing these facts would not be aware of an insufficiency:

> [114] ...the white space does not contain the following:
> 1. A statement that Mr Pattullo was a participant in the CRC Mark II tax avoidance scheme.

The important point was not the name of the scheme but that it was a marketed scheme. But this is not likely to arise now, because of DOTAS (and the GAAR).

> 2. A statement that the petitioner and his advisers had adopted a different view of the law from that published as HMRC's....[73]
> 3. There is no explanation as to how Mr Pattullo contends that Section 37 operates in order to produce the capital loss.
> 4. The details other than the basics of the transactions which have been entered into are not contained within the white space.

The judge wisely does not seek to identify what details were missing.

> 5. There is no indication of any doubt in the disclosure that the petitioner is entitled to the loss. I accept ... that the taxpayer does not require in order to clearly alert to say there is an insufficiency as of course that is not his position. However, in circumstances such as this a reference to doubt or as I have said to the fact that it is, a position contrary to

[71] [2009] CSOH 137.

[72] The context shows that some words like this were omitted from the law report.

[73] See 121.11.5 (Disagreeing with HMRC view).

> HMRC's would be necessary to comply with the duty incumbent upon him.
>
> In the absence of information of the type as above described an inspector ... could not in my judgment have been aware of actual insufficiency. ...

The judge does not say whether it is generally necessary to indicate a doubt in order to meet the full-disclosure requirement. It is suggested that this should not be necessary except in special cases. There must always be some doubt when there is a white box disclosure, for if there is no doubt, what is the point of disclosure?

A less onerous view of the full-disclosure requirement was taken in *Charlton v HMRC.*[74] This was another second-hand policy scheme, so the taxpayer was no more meritorious. The disclosure was essentially as follows:

> I acquired a life policy on [date] for £205k.
>
> I made a partial surrender of the policy on [date] for £192k.
>
> I sold my residual interest in the policy on [date] for £10k.
>
> The loss on sale is calculated as the difference between the sale proceeds and the cost of acquisition.
>
> Proceeds from the partial surrender are excluded from the capital gains calculation as they have already been taken into account as a receipt in computing income for the purposes of income tax.

The DOTAS scheme number was disclosed on the return so the disclosure was better that *Pattullo* in that respect.[75]

It was not mentioned that the scheme had been held to be unsuccessful by the Special Commissioners in *Drummond v HMRC*,[76] the advisers having formed the bold view that *Drummond* was wrongly decided.[77]

This met the full-disclosure requirement:

> [93] We do not accept that
>
> [1] there is any overriding requirement that the information has to explain how the scheme works ... nor
>
> [2] that the information must specify, if it be the case, that the view

[74] [2012] UKFTT 770 (TCC).

[75] This did not happen in *Pattullo* because the transactions were carried out before DOTAS.

[76] 79 TC 793.

[77] The FTT (the reader may think, surprisingly) found this to be a reasonable view, though it turned out to be wrong, as the Special Commissioner's decision was subsequently upheld.

> adopted by the taxpayer is different from that taken by HMRC.
> It is a question of degree in all cases. ... the factors the tribunal identified as being those the hypothetical officer would have known from the information made available to him ... were of themselves sufficient so that the hypothetical officer should have been aware of the insufficiency. It is not necessary that the hypothetical officer should have been able to comprehend all the workings of the scheme, or the legal and factual arguments that might arise, or be able to form a reasoned view of those matters. Having regard to the knowledge and understanding that we consider the hypothetical officer might reasonably be expected to have, the difference between the allowable loss claimed and the income declared was enough, in our judgment, to justify an officer making the assessment.[78]

That was a good win, and out of line with other cases.

Sanderson concerned a CGT avoidance scheme known as the Castle Trust. The disclosure was:

> I am entitled to the loss of £1,825,663 by virtue of the provisions of TCGA 1992 s.71(2). The loss is part of a loss of £1,000,000,000, which accrued to the Trustees of the Castle Trust on 8th April 1997, on the disposal of a European Average rate Option (Trade No. 82831) relating to shares in Deutsche Telecom.
> On 24th November 1998, I purchased for a fee (part of which is contingently payable) from the Trustees of the Charter Trust 2.273% of their beneficial interest in the Trust Fund of the Castle Trust. The interest determined on 25th November 1998, when I became absolutely entitled to receive from the Trustees of the Castle Trust the sum of £16.04.

This did not begin to meet the full-disclosure requirement. The return only disclosed half the steps under which the loss accrued to the trust.[79]

Hicks v HMRC concerned an IT avoidance scheme. The information available on the tax return included the following:

> Occupation: trader, with trading turnover of approximately £2.7 million and trading expenses of approximately £2.5 million.
> The return also shows a further deduction of £1.5 million, and a non-taxable receipt of £1.5 million.

[78] [2012] UKFTT 770 (TCC) at [93].

[79] In short: The scheme steps included an option and a counter-option and a migration to the UK; [2016] EWCA Civ 19.

> The carried forward loss is shown as approximately £1.2 million.

The information available (via DOTAS form AAG1) was:

> The arrangement is available to self employed derivative traders who work at least 10 hours per week on average in the trade. The trader acquires dividend rights but while the cost of such rights is a deductible expense of the trade the income is not taxable per section 730 TA 1988
> 1. An individual is a self employed trader carrying on business on a commercial basis with a view to profit.
> 2. The trader acquires at a discount the right to receive dividends declared but not yet paid.
> 3. The income is on the other hand not taxable due to section 730 TA 1988. The result is a net loss for tax purposes to the trader.
> 4. Those traders who meet the condition of working in their trade on average 10 hours per week may be able to offset any loss for sideways loss relief purposes

This was sufficient to meet the full-disclosure requirement:

> the hypothetical officer had sufficient information available ... at closure of the enquiry window to make it reasonable for him to have been justified in raising an assessment for the insufficiency. The central issues, relating to section 730 and trading, were not matters of such complexity that the disclosure did not achieve this result.

In *Smith v HMRC*[80] the disclosure was:

> During the period Mr Smith acquired a non-qualifying second hand insurance bond for £532,695.
> This bond was subsequently redeemed in full, on 6 March 2001 for an amount of £483,228.93.
> For tax purposes the surrender proceeds fall to be taxed under both s.54 1TA 1988 (income) and s.22 TCGA 1992 (capital gains).
> For income purposes a charge arises equal to the excess of surrender proceeds over premiums paid into the policy. In the case of Mr Smith the income arising is:
>
> | | |
> |---|---|
> | Proceeds received on surrender | 483,228 |
> | Premiums paid into the policy | (510,000) |
> | Income Charge | Nil |
>
> In calculating the capital gain arising on the final surrender the proceeds

[80] *Smith v HMRC* [2013] UKFTT 368 (TC).

> are again the amount received on surrender. However, s.37 TCGA 1992 provides that sale proceeds which have been taken into account for income purposes should not be taken into account for capital gains purposes. As the proceeds of £483,228.93 have been taken into account above in calculating the chargeable event gain, the proceeds for capital gains tax purposes are-
>
> | | |
> |---|---|
> | Proceeds received on surrender | 483,228 |
> | Less amounts excluded under s.37 TCGA 1992 | (483,228) |
> | Proceeds for capital gains purposes | Nil |
>
> The expenditure incurred for capital gains purposes is the amount paid by Mr Smith for the bond i.e. £532,695.
>
> The capital gains tax computation on surrender of the bond is:
>
> | | |
> |---|---|
> | Sale proceeds (as above) | 0 |
> | Allowable expenditure (as above) | (532,695) |
> | Capital gain/(loss) | (532,695) |

This was not sufficient to amount meet the full-disclosure requirement:

> 79. The return does not specifically draw the officer's attention to the fact that Mr Smith participated in a tax avoidance scheme during the year. That was held to be a relevant factor in the Scottish case of *Pattullo* (at [115]). In our view, although it is relevant it is only one of several relevant factors (and we understand the Outer House to be saying as much at [114]) – we note that the Tribunal in *Blumenthal* took a different view (at [204 – 205]). (In *Charlton* the point did not arise – or more accurately, was a foregone conclusion – because the return included a registered tax avoidance scheme reference number.)
>
> 80. The white space entries describe the acquisition and redemption of the bond; they cross-refer between the income pages and the capital gain pages; they cite s 541 TA 1988 and ss 22 & 37 TCGA 1992; they show the (simple) calculation of nil income and a £532,695 capital loss on redemption; and they give a short description of how those results are obtained.
>
> 81. An important and relevant point arising from *Lansdowne Partners* concerns the degree of complexity of the legal position governing the matter under consideration. In that case the contentious item concerned the deductibility of payments to partners, a matter on which there was clear House of Lords authority (see [50]). Moses LJ stated:
>
> > [69] … The legal points were not complex or difficult. As the Chancellor points out (at [56]), awareness of an insufficiency does not require resolution of any potential dispute. After all, once an amendment is made, it may turn out after complex debate in a succession of appeals as to the facts or law, that the profits stated

> were not insufficient. I have dwelt on this point because I wish to leave open the possibility that, even where the taxpayer has disclosed enough factual information, there may be circumstances in which an officer could not reasonably be expected to be aware of an insufficiency by reason of the complexity of the relevant law.

82. In our opinion the relevant law relating to the scheme adopted by Mr Smith was of a degree of complexity such as to make it unreasonable for the officer to be aware of an insufficiency on the basis of the information contained in Mr Smith's tax return.

We do consider that the information was sufficient to warrant the hypothetical officer opening a s 9A enquiry – but that is not the relevant test.[81]

We note that a similar conclusion was reached by the Tribunal in *Blumenthal* (at [206]) on the facts in that case.

83. *Charlton* ... rejected the validity of the s 29 assessment. There were two important factual distinctions from the current case.

(1) First, in *Charlton* the taxpayers' returns included the scheme reference number that had been allocated by HMRC when the tax avoidance scheme had been registered by the scheme promoters. The relevant legislation post-dates the 2000-01 tax year in point in the current case.

(2) Secondly, in *Charlton* before the taxpayers submitted their returns the Special Commissioners had already decided in *Drummond* that the scheme failed. Further, the High Court had affirmed the decision of the Special Commissioner ... before the expiry of the relevant enquiry window on 31 January 2009. HMRC accepted that by 31 January 2009 HMRC technical specialists had formed a view as to the efficacy of the scheme. In the current case, obviously, *Drummond* was still several years away when the enquiry window closed in January 2003. ... at 31 January 2003 HMRC were ruminating ... Accordingly, the hypothetical officer, even if he could or should have accessed the minds of HMRC's technical specialists, "could not have been reasonably expected, on the basis of the information made available to him before that time, to be aware of the [insufficiency]".

121.13 IT/CGT assessment time limits

121.13.1 *Summary and table*

IT/CGT enquiry/assessment time limits can be summarised as follows:

[81] This is mistaken, as no justification at all is needed to open an enquiry. But it does not matter here.

Time limit	**Facts**	**TMA s.**	**See para**
Enquiry			
1 year	Enquiry period	29	121.8
Assessment			
4 years	Return made	34	121.14
6 years	Careless error	36(1)	121.15
12 years	Offshore Matter	36A	121.16
20 years	Deliberate error	36(1A)(a)	121.17
20 years	Failure to notify	36(1A)(b)	121.18
20 years	DOTAS breach	36(1A)(c)(d)	*Not discussed*

It may be useful to set out an aide memoire of IT/CGT time limits:

TAX YEAR	**LAST ASSESSABLE DATE**				
	Not Offshore Matter		**Offshore Matter**[82]		
	Not careless[83]	***Careless***[84]	***Not careless***	***Careless***	***Deliberate***[85]***/ failure to notify***
2003/04	-	-	-	-	5/4/2024
2004/05	-	-	-	-	5/4/2025
2005/06	-	-	-	-	5/4/2026
2006/07	-	-	-	-	5/4/2027
2007/08	-	-	-	-	5/4/2028
2008/09	-	-	-	-	5/4/2029
2009/10	-	-	-	-	5/4/2030
2010/11	5/4/2015	5/4/2017	-	-	5/4/2031
2011/12	5/4/2016	5/4/2018	-	-	5/4/2032
2012/13	5/4/2017	5/4/2019	-	-	5/4/2033
2013/14	5/4/2018	5/4/2020	-	5/4/2026	5/4/2034
2014/15	5/4/2019	5/4/2021	-	5/4/2027	5/4/2035
2015/16	5/4/2020	5/4/2022	5/4/2028	5/4/2028	5/4/2036
2016/17	5/4/2021	5/4/2023	5/4/2029	5/4/2029	5/4/2037
2017/18	5/4/2022	5/4/2024	5/4/2030	5/4/2030	5/4/2038
2018/19	5/4/2023	5/4/2025	5/4/2031	5/4/2031	5/4/2039
2019/20	5/4/2024	5/4/2026	5/4/2032	5/4/2032	5/4/2040
2020/21	5/4/2025	5/4/2027	5/4/2033	5/4/2033	5/4/2041

Where the date is shaded, the Requirement to Correct code extended the time limit if the RTC conditions are satisfied: the RTC deadline of 5 April 2021 applied instead of the earlier date set out shaded in the table.[86] But

[82] See 121.16 (12-year limit: Offshore Matter).

[83] See 121.14 (4 year limit).

[84] See 121.15 (6 year limit: Carelessness).

[85] See 121.17 (20 year limit).

[86] See 121.19 (RTC time limit: 5/4/21).

that deadline has now passed.

This chapter focuses on the current rules. The rules have changed over time, so the older versions of the rules would need to be checked for older years.

For income/gains taxable under the remittance basis, what matters is not the date when the income/gain arose, but the date it is remitted and so assessable.

121.13.2 *Time limits: Policy*

In *Birmingham City Council v Abdulla*:

> ... issues of limitation are bedevilled by an unarticulated tendency to treat it as an unmeritorious procedural technicality. This is, I think, unjustified. Limitation in English law is ... not a technicality, nor is it necessarily unmeritorious... Limitation reflects a fundamental and all but universal legal policy that the litigation of stale claims is potentially a significant injustice. Delay impoverishes the evidence available to determine the claim, prolongs uncertainty, impedes the definitive settlement of the parties' mutual affairs and consumes scarce judicial resources in dealing with claims that should have been brought long ago or not at all.[87]

121.14 4 year limit

s.34(1) TMA	**para 46(1) sch 18 FA 1998**
Subject to the following provisions of this Act, and to any other provisions of the Taxes Acts allowing a longer period in any particular class of case,	Subject to any provision of the Taxes Acts allowing a longer period in any particular class of case
an assessment to income tax or capital gains tax may be made at any time not more than 4 years after the end of the year of assessment to which it relates.	no assessment may be made more than [4 years] after the end of the accounting period to which it relates.

For worked examples, see 125.14 (Assessment time limit: Table).

[87] [2012] UKSC 47 at [41]. I am grateful to Keith Gordon for drawing this comment to my attention.

121.14.1 *Income received after tax year*

Section 35 TMA provides:

> (1) Where income to which this section applies is received in a year of assessment subsequent to that for which it is assessable, an assessment to income tax as respects that income may be made at any time not more than 4 years after the end of the year of assessment in which it was received.
> (2) This section applies to—
> (a) employment income,
> (b) pension income, and
> (c) social security income.

When will this apply?

121.15 6 year limit: Carelessness

s.34(2) TMA	**para 46(2) sch 18 FA 1998**
An assessment on a person in a case involving a loss of income tax or capital gains tax brought about carelessly by the person may be made at any time not more than 6 years after the end of the year of assessment to which it relates	An assessment in a case involving a loss of tax brought about carelessly by the company (or a related person) may be made at any time not more than 6 years after the end of the accounting period to which it relates
(subject to subsection (1A) and any other provision of the Taxes Acts allowing a longer period).	(subject to sub-paragraph (2A) and to any other provision of the Taxes Acts allowing a longer period).

In short, there is normally an (approximately) 4-year limit on assessments. In the case of carelessness, the time limit is 6 years. For worked examples, see 125.14 (Assessment time limit: Table).

121.15.1 *Definition of "careless"*

Careless is relevant for the TMA rules discussed in this chapter, and for penalties. The term is defined twice but with the same meaning, so it is convenient to consider the definitions together:

s.118(5) TMA	**para 3(1) sch 24 FA 07**
For the purposes of this Act a loss of tax or a situation is brought about carelessly by a person if the	For the purposes of a penalty under paragraph 1, inaccuracy in a document given by P to HMRC is –

person fails to take reasonable care to avoid bringing about that loss or situation.	(a) "careless" if the inaccuracy is due to failure by P to take reasonable care ...

121.15.2 *Failure to correct error*

s.118(6) TMA	**para 3(2) sch 24 FA 07**
Where – (a) information is provided to Her Majesty's Revenue and Customs,	An inaccuracy in a document given by P to HMRC, which was neither careless nor deliberate on P's part when the document was given, is to be treated as careless if P –
(b) the person who provided the information, or the person on whose behalf the information was provided, discovers some time later that the information was inaccurate, and	(a) discovered the inaccuracy at some later time, and
(c) that person fails to take reasonable steps to inform HMRC,	(b) did not take reasonable steps to inform HMRC.
any loss of tax or situation brought about by the inaccuracy shall be treated for the purposes of this Act as having been brought about carelessly by that person.	

See too 122.9.1 (Disclosure of weak position).

121.15.3 *Careless/negligent compared*

A note on terminology. Enquiry Manual provides:

> **EM5125 Neglect, Negligence and Negligent Conduct** [Jul 2020]
> The terms neglect, negligence and negligent conduct are interchangeable.

The definition of careless - "failure to take reasonable care" - is the definition of negligence. So "careless" is just a Plain English synonym of "negligent". The change from neglect (the pre-2008 term) to carelessness (the current term) is one of terminology and not of substance.

121.15.4 *What is reasonable care*

There are hundreds of cases discussing what is reasonable care by a taxpayer.

In *Hanson v HMRC*:

> What is reasonable care in any particular case will depend on all the circumstances. In my view this will include the nature of the matters being dealt with in the return, the identity and experience of the agent, the experience of the taxpayer and the nature of the professional relationship between the taxpayer and the agent.[88]

In *Alan Anderson:*

> The "reasonable care" which should be taken is to be assessed by reference to what a reasonable and prudent taxpayer would do looking at an objective hypothetical standard. But what that reasonable and prudent taxpayer would do is not assessed in a vacuum but by reference to the actual circumstances of the taxpayer in question.[89]

The question must be decided in the light of the position as it was at the relevant time without the benefit of hindsight. The fact that a view turns out to be mistaken does not show that it was careless to form that view. Otherwise any judge whose decision is reversed on appeal would be guilty of carelessness and how often does that happen!

121.15.5 *Careless: HMRC guidance*

> **EM5125: neglect, negligence and negligent conduct** [Jul 2020]
> ... Baron Alderson in *Blyth v Birmingham Waterworks Co*, 1856, 11 Ex 781, p784, which was concerned with the law of tort says
>
> > Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do. The defendants might be liable for negligence, if, unintentionally, they omitted to do that which a reasonable person would have done, or did that which a person taking reasonable precautions would not have done.

Blyth is a classic statement of negligence, but it is not now necessary to refer to a 19th century case on a negligent waterworks company. There is

[88] [2012] UKFTT 314 (TC) at [21].

[89] at [123], approved *Hicks v HMRC* [2018] UKFTT 22 (TC) at [141].

plenty of authority closer to home.

The EM continues:

> We can assume that a reasonable person would, amongst other things
>
> - comply with the requirements of the law by, for example, notifying their chargeability
> - make, promptly, a complete and correct return of their income and gains when required to do so under statutory authority
> - keep such records as are necessary to enable them to make accurate returns or prepare accurate accounts
> - read carefully the notes supplied with the return form, so far as they affect their own circumstances
> - seek professional help with matters, such as the preparation of accounts, which they are unable to cope with satisfactorily alone.
>
> The longstanding concept in general law of "negligence" can be linked to the concept of "failure to take reasonable care" for penalties under FA07/Sch24. Although it is not binding, the First Tier Tribunal (FTT) case, *David Collis v HMRC Commissioners* [2011] UKFTT 588(TC), provides a clear link between these two concepts. In this case "reasonable care" was defined as being "that of a prudent and reasonable taxpayer in the position of the taxpayer in question". For further guidance, see CH53400.

The CH Manual provides:

> **CH53400 What Is Careless Behaviour** [May 2020]
>
> ... This is not a question of whether or not the person knew about an inaccuracy in a return or document or their failure to comply with an obligation. If they did that would be deliberate, see CH53700. It is simply a question of examining what the person did or failed to do and asking whether a prudent and reasonable person taking reasonable care would have done that or failed to do that in those circumstances.
>
> Repeated inaccuracies may form part of a pattern of behaviour which suggests a lack of care by a person in developing adequate systems for the recording of transactions or preparing tax returns. Similarly, repeated failures in relation to the relevant obligations in CH53900 to CH54100 inclusive may suggest a lack of care. It is, however, important to keep a sense of proportion. For example, repetition of the same inaccuracy would not always, of itself, indicate a failure to take reasonable care.
>
> People do make mistakes. We do not expect perfection. We are simply seeking to establish whether the person has given the care and attention that could be expected from a reasonable person taking reasonable care

> in similar circumstances.
>
> For examples of careless behaviour and its effect upon the assessing time limit, see CH53500. You will find further help in establishing behaviour in the guidance for the specific offence that has led to the under-assessment or over-repayment of tax.

121.15.6 *Carelessness of agent*

Section 36(1B) TMA provides:

> In subsections (1) and (1A), references to a loss brought about by the person who is the subject of the assessment include a loss brought about by another person acting on behalf of that person.

CT achieves this by its reference to a related person. Para 46(2B) sch 18 FA 1998 provides:

> (2B) In this paragraph "related person", in relation to a company, means—
> (a) a person acting on behalf of the company, or
> (b) a person who was a partner of the company at the relevant time.

What is the meaning of "on behalf of"*?* In *Hicks v HMRC*:[90]

> the expression "person acting on…behalf" is not apt to describe a mere adviser who only provides advice to the taxpayer or to someone who is acting on the taxpayer's behalf. In our judgment the expression connotes a person who takes steps that the taxpayer himself could take, or would otherwise be responsible for taking. Such steps will commonly include steps involving third parties, but will not necessarily do so. Examples would in our view include completing a return, filing a return, entering into correspondence with HMRC, providing documents and information to HMRC and seeking external advice as to the legal and tax position of the taxpayer. The person must represent, and not merely provide advice to, the taxpayer.

In *Shakoor v HMRC*:[91]

> 24. ... If a taxpayer claims that his accountant has been negligent, for example, by failing to meet a deadline for filing a return or undertaking

[90] [2020] UKUT 12 (TCC) at [122]. In *Hicks* the taxpayer conceded that his accountant acted on his behalf, see at [126]; but applying this test, so far as the accountant gave (negligent) tax advice, as opposed to (say) negligently forgetting to file the the tax return, the accountant was not acting on behalf of the taxpayer..

[91] *Shakoor v HMRC* [2012] UKFTT 532 (TC) at [9].

> some or other administrative task, then the negligence of the accountant will not usually provide a defence to a penalty because the accountant is simply acting as the taxpayer's agent or functionary in filing the document that needs to be filed by a particular deadline. In other words, he is acting as a mere agent or functionary for his principal; but not as an independent professional adviser.

But professional advice is different:

> However, in a situation where a professional adviser is not retained simply to act as a functionary, but is retained to give professional advice based upon the best of his skill and professional ability, he is not then a functionary or agent for his principal. He is a professional person acting under a retainer to give professional advice upon identified issues. He is bound to provide that advice to the best of his professional skill and ability, whilst taking reasonable care in and about preparing and giving that advice. In other words, he is acting as a true professional, rather than as an agent or functionary.

This is perhaps a generous reading, but it leads to a sensible result:

> 25. In our judgement, where an accountant acts as a mere agent, administrator or functionary, he is acting as the taxpayer's agent and his default (whether negligent or not) will usually provide a taxpayer with little opportunity to claim that he is not in default of a particular obligation. However, when a professional person acts in a truly professional advisory capacity, the situation is otherwise and reliance upon properly provided professional advice, absent reason to believe that it is wrong, unreliable or hedged about with substantial caveats, will usually lead to the conclusion that a taxpayer has not been negligent if she has taken and acted upon that advice.[92]

121.15.7 *Relying on advisers*

A taxpayer who is not an expert in taxation must leave technical tax issues to their professional advisers. When tax law is complicated a properly represented taxpayer cannot be expected to identify their advisers' mistakes. The Tribunal has often affirmed this:

> In preparing and submitting his return, [the taxpayer] relied on [an accountant]. In all the circumstances I do not consider that he failed to take reasonable care in doing so. A taxpayer, particularly one ... who

[92] [2012] UKFTT 532 (TC).

> lacked any real tax expertise, is entitled to rely on his adviser, with some caveats.

Four caveats are identified:

> [1] The taxpayer should reasonably believe that the adviser is competent in the field in question, if necessary with the assistance of third parties for information, technical input or expert advice;
> [2] he should ensure that he supplies the adviser with the information the adviser needs to prepare and complete the return;
> [3] he should check the adviser's work to the extent he is able to do so, and
> [4] he should not rely blindly on the adviser's advice if it is obviously wrong or adopts a clearly untenable position.[93]

A fifth caveat is if the disqualified advice rules apply.[94]

For an example of an individual able to rely on his adviser to avoid an accusation of carelessness, see 17.12.1 (7 & 12-year residence tests) where the taxpayer's accountants ticked the wrong long-term residence box. For an example of an individual unable to rely on advice, see *Thomson v HMRC*:[95]

> [Counsel's] opinion would not, however, have given a reasonable taxpayer in Mr Thomson's position comfort that he was carrying on a trade on a commercial basis with a view to profit since the advice on this

[93] *Hicks v HMRC* [2018] UKFTT 22 (TC) at [200]; likewise *AB v HMRC* [2007] STC (SCD) 99 at [105]; *Shakoor v HMRC* [2012] UKFTT 532 (TC) at [21]; and many examples could be given.
Hicks has clearly been influenced by submissions based on "Modernising Powers, Deterrents and Safeguards: Working with Tax Agents" (2009).
"A taxpayer who
[1] goes to an ostensibly competent professional adviser,
[2] provides a full and accurate account of the facts,
[3] checks that advice to the limit of his or her ability and competence,
[4] and then follows the agent's advice (or signs the return prepared on that basis) has not been negligent. He or she has taken reasonable care. If it turns out that the agent has made a careless error in giving the advice or in preparing the tax return the taxpayer who has taken reasonable care will not be penalised."
This wording was somewhat overfavourable to HMRC (depending on what nuance one puts on the expressions used) and the Tribunal toned down the rigour of paragraphs [2] and [3].

[94] See 126.11 (Disqualified advice codes).

[95] [2018] UKFTT 396 (TC) at [223].

issue was generic and did not take into account the actual transactions that Mr Thomson had effected.

What should the taxpayer do if two advisers disagree? A safe course (if the amounts involved make this reasonable) is to seek the advice of counsel, or more senior counsel, or a KC, but what is to be done if two KCs disagree or if the amount at stake does not justify the expense? It is suggested that the correct course is as follows:

(1) The individual must consider whether one view or the other is obviously or glaringly wrong. However it is not to be expected that this will often provide a solution.

(2) Subject to that, the individual can in principle follow whichever view suits them, provided that the person whose advice is adopted is suitably experienced, has seen the contrary advice and maintains their view. Then (even if the practitioner whose view is adopted turns out to be wrong) any error is non-careless and a reasonable-excuse error. Either position passes the properly-arguable standard, indeed both may pass the reasonably-arguable standard.

121.15.8 *Standard of care: Practitioners*

Carelessness by tax practitioners may matter for various purposes, including:

(1) Time limit for assessment (where the agent is acting on behalf of the taxpayer)

(2) Negligence claim against the practitioner

(3) Professional conduct (mere carelessness is not misconduct, but sufficiently gross carelessness can be)

The question here is what a tax practitioner should do in advising or completing a client's tax return. The standard of care is that to be expected of a reasonable practitioner.[96]

A solicitor or accountant is entitled to rely on advice given by an appropriate expert counsel (provided it is not obviously or glaringly

[96] The adviser's duty is not merely (merely?) to understand the law. They should explain it clearly and record it in writing; (is this so obvious that it is unnecessary to say? It is not: *Chandrasekaran v Deloitte & Touche Wealth Management* [2004] EWHC 1378 at [72]). They should explain risks: *Barker v Baxendale Walker* [2018] STC 310 at [59] - [73]; though the extent of the duty to explain risks is "highly fact-sensitive" and *Baxendale Walker* is likely to be an outlier.

wrong). A person who acts in this way is not careless.[97] This rule applies in the completion of a tax return.

What should a practitioner do if the law is so unclear that they are unable to form a view? In many cases the only honest answer to the question of how a court would decide is "I don't know" or "toss a coin". This includes some basic issues, such as the source of interest. In such cases the proper course is to file the tax return on whichever view best suits the client. Both views may pass the reasonably-arguable standard.

A trickier question is where professional views differ between views A and B, the practitioner prefers view A, but view B suits the client. It is suggested the practitioner can advise the client to fill in their return on view B. Take, for example, the old chestnut problem of GWR and trusts. Some practitioners thought there is no IHT charge on the death of an individual who has a GWR in an excluded property trust even if they are IHT deemed domiciled (or indeed actually UK domiciled). Some practitioners (I think, a minority) took the view that there is a charge and for a decade or so HMRC also officially took that view.[98] Should they really advise their clients to file the return on that basis? I would have thought not. If that were wrong, then the best advice one could give would be to change advisers, which can hardly be right.

121.15.9 *Practitioners advising themselves*

In *Thomson v HMRC*:[99]

> If Mr Thomson had performed a proper analysis of the law and applied that to his own activities, it might have been reasonable for Mr Thomson to rely on his own belief that the Pendulum arrangements produced the relievable trading loss he was claiming. However, Mr Thomson performed no such proper analysis. Moreover, a reasonable tax professional would have realised that his own analysis of the efficacy of the arrangements might be influenced by a wish to obtain the tax saving

[97] See Jackson & Powell, *Professional Liability* (8th ed, 2016), para 11-120; *Langsam v Beachcroft LLP* [2012] EWCA Civ 1230 at [85].
Contrast *Hicks v HMRC* at [2018] UKFTT 22 (TC) at [206] where an accountant was not negligent for relying on advice from a scheme provider, even though that was not an independent source of advice. But see 126.11 (Disqualified advice).

[98] This paragraph was written before HMRC issued guidance accepting the view put forward in this book, which for practical purposes resolves the problem; but I retain the text as the example neatly illustrates the issue.

[99] [2018] UKFTT 396 (TC) at [224].

> that was being offered and taken particular care to ensure that, if he "advised himself" on the arrangements, his advice was appropriately objective and dispassionate. Mr Thomson took no such care. No doubt because he wanted to reduce his tax liability he performed only the most cursory analysis of the law before concluding that he could properly claim the loss. That falls short of taking reasonable care.

121.15.10 *Careless: Causation*

The issue is not whether a person is careless in general or in the abstract, but whether their failure to take reasonable care brought about the insufficiency.[100] There must be causal carelessness. In *Marsh v HMRC*:[101]

> Because income from property is always taxable irrespective of a person's residence status it was in our view careless of the appellant to omit it from her returns. The discovery assessment is therefore justified in relation to this income. But this small amount does not we think act as a peg, or jumping off point, to justify the much larger CGT assessment. We think that s 29(1) TMA must be considered separately in relation to each source at least as far as income and chargeable gains are concerned.

121.15.11 *Carelessness: Onus of proof*

The onus of proof rests on HMRC to prove carelessness. In the 2013/14 edition of this work I said:

> An allegation of carelessness is a serious one and it should not be lightly made. I stress these points because HMRC ignore them and allege neglect as a matter of course, whenever carelessness is necessary to justify out of time assessments.[102]

There has been Tribunal criticism:

> It is ... curious that of the 134 clients that had implemented the scheme, that did not escape penalties by having died, emigrated or become insolvent, all, bar the possible exception of one, were subjected to

[100] See *Hicks v HMRC* [2018] UKFTT 22 (TC) at [187].

[101] [2017] UKFTT 320 (TC) at [133].

[102] International Manual which formerly contained this revealing statement:
*"**INTM268520 Assessing time limits** [June 2022]*
If we come to the reasonable conclusion that there is a PE, or that the company is resident in the UK, there must have been careless or deliberate conduct in the failure to notify."
It is encouraging to note that this sentence was deleted May 2023.

> penalties. When the test of reasonable conduct must indicate on these facts that all 134 or 133 participants uniformly had standards that fell below that of the reasonable man, the obvious question must be posed as to whether the standards of the reasonable man have been pitched too high.[103]

HMRC practice did not change, and the criticism was repeated in *H&H Contract Scaffolding Ltd v HMRC*:[104]

> The Respondents' case therefore appears to be that if the Appellant cannot show that it qualified for the claim made then the Appellant would have been careless. The Tribunal disagrees. ... The existence of the inaccuracy does not answer whether the inaccuracy itself is careless.

See too 4.24.9 (Allegation of carelessness).

121.16 12-year limit: Offshore Matter

Section 36A TMA provides:

> (1) This section applies in a case involving a loss of income tax or capital gains tax, where—
>
> (a) the lost tax involves an offshore matter, or
>
> (b) the lost tax involves an offshore transfer which makes the lost tax significantly harder to identify.
>
> (2) An assessment on a person ("the taxpayer") may be made at any time not more than 12 years after the end of the year of assessment to which the lost tax relates.
>
> This is subject to
>
> [a] section 36(1A) above[105] and
>
> [b] any other provision of the Taxes Acts allowing a longer period.

Section 36A(11) TMA provides:

> Section 36(2) to (3A) applies for the purposes of this section (as if references to section 36(1) or (1A) were to subsection (1) of this section).

This applies rules concerning partnerships[106] and claim time limits[107].

[103] *Herefordshire Property Company v HMRC* [2015] UKFTT 79 (TC) at [46].

[104] [2024] UKFTT 151 (TC) at [12].

[105] See 121.17 (20 year limit: deliberate error).

[106] See 121.17.6 (Partnership default).

[107] See 123.8 (Late claim: Culpable taxpayer).

For the definitions of Offshore Matter/Transfer, see 126.23 (Offshore/ domestic matters).

121.16.1 *Significantly harder to identify*

This is required for an Offshore Transfer but not for an Offshore Matter.

Where:

(1) there is not an Offshore Matter, and

(2) there is an Offshore Transfer, made before the relevant date,

it may be desired to make an appropriate disclosure in the white space of a tax return. Then lost tax (if there is any) is not "significantly harder to identify" and the 12-year assessment period will not apply. But of course in a case where there might be lost tax, disclosure may be necessary, or desirable, for other reasons.

Section 36A(6) TMA elucidates the concept of "significantly harder to identify":

> Where lost tax involves an offshore transfer, the cases in which the transfer makes the lost tax significantly harder to identify include any case where, because of the transfer—
>
> (a) HMRC was significantly less likely to become aware of the lost tax, or
>
> (b) HMRC was likely to become aware of the lost tax only at a significantly later time.

That seems (more or less) self-evident.

121.16.2 *12-year limit: Exceptions*

Section 36A TMA provides:

> (7) But an assessment may not be made under subsection (2) if—
>
> (a) before the time limit that would otherwise apply for making the assessment, HMRC received relevant overseas information on the basis of which HMRC could reasonably have been expected to become aware of the lost tax, and
>
> (b) it was reasonable to expect the assessment to be made before that time limit.
>
> (8) In subsection (7)(a) "relevant overseas information" means information which is provided to HMRC by an authority in a territory outside the UK under—
>
> (a) any provision of EU law relating to any tax, or

> (b) an agreement to which the UK and that territory are parties, with or without other parties.

The House of Lords Economic Affairs Committee said:

> We see no logic in applying an exclusion from the time limit to situations where information has been supplied by overseas tax authorities, but not where that same information has been supplied by the taxpayer.[108]

But there it is.

121.16.3 *Transfer pricing time limit*

For completeness: s.36A(9) TMA provides:

> An assessment may also not be made under subsection (2) to the extent that liability to the lost tax arises as a result of an adjustment under Part 4 of TIOPA 2010 (transfer pricing adjustments).

121.16.4 *12-year limit: Commencement*

Section 36A was introduced by s.80 FA 2019. Section 80(5) FA 2019 provides:

> The amendments made by this section have effect—
> (a) in relation to assessments on a person relating to the 2013-14 year of assessment and subsequent years of assessment, where the loss of tax is brought about carelessly by that person or by a person acting on that person's behalf, and
> (b) in any other case, in relation to assessments relating to the 2015-16 year of assessment and subsequent years of assessment.

That is, the 12 year time limit applies to assessments which were in time to assess in 2019/20 (ie on 5 April 2020).

In the absence of carelessness, the years 2013/14 and 2014/15 cannot be assessed under the 12 year time limit. Those years could have been assessed up to 5/4/2021, under the RTC time limit[109] which does not require carelessness; but that power to assess has now lapsed.

[108] Economic Affairs Committee, "The Powers of HMRC: Treating Taxpayers Fairly" (2018) para 42 *https://publications.parliament.uk/pa/ld201719/ldselect/ldeconaf/242/242.pdf*

[109] See 121.19 (RTC time limit: 5/4/21). For completeness: This view is confirmed by *Scott v HMRC* [2023] UKFTT 360 (TC).

121.16.5 *12 year limit: Critique*

The House of Lords Economic Affairs Committee said:

> 41. This proposal places burdens on all those with offshore elements to their tax affairs to retain records for long periods of time to deal with potential HMRC questions. HMRC already has a 20-year time limit to deal with fraud. We consider the extension of time limits to 12 years for offshore matters unreasonably onerous and disproportionate to the risk.
> ...
> 43. It is wrong if, rather than funding HMRC sufficiently to conduct offshore enquiries in a timely manner, the Government is placing disproportionate burdens on taxpayers and eroding important taxpayer safeguards.
> 44. There was deep and consistent opposition from our witnesses to the proposed legislation to extend the offshore time limits for assessment. Witnesses felt this measure was unnecessary and undesirable. We recommend that it is withdrawn.
> 45. The Government should start a fresh dialogue with representatives of tax professionals to consider how offshore tax matters can be managed more effectively. Any revised measure should be more proportionate and targeted.[110]

This may be seen in the context of a longstanding struggle by the Lords for involvement in Finance Bills, which the Government have consistently resisted. The controversy - combined with a lack of a Government majority - did lead to an unusual provision requiring a government review on the topic.[111] The review was duly published,[112] but it was just a restatement of the HMRC case for the legislation. A statutory provision requiring the Government to assess the success of its own policy, in an area of political controversy, is not likely to be productive.

[110] Economic Affairs Committee, "The Powers of HMRC: Treating Taxpayers Fairly" (2018) *https://publications.parliament.uk/pa/ld201719/ldselect/ldeconaf/242/242.pdf*

[111] Section 95(1) FA 2019 provided: "The Chancellor of the Exchequer must review the effects of the changes made by sections 80 and 81 to TMA 1970 and IHTA 1984, and lay a report on that review before the House of Commons not later than 30 March 2019."

[112] HM Treasury, "Section 95 of the Finance Act 2019: report on time limits and the charge on disguised remuneration loans" (2019) *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/789160/DR_loan_charge_review_web.pdf*

121.17 20 year limit: deliberate error

s.36(1A) TMA	**para 46(2A) sch 18 FA 1998**
An assessment on a person in a case involving a loss of income tax or capital gains tax —	(2A) An assessment in a case involving a loss of tax—
(a) brought about deliberately by the person ...	(a) brought about deliberately by the company (or a related person) ...
may be made at any time not more than 20 years after the end of the year of assessment to which it relates (subject to any provision of the Taxes Acts allowing a longer period).	may be made at any time not more than 20 years after the end of the accounting period to which it relates (subject to any provision of the Taxes Acts allowing a longer period).

There are no provisions allowing a longer period: the drafter copied the words in brackets inappropriately, from s.36(1).

For worked examples, see 125.14 (Assessment time limit: Table).

121.17.1 *Inaccuracy*

In order to determine whether a tax return is inaccurate, one has to read the whole of it.[113]

121.17.2 *"Deliberate" inaccuracy*

HMRC v Tooth has explained "deliberate inaccuracy". It means:

> An inaccuracy in a document is a statement which is inaccurate. Thus the required intentionality is attached both to the making of the statement and to its being inaccurate... for there to be a deliberate inaccuracy in a document ... there will have to be demonstrated an intention to mislead the Revenue on the part of the taxpayer as to the truth of the relevant statement or, perhaps, (although it need not be decided on this appeal) recklessness as to whether it would do so.[114]

A deliberate error is in general also likely to be dishonest, indeed it is the

[113] The reader may think that so obvious it did not need saying, and so did the Supreme Court ("This is, with respect, a very unattractive argument"). But a majority of the CoA had reached the opposite conclusion.

[114] [2021] UKSC 17 at [42, [47]; reversing the CoA decision which this work had described as astonishing.

paradigm of tax-dishonesty. However the two concepts are not quite the same.[115] It is possible to envisage a deliberate error which is not (or at least, may not be) dishonest, eg:

(1) Where the amount involved is immaterial, and less than the cost of finding the right figure

(2) Where everyone else, or at least most others, are doing the same

(3) Where the taxpayer reasonably believes that such is the case

121.17.3 *Recklessness*

Canada Square Operations Ltd v Potter[116] considered the meaning of deliberately concealment in the Limitation Act 1980, noting that "Although 'deliberate' is a common English word, I do not consider that there is a clear, 'natural' meaning in this context". The word includes actual awareness of the commission of the act or concealment, and wilful blindness to the same. It also encompassed recklessness.

Although *Tooth* left the point open, it is considered that recklessness should suffice for deliberate behaviour. This raises the question of what amounts to recklessness. In *Canada Square Operations Ltd v Potter:*[117]

> a person acts recklessly with respect to a circumstance when he is aware of a risk that it exists or will exist and it is, in the circumstances known to him, unreasonable to take the risk. A person acts recklessly with respect to a result when he is aware of the risk that it will occur and it is, in the circumstances known to him, unreasonable to take that risk.

In *Clynes v HMRC*:[118]

> ... an inaccuracy may also be held to be deliberate where it is found that the person consciously or intentionally chose not to find out the correct position, in particular, where the circumstances are such that the person knew that he should do so. A person cannot simply escape liability by claiming complete ignorance where the person clearly knew that he should have taken steps to ascertain the position. We view the case where a person makes such a conscious choice not to take such steps

[115] This is self-evident, but if authority is needed, see *Clynes v HMRC* [2016] UKFTT 369 (TC) at [80]: "cases on the meaning of "dishonesty" are not of material assistance in interpreting the provisions of schedule 24 as regards "deliberate" conduct."

[116] [2021] EWCA Civ 339 at [86] ff.

[117] [2021] EWCA Civ 339 at [87].

[118] [2016] UKFTT 369 (TC) at [86] followed in *Grangewood Enterprises v HMRC* [2021] UKFTT 323 (TC).

> with the result that an inaccuracy occurs, as no less of a "deliberate inaccuracy" on that person's part than making the inaccuracy with full knowledge of the inaccuracy.

In *Rodriguez-Issa v HMRC:*[119]

> We agree that an inaccuracy may be held to be deliberate where it is found that the person consciously or intentionally chose not to find out the correct position. However, as the Tribunal indicated in *Clynes*, this will be a question of fact and degree that must be determined on a case by case basis. Care must be taken not to blur the line between careless and deliberate conduct.

121.17.4 *Deliberate error of agent*

Section 36(1B) TMA provides:

> In subsections (1) and (1A), references to a loss brought about by the person who is the subject of the assessment include a loss brought about by another person acting on behalf of that person.

The same agency rule applies for carelessness and for deliberate error; see 121.15.6 (Carelessness of agent).

Section 118(7) TMA provides:

> In this Act references to a loss of tax or a situation brought about deliberately by a person include a loss of tax or a situation that arises as a result of a deliberate inaccuracy in a document given to Her Majesty's Revenue and Customs by or on behalf of that person.

Thus the s.36(1A) rule applies if:

(1) There is an inaccuracy in a document
(2) The inaccuracy is deliberate
(3) The document is given to HMRC (typically, a tax return)
(4) The document is given by/on behalf of the individual

121.17.5 *Deliberate: HMRC examples*

The Compliance Handbook offers some common examples of deliberate behaviour:

> **CH53700 What is deliberate behaviour?** [Nov 2019]
>
> ...
>
> - knowingly failing to record all sales, especially where there is a

[119] [2021] UKFTT 154 (TC) at [22].

pattern to the under-recording, such as omitting all transactions with a particular customer or at a particular time of the week, month or year

- describing transactions inaccurately or in a way likely to mislead
- giving a VAT return to HMRC that includes a figure of net VAT due that is too low because the person does not have the cash at that time to pay the full amount, and later telling HMRC the true figure when he has the funds to pay
- similarly declaring less tax due for aggregates levy, climate change levy, landfill tax or excise duty because the person does not have the funds at that time to pay the full amount
- claiming a deduction for personal expenses of such a size or frequency that the inaccuracy must have been known
- knowingly making an understatement of consideration on SDLT1 compared to Land Registry form (TR1) to reduce the SDLT payable
- knowingly making a duplicated claim for repayment of SDRT
- knowingly claiming a higher (than is just and reasonable) proportion of shared costs in a taxable field for petroleum revenue tax
- knowingly omitting or understating the value of a property for inheritance tax...

121.17.6 *Partnership default*

Section 36(2) TMA provides:

> [a] Where the person mentioned in subsection (1) or (1A) [person who commits careless/deliberate error] ("the person in default") carried on a trade, profession or business with one or more other persons at any time in the period for which the assessment is made,
>
> [b] an assessment in respect of the profits or gains of the trade, profession or business in a case mentioned in subsection (1A) or (1B) [deliberate error] may be made not only on the person in default but also on his partner or any of his partners.

This seems to apply only in a s.36(1A) case, ie deliberate error/failure to notify/breach of DOTAS.

121.18 20 year limit: Failure to notify

s.36(1A) TMA	**para 46 sch 18 FA 1998**
An assessment on a person in a case involving a loss of income tax or capital gains tax ...	An assessment in a case involving a loss of tax—

(b) attributable to a failure by the person to comply with an obligation under section 7 ...	(b) attributable to a failure by the company to comply with an obligation under paragraph 2 ...
may be made at any time not more than 20 years after the end of the year of assessment to which it relates (subject to any provision of the Taxes Acts allowing a longer period).	may be made at any time not more than 20 years after the end of the accounting period to which it relates (subject to any provision of the Taxes Acts allowing a longer period).

For the obligation to notify liability under s.7/para 2, see 121.2 (Duty to notify HMRC).

There are no provisions allowing a longer period than 20 years: the drafter copied the words in brackets, inappropriately, from s.36(1).

For worked examples, see 125.14 (Assessment time limit: Table).

This applies even if the person was not careless or dishonest, eg if they reasonably thought that they were under no duty to notify.

If a person puts in a notice of liability late, there is a failure to comply with s.7/para 2, but the loss of tax may not be attributable to that failure.

121.19 RTC time limit: 5/4/21

Para 26 sch 18 F(no.2)A 2017 provides:

> (1) This paragraph applies where-
> (a) at the end of the tax year 2016-17 a person has relevant offshore tax non-compliance to correct,[120] and
> (b) the last day on which it would (disregarding this paragraph) be lawful for HMRC to assess[121] the person to any offshore tax[122] falls within the period beginning with 6 April 2017 and ending with 4[123] April 2021.
>
> (2) The period in which it is lawful for HMRC to assess the person to the offshore tax is extended by virtue of this paragraph to end with 5

[120] See 126.44 (Relevant offshore tax non-compliance).

[121] Tax includes IHT, and "assess" includes an IHT notice of determination: see 126.49 (RTC: Interpretation).

[122] Para 26(3) sch 18 F(no.2)A 2017 provides: "In this paragraph "offshore tax", in relation to any relevant offshore tax non-compliance, means tax corresponding to the offshore PLR [potential lost revenue] in respect of the non-compliance." See 126.31 (Offshore PLR).

[123] This seems to be a slip for 5 April.

April 2021.

This was a stop gap, pending the introduction of the 12 year time limit for Offshore Matters, in 2019.[124] The rule effectively lapsed on 6 April 2021.

Normal assessing rules apply to decide whether HMRC is able to raise an assessment in the period 6/4/2017 - 4/4/2021. For worked examples, see 125.14 (Assessment time limit: Table).

An assessment under the extended RTC time limit is possible even though:

(1) A taxpayer has a reasonable excuse, and so is not subject to a penalty under the RTC rules; and

(2) The taxpayer has not been careless.

121.20 Personal representatives

121.20.1 *Liability of PRs*

The starting point is that PRs step into the shoes of the deceased. Section 74 TMA provides:

> (1) If a person chargeable to income tax dies, the executor or administrator of the person deceased shall be liable for the tax chargeable on such deceased person, and may deduct any payments made under this section out of the assets and effects of the person deceased.
> (2) On neglect or refusal of payment, any person liable under this section may be proceeded against in like manner as any other defaulter.

I cannot find an equivalent for CGT, but no-one doubts that the same principle applies.

121.20.2 *Time limits for assessing PRs*

Section 40(1) TMA provides a time limit for assessing PRs:

> (1) For the purpose of the charge of tax[125] on the executors or administrators of a deceased person in respect of the income, or chargeable gains, which arose or accrued to him before his death, the time allowed by section 34, 35, 36 or 36A above shall in no case extend

[124] See 121.16 (12-year limit: Offshore Matter).

[125] Section 40(3) provides:
In this section "tax" means income tax or capital gains tax.
That is unnecessary as the general definition in the TMA would have the same effect, but it does no harm.

> more than 4 years after the end of the year of assessment in which the deceased died.

Section 40(2) TMA provides:

> In a case involving a loss of tax brought about carelessly or deliberately by a person who has died (or another person acting on that person's behalf before that person's death), an assessment on his personal representatives to tax for any year of assessment ending not earlier than six years before his death may be made at any time not more than 4 years after the end of the year of assessment in which he died.

By implication, HMRC cannot assess PRs for years of assessment ending earlier than 6 years before death. It may be useful to set out an aide memoire of IT/CGT time limits for PRs:

Year of death	**Tax years in time to assess**		**Last assessment date**
	Not careless	*Careless/deliberate*	
2018/19	2014/15	2012/13	5 April 2023
2019/20	2015/16	2013/14	5 April 2024
2020/21	2016/17	2014/15	5 April 2025
2021/22	2017/18	2015/16	5 April 2026

121.21 Enquiry ends: Closure notice

Section 28A TMA provides:

> (1A) Any matter to which the enquiry relates is completed when an officer of Revenue and Customs informs the taxpayer by notice (a "partial closure notice") that the officer has completed his enquiries into that matter.
>
> (1B) The enquiry is completed when an officer of Revenue and Customs informs the taxpayer by notice (a "final closure notice")—
>
> (a) in a case where no partial closure notice has been given, that the officer has completed his enquiries, or
>
> (b) in a case where one or more partial closure notices have been given, that the officer has completed his remaining enquiries.
>
> (2) A partial or final closure notice must state the officer's conclusions and—
>
> (a) state that in the officer's opinion no amendment of the return is required, or
>
> (b) make the amendments of the return required to give effect to his conclusions.
>
> (3) A partial or final closure notice takes effect when it is issued.

121.21.1 *Application for closure notice*

Section 28A TMA provides:

> (4) The taxpayer[126] may apply to the tribunal for a direction requiring an officer of the Board to issue a partial or final closure notice within a specified period.
> (5) Any such application is to be subject to the relevant provisions of Part 5 of this Act (see, in particular, section 48(2)(b)).
> (6) The tribunal shall give the direction applied for unless satisfied that there are reasonable grounds for not issuing the partial or final closure notice within a specified period.
> (8) In the Taxes Acts, references to a closure notice under this section are to a partial or final closure notice under this section.

121.22 Appeals

A discussion of tax appeals needs a book to itself, and a number of such books have been written.

121.22.1 *Right of appeal*

Section 31(1) TMA confers the right to appeal:

> An appeal may be brought against—
> (a) any amendment of a self-assessment under section 9C of this Act (amendment by Revenue during enquiry to prevent loss of tax),
> (b) any conclusion stated or amendment made by a closure notice under section 28A or 28B of this Act (amendment by Revenue on completion of enquiry into return),
> (c) any amendment of a partnership return under section 30B(1) of this Act (amendment by Revenue where loss of tax discovered), or
> (d) any assessment to tax which is not a self-assessment.

The rest of s.31 provides minor supplemental rules.

> (2) If an appeal under subsection (1)(a) above against an amendment of a self-assessment is made while an enquiry is in progress in relation to any matter to which the amendment relates or which is affected by the amendment none of the steps mentioned in section 49A(2)(a) to (c) may

[126] Section 28ZA(7) provides: "In this section "the taxpayer" means the person to whom notice of enquiry was given."

be taken in relation to the appeal until a partial closure notice is issued in relation to the matter or, if no such notice is issued, a final closure notice is issued.

(3A) In the case of a simple assessment, the right to appeal under subsection (1)(d) does not apply unless and until the person concerned has—

(a) raised a query about the assessment under section 31AA, and

(b) been given a final response to that query.

(4) This section has effect subject to any express provision in the Taxes Acts, including in particular any provision making one kind of assessment conclusive in an appeal against another kind of assessment.

121.22.2 *Determination of appeal*

Section 50 TMA provides:

(6) If, on an appeal notified to the tribunal, the tribunal decides—

(a) that the appellant is overcharged by a self-assessment;

(b) that any amounts contained in a partnership statement are excessive; or

(c) that the appellant is overcharged by an assessment other than a self-assessment,

the assessment or amounts shall be reduced accordingly, but otherwise the assessment or statement shall stand good.

(7) If, on an appeal notified to the tribunal, the tribunal decides—

(a) that the appellant is undercharged to tax by a self-assessment;

(b) that any amounts contained in a partnership statement are insufficient; or

(c) that the appellant is undercharged by an assessment other than a self-assessment,

the assessment or amounts shall be increased accordingly.

(7A) If, on an appeal notified to the tribunal, the tribunal decides that a claim or election which was the subject of a decision contained in a closure notice under section 28A of this Act should have been allowed or disallowed to an extent different from that specified in the notice, the claim or election shall be allowed or disallowed accordingly to the extent that the tribunal decides is appropriate, but otherwise the decision in the notice shall stand good.

(8) Where, on an appeal notified to the tribunal against an assessment (other than a self-assessment) which—

(a) assesses an amount which is chargeable to tax, and

(b) charges tax on the amount assessed,

the tribunal decides as mentioned in subsection (6) or (7) above, the

> tribunal may, unless the circumstances of the case otherwise require, reduce or, as the case may be, increase only the amount assessed; and where any appeal notified to the tribunal is so determined the tax charged by the assessment shall be taken to have been reduced or increased accordingly.
>
> (9) Where any amounts contained in a partnership statement are reduced under subsection (6) above or increased under subsection (7) above, an officer of the Board shall by notice to each of the relevant partners amend—
>
> (a) the partner's return under section 8 or 8A of this Act [SA return], or
>
> (b) the partner's company tax return,
>
> so as to give effect to the reductions or increases of those amounts.

121.22.3 *Further appeals*

Section 50 TMA provides:

> (10) Where an appeal is notified to the tribunal, the decision of the tribunal on the appeal is final and conclusive.
>
> (11) But subsection (10) is subject to—
>
> (a) sections 9 to 14 of the TCEA [Tribunals, Courts and Enforcement Act] 2007,
>
> (b) Tribunal Procedure Rules, and
>
> (c) the Taxes Acts.

121.23 CT registration

121.23.1 *1st accounting period: s.55 notice*

Section 55(1) FA 2004 provides:

> A company[127] must give notice to the Board—
>
> (a) of the beginning of its first accounting period,[128] and
>
> (b) of the beginning of any subsequent accounting period that does not immediately follow the end of a previous accounting period.

I refer to this as a "**s.55 notice**".

[127] Section 55(5) FA 2004 provides: "In this section ... (b) "company" means a body corporate and does not include an unincorporated association or a partnership." This is a non-standard definition as company normally includes an unincorporated association; see 90.8 (Definition of "company"). I would be interested if readers could suggest the reason, perhaps it lies in the history of the provision. But the point will not often arise.

[128] Section 55(5) FA 2004 provides: "In this section— (a) "accounting period" means an accounting period for the purposes of corporation tax".

The rules defining accounting periods are in Chapter 2 Part 2 CTA 2009. I do not consider the rules relating to companies in administration or winding up.

In short, merely holding an asset does not bring a company within the requirement to serve a s.55 notice. There must be one of the following:

(1) profits within CT
(2) a UK company carries on a business (even if not producing profits)
(3) a chargeable gain/allowable loss

121.23.2 *Company within charge to CT*

Section 9(1) CTA 2009 provides the general rule:

> An accounting period of a company begins—
> (a) when the company comes within the charge to corporation tax, or
> (b) immediately after the end of the previous accounting period of the company, if the company is still within the charge to corporation tax.

This applies in particular if:

(1) An offshore company carried on a UK property business prior to the introduction of CT on its property income; the first accounting period begins 6 April 2020, so a notice was required by 6 June 2020.
(2) A non-resident company deals in/develops UK land and realises a profit

121.23.3 *UK company starts business*

Section 9(2) CTA 2009 provides:

> For the purposes of this section a UK resident company is treated as coming within the charge to corporation tax when it starts to carry on business, if it would not otherwise be within the charge to corporation tax.

121.23.4 *Chargeable gain/allowable loss*

Section 9(3) CTA 2009 provides:

> If a chargeable gain or allowable loss accrues to a company at a time which is not (ignoring this subsection) within an accounting period of the company—
> (a) an accounting period of the company begins at that time, and
> (b) the gain or loss accrues in that accounting period.

The context shows that there is only a duty to put in a s.55 notice where a chargeable gain is within the scope of CT.[129]

What if a loss is in principle allowable but no notice is given under s.16(2A) TCGA? This is not an allowable loss so no s.55 notice is strictly needed.[130] HMRC guidance seems to assume that a s.55 notice is expected. But there is no clear statement to that effect: it appears HMRC have not noticed this point. However in practice the company would normally put in s.55 notice, either for the avoidance of doubt, or because the company wants to have the allowable loss, in order to set it against a future chargeable gain.

121.23.5 *When accounting period ends*

Section 10 CTA 2009 provides:

> (1) An accounting period of a company comes to an end on the first occurrence of any of the following—

There follow a list of 10 circumstances when an accounting period ends:

> (a) the ending of 12 months from the beginning of the accounting period,
> (b) an accounting date of the company,
> (c) if there is a period for which the company does not make up accounts, the end of that period,
> (d) the company starting or ceasing to trade,
> (e) if the company carries on only one trade, coming, or ceasing to be, within the charge to corporation tax in respect of that trade,
> (f) if the company carries on more than one trade, coming, or ceasing to be, within the charge to corporation tax in respect of all the trades it carries on,
> (g) the company becoming, or ceasing to be, UK resident,
> (h) the company ceasing to be within the charge to corporation tax,
> (i) the company entering administration, and
> (j) the company ceasing to be in administration.

If a company not otherwise required to register disposes of a land-rich asset:

(1) An accounting period begins as it will in principle realise a gain or a loss.

[129] The drafter has overlooked the definition of chargeable gain; see 56.6.1 ("Chargeable" gain).

[130] See 123.2.3 (Capital loss claims).

(2) The accounting period ends the next day, as it ceases to be within the charge to CT.[131]

So a notice is required each time there is a disposal of a land-rich asset.

121.23.6 *Content of notice*

Section 55(2) FA 2004 provides:

> The notice required by this section—
> (a) must be in writing;
> (b) must state when the accounting period began;
> (c) must contain such other information as may be prescribed;
> (d) may be given to any officer of the Board ...

Reg 2 Corporation Tax (Notice of Coming within Charge - Information) Regulations 2004 provides:

> (1) For the purposes of [s.55(2)(c) FA 2004] the information specified in the following paragraphs of this regulation is prescribed.
> (2) In the case of the company's accounting period falling within either paragraph (a) or (b) of [s.55(1) FA 2004], the prescribed information is the date on which that accounting period commenced (within the meaning of [s.12(2) ICTA 1988) [now, s.9 CTA 2009]), together with the information in paragraph (3).
> (3) The information to be given in respect of any company to which the section applies is–
> (a) the company's name and its registered number;
> (b) the address of the company's registered office;
> (c) the address of the company's principal place of business;
> (d) the nature of the business being carried on by the company;
> (e) the date to which the company intends to prepare accounts;
> (f) the full name and home address of each of the directors of the company;
> (g) if the company has taken over any business, including any trade, profession or vocation formerly carried on by another–
> (i) the name and address of that former business; and
> (ii) the name and address of the person from whom the business was acquired;
> (h) if the company is deemed, by virtue of [s.413(3) ICTA 1988, now s.152 CTA 2010], to be a member of a group of companies

[131] It is suggested that a company ceases to be within the charge even if it realised a loss on the disposal.

> for the purposes of [Chapter 4 Part 10 ICTA, now Part 5 CTA 2010], the name of the parent company and the address of its registered office; and
>
> (i) in the case of a company which, at the time it gives notice under the section, has been obliged to comply with the requirements of the Income Tax (Pay as You Earn) Regulations 2003, the date on which that obligation first arose.

The CTM provides:

> **COM40030: Case records: new company records: information a company must provide to HM Revenue and Customs** [Nov 2019]...
> **Companies newly coming within the charge to CT**
> When a company registers at Companies House, they have the opportunity to supply the required information if it is available. However, many companies do not start to trade immediately and do not have all the necessary information at the time of registration.
> COTAX issues a CT41G to newly incorporated companies when they are set up on COTAX. That form gives the company their UTR and explains that, if they were unable to supply the information needed to satisfy S55 at the time of registration, the easiest way to supply it is by using the Online Tax Registration Service (OTRS), although we do accept the information in a letter...

121.23.7 *Time limit for s.55 notice*

Section 55(2) FA 2004 provides:

> The notice required by this section ...
>
> (e) must be given not later than three months after the beginning of the accounting period.

121.23.8 *HMRC practice: Registration*

HMRC say:[132]

Who should register

Register if you dispose of UK property or land and any of the following apply:

- you're a non-resident company and not registered with UK Companies House
- you're a collective investment vehicle (CIV) deemed as a company (as long as you have not elected for transparent or exempt treatment)

Re-register if you were previously registered for UK Corporation Tax but your company has since been dormant for Corporation Tax purposes.

[132] HMRC, *"*Register a non-resident company for Corporation Tax*"* (Oct 2020) *https://www.gov.uk/guidance/register-a-non-resident-company-for-corporation-tax*

If you are an agent acting on behalf of a company you can still register, even if you do not have authorisation to act on your client's behalf for all Corporation Tax affairs through form 64-8.

If you're an offshore property development company dealing in or developing UK land, use the register as an overseas company guide to register for Corporation Tax. This will also tell you what to do if you do not have a base in the UK.

If you are a non-resident landlord now required to submit a Corporation Tax return you should not use this g-form but should instead contact non-resident landlords.

Exemptions

You do not have to register if any of the following apply:

- the disposal is an excluded disposal
- an exemption applies
- no chargeable gain or allowable loss arises

Examples include:

- no gain or no loss transfers
- a disposal where no gain arises because sales proceeds equal the acquisition cost
- the substantial shareholding exemption applies to a disposal
- the disposal is a grant of a lease for no premium
- the disposal has an appropriate connection to a CIV and relief is provided under the terms of the relevant Double Taxation Treaty (HMRC is applying a concessionary treatment to these disposals which is subject to review - 'appropriate connection' is defined at CG73996J)

You can still register and submit returns in such cases if you want to disclose your disposals and the applicable exemptions.

There's no need to register unless there's a disposal of an interest in UK land or property. So holding an asset does not bring a non-resident company within the charge to Corporation Tax.

When to register

You must register within 3 months of the date you become chargeable to UK Corporation Tax.

You become chargeable when you sell, give or transfer ownership of UK property or land. This date cannot be before 6 April 2019 or after the date you register.

What you'll need

If you're registering for the first time or re-registering a company you'll need the:

- company name, registered address and contact details (HMRC will use the registered office address for initial contact)
- previous company name (if there was one)
- incorporation date and country of incorporation (or for a CIV the date of establishment)
- company registration or incorporation number (if it has one)
- director's name, address and contact details (or for a CIV, somebody authorised to act on behalf of the CIV)
- date of the disposal of interests in UK property or land
- Income Tax Self Assessment Unique Taxpayer Reference (UTR), if you have received UK rental income not subject to tax deducted at source

If you're re-registering, you'll also need the Corporation Tax UTR from any previous correspondence with HMRC.

How to register

If you already have a Government Gateway user ID and password

You'll need the Government Gateway user ID and password you used in previous registration for Corporation Tax. If you have recently registered for online services it can take 2 to 8 weeks to receive your codes. They will arrive at the overseas registered office.

If you do not have a Government Gateway user ID and password

Register online if you do not have a Government Gateway user ID and password.

After you've registered

After you've registered HMRC will:

- set up a HMRC record for the company
- send you a Corporation Tax UTR
- send you more information by post about what you need to do next

HMRC aim to deal with your registration within 15 working days. This information will arrive at the overseas registered office. It can take up to 2 to 8 weeks to arrive.

When you receive your UTR you can then register for HMRC online services so that you can file a Corporation Tax Return and pay any tax due. You cannot register for HMRC online services and file your return before you receive your UTR.

Your online services activation codes will arrive at the overseas registered office. It can take 2 to 8 weeks to receive them.

121.23.9 *Reasonable excuse defence*

Section 55(4) FA 2004 provides:

> A company that has a reasonable excuse for failing to give notice as required by this section—
>
> (a) is not to be regarded as having failed to comply with this section until the excuse ceases, and
>
> (b) after the excuse ceases is not to be regarded as having failed to comply with this section if the required notice is given without unreasonable delay after the excuse ceases.

See 126.10 (Reasonable excuse).

HMRC say:

Chapter 4: Obligations of Non-UK resident Company Landlords

... HMRC would regard as a reasonable excuse for not notifying HMRC within this three month time period the need for any true-up of the amount withheld on account of tax under the Non-residents Landlord Scheme at the end of the annual period, and its comparison with the calculation of non-UK resident company landlord's Corporation Tax liability for the accounting period which relates to the annual period in order to establish any shortfall.

However, HMRC would consider that this reasonable excuse is one which is capable of being resolved with twelve months from the end of the company's accounting period. This means that HMRC would expect a company that has a shortfall of Corporation Tax after taking into account the amount on account of tax withheld to give notice of its chargeability within twelve months from the end of its accounting period.

121.23.10 *HMRC practice: Returns*

HMRC say:[133]

Returns

If you have no other business in the UK, file a single return for the date of the disposal.

If you have another disposal at a later date, you'll need to send a new return for each disposal.

If you are a non-resident company landlord and have previously been exempted from notifying chargeability to Corporation Tax because your tax liability was fully offset by tax deducted under the non-resident landlord scheme, the exemption will cease to apply if you make a disposal in an accounting period ending on or after 6 April 2020.

From that point you will be sent a notice requiring you to report your property income annually via a Corporation Tax return until the property business ceases, even if you continue receiving your rents with tax deducted under the non-resident landlord scheme.

You may be liable to financial penalties if you do not file a Corporation Tax return when we ask you to do so.

Contact Non-UK resident landlords team in writing if you believe that you would continue to qualify for the exemption going forward in later accounting periods. You must notify HMRC if you cease to qualify for the exemption.

You must submit the return online and it must include:

- CT600 return form
- iXBRL tagged computations

You do not need to submit iXBRL tagged accounts for a one day accounting period.

If you're a CIV or a company that has or expects to have 4 or more disposals in a financial year, by concession, there will be a 12 month accounting period. You will need to submit:

- a CT600 return form
- iXBRL tagged accounts and computations

So that HMRC does not have to contact you for additional information in relation to the disposal, your computation should include details of how you have utilised any losses, exemptions and reliefs.

It should give a clear breakdown of how you have calculated the gain or loss on the disposal.

Additionally, the type of asset should be identified from one of the following along with the address of the property:

- residential property or land
- non-residential property or land
- mixed use (the property or land was partly residential during ownership)
- indirect disposal of UK land

Alternatively, this information can be provided in a covering letter accompanying your CT600.

Accounts forming part of an online return must be in XBRL format.

[133] HMRC, *"*Register a non-resident company for Corporation Tax*"* (Oct 2020) *https://www.gov.uk/guidance/register-a-non-resident-company-for-corporation-tax*

You do not need to tag the accounts in XBRL if the following apply:

- there's no appropriate taxonomy for the accounting standard the accounts have been prepared
- the HMRC online service does not accept the taxonomy.

If you use an unsupported standard, then submit your accounts in PDF format.

After you've re-registered

If you're re-registering for Corporation Tax we'll use the information provided to update our records. You'll then be able to use HMRC online services to file returns and make payments.

Paying Corporation Tax

When you pay Corporation Tax will depend on your taxable profits and length of your accounting period.

If you hold no other chargeable interests in UK property or land after the disposal, you'll stop being chargeable to UK Corporation Tax. You'll also have a one day accounting period.

The rules for paying in instalments mean your tax may be due on the date of the disposal. HMRC will apply concessionary treatment in these cases. Payment of Corporation Tax will be due 3 months and 14 days after the end of your one day accounting period.

Non-resident landlord scheme guidance provides:[134]

4.3 Exception to duty to give notice

A non-UK resident company landlord will not be required to give notice of its coming within the charge to Corporation Tax or to notify its chargeability to Corporation Tax if:

- it has not been given a notice to file a tax return,
- it has borne (or it will bear) Income Tax by deduction on all the income on which it is chargeable to Corporation Tax for the accounting period,
- its liability to Corporation Tax for the accounting period will be fully offset, for instance by the amounts withheld under the Non-residents Landlord Scheme, and
- it has no chargeable gains for that period.

4.4 Example

In the example at Chapter 3, ABC Ltd has the following items to consider when determining its liability to Corporation Tax for the accounting period which includes the four quarters to 31 March 2021:

Rental income	£7,500
Deductible expenses other than financing costs	£1,200
Financing costs	£1,700
[Net income	£4,600]
[Corporation tax £4,600 @19%	£874]
Income Tax deducted at source [£4,600 @ 20%]	£920

If the annual period straddles two of ABC Ltd's accounting periods because the date to

[134] HMRC, "The Non-resident Landlords Scheme: Guidance notes for letting agents and tenants" (2016) *https://www.gov.uk/government/publications/non-resident-landord-guidance-notes-for-letting-agents-and-tenants-non-resident-landlords-scheme-guidance-notes*

which it makes up is financial statements ends on a date other than 31 March, the amounts should be apportioned between the accounting periods on a just and reasonable basis.

The amount of financing costs that can be included in determining the Corporation Tax liability of ABC Ltd for an accounting period depends on the application of the TIOPA Corporate Interest Restriction rules according to the specific circumstances of the company.

If ABC Ltd is a singleton company, the amount of financing costs would be below the de minimis exemption available under the Corporate Interest Restriction rules and none of the financing costs would be capped.

In these circumstances it is likely that the amounts withheld at source under the Non-residents Landlord Scheme has met ABC Ltd's Corporation Tax liability (assuming it has no further chargeable income and it has no chargeable gains).

In this situation, if ABC Ltd has not already registered for Corporation Tax, it is not required to notify HMRC that it has come within the charge for Corporation Tax for an accounting period provided that it has no chargeable gains in that period and has not already received a notice to file a tax return.

If ABC Ltd considers that its Corporation Tax liability for the relevant accounting period is less than the Income Tax deducted at source under the Non-residents Landlord Scheme, it can choose to register and file a Company Tax Return in order to claim a repayment of the difference.

IT deducted at source will generally exceed CT, as the IT rate is higher. But this will cease to apply when the CT rate increases above the IT basic rate, in 2023.

If ABC Ltd considers that its Corporation Tax liability for the relevant accounting period is more than the Income Tax deducted at source under the Non-residents Landlord Scheme, it must register and file a Company Tax Return in order to pay the balance due. It must do this within twelve months from the end of the relevant accounting period.

Once registered for Corporation Tax, HMRC will send ABC Ltd a notice to file a Company Tax Return for each subsequent accounting period.

121.23.11 *Company law requirements*

An overseas company which opens a "UK establishment" (as defined) also needs to register under reg 4 Overseas Companies Regulations 2009. The deadline is " within one month of having opened a UK establishment".

CHAPTER ONE HUNDRED AND TWENTY TWO

TAX RETURN FILING POSITION

122.1 Codes of conduct
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122.12 Professional conduct: Back duty

122.1 Codes of conduct

There are many codes of conduct and a full discussion requires a book to each one. I discuss the following:[1]

(1) *Professional Conduct in Relation to Taxation* ("PCRT").[2] This is framed in terms of Fundamental Principles and Standards, supplemented by non-binding guidance in:

(a) Helpsheets[3] A-E:
A: Submission of tax information and Tax filings
B: Tax Advice

[1] Further consideration may be needed for those governed by Scots/Northern Ireland or other codes of conduct.

[2] *https://www.tax.org.uk/professional-conduct-in-relation-to-taxation-pcrt*
For an introduction to PCRT, see *Hannah (R, oao) v CIOT* [2021] EWHC 1069 (Admin). For PCRT on tax avoidance, see 2.5.8 (Codes of practice/regulators).

[3] PCRT says "Help Sheet" A-E, not Helpsheet; but I write it here as one word, not two, as that is the standard usage.

C: Dealing with errors
C2: Dealing with errors - Members in business
D: Request for data by HMRC
E: Members' Personal Tax Affairs[4]

(b) 2 sets of Q&As, entitled: PCRT member QAs, and FAQs

(2) *Bar Code of Conduct*, part of the BSB Handbook ("Bar Code"). This is framed in terms of Core Duties, Rules and Guidance.

(3) *SRA Code of Conduct for Solicitors* ("SRA Code")[5]

(4) *ICAEW Code of Ethics* ("ICAEW Code")

Each code has a technical vocabulary of its own (beginning with idiosyncratic use of the cuddly words Handbook and Helpsheet); it is not practical to discuss them without using this terminology. I use initial capitals, to reflect the technical nature of the words.

CIOT formerly published "Standards for the Provision of Taxation Services", a series which included SPTS no.2 (Tax Return Filing Positions).[6] SPTSs were withdrawn in 2011 because the topics were thought to be covered by PCRT. But PCRT does not have the same level of detail. I think SPTS2 still offers good guidance; it is the most detailed guidance available on tax return filing positions.

122.1.1 *Status of PCRT*

CIOT set out the recent edition history of PCRT[7]

Effective from: 1 March 2017
Republished: 1 March 2019

[4] CIOT formerly published Helpsheets numbered numerically: 1: Tax evasion, 2: Tax returns, 3: Voluntary disclosures under disclosure facilities, 4: The GAAR. These are now withdrawn.

[5] Nov 2019, replacing the Code of Conduct 2011.

[6] The same or similar issues arise in foreign jurisdictions, and there is some interaction or influence between jurisdictions.
SPTS2 is influenced by US practice: AICPA, "Statement on Standards for Tax Services No. 1, Tax Return Positions" is substantially the same as SPTS2, at some points using the same wording; though it uses the expression "reasonable basis" where SPTS has "tenable" and does not offer examples.
https://www.aicpa.org/content/dam/aicpa/interestareas/tax/resources/standardsethics/statementsonstandardsfortaxservices/downloadabledocuments/ssts-interpretations-no-1-tax-return-positions.pdf
An international survey would be an informative exercise.

[7] *https://www.tax.org.uk/professional-conduct-in-relation-to-taxation-pcrt*

> Republished: 1 January 2023 - this document was reviewed by the PCRT Group in September 2022 to consider if it needed any updating; it was agreed that no updating of substance was required although some minor updating of references was made.

PCRT applies to members of CIOT, STEP, and accountancy bodies.[8]

It is not binding on solicitors or barristers unless they are members of CIOT/STEP (which for private client practitioners is often the case). In the event of conflict, the Bar/SRA Codes prevail over PCRT:

> ... nothing in PCRT shall override a member's professional duties or be interpreted so as to give rise to any conflict under general law, statutory regulation, or professional regulation of solicitors or barristers, and in the event of any conflict general law, statutory regulation or such professional regulation shall prevail.[9]

SRA say that solicitors should "be familiar with the PCRT and adhere to its standards".[10] So PCRT is indicative of good practice for solicitors. PCRT is not recognised by the Bar, but it should again be taken as indicative of good practice.

HMRC endorse PCRT.[11]

122.1.2 *HMRC standard for agents*

HMRC issue a code of conduct: *HMRC: the standard for agents* ("HMRC Standard").[12] This is now in its third edition:

Edition	**Date**
1	Aug 2016
2	Jan 2018
3	Jan 2023

The HMRC Standard applies to:

> individuals and businesses who are tax agents. Tax agents are agents

[8] Namely: Association of Accounting Technicians, Association of Chartered Certified Accountants, Association of Taxation Technicians, ICAEW, and Institute of Chartered Accountants of Scotland.

[9] Para 1.6 PCRT.

[10] *https://www.sra.org.uk/solicitors/guidance/tax-avoidance-duties/*
For tax avoidance aspects of PCRT, see 2.5.8 (Codes of practice/regulators).

[11] HMRC Standard para 1.1.

[12] *https://www.gov.uk/government/publications/hmrc-the-standard-for-agents/hmrc-the-standard-for-agents*

> and advisers, based in the UK or in other countries, who are acting professionally in relation to the tax affairs of others. This includes third party agents and advisers, whether acting in respect of UK or offshore tax affairs, and to all dealings they have with HMRC.[13]

Since HMRC do not regulate tax practitioners, the question arises as to what is the sanction if the Standard is breached. The HMRC Standard provides:

> **4.2 What happens when the standard is breached**
> The options may include:
> - blocking access to HMRC's agent services
> - dishonest tax agent conduct notices, with the potential for further penalties and publication
> - criminal investigation if an offence is suspected
> - refusing to deal with an agent altogether
>
> When appropriate, relevant professional bodies will be informed directly about misconduct by their members in a Public Interest Disclosure.[14]

HMRC say:

> **5. How HMRC and professional body standards are related**
> ... The HMRC standard for agents does not override legal professional privilege or professional duties set by relevant professional bodies.

But there is nothing in the HMRC Standard which is not in PCRT:

> 5.1 ... If agents meet their professional body's code of ethics, however, the HMRC standard for agents should not place further requirements on them.

I suspect that the HMRC Standard is addressed to tax agents who are not members of a professional body, and so not subject to any other code of conduct; it should have no relevance to those who are governed by any of the professional codes of conduct. I do not discuss it further here.

[13] The HMRC Standard does not apply to Trusted Helpers, HMRC terminology meaning a friend or relative authorised to manage a person's tax affairs; *https://www.gov.uk/appoint-tax-agent*

[14] HMRC expand on these sanctions in "Raising standards in the tax advice market - HMRC's review of powers to uphold its Standard for Agents" (March 2022) *https://www.gov.uk/government/publications/raising-standards-in-the-tax-advice-market-hmrcs-review-of-powers-to-uphold-its-standard-for-agents*

122.2 Adviser's duties

122.2.1 *Advocate for client*

SPTS2 provided:

> 4. When recommending a filing position, a member has both the right and responsibility to be an advocate for the taxpayer with respect to any position satisfying the aforementioned guidance. ...

Similarly Bar Code of Conduct:

> **CD2** You must act in the best interests of each client[15]
> **gC6** You are obliged by CD2 to promote and to protect your client's interests so far as that is consistent with the law and with your overriding duty to the court under CD1.

There is no resounding equivalent expressed in PCRT or the ICAEW code. On the contrary, the ICAEW code expresses itself in terms which could be taken as rather different in its emphasis:

> A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest.[16]

But I would have thought that the duty of care which an accountant owes to their client when acting as their tax agent (as opposed to auditing work) comes to the same effect as the duty (in the words of the Bar code) to promote and protect the client's interest, so far as consistent with the law. Though curiously, or perhaps significantly, the accountancy profession does not proclaim it so openly.

122.2.2 *Reliance on client*

PCRT provides:

> A member must act honestly in all their dealings with their clients, all tax authorities and other interested parties, and do nothing knowingly or carelessly that might mislead either by commission or omission.[17]

PCRT provides:

> Where acting as a tax agent, a member is not required to audit the

[15] Likewise SRA Principle 7.
[16] para 100.1.
[17] Para 2.4 PCRT.

> figures in the books and records provided or verify information provided by a client or by a third party. However, a member should take care not to be associated with the presentation of facts they know or believe to be incorrect or misleading ...[18]

Likewise ICAEW Code:

> 110.2 A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the professional accountant believes that the information:
> (a) Contains a materially false or misleading statement;
> (b) Contains statements or information furnished recklessly; or
> (c) Omits or obscures information required to be included where such omission or obscurity would be misleading.
> When a professional accountant becomes aware that the accountant has been associated with such information, the accountant shall take steps to be disassociated from that information.

This contrasts with the Bar Code of Conduct:

> **rC6** Your duty not to mislead the court will include the following obligations:
> .1 you must not:
> .a make submissions, representations or any other statement; or
> .b ask questions which suggest facts to witnesses,
> which you know, or are instructed, are untrue or misleading.
> .2 you must not call witnesses to give evidence or put affidavits or witness statements to the court which you know, or are instructed, are untrue or misleading, unless you make clear to the court the true position as known by or instructed to you.
>
> ***Guidance***
>
> **gC6** ... Your duty to the court does not prevent you from putting forward your client's case simply because you do not believe that the facts are as your client states them to be (or as you, on your client's behalf, state them to be), as long as any positive case you put forward accords with your instructions and you do not mislead the court. Your role when acting as an advocate or conducting litigation is to present your client's case, and it is not for you to decide whether your client's case is to be believed.
>
> **gC7** For example, you are entitled and it may often be appropriate to draw to the witness's attention other evidence which appears to conflict

[18] Para 13 PCRT Helpsheet A.

> with what the witness is saying and you are entitled to indicate that a court may find a particular piece of evidence difficult to accept. But if the witness maintains that the evidence is true, it should be recorded in the witness statement and you will not be misleading the court if you call the witness to confirm their witness statement.[19]

On this point PCRT and the Bar/SRA Codes conflict and (for solicitors/ barristers) the Bar/SRA Codes prevail.[20] This is an aspect of a broader distinction of outlook:

> It is easy for a lawyer to adopt an undivided loyalty to a client; for better or for worse, that is his professional tradition and obligation. The accountant's tradition is quite the opposite: he is proud of his "independent" status as a certifier of statements. In the exercise of this function, he is the adversary of his client, and his liability is to the creditors who rely upon him. Of course, he is paid by the client, and his certification is ultimately in the client's interest, but he trusts his client as his own peril. In this respect, the accountant is more policeman than counselor. The accountant's advisory function, which for a long time was quite secondary, blossomed into a major activity with the growth of the income tax. In some instances, this conversion has been very marked: the accountant is often the client's confidant as the lawyer is not. But even in these cases the relics of the past may intrude. Will the accountant always prepare a tax return in the client's best interest, if he knows that he must certify a statement of the tax liability which has a substantial possibility of being an understatement?[21]

Lawyers are more sensitive to the need for legal representation, which is a requirement of the Rule of Law.[22] But perhaps the issue does not often arise.[23] Accountants are not mind-readers, and, particularly when the tax

[19] Para gC6, gC7 *https://www.barstandardsboard.org.uk/the-bsb-handbook.html* The SRA Code of Conduct is, I think, the same on this point, though it is not so clearly expressed.

[20] See 122.1.1 (Status of PCRT).

[21] Johnson, "Does the Tax Practitioner Owe a Dual Responsibility to his Client and to the Government?", in Bitker (ed), *Professional Responsibility in Federal Tax Practice* (1970), Chapter 9, p.170. See too Moraine, "Loyalty Divided: Duties to Clients and Duties to Others—the Civil Liability of Tax Attorneys Made Possible by the Acceptance of a Duty to the System" The Tax Lawyer Vol. 63, No. 1 (2009).

[22] See 2.8 (The Rule of Law).

[23] Brandeis, "The Opportunity in the Law" (1914): "As a practical matter, the lawyer is not often harassed by this problem; partly because he is apt to believe, at the time, in most of the cases that he actually tries; and partly because he either abandons or

issue is one which turns on the client's intention, they are entitled to believe their clients unless it is clear that the client is lying.[24] There must be an objective element in the test of belief, or a jaded and cynical practitioner could not practice.

122.2.3 *No duty of consistency*

The 2011 version of PCRT provided:

> *2.7 In principle it is possible to put forward different tenable positions for different clients with different circumstances.*

That is omitted from subsequent editions, but it must be right. It follows from the duty to act in the best interest of the client. If it were not right, the firm could not properly act for both clients, which would be surprising.

On the other hand, HMRC ought to be consistent. While they may change their mind, they should not put forward different positions for different taxpayers, even if both positions are tenable.[25]

122.3 Tax return filing position

Section 8(2) TMA provides:

> Every return under this section[26] shall include a declaration by the person making the return to the effect that the return is to the best of his knowledge correct and complete.

There is no difference of principle between completing a tax return and other HMRC correspondence; but the issues arise most pressingly in a tax return, which presents a series of questions which the taxpayer has to answer.[27]

In short:

There are two levels, or standards of confidence, in a tax position:

settles a large number of those he does not believe in."

[24] Indeed, even HMRC say that "We'll assume you're telling the truth, unless we've good reason to think you're not." Though no-one takes any notice of that; see 6.36 (Residence: Burden of proof).

[25] HMRC Litigation and Settlement Strategy (2017) provides: "HMRC ... must apply the law fairly and consistently." *https://www.gov.uk/government/publications/litigation-and-settlement-strategy-lss*

[26] See 121.4 (Notice to make return). As this only applies to s.8, it has to be repeated verbatim for trust returns in s.8A(2) TMA.

[27] See s.8(1)(a) TMA set out in 121.4 (Notice to make return).

(1) Properly-arguable (or sustainable or tenable)
(2) More than 50% (or realistic possibility)[28]

A position which does not pass the first standard should not be taken at all.

A position which passes the first but not the second standard may be taken, but should be accompanied by disclosure of relevant facts. CIOT agree:

> Under the self-assessment system the taxpayer reaches its own view of the correct tax that should be assessed and, in doing so, may take the benefit of any doubt. Indeed, if there is a doubt on a matter, a taxpayer is bound to take the benefit of it in filing a self-assessment, as the alternative is that it volunteers tax that may not actually be due. When it does so, it will obviously need to consider what additional 'white space' disclosure it should make to minimise the risk of penalties for an incorrect or careless return.[29]

A position which passes the second standard may be taken without disclosure of doubts, or facts which may raise doubts; (full disclosure may be advantageous but is not compulsory).

122.4 Properly-arguable standard

PCRT provides:

> a member should take care not to ... assert tax positions in a tax filing which they consider to have no sustainable basis.[30]

The Bar Code provides:

> rC9 ...
> .2 you must not draft any statement of case, witness statement, affidavit or other document containing:
> .a any statement of fact or contention which is not supported by your client or by your instructions;

[28] For this standard, see 122.9.1 (Disclosure of weak position).

[29] CIOT, "Notification of uncertain tax treatment: CIOT response" (August 2020) *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/2ff47477-af4f-4c8f-b1ab-f6ac2669439c/200826%20Notification%20of%20uncertain%20tax%20treatment%20by%20large%20businesses%20-%20CIOT%20response.pdf*

[30] Para 13 PCRT Helpsheet A.

> .b any contention which you do not consider to be properly arguable;
>
> ...
>
> .d (in the case of a witness statement or affidavit) any statement of fact other than the evidence which you reasonably believe the witness would give if the witness were giving evidence orally;
>
> .3 you must not encourage a witness to give evidence which is misleading or untruthful;

Similarly the SRA Code:

> 2.4 You only make assertions or put forward statements, representations or submissions to the court or others which are properly arguable.

Although the Bar/SRA Codes are concerned with a lawyer's submissions to a court, the same applies for a professional's submission to HMRC. In *Altus Group v Baker Tilly*:

> ... a professional would be expected to adopt any filing position that was *properly arguable* and was in the client's best interests, while at the same time making full disclosure of any matter that would be necessary for HMRC to understand and appraise the filing position.[31]

Sustainable (PCRT), *properly arguable* (Bar/SRA Codes, *Altus Group*), and *tenable* (SPTS2) are all vague and evaluative words. It seems to me that they are different ways of expressing the same test, a standard below which it would not be proper to raise an argument, or file a return, even if accompanied by a full disclosure. I refer to this as the **"properly-arguable"** standard.

This is a low standard:

> Applicants with weak cases are entitled to seek to advance their case and have it adjudicated upon; that is a fundamental aspect of having a right of access to a court.[32]

The distinction is between a weak case and one bound to fail. Examples of arguments which falls short of the properly-arguable standard (if indeed they are bona fide arguments) would include:

(1) Mr Trull, who said he was exempt from the community charge/poll-

[31] [2015] EWHC 12 (Ch) at [64].

[32] *Sathivel (R, oao) v Secretary of State for the Home Department* [2018] EWHC 913 (Admin) at [16].

tax by virtue of letters patent issued by Henry VII in 1508.[33]

(2) Chris Coverdale, who said it would be a criminal offence to pay Council Tax because it would be used by the Ministry of Defence to commit war crimes.[34]

The test in the Codes of Conduct is a subjective one: the question in each Code is whether the adviser *considers* the argument to be properly arguable.

122.4.1 *HMRC's compliance duties*

Does the same rule apply to HMRC? Or are HMRC subject to stricter principles, as a public body?

Ad Hoc Property Management v HMRC[35] suggests the same principles apply. In this case, leading counsel advised HMRC that they were likely to lose a tax appeal. HMRC defended the appeal regardless, and backed down much later in the day. An application for costs on an indemnity basis was not successful. The point was that Counsel had not gone so far as to advise that the case was hopeless.

Perhaps without realising the disturbing implications, the Tribunal held that "this was not conduct outside the norm". The reader may wonder whether HMRC's main object, in pursuing appeals it knows it is likely to lose, as far as the door of the Court but no further, is to test whether the taxpayer had the gumption to proceed with the appeal; especially in circumstances where HMRC's resources outweigh those of the taxpayer.

Would the result have been different if the Tribunal had been referred to the HMRC Litigation and Settlement Strategy, which states that where HMRC believes that it is unlikely to succeed in litigation it will concede the issue?[36] Discuss.

[33] See Baker, "The Curious Case of Mr Trull" in Harris & Cogan (ed) *Studies in the History of Tax Law* vol 8. Similar pseudolegal arguments echo through social media, propounded by movements such as "Freemen on the land", who contend that they are not bound by law to which they do not consent (!); though they have not yet troubled the FTT.

[34] *https://taxpolicy.org.uk/2024/03/19/fake-anti-war/*

[35] [2019] UKFTT 315 (TC).

[36] HMRC, "Litigation and Settlement Strategy" para 18. (This is subject to exceptions in special circumstances which do not seem to be applicable here.) See *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/655344/HMRC_Resolving_tax_disputes.pdf*
Less charitably, the HMRC tactic might be called bluffing if not oppressive; see

Of course in practice the taxpayer is not likely to know exactly what advice HMRC have received, as HMRC will not waive legal privilege.

BPP Holdings v HMRC[37] discussed this question in circumstances where HMRC failed to comply with an "unless" order and were debarred from defending an appeal:

> [Counsel for HMRC] argued that the Judge should have ... taken into account, the fact that the debarring order in this case prevents HMRC from discharging its public duty and could lead to the public interest being harmed in that VAT which should be paid may not be recovered. I consider that it would set a dangerous precedent if that point were accepted, as it would discourage public bodies from living up to the standards expected of individuals and private bodies in the conduct of litigation. It seems to me that there is at least as strong an argument for saying that the courts should expect higher standards from public bodies than from private bodies or individuals.

The question whether HMRC are bound by the same standards as individuals, or lower or higher, is too general to admit an answer. It depends on the context. But the starting point should be that the same standards are to be expected.

122.5 SPTS examples

It may be helpful to summarise the SPTS examples in a table:

Example	***Legislation***	***Enactment history***	***Pro-taxpayer filing position***
1	unfavourable	neutral	untenable
2	unfavourable	favourable	realistic possibility
3	unfavourable	arguably some support	tenable
	Legislation	***HMRC guidance***	
4	unfavourable	favourable	tenable
5	unfavourable	"technical correction" proposed	tenable
6	unfavourable	favourable statement withdrawn	untenable
	Case law	***HMRC guidance***	
10	inconsistent	unfavourable	tenable
	Reason for non-compliance		
7	HMRC may not notice		untenable
8	Compliance cost exceeds tax		untenable
9	Estimate in good faith		tenable

The examples are helpful, as far as they go, though in practice matters

122.10.1 (HMRC/taxpayer relationship).

[37] [2017] UKSC 55 at [30].

may be very fact sensitive.

122.5.1 *Examples: Enactment history*

In the first set of illustrations, enactment history is (or may be) more favourable to the taxpayer than the statutory law. SPTS2 provides:

> **15. Illustration 1.**
> A taxpayer has engaged in a transaction that is adversely affected by a new statutory provision. Prior law supports a position favourable to the taxpayer. The taxpayer believes, and the member concurs, that the new statute is constitutional, clearly drafted, and unambiguous. The legislative history (as recorded in Hansard) discussing the new statute contains general comments that do not specifically address the taxpayer's situation.
> **Conclusion**
> The member should recommend the filing position supported by the new statute. A position contrary to a constitutional, clear, and unambiguous statute would not be considered to be a tenable position.

Illustration 1 is straightforward; its purpose is to set the scene for the more interesting set of illustrations where legislative history (including Hansard but not limited to that) is (or may be) more favourable to the taxpayer than the statutory law:

> **16. Illustration 2**
> The facts are the same as in illustration 1 except that the legislative history discussing the new statute specifically addresses the taxpayer's situation and supports a position favourable to the taxpayer.
> **Conclusion**
> In a case where the statute is clearly unambiguously against the taxpayer's position but a contrary position exists based on legislative history specifically addressing the taxpayer's situation, a filing position based either on the statutory language or on the legislative history satisfies the realistic possibility standard.
> **17. Illustration 3**
> The facts are the same as in illustration 1 except that the legislative history can be interpreted to provide some evidence or authority in support of the taxpayer's position; however, the legislative history does not specifically address the situation.
> **Conclusion**
> In a case where the statute is clear and unambiguous, a contrary position based on an interpretation of the legislative history that does not explicitly address the taxpayer's situation does not meet the realistic

possibility standard. However, because the legislative history provides some support or evidence for the taxpayer's position, such a filing position is not untenable. A member may recommend the position to the taxpayer if the member also recommends appropriate disclosure.

122.5.2 *Examples: HMRC guidance*

In the next set of illustrations, HMRC guidance is (or may be) more favourable to the taxpayer than the statutory law. SPTS2 provides:

> **18. Illustration 4**
> A taxpayer is faced with an issue involving the interpretation of a new statute. Following its passage, the statute was widely recognised to contain a drafting error, and a technical correction proposal has been introduced. The tax authority issues a pronouncement indicating how it will administer the provision. The pronouncement interprets the statute in accordance with the proposed technical correction.
> **Conclusion**
> Filing positions based on either the existing statutory language or the Inland Revenue pronouncement satisfy the tenable view.
> **19. Illustration 5**
> The facts are the same as in illustration 4 except that no Inland Revenue pronouncement has been issued.
> **Conclusion**
> In the absence of Inland Revenue pronouncement interpreting the statute in accordance with the technical correction, only a return position based on the existing statutory language will meet the realistic possibility standard. A filing position based on the proposed technical correction may be recommended if it is appropriately disclosed, since it is a tenable view.
> **20. Illustration 6**
> A tax form published by the Inland Revenue is incorrect, but completion of the form as published provides a benefit to the taxpayer. The member knows that the Inland Revenue has published an announcement acknowledging the error.
> **Conclusion**
> In these circumstances, a return position in accordance with the published form is not a tenable argument.

This can be contrasted with a case where HMRC guidance is (or may be) less favourable than the strict law:

> **24. Illustration 10**
> On a given issue, a member has located and weighed two authorities

> concerning the treatment of a particular expenditure. The Inland Revenue has issued an administrative ruling that required the expenditure to be capitalised and amortised over several years.
> On the other hand, a court opinion permitted the current deduction of the expenditure.
> The member has concluded that these are the relevant authorities, considered the source of both authorities, and concluded that both are persuasive and relevant.
> **Conclusion**
> The tenable view standard is met by either position.

122.6 Low detection risk

Para 3.2 PCRT provides:

> Tax advice must not rely for its effectiveness on HMRC having less than the relevant facts. Any disclosure must fairly represent all relevant facts.

SPTS 2 provides:

> 3. A member should not recommend a filing position or prepare a return reflecting a position that the member knows:-
> a) Takes advantage of the enquiry selection process of the Inland Revenue, or other tax authority where relevant.
> b) Serves as a mere arguing position advanced solely to obtain leverage in the bargaining process of settlement negotiation with a taxing authority.

The next set of examples discuss these excuses for incorrect returns. The examples are mundane, but I set them out for completeness. SPTS2 provides:

> **21. Illustration 7**
> A taxpayer wants to take a position that a member has concluded is not tenable. The taxpayer maintains that even if the Inland Revenue examines the return, the issue will not be raised.
> **Conclusion**
> The member should not consider the likelihood of an enquiry when determining whether the realistic possibility standard has been met. The member should not prepare a return that contains an untenable position even if it is fully disclosed.

Similarly for accounting purposes. IFRIC 23 provides:

> An entity is to assume that a taxation authority with the right to

examine any amounts reported to it will examine those amounts and will have full knowledge of all relevant information when doing so.

122.7 Cost and estimates

SPTS 2 provides:

> **22. Illustration 8**
> A statute is passed requiring capitalisation of certain expenditure. The taxpayer believes, and the member concurs, that to comply fully, the taxpayer will need to acquire new computer hardware and software and implement a number of new accounting procedures.
> The taxpayer and member agree that the costs of full compliance will be significantly greater than the resulting increase in tax due under the new provision. Because of these cost considerations, the taxpayer makes no effort to comply. The taxpayer wants the member to prepare a return on which the new requirement is simply ignored.
> **Conclusion**
> The return position proposed by the taxpayer is not tenable, and the member should not prepare the return.
> **23. Illustration 9**
> The facts are the same as in illustration 8 except that the taxpayer has made a good-faith effort to comply with the law by calculating an estimate of expenditure to be capitalised under the new provision.
> **Conclusion**
> In this situation, the tenable view standard has been met.[38]

122.8 Disclosing doubt/further information

I distinguish between three types of disclosure:

Disclosure	**Required by law**	**Sanction**
Voluntary	No	No, but disclosure may have advantages
Necessary	Yes	Yes: penalties/disciplinary proceedings
Precautionary	Position unclear	Risk , but disclosure avoids the risk

122.8.1 *No general duty of disclosure*

Everyone responsible for completing a tax return has to ask themselves questions and decide on the answers. If an answer is reached, with sufficient confidence, there is in general no obligation to disclose to HMRC the reasons, or doubts, or information which might support a

[38] SA100 (2023) box 20 allows for this. The rubric provides: “If this tax return contains provisional figures, put ‘X’ in the box”.

different tax treatment. Failure to disclose these things does not in principle render answers in the return to be deliberate or careless errors (even if they turn out to be wrong).

In particular, the fact that there is a possibility that the courts might disagree with an adviser's view does not in itself require disclosure.

This applies to both sides. When HMRC assess tax to the best of their judgement, they must specify what tax they honestly and reasonably consider due, but are under no obligation to disclose doubts or information which might support a different tax treatment.

PCRT used to say that clearly:

> *In the preparation of a tax return, there is no duty to provide more information to the tax authorities than the return requires simply because some pieces of information known to the member might support a different tax treatment from that which the member, after due consideration of all the information available to him, honestly considers to be the tax treatment.*[39]

That continues to be the law, but the current version of PCRT no longer has the confidence to express it in such clear and uncompromising terms. However one can infer that the authors' view has not changed, as PCRT refers to "the minimum information required by law".[40]

In the 2019/20 edition of this work I said:

> The law could not sensibly be otherwise, as that possibility almost always exists, even if the law seems clear.[41]

Perhaps this had an element of rhetorical hyperbole. But there will often be doubt about whether a matter is one of doubt. Or to be more precise, whether the matter is of sufficient doubt to require disclosure, as "doubt"

[39] PCRT 2004 version, para 3.10.
The Keith Committee recommended that taxpayers should be required to disclose doubts to HMRC but the recommendation was rightly rejected as impractical: see Committee on Enforcement Powers of Revenue Departments (1983) Cmnd 8822 para 7.3.6 and HMRC consultation papers "The Inland Revenue and the Taxpayer" and "Keith: Further Proposals" (1988).

[40] Para 19 PCRT Helpsheet A: "If a client is unwilling to include in a tax filing the minimum information required by law, the member should follow the guidance in Helpsheet C: Dealing with Errors."

[41] The text continued: "Readers will easily bring to mind examples of mistaken or improbable decisions, some corrected on appeal and others not, to illustrate the uncertainties – or (which comes to the same thing) the lottery element in litigation."

is a matter of degree which cannot easily be resolved into a binary question; and a phrase such as "substantial doubt" is no clearer.

122.8.2 *Disclosure required/advisable*

Notwithstanding the general principle, there are situations where fuller disclosure is required, and situations where disclosure is voluntary but advisable.

SPTS2 distinguished between 2 standards:

(1) *Realistic possibility* standard: a position which has a realistic possibility of being sustained
(2) *Tenable* (properly-arguable) standard: a position which is merely tenable/properly arguable

The point of the distinction is that a filing which depends on a merely tenable argument should be supplemented by further disclosure. A filing which reaches the higher standard does not or may not require to be supplemented by further disclosure.

A distinction of this kind makes sense, but the SPTS terminology is imprecise and perhaps not the ideal.

Disclosure may be required (not merely voluntary) in circumstances where a reasonable taxpayer would disclose.[42]

Voluntary disclosure (in the words of PCRT, "fuller disclosure than is strictly necessary") may be desirable, or even essential, for the following reasons:

(1) It may prevent a discovery assessment after the one-year enquiry window[43]
(2) It may facilitate good relations with HMRC
(3) It may help avoid allegations of misconduct

122.9 When disclosure required

There are some circumstances where a reasonable taxpayer would make some disclosure beyond giving short answers in a tax return or making a claim.

The duty may be based on:

(1) The principle that one need not disclose matters of doubt does not apply where silence may be said to mislead.

[42] See 122.9.2 (When disclosure required).

[43] See 121.10 (Full-disclosure requirement).

(2) The duty to act as a reasonable taxpayer: if a reasonable taxpayer would disclose, a failure to do so would be regarded as careless, and if the weak argument turns out to fail, penalties would be due accordingly.

Perhaps those are two different ways of making the same point.

Disclosure in these circumstances is not voluntary.

In this respect I suspect that the law has evolved in recent years; but reasonable conduct is a flexible standard which may change over time.

The questions then are:

(1) In what circumstances is disclosure required
(2) What must be disclosed.

PCRT provides:

> 21. It may be advisable to consider fuller disclosure than is strictly necessary. Reference to 'The Standards for Tax Planning' in PCRT may be relevant.[44] The factors involved in making this decision include:
> - A filing relies on a valuation;
> - The terms of the applicable law;
> - The view taken by the member;
> - The extent of any doubt that exists;
> - The manner in which disclosure is to be made; and
> - The size and gravity of the item in question.[45]

This list of factors is not exactly guidance, but it is perhaps a start. But the reference to *fuller disclosure than is strictly necessary* suggests that we are not dealing with a *duty* of disclosure.

An example of this category is where a taxpayer wishes to resile from an agreed post-transaction valuation.[46] The CG Manual provides:

[44] This refers to para 3.8 PRCT which provides:
[a] Disclosure should be made whenever required by law and
[b] fuller disclosure must be recommended to clients wherever it is appropriate given a wider relationship or dialogue with HMRC relevant to that client.
[c] What is actually to be disclosed will inevitably reflect a professional judgement taking into account all relevant facts and law specific to the case in question and what the client consents should be disclosed.
But para [a] is obvious, and para [b] gives no guidance as to when disclosure is "appropriate".

[45] Para 21 PCRT Helpsheet A.

[46] It would be sensible if a post-transaction valuation were binding on the taxpayer, once agreed. But that would require legislation, and in practice the issue will rarely arise.

> **CG16612: post transaction valuation checks: action on receipt of return** [May 2020]
> ... Agreement to a valuation by the use of this service will normally lead to the use of that valuation in the Return. But agreement does not bind the customer to using that valuation. In rare cases they may discover that a relevant fact has been overlooked or feel on reflection that agreement was inappropriate. If an agreed valuation is not followed in making a Return we would expect a note drawing our attention to the change of view.

This is a case where silence may be said to mislead, as HMRC would reasonably expect an agreed valuation to be adopted.

Likewise if a taxpayer disagrees with refusal of a non-statutory clearance:

> If you disagree with HMRC's advice you may complete your return in line with your own view of the proper tax treatment, but you should draw HMRC's attention to the particular entry in your return and explain what you've done.[47]

122.9.1 *Disclosure of weak position*

I think a filing position which passes the properly-arguable test may still be so weak that a reasonable taxpayer would disclose the relevant facts so HMRC can fairly form their own view. In *Altus Group v Baker Tilly*:

> a professional would be expected to adopt any filing position that was properly arguable and was in the client's best interests, *while at the same time making full disclosure of any matter that would be necessary for HMRC to understand and appraise the filing position.*[48]

The sanction for failing to disclose when a reasonable taxpayer would do so would be penalties on the basis of carelessness, (assuming tax was held to be due).

What constitutes a weak position, in the sense that a disclosure is required? I think it is in principle one which reaches the merely tenable

So the change would be more trouble than it is worth, unless part of a wider review of the law.

[47] HMRC, Non-Statutory Clearance Service *https://www.gov.uk/guidance/non-statutory-clearance-service-guidance* (accessed May 2021)

[48] [2015] EWHC 12 (Ch) at [64].

standard, so it may be properly taken; but its prospects of success are judged at less than 50%.[49] This may be what SPTS2 means in referring to the "realistic possibility" standard. But one may also have regard to the other factors, in particular the amount at stake. If the amounts are larger, the reasonable taxpayer should take more care, and vice versa.

If the position is judged sufficiently weak, the relevant facts should be disclosed. I see no general duty to disclose that an argument/filing position is judged a weak one, or to set out the argument in detail, if a reasonably competent officer can work it out for themselves from the facts disclosed.

Precautionary disclosure arises for a position which the adviser does not consider to be a weak one, but there is a risk that others may think it so. In particular if the adviser is following a view in the profession which is very much a minority view, even if the adviser does share that view.[50]

This view is consistent with accountancy principles. IFRIC 23 provides:

> An entity has to consider whether it is probable that the relevant authority will accept each tax treatment, or group of tax treatments, that it used or plans to use in its income tax filing.
> If the entity concludes that it is probable that a particular tax treatment is accepted, the entity has to determine taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment included in its income tax filings. If the entity concludes that it is not probable that a particular tax treatment is accepted, the entity has to use the most likely amount or the expected value of the tax treatment when determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. The decision should be based on which method provides better predictions of the resolution of the uncertainty.

HMRC note that IFRIC only applies to income taxes.[51] But logically it

[49] Clarke broadly agrees, suggesting that the taxpayer should disclose unless he considers the prospects of success are better than 50:50: Lawrance & Harrison, *Clarke's Offshore Tax Planning — Foreign Domiciliaries* (2023-24) para 93.16 (Proceeding without disclosure).

[50] But this assumes that there is a "view in the profession"; which is by no means necessarily true, or easy to ascertain.

[51] Para 3 provides:

> 'tax treatments' refers to the treatments used by an entity or that it plans to use in its income tax filings.

That should include corporation tax on chargeable gains.

should apply to all tax risks.

What is the position if:

(1) A return is (correctly) submitted without further information on the basis that the prospects of success reach the realistic possibility/50% standard.
(2) Subsequently it emerges that the taxpayer's position is still a tenable one but less than the realistic possibility/50% standard.

It is suggested that there is no duty to disclose, unless information actually provided was inaccurate, which requires reasonably-known inaccuracy, not merely the possibility of inaccuracy.[52]

122.9.2 *Disclosure that HMRC disagree*

Suppose a taxpayer takes a position which is not regarded as weak, but which is contrary to a HMRC view which has been formally published in a SP. I think a reasonable taxpayer will generally disclose the fact that the position adopted is contrary to an SP unless the SP is clearly wrong.

The same applies if the HMRC view is clearly and cogently expressed in less formal sources:

(1) RI or Business Briefs, or correspondence formally published by the professional bodies
(2) Private correspondence addressed to the taxpayer (but not if addressed to others)

unless the HMRC view expressed is thought likely (on the balance of probabilities) to be wrong.

The same applies if the HMRC view is clearly and explicitly expressed in the HMRC Manuals, but it should be borne in mind that the Manuals are a vast ocean, of mixed quality, frequently out of date, and at least in its origin, it was intended for internal HMRC use, not for taxpayers.[53] So it is easier to disregard this than formal statements of HMRC views.

Hyman v HMRC contains a more sceptical view of the quality of HMRC

[52] See 121.15.2 (Failure to correct error).

[53] See *Aozora GMAC Investment, R (oao) v HMRC* [2019] EWCA Civ 1643 at [23]. But while in origin the Manuals were only for internal use, they are now sometimes (I would say, generally) used as a platform to set out HMRC guidance for its customers. There seems to be a trend for guidance published separately to be moved to the Manuals, (eg RDR3, DIMF guidance); and for important guidance to be published in the Manuals (eg the *Anson* guidance in 2023).

guidance, SPs as well as Manuals:[54]

> The guidance [in Statements of Practice and the HMRC Manual] was non-statutory guidance. Such guidance can in some cases be persuasive when a court or tribunal is asked to construe legislation. However, it does not differ from a statement by an academic author in a text book or an article and it does not enjoy any particular legal status; there is no presumption that the guidance is correct... It is by no means unprecedented for the court or tribunal to say that the guidance is simply wrong.

Full disclosure is obviously required if it is desired to make full disclosure to prevent HMRC making a discovery which would authorise an assessment after the enquiry period.[55] But that is a different question from whether non-disclosure could be regarded as careless or in any way improper.

122.9.3 *Large business disclosure*

Sch 15 FA 2022 requires large companies to disclose "uncertain tax treatment".[56] This is defined (in short) to mean:

(1) accounts reflect that it is probable (more likely than not) that a different tax treatment applies;[57] or
(2) the taxpayer knows that HMRC disagree.

The new code will have no significant impact, because:

(1) Only very large businesses are affected, in short, turnover over £200m

[54] [2021] UKUT 68 (TCC) at [42]. The position may be compared to the OECD Commentary to the Model Convention, which has been said to have only "such persuasive force as aids to interpretation as the cogency of their reasoning deserves"; see 107.11.2 (Post-DTA Commentary changes).

[55] See 121.11.5 (Disagreeing with HMRC view).

[56] The background can be traced in a series of HMRC consultation & response papers: See "Notification of uncertain tax treatment by large businesses" (Mar 2020), followed by:
• a summary of responses (Mar 2021)
• a second consultation (Mar 2021)
• a second summary of responses (Jul 2021)
https://www.gov.uk/government/publications/large-businesses-notification-of-uncertain-tax-treatment
These are now of historic interest only.

[57] IFRIC 23; see 122.9.1 (Disclosure of weak position).

or balance sheet over £2 billion,[58] and tax at stake over £5m
(2) Penalty for breach is nominal: £5k, or £50k for 3rd & later breaches[59]
(3) The definition of uncertain tax treatment is narrow[60]

I do not discuss the rules in detail here: that would need a chapter to itself.

One might have hoped that a consultation paper proposing new law would summarise the existing law: that is, to consider to what extent the current law requires the taxpayer to disclose matters of doubt. But that is not mentioned. Presumably it was just too obscure.

One might infer that since only large businesses are subject to the new code, no duty to disclose these matters rests on taxpayers who are not large businesses. But that is an argument from redundancy, and it is considered that no inference should be drawn as to the general law of disclosure.[61]

The Code of Practice on Taxation for Banks requires that banks disclose "significant uncertainties in relation to tax matters".

122.10 Disclosure for good HMRC relations

PCRT formerly provided:

> *It may be in the client's best interest to furnish more information than he is strictly required to do because this is likely to lead to a more reasonable approach by the tax authorities, thereby saving money and time in the long run ...*

PCRT was tentative (note the *may*) and the validity of the point is not easy to assess: it may vary from client to client, from time to time, and from department to department. Disclosure in these circumstances is voluntary.

[58] Following the model of Senior Accounting Officer regime (Sch 46 FA 2009) and Publication of Tax Strategies regime (Sch 19 FA 2016).

[59] Though there is also a possible reputational cost.
It is possible that the scope of the code will be extended in the future, and penalties increased; as we have seen with DOTAS. An extended assessment time limit for breach of the duty, for a start. Time will tell.

[60] The original proposals were wider, including a duty to disclose "substantial doubt" but this was withdrawn because businesses objected, rightly, that "substantial doubt" was too vague. This was a rerun of the Keith Committee debate; see 122.8.1 (No general duty of disclosure).
The reader may infer that lobbying on behalf of large businesses is more effective than for other taxpayers.

[61] See App 2.1.2 (Argument from redundancy).

In the 2010/11 edition of this work I commented:

> It seems to me that the only tangible incentive for above-minimum disclosure is to curtail the enquiry period, and obtaining "a more reasonable approach by the tax authorities" is uncertain, unquantifiable, unenforceable and ultimately chimerical. But readers who deal directly with HMRC on a daily basis will be in a better position to form a view on this issue, and this is (understandably) an attitude that HMRC wish to encourage.[62]

The authors of PCRT may agree, since in 2011 they watered down this passage; it now reads:

> *In general,* it is *likely* to be in a client's own interests to ensure that factors relevant to their tax liability are adequately disclosed to HMRC because:
>
> - Their relationship with HMRC is *more likely* to be on a satisfactory footing if they can demonstrate good faith in their dealings with them.[63]

If it is anticipated that questions will be asked, it is sensible to anticipate them by providing details in a tax return or elsewhere.

122.10.1 *HMRC/taxpayer relationship*

The debate about disclosure should be seen in the context of a broader controversy concerning the relationship between HMRC and the taxpayer. The traditional view has been that:

(1) The relationship is adversarial: the interests of HMRC and taxpayer are distinct and each acts in their own interest.

(2) The relationship should be characterised by adherence to legal rules (substantive tax rules determining the amount of tax due, and the requirement of honesty) supplemented by procedural rules of conduct (such as courtesy and efficiency).

A rival (and more recent[64]) view is the opposite:

[62] See comments on the "enhanced relationship" in OECD, Study into the Role of Tax Intermediaries, 2008, *http://www.oecd.org/dataoecd/28/34/39882938.pdf* and OECD "Engaging with High Net Worth Individuals on Tax Compliance" (May 2009);*http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/engaging-with-high-net-worth-individuals-on-tax-compliance_9789264068872-en*

[63] Para 20 PCRT Helpsheet A.

[64] It is difficult to identify a specific date when this school of thought emerged, but I think it reflects a change of administration around the beginning of the second term

(1) The relationship should be a collaborative one, taxpayer and HMRC working together in harmony towards a common goal, to ascertain the right amount of tax.

(2) The right amount of tax[65] is defined only partly in legal rules but also discernable from a more insubstantial spirit of the rules.[66] (Perhaps HMRC consider themselves the arbiter of this spirit, or perhaps no arbiter is needed: so far as the point is not governed by law, the question can be fudged.)[67]

I refer to the traditional view as the **"adversarial approach"**, and the rival view as the "**collaborative approach**". A range of positions are possible between the two extremes.

The controversy raises various questions:

(1) Empirical questions: do HMRC and taxpayers actually regard the collaborative approach as the model of their relationship, or to what extent do they do so, or pretend to do so

(2) Political and moral questions: should they do so, or to what extent should they do so[68]

(3) Legal questions: do the courts enforce a collaborative approach, or to

of the Labour Government (2001). Contrast the use of the term "compliant" and "customer"; see App 1.4 ("Compliant"), App.1.5 ("Customers" of HMRC).

[65] Also called "the proper amount of tax".

[66] An example is the Code of Practice on Taxation for Banks, (introduced 2009, current version 2013, with commentary periodically updated). This provides:

> "Relationships with HMRC should be transparent and constructive, based on mutual trust" [adding with jarring realism: "wherever possible"].
>
> "The features of this relationship should include disclosing fully the significant uncertainties in relation to tax matters... engaging in a co-operative, supportive and professional manner in all interactions ... working collaboratively...."

https://www.gov.uk/government/publications/code-practice-taxation-banks/code-of-practice-on-taxation-for-banks

Similarly, "A European Taxpayers Code" (2016): Tax administrations should "aim to engage full-heartedly and in a spirit of cooperation with taxpayers to resolve tax issues".

https://taxation-customs.ec.europa.eu/system/files/2016-11/guidelines_for_a_model_for_a_european_taxpayers_code_en.pdf

[67] HMRC say: "Any disagreements arising under the Code will be dealt with using existing processes." See "A Code of Practice on Taxation for Banks - Consultation Response Document" (2009).

[68] Different considerations apply to a charity: see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 47.2 (Charity/ HMRC relationship).

what extent do they do so

The short answer to the legal question seems to be that the courts will not enforce a collaborative approach. So far as it happens at all, it rests outside the law.[69] Here are three examples:

Bampton Property Group (R, oao) v King:[70] HMRC noticed that a company had failed to put in a loss election, but did not inform the company until the deadline for the election had passed. The court held that there was nothing wrong in that.

MPTL Ltd v HMRC:[71] the taxpayer told HMRC that they intended to appeal but did not file a notice of appeal with the Tribunal. The Tribunal held that HMRC were under no duty to inform a taxpayer about that.

Kriticos v HMRC:[72] an unrepresented taxpayer owed tax of £1,010 and £800 penalties for late payment of previous tax. He paid HMRC £1,010 but failed to direct whether it should be used in payment of the penalties or the tax. This was said to give HMRC a discretion, and HMRC allocated the payment in the way most detrimental to the taxpayer and most advantageous to HMRC: towards the penalties. Thus £810 tax liability remained outstanding and attracted further penalties for late payment. The Tribunal found nothing wrong in that.

I am not saying that these are wrong; but it is not the co-operation model, and it is difficult to describe the tax paid by the taxpayers as "the right amount of tax" if that expression means anything other than the amount of tax due by law.

HMRC Settlement and Litigation Strategy states that HMRC will handle disputes by working collaboratively with its customers, and that a collaborative approach requires the parties to be open and transparent. But it is easier to preach the virtues of openness and transparency that to act on them. In practice:

(1) HMRC are not open or transparent when it comes to documents which qualify for legal professional privilege.[73] The Strategy

[69] HMRC rightly say (under the heading "The Rule of Law"): The Code is not law. See "A Code of Practice on Taxation for Banks - Consultation Response Document" (2009).

[70] [2012] EWCA Civ 1744.

[71] [2022] UKFTT 472 (TC).

[72] [2019] UKFTT 0677 (TC).

[73] See HMRC, "Litigation and Settlement Strategy" (Oct 2017) *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attac*

document did not shed much light on how the Tribunal should exercise its discretion to direct disclosure.[74]

(2) HMRC Solicitors Office act adversarially and not collaboratively.[75]

There are at least three reasons to regard the collaborative approach with suspicion:

(1) It has resource implications for HMRC.
(2) It may lead away from the view that tax should be governed by law.
(3) It is more difficult (and perhaps not reasonable to expect) that one side should act collaboratively unless it is satisfied that the other will also do so; and that requires mutual trust which will not generally exist.

For a restatement of the traditional view, see the speech of Anthony Thomas, then CIOT president:

> We need to return to the "healthy tension" between HMRC and the tax profession that existed 10 to 20 years ago: no special relationships, no cosy conferences; no favours, deals and understandings; no inside tracks and private access. ... Senior tax officials did not subject directors, businesses and the professions to the kind of lectures one would expect from a politician. The job of civil servants is, and always has been, to apply the rule of law in an even handed manner.[76]

hment_data/file/655344/HMRC_Resolving_tax_disputes.pdf

[74] *McCabe v HMRC* [2020] UKUT 266 (TCC) at [56]; for this case see 9.18 (Tie-breaker: Mutual agreement); see too 122.4.1 (HMRC's compliance issues).

[75] In *Thakoral Tailor v HMRC* [2017] UKFTT 845 (TC) the taxpayer was elderly, unrepresented, in difficult financial circumstances, and with cognitive impairment. Even in those circumstances, HMRC acted adversarially. The Tribunal urged HMRC to consider the "unfairness which should have been apparent" (the taxpayer had fallen into the *Lobler* trap, yet again); but was otherwise impotent.

In *Oppenheimer v HMRC* [2022] UKFTT 112 (TC) at [219] the Tribunal noted with some exasperation:

> "... at a meeting between Mr Oppenheimer' advisers, the HMRC officer who was conducting the enquiry and a Mr Thomas of the UK Competent Authority Treaty Claims unit of HMRC, Mr Thomas, whose field of expertise it is, confirmed that in his view the issues were finally balanced. HMRC confirmed that again on a number of occasions in subsequent correspondence.
>
> We agree, but it would have been very difficult to have discerned that from the Skeleton Arguments, Notes on Evidence and Closing Submissions since, on the face of it, the parties were diametrically opposed on almost every issue and on the approach to those issues."

[76] "We Need Trust", Taxation Magazine (2 June 2011) p.7.

That was said in 2011. I am not sure how far this view prevails today.

A full discussion lies beyond the scope of this book, but the issues are deep, and will not go away.

122.11 Certificate of tax position

CIOT say:

Background
Over the past couple of years, HMRC have been sending out letters to UK individuals who they have identified as having received income, gains or assets from overseas accounts or investments. These have been prompted by information HMRC have been receiving from overseas tax authorities under Automatic Exchange of Information (AEOI) agreements about UK residents with financial accounts and investments overseas.[77] As noted, the letters are targeted at individuals whom the data identifies as having received income, gains or assets from overseas accounts or investments, and HMRC also undertake some additional risk assessment before sending the letters...

What's in the letters?
HMRC's letters use standard wording and start by informing the individual that HMRC have information which shows that they have an interest in overseas property or ay have received overseas income or gains which may be taxable in the UK.

Some of the letters the CIOT is aware of are:

March 2017: based on information from the US IRS under the IGA to improve international tax compliance and implement FATCA

February 2018: based on information from AEOI with the Crown Dependencies and Overseas Territories

February 2019: based on information from tax information exchange agreements with other countries, including as a result of the CRS.

February 2020: based on information from tax information exchange agreements with other countries, including as a result of the CRS (with some changes in the wording of the letter and Certificate of Tax position compared to the February 2019 version).

The most recent letters have come from HMRC's "Risk and Intelligence Service, Offshore". Some of them include a "Certificate of Tax Position" form which HMRC ask the individual to complete and return whether they have additional tax liabilities to disclose or not. We understand that one reason why HMRC use the "Certificate of Tax Position" is because it helps them minimise the number of "no response" cases they would otherwise need to follow up.

On the certificate, the individual is asked to sign and make a declaration to the effect that:

a) The information they provide on the certificate will be "correct and complete to the best of their knowledge and belief"- [this is identical to the declaration on the self-assessment tax return Box 22 of SA100] and

b) They understand that choosing to make a false statement or complete a false certificate is a criminal offence that can result in investigation and prosecution -

[77] See 130.1 (CRS & other information sources).

[this is similar, but not identical, to the declaration on the SA100 which is "I understand that I may have to pay financial penalties and face prosecution if I give false information].

They are also asked to tick that either:

a) Their tax affairs need to be brought up to date and they will make a disclosure of irregularities through the Worldwide Disclosure Facility (WDF); or

b) Their tax affairs do not need updating and they do not have additional tax to pay. There is then a further declaration: "I have declared all of my offshore income, assets and gains". Previous versions of the letter included the words "which are taxable in the UK" at the end of the sentence.

What you should do if a client receives one of these letters from HMRC

1. Check the position.

It should be noted that HMRC are saying in the letter that they are aware the person has overseas income, not that their tax return is necessarily wrong. However, HMRC do carry out some risk assessment before sending a letter, so it will clearly be essential to check whether the individual's tax affairs are correct and complete to the best of their knowledge and belief before responding to the letter.

We are also aware that discrepancies in the data may exist due to it often relating to a calendar year, thereby crossing over two UK tax years, and because it does not come into HMRC in a standard format. This is expected to affect mainly the early years of data exchange and should become less of an issue as we move into future tax years and HMRC's systems become more sophisticated at analysing the data they receive.

2. Respond to HMRC's letter, whether or not there is anything to disclose.

a. If a disclosure needs to be made, use the WDF (or another appropriate method).

If a disclosure is required, the letter advises that this must be made via the WDF. However, HMRC cannot compel a taxpayer to use any specific method for their disclosure and using the WDF may not necessarily be the most appropriate method. Depending on the individual circumstances of the taxpayer, other approaches may be better e.g. COP9 (Contractual Disclosure Facility). Agents should therefore consider their client's specific circumstances and advise on the most appropriate method for a disclosure. As noted, this may not always be the WDF.

A CIOT member must comply with the fundamental principle of professional competence and due care as set out in PCRT. This means that they should not undertake professional work which they are not competent to perform unless they obtain appropriate assistance from a suitably qualified specialist. Advice from another adviser specialising in tax disputes may therefore be needed if the agent does not have the necessary expertise to handle a disclosure themselves.

It is also important to note that there is no de mimimis level below which mistakes do not need to be disclosed.

b. If no disclosure is needed, the person should consider sending HMRC an explanation by letter.

HMRC will accept a response by letter should an individual choose not to complete the "Certificate of tax position" (see 3. below).

Where no response is received, HMRC will follow up so not responding at all will attract more attention from HMRC. Follow up is likely to be by a further letter in the first instance. If no response is forthcoming after the second letter, HMRC will consider the most appropriate action to take next following further risk assessment. This could range from contacting the person by telephone to opening an enquiry or investigation.

Responding to the initial letter will therefore mitigate the risks of further action being taken by HMRC.

If possible, try to respond within the 30 days provided by HMRC. However, if it is not possible or practical to respond fully to the letter within this timescale consider contacting HMRC either by telephone or letter to agree a more realistic timescale with them.

3. In view of the serious consequences of making a false declaration, consider very carefully whether to sign and return the "Certificate of tax position".

Although the declarations in the "Certificate of tax position" are similar, if not completely identical, to those on the self-assessment tax return, there are two important differences.

Unlike the tax return:

- There is no legal obligation on the individual to complete the "Certificate of tax position" and return it to HMRC; and
- The period covered by the "Certificate of tax position" - and therefore the declarations - is not restricted to a particular tax year. It applies to all years.

The certificate does not have a de minimis level.

The individual should consider very carefully whether to sign and return the certificate, regardless of whether they have irregularities to disclose or not. When advising a client who has received one of these letters, it will clearly be important that these consequences are made clear to them.

In discussions between the CIOT and HMRC, HMRC have agreed that there is no legal obligation for the individual to complete and return the certificate to them. They have told us that they will accept a response by letter as an alternative should an individual choose not to complete the declaration.

As mentioned, in view of the serious consequences of making a false declaration, it may therefore be preferable to respond by letter to HMRC, particularly if, after reviewing their tax affairs, the individual believes that their affairs are correct and up to date and they do not need to make a disclosure. The wide wording of the declaration (which, as mentioned above, no longer limits it to offshore income, assets and gains taxable in the UK), also indicates that a response by letter would be preferable since responding by letter enables an explanation to be included, which could pre-empt further queries by HMRC. For example, in the case of a non-UK domiciled individual, to confirm that no funds were remitted to the UK and that all the funds deposited into the account came from funds on which UK tax was paid as appropriate in past years (i.e. that there may have been offshore income, gains or assets which have legitimately not been disclosed). As mentioned, HMRC's letter does require a response, in one form or another. If the individual needs to make a disclosure but chooses not to complete the "Certificate of tax position", it would be good practice to respond to HMRC's letter in writing and advise HMRC that a disclosure via the WDF (or other method) is being made.

With data from overseas now being constantly received under AEOI agreements, HMRC are adopting an approach of sending out batches of letters at regular intervals.

Members should be aware that this approach will continue for the foreseeable future.[78]

122.12 Professional conduct: Back duty

This topic was covered by PCRT Helpsheet 3 (Voluntary disclosures under disclosure facilities) and now by Helpsheets C1 and C2, which I hope to consider in a future edition.

[78] *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/6890e36f-25a4-48c3-b18f-9dbc76fa4a72/190614%20UPDATED%20200303%20CIOT%20member%20guidance%20re%20offshore%20nudge%20letters%20FINAL.pdf*

CHAPTER ONE HUNDRED AND TWENTY THREE

CLAIMS

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123.1 Claims

This chapter discusses procedures for making claims and their time limits.

123.2 Standard claim rules

123.2.1 *s.42 claim-procedure rules*

Statutory terminology refers to claims, elections and notices.

Section 42(1) TMA 1970 provides:

> Where any provision of the Taxes Acts provides for relief to be given, or any other thing to be done, on the making of a claim, this section shall, unless otherwise provided, have effect in relation to the claim.

In short, s.42 sets out default rules for “claims”. I refer to this as the **“s.42 claim-procedure rules”**.

Where the statutory rule does not use the word “claim”, but some other term such as election or notice, the s.42 rules would not apply, but sometimes they are incorporated by reference, with or without some amendment. I set out the examples relevant to this book in the next section.

123.2.2 *Claim time limit*

Section 43(1) TMA provides:

> Subject to any provision of the Taxes Acts prescribing a longer or shorter period, no claim for relief in respect of income tax or capital gains tax may be made more than 4 years after the end of the year of assessment to which it relates.

In short, s.43 sets out the default time limit for claims for relief. I refer to this as the **"s.43 claim time limit"**. The rule and its wording is aligned with the 4 year time limit for assessments.[1]

The s.43 claim time limit only applies to a "claim for relief".[2] As worded, it does not apply in the case of:

(1) A statutory provision which does not use the word "claim", or

(2) A statutory provision which is not a claim "for relief".

But sometimes the s.43 time limit is incorporated by reference.

It may be useful to set out an aide memoire of s.43 claim time limits:

Tax Year	Last date for claim	Tax Year	Last date for claim
2015/16	5/4/2020	2019/20	5/4/2024
2016/17	5/4/2021	2020/21	5/4/2025
2017/18	5/4/2022	2021/22	5/4/2026
2018/19	5/4/2023	2022/23	5/4/2026

I refer to s.42 claim-procedure rules and the s.43 claim time limit together as **"s.42/43 claim procedure rules"**.

123.2.3 *Capital loss claims*

Section 16(2A) TCGA provides:

> [i] A loss accruing to a person in a year of assessment shall not be an allowable loss for the purposes of this Act unless, in relation to that year, he gives a notice to an officer of the Board quantifying the amount of that loss;
>
> [ii] and sections 42 and 43 of the Management Act shall apply in relation to such a notice as if it were a claim for relief.

This notice is not a claim, or at least, not described as a claim, but the s.42/43 claim procedure rules apply as if it were. It would have been

[1] See 121.14 (4 year limit).

[2] Contrast s.42 which applies on (1) a claim for relief or (2) a claim for any other thing to be done.

easier to say that an allowable loss requires a "claim"; or is there some difference which follows from using the word "notice" and incorporating s.42/43 "as if the notice were a claim"?

Similarly for a foreign-loss election by a remittance basis taxpayer.[3] Section 16ZA(4) TCGA provides:

> Sections 42 and 43 of the Management Act (procedure and time limit for making claims), except section 42(1A) of that Act,[4] apply in relation to an election under this section as they apply in relation to a claim for relief.

For losses and s.1(3) amounts (trust gains) see 61.6.4 (Claims for relief).

123.2.4 *Remittance basis claims*

For these claims, see 17.7 (Remittance-basis claim: s.809B).

Section 809B(3) ITA applies the standard claim procedure rules to remittance basis claims subject to some tinkering:

> Sections 42 and 43 of TMA 1970 (procedure and time limit for making claims), except s.42(1A) of that Act, apply in relation to a claim under this section as they apply in relation to a claim for relief.

The relevant section actually refers to a "claim" for the remittance basis, so the s.42 claim procedure rules would apply to a remittance basis claim in any event.[5] Presumably the point here is to disapply s.42(1A).[6] It seems a slightly roundabout way to achieve that, but there it is. The drafter has perhaps adopted precedents found elsewhere. However that may be, a remittance basis claim of unremitted income/gains does not need to be quantified, that is, it is not necessary to specify the amount of unremitted income/gains.

The s.43 claim time limit would only apply to a claim for the remittance basis if the claim were a claim "for relief", which it is not, at least in the strict sense, so s.809B(3) applies s.43 expressly.

123.2.5 *2017 rebasing election*

For these elections, see 56.16.13 (Election out of 2017 rebasing).

[3] See 64.16.4 (Foreign-loss election).

[4] See 123.3 (Quantification of claim).

[5] Even if the claim is not a "claim for relief", it is a claim for a "thing to be done".

[6] See 123.3 (Quantification of claim).

Para 43(2) sch 8 F(no.2)A 2017 provides:

> Sections 42 and 43 of TMA 1970 (procedure and time limit for claims), except section 42(1A) of that Act, apply in relation to an election under this paragraph as they apply in relation to a claim for relief.

This follows the wording used for foreign-loss elections.

123.3 Quantification of claim

Section 42(1A) TMA provides:

> Subject to subsection (3) below,[7] a claim for a relief, an allowance or a repayment of tax shall be for an amount which is quantified at the time when the claim is made.

Quantification may be estimated: In *Claimants Listed in Class 8 of the Group Register of the CFC and Dividend GLO v HMRC*:[8]

> ... that provision makes no reference to the amount being accurate, only to it being quantified. And one can quite see why quantification is necessary in a self-assessment system, where paragraph 7 of schedule 18 provides for taxpayers to make a self-assessment tax return "of the amount of tax which is payable by the company for that period … (a) on the basis of the information contained in the return, and (b) taking into account any relief … for which a claim is included in the return". Moreover, paragraph 56 allows for a supplementary claim to be made to correct an original claim.

123.4 Types of claim

There are two types of claim:

Type of claim (my term)	**Where made**	**See**
Tax return claim	In tax return	20.5
Free-standing claim	Outside tax return	20.6

The practical difference is that tax return claims are governed by the procedures for enquiry and appeals which apply to tax returns. Freestanding claims are governed by sch 1A TMA.

123.5 Tax return claims

Section 42(2) TMA 1970 provides (so far as relevant):

[7] Subsection (3) deals with PAYE and is not discussed here.

[8] [2019] EWHC 338 (Ch) at [99]-[100].

> [a] Subject to subsections (3) to (3ZC) below,[9]
> [b] where notice has been given under
>   [i] section 8 [personal return][10]
>   [ii] 8A [trustee return] or
>   [iii] 12AA of this Act [partnership return]
> [c] a claim shall not at any time be made otherwise than by being included in a return[11] under that section if it could, at that or any subsequent time, be made by being so included.

Thus the starting point is that a claim should be made in a tax return, not as a free-standing claim.

123.5.1 *Amendment window*

A taxpayer may amend a return.[12] If a tax return is submitted without a remittance basis or other claim, the claim can be made by amending the return; similarly, if a tax return is submitted with a claim, the claim can be withdrawn by amending the return.

HMRC agree. The RDR Manual provides:

> **RDRM32020 Claiming the remittance basis: Making a claim** [Jan 2019]
> ... If the return is subsequently amended, the claim may be included then or a previously made claim may be amended or deleted (s.42(5) TMA 1970).

However the time limit for amending a tax return is quite short, one year from the filing date. I refer to this period as the **"amendment window"**.

The RDR Manual provides:

> **RDRM32020 Claiming the remittance basis: Making a claim** [Jan 2019]
> ... when the time period for making an amendment has passed, the

[9] The exceptions referred to in para [a] are specialist cases where a tax return is not expected to be made:

Subsection	**Topic**
3	PAYE claim
3ZA, 3ZB	Charity tax relief/tax repayment claim
3ZC	GAAR claim

[10] See 121.4 (Notice to make return).

[11] Section 42(5) TMA provides: "The references in this section to a claim being included in a return include references to a claim being so included by virtue of an amendment of the return."

[12] See 106.4 (Amending a return).

> claim may not be withdrawn even if the making of the claim turns out to have been an error. This is because error or mistake relief does not apply to claims made to use the remittance basis under s.809B ITA 2007 (s.33(2A)(c) TMA 1970).

Section 33(2A)(c) TMA formerly provided that no relief was given under s.33 for an error or mistake consisting of the making of a remittance basis claim. The reference in the Manual is out of date as the legislation was rewritten in 2009. The provisions are now in sch 1AB TMA, which does not refer expressly to remittance basis claims, but the new provisions only apply where tax has been paid, or assessed, which is not due. That is not the case where making a remittance basis claim was a mistake in the sense that it was not beneficial. So the position remains as before. That is, after amendment window has closed, it is only possible to withdraw a remittance basis or other claim in the circumstances below.

123.6 Free-standing claims

A free-standing claim is made if:

(1) HMRC do not give notice to complete a tax return[13]
(2) It is too late to make or amend a return
(3) Fo some other reason a claim cannot be made in a return (for instance, a claim for hold-over relief generally needs to be made by transferor and transferee, so cannot be made in the transferor's return).

Freestanding claims are governed by sch 1A TMA. I do not discuss this here, though I hope to do so in a future edition.

In the absence of an official form, a free-standing claim could be made informally, eg by letter.

Where a free-standing claim is needed because there was no notice to submit a tax return, I suspect it is common practice to voluntarily submit a return (despite the absence of a notice requiring one) and make the claim in that return.[14]

Once the return is made, and the deadline for amending the return has passed, the claim cannot subsequently be included in the return; and that

[13] Form SA316. In practice a person who wishes to make a remittance basis or other claim will usually receive a notice to complete a tax return.

[14] A claim in an unsolicited tax return is an effective claim; see 121.4.8 (Voluntary return) and, if authority is needed, *Weerasinghe v HMRC* [2013] UKFTT 144 (TC).

opens up the possibility of making the claim outside the return, subject to the 4 year time limit.

HMRC agree. A consultation paper in 2015 summarised the position for remittance basis claims:[15]

> - the [remittance basis] claim will continue to be made on the self-assessment tax return, which has a deadline for filing at the end of January of the following year. For example, the return for 2013-14 is due by 31 January 2015. This means individuals will have a good understanding of their income and gains for up to 21 months of the 36 months covered by the claim
> - individuals will continue to be able to amend their self-assessment tax returns within 12 months of the statutory filing date, so individuals will be able to change a decision on a claim within that time limit if they choose to do so
> - individuals who pay tax on the arising basis [because they did not make a remittance basis claim] will continue to have four years after the end of the tax year in which to claim the remittance basis, which also allows individuals to make a final decision based on a full understanding of their worldwide income and gains in those circumstances if they choose to do so

The RDR Manual provides:

> **RDRM32030 Claims - Time Limits** [Jan 2019]
> The time limits for making claims are set out in Section 43 TMA 1970. The general time limit as set out in TMA70/s43(1) for making a claim also applies to making a claim for the remittance basis.

The Manual adds:

> If there is a likelihood that the claim might not be made within the general time limit for making the claim, then the individual must tell HMRC of the intention to make the claim. This must stipulate:
> - the nature of the claim, and
> - the year for which it is to be made

[15] HMRC "Non-UK domiciled individuals: consultation on a minimum claim period for the remittance basis charge" (2015) *https://www.gov.uk/government/consultations/non-uk-domiciled-individuals-consultation-on-a-minimum-claim-period-for-the-remittance-basis-charge*
The proposal in this consultation paper was abandoned, presumably because it was overtaken by the more far-reaching deemed domicile rules, but that does not affect the points made here.

But I think what the Manual describes as "telling HMRC of the intention to make the claim" actually amounts to making a claim.

123.6.1 *Amending freestanding claim*

Para 3 sch 1A TMA provides:

> (1) Subject to sub-paragraph (2) below—
> (a) at any time before the end of the period of nine months beginning with the day on which a claim is made, an officer of the Board may by notice to the claimant so amend the claim as to correct any obvious errors or mistakes in the claim (whether errors of principle, arithmetical mistakes or otherwise); and
> (b) at any time before the end of the period of twelve months beginning with the day on which the claim is made, the claimant may amend his claim by notice to an officer of the Board.
> (2) No amendment of a claim may be made under sub-paragraph (1) above at any time during the period—
> (a) beginning with the day on which an officer of the Board gives notice of his intention to enquire into the claim, and
> (b) ending with the day on which the officer's enquiries into the claim are completed.

123.7 Late claim: Non -culpable taxpayer

123.7.1 *Late claim after assessment*

Section 43(2) TMA permits a late claim following an assessment:

> [a] A claim (including a supplementary claim) which could not have been allowed but for the making of an assessment to income tax or capital gains tax after the year of assessment to which the claim relates
> [b] may be made at any time before the end of the year of assessment following that in which the assessment was made.

Section 43A TMA provides:

> (1) This section applies where—
> (a) by virtue of section 29 of this Act an assessment to income tax or capital gains tax is made on any person for a year of assessment, and
> (b) the assessment is not made for the purpose of making good to the Crown any loss of tax brought about carelessly or deliberately by that person or by someone acting on behalf of

that person.

(2) Without prejudice to section 43(2) above but subject to section 43B below, where this section applies—

The rules which follow are best read side by side:

Making a claim: s.43A(2)(a)	**Revoking/varying claim: s.43A(2)(b)**
(a) any relevant[16] claim, election, application or notice which could have been made or given within the time allowed by the Taxes Acts may be made or given at any time within one year from the end of the year of assessment in which the assessment is made, and	(b) any relevant claim, election, application or notice previously made or given may at any such time be revoked or varied— (i) in the same manner as it was made or given, and (ii) by or with the consent of the same person or persons who made, gave or consented to it (or, in the case of any such person who has died, by or with the consent of his personal representatives),

except where by virtue of any enactment it [the claim, etc] is irrevocable.

123.7.2 *Cap on late claim/amendment*

Section 43B TMA provides a cap on the relief given by a late claim or

[16] Section 42A TMA provides:
"(2B) For the purposes of this section and section 43B below, a claim under Schedule 1AB is relevant in relation to an assessment for a year of assessment if it relates to that year of assessment.
(3) For the purposes of this section and section 43B below, any other claim, election, application or notice is relevant in relation to an assessment for a year of assessment if—
(a) it relates to that year of assessment or is made or given by reference to an event occurring in that year of assessment, and
(b) it or, as the case may be, its revocation or variation has or could have the effect of reducing any of the liabilities mentioned in subsection (4) below.
(4) The liabilities referred to in subsection (3) above are—
(a) the increased liability to tax resulting from the assessment,
(b) any other liability to tax of the person concerned for—
(i) the year of assessment to which the assessment relates, or
(ii) any year of assessment which follows that year of assessment and ends not later than one year after the end of the year of assessment in which the assessment is made."

revocation:

> (3) In any case where—
>
> (a) one or more relevant claims, elections, applications or notices are made, given, revoked or varied by virtue of the application of section 43A above in the case of an assessment, and
>
> (b) the total of the reductions in liability to tax which, apart from this subsection, would result from the action mentioned in paragraph (a) above would exceed the additional liability to tax resulting from the assessment,
>
> the excess shall not be available to reduce any liability to tax.
>
> (4) Where subsection (3) above has the effect of limiting either the reduction in a person's liability to tax for more than one period or the reduction in the liability to tax of more than one person, the limited amount shall be apportioned between the periods or persons concerned—
>
> (a) except where paragraph (b) below applies, in such manner as may be specified by the inspector by notice in writing to the person or persons concerned, or
>
> (b) where the person concerned gives (or the persons concerned jointly give) notice in writing to the inspector within the relevant period, in such manner as may be specified in the notice given by the person or persons concerned.
>
> (5) For the purposes of paragraph (b) of subsection (4) above the relevant period is the period of 30 days beginning with the day on which notice under paragraph (a) of that subsection is given to the person concerned or, where more than one person is concerned, the latest date on which such notice is given to any of them.

A typical case is if no remittance basis claim was made as a taxpayer reasonably considered that some relief applied. Likewise a late claim for DT relief may be made if a taxpayer reasonably considered that some other relief was available.

HMRC agree. The Self Assessment Claims Manual provides:

> **SACM9015. Non-Culpable Additions** [Feb 2019]
>
> Where you
>
> - amend a return in an SA enquiry closure notice, or
> - make a discovery assessment for reasons other than careless or deliberate behaviour
>
> the taxpayer can make a relevant out-of-time claim, election, application or notice within one year from the end of the year of assessment in which the notice is issued. S.43A and s.43C(2).

In s.43A for a claim, election, application or notice to be relevant to an amendment or assessment it must

- relate to the same year of assessment, or
- be made or given by reference to an event in that year, see s.43A(3) TMA 1970).

The taxpayer can also

- revoke a claim, election, application or notice already made, or
- amend a claim, election, application or notice, except where it is irrevocable in law.

The effect of the taxpayer making, revoking or amending a claim, election, application or notice is limited to the additional liability to tax resulting from the assessment or your amendment.

So if an ITSA enquiry increases a taxpayer's self assessment by £1,500 tax, the effect of any out-of-time claims or elections is limited to £1,500, see s.43B(3) TMA 1970. Any "excess" tax effect of the claim or election "shall not be available to reduce any liability to tax".

123.7.3 *Late claim after return amended*

Section 43C(2) TMA applies the same following amendment of a return (as opposed to an assessment):

> Where-
>
> (a) a return is amended under section 28A(2)(b) [amendment on closure of enquiry][17] and
>
> (b) the amendment is not made for the purpose mentioned in subsection (1)(b) above [ie not for "the purpose of making good to the Crown any loss of tax brought about carelessly or deliberately by the taxpayer or a person acting on his behalf"]
>
> sections 43(2), 43A and 43B apply in relation to the amendment as they apply in relation to any assessment under section 29.

Amended as s.43C directs, these statutory provisions become:

Section 43(2) TMA:

> [a] A claim (including a supplementary claim) which could not have been allowed but for the making of an ~~assessment~~ amendment to a return to income tax or capital gains tax after the year of assessment to which the claim relates
>
> [b] may be made at any time before the end of the year of assessment following that in which the ~~assessment~~ amendment to a return was made.

[17] See 121.21 (Enquiry ends: Closure notice).

Section 43A TMA:

(1) This section applies where—

(a) by virtue of section 29 of this Act an ~~assessment~~ amendment to a return to income tax or capital gains tax is made on any person for a year of assessment, and

(b) the ~~assessment~~ amendment to a return is not made for the purpose of making good to the Crown any loss of tax brought about carelessly or deliberately by that person or by someone acting on behalf of that person.

(2) Without prejudice to section 43(2) above but subject to section 43B below, where this section applies—

Making a claim: s.43A(2)(a)

(a) any relevant[18] claim, election, application or notice which could have been made or given within the time allowed by the Taxes Acts may be made or given at any time within one year from the end of the year of assessment in which the ~~assessment~~ amendment to a return is made, and

Revoking/varying claim: s.43A(2)(b)

(b) any relevant claim, election, application or notice previously made or given may at any such time be revoked or varied—

(i) in the same manner as it was made or given, and

(ii) by or with the consent of the same person or persons who made, gave or consented to it (or, in the case of any such person who has died, by or with the consent of his personal representatives),

[18] Section 42A TMA provides:

"(2B) For the purposes of this section and section 43B below, a claim under Schedule 1AB is relevant in relation to an ~~assessment~~ amendment to a return for a year of assessment if it relates to that year of assessment.

(3) For the purposes of this section and section 43B below, any other claim, election, application or notice is relevant in relation to an ~~assessment~~ amendment to a return for a year of assessment if—

(a) it relates to that year of assessment or is made or given by reference to an event occurring in that year of assessment, and

(b) it or, as the case may be, its revocation or variation has or could have the effect of reducing any of the liabilities mentioned in subsection (4) below.

(4) The liabilities referred to in subsection (3) above are—

(a) the increased liability to tax resulting from the assessment,

(b) any other liability to tax of the person concerned for—

(i) the year of assessment to which the assessment relates, or

(ii) any year of assessment which follows that year of assessment and ends not later than one year after the end of the year of assessment in which the ~~assessment~~ amendment to a return is made."

> except where by virtue of any enactment it [the claim, etc] is irrevocable.

Section 43B TMA provides:

> (3) In any case where—
>
> (a) one or more relevant claims, elections, applications or notices are made, given, revoked or varied by virtue of the application of section 43A above in the case of an ~~assessment~~ amendment to a return , and
>
> (b) the total of the reductions in liability to tax which, apart from this subsection, would result from the action mentioned in paragraph (a) above would exceed the additional liability to tax resulting from the ~~assessment~~ amendment to a return ,
>
> the excess shall not be available to reduce any liability to tax.
>
> (4) Where subsection (3) above has the effect of limiting either the reduction in a person's liability to tax for more than one period or the reduction in the liability to tax of more than one person, the limited amount shall be apportioned between the periods or persons concerned—
>
> (a) except where paragraph (b) below applies, in such manner as may be specified by the inspector by notice in writing to the person or persons concerned, or
>
> (b) where the person concerned gives (or the persons concerned jointly give) notice in writing to the inspector within the relevant period, in such manner as may be specified in the notice given by the person or persons concerned.
>
> (5) For the purposes of paragraph (b) of subsection (4) above the relevant period is the period of 30 days beginning with the day on which notice under paragraph (a) of that subsection is given to the person concerned or, where more than one person is concerned, the latest date on which such notice is given to any of them.

So in short, if:

(1) HMRC raise a late assessment, and

(2) there is no carelessness/deliberate error

it is possible to make a late remittance basis claim if the claim is one "which could not have been allowed but for the making of an amended return". That would be the case if there is no income returned against which the claim could be allowed.

123.7.4 *Late claim for tax repayment*

ESC B41 provides:

> Under the Taxes Management Act, unless a longer or shorter period is prescribed, no statutory claim for relief is allowed unless it is made within four years from the end of the tax year to which it relates.
>
> However, repayments of tax will be made in respect of claims made

> outside the statutory time limit where an over-payment of tax has arisen because of an error by the Inland Revenue or another government department, and where there is no dispute or doubt as to the facts.

The SAC Manual provides:

> **SACM10040 Late Claims** [Jan 2019]
> ... For example, you might accept a late claim under ESC B41 where, before the time limit for making the claim, an HMRC officer
>
> - told a person that they could make a claim or election later than the statutory time limit, or
> - wrongly advised them that a claim or election was not possible, where the officer ought to have known, from the information given to them, that this advice was incorrect.
>
> If an error like this comes to a person's attention, they must notify HMRC as soon as they reasonably can that they will want to make a late claim.

123.8 Late claim: Culpable taxpayer

In cases of carelessness, or deliberate error, late claims may still be permitted under s.36(3) TMA:

> If the person on whom the assessment is made so requires, in determining the amount of the tax to be charged for any chargeable period in any assessment made in a case mentioned in subsection (1) or (1A) above, [extended assessment period due to carelessness, deliberate error, breach of DOTAS][19] effect shall be given to any relief or allowance to which he would have been entitled for that chargeable period on a claim or application made within the time allowed by the Taxes Acts.

Section 43C TMA provides:

> (1) Where—
> (a) a return is amended under section 28A(2)(b) ... and
> (b) the amendment is made for the purpose of making good to the Crown any loss of tax brought about carelessly or deliberately by the taxpayer or a person acting on his behalf,
>
> sections 36(3) and 43(2) apply in relation to the amendment as they apply in relation to any assessment under section 29.
> (2) Where—

[19] See 121.13 (IT/CGT assessment time limits).

(a) a return is amended under section 28A(2)(b) ... and

(b) the amendment is not made for the purpose mentioned in subsection (1)(b) above,

sections 43(2), 43A and 43B apply in relation to the amendment as they apply in relation to any assessment under section 29.

(3) References to an assessment in sections 36(3), 43(2), 43A and 43B, as they apply by virtue of subsection (1) or (2) above, shall accordingly be read as references to the amendment of the return.

CHAPTER ONE HUNDRED AND TWENTY FOUR

COLLECTION OF IT/CGT FROM UK REPRESENTATIVES

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124.1 Tax collected from non-resident

The former International Tax Handbook provided:

> **903. Machinery of assessment: direct charge on non-residents**
> It always was and still is possible to assess a non-resident directly if, in the words of the Courts, he can be reached. A simple example of such a situation arose in the case of *Tischler v Apthorpe* [2 TC 89]. Mr Tischler was not resident. He was a partner in a French wine firm who spent four months or so a year in England. He lived then in a London hotel and sold wine to English customers. His firm also employed London agents and the question was whether the English profits could be assessed directly on Mr Tischler or whether such assessments should, Mr Tischler being non-resident, be made only on the English agents. The High Court held that an assessment made directly on the firm was good and that Mr Tischler was obliged to make a return served on him. In the words of Mathew J
> 'If the principal can be got at there is no need to have recourse to Section 41' (of the 1842 Act which was consolidated in Section 78 TMA 1970).
> An individual, clearly, can be physically present in this country without being resident here and we used to have to rely on the principle established by the Tischler case in reaching the profits made by overseas sportsmen and women and artistes who come to this country for quite brief engagements. The modern view certainly, is that a non-resident company which trades here equally is here and that it may similarly be reached. If the company has a branch presence here

> with all the physical trappings of its trade it is visibly here and will have a registered place of business, an address at which it may be found and at which legal notices may be served.
>
> The principle of direct assessment is not confined to non-residents who actually come here. There is no bar on direct assessment of non-residents who are not here whether or not they have agents in the UK. This was made clear in the case of *Werle v Colquhoun* [2 TC 402]. The difficulty with direct assessment on a person who is not here lies in recovering the tax, although now that the Supreme Court rules allow service of writs abroad this may be a little easier provided there are assets in the UK. But it is still true to say that if a non-resident company acting through an agent has no such physical presence here and has nothing here the Revenue cannot, in practice, impose its charge effectively without more adequate machinery including that for the service of notices and returns as well as for the actual gathering of the tax. It was in such situations – where the non-resident had only an agent here – that the original form of Part VIII was intended to come to the Revenue's aid. In practice Part VIII is normally used today even in those cases where the taxpayer can be reached directly ...

This was written before the 1995 changes and before the mutual collection of tax agreements but the point is still valid.

124.2 Tax collected from UK representative

The rules are set out three times:

(1) For IT the rules are in Chapters 2B and 2C Part 14 ITA. This does not apply to companies[1] so effectively this applies to non-resident individuals and trusts.
(2) For CGT the rules are in Part 7A TCGA.
(3) For CT the rules are in Chapter 6 Part 22 CTA 2010.

This does make a coherent discussion somewhat harder. In this chapter I set out the IT rules in full, and (in the absence of material differences) give CGT and CT references in a footnote only.

Section 835U(1) ITA provides the basic rule:

> The obligations and liabilities of a non-UK resident are to be treated, for the purposes of the enactments to which this Chapter applies,[2] as if they

[1] Section 835D ITA provides:
"This Chapter does not apply in relation to income tax chargeable on income of a company otherwise than as a trustee."

[2] This relates back to s.835T ITA which provides:
(1) This Chapter applies to the enactments relating to income tax so far as they make provision for or in connection with the assessment, collection and recovery of tax,

> were also the obligations and liabilities of the UK representative of the non-UK resident.

This is a collection provision (the metaphor often used is "machinery provision[3]") and not a charging provision: the UK representative is only subject to tax if there is a charge to tax on usual principles on the non-resident principal. The INT Manual provides:

> **INTM268010 Introduction - What are the machinery provisions for assessment and collection?** [May 2019]
> ... The machinery provisions alone cannot create or extend a tax liability on the non-resident. There has to be a charge to tax in respect of the non-resident under the domestic provisions in the first place. The provisions work by treating the tax obligations and liabilities of the non-resident as though they were additionally the obligations and liabilities of the UK representative. This provides a practical assessment and collection mechanism for non-residents. Once either the non-resident or the UK representative has paid the liabilities both parties are treated as having met their liabilities. ...

Section 835U goes on to deal with the discharge of obligations:

> (2) Subsection (3) applies if—
> (a) the UK representative of a non-UK resident discharges an obligation or liability imposed by this section that corresponds to one to which the non-UK resident is subject, or
> (b) a non-UK resident discharges an obligation or liability that corresponds to one to which the non-UK resident's UK representative is subject by virtue of this section.
> (3) The corresponding obligation or liability—
> (a) of the non-UK resident (in a case within subsection (2)(a)), or
> (b) of the UK representative (in a case within subsection (2)(b)),
> is discharged.
> (4) A non-UK resident is bound, as if they were the non-UK resident's own, by acts or omissions of the non-UK resident's UK representative in the discharge of the obligations and liabilities imposed on the representative by this section. ...

or of interest on tax.

(2) Those enactments have effect in accordance with section 835U in relation to amounts in respect of which a branch or agency is to be treated as the UK representative of a non-UK resident under Chapter 2B.

[3] See App.1.7 (Machinery/mechanism metaphor).

124.3 UK representative

124.3.1 *Why UK representatives matter*

A UK representative is important for two reasons:

(1) A UK representative is liable for tax due from the non-resident principal, the topic of this chapter.

(2) Income in relation to which a non-UK resident has a UK representative falls outside non-resident IT relief.[4]

124.3.2 *Definition of "UK representative"*

Section 835E ITA gives the basic definition for IT:

> (1) This section applies if a non-UK resident carries on (alone or in partnership) any trade, profession or vocation through a branch or agency in the UK.
> (2) The branch or agency is the UK representative of the non-UK resident in relation to—
> (a) the amount of any income from the trade, profession or vocation that arises (directly or indirectly) through or from the branch or agency, and
> (b) the amount of any income from property or rights which are used by, or held by or for, the branch or agency.

Thus for IT and CGT a UK representative is in short a branch or agency.

For CT, the term PE is used instead of branch/agency. Section 969(3) CTA 2010 provides:

> For the purposes of this Chapter, the following rules apply to a permanent establishment in the UK through which a non-UK resident company carries on a trade.
> *Rule 1*
> The permanent establishment is the UK representative of the non-UK resident company in relation to chargeable profits of the company attributable to that establishment.

In the following discussion the "**non-resident principal**" is the person for whom the UK representative is a representative (which the statute calls "the non-UK resident").

The question whether the non-resident principal is trading is crucial for the UK representative rules, because these rules only apply if the non-

[4] See 45.5 (Disregarded income).

resident principal is carrying on a trade, profession or vocation.[5]

The INT Manual provides:

> **INTM268030 Extent of UK representative's liability** [Jun 2018]
> A person can only be the UK representative in respect of the permanent establishment/branch or agency with which they are linked. Where a non-resident has more than one UK permanent establishment/branch or agency, then it is possible that each will have a different UK representative. In those circumstances, each UK representative would only be responsible in respect of the part of their non-resident's liabilities and obligations arising from their own permanent establishment/branch or agency [*Neilsen Andersen v Collins*, and *Tarn v Scanlan* 13 TC 91].

The former International Tax Handbook explained "directly or indirectly" in s.835E(2)(a):

> **914. General**
> Section 79 [TMA 1970] is another 1915 amendment. It provides that a non-resident shall be chargeable on profits or gains arising directly or indirectly through any branch, agency etc here. The sort of thing that was happening, before this provision was introduced, was that an agent for a non-resident would negotiate a contract here and at the end of the oral negotiations the agent and the third party would agree to sign the formal documents abroad. The view the Revenue took, and defensibly so, was that in substance all had been done here apart from signing a piece of paper and that it was wrong for liability so to be avoided.
> Problems of that sort are really problems of fact and proof as was mentioned in chapter 8 (ITH822). If the Revenue could have proved that there was an unwritten agreement made in London, it would have succeeded in a claim that the non-resident was trading here, and that is what we would argue today. Millions of pounds worth of business are done in the City of London every day on the basis of spoken agreements which are later confirmed in writing and nobody wishes to deny that the word is the contract. But, when the parties to the contract do not wish to act openly, proof is difficult to come by. What these words were meant to do was to enable the Revenue to say – "we must accept that this contract was made abroad because we cannot prove otherwise but a lot of negotiation took place in London and we want to look at the substance of the matter and the words 'directly or indirectly' will enable us to do that".

[5] See 72.15 (What is a financial trade?).

124.3.3 *Representative ceasing to act*

Rule 1 s.835E(3) ITA provides for the UK representative ceasing to act:

> *Rule 1*
> The UK representative continues to be the UK representative of the non-UK resident in relation to the amount even after ceasing to be a branch or agency through which the non-UK resident carries on the trade, profession or vocation concerned.

The INT Manual provides:

> **INTM268040 What assessments should be raised and how is that done?** [May 2019]
> ... Where the trading activities in the UK have ceased, the UK permanent establishment / branch or agency retains the obligations and liabilities as the UK representative even after the cessation. This provision is at ITA07/S835E Rule1 and ITTOIA05/Sch6 Para 3 (old FA95/S126 (3)) for income tax and at CTA10/S969(3) Rule 3 (old FA03/S150(2)(c)) for corporation tax. So assessments can still be raised on the UK representative subject to the usual assessing time limits. Where however the trading was conducted through a branch or fixed place of business and that presence has discontinued there may be difficulties identifying any person as the UK representative or any assets within the UK upon which recovery may rely. It is therefore recommended that assessments for such UK branches are raised and tax brought into charge at as early a stage as possible.
> Additionally, by EU Directive member states of the European Union are able to seek the assistance of another member state in the recovery of direct and indirect taxes (see the guidance at DMBM560010).

124.3.4 *Separate personality*

Rule 2 s.835E(3) ITA provides for deemed separate personality:

> *Rule 2*
> The UK representative is treated in relation to the amount as a distinct and separate person from the non-UK resident (if the representative would not otherwise be so treated).

The SALF Manual provides:

> **SALF704 UK representatives of non-residents chargeable under Case I and II Schedule D** [Jan 2019]
> *UK representative is treated as a separate person*
> The UK representative and the non-resident are treated as separate

persons. This allows, for example, service of notices and collection to take place at the branch or agency/permanent establishment.

124.4 Partnership: UK representative

Rule 3 s.835E(3) ITA provides:

> *Rule 3*
> If the branch or agency is carried on by persons in partnership, the partnership, as such, is treated in relation to the amount as the UK representative of the non-UK resident.

Section 835F ITA provides:

> (1) Subsection (2) applies if a trade or profession carried on by a non-UK resident through a branch or agency in the UK is carried on by the non-UK resident in partnership.
> (2) The trade or profession carried on through the branch or agency is, for the purposes of section 835E and Chapter 2C, to be treated as including the notional trade or profession.
> (3) Subsection (4) applies (in addition to subsection (2) if that subsection also applies) if—
> (a) a trade or profession carried on by a non-UK resident in the UK is carried on by the non-UK resident in partnership, and
> (b) any member of the partnership is resident in the UK.
> (4) The notional trade or profession is, for the purposes of section 835E and Chapter 2C, to be treated as being a trade carried on in the UK through the partnership as such.
> (5) In this section "the notional trade or profession" means the notional trade from which the non-UK resident's share in the partnership's profits or losses is treated for the purposes of section 852 of ITTOIA 2005 as deriving.

The INT Manual provides:

> **INTM268020 Who can be the non-resident's UK representative?**
> [Jun 2018]
> ***Partnerships can be the UK representative of a non-resident***
> A partner in a partnership can be the UK representative of a non-resident. This will occur, for example, where a non-resident trades in the UK though the agency of a UK partnership (of which he or she is not a member). In such circumstances, the partners in the UK partnership will be jointly liable, as UK representative, for the tax payable by the non-resident. This provision is at ITA07/S835E and TIOPA10/S835E for income tax and is implicit in CTA10/S969 for

> corporation tax.
>
> Where a business that is carried on by a partnership that includes non-resident partners is carried on in the UK through a permanent establishment / branch or agency, the permanent establishment / branch or agency is the UK representative of each non-resident partner. This provision is at ITA07/S835F and TIOPA10/S835F for income tax and is implicit in CTA10/S969 for corporation tax.
>
> Where a business is carried on in the UK by a partnership that includes both resident and non-resident partners, the partnership is treated as the UK representative of each non-resident partner. The partners are thus jointly liable for the tax payable by the non-resident partners on their shares of the partnership profit. This provision is at ITA07/S835F and TIOPA10/S835F for income tax and is implicit in CTA10/S969 for corporation tax.

The SALF Manual provides:

> **SALF704 UK representatives of non-residents chargeable under Case I and II Schedule D** [Jan 2019]
>
> *A partnership can be the UK representative of a non-resident*
>
> A partner in a partnership can be the UK representative of a non-resident. This will occur, for example, where a non-resident trades in the UK though the agency of a UK partnership (of which he or she is not a member). In such circumstances, the partners in the UK partnership will be jointly liable, as UK representative, for the tax payable by the non-resident.
>
> *Partnership, which includes non-resident partners, trading in the UK through a branch or agency/permanent establishment: the branch or agency/permanent establishment is treated as the UK representative of non-resident partners*
>
> Where a business that is carried on by a partnership that includes non-resident partners is carried on in the UK through a branch or agency/permanent establishment, the branch or agency/permanent establishment is treated as the UK representative of each non-resident partner.
>
> *Partnership trading in the UK which includes resident and non-resident members is treated as UK representative of non-resident partners*
>
> Where a business is carried on in the UK by a partnership which includes both resident and non-resident partners, the partnership is treated as the UK representative of each non-resident partner. The partners are thus jointly liable for the tax payable by the non-resident partners on their shares of the partnership profit.

124.5 UK representatives: Exemptions

Sections 835G-K set out 5 exemptions:

Section	**Topic**
835G	Agents
835H	Brokers
835I	Investment managers
835J	Alternative finance arrangements (Sharia-compliant arrangements)
835K	Lloyds agents

I consider the first three of these here; the last two are of specialist interest.

124.5.1 *Casual agent*

Section 835G ITA provides:

> (1) This section applies if a non-UK resident carries on (alone or in partnership) a business through an agent in the UK.
> (2) The agent is not the UK representative of the non-UK resident in relation to an amount within section 835E(2) arising to the non-UK resident from—
> (a) so much of the non-UK resident's business as relates to disregarded transactions, or
> (b) property or rights which, as a result of disregarded transactions, are used by, or held by or for, the agent on behalf of the non-UK resident.
> (3) "Disregarded transactions" are transactions—
> (a) carried out through the agent in the UK, and
> (b) in respect of which the agent does not act in the course of carrying on a regular agency for the non-UK resident.

I call this the "**casual agent exemption**".

The INT Manual provides:

> **INTM268020 Who can be the non-resident's UK representative?**
> [Jun 2018]
> Schedule 6 paragraphs 5-9 TIOPA 2010 and Subsections 835G-835K ITA 2007 ... lists the persons who cannot be the UK representative for income tax and capital gains tax:
> 1) Agents who are not regular agents. In general if a non-resident is trading in the UK through an agent that agent should be regarded as a regular agent. This was considered in the cases of *Neilsen Andersen v Collins* and *Tarn v Scanlan* (13 TC 91 at p.121–2) when

> Scrutton LJ considered "the contrast intended to be drawn is between casual employment, temporary employment, for a transaction or few transactions, and regular appointment of a permanent agent who is there as representing the foreigner". ...

The former International Tax Handbook provided:

> **942. NRs: accepting TMA 70 s.82 exemption: regular agency**
> ... casual agents are protected from assessment. As a general rule if there is UK source income and there is an agent we would want to assess the agent. A non-resident trading here through an agent will usually clearly do so through a regular agency.
> It may be less clear whether an agent is a regular agent when he acts for his principal in only one transaction. This was the issue in the case of *Willson v Hooker* 67 TC 585. Acting for an Isle of Man company, Mr Willson instructed a firm of surveyors to bid for some land in the UK and instructed solicitors concerning the purchase and sale of the land. The Court said that a regular agency is any agency that is not a casual or occasional agency and that it was impossible to regard Mr Willson as a casual or occasional agent. He was the person through whom all the transactions of the company in the UK were carried out in the relevant period and so did not enjoy protection.

CT does not need the same exemption, as a casual agent is not a PE.

124.5.2 *Broker/Investment manager*

The exemptions are in s.835H and s.835I ITA. They are easier to follow if set side by side:

Section 835H (Brokers)	**Section 835I (Investment Managers)**
(1) This section applies if a non-UK resident carries on (alone or in partnership) a business through a broker in the UK.	(1) This section applies if a non-UK resident carries on (alone or in partnership) a business through an investment manager in the UK.
(2) The broker is not the UK representative of the non-UK resident in relation to an amount within section 835E(2) if—	(2) The investment manager is not the UK representative of the non-UK resident in relation to an amount within section 835E(2) if—
(a) the amount is transaction income in relation to a transaction carried out through the broker in the UK on behalf of the non-UK resident, and	(a) the amount is transaction income in relation to an investment transaction carried out through the investment manager in the UK on

	behalf of the non-UK resident, and
(b) the independent broker conditions are met in relation to the transaction (see section 835L).	(b) the independent investment manager conditions are met in relation to the investment transaction (see section 835M).
(3) In subsection (2) "transaction income", in relation to a transaction carried out through a broker in the UK on behalf of a non-UK resident, has the same meaning as in Chapter 1 (see section 814(5)).	(3) In subsection (2) "transaction income", in relation to a transaction carried out through an investment manager in the UK on behalf of a non-UK resident, has the same meaning as in Chapter 1 (see section 814(5)).

124.6 Subsidiary points

124.6.1 *HMRC procedures*

The INT Manual provides:

> **INTM268040 What assessments should be raised and how is that done?** [May 2019]
>
> As already explained above (INTM268030)) both the non-resident and their UK representative have a personal responsibility for the tax obligations and liabilities arising from the UK permanent establishment/branch or agency. Either party is able to discharge those obligations and liabilities. So we can assess either or both parties if necessary. Once one party has paid, the personal responsibility on the other party lapses for that self assessment period. Obviously in cases where self assessments are returned by or for a non-resident taxpayer and tax payments are made at the appropriate times no further action would be needed. This guidance concerns the practicalities of how to handle cases where obligations and liabilities are not met.
>
> Because the UK representative is personally responsible for the non-residents tax obligations and liabilities, a unique tax reference should be allocated to the UK representative in that capacity. Where the UK representative is an agent (rather than a branch or fixed place of business permanent establishment) that unique tax reference should be a distinct and different reference to the one allocated to the agent for their own business. Non-resident companies intending to set up places of business in the UK are obliged to notify Companies House (see **Self assessment** at INTM261000). The consequential process in place automatically generates tax references and allocates them to the office responsible for the UK registered office address. Where that process has not happened, or for non-corporates, a taxpayer record with unique tax reference will need to be created on notification or discovery of liability.
>
> The High Court held in the case of *Tischler v Apthorpe* [2 TC 89] that a non-resident could be assessed directly "wherever he could be reached"

including the UK branch address. The decision in that case was that an assessment raised directly on the non-resident at the UK branch address was valid, even though there was also a UK representative who could have been assessed under the machinery provisions (for the TMA 1970 version *see* INTM268010). It is probably unusual for a non-resident to have both a physical UK branch and an appointed UK agent but the reasoning in that case supports the equal validity of assessments made on the non-resident either directly at their UK branch or at the overseas address. In that case, of course, the UK agent could not be responsible for the tax assessed as he had not been notified.

So, on a practical level, assessments should be addressed in the manner most suited to the facts of the case and with the object of informing the relevant persons of the liability and securing the necessary payment of tax. Depending upon how near to expiry the assessing time limits are this could include any but possibly all of the following:

Assessment for a branch or fixed place of business in the UK

- Assess in the name of the non-resident individual or company at the UK business address.
- Send a copy also, for information, to the non-resident's address abroad if known.
- Assess any person who clearly has the capacity of "UK representative" e.g. the manager of the UK operations, as "Mr X as UK representative of XYZ".

Assessment for UK trade carried out through an agent

- Assess in the form "Mr X as agent for XYZ" sent to the agent's address.
- Send a copy of the assessment on the agent, for information, to the non-resident at their address abroad if known.
- Assess the non-resident individual or company at their address abroad if known.

Partners and partnerships

Where the UK representative is a UK partnership the partnership itself is the UK representative. In such circumstances the partners in the UK partnership will be jointly liable for the tax payable by the non-resident. It follows that any assessment that is required should be made on the partnership as agent for the non-resident. Where a non-resident is a partner in a partnership which trades in the UK directly, typically through a UK branch or fixed place of business, the form of assessment depends on whether there is a partner resident in the UK. If there is a UK resident partner the assessment should be made on the partnership as a whole but the UK resident partner will be jointly liable for the tax payable by the entire partnership. Where there is no UK resident partner then assessments on the branch profits of the non-resident partners should be made on the UK branch of the partnership.

The SALF Manual provides:

SALF704 UK representatives of non-residents chargeable under Case I and II Schedule D [Jan 2019]

General rule for the obligations and liabilities of UK representatives

The general rule is that UK representatives are jointly responsible with the non-resident for all the tax obligations and liabilities in relation to the trade, profession or vocation carried on through the branch or agency/permanent establishment.

This joint responsibility extends to all matters relating to the assessment of tax and to the collection and recovery of tax. For example, it extends to all the mechanisms of self assessment, including notification of chargeability, the obligation to make a tax return and self assessment, liability to make interim and final payments of tax, and liability to surcharges, interest and penalties in connection with those obligations and liabilities.

Either party is able to discharge the obligations and liabilities arising, but equally any acts or omissions of the non-resident are treated as acts or omissions of the UK representative (but see also the first two paragraphs under Offences below in relation to tax offences).

Where the trigger for an obligation or liability is the receipt of formal notification, then the obligation or liability only falls on the UK representative once they have received the relevant notification (or a copy).

124.6.2 *Notices and information*

Section 835V ITA provides:

> (1) An obligation or liability attaching to a non-UK resident ("X") by reason of a notice or other document having been given or served on X does not also attach to the UK representative of X by virtue of section 835U unless the notice or other document (or a copy of it) has been given to or served on the representative.
>
> (2) An obligation or liability attaching to X by reason of a request or demand having been received by X does not also attach to the UK representative of X by virtue of section 835U unless the representative has been notified of the request or demand.
>
> (3) Subsection (4) applies to obligations relating to the provision of information that are imposed on the UK representative of X by section 835U in a case where the representative is X's independent agent.
>
> (4) The obligations do not require the UK representative to do anything except so far as it is practicable for the representative to do so.
>
> (5) For this purpose, the representative must act to the best of the representative's knowledge and belief after taking all reasonable steps to obtain the necessary information.
>
> (6) An obligation of X to provide information is not discharged by virtue of section 835U in a case where the UK representative of X has discharged the obligation only so far as required by subsection (4) of this

> section.
>
> (7) X is not bound by virtue of section 835U by mistakes in information provided by the UK representative of X in discharging, so far as required under subsection (4) of this section, an obligation imposed on the representative by section 835U unless—
>
> (a) the mistake is the result of an act or omission of X, or
>
> (b) the mistake is one to which X consented or in which X connived.
>
> (8) In this section "information" includes anything contained in a return, self-assessment, account, statement or report required to be provided to the Commissioners for Her Majesty's Revenue and Customs or to any officer of Revenue and Customs.

124.6.3 *Criminal offences/penalties*

Section 835W ITA provides:

> (1) A person is not by virtue of section 835U liable to be proceeded against for a criminal offence unless the person—
>
> (a) committed the offence, or
>
> (b) consented to or connived in its commission.
>
> (2) An independent agent of a non-UK resident is not by virtue of section 835U liable to any civil penalty or surcharge in respect of an act or omission if conditions A and B are met.
>
> (3) Condition A is that the act or omission is not—
>
> (a) an act or omission of the independent agent, or
>
> (b) an act or omission to which the agent consented or in which the agent connived.
>
> (4) Condition B is that the independent agent is able to show that the amount of the penalty or surcharge will not be recoverable out of the sums mentioned in section 835X(3) (after being indemnified for any other liabilities under section 835X).

The SALF Manual provides:

> **SALF704 UK representatives of non-residents chargeable under Case I and II Schedule D** [Jan 2019]
>
> *Offences*
>
> The criminal and civil liabilities of a UK representative in respect of the non-resident's tax affairs are limited in certain circumstances.
>
> UK representatives cannot be guilty of a criminal offence under these rules as a result of something done by the non-resident unless:
>
> - they committed the offence
> - consented to its commission, or

- connived in its commission.

The same applies for the non-resident in relation to the acts of the UK representative.

UK representatives who are independent agents are not liable to civil penalties and surcharges unless:

- they committed an act or omission or consented to, or connived in, its commission, or
- they will be able to recover the penalty out of monies of the non-resident.

124.6.4 *Indemnities*

Section 835X ITA provides:

> (1) An independent agent of a non-UK resident is entitled to be indemnified for the amount of any liability of the non-UK resident which the agent has discharged by virtue of section 835U.
>
> (2) An independent agent of a non-UK resident is entitled to retain, from the sums mentioned in subsection (3), amounts sufficient to meet any liabilities which by virtue of section 835U the agent has discharged or to which the agent is subject.
>
> (3) The sums are those which—
>
> (a) (ignoring subsection (2)) are due from the independent agent to the non-UK resident, or
>
> (b) are received by the independent agent on behalf of the non- UK resident.

124.7 Agents/investment managers

An "independent agent" has three advantages:

(1) Lower information requirements; see 124.6.2 (Notices and information)

(2) Lower liabilities for penalties: see 124.6.3 (Criminal offences/ penalties)

(3) A right to an indemnity: see 124.6.4 (Indemnities)

Section 835Y ITA provides the definition:

> (1) In this Chapter "independent agent", in relation to a non-UK resident ("X"), means a person who is the UK representative of X in respect of any agency in which the person is acting on behalf of X in an independent capacity.
>
> (2) For this purpose a person does not act in an independent capacity on behalf of X unless the relationship between them, having regard to its characteristics, is a relationship between persons carrying on

independent businesses dealing with each other at arm's length.

This is based on the definition in the IME rules.[6]

Investment managers and brokers may qualify for the IME exemptions.[7]

The SALF Manual provides:

> **SALF704 UK representatives of non-residents chargeable under Case I and II Schedule D** [Jan 2019]
>
> *Obligations and liabilities are limited where the UK representative is independent of the non-resident*
>
> Where the UK representative is an independent agent of the non-resident acting in the ordinary course of business, its obligations to provide information are limited to ones within its competence to act for the non-resident.
>
> 'Independent agent' is defined at Paragraph 7 Schedule 23 FA 1995. The definition is based on that used in OECD Model Tax Convention and UK double taxation agreements. Broadly, to be an 'independent agent', the agent must be both legally and economically independent of the non-resident. As an independent agent is not within the definition of permanent establishment for corporation tax purposes such an agent could not become the UK representative of a non-resident company.
>
> The rules recognise that, where the UK representative is an independent agent, the agent may not be able to provide complete information about the affairs of the non-resident. The agent is therefore required to provide any information requested, for example a return, to the best of its knowledge and belief after taking all reasonable steps to obtain the information. The non-resident remains responsible for completing or correcting the information where necessary.
>
> However, the non-resident can correct any error or omission made by the UK representative provided the non-resident did not know about it or participate in it.

[6] See 72.9 (Cond. C: Independent relationship) and 106.16 (Independent agent exemption).

[7] See 72.1 (Investment manager exemptions).

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by

JAMES KESSLER KC

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TWENTY FOURTH EDITION

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Tel: 01865 352121
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125.1 IHT compliance: Introduction

This chapter considers the following topics:
(1) Who is liable for IHT
(2) Reporting duties
(3) IHT recovery time limits
(4) The Inland Revenue charge

I go beyond the themes of this book and address the topic as a whole.

125.2 Meaning of "PRs" for IHT

The definition of "personal representatives" matters for all these topics. Section 272 IHTA provides:

> In this Act, except where the context otherwise requires ...
> "personal representatives" includes[1]
> [a] any person by whom or on whose behalf an application
> [i] for a grant of administration or
> [ii] for the resealing of a grant made outside the UK
> is made, and
> [b] any such person as mentioned in section 199(4)(a) above;

Para [b] takes us to s.199(4)(a) IHTA which refers to:

> (a) [i] any person who takes possession of or intermeddles with, or otherwise acts in relation to, property so as to become liable as executor or trustee[2]
> [ii] (or, in Scotland, any person who intromits with property or has become liable as a vitious intromitter) ...

[1] The definition is inclusory but it is difficult to think of a person who is a PR in the general sense but who is not within s.272.

[2] This wording derives from s.55 Administration of Estates Act 1925 ("... any person who takes possession of or intermeddles with the property of a deceased person without the authority of the personal representatives or the court...").

I refer to this as "de facto executor"; the traditional English succession law term is executor *de son tort* but it is not necessary, or desirable, to use antique Law French.[3]

The only reported case in a CTT/IHT context is *IRC v Stype Investments*[4] where a Jersey nominee held land in England subject to a contract for sale. That was a UK situate asset. The beneficial owner died and the Jersey nominee directed the sale proceeds to be paid outside the UK. That act made it a de facto executor, and so a PR for IHT purposes.[5]

A person who applies for a foreign grant which is not resealed in the UK is not a PR within the IHT definition; otherwise para [a][ii] would be unnecessary.

The IHM Manual provides:

> **IHTM30031 Personal Representatives** [Sep 2018]
> ... In Scottish law 'personal representatives' has no precise meaning. It should be regarded as comprising in Scotland those persons who would answer the description in English law (including the extension by IHTA84/S272). Any question of whether a Judicial Factor is included in the term should be referred to Technical in Edinburgh.

The IHT definition of PRs is different from the IT/CGT definition.[6]

125.3 Who is liable for IHT

In outline, the rules are as follows:

IHT charge	IHTA	Primary liability	See para
Lifetime transfer			
– lifetime IHT	s.199(1)	Transferor	125.3.1
– IHT on death	s.199(2)	PRs	125.3.2
Transfer on death	s.200	PRs	125.3.1
Trust IHT	s.201	Trustees	125.3.4
Close co transfer of value	s.202	Company	81.11

The primary liability is where one might expect. But the picture is a complex one, because:

[3] The same applies to the expression trustee *de son tort*; see 7.2 (Who are the trustees).

[4] [1982] STC 625.

[5] The taxpayer was unmeritorious (perhaps dishonest) and this is a case (as happened with more than one Templeman decision) where the Court decided the answer first and the reasoning second.

[6] See 88.3 (PRs: meaning for CGT/IT/CT).

(1) The full list of persons liable for IHT is wider and includes (in short) donees, nominees, life tenants and beneficiaries.
(2) There are many distinct charges to IHT, which require separate rules for liability.

I do not consider rules relating to Scotland or the power to collect IHT from a spouse (s.203 IHTA).

125.3.1 *Lifetime transfer/transfer on death*

It is helpful to read s.199/s.200 (lifetime/death transfer) side by side because they have some wording in common:

Lifetime transfer: s.199(1)	**Transfer on death: s.200(1)**
The persons liable for the tax on the value transferred by a chargeable transfer made by a disposition[7] (including any omission treated as a disposition under section 3(3) above)[8] of the transferor are—	The persons liable for the tax on the value transferred by a chargeable transfer made (under section 4 above)[9] on the death of any person are —
(a) the transferor;	(a) so far as the tax is attributable to the value of property which either— (i) was not immediately before the death comprised in a settlement, or (ii) was so comprised and consists of land in the UK which devolves upon or vests in the deceased's personal representatives, the deceased's personal representatives;
(b) any person the value of whose estate is increased by the transfer;	(b) so far as the tax is attributable to the value of property which, immediately before the death, was comprised in a settlement, the trustees of the settlement;
(c) so far as the tax is	(c) [same]

[7] See 76.2 (Lifetime IHT charge).

[8] See 74.5 (Omission: Deemed disposition).

[9] See 76.4 (Death: IHT charge & exemption).

attributable to the value of any property,	
[i] any person in whom the property[10] is vested[11] (whether beneficially or otherwise) at any time after the transfer,	[i] any person in whom the property is vested (whether beneficially or otherwise) at any time after the death,
[ii] or who at any such time is beneficially entitled to an interest in possession in the property;	[ii] or who at any such time is beneficially entitled to an interest in possession in the property;[12]
(d) where by the chargeable transfer any property becomes comprised in a settlement,	(d) so far as the tax is attributable to the value of any property which, immediately before the death, was comprised in a settlement,
any person for whose benefit any of the property or income from it is applied.	any person for whose benefit any of the property or income from it is applied after the death.

[10] Section 199(5) IHTA provides (perhaps unnecessarily, but it does not matter):

> "References in this section to any property include references to any property directly or indirectly representing it."

See App.2.9 ('Representing' assets). The same rule applies for s.200: see s.200(5) IHTA.

[11] Section 199(4) IHTA provides an extended definition of "vested":

> "For the purposes of this section—
> (a) any person who takes possession of or intermeddles with, or otherwise acts in relation to, property so as to become liable as executor or trustee (or, in Scotland, any person who intromits with property or has become liable as a vitious intromitter), and
> (b) any person to whom the management of property is entrusted on behalf of a person not of full legal capacity,
> shall be treated as a person in whom the property is vested."

The wording is discussed elsewhere: see 125.2 (Meaning of "PRs" for IHT).

Section 199(4) also applies for s.200: see s.200(5) IHTA.

[12] Section 200(3) IHTA provides:

> "For the purposes of subsection (1) above a person entitled to part only of the income of any property shall, notwithstanding anything in section 50 above, be deemed to be entitled to an interest in the whole of the property."

This does not apply for s.199.

125.3.2 *Nature of PRs liability*

In *IRC v Stannard,* PRs were liable for IHT. The question was whether liability was:

(1) personal liability of the PRs
(2) representative liability, ie enforceable only against the assets of the estate:

> It is plain, in my view, from [s.200] that the liability in respect of capital transfer tax for which a personal representative becomes liable is not and could never have been a liability of the deceased. It is necessarily an original liability which is in terms imposed on the personal representative. There is nothing in the statutory scheme which in express terms limits the liability of the personal representative to assets of the estate except in so far as such limitation is found in [s.204] of the Act. There is... nothing in [s.200] which justifies limiting the liability of a personal representative to liability in a representative capacity only. The relevant limitation is that limitation which is provided by [s.204] and which goes to the extent of the liability, not its character. There is no basis, as it seems to me, for distinguishing between the liability of personal representatives imposed under para (a) and the liability of trustees imposed under para (b). Both incur original liability, both are plainly designated as persons liable, and in respect of neither is there any indication apt to render liability anything other than personal liability.
> ... "Thus, if an administrator dies intestate while duty payable by him is outstanding, his administrator, although not in the chain of representation to the first intestate, is liable for the unpaid duty. So also is the executor or administrator of one of several trustees, notwithstanding that other trustees survive."
> In my judgment, the same is true in respect of capital transfer tax.
> Accordingly, in my judgment, the appropriate order where the Crown establishes liability to capital transfer tax against a personal representative is an order in the *de bonis propriis* [personal liability] form.
> An order in the *de bonis testatoris* [representative liability] form seems to me only to be justified where the liability of the executor which is being reflected in the order is a liability transmitted from the deceased whose liability it originally was. This can never be true of capital transfer tax except in the case where the deceased was liable for the tax.[13]

[13] [1984] STC 245.

The point will not often matter

125.3.3 *Additional IHT on death: PRs*

On death:

(1) IHT may become due on a failed PET

(2) Additional tax may fall due on a chargeable transfer within 5 years of death

Section 199(2) IHTA provides:

> Subsection (1)(a) above shall apply in relation to—
>
> (a) the tax on the value transferred by a potentially exempt transfer; and
>
> (b) so much of the tax on the value transferred by any other chargeable transfer made within seven years of the transferor's death as exceeds what it would have been had the transferor died more than seven years after the transfer,
>
> with the substitution for the reference to the transferor of a reference to his personal representatives.

125.3.4 *Liability for trust IHT*

Section 201 IHTA provides:

> (1) The persons liable for the tax on the value transferred by a chargeable transfer made under Part III of this Act are—
>
> (a) the trustees of the settlement;[14]
>
> (b) any person entitled (whether beneficially or not) to an interest in possession in the settled property;
>
> (c) any person for whose benefit any of the settled property or income from it is applied at or after the time of the transfer;
>
> (d) where the transfer is made during the life of the settlor and the trustees are not for the time being resident in the UK, the settlor.
>
> (2) Where the chargeable transfer
>
> [a] is made within seven years of the transferor's death
>
> [b] but is not a potentially exempt transfer,
>
> subsection (1)(d) above shall not apply in relation to so much of the tax as exceeds what it would have been had the transferor died more than seven years after the transfer.[15]

[14] See 7.2 (Who are the trustees).

[15] For completeness: there follow two transitional provisions now of limited interest:

> (3) Subsection (1)(d) above shall not apply in relation to a settlement made before

125.3.5 *Liability for GWR*

Section 204(9) IHTA deals with GWR:

> Where by virtue of subsection (3) of section 102 of the Finance Act 1986 the estate of a deceased person is treated as including property which would not apart from that subsection form part of his estate, a person shall be liable under section 200(1)(a) above as personal representative[16] for tax attributable to the value of that property
> [a] only if the tax remains unpaid twelve months after the end of the month in which the death occurs and, subject to that,
> [b] only to the extent of the assets mentioned in subsection (1) above.

125.3.6 *Liability: Asset cap*

Section 204 IHTA caps liability for PRs and trustees, by reference to the value of their assets. The rules are conveniently read side by side:

s.204(1): PRs	**s.204(2): trustees**
A person shall not be liable under section 200(1)(a) above for any tax as a personal representative of a deceased person, except to the extent of the following assets, namely—	A person shall not be liable for tax as trustee in relation to any property, except to the extent of—
(a) so far as the tax is attributable to the value of any property other than such as is mentioned in paragraph (b) below,	
the assets (other than property so mentioned) which he has received as personal representative or might	(a) so much of the property as he has actually received or disposed of or as he has become liable to

11th December 1974 if the trustees were resident in the UK when the settlement was made, but have not been resident there at any time during the period between 10th December 1974 and the time of the transfer.
(3A) Subsection (1)(d) above shall not apply in relation to the tax chargeable on the value transferred by a potentially exempt transfer which proves to be a chargeable transfer in a case where the settlement was made before 17th March 1987 if the trustees were resident in the UK when the settlement was made, but have not been resident there at any time between 16th March 1987 and the death of the transferor.

[16] See 125.3.1 (Lifetime transfer/transfer on death).

have so received but for his own neglect or default; and	account for to the persons beneficially entitled thereto, and
(b) so far as the tax is attributable to property which, immediately before the death, was comprised in a settlement and consists of land in the UK,	
so much of that property as is at any time available in his hands for the payment of the tax, or might have been so available but for his own neglect or default.	(b) so much of any other property as is for the time being available in his hands as trustee for the payment of the tax or might have been so available but for his own neglect or default.

Section 204(3) IHTA provides similar relief for a nominee/life tenant:

> A person not liable as mentioned in subsection (1) or (2) above but
> [a] liable for tax as a person in whom property is vested or
> [b] liable for tax as a person entitled to a beneficial interest in possession in any property
> shall not be liable for the tax except to the extent of that property.

Section 204(5) IHTA provides similar relief for beneficiaries:

> [a] A person liable for tax as a person for whose benefit any settled property, or income from any settled property, is applied, shall not be liable for the tax except to the extent of the amount of the property or income
> [b] (reduced in the case of income by
> [i] the amount of any income tax borne by him in respect of it, and
> [ii] in the case of other property in respect of which he has borne income tax by virtue of Chapter 2 of Part 13 of the Income Tax Act 2007 [Transfer of Assets Abroad] by the amount of that tax).

125.4 Priority of persons liable

Section 205 IHTA provides:

> Except as otherwise provided, where under this Act two or more persons are liable for the same tax, each of them shall be liable for the whole of it.

Nevertheless, there are rules for priority.

125.4.1 *Transferor/PRs/trustees primary liability*

Section 204(6) IHTA makes transferor/PRs/trustees primarily liable over other categories:

> Where a person is liable for any tax—
>
> (a) under section 199 above [lifetime disposition by transferor] otherwise than as transferor or personal representative of the transferor, or
>
> (b) under section 201 [trusts] above otherwise than as trustee of the settlement,
>
> [A] he shall be liable only if the tax remains unpaid after it ought to have been paid and,
>
> [B] in a case where any part of the value transferred is attributable to the tax on it, shall be liable to no greater extent than he would have been had the value transferred been reduced by the tax remaining unpaid.

125.4.2 *Transferor/PRs/trust secondary liability*

Section 204(7) IHTA disapplies this rule for failed PETs/additional tax on death:

> Where the tax exceeds what it would have been had the transferor died more than seven years after the transfer, subsection (6) above shall not apply in relation to the excess.

Instead, s.204(8) provides the opposite rule:

> A person liable by virtue of section 199(2) above for any tax as personal representative of the transferor shall be liable only to the extent that either—
>
> (a) in consequence of subsections (2), (3) and (5) above, no person falling within paragraphs (b) to (d) of section 199(1) above is liable for the tax, or
>
> (b) the tax remains unpaid twelve months after the end of the month in which the death of the transferor occurs,
>
> and, subject to that, shall be liable only to the extent of the assets mentioned in subsection (1) above.

IHTM provides:

> **IHTM30044: PETs: practice relating to PRs** [Sep 2018]
>
> The liability of the transferor’s personal representatives (IHTM05012)

> is a sensitive area of the legislation. You must alert the personal representatives at an early stage where recourse to them might occur.
>
> In cases where the transferee (IHTM30051) is not resident in the UK we are likely to be aware of that fact from the replies on the schedule IHT403, but nevertheless we should still warn the personal representatives of their potential liability, if the transferee and any other persons who may be liable under IHTA84/S199 (1) do not pay.
>
> Similarly Shares and Assets Valuation (SAV) should be alert to any valuation in which it is evident that the value of the assets transferred is far less than the value transferred and where tax will be payable on the gift. SAV should give a warning to this effect as soon as possible to whoever issued the valuation request and it will then be their responsibility to decide what further action to take.
>
> You must remember that the facility to have recourse to the transferor's personal representatives is not to be regarded as a soft option. We are to make all the attempts at recovering from the persons liable under IHTA84/S199(1) that we would presently contemplate in a similar situation against any liable person. But having warned the personal representatives that we may look to them to discharge the tax liability, we must ensure firstly that they are kept fully in the picture and secondly that a decision actually to collect from them is not delayed for years...
>
> Note that tax collected from personal representatives of the transferor under IHTA84/S199 (2) was never a liability of the transferor. Accordingly IHTA84/S5 (4) cannot apply and
>
> - the tax so collected is not deductible against the transferor's taxable estate and
> - there is no question of grossing up (IHTM14593) the lifetime transfer

125.5 Reporting duties

Section 216(1) IHTA provides the standard reporting duties.

These duties are slightly relaxed by 3 regulations, which together I call the **"Excepted Disclosure regulations"**. Their full names are too long to use, so I abbreviate as follows:

My term	Full name
EER 2004	IHT (Delivery of Accounts) (Excepted Estates) Regs 2004
ESR 2008	IHT (Delivery of Accounts) (Excepted Settlements) Regs 2008
ETR 2008	IHT (Delivery of Accounts) (Excepted Transfers & Excepted Terminations) Regs 2008

I discuss EER and ESR, and hope to consider ETR in a future edition.

125.6 Standard reporting duties

s.**216(1) IHTA**	**Type of charge**	**See para**
Except as otherwise provided by this section or by regulations under section 256 below,[17]		
the personal representatives of a deceased person	IHT on death	125.3.3
and every person who—		
(a) is liable as transferor for tax on the value transferred by a chargeable transfer, or would be so liable if tax were chargeable on that value, or	Lifetime chargeable transfer	125.3.1
(b) is liable as trustee of a settlement for tax on the value transferred by a transfer of value, or would be so liable if tax were chargeable on that value, or	Trust IHT	125.3.1
(bb) is liable under section 199(1)(b) above for tax on the value transferred by a potentially exempt transfer which proves to be a chargeable transfer, or would be so liable if tax were chargeable on that value, or	Failed PET	125.3.1
(bc) is liable under section 200(1)(c) above for tax on the value transferred by a chargeable transfer made on death, so far as the tax is attributable to the value of property which, apart from section 102(3) of the Finance Act 1986 would not form part of the deceased's estate, or would be so liable if tax were chargeable on the value transferred on the death, or	GWR	125.3.5
(bd) is liable under section 201(1)(b), (c) or (d) above for tax on the value transferred by a potentially exempt transfer which is made under section 52 above and which proves to be a chargeable transfer, or would be so liable if tax were chargeable on that value, or	Trust property failed PET	125.4

[17] See 125.7 (Excepted estates).

(c) is liable as trustee of a settlement for tax on an occasion on which tax is chargeable under Chapter III of Part III of this Act (apart from section 79), or would be so liable if tax were chargeable on the occasion,	Trust:10-year & exit charges	125.4
shall deliver to the Board an account specifying to the best of his knowledge and belief all appropriate property and the value of that property.		

The word "account" is an archaic term for a tax return. The drafter has copied the wording from the old estate duty provision;[18] but it oes not much matter. I refer to it as an "**IHT Account**" (with initial capitals to reflect the technical nature of the expression); or more specifically:
IHT400 Account: the form on death
IHT100 Account: the form on a lifetime transfer, 10 year or exit charge

The expression "would be liable if tax were chargeable" is apt to cover cases where
(1) the value is low and falls within nil rate thresholds; and
(2) 100% BPR/APR applies

125.6.1 *"Appropriate property"*

There are two definitions of "appropriate property", for PRs and for non-PRs.

For PRs, s.216(3) IHTA provides (so far as relevant):

> Subject to subsections (3A) and (3B) below,[19] where an account is to be delivered by personal representatives (but not where it is to be delivered by a person who is an executor of the deceased only in respect of settled land in England and Wales), the appropriate property is—
> (a) [i] all property which formed part of the deceased's estate immediately before his death
> [ii] other than property which would not, apart from section 102(3) of the FA 1986, form part of his estate [GWR property]; and
> (b) all property to which was attributable the value transferred by

[18] Section 6(4) FA 1894.
[19] Subsections (3A) and (3B) are not relevant here.

> any chargeable transfers made by the deceased within seven years of his death.

Excluded property is not appropriate property for PRs, as:
(a) it does not form part of the deceased's estate immediately before death
(b) A lifetime gift of excluded property is not a chargeable transfer

For persons other than PRs, s.216(4) IHTA provides:

> Where subsection (3) above does not apply the appropriate property is any property to the value of which the tax is or would be attributable

"Would be attributable" means "would be attributable if tax is chargeable". That is apt to include the cases where value is low and within IHT thresholds, or where 100% BPR/APR applies. But context shows it does not include excluded property. That view meets territorial limitations, and is consistent with the position for PRs.

The term "appropriate property" is not the most transparent of labels, but it is best to adopt the statutory terminology.

125.6.2 *PRs: No appropriate property*

There is no obligation to deliver an IHT400 Account if there is no appropriate property, ie if:

(1) the deceased had no chargeable (non-excluded) property at the time of death, and
(2) has made no chargeable transfers within 7 years of death.

An IHT400 Account may be required for a standard estate even though no IHT is payable on the death (eg because the chargeable property falls within the nil rate band). But in practice one would expect foreign PRs to disregard trivial UK situate assets, if there is no need for a grant of probate in the UK.

125.6.3 *PRs with appropriate property*

In other cases (eg if the deceased had some UK property, even if of little value) PRs have an obligation to deliver an IHT400 Account, giving details of the appropriate property.

Question 6 IHT400 (2022) provides:

> **Where was the deceased domiciled at the date of death? ...**
> - England and Wales
> - Scotland

- Northern Ireland
- other country, specify country below

IHT400 Notes (2022) comments on this box:

> If ... the deceased is treated for Inheritance Tax purposes as being domiciled in the UK, you should still enter the name of the foreign country in the box, but fill in the rest of the form as if the deceased was domiciled in the UK. Write in the 'Additional information' boxes on form IHT400 page 16 that the deceased was treated as domiciled (or 'deemed domiciled') in the UK for Inheritance Tax purposes.
>
> If the special rules [deemed domicile] do not apply and the deceased was domiciled outside the UK, you should fill in Schedule IHT401, 'Domicile outside the United Kingdom' to give us details. Fill in the IHT400 with details of assets in the UK only.

There is no statutory obligation to disclose excluded property. However Question 23 in form IHT401 (2022) (Domicile outside the UK) asks:

> Did the deceased leave any assets outside the UK? No/Yes – Give approximate value.

There is no legal duty to supply this information.[20] But refusal to answer the question may give rise to further enquiries.

There is no statutory duty to disclose details of gifts of excluded property which the deceased made before death. However form IHT400 (10/22) Question 30 asks:

> **Gifts and other Transfers of Value**: Did the deceased make any lifetime gifts or other transfers of value on or after 18 March 1986?

It is considered that the reference in the question to "gifts" means gifts which are transfers of value so that if the deceased made gifts of excluded property it is correct to answer "no". The guidance in IHT400 Notes (2022) is consistent with this:

> **Gifts and other transfers of value**
>
> You can tick 'No' and do not need to fill in Schedule IHT403 if the

[20] The former HMRC form D2 (Notes, 12/05) tacitly recognised this:
"*If the deceased was domiciled outside the UK when they died, any assets they owned abroad will not be liable to inheritance tax. Even so, you can help us to deal with this estate more quickly if you can give us a rough idea of the value of all of the deceased's estate outside the UK.*"
I have not found a similar comment in the current forms.

> only gifts made by the deceased were in the following categories:
> - to their spouse or civil partner and Spouse or Civil Partner Exemption applies
> - outright gifts to any individual which do not exceed £250 in any one year (these will be covered by the Small Gifts Exemption)
> - outright gifts to any individual of money or listed stocks and shares that are wholly covered by the Annual Exemption
> - outright gifts made regularly from income where the total gifts did not exceed £3,000 in each year...
>
> If the deceased had made any other gifts or 'transfers of value' since 18 March 1986, including transfers into trust, payment of insurance premiums for the benefit of another person, advances out of a trust fund or any assets that were taken out of a trust before death, you must fill in Schedule IHT403, 'Gifts and other transfers of value'. In general, a 'transfer of value' is any transaction where the deceased did not receive full value in exchange.

Question 45 IHT400 (2022) provides:

> **Assets held in trust**: Did the deceased have any right to benefit from any assets held in trust (including the right to receive assets held in a trust at some future date)? No/Yes – Use Schedule IHT418.

The word "right" only includes fixed interests, it is not apt to describe discretionary trusts. But it appears that "right to benefit" here is used (confusingly) to mean a right to an estate IIP. IHT400 Notes (2022) provides:

> ***Schedule IHT418 Assets held in trust***
> You must complete Schedule IHT418 if the deceased had an interest in possession and the trust is one of the following:
> - a trust that was set up before 22 March 2006 from which the deceased
>   was entitled to benefit
> - an immediate post-death interest
> - a disabled person's interest
> - a transitional serial interest

This would include an excluded property trust where the deceased had an estate IIP. In such a case the answer to Question 45 is, "yes". However only limited information needs to be disclosed in form IHT418. IHT400 Notes (2022) provides:

> **Foreign trusts** If the deceased had a right to benefit from settled

property where the assets are overseas, and the person who set up the trust was domiciled outside the UK when the trust was created, please answer questions 2 to 5 only.

125.6.4 *No PRs within 1 year*

Section 216(2) IHTA provides:

> Where in the case of the estate of a deceased person no grant of representation or confirmation has been obtained in the UK before the expiration of the period of twelve months from the end of the month in which the death occurred—
>
> (a) every person in whom any of the property forming part of the estate vests (whether beneficially or otherwise) on or at any time after the deceased's death or who at any such time is beneficially entitled to an interest in possession in any such property, and
>
> (b) where any of the property is at any such time comprised in a settlement and there is no person beneficially entitled to an interest in possession in that property, every person for whose benefit any of that property (or income from it) is applied at any such time,
>
> shall deliver to the Board an account specifying to the best of his knowledge and belief the appropriate property vested in him, in which he has an interest or which (or income from which) is applicable for his benefit and the value of that property.

125.6.5 *Reporting time limits*

Section 216(6) IHTA provides:

> An account under the preceding provisions of this section shall be delivered—[21]

Case	Time limit
(a) in the case of an account to be delivered by personal representatives,	[i] before the expiration of the period of twelve months from the end of the month in which the death occurs, [ii] or, if it expires later, the period of three months beginning with the date on which the personal representatives first act as such;

[21] I set out the words of the statute in tabular form for clarity.

(aa) in the case of an account to be delivered by a person within subsection (1)(bb) or (bd) above [failed PETs],	before the expiration of the period of twelve months from the end of the month in which the death of the transferor occurs;
(ad) in the case of an account to be delivered by a person within subsection (1)(c) above [Trust IHT],	before the expiration of the period of six months from the end of the month in which the occasion concerned occurs;
(b) in the case of an account to be delivered by a person within subsection (2) above [No PRs within 1 year],	before the expiration of the period of three months from the time when he first has reason to believe that he is required to deliver an account under that subsection;
(c) in the case of an account to be delivered by any other person,	[i] before the expiration of the period of twelve months from the end of the month in which the transfer is made [ii] or, if it expires later, the period of three months beginning with the date on which he first becomes liable for tax.[22]
(7) A person liable for tax under section 32, 32A, 79 or 126 above or under Schedule 5 to this Act shall deliver an account under this section	before the expiration of the period of six months from the end of the month in which the event by reason of which the tax is chargeable occurs.

125.7 Excepted estate

The law is in the IHT (Delivery of Accounts) (Excepted Estates) Regulations 2004, which I abbreviate to EER.

This chapter sets out the law for deaths before 1 January 2022. Reporting for deaths from that date will be affected by the IHT (Delivery of Accounts) (Excepted Estates) (Amendment) Regulations 2021, and I will update in due course.

[22] Different rules apply where there is a s.267ZA spouse election; see 5.14.11 (IHT payment/return dates).

125.7.1 *"Excepted estate"*

The legislation distinguishes between:

(1) "**Excepted estates**" and

(2) **"Standard estates"** (my term for a non-excepted estate)

Regulation 4(1) EER 2004 provides:

> An excepted estate means the estate of a person immediately before his death in the circumstances prescribed by paras (2), (3) or (5).

There are three categories of excepted estate:

Para	**Requirements (in short)**	**See para**
4(2)	Low value estate	125.7.4
4(3)	IHT spouse /charity exemption	125.7.5
4(5)	Non-domiciled deceased	125.7.7

Before considering these, it is helpful to deal with some definitions.

125.7.2 *"Specified transfer"*

Regulation 4(6) EER 2004 provides the definition:

> For the purposes of paragraphs (2) and (3)—
> "specified transfers", subject to paragraph (7A), means chargeable transfers made by a person during the period of seven years ending with that person's death where the value transferred is attributable to—
> (a) cash;
> (b) personal chattels or corporeal moveable property;
> (c) quoted shares or securities; or
> (d) an interest in or over land, save to the extent that
> [i] sections 102 and 102A(2) of the Finance Act 1986 apply to that transfer or
> [ii] the land became settled property on that transfer

125.7.3 *"Specified exempt transfer"*

Regulation 4(6) EER 2004 provides the definition:

> "specified exempt transfers" means transfers of value made by a person during the period of seven years ending with that person's death which are exempt transfers only by reason of—
> (a) section 18 (transfers between spouses or civil partners),
> (b) section 23 (gifts to charities),
> (c) section 24 (gifts to political parties),

> (d) section 24A (gifts to housing associations),
> (e) section 27 (maintenance funds for historic buildings, etc), or
> (f) section 28 (employee trusts) of the 1984 Act.

125.7.4 *Low value estate*

Regulation 4(2) EER 2004 provides:

> The circumstances prescribed by this paragraph are that—
> (a) the person died on or after 6th April 2004, domiciled in the UK;
> (b) the value of that person's estate is attributable wholly to property passing—
> (i) under his will or intestacy,
> (ii) under a nomination of an asset taking effect on death,
> (iii) under a single settlement in which he was entitled to an interest in possession in settled property, or
> (iv) by survivorship in a beneficial joint tenancy or, in Scotland, by survivorship in a special destination;

If the estate includes GWR property, it will not meet condition (b).

> (c) of that property —
> (i) not more than £150,000 represented value attributable to property which, immediately before that person's death, was settled property; and
> (ii) not more than £100,000 represented value attributable to property which, immediately before that person's death, was situated outside the UK;
> (ca) that person was not a person by reason of whose death one of the alternatively secured pension fund provisions applies;
> (d) subject to paragraph (7A), that person died without having made any chargeable transfers during the period of seven years ending with his death other than specified transfers where, subject to paragraph (7), the aggregate value transferred did not exceed £150,000; and
> (e) the aggregate of—
> (i) the gross value of that person's estate,
> (ii) subject to paragraph (7), the value transferred by any specified transfers[23] made by that person, and
> (iii) the value transferred by any specified exempt transfers made by that person,

[23] See 125.7.2 ("Specified transfer").

did not exceed the IHT threshold.[24]

For this purpose BPR/APR is disregarded, so an IHT Account is in principle needed on the death of a person holding UK business property, even though it qualifies for 100% relief.[25]

125.7.5 *IHT spouse/charity exemption*

Regulation 4(3) EER 2004 provides:

> The circumstances prescribed by this paragraph are that—
> [Paras (a)(b) are the same as reg 42(a)(b) and need not be set out again]
> (c) of that property—
> (i) subject to paragraph (8),[26] not more than £150,000 represented value attributable to property which, immediately before that person's death, was settled property; and
> (ii) not more than £100,000 represented value attributable to property which, immediately before that person's death, was situated outside the UK;
> (ca) that person was not a person by reason of whose death one of the alternatively secured pension fund provisions applies;
> (d) subject to paragraph (7A), that person died without having made any chargeable transfers during the period of seven years ending with his death other than specified transfers[27] where, subject to paragraph (7), the aggregate value transferred did not exceed £150,000;
> (e) the aggregate of—
> (i) the gross value of that person's estate,
> (ii) subject to paragraph (7), the value transferred by any specified transfers made by that person, and
> (iii) the value transferred by any specified exempt transfers made by that person,
> did not exceed £1,000,000;
> (ea) the total value transferred on that person's death by a spouse,

[24] "IHT threshold" is elaborately defined in reg 5A EER 2004.

[25] See 125.7.8 (BPR/APR).

[26] Regulation 4(8) EER 2004 provides: "Paragraph (3)(c)(i) does not apply to property which immediately before the person's death was settled property, to the extent that the property is transferred on that person's death by a spouse, civil partner or charity transfer."

[27] See 125.7.2 ("Specified transfer").

> civil partner or charity transfer is greater than nil; and
>
> (f) the aggregate of A − (B + C)
>
> does not exceed the IHT threshold, where—
>
> A is the aggregate of the values in sub-paragraph (e),
>
> B, subject to paragraph (4), is the total value transferred on that person's death by a spouse, civil partner or charity transfer, and
>
> C subject to paragraph (7B) is the total liabilities of the estate.[28]

125.7.6 *Deceased deemed UK-dom*

HMRC say that an individual who is deemed UK domiciled cannot qualify under the first two categories:

> **IHTM06023 What is not an excepted estate** [Sep 2018]
> There are instances when an estate cannot qualify as an excepted estate, regardless of the value. These are:
>
> [1] where the deceased held an interest in possession (IHTM16060) in more than one item of settled property (IHTM16041)
>
> [2] for deaths on or after 1 September 2006 where a charge arises under IHTA1984 s.151A-C (IHT charge on an alternatively secured pension fund),
>
> [3] where , on or after 18 March 1986, the deceased made a gift with reservation of benefit and either:
> - the reservation still subsists at the death (IHTM04072), or
> - the property ceased to be subject to the reservation within the seven years before the death - (unless this constituted a specified transfer (IHTM06018),
>
> [4] where the deceased has elected that property should be treated as part of their estate for IHT rather than pay a pre-owned asset charge,
>
> [5] where the deceased is regarded as deemed domiciled (IHTM13024) in the UK under the provisions of IHTA1984 S.267.

I am not sure about point [5], but it does not much matter.

125.7.7 *Deceased non-dom*

Regulation 4(5) EER 2004 provides:

> The circumstances prescribed by this paragraph are that—
>
> (a) the person died on or after 6 April 2004;
>
> (b) that person was never

[28] This expression is defined in reg 4(7B).

> [i] domiciled in the UK or
> [ii] treated as domiciled in the UK by section 267 [IHTA]

It is considered that a person treated as UK domiciled by a spouse election may qualify.

> (ba) that person was not a person by reason of whose death one of the alternatively secured pension fund provisions[29] applies; and
> (c) the value of that person's estate situated in the UK is wholly attributable to
> [i] cash[30] or
> [ii] quoted shares or
> [iii] securities
> passing under his will or intestacy or by survivorship in a beneficial joint tenancy or, in Scotland, by survivorship in a special destination, the gross value of which does not exceed £150,000.

125.7.8 *BPR/APR*

Regulation 4(7) EER 2004 provides:

> For the purpose of paragraphs (2)(d) and (e) and (3)(d) and (e), sections 104 (business property relief) and 116 (agricultural property relief) of the 1984 Act shall not apply in determining the value transferred by a chargeable transfer.

Thus an IHT account is needed for an estate even if it qualifies for 100% business/agricultural property relief.

Regulation 4(7A) EER 2004 provides:

> For the purpose of paragraphs (2)(d) and (e), (3)(d) and (e) and (6) any transfers of value made by that person in any period from 6th April in any year until and including the following 5th April which—
> (i) are exempt transfers by virtue of section 21 (normal expenditure out of income) of the 1984 Act,

[29] Reg 4(9) provides:
"In this regulation 'the alternatively secured pension fund provisions' means the following sections of the 1984 Act—
(a) section 151A (person dying with alternatively secured pension fund);
(b) section 151B (relevant dependant with pension fund inherited from member over 75); and
(c) section 151C (dependant dying with other pension fund)."

[30] IHT Manual 6018 shows that HMRC sensibly construe "cash" widely, so as to include a bank account.

(ii) are made less than seven years prior to the death of that person, and

(iii) are in total more than £3,000,

shall be treated as chargeable transfers.

125.8 Reporting excepted estate

Regulation 3(1) EER 2004 provides:

> No person is required to deliver an account under section 216 of the 1984 Act of the property comprised in an excepted estate.

Regulation 6(1) EER 2004 provides:

> Subject to paragraphs (3) and (4), a person who by virtue of these Regulations is not required to deliver to the Board an account under section 216 of the 1984 Act of the property comprised in an excepted estate, must produce
>
> [a] the information specified in paragraph (2)
>
> [b] and, where the criteria specified in regulation 5A(3) and (4) are met, paragraph (2A),
>
> to the Board in such form as the Board may prescribe.

Thus the term "excepted estate" is not apt, because the estate is not excepted from all reporting requirements. An excepted estate is not required to deliver an IHT400 Account, but it is required to produce a great deal of information in what I call the "**IHT205 Account**" from the name of the relevant form.[31] The IHT205 Account is however shorter and simpler than the IHT400.

I adopt the statutory term "excepted estate", as a paraphrase is even more confusing, but quotation marks would be justified.

The main requirement is the list in reg 6(2):

> The information specified for the purpose of para (1) is—
>
> (a) the following details in relation to the deceased—
>
> (i) full name;
>
> (ii) date of death;
>
> (iii) marital or civil partnership status;
>
> (iv) occupation;
>
> (v) any surviving spouse or civil partner, parent, brother or sister;

[31] The term "excepted estate" made sense under the 2002 Excepted Estates Regulations, under which an excepted estate was not required to submit an IHT Account.

> (vi) the number of surviving children, step-children, adopted children or grandchildren;
> (vii) national insurance number, tax district and tax reference;
> (viii) if the deceased was not domiciled in the UK at his date of death, his domicile and address;
>
> (b) details of all property to which the deceased was beneficially entitled and the value of that property;
> (c) details of any specified transfers, specified exempt transfers and the value of those transfers;
> (d) the liabilities of the estate; and
> (e) any spouse, civil partner or charity transfers and the value of those transfers.

It is considered that there is no obligation to give information about excluded property. This is perhaps a purposive construction, because, strictly, excluded property is "property to which the deceased was beneficially entitled" even though it does not form part of their estate for IHT purposes immediately before death. However, it is absurd to say that there is an obligation on excepted estates to disclose excluded property, when there is no such obligation on standard estates. In practice form IHT205 does not ask about non-UK property.

125.9 Excepted settlements

125.9.1 *"Chargeable event"*

Reg 2 ESR 2008 provides:

> "a chargeable event" means an occasion on which tax is chargeable under
> [a] section 64 (charge at ten-year anniversary),
> [b] section 65 (charge at other times) or
> [c] section 71E (charge to tax on property to which s.71D applies)

125.9.2 *The relief*

Regulation 3(1) ESR 2008 provides:

> No person is required to deliver an account under section 216 of the property comprised in an excepted settlement unless the Commissioners so require by notice in writing addressed to that person.

Unlike the excepted estates regs, this is an exemption.

> (2) If in reliance on these Regulations a person has not delivered an

> account and it is discovered at any time that the settlement is not an excepted settlement, the delivery to the Commissioners within six months of that time of an account of the property comprised in that settlement shall satisfy any requirement to deliver an account imposed on that person.

125.9.3 *"Excepted settlement"*

Regulation 4(1) ESR 2008 provides:

> An excepted settlement means a settlement in which no qualifying interest in possession subsists on an occasion of a chargeable event on or after 6th April 2007 in the circumstances in paragraph (2) or (3).

Para 4(2) ESR 2008 concerns pilot trusts:

> The circumstances are that-
> (a) throughout the existence of the settlement, cash is the only property comprised in the settlement;
> (b) after making the settlement, the settlor provided no further property which became comprised in the settlement;
> (c) the trustees of the settlement are resident in the United Kingdom throughout the existence of the settlement;
> (d) the gross value of the settled property throughout the existence of the settlement does not exceed £1,000; and
> (e) there are no related settlements.

This is of no practical importance as such trusts are not found.

Para 4(3) is a set of small trust reliefs:

> The circumstances are that-
> (a) the settlor is domiciled in the United Kingdom at the time the settlement was made and throughout the existence of the settlement until either the chargeable event or the death of the settlor, whichever is earlier;
> (b) the trustees of the settlement are resident in the United Kingdom throughout the existence of the settlement;
> (c) there are no related settlements; and
> (d) the relevant condition contained in paragraph (4), (6), (7) or (8) is met.
>
> (4) On the occasion of a chargeable event under section 64, the condition is that the value transferred by a chargeable transfer of the description specified in section 66(3) does not exceed 80% of the IHT threshold.
>
> (5) Where, in reliance on these Regulations, no person was required to

deliver an account under section 216 of the property comprised in the settlement on an occasion of a chargeable event under section 65 in respect of the settlement in the ten years before the chargeable event in paragraph (4), the amounts on which any charges to tax were imposed under section 65 shall, for the purpose of determining the value transferred by a chargeable transfer of the description specified in section 66(3), be without deduction for liabilities or reliefs contained in the 1984 Act.

(6) On the occasion of a chargeable event under section 65 preceding the first ten-year anniversary after the settlement's commencement, the condition is that the value transferred by a chargeable transfer of the description specified in section 68(4) does not exceed 80% of the IHT threshold.

(7) On the occasion of a chargeable event under section 65 following one or more ten-year anniversaries after the settlement's commencement, the condition is that the value transferred by a chargeable transfer of the description specified in section 66(3), taking into account section 69, does not exceed 80% of the IHT threshold.

(8) On the occasion of a chargeable event under section 71E by reason of the happening of an event within section 71F(2), the condition is that the value transferred by a chargeable transfer of the description specified in section 71F(8) does not exceed 80% of the IHT threshold.

(9) For the purposes of this regulation-

(a) trustees of a settlement shall be regarded as resident in the United Kingdom if the general administration of the settlement is ordinarily carried on in the United Kingdom and the trustees or a majority of them (and, where there is more than one class of trustees, a majority of each class) are for the time being resident in the United Kingdom; and

(b) in determining value for the purposes of paragraph (4), (6), (7) or (8) disregard any liabilities or reliefs contained in the 1984 Act.

125.9.4 *Discharge from tax*

ESR 2008 provides:

5 (1) Paragraph (2) shall apply to an excepted settlement within regulation 4(2).

(2) The trustees of the settlement shall, on the expiration of the period of six months beginning with the date of the chargeable event, be discharged from any claim for tax on the occasion of the chargeable event and attributable to the value of the property comprised in the

> excepted settlement and any Inland Revenue charge for that tax shall then be extinguished unless, within that period, the Commissioners issue a notice requiring an account of that property.
> (3) This regulation is subject to regulation 6.
> 6 Regulation 5 does not-
> (a) discharge any person from tax in the case of fraud or failure to disclose material facts; or
> (b) affect the liability to tax of any persons other than the trustees of the settlement, or any tax that may be payable if the settlement is not an excepted settlement.

This will rarely if ever apply.

125.9.5 *Transfers reported late*

> 7 Where no account of an excepted settlement is required by the Commissioners, an account of that settlement shall, for the purposes of section 264(8) (delivery of account to be treated as payment where tax rate nil), be treated as having been delivered twelve months after the end of the month in which the chargeable event occurred.

125.10 Disclosure: Territorial limitation

The IHT provisions do not provide much of a territorial limitation on the duty to submit an IHT Account. They merely provide two regimes of disclosure, for excepted/standard estates.

The Courts may devise further territorial limitation, as they have on occasion done elsewhere.[32] It might be argued that no duty applies to foreign personal representatives, in the absence of any IHT liability. But disclosure in one form or another will be required in all cases where PRs need a UK grant of probate.

125.10.1 *Conclusion*

PRs may be required to submit an IHT205 Account for an excepted estate even though no IHT is payable on the death (eg because the chargeable property falls within the nil rate band). But in practice one would expect PRs of an excepted estate, and foreign PRs, to disregard trivial UK situate assets, if there is no need for a grant of probate in the UK.

If a foreign domiciled individual wishes to ensure that their personal representatives are under no duty to put in any IHT Account on death, they

[32] See 16.11 (General territorial principle).

should not have any UK situate property at the time of their death (and consider appointing foreign executors.) Then there is no duty to put in any IHT Account.

125.11 Correcting error in Account

Section 217 IHTA provides:

> If a person who has delivered an account under section 216 above discovers at any time that the account is defective in a material respect by reason of anything contained in or omitted from it he shall, within six months of that time, deliver to the Board a further account containing such information as may be necessary to remedy the defect.

Six months is a leisurely, long-stop time limit. There is a separate duty to take "reasonable steps" to inform HMRC of errors in an Account, with a sanction of penalties,[33] and reasonable steps will generally require a swifter response.

125.12 Payment due dates

I do not consider the rules for payment of tax by instalments.

Unlike IT/CGT, there is no specific penalty for late payment, though interest is payable.

125.12.1 *Payment by PRs*

Section 226(1) IHTA provides:

> Except as otherwise provided by the following provisions of this Part of this Act, the tax on the value transferred by a chargeable transfer shall be due
> [a] six months after the end of the month in which the chargeable transfer is made
> [b] or, in the case of a transfer made after 5th April and before 1st October in any year otherwise than on death, at the end of April in the next year.[34]

IHT is due before the IHT Account is due: a curious state of affairs. And why should the payment period be longer for deaths in the period April-

[33] See 126.9.2 (Careless: Definition).

[34] Different rules apply where there is a s.267ZA spouse election; see 4.13.10 (IHT payment/return dates).

September? But there it is.

Section 226 IHTA provides:

> (2) Personal representatives shall, on delivery of their account, pay all the tax for which they are liable and may, on delivery of that account, also pay any part of the tax chargeable on the death for which they are not liable, if the persons liable for it request them to make the payment...
> (5) The Board may in the first instance, and without prejudice to the recovery of the remainder of the tax, accept or demand payment of an amount by reference to the value stated in an account delivered to the Board under section 216 or 217 above.

125.12.2 *Tax on failed PET*

Section 226 IHTA provides:

> (3) So much of the tax chargeable on the value transferred by a chargeable transfer made within seven years of the death of the transferor as—
> (a) exceeds what it would have been had the transferor died more than seven years after the transfer,
> shall be due six months after the end of the month in which the death occurs.
> (3A) Without prejudice to subsection (3) above, the tax chargeable on the value transferred by a potentially exempt transfer which proves to be a chargeable transfer shall be due six months after the end of the month in which the transferor's death occurs.

125.12.3 *Trust tax*

Section 226 IHTA provides:

> (3B) So much (if any) of the tax chargeable on the value transferred by a chargeable transfer made under Chapter III of Part III of this Act within the period of seven years ending with the settlor's death as exceeds what it would have been had the settlor died more than seven years after the date of the transfer shall be due six months after the end of the month in which the death occurs.
> (3C) Tax chargeable under Chapter 3 of Part 3 of this Act on the value transferred by a chargeable transfer, other than any for which the due date is given by subsection (3B) above, is due six months after the end of the month in which the chargeable transfer is made.

125.13 Notice of determination

Section 221 IHTA provides:

> (1) [a] Where it appears to the Board that a transfer of value[35] has been made or
>
> [b] where a claim under this Act is made to the Board in connection with a transfer of value,
>
> the Board may give notice in writing to any person who appears to the Board to be the transferor or the claimant or to be liable for any of the tax chargeable on the value transferred, stating that they have determined the matters specified in the notice.
>
> (2) The matters that may be specified in a notice under this section in relation to any transfer of value are all or any of the following—
>
> (a) the date of the transfer;
>
> (b) the value transferred and the value of any property to which the value transferred is wholly or partly attributable;
>
> (c) the transferor;
>
> (d) the tax chargeable (if any) and the persons who are liable for the whole or part of it;
>
> (e) the amount of any payment made in excess of the tax for which a person is liable and the date from which and the rate at which tax or any repayment of tax overpaid carries interest; and
>
> (f) any other matter that appears to the Board to be relevant for the purposes of this Act.
>
> (3) A determination for the purposes of a notice under this section of any fact relating to a transfer of value—
>
> (a) shall, if that fact has been stated in an account or return under this Part of this Act and the Board are satisfied that the account or return is correct, be made by the Board in accordance with that account or return, but
>
> (b) may, in any other case, be made by the Board to the best of their judgment.
>
> (4) A notice under this section shall state the time within which and the manner in which an appeal against any determination in it may be made.
>
> (5) Subject to any variation by agreement in writing or on appeal, a determination in a notice under this section shall be conclusive for the purposes of this Act against the person on whom the notice is served; and if the notice is served on the transferor and specifies a

[35] See 74.3.1 (Transfer of value: Extended definition).

> determination of the value transferred by the transfer of value or previous transfers of value, the determination, so far as relevant to the tax chargeable in respect of later transfers of value (whether or not made by the transferor) shall be conclusive also against any other person, subject however to any adjustment under section 240 or 241 below.

"Notice of determination" is an old-fashioned expression for what would nowadays be called an assessment or closure notice. The terminology does not much matter.

Unlike closure notices, there is no provision for a taxpayer to apply to close an enquiry and obtain a notice of determination, which can then be appealed. In practice we seem to muddle through without one.

125.14 IHT recovery time limits

125.14.1 *IHT time limits: outline*

IHT recovery time limits and the IT/CGT assessment time limits are best regarded as distinct codes, though they share some rules and terminology.

Time limits for the recovery of IHT can be summarised as follows:

Time limit	**Facts**	**IHTA**	**See para**
n/a	Certificate of discharge	s.239	125.17
	IHT Account made and:		
4 years	- No culpable error	s.240(2)	125.14.2
6 years	- Careless error	s.240(4)	125.14.3
12 years	- Offshore matter	s.240B	125.15
20 years	- Deliberate error	s.240(5)	125.14.3
20 years	- DOTAS breach	s.240(5A)	125.14.4
	No IHT Account made and:		
20 years	- No deliberate error	s.240(6)(7)	125.14.4
No limit	- Deliberate error	s.240(1)	125.16

Section 240(1) IHTA provides the starting point:

> [a] Where too little tax has been paid in respect of a chargeable transfer
> [b] the tax underpaid shall be payable
> [c] with interest under section 233 above,
> [d] whether or not the amount that has been paid was that stated as payable in a notice under section 221 above [notice of determination];
> [e] but subject

> [i] to section 239 above[36] and
> [ii] to the following provisions of this section.

So the default rule is that unless one of the express time limits discussed below applies, there is no time limit for the recovery of IHT. Fortunately the default rule only rarely applies.

125.14.2 *Tax paid: 4-year limit*

Section 240(2) IHTA provides:

> Where
> [A] tax attributable to the value of any property is paid in accordance with an account duly delivered to the Board under this Part of this Act and
> [B] the payment is made and accepted in full satisfaction of the tax so attributable,
> no proceedings shall be brought for the recovery of any additional tax so attributable after the end of the period of four years beginning with the later of—
> (a) the date on which the payment (or in the case of tax paid by instalments the last payment) was made and accepted, and
> (b) the date on which the tax or the last instalment became due;
> and at the end of that period any liability for the additional tax and any Inland Revenue charge for that tax shall be extinguished.

I refer to this as the **"s.240(2) tax-paid rule"**.

Section 240(3) IHTA signposts exceptions to the s.242(2) tax-paid rule:

> Subsection (2) has effect subject to subsections (4) to (5A).

125.14.3 *Carelessness/deliberate error*

Section 240(4)/(5) IHTA extend the time limit of the s.240(2) tax-paid rule in cases of carelessness/deliberate misconduct. The rules are easier to follow if set out side by side:

Proceedings in a case involving a loss of tax brought about carelessly by	Proceedings in a case involving a loss of tax brought about deliberately by
[a] a person liable for the tax[37]	[a] [identical]

[36] See 125.17 (IHT certificate of discharge).

[37] This includes the settlor: see 125.14.6 (Culpable settlor).

[b] (or a person acting on behalf of such a person)[38]	[b] [identical]
may be brought at any time not more than 6 years after the later of the dates in subsection (2)(a) and (b).[39]	may be brought at any time not more than 20 years after the later of the dates in subsection (2)(a) and (b).

Section 240A(2)/(4) IHTA define carelessly/deliberately in the same way as the TMA does for IT/CGT.[40]

125.14.4 *Breach of DOTAS*

Section 240(5A) IHTA extends the time limit of the s.240(2) tax-paid rule in cases of breach of DOTAS:

> Proceedings in a case involving a loss of tax
> [a] attributable to arrangements which were expected to give rise to a tax advantage
> [b] in respect of which a person liable for the tax was under an obligation to make a report under section 253 of the Finance Act 2014 (duty to notify Commissioners of promoter reference number) but failed to do so,
> may be brought at any time not more than 20 years after the later of the dates in subsection (2)(a) and (b).

125.14.5 *No IHT Account delivered*

Section 240 IHTA then deals with cases where the s.240(2) tax-paid rule does not apply, ie (in short) where no IHT Account is delivered to HMRC.

> (6) Subsection (7) applies to any case
> [a] not falling within subsection (2)[41]
> [b] where too little tax has been paid in respect of a chargeable transfer,

[38] See 121.15.6 (Carelessness of agent).

[39] The dates are:
(a) the date on which the payment (or in the case of tax paid by instalments the last payment) was made and accepted, and
(b) the date on which the tax or the last instalment became due.
See 125.14.2 (Four year limit).

[40] See 121.15.4 (What is reasonable care); 121.17.2 (“Deliberate” inaccuracy).

[41] See 125.14.2 (Four year limit).

> [c] provided that the case does not involve a loss of tax brought about deliberately by
> [i] a person liable for the tax[42]
> [ii] (or a person acting on behalf of such a person).[43]
>
> (7) Where this subsection applies—
> (a) no proceedings are to be brought for the recovery of the tax after the end of the period of 20 years beginning with the date on which the chargeable transfer was made, and
> (b) at the end of that period
> [i] any liability for the tax and
> [ii] any Inland Revenue charge for that tax[44]
> is extinguished.

125.14.6 *Culpable settlor*

Section 240(8) IHTA provides:

> In relation to cases of tax chargeable under Chapter 3 of Part 3 of this Act (apart from section 79), the references in subsections (4) to (6) to a person liable for the tax are to be treated as including references to a person who is the settlor in relation to the settlement.

Thus carelessness/deliberate error of the settlor counts for time limits, even though in general the settlor is not actually liable for trust IHT.

125.14.7 *RTC time limit*

Where the requirement to correct rules apply, in short, where IHT involving offshore matters was undeclared on 5/4/2017, the time limit was extended to 5 April 2021, so IHT occasions of charge from 5 April 1997 remained recoverable until then; but this time limit has now passed.[45]

125.15 12 year limit: Offshore matter

Section 240B IHTA provides:

> (1) This section applies in a case within section 240(2) which involves a loss of tax in relation to a chargeable transfer, where—
> (a) the lost tax involves an offshore matter, or
> (b) the lost tax involves an offshore transfer which makes the lost

[42] This includes the settlor: see 125.14.6 (Culpable settlor).

[43] See 121.15.6 (Carelessness of agent).

[44] See 125.18 (Inland Revenue charge).

[45] See 121.19 (RTC time limit: 5/4/21).

> tax significantly harder to identify.
>
> (2) Proceedings for the recovery of the lost tax may be brought at any time not more than 12 years after the later of the dates in section 240(2)(a) and (b).

125.15.1 *Offshore matter/transfer*

Section 240B IHTA provides:

> (3) Lost tax "involves an offshore matter" if it is charged on or by reference to property which is situated or held in a territory outside the UK at, or immediately after, the time of the chargeable transfer.
>
> (4) Lost tax "involves an offshore transfer" if—
>
> (a) it does not involve an offshore matter, and
>
> (b) the property is transferred to a territory outside the UK at a relevant time.[46]

See too 126.23 (Offshore/Domestic Matters).

Section 240B(6) IHTA provides:

> Where lost tax involves an offshore transfer, the cases in which the transfer makes the lost tax significantly harder to identify include any case where, because of the transfer—
>
> (a) HMRC was significantly less likely to become aware of the lost tax, or
>
> (b) HMRC was likely to become aware of the lost tax only at a significantly later time.

Section 240B(7)(8) provides an exception where HMRC should have acted sooner. This is the same rule as for IT; see 121.16.2 (12-year limit: Exceptions).

> (9) This section is subject to any provision of this Act which allows for a longer period for the bringing of proceedings.

125.15.2 *12-year rule: Commencement*

Section 240B IHTA was introduced by s.81 FA 2019. Section 81(4) FA 2019 provides:

[46] Section 240B(5) IHTA provides: "In subsection (4)(b) "relevant time" means a time after the chargeable transfer but before—
(a) the date on which an account under section 216 is delivered to HMRC in relation to the chargeable transfer, or
(b) any later date on which an account under section 217 is so delivered."

> (4) The amendments made by this section have effect—
> (a) in a case involving loss of tax brought about carelessly by a person liable for the tax (or a person acting on behalf of such a person),[47] in relation to chargeable transfers taking place on or after 1 April 2013, and
> (b) in any other case, in relation to chargeable transfers taking place on or after 1 April 2015.

125.16 No time limit

None of the express time limits apply if (in short):
(1) the s.240(2) tax-paid rule does not apply (in short, no IHT Account is delivered) and
(2) the taxpayer has acted deliberately.

Then the default rule applies, so there is no time limit for collection of tax.

This is contrary to the principle of finality, and out of line with other taxes. It is suggested that there should be some cut off. 20 years seems enough, and in line with other taxes; though any figure is better than none. But after 20 years, there may be no or insufficient evidence of deliberate misconduct, as opposed to mere carelessness or innocent error. The onus of proof becomes important here.

125.17 IHT certificate of discharge

The IHT rules, drafted in an earlier era, are more concise than the IT/CGT rules, and have a number of gaps, but the standard of disclosure is similar.

125.17.1 *Certificate of IHT paid*

Section 239(1) IHTA provides:

> Where application is made to the Board by a person liable for any tax on the value transferred by a chargeable transfer which is attributable to the value of property specified in the application, the Board, on being satisfied that the tax so attributable has been or will be paid, may give a certificate to that effect, and shall do so if the chargeable transfer is one made on death or the transferor has died.

Section 239(3) IHTA explains its effect:

[47] Section 90(5) FA 2019 provides: "Section 240(8) of IHTA 1984 applies to the reference to "person liable for the tax" in subsection (4)(a)."

> Subject to subsection (4) below,—
>
> (a) a certificate under subsection (1) above shall discharge the property shown in it from the Inland Revenue charge on its acquisition by a purchaser[48]

This is of limited importance,[49] and I think references to certificates of discharge are generally to the next type of certificate, under s.239(2) IHTA.

125.17.2 *Certificate IHT due/not due*

Section 239(2) IHTA provides:

> Where tax is or may be chargeable on the value transferred by a transfer of value[50] and—
>
> (a) application is made to the Board after the expiration of two years from the transfer (or, if the Board think fit to entertain the application, at an earlier time) by a person who is or might be liable for the whole or part of the tax, and
>
> (b) the applicant delivers to the Board,
>
> [i] if the transfer is one made on death, a full statement to the best of his knowledge and belief of all property included in the estate of the deceased immediately before his death
>
> [ii] and, in any other case, a full and proper account under this Part of this Act,

If these conditions ("certificate application conditions") are met, we move on to the relief available:

> [A] the Board may, as the case requires, determine the amount of the tax or determine that no tax is chargeable;
>
> [B] and subject to the payment of any tax so determined to be chargeable the Board may give a certificate of their determination, and shall do so if the transfer of value is one made on death or the transferor has died.

I refer to this as an **"IHT certificate of discharge"**.

The application form is IHT30 (Inheritance Tax: application for a clearance certificate).

An application can only be made if there is a transfer of value. The IHT

[48] See 125.18 (Inland Revenue charge).

[49] See 125.18.5 (Purchase of charged property).

[50] See 74.3.1 (Transfer of value: Extended definition).

Manual provides:

> **IHTM40040: is a certificate appropriate?** [May 2020]
> You can issue a certificate where
> - tax would be payable if the minimum taxable threshold were exceeded
> - a relief covers the tax otherwise chargeable.
>
> You can also issue a certificate where no tax is payable because of exempt gifts
> - to spouses or civil partners
> - to charities
> - to political parties
> - for national purposes
> - for public benefit, and where
> - the estate includes government securities in foreign ownership which are exempt under IHTA84/S6 (2) [FOTRA securities].
>
> You cannot issue a certificate where the property is not chargeable to tax at all (IHTM04141), for example because of the surviving spouse exemption available under IHTA84/Sch6Para2 [Estate duty transitional rule]...

A certificate can be obtained on a death where the estate includes chargeable and excluded property (whether FOTRA securities, which are mentioned in this list, or non-UK situated property, which is not mentioned).

Where an estate consists *only* of excluded property, the certificate application conditions are not strictly satisfied, but in practice HMRC will give a domicile ruling on a death.[51]

HMRC Trusts and Estates Newsletter (Aug 2022) deals with the procedure:

> **Process for Inheritance Tax clearance**
> If you want to apply for clearance in respect of an Inheritance Tax liability, you must use form IHT30 ‘Application for a clearance certificate’. Only do this when you are sure there will be no further changes that will affect the tax position on the estate. We will not accept a letter requesting clearance.
>
> Do not send your IHT30 at the same time as amendments to the account as clearance should only be applied for after all amendments have been reported to, and accepted by, HMRC.

[51] See 4.23 (HMRC domicile ruling).

> The Inheritance Tax legislation states that it is appropriate to apply for clearance once 2 years have passed since the date of death. In practice, we will consider a request for clearance earlier than this, but only if you are sure that there will be no more changes to report. We would not normally expect you to apply until a year has passed since the date of death.
> During coronavirus (COVID-19) we replaced stamping and returning the IHT30 form with a separate certificate, SL120. We have now made this change permanent and the SL120 is being amended to remove the reference to COVID-19.

125.17.3 *Lifetime chargeable transfer*

The IHT Manual provides:

> **HTM40011: who can apply for clearance certificates?** [May 2020]
> You may receive a request for clearance in respect of a lifetime transfer that was chargeable when made (IHTM04067). You should normally tell the applicants that we do not give clearance in these circumstances. It is considered that the normal process of assessment and payment of tax are sufficient evidence that the liability has been satisfied.
> We do not issue clearance as the subsequent death of the transferor may bring failed potentially exempt transfers (IHTM14511) into cumulation. Clearance can be given if the transferor has subsequently died and you are satisfied that no further liabilities can arise in respect of the transfer.

It may happen that a person makes a gift of foreign property to a trust, but there are doubts as to their domicile. If foreign domiciled the property is excluded property and there is no transfer of value. If UK domiciled, there is a lifetime chargeable transfer. In neither case is a formal certificate available, but HMRC will, no doubt, give a ruling as to domicile if asked.

125.17.4 *Clearance certificate: PETs*

Section 239(2A) IHTA deals with PETs:

> An application under subsection (1) or (2) above with respect to tax which is or may become chargeable on the value transferred by a potentially exempt transfer may not be made before the expiration of two years from the death of the transferor (except where the Board think fit to entertain the application at an earlier time after the death).

125.17.5 *Certificate protection*

Section 239(3) IHTA explains the effect of a s.239(2) certificate:

> Subject to subsection (4) below ...
> (b) a certificate under subsection (2) above shall discharge all persons from any further claim for the tax on the value transferred by the chargeable transfer concerned and extinguish any Inland Revenue charge for that tax.

Section 239(4) IHTA provides a set of limits to certificate protection:

> A certificate under this section
> [i] shall not discharge any person from tax in case of fraud or failure to disclose material facts and
> [ii] shall not affect any further tax—
> (a) that may afterwards be shown to be payable by virtue of section 93, 142, 143, 144 or 145 above

The exceptions at [ii] concern provisions which may retrospectively increase an IHT liability:

Section	**Provision**	**See para**
s.93	Disclaimer	99.18
s.142	Instrument of variation	77.6
s.143	Compliance with testator's request	
s.144	Discretionary will trust	
s.145	*Repealed (the need to delete the reference was overlooked)*	

Section 239(4) IHTA provides:

> A certificate under this section ... shall not affect any further tax ...
> (aa) that may afterwards be shown to be payable by reason of too great an increase having been made under section 8A(3) above

This relates to the transferable nil-rate band.
Section 239(4) IHTA provides:

> A certificate under this section ... shall not affect any further tax ...
> (b) that may be payable if any further property is afterwards shown to have been included in the estate of a deceased person immediately before his death;

These limits to certificate protection do reduce the value of the certificate, though the onus of proof does shift to HMRC.

125.17.6 *Certificate protection: PRs*

HMRC practice provides a further relief for PRs who have an IHT certificate of discharge. IHTM provides:

> **IHTM30044: PETs: practice relating to PRs** [Sep 2018]
> ... The Law Societies of England and Scotland have expressed concern about the liability of personal representatives under IHTA84/S199 (2). In response HMRC have indicated that we 'will not actually pursue for inheritance tax personal representatives who
>
> - after making the fullest enquiries that are reasonably practicable in the circumstances to discover lifetime transfers, and so
> - having done all in their power to make full disclosure of them to the Board of HMRC
>
> have obtained a certificate of discharge and distributed the estate before a chargeable lifetime transfer comes to light.
> This statement of the Board's position is made without prejudice to the application in an appropriate case of IHTA84/S199 (2) Inheritance Tax Act 1984.'
> The quotation is from letters sent to the two Law Societies on 6 February 1991. It was published in the Law Society's Gazette dated 13 March 1991, page 17.

Although the heading refers to failed PETs, the same ought to apply to a lifetime chargeable transfer so far as additional tax is payable on death under s.199(2).

125.17.7 *Protection for purchaser*

A purchaser's protection under a certificate of discharge is unrestricted. Section 239(4) IHTA provides

> but in so far as the certificate shows any tax to be attributable to the value of any property it shall remain valid in favour of a purchaser of that property without notice of any fact invalidating the certificate.

125.17.8 *Discharge: Excepted estate*

Para 8 IHT (Delivery of Accounts) (Excepted Estates) Regulations 2004, which I abbreviate to **"EER 2004"**, provides a separate rule for excepted estates:[52]

> (1) Subject to paragraph (2) and regulation 9, if the information specified in regulation 6 has been produced in accordance with these Regulations, all persons shall on the expiration of the prescribed period[53] be discharged from any claim for tax on the value transferred

[52] See 125.7 (Excepted estates).

[53] Defined reg.1 EER 2004: "'the prescribed period' in relation to any person is the period beginning with that person's death and ending—

> by the chargeable transfer made on the deceased's death and attributable to the value of the property comprised in an excepted estate and any Inland Revenue charge for that tax shall then be extinguished.
>
> (2) Paragraph (1) shall not apply if within the prescribed period the Board issue a notice to—
>
> (a) the person or persons who would apart from these Regulations be required to deliver an account under section 216 of the 1984 Act, or
>
> (b) the solicitor or agent of that person or those persons who produced the specified information pursuant to regulation 6,
>
> requiring additional information or documents to be produced in relation to the specified information produced pursuant to regulation 6.

The difference between this and the IHT certificate of discharge is that discharge for an excepted estate comes automatically on the expiry of the prescribed period, unless HMRC issue a notice to require additional information. There is no need to apply for a certificate.

Unfortunately, reg 9 EER 2004 (more or less) undoes the benefit of the automatic discharge under reg 8:

> Regulation 8
>
> [1] shall not discharge any person from tax in the case of fraud or failure to disclose material facts and
>
> [2] shall not affect any tax that may be payable if further property is later shown to form part of the estate and, in consequence of that property, the estate is not an excepted estate.

This echoes s.239(4) IHTA.

125.17.9 *Informal IHT clearance*

The IHTM provides:

> **IHTM40001: Clearance certificates: summary** [May 2020]
> **...Non-statutory assurance**
> You should treat the non-statutory assurance (IHTM40151) given by standard letter SL135 in all respects as if the taxpayer had applied for and you had issued formal clearance on form IHT30. You should

(a) in England, Wales and Northern Ireland, 35 days after the making of the first grant of representation in respect of that person (not being a grant limited in duration, in respect of property or to any special purpose); or

(b) in Scotland, 60 days after the date on which confirmation to that person's estate was first issued".

> therefore consider the instructions in this section before you issue a non-statutory assurance.
>
> Once you have issued a non-statutory assurance you should treat any further developments on the case in accordance with the instructions in this section and on the basis that clearance has been given. This paragraph does not apply to Estate Duty cases.
>
> As the non-statutory assurance letter has the same effect as a formal clearance certificate there is no need for the taxpayer to request a certificate once it has been issued. However, if they choose to submit a form IHT30 you should still issue it if they have paid all the Inheritance Tax that is due.

There are two possible advantages in seeking a formal statutory clearance.

(1) This may extend the period of administration of the estate[54]

(2) If HMRC seek to resile from the clearance, the dispute is decided by the FTT and not by way of judicial review.

125.18 Inland Revenue charge

Section 237(1) IHTA provides:

> Except as otherwise provided, where any tax charged on the value transferred by a chargeable transfer, or any interest on it, is for the time being unpaid a charge for the amount unpaid (to be known as an Inland Revenue charge) is by virtue of this section imposed in favour of the Board on—
>
> (a) any property to the value of which the value transferred is wholly or partly attributable, and
>
> (b) where the chargeable transfer
>
> [i] is made by the making of a settlement or
>
> [ii] is made under Part III of this Act [settlements],
>
> any property comprised in the settlement.

One might refer to this as the "HMRC charge"; but it is better to use the statutory term.

Section 237(2) IHTA provides:

> References in subsection (1) above to any property include references to any property directly or indirectly representing it.

If there is an Inland Revenue charge on shares of a company, that does not extend to a charge on assets of the company, as the assets do not represent

[54] See 88.2 (Period of administration).

the shares.[55]

125.18.1 *IHT residential-property code*

Section 237(2A) IHTA provides:

> Where tax is charged by virtue of Schedule A1 on the value transferred by a chargeable transfer, the reference in subsection (1)(a) to property to the value of which the value transferred is wholly or partly attributable includes the UK residential property interest (within the meaning of that Schedule) to which the charge to tax relates.

In short, the Inland Revenue charge applies to:
(1) Sch A1 property
(2) The UK residential property interest to which the charge relates
(3) Property representing (1) and (2)

The drafter no doubt had in mind cases where:
(1) T (individual or trust) holds a company which holds a UK residence.
(2) T holds a relevant (de-excluded) loan.

What if T holds residence-securities? Sch A1 Q&As provide:

> *Example 13*
> A mother resident[56] in Hong Kong guarantees a loan from the bank to her son which is made in order to enable the son to buy a property in the UK. The mother gives security to the bank over non-UK investment assets and then dies.

The investment assets (security) are chargeable (de-excluded property) up to the value of the loan.

> On the death of the mother can HMRC impose a charge over the property owned by the son as security for the payment of IHT on the collateral even though the parent has no interest in the property and is not owed any money by the son and the son may not even inherit anything from his mother?
> *Suggested answer:* Correct

HMRC agree.

My own suggested answer is that the charge to tax does not relate to the land, so there is no Inland Revenue charge.

[55] See App 2.9.6 (Do shares represent co assets).
[56] Author’s footnote: It is assumed the mother is domiciled in Hong Kong.

125.18.2 *Charge on deceased's estate*

Section 237(3) IHTA provides:

> Where the chargeable transfer is made on death, personal or movable property situated in the UK which was beneficially owned by the deceased immediately before his death and vests in his personal representatives is not subject to the Inland Revenue charge;

A Residence-company is not usually UK situate so this exemption will not apply. But it might apply in the case of a UK situate relevant loan.

125.18.3 *PETs*

Section 237(3A) IHTA provides:

> In the case of a potentially exempt transfer which proves to be a chargeable transfer—
> (a) property concerned,[57] or an interest in property concerned, which has been disposed of to a purchaser before the transferor's death is not subject to the Inland Revenue charge, but
> (b) property concerned which has been otherwise disposed of before the death and property which at the death represents any property or interest falling within paragraph (a) above shall be subject to the charge...

125.18.4 *Priority of charge*

Section 237(5) IHTA provides:

> The Inland Revenue charge imposed on any property shall take effect subject to any incumbrance on it which is allowable as a deduction in valuing that property for the purposes of the tax.

There are, at least in theory, problems for mortgagees where the debt is not deductible for IHT purposes, but perhaps in practice the issue will not arise.

125.18.5 *Purchase of charged property*

Section 237(6) IHTA provides:

[57] Subsection 3A provides a definition: "... in this subsection "property concerned" means property to the value of which the value transferred by the transfer is wholly or partly attributable."

> Except as provided by section 238 below [purchase of charged property], a disposition of property subject to an Inland Revenue charge shall take effect subject to that charge.

Section 238(1) IHTA provides:

> Where property subject to an Inland Revenue charge, or an interest in such property, is disposed of to a purchaser, then if at the time of the disposition[58]—
>
> (a) in the case of land in England and Wales, the charge was not registered as a land charge or, in the case of registered land, was not protected by notice on the register, or
>
> (b) [i] in the case of land in Northern Ireland the title to which is registered under the Land Registration Act (Northern Ireland) 1970, the charge
>
> [A] was not entered as a burden on the appropriate register maintained under that Act or
>
> [B] was not protected by a caution or inhibition under that Act or,
>
> [ii] in the case of other land in Northern Ireland, the purchaser had no notice of the facts giving rise to the charge, or
>
> (c) in the case of
>
> [i] personal property situated in the UK other than such property as is mentioned in paragraph (a) or (b) above,[59]
>
> [ii] and of any property situated outside the UK,
>
> the purchaser had no notice of the facts giving rise to the charge, or
>
> (d) in the case of any property,
>
> [i] a certificate of discharge had been given by the Board under section 239 below and
>
> [ii] the purchaser had no notice of any fact invalidating the certificate,
>
> the property or interest shall then cease to be subject to the charge

[58] In this section "the time of the disposition" means—
(a) in relation to registered land—
(i) if the disposition is required to be completed by registration, the time of registration, and
(ii) otherwise, the time of completion, and
(b) in relation to other property, the time of completion."

[59] The reference to personal property "other than such property as is mentioned in paragraph (a) or (b) above" is strange, as the property mentioned in (a)and (b) is land, not personal property; but it does not matter.

> but the property for the time being representing it shall be subject to it.

125.18.6 *Time limit for purchasers*

Section 238(2) IHTA provides:

> Where property subject to an Inland Revenue charge, or an interest in such property, is disposed of to a purchaser in circumstances where it does not then cease to be subject to the charge, it shall cease to be subject to it at the end of the period of six years beginning with the later of—
>
> (a) the date on which the tax became due, and
>
> (b) the date on which a full and proper account of the property was first delivered to the Board in connection with the chargeable transfer concerned.

The IHT Manual provides:

> **IHTM30125 Liability: Liability In Special Cases: Liability Of Purchaser** [May 2020]
>
> ... The term 'notice' in IHTA/S238(1)(c) is considered to have a wide meaning and it is not limited to cases where, for example, an actual notice was given to purchaser. It will include cases where a purchaser acquires business property where they are aware that the property was given away less than 7 years prior to their purchase. In such cases the statutory charge created by IHTA84/S237 will apply to the business property in the hands of the purchaser if the tax remains unpaid by either the transferee or personal representatives.
>
> However, this extension of liability to a purchaser only applies where the lifetime transfer was a chargeable transfer when made (IHTM04067) – most commonly this will be where relevant business property has been transferred to the trustees of a relevant property trust. The extension does not apply to a purchaser where the lifetime transfer was a potentially exempt transfer (PET) (IHTM04057) which later falls into charge by reason of death within seven years. This is because IHTA84/S237(3A)(a) excludes a PET, where the transferee has subsequently sold the gifted property, from the charge. Instead, the charge applies to the proceeds of the sale, or any other property representing the gifted property. But the charge does apply to the property given away by a PET where the transferee has disposed of the property otherwise than by a sale.
>
> It should only be in exceptional circumstances that you should need to consider recovering the tax from a purchaser or other subsequent owner

of gifted property. You should make every effort to recover the tax from the transferee, or person in whom the gifted property was vested and follow the instruction at IHTM30044 if there is any prospect that you may need to have recourse to the personal representatives. In the very rare case where it appears that there may be difficulty in recovering the tax from both the transferee and the personal representatives, you should warn the purchaser of their potential liability as soon as it is apparent that it may be necessary to have to recourse to them.

CHAPTER ONE HUNDRED AND TWENTY SIX

PENALTIES

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126.1 Penalties: Introduction

This chapter discusses a set of seven penalties:

Topic	**Provision**[1]	**See para**
Error-based penalties ("sch 24 rules")	*Sch 24 FA 07*	
Error in document	Para 1	126.2
Error due to 3rd party	Para 1A	126.3
Uncorrected assessment	Para 2	126.4
Failure by omission	-	
Failure to notify liability	Para 1 sch 41 FA 08	126.5
Failure to make return	Para 1 sch 55 FA 09	126.6
Asset-based penalties	Para 1 sch 22 FA 16	126.7
Requirement to correct (RTC)[2]	Para 1 sch 18 F2A 17	126.8
GAAR penalties	s.212A, 212B FA 13	126.52

I also discuss a related topic, publication of defaulters.

Penalties are scattered across about a dozen statutes and statutory instruments, with repetition and near-repetition making a statute-focussed discussion more difficult, though no less necessary.

I use the term **"penalty template wording"** to describe provisions (often, definitions) which are the same or substantially the same across the different penalty codes, and where possible I set out such wording once only.

A consolidation might assist - if the current law was judged to be stable. Another feature of the law has been frequent amendment, and statutory amendments as far back as FA 2015 have yet come into force - if they ever will.[3]

This chapter is mainly a sketch of the "top 7" penalties. Penalties are, I think, more litigated than any other topic. Presumably HMRC's customers object to paying them. So there is a substantial case law. A full discussion needs a book to itself.

[1] For the sake of brevity, I abbreviate statutory references as indicated in this table.

[2] This penalty is also called Failure to Correct (FTC).

[3] See, for example, changes yet to be applied to Schedule 21, FA 2015.

HMRC guidance is in the Compliance Handbook; I do not discuss that here. I do consider some RTC guidance, which I call:

- "**HMRC RTC guidance**"[4]
- "**CIOT RTC guidance**"[5]

The 2023/24 edition of this work para 123.51 (EU-law compliance) discussed EU law issues, but after Brexit this may not arise.

126.2 Error in taxpayer document

This is the most important of the three sch 24 penalties.

Para 1(1) sch 24 FA 07 provides:

> A penalty is payable by a person (P) where–
> (a) P gives HMRC a document of a kind listed in the Table below, and
> (b) Conditions 1 and 2 are satisfied.

When statute refers to "a penalty under para 1", I gloss that as an **"error in document"**, though that is not a completely accurate label.

The conditions are:

Condition	**Requirement**
1	Inaccuracy requirement
2	Culpability requirement

Para 1 sch 24 FA 07 provides:

> (2) Condition 1 is that the document contains an inaccuracy which amounts to, or leads to–
> (a) an understatement of a liability to tax,
> (b) a false or inflated statement of a loss, or
> (c) a false or inflated claim to repayment of tax.
> (3) Condition 2 is that the inaccuracy was careless (within the meaning of paragraph 3) or deliberate on P's part.

[4] *https://www.gov.uk/guidance/requirement-to-correct-tax-due-on-offshore-assets*

[5] CIOT, "Requirement to Correct Offshore Tax Non-Compliance - Practical Notes for CIOT and ATT members" (2018) *https://assets-eu-01.kc-usercontent.com/220a4c02-94bf-019b-9bac-51cdc7bf0d99/466bd776-586a-4de1-9471-d090407c3432/180829%20Practical%20Note%20for%20CIOT%20&%20ATT%20Members%20-%20Requirement%20to%20Correct%20-%20Updated%20180914.pdf*

126.2.1 *Sch 24 Table*

There about 50 items in the Table[6] ("the sch 24 Table"), including IT/CGT/CT returns, IHT Accounts, and concluding with:

> Any document which is likely to be relied upon by HMRC to determine, without further inquiry, P's liability to tax...

So most documents provided to HMRC will fall within the sch 24 Table. Para 12(1) sch 24 FA 07 provides one exception:

> The final entry in the Table in paragraph 1 excludes a document in respect of which a penalty is payable under section 98 of TMA 1970 (special returns).

I hope to deal with s.98 in a future edition.

126.2.2 *Multiple inaccuracies*

Para 1(4) sch 24 FA 07 provides:

> Where a document contains more than one inaccuracy, a penalty is payable for each inaccuracy.

126.3 Error due to 3rd party

Para 1A sch 24 FA 07 provides:

> (1) A penalty is payable by a person (T) where –
> (a) another person (P) gives HMRC a document of a kind listed in the Table in paragraph 1 [the sch 24 Table[7]],
> (b) the document contains a relevant inaccuracy, and
> (c) the inaccuracy was attributable
> [i] to T deliberately supplying false information to P (whether directly or indirectly), or
> [ii] to T deliberately withholding information from P,
> with the intention of the document containing the inaccuracy.

This penalty only arises if the 3rd party (T) acts deliberately: carelessness is not enough.
"Deliberate" is not defined.
Clearly, T acts deliberately if:

[6] I follow the statute which generally writes Table with an initial capital (though lower case *t* is used in sch 22 FA 16).

[7] See 126.2.1 (Sch 24 Table).

(1) T supplies information which T knows is false; or
(2) T withholds information which T knows is needed, ie T knows that the consequence of withholding is that P will submit an inaccurate return.

It is considered that recklessness would suffice.[8] T acts deliberately if:
(1) (a) T supplies information which T knows may be false; or
(b) T withholds information which T knows may be needed; and
(2) The risk is an unjustifiable one

The risk is in principle unjustifiable if T intentionally chose not to investigate the position. T does not act deliberately if T takes reasonable care to ensure that information supplied is true/information withhold is not needed; even if T knows it is possible that may be wrong.

In addition, T must have the intention of the document containing the inaccuracy; but if T acts deliberately, that is likely to be the case.

126.3.1 *Relevant inaccuracy*

Para 1A(2) sch 24 FA 07 provides a commonsense definition:

> A "relevant inaccuracy" is an inaccuracy which amounts to, or leads to –
> (a) an understatement of a liability to tax,
> (b) a false or inflated statement of a loss, or
> (c) a false or inflated claim to repayment of tax.

That is the equivalent to the inaccuracy requirement in para 1 condition 1.

126.3.2 *Interaction of para 1/1A*

Para 1A(3) sch 24 FA 07 provides:

> A penalty is payable under this paragraph in respect of an inaccuracy whether or not P is liable to a penalty under paragraph 1 in respect of the same inaccuracy.

For the para 1A penalty, it does not matter that the taxpayer (P) is acting with reasonable care (so that P is not subject to a penalty). Indeed, that will normally be the case, because it is envisaged the third party (T) has supplied false information to P (or T has failed to provide information to P). But it is possible that both T and P are at fault. It may be that P

[8] See 121.17.3 (Recklessness).

should have noticed that information was wrong, or lacking.

Para 12 sch 24 FA 07 provides:

> (4) Where penalties are imposed under paragraphs 1 and 1A in respect of the same inaccuracy, the aggregate of the amounts of the penalties must not exceed the relevant percentage of the potential lost revenue.
> (5) The relevant percentage is—
> (za) if the penalty imposed under paragraph 1 is for an inaccuracy in category 0, 100%,[9]
> (a) if the penalty imposed under paragraph 1 is for an inaccuracy in category 1, 125%,
> (b) if the penalty imposed under paragraph 1 is for an inaccuracy in category 2, 150%, and
> (c) if the penalty imposed under paragraph 1 is for an inaccuracy in category 3, 200%.

In tabular format (ignoring category 0, which is supposed to be forthcoming):

Category	**Penalty cap**
1	125%
2	150%
3	200%

126.4 Uncorrected assessment

Para 2(1) sch 24 FA 07 provides:

> A penalty is payable by a person (P) where –
> (a) an assessment[10] issued to P by HMRC understates P's liability to a relevant tax[11] and
> (b) P has failed to take reasonable steps to notify HMRC, within the period of 30 days beginning with the date of the assessment, that it is an under-assessment.

If the taxpayer has made a careless mistake, penalties arise under para 1.

[9] There is at present no category 0.

[10] Para 2(4) provides: "In this paragraph (and in Part 2 of this Schedule so far as relating to this paragraph) –
(a) "assessment" includes determination, and
(b) accordingly, references to an under-assessment include an under-determination."

[11] Para 2(3) provides: In sub-paragraph (1) "relevant tax" means any tax mentioned in the Table in paragraph 1.

So this penalty primarily arises where HMRC have made a mistake: the taxpayers is under a duty to assist HMRC by pointing this out.

What is reasonable cannot sensibly be defined, but the drafter has a go. Para 2(2) sch 24 FA 07 provides:

> In deciding what steps (if any) were reasonable HMRC must consider–
> (a) whether P knew, or should have known, about the under-assessment, and
> (b) what steps would have been reasonable to take to notify HMRC.

126.5 Failure to notify liability

Para 1 sch 41 FA 08 provides:

> A penalty is payable by a person (P) where P fails to comply with an obligation specified in the Table below (a "relevant obligation").

This Table ("the sch 41 Table") has 9 items. The items relevant to this work concern the duty to notify liability to IT/CGT/CT:

Tax	**Obligation**	**See para**
IT/CGT	s.7 TMA	121.2
CT	Para 2 sch 18 FA 1998	121.2

Failure to notify would not fall within para 1 sch 24 (error in document), because the taxpayer does not give any document to HMRC.

126.6 Failure to make return

Para 1(1) sch 55 FA 09 provides:

> A penalty is payable by a person ("P") where P fails to make or deliver a return,[12] or to deliver any other document, specified in the Table below on or before the filing date.[13]

[12] Para 1(4) provides commonsense definitions: "(5) In the provisions of this Schedule which follow the Table-
(a) any reference to a return includes a reference to any other document specified in the Table, and
(b) any reference to making a return includes a reference to delivering a return or to delivering any such document."

[13] Para 1(4) provides a commonsense definition: "In this Schedule "filing date" , in relation to a return or other document, means the date by which it is required to be made or delivered to HMRC".

126.6.1 *Sch 55 Table*

This Table ("the sch 55 Table") has 20 items, numbered non-numerically from 1 to 29. The items most relevant to this work are:[14]

No.	Tax	Requirement	Provision	See para
1(a)	IT/CGT	Return	s.8(1)(a) TMA 1970	121.4
(b)		Documents	s.8(1)(b) TMA 1970	121.4
2(a)	IT/CGT	Return	s.8A(1)(a) TMA 1970	121.4
(b)		Documents	s.8A(1)(b) TMA 1970	121.4
2A	CGT	Return	Sch 2 FA 2019 (except para 9, 15)	
3(a)	IT/CT	Return	s.12AA(2)(a), (3)(a) TMA	
(b)		Documents	s.12AA(2)(b), (3)(b) TMA	
4	IT	Return	Reg 67B, 67D PAYE Reg	
7	CT	Return	Para 3 sch 18 FA 1998	
8	IHT	Account	s.216, 217 IHTA	125.5, 125.11

126.6.2 *Trustees: Who is P?*

In *Trustees of the Paul Hogarth Life Interest Trust v HMRC:*[15]

> Section 8A(1) TMA allows HMRC to issue a notice to any relevant trustee to complete a tax return, and HMRC may issue a notice to each trustee (if more than one) or to any one or more trustees, but only if they are relevant trustees, and the pool of relevant trustees are those people described in s 7(9) who are relevant trustees in relation to the tax year for which the return is required. It follows that the trustee or trustees to whom the notice to file is in fact issued is or are P.

126.7 Asset-based penalty

Para 1(1) Sch 22 FA 16 provides:

> An asset-based penalty is payable by a person (P) where—
> (a) one or more standard offshore tax penalties have been imposed on P in relation to a tax year (see paragraphs 2 and 3), and
> (b) the potential lost revenue threshold is met in relation to that tax year (see paragraph 4).

126.7.1 *"Standard offshore tax penalty"*

Para 2(1) Sch 22 FA 16 provides:

[14] For brevity I have slightly abbreviated the wording of the statute.

[15] [2018] UKFTT 595 (TC) at [21].

> A standard offshore tax penalty is a penalty that falls within sub-paragraph (2), (3) (4) or (4A).

Thus there are four categories standard offshore tax penalty:

Category	**Para 2 sub-para**
Error in document	(2)
Failure to notify chargeability	(3)
Failure to make return	(4)
RTC	(4A)

It is helpful to read these side by side:

(2) A penalty falls within this sub-paragraph if-	(3) A penalty falls within this sub-paragraph if-	(4) A penalty falls within this sub-paragraph if-	(4A) A penalty falls within this paragraph if-
(a) it is imposed under paragraph 1 of Schedule 24 to FA 07 (inaccuracy in taxpayer's document),	(a) it is imposed under paragraph 1 of Schedule 41 to FA 08 (penalty for failure to notify),	(a) it is imposed under paragraph 6 of Schedule 55 to FA 09 (penalty for failure to make return more than 12 months after filing date),	(a) it is imposed on a person under paragraph 1 of Schedule 18 to F(no.2)A[16] 2017 (requirement to correct relevant offshore tax non-compliance),
(b) the inaccuracy for which the penalty is imposed involves an offshore matter or an offshore transfer,	(b) the failure for which the penalty is imposed involves an offshore matter or an offshore transfer,	(b) it is imposed for the withholding of information involving an offshore matter or an offshore transfer,	
(c) it is imposed for deliberate action (whether concealed or not), and	(c) it is imposed for a deliberate failure (whether concealed or not), and	(c) it is imposed for a deliberate withholding of information (whether concealed or not),	(b) the person was aware at any time during the RTC period that at the end of the 2016-17 tax year

[16] Sch 22 FA 2016 consistently refers to "FA 2017" but the reference should be Finance (no.2) Act 2017, so for clarity I correct this to F(no.2)A 2017.

		and	P had relevant offshore tax non-compliance to correct, and
(d) the tax at stake is (or includes) capital gains tax, inheritance tax or asset-based income tax.	(d) the tax at stake is (or includes) capital gains tax or asset-based income tax.	(d) the tax at stake is (or includes) capital gains tax, inheritance tax or asset-based income tax.	(c) the tax at stake is (or includes) capital gains tax, inheritance tax or asset-based income tax.

Para 2 sch 22 FA 16 then deals with apportionment:

> (5) In a case where the inaccuracy, failure or withholding of information for which a penalty is imposed involves both an offshore matter or an offshore transfer and a domestic matter, the standard offshore tax penalty is only that part of the penalty that involves the offshore matter or offshore transfer.
> (5A) Sub-paragraph (5) does not apply to a penalty imposed under paragraph 1 of Schedule 18 to F(no.2)A 2017.
> (6) In a case where the tax at stake in relation to a penalty includes a tax other than capital gains tax, inheritance tax or asset-based income tax, the standard offshore tax penalty is only that part of the penalty which relates to capital gains tax, inheritance tax or asset-based income tax.

126.7.2 *Asset-based IT*

Para 2(7) sch 22 FA 16 provides:

> "Asset-based income tax" means income tax that is charged under any of the provisions mentioned in column 1 of the table in paragraph 13(2).

This Table ("the sch 22 Table") has 10 items:[17]

ITTOIA Provision: Topic	**Asset**
Part 3 ITTOIA Chap	
3,7,10: Property business	The estate, interest or right in or over the land that generates the income for the business (see ss 264 to 266 ITTOIA)

[17] For clarity I set this out in tabular form and in the first two columns use my own terminology, rather than a precise quote of the statute.

8: s.12(4) concern	The estate, interest or right in or over the land that generates the rent receivable in connection with a UK s.12(4) concern (see ss 335, 336 ITTOIA)
Part 4 ITTOIA Chap	
2/2A: Interest	The asset that generates the interest
3 - 5: Dividends etc	The shares or other securities in relation to which the dividend or distribution is paid
7: Purchased life annuity	The annuity that gives rise to the payments
8: Deeply discounted security	The deeply discounted securities that are disposed of (see ss 427 - 430 ITTOIA)
9: Life policies, etc	The policy or contract from which the gain is treated as arising
11: Transaction in deposits	The deposit right which is disposed of (see ss 551, 552 ITTOIA)
Part 5 ITTOIA Chap	
2: Intellectual property	The intellectual property, knowhow or patent rights which generate the income (see ss 579, 583, 587 ITTOIA)
4:Telecommunications	The relevant telecommunication right from which the income derives (see s.614 ITTOIA)
5: Settlor-interested trust	The settlement which gives rise to the income or capital sums treated as income of a settlor

126.7.3 *Tax year relating to penalty*

Para 3 Sch 22 FA 16 provides:

> (1) Where a standard offshore tax penalty is imposed under paragraph 1 of Schedule 24 to FA 07, the tax year to which that penalty relates is-
>
> (a) if the tax at stake as a result of the inaccuracy is income tax or capital gains tax, the tax year to which the document containing the inaccuracy relates;
>
> (b) if the tax at stake as a result of the inaccuracy is inheritance tax, the year, beginning on 6 April and ending on the following 5 April, in which the liability to tax first arose.
>
> (2) Where a standard offshore tax penalty is imposed under paragraph 1 of Schedule 41 to FA 08 for a failure to comply with an obligation specified in the table in that paragraph, the tax year to which that penalty relates is the tax year to which the obligation relates.
>
> (3) Where a standard offshore tax penalty is imposed under paragraph 6 of Schedule 55 to FA 09 for a failure to make a return or deliver a document specified in the table of paragraph 1 of that Schedule, the tax year to which that penalty relates is-

(a) if the tax at stake is income tax or capital gains tax, the tax year to which the return or document relates;

(b) if the tax at stake is inheritance tax, the year, beginning on 6 April and ending on the following 5 April, in which the liability to tax first arose.

(4) Where a standard offshore penalty is imposed under paragraph 1 of Schedule 18 to F(no.2)A 2017, the tax year to which that penalty relates is-

(a) if the tax at stake in relation to the uncorrected relevant offshore tax non-compliance is income tax or capital gains tax, the tax year or years to which the failure or inaccuracy constituting the relevant offshore tax non-compliance in question relates;

(b) if the tax at stake in relation to the uncorrected relevant offshore tax non-compliance is inheritance tax, the year, beginning on 6 April and ending on the following 5 April, in which the liability to tax first arose.

(5) In sub-paragraph (4) references to uncorrected relevant offshore tax non-compliance are to the relevant offshore tax non-compliance in respect of which the standard offshore penalty is imposed.

126.7.4 *PLR threshold*

Para 4(1) Sch 22 FA 16 provides:

The potential lost revenue threshold is reached where the offshore PLR in relation to a tax year exceeds £25,000.

126.7.5 *Multiple asset-based penalties*

Para 6 sch 22 FA 16 provides:

(1) Sub-paragraphs (2) and (3) apply where-

(a) a standard offshore tax penalty (other than one imposed under paragraph 1 of Schedule 18 to F2A 2017) has been imposed on P, and

(b) the potential lost revenue threshold is met,

in relation to more than one tax year falling within the same investigation period.

(2) Only one asset-based penalty is payable by P in the investigation period in relation to any given asset.

(3) The asset-based penalty is to be charged by reference to the tax year in the investigation period with the highest offshore PLR.

(4) An "investigation period" is-

> (a) the period starting with the day on which this Schedule comes into force and ending with the last day of the last tax year before P was notified of an asset-based penalty in respect of an asset, and
> (b) subsequent periods beginning with the day after the previous period ended and ending with the last day of the last tax year before P is notified of a subsequent asset-based penalty in respect of the asset,
>
> and different investigation periods may apply in relation to different assets.

126.8 RTC penalty

Para 1 sch 18 F2A 17 provides:

> A penalty is payable by a person who-
> (a) has any relevant offshore tax non-compliance to correct at the end of the tax year 2016-17, and
> (b) fails to correct the relevant offshore tax non-compliance within the period beginning with 6 April 2017 and ending with 30 September 2018 (referred to in this Schedule as "the RTC period").

The RTC code applies for years up to 2015/16. It does not apply to the year 2016/17 because at the end of that year (ie at 5 April 2016) there could not yet be anything to correct.

I consider the terms "relevant offshore tax non-compliance" and "failure to correct" separately, later in this chapter.[18]

The RTC code also provided an extended time limit (up to 5 April 2021) for assessments.[19]

While the RTC code is strictly of historical interest only, RTC penalties will continue to occupy practitioners for some years, as non-compliance comes home to roost, so the topic is considered in detail here.

126.8.1 *2018 reporting deadline*

HMRC RTC guidance provides:

> 30 September 2018 was chosen as the final date for corrections as this is the date by which more than 100 countries will exchange data on financial accounts under the Common Reporting Standard.

[18] See 126.39 (RTC Definitions).

[19] See 121.19 (RTC time limit: 5/4/21).

HMRC RTC guidance provided a minor extension:

> You will not be liable to penalties for failing to correct by 30 September 2018 in the following limited circumstances where information is provided later:
>
> - if by midnight on 30 September 2018 you notify your intention to make a disclosure via HMRC's Worldwide Disclosure Facility (WDF) ...
> - or before 30 September 2018 you email a completed form CDF1 to HMRC ... and inform HMRC that you wish to make a disclosure of deliberate behaviour involving offshore tax non-compliance ...
> - HMRC is already undertaking any enquiry or intervention[20] into your affairs and on or before 30 September 2018 you inform the person conducting the enquiry that you wish to make a disclosure of offshore tax non-compliance...[21]

Although the 2018 deadline has passed, and the extended deadline for assessment expires on 5 April 2021, penalties will continue to be imposed as pre-2018 omissions come to light, so the law will continue to be important.

126.9 Culpability definitions

126.9.1 *Significance of culpability*

Culpability is relevant to whether a penalty is due, and to the amount of a penalty if one is due. There are broadly four levels of culpability. In summary:

	Careless	Reasonable excuse	Deliberate not concealed	Deliberate & concealed
Error in document	x		x	x
3rd party error			x	x
Uncorrected assessment	Reasonable steps			
Failure to notify			x	x

[20] CIOT RTC guidance states this includes COP8 (fraud) investigations.

[21] I set out this statement in full in the 2019/20 edition of this work, but abbreviate it here as these details are now becoming less important.

Failure to make return	x	x	x
Asset-based penalty		x	
RTC	x		

126.9.2 *Careless: Definition*

For the definition of careless, see 121.15 (6 year limit: Carelessness). Certain inaccuracies are deemed to be careless where the person is subject to a special measures notice.[22] This topic is not discussed here.

126.9.3 *Deliberate/concealed: Definition*

The definitions are effectively the same, with minor differences of wording and clause order:

Para 3 sch 24 FA 07	**Para 5 sch 41FA 08**	**Para 27 Sch 55 FA 09**
(1) For the purposes of a penalty under paragraph 1, inaccuracy in a document given by P to HMRC is ...	(1) A failure by P to comply with a relevant obligation is- ...	(2) The withholding of information by P is—...
(b) "deliberate but not concealed" if the inaccuracy is deliberate on P's part but P does not make arrangements to conceal it	(b) "deliberate but not concealed" if the failure is deliberate but P does not make arrangements to conceal the situation giving rise to the obligation.	(b) "deliberate but not concealed" if P deliberately withholds the information but does not make arrangements to conceal the fact that the information has been withheld.
(c) "deliberate and concealed" if the inaccuracy is deliberate on P's part and P makes arrangements to conceal it (for example, by submitting false evidence in support of an inaccurate figure)	(a) "deliberate and concealed" if the failure is deliberate and P makes arrangements to conceal the situation giving rise to the obligation	(a) "deliberate and concealed" if P deliberately withholds the information and makes arrangements to conceal the fact that the information has been withheld

[22] Para 47 sch 19 FA 16.

See 121.17.2 (“Deliberate” inaccuracy).

126.10 Reasonable excuse

126.10.1 *Reasonable excuse: Significance*

Para 23(1) sch 55 FA 09	**Para 23(1) sch 18 F2A 17**
Liability to a penalty under any paragraph of this Schedule does not arise in relation to a failure to make a return if P satisfies HMRC or (on appeal) the First-tier Tribunal or Upper Tribunal that there is a reasonable excuse for the failure.	Liability to a penalty under paragraph 1 [RTC penalty] does not arise in relation to a particular failure to correct any relevant offshore tax non-compliance within the RTC period if the person concerned (P) satisfies HMRC or the relevant tribunal (as the case may be) that there is a reasonable excuse for the failure.

For RTC, the date of the failure to correct is 30 September 2018, so that is the date on which there must be a reasonable excuse for the failure.

126.10.2 *Reasonable excuse: Definition*

Apart from the statutory provisions, there is no difference between reasonable excuse and carelessness, which is also a reasonableness test. Perhaps the term “reasonable excuse” is preferred because it seems wrong to put the onus of proof on the individual to show that they were not careless?

There is no general definition, but certain matters are deemed not to be a reasonable excuse. The exclusions mostly concern matters which would probably not be reasonable excuses in any event, ie they are only for the avoidance of doubt. So they set a standard of reasonableness which can be regarded as a fair one.

Archer v HMRC[23] adopted the same general approach to establishing whether a taxpayer has made out a reasonable excuse for s.118(2) TMA purposes as for the penalty regime.

126.10.3 *Tribunal approach*

Perrin v HMRC set out a recommended process for considering whether

[23] [2022] UKUT 61 (TCC) .

a person has a reasonable excuse:[24]

> (1) First, establish what facts the taxpayer asserts give rise to a reasonable excuse (this may include the belief, acts or omissions of the taxpayer or any other person, the taxpayer's own experience or relevant attributes, the situation of the taxpayer at any relevant time and any other relevant external facts).
> (2) Second, decide which of those facts are proven.
> (3) Third, decide whether, viewed objectively, those proven facts do indeed amount to an objectively reasonable excuse for the default and the time when that objectively reasonable excuse ceased. In doing so, the Tribunal should take into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times. It might assist the Tribunal, in this context, to ask itself the question "was what the taxpayer did (or omitted to do or believed) objectively reasonable for this taxpayer in those circumstances?"
> (4) Fourth, having decided when any reasonable excuse ceased, decide whether the taxpayer remedied the failure without unreasonable delay after that time. In doing so, the Tribunal should again decide the matter objectively, but taking into account the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times.

That seems obvious, but perhaps it is helpful to see it expressed.

There have been thousands of reasonable excuse cases, and I do not attempt to review them here.

126.10.4 *Insufficiency of funds*

Para 23(1)(a) sch 55 FA 09/Para 23(2) sch 18 F2A 17 provides:

> an insufficiency of funds is not a reasonable excuse, unless attributable to events outside P’s control

126.10.5 *Unreasonable reliance*

Para 23(1)(b) sch 55 FA 09/Para 23(2) sch 18 F2A 17 provides:

> where P relied on any other person to do anything, that cannot be a reasonable excuse unless P took reasonable care to avoid the failure

That seems obvious and otiose, but it does no harm.

[24] [2018] UKUT 156 at [81].

126.10.6 *Ignorance of law*

In *Perrin v HMRC*:[25]

> One situation that can sometimes cause difficulties is when the taxpayer's asserted reasonable excuse is purely that he/she did not know of the particular requirement that has been shown to have been breached. It is a much-cited aphorism that "ignorance of the law is no excuse", and on occasion this has been given as a reason why the defence of reasonable excuse cannot be available in such circumstances. We see no basis for this argument. Some requirements of the law are well-known, simple and straightforward but others are much less so. It will be a matter of judgment for the FTT in each case whether it was objectively reasonable for the particular taxpayer, in the circumstances of the case, to have been ignorant of the requirement in question, and for how long.

126.10.7 *Excuse ceases*

Para 23(1)(c) sch 55 FA 09/Para 23(2) sch 18 F2A 17 provides:

> where P had a reasonable excuse but the excuse has ceased, P is to be treated as continuing to have the excuse if the failure is remedied without unreasonable delay after the excuse ceased

Contrast 121.15.2 (Failure to correct error).

126.11 Disqualified advice codes

The expression “disqualified advice” is relevant to two penalties. I coin the following terminology:

Code (my terminology)	**Penalty**	**Provision**
Sch 24 disqualified advice code	Error in document	Para 3A, 3B sch 24 FA 07
Sch 18 disqualified advice code	RTC	Para 23(2)(d) sch 18 F2A 17

There are differences in the scope of the rules, and they are best considered as two distinct codes, albeit with substantial overlap. The most important difference is that para 3A sch 24 FA 07 begins:

> (1) This paragraph applies where a document of a kind listed in the Table in paragraph 1 [the sch 24 Table[26]] is given to HMRC by a person (“P”) and the document contains an inaccuracy which –

[25] [2018] UKUT 156 at [82].

[26] See 120.2.1 (Sch 24 Table).

(a) falls within paragraph 1(2) [causes a loss of tax][27], and
(b) arises because the document is submitted on the basis that particular avoidance arrangements (within the meaning of paragraph 3B) had an effect which in fact they did not have.

So:

(1) The sch 24 disqualified advice code only applies when there are (unsuccessful) Avoidance Arrangements.

(2) The RTC code does not have the equivalent provision. As will be seen, *parts* of the RTC disqualified advice code apply only in the case of Avoidance Arrangements; but other parts apply even in the absence of Avoidance Arrangements. Of course, the RTC code only applies if there is offshore tax non-compliance, but that need not involve Avoidance Arrangements.

The rules overlap with and reinforce general principles of when a taxpayer can properly rely on advice; see 121.15.7 (Relying on advisers).

126.11.1 *Avoidance Arrangements*

The definitions are essentially the same in both codes:

Para 3B sch 24 FA 07	**Para 23(6) sch 18 F2A 17**
(1) In paragraph 3A "avoidance arrangements" means, subject to sub-paragraph (3), arrangements which fall within sub-paragraph (2).	
(2) Arrangements[28] fall within this sub-paragraph if, having regard to all the circumstances, it would be reasonable to conclude[29] that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements.	In this paragraph "avoidance arrangements" means arrangements as respects which, in all the circumstances, it would be reasonable to conclude that their main purpose, or one of their main purposes, is the obtaining of a tax advantage.

Para 3B(10) sch 24 FA 07/Para 23(9) sch 18 F2A 17 provide something

[27] See 126.2 (Error in taxpayer document). Disqualified advice is not relevant in relation to the penalties in para 1A and 2 (3rd party errors and uncorrected assessments).

[28] Para 3A(9) sch 24 FA 07/Para 23(9) sch 18 F2A 17 provide the standard (unnecessary) IT definition: see App 2.2.3 (Definitions of "arrangement").

[29] See App 2.24 (Reasonable-to-assume).

close to the GAAR definition of tax advantage.[30]

The terminology ("avoidance arrangements") is tendentious because the arrangements need not constitute "avoidance" in the strict sense of the word. I write Avoidance Arrangements with initial capitals to reflect the technical nature of the expression. But the concept is a familiar one.[31]

126.11.2 *Established practice*

Para 3B(3) sch 24 FA 07	**Para 23(7) sch 18 F2A 17**
Arrangements are not avoidance arrangements for the purposes of paragraph 3A if (although they fall within sub-paragraph (2))—	But arrangements are not avoidance arrangements for the purposes of this paragraph if (although they fall within sub-paragraph (6))-
(a) they are arrangements which accord with established practice, and	[Identical]
(b) HMRC had, at the time the arrangements were entered into, indicated its acceptance of that practice.	[Identical]

I refer to this as the "**established-practice defence**".[32]

HMRC RTC guidance provides:

> There will be cases where HMRC have agreed the correct treatment for an issue (for example during the course of an enquiry, via a ruling or through discussion with a CRM).
>
> Provided there has been no material change to the relevant facts or legislation and that all relevant information requested at the time was provided, HMRC will accept that any returns subsequently submitted in line with the agreed treatment were made in accordance with established practice and the arrangements concerned will not be considered avoidance arrangements for the purposes of the RTC. This is in line with the acceptance of established practice in relation to advice from an interested person.

[30] See 3.19.1 (Tax advantage: Definitions). For completeness, the term is extended to include:

> (g) in relation to VAT, anything which is a tax advantage for the purposes of Schedule 18 to FA 16 under paragraph 5 of that Schedule.

VAT is not discussed here.

[31] See 3.19 ("Tax advantage").

[32] See 121.9.3 (Prevailing practice defence).

126.11.3 *Avoidance arrangements: Significance*

The rule is in para 3A(2) but it needs to be read with para (1) to follow the sense:

> (1) This paragraph applies where a document of a kind listed in the Table in paragraph 1 [the sch 24 Table[33]] is given to HMRC by a person ("P") and the document contains an inaccuracy which –
>
> (a) falls within paragraph 1(2) [causes a loss of tax][34], and
>
> (b) arises because the document is submitted on the basis that particular avoidance arrangements (within the meaning of paragraph 3B) had an effect which in fact they did not have.
>
> (2) It is to be presumed that the inaccuracy was careless, within the meaning of paragraph 3, unless –
>
> (a) the inaccuracy was deliberate on P's part, or
>
> (b) P satisfies HMRC or (on an appeal notified to the tribunal[35]) the tribunal that P took reasonable care to avoid inaccuracy.

One consequence of Avoidance Arrangements for the Sch 24 disqualified advice code is that the onus of proof on carelessness/reasonable care is on P. This is distinct from the disqualified advice rules considered separately below: this rule applies even if there is no disqualified advice.

There is no equivalent rule in the RTC code, as the onus of proof is already on the taxpayer.

126.12 Disqualified advice

126.12.1 *Why disqualified advice matters*

Sch 24 code: Para 3A(3) sch 24 FA 07	**RTC: para 23(2)(d) sch 18 F2A 17**
In considering whether P took reasonable care to avoid inaccuracy, HMRC and (on an appeal notified to the tribunal) the tribunal must take no account of any evidence of any reliance by P on advice where the advice is disqualified.	reliance on advice is to be taken automatically not to be a reasonable excuse if it is disqualified under sub-paragraph (3).

[33] See 122.2.1 (Sch 24 Table).

[34] See 126.2 (Error in taxpayer document). Disqualified advice is not relevant in relation to the penalties in para 1A and 2 (3rd party errors and uncorrected assessments).

[35] "The tribunal" has the same meaning as in paragraph 17 (see paragraph 17(5A)).

The rules appear to be the same: In short, disqualified advice is ignored in determining carelessness/reasonable excuse, so a taxpayer who in fact took reasonable care (relying on advisers) may be deemed careless/not have a reasonable excuse. But as noted above, the Sch 24 disqualified advice code only applies where there are Avoidance Arrangements.

I refer to advice that is not disqualified as **"independent advice"**.

Advisers need to consider whether their advice is disqualified, within the scope of these rules, and if it is, they should advise the client to take independent advice.

What happens if this is not done? The fact that the taxpayer relies on disqualified advice does not necessary mean that they are careless. The circumstances may be such that a reasonable taxpayer might have proceeded without advice in which case they are not careless. Or it may be that an independent adviser would have given the same advice as the disqualified adviser, in which case the taxpayer may be held to be careless, but the carelessness does not cause the loss of tax.

126.12.2 *Disqualified advice: Definition*

Sch 24 code: para 3A(4) sch 24 FA 07	**RTC: para 23(3) sch 18 F2A 17**
Advice is "disqualified" if any of the following applies ... but this is subject to sub-paragraphs (5) and (7).	Advice is disqualified (subject to sub-paragraph (4)) if-

There are five categories of disqualified advice.

126.13 Interested person

Para 3A(3)(a) sch 24 FA 07/Para 23(3)(a) sch 18 F2A 17 provides advice is disqualified if:

> (a) the advice was given to P by an interested person

It is necessary to identify the person who gives the advice. HMRC RTC guidance provides:

> HMRC's view is that when considering who the interested person is, person includes a body of persons both corporate or unincorporate. It therefore follows that the interested person might be an individual, or an organisation such as a limited company, firm of accountants or a limited liability partnership.

In fact a firm (ie a partnership) is not a person, but para (a) and (b) are wide enough that the point is not likely to arise.

126.13.1 *"Interested person"*

"Interested person" matters because their advice is disqualified. The basic definitions are effectively identical:

Sch 24 code: para 3A(6) sch 24 FA 07	**RTC: para 23(5) sch 18 F2A 17**
In sub-paragraph (4) "an interested person" means –	In sub-paragraph (3) "an interested person" means, in relation to any relevant offshore tax non-compliance-
(a) a person, other than P, who participated in the avoidance arrangements or any transaction forming part of them, or (b) a person who for any consideration (whether or not in money) facilitated P's entering into the avoidance arrangements.	(a) a person (other than P) who participated in relevant avoidance arrangements[36] or any transaction forming part of them, or (b) a person who for any consideration (whether or not in money) facilitated P's entering into relevant avoidance arrangements.

The object is to prevent an adviser marking their own homework; and what amounts to "facilitating" should be understood in that context. Para 3A(7) sch 24 FA 07 provides an exception:

> Where (but for this sub-paragraph) advice would be disqualified under paragraph (a) of sub-paragraph (4) [advice by disqualified person] because it was given by a person within sub-paragraph (6)(b) [a person who facilitates the arrangements], the advice is not disqualified under that paragraph if –
> (a) the person giving the advice had appropriate expertise for giving it,
> (b) the advice took account of P's individual circumstances, and
> (c) at the time when the question whether the advice is disqualified arises–

[36] Para 23(8) sch 18 F2A 17 provides: "Where any relevant offshore tax non-compliance arose originally because information was submitted to HMRC on the basis that particular avoidance arrangements had an effect which they did not have, those avoidance arrangements are "relevant avoidance arrangements" in relation to that tax non-compliance."

> (i) Condition E in paragraph 3B(5) is met in relation to the avoidance arrangements [avoidance related rule], but
> (ii) none of Conditions A to D in paragraph 3B(5) is or has at any time been met in relation to them.

I find this rather strange. Perhaps HMRC thought so too, because it has no RTC counterpart.

126.13.2 *Scope of disqualification*

Advice by an interested person which does not relate to Avoidance Arrangements is not disqualified.
CIOT RTC guidance provides:

> The adviser is only disqualified as respects the advice they gave on the tax avoidance. But their advice can be relied on in relation to other matters, e.g. whether the taxpayer's behaviour was deliberate or careless, e.g. if the adviser helps the person disclose and that disclosure is on the basis that 4 years' tax was due (reasonable care) then this is not disqualified advice if it later turns out that the person was careless, so 6 years' tax is due.

HMRC RTC guidance provides an example relating to domicile advice:

> **Example 9: advice not related to avoidance arrangements (not disqualified) (Ian ("N"))**
> N was unsure as to his correct domicile status and sought advice from a large firm of accountants. The firm thoroughly reviewed his circumstances and advised that in their view he was not domiciled in the UK for tax purposes.
> The firm then advised N on how to structure his affairs to pay less tax on his foreign income. N did not make a correction under the RTC because he believed, based on the advice he had received, that he had no correction to make.
> Some years later HMRC challenged N's domicile status and after a lengthy enquiry established that he was actually domiciled in the UK. Because of this N owed tax in relation to his offshore income for tax years 2013 to 2014, 2014 to 2015 and 2015 to 2016. N should have made a correction under the RTC.
> N claimed that he had a reasonable excuse because he had taken and followed appropriate advice and claimed that the incorrect advice is not disqualified. The incorrect advice related to his domicile status.
> The advice was given by someone with the appropriate expertise, took account of all of his relevant circumstances and did not relate to

> avoidance arrangements. The advice was not therefore disqualified and N did have a reasonable excuse.
> It is important that the inaccurate advice related to N's domicile status but that the domicile status did not involve avoidance arrangements facilitated by the advisor. N did not take any steps to alter his domicile status based on the advice.
> In these circumstances his domicile status does not fall within the definition of avoidance arrangements. Although the subsequent steps do fall within the definition of avoidance arrangements, the advice relating to the avoidance arrangements was correct.

CIOT RTC guidance provides:

> Example 9 in the updated RTC guidance is correct only if the taxpayer gave the adviser all correct and complete relevant information to use when providing the advice on his domicile status. If this did not happen then there is no reasonable excuse

Bearing in mind that there is no limit to evidence which may be relevant to domicile, this requirement is impossible to satisfy, if it is applied strictly. Though there is always the defence in 126.18 (Advice not thought disqualified).

126.14 Arrangement with interested person

Para 3A(3)(b) sch 24 FA 07/Para 23(3)(b) sch 18 F2A 17 provides advice is disqualified if:

> (b) the advice was given to P as a result of arrangements made between an interested person and the person who gave the advice

HMRC RTC guidance provides:

> [1] HMRC accepts that if a person gives all of the advice after all of the avoidance arrangements have taken place that advice cannot relate to the facilitation of those avoidance arrangements and will not be disqualified on the grounds of it being from an interested person (as long as the adviser did not participate in the relevant avoidance arrangements).
> [2] HMRC will also not seek to argue that the new advice is disqualified because it is as a result of arrangements made between an interested person and the person who gave the advice.

Point [1] is self-evident, but point [2] is important.

126.15 Appropriate expertise

Para 3A(3)(c) sch 24 FA 07/Para 23(3)(c) sch 18 F2A 17 provides advice is disqualified if:

> (c) the person who gave the advice did not have appropriate expertise for giving the advice,

HMRC RTC guidance provides:

> **CH123300 circumstances when a penalty is not due** [Jan 2022]
> HMRC will accept that anyone who is a member of a UK recognised legal, accounting, or tax advisory body will have the appropriate expertise to give advice on UK tax matters.

At first sight this seems generous, as CIOT note in the CIOT RTC guidance:

> However, if it questionable whether the member genuinely has the appropriate expertise on the area of tax concerned or if the client knows he lacks the expertise, HMRC's guidance may not offer protection.

But the individual may reasonably expect a competent and qualified adviser to know whether he has the expertise, and to refuse to act if not; and so the individual should in principle be protected; see 126.18 (Advice not thought disqualified).

126.16 All relevant circumstances

Advice is disqualified if:

Sch 24 code: para 3A sch 24 FA 07	**RTC: para 23 sch 18 F2A 17**
(d) the advice took no account of P's individual circumstances;	(d) the advice failed to take account of all P's individual circumstances (so far as relevant to the matters to which the advice relates)

The RTC wording seems to have a more stringent nuance, but it comes to the same thing.

RTC advice continues:

> Advice needs to take account of all of the taxpayer's relevant circumstances
> You can only claim that you have a reasonable excuse for not making a correction because you relied on advice if the advice that you are

> relying on takes account of all your relevant individual circumstances. This means that the adviser must have been given full and accurate details of all matters that are relevant to the issue.
>
> Care should be taken if you have relied on advice that was given before the transactions took place. Such advice runs the risk of failing to take account of all of your relevant circumstances.
>
> If you rely on advice that was given before the transactions took place and the transactions then took place in a slightly different way and that slight difference means tax is due, it will be HMRC's position that the advice failed to take account of all of your relevant circumstances. This will particularly be the case if you have failed to correctly follow the advice.
>
> Whether advice takes account of all your relevant individual circumstances is a continuing requirement. For example, if advice that takes account of all your circumstances was taken in 2011, it is reasonable for you to be able to rely on that advice when completing your next tax return.
>
> However, as time passes it is increasingly likely that your circumstances, or the legislation that the advice is based on, will have changed and the advice may no longer be correct.
>
> If you rely on advice that, whilst originally accurate, becomes wrong because of a change in your circumstances or a change in the legislation you cannot claim to have a reasonable excuse based on the advice that has become out of date.
>
> For this reason, if you are relying on old advice, you should check your position carefully before deciding whether or not a correction is needed.

CIOT RTC guidance provides:

> Even one unknown or ignored fact therefore may disqualify the advice or otherwise mean that the taxpayer will not be deemed to have a reasonable excuse for failing to correct (unless the taxpayer provided all the information/documentation that the adviser requested and did not know that the other piece of information was needed/relevant)

CIOT RTC guidance provides:

> Fresh advice is difficult to rely on in any case where there is a risk that facts could come to light later of which account should have been taken.
>
> This means that nil liability disclosures will normally need to be used as a route to providing certainty for taxpayers.

126.16.1 *Old advice*

HMRC RTC guidance provides:

> **Example 13: disqualified advice: failure to take account of all circumstances (Larry)**
> L is not domiciled in the UK and took advice from an accountant in 2006 about what tax he should pay on his foreign income. He was correctly advised on how to structure his affairs and what income to declare if he did this.
> L followed this advice and completed his return for tax year 2006 to 2007 and subsequent years accordingly but never took any further advice.
> Because of changes to the rules on tax payable by people who are not domiciled in the UK, all of L's returns since tax year 2008 to 2009 have been incorrect. L was unaware of the changes, and did not make a correction under the RTC.
> In 2019 HMRC opened an enquiry and established the correct position.
> L has not acted deliberately but cannot be said to have taken reasonable care in relation to his returns submitted some years after the advice was taken.
> His failure to take further advice means he has been careless and should have corrected his non-compliance for the tax years 2011 to 2012 through to 2016 to 2017. L cannot claim to have a reasonable excuse as the advice that he relied on failed to take account of all of his relevant circumstances.

L should not have completed his own returns. He should have instructed accountants to do this for him. The experience of Belloc's Lord Finchley comes to mind. But perhaps this does not often happen.

CIOT RTC guidance provides:

> Historic advice may be difficult to rely on as a reasonable excuse because
> (1) Risk facts may come to light which are relevant circumstances of which account was not taken
> (2) Uncertainty over whether what the advice related to does or does not fall within the definition of avoidance
> (3) Law may have changed as a result of subsequent decided cases
>
> HMRC consider that a change in law or practice since the advice was given is a relevant circumstance and thus invalidates the advice or the reasonable excuse

126.16.2 *Second opinion*

HMRC give some advice on how to obtain advice:

> If the advice you intend to rely on is disqualified as it was given by an interested person, or someone who has made arrangements with the interested person, you should consider either disclosing the matter to HMRC so it has been corrected and no FTC [failure to correct] penalty could be due, or taking further advice from a person who did not participate in, and was not involved in facilitating, the avoidance arrangements.
>
> In particular, taxpayers with more complex structures including those where the purported tax advantages are reliant on commerciality or the interpretation of complicated anti avoidance provisions are encouraged to consider seeking specialist tax advice from someone not involved in the original arrangements. This will enable them to identify the potential risks associated with a structure to identify whether there is an obligation to correct. By taking these steps, a taxpayer may well assist any future reasonable excuse claim should a challenge by HMRC be forthcoming.
>
> *Further advice from the same adviser*
>
> The legislation makes it clear that advice given to the taxpayer as a result of arrangements made between an interested person and the person who gave the advice is disqualified.
>
> You should therefore take care when seeking further advice to ensure it is not disqualified on this basis.

126.17 Receiver of advice

Para 3A(4) sch 24 FA 07/Para 23 sch 18 F2A 17 provides advice is disqualified if:

> (e) the advice was addressed to, or was given to, a person other than P.

I do not think there is any meaningful difference between addressed to and given to; in the discussion below I refer to "given" and leave "addressed" to be understood.

It is necessary to identify the person to whom advice is given. In formal written advice this should be stated expressly but the contract between adviser and client (in the form of a client care letter) will generally identify to whom advice is given. That will generally be the same as the person to whom the adviser owes contractual or common law duties of care.

CIOT RTC advice notes:

> Trustees cannot therefore rely on advice given to the settlor or beneficiaries.

And vice versa. But an adviser can give advice to trustees and to settlor/beneficiaries at the same time, and (unless there are separate advisers, or conflicts) that is what an adviser should do. In that case they can all rely on the advice. Advice is not disqualified if it is given to a number of persons including P. That would be absurd.

126.18 Advice not known disqualified

Sch 24 code: para 3A(5) FA 07	**RTC: para 23(5) sch 18 F2A 17**
Where (but for this sub-paragraph) advice would be disqualified under any of paragraphs (a) to (c) of sub-paragraph (4), the advice is not disqualified under that paragraph if at the relevant time[37] P –	Where advice would otherwise be disqualified under any of paragraphs (a) to (d) of sub-paragraph (3) the advice is not disqualified if at the end of the RTC period P –
(a) has taken reasonable steps to find out whether or not the advice falls within that paragraph, and (b) reasonably believes that it does not.	[Identical]

This defence does not apply:

(1) for the Sch 24 disqualified advice code only: to disqualification (d) (advice took no account of P's individual circumstances)

(2) to disqualification (e) (advice addressed to P).

I wonder if that is just a drafting error.

126.19 *Disqualified advice: PRs*

Para 3A(8) sch 24 FA 07 provides:

> If the document mentioned in sub-paragraph (1) is given to HMRC by P as a personal representative of a deceased person ("D")–
>
> (a) sub-paragraph (4) is to be read as if–
>
> (i) the references in paragraphs (a) and (b) to P were to P or D;

[37] Para 3A(9) provides: In this paragraph ... "the relevant time" means the time when the document mentioned in sub-paragraph (1) is given to HMRC".

(ii) the reference in paragraph (d) to P were to D, and

(iii) the reference in paragraph (e) to a person other than P were to a person who is neither P nor D,

(b) sub-paragraph (6) is to be read as if–

(i) the reference in paragraph (a) to P were a reference to the person to whom the advice was given, and

(ii) the reference in paragraph (b) to P were to D (or, where P also participated in the avoidance arrangements, P or D), and

(c) sub-paragraph (7) is to be read as if the reference in paragraph (b) to P were to D.

Amended as para 3A(8) directs, para 3A sch 24(4)(6)(7) FA 07 provide:

(4) Advice is "disqualified" if any of the following applies –

(a) the advice was given to P or D by an interested person;

(b) the advice was given to P or D as a result of arrangements made between an interested person and the person who gave the advice;

(c) the person who gave the advice did not have appropriate expertise for giving the advice;

(d) the advice took no account of P's individual circumstances;

(e) the advice was addressed to, or given to, a person ~~other than P~~ who is neither P nor D;

but this is subject to sub-paragraphs (5) and (7).

...

(6) In sub-paragraph (4) "an interested person" means –

(a) a person, other than ~~P~~ the person to whom the advice was given, who participated in the avoidance arrangements or any transaction forming part of them, or

(b) a person who for any consideration (whether or not in money) facilitated ~~P's~~ D's (or, where P also participated in the avoidance arrangements, P's or D's) entering into the avoidance arrangements.

(7) Where (but for this sub-paragraph) advice would be disqualified under paragraph (a) of sub-paragraph (4) [advice by disqualified person] because it was given by a person within sub-paragraph (6)(b) [a person who facilitates the arrangements], the advice is not disqualified under that paragraph if –

(a) the person giving the advice had appropriate expertise for giving it,

(b) the advice took account of ~~P's~~ D's individual circumstances, and

(c) at the time when the question whether the advice is disqualified arises–

(i) Condition E in paragraph 3B(5) is met in relation to the avoidance arrangements [avoidance related rule], but

(ii) none of Conditions A to D in paragraph 3B(5) is or has at any time been met in relation to them.

126.20 Egregious arrangements

Para 3B sch 24 FA 07 provides:

> (4) If, at any time, any of Conditions A to E is met in relation to particular arrangements–

I refer to this as **"egregious arrangements"**. In such cases:

> (a) for the purposes of this Schedule the arrangements are to be taken to fall within (and always to have fallen within) sub-paragraph (2)

That is, egregious arrangements are taken to be Avoidance Arrangements.

> (b) in relation to the arrangements, sub-paragraph (3) (and the reference to it in sub-paragraph (1)) are to be treated as omitted.

That is, the established-practice defence does not apply. Para 3B(4) concludes:

> This does not prevent arrangements from falling within sub-paragraph (2) other than by reason of one or more of Conditions A to E being met.

126.20.1 *Cond. A: DOTAS applies*

Para 3B sch 24 FA 07 provides:

> (5) Conditions A to E are as follows–
>
> (a) Condition A is that the arrangements are DOTAS arrangements within the meaning given by section 219(5) and (6) of FA 2014;

That takes us to s.219 FA 2014:

> (5) "DOTAS arrangements" means—
>
> (a) notifiable arrangements to which HMRC has allocated a reference number under section 311 of FA 2004,
>
> (b) notifiable arrangements implementing a notifiable proposal where HMRC has allocated a reference number under that section to the proposed notifiable arrangements, or
>
> (c) arrangements in respect of which the promoter must provide prescribed information under section 312(2) of that Act by reason of the arrangements being substantially the same as notifiable arrangements within paragraph (a) or (b).

> (6) But the notifiable arrangements within subsection (5) do not include arrangements in relation to which HMRC has given notice under section 312(6) of FA 2004 (notice that promoters not under duty imposed to notify client of reference number).

Condition B relates to VAT and indirect tax, and is not discussed here.

126.20.2 *Condition C: GAAR applies*

Para 3B(5) sch 24 FA 07 provides:

> (c) Condition C is that both of the following apply–
> (i) P has been given a notice under a provision mentioned in sub-paragraph (6) stating that a tax advantage arising from the arrangements is to be counteracted, and
> (ii) that tax advantage has been counteracted under section 209 of FA 2013;
>
> (6) The provisions referred to in sub-paragraph (5)(c)(i) are–
> (a) paragraph 12 of Schedule 43 to FA 2013 (general anti-abuse rule: notice of final decision);
> (b) paragraph 8 or 9 of Schedule 43A to that Act (pooled or bound arrangements: notice of final decision);
> (c) paragraph 8 of Schedule 43B to that Act (generic referrals: notice of final decision).

126.20.3 *Cond D: Follower notice*

Para 3B(5) sch 24 FA 07 provides:

> (d) Condition D is that a follower notice[38] under section 204 of FA 2014 has been given to P by reference to the arrangements (and not withdrawn) and–
> (i) the necessary corrective action for the purposes of section 208 of FA 2014 has been taken in respect of the denied advantage, or

[38] Para 3B(7) provides: "In sub-paragraph (5)(d) the reference to giving a follower notice to P includes giving a partnership follower notice in respect of a partnership return in relation to which P is a relevant partner; and for the purposes of this sub-paragraph–
(a) "relevant partner" has the meaning given by paragraph 2(5) of Schedule 31 to FA 2014;
(b) a partnership follower notice is given "in respect of" the partnership return mentioned in paragraph 2(2)(a) or (b) of that Schedule."

> (ii) the denied advantage has been counteracted otherwise than as mentioned in sub-paragraph (i);

Para 3B sch 24 FA 07 provides:

> (8) For the purposes of sub-paragraph (5)(d) it does not matter whether the denied advantage has been dealt with–
>
> (a) wholly as mentioned in one or other of sub-paragraphs (i) and (ii) of sub-paragraph (5)(d), or
>
> (b) partly as mentioned in one of those sub-paragraphs and partly as mentioned in the other;
>
> and "the denied advantage" has the same meaning as in Chapter 2 of Part 4 of FA 2014 (see section 208(3) of and paragraph 4(3) of Schedule 31 to that Act).

126.20.4 *Cond. E: Avoidance-related rule*

Para 3B(5) sch 24 FA 07 provides:

> (e) Condition E is that a tax advantage asserted[39] by reference to the arrangements has been counteracted (by an assessment, an amendment of a return or claim, or otherwise) on the basis that an avoidance-related rule applies in relation to P's affairs.

Para 3B(10) sch 24 FA 07 provides:

> In this paragraph–
>
> "avoidance-related rule" has the same meaning as in Part 4 of Schedule 18 to FA 16 (see paragraph 25 of that Schedule)

So we turn to para 25 sch 18 FA 16:

> (1) In this Part of this Schedule "avoidance-related rule" means a rule in Category 1 or 2.
>
> (2) A rule is in Category 1 if it refers (in whatever terms)—
>
> (a) to the purpose or main purpose or purposes of a transaction, arrangements or any other action or matter, and
>
> (b) to whether or not the purpose in question is or involves the avoidance of tax or the obtaining of any advantage in relation to tax (however described).
>
> (3) A rule is also in Category 1 if it refers (in whatever terms) to—
>
> (a) expectations as to what are, or may be, the expected benefits

[39] Para 3B(9) provides: "For the purposes of sub-paragraph (5)(e) a has been "asserted by reference to" the arrangements if a return, claim or appeal has been made by P on the basis that the results from the arrangements."

of a transaction, arrangements or any other action or matter, and

(b) whether or not the avoidance of tax or the obtaining of any advantage in relation to tax (however described) is such a benefit.

For the purposes of paragraph (b) it does not matter whether the reference is (for instance) to the "sole or main benefit" or "one of the main benefits" or any other reference to a benefit.

(4) A rule falls within Category 2 if as a result of the rule a person may be treated differently for tax purposes depending on whether or not purposes referred to in the rule (for instance the purposes of an actual or contemplated action or enterprise) are (or are shown to be) commercial purposes.

(5) For example, a rule in the following form would fall within Category 1 and within Category 2—

> "**Example rule**
>
> Section X does not apply to a company in respect of a transaction if the company shows that the transaction meets Condition A or B.
>
> Condition A is that the transaction is effected—
>
> (a) for genuine commercial reasons, or
>
> (b) in the ordinary course of managing investments."

126.21 Amount of penalty

126.21.1 *Navigation*

Type of penalty	**Amount specified in**	**See para.**
Error-based penalties	*Sch 24 FA 07*	
Error in document	Para 4	126.21.2
Error due to 3rd party	Para 4B	126.21.3
Uncorrected assessment	Para 4C	126.21.3
Failures of omission		
Failure to notify chargeability	Para 6(1) sch 41 FA 08	126.21.4
Failure to make return	Paras 3-6 sch 55 FA 09	126.21.5
Asset-based penalties	Para 7 sch 22 FA 16	126.21.10
Requirement to correct	Para 14(1) sch 18 F2A 17	126.21.11

126.21.2 *Amount: Error in document*

Para 4 sch 24 FA 07 provides:

> (1) This paragraph sets out the penalty payable under paragraph 1 [error in document].

(2) If the inaccuracy is in category 1, the penalty is—	(3) If the inaccuracy is in category 2, the penalty is—	(4) If the inaccuracy is in category 3, the penalty is—
(a) for careless action,	(a) for careless action,	(a) for careless action,

30% of the potential lost revenue, (b) for deliberate but not concealed action, 70% of the potential lost revenue, and (c) for deliberate and concealed action, 100% of the potential lost revenue.	45% of the potential lost revenue, (b) for deliberate but not concealed action, 105% of the potential lost revenue, and (c) for deliberate and concealed action, 150% of the potential lost revenue.	60% of the potential lost revenue, (b) for deliberate but not concealed action, 140% of the potential lost revenue, and (c) for deliberate and concealed action, 200% of the potential lost revenue.

In tabular form:

Category	**Careless**	**Deliberate not concealed**	**Deliberate & concealed**
1	30%	70%	100%
2	45%	105%	150%
3	60%	140%	200%

126.21.3 *3rd party error/uncorrected assessment*

Sch 24 FA 07 provides:

> 4B The penalty payable under paragraph 1A [error due to 3rd party] is 100% of the potential lost revenue.
> 4C The penalty payable under paragraph 2 [uncorrected assessment] is 30% of the potential lost revenue.

126.21.4 *Amount: Failure to notify*

Para 6(1) sch 41 FA 08 provides:

> This paragraph sets out the penalty payable under paragraph 1 [failure to notify chargeability].

Para 6(2): category 1	**Para 6(3): category 2**	**Para 6(4): category 4**
(2) If the failure is in category 1, the penalty is- (a) for a deliberate and concealed failure, 100% of the potential lost revenue, (b) for a deliberate but not concealed failure, 70% of the potential lost revenue, and (c) for any other case, 30% of the potential lost revenue.	(3) If the failure is in category 2, the penalty is- (a) for a deliberate and concealed failure, 150% of the potential lost revenue, (b) for a deliberate but not concealed failure, 105% of the potential lost revenue, and (c) for any other case, 45% of the potential lost revenue.	(4) If the failure is in category 3, the penalty is- (a) for a deliberate and concealed failure, 200% of the potential lost revenue, (b) for a deliberate but not concealed failure, 140% of the potential lost revenue, and (c) for any other case, 60% of the potential lost revenue.

This is the same as error-based penalties, though (for no obvious reason) set out in a different order. In tabular form:

Category	**Careless**	**Deliberate not concealed**	**Deliberate & concealed**
1	30%	70%	100%
2	45%	105%	150%
3	60%	140%	200%

126.21.5 *Amount: Failure to make return*

For IT/CGT/CT it makes sense that the penalties are less, because the taxpayer is by definition on the HMRC radar: a duty to make a return arises when HMRC have given the necessary notice. So the failure, unless very extended, is only administrative and the purpose is mainly to chivy compliance. But for failure to deliver an IHT Account, that is not the case and the rule is perhaps slightly generous.

Para 1 sch 55 FA 09 provides:

> (3) If P's failure falls within more than one paragraph of this Schedule, P is liable to a penalty under each of those paragraphs (but this is subject to paragraph 17(3)).

Sch 55 FA 09 provides:

> 2 Paragraphs 3 to 6 apply in the case of a return falling within any of items 1 to 3, 5 and 7 to 13 in the Table.

That list includes the IT/CT/IHT returns which concern the main themes of this book.[40]

126.21.6 *Delay up to 3 months*

Para 3 sch 55 FA 09 provides:

> 3 P is liable to a penalty under this paragraph of £100.

126.21.7 *Delay after 3 months*

Para 4 sch 55 FA 09 provides:

> 4 (1) P is liable to a penalty under this paragraph if (and only if)-
> (a) P's failure continues after the end of the period of 3 months beginning with the penalty date,
> (b) HMRC decide that such a penalty should be payable, and

[40] See 126.6.1 (Sch 55 Table).

> (c) HMRC give notice to P specifying the date from which the penalty is payable.
>
> (2) The penalty under this paragraph is £10 for each day that the failure continues during the period of 90 days beginning with the date specified in the notice given under sub-paragraph (1)(c).
>
> (3) The date specified in the notice under sub-paragraph (1)(c)-
>
> (a) may be earlier than the date on which the notice is given, but
>
> (b) may not be earlier than the end of the period mentioned in sub-paragraph (1)(a).

126.21.8 *Delay after 6 months*

Now we are getting more serious. Para 5 sch 55 FA 09 provides:

> 5 (1) P is liable to a penalty under this paragraph if (and only if) P's failure continues after the end of the period of 6 months beginning with the penalty date.
>
> (2) The penalty under this paragraph is the greater of-
>
> (a) 5% of any liability to tax which would have been shown in the return in question, and
>
> (b) £300.

126.21.9 *Delay after 12 months*

Para 6 sch 55 FA 09 provides:

> (1) P is liable to a penalty under this paragraph if (and only if) P's failure continues after the end of the period of 12 months beginning with the penalty date.
>
> (2) Where, by failing to make the return, P deliberately withholds information which would enable or assist HMRC to assess P's liability to tax, the penalty under this paragraph is determined in accordance with sub-paragraphs (3) and (4).
>
> (3) If the withholding of the information is deliberate and concealed, the penalty is the greater of-
>
> (a) the relevant percentage of any liability to tax which would have been shown in the return in question, and
>
> (b) £300.
>
> (4) If the withholding of the information is deliberate but not concealed, the penalty is the greater of-
>
> (a) the relevant percentage of any liability to tax which would have been shown in the return in question, and
>
> (b) £300.

> (3A) For the purposes of sub-paragraph (3)(a), the relevant percentage is-
> (a) for the withholding of category 1 information, 100%,
> (b) for the withholding of category 2 information, 150%, and
> (c) for the withholding of category 3 information, 200%.
>
> (4A) For the purposes of sub-paragraph (4)(a), the relevant percentage is-
> (a) for the withholding of category 1 information, 70%,
> (b) for the withholding of category 2 information, 105%, and
> (c) for the withholding of category 3 information, 140%.
>
> (5) In any case not falling within sub-paragraph (2) , the penalty under this paragraph is the greater of-
> (a) 5% of any liability to tax which would have been shown in the return in question, and
> (b) £300.

In summary tabular form:

Category	**Not deliberate**	**Deliberate not concealed**	**Deliberate & concealed**
1	5%	70%	100%
2	5%	105%	150%
3	5%	140%	200%

126.21.10 *Amount: Asset-based penalty*

Para 7 sch 22 FA 16 provides:

> (1) The standard amount of the asset-based penalty is the lower of-
> (a) 10% of the value of the asset, and
> (b) offshore PLR × 10.

I do not discuss the rules for valuation and identification of assets, in part 10-14 sch 22 FA 16, though I hope to do so in a future edition.

126.21.11 *Amount: RTC penalty*

Para 14(1) sch 18 F2A 17 provides:

> The penalty payable under paragraph 1 [RTC penalty] is 200% of the offshore PLR attributable to the uncorrected offshore tax non-compliance (subject to any reduction under a provision of this Part of this Schedule).

This is more than the normal penalties. Para 14(2) sch 18 F2A 17 provides:

In this Part of this Schedule "the uncorrected offshore tax non-compliance" means-

(a) the relevant offshore tax non-compliance, in a case where none of it is corrected within the RTC period, or

(b) so much of the relevant offshore tax non-compliance as has not been corrected within the RTC period, in a case where part of it is corrected within that period.

126.22 Categories of information/inaccuracy/failure

126.22.1 *Navigation*

Category	**Provision**	**See para.**
Information	Para 6A sch 55 FA 09	126.22.2
Inaccuracy	Para 4A sch 24 FA 07	126.22.3
Failure	Para 6A sch 41 FA 2008	126.22.4

126.22.2 *Categories of information*

This is relevant to the penalty for failure to make a return.

Para 6A sch 55 FA 09 provides:

Category 1	**Category 2**	**Category 3**
(1) Information is category 1 information if-	(2) Information is category 2 information if-	(3) Information is category 3 information if-
(a) it involves a domestic matter, or		
(b) it involves an offshore matter and-	(a) it involves an offshore matter or an offshore transfer,	(a) it involves an offshore matter or an offshore transfer,
(i) the territory in question is a category 1 territory, or	(b) the territory in question is a category 2 territory, and	(b) the territory in question is a category 3 territory, and
(ii) it is information which would enable or assist HMRC to assess P's liability to a tax other than income tax or capital gains tax.	(c) it is information which would enable or assist HMRC to assess P's liability to income tax, capital gains tax or inheritance tax	(c) it is information which would enable or assist HMRC to assess P's liability to income tax, capital gains tax or inheritance tax.

126.22.3 *Categories of inaccuracy*

Para 4A sch 24 FA 07 provides:

Category 1	**Category 2**	**Category 3**
(1) An inaccuracy is in category 1 if—	(2) An inaccuracy is in category 2 if—	(3) An inaccuracy is in category 3 if—
(a) it involves a domestic matter, or		
(b) it involves an offshore matter and—	(a) it involves an offshore matter or an offshore transfer,	(a) it involves an offshore matter or an offshore transfer,
(i) the territory in question is a category 1 territory, or	(b) the territory in question is a category 2 territory, and	(b) the territory in question is a category 3 territory, and
(ii) the tax at stake is a tax other than income tax or capital gains tax.	(c) the tax at stake is income tax, capital gains tax or inheritance tax.	(c) the tax at stake is income tax, capital gains tax or inheritance tax.

126.22.4 *Categories of failure*

Para 6A sch 41 FA 2008 provides:

Para 6A(1): Category 1	**Para 6A(2): Category 2**	**Para 6A(3): Category 3**
A failure is in category 1 if—	A failure is in category 2 if—	A failure is in category 3 if—
(a) it involves a domestic matter, or		
(b) it involves an offshore matter and—	(a) it involves an offshore matter or an offshore transfer,	(a) it involves an offshore matter or an offshore transfer,
(i) the territory in question is a category 1 territory, or	(b) the territory in question is a category 2 territory, and	(b) the territory in question is a category 3 territory, and
(ii) the tax at stake is a tax other than income tax or capital gains tax.	(c) the tax at stake is income tax or capital gains tax.	(c) the tax at stake is income tax or capital gains tax.

126.22.5 *Inaccuracy/failure categories compared*

The definitions are almost the same, substituting failure for inaccuracy, except that categories 2 and 3 are restricted to IT/CGT.

See too 126.23.8 (Multiple categories).

126.23 Offshore/Domestic Matters

126.23.1 *Navigation*

The expressions “involving an Offshore Matter/Transfer” are labels for complex sets of rules. I write these expressions with initial capitals to reflect their technical nature. There are about 20 definitions altogether, located as follows:

Term	**sch 24**	**sch 41**	**sch 55**	**sch 18**	**s.36A**	**s.240B**	**See**
	FA 07	**FA 08**	**FA 09**	**F2A 17**	**TMA**[41]	**IHTA**	**para**
Inaccuracy							
involves Offshore Matter	4A(4)						126.23.2
involves Offshore Transfer	4A(4B)						126.23.3
Applicable condition	4AA						126.23.4
involves domestic matter	4A(5)						126.23.7
Failure							
involves Offshore Matter		6A(4)					126.23.2
involves Offshore Transfer		6A(4B)					126.23.3
Applicable condition		6AA					126.23.4
Involves domestic matter		6A(5)					126.23.7
Information							
involves Offshore Matter			6A(4)				126.23.2
involves Offshore Transfer			6A4(B)				126.23.3
Applicable condition			6AA				126.23.4
involves domestic matter			6A(5)				126.23.7
Tax non-compliance:							
failure to comply							
involves Offshore Matter				9(2)			126.24.1
involves Offshore Transfer				9(3)			126.24.2
Applicable condition				9(4)(5)			126.24.2
failure to make return							
involves Offshore Matter				10(2)			126.24.1
involves Offshore Transfer				10(4)			126.24.2
Applicable condition				10(5)-(7)			126.24.2
inaccurate return							
involves Offshore Matter				10(2)			126.24.1
involves Offshore Transfer				10(4)			126.24.2
Applicable condition				10(5)-(7)			126.24.2
Lost IT/CGT							
involves Offshore Matter					36A(3)		126.23.2
involves Offshore Transfer					36A(4)		126.23.3

[41] See 121.16 (12-year limit: Offshore Matter).

Lost IHT		
involves Offshore Matter	240B(3)	125.15.1
involves Offshore Transfer	240B(4)	125.15.1

I consider

- 4 of the 5 sets of definitions here
- RTC separately in the following section
- IHT separately in 125.15.1 (Involves an offshore matter/transfer)

Unfortunately an ordinary page is not wide enough to set them all out side by side, for easy comparison.

126.23.2 *"Involves an Offshore Matter"*

Para 4A(4) sch 24	**Para 6A(4) Sch 41**	**Para 6A(4) sch 55**	**s.36A(3) TMA**
An inaccuracy "involves an offshore matter" if it results in a potential loss of revenue that is charged on or by reference to—	A failure "involves an offshore matter" if it results in a potential loss of revenue that is charged on or by reference to-	Information "involves an offshore matter" if the liability to tax which would have been shown in the return includes a liability to tax charged on or by reference to-	Lost income tax or capital gains tax "involves an offshore matter" if it is charged on or by reference to—
(a) income arising from a source in a territory outside the UK,	[Identical]	[Identical]	[Identical]
(b) assets situated or held *[Note 1]* in a territory outside the UK,	[Identical]	[Identical]	[Identical]
(c) activities carried on wholly or mainly *[Note 2]* in a territory outside the UK, or	[Identical]	[Identical]	[Identical]
(d) anything having effect as if it were income, assets or activities of a kind described above.	[Identical]	[Identical]	[Identical]

Note 1

This would apply if a UK situate asset is held by a non-resident nominee or trustee.

Para 4A sch 24 FA 07 provides:

> "Where the tax at stake is inheritance tax, assets are treated for the purposes of sub-paragraph (4) as situated or held in a territory outside the UK if they are so situated or held immediately after the transfer of value by reason of which inheritance tax becomes chargeable."

Note 2

Presumably "activities" means trading.

If the trade is carried on *wholly* outside the UK, the income is foreign source income within para (a), and para (c) is not needed.

It the trade is carried on mainly (not wholly) outside the UK, it is UK source income and it is not obvious why it should regarded as an offshore matter; perhaps the reason is that the trade may be harder for HMRC to identify; or the trader might mistakenly think that the income is foreign source.

I do not think that the words in para (d) has any meaningful content. It suggests, perhaps, that the drafter was concerned that the terms of para (a)-(c) might be too narrow, but did not know what to do about it.[42]

126.23.3 *"Involves an Offshore Transfer"*

Para 4A(4B) sch 24	**Para 6A(4A) Sch 41**	**Para 6A(4B) sch 55**	**s.36A(4) TMA**
An inaccuracy "involves an offshore transfer" if—	A failure "involves an offshore transfer" if-	Information "involves an offshore transfer" if-	Lost income tax or capital gains tax "involves an offshore transfer" if—
(a) it does not involve an offshore matter,	[Identical]	[Identical]	[Identical]
		(b) it is information which would enable or assist HMRC to assess P's liability to income tax, capital gains tax or inheritance tax,	
(b) it is deliberate (whether or not concealed) and results in a potential loss of revenue,	[identical to sch 24]	(c) by failing to make the return, P deliberately withholds the information (whether or not the withholding of the information is also concealed), and	
(c) the tax at stake is income tax,	(c) the tax at stake is income tax or		

[42] See too 49.15.1 (Substance); App.7.6 (Real nature of transaction); 126.23.9 (Definition of source/situs etc).

capital gains tax or inheritance tax, and	capital gains tax, and		
(d) the applicable condition in paragraph 4AA is satisfied.	(d) the applicable condition in paragraph 6AA is satisfied.	(d) the applicable condition in paragraph 6AA is satisfied.	(b) the income or the proceeds of the disposal on or by reference to which it is charged, or any part of the income or proceeds, is transferred to a territory outside the UK before the relevant date.

126.23.4 *Applicable condition*

This term is a key part of the definition of "involves an Offshore Transfer".

Para 4AA sch 24	**Para 6AA sch 41**	**Para 6AA sch 55**
(1) This paragraph makes provision in relation to offshore transfers.	[Identical]	[Identical]
(2) Where the tax at stake is income tax,	[Identical to sch 24]	(2) Where the liability to tax which would have been shown in the return is a liability to income tax,
the applicable condition is satisfied if the income on or by reference to which the tax is charged, or any part of the income— (a) is received in a territory outside the UK, or	[Identical]	[Identical]
(b) is transferred before the filing date to a territory outside the UK.	(b) is transferred before the calculation date to a territory outside the UK.	(b) is transferred before the relevant date to a territory outside the UK.
(3) Where the tax at stake is capital gains tax,	[Identical to sch 24]	(3) Where the liability to tax which would have been shown in the

		return is a liability to capital gains tax,
the applicable condition is satisfied if the proceeds of the disposal on or by reference to which the tax is charged, or any part of the proceeds— (a) are received in a territory outside the UK, or	[Identical to sch 24]	[Identical]
(b) are transferred before the filing date to a territory outside the UK.	(b) are transferred before the calculation date to a territory outside the UK.	(b) are transferred before the relevant date to a territory outside the UK.
(4) Where the tax at stake is inheritance tax, the applicable condition is satisfied if—		(4) Where the liability to tax which would have been shown in the return is a liability to inheritance tax,
(a) the disposition that gives rise to the transfer of value by reason of which the tax becomes chargeable involves a transfer of assets, and		[Identical]
(b) after that disposition but before the filing date the assets, or any part of the assets, are transferred to a territory outside the UK.		(b) after that disposition but before the relevant date the assets, or any part of the assets, are transferred to a territory outside the UK.[43]

126.23.5 *Filing/calculation/relevant date*

The filing/calculation/relevant dates are as follows:

[43] This condition is not met a resident of a foreign state is entitled to income, and receives it in the foreign state, unless they transfer it to another foreign state.

Para 4AA(7) sch 24 Filing date	**Para 6AA(6) sch 41 Calculation date**	**Para 6AA(7) sch 55 Relevant date**	**s.36A(5) TMA Relevant date**
"Filing date" means the date when the document containing the inaccuracy is given to HMRC.	In this paragraph "calculation date" means the date by reference to which the potential lost revenue is to be calculated (see paragraph 7).	"Relevant date" means the date on which P becomes liable to a penalty under paragraph 6.	In subsection (4) "relevant date" means— (a) in a case where the taxpayer (or a person acting on the taxpayer's behalf) delivered a return under the Taxes Acts to HMRC for the year of assessment to which the lost tax relates and in which information relating to the lost tax was required to be provided, the date on which the return was delivered, and (b) in any other case, 31 January in the year of assessment after that to which the lost tax relates;

126.23.6 *Assets representing assets*

Penalty template wording provides a definition:

> In the case of a transfer falling within sub-paragraph (2)(b), (3)(b) or (4)(b), references to the income, proceeds or assets transferred are to be read as including references to any assets derived from or representing[44] the income, proceeds or assets.

All the penalties discussed here include the same or a substantially similar provision.[45]

126.23.7 *"Involves a domestic matter"*

Para 4A(5) sch 24 FA 07	**Para 6A(5) sch 41 FA 08**	**Para 6A sch 55 FA09**
An inaccuracy "involves a domestic matter" if it results in a potential loss of revenue and does not involve either an offshore matter or an offshore transfer.	[identical to sch 24]	Information "involves a domestic matter" if it does not involve an offshore matter or an offshore transfer.

[44] See App.2.9.3 (Derive from/represent compared).

[45] Para 4B(5) sch 24 FA 07; para 6A sch 55 FA 09; 36A(5) TMA.

126.23.8 *Multiple categories*

Para 4A(6) sch 24 FA 07	**Para 6A(6) sch 41 FA 08**	**Para 6A(6) sch 55 FA09**
If a single inaccuracy is in more than one category (each referred to as a "relevant category")—	If a single failure is in more than one category (each referred to as a "relevant category")—	If the information which P withholds falls into more than one category-
(a) it is to be treated for the purposes of this Schedule as if it were separate inaccuracies, one in each relevant category according to the matters or transfers that it involves, and	(a) it is to be treated for the purposes of this Schedule as if it were separate failures, one in each relevant category according to the matters or transfers that it involves, and	(a) P's failure to make the return is to be treated for the purposes of this Schedule as if it were separate failures, one for each category of information according to the matters or transfers which the information involves, and
(b) the potential lost revenue is to be calculated separately in respect of each separate inaccuracy.	(b) the potential lost revenue in respect of each separate failure is taken to be such share of the potential lost revenue in respect of the single failure (see paragraphs 7 and 11) as is just and reasonable.	(b) for each separate failure, the liability to tax which would have been shown in the return in question is taken to be such share of the liability to tax which would have been shown in the return mentioned in paragraph (a) as is just and reasonable.

126.23.9 *Definition of source/situs etc*

CGT definitions of situs apply for CGT, and IHT/common law definitions apply for IHT/IT.

For completeness: Para 21B Sch 24 FA 07 provides:

> (1) The Treasury may by regulations make provision for determining for the purposes of paragraph 4A where-
>
> (a) a source of income is located,
> (b) an asset is situated or held, or
> (c) activities are wholly or mainly carried on.
>
> (1A) The Treasury may by regulations make provision for determining for the purposes of paragraph 4AA where-
>
> (a) income is received or transferred,
> (b) the proceeds of a disposal are received or transferred, or

(c) assets are transferred.

Although para 21B is expressed to apply for the purposes of para 4A/4AA, the provision is repeated or incorporated by reference elsewhere.

It is difficult to see why this is needed. Perhaps the drafter had some inchoate concern which, when they subsequently tried, they found they were unable to express in words. *Wovon man nicht sprechen kann, darüber muss man schweigen.* For that or some other reason, no regulations have been made: Para 21B should be repealed.

126.24 Offshore Matter/Transfer: RTC

In the RTC code, the expressions "involving an Offshore Matter/Transfer" are each defined 3 times. In outline:

Failure	**Para**
Failure to notify IT/CGT	9
Failure to deliver return	10
Inaccurate return	11

Para 9(1) sch 18 F2A 17	**Para 10(1)**	**Para 11(1)**
This paragraph applies to	This paragraph applies where-	This paragraph applies to any tax non-compliance by a person if—
any tax non-compliance consisting of a failure to comply with an obligation under section 7[46] of TMA 1970 to notify chargeability to income tax or capital gains tax.	(a) any tax non-compliance by a person consists of a failure to comply with an obligation to deliver a return or other document, and	(a) the tax non-compliance consists of delivering or giving HMRC a return or other document which contains an inaccuracy, and
	(b) a complete and accurate return or other document would have included information that would have enabled or assisted HMRC to assess the person's liability to tax.	(b) the inaccuracy relates to information that would have enabled or assisted HMRC to assess the person's liability to tax.

[46] See 121.2 (Duty to notify HMRC).

126.24.1 *Involves Offshore Matter*

I set out the wording in this section, but the wording is based on the provisions set out in the last section, so see above for discussion.

Sch 18 F2A 17 provides:

Para 9(2): Failure to notify	*Para 10(2): No return*	*Para 11(2): Incorrect return*
The tax non-compliance "involves an offshore matter" if	same as para 9	The tax non-compliance to which this paragraph applies "involves an offshore matter" if the information that should have been given in the tax document relates to—
the potential loss of revenue is charged on or by reference to-	the liability to tax that would have been shown in the return or other document is or includes a liability to tax charged on or by reference to-	
(a) income arising from a source in a territory outside the UK, (b) assets situated or held in a territory outside the UK, (c) activities carried on wholly or mainly in a territory outside the UK, or (d) anything having effect as if it were income, assets or activities of a kind described above.	same	same
	(3) Where the tax at stake is inheritance tax, assets are treated for the purposes of sub-paragraph (2) as situated or held in a territory outside the UK if they are so situated or held immediately after	(3) same as para 10

	the transfer of value by reason of which inheritance tax becomes chargeable.	

126.24.2 *Involves Offshore Transfer*

Sch 18 F2A 17 provides:

Para 9(3): Failure to notify	**Para 10(4): No return**	**Para 11(4): Incorrect return**
The tax non-compliance "involves an offshore transfer" if-	same as para 9	Tax non-compliance to which this paragraph applies "involves an offshore transfer" if—
(a) it does not involve an offshore matter, and	same	same
(b) the applicable condition is satisfied (see sub-paragraphs (4) and (5)).	(b) the applicable condition is satisfied in respect of the liability to tax that would have been shown by the return or other document (see sub-paragraphs (5) to (7)).	(b) the applicable condition is satisfied in respect of the liability to tax that would have been shown by the return or other document (see sub-paragraphs (5) to (7)).

So we turn to the definition(s) of "applicable condition". There are three sets of definitions, for the separate taxes:

Tax	**Definition of "applicable condition" in para:**
IT	9(4), 10(5), 11(5)
CGT	9(5), 10(6), 11(6)
IHT	9(6), 10(7), 11(7)

For IT, the same definition is repeated 3 times, so it need only be set out once. Para 9(4)/10(5)/11(5) sch 18 F2A 17 provide:

> Where the tax at stake is income tax the applicable condition is satisfied if the income on or by reference to which tax is charged, or any part of the income-
>
> (a) was received in a territory outside the UK, or
>
> (b) was transferred on or before 5 April 2017 to a territory outside the UK.

For the CGT/IHT, the definitions differ, and need to be set out side by side:

(5) Where the tax at stake is capital gains tax, the applicable condition is satisfied if	(6) [identical]	[identical]
		(a) the information that should have been given in the tax document relates to the proceeds of the disposal on or by reference to which the tax is charged, and
the proceeds of the disposal on or by reference to which the tax is charged, or any part of the proceeds-	[identical]	(b) the proceeds, or any part of the proceeds—
(a) were received in a territory outside the UK, or	(a) was received in a territory outside the UK, or	(i) were received in a territory outside the UK, or
(b) were transferred on or before 5 April 2017 to a territory outside the UK.	was transferred on or before 5 April 2017 to a territory outside the UK.	(ii) were transferred on or before 5 April 2017 to a territory outside the UK.
	(7) Where the liability to tax which would have been shown in the document is a liability to inheritance tax, the applicable condition is satisfied if—	(7) Where the tax at stake is inheritance tax, the applicable condition is satisfied if—
	(a) the disposition that gives rise to the transfer of value by reason of which the tax becomes chargeable involves a transfer of assets, and (b) after that disposition but on or before 5 April 2017 the assets, or any part of the assets, are transferred to a territory outside the UK.	(a) the information that should have been given in the tax document relates to the disposition that gives rise to the transfer of value by reason of which the tax becomes payable relates to a transfer of assets, and (b) after that disposition but on or before 5 April 2017 the assets or any part of the assets are transferred to a territory outside the UK.

126.25 Categories of territory

Para 21A sch 24 FA 07 provides:

> (1) A category 1 territory is a territory designated as a category 1 territory by order made by the Treasury.
> (2) A category 2 territory is a territory that is neither—
> (a) a category 1 territory, nor
> (b) a category 3 territory.
> (3) A category 3 territory is a territory designated as a category 3 territory by order made by the Treasury.[47]

This takes us to the schedule of Penalties, Offshore Income etc (Designation of Territories) Order 2011 which provides:

Category 1 territories
Anguilla
Aruba
Australia
Belgium
Bulgaria
Canada
Cayman Islands
Cyprus
Czech Republic
Denmark (not including Faroe Islands & Greenland)
Estonia
Finland
France
Germany
Greece
Guernsey
Hungary
Ireland
Isle of Man
Italy
Japan
Korea,
Latvia
Liechtenstein
Lithuania
Malta
Montserrat
Netherlands (not including Bonaire, Sint Eustatius & Saba)
New Zealand (not including Tokelau)
Norway
Poland
Portugal
Romania
Slovakia
Slovenia
Spain
Sweden
Switzerland

[47] For completeness: para 21A(4) sch 24 FA 07 explains the principles of categorisation: "In considering how to classify a territory for the purposes of this paragraph, the Treasury must have regard to—
(a) the existence of any arrangements between the UK and that territory for the exchange of information for tax enforcement purposes,
(b) the quality of any such arrangements (in particular, whether they provide for information to be exchanged automatically or on request), (c) the benefit that the UK would be likely to obtain from receiving information from that territory, were such arrangements to exist with it,
(d) the existence of any other arrangements between the UK and that territory for co-operation in the area of taxation, and
(e) the quality of any such other arrangements (in particular, the extent to which the co-operation provided for in them assists or is likely to assist in the protection of revenue raised from taxation in the UK)."

United States of America
(not including overseas
territories &
possessions)

Category 3
territories
Albania
Algeria
Andorra
Bonaire, Sint
Eustatius and Saba
Brazil
Cape Verde
Colombia
Congo, Republic of
Cook Islands
Costa Rica
Curaçao
Cuba
Democratic People's
Republic of Korea
Dominican Republic
South Ecuador
El Salvador
Gabon
Guatemala
Honduras
Iran
Iraq
Jamaica
Kyrgyzstan
Lebanon
Macau
Marshall Islands
Micronesia, Federated
States of
Monaco
Nauru
Nicaragua
Niue
Palau
Panama
Paraguay
Peru
Seychelles
Sint Maarten
Suriname
Syria
Tokelau
Tonga
Trinidad and Tobago
United Arab Emirates
Uruguay

Everywhere else is category 2.

Penalty template wording incorporates these rules elsewhere if needed:[48]

> For the purposes of this Schedule-
> (a) paragraph 21A of Schedule 24 to FA 07 (classification of territories) has effect, but
> (b) an order under that paragraph does not apply to a failure if the filing date is before the date on which the order comes into force.

126.25.1 *More than 1 category in point*

There may be more than one "territory in question".

Para 4AA(6) sch 24 FA 07	**Para 6AA(5) sch 41 FA 08**	**Para 6AA(6) Sch 55 FA 09**
In relation to an offshore transfer, the territory in question for the purposes of paragraph 4A is the highest category of	In relation to an offshore transfer, the territory in question for the purposes of paragraph 6A is the highest category of	[identical to sch 41]

[48] Para 6A(7) sch 55 FA 09 (quoted); para 6A(7) sch 41 FA 2008 (minor variations).

territory by virtue of which the inaccuracy involves an offshore transfer.	territory by virtue of which the failure involves an offshore transfer.

126.26 Potential lost revenue

Potential lost revenue ("PLR") matters because for most of the penalties the amount of penalty is a percentage of PLR or offshore PLR. For asset-based penalties, one requirement is a minimum offshore PLR threshold of £25k.

The definitions are located as follows:

Term	**sch 24**	**sch 41**	**sch 22**	**sch 18**	**See para.**
	FA 07	**FA 08**	**FA 16**	**F2A 17**	
Potential lost revenue	5-8				126.27
		7-10			126.28
Offshore PLR			5		126.30
				15	126.31

126.27 PLR: Error-based penalties

126.27.1 *PLR: Normal rule*

Para 5 sch 24 FA 07 provides:

> (1) "The potential lost revenue" in respect of an inaccuracy in a document or a failure to notify an under-assessment is the additional amount due or payable in respect of tax[49] as a result of correcting the inaccuracy or assessment.
>
> (2) The reference in sub-paragraph (1) to the additional amount due or payable includes a reference to—
>
> (a) an amount payable to HMRC having been erroneously paid by way of repayment of tax, and
>
> (b) an amount which would have been repayable by HMRC had the inaccuracy or assessment not been corrected.

126.27.2 *Disregarded reliefs*

Para 5 sch 24 FA 07 provides:

> (4) The following shall be ignored in calculating potential lost revenue

[49] Defined para 5(3) sch 24 FA 07:In sub-paragraph (1) "tax" includes national insurance contributions."

> under this paragraph—
>
> (a) group relief, and
>
> (b) section 419(4) of ICTA (close company: relief for loans);
>
> (but this sub-paragraph does not prevent a penalty being charged in respect of an inaccurate claim for relief).

Another unfair rule.

126.27.3 *Multiple errors*

Para 6 sch 24 FA 07 provides:

> (1) Where P is liable to a penalty in respect of more than one inaccuracy, and the calculation of potential lost revenue under paragraph 5 in respect of each inaccuracy depends on the order in which they are corrected—
>
> (a) careless inaccuracies shall be taken to be corrected before deliberate inaccuracies, and
>
> (b) deliberate but not concealed inaccuracies shall be taken to be corrected before deliberate and concealed inaccuracies.
>
> (2) In calculating potential lost revenue where P is liable to a penalty in respect of one or more understatements in one or more documents relating to a tax period, account shall be taken of any overstatement in any document given by P which relates to the same tax period.
>
> (3) In sub-paragraph (2)—
>
> (a) "understatement" means an inaccuracy that satisfies Condition 1 of paragraph 1, and
>
> (b) "overstatement" means an inaccuracy that does not satisfy that condition.
>
> (4) For the purposes of sub-paragraph (2) overstatements shall be set against understatements in the following order—
>
> (a) understatements in respect of which P is not liable to a penalty,
>
> (b) careless understatements,
>
> (c) deliberate but not concealed understatements, and
>
> (d) deliberate and concealed understatements.

126.27.4 *PLR: Losses*

Para 7 sch 24 FA 07 provides:

> (1) Where an inaccuracy has the result that a loss is wrongly recorded for purposes of direct tax and the loss has been wholly used to reduce the amount due or payable in respect of tax, the potential lost revenue is calculated in accordance with paragraph 5.

> (2) Where an inaccuracy has the result that a loss is wrongly recorded for purposes of direct tax and the loss has not been wholly used to reduce the amount due or payable in respect of tax, the potential lost revenue is—
>
> (a) the potential lost revenue calculated in accordance with paragraph 5 in respect of any part of the loss that has been used to reduce the amount due or payable in respect of tax, plus
>
> (b) 10% of any part that has not.
>
> (3) Sub-paragraphs (1) and (2) apply both—
>
> (a) to a case where no loss would have been recorded but for the inaccuracy, and
>
> (b) to a case where a loss of a different amount would have been recorded (but in that case sub-paragraphs (1) and (2) apply only to the difference between the amount recorded and the true amount).
>
> (4) Where an inaccuracy has the effect of creating or increasing an aggregate loss recorded for a group of companies—
>
> (a) the potential lost revenue shall be calculated in accordance with this paragraph, and
>
> (b) in applying paragraph 5 in accordance with sub-paragraphs (1) and (2) above, group relief may be taken into account (despite paragraph 5(4)(a)).
>
> (5) The potential lost revenue in respect of a loss is nil where, because of the nature of the loss or P's circumstances, there is no reasonable prospect of the loss being used to support a claim to reduce a tax liability (of any person).

126.27.5 *PLR: Delayed tax*

Para 8 sch 24 FA 07 provides:

> (1) Where an inaccuracy resulted in an amount of tax being declared later than it should have been ("the delayed tax"), the potential lost revenue is—
>
> (a) 5% of the delayed tax for each year of the delay, or
>
> (b) a percentage of the delayed tax, for each separate period of delay of less than a year, equating to 5% per year.
>
> (2) This paragraph does not apply to a case to which paragraph 7 applies.

126.28 PLR: Failure to notify chargeability

Para 7(1) sch 41 FA 08 provides:

> "The potential lost revenue" in respect of a failure to comply with a relevant obligation is as follows.

126.28.1 *No notice requiring return*

We will normally be considering para 7(2)(3) sch 41 FA 08 which provide:

para 7(2): IT/CGT	**para 7(3): CT**
In the case of a relevant obligation relating to income tax or capital gains tax and a tax year (not falling within subparagraph (1A)), the potential lost revenue is so much of any income tax or capital gains tax to which P is liable in respect of the tax year as by reason of the failure is unpaid on 31 January following the tax year.	In the case of a relevant obligation relating to corporation tax and an accounting period, the potential lost revenue is (subject to sub-paragraph (4)) so much of any corporation tax to which P is liable in respect of the accounting period as by reason of the failure is unpaid 12 months after the end of the accounting period.

Para 7(4) sch 41 FA 08 provides for one disregarded relief for CT

> In computing the amount of that tax no account shall be taken of any relief under section 458 of CTA 2010 (relief in respect of repayment etc of loan) which is deferred under subsection (5) of that section.

"By reason of" is a causation test; see *Fuller v HMRC* [2020] UKFTT 189 (TC).

126.28.2 *Notice requiring tax return withdrawn*

Para 7 sch 41 FA 08 deals with what is (I think) an usual case:

> (1A) In the case of an obligation under section 7[50] of TMA 1970 which arises by virtue of subsection (1B) of that section, the potential lost revenue is so much of any income tax or capital gains tax to which P is liable in respect of the tax year in question as is, by reason of the failure to comply with the obligation-
>
> (a) where the period specified in subsection (1C)(b)(ii) of that section applies and ends after the relevant date, unpaid at the end of that period, or
>
> (b) in any other case, unpaid on the relevant date.
>
> (1B) For the purposes of sub-paragraph (1A) the relevant date is-

[50] See 121.2 (Duty to notify HMRC).

> (a) 31 January following the tax year, or
> (b) if, after that date, HMRC refund a payment on account in respect of the tax year to P, the day after the refund is issued.

126.28.3 *Other cases*

Para 7(10) sch 41 FA 08 provides:

> In the case of a failure to comply with a relevant obligation relating to any other tax, the potential lost revenue is the amount of any tax which is unpaid by reason of the failure

126.29 Matching overpayment

Para 6 sch 24 FA 07	**Para 7 sch 41 FA 08**
(5) In calculating potential lost revenue in respect of a document given by or on behalf of P no account shall be taken of the fact that a potential loss of revenue from P is or may be balanced by a potential over-payment by another person (except to the extent that an enactment requires or permits a person's tax liability to be adjusted by reference to P's).	(1) In calculating potential lost revenue in respect of a relevant act or failure[51] on the part of P no account is to be taken of the fact that a potential loss of revenue from P is or may be balanced by a potential over-payment by another person (except to the extent that an enactment requires or permits a person's tax liability to be adjusted by reference to P's).

126.30 Offshore PLR: Asset-based penalty

Para 5 sch 22 FA 16 provides:

> (1) The offshore PLR, in relation to a tax year, is the total of—
> (a) the potential lost revenue (in the case of a standard offshore tax penalty imposed under Schedule 24 to FA 2007 or Schedule 41 to FA 2008 or Schedule 18 to FA 2017), and
> (b) the liability to tax (in the case of a standard offshore tax penalty imposed under Schedule 55 to FA 2009),
>
> by reference to which all of the standard offshore tax penalties imposed on P in relation to the tax year are assessed.
>
> (2) Sub-paragraphs (3) to (5) apply where—
> (a) a penalty is imposed on P under paragraph 1 of Schedule 24

[51] Defined Para 7(2) sch 41 FA 08 "In this Schedule "a relevant act or failure" means (a) a failure to comply with a relevant obligation ..."

to FA 2007, paragraph 1 of Schedule 41 to FA 2008 or paragraph 6 of Schedule 55 to FA 2009, and

(b) the potential lost revenue or liability to tax by reference to which the penalty is assessed relates to a standard offshore tax penalty and one or more other penalties.

In this paragraph, such a penalty is referred to as a "combined penalty".

(3) Only the potential lost revenue or liability to tax relating to the standard offshore tax penalty is to be taken into account in calculating the offshore PLR.

(4) Where the calculation of the potential lost revenue or liability to tax by reference to which a combined penalty is assessed depends on the order in which income or gains are treated as having been taxed, for the purposes of calculating the offshore PLR—

(a) income and gains relating to domestic matters are to be taken to have been taxed before income and gains relating to offshore matters and offshore transfers;

(b) income and gains relating to taxes that are not capital gains tax, inheritance tax or asset-based income tax are to be taken to have been taxed before income and gains relating to capital gains tax, inheritance tax and asset-based income tax.

(5) In a case where it cannot be determined—

(a) whether income or gains relate to an offshore matter or offshore transfer or to a domestic matter, or

(b) whether income or gains relate to capital gains tax, asset-based income tax or inheritance tax or not,

for the purposes of calculating the offshore PLR, the potential lost revenue or liability to tax relating to the standard offshore tax penalty is to be taken to be such share of the total potential lost revenue or liability to tax by reference to which the combined penalty was calculated as is just and reasonable.

(6) Sub-paragraph (7) applies where—

(a) a standard offshore tax penalty or a combined penalty is imposed on P, and

(b) there are two or more taxes at stake, including capital gains tax and asset-based income tax.

(7) Where the calculation of the potential lost revenue or liability to tax by reference to which the penalty is assessed depends on the order in which income or gains are treated as having been taxed, for the purposes of calculating the offshore PLR, income and gains relating to asset-based income tax are to be taken to have been taxed before income and gains relating to capital gains tax.

126.31 Offshore PLR: RTC

PLR is **P**otential **L**ost **R**evenue.

Offshore PLR matters for:

(1) RTC condition C

(2) the quantum of the RTC penalty

(3) the RTC assessment time limit

Para 15(1) sch 18 F2A 17 provides:

> In this Schedule “offshore PLR”, in relation to any offshore tax non-compliance means the potential loss of revenue attributable to that non-compliance, to be determined as follows.

The PLR depends on the nature of the non-compliance.

Para 15 Sch 18 F2A 17 provides:

> (2) The potential lost revenue attributable to any offshore tax non-compliance is (subject to sub-paragraphs (5) and (6))-

(a) if the non-compliance is a failure to notify chargeability,	(b) if the non-compliance is a failure to deliver a return or other document,	(c) if the non-compliance is delivering a return or other document containing an inaccuracy,
[i] the potential lost revenue under the applicable provisions of paragraph 7 of Schedule 41 to FA 08	[i] the amount of the liability to tax under the applicable provisions of paragraph 24 of Schedule 55 to FA 09	[i] the potential lost revenue under the applicable provisions of paragraphs 5 to 8 of Schedule 24 to FA 07
[ii] (or, where the original offshore tax non-compliance took place before 1 April 2010, the amount referred to in section 7(8) of TMA 1970)	[ii] (or, where the original offshore tax non-compliance took place before 1 April 2011, the amount of liability to tax that would have been shown in the return as defined in section 93(9) of TMA 1970),	[ii] (or, where the original offshore tax non-compliance took place before 1 April 2008, the difference described in section 95(2) of TMA 1970).

Para 15 sch 18 F2A 17 provides:

> (3) In its application for the purposes of sub-paragraph (2)(c) above, paragraph 6 of Schedule 24 to FA 07 has effect as if-
>
> (a) for sub-paragraph (1) there were substituted-
>
> "(1) Where-
>
> (a) P is liable to a penalty in respect of two or more inaccuracies (each being an inaccuracy in a return or other document listed in paragraph 8(3) or (4) of Schedule 18) to F(No 2)A 2017) in relation to a tax year or, in the case of inheritance tax, a single transfer of value,
>
> (b) in relation to any one (or more than one) of those inaccuracies, the delivery of the return or other document containing it constitutes offshore tax non-compliance, and
>
> (c) the calculation of potential lost revenue attributable to each of those inaccuracies depends on the order in which they are corrected,
>
> the potential lost revenue attributable to any offshore tax non-compliance constituted by any one of those inaccuracies is to be taken to be such amount as is just and reasonable.
>
> (1A) In sub-paragraph (1) "offshore tax non-compliance" has the same meaning as in Schedule 18 to F(No2)A 2017."; and
>
> (b) in sub-paragraph (4), for paragraphs (b) to (d) there were substituted-
>
> "(b) other understatements."
>
> (4) In sub-paragraphs (5) and (6) "combined tax non-compliance" is tax non-compliance that-
>
> (a) involves an offshore matter or an offshore transfer, but
>
> (b) also involves an onshore matter.

I discuss PLR above. The amendments relate to the rules for multiple errors. Amended as para 15 sch 18 F2A 17 requires, para 6 sch 24 FA 07 provides:

> **6 Potential lost revenue: multiple errors**
>
> ~~(1) Where P is liable to a penalty under paragraph 1 in respect of more than one inaccuracy, and the calculation of potential lost revenue under paragraph 5 in respect of each inaccuracy depends on the order in which they are corrected—~~

~~(a) careless inaccuracies shall be taken to be corrected before deliberate inaccuracies, and~~

~~(b) deliberate but not concealed inaccuracies shall be taken to be corrected before deliberate and concealed inaccuracies.~~

(1) Where-

(a) P is liable to a penalty in respect of two or more inaccuracies (each being an inaccuracy in a return or other document listed in paragraph 8(3) or (4) of Schedule 18) to F(No 2)A 2017) in relation to a tax year or, in the case of inheritance tax, a single transfer of value,

(b) in relation to any one (or more than one) of those inaccuracies, the delivery of the return or other document containing it constitutes offshore tax non-compliance, and

(c) the calculation of potential lost revenue attributable to each of those inaccuracies depends on the order in which they are corrected,

the potential lost revenue attributable to any offshore tax non-compliance constituted by any one of those inaccuracies is to be taken to be such amount as is just and reasonable.

(1A) In sub-paragraph (1) "offshore tax non-compliance" has the same meaning as in Schedule 18 to F(No2)A 2017.

(2) In calculating potential lost revenue where P is liable to a penalty under paragraph 1 [RTC penalty] in respect of one or more understatements in one or more documents relating to a tax period, account shall be taken of any overstatement in any document given by P which relates to the same tax period.

(3) In sub-paragraph (2)—

(a) "understatement" means an inaccuracy that satisfies Condition 1 of paragraph 1, and

(b) "overstatement" means an inaccuracy that does not satisfy that condition.

(4) For the purposes of sub-paragraph (2) overstatements shall be set against understatements in the following order—

(a) understatements in respect of which P is not liable to a penalty,

~~(b) careless understatements,~~

~~(c) deliberate but not concealed understatements, and~~

~~(d) deliberate and concealed understatements.~~

(b) other understatements.

(5) In calculating for the purposes of a penalty under paragraph 1 [RTC penalty] potential lost revenue in respect of a document given by or on

> behalf of P no account shall be taken of the fact that a potential loss of revenue from P is or may be balanced by a potential over-payment by another person (except to the extent that an enactment requires or permits a person's tax liability to be adjusted by reference to P's).

126.31.1 *Combined tax non-compliance*

Para 15 sch 18 F2A 17 provides:

> (5) Any combined tax non-compliance is to be treated for the purposes of this Schedule as if it were two separate acts of tax non-compliance, namely-
> (a) the combined tax non-compliance so far as it involves an offshore matter or an offshore transfer (which is then offshore tax non-compliance within the meaning of this Schedule), and
> (b) the combined tax non-compliance so far as it involves an onshore matter.
> (6) The potential lost revenue attributable to the offshore tax non-compliance referred to in sub-paragraph (5)(a) is to be taken to be such share of the potential lost revenue attributable to the combined tax non-compliance as is just and reasonable.

126.32 Reductions for disclosure: Which para?

126.33 *Summary*

The penalty provisions adopt a verbose template, and it is helpful to summarise the position in a table:

Penalty	**Matter**	**Governed by**	**Reduction under**
Sch 24			
Para 1: error in taxpayer doc	Domestic	Para 9(A1)	Para 10(1)
Para 1A: error due to 3rd party			Para 10(1A)
Para 2: uncorrected assessment			Para 10(2)
Para 1: error in taxpayer doc	Offshore	Para 9(A2)	Para 10A
Sch 41			
Para 1: failure to notify	Domestic	Para 12(1)(a)	Para 13(1)
ditto	Offshore	Para 12(1A)	Para 13A
Sch 55			
failure to make return	Domestic	Para 14(1)	Para 15
ditto	Offshore	Para 14 (1A)	Para 15A
Sch 18: RTC			Para 16

The provisions in full detail are as follows:

126.33.1 *Error based penalties*

Para 9 sch 24 FA 07 provides:

> (A1) Paragraph 10 provides for reductions in penalties—
>
> (a) under paragraph 1 [Error in document] where a person discloses an inaccuracy that involves a domestic matter,
>
> (b) under paragraph 1A [Error due to 3rd party] where a person discloses a supply of false information or withholding of information, and
>
> (c) under paragraph 2 [uncorrected assessment] where a person discloses a failure to disclose an under-assessment.
>
> (A2) Paragraph 10A provides for reductions in penalties under paragraph 1 [Error in document] where a person discloses an inaccuracy that involves an offshore matter or an offshore transfer.

126.33.2 *Failure to notify chargeability*

Para 12 sch 41 FA 08 provides:

> (1) Paragraph 13 provides for reductions in penalties—
>
> (a) under paragraph 1 where P discloses a relevant failure that involves a domestic matter, and
>
> (b) under paragraphs 2 to 4 where P discloses a relevant act or failure.[52]
>
> (1A) Paragraph 13A provides for reductions in penalties under paragraph 1 where P discloses a relevant failure that involves an offshore matter or an offshore transfer.
>
> (1B) Sub-paragraph (2) applies where P discloses—
>
> (a) a relevant failure that involves a domestic matter,
>
> (b) a non-deliberate relevant failure that involves an offshore matter, or
>
> (c) a relevant act or failure giving rise to a penalty under any of paragraphs 2 to 4.

126.33.3 *Failure to make return*

Para 14 sch 55 FA 09 provides:

> (1) Paragraph 15 provides for reductions in the penalty under paragraph 6(3) or (4) where P discloses relevant information that involves a domestic matter or 11(3) or (4) where P discloses relevant information.
>
> (1A) Paragraph 15A provides for reductions in the penalty under paragraph 6(3) or (4) where P discloses relevant information that

[52] Defined Para 7(2) sch 41 FA 08 "In this Schedule "a relevant act or failure" means (a) a failure to comply with a relevant obligation ..."

involves an offshore matter or an offshore transfer.

126.33.4 *RTC*

Para 16 sch 18 F2A 17 provides:

> (1) This paragraph provides for a reduction in a penalty under paragraph 1 [RTC penalty] for any uncorrected relevant offshore tax non-compliance if the person ("P") who is liable to the penalty discloses any matter mentioned in sub-paragraph (2) that is relevant to the non-compliance or its correction or to the assessment or enforcement of the offshore tax attributable to it.
> (2) The matters are-
> (a) chargeability to income tax or capital gains tax (where the tax non-compliance is a failure to notify chargeability),
> (b) a missing tax return,
> (c) an inaccuracy in a document,
> (d) a supply of false information or a withholding of information, or
> (e) a failure to disclose an under-assessment.

126.34 What disclosure requires

126.34.1 *Disclosure: Error-based penalty*

Para 9 sch 24 FA 07 provides two definitions of what is required:

(A3) Sub-paragraph (1) applies where a person discloses—	(1A) Sub-paragraph (1B) applies where a person discloses—
(a) an inaccuracy that involves a domestic matter,	
(b) a careless inaccuracy that involves an offshore matter,	(a) a deliberate inaccuracy (whether concealed or not) that involves an offshore matter, or
(c) a supply of false information or withholding of information, or	
(d) a failure to disclose an under-assessment.	
	(b) an inaccuracy that involves an offshore transfer.
(1) A person discloses an inaccuracy, a supply of false information or withholding of information, or a failure to disclose an under-assessment by—	(1B) A person discloses the inaccuracy by—
(a) telling HMRC about it,	[identical]

(b) giving HMRC reasonable help in quantifying the inaccuracy, the inaccuracy attributable to the supply of false information or withholding of information, or the under-assessment, and	(b) giving HMRC reasonable help in quantifying the inaccuracy,
(c) allowing HMRC access to records for the purpose of ensuring that the inaccuracy, the inaccuracy attributable to the supply of false information or withholding of information, or the under-assessment is fully corrected.	(c) allowing HMRC access to records for the purpose of ensuring that the inaccuracy is fully corrected, and
	(d) providing HMRC with additional information.

126.34.2 *Disclosure: Failure to notify*

Para 12 sch 41 FA 08 provides two definitions of what is required:

(1B) Sub-paragraph (2) applies where P discloses-	(2A) Sub-paragraph (2B) applies where P discloses-
(a) a relevant failure that involves a domestic matter,	
(b) a non-deliberate relevant failure that involves an offshore matter, or	(a) a deliberate relevant failure (whether concealed or not) that involves an offshore matter, or
(c) a relevant act or failure giving rise to a penalty under any of paragraphs 2 to 4. [These paras not discussed here]	
	(b) a relevant failure that involves an offshore transfer.
(2) P discloses the relevant act or failure by-	(2B) P discloses the failure by-
(a) telling HMRC about it,	[identical]
(b) giving HMRC reasonable help in quantifying the tax unpaid by reason of it, and	[identical]

(c) allowing HMRC access to records for the purpose of checking how much tax is so unpaid.	[identical]
	(d) providing HMRC with additional information.

126.34.3 *Disclosure: Failure to make return*

Para 14 sch 55 FA 09 provides two definitions of what is required:

(1B) Sub-paragraph (2) applies where-	(2A) Sub-paragraph (2B) applies where
(a) P is liable to a penalty under paragraph 6(3) or (4) and P discloses relevant information that involves a domestic matter, or	P is liable to a penalty under paragraph 6(3) or (4) and P discloses relevant information that involves an offshore matter or an offshore transfer.
(b) P is liable to a penalty under any of the other provisions mentioned in sub-paragraph (1) and P discloses relevant information.	
(2) P discloses relevant information by-	(2B) P discloses relevant information by-
(a) telling HMRC about it,	[identical]
(b) giving HMRC reasonable help in quantifying any tax unpaid by reason of its having been withheld, and	[identical]
(c) allowing HMRC access to records for the purpose of checking how much tax is so unpaid.	[identical]
	(d) providing HMRC with additional information.

126.34.4 *Disclosure required: RTC*

Para 16(3) sch 18 F2A 17 provides only one definition:

> A person discloses a matter for the purposes of this paragraph only by–
> (a) telling HMRC about it,
> (b) giving HMRC reasonable help in relation to the matter (for example by quantifying an inaccuracy in a document),

> (c) informing HMRC of any person who acted as an enabler[53] of the relevant offshore tax non-compliance or the failure to correct it, and
>
> (d) allowing HMRC access to records-
>
> (i) for any reasonable purpose connected with resolving the matter (for example for the purpose of ensuring that an inaccuracy in a document is fully corrected), and
>
> (ii) for the purpose of ensuring that HMRC can identify all persons who may have acted as an enabler of the relevant offshore tax non-compliance or the failure to correct it.

126.34.5 *Reduction for asset-based penalties*

Para 8(1) sch 22 FA 16 provides:

> HMRC must reduce the standard amount of the asset-based penalty where P does all of the following things
>
> (a) makes a disclosure of the inaccuracy or failure relating to the standard offshore tax penalty;
>
> (b) provides HMRC with a reasonable valuation of the asset;
>
> (c) provides HMRC with information or access to records that HMRC requires from P for the purposes of valuing the asset.

126.34.6 *Prompted/unprompted*

A commonsense penalties template definition provides:

> Disclosure—
>
> (a) is "unprompted" if made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy, the supply of false information or withholding of information, or the under-assessment, and
>
> (b) otherwise, is "prompted".[54]

[53] Para 16(7) sch 18 F(no2)A 2017 provides a definition: "For the purposes of sub-paragraph (3) a person "acted as an enabler" of relevant offshore tax non-compliance by another if the person encouraged, assisted or otherwise facilitated the conduct by the other person that constituted the offshore tax non-compliance. or otherwise facilitated the conduct by the other person that constituted the offshore tax non-compliance."

[54] Para 9(2) sch 24 FA 07/Para 12(3) sch 41 FA 08; Para 14(3) sch 55 FA 09 is effectively the same.

For asset based penalties, para 8 sch 22 FA 16 provides:

> (5) A case involves only unprompted disclosures where
>
> (a) in a case where the asset-based penalty relates to only one standard offshore tax penalty, that standard offshore tax penalty was reduced on the basis of an unprompted disclosure, or
>
> (b) in a case where the asset-based penalty relates to more than one standard offshore tax penalty, all of those standard offshore tax penalties were reduced on the basis of unprompted disclosures.
>
> (6) A case involves prompted disclosures where any of the standard offshore tax penalties to which the asset-based penalty relates was reduced on the basis of a prompted disclosure.

The Compliance Handbook provides:

> **CH82421 Determining unprompted or prompted disclosure** [Apr 2018]
>
> You must check the date from which these rules apply for the tax or duty you are dealing with. See CH81011 for full details.
>
> Whether a disclosure is unprompted or prompted is an objective test. The particular facts and circumstances of the disclosure are the basis of the test, not the belief that it was either unprompted or prompted.
>
> A national campaign highlighting an area of the trading community on which HMRC will be concentrating would not stop a disclosure from being unprompted. However a disclosure would be prompted if a person made the disclosure after
>
> - we contacted them to tell them we wished to make a compliance check of their return
> - we arranged to visit their premises to explore the risks we had identified, or
> - we told them that we had asked the Valuation Office Agency to consider the value of a property included in an inheritance tax account, or
> - HMRC has been supplied with information, under an automatic exchange of information agreement that would, when reviewed, lead to the discovery of the issue being disclosed. This would not apply where the person had no reason to believe that the information had been supplied to HMRC
>
> It will be exceptional for a disclosure to be unprompted if a compliance check is in progress. The disclosure will be unprompted only if it is about something the compliance officer has not discovered or is not

about to discover.

A disclosure may be made during the course of a compliance check. If it is related to the subject matter being reviewed then it will be considered to be a related disclosure and therefore prompted.

Some companies will be in continuous dialogue to share a Risk Profile with HMRC. A disclosure can be unprompted if it relates to an

- an area of risk identified by the company, or
- an area identified as part of risk profile discussions that is not yet the subject of a specific enquiry. ...

A person is only able to disclose something they know is wrong. They may be genuinely unaware that they have done anything wrong. However, a disclosure made after we challenge a particular issue cannot be unprompted.

An unprompted disclosure can be made for both inaccuracies and under-assessments.

CH82422 Examples of unprompted or prompted disclosure [Apr 2018]

...

Example 1

Jemima returned a capital gain which is the subject of a compliance check. There is no intention to expand the scope of the compliance check during the review. She discloses that she has not declared her car benefit. This is an unprompted disclosure.

Example 2

During a VAT assurance visit considering the credibility of Alphonse's sales records, he discloses that his sales have also been understated for income tax. This would be related to the subject under review and so is a prompted disclosure.

Example 3

During an Employer Compliance review the employer makes a disclosure that the basis of the transfer pricing calculation for Corporation Tax is wrong. This is unrelated to the subject under review and so there is an unprompted disclosure.

Example 4

During an enquiry into an inheritance tax account, we referred the value of the deceased's house to the Valuation Office Agency and tell the personal representatives that we have done so. The personal representatives subsequently correct the value upwards saying that they sold the property for the higher value shortly before submitting the account. This is a prompted disclosure.

Example 5

During an audit of a winery, the manager discloses to the officer that the duty declared on the previous return was actually incorrect. He admits that this had been incorrectly calculated on the strength of wine at 13% abv instead of 16% abv. The manager had made no previous attempt to inform HMRC about this inaccuracy before the stock records were checked. This is a prompted disclosure.

Example 6

On 17 May 2010 a central assessment is raised because Banner Ltd's VAT return for the quarter end 31 March 2010 has not been received. On 1 August 2010 a compliance check is arranged with the company and a visit takes place on 15 August. During the visit the directors produce the completed VAT return for the period to 31 March 2010 showing a liability in excess of the central assessment. The assessment based on the completed return replaced the assessment raised on 17 May 2010. The production of the return is a prompted disclosure of an under-assessment.

Note that if a disclosure of an under-assessment is made within 30 days of the date the assessment is issued there will be no penalty in respect of the under-assessment, see CH81170.

Example 7

Darren, a Trustee of a Settlement, included a capital gain in the SA Trust return. The gain is the subject of a compliance check. During the check, Darren discloses that he has used the wrong acquisition value as there was a held-over gain on the transfer of the asset to the Settlement. This is related to the subject under review and so is a prompted disclosure.

Example 8

David holds funds received from consultancy income earned abroad in a bank account in a CRS (Common Reporting Standard) reporting country. The overseas bank wrote to David to tell him that details of his account were being exchanged under CRS. His disclosure includes the undeclared income, interest received and income from other offshore structures. Details of these offshore bank accounts have been given to HMRC under CRS and there has been significant activity promoting this exchange. HMRC expect most people who are affected will be well aware of these changes and David was explicitly told by his bank that they were reporting his account under CRS. We will treat this as a prompted disclosure as David knew the information had been supplied to HMRC and he therefore had reason to believe HMRC were about to find out about the undeclared income.

Example 9

Sarah had a bank account in a CRS reporting country and has not declared the interest she receives in that account. The account was

> closed in 2015 and because of this HMRC will not receive information about it under the Common Reporting Standard (CRS). Sarah becomes aware of the CRS and although her account will not be reported she decides to make a disclosure to HMRC. Because Sarah made her disclosure at a time when she had no reason to believe her undisclosed income was about to be discovered her disclosure will be treated as unprompted.

Disclosure following an HMRC "nudge letter" is prompted.

126.34.7 *"Quality"*

Penalty template wording provides:[55]

> In relation to disclosure "quality" includes timing, nature and extent.

126.35 Additional information

The additional information is set out in regulations[56] whose full name is too long to be used: Penalties Relating to Offshore Matters and Offshore Transfers (Additional Information) Regulations 2017. I refer to the "Additional Information Regs".
Reg 3 Additional Information Regs provides:

> The additional information required for the purposes of
> [1] paragraph 9(1B)(d) of Schedule 24 to the Finance Act 2007,
> [2] paragraph 12(2B)(d) of Schedule 41 to the Finance Act 2008 and
> [3] paragraph 14(2B)(d) of Schedule 55 to the Finance Act 2009,
> is that a person ("P") must
> (a) tell HMRC whether or not regulations 4 or 5 (or both) apply to P; and
> (b) provide HMRC with the information specified in relation to those regulations set out in regulations 6 and 7 (as appropriate).

This concerns:
(1) Enablers
(2) Property holders

[55] Para 9(3) sch 24 FA 07/para 12(4) sch 41 FA 08/ para 14(4) sch 55 FA 09. Para 15(6) sch 18 F2A 17 is substantially the same: "In relation to disclosure or assistance, "quality" includes timing, nature and extent."

[56] Authorised by Para 9(1C) sch 24 FA 07; para 12(2C) sch 41 FA 08; Para 14(2C) sch 55 FA 09

126.35.1 *Enablers*

Reg 4 Additional Information Regs provides:

> 4 This regulation applies to P if there is a person ("the enabler") who encouraged, assisted or otherwise facilitated the conduct by P giving rise to the penalty in question.

If so, reg 6 sets out the information required:

> The additional information to be provided to HMRC where regulation 4 applies to P is
> (a) the name and address of the enabler;
> (b) a description of the enablers conduct that encouraged, assisted or otherwise facilitated the conduct by P giving rise to the penalty in question;
> (c) a description of how the first contact between P and the enabler was made and how the contact was maintained during the times when the enablers conduct encouraged, assisted or otherwise facilitated the conduct by P giving rise to the penalty in question; and
> (d) a description of all documents held by P relating to the enablers conduct that encouraged, assisted or otherwise facilitated the conduct by P giving rise to the penalty in question.

126.35.2 *Property holders*

Reg 5 Additional Information Regs provides:

> This regulation applies to P if
> (a) P is the sole or a joint beneficial owner of an asset ("the asset") situated or held in a territory outside the United Kingdom; and
> (b) the person holding the asset ("the asset holder") is not P.

If so, reg 7 sets out the information required:

> The additional information to be provided to HMRC where regulation 5 applies to P is
> (a) the name and address of any other joint beneficial owner of the asset; (b) the extent of Ps share of the beneficial ownership of the asset;
> (c) a description of all documents of title or other documents indicating Ps beneficial ownership of the asset;
> (d) details of where the asset is situated or held;

(e) details of when and how P became a beneficial owner of the asset (including a description of all documents held by P relating to the acquisition of Ps beneficial ownership of the asset);

(f) a description of all changes in the arrangements for the ownership of the asset since P became a beneficial owner of it (including the date of any change in the arrangements and a description of all documents held by P relating to such changes);

(g) the names and last known addresses of all persons who have been asset holders of the asset during Ps beneficial ownership of it; and

(h) in relation to an asset holder who is not an individual, the name and business address (if known) of any director, senior manager, employee or agent of the asset holder who has advised or assisted P in relation to Ps beneficial ownership of the asset.

126.35.3 *Misc provisions*

Reg 2 Additional Information Regs provides:

> In these Regulations
> “asset” has the meaning given in section 21(1) of the Taxation of Capital Gains Act 1992, but also includes sterling;
> “document” includes part of a document.

Reg 8 Additional Information Regs provides:

> 8 (1) A description of a document provided in accordance with regulations 6 or 7 must (as far as it is reasonably practicable to do so) state in relation to the document
>
> (a) the latest of the date when the document was made, prepared or, if appropriate, signed or executed;
>
> (b) the person who made or prepared it (and the person on whose behalf it was made or prepared if different);
>
> (c) the person who signed or executed the document (if appropriate);
>
> (d) the person to whom the document was given or sent (if appropriate);
>
> (e) a summary of its contents or the information recorded in the document;
>
> (f) the location of the document or where it may be inspected.
>
> (2) The requirement to provide a description of a document in

> accordance with regulations 6 or 7 may be met by the provision of the document in question to HMRC or a suitable copy of it.
> (3) The provision of a document (or a copy of it) to HMRC as described in paragraph (2) is without prejudice to any requirement to produce the document in question to HMRC or power of HMRC to require the production of the document.

126.36 Amount of reduction for disclosure

126.36.1 *Benefit of disclosure: General*

Penalty template wording provides:[57]

> (1) If a person who would otherwise be liable to a penalty of a percentage shown in column 1 of the Table (a "standard percentage") has made a disclosure, HMRC must reduce the standard percentage to one that reflects the quality of the disclosure.
> (2) But the standard percentage may not be reduced to a percentage that is below the minimum shown for it—
> (a) in the case of a prompted disclosure, in column 2 of the Table, and
> (b) in the case of an unprompted disclosure, in column 3 of the Table.

Thus in each case we have two Tables. It would have been easier to have just one, but there it is.

Para 13(3) and 13A(3) sch 41 FA 08 provide:

> (3) Where the Table shows a different minimum for case A and case B-
> (a) the case A minimum applies if-
> (i) the penalty is one under paragraph 1, and
> (ii) HMRC become aware of the failure less than 12 months after the time when the tax first becomes unpaid by reason of the failure, and
> (b) otherwise, the case B minimum applies.

For asset-based penalties, para 8 sch 22 FA 16 provides:

> (2) A reduction under sub-paragraph (1) must reflect the quality of the disclosure, valuation and information provided (and for these purposes "quality" includes timing, nature and extent).

[57] This wording (with trivial variants) is found 6 times: Para 10, 10A sch 24 FA 07;Para 13,13A sch 41 FA 08; Para 15,15A sch 55 FA 09.

126.36.2 *Error-based penalty reduction*

The para 10 sch 24 FA 07 table provides:

Standard %	Minimum % prompted disclosure	Minimum % unprompted
30%	15%	0%
70%	35%	20%
100%	50%	30%

The para 10A sch 24 FA 07 table provides:

Standard %	Minimum % prompted disclosure	Minimum % unprompted
30%	15%	0%
37.5%	18.75%	0%
45%	22.5%	0%
60%	30%	0%
70%	45%	30%
87.5%	53.75%	35%
100%	60%	40%
105%	62.5%	40%
125%	72.5%	50%
140%	80%	50%
150%	85%	55%
200%	110%	70%

126.36.3 *Failure to notify reduction*

The para 13 sch 41 table is as follows:

Standard %	Minimum % prompted disclosure	Minimum % unprompted
30%	case A: 10%	case A: 0%
	case B: 20%	case B: 10%
70%	35%	20%
100%	50%	30%

The para 13A sch 41 table is as follows:

Standard %	Minimum % prompted disclosure	Minimum % unprompted
30%	case A: 10%	case A: 0%
	case B: 20%	case B: 10%
37.5%	case A: 12.5%	case A: 0%
	case B: 25%	case B: 12.5%
45%	case A: 15%	case A: 0%
	case B: 30%	case B:15%
60%	case A: 20%	case A: 0%
	case B: 40%	case B: 20%

70%	45%	30%
87.5%	53.75%	35%
100%	60%	40%
105%	62.5%	40%
125%	72.5%	50%
140%	80%	50%
150%	85%	55%
200%	110%	70%

126.36.4 *Failure to make return reduction*

The para 15 sch 55 table is as follows:

Standard %	Minimum % prompted disclosure	Minimum % unprompted
70%	35%	20%
100%	50%	30%

Para 15(3) sch 55 FA 09 provides a minimum penalty:

> But HMRC must not under this paragraph reduce a penalty below £300.

Subject to the £300 cap, the para 15A table is:

Standard %	Minimum % prompted disclosure	Minimum % unprompted
70%	45%	30%
87.5%	53.75%	35%
100%	60%	40%
105%	62.5%	40%
125%	72.5%	50%
140%	80%	50%
150%	85%	55%
200%	110%	70%

126.36.5 *Asset-based penalty reduction*

Asset-based penalties do not follow the template of the others, so I deal with this separately, though the outcome is not so different.

Reg 2 Asset-based Penalty for Offshore Inaccuracies and Failures (Reductions for Disclosure and Co-operation) Regulations:

> The maximum amount by which the standard amount of the asset-based penalty determined in accordance with paragraph 7 of Schedule 22 to the Finance Act 2016 (standard amount of asset-based penalty) may be reduced as required by paragraph 8 of that Schedule (reductions for disclosure and co-operation) is—
>
> (a) 50% of the standard amount in a case involving only

unprompted disclosures, and
(b) 20% of the standard amount in a case involving prompted disclosures.

126.36.6 *RTC reduction amount*

RTC does not need a table. Para 16 sch 18 F2A 17 provides:

> (4) Where a person liable to a penalty under paragraph 1 [RTC penalty] discloses a matter HMRC must reduce the penalty to one that reflects the quality of the disclosure.
> (5) But the penalty may not be reduced below 100% of the offshore PLR.

126.37 Reduction: Special circumstances

Para 11(1) sch 24 FA 07	**Para 17 sch 18 F2A 17**
If they think it right because of special circumstances, HMRC may reduce a penalty[58] under paragraph 1,1A or 2 [Error-based penalties].	(1) If they think it right because of special circumstances, HMRC may reduce a penalty under paragraph 1 [RTC penalty].

Para 11(2) sch 24 FA 07/para 17(2) sch 18 F2A 17 provide two exceptions:

> In sub-paragraph (1) "special circumstances" does not include—
> (a) ability to pay, or
> (b) the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.

Does this apply if the over-payment is actual and not potential?

An example of special circumstances is HMRC delay: *Fuller v HMRC* [2020] UKFTT 189 (TC).

126.38 Interaction of penalties

126.38.1 *Interaction of error-based and other penalties*

Para 12 sch 24 FA 07 provides:

> (2) The amount of a penalty for which P is liable under paragraph 1 or 2 in respect of a document relating to a tax period shall be reduced by

[58] Para 11(3) sch 24 FA 07/para 17(3) sch 18 F2A 17 provide a definition:
"In sub-paragraph (1) the reference to reducing a penalty includes a reference to—
(a) staying a penalty, and
(b) agreeing a compromise in relation to proceedings for a penalty."

> [a] the amount of any other penalty incurred by P, or
> [b] any surcharge for late payment of tax imposed on P,
>
> if the amount of the penalty or surcharge is determined by reference to the same tax liability.
>
> (2A) In sub-paragraph (2) "any other penalty" does not include a penalty under Part 4 of FA 2014 (penalty where corrective action not taken after follower notice etc) or Schedule 22 to FA 16 (asset-based penalty)
>
> (3) In the application of section 97A of TMA 1970 (multiple penalties) no account shall be taken of a penalty under paragraph 1 or 2.

126.38.2 *Interaction of asset-based penalty/RTC*

Para 6A sch 22 FA 16 provides:

> Where-
> (a) a penalty has been imposed on a person under paragraph 1 of Schedule 18 to FA 2017, and
> (b) the potential loss of revenue threshold has been met,
>
> only one asset-based penalty is payable by the person in relation to any given asset.

126.38.3 *RTC/other penalties interaction*

Para 24 sch 18 F2A 17 provides:

> (1) Where by reason of any conduct[59] a person-
> (a) has been convicted of an offence, or
> (b) is liable to a penalty otherwise than under paragraph 1 [RTC penalty] for which the person has been assessed (and the assessment has not been successfully appealed against or withdrawn),
>
> that conduct does not give rise to liability to a penalty under paragraph 1.

This relief is narrowed by a limited definition of penalties to which it applies:

> (2) In sub-paragraph (1) the reference to a penalty otherwise than under paragraph 1—
> (a) includes a penalty under paragraph 6 of Schedule 55 to FA 2009, but does not include penalties under any other provision of that Schedule, and

[59] Para 24(4) provides: "In sub-paragraph (1) "conduct" includes a failure to act."

> (b) includes a penalty under subsection (5) of section 93 of TMA 1970 but, does not include penalties under any other provision of that section.

Para 24 sch 18 F2A 17 provides another cap:

> (3) But the aggregate of-
> (a) the amount of a penalty under paragraph 1, and
> (b) the amount of a penalty under paragraph 5 of Schedule 55 which is determined by reference to a liability to tax,
> must not exceed 200% of that liability to tax.

126.39 RTC Definitions

Para 2 sch 18 F2A 17 provides:

> Paragraphs 3 to 13 have effect for the purposes of this Schedule.

The heavy lifting is in these definitions. The key term is "relevant offshore tax non-compliance" but that is reached by a cascade of definitions. I deal with these in their logical order (rather than the statutory order):

Term	**Defined**	**See para**
Tax	Para 12	126.40
Tax non-compliance	Para 8	126.41
Offshore tax non-compliance	Para 7	126.42
Involves Offshore Matter	Para 9-11	126.24
Original offshore tax non-compliance	Para 3	126.43
Relevant offshore tax non-compliance	Para 3	126.44

126.40 RTC: "Tax"

Para 12(1) sch 18 F2A 17 provides:

> References to "tax" are (unless in the context the reference is more specific) to income tax, capital gains tax or inheritance tax.

CIOT RTC guidance provides:

> Tax payable by the employee (e.g. on benefits in kind) is within RTC. PAYE is included if the employer no longer exists e.g. because it is liquidated. Otherwise PAYE is not within RTC.

NICs are outside RTC.

CT is also outside RTC, and para 12(2) sch 18 F2A 17 extends this to the former NRCGT (which was payable by companies but classified as CGT, not CT):

> References to "capital gains tax" do not include capital gains tax payable by companies[60] in respect of chargeable gains accruing to them to the extent that those gains are NRCGT gains in respect of which the companies are chargeable to capital gains tax under section 14D or 188D of TCGA 1992 (see section 1(2A)(b) of that Act).

126.41 RTC: "Tax non-compliance"

Para 8(1) sch 18 F2A 17 provides:

> "Tax non-compliance" means any of the following-
>
> (a) a failure to comply on or before the filing date[61] with an obligation under section 7 of TMA 1970[62] to give notice of chargeability to income tax or capital gains tax,
>
> (b) a failure to comply on or before the filing date with an obligation to deliver to HMRC a return or other document which is listed in sub-paragraph (3), or
>
> (c) delivering to HMRC a return or other document which
>
> [A] is listed in sub-paragraph (3) or (4) and
>
> [B] contains an inaccuracy which amounts to, or leads to-
>
> (i) an understatement of a liability to tax,
>
> (ii) a false or inflated statement of a loss,[63] or
>
> (iii) a false or inflated claim to repayment of tax.[64]

126.41.1 *Para (3) list*

Failure to deliver a document in this list, or delivering an inaccurate document, counts as tax non-compliance. Para 8(3) sch 18 F2A 17 provides:

> The documents relevant for the purposes of both of paragraphs (b) and

[60] Para 12(3) sch 18 F2A 17 provides: "In sub-paragraph (2) "company" has the same meaning as in TCGA 1992."

[61] Para 8(2) sch 18 F2A 17 provides: "In sub-paragraph (1) -
(a) "filing date", in relation to a notice of chargeability or a return or other document, means the date by which it is required to be given, made or delivered to HMRC".

[62] See 121.2 (Duty to notify HMRC).

[63] Para 8(2) sch 18 F2A 17 provides: "In sub-paragraph (1)...
(b) "loss" includes a charge, expense, deficit and any other amount which may be available for, or relied on to claim, a deduction or relief".

[64] Para 8(2) sch 18 F2A 17 provides: "In sub-paragraph (1) ...
(c) "repayment of tax" includes a reference to allowing a credit against tax."

> (c) of sub-paragraph (1) are (so far as they relate to the tax or taxes shown in the first column)-[65]

Tax	**Document**	**Provision**	**See para**
IT/CGT	personal return	s.8(1) TMA	121.4
IT/CGT	trust return	s.8A(1) TMA	121.4
IT	partnership return	s.12AA(2)(3) TMA	
IT	pension scheme return	s.254 FA 2004	
IT	pension scheme information	reg 12 Retirement Benefits Schemes (Information Powers) Regs 1995	
CGT	NRCGT return	s.12ZB TMA [now abolished]	
IHT	IHT Account	s.216, 217 IHTA	125.5, 125.11

126.41.2 *Para (4) list*

Delivering an inaccurate document in the para (4) list counts as tax non-compliance. Para 8(4) sch 18 F2A 17 provides:

> The documents relevant for the purposes only of paragraph (c) of sub-paragraph (1) are (so far as they relate to the tax or taxes shown in the first column)-

Tax	**Document**[66]
IT/CGT	Return statement or declaration in connection with a claim for an allowance, deduction or relief
IT/CGT	Accounts in connection with ascertaining liability to tax
IT/CGT	Statement or declaration in connection with a partnership return
IT/CGT	Accounts in connection with a partnership return
IHT	Information/document under regulations under s.256 IHTA 1984
IHT	Statement or declaration in connection with a deduction exemption or relief.
IT/CGT/IHT	Any other document given to HMRC by a person ("P") which is likely to be relied on by HMRC to determine, without further inquiry, a question about– (a) P's liability to tax; (b) payments by P by way of or in connection with tax; (c) any other payment by P (including penalties); (d) repayments or any other kind of payment or credit to P.

The list is wide, as one would expect, but it does not cover everything.

[65] I have slightly tweaked the layout and wording of this list, for clarity.

[66] I have slightly tweaked the layout and wording of this list, for clarity.

126.42 "Offshore" non-compliance

Para 7 sch 18 F2A 17 provides:

> (1) "Offshore tax non-compliance" means tax non-compliance which involves
> [a] an offshore matter or
> [b] an offshore transfer,
> whether or not it also involves an onshore matter.
> (2) Tax non-compliance "involves an onshore matter" if and to the extent that it does not involve an offshore matter or an offshore transfer.

See 126.24 (Offshore Matter/Transfer: RTC).

126.43 Original tax non-compliance

This term is defined in passing in para 3(1)(a) sch 18 F2A 17:

> At the end of the 2016-17 tax year a person has "relevant offshore tax non-compliance" to correct if-
> (a) Conditions A and B[67] are satisfied in respect of any offshore tax non-compliance committed by that person on or before 5 April 2017 ("the original offshore tax non-compliance")

126.44 Relevant tax non-compliance

Armed with these definitions, we can turn to the definition of "relevant offshore tax non-compliance". Para 3(1) sch 18 F2A 17 provides:

> At the end of the 2016-17 tax year a person has "relevant offshore tax non-compliance" to correct if-
> (a) Conditions A and B are satisfied in respect of any offshore tax non-compliance committed by that person on or before 5 April 2017 ("the original offshore tax non-compliance"), and
> (b) Condition C will be satisfied on the relevant date (see paragraph 6).

126.44.1 *Cond. A: Uncorrected error*

Para 4 sch 18 F2A 17 provides:

> Condition A is that the original offshore tax non-compliance has not been fully corrected before the end of the tax year 2016-17 (see paragraph 13).

[67] See 126.20.1 (Cond. A: Uncorrected error); 126.44.2 (Condition B: PLR).

126.44.2 *Condition B: PLR*

Para 5 sch 18 F2A 17 provides:

> Condition B is that-
> (a) the original offshore tax non-compliance involved a potential loss of revenue when it was committed, and
> (b) if the original offshore tax non-compliance has been corrected in part by the end of the tax year 2016-17, the uncorrected part at that time involved a potential loss of revenue.

126.44.3 *Correction in part*

Para 3(2) sch 18 F2A 17 provides:

> Where the original offshore tax non-compliance committed by a person has been corrected in part by the end of the tax year 2016-17, the person's "relevant offshore tax non-compliance" is the uncorrected part of the original offshore tax non-compliance.

126.45 Cond. C: Assessable in 2017

Para 6 sch 18 F2A 17 provides:

> (1) Condition C is that
> [i] on the relevant date
> [ii] it is lawful, on the assumptions set out in sub-paragraph (2),
> [iii] for HMRC to assess the person concerned to any tax
> [iv] the liability to which would have been disclosed to or discovered by HMRC if on that date-
> (a) where none of the original offshore tax non-compliance was corrected before the end of the 2016-17 tax year, HMRC were aware of the information missing as a result of the failure to correct that tax non-compliance, or
> (b) where the original offshore tax non compliance was corrected in part before that time, HMRC were aware of the information missing as a result of the failure to correct the rest of that tax non-compliance.

This brings in time limits.

Para 6 sch 18 F2A 17 provides:

> (2) The assumptions are-
> (a) that paragraph 26 [extended time limit][68] is to be disregarded,

[68] See 121.19 (RTC time limit: 5/4/21).

> and
>
> (b) where the tax at stake is inheritance tax, that the relevant offshore tax non-compliance is not corrected before the relevant date

What is the point of para (b)?

126.45.1 *The relevant date*

Para 6(3) sch 18 F2A 17 provides:

> In this paragraph "the relevant date" is-
>
> (a) where the tax at stake is income tax or capital gains tax, 6 April 2017, and
>
> (b) where the tax at stake is inheritance tax, the day after the day on which this Act is passed.[69]

2016–17 is not within the scope of RTC, as non-compliance did not exist on 5 April 2017. Errors in this year are governed by the normal penalty provisions.

126.46 Correcting non-compliance

Para 13 sch 18 F2A 17 provides:

> (1) This paragraph sets out how offshore tax non-compliance may be corrected.
>
> (2) References to the correction of offshore tax non-compliance of any description are to the taking of any action specified in this paragraph as a means of correcting offshore tax non-compliance of that description.

The concept of "correcting" offshore tax non-compliance is defined 3 times:

Failure	**Para**
Notify IT/CGT	13(3)(4)
Deliver return	13(5)(6)
Inaccurate return	13(7)(8)

The legislation may be easier to follow if these sub-paragraphs are set out side by side.

Para 13(3): Failure to notify	*Para 13(5): No return*	*Para 13(7): Incorrect return*
Offshore tax non-compliance	Offshore tax non-compliance	Offshore tax non-compliance

[69] The Act was passed on 16 Nov 2017 so the relevant date for IHT is 17 Nov 2017.

consisting of a failure to notify chargeability may be corrected by-	consisting of a failure to make or deliver a return or other document may be corrected by giving HMRC the relevant information by-	consisting of making and delivering a return or other document containing an inaccuracy may be corrected by giving HMRC the relevant information by-
(a) [i] giving the requisite notice to HMRC (unless before doing so the person has received a notice requiring the person to make and deliver a tax return) and		
[ii] giving HMRC the relevant information by any means mentioned in paragraph (b),		
(b) giving HMRC the relevant information-		
(i) by making and delivering a tax return,	(a) making or delivering the requisite return or document,	(a) in the case of an inaccurate tax document, amending the document or delivering a new document,
(ii) using the digital disclosure service or any other service provided by HMRC as a means of correcting tax non-compliance,	(b) using the digital disclosure service or any other service provided by HMRC as a means of correcting tax non-compliance,	(b) using the digital disclosure service or any other service provided by HMRC as a means of correcting tax non-compliance,
(iii) communicating it to an officer of Revenue and Customs in the course of an enquiry into the person's tax affairs, or	(c) communicating it to an officer of Revenue and Customs in the course of an enquiry into the person's tax affairs, or	(c) communicating it to an officer of Revenue and Customs in the course of an enquiry into the person's tax affairs, or
(iv) using a method agreed with an officer of Revenue and Customs.	(d) using a method agreed with an officer of Revenue and Customs.	(d) using a method agreed with an officer of Revenue and Customs.

"Relevant information" is also defined three times:

Para 13(4): Failure to notify	*Para 13(6): No return*	*Para 13(8): Incorrect return*
In sub-paragraph (3) "relevant information" means information relating to offshore tax that-	(6) In subsection (5) "relevant information" means information relating to offshore tax that–	(8) In sub-paragraph (7) "relevant information" means information relating to offshore tax that–
(a) had the requisite notice been given in time and the person given a notice to make and deliver a tax return, would have been required to be included in the tax return, and	(a) should have been included in the return or other document, and	(a) should have been included in the return but was not (whether due to an omission or the giving of inaccurate information), and
(b) would have enabled or assisted HMRC to calculate the offshore tax due.	(b) would have enabled or assisted HMRC to calculate the offshore tax due.	(b) would have enabled or assisted HMRC to calculate the offshore tax due.

While this is not completely clear, it is suggested that relevant information means information in para (a) or (b) (it does not have to be both (a) and (b).

CIOT RTC guidance provides:

> If an estimated liability is provided in the absence of accurate information (e.g. because the taxpayer could not obtain the information or because another figure was used rather than getting a professional asset valuation) then this should be explained. The figure provided should be correct to the best of the taxpayer's knowledge and belief
> If the eventual tax liabilities are materially higher, then HMRC may revisit FTC [failure to correct] penalties as this might indicate the taxpayer was not compliant with RTC. HMRC recommend erring on the side of caution when stating the amounts of tax owed

Para 13(9) sch 18 F2A 17 provides:

> In this paragraph "offshore tax", in relation to any offshore tax non-compliance, means tax corresponding to the offshore PLR in respect of the non-compliance.

126.46.1 *Multiple parties*

CIOT RTC guidance provides:

> In the case of a single report being prepared for multiple parties (for

> example trustee, underlying companies and beneficiaries) it will still be necessary for each party to register separately for the WDF and for the report to be submitted for each party

126.46.2 *Trustees*

CIOT RTC guidance provides:

> In the case of a change of trustees but where the trust remains the same settlement, the new trustees can and should make the correction even if the non-compliance occurred during the trusteeship of a previous trustee. The liability is that of the trust and anyone authorised to act on behalf of the trust, including new trustees, can make the correction.

More analytically, new trustees can and should correct non-compliance of old trustees because trustees are treated as a single and continuing body.

126.46.3 *Deceased taxpayer*

CIOT RTC guidance provides:

> Personal representatives (PRs) do not inherit the deceased's "relevant offshore tax non-compliance" so they have nothing to correct
> If a taxpayer dies after the end of the RTC period without having corrected "relevant offshore tax non-compliance", in line with their normal practice, HMRC will not charge FTC penalties on the deceased's estate
> There may be occasions where other parties (not the PRs) may have a requirement to correct – such as trustees – and this should always be considered

126.47 RTC: Nil liability disclosure

HMRC RTC guidance provides:

> If the advice you have received is that no further tax is due, but the matter is not clear cut, you can use the internet to provide HMRC with the relevant information without accepting that you have unpaid liabilities.
> To do this you should register to make an offshore disclosure via HMRC's digital disclosure service. Once you have done this you will be sent a Disclosure Reference Number (DRN).
> The DRN will consist of the letters 'WDF' followed by a series of numbers. When you receive your DRN you should then complete the disclosure process on the digital disclosure service showing that you owe no tax.

> At the same time as you submit your disclosure via the digital disclosure service you should send a report that contains all of the relevant information to ocu.hmrc@hmrc.gsi.gov.uk.
>
> Your email must include your DRN and the words 'Requirement to Correct' in the subject heading.
>
> Provided you give HMRC all the relevant information about the matter you will have made a correction under the RTC even if you do not agree that additional tax is due. As you have made a correction no FTC [failure to correct] penalty can be due.
>
> HMRC will then consider the information you have provided to decide whether or not they agree that no tax is due....
>
> **Information you must supply when making a disclosure that no tax is due**
>
> HMRC can see no reason for you to make a disclosure that no tax is due except where you have doubt about whether tax is correctly due.
>
> When making such a disclosure you should therefore
>
> [1] set out a full explanation of why you have doubt about whether tax is due and
>
> [2] set out all of the relevant facts that you took into account in deciding that no tax is due.
>
> You should also provide an indication of the amount of income, gains and similar that you think are not liable to tax as a result of your decision.
>
> If you do this, provided the information you supply is accurate, the penalties for a Failure to Correct will not be due if it later transpires that additional tax is due as a result of the issue you have told us about (other existing penalties may apply).
>
> HMRC will acknowledge the information has been supplied but the offer to pay no tax will not be formally accepted. HMRC will only contact you for further information if they are concerned that your conclusion is incorrect.

CIOT RTC guidance provides:

> This process is a concession provided in the guidance that allows taxpayers, in limited circumstances, to provide less information than might strictly be required by the legislation and is designed to facilitate nil liability disclosures
>
> HMRC will look at all nil disclosures and may query/investigate them
>
> HMRC will not seek a FTC penalty if all relevant facts are disclosed as in effect the taxpayer will be treated as having made a correction
>
> This route is only for taxpayers not under enquiry and should not be used where the taxpayer is under enquiry. Here the case officer should

be contacted with a view to agreeing what should be supplied before 30 September

126.48 Application of TMA rules

Para 25 sch 18 F2A 17 provides:

> Subject to the provisions of this Part of this Schedule, the following provisions of TMA 1970 apply for the purposes of this Part of this Schedule as they apply for the purposes of the Taxes Acts-
> (a) section 108 (responsibility of company officers),
> (b) section 114 (want of form), and
> (c) section 115 (delivery and service of documents).

126.49 RTC: Interpretation

Para 32 sch 18 F2A 17 provides minor definitions:

> (1) In this Schedule (apart from the amendments made by Part 3)-
> "tax period" means a tax year or other period in respect of which tax is charged (or in the case of in-heritance tax, the year beginning with 6 April and ending on the following 5 April in which the liability to tax first arose);
> "tax year", in relation to inheritance tax, means a period of 12 months beginning on 6 April and ending on the following 5 April;
> "United Kingdom" means the UK, including its territorial sea.
> (2) A reference to making a return or doing anything in relation to a return includes a reference to amending a return or doing anything in relation to an amended return.
> (3) References to delivery (of a document) include giving, sending and any other similar expressions.
> (4) A reference to delivering a document to HMRC includes–
> (a) a reference to communicating information to HMRC in any form and by any method (whether by post, fax, email, telephone or otherwise, and
> (b) a reference to making a statement or declaration in a document.
> (5) References to an assessment to tax, in relation to inheritance tax, are to a determination.
> (6) An expression used in relation to income tax has the same meaning as in the Income Tax Acts.
> (7) An expression used in relation to capital gains tax has the same meaning as in the enactments relating to that tax.
> (8) An expression used in relation to inheritance tax has the same meaning as in IHTA 1984.

126.50 Assessment of penalties

Para 18 sch 55 FA 2009 provides:

> (1) Where P is liable for a penalty under any paragraph of this Schedule HMRC must—
>
> (a) assess the penalty,
> (b) notify P, and
> (c) state in the notice the period in respect of which the penalty is assessed.
>
> …
>
> (3) An assessment of a penalty under any paragraph of this Schedule—
>
> (a) is to be treated for procedural purposes in the same way as an assessment to tax (except in respect of a matter expressly provided for by this Schedule),
> (b) may be enforced as if it were an assessment to tax, and
> (c) may be combined with an assessment to tax.

The rules for assessing a penalty are not the same as for assessing tax. In *Trustees of the Paul Hogarth Life Interest Trust v HMRC:*[70]

> Paragraph 18(1) says it is P who must be assessed. Not only is that an express provision, it is a mandatory one, unlike it seems s 30AA TMA. Thus it is the relevant trustee or trustees who were given the s 8A(1) TMA notice who are to be assessed. This is also consistent with the requirements in s 8A(5) to read relevant references in other parts of TMA (notably s 29) by reference to the identity of the s 8A(1) notice recipient.

126.51 RTC: Disguised remuneration

CIOT RTC guidance provides:

> HMRC are updating both the RTC Guidance and the DR Settlement Terms Guidance to explain what will happen where a taxpayer has not finished the correction process on a DR settlement by 30 September 2018; indeed, the aim is for people to settle by 31 March 2019 in advance of the 5 April 2019 loan charge. The updated guidance will be published soon. It seems likely that HMRC's position will be that the DR Settlement Terms will fall to be treated as "any other service provided by HMRC as a means of correcting tax non-compliance" (para 13 (3)(b)(ii)) but this will not be confirmed until the updated guidance

[70] [2018] UKFTT 595 (TC) at [26].

is published.

Some DR settlements must include liabilities by way of "voluntary restitution". HMRC's view is that any amounts that fall within "voluntary restitution" are not liabilities in need of correction at April 2017 (para 3(1)(b)). Consequently, they are outside the scope of RTC and no FTC [failure to correct] sanctions can arise in relation to them.

126.52 GAAR penalties

I consider this topic in outline only.

Section 212A FA 2013 provides:

> (1) A person (P) is liable to pay a penalty if—
> (a) P has been given a notice under—
> (i) paragraph 12 of Schedule 43
> (ii) paragraph 8 or 9 of Schedule 43A, or
> (iii) paragraph 8 of Schedule 43B,
>
> stating that a tax advantage arising from particular tax arrangements is to be counteracted,

These notices are:

Provision	**Notice**
Para 12 sch 43	HMRC counteraction after GAAR advisory panel opinion
Para 8 or 9 sch 43A	Pooling notices
Para 8 sch 43B	Generic referral of tax arrangements

Section 212A FA 2013 continues:

> (b) a tax document has been given to HMRC on the basis that the tax advantage arises to P from those arrangements,
> (c) that document was given to HMRC—
> (i) by P, or
> (ii) by another person in circumstances where P knew, or ought to have known, that the other person gave the document on the basis mentioned in paragraph (b), and
> (d) the tax advantage has been counteracted by the making of adjustments under section 209.
>
> (2) The penalty is 60% of the value of the counteracted advantage.
>
> (3) Schedule 43C—
> (a) gives the meaning of "the value of the counteracted advantage", and
> (b) makes other provision in relation to penalties under this section.
>
> (4) In this section "tax document" means any return, claim or other document submitted in compliance (or purported compliance) with any

> provision of, or made under, an Act.
> (5) In this section the reference to giving a tax document to HMRC is to be interpreted in accordance with paragraph 11(g) and (h) of Schedule 43C.

Section 212B FA 2013 makes equivalent provision for partnerships, not discussed here.

126.53 Public list of defaulters

In 1905, the Departmental Committee on Income Tax reported:

> Besides the pecuniary penalties, publicity would be the most effectual and appropriate penalty for fraud. We recommend that the Board of Inland Revenue or the General Commissioners should be empowered to publish names and details in cases of gross fraud, whenever and in so far as they consider that course desirable.[71]

Statutory "naming and shaming" was introduced a century later. Section 94 FA 2009 provides:

> (1) The Commissioners may publish information about any person if—
> (a) in consequence of an investigation conducted by the Commissioners, one or more relevant tax penalties[72] is found to have been incurred by the person, and
> (b) the potential lost revenue[73] in relation to the penalty (or the aggregate of the potential lost revenue in relation to each of the

[71] Report para 37.

[72] Defined s.94(2) FA 2009: "A "relevant tax penalty" is—
(a) a penalty under paragraph 1 of Schedule 24 to FA 07 (inaccuracy in taxpayer's document) in respect of a deliberate inaccuracy on the part of the person,
(b) a penalty under paragraph 1A of that Schedule (inaccuracy in taxpayer's document attributable to deliberate supply of false information or deliberate withholding of information by person),
(c) a penalty under paragraph 1 of Schedule 41 to FA 08 (failure to notify) in respect of a deliberate failure on the part of the person, or
(d) a penalty under paragraph 2 (unauthorised VAT invoice), 3 (putting product to use attracting higher duty etc) or 4 (handling goods subject to unpaid excise duty) of that Schedule in respect of deliberate action by the person."

[73] Defined s.94(3) FA 2009: ""Potential lost revenue", in relation to a penalty, has the meaning given by—
(a) paragraphs 5 to 8 of Schedule 24 to FA 07, or
(b) paragraphs 7 to 11 of Schedule 41 to FA 08,
in relation to the inaccuracy, failure or action to which the penalty relates."

penalties) exceeds £25,000.

(4) The information that may be published is—

(a) the person's name (including any trading name, previous name or pseudonym),

(b) the person's address (or registered office),

(c) the nature of any business carried on by the person,

(d) the amount of the penalty or penalties and the potential lost revenue in relation to the penalty (or the aggregate of the potential lost revenue in relation to each of the penalties),

(e) the periods or times to which the inaccuracy, failure or action giving rise to the penalty (or any of the penalties) relates, and

(f) any such other information as the Commissioners consider it appropriate to publish in order to make clear the person's identity.

The list is online, for readers who are curious, with about 300 names.[74]

126.53.1 *Trustees/controlling persons*

Section 94 FA 2009 provides:

Body corporate/partnership	**Trustees**
(4A) Subsection (4B) applies where a person who is a body corporate or a partnership has incurred—	(4C) Subsection (4D) applies where one or more trustees of a settlement have incurred—
(a) a penalty under paragraph 1 of Schedule 24 to FA 2007 in respect of a deliberate inaccuracy which involves an offshore matter or an offshore transfer (within the meaning of paragraph 4Aof that Schedule), or (b) a penalty under paragraph 1 of Schedule 41 to FA 2008 in respect of a deliberate failure which involves an offshore matter or an offshore transfer (within the meaning of paragraph 6A of that Schedule).	[identical]

[74] *https://www.gov.uk/government/publications/publishing-details-of-deliberate-tax-defaulters-pddd/current-list-of-deliberate-tax-defaulters*

(4B) The Commissioners may publish the information mentioned in subsection (4) in respect of any individual who—
(a) controls the body corporate or the partnership (within the meaning of section 1124 of CTA 2010) [strict-sense control], and
(b) has obtained a tax advantage[75] as a result of the inaccuracy or failure.

(4D) The Commissioners may publish the information mentioned in subsection (4) in respect of any trustee who is an individual and who has obtained a tax advantage as a result of the inaccuracy or failure....

126.53.2 *Process*

Section 94 FA 2009 provides:

> (6) Before publishing any information about a person under subsection (1) the Commissioners—
> (a) must inform the person that they are considering doing so, and
> (b) afford the person reasonable opportunity to make representations about whether it should be published.
>
> (6A) Before publishing any information about an individual under subsection (4B) or (4D), the Commissioners—
> (a) must inform the individual that they are considering doing so, and
> (b) afford the individual reasonable opportunity to make representations about whether it should be published.
>
> (7) No information may be published before the day when the penalty becomes final (or the latest day when any of the penalties becomes final).
>
> (8) No information may be published for the first time after the end of the period of one year beginning with that day (or that latest day).
>
> (9) No information may be published (or continue to be published) after the end of the period of one year beginning with the day on which it is first published.
>
> (10) No information may be published if the amount of the penalty is reduced under—[76]

[75] Section 94(16) FA 2009 Para 6(2) incorporates the GAAR definition of tax advantage by reference: "In this section ... "tax advantage" has the meaning given by section 208 of FA 2013."

[76] For clarity I have set this out in tabular form rather than the layout of the statute.

Provision	**See para**
Para 10 sch 24 FA 2007	126.36.2
Para 10A sch 24 FA 2007 to the full extent permitted following an unprompted disclosure	126.36.2
Para 13 sch 41 FA 2008, to the full extent permitted, or	126.36.3
para 13A sch 41 FA 2008 to the full extent permitted following an unprompted disclosure.	126.36.3

126.53.3 *Publication rule: Critique*

We have seen the usual mission creep, together with an erosion of the minimum limit by inflation. The House of Lords Economic Affairs Committee say:

> Naming and shaming provisions have subsequently been introduced to allow HMRC to publish the names of large corporations whose behaviour is consistently uncooperative and of promoters and participants in failed avoidance schemes.
> 114. The extension of the naming sanction to taxpayers and promoters whose behaviour is legal, but of which HMRC disapproves, blurs an important boundary between those who break the law and those who do not.
> 115. We recommend that naming and shaming provisions should be restricted to those who have broken the law.[77]

But no-one has taken any notice of that.

126.54 Public attitude(s) to compliance

One wonders what the public think of all this. In *Ruddigore*, Robin is examined to see if he has complied with an ancestral obligation to commit a crime every day:

> **Sir Roderic.** It is our duty to see that our successors commit their daily crimes in a conscientious and workmanlike fashion. It is our duty to remind you that you are evading the conditions under which you are permitted to exist.
> **Robin.** Really, I don’t know what you’d have. I’ve only been a bad baronet a week, and I’ve committed a crime punctually every day.
> **Sir Roderic.** Let us inquire into this. Monday?

[77] House of Lords Economic Affairs Committee “HMRC: Treating Taxpayers Fairly” (2018) *https://publications.parliament.uk/pa/ld201719/ldselect/ldeconaf/242/242.pdf*

Robin. Monday was a Bank Holiday.
Sir Roderic. True. Tuesday?
Robin. On Tuesday I made a false income-tax return.
All. Ha! ha!
Sir Rupert. That's nothing.
Sir Jasper. Nothing at all.
Sir Conrad. Everybody does that.
Sir Gilbert. It's expected of you.

That was 1887. Since 2007 we have seen new penalty regimes culminating in 2017 with RTC and the attempt to change corporate culture by the criminal offence of failing to prevent tax evasion.[78] Has the joke had its day? Discuss.

[78] See 120A.1 (Failure to prevent evasion).

CHAPTER ONE HUNDRED AND TWENTY SEVEN

FAILURE TO PREVENT TAX EVASION

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127.1 Failure to prevent evasion

The main topic of this chapter is the offence of failure to prevent tax evasion; or, viewing the same topic from a different perspective, the requirement for businesses to have evasion prevention policies and procedures. I also discuss a variety of other tax offences.

The law is in Part 3 Criminal Finances Act 2017.

HMRC have issued 50 pages of guidance (**"CFA guidance"**).[1] This is statutory guidance.[2] I am not sure that has added to its quality; but the disclaimer is more than a page long, which is, I think, a record.

HMRC's guidance is supplemented by industry guidance from:

Law Society[3]
Financial Services Sector[4]
London & International Insurance Brokers' Association

A full discussion would require a book to itself.

The background is in HMRC consultation papers,[5] now of mainly historical interest.

As at July 2023 no charges have been brought.[6] But the measure of success should be whether the legislation has changed behaviour and reduced facilitation of evasion. Has that happened? Is it possible to tell?

[1] HMRC, "Tackling tax evasion: Government guidance for the corporate offences of failure to prevent the criminal facilitation of tax evasion" (2017).
https://www.gov.uk/government/publications/corporate-offences-for-failing-to-prevent-criminal-facilitation-of-tax-evasion
This draws at points on guidance relating to the Bribery Act 2010.

[2] It is required by s.47 CFA.

[3] *https://www.lawsociety.org.uk/en/topics/tax/criminal-finances-act-2017*

[4] "Failure to prevent the criminal facilitation of tax evasion: Guidance for the financial services sector on the corporate criminal offences within the Criminal Finances Act 2017"
https://www.ukfinance.org.uk/system/files/Corporate-Criminal-Offences-guidance-clean-version-as-approved-by-UK-Finance.pdf
This in turn draws on Joint Money Laundering Steering Group guidance entitled "Prevention of money laundering and combating terrorist financing".

[5] HMRC, "Tackling offshore tax evasion: A new corporate criminal offence of failure to prevent the facilitation of evasion" (July 2015)
HMRC, "Tackling offshore tax evasion: A new criminal offence for offshore evaders Summary of Responses" (Dec 2015)
https://www.gov.uk/government/consultations/tackling-offshore-evasion

[6] HMRC FOI release, "Number of live Corporate Criminal Offences investigations" 27 July 2023
https://www.gov.uk/government/publications/number-of-live-corporate-criminal-offences-investigations/number-of-live-corporate-criminal-offences-investigations

Discuss.

The Law Commission consider the possibility of new failure to prevent style offences in the report "Corporate Criminal Liability" (2022).[7]

127.2 Definitions

CFA is not part of the Taxes Acts, so the usual Taxes Acts definitions do not apply.

127.2.1 *Relevant body*

Section 44 CFA 2017 provides:

> (1) This section defines expressions used in this Part [Part 3 CFA].
> (2) "Relevant body" means a body corporate or partnership (wherever incorporated or formed).

That covers all businesses other than individual sole traders (such as barristers in private practice).

Section 44(3) CFA 2017 provides:

> "Partnership" means-
> (a) a partnership within the meaning of the Partnership Act 1890, or
> (b) a limited partnership registered under the Limited Partnerships Act 1907,
>
> or a firm or entity of a similar character formed under the law of a foreign country.

The definition is from s.1208 Companies Act 2006.[8] An LLP is not a partnership, but it is a body corporate and so a relevant person.

127.2.2 *Associated person*

Section 44(4) CFA 2017 provides:

> A person (P) acts in the capacity of a person associated with a relevant body (B) if P is-
> (a) an employee of B who is acting in the capacity of an employee,
> (b) an agent of B (other than an employee) who is acting in the capacity of an agent, or
> (c) any other person who performs services for or on behalf of B who is acting in the capacity of a person performing such

[7] *https://www.lawcom.gov.uk/project/corporate-criminal-liability/*

[8] See 90.3.3 (Foreign-entity clauses).

services.

Section 44(5) CFA 2017 provides:

> For the purposes of subsection (4)(c) the question whether or not P is a person who provides services for or on behalf of B is to be determined by reference to all the relevant circumstances and not merely by reference to the nature of the relationship between P and B.

I am not sure what (if anything) the drafter had in mind here, but it shows that the phrase "for or on behalf of B" is not to be narrowly understood.

The wording draws on s.8 Bribery Act 2010 and guidance/discussion on that provision may be helpful here.

A director is not an employee.[9] But they probably perform services for their company, so a director may be an Associate under para (c).

127.3 The CFA offences

s.45 CFA (UK tax evasion)

(1) A relevant body (B) is guilty of an offence if a person commits a UK tax evasion facilitation offence when acting in the capacity of a person associated with B.

s.46 CFA (foreign tax evasion)

(1) A relevant body (B) is guilty of an offence if at any time-
(a) a person commits a foreign tax evasion facilitation offence when acting in the capacity of a person associated with B, and
(b) any of the conditions in subsection (2) is satisfied.

(2) The conditions are-
(a) that B is a body incorporated, or a partnership formed, under the law of any part of the UK;
(b) that B carries on business or part of a business in the UK;
(c) that any conduct constituting part of the foreign tax evasion facilitation offence takes place in the UK;
and in paragraph (b) "business" includes an undertaking.

[9] Unless in addition to the office of director, they have also entered into a contract of employment.

In this chapter:

Term	**Meaning**
Facilitation Offence	UK/foreign tax evasion facilitation offence
Facilitation Offender	Person who commits that offence
Failure to prevent evasion offence	Offence under s.45(1)/46(1) CFA

127.4 Facilitation Offence

This term has a (relatively) straightforward meaning:

s.45(5) CFA (UK tax evasion)	**s.46(6) CFA (foreign tax evasion)**
In this Part [Part 3 CFA] "UK tax evasion facilitation offence" means	In this Part [Part 3 CFA] "foreign tax evasion facilitation offence" means
an offence under the law of any part of the UK consisting of—	conduct which- (a) amounts to an offence under the law of a foreign country,
(a) being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax by another person, (b) aiding, abetting, counselling or procuring the commission of a UK tax evasion offence, or (c) being involved art and part[10] in the commission of an offence consisting of being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax.	(b) relates to the commission by another person of a foreign tax evasion offence under that law, and (c) would, if the foreign tax evasion offence were a UK tax evasion offence, amount to a UK tax evasion facilitation offence (see section 45(5) and (6)).

It is difficult to see what paras (b)/(c) add to para (a); but it does not matter.

Section 45(6) CFA provides:

> Conduct carried out with a view to the fraudulent evasion of tax by another person is not to be regarded as a UK tax evasion facilitation offence by virtue of subsection (5)(a) unless the other person has

[10] "Art and part" is a term of Scots law meaning to aid or abet an offence.

committed a UK tax evasion offence facilitated by that conduct.

127.4.1 *"Tax evasion offence"*

The term "tax evasion offence" matters because it is a requirement of a Facilitation Offence under s.45(5)(b) and s.46(5).

s.45(4) CFA (UK tax evasion)	**s.46(5) CFA (foreign tax evasion)**
In this Part [Part 3 CFA] "UK tax evasion offence" means- (a) an offence of cheating the public revenue, or (b) an offence under the law of any part of the UK consisting of being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of a tax.[11]	In this Part [Part 3 CFA] "foreign tax evasion offence" means conduct which— (a) amounts to an offence under the law of a foreign country, (b) relates to a breach of a duty relating to a tax imposed under the law of that country, and (c) would be regarded by the courts of any part of the UK as amounting to being knowingly concerned in, or in taking steps with a view to, the fraudulent evasion of that tax.

127.4.2 *"Knowingly concerned"*

"Knowingly concerned" matters for:
(1) the definition of Facilitation Offence
(2) statutory offences of fraudulent evasion

What knowledge is required by "knowingly", and what conduct is required by "concerned in"? Or is it a question of fact for the magistrate/jury?

127.4.3 *"Tax*"

Section 45(7) CFA provides:

> For the purposes of this section "tax" means a tax imposed under the law of any part of the UK, including national insurance contributions under-
> (a) Part 1 of the Social Security Contributions and Benefits Act 1992, or
> (b) Part 1 of the Social Security Contributions and Benefits (Northern Ireland) Act 1992.

[11] See 127.8 (Fraudulent evasion).

127.5 Prevention procedures

s.45(2) CFA (UK tax evasion)	**s.46(3) CFA (foreign tax evasion)**
It is a defence for B to prove that, when the UK tax evasion facilitation offence was committed-	It is a defence for B to prove that, when the foreign tax evasion facilitation offence was committed-
(a) B had in place such prevention procedures as it was reasonable in all the circumstances to expect B to have in place, or (b) it was not reasonable in all the circumstances to expect B to have any prevention procedures in place.	[Identical]

Parallels may be drawn with:

(1) Adequate procedures defence under s.7 Bribery Act 2010
(2) The senior accounting officer regime; sch 46 FA 2009
(3) AML requirements

127.5.1 *"Prevention procedures"*

s.45(3) CFA (UK tax evasion)	**s.46(4) CFA (foreign tax evasion)**
In subsection (2) "prevention procedures" means procedures designed to prevent persons acting in the capacity of a person associated with B from committing UK tax evasion facilitation offences.	In subsection (3) "prevention procedures" means procedures designed to prevent persons acting in the capacity of a person associated with B from committing foreign tax evasion facilitation offences under the law of the foreign country concerned.

A key issue is what is required by *reasonable* prevention procedures. HMRC CFA guidance states six times:

> [The Principal's] compliance with any applicable published guidance, its contractual terms for its staff, the training it provides, and any steps taken to monitor and ensure compliance would all be relevant to the assessment of whether it had reasonable prevention procedures.

That does not take us far. Industry guidance should be more specific.

127.6 Procedural aspects

127.6.1 *Penalty*

Section 45(8)/46(7) CFA provides:

> A relevant body guilty of an offence under this section is liable-
> (a) on conviction on indictment, to a fine;
> (b) on summary conviction in England and Wales, to a fine;
> (c) on summary conviction in Scotland or Northern Ireland, to a fine not exceeding the statutory maximum.

Section 48(2)-(4) deal with jurisdiction. The offences are tried in magistrates courts (in Scotland, sheriff's courts). Criminal practitioners doubt whether this is appropriate, but there it is.

127.6.2 *Extra-territorial application*

Section 48(1) CFA provides:

> (1) It is immaterial for the purposes of section 45 or 46 (except to the extent provided by section 46(2)) whether-
> (a) any relevant conduct of a relevant body, or
> (b) any conduct which constitutes part of a relevant UK tax evasion facilitation offence or foreign tax evasion facilitation offence, or
> (c) any conduct which constitutes part of a relevant UK tax evasion offence or foreign tax evasion offence,
>
> takes place in the UK or elsewhere.

127.6.3 *Offence by partnership*

Section 50 CFA provides:

> (1) Proceedings for an offence under section 45 or 46 alleged to have been committed by a partnership must be brought in the name of the partnership (and not in the name of any of the partners).
> (2) For the purposes of such proceedings-
> (a) rules of court relating to the service of documents have effect as if the partnership were a body corporate, and
> (b) the following provisions (which concern procedure in relation to offences by bodies corporate) apply as they apply to a body corporate-
> (i) section 33 of the Criminal Justice Act 1925 and Schedule 3 to the Magistrates' Courts Act 1980, and
> (ii) section 18 of the Criminal Justice Act (Northern Ireland)

> 1945 (c 15 (NI)) and Schedule 4 to the Magistrates' Courts (Northern Ireland) Order 1981 (SI 1981/1675 (NI 26)).
>
> (3) A fine imposed on a partnership on its conviction for an offence under section 45 or 46 is to be paid out of the partnership assets.

In short, a partnership is treated as a legal person.

127.6.4 *Terminology*

Before turning to the examples, it is helpful to set out my terminology:

Term	**Meaning**
Taxpayer Evader	Person committing tax offence /fraudulent evasion
Facilitation Offence	UK/foreign tax evasion facilitation offence
Facilitation Offender	Person who commits that offence
Principal	Person for whom Associate is working
Associate	Person working for Principal

127.7 HMRC CFA guidance

I do not address the whole of the guidance. I do however consider its anodyne examples. I am not sure that one adds more to the next, but an adviser in this area will start by reading these, so I set them out here.

The guidance was not, I think, written by a lawyer.

127.7.1 *Branches*

HMRC CFA guidance provides:

> Gladstone Bank is a bank incorporated and headquartered in Switzerland.
>
> The bank has branches in a number of jurisdictions, including the UK and Germany. Whilst the bank has several branches across the world, the branches are not separate legal entities (they are branches not subsidiaries): the bank is a single legal entity, a company incorporated under Swiss law. All the bank's branches comprise a single legal person.
>
> The Bank chooses not to put in place procedures to prevent persons providing services for or on its behalf facilitating tax evasion. However, the UK branch does its best to put in place UK focused procedures aimed purely at staff working in its UK offices.
>
> The UK Branch consists of a small number of employees whose functions are restricted to:
>
> - attracting and on-boarding clients for Gladstone Bank;
> - providing minor administrative services; and
> - acting as a first point of contact for UK based customers.

> The UK branch attracts and on-boards a number of clients for Gladstone Bank resident in London, including Freya who has UK tax liabilities and Larry who has German tax liabilities.
>
> The employees of the UK branch attract the clients in good faith believing that Gladstone Bank is providing routine financial services to its clients. Once the clients have been attracted all financial services are provided by either the bank's headquarters in Switzerland or employees in the German Branch.
>
> Employees of the German Branch, deliberately and dishonestly help Larry to evade his German tax liabilities. The employees:
>
> - advise Larry on structures that allow him to hide his assets and income from the German tax authorities;
> - provide false certification to hide the true owners of accounts; and
> - deliberately fail to comply with the applicable Anti Money Laundering Regulations.
>
> Employees of the Swiss headquarters deliberately and dishonestly help Freya to evade her UK tax liabilities. The employees:
>
> - advise Freya on structures to help her hide overseas income from the UK tax authorities;
> - deliberately set up a bank account in Switzerland knowing it is going to be used to hide the overseas income from the UK tax authorities.

The example might have been easier to follow if it had been split into two examples, one for the UK taxpayer and another for the German taxpayer. But there it is.

The HMRC analysis is as follows:

Freya

> Stage 1: Taxpayers
>
> Freya has deliberately and dishonestly failed to declare her taxable income and assets to HMRC with the intention of not paying the tax that she legally owes. She has committed [inter alia] the offence of being knowingly concerned in the fraudulent evasion of income tax contrary to section 106A of the Taxes Management Act 1970.

Freya is a Taxpayer Evader.

Gladstone Employees

> Stage 2: Associated persons of Gladstone Bank and criminal facilitation
>
> Employees of Gladstone's Swiss Head Office have deliberately and dishonestly provided services to Freya to help her to hide her taxable income and assets in order to help her evade her UK tax liability. They

are also guilty [inter alia] of being knowingly concerned in the fraudulent evasion of income tax, an offence contrary to section 106A of the Taxes Management Act 1970.

The associated person was providing services (advice to clients) for or on behalf of the bank when they committed the tax evasion facilitation offence.

Gladstone employees (Associates) are Facilitation Offenders.

Gladstone Bank

Stage 3: Liability for Gladstone Bank for failing to prevent the criminal facilitation of tax evasion

Gladstone Bank is not guilty of the section 106A Taxes Management offence. It is not possible to attribute the requisite guilty mind to the bank itself in respect of the criminal act committed, because none of the people considered to be the bank's directing mind and will (typically the Board of Directors) were involved in the offence.

However, the bank is liable for having failed to prevent its associated persons operating in its Swiss Head Office from criminally facilitating Freya's UK tax liability (the new UK tax offence) unless it is able to establish the reasonable prevention procedures defence.

Gladstone Bank may struggle to mount a reasonable prevention procedures defence, its procedures were arguably not reasonable because it had only implemented procedures for a small number of UK-based staff. It is no defence to claim that it should not be expected to put in place prevention procedures designed to prevent its associated persons from being complicit in fraud resulting in a tax loss outside of Switzerland.

Turning to Larry, the analysis is the same:

Larry

B. Liability for the Overseas Fraud Offence

Stage 1: taxpayers

Larry has deliberately and dishonestly failed to declare his taxable income and assets to the German revenue authorities with the intention of not paying the tax that he legally owes. There is 'dual criminality' as there are equivalent offences at the taxpayer level in the UK and Germany.

Larry is a Taxpayer Evader.

Gladstone employees

Stage 2: Associated persons of Gladstone Bank and criminal facilitation

> Employees of Gladstone's German branch have deliberately and dishonestly provided services to Larry to help him hide his taxable income and assets in order to help him evade his German tax liability. The associated person was providing services (advice to clients) for or on behalf of the bank. There is 'dual criminality' at the facilitator level as there equivalent offences in both the UK and Germany.

Gladstone employees (Associates) are Facilitation Offenders.

Gladstone Bank

> Stage 3: As Gladstone Bank has a UK branch and the bank is a single legal entity it is within scope of the new foreign tax evasion facilitation offence, because it is a relevant body conducting part of its business in the UK. Gladstone Bank has also failed to prevent its associated person, i.e. employees of its German Branch, from criminally facilitating the evasion of German tax by Larry.
>
> Gladstone Bank is likely to struggle to put forward a defence of having put in place reasonable procedures to prevent the criminal facilitation of tax evasion because its procedures were arguably not reasonable as it decided to only introduce prevention procedures for staff dealing with UK taxpayers. Claiming that it does not believe that it should have to exercise due diligence over employees of its branches in other countries provides no defence to this.

127.7.2 *Example 1: introductions*

HMRC CFA guidance Example 1 provides:

> Sarah was referred by her bank to Malus GmbH, a Swiss adviser, to create a tax efficient structure for potential future investment into UK property. Malus was an approved intermediary[12] of a UK high street bank (with the referral made in good faith after they carried out appropriate due diligence on Malus), and Sarah planned to put her post-tax employment earnings into this structure.
>
> Sarah had a relative, Maisie, who was neither resident nor domiciled in the UK. Malus advised Sarah that she should set up a Swiss trust using Maisie as the settlor. This was done, although Maisie was never asked to sign anything and was not aware that a trust was being set up with her named as the settlor. Sarah was advised that she retained beneficial ownership of all the assets despite the trust arrangement.
>
> The trust had bank accounts with Lunar Bank in Monaco. Sarah

[12] "Intermediary" does not seem to be an apt word.

> admitted her actions following initial contact with Malus were deliberate.

Sarah is a Taxpayer Evader.
The HMRC analysis is as follows:

> *UK high street bank*
> The UK high-street bank did not know that Malus would help Sarah to evade UK tax, and the 'vanilla' referral to Malus was made in good faith. Under these circumstances Malus was not acting as an 'associated person' of the UK high-street bank, so the UK High Street Bank is not liable under the new offences.

More analytically, Malus was not an Associate of the UK bank, as it (and its employees) did not provide services to that bank.

Malus' employees

> Malus's staff, however, by providing advice, as well as professional trustee services to Sarah's trust which they knew was not properly constituted, have deliberately facilitated Sarah's acts to hide her assets and evade tax. In doing so, the staff of Malus were acting in the capacity of persons associated with it.

Malus employees are Facilitation Offenders.

Malus GmbH

> If Malus had not taken reasonable steps to prevent their staff from facilitating Sarah's tax evasion then Malus would be guilty of the new offence....

Lunar Bank

> Lunar Bank's staff have performed acts that in fact facilitated Sarah's tax evasion. However, they did so without being aware of any tax evasion. They may have been negligent and failed to comply with their anti-money laundering obligations, but they lack the requisite guilty state of mind to commit an offence relating to facilitating Sarah's tax evasion. Therefore, there is no tax evasion facilitation offence that Lunar Bank has failed to prevent.

More analytically, Malus was not an Associate of Lunar, as it (and its employees) did not provide services to that bank.

127.7.3 *Advice on jurisdictions/investments/structures*

HMRC CFA guidance Example 2 provides:

> John ran a UK business. John opened a Channel Islands bank account in which he could hide untaxed business income from HMRC.
>
> John took his untaxed funds on a regular basis to a business contact, Michael, who travels regularly to the Channel Islands. Michael would take the money in a suitcase to the Channel Islands and deposit it in John's bank account.
>
> In 2004, following unsolicited advice from the Channel Island bank to help him continue hiding his untaxed wealth from HMRC, John transferred the bank accounts to a nominee Foundation in Panama thereby avoiding reporting under the EU Savings Directive and retaining secrecy over his funds. The Foundation was operated by other Channel Island professionals to whom the bank subcontracted the work.

The HMRC analysis is as follows:

Michael

> Michael was knowingly helping John to physically move funds offshore for tax evasion purposes. Michael was happy to do this because it fostered continued good business relations with John. Michael is guilty of a tax evasion facilitation offence by virtue of facilitating John's actions but, as he is an individual and not an associated person of a relevant body, no question of his committing the new offence arises.

John is a Taxpayer Evader, and Michael is a Facilitation Offender.

CI Bank employees

> The Channel Island bank's staff initially opened the account for John knowing that he wanted his activities to remain hidden from HMRC. Many years later the Channel Island bank staff actively advised John on how he could continue to hide his money. This conduct amounts to the criminal facilitation of tax evasion.

The CI Bank employees are Facilitation Offenders.

CI Bank

> The Channel Island bank would be guilty of the new offence unless it had taken reasonable steps to prevent its staff facilitating John's tax evasion. ... The Channel Island bank professionals helped John to maintain a structure which facilitated his evasion activities. These professionals were asked by the bank to assist others in John's position and knew they were assisting people evading UK tax. This conduct amounts to the criminal facilitation of tax evasion.
>
> The bank therefore failed to prevent this conduct occurring and would be guilty of the new offence if it could not show that it had taken

reasonable steps to prevent its associated persons from facilitating John's tax evasion.

127.7.4 *Company/trust/banking services*

HMRC CFA guidance Example 3 provides:

> Manjit was the owner and Director of a UK-based interior design business. He generated false invoices and drew cheques with fictitious payee details logged in the company records, in order to divert proceeds offshore and reduce taxable profits in the UK. These cheques were in fact made payable to an extensive network of offshore discretionary trusts and corporate vehicles in Gibraltar, Belize, Seychelles, and the British Virgin Islands ("BVI").
>
> In particular, the trustees invested the funds in a portfolio of bank accounts and investment properties held in the name of "off the shelf" corporate vehicles in the Seychelles and BVI. The properties, acquired with the proceeds of tax evasion, were then rented out commercially with UK taxes paid on the rental income under the non-resident landlord scheme ("NRLS") to give the appearance of a genuine offshore ownership arrangement. The NRLS arrangement had been accepted by HMRC, being the only contemporaneous information that was available at the time.

Manjit

> Following an HMRC investigation, Manjit accepted that these transactions were fraudulent. Manjit admitted he deliberately committed offshore tax evasion.

Manjit is the Taxpayer Evader

The Trustees

> The trustees claimed that they believed everything they were doing was "above board" - but they also stated that "the affairs of their clients were none of their business". HMRC's view was that the trustees turned a blind eye to the true beneficial ownership of the structure in order to retain Manjit's business. If the trustees in truth had knowledge of, but decided to ignore, Manjit's tax evasion, their conduct would amount to the criminal facilitation of Manjit's tax evasion

In practice the trustee is likely to be a company ("Trustco"). References to "the trustees" would make more sense if the reference is to the employees of Trustco.

> *Trustco*
>
> ... any trust company or partnership for which they worked would be guilty of the new offence if it had not taken reasonable steps to prevent the facilitation of Manjit's tax evasion...
>
> Of course, if the trustees [that is, the employees of TrustCo] were truly unaware of the tax evasion (whether out of negligence or otherwise) their assistance would not amount to a tax evasion facilitation offence (as these cannot be committed negligently) and the new offence would not be committed.

127.7.5 *Trust/company/legal services*

HMRC CFA guidance Example 4 provides:

> Paula was domiciled in Australia, but had been resident in the UK since the 1970s. In 2017, Paula wanted to regularise her affairs and disclosed to HMRC that she had been hiding substantial UK taxable income for a prolonged period. She had been using companies in Bermuda and the Bahamas to shelter both business and private assets and to facilitate the movement of funds through a variety of jurisdictions.
>
> The network of companies had been set up by Paula's lawyer, a partner in a Guernsey-based legal partnership, in total secrecy, meaning that Paula had never paid UK taxes for more than 30 years of UK residence.

Paula is the Taxpayer Evader.

> *Paula's Lawyer*
>
> The lawyer actively assisted Paula in evading UK taxes, knowing that the structures would enable her to evade UK tax.

The lawyer is the Facilitation Offender.

> *The lawyer's partnership*
>
> Any company or partnership for which the lawyer was an associated person would be guilty of the new offence if it had not taken reasonable steps to prevent him facilitating Paula's tax evasion. ...

127.7.6 *Financial assistance*

HMRC CFA guidance Example 5 provides:

> Christoph was a wealthy non-domiciled individual who was a long-term UK resident. His job entitled him to significant bonus payments, related to duties performed wholly in the UK, on which he did not want to pay UK tax.
>
> His UK accountant put him in touch with an adviser in Israel.

> The Israeli adviser set up a number of bank accounts in Singapore in the names of BVI-registered companies, under the control of a discretionary trust. Christoph arranged for his bonus payments to be lodged in the accounts operated in Singapore. As well as evading income tax on his employment income over a number of years, Christoph's settlements also attracted significant Inheritance Tax liabilities.[13]

Christoph is the Taxpayer Evader.

> *UK accountant*
>
> The UK accountant knew what Christoph was trying to achieve, and for many years acted as a conduit through which Christoph contacted the Israeli adviser. This amounts to a tax evasion facilitation offence.

The accountant is the Facilitation Offender.

> *The UK accountant's Principal*
>
> The company or partnership that the accountant worked for would be guilty of the new offence if it had not taken reasonable steps to prevent him or her facilitating the tax evasion. ...
>
> *Israeli adviser*
>
> The Israeli adviser also knew Christoph's aims, and knew that secrecy was key to achieving those aims. He provided advice, and also set up and maintained the structure. This conduct facilitated Christoph's tax evasion.

The Israeli adviser is a Facilitation Offender.

> *The Israeli adviser's Principal*
>
> The company or partnership that the adviser worked for would be guilty of the new offence if it had not taken reasonable steps to prevent the adviser facilitating the tax evasion...
>
> *Singapore bank employees*
>
> The Singapore bank's staff were unaware that the structure was being used to evade UK tax. As such they would not have the requisite state of mind to be guilty of facilitating Christoph's tax evasion.
>
> *Singapore bank employees*
>
> Therefore the Singapore bank could not be guilty of failing to prevent its staff from facilitating tax evasion.

[13] It appears that Christoph was deemed domiciled when he made the settlement. But there is no IHT if the trusts were shams or otherwise invalid.

127.7.7 *Example 6: Payroll services*

HMRC CFA guidance Example 6 provides:

> Bruce is contractually employed by Warrington Ltd and has worked for them for many years. Warrington Ltd provides skilled workers for offshore oil and gas platforms around the UK.
>
> After many years of working in the oil and gas industry, Bruce becomes disillusioned with his pay and a perceived difference in lifestyle between himself and his colleagues. Bruce airs his grievances with some of his colleagues. Bruce's colleague Nick tells him that the easiest way to take home more pay is to have some of his wages paid into an account in a tax efficient jurisdiction and not to tell the tax man about it.
>
> Nick tells Bruce to speak to Sandra who is responsible for payroll and to mention that they have spoken and that he is looking to mitigate his tax liabilities.
>
> Bruce speaks to Sandra in Warrington Ltd's payroll department and [Sandra][14] agrees that for an administrative fee she can pay a portion of Bruce's pay into an offshore account of his choice and remove that pay from his payslip. Bruce expresses some concerns about losing his job if the company finds out that he is being partially paid "off the books". Sandra reassures Bruce that she helps lots of people in the company to mitigate their taxes and that the company understands that it is just the price that has to be paid to retain long serving employees like Bruce.
>
> With the help of his colleague and friend Nick, Bruce opens an account with a bank in Jersey, falsifying information about his identity and tax residency so that the account is not reportable to the UK, where he has a tax liability. As promised Sandra ensures that 40% of Bruce's pay is kept off the balance sheet, taking a fee for her services before paying the remainder into Bruce's account in Jersey with MJS Bank.
>
> Through a joint investigation with the Jersey authorities HMRC identify the undeclared accounts of Bruce, Nick and other employees of Warrington Ltd at MJS Bank. During an interview under caution Bruce admits everything and fully co-operates with HMRC.

Bruce is the Taxpayer Evader.

Sandra

Sandra knew that Bruce was seeking to evade tax and that in order to achieve this he required her assistance and she provided that assistance. This amounts to a tax evasion facilitation offence. Sandra undertook

[14] The original reads: "Jess".

these activities whilst acting in the capacity of a person associated with Warrington Ltd.

Sandra is a Facilitation Offender (as is Nick).

Warrington Ltd

Warrington Ltd would be liable for the new domestic tax evasion offence if it had not taken reasonable steps to prevent Sandra from facilitating the tax evasion...

MJS Bank

MJS Bank are not liable under the new offence as persons associated with it were acting in good faith when opening bank accounts for Bruce, Nick and other employees of Warrington Ltd. They performed the customer checks required by law and did not know that their provision of financial services were being used to further criminal activity.

It is assumed that Sandra and Nick are not providing services to MJS.

127.8 Fraudulent evasion offences

The most common offences involving fraudulent evasion will be:

(1) cheating the Revenue
(2) s.106A TMA 1970 and s.72 VATA (from which s.106A derives):

s.106A(1) TMA	**s.72 VATA**
A person commits an offence if that person is knowingly concerned in the fraudulent evasion of income tax by that or any other person.	(1) If any person is knowingly concerned in, or in the taking of steps with a view to, the fraudulent evasion of VAT by him or any other person, he shall be liable— (a) on summary conviction, to a penalty of the statutory maximum £20,000 or of three times the amount of the VAT, whichever is the greater, or to imprisonment for a term not exceeding 6 months or to both; or (b) on conviction on indictment, to a penalty of any amount or to imprisonment for a term not exceeding 7 years or to both.

It seems strange to refer to a person as knowingly concerned in his own evasion. How could they not be? But it does not matter.

127.9 A change in corporate culture?

The object of the CFA is to require businesses to set up prevention procedures, and the sanction for failing to do that is that they are otherwise at risk of committing an offence of strict liability. It is, I think, a very contemporary mix of regulatory and criminal law. The aim is to change corporate culture.[15]

HMRC CFA guidance examples give a somewhat jaded impression of a flourishing offshore evasion industry. After CRS, and vast fines on banks facilitating US tax evasion, how much of this activity goes on today, and where? Discuss.

127.10 Offshore tax offences

127.10.1 *Non-fraudulent offences*

The legislation is in s.106B-106H TMA, introduced by FA 2016, supplemented by the Taxes Management Act 1970 (Specified Threshold Amount) Regulations 2017. The offences are:

Section	**Offence**
106B	Failing to give notice of being chargeable to tax
106C	Failing to deliver return
106D	Making inaccurate return

I do not refer to these offences as "evasion" as they do not require dishonesty/fraudulent intent, and I would reserve the word "evasion" for the offences which do.[16] The word "evasion" has a complicated history, but from about the 1970s it has generally been used to mean only fraudulent evasion.[17]

It would be possible to use the word "evasion" broadly, to include a negligent failure to pay tax, even if there is no deliberate concealment or other dishonesty. There is indeed some historical precedent for that usage.[18] But greater precision of terminology would aid precision of thought. There is an important difference between those who are dishonest/fraudulent, and those who make innocent (non-fraudulent) mistakes.

It is not just a semantic point which is being made here. Evasion is now an essentially contested concept. HMRC would like to stigmatise as tax

[15] See 126.54 (Public attitude(s) to compliance).

[16] For those offences, see 127.8 (Fraudulent evasion offences).

[17] See 2.2.2 (Avoidance/evasion distinction)

[18] See above footnote.

evaders those who make innocent (non-fraudulent but perhaps negligent) errors. But this expansion of the concept of evasion erodes its value. If the word "evasion" is used in this sense, it would be appropriate to put it in scare quotation marks.

I refer to the three offences as "**offshore tax offences**".

127.10.2 *No notice of chargeability*

Section106B(1) TMA provides:

> A person
> [i] who is required by section 7 to give notice of being chargeable to income tax or capital gains tax (or both) for a year of assessment and
> [ii] who has not given that notice by the end of the notification period[19]
> commits an offence if—
> (a) the tax in question is chargeable (wholly or in part) on or by reference to offshore income, assets or activities, and
> (b) the total amount of income tax and capital gains tax that is chargeable for the year of assessment on or by reference to offshore income, assets or activities exceeds the threshold amount.

127.10.3 *Failing to make return*

Section 106C(1) TMA provides:

> A person who is required by a notice under section 8 to make and deliver a return for a year of assessment commits an offence if-
> (a) the return is not delivered by the end of the withdrawal period,[20]
> (b) an accurate return would have disclosed liability to income tax or capital gains tax (or both) that is chargeable for the year of assessment on or by reference to offshore income, assets or activities, and
> (c) the total amount of income tax and capital gains tax that is chargeable for the year of assessment on or by reference to offshore income, assets or activities exceeds the threshold amount.

[19] Defined by reference in s.106B (3) TMA: "In this section "the notification period" has the same meaning as in section 7 (see subsection (1C) of that section).

[20] Defined by reference in s.106C(3): "In this section "the withdrawal period" has the same meaning as in section 8B (see subsection (6) of that section)."

127.10.4 *Inaccurate return*

Section 106D(1) TMA provides:

> A person who is required by a notice under section 8 to make and deliver a return for a year of assessment commits an offence if, at the end of the amendment period[21]-
> (a) the return contains an inaccuracy the correction of which would result in an increase in the amount of income tax or capital gains tax (or both) that is chargeable for the year of assessment on or by reference to offshore income, assets or activities, and
> (b) the amount of that increase exceeds the threshold amount.

127.10.5 *Reasonable excuse defences*

s.106B(2) TMA	**S.106C(2)TMA**	**s.106D(2) TMA**
It is a defence for a person accused of an offence under this section to prove that the person had a reasonable excuse for failing to give the notice required by section 7.	It is a defence for a person accused of an offence under this section to prove that the person had a reasonable excuse for failing to deliver the return	It is a defence for a person accused of an offence under this section to prove that the person took reasonable care to ensure that the return was accurate.

The reader may think it is astonishing that in a civil case the onus of proving carelessness is on HMRC; but in a *criminal* case the onus is on the defendant to prove that they were not careless.
See 126.10 (Reasonable excuse).

127.10.6 *Exemption for trustees/executors*

Section 106E(1) TMA provides:

> A person is not guilty of an offence under section 106B, 106C or 106D if the capacity in which the person is required to give the notice or make and deliver the return is-
> (a) as a relevant trustee of a settlement, or
> (b) as the executor or administrator of a deceased person.

[21] Defined by reference in s.106D (3) “In this section "the amendment period" means the period for amending the return under section 9ZA.”

127.10.7 *Time extension*

Section 106F(1) TMA provides:

> Where a period of time is extended under subsection (2) of section 118 by HMRC, the tribunal or an officer (but not where a period is otherwise extended under that subsection), any reference in section 106B, 106C or 106D to the end of the period is to be read as a reference to the end of the period as so extended.

127.11 "Offshore income/assets/activities"

This term is used in all three offshore tax offences:

s.106B(1) TMA	**s.106C(1)TMA**	**s.106D(1) TMA**
(a) the tax in question is chargeable (wholly or in part) on or by reference to offshore income, assets or activities	(b) an accurate return would have disclosed liability to income tax or capital gains tax (or both) that is chargeable for the year of assessment on or by reference to offshore income, assets or activities,	(a) the return contains an inaccuracy the correction of which would result in an increase in the amount of income tax or capital gains tax (or both) that is chargeable for the year of assessment on or by reference to offshore income, assets or activities,

Section 106F(4) TMA provides:

> In sections 106B to 106D and this section "offshore income, assets or activities" means-
> (a) income arising from a source in a territory outside the UK,
> (b) assets[22] situated or held in a territory outside the UK, or
> (c) activities carried on wholly or mainly in a territory outside the UK.

127.12 Offshore tax offences penalties

Section 106G TMA provides:

> (1) A person guilty of an offence under section 106B, 106C or 106D is liable on summary conviction-
> (a) in England and Wales, to a fine or to imprisonment for a term

[22] Defined s.106F(4): "(5) In subsection (4), "assets" has the meaning given in section 21(1) of the 1992 Act, but also includes sterling."

> not exceeding 51 weeks or to both, and
> (b) in Scotland or Northern Ireland, to a fine not exceeding level 5 on the standard scale or to imprisonment for a term not exceeding 6 months or to both.
>
> (2) In relation to an offence committed before the coming into force of section 281(5) of the Criminal Justice Act 2003, the reference in subsection (1)(a) to 51 weeks is to be read as a reference to 6 months.

127.12.1 *Offshore offences: Critique*

In the absence of dishonesty, which has hitherto been regarded as central to tax offences, one wonders what is the point of the provisions or of a prosecution. Presumably they are intended to operate *in terrorem*. Perhaps there will never be a prosecution?

127.13 Enablers of offshore tax offences

The legislation is in sch 20 FA 2016.

127.14 Liability for penalty

Para 1 sch 20 FA 2016 provides:

> (1) A penalty is payable by a person (P) who has enabled another person (Q) to carry out offshore tax evasion or non-compliance, where conditions A and B are met.

127.14.1 *Offshore evasion/non compliance*

Para 1 sch 20 FA 2016 provides:

> (2) For the purposes of this Schedule-
> (a) Q carries out "offshore tax evasion or non-compliance" by-
> (i) committing a relevant offence, or
> (ii) engaging in conduct that makes Q liable (if the applicable conditions are met) to a relevant civil penalty,
>
> where the tax at stake is income tax, capital gains tax or inheritance tax, and

127.14.2 *Enabling*

Para 1(2)(b) sch 20 FA 2016 provides:

> (b) P "has enabled" Q to carry out offshore tax evasion or non-compliance if P has encouraged, assisted or otherwise facilitated conduct by Q that constitutes offshore tax evasion or non-compliance.

127.14.3 *Relevant offences*

Para 1 sch 20 FA 2016 provides:

> (3) The relevant offences are-
> (a) an offence of cheating the public revenue involving offshore activity, or
> (b) an offence under section 106A of TMA 1970 (fraudulent evasion of income tax) involving offshore activity,
> (c) an offence under section 106B, 106C or 106D of TMA 1970 (offences relating to certain failures to comply with section 7 or 8 by a taxpayer chargeable to income tax or capital gains tax on or by reference to offshore income, assets or liabilities).

Para 1 sch 20 FA 2016 provides:

> (4) The relevant civil penalties are-
> (a) a penalty under paragraph 1 of Schedule 24 to FA 2007 (errors in taxpayer's document) involving an offshore matter or an offshore transfer (within the meaning of that Schedule),
> (b) a penalty under paragraph 1 of Schedule 41 to FA 2008 (failure to notify etc) in relation to a failure to comply with section 7(1) of TMA 1970 involving offshore activity,
> (c) a penalty under paragraph 6 of Schedule 55 to FA 2009 (failure to make return for 12 months) involving offshore activity,
> (d) a penalty under paragraph 1 of Schedule 21 to FA 2015 (penalties in connection with relevant offshore asset moves),

127.14.4 *Condition A*

Para 1 sch 20 FA 2016 provides:

> (5) Condition A is that P knew when P's actions were carried out that they enabled, or were likely to enable, Q to carry out offshore tax evasion or non-compliance.

127.14.5 *Condition B*

Para 1 sch 20 FA 2016 provides:

> (6) Condition B is that-
> (a) in the case of offshore tax evasion or non-compliance consisting of the commission of a relevant offence, Q has been convicted of the offence and the conviction is final, or
> (b) in the case of offshore tax evasion or non-compliance consisting of conduct that makes Q liable to a relevant penalty-

(i) Q has been found to be liable to such a penalty, assessed and notified, and the penalty is final, or

(ii) a contract has been made between the Commissioners for Her Majesty's Revenue and Customs and Q under which the Commissioners undertake not to assess the penalty or (if it has been assessed) not to take proceedings to recover it.

(7) For the purposes of sub-paragraph (6)(a)-

(a) "convicted of the offence" means convicted of the full offence (and not for example of an attempt), and

(b) a conviction becomes final when the time allowed for bringing an appeal against it expires or, if later, when any appeal against conviction has been determined.

(8) For the purposes of sub-paragraph (6)(b)(i) a penalty becomes final when the time allowed for any appeal or further appeal relating to it expires or, if later, any appeal or final appeal relating to it is determined.

(9) It is immaterial for the purposes of condition B that-

(a) any offence of which Q was convicted, or

(b) any penalty for which Q was found to be liable,

relates also to other tax evasion or non-compliance by Q.

(10) In this Schedule "other tax evasion or non-compliance by Q" means conduct by Q that-

(a) constitutes an offence of cheating the public revenue or an offence of fraudulent evasion of tax, or

(b) makes Q liable to a penalty under any provision of the Taxes Acts,

but does not constitute offshore tax evasion or non-compliance.

(11) Nothing in condition B affects the law of evidence as to the relevance if any of a conviction, assessment of a penalty or contract mentioned in sub-paragraph (6) for the purpose of proving that condition A is met in relation to P.

(12) In this Schedule "conduct" includes a failure to act.

127.15 "Involving offshore activity" and related expressions

Para 2 sch 20 FA 2016 provides:

(1) This paragraph has effect for the purposes of this Schedule.

(2) Conduct involves offshore activity if it involves-

(a) an offshore matter,

(b) an offshore transfer, or

(c) a relevant offshore asset move.

(3) Conduct involves an offshore matter if it results in a potential loss

of revenue that is charged on or by reference to-

(a) income arising from a source in a territory outside the United Kingdom,

(b) assets situated or held in a territory outside the United Kingdom,

(c) activities carried on wholly or mainly in a territory outside the United Kingdom, or

(d) anything having effect as if it were income, assets or activities of the kind described above.

(4) Where the tax at stake is inheritance tax, assets are treated for the purposes of sub-paragraph (3) as situated or held in a territory outside the United Kingdom if they are so held or situated immediately after the transfer of value by reason of which inheritance tax becomes chargeable.

(5) Conduct involves an offshore transfer if-

(a) it does not involve an offshore matter,

(b) it is deliberate (whether or not concealed) and results in a potential loss of revenue,

(c) the condition set out in paragraph 4AA of Schedule 24 to FA 2007 is satisfied.

(6) Conduct involves a relevant offshore asset move if at a time when Q is the beneficial owner of an asset ("the qualifying time")-

(a) the asset ceases to be situated or held in a specified territory and becomes situated or held in a non-specified territory,

(b) the person who holds the asset ceases to be resident in a specified territory and becomes resident in a non-specified territory, or

(c) there is a change in the arrangements for the ownership of the asset,

and Q remains the beneficial owner of the asset, or any part of it, immediately after the qualifying time.

(7) Paragraphs 4(2) to (4) of Schedule 21 to FA 2015 apply for the purposes of sub-paragraph (6) above as they apply for purposes of paragraph 4 of that Schedule.

(8) In sub-paragraph (6) above, "specified territory" has the same meaning as in paragraph 4(5) of Schedule 21 to FA 2015.

127.16 Amount of penalty

Para 3 sch 20 FA 2016 provides:

(1) The penalty payable under paragraph 1 is (except in a case mentioned in sub-paragraph (2)) the higher of-

> (a) 100% of the potential lost revenue, or
> (b) £3,000.
>
> (2) In a case where P has enabled Q to engage in conduct which makes Q liable to a penalty under paragraph 1 of Schedule 21 to FA 2015, the penalty payable under paragraph 1 is the higher of-
> (a) 50% of the potential lost revenue in respect of the original tax non-compliance, and
> (b) £3,000.
>
> (3) In sub-paragraph (2)(a) "the original tax non-compliance" means the conduct that incurred the original penalty and "the potential lost revenue" (in respect of that non-compliance) is-
> (a) the potential lost revenue under Schedule 24 to FA 2007,
> (b) the potential lost revenue under Schedule 41 to FA 2008, or
> (c) the liability to tax which would have been shown on the return (within the meaning of Schedule 55 to FA 2009),
>
> according to whether the original penalty was incurred under paragraph 1 of Schedule 24, paragraph 1 of Schedule 41 or paragraph 6 of Schedule 55.

127.17 PLR: enabling Q to commit offence

Para 4 sch 20 FA 2016 provides:

> (1) The potential lost revenue in a case where P is liable to a penalty under paragraph 1 for enabling Q to commit a relevant offence is the same amount as the potential lost revenue applicable for the purposes of the corresponding relevant civil penalty (determined in accordance with the relevant sub-paragraph of paragraph 5).
>
> (2) Where Q's offending conduct is-
> (a) an offence of cheating the public revenue involving offshore activity, or
> (b) an offence under section 106A of TMA 1970 involving offshore activity,
>
> the corresponding relevant civil penalty is the penalty which Q is liable for as a result of that offending conduct.
>
> (3) Where Q's offending conduct is an offence under section 106B, 106C or 106D of TMA 1970, the corresponding relevant civil penalty is-
> (a) for an offence under section 106B of TMA 1970, a penalty under paragraph 1 of Schedule 41 to FA 2008,
> (b) for an offence under section 106C of TMA 1970, a penalty under paragraph 6 of Schedule 55 to FA 2009, and
> (c) for an offence under section 106D of TMA 1970, a penalty

> under paragraph 1 of Schedule 24 to FA 2007.
>
> (4) In determining any amount of potential lost revenue for the purposes of this paragraph, the fact Q has been prosecuted for the offending conduct is to be disregarded.

127.18 PLR: enabling Q's conduct incurring civil penalty

Para 5 sch 20 FA 2016 provides:

> (1) The potential lost revenue in a case where P is liable to a penalty under paragraph 1 for enabling Q to engage in conduct that makes Q liable (if the applicable conditions are met) to a relevant civil penalty is to be determined as follows.
>
> (2) In the case of a penalty under paragraph 1 of Schedule 24 to FA 2007 involving an offshore matter or an offshore transfer, the potential lost revenue is the amount that under that Schedule is the potential lost revenue in respect of Q's conduct.
>
> (3) In the case of a penalty under paragraph 1 of Schedule 41 to FA 2008 in relation to a failure to comply with section 7(1) of TMA 1970 involving offshore activity, the potential lost revenue is the amount that under that Schedule is the potential lost revenue in respect of Q's conduct.
>
> (4) In the case of a penalty under paragraph 6 of Schedule 55 to FA 2009 involving offshore activity, the potential lost revenue is the liability to tax which would have been shown in the return in question (within the meaning of that Schedule).

127.19 PLR: tax evasion/non-compliance

Para 6 sch 20 FA 2016 provides:

> (1) This paragraph applies where any amount of potential lost revenue in a case falling within paragraph 4 or 5 is attributable not only to Q's offshore tax evasion or non-compliance but also to any other tax evasion or non-compliance by Q.
>
> (2) In that case the potential lost revenue in respect of Q's offshore tax evasion or non-compliance is to be taken for the purposes of assessing the penalty to which P is liable as being or (as the case may be) including such share as is just and reasonable of the amount mentioned in sub-paragraph (1).

127.20 Reduction of penalty: disclosure

Para 7 sch 20 FA 2016 provides:

> (1) If P (who would otherwise be liable to a penalty under paragraph 1)-

> (a) makes a disclosure to HMRC of-
>
> (i) a matter relating to an inaccuracy in a document, a supply of false information or a failure to disclose an under-assessment,
>
> (ii) P's enabling of actions by Q that constituted (or might constitute) a relevant offence or that made (or might make) Q liable to a relevant penalty, or
>
> (iii) any other matter HMRC regard as assisting them in relation to the assessment of P's liability to a penalty under paragraph 1, or
>
> (b) assists HMRC in any investigation leading to Q being charged with a relevant offence or found liable to a relevant penalty,
>
> HMRC must reduce the penalty to one that reflects the quality of the disclosure or assistance.
>
> (2) But the penalty may not be reduced-
>
> (a) in the case of unprompted disclosure or assistance, below whichever is the higher of-
>
> (i) 10% of the potential lost revenue, or
>
> (ii) £1,000, or
>
> (b) in the case of prompted disclosure or assistance, below whichever is the higher of-
>
> (i) 30% of the potential lost revenue, or
>
> (ii) £3,000.

Para 8 2 sch 20 FA 2016 provides:

> (1) This paragraph applies for the purposes of paragraph 7.
>
> (2) P discloses a matter by-
>
> (a) telling HMRC about it,
>
> (b) giving HMRC reasonable help in relation to the matter (for example by quantifying an inaccuracy in a document, an inaccuracy attributable to the supply of false information or withholding of information or an under-assessment), and
>
> (c) allowing HMRC access to records for any reasonable purpose connected with resolving the matter (for example for the purpose of ensuring that an inaccuracy in a document, an inaccuracy attributable to the supply of false information or withholding of information or an under-assessment is fully corrected).
>
> (3) P assists HMRC in relation to an investigation leading to Q being charged with a relevant offence or found liable to a relevant penalty by-
>
> (a) assisting or encouraging Q to disclose all relevant facts to HMRC,

(b) allowing HMRC access to records, or
(c) any other conduct which HMRC considers assisted them in investigating or assessing Q's liability to such a penalty.

(4) Disclosure or assistance by P-
(a) is "unprompted" if made at a time when P has no reason to believe that HMRC have discovered or are about to discover Q's offshore tax evasion or non-compliance (including any inaccuracy in a document, supply of false information or withholding of information, or under-assessment), and
(b) otherwise is "prompted".

(5) In relation to disclosure or assistance, "quality" includes timing, nature and extent.

127.21 Special circumstances

Para 9 sch 20 FA 2016 provides:

> (1) If they think it right because of special circumstances, HMRC may reduce a penalty under paragraph 1.
>
> (2) In sub-paragraph 1 "special circumstances" does not include-
> (a) ability to pay, or
> (b) the fact that a potential loss of revenue from one taxpayer is balanced by a potential overpayment by another.
>
> (3) In sub-paragraph (1) the reference to reducing a penalty includes a reference to-
> (a) staying a penalty, or
> (b) agreeing a compromise in relation to proceedings for a penalty.

127.22 Procedure for assessing penalty, etc

Para 10 sch 20 FA 2016 provides:

> (1) Where a person is found liable for a penalty under paragraph 1 HMRC must-
> (a) assess the penalty,
> (b) notify the person, and
> (c) state in the notice the period in respect of which the penalty is assessed.
>
> (2) A penalty must be paid before the end of the period of 30 days beginning with the day on which notification of the penalty is issued.
>
> (3) An assessment of a penalty-
> (a) is to be treated for procedural purposes in the same way as an assessment to tax (except in respect of a matter expressly provided for by this Schedule), and

(b) may be enforced as if it were an assessment to tax.

(4) A supplementary assessment may be made in respect of a penalty if an earlier assessment operated by reference to an underestimate of the liability to tax that would have been shown in a return.

(5) Sub-paragraph (6) applies if-

(a) an assessment in respect of a penalty is based on a liability to tax that would have been shown on a return, and

(b) that liability is found by HMRC to have been excessive.

(6) HMRC may amend the assessment so that it is based upon the correct amount.

(7) But an amendment under sub-paragraph (6)-

(a) does not affect when the penalty must be paid, and

(b) may be made after the last day on which the assessment in question could have been made under paragraph 11.

127.23 Time limits

Para 11 sch 20 FA 2016 provides:

> An assessment of a person as liable to a penalty under paragraph 1 may not take place more than 2 years after the fulfilment of the conditions mentioned in paragraph 1(1) (in relation to that person) first came to the attention of an officer of Revenue and Customs.

127.24 Appeals

Para 12 sch 20 FA 2016 provides:

> A person may appeal against-
>
> (a) a decision of HMRC that a penalty under paragraph 1 is payable by that person, or
>
> (b) a decision of HMRC as to the amount of a penalty under paragraph 1 payable by the person.

Para 13 sch 20 FA 2016 provides:

> (1) An appeal under paragraph 12 is to be treated in the same way as an appeal against an assessment to the tax at stake (including by the application of any provision about bringing the appeal by notice to HMRC, about HMRC review of the decision or about determination of the appeal by the First-tier Tribunal or Upper Tribunal).
>
> (2) Sub-paragraph (1) does not apply-
>
> (a) so as to require the person bringing the appeal to pay a penalty before an appeal against the assessment of the penalty is determined,

> (b) in respect of any other matter expressly provided for by this Schedule.

Para 14 sch 20 FA 2016 provides:

> (1) On an appeal under paragraph 12(a) that is notified to the tribunal, the tribunal may affirm or cancel HMRC's decision.
> (2) On an appeal under paragraph 12(b) that is notified to the tribunal, the tribunal may-
> (a) affirm HMRC's decision, or
> (b) substitute for that decision another decision that HMRC had power to make.
> (3) If the tribunal substitutes its own decision for HMRC's, the tribunal may rely on paragraph 7 or 9 (or both)-
> (a) to the same extent as HMRC (which may mean applying the same percentage reduction as HMRC to a different starting point),
> (b) to a different extent, but only if the tribunal thinks that HMRC's decision in respect of the application of that paragraph was flawed.
> (4) In sub-paragraph (3)(b) "flawed" means flawed when considered in the light of the principles applicable in proceedings for judicial review.
> (5) In this paragraph "tribunal" means the First-tier Tribunal or Upper Tribunal (as appropriate by virtue of paragraph 13(1).

127.25 Double jeopardy

Para 15 sch 20 FA 2016 provides:

> A person is not liable to a penalty under paragraph 1 in respect of conduct for which the person-
> (a) has been convicted of an offence, or
> (b) has been assessed to a penalty under any provision other than paragraph 1.

127.26 Application of TMA 1970

Para 16 sch 20 FA 2016 provides:

> Subject to the provisions of this Part of this Schedule, the following provisions of TMA 1970 apply for the purposes of this Part of this Schedule as they apply for the purposes of the Taxes Acts-
> (a) section 108 (responsibility of company officers),
> (b) section 114 (want of form), and
> (c) section 115 (delivery and service of documents).

127.27 Interpretation of Part 1

Para 17 sch 20 FA 2016 provides:

> (1) This paragraph applies for the purposes of this Schedule.
> (2) References to an assessment to tax, in relation to inheritance tax, are to a determination.

127.28 Naming and shaming

Para 22 sch 20 FA 2016 provides:

> (1) The Commissioners for Her Majesty's Revenue and Customs ("the Commissioners") may publish information about a person if-
> (a) in consequence of an investigation the person has been found to have incurred one or more penalties under paragraph 1 (and has been assessed or is the subject of a contract settlement), and
> (b) the potential lost revenue in relation to the penalty (or the aggregate of the potential lost revenue in relation to each of the penalties) exceeds £25,000.
> (2) The Commissioners may also publish information about a person if the person has been found to have incurred 5 or more penalties under paragraph 1 in any 5 year period.
> (3) The information that may be published is-
> (a) the person's name (including any trading name, previous name or pseudonym),
> (b) the person's address (or registered office),
> (c) the nature of any business carried on by the person,
> (d) the amount of the penalty or penalties in question,
> (e) the periods or times to which the actions giving rise to the penalty or penalties relate,
> (f) any other information that the Commissioners consider it appropriate to publish in order to make clear the person's identity.
> (4) The information may be published in any manner that the Commissioners consider appropriate.
> (5) Before publishing any information the Commissioners must-
> (a) inform the person that they are considering doing so, and
> (b) afford the person the opportunity to make representations about whether it should be published.
> (6) No information may be published before the day on which the penalty becomes final or, where more than one penalty is involved, the latest day on which any of the penalties becomes final.

(7) No information may be published for the first time after the end of the period of one year beginning with that day.

(8) No information may be published if the amount of the penalty-

(a) is reduced under paragraph 7 to-

(i) 10% of the potential lost revenue (in a case of unprompted disclosure or assistance), or

(ii) 30% of potential lost revenue (in a case of prompted disclosure or assistance),

(b) would have been reduced to 10% or 30% of potential lost revenue but for the imposition of the minimum penalty,

(c) is reduced under paragraph 9 to nil or stayed.

(9) For the purposes of this paragraph a penalty becomes final-

(a) if it has been assessed, when the time for any appeal or further appeal relating to it expires or, if later, any appeal or final appeal relating to it is finally determined, and

(b) if a contract settlement has been made, at the time when the contract is made.

(10) In this paragraph “contract settlement”, in relation to a penalty, means a contract between the Commissioners and the person under which the Commissioners undertake not to assess the penalty or (if it has been assessed) not to take proceedings to recover it.

CHAPTER ONE HUNDRED AND TWENTY EIGHT

REPORTING OFFSHORE TRUSTS

128.1 Reporting offshore trusts: Introduction
128.2 IHT: Reporting creation of trust
128.2.1 Non-resident practitioner
128.2.2 Failure to report: Penalty
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128.4 CGT: Reporting creation of trust
128.4.1 Deemed-domiciled settlor
128.5 Reporting: Settlor becomes UK-dom
128.6 CGT: Reporting trust emigration
128.7 Exceptions to CGT reporting
128.8 IHT/CGT reporting compared

128.1 Reporting offshore trusts: Introduction

This chapter considers:

(1) IHT reporting rules on creation of an offshore trust
(2) CGT reporting rules relating to offshore trusts

The significance of this has been overtaken by CRS and TRS, discussed in the previous chapters, and the rules ought to be repealed. Until that happens, they should strictly be observed, but I wonder how much that happens in practice.

In summary, the rules discussed here are:

Topic	Provision	See para
Creation of trust	s.218 IHTA	128.2
Addition to pre-1998 trust	Para 2 sch 5A TCGA	128.3
Creation of trust	Para 3 sch 5A TCGA	128.4
Settlor becomes UK-dom	Para 4 sch 5A TCGA	128.5
Trust emigration	Para 5 sch 5A TCGA	128.6

The CGT rules apply from the Commencement day, defined in para 1 sch 5A TCGA:

> In this Schedule “the commencement day” means the day on which the FA 1994 was passed.

128.2 IHT: Reporting creation of trust

Section 218(1) IHTA provides:

> Where any person, in the course of a trade or profession carried on by him, other than the profession of a barrister,[1] has been concerned with the making of a settlement and knows or has reason to believe—
>
> (a) that the settlor was domiciled in the UK, and
>
> (b) that the trustees of the settlement are not or will not be resident in the UK,
>
> he shall, within three months of the making of the settlement, make a return to the Board stating the names and addresses of the settlor and of the trustees of the settlement.

The duty to report rests on a person ("the practitioner") acting in the course of their trade or profession. The duty rests on the firm or company acting and not directly on its employees.

Barristers are exempt. The reason is that they will usually be instructed by others who are subject to the duty.[2]

The practitioner must be concerned with the making of a settlement. This would include not only solicitors who might draft the settlement but other advisers who advise in relation to the creation of a settlement, even if the actual execution of the settlement were delegated to foreign advisers.

The practitioner might advise on the matter generally, leaving the client to take whatever action they wish in light of the advice, perhaps in conjunction with the trustees; in such circumstances they are probably not "concerned with the making of a settlement"; this presupposes the settlement had been established. What if the client had decided against a non-resident settlement after all or wanted to think about it? The practitioner may not know what the client eventually decided to do. The obligation under s.218 must be restricted to those who are able to provide the relevant information.

The practitioner must know or have reason to believe that the settlor is domiciled in the UK. A settlement may have more than one settlor.[3]

[1] Section 272 IHTA addresses Scots terminology: "barrister" includes a member of the Faculty of Advocates.

[2] A consultation paper was published in 2009 but the proposed reforms were dropped. See HMRC Consultation Document "Modernising Powers, Deterrents and Safeguards: Tackling Offshore Tax Evasion" (2009); HMRC Consultation Response Document "Tackling Offshore Tax Evasion" (2010).

[3] "Settlor" for this purpose has the usual IHT meaning: see 99.1 (Why settlors matter). The separate settlements fiction does not apply for this purpose: see 79.5 (Separate settlement fiction).

Suppose one settlor is domiciled in the UK but the other is not. Does the reporting requirement arise? On a literal construction one could not say "the settlor" is UK domiciled and the reporting requirement would not arise. A purposive construction suggests that the duty does arise. That is the better view at least if the foreign domiciled settlor only provides a nominal amount. A practitioner should err on the side of caution.

A question also arises about the time when the settlor's domicile is relevant. Section 218 merely says that it applies if the settlor *was* domiciled in the UK. Does this mean domiciled in the UK at the time the settlement was made? Or does it mean that the settlor had at any time been domiciled in the UK? Context and common sense dictate that the provision is referring to the domicile of the settlor at the time the settlement was made because that is the date that matters for IHT.

IHT Manual formerly provided:[4]

> **IHTM42993 Section 218 notices** [April 2010]
> ***Where settlor is a company***
> ... s.218 refers to settlors domiciled in the UK
>
> - 'settlor' in relation to a settlement includes any person by whom the settlement was made (s.44 IHTA)
> - In terms of the Interpretation Act 1889 Rule 19 'the expression person shall, unless the contrary appears, include any body of persons corporate or unincorporate'[5]
> - In general a company is domiciled where it is registered – *Gasque v IRC* [1940] 2 KB 80.
>
> So where a non-UK resident [Employee Benefit Trust] is established by a company registered in the UK a s.218 notice is mandatory.

The person must know or have reason to believe that the trustees of the settlement are not or will not be resident in the UK.

In marginal cases the practitioner may be placed in difficulty. It may be necessary in some cases to report the creation of the settlement to HMRC out of caution.

There is no requirement under s.218 to notify the amount or nature of the settled property. However, HMRC have wide powers to obtain information and would know from the notification to whom further enquiries could be directed.

[4] Since April 2011 the Manual reads 'our guidance on Employee Benefit Trusts is currently being rewritten'.

[5] The reference should now be to the Interpretation Act 1978, but the point is still valid.

For the position where IHT DT relief applies see 114.7 (Claims for IHT DTA reliefs).

128.2.1 *Non-resident practitioner*

It is suggested that no duty will arise on foreign practitioners who have no UK connection; the usual territorial limitation must apply.[6] At first sight the requirement that the settlor is domiciled in the UK is sufficient to meet the territorial requirement so that no further territorial limitations should be implied. But the domicile connection may be a faint one. Suppose an individual leaves the UK in 2000 and settles in the USA, and in 2003 he makes a settlement. The individual may still be IHT deemed domiciled, but it is not realistic to expect the US practitioner to file a s.218 return (particularly having regard to the fact that the USA IHT DTA provides some IHT exemption).

128.2.2 *Failure to report: Penalty*

Failure to make the return gives rise only to a nominal penalty.[7] More seriously, the practitioner faces criminal liability for fraud on HMRC, or professional disciplinary sanctions, if:

(1) the practitioner dishonestly fails to report in breach of the duty to do so; or

(2) any person dishonestly agreed with another practitioner or a client that there shall be no report, in breach of the duty to do so.

128.3 Reporting addition to pre-1998 trust

Para 2 sch 5A TCGA provides:

> (1) This paragraph applies if—
>
> (a) a settlement was created before 17th March 1998,
>
> (b) on or after the commencement day a person transfers property to the trustees otherwise than under a transaction entered into at arm’s length and otherwise than in pursuance of a liability incurred by any person before that day,
>
> (c) the trustees are not resident in the UK at the time the property is transferred, and
>
> (d) the transferor knows, or has reason to believe, that the trustees are not so resident.

[6] *Clark v Oceanic* 56 TC 183.

[7] Section 245A(1) IHTA 1984.

> (2) Before the expiry of the period of twelve months beginning with the relevant day, the transferor shall deliver to the Board a return which—
>
> (a) identifies the settlement, and
>
> (b) specifies the property transferred, the day on which the transfer was made, and the consideration (if any) for the transfer.
>
> (3) For the purposes of sub-paragraph (2) above the relevant day is the day on which the transfer is made.

128.4 CGT: Reporting creation of trust

Para 3 sch 5A TCGA provides:

> (1) This paragraph applies if a settlement is created on or after the commencement day, and at the time it is created—
>
> (a) the trustees are not resident in the UK, or
>
> (b) the trustees are resident in the UK but fall to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the UK.
>
> (2) Any person who—
>
> (a) is a settlor in relation to the settlement at the time it is created, and
>
> (b) at that time fulfils the condition mentioned in sub-paragraph (3) below,
>
> shall, before the expiry of the period of three months beginning with the relevant day, deliver to the Board a return specifying the particulars mentioned in sub-paragraph (4) below.
>
> (3) The condition is that the person concerned is domiciled in the UK and is resident in the UK.
>
> (3A) Section 835BA of ITA 2007 (deemed domicile) applies for the purposes of sub-paragraph (3).
>
> (4) The particulars are—
>
> (a) the day on which the settlement was created;
>
> (b) the name and address of the person delivering the return;
>
> (c) the names and addresses of the persons who are the trustees immediately before the delivery of the return.
>
> (5) For the purposes of sub-paragraph (2) above the relevant day is the day on which the settlement is created.

128.4.1 *Deemed-domiciled settlor*

Para 9 sch 12 FA 2017 provides:

> (1) In Schedule 5A (settlements with foreign element: information), in paragraph 3, after sub-paragraph (3) insert—

> "(3A) Section 835BA of ITA 2007 (deemed domicile) applies for the purposes of sub-paragraph (3)."
>
> (2) The amendment made by this paragraph has effect in relation to settlements created on or after 6 April 2017.

Thus for settlors who are deemed domiciled for IT/CGT, the obligation to report the creation of a trust only applies for a post-2017 trust. But a person cannot be deemed domiciled before 6/4/2017, so the issue does not arise for pre-2017 trusts.

More importantly, perhaps, deemed domicile does not apply elsewhere in sch 5A,[8] so there is no duty to report under other paragraphs of sch 5A.

128.5 Reporting: Settlor becomes UK-dom

Para 4 sch 5A TCGA provides:

> (1) This paragraph applies if a settlement is created on or after 19th March 1991, and at the time it is created—
>
> (a) the trustees are not resident in the UK, or
>
> (b) the trustees are resident in the UK but fall to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the UK.
>
> (2) Any person who—
>
> (a) is a settlor in relation to the settlement at the time it is created,
>
> (b) at that time does not fulfil the condition mentioned in sub-paragraph (3) below, and
>
> (c) first fulfils that condition at a time falling on or after the commencement day,
>
> shall, before the expiry of the period of twelve months beginning with the relevant day, deliver to the Board a return specifying the particulars mentioned in sub-paragraph (4) below.
>
> (3) The condition is that the person concerned is domiciled in the UK and is resident in the UK.
>
> (4) The particulars are—
>
> (a) the day on which the settlement was created;
>
> (b) the name and address of the person delivering the return;
>
> (c) the names and addresses of the persons who are the trustees immediately before the delivery of the return.
>
> (5) For the purposes of sub-paragraph (2) above the relevant day is the day on which the person first fulfils the condition as mentioned in paragraph (c) of that sub-paragraph.

[8] The deemed domicile rules do not apply: see 5.3.1 (Scope of IT/CGT deemed-dom).

128.6 CGT: Reporting trust emigration

Para 5 sch 5A TCGA provides:

> (1) This paragraph applies if—
>
> (a) the trustees of a settlement cease at any time (the relevant time) on or after the commencement day to be resident in the UK, or
>
> (b) the trustees of a settlement, while continuing to be resident in the UK, become at any time (the relevant time) on or after the commencement day trustees who fall to be regarded for the purposes of any double taxation relief arrangements as resident in a territory outside the UK.
>
> (2) Any person who was a trustee of the settlement immediately before the relevant time shall, before the expiry of the period of twelve months beginning with the relevant day, deliver to the Board a return specifying—
>
> (a) the day on which the settlement was created,
>
> (b) the name and address of each person who is a settlor in relation to the settlement immediately before the delivery of the return, and
>
> (c) the names and addresses of the persons who are the trustees immediately before the delivery of the return.
>
> (3) For the purposes of sub-paragraph (2) above the relevant day is the day when the relevant time falls.

See 12.4 (Charge on emigration of trust).

128.7 Exceptions to CGT reporting

There are minor exceptions in para 6 sch 5A TCGA:

> (1) Nothing in paragraph 2, 3, 4 or 5 above shall require information to be contained in the return concerned to the extent that—
>
> (a) before the expiry of the period concerned the information has been provided to the Board by any person in pursuance of the paragraph concerned or of any other provision, or
>
> (b) after the expiry of the period concerned the information falls to be provided to the Board by any person in pursuance of any provision other than the paragraph concerned.
>
> (2) Nothing in paragraph 2, 3, 4 or 5 above shall require a return to be delivered if—
>
> (a) before the expiry of the period concerned all the information concerned has been provided to the Board by any person in pursuance of the paragraph concerned or of any other provision, or

(b) after the expiry of the period concerned all the information concerned falls to be provided to the Board by any person in pursuance of any provision other than the paragraph concerned.

128.8 IHT/CGT reporting compared

Sch 5A TCGA imposes overlapping reporting requirements. But s.218 IHTA is wider in some respects. It applies to IHT-settlements which are not necessarily non-resident, and not necessarily trusts, under the CGT definitions.[9] The main differences are:

	IHT	**CGT**
Duty on:	Professional adviser	Settlor/trustees
When applies	Creation of trust	Creation/addition/migration/settlor becomes UK domiciled

[9] For IHT Trust residence, see 7.19 (Trust residence for IHT). This is quite different from the IT/CGT definition.

CHAPTER ONE HUNDRED AND TWENTY NINE

INTERNATIONAL MOVEMENT OF CAPITAL: REPORTS

129.1 IMOC: Introduction
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129.8.3 Other definitions

129.1 IMOC: Introduction

Para 4(1) sch 17 FA 2009 provides:

> If a UK corporate parent is a reporting body at the time a reportable event takes place or a reportable transaction is carried out, it must, within 6 months of that time, make a report to an officer of Revenue and Customs.

The INT Manual provides:

> **INTM700310: International movements of capital: Reporting requirement: where should reports be sent?** [May 2020]
> The recommendation is that businesses should address the reports directly to the customer compliance manager ('CCM') dealing with their affairs. In cases where a business does not have a CCM appointed the reports should be sent to the office to which corporation tax returns are made.

129.1.1 *"UK corporate parent"*

Para 7 sch 17 FA 2009 provides the definition:

> In this Schedule "UK corporate parent" means a body corporate that-
> (a) is resident in the UK,
> (b) controls one or more bodies corporate that are not resident in the UK, and
> (c) s not controlled by-
> (i) a body corporate that is resident in the UK, or
> (ii) two or more bodies corporate taken together each of which is resident in the UK.

129.1.2 *Contents of report*

Para 4 sch 17 FA 2009 provides:

> (2) The report must contain such information relating to the event or transaction, or persons connected with the event or transaction, as is specified in regulations made by the Commissioners.
> (3) The purpose of the report is to enable the Commissioners to consider whether the event or transaction results, directly or indirectly, in an advantage for any person in respect of corporation tax or any other tax or duty.

The INT Manual provides:

> **INTM700800: International movements of capital: What information should the report include?** [May 2020]
> The report must include such information relating to the event or transactions as is specified in the regulations made by HMRC. The purpose of the report is to enable HMRC to consider whether or not the event or transaction gives rise to an advantage in relation to UK taxation.
> Regulation 3 deals with the information which a reporting body is required to provide. It provides that the information required as it relates to a foreign subsidiary is its name and the territory from which it derives its status as a body corporate. The report should also contain

a full description of the steps taken in the course of a transaction including in particular the date, the names of the parties, the reasons for it, and an estimate of its effect on liability to UK tax.

It can be seen from these provisions that the new reporting requirement takes a different approach to that under S.I. 1990 / No. 1671 which set out in some detail what was to be supplied under ICTA88/S765A (see INTM700110). When compiling a report under Schedule 17 businesses should bear in mind the purpose of that report when viewed from HMRC's perspective.

The legislation states that the reports are intended to enable HMRC to consider whether or not the event or transaction gives rise to an advantage in relation to UK taxation. This is a fundamental element of the department's work in assessing UK tax risks. The reports are therefore intended to play a part in the ongoing risk assessments carried out on all major groups. With this in mind a business needing to make a report ought to ensure that it is sufficiently detailed to make the consequences of the transaction clear. There is no advantage for either HMRC or businesses if additional information has to be sought (whether under formal information powers or not) because the report is insufficient.

To this end, for example, the inclusion of key documents relating to a particular transaction is to be encouraged. A particular agreement is likely to contain a great deal of factual information about the parties involved and the steps taken. Similarly, in multi-stage transactions a diagrammatic approach setting out what has happened will in most cases provide a more effective report than one that relies solely on description, although a narrative element will usually be required.

The extent to which the tax effect of a particular transaction can be estimated will vary from case to case. A distinction might be drawn between transactions planned and intended to generate a UK tax advantage and those which might well have such an effect but not in a precisely quantifiable manner. An estimate may therefore not necessarily be expressed in terms of a certain sum of money each year but as a narrative of the likely consequences. HMRC recognises that a reasonable estimate of the tax effect of some transactions may not be possible. In such cases it would be appropriate to include a brief description of the reasons for this.

129.2 Definitions of "Reporting body"

There are two definitions of reporting body, one in sch 17 and one in International Movement of Capital (Required Information) Regulations 2009 ("IMOCR"). It is bad drafting to use the same term differently in what is in effect one single code of rules; but there it is.

129.2.1 *Reporting body: Sch 17 definition*

Para 5(1) sch 17 FA 2009 provides:

> For the purposes of this Schedule a body corporate ("body A") is a reporting body at any time if, at that time-
> (a) it is a UK corporate parent, and
> (b) condition A, B, C or D is met.

129.2.2 *Condition A: no foreign control*

Para 5(2) sch 17 FA 2009 provides:

> Condition A is that body A is not controlled by a body corporate resident outside the UK.

129.2.3 *Condition B: one UK parent*

Para 5(3) sch 17 FA 2009 provides:

> Condition B is that-
> (a) body A is controlled by a body corporate resident outside the UK ("the foreign parent"), and
> (b) no other relevant UK body corporate is controlled by the foreign parent.

129.2.4 *Condition C/D: > 1 UK parent*

Conditions C and D concern nomination arrangements, and are conveniently read side by side:

Para 5(4): Condition C	**Para 5(5): Condition D**
(4) Condition C is that-	(5) Condition D is that-
(a) body A is controlled by a body corporate resident outside the UK ("the foreign parent"),	[Identical]
(b) one or more other UK corporate parents are controlled by the foreign parent, and	[identical]
(c) body A is not a party to an arrangement under paragraph 6.	(c) body A is a party to an arrangement under paragraph 6 and is the nominated reporting body under that arrangement.

129.2.5 *Nomination of reporting body*

The INT Manual provides:

> **INTM700400: International movements of capital: Who should make reports?** [May 2020]
> ... If a group is structured as, for example, two or more parallel sub-groups controlled by a foreign parent then the UK resident parents of each sub-group will be reporting bodies in respect of their subsidiaries unless between them they nominate a single reporting body (see INTM700410).

Para 6 sch 17 FA 2009 provides:

> (1) Sub-paragraph (2) applies where-
> (a) a UK corporate parent is controlled by a body corporate resident outside the UK ("the foreign parent"), and
> (b) one or more other UK corporate parents are controlled by the foreign parent.
> (2) Two or more of the UK corporate parents controlled by the foreign parent may enter into an arrangement under which one of their number ("the nominated reporting body") is nominated to exercise, on behalf of all of them, the functions conferred under this Schedule on a reporting body.
> (3) A party to an arrangement under this paragraph may withdraw from the arrangement.
> (4) The Commissioners may by regulations make provision about entering into and withdrawing from an arrangement under this paragraph.
> (5) Regulations under sub-paragraph (4) may, in particular, include provision-
> (a) as to the form and manner in which bodies may enter into, or a body may withdraw from, an arrangement,
> (b) requiring a person to give information to HMRC in connection with entering into or withdrawing from an arrangement, and
> (c) as to circumstances in which a body is to be treated as having withdrawn from an arrangement.

129.2.6 *Nomination procedure*

Article 6 IMOCR provides:

> (1) This regulation contains provision about an arrangement under paragraph 6 of Schedule 17.
> (2) The parties to an arrangement must give notice to an officer of

> Revenue and Customs within 28 days of entering into it.
> (3) The notice must be in writing and signed by all the parties to the arrangement.
> (4) The notice must state-
> (a) the name of each party,
> (b) the tax reference of each party, and
> (c) which party is the nominated reporting body.
> (5) The parties to an arrangement are treated as having withdrawn from it if they fail to give notice in accordance with paragraphs (2) to (4).
> (6) A party to an arrangement is treated as having withdrawn from it if that party ceases to be controlled by the foreign parent.
> (7) A party which withdraws from or is treated as having withdrawn from an arrangement must give notice in writing of that fact to an officer of Revenue and Customs and to any other party to the arrangement within 28 days of the date of withdrawal or, as the case may be, the date on which it ceases to be controlled by the foreign parent.

129.2.7 *Reporting body: IMOCR definition*

Article 2(3) IMOCR provides:

> In these Regulations, references to a reporting body include a body corporate which would be a reporting body if it had not entered into an arrangement under paragraph 6 of Schedule 17.

129.3 Reportable event/transaction

Para 8(1) sch 17 FA 2009 provides:

> For the purposes of this Schedule an event or transaction is "reportable", in relation to a reporting body, if-
> (a) it is of a value exceeding £100 million,
> (b) it is within sub-paragraph (2), and
> (c) it is not an excluded transaction (see paragraph 9).

129.3.1 *Valuation of event/transaction*

£100m is a substantial amount; but it has not been increased for inflation, so gradually more corporate groups are coming within the scope of IMOC.
Article 4 IMOCR provides:

> (1) The value of an event or transaction is to be determined for the purposes of paragraph 8 of Schedule 17 in accordance with this regulation.

> (2) The value of an issue or transfer of shares or debentures is the market value of the shares or debentures.
> (3) The value of an event or transaction which results in a foreign subsidiary becoming, or ceasing to be, a controlling partner in a partnership is the market value of the share of the subsidiary in the assets of the partnership immediately after it becomes a controlling partner or, as the case may be, immediately before it ceases to be a controlling partner.
> (4) For the purposes of paragraphs (2) and (3), the value of an event or transaction that is one of a series is the aggregate of the value of all the events and transactions in the series.

129.4 Reportable transactions

Para 8 sch 17 FA 2009 provides:

> (2) An event or transaction is within this sub-paragraph if-

A set of 5 categories of reportable transaction then follow.

129.4.1 *Issue of shares/debentures*

Para 8 sch 17 FA 2009 provides:

> (2) An event or transaction is within this sub-paragraph if-
> (a) it is an issue of shares or debentures by a foreign subsidiary,

129.4.2 *Transfer of shares/debentures*

Para 8 sch 17 FA 2009 provides:

> (2) An event or transaction is within this sub-paragraph if ...
> (b) it is a transfer by the reporting body, or a transfer caused or permitted by the reporting body, of shares or debentures of a foreign subsidiary in which the reporting body has an interest,
> (c) where the reporting body is a party to an arrangement under paragraph 6, it is a transfer by another party to the arrangement, or a transfer caused or permitted by such a party, of shares or debentures of a foreign subsidiary in which that party has an interest,

129.4.3 *Change of partnership control*

Para 8 sch 17 FA 2009 provides:

> (2) An event or transaction is within this sub-paragraph if ...

> (d) it results in a foreign subsidiary becoming, or ceasing to be, a controlling partner in a partnership.

Para 8(3) sch 17 FA 2009 provides:

> For the purposes of sub-paragraph (2)(d) a foreign subsidiary is a "controlling partner" in a partnership if, whether alone or taken together with one or more other partners that are subsidiaries, it controls the partnership.

Para 12(3) sch 17 FA 2009 provides:

> For the purposes of this Schedule "control" in relation to a partnership, means the right to a share of more than 50% of the assets, or of more than 50% of the income, of the partnership.

This is the standard definition.[1]

Para 12(4) sch 17 FA 2009 provides an (unnecessary) foreign-entity definition of partnership:[2]

> In this Schedule-
> "partnership" includes an entity established under the law of a country or territory outside the UK of a similar character to a partnership, and "partner" is to be read accordingly;

129.4.4 *Regulations*

Para 8 sch 17 FA 2009 provides:

> (2) An event or transaction is within this sub-paragraph if ...
> (e) it is of a description specified in regulations made by the Commissioners.

No further events/transactions have been specified.

129.5 Excluded transactions

Excluded transactions are not reportable.

Para 9 sch 17 FA 2009 provides:

> (1) For the purposes of this Schedule a transaction is "excluded" if-

A set of five excluded transactions then follow:

[1] See 104.11 (Control of partnership).

[2] See 90.3.3 (Foreign-entity clauses).

129.5.1 *Ordinary course of trade*

Para 9 sch 17 FA 2009 provides:

> (1) For the purposes of this Schedule a transaction is "excluded" if-
> (a) it is carried out in the ordinary course of a trade,

129.5.2 *All parties resident in same territory*

Para 9 sch 17 FA 2009 provides:

> (1) For the purposes of this Schedule a transaction is "excluded" if ...
> (b) all the parties to the transaction are, at the time the transaction is carried out, resident in the same territory,

129.5.3 *Security*

Para 9 sch 17 FA 2009 provides:

> (1) For the purposes of this Schedule a transaction is "excluded" if ...
> (c) it consists in giving to the bankers of a foreign subsidiary any security for the payment of any sum due or to become due from it to them by reason of any transaction entered into with it by them in the ordinary course of their business as bankers,
> (d) it consists in a foreign subsidiary giving to an insurance company any security for the payment of any sum due or to become due from that subsidiary to that company by reason of any transaction entered into with that subsidiary by that company in the ordinary course of that company's business by way of investment of its funds, or

129.5.4 *Cash pooling arrangement*

Para 9 sch 17 FA 2009 provides:

> (1) For the purposes of this Schedule a transaction is "excluded" if ...
> (e) it is of a description specified in regulations made by the Commissioners.

Article 5 IMOCR and the schedule specify the other excluded transactions. Article 5 IMOCR provides:

> (1) A transaction is excluded for the purposes of Schedule 17 if-
> (a) it is a transaction within paragraph 8(2)(a) to (c) of Schedule 17 that is entered into pursuant to cash pooling arrangements in respect of which the conditions specified in paragraph (2) have been met ...

> (2) The conditions mentioned in paragraph (1)(a) are that before the transaction takes place-
>
> (a) the parties to the cash pooling arrangements notify an officer of Revenue and Customs in writing of the terms of the arrangements;
>
> (b) an officer of Revenue and Customs gives notice in writing to the parties that transactions entered into pursuant to the cash pooling arrangements after the date of the notice will be excluded transactions for the purposes of Schedule 17.

The INT Manual provides:

> **INTM700710: International movements of capital: Exclusions: cash pooling arrangements** [May 2020]
>
> **Cash Pooling Arrangements**
>
> The legislation does not define 'cash pooling arrangements'. Broadly they are arrangements which enable companies to minimise expenditure in connection with banking facilities. Entities within a group may transfer their surplus cash to a single account overnight and, in return, draw on that account for their cash flow needs. The central account is usually held by a group treasury company.
>
> The detail of such arrangements will vary enormously but in general the result is a frequently changing network of very short term intra-group loans reflecting the needs of operating companies. Where such transactions are not otherwise excluded from the scope of the reporting requirement regulation 5(1)(a) may be of value. Due to the £100 Million limit (see INTM700600) it is not expected that many groups will need to consider this exclusion.
>
> **Notifying HMRC**
>
> Where a group wishes to take advantage of the exclusion for cash pooling arrangements it should in the first place approach its CCM or the office to which its corporation tax returns are made.
>
> The business should supply sufficient information concerning the terms on which group cash is pooled to enable HMRC to consider the risks attached to excluding the related transactions from the reporting requirement. The process will involve description and discussion of a group's procedures and it is very likely that the provision internally prepared documentation describing those processes will be of value.
>
> **Changes to arrangements**
>
> Where changes are made to cash pooling arrangements subsequent transactions will not be excluded from the scope of the reporting requirement. Groups will therefore need to notify HMRC of such changes. However, this should only be necessary where such changes

> have a material impact on the arrangements.
> For example, the variation of an interest rate should not be regarded as a change if the previously notified arrangements provide for a floating rate and the variation reflects an underlying movement in LIBOR. It would be a change to move interest rates from a floating to a fixed basis where such a change was not a provision of the original arrangements.

Article 5 IMOCR provides:

> (1) A transaction is excluded for the purposes of Schedule 17 if ...
> (b) it is described in one of the paragraphs in the Schedule (excluded transactions) to these Regulations and meets such conditions (if any) as are specified there.

We journey on to sch IMOCR:

> 1 The following transactions are excluded transactions mentioned in regulation 5(1)(b).

It seems strange drafting not to define all the excluded transactions in one place; but there it is.

129.5.5 *Issue of shares inter-group*

Para 2 sch IMOCR provides:

> (1) The first transaction is the issue of shares by the foreign subsidiary to the reporting body or to a group company.
> (2) The conditions are that the issue-
> (a) is of shares that are not redeemable; and
> (b) is either-
> (i) at market value and for consideration paid in cash to the foreign subsidiary, or
> (ii) in or towards payment for any business undertaking or property acquired by the foreign subsidiary at market value.

129.5.6 *Issue of shares to unconnected person*

Para 3 sch IMOCR provides:

> (1) The second transaction is the issue of shares by the foreign subsidiary to a person not connected with the reporting body.
> (2) The conditions are-
> (a) that the issue-
> (i) is at market value and for consideration paid to the foreign subsidiary, and

> (ii) is not to a nominee or trustee for a person who is connected with the reporting body;
>
> (b) that no arrangements exist as a consequence of which the reporting body or a person connected with the reporting body, or a nominee or trustee for that person or the reporting body, is or may become entitled to the shares so issued or to any of them or to any interest in them or in any of them.

129.5.7 *Rights issue*

Para 4 sch IMOCR provides:

> (1) The third transaction is the issue of shares by the foreign subsidiary to all persons who are its shareholders at the time of the issue.
>
> (2) The conditions are that the issue-
>
> (a) is in respect of and in proportion to the shares held by the shareholders in the foreign subsidiary at the time of the issue; and
>
> (b) either-
>
> (i) is of shares that are not redeemable, or
>
> (ii) where no shares are issued to a company which is resident in the UK or to a nominee or trustee for such a company, is at market value for consideration paid in cash to the foreign subsidiary.

129.5.8 *Debenture issue intra-group*

Para 5 sch IMOCR provides:

> (1) The fourth transaction is the issue of debentures by the foreign subsidiary to the reporting body or to a group company.
>
> (2) The condition is that the circumstances specified in sub-paragraph (3) are not associated with or present in connection with the issue of the debentures.
>
> (3) The circumstances are that a loan, whether or not of the same amount as that secured by the debentures, is made by a company which is not resident in the UK to a company which is resident in the UK.

129.5.9 *Debenture issue to unconnected person*

Para 6 sch IMOCR provides:

> (1) The fifth transaction is the issue of debentures by the foreign subsidiary to persons not connected with the reporting body.
>
> (2) The conditions are-
>
> (a) that the issue-

> (i) is at market value and for consideration paid to the foreign subsidiary, and
> (ii) is not to a nominee or trustee for a person who is connected with the reporting body;
>
> (b) that no arrangements exist as a consequence of which the reporting body or a person connected with the reporting body, or a nominee or trustee for that person or the reporting body, is or may become entitled to the debentures so issued or to any of them or to any interest in them or in any of them.

129.5.10 *Transfer of securities to unconnected person*

Para 7 sch IMOCR provides:

> (1) The sixth transaction is the transfer by the reporting body or a company (whether or not it is resident in the UK) of shares or debentures of the foreign subsidiary to a person not connected with the reporting body.
>
> (2) The conditions are-
>
> (a) that the transfer-
> (i) is at market value for consideration paid to the transferor company, and
> (ii) is not to a nominee or trustee for a person who is connected with the reporting body;
>
> (b) that no arrangements exist as a consequence of which-
> (i) the reporting body, or
> (ii) a nominee or trustee for the reporting body, or
> (iii) a person connected with the reporting body, or
> (iv) a nominee or trustee for a person connected with the reporting body,
>
> is or may become entitled to the shares or debentures transferred or to any of them or to any interest in them or in any of them.

129.5.11 *Inter-group transfer of securities*

Para 8 sch IMOCR provides:

> The seventh transaction is a transfer by the reporting body of shares or debentures of the foreign subsidiary to a group company.

Para 9 sch IMOCR provides:

> (1) The eighth transaction is a transfer within sub-paragraph (2) to the reporting body or a group company.

> (2) A transfer is within this sub-paragraph if it-
>
> (a) is not by the reporting body,
>
> (b) is of shares or debentures of a foreign subsidiary in which the reporting body has an interest, and
>
> (c) is permitted or caused by the reporting body.

129.5.12 *Security over shares*

Para 10 sch IMOCR provides:

> The ninth transaction consists in the reporting body or a group company giving security over the shares of a foreign subsidiary in connection with borrowing money from a lender who is unconnected to the reporting body or the group company.

129.6 Information in report

Article 3 IMOCR provides:

> (1) Paragraphs (2) and (3) specify the information (in this regulation referred to as "the required information") to be contained in the report which is required to be made to an officer of Revenue and Customs under paragraph 4(1) of Schedule 17.
>
> (2) The required information as it relates to a foreign subsidiary connected with the event or transaction is-
>
> (a) its name, and
>
> (b) the territory from the laws of which it derives its status as a body corporate.
>
> (3) The required information as it relates to an event or transaction is a full description of the event or transaction (and, in the case of a transaction, a full description of all the steps taken in the course of the transaction) and includes in particular-
>
> (a) the date on which the event took place or the transaction was carried out,
>
> (b) for a transaction, the name of each party to it,
>
> (c) the reason for the event or transaction, and
>
> (d) an estimate of the effect of the event or transaction on the liability to tax in the UK of the reporting body and of any group company

129.7 Penalties

Penalties arise under s.98 TMA 1970 (special returns etc). The amounts are nominal: presumably company groups in excess of £100m are not thought to need the sanction of substantial penalties.

129.8 Definitions

129.8.1 *Control*

Para 12(1) sch 17 FA 2009 provides:

> For the purposes of this Schedule "control", in relation to a body corporate, means the power of a person to secure-
> (a) by means of the holding of shares or the possession of voting power in or in relation to the body or any other body corporate, or
> (b) by virtue of any powers conferred by the articles of association or other document regulating the body or any other body corporate,
> that the affairs of the body are conducted in accordance with that person's wishes.

This is strict-sense control.[3]
Para 12(2) sch 17 FA 2009 provides:

> Where two or more persons, taken together, have the power mentioned in sub-paragraph (1), they are taken for the purposes of this Schedule to control the body corporate.

129.8.2 *"Connected"*

Article 2(2) IMOCR cuts down the standard definition of connected person:

> [a] For the purposes of these Regulations, whether a person is connected with another shall be determined
> [b] as it would in accordance with the provisions of subsections (2) to (8) of section 839 (connected persons) of ICTA [now s.1122 CTA 2010]
> [c] if the words "paragraph 12 of Schedule 17 to the Finance Act 2009" were substituted for the words "section 416" in the definition of "control" in subsection (8).

The effect of [c] is now to substitute the words "paragraph 12 of Schedule 17 to the Finance Act 2009" for the words "sections 450 and 451" in s.1123(1) CTA 2010.

[3] See 104.9 (Control: Strict sense).

129.8.3 *Other definitions*

Para 12 sch 17 FA 2009 provides:

> (4) In this Schedule-
> "foreign" means resident outside the UK;
> "subsidiary", in relation to a reporting body, means a body corporate that is controlled by-
> (a) the reporting body, or
> (b) where the reporting body is a party to an arrangement under paragraph 6, any party to the arrangement.
> (5) Section 150 of TIOPA 2010 (meaning of "transaction" and "series of transactions") applies for the purposes of this Schedule.[4]

Article 2 IMOCR provides:

> (1) In these Regulations-
> "group company" means any company which is resident in the UK and which would be deemed to be a member of the group of companies which includes the reporting body for the purposes of Chapter IV of Part X of the Income and Corporation Taxes Act 1988 if in section 413(3) of that Act the words "51 per cent" were substituted for the words "75 per cent";
> ...
> "redeemable", in relation to shares, means that the shares satisfy one or both of the following conditions-
> (a) that, by virtue of the terms of their issue or the exercise of a right by any person or the existence of any arrangements, they are liable to be redeemed, cancelled or repaid, in whole or in part;
> (b) that, by virtue of any material arrangements, the holder has a right to require another person to acquire the shares or is obliged in any circumstances to dispose of them or another person has a right or is in any circumstances obliged to acquire them;
> and arrangements are material arrangements if the company which issued the shares or a company connected with that company is a party to the arrangements.

[4] See 20.7.1 (Transaction/series).

CHAPTER ONE HUNDRED AND THIRTY

COMMON REPORTING STANDARD

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130.34.7 Currency
130.35 CRS TAAR

130.1 CRS & other information sources

HMRC obtain information about Beneficial Ownership/Controlling Persons from the following:[1]

(1) Automatic Exchange of Information (AEOI) agreements:
  (a) CRS (Common Reporting Standard)[2]
  (b) FATCA (the US Foreign Account Tax Compliance Act)
(2) Beneficial Ownership registers:
  (a) UK companies/LLPs: Persons with Significant Control register[3]
  (b) Equivalents in foreign jurisdictions[4]
  (c) The Trust Register, known as TRS
  (d) Register of Overseas Entities owning UK land[5]

This chapter considers CRS and touches on FATCA. The next chapter considers TRS and MLR; I hope to consider the others in a future edition. But a full discussion would need several volumes.

CRS also addresses the topic of AML/KYC (anti-money laundering/

[1] Also, until Brexit, Council Directive 2011/16/EU (Administrative co-operation in the field of taxation) provided for exchange of information between member states (it applies CRS throughout the EU).

[2] Standard for Automatic Exchange of Financial Account Information *http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/*

[3] Part 21A (s.790A-790ZG) Companies Act 2006.

[4] British Overseas Territories are required to establish public registers of company beneficial owners; s.51 Sanctions and Anti-Money Laundering Act 2018. But the EC decision in Joined Cases C-37/20 | *Luxembourg Business Registers* and C-601/20 | *Sovim* will cause rethinking and delay here.

[5] Economic Crime (Transparency and Enforcement) Act 2022.

know your client), also known as due diligence; but the topic of this chapter is the reporting of Beneficial Ownership/Controlling Persons.

130.2 Common Reporting Standard

In outline, there are two basic types of entity:

(1) *Financial Institutions* (FIs) who make reports to their local tax authority; in more detail, they report to their Competent Authority, on Reportable Accounts, held by Reportable Persons, resident in Reportable Jurisdictions.

(2) *NFEs* who do not make reports, but FIs make reports for them

Competent Authorities exchange this information between themselves.

CRS has vocabulary and concepts of its own, and it is not possible to discuss it without using its terminology.

130.2.1 *Implementation in UK law*

CRS is implemented in international law by a treaty, CRS Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of information between tax authorities.

CRS is implemented in UK law by s.222 FA 2013 and International Tax Compliance Regulations 2015 (ITCR).[6]

Of course a foreign entity is concerned with the law and practice in the jurisdiction where it is located, rather than UK law. But I wonder how much the different jurisdictions actually vary. The major jurisdiction which has not implemented CRS is, needless to say, USA.

130.2.2 *CRS guidance*

CRS has attracted what readers may regard as a surfeit of guidance.

OECD guidance:

- A commentary ("CRS commentary")
- CRS Implementation Handbook 2nd edition April 2018
- OECD CRS FAQ[7]

[6] The OECD has recently released amendments to the CRS in 2023, the full report is titled "International Standards for Automatic Exchange of Information in Tax Matters: Crypto-Asset Reporting Framework and 2023 Update to the Common Reporting Standard" *https://www.oecd-ilibrary.org/sites/896d79d1-en/index.html?itemId=/content/publication/896d79d1-en*

[7] The full title is: CRS-related Frequently Asked Questions *http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/*

- Model disclosure rules concerning CRS avoidance[8]
- Cryptoasset Reporting Framework and 2023 Update To the Common Reporting Standard contains a commentary on its provisions[9]

HMRC guidance

- International Exchange of Information Manual

STEP guidance: two guidance notes which I call:

- STEP CRS guidance[10]
- STEP CRS guidance (2016)[11]

For the background, see Casi *et al.,* "A Call to Action: From Evolution to Revolution on the CRS" [2019] BTR 166.

See too Jackson & Brown, *A Practitioner's Guide To International Tax Information Exchange Regimes.*

130.2.3 *FATF recommendations*

CRS refers at times to the FATF recommendations on money laundering ("FATF Recommendations").[12] This was issued in 1990 and revised in 1996, 2003 and 2012. The 2012 edition is the current one, though that has been subsequently revised.

130.3 FATCA

FATCA is governed by a USA/UK Intergovernmental Agreement. I refer to this as the FATCA IGA, or just FATCA.[13] This is implemented in UK

[8] The full title is: OECD, "Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures" (2018) *http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/*

[9] *https://www.oecd.org/tax/international-standards-for-automatic-exchange-of-information-in-tax-matters-896d79d1-en.htm*
This was preceded by an OECD consultation document, "Crypto-Asset Reporting Framework and Amendments to the Common Reporting Standard" (2022).

[10] The full title is: STEP Guidance Note: CRS and trusts (2017) *https://www.step.org/system/files/media/files/2020-03/Guidance_note_CRS_and_trusts.pdf*

[11] The full title is: STEP Guidance Note: Common Reporting Standard. *https://www.step.org/system/files/media/files/2020-03/Guidance_Note_CRS.pdf*

[12] The full title is: International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations *https://www.fatf-gafi.org/content/dam/fatf-gafi/recommendations/FATF%20Recommendations%202012.pdf.coredownload.inline.pdf*

[13] The full title is: Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America to Improve International Tax Compliance and to Implement FATCA (2012).

law by ITCR 2015. FATCA is not identical to CRS but they share a common framework.

In outline: FATCA requires financial institutions outside the USA to provide information about US persons to the IRS. The US provides data on US accounts of UK residents to HMRC.

The professional bodies have produced guidance ("PB FATCA guidance").[14] They have also produced a flowchart[15] but that can only be an outline sketch of the position.[16]

130.4 CRS/FATCA navigation

130.4.1 *Index of provisions*

The provisions of CRS are laid out as follows:

Section	**Topic**
I	Reporting Requirements
II - VII	Due Diligence Requirements
VIII	Definitions
IX	Implementation

130.4.2 *Definitions*

CRS capitalises the initial letter of defined terms and I adopt that here.

Section VIII CRS (definitions) is divided into parts (A to E) which are subdivided into numbered sections. In FATCA the definitions are in art 1:

CRS	***FATCA***	***Para***	***CRS***	***FATCA***	***Para***
A. Reporting Financial Institutions					
1 Reporting Financial Institution		130.32	5 Depository Institution	1(i)	130.10
2 Participating Jurisdiction FI		130.14	6 Investment Entity	1(j)	130.11

https://www.gov.uk/government/publications/agreement-between-the-uk-and-the-usa-to-improve-international-tax-compliance-and-to-implement-fatca

[14] *https://www.step.org/system/files/media/files/2020-03/Updated_FATCA_Guidance_14_August_2014.pdf* (Aug 2014).

[15] *https://www.step.org/system/files/media/files/2020-03/fatca-flowchart-iga.pdf*

[16] The IEIM provides:

> **EIM400820 Trusts Managed by a Financial Institution** [Dec 2021]
> STEP in conjunction with the Law Society for England and Wales and ICAEW have produced a series of questions and a supporting flowchart that may be useful when considering the status of a trust. Please note that use of this flowchart will in no way take the place of HMRC guidance and it should be used as a supplementary tool only.

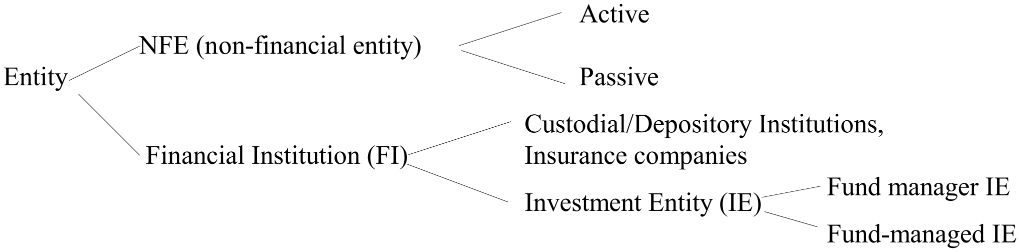
3 Financial Institution	1(g)	130.9	7 Financial Asset		130.16
4 Custodial Institution	1(h)	130.10	8 Specified Insurance Co	1(k)	
B. Non-Reporting Financial Institutions					
1 Non-Reporting FI		130.33	6 Narrow Participation Retirement Fund		
2 Governmental Entity		130.8.3	7 Governmental Pension Fund, etc		
3 International Organisation		130.8.3	8 Qualified Credit Card Issuer		130.35
4 Central Bank			9 Exempt Collective Investment Vehicle		
5 Broad Participation Retirement Fund					
C. Financial Accounts					
1 Financial Account	1(s)	130.17	10 New Account		
2 Depository Account	1(t)	130.17.1	11 Pre-existing Individual Account		
3 Custodial Account	1(u)	130.17.2	12 New Individual Account		
4 Equity Interest	1(v)	130.17.3	13 Pre-existing Entity Account		
5 Insurance Contract	1(w)		14 Lower Value Account		
6 Annuity Contract	1(x)		15 High Value Account		
7 Cash Value Insurance Contract	1(y)		16 New Entity Account		
8 Cash Value	1(z)		17 Excluded Account		
9 Pre-existing Account	1(aa)	130.34.6			
D. Reportable Accounts					
1 Reportable Account	1(bb)	130.19	6 Controlling Persons	1(mm)	130.23
2 Reportable Person		130.20	7 NFE		130.7
3 Reportable Jurisdiction Person		130.22	8 Passive NFE		130.9
4 Reportable Jurisdiction		130.21	9 Active NFE		130.8
5 Participating Jurisdiction		130.21			
E. Miscellaneous					
1 Account Holder	1(ee)	130.17.6	4 Related Entity	1(kk)	130.5.1
2 ML/KYC Procedures			5 TIN		
3 Entity 1(hh)		130.5	6 Documentary Evidence		

Terms which are undefined, or only defined indirectly, include:

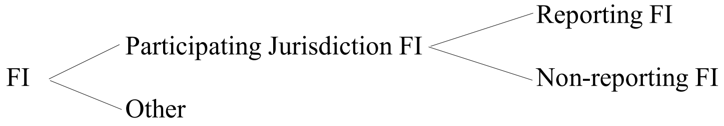
Term	**See para**
Beneficiary	130.18
Distribution	130.18.1
Income	130.6

130.4.3 *Types of Entity: Summary*

Types of CRS Entity may be summarised by this table:


Active
NFE (non-financial entity)
Entity
Passive
Custodial/Depository Institutions,
Insurance companies
Financial Institution (FI)
Fund manager IE
Investment Entity (IE)
Fund-managed IE

Financial Institutions may also be categorised as follows:



130.5 Entity

Entity is a broad term. Section VIII (E)(3) CRS provides:

> 3. The term "**Entity**" means a legal person or a legal arrangement, such as a corporation, partnership, trust, or foundation.

An individual is not an entity. A trust with individual trustees is an entity, the trust. A trust with a corporate trustee involves two entities, the trust and the trustee.[17]

It may be difficult to identify the dividing line between what is and what is not an entity. Co-ownership is not an entity in UK law, in the absence of further features which might turn it into a partnership or unit trust, which are entities. In US law co-ownership may give rise an entity.

What about a non-express trust (which is outside TRS)? What about a bare trust (generally within TRS)?

130.5.1 *Related Entity*

Section VIII (E)(4) CRS provides:

> An Entity is a **"Related Entity"** of another Entity if either Entity controls the other Entity, or the two Entities are under common control. For this purpose control includes direct or indirect ownership of more than 50% of the vote and value in an Entity.

130.6 "Income"

Income is relevant in determining the type of Entity.

Income is not defined but should be ascertained by accountancy principles.

Ryan[18] suggests that income includes repaying debt to a shareholder, but that would not normally be regarded as income.

[17] Duplication of reporting is avoided as if the trustee reports, the trust is a non-reporting FI; see 130.33.3 (Trust with reporting trustee).

[18] "A crash course in the CRS" *https://www.step.org/journal/tqr-march-2016/crash-course-crs*

130.6.1 *Passive income*

Income may be passive or non-passive/active. The distinction matters for determining whether a NFE is passive or active.

Commentary on Section VIII CRS provides:

> 126. In determining what is meant by "passive income", reference must be made to each jurisdiction's particular rules. Passive income would generally be considered to include the portion of gross income that consists of:
>
> *a)* dividends;
> *b)* interest;
> *c)* income equivalent to interest;
> *d)* rents and royalties, other than rents and royalties derived in the active conduct of a business conducted, at least in part, by employees of the NFE;
> *e)* annuities;
> *f)* the excess of gains over losses from the sale or exchange of Financial Assets that gives rise to the passive income described previously;
> *g)* the excess of gains over losses from transactions (including futures, forwards, options, and similar transactions) in any Financial Assets;
> *h)* the excess of foreign currency gains over foreign currency losses;
> *i)* net income from swaps; or
> *j)* amounts received under Cash Value Insurance Contracts.
>
> Notwithstanding the foregoing, passive income will not include, in the case of a NFE that regularly acts as a dealer in Financial Assets, any income from any transaction entered into in the ordinary course of such dealer's business as such a dealer.[19]

[19] The text at (f)-(g) will be updated by the 2023 CRS Amendments when they take effect to read: "f) income derived from Relevant Crypto-Assets; g) the excess of gains over losses from the sale or exchange of Financial Assets or Relevant Crypto-Assets; h) the excess of gains over losses from transactions (including futures, forwards, options, and similar transactions) in any Financial Assets or Relevant Crypto-Assets". There is a similar insertion of "or Relevant Crypto-Assets" after "Financial Assets" in the paragraph beginning with "Notwithstanding the foregoing".
By the same amendments, there will also be a new paragraph after the paragraph beginning with "Notwithstanding the foregoing" which reads: " To facilitate effective implementation of the Standard, a jurisdiction's definition of passive income should in substance be consistent with the list provided in paragraph 126. Each jurisdiction

The "passive income" is not used (or at least not much) in domestic UK tax law, but it is used in international tax law.[20]

130.7 Non-financial Entity (NFE)

Section VIII (D)(7) CRS provides:

> 7. The term **"NFE"** means any Entity that is not a Financial Institution.

NFEs may be active or passive.

130.8 Active NFE

Section VIII (D)(9)(a) CRS provides:

> 9. The term "**Active NFE**" means any NFE that meets any of the following criteria:

There follow 8 categories of active NFE:

Para	**Topic**
(a)	Mainly active income
(b)	Listed NFE
(c)	Government/international Entity
(d)	Entity holding assets for NFE
(e)	Entity providing services to NFE
(f)	Non-FI in liquidation
(g)	Group treasury company
(h)	Non-profit organisation

130.8.1 *Mainly active income*

Section VIII (D)(9)(a) CRS provides:

> 9. The term "**Active NFE**" means any NFE that meets any of the following criteria:
>
> a) [i] less than 50% of the NFE's gross income for the preceding calendar year or other appropriate reporting period is passive income[21] and

may define in its particular rules the items contained in the list of passive income (such as, income equivalent to interest and dividends) consistent with domestic rules."

[20] See for instance Katz Commission 5th Report "Basing the South African Income Tax System on the Source Or Residence Principle - Options and Recommendations" Chapter 4 - Definition of Active and Passive Income *http://www.treasury.gov.za/publications/other/katz/5.pdf*

[21] See 130.6.1 (Passive income).

> [ii] less than 50% of the assets held by the NFE during the preceding calendar year or other appropriate reporting period are assets that produce or are held for the production of passive income;

For the purposes of this book, this is the most important category.

130.8.2 *Listed NFE*

Section VIII (D)(9)(b) CRS provides:

> 9. The term "**Active NFE**" means any NFE that meets any of the following criteria ...
>
> b) the stock of the NFE is regularly traded on an established securities market or the NFE is a Related Entity of an Entity the stock of which is regularly traded on an established securities market;

130.8.3 *Government/international Entity*

Section VIII (D)(9)(c) CRS provides:

> 9. The term "**Active NFE**" means any NFE that meets any of the following criteria ...
>
> c) the NFE is a Governmental Entity, an International Organisation, a Central Bank, or an Entity wholly owned by one or more of the foregoing;

130.8.4 *Holding/services to NFE*

Section VIII (D)(9)(d) CRS provides:

> 9. The term "**Active NFE**" means any NFE that meets any of the following criteria ...
>
> d) [i] substantially all of the activities of the NFE consist of holding (in whole or in part) the outstanding stock of, or providing financing and services to, one or more subsidiaries that engage in trades or businesses other than the business of a Financial Institution,
>
> [ii] except that an Entity does not qualify for this status if the Entity functions (or holds itself out) as an investment fund, such as a private equity fund, venture capital fund, leveraged buyout fund, or any investment vehicle whose purpose is to acquire or fund companies and then hold interests in those companies as capital assets for investment purposes;

Section VIII (D)(9)(e) CRS provides:

> 9. The term "**Active NFE**" means any NFE that meets any of the following criteria ...
>
> e) the NFE is not yet operating a business and has no prior operating history, but is investing capital into assets with the intent to operate a business other than that of a Financial Institution, provided that the NFE does not qualify for this exception after the date that is 24 months after the date of the initial organisation of the NFE;

130.8.5 *Non-FI in liquidation*

Section VIII (D)(9)(f) CRS provides:

> 9. The term "**Active NFE**" means any NFE that meets any of the following criteria ...
>
> f) [i] the NFE was not a Financial Institution in the past five years, and
>
> [ii] is in the process of liquidating its assets or is reorganising with the intent to continue or recommence operations in a business other than that of a Financial Institution;

130.8.6 *Group treasury company*

Section VIII (D)(9)(g) CRS provides:

> 9. The term "**Active NFE**" means any NFE that meets any of the following criteria ...
>
> g) the NFE primarily engages in financing and hedging transactions with, or for, Related Entities that are not Financial Institutions, and does not provide financing or hedging services to any Entity that is not a Related Entity, provided that the group of any such Related Entities is primarily engaged in a business other than that of a Financial Institution; or

130.8.7 *Non-profit organisation*

Section VIII (D)(9)(h) CRS provides:

> 9.The term "**Active NFE**" means any NFE that meets any of the following criteria ...
>
> h) the NFE meets all of the following requirements:
>
> i) it is established and operated in its jurisdiction of residence exclusively for religious, charitable, scientific, artistic, cultural,

athletic, or educational purposes; or it is established and operated in its jurisdiction of residence and it is a professional organisation, business league, chamber of commerce, labour organisation, agricultural or horticultural organisation, civic league or an organisation operated exclusively for the promotion of social welfare;

ii) it is exempt from income tax in its jurisdiction of residence;

iii) it has no shareholders or members who have a proprietary or beneficial interest in its income or assets;

iv) the applicable laws of the NFE's jurisdiction of residence or the NFE's formation documents do not permit any income or assets of the NFE to be distributed to, or applied for the benefit of, a private person or noncharitable Entity other than pursuant to the conduct of the NFE's charitable activities, or as payment of reasonable compensation for services rendered, or as payment representing the fair market value of property which the NFE has purchased; and

v) the applicable laws of the NFE's jurisdiction of residence or the NFE's formation documents require that, upon the NFE's liquidation or dissolution, all of its assets be distributed to a Governmental Entity or other non-profit organisation, or escheat to the government of the NFE's jurisdiction of residence or any political subdivision thereof.

130.9 Passive NFE

"Passive NFE" matters because:

(1) It is not a FI and does not have direct reporting duties

(2) Its accounts may be (and if the Passive NFE is a trust, will be) Reportable Accounts[22] so other FIs have the reporting duties.

There are two categories of Passive NFE.

Section VIII (D)(8) CRS provides:

> 8. The term "**Passive NFE**" means any:
>
> *(i)* NFE that is not an Active NFE,,,

A trust that is not a FI is likely to be a Passive NFE, but it depends on the type of income which it receives, active or passive.

Section VIII (D)(8) CRS provides:

[22] See 130.19 (Reportable Account).

> 8. The term "**Passive NFE**" means ...
>
> *(ii)* an Investment Entity
>
> [a] described in subparagraph A(6)(b) [fund-managed IE][23]
>
> [b] that is not a Participating Jurisdiction Financial Institution.[24]

In practice FIs outside Participating Jurisdictions (and outside USA) are few, so this category of Passive NFE will be rare.

130.10 Financial Institution

"Financial Institution" (FI) matters, as:

Reason	**See para**
Reporting Financial Institution has reporting duties	130.34
FI is not an NFE, so the FI's own accounts are not Reportable	130.7; 130.19

FI is, needless to say, a technical term. Section VIII (A)(3) CRS provides:

> 3. The term "**Financial Institution**" means
>
> [a] a Custodial Institution,
>
> [b] a Depository Institution,
>
> [c] an Investment Entity, or
>
> [d] a Specified Insurance Company.

Custodial Institutions are (in short) security and brokerage firms.[25] Depositary Institutions are banks.[26] These are all financial institutions in

[23] See 130.13 (Fund-managed IE).

[24] See 130.14 (Participating Jurisdiction FI).

[25] Section VIII (A)(4) CRS provides:

"4.[a] The term "Custodial Institution" means any Entity that holds, as a substantial portion of its business, Financial Assets for the account of others.

[b] An Entity holds Financial Assets for the account of others as a substantial portion of its business if the Entity's gross income attributable to the holding of Financial Assets and related financial services equals or exceeds 20% of the Entity's gross income during the shorter of:

(i) the three-year period that ends on 31 December (or the final day of a non-calendar year accounting period) prior to the year in which the determination is being made; or

(ii) the period during which the Entity has been in existence.

[26] Section VIII (A)(5) CRS provides: "The term "Depository Institution" means any Entity that accepts deposits in the ordinary course of a banking or similar business." This section will be updated by the 2023 CRS Amendments when they take effect to read: "The term "Depository Institution" means any Entity that: a) accepts deposits

the general sense of the term. But the important category, for this work at least, is Investment Entity (IE). An Investment Entity is a "Financial Institution" in the defined sense.

130.11 Investment Entity

"Investment Entity" matters as an IE is a Financial Institution and not a NFE.

There are two categories of Investment Entity. I coin the following terminology:

CRS term	**My Term**	**See para**
Investment Entity described in subpara A(6)(a) of Section VIII	Fund-manager IE	130.12
Investment Entity described in subpara A(6)(b) of Section VIII	Fund-managed IE	130.13

130.11.1 *Exclusions*

Section VIII (A)(6) CRS provides a rule which applies for both types of IE:

> ... The term "Investment Entity" does not include an Entity that is an Active NFE because it meets any of the criteria in [section VIII] subparagraphs D(9)(d) through (g).

That excludes:

Para	**Topic**
(d)	Entity holding assets for NFE
(e)	Entity providing services to NFE
(f)	Non-FI in liquidation
(g)	Group treasury company

See 130.8 (Active NFE).

130.11.2 *FATF Recommendations*

Section VIII (A)(6) CRS provides:

> ... This paragraph [Section VIII (A)(6) CRS, definition of IE] shall be interpreted in a manner consistent with similar language set forth in the definition of "financial institution" in the Financial Action Task Force Recommendations.[27]

in the ordinary course of a banking or similar business; or b) holds Specified Electronic Money Products or Central Bank Digital Currencies for the benefit of customers."

[27] See 130.2.3 (FATF recommendations).

130.12 Fund-manager IE

These are two requirements:
(1) A fund-manager requirement
(2) An income requirement

130.12.1 *Fund-manager requirement*

Section VIII (A)(6)(a) CRS provides:

> The term "**Investment Entity**" means any Entity:
> *a)* that primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer:
> *i)* trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;
> *ii)* individual and collective portfolio management; or
> *iii)* otherwise investing, administering, or managing Financial Assets or money on behalf of other persons;[28]

I refer to activities within para (a)(i)-(iii) as **"Investment Activities"** and an entity carrying on investment activities is a **"professional fund-manager"**.

130.12.2 *Income requirement*

Section VIII (A)(6) CRS provides:

> An Entity is treated as primarily conducting as a business one or more of the activities described in subparagraph A(6)(a) [Investment Activities]...
> if the Entity's gross income attributable to the relevant activities equals or exceeds 50% of the Entity's gross income during the shorter of:
> *(i)* the three-year period ending on 31 December of the year preceding the year in which the determination is made; or
> *(ii)* the period during which the Entity has been in existence.

What if there is no income? The Entity is not likely to be carrying on a business.

[28] Section VIII (A)(6)(a)(iii) CRS will be updated by the 2023 CRS Amendments when they take effect to read: "otherwise investing, administering, or managing Financial Assets, money, or Relevant Crypto-Assets on behalf of other persons".

130.12.3 *Professional trust co*

In the following discussion a "professional trust company" is one carrying on the business of managing trusts. It is typically a Fund-manager IE, on the basis that:

(1) It has customers.
(2) It manages Financial Assets on behalf of customers.
(3) Its income is attributable to Investment Activities.

It is conceivable that a professional trust company is not a Fund-manager IE, eg, if the company is managing trusts (or mainly managing trusts) whose assets are not Financial Assets.

A family (SPV) trust company (a company set up to manage the trusts of one family) may not be carrying on a business, on the basis that it does not charge but acts gratuitously.

130.13 Fund-managed IE

Section VIII (A)(6)(b) CRS provides:

> The term "**Investment Entity**" means any Entity...
> *b)*[A] the gross income of which is primarily attributable to investing, reinvesting, or trading in Financial Assets,[29]
> [B] if the Entity is managed by another Entity that is
> [i] a Depository Institution,
> [ii] a Custodial Institution,
> [iii] a Specified Insurance Company, or
> [iv] an Investment Entity described in subparagraph A(6)(a) [Fund-manager IE]

I refer to an IE which meets these requirements as a **"fund-managed IE"**. There are two requirements here:

(1) An income requirement
(2) A managed-funds requirement

130.13.1 *Income requirement*

The relevant part of the definition of Fund-managed IE requires:

> *b)* [A] the gross income of [the Entity] is primarily attributable to

[29] This text will be updated by the 2023 CRS Amendments when they take effect to read: "... or trading in Financial Assets or Relevant Crypto-Assets, if the Entity is managed by another Entity ...".

> investing, reinvesting, or trading in Financial Assets,

Section VIII (A)(6)(b) CRS provides:

> [c] ... [ii] an Entity's gross income is primarily attributable to investing, reinvesting, or trading in Financial Assets[30] for purposes of subparagraph A(6)(b),
>
> if the Entity's gross income attributable to the relevant activities equals or exceeds 50% of the Entity's gross income during the shorter of:
>
> *(i)* the three-year period ending on 31 December of the year preceding the year in which the determination is made; or
>
> *(ii)* the period during which the Entity has been in existence.

130.13.2 *Managed-funds requirement*

The relevant part of the definition of Fund-managed IE requires:

> the Entity is managed by another Entity that is
>
> [i] a Depository Institution,
>
> [ii] a Custodial Institution,
>
> [iii] a Specified Insurance Company, or
>
> [iv] an Investment Entity described in subparagraph A(6)(a) [Fund-manager IE]

130.13.3 *"Managed"*

OECD Commentary on Section VIII (A)(6)(b) provides an artificially wide definition:

> 17. ...
>
> [a] An Entity is "managed by" another Entity if the managing Entity performs, either directly or through another service provider, any of the activities or operations described in subparagraph A(6)(a) [Investment Activities] on behalf of the managed Entity.
>
> [b] However, an Entity does not manage another Entity if it does not have discretionary authority to manage the Entity's assets (in whole or part).

I write "Managed" with an initial capital, to reflect the technical nature of the term.

An Entity may be "Managed" by more than one person. OECD Commentary addresses this:

[30] The 2023 CRS Amendments insert "or Relevant Crypto-Assets" here.

> 17. ... Where an Entity is managed by a mix of Financial Institutions, NFEs or individuals, the Entity is considered to be managed by another Entity that is a Depository Institution, a Custodial Institution, a Specified Insurance Company, or an Investment Entity described in subparagraph A(6)(a) [Fund-manager IE], if any of the managing Entities is such another Entity.[31]

STEP CRS guidance provides:

> In a typical trust example, the PTC or the holding company (owned by the trust) enters into a contract with a corporate service provider to provide services that include ‘investing, administering, or managing Financial Assets or money’ on behalf of the trust or underlying holding company. As part of the services provided, the corporate service provider will provide a director (either and individual or corporate director) who will be directly responsible (with the other directors) for the investment of the underlying assets of the trust or holding company. The corporate service provider will charge a fee for such services. The corporate service provider will, in many circumstances, provide services to other third parties. On occasion, the corporate service provider may provide such services only to the trust, holding company and other related entities.
>
> 10.3 The guidance in some IGA jurisdictions in relation to US FATCA confirmed that a trust can be treated as an FI if it receives services from a Trust and Corporate Service Provider (TCSP) that is itself an FI.
>
> 10.4 The guidance also considers the provision of directors to a company. While noting that the provision of individual employees or partners of a company services provider to serve as directors of an entity will not usually (on its own) cause the company to fall within the

[31] The text will be updated by the 2023 CRS Amendments when they take effect to continue to read: “For example, a private trust company that acts as a registered office or registered agent of a trust or performs administrative services unrelated to the Financial Assets, Relevant Crypto-Assets or money of the trust, does not conduct the activities and operations described in subparagraph (A)(6)(a) on behalf of the trust and thus the trust is not “managed by” the private trust company within the meaning of subparagraph (A)(6)(b). Also, an Entity that invests all or a portion of its assets in a mutual fund, exchange traded fund, or similar vehicle will not be considered “managed by” the mutual fund, exchange traded fund, or similar vehicle. In both of these examples, a further determination needs to be made as to whether the Entity is managed by another Entity for the purpose of ascertaining whether the first-mentioned Entity falls within the definition of Investment Entity, as set out in subparagraph (A)(6)(b).”

> 'managed by' test, the guidance notes that a company with individual or corporate directors provided by a corporate services provider may, should it wish to do so, elect to be treated as being managed by such corporate service provider and so be an investment entity itself.
>
> HMRC take the view that the provision of individual employees or partners of a company services provider (or similar) to serve as directors of an entity in the circumstances outlined above will cause the company to fall within the 'managed by' test.

The IEI Manual provides:

> **EIM400820 Trusts Managed by a Financial Institution** [Dec 2021]
>
> A trust is typically regarded as being managed by a Financial Institution where either
>
> [1] one or more of the trustees is a Financial Institution [see IEIM400600] or
>
> [2] the trustees have appointed a Financial Institution, such as a discretionary fund manager, to manage the trust's assets or to manage the trust.
>
> **Does a Financial Institution Manage the Trust?**
>
> A Financial Institution will manage the trust where it has been appointed by the trustees to carry out the day to day functions of the trust on behalf of the trustees. This goes beyond managing the investment of the trust's assets and includes other management functions that the trustees have to perform but which are contracted to the Financial Institution.
>
> **Does a Financial Institution Manage the Financial Assets of the Trust?**
>
> A Financial Institution manages the financial assets of the trust where it has discretion to manage the investments or investment strategy for the assets. This will usually be where the trust has appointed a discretionary fund manager to manage their portfolio or a part thereof.
>
> The appointment of a discretionary fund manager will be evidenced by an agreement between the parties that provides for discretionary management.
>
> Where the trustees of a trust invest in retail investments and the trustees make the decision on what investments to make, the arrangement will not amount to discretionary management. The Glossary of Definitions in the Financial Services Handbook defines both retail investment and retail investment activity.

130.13.4 *Trusts*

A trust is typically a Fund-managed IE on the basis that:

(1) It holds Financial Assets; and
(2) It is Managed by a Fund-manager IE.

But not all trusts meet the requirements. If not, then the trust is a NFE.

130.13.5 *Trusts: Underlying company*

An underlying company held by a trust is typically a Fund-managed IE, on the basis that:
(1) The company holds Financial Assets and
(2) It is managed by a Fund-manager IE.

But not all underlying companies meet the requirements. If not, then the underlying company is a NFE.

130.14 Participating Jurisdiction FI

Section VIII (A)(2) CRS provides:

> 2. The term "**Participating Jurisdiction Financial Institution**" means
> *(i)* [A] any Financial Institution that is resident in a Participating Jurisdiction,
> [B] but excludes any branch of that Financial Institution that is located outside such Participating Jurisdiction, and
> *(ii)* any branch of a Financial Institution that is not resident in a Participating Jurisdiction, if that branch is located in such Participating Jurisdiction.

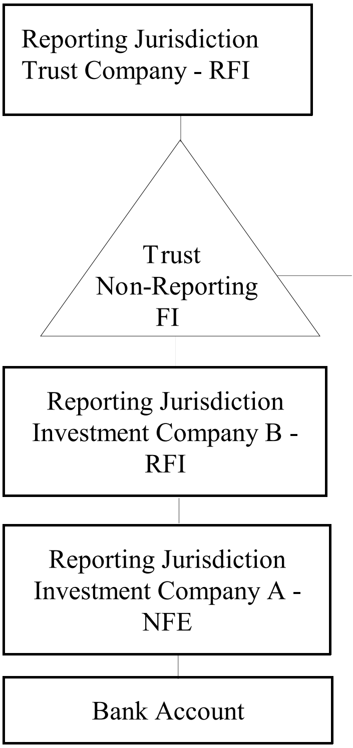
130.14.1 *Branch*

OECD Commentary on para VIII (A)(2) CRS provides:

> 6. A "branch" is a unit, business, or office of a Financial Institution that is treated as a branch under the regulatory regime of a jurisdiction or that is otherwise regulated under the laws of a jurisdiction as separate from other offices, units, or branches of the Financial Institution. A branch includes a unit, business, or office of a Financial Institution located in a jurisdiction in which the Financial Institution is resident, and a unit, business, or office of a Financial Institution located in the jurisdiction in which the Financial Institution is created or organised. All units, businesses, or offices of a Reporting Financial Institution in a single jurisdiction shall be treated as a single branch.

130.15 Passive NFE held by a trust

STEP CRS guidance provides:


Reporting Jurisdiction
Trust Company - RFI
Trust
Non-Reporting
FI
Settlor and beneficiaries in
Reporting Jurisdiction A
Reporting Jurisdiction
Investment Company B -
RFI
Reporting Jurisdiction
Investment Company A -
NFE
Bank Account

11.1 In the above example, the Bank will obtain AML information about Company A.

Company A is an NFE in a jurisdiction that has implemented the CRS. Company A is owned by Company B. Company B is an RFI in a jurisdiction that has implemented the CRS. Company B is owned by a trust of which a corporate RFI is trustee.

(a) The Bank will want to identify Controlling Persons for Company A. Under current guidance, it is unclear who the Controlling Persons of Company A are.

(b) As a threshold matter, because Company A is owned by a Reporting FI in a Participating Jurisdiction, it is not entirely clear whether Company A should (as a policy matter) be required to identify its Controlling Persons, because Company B and the trust will have to identify their Account Holders and report them, if they are reportable.

(c) Assuming that Company A is required to identify its Controlling Persons, it is unclear whether any individual would hold a controlling interest by ownership. Arguably, each Controlling Person of the trust may be treated as a

Controlling Person of Company A. Alternatively, the senior managing official of Company A might be seen as the Controlling Person.

11.2 Company B will need to identify its Account Holders. In this example, its Account Holder is the trust, which is not a Reportable Person because it is an RFI.

Company B therefore has nothing to report.

11.3 The trustee will identify the Account Holders of the trust. This will include in the example in Figure 1: the settlor, any mandatory beneficiaries, and any discretionary beneficiaries who have received distributions. The trustee will report the full value of the trust assets in relation to the settlor and any mandatory beneficiaries, and the amounts distributed to any mandatory and discretionary beneficiaries.

11.4 Note: As pointed out above, there is no advantage in the Bank having to look through Company A, Company B, and the trust to the Controlling Persons of the trust. If the Bank is required to look through the trust, the Bank would disclose the value of the account by reference to the settlor and all of the beneficiaries, whether or not they have received a distribution. It should be noted that, under the US FATCA regulations, it is not necessary to look through Financial Institutions (such as the trust in this example). We understand that the OECD is still considering further guidance on the reporting of Controlling Persons in an ownership chain of entities.

130.16 Financial Asset

The term "Financial Asset" is used in many places, in particular, the definitions of:

(1) Investment Entity
(2) Custodial Institution
(3) Custodial Account
(4) Excluded Account

130.16.1 *Categories of Financial Asset*

Section VIII (A)(7) CRS identifies 7 categories of Financial Asset. The first 6 are:

> 7. The term "**Financial Asset**" includes
> [a] a security (for example,
> [i] a share of stock in a corporation;
> [ii] partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust;

> [iii] note, bond, debenture, or other evidence of indebtedness),
>
> [b] partnership interest,
>
> [c] commodity,
>
> [d] swap (for example,
>
> [i] interest rate swaps,
>
> [ii] currency swaps,
>
> [iii] basis swaps,
>
> [iv] interest rate caps,
>
> [v] interest rate floors,
>
> [vi] commodity swaps,
>
> [vii] equity swaps,
>
> [viii] equity index swaps,
>
> [ix] and similar agreements),
>
> [e] Insurance Contract or
>
> [f] Annuity Contract

The last category is an interest in any of the above. Section VIII (A)(7) CRS provides:

> 7. The term "**Financial Asset**" includes ...
>
> [g] any interest (including a futures or forward contract or option) in
>
> [i] a security,[32]
>
> [ii] partnership interest,
>
> [iii] commodity,
>
> [iv] swap,
>
> [v] Insurance Contract, or
>
> [vi] Annuity Contract.

This is an inclusive definition so other Financial Assets may be included. OECD Commentary on Section VIII CRS provides:

> 23. ...While ["Financial Asset"] does not refer to assets of every kind, it intends to encompass any assets that may be held in an account maintained by a Financial Institution with the exception of a non-debt, direct interest in real property.
>
> 24. ... the term "Financial Asset" does not include a non-debt, direct interest in real property; or a commodity that is a physical good, such as wheat.
>
> 25. Negotiable debt instruments that are traded on a regulated market

[32] The 2023 CRS Amendments will add "Relevant Crypto-Asset,".

> or over-the-counter market and distributed and held through Financial Institutions, and shares or units in a real estate investment trust, would generally be considered Financial Assets.[33]

130.16.2 *Land not Financial Asset*

Section VIII (A)(7) CRS provides:

> The term "Financial Asset" does not include a non-debt, direct interest in real property.

An underlying company is not transparent, so it may convert a non-Financial Asset (eg, land) into a Financial Asset (shares). OECD FAQ provides:

> [1] An Entity the gross income of which is primarily attributable to investing, reinvesting, or trading real property is not an Investment Entity (irrespective of whether it is professionally managed) because real property is not a Financial Asset...
> [2] If, instead, an Entity is holding an interest in another Entity that directly holds real property, the interest held by the first-mentioned Entity is a Financial Asset, and the gross income derived from that interest is to be taken into account to determine whether the Entity will meet the definition of Investment Entity under Section VIII, subparagraph (A)(6)(a)(iii) [Fund-manager IE] or paragraph (A)(6)(b) [Fund-managed IE].

130.17 Financial Account

Section VIII (C)(1) CRS provides the definition. There are six or so categories of Financial Account:

> 1. The term **"Financial Account"** means an account maintained by a Financial Institution, and includes a Depository Account, a Custodial Account and:
>
> a) [i] in the case of an Investment Entity other than an Investment Entity that is a Financial Institution solely because it manages an Investment Entity described in subparagraph A(6)(b) [Fund-managed IE],
> [ii] any equity or debt interest in the Financial Institution;

[33] The text will be updated by the 2023 CRS Amendments when they take effect to continue to read: "In each case, the determination of whether an asset is a Financial Asset is independent from the form in which such asset is issued. Therefore, an asset issued in the form of a Crypto-Asset may simultaneously be a Financial Asset."

b) [i] in the case of a Financial Institution not described in subparagraph C(1)(a),

[ii] any equity or debt interest in the Financial Institution, if the class of interests was established with a purpose of avoiding reporting in accordance with Section I; and

c) any Cash Value Insurance Contract and any Annuity Contract issued or maintained by a Financial Institution, other than a noninvestment-linked, non-transferable immediate life annuity that is issued to an individual and monetizes a pension or disability benefit provided under an account that is an Excluded Account.

The term "Financial Account" does not include any account that is an Excluded Account.

130.17.1 *Depository Account*

A Depository Account is a Financial Account.

Section VIII (C)(2) CRS provides:

> 2. The term **"Depository Account"** includes any commercial, checking, savings, time, or thrift account, or an account that is evidenced by a certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar instrument maintained by a Financial Institution in the ordinary course of a banking or similar business. A Depository Account also includes an amount held by an insurance company pursuant to a guaranteed investment contract or similar agreement to pay or credit interest thereon.[34]

130.17.2 *Custodial Account*

A Custodial Account is a Financial Account.

Section VIII (C)(3) CRS provides:

> 3. The term **"Custodial Account"** means an account (other than an Insurance Contract or Annuity Contract) for the benefit of another person that holds one or more Financial Assets.

[34] The text will be updated by the 2023 CRS Amendments when they take effect to read: "... or other similar instrument maintained by a Depository Institution. A Depository Account also includes: a) an amount held by an insurance company pursuant to a guaranteed investment contract or similar agreement to pay or credit interest therein; b) an account or notional account that represents all Specified Electronic Money Products held for the benefit of a customer; and c) an account that holds one or more Central Bank Digital Currencies for the benefit of a customer."

130.17.3 *Equity Interest: Partnership*

Section VIII (C)(4) CRS provides:

> 4. The term **"Equity Interest"** means,
> [a] in the case of a partnership that is a Financial Institution, either a capital or profits interest in the partnership.

130.17.4 *Equity Interest: Trust*

Section VIII (C)(4) CRS provides:

> 4. The term **"Equity Interest"** means ...
> [b] In the case of a trust that is a Financial Institution, an Equity Interest is considered to be held by
> [i] any person treated as a settlor or beneficiary of all or a portion of the trust, or
> [ii] any other natural person exercising ultimate effective control over the trust.

This is an artificial definition, as even a settlor who is excluded has an Equity Interest.

It is considered that "any person *treated as* a settlor" just means any person who is a settlor.[35] In other words, the words "treated as" do not add much (if anything) to the meaning, but they do indicate that the word settlor is not to be understood strictly, ie it includes an economic settlor as well as a nominal settlor.

STEP CRS guidance provides:

> **1.8 settlors who cannot be beneficiaries of trust**
> There are many cases in which settlors will have established trusts from which they are formally and completely excluded as beneficiaries at inception (or subsequently). HMRC are of the view that in these circumstances the settlor's equity interest (if the trust is a Reporting Financial Institution) should be reported as the full value of the trust assets and cannot be regarded as having a zero value. STEP has pointed out it will be helpful in future to be able to add information that the individual has been permanently excluded in order to avoid unnecessary enquiries by the settlor's home tax authority.

130.17.5 *Pre-existing account*

Section VIII (C)(9) CRS provides a commonsense definition:

[35] See App 8.4 (Deemed/treated misused).

> 9. The term “Pre-existing Account” means a Financial Account maintained by a Reporting Financial Institution as of [xx/xx/ xxxx].[36]

130.17.6 *“Account Holder”*

Section VIII (E)(1) CRS provides

> 1. [a] The term “Account Holder” means the person listed or identified as the holder of a Financial Account by the Financial Institution that maintains the account.
>
> [b] A person, other than a Financial Institution, holding a Financial Account for the benefit or account of another person as agent, custodian, nominee, signatory, investment advisor, or intermediary, is not treated as holding the account for purposes of the Common Reporting Standard, and such other person is treated as holding the account.
>
> [c] In the case of a Cash Value Insurance Contract or an Annuity Contract, the Account Holder is any person entitled to access the Cash Value or change the beneficiary of the contract. If no person can access the Cash Value or change the beneficiary, the Account Holder is any person named as the owner in the contract and any person with a vested entitlement to payment under the terms of the contract. Upon the maturity of a Cash Value Insurance Contract or an Annuity Contract, each person entitled to receive a payment under the contract is treated as an Account Holder.

130.18 “Beneficiary”

Section VIII (C)(4) CRS provides a commonsense definition:

> 4. ... A Reportable Person will be treated as being a beneficiary of a trust if such Reportable Person
>
> [a] has the right to receive directly or indirectly (for example, through a nominee) a mandatory distribution or
>
> [b] may receive, directly or indirectly, a discretionary distribution from the trust.

OECD CRS commentary provides:

[36] The text will be updated by the 2023 CRS Amendments when they take effect to continue: “or, if the account is treated as a Financial Account solely by virtue of the amendments to the Common Reporting Standard, as of [effective date of the revised CRS-1 day].”

> For these purposes, a beneficiary who may receive a discretionary distribution from the trust only will be treated as a beneficiary of a trust if such person receives a distribution in the calendar year or other appropriate reporting period (i.e. either the distribution has been paid or made payable).[37]

STEP CRS guidance refers to this and continues:[38]

> Note that this limitation is contained in the Commentary and not the Standard itself, which has a wider definition of beneficiary. Although jurisdictions implementing the Standard are encouraged to follow the Commentary when applying and interpreting the relevant domestic law provisions, jurisdictions may not do so, so the local law must always be considered.

130.18.1 *"Distribution"*

This term is used in the definition of "beneficiary". It is not defined. STEP CRS guidance provides:

> 12.1 There is guidance in the context of the UK IGAs (in the Jersey notes) that states that a payment to a beneficiary by way of loan is not a distribution in the year the loan is made, but only when it is written off...[39]

[37] p.178 para 70.

[38] CRS and Trusts (2017) 3.1 *https://www.step.org/system/files/media/files/2020-03/Guidance_note_CRS_and_trusts.pdf* In addition, STEP issued a paper, CRS (2015) *https://www.step.org/system/files/media/files/2020-03/Guidance_Note_CRS.pdf*

[39] The reference is to Taxation (International Tax Compliance) (Jersey) Regulations 2014 Guidance Notes (2016) p.58 *https://www.gov.je/SiteCollectionDocuments/Tax%20and%20your%20money/ID%20IGA%20Guidance%20Notes%2020160520%20jc3.pdf*
The relevant passage provides:

> "Where a loan has been made to a settlor or beneficiary, the outstanding loan is considered a debt due to the trustees for the benefit of the trust.
> The debt due is an asset of the trust, and no distribution arises. If and when the loan is written off, then there is a distribution of that amount (written off) to the debtor, which should be reported.
> For example:
> - Trustee A (as Trustee of The 1 Trust) makes a loan to Mr B (who is a beneficiary of The 1 Trust) of £500,000 on 1 January 2016
> - The terms of the loan are that the sum of £500,000 is repayable to Trustee A on demand

> 12.2 A loan that is on commercial terms (i.e. a loan that is not on beneficial terms) should not be treated as a distribution.
> 12.3 HMRC have been asked to consider whether an interest-free loan or a loan made on other than commercial terms (e.g. in circumstances where a beneficiary, if UK resident, would be treated as receiving a capital benefit from the trust for the purposes of Section 87 TCGA 1992) would be disclosable as a distribution in the year it is made or the year it is written off (but not the years when the loan remains outstanding).

130.18.2 *Arrangement similar to trust*

OECD CRS commentary continues:

> The same is applicable with respect to the treatment of a Reportable Person as a beneficiary of a legal arrangement that is equivalent or similar to a trust, or foundation.[40]

STEP CRS guidance (2006) provides:

> In paragraph 196 there is reference to 'other similar legal arrangements'. It would be helpful to understand what is meant by this. It is not uncommon to set up partnerships as a vehicle for holding family wealth. For example: a grandfather contributes to a partnership for the primary benefit of his grandchildren. His son is appointed as general partner and controls the allocation of income and capital among the limited partners. The grandfather is not a controlling person, but if this were a trust (which is not the case) he would be. Is there any intention to treat a family partnership such as this 'legal arrangement' similar to a trust?
> The OECD Secretariat confirmed that in the example given the partnership would be treated as a partnership and not a 'legal arrangement' similar to a trust.

130.19 Reportable Account

"Reportable Account" matters, because, as its name suggests, it will be

- Mr B does repay £100,000 of the loan during the calendar year 2017
- On 30 June 2018 Trustee A decides that the balance of the loan (£400,000) will be written off
- For the purposes of reporting under the IGAs, Trustee A will make a report, relating to the calendar year 2018, detailing the distribution to Mr B of £400,000 during the calendar year 2018."

[40] p.178 para 70.

reported.

Section VIII (D)(1) CRS provides:

> 1. The term “**Reportable Account**” means an account held by
>
> [a] one or more Reportable Persons or
>
> [b] [i] by a Passive NFE with one or more Controlling Persons that is a Reportable Person,
>
> [ii] provided it has been identified as such pursuant to the due diligence procedures described in Sections II through VII.

130.20 Reportable Person

“Reportable Person” matters because the term is used in the definition of Reportable Account. As the name suggests, the details of Reportable Persons, and of a Passive NFE controlled by such persons, will be reported.

Section VIII (D)(2) CRS provides:

> 2. The term “Reportable Person” means a Reportable Jurisdiction Person other than:

There follow a list of 6 exceptions:

> (i) a corporation the stock of which is regularly traded on one or more established securities markets;
>
> (ii) any corporation that is a Related Entity of a corporation described in clause (i); [41]
>
> (iii) a Governmental Entity;
>
> (iv) an International Organisation;
>
> (v) a Central Bank; or
>
> (vi) a Financial Institution.

130.21 Reportable/Participating Jurisdictions

Section VIII (D)(4) CRS	**Section VIII (D)(5) CRS**
4. The term “Reportable Jurisdiction” means a jurisdiction	5. The term “Participating Jurisdiction” means a jurisdiction
(i) with which an agreement is in place pursuant to which there is an	(i) with which an agreement is in place pursuant to which it will

[41] The text will be updated by the 2023 CRS Amendments when they take effect to read “Entity” instead of “corporation” in (i) and (ii).

obligation in place to provide the information specified in Section I, and	provide the information specified in Section I, and
(ii) which is identified in a published list.	(ii) which is identified in a published list.

OECD keep a list with links to local legislation and guidance.[42] IEIM402340 has a list of Reportable Jurisdictions and IEIM400090 has a list of Participating Jurisdictions.

130.22 Reportable Jurisdiction Person

Section VIII (D)(3) CRS provides:

> 3. The term "Reportable Jurisdiction Person" means
>
> [a] an individual or Entity that is resident in a Reportable Jurisdiction under the tax laws of such jurisdiction, or
>
> [b] an estate of a decedent that was a resident of a Reportable Jurisdiction.

Para (3) goes on to define residence of partnerships:

> For this purpose, an Entity such as a partnership, limited liability partnership or similar legal arrangement that has no residence for tax purposes shall be treated as resident in the jurisdiction in which its place of effective management is situated.

STEP CRS guidance (2016) discusses dual resident trusts:

> We note the guidance about trusts being resident where the trustee is resident. We note that, in the case of corporate trustees (including both PTCs and regulated trust companies), the corporate trustee might well be incorporated and licensed in Jurisdiction A, but effectively managed and tax resident in Jurisdiction B. If one refers to Paragraph 97 in the context of guidance on the tax residence of entities, we consider that it would be correct to treat the trusts in these cases as essentially resident in both jurisdictions A and B with the necessary dual reporting. Is it possible in these circumstances for the trustee to rely on Paragraph 211 and only report in one of Jurisdictions A and B assuming both are Reporting Jurisdictions?

[42] *https://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/crs-by-jurisdiction*

We note that this is permitted, for example, under the IGA between the Cayman Islands and the United Kingdom.
The OECD Secretariat confirmed that reporting would be required in both jurisdictions. The accommodation provided in paragraph 211 would only apply where the trust itself is treated as a separate tax resident person in a jurisdiction, and undertakes the required reporting. This is likely to be of limited application. However the option to allow the use of service providers may provide similar relief.

130.23 Controlling person

Section VIII (D)(6) CRS begins with a commonsense definition:

> [a] The term "Controlling Persons" means the natural persons who exercise control over an Entity.

CRS then extends this so it becomes an artificial definition:

> [b] In the case of a trust, such term means[43]
> [i] the settlor,
> [ii] the trustees,
> [iii] the protector (if any),
> [iv] the beneficiaries or class of beneficiaries, and
> [v] any other natural person exercising ultimate effective control over the trust, and
> [c] in the case of a legal arrangement other than a trust, such term means persons in equivalent or similar positions.

It follows that "Controlling Person" is not a wholly apt label for this concept. One should not carp. It is a better term than "beneficial owner".[44] But it merits initial capitals, to reflect the technical nature of the expression.

OECD CRS commentary provides:

> In addition, any other natural person(s) exercising ultimate effective control over the trust (including through a chain of control or ownership) must also be treated as a Controlling Person of the trust.

[43] The word "includes" would be more apt. OECD CRS commentary provides: "The settlor(s), the trustee(s), the protector(s) (if any), and the beneficiary(ies) or class(es) of beneficiaries, must always be treated as Controlling Persons of a trust, regardless of whether or not any of them exercises control over the trust. It is for this reason that the second sentence of subparagraph D(6) supplements the first sentence of such subparagraph."

[44] See 131.15 (Beneficial Owner: MLR meaning).

> With a view to establishing the source of funds in the account(s) held by the trust, where the settlor(s) of a trust is an Entity, Reporting Financial Institutions must also identify the Controlling Person(s) of the settlor(s) and report them as Controlling Person(s) of the trust.

130.23.1 *FATF Recommendations*

Section VIII (D)(6) CRS provides:

> [d] The term "Controlling Persons" must be interpreted in a manner consistent with the Financial Action Task Force Recommendations.[45]

OECD CRS commentary provides:

> 132. Subparagraph D(6) sets forth the definition of the term "Controlling Persons". This term
> [1] corresponds to the term "beneficial owner" as described in Recommendation 10 and the Interpretative Note on Recommendation 10 of the [FATF Recommendations] and
> [2] must be interpreted in a manner consistent with such Recommendations,
> with the aim of protecting the international financial system from misuse including with respect to tax crimes.

130.23.2 *Settlor*

FATF Recommendations, which, as noted above, is relevant to CRS, provides a definition in its General Glossary:

> *Settlors* are natural or legal persons who transfer ownership of their assets to trustees by means of a trust deed or similar arrangement.

For nominal settlors, see 99.5 (Nominal settlor).

130.23.3 *Joint settlors*

STEP CRS guidance provides:[46]

> ... an alternative scenario where (C) and (D) are joint settlors. For example, it may not be uncommon for a husband and wife to make a

[45] See 130.2.3 (FATF recommendations).

[46] CRS and Trusts (2017) para 1.4 *https://www.step.org/system/files/media/files/2020-03/Guidance_note_CRS_and_trusts.pdf*

> transfer of assets to a trust for their children and wider family. If, in these circumstances, C and D contribute assets to the trust from assets that they hold jointly, then it would be fair to regard both parties as 'joint' settlors for CRS purposes.[47]
>
> HMRC confirmed that in this case they consider that both C and D would be disclosed as settlors and that the full value of the trust assets should be reported with respect to both C and D, notwithstanding the fact that each had added only a proportion of the trust assets.
>
> In circumstances where an entity is jointly owned by two or more persons it is necessary to identify all of the relevant Controlling Persons as settlors or as 'any other natural person exercising effective ultimate control' for CRS purposes.

130.23.4 *Co settlor: change of owner*

STEP CRS guidance provides:[48]

> **1.5 Example 4: settlors who are entities**
>
> We note the guidance set out at paragraph 134 of the Commentary in the context of settlors who are entities.[49] In most cases, the ownership of an entity that acts as a settlor will remain with the same individual. It is however possible that during the lifetime of that individual, ownership of the entity that served as the settlor could change. In these circumstances, it is necessary to consider the Controlling Person of the entity at the time it contributes assets to the trust in order to determine who should be regarded as the settlor for CRS purposes. HMRC are of the view that it is also necessary to identify the Controlling Persons of the entity during each relevant year with respect to which the report is made. This is viewed as important on the basis that the entity may still have some continuing role with respect to the trust, e.g. powers of the trust assets or a power of revocation. In this case, however, the Controlling Persons with respect to the entity could be disclosed within the category of 'any other natural person exercising effective ultimate control'.

[47] But see 94.4 (Trust from joint account: Who is settlor).

[48] CRS and Trusts (2017) 1.4 *https://www.step.org/system/files/media/files/2020-03/Guidance_note_CRS_and_trusts.pdf*

[49] This passage provides: "With a view to establishing the source of funds in the account(s) held by the trust, where the settlor(s) of a trust is an Entity, Reporting Financial Institutions must also identify the Controlling Person(s) of the settlor(s) and report them as Controlling Person(s) of the trust."

130.23.5 *Sub-funds*

STEP CRS guidance provides:[50]

> 2.1 Example 8:
> A establishes a trust for the benefit of A's three children X, Y and Z on discretionary trust. The trust is irrevocable and A is excluded from benefit. At the time of creation of the trust, X, Y and Z are teenage children and the trust is administered for them in undivided shares.
> Some years later, X, Y and Z are now adults and the trustees take a decision to appoint specific assets to separate subfunds (i) one for the benefit of X and his children; (ii) one for the benefit of Y and his children; (iii) one for the benefit of Z and his children; and (iv) the remaining fund being held for the benefit of all of X, Y and Z and their children.
> In these circumstances, for CRS purposes there could be one composite trust or there could be four, depending on the facts and circumstances as to how the trusts are administered.
> (a) If the trustee (or trustees) administers the sub-funds as one trust, any CRS reporting should be on the basis that it is one composite trust, notwithstanding the fact that separate sub-funds have been set up.
> (b) If the trustee (or trustees) administers some or all of the sub-funds as separate trusts, any CRS reporting should be on the basis that those subfunds are separate trusts.
> 2.2 Trustees could be regarded as treating the sub-funds as separate trusts where, for example (and this is not an exhaustive list),
> [a] a replacement or additional trustee is appointed in relation one sub-fund but not all;
> [b] different protectors are appointed in relation to each sub-fund;
> [c] there is no cross-over of beneficiaries in each sub-fund;
> [d] the trustees treat the sub-funds as separate trusts for tax purposes [ie the trustees make a sub-fund election].
> HMRC's position is that the identification of sub-funds as one trust or separate trusts should follow the facts in each case and should be reported as separate trusts only where the facts demonstrate that separate trusts have been created.

It is considered that the normal sub-fund/separate trust distinction should

[50] CRS and Trusts (2017) 2.1, 2.2 *https://www.step.org/system/files/media/files/2020-03/Guidance_note_CRS_and_trusts.pdf*

be applied.[51] HMRC's comment in the last paragraph seems consistent with that view.

130.23.6 *Beneficiaries*

OECD CRS commentary provides:

> For beneficiary(ies) of trusts that are designated by characteristics or by class, Reporting Financial Institutions should obtain sufficient information concerning the beneficiary(ies) to satisfy the Reporting Financial Institution that it will be able to establish the identity of the beneficiary(ies) at the time of the pay-out or when the beneficiary(ies) intends to exercise vested rights. Therefore, that occasion will constitute a change in circumstances and will trigger the relevant procedures.
>
> When implementing the Common Reporting Standard, a jurisdiction may allow Reporting Financial Institutions to align the scope of the beneficiary(ies) of a trust treated as Controlling Person(s) of the trust with the scope of the beneficiary(ies) of a trust treated as Reportable Persons of a trust that is a Financial Institution (see paragraphs 69-70 above).[52]

OECD CRS FAQ provides:

> **6. Intermittent distributions to discretionary beneficiaries of a trust that is a Reporting Financial Institution**
>
> In the case of a trust that is a Financial Institution, an Equity Interest is considered to be held by any person treated as the settlor or beneficiary of all or a portion of the trust. For these purposes, a beneficiary who may receive a discretionary distribution from the trust only will be treated as a beneficiary of the trust if such person receives a distribution in the calendar year or other appropriate reporting period (see Section VIII (C)(4) and related commentary). If a discretionary beneficiary of a trust that is a Financial Institution receives a distribution from the trust in a given year, but not in a following year, should the absence of a distribution in such following year be treated as an account closure?
>
> No, the absence of a distribution does not constitute an account closure, as long as the beneficiary is not permanently excluded from receiving future distributions from the trust.

[51] For the distinction between (1) separate trusts and (2) sub-funds of one trust, see 99.22.2 (Variation or resettlement?).

[52] Commentary on Section VIII, para 134.

STEP CRS guidance provides:

> There is no need to report the death of a discretionary beneficiary as an 'account closed' matter as distinct from circumstances in which the beneficiary is formally excluded as a beneficiary during lifetime.
>
> Further, in circumstances where a trust is wound up because all of the assets are appointed for the benefit of one of the discretionary beneficiaries, it is not then expected that all beneficiaries who have previously received distributions in prior years (who can no longer benefit from the trust assets) would be referenced in the year of the distribution of the trust fund to another beneficiary.
>
> **4.2 Identifying the class of discretionary beneficiaries for the purposes of reporting**
>
> There are a number of cases where it is necessary under CRS to identify discretionary beneficiaries who may not have received a distribution in a particular accounting year. This is specifically the case in circumstances where the trust is a passive NFE where the relevant jurisdiction has not permitted the option of allowing FIs to identify discretionary beneficiaries as Controlling Persons only when they receive a distribution. In order to make the reporting of discretionary beneficiaries sensible and manageable, it would seem sensible that a discretionary beneficiary should only be treated as a Controlling Person where the discretionary beneficiary concerned is eligible to receive a distribution in the year concerned. We set out below some common scenarios below. In many cases these contingent or default beneficiaries may be totally unaware of the fact that they are named as beneficiaries in such a trust. HMRC's view is that where a trust is a passive NFE, it is a requirement of the EU Directive that all beneficiaries be identified as Controlling Persons, including named discretionary beneficiaries, regardless of any contingencies under which they might receive a benefit. In STEP's view, consideration should be given to the specific terms of the trust to determine whether any named individual can be regarded as a beneficiary of the trust in the relevant year.
>
> **Beneficiaries include individuals X and Y and their children and remoter issue.**
>
> The children and remoter issue are identified by reference to a class and not named individually and no distributions are made to them during the year. In this case it is only necessary to identify X and Y. Current, contingent or default beneficiaries who are only described by reference to a class and are not named and have not received distributions do not need to be identified as Controlling Persons.

5. Beneficiaries receiving mandatory distributions

5.1 This category of beneficiary may, if the income interest has been provided for the duration of their lifetime, be known as having a ‘life interest’ or ‘fixed interest’ in the trust income. It will be necessary to consider carefully the terms of the trust instrument to form a judgement as to whether an unqualified right to receive trust income does exist as opposed to one that is dependent upon the exercise of a trustee’s discretion.

5.2 The Implementation Handbook makes reference to values being reported by a Reporting Financial Institution in the context of mandatory beneficiaries.

5.3 The Implementation Handbook states (at paragraph 220) in relation to trusts that are RFIs: ‘The account balance is the value calculated by the Reporting Financial Institution (the trust) for the purpose that requires the most frequent determination of value. For...mandatory beneficiaries, for example, this may be the value that is used for reporting to the Account Holder on the investment results for a given period. If the Financial Institution has not otherwise recalculated the balance or value for other reasons, the account balance for…mandatory beneficiaries may be the value of the interest upon acquisition or the total value of all trust property’.

5.4 For trusts that are passive NFEs, the Implementation Handbook states (at paragraph 236) that ‘The financial information to be reported will be the account balance or value of the account held by the trust and payments made or credited to such account. Each Controlling Person is attributed the entire value of the account, as well as the entire amounts paid or credited to the account, as shown below in Table 8.’

5.5 It is understood that if there is a class of one or more beneficiaries who are:

(a) entitled to part of the income of a common trust fund; or

(b) entitled to all the income of a separate sub-fund

then any reporting that needs to be made by reference to the mandatory beneficiary should be based on the relevant sub-fund or proportion of common fund that the beneficiary has an income interest in. HMRC’s position is that the identification of sub-funds as one trust or separate trusts should follow the facts in each case and should be reported as separate sub-funds only where the facts demonstrate that separate sub-funds have been created.

5.6 **Beneficiary A has a right to receive all the income from Trust A.** In this case A is reported as having a mandatory interest in the whole of Trust A.

5.7 **Beneficiary A has a right to receive X% of the income from the trust and B has the right to receive Y% of the income from the trust and the trustee reports to them on this basis.**

(a) If the trust is an RFI, A is reported as having a mandatory interest in X% of the value of the trust assets and B is reported as having a mandatory interest in Y% of the value of the trust assets.

(b) If the trust is a passive NFE, the full value of the trust assets are reported with respect to both A and B.

5.8 **A is treated as the grantor of Trust X for US tax purposes.**
A has a power of revocation (or equivalent) over the assets of Trust X. The income of Trust X is payable to, or on the order or direction of, A. A may direct the trustees to distribute the income to him or to other persons. No distributions are made to A or any other person. In this case, A is not reported as having a mandatory interest in the assets of Trust X as there is no mandatory obligation to distribute income to him (although he will be reported as the settlor and may be reportable as a person who has the power to exercise effective control over the trust).

130.23.7 *Protector*

"Protector" matters as a protector is a Controlling Person.
STEP CRS guidance provides:

> 6.3 In the drafting of the CRS framework surrounding trusts, protectors are dealt with very differently if one compares the situation of a trustee who acts as an RFI compared with a situation where the trustee is a passive NFE.
>
> 6.4 In the former case, the CRS framework provides for reporting in the context of trustees who are RFIs to be made of persons who are treated as having an 'equity interest' in the trust fund. In this context, Section VIII.C.4 of the Standard states that an equity interest is held 'by any person treated as a settlor or a beneficiary of all or a portion of the trust or any other natural person exercising ultimate effective control over the trust'.
>
> 6.5 By contrast, in relation to a trust that is a passive NFE, it is necessary to identify Controlling Persons in relation to the trust. In the Standard, Section VIII D(6) defines 'Controlling Person' on the basis that the expression is intended to correspond to the term 'beneficial owner' as described in Recommendation 10 and the interpretative note on Recommendation 10 of [FATF Recommendations][53]. In the case of

[53] See 130.2.3 (FATF recommendations).

a trust, Controlling Persons means 'settlor, the trustees, the protector (if any) 1 the beneficiary or class of beneficiaries and any other natural person exercising ultimate effective control over the trust'.

6.6 We note that in its FAQ issued in June 2016, OECD takes the position that where a trust is a Reporting Financial Institution, a protector 'must be treated as an account holder irrespective of whether it has effective control over the trust'. This response does not address the clear distinction in the Standard itself between the holders of equity interests in a trust that is an RFI (see paragraph 6.4 above – which only includes protectors if they actually exercise ultimate effective control), when contrasted with the Controlling Persons definition of a trust that is a passive NFE (see paragraph 6.5 above which includes protectors regardless of the powers they hold). In this context, we note that the OECD's guidance does not constitute a legally binding interpretation of the Standard and that the RFIs should seek their own legal counsel before determining their formal reporting position, given that the legal basis for the position taken by OECD is unclear to us. We note that the OECD Secretariat has confirmed that it is the intention that protectors of trusts that are RFIs should be reported and the FAQ was discussed and approved in the relevant Working Party of the OECD. Until the legal basis for this is made clear in the CRS treaty, it is considered that there is a reasonable basis for forming the opposite conclusion.

STEP CRS guidance (2016) provides:

a. In some cases, there will be corporate protectors appointed with respect to a trust where an RFI is the trustee. If these corporate protectors have sufficiently wide powers, such that they would be potentially be regarded as Reportable Persons with respect to the trust if they were individuals (see comments in section 8 above on NPEECs), will it then be necessary to identify the distinct Controlling Persons of the corporate protector?

b. It is not uncommon for corporate protectors to be appointed who are regulated trustee service providers in their 'home' jurisdiction. Is it going to be necessary to perform an analysis on the Controlling Persons of such Entities (which is meaningless in tax reporting terms1), or would they not be regarded as Reportable Persons either because they are in effect Reporting Financial Institutions by analogy to the classification set out at paragraph 99 of the Handbook or because they are active NFEs?

In the OECD Secretariat's view it would be necessary to identify Controlling Persons in these circumstances. There was a discussion about certain types of structure where this could give rise to a problem,

> e.g. a corporate protector administered by a law firm which is owned by discretionary trusts established by the partners of that law firm. Following OECD Secretariat guidance would mean that Controlling Persons in relation to those discretionary trusts would also need to be disclosed even though they have no beneficial interest or control in the underlying trust of which the corporate protector acts as trustee. However, as noted in question 4, where the Reporting Financial Institution has information on the type of Controlling Person (such as being a protector), this must be included in the report. Doing so will enable the tax administration receiving the information to[54] make appropriate use of the information in tax compliance actions.

130.24 Change of controlling persons

130.24.1 *Discretionary beneficiaries*

STEP TRS guidance provides:

> 4.1 **Excluding discretionary beneficiaries from a trust**
> The answer to FAQ 6 in Section 1 of the June 2016 publication addresses the question of intermittent distributions to discretionary beneficiaries of a trust that is an RFI. It notes in particular that if discretionary beneficiary receives a distribution in a particular year but not in subsequent years, the absence of a distribution should not be treated in effect as an account closure 'as long as the beneficiary is not permanently excluded from receiving future distributions from the trust'.
> There is no need to report the death of a discretionary beneficiary as an 'account closed' matter as distinct from circumstances in which the beneficiary is formally excluded as a beneficiary during lifetime.
> Further, in circumstances where a trust is wound up because all of the assets are appointed for the benefit of one of the discretionary beneficiaries, it is not then expected that all beneficiaries who have previously received distributions in prior years (who can no longer benefit from the trust assets) would be referenced in the year of the distribution of the trust fund to another beneficiary.

[54] [Footnote original] To give an example, we are aware of a corporate protector controlled by the partners of a Bermuda law firm which is owned by trusts set up for the benefit of their families. If it is necessary to provide information about the Controlling Persons relating to the Protector it may be necessary to provide information about Controlling Persons in relation to these trusts. This information is totally meaningless in tax terms for determining who has a financial interest in the Trust of which the corporate protector acts as protector.

4.2 Identifying the class of discretionary beneficiaries for the purposes of reporting

There are a number of cases where it is necessary under CRS to identify discretionary beneficiaries who may not have received a distribution in a particular accounting year. This is specifically the case in circumstances where the trust is a passive NFE where the relevant jurisdiction has not permitted the option of allowing FIs to identify discretionary beneficiaries as Controlling Persons only when they receive a distribution. In order to make the reporting of discretionary beneficiaries sensible and manageable, it would seem sensible that a discretionary beneficiary should only be treated as a Controlling Person where the discretionary beneficiary concerned is eligible to receive a distribution in the year concerned. We set out below some common scenarios below. In many cases these contingent or default beneficiaries may be totally unaware of the fact that they are named as beneficiaries in such a trust.

HMRC's view is that where a trust is a passive NFE, it is a requirement of the EU Directive that all beneficiaries be identified as Controlling Persons, including named discretionary beneficiaries, regardless of any contingencies under which they might receive a benefit. In STEP's view, consideration should be given to the specific terms of the trust to determine whether any named individual can be regarded as a beneficiary of the trust in the relevant year.

(a) **Example 9**: Beneficiaries include individuals X and Y and their children and remoter issue. The children and remoter issue are identified by reference to a class and not named individually and no distributions are made to them during the year. In this case it is only necessary to identify X and Y. Current, contingent or default beneficiaries who are only described by reference to a class and are not named and have not received distributions do not need to be identified as Controlling Persons.

130.24.2 *Deceased settlor*

STEP CRS guidance provides:

Example 5: dead settlors – there is no express guidance on the position where a person regarded as the settlor of a trust for CRS is deceased. We understand if one considers both paragraph 222 and table 7 in the Implementation Handbook and one of the responses to the FAQs issued in June 2016 (at page 2 on reporting requirements in year of closure of a trust account), that one should reference the 'fact of closure'. We consider it is correct to say by analogy that in the year in which a settlor dies, his equity interest in relation to the trust will be

> regarded as having ‘closed’. Logically, in subsequent years, a dead settlor will have no equity interest that is capable of being reported and equally cannot be a Controlling Person of a trust. This position is understood to be accepted by HMRC.

STEP CRS guidance provides:

> 13.1 Table 7 in the Handbook implies that if the equity interest comes to an end in a CRS Reporting Year, no information needs to be given by the trustee about the prior payments to a beneficiary. This could arise because
> (a) a beneficiary is excluded (see FAQs on discretionary beneficiary);
> (b) a settlor dies;
> (c) a protector resigns (if the protector is reportable);
> (d) a trustee retires; or
> (e) the trust is wound up completely.
> 13.2 In this event, HMRC confirmed that they consider it is necessary also to report all other relevant activity during the calendar year.

130.25 Inter-trust transfer

STEP CRS guidance provides:

> 14.1 Normally a transfer from one trust to another is not reportable because there is no distribution to a beneficiary of the trust where the trustee is exercising an express power or overriding power of appointment to make a trust to trust transfer.
> 14.2 The same considerations should apply where the recipient trust is a charitable trust.
> 14.3 However, HMRC note that a distribution to an entity recipient will result in the recipient entity being regarded as a beneficiary of the trust, so due diligence should be carried out by an RFI to identify whether the entity is a reportable person.
> 14.4 Whether a recipient is an entity or a natural person will be relevant where the recipient is a beneficiary of a trust that is a passive NFE and the RFI is identifying Controlling Persons. The entity is still identified and due diligence carried out on the entity, but additionally the RFI must establish and carry out due diligence on the Controlling Persons of that entity. The only difference would come where the beneficiary is a charity, because the charity would usually be an active NFE, where not an RFI in its own right.

130.26 Controlling person: Non-trusts

CRS guidance provides:

> 133. For an Entity that is a legal person, the term “Controlling Persons” means the natural person(s) who exercises control over the Entity. “Control” over an Entity is generally exercised by the natural person(s) who ultimately has a controlling ownership interest in the Entity. A “control ownership interest” depends on the ownership structure of the legal person and is usually identified on the basis of a threshold applying a risk-based approach (e.g. any person(s) owning more than a certain percentage of the legal person, such as 25%). Where no natural person(s) exercises control through ownership interests, the Controlling Person(s) of the Entity will be the natural person(s) who exercises control of the Entity through other means. Where no natural person(s) is identified as exercising control of the Entity, the Controlling Person(s) of the Entity will be the natural person(s) who holds the position of senior managing official.

130.27 Controlling person: Foundation

CRS guidance provides:

> 136. In relation to legal persons that are functionally similar to trusts (e.g. foundations), Reporting Financial Institutions should identify Controlling Persons through similar customer due diligence procedures as those required for trusts, with a view to achieving appropriate levels of reporting.
>
> 137. Where a Reporting Financial Institution relies on information collected and maintained pursuant to AML/KYC Procedures for purposes of determining the Controlling Persons of an Account Holder of a New Entity Account (see subparagraph A(2)(b) of Section VI), such AML/KYC Procedures must be consistent with Recommendations 10 and 25 of the FATF Recommendations,[55] including always treating the settlor(s) of a trust as a Controlling Person of the trust and the founder(s) of a foundation as a Controlling Person of the foundation. For purposes of determining the Controlling Persons of an Account Holder of a Pre-existing Entity Account (see subparagraph D(2)(b) of Section V), a Reporting Financial Institution may rely on information collected and maintained pursuant to the Reporting Financial Institution’s AML/KYC Procedures.

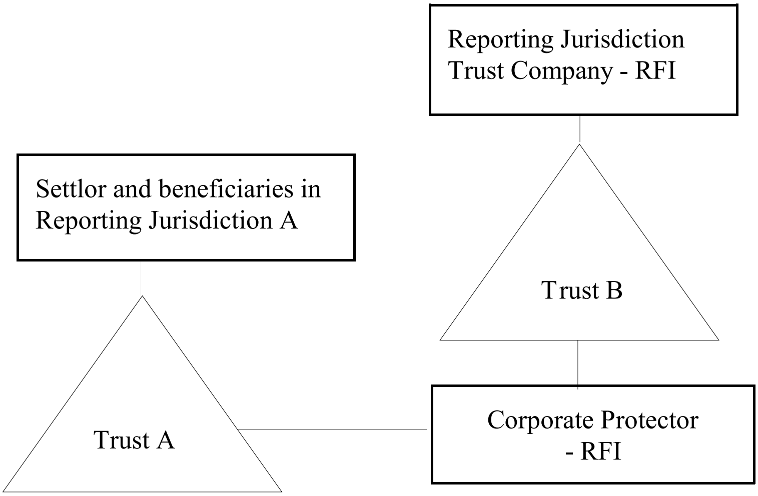
130.28 Control of controlling person

STEP CRS guidance provides:

[55] See 130.2.3 (FATF recommendations).

Paragraphs 214 and 230 of the Implementation Handbook confirm it is necessary to look through any entity that is a settlor, trustee, protector, etc to identify those holding an equity interest or being regarded as a Controlling Person of the trust.

7.1 Example 12: Trust A has a corporate trustee (RFI) and a corporate protector (RFI). Under the guidance it appears to be necessary to identify the Controlling Persons in relation to both the trustee and the protector, regardless of whether the trust is an RFI or a Passive NFE. In the example below (Figure 2), the corporate protector of Trust A is a professional protector administered by a law firm in a jurisdiction that has implemented the CRS. The corporate protector is owned by Trust B for the benefit of the partners of the law firm. The trustees of Trust B are the individual partners of the law firm. The Implementation Handbook suggests that it would be necessary to treat the individual trustees of Trust B as Controlling Persons of Trust A and disclose the full value of Trust A's assets in relation to such persons, even though they have no interest in nor any control over such assets. The OECD are considering the extent to which it is necessary to identify Controlling Persons in a chain of entities. One way to mitigate the burden in this situation would be to provide guidance that it is not necessary to look through an RFI in these circumstances (assuming that, in this case, the corporate protector is an RFI because it conducts one of the enumerated activities as a business on behalf of customers). If that guidance were provided, the due diligence and reporting obligations would fall on (and only on) the RFI that is closest to the individuals to be reported.



7.2 Example 13: There are also a number of professional trust and

> protector companies where a controlling interest is held by an independent private equity fund. For example, an interest in a global fiduciary service provider corporate and fund services group has been acquired by a private equity house. The acquired company is a multi-jurisdictional business that provides trust and corporate services to a wide range of clients across the globe, administering over 10,000 structures for almost 6,000 clients from nine locations. The business has three core service lines: Corporate Administration, Trust Administration and Fund Services. This investment was made by a buyout fund. If you follow the above analysis, it would be necessary to identify and provide information about the Controlling Persons of the private equity fund as ultimate owners of the trust company, which include the investors in the buyout fund and private equity fund personnel. None of these people have any connection with the underlying trusts managed by the trust company that holds the relevant financial account. As the trust company, in this case, is an RFI (which is likely to be the case, save in relation to US service providers) and it was not necessary to look through the RFI, this information would not need to be disclosed.
>
> 7.3 We suggest that the solution to this issue is to conclude that in circumstances where a Controlling Person in relation to a trust is itself a regulated service provider that offers professional trustee services, as a practical matter there should be no need to identify the natural persons who own that regulated service provider but only the directors (or similar) who control that regulated service provider. We understand that the OECD is still considering the reporting of Controlling Persons in an ownership chain of entities.

130.29 Charities

A charity is typically an Active NFE,[56] but it may be a FI.

STEP CRS guidance provides:

> 8. Charitable trusts
>
> ... many charities fall within the definition of FIs because they hold endowment funds that are professionally managed. It appears that under the CRS, these charities would be treated as RFIs. FATCA treats such charities as non-reporting. In HMRC’s view, there are sound policy reasons for treating certain charities as RFIs. For further guidance on this point, see HMRC’s charity guidance.[57]

[56] See 130.8.7 (Non-profit organisation).

[57] *https://www.gov.uk/guidance/automatic-exchange-of-information-guidance-for-charities*

130.30 Private trust companies

130.30.1 *Trust law background*

A private trust company (one might use the term family trust company) is a SPV set up to act as trustee of family trusts. It may or may not be carrying on a business.

STEP CRS guidance provides:

> 9.1 The only existing commentary that exists in OECD materials with regard to private trust companies is in the Implementation Handbook on page 113. This comments on the role of a private trust company in the context of a 'managed by' test for the purposes of when an entity will be managed by another entity. This ignores the fact that many families use PTCs to act as trustee of trusts in a manner where the PTC conducts activity in its trustee capacity that is synonymous with that undertaken by professional trustee companies, i.e. the PTC would oversee in its trustee capacity the investment activity being undertaken by the trust, which would be regarded as an investment entity for this purpose.
>
> 9.2 It should be noted that, typically, the administration of the PTC will be required to be carried on by a trust and corporate service provider (TCSP) who is generally a person regulated in that capacity in many jurisdictions. Many of the offshore jurisdictions in their guidance on US FATCA make it clear that PTCs could, on the basis set out above, elect to be treated as FIs if, in similar circumstances, a professional trust company would be an FI.
>
> 9.3 There are many ownership structures associated with a PTC. A typical holding structure is where the shares in the PTC are owned by a purpose trust, the trustee of which is an independent professional trustee. In this case, the professional trustee has the power to change the directors of the PTC but otherwise has no control, influence over or interest in the trusts of which the PTC acts as trustee.

130.30.2 *Status for CRS*

STEP CRS guidance provides:

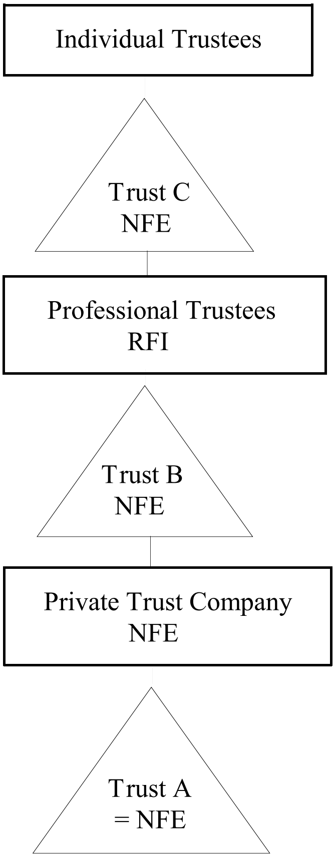
> 9.4 **Example 21**: A private trust company acts as trustee of Trust A. The directors of the PTC are Z, X and Y and they alone exercise control over PTC. The shares in the PTC are owned by Professional Trustee as trustee of Purpose Trust B. Professional Trustee is one of the services provided by a law firm in offshore jurisdiction. Professional Trustee is owned by Trust C for the benefit of the partners of that law

firm. The partners of the law firm are trustees of Trust C.

If you follow through the guidance, it would be necessary to identify as Controlling Persons of Trust A, Trust B, Professional Trustee, Trust C and Individual Trustees. None of these persons exercises control over Trust A or has any financial interest in Trust A.

Conclusion: In this scenario it would be helpful to have guidance that only individuals or entities who actually exercise effective control over PTC should be identified – in this case the directors of PTC X, Y and Z but not the shareholders.

It should be noted that the OECD is still considering the reporting of Controlling Persons in an ownership chain of entities.


Individual Trustees
Trust C
NFE
Professional Trustees
RFI
Trust B
NFE
Private Trust Company
NFE
Trust A
= NFE

130.31 CRS-residence

130.31.1 *General principles*

OECD Commentary on Section VIII (A)(2) CRS para 4 provides:

> For this purpose, a Financial Institution is "resident" in a Participating Jurisdiction if it is subject to the jurisdiction of such Participating Jurisdiction (i.e. the Participating Jurisdiction is able to enforce reporting by the Financial Institution).

The question whether a FI is subject to the jurisdiction of a participating jurisdiction is a matter of private international law. The OECD commentary offers a shortcut:

> In general, where a Financial Institution is resident for tax purposes in a Participating Jurisdiction, it is subject to the jurisdiction of such Participating Jurisdiction and it is, thus, a Participating Jurisdiction Financial Institution.

I refer to residence for the purposes of CRS as **"CRS-residence"**.

Para [a] provides a jurisdiction test to determine CRS-residence, and para [b] provides a tax residence test to determine jurisdiction. Thus where a FI is tax-resident in a jurisdiction, it is CRS-resident there.

An entity may be subject to the jurisdiction of two states, in which case it is in principle dual resident for CRS.

130.31.2 *CRS-residence of trust*

OECD Commentary on Section VIII (A)(2) CRS provides:

> [1] In the case of a trust that is a Financial Institution (irrespective of whether it is resident for tax purposes in a Participating Jurisdiction), the trust is considered to be subject to the jurisdiction of a Participating Jurisdiction if one or more of its trustees are resident in such Participating Jurisdiction
>
> [2] except if the trust reports all the information required to be reported pursuant to the CRS with respect to Reportable Accounts maintained by the trust to another Participating Jurisdiction because it is resident for tax purposes in such other Participating Jurisdiction.

Para [2] deals with cases of dual CRS-residence.

What about a trust with trustees resident in different places, one of which is the UK? The trustees may be deemed non-resident for UK tax purposes. If so it is non-resident for CRS purposes if it complies with CRS in another Participating Jurisdiction. If it does not, it must comply with CRS in the UK, even though not tax-resident.

130.31.3 *FI without residence*

OECD Commentary on Section VIII (A)(2) CRS provides:

> However, where a Financial Institution (other than a trust) does not have a residence for tax purposes (e.g. because it is treated as fiscally transparent, or it is located in a jurisdiction that does not have an income tax), it is considered to be subject to the jurisdiction of a Participating Jurisdiction and it is, thus, a Participating Jurisdiction Financial Institution if:
>
> *a)* it is incorporated under the laws of the Participating Jurisdiction;
> *b)* it has its place of management (including effective management) in the Participating Jurisdiction; or
> *c)* it is subject to financial supervision in the Participating Jurisdiction.
>
> In this context, the term "Participating Jurisdiction" refers to a jurisdiction that has implemented the Common Reporting Standard.

130.31.4 *Dual CRS-residence*

OECD Commentary on Section VIII(5) CRS provides:

> 5. Where a Financial Institution (other than a trust) is resident in two or more Participating Jurisdictions, such Financial Institution will be subject to the reporting and due diligence obligations of the Participating Jurisdiction in which it maintains the Financial Account(s).

130.32 Reporting Financial Institution

"Reporting Financial Institution" matters because, as its name suggests, it must make reports.

Section VIII (A)(1) CRS provides a negative definition:

> 1. The term "Reporting Financial Institution" means any Participating Jurisdiction Financial Institution that is not a Non- Reporting Financial Institution.

130.33 Non-reporting FI

Section VIII (B) CRS provides:

> 1. The term "Non-Reporting Financial Institution" means any Financial Institution that is:

There follows a list of 5 categories of entities

130.33.1 *Governmental entities etc*

The first three categories concern governments and other major players:

> 1. The term "Non-Reporting Financial Institution" means any Financial Institution that is:
>   a) a Governmental Entity, International Organisation or Central Bank, other than with respect to a payment that is derived from an obligation held in connection with a commercial financial activity of a type engaged in by a Specified Insurance Company, Custodial Institution, or Depository Institution;[58]
>   b) a Broad Participation Retirement Fund; a Narrow Participation Retirement Fund; a Pension Fund of a Governmental Entity, International Organisation or Central Bank; or a Qualified Credit Card Issuer;
>   c) any other Entity that presents a low risk of being used to evade tax, has substantially similar characteristics to any of the Entities described in subparagraphs B(1)(a) and (b), and is defined in domestic law as a Non-Reporting Financial Institution, provided that the status of such Entity as a Non-Reporting Financial Institution does not frustrate the purposes of the Common Reporting Standard;

130.33.2 *Exempt Collective Investment Vehicle*

> 1. The term "Non-Reporting Financial Institution" means any Financial Institution that is ...
>   d) an Exempt Collective Investment Vehicle; or

The definition is in section VIII (B) (9) CRS:

> The term "Exempt Collective Investment Vehicle" means an Investment Entity that is regulated as a collective investment vehicle, provided that all of the interests in the collective investment vehicle are held by or through individuals or Entities that are not Reportable Persons, except a Passive NFE with Controlling Persons who are Reportable Persons.

[58] The text will be updated by the 2023 CRS Amendments when they take effect to read: "... other than: i) with respect to a payment that is derived from an obligation held in connection with a commercial financial activity of a type engaged in by a Specified Insurance Company, Custodial Institution, or Depository Institution; or ii) with respect to the activity of maintaining Central Bank Digital Currencies for Account Holders which are not Financial Institutions, Governmental Entities, International Organisations or Central Banks."

An Investment Entity that is regulated as a collective investment vehicle does not fail to qualify under subparagraph B(9) as an Exempt Collective Investment Vehicle, solely because the collective investment vehicle has issued physical shares in bearer form, provided that:

a) the collective investment vehicle has not issued, and does not issue, any physical shares in bearer form after [xx/xx/xxxx];
b) the collective investment vehicle retires all such shares upon surrender;
c) the collective investment vehicle performs the due diligence procedures set forth in Sections II through VII and reports any information required to be reported with respect to any such shares when such shares are presented for redemption or other payment; and
d) the collective investment vehicle has in place policies and procedures to ensure that such shares are redeemed or immobilised as soon as possible, and in any event prior to [xx/xx/xxxx].

130.33.3 *Trust with reporting trustee*

1. The term "Non-Reporting Financial Institution" means any Financial Institution that is ...

e) a trust to the extent that the trustee of the trust is a Reporting Financial Institution and reports all information required to be reported pursuant to Section I with respect to all Reportable Accounts of the trust.

130.34 Reporting duties

Armed with these definitions, we can turn to the reporting duties.

Section I (A)(1) CRS provides:

A. Subject to paragraphs C through F, each Reporting Financial Institution must report the following information with respect to each Reportable Account of such Reporting Financial Institution:

130.34.1 *Account Holder details*

Section I (A)(1) CRS provides:

A. Subject to paragraphs C through F, each Reporting Financial Institution must report the following information with respect to each Reportable Account of such Reporting Financial Institution:

1. [a] the name, address, jurisdiction(s) of residence, TIN(s)[59] and

[59] Taxpayer Identification Number(s).

date and place of birth (in the case of an individual) of each Reportable Person that is an Account Holder of the account and,[60]

[b] in the case of any Entity

[i] that is an Account Holder and

[ii] that, after application of the due diligence procedures consistent with Sections V, VI and VII, is identified as having one or more Controlling Persons that is a Reportable Person,

the name, address, jurisdiction(s) of residence and TIN(s) of the Entity and the name, address, jurisdiction(s) of residence, TIN(s) and date and place of birth of each Reportable Person;[61]

130.34.2 *Account details*

Section I (A)(2)-(4) CRS provides:

> A. Subject to paragraphs C through F, each Reporting Financial Institution must report the following information with respect to each Reportable Account of such Reporting Financial Institution ...
>
> 2. the account number (or functional equivalent in the absence of an account number);[62]
> 3. the name and identifying number (if any) of the Reporting Financial Institution;
> 4. [a] the account balance or value
>
>   [b] (including, in the case of a Cash Value Insurance Contract or Annuity Contract, the Cash Value or surrender value)
>
>   as of
>
>   [i] the end of the relevant calendar year or other appropriate reporting period

[60] The text will be updated by the 2023 CRS Amendments when they take effect to read: "... that is an Account Holder of the account and whether the Account Holder has provided a valid self-certification;".

[61] The text will be updated by the 2023 CRS Amendments when they take effect to read: "... and place of birth of each Reportable Person, as well as the role(s) by virtue of which each Reportable Person is a Controlling Person of the Entity and whether a valid self-certification has been provided for each Reportable Person; and
c) whether the account is a joint account, including the number of joint Account Holders."

[62] The text will be updated by the 2023 CRS Amendments when they take effect to read: "... in the absence of an account number), the type of account and whether the account is a Preexisting Account or a New Account;".

[ii] or, if the account was closed during such year or period, the closure of the account;

STEP CRS guidance (2016) comments on account value:

> a. We note the reference to the 'value calculated by the RFI for the purpose that requires the most frequent determination of value' is to be used for reporting the account value. There is no unified standard for the preparation of trust accounts and it is rare that trust accounts are subject to an audit. In many cases, the directly held trust assets may be shares in a holding company that is an Investment Entity and therefore a Financial Institution. It is also not unusual for the trust assets to be shown in trust accounts at historic cost, and there is no general requirement to 'mark to market' the trust assets annually. In such cases, can the trustee, as RFI, use the value of assets on acquisition either
> i. where the trust accounts show trust assets at historic cost; or
> ii. where the directly held trust asset are shares in one or more holding companies that are carried at historic cost.
> b. It is also not clear, where the trustee is an RFI, whether the obligation to report the value of the trust requires them to report the full value of all trust assets or just the value of financial assets. This would not be the case for a trust that is an NFE, where the RFI in relation to the relevant accounts would only report the value of the financial assets held by that trust. We assume that the intention is that a trustee that is an RFI is only required to provide financial information about the financial assets and not the non-financial assets. If this is correct, it would be helpful if this could be made clear.
> The OECD Secretariat advised that it would be necessary to disclose the full value of all assets in the trust, both financial and non-financial assets.

130.34.3 *Reporting: Exceptions*

Section I (D)-(E) CRS provides minor exceptions for TINs and dates of birth:

> D. Notwithstanding subparagraph A(1), the TIN is not required to be reported if
> *(i)* a TIN is not issued by the relevant Reportable Jurisdiction or
> *(ii)* the domestic law of the relevant Reportable Jurisdiction does not require the collection of the TIN issued by such Reportable Jurisdiction.
> E. Notwithstanding subparagraph A(1), the place of birth is not required to be reported unless the Reporting Financial Institution is otherwise

required to obtain and report it under domestic law and it is available in the electronically searchable data maintained by the Reporting Financial Institution.

130.34.4 *Custodial/Depositary A/c*

Section I (A)(5)-(6) CRS provides:

> A. Subject to paragraphs C through F, each Reporting Financial Institution must report the following information with respect to each Reportable Account of such Reporting Financial Institution:
> 5. in the case of any Custodial Account:
>   *a)* [i] the total gross amount of interest, the total gross amount of dividends, and the total gross amount of other income generated with respect to the assets held in the account,
>   [ii] in each case paid or credited to the account (or with respect to the account) during the calendar year or other appropriate reporting period; and
>   *b)* [i] the total gross proceeds from the sale or redemption of Financial Assets paid or credited to the account during the calendar year or other appropriate reporting period
>   [ii] with respect to which the Reporting Financial Institution acted as a custodian, broker, nominee, or otherwise as an agent for the Account Holder;
> 6. in the case of any Depository Account, the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period;[63]

130.34.5 *Reporting: Other account*

Section I (A)(7) CRS provides:

> 7. [i] in the case of any account not described in subparagraph A(5) or (6), [ie not a Custodial/Depositary Account]
>   [ii] the total gross amount paid or credited to the Account Holder with respect to the account during the calendar year or other appropriate reporting period
>   [iii] with respect to which the Reporting Financial Institution is the obligor or debtor,

[63] The text will be updated by the 2023 CRS Amendments when they take effect to read: "... other appropriate reporting period; in the case of any Equity Interest held in an Investment Entity that is a legal arrangement, the role(s) by virtue of which the Reportable Person is an Equity Interest holder; and".

> [iv] including the aggregate amount of any redemption payments made to the Account Holder during the calendar year or other appropriate reporting period.

Section I (F) CRS provides:

> F. Notwithstanding paragraph A, the information to be reported with respect to [xxxx] is the information described in such paragraph, except for gross proceeds described in subparagraph A(5)(b).

130.34.6 *Pre-existing account*

Section I (C) CRS provides a minor transitional relief:

> C. Notwithstanding subparagraph A(1), with respect to each Reportable Account that is a Pre-existing Account, the TIN(s) or date of birth is not required to be reported if such TIN(s) or date of birth is not in the records of the Reporting Financial Institution and is not otherwise required to be collected by such Reporting Financial Institution under domestic law. However, a Reporting Financial Institution is required to use reasonable efforts to obtain the TIN(s) and date of birth with respect to Pre-existing Accounts by the end of the second calendar year following the year in which such Accounts were identified as Reportable Accounts.[64]

130.34.7 *Currency*

Section I (B) CRS provides:

> B. The information reported must identify the currency in which each amount is denominated.

130.35 CRS TAAR

Section IX(A)(1) CRS provides:

> A. A jurisdiction must have rules and administrative procedures in place to ensure effective implementation of, and compliance with, the reporting and due diligence procedures set out above including:
>
> 1. rules to prevent any Financial Institutions, persons or

[64] The text will be updated by the 2023 CRS Amendments when they take effect to read: "... identified as Reportable Accounts and whenever it is required to update the information relating to the Preexisting Account pursuant to domestic AML/KYC Procedures."

> intermediaries from adopting practices intended to circumvent the reporting and due diligence procedures;

Regulation 23 ITCR 2015 provides:

> If--
> (a) a person enters into any arrangements, and
> (b) the main purpose, or one of the main purposes, of the person in entering into the arrangements is to avoid any obligation under these Regulations,
>
> these Regulations are to have effect as if the arrangements had not been entered into.

This wording is authorised by CRS, so is not *ultra vires*.[65]

OECD Commentary on Section IX(4) CRS provides:

> 5. The following are examples of situations where it is expected that an anti-avoidance rule would apply:
>
> *Example 1 (Shift Maintenance of an Account):*
>
> A Reporting Financial Institution advises a customer to maintain an account with a Related Entity in a non-Participating Jurisdiction that enables the Reporting Financial Institution to avoid reporting while offering to provide services and retain customer relations as if the account was maintained by the Reporting Financial Institution itself. In such a case, the Reporting Financial Institution should be considered to maintain the account and have the resulting reporting and due diligence requirements.
>
> *Example 2 (Year-end amounts):*
>
> Financial Institutions, individuals, Entities or intermediaries manipulate year-end amounts, such as account balances, to avoid reporting or being reported upon.
>
> *Example 3 (Park Money with Qualified Credit Card Issuers):*
>
> Individuals or Entities park balances from other Reportable Accounts with Qualified Credit Card Issuers for a short period at the end of the year to avoid reporting.
>
> *Example 4 (Electronic records and computerised systems):*
>
> A Reporting Financial Institution deliberately does not create any electronic records (such that an electronic record search would not yield any results) or maintains computerised systems artificially dissociated (to avoid the account aggregation rules).

[65] Unlike the equivalent rule in the Country by Country reporting regulations: see 2.8.2 (Rule of law v. other values).

Conduct of this kind[66] generally involves fraudulent concealment from Revenue authorities, which has implications beyond CRS.

[66] *https://www.oecd.org/tax/exchange-of-tax-information/public-consultation-document-crypto-asset-reporting-framework-and-amendments-to-the-common-reporting-standard.pdf*

CHAPTER ONE HUNDRED AND THIRTY ONE

TRUST REGISTRATION (TRS)

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131.1 MLR: Introduction

This chapter and the next consider the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017. The name is too long to use even as an abbreviation ("MLTFTFIPR"); I abbreviate it to "MLR".

MLR derives from the 5th Money Laundering Directive (2018/843) which the UK will continue to apply post-Brexit.

The extent and complexity of the obligations imposed by MLR is dispiriting. Some readers may use stronger language. They were introduced under a government which claimed to wish to cut red tape![1]

[1] *The Times* records on 7 January 2021: "Boris Johnson has declared the "time is now" to deregulate Britain's economy as he invited business leaders to propose areas where his government can cut red tape."

But if the object is to discourage trusts by making them more onerous to administer, Perhaps belatedly, a consultation published March 2024 is now to review the MLR generally, including a review of TRS.

131.2 TRS: Introduction

The main topic of this chapter is trust registration (TRS). I also discuss: trust record keeping and supply of trust data to third parties.

The rules are in Part 5 (reg 42-45ZB) MLR.

Reg 42(1) MLR provides:

> This Part [Part 5, Beneficial Ownership Information] applies to
> [a] UK bodies corporate and
> [b] relevant trusts.

The term relevant trust brings in the territorial limits of Part 5, as relevant trusts must have UK links of some kind.

Similar rules apply to companies and so I consider companies here too, but the focus of the chapter is on trusts. I do not discuss enforcement provisions in Part 9 but note they include criminal offences and unlimited penalties.

The rules changed in 2020 and now require (almost) all trusts to register if they were not required to register under the pre-2020 rules.

I do not consider penalties.

131.2.1 *TRS: Guidance*

The following guidance is available:

HMRC:
- Trust Registration Service Manual (TRSM)
- "Register a trust as an agent" (entry-level guidance)[2]

Law Society: TRS legal sector guidance:[3]
- Non-corporate guidance ("Law Soc non-corporate TRS guidance")
- Corporate guidance

LSAG:[4]
Anti-Money Laundering Guidance for the Legal Sector ("LSAG TRS guidance")
Articles

TRS has been a success.

[2] *https://www.gov.uk/guidance/register-your-clients-trust*

[3] *https://www.lawsociety.org.uk/topics/anti-money-laundering/trust-registration-service-trs-and-aml-compliance*

[4] *https://www.lawsociety.org.uk/en/topics/anti-money-laundering/anti-money-laundering-guidance* (2021)

Morton & Doukova, "The Trust Registration Service: the next iteration of the regime"[5]

The background can be found in HM Treasury consultation and response papers, now of historical interest only:

- Transposition of the Fifth Money Laundering Directive: consultation
- Transposition of the Fifth Money Laundering Directive: response to the consultation[6]
- Fifth Money Laundering Directive and Trust Registration Service: Technical consultation document[7]

131.3 MLR: EU law background

Chapter 3 of the 4th money laundering directive[8] deals with companies in art 30 and trusts in art 31. It is easier to follow if the two are set out side by side:

Article 30 (companies)	***Article 31 (trusts)***
	1. Member States shall ensure that this Article applies to [a] trusts and [b] other types of legal arrangements, such

[5] [2021] BTR 142.

[6] *https://www.gov.uk/government/consultations/transposition-of-the-fifth-money-laundering-directive* (April 2019/Jan 2020).

[7] *https://www.gov.uk/government/consultations/technical-consultation-fifth-money-laundering-directive-and-trust-registration-service* (Jan 2020).

[8] The full title is: Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC See
https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32015L0849
The 4th directive was amended by the 5th moneylaundering directive, which took effect on 10 January 2020. Its full title is Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU
https://eur-lex.europa.eu/eli/dir/2018/843/oj
The 2021/22 edition of this work para 122.2 set out a track change version identifying the changes of the 5th directive, but this is now of historical interest only.

	as, inter alia, fiducie, certain types of Treuhand or fideicomiso, where such arrangements have a structure or functions similar to trusts. Member States shall identify the characteristics to determine where legal arrangements have a structure or functions similar to trusts with regard to such legal arrangements governed under their law.
1. Member States shall ensure that corporate and other legal entities incorporated within their territory are required to obtain and hold adequate, accurate and current information on their beneficial ownership, including the details of the beneficial interests held.	Each Member State shall require that trustees of any express trust administered in that Member State obtain and hold adequate, accurate and up-to-date information on beneficial ownership regarding the trust. That information shall include the identity of: (a) the settlor(s); (b) the trustee(s); (c) the protector(s) (if any); (d) the beneficiaries or class of beneficiaries; (e) any other natural person exercising effective control of the trust.
Member States shall ensure that breaches of this Article are subject to effective, proportionate and dissuasive measures or sanctions.	Member States shall ensure that breaches of this Article are subject to effective, proportionate and dissuasive measures or sanctions.
Member States shall ensure that those entities are required to provide, in addition to information about their legal owner, information on the beneficial owner to obliged entities when the obliged entities are taking customer due diligence measures in accordance with Chapter II. Member States shall require that the beneficial owners of corporate or other legal entities, including through shares, voting rights, ownership interest, bearer shareholdings or control via other means, provide those entities with all the information necessary for the corporate or other legal entity to comply with the requirements in the first subparagraph.	

	2. Member States shall ensure that trustees or persons holding equivalent positions in similar legal arrangements as referred to in paragraph 1 of this Article, disclose their status and provide the information referred to in paragraph 1 of this Article to obliged entities in a timely manner, where, as a trustee or as person holding an equivalent position in a similar legal arrangement, they form a business relationship or carry out an occasional transaction above the thresholds set out in points (b), (c) and (d) of Article 11.
2. Member States shall require that the information referred to in paragraph 1 can be accessed in a timely manner by competent authorities and FIUs.	3. Member States shall require that the information referred to in paragraph 1 can be accessed in a timely manner by competent authorities and FIUs.
3. Member States shall ensure that the information referred to in paragraph 1 is held in a central register in each Member State, for example a commercial register, companies register as referred to in Article 3 of Directive 2009/101/EC of the European Parliament and of the Council (16), or a public register. Member States shall notify to the Commission the characteristics of those national mechanisms. The information on beneficial ownership contained in that database may be collected in accordance with national systems.	3a. Member States shall require that the beneficial ownership information of express trusts and similar legal arrangements as referred to in paragraph 1 shall be held in a central beneficial ownership register set up by the Member State where the trustee of the trust or person holding an equivalent position in a similar legal arrangement is established or resides. Where the place of establishment or residence of the trustee of the trust or person holding an equivalent position in similar legal arrangement is outside the Union, the information referred to in paragraph 1 shall be held in a central register set up by the Member State where the trustee of the trust or person holding an equivalent position in a similar legal arrangement enters into a business relationship or acquires real estate in the name of the trust or similar legal arrangement. Where the trustees of a trust or persons holding equivalent positions in a similar legal arrangement are established or reside in different Member States, or where the trustee of the trust or person holding an equivalent position in a similar legal

	arrangement enters into multiple business relationships in the name of the trust or similar legal arrangement in different Member States, a certificate of proof of registration or an excerpt of the beneficial ownership information held in a register by one Member State may be considered as sufficient to consider the registration obligation fulfilled.
4. Member States shall require that the information held in the central register referred to in paragraph 3 is adequate, accurate and current, and shall put in place mechanisms to this effect. Such mechanisms shall include requiring obliged entities and, if appropriate and to the extent that this requirement does not interfere unnecessarily with their functions, competent authorities to report any discrepancies they find between the beneficial ownership information available in the central registers and the beneficial ownership information available to them. In the case of reported discrepancies, Member States shall ensure that appropriate actions be taken to resolve the discrepancies in a timely manner and, if appropriate, a specific mention be included in the central register in the meantime.	5. Member States shall require that the information held in the central register referred to in paragraph 3a is adequate, accurate and current, and shall put in place mechanisms to this effect. Such mechanisms shall include requiring obliged entities and, if appropriate and to the extent that this requirement does not interfere unnecessarily with their functions, competent authorities to report any discrepancies they find between the beneficial ownership information available in the central registers and the beneficial ownership information available to them. In the case of reported discrepancies Member States shall ensure that appropriate actions be taken to resolve the discrepancies in a timely manner and, if appropriate, a specific mention be included in the central register in the meantime.
5. Member States shall ensure that the information on the beneficial ownership is accessible in all cases to: (a) competent authorities and FIUs, without any restriction; (b) obliged entities, within the framework of customer due diligence in accordance with Chapter II; (c) any member of the general public.	4. Member States shall ensure that the information on the beneficial ownership of a trust or a similar legal arrangement is accessible in all cases to: (a) competent authorities and FIUs, without any restriction; (b) obliged entities, within the framework of customer due diligence in accordance with Chapter II; (c) any natural or legal person that can demonstrate a legitimate interest; (d) any natural or legal person that files a written request in relation to a trust or similar legal arrangement which holds or owns a controlling interest in any corporate

	or other legal entity other than those referred to in Article 30(1), through direct or indirect ownership, including through bearer shareholdings, or through control via other means.
The persons referred to in point (c) shall be permitted to access at least the name, the month and year of birth and the country of residence and nationality of the beneficial owner as well as the nature and extent of the beneficial interest held. Member States may, under conditions to be determined in national law, provide for access to additional information enabling the identification of the beneficial owner. That additional information shall include at least the date of birth or contact details in accordance with data protection rules.	The information accessible to natural or legal persons referred to in points (c) and (d) of the first subparagraph shall consist of the name, the month and year of birth and the country of residence and nationality of the beneficial owner, as well as nature and extent of beneficial interest held. Member States may, under conditions to be determined in national law, provide for access of additional information enabling the identification of the beneficial owner That additional information shall include at least the date of birth or contact details, in accordance with data protection rules. Member States may allow for wider access to the information held in the register in accordance with their national law. Competent authorities granted access to the central register referred to in paragraph 3a shall be public authorities with designated responsibilities for combating money laundering or terrorist financing, as well as tax authorities, supervisors of obliged entities and authorities that have the function of investigating or prosecuting money laundering, associated predicate offences and terrorist financing, tracing, and seizing or freezing and confiscating criminal assets.
5a. Member States may choose to make the information held in their national registers referred to in paragraph 3 available on the condition of online registration and the payment of a fee, which shall not exceed the administrative costs of making the information available, including costs of maintenance and developments of the register.	4a. Member States may choose to make the information held in their national registers referred to in paragraph 3a available on the condition of online registration and the payment of a fee, which shall not exceed the administrative costs of making the information available, including costs of maintenance and developments of the register.

6. Member States shall ensure that competent authorities and FIUs have timely and unrestricted access to all information held in the central register referred to in paragraph 3 without alerting the entity concerned. Member States shall also allow timely access by obliged entities when taking customer due diligence measures in accordance with Chapter II.	
Competent authorities granted access to the central register referred to in paragraph 3 shall be those public authorities with designated responsibilities for combating money laundering or terrorist financing, as well as tax authorities, supervisors of obliged entities and authorities that have the function of investigating or prosecuting money laundering, associated predicate offences and terrorist financing, tracing and seizing or freezing and confiscating criminal assets.	
7. Member States shall ensure that competent authorities and FIUs are able to provide the information referred to in paragraphs 1 and 3 to the competent authorities and to the FIUs of other Member States in a timely manner and free of charge.	7. Member States shall ensure that competent authorities and FIUs are able to provide the information referred to in paragraphs 1 and 3 to the competent authorities and to the FIUs of other Member States in a timely manner and free of charge.
8. Member States shall require that obliged entities do not rely exclusively on the central register referred to in paragraph 3 to fulfil their customer due diligence requirements in accordance with Chapter II. Those requirements shall be fulfilled by using a risk-based approach.	6. Member States shall ensure that obliged entities do not rely exclusively on the central register referred to in paragraph 4 to fulfil their customer due diligence requirements as laid down in Chapter II. Those requirements shall be fulfilled by using a risk-based approach.
9. In exceptional circumstances to be laid down in national law, where the access referred to in points (b) and (c) of the first subparagraph of paragraph 5 would expose the beneficial owner to	7a. In exceptional circumstances to be laid down in national law, where the access referred to in points (b), (c) and (d) of the first subparagraph of paragraph 4 would expose the beneficial owner to

disproportionate risk, risk of fraud, kidnapping, blackmail, extortion, harassment, violence or intimidation, or where the beneficial owner is a minor or otherwise legally incapable, Member States may provide for an exemption from such access to all or part of the information on the beneficial ownership on a case-by-case basis. Member States shall ensure that these exemptions are granted upon a detailed evaluation of the exceptional nature of the circumstances. Rights to an administrative review of the exemption decision and to an effective judicial remedy shall be guaranteed. A Member State that has granted exemptions shall publish annual statistical data on the number of exemptions granted and reasons stated and report the data to the Commission.	disproportionate risk, risk of fraud, kidnapping, blackmail, extortion, harassment, violence or intimidation, or where the beneficial owner is a minor or otherwise legally incapable, Member States may provide for an exemption from such access to all or part of the information on the beneficial ownership on a case-by-case basis. Member States shall ensure that these exemptions are granted upon a detailed evaluation of the exceptional nature of the circumstances. Rights to an administrative review of the exemption decision and to an effective judicial remedy shall be guaranteed. A Member State that has granted exemptions shall publish annual statistical data on the number of exemptions granted and reasons stated and report the data to the Commission. Where a Member State decides to establish an exemption in accordance with the first subparagraph, it shall not restrict access to information by competent authorities and FIUs.
Exemptions granted pursuant to the first subparagraph of this paragraph shall not apply to credit institutions and financial institutions, or to the obliged entities referred to in point (3)(b) of Article 2(1) that are public officials.	Exemptions granted pursuant to the first subparagraph shall not apply to the credit institutions and financial institutions, and to obliged entities referred to in point (3)(b) of Article 2(1) that are public officials.
10. Member States shall ensure that the central registers referred to in paragraph 3 of this Article are interconnected via the European Central Platform established by Article 22(1) of Directive (EU) 2017/1132 of the European Parliament and of the Council (17). The connection of the Member States' central registers to the platform shall be set up in accordance with the technical specifications and procedures established by implementing acts adopted by the Commission in accordance with Article 24 of Directive (EU) 2017/1132 and with Article 31a of this Directive.	9. Member States shall ensure that the central registers referred to in paragraph 3a of this Article are interconnected via the European Central Platform established by Article 22(1) of Directive (EU) 2017/1132. The connection of the Member States' central registers to the platform shall be set up in accordance with the technical specifications and procedures established by implementing acts adopted by the Commission in accordance with Article 24 of Directive (EU) 2017/1132 and with Article 31a of this Directive.

Member States shall ensure that the information referred to in paragraph 1 of this Article is available through the system of interconnection of registers established by Article 22(1) of Directive (EU) 2017/1132, in accordance with Member States' national laws implementing paragraphs 5, 5a and 6 of this Article.	Member States shall ensure that the information referred to in paragraph 1 of this Article is available through the system of interconnection of registers established by Article 22(2) of Directive (EU) 2017/1132, in accordance with Member States' national laws implementing paragraphs 4 and 5 of this Article.
	Member States shall take adequate measures to ensure that only the information referred to in paragraph 1 that is up to date and corresponds to the actual beneficial ownership is made available through their national registers and through the system of interconnection of registers, and the access to that information shall be in accordance with data protection rules.
The information referred to in paragraph 1 shall be available through the national registers and through the system of interconnection of registers for at least five years and no more than 10 years after the corporate or other legal entity has been struck off from the register. Member States shall cooperate among themselves and with the Commission in order to implement the different types of access in accordance with this Article.	The information referred to in paragraph 1 shall be available through the national registers and through the system of interconnection of registers for at least five years and no more than 10 years after the grounds for registering the beneficial ownership information as referred to in paragraph 3a have ceased to exist. Member States shall cooperate with the Commission in order to implement the different types of access in accordance with paragraphs 4 and 4a.
	10. Member States shall notify to the Commission the categories, description of the characteristics, names and, where applicable, legal basis of the trusts and similar legal arrangements referred to in paragraph 1 by 10 July 2019. The Commission shall publish the consolidated list of such trusts and similar legal arrangements in the Official Journal of the European Union by 10 September 2019. By 26 June 2020, the Commission shall submit a report to the European Parliament and to the Council assessing whether all trusts and similar legal arrangements as

referred to in paragraph 1 governed under the law of Member States were duly identified and made subject to the obligations as set out in this Directive. Where appropriate, the Commission shall take the necessary steps to act upon the findings of that report.

131.4 MLR definitions

131.4.1 *Definitions: Navigation*

A table of defined expressions may be helpful:

Term	**Defined**	**See para**
Business relationship	Reg 4(1)	132.4
Residence	Reg 42(3)	131.4.2
Interest in Land*	Reg 42(5)	131.4.4
Body corporate	Reg 3(1)	131.4.5
UK body corporate	Reg 42(2)	131.4.6
Eligible Scottish partnership	Reg 3(1)	131.4.7
Firm	Reg 3(1)	131.4.8
Trusts:		
Relevant trust	Reg 42(2)	131.5
Relevant trust type (i)	*My terminology*	131.7
Relevant trust type (ii)	*My terminology*	131.8
Relevant trust type (iii)	*My terminology*	131.9
Type 10A/B/C trust	*My terminology*	131.24
UK/Non-UK trust	Reg 42(2)	131.7
Type A/B/C trust	Reg 45ZA(2)	131.25
Taxable relevant trust	Reg 45(14)	131.14
EEA registered trust	Reg 42(4)	131.4.3
Excluded trust	Sch 3A	131.11
Relevant [regulated] person	Reg 3(1)	131.4.11, 132.5
Tax adviser	Reg 11(d)	132.6
Independent Legal Professional*	132.7	
Beneficial Owner:	-	131.16
of company	Reg 5(1)	131.16
of partnership	Reg 5(3)	131.18
of trust	Reg 6(1)	131.19
of estate	Reg 6(6)	131.20
Control:		
of company	Reg 5(2)	131.17
of beneficiary/settlor	Reg 6(4)	131.19.3

Significant control	Reg 5(2)/CA 06	131.17.1
Subsidiary undertaking	Reg 5(2)/CA 06	131.17.1
Entity: Controlling interest	Reg 42(6)	131.4.10
Third country entity	Reg 42(6)	131.4.9

* Note: these expressions have a technical meaning, not a commonsense meaning

131.4.2 *Residence for MLR*

I use the term "MLR-residence" to mean residence for the purposes of the MLR.

Reg 42(3) MLR defines MLR-residence for trustees and settlors:

> A trustee or settlor is resident in the UK—
> (a) in the case of a body corporate, if it is a UK body corporate;
> (b) in the case of an individual, if the individual is resident in the UK for the purposes of one or more of the taxes referred to in regulation 45(14).

In the case of a trustee/settlor which is a company, MLR-residence is not quite the same as UK tax residence, but it will normally come to the same thing, and it is a simpler test.

In the case of a trustee/settlor who is an individual, the test is residence for the purposes of the taxes referred to, which are IT, CGT, IHT and stamp taxes.[9] The test of residence for the first three of these is the SRT.[10] SDLT has a different (simpler) residence test, but that only applies for specific purposes, not for SDLT as a whole, so perhaps that does not count. So the test for MLR-residence for a trustee/settlor appears to be the SRT. The reader may think it would have been easier if the MLR had stated this directly; but there it is.

In relation to individual Beneficial Owners of a trust, the trust must disclose "the individual's country of residence". Here there is no definition of residence of an individual. Reg 42(3) does not apply. Strictly the test should be the common law test which applied pre-SRT. But as far as residence in the UK is concerned, the SRT comes to more or less the same thing, and no-one would be criticised for adopting the SRT as the test of an individual's residence in the UK. An individual may of course be dual resident.

[9] For this list of taxes, see 131.14 (Taxable relevant trust).

[10] See 6.3 (Scope of SRT).

A trust must also disclose "the country where it is considered to be resident for tax purposes". Whether a trust is resident in the UK for tax purposes should be determined by the standard IT/CGT test. There are also some other, somewhat niche, tests of trust residence, eg for IHT, but these can be ignored.) Whether a trust is resident in some other country for tax purposes will depend on the tax law of that country. But trustees should generally know where their trust is resident for tax purposes.

This is a complex picture, if one tries to address it analytically and in full detail, but in practice we will no doubt muddle through.

131.4.3 *EEA registered trust*

Reg 42(4) MLR 2007 provides:

> For the purposes of this Part, an "EEA registered trust" is a trust
> [1] established in a country or territory other than the UK
> [2] where national legislation applies having a broadly equivalent effect to the requirements laid down in the fourth money laundering directive.

For brevity I shorten this to **"EEA trust"**. This would include all EU countries. It would include the other members of the EEA (Iceland/ Liechtenstein/Norway) if they have legislation similar to the 4th money laundering directive, which no doubt they do.

TRSM provides:

> **TRSM23150 trusts registered on EEA register** [Sep 2022]
> There is no statutory definition of 'establishment' for TRS purposes: a trust can be considered as established in an EEA member state for TRS purposes if that is where the trustees are resident or where the administration of the trust is carried out.

That may not be right,[11] and on that definition a trust could be established in two places, but in practice the problem will not often arise.

131.4.4 *Interest in UK land*

Reg 42(5) MLR 2007 restricts this term to major interests:

> For the purposes of this Part, the trustees acquire an interest in land in the UK where at least one of the trustees becomes registered—[12]

[11] See 38.10.1 ("Pension scheme").

[12] For clarity I have set this out in a tabular format.

England	**Scotland**	**Northern Ireland**
(a) in the register of title kept under the Land Registration Act 2002	(b) in the Land Register of Scotland	(c) in the register kept under the Land Registration Act (Northern Ireland) 1970
as the proprietor of— (i) a freehold estate in land; or (ii) a leasehold estate in land granted for a term of more than 7 years from the date of the grant;	as the proprietor or as the tenant under a lease ("lease" and "proprietor" having the meanings given by section 113(1) of the Land Registration etc (Scotland) Act 2012); or	as the owner of— (i) a freehold estate in land; or (ii) a leasehold estate in land granted for a term of more than 21 years from the date of the grant.

I write this term with initial capitals, to reflect the technical nature of the expression. Trustees do not have an Interest in UK Land if the land is registered in the name of nominees for the trustees. But that will not normally matter. Law Soc non-corporate TRS guidance provides (p.5):

> If the interest in UK land is held by a nominee for the trustees, the trustees will not need to register the trust but it is likely that the nominees will need to register the nominee arrangement. ... nominee holdings are only excluded where the nominee is a FCA authorised person involved with safeguarding and administering assets. Legal professionals who act, or whose vehicles act, as nominees to hold client assets, (for example for valid confidentiality reasons) will need to register such arrangements with the TRS. However, non-UK trustees who acquire an interest in UK land are likely to become subject to UK tax at some point and therefore will need to register if the trust becomes a relevant taxable trust.

131.4.5 *Body corporate*

Reg 3(1) MLR provides:

> In these Regulations ...
> "body corporate"—
> (a) includes—
> (i) a body corporate incorporated under the laws of the UK or any part of the UK, and
> (ii) a body corporate constituted under the law of a country or territory outside the UK;
> (b) but does not include—
> (i) a corporation sole, or

> (ii) a partnership that, whether or not a legal person, is not regarded as a body corporate under the law by which it is governed;

Leaving aside the specialist topic of a corporation sole, this means that a body corporate includes a body corporate, but does not include something which is not a body corporate. The definition is based on wording in s.1173 Companies Act 2006.

In this chapter where brevity is needed I use the word "company" to refer to a body corporate, as the meaning is (more or less) the same.

131.4.6 *UK body corporate*

Reg 42(2)(a) MLR provides:

> (2) For the purposes of this Part—
> (a) a "UK body corporate" is
> [i] a body corporate which is incorporated under the law of the UK or any part of the UK,
> [ii] and includes an eligible Scottish partnership;

131.4.7 *Eligible Scottish partnership*

This term matters as an eligible Scottish partnership counts as a UK body corporate.

Reg 3(1) MLR provides:

> In these Regulations ...
> "eligible Scottish partnership" has the meaning given in regulation 3 of the Scottish Partnerships (Register of People with Significant Control) Regulations 2017 (key terms)

That takes us to reg 3(2) of the 2017 Regulations ("SLR 2017"), which provides:

> An "eligible Scottish partnership" is—
> (a) a limited partnership registered in Scotland (a "Scottish limited partnership"), or
> (b) a general partnership constituted under the law of Scotland, during any period in which it is a qualifying partnership (a "Scottish qualifying partnership").

Reg 2 SLR 2017 provides:

> "qualifying partnership" has the meaning given in regulation 3 of the

> Partnerships[13] (Accounts) Regulations 2008

So we turn to reg 3(1) Partnerships (Accounts) Regulations 2008 which provides:

> A "qualifying partnership" is a partnership formed under the law of any part of the UK each of whose members or, in the case of a limited partnership, each of whose general partners is—
> (a) a limited company;
> (b) an unlimited company each of whose members is a limited company;
> (c) a Scottish partnership which is not a limited partnership, each of whose members is a limited company; or
> (d) a Scottish partnership which is a limited partnership, each of whose general partners is a limited company.

The regulation then sets out statutory foreign-entity definitions but that is of limited significance.[14]

131.4.8 *Firm*

Reg 3(1) MLR provides:

> "firm" means any entity that, whether or not a legal person, is not an individual and includes a body corporate and a partnership or other unincorporated association;

131.4.9 *Third country entity*

Reg 42(6)(b) MLR provides:

[13] The original erroneously reads: partnership.

[14] Reg 3 Partnerships (Accounts) Regulations 2008 provides:
"(2) Each reference in paragraph (1) to a limited company includes a reference to any comparable undertaking incorporated in a country or territory outside the UK.
(3) The reference in paragraph (1)(b) to an unlimited company includes a reference to any comparable undertaking incorporated in a country or territory outside the UK.
(4) The reference in paragraph (1)(c) to a Scottish partnership which is not a limited partnership includes a reference to any undertaking comparable to such a Scottish partnership incorporated in or formed under the law of a country or territory outside the UK.
(5) The reference in paragraph (1)(d) to a Scottish partnership which is a limited partnership includes a reference to any undertaking comparable to such a Scottish partnership incorporated in or formed under the law of a country or territory outside the UK; and in relation to such an undertaking the reference in that paragraph to the general partners is to be construed as a reference to the members of the undertaking comparable to general partners." See 90.3.3 (Foreign-entity clauses).

> "third country entity" means a body corporate, partnership or other entity that —
> (i) is governed by the law of a country or territory other than the United Kingdom and (in each case) is a legal person under that law, and
> (ii) is not subject to national legislation having a broadly equivalent effect to the requirements laid down in Article 30 of the fourth money laundering directive.

131.4.10 *Controlling interest in entity*

Reg 42(6) MLR provides:

> For the purposes of this Part—
> (a) the trustees have a controlling interest in a third country entity if they meet any of the specified conditions in paragraphs 2 to 5 of Schedule 1A to the Companies Act 2006[15] (people with significant control over a company) where that Schedule is read with the following modifications—
> (i) references to X having or holding a share in or a right in relation to, or exercising significant influence or control over, company Y are to be read as references to the trustees (in their capacity as such) having or holding a share in or a right in relation to, or exercising significant influence or control over, the third country entity;
> (ii) for "25%" wherever it occurs in each of paragraphs 2 (ownership of shares), 3 (voting rights), 13 (calculating shareholdings), and 14 (voting rights), read "50%";

131.4.11 *Relevant person*

For the definition, see 132.5 (Relevant person). I do not deal with this topic here as "relevant person" has limited importance for TRS. The obligation to register rests on trustees whether or not they are relevant (regulated) persons.

131.5 Relevant Trust

"Relevant trust" is a key term because only relevant trusts are within the scope of Part 5 MLR and so subject to its registration, record keeping and 3rd party access rules.

Reg 42(2)(b) MLR provides:

[15] See 131.17.1 (Significant control).

a "relevant trust" is—

The regulation then sets out three categories of relevant trust:

(i) a UK trust which is an express trust;
(ii) a non-UK trust which is an express trust; and
(aa) receives income from a source in the UK; or
(bb) has assets in the UK,
on which it is liable to pay one or more of the taxes referred to in regulation 45(14); or
(iii) any other non-UK trust which
[A] is an express trust,
[B] is not a trust listed in Schedule 3A (excluded trusts)
[C] and whose trustees (in their capacity as such)—
(aa) acquire an interest in land in the UK; or
(bb) enter into a business relationship with a relevant [regulated] person, where at least one of those trustees is resident in the UK and the trust is not an EEA registered trust;

I refer to these as "**relevant trust types (i) -(iii)**". In short:

Description	**Type**	**See para**
UK trust	(i)	131.7
Non-UK trust:		
Taxable in UK	(ii)	131.8
Other UK link:	(iii)	131.9
- UK land		
- one or more UK trustees		

The term relevant trust brings in two sets of limitations to Part 5:
(1) It excludes non-express trusts
(2) It brings in territorial limitations: relevant trusts must have UK links of the specified kinds

"Trust" is not defined. The Money Laundering Directive is expressed to apply to:
(1) Trusts; and
(2) "Other types of legal arrangements, such as, inter alia, fiducie, certain types of Treuhand or fideicomiso, where such arrangements have a structure or functions similar to trusts"[16]

[16] Art 31(1); see 131.3 (MLR: EU law background).

I would regard arrangements within (2) as trusts in the general sense; but even if that were wrong, they constitute trusts for the purposes of the MLR.[17]

A bare trust is a relevant trust (assuming it is an express trust with one of the specified UK links) and so within the scope of Part 5 MLR. However it is not a taxable trust.[18]

A family investment partnership is not a trust (or similar to a trust).[19]

131.6 Express trusts

A non-express trust is not a relevant trust and so is outside the scope of Part 5 MLR.

The term "express trust" is not defined. It is an established concept of trust law, though until the MLR its role was limited to the topic of limitation, so private client practitioners may not have been familiar with the term. *Lewin on Trusts* provides:[20]

> A distinction may be drawn between express trusts and trusts arising by operation of law...
> Express trusts are created when a settlor or testator constitutes a trust with the express or inferred intention of creating a trust, whether by declaration of trust or by will, or by disposition of property to trustees, or by contract, in each case complying with any applicable formalities required by law... Express trusts may also be created by statute or by the exercise of powers of disposition over property. Trusts which are not of the above kinds are those which arise by operation of law. They are called resulting, implied and constructive trusts.

TRSM provides:

> **TRSM21030: what is an express trust** [May 2021]
> An express trust is a trust created deliberately by a settlor, usually in the form of a document such as a written deed or declaration of trust. Express trusts can be created:
>
> - to take effect during the settlor's lifetime, or
> - by will, to take effect on death.
>
> Express trusts can be contrasted with trusts that come into being through the operation of the law and that do not result from the clear intent or

[17] See 90.18 (Civil law trust equivalents) ff.

[18] See 121.5 (Reporting bare trusts).

[19] See 130.18.2 (Arrangement similar to trust).

[20] 20th edition para 1-033; 8-001 (Express trusts and trusts arising by operation of law).

> decision of a settlor to create a trust or similar legal arrangement (for example, implied or constructive trusts).[21]

Law Soc non-corporate TRS guidance provides (p.1):

> the following are not express trusts ...
> - trusts which arise on intestacy; and
> - trusts created by court orders (such as following a dispute or on divorce).

CIOT say:

> Junior ISAs, like Child Trust Funds, are not express trusts and therefore not required to register on TRS. This would apply to all types of Junior ISAs: cash ISAs (which would have been excluded from registration under Sch3A(6A) regardless), but also stocks and shares ISAs. The confirmation that Junior ISAs are not registerable has been added to the Trust Registration Service Manual - see TRSM10030 and TRSM23160. HMRC are still considering whether premium bonds held for minors are deemed to be held on trust as a result of legislation and therefore should be excluded from registration as legislative trusts.

131.7 Relevant trust (i): UK trust

Reg 42(2)(b) MLR provides:

> (b) a "relevant trust" is—
> (i) a UK trust which is an express trust ...

Reg 42(2) MLR provides:

> (c) a trust is a "UK trust" if—
> (i) all the trustees are resident in the UK; or
> (ii) sub-paragraph (d) applies;
> (d) this sub-paragraph applies if—
> (i) at least one trustee is resident in the UK, and
> (ii) the settlor was resident and domiciled in the UK at the time when—

[21] For completeness: This view is approved in COM(2020) 560 final "Report from the Commission to the European Parliament and the Council assessing whether Member States have duly identified and made subject to the obligations of Directive (EU) 2015/849 all trusts and similar legal arrangements governed under their laws" *https://ec.europa.eu/transparency/documents-register/detail?ref=COM(2020)560&lang=en*

> (aa) the trust was set up, or
> (bb) the settlor added funds to the trust;

UK trust (as defined) is not quite the same as a UK resident trust under the standard IT/CGT definition of trust residence, but it will usually come to the same thing.

Reg 42(2)(e) MLR provides:

> a trust is a "non-UK trust" if it is not a UK trust.

131.8 Rel trust (ii): Taxable trust

Reg 42(2)(b) MLR provides:

> (b) a "relevant trust" is ...
> (ii) a non-UK trust which is an express trust; and
> (aa) receives income from a source in the UK; or
> (bb) has assets in the UK,
> on which it is liable to pay one or more of the taxes referred to in regulation 45(14)[22]

The final phrase ("on which it is liable to pay one or more of the taxes referred to in reg 45(14)") appears to govern para (bb) only, and does not govern para (aa). But the question will not often arise, as if income has a UK source, then UK tax will normally follow.

Suppose a chargeable gain from assets in the UK accrues to a trust and the trust thereby becomes taxable, either because it is a gain on a disposal of UK land or because the trust is UK resident. It is considered that the trust becomes taxable at the end of the tax year when the gain accrues, (not at the actual time when the gain accrues) because CGT is charged on net gains less losses, which is only determined at the end of the year.

The TRS Manual considers whether a settlor-interested trust is liable to pay income tax:

> **TRSM10030 common types of trusts and interaction with the register** [Jul 2022]
> Income arising to a settlor-interested trust is treated as the settlor's income for tax purposes. However, s646(8) ITTIOA 2005 provides that the trustees also have a concurrent liability to that tax[23] and therefore a settlor-interested trust is required to register for taxable purposes if it has a UK tax liability (see TRSM25000).

[22] For this list of taxes, see 131.14 (Taxable relevant trust).

[23] See 47.11.1 (Tax on trust income).

131.9 Rel trust (iii): Other UK link

There are two types of relevant trust type (iii).

131.9.1 *Trust holds UK land*

Reg 42(2)(b) MLR provides:

> (b) a "relevant trust" is ...
> (iii) any other non-UK trust which
> [A] is an express trust,
> [B] is not a trust listed in Schedule 3A (excluded trusts)
> [C] and whose trustees (in their capacity as such)—
> (aa) acquire an interest in land in the UK ...

131.9.2 *Non-UK trust with UK trustee*

Reg 42(2)(b) MLR provides:

> (b) a "relevant trust" is ...
> (iii) any other non-UK trust which
> [A] is an express trust,
> [B] is not a trust listed in Schedule 3A (excluded trusts)
> [C] and whose trustees (in their capacity as such) ...
> (bb) enter into a business relationship with a relevant [regulated] person, where
> [I] at least one of those trustees is resident in the UK and
> [II] the trust is not an EEA registered trust;

This requires a non-resident trust with one or more UK resident trustees, which will be rare.[24]

131.10 Underlying trust company

131.10.1 *Underlying co has UK residence*

Suppose a non-UK trust owns a non-UK company which owns a UK residence. It does not have a UK asset: the company owns the UK asset. So it is not a relevant trust type (ii) (one which "has assets in the UK", "on which it is liable" to pay UK taxes.

STEP wrote to HMRC as follows:[25]

[24] See 7.6 (Mixed-resident trustees).

[25] As far as TRS is concerned, the STEP letter is not important following HMRC's climb-down. But I set it out at length here as it illustrates how the IHT residence-

> We accept that, on a purposive reading, it might just about be possible to treat a trust in these circumstances as if it "has" a UK asset but frankly we think that is straining the wording of the legislation. ... Even assuming it could be said that the trust has a UK asset (which we do not think is the correct interpretation), it is quite clear that the trust is not liable to pay inheritance tax on that asset.
>
> ... the way schedule A1 IHTA works is that inheritance tax is paid on the shares in the non-UK company to the extent that the value of those shares is attributable to the value of the UK residential property. The inheritance tax is therefore being paid on a non-UK asset (which is prevented by schedule A1 IHTA from being "excluded property" for inheritance tax purposes) and not on a UK asset. ...
>
> We do understand that the purpose of the inheritance tax changes is to put taxpayers who own UK residential property through an overseas structure in broadly the same position as if they had owned it direct but the fact is that parliament chose to do that by charging tax on the shares in the overseas company and not on the UK residential property itself. Obligations cannot be imposed on trustees based on what the regulations might have said had the draftsman thought about this point. Instead, the regulations should be applied based on what they actually say...[26]

HMRC rightly accepted this, and TRSM now provides:

> **TRSM25030: when does a trust liability to UK taxation trigger the requirement to register** [Jun 2022]
>
> ... The requirement to register is not triggered by a UK tax liability arising to the trustees from non-UK assets. This includes situations where trustees are liable under Schedule A1 IHTA84 to Inheritance Tax on shares in a non-UK company to the extent that the value of those shares is attributable to the value of UK residential property, because the tax liability has arisen from non-UK assets.
>
> Where a trust owns shares in a company and that company owns UK assets which trigger a UK tax liability, this would not ordinarily trigger the requirement for the trust to register on TRS because the liability arises to the company rather than to the trustees.
>
> However, if the ownership of any asset (or receipt of income from the asset) is treated as a 'look through' for any relevant tax purposes such that any UK tax liability is the tax liability of the trustees and not the company then the trustees will need to register the trust on TRS.

property code operates, which is important. See 82.2.1 (Effect of de-exclusion).

[26] See App 7.12 (Piercing corporate veil/facade).

> **Non-UK trusts & CGT on UK Property Account**
> Though the requirement to register is not triggered by a UK tax liability arising to the trustees from non-UK assets, non-UK trusts that become liable to non-resident Capital Gains Tax (NRCGT) on a disposal of non-UK shares must register with TRS for the purpose of obtaining a Unique Taxpayer Reference (UTR) number before creating a CGT on UK Property Account. Trusts registered for this purpose are not required to keep the information on the register up to date and are not subject to the third party access provisions set out at TRSM60000.
> Where trustees need to report a disposal of property or land but there is no NRCGT liability to pay, there is no requirement to obtain a trust UTR or TRN via TRS. In this circumstance, trustees can request a CGT on UK Property Account paper return. Paper returns may be requested by contacting HMRC.

131.10.2 *Underlying Co has business relationship*

Law Soc non-corporate TRS guidance provides (p.5):

> Absent any UK tax liability, a trust is not required to register with the TRS if the trustees own a company (as a trust asset) which enters into the business relationship with the UK relevant [regulated] person. The business relationship would need to be entered into by the trustees themselves to fall within the Type B category.
> Similarly, a Type C scope trust, even one with no UK resident trustees, will not need to register with the TRS if the trust owns a company which acquires an interest in UK land.

131.11 Excluded trusts

Sch 3A MLR is headed “Excluded Trusts”. Excluded trusts are not type 10A/B/C or A/B/C trusts, so they are not subject to the duties imposed on those types of trust. Excluded trusts also fall outside relevant trust type (iii). However they may fall within relevant trust type (i) and (ii), in which case they are subject to the duties imposed on relevant trusts. If they are taxable they are required to register. So the label “excluded trust” is not entirely apt. Perhaps the drafter thought that too, as MLR generally refers to these as trusts “listed in Schedule 3A”. But we need short labels, and I use the term “excluded trust” for lack of better; the reader will have to bear in mind that (so called) excluded trusts are only excluded from *some* of the MLR obligations which normally apply to trusts.

Sch 3A MLR sets out 23 categories, or sets of categories, of excluded trust:

Sch 3A para	Category	See para
1, 2	Trusts made by statute/Court	131.12.1
3	Pension trusts	131.12.2
5	Charitable trusts	131.12.3
6	Pre-2020 pilot trusts	131.12.4
6A	Bank account trusts	131.12.5
9	Co-ownership trusts	131.12.6
10	Financial markets infrastructure	131.12.7
11	Safeguarding/administering investments	131.12.8
11	Authorised unit trusts	131.12.9
11	Escrow agreement	131.12.10
12	Client money, etc	131.12.11
13	Capital markets	131.12.12
14	Commercial transactions	131.12.13
15	Conveyancing trusts	131.12.14
16, 17, 22	IHT relieved trusts	131.12.15
18	PI trusts	131.12.16
19	Service charge funds	131.12.17
20, 21	Share schemes	131.12.18
23	Public authorities	131.12.19
4, 8	Trust holding policies	131.12.20
7	Short term will trusts	131.13.2

131.12 Excluded trust categories

131.12.1 *Trusts made by statute/Court*

Sch 3A MLR provides:

> **Legislative Trusts**
> 1 A trust imposed or required by an enactment.
> **Trusts imposed by court order**
> 2 A trust created by, or in order to satisfy the terms of, an order of a court or tribunal.

131.12.2 *Pension trusts*

Sch 3A MLR provides:

> **Pension scheme trusts**
> 3 A trust holding sums or assets of a pension scheme which is a registered pension scheme for the purposes of Part 4 of the Finance Act 2004....

131.12.3 *Charitable trusts*

Sch 3A MLR provides:

> **Charitable trusts**
> 5 A trust for charitable purposes which—
> (a) in Scotland or Northern Ireland, is registered as a charity; or
> (b) in England and Wales, is registered as a charity or not required to register by virtue of section 30(2)(a) to (d) of the Charities Act 2011.[27]

131.12.4 *Pre-2020 pilot trusts*

Sch 3A MLR provides:

> **Pilot trusts**
> 6 A trust which—
> (a) holds property with a value not exceeding £100, and
> (b) was created before the date on which regulation 42(2)(iii) of these Regulations comes into force.

HMRC identify the date on which reg 42(2)(iii) comes into force as 6 October 2020. TRSM provides:

> **TRSM23090 historic pilot trusts** [Dec 2021]
> ... There is no exclusion for trusts holding a nominal amount where that trust was created on or after 6 October 2020. These must be included on the register.
> **Example** (Jared)
> As part of his estate planning, J set up a trust in 1987 that would receive assets on his death. This trust was set up with £10 and there have been no additions to the trust since. The trustees of this trust therefore do not have to register the trust on TRS.
> J dies in 2024. As provided for under the terms of his will, the trust receives £200,000 from his estate. The trust is required to register from the date these funds are transferred into the trust. Note that the trust was created in J's lifetime, so the exclusion for trusts created by will (see TRSM23020) does not apply.

TRSM provides:

> **TRSM23020 Estates And Trusts Created On Death** [Oct 2022]
> **Wills that interact with existing trusts or property trusts**
> A will may direct an addition to an existing trust; this would not be a trust created by will and so would not be within the exemption.

[27] On TRS for charitable trusts, see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 47.3.1 (Trust registration service) online edition *https://taxationofcharities.co.uk*

> *Example (Sunita)*
> S sets up a trust on 1 May 2012 with a nominal £10. The trust lists her sister and her child as beneficiaries. S also amends her will so that her share portfolio will transfer to the trust on her death.
> S dies on 1 February 2023 and the shares are transferred into the trust. The exclusion from registration does not apply as the trust was not created by the will. During S's lifetime the trust was excluded from registration as a historic pilot trust (see TRSM23090), but the trust is required to register from the point the assets are transferred into the trust following her death.
> A trust on death may also interact with an existing trust.

In practice, pilot trusts are not used in this way.

131.12.5 *Bank account trusts*

Sch 3A MLR provides:

> **Bank accounts for minors etc**
> 6A(1) A trust which is created as a requirement of opening a relevant account[28]

[28] Defined in para 6A(2):

> "In this paragraph—
> "relevant account" means an account, consisting only of a sum of money, held with an authorised Part 4A person carrying on by way of business the activity specified in article 5 (accepting deposits) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001;
> "authorised Part 4A person" means an authorised person who has a Part 4A permission, within the meaning given to that term in section 55A(5) of FSMA, to carry on that specified activity."

That takes us to art 5 Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 which provides:

> "(1) Accepting deposits is a specified kind of activity if—
> (a) money received by way of deposit is lent to others; or
> (b) any other activity of the person accepting the deposit is financed wholly, or to a material extent, out of the capital of or interest on money received by way of deposit.
> (2) In paragraph (1), "deposit" means a sum of money, other than one excluded by any of articles 6 to 9A, paid on terms—
> (a) under which it will be repaid, with or without interest or premium, and either on demand or at a time or in circumstances agreed by or on behalf of the person making the payment and the person receiving it; and
> (b) which are not referable to the provision of property (other than currency) or services or the giving of security.
> (3) For the purposes of paragraph (2), money is paid on terms which are referable to the provision of property or services or the giving of security if, and only if—

> for the sole benefit of—
> (a) a person under the age of 18;

The other categories are for persons lacking capacity in a UK jurisdiction and are conveniently read side to side:

6A(1) A trust which is created as a requirement of opening a relevant account[29] for the sole benefit of—

English law: para 6A(1)(b)	**Scots law: para 6A(1)(c)**	**N.I. Law: para 6A(1)(d)**
a person who lacks capacity within the meaning of section 2 of the Mental Capacity Act 2005	a person who is incapable within the meaning of section 1 of the Adults with Incapacity (Scotland) Act 2000; or	a person who is incapable of managing and administering the person's property and affairs, by reason of mental disorder within the meaning of Article 3(1) of the Mental Health (Northern Ireland) Order 1986.

131.12.6 *Co-ownership trusts*

Sch 3A MLR provides:

> **Co-ownership**
> 9 A trust of jointly held property where the trustees and the beneficiaries are the same persons.

(a) it is paid by way of advance or part payment under a contract for the sale, hire or other provision of property or services, and is repayable only in the event that the property or services is or are not in fact sold, hired or otherwise provided;
(b) it is paid by way of security for the performance of a contract or by way of security in respect of loss which may result from the non-performance of a contract; or
(c) without prejudice to sub-paragraph (b), it is paid by way of security for the delivery up or return of any property, whether in a particular state of repair or otherwise."

[29] Defined in para 6A(2):
"In this paragraph—
"relevant account" means an account, consisting only of a sum of money, held with an authorised Part 4A person carrying on by way of business the activity specified in article 5 (accepting deposits) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001;
"authorised Part 4A person" means an authorised person who has a Part 4A permission, within the meaning given to that term in section 55A(5) of FSMA, to carry on that specified activity."

TRSM provides:

> **TRSM23020 Estates And Trusts Created On Death** [Oct 2022]
> Example (Alice, Bob, Clara and David)
> A and Bob own a property with a declaration of trust confirming they own as tenants in common. This trust is excluded from registration during A's lifetime as an exempt co-ownership trust (see TRSM23050).
> A dies and by the terms of her will leaves her share of the property on trust to B to occupy for the remainder of his life; and thereafter to her daughter C. A's son D is appointed as executor and trustee of the will and also appointed as a second trustee of the property with B.
> There are two trusts: 1) the new trust created by A's will; and 2) the ongoing trust of the property.

That is correct.

> The trust created by A's will is excluded from the requirement to register for two years following A's death. If the trust is still in existence two years after A's death, the trust is required to register from that point.

That is only right if the estate is by then administered.

> The ongoing trust of the property is no longer an exempt co-ownership trust as the trustees and beneficiaries are not the same persons – see TRSM23050. Registration is required 90 days after A's death.
> If C were appointed as the second trustee of the property instead of D, then this would still be an exempt co-ownership trust as the trustees and beneficiaries would be the same persons, and therefore registration would not be required.
> The co-ownership exemption is only relevant in relation to the co-ownership trust; the will trust needs to be registered. The co-ownership exemption would not be relevant where there was no co-ownership trust.

131.12.7 *Financial markets infrastructure*

Sch 3A MLR provides:

Financial markets infrastructure

10 (1) A trust—

(a) created under, or for the purpose of, the default arrangements of a designated system or of the default rules of a recognised body, or for the purpose of any action or proceedings taken by or for such a system or body under such arrangements or rules;

(b) relating to the creation of a beneficial interest in securities belonging to a person whose name and address are maintained on a register of securities (within the meaning of regulation 3(1) of the Uncertificated Securities Regulations 2001); or

(c) created by or for a segregating entity—
 (i) for the purpose of protecting sums or assets belonging to the segregating entity's clients; or
 (ii) for the purpose of complying with a legal obligation to safeguard and segregate sums or assets belonging to the segregating entity's clients or to keep separate client records and accounts.

[Para (2) sets out definitions for para 10(1) which are not considered here].

131.12.8 *Safeguarding/administering investments*

The heading of para 11 Sch 3A MLR is "professional services" but this covers a range of trusts.

Para 11 Sch 3A MLR provides:

11 A trust created for the purpose of enabling or facilitating the holding of sums, assets or (in the case of sub-paragraph (c)), documents, belonging to a person other than the trustee, in connection with which sums, assets or documents the trustee is—

(a) carrying on by way of business the activity specified in article 40 (safeguarding and administering investments) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001;

This takes us to para 40 which provides:

(1) The activity consisting of both—
(a)the safeguarding of assets belonging to another, and
(b)the administration of those assets,
or arranging for one or more other persons to carry on that activity, is a specified kind of activity if the condition in sub-paragraph (a) or (b) of paragraph (2) is met.
(2)The condition is that—
(a)the assets consist of or include any investment which is a security or a contractually based investment; or
(b)the arrangements for their safeguarding and administration are such that the assets may consist of or include such investments, and either the assets have at any time since 1st June 1997 done so, or the arrangements have at any time (whether before or after that date) been held out as ones under which such investments would be safeguarded and administered.
(3)For the purposes of this article—
(a)it is immaterial that title to the assets safeguarded and administered is held in uncertificated form;
(b)it is immaterial that the assets safeguarded and administered may be transferred to another person, subject to a commitment by the person safeguarding and administering them, or arranging for their safeguarding and administration, that they will be replaced by equivalent assets at some future date or when so requested by the person to whom they belong.

131.12.9 *Authorised unit trusts*

Para 11 Sch 3A MLR provides:

11 A trust created for the purpose of enabling or facilitating the holding of sums, assets or (in the case of sub-paragraph (c)), documents, belonging to a person other than the trustee, in connection with which sums, assets or documents the trustee is ...

(b) acting by way of business as the trustee of an authorised unit trust scheme (and for this purpose "trustee" and "authorised unit trust scheme" have the meanings given in section 237 of FSMA)

131.12.10 *Escrow agreement*

Para 11 Sch 3A MLR provides:

11 A trust created for the purpose of enabling or facilitating the holding of sums, assets or (in the case of sub-paragraph (c)), documents, belonging to a person other than the trustee, in connection with which sums, assets or documents the trustee is ...

(c) acting by way of business as an agent holding sums, assets or documents in escrow until the performance of a contractual condition agreed between two or more other persons, including the person for whom the sums, assets or documents are being held.

131.12.11 *Client money, etc*

Para 12 Sch 3A MLR provides

A trust created by a relevant supervised person[30] for the purpose of holding client money, securities or other assets, where that trust is incidental to the carrying on of business by the relevant supervised person.

131.12.12 *Capital markets*

Para 13 Sch 3A MLR provides:

A trust created for the purpose of enabling or facilitating an activity listed in points 2, 3, 6, 7 or 8 of Annex 1 to the capital requirements directive as set out in Schedule 2, or for protecting or enforcing rights relating to that activity, where—

(a) one or more of the participants in that activity is a relevant supervised person, and
(b) the use of the trust is incidental to the principal purpose of that activity.

131.12.13 *Commercial transactions*

Sch 3A MLR provides:

[30] This term is used in para 12 and 13, and is defined in para 24: "In this Schedule, "relevant supervised person" means—

(a) a relevant [regulated] person; or
(b) a person who is subject to requirements in national legislation having an equivalent effect to those laid down in the fourth money laundering directive on an obliged entity (within the meaning of that directive) and supervised for compliance with those requirements in a manner equivalent to section 2 of Chapter VI of the fourth money laundering directive.

> **Commercial transactions**
> 14 A trust created for the purpose of—
> (a) enabling or facilitating a transaction effected for genuine commercial reasons; or
> (b) protecting or enforcing rights relating to such a transaction,
> where the use of the trust is incidental to the principal purpose of the transaction.

131.12.14 *Conveyancing trusts*

Sch 3A MLR provides:

> **Registration of assets**
> 15 A trust created on the transfer or disposal of an asset where the purpose of the trust is to hold the legal title to the asset on trust for the person to whom the transfer or disposal is being made until the time when the procedure required by law to effect the transfer or disposal of legal title is completed.

131.12.15 *IHT relieved trusts*

Sch 3A MLR provides:

> **Trusts meeting legislative requirements**
> 16 A trust holding property to which section 71A [Bereaved minors trust] or 71D [Age 18-25 trusts] of the Inheritance Tax Act 1984 applies.

In practice a bereaved minors trust is rare, and an age 18-25 trust is best avoided.

> 22 A trust holding property for a beneficiary who is a disabled person within the meaning given by Schedule 1A to the Finance Act 2005.

This is also rare. It is difficult to see why any of these trusts should be excepted trusts.
Sch 3A MLR provides:

> 17 A trust of property in respect of which a direction under paragraph 1 of Schedule 4 [maintenance funds for historic buildings] to the Inheritance Tax Act 1984 has effect.

This is a specialist topic

131.12.16 *Personal injury trusts*

Sch 3A MLR provides:

> 18 A trust of funds derived from a payment—
> (a) made for the benefit of a person in consequence of a personal injury to that person, and
> (b) disregarded from capital under regulation 46(2) of, and paragraph 12 of Schedule 10 to, the Income Support (General) Regulations 1987.

131.12.17 *Service charge funds*

Sch 3A MLR provides:

> 19 A trust holding tenants' contributions for the purposes of section 42 of the Landlord and Tenant Act 1987.

131.12.18 *Share schemes*

Sch 3A MLR provides:

> 20 The plan trust of a share incentive plan which meets the requirements of Part 9 of Schedule 2 to the Income Tax (Earnings and Pensions) Act 2003.
> 21 A trust created under a share option scheme that meets the requirements of Parts 2 to 7 of Schedule 3 to the Income Tax (Earnings and Pensions) Act 2003.

131.12.19 *Public authorities*

Sch 3A MLR provides:

> 23 A trust created for the purposes of enabling or assisting—
> (a) a public authority, within the meaning of section 3(1) of the Freedom of Information Act 2000, or a body specified in section 80(2) of that Act;
> (b) a Scottish public authority, within the meaning of section 3(1) of the Freedom of Information (Scotland) Act 2002;
> (c) the Security Service, the Secret Intelligence Service, the Government Communications Headquarters or the National Crime Agency; or
> (d) the Welsh Assembly Government,
> to carry out its functions, including any functions as a court or tribunal and, in the case of the Bank of England, any of its functions as a monetary authority within the meaning of section 244(2)(c) of the Banking Act 2009.

131.12.20 *Trust holding policies*

Sch 3A MLR provides 4 categories of excluded trusts which relate to life or insurance policies:

> 4(1) A trust of a life policy paying out only—
>
> (a) on the death, terminal or critical illness, or permanent or temporary disablement of the person assured; or
>
> (b) to meet the cost of healthcare services provided to the person assured.
>
> (2) A trust of an insurance policy paying out only—
>
> (a) on the temporary disablement of the person assured, where that policy was applied for at the same time as a policy under sub-paragraph (1); or
>
> (b) to meet the cost of healthcare services provided to the person assured.
>
> (3) A trust of the benefits payable on the death of the person assured under a retirement policy.
>
> 8 A trust where—
>
> (a) the trust is holding only benefits received on the death of the person assured under a policy within paragraph 4, and
>
> (b) less than two years has passed since that person's death.

TRSM provides:

> **TRSM23030 Insurance Policies And Compensation Pay-Outs** [Jul 2022]
>
> **...Policies with surrender values**
>
> Some policies can be surrendered by the policyholder for a cash sum during the term of the policy. The possibility of a policy being surrendered does not in itself mean that a trust holding that policy cannot qualify for the exclusion at Sch3A(4). This is because HMRC accepts that the surrendering of a policy does not ordinarily constitute a pay out from that policy.
>
> The general position is that trusts holding policies with surrender values can remain excluded from registration under Sch3A(4) until such time as the policy is actually surrendered. If a policy is surrendered and the cash sum is retained in the trust, the trust would be required to register from that point.
>
> **Example** (Iqbal)
>
> > I takes out a whole of life insurance policy, which is written into trust at commencement. The policy will only pay out on the event of I's death, but the policy is able to be surrendered for a cash value during I's lifetime. As this meets the conditions set out above, the trust holding the policy is excluded from registration on TRS.
>
> However, some policies (such as investment bonds) are designed to

> provide regular or periodic payments to the policyholder in the form of surrenders or part-surrenders during the term of the policy, with a small life assurance element payable on death which is incidental to the benefits provided through the surrenders. In those cases, HMRC's view is that the withdrawals of cash in the event of a part or full surrender does constitute a pay out from the policy, because those withdrawals are intended from the outset as expected payments of funds from the policy. As this occurs on an occasion other than those listed at Sch3A(4), the exclusion does not apply to trusts holding these policies.
>
> **Example** (Margaret)
>
> > M takes out an investment bond which she places in trust. Under the terms of the policy, M is able to withdraw up to 5% of the funds invested per year in the form of a part-surrender of the policy. As these withdrawals are anticipated as an integral part of the design of the policy, they do constitute pay outs from that policy. As these pay outs are on occasions other than those listed at Sch3A(4), the exclusion from registration on TRS does not apply.

131.13 Estates and will trusts

131.13.1 *Estate of deceased person*

The estate of a deceased person in the course of administration does not have to register under TRS as it is not a trust.[31]

However "complex" estates need to obtain a UTR in order to submit returns, and a UTR is obtained by registering under the TRS system.[32]

TRSM provides:

> **TRSM23020 Estates And Trusts Created On Death** [Oct 2022]
>
> The complex estate registration is for administration period tax purposes only, and is separate from registration under TRS, which requires registration as a trust rather than an estate, even if the trust covers or relates to the period of administration of the estate. Therefore, if there is a will trust which needs to be registered as well as a complex estate, the complex estate UTR (unique taxpayer reference) should not be used when registering the will trust.

Jack Harper comments in the Trusts Discussion Forum:

> HMRC are using the TRS as a means of notifying the existence of what they call "complex" estates. This is not authorised by the TRS

[31] See 88.1.1 (Estate is not a trust).

[32] See 89.21 (Tax returns & registration).

regulations but no one, least of all HMRC, seems to be worried that this may be outside their lawful powers. The line of least resistance is to comply. But note that this action does not supersede the need to comply also with s7 TMA or precluding it by filing an estate tax return.

During the administration period there is no trust subsisting so none needs to be registered separately. HMRC acknowledge that legal analysis as correct but do not fully reflect it by their practice. It is a requirement to estimate the asset value when registering a taxable trust but that is for later.

A crunch point may arise 2 years after death or when the admin period ends as regards the trust assets if earlier. It is then that a trust declared by the Will may need to be registered. HMRC seem to regard that as necessary for a non-taxable trust at the 2 year point even if the admin period has not then ended as regards the trust assets, which is wrong in law and inconsistent with their view in e.g. TSEM6035 and 6045. Estates and trusts are even dealt with by separate departments within HMRC. Again compliance is the expedient route. But that is not how taxable trusts are to be dealt with. They must be notified via TRS by a deadline linked to the date a tax liability arises TRSM40030. They need a separate UTR and not that previously given to the estate: TRSM27030.

131.13.2 *Short term will trusts*

Sch 3A MLR provides:

> **Trusts having effect on death**
>
> 7 (1) A trust effected by will where—
>
> (a) the trust is holding only the property comprised in a person's estate on death, and
>
> (b) less than two years has passed since that person's death.
>
> (2) In this paragraph, a person's "estate" means the aggregate of all the property to which that person is beneficially entitled

In short, short term will trusts are excluded trusts. This only arises if the period of administration is less than two years.

TRSM provides:

> **TRSM23020 Estates And Trusts Created On Death** [Oct 2022]
>
> ... If an estate administration is completed within 2 years, but there is an ongoing express trust, this ongoing trust would need to register on TRS after two years from the date of death.
>
> *Example* (Imre, Lydia and Natalie)
>
> I dies on 10 January 2022. His will appoints L as his executor and leaves

£500,000 on trust for his minor granddaughter N.
L deals with the estate which is fully administered by 1 July 2023. The trust of the legacy continues for a further five years until N reaches the age of 18.
The trust of the legacy to N commences from the date death. However, as a trust created by will this trust is not required to register until 10 January 2024, 2 years after the date of death...

131.13.3 *Will not creating express trust*

TRSM provides:

> **TRSM23020 Estates And Trusts Created On Death** [Oct 2022]
> **Estates in administration for more than two years**
> A trust is only required to register on TRS if it is an express trust, so if the will does not create a trust then no registration is required.
> *Example* (Paula, Ronald and Leona)
> P dies in England on 6 July 2022. Her will states that she appoints R as her executor and directs him to pay all debts and funeral expenses and transfer her residuary estate to her daughter L.
> The executor is not appointed as a trustee and no trust is declared over the estate. Any trust which arises is through operation of law because of R’s duties as executor and so is not an express trust. No TRS registration is required regardless of the length of the administration period.

131.13.4 *Will creates express trust*

TRSM goes wrong here. It provides:

> **TRSM23020 Estates And Trusts Created On Death** [Oct 2022]
> A will may create an express trust. If that trust is still in existence at two years from the date of death, it will need to be registered on TRS. A careful examination of the wording of the will is needed to understand what type of trust it creates and when it arises. Some examples are below.
> 1. A will may expressly state that the executor holds the estate upon trust as part of the administration of the estate, sometimes known as an administration trust. Example wording:
>
> > I give my estate to my executors on trust with power at their discretion to sell all or any part of parts of such property when they think fit. My executors shall pay my funeral and testamentary expenses my debts and any legacies given by this will out of such property or its proceeds of sale and hold the balance upon trust for such of Donald, Harold and Michaela as are living at my death and

> if more than one in equal shares.
>
> Whilst there may be overlap between the duties of an executor and a trustee, there is clearly an express trust which covers the administration period and therefore starts from the date of death.So, if the administration of the estate continues after 2 years from date of death it must be registered on TRS as a will trust rather than as an estate. This trust would continue until all of the assets are paid outright to Donald, Harold and Michaela.

That is not right: no trust comes into effect until the completion of administration.

> 2. A will may leave a specific amount of money or an asset as a legacy to hold on trust, rather than as part of the residuary estate. This trust is also treated as coming into effect on death and therefore, if it continues after 2 years from date of death it must be registered on TRS.

That is wrong for the same reason.

> 3. Other trusts effected by will may commence at a later date, either during or before the end of the administration period. In such cases the trust is not required to register until assets have been transferred from the estate to the trust, and only from 2 years following the date of death. *[Example* Sophie and Gisele]
>
> For example a will may appoint executors without creating a trust but confirm that the residuary estate is held on trust:
>
> > "I appoint S as my executor to pay my debts, funeral expenses and to hold the balance upon trust for G absolutely"
>
> Here, the trust technically comes into existence when the administration period has ended and Sn switches role from executor to trustee.It may be difficult to ascertain when this occurs. If the assets have not been transferred to G within 2 years of death than the trust needs to be registered at that point if the administration period has ended or at the date when the administration period ends if later.

That at least is correct. The Manual continues

> These rules may interact as various trusts can be created by one will.
>
> Example (George, Harry, Jerry, Philip and Rosa)
>
> George dies in England on 4 August 2022. His will appoints Harry as his executor and leaves £500,000 on trust for his husband Jerry, during his lifetime, and then for his son Philip. George leaves the residuary estate on trust for Philip and his daughter Rosa. The estate administration takes longer than anticipated and the residuary estate is assented by the executors to themselves as trustees of the residuary fund on 16

> December 2025.

The HMRC analysis is as follows:

> The trust of the legacy commences from death and, if still in existence two years from the date of death, it will need to be registered on TRS.

Wrong.

> The trust of the residuary estate begins when assets are appropriated (transferred) to the trustees or when the administration period ends. The trust of the residuary estate would therefore need to be registered after 16 December 2025 – until then the trust is not in existence as the trustees do not have any assets.

Correct.

> If the wording of the will had been different, so that the estate was given to the executors upon trust, the trust would need to be registered from 4 August 2024. However, provided the trustees are the same this is not a different trust from the residuary estate trust and only one registration is required.

The first sentence is wrong and the second, right.

> *Example (Charles & Debra)*
> C and D live together in a property owned outright by C. C dies and by the terms of his will creates a trust which gives D a life interest in the property, with the trustees having the power to sell and purchase a replacement property on the same terms. As a trust created by will, the trustees are not required to register the trust immediately on C's death. 12 months following C's death, the trustees sell the property and use the proceeds to purchase another property of similar value on the same terms, with D retaining her life interest.
> As the trust fund still consists only of property from C's estate (there has been a substitution but no additions), the trust is still excluded from registration. If the trust is still in existence two years after C's death, the trust will be required to register from that point.

131.13.5 *Deeds of variation*

TRSM provides:

> **TRSM23020 Estates And Trusts Created On Death** [Oct 2022]
> **Trusts created by Deeds of Variation**
> If the beneficiaries under a will or intestacy create a Deed of Variation which includes a trust, the trust is created by the Deed of Variation and

> not by the will, so the exclusion from registration [for short term will trusts] will not apply.
>
> *Example* (Caroline & Martha)
>
> C leaves her estate to M. M decides to enter into a Deed of Variation to give her entitlement to a trust for her sisters and their two children. Although certain tax provisions may apply as if this trust was included in the will (see IHTM35011), in general law a variation takes effect from the date of the deed. The settlor of this trust is M (see TRSM32040) and it comes into existence when the deed of variation is made (if assets are already available for the trust, or when assets are transferred to be held on the trusts if the estate has not yet been fully administered). This is not a trust created by will and therefore the 2 year exemption does not apply.

131.13.6 *Intestacy*

TRSM provides:

> **TRSM23020 Estates And Trusts Created On Death** [Oct 2022]
>
> **Intestacy and trust creation**
>
> In some cases in England and Wales, trusts may be created in the absence of a will under the intestacy rules. These will hold the assets on behalf of the individuals, often minors. These trusts are statutory trusts, imposed by legislation. Trusts for bereaved minors can be created on intestacy in this way.
>
> As these were not intentionally created by the settlor, trusts created in these instances are not express trusts and therefore not registrable express trusts for the purposes of TRS, see TRSM21030.

131.14 "Taxable" relevant trust

Reg 45(14) MLR provides:

> For the purposes of this regulation, a taxable relevant trust is
>
> [a] a relevant trust[33]
>
> [b] in any year in which its trustees are liable to pay any of the following taxes in the UK in relation to assets or income of the trust—

This definition only applies for the purposes of reg 45, but it is incorporated by reference elsewhere.

There are 7 taxes in this list:[34]

[33] See 131.5 (Relevant trust).

[34] For clarity I have set this out in tabular form and with my own wording, rather than that in the statute.

(1) Income tax
(2) Capital gains tax
(3) Inheritance tax
(4) Stamp taxes:
 (a) stamp duty land tax
 (b) land and buildings transaction tax (Scotland)
 (c) land transaction tax (Wales)
 (d) stamp duty reserve tax

I refer to these together as "UK taxes".

Corporation tax is not included as a trust will not be liable to CT.

Section 1(3) amounts (trust gains) and foreign income within s.624/720 do not count, as non-resident trustees are not taxable on that.

A trust may be a taxable relevant trust in one year but not in another year.

131.15 Beneficial Owner: MLR meaning

Beneficial Owner is elaborately defined. To an English practitioner, the label seems inapt, as the MLR definition does not correspond to the English property/trust law meaning, or indeed to the natural meaning, if there is such a thing.[35] But in the context of moneylaundering the wide usage of this term is long established.[36] I write the term with initial capitals, to reflect the technical nature of the expression.

131.16 Beneficial Owner: Company

Reg 5(1) MLR provides an artificially wide definition of "beneficial owner" of a body corporate:

> In these Regulations, "beneficial owner", in relation to a body corporate which is not a company whose securities are listed on a regulated market, means—
> (a) any individual who exercises ultimate control over the management of the body corporate;
> (b) any individual who ultimately owns or controls (in each case whether directly or indirectly), including through bearer share holdings or by other means, more than 25% of the shares or voting rights in the body corporate; or
> (c) an individual who controls the body corporate.

[35] See App App 6.1 (Beneficial ownership: Meanings). CRS uses the more apt term "Controlling Persons"; see 130.23 (Controlling person).

[36] I give references in the 2018/19 edition of this work para 67.14.1 (Beneficial ownership: Meanings) but omit that material here as it is of historical interest only.

131.17 Control of company

"Control" matters because if a person (a controller) "controls" a company:

(1) the controller is a Beneficial Owner of the company
(2) If the company has control of a trust, the controller has control of the trust.

Needless to say, "control" has a wide definition which goes far beyond "control" in the normal sense.

There are two categories of control, which I call:

(1) Significant control
(2) Subsidiary undertaking

131.17.1 *Significant control/subsidiary*

Reg 5(2) MLR provides:

> For the purposes of paragraph (1)(c),[37] an individual controls a body corporate if—
>
> (a) [i] the body corporate is a company or a limited liability partnership and
> [ii] that individual satisfies one or more of the conditions set out in Part 1 of Schedule 1A to the Companies Act 2006 (people with significant control over a company)
>
> (b) the body corporate would be a subsidiary undertaking of the individual (if the individual was an undertaking) under section 1162 (parent and subsidiary undertakings) of the Companies Act 2006 read with Schedule 7 to that Act.

It is helpful to read sch 1A/s.1162 CA 2006 side by side:

sch 1A: Significant control	**s.1162: subsidiary undertaking**
1 Introduction This Part of this Schedule specifies the conditions at least one of which must be met by an individual ("X") in relation to a company ("company Y") in order for the individual to be a person with "significant control" over the company.	(1) This section (together with Schedule 7) defines "parent undertaking" and "subsidiary undertaking" for the purposes of the Companies Acts. (2) An undertaking is a parent undertaking in relation to another undertaking, a subsidiary undertaking, if—
2 Ownership of shares The first condition is that X holds,	

[37] See 131.16 (Beneficial Owner: Company).

directly or indirectly, more than 25% of the shares in company Y.	
3 Ownership of voting rights The second condition is that X holds, directly or indirectly, more than 25% of the voting rights in company Y.	(a) it holds a majority of the voting rights in the undertaking, or (d) it is a member of the undertaking and controls alone, pursuant to an agreement with other shareholders or members, a majority of the voting rights in the undertaking.
4 Ownership of right to appoint or remove directors The third condition is that X holds the right, directly or indirectly, to appoint or remove a majority of the board of directors of company Y.	(b) it is a member of the undertaking[38] and has the right to appoint or remove a majority of its board of directors, or
5 Significant influence or control The fourth condition is that X has the right to exercise, or actually exercises, significant influence or control over company Y.	(c) it has the right to exercise a dominant influence over the undertaking— (i) by virtue of provisions contained in the undertaking's articles, or (ii) by virtue of a control contract, or
6 Trusts, partnerships etc The fifth condition is that— (a) the trustees of a trust or the members of a firm that, under the law by which it is governed, is not a legal person meet any of the other specified conditions (in their capacity as such) in relation to company Y, or would do so if they were individuals, and (b) X has the right to exercise, or	(4) An undertaking is also a parent undertaking in relation to another undertaking, a subsidiary undertaking, if— (a) it has the power to exercise, or actually exercises, dominant influence or control over it, or (b) it and the subsidiary undertaking are managed on a unified basis.

[38] Section 1162 CA 2006 provides the following definitions:

> (3) For the purposes of subsection (2) an undertaking shall be treated as a member of another undertaking—
>
> (a) if any of its subsidiary undertakings is a member of that undertaking, or
>
> (b) if any shares in that other undertaking are held by a person acting on behalf of the undertaking or any of its subsidiary undertakings...
>
> (6) Schedule 7 contains provisions explaining expressions used in this section and otherwise supplementing this section.
>
> (7) In this section and that Schedule references to shares, in relation to an undertaking, are to allotted shares.

actually exercises, significant influence or control over the activities of that trust or firm.

(5) A parent undertaking shall be treated as the parent undertaking of undertakings in relation to which any of its subsidiary undertakings are, or are to be treated as, parent undertakings; and references to its subsidiary undertakings shall be construed accordingly.

DBEIS have issued 19 pages of guidance on sch 1A.[39]

Schedule 7 CA 2006 provides:

1 Introduction

The provisions of this Schedule explain expressions used in section 1162 (parent and subsidiary undertakings) and otherwise supplement that section.

2 Voting rights in an undertaking

(1) In section 1162(2)(a) and (d) the references to the voting rights in an undertaking are to the rights conferred on shareholders in respect of their shares or, in the case of an undertaking not having a share capital, on members, to vote at general meetings of the undertaking on all, or substantially all, matters.

(2) In relation to an undertaking which does not have general meetings at which matters are decided by the exercise of voting rights the references to holding a majority of the voting rights in the undertaking shall be construed as references to having the right under the constitution of the undertaking to direct the overall policy of the undertaking or to alter the terms of its constitution.

3 Right to appoint or remove a majority of the directors

(1) In section 1162(2)(b) the reference to the right to appoint or remove a majority of the board of directors is to the right to appoint or remove directors holding a majority of the voting rights at meetings of the board on all, or substantially all, matters.

(2) An undertaking shall be treated as having the right to appoint to a directorship if—

(a) a person's appointment to it follows necessarily from his appointment as director of the undertaking, or

(b) the directorship is held by the undertaking itself.

(3) A right to appoint or remove which is exercisable only with the consent or concurrence of another person shall be left out of account unless no other person has a right to appoint or, as the case may be, remove in relation to that directorship.

Right to exercise dominant influence

(1) For the purposes of section 1162(2)(c) an undertaking shall not be regarded as having

[39] "Statutory Guidance on the Meaning of 'Significant Influence or Control' over Companies in the Context of the Register of People with Significant Control" (2017) *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/675104/psc-statutory-guidance-companies.pdf*

the right to exercise a dominant influence over another undertaking unless it has a right to give directions with respect to the operating and financial policies of that other undertaking which its directors are obliged to comply with whether or not they are for the benefit of that other undertaking.

(2) A “control contract” means a contract in writing conferring such a right which—

(a) is of a kind authorised by the articles of the undertaking in relation to which the right is exercisable, and

(b) is permitted by the law under which that undertaking is established.

(3) This paragraph shall not be read as affecting the construction of section 1162(4)(a).

5 Rights exercisable only in certain circumstances or temporarily incapable of exercise

(1) Rights which are exercisable only in certain circumstances shall be taken into account only—

(a) when the circumstances have arisen, and for so long as they continue to obtain, or

(b) when the circumstances are within the control of the person having the rights.

(2) Rights which are normally exercisable but are temporarily incapable of exercise shall continue to be taken into account.

Rights held by one person on behalf of another

6 Rights held by a person in a fiduciary capacity shall be treated as not held by him.

7(1) Rights held by a person as nominee for another shall be treated as held by the other.

(2) Rights shall be regarded as held as nominee for another if they are exercisable only on his instructions or with his consent or concurrence.

8 Rights attached to shares held by way of security

Rights attached to shares held by way of security shall be treated as held by the person providing the security—

(a) where apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in accordance with his instructions, and

(b) where the shares are held in connection with the granting of loans as part of normal business activities and apart from the right to exercise them for the purpose of preserving the value of the security, or of realising it, the rights are exercisable only in his interests.

9 Rights attributed to parent undertaking

(1) Rights shall be treated as held by a parent undertaking if they are held by any of its subsidiary undertakings.

(2) Nothing in paragraph 7 or 8 shall be construed as requiring rights held by a parent undertaking to be treated as held by any of its subsidiary undertakings.

(3) For the purposes of paragraph 8 rights shall be treated as being exercisable in accordance with the instructions or in the interests of an undertaking if they are exercisable in accordance with the instructions of or, as the case may be, in the interests of any group undertaking.

10 Disregard of certain rights

The voting rights in an undertaking shall be reduced by any rights held by the undertaking itself.

11 Supplementary

References in any provision of paragraphs 6 to 10 to rights held by a person include rights falling to be treated as held by him by virtue of any other provision of those paragraphs but not rights which by virtue of any such provision are to be treated as not held by him.

131.18 Beneficial Owner: Partnership

Reg 5(3) MLR provides:

> In these Regulations, "beneficial owner", in relation to a partnership (other than a limited liability partnership[40]), means any individual who—
> (a) ultimately is entitled to or controls (in each case whether directly or indirectly) more than 25% share of the capital or profits of the partnership or more than 25% of the voting rights in the partnership;
> (b) satisfies one or more the conditions set out in Part 1 of Schedule 1 to the Scottish Partnerships (Register of People with Significant Control) Regulations 2017 (references to people with significant control over an eligible Scottish partnership); or
> (c) otherwise exercises ultimate control over the management of the partnership.

131.19 Beneficial Owner: Trust

131.19.1 *Five categories*

Reg 6(1) MLR provides:

> In these Regulations, "beneficial owner", in relation to a trust, means each of the following—

There follows a list of five categories of Beneficial Owner:

> (a) the settlor;[41]
> (b) the trustees;
> (c) the beneficiaries;
> (d) where the individuals (or some of the individuals) benefiting from the trust have not been determined, the class of persons in whose main interest the trust is set up, or operates;
> (e) any individual who has control over the trust.

We have moved a long way from beneficial ownership in the natural

[40] LLPs are governed by the rules for bodies corporate.
Reg 5(4) MLR provides: "In this regulation "limited liability partnership" has the meaning given by the Limited Liability Partnerships Act 2000." But this is otiose: see 85.21.1 (Definition and nature of LLP).

[41] "Settlor" is not defined; see 99.2.16 (Settlor: Non-tax definitions).

sense. "In some way connected with" would be more apt.

131.19.2 *Individual controlling trust*

Reg 6(1) MLR provides:

> In these Regulations, "beneficial owner", in relation to a trust, means...
> (e) any individual who has control over the trust.

Reg 6(2) MLR provides:

> In paragraph (1)(e), "control" means a power (whether exercisable alone, jointly with another person or with the consent of another person) under the trust instrument or by law to—
> (a) dispose of, advance, lend, invest, pay or apply trust property;
> (b) vary or terminate the trust;
> (c) add or remove a person as a beneficiary or to or from a class of beneficiaries;
> (d) appoint or remove trustees or give another individual control over the trust;
> (e) direct, withhold consent to or veto the exercise of a power mentioned in sub-paragraphs (a) to (d).

This is a wide definition: some element of control is sufficient.

131.19.3 *Control of co involved in trust*

Reg 6(4) MLR provides:

> (4) For the purposes of paragraph (1)—
> (a) where an individual is the beneficial owner of a body corporate which is entitled to a specified interest in the capital of the trust property or which has control over the trust, the individual is to be regarded as entitled to the interest or having control over the trust

It may be convenient to have a label to refer to a company within (a), and I call it a company "involved" with the trust.

There are two rules here:

Control of company with specified interest in trust:

> (a) where an individual is the beneficial owner of a body corporate which is entitled to a specified interest[42] in the capital of the trust

[42] Regulation 6(5) MLR provides: "For the purposes of paragraph (4), "specified interest" means a vested interest which is—
(a) in possession or in remainder or reversion (or in Scotland, in fee); and

> property ... the individual is to be regarded as entitled to the interest
>
> *Controller of company with control over trust*
>
> (a) where an individual is the beneficial owner of a body corporate which ... has control over the trust, the individual is to be regarded as having control over the trust

131.19.4 *Control: Exceptions*

Reg 6(4) MLR sets out 4 powers which are not sufficient to amount to "control". Three of these are statutory powers, and the fourth is the power of beneficiaries under the rule in *Saunders v Vautier*:

> For the purposes of paragraph (1) ...
>
> (b) an individual ("P") does not have control solely as a result of—
> (i) P's consent being required in accordance with section 32(1)(c) (power of advancement) of the Trustee Act 1925;
> (ii) any discretion delegated to P under section 34 (power of investment and delegation) of the Pensions Act 1995;
> (iii) the power to give a direction conferred on P by section 19(2) (appointment and retirement of trustee at instance of beneficiaries) of the Trusts of Land and Appointment of Trustees Act 1996; or
> (iv) the power exercisable collectively at common law to vary or extinguish a trust where the beneficiaries under the trust are of full age and capacity and (taken together)
> [A] absolutely entitled to the property subject to the trust
> [B] (or, in Scotland, have a full and unqualified right to the fee).

131.19.5 *Foundation/trust equivalent*

Reg 6(3) MLR provides:

> In these Regulations, "beneficial owner", in relation to a foundation or other legal arrangement similar to a trust, means those individuals who hold equivalent or similar positions to those set out in paragraph (1).[43]

131.20 Beneficial Owner: Estate

Reg 6(6) MLR provides:

(b) defeasible or indefeasible."

[43] See 131.19.1 (Five categories).

> In these Regulations, "beneficial owner", in relation to an estate of a deceased person in the course of administration, means—
> (a) in England and Wales and Northern Ireland, the executor, original or by representation, or administrator for the time being of a deceased person;
> (b) in Scotland, the executor for the purposes of the Executors (Scotland) Act 1900).

A beneficiary is not the Beneficial Owner of an estate. That seems surprising, but it does not much matter.

131.21 Beneficial Owner: Other entities

Reg 6(7) MLR provides:

> In these Regulations, "beneficial owner", in relation to a legal entity or legal arrangement which does not fall within regulation 5 [body corporate] or paragraphs (1) [trust], (3) [entity similar to trust] or (6) [estate] of this regulation, means—
> (a) any individual who benefits from the property of the entity or arrangement;
> (b) where the individuals who benefit from the entity or arrangement have yet to be determined, the class of persons in whose main interest the entity or arrangement is set up or operates;
> (c) any individual who exercises control over the property of the entity or arrangement.
> (8) For the purposes of paragraph (7), where an individual is the beneficial owner of a body corporate which benefits from or exercises control over the property of the entity or arrangement, the individual is to be regarded as benefiting from or exercising control over the property of the entity or arrangement.

131.21.1 *Other cases*

Reg 6(9) MLR provides:

> In these Regulations, "beneficial owner", in any other case, means the individual who ultimately owns or controls the entity or arrangement or on whose behalf a transaction is being conducted.

When could this apply?

131.22 Trusts register (TRS)

With the above 50 pages of definitions in mind, we can turn to consider

TRS and other duties imposed by MLR. I consider TRS first.

131.22.1 *The trusts register*

Reg 45 MLR provides:

> (1) The Commissioners must maintain a register ("the register") of—
> (a) beneficial owners of taxable relevant trusts[44]; and
> (b) potential beneficiaries (referred to in regulation 44(5)(b)) of taxable relevant trusts....

I refer to that as the "**trusts register**".

131.22.2 *Information in register*

Reg 45(10) MLR provides:

> The register must contain the information referred to in—

There are three categories of information:[45]

Para	**Applies to**
44(2)(b), (5)(b)	Taxable relevant trusts
44(2)(b), (5)(b), (10E) -(10G)	Type 10A/B/C trusts
45ZA(3)(4)	Type A/B/C trusts

131.23 TR trust: Duty to register

Reg 45(2) MLR provides:

> The trustees of a taxable relevant trust[46] must within the time specified in paragraph (3) provide the Commissioners with—

There follow four categories of information required. In outline:

Para	**Information about**
45(5)	The trust/trust assets
45(6)	Beneficial Owners of the trust who are individuals, & potential beneficiaries
45(7)	Beneficial Owners of the trust who are legal entities
45(8)	Classes of beneficiaries

I refer to that as **"TR trust data"**.

[44] See 131.14 (Taxable relevant trust).

[45] For clarity I have set this out in tabular form and not a precise quote of the statute.

[46] See 131.14 (Taxable relevant trust).

131.23.1 *Trust/trust asset data*

Regulation 45 MLR provides:

> (2) The trustees of a taxable relevant trust must within the time specified in paragraph (3) provide the Commissioners with-
> (a) the information specified in paragraph (5) in relation to the trust;
>
> (5) The information specified in this paragraph is—
> (a) the full name of the trust;
> (b) the date on which the trust was set up;
> (c) a statement of accounts for the trust,
> [i] describing the trust assets and
> [ii] identifying the value of each category of the trust assets
> at the date on which the information is first provided to the Commissioners (including the address of any property held by the trust);
> (d) the country where the trust is considered to be resident for tax purposes;
> (e) the place where the trust is administered;
> (f) a contact address for the trustees;
> (g) the full name of any advisers who are being paid to provide legal, financial or tax advice to the trustees in relation to the trust.

131.23.2 *Individual Ben. Owner data*

Reg 45 MLR provides:

> (2) The trustees of a taxable relevant trust must within the time specified in paragraph (3) provide the Commissioners with ...
> (b) [i] the information specified in paragraph (6) in relation to each of the individuals referred to in regulation 44(2)(b) and (5)(b)

The individuals referred to at (b)[i], in respect of whom information is required, are:

Para	**Category**	**See**
44(2)(b)	Beneficial Owners	131.31
44(5)(b)	Potential beneficiaries	131.35

The regulation continues with an exception:

> [ii] (but if sub-paragraph (d) applies,[47] this information does not

[47] See 131.23.4 (Class of beneficiaries data).

need to be provided in relation to the beneficiaries of the trust);

Since sub-para (d) will normally apply, this head of disclosure does not normally apply to beneficiaries, but only to Beneficial Owners who are not beneficiaries, such as trustees, settlors and protectors.

Reg 45(6) MLR provides:

> The information specified in this paragraph is—
> (a) the individual's full name;
> (b) the individual's national insurance number or unique taxpayer reference, if any;
> (c) if the individual does not have a national insurance number or unique taxpayer reference, the individual's usual residential address;
> (d) if the address provided under sub-paragraph (c) is not in the UK—
> (i) the individual's passport number or identification card number, with the country of issue and the expiry date of the passport or identification card; or
> (ii) if the individual does not have a passport or identification card, the number, country of issue and expiry date of any equivalent form of identification;
> (e) the individual's date of birth;
> (f) the nature of the individual's role in relation to the trust.

131.23.3 *Corporate Ben. Owner data*

Reg 45 MLR provides:

> (2) The trustees of a taxable relevant trust must within the time specified in paragraph (3) provide the Commissioners with ...
> (c) the information specified in paragraph (7) in relation to each of the legal entities referred to in regulation 44(2)(b);

The legal entities referred to are those which are Beneficial Owners of the trust.[48]

Reg 45(7) MLR provides:

> The information specified in this paragraph is—
> (a) the legal entity's corporate or firm name;
> (b) the legal entity's unique taxpayer reference, if any;
> (c) the registered or principal office of the legal entity;

[48] See 131.31 (Disclosure to relevant person).

> (d) the legal form of the legal entity and the law by which it is governed;
> (e) if applicable, the name of the register of companies in which the legal entity is entered (including details of the country in which it is registered), and its registration number in that register;
> (f) the nature of the entity's role in relation to the trust.

131.23.4 *Class of beneficiaries data*

Reg 45 MLR provides:

> (2) The trustees of a taxable relevant trust must within the time specified in paragraph (3) provide the Commissioners with ...
> (d) the information specified in paragraph (8), where the beneficial owners include a class of beneficiaries, not all of whom have been determined.

Reg 45(8) MLR provides:

> The information specified in this paragraph is a description of the class of persons who are beneficiaries or potential beneficiaries under the trust.

It may be advantageous to ensure that the class is not determined, so as to fall within para (d), but that would normally be the case in any event.

131.23.5 *Annual statement*

Reg 45(9) MLR provides:

> The trustees of a taxable relevant trust must ...
> (b) if the trustees are not aware of any change to any of the information provided under paragraph (2), confirm that fact to the Commissioners on or before 31st January after the tax year in which the trustees are liable to pay any UK taxes.

131.24 Type 10A/B/C trusts

Reg 45 provides:

UK relevant trust	**Non-UK relevant trusts**	
Type 10A trust	***Type 10B trust***	***Type 10C trust***
(10A) The trustees of a taxable relevant trust which	(10B) This paragraph applies to the trustees of a taxable relevant trust which	(10C) This paragraph applies to the trustees of a taxable relevant trust which
[i] is a UK trust, and	[i] is a non-UK trust,	[i] is a non-UK trust and

	[ii] has at least one trustee resident in the UK and	
[ii] is not an EEA registered trust or a trust listed in Schedule 3A [excluded trust],	[iii] is not an EEA registered trust or a trust falling within Schedule 3A [excluded trust],	[ii] is not a trust listed in Schedule 3A [excluded trust],
	[iv] where the trustees of that trust, in their capacity as such— (a) enter into a business relationship with a relevant [regulated] person; or (b) acquire an interest in land in the UK.	[iii] where [A] none of the trustees are resident in the UK and [B] those trustees, in their capacity as such, acquire an interest in land in the UK.
must provide the Commissioners	(10D) Where paragraph (10B) or (10C) applies, the trustees must provide the Commissioners	
with the information specified in paragraph (10E), apart from any information already provided to the Commissioners under regulation 45ZA (at a time when the trust was not a taxable relevant trust)—	[identical]	

I refer to trusts within (10A)-(10C) as **"type 10A/B/C trusts"**.

131.24.1 *Relevant trusts/10A/B/C trusts compared*

Type 10A/B/C trusts are taxable relevant trusts which meet further criteria. Thus type 10A/B/C trusts are taxable relevant trusts, but taxable relevant trust is not necessarily type 10A/B/C.
It may be helpful to compare trust type 10A with relevant trust type (i).

Rel trust type (i)	**Type 10A**
a UK trust which is an express trust	a taxable relevant trust which [i] is a UK trust, and [ii] is not an EEA registered trust

or a trust listed in Schedule 3A
[excluded trust]

The difference is that EEA/excluded trusts are not type A but may still be a relevant trust type (i).

It may be helpful to compare trust types 10B/C with relevant trust type (iii).

Rel trust type (iii)	**Type10 B**	**Type 10C**
A non-UK trust which is an express trust, is not a trust listed in Schedule 3A (excluded trusts) and whose trustees (in their capacity as such)— (aa) acquire an interest in land in the UK; or (bb) enter into a business relationship with a relevant [regulated] person, where at least one of those trustees is resident in the UK and the trust is not an EEA registered trust;	a taxable relevant trust which [i] is a non-UK trust, [ii] has at least one trustee resident in the UK and [iii] is not an EEA registered trust or a trust falling within Schedule 3A [excluded trust], [iv] where the trustees of that trust, in their capacity as such— (a) enter into a business relationship with a relevant [regulated] person; or (b) acquire an interest in land in the UK.	a taxable relevant trust which [i] is a non-UK trust and [ii] is not a trust listed in Schedule 3A [excluded trust], [iii] where [A] none of the trustees are resident in the UK and [B] those trustees, in their capacity as such, acquire an interest in land in the UK.

The difference between relevant trust type (iii) and type B is that type B requires at least one UK trustee.

The difference between relevant trust type (iii) and type C is that type C requires UK land.

131.24.2 *Type 10A/B/C: Duty to register*

As type 10A/B/C trusts are relevant trusts they already require the TR trust data to be registered.[49] I refer to that as **"10A/B/C trust data".**

Reg 45 MLR specifies 3 items of information for this:

> (10E) The trustees must provide the Commissioners with the following information
>
> [i] in relation to each of the beneficial owners of the trust who is an

[49] See 131.23 (TR trust: Register data).

> individual, and
>
> [ii] in relation to any other individual referred to as a potential beneficiary in a document from the settlor relating to the trust such as a letter of wishes—
>
> (a) the individual's country of residence;
>
> (b) the individual's nationality;
>
> (c) the nature and extent of the individual's beneficial interest,
>
> but if paragraph (10F) applies, this information does not need to be provided in relation to the beneficiaries of the trust.
>
> (10F) Where the beneficial owners include a class of beneficiaries, not all of whom have been determined, the information to be provided under paragraph (10E) is a description of the class of persons who are beneficiaries or potential beneficiaries under the trust.

Para 10F is the equivalent of para 45(2)(b)[ii].[50]

131.24.3 *3rd country entity data*

Reg 45(10G) MLR provides:

> The trustees of a trust to which paragraph (10A) or (10B) applies must—
>
> (a) if they have a controlling interest in a third country entity, provide the Commissioners with the following information, apart from any information already provided under regulation 45ZA(4), at the same time as providing the information under paragraph (10E)—
>
> (i) the third country entity's corporate or firm name;
>
> (ii) the country or territory by whose law the third country entity is governed;
>
> (iii) the registered or principal office of the third country entity;
>
> (b) if they acquire an interest in a third country entity after providing the information under paragraph (10E), provide the Commissioners with the information specified in this paragraph within 90 days of the date on which they acquired that interest.

131.25 Type A/B/C trusts

131.25.1 *Types A/B/C*

Reg 45ZA(2) MLR identifies 3 types of trusts for the purposes of reg 45ZA. These are similar to relevant trust types (i) and (iii). It is helpful

[50] See 131.23.2 (Individual Ben. Owner data),

to see them side by side:

Type A trust	Type B trust	Type C trust
(a) a "type A trust" is a UK trust which	(b) a "type B trust" is a non-UK trust which	(c) a "type C trust" is a non-UK trust which
	has at least one trustee resident in the UK,	
is an express trust and	is an express trust and	is an express trust and
is not an EEA registered trust or	is not an EEA registered trust or	
a trust listed in Schedule 3A [excluded trust];	a trust listed in Schedule 3A [excluded trust],	is not a trust listed in Schedule 3A [excluded trust],
	where the trustees of that trust, in their capacity as such— (i) enter into a business relationship with a relevant [regulated] person; or (ii) acquire an interest in land in the UK;	where none of the trustees are resident in the UK and those trustees, in their capacity as such, acquire an interest in land in the UK.

131.25.2 *Relevant trusts/Types A/B/C compared*

It may be helpful to compare trust type A with relevant trust type (i).

Rel trust type (i)	Type A
a UK trust which is an express trust	a UK trust which is an express trust and is not an EEA registered trust or a trust listed in Schedule 3A [excluded trust];

The difference is that EEA/excluded trusts are not type A but may still be a relevant trust type (i).

It may be helpful to compare trust types B/C with relevant trust type (iii).

Rel trust type (iii)	Type B	Type C
A non-UK trust which is an express trust, is not a trust listed in Schedule 3A	a non-UK trust which has at least one trustee resident in the UK, is an	a "type C trust" is a non-UK trust which is an express trust and is not a

(excluded trusts) and whose trustees (in their capacity as such)— (aa) acquire an interest in land in the UK; or (bb) enter into a business relationship with a relevant [regulated] person, where at least one of those trustees is resident in the UK and the trust is not an EEA registered trust;	express trust and is not an EEA registered trust or a trust listed in Schedule 3A, where the trustees of that trust, in their capacity as such— (i) enter into a business relationship with a relevant [regulated] person; or (ii) acquire an interest in land in the UK;	trust listed in Schedule 3A, where none of the trustees are resident in the UK and those trustees, in their capacity as such, acquire an interest in land in the UK.

The difference between relevant trust type (iii) and type B is that type B requires at least one UK trustee.

The difference between relevant trust type (iii) and type C is that type C requires UK land.

Type A/B/C trusts will always be relevant trusts but it is possible to have relevant trusts which are not type A/B/C trusts.

131.25.3 *Type A/B/C: Duty to register*

Reg 45ZA(1) MLR provides:

> In relation to trusts which are—
>
> (a) type A trusts, other than taxable relevant trusts;
> (b) type B trusts, other than taxable relevant trusts;
> (c) type C trusts, other than taxable relevant trusts,
>
> the information to be contained in the register maintained under this Part is the information referred to in paragraphs (3) and (4), and in this paragraph, "taxable relevant trust" has the meaning given in regulation 45.

I refer to this as **"type A/B/C trust data"**.

Reg 45ZA(3) MLR provides:

> The trustees of a trust to which paragraph (1) applies [in short, type A/B/C trusts] must, within the time specified in paragraph (5), provide the Commissioners with the following information, apart from any information already provided to the Commissioners under regulation 45 (at a time when the trust was a taxable relevant trust within the meaning of that regulation)—
>
> (a) the information specified in paragraphs (i) to (v)
>
> [I] relation to each of the beneficial owners of the trust who is

> an individual, and
>
> [II] in relation to any other individual referred to as a potential beneficiary in a document from the settlor relating to the trust such as a letter of wishes—
>
> (i) the individual's full name;
>
> (ii) the individual's month and year of birth;
>
> (iii) the individual's country of residence;
>
> (iv) the individual's nationality;
>
> (v) the nature and extent of the individual's beneficial interest,
>
> but if sub-paragraph (b) applies, this information does not need to be provided in relation to the beneficiaries of the trust;
>
> (b) where the beneficial owners include a class of beneficiaries, not all of whom have been determined, a description of the class of persons who are beneficiaries or potential beneficiaries under the trust;
>
> (c) the information specified in paragraphs (i) to (iii) in relation to each of the beneficial owners of the trust who is a legal entity—
>
> (i) the legal entity's corporate or firm name;
>
> (ii) the registered or principal office of the legal entity;
>
> (iii) the nature of the entity's role in relation to the trust.

131.25.4 *3rd country entity: Type A/B trusts*

Reg 45ZA(4) MLR provides:

> The trustees of a trust to which paragraph (1)(a) or (b) applies [in short, type A/B trusts] must—
>
> (a) if they have a controlling interest in a third country entity, provide the Commissioners with the following information, apart from any information already provided under regulation 45(10G), at the same time as providing the information under paragraph (3)—
>
> (i) the third country entity's corporate or firm name;
>
> (ii) the country or territory by whose law the third country entity is governed;
>
> (iii) the registered or principal office of the third country entity;
>
> (b) if they acquire an interest in a third country entity after providing the information under paragraph (3), provide the Commissioners with the information specified in this paragraph within 90 days of the date on which they acquired that interest.

131.26 UK trust holds Irish bond

To discuss TRS in other jurisdictions would require a whole book and perhaps several volumes. I do not attempt that here. But one point particularly concerns UK trustees. STEP say:

> ... STEP's GDPR group understands from Office of Revenue Commissioners Ireland guidance that a UK trust that holds an investment bond[51] in the Republic of Ireland
> [1] is deemed to have a 'business relationship' in that country and
> [2] is therefore obliged to register on Ireland's Central Register of Beneficial Ownership of Trusts (CRBOT),
> as well as the UK Trust Registration Service (TRS).[52]

It is not uncommon for UK trustees to hold such bonds.

As to point [1], it seems reasonably clear that holding an investment bond is a business relationship, as defined.[53]

As to point [2], if the facts were reversed, a trust with wholly *Irish* trustees holding a *UK* bond would not have to register under TRS. But it seems that the EU rules are more stringent. Irish Revenue guidance provides:[54]

> Trusts where none of the trustees are resident in the European Union (EU) and the trust is not administered in the EU must register with the CRBOT [Central Register of Beneficial Ownership of Trusts] if a trustee enters a business relationship in the State on behalf of the trust... This will apply as long as the business relationship exists...

Dual registration would not have been required when the UK was in the EU, it is one of the bureaucratic burdens arising from Brexit.

STEP say:[55]

> UK trustees face difficulties in registering on CRBOT. In order to do so, they first have to register with the Office of the Revenue Commissioners of Ireland's (the Revenue's) online service, which requires them to

[51] The term is not defined, but context shows it refers to life insurance policies, life annuity contracts and capital redemption policies, within the UK chargeable event regime.

[52] STEP UK News Digest (16 Aug 2022).

[53] See 132.4 (Business relationship).

[54] *https://www.revenue.ie/en/crbot/trusts-that-must-register/non-residents.aspx*
(I have not reviewed the relevant legislation which is the [Ireland] European Union (Anti-Money Laundering: Beneficial Ownership of Trusts) Regulations 2021 and am unsure if an updated version of the regulations is readily available).

[55] *https://www.step.org/industry-news/ireland-suspends-non-registration-penalties-uk-trustees-until-registration-simplified*

> already have a unique identifying number called a TAIN. Non-residents of Ireland have typically not been issued with an Irish tax number. The Revenue has recognised the problem for UK trustees. Its latest guidance says it is working on simplifying access to the CRBOT for such trustees or their representatives and it will not levy penalties on UK trustees for non-registration in this interim period. It says UK trust representatives who have not yet applied for a TAIN now need not do so, although those who have already submitted a TAIN application will soon receive confirmation that their application has been received.

Going forward, other matters being equal, UK trustees might prefer to avoid:

(1) business relationships with EU entities; and in particular
(2) investment in Irish or other EU investment bonds

131.27 Estates

Estates do not have to register under TRS as they are not trusts.[56] However "complex" estates need to register with HMRC in order to obtain a UTR and submit a return and this is done via the TRS.[57]

131.28 Unit trusts/CIS

131.28.1 *Unit trusts*

Prior to 3/2/2023, TRSM 10030 provided:

> Unit trusts (both authorised and unauthorised) are not required to register on TRS.

That was an informal concession or perhaps just a mistake. But TRSM now provides:

> **TRSM10030 common types of trusts and interaction with the register** [Feb 2023]
> Authorised unit trusts are not required to register on TRS as registrable express trusts (see TRSM23110) but may have to register for taxable purposes if they have a UK tax liability (see TRSM25000).

That is, AUTs are excluded trusts.[58] TRSM continues:

> There is no specific exclusion for unauthorised unit trusts. Unauthorised

[56] See 88.1.1 (Estate is not a trust).

[57] See 89.21 (Tax returns & registration).

[58] See 131.12.9 (Authorised unit trusts).

> unit trusts should register if they meet the general registration requirements set out at TRSM21010.

I would have thought that unauthorised unit trusts are excluded trusts.[59] But unit trusts still have to register if they become taxable relevant trusts.

131.28.2 *CIS trustees*

Reg 44(11) MLR provides:

> For the purposes of this regulation, in the case of a relevant trust which is a collective investment scheme, a reference to the trustees of a relevant trust includes a reference to the manager or operator of the collective investment scheme.

This applies only for the purposes of reg 44, so it is repeated verbatim in reg 45(15) MLR.

131.28.3 *CIS: Definition*

Reg 42(2)(f) MLR provides:

> a "collective investment scheme" has the meaning given in regulation 12H of the International Tax Compliance Regulations 2015.

That takes us to reg 12H(3) International Tax Compliance Regulations 2015, which is wider than the standard FSMA definition:

> In this regulation "collective investment scheme" means—
> (a) an investment trust within the meaning of the Corporation Tax Acts,
> (b) a venture capital trust within the meaning of Part 6 of ITA 2007, or
> (c) any arrangements that are a "collective investment scheme" within the meaning of the Financial Services and Markets Act 2000.

131.29 Data format

The same rule applies throughout Part 5 MLR:

Reg 45(4) MLR	**Reg 45(10I)**	**Reg 45ZA*(7)***
The information required under paragraphs (2) and	The information required under paragraphs (10E)	The information required under paragraphs (3), (4)

[59] See 131.12.8 (Safeguarding/administering investments).

(9)[60] must be provided in such form as the Commissioners reasonably require.	to (10H) must be provided in such form as the Commissioners reasonably require.	and (6) must be provided in such form as the Commissioners reasonably require.

131.30 Trust record keeping

Reg 44(1) MLR provides:

> The trustees of a relevant trust[61] must maintain accurate and up-to-date records in writing
> [a] of all the beneficial owners of the trust, and
> [b] of any potential beneficiaries referred to in paragraph (5)(b),[62]
> containing the information required by regulation 45(2)(b) to (d) and (5)(f) and (g).[63]

If the trust is registered, this just repeats the data required on registration. But whether or not the trust is registered, this is data which one would expect trustees to have to hand, and they will need it in order to deal with relevant (regulated) persons.

The equivalent rule for companies is in CA 2006, not in the MLR.

131.31 Disclosure to relevant person

Reg 43(1): Body corporate	**Reg 44(2): Trust**
(1) When a UK body corporate which is not listed on a regulated market [i] enters into a relevant transaction with a relevant [regulated] person, or [ii] forms a business relationship with a relevant [regulated] person, the body corporate must	When a trustee of a relevant trust, acting as trustee, [i] enters into a relevant transaction with a relevant [regulated] person, or [ii] forms a business relationship with a relevant [regulated] person, the trustee must—
on request from the relevant [regulated] person provide the relevant [regulated] person with— (a) information identifying— (i) its name, registered number, registered office and principal place of business;	(a) inform the relevant [regulated] person that it is acting as trustee; and (b) on request from the relevant [regulated] person, provide the

[60] See 131.23 (Duty to register).

[61] See 131.5 ("Relevant trust").

[62] See 131.35 (Disclosure to authority).

[63] See 131.23 (TR trust: Register data).

(ii) its board of directors, or if there is no board, the members of the equivalent management body;
(iii) the senior persons responsible for its operations;
(iv) the law to which it is subject;
(v) its legal owners;
(vi) its beneficial owners; and
(b) its articles of association or other governing documents.

(2) For the purposes of paragraph (1)(a)(v) and (vi), references to the legal owners and beneficial owners of a UK body corporate include a reference to the legal owners and beneficial owners of any body corporate or trust which is directly or indirectly a legal owner or beneficial owner of that body corporate.

(3) Paragraph (1)(a)(vi) does not apply if no person qualifies as a beneficial owner (within the meaning of regulation 5(1)) of—
(a) the UK body corporate; or
(b) any body corporate which is directly or indirectly the owner of that UK body corporate.

relevant [regulated] person with information identifying all the beneficial owners of the trust (which, in the case of a class of beneficiaries, may be done by describing the class of persons who are beneficiaries or potential beneficiaries under the trust).

This assists the relevant (regulated) person to comply with AML/KYC obligations discussed in the next chapter..

131.31.1 *"Relevant transaction"*

Reg 43(9)/44(4) MLR provide:

> For the purposes of this regulation, a "relevant transaction" means a transaction in relation to which the relevant [regulated] person is required to apply customer due diligence measures under regulation 27.

131.32 Changes to trust data

131.32.1 *TR trusts: Data changes*

Reg 45(9) MLR provides:

> The trustees of a taxable relevant trust must—
> (a) if a trustee becomes aware that any of the information provided to the Commissioners under paragraph (2) (other than

> information provided in relation to the value of the trust assets under paragraph (5)(c)) has changed, notify the Commissioners of the change and the date on which it occurred on or before 31st January—
>
> (i) after the tax year in which the change occurred; or
>
> (ii) if the trustees are not liable to pay any UK taxes in that year, after the tax year in which the trustees are liable to pay any UK taxes

131.32.2 *Type 10A/B/C: Data changes*

Reg 45(10H) MLR provides:

> The trustees of a taxable relevant trust to which paragraph (10A), (10B) or (10C) applies must, if the trustee becomes aware that any of the information provided to the Commissioners under paragraphs (10E) to (10G) has changed, notify the Commissioners of the change and the date on which it occurred within 90 days of the trustee becoming aware of the change.

131.32.3 *Type A/B/C: Data changes*

Reg 45ZA(6) MLR provides:

> If a trustee becomes aware that any of the information provided to the Commissioners under paragraph (3) or (4) has changed, the trustee must notify the Commissioners of the change within 90 days of the trustee becoming aware of the change.

131.32.4 *Changes: business relationship*

Reg 43(4): Body corporate	**Reg 44(3): Trust**
If, during the course of a business relationship, there is any change in the identity of the individuals or information falling within paragraph (1), the UK body corporate referred to in paragraph (1) must notify the relevant [regulated] person of the change and the date on which it occurred within fourteen days from the date on which the body corporate becomes aware of the change.	If, during the course of a business relationship, there is any change in the information provided under paragraph (2), the trustees must notify the relevant [regulated] person of the change and the date on which it occurred within fourteen days from the date on which any one of the trustees became aware of the change.

131.33 Time limits

131.33.1 *TR trust data: Time limit*

Reg 45(3) MLR provides:

> The information required under paragraph (2)[64] must, apart from any information already provided to the Commissioners under regulation 45ZA (at a time when the trust was not a taxable relevant trust), be provided—
>
> (a) on or before 31st January after the tax year in which the trustees were first liable to pay any of the taxes referred to in paragraph (14) ("UK taxes"),[65] in the case of a trust which is set up before 6th April 2021;
>
> (b) on or before 1st September 2022, in the case of a trust which is set up after 5th April 2021 where the trustees become liable to pay UK taxes before 4th June 2022;
>
> (c) within 90 days of the trustees becoming liable to pay UK taxes, in any other case.

It is considered that the date that the trustees "become liable" is the date the tax is due to be paid (not the date that income/gains may arise). But it would be good practice to register promptly once it is known that the trustees will have to do so.

131.33.2 *10A/B/C data: Time limit*

The 10A/B/C time limits are as follows:

UK taxable relevant trust	**Non-UK taxable relevant trusts**
(a) on or before 1st September 2022, where the trustees become liable to pay UK taxes before 4th June 2022;	[identical]
(b) within 90 days of the trustees becoming liable to pay UK taxes, in any other case.	(b) otherwise, within 90 days of the trustees acquiring the land or (where paragraph (10B)(a) applies) entering into the business relationship.

[64] See 131.23 (Duty to register).

[65] For this list of taxes, see 131.14 (Taxable relevant trust).

131.33.3 *Type A/B/C trust data: Time limit*

Reg 45ZA(5) MLR provides:

> The information required under paragraph (3)[66] must be provided—
> (a) on or before 1st September 2022, in the case of a trust which first falls within paragraph (1)(a), (b) or (c) before 4th June 2022;
> (b) in any other case, within 90 days of the trust being set up, or, if later, within 90 days of the trust first falling within paragraph (1)(a), (b) or (c).

131.34 Retention of data

Reg 44(9) MLR provides:

> If the trustees of a relevant trust are relevant [regulated] persons who are being paid to act as trustees of that trust, they must—
> (a) retain the records referred to in paragraph (1) for a period of five years after the date on which the final distribution is made under the trust;
> (b) make arrangements for those records to be deleted at the end of that period, unless—
> (i) the trustees are required to retain them by or under any enactment or for the purpose of court proceedings;
> (ii) any person to whom information in a record relates consents to the retention of that information; or
> (iii) the trustees have reasonable grounds for believing that records containing the personal data need to be retained for the purpose of legal proceedings.

Reg 45(10J) MLR provides:

> The Commissioners must keep the information referred to in paragraph (10) on the register for at least five years, and no more than 10 years, after the trust to which it relates has ceased to exist or has ceased to be a type of trust referred to in paragraph (10).

131.35 Authorities information power

Reg 43(5): Body corporate	**Reg 44(5): Trust**
The UK body corporate must on request provide all or part of the information referred to in paragraph	The trustees of a relevant trust must on request provide information to any law enforcement authority—

[66] See 131.23.3 (Type A/B/C: Register data).

(1) to a law enforcement authority.	(a) about the beneficial owners of the trust; and (b) about any other individual referred to as a potential beneficiary in a document from the settlor relating to the trust such as a letter of wishes.

HMRC and the other authorities have so many information powers one wonders whether this one is needed. But it does no harm.

Reg 43(6)/44(6) provide the time limit for this disclosure:

> Information requested under paragraph (5), must be provided before the end of such reasonable period as may be specified by the law enforcement authority.

131.35.1 *Law enforcement authority*

This term is used in reg 43(5)/44(5).

Reg 44(10) MLR provides:

> For the purposes of this regulation, any of the following authorities is a law enforcement authority—
> (a) the Commissioners;
> (b) the FCA;
> (c) the NCA;
> (d) police forces maintained under section 2 of the Police Act 1996;
> (e) the Police of the Metropolis;
> (f) the Police for the City of London;
> (g) the Police Service of Scotland;
> (h) the Police Service of Northern Ireland;
> (i) the Serious Fraud Office.

131.36 MLR disclosure immunity

Reg 43/44 MLR provide:

> (7) The provision of information in accordance with this regulation is not to be taken to breach any restriction, however imposed, on the disclosure of information.
> (8) Where a disclosure is made in good faith in accordance with this regulation no civil liability arises in respect of the disclosure on the part of the UK body corporate.

See 133.8 (POCA disclosure immunity).

131.37 Third party access

131.37.1 *3 information rights*

There are 3 information rights. In short:

Para	**Information**	**Available if**
45ZB(1)	Accessible information	Legitimate interest
45ZB(2)	To meet MLR obligations	Trustee
45ZB(3)	Accessible info about Type A/B trust	In line with objects of directive

Reg 45ZB MLR provides:

> (1) The Commissioners must make the accessible information available to a person who demonstrates to the Commissioners a legitimate interest in the beneficial ownership of a trust, where that person so requests.
> (2) The Commissioners must make available to a trustee, on a request by that trustee, such information as the trustee reasonably requires in order to enable a relevant [regulated] person to meet the relevant [regulated] person's obligations under Part 3, where that relevant [regulated] person proposes to—
> (a) form a business relationship with the trust; or
> (b) enter into a transaction with the trust in relation to which the relevant [regulated] person is required to apply customer due diligence measures under regulation 27.
> (3) The Commissioners must make the accessible information available to a person who makes a written request about a type A trust or a type B trust (within the meaning given in regulation 45ZA(2)), where the trustees of that trust have a controlling interest in a third country entity.

Type C trusts do not fall within (3).

Law Soc non-corporate TRS guidance provides (p.6):

> Where a trust holds a controlling or majority (50% plus) interest in a third country entity, a third party can request beneficial ownership information without needing to demonstrate any legitimate interest. However, HMRC has indicated that the information will only be made available if the request is in line with the objectives of the 4th and 5th Directives This means the requester will need to be able to show that the request is connected with the detection or prevention of money laundering or terrorist financing. Requesters will need to be able to identify the specific third country entity and its relationship with the trust. They will not be able to access information about a non-UK

resident trust with a controlling stake in a third country entity if the only reason the trust is registered is because it has acquired an interest in UK land on or after 6 October 2020 and has no UK resident trustees or it has no UK tax liabilities.

131.37.2 *Accessible information*

Reg 45ZB(8) MLR provides:

> For the purposes of this regulation, the "accessible information" means the details specified in paragraph (9) or (10) which are held on the register in relation to a beneficial owner of a type A trust or a type B trust (within the meaning given in regulation 45ZA(2)), or in relation to an individual referred to as a potential beneficiary in a document from the settlor relating to the trust such as a letter of wishes.
>
> (9) The details are, in relation to an individual—
>
> (a) the individual's full name;
> (b) the individual's month and year of birth;
> (c) the individual's country of residence;
> (d) the individual's nationality;
> (e) the nature and extent of the individual's beneficial interest.
>
> (10) The details are, in relation to a legal entity—
>
> (a) the legal entity's corporate or firm name;
> (b) the registered or principal office of the legal entity;
> (c) the nature of the entity's role in relation to the trust.

131.37.3 *Fees and procedure*

Reg 45ZB(4) MLR provides:

> The Commissioners may—
>
> (a) charge a fee to any person making a request for accessible information under paragraph (1) or (3), which must not exceed such amount as the Commissioners consider will enable them to meet any expenses reasonably incurred by them in dealing with such requests, including expenses incurred in maintaining the register;
> (b) require the person to submit the request in such a manner as the Commissioners may reasonably require, including by requiring the person to register in a manner specified by the Commissioners; and
> (c) require the person to provide such information to support the request as the Commissioners may specify.

131.37.4 *Disclosure exemptions*

There are exemptions for Beneficial Owners who are in some way vulnerable, in short:

Para	**Exemption**
(a)	Disproportionate risk of kidnapping, extortion, etc
(b)	Under 18
(c)	Mental patients

In full detail, reg 45ZB(5) MLR provides:

> Paragraphs (1) and (3) do not apply to the accessible information in a case where, and to the extent that, the Commissioners consider that the information should be exempt because—
>
> (a) the Commissioners consider that making the information available would expose the beneficial owner to a disproportionate risk of fraud, kidnapping, blackmail, extortion, harassment, violence or intimidation;
>
> (b) the beneficial owner is under the age of 18; or
>
> (c) the beneficial owner—
>
> (i) lacks capacity within the meaning of section 2 of the Mental Capacity Act 2005;
>
> (ii) is incapable within the meaning of section 1 of the Adults with Incapacity (Scotland) Act 2000; or
>
> (iii) is incapable by reason of mental disorder within the meaning of Article 3(1) of the Mental Health (Northern Ireland) Order 1986,
>
> and in this paragraph, references to the beneficial owner include references to any other individual referred to as a potential beneficiary in a document from the settlor relating to the trust such as a letter of wishes.

Regulation 45ZB(6)(7) MLR deals with procedures:

> (6) Where the Commissioners decide to exempt any of the accessible information in accordance with paragraph (5), the Commissioners must inform the person requesting the information of the decision, explain that the person is entitled to seek a review, and specify the period in which the person must inform the Commissioners that the person wishes to seek a review (which must not be less than 30 days beginning with the day on which the person is informed of the decision).
>
> (7) If the person seeks a review, the Commissioners may decide to—
>
> (a) uphold the decision to exempt the information;

(b) make the information available; or
(c) exempt less of the requested information and make more of the requested information available,

and must inform the person who made the request of their decision.

131.38 Legitimate interest

Reg 45ZB(11) MLR provides:

> For the purposes of this regulation, the Commissioners must take account of the following when determining whether a person has a legitimate interest in the beneficial ownership of a trust—
>
> (a) whether the person is involved in an investigation into money laundering, terrorist financing or proliferation financing;
> (b) whether the person is making the request for accessible information in order to further an investigation into a specified suspected instance of money laundering, terrorist financing or proliferation financing;
> (c) whether the disclosure of the information to that person would be likely to prejudice—
>   (i) any criminal investigation or criminal proceedings;
>   (ii) any other investigation mentioned in section 342(1) of the Proceeds of Crime Act 2002 (offences of prejudicing investigation); or
>   (iii) any investigation by an appropriate officer (within the meaning given in regulation 87(10)) into a potential contravention of a relevant requirement,
>
> which is or are being, or is or are about to be, conducted;
> (d) whether, having regard to the information produced by the person making the request, it is reasonable for that person to suspect that the trust is being used for money laundering, terrorist financing or proliferation financing.

Law Soc non-corporate TRS guidance provides (p.6):

> This means that third parties will need to identify a specific trust and present detailed information as to why they suspect it is being used for money laundering or terrorist financing as well as why access to information on the TRS would assist, before they are granted access to beneficial owner information.

CHAPTER ONE HUNDRED AND THIRTY TWO

CUSTOMER DUE DILIGENCE

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132.1 Customer due diligence: Introduction

This chapter considers:

- customer due diligence (CDD)
- associated duties: risk assessments, policies, training, etc

A full discussion would need volumes. I focus on the rules as they affect tax advisers. I do not consider penalties.

The law is in Parts 2-4 MLR.[1]

For a critique of the rules, see Saperstein *et al.*, "The Failure of Anti-Money Laundering Regulation: Where is the Cost-Benefit Analysis?"[2]

Perhaps belatedly, a consultation published March 2024 announced a

[1] See 131.1 (MLR: Introduction).

[2] *https://scholarship.law.nd.edu/ndlr_online/vol91/iss1/4/*

broad review of the MLR.[3]

132.2 LSAG guidance

The principal guidance for lawyers is Anti-money Laundering Guidance for the Legal Sector, published by LSAG ("LSAG guidance").[4]

The guidance is split into four parts, numbered 1, 2a, 2b, and 2c.

Part 2a provides:

> This is one of three "Part 2" sections of the Legal Sector Affinity Group (LSAG) anti- money laundering guidance for the legal sector in the UK. These Part 2 sections are intended to provide more tailored AML guidance for specific types of legal practices or practitioners or those providing certain services.
> • Part 2a – Barristers/Advocates
> • Part 2b – Trust or Company Service Providers (TCSP)
> • Part 2c – Notaries
> Barristers and advocates should read this part of the Guidance in the first instance, drawing on Part 1 where relevant.
> 2b and 2c are to be read alongside Part 1 of the guidance.

So Part 2a (155 pages) is meant to stand alone, but Part 1 (220 pages) might also be relevant. References below are to Part 2a unless otherwise stated. Part 1 is dated 2023 and Part 2a is dated 2021.

The LSAG guidance is supplemented by an addendum published in December 2023.

132.2.1 *Status of LSAG guidance*

LSAG guidance provides:

Guidance Part 1 para 1.1	**Guidance Part 2a (Introduction)**
In accordance with[5]	[Identical]

[3] *https://www.gov.uk/government/consultations/improving-the-effectiveness-of-the-money-laundering-regulations*
This is issued pursuant to reg 47 MLR which requires supervisory authorities to issue guidance.

[4] *https://www.barcouncilethics.co.uk/documents/money-laundering-terrorist-financing/*
At the time of writing (Mar 2023) this version (described as last reviewed 1/7/22) is more up to date than that on the Law Society website.

[5] For clarity I have adopted my usual abbreviations here rather than the wording of the guidance.

[1] ss330(8) and 331(7) POCA, [2] s.21A(6) Terrorism Act 2000, and [3] Reg 86(2)(b) MLA, the court is required to consider compliance with this guidance in assessing whether a person committed an offence or took all reasonable steps and exercised all due diligence to avoid committing the offence.	once approved the court is required to consider compliance with this guidance in assessing whether a person committed an offence or took all reasonable steps and exercised all due diligence to avoid committing the offence.

One would expect Part 2a to have been formally approved at the same time as Part 1, which was approved in 2022, but I am not sure if that happened. No doubt an updated version of Part 2a will be published in due course which will clarify the point.

Statute-recognised guidance seems like a halfway house between law and conventional guidance, but I am not sure that it makes much difference to outcomes in practice. If that is right, there is likewise no practical difference between:

(1) Guidance approved by HM Treasury (LSAG guidance part 1); and
(2) Guidance published by LSAG pending approval (LSAG parts 2a/b/c)

132.3 Regulators

132.3.1 *Supervisory authority*

Reg 3(1) MLR provides:

> "supervisory authority" in relation to-
> (a) any relevant [regulated] person, means the supervisory authority specified for such a person by regulation 7;

So we turn to reg 7(b):

> (b) each of the professional bodies listed in Schedule 1 is the supervisory authority for relevant persons who are members of it, or regulated or supervised by it

Schedule 1 MLR sets out a list of 22 professional bodies - who would have thought we had so many? This list includes, unsurprisingly, the Law Society and the Bar Council.

132.3.2 *Bar Council & BSB*

The BSB website explains:[6]

> The General Council of the Bar is the designated Professional Body Supervisor under the Regulations. In line with our Protocol for ensuring regulatory independence, supervisory responsibility is delegated to the Bar Standards Board. We have a Protocol for Anti-Money Laundering and Counter-Terrorist Financing[7] with the Bar Council which sets our respective roles under the Regulations.

The full titles of these two Protocols are:

- General Council of the Bar and Bar Standards Board: Protocol for ensuring regulatory independence and the provision of assurance
- Memorandum of Understanding: Anti-Money Laundering and Counter-Terrorist Financing

132.3.3 *OPBAS*

The Office for Professional Body Anti-Money Laundering Supervision (OPBAS) is, I think, a branch of the FCA.[8] It is governed (or at least, empowered) by The Oversight of Professional Body Anti-Money Laundering and Counter Terrorist Financing Supervision Regulations 2017. According to its website, "OPBAS supervises the 25[9] professional body supervisors in the legal and accountancy sectors". It is the regulator's regulator.

OPBAS has published a document called a "Sourcebook"[10] which "provides information for professional body supervisors on how to comply effectively with their obligations under the MLR".[11]

[6] *https://www.barstandardsboard.org.uk/for-barristers/compliance-with-your-obligations/anti-money-laundering-counter-terrorist-financing.html#:~:text=Protocol%20with%20the%20Bar%20Council&text=In%20line%20with%20our%20Protocol,respective%20roles%20under%20the%20Regulations.*

[7] The title of this document is:

[8] In its website it describes itself as "housed" within the FCA.

[9] *https://www.fca.org.uk/about/how-we-operate/who-work-with/opbas#section-opbas-sourcebook* accessed June 2023. I think 25 may be a slip for 22, but it must be difficult to keep track.

[10] *https://www.fca.org.uk/about/how-we-operate/who-work-with/opbas#section-opbas-sourcebook*
At the time of writing, the current version is dated Jan 2023.

[11] Sourcebook, para 1.1

132.3.4 *LSAG*

Legal Sector Affinity Group comprises legal sector regulators and representative bodies.[12] "Affinity" seems a strange word in this context. The label does not matter, but where does it come from?

132.3.5 *AML regulation: The future*

This topic is currently the subject of consultation; see HMT, "Reform of the Anti-Money Laundering and Counter-Terrorism Financing Supervisory Regime: Consultation" (June 2023).[13]

132.4 Business relationship

This term is used throughout MLR.

The starting point is reg 4(1) MLR which provides:

> For the purpose of these Regulations, "business relationship" means a business, professional or commercial relationship between a relevant person and a customer, which—
> (a) arises out of the business of the relevant person, and
> (b) is expected by the relevant person, at the time when contact is established, to have an element of duration.

A transaction that does not have (or more accurately, is not expected to have) an element of duration is known as an **"occasional transaction"**. A single piece of advice does not make a Business Relationship unless:

(1) the adviser expects more work from the same customer; or
(2) the work itself takes so long as to have an element of duration

LSAG guidance part 1 provides:

> **6.4 Definition of Business Relationship**
> There may be several indicators that a client is establishing a business relationship, as opposed to the matter being an "occasional transaction" including but not limited to:
> [1] an explicit expectation from the client or practice that a business relationship is being established;
> [2] the nature of the client or the transaction suggests they may wish to

[12] LSAG does not have a website, and I have not seen a list of its members, but perhaps that does not matter for present purposes.

[13] *https://www.gov.uk/government/consultations/reforming-anti-money-laundering-and-counter-terrorism-financing-supervision*

> undertake more than one transaction e.g., it is in the nature of their business;
>
> [3] or the transaction itself will inherently take time to complete e.g., the buying/selling of real property.
>
> The definition of business relationship under the Regulations requires the legal practitioner to have an expectation at the time the contact is established, that the relationship will have "an element of duration".

The guidance continues:

> ... it is reasonable to assume that any legal professional will have an expectation of possible further business from any initial contact made with a client. When dealing with a client for the first time, you should assume that a business relationship is being formed unless you have explicit reasons to know that this is not the case i.e., that there will not be an "element of duration."

This misstates the test. The test is whether the relevant person *expects* the relationship to have an element of duration. The test is not:

- an expectation of *possible* further business or that the client *may* wish to undertake more than one transaction
- *knowing* that there will not be an element of duration

It is also questionable as a matter of fact, because it is not correct to assume generically that any legal professional "will have an expectation of possible further business from any initial contact made with a client." In some cases the individual will have that expectation, and in other cases they will not.

> **6.5 Definition of an occasional transaction**
>
> A transaction that falls outside of a "business relationship," is known as an occasional transaction.
>
> By definition it can only apply where a practice-client relationship lacks an expectation of an "element of duration." For this definition to apply, the relationship must be limited to a single service provided at a certain point in time...
>
> It may apply in the case of a limited ancillary service, provided as a one-off or in some examples of notarial work in particular...

LSAG does not think this is likely:

> this will in practice be in the rarest of exceptions...
>
> Due to the ongoing duties a practice would have in most foreseeable circumstances, this definition is not likely to apply to the relationship

between a legal practice and a client for any transaction.

This is typically the case for solicitors, who offer a broad range of services, and hope the client will return whenever they need legal advice.

Tax barristers have two classes of client:

(1) The professional client; here, typically, there is likely to be an expectation that (if the barrister does a good job) the client will return on behalf of other clients, when other tax issues arise

(2) A lay client. It is possible that the lay client may regularly have tax issues on which it will instruct the barrister to advise; for instance a bank or investment manager, who will (or at least should) be concerned to consider the tax issues of their own customers from time to time. But more commonly, the lay client will be an individual, company or trust, with a single tax problem, on which the barrister is instructed to advise, and there is no reason to expect repeat work.

The LSAG guidance assumes that an adviser will have "ongoing duties". "Ongoing" suggests, or perhaps means, an element of duration. But at least in most circumstances, a tax barrister does not have ongoing duties.[14]

However this point is recognised, as this guidance is in LSAG part 1 (general) and not part 2a (specific guidance for barristers).

132.4.1 *Sufficient element of duration*

How long is required for the element of duration?

LSAG gives buying/selling real property as an example of work with an element of duration. The time taken to buy/sell real property will vary so that it is perhaps not helpful in determining what is an element of duration. But in a complex case, it might easily take three months. The LSAG view seems to be that that would constitute an element of duration (even though repeat work is not expected).

Law Soc non-corporate TRS guidance takes a different view of what is

[14] The Bar Council's Client Care Guidance provides on page 9:

> "The only ongoing duty to clients that persists after you cease to act for a client is that of client confidentiality"

https://www.barcouncilethics.co.uk/wp-content/uploads/2019/10/Client-care-guidance-.pdf

Whether solicitors or accountants have ongoing duties depends on the nature of their retainer, and the same is strictly true of a barrister, but in practice barristers do not usually undertake ongoing duties.

an element of duration:[15]

> ... the business relationship will need to have an element of duration and that this would normally involve an ongoing relationship that at the outset is expected to last for more than 12 months.

Reg 4(2)[16] supports the Law Society view, as:

(1) It assumes that the CDD transactions to which it refers do not have a sufficient element of duration.

(2) It is not consistent with the view that occasional transactions are "exceptional".

One set of instructions will not have an element of duration.

132.4.2 *Record keeping*

LSAG guidance provides:

> The nature of the relationship should be recorded in the client risk assessment. Any reasons for not applying CDD must be clearly recorded ...

132.4.3 *When duration not required*

In four circumstances an element of duration is not required, so an occasional transaction constitutes a Business Relationship:

Reg 4(2) MLR provides:

> A relationship where the relevant person is asked to provide one or more of the services described in regulation 12(2)(a), (b) or (d) is to be treated as a business relationship for the purpose of these Regulations, whether or not the relationship is otherwise expected to have an element of duration.

The services referred to are 3 of the 5 categories which I call CDD Transactions:[17]

Para	**Topic**
12(2)(a)	Forming a firm
12(2)(b)	Managing of client money or assets
12(2)(d)	Organisation of contributions for companies

[15] *https://www.lawsociety.org.uk/topics/anti-money-laundering/trust-registration-service-trs-and-aml-compliance* p.5

[16] See 132.4.3 (When duration not required).

[17] See 132.7 (Independent Legal Professional).

Regulation 4(3) MLR provides a rule for estate agents, not discussed here.

I write Business Relationship with initial capitals, to reflect the technical nature of the expression.

132.4.4 *Customer*

Customer is not defined and will have its normal meaning.

In the context of a lawyer or accountant, the customer is the client. The professional will have a client care agreement, and the parties to that agreement are clients and are so customers. For a barrister this includes professional and lay clients:

> *The "Customer"*
> 15. The Regulations do not distinguish between lay and professional clients. They apply to all clients[18] with whom you have entered into a "business relationship" within the meaning of reg. 4(1). In approving this guidance, HM Treasury has stated that, in its opinion, where you are instructed by a professional client (such as a solicitor) on behalf of a lay client, your "customer" under the Regulations is both your instructing professional client and your lay client. You should therefore carry out 'Customer Due Diligence' ["CDD"] on both your lay and professional client.

A lawyer or accountant may owe a duty of care to persons who are not clients, but these are not customers. The clients/customers of the professional person's clients are not customers of the professional person. Any other view is unworkable as it would not be possible to apply CDD measures to non-clients.

132.5 Relevant person

"Relevant person" matters for the following purposes:

Topic	**See para**
Customer due diligence	*Discussed here*
Business Relationship	132.4
Relevant trust type (iii)/trust type C	131.9.2; 131.25.1
Data retention duties	131.34
3rd party access rights	131.28

Reg 3(1) MLR provides:

[18] Note that this assumes that in the context of a professional person, customers are clients.

> In these Regulations ... “relevant person” means a person to whom, in accordance with regulation 8, Parts 1 to 6, 7A and 8 to 11 of these Regulations apply;

“Relevant person” is an opaque term, and for clarity I refer to a **“relevant (regulated) person”**.

The Parts of the MLR are as follows:

Part	**Topic**
1	Introduction
2	Money laundering and terrorist financing
3	CDD
4	Reliance & record keeping
5	Beneficial ownership information
6	Supervision & registration
7	Transfer of Funds (Information on the Payer) Regulations
7a	Cryptoasset Transfers
8	Information, Investigation and Directions
9	Enforcement
10	Appeals
11	Miscellaneous

So we turn to reg 8 MLR:

> (1) Parts 1 to 6, 7A and 8 to 11 apply to the persons (“relevant persons”) acting in the course of business carried on by them in the UK, who—
> (a) are listed in paragraph (2); and
> (b) do not come within the exclusions set out in regulation 15.

132.5.1 *Listed persons*

Reg 8(2) MLR provides:

> The persons listed in this paragraph are—

There follows a list of 11 categories or sets of categories:

> (a) credit institutions;
> (b) financial institutions;
> (c) auditors, insolvency practitioners, external accountants and tax advisers;
> (d) independent legal professionals (“ILPs”);
> (e) trust or company service providers; (“TCSPs”)
> (f) estate agents and letting agents;
> (g) high value dealers;

(h) casinos;
(i) art market participants;
(j) cryptoasset exchange providers;
(k) custodian wallet providers.

I consider the definitions of tax advisers, ILPs, and TCSPs, but not the other definitions.

132.6 Tax adviser

"Tax adviser" matters because a tax adviser is a relevant (regulated) person.

Reg 11(d) MLR provides:

> "tax adviser" means a firm[19] or sole practitioner who
> [a] by way of business
> [b] provides material aid, or assistance or advice,
> [c] in connection with the tax affairs of other persons,
> [d] whether provided directly or through a third party,
> [e] when providing such services.

SRA have issued guidance ("SRA Tax Adviser guidance").[20] This provides:

> The definition of 'tax adviser' is broad, extends beyond providing advice and includes providing assistance and material aid. Activities known informally by other terms, such as 'estate planning', 'tax planning' and 'tax mitigation' are likely (?) to be in scope of the regulations through this definition.
> ... The definition of 'tax adviser' is very broad, and any firm providing a service that addresses or might impact the tax affairs of a client should carefully consider whether their services fall within it.

For the meaning of "tax adviser" see *Online Tax Rebate Ltd v HMRC*.[21]

132.6.1 *Generic advice*

"SRA Tax Adviser guidance provides:

[19] See 131.4.8 (Firm).

[20] "Tax Adviser Guidance" (18 March 2021) *https://www.sra.org.uk/solicitors/resources/money-laundering/guidance-support/tax-adviser-guidance/#:~:text=The%20definition%20of%20'tax%20adviser,the%20regulations%20through%20this%20definition*

[21] [2019] UKUT 167 (TCC).

> With regards the ‘advice’ component, when contrasting this with providing information, a useful way to think about it is whether information you are providing has been tailored in any way to the tax-relevant circumstances of the client. If the information you are providing is only relevant due to the client’s particular circumstances (eg a specific transaction they are involved in or issue you are otherwise advising them on), it will be more likely to fall within the definition.
> For example, sending an internet link to something like a HMRC web page about income tax is unlikely to meet this threshold as it is unlikely to contain any tailored advice.

Generic or untailored information is actually advice, and even if not, is clearly assistance, but it does not count. Perhaps the underlying intuition is some sort of de minimis test.[22]

> However, sending someone a link to a HMRC website about something very specific (eg a tax credit they may receive for having invested in a venture capital trust), alongside some commentary or explanation as to its relevance for the client, is much more likely to be tax advice in scope of the regulations.
> ‘Assistance’ includes non-advisory services, such as drawing up documents on behalf of your clients eg tax covenants between entities.
> ‘Material aid’ is likely (?) to include, for example, administering tax filings and payments on behalf of your client.
> ‘Through a third party’ is also a very wide definition and may include scenarios such as:
>
> - a tax specialist, such as a sole practitioner, freelancer or an accountant, being instructed by a firm on the client’s behalf
> - a firm that is in common ownership with a wealth management firm, providing tax advice to the wealth management firm’s client.
>
> This means that it does not matter if the contractual relationship is between your firm and the underlying client. When you are providing tax adviser services, the person to whom the tax affairs being advised on

[22] An information/advice distinction does not work: *BPE Solicitors v Hughes-Holland* [2017] UKSC 21 at [39]:

> “Turning to the distinction between advice and information, this has given rise to confusion largely because of the descriptive inadequacy of these labels. On the face of it they are neither distinct nor mutually exclusive categories. Information given by a professional man to his client is usually a specific form of advice, and most advice will involve conveying information”.

This was followed in *Khan v Meadows* [2021] UKSC 21 at [41].

> relate to is your client for the purposes of the regulations.[23]

132.6.2 *Litigation exemption*

SRA Tax Adviser guidance provides a litigation exemption:

> Litigation and dispute resolution services are not generally in scope, but you should consider carefully whether the services you provide stray into the definition of tax advice services. This is ultimately for you to determine.
>
> HMRC might engage with, investigate or negotiate with individuals and corporate entities about their tax affairs. Being involved with services in this regard, may fall within the definition, depending on the service provided.
>
> Advice and services provided in relation to a criminal investigation or prosecution by HMRC in our view is a litigation service and is likely to be out of scope.

132.6.3 *Policy*

SRA discuss the policy background:

> **Why are tax advisers in scope?**
>
> Evasion of tax is a crime and any proceeds from this become by definition the proceeds of crime. Many services, transactions and activities may have tax implications. Criminals might seek to avoid any and all forms of tax, creating proceeds of crime from many different kinds of activity, hence the risks involved in providing tax adviser services.
>
> Some criminals might also seek to pay tax on the proceeds of crime, in an effort to make it seem more legitimate.
>
> So including tax advisers in scope of the regulations addresses a channel criminals might look to exploit.

The reader may be unconvinced. But there it is.

132.7 Independent Legal Professional

"Independent Legal Professional" matters because an Independent Legal Professional is a relevant (regulated) person.

Regulation 12(1) MLR provides:

[23] SRA, "Tax Adviser guidance" (Nov 2020) *https://www.sra.org.uk/solicitors/resources/money-laundering/money-laundering/tax-adviser-guidance/*

> In these Regulations, "independent legal professional" means a firm or sole practitioner who by way of business provides legal or notarial services to other persons, when participating in financial or real property transactions concerning-
>
> (a) forming a firm;[24]
> (b) the managing of client money, securities or other assets;
> (c) the opening or management of bank, savings or securities accounts;
> (d) the organisation of contributions necessary for the creation, operation or management of companies; or
> (e) the creation, operation or management of trusts, companies, foundations or similar structures,

I refer to transactions within (a)-(e) as **"CDD Transactions"** and I write "Independent Legal Professional" with initial capitals, to reflect the technical nature of the expression.

132.7.1 *Participating in transaction*

Reg 12(1) MLR explains the meaning of "participate" in a transaction:

> and, for this purpose, a person participates in a transaction by assisting in the planning or execution of the transaction or otherwise acting for or on behalf of a client in the transaction.

LSAG guidance provides:

> 23. The provision of legal advice by a barrister or advocate, instructed to advise or give an opinion in relation to specific aspects of a transaction and not otherwise carrying out or participating in the transaction, would not generally be viewed as participation in a financial transaction for the purposes of the Regulations...
> For example, where your involvement in the matter amounts to giving legal advice only in relation to the risk of enforcement action succeeding and the need for an indemnity against such an action, then you would not generally be considered to be "assisting in the planning or execution of the transaction" or "acting for or on behalf of a client in the transaction".
> 26 ... However, if you were to go on to draft a term of the agreement there is at least an argument to say that you are "acting for or on behalf of a client in the transaction", and a strong argument to say that you are

[24] See 131.4.8 (Firm).

> "you are assisting the client in the planning…of a transaction". In those circumstances you should consider that the obligations under the Regulations apply, and that you need to undertake CDD, to monitor the level of risk that arises in relation to your instructions and to maintain records of the same.

A barrister is not likely to be an Independent Legal Professional because:
(1) a barrister does not typically "participate" in a CDD transaction in this sense
(2) the litigation exemption may apply

132.7.2 *Litigation exception*

In *Ordre des Barreaux Francophones et Germanophones v Conseil des Ministres:*[25]

> 33. [These obligations apply] only insofar as they advise their client in the preparation or execution of certain transactions—essentially those of a financial nature or concerning real estate, as referred to in Art.2a(5)(a) of that directive—or when they act on behalf of and for their client in any financial or real estate transaction. As a rule, the nature of such activities is such that they take place in a context with no link to judicial proceedings and, consequently, those activities fall outside the scope of the right to a fair trial.[26]
> 34. Moreover, as soon as the lawyer acting in connection with a transaction as referred to in Art.2a(5) of Directive 91/308 is called upon for assistance in defending the client or in representing him or her before the courts, or for advice as to the manner of instituting or avoiding judicial proceedings, that lawyer is exempt, by virtue of the second sub-paragraph of Art.6(3) of the directive, from the obligations laid down in Art.6(1), regardless of whether the information has been received or obtained before, during or after the proceedings. An exemption of that kind safeguards the right of the client to a fair trial.

LSAG guidance provides:

> 24 ... "participating in a transaction", for example, is a broad term. Whilst the Regulations do not apply to contentious matters, non-contentious trust, company, corporate and matrimonial matters may engage areas of activity by your lay clients that come within the scope of the Regulations.

[25] Case C-305/05; [2007] ECR I-5305

[26] Article 6 ECHR.

132.7.3 *Application to bar*

A barrister could be a "Independent Legal Professional" but only if:
(1) The work concern a CDD transaction (possible but unusual)
(2) The work is not "legal advice only" (which is unlikely); and
(3) The litigation exception does not apply (which it often will)

132.8 Trust/company service provider

"Trust/company service provider" ("TSCP") matters because they are relevant (regulated) persons.

Regulation 12(2) MLR provides:

> In these Regulations, "trust or company service provider" means a firm or sole practitioner who by way of business provides
> [a] any of the following services to other persons,
> [c] when that firm or practitioner is providing such services-

The services are:

> (a) forming a firm;[27]
> (b) acting, or arranging for another person to act-
> (i) as a director or secretary of a company;
> (ii) as a partner of a partnership; or
> (iii) in a similar capacity in relation to other legal persons;
> (c) providing a registered office, business address, correspondence or administrative address or other related services for a company, partnership or any other legal person or legal arrangement;
> (d) acting, or arranging for another person to act, as-
> (i) a trustee of an express trust or similar legal arrangement; or
> (ii) a nominee shareholder for a person other than a company whose securities are listed on a regulated market.

132.9 Relevant person: Exclusions

There are 8 exceptions, or sets of exceptions, to the definition of relevant (regulated) person. These are all of specialist interest but I set them out for completeness.

Reg 15 MLR provides:

> (1) Parts 1 to 4, 6 and 8 to 11 do not apply to the following persons when carrying on any of the following activities—

[27] See 131.4.8 (Firm).

(a) a registered society within the meaning of section 1 of the Co-operative and Community Benefit Societies Act 2014 (meaning of "registered society"), when it—
   (i) issues withdrawable share capital within the limit set by section 24 of that Act (maximum shareholding in society); or
   (ii) accepts deposits from the public within the limit set by section 67(2) of that Act (carrying on of banking by societies);

(b) a society registered under the Industrial and Provident Societies Act (Northern Ireland) 1969, when it—
   (i) issues withdrawable share capital within the limit set by section 6 of that Act (maximum shareholding in society); or
   (ii) accepts deposits from the public within the limit set by section 7(3) of that Act (carrying on of banking by societies);

(c) a person who is (or falls within a class of persons) specified in any of paragraphs 2 to 23, 26 to 38 or 40 to 49 of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001, when carrying out any activity in respect of which that person is exempt;

(d) a local authority within the meaning given in article 3(1) of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, when carrying on an activity which would be a regulated activity for the purposes of FSMA but for article 72G of that Order;

(e) a person who was an exempted person for the purposes of section 45 of the Financial Services Act 1986 (miscellaneous exemptions) immediately before its repeal, when exercising the functions specified in that section;

(f) a person whose main activity is that of a high value dealer, when engaging in financial activity on an occasional or very limited basis as set out in paragraph (3); or

(g) a person preparing a home report, which for these purposes means the documents prescribed for the purposes of section 98, 99(1) or 101(2) of the Housing (Scotland) Act 2006 (duties: information and others).

132.9.1 *De minimis exception*

Reg 15(2) MLR provides:

> These Regulations do not apply to a person who falls within regulation 8 [definition of relevant (regulated) person] solely as a result of that person engaging in financial activity on an occasional or very limited basis as set out in paragraph (3).

Reg 15(3) MLR provides:

> For the purposes of paragraphs (1)(f) and (2), a person is to be considered as engaging in financial activity on an occasional or very limited basis if all the following conditions are met—
>
> (a) the person's total annual turnover in respect of the financial activity does not exceed £100,000;

(b) the financial activity is limited in relation to any customer to no more than one transaction exceeding 1,000 euros, whether the transaction is carried out in a single operation, or a series of operations which appear to be linked;
(c) the financial activity does not exceed 5% of the person's total annual turnover;
(d) the financial activity is ancillary and directly related to the person's main activity;
(e) the financial activity is not the transmission or remittance of money (or any representation of monetary value) by any means;
(f) the person's main activity is not that of a person falling within regulation 8(2)(a) to (f) or (h) to (k);
(g) the financial activity is provided only to customers of the main activity of the person and is not offered to the public.

132.9.2 *Exceptions for government*

Reg 15(4) MLR provides:

> Chapters 2 and 3 of Part 2, and Parts 3 to 9, do not apply to—
> (a) the Auditor General for Scotland;
> (b) the Auditor General for Wales;
> (c) the Bank of England;
> (d) the Comptroller and Auditor General;
> (e) the Comptroller and Auditor General for Northern Ireland;
> (f) the Official Solicitor to the Supreme Court, when acting as trustee in his or her official capacity;
> (g) the Treasury Solicitor.

132.10 Risk assessments

The authors of the MLR believed strongly in the value of risk assessments. The following are required:

Risk assessment	**Carried out by**	**Reg**	**See**
Government risk assessment	Treasury/Home office	16, 16A	*Not discussed*
Sector risk assessment	Supervisory authority	17	*Not discussed*
Practice risk assessments	Firm	18, 18A	132.11
Client risk assessment	Firm	28(12)(13)	132.20

MLR frequently refers to "information made available by the supervisory authority under regulations 17(9) and 47". I gloss that as "sector risk assessment/guidance".

132.11 Practice risk assessments

132.11.1 *Need for risk assessments*

Regulation 18 deals with money laundering and terrorist financing. Regulation 18A deals with proliferation financing. That is a somewhat specialist topic. The definition is in reg 16A(9) MLR:

> In this regulation, "proliferation financing" means the act of providing funds or financial services for use, in whole or in part, in the manufacture, acquisition, development, export, trans-shipment, brokering, transport, transfer, stockpiling of, or otherwise in connection with the possession or use of, chemical, biological, radiological or nuclear weapons, including the provision of funds or financial services in connection with the means of delivery of such weapons and other CBRN-related goods and technology, in contravention of a relevant financial sanctions obligation.

Lawyers will not be concerned with proliferation financing, but I deal with them both. It is helpful to consider the two side by side:

Reg 18(1) MLR	**Reg 18A(1) MLR**
A relevant [regulated] person must take appropriate steps to identify and assess the risks of money laundering and terrorist financing to which its business is subject.	A relevant person must take appropriate steps to identify and assess the risks of proliferation financing to which its business is subject.

I refer to these together as **"practice risk assessments"**.

132.11.2 *Risk assessment considerations*

Reg 18(2)(3) MLR	**Reg 18A(2)(3) MLR**
(2) In carrying out the risk assessment required under paragraph (1), a relevant [regulated] person must take into account	[Identical]
(a) information made available to them by the supervisory authority under regulations 17(9) and 47 [sector risk assessment/guidance], and	(a) information in the report referred to in regulation 16A (risk assessment by the Treasury); and

(b) risk factors including factors relating to- (i) its customers; (ii) the countries or geographic areas in which it operates; (iii) its products or services; (iv) its transactions; and (v) its delivery channels.	[identical]
(3) In deciding what steps are appropriate under paragraph (1), the relevant [regulated] person must take into account the size and nature of its business.	[identical]

132.11.3 *Record keeping & supervision*

Regulation 18 MLR provides:

> (4) A relevant [regulated] person must keep an up-to-date record in writing of all the steps it has taken under paragraph (1) [practice risk assessment], unless its supervisory authority notifies it in writing that such a record is not required.
> (5) A supervisory authority may not give the notification referred to in paragraph (4) unless it considers that the risks of money laundering and terrorist financing applicable to the sector in which the relevant [regulated] person operates are clear and understood.
> (6) A relevant [regulated] person must provide the risk assessment it has prepared under paragraph (1), the information on which that risk assessment was based and any record required to be kept under paragraph (4), to its supervisory authority on request.

Regulation 18A(4)(5) MLR repeat reg 18(4)(6) MLR. There is no equivalent of reg 18(5) but it does not matter.

132.12 Policies and procedures

132.12.1 *Need for AML policy*

Reg 19(1) MLR provides:

> A relevant [regulated] person must-
> (a) establish and maintain policies, controls and procedures to mitigate and manage effectively the risks of money laundering and terrorist financing identified in any risk assessment

> undertaken by the relevant [regulated] person under regulation 18(1) [practice risk assessments];
>
> (b) regularly review and update the policies, controls and procedures established under sub-paragraph (a);
>
> (c) maintain a record in writing of-
>
> (i) the policies, controls and procedures established under sub-paragraph (a);
>
> (ii) any changes to those policies, controls and procedures made as a result of the review and update required by sub-paragraph (b); and
>
> (iii) the steps taken to communicate those policies, controls and procedures, or any changes to them, within the relevant [regulated] person's business.

I refer to the policies, controls and procedures as the "AML policy".

132.12.2 *Content of AML policy*

Reg 19 MLR provides:

> (2) The policies, controls and procedures adopted by a relevant [regulated] person under paragraph (1) must be-
>
> (a) proportionate with regard to the size and nature of the relevant [regulated] person's business, and
>
> (b) approved by its senior management.
>
> (3) The policies, controls and procedures referred to in paragraph (1) must include-
>
> (a) risk management practices;
>
> (b) internal controls (see regulations 21 to 24);
>
> (c) customer due diligence (see regulations 27 to 38);
>
> (d) reliance and record keeping (see regulations 39 to 40);
>
> (e) the monitoring and management of compliance with, and the internal communication of, such policies, controls and procedures.
>
> (4) The policies, controls and procedures referred to in paragraph (1) must include policies, controls and procedures-
>
> (a) which provide for the identification and scrutiny of-
>
> (i) any case where-
>
> (aa) a transaction is complex or unusually large, or there is an unusual pattern of transactions, or
>
> (bb) the transaction or transactions have no apparent economic or legal purpose, and
>
> (ii) any other activity or situation which the relevant [regulated] person regards as particularly likely by its nature to be

> related to money laundering or terrorist financing;
>
> (b) which specify the taking of additional measures, where appropriate, to prevent the use for money laundering or terrorist financing of products and transactions which might favour anonymity;
>
> (c) which ensure that when new new products, new business practices (including new delivery mechanisms) or new technology are adopted by the relevant [regulated] person, appropriate measures are taken in preparation for, and during, the adoption of such products, practices or technology to assess and if necessary mitigate any money laundering or terrorist financing risks this new product, practice or technology may cause;
>
> (d) under which anyone in the relevant [regulated] person's organisation who knows or suspects (or has reasonable grounds for knowing or suspecting) that a person is engaged in money laundering or terrorist financing as a result of information received in the course of the business or otherwise through carrying on that business is required to comply with-
>
> (i) Part 3 of the Terrorism Act 2000; or
>
> (ii) Part 7 of the Proceeds of Crime Act 2002;
>
> (e) [applies to money service business that uses agents]

132.12.3 *Guidance*

Regulation 19(5) MLR provides:

> In determining what is appropriate or proportionate with regard to the size and nature of its business, a relevant [regulated] person may take into account any guidance which has been-
>
> (a) issued by the FCA; or
>
> (b) issued by any other supervisory authority or appropriate body and approved by the Treasury.

This includes LSAG guidance and the BSB risk assessment.

The BSB risk assessment places the risk of money laundering for barristers as low.[28] Readers may think that self-evident.

LSAG guidance provides:

> However, that does not mean that the risk in your practice or any matter in which you are instructed is at the same level. You must determine

[28] *https://www.barstandardsboard.org.uk/for-barristers/compliance-with-your-obligations/anti-money-laundering-counter-terrorist-financing.html*

> what is appropriate or proportionate in relation to the risk of your practice and avail of any risk assessments undertaken by the relevant supervisor in your jurisdiction.

In practice I expect (more or less) every barrister assesses the risk as low.

132.13 Internal controls

132.13.1 *Compliance officer/screening/audit*

Regulation 21 MLR provides:

> (1) Where appropriate with regard to the size and nature of its business, a relevant [regulated] person must-

Three duties follow:
(a) Compliance officer
(b) Screening employees
(c) Audit

132.13.2 *Compliance officer*

Regulation 21 MLR provides:

> (1) Where appropriate with regard to the size and nature of its business, a relevant [regulated] person must-
>
> (a) appoint one individual who is a member of the board of directors (or if there is no board, of its equivalent management body) or of its senior management as the officer responsible for the relevant [regulated] person's compliance with these Regulations;

132.13.3 *Screening employees*

Regulation 21 MLR provides:

> (1) Where appropriate with regard to the size and nature of its business, a relevant [regulated] person must ...
>
> (b) carry out screening of relevant employees[29] appointed by the

[29] Reg 21(2) provides: "For the purposes of paragraph (1)(b)-
(a) "screening" means an assessment of-
(i) the skills, knowledge and expertise of the individual to carry out their functions effectively;
(ii) the conduct and integrity of the individual;
(b) a relevant employee is an employee whose work is-

> relevant [regulated] person, both before the appointment is made and during the course of the appointment;

LSAG guidance provides:

> 36. If you directly employ your clerk(s), or any other employee or agent that falls within the definition of reg. 21(2)(b), the "internal controls" requirements of reg. 21 may be of application to your practice (reg. 21(6)). You will need to make an assessment of the factual circumstances and the application of the regulation. Such an assessment would include considering the nature of your professional relationship with your clerk (or other relevant third-party) and the level of involvement that person has in your AML/CTF policies and procedures. Even where reg. 21 does not apply you should be aware of your broader obligations with regards to appropriate risk management procedures (see, for example, in relation to practitioners in England and Wales, the BSB Handbook, rC 89.8).

Rule rC89 says:

> Taking into account the provisions of Rule rC90, you must take reasonable steps to ensure that ...
> appropriate risk management procedures are in place and are being complied with

That takes us to Rule rC90:

> For the purposes of Rule rC89 the steps which it is reasonable for you to take will depend on all the circumstances, which include, but are not limited to:
> .1 the arrangements in place in your chambers for the management of chambers;
> .2 any role which you play in those arrangements; and
> .3 the independence of individual members of chambers from one another.

(i) relevant to the relevant [regulated] person's compliance with any requirement in these Regulations, or

(ii) otherwise capable of contributing to the-

(aa) identification or mitigation of the risks of money laundering, terrorist financing and proliferation financing to which the relevant [regulated] person's business is subject, or

(bb) prevention or detection of money laundering, terrorist financing and proliferation financing in relation to the relevant [regulated] person's business."

These generalities do not take us much further.

132.13.4 *Audit*

Regulation 21 MLR provides:

> (1) Where appropriate with regard to the size and nature of its business, a relevant [regulated] person must ...
> (c) establish an independent audit function with the responsibility-
> (i) to examine and evaluate the adequacy and effectiveness of the policies, controls and procedures adopted by the relevant [regulated] person to comply with the requirements of these Regulations;
> (ii) to make recommendations in relation to those policies, controls and procedures; and
> (iii) to monitor the relevant [regulated] person's compliance with those recommendations.

LSAG guidance provides:

> 36. If you directly employ your clerk(s), or any other employee or agent that falls within the definition of reg. 21(2)(b), the "internal controls" requirements of reg. 21 may be of application to your practice (reg. 21(6)). You will need to make an assessment of the factual circumstances and the application of the regulation. Such an assessment would include considering the nature of your professional relationship with your clerk (or other relevant third-party) and the level of involvement that person has in your AML/CTF policies and procedures. Even where reg. 21 does not apply you should be aware of your broader obligations with regards to appropriate risk management procedures (see, for example, in relation to practitioners in England and Wales, the BSB Handbook, rC 89.8).

Rule rC89 says:

> Taking into account the provisions of Rule rC90, you must take reasonable steps to ensure that ...
> appropriate risk management procedures are in place and are being complied with

That takes us to Rule rC90:

> For the purposes of Rule rC89 the steps which it is reasonable for you to take will depend on all the circumstances, which include, but are not limited to:

> .1 the arrangements in place in your chambers for the management of chambers;
> .2 any role which you play in those arrangements; and
> .3 the independence of individual members of chambers from one another.

That does not take us much further.

132.14 Nominated officer

132.14.1 *Appointing nominated officer*

Reg 21(3) MLR provides:

> An individual in the relevant [regulated] person's firm must be appointed as a nominated officer.

132.14.2 *Reporting to regulator*

Regulation 21(4) MLR provides:

> A relevant [regulated] person must, within 14 days of the appointment, inform its supervisory authority of-
> (a) the identity of the individual first appointed under paragraph (1)(a);
> (b) the identity of the individual first appointed under paragraph (3); and
> (c) of any subsequent appointment to either of those positions.

132.14.3 *Duties of nominated officer*

Reg 21(5) MLR provides:

> Where a disclosure is made to the nominated officer, that officer must consider it in the light of any relevant information which is available to the relevant [regulated] person and determine whether it gives rise to knowledge or suspicion or reasonable grounds for knowledge or suspicion that a person is engaged in money laundering or terrorist financing.

LSAG guidance provides:

> 46. Self-employed barristers are individually responsible for their own professional practices (see, for example in relation to practitioners in England and Wales, in the BSB Handbook, each of the Core Duties, gC2, and rC20) and, where applicable, chambers staff provide administrative support only (as opposed to being fee-earners). It is

therefore not considered necessary or desirable for self-employed barristers or their chambers to appoint a nominated officer to whom other barristers must report.

132.14.4 *Record keeping*

Reg 21 MLR provides:

> (8) A relevant [regulated] person must establish and maintain systems which enable it to respond fully and rapidly to enquiries from any person specified in paragraph (9) as to-
> (a) whether it maintains, or has maintained during the previous five years, a business relationship with any person; and
> (b) the nature of that relationship.
> (9) The persons specified in this paragraph are-
> (a) financial investigators accredited under section 3 of the Proceeds of Crime Act 2002 (accreditation and training);
> (b) persons acting on behalf of the Scottish Ministers in their capacity as an enforcement authority under that Act; and
> (c) constables or equivalent officers of any law enforcement authority.

132.14.5 *What is appropriate*

Reg 21(10) MLR provides:

> In determining what is appropriate with regard to the size and nature of its business, a relevant [regulated] person-
> (a) must take into account its risk assessment under regulation 18(1) and 18A(1) [practice risk assessments]; and
> (b) may take into account any guidance which has been-
> (i) issued by the FCA; or
> (ii) issued by any other supervisory authority or appropriate body and approved by the Treasury

This includes LSAG guidance and the BSB risk assessment.

132.14.6 *Exemption for individuals*

Reg 21(6) MLR provides:

> Paragraphs (1) and (3) do not apply where the relevant [regulated] person is an individual who neither employs nor acts in association with any other person.

The disapplied rules are:

Para	**Topic**	**See para**
(1)	Compliance officer/screening/audit	127.13
(3)	Nominated officer	132.14.1

132.15 Training

Reg 24 MLR provides:

> (1) A relevant [regulated] person must-
>
> (a) take appropriate measures to ensure that its relevant employees, and any agents it uses for the purposes of its business whose work is of a kind mentioned in paragraph (2), are-
>
> (i) made aware of the law relating to money laundering, terrorist financing and proliferation financing, and to the requirements of data protection, which are relevant to the implementation of these Regulations; and
>
> (ii) regularly given training in how to recognise and deal with transactions and other activities or situations which may be related to money laundering, terrorist financing or proliferation financing;
>
> (b) maintain a record in writing of the measures taken under sub-paragraph (a), and in particular, of the training given to its relevant employees and to any agents it uses for the purposes of its business whose work is of a kind mentioned in paragraph (2).
>
> (2) For the purposes of paragraph (1), a relevant employee is an employee whose work is-
>
> (a) relevant to the relevant [regulated] person's compliance with any requirement in these Regulations, or
>
> (b) otherwise capable of contributing to the-
>
> (i) identification or mitigation of the risk of money laundering, terrorist financing and proliferation financing to which the relevant [regulated] person's business is subject; or
>
> (ii) prevention or detection of money laundering, terrorist financing and proliferation financing in relation to the relevant [regulated] person's business.

132.15.1 *What is appropriate*

Reg 24 MLR provides:

> (3) In determining what measures are appropriate under paragraph (1), a relevant [regulated] person-

> (a) must take account of-
> (i) the nature of its business;
> (ii) its size;
> (iii) the nature and extent of the risks of money laundering, terrorist financing and proliferation financing to which its business is subject; and
>
> (b) may take into account any guidance which has been-
> (i) issued by the FCA; or
> (ii) issued by any other supervisory authority or appropriate body and approved by the Treasury.

This includes LSAG guidance and the BSB risk assessment.

132.16 Types of CDD

In short, a relevant (regulated) person is generally required to carry out CDD for their customers. There are four types of CDD:

Type of CDD	**Reg**	**See para**
Standard CDD	28	132.18
Enhanced CDD	33	132.26
PEP CDD	35	132.27
Simplified CDD	37	132.28

LSAG guidance provides:

> 82. There is no obligation under the Regulations to conduct CDD for work that is not within the scope of the Regulations.

132.17 When CDD required

132.17.1 *Establishing Business Relationship*

Reg 27 MLR provides:

> (1) A relevant [regulated] person must apply customer due diligence measures if the person-
> (a) establishes a business relationship;

132.17.2 *Transfer of funds over* €1k

Reg 27 MLR provides:

> (1) A relevant [regulated] person must apply customer due diligence measures if the person ...
> (b) carries out an occasional transaction that amounts to a transfer of funds within the meaning of Article 3.9 of the funds transfer

> regulation exceeding 1,000 euros;

That takes us to art 3.9 of the funds transfer regulation:[30]

> 'transfer of funds' means any transaction at least partially carried out by electronic means on behalf of a payer through a payment service provider,[31] with a view to making funds available to a payee through a payment service provider, irrespective of whether the payer and the payee are the same person and irrespective of whether the payment service provider of the payer and that of the payee are one and the same, including:
>
> (a) a credit transfer as defined in point (1) of Article 2 of Regulation (EU) No 260/2012;
>
> (b) a direct debit as defined in point (2) of Article 2 of Regulation (EU) No 260/2012;
>
> (c) a money remittance as defined in point (13) of Article 4 of Directive 2007/64/EC, whether national or cross border;
>
> (d) a transfer carried out using a payment card, an electronic money instrument, or a mobile phone, or any other digital or IT prepaid or postpaid device with similar characteristics;

There is a morass of references here, but in short, any bank transfer is caught. If a person advises for a fee above €1k, is that caught? The answer is, no. LSAG guidance provides:

> **6.5 Definition of an occasional transaction**
>
> It will still be necessary to undertake CDD for an occasional transaction where it has a value of 15,000 Euros or more. 15,000 Euros relates only to the sums involved in the transaction(s) and does not include legal fees or distributions.

132.17.3 *Suspicions*

Reg 27 MLR provides:

> (1) A relevant [regulated] person must apply customer due diligence

[30] Reg 3 MLR provides: "Funds transfer regulation" means Regulation 2015/847/EU of the European Parliament and of the Council of 20th May 2015 on information accompanying transfers of funds;

[31] 'Payment service provider' means the categories of payment service provider referred to in Article 1(1) of Directive 2007/64/EC, natural or legal persons benefiting from a waiver pursuant to Article 26 thereof and legal persons benefiting from a waiver pursuant to Article 9 of Directive 2009/110/EC of the European Parliament and of the Council (19), providing transfer of funds services;

> measures if the person ...
> (c) suspects money laundering or terrorist financing; or
> (d) doubts the veracity or adequacy of documents or information previously obtained for the purposes of identification or verification.

132.17.4 *Transaction above €15k*

Reg 27(2) MLR provides:

> A relevant [regulated] person who is not
> [a] a letting agent,
> [b] a high value dealer
> [c] an art market participant,
> [d] a cryptoasset exchange provider of the kind referred to in paragraph (7D) or (7E),
> [e] a custodian wallet provider of the kind referred to in paragraph (7E) or
> [f] a casino
> must also apply customer due diligence measures if the person carries out an occasional transaction that amounts to 15,000 euros or more, whether the transaction is executed in a single operation or in several operations which appear to be linked.

132.17.5 *Reviews, changes, appropriate times*

Reg 27(8) MLR provides:

> A relevant [regulated] person must also apply customer due diligence measures-
> (za) when the relevant [regulated] person has any legal duty in the course of the calendar year to contact an existing customer for the purpose of reviewing any information which-
> (i) is relevant to the relevant [regulated] person's risk assessment for that customer, and
> (ii) relates to the beneficial ownership of the customer, including information which enables the relevant [regulated] person to understand the ownership or control structure of a legal person, trust, foundation or similar arrangement who is the beneficial owner of the customer;
> (zb) when the relevant [regulated] person has to contact an existing customer in order to fulfil any duty under the International Tax Compliance Regulations 2015;
> (a) at other appropriate times to existing customers on a risk based approach;

(b) when the relevant [regulated] person becomes aware that the circumstances of an existing customer relevant to its risk assessment for that customer have changed.

132.17.6 *Appropriate time*

Reg 27(9) MLR provides:

> For the purposes of paragraph (8), in determining when it is appropriate to take customer due diligence measures in relation to existing customers, a relevant [regulated] person must take into account, among other things-
>
> (a) any indication that the identity of the customer, or of the customer's beneficial owner, has changed;
>
> (b) any transactions which are not reasonably consistent with the relevant [regulated] person's knowledge of the customer;
>
> (c) any change in the purpose or intended nature of the relevant [regulated] person's relationship with the customer;
>
> (d) any other matter which might affect the relevant [regulated] person's assessment of the money laundering or terrorist financing risk in relation to the customer.

132.18 CDD: Standard information

132.18.1 *Information in outline*

Reg 28(1) MLR provides:

> This regulation applies when a relevant [regulated] person is required by regulation 27 to apply customer due diligence measures.

Reg 28(2)-(6) and (10) require information which I call "standard CDD information":

Reg	**Information**	**See para**
28(2)(a)(b)	Identify/verify customer	132.18.2
28(2)(c)	Business/transaction	132.18.3
28(3)	Body corporate customer	132.18.4
28(3A)	Ownership/control structure	132.18.5
28(4)	Beneficial owner of customer	132.18.6
28(5)	Listed company	132.18.7
28(6)(7)	Beneficial owner unknown	132.18.8
28(10)	Agent for customer	132.18.9

132.18.2 *Identify/verify customer*

Reg 28(2) MLR provides:

> The relevant [regulated] person must-
>
> (a) identify the customer unless the identity of that customer is known to, and has been verified by, the relevant [regulated] person;
>
> (b) verify the customer's identity unless the customer's identity has already been verified by the relevant [regulated] person;

132.18.3 *Information about business/transaction*

Reg 28(2) MLR provides:

> The relevant [regulated] person must...
>
> (c) assess, and where appropriate obtain information on, the purpose and intended nature of the business relationship or occasional transaction.

132.18.4 *Body corporate customer*

Reg 28(3) MLR provides:

> Where the customer is a body corporate-
>
> (a) the relevant [regulated] person must obtain and verify-
>
> (i) the name of the body corporate;
>
> (ii) its company number or other registration number;
>
> (iii) the address of its registered office, and if different, its principal place of business;
>
> (b) subject to paragraph (5), the relevant [regulated] person must take reasonable measures to determine and verify-
>
> (i) the law to which the body corporate is subject, and its constitution (whether set out in its articles of association or other governing documents);
>
> (ii) the full names of the board of directors (or if there is no board, the members of the equivalent management body) and the senior persons responsible for the operations of the body corporate.

132.18.5 *Ownership/control structure*

Reg 28(3A) MLR provides:

> Where the customer is a legal person, trust, company, foundation or similar legal arrangement the relevant [regulated] person must take reasonable measures to understand the ownership and control structure of that legal person, trust, company, foundation or similar legal arrangement.

"Legal person, trust, company, foundation or similar legal arrangement" means anything other than an individual.

If ownership and control are dealt with separately, where is the role of an ownership/control structure.

132.18.6 *Beneficial owner of customer*

Reg 28(4) MLR provides:

> Subject to paragraph (5), where the customer is beneficially owned by another person, the relevant [regulated] person must-
> (a) identify the beneficial owner;
> (b) take reasonable measures to verify the identity of the beneficial owner so that the relevant [regulated] person is satisfied that it knows who the beneficial owner is; and
> (c) if the beneficial owner is a legal person, trust, company, foundation or similar legal arrangement take reasonable measures to understand the ownership and control structure of that legal person, trust, company, foundation or similar legal arrangement.

See 131.15 (Beneficial Owner: MLR meaning).

132.18.7 *Listed company customer*

Reg 28(5) MLR provides:

> Paragraphs (3)(b), (3A) and (4) do not apply where the customer is a company which is listed on a regulated market.

The disapplied rules are:

Reg	**Topic**	**See para**
28(3)(b)	Governing law/directors names	132.18.4
28(3A)	Ownership/control structure	132.18.5
28(4)	Beneficial ownership	132.18.6

132.18.8 *Beneficial owner unknown*

Reg 28MLR provides:

> (6) If the customer is a body corporate, and paragraph (7) applies, the relevant [regulated] person may treat the senior person in that body corporate responsible for managing it as its beneficial owner.
> (7) This paragraph applies if (and only if) the relevant [regulated] person has exhausted all possible means of identifying the beneficial owner of the body corporate and-

> (a) has not succeeded in doing so, or
> (b) is not satisfied that the individual identified is in fact the beneficial owner.
>
> (8) If paragraph (7) applies, the relevant [regulated] person must-
> (a) keep records in writing of all the actions it has taken to identify the beneficial owner of the body corporate;
> (b) take reasonable measures to verify the identity of the senior person in the body corporate responsible for managing it, and keep records in writing of-
> (i) all the actions the relevant [regulated] person has taken in doing so, and
> (ii) any difficulties the relevant [regulated] person has encountered in doing so.

132.18.9 *Agent for customer*

Reg 28(10) MLR provides:

> Where a person ("A") purports to act on behalf of the customer, the relevant [regulated] person must-
> (a) verify that A is authorised to act on the customer's behalf;
> (b) identify A; and
> (c) verify A's identity on the basis of documents or information in either case obtained from a reliable source which is independent of both A and the customer.

That will include the director of a company.

132.19 How to get CDD data

132.19.1 *How to verify*

Reg 28 MLR provides:

> (18) For the purposes of this regulation-
> (a) except in paragraph (10), "verify" means verify on the basis of documents or information in either case obtained from a reliable source which is independent of the person whose identity is being verified;
> (b) documents issued or made available by an official body are to be regarded as being independent of a person even if they are provided or made available to the relevant [regulated] person by or on behalf of that person.
>
> (19) For the purposes of this regulation, information may be regarded as obtained from a reliable source which is independent of the person

whose identity is being verified where-

(a) it is obtained by means of

[i] an electronic identification process, including by using electronic identification means or

[ii] by using a trust service (within the meanings of those terms in Regulation (EU) No 910/2014 of the European Parliament and of the Council of 23rd July 2014 on electronic identification and trust services for electronic transactions in the internal market); and

(b) that process is secure from fraud and misuse and capable of providing assurance that the person claiming a particular identity is in fact the person with that identity, to a degree that is necessary for effectively managing and mitigating any risks of money laundering and terrorist financing.

132.19.2 *How to verify professional client*

LSAG guidance provides:

> 133. In relation to partnerships such as law firms, the necessary enquiries should be met by confirming the solicitor's regulated status through reference to the current membership directory of the relevant professional association (for example, law society or accountancy body).
> 134. Where you are required to conduct CDD upon an instructing solicitor, such a check is the standard requirement and, given the regulatory position of solicitors, will usually be sufficient. Where the person instructing you is understood to be a solicitor practising in England and Wales, a check should be made of the SRA's database of organisations and people providing legal services in England and Wales who are regulated by the SRA (see here). Advocates in Scotland and barristers in Northern Ireland should perform the equivalent check with their corresponding Law Societies and other relevant regulatory authorities.
> 135. Where an instructing solicitor has instructed you in the recent past, the application of a risk-based approach may mean that you are not required to re-apply CDD measures in relation to the solicitor upon receipt of fresh instructions. In such circumstances what is required is that you keep a record that a risk-based approach was taken and that due to the existing relationship and the low-level of money laundering/terrorist financing risk, fresh CDD measures did not need to be applied. Your obligation to undertake CDD upon your lay client would remain.

132.19.3 *No reliance on registers*

Reg 28(9) MLR provides:

> Relevant [regulated] persons do not satisfy their requirements under paragraph (4) by relying solely on the information-
>
> (a) contained in-
>
> (i) the register of people with significant control kept by a company under section 790M of the Companies Act 2006 (duty to keep register);
>
> (ii) the register of people with significant control kept by a limited liability partnership under section 790M of the Companies Act 2006 as modified by regulation 31E of the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009; or
>
> (iii) the register of people with significant control kept by a UK Societas (within the meaning of the Council Regulation 2157/2001/EC of 8 October 2001 on the Statute for a European Company) under section 790M of the Companies Act 2006 as modified by regulation 5 of the European Public Limited Liability Company (Register of People with Significant Control) Regulations 2016;
>
> (b) referred to in sub-paragraph (a) and delivered to the registrar of companies (within the meaning of section 1060(3) of the Companies Act 2006 (the registrar)) under any enactment; or
>
> (c) contained in required particulars in relation to eligible Scottish partnerships delivered to the registrar of companies under regulation 19 of the Scottish Partnerships (Register of People with Significant Control) Regulations 2017.

132.19.4 *Ongoing monitoring*

Reg 28(11) MLR provides:

> The relevant [regulated] person must conduct ongoing monitoring of a business relationship, including-
>
> (a) scrutiny of transactions undertaken throughout the course of the relationship (including, where necessary, the source of funds) to ensure that the transactions are consistent with the relevant [regulated] person's knowledge of the customer, the customer's business and risk profile;
>
> (b) undertaking reviews of existing records and keeping the documents or information obtained for the purpose of applying customer due diligence measures up-to-date.

132.20 Client risk assessment

Reg 28 MLR provides:

> (12) The ways in which a relevant [regulated] person complies with the requirement to take customer due diligence measures, and the extent of the measures taken-
>
> (a) must reflect-
>
> (i) the risk assessment carried out by the relevant [regulated] person under regulation 18(1) [practice risk assessments];
>
> (ii) its assessment of the level of risk arising in any particular case;
>
> (b) may differ from case to case.
>
> (13) In assessing the level of risk in a particular case, the relevant [regulated] person must take account of factors including, among other things-
>
> (a) the purpose of an account, transaction or business relationship;
>
> (b) the level of assets to be deposited by a customer or the size of the transactions undertaken by the customer;
>
> (c) the regularity and duration of the business relationship.

A risk assessment is required for every client.

132.21 CDD/Tipping off

Reg 28 MLR provides:

> (14) If paragraph (15) applies, a relevant [regulated] person is not required to continue to apply customer due diligence measures under paragraph (2) or (10) in respect of a customer.
>
> (15) This paragraph applies if all the following conditions are met-
>
> (a) a relevant [regulated] person has taken customer due diligence measures in relation to a customer;
>
> (b) the relevant [regulated] person makes a disclosure required by-
>
> (i) Part 3 of the Terrorism Act 2000, or
>
> (ii) Part 7 of the Proceeds of Crime Act 2002; and
>
> (c) continuing to apply customer due diligence measures in relation to that customer would result in the commission of an offence by the relevant [regulated] person under-
>
> (i) section 21D of the Terrorism Act 2000 (tipping off: regulated sector); or
>
> (ii) section 333A of the Proceeds of Crime Act 2002 (tipping off: regulated sector).

132.22 Supervision of CDD

Reg 28(16) MLR provides:

> The relevant [regulated] person must be able to demonstrate to its supervisory authority that the extent of the measures it has taken to satisfy its requirements under this regulation are appropriate in view of the risks of money laundering and terrorist financing, including risks-
>
> (a) identified by the risk assessment carried out by the relevant [regulated] person under regulation 18(1) [practice risk assessment];
>
> (b) identified by its supervisory authority and in information made available to the relevant [regulated] person under regulations 17(9) and 47 [sector risk assessment/guidance].

132.23 CDD time limits

Reg 30(1) MLR provides:

> This regulation applies when a relevant [regulated] person is required to take any measures under regulation 27, 28 or 29.

The references are:

Regulation	**Topic**	**See**
27	When CDD required	132.17
28	Standard CDD	132.10
29	Additional CDD: credit/financial institutions	-

Reg 30(2) MLR provides:

> Subject to paragraph (3) or (4), a relevant [regulated] person must comply with the requirement to verify the identity of
>
> [a] the customer,
>
> [b] any person purporting to act on behalf of the customer and
>
> [c] any beneficial owner of the customer
>
> before the establishment of a business relationship or the carrying out of the transaction.

132.23.1 *Cases of urgency*

Reg 30(3) MLR provides:

> Provided that the verification is completed as soon as practicable after contact is first established, the verification of the customer, any person purporting to act on behalf of the customer and the customer's beneficial owner, may be completed during the establishment of a business relationship if-

(a) this is necessary not to interrupt the normal conduct of business; and

(b) there is little risk of money laundering and terrorist financing.

132.23.2 *Verifying non-corporate*

Reg 30 MLR provides:

> (6) Paragraph (7) applies if-
>
> (a) the relevant [regulated] person is required to apply customer due diligence measures in the case of a trust, a legal entity (other than a body corporate) or a legal arrangement (other than a trust); and
>
> (b) the beneficiaries of that trust, entity or arrangement are designated as a class, or by reference to particular characteristics.
>
> (7) If this paragraph applies, the relevant [regulated] person must establish and verify the identity of any beneficiary before-
>
> (a) any payment is made to the beneficiary; or
>
> (b) the beneficiary exercises its vested rights in the trust, legal entity or legal arrangement.

132.24 Duty to check register

132.24.1 *Duties to check*

Reg 30A(1)(2A) MLR imposes duties to check the register:

Reg 30A(1) MLR: Initial check

Before establishing a business relationship with—

(a) a company which is subject to the requirements of Part 21A of the Companies Act 2006 (information about people with significant control);

(b) an unregistered company which is subject to the requirements of the Unregistered Companies Regulations 2009;

(c) a limited liability partnership which is subject to the requirements of the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009;

(d) an eligible Scottish partnership which is subject to the requirements of the Scottish Partnerships (Register of People with Significant Control) Regulations 2017,

Reg 30A(2A) MLR: Ongoing checks

(2A) When taking measures to fulfil the duties to carry out customer due diligence and ongoing monitoring of a business relationship (including enhanced customer due diligence and enhanced ongoing monitoring) under Part 3 of these Regulations after a business relationship with a customer of a type described in paragraph (1)(a) to (f) has been established,

(e) a trust which is subject to registration under Part 5 of these Regulations, or
(f) an overseas entity which is subject to registration under Part 1 of the Economic Crime (Transparency and Enforcement) Act 2022,

a relevant person must collect an excerpt of the register which contains full details of any information specified in paragraph (1A) held on the register at the relevant time before the business relationship is established, or must establish from its inspection of the register that there is no such information held on the register at that time.

a relevant person must also collect an excerpt of the register which contains full details of any information specified in paragraph (1A) which is held on the register at that time, or must establish from its inspection of the register that there is no such information held on the register at that time.

132.24.2 *Data required*

Reg 30A(1A) MLR provides:

> The information specified in this paragraph is as follows—
> (a) in relation to a firm of a type described in paragraphs (1)(a) to (e), information relating to beneficial owners of the customer; and
> (b) in relation to an overseas entity of a type described in paragraph (1)(f), required information relating to registrable beneficial owners specified under Schedule 1 to the Economic Crime (Transparency and Enforcement) Act 2022.

132.24.3 *Reporting discrepancy*

Reg 30A(2) and (2A) MLR imposes duties to report errors in the register:

Reg 30A(2) MLR

The relevant person must report to the person mentioned in paragraph (3) any material discrepancy the relevant person finds between information relating to the beneficial ownership of the customer—
(a) which the relevant person collects under paragraph (1), and
(b) which otherwise becomes

Reg 30A(2B) MLR

The relevant person must report to the person mentioned in paragraph (3) any material discrepancy the relevant person finds between information relating to the beneficial ownership of the customer—
(a) which the relevant person collects under paragraph (2A), and
(b) which otherwise becomes

available to the relevant person in the course of carrying out its duties under these Regulations when establishing a business relationship with the customer.	available to the relevant person in the course of carrying out its duties under these Regulations.

132.24.4 *To whom report made*

Reg 30A(3) MLR provides:

> A material discrepancy referred to in paragraphs (2) and (2B) must be reported—
>
> (a) if it relates to a company, an unregistered company, a limited liability partnership an eligible Scottish partnership or an overseas entity, to the registrar[32]; or
>
> (b) if it relates to a trust, to the Commissioners.

132.24.5 *Legal privilege*

Reg 30A(4) MLR provides:

> The relevant person is not required under paragraph (2) or (2B) to report information which that person would be entitled to refuse to provide on grounds of legal professional privilege in the High Court (or in Scotland, on the ground of confidentiality of communications in the Court of Session).

132.24.6 *Supplemental*

Reg 30A MLR provides:

> (5) The person to whom a material discrepancy is reported must take such action as that person considers appropriate to investigate and, if necessary, resolve the discrepancy in a timely manner.
>
> (6) A discrepancy which is reported to the registrar under paragraph (3) is material excluded from public inspection for the purposes of—
>
> (a) section 1087 of the Companies Act 2006 (material not available for public inspection), including for the purposes of that section as applied—
>
> (i) to unregistered companies by paragraph 20 of Schedule 1 to the Unregistered Companies Regulations 2009;

[32] Defined reg 30A(7) MLR: "A reference to the registrar in this regulation is to the registrar of companies within the meaning of section 1060(3) of the Companies Act 2006."

> (ii) to limited liability partnerships by regulation 66 of the Limited Liability Partnerships (Application of Companies Act 2006) Regulations 2009; and
>
> (iii) to eligible Scottish partnerships by regulation 61 of the Scottish Partnerships (Register of People with Significant Control) Regulations 2017; and
>
> (b) section 22 of the Economic Crime (Transparency and Enforcement) Act 2022 (material unavailable for inspection).

132.24.7 *Material discrepancy*

Regulation 30A(8) MLR provides:

> In this regulation, a "material discrepancy" is one described in Schedule 3AZA.

That takes us to schedule 3AZA which provides:

> A material discrepancy in this Schedule may arise, as the case may be,
>
> [a] in relation to information about a beneficial owner within the meaning of regulation 3 of these Regulations (including about a person of significant control within the meaning of Part 21A of the Companies Act 2006) and
>
> [b] in relation to information about a registrable beneficial owner within the meaning of Part 3 of Schedule 1 to the Economic Crime (Transparency and Enforcement) Act 2022.
>
> 1. A material discrepancy in this Schedule is one which satisfies the condition in paragraph 2, including one which is in a form listed in paragraph 3.
>
> 2. The condition in this paragraph is that the discrepancy, by its nature, and having regard to all the circumstances, may reasonably be considered—
>
> (a) to be linked to money laundering or terrorist financing; or
>
> (b) to conceal details of the business of the customer.

The test is objective; it does not matter if the discrepancy is deliberate or not.

> 3. Discrepancies listed in this paragraph are in the form of—
>
> (a) a difference in name;
>
> (b) an incorrect entry for nature of control;
>
> (c) an incorrect entry for date of birth;
>
> (d) an incorrect entry for nationality;
>
> (e) an incorrect entry for correspondence address;
>
> (f) a missing entry for a person of significant control or a registrable beneficial owner;

(g) an incorrect entry for the date the individual became a registrable person.

132.24.8 *Guidance*

HMRC say:[33]

You can submit a report to HMRC if you are a relevant person and either:

- there's a material discrepancy in the information you have about the trust and what is on the proof of registration
- the trust is not registered with HMRC and you think it should be

You should first try to contact the trustee or agent of the trust to resolve any discrepancies. You might be able to do this by:

- encouraging them to register the trust with HMRC
- asking them to correct out of date information and manage the trust's details online

If you cannot resolve any material discrepancies with the trustee, you should report them to HMRC.

What a material discrepancy is

A material discrepancy happens when the relevant person both:

- holds information about a trust that is significantly different from the proof of registration given by the trustee or agent — this includes when the trust is a registrable express trust that is not registered (the trustee cannot provide proof of registration)
- reasonably believes the discrepancy has occurred from money laundering, terrorist financing or concealing the business of the trust (whether deliberately or by accident)

Examples of when you should report a material discrepancy include if:

- you have not seen a proof of registration, even though the trust is supposed to be registered
- you believe proof of registration information you have been given is fake
- you have information which leads you to suspect money laundering or terrorist financing in the proof of registration:
- there are clear differences in the trust name, Unique Tax Reference, trust start date or correspondence address
- personal information about the beneficial owner is wrong (for example, their month or year of birth is incorrect)
- any of the beneficial owners are missing or wrongly included and should be removed
- none of the trust information matches what you expect to see

What you do not need to report

You do not need to tell us about:

- spelling errors (for example, Jon Smith instead of John Smith)
- missing, or slightly different spellings of, middle names
- slight differences in the trust name

Companies House say:[34]

[33] *https://www.gov.uk/guidance/report-a-trust-discrepancy-to-hmrc*

[34] *https://www.gov.uk/guidance/report-a-discrepancy-about-a-beneficial-owner-on-the-psc-register-by-an-obliged-entity*

Examples of material discrepancies

When you conclude that the discrepancy is linked to the conditions of money laundering, terrorist financing or concealment, the discrepancy is considered 'material' and is therefore reportable.

Material discrepancies that could be linked to these conditions may include the following examples.

A difference in name

The person or entity could be considered to be a different person or entity rather than a spelling error, such as an omitted, incomplete, or inverted:

- PSC surname
- registrable beneficial owner surname
- relevant legal entity (RLE) name

For example:

- Smith Maria instead of Maria Smith (forename and surname reversed)
- John Smith instead of Paul Smith (different name)
- John Smythe instead of John Smith (different spelling indicates it could be a different person)
- Amira Brown instead of Amira Wallace-Brown (part of hyphenated surname missing)
- Sunshine News Limited instead of Sunshine News International Limited (part of registered company name missing)

An incorrect entry for nature of control

The PSC's natures of control do not correctly reflect the control they hold in terms of the qualifying conditions in the Department for Business and Trade (DBT) guidance on the register of people with significant control (PDF 1,806KB).

This includes incomplete natures of control, such as missing voting rights.

For example:

- an individual who holds more than 25% of the shares is notified as a PSC with 'significant influence or control'
- an individual who holds 50% of the shares is notified as a PSC with 'ownership of shares – more than 50% but less than 75%'
- an individual who holds more than 25% of the shares and attached voting rights is notified as a PSC with ownership of shares only
- an entity is notified as a PSC with 'ownership of shares – more than 50% but less than 75%' however an individual is identified as directly owning 100% shares

This also applies if a registrable beneficial owner's natures of control do not correctly reflect the control they have.

An incorrect entry for date of birth

The PSC's or registrable beneficial owner's month or year of birth (or both), as verified by the obliged entity, does not match what is shown on the Companies House register.

For example, the date of birth on an individual's passport is 24 May 1985, but the month and year of birth shown in their PSC or beneficial owner information on the register is October 1985.

An incorrect entry for nationality

The PSC's or registrable beneficial owner's nationality, as verified by the obliged entity, does not match the nationality shown on the Companies House register.

For example, an individual has provided a French passport as proof of nationality, however the nationality shown in their PSC or beneficial owner information on the register is British.

An incorrect entry for correspondence address

The PSC's or registerable beneficial owner's address significantly differs from the address on the register, such as the property number or the postcode.

For example, the first line of an individual's correspondence address is '4 Daisy Lane', however the first line of their correspondence address is shown on the Companies House register as 'The Mill, Daisy Lane'.

A missing entry for a PSC or a registrable beneficial owner

An individual or legal entity that qualifies as a PSC or RLE is not recorded as a PSC or registrable beneficial owner.

For example, you have established that an individual holds more than 25% of the shares, however the individual is not recorded on the register as a PSC or beneficial owner.

The report should include the reason why the obliged entity believes that the individual would qualify as a PSC or beneficial owner.

An incorrect entry for the date the individual became a registrable person

The date that an individual became a PSC or registerable beneficial owner does not match the date on the register.

For example, an individual or legal entity's notification date is shown as 12 June 2019 on the Companies House register, however their notification date was 27 June 2020.

...

What you do not need to report

You do not need to report the following:

- if a discrepancy is not reasonably considered to be linked to money laundering, terrorist financing or to conceal details of a PSC or a registrable beneficial owner, it does not need to be reported to Companies House
- if you've already made a discrepancy report, you do not need to report the same material discrepancy again
- if the material discrepancy is resolved before you submit a report, you do not need to report it - see When to obtain an extract and make a discrepancy report
- when an obliged entity holds information that is not required to be included on the Companies House register
- a spelling error - for example, Jon Smith instead of John Smith, or a missing or slightly different spelling of a middle name
- a shortened name - for example, Jim instead of James
- minor variations in an address – for example, Glos Rd instead of Gloucester Road
- where the nationality of Welsh, English, Scottish or Northern Irish is given to the obliged entity, but the register shows UK
- where a company has claimed an exemption from providing their PSC details because they are trading on a regulated market, PSC details will not be shown on the register
- if a person or company owns less than 25% of shares they are not registrable as a PSC or a beneficial owner of an overseas entity - this does not affect the duty in terms of PSCs or registrable beneficial owners who control the company in another way

132.25 Unable to satisfy CDD

Reg 31 MLR provides:

(1) Where, in relation to any customer, a relevant [regulated] person is unable to apply customer due diligence measures as required by regulation 28,[35] that person-

(a) must not carry out any transaction through a bank account with the customer or on behalf of the customer;

(b) must not establish a business relationship or carry out a transaction with the customer otherwise than through a bank account;

(c) must terminate any existing business relationship with the customer;

(d) must consider whether the relevant [regulated] person is required to make a disclosure (or to make further disclosure) by-

(i) Part 3 of the Terrorism Act 2000; or

(ii) Part 7 of the Proceeds of Crime Act 2002.

(2) Paragraph (1)(a) does not prevent money deposited in an account being repaid to the person who deposited it, provided that, in any case where a disclosure is required by the legislation referred in paragraph (1)(d), the relevant [regulated] person has-

(a) consent (within the meaning of section 21ZA of the Terrorism Act 2000 (arrangements with prior consent)) to the transaction, or

(b) the appropriate consent (within the meaning of section 335 of the Proceeds of Crime Act 2002 (appropriate consent)) to the transaction.

132.25.1 *Legal advice exemption*

Reg 31(3) MLR provides:

Paragraph (1) does not apply where an independent legal professional or other professional adviser[36] is in the course of ascertaining the legal position for a client or performing the task of defending or representing that client in, or concerning, legal proceedings, including giving advice on the institution or avoidance of proceedings.

[35] See 132.18 (CDD: Standard information).

[36] Reg 31(4) provides: “In paragraph (3), “other professional adviser” means an auditor, external accountant or tax adviser who is a member of a professional body which is established for any such persons and which makes provision for-

(a) testing the competence of those seeking admission to membership of such a body as a condition for such admission; and

(b) imposing and maintaining professional and ethical standards for its members, as well as imposing sanctions for noncompliance with those standards.”

This exception only applies to litigation and contentious matters, not to CDD transactional work.

132.26 Enhanced CDD

132.26.1 *High-risk third country*

Reg 33 MLR provides:

> (3) For the purposes of paragraph (1)(b)-
> (a) a "high-risk third country" means a country named on either of the following lists published by the Financial Action Task Force as they have effect from time to time —
> (i) High-Risk Jurisdictions subject to a Call for Action;
> (ii) Jurisdictions under Increased Monitoring;

As at 27 June 2023, the list is:

> Barbados, Bulgaria, Burkina Faso, Cameroon, Croatia, Democratic People's Republic of Korea, Democratic Republic of the Congo, Gibraltar, Haiti, Iran, Jamaica, Mali, Mozambique, Myanmar, Nigeria, Philippines, Senegal, South Africa, South Sudan, Syria, Tanzania, Turkey, Uganda, United Arab Emirates, Vietnam, Yemen.

There are few surprises in the list.

132.26.2 *Other definitions*

Reg 33(3) MLR provides:

> (b) a "relevant transaction" means a transaction in relation to which the relevant [regulated] person is required to apply customer due diligence measures under regulation 27;[37]

In my terminology, that is a CDD transaction.

> (c) being "established in" a country means-
> (i) in the case of a legal person, being incorporated in or having its principal place of business in that country, or, in the case of a financial institution or a credit institution, having its principal regulatory authority in that country; and
> (ii) in the case of an individual, being resident in that country, but not merely having been born in that country.

[37] See 132.17 (When CDD required).

132.26.3 *When enhanced CDD required*

Reg 33 MLR provides:

> (1) A relevant [regulated] person must apply enhanced customer due diligence measures and enhanced ongoing monitoring, in addition to the customer due diligence measures required under
> [a] regulation 28[38]
> [b] and, if applicable, regulation 29 [additional CDD: credit/financial institutions],
> to manage and mitigate the risks arising-
> (a) in any case identified as one where there is a high risk of money laundering or terrorist financing-
> (i) by the relevant [regulated] person under regulation 18(1) [practice risk assessment], or
> (ii) in information made available to the relevant [regulated] person under regulations 17(9) and 47 [sector risk assessment/guidance];
> (b) in any business relationship with a person established in a high-risk third country or in relation to any relevant transaction where either of the parties to the transaction is established in a high-risk third country;
> (c) in relation to correspondent relationships with a credit institution or a financial institution (in accordance with regulation 34);
> (d) if a relevant [regulated] person has determined that a customer or potential customer is a PEP, or a family member or known close associate of a PEP (in accordance with regulation 35);
> (e) in any case where the relevant [regulated] person discovers that a customer has provided false or stolen identification documentation or information and the relevant [regulated] person proposes to continue to deal with that customer;
> (f) in any case where-
> (i) a transaction is complex or unusually large,
> (ii) there is an unusual pattern of transactions, or
> (iii) the transaction or transactions have no apparent economic or legal purpose, and
> (g) in any other case which by its nature can present a higher risk of money laundering or terrorist financing.

[38] See 132.18 (CDD: Standard information).

132.26.4 *Branch/group relief*

Reg 33 MLR provides:

> (2) Paragraph (1)(b) does not apply when the customer is a branch or majority owned subsidiary undertaking of an entity which is established in a third country if all the following conditions are satisfied-
>
> (a) the entity is-
>
> (i) subject to requirements in national legislation having an equivalent effect to those laid down in the fourth money laundering directive on an obliged entity (within the meaning of that directive); and
>
> (ii) supervised for compliance with those requirements in a manner equivalent to section 2 of Chapter VI of the fourth money laundering directive;
>
> (b) the branch or subsidiary complies fully with procedures and policies established for the group under requirements equivalent to those laid down in Article 45 of the fourth money laundering directive; and
>
> (c) the relevant [regulated] person, applying a risk-based approach, does not consider that it is necessary to apply enhanced customer due diligence measures.

132.26.5 *What enhanced CDD requires*

Reg 33 MLR provides:

> (3A) The enhanced due diligence measures taken by a relevant [regulated] person for the purpose of paragraph (1)(b) must include-
>
> (a) obtaining additional information on the customer and on the customer's beneficial owner;
>
> (b) obtaining additional information on the intended nature of the business relationship;
>
> (c) obtaining information on the source of funds and source of wealth of the customer and of the customer's beneficial owner;
>
> (d) obtaining information on the reasons for the transactions;
>
> (e) obtaining the approval of senior management for establishing or continuing the business relationship;
>
> (f) conducting enhanced monitoring of the business relationship by increasing the number and timing of controls applied, and selecting patterns of transactions that need further examination.
>
> (4) The enhanced customer due diligence measures taken by a relevant [regulated] person for the purpose of paragraph (1)(f) must include-
>
> (a) as far as reasonably possible, examining the background and purpose of the transaction, and
>
> (b) increasing the degree and nature of monitoring of the business

relationship in which the transaction is made to determine whether that transaction or that relationship appear to be suspicious.

(4A) Where a relevant [regulated] person provides a life insurance policy, the relevant [regulated] person must consider the nature and identity of the beneficiary of the policy when assessing whether there is a high risk of money laundering or terrorist financing, and the extent of the measures which should be taken to manage and mitigate that risk.

(4B) Where the beneficiary of a life insurance policy provided by a relevant [regulated] person-

(a) is a legal person or a legal arrangement, and

(b) presents a high risk of money laundering or terrorist financing,

the relevant [regulated] person must take reasonable measures to identify and verify the identity of the beneficial owner of that beneficiary before any payment is made under the policy.

(5) Depending on the requirements of the case, the enhanced customer due diligence measures required under paragraph (1) may also include, among other things-

(a) seeking additional independent, reliable sources to verify information provided or made available to the relevant [regulated] person;

(b) taking additional measures to understand better the background, ownership and financial situation of the customer, and other parties to the transaction;

(c) taking further steps to be satisfied that the transaction is consistent with the purpose and in-tended nature of the business relationship;

(d) increasing the monitoring of the business relationship, including greater scrutiny of transactions.

(6) When assessing whether there is a high risk of money laundering or terrorist financing in a particular situation, and the extent of the measures which should be taken to manage and mitigate that risk, relevant [regulated] persons must take account of risk factors including, among other things-

(a) customer risk factors, including whether-

(i) the business relationship is conducted in unusual circumstances;

(ii) the customer is resident in a geographical area of high risk (see sub-paragraph (c));

(iii) the customer is a legal person or legal arrangement that is a vehicle for holding personal assets;

(iv) the customer is a company that has nominee shareholders or shares in bearer form;

(v) the customer is a business that is cash intensive;

(vi) the corporate structure of the customer is unusual or excessively complex given the nature of the company's business;

(vii) the customer is the beneficiary of a life insurance policy;

(viii) the customer is a third country national who is applying for residence rights in or citizenship of a state in exchange for transfers of capital, purchase of a property, government bonds or in-vestment in corporate entities in that state;

(b) product, service, transaction or delivery channel risk factors, including whether-

(i) the product involves private banking;

(ii) the product or transaction is one which might favour anonymity;

(iii) the situation involves non-face-to-face business relationships or transactions, without certain safeguards, such as an electronic identification process which meets the conditions set out in regulation 28;[39]

(iv) payments will be received from unknown or unassociated third parties;

(v) new products and new business practices are involved, including new delivery mechanisms, and the use of new or developing technologies for both new and pre-existing products;

(vi) the service involves the provision of nominee directors, nominee shareholders or shadow directors, or the formation of companies in a third country;

(vii) there is a transaction related to oil, arms, precious metals, tobacco products, cultural artefacts, ivory or other items related to protected species, or other items of archaeological, historical, cultural or religious significance or of rare scientific value;

(c) geographical risk factors, including-

(i) countries identified by credible sources, such as mutual evaluations, detailed assessment re-ports or published follow-up reports, as not having effective systems to counter money laundering or terrorist financing;

(ii) countries identified by credible sources as having significant levels of corruption or other criminal activity, such as terrorism (within the meaning of section 1 of the Terrorism Act 2000), money laundering, and the production and supply of illicit drugs;

(iii) countries subject to sanctions, embargos or similar measures issued by, for example, the European Union or the United Nations;

(iv) countries providing funding or support for terrorism;

(v) countries that have organisations operating within their territory which have been designated-

(aa) by the government of the UK as proscribed organisations under Schedule 2 to the Terrorism Act 2000, or

(bb) by other countries, international organisations or the European Union as terrorist organisations;

(vi) countries identified by credible sources, such as evaluations, detailed assessment reports or published follow-up reports published by the Financial Action Task Force, the International Monetary Fund, the World Bank, the Organisation for Economic Co-operation and Development or other international bodies or non-governmental organisations as not implementing requirements

[39] See 132.18 (CDD: Standard information).

to counter money laundering and terrorist financing that are consistent with the recommendations published by the Financial Action Task Force in February 2012 and updated in June 2019.

(7) In making the assessment referred to in paragraph (6), relevant [regulated] persons must bear in mind that the presence of one or more risk factors may not always indicate that there is a high risk of money laundering or terrorist financing in a particular situation.

132.27 Politically exposed person (PEP)

132.27.1 *"PEP" & other definitions*

Reg 35 MLR provides:

(12) In this regulation-

(a) "politically exposed person" or "PEP" means an individual who is entrusted with prominent public functions, other than as a middle-ranking or more junior official;

(b) "family member" of a politically exposed person includes-

(i) a spouse or civil partner of the PEP;

(ii) children of the PEP and the spouses or civil partners of the PEP's children;

(iii) parents of the PEP;

(c) "known close associate" of a PEP means-

(i) an individual known to have joint beneficial ownership of a legal entity or a legal arrangement or any other close business relations with a PEP;

(ii) an individual who has sole beneficial ownership of a legal entity or a legal arrangement which is known to have been set up for the benefit of a PEP.

(d) "domestic PEP" means a politically exposed person entrusted with prominent public functions by the United Kingdom;

(e) "non-domestic PEP" means a politically exposed person who is not a domestic PEP;

(f) "enhanced risk factors", in relation to a customer or potential customer who is a domestic PEP or a family member or a known close associate of that domestic PEP, mean risk factors other than the customer's or potential customer's position as a domestic PEP or as a family member or a known close associate of that domestic PEP.

(13) For the purposes of paragraph (5), a reference to a business relationship with an individual includes a reference to a business relationship with a person of which the individual is a beneficial owner.

(14) For the purposes of paragraphs (9), (11) and (12), individuals entrusted with prominent public functions include-

(a) heads of state, heads of government, ministers and deputy or assistant ministers;

(b) members of parliament or of similar legislative bodies;

(c) members of the governing bodies of political parties;

> (d) members of supreme courts, of constitutional courts or of any judicial body the decisions of which are not subject to further appeal except in exceptional circumstances;
> (e) members of courts of auditors or of the boards of central banks;
> (f) ambassadors, charges d'affaires and high-ranking officers in the armed forces;
> (g) members of the administrative, management or supervisory bodies of State-owned enterprises;
> (h) directors, deputy directors and members of the board or equivalent function of an international organisation.
>
> (15) For the purpose of deciding whether a person is a known close associate of a politically exposed person, a relevant [regulated] person need only have regard to information which is in its possession, or to credible information which is publicly available.

132.27.2 *PEP Policy*

Reg 35(1) MLR provides:

> A relevant [regulated] person must have in place appropriate risk-management systems and procedures
> [A] to determine whether a customer or the beneficial owner of a customer is-
> (a) a politically exposed person (a "PEP"); or
> (b) a family member or a known close associate of a PEP,
> [B] and to manage the enhanced risks arising from the relevant [regulated] person's business relationship or transactions with such a customer.

I refer to the risk-management systems and procedures as a "PEP policy".

132.27.3 *"Appropriate" policy*

Reg 35(2) MLR provides:

> In determining what risk-management systems and procedures are appropriate under paragraph (1), the relevant [regulated] person must take account of-
> (a) the risk assessment it carried out under regulation 18(1) [practice risk assessment];
> (b) the level of risk of money laundering and terrorist financing inherent in its business;
> (c) the extent to which that risk would be increased by its business relationship or transactions with a PEP, or a family member or known close associate of a PEP, and
> (d) any relevant information made available to the relevant [regulated] person under regulations 17(9) and 47 [sector risk assessment/ guidance].

132.27.4 *PEP risk assessment*

Reg 35 MLR provides:

> (3) If a relevant [regulated] person has determined that a customer or a potential customer is a PEP, or a family member or known close associate of a PEP, the relevant [regulated] person must assess-
> (a) the level of risk associated with that customer, and
> (b) the extent of the enhanced customer due diligence measures to be applied in relation to that customer.
>
> (3A) For the purpose of the relevant person's assessment under paragraph (3), where a customer or potential customer is a domestic PEP, or a family member or a known close associate of a domestic PEP—
> (a) the starting point for the assessment is that the customer or potential customer presents a lower level of risk than a non-domestic PEP, and
> (b) if no enhanced risk factors are present, the extent of enhanced customer due diligence measures to be applied in relation to that customer or potential customer is less than the extent to be applied in the case of a non-domestic PEP.
>
> (4) In assessing the extent of the enhanced customer due diligence measures to be taken in relation to any particular person (which may differ from case to case), a relevant [regulated] person-
> (a) must take account of any relevant information made available to the relevant [regulated] person under regulations 17(9) and 47 [sector risk assessment/guidance]; and
> (b) may take into account any guidance which has been-
> (i) issued by the FCA; or
> (ii) issued by any other supervisory authority or appropriate body and approved by the Treasury.

This includes LSAG guidance and the BSB risk assessment.

132.27.5 *PEP CDD*

Reg 35 MLR provides:

> (5) A relevant [regulated] person who proposes to have, or to continue, a business relationship with a PEP, or a family member or a known close associate of a PEP, must, in addition to the measures required by regulation 33 [enhanced CDD]-
> (a) have approval from senior management for establishing or continuing the business relationship with that person;
> (b) take adequate measures to establish the source of wealth and source of funds which are involved in the proposed business relationship or transactions with that person; and
> (c) where the business relationship is entered into, conduct enhanced ongoing monitoring of the business relationship with that person.
>
> (6)-(8) [This concerns insurance companies]

132.27.6 *Ceasing to be a PEP*

Reg 35 MLR provides:

> (9) Where a person who was a PEP is no longer entrusted with a prominent public function, a relevant [regulated] person must continue to apply the requirements in paragraphs (5) and (8) in relation to that person-
>
> (a) for a period of at least 12 months after the date on which that person ceased to be entrusted with that public function; or
>
> (b) for such longer period as the relevant [regulated] person considers appropriate to address risks of money laundering or terrorist financing in relation to that person.
>
> (10) Paragraph (9) does not apply in relation to a person who-
>
> (a) was not a politically exposed person within the meaning of regulation 14(5) of the Money Laundering Regulations 2007, when those Regulations were in force; and
>
> (b) ceased to be entrusted with a prominent public function before the date on which these Regulations come into force.
>
> (11) When a person who was a PEP is no longer entrusted with a prominent public function, the relevant [regulated] person is no longer required to apply the requirements in paragraphs (5) and (8) in relation to a family member or known close associate of that PEP (whether or not the period referred to in paragraph (9) has expired).

132.27.7 *Interaction with other duties*

Reg 36 MLR provides:

> (1) The duty under section 30(1) of the Bank of England and Financial Services Act 2016 (duty to ensure that regulations or orders implementing the fourth money laundering directive comply with paragraphs (a) to (d) of that subsection) does not apply if, and to the extent that, the duty is otherwise satisfied as a result of any provision contained in these Regulations, or any guidance issued by the FCA under these Regulations.
>
> (2) The duty under section 333U(1) and (2) of FSMA (duty to issue guidance in connection with politically exposed persons) does not apply if, and to the extent that, the duty is otherwise satisfied as a result of guidance issued by the FCA under these Regulations.

132.28 Simplified CDD

132.28.1 *When simplified CDD applies*

Reg 37(1) MLR provides:

> A relevant [regulated] person may apply simplified customer due diligence measures in relation to a particular business relationship or transaction if it determines that the business relationship or transaction

> presents a low degree of risk of money laundering and terrorist financing...

132.28.2 *What simplified CDD requires*

Reg 37(2) MLR provides:

> Where a relevant [regulated] person applies simplified customer due diligence measures, it must-
>
> (a) [i] continue to comply with the requirements in regulations 28 and 30A, but
>
> [ii] it may adjust the extent, timing or type of the measures it undertakes under regulation 28 to reflect its determination under paragraph (1); and
>
> (b) carry out sufficient monitoring of any business relationships or transactions which are subject to those measures to enable it to detect any unusual or suspicious transactions.

This relaxes the requirements of reg 28 (standard CDD)[40] but not the requirements of reg 30A (checking the register).[41]

132.28.3 *Risk factors*

Reg 37(1) MLR provides that the risk policy is to be made:

> ... having taken into account-
>
> (a) the risk assessment it carried out under regulation 18(1) [practice risk assessment];
>
> (b) relevant information made available to it under regulations 17(9) and 47 [sector risk assessment/guidance]; and
>
> (c) the risk factors referred to in paragraph (3).

Reg 37 MLR provides:

> (3) When assessing whether there is a low degree of risk of money laundering and terrorist financing in a particular situation, and the extent to which it is appropriate to apply simplified customer due diligence measures in that situation, the relevant [regulated] person must take account of risk factors including, among other things-
>
> (a) customer risk factors, including whether the customer-
>
> (i) is a public administration, or a publicly owned enterprise;
>
> (ii) is an individual resident in a geographical area of lower risk (see sub-paragraph (c));

[40] See 132.18 (CDD: Standard information).

[41] See 132.24 (Duty to check register).

(iii) is a credit institution or a financial institution which is-

(aa) subject to requirements in national legislation having an equivalent effect to those laid down in the fourth money laundering directive on an obliged entity (within the meaning of that directive); and

(bb) supervised for compliance with those requirements in a manner equivalent to section 2 of Chapter VI of the fourth money laundering directive;

(iv) is a company whose securities are listed on a regulated market, and the location of the regulated market;

(b) product, service, transaction or delivery channel risk factors, including whether the product or service is-

(i) a life insurance policy for which the premium is low;

(ii) an insurance policy for a pension scheme which does not provide for an early surrender option, and cannot be used as collateral;

(iii) a pension, superannuation or similar scheme which satisfies the following conditions-

(aa) the scheme provides retirement benefits to employees;

(bb) contributions to the scheme are made by way of deductions from wages; and

(cc) the scheme rules do not permit the assignment of a member's interest under the scheme;

(iv) a financial product or service that provides appropriately defined and limited services to certain types of customers to increase access for financial inclusion purposes in the UK;

(v) a product where the risks of money laundering and terrorist financing are managed by other factors such as purse limits or transparency of ownership;

(vi) a child trust fund within the meaning given by section 1(2) of the Child Trust Funds Act 2004;

(vii) a junior ISA within the meaning given by regulation 2B of the Individual Savings Account Regulations 1998;

(c) geographical risk factors, including whether the country where the customer is resident, established or registered or in which it operates is-

(i) the UK;

(ii) a third country which has effective systems to counter money laundering and terrorist financing;

(iii) a third country identified by credible sources as having a low level of corruption or other criminal activity, such as terrorism (within the meaning of section 1 of the Terrorism Act 2000), money laundering, and the production and supply of illicit drugs;

(iv) a third country which, on the basis of credible sources, such as evaluations, detailed assessment reports or published follow-up reports published by the Financial Action Task Force, the International Monetary Fund, the World Bank, the Organisation for Economic Co-operation and Development or other international bodies or non-governmental organisations-

(aa) has requirements to counter money laundering and terrorist financing that are consistent with the revised Recommendations published by the Financial Action Task Force in February 2012 and updated in October 2016; and

(bb) effectively implements those Recommendations.

(4) In making the assessment referred to in paragraph (3), relevant [regulated] persons must bear in mind that the presence of one or more risk factors may not always indicate that there is a low risk of money laundering and terrorist financing in a particular situation.

132.28.4 *End to simplified CDD*

Reg 37(8) MLR provides:

> A relevant [regulated] person must not continue to apply simplified customer due diligence measures under paragraph (1)-
>
> (a) if it doubts the veracity or accuracy of any documents or information previously obtained for the purposes of identification or verification;
>
> (b) if its risk assessment changes and it no longer considers that there is a low degree of risk of money laundering and terrorist financing;
>
> (c) if it suspects money laundering or terrorist financing; or
>
> (d) if any of the conditions set out in regulation 33(1) apply.

132.29 Reliance on third party

132.29.1 *Authority to rely*

Reg 39 MLR provides:

> (1) A relevant [regulated] person may rely on a person who falls within paragraph (3) ("the third party")
>
> [a] to apply any of the customer due diligence measures required by regulation 28(2) to (6) and (10), or
>
> [b] to carry out any of the measures required by regulation 30A...

These measures are:

Reg	**Topic**	**See**
28(2)-(6) & (10)	Standard CDD data	132.18
30A	Register check	132.24

132.29.2 *Remaining liable*

Reg 39(1) MLR provides:

> but, notwithstanding the relevant [regulated] person's reliance on the

> third party, the relevant [regulated] person remains liable for any failure to apply such measures.

The rule that a person "may rely" but "remains liable for any failure" represents an uneasy compromise, if not a contradiction.

LSAG guidance provides:

> 169. Whatever approach you take, liability for carrying out the required CDD remains with you as the relevant [regulated] person. Where you rely upon another person conducting the CDD checks, the responsibility remains yours. You cannot avoid criminal sanction by the plea that you relied upon your solicitor's CDD or paid an external provider and that they failed to do the job properly - the buck stops with you.

132.29.3 *Reliance on register check*

Reg 39(2) MLR provides:

> When a relevant [regulated] person relies on the third party to apply customer due diligence measures or carry out any of the measures required by regulation 30A under paragraph (1) it—
>
> (a) must immediately obtain from the third party all the information needed to satisfy the requirements of regulation 28(2) to (6) and (10) and regulation 30A in relation to the customer, customer's beneficial owner, or any person acting on behalf of the customer;
>
> (b) must enter into arrangements with the third party which—
>
> (i) enable the relevant [regulated] person to obtain from the third party immediately on request copies of any identification and verification data and any other relevant documentation on the identity of the customer, customer's beneficial owner, or any person acting on behalf of the customer;
>
> (ii) require the third party to retain copies of the data and documents referred to in paragraph (i) for the period referred to in regulation 40.

LSAG guidance provides:

> 158. Reliance does not mean simply obtaining the third party's CDD documents. Rather, it means obtaining from them all of the "information" that you need to meet all of your CDD obligations under reg. 28. This does not mean and does not require you to obtain the underlying documentation. Even where you do obtain copy documents, the obligation upon you is to ensure that the information provided to you

permits you to meet the requirements of Regulation-compliant CDD.

159. To undertake reliance you should

[a] enquire of the third party what steps it has taken to satisfy its CDD obligations, review and

[b] check the CDD information provided to you and consider whether the steps taken by the third party are sufficient to meet the requirements of the Regulations.

You should assess whether the CDD upon which you propose to rely is sufficient for you to comply with your CDD obligations under the Regulations. If it is not, then you should not rely upon it.

160. In practice, you need to know:

- the identity of the customer or beneficial owner whose identity is being verified;
- the level of CDD that has been carried out; and
- confirmation of the third party's understanding of their obligation to make available, on request, copies of the verification data, documents or other information.

If you routinely rely on CDD checks done by a particular third party, it is good practice to request sample documents to test their reliability.

161. You must confirm that the third party is someone who can grant reliance under the Regulations and keep a written record of having done so. You should also consider whether you are required to undertake CDD upon the third party upon whom you are seeking reliance.

132.29.4 *Who can be relied on*

Reg 39 MLR provides:

> (3) The persons within this paragraph are—
>
> (a) another relevant [regulated] person who is subject to these Regulations under regulation 8;
>
> (c)[42] a person who carries on business in a third country who is—
>
> (i) subject to requirements in relation to customer due diligence and record keeping which are equivalent to those laid down in the fourth money laundering directive; and
>
> (ii) supervised for compliance with those requirements in a manner equivalent to section 2 of Chapter VI of the fourth money laundering directive;
>
> (d) organisations whose members consist of persons within sub-paragraph (a) or (c).

[42] There is no para (b).

132.29.5 *High-risk countries*

Reg 39(4) MLR provides:

> A relevant [regulated] person may not rely on a third party established in a high-risk third country, and for these purposes "high-risk third country" has the meaning given in regulation 33(3).[43]

132.29.6 *Outsourcing CDD service provider*

Reg 39 MLR provides:

> (7) Nothing in this regulation prevents a relevant [regulated] person applying customer due diligence measures, or carrying out any of the measures required by regulation 30A, by means of an agent or an outsourcing service provider provided that the arrangements between the relevant [regulated] person and the agent or outsourcing service provider provide for the relevant [regulated] person to remain liable for any failure to apply such measures.
>
> (8) For the purposes of paragraph (7), an "outsourcing service provider" means a person who—
>
> (a) performs a process, a service or an activity that would otherwise be undertaken by the relevant [regulated] person, and
>
> (b) is not an employee of the relevant [regulated] person.

132.30 Record-keeping

Regulation 40 MLR provides:

> (1) Subject to paragraph (5), a relevant [regulated] person must keep the records specified in paragraph (2) for at least the period specified in paragraph (3).
>
> (2) The records are-
>
> (a) a copy of any documents and information obtained by the relevant [regulated] person to satisfy the customer due diligence requirements in regulations
>
> [i] 28 [standard CDD],
>
> [ii] 29 [Additional CDD: credit/financial institutions] and
>
> [iii] 33 to 37
>
> [iv] and the requirements of regulation 30A [checking the register],
>
> [v] and of regulations 64C and 64G(1);
>
> (b) sufficient supporting records (consisting of the original documents or copies) in respect of a transaction (whether or not the transaction is an occasional transaction) which is the subject of customer due diligence measures or ongoing monitoring to enable the transaction to be

[43] See 132.26.1 (High-risk third country).

reconstructed;

(c) [this concerns an inter-cryptoasset business transfer]

(d) [this concerns an unhosted wallet transfer]

(3) Subject to paragraph (4), the period is five years beginning on the date on which the relevant person knows, or has reasonable grounds to believe-

(a) that the transaction is complete, for records relating to an occasional transaction; or

(b) that the business relationship has come to an end for records relating to-

(i) any transaction which occurs as part of a business relationship, or

(ii) customer due diligence measures taken in connection with that relationship.

(4) A relevant [regulated] person is not required to keep the records referred to in paragraph (3)(b)(i) for more than 10 years.

(5) Once the period referred to in paragraph (3), or if applicable paragraph (4), has expired, the relevant [regulated] person must delete any personal data obtained for the purposes of these Regulations unless-

(a) the relevant [regulated] person is required to retain records containing personal data-

(i) by or under any enactment, or

(ii) for the purposes of any court proceedings;

(b) the data subject has given consent to the retention of that data; or

(c) the relevant [regulated] person has reasonable grounds for believing that records containing the personal data need to be retained for the purpose of legal proceedings.

(6) A relevant [regulated] person who is relied on by another person must keep the records specified in paragraph (2) for the period referred to in paragraph (3) or, if applicable, paragraph (4).

(7) A person referred to in regulation 39(3) ("A") who is relied on by a relevant [regulated] person ("B") must, if requested by B within the period referred to in paragraph (3) or, if applicable, paragraph (4), immediately-

(a) make available to B any information about the customer, any person purporting to act on behalf of the customer and any beneficial owner of the customer, which A obtained when applying customer due diligence measures; and

(b) forward to B copies of any identification and verification data and other relevant documents on the identity of the customer, any person purporting to act on behalf of the customer and any beneficial owner of the customer, which A obtained when applying those measures.

(8) Paragraph (7) does not apply where a relevant [regulated] person applies customer due diligence measures by means of an agent or an outsourcing service provider (within the meaning of regulation 39(8)).

(9) For the purposes of this regulation-

(a) B relies on A where B does so in accordance with regulation 39(1);

(b) "copy" means a copy of the original document which would be admissible as evidence of the original document in court proceedings;

(c) "data subject" has the same meaning as in the Data Protection Act 2018 (see section 3 of that Act);

(d) “personal data” has the same meaning as in Parts 5 to 7 of that Act (see section 3(2) and (14) of that Act);

(e) “beneficiary”, “cryptoasset business”, “inter-cryptoasset business transfer”, “intermediary cryptoasset business” and “unhosted wallet transfer” have the meanings given by regulation 64B.

CHAPTER ONE HUNDRED AND THIRTY THREE

MONEY LAUNDERING: POCA

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133.1 Money laundering: Introduction

In this chapter I consider four criminal offences relating to money laundering, which are found in Part 7 Proceeds of Crime Act 2002 ("POCA").[1]

Conviction of these offences is punishable by up to 14 years imprisonment and an unlimited fine.

Guidance can be found from various sources, and I draw on:

Issued by	My term	Full Title
LSAB	LSAB guidance	AML Guidance for the Legal Sector[2]

[1] See too 122.2 (Adviser's duties).

[2] (2021) draft guidance pending approval from HM Treasury *https://www.lawsociety.org.uk/topics/anti-money-laundering/anti-money-laundering-guidance*

CCAB	CCAB accountants guidance	AML & Counter-Terrorist Financing Guidance for the Accountancy Sector[3]
CCAB	CCAB tax guidance	Supplementary AML Guidance for Tax Practitioners[4]

A full discussion needs a long chapter. I focus on the issues relevant to tax advisors. I do not consider the NCA's general Revenue functions.[5]

133.2 "Money laundering"

In the normal sense of the expression, money laundering is the process by which proceeds of crime are disguised, so funds appear to come from a legitimate source.

POCA defines the expression more widely. It includes:

(1) Handling or possessing Criminal Property, including possessing the proceeds of one's own crime

(2) Assisting in handling/possessing of Criminal Property

Section 340 POCA provides:

> (1) This section applies for the purposes of this Part....
>
> (11) Money laundering is an act which—
>
> (a) constitutes an offence under[6]
>
> | Section | Topic | See para |
> |---|---|---|
> | 327 | Conceal/transfer criminal property | 133.5 |
> | 328 | Assisting money laundering | 133.6 |
> | 329 | Possession of criminal property | 133.7 |
>
> (b) constitutes an attempt, conspiracy or incitement to commit an offence specified in paragraph (a),
>
> (c) constitutes aiding, abetting, counselling or procuring the commission of an offence specified in paragraph (a), or
>
> (d) would constitute an offence specified in paragraph (a), (b) or (c) if done in the UK.

[3] (2020) draft guidance pending approval from HM Treasury *https://www.ccab.org.uk/anti-money-laundering-guidance-for-the-accountancy-sector/*

[4] (2019) approved by HM Treasury *https://www.ccab.org.uk/wp-content/uploads/2020/09/Supplementary-Anti-Money-Laundering-Guidance-for-Tax-Practitioners-.pdf*

[5] s.317 POCA 2007.

[6] For clarity I have set this out in tabular form and with my own wording, rather than as in the statute.

133.3 Criminal Property

Section 340 POCA provides:

> (1) This section applies for the purposes of this Part.
> (3) Property[7] is criminal property if—
> (a) [i] it constitutes a person's benefit from criminal conduct[8] or
> [ii] it represents[9] such a benefit (in whole or part and whether directly or indirectly), and
> (b) the alleged offender knows or suspects[10] that it constitutes or represents such a benefit.

I write this term with initial capitals, to reflect the technical nature of the expression.

Section 340(4) POCA continues with provisions which widen the scope of Criminal Property:

> It is immaterial—
> (a) who carried out the conduct;
> (b) who benefited from it;
> (c) whether the conduct occurred before or after the passing of this Act.

133.3.1 *Benefit from conduct*

Section 340 POCA provides:

> (5) A person benefits from conduct if he obtains property as a result of or in connection with the conduct.
> (6) If a person obtains a pecuniary advantage as a result of or in connection with conduct, he is to be taken to obtain as a result of or in connection with the conduct a sum of money equal to the value of the pecuniary advantage.
> (7) References to property or a pecuniary advantage obtained in connection with conduct include references to property or a pecuniary advantage obtained in both that connection and some other.
> (8) If a person benefits from conduct his benefit is the property obtained as a result of or in connection with the conduct.

[7] Defined widely in s.340(9)(10) POCA.

[8] Section 340 POCA provides: "Criminal conduct is conduct which—
(a) constitutes an offence in any part of the UK, or
(b) would constitute an offence in any part of the UK if it occurred there."

[9] See App.2.9 ('Representing' assets).

[10] See 133.4 (Knows or suspects).

133.3.2 *Criminal Property: Tax offences*

Dishonest non-payment of tax on income/gains is criminal conduct. But it is not obvious that the income/gains represent the benefit and so constitutes Criminal Property of the offender. The unpaid tax might have been paid from other property of the taxpayer.[11] But in *R v K*:

> To take a simplified paradigm case, let us suppose that over a two year period D fraudulently under-declares the takings of his business by £250,000 per annum with the result that he deprives the revenue of £100,000 in income tax and £25,000 in VAT in each of the two years. In each year, D has obtained a pecuniary advantage of £125,000 as a result of his cheating the revenue. That is a benefit within the meaning of section 340(3)(a) of POCA. The undeclared takings of £500,000 represent that benefit in part within the meaning of section 340(3)(a) in the sense that the undeclared takings of £500,000 should have borne tax and a sum representing or equivalent to part of that figure should have been paid in tax.[12]

Moreover, in *R v William*:[13]

> The reference to "in whole or in part" [in s.340(3)(a)[i]] is important because it shows that the whole property is treated as criminal property, even where only part of it represents benefit from criminal conduct...
> In cases where the turnover is falsely represented, the benefit is the tax due on the undeclared turnover. However, the criminal property as defined by s 340 is the entirety of the undeclared turnover and not merely the tax due because the benefit is represented in part by that sum.

The reasoning was purposive. If the profit was not Criminal Property as defined, the result would mean that the money laundering provisions could never apply to tax evasion offences. This is perhaps a stretch, but "represent" is a flexible concept.

The capital from which the income arose is not Criminal Property, but in practice there is likely to be a mixed fund.

By analogy, income of a person abroad within s.720 is Criminal Property if the transferor dishonestly fails to declare it.

In the case of a taxpayer who dishonestly fails to pay tax on a benefit due

[11] Assume that there was other property. It would be different for fraudulent tax reclaims, and for IHT (because of the Revenue charge).

[12] [2007] EWCA Crim 491 at [21].

[13] [2013] EWCA Crim 1262 at [27].

under s.731 or s.87, it is suggested that the Criminal Property is both the benefit, and the relevant income/trust gains.

LSAB guidance provides:

> 18.5.5 Tax issues
> If the purchase price is recorded incorrectly, this may be in an attempt to evade stamp duty (the saving would represent the proceeds of crime.)

It is suggested that the property represents the proceeds of crime, even though that would not normally have been used to pay the SDLT.

133.4 Knows or suspects

"Knows or suspects" is used in many places in POCA, in particular:

Context	**POCA**	**See para**
Assisting money laundering	s.328	133.6
Adequate consideration	s.329(3)	133.7
Duty to disclose money laundering	s.330(2), (5A)	133.9
Definition of Criminal Property	s.340(3)	133.3

Suspicion must be based on some evidence, even if that evidence is tentative. General assumptions do not amount to suspicion of particular individuals, eg a belief that:

(1) Underdeclaring cash takings is endemic
(2) Behind every great fortune is a great crime[14]

In *R v Da Silva*:

> ... the essential element in the word "suspect" and its affiliates, in this context, is that the defendant must think that there is a possibility, which is more than fanciful, that the relevant facts exist. A vague feeling of unease would not suffice. But the statute does not require the suspicion to be "clear" or "firmly grounded and targeted on specific facts", or based upon "reasonable grounds"
> ... the suspicion must be of a settled nature; a case might, for example, arise in which a defendant did entertain a suspicion in the above sense but, on further thought, honestly dismissed it from his or her mind as being unworthy or as contrary to such evidence as existed or as being outweighed by other considerations.[15]

[14] The thought derives from Balzac, *Le Père Goriot*: "Le secret des grandes fortunes sans cause apparente est un crime oublié, parce qu'il a été proprement fait."

[15] [2006] EWCA Crim 1654 at [16]-[17].

133.5 Conceal/transfer Criminal Property

Section 327(1) POCA provides:

> A person commits an offence if he—
> (a) conceals[16] criminal property;
> (b) disguises criminal property;
> (c) converts criminal property;
> (d) transfers criminal property;
> (e) removes criminal property from England and Wales or from Scotland or from Northern Ireland.

This would include transferring Criminal Property from a Swiss account to a trust or other entity.

A professional adviser is not likely to commit this offence but if the client has done so, or may do so, that has consequences for the professional's responsibilities for assisting/disclosing.

133.6 Assisting money laundering

Section 328(1) POCA provides:

> A person commits an offence if he enters into or becomes concerned in an arrangement which he knows or suspects[17] facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person.

LSAB guidance provides:

> **16.3.6 What is not an arrangement?**
> *Bowman v Fels*[18] held that s328 does not cover or affect the ordinary conduct of litigation by legal professionals, including any step taken in litigation from the issue of proceedings and the securing of injunctive relief or a freezing order up to its final disposal by judgment.
> Dividing assets in accordance with a judgment, including the handling of the assets which are criminal property, is not an arrangement. Settlements, negotiations, out of court settlements, alternative dispute resolution and tribunal representation are also not arrangements. However, the property will generally still remain criminal property and

[16] Defined in subsection (3): "Concealing or disguising criminal property includes concealing or disguising its nature, source, location, disposition, movement or ownership or any rights with respect to it."

[17] See 133.4 (Knows or suspects).

[18] [2005] EWCA Civ 226.

you may need to consider referring your client for specialist advice regarding possible offences they may commit once they come into possession of the property after completion of the settlement.

133.7 Possession of Criminal Property

Section 329(1) POCA provides:

> A person commits an offence if he—
> (a) acquires criminal property;
> (b) uses criminal property;
> (c) has possession of criminal property.

A professional adviser is not likely to commit this offence but if the client has done so, or may do so, that has consequences for the professional's responsibilities for assisting/disclosing.

Section 329(2) POCA:

> (2) But a person does not commit such an offence if ...
> (c) he acquired or used or had possession of the property for adequate consideration ...

Section 329(3) POCA defines "adequate consideration":

> For the purposes of this section-
> (a) a person acquires property for inadequate consideration if the value of the consideration is significantly less than the value of the property;
> (b) a person uses or has possession of property for inadequate consideration if the value of the consideration is significantly less than the value of the use or possession;
> (c) the provision by a person of goods or services which he knows or suspects may help another to carry out criminal conduct is not consideration.

133.8 POCA disclosure immunity

133.8.1 *Authorised disclosure*

Section 338 POCA provides:

> (1) For the purposes of this Part a disclosure is authorised if—
> (a) it is a disclosure to a constable, a customs officer or a nominated officer[19] by the alleged offender that property is

[19] Section 338(5) POCA provides: "disclosure to a nominated officer is a disclosure which—

> criminal property, and[20]
>
> (c) the first, second or third condition set out below is satisfied.
>
> (2) The first condition is that the disclosure is made before the alleged offender does the prohibited act.
>
> (2A) The second condition is that—
>
> (a) the disclosure is made while the alleged offender is doing the prohibited act,[21]
>
> (b) he began to do the act at a time when, because he did not then know or suspect that the property constituted or represented a person's benefit from criminal conduct, the act was not a prohibited act, and
>
> (c) the disclosure is made on his own initiative and as soon as is practicable after he first knows or suspects[22] that the property constitutes or represents a person's benefit from criminal conduct.
>
> (3) The third condition is that—
>
> (a) the disclosure is made after the alleged offender does the prohibited act,
>
> (b) he has a reasonable excuse for his failure to make the disclosure before he did the act, and
>
> (c) the disclosure is made on his own initiative and as soon as it is practicable for him to make it.

133.8.2 *Indemnity for authorised disclosure*

Section 338 POCA provides:

> (4) An authorised disclosure is not to be taken to breach any restriction on the disclosure of information (however imposed).
>
> (4A) Where an authorised disclosure is made in good faith, no civil liability arises in respect of the disclosure on the part of the person by or on whose behalf it is made.

133.9 Duty to disclose money laundering

Section 330(1) POCA provides:

(a) is made to a person nominated by the alleged offender's employer to receive authorised disclosures, and

(b) is made in the course of the alleged offender's employment...”

[20] There is no para (b).

[21] Section 338(6) POCA provides: “References to the prohibited act are to an act mentioned in section 327(1), 328(1) or 329(1) (as the case may be).”

[22] See 133.4 (Knows or suspects).

> A person commits an offence if the conditions in subsections (2) to (4) are satisfied.

I refer to these conditions as **"POCA disclosure conditions"**.

133.9.1 *Condition 1: Knowledge*

Section 330(2) POCA provides:

> The first condition is that he—
> (a) knows or suspects[23], or
> (b) has reasonable grounds for knowing or suspecting,
> that another person is engaged in money laundering.

133.9.2 *Condition 2: Professional*

Section 330(3) POCA provides:

> The second condition is that the information or other matter—
> (a) on which his knowledge or suspicion is based, or
> (b) which gives reasonable grounds for such knowledge or suspicion,
> came to him in the course of a business in the regulated sector.

133.9.3 *Regulated sector*

Para 1(1) sch 9 POCA provides:

> A business is in the regulated sector to the extent that it consists of—

There follows a list of 22 activities, numbered alphabetically. The list includes:

> (l) the provision to other persons of accountancy services by a firm or sole practitioner who by way of business provides such services to other persons;
> (m) the provision of material aid, or assistance or advice, in connection with the tax affairs of other persons by a firm or sole practitioner, whether provided directly or through a third party, if the firm or sole practitioner by way of business provides (as the case may be) aid, assistance or advice in connection with the tax affairs of other persons;
> (n) the participation[24] in financial or real property transactions

[23] See 133.4 (Knows or suspects).

[24] Para 9(3) provides: "For the purposes of sub-paragraph (1)(n) a person participates in a transaction by assisting in the planning or execution of the transaction or otherwise acting for or on behalf of a client in the transaction."

concerning—

(i) the buying and selling of real property (or, in Scotland, heritable property) or business entities;

(ii) the managing of client money, securities or other assets;

(iii) the opening or management of bank, savings or securities accounts;

(iv) the organisation of contributions necessary for the creation, operation or management of companies; or

(v) the creation, operation or management of trusts, companies or similar structures,

by a firm or sole practitioner who by way of business provides legal or notarial services to other persons;

(o) the provision to other persons by way of business by a firm or sole practitioner of any of the services mentioned in sub-paragraph (4);

(4) The services referred to in sub-paragraph (1)(o) are—

(a) forming companies or other legal persons;

(b) acting, or arranging for another person to act—

(i) as a director or secretary of a company;

(ii) as a partner of a partnership; or

(iii) in a similar position in relation to other legal persons;

(c) providing a registered office, business address, correspondence or administrative address or other related services for a company, partnership or any other legal person or arrangement;

(d) acting, or arranging for another person to act, as—

(i) a trustee of an express trust or similar legal arrangement; or

(ii) a nominee shareholder for a person other than a company whose securities are listed on a regulated market.[25]

133.9.4 *Condition 3: Knowledge of identity*

Section 330(3A) POCA provides:

The third condition is—

(a) that he can identify the other person mentioned in subsection (2) or the whereabouts of any of the laundered property,[26] or

[25] Para 1(5) provides: “For the purposes of sub-paragraph (4)(d) "regulated market" has the meaning given by regulation 3(1) (general interpretation) of the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (SI 2017/692).”

[26] This has a commonsense definition in subsection (5A) “The laundered property is the property forming the subject-matter of the money laundering that he knows or

> (b) that he believes, or it is reasonable to expect him to believe, that the information or other matter mentioned in subsection (3) will or may assist in identifying that other person or the whereabouts of any of the laundered property.

Disclosure conditions 1 to 3 will be met by a non-compliant UK resident and domiciled individual with an undisclosed Swiss bank account.

133.9.5 *Condition 4: Disclosure*

Disclosure is one option. Section 330(4) POCA provides:

> The fourth condition is that he does not make the required disclosure[27] to—
> (a) a nominated officer, or
> (b) a person authorised for the purposes of this Part by the Director General of the National Crime Agency,
> as soon as is practicable after the information or other matter mentioned in subsection (3) comes to him.

Thus in the absence of some other defence, s.330 effectively imposes a duty to disclose the client.

Section 330(5) POCA provides:

> The required disclosure is a disclosure of—
> (a) the identity of the other person mentioned in subsection (2), if he knows it,
> (b) the whereabouts of the laundered property,[28] so far as he knows it, and
> (c) the information or other matter mentioned in subsection (3).

133.10 Professional privilege

133.10.1 *Professional advisers*

Section 330(6) POCA provides:

suspects, or has reasonable grounds for knowing or suspecting, that other person to be engaged in."

[27] Defined subsection (5) "The required disclosure is a disclosure of—
(a) the identity of the other person mentioned in subsection (2), if he knows it,
(b) the whereabouts of the laundered property, so far as he knows it, and
(c) the information or other matter mentioned in subsection (3)."

[28] Defined ss(5A): "The laundered property is the property forming the subject-matter of the money laundering that he knows or suspects, or has reasonable grounds for knowing or suspecting, that other person to be engaged in."

> But he does not commit an offence under this section if...
>
> (b) he is a professional legal adviser or relevant professional adviser and—
>
> (i) if he knows either of the things mentioned in subsection (5)(a) and (b),[29] he knows the thing because of information or other matter that came to him in privileged circumstances, or
>
> (ii) the information or other matter mentioned in subsection (3) came to him in privileged circumstances

133.10.2 *Partners/employees*

Section 330(6) POCA provides:

> (6) But he does not commit an offence under this section if...
>
> (c) subsection (7)[30] or (7B) applies to him...

Section 330(7B) POCA provides protection for employees and partners:

> This subsection applies to a person if—
>
> (a) he is employed by, or is in partnership with, a professional legal adviser or a relevant professional adviser to provide the adviser with assistance or support,
>
> (b) the information or other matter mentioned in subsection (3) comes to the person in connection with the provision of such assistance or support, and
>
> (c) the information or other matter came to the adviser in privileged circumstances.

133.10.3 *"Privileged circumstances"*

Section 330(10) POCA provides:

> Information or other matter comes to a professional legal adviser or relevant professional adviser in privileged circumstances if it is communicated or given to him—
>
> (a) by (or by a representative of) a client of his in connection with the giving by the adviser of legal advice to the client,
>
> (b) by (or by a representative of) a person seeking legal advice from the adviser, or
>
> (c) by a person in connection with legal proceedings or contemplated legal proceedings.

[29] See 133.9.5 (Condition 4: Disclosure).

[30] Subsection (7) relates to untrained employees.

This is similar to legal professional privilege.

CCAB tax guidance provides:

> 7.6 In this context 'legal advice' (as referred to in the statute) given by a tax practitioner other than a lawyer includes tax advice.

133.10.4 *Crime/fraud exception*

Section 330(11) POCA provides:

> But subsection (10) does not apply to information or other matter which is communicated or given with the intention of furthering a criminal purpose.

CCAB accountancy guidance provides:

> 6.5.31 Communications that would otherwise qualify for the privilege reporting exemption are excluded from it when they are intended to facilitate or guide someone in committing or advancing some crime or fraud. This is usually the client but could be a third party. An example of such a situation could be where a person seeks tax advice ostensibly to regularise their tax affairs but in reality, to help them evade tax by improving their understanding of the issues.
>
> 6.5.32 Someone worried that they may be guilty of tax evasion can still seek legal advice from a tax adviser without fear of the exception being invoked. This remains true even when, having received the advice, the person declines a business relationship and the business never knows if the irregularities were rectified. However, if that person's behaviour leads the business to suspect the advice has been used to further evasion, then a SAR could be required.

133.10.5 *Relevant professional adviser*

This term is defined in s.330(14) POCA:

> A relevant professional adviser is an accountant, auditor or tax adviser who is a member of a professional body which is established for accountants, auditors or tax advisers (as the case may be) and which makes provision for—
>
> (a) testing the competence of those seeking admission to membership of such a body as a condition for such admission; and
>
> (b) imposing and maintaining professional and ethical standards for its members, as well as imposing sanctions for non-compliance with those standards.

CCAB tax guidance provides:

> 7.5 The legislation does not list the professional bodies which meet the criteria but the CCAB bodies, the Chartered Institute of Taxation and the Association of Taxation Technicians meet the criteria and hence their members may be considered to be 'relevant professional advisers'.

133.10.6 *Privileged circumstances: CCAB examples*

CCAB tax guidance provides:

> **Privileged circumstances**
> You are approached by a long-standing client seeking advice on what to do about an undisclosed Swiss bank account, where the original money came from undeclared income. They are concerned about the arrangement agreed between the Swiss banks and HMRC. You explain their options and advise that they make a declaration to HMRC.
> Clearly you now know that they have been evading tax; as such, they have committed a money laundering offence. However, the client approached you seeking advice on making an unprompted disclosure under the tax legislation of their undeclared income. It does not appear that this information was disclosed to you with the intention of furthering a criminal offence so it is covered by the privilege exemption. In such circumstances, tax practitioners should also consider whether they should continue to act if they have concerns that the client has not fully disclosed and so that they do not become complicit in further money laundering offences. You must not report them to NCA.
> Having advised them to make a declaration, and explained the consequences, your advice remains privileged even if they subsequently decide not to follow your recommendation.
> **Not-privileged circumstances**
> Now contrast that with the situation whereby, during the preparation of the client's tax return, a member of staff encounters a bank statement from the Swiss bank account among the papers supplied by the client. You ask your client about this bank account; they then admit to the tax evasion. You have the same information as before, but received in a different way.
> In this situation you must report.
> **Applying the crime/fraud exemption**
> Consider the situation where you act for a wife in an acrimonious divorce that is heading for the courts. The wife is claiming 50% of her husband's assets. In preparation for the hearing she notifies you of her husband's undisclosed Swiss bank account, providing you with full details. She wishes to claim 50% of that as well!
> While this appears to be covered by litigation privilege, her intention in providing the information is to acquire criminal property (i.e. half the money in the Swiss bank account). It would fall under the crime/fraud exemption, so would not be privileged.
> You would therefore need to report.

133.11 Overseas conduct

133.11.1 *Territorial limitation*

All the money laundering offences have a territorial limitation. This is set out three times in the same words.[31] Section 327(2A) POCA provides:

> Nor does a person commit an offence under subsection (1) if—
> (a) he knows, or believes on reasonable grounds, that the relevant criminal conduct[32] occurred in a particular country or territory outside the UK, and
> (b) the relevant criminal conduct—
> (i) was not, at the time it occurred, unlawful under the criminal law then applying in that country or territory, and
> (ii) is not of a description prescribed by an order made by the Secretary of State.

The territorial limitation only applies if both conditions in (b) are satisfied. Para 2 Proceeds of Crime Act 2002 (Money Laundering: Exceptions to Overseas Conduct Defence) Order 2006 provides the latter:

> (1) Relevant criminal conduct of a description falling within paragraph (2) is prescribed for the purposes of sections 327(2A)(b)(ii), 328(3)(b)(ii) and 329(2A)(b)(ii) of the Proceeds of Crime Act 2002 (exceptions to defence where overseas conduct is legal under local law).
> (2) Such relevant criminal conduct is conduct which would constitute an offence punishable by imprisonment for a maximum term in excess of 12 months in any part of the UK if it occurred there other than—
> (a) an offence under the Gaming Act 1968;
> (b) an offence under the Lotteries and Amusements Act 1976, or
> (c) an offence under section 23 or 25 of the Financial Services and Markets Act 2000.

So the overseas conduct exemption does not amount to much. In particular, it does not exclude tax offences (the penalty for which exceeds 12 months).

133.11.2 *Foreign tax evasion*

CCAB tax guidance provides:

> 8.1.4 If the suspected evasion is of taxes outside the UK, in circumstances which would be a criminal offence if the conduct occurred in the UK, this should also be reported immediately

The guidance continues:

[31] See s.328(3), 330(7A) POCA.

[32] Defined in subsection (2B): "In subsection (2A) "the relevant criminal conduct" is the criminal conduct by reference to which the property concerned is criminal property."

> unless
> [a] it is known to be lawful under the criminal law applying in that country and
> [b] that conduct, if carried out in the UK, would attract a maximum sentence in the UK of less than twelve months, except as prescribed by Order.

But that will never be the case for tax evasion crimes.

The guidance continues:

> As in other cases, this is unless the privilege reporting exemption applies. There are other very limited exceptions regarding the reporting of overseas criminal conduct; see para 2.2.2 of AMLGAS.

133.12 General defences

Section 327(2)/338(2) POCA provide 3 defences:

> But a person does not commit such an offence if-
> (a) he makes an authorised disclosure under section 338 and (if the disclosure is made before he does the act mentioned in subsection (1)) he has the appropriate consent;
> (b) he intended to make such a disclosure but had a reasonable excuse for not doing so;
> (c) the act he does is done in carrying out a function he has relating to the enforcement of any provision of this Act or of any other enactment relating to criminal conduct or benefit from criminal conduct.

The same defences are found in s.329(2) POCA.

Section 330(6) provides a wider reasonable excuse defence:

> But he does not commit an offence under this section if-
> (a) he has a reasonable excuse for not making the required disclosure.

APPENDIX ONE

WORDS OF DISPUTE

App. 1.1 Words of dispute: Introduction
App. 1.2 Clarify/modernise/reform
App. 1.3 "Clear"
App. 1.4 "Compliant"
App. 1.5 "Customers" of HMRC
App. 1.6 Principles-based drafting
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App. 1.1 Words of dispute: Introduction

This appendix considers some non-legal terms which are used in taxation in contested or rhetorical ways, and which are so common that they are more conveniently considered as discrete topics, rather than in any particular context in which they are found.

App. 1.2 Clarify/modernise/reform

The word "clarify" is a convenient cloak. To describe a reform as a clarification is a way to stifle debate. Who could object to clarification? Often, perhaps more often than not, it is used tendentiously to disguise substantive changes.[1] Tax reform by stealth is not an uncommon phenomenon and (mis)use of the word "clarify" is one way towards it.

Similar points apply to the word "modernise", a favourite of the Blair administration, which re-emerged in Spring Budget 2024 to describe FIG relief and abolition of the remittance basis.

Likewise "reform". Of course this usage is not limited to tax:

> Reform means to change things with a view to securing an improvement. Law reform sadly means changing things so as to impede access to justice and to cut funding to unsustainable levels.[2]

[1] There are many examples in ths work, see for instance 75.15 (Adding property).

[2] Professor Dominic Regan, New Law Journal, 21 Feb 2020; 18.38 (Security for debt: Amount remitted).

App. 1.3 "Clear"

Judicial rhetoric frequently describes the position as "clear" when it is not. An example is the now-obsolete case of *IRC v Gaunt,*[3] holding that the word "spouse" included a widow. The Court of Appeal said the point was "clear" (Goddard LJ), "perfectly clear" (Clausen LJ) and "obvious" (Scott LJ). Yet the High Court had reached the opposite view, and only six years later, the House of Lords held their view to be wrong, in the first *Vestey* case.[4]

App. 1.4 "Compliant"

The word "compliant" has become an essentially contested concept, that is, it admits of two distinct conceptions that are a battleground for profound substantive disagreements. HMRC use the term to mean those who comply with the legal rules of taxation and do not engage in tax avoidance (whatever that is).[5] I think practitioners would generally regard "compliant" as apt to describe those who seek to comply with the legal requirements of taxation.

App. 1.5 "Customers" of HMRC

In the 2010/11 edition of this work I summarised the tax competition argument thus:

> Where there is tax competition, the term "customer", which HMRC have (controversially) applied to taxpayers since 2001[6] is slightly less inapt. UK resident foreign domiciliaries are in principle more free than other taxpayers to take their "custom" elsewhere.

[3] 24 TC 69.

[4] See App 3.2.1 (Spouse: General meaning).

[5] Two examples will suffice to illustrate the point: the title of the HMRC paper (Mar 2019): "Tackling tax avoidance, evasion, and other forms of noncompliance"; likewise: "This measure has no impact on compliant businesses.... It is likely to affect ... non-compliant businesses ... which are currently involved in tax avoidance arrangements"; see 53.23 (PFA impact).
Contrast the two views of the taxpayer/HMRC relationship; see 122.10.1 (HMRC/taxpayer relationship),

[6] A press release at the time provided: (14/06/01) "M and C Saatchi, a leading advertising agency, has been appointed by the IR to rebrand the department. Branding and design consultants, Corporate Edge, will also be working with the IR and M and C Saatchi to 'create a customer driven department'."

As far as I am aware, no other Revenue department in the world calls its taxpayers "customers" and it is interesting to consider what the word implies for the taxpayer/HMRC relationship.

It appears to suggest that the relationship should be based on the market, but what does that entail? A person who regards himself as a customer (as opposed, say, to a "citizen") has no disposition to put public good ahead of private interest, and no moral relationship with their supplier. Customers control producers of commodities only by buying or not buying as they like.

Rowan Williams (Archbishop of Canterbury, 2003-2012) observes how the language of the market has expanded beyond a market context:

> The language of customer and provider has wormed its way into practically all areas of our social life, even education and healthcare, and we forget that it is a metaphor when we call a student, a patient or a traveller a "customer". The implication is that the most basic relation between one human being and another or one group and another is that of the carefully calibrated exchange of material resources; the most basic kind of assessment we can make about the actions of another, from the trader to the nurse to the politician, is the evaluation of how much they can increase my liberty to negotiate favourable deals and maximize my resources.[7]

But this is not of course the inference which HMRC intend. Sir Nicholas Montagu (Chair of the Board of Inland Revenue, 1997-2004) said that the reason for the change was to remind Revenue staff that the needs of the consumer of public services should be considered first.[8]

[7] Williams, "Knowing our Limits" in Williams and Elliott (eds), *Crisis and Recovery: Ethics, Economics and Justice* (2010), p.20. But is "customer" a metaphor? Robert Bellah takes it literally: "... all the primary relationships in our society, those between employers and employees, between lawyers and clients, between doctors and patients, between universities and students are being stripped of any moral understanding other than that of market exchange. Business has no obligation to its employees, the communities where it operates, or the larger society. The same forces that are uprooting decades-long practices in industry are to be found at work in medicine, education , and even in the church and the family. To put it in Pierre Bourdieu's terms, we could say that the economic field is encroaching even more than ever on the autonomy of the other fields.... Instead of medicine we have the health care industry; instead of the university we have the education industry. These are not metaphors but the direct imposition of the logic of the economic field on the other fields." Bellah, "Class Wars and Culture Wars in the University Today" (1997).

[8] See "The Customer is always right" Tax Adviser, (February 2003).

The usage has not caught on outside HMRC. A sensitivity to language (some readers may think, a sense of the ridiculous) prevents the parliamentary drafter from using the expression: for instance the SRT only uses the term "taxpayer".

In 2013, the Tribunal commented:

> I note in passing that all the reports mentioned below refer to HMRC's 'customers'. While this is a regrettable misuse of language by HMRC as it implies people have a choice whether to interact with HMRC and that therefore the payment of taxes is voluntary, nevertheless it is clear that references to 'customers' are meant to be references to taxpayers. Needless to say the payment of taxes is not voluntary despite the misnomer ....[9]

In the 2017/18 edition of this work, I said:

> The terminology will not cease to give rise to derision as long as the current generation of tax practitioners remain in practice[10]... It is conceivable that the terminology will last until a future generation sees nothing to laugh at in expressions such as "*penalties designed to change customer behaviour*"[11] but I think that unlikely. Perhaps at some point it will be dropped.

In 2017 the HMRC view was unchanged, even defiant:

> Mr Troup [HMRC chair] defended HMRC's sometimes controversial description of taxpayers as 'customers' saying that he genuinely believes the tax authority is a customer-centric business.[12]

[9] *LH Bishop Electric Co v HMRC* [2013] UKFTT 522 (TC) at [234].

[10] See Cameron, "Customer Service?" Taxation Magazine, 10 Apr 2008, p.361: "It never ceases to amaze me that HMRC have adopted the word 'customer' to describe the taxpaying public. A customer is someone who chooses to patronise a business." Andy Wells agrees: "I will never be a 'customer' of HMRC. This disregard for the English language irks just about every tax professional I come across..." Taxation Magazine, 4 June 2009, p.549. Similarly Anthony Thomas (then president of CIOT): "HMRC now refer to taxpayers as customers, but they do not treat them as customers"; "We need Trust", Taxation Magazine, 2 June 2011, p.7; Truman, "Still Not a Customer" Taxation Magazine, 14 June 2012, p.8.

[11] *http://webarchive.nationalarchives.gov.uk/+/http://www.hmrc.gov.uk/e-learning/New_Penalties_Awareness/Inaccuracy_Pen_ext/HTML/Inaccuracy_Pen_ext_106.html*

[12] *https://www.tax.org.uk/media-centre/blog/other-areas/departing-thoughts-hmrc-chair-edward-troup* (2017).

But in 2018 the debate still rumbled on.[13]

Looking back after two decades, the reader's irritation may have faded over time to weary cynicism. It seems at present that HMRC will continue to use it, taxpayers will not adopt it, and we must leave it there.

Underlying the controversy over terminology, and perhaps concealed by it, are deeper issues, linguistic, normative and factual:

- What (if anything) do HMRC mean by "customer-centric"?[14]
- Should HMRC seek to be "customer-centric"?[15]
- To what extent are HMRC actually "customer-centric"?

On the third, factual, question: One might think it is not a customer-centric policy to insist on using a term which the majority of taxpayers/customers find objectionable. The change of terminology from taxpayer to "customer" came at a time which saw a substantial increase in HMRC's enthusiasm for civil and criminal penalties[16] a trend which has intensified

[13] HLEconomic Affairs Committee in its critical report "The Powers of HMRC: Treating Taxpayers Fairly" (2018) para 135: "HMRC describes taxpayers as 'customers' ... In this report we refer to individuals as taxpayers."
https://publications.parliament.uk/pa/ld201719/ldselect/ldeconaf/242/242.pdf

[14] "Customer-centric" is a well established marketing term. I do not know when it first arose, but books with "CustomerCentric" in the title date at least back to 2003. One definition is:"Customer centric is a way of doing business with your customer in a way that provides a positive customer experience before and after the sale in order to drive repeat business, customer loyalty and profits." In the context of HMRC's "business" the usage, as Rowan Williams says, is best regarded as a vivid metaphor, such metaphors often hinder clarity of thought.

[15] Section 1 TMA 1970 provides that HMRC are "responsible for the collection and management" of IT/CT/CGT; which one might think a different matter. See too 122.10.1 (HMRC/taxpayer relationship).

[16] "The Department expects the new [civil] penalty regime to result in higher penalties as the minimum penalty for deliberate evasion and concealment is 50%. The Department should track the level of penalties imposed to ensure that it is applying the new regime rigorously." House of Commons Committee of Public Accounts, "HM Revenue & Customs: Managing civil tax investigations" (2011)
https://publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/765/76506.htm
"We have recruited an additional 200 criminal investigators to increase the number of people prosecuted for tax evasion from 165 in 2010 to 2011, to 565 in 2012 to 2013, and to 1,165 in 2014 to 2015."
https://www.gov.uk/government/policies/reducing-tax-evasion-and-avoidance
The wisdom (and cost/benefit) of the vast increase in prosecutions has never been the subject of public debate.

over the last few years. Whether that is right or wrong, it is certainly not customer-centric.[17]

Probably the terminology is (more or less) meaningless spin, with no substance or reality beyond vague aspiration. That is not necessarily a criticism: presentation, perception and aspiration are important aspects of tax administration. But they should be recognised for what they are.

If that is right, the discussion above is somewhat over-intellectualised. But it is good to know what we are talking about.

App. 1.6 Principles-based drafting

The Income Streams code and the disguised interest rules claim the high ground of "principles-based drafting". Who could object to principles? But the rhetoric fails when it moves from theory to practice. In the Income Streams code, the principle is not easy to grasp,[18] and in the disguised interest code is just a form-over-substance rule, with all the difficulties that brings. The reader may conclude that the use of the term here is inapt if not tendentious.

It is a sad truth that if tax has principles, which might be debated, they are at such a high level of generality that they cannot be used for drafting. Is the aspiration is to be commended or criticised as naive? Discuss.

App. 1.7 Machinery/mechanism metaphor

The metaphor of "machinery"[19] has been used:

(1) To describe tax collection (as opposed to tax charging) provisions, the point being that a tax collection provision only applies if there is a charge[20]

(2) To describe an author's contract for royalties, the point being that the source of the income is the author's profession, the contract being machinery lacking "independent vitality"[21]

Memec v IRC applies the metaphor in the context of whether a foreign

[17] House of Commons Treasury Committee, "Administration and effectiveness of HMRC" Sixteenth Report of Session 2010–12 at 143: "we question whether a strategy focused around shifting customers' behaviour can truly be described as customer-centric."

[18] See 54.5 (Transfer of income, not asset).

[19] The word "mechanism" is used in the same way.

[20] See 124.2 (Tax collected from UK representative).

[21] See 31.4.3 (Post-cessation Annual Payments).

entity is transparent, but with an important note of caution:[22]

> Metaphorical language is not a substitute for analysis, but it may help to explain the conclusion: adopting Lord Asquith's phrases,[23] I conclude that [the "silent partner's"] rights under the ["silent partnership" agreement] did have independent vitality and were not mere incidental machinery.

"Mere machinery" is always an expression of a conclusion; it is not an argument or basis for reaching a conclusion, or at least not an adequate one.

App. 1.8 Technical

The word "technical", used to describe an argument, or a distinction, is generally pejorative; the point might be emphasised by the collocation "narrow technical argument".

Any argument (other than purposive construction) can be castigated as technical, whether based on statutory words or common law principle. For example, there was formally a rule prohibiting references to Hansard. *Pepper v Hart* described the rule as "a technical rule of construction".[24] In a later case (qualifying if not rejecting the *Pepper v Hart* approach) the same rule was "a cardinal constitutional principle"![25]

"Technical" (in this sense) is not a technical term. It is merely a term of abuse. If not completely meaningless, it is difficult to pin down what the meaning is. It is an expression of rhetoric rather than sober analysis. Like the term "legal nicety", it may be regarded as expressing a conclusion rather than a reason for reaching a conclusion. If one substituted for "technical argument" the words "unconvincing argument", or for "technical distinction" the words "irrelevant distinction" the gap in the

[22] 71 TC 77 at p.114. Likewise *Hadee Engineering Co v HMRC* [2022] UKUT 84 (TCC) at [80]: "the issue before us [cannot] be determined by an analysis of whether paragraph 4 of Schedule 1A of TMA, or s393A of ICTA, should appropriately be labelled as "machinery" or "the governing statute in respect of tax liability". Rather the task,... is to construe the statutory provisions involved."

[23] See 31.4.3 (Post-cessation Annual Payments).

[24] [1993] AC 593 at p.616.

[25] *Wilson v Secretary of State* [2003] UKHL 40 at [67] also reported under the name *Wilson v First Country Trust (no.2)*. For another example of (mis)describing an otherwise unanswerable argument as "technical", in order to summarily reject it, see *Marshall v Kerr* 67 TC 56 at p.85: "Your Lordships were invited to accept a narrow and technical argument ... This is an invitation which is not difficult to resist..."

reasoning becomes clear. The unanswered and perhaps unasked question is: *why* is the point unconvincing or irrelevant?

Alternatively, "technical" connotes *unmeritorious*. In one case HMRC sent the notice of enquiry to the wrong address. The taxpayer was not prejudiced because a copy was sent to his accountants, and indeed no-one noticed until 9 years later. His objection was a technical point.[26] But had the taxpayer been prejudiced, the rule requiring notices to be sent to the right address would not, presumably, have been described as technical.

A variant of "technical" is the term *legalistic*. It is strange that lawyers should use *legalistic* as a pejorative term, but they do.[27]

App. 1.9 Technical Notes

HMRC say:

> HMRC do not own gov.uk and so must conform to their rules. Gov.uk aim for a reading age of 11 and they are not keen on long FAQs and examples.[28]

This explains some striking developments of recent years:

- The informal, chatty style in HMRC manuals and other guidance, eg employing informal contractions such as "isn't" for "is not".[29]
- The style of HMRC manual examples, which I describe elsewhere as childish; that may seem unkind, but is in fact an objective description of the author's intention.
- The publication of documents called "technical notes" which do not contain material which a practitioner would call "technical". A document with a reading age of 12 or above should now be described as "technical".

The policy aim of making guidance easily readable is commendable; but policy is one thing and implementation is another. Thus the term "technical note" has, perhaps ironically, become a technical expression.

[26] *Tinkler v HMRC* [2021] UKSC 39 at [85].

[27] Eg *HMRC v Parry* [2020] UKSC 35 at [94] ("narrow and legalistic approach ... which does not seem to me to be appropriate"). Note how "narrow" is again thrown in for additional rhetorical impact.

[28] Joint Expatriate Forum on Tax and NICs (Minutes, Feb 2018) *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/710618/Joint_Expatriate_Forum_on_tax_and_NICs_minutes_28_February_2018.pdf*

[29] I think this began in about 2015.

App. 1.10 Loophole/tax break

"Loophole" is an irresistible pejorative term. It suggests unintended and self-evidently inappropriate rules, which facilitate tax avoidance; but may be applied to any rule which the author wishes to deprecate.

The Labour Manifesto 2019 offers an example:

> We will close the tax loopholes enjoyed by elite private schools and use that money to improve the lives of all children.

The tabloid slang "tax break" similarly hinders clarity of thought. It has no place in any serious or impartial discussion of tax policy: it is a good rule of thumb to presume slack thinking and partiality whenever we encounter it.

App. 1.11 Arbitrary

News Corp v HMRC draws an important distinction between two senses of the word "arbitrary":[30]

(1) the sense that there were no reasons for the choices made; ie irrational
(2) the weaker sense that the reasons did not compel one particular set of choices rather than another

It is inevitable that many, perhaps most, tax rules must be arbitrary in the weaker sense. I refer to that as "somewhat arbitrary". Though just how arbitrary is, obviously, a matter of degree.

[30] [2023] UKSC 7 at [112].

APPENDIX TWO

COMMON LEGAL EXPRESSIONS

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App. 2.1 Introduction

This and the following appendices consider some legal terms, concepts and expressions which are so common in taxation that they are more conveniently considered as discrete topics, rather than in any particular context in which they arise. The layout is as follows:

Appendix	**Topic**
2	Misc terminology (see index above)
3	Family terminology: spouse, child, etc
4	Consideration/full consideration, arm’s length, and related concepts
5	Commercial/view to profit
6	Beneficial ownership/entitlement
7	Offshore Fund/collective investment scheme/OEIC
8	Real/reality/realistic, and form v substance

These terms are used frequently in tax and non-tax law. Their meaning is mostly a question of general (non-tax) law; except for “real”, whose meaning, if any, is in more the realm of philosophy, and rhetoric.

App. 2.1.1 *Context*

The IT Codification Committee say:[1]

> One of the chief causes of difficulty in interpreting the existing Acts is that the same word is used in different senses in different places, sometimes even in the same sentence. This has often been the subject of adverse comment in the Courts. In *Kensington Income Tax Commissioners v Aramayo*[2] Lord Wrenbury said:
>
> > My Lords, this case affords a striking illustration of the involved and almost unintelligible expression of the law contained in the Statutes relating to income tax. ... The same word is used here in one sense and there in another. ... No reliance can be placed upon an assumption of accuracy in the use of language in these Acts.

I think there is an element of hyperbole in the last sentence, or perhaps the standard of drafting has improved a little since Lord Wrenbury wrote those words in 1915. But the reader will not need to be reminded that meaning is subject to context: any word may be used inaccurately, one word may be used inconsistently ie with two different meanings, and two different words may be used with the same meaning.

App. 2.1.2 *Argument from redundancy*

In *Walker v Centaur Clothes*:[3]

> I seldom think that an argument from redundancy carries great weight even in a Finance Act. It is not unusual for Parliament to say expressly what the courts would have inferred anyway.

That was before the tax law rewrite. Nowadays, I would say "... *especially* in a Finance Act".

Note that *Centaur Clothes* states that the argument is *seldom* convincing, not never. No doubt some redundancies are more natural, and others are more suggestive.

[1] (1936) Cmd 5131 at [31], cited in *Lawrence v IRC* 23 TC 333 at p.344.

[2] 6 TC 613.

[3] [2000] STC 324 at p.330. If further authority is needed, which I doubt, see *Phipson-Stow v IRC* [1961] AC 727 at p.727 and p. 749:

> "Nor, even if there is some tautology, does it have much weight with me. That is a common feature of legislation".
>
> "In so complicated a matter I do not think that the presumption that provisions are not redundant is at all strong."

Likewise *DMWSHNZ Ltd v HMRC* [2015] EWCA Civ 1036 at [38].

Anson v HMRC, discussing the USA/UK DTA,[4] seems to take a more positive view:[5]

> it is a general principle of treaty interpretation *ut res magis*[6] *valeat quam pereat*... the court would be reluctant to conclude that a provision in an agreement made between two governments was otiose, if that conclusion could reasonably be avoided.

The maxim *ut res magis valeat quam pereat*, literally, "it is better for a thing to have effect than to be void", is the argument from redundancy couched in Latin. It could be that different principles apply to DTAs but they should not. My conclusion is that the Courts are not wholly consistent in their approach to the argument from redundancy; it is an argument which appeals to some judges more than others. In a tax statute, at least, the approach of *Centaur Clothes* is to be preferred.

App. 2.1.3 *Dictionaries*

Arbuthnot v Fagan is often cited:[7]

> Dictionaries never solve concrete problems of construction. The meaning of words cannot be ascertained divorced from their context. And part of the contextual scene is the purpose of the provision.

A dictionary may provide a convenient starting point, but it rarely says anything one did not already know.

App. 2.2 Arrangement

App. 2.2.1 *"Arrangement" undefined*

It is said that "Everybody knows what is meant by an arrangement"[8] and perhaps they do; but the word may be problematic and require elucidation.

[4] See 111.11.1 (DTA credit: Exclusion of underlying tax). The reader might think that the argument from redundancy is a technical rule which should have even less role to play in a DTA.

[5] [2015] UKSC 44 at [94] approved in *Royal Bank of Canada v HMRC* [2023] EWCA Civ 695 at [75].

[6] The original reads *magit* not *magis* but that is a typo. A Latin scholar has kindly informed me that *magis* is an adverb strengthening *valeat* (it's better to have much effect). Adverbs do not change endings. Such errors are to be expected when we quote Latin without understanding it.

[7] [1995] CLC 1396 at p.1400.

[8] *Re British Slag Ltd's Application* [1963] 1 WLR 727 at p.739, a comment often cited.

(This may be true of most words which "everybody knows"? Discuss.)

In *Newton v FCT*:[9]

> the word 'arrangement' is apt to describe something less than a binding contract or agreement, something in the nature of an understanding between two or more persons - a plan arranged between them which may not be enforceable at law.

In *Farnborough Airport v HMRC*:[10]

> The concept of 'arrangements' ... involves an element of deliberate planning or co-ordination to bring about a particular state of affairs.

Basically, anything with an element of volition is an arrangement. I do not think there is a single case where a taxpayer has succeeded in arguing that an act, or transaction, or indeed anything at all, is not an arrangement. 'Arrangement' is, then, a word of wide meaning.[11]

It is possible for context to show that arrangement is to be understood more narrowly, or that at least certain matters are not intended to constitute 'arrangements' in the relevant sense. But arguments along those lines have not in practice been successful.[12]

The word is usually used in the plural (arrangements) but occasionally in the singular (arrangement). I do not think there is any difference in the meaning.[13]

[9] [1958] AC 450 at p.465. The same point is made in *Scottish and Universal Newspapers v Fisher* [1996] STC (SCD) 311 at [16]: ''arrangements' is a wide expression which will often mean something less than a legally binding contract.'

[10] [2019] EWCA Civ 118 at [74].

[11] If further authority is needed, which I doubt, see *Office of Fair Trading v Lloyds TSB Bank* [2004] EWHC 2600 (Comm) at [24]: "broad, loose language".

[12] For instance *Farnborough Airport Properties v HMRC* [2019] EWCA Civ 118 at [76]:

> "It is only by a process of circular wishful thinking ... that the concept of 'arrangements', which is of course a staple feature of much anti-avoidance legislation, could be confined in its scope by reference to an unstated statutory purpose."

But it is sometimes hard to see the difference between purposive construction and wishful thinking.

[13] This is self-evident, but if authority is needed, see *Pilkington Bros v IRC* [1982] STC 103 at p.112-113 rejecting an argument the use of the plural shed light on what constituted the arrangements; one might also cite the Interpretation Act rule that the singular includes the plural and vice versa.

App. 2.2.2 *Scheme or arrangement*

'Scheme' and 'arrangement' are (more or less) synonymous:

> The term 'scheme' has a normal dictionary meaning: 'a plan, a design; a project, an enterprise; a programme of work or action to attain an objective, a plan for regular contributions towards a pension etc' ... I accept [counsel's] definition of 'arrangement' ('structure or combination of thing for a purpose'). So it is inherently unlikely that a combination of circumstances which amount to a 'scheme' will not also be an 'arrangement' (and vice versa).[14]

"Scheme or arrangement" is a doublet; it does not refer to two distinct things.

Scheme is (sensibly) not usually defined; when there is a definition[15] it adds nothing to the meaning.

App. 2.2.3 *Definitions of 'arrangement'*

There are two standard definitions of 'arrangements' in tax legislation:

Standard IT/CGT definition	**Standard IHT definition**
'arrangements' includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).	'arrangements' includes any scheme, transaction or series of transactions, agreement or understanding, whether or not legally enforceable, and any associated operations

The standard IT/CGT definition (my terminology) was first used in 2005[16]

[14] *HMRC v Barclays Bank* [2005] UKSPC SPC00520 at [73] (not questioned in the subsequent appeals); likewise *Snell v HMRC* [2006] EWHC 3350 (Ch) at [28].
For completeness: "arrangement" is discussed in an old Restrictive Trade Practices case, but *Farnborough Airport Properties v HMRC* did not find that very helpful, see [2016] UKFTT 431 (TC) at [50]:

> Nor do I regard the discussion of the meaning of 'arrangements' in *In re British Basic Slag Ltd* as helpful, since the discussions in that case ... are predicated on the definition of 'agreement' in section 6 of the Restrictive Trade Practices Act 1956, which makes express reference to 'acceptance by two or more parties', and hence connotes an element of mutuality or meeting of minds. The CTA 2010 contains no such qualification.

The point was taken, and *British Basic Slag* has hardly been cited since then.

[15] Eg in the definition of "employer-financed employee benefit scheme"; see 84.8 (EFURBS).

[16] Section 144ZD(8) TCGA, introduced by F(No.2) Act 2005.

and it must have found its way into an (unpublished) OPC Finance Bill handbook, as it has now been repeated in Finance Acts on about 100 occasions, but is not found elsewhere.

The standard IHT definition (my terminology) was first used in 2013,[17] and again must have found its way into the drafter's IHT handbook, as it has been used subsequently.[18] This definition reshuffles the words, and adds associated operations; but I do not think there is any identifiable difference in meaning between the definitions.

Neither definition adds anything to the normal meaning of the word, which has been used without definition in tax legislation since at least 1922.

Why then do we have a definition? Perhaps some lobbyist objected to the vagueness of the word, and the drafter provided the definition in response, without realising (or, cynically, realising) that it did not provide any clarification. Once it was there, of course it had to be followed later. Thus on one occasion HMRC said, I think without conscious irony:

> The government will amend the draft legislation so that ... 'arrangements' is clearly defined.[19]

Why we have more than one definition is harder to explain. They do not do much harm. Such is the patchwork nature of taxation.

App. 2.2.4 *Identifying the arrangement*

It is necessary to distinguish two distinct questions:
(1) Is there an arrangement?
(2) If so, what steps are included in, or constitute, the arrangement?

Question (1) is usually easy. But question (2) is often imponderable, and the answer is context-dependent: what solution fits the provisions?

It may be necessary, or at least, helpful, to identify what is the arrangement for the following purposes:[20]

(1) Where the settlement-arrangement definition is in point, to identify:

[17] Section 162A IHTA.

[18] Para 6 sch 1A IHTA.

[19] HMRC 'Company distributions: Summary of Responses' (2016) para 2.51 *https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/510263/Company_distributions_-_summary_of_responses.pdf*
In due course the standard definition was supplied.

[20] See too 87.4.2 (Trust + steps arrangement).

(a) Whether the arrangement has bounty (gratuitous intent) so as to qualify as a "settlement"
(b) The settlor and the beneficiaries of the settlement
(c) The income arising under/property comprised in the settlement
(d) Whether the settlement is an outright gift

(2) In a TAAR, to identify the purpose(s) of the arrangement[21]

App. 2.2.5 *Sufficient unity test*

An arrangement may take the form of a series of steps planned from the outset, but taking place over a period of time. This may still constitute one arrangement (and so, one settlement under the settlement-arrangement definition). That is self-evident.

An arrangement may take the form of a series of steps which are developed over time, without every aspect of the arrangements being planned or determined from the outset. This too can still constitute one arrangement (and so, one settlement under the settlement-arrangement definition). *Crossland v Hawkins*[22] is an example. The facts were as follows:

Step 1: setup of company with services contract (Dec 1954)

(a) On 3 December 1954 the actor Jack Hawkins caused a company to be formed; two shares were issued.[23]
(b) On 10 December 1954 he agreed with the company to make his services available, as the company may direct, for a salary (£50 per week[24]).

Step 2: settlement of company (Mar 1955)

On 3 March 1955 the actor's father-in-law settled £100 on trust for the actor's minor children, and the trustees used this money to subscribe for 98 shares in the company.

Step 3: operation of company - filming and distribution of profit (1956)

(a) The company was paid £25,000 for the actor's services in a film, (called "Fortune is a Woman")
(b) The company paid a dividend of £500 to the trustees, most of which

[21] See 3.4 (View arrangement as a whole).

[22] 39 TC 493.

[23] For completeness; these two shares were issued to Hawkins' solicitors, and belonged beneficially to him.

[24] This was not a nominal salary in absolute terms. In 1954 the average UK weekly wage was £9 / 9 for men and £5 for women. But it was nominal compared to the value of the services provided.

was distributed to the children.

The arrangement consisted of:

(1) step 1: the formation of the company and the service agreement, in December 1954; and

(2) step 2: the settlement and issue of the company's shares to the trust, in March 1955

At the time of step 1, when the actor agreed to supply his services to the company, step 2 (the creation of the children's trust) was allegedly not in contemplation.[25] That did not prevent the two steps from forming one arrangement:

> I do not think that ... the whole of the eventual arrangement must be in contemplation from the very outset…I think there is sufficient unity about the whole matter to justify it being called an arrangement for this purpose, because, as I have said, the ultimate object is to secure for somebody money free from what would otherwise be the burden or the full burden of surtax. Merely because the final step to secure this objective is left unresolved at the outset, and decided on later, does not seem to me to rob the scheme of the necessary unity to justify it being called an 'arrangement'.[26]

The test is evaluative: "sufficient" unity.

Incidentally, even if step 1 was not part of the arrangement (eg if the company had been set up many years before) a Court would find that:

(1) Step 2 was (obviously) a settlement (in every sense); and

(2) the actor was a "settlor" of that settlement, providing property indirectly by allowing the trustees to subscribe for shares in his valuable[27] company for a nominal £100.

So it did not actually matter whether the arrangement (settlement) was step 1 and 2, or just step 2 alone.

App. 2.2.6 *Post-arrangement steps*

A plan may envisage:

[25] That seems implausible, but it does not matter.

[26] 39 TC 493 at p.505 (emphasis added).

[27] On the facts of *Hawkins* the service contract with the company had a 3 year term. If the actor had power to revoke the contract, or if the contract had a short term, then the company would not be valuable, but the actor would provide funds by working for the company at an undervalue.

(1) a number of steps which constitute an arrangement and
(2) further (post-arrangement) steps

The further steps may not constitute part of the arrangement, even though they were envisaged from the outset.

In *Hawkins*, step 3 - Jack Hawkins' performance in the film, the payment of his fee to the company and the payment of the dividend by the company (which occurred in 1956) - was not part of the arrangement (settlement). This was the arrangement being put to its intended use:

> Normally (there may be exceptions) the arrangement is to be identified by the constituent parts or components of the legal structure designed for a purpose, and not by what is done (sometimes months or even years later) in using the structure for its intended purpose.[28]

That seems an arbitrary cut-off, but it has the helpful consequence of supporting the argument that the income arising under the settlement is the dividend income, not the company's trading income.

Perhaps the underlying idea is that arrangments are envisaged as being relatively short term. Matters which carry on for a long time are not part of the same arrangement. We still travel today along roads that the Romans built; but our journeys are not part of the arrangements made by the Roman road-planners.

App. 2.2.7 *Pre-arrangement steps*

Clipperton and *Dunsby*[29] (the "dividend replacement strategy" cases) were hare-brained (pre-GAAR) schemes intended to allow shareholders of a family company to receive a dividend free of IT.

The schemes were similar though not quite identical. In short:

Clipperton	***Dunsby***
Step 1: Co transfers share in Newco to trust: A company ("the original company") transferred a worthless B share in a new company ("Newco") to a classic trust.	*Step 1*: *co issues share to individual* The company issued a worthless S share to a non-resident individual ("G").

[28] See *Jones v Garnett* [2007] UKHL 35 at [53]. The same point is made in Jones v Garnett which I discuss elsewhere; see 87.5.4 (Applying bounty test).

[29] *Clipperton v HMRC* [2022] UKUT 351 (TCC); *Dunsby v HMRC* [2021] UKUT 289 (TCC). *Clipperton* is not yet final; the reader may be surprised that the taxpayer obtained permission to appeal.

Note: The B share was worthless because at this point Newco had no assets	The S share was worthless because its dividends depended on the decision of the ordinary shareholders.
Step 2: The original company funded Newco so that it held £200k.	*Step 2*: G gave that share to a classic trust whose beneficiaries were the company owner and G .
Note: The shareholders were entitled to (most of) the trust income but the original company was also a beneficiary	The shareholders were entitled to (most of) the trust income but G was also a beneficiary
Step 3: Newco paid a dividend on the B share to the trust, mostly received by the shareholders	*Step 3:* The company declared a dividend on the S share to the trust, mostly received by the shareholders

The intended analysis was:

Clipperton	***Dunsby***
The settlor was the original company, not the shareholders	The settlor was G, not the shareholders
Under s.624 the dividend was treated as arising to the original company. So the shareholders were not taxed	Under s.624 the dividend was treated as arising to G. So the shareholders were not taxed

The taxpayer's analysis was:

(1) The arrangement (settlement) is the creation of the classic trust, alone, not steps 1 and 2, (or 1, 2 and 3).

(2) The settlor not the company owner but someone else: the original company (in *Clipperton*) or G (in *Dunsby)* (the purported settlor)

(3) Under s.624 the dividend was treated as accruing to purported settlor. So the shareholder was not taxed! (Nor were the purported settlors taxable, G as she was non-resident, and the original company as a company is not taxable on UK dividends)

So both schemes were based on a common idea, namely, to conjure up a different (non-taxable) settlor, and then take advantage of the settlor-interested trust rule. It no doubt seemed very droll to use an anti-avoidance rule as the basis of an avoidance scheme! The schemes were marketed under the label "dividend replacement strategy" and I use that here.

As often happens with avoidance schemes, the cases raise many distinct issues and failed for many distinct reasons. Many of these issues were the same in both cases, so it is helpful to consider them together.

The s.624 issues were:

Issue	**See**
What was the arrangement (settlement)	*Discussed here*
Who was the settlor	99.2.8
If there were two settlors, what then	100.2.1

There was clearly an arrangement, but which steps did the arrangement consist of? The taxpayer argued that the arrangement consisted only of step 2: the gift to the classic trust by G.[30] But no, the arrangement consisted of steps 1 *and* 2:[31]

> 96. ... whether the act of settlement, narrowly defined, has an economic logic that is freestanding and severable from the preparatory steps leading to that settlement. If it does, then (absent unusual circumstances) that is a strong indication that the preparatory steps are not to be regarded as integral to that settlement.

"Freestanding and severable" is evaluative and leaves plenty of wiggle room. But:

> 99 ... the settlement can therefore only sensibly be defined by reference to the sequence of transactions constituting the Scheme. To describe it by reference solely to G's creation of the Trust [Step 2] is wholly artificial and unrealistic.

That is clearly right.[32]

[30] But the scheme would have failed even if the settlement-arrangement consisted only of step 2, the creation of the classic trust, because in each case the company owner was at the very least a joint settlor of the classic trust, having provided the trust property indirectly.

[31] *Dunsby v HMRC* [2021] UKUT 289.
On the other hand, step 3 was a post-arrangement step which was not part of the settlement-arrangement, see [109]: "I have not treated the payment of the dividend on the S share as part of the "arrangement". The S share became subject to the Trust. It was the property comprised in the settlement. The dividend on the S share was the income, which arose under the settlement, rather than one of the steps in its creation."

[32] The FTT took the same view: [2020] UKFTT 271 (TC) at [106], [107]. The UT could (I think, should) have also said that what is the arrangement is a question of fact for the FTT. They might then have gone on to say they would have made the same decision as the FTT, and perhaps that any other decision would be perverse.

For completeness: The reader may have puzzled over the antique case of *Chamberlain v IRC*.[33] Here the steps were:

Step 1 creation of company structure: The taxpayer:

(a) formed a company (Staffa Investment co, "the holding co") and

(b transferred shares in another company (the "underlying co") to the holding co, in consideration of cash[34] and an issue of shares by the holding co

Step 2 creation of trust structure

(a) The taxpayer established a number of classic family trusts.

(b) The trustees used cash given to those trusts to acquire shares in the holding company.

There was clearly an arrangement, but which steps did the arrangement consist of? Was step 1 part of the arrangement? Or was that a pre-arrangement step, so step 2, in short, the classic trusts, were the only arrangements (settlements)?

Lord Macmillan supports the latter view:[35]

> It is, I think, fallacious to confuse the steps taken by the Appellant with a view to effecting a settlement or arrangement with the settlement or arrangement itself.
>
> When the Appellant [at step 1] created the [holding co], and sold to it his 470 shares in [the underlying co], he made no settlement or arrangement such as the Statute contemplates... It was not until he granted the trust deeds [at step 2] that he entered the legal stage of the settlement. All that he did previously was preparatory to making settlements.

This is not authority for a general proposition that steps prior to the creation of a classic trust are always to be ignored when determining the scope of the settlement-arrangement. This is for three reasons (any one would suffice):

(1) One needs to read all the speeches, and Macmillan was the only judge who took this view. The majority preferred the view (surely more natural) that the arrangement consisted of steps 1 *and* 2.[36]

[33] 25 TC 317.

[34] Nowadays the transactions in securities rules would need consideration at this point.

[35] 25 TC 317 at p.332.

[36] But it did not matter, as the "property comprised in the settlement" was the trust property only; see 47.3 (Arising under a settlement).

(2) Nowadays, identifying an arrangement is regarded as a question of fact, so *Chamberlain* is not a binding precedent.

(3) *Chamberlain* was distinguished in *Clipperton* on the grounds that in *Chamberlain* the two steps which Lord Macmillan held not to form a single arrangement were substantial steps, involving substantial funds, and not an asset of nominal value.[37]

Chamberlain does illustrate that identifying what steps constitute an arrangement is a fact sensitive, context-dependent enquiry, on which views may differ.

App. 2.2.8 *When arrangements begin*

SP 3/93 discusses this issue in the context of group relief:

> **SP 3/93 Groups of companies—arrangements**
> 2 This statement gives general guidance on how HMRC interpret 'arrangements' in the following provisions:[38]

ICTA 1988	**now CTA 2010**	**Topic**
s.410(1)(2)	s.154-155	Group and consortium reliefs
para 5B(1) sch 18	s.173(2)	Option arrangements
s.240(11)(a)	*Now obsolete*	Surrender of ACT to subsidiary
s.247(1A)(b)	*Now obsolete*	Consortium group income elections

> 4 This statement of practice gives general guidance ... . Comprehensive guidance cannot be given about what constitutes 'arrangements' or 'option arrangements', nor about precisely when they come into existence. Particular cases depend on the particular relevant facts.
> 5 As regards 'option arrangements' the Commissioners for HMRC view is that if an agreement provides for the creation of specified option rights exercisable at some future time 'option arrangements' come into existence when the agreement was entered into.
> **Disposal of shares or securities in a company**
> 6 Where a holder of shares or securities in a company is preparing to dispose of them, straightforward negotiations for the disposal will not give rise to the existence of 'arrangements' before the point at which an offer is accepted subject to contract or on a similar conditional basis. Equally, unless there are exceptional features, an offer made to the public at large of shares or a business will not at that stage bring 'arrangements' into existence.

[37] [2022] UKUT 351 (TCC) at [143].

[38] I have amended the layout for clarity.

> 7 If a disposal requires the approval of shareholders, operations leading towards disposal will not give rise to the existence of 'arrangements' before that approval is given or until the directors become aware that it will be given.
>
> 8 If following negotiations with potential purchasers a holder of shares or securities concentrates on a particular potential purchaser this will not of itself be regarded as bringing 'arrangements' into existence. But 'arrangements' might exist if there were an understanding between the parties in the character of an option. For example, an offer, whether formally made or not, might be allowed to remain open for an appreciable period so that the potential purchaser was allowed to choose the moment to create a bargain.
>
> **Company reconstructions**
>
> 9 The approval of shareholders for a company reconstruction may be required under company law or to comply with the rules of a stock exchange. 'Arrangements' will not come into existence before approval is given or until the directors become aware that it will be given...

Fortunately, the question of exactly when arrangements begin does not arise in relation to the private client topics discussed in this book.

App. 2.3 Chargeable/liable to tax

The expressions chargeable to tax/liable to tax are common in tax legislation. The meaning is context dependent,[39] but some general observations may be made.

In their general sense there is (more or less) no difference between the words chargeable/liable; they are sometimes used interchangeably.[40]

Here is a list of places in this book where the expressions are used and discussed:

Context: expression used	**See para**
Charged/chargeable to tax	
ITTOIA	
s.318A, 683, 687: charged to IT	14.7.2
s.624: chargeable to tax if remitted	47.8
s.624: not chargeable because non-resident	47.9

[39] This is (more or less) self-evident, but if authority is needed, see *Barnes v HMRC* [2014] EWCA Civ 31 at [38]: "words similar to 'chargeable to tax' have no fixed meaning ... their meaning in a particular section needs to be determined from their immediate context...".

[40] For examples of the words being used interchangeably, see 121.2 (Duty to give notice of liability); 15.17.4 (Benefit: Motive defence applies).

s.648: chargeable/would be if received by UK resident	47.2
s.685A: settlor charged to tax under section 619(1)	47.10.1
s.830: chargeable/would be if s.832 did not apply (RFI definition)	16.9.2
ITA	
s.809AZA: charged to income tax as income of transferor	54.4
TCGA	
s.37: charged to IT as income	56.4.12
s.87: payment chargeable to IT (capital payment definition)	61.7.4

Liable to tax

s.643: benefit liable to IT	47.21.5
s.731: benefit liable to IT	50.16
OECD Model: liable to tax	9.5

Taken/brought into account

s.37 TCGA: taken into account in computing income	47.12
s.103K TCGA: brought into account in calculating profits of trade	73.19.3
s.743 ITA: taken into account in charging IT under ToA rules	51.5; 51.9
s.809AZA ITA: brought into account in calculating profits for IT	54.4
s.259BC TIOPA: brought into account in calculating profits	91.14; 91.17.3

Similar expressions

s.633/729: sum payable as income (capital sum definition)	49.24.2
s.87: payment received as income (capital payment definition)	61.7.4
s.809VH ITA: income for IT/CT or would be if liable to tax	19.14
Non-OECD model DTA: Subject to tax	108.13

The IT Codification Committee discussed the meaning of *charge* to tax:[41]

> The word "charge" is used in relation both
> [1] to the amount of the tax payable in consequence of an assessment, and
> [2] to the process of imposing upon a taxpayer liability to pay tax.

App. 2.3.1 *Unremitted RFI "chargeable"*

Everyone would agree that remitted RFI of a remittance basis taxpayer is chargeable to IT.[42]

Although less obvious, unremitted RFI is also chargeable to tax. The scheme of ITTOIA is that for every category of income there is:

(1) a charging provision; and
(2) a provision specifying the *amount on which* tax is charged.

For instance, in relation to dividends from non-resident companies, s.402

[41] (1936) Cmd 5131 at [38].

[42] See 17.13 (Charge on remitted RFI).

ITTOIA provides:

> **402 Charge to tax on dividends from non-UK resident companies**
> (1) Income tax is charged on dividends of a non-UK resident company.
> ...
> **403 Income charged**
> (1) Tax is charged under this Chapter on the...amount of the dividends arising in the tax year.
> (2) Subsection (1) is subject to ... Part 8 (foreign income: special rules).

The (perhaps subtle) point is that IT is *charged* on dividends under s.402 ITTOIA. Section 403 ITTOIA does not impose a charge. It merely quantifies the *amount on which* income tax is charged. Likewise s.832(2) ITTOIA does not impose a charge, it merely quantifies the *amount on which* income tax is charged.[43]

So references to income chargeable/liable to income tax in principle include unremitted income (un)taxed on the remittance basis.[44] Of course context may show that the word "chargeable" is used in a narrower sense so as not to include unremitted income (un)taxed on the remittance basis.

The same applies to the expression "liable" to tax. That is consistent with the well established rule that pension schemes and charities are "liable" to tax for the purposes of DTAs even though they qualify for pension or charity exemptions.[45]

App. 2.3.2 *Charge/bear tax compared*

The IT Codification Committee adopted a distinction between *charge* to tax and *bearing* tax:[46]

> The word "charge" is used in relation both
> [1] to the amount of the tax payable in consequence of an assessment, and
> [2] to the process of imposing upon a taxpayer liability to pay tax.
> In this connection, the word "charge" has, so far as practicable, been confined to a direct charge, and does not cover tax borne by deduction.

[43] Hence the legislation states that tax is charged "in accordance with" s.832 not *under* s.832. See eg ss.13, 14, 16 ITA.

[44] See 50.17.3 (Benefit remittance-basis exempt); 61.7.4 (Chargeable to IT).

[45] See 9.5.2 (Narrow exemption). *Stonor v IRC* [2001] STC (SCD) 199 might be cited against this view but a Special Commissioners decision on other provisions, and not fully argued, does not count for much.

[46] (1936) Cmd 5131 at [38].

> In the latter case the recipient of a payment from which tax has been deducted is said to "bear" tax, not to be "charged with" tax.
> On the other hand, the expression "bear tax" is used to cover the suffering of tax whether by direct charge or by deduction or otherwise...

Similarly, a permanent establishment (not being a legal person) does not directly *pay* remuneration, but is said to *bear* remuneration.[47]

However the distinction between charge (or chargeable) to tax (a direct charge), and "bear" tax (a wider term, including an indirect charge, by deduction), is not observed (or at least, not strictly observed) in contemporary tax legislation. For instance:

- s.648 ITTOIA refers to income "chargeable to income tax by deduction or otherwise".[48]
- s.13 TIOPA refers to "tax charged directly on the dividend (whether by charge to tax, deduction of tax at source or otherwise)".[49]

App. 2.3.3 *Bear tax "by deduction or otherwise"*

The IT Codification Committee comment on the expression "by deduction or otherwise".[50] In the expression "pay or bear tax by deduction or otherwise" do the words "or otherwise" add anything? Could one "bear" tax, without a direct charge, but otherwise than by deduction? I do not think the point is likely to matter, today, but for completeness, the Committee thought the answer was, yes, and offer this subtle example:

> ... the expression "bear tax" is used to cover the suffering of tax whether by direct charge or by deduction or otherwise, the expression "or otherwise" being intended to cover such cases as those where trustees pay or bear tax and distribute the net sum amongst the beneficiaries without specific deduction of tax as such.[51]

But in practice adding the words "by deduction or otherwise" makes no difference, for they will generally be implied if not there.

[47] See 37.7 (STBV payment condition (b)).

[48] See 47.2 ("Income" arising under a settlement).

[49] See 111.11 (Tax credit: Dividends).

[50] (1936) Cmd 5131 at [38].

[51] The point is perhaps that the beneficiaries could be said to bear tax, but not by deduction. This would not apply to UK trusts after 1973, but it does apply in the case of non-resident trusts who receive UK source income and distribute it to non-residents. The non-resident beneficiaries are not charged to UK tax, and do not bear tax by deduction, but they do bear tax otherwise than by way of deduction.

App. 2.4 In connection with/respect of/relating to

There is a cluster of similar (I think, more or less, identical) phrases which require a nexus of some kind between A and B: This includes:

- in respect of
- in connection with
- relating to

Exactly what that nexus requires is left to the Court to sort out from the context, but these are wide phrases. They are wider than terms of causation, such as:

- as a result of
- by virtue of
- in consequence of

That is perhaps self-evident, but some reference to case law may be helpful.

App. 2.4.1 *In respect of*

In *Albon v Naza Motor Trading*:[52]

> The words 'in respect of' are difficult of definition, but they have the widest possible meaning of any expression intended to convey some connection or relation between the two subject-matters to which the words refer.

App. 2.4.2 *In connection with*

In *Coventry Waste Ltd v Russell*:[53]

> It may be that in some contexts the substitution of the words "having to do with" will solve the entire problem which is created by the use of the words "in connection with." But I am not ... satisfied that it does so in this case ... the phrase is a protean one which tends to draw its meaning from the words which surround it.

HMRC v Barclays Bank[54] considered whether a payment was made "in

[52] [2007] 2 All ER 719 at [27]. In *Cunard's Trustees v IRC* 27 TC 122 at p.135 Lord Greene described the phrase *in respect of* as 'colourless words' meaning, I think, that they were vague words, devoid of much content (colour). Thus the adjectives good/bad are described as colourless, whereas valid/suitable/efficient and their antonyms are not. But a metaphor which needs such explanation is not a helpful one.

[53] [1999] 1 WLR 2093 at p.2103.

[54] [2007] EWCA Civ 442 at [18].

connection with past service" in the context of the charge on benefits from an employer-financed retirement benefit scheme. The Court cited that comment and continued:

> Accordingly, the other parts of the definition of "relevant benefits" and the surrounding provisions of the legislative scheme, will inform the court as to the extent of the link required by any particular provision. Thus the court must examine the function or purpose of the definition of "relevant benefits". Here, the purpose of the definition is to identify the chargeable payments under a retirement benefits scheme. At the very least, Parliament is unlikely to have intended to limit connections to direct connections. That would have left the possibility that taxpayers could easily circumvent the charging provisions. Furthermore, it must have been foreseen that, over the life of the scheme, changes might be made to benefits. The changes would not simply involve a straight exchange or substitution of one benefit for another, but, on occasion, the loss of a benefit and the rendering of some monetary recompense. The charging provisions could only fairly apply if they applied to the giving of the new benefits, or recompense, as much as to the giving of the benefit originally provided by the scheme. It is also significant that Parliament did not limit itself to payments in consideration for services. Thus I conclude that a connection may be indirect for the purpose of the definition of relevant benefits.[55]

London Luton Hotel BPRA Property Fund v HMRC reviews the cases and concludes:[56]

> the words will usually take their meaning from those which surround it and the wider context, and that courts and tribunals may have to determine whether the words have a broad or a narrow meaning, understood in context. In literal terms, both meanings are possible.

Examples where the expression is found include:

Context	**See para**
ToA code	49.24.3
TiS code	55.6, 55.7

[55] Similarly *Derby Teaching Hospitals NHS Foundation Trust v Derby City Council* [2019] EWHC 3436 (Ch) at [74]: "The concept of 'connection' [in the phrase 'the provision of services provided to individuals for or in connection with the prevention, diagnosis or treatment of illness'] is not confined to activities which are subservient to or ancillary to or incidental to the purpose of the prevention, diagnosis or treatment of illness nor confined to being a means to that end."

[56] [2023] EWCA Civ 362 at [63].

App. 2.4.3 *Relating to*

The *Derby Teaching Hospitals* case discussed the authorities:[57]

> ... the decision of the High Court of Australia in *Tooheys Ltd v Commissioner of Stamp Duties (NSW)* (1960-1961) 105 CLR 602. The issue in that case concerned the interpretation of an exemption in a statute dealing with stamp duty. The exemption referred to
>
> > 'instruments relating to the services of apprentices, clerks and servants'.
>
> The High Court was divided, with three judges holding that the exemption did not apply and two judges holding that it did. Kitto J, in the minority, reviewed a number of earlier English authorities. His judgment makes it clear that when one considers the ambit of the words 'relating to' or 'related to', one must consider the context and the object of the provision being construed. Taylor J, in the majority, said at page 620:
>
> > 'There can be no doubt that the expression 'relating to' is extremely wide but it is also vague and indefinite. Clearly enough it predicates the existence of some kind of relationship but it leaves unspecified the plane upon which the relationship is to be sought and identified. That being so all that a court can do is to endeavour to seek some precision in the context in which the expression is used. With this in mind it may be said with some certainty that an examination of the language of the exempting provision shows that it does not admit of its application to an instrument merely because it makes a reference to the existence of a relationship of master and servant between the parties to it, or still less, because it refers to the existence of a master and servant relationship between persons who are not parties to it. It is, I think, not open to argument that 'relating to', in the context in which it appears, is equivalent to 'referring to' and the 'relationship' must be based upon some more substantial ground.'
>
> In *Tooheys Ltd*, Windeyer J at page 624 referred to 'the elastic character' of the phrase 'relating to'.

Section 43(2) National Health Service Act 2006 provides:

> (2) An NHS foundation trust may provide goods and services for any purposes related to—
>
> (a) the provision of services provided to individuals for or in connection with the prevention, diagnosis or treatment of

[57] *Derby Teaching Hospitals NHS Foundation Trust v Derby City Council* [2019] EWHC 3436 (Ch) at [53].

illness, and
(b) the promotion and protection of public health.

The *Derby Teaching Hospitals* case comments:

> The phrase 'related to' is used in [s.43(2) NHS Act 2006 Act] to describe the degree of connection between 'any purposes' and the purposes of the prevention, diagnosis or treatment of illness of the purpose of the promotion and protection of public health. The phrase shows that there must be a connection but does not tell one very much about how close that connection must be. The closeness of the connection, or the relationship, which is required depends upon the perceived purpose of the statutory provision.

For an example of the phrase narrowly construed, see App 4.4.3 (Covenant incidental to sale).

App. 2.5 Loan

App. 2.5.1 *Meaning of 'loan'*

'Loan' is a technical legal term. It means a loan of money. It does not include the right to an unpaid purchase price, even if:
(1) the purchase price is left outstanding[58] or
(2) the purchase price is satisfied by the issue of a promissory note.[59]

Interest accrued and due on a loan is a debt, but is not itself a loan.

However, in practice the strict legal meaning of loan may not matter, because:
(1) The term 'loan' is often given a wider definition, to include any form of credit; or
(2) The drafter reaches the same destination by framing a rule which applies both to loans and to other debts (eg the definition of loan creditor refers to a debt for money borrowed *or capital assets acquired* by a company).

For discussion of the related concepts of debt/liability, see 80.1 (IHT deduction for debts: Introduction).

[58] *Ramsden v IRC* 37 TC 619 at p.625; *Chitty on Contracts* (34th ed., 2021), para 41-262 (Definition of loan).

[59] *Lee v IRC* 24 TC 207. This is so even if the promissory notes are called 'loan notes' (which I think is nowadays the more usual label; though in a case where s.727 may be relevant, it might be thought better to use the more accurate expression 'promissory notes'). HMRC accept this; see 49.24.2 ('Capital sum').

App. 2.5.2 *Loan or outright payment?*

The loan/outright payment distinction is a matter of general (contract/property) law and not tax law. If A transfers money to B, the transaction may be a loan or an outright transfer. That depends on the intention of the parties. There is a loan if A and B intend that B should be obliged to repay A. There is an outright transfer if they do not intend repayment.[60]

The issue arose neatly in *Sofer v Swissindependent Trustees*[61] where trustees had power to lend to the settlor but no power to make outright distributions. The trustees made payments documented as interest-free unsecured loans.[62] The trustees made no enquiry as to the ability of the settlor to repay the "loans". It was said that the intention of the parties was that the "borrower" should not have to repay if he did not wish to.

Needless to say, repayment was not forthcoming. The Court dealt with the position very briefly:[63]

> whether a payment is made by way of gift[64] or by way of loan is primarily a question of fact as to the intentions of the parties.

That does not take us very far. There are various issues here.

(1) Sham: It is possible that the parties may not intend repayment, but pretend that they do, in which case the document, not reflecting the parties' intention, may be invalid as a sham. In what circumstances can a party to a formal deed ignore it on the basis that it was not the intention of the parties? Does sham operate inter partes?

(2) If so, how does one ascertain intention here?

The second issue turns on one's understanding of "intention", which is not the simple concept it may appear to be. In philosophical terms, this raises Kavka's toxin puzzle: can a person intend to do something which they know they will later decide not to do? or more simply, can a person intend to do something which they know they will not do?

[60] Further consideration may be needed if the applicable law is not English law, or if A or B do not have legal power to enter into transactions of loan or transfer.

[61] [2020] EWCA Civ 699.

[62] The proper law of the loans was not discussed, but English law principles would be assumed to apply unless the contrary is proven.

[63] [2020] EWCA Civ 699 at [42].

[64] CA used the term "gift" loosely, to mean "outright distribution". Strictly speaking, "Gift" is not apt to describe a distribution by trustees, as trustees have no gratuitous intent; but nothing turns on that.

If the case goes all the way to trial, the judgement may shed light on these issues - or it may skate past them. Time will tell.

App. 2.5.3 *Loan unlikely to be repaid*

The INT Manual provides:

> **INTM601640 Examples of amount or value of loan** [Jul 2023]
> ... The above assumes that monies made available to the individual were in fact by way of loan and, in appropriate cases, evidence of a loan having been made, should be obtained. If, on enquiry, it transpires that the payment was not a loan, then the payment should be treated as [an outright] cash payment...
> From 6 April 2017, rules were introduced in ITA07/S742C regarding the calculation of the value of the benefit relating to loans. Guidance on this can be found at INTM603640.

Similarly, in *Wildbirds Food v HMRC*:

> 39. What [HMRC's] argument essentially boils down to is this: given that, at the time each relevant payment was advanced, BFL could not have repaid it (or the interest on it) and had no plausible plan for doing so, it cannot properly be said that the resultant debt 'arises from a transaction for the lending of money' ....
> 40. I disagree. The modern business world has many famous examples of companies, especially in the technology sector, with no cash and no immediate prospect of generating a profit which go on to be very successful. Clearly the appellant considers BFL potentially to be such a company and is therefore prepared to subsidise its running costs by way of loan for the time being in the hope of obtaining repayment of some or all of its loans in due course, possibly with a gain on its share investment as well.
> 41. ... there is no requirement that for a loan relationship to exist, interest must be charged; were it otherwise, many perfectly normal intra-group loans would fall foul of that requirement ... Nor is there any requirement that, for a loan relationship to exist, the lender must have any degree of certainty that the debt will be repaid – normal commercial loans are inherently hedged about with uncertainty about whether repayment will be made and save in degree, the present situation is no different. Lack of a fixed repayment date for a loan is perfectly commonplace. ... The loans have been advanced as a matter of arm's length negotiation between the two parties, there is an obligation to repay (as recognised by both companies in their respective audited accounts and confirmed in evidence), and the fact that the appellant may well not recover some or

> all of its money is neither here nor there.[65]

An argument that a long term interest-free loan from a company to a shareholder should be characterised as a company distribution was rejected in *CT Audit v Cigarette Company of Jamaica*.[66]

App. 2.5.4 *Who is the borrower?*

Bayonet Ventures LLP v HMRC concerned a loan agreement between A and B; the sum borrowed was paid to a 3rd party, C.[67] But the 3rd party was not the borrower to whom the lender made the loan:

> the mere fact that funds flow from person A to person C, notwithstanding that the loan agreement is between person A and person B is certainly not unusual, for example, where the funds are paid to the borrower's agent or solicitor to be used or deployed on behalf of the borrower...
>
> [The borrower] was at liberty to cause or permit that money to be paid to [C]... The mere fact that the monies actually passed from [the lender] to [C] does not mean that the loan was made to [the member] ... The identity of the parties to a loan is a matter of law; albeit informed by the factual matrix within which the loan is made and documented.[68]

App. 2.5.5 *Loans: Non-tax aspects*

A loan should be documented by a written agreement made at or before the time of the loan.

If a party to a loan is a trust or company, the loan should be recorded in the trust/company accounts.

If a party to a loan is a trust, or a company held by a trust, the trustees need to consider whether they can properly enter into the loan, or permit the company to do so.

If a company lends to directors/connected persons, company law restrictions on loans may need to be considered. This will depend on the applicable company law.

The position following the death of an individual borrower/lender may

[65] [2018] UKFTT 341 (TC).

[66] [2012] UKPC 9 at [24]. The loan was recorded in the company accounts. The loan was not even "artificial"; see 3.21.2 ('Artificial'/ 'devices').
See too 52.29.2 (Methods of distribution).

[67] The recipient was a member of the LLP borrower, but nothing turned on that.

[68] [2018] UKFTT 262 (TC) at [17], [26].

need thought, preferably at the time the loan is made, not after the death.

Consider whether any party to the loan needs independent legal advice.

Take care the loan does not accidentally become time-barred: diarise the limitation period.[69]

These may seem basic points, but it is remarkable how often they are overlooked.

App. 2.6 Person/legal personality

Legal personality has generated a lively scholarship. This section draws on:

Twining, *General Jurisprudence*[70]

Bryant Smith, "Legal Personality" 1928 Yale Law Journal, p. 283[71]

App. 2.6.1 *Legal person: UK law*

The starting point is that 'person' has a legal sense, distinct from the ordinary meaning (if there is such a thing). A person is:

> any being[72] whom the law regards as capable of rights and duties. Any being that is so capable is a person, whether a human being or not.[73]

In *JH Rayner (Mincing Lane) v Department of Trade and Industry*:[74]

> A body which, as distinct from the natural persons composing it, can have rights and be subject to duties and can own property must be regarded as having a legal personality, whether it is or is not called a corporation.

A (more or less) equivalent way of expressing the point is that an entity has legal personality if it has the ability to own property in its name, and to sue and be sued in its name.

An entity may have some rights and duties and not others. For example a body may have the right to enter into an employment contract but not to hold real property. A minor has fewer rights than an adult; and a newborn

[69] See 80.8 (Time-barred debt).

[70] (2009) *http://www.cambridge.org/download_file/167999*

[71] *https://www.google.com/search?q=Legal+Personality%2C+Bryant+Smith&oq=Legal+Personality%2C+Bryant+Smith&aqs=chrome..69i57j0i546l5.741j0j7&sourceid=chrome&ie=UTF-8*

[72] I think that nowadays the word "entity" (or even "thing") would be more appropriate than "being": a company is a legal person, but not normally called a "being".

[73] Salmond, *Jurisprudence* (12th ed, 1966), p. 299.

[74] [1990] 2 AC 418 at p.504.

baby only has duties in the artificial sense that a person representing it may have duties. An English partnership cannot hold property, but it can sue and be sued in the partnership name.

It might be that an entity which has some rights and duties does not have enough of them to be a legal person. Legal personality is all or nothing, and not regarded as a matter of degree. Avery Jones states:

> there are, with few exceptions, no degrees of legal capacity.[75]

So the question should strictly be whether the entity has *sufficient* rights and duties. But in practice this issue has not arisen.

There are two express definitions of 'person':

Definition	**Applies for**	**See**
Interpretation Act definition	Acts of Parliament	85.14.1
OECD Model definition	DTAs	9.4

But these definitions do not take us far, so we fall back on the normal legal meaning. Of course that meaning as always is subject to context.

Statute may deem an entity to be a legal person for tax purposes. For instance, as a matter of general law an unincorporated association is not a legal person. But an unincorporated association is a company, for tax purposes, which may be taken to imply that it is a legal person for tax purposes. But this only goes to show the importance of context.

The concept of legal personality is distinct from the concept of transparency/opacity.[76]

App. 2.6.2 *Person: Terminology*

We begin as usual with terminology.

[75] Footnote original: It is possible in the UK that a registered trade union (which has the power to contract in its own name, be sued in its name and a judgment against the name could be enforced only against property held for its benefit, but not the power to hold property in its name), and friendly societies, are legal persons, although not corporations, see Salmond on Jurisprudence (12th ed., 1966), p.306 quoted in *Bumper Development Corporation v Comr of Police* [1991] 1 WLR 1362. A registered trade union is sufficiently a separate person to enable a member to sue it without its being said that he is suing himself and others on the ground that any wrong was done by an agent for himself, as would be the case with a common law partnership see *Bonsor v Musicians Union* [1956] AC 104 in which Lord Porter described the trade union as 'a thing created by statute, call it what you will, an entity, a near-corporation, which by statute has in certain respects an existence apart from its members' (p.131) ...

[76] See 90.6 ('Transparent' and 'opaque').

An individual is a legal person in a sense, since an individual has rights and duties, but usual usage is to refer to an individual as a "natural person", and "legal person" is restricted to legal entities.

When the word "person" is used in this sense, it may assist clarity to use the expression 'legal person' (ie something that the law regards as a person); this avoids confusion with the ordinary sense of the word.[77] But the word "person" in a legal context will be taken to mean legal person.

Similarly 'legal personality' is the characteristic of being a legal person. To be a legal person, and to have legal personality, are two different ways of saying the same thing.

Twining says:[78]

> Bearers of legal rights, duties and other relations have been variously known in jurisprudence as 'legal units', 'legal subjects', 'legal entities', and 'legal persons'.[79] Not much turns on the choice between these terms, except that the idea of 'person' has associations with philosophical issues concerning human identity, individuality, moral personality, gender, and character that have muddied the waters of the extensive theoretical debates about the nature of legal personality.
>
> ... So much of modern law is expressed in terms of legal personhood, legal persons, and legal personality that it is difficult to avoid these terms altogether. However, I shall here follow the German tradition of using the word 'subject' as a more useful analytical concept.

When discussing the DTAs, or statutes, which do use the word 'person', it is best to stick to the treaty or statutory terminology; so 'person' is the term used in this work. Though Twining is right that it is necessary to avoid confusion between:

(1) *Legal* questions (does the entity have rights, can it own property)

(2) *Philosophical* questions (does the entity have other attributes of a natural (human) person, such as consciousness).

Both sets of questions may arise, eg in the debate whether AI should have

[77] It has occasionally been suggested that the law distinguishes between person and legal person; eg an English partnership may be said to be a person but not a legal person. But this is, I think, based on a conceptual muddle. "Legal person" is just a way to clarity that one is using the word person in its legal sense. Legal person and person are not two different things, unless context shows that person is being used in some sense which is not the standard legal meaning.

[78] Para 15.2; I omit the footnotes.

[79] Author's footnote: or 'juristic person' but that is less common and I suspect mainly used in translation of the German *juristische Person*.

legal personality;[80] and in that case the use of different terms would assist clarity of thought. But in relation to legal entities discussed in this book, the second set of issues does not arise. No-one thinks that conferring legal personality on a company or Scots partnership means that it has consciousness.[81] Hohfeld's principal of legal contamination may be at work here.

App. 2.6.3 *Legal personality jurisprudence*

Legal personality raises issues which do not arise for a natural person, such as determining what is its purpose or intention in entering into a transaction. Twining says:

> English[82] law does not have a general theory of legal personality and is better off without one. Rather it ... treats ... legal persons as juridical extensions of individual human personality (corporate body, will, property), and approaches practical problems arising from this extension in a pragmatic, largely case-by-case fashion without guidance from or regard to any general theory. .. In fact, in the United States the old debates had been declared dead by 1930 ... partly because legal personality was one of the indeterminate abstract concepts that had been subject to effective critique by Legal Realists.
>
> Of course, practical legal issues surrounding corporations and other nonhuman entities continued to trouble specialists in company law, criminal law, labour law, public corporations and latterly in public international law and human rights ...

I would add tax law to this list.

> ... but typically without much assistance from legal theory, and without much communication with each other.

Legal personality has been described as a fiction, but:

> The fact of the matter surely is that the law's *non-personification* of certain types of social collectivity is far more a matter of fiction than its conferment of personality is in the case of others. The fiction is not that

[80] See Turner, *Robot Rules* (2019) chap 5 (Legal personality for AI).

[81] Garner, *Dictionary of Legal Usage* (3rd ed., 2011), entry under *Person*, defends the traditional terminology: "Lon Fuller, among others, has questioned whether *person* is the most desirable word for the concept. What term might be better? Fuller suggests *legal subject* or *right-and-duty bearing unit*. On second thought, perhaps *person* is not quite so bad."

[82] Author's footnote: The concept of legal personality in Scots law is the same as England, though Scots partnership law differs as a Scots partnership is a legal person.

> the Royal Bank of Scotland has corporate identity, but that the National Union of Bank Employees lacks it. Indeed, clubs, trade unions and other unincorporated associations often have (as F W Maitland noted[83]) much more reality than some such legally incorporated bodies as the one-man company in the celebrated case of *Salomon v Salomon and Co Ltd*.[84]

Avery Jones makes the same point:

> A proposal has been made to make an English partnership a legal person in line with a Scots partnership with no suggestion that whether it is a legal person or not is fundamental to its nature.[85] In practice, from the commercial, as opposed to the strictly legal, point of view, a common law partnership has many characteristics of a legal person: it will normally have a name, a bank account in that name, it can issue invoices and receive cheques in that name, receive and deliver goods and services in that name, partnership accounts are drawn up in form similar to company accounts showing partners as debtors and creditors to the partnership, partners appear to act as agents for the firm, and appear liable in practice only to the extent that the partnership assets are insufficient to meet its liabilities because a creditor will normally proceed against the partnership (or, more accurately, the partners jointly) first. In this way, the appearance, rather than the legal position, is closer to a civil law formal partnership.

I do not think it is helpful to use the word "fiction" in this area. As Bryant Smith says, "The legal personality of a corporation is just as real as and no more real than the legal personality of a normal human being. In either case it is an abstraction, one of the major abstractions of legal science, like title, possession, right and duty."[86]

App. 2.7 Ascertaining whether entity a legal person

The question whether specific entities have legal personality/constitute legal persons is discussed in the context of the entity concerned. I here make some general comments.

[83] Maitland, 'Moral Personality and Legal Personality' (1903) *https://oll-resources.s3.us-east-2.amazonaws.com/oll3/store/titles/873/Maitland_0242-03_EBk_v6.0.pdf*

[84] MacCormick, *Institutions of Law* (2007), p 84. See too Scottish Law Commission, *Discussion Paper on Unincorporated Associations* (2008) *https://www.scotlawcom.gov.uk/files/8412/7877/4124/dp140.pdf*

[85] Law Commission *Partnership Law* (2003) para. 4.17. But this recommendation was rejected.

[86] Contrast 102.2.1 (Is situs fictional?).

App. 2.7.1 *UK entities*

Sometimes statute states that an entity has legal personality, which answers the question. Sometimes statute states that an entity is a body corporate, which answers the question as one of the attributes of a body corporate is that it has legal personality.[87] Sometimes we see both.[88]

Otherwise it is a question of looking to see whether the entity is capable of rights and duties, or sufficient rights and duties. If so, it is a legal person in UK law..

App. 2.7.2 *Legal person: Foreign law*

As to whether a foreign entity is a legal person, in the UK law sense, it is again a question of looking to see whether the entity is capable of rights and duties, a question of the foreign law. If so, the entity is a legal person in UK law.

Avery Jones says:[89]

> Legal person - like partnership - is a concept that each country understands within its own legal system, and one tends to assume, wrongly, that it means much the same everywhere...[90]
>
> In some countries, bodies which other countries would say had all the attributes of a legal person do not, in the country in which they are created, qualify as a legal person because in the country concerned a legal person has different requirements or attributes. We can illustrate these differences by reference to a body which is identical in all European countries (except for whether it is a legal person), the European Economic Interest Grouping.[91]...

Avery Jones refers to art 1 EEIG Regulation:[92]

> (2) A grouping shall ... have the capacity, in its own name, to have rights and obligations of all kinds, to make contracts or accomplish other legal acts, and to sue and be sued.
>
> (3) The Member States shall determine whether or not groupings

[87] See 90.9.3 (What is a body corporate?).

[88] Section 1(2) LLPA 2000, stating that a LLP is “a body corporate (with legal personality separate from that of its members)”; though I think the words in brackets are not strictly needed.

[89] ‘Characterisation of Other States’ Partnerships for Income Tax’ [2002] BTR 375. Some footnotes are omitted or abbreviated.

[90] See 99.3 (How labels may mislead).

[91] See 90.38 (European Economic Interest Grouping).

[92] Council Regulation (EEC) No. 2137/85 of July 25, 1985.

> registered at their registries ... have legal personality.

An EEIG is clearly a legal person in the UK law sense. Avery Jones continues:

> In general, European states have decided that it has legal personality, but in Germany and Italy it does not. What is a legal person can be illustrated by comparing the approach of various European countries to deciding this question. The reason why Germany and Italy have not made an EEIG a legal person is that in the German legal tradition, which in this respect also applies in Italy, the state recognises as legal persons entities which continue in being despite changes in their members. This results in a strict separation between the assets of the legal person and its members, with the result that the members of a legal entity cannot be liable for the entity's liabilities. Since the members of an EEIG are so liable it does not conform to the German and Italian domestic concept of a legal person, and so those countries do not categorise an EEIG as a legal person in spite of its capacity.
>
> In contrast, in some other countries, the liability of the members is not a factor of any relevance to this question.[93] In the French and Scandinavian legal traditions, as in England, being a legal person and having legal capacity go together. So in these traditions the EEIG's capacities are such that it is naturally categorised as a legal entity. In England, there is no intermediate category of reduced legal personality into which an EEIG can be put so it is a legal person... Thus, an EEIG which is identical in all European countries in respect of its legal capacity, the liability of its members and all other attributes, may, therefore, be a legal person or not according to each country's concept of legal person.
>
> ... These differences are merely differences in what is meant by a legal person in different countries. It is not clear that asking the question whether another state's partnership is a legal person and obtaining the answer based on the other state's meaning of the term will result in a meaningful answer.[94]

[93] Footnote original: In common law countries, corporations whose members had unlimited liability existed long before the introduction of limited liability and so the connection between the limited liability and the legal personality is less strong; in Australia and the UK unlimited companies exist today. The EEIG is unique in the UK because it is a legal person whose members are liable in the first instance for the EEIG's liabilities in the same way as partners in England...

[94] Footnote original: As was said in a Belgian tax case concerning a Michigan (US) partnership (Court of Appeals Brussels, April 30, 1998, discussed in 1998 European

One should not ask whether a foreign entity has legal personality in the abstract. The question should be whether it has legal personality
- *in the English law sense (that it can hold property, sue and be sued)*
or if appropriate
- *in the (say) German law sense that it has perpetual succession, (ie will not come to an end on the death of a member) and/or separation of entity/member liabilities (liabilities rest on the entity and not on the members).*

Of course, the context may show which sense is intended.

Applying the German conception, a Scots partnership or an unlimited company might not be legal persons, as the former does not have perpetual succession and neither has a complete separation of member/entity liabilities.

App. 2.8 Individual

Everyone knows that "individual" is used in legal English to mean human beings, and excludes companies, but perhaps one authority should be cited to nail the point home. In *Jasmine Trustees v Wells & Hind*:[95]

> ... in a legal context the more natural meaning of the word "individual" is that it equates to a natural person, and would therefore exclude corporations. In everyday parlance that is a more natural meaning. I would not consider it natural for even a lawyer to refer to a company as an individual.

Of course that is subject to context.[96] But I am not aware of any tax statute where "individual" includes a company. The distinction is so ingrained and so fundamental to taxation that the drafter is unlikely to overlook it.

Similarly, everyone knows that "individual" excludes a trustee[97] and excludes a personal representative, (even if the trustee or PR is an individual in their private capacity).

Taxation 249) 'with respect to the issue whether the plaintiff possessed a permanent establishment in the US, [the Michigan partnership] does not have legal personality under the standards of the USA, nor under the standards of Belgium.'

[95] [2007] EWHC 38 (Ch) at [22].

[96] The passage cited continues: "Having said that, the word when used in legislation takes its colour from its surroundings ... the word is capable of including a corporation if the context requires it."

[97] See 7.3 (Trustees a distinct person).

App. 2.9 “Representing” assets

This section considers the following family of expressions:

- property *representing* other property
- property *deriving* from other property
- property which *represents the value of* other property or *whose value is attributable* to other property

One sometimes sees “assets” instead of “property” but the words are synonymous.

Of course the meaning of the phrase may depend on the context, but it is useful to consider these phrases together as a topic in itself. In each case there must be a nexus between one asset and another asset, but the nexus is at least more precisely defined than in vague expressions such as “relating to”.

App. 2.9.1 *Representation of assets*

I start with the concept of assets representing assets (“representation of assets”) The general idea is that of a continuing fund, not merely the specific assets at any moment, but with an identity of its own.

A paradigm example of a fund with an identity of its own is a trust fund,[98] but assets may represent assets whether or not they are trust property.

Context may show that references to property should be read as referring to a continuing fund even without a reference to assets representing other assets.[99]

[98] Maitland, “Trust and Corporation” put the point poetically:

> “the “trust fund” can change its dress, but maintain its identity. To-day it appears as a piece of land; tomorrow it may be some gold coins in a purse; then it will be a sum of Consols; then it will be shares in a Railway Company, and then Peruvian Bonds.”

For the essay see
https://oll-resources.s3.us-east-2.amazonaws.com/oll3/store/titles/873/Maitland_0242-03_EBk_v6.0.pdf

Maitland went further and described a trust fund as “an incorporeal thing”. But while sometimes a trust fund may be regarded as a single thing (eg for the situs of an equitable interest), on other occasions (perhaps most occasions) it should be regarded as a collection of separate things. See Nolan, “Property in a fund” [2004] LQR 108. But pursuing this point is not going to shed much light on representation of assets.

[99] For an example, see 79.10 (Same-settlement fiction: s.81).

App. 2.9.2 *Directly or indirectly*

Sometimes the words *directly or indirectly* are missing, but they do not add much, for indirect representation is still a kind of representation. They emphasise that the phrase is not to be narrowly understood.

The paradigm case of one asset representing another asset is:

(1) T sells an asset ('asset 1') for cash ('asset 2').
(2) T uses the cash to purchase a new asset ('asset 3').
(3) And so on for assets 4, 5, etc.

One might say that asset 2 (the cash) directly represents asset 1 and assets 3, 4, etc indirectly represent asset 1.[100] But if the words *directly or indirectly* are missing, one would still say that assets 3, 4 etc represent asset 1.

If substitute property (asset 2) represents the original property (asset 1) it would usually follow that asset 1 no longer represents the property.[101]

If money is spent maintaining an asset, the asset does not represent the money. But if money is spent improving an asset, the asset may be said to represent the money, at least in part.

App. 2.9.3 *Derive from/represent compared*

If asset A represents asset B, it may also be said to derive from asset B. In the paradigm case above, one would say that assets 2, 3, etc are *derived from* asset 1 as well as *representing* asset 1. Derivation and representation are (more or less) the same.

Occasionally statute refers to property/assets *derived from or representing* other property/assets.[102] What the drafter is trying to say by this expression is perhaps that the concept of derivation/ representation is not to be narrowly understood. But the phrase is a relapse to the old style of legal drafting which heaped synonym on synonym without much

[100] This is self-evident, but if authority is needed, see *IRC v Stype Investments (Jersey) Ltd* discussed at app 2.9.6 (Do shares represent co assets).

[101] See 18.18.6 (T sells asset to P).

[102] Section 439 ITA 2007; examples relevant to this book include:

Topic	**See para**
Penalty template wording	126.23.6
Onward gift template wording	61.31.6

In the disguised trade receipts code we have "represents, or has arisen or derives from, or is otherwise connected with...". We can infer that the drafter felt particularly strongly. But the reader may hope that such language does not become standard.

thought as to their meaning.

The expression 'derived property' may be used as a defined term when it is convenient to have a short label for:

(1) property derived from other property; or
(2) property representing other property[103]

As derive from/represent are (more or less) the same, this label seems apt in both cases.

The issue of derivation arises in the context of remittances, where the wording is: *derives wholly or in part, and directly or indirectly from*. There is a discussion at para 18.18 (Derived property), which is also relevant where the word used is *representing*.

App. 2.9.4 *Income from assets*

Where income arises from an asset the income does not represent the asset. Where the drafter refers to property representing property, and wishes to include the income from the property, this is stated expressly.[104] In the absence of such a provision, that would not be the case.

Although income (eg, a dividend) does not represent the asset from which it arises (eg, shares), the income may be said to *derive from* the asset.[105] This is the only point I can think of where *represent* and *derive from* may differ.

App. 2.9.5 *Borrowing charged on asset*

Suppose T borrows and charges the debt on an asset. Does the borrowed money represent the asset?

In *Trennery v West* trustees borrowed money on the security of shares in the trust fund. One question was whether the borrowed money was

[103] For statutory examples, see s.77(8) TCGA, discussed below; para 9(1) sch 4ZA TCGA discussed at 63.7 (Cond. 4: Distinct beneficiaries).

[104] For an example, see 99.2.11 (Settlor: CGT s.86 definition): "references to property representing other property include references to property representing accumulated income from that other property". For two more examples, see 74.11.2 (ToA/IHT assoc ops compared), in short, referring to: "property which represents ... [a] that property, or [b] income arising from that property, or [c] any property representing accumulations of any such income".
It is also assumed in the wording of para 5(5) sch 20 FA 1986 that income from an asset derives from an asset but does not represent the asset: see 78.22.4 (Accumulated income).

[105] Subject of course to context: see 18.18.15 (Income from income/gains).

derived property for the purposes of s.77 TCGA (now repealed). So far as relevant, s.77(8) TCGA at that time provided:[106]

> 'derived property', in relation to any property, means ... any ... property directly or indirectly representing proceeds of ... that property ...

So the question was whether the borrowed money (directly or indirectly) represented 'proceeds' of the mortgaged shares. The court said:[107]

> The final question is whether the Revenue are correct in contending that the [borrowed] moneys ... constituted derived property within the meaning of s 77(8) in relation to the Einkorn shares. There can be only one answer to this: of course they do. The [borrowed] moneys ... directly represented the proceeds of a mortgage of the Einkorn shares ... It will be observed that I have equated the proceeds of a mortgage of property with the proceeds of the property itself. But the subsection does not refer to 'the proceeds of a sale of that property', but to 'the proceeds of that property'; and this covers any proceeds, whether sale or mortgage or otherwise howsoever, by which value is extracted from one property and transferred to another.[108]

The wording here was non-standard (not *property representing property* but *property representing proceeds of property.* That makes a difference. Obviously, in this case, the avoidance context pre-determined the outcome.

App. 2.9.6 *Do shares represent co assets*

Do shares in a company represent the assets of the company?

The answer in strictness must be no. On first principles, the *value* of the shares is attributable to the *value* of assets of the company; but it does not follow that the shares *represent* the assets: the whole basis of company law is that company shares and company assets are distinct, and one does not lightly pierce the corporate veil.

This view is to an extent supported by the extended definition of 'representing' in s.717(b) ITA:

> references to assets representing any assets … include references to ...

[106] In 2006 the provision was amended with retrospective effect, only to be repealed in 2008.

[107] [2005] UKHL 5 at [16].

[108] Likewise Lord Walker at [42]: 'In my opinion the [borrowed money] started off as derived property...'

> shares in or obligations of any company to which the assets… are or have been transferred

The point arose in *IRC v Stype Investments (Jersey) Ltd.*[109] The case discusses the Inland Revenue charge. Section 237(1) IHTA (in short) imposes the charge on "any property" transferred.[110] Section 237(2) IHTA provides:

> References in subsection (1) above to any property include references to any property directly or indirectly representing it.

The article provides:

> The Inland Revenue had a charge under s 237(1) on the company's shares … [The Revenue] argued that s 237(2) must be read as extending the charge to the underlying assets of the company.

This argument met with no success:

> Vinelott J was not persuaded that this was a tenable construction. In his judgment subs (2) was not intended and was not apt to create a double charge [ie a charge on the company shares, and a charge on the company assets] in such circumstances.
> The word 'indirectly' was used in subs (2) to make it clear that the charge extends not only to the proceeds of sale of property purchased with those proceeds (which may be said to represent that property 'directly') but also to any property into which the property subject to the charge or the proceeds of sale can be traced.[111]

The point also arose in *Coombes v HMRC.*[112] An individual provided property to a company held by a trust ('the underlying company'). The question was whether the individual was a settlor within the s.86 TCGA definition. The definition is non-standard:

> a person is a settlor in relation to a settlement if the settled property consists of or includes property originating from him.

[109] This case was decided 15 November 1983. It is unreported but discussed in Capital Taxes News and Reports, March 1987 Vol 7, No.17
see *https://www.kessler.co.uk/case-law-archive*

[110] See 125.18 (Inland Revenue charge).

[111] This is not self-evidently right, but the decision has stood for so long that it should not be challenged now. It is also assumed to be right in s.237(2A) IHTA; see 125.18.1 (IHT residential-property code).

[112] [2007] EWHC 3160 (Ch).

> References ... to property originating from a person are references to—
> (a) property provided by that person;
> (b) property representing property falling within paragraph (a) above ...

The judge said:

> [24] The appellant argues that he could not be treated as a settlor in relation to the settlement, because no part of the settled property, held on the trust of the settlement, was provided by him or represents property provided by him. The only relevant property provided by him was the £700,000 provided by him to enable [the underlying company] to purchase the farm. The land disposed of by [the underlying company] ... admittedly represented the £700,000 provided by the appellant, but (submits the appellant) that land was not held on any trust arising under the ... Settlement. It was the absolute beneficial property of [the underlying company].
> [25] HMRC seeks to counter this submission by pointing to the fact that, by providing [the underlying company] with the means of acquiring the land, the appellant increased the value of the shares in [the underlying company], which clearly are settled property subject to the trust of the settlement. So, the value of those shares (submits the Revenue) was provided by the appellant...
> [28] HMRC points out that the appellant's argument emasculates the anti-tax avoidance effect of s 86 ... That may be,[113] but that fact does not, of course, (!) enable me to do violence to the actual provisions of ... the 1992 Act.
> [29] ... the land disposed of by [the underlying company] was not settled property originating from the appellant as settlor, because it was not at any stage held on the trust of the ... Settlement and did not represent property ever held on those trusts.

In the s.86 context, that decision binds the first-tier tribunal, and should be followed in the Upper Tribunal and above, given that the decision has not been questioned. But the reasoning at [28] is (to say the least) not the

[113] At first sight one might think that there is considerable scope for tax avoidance, avoiding s.86 by providing funds to a company held by a trust, rather than providing funds to the trust. But a gift to a company held by a trust is in principle a chargeable transfer for IHT purposes. That would have been the case in *Coombes* itself, if anyone noticed. An interest-free loan to a company avoids a chargeable transfer, but the company's gains may be attributed to the lender under s.3 TCGA; see 64.9 (Participators overlap: Loan creditors).

contemporary approach to construction of tax legislation, so its approach is not likely to be followed in other contexts where to do so would 'emasculate the anti-tax avoidance effect'. In other words, the context may show that company shares do indirectly represent the company assets.

Suppose a company is sold or wound up. The proceeds of sale or liquidation represent the shares. Do they also represent the assets of the company? It is suggested that the answer may be yes or no, depending on what makes better sense in the context of the provision. Perhaps in the absence of context the better answer is that they do represent the assets, but that can give rise to anomalies.

App. 2.9.7 *Apportionment*

Occasionally one sees the form:

> so much of any property representing both [derived property] and other property as, on a just apportionment, can be taken to represent [the derived property].[114]

But apportionment must be possible in all cases, so this adds nothing.

App. 2.9.8 *Derive/represent value*

A variety of phrases are found:

Phrase/Example of context	**See para**
Property which *derives its value* from other assets	
Pre-owned assets	83.16
Transactions in land	22.8; 22.10.1; 22.11
CGT: land-rich assets	57.2; 57.4
Property which *represents the value* of other assets	
Transactions in securities	55.9.1
Value of property which is *attributable* to other assets	
IHT Residential-Property	82.3.1
Value which *derives* from the profits of a business	
Profit fragmentation	53.6

These phrases have (more or less) the meaning.

This concept is similar to representation of assets but not quite the same:

(1) Shares do not represent the underlying assets of the company, but

(2) The value of shares is derived from the value of the underlying assets and the shares represent the value of underlying assets.

[114] For example, para 8 sch 5 TCGA, set out in 99.2.11 (CGT s.86 definition of settlor)..

App. 2.10 Withdrawal from mixed fund

Suppose a person holds a mixed fund which includes or derives from:
(1) asset A (or a set of assets, fund A); and
(2) asset B (or a set of assets, fund B).

If the person withdraws some asset out of the mixed fund, it may be necessary to know whether the withdrawn property is represented by (1) asset A, or (2) asset B, or (3) a mixture of the two. Likewise the property remaining in the mixed fund.

In theory, one might apply:
(1) FIFO (first in first out)
(2) LIFO (last in first out)
(3) A proportional approach
(4) A power of election: The person withdrawing the property may choose what the withdrawn property represents

In the context of remittances, the statutory mixed fund rules usually govern this question. In other contexts, it is considered that the rule in *Clayton's case* should be applied:[115]

> ... this is the case of a banking account, where all the sums paid in form one blended fund, the parts of which have no longer any distinct existence.

In modern terminology, a mixed fund.

> In such a case, there is no room for any other appropriation than that which arises from the order in which the receipts and payments take place, and are carried into the account. Presumably, it is the sum first paid in, that is first drawn out. It is the first item on the debit side of the account, that is discharged, or reduced, by the first item on the credit side. The appropriation is made by the very act of setting the two items against each other. Upon that principle, all accounts current are settled, and particularly cash accounts....
> If the usual course of dealing was, for any reason, to be inverted, it was surely incumbent on the creditor to signify that such was his intention. He should either have said to the bankers,—"Leave this balance altogether out of the running account between us,"—or,—"Always enter your payments as made on the credit of your latest receipts, so as that the oldest balance may be the last paid."[116]

[115] (1816) 1 Mer 529 at p.608.
[116] at p.608, 609.

The rule is therefore that:

(1) The withdrawn assets are taken from that part of a mixed fund as the person making the transfer may direct.
(2) Subject to that, a FIFO basis applies.

It appears that HMRC accept this.

Likewise, prior to the statutory mixed fund rules, where an overseas mixed fund contained some UK source income, which had suffered UK tax, a taxpayer was entitled to remit that income in priority to foreign income which was assessable if remitted.[117]

App. 2.11 Securities

The word 'securities' is often used, in tax and elsewhere.

I consider its meaning in the following contexts:

Context	**See para**
General meaning	App.2.12
Statutory definitions:	App.2.14
s.132 TCGA definition	
Distribution code definition	
Transactions in securities code definitions	
Repo code definition	
Debt on a security: s.251 TCGA	App.2.14.1
Deeply discounted securities	App.2.17
Accrued income scheme	28.2
CGT situs of securities	103.2.3

App. 2.12 Security: general meaning

App. 2.12.1 *History of word "security"*

To understand the word we need to understand its history. The following discussion draws on Joanna Benjamin's books *Financial Law* and *Interests in Securities*, and *Gore-Browne on Companies.*[118]

The meaning of the term 'securities' has varied over time.[119]

[117] See 20.17.1 (Fund: taxed/untaxed income). It is also comparable to the rule that a debtor paying part of a debt may determine whether the payment is interest or capital; see 26.6 (Part payment: Interest or principal).

[118] Benjamin, *Interests in Securities* (1st ed., 2000) para 1.03, 1.10; *Financial Law* (1st ed 2007), para 8.63; *Gore-Browne,* Looseleaf, para 27(5), p. 27-14.

[119] *Re Rayner* [1904] 1 Ch 176 at p.185: 'The word [securities] is not a term of art ... It is a commercial word which will vary with the history of commerce.'

Originally the term meant secured debt obligations. In the early modern period, companies and governments began to raise capital from the public by issuing transferable debt obligations, the repayment obligation being secured on assets of the issuer. By a process of elision, these secured debt obligations came to be known as 'securities'.[120] I am not sure if government obligations were secured on assets in the strict sense, but they did not need to be, and were "secure" in the sense of "safe".

Since late medieval times, commercial companies have raised funds by issuing participations or shares. In the Victorian era the transferability of these shares was put beyond doubt. As shares became more readily transferable, their functional likeness to debt securities became clearer, and both forms of investment became known as 'securities'.[121]

More recently, the term 'securities' has been extended to include units in investment funds and other forms of readily transferable investment.

Futures, options, swaps and cash are not "securities" in the general sense of the word.

App. 2.12.2 *Security terminology*

If referring specifically to securities which take the form of debts, rather than shares, it is convenient to refer to **"debt-securities"**. A debt which is not a security is a **"simple debt"**.

It is unfortunate that (for historical reasons) the word 'security' is used in two different senses:

(1) A debt-security (or share/financial investment)

(2) Where an obligation is supported by a charge (or mortgage pledge or lien) giving priority over unsecured creditors. One needs terminology to describe:

   (a) the obligation *(Taylor Clark* coined the term 'proprietary security')

   (b) the property subject to the charge (security or 'collateral')[122]

   (c) the interest of the chargee in the charged property (a "security interest".)

It is not too confusing as long as one bears the two situations in mind.

[120] See *Re Smithers* [1939] Ch 1015 at p.1017-1020.

[121] *Re Douglas' Will Trusts* [1959] WLR 744 at p.749: 'I am prepared to make a declaration that 'securities' includes any stocks or shares or bonds by way of investment'; *Re Rayner* [1904] 1 Ch 176 at p.189, 191.

[122] See 82.10.1 (Security/collateral).

Once it is realised that the word ‘security’ is being used in different senses, there is nothing inconsistent, or even incongruous, in saying that:

- a secured debt may not be a security
- an unsecured debt may be a security; it may be referred to as a personal security

App. 2.12.3 *Security: range of meaning*

Thus “securities” may mean:

(1) Debt-securities only
(2) Debt-securities and also shares
(3) Debt-securities, shares, and also other financial investments[123]

In one case it was said that the normal meaning was debt-securities, and it did not include shares unless the context showed otherwise.[124] Another case considering the word in a home-made Will said the word “is used frequently, if not universally, in the extended meaning of investments.”[125] I think that is the better view, at least in ordinary speech, but it does not matter, and Gore-Browne splits the difference:

> Determining which meaning is applicable is merely a matter of construing the context, with no presumption one way or the other.

In tax statutes, at least, the context (or, sometimes, a definition) will normally make it clear whether “securities” includes shares.

It is often said that the word is imprecise. In *Taylor Clark International v Lewis*:[126]

> “security” is an imprecise term which takes its colour from its setting

In *Parker v IRC*[127]

> Securities is not a term of art, and it has no precise meaning.

No doubt. But is the term is significantly more imprecise than most other common legal terms? I don’t think so, particularly in the light of more

[123] This is self-evident but if authority is needed, see *IRC v Parker* 43 TC 396 at p.408.

[124] *IRC v Parker* 43 TC 396 at p.408.

[125] *Re Scorer,* [1924] All ER 330 at p.333.

[126] [1997] STC 499 at p.519. The related concept of ‘debenture’ is similarly imprecise: see 103.2.4 (‘Debenture’).

[127] 43 TC 396 at p.405. If further authority is needed, which I doubt, see *Re Scorer*: [1924] All ER 330 at p.333:

> “at the present day the word "securities" has a flexible meaning”.

recent cases which clarify the debt-security/simple debt borderline.

There are many cases[128] but it is not necessary, or practical, to discuss them all. And of course they need to be read in their context. In *Singer v Williams*:[129]

> The word "securities" has no legal signification which necessarily attaches to it on all occasions of the use of the term. It is an ordinary English word used in a variety of collocations: and it is to be interpreted without the embarrassment of a legal definition and simply according to the best conclusion one can make as to the real meaning of the term as it is employed in, say, a testament, an agreement, or a taxing or other statute, as the case may be. The attempt to transfer legal definitions derived from one collocation to another leads to confusion and sometimes to a defeat of true intention.

App. 2.13 Security: 5 statutory definitions

s.132(3) TCGA	**s.1117(1) CTA 2010** *Distribution code*	**s.263AA(8) TCGA** *Repo code*
For the purposes of this section and section 133...	In this Part [Part 23 Company Distributions], except where the context otherwise requires—	In section 263A and this section "securities" means—
		(a) shares in a company wherever resident,
(b) 'security' includes any loan stock or similar security whether [A] of the Government of the UK or [B] of any other government, or [C] of any public or local authority in the UK or elsewhere, or		(b) loan stock or other securities of— (i) the government of the UK, (ii) a local authority in the UK, (iii) another public authority in the UK, (iv) a company resident in the UK or other body

[128] In addition to cases cited elsewhere in this section Gore-Browne cites: *Bristol Airport plc v Powdrill* [1990] Ch 744; *Tarmac Roadstone Holdings Ltd v Williams* [1996] STC (SCD) 409; *Brown, Shipley & Co v IRC* [1895] 2 QB 598; *Re Rayner* [1904] 1 Ch 176; *Re Gent and Eason's Contract* [1905] 1 Ch 386; *Re United Law Clerks Society* [1947] Ch 150 at p.152; *IRC v Henry Ansbacher & Co Ltd* [1963] AC 191 at p.207.

[129] 7 TC 419 at p.435.

[D] of any company,		resident in the UK, or (c) shares, loan stock, stock or other securities issued by— (i) a government, local authority or other public authority of a territory outside the UK, or (ii) another body of persons not resident in the UK.
[ii] and whether secured or unsecured.	'security' includes securities not creating or evidencing a charge on assets	

The transactions in securities code has two definitions:

s.713(1) ITA	**s.685(9) ITA**
In this Chapter [Chapter 1 Part 13] ...	In this section—
"securities"— (a) includes shares and stock...	"security" includes securities not creating or evidencing a charge on assets;

There is no standard definition, but there are some common themes.

The s.132 definition is said to apply for the purposes of s.132, 133, but is incorporated by reference in other contexts. The s.1117 definition is also incorporated by reference in some other contexts.

It is well settled that a charge or mortgage is not required: a security may be unsecured. The definitions do not add anything by saying that expressly, and the absence of a definition makes no difference on that point But perhaps that was less clear when the definitions were first used

App. 2.14 Security: s.132 definition

The s.132 definition is not very different from the normal meaning of 'security'.

A CCAB statement provides:

> [1] The definition of 'security' in [s.132(3)(b) TCGA] ... is regarded as exhaustive

> [2] so that the debt must be a loan stock or a similar security of a government, public or local authority or company...[130]

It seems reasonably arguable from the statutory definition that point [2] is correct; that is, only securities issued by companies or state entities within s.132(3)(b)[i] are within the s.132 definition; securities issued by individuals, trusts, and other non-state non-company entities are not within the s.132 definition. If that is right, the s.132 definition should be regarded as exhaustive, ie the word "includes" actually means "means".

App. 2.14.1 *Debt on a security*

There is a CGT exemption for (first-hand) debts - except in the case of a 'debt on a security (as defined in s.132)'.[131]

'Debt on a security' has been described as 'particularly obscure',[132] 'baffling', 'a strange phrase' and 'the expression... is not one which is familiar to either lawyers or, I think, business men.'[133] But perhaps expectations of clarity in tax legislation have fallen since these observations were made in 1980. Although the phrase was a neologism when first used in the CGT legislation in 1965, it seems straightforward to me: it means a debt which is a security; as opposed to:

(1) a simple debt (a debt which is not a security) or
(2) a share (which is a security but not a debt).

App. 2.15 Debt-security or simple debt

The question of when a debt is a security needs further elucidation. What distinguishes a debt-security from a simple debt? A security must be something more than a simple debt. What is the something more?

In *Parker v IRC* (a TiS case):[134]

> It is submitted ... that even if securities secured by covenant without a charge on property were [securities within TiS], yet these particular

[130] The statement was made in 1969. LexisNexis states 'Confirmed as current in 1989, but in the light of case law (*Ramsay v IRC* 54 TC 101) the Revenue take a less restrictive view than they did in 1969.' No reference is given for this. *Ramsay* (1981) does not give reason to cast doubt on the CCAB statement; I think HMRC were right to confirm it in 1989.

[131] See 56.22.1 (CGT debt exemption).

[132] *Aberdeen Construction Group v IRC* [1978] AC 885, at p.902

[133] *Ramsay v IRC* 54 TC 101 at p.329, p.333. Similarly *Savva v HMRC* [2015] UKUT at [35]: an 'enigmatic phrase'.

[134] This passage was approved in the House of Lords.

> debentures are not securities on the ground
> [1] that they do not give any advantage over a mere debt,
> [2] that they do not involve a creditor/debtor relationship and
> [3] that they do not provide for the payment of interest.

I do not understand point [2] but the judge rejected all three points:

> They confer the advantage over a mere debt that consideration need not be proved and that the proof of the document establishes the company's obligation. ... liability to pay interest is not an essential feature of a security. In my view, it could not be said that the conditions of the debentures and the absence of obligation to pay interest would prevent these debentures, if secured by a charge on property, from being a security; nor do I understand that to be suggested. And it is not suggested that these debentures are not in every other respect than those which I have mentioned debentures and securities of the company. The nub of the Respondents' case is that it is the absence of a charge on property that prevents this debenture being a security. In my view, neither that nor the other features relied on by the Respondents prevent the debentures being securities at any rate in an appropriate context, and my conclusion is that these debentures in the context of [the transactions in securities code] are securities within the meaning of that section.

In *IRC v Laird Group* (a TiS case):[135]

> The word ‘securities’ includes not only stocks and shares of every description, including preference shares, but also debentures and unsecured loan notes.

App. 2.15.1 *Legal charge irrelevant*

The CCAB statement provided in 1969 that:

> the words [in the s.132 definition] ‘whether secured or unsecured’ in the definition made the existence of a charge immaterial.

The CG Manual refers to the s.132 definition and continues:

> **CG53421 definition of debt on a security** [Jul 2019]
> This definition is of limited use because there is no statutory guidance on the meaning of ‘loan stock or similar security.’ However, the final words make it clear that the debt does not have to be secured to be the debt on a security. Therefore ‘debt on a security’ is not the same as ‘secured debt.’

[135] [2003] UKHL 54 at [29].

But it is well-established that a debt-security need not be a secured debt. In *Taylor Clark International v Lewis*[136] a debt repayable on demand was held *not* to be a debt on a security, even though the debt *was* charged (secured) on assets.

App. 2.15.2 *Marketability*

The CG Manual provides:

> **CG53423 Debt on a security: *Ramsay v CIR* 54 TC 101** [Jul 2019]
> The *Ramsay* case involved a company which had incurred an agreed gain on the sale of a farm. It then entered into an avoidance scheme designed to produce an allowable loss to set off against the gain. The scheme removed value from a chargeable asset (shares) to produce an allowable loss on their disposal. The value passed into a loan, known as L2. This loan was also disposed of. If L2 was not a debt on a security, it would not be a chargeable asset. Therefore the gain on the disposal of the loan would not have been chargeable. However, the House of Lords held that the loan L2 did amount to a debt on a security. The gain on the disposal of L2 was thus a chargeable gain and the scheme failed.
> **CG53424 House of Lords decision: marketability** [Jul 2019]
> In *Ramsay* the House of Lords considered the underlying purpose of the distinction between debts and debts on a security in TCGA92/S251 (1). Both Lord Fraser and Lord Wilberforce suggested the essential feature of the debt on a security is that it should be marketable.
> At page 194 Lord Fraser says
>
> > 'the distinction ... is, I think, between a simple unsecured debt and a debt of the nature of an investment, which can be dealt in and purchased with a view to being held as an investment.'
>
> Later having analysed the essential features of the loan he says 'it possessed the characteristic of marketability.'
> At page 189 Lord Wilberforce says
>
> > 'it can be seen, however, in my opinion, that the Legislature is endeavouring to distinguish between mere debts, which normally (though there are exceptions), do not increase but may decrease in value, and debts with added characteristics such as may enable them to be realised, or dealt with at a profit.'

Benjamin, *Interests in Securities* states:[137]

[136] 71 TC 226.

[137] 1st ed., 2000, para 1.03, 1.10.

> Transferability is an essential characteristic of securities.[138]

Clearly, transferability is required for marketability and to be an investment.

App. 2.15.3 *Investment/profitability*

The CG Manual provides:

> **CG53425 Debt on a security: essential characteristics of** [Jul 2019]
> Both speeches in the House of Lords emphasised that for a debt to be the debt on a security it should be capable of being
> - held as an investment; and
> - realised at a profit.
>
> These conditions are, to some extent, interrelated, but it is important that both should be satisfied. For example, a debt may be regarded as a good investment. But if it cannot be realised at a profit it cannot be a debt on a security. These points are discussed in the following paragraphs.
> **CG53426 held as an investment** [Jul 2019]
> For a debt to be held as an investment it should either
> - carry a commercial rate of interest; or
> - carry a premium on repayment, equivalent to the interest which would have been paid; or
> - be issued at a discount, so that repayment at face value again reflects the interest which would have been paid on the debt.
>
> Where these criteria are not met and the return on the investment is clearly uncommercial, debt on a security status should not be accepted.
> **CG53427 sold at a profit** [Jul 2019]
> Whether a debt can be realised at a profit will depend, in part, on the premium, or rate of interest which the debt carries. But even if a debt carries an attractive rate of interest, it may not be regarded as a worthwhile investment by a potential purchaser. For example, the terms of the loan may enable the borrower to repay the debt early. A potential purchaser would need to consider whether the loan would last long enough to cover the costs of acquisition, and obtain a worthwhile return on the investment.

This overlaps with the structure of permanence requirement below.
The CG Manual provides:

> **CG53433 Debt on security: exchange gains** [Jul 2019]
> If a debt is denominated in a foreign currency, exchange gains (or losses)

[138] Footnote original: Indeed, the repackaging of relatively illiquid assets into readily transferable assets is known as ‘securitisation’.

can arise if the currency fluctuates against the pound. You should consider whether any such debt is the debt on a security purely in terms of the currency in which the debt is denominated. Neither realised, nor potential, exchange gains or losses should be taken into account in deciding whether a debt is the debt on a security.

App. 2.15.4 *Structure of permanence*

The CG Manual provides:

> **CG53428 structure of permanence** [Jul 2019]
> This point was made by Lord Wilberforce, in *Ramsay*, where he commented (at page 190) that the relevant loan had 'a structure of permanence such as fitted it to be dealt in ....' In fact, the loan in that case was repaid early. But it had been issued on terms which meant that a large penalty would be payable in the event of early repayment. It is not possible to set any precise limits for the 'life' of a debt, which would enable it to be regarded as a debt on a security. The attractiveness of any particular debt will depend upon the other terms of the loan, and on the type of market in which the debt would normally be traded. You can accept that any loan which could not be terminated by the borrower within a year from the date of commencement will have the required 'structure of permanence'. But a debt will not have a 'structure of permanence' merely because the borrower is not in a position to repay the debt in the foreseeable future.
> **CG53429 repayment at short notice** [Jul 2019]
> You cannot say that a debt is not a debt on a security simply because it can be repaid at short notice. But it is reasonable to suggest that in such cases there should be some compensation for the creditor to counterbalance the uncertainty as to the term of the loan. For example, a penalty can turn an otherwise uncertain, and therefore inherently unattractive, loan into a worthwhile investment. If a loan can be repaid at short notice, but there is no compensating benefit for the creditor, this would count against accepting the loan as a debts on a security.
> **CG53430 events of default** [Jul 2019]
> Some agreements include standard clauses requiring the debt to be repaid immediately if certain events happen. For example, if the borrower defaults on repayment, or goes into liquidation. These standard clauses should not be taken as displacing any stated terms for repayment for the debt set out in the agreement.

App. 2.15.5 *Documentation*

The CG Manual provides:

> **CG53434 Debt on security: documentation** [Jul 2019]
> The existence of a formal document constituting or evidencing the debt is not an essential feature of the debt on a security. At page 194 in *Ramsay* Lord Fraser says 'Further consideration has satisfied me that the existence of a document or certificate cannot be the distinguishing feature between the two classes of debt'. However, cases where debt on a security status is claimed for debts where no documentation exists need to be examined carefully to check whether or not the required features are present. Equally you should resist any suggestion that a debt MUST be a debt on a security if it is acknowledged by a document described as loan stock. This would be inconsistent with the approach taken in *Ramsay*, that the marketability test will be appropriate in deciding in ANY case whether a debt amounts to the debt on a security.

App. 2.15.6 *Loan stock/similar security*

The CCAB statement provides:

> The view is also taken that the reference to loan 'stock' implies in general a class of debt the holdings in which are transferable by purchase and sale...

The CG Manual provides:

> **CG53435 Debt on security: loan stock or similar security** [Jul 2019]
> In *Ramsay* Lord Wilberforce did not regard it as necessary to decide whether the loan L2 was, in fact, within the meaning of 'loan stock'. He observed that TCGA92/S132 (3)(b)
>
> > 'includes within 'security' any 'similar security' to loan stock: in my opinion these words cover the facts. This was a contractual loan, with a structure of permanence such as fitted it to be dealt in ...' (page 190).
>
> Lord Fraser took a similarly broad approach in his judgment (page 194).

App. 2.15.7 *Inter-group loan*

The CG Manual provides:

> **CG53436 Debt on security: loan accounts** [Jul 2019]
> Debt on loan account, for example between associated companies, may well not amount to the debt on a security. ...

Informal inter-company loan is not likely to take the form of a debt on a security. The loans are likely to be repayable on demand. In the case of UK companies, of course, the loan relationship rules would need consideration, and the debt on a security issue would not arise.

App. 2.15.8 *Date to test security*

Market conditions change over time. The CG Manual provides:

> **CG53431 Debt on security: when conditions satisfied** [Jul 2019]
> You should consider whether any debt amounts to the debt on a security by reference to the circumstances prevailing at the time the debt was created. For example, you should consider whether a rate of interest is commercial by reference to the market conditions at the time the debt was created. Thus, you may take into account any market opinion, at the time the debt was created, as to the likely future changes in the market rate of interest. Changes in the rate of interest which were not anticipated at the time the debt was created cannot be taken into account.

The terms of a debt may change over time, for instance on a specified date a debt may become payable. Clearly the debt does not cease for that reason to be a debt on a security (though it ceases to have any structure of permanence).

The terms of a debt may change by agreement between the parties:

(1) If the change constitutes a novation, (a disposal of the old loan and the creation of a new loan)[139] then the position is self-evident: the question of whether the debt is a debt on a security is decided at the date of the creation of the new debt.

(2) If the change is a variation of the existing loan, but not a novation, it is considered that the change should not alter the question of whether the debt is a debt on a security; this question is to be decided at the time the debt came into existence.[140]

The CG Manual skims over deep waters, but it suggests that HMRC agree:

> **CG53432 changes in terms** [Jul 2019]
> You should not accept that a debt can be regarded as the debt on a security because the terms of the loan could have been amended to make the debt marketable. If the terms of the debt have changed this cannot affect the status and tax treatment of the debt prior to the changes. You may, however, need to consider whether or not the changes had the effect of bringing to an end the original debt, and creating a new one, to which a different tax treatment may apply.

On contract law aspects of changes to the terms of a debt, see *Chitty on*

[139] See 70.18.1 (Novation/variation distinction).

[140] Further thought would be needed if changes to the terms of the loan were in contemplation at the time the loan was originally made.

Contracts (34th ed., 2021), para 25-030 (Substituted contract).

App. 2.16 Deemed security

This topic is somewhat niche, but I mention it for completeness. Perhaps it also sheds light on the general meaning.

App. 2.16.1 *Security in reorganisations*

Section 251(6) TCGA provides:

> For the purposes of this section a debenture issued by any company on or after 16th March 1993 shall be deemed to be a security (as defined in section 132) if—

A set of 6 categories then follow:

> (a) it is issued on a reorganisation (as defined in section 126(1)) or in pursuance of its allotment on any such reorganisation;
>
> (b) it is issued in exchange for shares in or debentures of another company and in a case to which section 135 applies and which is unaffected by section 137(1);
>
> (c) it is issued under any such arrangements as are mentioned in subsection (1)(a) of section 136 and in a case unaffected by section 137 where section 136 requires shares or debentures in another company to be treated as exchanged for, or for anything that includes, that debenture; or
>
> (d) it is issued in pursuance of rights attached to any debenture issued on or after 16th March 1993 and falling within paragraph (a), (b) or (c) above.
>
> [e] and any debenture which
>
> [i] results from a conversion of securities within the meaning of section 132, or
>
> [ii] is issued in pursuance of rights attached to such a debenture,
>
> shall be deemed for the purposes of this section to be a security (as defined in that section).

App. 2.16.2 *Deeply discounted security*

Section 251 TCGA provides:

> (7) Where any instrument specified in subsection (8) below is not a security (as defined in section 132), that instrument shall be deemed to be such a security for the purposes of this section, other than the purposes of determining what is or is not an allowable loss in any case.

> (8) The instruments mentioned in subsection (7) above are—
>
> (b) any instrument which
>
> [i] is not a loan relationship of a company
>
> [ii] but which would be a deeply discounted security for the purposes of Chapter 8 of Part 4 of ITTOIA 2005 if section 432(2) of that Act (excluded indexed securities) were omitted.

App. 2.17 'Security' in DDS code

SAI Manual states:

> **SAIM3010 Introduction** [Mar 2022]
> ... The term 'security' is not defined in the [deeply discounted securities] legislation. It may be taken to have a broad meaning comparable to the definition in s.132(3)(b) TCGA (CG53420) ...

This follows from the fact that the s.132 definition broadly reflects the normal meaning of the word. In the DDS case of *Savva v HMRC*[141] the Tribunal referred to *Taylor Clark International* (a debt on a security case) for guidance on the meaning of 'security' in the DDS code.

App. 2.17.1 *Security of non-company*

A security is normally debt owed by a company, but debt owed by a non-company (individual or trust) may be a security. The word 'issued' may be more usual for a corporate issuer, but a non-company may 'issue' a security.[142]

A security issued by an individual or trust is not a security within the s.132 definition, if the CCAB statement is right to say that the s.132 definition is an exclusive definition; but it is still a security in the general sense, and a security for the purposes of the DDS code. The SAI Manual passage set out above states that the meaning of 'security' in the DDS code is 'comparable' to the s.132 definition which admits the possibility that there can be a security for the DDS code which is not a security within the s.132 definition. In Hansard it was stated that the DDS provisions apply

[141] *Savva v HMRC* [2015] UKUT 141 (TCC).

[142] The drafter took this view in para 2(1)(c) sch 4B TCGA (issue of security by trustees); see 62.7 (Issue of security). See too Fuller, *Law & Practice of International Capital Markets* (3rd edition, 2012) at 1.15 (Distinctions between debt and equity securities): "A debt security may be issued by any type of issuer whether or not it is a company)."

to *corporate* debt, but the passage does not bear any weight.[143]

App. 2.18 Listed/Recognised stock exchange

The expression ‘listed on a recognised stock exchange’ occurs throughout the Taxes Acts, too often to give a full list. Examples are:

(1) Securities must be listed to qualify as investments which may be held in Individual Savings Accounts and for the quoted Eurobond exemption.

(2) Securities must not be listed to qualify for remittance investment relief, and IHT business property relief.

The HMRC guidance set out in this section is found on the HMRC website[144] rather than in a Manual.

App. 2.18.1 *Recognised stock exchange*

Section 1005(1) ITA provides:

> In the Income Tax Acts “recognised stock exchange” means—
> (a) any market of a recognised investment exchange[145] which is for the time being designated as a recognised stock exchange for the purposes of this section by an order made by the Commissioners for Her Majesty's Revenue and Customs, and
> (b) any market outside the United Kingdom which is for the time being so designated.[146]

In short, a recognised stock exchange is one recognised and approved by HMRC. HMRC say:

> HMRC will consider the designation of a stock exchange as a recognised stock exchange under S1005 ITA 2007 on receipt of a request made by a stock exchange. The fact that a particular exchange is not recognised

[143] Hansard 26/4/1996 col 1360 (Lord Mackay, then Lord Chancellor: ‘Clauses 80 to 105 cover the measures in this Bill which relate to the taxation of corporate debt.’) *http://hansard.millbanksystems.com/lords/1996/apr/26/finance-bill*

[144] Unless otherwise stated, quotes are from: *https://www.gov.uk/government/publications/recognised-stock-exchanges-definition-legislation-and-tables/recognised-stock-exchanges-definition-legislation-and-tables-of-recognised-exchanges*

[145] Section 1005(6) ITA provides: “In this section “recognised investment exchange” has the same meaning as in FISMA 2000 (see section 285)”.

[146] Section 1005 ITA continues with further provisions about designation orders, which need not be set out here.

> may simply mean that recognition has not been requested.[147]
>
> **What recognition means for a stock exchange**
>
> Recognition under section 1005 Income Tax Act (ITA) 2007 is for tax purposes only and confers no other status on the exchange concerned. It does not constitute any form of recognition or approval for regulatory or other purposes nor does it provide any form of approval or recommendation of any of the investments which are listed or traded on that exchange...

The expression sometimes used is "a designated UK market".[148] This has a distinct meaning, and is not discussed here.

App. 2.18.2 *"Listed" on exchange*

Section 1005(3) ITA provides:

> References in the Income Tax Acts to securities[149] which are listed on a recognised stock exchange are to securities—
>
> (a) which are admitted to trading on that exchange, and
>
> (b) [i] which are included in the official UK list[150] or
>
> [ii] are officially listed in a qualifying country outside the UK[151] in accordance with provisions corresponding to those generally applicable in EEA states.

HMRC say:

> ... while some securities (for example a depositary receipt) could meet the HMRC definition of 'listed on a recognised stock exchange' for the purposes of section 1005 ITA, certain HMRC tax treatments, such as Individual Savings Accounts, require that the underlying investment represented by the security must meet the HMRC definition of 'listed on a recognised stock exchange'. It is therefore necessary to check the guidance or legislation for the particular tax treatment to check whether

[147] *https://www.gov.uk/guidance/recognised-stock-exchanges* (last updated Dec 2020).

[148] See 432(1)(a)ITA/s.204 CTA 2010, and s.421L(6)(b) ITEPA.

[149] Section 1005(6) ITA provides: "In this section ... "securities" includes shares and stock".

[150] Section 1005(5) ITA provides:

"References in the Income Tax Acts to securities which are included in the official UK list are to securities which are included in the official list (within the meaning of Part 6 of FISMA 2000) in accordance with the provisions of that Part."

[151] Section 1005(4) ITA provides:

"For this purpose "qualifying country outside the UK" means any country outside the UK in which there is a recognised stock exchange."

there are any additional requirements.

App. 2.18.3 *AIM shares*

The alternative investment market ("AIM") is part of the London Stock Exchange. AIM shares are not regarded as "listed" because they are not included in the Official List maintained by the Financial Services Authority as the UK listing authority.[152] Thus AIM shares may qualify for, inter alia, remittance investment relief and IHT business property relief.

App. 2.18.4 *"Dealt in" on exchange*

Sometimes the expression used is "dealt in" on a stock exchange, rather than "listed". HMRC say:

> HMRC recognise that in certain cases markets use terms such as 'listed', 'admitted to trading', or 'quoted'. Both Table 1 and Table 2 identify the markets which we consider would meet the HMRC definition of 'listed'. Where HMRC legislation uses the term 'dealt in on a recognised stock exchange' shares dealt in on the recognised stock exchanges named in Table 1 or Table 2 would meet 'dealt in on a recognised stock exchange' whether the shares meet the HMRC definition of 'listed' or not (unless the specific legislation further qualifies the term 'dealt in on a recognised stock exchange).

App. 2.18.5 *HMRC tables*

HMRC website contains lengthy tables which I do not set out here:[153]

- 3 tables specifying recognised stock exchanges, and what qualifies as "listed" (I am not sure why the material is in 3 separate tables)
- Table of Stock exchanges recognised for s.48A FA 2005 (alternative finance investment bonds/sharia finance)

The tables come with a disclaimer:

[152] For the history, see CG50255 London stock exchange: History: The Alternative Investment Market (now archived).

[153] For the first three tables see *https://www.gov.uk/government/publications/recognised-stock-exchanges-definition-legislation-and-tables/recognised-stock-exchanges-definition-legislation-and-tables-of-recognised-exchanges#tables-of-recognised-stock-exchanges*
For the last table see *https://www.gov.uk/government/publications/designated-recognised-stock-exchanges-section-1005-income-tax-act-2007/designated-recognised-stock-exchanges-section-1005-income-tax-act-2007-v3*

> While HMRC tries to maintain an up to date list this is not always possible because markets frequently rename, re-structure or merge. It is possible that you may identify stock exchanges within the law of a named jurisdiction (table 2) which we have not yet identified, but which would meet recognised stock exchange status. Equally you may identify a market of a recognised stock exchange where we have not given an opinion as to whether it meets the HMRC definition of listed.[154]

App. 2.19 'UK' and related expressions

App. 2.19.1 *UK*

Interpretation Act 1978 sch 1 provides:

> 'UK' means Great Britain and Northern Ireland.

Section 1313(1) CTA 2009 provides:

> Activities in UK sector of continental shelf
> (1) Any profits—
> (a) from exploration or exploitation activities carried on in the UK sector of the continental shelf, or
> (b) from exploration or exploitation rights,
> are treated for corporation tax purposes as profits from activities or property in the UK.

In *Royal Bank of Canada v HMRC*:[155]

> [HMRC] submitted that because the concept of immovable property is generally defined in accordance with the law of the Contracting State in which the property is situated ... it is appropriate to have recourse to s.1313 CTA 2009, on the basis that income falling within that provision should be treated as deriving from UK immovable property. Effectively, s.1313 represented an exercise of the UK's right to determine what amounted to immovable property. That cannot be right. Section 1313 says nothing about the concept of immovable property under English (or Scottish) law. It simply establishes a domestic tax charge in respect of profits from certain activities. To the extent that it is necessary to spell out that the UK sector of the continental shelf comprises UK immovable

[154] *https://www.gov.uk/government/publications/recognised-stock-exchanges-definition-legislation-and-tables/recognised-stock-exchanges-definition-legislation-and-tables-of-recognised-exchanges*

[155] [2023] EWCA Civ 695 at [104].

property, that is addressed by Article 3 of the Treaty.

App. 2.19.2 *British Isles/Crown dependencies*

Interpretation Act 1978 sch 1 provides:

> 'British Islands'[156] means the UK, the Channel Islands and the Isle of Man.

So the Isle of Man and the Channel Islands do not form part of the UK. In *Barclay (R, oao) v Lord Chancellor*:[157]

> The Channel Islands consist of two Bailiwicks, Jersey and Guernsey. The Channel Islands are Crown dependencies but they are not part of the UK nor are they colonies. When King Philippe Auguste retook possession of continental Normandy in 1204, King John retained the Channel Islands. His right as Duke of Normandy lapsed and a separate title grew up by force of occupation, which attached to him as King of England. This was confirmed by the Treaty of Brétigny[158] in 1360.

See too 4.22.2 (Bailiwick of Guernsey).

App. 2.19.3 *Great Britain*

'Great Britain' means England, Wales and Scotland: s.1 Union with Scotland Act 1706 provides:

> That the two Kingdoms of England and Scotland shall upon the First day of May which shall be in the year 1707 and forever after be united into one Kingdom by the name of Great Britain …

App. 2.19.4 *England*

The definition of 'England' is not usually an issue for tax. However, for completeness, para 5(a) sch 2 Interpretation Act 1978 provides:

> in any Act passed before 1st April 1974, a reference to England includes Berwick upon Tweed and Monmouthshire and, in the case of an Act passed before the Welsh Language Act 1967, Wales.

[156] The terms British Isles/Islands are synonymous. 'British Islands' is mostly found in very formal legal writing.

[157] [2009] UKSC 9 at [8].

[158] The treaty was signed at Brétigny, and later ratified as the Treaty of Calais on 24 October 1360. It marked the end of the first phase of the Hundred Years' War (1337–1453) – as well as the height of English power on the Continent.

App. 2.19.5 *Territorial sea*

‘Territorial sea’ extends 12 nautical miles from shore.[159]

Section 1013 ITA provides:

> The territorial sea of the UK is treated for the purposes of the Income Tax Acts as part of the UK.

The same applies for CGT, CT and NIC.[160]

There is no equivalent provision in the IHT legislation so territorial sea is not part of the UK for IHT purposes. This is perhaps a consequence of art 26(1) United Nations Convention on the Law of the Sea:

> No charge may be levied upon foreign ships by reason only of their passage through the territorial sea.

In the Dover Strait, the southerly shipping lane is territorial sea, and so counts as part of the UK, but this may not matter, given the exemption for property in transit.[161]

App. 2.20 Land

The Interpretation Act 1978 provides (for Acts after 1 Jan 1979):

> ‘Land’ includes
> [a] buildings and other structures,
> [b] land covered with water, and
> [c] any estate, interest, easement, servitude or right in or over land.

This provision seems to have been forgotten, as it is repeated in recent statutory provisions (with insignificant variations of wording); see for instance, s.6B(3) ITTOIA; s.717S(1) ITA; s.1C(6) TCGA; para 4(7) sch 4B TCGA. These do no harm, but the point of the Interpretation Act is to prevent repetition in statutory drafting.

App. 2.21 Interest in land/chargeable interest

This section considers the following statutory definitions:

Term	**Definition**	**Relevant for**[162]
Interest in UK land	s.1C TCGA	CGT/CT charge on non-residents *also:* IHT residential-property code

[159] It is more precisely defined in the United Nations Convention on the Law of the Sea.

[160] See s.276 TCGA, s.1170 CTA 2010; s.172 SSCBA.

[161] See 18.14.5 (Property in transit).

[162] This list is not comprehensive.

Interest in land	Para 4 sch 1B TCGA	Meaning of Residential Property Gain
Chargeable interest	s.48 FA 2003	SDLT
Chargeable interest	s.107 FA 2013	ATED

The definitions are very similar so they are conveniently considered together.

App. 2.21.1 *Scope of definitions*

Section 1C(1) TCGA provides:

> For the purposes of section 1A(3)(b) an ‘interest in UK land’ means ...

This definition is said to apply for the purposes of s.1A(3)(b) but it is applied elsewhere when needed for CGT,[163] and is also incorporated by reference for the IHT residential-property code.[164]

Para 4(1) sch 1B TCGA provides:

> For the purposes of this schedule an ‘interest in land’ means ...

This definition applies for schedule 1B.

For ATED, s.107(1) FA 2013 provides:

> In this Part [Part 3 FA 2013, ATED] ‘chargeable interest’ means–

The definition applies for ATED.

Similarly for SDLT, s.48(1) FA 2003 provides:

> In this Part [part 4 FA 2003, SDLT] ‘chargeable interest’ means—

The definition applies for SDLT.

App. 2.21.2 *Interest in land: Definitions*

s.1C(1) TCGA	**Para 4(1) sch 1B TCGA**
For the purposes of section 1A(3)(b) an ‘interest in UK land’ means	For the purposes of this Schedule an ‘interest in land’ means—

[163] Para 7 sch 1A TCGA provides: ‘For the purposes of this Part of this schedule [Part 2, land-rich asset test] ‘interest in UK land’ has the meaning given by section 1C.’ Para 47 sch 5AAA TCGA (UK property-rich collective investment vehicles): ‘’interest in UK land’ is to be read in accordance with section 1C’; similarly s.25ZA(7) TCGA; s.80A TCGA; s.159A TCGA; s.168A TCGA; s.187B TCGA. The definition also applies for CT: s.2B(5) TCGA provides: ‘Section 1C applies for the purposes of subsection (4)(a) as it applies for the purposes of section 1A(3)(b) (disposing of interests in UK land).’

[164] See 82.19 (‘Residential property interest’).

(a) an estate, interest, right or power in or over land[165] in the UK, or	(a) an estate, interest, right or power in or over land, or
(b) the benefit of an obligation, restriction or condition affecting the value of an estate, interest, right or power in or over land in the UK,	(b) the benefit of an obligation, restriction or condition affecting the value of an estate, interest, right or power in or over land
other than an excluded interest.	other than an excluded interest.

The sch 1B and s.1C definitions are the same, except the sch 1B definition extends to non-UK land; so references to the UK are deleted, and para 4(6) sch 1B TCGA is added. This provides:

> In applying the domestic concepts of law mentioned in this paragraph to land outside the UK, this paragraph is to be read so as to produce the result most closely corresponding with that produced in relation to land in the UK.[166]

The SDLT/ATED provisions are more or less the same:

s.48(1) FA 2003: SDLT	**s.107 FA 2013: ATED**
(1) In this Part 'chargeable interest' means—	(1) In this Part 'chargeable interest' means—
(a) an estate, interest, right or power in or over land in England or Northern Ireland, or	(a) an estate, interest, right or power in or over land in the UK, or
(b) the benefit of an obligation, restriction or condition affecting the value of any such estate, interest, right or power,	(b) the benefit of an obligation, restriction or condition affecting the value of any such estate, interest, right or power.
other than an exempt interest.	(3) An exempt interest is not a chargeable interest for the purposes of this Part.

[165] Section 1C(6) TCGA and para 4(7) sch 4B TCGA (more or less) duplicate the Interpretation Act 1978 definition of land, so they add nothing; see App.2.20 (Land).

[166] Para 4(6) has no particular effect, see 90.3.3 (Foreign-entity clauses); but presumably the point is to prevent an inference that 'land' in the sch 1B definition might be restricted to UK land.

The definitions are the same as the CGT definitions set out above, except that the SDLT definition is restricted to land in England/Northern Ireland, and the term "exempt interest" is used instead of "excluded interest". (It is a pity that the terminology is not aligned; I refer where appropriate to an exempt/excluded interest).

App. 2.21.3 *Exempt/excluded interest*

Section 1C(2) TCGA provides:

> The following interests are 'excluded interests'-
> (a) any interest or right held for securing the payment of money or the performance of any other obligation,
> (b) a licence to use or occupy land,
> (c) in England and Wales or Northern Ireland,
> [i] a tenancy at will or
> [ii] an advowson, franchise[167] or manor, and
> (d) such other descriptions of interest or right in relation to land in the UK as may be specified in regulations made by the Treasury.[168]

A tenancy at will can have no value, and the items in (c)[ii] are of very specialist interest.

For completeness, s.1C(3) TCGA provides:

> An interest or right is not within subsection (2)(a) if it is-
> (a) a rentcharge, or
> (b) in Scotland, a feu duty or a payment mentioned in section 56(1) of the Abolition of Feudal Tenure etc (Scotland) Act 2000.[169]

Rentcharges cannot be created after 1977,[170] and feu duty (a Scots law concept) was abolished in 2004,[171] so this provision is (more or less) obsolete; I expect the drafter was following old precedents without giving much thought to the matter.

[167] Section 1C(6) TCGA provides: 'In this section-
'franchise' means a grant from the Crown such as the right to hold a market or fair, or the right to take tolls'.
Para 4(7) sch 1B TCGA is identical.

[168] Para 4(2) sch 1B TCGA is identical.

[169] Para 4(3) sch 1B TCGA is identical.

[170] Rentcharges Act 1977. Any remaining pre-1977 rentcharges will be extinguished in 2037.

[171] Abolition of Feudal Tenure etc. (Scotland) Act 2000.

The SDLT/ATED provisions are effectively identical.

s.48(2) FA 2003: SDLT	**s.107(4) FA 2013: ATED**
The following are exempt interests–	The following are exempt interests–
(a) any security interest;	[Identical]
(b) a licence to use or occupy land;	[Identical]
(i) a tenancy at will; (ii) an advowson, franchise or manor.	in England and Wales or Northern Ireland, a tenancy at will.[172]

Section 107(5) FA 2013 provides the definition:

> In subsection (4) 'security interest' means an interest or right (other than a rentcharge[173]) held for the purpose of securing the payment of money or the performance of any other obligation.

If A lends to B unsecured, A has an asset (the debt) but the asset is not an interest in land/chargeable interest. If the loan is secured on land, the asset is an interest in land, as a matter of general (land) law; but it is an exempt/excluded interest and so it does not count as an interest in land/chargeable interest, as defined.

App. 2.22 Dwelling/residential property

This section considers the following statutory definitions:

Defined term	**Provision**	**My term: Relevant for**
Dwelling	sch 1B TCGA	**TCGA definition,** relevant for: UK land rebasing Meaning of "residential property gain" IHT residential-property code
Residential Property	s.116 FA 2003	**SDLT definition**: SDLT
Dwelling	s.112 FA 2013	**ATED definition:** ATED

The definitions are (mostly) the same, so they are conveniently considered together. I focus on the TCGA and SDLT definitions.

The TCGA definition is expressed to be for the purposes of sch 1B

[172] The rule that an advowson, franchise or manor is an exempt interest is not needed for ATED, as these are not dwelling-interests.

[173] Section 107(6) FA 2013 makes provision for Scotland which did not use the term 'rentcharge'. But as noted above, the reference is obsolete.

TCGA, but it is incorporated elsewhere when needed.[174] It is also incorporated by reference in the IHT residential-property code.[175]

The terms dwelling/residential property are elaborately defined; for the general meaning of the words, see 6.21.2 (Home/dwelling compared); 6.21.3 (Home/residence compared).

TCGA definition: **para 5(1) sch 1B TCGA**	**SDLT definition:** **s.116(1) FA 2003**
For the purposes of this Schedule a building[176] is a dwelling at any time when—	In this Part [Part 4, SDLT] "residential property" means—
(a) it is used, or suitable for use, as a dwelling, or	(a) a building that is used or suitable for use as a dwelling,
(b) it is in the process of being constructed or adapted for use as a dwelling,	or is in the process of being constructed or adapted for such use, and
	(b) [garden & grounds, see below] and
[For equivalents to para (c), see App.2.21.2 (Interest in land: Definitions); 82.19.1 (Easement/restrictive covenant).]	(c) an interest in or right over land that subsists for the benefit of a building within paragraph (a) or of land within paragraph (b);
	and "non-residential property" means any property that is not residential property.
and, in each case, it is not an institutional building.	This is subject to the rule in subsection (7) in the case of a transaction involving six or more dwellings.

Whether a building is used/suitable for use as a dwelling is a question of fact, depending on the facts at the time of the charge; for an example, see

[174] Para 21(3) sch 4AA TCGA provides: 'For the purposes of this Schedule, whether a building is a dwelling is determined in accordance with Schedule 1B.'

[175] See 82.19 ('Residential property interest').

[176] Para 8(3) sch 1B TCGA provides: In this Schedule 'building' includes a part of a building.

P N Bewley Ltd v HMRC:[177]

> No doubt a passing tramp or group of squatters could have lived in the bungalow as it was on the date of purchase. But taking into account the state of the building ... with radiators and pipework removed and with the presence of asbestos preventing any repairs or alterations that would not pose a risk to those carrying them out, we have no hesitation in saying that in this case the bungalow was not suitable for use as a dwelling.

App. 2.22.1 *Garden or grounds*

Para 5(2) sch 1B TCGA	**s.116(1) FA 2003**
Land that at any time is, or is intended to be, occupied or enjoyed with a dwelling as a garden or grounds (including any building or structure) is taken to be part of the dwelling at that time.	In this Part [Part 4, SDLT] "residential property" means ... (b) land that is or forms part of the garden or grounds of a building within paragraph (a) (including any building or structure on such land) ...

The wording of the definitions has drifted apart slightly. It is theoretically possible that garden or grounds could be included under the SDLT definition (because it is garden and grounds) and not TCGA definition (because it is not intended to be enjoyed as such). But that will rarely if ever happen. I wonder if that is deliberate?

What is important is the concept of garden and grounds, which is the same in both definitions.

The wording is derived from CGT private residence relief, and HMRC PRR guidance[178] is relevant here. There is also SDLT guidance.

In the context of PRR, taxpayers will wish to argue that land *is* garden or grounds, in order to qualify for the relief, and HMRC will argue that it is not. In other contexts, such as IHT and SDLT, the position is reversed: taxpayers will wish to argue that land is *not* garden or grounds, and HMRC will argue that it is.

Whether land is garden/grounds is a question of fact. There have been a flurry of recent cases, in some of which estate agent particulars described the land as garden or grounds, and SDLT was paid at that basis; but a repayment claim was subsequently made on the basis that some part of the land which was not garden/grounds. (SDLT residential property rates are payable only if the land consists *entirely* of residential property. This

[177] [2019] UKFTT 65 (TC) at [53].

[178] See 59.2.6 (Garden or grounds).

"cliff-edge" rule would seem suitable for review but I do not pursue that here).

Hyman v HMRC makes some general comments:[179]

> 37. The SDLT legislation does not define the expression "garden or grounds" so I must give it its ordinary meaning. It is common ground, if I may use that word, that the hedged-in cultivated garden and the additional fenced and mown area are "garden or grounds". "Grounds" must be something different from, and additional to, "gardens".
> 38. The Oxford English Dictionary defines "grounds" as "An area of enclosed land surrounding a large house or other building". The Cambridge Dictionary's definition is "land that surrounds a building".

But dictionary definitions of ordinary English words almost never help.[180]

> 62. In my view "grounds" has, and is intended to have, a wide meaning. It is an ordinary word and its ordinary meaning is land attached to or surrounding a house which is occupied with the house and is available to the owners of the house for them to use. I use the expression "occupied with the house" to mean that the land is available to the owners to use as they wish. It does not imply a requirement for active use. "Grounds" is clearly a term which is more extensive than "garden" which connotes some degree of cultivation. It is not a necessary feature of grounds that they are used for ornamental or recreational purposes. Grounds need not be used for any particular purpose and can, as in this case, be allowed to grow wild. I do not consider it relevant that the grounds and gardens are separated from each other by hedges or fences. This may simply be ornamental, or may serve the purpose of delineating different areas of land as being for different uses. Nor is it fatal that other people have rights over the land. The fact that there is a right of way over grounds might impinge on the owners' enjoyment of the grounds and even impose burdensome obligations on them, but such rights to not make the grounds any the less the grounds of that person's residence. Land would not constitute grounds to the extent that it is used for a separate, eg commercial purpose. It would not then be occupied with the residence, but would be the premises on which a business is conducted.

In *Myles-Till v HMRC*[181]

> What indicates that a piece of adjoining land has become part of the

[179] FTT's comments cited and approved on appeal: [2021] UKUT 68 (TCC) at [14].
[180] See App 2.1.3 (Dictionaries).
[181] [2020] UKFTT 127 (TC) at [44] -[45].

> “grounds” of a dwelling building? Technically, fact that a dwelling building is sold together with adjoining land, as a single chargeable transaction for SDLT purposes, does not make that adjoining land, necessarily, part of the grounds of the dwelling building: s55 clearly envisages the possibility that the subject matter of a single chargeable transaction will include both residential and non-residential land. Common ownership is a necessary condition for the adjacent land to become part of the grounds of the dwelling building - but not, in my view, a sufficient one. To that extent I cannot accept HMRC’s submission that it is sufficient that the adjacent land is available to the owners to use as they wish. One must, in addition, look at the use or function of the adjoining land to decide if its character answers to the statutory wording in s116(1) - in particular, is the land grounds “of” a building whose defining characteristic is its “use” as a dwelling? The emphasised words indicate that that the use or function of adjoining land itself must support the use of the building concerned as a dwelling. For the commonly owned adjoining land to be “grounds”, it must be, functionally, an appendage to the dwelling, rather than having a self-standing function... Quite how the commonly held adjoining land “supports” the dwelling building (in my formulation) will be a matter of fact and degree - ranging from pure ornamentation (simply improving the view from the house) to on-site leisure activities (a horse-riding paddock and stables for use by the house-dwellers).

In *Hyman*, a barn, meadow and bridleway were held to be grounds of the dwelling building (or buildings on those grounds). In *Goodfellow,* paddocks and stables used for recreational activity were held to be grounds.[182] In *Myles-Till*, a paddock formed part of the grounds.

There is no requirement that the garden must be needed for reasonable enjoyment of the dwelling.[183]

App. 2.22.2 *Institutional building*

An institutional building does not count as a dwelling within the TCGA definition.

Para 5(3) sch 1B TCGA provides the definition. There are 10 categories of institutional building:

[182] *Goodfellow v HMRC* [2019] UKFTT 750 (TC); and see Sheldon, “A stable proposition” Tax Adviser, April 2020.

[183] This is self-evident, but if authority is needed, see *Hyman v HMRC* [2021] UKUT 68 (TCC).

> A building is an institutional building if—
> (a) it is used as residential accommodation for school pupils,
> (b) it is used as residential accommodation for members of the armed forces,
> (c) it is used as a home or other institution providing residential accommodation for children,
> (d) it is used as a home or other institution providing residential accommodation with personal care for persons in need of personal care because of old age, disability, past or present dependence on alcohol or drugs or past or present mental disorder,
> (e) it is used as a hospital or hospice,
> (f) it is used as a prison or similar establishment,
> (g) it is used as a hotel or inn or similar establishment,
> (h) it is otherwise used, or suitable for use, as an institution that is the sole or main residence of its residents...

App. 2.22.3 *Student accommodation*

Para 5 sch 1B TCGA provides:

> (3) A building is an institutional building if ...
> (i) it falls within—
> (i) paragraph 4 of Schedule 14 to the Housing Act 2004 (buildings in England or Wales occupied by students and managed or controlled by educational establishment etc), or
> (ii) any provision having effect in Scotland or Northern Ireland that is designated by regulations made by the Treasury as provision corresponding to paragraph 4 of that Schedule, or
> (j) it qualifies in accordance with the next sub-paragraph as student accommodation.
>
> (4) A building qualifies as student accommodation in accordance with this sub-paragraph at any time if the time falls in a tax year in which—
> (a) the accommodation provided by the building includes at least 15 bedrooms,
> (b) the accommodation is purpose-built, or is converted, for occupation by students, and
> (c) the accommodation is occupied by students on at least 165 days.
>
> (5) Accommodation is to be regarded as occupied by persons as students if they occupy it wholly or mainly for undertaking a course of education (otherwise than as school pupils).

App. 2.22.4 *Temporarily unsuitable*

Para 6(1) sch 1B TCGA provides:

> A building is treated for the purposes of paragraph 5 as continuing to be suitable for use as a dwelling at any time when it has become temporarily unsuitable for use as a dwelling.

App. 2.22.5 *Accidental damage*

Para 6 sch 1B TCGA provides:

> (2) There is an exception to this rule if—
> (a) the temporary unsuitability resulted from accidental damage to the building, and
> (b) the damage resulted in the building becoming unsuitable for use as a dwelling for a period of at least 90 consecutive days ('the 90 day period').
>
> (3) This exception does not apply if the damage occurred in the course of work that—
> (a) was being done for the purpose of altering the building, and
> (b) itself involved, or could be expected to involve, making the building unsuitable for use as a dwelling for at least 30 consecutive days.
>
> (4) If the exception applies, work done in the 90 day period to restore the building to suitability for use as a dwelling is not to count for the purposes of paragraph 5 as constructing or adapting the building for use as a dwelling.
>
> (5) For the purposes of this paragraph—
> (a) references to accidental damage include damage otherwise caused by events beyond the control of the person disposing of the interest in land,
> (b) references to alteration of a building include its partial demolition, and
> (c) the 90 day period does not include the day of the disposal (or later days).

This level of detail seems absurd; but there it is.

App. 2.22.6 *Work on building*

Para 6(6) sch 1B TCGA provides:

> For the purposes of this paragraph a building's unsuitability for use as a dwelling is not regarded as temporary if paragraph 7 applies (disposal of a building that has undergone works).

Para 7 sch 1B TCGA provides:

(1) If—

(a) a person disposes of an interest in land on which a building has been suitable for use as a dwelling, and

(b) as a result of qualifying works, the building has, at or before the time of completion[184] of the disposal, ceased to exist[185] or become unsuitable for use as a dwelling,

the building is to be regarded for the purposes of paragraph 5 as unsuitable for use as a dwelling throughout the works period.

(2) For the purposes of this paragraph works are 'qualifying' works if—

(a) any planning permission[186] or development consent required for the works, or for any change of use with which they are associated, has been granted (whether before or after completion), and

(b) the works have been carried out in accordance with the permission or consent.

(3) In this paragraph 'the works period' means—

(a) the period when the works were in progress, and

(b) such period (if any) ending immediately before the start of the works throughout which the building was, for reasons connected with the works, not used as dwelling.

(4) If at any time when qualifying works are in progress—

(a) the building was undergoing any other work, or put to any other

[184] Para 8(2) sch 1B TCGA provides: 'For the purposes of this Schedule the completion of the disposal of an interest in land is regarded as occurring—
(a) at the time of the disposal, or
(b) if the disposal is under a contract which is completed by a conveyance, transfer or other instrument, at the time when the instrument takes effect.'

[185] Para 8(1) Sch 1B TCGA provides: 'For the purposes of this Schedule a building is regarded as ceasing to exist from the time when either—
(a) it has been demolished completely to ground level, or
(b) it has been demolished to ground level except for a single facade (or a double facade if it is on a corner site) the retention of which is a condition or requirement of planning permission or development consent.'

[186] Para 8(3) sch 1B TCGA provides: 'In this Schedule ... 'planning permission'—
(a) in the case of land in England or Wales, has the meaning given by section 336(1) of the Town and Country Planning Act 1990,
(b) in the case of land in Scotland, has the meaning given by section 227(1) of the Town and Country Planning (Scotland) Act 1997,
(c) in the case of land in Northern Ireland, has the meaning given by Article 2(2) of the Planning (Northern Ireland) Order 1991, and
(d) in the case of land outside the UK, means permission corresponding to any planning permission in relation to land anywhere in the UK.'

use, in relation to which planning permission or development consent[187] was required but has not (at any time) been granted, or

(b) anything else was being done in contravention of a condition or requirement attached to a planning permission or development consent relating to the building,

the works period does not include that time.

(5) If sub-paragraph (1) would have applied but for the fact that, at the completion of the disposal, the works are not qualifying works, the works are regarded as not affecting the building's suitability for use as a dwelling at any time before the disposal.

App. 2.23 Trade

App. 2.23.1 *Introduction*

A full discussion on what is a trade needs a chapter to itself. But I am not sure how easy that would be to write, or how satisfying to read. 'Trade' is a varied and vague concept. The case law began in the first volume of Tax Cases,[188] and has continued ever since. No tax issue has generated more litigation, except, perhaps, the income/capital distinction, to which it is related, where case law is 'thick as autumn leaves'.[189] Almost any proposition asserted in one case may be contradicted, or appear to be contradicted, in other cases.

> The law has never succeeded in establishing precise rules which can be applied to all situations to distinguish between trading stock and capital assets.[190]

[187] Para 8(3) sch 1B TCGA provides: 'In this Schedule ... 'development consent' means—
(a) in the case of land in the UK, development consent under the Planning Act 2008, and
(b) in the case of land outside the UK, consent corresponding to development consent under that Act'.

[188] *Erichsen v Last* (1881) 1 TC 351 and 4 TC 422.

[189] *London & Thames Haven Oil Wharves Ltd v Attwooll* 43 TC 491 at p.513; the reference is to Paradise Lost.

[190] *Waylee Investment v IRC* [1990] STC 780 at p.784g. Nothing has changed since 1881; in *Erichsen v Last* 4 TC 422: "I do not think there is any principle of law which lays down what carrying on of trade is. There are a multitude of incidents which together make the carrying on a trade, but I know of no one distinguishing incident which makes a practice a carrying on of trade, and another practice not a carrying on of trade. If I may use the expression, it is a compound fact made up of

This section contains general comments. But the topic is context-sensitive, so the question of whether specific types of activity constitute a trade is best discussed separately, in the context in which it may arise:[191]

Topic	**See para**
Rent or trading income	14.7.3
Chattel hire trading	21.18.1
Trading in land	22.2
Trading royalties	32.3.1
Financial trade	72.15
Gambling	72.15.4
Cryptoassets	96.7

See *Taxation of Charities and Nonprofit Organisations*[192] for discussion of:

- Trading by charities and clubs
- Mutual trading

Hopscotch v HMRC provides a case law reading list:[193]

> 23... So far as principles that have been found, they remain best expressed in the decision of the House of Lords in *Ransom v Higgs* and the decision of the High Court in *Marson v Morton*.
> 24. That was confirmed as much by the Court of Appeal in *Degorce v HMRC* where reference was made to the earlier decisions of the Court of Appeal in *Eclipse Film Partners (No 35) LLP v HMRC* and *Samarkand Film Partnership No 3 v HMRC* as providing "an authoritative and recent re-statement of the principles which should be applied in deciding whether activities undertaken by a taxpayer constitute a trade for tax purpose.

App. 2.23.2 *Statutory definition*

The pre-rewrite definition provided that:

> "trade" includes every trade, manufacture, adventure or concern in the nature of trade.

a variety of incidents."

[191] For trading by charities, see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 8.2 (What is a trade) online version *https://www.taxationofcharities.co.uk*

[192] Kessler, Wong & Shah, (14th ed., 2024-25), online *https://www.taxationofcharities.co.uk*

[193] [2020] UKUT 294 (TCC).

The tax law rewrite recast this. Section.989 ITA/ s.1119 CTA 2010 provide:

> trade includes any venture in the nature of trade[194]

The pre-rewrite case law continues to apply.

App. 2.23.3 *Concept of trade*

Modern law on this topic starts with *Ransom v Higgs*:[195]

> ... the legal concept of 'trade'... may be called a concept of common law. Trade has for centuries been, and still is, part of the national way of life: everyone is supposed to know what 'trade' means: so Parliament, which wrote it into the law of income tax in 1799, has wisely abstained from defining it and has left it to the Courts to say what it does or does not include. Trade is infinitely varied; so we often find applied to it the cliché that its categories are not closed. Of course they are not: but this does not mean that the concept of trade is without limits, so that any activity which yields an advantage, however indirect, can be brought within the net of tax. ...

That does not take us far, but it sets the scene.

App. 2.23.4 *Fact or law*

As usual, trade involves a mixture of both. In *Ransom v Higgs*:

> Sometimes the question whether an activity is to be found to be a trade becomes a matter of degree, of frequency, of organisation, even of intention, and in such cases it is for the fact-finding body to decide on the evidence whether a line is passed. The present is not such a case: it involves the question as one of recognition whether the characteristics of trade are sufficiently present. I do not think that we need here to get enmeshed in the intricacies - I am tempted to say sophistries - of primary or secondary facts or inferences. We are clearly in the realm of principle and of law.

In *Eclipse Film Partners (No 35) LLP v HMRC*:[196]

> ... Its meaning in tax legislation is a matter of law. Whether or not a particular activity is a trade, within the meaning of the tax legislation,

[194] Section 288(1) TCGA incorporates this definition by reference: 'Trade' has the same meaning as in the Income Tax Acts.

[195] 50 TC 1 at p.88.

[196] [2015] EWCA Civ 95 at [112].

> depends on the evaluation of the activity by the tribunal of fact. These propositions can be broken down into the following components. It is a matter of law whether some particular factual characteristic is capable of being an indication of trading activity. It is a matter of law whether a particular activity is capable of constituting a trade. Whether or not the particular activity in question constitutes a trade depends upon an evaluation of all the facts relating to it against the background of the applicable legal principles. To that extent the conclusion is one of fact, or, more accurately, it is an inference of fact from the primary facts found by the fact-finding tribunal.

App. 2.23.5 *One-off transactions*

The statutory definition (that trade includes a venture in the nature of trade) is taken to mean that a one-off transaction may constitute a trade, if it is in the nature of trade; but that does not take one very far.

In *CIR v Livingston*:[197]

> I think the test, which must be used to determine whether a venture such as we are now considering is, or is not, 'in the nature of trade,' is whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made, If they are, I do not see why the venture should not be regarded as 'in the nature of trade,' merely because it was a single venture which took only three months to complete.

App. 2.23.6 *Novel trade*

In *Ransom v Higgs*:[198]

> I attach no importance to the fact that, if there was trade, there is a difficulty in knowing what to call it. Christening normally follows some time after birth, and if Mr. Higgs's activities were found to be trading activities, a description would soon be found.

App. 2.23.7 *Trade needs customers*

In *Ransom v Higgs*:[199]

> Trade involves, normally, the exchange of goods or of services for reward - not of all services, since some qualify as a profession or employment or

[197] 11 TC 538 at p.542.

[198] 50 TC 1 at p.88.

[199] 50 TC 1 at p.88.

> vocation, but there must be something which the trade offers to provide by way of business. Trade, moreover, presupposes a customer (to this too there may be exceptions, but such is the norm), or, as it may be expressed, trade must be bilateral - you must trade with someone...

There is some vagueness here, not only because of the possibility of exceptions, but because the concept of "customers" is imprecise.[200]

App. 2.23.8 *Trade: Commerciality*

In *British Legion, Peterhead Branch, Remembrance and Welcome Home Fund v IRC*:[201]

> ... a person cannot be said to be engaged in carrying on a trade or a concern in the nature of trade within the meaning of the Income Tax Acts unless, in a reasonable sense, he is conducting business on commercial principles.

Wannell v Rothwell concluded that it had to be possible for an non-commercial activity to be a trade, because (what is now) s.66 ITA would otherwise be redundant.[202] But an argument from redundancy carries little weight,[203] the relevant cases were not cited, and the point did not arise for decision. So the issue remains open to argue, and the authorities still support the view that an non-commercial activity is not a trade.

However, it seems to me that the question whether a trade has to be commercial is not well framed unless one clarifies what is meant by the somewhat vague concept of commercial. Suppose for instance:

(1) For charitable or other reasons a person charges low prices when they could charge high prices.
(2) The activity is profitable but not as profitable as it could be.
(3) It is not the object of the person to make a profit.

No doubt that can constitute trading.[204] Is the activity commercial? It is not wholly commercial, but one might regard commerciality as a matter of degree.[205] If one regards the activity as non-commercial, then that is an

[200] See App.1.5 ("Customers" of HMRC).

[201] 35 TC 508 at p.514.

[202] 68 TC 719 at p.732; see 5.1.1 (Trade/commercial/profit compared).

[203] See App.2.1.2 (Argument from redundancy).

[204] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25) para 8.1 (Trade carried on by charity*)*.

[205] Some ambiguity is recognised in the quote set out above, which refers to commercial principles 'in a reasonable sense'.

example of a non-commercial trade.

HMRC pay due respect to the decision:

> **BIM85705 uncommercial trades – not on a commercial basis** [Jan 2019]
> ... following the High Court decision in *Wannell v Rothwell* [1996] 68 TC 719 we now accept that in very unusual cases the activities may constitute a trade even though they are uncommercial...

It is at least clear that an activity which cannot objectively make a profit, and not intended subjectively to make a profit, is not a trade or business.

As to the significance of tax avoidance in determining whether there is a trade, see *Thomson v HMRC*.[206] As *Thomson* illustrates, if a trade is needed in order for a tax avoidance scheme to succeed, and not for its own sake, it may be more difficult to prove the required element of commerciality, because the decision to trade is not itself made for commercial reasons.

App. 2.23.9 *Trade: view to profit*

In *Hoey v HMRC*:[207]

> it is not a requirement of the concept of a trade for tax purposes, unless the legislation in question expressly says so, that the relevant activities should be carried on with a view to profit. For example, a trade may be carried on as a hobby, or on a not-for-profit basis.

App. 2.23.10 *The badges of trade*

The charming term 'badges of trade' comes from the Royal Commission on the Taxation of Profits and Income,[208] which identified six badges (ie, indicia) of trade. Nowadays one would call it a multifactorial test.

Marson v Morton 59 TC 381 is the leading case and identifies 9 badges, in the context of trading in land;[209] no doubt one can devise more. The traditional badges are focussed on activities involving the sale of assets, rather than activities involving the provision of services, which are equally if not more important.

[206] [2018] UKFTT 396 (TC) at [187].

[207] [2022] EWCA Civ 656 at [192].

[208] Final Report (1955) (Cmd. 9474), para. 116.

[209] See 22.2 (What is trading in land); and see BIM20200 onwards.

App. 2.24 Reasonable-to-assume

App. 2.24.1 *Reasonable-to-assume wording*

As far as I know, the forms of words discussed here first appeared in the 2005[210] rewrite of the ToA motive defence[211]:

Old condition A (pre-2005)	New condition A (post-2005)
the purpose of avoiding liability to taxation was not the purpose, or one of the purposes, for which the relevant transactions or any of them were effected.	*it would not be reasonable to draw the conclusion, from all the circumstances of the case*, that the purpose of avoiding liability to taxation was the purpose, or one of the purposes, for which the relevant transactions or any of them were effected.[212]

This wording, or equivalent, migrated from there to:
- a selection of TAARs
- the GAAR
- In DTAs, the PPT (which is just a TAAR with a more accurate name)[213]

In these provisions the issue is not whether an arrangement has a tax avoidance/advantage purpose, but is said to be whether it is *reasonable to assume* such a purpose.[214]

It is found in other provisions, primarily but not exclusively anti-avoidance, where the issue is not whether specified circumstances exist, but is said to be whether it is reasonable to assume that they do. For instance:

Topic	Text (in short)	Da te	See para
Disguised remuneration	Reasonable to suppose arrangement a means of providing remuneration[215]	2011	-

[210] The provisions enacted in FA 2006 with effect from 2005.

[211] See 52.3 (Motive defence condition A); 52.4 (Motive defence condition B).

[212] The wording is repeated in Motive Defence condition B:

Old condition B (pre-2005)	New condition B (post-2005)
the transfer and any associated operations... (b) were not designed for the purpose of avoiding liability to taxation.	*it would not be reasonable to draw the conclusion, from all the circumstances of the case*, that any one or more of those transactions was more than incidentally designed for the purpose of avoiding liability to taxation.

[213] See 108.8 (Principal purpose test).

[214] For the GAAR, see s.207 FA 2013. For a list of TAARs with reasonable-to-assume wording, see 3.2.1 (Types of unallowable purpose).

[215] Section 554A ITEPA.

Tainted donations	Reasonable to assume donation & arrangement not entered into independently[216]	2011	-
Remittance investment relief	Reasonable to assume benefit would not be available in the absence of the investment	2012	19.11.3
Disguised interest	Reasonable to assume return is by reference to time value of money	2013	26.25.2
Mixed partnerships	Reasonable to suppose:	2014	86.6
	- A's deferred profit included in B's profit share		
	- B's profit share attributable to A's power to enjoy		
	- A's profit share lower than in absence of A's power to enjoy		
	- A would have been a partner but for s.809C	2014	86.13
	Amount as is reasonable to suppose attributable		
Salaried members code	Reasonable to expect:	2014	
	- 80% of remuneration disguised salary		
	- time when arrangements will end		
Disguised IM fees	Reasonable to assume:		
	-Absent arrangements,sum would have arisen to A	2015	73.17.2
	-Main purpose is avoidance of tax	2015	73.17.2
Hybrid entities	Reasonable to suppose a hybrid payee mismatch[217]	2016	91.17
Disqualified advice	Reasonable to conclude tax advantage is a purpose	2017	126.11.1
Onward gifts	Reasonable to expect onward gift to UK resident	2018	61.31.2
Profit fragmentation	Reasonable to conclude value transferred relates to something done by an individual	2019	53.8.1
UK land of non-resident[218]	Reasonable to conclude UK land used for trading	2019	57.8
	Reasonable to conclude trade will continue		57.8
Loss reliefs[219]	Profits reasonably expected/trade carried on with reasonable expectation of profit		App.5.4

There are variations of wording. We have reasonable to assume/ suppose/expect/conclude/draw the conclusion; but the meaning must be the same.

I refer to these forms as **"reasonable-to-assume wording"**.

App. 2.24.2 *From all the circumstances*

The ToA provision added *from all the circumstances of the case;* but that

[216] Section 809ZJ ITA; see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 7.8 (Donation-dependent arrangement), online version *https://www.taxationofcharities.co.uk*

[217] Reasonable to suppose/ expect is used in further places in the hybrid mismatch code not listed here.

[218] This is the first time I am aware that the expression "reasonable to conclude" has ventured from its usual (anti-avoidance) context; let us hope it will not happen often.

[219] Loss relief is slightly from other items in this list, in that it is considering a future prediction (future profit) not a present state of affairs (such as present intention); but it is not necessary to pursue that.

cannot add anything to the meaning. Presumably the OPC agreed, as this phrase was not used subsequently, until it resurfaced in the GAAR and in the PPT.[220]

The drafter of DOTAS Description 9 (Financial products) tried harder:

> it would be reasonable *to expect an informed observer (having studied the arrangements and having regard to all relevant circumstances)* to conclude...[221]

But again, the additional words add nothing to the meaning. Let us hope, in the interests of brevity, that this verbiage does not become standard.

App. 2.24.3 *Effect of wording*

What (if anything) does reasonable-to-assume wording mean? Is there a difference between the propositions *X is the case* and *it is reasonable to assume that X is the case?*; and if so, what is it?

Perhaps we should look first to see what HMRC said they intended to achieve when the wording was first used:

> 59. The new section 741A ICTA [New Conditions A and B] aims to ensure that all relevant factors are taken into account in deciding whether exemption is due. That is the normal way of applying any purpose test, but in relation to section 741 [Old Conditions A and B] the view is sometimes expressed by tax practitioners that the present test should be interpreted more narrowly. They contend that
> [1] it is only necessary to look at the subjective intentions of the individual, and
> [2] that no account need be taken of any other circumstances, even if they included for example the fact that a particular transaction might have been structured in such a way that it directly resulted in a significant tax reduction that was not on the face of it intended by Parliament.

There are two distinct contentions here:

(1) It is only necessary to ascertain the subjective intentions of the individual. That is correct.

[220] In the GAAR we have ("... if, having regard to all the circumstances, it would be reasonable to conclude ..."); see 3.26.2 (Tax arrangements).
In the PPT we have: "reasonable to conclude, *having regard to all relevant facts and circumstances...*"; see 108.8 (Principal purpose test). Perhaps this was not drafted by the OPC.

[221] Reg 19 Tax Avoidance Schemes (Prescribed Descriptions of Arrangements) Regulations 2006 (inserted 2016); again, probably not drafted by the OPC.

(2) In ascertaining that attention, no account need be taken of any other circumstances, such as that the transaction resulted in the avoidance of tax. That is not correct. It cannot even be taken seriously.[222]

> 60. HMRC has consistently taken the view that such a narrow interpretation of section 741 is not a correct reading of the law. If such an interpretation is accepted, the purpose of the transfer of assets abroad legislation to prevent individuals avoiding income tax ... could not be properly achieved. The new test makes it the condition for exemption that the individual must broadly show that it would not be reasonable to conclude from all the circumstances of the case that any of the transactions had a tax avoidance purpose. The wording of the test is intended to put it beyond doubt that exemption will not be due *solely* on the basis of an assertion by individuals that tax avoidance was not their subjective intention. Evidence of individuals' subjective intention will be one factor to take into account. However, all other relevant circumstances of the particular case must also be considered, including the actual objective outcome of the transactions.[223]

I think this is making the point made at 3.9 (How to identify purpose). All relevant circumstances must be taken into account in order to identify an individual's purpose. A particularly significant fact is whether the transaction resulted in a significant tax reduction, that is, the effect of the transactions.

The INT Manual makes my point:

> **INTM602960 Avoidance purpose exemption: Purposes** [Jul 2023]
> ...Over the years there has been long debate about exactly how a test of purpose should be construed, in particular whether the test is an objective or a subjective one. ...
> HMRC take the view that the proper way to apply a purpose test is to consider all the facts in an objective manner, but that is not the same as saying the test is 'objective'. It is clearly wrong to assert that it is only necessary to look at the purpose individuals ascribe to their actions in deciding whether exemption is due; but it is equally wrong to say that only the outcome is relevant. It is essential to consider both. Thus, purpose or intention is essentially a subjective concept, but in practice the objective facts must be examined to draw an inference: see Pennycuick J in *Lloyd's Bank v Marcan* (2 All ER 359) at 367-8:
>
> The word 'intent' denotes a state of mind. A man's intention is a

[222] See 3.9 (How to identify purpose).

[223] EN Draft Clauses (2005). The point is made more briefly in EN FB 2006 para 66.

> question of fact. Actual intent may unquestionably be proved by direct evidence or may be inferred from surrounding circumstances. Intent may also be imputed on the basis that a man must be presumed to intend the natural consequences of his own act.[224]

This approach is borne out by the construction of the exemption test, referring as it does to 'all the circumstances of the case' in considering purposes including the intentions and purposes of any person who designs, effects, or provides advice in relation to the relevant transactions or any of them.

There was a helpful discussion around 'purpose' by the First-tier Tribunal in the case of *Fisher v HMRC* ([2014] UKFTT 804 (TC)) at paragraphs [241] - [289]. At [287], the court summarised that discussion in these terms:

> From the above, we summarise the following propositions in relation to the motive defence:
>
> (1) The test is subjective. (*Carvill*)
>
> (2) Evidence of a person's reactions to what is said to them and circumstances as well what they say their purpose is may be relevant. (*Philippi*)
>
> (3) It is not enough to show a tax avoidance effect.
>
> (4) Knowledge that less tax is paid does not equate to a tax avoidance purpose (but knowledge is a pre-requisite to having a purpose.)
>
> (5) Awareness of tax aspects does not equate to having a tax avoidance motive. (*Willoughby*)
>
> (6) The mere fact of taking tax advice does not mean there is a tax avoidance motive. (*Beneficiary v IRC*)
>
> (7) Picking a lower tax route over a higher tax route does not equate to tax avoidance (but equally does not preclude tax avoidance). (*Brebner / Willoughby*)

At the time that the reasonable-to-assume wording was devised, in 1995, HMRC were arguing that "purpose of a transaction", in the motive defence, was an objective concept, meaning the effect of the transaction. (Subsequently, HMRC wisely abandoned this argument, but that came later.[225]) I think what happened here is that parliamentary counsel misunderstood what this objective/subjective argument was actually about, and used the statutory wording to defeat a rather different, and completely

[224] [1973] 2 All ER 359 at p.367-8 citing *Freeman v Pope* (1870) 5 Ch App 538. I set out here the precise words of the quoted text (the drafter of the 2009 guidance changed "man" to "person").

[225] See 3.8 (A subjective test).

ridiculous, argument. It is possible that some taxpayer did try to raise just the argument to which the EN refers. If so, the correct response would have been to laugh, not to legislate.

I originally wondered whether the drafter's aim here is something different: to replace the subjective purpose test (which applies to the Old Conditions) with an objective results test. However this is inconsistent with what the EN actually said. If it were the intention to replace the subjective purpose test with an objective results test, then "evidence of individuals' subjective intention" should cease to be "one factor to take into account". It will be irrelevant. However, the EN is unclear. It is wrong to construe a muddled explanatory note in order to understand a statutory provision. We do not wish to move to the position, sometimes said to apply in the USA, that "if the legislative history is unclear, you read the words of the statute".

Turning, as we must, to the legislation itself, we find that the ToA motive defence still depends on the purpose of the transactions. It is reasonably clear that:

(1) this means the purpose of those who carried out the transactions, and
(2) purpose means subjective purpose.

What the reasonable-to-assume wording stresses (one might say, charitably, for the avoidance of doubt) is that all the circumstances of the case must be taken into account in order to ascertain the subjective purpose. It allows for the possibility of rejecting the transferor's claimed purpose in cases of deception, (including, perhaps, self-deception in exceptional cases).

The same view is taken in CTM comments on comparable wording in the winding-up TAAR[226]:

> **CTM36340: company winding up TAAR: condition D** [Sep 2018]
> The purpose test is subjective but the purpose may be inferred from objective characteristics having regard to all the circumstances surrounding the winding-up to which the test is being applied, much as Lord Brightman was able to draw an inference in a different context. In *Mallalieu v Drummond* (1983) 57 TC 330 he was able to distinguish between the motive the barrister asserted of maintaining a wardrobe of a certain type and standard, and the object or purpose of the purchase of it.

[226] See 30.14 (Winding-up TAAR).

It is significant that *Mallalieu v Drummond* managed to reach its conclusion in the absence of any reasonable-to-assume wording.

The Partnerships Manual attempts to explain reasonable-to-assume wording in the context of the mixed partnerships code:[227]

> **PM218000 - Condition X** [Jul 2019]
> Condition X applies where it is reasonable to suppose that amounts representing the individual member's deferred profit are included in the non-individual member's profit share.
> [1] Reasonable to suppose means that you take a realistic view of the facts and use a balanced common sense approach.
> [2] Reasonable to suppose does not mean that it has to be certain.
> [3] Reasonable to suppose means you should ignore an improbable or extreme outcome.

While points [1] to [3] are no doubt correct, would anyone say that the position would be different in the absence of the reasonable-to-assume wording?

In the context of the DTA principal purpose test, OECD Commentary on art 29 provides:

> 179. A person cannot avoid the application of this paragraph by merely asserting that the arrangement or transaction was not undertaken or arranged to obtain the benefits of the Convention. All of the evidence must be weighed to determine whether it is reasonable to conclude that an arrangement or transaction was undertaken or arranged for such purpose. The determination requires reasonableness, suggesting that the possibility of different interpretations of the events must be objectively considered.

This is self-evident. It echos HMRC guidance on the ToA motive defence.

App. 2.24.4 *Reasonable-to-assume: Critique*

Reasonable-to-assume wording is discussed in HMRC Unallowable Purpose Tests Draft Guidance:

> An alternative test to a "main purpose" test would be to assess whether "it is reasonable to assume that the main, or one of the main purposes is unallowable". In this way, purpose can be assessed objectively and the test can potentially penetrate purported subjective purposes which do not stand up to objective scrutiny. The potential impact of such drafting is

[227] See 86.6 (Condition X: Deferred profit).

> currently being examined. In the future, such an approach may be recommended if the outcome of internal consideration and external comment is positive.[228]

The response to the consultation was not positive, and the response document provided:

> There was widespread opposition to any use of a 'reasonable to believe' test in respect of any purpose threshold.
> The proposed framework will therefore recommend that policy owners do not use a 'reasonable to believe' test.[229]

But this recommendation has been forgotten, or rejected, in many subsequent anti-avoidance provisions.

The conclusion of the discussion is that reasonable-to-assume wording is otiose; and an uncharitable commentator would call it verbiage. It may reflect an awareness that the provision in point is imponderable, or disputable; but adding "reasonable to assume" does not help.

Perhaps it does not matter, as tax statutes often contain material which is redundant.[230] But it is good to know what we are talking about.

App. 2.24.5 *"It is shown that"*

Occasionally statutes provide rules which apply where *it is shown that* X is the case (not just that *X is the case*). Examples include:

Provision	**Topic**	**See para**
3A(1) TCGA	s.3 motive defence	64.16
48(4) IHTA	FOTRA securities exempt	75.11.2
3(3) IHTA	Omissions/transfers of value	74.5
103 FA 1986	Debts for IHT	80.12.6, 80.12.10
s.10 IHTA	Arm's length transaction	74.13

As the burden of proof is already on the taxpayer,[231] the words are clearly otiose. And as the drafter uses this form, albeit rarely and perhaps sometimes for historical reasons, it is easier to conclude that reasonable-to-assume wording is likewise redundant.

A similar wording (from the ToA motive defence) is if a person *satisfies*

[228] p.18.

[229] HMRC Discussion Response Document "Simplifying Unallowable Purpose Tests (2009), p.7.

[230] See App.2.1.2 (Argument from redundancy).

[231] See 6.36 (Residence: Burden of proof).

HMRC that ...[232]

App. 2.25 Highest part of income

Section 1012 ITA provides:

> (1) This section makes provision about the relationship between rules requiring particular income to be treated as the highest part of a person's total income.
> (2) It has effect for the purposes of the Income Tax Acts except sections 535 to 537 of ITTOIA 2005 (gains from contracts for life insurance etc: top slicing relief).
> (3) If more than one of the provisions listed in subsection (4) applies in relation to a person, a provision mentioned earlier in the list has priority over a provision mentioned later in the list.
> (4) The provisions are–[233]

Section	**Topic**	**See para**
s.465A ITTOIA	Chargeable events	-
s.685A(5A) ITTOIA	Settlor-interested trusts	47.10.2
s.404A ITEPA	Termination of employment	-
s.16 ITA	Savings/Dividend Income	43.4.3

Section 1012(5) ITA provides:

The provisions listed in subsection (4) have priority over–[234]

Section	**Topic**	**See para**
s.619A(2) ITTOIA	Settlor-interested trusts	47.11.4
s.768(6)(7) ITA[235]	Pre-2016 transactions in land	22.5
786(6)(7) ITA	Sale of Occupation Income	-

any other provisions of the Income Tax Acts requiring income of any description to be treated as the highest part of a person's total income.

Section 1012(6) ITA provides:

> The effect of one provision having priority over another is that the second provision has effect subject to the first.

See too 64.20.1 (Amount of distribution tax: s.3 TCGA distribution relief.

[232] See 52.34.1 ("Satisfies an officer").

[233] For the sake of clarity, I set this out in table format with my own topic descriptions.

[234] For the sake of clarity, I set this out in table format with my own topic descriptions.

[235] This provision was deleted when rewriting the TiL provisions, now in Part 9A ITA; the need to delete the reference here was overlooked.

APPENDIX THREE

FAMILY TERMINOLOGY

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App. 3.1 Family terms: Introduction

This chapter considers the meaning of terminology relating to the family (spouse, civil partner, etc).

These terms are used frequently in tax and non-tax legislation, and their meaning is a matter of general (non-tax) law; though of course meaning is always subject to context.

App. 3.2 "Spouse"

App. 3.2.1 *Spouse: General meaning*

The IHT Manual provides:

> **IHTM11032. Definition of spouse and civil partner** [Jan 2020]
> The IHT legislation does not define 'spouse' or 'civil partner' so the

> definitions come from general law...
>
> Spouses include
>
> - people who are legally married but separated
> - parties to a valid polygamous marriage. The marriage confers the IHTA84/S18 exemption on all transfers to all the spouses of the transferor or deceased who qualify under IHTA84/S18. Where the IHTA84/S18 (2) limit applies because of foreign domicile of those spouses (IHTM11033), the total exemption (including any similar lifetime exemptions) may not exceed the IHTA84/S18 (2) limit of £55,000 when the date of transfer was before 6 April 2013, and the applicable nil-rate band when the date of transfer was on or after this date.
>
> The following are not spouses
>
> - people who are living together but not lawfully married, however long the relationship may have lasted (in England, Wales and Northern Ireland)
> - In Scotland the one form of irregular marriage that has been recognised by Scots law is that by cohabitation with habit and repute. This arises where a man and woman cohabit together as husband and wife and behave towards each other as such for a considerable length of time, so it is generally believed by the society and neighbourhood in which they live, and among their friends and relatives that they are married. They are then presumed to be married, although it is impossible to state precisely the place and a time when they exchanged the consent which is essential for marriage. Marriage by cohabitation with habit and repute was abolished by The Family Law (Scotland) Act 2006. It will remain an issue for the Courts for some time to come, however, since claims can still be admitted if based on a period of cohabitation that occurred before the commencement of the Act. If it is claimed that this common law style of marriage entitles the parties to the exemption under IHTA84/S18 (1) in either a death or lifetime situation you should refer the file to Technical.
> - parties to a bigamous marriage
> - people who were formerly lawfully married but divorced before the date of death/transfer

Likewise the CG Manual provides:

> **CG22070 Transfer Of Assets Between Husband And Wife: Definitions** [Jul 2019]
>
> ... A polygamous marriage may be recognised as valid in UK law if it was valid in the country in which the ceremony occurred and, broadly, it was contracted by persons domiciled in that country. In these

circumstances the spouses will be connected with each other under s.286(2). A transfer between spouses living together will be within s.58 TCGA and so will be at no gain/no loss.

The courts have decided that discrimination between married and unmarried couples is human-rights compliant, though only just.[1]

The first *Vestey* case[2] decided that "spouse" in the settlor-interested trust code did not include a widow; and it is considered that this is the general meaning of the word.

App. 3.2.2 *Same-sex marriage*

The Marriage (Same Sex Couples) Act 2013 ("**M(SSC)A**") provides separate rules for:

(1) existing legislation[3] and
(2) new legislation[4]

I refer to "**pre- and post- 2013 legislation**".

For pre-2013 legislation, para 1 sch 3 M(SSC)A provides:

> (1) In existing England and Wales legislation—
> (a) a reference to marriage is to be read as including a reference to marriage of a same sex couple;
> (b) a reference to a married couple is to be read as including a reference to a married same sex couple; and
> (c) a reference to a person who is married is to be read as including

[1] *Holland v IRC* [2003] STC (SCD) 43; *Burden v UK* [2007] STC 252; *Smith v Lancashire Teaching Hospitals NHS Trust* [2016] EWHC 2208 (QB).

[2] *Vestey v IRC* 31 TC 1.

[3] Section 11(7) M(SSC)A provides a definition: "In schedules 3 and 4 "existing England and Wales legislation" means—
(a) in the case of England and Wales legislation that is primary legislation, legislation passed before the end of the Session in which this Act is passed (excluding this Act) [17 July 2013] or
(b) in the case of England and Wales legislation that is subordinate legislation, legislation made on or before the day on which this Act is passed (excluding legislation made under this Act)" [17 July 2013] .

[4] Section 11(7) M(SSC)A provides a definition: "In schedules 3 and 4 ...
"new England and Wales legislation" means—
(a) in the case of England and Wales legislation that is primary legislation, legislation passed after the end of the Session in which this Act is passed, or
(b) in the case of England and Wales legislation that is subordinate legislation, legislation made after the day on which this Act is passed."

> a reference to a person who is married to a person of the same sex.
>
> (2) Where sub-paragraph (1) requires a reference to be read in a particular way, any related reference (such as a reference to a marriage that has ended, or a reference to a person whose marriage has ended) is to be read accordingly.
>
> (3) For the purposes of sub-paragraphs (1) and (2) it does not matter how a reference is expressed.

For post-2013 legislation, para 5(1) sch 3 M(SSC)A provides:

> (1) This paragraph applies to provision made by—
>
> (a) this Act and any subordinate legislation made under it, or
>
> (b) new England and Wales legislation,
>
> including any such provision which amends existing England and Wales legislation.

Three sets of definitions follow. The first concerns the ubiquitous terms husband/wife/widow/widower:

> (2) The following expressions have the meanings given—
>
> (a) "husband" includes a man who is married to another man;
>
> (b) "wife" includes a woman who is married to another woman;
>
> (c) "widower" includes a man whose marriage to another man ended with the other man's death;
>
> (d) "widow" includes a woman whose marriage to another woman ended with the other woman's death;
>
> and related expressions are to be construed accordingly.

The other definitions concern expressions found only after the M(SSC)A:

> (3) A reference to marriage of same sex couples is a reference to—
>
> (a) marriage between two men, and
>
> (b) marriage between two women.
>
> (4) A reference to a marriage of a same sex couple is a reference to—
>
> (a) a marriage between two men, or
>
> (b) a marriage between two women.

I do not know why a distinction is drawn between pre- and post-2013 legislation. The Act's explanatory notes discuss the provisions without answering this question.[5] For instance, the definition of "relevant person"

[5] 103. Part 1 sets out details of how particular terms used in existing legislation in England and Wales are to be read once marriage of same couples becomes possible.

The particular terms mentioned in paragraph 1 are references to a marriage, a married couple or married person in existing legislation in England and Wales; these are to be read as also referring to a marriage of a same sex couple, married same sex couples or to a person married to someone of the same sex.

104. Under paragraph 1(2), such references are also to be read across to, for example, cases where a marriage has ended. A reference to a person as a widow would be read as including a reference to a woman whose marriage to another woman ended with the other woman's death, for example.

105. Paragraph 1(3) ensures that existing England and Wales legislation will be interpreted in accordance with paragraphs 1(1) and (2) no matter what language it uses in making reference to any of the relevant concepts.

106. Paragraph 2 particularly deals with references to couples living together as if married; these are to be read as also referring to a person who is living with someone of the same sex as if they are married.

107. Paragraph 3 deals with legislation where there is existing provision which deals differently with a man and a woman living together as if married, and a same sex couple living together as if civil partners. The effect of this paragraph is to preserve the current effect for same sex couples despite the introduction of marriage of same sex couples. In other words, the current distinction is maintained by which an unmarried opposite sex couple are treated as if married, while an unmarried same sex couple not in a civil partnership are treated as if in a civil partnership.

108. Paragraph 4 ensures that the terms specified in Part 1 of Schedule 3 are not the only terms whose meaning will change once marriage of same sex couples becomes possible.

Examples

- Section 105(1) of the Children Act 1989, as amended, defines the meaning of "child of the family" for the purposes of that Act:

> *""child of the family", in relation to parties to a marriage, or to two people who are civil partners of each other, means –*
> *(a) a child of both of them, and*
> *(b) any other child ... who has been treated by both of them as a child of their family;".*

The effect of paragraph 1(1)(a) of Schedule 3 means that the reference to "parties to a marriage" is to be interpreted now as including a reference to a marriage of a same sex couple.

- Section 144(4) of the Adoption and Children Act 2002 defines the meaning of "a couple" for the purposes of that Act:

> *"In this Act, a couple means –*
> *(a) a married couple, or*
> *(aa) two people who are civil partners of each other, or*
> *(b) two people (whether of different sexes or the same sex) living as partners in an enduring family relationship.".*

Paragraph 1(1)(b) allows for the reference here to a married couple now to include a married same sex couple.

- Section 2(1) of the Offices, Shops and Railway Premises Act 1963 as amended in the ITA remittance basis includes "the individual's husband or wife."[6] In new legislation that wording would include parties to a same-sex marriage. By normal rules of construction, that should not apply to pre-2013 legislation! That would be a strange result. It is suggested that the courts should apply a commonsense approach, that (where the context requires, as it normally will) references in pre-2013 legislation to husbands and wives should include same sex spouses, even though that essentially requires one to ignore the words of schedule 3. This is consistent with s.11 M(SSC)A:

> (1) In the law of England and Wales, marriage has the same effect in relation to same sex couples as it has in relation to opposite sex couples.
> (2) The law of England and Wales (including all England and Wales legislation whenever passed or made) has effect in accordance with subsection (1).

In Scotland the position is governed by the Marriage and Civil Partnership

states that: "This Act shall not apply to any premises to which it would, apart from this subsection, apply, if none of the persons employed to work in the premises is other than the husband, wife, civil partner ......of the person by whom they are so employed." The terms "husband" and "wife" here refer to a person who is married for the purposes of paragraph 1(1)(c) of Schedule 3. This means that "husband" here will be read as including a man or a woman in a marriage of a same sex couple, as well as a man married to a woman. In a similar way, "wife" will be read as including a woman married to another woman or a man married to a man. The result is that this section is to be read as including both male and female spouses in marriages of same sex couples.
Part 2 – New England and Wales legislation
109. Part 2 governs how new legislation made after the passing of this Act is to be interpreted. It sets out the meanings of specific words relating to marriage (such as "husband" and "wife"). It reflects the main principle of the Act, which is to put marriage of same sex couples on an equal footing with marriage of opposite sex couples. This will ensure that gender-specific terms such as "husband" keep their gender-specific effect.
110. It should be noted that in Part 7 of Schedule 4, paragraph 27 provides a power for the Secretary of State to modify or disapply the provisions of Schedule 3 in specified circumstances.
Example
- The term "husband" will in future legislation include a man who is married to another man (but not a woman married to another woman); and "wife" will include a woman who is married to another woman (but not a man married to another man) unless specific alternative provision is made.

[6] See 18.4 (Relevant person: Family).

(Scotland) Act 2014. In Northern Ireland the position is governed by section 8 of the Northern Ireland (Executive Formation etc.) Act 2019, which refers to "Same sex marriage and opposite sex civil partnership".

App. 3.2.3 *"Spouse" in special contexts*

For the definition of "spouse" in particular contexts, see:

Context	**See**
Settlor-interested trust code	47.6.3
USA IHT DTA	119.12.2

App. 3.2.4 *"Spouse" in general speech*

UK legislation distinguishes between a civil partner and a spouse in its terminology and, strictly, the word "spouse" does not (in the absence of special context) include a civil partner. However for (almost[7]) all legal purposes the two are in the same position. In loose language they are elided because it is tiresome to constantly refer to spouse/civil partner.

So in this book "spouse" is generally used to mean either a spouse or a civil partner. The Law Commission has done the same.[8]

In the 2018/19 edition of this work I said:

> I expect this is standard usage outside the formal context of statutes and legal documentation such as trusts and wills.

Popular usage might change following the introduction of mixed-sex civil partnerships in 2019. Those who choose civil partnership rather than marriage presumably do so specifically because they do not like the institution or vocabulary of marriage/husband/wife/spouse, and its perceived connotations. Conversely, some will champion marriage over civil partnership.[9] The legislation does not determine the social meaning of civil partnerships, except, perhaps, the prohibition of religious

[7] Under foreign law, a civil partner may not be regarded as married, even though a same sex marriage may be recognised: see 119.12.2 ("Spouse" in US/UK IHT DTA).

[8] Law Commission, *Intestacy & Family Provision Claims on Death* (2011), para 1.38: "The legal treatment of husbands, wives and civil partners is identical in the law of intestacy and family provision claims, and for brevity we use the term "spouse" in this Report to refer to all three..."

[9] For instance, "Civil Partnerships – for same sex and opposite sex couples. A pastoral statement from the House of Bishops of the Church of England" (2019) *https://www.churchofengland.org/sites/default/files/2020-01/Civil%20Partnerships%20-%20Pastoral%20Guidance%202019%20%282%29.pdf*

ceremony. But I expect "spouse" will continue to be used to include civil partners, at least as long as there is no convenient word which refers to both.

App. 3.3 "Civil partner"

Schedule 1 Interpretation Act 1978 provides:

> "Civil partnership" means a civil partnership which exists under or by virtue of the Civil Partnership Act 2004 (and any reference to a civil partner is to be read accordingly).

This takes us to s.1(1) Civil Partnership Act 2004 which provides:

> A civil partnership is a relationship between two people ("civil partners")—
> (a) which is formed when they register as civil partners of each other—
> (i) in England or Wales (under Part 2),
> (ii) in Scotland (under Part 3),
> (iii) in Northern Ireland (under Part 4), or
> (iv) outside the UK under an Order in Council made under Chapter 1 of Part 5 (registration at British consulates etc. or by armed forces personnel), or
> (b) which they are treated under Chapter 2 of Part 5 as having formed (at the time determined under that Chapter) by virtue of having registered an overseas relationship. ...

Thus there are two types of civil partnership:
(1) those made under UK law, and
(2) overseas relationships.

App. 3.3.1 *Foreign civil partnership*

Section 212(1) CPA 2004 provides:

> For the purposes of this Act an overseas relationship is a relationship which—
> (a) is either
> [i] a specified relationship or
> [ii] a relationship which meets the general conditions, and
> (b) is registered (whether before or after the passing of this Act) with a responsible authority in a country or territory outside the UK ...

Thus there are two types of overseas relationships:
(1) specified ones, and

(2) those not specified which meet the general conditions.

Section 213 and schedule 20 CPA 2004 defines "specified relationships". It was amended in 2019 to include same sex relationships.

Section 214 CPA 2004 explains the "general conditions":

> The general conditions are that, under the relevant law—
> (a) the relationship may not be entered into if either of the parties is already a party to a relationship of that kind or lawfully married,
> (b) the relationship is of indeterminate duration, and
> (c) the effect of entering into it is that the parties are—
> (i) treated as a couple either generally or for specified purposes, or
> (ii) treated as married.

Section 214 CPA 2004 in Scotland is slightly different:

> The general conditions are that, under the relevant law—
> (a) the relationship may not be entered into if either of the parties is already a party to a relationship of that kind or lawfully married,
> (b) the relationship is of indeterminate duration, and
> (ba) **the relationship is not one of marriage,**
> (c) the effect of entering into it is that the parties are—
> (i) treated as a couple either generally or for specified purposes, **but are not treated as married**.

App. 3.3.2 *Pre-2000 foreign civil partnership*

Section 215 CPA 2004 provides:

> (1) Two people are to be treated as having formed a civil partnership as a result of having registered an overseas relationship if, under the relevant law, they—
> (a) had capacity to enter into the relationship, and
> (b) met all requirements necessary to ensure the formal validity of the relationship.
>
> (2) Subject to subsection (3) and (5B),[10] the time when they are to be

[10] Subsection (5B) regarding the commencement date is numbered as (5F) in Northern Ireland; in Scotland, the Civil Partnership (Scotland) Bill (introduced 2019) will insert a subsection (3A) pertaining mainly to subordinate legislation to be made by Scottish Ministers.

> treated as having formed the civil partnership is the time when the overseas relationship is registered (under the relevant law) as having been entered into.
> (3) If the overseas relationship is registered (under the relevant law) as having been entered into before this section comes into force, the time when they are to be treated as having formed a civil partnership is the time when this section comes into force.

Persons with existing overseas relationships became civil partners in England law without doing anything more.

The IHT Manual provides:

> **IHTM11032 definition of spouse and civil partner** [Jan 2020]
> Civil partners are same-sex couples who have entered into a contractual partnership formally recognised by law under the Civil Partnership Act 2004, which came into effect on 5 December 2005. In addition to civil partnerships formed in the UK, the Act recognises some overseas relationships, in particular the specified relationships listed in its own Schedule 20. It should be remembered that under Section 216 of the Civil Partnership Act 2004 it is essential that both the partners were of the same sex when the partnership was formed. A relationship such as the French pacte civil de solidarité is open to partners of opposite sexes as well as partners of the same sex – in practice it has come to be seen by opposite-sex couples as an optional prelude to marriage – but the exemption available for transfers between civil partners is available only where the overseas civil partnership is formed by a same-sex couple. The same applies to the exemption for gifts on the registration of a civil partnership (IHTM14191).
> The term 'civil partners' will not apply to those individuals whose civil partnership had been dissolved by a court order before the date of death/transfer.

App. 3.3.3 *The future*

Civil partnership formations declined sharply following the introduction of same-sex marriage in 2014 in England[11] and Scotland[12], at which point it seemed that the institution might fade away for lack of use. But following the extension of civil partnership to opposite-sex couples in

[11] Marriage (Same Sex Couples) Act 2013
https://www.legislation.gov.uk/ukpga/2013/30/contents/enacted/data.htm

[12] Marriage and Civil Partnership (Scotland) Act 2014
https://www.legislation.gov.uk/asp/2014/5/contents/enacted

England in 2019[13] and in Scotland in 2020, it has become more popular.[14] In Northern Ireland, civil partnerships for opposite-sex couples both became available in 2020.[15]

7,566 opposite-sex civil partnerships were formed in England and Wales in 2020, of which 7,208 were registered in England and 358 were registered in Wales. By contrast, 785 civil partnerships were formed in England and Wales in the same year, of which 745 were in England and 40 were in Wales; this represents the lowest number recorded for England since the introduction of same-sex civil partnerships in 2005.[16]

App. 3.4 Living together as husband/wife

App. 3.4.1 *Cohabitee treated as spouse*

As noted above, the term "spouse" does not include those living together but not married. Contemporary anti-avoidance provisions referring to spouses generally extend the provision to apply to cohabitees, ie a cohabitee is treated in the same way as a spouse.

For instance, s.809M(3) ITA provides:

> For that purpose—
> (a) a man and woman living together as husband and wife are treated as if they were husband and wife;
> (b) two people of the same sex[17] living together as if they were civil partners of each other are treated as if they were civil partners of each other.

This provision treats cohabitees as married persons and so relevant persons. In 2008 this was a relatively new development in tax; but it has become standard, reflecting contemporary social practice and attitudes to cohabitation.

[13] Civil Partnerships, Marriages and Deaths (Registration etc.) Act 2019 *https://www.legislation.gov.uk/ukpga/2019/12/contents/enacted*

[14] Civil Partnership (Scotland) Act 2020 *https://www.legislation.gov.uk/asp/2020/15/enacted*

[15] Northern Ireland (Executive Formation etc) Act 2019 *https://www.legislation.gov.uk/ukpga/2019/22/contents/enacted*

[16] Office for National Statistics: Civil Partnerships in England and Wales 2020 *https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/marriagecohabitationandcivilpartnerships/bulletins/civilpartnershipsinenglandandwales/2020*

[17] The words "of the same sex" are not appropriate following the introduction of mixed sex civil partnerships, but no doubt we shall muddle through.

At first sight the reference to civil partners seems otiose after 2013, now that we have same-sex marriages; but it is appropriate for cohabitees in jurisdictions where civil partnership is recognised but same-sex marriage is not (which included Northern Ireland in the period 2015 - 2020).

App. 3.4.2 *Rules excluding separated spouse*

Conversely, statute occasionally provides rules which only apply to spouses who are living together. Examples are:

(1) CGT spouse exemption

(2) Only one residence of spouses living together can qualify for private residence relief

The definition of relevant relationship in the SRT illustrates both rules: it excludes spouses who are separated, but includes cohabitees. The expression "living together"[18] is therefore important for tax, both for married and unmarried couples.

App. 3.4.3 *Living together: Married couple*

For married couples, s.1011 ITA provides:

> Individuals who are married to, or are civil partners of, each other are treated for the purposes of the Income Tax Acts as living together unless—
>
> (a) they are separated under an order of a court of competent jurisdiction,
>
> (b) they are separated by deed of separation, or
>
> (c) they are in fact separated in circumstances in which the separation is likely to be permanent.

Section 288(3) TCGA incorporates this definition for CGT.

Section 1116 CTA 2010 repeats the definition verbatim for the purpose of Part 23 CTA 2010 (company distributions). Perhaps the expression is not found elsewhere in the CT legislation. Elsewhere the definition is incorporated by reference.

For the position where one spouse is non-resident, see 93.13 (Non-resident spouse).

App. 3.4.4 *Living together: unmarried couple*

The Law Commission consultation paper "Intestacy and Family

[18] See App 3.4.3 (Living together: married couple).

Provision" (2009) is a convenient starting point:

> 2.70 The requirement that the applicant should have been living "as" the spouse or civil partner of the deceased has been the subject of analysis by the courts. In *Re Watson*, it was said that the test is:
>
> > whether, in the opinion of a reasonable person with normal perceptions, it could be said that the two people in question were living together as husband and wife; but, when considering that question, one should not ignore the multifarious nature of marital relationships.[19]
>
> 2.71 Accordingly, it was not determinative in that case that Mr Watson and Miss Griffiths had not continued a sexual relationship during the period when they were living together, nor that they had informally agreed to share outgoings, nor that Miss Griffiths had rejected Mr Watson's marriage proposal. On the whole of the evidence the judge reached the conclusion that Miss Griffiths had been living "as the wife" of Mr Watson.
>
> 2.72 The couple must have been living in the same household, which means that it does not matter if the parties each have a separate home, provided that they have formed one joint household. It has been said that this seems:
>
> > To have elements of permanence, to involve a consideration of the frequency and intimacy of contact, to contain an element of mutual support, to require some consideration of the degree of voluntary restraint upon personal freedom which each party undertakes, and to involve an element of community of resources.[20]

The Claimant Compliance Manual provides:

> **CCM15040 Couples who are Unmarried and Not Civil Partners** [Oct 2017] ... The legislation does not say what conditions must exist before we will conclude that a couple are LTAHAW [living together as husband and wife].[21]

[19] Footnote original: [1999] 1 FLR 878, 883, by Lord Neuberger of Abbotsbury.

[20] Footnote original: *Churchill v Roach* [2002] EWHC 3230. See also *Kotke v Saffarini* [2005] EWCA Civ 221, [2005] 2 FLR 517, a case on similar wording in section 1(3)(b) of the Fatal Accidents Act 1976, where the CoA held at [59] that it was correct to distinguish between "wanting and intending to live in the same household, planning to do so, and actually doing so".

[21] The latest figures published by the Office of National Statistics (in January 2015) estimate that the number of married couple families in the UK increased by 266,000 between 2004 and 2014, to 12.5 million and that there were nearly 3 million opposite sex cohabiting couple families and 84,000 same sex cohabiting couple families in 2014. See *http://www.ons.gov.uk/ons/dcp171778_393133.pdf*

We have therefore adopted the approach used by the DWP. Using the same approach for same-sex couples means they are not treated any more or less favourably.

Since 1977 the Department for Work and Pensions (DWP - formerly the Benefits Agency) has followed a standard approach to the question of whether a man and woman are living together based on a list of criteria to be considered both individually and as a whole. Working Families' Tax Credit (WFTC) adopted the same criteria and this has continued for WTC and CTC. This approach ensures unmarried couples are not treated any more or less favourably than married couples.

Living together as husband and wife (LTAHAW) has its normal meaning in every day language, but the Courts and administrative practice have developed a number of criteria to help apply that meaning to every day situations. They are:-

- living in the same household - CCM15070-CCM15075
- stability of relationship - CCM15080
- financial support - CCM15090
- dependent children - CCM15100
- public acknowledgement - CCM15110

Remember that these are only indicators to help you form a sustainable view of whether a couple are living together for the purposes of the tax credit claim. They are not intended as a crude checklist and you should not apply a blanket "four out of five ticked" type test. The weight and worth of each indicator will vary from relationship to relationship and you should arrive at your conclusions on the balance of evidence, based on the facts (see CCM15060). However, you need to be aware of the changing nature of relationships - see CCM15045.

CCM15045 Modern-Day Relationships [August 2016]

Since the LTAHAW criteria was devised in the 1970's, the UK has undergone major social and economic changes. These have had an impact on the nature of personal relationships.

In the 1970's a typical couple might not have lived together before marriage and, after marrying, they might have pooled the whole of their income with the man as the main breadwinner and the woman possibly working part-time and responsible for childcare and running the household.

By 2004, 70% of first domestic partnerships involved unmarried couples and it is now common for each party in a couple to work full-time, keep their own incomes and bank accounts and perhaps only pay money into a joint account for items of joint responsibility. Often because of demands on time both parties share childcare and domestic tasks.

It may therefore be more difficult to identify the criteria shown at CCM15040 but you should still explore all of these items.

CCM15060 Balance of Evidence [August 2016]

It is not possible to lay down hard and fast rules about the weight and worth of the various criteria in establishing that a couple are living together. You will need to decide every case on its merits and on the balance of evidence. Sometimes the conclusion will be obvious, and at other times it will be a very fine judgement. Although you must consider each of the five criteria listed at

CCM15040 you might not be able to gather evidence for each of them. For example the customer might say they have no idea what others think of their relationship.

If you are having difficulties in making up your mind about what the evidence means, you may find it helpful to list the evidence on both sides of the argument. This should help you identify where the balance of evidence lies – though you should not base your decision on a crude numerical assessment, as some elements of the evidence may be far more critical than others.

...

App. 3.4.5 *Living in the household*

The Claimant Compliance Manual provides:

CCM15070 Living in the Same Household [Oct 2017]

The customer may admit they live in the same household as the suspected partner but that does not automatically mean they are Living Together as Husband and Wife (LTAHAW), Living Together as Civil Partners (LTACP) or Living Together as a Same Sex Couple (LTAASSC).

There may be any number of reasons why a man and woman share accommodation. They include:

- a couple with disabilities or ill health may care for and support each other
- one of them may require care/support to live a normal life
- the customer may provide accommodation for a friend, or relative or tenant
- the customer may have been provided with accommodation by a friend, relative or landlord in that person's own home.
- a formerly married or unmarried couple may still live in the same house until they reach a financial agreement. During periods when property prices or rents are high, the property market is sluggish, or negative equity is common, former couples may be compelled by economic necessity to share the same premises for some time after the relationship has ended- see CCM15395

The relevant factors to consider when determining whether a couple are living in the same household may be:-

- how/why the couple came together
- is rent received or paid? If so the income will (unless it is exempt under the rent a room scheme) be treated as income in the hands of the recipient.
- what kind of accommodation they share
- if there is no formal rent agreement how are costs shared? How would exceptional expenditure be met? For example, if major unexpected repairs had to be carried out or home improvements made.
- any absences from the household - why and how often - see CCM15073
- any other reasons for them living in the same household.

Even if you establish a couple are living in the same house this does not necessarily mean they are LTAHAW, LTACP or LTAASSC. Before you can amend the award you must therefore consider the other criteria detailed at CCM15080-CCM15110.

CCM15073 Absences From The Home [Oct 2017]

Absences from the home, whether occasional or regular, do not necessarily mean that a couple is not LTAHAW, LTACP or LTASSC. For instance, the absence could be due to:-

- work (eg. oil rig worker or long distance lorry driver)
- hospital in-patient
- holiday
- visit to relatives
- higher education
- custody of less than 52 weeks
- armed forces

This list is not exhaustive, but gives some suggestions to the types of absence. The common feature of all of these reasons for absence is their temporary nature. There is no specific period of time after which an absence ceases to be temporary and you will need to draw conclusions based on the particular facts of each case. Factors to be considered include:

- the length of the absence
- how much longer it is expected to last
- to what extent the couple have maintained contact
- their future intentions

One situation you might encounter is where the partner works away for a few days at a time and either lives with friends or in hotels/bed and breakfast accommodation. They only return to the customer's home for a couple of days at a time, the suggestion is this is purely to see the children and they stay at the customer's home as they have nowhere else to stay in the area. As well as exploring the other criteria described in CCM15080-CCM15110 you will need to establish

- the reason why they have this arrangement
- how long has the arrangement lasted
- how much longer is it likely to last?
- what would happen if the partner lost their job?

CCM15075 Undisclosed Partner has No Other Address [Oct 2017]

A customer may accept that the suspected partner uses their address for mailing purposes. This could be for:

- tax and benefit purposes
- financial purposes (bank account, credit card, loan)
- for motor vehicle purposes (insurance, vehicle registration)

The customer might suggest this is because the suspected partner has no fixed abode and simply drifts around a series of friends or because their mail is not secure at their own home.

You are entitled to ask for evidence of the suspected partner's other accommodation address and often an appeal tribunal will ask for this sort of information. However, you cannot demand that they provide such information nor can you say that if they do not provide evidence of an alternative address you will treat them as LTAHAW or LTACP and terminate their award.

The absence of such evidence is not conclusive proof that the customer is living with the suspected partner. Where the customer cannot provide such evidence you must still look at all of the other criteria and decide their various strengths and weaknesses. In addition, you should consider whether it is reasonable for the suspected partner to be using the customer's address.

App. 3.4.6 *Stability of relationship*

The Claimant Compliance Manual provides:

> **CCM15080.Stability of Relationship** [Oct 2017]
> The length of time a couple have been together does not necessarily indicate how stable the relationship is. At one end of the scale you may come across couples who have known each other only a few weeks or days, but who have moved in together with the firm intention of staying together.[22] At the other end of the scale may be couples who have divorced after say 25 years of marriage and who are still both occupying the formal marital home until they can afford to live apart. Some couples may also have a history of repeated temporary splits and reconciliations.
> Relevant factors may be:–
>
> - on what basis they split household chores and responsibilities, such as cooking, cleaning and paying bills
> - whether they are both involved in caring for any children who live in the household
> - whether they tend to spend their leisure time together or separately
> - whether they normally take joint holidays
> - whether they plan any future activities or responsibilities jointly or separately
> - whether they intend to get engaged or married
> - whether the relationship has a volatile history ie. the couple is known to have had several splits and reconciliations.
>
> An established pattern of domestic or financial activity will usually indicate an established relationship.
> **CCM15090 Financial Support** [Oct 2017]
> How a couple organise their finances will vary from couple to couple. Relevant factors may be:
>
> - the existence of joint accounts or investments. If the customer claims that the joint account is being maintained because one of them is credit blacklisted, does the pattern of transactions suggest that the other person is withdrawing his/her wages for their own use? Or are there indications that the wages are available to meet general household expenditure?
> - the extent to which money and other financial resources are pooled.
> - who pays the household expenses?
> - whether the suspected partner makes regular payments to the customer, and if so, what they are for.
> - whether the suspected partner would provide financial support if the customer's income ceased.

[22] The RDR Manual makes the same point:

> **RDRM33030. Relevant person - definition** [Jan 2019]
> ... There is a no minimum period for cohabitation; it is a question of fact as to whether two individuals are living together as spouses or civil partners.

- whether the customer would support the suspected partner if their income ceased.
- whether a set amount of maintenance to be paid by the absent parent following a decision by the CSA or a binding agreement between the parties.

At any meeting you should attempt to establish the customer's incomings and outgoings so that you can see whether they could exist on their own income. If you have already seen bank statements and household bills you should be ready to challenge suspect items. For example deposits into the bank account, direct debits, patterns of withdrawal or any expenses for which you would have expected to see bills but none have been produced.

App. 3.4.7 *Dependent children*

The Claimant Compliance Manual provides:

CCM15100 Dependent Children [Oct 2017]
Joint responsibility for a child or children (who may belong to either or both of the couple) may be an indication that the couple is LTAHAW or LTACP, but it is not conclusive proof. Relevant factors may be:

- parentage of the child or children.
- whether, and how, the couple exercises joint responsibility, for example:
  - who visits the school or delivers/collects to and from the school
  - who would the school contact in an emergency
  - who arranges and takes the children to and from medical and dental appointments
  - who exercises control of or offers guidance to the children
  - who the Child Benefit Office has as the alternative payee
  - who provides financial support/pocket money/pays for treats
  - who buys the clothes and or toys.

An intention to adopt by the non-birth partner could be a particularly telling indication of the couple's long term view of the family unit. You should not, because of its sensitivity, seek out the information; but if it is spontaneously offered you should give it proper weight in arriving at your conclusions. Be wary of drawing conclusions about the current relationship based on say the fact that the children continue to be known by the surname of the ex-husband or ex-partner as this is common practice and is not evidence of a continuing relationship between the parents. Nor does the presence of photographs of the child's father or mother indicate the customer is living with that person.

App. 3.4.8 *Public acknowledgement*

The Claimant Compliance Manual provides:

CCM15110 Public Acknowledgement [Oct 2017]
An important consideration is how the outside world (including family, friends, neighbours, social workers, employers, schools, childcare providers, etc.), perceive the couple. Relevant factors may be:

- Whether both members use the same surname

- Whether schools/child care providers/employers/others regard them as a couple
- Whether they engage in social activities together
- Whether they are joint members of clubs/leisure centres/societies
- Whether they plan and organise their lives jointly.

CCM5500 lists the third parties you can legally approach for information during the course of your examination. You cannot obtain information from family members, friends, neighbours, social workers or schools, unless they also fall into one of the categories listed at CCM5500.

For example – A family member may also be an employer, or a neighbour may also provide registered child care. But it is perfectly acceptable for you to ask the customer what their family/neighbours etc. would say if they were asked whether they regarded him/her as being a member of a couple.

App. 3.4.9 *Sexual relationship*

The Claimant Compliance Manual provides:

CCM15120 Sexual Relationship [Jan 2021]

DWP used to consider the couple's sexual relationship as one of the criteria for determining LTAHAW but this is no longer the case. The couple's sexual relationship is of little help in deciding whether they are living together as husband and wife or living together as civil partners. There may be no sexual relations in a marriage or civil partnership and sexual relationships of a casual nature, where neither partner has any lasting commitment to the other, are a common feature of contemporary life.

You must not ask any questions about a couple's sexual relationship. If the customer introduces the subject, you should take note of any information volunteered but should bear in mind (and explain to the customer) that it is unlikely to have any relevance to the question of whether they are living together as husband and wife.

Appeal tribunals sometimes ask customers about their sexual relationships, however, it remains our policy that you must not ask such questions. If a tribunal asks you why you have not established the position you should say that our internal policy, in common with that in DWP, is not to ask about this side of the relationship.

In one particular appeal case the Social Security Commissioner said that where there has never been a sexual relationship between the parties, strong alternative grounds are needed to reach the conclusion that the relationship is akin to husband and wife. However, absence of a sexual relationship at anytime where there has been one in the past is not itself indicative that the couple are not LTAHAW.

Where the customer's sole objection to your conclusion is that they have no sexual relationship with the suspected partner or they appeal against a decision on these grounds you should seek further advice via your TALLO from Technical Advice Line.

App. 3.4.10 *Reasons against living together*

The Claimant Compliance Manual provides:

CCM15150 Reasons for Failure To Report A Partner [Oct 2017]

Customers may offer a range of reasons or excuses for their failure to report the existence of a partner. These may include:

- S/he does not stay here all of the time - see CCM15073.
- S/he lives at another address but uses my address as a post box - see CCM15075.
- I thought s/he could stay 3 nights a week without it affecting my entitlement.
- S/he does not give me any money, or payments are not regular - see CCM15090.
- S/he is not the mother/father of my child (ren).
- S/he is a lodger - see CCM15070.
- S/he is just a friend.
- It is hard being a single parent.
- The Government does not pay people like me enough.
- The rules on income are not fair.
- We do not have a sexual relationship - see CCM15120.

The 3 nights rule is a popular misconception. No such legal loophole exists. If a suspected partner spends 3 nights with the customers on a regular basis, s/he may be a member of an established couple. Also, the children's parentage is not, in isolation, reliable evidence.

You will need to explain to the customers the criteria which we use to determine whether they are living together as husband and wife, living together as civil partners or living together as a same sex couple, see CCM15040. You will then need to establish the facts by considering all the evidence from all legally available sources, including the customer. Note: The Marriage (same sex couples) Act 2013 extended marriage to same sex couples. See TCTM06100 for the definition of a couple.

App. 3.4.11 *Privacy*

The Claimant Compliance Manual provides:

CCM15160 Respecting Customer's Privacy [Oct 2017]

In all your contacts with customers you must always be aware of Human Rights issues, and of the need to respect the customer's privacy. It is particularly important that you adopt this approach in any discussions which may touch on their private life.

You should avoid any impression that you are examining the customer's home or household for signs of any such relationship. You must not ask about the customer's sleeping arrangements in an attempt to find out whether s/he shares a bedroom with another adult.

Customers may however volunteer information of this kind when, for example, confirming the number of children who live there; describing how friends or relatives sometimes stay to help out with childcare or explaining that their ex-partners stays in the spare room whenever they come to visit the children. If the customer simply says their partner stays overnight when they come to visit or care for the children you must not ask where they sleep.

You should not normally ask customers about the number of bedrooms in their house but if the customer has suggested that an adult who lives in the house is a paying lodger, it is reasonable to expect the lodger would have his/her room rather than sleeping on a sofa or floor.

In the circumstances it will be appropriate to ask how many bedrooms there are and what room(s) the lodger occupies, and to test the answer in the light of other information/evidence. The number of bedrooms and the ages/sexes of the other occupants of the house will be relevant. For example the customer may live in a 3 bedroom house with 2 children, a boy of 12 and a girl of 16, and it will be reasonable to ask what arrangements have been made so that the lodger can occupy his/her own room.

It is important that any questions you need to ask should be directed at establishing the room the lodger occupies and their relationship with the customer and not at establishing who the customer sleeps with.

CCM15170 (This text has been withheld because of exemptions in the Freedom of Information Act 2000) [Oct 2017]

CCM15180 (This text has been withheld because of exemptions in the Freedom of Information Act 2000) [Oct 2017]

CCM15190 Customer Has Been Involved in Different Relationships [Oct 2017]

Where the customer has been involved in relationships with different partners at different times during the year, you should treat the ending of one and beginning of another as a CoC on each occasion. However, where the customer has split up and reconciled with the same partner, you should normally ignore the splits and treat the customer and partner as a couple throughout the period.

If the customer objects to this approach you should consider whether in spite of the temporary break in the relationship, the customer and partner would still be considered a couple in accordance with other relevant criteria eg. nature of any financial support. If you cannot establish that the couple were effectively living together throughout the period, you should apply the CoC provisions to each break in the relationship.

App. 3.4.12 *Date relationship begins*

The Claimant Compliance Manual provides:

CCM15195 Date on which Customers Became A Couple [Oct 2017]

The question of whether the customer was in reality a member of a couple is not just relevant to the date at which the claim commenced. Becoming or ceasing to be a member of a couple is a notifiable change of circumstances so it is also relevant at all other times during the year.

You will sometimes have evidence that places the suspected partner at the customer's address at one or more dates during the year for example a series of letters signed by the partner to his/her employer or tax office. However, you may not be able to point to anything which strongly indicates their presence at the beginning of the year or claim period.

When challenged about the existence of a partner, customers may be reluctant to admit to their failure to declare the partner on the claim, claiming instead that s/he only moved in some time later.

You will need to use your judgement in these cases. As a general rule if you are confident the evidence you have is reasonable proof that the customer was a member of a couple from the date the claim commenced, you should put that date forward to the customer. If you feel there is some doubt around that date, or you would have difficulty in substantiating it, but you are convinced that the customer was a member of a couple at some point during the year, you should propose to the customer an appropriate date from which they should be treated as a member of a couple. You should be prepared to negotiate the date with the customer bearing in mind the important factor of getting the claim on the right basis for the future. However, you must remember that your decision may have to be defended before an appeal tribunal so you must have evidence to support the proposal.

App. 3.4.13 *Sources of information*

The Claimant Compliance Manual provides:

CCM15200 Information held by HMRC [Oct 2017]

A case identified for enquiry on the grounds of a suspected undisclosed partner will usually have been selected because information held by us indicates another adult living at the customer's address. The CCRO will have checked HMRC and other databases and other available information sources, before passing the case to you. You will therefore already have most of the evidence you will want to discuss with the customer before you open the case.

The information is likely to include some or all of the following sources.

Type	**Identifies**
Voter's List	Suspected partner listed?
HMRC address database	What address does the HMRC hold for suspected partner?
Telephone Directory	What address/phone number is listed for suspected partner?
Yellow Pages/Other	Ditto for self employed suspected partner.
SA	Ditto for self employed suspected partner.
TRP Data Mart	Any joint bank accounts etc, listed?
COP/CODA	Any additional allowances?
Child Benefit	Partner shown on original claim/as alternative payee?
Previous Claims	Was partner shown on earlier WFTC/DPTC/WTC/CTC claims?
Equifax/Experian	Is suspected partner shown at customer's address?
DWP	Intelligence suggesting a live-in partner?
CSA	Maintenance paid? Reference to partner in interview notes.
Housing or Council Tax Benefit	Details of occupants. CT reduction for single adult being received?

Letters on File	Any indication (particularly recent) of suspected partner living at customer's address?

CCM15210. Information from Customer [Oct 2017]

Despite the information that will have been given to you by the CCRO there will also be information you can only obtain from the customer or with the customer's agreement, for example:

- Bank statements - are they joint? If not, do they contain evidence of joint incomings/outgoings/spending?
- Utilities and other bills - who are these sent to?
- Council tax bills - a single occupier is entitled to a reduction, which will be identified on the statement.
- Mortgage claims/statement - whose name appears on any documentation?
- Rent book - whose name appears in the book as landlord and tenant?
- Hire purchase agreements - whose name is on the documents?
- Services and rentals eg. TV, satellite, telephone agreements - whose name are they in?
- Marriage certificate - does it show a recent marriage to the suspected partner?

(This content has been withheld because of exemptions in the Freedom of Information Act 2000)

App. 3.4.14 *Length of relationship*

The Claimant Compliance Manual provides:

CCM15220 Short Term Relationships [Oct 2017]

In some cases the customer might admit they had a partner during the period under review but says they are no longer a couple. You will need to review the facts to establish whether they are in fact still a couple.

Where the customer admits to a short term relationship which you accept has now ended you will need to decide whether the relationship amounted to them living together as husband and wife (LTAHAW), living together as civil partners (LTACP) or living together as a same sex couple (LTAASSC). You will need to explore the criteria at CCM15040.

There are no hard and fast rules as to the length of time a couple are together before we consider it to be LTAHAW, LTACP or LTAASSC. If they are LTAHAW, LTACP or LTAASSC then we will treat them as a couple for tax credit purposes even if they are only together a short time. However, in reality a short term relationship (less than 3 months) is unlikely to meet the criteria at CCM15040. They may satisfy one of the criteria but not the others. In such cases you will have to use your judgement and you should consult your manager if necessary. Remember your decision may have to be defended before an appeal tribunal so you must have evidence to support the proposal.[23]

[23] Earlier versions of this guidance are (1) The Independent Taxation Manual (paragraphs now withdrawn) and (2) the ACG–WFTC/DPTC Applicant Compliance Guide para 9010 (not set out here as it adds nothing to the Claimant Compliance Manual). The text is in the 9th ed of this work.

App. 3.4.15 *Multiple cohabitees*

The Law Commission consider the salacious possibility that an individual may have more than one cohabitee:

> 4.108 ... where the deceased was a party to more than one cohabiting relationship at the date of death, it may be more difficult to determine whether the deceased "was sufficiently involved in either household for one or both to amount to cohabitation at all".[24] However, cases may arise in which it can be shown that both partners are cohabitants within the definition adopted, for example where there are religious marriages which do not qualify as legal marriages.[25]

App. 3.4.16 *Prohibited relationships*

The Claimant Compliance Manual provides:

> **CCM15025 Prohibited Relationships** [Oct 2017]
> The law prohibits certain relationships by relatives. For example a woman cannot marry or form a civil partnership with her grandfather or her uncle and a man cannot marry or form a civil partnership with his daughter or sister. A full list of prohibited relationships is contained at CCM15030.
> Where you establish that a customer is living as a couple with a relative who appears on the list of prohibited relationships we do not consider this to be an LTAHAW or LTACP situation. The reason for this is that the couple cannot marry or become civil partners in law so we cannot say they are living together as husband and wife as they could never be husband and wife or living together as civil partners as they could never be civil partners. The customer will therefore be treated as a single customer.
> **CCM15030 List of Prohibited Relationships - Marriage** [Oct 2017]
> Throughout the UK and Guernsey, Jersey and the Isle of Man, the law prohibits certain blood relatives, step relatives and relatives-in-law from getting married.
> A man cannot marry his:
>
> - mother
> - adopted mother/ former adoptive mother
> - daughter
> - adoptive daughter/ former adoptive daughter
> - grandmother

[24] Footnote original: Cohabitation: the Financial Consequences of Relationship Breakdown (2007) Law Com No 307, para 3.68.

[25] Footnote original: *Churchill v Roach* [2002] EWHC 3230. See also *Kotke v Saffarini* [2005] EWCA Civ 221, [2005] 2 FLR 517, a case on similar wording in section 1(3)(b) of the Fatal Accidents Act 1976, where the CoA held at [59] that it was correct to distinguish between "wanting and intending to live in the same household, planning to do so, and actually doing so".

- granddaughter
- sister
- aunt
- niece

A woman cannot marry her:

- father
- adopted father/ former adoptive father
- son
- adoptive son/ former adoptive son
- grandfather
- grandson
- brother
- uncle
- nephew

Additionally, people cannot marry if:

- either of them is aged less than 16, or
- in a 'step' relationship, the younger person had, before reaching age 18:
  - lived in the same household as the older person, and/or
  - been treated as a child of the older person's family, or
- in an 'in-law' relationship:
  - either person involved is aged less than 21, and/or
  - any person originally involved in creating the 'in-law' relationship' is still alive, for example we do not consider LTAHAW if a man lives in the same household as his daughter-in-law and the man's son or wife is still alive.

If you are unsure whether the customer is in a prohibited relationship you should seek further advice via your TALLO from Technical Advice Line .

CCM15032. List of Prohibited Relationships - Civil Partners [Oct 2017]

The law in the UK prohibits certain blood relatives, step relatives and relatives by civil partnership from forming a civil partnership. The legislation in Scotland is slightly different from the legislation that applies in England, Wales and Northern Ireland.

In England, Wales and Northern Ireland someone cannot form a civil partnership with their:

- parent
- adopted parent/ former adoptive parent
- child
- adoptive child/ former adoptive child
- grandparent
- grandchild
- brother, sister, half-brother or half-sister
- parent's brother, sister, half-brother or half-sister
- niece or nephew

Additionally, someone cannot form a civil partnership with the:

- Child of former civil partner
- Child of former spouse
- Former civil partner of grandparent

- Former civil partner of parent
- Former spouse of grandparent
- Former spouse of parent
- Grandchild of former civil partner
- Grandchild of former spouse

If:

- either of them is aged less than 21, or
- the younger person had, before reaching age 18:
- lived in the same household as the older person, and/or
- been treated as a child of the older person's family, or

Additionally, someone cannot form a civil partnership with the:

- Child of former civil partner
- Child of former spouse
- Former civil partner of parent
- Former spouse of parent

If:

- either person involved is aged less than 21, and/or
- any person originally involved in creating the relationship is still alive, for example we do not consider LTACP if a woman lives in the same household as her daughter-in-law and the woman's son or husband is still alive.

In Scotland someone cannot form a civil partnership with their:

- parent
- adopted parent/ former adoptive parent
- child
- adoptive child/ former adoptive child
- grandparent
- grandchild
- brother, sister, half-brother or half-sister
- parent's brother, sister, half-brother or half-sister
- niece or nephew

Additionally, someone cannot form a civil partnership with the:

- Child of former civil partner
- Child of former spouse
- Former civil partner of grandparent
- Former civil partner of parent
- Former spouse of grandparent
- Former spouse of parent
- Grandchild of former civil partner
- Grandchild of former spouse

App. 3.4.17 *Same-sex cohabitees*

The M(SSC)A again provides separate rules for existing and for new legislation.

Para 2 sch 3 M(SSC)A provides:

> (1) In existing England and Wales legislation—
>
> (a) a reference to persons who are not married but are living together as a married couple is to be read as including a reference to a same sex couple who are not married but are living together as a married couple;
>
> (b) a reference to a person who is living with another person as if they were married is to be read as including a reference to a person who is living with another person of the same sex as if they were married.
>
> (2) Where sub-paragraph (1) requires a reference to be read in a particular way, any related reference (such as a reference to persons formerly living together as a married couple) is to be read accordingly.
>
> (3) For the purposes of sub-paragraphs (1) and (2) it does not matter how a reference is expressed.
>
> 3 (1) This paragraph applies to existing England and Wales legislation which deals differently with—
>
> (a) a man and a woman living together as if married, and
>
> (b) two men, or two women, living together as if civil partners.
>
> (2) If two men, or two women, are living together as if married, that legislation applies to them in the way that it would apply to them if they were living together as civil partners.

For new legislation, para 5 M(SSC)A provides:

> (1) This paragraph applies to provision made by—
>
> (a) this Act and any subordinate legislation made under it, or
>
> (b) new England and Wales legislation, including any such provision which amends existing England and Wales legislation.
>
> ...
>
> (5) A reference to a same sex couple who are not married but are living together as a married couple is a reference to—
>
> (a) two men who are not married but are living together as a married couple, or
>
> (b) two women who are not married but are living together as a married couple.

Fortunately it will rarely if ever be necessary to distinguish between living together as civil partners or as a married couple.

App. 3.5 "Child"

In the absence of a specific definition, the position is correctly explained in RDR3:

> **C15** A child can be either an individual's own natural child or a child they have adopted. It does not include step-children, unless the individual has adopted them.

In modern legislation the term child is often defined to include step-children.[26]

App. 3.6 Brother/Sister

Similarly, brother/sister does not include step-siblings. Thus the CT Manual comments on the rule that brothers and sisters are "associates"[27]:

> **CTM60150 Tests: Associates** [Nov 2019]
> Other relatives ... should be regarded as associated only if there is a blood relationship, for example, half-brothers are associated but stepbrothers are not...

App. 3.7 Illegitimacy

Section 1 FLRA 1987 provides:

> In this Act and enactments passed and instruments made after the coming into force of this section, references (however expressed) to any relationship between two persons shall, unless the contrary intention appears, be construed without regard to whether or not the father and mother of either of them, or the father and mother of any person through whom the relationship is deduced, have or had been married to each other at any time.

For exceptional cases where illegitimacy still matters, see 39.4.1 ("Family") and 4.4 (Domicile of origin).

[26] For the meaning of "step-children" see Kessler et al, *Drafting Trusts & Will Trusts* (15th ed, 2023), para 5.22 (Stepchildren).

[27] See 104.6.3 (Associates: Relatives).

APPENDIX FOUR

CONSIDERATION, ARM’S LENGTH, FULL VALUE

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App. 4.1 Introduction

This appendix considers a cluster of related expressions and concepts:

- consideration/value of consideration
- market value/full consideration
- arm’s length
- intention to confer gratuitous benefit
- fair bargain

There may be differences in nuance, but in practice these cover the same ground. So I consider them together here, together with the related topics of market-value adjustment clauses and disposals conditional on tax consequences.

The concept of bounty is related to the above, but I discuss that elsewhere.[1]

VAT also has a concept of consideration, but I do not consider that here.

App. 4.2 Consideration

App. 4.2.1 *A technical term*

"Consideration" is a common term in tax and other statutes. The word is not usually defined. It is a technical term in the sense that it has a legal meaning which is not used in non-legal contexts. This is, I think, self-evident but authority can be cited if needed. In *C&E v Apple and Pear Development Council*:[2]

> [1] The word "consideration" is a term of art in English law, and I think that, used in an English[3] statute, it must be assumed to bear its ordinary meaning in the law, save in so far as the provisions of the statute indicate some other meaning.

And again:[4]

> In our view the meaning of the word "consideration" must be the legal meaning of it and not any common or garden meaning; that really goes without saying. ...

The terms "price" and consideration are (more or less) synonymous and no-one suggests that "price" is a technical term.

App. 4.2.2 *Reciprocity required*

In *C&E v Apple and Pear Development Council*:[5]

[1] See 87.5 (Bounty requirement).

[2] *C&E v Apple and Pear Development Council* [1985] STC 383 at p.388.

[3] The reference to an *English* statute is questionable, as the case was concerned with the word (consideration) in a tax statute which also applies in Scotland. But reciprocity is inherent in the general sense of the word consideration. It is not a specifically English law concept; so the point does not matter.

[4] *R v Braithwaite* [1983] 1 WLR 385 at p.391.

[5] *C&E v Apple and Pear Development Council* [1985] STC 383 at p.388.

> In its usage in English law the central feature of consideration is reciprocity ... . Something is given in return for something else. It may, for example, be a promise in return for a promise or a payment in return for a promise. It can be a detriment to the promise or a benefit to the promisor. But whatever its form, I think that reciprocity is involved. It is essentially mutual.

Another example from a non-tax case:[6]

> In our judgment the word "consideration" connotes the existence of something in the shape of a contract or a bargain between the parties. ... Consideration deals with the situation where there is a contract or a bargain[7] and something moving the other way.

Reciprocity is a matter of degree.[8] In *Vaughan-Jones v Vaughan-Jones*:

(1) H died leaving property to his children.
(2) The children entered into a deed of variation giving the property to W (so H's estate qualified for the IHT spouse exemption).
(3) A contemporary note recorded the parties intentions: "the [children] are losing out on a short-term basis, but the plan is to pay as little IHT as possible at this stage and for [W] to transfer as much as she can and survive seven years."

W's plan to give "as much as she can" to the children did not constitute consideration for the gift from the children to the mother. The level of reciprocity was insufficient, or too imprecise:

> ... the expression "any consideration in money or money's worth" [in s.142(3) IHTA][9] is a technical expression which requires a bargain which is sufficiently definite. ... it does not include a generalised intention to give sums of an indefinite amount at an indefinite time in the future, which gives rise to no legally enforceable obligation, and where [W] could, without adverse consequences to herself, change her mind at any time.[10]

Context may of course show that "consideration" is used in a special

[6] *R v Braithwaite* [1983] 1 WLR 385 at p.391.

[7] The reference to a contract *or bargain* anticipates the point made below that consideration does necessarily require a contract.

[8] A similar point arises in the definition of settlor; see 99.4 (Reciprocal arrangements).

[9] See 77.6.3 (Variation for consideration).

[10] [2015] EWHC 1086 (Ch) at [50], [51].

sense.[11] But the above is the starting point.

App. 4.2.3 *Contract not required*

A valid contract in English law requires consideration. But consideration does not require a contract:

> [The reference to consideration in what is now s.5(2)(a) VATA 1984] is not necessarily contemplating the existence of a contract. A barrister, for example, receives consideration for his services from a solicitor, but there is no contract.[12]

And again:

> I reject the contention that [the words] "otherwise than for full valuable consideration" apply only to full valuable consideration under a contract ... they apply whenever full valuable consideration is given, whether under contract or otherwise...
> ... the phrase "for full valuable consideration" is not to be construed as being limited to benefits provided under a contract...[13]

App. 4.2.4 *"Amount or value"*

Statute frequently refers to "amount or value" of consideration (or of a benefit), for instance, in s.38(1) TCGA which restricts CGT deductions to:

> the amount or value of the consideration ... wholly and exclusively for the acquisition of the asset ...

This means: the amount of the consideration, if it is money; or the value of the consideration, if it is not money.[14]

[11] For instance, in the context of VAT, an EU-law concept of "consideration" is adopted in preference to the UK law meaning; though the EU-law concept is also founded on reciprocity, so it is not fundamentally different.

[12] *C&E Commissioners v Apple & Pear Development Council* [1985] STC 383 at p.389. Nowadays there normally is a contract between solicitor and barrister, but that does not affect the point made here.

[13] *Jelley v Iliffe* [1981] Fam 128 at p.136, discussing s.1(3) Inheritance (Provision for Family and Dependants) Act 1975.
Similarly in some tripartite cases the courts have been prepared to regard benefits received as consideration, in the absence of a contractual relationship between the parties, eg *Unilever v IRC* 76 TC 300 in the High Court at [46] reversing the Special Commissioners (but without any substantial discussion of the issue). The CoA did not consider the point.

[14] This is self-evident, but if authority is needed, see *Stanton v Drayton Investments* 55 TC 286 at p.314.

App. 4.2.5 *"Money or money's worth"*

Statute frequently refers to consideration "in money or money's worth". In *Secretan v Hart*:[15]

> The expression "consideration in money's worth" is of course one which is very familiar to lawyers, as being a way of expressing the price or consideration given for property where property is acquired in return for something other than money, such as services or other property. where the price or consideration which the acquirer gives for the property has got to be turned into money before it can be expressed in terms of money.

The expression *money or money's worth* excluded consideration of marriage, but marriage consideration is now an archaic concept.[16]

The expression also excludes consideration of "natural love and affection" and similar emotional benefits,[17] but that is not consideration in the true sense at all.[18]

So there is no practical difference between "consideration" and consideration "in money or money's worth". The words "in money or money's worth" do not add anything.

For completeness: In the 2017 penalty and RTC provisions we have the novel wording "consideration (whether or not in money)".[19] I guess the drafter thought that was a Plain English equivalent of "consideration in money or money's worth". It would have been better to just say consideration, or else use the established phrase. I hope that does not catch on. But it does not matter.

App. 4.3 Contract states consideration

Issues frequently arising are:

(1) Identifying the consideration

(2) Once identified (if the consideration is not money):

[15] 45 TC 701 at p.705.

[16] Marriage was formerly regarded as a contract, and agreeing to marry was consideration for the contract. However, marriage consideration is not "money or money's worth".

[17] Contrast 50.4.8 (Moral/sentimental/hard to value benefit).

[18] The phrase "in consideration of natural love and affection" seems rather inapt: it is a traditional conveyancer's expression which perhaps antecedes the modern sense of "consideration". But the phrase is not much used now.

[19] See 126.13 (Interested person).

(a) valuing the consideration or
(b) (exceptionally) whether the consideration cannot be valued

These issues are conceptually distinct, and I consider them separately. Any one case typically raises both issues, and one must identify consideration before valuing it; but discussion easily segues from point (1) to point (2), as there is not much difference between saying that something is for no consideration, or it is for consideration of nil value.

App. 4.3.1 *General principle*

The issues of identifying/valuing consideration are governed by the same principle: subject to certain ill-defined limits, the parties to a contract may identify or specify:

(1) what is the consideration
(2) what is the value of the consideration (if not money)
(3) how consideration is apportioned between different matters[20]

In *Spectros v Madden*:[21]

> What is the relevant consideration may depend upon the terms and form of the transaction adopted by the parties. The parties to a proposed transaction frequently can achieve the same practical and economic result by different methods.
> The law respects the freedom of the parties to a transaction to frame and formulate their agreement as they wish and to suit their own legitimate interests (taxation and otherwise)

The restriction on this freedom is as follows:

> and, so long as the form adopted is genuine, and not a sham, honest, and not a fraud on someone else, and does not contravene some established principle of public policy, the Court will give effect to the method adopted;

The qualifications in *Spectros* of genuine/honest, etc, allow some wiggle room.[22] But subject to that, what is sauce for the goose is sauce for the gander:

[20] This is an aspect of a broader cardinal principle; see App 7.9 (Form v substance: Cardinal principle).

[21] 70 TC 349 at p.374; this principle has often been followed, in various contexts; see eg *HMRC v Collins* [2009] EWHC 284 (Ch) at [27].

[22] See App 4.4.4 (Consideration dishonestly misapportioned).

> but as a corollary to this freedom, where the parties have chosen one method, it is not open to them to invite the Court to treat as adopted some other method because it is more advantageous to them, because it leads to the same practical and economic result and because it is the more obvious and sensible method to have adopted.

App. 4.3.2 *Examples*

There are many examples. *Spectros* gives this one:

> Take for example the position of the owners of the entire issued capital of a company with
> [1] gross assets of £2m and
> [2] net assets (after discharging a debt of £1m owed to the owner or someone else) of £1m.
> The shares are worth £1m, but would be increased to £2m if the owner at his own cost and for the benefit of the company released or discharged the debt. In this situation, the owner may agree to sell his shares
> [1] for £1m
> [2] or, on condition that he first releases or discharges the debt, for £2m.

Thus the consideration is £1m or £2m depending on the drafting. In the second case there would be no difficulty, or unfairness, if the £1m which the owner of the company spent on releasing or discharging the debt was deductible in computing the gain. It ought to be but it is not.

HMRC v Collins offers another example. Here the company being sold wished to make a pension contribution of c.£95k. If it had made the contribution, and then been sold for a correspondingly lower price, that would have been the consideration. Unfortunately it was not done that way:

> there can in my judgment be no doubt about the answer to the question whether the £95,179 formed part of the consideration for the disposal of Mr Collins' shares. The answer has to be found in the true construction of the Share Sale Agreement, read in the light of the relevant surrounding circumstances. The terms of the agreement are clear and unambiguous. The £95,179 was part of the consideration payable on completion for Mr Collins' shares. That is what [the sale contract] expressly provided. The fact that the sum was not payable to Mr Collins himself, but to the Company at his direction, is irrelevant. The sum still formed part of the consideration agreed between the parties for the sale of his shares. It is equally irrelevant that the agreement went on to

> specify what the Company was to do with the payment. If I dispose of an asset on terms that the purchase price is to be paid, at my direction, to a third party, and then applied by the third party in a specified way for my benefit, none of that alters the fact that the agreed purchase price is the consideration for my disposal of the asset.[23]

The moral is: take care on the drafting!

The same principles apply in Scotland. In *HMRC v Vermilion Holdings*[24] an agreement provided:

(1) an existing option was cancelled
(2) a new option was granted for "no consideration"

The UT said at [21]:

> Clause 2.2 states ... that no consideration is payable for the grant of the option. If the parties intention was that there was consideration and that the consideration was the cancellation of the 2006 Option they could easily have said so. We find as a matter of law that no consideration was payable for the grant of the 2007 Option.

It is significant that the existing option was said to be worthless because the company which granted the option was about to go bust. Rather than worthless, one might describe it as difficult to value, but that should make no difference.

App. 4.3.3 *Contracts construed*

As the question of what is the consideration is determined by the contract, it may be necessary to construe the contract, which should be clear; but if the drafter has not paid attention to the point, it may not be. The usual principles of construction apply:

> If the question is raised what method has been adopted and the transaction is in writing, the answer must be found in the true construction of the document or documents read in the light of all the relevant circumstances. If the terms of the documents are clear, that is the end of the question. If however there is any doubt or ambiguity upon the language used read in its proper context, it may be possible to resolve that doubt or ambiguity by reference to the inherent probabilities of businessmen entering into the transaction in one form rather than

[23] [2009] EWHC 284 (Ch) at [29]. The Judge described this as "simple and obvious"; though the Special Commissioner had reached the opposite conclusion.

[24] [2020] UKUT 162 (TCC). This point was not discussed in the subsequent appeals.

another.[25]

In *Stanton v Drayton Investments*[26] the buyer bought a portfolio of securities. The agreement identified the consideration thus:

> The vendor will sell and the purchaser will purchase ... the said portfolio
> [1] at the price of [c.£4m]
> [2] to be satisfied by the allotment by [the purchaser] to the vendor of [c.2.5m] ordinary shares of 25p each in [the purchaser], the issue price of each such share for the purpose of satisfying the consideration being 160p.

What was the consideration given by the buyer for the acquisition of the portfolio? Was it the price or the issue of shares in the buyer? It was held to be the shares issued. It was not the stated price, the cash sum, or notional cash sum, of £4m. Under the contract, properly construed, that is what the parties identified as the consideration. One might say that the wording at [2] overrode the wording at [1]. Or one might say that what mattered is what the seller actually received from the buyer. The contract described the cash sum as the "price", and "price" is a synonym of "consideration". But when one reads the whole contract, it is clear that the true consideration is the issue of shares and not the money.

(Since the consideration was not in money, it was necessary next to value the consideration; this point is considered separately below).

Hannah v HMRC[27] was a hare-brained (pre-GAAR) SDLT avoidance scheme. A buyer bought land. The purchase price was specified as £765k, but the contract provided:

> the Buyer shall be entitled to satisfy the balance of the Purchase Price (as exceeds the Deposit) by the issuance and delivery to the Seller of an annuity contract

The wording was similar to *Drayton Investments*, but in *Drayton* the buyer was *required* to satisfy the purchase price by the issue of shares; and in *Hannah* the buyer was *entitled* to satisfy the purchase price by the issue of the annuity contract. But the buyer immediately exercised its right to do that, and if the seller had retained the annuity, that should have been the consideration. However when the seller received the annuity, they

[25] 70 TC 349 at p.375.
[26] 55 TC 286.
[27] [2021] UKUT 22 (TCC).

promptly surrendered it for a cash sum equal to the specified purchase price. Blink and you missed it. The consideration was the £765k, not the annuity. The result could be explained as a "realistic view of facts" or by *Ramsay*; or is there no difference between the two?[28]

See too 56.4.6 (Chose in action analysis).

App. 4.4 Value of consideration

App. 4.4.1 *Contract stating value*

Just as a contract may identify what is the consideration,[29] a contract may identify the value of the consideration (if the consideration is not money) subject to the same ill-defined limits.

In *Stanton v Drayton Investments*[30] the consideration was an issue of shares and the question was: what was the value of the consideration for CGT purposes. It was held that this did not mean market value, but the value specified by the parties in the contract:

> ... as a pure matter of construction of [s.38(1)(a) TCGA], I see no indication that value is used as meaning market value. ... in the ordinary case under s.38(1)(a) TCGA [as opposed to the special case of non-arm's length transactions deemed to be at market value] such a value is available-namely the price agreed between the parties. Consequently there is not need to look to the market value, and no need to read in the word 'market' before 'value' where Parliament has not seen fit to use it.[31]

Again, there is a requirement of honesty and bona fides which provides some wiggle room:

> provided the agreed value has been honestly reached by a bargain at arm's length, it must, in my opinion, be final and it is not open to attack by the Inland Revenue.[32]

The reader may find that analysis surprising. One might have thought:

(1) Value means market value, not the price agreed between the parties, if different.

(2) But the fact that arm's length parties have agreed a price is (more or

[28] See App 7.8 (Realistic view of facts).

[29] See App.4.3 (Contract states consideration).

[30] For the facts of this case, see App.4.3 (Contract states consideration).

[31] 55 TC 286 at p.317.

[32] 55 TC 286 at p.317.

less) conclusive evidence that the agreed price falls within the market value range.

(3) Assuming the price agreed fell within the market value range, it should be conclusively taken as "the" market value.

But the end result is the same. In any event, the decision is binding. Of course, the qualifications "honestly" and "at arm's length" provide some wiggle room.

The decision in *Stanton v Drayton* is expressed in rather abstruse reasoning about the meaning of the word "value" in s.38, in the context of the TCGA, and the method of ascertaining the value. But a practical consideration lies beneath:

> Once it is accepted ... that market value could not necessarily be ascertained almost instantly by reference to the Stock Exchange price list, but might have to be proved by the evidence of accountants and other financial experts, the practical inconvenience of leaving agreements liable to be reopened to such inquiry becomes clear. I do not believe that Parliament can have intended to permit that inconvenience in cases where bargains have been made at arm's length.[33]

One can collect from *Stanton v Drayton* a strong inclination not to reopen a valuation agreed between parties acting at arm's length.

App. 4.4.2 *Apportionment of consideration*

A contract may apportion consideration, eg if in one contract, A agrees to purchase two different assets, it may specify what consideration is given for each. In *Booth v Bucknell*:[34]

> where parties to a composite transaction have, as a result of negotiations between themselves, provided that part of the consideration is to be paid for one part of the transaction and part for another, they cannot subsequently seek to re-allocate the consideration for tax purposes. They have chosen to carry through the transaction in a particular manner, and the taxation consequences flow from the manner adopted.

The CG Manual provides:

> **CG14773 - Apportionment** [Jul 2019]
> If you need to apportion consideration, then you should check the

[33] 55 TC 286 at p.317.
[34] 53 TC 425 at p.431,

> relevant documentation, such as the contract for disposal, to see if an apportionment is provided. We would expect to see an apportionment in a case where unconnected parties have contracted a bargain at arm's length. If they have, and if the apportionment appears reasonable by reference to the facts, then we would not expect to disturb it. There is clear authority for the proposition that the parties cannot disturb an apportionment they have agreed in a contract, see *Booth v Buckwell* 53 TC 428.
>
> In *Booth v Buckwell* it was held that the two parties to the contract could not seek to alter the agreed apportionment simply to mitigate a Capital Gains Tax liability. It was, however, acknowledged that 'in certain cases' the Inspector's position would be different. The decision did not, however, define the circumstances in which the Inspector could alter an agreed apportionment.

Section 52(4) TCGA provides:

> For the purposes of any computation of the gain any necessary apportionments shall be made of any consideration or of any expenditure and the method of apportionment adopted shall, subject to the express provisions of this Chapter [Chapter 3 Part 2, Computation of gains], be just and reasonable.

The CG Manual provides:

> **CG14773 - Apportionment** [Jul 2019]
>
> Our current thinking is that we are only justified in using our powers under Section 52(4) where:
>
> • there is no apportionment provided, or
>
> • although there is an apportionment provided, this is unreasonable on the facts of the case.
>
> We would not consider it justified to use our powers where:
>
> • there is an apportionment provided which is reasonable on the facts of the case.

App. 4.4.3 *Covenant incidental to sale*

In *Fielder v Vedlynn*[35] the essential facts[36] were:

[35] 65 TC 145.

[36] Some background facts:

(1) The purpose of the sale was that P should acquire the capital losses of the companies it acquired. (The sale of capital loss companies was held to work for CT purposes in *Shepherd v Lyntress* 62 TC 495, but sch 7A TCGA now prevents this). The contingent liability owed from the target companies to V was to pay

(1) A buyer bought 8 companies ("target companies") from a seller ("S") for market value (£19k).

(2) The target companies held subsidiaries which owed a contingent liability to S. The buyer covenanted to procure that the these liabilities would be met. The parent of the buyer in turn guaranteed performance of the buyer's guarantee.

HMRC argued that the covenants were valuable consideration in addition to the purchase price.

The Special Commissioners rejected this for two reasons. First:

> the guarantees are no more than a term of the agreements for sale of the [target] companies. They do not fall to be separated out from the other terms and conditions upon which the shares were sold or to be invested with an overwhelming importance. I would regard them [as] comparable with the warranties and covenants given by [the seller].[37]

The High Court agreed:

> the Special Commissioner was entirely entitled to reach the conclusion that there was no basis on which a separate and additional monetary value could be placed upon the guarantees as part of the consideration to be added to the undoubted monetary price paid which was the true open market price of the shares.[38]

It is not clear whether the basis of the decision is that:

(1) The guarantee was not consideration. If so, the question of its value, if any, did not matter. Or:

(2) The guarantee was of nil value. Something of nil value perhaps cannot be consideration, but this does not matter here.

The better view is that both are correct: the guarantee was held to have nil value and not to constitute consideration.

At first sight, it seems odd to say that the guarantee had *nil* value. It must have been worth *something* though it was difficult (in fact,

a sum equal to 7.5% of losses (if any) agreed by HMRC.

(2) The arrangements also included a pre-sale dividend to reduce the value of the target companies.

These facts do not affect the technical points decided in *Vedlynn*, but they may explain why HMRC tried to pursue the consideration issue.

[37] 65 TC 145 at p.160.

[38] at p.163.

impossible) to value.[39] But I think it is right to say that the consideration had nil value in this case, because the parties put a nil value on it, and the parties' valuation of consideration in good faith is binding on HMRC.[40]

The guarantee was also not for consideration, at least for the purposes of computing the chargeable gain, because the parties have freedom to determine what is the consideration for a transaction.[41]

The issue may arise in non-tax contexts. In *Muat v Betts Motors,*[42] a buyer bought a car (then in short supply, in New Zealand) for £1,207. The contract of sale included a covenant that the buyer was not to resell within 2 years unless he first offered to sell the car back to the seller. The buyer argued, ingeniously but unmeritoriously, that the covenant was void, because:

(1) the price [ie consideration] for the car was £1,207 *and* the value of the covenant, and
(2) added together, this exceeded the maximum allowed under price control legislation.

The answer was that the covenant was not part of the price:

> ... under the statutory definition,[43] the only kind of valuable consideration which comes within the "price" is a valuable consideration "which in effect relates to the sale." The special covenant in this case was, in a sense, valuable consideration - just as any collateral contract is consideration for the making of a main contract - but it did not relate to the sale (!).

Why not? The Court gave a somewhat narrow definition of what relates to a sale:

> It is of the essence of a sale that the property in the goods should be transferred from the seller to the buyer: and a valuable consideration only relates to the sale if it is given as the inducement - or one of the inducements - for the transfer of the property. In this case the sole and

[39] See App.4.4.5 (Consideration can't be valued).

[40] See App.4.4.1 (Contract may identify value).

[41] See App.4.3 (Contract states consideration).

[42] [1959] AC 71.

[43] Section 2(1) [New Zealand] Control of Prices Act 1947 provided:

> 'Price', in relation to the sale of any goods … includes every valuable consideration whatsoever, whether direct or indirect; and includes any consideration which in effect relates to the sale of any goods … although ostensibly relating to any other matter or thing.

> entire inducement for the transfer was the cash sum of £1,207. The special covenant was not given for the property but for something different. It was given for the privilege of being allowed to buy a new car. It was not expected to yield any benefit to the seller. Its purpose was to stop the purchaser taking advantage of his privileged position contrary to the interests of the trade and the public. It was a prerequisite to the transfer of the property and not part of the consideration for it. In these circumstances their Lordships think it cannot properly be said to form part of the "price" within the statutory definition.

This would nowadays be called a purposive interpretation of the (normally) wide expression "relating to". Perhaps an easier way to reach the same answer would be to say that the contract specified the price, and by implication specified that the covenant was not consideration for the sale, or the value of the covenant was nil.

App. 4.4.4 *Consideration dishonestly misapportioned*

In *Saunders v Edwards*[44] the buyer agreed to buy a lease and its chattels. The total purchase price of £45k was apportioned £40k for the lease and £5k for the chattels. The chattels were worth about £500, possibly up to £1,000. The object was to evade Stamp Duty. Whatever the limits of the principle of freedom to apportion consideration, this passed them:

> What happened in this case may well be common practice. But it cannot be condoned. If a solicitor is involved in an apportionment of this kind, which he knows not to be in accordance with the facts, then he must be guilty of professional misconduct. Furthermore, apart from this and possible criminal offences, the consequence for buyers may well be that their contract becomes unenforceable.[45]

App. 4.4.5 *Consideration can't be valued*

Consideration which cannot be valued matters, because it brings into effect the CGT market value rule.[46]

This issue arise in *Fielder v Vedlynn*. The case concerned a sale whose terms included a guarantee which was held not to be consideration for the sale, or perhaps, consideration of nil value.[47] The Special Commissioner

[44] [1987] 1 WLR 1116.

[45] [1987] 1 WLR 1116 at p.1125.

[46] See App.4.8 (CGT market value rule).

[47] See App.4.4.3 (Covenant incidental to sale).

went on to say:[48]

> If I am wrong in coming to this conclusion, the question arises what is the value of the guarantees. ... It seems to me to be quite impossible to place a rational value on the guarantees. ... How do you value the guarantees in monetary terms? I do not think you can. No evidence was led to suggest that you can. So if the guarantees are part of the consideration given by [P] for the [target] companies, that part of the consideration, in my opinion, "cannot be valued".

The High Court upheld that finding of fact.

The consequence of this analysis is not altogether attractive, because it brings into effect the CGT market value rule. But no doubt parties acting at arm's length will normally be taken to have agreed a market value price, so it makes no difference to them.

App. 4.5 Transfer on liquidation

The transfer of property to shareholders from a company in the course of liquidation is not for consideration. There is no bargain between the shareholders and the company. The liquidator is under a duty to make the transfer by virtue of the liquidation. The liquidation may require a special majority vote; but apart from that, once that is done, the winding up commences, the transfer does not depend on the wishes of any shareholder.[49]

HMRC agree. The SDLT Manual provides:

> **SDLTM04042 SDLT on de-enveloping transactions** [Feb 2020]
> ... de-enveloping may occur by a capital distribution to the shareholders following the liquidation of the company. The [SDLT] consequences of de-enveloping will depend on whether there is any consideration given by the shareholders for the transfer of the property.
>
> There will be two situations where HMRC will not consider there to be any consideration given.
>
> The first is where the company is debt free: its only asset is the property and there are no liabilities (other than issued share capital). In such a situation the shareholders have given no consideration directly or indirectly for the property and therefore there is no SDLT liability.[50]

[48] 65 TC 145 at p.161.

[49] See *Wigan Coal and Iron Co v IRC* [1945] 1 All ER 392; this is also assumed in s.53, 54 FA 2003.

[50] The material now in SDLTM04042 and SDLTM04043 was previously published as a statement on *https://www.gov.uk/business-tax/stamp-taxes* (2013).

The same reasoning applies to:
(1) A transfer by way of dividend or other company distribution
(2) A transfer from a trust

This is recognised by provisions which for CGT purposes deem these transfers to be made for consideration.[51]

App. 4.6 Transfer on divorce

The starting point is to understand the family law background.

A transfer in connection with divorce may be made:
(1) Pursuant to a court order
  (a) following a contested hearing; or
  (b) approving a settlement agreed by the parties
(2) Without a court order but under an agreement between the parties (the transferee usually agreeing to seek no (or a reduced) court order in return for the transfer)

Assume (as will normally be the case on divorce) that the transfer is made at arm’s length and with no gratuitous intent. Is a transfer of this kind made for consideration?

One might have thought that the answer was no. The word consideration is wide enough to apply in the absence of a contract, but in the case of a court order, there is no bargain of any kind. The reciprocity which is the essence of consideration is lacking.

Accordingly in *G v G*[52] the High Court held that a transfer pursuant to a court order at a contested hearing was not made for consideration, so that CGT hold-over relief was available.[53]

However in *Hill v Haines*[54] the CoA held that a transfer pursuant to a court order at a contested hearing *was* made for consideration, for the purposes of s.339 Insolvency Act 1986.

Where does this leave *G v G* and CGT hold-over relief? Either it is overruled or else a transfer might be for consideration for the purpose of one statute, but not for the purposes of CGT, or at least, not for the purpose of CGT hold-over relief.

[51] See App.4.8 (CGT market value rule).

[52] *G v G* [2002] EWHC 1339 [2003] Fam Law 14 [2002] 2 FLR 1143 at [43] *https://www.kessler.co.uk/wp-content/uploads/2012/04/GvG.pdf*

[53] See 57.32.5 (Actual consideration).

[54] [2007] EWCA Civ 1284.

Each view has some support in *Hill v Haines* (though they cannot both be right). Morritt C said:

> [30] ... the fact that a transfer ordered by the court does not give rise to a payment of consideration so as to reduce the value of hold-over relief *for capital gains tax* [does not entail] a conclusion that a property adjustment order must be regarded as made for no consideration.

In other words, "consideration" in the CGT code has a different meaning. But Rix LJ preferred the view that *G v G* was wrong.[55] Since Rix also agreed with Morritt, it is clear that he did not give a great deal of attention to this point (which did not need to be decided and which would not have been fully argued). A legal realist might say that each decision was result led, the court first deciding what is the just result and then holding that there was/was not consideration in order to reach that result. But it is considered that the two decisions can be reconciled and the view of Morritt is to be preferred. Rights under the Matrimonial Causes Act are not assets for CGT purposes: no gain arises when a spouse is awarded a capital sum. Accordingly, there is no "consideration" for CGT purposes. However that is a special case and a transfer on divorce is made for consideration in the general sense of the expression.

The rule, in short, is that a divorce payment is in principle made for consideration, but the context may show otherwise. The word "consideration", like all words, must take its meaning from its context.

The CG Manual provides:[56]

> **CG67192. Hold-over relief: Consideration** [Jul 2019]
> The disposal of an asset from one spouse or civil partner to the other in the circumstances described in CG67191 [that is, a disposal in a year after separation, which does not qualify for the CGT spouse exemption]

[55] At [81] "... As for *G v G*, the view expressed by Coleridge J at para 43 regarding potential consequences for the purposes of capital gains tax can hardly be regarded as authoritative in the absence of the revenue. As Coleridge J stated, his view that the wife gave no consideration for the shares transferred to her because 'neither party has any 'rights'… cannot, of course, ultimately bind the Inland Revenue': he merely proceeded "on the footing" that business hold-over relief would be available to the husband. In doing so, he appears to have drawn an unnecessary inference from the decision of this court in the *Xydhias* case."

[56] The passage has not been revised after *Hill v Haines,* but as several years have elapsed since that decision, it may be taken as a statement of the HMRC current view.

> is, where there is no recourse to the courts, usually made in exchange for a surrender by the donee of rights which they would otherwise be able to exercise to obtain alternative financial provision. In such cases we take the view that the value of the rights surrendered represents actual consideration of an amount which would reduce the gain potentially eligible for hold-over relief to nil. "Consideration" is not limited to money or money's worth.

After considering the case where there is gratuitous intent, which is so rare that it need not be considered here, the Manual continues:

> However, in cases where there is recourse to the courts and a court makes an order
>
> - for ancillary relief under the Matrimonial Causes Act 1973 which results in a transfer of assets from one spouse to another, or
> - for property adjustment under the Civil Partnership Act 2004, or
> - formally ratifying an agreement reached by the divorcing parties or by the civil partners of a dissolved civil partnership dealing with the transfer of assets,
>
> we take the view that the spouse or civil partner to whom the assets are transferred does not give actual consideration, in the form of surrendered rights, for their transfer. A Court Order, made in these circumstances, reflects the exercise by the court of its independent statutory jurisdiction and is not the consequence of any party to the proceedings agreeing to surrender alternative rights in return for assets. This approach represents a change in the Revenue's prevailing practice, following consideration of judicial observations made in the case of *G v G* [2002] EWHC 1339 and applies with effect from 31 July 2002. Therefore, where assets are transferred between divorcing parties or between civil partners of a dissolved civil partnership by reason of a Court Order as described above and a claim for gift hold-over relief is made, or remains unsettled, on or after that date, the relief should not be restricted in accordance with TCGA92/165(7) on the grounds that actual consideration has been given by the donee.

Thus in the HMRC view:

(1) A transfer made pursuant to a court order, including a consent or *Tomlin* order, is not made for consideration.

(2) A transfer not made pursuant to a court order is made for consideration.

It is considered that the position is in both cases the same:

(1) The transfer is made for consideration in the general sense of the

word;

(2) The transfer is not made for consideration for CGT purposes.

App. 4.7 Sale and leaseback

This section considers whether a sale and leaseback transaction is for consideration. I refer to the parties to the transaction as "purchaser/landlord" and "vendor/tenant".

The conveyancing can be done in (at least) two ways:

(1) *Transfer requiring purchaser/landlord to grant lease:*
   (a) Vendor/tenant transfers freehold to purchaser/landlord
   (b) Purchaser/landlord grants lease to vendor/tenant

(2) *Transfer subject to an existing lease:*
   (a) Vendor/tenant grants lease to nominee, and
   (b) Vendor/tenant transfers freehold subject to the lease to purchaser/landlord[57]

At first sight, the analysis should depend on the conveyancing:

(1) Route (1) involves a grant of a lease for consideration (the transfer of the freehold).

(2) Route (2) does not involves a grant of a lease for consideration.

But both conveyancing methods lead to the same result, so it is tempting to say that the same tax analysis should apply, regardless of the conveyancing. In that case one might apply either analysis, ie the lease may or may not be regarded as granted for consideration, depending on which makes better sense in the particular context.

The former CTO Advanced Instruction Manual seemed to adopt this approach:

> **E.15. Introduction**
>
> A lease for life etc is treated as a settlement under s43(3) IHTA unless the lease was granted for full consideration in money or money's worth. We do not consider that this provision applies to the common case in which an occupying owner transfers the property to another person reserving such a lease for himself.
>
> Nor do we apply it where the transfer is made on condition that the transferee grants him such a lease at less than a rack rent. Where this is

[57] There could be a transfer of a leasehold interest and a sub-lease back; but for simplicity I refer to a freehold and lease. Further consideration is needed if the land is not in England or Wales.

> done it is the transferee who grants the lease and for this the transfer is at least full consideration.

The same point was made in former SP E10:

> You were concerned that a vendor of property who wished to retain a lease for his life might be barred from the relief afforded by the exception for leases granted for full consideration if the creation of the lease was by way of a reservation out of the interest conveyed rather than by a separate grant of the leasehold interest. I can confirm that we would not seek to exclude relief solely on these grounds. Whether or not full consideration is given is a matter which depends upon the facts of the individual case, but for this purpose we would take into account a reduction in the price obtained by the vendor because of the reservation of the leasehold interest.

The Manual passage is not in the current IHT Manual. The SP is now described as "obsolete and for information only."[58] There has been no announcement that HMRC practice has changed. It seems unrealistic to expect an established HMRC practice on the grant of a lease for life, as it would not arise very often.

App. 4.8 CGT market value rule

Section 17(1) TCGA provides:

> Subject to the provisions of this Act, a person's acquisition or disposal of an asset shall for the purposes of this Act be deemed to be for a consideration equal to the market value of the asset—

I refer to this as the **"CGT market value rule"** (or where it is necessary to distinguish this rule from other market value rules, "the s.17 market value rule").

One might identify two deemings here:

(1) If the disposal/acquisition is *not* made for consideration:
  (a) it is deemed to be made for consideration, and
  (b) the value of the consideration is deemed to be market value

(2) If the disposal/acquisition *is* made for consideration, but the value of the consideration is not market value, the value of the consideration is deemed to be market value

[58] HMRC, "Obsolete statements relating to Inheritance Tax" (2014) *https://www.gov.uk/government/publications/obsolete-statements-relating-to-inheritance-tax-also-applicable-where-tax-charged-is-capital-transfer-tax*

Section 17(1) then sets out 7 circumstances where the CGT market value rule applies:

> (a) where he acquires or, as the case may be, disposes of the asset otherwise than by way of a bargain made at arm's length, and in particular where he acquires or disposes of it
> [i] by way of gift or
> [ii] on a transfer into settlement by a settlor or
> [iii] by way of distribution from a company in respect of shares in the company, or
>
> (b) where he acquires or, as the case may be, disposes of the asset
> [i] wholly or partly for a consideration that cannot be valued,
> [ii] or in connection with his own or another's loss of office or employment or diminution of emoluments,
> [iii] or otherwise in consideration for or recognition of his or another's services or past services in any office or employment or of any other service rendered or to be rendered by him or another.

The s.17 CGT market value rule is one of many rules which deem a disposal to be made for market value consideration for CGT (**"deemed market value rules"**). For instance, for CGT purposes, a transfer from a trust to a beneficiary is deemed to be made for market value consideration.[59]

It can happen that

(1) a bargain is not at arm's length but

(2) the consideration (as computed for CGT purposes) is market value.

In that case the CGT market value rule obviously has no effect. The CG Manual after noting that a gratuitous benefit indicates a non-arm's length transaction, gives an example:

> **CG14544 Market Value: Gratuitous Benefit Conferred** [Jul 2019]
> The gratuitous benefit conferred on the other party to the transaction need not be a price difference. It could consist of other favourable terms of a contract, for example a very long time to pay the consideration. However, unless the price paid differs from market value, the application of the market value rule will have no direct effect [ie for CGT on the disposal].

See too 121.11.3 (Disclosing valuations).

[59] See 56.21.5(Disposal on trust termination).

App. 4.8.1 *Acquisition without disposal*

Section 17(2) TCGA provides an exception to the CGT market value rule:

> Subsection (1) shall not apply to the acquisition of an asset if—
> (a) there is no corresponding disposal of it, and
> (b) [i] there is no consideration in money or money's worth or
> [ii] the consideration is of an amount or value lower than the market value of the asset.

So in the case of an acquisition without a corresponding disposal, the CGT base cost is the lower of:
(1) the consideration (if any) and
(2) market value

That makes some sense: the reason for the (deemed) market value acquisition cost on an acquisition is that someone has a (deemed) market value disposal, which is in principle taxable. The rule is symmetrical. Where there is no corresponding disposal there is no reason to deem the acquisition cost to be market value.

Acquisition without corresponding disposal happens on the creation of an asset. Examples are:

Asset acquired	**Acquisition on**	**See para**
Right to compensation/damages	Breach of contract/tort	18.18.2
Debt	Making a loan	
Contractual chose in action	Entering into a contract	56.4.6
Shares	Share issue	64.29.2
Interest under a trust	Gift to trust/trustee appointment	-

App. 4.9 Market value/full consideration

App. 4.9.1 *MV/full consideration compared*

The expressions market value (MV) and full consideration are ubiquitous in tax and non-tax legislation.

Market value comes up regularly in the context of deemed disposals at market value for CGT purposes.

References to full consideration relevant to the themes of this book include (this is not a full list):

Topic	**See para**
Gift with Reservation (GWR)	78.7
Remittance conditions C and D	18.29.4
Pre-owned assets	83.21

Section 272(1) TCGA provides a commonsense definition of market value:

> In this Act "market value" in relation to any assets means the price which those assets might reasonably be expected to fetch on a sale in the open market.

Full consideration is never defined. Despite the lack of a definition I think there is little if any difference between the two terms. Comment on one is relevant to the other, and so I discuss them together in this section.

To ascertain market value, one must assume that there is an open market even if none exists; but the same is true in ascertaining full consideration.

For market value of specific types of benefit see:

Benefit	**See para**
Benefits generally	50.7
Beneficial loan	50.10.2
Use of land	50.12.2

Where there are statutory valuation rules, it is necessary to distinguish between market value and statutory value; statutory valuation rules are not discussed here.[60]

App. 4.9.2 *MV/arm's length bargain compared*

If a transaction has attributes of a bargain at arm's length,[61] the consideration is more likely to be market value. Thus the two concepts overlap in practice even though they are conceptually distinct.

In a letter published 18 May 1987, the Revenue say:

> ...Whether an arrangement is for full consideration will of course depend on the precise facts. But among the attributes of an acceptable arrangement would be the existence of a bargain
> [1] negotiated at arm's length
> [2] by parties who were independently advised
> [3] and which followed the normal commercial criteria in force at the time it was negotiated...
>
> You referred to potential difficulties in determining what amounts to "full consideration" for the donor's continued enjoyment of gifted chattels, particularly pictures and paintings... These may not be

[60] See 50.9 (Statutory valuation rules).

[61] See App.4.10 (Arm's length).

insuperable, as appears from the recent case of *IRC v Macpherson,*[62] and in any event it would be difficult to overturn an arm's length, commercial arrangement entered into by parties who were independently advised.[63]

App. 4.9.3 *Market value: Separate advice*

A characteristic of a transaction at arm's length is that the parties are separately advised. Parties seeking to ensure full consideration may take advantage of this by instructing separate valuers. Edward Manisty explains HMRC practice on what constitutes full consideration for the use of chattels, in circumstances where:

(1) A donor gave chattels to a donee
(2) The donor enjoyed use of the chattels
(3) The donor paid (what was intended to be) full consideration for the use, to avoid what would otherwise be a reservation of benefit.[64]

Although the Revenue was unable provide any definitive comment, the following has emerged from correspondence:-

(1) *The need for separate advice*

(a) In reviewing the adequacy of consideration paid by the donor for the benefits enjoyed by him the Revenue attach great importance to the parties, and in particular the donee, having the benefit of entirely independant advice from agents familiar with relevant sectors of the art market, with market fluctuations in relation to relevant chattels, and with current trends relating to the letting or loan of such chattels.

(b) The Capital Taxes Office accept there can be no absolute requirement that the donor must take separate advice. However, they regard it as crucial that the parties are able to demonstrate that the arrangements were made and maintained on an "arm's length" basis. They observe that the chances of the Revenue's requirements being met in this respect will be very much stronger if both sides are so separately advised.

(c) The Capital Taxes Office have confirmed the importance they attribute to

[62] In *Macpherson*, trustees agreed that a beneficiary should have use of valuable paintings for 14 years, at a rent of £60 p/a, the beneficiary undertaking their care and insurance. The Revenue conceded this was a transaction which might have been made by unconnected parties, and not intended to confer gratuitous benefit; see [1985] STC 471. The dispute in *Macpherson* concerned associated operations; see 74.14 (Relevant operation).

[63] Christie's Bulletin (Autumn 1995). The article states: "The Capital Taxes Office have seen this article in draft and have no objection to it."

[64] See para 6 sch 20 FA 1986, discussed at 78.7 (Full consideration exemption).

> the agents instructed receiving proper instructions. This will normally involve the agents having before them a recent valuation of the open market value of the chattels concerned prepared by a valuer experienced in evaluating chattels of the kind in question on that basis with a first draft of the proposed lease/licence. The importance of preserving such instructions and other material relating to the valuation exercise is self evident.

The GWR full consideration exemption is a cliff-edge rule: GWR operates if the payment made is anything less than full consideration. Accordingly the cost of instructing two valuers may be worthwhile. That is not to say that two valuers are appropriate in every case where market value/full consideration is an issue. An alternative may be to instruct one joint valuer.

The instructions to the valuer(s) are as important as the valuation itself, and will be disclosed to HMRC, in the event of a dispute, together with the valuation.

App. 4.9.4 *Full consideration range*

References to "the" market value might suggest there is a single price which assets may be expected to fetch. In practice there is usually a range of values; and anything within the range may be said to be market value. This mitigates the cliff-edge nature of rules requiring a disposal for full consideration, such as the GWR full consideration exemption. HMRC agree. RI 55 provides:

> ... we do recognise that there is no single value at which consideration can be fixed as "full". Rather, we accept that what constitutes full consideration in any case lies within a range of values reflecting normal valuation tolerances, and that any amount within that range can be accepted as satisfying the para 6(1)(a) [sch 20 FA 1986, GWR] test.

The extent of the market value range depends on the asset; some assets may be valued precisely, or within a narrow range, and others will have a wide market value range.

Thus there is no real difference between MV/full consideration.

App. 4.9.5 *Market value: use of chattel*

Manisty explains HMRC views on what constitutes full consideration for the use of chattels:

(a) The Revenue accept that currently available evidence relating to the loan of chattels to or by public museums or by businesses established to loan chattels forming part of their stock in trade on a commercial basis to third parties is scarce and hence of little value in assessing the adequacy of the consideration paid by a donor for his continued retention of chattels in a GWR situation where it is desired to take advantage of [para 6 sch 20 FA 1986] dispensation.

(b) However, the suggestion - which has been inferred from *IRC v Macpherson*[65] - that if the donor assumes responsibility for the housing, preservation and insurance of the chattels this of itself is likely to amount to "full" consideration, receives no support from the Capital Taxes Office.

As already mentioned, the Official view is that an "arm's length" situation must be assumed if the requirements of paragraph 6 are to be fulfilled. In the Capital Taxes Office's eyes this means that neither side muse be seen to be doing the other any favours, and, in particular, that it must not be assumed in establishing the consideration to be paid by the donor that the new owner of the chattels may find possession of them a burden. He must be assumed to be willing and able to preserve and insure them: the "arm's length" hypothesis also involves assuming that the new owner would not willingly allow any third party to enjoy them unless that party were to shoulder these obligations and on top of this pay a rent for their use and enjoyment.[66] Unless such criteria are observed, the Revenue perceive no benefit so the donee of the ownership of gifted property, which is of undoubted value in the marketplace, and would not be willing to accept that the arrangements whereby the donor retains them can meet the required "arm's length" test.

(c) However, the Revenue accept that if the donor is shown to have assumed the burdens of housing, preserving and fully insuring the chattels, plus paying an appropriate (reasonable) rent ascertained and maintained by reference to current capital value of the chattels, this will "probably" (a customary Revenue precautionary word used in the giving of hypothetical advice of this kind) satisfy the requirements of [para 6 sch 20 FA 1986].

(d) As to the quantum of the rent, although the Capital Taxes Office reject any inference that might be drawn from *IRC v Macpherson* that this may be purely nominal, they have indicated that the appropriate percentage to be fixed by reference to capital value, and reviewed periodically, is not likely to be very high.

They have confirmed that the relevant percentage is likely to be greater if the chattels in question provide an element of utility and/or may depreciate in as a result of enjoyment of them pursuant to the terms of the relevant lease/licence.

Somewhat more controversially the Revenue suggest that circumstances might justify the payment of a "premium rent" for particularly important artefacts to reflect that an '"arm's length" lessee/licensee might be prepared to pay such a premium rent for the privilege of enjoying such a work of art. Although support for this line would seem sparse at the present time, this is a factor that agents instructed to negotiate full consideration for the purposes of leases or licenses of particularly important items designed to fulfil the criteria of [para 6 sch 20 FA 1986], must have in mind.

HMRC had argued that the industry standard guideline for works of art (market rent = 1% of capital value, or less for very valuable assets) is too low.[67] Valuation experts disagreed. Presumably the 2017 statutory

[65] See footnote above.

[66] Author's footnote; this is not correct.

[67] See App.4.9 (Market value/full consideration).

valuation rule reflected a realisation that they would lose that argument.[68]

App. 4.10 Arm's length

App. 4.10.1 *Why "arm's length" matters*

The term "arm's length"[69] is found in a variety of expressions:[70]

Expression	**Topic**	**See para**
Disposal:		
by way of a bargain made at arm's length	Deemed market value	App.4.8
under a bargain at arm's length	Hold-over relief	57.32
Transaction:		
entered into at arm's length	Capital payment: s.87	61.7.4
entered into on arm's length terms	Tainting protected trust	92.5.1
at arm's length	IHT arm's length transaction relief	74.13

These are not exactly the same, but they share the concept of "arm's length".

App. 4.10.2 *Arm's length: Meaning*

In *Mansworth v Jelley*:[71]

> the phrase "bargain at arm's length" ... connotes a transaction between two parties with separate and distinct interests who have each agreed terms (actually or inferentially) with a mind solely to his own respective interests.

Between transactions which obviously are/are not arm's length there is a grey area where the law must seek to find the dividing line.

Since one is looking into the mind of the parties to see if they agreed terms in their own interests, the test is subjective. HMRC agree. The CG Manual provides:

> **CG14545 Market Value Rule: Objective Indicators** [Jul 2019]
> The test which must be satisfied is subjective: the test is whether there was an intention to confer a gratuitous benefit or 'give bounty'.
>
> **CG14542 Market Value Rule: Subjective Intention Test** [Jul 2019]
> A transaction is 'otherwise than by way of a bargain made at arm's

[68] See 50.11 (Use of chattel).

[69] Not "arms' length": one arm is all that is required.

[70] Of course this is not a full list.

[71] [2002] STC 1013 at [13].

> length' when one of the persons involved in the transaction does not intend to get the best deal for themselves ... . That person enters into the transaction with the subjective intention of giving some gratuitous benefit to the other person.

There is no difference between the formulation in *Mansworth* (a "sole interests" test) and the formulation in the Manual (a "bounty" test), they come to the same thing; though it is better to adopt the language used in the case law.

Whether a transaction is at arm's length is a question of fact.[72]

App. 4.10.3 *Arm's length factors*

In the textbook *Capital Gains Tax*:[73]

> it can perhaps be suggested that the following matters would be taken into account (though the list may not be exhaustive):
> 1. the presence or absence of bona fide negotiation between the parties as to the terms of the transaction (including particularly the consideration);
> 2. the degree to which the terms of the transaction compare with those found in similar commercial transactions;
> 3. whether the parties have separate legal or other professional representation;
> 4. the relationship between the parties independently of the transaction in question; and
> 5. the character of any comparable prior dealings between the parties.

Nader v HMRC cites this and continues:[74]

> the factors listed in *Spencer-Nairn*[75] and the observations made by Lightman J in *Mansworth v Jelley* are not rules of law but simply helpful factors and guidance to be taken into account. Ultimately the question is an evaluative exercise taking account of all the relevant facts and circumstances of the particular case.

The significance of these factors varies from one case to the next. In a sale of land or a private company, for significant value, one would expect

[72] This is self evident, but if authority is needed, see *Narar v HMRC* [2018] UKFTT 294 (TC) at [180].

[73] Whiteman & Sherry, *Capital Gains Tax* (looseleaf) para 9.32.

[74] [2018] UKFTT 294 (TC) at [180].

[75] *IRC v Spencer-Nairn* [1991] STC 60 at p.75.

arm's length parties to have separate legal and valuation advice; that is needed, and normal practice. Absence of such advice would seem to indicate that the bargain is not at arm's length. (Though the existence of separate representation may be a more neutral factor). In the sale of simple assets, such as a chattel, or assets of lower value, one would not expect arm's length parties to have much legal or valuation advice, and its absence does not indicate a bargain is not at arm's length.

The CG Manual provides:

> **CG14545 Market Value Rule: Objective Indicators** [Jul 2019]
> There are objective pointers which may indicate the underlying intention. The following list (which is not exhaustive) suggests information which you may need to consider:
> [The manual paraphrases the five factors set out above and continues:]
> It is important to consider all of the available evidence.

App. 4.10.4 *Bad bargain*

The CG Manual continues:

> **CG14541: market value rule: at arm's length** [July 2019]
> This does not mean that a bad bargain cannot be a bargain made at arm's length.

The Manual gives two examples of bad bargains made at arm's length.[76] The first is a seller desperate to sell:

> For example Mr A may wish to sell his property quickly so that he can go and live in Malta. Mr B knows that Mr A wants to sell his property quickly so he offers him a low price for a quick sale. No-one else makes an offer. Mr A accepts the price Mr B has offered. This may not have been the best possible price which Mr A could have achieved if he had left the property on the market for longer but he was still trying to achieve the best deal possible for himself. It was a bargain made at arm's length.

The second example concerns information inequality: information is available to the purchaser, not to the seller. One might refer to that as a unilateral mistake:

> Another example where a bad bargain could nonetheless be a bargain

[76] The concept of bad bargain may be contrasted with "fair bargain"; see 39.35.3 ("Benefit").

> made at arm’s length is where one party to the transaction has better information about the asset than another. For example Mrs S may sell a picture from her attic to Mr T for £500. Mr T, who is an art dealer, knows that the picture is worth £5,000. There has been a bargain with both people trying to get the best deal for themselves. Again, this is a bargain made at arm’s length even if the price paid is not the ‘market value’ of the asset.[77]

Suppose in these cases the seller and buyer were connected persons. One applies the CGT market value rule, but what is the market value? Market value is assessed by reference to a hypothetical sale, but in considering that hypothetical sale, one does not assume (contrary to the facts) that
(1) In example 1, the seller Mr A is not desperate to sell
(2) In example 2, the seller Mrs S has the knowledge of an art dealer.

In the hypothetical sale, the hypothetical purchaser would pay no more than was actually paid in the actual sale; so it is suggested that the price actually received is in fact the market value.

App. 4.10.5 *Objective test*

We have noted above that “arm’s length” is a subjective test.

IHT arm’s length transaction relief[78] applies to a transaction between connected persons if it is:

> such as might be expected to be made in a transaction at arm’s length between persons not connected with each other

The point of the underlined words is to transfer what is normally a subjective test (“transaction at arm’s length”) into an objective test.

In *IRC v Spencer-Nairn*[79] the taxpayer sold asset worth £200k for £100k, to a connected person. The reason for the undervalue was that the taxpayer made a mistake relating to landlord and tenant legislation.[80] The mistake was a reasonable one because:
(1) The land was not attractive to an institutional investor, so there was a limited market.

[77] See 39.35.5 (Unintendedly bad bargain).

[78] See 74.13 (Arm’s length transaction relief); similar wording is found in the tainted donation rules.

[79] [1991] STC 60.

[80] It seems likely that the purchaser made the same mistake, but it does not matter whether the mistake was unilateral or bilateral.

(2) It was said that the value was too low to justify the cost of specialist professional advice (though a professional valuer no doubt would point out that if the seller had taken advice, it would have been worth it).
(3) The Special Commissioners found (the reader may think, somewhat implausibly) that the seller did not realise that the purchaser (a Jersey company) was owned or controlled by the son of the seller, and so a connected person.

On these (somewhat unusual) facts the Special Commissioners found that the transaction was what one would expect between unconnected persons, ie one would expect the seller to enter into a bad bargain.

One might say that the statutory wording did not really succeed in moving from a subjective test to an objective test, because the outcome still depended on subjective factors in the mind of the taxpayer. If the seller had actually known the relevant landlord and tenant law, and known that the land was worth £200k, the outcome would have been different. One might say that there is really little practical difference between the simple subjective test (arm's length) and the more wordy objective test ("such as might be expected to be made in a transaction at arm's length"). For if a bargain is at arm's length, it will surely be one which might be expected to be made at arm's length. Or if a bargain is one which "might be expected to be made at arm's length" then in practice one would expect it is made at arm's length.

App. 4.10.6 *Composite transactions*

The CG Manual provides:

> **CG14543 Market Value Rule: Apply To Each Transaction** [Jul 2019]
> The subjective intention test has to be applied to each individual transaction. If the terms of a transaction have been influenced by any other transaction or arrangement between the persons entering into the transaction then the parties may not be trying to reach the best possible deal from THAT PARTICULAR TRANSACTION. In these circumstances it is likely that one of the parties will have intended to confer a gratuitous benefit on the other as a result of that particular transaction, even if the larger, overall deal is not intended to do this. That particular transaction will be 'otherwise than by way of a bargain made at arm's length'. The other transactions within the wider deal would also have to be examined to see whether they passed the

> subjective intention test.

The Manual gives a straightforward example. Omitting irrelevant detail:[81]

> Mr B owns:
> (1) a house worth £100,000, which qualifies for private residence relief
> (2) adjacent fields worth £50,000
> Mr B agrees to sell the fields for £10,000 (an undervalue) on condition the purchaser buys the house for £140,000 (an overvalue)

The HMRC analysis is as follows:

> There are two separate transactions, the sale of the house and the sale of the fields
> Mr B gives a gratuitous benefit to the developer when he sells the fields for £10,000 because he knows they are worth more than this. Accordingly the transaction is 'otherwise than by way of a bargain made at arm's length' and the market value should be substituted.
> The developer gives a gratuitous benefit to Mr B when he buys the house for £140,000 because it is not worth this much. Accordingly this transaction is 'otherwise than by way of a bargain made at arm's length' and the market value of the house should be substituted.

This is an analysis which the FTT has repeatedly rejected. In *Bullivant Holdings v IRC*[82] the taxpayer acquired shares at a price which was less than the market value. He was able to do so because the shares had been acquired as part of a composite transaction in which the taxpayer's counterparty had obtained a benefit by virtue of another part of the transaction. The taxpayer's argument that the undervalue meant that the shares had not been acquired by way of a bargain made at arm's length failed, because there was no element of bounty involved in the seller's agreement to sell the subject shares at an undervalue:

> A process under which a party has to yield in respect of one part of a composite transaction in order to obtain the much desired benefits of

[81] The example in full, including its irrelevant detail, is as follows:
"Mr B owns a house with a walled garden and five adjacent fields. A developer wishes to buy all the property, demolish the house and build a sports centre and mini golf course. The market value of the house and garden is £100,000 and of the fields is £50,000.
Mr B agrees to sell the fields for £10,000 on condition the developer buys the house for £140,000 (Mr B will qualify for private residence relief)."

[82] [1988] STC 905.

> another part of the same transaction is of the essence of a genuine commercial bargain.

In *Conegate v HMRC*:[83]

> 85. ... it can be relevant to look at the overall or composite bargain reached when considering whether a party to a specific transaction was acting solely in his own interests. We accept that, as in *Bullivant Holdings*, there can be circumstances in which a person who is acting in his own interests might reach an apparently poor deal when looking at an individual transaction in isolation, but can be seen to be agreeing to that poor deal only in order to achieve a much better bargain overall.
> 86. So, in looking at the Appellant's acquisition or disposal of shares, we consider that the test is whether the Appellant agreed the terms of that acquisition or disposal with a mind to its own interests. In considering whether the Appellant has acted solely in its own interests, we can have regard to the overall bargain of which the specific transaction forms a part.

But the taxpayer in the Manual's house/fields example should fail for a different reason. Assuming there are two distinct contracts,[84] the two are clearly contractually linked. The consideration for entering into the contract to sell the fields at an undervalue includes the purchaser's promise to enter into the contract to buy the house at an overvalue. The consideration for the sale of the fields is £50k, not £10k.

App. 4.10.7 *Shareholder/co transaction*

The CG Manual provides:

> **CG14547 Market Value Rule: Control** [Jul 2019]
> Where one of the parties to a transaction is controlled by another person the controlled party may confer a gratuitous benefit on the other party to the transaction on the directions of the controlling person. The controlling person need not be a party to the particular transaction. But if they have exercised control so that the intention of the controlled person is to confer a gratuitous benefit by the transaction then it will have been carried out otherwise than by way of a bargain made at arm's length. For example the parent company of a group may have negotiated an overall deal to sell part of the group's business to an unconnected

[83] [2018] UKFTT 82 (TC).

[84] If there is a single contract, for the sale of two assets, the analysis is different but the outcome is the same: the parties apportionment of the total consideration between the two assets is not in good faith and does not bind HMRC.

> third party. As part of the deal one of the subsidiary companies sells two brand names at undervalue to the third party. In that particular transaction the intention of the subsidiary company was to confer a gratuitous benefit on the third party, because it was directed to do so by its parent company.
> Transactions between a company and its controlling shareholders may or may not be bargains made at arm's length. Where there is both an acquisition and a disposal the connected persons rules apply. Otherwise the subjective intention test must be applied.

App. 4.10.8 *Share subscription at overvalue*

The CG Manual provides:

> **CG14548 Market Value Rule: Share Subscriptions** [Jul 2019]
> Transactions between a company and its controlling shareholders may also be otherwise than by way of a bargain made at arm's length when the gratuitous benefit of the transaction is in the company's favour.
> EXAMPLE
> Company A is controlled by two people X and Y who each own 40 per cent of the issued share capital. Company A has not been trading profitably and has borrowed £100,000 from X and £50,000 from Y. Company T makes an offer to buy Company A for £3,000 on condition that it does not have any outstanding borrowings.
> Company A then issues 150 shares, 100 to X for £100,000 and 50 to Y for £50,000. Company A uses the money it receives for the shares to pay back its debts.
> The shareholders then sell all their shares to Company T and X and Y each claim a loss on the disposal of their shares.

The HMRC analysis is as follows:

> The purchases[85] of the 150 shares in Company A were otherwise than by way of bargains made at arm's length as X and Y purchased the shares for 150,000 knowing that they were not worth that much. They conferred a gratuitous benefit on Company A by purchasing its shares at overvalue.
> X and Y must each use the market value of their new shares at the date of issue as their acquisition cost.

Is that right? On the facts given, the bargain was at arm's length, since X

[85] Author's footnote: The apt company law term is acquisition, or issue, not purchase; but it does not matter.

and Y procured the repayment of their debt which was otherwise (more or less) worthless. Discuss.[86]

App. 4.10.9 *Deemed non-arm's length*

Section 18 TCGA provides:

> (1) This section shall apply where a person acquires an asset and the person making the disposal is connected with him.
> (2) Without prejudice to the generality of section 17(1) the person acquiring the asset and the person making the disposal shall be treated as parties to a transaction otherwise than by way of a bargain made at arm's length.

This only applies for CGT purposes. It switches on the CGT market value rule.[87]

App. 4.11 Market value adjustment clause

If values are uncertain, the parties may be in a quandary. Consider, say, a sale from an individual to a trust:

(1) If the trust pays too little:
  (a) The seller (if not the settlor) may become a settlor.
  (b) If the seller is the settlor, the sale may taint the trust.
  (c) The seller may make a transfer of value.
  (d) Assuming a sale between connected persons, CGT on the sale is computed by reference to market value, not the agreed price.[88]

(2) If the trust pays too much, there may be a benefit/capital payment to the seller.

If the underpayment is unintended and accidental, the tax risks are only slight:

(1) A bona fide sale, even between connected persons, is itself evidence (not conclusive, of course) of market value.
(2) The tax charges in (1)(a)(b)(c) above do not arise.[89]

But there may be a concern that HMRC may argue that there is an element

[86] See too s.128(2) TCGA.

[87] See App.4.8 (CGT market value rule).

[88] See App.4.10.9 (Deemed non-arm's length).

[89] See (a) 99.28 (Transaction on favourable terms); (b) 92.5.1 (Gratuitous intent: Disregards (a)(b)); (c) 74.13 (Arm's length disposal relief).

of gratuitous intent.

A market-value adjustment clause is often proposed as a way to avoid or at least to reduce these risks.[90] SP 5/92 provides:

> 13 Solely for the purposes of TCGA 1992 sch 5 para 9(3)(a) [tainting], a provision in the document governing the transaction for an appropriate adjustment to the consideration where
> [a] the value agreed by the Revenue[91]
> differs from
> [b] the original consideration arrived at by an independent valuer and specified in the sale document
> is, in general, regarded as falling within the terms of the above definition of an arm's length transaction.
> The arm's length value of the transaction is to be determined in accordance with the principles set out in para 12 above.[92] This will usually correspond to the value for CGT purposes except, for example, where TCGA 1992 s 19 would apply [assets disposed of in a series of transactions].
> 14 It would also be necessary for the terms of the contract to provide for compensating interest at a commercial rate to be paid in either direction once the arm's length value is determined. For this purpose, the official rate of interest for [employment-related loan] purposes[93] will usually be regarded as equivalent to a commercial rate of interest, although a different rate may be accepted as so equivalent if the circumstances of a particular case warrant this treatment.
> 15 This practice is, however, subject to the consideration passing on

[90] A price adjustment clause would not avoid the CGT issue at (1)(d).

[91] The passive voice may conceal ambiguity because the actor may not be identified. By whom must the value be agreed? In addition to the Revenue, there will be at least two persons interested (seller and purchaser), and there may be others (settlor, beneficiaries). In some cases HMRC may not agree a value, or there may be no appeal against a Revenue view. These issues would need to be considered when drafting a market-value adjustment clause. (Contrast 6.22.3 (Para 26(2) employment-income test) where a similar point arises in connection with the phrase "if value were received".)

[92] Para 12 contains generalities which do not take us very far: "Each case depends on its own facts and circumstances but a transaction is, in general, regarded as being at arm's length where all the facts and circumstances of the transaction are such as might have been expected if the parties to the transaction had been independent persons dealing at arm's length ie dealing with each other in a normal commercial manner unaffected by any special relationship between them."

[93] See 40.5 (Official rate of interest).

> sale being realistically based, ie on a third party valuation by a qualified valuer, all the other terms of the transaction being at arm's length and the compensating interest being timeously paid. The position in a particular case depends on all the facts and circumstances.

Tax Bulletin 16 adds:

> "One-way" adjuster clauses are satisfactory, provided that the parties are not concerned that they might face a claim that a "capital payment" had been made by the trustees if more passed out of the trust than was received in return.

Although the SP is said to be "solely for the purposes of para 9(3)(a) sch 5 TCGA", the same practice ought to apply for other purposes.

There must be doubts about the merits of a market-value adjustment clause:

(1) The clause may be taken to suggest that the parties are uncertain as to value, and so might encourage HMRC investigation and challenge.
(2) The clause brings in uncertainty over the rights of the parties to the agreement. The uncertainty will last for the period, lengthy, and potentially indefinite,[94] during which HMRC may raise the valuation issue. It is true that in the absence of the clause there might be a different uncertainty as to the tax position. But an adjustment clause does not provide certainty, it merely moves it from one sphere (taxation) to another (private rights of the parties).
(3) If trustees enter into a contract with such a clause, their potential liability may complicate trust administration.
(4) An agreement with a market-value adjustment clause is unlikely to constitute a bargain at arm's length, as arm's length parties would not be expected to allow HMRC to determine or reopen a valuation.[95]

None of these objections are overwhelming, but do the advantages of the clause outweigh these disadvantages?

If used, the drafting of a market-value adjustment clause would require some thought. It may be necessary to consider foreign Revenue authorities as well as HMRC.

[94] Because "who is the settlor" questions could arise at any time in the future. ((One might perhaps put a time limit on claims under the MV adjustment clause, but that would reduce some of the hoped-for tax efficacy of the clause.)

[95] However in practice it may not often matter whether the agreement is a bargain at arm's length.

I am inclined to think that in a bona fide transaction a market-value adjustment clause is rarely needed, or wise; and in practice if it is used I suspect it is quickly forgotten, and neither good nor harm ensues.[96]

A clause of this kind was discussed in *Iny v HMRC*[97] where a company (Castlegold) worth £2m was sold to a friendly trust for a token price of £20k:

> 58. The agreement included a price adjustment clause, which was to come into effect only if the Inland Revenue should question the price of £20,000. In that eventuality, Castlegold's auditors were to value the shares as at the date of the agreement, the valuation to be made within the six months following the first indication by the Inland Revenue of its concern. The valuation so made was to be binding on the parties and, should the value so ascertained differ from £20,000, a payment, with interest, was to be made immediately in the appropriate direction. The Commissioners argue that the inclusion in the agreement of this clause is itself an indication that the bargain was not one at arm's length. [The taxpayer] argued that the clause was explicable as a means of achieving fairness between the seller and purchaser of an asset whose value was difficult to determine.

The FTT referred, unusually, to a US case, *King v USA*[98] where a sale agreement included an upwards adjustment of the price should the Internal Revenue Service contend, as it did, that the true value of the shares was greater. The Court said:

> "The district court [found] that the parties intended that the trusts pay a full and adequate consideration for the stock and that the clause was a proper means of overcoming the uncertainty in ascertaining the fair market value of the stock. The court concluded that there was an intention to cause the trusts to pay full and fair consideration for the stock and to make an actual adjustment of the price paid upon the event of a determination by the IRS. We agree. It is important to observe that the IRS does not dispute the contention that it was difficult, if not impossible, to accurately value the stock at the time of its transfer in 1969 and that the parties inserted the specific valuation paragraph in the agreement because the transaction was intended as a sale and not as a gift..."

[96] Assuming the sale is on the basis set out in SP 5/92 para 15, ie the price is ascertained by a qualified valuer.

[97] [2010] UKFTT 457 (TC).

[98] 545 F 2d 700 at [25].

The FTT were not impressed by that:

> 59. We are not persuaded that that case offers much useful guidance here. The determination of the true value, in *King v USA*, was to be made by the IRS. Here, if there should be a challenge by the Inland Revenue, it was Castlegold's auditors who were to make the valuation. It is difficult, if not impossible, to understand why, if the auditors might be required to make a valuation, possibly several years later, in the event of a challenge, they were not asked to make one shortly before the agreement for sale was concluded. As we have said, Mr Iny told us that he believed his family had taken advice on the value of his shares; if so, it is odd that he was unable to produce the advice and, if the advice was obtained from someone competent to give it, that it was thought necessary to provide for later adjustment of the price.[99] It is also odd, though perhaps no more, that the auditors' valuation was to be binding on the parties to the agreement, whether or not the Inland Revenue accepted it and whether or not it was upheld in an appeal such as the appeal before us.
> 60. In our view the conclusion to be drawn is not that the adjustment was designed to achieve a fair balance between the vendor and the purchaser, but that its purpose was to give the impression that a genuine attempt had been made to arrive at a fair price.

Similarly, *HMRC v Conran*[100] concerned a sale for £8.5m, with a "tax reducer clause" which reduced the purchase price to £1, if or so far as HMRC denied the purchaser CT relief for amortisation of the consideration.[101] The clause was held to support HMRC's argument that the payment of the purchase price was a distribution in respect of shares:

> ... The tax reducer clause was not consistent with a party acting at arm's length, or "as if at arm's length" so there could be no question of the transaction being rationalised as a mere bad bargain (i.e. paying £8.25m for an asset worth £1). We reject [the taxpayer's] argument that the tax reducer clause was consistent with the parties being concerned about market value and a reflection of the connected nature of the parties which had nothing to say about the question of capacity. On the contrary, it shows the price was driven, not by the value of the business,

[99] The £20k price was a token payment, there was no valuation, and no negotiation; see at [79].

[100] [2023] UKUT 166 (TCC) at [112]. For this case, see 30.6.2 (Para B: Other distributions).

[101] Under Sch 29 FA 2002.

> but by the extent of favourable tax treatment to [the purchaser].

App. 4.12 Disposition conditional on tax consequences

A related topic is a provision which says that the validity of a disposition is dependent on it having a certain tax effect. In *Glowacki v HMRC*[102] a Deed of Variation provided:

> if the effectiveness of the variations in Clause 1 of this Deed is challenged by or on behalf of [HMRC] and either
>
> (1) [the parties] ... decide not to contest (or at any time decide not to continue contesting) that challenge by appeal or otherwise ... or
>
> (2) the result of any such appeal or proceedings is in favour of the Revenue challenge and such challenge is upheld—
>
> then ... the variations in [specified] Clauses of this Deed shall be deemed to be and always to have been without effect

The deed of variation (inevitably) failed to have the intended tax effect, and (without further discussion) it was held to be void. But as is the case for market value adjustment clauses, there must be doubts about the merits of clauses of this kind.

[102] [2007] UKSPC SPC00631.

APPENDIX FIVE

COMMERCIAL/VIEW TO PROFIT

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App. 5.1 Commercial basis/view to profit

This appendix considers the terms “commercial” and “view to profit”.

Statute frequently refers to a trade or business carried on (1) on a commercial basis and (2) with a view to profit: the two expressions are used in tandem. This is so common that I do not attempt to provide a list: a short list would be of little value, and a full list is impossible.

TAARs often refer to a transaction or arrangement made (1) for commercial reasons as well as (2) not for tax avoidance/advantage.[1] There is (more or less) no difference between “for commercial reasons” and “on a commercial basis” except that the former is more apt to describe a single transaction, and the latter for a continuing business activity.

Partnership law refers to carrying on business with a view to profit (without expressly referring to commerciality).[2]

[1] For a list, see 3.2.1 (Types of unallowable purpose).

[2] If the PA 1890 were drafted today, a commerciality test might have been included; but as will be seen, it makes little difference.

The word "commercial" is also identified as an ingredient or characteristic of other fundamental tax concepts, such as arm's length, trade, and "bounty".

Of course there are differences of wording and of context. But there are common underlying concepts, so commerciality/profitability are best addressed together, rather than in any particular context in which they may arise.

This topic has been a fruitful source of litigation.[3]

App. 5.1.1 *Trade/commercial/profit compared*

For illustration, consider s.66 ITA which provides:

> (1) Trade loss relief against general income for a loss made in a trade in a tax year is not available unless the trade is commercial.
> (2) The trade is commercial if it is carried on throughout the basis period for the tax year—
> (a) on a commercial basis, and
> (b) with a view to the realisation of profits of the trade.

The questions which arise here are:

(1) Is there a trade (the **"trading test"**)

(2) Is the trade carried on on a commercial basis (the **"commerciality test")**

(3) Is the trade carried on with a view to the realisation of profits (the **"profitability test"**)

The questions are conceptually distinct, but there is such a large degree of overlap that they seem like three ways of asking the same question.

Section 66 ITA assumes that an activity could be a trade even if it is not carried on on a commercial basis or with a view to profit. That seems far-fetched; but it depends on what is meant by commercial.[4]

If there is no view to profit, the trade is not likely to be conducted on a commercial basis; and vice versa. But one can devise instances where one test is satisfied and not the other.

Examples of a business with a view to profit but not commercial are:

[3] There have many first instance cases, turning on their own facts, and of limited or no general interest; but in addition to the cases cited in this appendix, see: *Beacon Estates (Chepstow) Ltd v HMRC* [2014] UKFTT 686 (TC); *Rowbottom v HMRC* [2016] UKFTT 9 (TC); *Scambler v HMRC* [2017] UKUT 1 (TCC).

[4] See App.2.23.8 (Trade: Commerciality).

(1) A person invests 100 with a view to receiving 101 in 10 year's time.
(2) A person provides their services at an undervalue, perhaps for philanthropic reasons.

A possible example of a business which might be commercial without a view to profit, if it has some other commercial benefit, a loss-leader perhaps, or generating a tax advantage (if that is commercial).

In the event of a dispute, HMRC are right in principle to argue on all 3 issues, as if they concede on trade, say, they have gone some way towards conceding on commerciality/profitability.

App. 5.1.2 *Loss relief: Policy background*

The Royal Commission Report on the Taxation of Profits and Income provides:

> 489. Criticism of the practical results of the right of set-off [of losses] concentrates mainly on the case of the "hobby-farmer", the man who, enjoying a substantial income from other sources, engages in farming as a part-time activity. It is said that he readily incurs farming losses because they are carried at the marginal rate of tax on his other income. As to the balance that comes out of his own pocket, various reasons are suggested why he may be indifferent to that: the supply of agricultural produce for his home consumption, the prospect of ultimately realising a capital profit on the sale of his farm, the value of which he has improved by liberal expenditure, the amusement that he derives from indulgence in his hobby, the attraction of a "hedge" against inflation.
> 490. No doubt there is something in all this. Even if farming is not the only part-time business activity which may have an element of hobby about it, it is the one that has attracted most attention. It is possible to imagine heavy expenditure on income account ripening into an appreciable gain on capital account. Though the Revenue requires farm produced consumed to be credited at cost for tax purposes, it is possible to imagine that the figures taken for cost cover some element of personal benefit, apart from the mere right of access to the supply. ...
> 494. In the result we have come to the conclusion that the complaints against the losses of the hobby-farmer are probably exaggerated and that nothing more is required than a small amendment of the existing tax code which will have the effect of making it more difficult for any abuses to be maintained or to step in. The step that we recommend is that the term "husbandry" in the statutory definition of "farm land" and "farming" in Section 526(1) Income Tax Act, 1952, should be

> strengthened by defining it as husbandry "carried on on a commercial basis and with a view to the realisation of profits", and that the term "market garden land" in the same section should be amended correspondingly by inserting after the words "for the sale of produce" the words "on a commercial basis and with a view to the realisation of profits"...
> 496. It will appear from what we have said above that we should not expect our recommendation to bring about any considerable change in the present position, or markedly to reduce the volume of loss claims in respect of out of court claims in respect of farming activities which can be seen clearly to lack commercial inspiration and to be nothing more than hobbies or private amenities.
> 497. Other activities than farming—for instance, spare-time or hobby shops or businesses—are capable of raising similar problems, though they are likely to offer less practical consolations for loss incurred. If at any time loss claims in respect of them were found to raise a serious problem, a remedy on the same lines as that which we have recommended in the case of farming ought to be considered.

Heathcoat-Amory, then Chancellor of the Exchequer, stated in Parliament:

> This Clause[5] is not designed to catch any undertaking which is run as a serious business, even if it is not very successfully managed. We are after the extreme cases which do not justify the term "farming undertaking", in which expenditure very greatly exceeds income or any possible income which can ever be made and in which, however long the period, no degree of profitability can ever be reached. ... no genuine farming enterprise, in which the aim is to run as efficiently and productively as possible, with the long-term purpose of earning a profit, can possibly be endangered by the Clause.[6]

A provision originally aimed at hobby farming losses has been used in the HMRC attack on film schemes designed to generate allowable losses.

App. 5.2 Commercial

App. 5.2.1 *A multi-factorial test*

"Commercial" is an imprecise word. Readers who struggle to comprehend it may take comfort from the comment of Viscount Dilhorne:

[5] Section 20 FA 1960, which is the predecessor of s.66 ITA.

[6] *http://hansard.millbanksystems.com/commons/1960/may/24/clause-18-restriction-of-relief-for*

> What exactly is comprehended in the phrase ... 'a bona fide commercial transaction', I do not know.[7]

The epithet "genuine" (a plain English equivalent for bona fide) does not help.[8]

It is considered that there is no single factor which determines what is "commercial" but a number of factors may indicate one way or the other. In other words, there is a multi-factorial test.

For an interesting empirical study of how the word commercial is understood, see Creative Commons, *Defining "Noncommercial"A Study of How the Online Population Understands "Noncommercial Use"*.[9]

Some more specialist issues are discussed in the context of the ToA motive defence; see 38.5.1 (Making/managing investments); 58.5.2 (Commercial: Whose viewpoint?).

App. 5.2.2 *Bounty (gratuitous intent)*

A transaction made with bounty (gratuitous intent) is not commercial.[10] By contrast, a transfer intended to make money is commercial: see below.

For instance, a gift to a trust for the benefit of the settlor's family is not a commercial transaction. The same applies even if the settlor is the principal beneficiary, and the trust is revocable. By contrast, a transfer of

[7] *IRC v Plummer* 54 TC 1 at p.48. Cf *IRC v Goodwin* 50 TC 583 at p.598.

[8] See 3.21.3 ("Genuine").

[9] *http://mirrors.creativecommons.org/defining-noncommercial/Defining_Noncommercial_fullreport.pdf* (2009)

[10] *Bulmer v IRC* [1967] Ch 145, citing *IRC v Goodwin* 50 TC 583 at p.607. HMRC adopt this approach in Venture Capital Schemes Manual, in the context of the requirement in s.165 ITA that "The relevant shares must be subscribed for by the investor for genuine commercial reasons...":

VCM11040. EIS: income tax relief: the investor: no tax avoidance [Sep 2017]

Commerciality

This requirement rules out any subscription which is motivated by considerations of benevolence. This could be the case if, for example, the company were the proprietor of an unsuccessful professional football club and a supporter of the club paid a large premium for shares in the company; that may well [interestingly, the text formerly said *would clearly*] not be a commercial subscription. Similarly, if the company is owned by a person whom the investor wishes to benefit, and the investor pays a large premium for the shares with the object of increasing the value of the other person's shares, that too would not be a commercial subscription. Deathbed investments are unlikely to be made for genuine commercial reasons."

assets to a company wholly-owned by the transferor may be a commercial transaction even if the transfer is for less than full (or nil) consideration, and a transfer to an employee trust may be commercial.[11]

App. 5.2.3 *Business transaction*

In *Carvill v IRC*:

> There was not much difference between the parties about what constituted a bona fide commercial transaction. [Counsel for the taxpayer] contended that this was any genuine transaction which implements or facilitates a business end; [counsel for HMRC] contended that the transaction must be in furtherance of commerce, ie a trade or business. I shall follow these two meanings.[12]

This seems a fair paraphrase though one should always beware of a paraphrase. At first sight it does not seem to take us very far because the word "business" is notoriously wide and slippery. Nevertheless, one can suggest examples of transactions which should not be classified as commercial because they are not in furtherance of a business:
(1) A transfer to a trust to avoid the hazards of war.[13]
(2) A transfer to avoid claims by non-business creditors, eg a claim on divorce or forced heirship.

These transfers involve an element of bounty (and may be classified as non-commercial for that reason) but in any event they should be classified as non-commercial transactions because they are not in furtherance of a business purpose.

App. 5.2.4 *Amateur/dilettante trade*

In *Wannell v Rothwell*:[14]

> I was not shown any authority in which the Court has considered the expression "on a commercial basis", but it was suggested that the best guide is to view "commercial" as the antithesis of "uncommercial", and I do find that a useful approach.

[11] This is supported by *Wannell v Rothwell* 68 TC 719 at p.733B; see too *IRC v Levy* 56 TC 68 at p.87, a case on the meaning of settlement-arrangement. The definition of settlement-arrangement does not include the word "commercial" but the case law requirement of bounty (gratuitous intent) overlaps with the concept of "commercial".

[12] [2000] STC (SCD) 143 at p.166.

[13] See 52.5 (Enactment history).

[14] 68 TC 719 at p.733.

I think the passage which follows is more useful:

> A trade may be conducted in an uncommercial way either because the terms of the trade are uncommercial (for instance, the hobby market-gardening enterprise where the prices of fruit and vegetables do not realistically reflect the overheads and variable cost of the enterprise) or because the way in which the trade is conducted is uncommercial in other respects (for instance, the hobby Art Gallery or Antique Shop where the opening hours are unpredictable and depend simply on the owner's convenience). The distinction is between a serious trader who, whatever his shortcomings in skill, experience or capital, is seriously interested in profit, and the amateur or dilettante. There may well be many borderline cases for the Commissioners to decide, and such borderline cases could as well occur in Bond Street as at a car boot sale.

The BI Manual provides:

> **BIM85705 uncommercial trades – not on a commercial basis** [Jan 2019]
> ... 'Commercial' is not the same as 'profitable'. We take it to mean, conducted in the way that we would expect a business of the same type to be carried on. A distinction may also be drawn between individual transactions and the trade itself; individual transactions may have the character of commerciality but overall the way in which the trade is conducted may lack commerciality. Indeed, even where the trader is serious about what he does but does not act in the way someone in that type of trade would act, we take the view that the trade is not being conducted on a commercial basis. ... One important question to be addressed is whether there are any non-commercial reasons for becoming involved in a particular business, for example, has the trader a general interest in sailing which might explain the venture into yacht chartering.

App. 5.2.5 *Commercial: Profit motive*

In *Samarkand Film Partnership No 3 v HMRC*:[15]

> "Commercial" and "with a view to profit" are two different tests but that does not mean that profit is irrelevant when considering whether a trade is being carried on on a commercial basis. ... the serious interest in a

[15] [2015] UKUT 211 (TCC) at [96]; the point was not discussed on appeal.

> profit is at the root of commerciality.[16]

The Court of Appeal agreed:[17]

> ... considerations of profitability cannot be divorced from an assessment of the commerciality of a business. In my judgment it is wrong to regard the profitability and commerciality tests in the legislation as mutually exclusive, and they necessarily overlap to an extent which will vary from case to case.

Again, in *Seven Individuals v HMRC*:[18]

> 40. ...As a matter of ordinary language to run a trade or business "on a commercial basis" suggests running the trade or business in a way that is at any rate designed to succeed as a commercial venture, that is one which is worth doing from a financial point of view. It is true that this means that there is an inevitable overlap between the commercial limb and profits limb, but the alternative would be to empty the commerciality limb of any connection with profit or profitability, when that is a central part of what would normally be understood by a reference to acting commercially...
> 46. ... I agree that a trader can fail the commerciality limb either because of a lack of commercial organisation ...or because of a lack of any interest in making money ... . But I do not think it follows that as long as the trade is sufficiently organised and the trader hopes to make a profit ... that is always enough. Let us assume that a trade is well organised. The question whether such a trade is being carried on on commercial lines is not to my mind answered simply by pointing to a hope by the trader to make profits. A trade run on commercial lines seems to me to be a trade run in the way that commercially-minded people run trades. Commercially-minded people are those with a serious interest in profits, or to put it another way, those with a serious interest in making a commercial success of the trade. If therefore a trade is run in a way in which no-one seriously interested in profits (or seriously interested in making a commercial success of the trade) would run it,

[16] Ambrose Bierce makes the same point in The Devil's Dictionary (1911) in his definition of "Merchant": "A commercial pursuit is one in which the thing pursued is the dollar."
Likewise *C&E v Morrison's Academy* [1978] STC 1: "I am not at all quite clear what is meant by a 'commercial element' if it is something different from the pursuit of profit...".

[17] [2017] EWCA Civ 77 at [90].

[18] [2017] UKUT 132 (TCC).

> that trade is not being run on commercial lines.

In *Seven Individuals v HMRC*:[19]

> A trade which lays out 100 in year 1 and recovers 101 in year 10 is a trade which makes a profit in the simple sense that its income exceeds its expenditure, yet it is unlikely that anyone with a serious interest in making a commercial success of the trade would regard that as a satisfactory return, even if it were virtually certain to happen.

App. 5.2.6 *Profit: Commerciality test*

In *Samarkand Film Partnership No 3 v HMRC*:[20]

> [96] ...[The FTT] were correct in regarding "profit" in the context of commerciality as a real, commercial profit, taking account of the value of money over time, and not simply an excess of income over receipts. [97] The FTT were, in our view, right to conclude that a trade that involved transactions that were intended to produce a loss in net present value terms, with no compensating collateral benefits, was not conducted on a commercial basis. No one who was seriously interested in running a business or trade on commercial lines would pay £10 for an income stream with a net present value of £7 unless there were some good reason to do so. Of course in this case the reason why the partnerships were willing to do this was because they believed that tax relief would be available to the partners.

App. 5.2.7 *Commercial: avoidance motive*

HMRC Unallowable Purpose Tests Draft Guidance states at para 10110:

> Often, a business will take the view that tax is a commercial cost and minimising it is a commercial aim. ... However, in deciding whether a "purpose test" is triggered, minimising tax is not regarded as a business or commercial purpose.

On the contrary, I would have thought that the only thing that matters, in business and indeed outside it, is post-tax profit. The fact that TAARs impose a commercial *and* a tax avoidance/advantage test also suggests that tax avoidance is or can be commercial matter, in the general sense of the word. But context can of course suggest that "commercial" reasons exclude tax advantages.

[19] [2017] UKUT 132 (TCC) at [54].

[20] [2015] UKUT 211 (TCC). The point was not discussed on appeal.

App. 5.3 A view to profit

This phrase originated in the definition of partnership[21] and (subject as always to context) the meaning should be the same in tax provisions.

The definition of partnership uses the expression "with a view *of* profit" whereas modern legislation uses the more contemporary phrase "with a view *to* profit". But nothing turns on the preposition; the two phrases have the same meaning.[22]

The BI Manual provides:

> The expression 'with a view of profit' distinguishes partnerships
> [1] from clubs and societies which do not have a profit seeking motive, and also
> [2] from arrangements only to share expenditure, where each person keeps their own income, for example some dentists or medical practitioners with joint surgeries, or some crop-sharing agreements.[23]

I would have thought that case [2] (expense sharing) is not a partnership because the persons are not carrying on business *in common*. But the end result is the same.

If there is no view of profit, there is no partnership in UK law. This issue may arise where a partnership is set up for tax rather than for commercial reasons.

App. 5.3.1 *With a view: Subjective test*

Macdonald v Dextra Accessories considered the meaning of "with a view to" in s.43 FA 1989 ("amounts ... held ... with a view to their becoming relevant emoluments"):

> the expression "with a view to" ... is a less specific expression than "for the sole purpose of…" or "with the principal or dominant intention of…"; and ... it suggests a degree of flexibility of meaning and application. That said, the word "view" plainly connotes some element (albeit undefined) of purpose, intention or contemplation.[24]

[21] See 85.5.2 ("View of profit"); 85.22.2 (LLP treated as partnership).

[22] This is self-evident, but if authority is needed, see *Ingenious Games LLP v HMRC* [2019] UKUT 226 (TCC) at [301].

[23] Author's footnote: barristers chambers are another example in this category

[24] 77 TC 146 at [64] (CA) approved at [18] (SC). This approach was applied in *Ingenious Games LLP v HMRC* [2019] UKUT 226 (TCC).

After some vacillation, the UT have decided that the test is a purely subjective one.[25]

App. 5.3.2 *View of partnership or of partners?*

In *Ingenious Games LLP v HMRC* [2019] UKUT 226 (TCC), a case on s.863 ITTOIA

> [338] The test is also to be applied at the level of the LLP. An LLP is a body corporate, and therefore a separate legal entity from its members. For the purposes of s 863 ITTOIA 2005 it is necessary to focus on the LLP, its business and the individuals who conduct that business on its behalf, rather than on the position of the LLP's members. This is in contrast with the position under s 2(1)(a) LLPA 2000, where the focus is on what view the members held at the point of incorporation

What matters is the controlling minds of the LLP (not the same as the members of the LLP).

The same applies to ordinary partnership (not a LLP). In *Samarkand Film Partnership No 3 and others v HMRC*:

> The availability of loss relief to the individual partners in their personal capacities cannot in my view be a relevant factor in assessing the commerciality of the partnership's business.[26]

This point should not apply to a sole trader (a non-partnership).

App. 5.3.3 *Mixed motives*

In *Ingenious Games LLP v HMRC*:[27]

> it will be sufficient for a taxpayer to show that there was an ancillary profit-making purpose,

And again:

> There is no need for profit to be the predominant aim. ... difficult questions can arise when any profit-making aim is subsidiary to other purposes. In those circumstances, it is necessary to consider at what point the line is crossed and there is in fact no view to profit. Some sort of 'reality check' is needed. It is necessary to identify whether there is

[25] *Ingenious Games LLP v HMRC* [2019] UKUT 226 (TCC) at [333].

[26] [2017] EWCA Civ 77 at [91].

[27] [2019] UKUT 226 (TCC) at [310].

> a 'real' intention rather than something that was not, in fact or reality, aimed for. ... Furthermore, an indifference to whether a profit is realised is not sufficient to meet the test.[28]

So:

> The question is whether there is a real and serious intention to make a profit. As noted at [344] and [345] below, the [objective] likelihood of profit may be an element of relevant evidence, but no more.[29]

App. 5.3.4 *What is profit*

In *Ingenious Games LLP v HMRC*:[30]

> 'profit' means an excess of (actual) income over expenses, that is the net amount remaining after paying out of the receipts of the business all the expenses incurred in obtaining those receipts, and that it is not determined by reference to particular methods of accounting computation.

But profit can only be determined by reference to some method of accounting. Profit is a commercial concept, and I would have thought that it should be determined in accordance with accountancy principles, ie UK GAAP or any other acceptable GAAP. A business operates with a view of profit if it expects to make a profits on accountancy principles, even though it expects to make a loss on tax principles, due say to capital allowances.

HMRC agree. The BI Manual provides:

> **BIM85710: not with a view to the realisation of profit** [Aug 2016]
> 'Profit' in this context is the commercial profit in the accounts, not the tax adjusted profit; that is, the profit before capital allowances but after depreciation and interest.

In *Ingenious Games LLP v HMRC*:[31]

> the amount of the profits intended to be realised by the venture does not matter unless it is, on a true analysis, *de minimis*.
> ... in determining whether there is a view to profit the court should not adopt or employ a purely quantitative analysis. The amount of the expected profit is only one of several factors to consider.

[28] at [333].

[29] at [340].

[30] [2019] UKUT 226 (TCC) at [303].

[31] [2019] UKUT 226 (TCC) at [304], [310].

App. 5.3.5 *A view to profit*

The BI Manual provides:

> **BIM85710: not with a view to the realisation of profit** [Aug 2016]
> ...
> There are two possible ways to displace the trader's assertion of expectation of profits: either it is not a reasonable expectation, or there is another reason for carrying on the trade.
> **It is not a reasonable expectation**
> You may be able to show that there is no possibility of profit ever regardless of however long the trade is carried on, so the expectation of profit is unfounded, by closely examining any business plan, profits projection or whatever is provided as the basis for the trader's expectations of profit. You are justified in pointing to past results when considering whether the trader's expectation of profit is reasonable...
> **There is another reason for carrying on the trade**
> A trader who makes losses with no realistic possibility of making a profit may have some other reason for carrying on the trade. For example, it may be that the trade is a hobby (which in itself may fall foul of the commercial basis part of the test see BIM85705) or gives the trader personal enjoyment. It may also be the case that the trader is simply seeking to offset personal expenditure or to increase the value of a capital asset.
> In the Special Commissioners' case of *Delian Enterprises v Ellis* [1999] SpC186 the Revenue was unable to prove that the trader was carrying on a hobby. This was specifically mentioned by the Special Commissioner as a factor in his decision. In another Special Commissioners' case *Brown v Richardson* [1997] SpC129 and TB31F the expressed intentions of the trader were not found to be conclusive. In this case the Special Commissioner found that the income generated was intended to offset expenditure rather than with a view to the realisation of profits.

App. 5.3.6 *Period of enquiry*

In *Ingenious Games LLP v HMRC*:[32]

> the law of partnership does not require a net gain over a determined period in order to establish that an activity is with a view to profit, noting that a partnership may, for example, incur initial losses during the start-up phase of its enterprise. It is sufficient that the enterprise is carried on with a view to profit in the future.

[32] [2019] UKUT 226 (TCC) at [310].

BI Manual provides:

> **BIM85710: not with a view to the realisation of profit** [Aug 2016]
> The criterion of the expectation of profit does not specify any period within which the trade must be expected to realise a profit and it is sufficient there is some realistic possibility of profit being earned at some future date, however distant. The fact that it is distant is not a ground for refusing relief. ...

App. 5.4 Reasonable expectation of profit

View to profit is a subjective test.

Statute occasionally refers to reasonable expectation of profit, which brings in an objective test, or an objective element. There is a variety of wording. It is helpful to set three sample provisions side by side as an illustration:

s.66 ITA **Trade loss relief**	**s.74 ITA** **Early trade losses relief**	**s.1(1) PA 1890** **Definition of partnership**
(1) Trade loss relief against general income for a loss made in a trade in a tax year is not available unless the trade is commercial.	(1) Early trade losses relief for a loss made by an individual in a trade in a tax year is not available unless the trade is commercial.	Partnership is the relation which subsists between persons carrying on a business in common
(2) The trade is commercial if it is carried on throughout the basis period for the tax year—	[identical]	
(a) on a commercial basis, and	[identical]	
(b) with a view to the realisation of profits of the trade.	(b) in such a way that profits of the trade could reasonably be expected to be made in the basis period or within a reasonable time afterwards.[33]	with a view of profit.
(3) If at any time a trade		

[33] The definition of "excluded company" in s.151 ITA is another example of this wording.

is carried on so as to afford a reasonable expectation of profit, it is treated as carried on at that time with a view to the realisation of profits.

There are (at least[34]) four possibilities, with different outcomes depending on whether one applies:

- the partnership test (view to profit)
- the s.74 test (reasonable expectation of profit)
- the s.66 test (view to profit + s.66(3)), which falls between the two

Case	**View to profit**	**Reasonable expect'n of profit**	**s.66 relief**	**s.74 relief**	**Partnership**
1	Yes	Yes	Yes	Yes	Yes
2	Yes	No	Yes	No	Yes
3	No	Yes	Yes	Yes	No
4	No	No	No	No	No

Section 74(1)(b) imposes an objective test. Whether the trader has a view to profit is not relevant. This would matter if a person carried on trade on a commercial basis, with a reasonable expectation of profit, but not with a view to profit; which seems highly unlikely even if logically possible.

It is possible that a trade which does not have a reasonable/objective expectation of profit is nevertheless carried on with a view to the realisation of profit: s.66(3) does not affect that.[35]

Case 2 arises if a person carried on a trade on a commercial basis but that profits could not reasonably be expected; it seems almost impossible, though perhaps not logically impossible.

App. 5.4.1 *Does objective/subjective matter*

I have some impatience with the whole objective/subjective distinction, which diverts lawyers in many contexts. The rival approaches of objective/subjective, or some combination of the two, so rarely produce a different outcome. That is especially so in the present context where the subjective test of view to profit is only part of a wider set of requirements which include objective requirements (trade/business, commerciality).

[34] To avoid too many permutations, assume that there is a trade or business carried on.

[35] If authority is needed, see *Seven Individuals v HMRC* [2017] UKUT 132 (TCC) at [35].

Ingeneous Games poses the example of a person who carries on a business to manufacture saddles for unicorns: even if he had deluded himself into having a subjective intention to make a profit, there would be no realistic or objective possibility of profit. Or so the Tribunal thought, perhaps unimaginatively. But does that actually happen? And if it did, would the saddler's trade be carried on on a commercial basis?

However that may be, adoption of a uniform test for all loss reliefs - and indeed in other tax contexts where similar language is used - would be a useful simplification.

App. 5.5 Commercial/view to profit: Tax motive

Tax motives may arise in the context of the commerciality test and the profitability test, but it is suggested that the principles are the same.

In *Newstead v Frost* a non-resident partnership was set up in order to convert (what would otherwise have been) UK source trading income into foreign source trading income taxed on the remittance basis. The Revenue contended:

(1) The business was carried on with a view to avoiding tax.
(2) Accordingly it was not carried on with a view to profit.

This was a hopeless argument: the premise was correct but the conclusion did not follow. HL dealt with it briefly:

> While it is clear that the partnership was formed with that object [tax avoidance], it must also have been formed with a view of profit. It was intended that profits should be made for if they were not made as a result of the taxpayer's activities, there would have been no tax to be avoided.[36]

That was a straightforward case of a partnership set up for mixed purposes. One of the purposes was to make a profit.

Again, in *Backman v R*:

> The question ... is whether the taxpayer can establish an intention to make a profit, whether or not he was motivated by tax considerations.[37]

On the other hand, if the *sole* reason for an activity is to give a tax advantage, and there is *no* contemplation in the parties' minds that a profit would arise from carrying on the activity, then the activity could not be

[36] [1980] STC 123 at p.128.
[37] [2001] 3 ITLR 647 at [22].

said to be carried on with a view of profit (and it might not be said to be a business).[38]

This difficulty arises if, as in *Ingenious Games*, the only serious driver for profit is to meet a tax requirement (in that case, s.863 ITTOIA) so there was no pressure from the members of the LLP to make a profit. In other words, this was not a normal business motivated by the desire for profit. The LLP's sales memorandum was prepared on a 'bottom up' basis, starting with a modest profit and working backwards, rather than starting with expected revenues. These facts do not preclude a view to profit, but they make it harder to attain.

HMRC Unallowable Purpose Tests Draft Guidance states at para 10110:

> Often, a business will take the view that tax is a commercial cost and minimising it is a commercial aim. ... However, in deciding whether a "purpose test" is triggered, minimising tax is not regarded as a business or commercial purpose.

On the contrary, I would have thought that the only thing that matters, in business and indeed outside it, is post-tax profit. The fact that TAARs impose a commercial *and* a tax avoidance/advantage test also suggests that tax avoidance is or can be a commercial matter, in the general sense of the word. But context can of course suggest that "commercial" reasons exclude tax advantages.

App. 5.5.1 *Intention to get loss relief*

An intention to obtain loss relief is a special case. In *Samarkand,* a film scheme case, a partnership activity was uncommercial and not profitable if one ignored loss relief; but if one could take loss relief into account, it was profitable for the partners and no doubt commercial. But loss relief was not allowed as relevant consideration in assessing commerciality:

> In order to obtain loss relief, the partners have to show that the trade is commercial; but they can only do this if they assume their entitlement to obtain such relief, which is the very issue under consideration. In other words, the argument is circular and proves nothing. The question of commerciality must therefore be addressed without reference to the availability or not of loss relief to the individual partners.[39]

The reasoning is invalid as:

[38] This is self-evident; but if authority is needed, see *Backman v R* 3 ITLR 647 at [23].

[39] [2017] EWCA Civ 77 at [91].

(1) The taxpayer's argument was not circular.[40]
(2) The loss was a tax loss, not a commercial loss.

But the point is settled at all levels below the Supreme Court.

Similarly, loss relief would not be allowed as a relevant factor in deciding whether there was a view to profit.

[40] In order to show that the trade was commercial; the partners did not have to assume their entitlement to loss relief. They only had to show that they expected or hoped to obtain that relief.

APPENDIX SIX

BENEFICIAL OWNERSHIP/ENTITLEMENT

App. 6.1 Beneficial ownership: Meanings
App. 6.2 English-law beneficial ownership
App. 6.3 A technical term
App. 6.4 Beneficial v bare legal ownership
App. 6.4.1 Critique of case law
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App. 6.1 Beneficial ownership: Meanings

The expression "beneficial ownership" has (at least) three distinct meanings. We need terms to describe them and I coin the following terminology:

My Term	**Context**	**See para**
English-law beneficial ownership	Property/trust/general law	*Discussed here*
DTA beneficial ownership[1]	DTAs	108.10
Money-laundering ben. ownership	Money laundering	131.15

Discussion of meaning in one context has little (if any) relevance in other contexts. While an English law beneficial owner should normally be beneficial owner for DTA and money-laundering purposes, the converse is not the case. Meanings (2) and (3) are international law concepts, shared by civil lawyers, to whom English-law beneficial ownership, a common law concept, is unfamiliar.[2]

I had thought this was self-evident, and "if authority is needed" cited *Hargreaves Property Holdings v HMRC*:[3]

> ... determining beneficial entitlement to income can depend on the context in which the phrase appears... the decision in *Indofood* [a case on DTA beneficial ownership] is of no relevance in determining the meaning of the phrase where it appears in [s.993 ITA, (Interest

[1] This is sometimes called the "international fiscal meaning".

[2] This point is made para 10.4 of the commentary on OECD Model art 11; see 108.10.4 (DTA meaning: General).

[3] [2021] UKFTT 390 (TC) at [128]. [130].

withholding tax) where the English-law beneficial ownership meaning applies].

But in a surprising decision, the UT reversed the decision in *Hargreaves* and gave (what I call) the DTA meaning to reference to "beneficial ownership" in a UK tax statute.[4] The authorities discussed below were not cited. Further discussion should wait until the decision is final.

It would have been better to have three distinct expressions, but the usage is too well established to alter that, and context should show which meaning is intended.

App. 6.2 English-law beneficial ownership

Beneficial ownership is one of a cluster of terms which are synonymous, or at least which have no discernable differences:

Term
Equitable ownership
Beneficially entitled
Ownership

These terms are found in many contexts relevant to this book:

Context	**Term**	**See para**
FOTRA: Interest relief	Beneficial owner	27.5
FOTRA: IHT relief	Beneficial ownership	73.11
Groups: Definition of subsidiary	Beneficial ownership	64.26
Definition of estate for IHT	Beneficially entitled	74.2
Interest withholding tax	Beneficially entitled	26.23.3; 26.24; 26.29.1

The meaning is more conveniently considered as a discrete topic, rather than in any particular context in which it may arise.

Where the statutory term is beneficial ownership one might abbreviate it to ownership; but terminology is confused enough already without cutting that corner.

The reference to "English law" beneficial ownership is not entirely apt, as we are discussing the meaning in the context of tax statutes which are also part of the law of Scotland, and some might prefer to refer to the "common law meaning".

The meaning of beneficial ownership has often been discussed in the context of company groups. But the question can and does arise almost

[4] [2023] UKUT 120 (TCC).

anywhere, and it is a mistake to look at the group relief cases to the exclusion of cases and guidance in other contexts. Unfortunately the case law is in disarray and a number of contradictory dicta can be found.

In the discussion below I use the term beneficial ownership but the same applies to beneficial entitlement. Reference may also be made to discussion of the word "entitled" in the context of income recognition. The underlying issue is a similar one: in what circumstances do we recognise a person as the owner of an asset?[5]

App. 6.3 A technical term

In *Sainsbury v O'Connor*:[6]

> Although I might not, with Lord Diplock, have gone so far as to think that the expression "beneficial ownership" is a term of art, it is certainly one which has for several centuries had a very well-recognised meaning amongst property lawyers. And there can be no doubt that, in enacting a provision such as [what is now s.1154 CTA 2010, definition of subsidiary], Parliament must have intended to adopt that meaning.

That meaning must of course give way to context, but there is a natural meaning, and (apart from contexts such as international treaties, such as DTAs, and moneylaundering, where there is a definition) it is not often that the context alters that.[7]

Similarly, in *BCM Cayman v HMRC*: [8]

[5] See 15.2.1 (Receipt/entitlement basis of liability); 15.3 (Recognition/attribution: Analysis).

[6] 64 TC 208 at p.250, a case on group relief.

[7] In New Zealand, *Cooper v Pinney* expresses slightly more enthusiasm for the scope of the expression to vary according to context; [2023] NZCA 62 at [56], citing English and New Zealand cases; but I do not think there is ultimately much difference between these two views.

The CG Manual offers an example of a case where context shows 'beneficial' was used in a tax statute with a wider, DTA-style meaning. The former s.210(2) TCGA provided an exemption for life policies, if (in short) the person making the disposal was the original "beneficial owner". But trustees qualified for the exemption as they were the "beneficial owner" for this purpose. The CG Manual formerly provided:

> ***CG69055 Exemption for second hand policies: Disposals before 9 April 2003*** *[Feb 2010]*
>
> *... Where trustees took out a life insurance policy ... it could be accepted that they were the beneficial owners of the policy within the old s.210(2) TCGA.*

[8] [2023] EWCA Civ 1179 at [78].

> The concepts of fiduciary ownership and beneficial interest or ownership are concepts of domestic law, but not specifically of tax law.

App. 6.4 Beneficial v bare legal ownership

The antonym of English-law beneficial ownership is bare legal ownership. In *Sainsbury v O'Connor*:[9]

> [Beneficial ownership] means ownership for your own benefit as opposed to ownership as trustee for another. It exists either where there is no division of legal and beneficial ownership or where legal ownership is vested in one person and beneficial ownership or, which is the same thing, the equitable interest in the property in another.

To an English lawyer that seems self-evident, and does not take one very far.

Two further propositions seem reasonably clear. An asset remains in the beneficial ownership of a person even if it is subject to a mortgage or charge.[10] An asset is not in the beneficial ownership of a person if it is subject to a contract of sale, even a conditional contract.[11]

An asset remains in the beneficial ownership of an individual even if they have granted put and call options, according to *Sainsbury v O'Connor*.[12] That seems a somewhat technical distinction.

App. 6.4.1 *Critique of case law*

The common meaning of beneficial ownership is to denote the sum of all the rights which a person can have over an asset; that is, beneficial ownership is a bundle of rights, or if you prefer, beneficial ownership has a number of incidents.[13] In the case of shares, the bundle (or incidents) consists principally of the right to dividends, capital, votes, and rights of disposal.

One can make some dent in the usual array of rights or incidents and still be regarded as the owner. This explains why one remains beneficial owner

[9] 64 TC 208 at p.250, a case on group relief.

[10] *English Sewing Cotton v IRC* [1947] 1 All ER 679.

[11] *Wood Preservation v Prior* 45 TC 112.

[12] 64 TC 208.

[13] For discussion, start with Rostill, *Possession, relative title, and ownership in English law*, (2021) chap 7 (Ownership). See too Turner, "Some Reflections on Ownership in English Law" (1941) 19 Can. Bar Review 342; Harris *Property and Justice* (1996) p.125; Jaffey, "Explaining the Trust" [2015] LQR 377 at p.386.

after granting a charge or licence. Where does one draw the line? The courts answer to this question has been confused because they insist that beneficial ownership must (with limited exceptions) be regarded as vested in one person or another. This causes artificial results when property is subject to a contract of sale and it is said that beneficial ownership must be vested in either the vendor or purchaser. There is no reason why that should be so, if one remembers that beneficial ownership is no more than a term for a bundle of rights. The better analysis is that beneficial ownership rights are split between vendor and purchaser. Neither need be nor should be regarded as "the" beneficial owner.[14] Likewise for property subject to an option. On this analysis, *Wood Preservation* was rightly decided but for the wrong reasons, and *Sainsbury* was wrongly decided. But perhaps *Sainsbury* leads to more satisfactory outcomes in the context of group relief, and the law on this point is settled.

App. 6.5 Beneficial owner: Partnership

The IHT Manual provides:

> **IHTM27264 Exempt securities as partnership assets** [Sep 2018]
> Very occasionally the assets of a partnership may include exempt securities which will normally constitute 'excepted assets' (see IHTA84/S112) so they will not qualify for Business Relief. In this situation a partner's transfer of their interest in the partnership will be excluded property:
>
> - to the extent that it is attributable to the exempt securities (IHTM27241)
> - and only if it satisfies the conditions specified for the security
>
> You should calculate the amount to be excluded as follows:
> (Value of exempt securities ÷ Total value of partnership) × Value of transferor's partnership interest

HMRC accept that a partnership share is for this purpose regarded as a share of the partnership assets.[15]

[14] Likewise the courts have come to reject the dogma that "where ownership is vested in a trustee, equitable ownership must necessarily be vested in someone else because it is an essential requirement of a trust that it confers upon individuals a complex of beneficial legal relations which may be called 'ownership'". See *CPT Custodian Pty v Commissioner of State Revenue* (2005) 221 ALR 196 at [25].

[15] In my terminology, this adopts the co-ownership analysis of a partnership share: see 85.3 (Nature of partnership share).

App. 6.6 Beneficial ownership: Scotland

The IHT Manual discusses the expression "beneficially entitled", in a passage which sheds a little light on beneficial ownership:

> **IHTM04031 what is meant by beneficially entitled?** [Sep 2018]
> The use of the words 'beneficially entitled' means broadly that the estate includes only property
> - to which a person is entitled, or
> - in which they have an interest for their own benefit. In England, Wales and Northern Ireland this includes property which a person owns either legally or beneficially (IHTM04441).

So far, the text is unexceptionable. The discussion then turns to Scotland:

> In Scotland, the term 'ownership' does not necessarily equate to beneficial entitlement, for example where the land that is being transferred is subject to missives of sale [or][16] there is an unrecorded disposition. This is because of the Scottish system of unitary ownership. Any case where the question is in point should be referred to Technical for advice.

No doubt the Scots law background is different: Scotland does not have the concept of equitable interests. Whether those differences have any practical effect on the meaning of "beneficial ownership" in the present context seems unlikely, but only a Scots lawyer can express an informed view on that.[17]

The passage concludes:

> A person is not beneficially entitled to property held
> - purely in a fiduciary capacity (for example as a trustee)
> - in a representative capacity (for example as an executor or a trustee in bankruptcy), or
> - by way of security (for example as a mortgagee prior to foreclosure).
>
> ...

This is clearly right.

[16] The original reads "of", but I think that is a slip for "or".

[17] I would be grateful to any Scots reader who could direct me to relevant authority. McDonald and Pagan, *Inheritance Tax in Scotland: Tax Annual* (Bloomsbury) may help.

APPENDIX SEVEN

WHAT DO WE MEAN BY "REAL"

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App. 7.1 What do we mean by real

The word "real" is one of a cluster of words (including "genuine"[1] and "bona fide" and "in truth") which are casually used, by lawyers and others, but merit careful thought. In this appendix I set out comments from the context of philosophy (JL Austin); literary criticism (Christopher Ricks); and some case law on "real" and form v substance distinctions.

The question whether *legal concepts or rules* should be described as fictions or legal fictions is a distinct question, because no-one doubts the validity of such rules even if they are called legal fictions.[2] Whereas if one identifies, say, a "realistic" view of *facts*, or a "real transaction", it is implied that rival views are unrealistic/unreal and ought to be disregarded.

App. 7.2 Reality: JL Austin

JL Austin, *Sense and Sensibilia*[3] has a profound discussion which I set out

[1] See 3.21.3 ("Genuine").

[2] See 102.2.1 (Is situs fictional?); App. 2.6.3 (Legal personality jurisprudence).

[3] Chapter 7, set out here with kind permission of OUP. Footnotes are original. The text of the entire book is available on:
http://selfpace.uconn.edu/class/percep/AustinChs1-6.pdf
http://selfpace.uconn.edu/class/percep/AustinChs7-11.pdf

here. If it was required reading before anyone wrote the word "real", a great deal of confusion might be avoided.

I want to take a closer look at this little word 'real'. I propose, if you like, to discuss the Nature of Reality a genuinely important topic, though in general I don't much like making this claim.

There are two things, first of all, which it is immensely important to understand here.

1. 'Real' is an absolutely *normal* word, with nothing new-fangled or technical or highly specialized about it. It is, that is to say, already firmly established in, and very frequently used in, the ordinary language we all use every day. ... And we must always be particularly wary of the philosophical habit of dismissing some (if not all) the ordinary uses of a word as 'unimportant', a habit which makes distortion practically unavoidable. For instance, if we are going to talk about 'real', we must not dismiss as beneath contempt such humble but familiar expressions as 'not real cream'; this may save us from saying, for example, or seeming to say that what is not real cream must be a fleeting product of our cerebral processes.

2. The other immensely important point to grasp is that 'real' is *not* a normal word at all, but highly exceptional; exceptional in this respect that, unlike 'yellow' or 'horse' or 'walk', it does not have one single, specifiable, always-the-same *meaning*. (Even Aristotle saw through this idea.) *Nor* does it have a large number of different meanings - it is not *ambiguous*, even 'systematically'. Now words of this sort have been responsible for a great deal of perplexity...

Let us begin, then, with a preliminary, no doubt rather haphazard, survey of some of the complexities in the use of 'real'. Consider, for instance, a case which at first sight one might think was pretty straightforward - the case of a 'real colour'. What is meant by the 'real' colour of a thing? Well, one may say with some confidence, that's easy enough: the *real* colour of the thing is the colour that it looks to a normal observer in conditions of normal or standard illumination; and to find out what a thing's real colour is, we just need to be normal and to observe it in those conditions.

But suppose *(a)* that I remark to you of a third party, 'That isn't the real colour of her hair'. Do I mean by this that, if you were to observe her in conditions of standard illumination, you would find that her hair did not look that colour? Plainly not - the conditions of illumination may be standard already. I mean of course, that her hair has been *dyed*, and normal illumination just doesn't come into it at all. Or suppose that you are looking at a ball of wool in a shop, and I say, 'That's not its real colour.' Here I *may* mean that it won't look that colour in ordinary daylight; but I *may* mean that wool isn't that colour before it's dyed. As so often, you can't tell what I mean just from the words that I use; it makes a difference, for instance, whether the thing under discussion is or is not of a type which is *customarily* dyed.

Suppose *(b)* that there is a species of fish which looks vividly multi-coloured, slightly glowing perhaps, at a depth of a thousand feet. I ask you what its real colour is. So you catch a specimen and lay it out on deck, making sure the condition of the light is just about normal, and you find that it looks a muddy sort of greyish white. Well, is *that* its real colour? It's clear enough at any rate that we don't have to say so. In fact, is there any right answer in such a case?

Compare: 'What is the real taste of saccharine?' We dissolve a tablet in a cup of tea and we find that it makes the tea taste sweet; we then take a tablet neat, and we find that it tastes bitter. Is it *really* bitter, or *really* sweet?

(c) What is the real colour of the sky? Of the sun? Of the moon? Of a chameleon? We say that the sun in the evening sometimes looks red - well, what colour is it *really*? (What are the 'conditions of standard illumination' for the sun?)

(d) Consider a *pointilliste* painting of a meadow, say; if the general effect is of green, the painting may be composed of predominantly blue and yellow dots. What is the real colour of the painting?

(e) What is the real colour of an after-image? The trouble with this one is that we have no idea what an alternative to its 'real colour' might be. Its apparent colour, the colour that it looks, the colour that it appears to be? - but these phrases have no application here. (You might ask me, 'What colour is it really?' if you suspected that I had lied in telling you its colour. But 'What colour is it really?' is not quite the same as 'What is its real colour?').

Or consider 'real shape' for a moment. This notion cropped up, you may remember, seeming quite unproblematic, when we were considering the coin which was said to 'look elliptical' from some points of view; it had a real shape, we insisted, which remained unchanged. But coins in fact are rather special cases. For one thing their outlines are well defined and very highly stable, and for another they have a *known* and *nameable* shape. But there are plenty of things of which this is not true. What is the real shape of a cloud? And if it be objected, as I dare say it could be, that a cloud is not a 'material thing' and so not the kind of thing which has to have a real shape, consider this case: what is the real shape of a cat? Does its real shape change whenever it moves? If not, in what posture *is* its real shape on display? Furthermore, is its real shape such as to be fairly smooth-outlined, or must it be finely enough serrated to take account of each hair. It is pretty obvious that there is *no* answer to these questions - no rules according to which, no procedure by which, answers are to be determined. Of course, there are plenty of shapes which the cat definitely is not - cylindrical, for instance. But only a desperate man would toy with the idea of ascertaining the cat's real shape 'by elimination'.

Contrast this with cases in which we *do* know how to proceed: 'Are those real diamonds?', 'Is that a real duck?' Items of jewellery that more or less closely resemble diamonds may not be real diamonds because they are paste or glass; that may not be a real duck because it is a decoy, or a toy duck, or a species of goose closely resembling a duck, or because I am having a hallucination. These are all of course quite difference cases. And notice in particular *(a)* that, in most of them 'observation by a normal observer in standard conditions' is completely irrelevant; *(b)* that something which is not a real duck is not a *non-existent* duck, or indeed a non-existent anything; and *(c)* that something existent, e.g. a toy, may perfectly well not be real, e.g. not a real duck.[4]

Perhaps by now we have said enough to establish that there is more in the use of 'real' than meets the cursory eye; it has many and diverse uses in many diverse contexts. We must next, then, try to tidy things up a little; and I shall now mention under four headings what might be called the salient features of the use of 'real' - though not *all* these features are equally conspicuous in all its uses.

1. First, 'real' is a word that we may call *substantive-hungry*. Consider:
   'These diamonds are real';
   'These are real diamonds'.

This pair of sentences looks like, in an obvious grammatical respect, this other pair:
   'These diamonds are pink';
   'These are pink diamonds'.

But whereas we can *just* say of something 'This is pink', we can't *just* say of something 'This is real'. And it is not very difficult to see why. We can perfectly well say of something that it is pink without knowing, without any reference to, what it *is*. But not so with 'real'. For one and the same object may be both a real *x* and not a real *y*; an object looking rather like a duck may be a real decoy duck (not just a toy) but not a real duck. When it isn't a real duck but a hallucination, it may still be a real hallucination - as opposed, for instance, to a passing quirk of a vivid imagination. That is, we must have an answer to the question ' A real *what*?', if the question 'Real or not?' is to have a definite sense, to get any foothold. And perhaps we should also mention here another point - that the question 'Real or not?' does not always come up, can't be raised.

[4] 'Exist', of course, is itself extremely tricky. The word is a verb, but it does not describe something that things do all the time, like breathing, only quieter - ticking over, as it were, in a metaphysical sort of way. It is only too easy to start wondering what, then, existing *is*. The Greeks were worse off than we are in this region of discourse - for our different expressions 'to be', 'to exist' and 'real' they made do with the single word .... We have not their excuse for getting confused on this admittedly confusing topic.

We *do* raise this question only when, to speak rather roughly, suspicion assails us - in some way or other things may not be what they seem; and we *can* raise this question only if there *is* a way, or ways, in which things may be not what they seem. What alternative is there to being a 'real' after-image?

'Real' is not, of course, the only word we have that is substantive-hungry. Other examples, perhaps better known ones, are 'the same' and 'one'. The same *team* may not be the same *collection of players*; a body of troops may be one *company* and also three *platoons*. Then what about 'good'? We have here a variety of gaps crying out for substantives - 'A good *what*?', Good *at* what? - a good book, perhaps, but not a good novel; good at pruning roses, but not good at mending cars.[5]

2. Next, 'real' is what we may call a *trouser-word*. It is usually thought, and I dare say usually rightly thought, that what one might call the affirmative use of a term is basic - that, to understand '*x*', we need to know what it is to be *x*, or to be an *x*, and that knowing this apprises us of what it is *not* to be *x*, not to be an *x*. But with 'real' (as we briefly noted earlier) it is the *negative* use that wears the trousers. That is, a definite sense attaches to the assertion that something is real, a real such-and-such, only in the light of a specific way in which it might be, or might have been, *not* real. 'A real duck' differs from the simple ' a duck' only in that it is used to exclude various ways of being not a real duck - but a dummy, a toy, a picture, a decoy, &c.; and moreover I don't know *just* how to take the assertion that it's a real duck unless I know *just* what, on that particular occasion, the speaker has it in mind to exclude. This, of course, is why the attempt to find a characteristic common to all things that are or could be called 'real' is doomed to failure; the function of 'real' is not to contribute positively to the characterisation of anything, but to exclude possible ways of being *not* real - and these ways are both numerous for particular kinds of things, and liable to be quite different for things of different kinds. It is identify of general function combined with immense diversity in specific applications which gives to the word 'real' the, at first sight, baffling feature of having neither one single 'meaning', nor yet ambiguity, a number of different meanings.

3. Thirdly, 'real' is (like 'good') a *dimension-word*. I mean by this that it is the most general and comprehensive term in a whole group of terms of the same kind, terms that fulfil the same function. Other members of this group, on the affirmative side, are, for example, 'proper', 'genuine', 'live', 'true', 'authentic',

[5] In Greek the case of *σοφος* [wise] is of some importance; Aristotle seems to get into difficulties by trying to use *σοφια* [wisdom] 'absolutely', so to speak, without specification of the field in which *σοφια* is exercised and shown. Compare on *δεινοτης* [cunning] too.

'natural'; and on the negative side, 'artificial', 'fake', 'false', 'bogus', 'makeshift', 'dummy', 'synthetic', 'toy' - and such nouns as 'dream', 'illusion', 'mirage', 'hallucination' belong here as well.[6] It is worth noticing here that, naturally enough, the *less* general terms on the affirmative side have the merit, in many cases, of suggesting more or less definitely what it is that is being excluded; they tend to pair off, that is, with particular terms on the negative side and thus, so to speak, to narrow the range of possibilities. If I say that I wish the university had a proper theatre, this suggest that it has at present a *makeshift* theatre; pictures are genuine as opposed to *fake*, silk is natural as opposed to *artificial*, ammunition is live as opposed to *dummy*, and so on. In practice, of course, we often get a clue to what it is that is in question from the substantive in the case, since we frequently have a well-founded antecedent idea in what respects the kind of thing mentioned could (and could not) be 'not real'. For instance, if you ask me 'Is this real silk?' I shall tend to supply 'as opposed to artificial', since I already know that silk is the kind of thing which can be very closely simulated by an artificial product. The notion of its being *toy* silk, for instance, will not occur to me.[7]

A large number of questions arises here - which I shall not go into - concerning both the composition of these families of 'reality' words and 'unreality' words, and also the distinctions to be drawn between their individual members. Why, for instance, is being a *proper* carving knife one way of being a real carving knife, whereas being *pure* cream seems not to be one way of being *real* cream? Nor to put it differently: how does the distinction between real cream and synthetic cream differ from the distinction between pure cream and adulterated cream? Is it just that adulterated cream still is, after all, *cream*? And why are false teeth called 'false' rather than, say, 'artificial'? Why are artificial limbs so-called, in *preference* to 'false'? Is it that false teeth, beside doing much the same job as real teeth, look, and are meant to look, *deceptively* like real teeth? Whereas an artificial limb, perhaps, is meant to do the same job, but is neither intended, nor likely, to be *passed off* as a real limb.

Another philosophically notorious dimension-word which has already been mentioned in another connection as closely comparable with 'real', is 'good'. 'Good' is the most general of a very large and diverse list of more specific

[6] Of course, not all the uses of all these words are of the kind we are here considering - though it would be wise not to assume, either, that any of their uses are *completely* different, *completely* unconnected.

[7] Why not? Because silk can't be a '*toy*'. Yes, but why not? Is it that a toy is, strictly speaking, something quite small, and specially made or designed to be manipulated in play? The water in toy beer-bottles is not toy beer, but *pretend* beer. Could a toy watch actually have clockwork inside and show the time correctly? Or would that be just a *miniature* watch?

words, which share with it the general function of expressing commendation, but differ among themselves in their aptness to, and implications in, particular contexts. It is a curious point, of which Idealist philosophers used to make much at one time, that 'real' itself, in certain uses, may belong to this family. 'Now this is a *real* carving knife!' may be one way of saying that this is a good carving knife.[8] And it is sometimes said of a bad poem, for instance, that it isn't really a poem at all; a certain standard must be reached, as it were, even to *qualify*.

4. Lastly, 'real' also belongs to a large and important family of words that we may call *adjuster-words* - words, that is, by the use of which other words are adjusted to meet the innumerable and unforeseeable demands of the world upon language. The position, considerably over-simplified no doubt, is that at a given time our language contains words that enable us (more or less) to say what we want to say in most situations that (we think) are liable to turn up. But vocabularies are finite; and the variety of possible situations that may confront us is neither finite nor precisely foreseeable. So situations are practically bound to crop up sometimes with which our vocabulary is not already fitted to cope in any tidy, straightforward style. We have the word 'pig', for instance, and a pretty clear idea which animals, among those that we fairly commonly encounter, are and are not to be so called. But one day we come across a new kind of animal, which looks and behaves very much as pigs do, but not *quite* as pigs do; it is somehow different. Well, we might just keep silent, not knowing what to say; we don't want to say positively that it *is* a pig, or that it is *not*. Or we might, if for instance we expected to want to refer to these new creatures pretty often, invent a quite new word for them. But what we could do, and probably would do first of all, is to say, 'It's *like* a pig'. ('Like' is *the* great adjuster-word, or, alternatively put, the main flexibility-device to whose aid, in spite of the limited scope of our vocabulary, we can always avoid being left completely speechless.) And then, having said of this animal that it's *like* a pig, we may proceed with the remark, 'But it isn't a *real* pig'. If we think of words as being shot like arrows at the world, the function of these adjuster-words is to free us from the disability of being able to shoot only straight ahead; by their use on occasion, such words as 'pig' can be, so to speak, brought into connexion with targets lying slightly off the simple, straightforward line on which they are ordinarily aimed. and in this way we gain, besides flexibility, precision; for if I can say, 'Not a real pig, but like a pig', I don't have to tamper with the meaning of 'pig' itself.

But, one might ask, do we *have* to have 'like' to serve this purpose? We have, after all, other flexibility-devices. For instance, I might say that animals of this

[8] Colloquially at least, the converse is also found: 'I gave him a good hiding' - 'a real hiding' - 'a proper hiding'.

new species are 'piggish'; I might perhaps call them 'quasi pigs', or describe them (in the style of vendors of peculiar wines) as 'pig-type' creatures. But these devices, excellent no doubt in their way, can't be regarded as substitutes for 'like', for this reason: they equip us simply with new expressions on the same level as, functioning in the same way as, the word 'pig' itself; and thus, though they may perhaps help us out of our immediate difficulty, they themselves may land us in exactly the same *kind* of difficulty at any time. We have this kind of wine, not real port, but a tolerably close approximation of port, and we call it 'port type'. But them someone produces a new kind of wine, not port exactly, but also not quite the same as what we now call 'port type'. So what are we to say? It is port-type type? It would be tedious to have to say so, and besides there would clearly be no future in it. But as it is we can say that it is *like* port-type wine (and for that matter rather like port, too); and in saying this we don't saddle ourselves with a *new word*, whose application may itself prove problematic if the vintners spring yet another surprise on us. The word 'like' equips us *generally* to handle the unforeseen, in a way in which new words invented *ad hoc* don't, and can't.

(Why then do we need 'real' as an adjuster-word as well as 'like'? Why exactly do we want to say, sometimes 'It is like a pig', sometimes 'It is not a real pig? To answer these questions properly would be to go a long way towards making really clear the use, the 'meaning', of 'real'.)[9]

It should be quite clear, then, that there are no criteria to be laid down *in general* for distinguishing the real from the not real. How this is to be done must depend on *what* it is with respect to which the problem arises in particular cases. Furthermore, even for particular kinds of things, there may be many different ways in which the distinction may be made (there is not just *one* way of being 'not a real pig')—this depends on the number and variety of the surprises and dilemmas nature and our fellow men may spring on us, and on the purposes and dilemmas we have been faced with hitherto. And of course, if there is *never* any dilemma or surprise, the question simply doesn't come up; if we had simply never had occasion to distinguish anything as being in any way like a pig but not a *real* pig, the words 'real pig' themselves would have no application—as perhaps the words 'real after-image' have no application.

Again, the criteria we employ at a given time can't be taken as *final*, not liable to change. Suppose that one day a creature of the kind we now call a cat takes to talking. Well, we say to begin with, I suppose, 'This cat can talk.' But then other cats, not all, take to talking as well; we now have to say that some cats

[9] Incidentally, nothing is gained at all by saying that 'real' is a *normative* word and leaving it at that, for 'normative' itself is much too general and vague. Just how, in what way, is 'real' normative? Not, presumably, in just the same way as 'good' is. And it's differences that matter.

talk, we distinguish between talking and non-talking cats. But again we may, if talking becomes prevalent and the distinction between talking and not talking seems to us to be really important, come to insist that a *real* cat to be a creature that can talk. And this will give us a new case of being 'not a real cat', i.e. being a creature just like a cat except for not talking.

Of course—this may seem perhaps hardly worth saying, but in philosophy it seems it does need to be said—we make a distinction between 'a real *x*' and 'not a real *x*' only if there is a way of telling the difference between what is a real x and what is not. A distinction which we are not in fact able to draw is—to put it politely—not worth making.

App. 7.3 Real: Literary criticism

Here is Christopher Ricks in *The Force of Poetry*:[10]

The *O-Scz* Supplement (1982) to the *Oxford English Dictionary* is a revelation as to the changes that have taken place for this word. One of the most important is the belated acknowledgement of usages which were perfectly available to the original compilers of the *OED* but were strikingly unrecognized. Thus the *OED* itself did not acknowledge one-hard-headed economic sense of *real*: 'Reckoned by purchasing power rather than monetary or nominal value', although this sense is (we now learn) as old as Dr. Johnson and Adam Smith. 'In real terms ...': oh yes, those terms are now understood to be all too real. And to this old but unacknowledged economic sense, the Supplement to the *OED* is able to add our characteristic extensions: *real money*, in American English (at first) as 'a large sum of money'; and *real money*, in British English, as 'the coinage or currency in which one habitually reckons, frequently as opposed to foreign currency'.

Another of the important usages with the *OED* declined to notice is *real life*, though this is as old as Thomas Jefferson and Maria Edgeworth. We should not be surprised that the Supplement's earliest citation is Jefferson's American English (if that term is altogether right for the year 1771): 'Considering history as a moral exercise, her lessons would be too infrequent if confined to real life'. 'Real life', like its brother 'the real world', has been suspected of being both soft-headed and hard-nosed. Those who believe that the bourgeoisie, or whoever, will oppressively claim that particular social arrangements are ineluctable reality are quick to put sneering quotation-marks around the word *real* ('real'). Those who, often from the opposite flank, object to the implications that factories are real whereas universities aren't, are quick to find unreal this use of 'real', especially when a university man is guilty of this *trahison des clercs*:

> The Vice-Chancellor of Lancaster University strongly believes "that the

[10] (1984), p.438; good holiday reading. Some references omitted here.

> university must keep contact with the real world outside." May I take this opportunity to ask ...: *(a)* what is real about the real world? *(b)* why is it always outside?

But then there are all those applications of *real* which were subsequent to the *OED* and which are pointers to the way we live now, the relation of our times to time. 'Real time': 'the actual time during which a process or event occurs, especially one analyzed by a computer, in contrast to time subsequent to it when computer processing may be done, a recording replayed, or the like'. ('It's rapidly rerun all the time'; 'I replay the past'.) More grimly, there is the newly-felt need for the sense of *real* which is at work in real coffee' ('coffee made, directly from ground coffee beans, as opposed to "instant" coffee' – *opposed* is good). This dates from 1964; and from 1972 there is the Campaign for Real Ale ('a name sometimes applied to draught beer that has been brewed and stored in the traditional way')...

Our world has become increasingly suspicious of both the real and the unreal. Hence the gingerly way in which the word *real* gets handled, as if the very thought of it were unreal. 'The real thing' ('True love, as distinct from infatuation, flirtation, etc. [a great *et cetera*]') goes back as far as 1857, we now learn from the Supplement (the *OED* did not acknowledge it); but as the years went by, 'the real thing' became suspected of the very unreality it was challenging. People felt that it was being capitalized upon, and the only way to protect us against this was to capitalize it back: the Real Thing. Mary McCarthy (1941): 'All that conjugal tenderness had been a brightly packaged substitute for the Real Thing '– where the capitals on the Real Thing make it look as if it too is a bit of bright packaging.

Real as meaning ' "genuine", free from nonsense, affection, or pretence' is likewise much older than one would have thought (it is in Tennyson); but it has lately been having its work cut out, stemming the tide of inauthenticity and insincerity, of illusions of feeling. Hence the escalation into the comparative form, 'realler' (not something you can usually do with the word 'real', after all).

> He [Seymour Krim] ... finds that criticism gets in the way of his 'truer, realer, imaginative bounce.' (1961)
> This was a realler America than I had known in the past, hitching on this or that bandwagon or presidential campaign. (1966)

Time Magazine gives a more wistful tone to its escalation: 'Billy is very sweet and very gentle and very real' (1977).

Then there has been the proliferation of reality-hyphenations (or -hypes, for short). Reality-content, reality-control, reality-based, reality-centred, reality-principle, reality-testing, reality-value, and reality-therapy; the stock-piling of these being enough to make reality seem, yet again, unreal. The very devices which seek to emphasise the real then have the effect of scepticizing it. Leslie

Fiedler, in his fiery emphasis, goes for the double 'really', with the second one underlined: 'what the self-appointed censors have always objected to ... is not really, *really* the act that they are violent ...' Czeslaw Milosz defines poetry as 'a passionate pursuit of the Real', whereupon Henry Gifford was drily though sincerely solicitous: 'The capital letter may increase rather than disarm the scepticism of many readers'. The 3rd edition of the *Oxford Dictionary of Quotations* (1979) no longer has room for Longfellow's 'Life is real! Life is earnest!'. I suspect that it was censored.

Which leads – finally – to a notable American invention to cope with some aspects of this, an invention which is itself then tinged with evanescence: 'for real'. *Real* no longer feeling real, American English calls into existence a demarcated variant. As meaning 'genuine, (in) earnest, true, sincere', the earliest citation in the *O-Scz* Supplement to the *OED* is Billie Holiday in 1956 ('The only joints fancy enough to have a victrola and for real enough to pick up on the best records'). If in 1984 John Glenn had one thing to offer – other than the obvious one – which none of the other Democratic Presidential hopefuls could claim, it was his having furnished the earliest *OED* Supplement citation for a sub-section of a word: under 'for real': 'adv. Really, truly, actually; in reality: 1962 J. Glen, *Into Orbit*: Everyone seemed to sense that we were going for real this time'. Senator Glenn, as he then wasn't, may claim to have put the adverbial usage into orbit. But it was John Berryman who made the most of 'for real', making real – realizing – the fact that it too is hastening towards unreality. *The Dream Songs: 7* long for the old (young) freshness which time has undone:

> 'THE PRISONER OF SHARK ISLAND'
> WITH PAUL MUNI
>
> Henry is old, old: for Henry remembers
> Mr Deeds' tuba, & the Cameo,
> & the race in *Ben Hur, – The Lost World*, with sound,
> & *The Man from Blankley's*, which he did not dig,
> nor did he understand one caption of,
> bewildered Henry, while the Big Ones laughed.
>
> Now Henry is unmistakeably a Big One,
> Fúnnee, he don't féel so.
> He just stuck around.
> The German & the Russian films into
> Italian & Japanese films turned, while many
> were prevented from making it.
>
> He wishing he could squirm again where Hoot
> is just ahead of rustlers, where William S
> forgoes some deep advantage, & moves on,
> where Hashknife Hartley having the matter taped

> the rats are flying. For the rats
> have moved in, mostly, and this is for real.

What Berryman does is combine the conviction that the reality is now known to be very ugly and is no play-acting, dummy-run or film fantasy ('For the rats / have moved in, mostly, and this is for real'), with the conviction – the instant obsolescence of a phrase like 'for real' – that these days no apprehension of the real can last for long. Even happy apprehensions of nemesis, as when Dylan sings, in 'When The Ship Comes In':

> Oh the foes will rise
> With the sleep still in their eyes
> And they'll jerk from their beds an think they're dreamin'.
> But they'll pinch themselves and squeal
> And know that it's for real,
> The hour when the ship comes in.

App. 7.4 Real used as intensifier

Applied to words which are matters of degree, "real" may be used as an intensifier (a term applied to crude expletives, as well as words such as *very*); or as a quantifier (a term applied to words such as *much, many*). For instance, *influence* is a matter of degree - one might have little or much. Thus *real influence* means substantial influence, or at least, more than tiny/de minimis amounts of influence; but how much more is not indicated.

The parliamentary drafter does not generally use the word real in this sense, the reader may think, quite rightly. There are other quantifiers or intensifiers which (though vague) give at least a slightly better indication of the meaning; such as *virtually; substantially; significant* risk.[11] For everyday conversation "real" as an intensifier is fine. But it should be banned in formal writing . Really.

App. 7.5 The real world

Ricks in the passage cited above notes battles to occupy the high ground of "the real world". In *Ramsay v IRC*:[12]

> The capital gains tax was created to operate in the real world, not that of make-belief. As I said in *Aberdeen Construction Group v IRC*,[13] it

[11] See 73.9.4 (Risk-free return).

[12] 54 TC 101 at p.187.

[13] 52 TC 281.

> is a tax on gains (or I might have added gains less losses), it is not a tax on arithmetical differences.

From the humdrum point of view of legal analysis, this is best regarded as a rhetorical flourish. It would be a mistake to analyse it as if it were a legal argument or principle. It announces a conclusion, rather than a reason for reaching a conclusion. So while, naturally, this elevated prose is often cited in argument, it has never made a difference to the outcome.

App. 7.6 Real nature of transaction

Sothern-Smith v Clancy discusses this expression in the context of the income/capital distinction:[14]

> ... whether it is in truth an income or a capital payment ... Questions of this kind are notoriously difficult and give rise to distinctions of a highly artificial character. ...
> It is no doubt true to say that in order to answer the question the real nature of the transaction must be ascertained. The proposition has an engaging appearance of simplicity but it is not so simple as it sounds. For the expression 'the real nature of the transaction' is ambiguous.
> It may mean the 'real nature' of the legal relationship of the parties which results from the transaction-a matter which may not be in doubt. Or it may include as well the 'real nature' of the transaction from a financial point of view, a matter which at once raises a number of difficulties.
> If the transaction be one under which A, being or becoming indebted to B for a sum of £1,000, agrees with B to repay this sum by ten yearly instalments, or if A being the purchaser of property from B for £1,000 agrees to pay the purchase price by ten yearly instalments, the 'real nature' of the transaction from the legal point of view is that A is contracting to pay by instalments in the one case a debt and in the other a purchase price. In such cases the very nature of the legal relationship constituted by the contract prevents the annual payments from being anything but payments of capital.

App. 7.7 Economic reality etc

App. 7.7.1 *Economic terms with antonym*

The adjective "economic" can make up useful labels, for instance:

[14] 24 TC 1, at p.6.

Label	**Antonym**	**See para**
Economic double taxation	Juridical double taxation	51.6.2; 107.3
Economic settlor	Nominal settlor	99.5
Economic employer	Formal employer	37.9.1

What grounds these expressions, and gives them reasonable precision, is that:

(1) they have an antonym, and

(2) the distinction between expression and antonym is capable of explanation and elaboration[15]

This relates to Austin's insight that the word "real" is correctly used when we have in mind some specific way in which something can be fail to be "real".

App. 7.7.2 *Economic reality/consequences*

The expression "economic reality" lacks the anchor of a clear antonym. So it is vague, evaluative, subjective and often debatable. The same applies where "economic" is in other collocations such as "economic consequences" and "economic activities".[16]

"Economic consequences/reality", I suggest, is more often than not a form/substance distinction under a more appealing name. This is a classification and not a criticism. There is nothing necessarily wrong with a form/substance distinction, but (1) it should be recognised for what it is; and (2) it does not offer a satisfactory basis for taxation unless kept firmly in place. In *Russell Baker v HMRC*:[17]

> We discount entirely any suggestion that the Appellant should be taxed on the basis of the "economic reality"[18] of what has taken place. Such a submission has a degree of unreality about it, bearing in mind the approach taken by HMRC in the sad appeals from defrauded investors in complicated life insurance bonds who have lost most or all of their investment but are still being taxed by HMRC on entirely fictitious gains arising under the life policy "chargeable events" rules.[19]

[15] I would add to this list the term "economic equivalent to interest", which though it has no short antonym, is defined with reasonable precision: see 26.25.4 (Economic equivalent to interest).

[16] See 3.20.7 (Economic consequences).

[17] [2013] UKFTT 394 (TC) at [60]; and see App.7.7 (Real nature of transaction).

[18] Author's footnote: The scare quotation marks are in the original.

[19] Is this referring to reported case law or just HMRC practise?

Incidentally, one wonders what economists would think of the terms economic consequences/purposes/reality. Lawyers are not economists, and there is some risk in what John Kay derides as "DIY economics".[20] It is said that the human sciences envy the precision of natural sciences ("physics envy"). There is no reason for lawyers to envy economists.

I think the answer to the question raised in the above paragraph is that the expressions economic consequences/purposes/reality have little to do with economics as understood by economists. These are legal expressions, not economics expressions. They are grasping for that most elusive of concepts, reality.

App. 7.8 Realistic view of facts

In *Collector of Stamp Revenue v Arrowtown Assets*:[21]

> The driving principle in the *Ramsay* line of cases continues to involve a general rule of statutory construction and an unblinkered approach to the analysis of the facts. The ultimate question is whether the relevant statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically.

The second sentence is a neat apothegm and often cited. But does "realistically" mean anything? - and if so, what does it mean? In earlier editions, I asked:

> Is it, perhaps, another euphemism for a form/substance distinction of some kind? Is there any difference between this and the *Ramsay* principle?

What it seems to mean in practice is that the Courts will do whatever it takes to defeat an artificial tax avoidance scheme of which they sufficiently disapprove. Though the GAAR ought to prevent the need for that for years from 2013/14.

Do the courts apply the same principles in non-tax cases? I think the answer until now has broadly been no.[22] This might perhaps change after

[20] *https://www.johnkay.com/2003/10/22/galileo-and-the-lure-of-amateur-economics/* Kay, *The Truth About Markets* (2003).

[21] [2003] HKCFA 46 at [35].

[22] By comparison, *Furniss v Dawson* was once or twice cited in landlord & tenant cases but its approach was subsequently rejected.

Wang, R (oao) v Secretary of State for the Home Department.[23] The opening paragraph described the facts as "a scheme designed to ensure qualification for leave to remain as a Tier 1 (Investor) Migrant in return for a payment of £200k". After that start, a reader with a tax background will not be surprised to find the scheme failed. It is noteworthy that the *Arrowtown* comment was cited at the outset of the analysis.

App. 7.9 Form v substance: Cardinal principle

In *Ramsay v IRC*:

> Given that a document or transaction is genuine [not a sham], the court cannot go behind it to some supposed underlying substance. This is the well-known principle of *IRC v Duke of Westminster*.[24] This is a cardinal principle ...

App. 7.9.1 *Cardinal principle qualified*

This well-known, cardinal principle is qualified or, some might say, heavily qualified:

> ... but it must not be overstated or overextended. While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded: to do so is not to prefer form to substance, or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded.
> ... For the Commissioners considering a particular case it is wrong, and an unnecessary self-limitation, to regard themselves as precluded by their own finding that documents or transactions are not "shams", from considering what, as evidenced by the documents themselves or by the manifested intentions of the parties, the relevant transaction is. They are

[23] [2023] UKSC 21. Two years earlier, in *Uber v Aslam* [2021] UKSC 5 the *Arrowtown* comment was cited in passing, but this was not an avoidance case and it did not affect the analysis.

[24] 19 TC 490.

> not, under the *Westminster* doctrine or any other authority, bound to consider individually each separate step in a composite transaction intended to be carried through as a whole. This is particularly the case where (as in *Rawling*[25]) it is proved that there was an accepted obligation once a scheme is set in motion, to carry it through its successive steps. It may be so where (as in *Ramsay* or in *Black Nominees Ltd v Nicol*[26]) there is an expectation that it will be so carried through, and no likelihood in practice that it will not.

App. 7.9.2 *Cardinal principle affirmed*

How we draw the line between the cardinal principal and the qualification, how the line has shifted in the four decades since the *Ramsay* decision, whether the Courts have succeeded in articulating that line, and whether any line can be drawn, - these are deep questions. But one can at least say that the principle itself continues.

Khan v HMRC[27] concerned a purchase of a company. It was originally proposed that:

(1) The company should buy in its own shares for £1.95m
(2) The purchaser should purchase (what was left of) the company for £18k.

The sellers were concerned they may be liable to income tax on the purchase of own shares. So the proposal was altered and the sale carried out with an added step which might fairly be described as artificial and self-cancelling:

(1) The purchaser borrowed £1.95m from the company.
(2) The purchaser purchased the company for the sum of £1.968m and used the borrowed money to pay the purchase price.[28]
(3) Immediately on completion of the purchase:
    (a) The company bought in 99% of its own shares, for the sum of £1.95m.
    (b) That sum was used to repay the loan.

The company's purchase of its own shares at step 3(a) was of course a distribution.[29] So at the end of these steps, the hapless Mr Khan had

[25] For this case, see 99.12.1 (Transfer: A's trust to B's trust).
[26] 50 TC 229.
[27] [2021] EWCA Civ 624.
[28] Was this compliant with company law?
[29] Section 1033 CTA 2010.

received an income-taxable distribution of £1.95m but had no money to show for it, as he used it to repay the loan.[30] The taxpayer argued that the Court should:[31]

> consider the sale and buyback of the shares as a single composite transaction and consider its overall effect rather than concentrating on the machinery by which it was effected (i.e. the legal steps in the chain). In substance and in truth, Mr Khan was no more than a conduit for the selling shareholders to effect the buyback of the 98 shares themselves and his intermediate role in that aspect of the transaction should be ignored. As a matter of practical[32] reality, the 98 shares were never Mr Khan's to do with as he pleased, nor were the buyback proceeds. He never had the benefit of nor control over the £1.95 million and it was "absurd" to tax him on that sum, all the more so if the selling shareholders were liable to pay CGT on that sum (less their cost of acquiring the shares)...
>
> the overall economic outcome was precisely the same as it would have been had the deal been structured in the manner originally envisaged and most of the shares had been the subject of a direct buyback by the Company from the vendor shareholders

More analytically, the question was whether Mr Khan received/was entitled to the distribution.[33]

Note how substance, truth and reality are all thrown into the submission pot. But the Court followed the approach of *Henriksen v Grafton Hotel*:[34]

> An attempt was made to rescue this argument from shipwreck by saying that if the lessor had undertaken to bear these payments and had consequently exacted a higher rent, the full rent could have been deducted as an expense. This argument has a familiar ring. The answer to it is that this was not the contract which the parties chose to make.
>
> It frequently happens in income tax cases that the same result in a business sense can be secured by two different legal transactions, one

[30] This arrangement - foolish does not begin to do it justice - was designed so that the sellers were subject to CGT on the sale proceeds. Of course, Mr Khan may have had a claim against his advisers.

[31] at [39], [75].

[32] An analytically minder reader might ask: Is there any other type of reality? But the question would be misconceived, because the expression is the language of rhetoric, not reason, and so not susceptible to a logical analysis.

[33] See 15.6 (When are dividends recognised).

[34] 24 TC 453 at p.460.

> of which may attract tax and the other not. This is no justification for saying that a taxpayer who has adopted the method which attracts tax is to be treated as though he had chosen the method which does not or vice versa.

One might also have cited *Spectros International v Madden*[35] and *IRC v Wesleyan and General Assurance Society.*[36] With these questions of high generality there is too much authority to cite it all. Did the point need repeating? The reader may think that *Khan* should not have been given permission to appeal, even for the first of its two appeals. For if Mr Khan was not entitled to the distribution, who was? It could not be the sellers. There could not be a distribution to which no-one is entitled. And there clearly was a distribution, because £1.95m was extracted from the company. On the facts of *Khan,* a substance approach just does not work.

App. 7.10 Reality and tax avoidance

In *Khan v HMRC*:[37]

> It is unusual for a taxpayer to rely upon the *Ramsay* approach, which is generally invoked by HMRC when seeking to challenge artificial tax-avoidance schemes (which this undoubtedly was not). However, the principles in *Ramsay* are of general application,

In fact, there was an avoidance motive in *Khan*, though those who (successfully) avoided income tax were the sellers and not the purchaser. But putting that to one side, as a matter of case law, is it really true to say

[35] See App. 4.3 (Contract stating consideration).

[36] 30 TC 11 at p.16: "In dealing with Income Tax questions it frequently happens that there are two methods at least of achieving a particular financial result. If one of those methods is adopted, tax will be payable. If the other method is adopted, tax will not be payable. It is sufficient to refer to the quite common case where property is sold for a lump sum payable by instalments. If a piece of property is sold for £1,000 and the purchase price is to be paid in ten instalments of £100 each, no tax is payable. If, on the other hand, the property is sold in consideration of an annuity of £100 a year for ten years. tax is payable. The net result from the financial point of view is precisely the same in each case. but one method of achieving it attracts tax and the other method does not.

There have been cases in the past where what has been called the substance of the transaction has been thought to enable the Court to construe a document in such a way as to attract tax. That particular doctrine of substance as distinct from form was, I hope, finally exploded by the decision of the House of Lords in the case of *Duke of Westminster v IRC*, 19 TC 490..."

[37] [2021] EWCA Civ 624 at [81].

that the Courts have applied the same principles in avoidance and non-avoidance cases? And as a matter of tax policy, would it not be sensible to apply different principles? Discuss.

App. 7.11 Essence/substance in tax statutes

"Essence" is used in the disguised remuneration/disguised trading income codes, referring (in short) to:

- arrangement "in essence" a means of providing remuneration/ benefits[38]
- payments "in essence" consideration for goods/ services [39]
- "In essence" some arrangement or connection between payment and provision of goods/services, or between a step and an arrangement[40]

In the last case, one might think that "some connection" and "arrangement" are vague enough without adding the reference to essences. But there it is. The drafter does not share the view, attributed to Wittgenstein, that "there are no essences".

In practice it is very difficult to imagine that the words "in essence" would ever make any difference.[41] But the heart does sink when one sees the words "in essence".

For good measure, the statute adds:

> For the purposes of [relevant subsections] in particular, all relevant circumstances are to be taken into account in order to get to the essence of the matter.[42]

Some readers may think this is verbiage, and regrettable. But there it is. Perhaps the author felt some exasperation, and this is how he expressed it. The task of the parliamentary drafter is not an easy one.

Similarly, substance is used in the income-stream code, where "transfer" includes "an arrangement which equates in substance to a transfer".[43] I think essence and substance are used synonymously here.

App. 7.12 Piercing corporate veil/facade

One area where the Courts have rejected arguments based on reality is in the use of companies. In economic reality, or in the eyes of a non-lawyer,

[38] Section 23C(3) ITTOIA; s.554A(1) ITEPA.

[39] Section 23C(5) ITTOIA.

[40] Section 23C(5) ITTOIA; s.554A(1) ITEPA.

[41] See too 49.15.1 (Substance).

[42] 23A(7)/23C(6) ITTOIA; s.554A(11) ITEPA.

[43] See 26.25.1 (Economic equivalent to interest).

there is little if any difference between an asset held by a company and the asset being held by its shareholder. But holding an asset through a company alters the tax position, sometimes in the taxpayer's favour, and sometimes giving scope for avoidance.[44] But arguments that the Courts should ignore this and "pierce the corporate veil", ie disregard the separate personality of the company, and assess tax as if the asset were held directly, have (more or less) never succeeded; or at least, not if the argument was framed in those terms.[45]

[44] For an example, see 76.17.5 (Companies: Situs planning).

[45] See *Hurstwood Properties v Rossendale BC* [2021] UKSC 16 at [63] ff. Planning of this kind has been possible since the repeal of the Mortmain Acts (one of whose purposes was to prevent tax avoidance by vesting land in companies).

APPENDIX EIGHT

DEEMING PROVISIONS

App. 8.1 Deeming/statutory assumptions
App. 8.1.1 "Deeming provision"
App. 8.1.2 Statutory assumptions
App. 8.2 Deeming provisions: Construction
App. 8.2.1 Carry through the deeming
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App. 8.1 Deeming/statutory assumptions

This appendix concerns the construction of deeming provisions and statutory assumptions. Such provisions are common in tax, and the topic arises at many points in this book.[1] It is therefore convenient to consider it as a discrete topic.

App. 8.1.1 *"Deeming provision"*

A "**deeming provision**" in the strict sense is one which assumes something to be a fact which is not (or may not be) the case: it creates a legal fiction.

The paradigm cases involve the word "deem". An example is the rule that the income of a married woman living with her husband was:

> deemed for income tax purposes to be his income and not to be her income.[2]

[1] It is not possible to give a full list but examples are:

Topic	**See para**
Deeming provisions	
Exempt property	19.29
DT relief: s.87 gain	61.60
Child of deemed dom parent	5.10.1
GWR on death/Spouse exemption	78.19
Divorce settlement	93.8
Legatee on transfer of shares	88.9.4
Statutory assumptions	
s.87 residence assumption	61.6.1

[2] Section 279 ICTA 1988 (repealed). The rule survived in Jersey until 2021.

The word "deem" is almost as old fashioned as joint taxation of husband and wife. OPC Drafting Guidance formerly provided:

> **deemed to be**: Treated as or perhaps regarded as, or even taken to be, might be more familiar.[3]

All three of these "more familiar" expressions are found (and more[4]) though "treated as" is most the more common:

Income which arises under a settlement	living accommodation provided ... by the employer	where property is provided by a ... company controlled by one person ...
is *treated* for income tax purposes as the income of the settlor and of the settlor alone.[5]	is to be *regarded* as provided by reason of the employment[6]	that person shall be *taken to* provide it[7]

There is no difference in meaning between deemed/treated as/regarded as/taken to be. In 2017 Parliamentary Counsel replaced "treated as" with "regarded as" in the deemed domicile rule:[8]

s.267(1) IHTA	**s.835BA ITA** (inserted 2017)
A person not domiciled in the UK ... *shall be treated* for the purposes of this Act as domiciled in the UK ... if—	An individual not domiciled in the UK ... *is to be regarded as* domiciled in the UK ... if—

Clearly, no difference in meaning was intended, and the choice is simply a matter of drafting style.

[3] (2014 edition) *http://data.parliament.uk/DepositedPapers/Files/DEP2014-0422/guidancebook_20_March.pdf* Para 2.1.24. This passage is not in the current OPC Drafting Guidance (2020) *https://www.gov.uk/government/publications/drafting-bills-for-parliament*

[4] "Assumed" may be used with the same meaning, eg in the definition of carried interest; see 73.10 (Subordinated interest: carried interest).

[5] See 47.5 (Settlor-interested trust). But "treated as" is not a modern innovation: that was the wording in the original provisions, s.21 FA 1936; s.38 FA 1938.

[6] See 39.10 (Employer-provision test).

[7] See 99.40.1 (Co settlor: s.86 definition). This wording goes back to 1991.

[8] See 5.13 (Deemed dom wording compared).

App. 8.1.2 *Statutory assumptions*

Consider two examples from TCGA:

s.87(4): s.1(3) amount (trust gain)	**s.3G(3): s.3 gain**
the amount upon which the trustees of the settlement would be chargeable to tax under s.1(3) ... *if* they were resident in the UK.	the amount of a gain ... accruing to a company is calculated *as if* the company were a company resident in the UK chargeable to corporation tax on the gain.

I would not call these deeming provisions, in the strict sense. The non-resident trustees or company are not deemed to be chargeable. But there is a fictional statutory assumption, for a more limited purpose (in this case for a computation). I refer to this as a **"statutory assumption"**[9] as the wording "on the assumption that" is common in provisions of this kind. Other expressions are also used, such is the patchwork nature of taxation:

Para 10 sch 9A FA 03: SDLT surcharge	**s.439(3) CTA 2010: Close co test**
the issued share capital in the company that A possesses ... would, *on the assumption* that the whole of the income of the company were distributed among the participators, entitle A to receive less than 5% of the income so distributed	such rights as would, *in the event of* the winding up of the company on the basis set out in section 440, entitle them to receive the greater part of the assets of the ... company which would then be available for distribution ...

In the first two examples above the statutory assumption is UK residence, and there are several other examples of that.[10] But as the next two examples illustrate, there is no limit to the content of a statutory assumption (just as there is no limit to the content of a statutory deeming).[11]

A statutory assumption amounts to or includes a deeming. Indeed, this form of drafting is sometimes called "a deeming provision", though that seems to me to be a slightly loose sense of that expression. In general, statutory assumptions apply for a limited purpose, and (what I call) deeming provisions apply generally, or at least, much more broadly.

[9] One sometimes sees the grander term, "statutory hypothesis".

[10] See 61.6.1 (S.87 residence assumption).

[11] For instance, IHTA refers to events where "tax is chargeable *as if* a transfer of value had been made"; see 74.3.1 (Transfer of value: extended definition).

However the same (purposive) principles of construction apply to both.[12] So perhaps the distinction between deeming provisions and statutory assumptions does not matter. But I think it is good to know what we are talking about.

App. 8.2 Deeming provisions: Construction

The story is the usual arc from literal to purposive construction.

App. 8.2.1 *Carry through the deeming*

The general rule of construction which applies to deeming provisions is this:

> If you are bidden to treat an imaginary state of affairs as real, you must surely, unless prohibited from doing so, also imagine as real the consequences and incidents which, if the putative state of affairs had in fact existed, must inevitably have flowed from or accompanied it.[13]
>
> ... because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs ...[14]

App. 8.2.2 *But how far?*

The question is how far the general rule should be applied (or in other words, when should it not be applied). The answer in the 1950s was: all the way:

> The statute says that you must imagine a certain state of affairs; it does not say that having done so, you must cause or permit your imagination to boggle when it comes to the inevitable corollaries of that state of affairs.[15]

Experience shows that parliament often fails to foresee the "inevitable corollaries" of its deeming, and nowadays the courts apply deeming provisions in a purposive and context-sensitive manner.[16] This is

[12] Thus *Bricom*, discussed below, which concerns the CFC residence assumption, see 61.60.1 (DT relief: s.87 gain), is a leading case on the construction of deeming provisions.

[13] *East End Dwellings v Finsbury Borough Council* [1952] AC 109 at p.132.

[14] *Marshall v Kerr* 67 TC 56 at p.79A.

[15] *East End Dwellings v Finsbury Borough Council* [1952] AC 109 at p.132.

[16] The turning point was *Murphy v Ingram* [1973] Ch 363. At first instance, at p.446 Megarry J said:

reaffirmed in *Bricom v IRC*[17] where the CoA referred to the dictum:

> The hypothetical must not be allowed to oust the real further than obedience to the statute compels.

The CoA said:

> ... I do not read this as intending to lay down a special rule which requires a statutory hypothesis to be narrowly and literally construed. The scope of a deeming provision is a question of construction and is not subject to any special rule. As on any other question of statutory construction, the Court must attempt to ascertain the intention of Parliament from the words used in the light of the legislative purpose. A statutory hypothesis, no doubt, must not be carried further than the legislative purpose requires, but the extent to which it must be carried depends upon ascertaining what that purpose is.

And again, in *Jenks v Dickinson*:[18]

> ... when considering the extent to which one can 'do some violence to the words' and whether one can 'discard the ordinary meaning', one can, indeed one should, take into account the fact that one is construing a deeming provision. This is not to say that normal principles of construction somehow cease to apply when one is concerned with interpreting a deeming provision; there is no basis in principle or authority for such a proposition. It is more that, by its very nature, a deeming provision involves artificial assumptions. It will frequently be difficult or unrealistic to expect the legislature to be able satisfactorily to prescribe the precise limit to the circumstances in which, or the extent to which, the artificial assumptions are to be made.

And again, though perhaps slightly more tentative, in the words of Peter Gibson J giving the leading judgment in *Marshall v Kerr*:

> For my part I take the correct approach in construing a deeming provision to be to give the words used their ordinary and natural meaning, consistent so far as possible with the policy of the Act and the

> "A research student in search of a suitable topic for a thesis might do worse than to choose as his subject "the Dangers of Deeming"."

But the CoA adopted the modern approach which reduces these dangers. For another example, see *De Rothschild v Lawrenson* 67 TC 300 at p.316.

[17] 70 TC 272.

[18] [1997] STC 853; the passage is approved in *HMRC v DCC Holdings* [2010] UKSC 58 at [39].

> purposes of the provisions so far as such policy and purposes can be ascertained; but if such construction would lead to injustice or absurdity, the application of the statutory fiction should be limited to the extent needed to avoid such injustice or absurdity, unless such application would clearly be within the purposes of the fiction. I further bear in mind that because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs, unless prohibited from doing so.

In *Barclays Wealth Trustees v HMRC*:

> This statement of principle has been cited with approval in many subsequent cases[19] ... the fact that deeming provisions are involved "does not displace the ordinary principles of statutory interpretation".[20]

We have come a long way from 1950's approach of not permitting the imagination to boggle.

App. 8.2.3 *The current position*

The most recent statement is from *Fowler v HMRC*:[21]

> (1) The extent of the fiction created by a deeming provision is primarily a matter of construction of the statute in which it appears.
> (2) For that purpose the court should ascertain, if it can, the purposes for which and the persons between whom the statutory fiction is to be resorted to, and then apply the deeming provision that far, but not where it would produce effects clearly outside those purposes.
> (3) But those purposes may be difficult to ascertain, and Parliament may not find it easy to prescribe with precision the intended limits of the artificial assumption which the deeming provision requires to be made.
> (4) A deeming provision should not be applied so far as to produce unjust, absurd or anomalous results, unless the court is compelled to do so by clear language.
> (5) But the court should not shrink from applying the fiction created by the deeming provision to the consequences which would inevitably flow from the fiction being real.

[19] citing *DV3 RS Ltd Partnership v HMRC* [2013] EWCA Civ 907 at [13] and [14].

[20] [2017] EWCA Civ 1512 at [47].

[21] [2020] UKSC 22 at [27] followed *HMRC v Vermilion Holdings* [2023] UKSC 37 at [23].

App. 8.2.4 *Deeming in non-tax cases*

The discussion above just cites tax cases. But the interpretation of deeming provisions is the same in non-tax cases:

> The intention of a deeming provision, in laying down a hypothesis, is that the hypothesis shall be carried as far as necessary to achieve the legislative purpose, but no further.[22]

App. 8.3 Deeming/artificial definition compared

A definition is "artificial" if a word is given a meaning far from its natural meaning. The use of artificial definitions has been castigated,[23] but it is very common in taxation. For instance, employment may be defined to include a trade or profession.[24] No-one calls that a deeming provision, but there is no difference (or at least no obvious difference) between that form and saying that a trade is deemed to be an employment, which *is* classified as a deeming provision. Which form is used is a matter of chance or of style.

The rule for construction of definitions is simply that they take effect subject to context. It is considered that the position is no different for deeming provisions. If that is right, the rather lengthy analysis in the cases set out above of the "principles of deeming provisions" is misconceived. There should be no special rule for deeming provisions, for the rule to apply the deeming contextually is not a special rule. We have here something akin to the error of reification: just because there is a name for something does not mean that it exists, or (here) that it requires a distinct principle of construction.

App. 8.4 Deemed/treated misused

App. 8.4.1 *Deemed as definition*

"Deemed" (and its synonyms) are sometimes used to make definitions, or at least, amount to definitions. ToA provides an example:

[22] *Szoma v Secretary of State* [2006] 1 AC 564 at [25].

[23] Eg OPC Drafting Guidance (2020) para 4.4.1: "Avoid labels that are misleading." The guidance gives this example (to avoid): *"In this Act, "child" means a young person in care".* *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/892409/OPC_drafting_guidance_June_2020-1.pdf*

[24] See 46.2.1 (Employment/employed).

> ... an individual is treated as having power to enjoy income of a person abroad if any of the enjoyment conditions are met.[25]

The meaning is simply that an individual *has* "power to enjoy" (in the defined sense) if the enjoyment conditions are satisfied. This is equivalent to a definition of the expression "power to enjoy". But the words "treated as" are apt, because although in most cases where the enjoyment conditions are satisfied, the individual does have power to enjoy in the normal sense, there are cases where the enjoyment conditions are satisfied but the individual does not have power to enjoy in the normal sense (eg if the individual's spouse has power to enjoy).

Definitions in the common form have the helpful rule that *means* is used for an exclusive (comprehensive) definition and *includes* is used for an inclusive definition. The wording *treated as* used in a definition tends to suggest an inclusive definition: ie an individual might have power to enjoy in the general sense of the expression even if the enjoyment conditions are not met.[26] But the context may show that there is an exclusive definition, ie the individual has power to enjoy if and only if the enjoyment conditions are met.

It would be clearer to say "if *and only if*"; and not to use deeming terminology when simpler words of definition (means/includes) could be used; but it happens.

App. 8.4.2 *"Deemed" meaningless*

"Deemed" (and its synonyms) are sometimes employed as a verbose or legalese equivalent of the simple present tense. Thus s.10 Limited Partnerships Act 1907 provides that certain transactions shall "be deemed to be of no effect". The meaning would be the same without the word deemed: the meaning is that the transactions *are* of no effect.

An example from CRS:

> an Equity Interest is considered to be held by ...any person treated as a settlor[27]

"Treated as settlor" just means "settlor".

[25] See 46.7 ("Power to enjoy").

[26] For an example, see *Office of Fair Trading v Lloyds TSB Bank Plc* [2006] EWCA Civ 268 at [63] to [65].

[27] See 121.17.4 (Equity Interest: Trust).

It would be better drafting not to use deeming language in this way; but it is not uncommon. One should not strive to construe such wording as a deeming provision when the context shows that there is no deeming in the strict sense.

APPENDIX NINE

PURPOSE IN TAX STATUTES

App. 9.1 Purpose of a statute
App. 9.2 Construction of tax/non-tax statutes compared
App. 9.3 How to ascertain tax policy
App. 9.4 Difficulty of ascertaining tax policy
App. 9.5 Fowler: a case study
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App. 9.5.5 Purpose: conclusion
App. 9.6 Purpose: Fact or law?

App. 9.1 Purpose of a statute

The interpretation (or construction) of statutes needs a book to itself, and many such books have been written. However most of the principles of interpretation can only be expressed at a high level of generality which makes their application doubtful and their usefulness to the practitioner is limited.[1] In short, language is difficult to put into words.[2] In this appendix I consider the topic of purposive construction, and in the next the narrower but related topic of deeming provisions.

When interpreting a statute, it is common to ask what is its purpose or policy (the words are here synonymous). This appendix considers:

- What is meant by purpose of a statutory provision
- How does one ascertain the purpose
- How far does a purposive approach override the apparent meaning

These are deep questions! They are best addressed as a specific topic rather than in any particular context where they may arise.

A difficulty of this enquiry is that it has to be selective - there is too much data - and a shallow dip in the data may give the impression of

[1] If authority is needed, which I doubt, see *Re Stratton's Disclaimer* [1958] Ch 42 at p.59 deprecating "sweeping generalities".

[2] This aphorism has been attributed to Voltaire, but seems to have no known source.

greater coherence than actually exists. In practice judges take different approaches, and a legal realist would say that they take the approach which justifies the conclusion which they wish to reach for other reasons. But we might at least ascertain the direction of the prevailing wind.

App. 9.2 Construction of tax/non-tax statutes compared

I start by noting a common misapprehension. In *IRC v McGuckian*:[3]

> During the last 30 years there has been a shift away from literalist to purposive methods of construction. Where there is no obvious meaning of a statutory provision the modern emphasis is on a contextual approach designed to identify the purpose of a statute and to give effect to it.

That is true as far as it goes, though the purposive approach is not limited to cases "where there is no obvious meaning".

> But under the influence of the narrow *Duke of Westminster* doctrine, tax law remained remarkably resistant to the new non-formalist methods of interpretation. It was said that the taxpayer was entitled to stand on a literal construction of the words used regardless of the purpose of the statute. Tax law was by and large left behind as some island of literal interpretation.

This Whig interpretation of tax history is often cited. But it is a fable, as even a cursory examination of tax case law in the 30 years to 1997 would reveal.[4] Does this matter? I leave the reader to consider that, and move on:

> On both fronts the intellectual breakthrough came in 1981 in the *Ramsay* case, and notably in Lord Wilberforce's seminal[5] speech ... Lord Wilberforce restated the principle of statutory construction that a subject

[3] 69 TC 1 at p.5.

[4] Lord Steyn cited 3 cases in support of his comment. One was a 19th century case. The second an early 20th century case *Cape Brandy Syndicate v IRC* (1921) 12 TC 358 at p.366 ("no equity about a tax"). A literalist approach, no doubt, but not different from that adopted for non-tax law at the time. The only case cited which actually fell in the 30 year period referred to was *IRC v Plummer* (1979) 54 TC 1. But this was an outlier, a 3:2 decision, reversed in 1993: *Moodie v IRC* (1993) 65 TC 610.
Incidentally, Lord Wilberforce, notwithstanding his "seminal" speech in *Ramsay* was one of the maligned literalists who decided the outcome in *Plummer.*

[5] The hyperbolic language, which seems to put *Ramsay* on a level with the theory of evolution or of relativity, is characteristic of judicial rhetoric.

> is only to be taxed upon clear words. To the question 'What are “clear words”?' he gave the answer that the court is not confined to a literal interpretation. He added
>
> > 'There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded'.[6]
>
> This sentence was critical. It marked the rejection by the House of pure literalism in the interpretation of tax statutes.

I don’t think anyone has ever said that the fundamental principles of construction are different for tax and non-tax statutes; but difference of context makes the same rules work in different ways, and that continues to be the case.

It might be that the Courts, or at least some judges, currently apply purposive construction more enthusiastically in tax cases than in non-tax cases. That would not be easy to prove or disprove, and no-one would admit to it consciously. But I do not think that non-tax cases have an equivalent of the constantly repeated exhortation in tax cases to construe purposively, and ascertain facts realistically.[7]

App. 9.3 How to ascertain tax policy

The courts ascertain the policy by using the ordinary methods of statutory construction, ie just by reading the statute, with supplemental material such as Hansard when admissible, and reflecting on it. That approach will not necessarily give a profound understanding of policy issues; what

[6] The quote is not unfair, but the passage read as a whole is more nuanced, see 54 TC 101 at 185:

“I think it opportune to restate some familiar principles and some of the leading decisions so as to show the position we are now in.

1. A subject is only to be taxed upon clear words, not upon "intendment" or upon the "equity" of an Act. ... What are "clear words" is to be ascertained upon normal principles: these do not confine the courts to literal interpretation. There may, indeed should, be considered the context and scheme of the relevant Act as a whole, and its purpose may, indeed should, be regarded...

2. A subject is entitled to arrange his affairs so as to reduce his liability to tax. The fact that the motive for a transaction may be to avoid tax does not invalidate it unless a particular enactment so provides...

4. Given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance... [For this aspect, see App 7.9 (Form v substance: Cardinal principle).]

[7] See App 7.8 (Realistic view of facts).

would one think of an essay on tax policy which restricted itself to these limited sources? But a Court is not equipped to do more.

This makes sense if one bears in mind that the legal concept of tax policy is like the legal concept of the intention of parliament; it is a construct. Just as the legal concept of the intention of parliament may differ from what was actually the intention of those involved,[8] so too the legal concept of tax policy.

App. 9.4 Difficulty of ascertaining tax policy

It is often difficult to ascertain what is the policy. For instance, in gifts with reservation, two wildly different policies were plausibly arguable:

(1) That the policy was to prevent *Ingram* style planning (tendentiously described as "to have one's cake and eat it").

(2) That the policy was to require donors to identify precisely the interests they give away and those (if any) they keep.[9]

In this respect, GWR is not unusual. It is often difficult (perhaps more often than not) to ascertain the policy of tax provisions and sometimes it is impossible:

> In reaching these conclusions I have not attempted any purposive construction of the detailed provisions of the Act, since I am not sure what their purpose is.[10]

And again:

> it is only too often that the purposes of a fiscal provision are not apparent.[11]

This should not be a surprise. There are several powerful factors which lead to this result:

(1) The difficulty of formulating a coherent tax policy: It often happens

[8] This is well established jurisprudence, but if authority is needed, see *R v Secretary of State ex p. Spath Holme* [2001] 2 AC 349: "The phrase is a shorthand reference to the intention which the court reasonably imputes to Parliament in respect of the language used. It is not the subjective intention of the minister or other persons who promoted the legislation. Nor is it the subjective intention of the draftsman, or of individual members or even of a majority of individual members of either House."

[9] See 79.2 (Purpose of GWR).

[10] *BP Oil Development. v IRC* 64 TC 498, at p.532B.

[11] *Marshall v Kerr* (CA) [1993] STC 360. Dividend taxation is a good example; see 30.17 (Dividend taxation: Critique).

that irreconcilable policy considerations yield no satisfactory solution, or at least, no consensus on what the solution should be.

(2) The inadequate way in which tax policy and drafting has been, and continues to be, formulated in the UK.[12]

(3) The shortage of informed discussion of tax policy at journalistic level, and, with notable exceptions, at academic level (I think the quality of academic discussion may be higher in the US).

(4) The total bulk of the material, and the speed of change, make detailed examination difficult and comprehensive examination impossible.

Two factors prevent statements of this kind being made much more often. The first is a judicial desire for comity with parliament, and the second is that the courts do not consider the policy behind tax provisions in much detail.

When there are differing views on what the tax policy should be, there are inevitable differing views as to what the policy actually is. The wish may be father to the thought. In *Marshall v Kerr:*[13]

> there is a real danger that if a court in every case feels bound to commence its construction of a statutory provision by finding their purpose, it will make a self-fulfilling assumption of what the purpose is.

For all these reasons, debates about tax policy will rarely be settled. Authoritative decisions of the courts ought to resolve the question for practical purposes, on the rare occasions when they exist; but even then, the losing side may seek to chip away at the issue.

App. 9.5 *Fowler*: a case study

I take as a case study the Supreme Court decision in *Fowler v HMRC.* This raised the issue of the purpose of the strange rule that employed North Sea divers are deemed to be carrying on a trade.[14]

[12] See 1.12 (State of UK tax reform).
In some cases the policy is founded on basic misconception; eg the false premise of ATED was that taxpayers used enveloping to avoid SDLT; see 98.39.3 (ATED purpose at outset). In some cases the purpose was to prevent avoidance arrangements which the HMRC (and the drafter) are unable to articulate, or refuse to identify; eg, see Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), Ch 7 (Tainted Donation Rules). In some cases the reasons given do not bear serious scrutiny; see eg 80.42.1 (s.175A disallowance: purpose).

[13] 67 TC 56 at p.78.

[14] See 37.16.1 (Deemed non-employment).

App. 9.5.1 *The purpose in fact*

John Avery Jones records:

> The deeming arose in 1978 because, whilst divers had been treated as self-employed in the past, the Revenue had made a ruling that they should be taxed as employees.
> The ruling was naturally unpopular and there were newspaper reports of a threatened strike. This would have been serious because ... divers were a highly skilled, highly mobile work force in extremely short supply. Deeming them to be self-employed was odd tax policy ... but presumably the change was considered preferable to North Sea oil production being disrupted, and ministers reluctantly agreed to it. Parliament was told at the time that the reason was that the standard way of classifying someone as employed or self-employed did not meet the rules of the industry, which does not seem to be particularly convincing.[15]

App. 9.5.2 *The purpose as published*

In Hansard:

> Mr Robert Sheldon [then Financial Secretary to the Treasury] ... these divers fall to be treated as employees under the existing law. Nevertheless, after careful examination of their particular circumstances, I recognise that there are certain distinctive features about their work, such as the danger which it entails, their vulnerability to long-term health hazards, the exceptional travelling difficulties involved and the shortness of their working life. Taking into account these and other factors, my right hon. Friend is now prepared to introduce legislation in the coming Finance Bill which will provide that earnings from diving operations in connection with exploration or exploitation activities in the UK Continental Shelf will, with effect from 1978 – 79, be assessable under Schedule D [trading income] rather than Schedule E [employment income].[16]

Office of Tax Simplification:[17]

[15] Avery Jones and Hattingh, "*Fowler v HMRC*: divers and the dangers of deeming" [2016] BTR p.417.

[16] HC Deb 3 February 1978 vol 943 c359 W.

[17] OTS, *Review of tax reliefs* (March 2011) *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/198570/ots_review_tax_reliefs_final_report.pdf*

> B.108 The regime was introduced in 1978 to ensure fairness amongst divers of all nationality and employment status when engaged on the UK continental shelf. This is because at that time, the divers had to pay their costs themselves, and therefore being taxed as self employed ensured they were able to obtain relief for these expenses.
> B.109 However since then, we understand that many employers have made agreements with the trade unions that they will cover these costs. It would therefore appear that there is no ongoing rationale for this regime to be retained.[18]

App. 9.5.3 *Purpose according to Courts*

In the FTT:

> It is hard to see how dangers, vulnerability to long-term health hazards and shortness of working life, for example, are relevant to the question whether the individual should be taxed on an employment or a self-employed basis. The real purpose of section 15 ITTOIA, in my judgment, is to be found in the more relaxed rules (when compared with those for employment income) for deductibility of expenses in the calculation of trading income (and, possibly, from the timing advantage conferred by the absence of PAYE).[19]

In the Supreme Court:[20]

> the FtT found that [the reason for the rule] was because ... this class of divers commonly incurred their own costs, and therefore deserved the more generous expenses regime afforded to the self-employed, by comparison with employees. The FtT relied on an opinion to that effect published by the Office of Tax Simplification in March 2011, in preference to broader but less persuasive observations by the Financial Secretary to the Treasury in February 1978 ... There is no good reason to doubt that essentially factual finding (!)[21] by the FtT. It is clear (!) that it was not a purpose of the deeming provision ... to resolve some legal or factual uncertainty about whether such divers were genuinely employed or self-employed. On the contrary, section 15 applies only to employed divers...

[18] OTS recommended that the rule should be repealed, but no-one took any notice of that.

[19] *Fowler v HMRC* [2016] UKFTT 234 (TC) at [94].

[20] *Fowler v HMRC* [2020] UKSC 22 at [25].

[21] See App 9.6 (Purpose: Fact or law).

App. 9.5.4 *Purpose of DTA*

The Supreme Court also considered the purpose of the relevant DTA:

> 15. If one asks, as is required, for what purposes and between whom is the fiction created, it is plainly (!) not for the purpose of rendering a qualifying diver immune from tax in the UK, nor adjudicating between the UK and South Africa as the potential recipient of tax. It is for the purpose of adjusting the basis of a continuing UK income tax liability which arises from the receipt of employment income. Therefore to apply the deeming provision in [s.15(2) ITEPA] so as to alter the meaning of terms in the Treaty with the result of rendering a qualifying diver immune from UK taxation would be contrary to its purpose
> 34. Nor should article 3(2) of the Treaty[22] be construed so as to bring a qualifying diver within article 7 [business profits] rather than article 14 [employment income]. To do so would be contrary to the purposes of the Treaty... the Treaty is not concerned with the manner in which taxes falling within the scope of the Treaty are levied. Section 15 ... charges income tax on the employment income of an employed diver, but in a particular manner which includes the fiction that the diver is carrying on a trade.

The distinction between deemed trade and taxing employment income in the manner of a trade is, to say the least, a fine one.

App. 9.5.5 *Purpose: conclusion*

What I think emerges from this case study is that the search for purpose if carried out seriously can be unedifying. Laws are indeed like sausages: it is better not to see how they are made.[23] The best that can be done is for the Courts to skate over these problems - as they do.

Perhaps the purposive pendulum will swing back a little. We are at risk of reaching the position, said to pertain in America, that when legislative purpose is not clear from the enactment history, one resorts to reading the statute.

App. 9.6 Purpose: Fact or law?

In *Fowler* the purpose of the provision was said to be "essentially" a

[22] See 107.12.1 (Domestic-law meaning).

[23] This aperçu has been attributed to Bismark, but originates from the American poet, John Godfrey Saxe.

matter of fact.[24] If it is fact, it is a fact of a somewhat unusual kind. An appellate court is entitled to determine the purpose, and is not bound by findings of the lower Court. On appeal, a decision of the higher courts on purpose will bind the lower courts. On that basis the purpose is properly described as a matter of law. After all, "if it looks like a duck, swims like a duck, and quacks like a duck, then it probably is a duck."

[24] See [25] *Fowler v HMRC* [2020] UKSC 22 followed in *A Taxpayer v HMRC* TC/2020/02072 at [155].

APPENDIX TEN

PARLIAMENTARIANS

App. 10.1 Houses of parliament
App. 10.1.1 Taxation of MPs/MLs: Critique
App. 10.2 European Parliament
App. 10.3 Scottish/Welsh parliamentarian
App. 10.3.1 Parliamentarian in part of year

App. 10.1 Houses of parliament

Section 41 Constitutional Reform and Governance Act 2010 ("CRGA") provides special rules for residence and domicile of MPs and members of the House of Lords ("MLs"):

> (1) Subsection (2) applies if a person is for any part of a tax year[1]—
> (a) a member of the House of Commons, or
> (b) a member of the House of Lords.[2]
>
> (2) The person is to be treated for the purposes of the taxes listed in subsection (3) as resident and domiciled in the UK for the whole of that tax year.
>
> (3) The taxes are—
> (a) income tax,
> (b) capital gains tax, and

[1] IHT does not use the concept of tax years, so s.41(9) CRGA provides:
"In this section, in relation to inheritance tax—
(a) 'tax year' means a year beginning on 6 April and ending on the following 5 April, and
(b) 'the tax year 2010-11' means the tax year beginning on 6 April 2010."

[2] Section 41(5)(10) CRGA defines ML:
For the purposes of this section and section 42 a person is a member of the House of Lords if the person is entitled to receive writs of summons to attend that House....
(10) In determining for the purposes of this section and section 42 whether a person is entitled to receive writs of summons to attend the House of Lords, ignore—
(a) section 2 of the Forfeiture Act 1870;
(b) sections 426A and 427 of the Insolvency Act 1986.

(c) inheritance tax.

In practice this means MPs and MLs are deemed UK resident and domiciled for almost all tax purposes, though minor taxes such as NICs slip through the net. But following the introduction of 15-year deemed domicile rule in 2017, this is not likely to have any practical effect.

EN CRGA provides:

> 269.The section provides that MPs and peers are deemed ROD [resident ordinarily resident and domiciled] for the whole of each tax year in which they are a member of either House (including those tax years in which they are a member for only part of the year). This means that they will be deemed ROD from the start of the tax year in which they become a member of that House and to the end of the tax year in which they cease to be a member.

DT relief may apply where a treaty has a tie-breaker in OECD Model form.

Section 41(4) CRGA defines when a person becomes or ceases to be a MP or a ML:

> For the purposes of this section a person—
> (a) becomes a member of the House of Commons when (having been elected to that House) the person makes and subscribes the oath required by the Parliamentary Oaths Act 1866 (or the corresponding affirmation), and
> (b) ceases to be a member of that House when—
> (i) the Parliament to which the person was elected is dissolved, or
> (ii) the person's seat is otherwise vacated.

Since a person will know the exact date when they become an MP or ML, they have an opportunity for pre-appointment planning and there may even be some scope for further planning when deemed UK domiciled (eg in relation to the IHT spouse exemption if the spouse is UK domiciled).[3] Note that when a person ceases to be a ML or MP, they will continue to be deemed IHT domiciled for another three or four years.

Sinn Féin MPs do not take their seats at Westminster so happily escape deemed UK residence and domicile.

[3] See Slevin "Not Quite the Same", Taxation (19 May 2011).

Section 41(6) CRGA excludes judges[4] and bishops (the section is after all only a *political* exercise). This level of micro-detail cannot sensibly be covered even in this book which aims to be comprehensive: it would be surprising if there are more than one or two individuals concerned (if indeed there are any at all).

App. 10.1.1 *Taxation of MPs/MLs: Critique*

Stephen Timms (then Financial Secretary to the Treasury) said:

> This is how the vast majority of the UK population is taxed, so it seems right to me ... that MPs and Members of the House of Lords should be taxed on that basis and should not have access to the remittance basis. It is helpful that there is now clear, albeit rather belated, cross-party support for action, following the Conservative's change of position to supporting the principle that MPs and Members of the House of Lords should be required to pay tax in full on their overseas income, gains and assets.[5]

A great deal more could be said about the policy issues relating to these provisions. The CRGA provisions were not debated in parliament: they were a late amendment to the CRGA, which was enacted in a breathless ping pong procedure just before the dissolution of parliament. But the context of the rules is wholly political - the scrabble for public approval and to knock the opposition - so it would be unrealistic to expect cool and considered reflection. The debate is long-standing.[6]

App. 10.2 European Parliament

The deemed UK residence/domicile rule does not apply to MEPs. EN CRGA para 275 discusses the position of a MEP who is also a member of the House of Lords:

> A peer is not entitled to receive a writ of summons if they are a Member

[4] This makes sense, as a ML who holds a disqualifying judicial office is disqualified from sitting or voting in the House of Lords: s.137(7) Constitutional Reform Act 2005.

[5] Hansard, 5 Jan 2010, Column 52WH.

[6] There was a comparable debate in relation to Lord Vestey who (though resident and domiciled when ennobled in 1922) had shortly before been a tax exile: see "Vestey: Royal Commission debate" *https://www.kessler.co.uk/wp-content/uploads/2017/11/Vestey_Royal_Commission_debate.pdf*

of the European Parliament, but they do receive writs of summons once they step down from the European Parliament. Therefore, a peer who is an MEP would not be deemed ROD under section 41, but once entitled to receive writs again they would be deemed ROD.Section 42(10) allows such MEPs to avoid being deemed ROD in these circumstances by making the transitional provision available to such MEPs in the same way as to those peers currently entitled to receive writs of summons.

App. 10.3 Scottish/Welsh parliamentarian

This section considers whether parliamentarians are Scottish/Welsh taxpayers.[7] The Scottish/Welsh provisions are best read side by side:

s.80D Scotland Act 1998	**s.113E Government of Wales Act 2006**
(1) For any tax year, a Scottish taxpayer is an individual (T)— (a) who is resident in the UK for income tax purposes for that year (see Schedule 45 to the FA 2013), and (b) who, for that year, meets condition A, B or C....	(1)For any tax year, a Welsh taxpayer is an individual (T)— (a) who is resident in the UK for income tax purposes for that year (see Schedule 45 to the Finance Act 2013), and (b) who, for that year, meets condition A, B or C....
(4) T meets condition C if, for the whole or any part of the year, T is— (a) a member of Parliament for a constituency in Scotland, (b) a member of the European Parliament for Scotland, or (c) a member of the Scottish Parliament.	(4) T meets condition C if, for the whole or any part of the year, T is— (a) a member of Parliament for a constituency in Wales, (b) a member of the European Parliament for Wales, or (c) an Assembly member.
(5) Subsection (1) does not apply if T is a Scottish parliamentarian for the whole or any part of the year (see section 116F).	(4A) Subsection (1) does not apply if T is a Welsh parliamentarian for the whole or any part of the year (see section 80DA).
(6) For the purposes of subsection (5) and section 116F, T is a Scottish parliamentarian if T is a member as	(4B) For the purposes of subsection (4A) and section 80DA, T is a Welsh parliamentarian if T is

[7] See 6.43 (Scottish/Welsh taxpayers).

described in any of paragraphs (a) to (c) of section 80D(4) of the Scotland Act 1998 (definition of a Scottish taxpayer).

a member as described in any of paragraphs (a) to (c) of section 116E(4) of the Government of Wales Act 2006 (definition of a Welsh taxpayer).

App. 10.3.1 *Parliamentarian in part of year*

There are rules dealing with the rare possibility that Scottish taxpayer is a member of the Welsh assembly for part of a year (and vice versa). We are approaching a level of micro detail here such that one wonders why it was necessary to make a provision for this case. It will rarely if ever happen, and the rules make next to no difference if it does. But here it is:

s.80DA Scotland Act 1998

(1) An individual (T) who is a Welsh parliamentarian for the whole or any part of a tax year is a Scottish taxpayer for that tax year if—

(a) T is resident in the UK for income tax purposes for that year (see Schedule 45 to the FA 2013),

(b) T meets condition C in section 80D for that year, and

(c) T meets either of the following conditions for that year.

(2) T meets the first condition if—

(a) the number of days in that year on which T is a member as described in any of paragraphs (a) to (c) of section 80D(4), exceeds

(b) the number of days in that year on which T is a Welsh parliamentarian.

(3) T meets the second condition if—

(a) the number of days in that year mentioned in paragraphs (a) and (b) of subsection (2) are the same, and

(b) T meets condition A or B in section 80D for that year.

s.116F Government of Wales Act 2006

(1) An individual (T) who is a Scottish parliamentarian for the whole or any part of a tax year is a Welsh taxpayer for that tax year if—

(a) T is resident in the UK for income tax purposes for that year (see Schedule 45 to the Finance Act 2013),

(b) T meets condition C in section 116E for that year, and

(c) T meets either of the following conditions for that year.

(2) T meets the first condition if—

(a) the number of days in that year on which T is a member as described in any of paragraphs (a) to (c) of section 116E(4),

(b) the number of days in that year on which T is a Scottish parliamentarian.

(3) T meets the second condition if—

(a) the number of days in that year mentioned in paragraphs (a) and (b) of subsection (2) are the same, and

(b) T meets condition A or B in section 116E for that year.

APPENDIX ELEVEN

VISITING FORCES

App. 11.1 Treaty background
App. 11.2 Residence for IT and CGT
App. 11.2.1 Who qualifies for relief
App. 11.2.2 Designated countries/HQs
App. 11.2.3 Residence/domicile relief
App. 11.2.4 Visiting forces: Personal allowances
App. 11.2.5 Visiting forces: Private residence
App. 11.3 Employment income
App. 11.3.1 Treaty background
App. 11.3.2 The relief
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App. 11.4.1 Excluded property
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App. 11.4.3 "Visiting force" and definitions
App. 11.5 SDLT

App. 11.1 Treaty background

The taxation of visiting forces is based on the following treaties:

(1) NATO Status of Forces Agreement 1951 ("NATO SOFA")[1]

(2) Partnership for Peace Status of Forces Agreement 1995 ("PfP SOFA")[2]

(3) EU Status of Forces Agreement 2003[3]. Its taxation provisions are

[1] The full title is: Agreement Between the Parties to the North Atlantic Treaty Regarding the Status of Their Forces 19 June 1951.
Accessible *http://www.nato.int/cps/en/natolive/official_texts_17265.htm*

[2] The full title is: Agreement among the States Parties to the North Atlantic Treaty and the other States participating in the Partnership for Peace regarding the Status of their Forces, 19 June 1995.
Accessible *http://www.nato.int/cps/en/natolive/official_texts_24742.htm*

[3] The full title is: Agreement between the member states of the European Union concerning the status of military and civilian staff seconded to the institutions of the European Union, of the headquarters and forces which may be made available to the European Union in the context of the preparation and execution of the tasks referred to in article 17(2) of the treaty on European Union including exercises, and of the military and civilian staff of the member states put at the disposal of the European Union to act in this context.
http://www.official-documents.gov.uk/document/cm75/7572/7572.pdf

> similar to the existing treaties.

The PfP SOFA incorporates the 1951 treaty by reference.

A House of Commons library note explains the background:[4]

> In order to regulate the extent to which foreign military personnel have exemption from local jurisdiction, it has become the practice, particularly since the Second World War, to regulate these issues through Status of Forces Agreements (SOFAs), which are negotiated between the sending and host state.
>
> Status of Forces Agreements allow a sending State's military forces to operate within, and at the consent of, the host state. They also provide for the status of military headquarters established in other countries. They may be bilateral or multilateral and there are no formal requirements as to the form, content, length, or title that a SOFA should take.
>
> In their most basic form they establish the legal jurisdiction over military personnel and related civilians; define the exemptions of such personnel from passport and visa regulations and customs and excise duties; set out the legal right for military personnel to patrol bases, transit the host state, wear uniform and bear arms in the host nation and set out the cost arrangements for establishing and maintaining military facilities.
>
> In 1951 NATO agreed a Status of Forces Agreement to govern hosting arrangements between the Alliance's member states. From the UK's perspective, it applies equally to visiting forces in the UK and to British forces based in NATO countries, for example in Germany.
>
> The Visiting Forces Act 1952 incorporates the NATO SOFA into UK law.[5] Together, they provide the overarching framework for the stationing of US forces in the UK.
>
> The provisions of the VFA were extended to NATO military headquarters in the UK by the International Headquarters and Defence Organisations Act 1964.
>
> The Visiting Forces Agreement was extended in 1995 by the Partnership for Peace Status of Forces Agreement to cover the forces

See The Visiting Forces and International Military Headquarters (EU SOFA) (Tax Designation) Order 2012.

[4] "US Forces in the UK: legal agreements" SN06808 (2015) (footnotes omitted) *http://researchbriefings.files.parliament.uk/documents/SN06808/SN06808.pdf*
See Parry & Grant, Encyclopaedic Dictionary of International Law (3 ed, 2009)

[5] Author's footnote: However the tax provisions of the treaties are incorporated into UK law by the tax legislation set out below.

of states who not members of NATO but had agreed to participate in NATO's Partnership for Peace plan.

The Armed Forces Act 1996 extended the Visiting Forces Act to third countries (i.e. neither members of NATO nor members of the Partnership for Peace plan) by Order in Council. It might also be applied to Service personnel from other countries undertaking training at UK military establishments. Algeria, for example, was added to the list of countries by Visiting Forces (Designation) Order 2010 (SI 2010/2970). The EU Status of Forces Agreement applies in circumstances in which forces are not regulated by either the NATO or the Partnership for Peace Status of Forces agreement.

App. 11.2 Residence for IT and CGT

App. 11.2.1 *Who qualifies for relief*

Article 1 NATO SOFA provides:

> In this Agreement the expression
>
> 'force' means the personnel belonging to the land, sea or air armed services of one Contracting Party when in the territory of another Contracting Party in the North Atlantic Treaty area in connexion with their official duties, provided that the two Contracting Parties concerned may agree that certain individuals, units or formations shall not be regarded as constituting or included in a 'force' for the purpose of the present Agreement;
>
> 'civilian component' means the civilian personnel accompanying a force of a Contracting Party who are in the employ of an armed service of that Contracting Party, and who are not stateless persons, nor nationals of any State which is not a Party to the North Atlantic Treaty, nor nationals of, nor ordinarily resident in, the State in which the force is located.

Section 833 ITA provides:

> (1) This section applies to an individual who—
> (a) is a member of a visiting force of a designated country or of a civilian component of such a force,
> (b) is in the UK, but only because of being a member of the force or the civilian component, and
> (c) is not a British citizen, a British overseas territories citizen, a British National (Overseas) or a British Overseas citizen.
>
> (2) For the purposes of subsection (1)—
> (a) members of the armed forces of a designated country who are

attached to a designated international military headquarters[6] are treated as a visiting force of that country, and

(b) whether an individual is a member of a civilian component of such a force is to be determined accordingly.

(2A) This section also applies to an individual within subsection (3) or (3A).

(3) An individual is within this subsection if the individual—

(a) is of a category for the time being agreed between Her Majesty's Government in the UK and the other members of the North Atlantic Council,

(b) is employed by a designated allied headquarters,

(c) is in the UK, but only because of being employed by the designated allied headquarters, and

(d) is not a British citizen, a British overseas territories citizen, a British National (Overseas) or a British Overseas citizen

(3A) An individual is within this subsection if the individual—

(a) belongs to the EU civilian staff,[7]

(b) is in the UK, but only because of serving as part of that staff, and

(c) is not a British citizen, a British overseas territories citizen, a British National (Overseas) or a British Overseas citizen.....

(6) Subsections (1) to (3) are to be interpreted as if—

(a) they were in Part 1 of the Visiting Forces Act 1952,[8] and

[6] Defined in s.833(7) ITA: In this section—
"allied headquarters" means an international military headquarters established under the North Atlantic Treaty, and
"designated" means designated for the purpose in question by or under an Order in Council made for giving effect to an international agreement."

[7] Defined in s.833(7) ITA: "the EU civilian staff means—
(a) civilian personnel seconded by a member State to an EU institution for the purposes of activities (including exercises) relating to the preparation for, and execution of, tasks mentioned in Article 43(1) of the Treaty on European Union (tasks relating to a common security and defence policy), as amended from time to time, and
(b) civilian personnel (other than locally hired personnel)—
(i) made available to the EU by a member State to work with designated international military headquarters or a force of a designated country, or
(ii) otherwise made available to the EU by a member State for the purposes of activities of the kind referred to in paragraph (a)."

[8] This incorporates, in particular, the definitions in s.17 Visiting Forces Act 1952:
"(1) In this Act, unless the context otherwise requires, the expression "forces", in relation to a country, means any of the naval, military or air forces of that country, the

(b) references in that Act to a country to which a provision of that Act applies were references to a designated country.

HMRC say:

> **Eligibility for SOFA status (Status of Forces Agreement)**
> My query relates to a client that needs to source a UK role at short notice. The role will be covered by/eligible for SOFA status.
> They have identified 2 individuals that are right for the role. One of them is a current US national/US resident who would be brought to the UK for the project.
> The second individual is someone who is another US national, but he is already present in the UK. He is someone who is here on an assignment, and is currently regarded as a tax resident in the UK (having been here for a few years).
> The question they have is that will SOFA status apply, as normal, to the individual that is already here in the UK? In other words will this individual be regarded as not UK resident under the SOFA status from the date of the SOFA stamp/the date at which he commences the project role until the date this ends or he returns to the US at the conclusion of the project.
> **Answer**
> The tax treatment of this individual is determined by the Agreement regarding the Status of Forces of Parties to the North Atlantic Treaty ("NATOSOFA") (Treaty Series No.3, 1955).
> Article I(a) defines a Visiting Force as the personnel of land, sea or air armed services of one Contracting Party while in the other Contracting Party in connection with their official duties.
> Article I(b) defines a Civilian Component as the civilian personnel accompanying a Visiting Force who are in the employ of the armed service and who are not stateless persons, nor nationals of any state which is not a party to the North Atlantic Treaty, nor nationals of, nor

expression "United Kingdom court" means a court exercising jurisdiction in the United Kingdom under United Kingdom law otherwise than by virtue of section two of this Act, and the expression "United Kingdom law" means the law of the United Kingdom or of any part thereof.

(2) For the purposes of this Act a member of a force of any country which (by whatever name called) is in the nature of a reserve or auxiliary force shall be deemed to be a member of that country's forces so long as, but only so long as, he is called into actual service (by whatever expression described) or is called out for training; and any reference in this Act to a person's becoming a member of a country's forces shall be construed accordingly."

ordinarily resident in, the State in which the force is located.

If the individual is a member of the armed forces then they are within Art 1(a) since they would be “in the Contracting Party in connection with their official duties.” If they are a Civilian Component, they would not be in I(b) if they were ordinarily resident in the UK. Ordinary residence for NATSOFA purposes does not have the same meaning as the tax meaning, so in this instance we take it that the individual is ordinarily resident in the UK, since they are already in the UK “on an assignment, and is currently regarded as a tax resident in the UK (having been here for a few years).”

The exemption from taxation of salary under Art X(1) will not apply because they continue to be resident in the UK because they are not here solely by being a member of the force or civilian component. They were here already.

An individual employed by a private company contracted to work on a defence contract (known sometimes as a “tech-rep”) is not a member of the “civilian component” for the purposes of NATOSOFA. The emoluments paid to him by the company which employs him for duties performed in the UK are liable to UK tax in accordance with the normal rules, as modified by the terms of the UK/US double taxation convention.

If the individual is a civilian who does not possess UK nationality but who is ordinarily resident in the UK (and are not therefore members of the civilian component), they may nevertheless qualify for exemption in respect of their earnings if they qualify as an “official agent of a foreign government” under Section 301 ITEPA 2003. Sub-section 5 defines this as a person who is not a consul, but is employed on the staff or a consulate or an official department or agency of a foreign state. It does not apply to a department or agency which carries on a trade, business or other undertaking for the purposes of profit.[9]

App. 11.2.2 *Designated countries/HQs*

105 countries have been designated:

Designated NATO countries

Albania
Belgium
Bulgaria
Canada
Croatia
Czech Republic

[9] Expatriate Forum Minutes Oct 2019 *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/855596/Expat_Forum_minutes_10_October_2019.pdf*

Denmark
Estonia
France
Germany
Greece
Hungary
Iceland
Italy
Latvia
Lithuania
Luxembourg
Netherlands
Norway
Poland
Portugal
Romania
Slovakia
Slovenia
Spain
Turkey
United States of America.[10]

Designated PfP countries

Armenia
Austria
Azerbaijan
Belarus
Bosnia and Herzegovina
Finland
Georgia
Ireland
Kazakhstan
Kyrgyz Republic
Malta
Moldova
Montenegro
Russia
Serbia
Sweden
Switzerland
Tajikistan
the former Yugoslav Republic of Macedonia
Turkmenistan
Ukraine
Uzbekistan.[11]

Designated countries under s.833(6) ITA/Visiting Forces Act 1952

Algeria
Antigua and Barbuda
Australia
Bangladesh
Barbados
Belize
Botswana
Brunei
Cameroon
Canada
Dominica
Fiji
Ghana
Grenada
Guyana
India
Jamaica
Jordan
Kenya
Kiribati
Lesotho
Malawi
Malaysia
Maldives
Malta
Mauritius
Morocco
Mozambique
Namibia
Nauru
New Zealand
Nigeria
Oman
Papua New Guinea
Pakistan
Saint Christopher and Nevis
Saint Lucia

[10] The Visiting Forces and International Military Headquarters (NATO and PfP) (Tax Designation) Order 2012 No. 3071, schedule 2.

[11] The Visiting Forces and International Military Headquarters (NATO and PfP) (Tax Designation) Order 2012 No. 3071, schedule 3.

Saint Vincent and the Grenadines
Saudi Arabia
Seychelles
Sierra Leone
Singapore
Solomon Islands
South Africa
Sri Lanka
Swaziland
Tanzania
the Bahamas
The Gambia
the New Hebrides
the Republic of Cyprus
Tonga
Trinidad and Tobago
Tuvalu
Uganda
Vanuatu
Western Samoa
Zambia
Zimbabwe

The following HQs have been designated:

(1) Headquarters of the Supreme Allied Commander Transformation (HQ SACT)
(2) Supreme Headquarters Allied Powers Europe (SHAPE)
(3) Maritime component Command Headquarters Northwood (CC-MAR HQ Northwood)
(4) Commander Submarines Allied Naval Forces North (COMSUBNORTH)
(5) NATO Airborne Early Warning and Control Force (NAEW&CF)
(6) NATO Joint Electronic Welfare Core Staff (NATO JEWCS)
(7) Headquarters UK–Netherlands Amphibious Force (UKNLAF)
(8) Headquarters UK–Netherlands landing Force (UKNLLF)
(9) The European Air Group (EAG)
(10) The Intelligence Fusion Centre (IFC)
(11) Headquarters Allied Rapid Reaction Corps (HQ ARRC)[12]

The former TDSI Guidance Notes provided:

> **Civilian component of visiting armed forces**
> ... A person is a member of a civilian component of a visiting force if his or her passport contains
>
> - an uncancelled entry made by or on behalf of the sending country stating that the bearer is a member of a civilian component of a visiting force of that country, and
> - an uncancelled recognition stamp of the UK Home Office.
>
> Employees of foreign contractors hired in the UK are not members of the civilian component of a visiting force. Their residence status is determined according to the normal rules ....[13]

[12] The Visiting Forces and International Military Headquarters (NATO and PfP) (Tax Designation) Order 2012 No. 3071, schedule 4.

[13] HMRC, "Tax Deduction Scheme for Interest: Guidance Notes for Financial Institutions (2012) para 4.50. *https://www.gov.uk/government/publications/guidance-notes-for-financial-instituti*

App. 11.2.3 *Residence/domicile relief*

Article X NATO SOFA provides:

> 1. [a] Where the legal incidence of any form of taxation in the receiving State depends upon residence or domicile, periods during which a member of a force or civilian component is in the territory of that State by reason solely of his being a member of such force or civilian component shall not be considered as periods of residence therein, or as creating a change of residence or domicile, for the purposes of such taxation...

A period of presence would not normally create a change of actual domicile, but it could create deemed domicile, and the drafter may have had in mind a civil law concept of domicile which is more like habitual residence.

Section 833(4) ITA provides the statutory relief:

> If this section applies to an individual throughout a period, the period is not treated for income tax purposes as—
> (a) a period of residence in the UK, or
> (b) creating a change of the individual's residence or domicile.

Section 271ZA TCGA extends the relief to CGT:

> (1) This section applies for the purposes of capital gains tax if section 833 of ITA 2007 (visiting forces and staff of designated allied headquarters) applies to an individual throughout a period.
> (2) The period is not a period of residence in the UK.
> (3) The period does not create a change of the individual's residence or domicile.

See too 26.22.5 (Usual place of residence) discussing US Forces on tour of duty in England.

There are two circumstances where it is advantageous to be UK resident, and these rules are disapplied: personal allowances and CGT private residence relief.

App. 11.2.4 *Visiting forces: Personal allowances*

Section 833(5) ITA provides:

ons
TDSI was abolished from 2016/17, and the Guidance Notes withdrawn. But the general point made here remains relevant.

> Subsection (4) does not affect the operation of section 56 or 460 of this Act (residence etc of claimants) in relation to an individual for any tax year.

EN ITA explains:

> 2498. Subsection (5) ensures that an individual to whom this section applies has the benefit of the personal reliefs to which the individual would be entitled if resident in the UK. Such reliefs will, accordingly, be available in calculating the individual's liability to UK income tax on such income as, for example, UK bank interest, dividends from UK resident companies and UK-based earnings which are not exempt under section 303 of ITEPA.

App. 11.2.5 *Visiting forces: Private residence*

Section 222 B(10) TCGA provides:

> Section 271ZA(2) (visiting forces etc) is to be disregarded in determining for the purposes of this section whether or not an individual is resident in the UK.

This overrides the usual disallowance of CGT private residence relief in relation to non-residents.[14]

App. 11.3 Employment income

App. 11.3.1 *Treaty background*

Article X.1 NATO SOFA provides:

> ... Members of a force or civilian component shall be exempt from taxation in the receiving State on the salary and emoluments paid to them as such members by the sending State or on any tangible movable property the presence of which in the receiving State is due solely to their temporary presence there.

App. 11.3.2 *The relief*

Section 303 ITEPA provides:

> (1) No liability to income tax arises in respect of earnings if—
> (a) they are paid by the government of a designated country to a member of a visiting force of that country or of a civilian component of such a force, and

[14] See 59.3 (Disapplication of private residence relief).

> (b) that person is not a British citizen, a British overseas territories citizen, a British National (Overseas) or a British Overseas citizen.
>
> (2) [*This is a definition provision identical to s.833(2) set out above*]
>
> (3) No liability to income tax arises in respect of earnings if they are paid by a designated international military headquarters to an employee of a category for the time being agreed between Her Majesty's government in the UK and the other members of the North Atlantic Council.
>
> (4) But where the employee is a British citizen, a British overseas territories citizen, a British National (Overseas) or a British Overseas citizen, subsection (3) only applies if it is necessary for it to do so to give effect to an agreement between parties to the North Atlantic Treaty.
>
> (4A) No liability to income tax arises in respect of earnings if—
>
> (a) they are paid by the government of a designated country to a person belonging to the EU civilian staff, and
>
> (b) that person is not a British citizen, a British overseas territories citizen, a British National (Overseas) or a British Overseas citizen.
>
> (5) & (6) [*These are definition provisions identical to s.833(6)(7) set out above]*.

App. 11.4 IHT reliefs

App. 11.4.1 *Excluded property*

Section 155(1) IHTA provides:

> Section 6(4) above applies to—
>
> (a) the emoluments paid by the Government of any designated country to a member of a visiting force of that country, not being a British citizen, a British Dependent Territories citizen, a British National (Overseas) or a British Overseas citizen, and
>
> (b) any tangible movable property the presence of which in the UK is due solely to the presence in the UK of such a person while serving as a member of the force.

This takes us to s.6(4) IHTA:

> Property to which this subsection applies by virtue of section 155(1) or (5A) below is excluded property.

In short, emoluments and tangible movable property of visiting forces qualify as excluded property for IHT purposes.

App. 11.4.2 *IHT deemed domicile*

Section 155(2) IHTA provides:

> A period during which any such member of a visiting force as is referred to in subsection (1) above is in the UK by reason solely of his being such a member shall not be treated for the purposes of this Act as a period of residence in the UK or as creating a change of his residence or domicile.

This is not needed,[15] but it does not harm.

Thus (in short) visiting forces do not become IHT deemed domiciled even if they reside 15 or more years in the UK (but in practice I expect that hardly ever happens). It is considered that this relief does not apply to members of visiting forces who are British citizens (etc) even though on a literal reading one might say that such persons are "referred to" in s.155(1).

App. 11.4.3 *"Visiting force" and definitions*

Section 155 IHTA provides

> (3) References in subsections (1) and (2) above to a visiting force shall apply to a civilian component of a visiting force as they apply to the force itself, and those subsections shall be construed as one with Part I of the Visiting Forces Act 1952 but so that for the purposes of this section references to a designated country shall be substituted in that Act for references to a country to which a provision of that Act applies.
> (4) For the purpose of conferring on persons attached to any designated allied international military headquarters the like benefits as are conferred by subsections (1) and (2) above on members of a visiting force or civilian component, any members of the armed forces of a designated country shall, while attached to any such headquarters, be deemed to constitute a visiting force of that country, and there shall be a corresponding extension of the class of persons who may be treated as members of a civilian component of such a visiting force.
> (5A) Section 6(4) also applies to—
> (a) the emoluments paid by the Government of any designated country to a person belonging to the EU civilian staff, not being a British citizen, a British overseas territories citizen, a British National (Overseas) or a British Overseas citizen, and
> (b) any tangible movable property the presence of which in the UK

[15] See 5.6.3 ("Residence" for 15-year rule).

> is due solely to the presence in the UK of such a person serving as part of that staff.
>
> (5B) A period during which any such person belonging to the EU civilian staff as is referred to in subsection (5A) is in the UK by reason solely of that person belonging to that staff is not to be treated for the purposes of this Act as a period of residence in the UK or as creating a change of that person's residence or domicile.

Section 155 IHTA provides:

> (6) For the purposes of this section—
> "allied headquarters" means any international military headquarters established under the North Atlantic Council;
> "designated" means [definition identical to IT definition]
> "the EU civilian staff" means [definition identical to IT definition]
> (7) Any Order in Council made under section 73 of the Finance Act 1960 which is in force immediately before the passing of this Act shall have effect for the purposes of this section as if had also been made under this section, and may be varied or revoked accordingly.

The exemption is not available to spouses of visiting forces.

App. 11.5 SDLT

Section 74A FA 1960 provides an exemption for land acquired as barracks or for training; this is too specialist a topic to be discussed here.

APPENDIX TWELVE

STUDENTS AND TEACHERS

App. 12.1 Scholarship income
App. 12.1.1 Payment from employer of relative
App. 12.2 Student grant: DT relief
App. 12.2.1 Students: non-OECD Model
App. 12.3 DT relief: Teachers

The following topics are considered elsewhere:
50.4.9 (School/university fees - s.731)

App. 12.1 Scholarship income

Section 776 ITTOIA provides:

> (1) No liability to income tax arises in respect of income from a scholarship[1] held by an individual in full-time education at a university, college, school or other educational establishment.
> (2A) No liability to income tax arises in respect of income from a payment made
> [a] under section 23C(5A) of the Children Act 1989 (duty to make payments to former relevant children who pursue higher education) or
> [b] under sections 110(6) or 112(2) of the Social Services and Well-being (Wales) Act 2014 (duty to make payments to certain young people who pursue higher education).

Scholarships from charities would not be taxable under general principles,[2] but this exemption would be needed if a private (non-charitable) trust awarded a bursary to a beneficiary.

[1] Scholarship is widely defined in s.776(3) ITTOIA: "In this section "scholarship" includes a bursary, exhibition or other similar educational endowment."

[2] See Kessler, Wong & Shah, *Taxation of Charities and Nonprofit Organisations*, (14th ed., 2024-25), para 12.5 (Charity beneficiaries)
Online version *https://www.taxationofcharities.co.uk*

SP 4/86 provides:

> **Payments made by employers to employees when in full-time attendance at universities and technical colleges**
> Scholarships, exhibitions, bursaries etc held by a person receiving full-time instruction at university, technical college or similar educational establishment are exempted from income tax by Section 776 ITTOIA 2005.
> This Statement of Practice sets out the circumstances when payments made by an employer to an employee for periods of attendance on a full-time course (including sandwich courses) can be exempted from income tax. The following conditions and exclusion apply.
> **Conditions**
> The employer requires that the employee must be enrolled at the educational establishment for at least one academic year and must attend the course for at least twenty weeks in that academic year. Or if the course is longer the employee must attend for at least twenty weeks on average, in an academic year over the period of the course.
> The educational establishments must be recognised universities, technical colleges or similar educational establishments, which are open to members of the public generally and offer more than one course of practical or academic instruction. For example an employer's internal training school or one run by an employer's trade organisation will not satisfy the educational establishment condition for the Statement of **Practice**.
> For courses commencing on or after 1 September 2007, the payments, including lodging, subsistence and travelling allowances, but excluding any tuition fees payable by the employee to the university etc, do not exceed £15,480 for the academic year.
> **Exclusion**
> This exemption does not apply to payments of earnings made for any periods spent working for the employer during vacations or otherwise.
> If the rate exceeds £15,480 HMRC may look at the arrangements in detail. This is because the level of payment exceeds what might reasonably be described as a scholarship or training allowance. However, an increase in the rate of payment over the qualifying limit, part way through a course, will not affect the exemption applying to any payments for the earlier part of the course.

The figure of £15,480 has not been revised since 2007.

App. 12.1.1 *Payment from employer of relative*

Section 776(2) ITTOIA provides:

> This exemption is subject to section 215 of ITEPA 2003 (under which only the scholarship holder is entitled to the exemption if the scholarship is provided by reason of another person's employment).

That takes us to s.215 ITEPA which provides:

> If an employment-related benefit consists in the provision of a scholarship, section 776(1) of ITTOIA 2005 (exemption for scholarship income) applies only in relation to the holder of the scholarship.

App. 12.2 Student grant: DT relief

Article 20 OECD Model Convention provides:

> Payments which a student or business apprentice
> [1] who is or was immediately[3] before visiting a Contracting State a resident of the other Contracting State and
> [2] who is present in the first-mentioned State solely for the purpose of his education or training
> receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments arise from sources outside that State.

This is not restricted to trust income, but in practice trust income may be the most common case where this DT relief applies.

The OECD commentary provides:

> 3. The Article covers only payments received for the purpose of the recipient’s maintenance, education or training. It does not, therefore, apply to a payment, or any part thereof, that is remuneration for services rendered by the recipient and which is covered by Article 15 (or by Article 7 in the case of independent services). Where the recipient’s training involves work experience, however, there is a need to distinguish between a payment for services and a payment for the recipient’s maintenance, education or training. The fact that the amount paid is similar to that paid to persons who provide similar services and

[3] The OECD commentary provides: “2. The word “immediately” was inserted in the 1977 Model Convention in order to make clear that the Article does not cover a person who has once been a resident of a Contracting State but has subsequently moved his residence to a third State before visiting the other Contracting State.”

are not students or business apprentices would generally indicate that the payment is a remuneration for services. Also, payments for maintenance, education or training should not exceed the level of expenses that are likely to be incurred to ensure the recipient's maintenance, education or training.

4. The Article only applies to payments arising from sources outside the State where the student or business apprentice is present solely for the purposes of education or training. Payments arising from sources within that State are covered by other Articles of the Convention: for instance, if, during his presence in the first-mentioned State, the student or business apprentice remains a resident of the other State according to Article 4, payments such as grants or scholarships that are not covered by other provisions of the Convention (such as Article 15) will be taxable only in his State of residence under paragraph 1 of Article 21. For the purpose of the Article, payments that are made by or on behalf of a resident of a Contracting State or that are borne by a permanent establishment which a person has in that State are not considered to arise from sources outside that State.

DTR Manual provides:

DT1930: Non-residents: UK income: Visiting students and apprentices [Nov 2019]

Some agreements also provide that certain remuneration which a student or business apprentice receives from employment in this country shall be exempt from United Kingdom tax. Various limitations are imposed in particular agreements, often relating to monetary limits, the student's need to supplement grant income, or the type of employment. In every case when an agreement provides an exemption of this type, details of any limitations are given in Part IV of this volume.

Claims for exemption under a students' Article are dealt with in the District which, but for the agreement, would have dealt with any tax on such payments or remuneration. In examining claims, refer to the relevant double taxation agreement to ensure that the conditions for exemption are fulfilled. The following notes give some guidance on matters to be taken into account in considering whether exemption is due

1. The exemption does not extend to income or capital gains derived by a student or business apprentice from his own investments or from trust income to which he is absolutely entitled.
2. Whether payments or remuneration are for the student's etc. maintenance, education or training, or for supplementing his resources, or are reasonably necessary, is a question of fact and the onus is on the claimant to provide the evidence. The figures quoted

in Statement of Practice SP4/86 (see SE1314)[4] can be used as a guide. Where the payments or remuneration seem to be unreasonably high, refer the case to Personal Tax Division (Schedule E), Sapphire House, Solihull.

3. If the payments or remuneration exceed the amount needed for the student's etc. maintenance, education or training, the whole amount is taxable and not merely the excess.
4. Where the Article provides that remuneration is to be exempted up to a certain monetary limit and the student or business apprentice is resident in the United Kingdom under United Kingdom domestic law, that amount is additional to the personal allowances available under United Kingdom law. For example, if the monetary limit in the agreement is 1,000 and the claimant is entitled to a personal allowance in the relevant year of 3,445, earnings of 4,445 or less will be exempt.

App. 12.2.1 *Students: non-OECD Model*

Some DTAs do not follow the OECD Model. For instance, art 19 Bangladesh/UK DTA provides a wider relief:

> (1) An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in the other Contracting State for the purpose of:
>
> (a) studying in the other Contracting State at a university or other recognised educational institution; or
>
> (b) securing training at a recognised educational institution required to qualify him to practise a profession; or
>
> (c) studying or carrying out research as a recipient of a grant, allowance or award from a governmental, religious, charitable, scientific, literary or educational organisation;
>
> shall be exempt from tax in that other Contracting State on:
>
> (i) remittances from abroad for the purpose of his maintenance. education, study, research or training;
>
> (ii) the grant, allowance or award; and
>
> (iii) income from personal services rendered in the other Contracting State (other than any rendered by an articled clerk or other individual undergoing professional training to the person or partnership to whom he is articled or who is providing the training) provided that the income constitutes earnings

[4] See App 12.1 (Scholarship income).

> reasonably necessary for his maintenance and education.
>
> (2) In no event shall an individual have the benefit of the provisions of this Article for more than five years.

App. 12.3 DT relief: Teachers

There is no specific relief for teachers in either the OECD Model or the UN Model, though of course art 15 (employees) will sometimes apply. But the UN Model discusses the possibility,[5] and some DTAs do contain a relief for teachers, such as art 20 Bangladesh/UK DTA:

> (1) An individual who visits one of the Contracting States for a period not exceeding two years for the purpose of teaching or engaging in research at a university, college or other recognised educational institution in that Contracting State, and who was immediately before that visit a resident of the other Contracting State, shall be exempted from tax by the first-mentioned Contracting State on any remuneration for such teaching or research for a period not exceeding two years from the date he first visits that State for such purpose.
>
> (2) This Article shall not apply to income from research unless such research is undertaken by the individual in the public interest and not primarily for the benefit of some other private person or persons.

[5] Commentary to article 20 (Students) para 10.

APPENDIX THIRTEEN

HOW TO IMPROVE RESIDENCE AND DOMICILE TAXATION

App. 13.1 Procedural changes
App. 13.2 Technical changes
App. 13.3 Section numbering system

App. 13.1 Procedural changes

The two most significant improvements to UK tax reform would be procedural:

(1) Less change[1]

(2) Comply with the Tax Consultation Framework[2]

App. 13.2 Technical changes

The following is a list of short technical improvements, with no significant tax cost, no significant winners or losers, and not politically contentious. It represents some cheap and (relatively) easy improvements to residence and domicile tax which no-one should find objectionable or difficult: the "low lying fruit" of tax reform.

Proposal	**Reference**
English/Northern Ireland law definition of domicile should adopt the amendments made in Scotland. (This involves a general law reform, not just tax law.)	See 4.4 (Domicile of origin); 4.18 (Child's domicile: Scotland)
Repeal s.267ZA(8) IHTA	See 5.14.13 (Critique)
Repeal IHT election-domicile.	See 5.14.13 (Election domicile: Critique)

[1] See 1.11 (The promise of stability).

[2] See 1.12.1 (Tax Consultation Framework).

Repeal s.763(3) ITA which is otiose.	See 7.3 (Trustees a distinct person)
IT/CGT definition of trustee residence should apply for IHT.	See 7.19.1 (IHT trust residence: Critique)
TNR rules: exemption if foreign tax paid and annual exemptions.	See 11.23 (TNR rules: Critique)
Repeal s.82 and s.65(3) TCGA (collection of exit charge from trustees).	See 12.5.2 (Critique)
Define RFI to mean all foreign source income; repeal s.830(3) ITTOIA.	See 16.9.4 (RFI definition: Critique); 97.8 (Clawback of unremittable assets relief)
Repeal s.838 ITTOIA (relief for expense of collecting RFI).	See 16.10 (RFI collection costs).
“Relevant persons” for remittance purposes should just be the taxpayer, spouse, cohabitee and minor children; investment relief can be abolished as unnecessary.	See 18.8.1 (Corporate relevant persons: Critique) 18.12 (Relevant person rules: Critique); 18.52.2 (Gifts to charity: Reform); 19.23 (Investment relief: Critique)
Payment into UK account of non-relevant person should not (for that reason alone) be a remittance.	See 18.14.6 (Gift to non-relevant person); 18.52.2 (Gift to charity: Reform)
Repeal s.809P(13) ITA	See 18.44 (Sets)
Foreign services relief: delete condition B and repeal s.809W(5) ITA.	See 19.27.1 (Services relief condition B: Critique); 19.28 (Exceptions: s.730 & s.87 benefits)
A person remitting from a mixed fund can determine what constituent of the fund the remittance consists of.	See: 20.21 (Mixed fund rules: Critique)
Align taxation of trades and professions/vocations so the same rules apply to all.	See 21.3.1 (Profession/vocation: Critique)

Source of interest should be as specified in OECD Model.	The current test is uncertain. See 26.15.1 (Source of interest: Critique)
Define "ordinary place of abode" in line with residence.	See 26.22.8 (Place of abode: Critique)
The DTA self-certificate system for royalties should apply to interest.	See 26.37 (Claim procedure: Critique)
Repeal relief for exempt foreign currency securities.	See 27.8 (Exempt foreign currency securities)
Abolish Accrued Income remittance basis (make gains subject to CGT).	See 28.9.7 (Critique)
Delete requirement that "foreign employers" must be resident outside the UK.	See 34.15 (Foreign employer)
Repeal the remittance basis for Chargeable Overseas	See 34.16 (Incidental duties in UK).
Repeal s.721(6) ITEPA (illegitimate child not counted as a child).	See 39.4.1 ("Family")
Abolish the s.105 ITEPA charge and extend s.106 to cover all the acquisition cost.	See 39.28.6 (Critique)
Shadow directors should be taken out of the benefit in kind charge.	See 39.33 (Home BiK: Critique)
Align treatment of Baker & Garland trusts, ie extend s.464 ITA to all trusts.	See 42.9.5 (Critique)
Repeal s.56(3)(a)-(f) - an odd list of entitlements to IT personal allowances.	See 44.7.5 (IT allowances: Misc)
Transactions in financial assets should in principle be deemed non-trading. The IME, AIF and OFTR exemptions can be repealed.	See 45.11 (Critique)
Repeal s.623 ITTOIA which has no effect.	See 47.4 (Settlor deductions/ reliefs)

Collect tax on income of settlor-interested trust from the settlor.	See 47.11 (Trustees of settlor-interested trust)
Replace pay and reclaim system with a rule that the settlor/life tenant pay their tax, and the trustees are only secondarily liable (if at all).	See 47.11.7 (Critique)
Split year rule should apply for s.643A/720/731/87	See 47.24 (s.643A remittance basis); 49.26.3 (Remittance in split year); 50.39.3 (Remittance in split year); 61.18 s.87 gains of split year
Simplify the genuine transactions defence	See 48.17 (Genuine transactions: Critique)
Repeal s.748 information notices	See 48.19 (ToA information notices)
Restore motive defence old condition B.	See 50.18.10 (s.733 computation: Critique)
Section 731 remittance basis should apply only if benefit is remitted (like the s.87 remittance basis).	See 50.43 (s.731: Critique)
simplify s.731 remittance basis: s.731 income should be regarded as remitted if the benefit is received or remitted to the UK, matching to UK source relevant income should not matter	See 50.43 (s.731: Critique)
Clarify the position for benefits received by non-residents: should be within s.731 only under settlor-attribution rule (ie settlor UK resident, and benefit received by non-resident close family) and not if income payment	See 50.46 (s.731 income arising to non-resident); 50.46.3 (Pre-residence benefits); 50.16 (Capital-benefit condition)
The statutory definition of "commercial" in s.738 ITA should be repealed.	See 52.8.4 ("Commercial": Critique)

Spouses should be treated as separate persons for CGT private residence reliefs.	See 59.8 (Spouses)
Align definition of "spouse" for CGT and IT settlor-interested trust rules, ie apply s.625(4) ITTOIA for CGT.	See 60.5.2 (Civil partner/same-sex spouse)
Repeal relief for pre-1991 protected trusts: there are probably none left in existence.	See 60.8.5 (Pre-1991 trusts: Critique)
Repeal s.87 interest surcharge.	See 61.17.4 (Interest surcharge: Critique)
Capital payment when non-resident not matched to gain when resident.	See 61.25 (Non-resident disregard: Critique)
Schedule 4B & 4C TCGA should only apply where there is a purpose specifically to avoid s.87 or s.86; or (better) repeal and replace with GAAR guidance.	See 62.38 (Critique)
Abolish the sub-fund regime	See 63.11 (Sub-funds: Critique)
Repeal s.262(3) [losses on sale of chattels under £6k should not be allowable].	See 65.10.2 (Loss on disposal of chattel)
Repeal carry-back of losses on death.	See 65.12.1 (Loss accruing before death)
Personal CGT losses should be deductible against s.87 gains.	See 65.14.1 (Personal loss & s.87: Critique)
Offshore income gains/accrued income profits should be protected foreign-source income	See 67.12.2 (OIG: Protected s.720 income?); 28.15 (AIP: Protected-trust relief).
Clarify that offshore income gains can qualify as protected income.	See 67.12.2 (OIG: Protected s.720 income?)
Repeal s.80 IHTA. The cure is worse than the disease.	See 75.13.10 (s.80 fictions: Critique)
The IHT spouse exemption should be restricted to spouses living together.	See 76.5.1 (Spouse exemption: Introduction)

UK bank accounts should qualify as excluded property as non-UK accounts.	See 76.13.4 (Foreign currency: Critique)
Inter-trust transfers should be ignored for IHT.	See 79.4 (Inter-trust transfer: IHT effect).
Repeal s.173 IHTA	See 80.46 (Foreign administration expenses)
Abolish the non-PET traps	See 81.4.4 (Non-PET trap); 81.6.1 (Alteration deemed disposition)
Replace POA rules with focussed anti-avoidance rules.	See 83.39.3 (Assessment)
Define "trade" to include "profession" and align the taxation of trades and professions	See 85.18 ("Trade")
Abolish CGT spouse exemption; replace with CGT exemption on divorce.	See 88.5.5 (Rebasing on death: Planning)
PRs should be deemed to be a single and continuing body distinct from the persons who are the PRs.	See 89.2 (Meaning of "PRs" for IT)
Provision that usufruct is not an IHT-settlement.	See 90.25.6 (Usufructs: Critique)
Restrict CGT spouse exemption for non-resident spouse.	See 93.13.1 (CGT spouse exemption: Critique).
The taxation of foreign currency should be the same as foreign currency bank accounts.	See 95.11.2 (Critique)
Yearly exchange rate averaging; Currency conversion date for income remittance is date of receipt, not date of remittance.	See 95.13 (Foreign currency issues: Critique)
Abolish ATED regime.	See 98.39.5 (The way forward)
A single definition of "settlor" which	See 99.2.15 (Definitions of

applies for all taxes	“settlor”: Critique); 99.12.3 (Appointment rules: Critique); 99.24 (Property provided to co in trust)
Repeal s.473 ITA (& CGT equivalent); dead letter law.	See 99.37.6 (Settlor of IoV: Critique)
Treat all assets other than UK land and securities as non-UK situate for the purposes of IHT & CGT.	See 102.37 (Reform of IHT/CGT situs rules)
Failing that, a second best: All securities situate for CGT in the place of incorporation of the company. s.275(1)(c) should be replaced by a rule that a debt is situate where the debtor is resident (applying the UK tax definition of residence).Repeal s.s.275(1)(k) TCGA (situs of judgement debt).	See 103.8.4 (Critique); 103.13.5 (Critique)103.11 (Debt rules: Critique)
Define PE by reference to OECD Model definition.	See 106.25 (Definitions of PE: Critique)
Replace branch/agency with PE.	See 106.28 (Branch/agency: Critique)
Replace remaining pre-1963 DTAs with OECD Model treaties	See 107.24 (Pre-1963 DTAs)
A 20 year time limit for collection of IHT.	See 125.16 (No time limit)
Repeal para 21B sch 24 FA 2007 which has never been used.	See 126.23.6 (Assets representing assets)

Reforms involving tax avoidance provisions

Proposal	**Reference**
Reform of offshore anti-avoidance code	See 10.1 (Reform of anti-avoidance rules: Introduction)
Repeal POA rules; replace with IHT charge on death in case of *Eversden*,	See 83.39 (Critique); 78.10.2 (Spouse exemption restricted)

Ingram and Home Loan schemes; repeal s.102(5A)-(5C) FA 1986.	
Repeal corporate residential property regime; or allow election for transparency	See 98.39.5 (The way forward)

App. 13.3 Section numbering system

The reader will have noticed that the system of numbering sections in the Taxes Acts is idiosyncratic.

OPC drafting guidance provides:

> The following applies when inserting whole provisions between existing provisions.
>
> - New provisions inserted between 1 and 2 are 1A, 1B, 1C etc.
> - New provisions inserted between 1A and 1B are 1AA, 1AB, 1AC etc.
> - New provisions inserted between 1 and 1A are 1ZA, 1ZB, 1ZC etc. (and not 1AA etc.)
> - New provisions inserted between 1A and 1AA are 1AZA, 1AZB, 1AZC etc[3]

This is sensible if inserting individual sections. However it does not work well when inserting Chapters, particularly if inserting a Chapter adjoining an existing insertion.

For instance, the 3 Chapters dealing with income streaming: section numbering begins with 809, followed by the Chapter letters, ie one of 809A/809AA/809D. The sections are then numbered ZA, ZB, etc. Hence:

- the 1st section of Chapter 5A is s.809AZA and the last is s.809AZG
- the 1st section of Chapter 5AA is s.809AAZA and the last is s.809AAZB

These chapters should not have been slotted into Part 13 ITA. The only benefit of putting all the provisions into Part 13 ITA is that all tax avoidance provisions are in a single Part where perhaps they logically belong. The benefit (if it is a benefit) is far outweighed by the clumsy statutory numbering that had to result. They should have been set out elsewhere, where they could be numbered arithmetically, if nowhere else was suitable, in the Finance Act where they were enacted.

At present there are provisions with *five* letters used in this way, eg

[3] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/727629/drafting_guidance_July_2018.2..pdf*

s.12ABZAA TMA. In the fullness of time, if we carry on as we have, provisions with a number and six or even more letters must follow.

For provisions which have now been enacted, only consolidation will remove the problem; a desperate remedy. But it would at least be desirable to avoid adding to section numbers of this kind, not (or not just) because they are ridiculous, though they are; but because it is hard to find and to cross refer to them. A section number is a label, and these are poor labels.

Is there any other country in the world which uses numbering like this? Discuss.

APPENDIX FOURTEEN

REFORM OF OFFSHORE ANTI-AVOIDANCE LAW

App. 14.1 Reform of anti-avoidance rules
App. 14.2 Outline of reforms discussed
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App. 14.1 Reform of anti-avoidance rules

This appendix notes some proposals towards simplification/rationalisation of the IT/CGT anti-avoidance rules which apply to non-resident trusts and companies.

The rules discussed in this appendix may be classified in 3 ways:

Classification	*Main provisions*	*Applies to*
IT rules	s.720/s.731 ITA, s.624 ITTOIA	IT
CGT rules	s.3/s.86/s. 87 TCGA	CGT

Alternatively:

Settlor rules	s.624/s.720/ s.86	settlors/transferors
Benefit rules	s.731/s.87/s.643A	receipt of benefits

Alternatively:

Basis of assessment	*Applies to:*
Arising basis	UK domiciled taxpayers
Remittance basis	Remittance basis taxpayers
Protected trust basis	Non-dom settlors/transferors

Proposals discussed in particular are:

2012 reform paper: CIOT proposals entitled "Reform of two anti-avoidance provisions".[1]
2015 reform paper: proposals from the professional bodies in 2015.[2]

Since then we have had the introduction of the protected trust regime in 2017 and 2018, the full implications of which have yet to be worked out, though it clearly represents an enormous setback to the cause of simplicity in trust taxation.

App. 14.2 Outline of reforms discussed

The main reforms discussed here are as follows:

(1) To reduce the overlap of IT rules so only one IT rule applies at any one time. At present the IT rules overlap: s.624, s.720 and s.731 rules can all operate at the same time. (CGT rules overlap rather less.)
(2) To align IT/CGT benefit rules
(3) To align IT/CGT settlor rules

Alignment is possible if and so far as the IT/CGT rules aim to achieve the same result, namely (in short) to tax income/gains arising to non resident entities in the following ways:

(a) *The individual responsible for funding the entity* (settlor/transferor) may be taxed on the entity's income/gains, on an arising or remittance basis, subject to protected-trust relief
(b) *Individuals who receive benefits from the entity* are taxed on the benefits (on a receipts basis or a remittance basis) so far as matched to the income/gains

The topic even more in need of reform is inheritance taxation of trusts; but that is not discussed here as it is too far from the themes of this book.[3]

[1] *http://www.tax.org.uk/system/files_force/file_uploads/131011%20Transfer%20of%20assets%20-%20further%20consultation%20-%20CIOT%20comments.pdf?download=1* (2012)

[2] Taxrep 59/15 (ICAEW Representation 152/15) *http://www.icaew.com/~/media/corporate/files/technical/tax/tax%20faculty/taxreps/2015/taxrep%2059-15%20reforms%20to%20the%20taxation%20of%20non%20domiciles.ashx*

[3] See Kessler, "The Quest for Fair Inheritance Taxation of Trusts" [2013] Trusts & Trustees p.364 *https://www.kessler.co.uk/wp-content/uploads/2012/10/JK4393-Lecture-Trust-tax-reform-5.pdf*

App. 14.3 Need for reform

The burden of operating the many sets of rules has increased over the years as

(1) The application of the rules has become much wider (significant extensions of scope, for instance, in 1998, 2005, 2008, 2017[4]).

(2) The content of the rules has become much more complicated (significant complications, for instance, in 2008, 2017 and 2018[5]).

Growth in complexity can be (very roughly)[6] measured by the number of pages discussing the topics in succeeding editions of this book. The figures are shocking, indeed frightening, as a glance at the ever increasing size of this book will indicate.[7]

No reader who studies this book will doubt the need for reform.

Discussion is theoretical in that there seems to be little current prospect of serious reform. But it may be worthwhile attempting to think the matter out in anticipation of a future change of political climate.

App. 14.4 How to assess reforms

Assessment of proposed reforms raises two sets of issues.

The first is that propounded by the Brown administration in the 2008 domicile reforms: does the reform produce a system which is fairer, simpler, and/or easier to operate;[8] not in absolute terms, but measured from

[4] 1998: Extending the s.87 regime to foreign domiciled settlors; 2005: applying the ToA motive test to associated operations; 2008: the ITA remittance basis; 2017: deemed domicile. But that only lists some highlights.

[5] 2008: ITA remittance basis; 2017 and 2018: protected property regime. But that only lists some highlights.

[6] Page count is a rough proxy for the ever growing complexity of the law, but not an altogether bad one. Some page growth is due to better coverage of existing law, and does not reflect increasing complexity. However I think it would be correct to say that 90% of the growth is due to increased complexity. Any major change leads to growth over several succeeding years, as the implications and HMRC guidance gradually emerge.

[7] A historical note: The emergence of distinct IT/CGT benefit rules at the same time in the FA 1981 is puzzling. The 2012 reform paper uses stronger language: "bizarre ... inexplicable". The explanation is no doubt that those responsible for one did not liaise with those responsible for the other. There was no public consultation. But the burden of separate codes was, perhaps, acceptable (if sub-optimal) when they first emerged.

[8] See 1.8 (Assessment of reform: Metricss).

the starting point of the present system.

The second set of issues is whether there are winners and losers, and if so who they are:

(1) If there are none, or few, the reforms may be described as "**technical**" and should not be politically controversial.

(2) If reform produces a balance of winners and losers, the Treasury should not be affected.

Winners and losers need to be identified if the results are to be defendable. Even the simplest reforms tend to produce both intended and unintended (or targeted and untargeted) winners or losers, in complex patterns.[9]

If the reform produces losers, transitional issues become more important. Losers generally object more loudly than winners. As the numbers become larger the reforms become more political.[10]

My emphasis here is on more technical reforms, but little if any worthwhile reform can be achieved without some winners or losers. Tax simplification cannot be achieved by technical reform alone. That is why it has not happened.

App. 14.5 Critique of present rules

App. 14.5.1 *Critique of s.87 regime*

The Jersey Court commented on the s.87 regime, in a variation of trusts case, and was not flattering:

> In essence, as we understand it, as a result of the changes introduced in the 1998 Finance Act of the United Kingdom, [which extended the s.87 regime to trusts with foreign domiciled settlors] UK resident beneficiaries are liable to be assessed for capital gains tax on the uplift in capital value in the underlying settlement assets between the date of the Settlement and the date of any appointment to them. ... such liability might be very significant and indeed account for a major proportion of the Trust assets ever appointed to them. It appears that this particular tax regime disregards the fact that the beneficiaries were not the owners of the assets during which time the gains were made, had no control over what gains were made or how the assets were invested or whether income or capital was appointed or retained. It is not as if the underlying settlement assets

[9] For an example, see 57.9 (Non-residents allowances: reform).

[10] Though politics depends on salience as well as significance measured by the tax at stake; the lively debate on the Budget 2012 "Pasty tax" is an illustration.

> were UK beneficially owned assets either or naturally fell within the UK tax net during the period of the Settlements... this is the clearest possible case where the artificial and unduly harsh nature of the basis of taxation would indeed prompt the exercise of discretion [to vary the trusts].[11]

The essence of the criticism is that the s.87 charge in its post-1998 form is excessively wide; even more so in its post-2008 form. Before 2018 I said "it operates a very rough justice".[12] But after the introduction of the non-resident disregard, "rough justice" is too generous an assessment.

App. 14.5.2 *Critique of ToA regime*

The first-tier tribunal has described the ToA legislation as "some of the most complex in the Taxes Acts".[13] That is really saying something.

The 2012 reform paper concludes:

> Essentially the current rules [the transfer of assets code] are not fit for purpose.

I think all readers who study the topic will agree with the professional bodies, the Jersey Court and the first-tier tribunal, that at present neither the IT rules nor the CGT rules can be defended as satisfactory. But to criticise is easy. The hard part is to say how to do better. This appendix does not have the solution, if indeed a solution is possible, but contains some notes towards that end.

App. 14.6 Abolish matching trust income/gains?

Much of the difficulty of the benefit rules is the need to match benefits to trust income/gains. But if IT/CGT are taxes on income/gains, then that is unavoidable.

A HMRC consultation paper "Reforms to the taxation of non-domiciles" produced a startling proposal:

> The government intends to base the new rules on the taxable value of benefits received by the deemed domiciled individual **without reference**

[11] *Re DDD Settlement* [2011] JRC 243 at [25] *http://www.jerseylaw.je* The court approved a variation - adding the settlor as a beneficiary - whose purpose was to facilitate arrangements to avoid the s.87 charge.

[12] See the 2017/18 edition of this work app 9.5.

[13] *Williams v HMRC* TC/2011/02663, 23 January 2012 (unreported). The ToA provisions now are much more complicated than they were when that comment was made, so I think the comment remains valid.

> **to the income and gains arising in the offshore structure**. This ... means that there will be no need for trustees to have to recreate the history of the income and gains in the trust for tax purposes once an individual becomes deemed-UK domiciled.[14]

This proposal was not fair and indeed not rational, unless the rationale was to tax trusts penally so that they cease to be accessible to deemed domiciled UK residents.[15]

While it is disconcerting that this proposal could pass from brainstorming session to consultation paper, it does suggest a recognition of the difficulty of matching trust income/gains to benefits, at least in a situation where one could not expect UK tax records to have been prepared.[16]

We move on to consider some more promising approaches to reform.

App. 14.7 Aligning benefit rules

Alignment of the IT/CGT benefit rules raises the question whether to take the CGT rules or the IT rules as the starting point for an aligned system. Is one better than the other, and if so, which? It matters less which set of rules one starts with, if one goes on to tinker with them. It is suggested that an aligned regime should combine features of both.

The 2012 reform paper proposed to apply the CGT benefit rules to IT (but adding a motive defence). The 2012 reform paper provides:

> Income arising to [non-settlor-interested] trusts could... be covered by adapting TCGA 1992 section 87-97 to income, albeit preserving a motive defence.
>
> Income arising to companies could be covered by adapting TCGA 1992 section [3]....
>
> As indicated above, the adaptation of TCGA 1992 sections 87-97 to income would have to have a motive defence built into it. The reason is that many trusts, at the time of creation, have no UK connection. It would be wrong to tax a beneficiary who comes to the UK by reference to income arising before he immigrated. A motive defence would be a blunt way of doing this.

[14] *https://www.gov.uk/government/consultations/reforms-to-the-taxation-of-non-domiciles/reforms-to-the-taxation-of-non-domiciles* (September 2015).

[15] This is (more or less) the case for UK domiciled settlors.

[16] Some readers may speculate whether the proposal was put forward with a view to withdrawing it in consultation as a sop to the consultation process; but that seems far-fetched.

App. 14.8 IT settlor/ToA rules overlap

The 2012 reform paper provides:

> The key point is that the ToA code is only required if the income arises to a non resident entity which is for income tax purposes opaque. If the entity is not opaque, anti avoidance legislation is not needed at all, as then the income is taxed on general principles as that of the underlying owner or owners....

In particular, a settlor-interested trust within s.624 is transparent.

It is already the case that s.720 does not apply where s.624 does apply.[17] The 2012 reform paper proposes that s.624 should exclude the ToA rules altogether, ie the s.731 benefits charge does not apply so that:

(1) income of a trust within s.624 is not relevant income.
(2) benefits conferred by a trust within s.624 do not count for the purposes of s.731.

Thus only one anti-avoidance rule applies at a time.

For this purpose a trust is within s.624 when the settlor is UK resident (whether or not a remittance basis taxpayer).

When the settlor is non-resident, the better course would be to amend s.624 so it does not apply, leaving s.731 to apply.

App. 14.9 CGT settlor/benefit rules overlap

The overlap of s.86 and s87 can be avoided by providing that a trust is not within the scope of s.87 if it is within the scope of s.86.

App. 14.10 IT/CGT settlor rules alignment

Residence of individuals is a sensible connecting factor for UK taxation: everyone will accept that an individual who is UK resident should be subject to UK tax on an arising or remittance basis. Residence of *trustees* is a matter which is chosen by the appointment of trustees, and makes very little sense as a connecting factor in the taxation of trusts.[18]

This is recognised in some contexts, where trust residence is (more or less) irrelevant for UK tax purposes:

[17] See 47.13 (s.624/s.720 compared).

[18] It might be said that UK resident trustees enjoy the benefit of the UK legal system; but it would be more accurate to say that the UK economy enjoys the benefit of work opportunities for UK resident trusts.

(1) IT settlor rules: s.624
(2) Chargeable-event gains
(3) Inheritance taxation of trusts

In these cases the main connecting factor for UK taxation is the residence or domicile of the settlor: trust residence is (more or less) irrelevant.

App. 14.10.1 *IT /CGT settlor rules compared*

The differences between the IT and CGT settlor rules (s.624 and s.86) are striking. The most important are:

(1) Definition of "settlor-interested": CGT definition much wider
(2) Foreign domiciled settlor: within s.624 but not within s.86
(3) Non-resident settlor: partly within s.624 (UK source income) but not within s.86.
(4) Definition of "settlement": Non-classic settlements within s.624 but not within s.86; non-bounteous settlements within s.86 but not s.624.

These distinctions due to contingent historical development; none are attributable to policy deliberation. There is no good policy reason why the rules should be different for the two taxes. A simpler and more rational system would apply the same rules.

App. 14.10.2 *Definitions of settlor-interested*

The rich variety of UK trust tax rules offers four possible starting points:

(1) A trust is within the scope of UK tax if:
    (a) the settlor (or close family) is a beneficiary.
    (b) the settlor/spouse is UK resident and
    This is (in short) the IT model under the IT settlor rules.
(2) Ditto but relax (a) so it sufficies if the settlor's wider family is a beneficiary. This is (in short) the CGT model under the CGT settlor rules.
(3) Ditto but delete (a): the beneficiaries do not matter. This is the chargeable event model for life policies
(4) Ditto but relax (b): a trust is within the scope of UK tax if the settlor is UK domiciled at the time the settlement is made. It does not matter who the beneficiaries are. This is (in short) the IHT model.

App. 14.10.3 *Aligning settlor rules*

Once one opens up the debate as to which is better, intractable problems appear. Changes in this area would be substantive and not merely technical, and in particular:

(1) Reform will produce losers.

(2) The other proposals made in this appendix are technical reforms on which, I think, there ought to be fairly widespread agreement among those who understand the tax system. But here there will be no general agreement, so there will be less support for any reform. If one sets out all the options, not one of them would command a majority support.

There are fundamental decisions to make, and no logical principles on which to make them; contemplation leaves one feeling giddy. The basic question is the purpose of settlor rules. In origin the purpose of the rule was to tax the settlor on benefits expected to accrue to the settlor. Hence the IT settlor rule is restricted to settlor-interested trusts. But if more widely extended, as in CGT, the purpose is rather to tax the trust. If that is the purpose, then the logic leads to the conclusion that the rule should not be restricted to *settlor-interested* trusts, as is the case for chargeable-event gains and IHT.

App. 14.10.4 *A proposal*

Tax reform, as politics, is the art of the possible. Perhaps the most realistic course is to leave the current settlor rules unaligned. Certainly that would be better if a more ambitious reform programme threatened the less controversial and badly needed technical reforms set out above. The 2012 reform paper wisely did not enter this arena.

If one were sufficiently radical, bold, or foolhardy, to enter into this arena, however, the author's solution would be as follows.

(1) Adopt the CGT definition of a settlor-interested trust.

(2) Extend the CGT rules to settlor-interested trusts.

A remittance basis settlor would qualify for the remittance basis/protected-trust relief.

Conversely, trusts should be exempt from CGT and IT on foreign income in relation to property provided (or wholly provided) by foreign domiciled non-resident settlors. At that point one falls back on the s.731/s.87 regime.

This is (I think) the basis of trust taxation in Canada, New Zealand and, I suspect, most other common law jurisdictions. HMRC made a proposal of this kind in 1972, though nothing came of it.[19]

[19] Inland Revenue, Tax Reform Committee First Report on Avoidance (1972) *https://www.kessler.co.uk/wp-content/uploads/2014/08/1437_001.pdf*

DT relief would apply where the trustees are treaty-resident in a foreign state.

Of course, domicile and residence of the settlor are not perfect connecting factors. Such a thing does not exist. International families can sometimes break the link by:

(1) transfers to individuals who are not connected to the UK, and

(2) the individual settles or resettles the property.

However this is easier to say than to do.[20]

[20] See 99.41 (Planning to create excluded property trust).

APPENDIX FIFTEEN

CITIZENSHIP-BASED TAXATION

App. 15.1 Citizenship-based taxation
App. 15.2 Citizenship-based tax: objections
App. 15.3 US exceptionalism
App. 15.4 Variant ideas
App. 15.5 When citizenship matters for UK tax

This appendix draws on an article by Dan Neidle of Tax Policy Associates[1]

Cross references

The following topics relating to citizenship are considered elsewhere.
44.7.6: Personal allowances for commonwealth citizens & human rights

App. 15.1 Citizenship-based taxation

A reform sometimes suggested is UK citizens[2] should pay UK tax regardless of residence. I am not sure that anyone familiar with tax would support the idea, but it is worth setting out the reasons which require the idea to be rejected.

Dan Neidle explains the thinking in this way:

> The problem with [residence-based taxation] from some people's perspective is that it becomes remarkably easy to stop being subject to UK tax. Simply quit the UK.

[1] Neidle, "Citizenship-based taxation. Should all UK citizens pay tax in the UK, even if they live abroad?" *https://www.taxpolicy.org.uk/2023/06/27/citizenship/*

[2] It would be necessary to define who is a British citizen and there would be some choices to make here. There are six classes of British citizenship: British citizenship, British overseas territories citizen, British overseas citizen, British subject, British national (overseas), British protected person. If it was desired to follow the US example the reform would also catch those entitled to live and work in the UK who were not citizens (equivalent to green card holders). The application of citizenship-based taxation in the Channel Islands and Isle of Man would raise further constitutional issues.

This is an exaggeration. Leaving the UK is not, for most, an easy step lightly taken. But UK tax is lost by taxpayers leaving the UK, realising capital gains or income after they go, and so far as the new country of residence does not tax the receipt, the taxpayer reaps the benefit. Just how much is involved here would be difficult to estimate; it always is.[3]

By contrast the US has "citizenship-based taxation". US citizens (and green card holders) are subject to US tax on their worldwide income and gains, no matter where they live. So a US citizen cannot avoid US tax by moving elsewhere. The individual can renounce US citizenship – but that incurs an exit tax which broadly eliminates the immediate US tax benefit.

App. 15.2 Citizenship-based tax: objections

On the face of it, if you want to stop UK residents from leaving the UK to avoid UK tax, this is the approach to adopt. But as Dan Neidle says, this is "a terrible idea".

The problem is that non-resident UK citizens would pay tax in two places.[4] A UK citizen living (say) in France would pay UK tax (as a UK citizen) and French tax (as a resident of France).

At first sight, this does not seem a problem, because the UK and most other countries allow a tax credit so that the individual may effectively pay the higher of the two taxes, but not both.[5] And in simple cases the US and UK do not usually both apply their full rate of tax to the same income.[6] But the problems go beyond simple double taxation.

We can get a sense of the issues by looking at the difficulties faced by US citizens (subject to US worldwide taxation) resident in the UK (and subject to UK worldwide taxation).

The US has the "foreign earned income exclusion" for the first c.$100k of income for citizens living abroad. An employee whose income is exempt in the US under the foreign earned income exclusion still has to file returns. And this relief does not apply to the self-employed, who do pay US self-employment tax on their income. A trader, plumber or IT

[3] Much would depend on the details of the rules which would replace the current system.

[4] Or more, if they are dual resident or have income/gains arising in a third country.

[5] In fact all UK DTAs would need to be renegotiated, as they mostly provide exemption for treaty non-residents, rather than a foreign tax credit.

[6] But sometimes the system of relief fails to work, eg, perhaps, where a UK resident receives income through a US LLC.

contractor, say, has to pay tax in both countries and claim a foreign tax credit. The computation of income is governed by different rules, for instance for what deductible expenditure.

Capital gains are a further problem. The US computes gains in US dollars. For example: an individual buys an asset for £300k and sells it a few years later for the same price. There is no UK capital gain. But if sterling appreciated over that period, so that the dollar purchase price was $380k but the dollar sale price was $450k, then you have a $70k US capital gain. And of course the UK does the same for US dollar denominated assets.

Tax returns will cover a different period: the UK tax year running from 6 April and the US tax year from 1 January. Other countries have different periods. The different filing and payment timetables may mean that you pay the full US tax, then the full UK tax, then claim a refund of the US tax.

If a couple have a joint account, and one is a US citizen and the other is not, then the joint account becomes subject to US tax. Married couples can normally not worry about the tax treatments of their family finances – but where one of the couple is a US citizen then even simple arrangements like joint accounts become complicated.

The US and UK differ on the taxation of the main private residence. The UK gives no tax relief on mortgage payments, but exempts capital gains on the sale of the home. The US gives relief on mortgage payments, but taxes the gain. A US citizen living in the UK gets the worst of both worlds. They get no tax relief on the mortgage for their UK tax, but have to pay US capital gains when they sell.

It becomes impossible to use investment funds. In the UK it is disadvantageous to hold non-reporting offshore funds. In the US it is disadvantageous for a US citizen to hold non-US funds. The US citizen living in the UK is subject to both sets of rules, and cannot realistically invest in any funds.

In the UK an ISA is a standard form of investment, and the return is exempt from tax. But it is not exempt from US tax. So a US citizen living in the UK cannot use an ISA (or, to be more accurate, if they use an ISA they get no benefit from it). It may be worse than that, as an ISA may have particularly unfavourable US tax treatment: that is part of the class of problems that arises when one country's tax system has to characterise the tax effect of another country's legal system.

FATCA was introduced to ensure that US citizens abroad declare and pay their US taxes. But that imposes a significant administrative burden on non-US financial institutions with US citizen clients and, as a result, some banks and investment managers do not allow US citizens to open accounts.

One could go on. The impact on minors. "Accidental Americans". Pension taxation. Inheritance/estate tax interaction. Social security/ national insurance interaction. You do not need to be wealthy, or to have complex personal finances, to have a terrible time navigating the US and UK tax systems at the same time. The position is hardest for those who can't afford the tax advice they need.

The problem for wealthier US citizens maybe mitigated to some extent by the remittance basis, though that of course raises its own problems, and is itself controversial.

So while the object and purpose of citizenship-based taxation would only be to bring into charge high net wealth UK citizens in low tax jurisdictions, it would at the same time inflict a heavy administrative cost on all UK citizens who choose to live abroad (and of course on HMRC who would have to administer the new rules). The difficulties would multiply if further countries adopted the same approach.

App. 15.3 US exceptionalism

That is why the US is (more or less) the only country that applies citizenship-based taxation.[7] Why does it do that? Some combination of: changing the US tax system is hard, US expats do not have valuable votes and so the campaign to change the law gets nowhere, and the US is big enough and bad enough to get away with things that other countries can't.

App. 15.4 Variant ideas

One variant idea would be to apply citizenship-based taxation only to

[7] The only other country which taxes worldwide income of non-resident citizens is Eritrea (but how effectively it does so may be open to question). A few countries (Finland, France, Hungary, Italy, Spain and Turkey) tax on citizenship, but only for a limited period or in special cases.
Ironically, in 2011 the United States condemned Eritrea at the United Nations for its "diaspora tax".
See Hammer, "Old Habits Die Hard: Should the United States Abolish Citizenship-Based Taxation?" (2016), IBFD

residents of tax havens. The problem with this is that there are many countries that may not tax expats who move there. Singapore, Portugal, Italy, Switzerland, and others, may not significantly tax the income of their resident expats and there are many more which may not tax capital gains. So the list of "tax havens" would either be very long, or ineffective.

Another idea would be to make citizenship a tie for the purposes of the residence test. That would not stop UK citizens being non-resident and so not paying UK tax, but would make it harder for them to be non-resident because they could spend less time here The tax yield of this reform would be restricted by two factors:

(1) In many (probably most) cases, individuals who are UK tax-resident only because of a citizenship tie would be treaty-resident elsewhere, and so while work of administration would be increased, no more UK tax would be paid.

(2) In other cases individuals would respond by spending less time in the UK so as to continue to be non-resident.

It seems unlikely that the tax yield would justify the downsides of the change.

I discuss some related ideas elsewhere:

Idea	**See**
Tax on citizen of nowhere	6.40
Exit tax on individual who ceases to be UK resident	12.10.

App. 15.5 When citizenship matters for UK tax

This does not mean that citizenship/nationality need never be relevant for UK tax, and in practice it occasionally is:

Topic	**See**
IT personal allowances	44.7.4
Treaty residence tie-breaker	9.15
Various IHT DTAs	*Too many to list*
Domicile	4.14

APPENDIX SIXTEEN

THE WISDOM OF PARLIAMENT

App. 16.1 Nature of parliamentary debate
App. 16.2 History of non-dom taxation
App. 16.3 Inheritance Tax
App. 16.4 Remittance investment relief

App. 16.1 Nature of parliamentary debate

The House of Lords decided in *Pepper v Hart* that the Courts should in some circumstances have regard to Parliamentary debate, recorded in Hansard, in order to understand statutes. The number of tax cases where Hansard has actually made a difference is limited.[1]

Hansard is unlikely to be on the reading list of many tax practitioners, and for good reason: the debates tend to be ill-tempered, ill-informed, and sometimes puerile.

This appendix provides a few highlights. Further contributions from readers would be welcome.

App. 16.2 History of non-dom taxation

Peter Dowd (Labour, Shadow Chief Secretary to the Treasury) misstates the early history of the remittance basis:

> Non-dom tax status was introduced in 1799 (!) to allow British colonialists with foreign property to shelter it from wartime taxes.[2]

The remittance basis goes back the Duties on Income Act 1799, but the remittance basis was available to all taxpayers until 1914, which restricted the remittance basis, in part, to foreign domiciliaries.[3] Does it matter? Discuss.

[1] Are there in fact any tax cases other than *Pepper v Hart* itself?

[2] *https://hansard.parliament.uk/commons/2017-10-31/debates/DC20529E-FB3B-4348-BB33-ED2AD0395E91/FinanceBill*

[3] See 17.2 (History of remittance basis).

Charlie Elphicke (Conservative) believes that the 2008 reforms were due to the Conservative opposition:

> in their first 12 years in power, the last Labour Government did nothing whatsoever about non-domiciled individuals, and then reacted reluctantly only when they were humiliated and forced to take action by the then Conservative Opposition.[4]

App. 16.3 Inheritance Tax

Peter Dowd thinks non-resident trusts give IHT advantages:

> The use of offshore trusts is not restricted only to inheritance tax.[5]

App. 16.4 Remittance investment relief

I thought it strange that there was no remittance investment relief, when the ITA remittance basis was introduced in 2008. Bambos Charalambous (Labour) explains there is no link between taxation and investment:

> A good business investment is a good business investment whether it gets tax relief or not, and let us not kid ourselves that the sweetener of business interest relief is anything more than a sugar-coated inducement for non-doms who have already made their money.[6]

So it was left to the Conservatives to introduce remittance investment relief in 2012.

[4] *https://hansard.parliament.uk/Commons/2017-10-31/debates/DC20529E-FB3B-4348-BB33-ED2AD0395E91/FinanceBill#contribution-A93BD203-4ECB-4B36-A695-D01A34F6295B* See 1.7 (Non-dom tax reform history).

[5] *https://hansard.parliament.uk/Commons/2017-10-31/debates/DC20529E-FB3B-4348-BB33-ED2AD0395E91/FinanceBill#contribution-A93BD203-4ECB-4B36-A695-D01A34F6295B* See 75.8 (Trusts: Foreign property)

[6] *https://hansard.parliament.uk/Commons/2017-10-11/debates/8D050056-D77B-44FE-A218-C1D1269428D3/FinanceBill#contribution-005E0DBD-38E5-42C6-9B24-ACEE5A11BC45* See 19.2 (Remittance investment relief).

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